FAIL BETTER - THE WIZARD

an abriged ForexFactory.com forum thread
http://www.forexfactory.com/showthread.php?t=287794

If you are still are not making money trading it is because something you are doing has not been working. And if something isn't working, there's only one way to fix it for good. You need to take it completely apart and rebuild it piece by piece. Only once this is done can you make sure that every single element of your trading is working at its optimum level.

Some of you may know me from my contributions to the J16 thread. I have a lot to thank J16 for since it was reading his thread that got me profitable and I initially built my accounts using "price action" in the way he taught.

However, when I used my record to get a seat at a professional futures trading firm in London, I was fortunate enough to sit alongside some incredible traders. And the one thing I learnt at this point in my career was that one could enter at the source of a move with a high degree of probability.

The source of the move is the level price turns at. It is not 116 pips after it's hit the level and formed a pin which was where I was looking for my entries.

I was forced into exploring this further because we had no choice but to keep the risk management tight and being able to enter at the source became of the utmost importance.

Now that is not to say that trading candlesticks is not a viable strategy. I still use them (particularly on the daily time frame) to gauge potential market direction.

However, after discussions with other successful traders, I began to distrust them in terms of entries one side and stops the other.

Let's look at this in a little more detail.

A bullish pin, by way of example, simply shows that demand has come in at a level. However, the fact that buyers came in does NOT mean that buyers will continue bidding prices up. I started to think of a candlestick pattern in the same way I thought of an indicator: it *lags*.

If you think of the market moves as having a cause and effect relationship, the cause of a move is the market participants that interact at the areas of perceived value (or lack of it), the effect is the resulting candlestick.

Now I would sit there waiting for setups and I would say to the other traders: "I'm waiting for confirmation" but what I didn't realise is that by trading the effect and not the cause, you are always one step behind the market.

So, the aim became to pinpoint an entry at an area that will *cause* other traders to follow you which can then create the *effect* of favourable momentum, meaning that still more traders join later and the momentum continues.

There are a few other important points to make about candlestick patterns.

Firstly, if price trades into a significant technical level, the probability shifts in favour of a reaction as the limit orders get hit from those traders entering and exiting the market. However, the duration of that reaction is unknown. Or to put it in laymans terms: it's one thing to accept that price will react to a key support level but it's another thing entirely when you have to work out how far it will travel in your favour. The simple fact is: if you enter at the source of the move rather than after the reaction, you have more options in the event there is no follow through from the other market participants.

This leads me onto my second point. The "entry" of the pin itself is usually at a random price. This then poses a problem for those traders that love to get their stops to "break even" because the majority of the time, their break even price means absolutely nothing to the market.

This loosely leads me onto my third point. Candlesticks have an open and a close. The forex market does not. All candlesticks do, is break the market movement down into convenient "slices" of time but it is important to realise that the market does not stop moving. This therefore means that a "setup" can be dependent on a completely arbitrary concept such as the time your broker considers to be the "close".

Perhaps worse than this, is the fact that you can miss a level that price has an extremely high probability of bouncing at simply because you failed to get a pretty candlestick that has just the right length wick and just the right size body to tuck it nicely within the previous candle within the window of time that you chose.

This last point requires time to digest.
Now I call myself a price action trader. But just not in the way everyone on forums these days seems to think of it.

I'm not too concerned what kind of candlestick price has formed but I am concerned with how price has *moved* and how price is *moving*.
I consider several things in my trading in order for me to make an informed decision. Here are some of the key elements:

The area of value or lack of (support/resistance)

- How price has reacted to this *previously* or how *significant* it is
- How price is reacting to it *presently*
- The *velocity* with which price approaches it
- How *far* price has moved on the day when it approaches it

Time

- The time of day when price encounters areas of value and the effect of that on liquidity

The market participants

- Where the weak hands are likely to be positioned
- What the strong hands have to do to shake the weak hands out

Market Sentiment

- The event risk each day in light of what traders are currently focusing on

Time for an example. This was the last trade I did in Forex (I trade multiple markets).

This is going to be quite hard to illustrate in static charts but I will give it a go.

USD/JPY traded into daily resistance on Friday (Non-Farms day). The fact that the market has not visited this area for a significant amount of time makes it an area of interest to me.

The actual resistance was marked on my chart as 84.39 as this was the *mean* point of the highs that made up the consolidation.

The mean is extremely effective in pinpointing areas. Far more so than the area with the most touches which is what many traders tend to look at.

Now the way in which price rallied into this area is what made it attractive.

Firstly price has exceeded its 20 period ATR on the daily chart .

Secondly price accelerated into resistance. This is key. As most of us should no doubt be aware by now, momentum does not necessarily indicate a force. But it does make it a hard trade to take psychologically. And the hardest trades to take are often the best ones.

Now I didn't get a fill at 84.39 which was fortuitous because there was only a minor reaction before price consolidated below the level and then went once again for the resistance. At this point, it becomes clear the the "market" is going to go for the swing point and take the stops and I'm going to get a better entry.

The fact that the strong hands in the market will attempt to push price here to take the weaker hands out is not groundbreaking stuff. This is all pretty simple stuff and not that clever. But then trading doesn't need to be.

I took an entry short at 84.51 (just beyond the swing high) with a target area of the circled highs. *See chart 1 below*.

It wasn't a perfect entry and I took a bit of heat but the trade made it to the target - the white dashed line in *chart 2* which marks the swing high circled in the previous chart and the price at which I had my limit buy order.

One of the hardest parts of trading is knowing how far the market is going to travel in the direction you anticipate. Knowing when to go for a short term move and when to try and hold for a swing or even a position requires a huge degree of experience and a flexible mindset.

There are plenty of professional traders that do one style of trading, whether that be scalping or swing trading and they keep to that and they make money with it and that is hard enough in itself but the two biggest traders I ever saw were able to switch between styles effortlessly. They would sit there scalping and then suddenly, get a position on and leave the office to let it run overnight.

That is an incredibly hard skill to acquire.

The books and the forums and the coaches always go on about needing "discipline" and needing "patience". They're right.

What they don't often tell you is that you need a good memory.

Memory is so important to me in trading that I started referring to my technique as not fundamental analysis, not technical analysis but memory analysis.

You might be wondering what on earth I'm talking about so let me hand you over to Edwin Lefevre's famous "Reminscences of a Stock Operator":

Another lesson I learned early is that there is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market to-day has happened before and will happen again. I've never forgotten that. I suppose I really manage to remember when and how it happened. The fact that I remember that way is my way of capitalising experience.

I try and remember everything.

But memory is fallible. A trading record is not.

So, the easiest way to get good at trading it is by keeping a trading record.

Even Livermore kept one. He called it a "dope sheet" if my memory is any good ;-)

So record keeping...and this is where everyone starts skim reading because they've heard it all before. Don't. It's absolutely vital.

I cannot emphasise the importance of this enough and yet still, so few people do it.

Now those that do keep a record often only do so, so that they can tell you what their strike rate or their risk/reward ratio is. Or maybe what day of the week they do best. That's all very interesting (and relevant to your edge) but the most important element of record keeping, in my opinion, is analysing each trade after you have taken it and noting down whether there was a better entry and exit to be had.

This is how you learn to refine your technique.

The reason I called this thread "Fail Better" is because that is the hallmark of a good trader.

No matter how good you get, there is always a way to improve. Trading is a learning process and is never mastered.

As Samuel Beckett wrote: "*Try again. Fail again. Fail better*".

Let me illustrate record keeping and its link to successful trading with an example.

I was illustrating the concept of record keeping to some traders recently.

The traders were using a discretionary entry and exit in their trades.

I got them to note down what the outcome was with their trades in terms of the number of pips made, the strike rate, the R value etc. I also got them to review the trade after they had exited and note down what would have happened using some other exit strategies.

We used some arbitrary exit strategies that were of interest (you could replace these with your own).

The first was no interaction. That means either the stop was hit or the target was hit. Nothing else is accepted.

The second was moving to breakeven when the trade is up a 0.5 R and then leaving it to either run onto the target or come back to breakeven.

The final was trailing a stop behind each hourly candle as soon as the trade is entered until either the stop is hit or the target is.

This was the outcome:

No interaction was the only one of the four exit strategies that would have made money in the period they did it for. The record provided clear and irrefutable evidence that they were right in their initial thought process (that the trade would move to the target before the stop was hit) but their discretionary management was causing them to be a losing trader.

The break even maneouvre was the second best but it still resulted in a loss over the period tested.

The third was their own discretionary management which had caused a substantial loss.

By far the worst was the trailing stop (incidentally favoured among many traders).

Now, again, this is not to say that these won't work for you because your *entries* will be different but what it does show you is concrete proof of what you need to do to profit.

In the above example, the trader has to simply take the trade and walk away.

Lets turn to the amateur.

In the above example, the fact that a "no interaction" based approach came out the leader doesn't mean it was a winner on every trade. It was just a clear winner *over time*. However, there were a few trades where "no interaction" meant that the market may have come close to the target and then resulted in a loser.

This drives the amateur mental.

The amateur, goes from one strategy to the next, always managing the next trade based on the outcome of the last one.

As a result he is always one step behind.

I've seen this time and time again.

One day he takes buys the EUR/USD and decides he is going to use no interaction. It comes close to his target and he takes a loss.

He chastises himself for being such a fool and the next trade he takes in the EUR/USD he decides to trail a stop right up behind the price to make sure that he doesn't give back his profits. This time he gets knocked out right near the beginning of the trade and then sees it hit the original target.

He is mad now, so he decides to switch back to no interaction, believing that the first time was just unfortunate. But this time the trade doesn't work out at all. It goes just half way to the target and then turns to a loser.

As a result, he now goes on the search for a totally different exit strategy that will save him in the event that it goes half way and comes back again. "I know, I'll use a breakeven stop at 0.5R", he thinks with excitement.

This trader will be in the game for years to come, wondering whether there is really any money to be made.

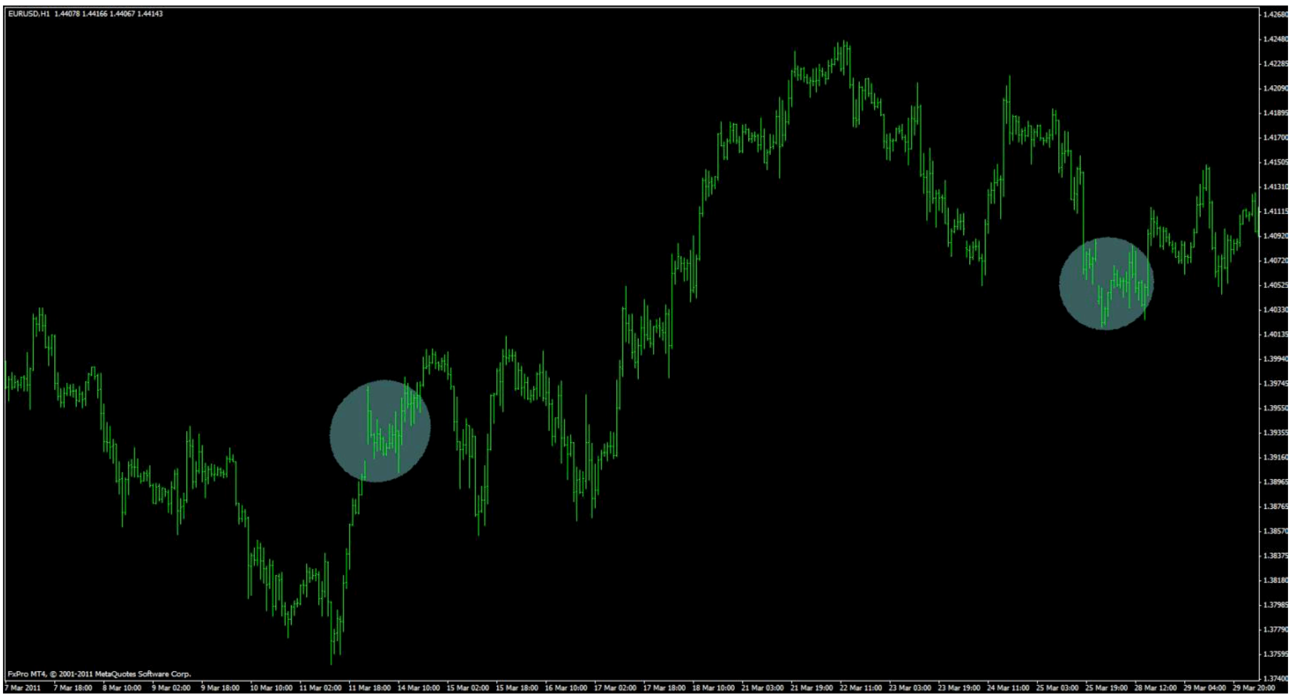
This time I will use an actual trade to illustrate both the value of record keeping and why the amateur consistently fails.

Let's look at the Sunday open in FX markets.

The Sunday gap (when it occurs) is an important part of my strategy. See *chart 1* for the last two I traded in the EUR/USD.

There is absolutely no excuse for not making money in this. You just have to use your record to find the right way.

Backtesting helps but as we all know, it's no substitute for live trading it where the emotions can kick in.

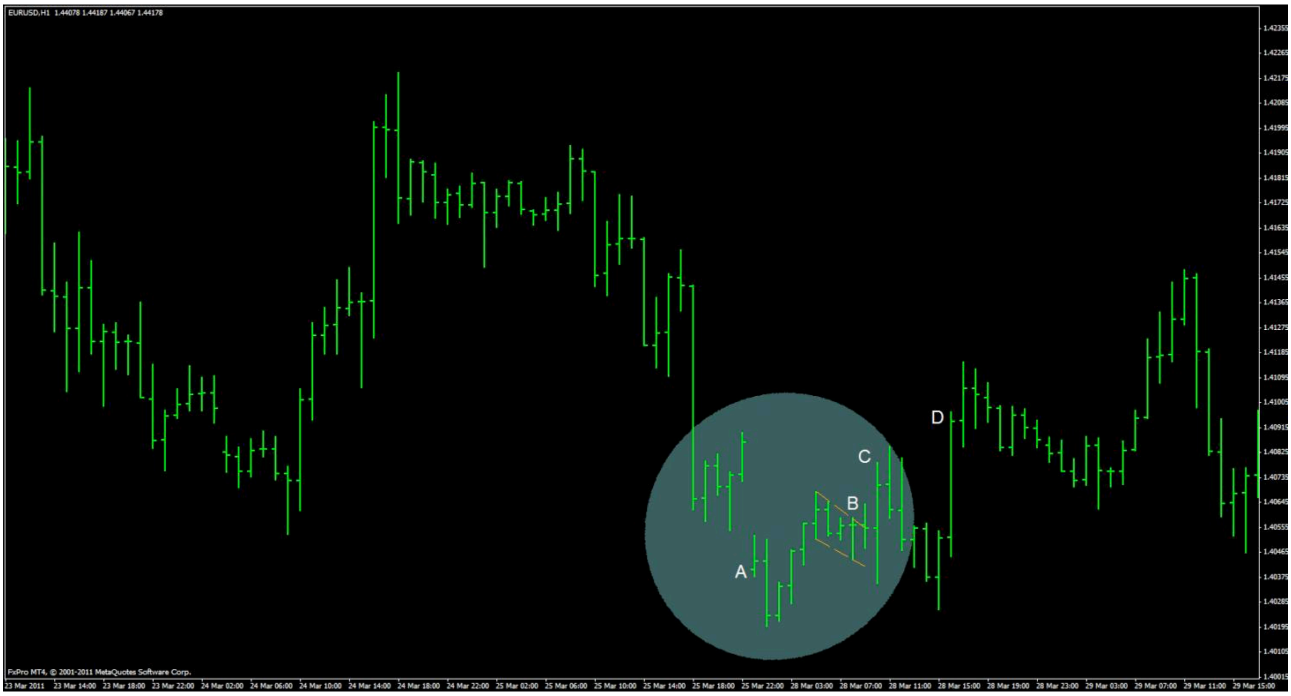


My strike rate for the way I play these gaps is 84% at a 0.5 R. At the moment I'm on my 8th winner in a row. Every trade so far in 2011 has had a positive result.

The way I achieve that result is with a no interaction based approach.

But let's turn once again to the amateur who usually finds it hard to sit on their hands for any amount of time.

Here is what I saw someone do on this particular gap:



Point A : Market opens. Trader goes long at the open. Market moves up into profit (10 pips) so the trader moves his stop up to the lows. He has no experience of how these play out because he has done no backtesting and has kept no record. Soon after, the market starts heading south, takes the stop out for a 6 pip loss and makes a very bearish bar. Trader is OK with the small loss and thinks they have done the right thing at the close of that bearish bar. It's late in London now so they go to bed.

Point B : It's 6am. The astute trader is infront of his screens. He has seen that the market has recovered and is now on the way to the gap fill. He knows that gaps have a high hit rate and he has now seen a bullish pin bar on the hourly. There is also a minor flag here that probably looks fairly prominent on the lower time frames. Hey presto - confluence! He takes the trade long on a break of the pin and not long after he is stopped out for a 19 pip loss.

Point C : The same bar that stops the trader out ends as a bullish engulfing bar. At this point it looks like a no brainer from the price action that it's going to fill that gap in its entirety. But entering on the "trigger" of the engulfing bar leaves him only 5 pips profit to the target so instead he takes it long at the close. That alone only gives him 13 pips to the target and a potential 39 pip loss but he doesn't care about this because he is now focused on making back some of his losses and sees this as a high probability trade. Who could doubt that from the price action? He knows that the setup hasn't officially "triggered" until it breaks that high so he feels vindicated when it does in the next bar. Unfortunately, however, it misses the target by 2 pips and at this point he is relying upon the fact that I have told him it will fill to the exact close 84% of the time. He holds it and it retraces the whole bar over the next five hours and takes him out for a 39 pip loss.

Point D : The trade later trades into the Friday close. At this point the trader is angry. He is out 64 pips over three losing trades back to back. I got an easy 44 pip win out of this with absolutely no interaction.

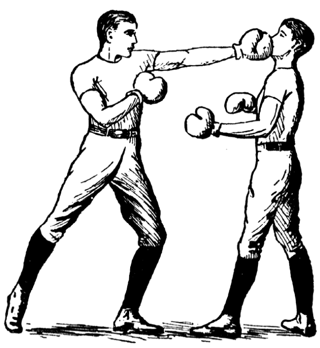
The only reason I have the confidence to not interact is because I have a record.

Two more things I wanted to say while we are on the subject of amateur traders.

Firstly, bet sizing. All the professionals I know, vary their bet sizing.

I think that it's been ingrained into too many traders that they need to always risk a fixed amount of their account. This would make theoretical sense if all setups were alike in their probabilities of a successful outcome. But in reality, they are not.

Since anything can happen in the market, it makes sense to have a fixed ceiling of risk which you will not breach. However, the professional trader will often vary their risk within the confines of that ceiling.



Think about it for a second. Let's say you were betting on my physical prowess in a boxing ring. I'm a skinny guy. About 5 ft 10". I never hit a person in my life. Each contestant I face in the ring is a potential trade. You can decide whether to "take it" and bet on them or not. Most traders have it ingrained in them from the advice they get from gurus to take each trade at let's say, 3% of their account (this is what I see touted most regularly).

First guy steps in. He's 6 ft 4", built like a tank. Used to be a cagefighter. Time to buy him at 3% risk.

Now, what if the dynamics changed? What if, before the fight starts, I have to wear a blindfold and get spun around 15 times? Still want to risk just 3% on this fight?

What about after blindfolding me and spinning me around, you find out I've got a fractured arm and a sprained ankle from the last fight and neither are healed. Still want to risk 3%?

The second thing I wanted to write about was risk/reward.
Too many traders get way too hung up on this element. They get it drummed into them that they need a risk/reward of 1:2 or higher. This is because*supposedly* its easier to get a higher R than it is to get a higher strike rate.
But R is dependent on strike rate. If your strike rate is high, your R doesn't have to be for you to have a clean curve.
The other point I want to make is that of utmost importance is the "evolving R".

Risk/Reward is not static.Once you understand this, you can improve your success significantly.
Again, many amateurs treat trading too black and white. They think: "The trade I just took had a 1:2 when I entered (e.g it risked 20 pips to make 40) and if I can get to breakeven during the trade, then I have a risk free trade." That is as far as they take it.
But consider the following chart. *See below*
This is a trade I called yesterday and is the EUR/USD.

The entry was 1.4247. This trade was a simple one since it constitutes a pullback to previous resistance and went 5 pips offside.

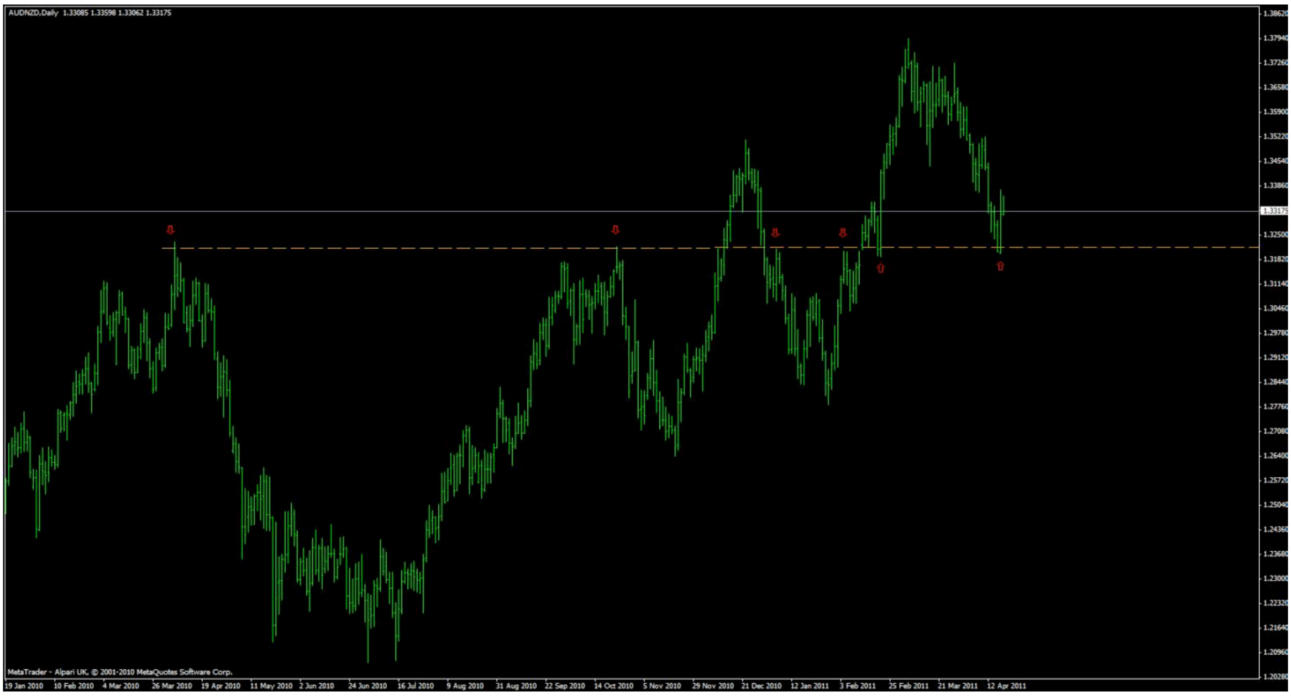
The initial stop was 1.4229 (risk = 20 pips when factoring in spread).
The target is 1.4446 (reward = 197 pips)

Therefore the intial R is 10.

I have seen traders use a two bar stop even when price is where it currently is.
From the current bar high, the reward is: 5. The risk if the two bar stop is hit, is 43.
Your R is now 0.11.
Clever? No.

However, always beaware of what is happening on the higher timeframes as this will help you manage the trades in terms of your exits.
Exits are one of the hardest elements in trading.
Many traders get caught in the trap of only watching one time frame and playing the levels but you need to be aware of the bigger picture.
So, lets look at the chart again. This is the level you highlighted. The market rallies into previous H1 support. If we just stay looking at the H1, we know we are with the trend and so we are probably ticking a box in our heads there too. Some people will just get involved straight off the bat at this point.

If we look at this same pair on the daily time frame the picture is less bearish in the short term.



The market has sold off into formidable support around 1.3200 and has posted a bullish engulfing that shows strong demand.

The way I look at this, the lower time frame setup (H1) is against the higher timeframe (D1) setup.

Can we still take it? Yes.

But in these situations I make sure I don't overstay my welcome and will take action as the market trades into problem areas.

What kind of action is down to the individual. You can take complete profit. You can take partial profit. You can begin to trail a stop.

My preferred approach when I am against the higher TF is just to take full profit.

This requires the trader to stop worrying about "what might be".

Back in the day, I never used to be comfortable just getting out at the first level because I always used to be thinking "what if this collapses here...if I trail my stop I could catch a huge move" and then the market would just come back time and time again and take out my trailing stop (even if it later made the big move I was hoping for).

Same goes for breakeven. I sincerely doubt that the times I've caught a BIG move and made good money would get anywhere even NEAR compensating me for the profit I've given back by seeing a breakeven or a wide trailing stop hit.

Here's something to think about: Is breakeven really a free trade?

Many traders think it is. They get in at a good area, the market moves into profit for them, it comes into another potential "trouble area" and they think "well, if I get to breakeven, I can't take a loser on this and it might go further".

But giving back profit is still taking a loss.

Profit on paper is still profit. Especially when all you have to do to realise it is click the mouse button.

I can't advise enough against moving to breakeven.

Significant levels are usually tested more than once (this is a very important point to grasp) and the market will react initially and then often come back to just knock out the previous lows/highs which will take out all the breakeven stops and the ones that accumulate at the lows/highs after it takes off.

Breakeven will do your account damage over time. Trust me.

Either take 50% off and leave your stop in its original place <u>or</u> get out of the complete position at the FTA. Trailing a stop is an option (not one I have too much admiration for but will do from time to time) but it's hard because to do it well, you need to keep it in a place the market can't easily hit but also be mindful of the evolving R (see earlier posts).

If you really want to be clever, once you have seen how many times the market comes back for a second go at a level, you can try exiting at the FTA on the first reaction and then trying to get the second entry back at the original level.
But let's do one step at a time, eh? ;-)

<u>The break even move</u>

I've got a good deal of experience with the "breakeven move" having seen it severely hinder performance in both my own account and others.

Infact one of the biggest and most successful professional traders I have ever worked with, who used to get sick of me ranting about "how I would still be in if I hadn't moved my stop to lock in profit" told me in plain English that I was a c*** for moving the stop to breakeven. (I'm not sure if he was that polite).

This is because almost every single time it makes absolutely no sense in the context of where the market is trading. If, for example, you take a trade at the top of a pin, you are entering in the middle of no-mans land after the market has moved away from support. The market knows about previous highs. It knows about previous lows. It knows about support. It knows about resistance. It knows about patterns. It does not know about where Johnny Green Fingers entered and has a risk free trade.

I give numerous examples in that thread of being well over 50 ticks up and then seeing the market come back to break even before making a huge move. Infact it is something that happens so often, James has actually covered it in a webinar and Seeking light actually coined a term to explain it!!!
The sad fact about the breakeven stop is that it means nothing when the market comes back and takes you out aside from the fact that you just got shaken out of what could (and usually is) a great trade because you were afraid to take a loser.
I think my biggest problem with break even is that it is common knowledge that one should trade the markets and not their P&L.

Using a break even stop in this strategy is trading your P&L in 99% of cases.
If you think it's going to turn and you are trading into a FTA get out!! But moving to break even smacks to me of relying on HOPE.

E.g. I HOPE it will go further but I don't want to take a loss if it doesn't. And once again, hope is a killer in trading.

Anyway, I've said enough on the subject. Sorry if it's been a bit of a rant but honestly, this break even thing is the one issue that just keeps coming back in most of the people I speak with. People can see it destroys their performance but they just can't deal with not using it because it's comfortable and makes them feel safe.

Ultimately though, the proof is in the testing.
If you don't believe me on any of this, try it yourself.

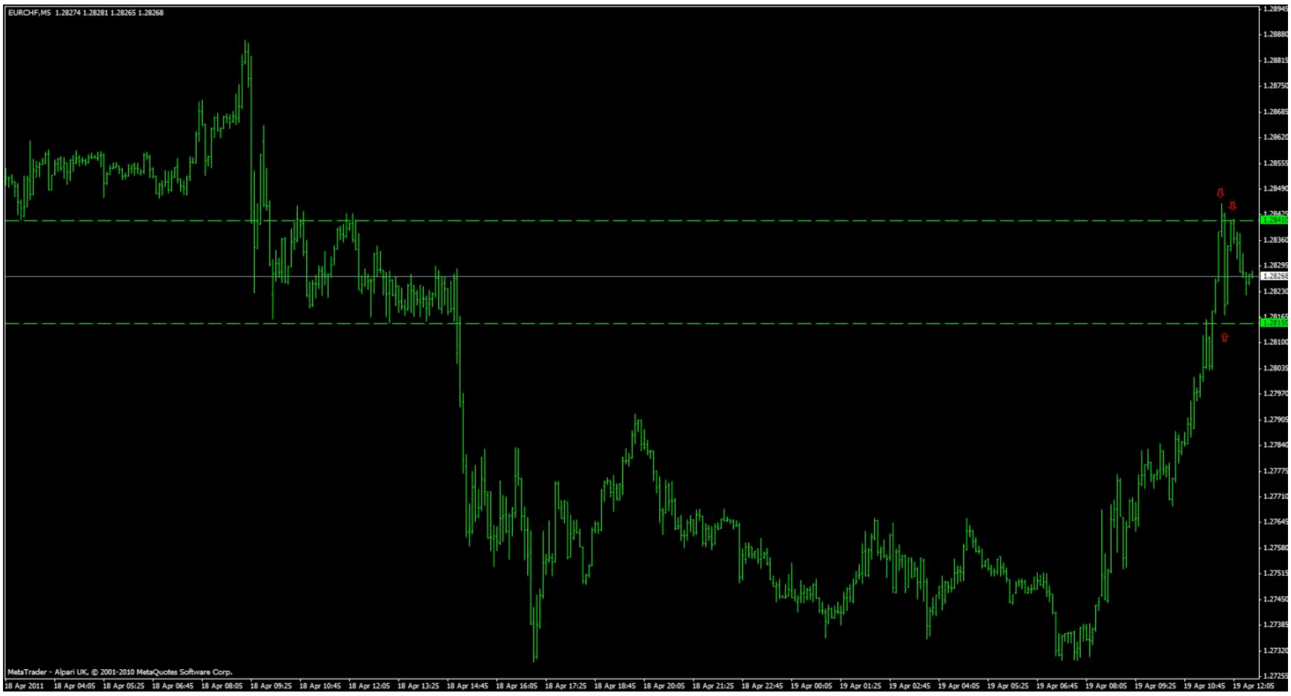
Never buy a support level (or sell a resistance for that matter) when price constantly returns to it. What's this, the 5th time back?

I'm looking for shorts by this point. Even before its broken out.

Remember the levels we all called ahead of time were 1.2815 and 1.2841.

Look at the chart.

Ive put this on a 5m. I don't usually do this but it's for illustrative purposes.



Price rallies hard into 41. Longs exit into the level. Some traders get short into the resistance.

Some other traders were long and were "hoping" it would go through 41 and now feeling a little bit nervous as price catapaults off there back down (the sharp reaction is news based - what a coincidence it happens right on the level)

So we come off hard back to 15. As we trade into that level, the limit buys start getting hit as the traders that have seen the move up all morning decide they want in "with the trend" and charge in on the pullback.

Up we go to 41 again. It's resistance. Some traders that bought ahead of 15 will cover here if we don't get through. The other traders that didn't get out at 41 the first time are now unlikely to make the same mistake twice.

In we come to 41's and off we come back again towards 15.

It's all just traders jostling for positions.

Some people say K.I.S.S. Trade the bars. Forget about who is doing what.

I find it helped me enormously to think about this stuff though. And I hope it helps you too.

Can you do this on a 5m chart?

Yes.

Should you start on a 5m chart?

No.

I no longer subscribe to the fact that 5m is all noise. I see the same patterns again and again no matter what the time frame.

Thing is, however, is this: 5m requires FASTER REACTION TIMES.

You have less time to analyse, less time to think, less time to react.

How do you get the skills necessary to do this?

Experience.

Learn to do it at a slower pace on a higher time frame. I use 1 hr. Some of you could go higher.

But that way you can build the skills you need at a slower pace so then it just becomes a matter of increasing your speed and not a case of doing everything at 12 X speed when you don't even know your proverbial a&se from your elbow :P

It's also worth noting that even <u>with</u> experience, it may not suit your personality or skillset to go lower. People are just naturally better at some things than others. To get good in trading you need to forget about what you want to do and work towards your strengths and away from your weaknesses.

If you have never been good at making decisions under pressure and go to pieces, stop trying to force it. Just accept it and find a route round it.

There is a big difference between what you want to do and what you are good at doing.

Once you realise this point, the rest falls into place.

I don't trade alot of the crosses/minors because of the spreads but also because there are plenty of opportunities out there and I find that I work best by knowing a few markets and their nuances, well.

I do think it helps Currency traders to keep an eye on the commodity space and the equity indices and even some of the fixed income.

It's an increasingly inter-related market these days.

Moves in equities, fixed income and commodities have a knock on effect on the dollar and vice versa.

I set my screens up in a specific way so that I can see these inter-relationships and how they play out.

Markets can affect one another fundamentally:

e.g. Demand for German bonds > suggests supply/demand for debt > debt issues relate to the Euro and the current Soverign Debt Crisis (SDC) worries.

Demand for Equities > suggest demand for risk > suggests demand for "risk" pairs

Demand for commodities > demand for commodity currencies

They can also affect one another technically:

e.g. S&P500 up - USD/CAD down (this is pretty closely inversely correlated)

There are a lot of nuances however.

T H E   S P I D E R

A huge spider just ran across my living room floor.

Who is scared of spiders? I mean, really scared.

If you are, think about what do you do when you see one.

I want you to imagine you are sitting down minding your own business and you see one dart across the floor towards you.

What do you do? I move out the way. Fast. I put some distance between us. How much distance? Enough so that its nowhere near me but not enough so that I can't see it.

And now, after you have thought of your initial reaction, I want you to think about what you do next.

If you are anything like me, you do a similar thing everytime.

The spider has stopped. Right in the middle of the floor. I approach it. The initial shock of seeing something that I am not only frightened by but wasn't expecting to see, has passed. I go in for a closer look.

Then suddenly it takes off and runs again.

What do you do next? I move, almost involuntarily away from it. But only if it runs in my direction.

Still with me?

What next? It's stopped once again. It's time to take some action. If it runs again your heart might skip a beat but you don't want to lose sight of it because you won't be able to relax knowing that it could pop out at anytime. So you have to deal with it.

The more you get used to it, the more you familiarise yourself with its size, its location and its speed the more you are able to get close to take the necessary action - which will be either a glass and a piece of paper or a boot. Depends on your morals ;-)

This thread has a plot. And I haven't lost it.

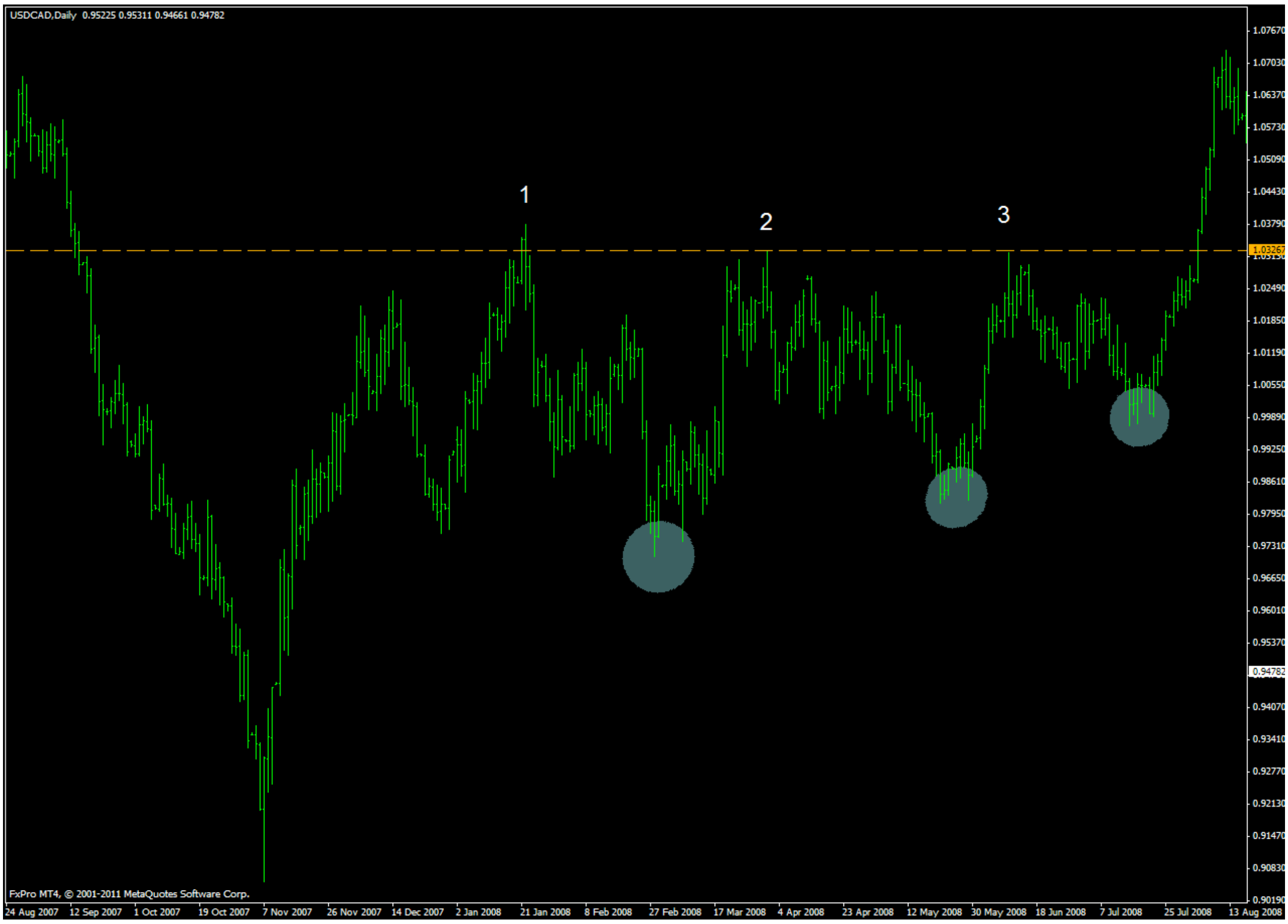
Does anyone know where I am going with this? Can you relate this to the market action at a key level?

This is a prelude to the next topic of discussion in the webinar and a pattern we will come back to time and time again to help us determine where the market is about to move and get a very high probability trade.

Some people call this a wedge I believe.

I call it the spider out of deference to the fear inspiring arachnid :-)

Lets discuss the points marked in the chart below. Pull it up in a seperate window and follow this along. You might need to read it a few times. This is why I prefer webinars. Easier to get the point across rather than writing a dissertation. LOL



1 : Price goes vertical and sees heavy selling come in. The spider is the level and the fear it has over us mere mortals. I am the price. This is not the best analogy since levels don't really run at you while spiders do but hey, I've said it now, so lets roll with it or I will look like a complete idiot.

OK, so the longs have seen price breaking a previous daily swing high and they have seen it accelerating and they are as happy as Larry. However, it suddenly turns hard and there is some panic. Infact at point

1, price posts a key reversal pattern, the bearish engulfing. This is me jumping back from the spider.

2 : Once we have seen the spider, although we are scared, the initial fear is gone because part of that initial fear was the fact we weren't expecting to see it darting towards us. So although we hate the things, we have regained a little of our composure because now we KNOW WHERE IT IS. It is the sudden shock of the unknown that scared us. We are still scared but we can control our fear somewhat because at least we now have our eye on it. Now relate that to the other traders or the collective "market". The traders know where that previous high is.

So after the panic, we may go back and approach it. I almost always do this. And markets do this many times too at a significant level. They come back for a second look. (I think this is why a lot of people often get into profit and then get shaken out when they move their stops to the level they got in at after the first move off it)

So, here I come, moving closer for a better look. I want to see exactly how big that spider is. Traders want to know the same thing. They want to know just exactly how formidable that resistance is. They might also want to take some stops which means you should be more scared of them than spiders because at least spiders don't try to rob the weak.

So as soon as I get close, I think it sees me (don't they have eight eyes?) because off it runs again. What do I do? I jump back once again. Why? Because it is running towards me. Remember, I am price. I've gone in for a closer look at those highs at point 1. If price runs back on me, I'm scared because resistance is being confirmed. If it runs away from me (i.e. through the high), then I'm OK. I don't need to panic.

In this example it comes back and off we go for the second leg down.

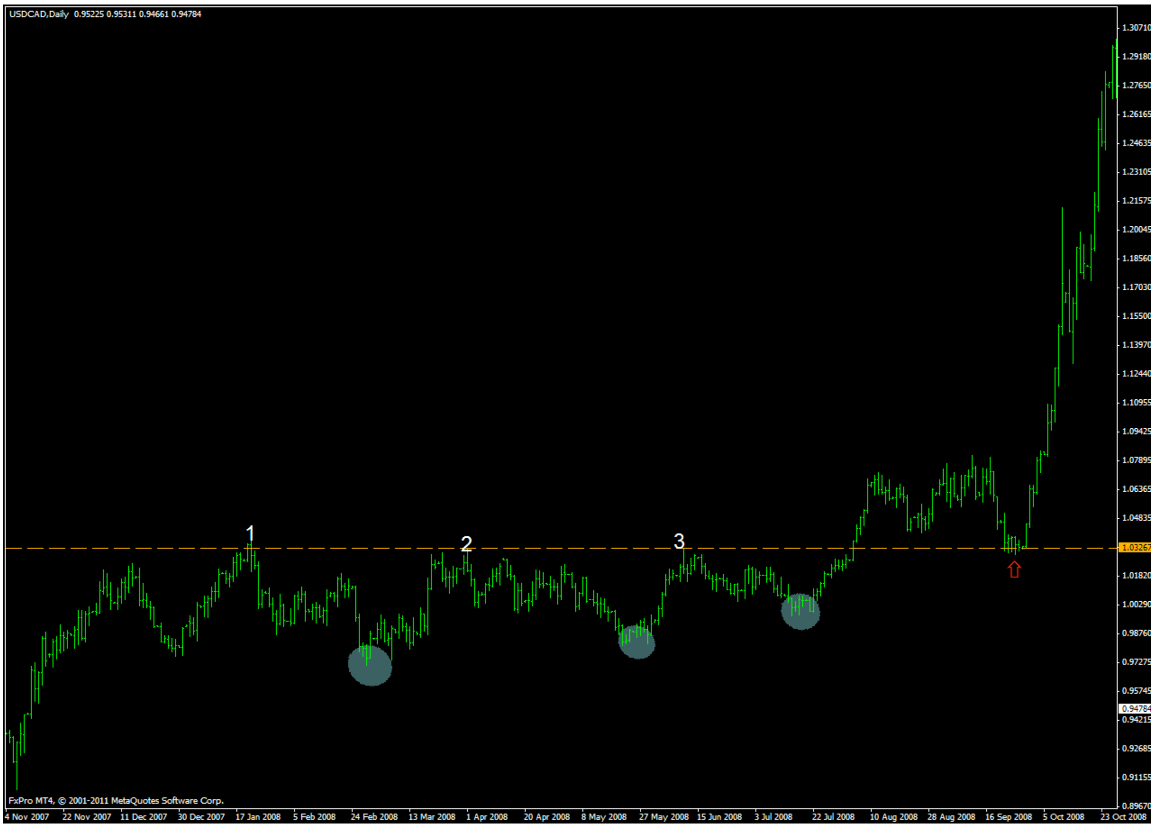
Now lets stop for a moment. None of this is to necessarily be anticipated. I don't KNOW the spider is going to run when I get near. Just as I don't know the market is going to sell off hard at that previous high. But I react when it does. As traders do. They see the order flow coming in, the market does its thing.

3 : Now at points 1 and 2 we have a solid, clear resistance developing. At point 3, I go back for another look. The spider moves. I move back again. But note how price is moving back less each time. This is more or less the same with the spider. Usually, once you are familiar with something, it becomes less scary. I know how big it is and as long as I can see it, I know where it is, so it can't surprise me.

Traders know the same things. They know exactly where the resistance is and they know from the number of touches how "big" it is.

Note the circled areas show higher swing lows as we come into the area. The sell offs are less each time. Price is not coming back as far before it goes once again to get a better look at the level. And the more they come back to explore it, the more FEAR is turning to CURIOUSITY and then what is happening?
The psychological dynamic towards the level (or the spider) is shifting.

Now all of this is just a childish little analogy BUT the key point is this. When price returns to 1.0326 on the far right hand side of the chart (for the fourth time) does it look scared to you? Or does it look like the market is getting accustomed to that level and is about to take some action (and stomp it)?
At this point, after this many touches, I am getting ready for a breakout. And so I watch and wait for the optimum opportunity where the spider will maneouvre itself into a position where it can be stomped. (You can't stomp it if its on a wall can you?)
So, here we go...we've got it. A glass and paper is all well and good but you have to get far too close for my liking to do that. So, get above it, lift your foot up....its the breakout.



Foot goes up, foot comes down hard on the spider.

Foot lifts up to check it's dead. (see red arrow)

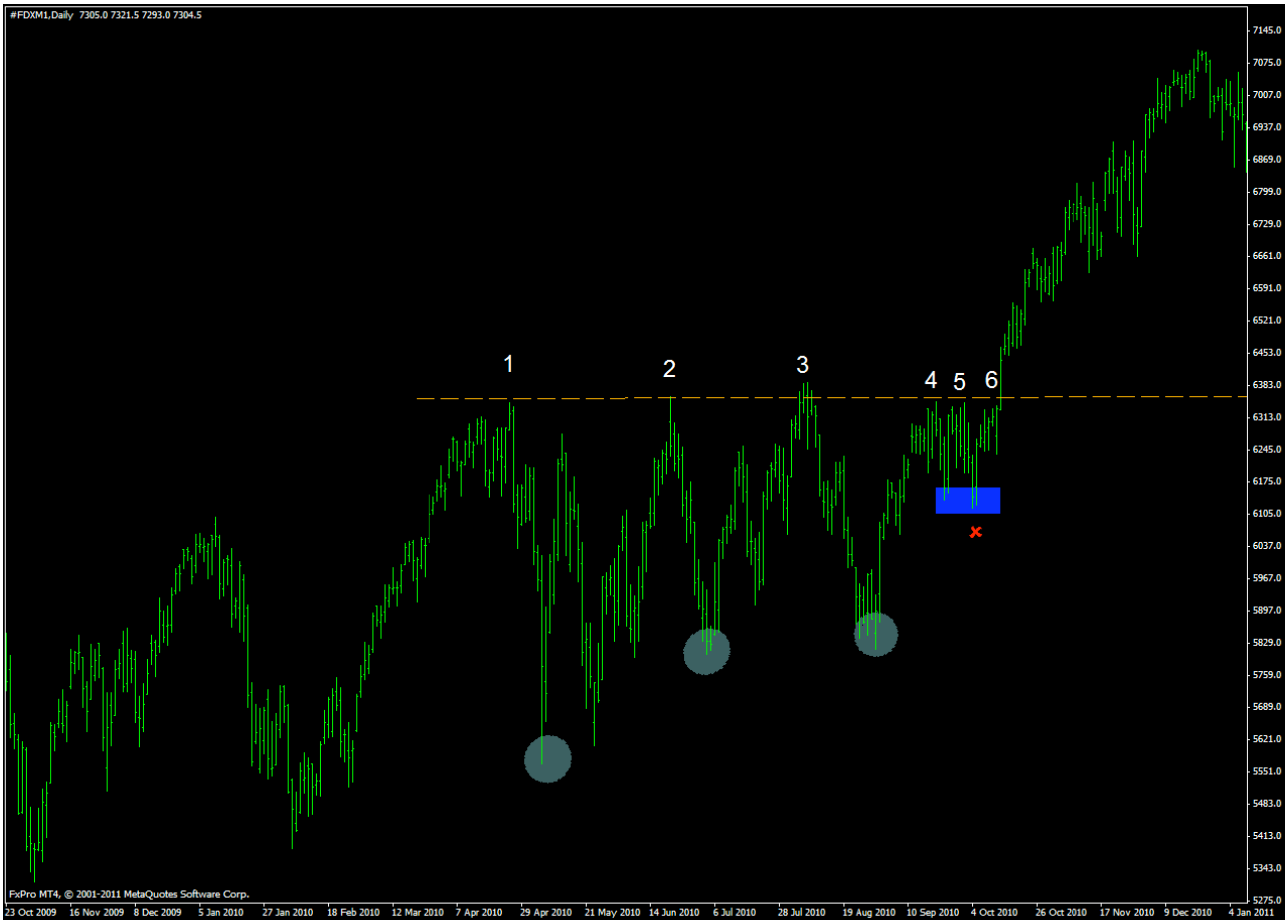
Now we (the price) can move on.

Please can I add that no spiders were killed in the making of these posts and I always use a glass and paper and urge you all too as well. Spiders are useful, beautiful little things. (my lawyer made me write this)

Another example. This time from the Dax.

Very similar to last time but more touches and a slightly different dynamic before the breakout.

The circled areas show higher lows but the blue rectangle briefly breaks the pattern by making a marginally lower low.



It is quite rare that market patterns are flawless but there is a question you need to keep asking yourself here.

At point 6, how scared does price look of that resistance?

Oh and while we are on the subject, how many traders do you think got shaken out at the spot marked with the X? The answer is: Most likely a fair few that got in early looking for the breakout and a fair few that saw price coming off for the 5th time, turned to their bible on technical analysis, read about how a resistance is made stronger the more it's touched and then promptly sold sold the swing low break (and got their lunch eaten for them).

I honestly don't think one ever "gets" the game.

One learns a high probability play. Makes money with it.

Then the market shifts. A new phase enters. One has to cope with this, constantly adapt to this and also be able to master themselves.

Always remember: You are only as good as our last trade.

One thing I like about J16 is he doesn't go on about needing a 1:2 (or higher), in terms of R, all day long.

If the probability of the trade is high enough, the R is largely irrelevant.

That's not to say one should start risking 100 pips to make 10 or anything silly like that but you do need to balance R with your strike rate.

They have an intricate relationship and their love child is called your EDGE :-)

For example the Sunday night gap. My R is 0.5. That means I risk 2 pips for every 1 that I make in the setup. The win loss ratio is 85%.

.....could you expand on what you have said about the way price approaches a PPZ?

I want;

i) Space on approach. Space is often but not always created by *time.*

ii) Although it is not a neccesity, I like price to *accelerate* into the level but if this happens, I prefer the acceleration to start some way above it

Here is an example.

First chart is the double top breakout and retest in Gold on D1 chart. It's a good technical setup and we are with trend on it. Next we will drill down to the H1 to look at the intricacies.

This is Gold on the H1 (see the D1 picture above)

Let's talk through the points;

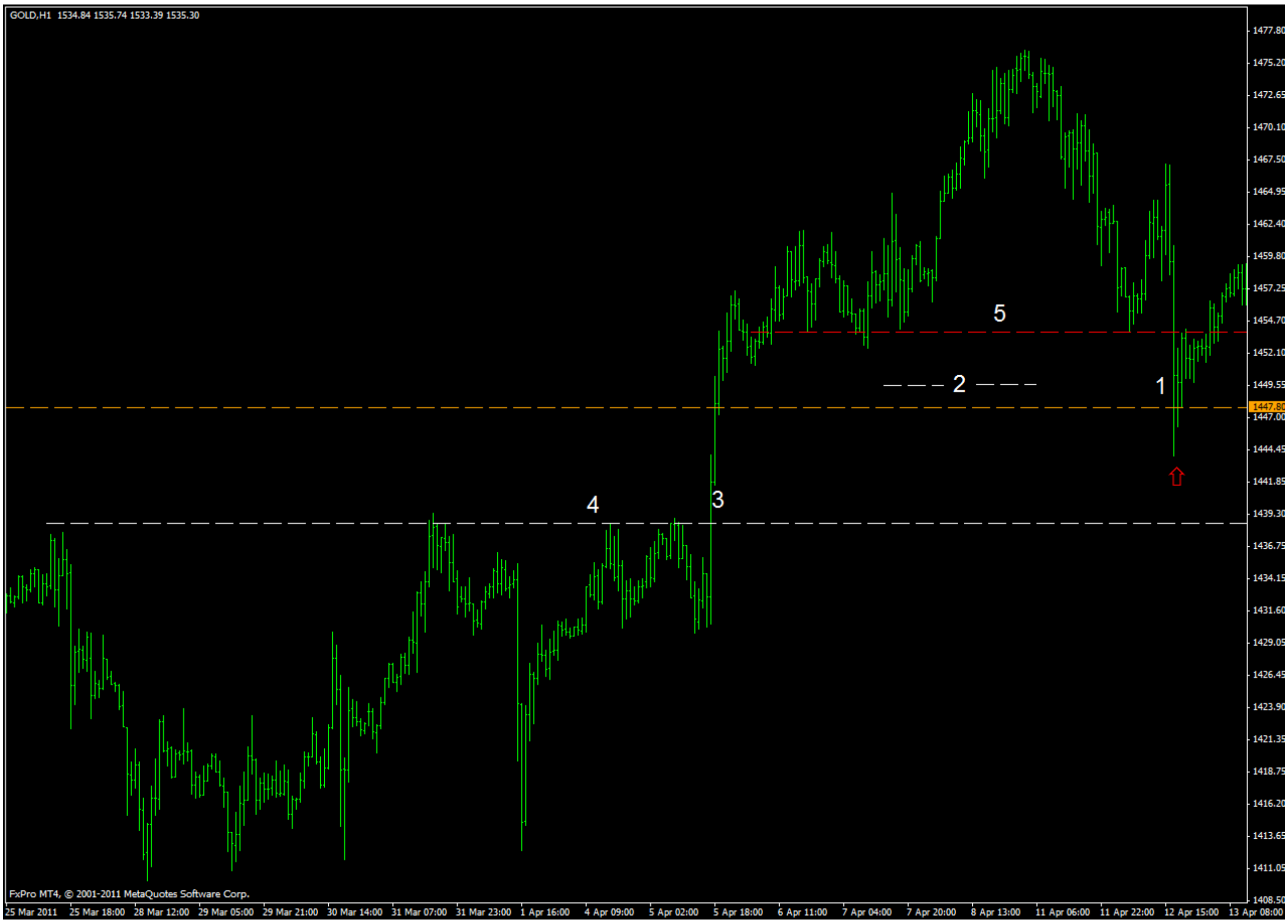
1) Price accelerates into the level. Gold has been quite notorious for making a sharp move to flush out those late to the party. I am OK to stand infront of this, despite it dropping $20 in two hours (200 ticks) in a violent down move.

Why?

Because;

- The strong hands that are short will likely trim positions at this level and some will even look for longs to fade the big move and join the trend.

- The weaker hands that are fortunate enough to be short are likely to try and "gamble" with the level and hold it because they mistake the violence for the start of a big move. At the same time, those that are net flat are probably too scared by the extent of the down move to stand infront of it. (how many people reading this thread are guilty of either or both of these thought processes? I know I was for a long time)



This ensure the weak hands do not participate in the up move which is always good :-)

2) There is space here which is created by two things;

- The time that has elapsed between the breakout and the retest

- The fact that the nearest resistance is some way away. E.g. We are not trading directly into price congestion.

3) This is usually the place where I will put my stop. Just under the low of the last "thrust" candle that opened below and closed above my level.

4) These previous highs worry me because if you read an earlier post of mine on this thread, I always check to see I am not stopping out into obvious areas at which price might bounce. This is an obvious area and it extends back even more than you can see on this chart. This now causes a problem with the stop placement for me.

5) This is the FTA since it marks the recent support lows that are now expected to act as resistance to any up move.

Trade Conclusion: The trade worked nicely (albeit suffering a bit of a squeeze) HOWEVER, the fact that I would want my stop below the highs at point 4 to protect it a little more means the r:r from the stop to the FTA is less than ideal and because of that I passed on this trade.

↔

The retest is simply price testing an area of support or resistance or the trigger point of a price pattern (e.g. the neckline of a head and shoulders) from the other side.

You do not need to wait for price to hit a level and THEN do a rounded retest. You simply need to wait for a key resistance or a support level to get broken and then take action when it trades back into that area from the other side.

The "rounded" pattern is what I look for when a market is retesting that level from the other side for the first time.

See chart 1 below which is the D1 chart for Coca-Cola stock. The price breaks out of former resistance at 65.86 and we are waiting with a buy limit on the return as long as price is "rounding back" to the level.

Most of the time, our intention is to enter at the start of the move e.g. off the level which marks the turning point.

However, there are some opportunities (e.g. the FTSE trade we went over in the Webinar) where the play may evolve from what you first expect.

Take a look at the chart below of the FTSE (chart 2) on the D1 timeframe. When price is trading into the resistance marked in yellow, my initial aim is to try and get LONG. The plan is;

- To wait for the breakout and then enter in long on the rounded retest with a limit buy order at the level.

What happens?

Price breaks out, probably hits a fair few buy stops, comes straight back within the range and then forms a huge BEOB. (chart 3)

Since I wasn't planning to go short here (note the spider into the level) then I would NOT have got an entry at the source.

In my opinion, it is only at the end of the day that the market has tipped its hand.

I can then use this BEOB to guage the directional play (in this case, a short position) and drop down a time frame to the H1 to find my entry.

Chart 1 is the S&P at the aforementioned 1371 level which is a fantastic S/R pivot.

Chart 2 clearly shows the <u>acceleration</u> into the level on the news and the subsequent reaction. This is exactly what I look for.

It is important to note that there are a lot of differences between what I do here and what a lot of the readers of such threads will be used to doing.

It is important I highlight the ways in which I now differ for the simple reason that if you don't understand these differences, you will struggle to make things work for you.

Here is a quick outline ;

1) We don't IGNORE news. News drives markets. I think too many people try to market their strategies by making them <u>too</u> simple. I recently read this classic on the net from a "professional trader" : "I do not waste my time reading the paper or visiting any news blogs...I couldn’t care less which Euro-zone country is going bankrupt or issuing bonds, and I don’t care what Oil country in the middle-east is starting a civil war; this stuff does not help a price action trader and it does not influence or concern me."

Try saying that at an interview to become a professional trader and there is a 99% chance you will get laughed out the room before you say anything else. Don't get me wrong. While I don't sit there trying to trade figures, NEWS DRIVES MARKETS and once you understand how new works (what news traders expect, what news they actually receive, how price reacts) then you can start to understand the puzzle a lot more.

News is ;

- The reason I got out of my Gold short at $1703 and caught 80 ticks rather than everyone that tried to run to the FTA and lost money

- The reason you know to short USDJPY every time they intervene APART from 16th March 2011. (16th March was co-ordinated CB intervention rather than single)

- The reason you get long EURCHF on the 6th September 2011. Everytime the SNB intervened, a study of pure historical *price action* tells you to begin looking for shorts on the day of intervention. A news trader, sees the peg announcement flash across the wires and not only does he know not to get short, he actually gets long on the rally.

- The reason you don't sell USDJPY at the 75.60 level on Friday after a blowout non farms number.

If you are long the FTSE off a great level and price starts plummeting because there has been a terrorist attack, a good trader will cut and reverse immediately. Meanwhile all the rest will be saying "Oh I don't watch the news...so I'll just hold this to my stop gets hit"...

Those that IGNORE news do not, to put it bluntly, have the first clue what is going on in these scenarios.

I could go on all day. Someone once asked one of the prominent J16'ers in a webinar, do you trade news and they said "Look at a chart, if you can backtest it visually and see that it works then news is unimportant because you can see the setups work and you have no idea of whether there was news or not".

While this is a good answer, I still think it is viewing things a little too simply. That is just my opinion.

How do you know that the setups that didn't work were all news based? How do you know whether the setups that do, were? You don't.

Now, no one should be suddenly pulling up their wires and reacting to every bit of news that comes out because much of the time this just serves to scare you out of taking or holding a position. But news and what it does to markets is something to WATCH and LEARN.

News related trading is a very hard area of trading to master. That's why it is usually ignored. But no one said the game was easy.

2) The breakeven maneouvre. If you are still using it, you haven't read the thread. Using breakeven is akin to gambling ; I HOPE it will carry on in my favour but I DON'T want to take a loser if it turns.

It's simple ; once it reaches the next key turning point, get out and be ready to get back in again if necessary.

The number one rule that you hear time and time again? Never trade your P&L. This is exactly what breakeven stops are. They are trading your P&L.

Use a stop that makes sense. Not one that is an emotional crutch.

3) Running trades. It is not neccessary to be trying to run a trade for 500 pips profit with this strategy. The people that try to do this are usually either ;

- Trying to compensate for a huge stop e.g. when you are trading a D1 pin with an entry on one side and a stop on the other.

- Trying to compensate for having a small account.

Once again, I am NOT saying that profitable traders do not run trades. Many do. However, I am saying that this is not my style and I think that if you have been trying to do this and not having success so far ; stop thinking it's all BAD LUCK and actually be honest and ask yourself if you fit into either of those two categories above.

Those that attend the webinars have been given a clear set of rules for when to get out. When you have a D1 bias, run to the D1 FTA and use the H1 to trail. If you do not have a D1 bias and enter on the H1, exit at the H1 FTA.

4) Forget about the crosses when you are new to this. The key to making decent profit in the markets is knowing a few in depth. You cannot possibly know large numbers of different markets inside out and back to front. It's part of many price action strategies because they almost always advocate taking W1 or D1 based trades which means you do not get enough trades to see any meaningful improvement unless you analyse 376 markets every night. If you use this strategy across the 6 - 7 USD majors, you should get one trade per day on average.