

Basic Day Trading Techniques

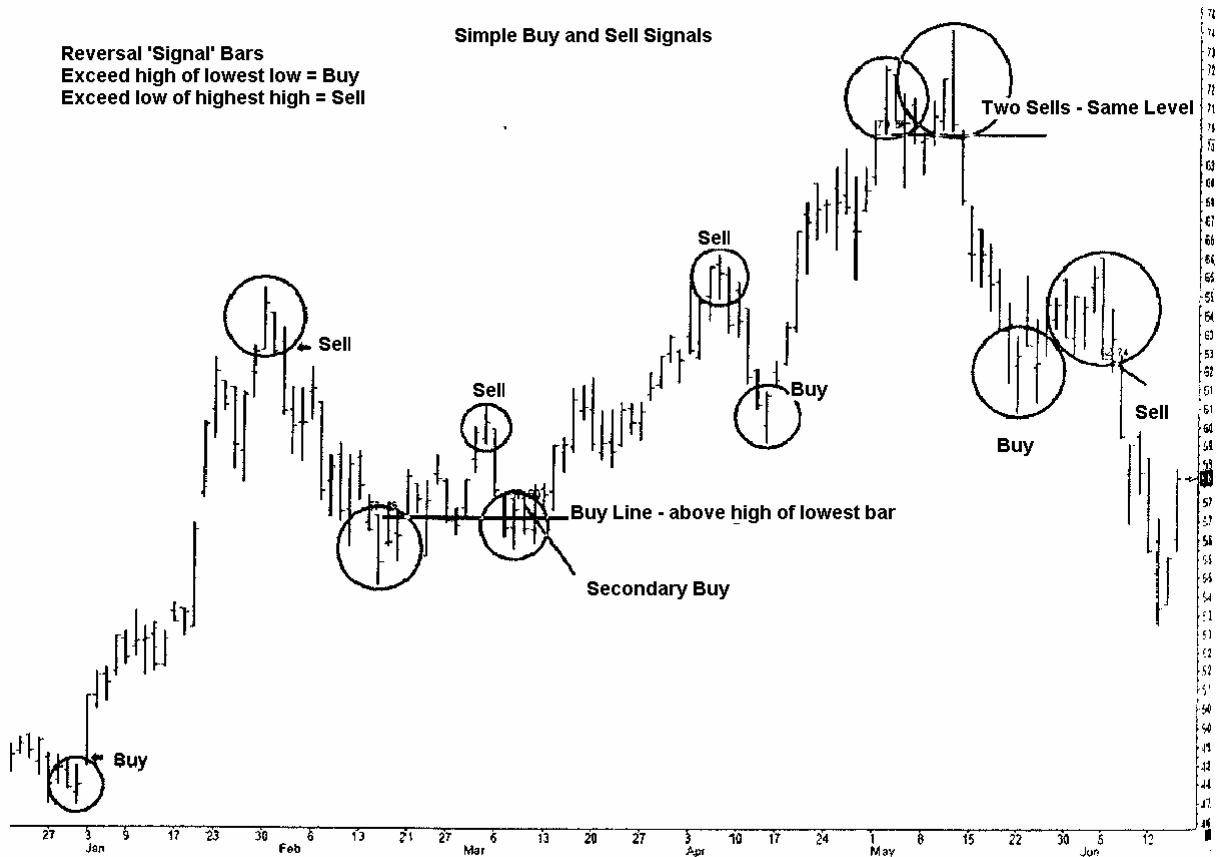
By Michael S. Jenkins

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Reversal 'Signal' Bars
Exceed high of lowest low = Buy
Exceed low of highest high = Sell

Simple Buy and Sell Signals



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PREFACE

During the past 36 years as a professional trader I have come to know a great many traders of all types and abilities. Their styles were as varied as was their success but most were disciplined and knew how to take a loss at the appropriate time. I have noted on many occasions that the success that many traders found was often luck, or due to some belief in a system, which was not always proven, but for many months at a time worked perfectly. Many of these traders made and then lost fortunes but I was always a keen observer of the few who always made money and rarely lost. These traders limited their trading to specific situations, which were familiar to them, and they never had the urge to trade everything everyday. They also followed certain principles as to entry and exit and always used stops.

During the bubble mania that culminated with the 2000 top I was affiliated with perhaps the worlds largest day trading firm which had over a thousand traders and many offices across the country, and I taught an evening class for some and often had many stop by my office to see what I was trading and get some advice. What was always a shock to me was that there were an enormous number of traders who were trying to trade for a living and most hadn't the slightest idea what they were doing. They had money and read a book or two and used some kind of crossover moving average or oscillator, but they didn't know the basic *principles* behind why charts worked or the well-known square root basis for all market movement. Also during this time, I had the opportunity to teach my private personal seminars to many people who had the money and experience not afforded ordinary traders but who nevertheless also didn't seem to know the basic principles of trading. Most had read a popular book, or went to extensive seminars but most didn't realize that there are very basic principles that work all the time and can make money for you under any circumstances if followed. This book is an effort to teach these principles. There are more advanced concepts in my other books and seminars, but for those who are having a difficult time just plain making money every single month, then those advanced ideas may be somewhat wasted until they can appreciate the more basic money making skills. This book will teach what I think are the basic postulates to trading. I will not get into elaborate entry and exit systems but will show how they develop from basic principles of trend determination. I will demonstrate some

simple approaches using basic tools but will develop them into the most advanced concepts of money making when applied correctly to any chart. The end result should be your greatly improved skills and confidence in your ability to make money in any situation on any type of trading vehicle. In this age of easy money and high leverage it should be possible for anyone who can discipline themselves to follow rules, to make a great deal of money without ever having to listen to any other persons advice.

Since this book gives the appearance of being a 'basic' or beginning book, please fight the temptation to skip through chapters, which seem too basic for you. The ideas developed herein come in a logical sequence and just as we teach addition and subtraction before multiplication and division, you will need to absorb the theory as to why 'the low of the high bar' has meaning and what the implications of such meaning are. To just conclude that it's just a price level that causes a breakdown would be to miss many finer implications of the theory that can be applied on many levels. Although these are principles, the very fact that there are such things is news to the vast majority of the investing public. If you never learn to add or subtract it will be hard to become a NASA rocket designer. While I'm not designing rockets here, if you can't easily make \$500 a day most days of the week, you will probably never get to the point where you can make \$10,000 to \$50,000 per day. If you learn the basics the money will take care of itself.

June 7, 2007

Michael S. Jenkins

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Acknowledgements

I wish to thank the following software products for the use of their charts in the various illustrations:

Ensign Windows
EnsignSoftware
www.ensignsoftware.com

The vast majority of charts in this book were produced with Ensign Windows which is totally programmable with a large library of tools and shared library of users

Market Analyst 4 Astro Edition
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Where To Begin

Trading stocks and commodities can be a very financially rewarding endeavor if one has the proper education and approach, and is disciplined enough to follow strict rules. It is a fact that 'return OF your capital' is much more important than 'return ON your capital'. Needless risk taking and ignorance about what is to be expected is nothing more than gambling and what we want to do is speculate, not gamble. The difference between gambling and speculation is that in gambling the odds are stacked against you and set by the gambling establishment. In speculation we control the risks - when to buy and sell and at what price, how much to buy and sell, and how much to risk on any trade. Many times we can set those odds 90% in our favor.

The way we determine those risks depends on our approach. Many study 'fundamentals' like earnings growth, and project an assumed growth rate into the future and similarly assume that growth will translate into price appreciation commensurate with that growth- That's a risky assumption but is the method 90% of all investors follow. Because they cannot determine their risk they resort to extending the investment period to many years so they can rationalize short-term losses in the hopes of achieving long term gains. Wall Street is full of highly paid salesmen whose job it is to convince you that no one can predict the future and your only hope is to invest for the long run and everything will work out. I don't believe in that philosophy. I am a trader and a technical trader at that. I could not be successful if trends did not *persist* and could not be predicted with a certain amount of reliability.

Technical analysis is the study of price patterns and volume fluctuations. The theory, which really can't be disproved, is that all known 'fundamentals' are revealed in the price action of the stock. Even if a company has a secret oil or gold discovery on its property, as soon as someone finds out it will show up in the price action of the stock as it goes up on increasing volume. The 'fundamental' news may be covered up for a year or more.

Some traders also are 'tape readers' as opposed to 'chart readers'. Tape readers simply look at the ticker tape and various news feeds and watch the price action for unusual blocks of volume and up ticks or down ticks in price action. Horizontal support and resistance is the key here.

While this method has made millions for countless individuals I prefer chart reading for trading. The chart gives so much more information than just one day's tape, and time cycle analysis can readily be applied to the chart patterns to predict the future. This book will show some of my methods of chart reading trading.

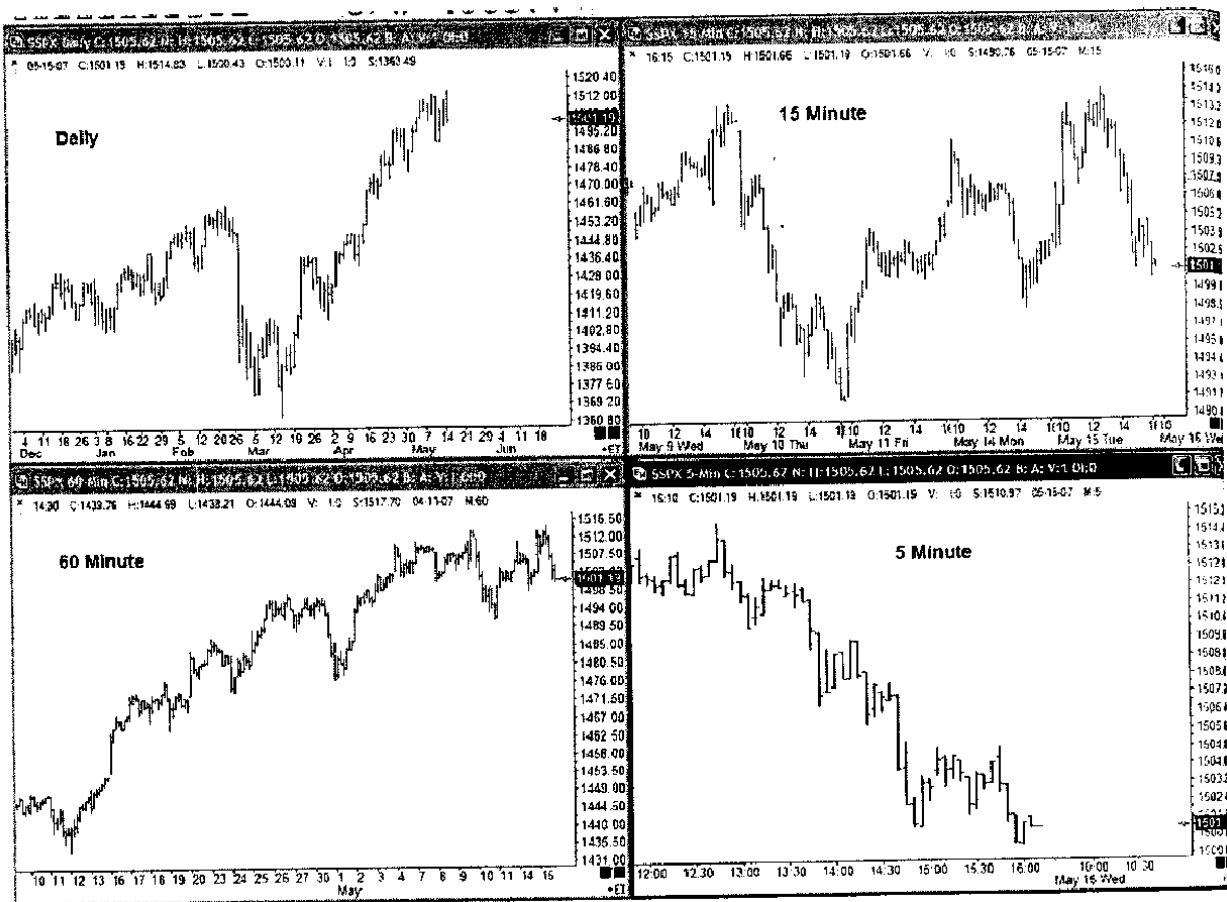
To start our study we need charts. We can draw these by hand which is always preferred if you are only following a dozen stocks or commodities, but for practical purposes a computer software program will make things much easier and allow you to follow thousands of individual issues and also mechanically trade with a system. Most software products will do the job but I like ones that have a number of features such as multiple windows of different time frame charts, all kinds of trendlines, arcs, circles, and some kinds of time cycle tools like cycle expanders, Fibonacci ratios and even astrological plotting. In my own trading I use Market Analyst, Trade Station, Ensign, and Metastock, but I have used perhaps another dozen systems over the years. They all seem to do the job although some are better than others. The chief feature should be the quality of the charts and the amount of data available. The ability to draw lines, circles, squares, parabolas, angles by-degree, and have a cycle finder tool is essential.

The first basic question to be answered is what time period do I set my chart windows for. Certainly you need a daily chart and also an hourly one. These are the two essentials but for most professional trading you will also need weekly charts and sometimes monthly, and usually 5 minute or 15 minute charts. The basic rule is that there must be a natural time and price correspondence in your chart like one point per day, or one point per hour, or natural divisions of those time periods. This principle is also utilized on both trading day bar charts and calendar day bar charts. This is true whether we trade a 24-hour GLOBEX clock or a 390-minute trading day from 9:30 AM to 4:00 PM (New York). This also requires a consideration of the spacing of the bars in our charts- do we leave spaces in our charts for holidays, weekends, and early closings, or do we only plot actual trading bars and leave the rest alone. Both work and give good results but you should follow one method so you don't get confused with your trendlines and time counts. I currently use a hybrid system of keeping both 24-hour charts and 6 1/2 hour charts for the actual NYSE trading hours. As the world markets evolve, trading will undoubtedly go to 24 hours a day all the time but the local time trading hour markets still

have a big influence. This can be easily proven by looking at our charts. For instance, in New York the trading day goes from 9:30 AM to 4:00 PM or a total of 390 minutes. Basic number theory consists of two distinct measuring systems. One is based on 360 circular measure and the other on 100 or 100%. These systems come from the Bible which in its first chapters tells how God made the universe in 6 days so 6 is the working number and 6×6 the square of that is completion. 36 times 10 equals our 360 circular measure, and $10 \times 6 = 60$ is our time cycle in minutes. Our basic divisions are by eights, quarters, thirds, halves and by tenths. Depending on the 'base' we can divide 360 by 8 and get 45, or by 2 and get 180, or by 3 and get 120, or using 10% we get 36. Using a 100 base we get 12.5, 25, 33.3, 50, and 10 for the same divisions. Now getting back to our charting example we apply these natural divisions to our time trading unit. If we use the 390 minute trading day we have basic 1/8th units of 48.75 minutes, and using 10% we get 39 minutes. We can prove the validity of this 390 trading minute cycle by looking 10% into the trading day or 9:30 am + 39 minutes = 10:09 AM which is almost always a turn on the charts every day, and then use $390 / 8 = 48.75$ or $9:30 + 48.75 = 10.19$ AM and this too is usually always a key turning point each day. Sometimes the turns are a minute or so later and this is due to the fact that the S&P futures trade until 4:15 PM or an extra 15 minutes each day after the stock market closes and that extra 15 minutes divided by 10 and 8 gives another minute or two. By the way, I have on my website (www.Stockcyclesforecast.com) several free programs that do all sorts of calculations and one is a program that calculates these 1/8th and 1/10th trading periods within the day.

These pragmatic observations prove the validity of using the trading hours day chart and our sub cycle chart should be a harmonic of that time period. In other words in the above example a 39 minute chart or a 48.75 minute chart would work perfectly, but we usually need smaller time periods for aggressive day trading styles that often buy and sell several times an hour. These 1/8th and 1/10th of the day cycles can always be used on any scale time period. The 39 minute chart can be divided by 10 again to 3.9 minutes and a round up to 4 minutes fits very well since the Earth rotates 360 degrees each day in 24 hours or 1 degree of revolution for each 4 minutes. A 4-minute chart is therefore better than a 5 minute one but the differences rarely can be seen except over many hours. So I would use a 4 or 5 minute chart as my smallest time period, although on

some occasions I will use a 1 minute chart for precise timing methods. 15-minute charts are also used since 1/24th is the natural time division of the Earth and we set our clocks by the suns travel of every 15 degrees longitude (24 hour day, 15 x 24 = 360). We can also divide a 24 hour day by 10 and by 10 again to get a unit of .24 hours or 14.4 minutes, again very close to 15 minutes on our chart. We also use a 60-minute chart as a primary fundamental chart since it is the working number of 6 x 10 and 60 minutes is 1/24th of the day or a natural 15 degree rotation of the Earth on its axis. I would recommend you at least have the capability to see 5 minutes, 15 minutes, 60 minutes, 1 day, 1 week, and 1-month charts. That's a lot of charts to keep track of especially if you follow dozens of issues but most of the time will be spent trading one time frame but the others are used to confirm the trend.



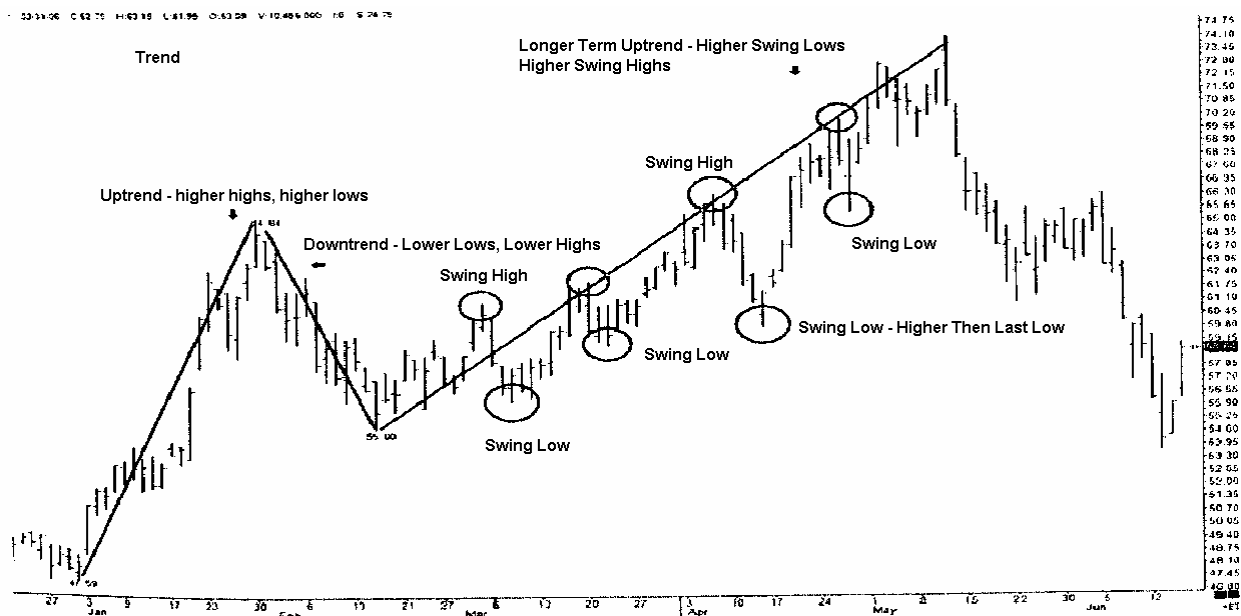
The Window Chart above has four time frames with differing trends- Daily, still strongly up, Hourly, up but consolidating or topping, 15 minutes, minor down trend to horizontal support, 5 Minutes, downtrend. If the change is turning as indicated by the downtrend in the 5 minute chart, the next frame to break will be the 15 minute chart but note that the horizontal support on the 15 minute chart extends over three days so a

break on this chart will also break the hourly chart and that will come close to breaking the daily chart. Our strategy should focus on a 15 minute breakdown for a short, or a bounce back long with a close stop to be confirmed with the hourly.



Before we can really answer how various time frames can confirm the trend we must define what a trend is. Trend can't be determined from just one observation. It is a series of observations over time and using bar charts as our guide, it is a *pattern* that develops on the bar chart. A bullish trend going up will show a *pattern* of making 'higher highs' and 'higher lows'. This means that over a series of bars subsequent bars will make higher highs than prior bars but also the bottoms of those bars will be moving higher also, as a competitive bidding war develops to buy the issue. The big moves in the market are always due to large institutions that accumulate very large positions in a stock or commodity and these positions can be accumulated over weeks or even months if the volume is not sufficient each day to fill their orders. Institutions are very value conscious and often buy or sell at limit orders based on some fundamental criteria like a price to earnings ratio. They will leave large orders of hundreds of thousands of shares with their brokers to fill at a limit price but as each day goes by that they don't get stock, they slowly raise their limits. This is what causes the 'higher bottoms' part of the pattern on a bull trend. Sooner or later the chart will make a higher top as the buyers

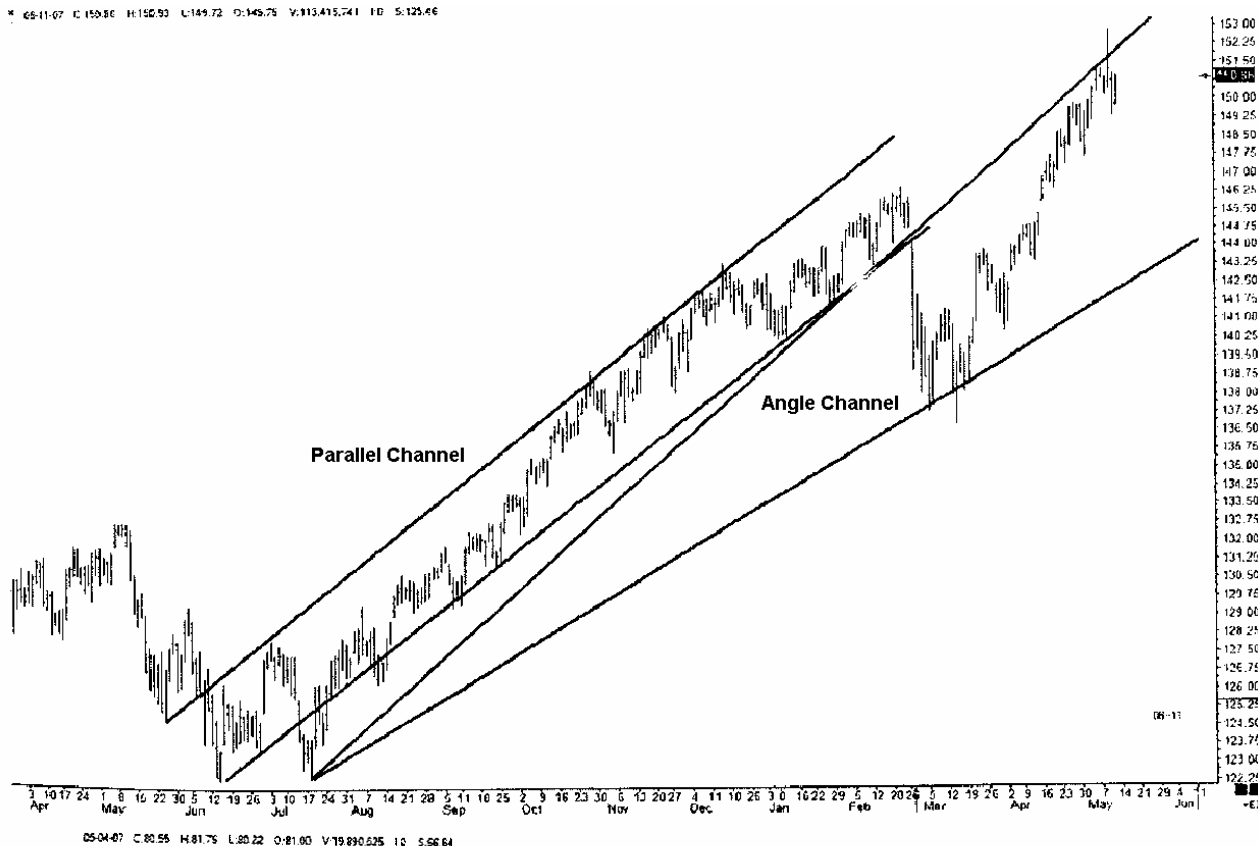
bid up the lows and impatient buyers take offerings rather than wait. It is extremely important to note that in a bull trend the bottom of the bar is more important than the top tick. The low each day is made by big buyers who step up to buy into a decline and are so big that their order is not filled, hence the low is made. As the bull trend progresses to a top it is the *low of the top day* that is important since when that goes it means all the big buyers have been filled on their orders and the short term trend is down since the market must move lower to find bargain hunter buyers at lower levels, or shorts who will cover at a profit. The top price of the bar at a high is usually made by desperate shorts covering at the market on little volume. We must be aware of the time frame of these patterns as a very bullish higher bottoms 5 minute chart may not be so bullish when viewed within a bearish daily or weekly chart. Because of this *we must always start with the biggest time frame chart and work down*. That way we can know if the trend is up monthly, up weekly, up daily, and then we don't care that much what the sub-daily charts say since we will be buyers on dips on the hourly chart and look for entry points for that buy perhaps on the 15 minute chart.



The downtrend pattern is one, which is making a series of 'lower lows and lower highs'. This shows competition on the sell side (offering) of the market with sellers jumping in front of sellers and people selling at the market on the bid. Opposite to the bull pattern, the long term institutions now have limit orders to sell at the high of the day and they can leave these orders there for weeks at a time. The low of the pattern is also important because to show *a true liquidating* downtrend we need to see

multiple sellers hitting the bids and driving the market lower to confirm the long-term trend as one of liquidation. Many times a big seller may push the market down and leave a large sell order at a limit, but if he is the only seller the stock will just go sideways below that level waiting for him to cancel or eventually getting filled at which point the stock moves back up again. So we basically see that a bull trend is really only concerned with higher bottoms showing accumulation while a bear trend is concerned with both lower bottoms and lower tops showing continued liquidation by desperate sellers who have to get out. *This basic recognition of patterns provides the entire basis to trading* whether you read a tape to see those 'stair step' patterns, or you look at charts. The more familiar you become with determining these basic patterns on the various time scales, the more successful you will become in trading. Basic trends differ only by the shape of the pattern. These patterns usually take the form of 'waves' with advances and then small declines and then another advance. In long term uptrends the swing lows *are all contained within an upward sloping parallel channel* with each wave low touching the lower channel line. Parallel channels occur within very strong trends, but many are more volatile and instead of a parallel channel you see a 'fan' angle that contains the dips. Many traders are familiar with channels but few note that *angles are another type of channel that allows for more variability*. On this next chart note the tight parallel channel that starts to increase in volatility and turns into an angle channel. Note the main long term trend (up) has not changed although a few weekly lows were broken in March but held the angle support.

The BIGGEST MISTAKE most traders make is assuming that the breaking of a trendline changes the trend. Sometimes that happens but most times it's just a loss of momentum. To change a trend you must break HORIZONTAL support levels AND have a pattern of lower lows and lower highs. Breaking a steep trendline will usually just mean a plunge to the next geometric angle down and then the existing trend resumes. Shorter term time frames will go into a change in trend but the longer term weekly, and monthly will not. The rule with angles is that "When they break one, they will trade to the next angle". As long as the angles are still rising the trend is theoretically up. Downtrends use angles with downward slopes, but horizontal levels must also break.

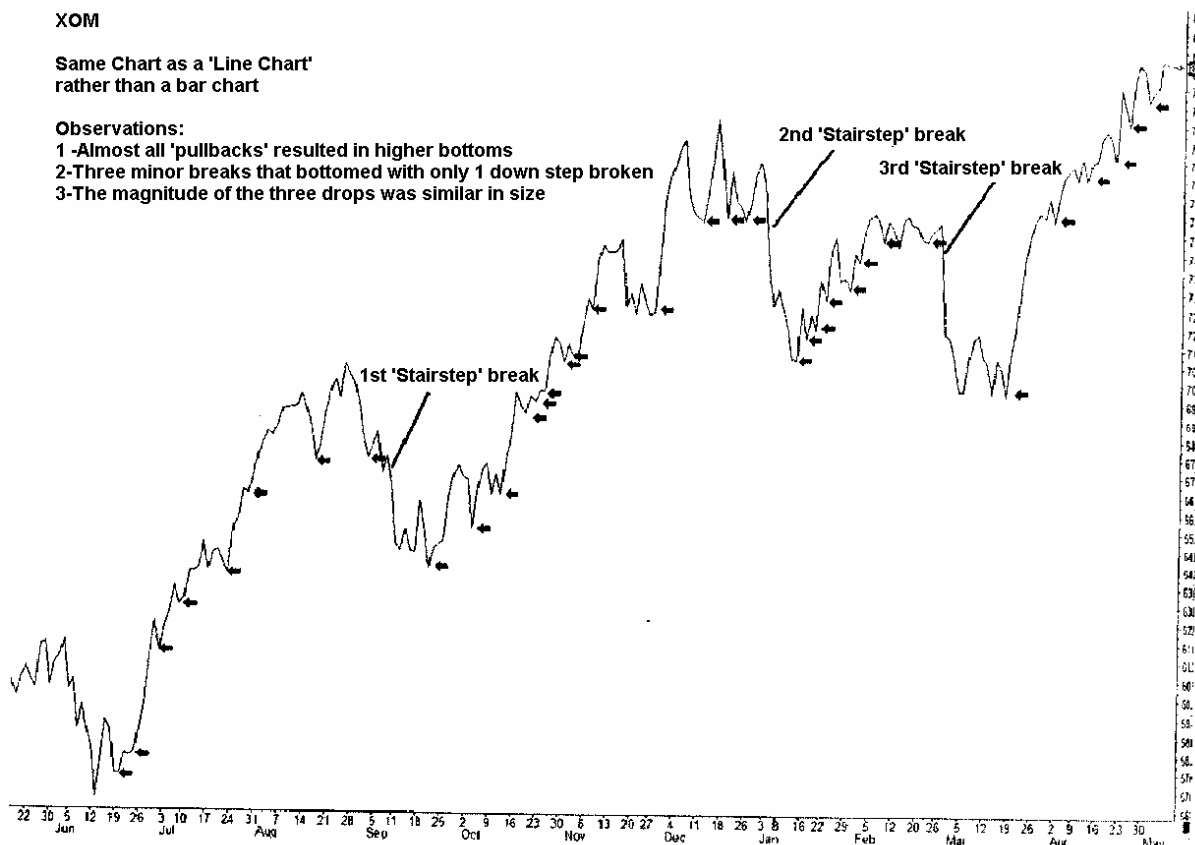


XOM

Same Chart as a 'Line Chart'
rather than a bar chart

Observations:

- 1 -Almost all 'pullbacks' resulted in higher bottoms
- 2-Three minor breaks that bottomed with only 1 down step broken
- 3-The magnitude of the three drops was similar in size



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Above we see a 'line' chart instead of the common 'bar' chart that has a high, low, and close. The line chart just connects the dots *at the end of the time period* and *will not show* the frequent 'whipsaws' that spike for 10 to 15 minutes at a time as seen on bar charts which show the whole range

during the time period. Because *the line chart only shows the closing price each time period* it is often better to use it to determine the true trend. It's hard to trade off a line chart, however, as the intra-period swings that don't show up can really cost you money if ignored. It's best to trade with a 'normal' high, low, close, bar chart but check the line chart every few hours to keep perspective. The chart above shows numerous higher bottoms with only three small declines over a one-year period and you can see clearly how bullish this trend was. The Exxon bar chart prior to this one (page 10) shows the same time period but the bars have the look of whippy consolidation areas that are hard to interpret and often give the appearance that they are reversing when in fact they never do. Trendlines on the two differing charts can also give slightly *different perspectives* so it's usually a good idea to switch back and forth between the two to gain perspective. If you are trying to forecast a future target price then *the line chart gives better forecasts* and leaves out all the stop order runs and choppy news items that only last for five minutes or so. One chart I don't use a lot is the candlestick chart but it is a good chart for beginners since it's color coded by trend and easy to read. You may find that candlesticks are good for quickly going through hundreds of charts and getting a quick feel for the overall market but if you study enough charts you will be able to see all the types 'in your head' without switching back and forth. In the final analysis each chart gives basically the same information and if you study them intensely they will tell you a great deal about the trend and when it is changing.

There are hundreds if not thousands of methods, systems, and studies to trade stocks with, but the basic trend is what it is really all about. All your mistakes will be forgiven if you invest with the trend so that is our basic objective at all times. Trading with the trend makes all the money and although small counter trend scalps can be profitable they require much greater skill than the typical speculator possesses. It is often said 'don't confuse brains with a bull market' since most 'genius' traders usually make their money riding a trend and once it changes they go broke if they don't recognize the change. Trying to prove your particular system is superior will cost you a lot of money if the main trend doesn't support it. The other observation about trend is that it is the whole underlying philosophical basis of day trading. That is because trends *persist* and we can go with them for several trading bars and make money. If the bars were completely random we could never trade. Persistence of trend is the

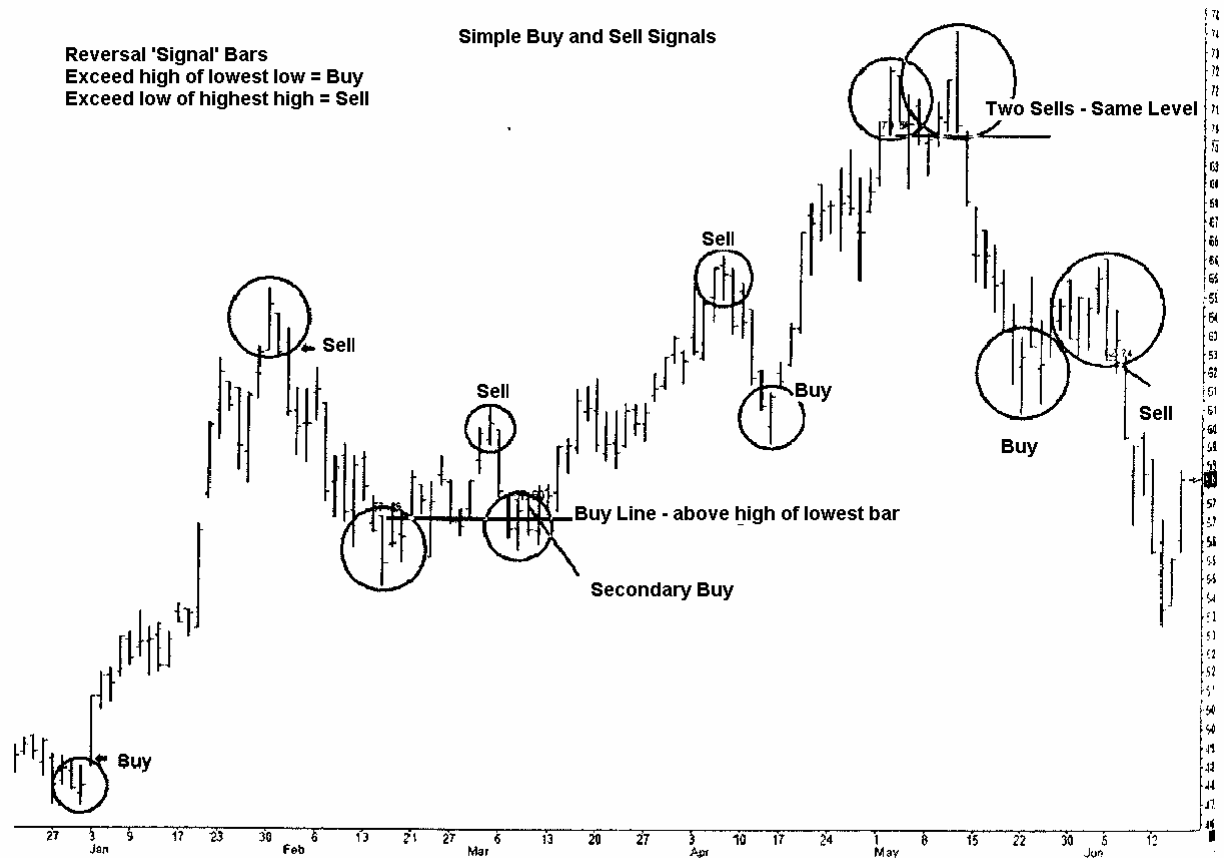
key. Persistence is a function of time cycles and varies with the time frame you are trading. A one or two day, daily bar chart trend, could have hundreds of bullish trending 5 minute bars or a dozen or so, hourly bars. I'll repeat again, if you trade off a 5 minute chart you may have a completely different view on the strength of the market than if you only look at daily bars. A good starting point is *always start each day with a quick look at the weekly, daily and hourly charts* to get a feel for potential reversals before starting to trade 5 or 15 minute charts. A basic observation about persistence of trend is that even minor trends go for *three bars* and if longer than that, often go to Fibonacci counts like 3,5,8,13,21,34...bars. Clearly a reversal on a weekly chart (3 bar minimum) will tell you a lot more than a reversal on an hourly chart.

We know that the trend is a *pattern* of higher or lower bars, so what is the *pattern* for a reversal in trend? Obviously a reversal comes at the extreme of the move so on the high day we see a reversal when the low of that day is broken. This can't be done until the next day but once the next day after a new high is made and the low the next day is lower than on the high day, that's pretty good evidence that the buyers on the bid side of the market on the high day are gone or have used up all their money. Likewise on a move to lower lows each day, there will come a day when the extreme low is made and the next day a higher bottom is made. If at that point or a subsequent day a higher high is made then that is a sign that the limit sell orders at the high of the low day have all been purchased and now the bulls out number the bears. Our reversals can now be summarized as "the breaking of the low of the high bar" is a sell, and "the breaking above the high of the low bar" is a buy signal. This next chart shows these simple reversal signals.

This chart shows simple reversal buys and sells and it is to be noted that because of the existence of persistence of trend, when these reversals occur they are usually profitable even if only for a day or two. In a strongly trending market the signals going with the trend often go for 5 to 8 days to even weeks before giving another reversal. This is so simple, and yet few traders are rich. That is because one of the HARDEST THINGS in all of trading is staying with a position until a clear reversal signal is given. 99% of all traders guess at a potential reversal and are so afraid of losing or giving back some profit that they become too afraid to win. Now intra day scalping S&P futures on a 1-minute chart may be an exception to this, but most trades that last 4 hours to 4 days should be held until some sign of a

reversal is given. The most frequent excuse is "I'll just get stopped out if I don't self" and this brings us to our next basic study, that of placing stops.

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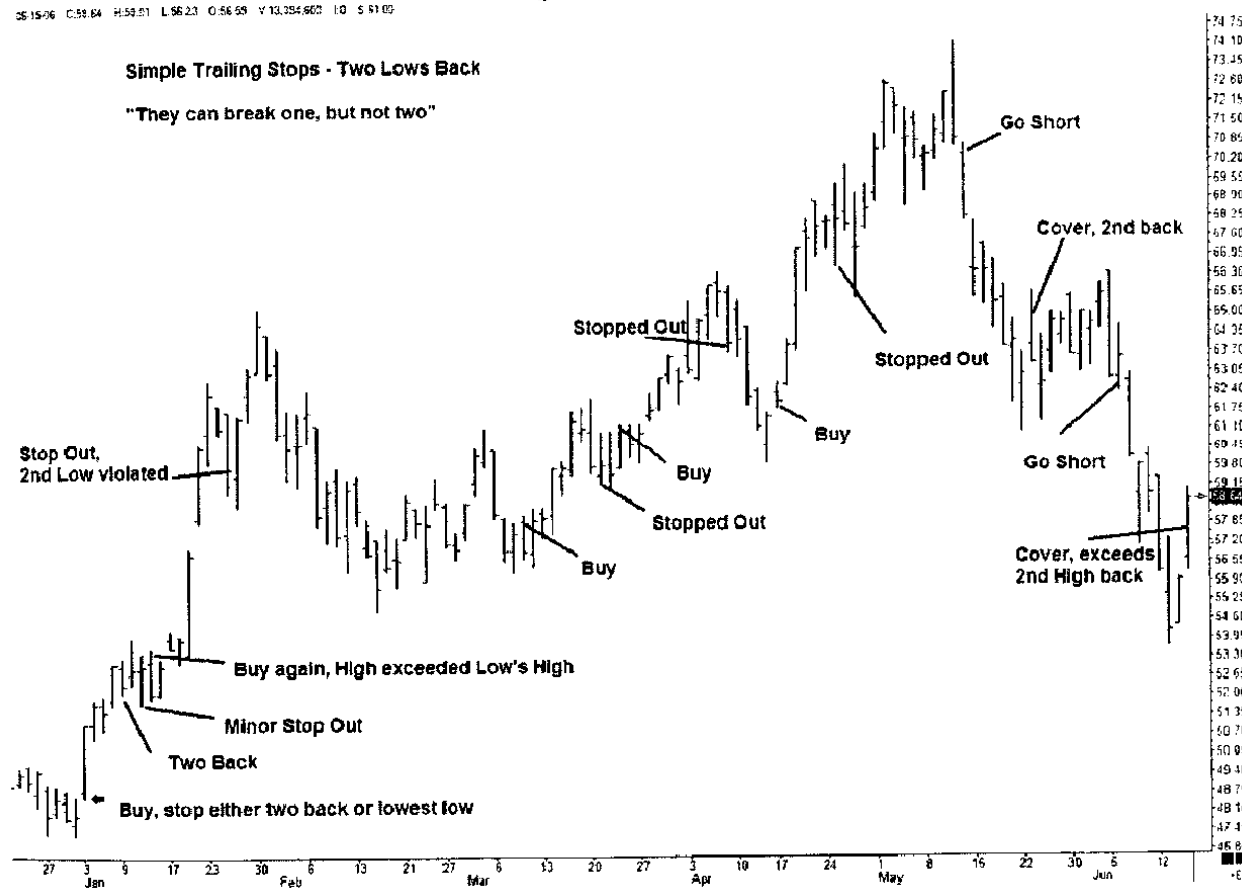
Stops

Stop orders are used to protect us from the unexpected. This could be a news item, terrorist attack, computer failure, or just to protect us from being on the wrong side of the market. Stop orders are *most importantly used* to help us define our *risk*. If we don't want the 50/50 odds of a gambler, then we must decide how much we are willing to risk on any trade. If we are to make a profitable profession out of day trading we must realize that it is only through *hundreds of disciplined, high probability trades*, that we make money over time. Any one trade is not important and if you find you are changing stops all the time because that trade is a 'good one*' and you don't want to get stopped out, then you have a basic problem that will lead to failure. If your stops are logically placed and your analysis well conceived then you have nothing to fear. All traders have bad luck at times or overlook significant factors; so getting stopped out

should never be more than an execution notice and time to re-evaluate the analysis.

The placement of stops is a subject an entire book could be written about. The great W.D. Gann used a simple percentage stop for money management purposes. He said to divide your capital into 10 parts and only invest 1 part on any given trade and use a 10% stop on that. In this way you would only lose 1% of your capital when you got stopped out. You would have to be an awfully bad trader to get wiped out with that advice. Of course those kinds of money management stops are frequently used with highly leveraged commodities that have small margins and are very volatile. On conservative stocks many traders prefer to put 'all their eggs in one basket' and watch the basket very closely with very tight stops. This greatly increases the chances of getting stopped out but allows you to use greater leverage and get huge annual returns. Most day trading firms frequently lend to their traders lines of borrowed money credit of \$1 million or more to be used intra day only and not overnight since the exposure to the market is very small (a few hours at a time at most) and they are scalping 20 cent trades rather than swing trading for several dollars over many days. In these types of environments, stops are often not physically placed on the books but just kept track of mentally, or they are considered 'time' stops where the trader liquidates his position after so many minutes or hours if it is not moving in his favor. The basic stop principle, however, is to place the stop *where a reversal in trend signal would be made* and you would be at that point, trading against the main trend. This would mean that in an up trend making new highs each bar, any violation of the prior bar's low could be such a reversal signal bar. You could use a trailing stop at that prior bar's low, but usually that's much too close because 'slippage' is quite frequent, so I usually recommend placing it at a minimum, the second bar back. I use the phrase 'you can break one but not two' to describe the swing lows hit on normal fluctuations. In other words, you will frequently see a prior bars low be broken but the up trend remains intact and then the up trend resumes, but if two bars back has a low broken its usually a legitimate reversal and your stop should not be lower than that. Now this is just a very simple rule of thumb from historical observations and its still only works about 70% of the time at best so we'll need to examine some more exact methods before we are done with this subject.

When trading as opposed to investing you should not be afraid to be stopped out frequently. Especially in this modern era with extremely low or no commissions. When I grew up, if you traded at Merrill Lynch you had to pay \$1.70 commission on *each share* on each side, which made it impossible to trade, which is what they wanted of course. Later, rates came down to an eighth and then 6 cents and now most firms charge a fixed flat rate of \$5 no matter how many shares you buy. These costs are now negligible so using very close stops and getting in and out is not a significant problem. Day traders live by the axiom 'when in doubt get out*'. Many times if I am using a technique like the breaking of the low of a prior day for a stop I will get right back in if a line chart for that time period doesn't actually break that price on a closing basis. I will also 'reposition' often by getting stopped out at an obvious level but having a slightly lower entry point with a logical stop just below that. You would do that in a situation where a base on a 5 minute chart would break, but just below that might be a major support area on the hourly or daily chart. When trading S&P futures and such, remember our stop is *placed at a small loss level only for the initial entry* since we are usually buying into a decline. Once we are in the trade, however, you should be making money right away if you are right and then you quickly move your stop up to your break even price. If you are in a trade for more than 15 to 20 minutes and it still isn't profitable, it's better to just get out as they rarely work. Good trades work immediately. A commission of \$5 is a 'good' loss on a doubtful trade.



The chart above shows the two bars back simple strategy for stops, all of the buys and sells on the chart are not noted as to not make the chart too confusing but I think you can see that it's a simple but effective method for making money if you know very little about the market. It also *works best in a trending market defined with parallel channel lines*, rather than in a flat sideways market. When looking at the chart just think about the last two bars from the bar you are at. If the current bar is lower than the 2nd one back, you are probably in a downtrend and longs need to be stopped. If the current bar is higher than the two prior bar tops then the trend is probably up and you would cover shorts and go long. Remember this principle works on all time frames because of the persistence of trend principle. It's best to watch the weekly chart first to get the trend, then the daily, and only then the hourly and smaller. Buy and sell signals are similar to those Chinese or Russian nested dolls each smaller than the prior one. When a sell signal on a 15-minute chart occurs it may affect the hourly chart and that may give a sell also, but rarely will it give a daily or weekly sell signal. *There are times, however, that you should be keenly aware of, and these are when the market has had an extended advance and has gone sideways for three to five days at the same level.* At that

point *all charts* will have been in a narrow range and if they turn down all time frames could trigger a sell signal and a huge meltdown occurs. Remember there are all kinds of traders and investors in the market and they trade differing time frames based on their long-term objectives. They will independently buy or sell their particular signal and then the herd effect causes big moves to take place. This is also why big impulse waves start at the birth of bull markets when a strong rally triggers off all these various time frame buy signals. I would also point out that in this modern computer age, there are numerous computer 'black box' systems that trade on autopilot and they will execute in a matter of seconds without any human thought. Don't try and rationalize signals like 'they always come back' or such. You must trade with the trend and at the turns it often doesn't look like anything big is occurring. Especially note that in the prior chart when a stop out was made, I did not double up and go short. This is because the longer term bullish trend on the weekly chart was strong. In these cases *you only want to trade long and when stopped out look to repurchase at a tower price*. We do this because if you examine the chart you will see frequent 'false stop outs' that don't really reverse the trend. The false stops are usually a key to the main trend. If you double up and reverse, these false stops will really compound your losses. This is why we just go with the main trend and when stopped, we repurchase the main trend.

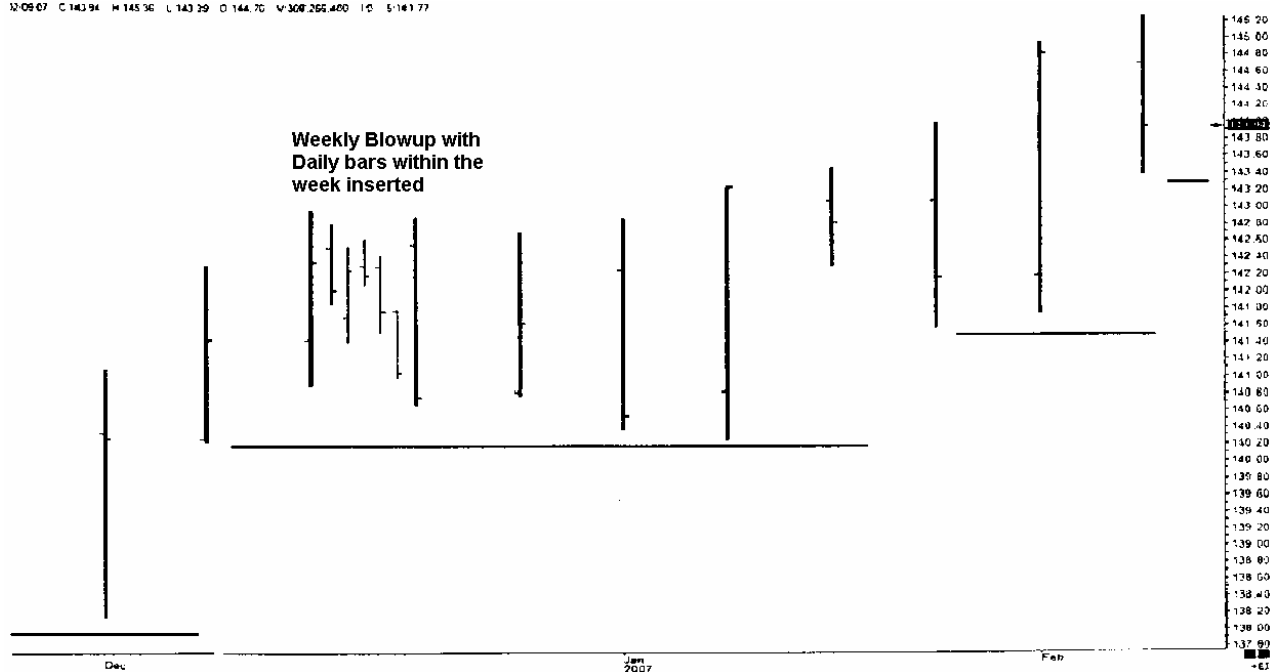
The prior charts showed daily charts and lesser time frames but I've mentioned to always start with the bigger picture and work down. This gives you much better perspective. The next chart is a weekly chart from 2007 and shows weekly bars all about uniform size with hardly any two bars back breakdowns. If you study this chart you will see why the institutions don't sell in such environments simply because a prior weeks low is never broken and certainly a monthly or quarterly chart is never broken. *All the corrections you see on the dailies and hourly are corrections that occur within the range height of these weekly bars*. The one big correction was a *three bar* persistence decline into March and then the main trend resumed. Before you assume that a daily bar break down will amount to a big trade, look to see where that daily bar falls within the prior weeks high and low range. Usually a two or three day correction just pulls back to a weekly or monthly support level and then it reverses and goes right back up.

25-18-07 C 151.22 H 151.96 L 150.19 O 150.70 V 396,125,842 I D S 125.61



The above weekly chart shows the big uptrend but when you look at the daily chart inserted into the same chart (below) you can see how you can get confused with the daily trend going down all week long, but not breaking the prior week's low.

32-09-07 C 143.94 H 145.36 L 143.29 O 144.70 V 308,265,460 I D S 143.77



From the above charts we can see that our trading strategy *must* incorporate a system of keeping track of various volatility ranges. We must decide on our trading objectives and fit our strategies into the most

appropriate trading time frame and associated stop levels. Obviously the 'height' of our bars *is the average volatility*, and the expected gain or loss during that time period. The above weekly chart with the daily bars squeezed in presents the idea that we could draw horizontal lines on our daily charts that show the high and low levels of the prior week, and on the intra day chart we can draw horizontal lines representing the prior days range. Perhaps we can color code our charts with lines for hourly, daily, and weekly range parameters. Most computer drawn charts only scale the current levels with a margin of about 5% at the tops and bottoms of the chart so you would first have to manually scale your chart to encompass the weekly ranges and then you would get a better perspective. If you don't do this there certainly will come a day when your 15-minute chart ventures outside of a daily bar range and the market explodes in your face and you don't know why. When you have the levels in front of you all the time you can see the trades starting to develop as they approach the critical levels.

Many strategies use 45-degree angles since they represent a 'one to one' correspondence of 'over one, up one' in plotting, and therefore divide time and price into equal units. One strategy would be to take your prior weeks range and run a 45-degree angle down from the high to the low. Instead of an absolute angle we would take the range and divide by the 5 daily bars to get a per day drop. We accumulate that per day drop amount as a trendline. For example if the prior weeks range was 1432 to 1404 on the S&P we would divide the range of 28 points by 5 to get 5.6 points per day as our momentum trendline to test the trend. This weekly derived, daily increment will also be a key part of our trading strategy to be explained later as the 'overlap' method. We use the increment, in this example 5.6 S&P points, and create a trendline going up and down from the top and bottom of our daily bars to see the maximum amount on average that one day should advance or decline from the prior day. We sell short the advance overlap, and buy into the overlap decline with stops below or above our maximum expected overlap for a normal market.

Measured Moves

When we see a reversal and we trade in the new direction, we want to know how far that trend will carry and what our price targets should be. All stocks have a unique distance they usually travel between corrections and a visual inspection of the chart on various time frames will point these out. Usually these distances will remain about the same dollar amount and percent but you must keep in mind the different time frame moves. A normal counter trend move on a 15-minute chart will be much smaller than the normal counter trend move on a daily or weekly chart. *You must make a habit of recording the typical measured moves for each timeframe.* Sometimes an envelope percent or a moving average of different lengths can keep track of these on the different time frames. You can also use the method from the paragraphs just prior, to measure the height of the weekly and monthly bars to look for normal extremes.

If you take the time to look at each and every bar of a chart you will see all kinds of things. You want to observe what the average daily range from high to low is, as well as the extreme 'elongated' bars that come a couple or three times a month. Most of these ranges are considered to be 'measured moves' or constant range fluctuations that consistently appear over long periods of time. In initially looking at a chart I always go back for at least a year or more and sometimes 10 years to find these extreme conditions. While I rarely use moving averages, one practical use of them is to examine the extreme deviation above or below a given moving average such as a 50-day moving average. This way we can find extreme moves very quickly with a computer and since cycles are additive and 'bunch up' these extremes above or below the moving average is often such a point in time where the cycles all sum up. This is always a good place to start cycle counts from. Note that the distances above or below a moving average are valid perhaps 70% of the time but at big reversal points when the market goes from below a moving average to above the moving average the measured moves are often twice or two and a half times the single side moving average distance. Usually a notebook listing of the price extreme ranges during a month is a minimum requirement. Most computers allow you to see a data sheet of the high, low, close, net change etc. I would scan a month of data and look at the net change to see the largest range but know that the high to low range might be at least

twice the 'net', so if you can 'dump' the data into Excel or some spreadsheet and subtract the net ranges you will have some good data to work with when you are thinking about shorting a high overlap bar or buying into a dip. This of course will be single day extremes but you will also want to consider swing trade ranges. These can be approximated with monthly bar data.



On this chart we see the deviations above the moving average and also the absolute price range between a high and a low. We should note the different price ranges and use them as a guide in the future when the market seems to be at an extreme. We use these measured moves in a couple of ways. First we can use them for potential stop out levels, but there is a more important use. The basic theory of trend encompasses the idea that the main trend will show several waves of about the same magnitude. The counter trend moves will also run about their same size. As the trend starts to change we will see an 'overbalancing' of time or price or both, that deviates from the normal experiences. The first time we see a correction in a bull trend that is bigger than the last one, we note that price may be overbalancing and the trend could be changing. In a

decline the first time a rally is greater in price than the last, the downtrend could be in the process of reversing. This is why we want to keep a table of absolute advance and decline statistics showing both the points gained or lost and the time duration. When it takes a longer or shorter time to do something then that too is an overbalancing sign and a key to a coming trend reversal. At the final highs and lows, traders get complacent and often don't realize that the market is drifting in a new direction for a good three or four days.



You should make it a habit of recording each swing run up or down by the number of points or dollars, and the time in hours or days the run lasted. Only in this way can you make a reasonable guesstimate of what future swings will look like, as well as know when something very strange is happening.

The idea of a 'measured move' also relates to the wave theory of markets in that primary trends usually consist of 5 waves- three in the primary trend, and two small counter trends. Sometimes you get 7, or 9 waves but 70% of the time you only get five and that's important to note since if the waves are obvious to count the correction always comes after the fifth and final wave. If the longer term direction is to continue we only

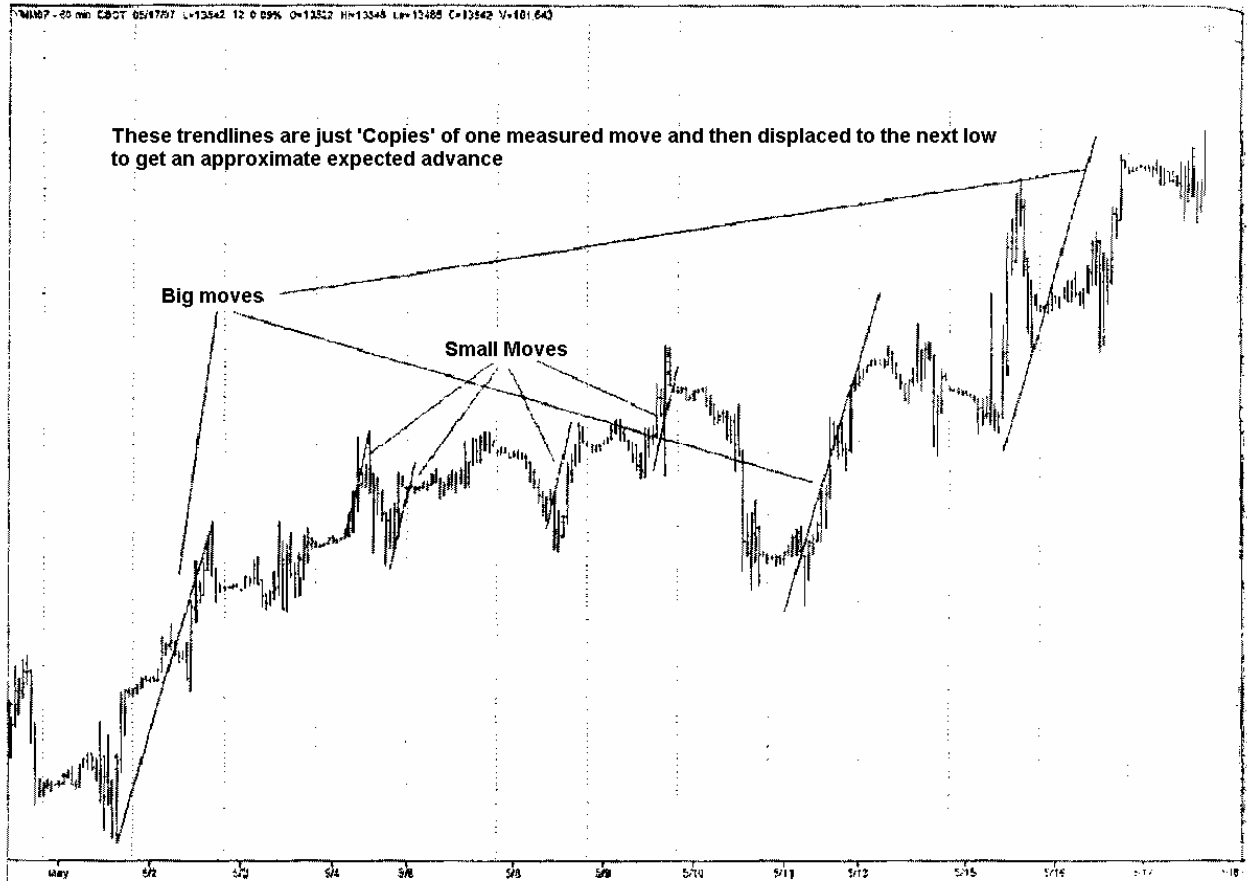
see an 'A' 'B' 'C' correction after the fifth wave and then we get five more major waves in the original direction. If a new trend, such as a new bear market is starting after a five wave bull is finished, then the correction turns out to be a primary direction and the new trend will take the form of five waves and that will confirm the long term nature of this new trend. The A, B, C legs are simple down, up, down moves following an advance or usually two measured moves with the small 'B' counter move in between.

This wave idea is often seen in parallel channels and in an uptrend the end of waves 1,3, and 5 will touch the top channel line and corrective waves 2, and 4 will touch the bottom channel in a perfect example, which rarely occurs. You can often make a good guess about how far into a move you are by watching the touches on the trendlines and using a measured move to see if it's complete. If not, the touch is only a wave 2, or 4 (in an uptrend touching the support trendline) and you can now estimate how far in time and price the next wave will take the market. My point in all this is that the observed measured moves must be fit into a wave scheme. The bigger measured moves will be the big waves 1, 3, and 5 or the total movement of the A, B, C correction.

For example if the S&P is climbing and every few days to weeks we get an 8-10 point drop, those would be minor dips within the bigger wave picture and the A, B, C corrections might be -10, +4, -10 to total 16 points instead of the normal 8-10 points. After the A, B, C, corrective drops, another 5 wave advance could take place so in an over all bull market major move, a total of 5 big waves of 5 waves could be seen. The bear trend is the exact opposite.

Most software packages allow you to draw trendlines and to create parallel lines or copy those trendlines. This is the easy way to keep track of these measured moves. Most of the charts above used this technique of drawing a trendline from the high to low and then *copying* that trendline and moving it over to the next high or low to keep us ever conscious of the *approximate* move distance without having to measure these all the time. The next chart shows these mechanical copied trendlines. From a trading perspective you would buy and try and stay in the trade until the market neared those expected moves but once the market started to go sideways and make a potential top at % the expected distance or better, you would use a very tight stop at that point looking for the end of the move. Keep ever in mind that using these 'copied' measured moves is just an approximation to make things easy for us. We want to use them only to

think about a market reversal as it approaches their limits but then we must look to the individual bars of the chart to get validation. This validation would be a signal reversal bar like the break of a low of the high bar or getting above the high of the low bar. *Only then do we consider the approximate measured move over and we commit to the new trend.*



Remember to keep track of the 'big' measured moves for wave counting purposes. If you see three big ones, they could be waves 1, 3, and 5, and a bigger correction than the smaller bars would possibly be indicated.

Once we have done a cursory examination of potential measured moves we need to now find the exact target prices the stock or commodity is headed for since **99% of all mistakes are made by buying or selling at the wrong price level.** Successful traders learn to wait and **ONLY** trade at their price levels and not the markets. If you are a professional you know that a new bus comes every few minutes and it's not necessary to jump on the bus pulling out of the station on the opening bar each day. You must sit and wait to set the trading odds in your favor at your price, and not take the odds the gambling casinos (big Wall Street firms) set for you on the opening or close each day. Support and resistance is the key.

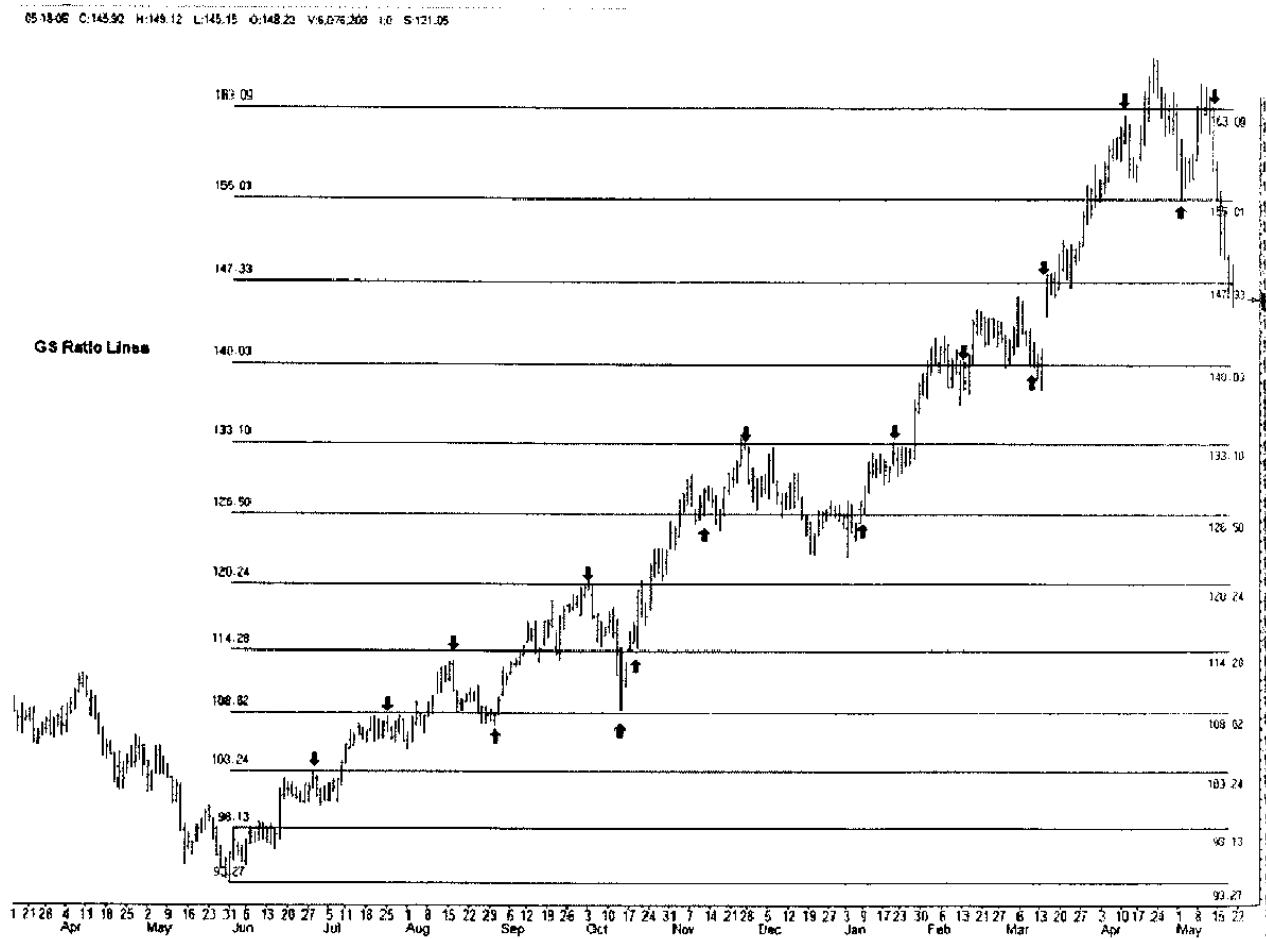
Support & Resistance

The price of stocks and commodities always demonstrate relationships to past highs and lows. These are always proportions and ratios. Simple proportions like $1/8^{\text{th}}$ or $1/3^{\text{rd}}$ work but there is a strong correlation between square roots of numbers and the highs and lows in the market. The basic fact is that from a low or a high you can take the square root of that number and increment or decrement it by a .25 and then re-square it and you will find support and resistance. The Gann Square of Nine is a well known number matrix and consists of a spiral arrangement of numbers in a circle that approximates the relationship of the full cycle being the square root incremented by two. In other words a price of 61 if taken the square root (7.81), and incremented by 2 and re-squared $(7.81 + 2)^2$ equals 96.25, the next number cycle up from that first level. Strong resistance is usually found at the square roots $+.75$, $+1$ and $+2$ or you can use Fibonacci ratios like $+.382$, or $+.618$ as increments. My other books have covered this in detail so I won't go into it too much here and there are dozens of books around on the subject. In any event look to find support and resistance at these root numbers plus or minus increments. My website also has a great square root calculator for all these numbers. Besides the square root increment method, stocks and markets work very well with full square root increments, or in minor corrections, the square root of a square root. For instance if the S&P is trading near 1521 (39×39), a 'big' decline would be $1521 - 39 = 1482$ (full square root), while a minor one would be $1521 - 6.25$ (square root of square root) = 1514.75.

One of the most revolutionary breakthroughs in technical analysis that I revealed in my 'Secret Science' book was that of using natural ratios to determine precise support and resistance numbers for each stock or commodity. The Market Analyst Software people called this the *Jenkins Natural Ratio* and incorporated it into their software along with the *Jenkins True Trend Lines* and a number of other tools I have discovered. In that book I compared this idea to music theory where our musical scale is based on a fixed ratio of 1.0595 (twelfth root of two) times each note to give the next note in the scale. This way a fixed ratio creates higher and higher expanding frequencies as it grows. Stocks do the exact same thing

only they *each have specific notes* they respond to. If you start with a major low and use the first small impulse wave high, the ratio of that high to low gives the *specific frequency* that stock or market will respond to. This relationship can extend for years so a stock selling for \$5 ten years ago may now be selling for over \$100 and yet the fixed ratios from the origin still work within a few cents accuracy. This next chart of Goldman Sachs shows these Jenkins Ratio Lines from the major low.

Note how they precisely provide support and resistance for months into the future and a near doubling in price. Also note this 'frequency pitch' was made from just two days that began the initial impulse wave to the new leg up. If you consider these ratios as notes in a musical scale, look on the GS chart at the 8th (Octave) line. That's the price of \$133.10 and a major correction (5 waves down) took place at that point.



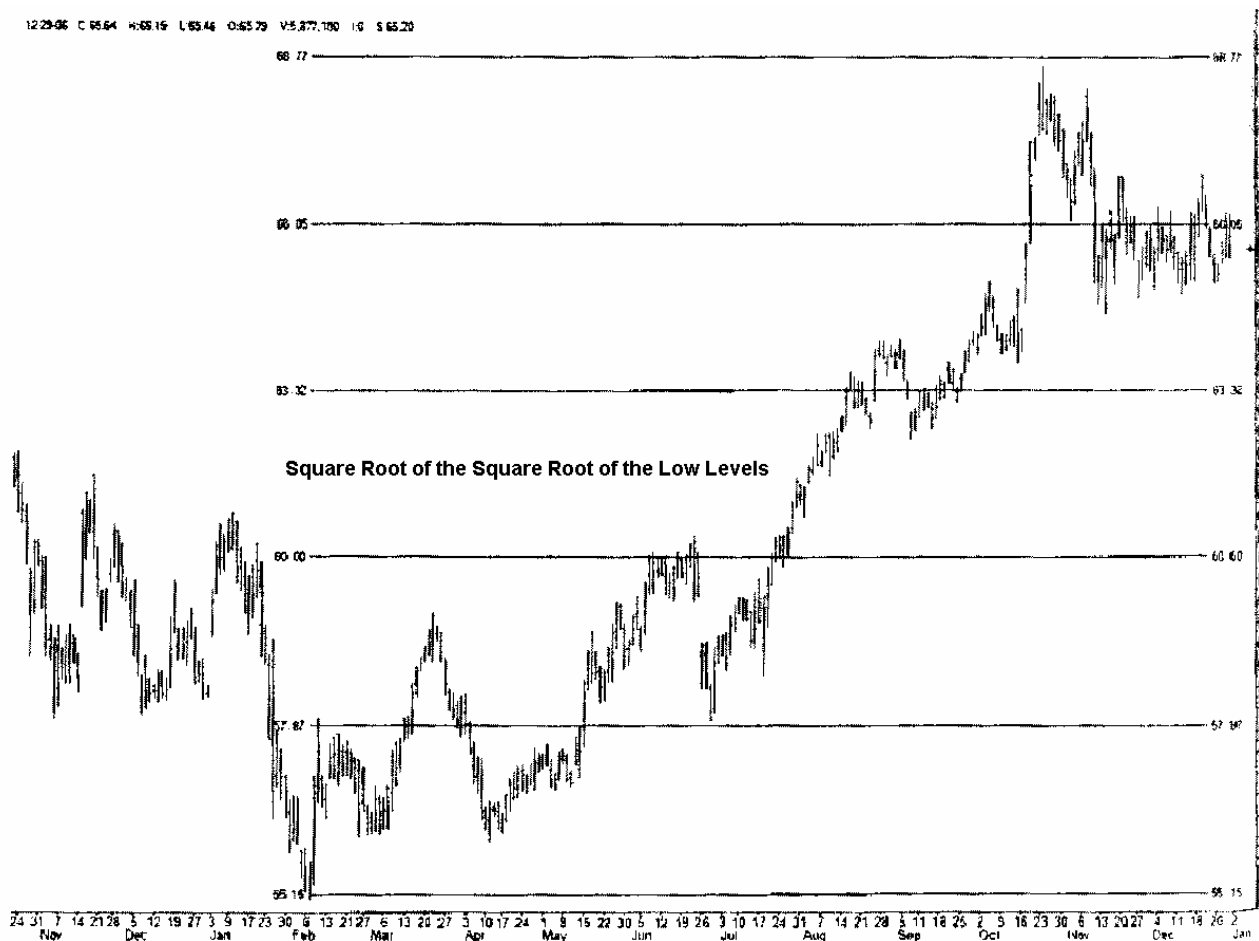
These levels can be used for price targets as well as stop out levels, but most times we also want to know how long the trend will last or when a counter trend will develop. We can use this same ratio idea in terms of time by just turning these grids vertically instead of horizontally. Many have been confused as to how to fix a perfect time and price unit such as

T 05:10:05 C:145.52 H:145.12 L:145.15 O:148.23 V:6.076,209 I:0 S:161.22



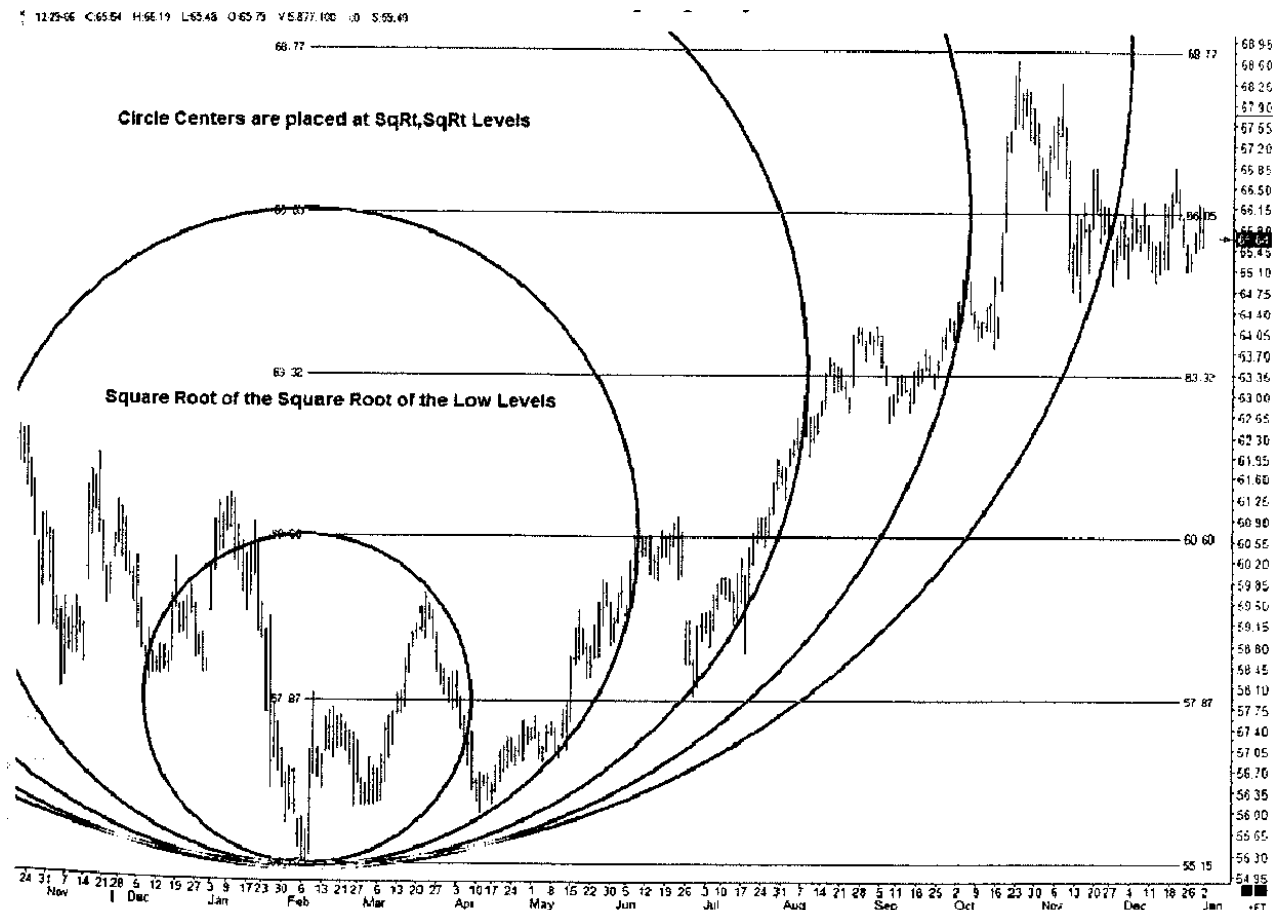
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targets, and combining that with a time cycle based on square roots, we can come up with a trading strategy that can define our risk and reward probabilities quite well. In trading stocks, a stock at \$49 will rarely drop its full square root (\$7) except perhaps once or twice a year, but the square root of the square root (\$2.65), it could do every week. This next chart shows the low incremented by multiples of the square root of the square root of the low.



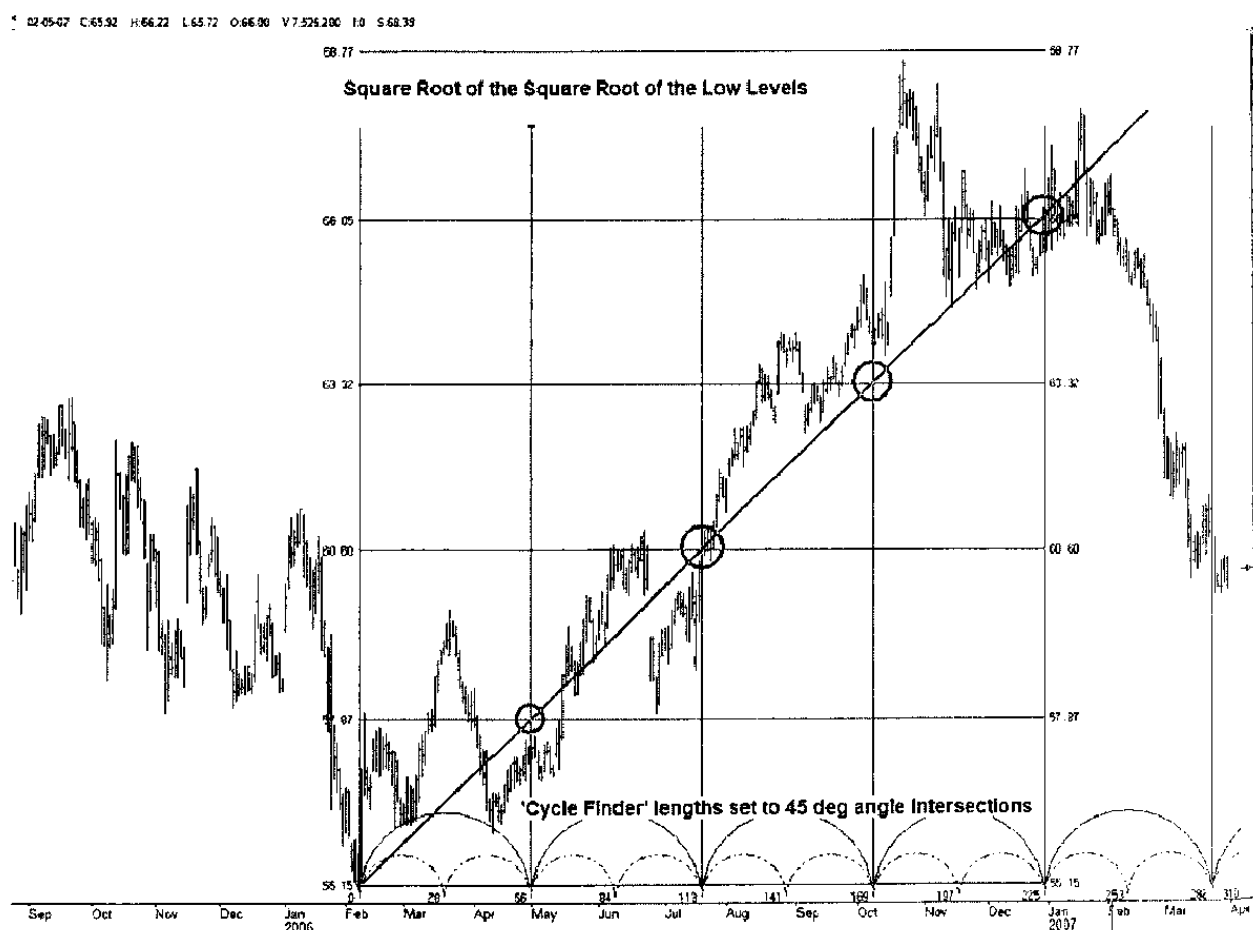
You can clearly see on this chart the strong support and resistance levels the square root, square root, levels provide. To get the time cycles we would normally draw a 45 degree timing angle up from the low, and where that angle intersected these horizontal lines you would put a vertical line representing the time cycle distance. This is easily done and will be shown in subsequent exhibits since it's a standard technique we will use all the time. This next chart, however, is more elaborate but shows the interconnectedness of the charts pattern and the square root, square root harmonics manifesting in all directions represented by the various circles centered on each of the target levels. We can now see how all markets lose momentum and drop to a lesser arc and then go up again

until the move is finally exhausted. Note that this picture is for illustration purposes and is somewhat *compressed* to show most of the circles on one graphic. The fact that the circular arcs to the right are missing the highs IS ONLY DUE TO THE SCALING FACTOR and if one were to perfectly scale this chart, these circles would fit exactly. The price axis works as support and resistance perfectly since it does not need a time component, but the calendar days scale on the chart should be adjusted to make it fit the circles to square your chart properly.



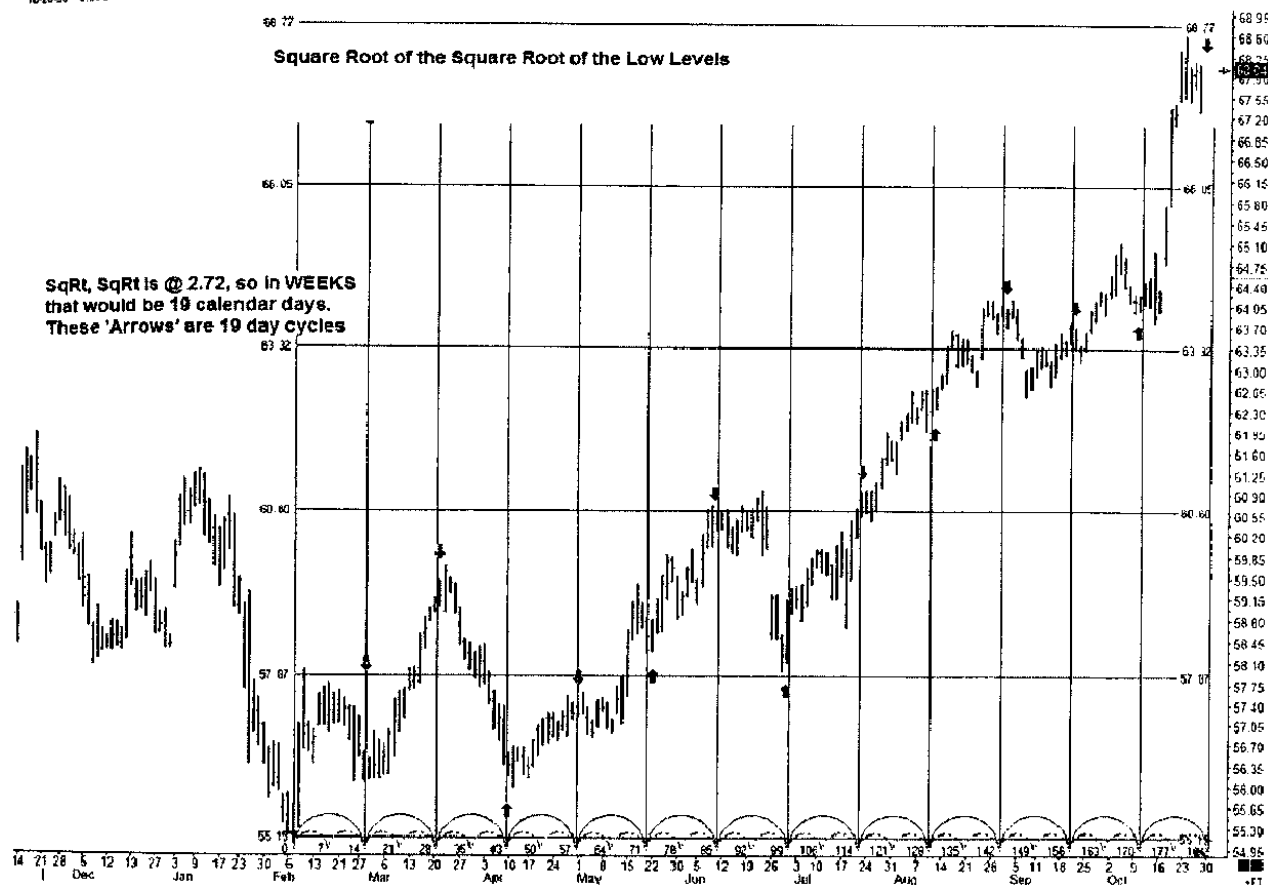
The next chart below is a first attempt to set that time correspondence by using a typical 45 degree angle and as it goes up and intersects the various target levels, it forms a box with that segment of the 45 degree angle as its hypotenuse. The small circles show those intersecting points and the important lesson is as we approach the end of these time cycle boxes which are square root, square root, equivalents, the *stocks breaks out for another leg up* or at the top, a leg down. The time correspondence is not perfect since there is still a scaling factor to make a 'true' 45 angle, but its close enough to give us a 'heads up' call.

The chart following is a calendar day approach equating the square root, square root, which is approximately 2.72 equal to 2.72 weeks or about 19 calendar days. You can clearly see that the 'hits' are much more accurate and if I were to follow up on this and show you the hourly square roots you would see them too. By the way, the S&P works very well indeed with hourly cycles of a full square root and also one half of the full square root.



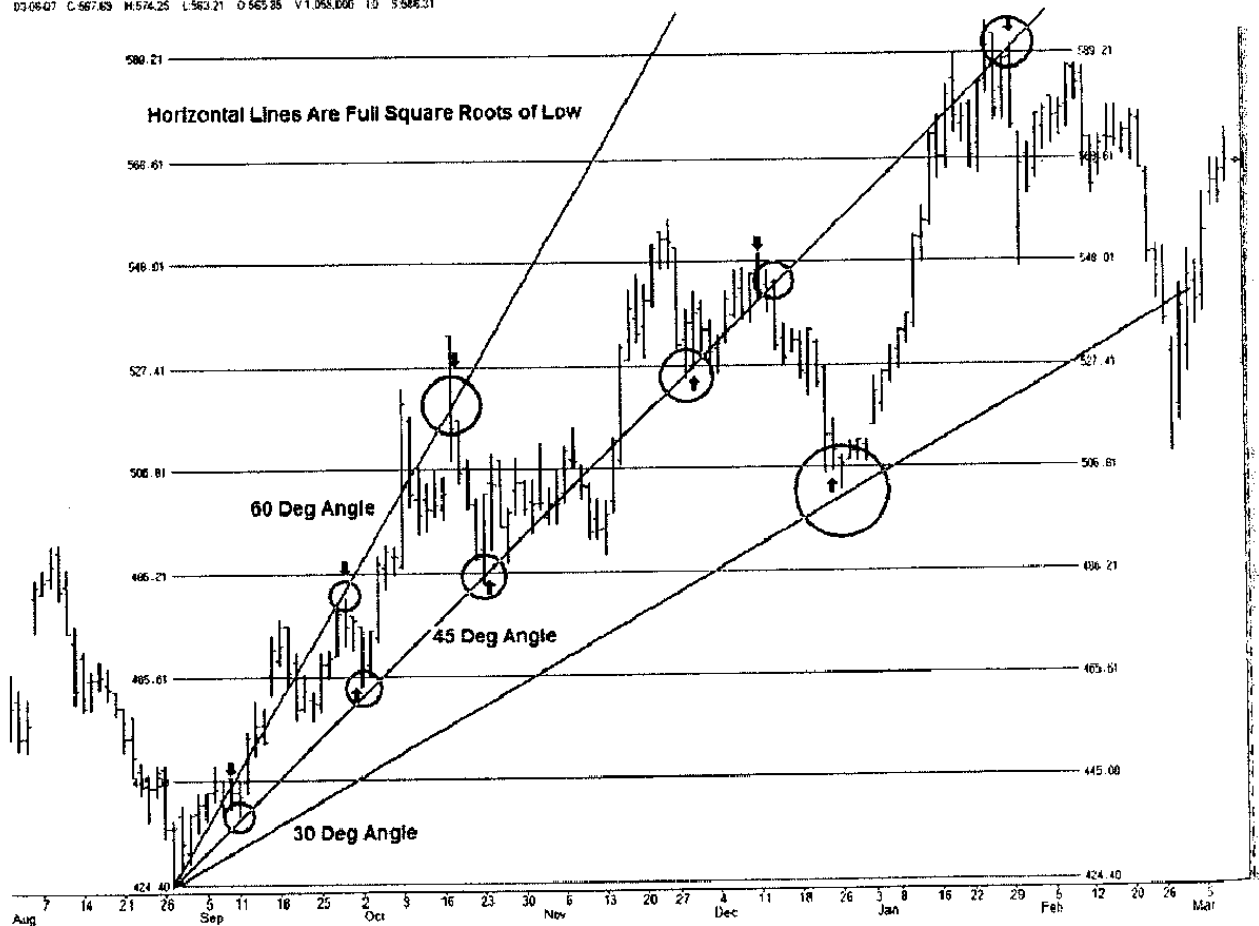
Here's the square root, square root treated in terms of weeks converted to calendar days and we can see the daily harmonics in time generated from a given price. Once again this points up the fact that numbers do relate to time and vice versa.

O.K. we've covered most of the basics but before we start with our trading methods and strategies we need to cover one more very important topic which is angles and how to draw them properly and use them for trading.

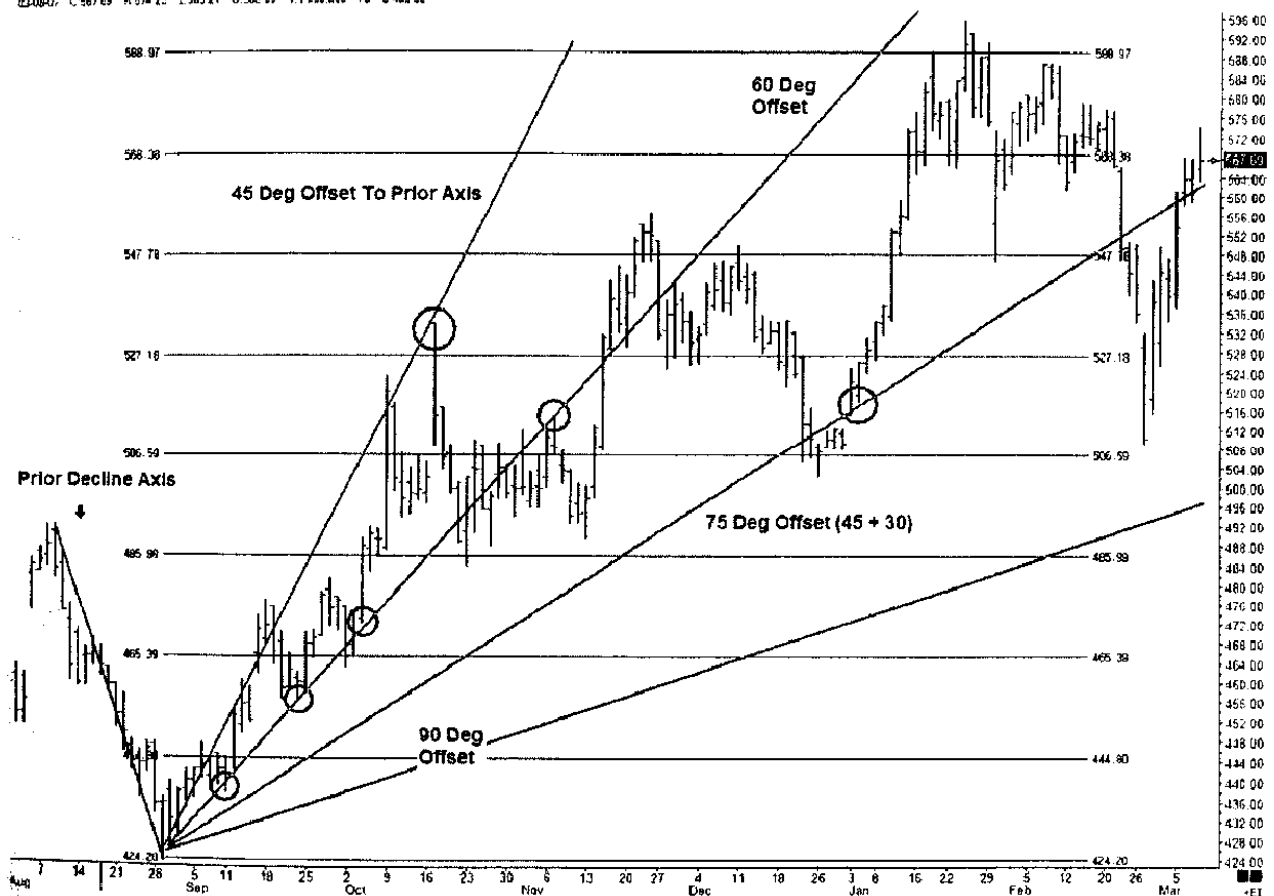


Angles

Earlier I mentioned that trend was defined by a pattern of higher bottoms and higher tops for an up trend, and a pattern of lower lows, and lower highs for the downtrend. This is true even on the most minute tape reading scale since horizontal support and resistance levels tells us where the buyers and sellers are. Angles are a form of straight line moving averages which estimate momentum and normally an angle suggests where buyers or sellers *should be*, based on a charts price movement momentum. Note, however, that angles per se do not show actual support and resistance like the patterns on a bar chart, and therefore must be used *only as an estimate to be verified with trading bars occurring at the same level*.



The above chart of CME shows traditional angles of 30, 45, and 60 degrees. Also shown are horizontal lines that are full square root increments up from the low. The 'circled' areas are where the projected resistance or support based on angle momentum *should* be found and it does work. Note especially, however, the small 'arrows' on the chart which point to the square root levels that are *most near* the expected angle targets. Since the angles are approximate targets we must look to find some kind of real support or resistance to sell against or buy on. *When the calculated targets combine with the projected angles targets, you will get a reversal.* Keep in mind two things. The first is that you need a reversal signal bar to know the trend has changed, so you just don't buy or sell on the angle per se, but you could use a very tight stop at that point. The second observation is that as a professional trader *you must buy or sell at precise targets* and not just any haphazard target that pops up. If you have an angle nearby, you should sell at the calculated target (those arrows above) or wait for your tight stop to be hit. Also note the principle that when one angle breaks the price must go to the next angle down.

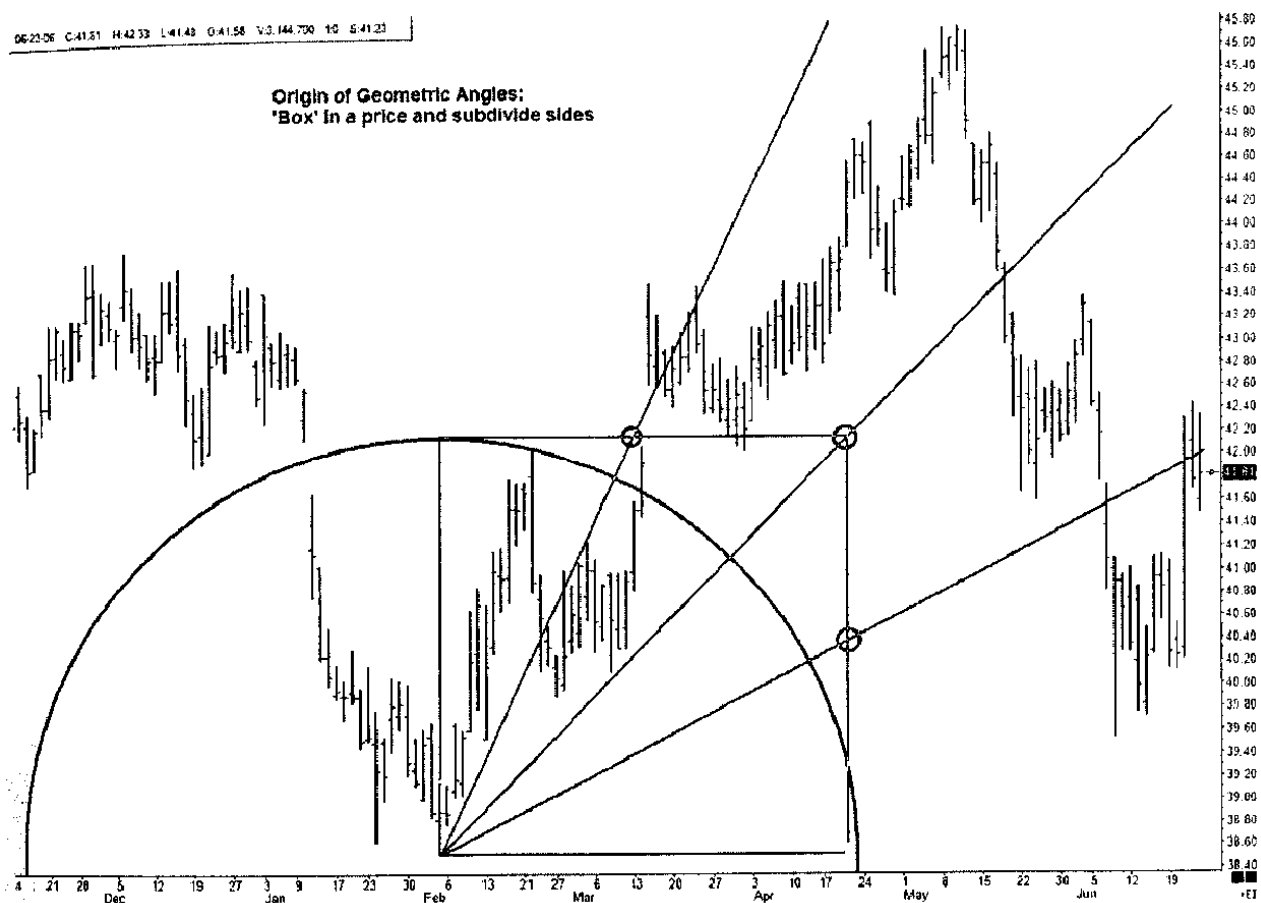


This chart shows my 'offset' method made popular in my earlier books and *often gives much better trendline fits if you are trading off the angle itself* as a target. The angles are 'offset' from the prior movements axis to incorporate the totality of the overall pattern. The longer and more powerful the prior advance or decline from which the angles are offset, the better they work. In this method it is to be noted that the long term trend is almost always broken when the powerful 90 degree offset angle is broken. The price almost always bounces off the 90 degree angle the first time it is hit, for another major leg. These are best used on longer term charts to see the swings but I use them every day on time frames as small as one minute.

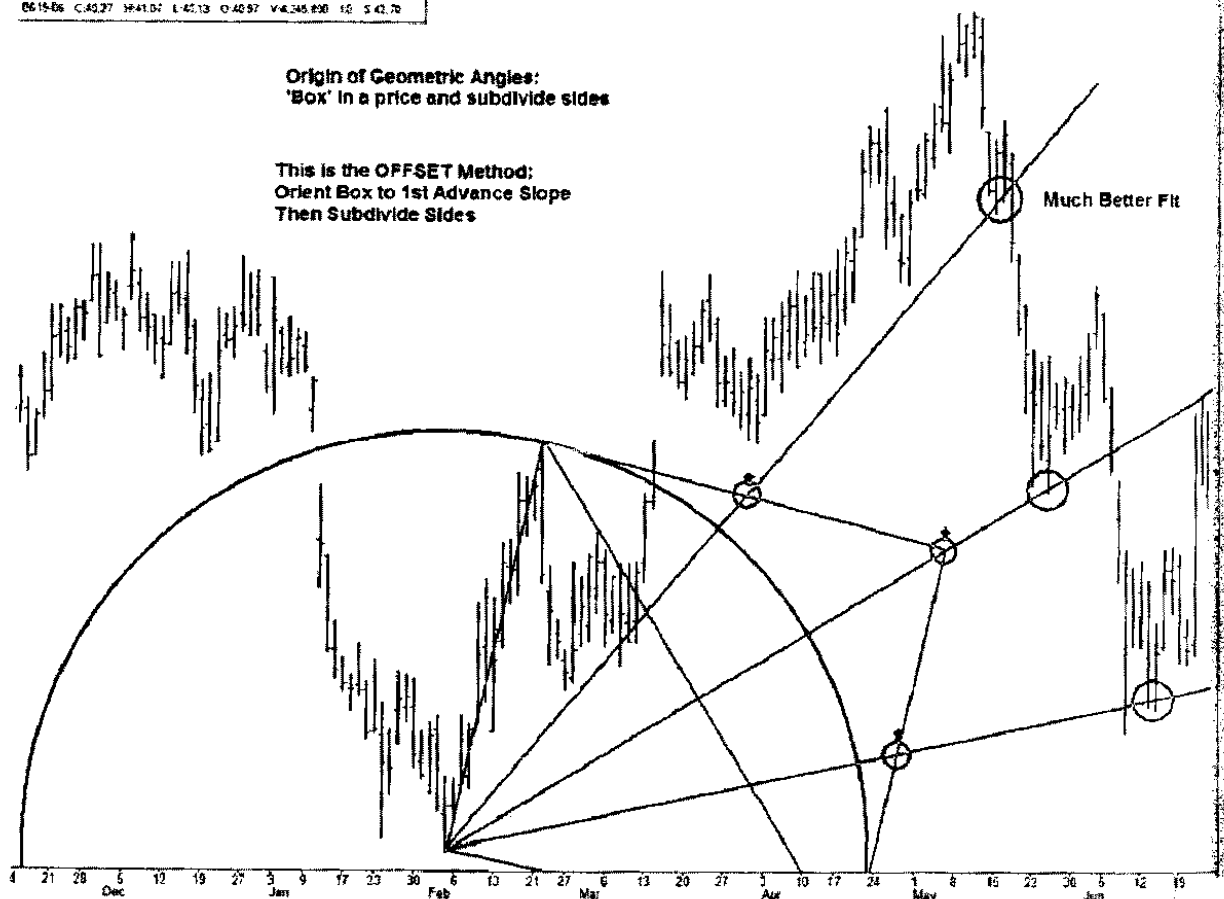


Here's a longer term chart of 3M Company showing how every major swing was a near perfect offset angle to the next leg. These types of angles can serve as projection forecasts because the price pattern often terminates on the angle at a major support or resistance target.

The above charts use traditional angles of 30, 45, 60, and 90 degrees as opposed to the very popular 'Gann' angles or 'geometric' angles. These angles also work but I prefer the traditional. The geometric angles come from dividing time and price 'boxes' into proportionate parts. The next chart shows the method. The 'key' is to get the correct size of the 'box'. I do that by drawing a circle around the 1st low to high and in this way I get a radius vector in any direction, which is superior to a straight up and down measurement of the low to high advance. After the circle is drawn I box it in and then subdivide the box sides.

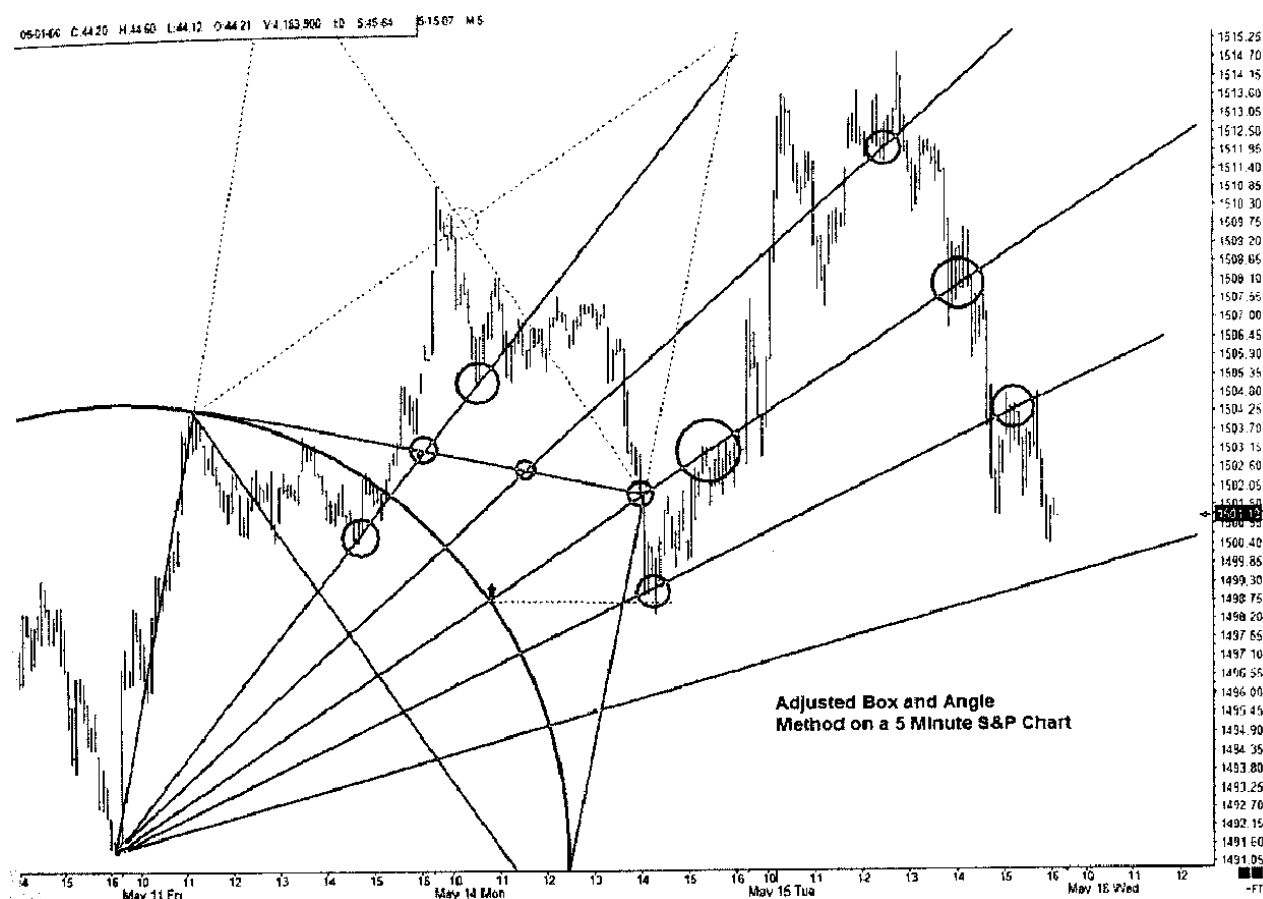


These angles are labeled 2x1, 1x1, 1x2, and in some cases you can use 1x4 and 1x8 subdivisions. The '2x1' tag is just your plotting coordinates of 'over 2, up 1', or 'over 1, up 2'. In this chart we see a rough correlation with price support and resistance but nothing great to trade off of. Unfortunately most software packages just draw these angles in a straight up and down axis, so you may have to make your own as I usually do. The following chart shows the vastly superior results when you orientate the axis of the 'box' to the price impulse axis of the chart. *Then* the angles can be used for trading purposes. Also note that the intersection of the angles within the box, and to the circle, create both horizontal support and resistance levels, and vertically, time cycle turns. If your software package allows you to move your 'Speed Resistance Lines' or 'Gann Fan', or 'Gann Square', then you should always line them up to the proper axis of the Charts direction and not straight up as they default to.



On this chart above also note the small 'arrows' at the intersection points. Straight up above arc the market turns.

The chart on the following page is that of a 5-minute S&P chart showing how the method works on any intra-day time frame and also advancing the concept to include the idea of 'stacked' boxes and more subdivisions of the box sides. If you took this to an extreme you would see just about all of the fluctuations on this chart accounted for with the various angles and intersecting time and price points.



One note in particular is of interest above. The 2x1 angle that subdivides the $\frac{1}{2}$ point of the top of the box continues up to the top of a second 'dotted' box placed on top of the first. Note that the end point of this trendline is at the same price level as the final high for the S&P. Since this angle is the hypotenuse of two stacked boxes, its length is the square root of 5 ($A^2+B^2=C^2$). See how if you use that length as the radius of a circle and swung it down it would describe the subsequent down leg perfectly and time the bottom as it reached horizontal.

As a side note, I might add that I usually don't have the time to program all kinds of angles and circles on my charts and I simply rely on inexpensive plastic triangles I buy at any office supply store. These are 30, 60, 90 triangles, and 45, 45, 90 triangles. I simply hold them over my charts and draw the lines with my trendline tool on the software. It really only takes 15 seconds or so once you get the hang of it. Most of the exhibits in this book, especially the 'offset' angles are constructed that way.

This pretty much concludes our basic review of the tools we will need to trade with and now in Part II we'll start to develop trading strategies, stop placements, and execution considerations.

Part II - Developing Trading Strategies

Business Plan

Before we start trading we must have a business plan if we are to make this our occupation. We must ask ourselves several important questions like 1) How much capital do I need? 2) What will be my annual rate of return? 3) How much can I afford to lose? 4) What will be my biggest draw down in capital and my average expected draw down? Many other questions like costs of execution, computer and hardware down time and malfunctions and others are important and should be considered but you must have a very thorough business plan or the first little 'bump in the road' will throw you off and get you to abandon your trading plan and trade erratically.

Most people dream big and always think they will make a lot of money but never do the simple 'back of the napkin' calculations to see if their goals fit their budget and skills. The following calculations are merely very simple estimates to get you to think about the subject and won't be reliable for a million different reasons, but at least it's a place to start.

If you are going to trade full time you obviously should make enough money to forego a regular occupation. For many that is a salary of \$100,000 a year. For others they want \$250,000 or more. Good hedge funds make 20-25% a year but exceptional ones make 40-80% a year for 5 or more years under the right circumstances. The market will determine its own volatility and you can only trade that, but I think it's fair to expect that you should be making 25% a year no matter what, to do it as a living. Investing is something completely different. There you can buy and hold and get huge returns on some 'go go' internet stock but the returns are certainly not week to week, month to month. Professional trading requires strategies that make money almost every day, and three of the four weeks in a month. This kind of reliability of returns necessitates a different trading style than that used by long term investors who blindly look the other way and take losses for a few weeks at a time assuming it will all work out okay in the long run. When you have to pay your bills every

month with capital gains, believe me, the long run is about 10 days maximum. Professional trading also uses leverage and borrowed money for capital. In my 36 years of professional investing and trading, perhaps the last 20 years have been with various Specialist firms that lend capital with a 50/50 split of income and a draw down of 10% as the immediate firing point which if exceeded on any one day, you just don't come back to work anymore. Payouts are monthly so every month you start over and must crank out another paycheck ever mindful of a terrorist attack or some accident that will cost you 10% and your job. This results in a great deal of mental anguish and like the quick draw target shooter who thinks he's the fastest gun in the west, when you are on the battle line in a life or death situation, the psychological pressures are a whole lot different than what is read about in a textbook. The trading strategies used must be so reliable and trustworthy that your subconscious mind won't panic and misdirect you at critical times. In any event borrowed money is one such fear. When I first started with a Specialist firm the thought that I was borrowing \$1,000,000 to trade with was scary since I had to pay it back every month or not survive. Small quick trades with little exposure to the market was at first the calming medicine. As I got more experience I knew that the statistics of winning more than losing and *not losing big on any one trade* would always allow me to survive and prosper. My first, day trading employer, told me he could take any two traders he had and have one short a stock and one go long the exact same stock, and at the end of the day both would be profitable, since the good traders always quickly stopped themselves out for small losses and then traded in the other direction which was the primary trend. You can only survive in this business if you follow the trend.

I studied for many years the 'batting averages' of traders thinking that a trader who was right 80% of the time would make a lot of money. This was true indeed, but what shocked me was when I found out that the most profitable trader in the firm by far, was only right 42% of the time and wrong 58% of the time! The difference was that he always took a quick and small loss and he let his profits run. With that kind of strategy you could do a coin toss with 50/50 odds and make money day trading if you stopped out at a 50-cent loss but took a \$1 gain. Why are there not more successful day traders then? The simple truth is that many people can't take a loss. They have all kinds of psychological excuses as to why they are trading against the trend and they are usually ashamed of taking a loss because

it's an admission of failure. The reality is that you must know that you will be making hundreds of trades every single month (perhaps thousands) and they'll be plenty of losses to take. The important ones are the quick and small ones, so you can regroup and get on with making money. The old saying 'when in doubt get out' is appropriate to day trading.

Now back to the math. If you make 25% on your money and you need \$100,000 as an annual income then you will need \$400,000 in capital or \$100,000 with four to one margin as with the current rules for day traders at all public firms. If we are trading stocks we want to be *diversified enough to avoid huge drawdowns* on any one position so you often go for 20-cent to 80-cent scalps on 2,000 shares. If the average listed stock that you trade is priced at about \$40 then your \$400,000 in capital can support 5 positions of 2,000 shares or 10 positions of 1,000 shares ($1,000 \times \$40 \times 10 = \$400,000$), open at the same time. Lets assume you will be better than the rest and will bat 60% right. We now have to factor in our gains and losses on the volatility of the stocks we select. Traders need stocks that move and have great volatility so you would try and trade stocks near \$40 that have a daily range of \$1.50 or more between their high and low for the day. If you are a true May trader' and don't carry positions overnight or you just can't afford the risk of that since you are using a lot of borrowed money, then you must know that the opening 'gaps' in your stocks cost you a lot. If you liquidate at night, the next morning may see your stock open up 40 cents and you have to pay up or miss it. Furthermore if you sell going into the close each night you might get clipped 20 cents as the stocks drifts down but you are forced to sell by the close. Because of all these factors you will only be able to take 50% at best of that \$1.50 daily range out of the stock each day even if you trade it perfectly. That would mean you make 75 cents on five positions of 2000 shares or a gross of \$7,500 per day. That would be $255 \text{ (trading days)} \times \$7,500 = \$1,912,500$ a year! What's wrong here? What's wrong, is all those losses we're not counting. This should point out to you again that it is the *losses that make the big difference*, not the gains. We said you would be right only 60% of the time. The 50% of the range you make is not due to trading but gap openings and lost opportunity. The days you lose, you will lose that 75 cents on each position of 2,000 shares. So now we lose \$7,500 per day times 40% of the trading days of 255 or $\$7,500 \times .40 \times 255 = \$765,000$, still leaving \$1,147,500 for the year or 287% on borrowed capital or 1148% on your own capital. Is this possible? No, but I have seen it for a year or two

with certain individuals. Obviously our assumptions about our batting average are too optimistic and perhaps our gain of $\frac{1}{2}$ the daily fluctuations. If we lower our batting average to 50/50 then our total is still a quite respectable \$956,250 on our \$400,000 but few can do this either although I have known quite a few traders who can do it. The simple truth is that trading looks easy and everybody thinks they can do it but the statistics tell another story. *Most traders could bat 50/50, but each day half their positions go down and half go up and they break even.* They also only capture about $\frac{1}{3}$ rd of the days fluctuations on the stocks they trade. What usually happens is that of the 5 days in a week, you win on three, lose on one and breakeven on one, which is a net two day win for the week, but good traders will also have two losing months a year where they lose as much as they make, and one breakeven month. That's gives us:

Winning day= 2000 shares x \$.50 gain x 5 positions = \$5000 on winning days.

Winning week = 2 net daily gains = \$10,000 Winning month = \$40,000

9 Winning Months: \$360,000

less 2 losing months: \$80,000

Total for year \$280,000 on \$400,000 capital.

This is much more in tune with reality and I know many world class traders who can do this every year. Traders just starting out, or run of the mill portfolio manager types make $\frac{1}{4}$ th of this and that's where the 20%-25% annual returns that the hedge funds and mutual funds make comes from. They're not bad traders but can't trade as often or as quick as in house proprietary traders who are the 'cream of the crop'. Remember an in house 'prop' trader who gets a 50% cut has no need to trade at a hedge fund for 20% unless they need a 'huge' paycheck from running a billion dollar portfolio. Most hedge funds are too big to strictly day trade and are subject to down opening gaps on their entire portfolios on many days of the year. They also swing trade for weeks at a time and that can easily cost them 10% a year on bad swings. Day trading is different. It is a grinding out of money each and every day through gimmicks, hard work, and lots of technical study. Day trading is the hardest type of trading you can do. A better bet would be a 1-3 day swing method encompassing buying weak closes on support and selling the gap up openings that the pure 'day' traders are shut out of, or letting profits run a full three days

with a stop. Scalping 20 to 80 cents every day is by far the hardest thing to do. Swing trading with a stop out of 30 cents on your losses and letting profits run or more is a better strategy but you will have to take overnight positions that may sometimes open down \$1 to \$2 on bad news.

Basic Overlap Methods

Let's go back to our basic daily bar chart again and take a closer look at those bars. Markets vary in their volatility and they vary within certain time periods as to volatility. Our first job in looking at a chart each day is to ask ourselves what kind of volatility is to be expected today? In other words will today's bar at the end of the day be the same average height as the last few days, or will it be a 'big' bar of twice the length with a gap opening and extreme close. How we answer this question will determine our trading strategy. The following chart of General Motors shows several parallel channels that are highlighted because they have different momentums for several days to a few weeks at a time. The 'Super' advance shows tremendous strength with bars gapping up nearly every day and almost no overlap to the downside with the prior day's bar. Obviously this is a unique and very strong time period and we could easily go long with a stop at the low of the prior day's bar and never get caught. This is a rare condition and we need not plan for it for everyday trading, but just know how to recognize it when it comes. The much more typical pattern is the 'Average' advance or the 'Flat' type patterns. Note that most of these can be distinguished by the slope of their advance. A steep Gann angle of 4 x 1 or 2 x 1 is always a strong market while a 1 x 1 or 1 x 2 angle are more modest advances. If you look at the 'Average' advance you will see the tops of each bar that advance are slightly higher each day by about a quarter or a third of the prior day's bar length, and the bottoms are similarly higher. This is the most common experience in trading. The same is true for declines.

For trading purposes *you should seek out patterns* that are in tight parallel channel trends. This means the bars are all uniform in size and the volatility is pretty much the same day to day, which makes buying and selling on measured moves very easy. There's no law that say you have to pick a difficult chart to trade. Try and find one that has a simple trend and doesn't gap up or down very often and you can make a good living

scalping it. Joining the 'crowd' in chasing Google or AAPL only hurts your odds of success since no one has an edge and most traders think alike and use the same stop levels and read charts the same way. Try and find charts that aren't so popular with enough volume to let you in and out each day easily.



Many 'pivot' systems are based on the idea that you divide the range into quarters or thirds, and allow that amount of overlap of the previous day's bar and you trade counter to it. In other words, if the prior days high was \$35.62 and the low was \$34.90 the range would be .72 and one third of this would be .24. The overlap would extend to a high at $35.62 + .24 = 35.86$, and the low overlap would be $34.90 - .24 = 34.66$. The strategy is to short an up opening up to the pivot target with *the most likely expected outcome being a decline over the next few hours to the midpoint of the prior day's bar*. That way you short up 30 cents on the day and cover on a dip of 25 cents or so down on the day. The reverse is done on a down opening below the prior days low but not exceeding the pivot amount. The gap down will be closed sometime during the day with the expected 'regression to the mean' middle of the prior day's low. Take a closer look again at the 'average advance' section of the GM chart. *Note that each bar,*

no matter how bullish or bearish for that week or so, overlapped a good 70% of the prior day's range. As long as we trade countertrend as a new day's bar approaches the overlap average, we can expect the bar to 'fill in' the prices, approaching at least the middle of the prior day's bar. Now look at the 'Super Strong' advance and note what happened about the 4th bar up from that low. At that point each bar gapped up and never overlapped for three to four days. This is your risk in adapting this kind of strategy.

You must know enough about the market or a particular stock's characteristics to know when a big momentum move is underway. Usually the overlap strategy is only employed on the opening and you put your orders in before the market even opens at the calculated prices, or on a scale up like 1,000 shares every 15 cents up to your stop point which might be two times the overlap amount. You don't need a market opinion or forecast to trade this way. It's just a basic regression towards the mean strategy. This common principle of trading is always employed by the NYSE Specialists when they open their stocks (or at least they did before electronic trading). The 'opening bulge' is the extreme high or low of the entire day on many occasions, simply because the Specialists open a stock up into resistance and then go short and pull it back down, or they open it down to attract sellers, and they buy and take the stock higher. Misdirection is the key word for making money for them as they try and open the stock into a major buy or sell order and after the 'small fry' are shaken out they reverse direction and move the stock quickly. Even in electronic trading these days, the big Wall Street firms still know where the 'bodies are buried' with their stop orders, and where the big buy and sell limit orders are located. They will try and misdirect you into those traps but the daily bar charts will show the accumulation patterns.

In studying overlap bars we can see how the common daily trading patterns develop. For example, let's say the market closed at the high on a given day and opens higher the next day. Unless it's a big momentum move, the up opening is a 'short the overlap' trade with a pull back expected towards the midpoint of the prior day's bar. This can give you the high of the day at 10 am and a decline into 1 pm or even a down day. In the same case of the strong prior day but a down opening, you can usually buy that dip if its close enough to the midpoint or lower of the prior day since in most bull moves the prior days low will not be broken and by the close you will make money, or on the up opening the next day.' In this

case you get a 10 am low and then a rally either to 1 PM or until the close. These patterns give rise to the well known rule that *a market cannot reverse direction unless it opens in the same direction it was in at the close*. For example an extended bull market can open up and then reverse down and reverse the trend, but an extended bull market that opens down usually bases and then extends up again. That's why we 'buy dips' in a bull trend. Likewise in a bear trend a down opening can reverse the whole trend, but a short covering up opening from a down close rarely reverses the trend and the rally burns out and goes to new lows. These rules come from simple overlap bars of differing sizes (hourly, daily, weekly etc.). The intra-day patterns usually turn near the first hour, mid day, and the close.

The overlap price target can be hit on any of those time periods so you must keep that in mind when watching the tape. A down opening can actually go up into midday to the overlap price and then reverse down and close at the low of the day, for a downside overlap the next day.

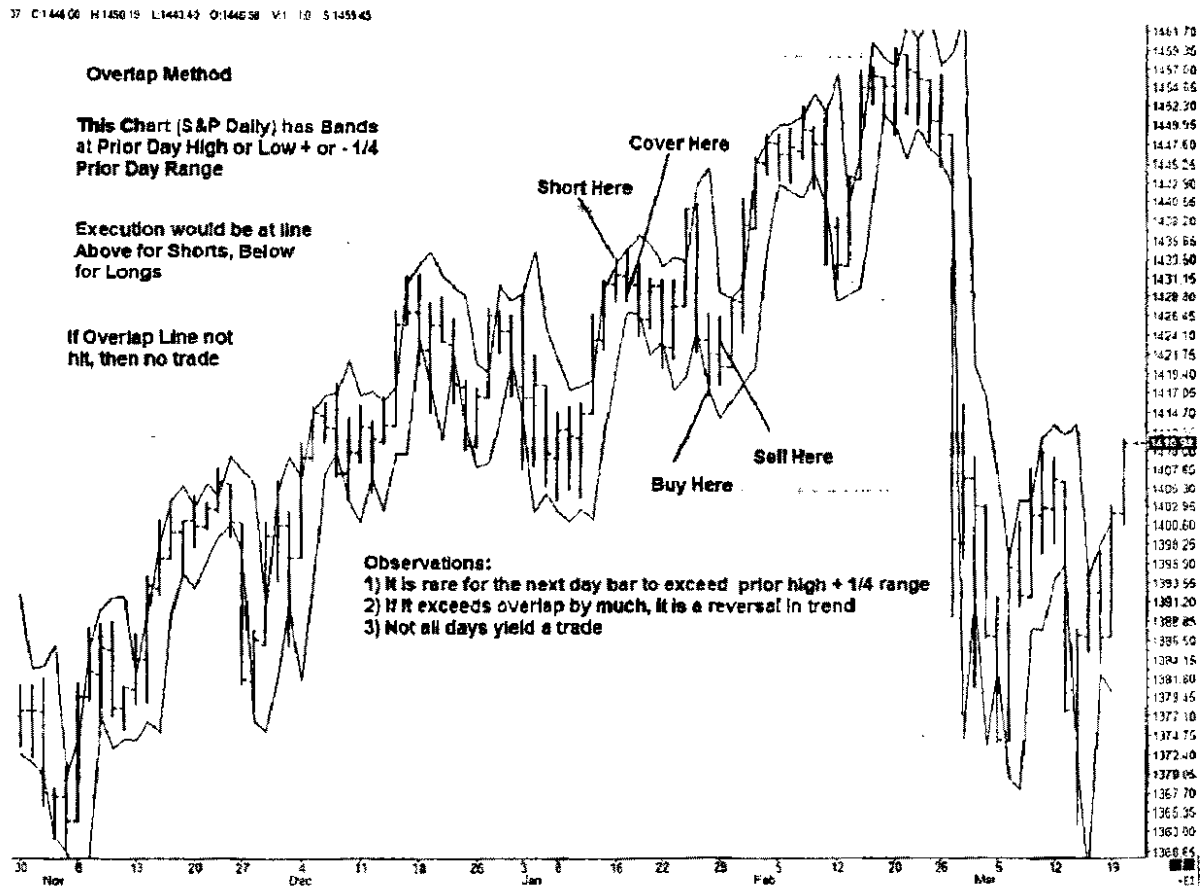
One easy way to try and keep track of these patterns is to use your computer and set up two or three separate quote pages with lets say the 30 Dow Jones names or any list of 'go go' names you trade. Most quote pages let you sort your list in ascending or descending order by color code such as green for up and red for down. What you do is sort the lists at 10 AM, 1 PM, and perhaps 3 PM by ascending and descending orders, but leave one unchanged at each time period change. So you set them all at 10 AM but at 1 PM leave the original 10 AM sort alone. By then you will see which stocks were down on the opening and then went up, or what stocks opened up and are now down due to their out of place colors on the list.

When studying overlap, we must think about the concept of volatility. Traders make a living off capital gains and the amount of fluctuations and their size determine the profit potential. We also would like a stable volatility history because as a trader we do the same things over and over again and if the volatility changes every day it would be hard to predict anything. *The overlap method is best used on stable volatility names like oil stocks, bank stocks or food stocks*, and not on the 'crazy go go' hi tech names that go up or down a great many dollars a day.

You can trade them but don't counter trend trade them with overlap methods unless you are a very good trader.

One problem I see all the time in helping traders is the problem of trading a certain volatility time frame but expecting to make a larger time

frame volatility profit. In other words a 5-minute bar chart has a volatility defined by the height of a 5-minute bar but you may want to capture the daily move as a profit. If you are trading S&P futures or e-mini's, or Dow Jones futures, you may want to trade a 5 minute chart but the big market makers who control the market and use arbitrage with futures, options, and stock baskets, will be trading off the daily bar expectations. You may be using stops based on a 5-minute bar height of 1.25 S&P points but the big guys can easily run the market 3 to 4 points because the daily bar volatility might be 8 to 12 S&P points. What you have to do is *time* your 5-minute *entries or exits* to key levels on the *daily bar*. Stops calculated with 5-minute bar volatility will not work and only stop you out on every trade. What you need is a stop calculated from an hourly chart bar and time your entry or exit to the hourly reversal. You can then watch the 5-minute chart for patterns and potential reversals but you won't get whipsawed as much.



This basic overlap chart with $\frac{1}{4}$ prior bar overlaps shows how the daily bars are fairly well contained within those overlap ranges. The big breakthroughs are usually when a downtrend of three or four days reverses and the trend actually changes. That's when you don't want to counter trade an overlap. This of course happens when the 'high of the

low bar' is exceeded (for a buy signal) so just keep that in mind each morning when putting orders and stops near those levels.

Basket Program Arbitrage

When trying to interpret a chart we must be ever mindful of what is causing the movement. Trading the S&P futures (or E-Mini's or Dow futures) is the purest form of intra-day trading and the most difficult. Most traders come to me to learn to trade these futures but I always warn that they are much harder than anything else because they are proxies for other vehicles. For example The S&P futures can be used to hedge the S&P cash basket of stocks, or the SPY trust (SPDR), or the SPY options, or options on the futures themselves. When they are used for *hedging, they go in the opposite direction to the cash market* and you see everything backwards. That can really screw up your regular trading habits.

In the traditional basket program an investor buys the 500 stocks in the S&P and collects dividends (perhaps 2% yield), he then sells short the S&P futures at a premium of perhaps 10 points over the cash, and he can do that four times a year for each of the quarterly futures series. That gives him another 2.6% yield (10×4 divided by 1500 (S&P cash level) = .0266) so he gets about 4.6% to 5% total (dividends and premiums) by doing this. This can be better than the risk free T-Bill rate and can also provide other benefits for brokerage firms like influencing the markets direction when they are long or short and providing liquidity for customer orders. You can also borrow money in Japan at V^* of a percent to 1% and invest in a basket and get nearly 5% in a 'carry trade' transaction hoping for an additional currency appreciation play. What you must know and what I have to say over and over a thousand times to get the average person to understand, is this: *these basket program trades are absolutely, positively, guaranteed to not lose a single penny on the trade no matter what the market does*. If the market goes up the gain on the stocks is exactly offset by the loss on the futures. If the market goes down, the loss on the stocks is exactly offset by the gain on the futures. On expiration date the futures settle in cash at the exact same price as the cash basket so there is no difference between cash and future. These programs are not put on to make capital gains money, only to get a better rate than the guaranteed T-Bill rate on all the firms' capital. You see, once you sell short

the futures against the long cash basket, you are locked in until expiration. At that point the futures sell at exactly the same value as the cash market and all losses or gains on either the cash or futures is exactly balanced out. If you tried to liquidate before expiration then you most certainly could have a loss or gain, as the futures premium would be different than what it was when you put it on. You may ask, who cares about arbitrage, isn't this is a day trading book? The answer is that you can't possibly be able to read the tape without knowledge about how the tape reacts when these programs are running. As the quarterly expiration approaches and the premium levels on the S&P futures fluctuate they sometimes can yield a slightly better return than when they were put on if they are taken off a few days early. They can also be taken off at a tiny loss in an effort to manipulate the market and make a fortune for those firms that buy cheap puts and calls in the direction the basket will be taken off.

Although illegal inside information is outlawed, in reality it is a way of life on Wall Street. The government has legislated that hedge funds and other trading entities use 'prime brokerage' accounts at the big Wall Street firms to segregate the customer's money, but the aggregation of hundreds or thousands of these customer accounts at the big Wall Street firms is a license to steal as an options expiration approaches. You see the firms get a computer printout every night of all the positions held at the firm and it's easy to see the total number of shorts that have to be covered by the options expiration deadline, or the number of baskets that have to be liquidated. Knowledge of those market-moving orders in a short time period is the cause of untold fortunes by the Wall Street firms. While it is illegal to use such knowledge and a 'Chinese Wall' supposedly exists between the record keepers and the trading desks, in reality it's impossible to police general knowledge about the direction of the market over a specific week or two. One could buy all kinds of puts and calls or futures and no one could ever prove he was trading against any particular order being executed.

I once had after work drinks with the senior partner of a big Specialist firm that I traded money for and he asked me if I had ever heard of such and such bank in Ohio. I said no, why do you ask? He opened a 5 inch thick computer printout on his desk that had all the positions of all the accounts at his firm that day and he said that this particular mutual fund just bought 200,000 shares of that bank and another pension fund bought 600,000 shares and several hedge funds bought 100,000 each.

He said those were new positions for them that day and they always bought at least ten times more stock than that. His implication was that there would be continued buying for some time in that issue and recommendations would be coming out on that issue. I then realized that I was trading the hard way trying to read the tape and the vast majority of the big firms just went along with the inside crowd.

Our purpose here, however, is simply to learn how to distinguish when these programs are running, especially if we are trading futures. If you watch a 5 minute bar chart you will note the 'big' bars that are very tall because of big volume moving the market in a certain direction. This is the big money that moves the market. It is usually a good idea to go with them since *they know* what they're doing (they are working a huge order over several hours to days, and are front running it with futures). Most days you can just trade in the direction of these big bars (impulse waves) and that will be the main trend. When I first moved to New York City in 1984 to trade professionally for a living, I bought and sold a lot of the relatively new product called the S&P Futures, I had direct lines to Chicago (which was very expensive back then- you didn't have to dial- it was a live line all day long). My pit brokers would flash me reports of who the big buyers or sellers were in the pit and I would get calls like "Solly's buying 10,000" or later it was Goldman in the pit with thousands of 'cars' to buy or sell. The entire pit and all the traders made their money by front running those big orders, indeed, the only advantage of owning a seat on the exchange was to be there when these big orders came in and you bought or sold in front of them and always made a good risk free living. As the markets evolved and the front running got extreme the big guys disguised their orders by offering a huge amount for sale above the market at a limit and then surreptitiously using a second broker to buy all the orders the small fry would sell thinking they were front running a big sell order. Then the big sell order would disappear until a half hour later. After a while no one could tell who was buying or selling and later, once the options on the futures and S&P's emerged you couldn't tell which transaction was the 'real' one- was he buying stock and selling futures or was he selling stock and buying futures? Furthermore if the big guy was buying, was he buying to buy, in which case you'd better tag along, or was he buying to cover a short to re-short a little later?

When basket programs are running, however, the big bars on the chart representing these heavy volume transactions will be in the

opposite direction to the real trend of the market and you will be misdirected, stopped out, and generally chopped up if you follow them. This is because as a buy basket executes, all 500 stocks in the S&P surge higher on the buying but within a minute or so of that just as you are buying because the cash market is breaking out, you will get hit with thousands of contracts of futures sell orders that are going short against the basket (I still get calls from inexperienced brokers who tell me Goldman is a 'big seller' of futures, when he's actually buying 100 times more stock in a basket and it's a bullish transaction). The 'look' of that transaction will be a big bar downside impulse wave that may well violate all kinds of short time frame trendlines or moving averages. It will look like a market reversal but it will dry up as fast as it came and then the cash basket will surge higher again taking the market all the way back up. When these baskets are taken off at the end of an expiration, it's just the opposite (unless it's a short basket). The cash market seems to be breaking down with all 500 stocks breaking stair step patterns, but as soon as you go short, huge futures orders to buy (to cover shorts) come in and spike the S&P futures higher either stopping you out or creating extreme anxiety at the least. These waves of buying and selling can last hours to several days around the expirations, and don't think for a minute that the big Wall Street firms don't know how to manipulate your trading stops with their timing of these waves. Now most of this information is for futures traders who by the nature of these very leveraged products use short term 5 or 15 minutes charts with stops because big moves can cost you a fortune if you are on the wrong side. The solution is to constantly use a larger time frame like daily bars to test the trend to look for higher bottoms for an up trend or lower bottoms and lower tops for a downtrend. The volume of futures traded counter to the cash market basket while substantial, is never bigger than the cash market so the S&P cash market bars will show the proper trend every few hours, while the futures will erratically break all kinds of support but will unexpectedly regain all of it a few minutes to hours later. Strategy here is to note the systematic waves of the cash market direction and then hold your breadth and buy into or sell into those scary looking sharp S&P futures moves on a timing basis using stops. A 'line chart' on the S&P cash will be a big help in determining the main trend to follow.

Historically the most misdirection, and what I've revealed on my hotwire over the years as my 'million dollar secret' is to watch the

Thursday before the quarterly expiration. That is the legal date when the new quarterly futures become the 'front month' and are active for trading purposes. The basket guys will still be in the old futures until the bitter end but they know *you* don't have a basket position and *must liquidate the old future* and go into the new one on that Thursday. This sets up a great opportunity to manipulate the market. For example if the expiration is bearish with basket liquidation and it has been drifting down all week, all the traders will be short the old contracts and will roll over into the new month by going short that one. What the arbs like to do is put on a big *buy* program on that Thursday and force the shorts to cover and then go long the next month creating a lot of premium expansion in all the futures and then on Friday or Monday they come back in as big sellers crushing the premium and creating a waterfall effect as everybody scrambles to get out and get back short again. If those arbs have bought cheap option expiration puts on that rally they see them triple very quickly. The opposite occurs if the expiration is to buy- they put on a big sell program to misdirect the futures traders into going short only to have to cover the next day. My 'secret' therefore is to always watch the Thursday the week before expiration and see if a 'straight line' direction movement starts the next day going into the expiration. Then you can go with that trend every day for the next week and be trading on the same side as the big arbs.

Besides the S&P baskets there are many other ways to arbitrage the market. Many funds buy the SPY, S&P proxy, with new cash and if the market suddenly reverses on them they simply sell S&P futures overnight to protect their portfolio against bad news. This is often the cause of sudden breaks in the market that look like 'it's the end of the world' but as soon as the selling dries up, the market goes right back up. These funds just keep all their stocks and take a short-term profit on the short futures and the covering of those futures creates more buying driving the market higher. The same technique can be done with SPY options. You can buy puts, sell calls, or sell deep in the money calls and you never have to sell stocks.

This is one of the keys to the long running bull market from 2003. It was all done with 'smoke and mirrors'- options and futures with little stock buying or selling other than through SPDR Trust baskets.

In the late 1980's it was a constant irritation to me to see a certain famous woman portfolio manager on TV always talking about how bullish she was and how her portfolio was 100% long and she had no fears what

so ever about any decline. I knew her broker and she was as terrified of a market meltdown as anybody else so every little dip in the market she sold deep in the money calls on the OEX to protect her portfolio and simply bought them back when the market stabilized. She was typical of the 'snake oil' salesmen and saleswomen on TV who need the public to keep buying so they can sell to them.

Options

Options affect the market in a similar fashion and you should at least know the basics of what they do to the market. For example when you want to buy a put thinking the market will go down, the seller of that put creates it by selling short the stock. That is because if you exercise the put you bought from him it requires him to buy your stock. He does that by covering his short. His only concern is if the stock goes up and then he covers anyway and only re-shorts if he has to honor the put, or he buys a call for protection and keeps his short on. If you want to buy a call, the call seller will buy stock and write the call to you hoping it will go up and you will buy his stock and give him a quick profit. He is then only concerned about a fall in the price of the stock and he will liquidate below a stop level or buy a put.

Sometimes he will write a 'naked call' meaning he sells you the call but has not bought the stock he will have to deliver if you exercise the call he sold you. The rule of thumb here is that 'the stock will trade to the premium level'. What this means is that if the stock is say, \$49 and he sells you a \$50 strike call for 50 cents, he will be 'naked' until he starts to lose on the trade. That can't happen until the stock exceeds \$50.50. So if a take over rumor starts or something that makes the stock to go up, *he will buy before* it gets to his loss level at \$50.50. By then he has bought and usually the buying in the stock dies out near the average premium level of the past few days or weeks where these options were sold. Today there are many 'go go' names like Google that often run \$20 dollars in a single day. Much of this is option related and if the stock was let's say at \$500 and the 510 calls were selling at \$8, then the normal expectation would be for the stock to run to the premium level of near \$518. It is the plus or minus premium levels on the stock that create the volatility. Indeed, you should

only trade stocks with 'big' option premiums since they guarantee excessive stock volatility.

On option expiration each month there are hundreds of thousands of puts and calls on the SPY and most of these are naked with the intent of the arbitrage community to drive the SPY index to the *one level* where the vast majority of all put and call premiums will expire worthless and all the speculators will get wiped out. You see most all of the big firms sell naked puts and calls. They never buy premium outright since 90% of all puts and calls expire worthless and that's a suckers game created for the public. With the arbs' big pockets they can easily force the market to any price level they need on options expiration to insure that all the premiums they have sold become worthless. Once every six years or so, however, an institution has a legitimate sell order on the expiration and then those hundreds of thousands of naked puts sold spring back to life. What the firms sold at 75 cents are now \$2.00 and since they have sold a zillion of them if they don't cover they will go broke. This is what causes the crashes like 1987 or 1998. In the normal expiration as long as the out of the money puts and calls are reasonable like 30 cents or so, the market will regress to the mean and they will all collapse to zero premium. At these times you also want to *be an overlap trader*, since it is basically impossible to get the market to breakout or break down until all those puts and calls get out of the way. Do you really think an individual can buy a 30-cent call and get rich?

I mentioned before with basket trading that I have to repeat a thousand times over that baskets don't lose money no matter what the market does. They are a hedged transaction. The public just doesn't understand that. The other thing even harder for the public to understand is that one or two Wall Street firms can move the market *anywhere* they want on options expiration. They trade on 1% margins normally and with puts and calls near options expiration, selling for 30 cents to control a \$100 stock they have leverage of a thousand times normal. If they want to peg the Dow Jones to 13,000 they will do it. If you try and sell 12 million shares of MMM to thwart them they will use options to create 3 million shares of BA and move it up the exact amount MMM goes down. They can sell short tens of thousands of SPY puts which creates basket program buying (the selling of a put requires a short to cover) because if they do get in trouble they can quickly sell short 10,000 S&P futures to insulate the transaction. In short, within the last 5 days of an expiration they can and

will do anything they want. Now the Monday after is another story. Now the SPY puts and calls aren't 30 cents anymore but \$3 and the leverage is gone. They now have to put up real money to make an impression and they will wait to see what the others do.

I can guarantee you that if you want to become a successful day trader you can't do it without having an options quote screen on the SPY on your computer that you refer to every 15 minutes or so. This is because every basket program or major institutional buy or sell order coming to market is known about by the firm doing it and the very first thing they do is buy a block of puts or calls for protection for the firm. When this happens you will see all the puts down on the day and all the calls up on the day on your SPY screen if it's a buy program. That's the best way to determine the days trend. Make sure that you are trading in the direction of the premium expansion on the SPY. A down day will see all calls down and puts up across the board in every strike and for several strike months, and an up day will see all the calls up and puts down. The amount of premium collapse will tell you how big the program is. Remember back when I mentioned the overlap method and said you only had to watch for when a big run away move was at work so you wouldn't get caught shorting into a big overlap? The premium crush and expansion will be a key as to what the markets momentum is. Many plus or minus days simply see two strike levels of calls and puts up or down 10 to 15 cents, but moves like 100 points on the Dow Jones will always see 5 or more strike levels active with premium movements or 40 to 60 cents or more. The 'big' money is always crooked and uses illegal inside information. At least that's what you HAVE TO THINK to survive. When they know what they know they don't fool around wasting expensive capital buying stocks, they use the leverage of options and buy many times more than they could normally have, since they have a guaranteed trade in their pocket.

The other thing to keep in mind is that when a big buy or sell order is coming to market, the firm handling the order will first place a big block of options for protection. That's because these big programs often take two to three days or more to fulfill, and inconvenient news could disrupt their ability to execute the order. When you see that block of options trade, let's say a block of 25,000 SPY calls at \$1.10, what you should do is transfer that transaction to your normal quote page and start watching that specific option for a day or two. As long as the premium level holds that price, it

TradeStation OptionStation Analysis SPY Daily [AMEX] S&P 500 Receipts

Date 6/06/07
SPY=152.57
Market down 69 on Dow Jones
notes:
all calls down
all puts up
Outstanding Interest on puts
below 152 strike huge compared
with 152 strike calls

58

sentiment and unlikely that the expiration will go below 151 strike and make those put buyers any money. If 151 did break, however, it could be a crash as most of those puts are probably shorted by the Wall Street firms who sold them to the timid public. One very important point in trading S&P's in particular but also all of day trading, is that the 'big guys' can't do anything *until the options open up for trading*. This can take well into 10 AM NY time to get all the strikes open and volume sufficient to hedge. This is why we always see those big morning swings that reverse at 10AM or 10:20 AM that tie in with the 1/8th and 1/10th breakpoints for the day. The guys who know about a coming program during the day need to *hold the futures in a tight range* until they get sufficient volume in them to place a block of offsetting options. This is why it sometimes is not a good idea to jump in and trade in the first hour each day. Although there is a lot of action, there is also a lot of chop and misdirection and if you are very professional you want to avoid 50/50 situations where you can get stopped out without knowing why. After the arbs position themselves by 10:30 AM it's a much safer bet to go with the trend.

Much is often made in the press about the huge short interest and how it is bullish. This is rarely the case. The way the markets work, the big brokerage firms don't have the same margin requirements that you or I must follow. We may have to put up 50% margin or for qualified day traders 25% margin, but members of the various stock exchanges can often get away with margins as low as 1% or 2 % if they have some hedging options. A fairly recent 'scam' (from the exchanges point of view) was that an individual who owned a seat on the Chicago Board of Trade had a very good attorney examining the regulations and found that nothing prohibited a partnership owning a seat and using the privileges such as margins at near 1% levels for day trading. He then packaged his seat to outside investors (perhaps thousands of them) for a \$25,000 'investment' down payment, and they would become co-partners able to use all those liberal margin advantages. This resulted in many new day trading firms that offer traders up to \$1,000,000 of capital for an 'investment' in the company of \$25,000. Of course they will offset any loss you make on your borrowed \$1,000,000 against your 'investment' (2.5%) so you'd better be a very good trader indeed if you take them up on that. The 'scam' part is the fees they charge you to use the capital and they force you to adapt strategies that only expose them to the market for 20 minutes at a time.

As mentioned previously in the note on the Carry Trade that used to borrow in Japan at a $\frac{1}{4}$ of a percent and arbitrage over here at 5%, the Wall Street firms do the same thing with options and basket programs. They raise money through what is called a 'reverse conversion'. Here they sell short their legal limit of a stock and then sell a covered put and take the premium they receive on that and buy a call option to protect the short. What they have effectively done is raise capital to put to use since they can keep the sell short proceeds and don't have to set aside the onerous margin requirements you or I do. They usually put these funds in basket programs yielding 5%. Because of this free gift of capital by the regulators to them, the short interest from all these reverse conversion shorts *will always go up* and up and *never* be covered unless the firm is going out of business. Perhaps this will be a saving grace if we ever get another 1929 type crash and they all do go out of business and have to unwind all of these positions, but under ordinary situations the short interest is not a good indicator of public, or unsophisticated investors, anymore, it will just permanently grow larger forever.

Another technical indicator that is worthless these days is the breadth of the market. While in theory, an advance decline line should show the direction of the market, it all depends on the price momentum of such advance or decline. Many days a 2000 issue down day is just the result of several basket programs being unwound and buyers will step right back in as soon as the program ends. To believe the technical condition of the market has really changed just because an up day sees thousands of up ticks, or a down day has every stock down, is not valid unless the price movement is much more than the normal 10 cents per share of a typical small basket program. When real market movements begin, individual institutions are buying and selling huge blocks of stock and a great many issues are up or down \$1 to \$2 each on a given day. On these kinds of days the advance decline line means something. *You should watch for many individual stocks moving \$1 or more before getting excited about a big move beginning.*

Speaking about useless indicators, and this is a bit out of place here, but I am often asked about what kind of 'moving average' I use. People who ask such questions usually haven't a clue as to how the market works. Back when I was running an S&P futures fund, a trader rushed into my office one day and inquired as to whether or not I knew the 5 day moving average of the futures just broke. I told him I didn't care since I was short

long before it was even touched since the *low of the high bar had been broken*. You see, if you truly understand a bar chart and what those support and resistance levels on the bars mean, you will get your information long before any kind of moving average can catch up. Perhaps a kind of momentum oscillator could coincide with the breaking of the low of the high bar, but usually the chart on what ever time scale you use will give a faster warning than waiting for a lagging moving average. That's why I don't use them. Now that is not to say I won't use a 'research', after hours program, to scan 3,000 stocks for the breaking of a 3 or 5 day average to mechanically spot stocks I haven't been following, but when you are trading real time, you had better be aware enough so that when a level breaks you know it long before any moving average has to beep or buzz to let you know. If you can't be that focused, you will not be successful in trading.

One final comment on options is that you must remember that closing transactions are the opposite of opening transactions. In other words a person who sells short a stock and writes a put to you will need to buy back that short when the put becomes worthless on options expirations, or he must write another one. This is what traps many short sellers near the expirations when they don't realize that the aggregate amount of SPY puts still outstanding can total billions of dollars in potential buy programs if those shorts are covered all at once. This is what the big Wall Street firms do deliberately- they try and force you to cover all at once and start a big rally they've been buying for. What they do is sell short a huge amount of the puts crushing the premiums down to near zero and as those premiums collapse it causes the underlying shorts to cover. If they can get a stampede going the market can often go up 100 points that day. Sometimes it works in reverse. They sell short the calls and long stock is liquidated causing a market meltdown. Near an expiration you must note the total outstanding interest in the down strike puts and the up strike calls to see how the market is balanced. For example if the SPY is 153 and the 150 strike has 200,000 puts outstanding and the 155 calls have only 20,000 outstanding it means everyone's bearish and those 150 strike puts will certainly expire worthless. Should the market approach the 150 strike, the speculators will start to sell those puts at a small profit but the very act of selling them creates buying driving them away from the strike. Also the big Wall Street firms see those potentially worthless puts and sell short all of them and then put on a few buy programs to keep the market

near 151 so all up strike calls will expire and all down strike puts will expire. That's why we always see the real move on the Tuesday after the options expiration only after all those buyers and sellers have been wiped out and can't benefit (Tuesday is the key since you can exercise a call or put into stock on the expiration close and get a 'free ride' on the margin until late Monday afternoon when you have to pay for it or sell out). If you look at a screen of the five up strike and five down strike puts and calls in the last week of the expiration, you will see the classic pyramid forming with the most outstanding interest in options *at levels that will most certainly not be reached*. As the Street shorts the out of the money puts and calls, they force the strikes to a level where they will make the most money and you will not. Predicting where the expiration is headed is not hard- you just figure out at what price the vast majority of options players will get wiped out, and that will be the close on options expiration! NOTE that Wall Street makes most of its money two ways 1) investment banking fees (all major tops are peak IPO calendar weeks) and 2) shorting options premiums. They don't do it buying and selling stocks. That is just to manipulate the option levels so they can short them. Because of this, once you see the expiration paired off at a certain level, you need not be concerned with breakouts or breakdowns in the futures and yow *can counter trade* (overlap method) all such potentials because the Street will short the calls or puts right back into line and they will not let the futures break out and upset their game.

How Do They Get Out?

Take a look at this next chart, which is a 5-minute chart of the S&P E-Mini Futures. It clearly shows an up trending day with a close at the high and there appears to be 5 nice waves suggesting that the top might be the high. Before you short into it for an overnight trade, however, you must ask yourself this important question. If the market had a big buy program that is now done and the trend will turn down, *what is the sign that the big money S&P traders have exited their long positions?* The answer is none. There is *no sign whatsoever* in the chart pattern, that the big money guys are anything but long overnight. In order to get out of big positions, the chart pattern would have shown many big downside impulse waves after 3 PM showing aggressive liquidation. Big players with hundreds of

thousands of contracts always leave 'footprints' in their comings and goings. You must ask yourself this simple question every time you identify them going in or out of the market. *If you can't see them leaving, then they have further plans the next day.* Usually an extreme close at the high is engineered to attract mutual fund buyers for the opening and the big guys will force the market higher on the opening and force the shorts to cover into the overlap area by 10 AM and then they will exit longs and possibly go short. Remember they often enter and exit with option hedges so the next day exit can't really be made until all the options open after 10 AM.

C:1524.00 H:1524.50 L:1523.50 O:1524.00 V:10.117 I:0 S:1528.87 D:15-07 M:5



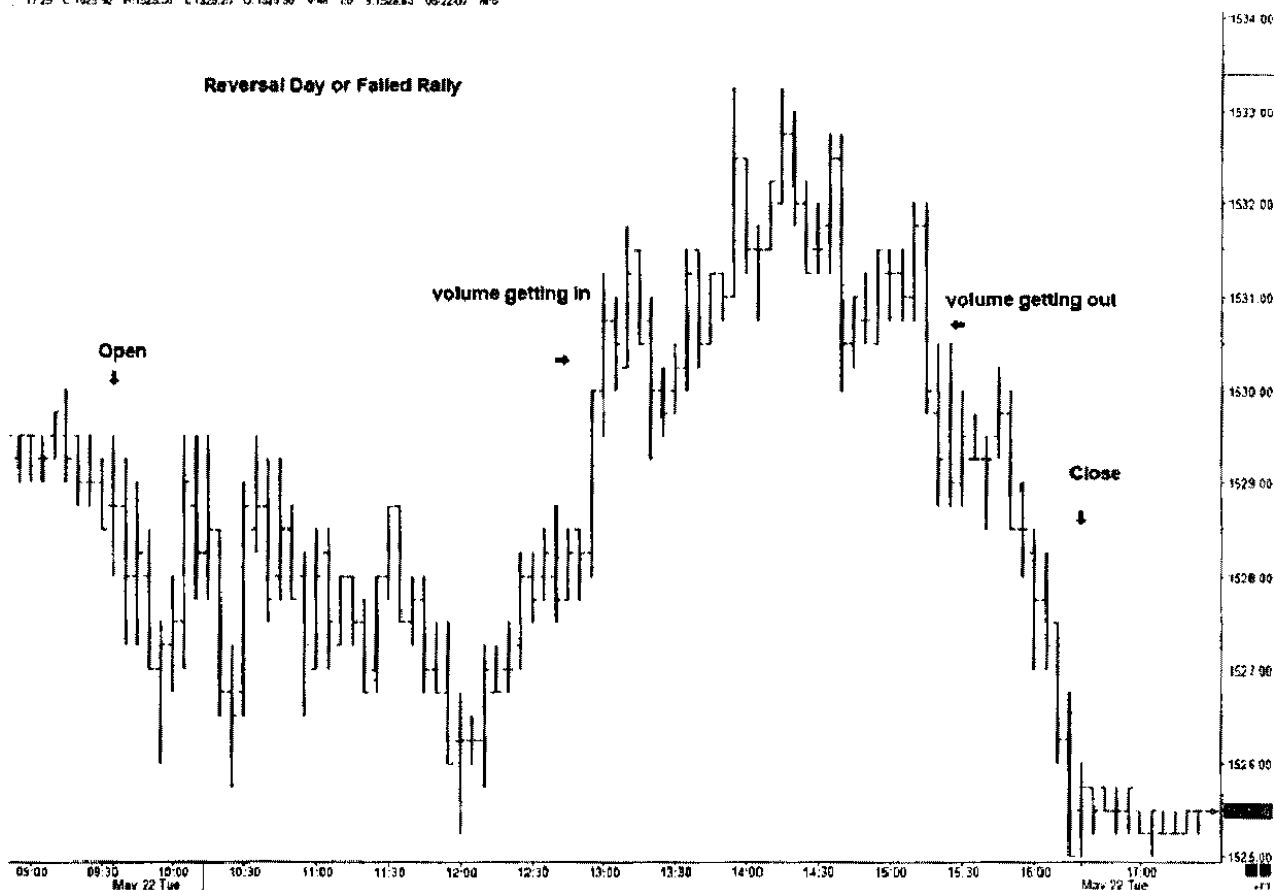
The chart on the next page shows the next trading day, which was a Monday after a weekend. You can see they had a lot more buying to do and it lasted until noon when they started the 'distribution phase' of getting out of their thousands of contracts and by 3 PM they 'pulled the plug' on the market and they were short with a swift breakaway to the downside. As a trader you must constantly *be aware of the time it takes to distribute shares* or contracts to get out of a position. This is true whether it's a basing low or a distribution high. It usually takes a minimum of several hours, so if you watch a 5- minute or 15- minute chart you will see

definite signs of liquidation. Rarely do markets just go straight up or down and turn on a dime unless it's a news item that's totally unexpected.

19:55 O:1527.50 H:1527.50 L:1527.50 O:1527.50 V:00 P:0 5:1526.28 05-21-07 M:5



I've placed a lot of emphasis in this book on the common mistakes most traders make by looking at 5-minute charts and getting blindsided by the implications of the daily chart. This 'distribution' or 'accumulation' idea at the beginnings or endings of a run is just the opposite. You may see a daily bar chart going straight up into resistance and want to sell short, but you will not often 'see' the distribution required to bring about a sell off. This is where the 5-minute or 15-minute charts come in. You can then see two or three hours of a 'flat' distribution period on the smaller time frames, so when the hourly low breaks you can short with a stop, long before there is any indication on the daily chart. *If you don't see the divergence on the shorter times frames, however, you can't short into a strong daily bar.*

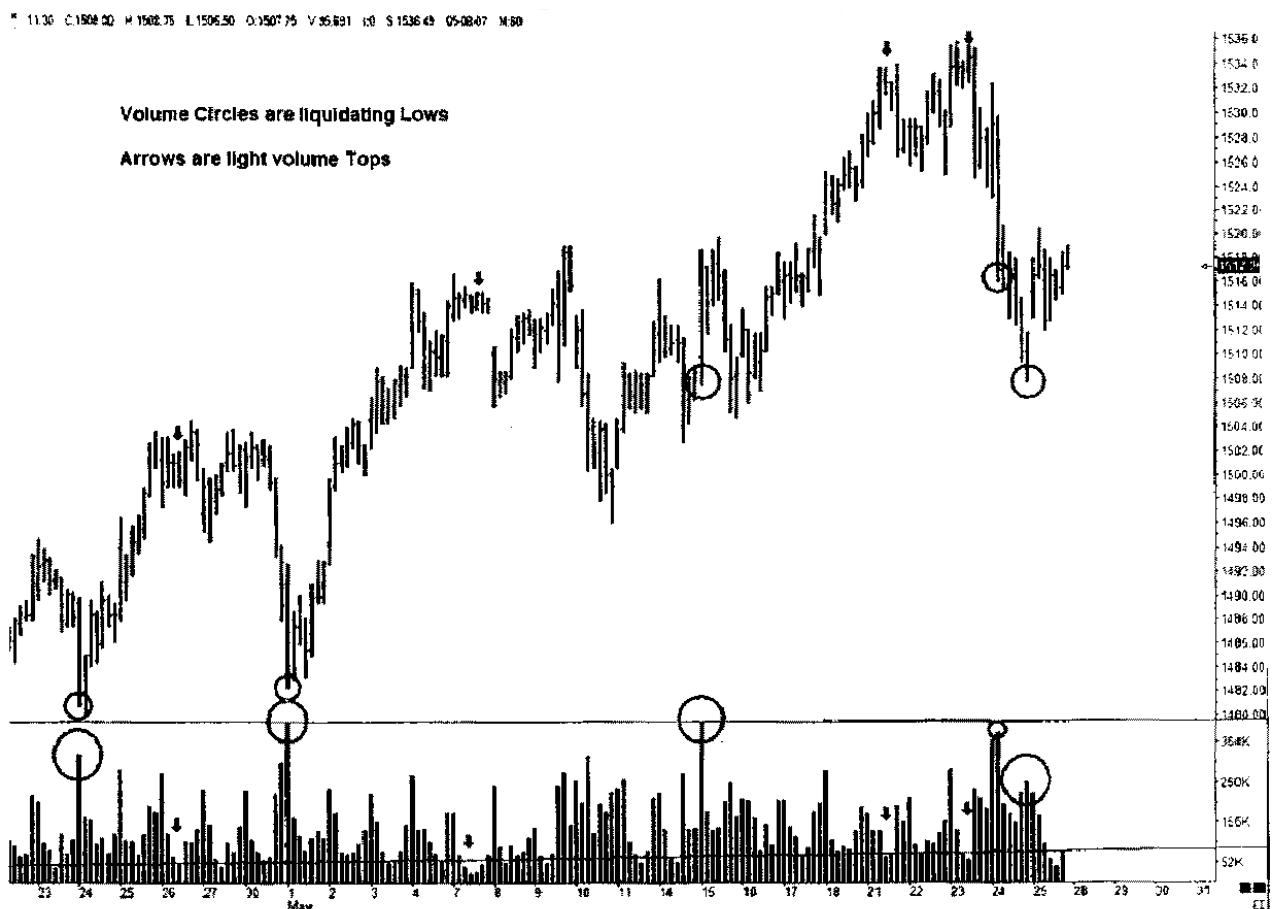


Here we see a day with a big up move (5 min S&P) and it doesn't hold and the same buyers who sent it up take it right back down. The big elongated bars are usually the heavy volume ones to look for. This type of pattern often happens near tops when the market is saturated with buyers and no new money comes into the market. Usually the day traders just jump in each day and are forced back out on the close.

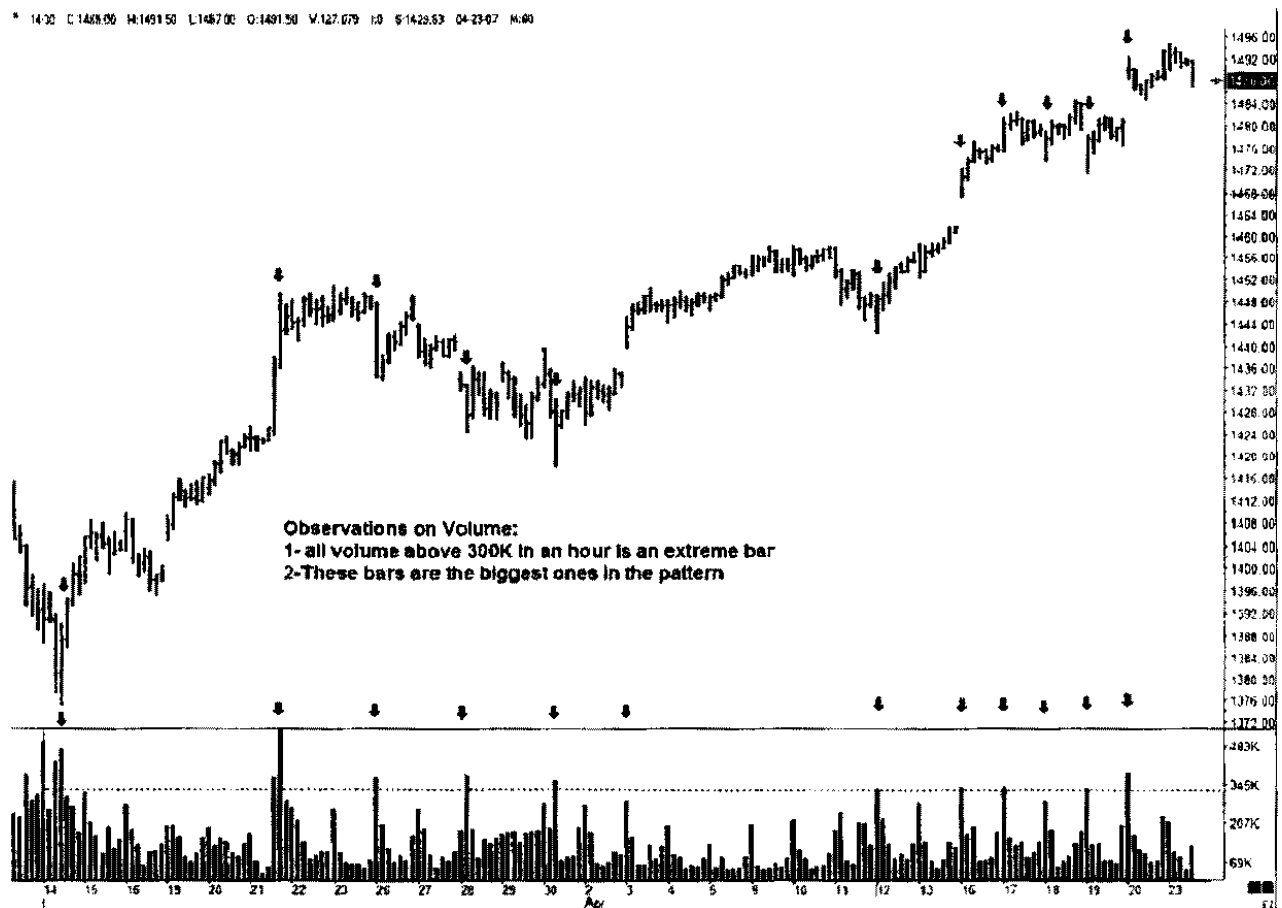
Volume

In speaking about how the players can get out of their contracts, we are basically talking about volume per bar. Volume is usually 'positively correlated' or in other words it goes in the direction of the main trend. In up trends it goes up and on minor pullbacks it declines. In downtrends it increases as the market declines and dries up as the counter trend rallies take place. This is a general rule but at times it often reverses with the phase of the market you are in. The best chart to watch it closely is usually the hourly chart. It's best to combine a volume analysis with a bar time count like Fibonacci runs of 5, 8, 13, or 21 hours. Usually the low hour

hit after one of those duration moves is the turning point. Volume correlations often reverse in extreme parts of a run. At the start of an up trend big volume usually correlates with advances taking out overhead resistance, but much, much later towards the end of the move, the market rallies on light volume and starts to break down on heavy volume. This is the start of individual institutions that are starting to sell and the bids disappear as the volume increases, but once the seller is out of the way the shorts are squeezed and a light volume rally takes place. This next chart shows that kind of a pattern. The important thing to note is the opposite extremes of volume at the extremes of price whichever way they correlate.



The most basic feature about volume is that it drives prices. It may be programs running the market or major reversals in trend but when the volume shows up changes occur. This next chart suggests that you might want to keep a log of volume per hour and note the recent historic extremes. Good trades develop on the extreme volume bars plus or minus one bar.



When trading stocks you will see massive volume for about six months to a year at a major low breaking out of a base. Then the market will rise for perhaps three to five years on mediocre volume and at the final top huge volume will show up again for six months. You need a weekly chart for about 5 to 7 years to see this and if you take the time to do it you will get a better understanding about long term trends - no volume change - no trend change. Remember volume is basically tied in with 'sponsorship' by the big institutions that create bull and bear markets. When they are accumulating shares it's a bull trend and when they distribute them it's the start of a bear trend. The public doesn't understand that once the top is in and the volume shows distribution, *the bulls have absolutely no intention of buying that stock again- at least not for a year or more*. Buying dips in that kind of liquidation because it looks like a bargain will wipe you out. Light volume declines are okay but once the heavy volume shows up it usually is because of a fundamental change in thinking. If you see a month or so of record volume and no price headway its time to think about long term shorts.

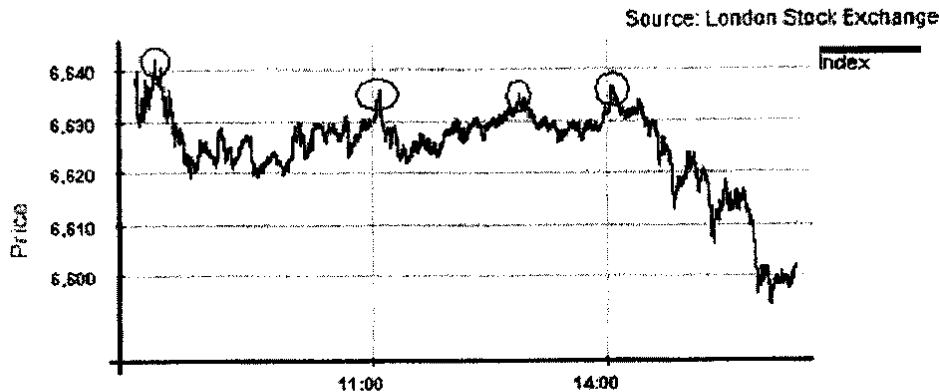
What Goes Round Comes Round

Cycles exist in the markets and patterns in the markets are caused by the human emotions of fear and greed. The frenzied buying and selling by the masses create similar patterns every few years and indeed, every few minutes. I suspect this is due to various natural cycles and for years I traded the markets off of the high tide tables for the Battery down near the New York Stock Exchange. I also noted that as the tides moved west with the moon's cycle the S&P's in Chicago often showed a second shadow of the New York pattern one hour later or more precisely the high tide at Chicago. As the global markets matured in the mid 1980's and electronic communications improved I had the opportunity to do some arbitrage with oil stocks in London that also traded ADR's in New York. I soon found patterns that were offset by a regular number of hours relating to the longitudes between the two cities. To make a long story short, it's very easy now to look at foreign stock market websites and see what the other markets are doing real time. On many days of the week, the patterns in foreign markets are later repeated in the New York market and vice versa. Some of this is due to natural factors and some just due to the fact that many stocks are dual listed on all the exchanges so round the clock trading can continue unabated. Since almost all of the big Wall

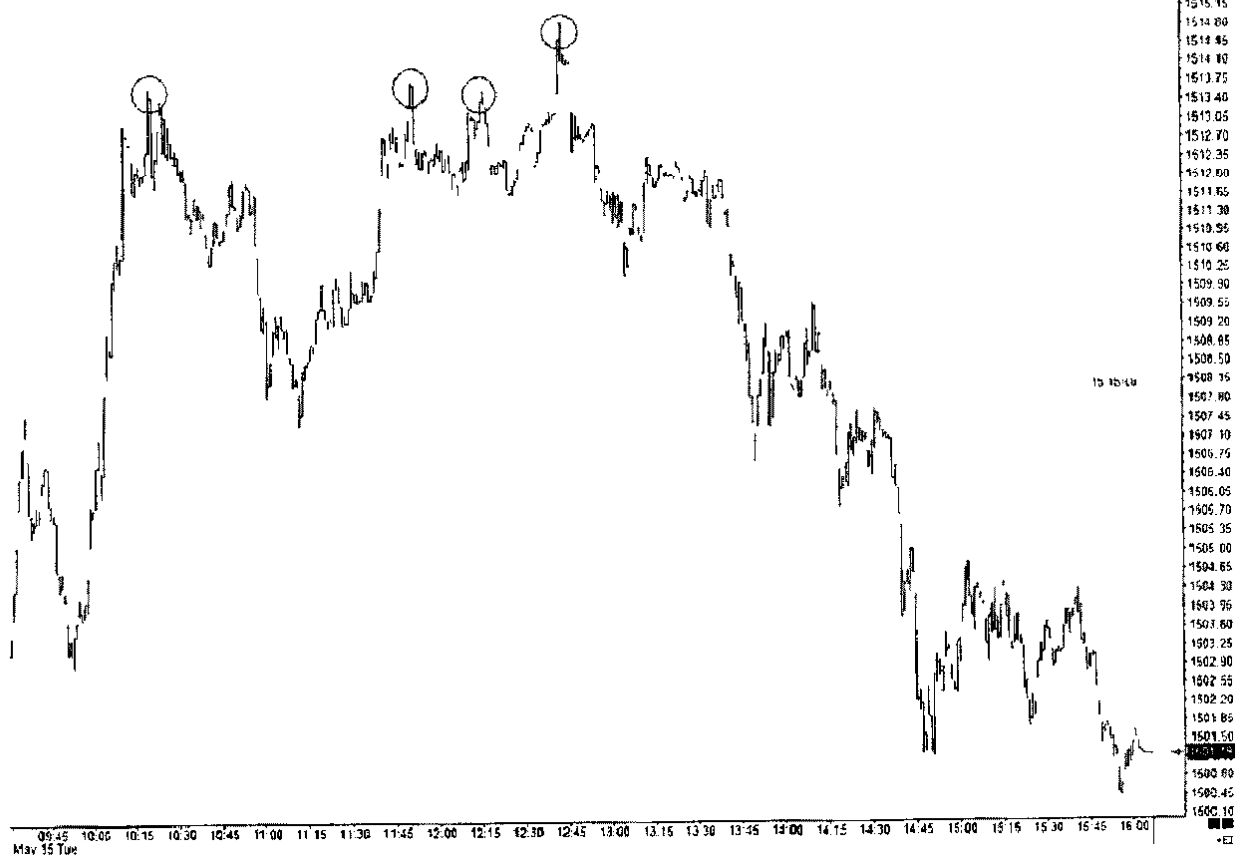
Street firms have offices in each of the major countries with developed stock exchanges, and those exchanges have dual listed stocks it allows the flexibility to execute customers orders round the clock in the various markets. Knowledge of these programs is perhaps what makes one market collapse in the last hour of trading and then in New York the same pattern emerges in the last hour. Maybe that is due to the sell program coming the next morning but I have observed intricate patterns that are extremely similar and are not due to programs. Without writing another book on the effects of cycles in foreign markets, my tip is to watch London each morning if you are trading New York, and then look for the Asian markets to often follow the New York pattern. The Asian trading hours are so different, however, that the patterns are not usually seen except with a 24-hour GLOBEX chart. The 4 to 5 hour difference between London and New York, however, can be seen clearly often with the exact Sun's displacement of 75 degrees (5 hours) that New York lies west of London.

This next chart is a tick chart of the London FTSE for May 22, 2007. Note the down opening and the labored advance until the last hour when the market went straight down to close at the low. The chart just below that is the Dow Jones for the same date. First note the four visible highs on the London chart during the day and then spot them on the Dow Jones market to see the fractal emerging for the day.

FTSE 100



15 16:07 C:1501.10 H:1501.10 L:1501.10 O:1501.10 V: 10 5:1512.50 05-15-07 M:1



Now the obvious top at 14:00 hours in London relates to the New York time of about 12:45 in terms of the pattern and that is not the normal 5 hour offset by civil time. The pattern, never the less, is very similar and if you can take my word for it after using it for 20 years, the *patterns* repeat

more often than not, so my trading day always starts with a review of the daily *patterns* in Asia overnight and especially London. I am keenly aware of patterns that have extreme high or low closes at the end of the day and at what time during the trading day the reversals occur. If you take the time to do this it will help your trading and you will not get trapped in a wrong way position going into the close. When the patterns diverge you can also surmise that one market has a program working and the other doesn't so you may be forewarned about program trading and the market may require range bound trading techniques.

Gimmicks Short Time Exposure

I have met many successful traders in my career and the common denominator is strict discipline. Many were psychologically insecure about their self esteem and that led them to extreme terror about realizing losses which to them was a public humiliation because they somehow made a mistake and they would do anything to get ride of losers as fast as possible. This is what really contributed to their success- taking losses very fast and letting their profits run. A couple of these types that I knew who later were mentioned in books as having made millions were so afraid of losses that they almost never traded in the market when there was *any* chance of risk.

When I first moved to New York in 1984 to work at a specialist firm I was placed in an office next to a very successful trader whose office was separated from mine by a big glass window so I could see everything he did during the day. I had heard of his reputation but one day when the managing director of the firm took me to lunch, I asked as to what kinds of returns this trader actually made and was he as successful as I had heard. The director told me that this trader had been there for some fifteen to eighteen years and in that whole period of time he only had three or four losing months. In many years his winnings carried the entire firm so he was considered a valuable asset, even though his personality was one of the most despicable of any human being I have ever met. One day I was trading the market and it was quite bullish and advancing almost every hour of the day. I had bought a lot of stock in the morning and was sitting tight until the end of the day, but I didn't remember seeing my neighbor executing any trades that day. Back then we all had very loud time stamp

punch clocks that made a big banging sound when we clocked our buy or sell tickets to time stamp them as required by law (this was long before computers took over). I hadn't heard him do that all day and I wondered if he was trading at all. As the day came to a close, and was closing near the extreme high of the day, I heard his time stamp banging relentlessly at about 5 minutes to 4 PM (actually it was a 3 PM or a 3:30 PM close back then- I don't recall exactly). I assumed he was selling his positions he must have bought in the morning and I didn't notice it, but I was surprised when he picked up the phone to call in his orders to our floor brokers on the floor of the stock exchange. He was buying! At 3 minutes to the close he bought 5,000 shares of 25 different stocks to own overnight. I at first thought maybe he was taking his lumps on shorts he had but later I found out that this was his usual practice. The next morning *before* the market even opened, he put in all those orders for sale on the opening price. Most of those 5,000 shares positions opened up \$1 and he was out, having made about a hundred thousand dollars *with market exposure of only about 3 minutes in time*. I later learned that he was a percentages player and only took sure bets. A market that closed on the extreme high of the day almost always had an up opening set by the Specialists who had stock to liquidate to the public who were chasing yesterday's rally. By buying right on the close and selling on the opening he had very little risk of any stock going down at all. In later years this method became obsolete with Market On Close basket programs that no longer had any stock left to buy and Specialists sold everything on the close, but the technique can still be used on individual stocks that have a dramatic one day breakout on great news.

One of the cardinal sayings of technical analysis is 'the length of the base is equal to the height of the move.' In other words, if you measure the horizontal time duration a stock or future trades in a basing pattern, when it breakouts to the upside it will go that distance vertically in price. Back when I was running mutual funds in the late 70's and early 80's I became the 10th best portfolio manager in the US two years in a row having annual returns of over 50% each year. This is harder to do than it appears when you understand that a diversified mutual fund probably has a portfolio of 100 stocks in it and half of them go sideways, 20% go down and to get a 50% return on the average the rest have to triple and quadruple. To get those triples I resorted to this simple rule of the base equal to the height. Most chart book services have it, but back then I used Investors Business

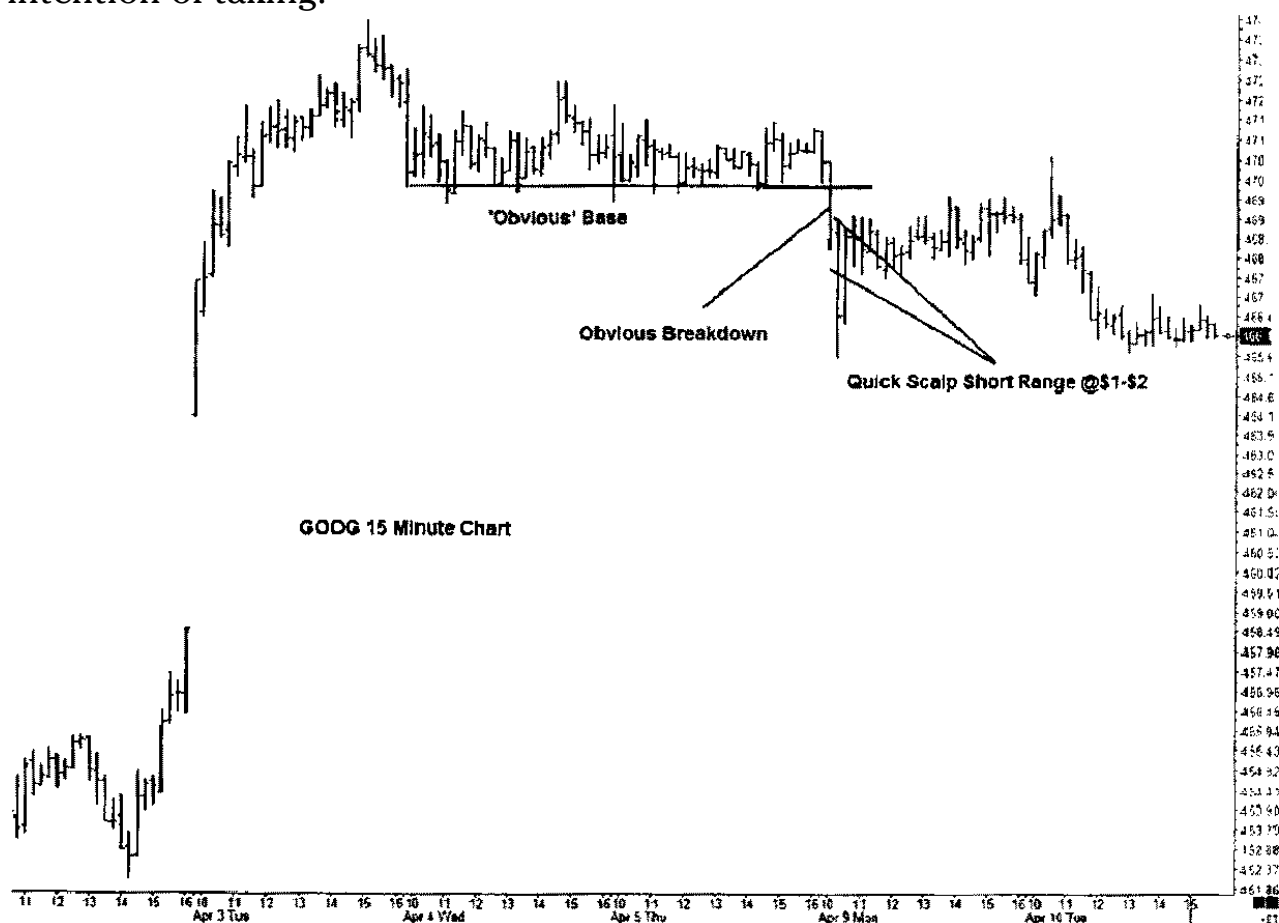
Over the past twenty years the definition of an Oxymoron was anyone who bought Occidental Petroleum. That was because it spent countless years trying to break out and failed every single time no matter what the hope for the future was. A couple of years ago it finally did break out of a huge base and then exploded. It's a perfect example of buying a long term base break out once the top of the base is clearly exceeded. The old failure tops were about \$30 (\$15 here because of a split) and once it broke above that it never looked back until it quadrupled.

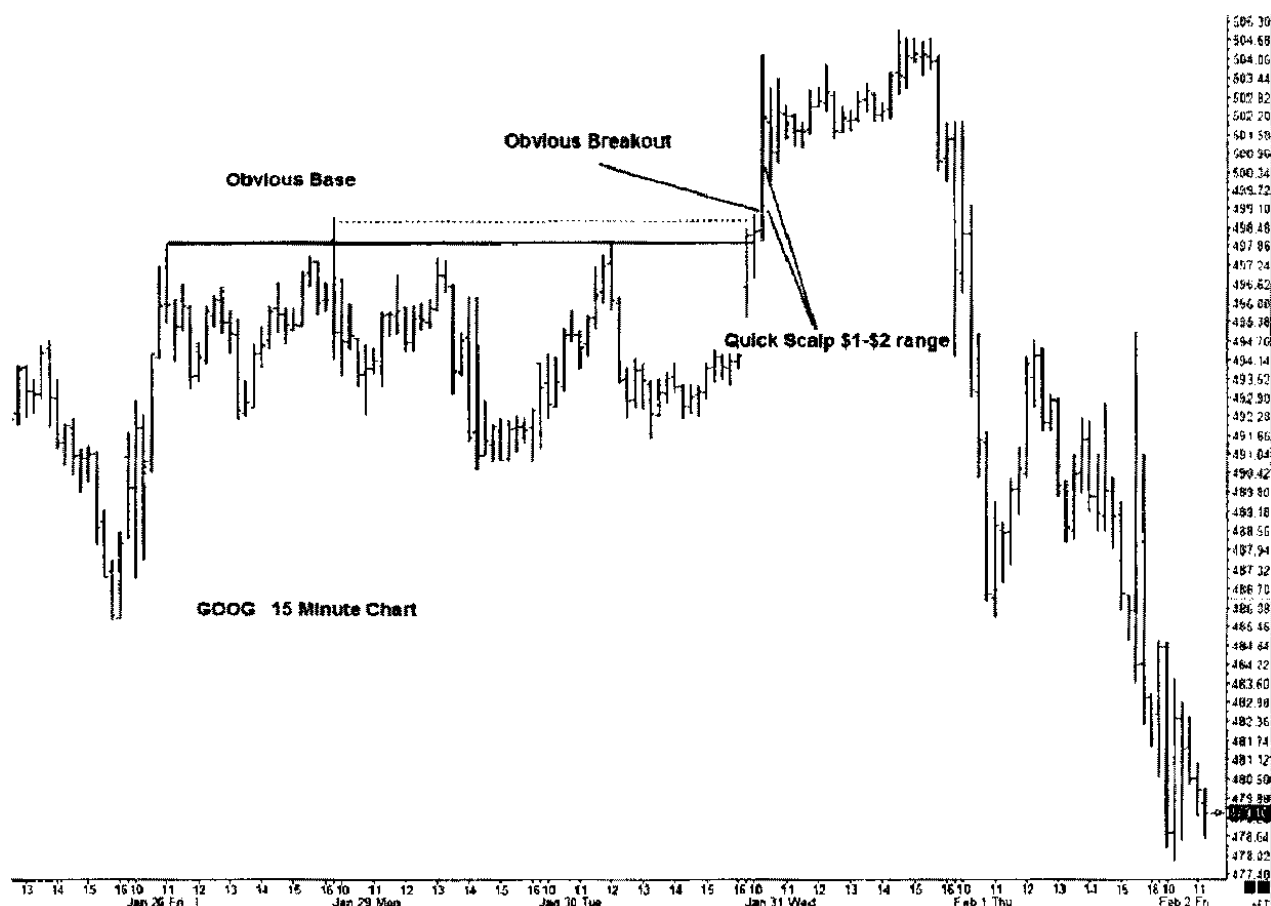


For over a decade I did TV commentary from the Stock Exchange floor and after one such outing a trader dropped by my office to ask about the cycles I had mentioned. He later became a famous 'Market Wizard' but at this time he was still developing his 'bet the farm' mentality. He was really risk adverse and was looking for sure thing trades that he could leverage up hugely for short periods of time. He wanted my advice on guaranteed cycles that always worked. Like the previous trader I knew, this one also had a personality which one would call antisocial at the least, but a big ego can sometimes help in trading if one is terrified of losses too. What his specialty involved was identifying long bases in the S&P futures that were long but at the same time 'obvious' to anyone who looked at a chart. He had a rare ability to WAIT endlessly for the right base. The base that if broken up out of, every person on the planet would jump out of their seat and exclaim "now they're really going to run!" When he saw that, he bought a maximum line of S&P futures as soon as the breakout *was obvious*. What he did next was unexpected and was the key to his success. He sold out immediately! Perhaps within 3 to 5 minutes. He didn't care if the market was going to the moon or that he could make a zillion dollars. What he wanted was a trade that was 99.9999% profitable all the time and he made up for the small price amount of the win by using huge leverage which later amounted to hundreds then thousands of contracts and netted him tens of millions of dollars with very little risk. Most traders would calculate a breakout potential target and patiently wait for that reasonable target to be hit and they would use a stop. He was only concerned with the smallest time exposure he could get in the market and still make money. A couple of years later when I read about him in the 'Wizards' book, I called his broker who was a subscriber to my newsletter and I asked him if the figures quoted in the book were exaggerated. I specifically was interested in the comment something to the effect that he never had a losing S&P trade in a year. I found that preposterous since the S&P futures are the most manipulated and volatile futures in existence. His broker who I trusted said not only was the book quote true but this was a year later or more and he still hadn't seen him make a losing trade at his firm! Such discipline is to be respected even if he may have left a lot of money on the table after all that waiting for the perfect base.

I have adopted a scalping method similar when trading the S&P's or E-Minis's or Dow futures, but the principle involves looking for 'obvious' patterns that are easily recognized. I need them to be recognized by other

traders so I can take advantage of their stops and entry points. These patterns can be bases, tops, or obvious trendlines connecting long advances and touching all the lows along the way. I then use two stop orders for entry and exit. I put the first as a buy stop (an upside breakout) slightly above the breakout level, and only slightly above that I put my sell order. This way I get a 'slingshot' trade which lasts usually less than a minute in time and only scalps .50 to .75 S&P points but it has a very high reliability. Doing that mechanically 10 times a day can add up to good 'house money' to be used for a trailing stop on a longer term swing trade that comes along. These kinds of 'obvious' scalps are best used with futures which always have plenty of stops on the books. Individual stocks also exhibit the behavior at certain key levels like the first crossing of \$100, which almost always goes 10% higher in a few days, 15-minute bases on heavy volume favorites like MSFT, AAPL, CSCO or GOOG can also work but remember the key is to take only 15 to 20 cents (on the inexpensive names) on perhaps 2,000 shares and get right out. Remember, these are 'gimmick' trades- a way to 'cheat' the system, and you don't want to stick with them too long or you'll get stuck in a long-term position you had no intention of taking.





Stocks like Google have lots of professional day traders in them along with lots of option buyers who cross big blocks of options. As soon as those blocks of options hit the tape it often causes a stampede into or out of the stock but it lasts for only about 10 minutes many times or until the stops are run or new options rolled up to the next strike (often the base *is* the option arbitrage placement). That's why you must make these trades with the intention of using *a single bar or two in time as your stop out* if your offering wasn't taken. You do offer your long or bid for your short in these trades at a predetermined scalp price, and not be concerned with how much you can make. You want to encourage some other trader to take your inventory since he thinks it will go obviously higher or lower. If your order isn't filled after a bar or two in time, you should liquidate at the market.

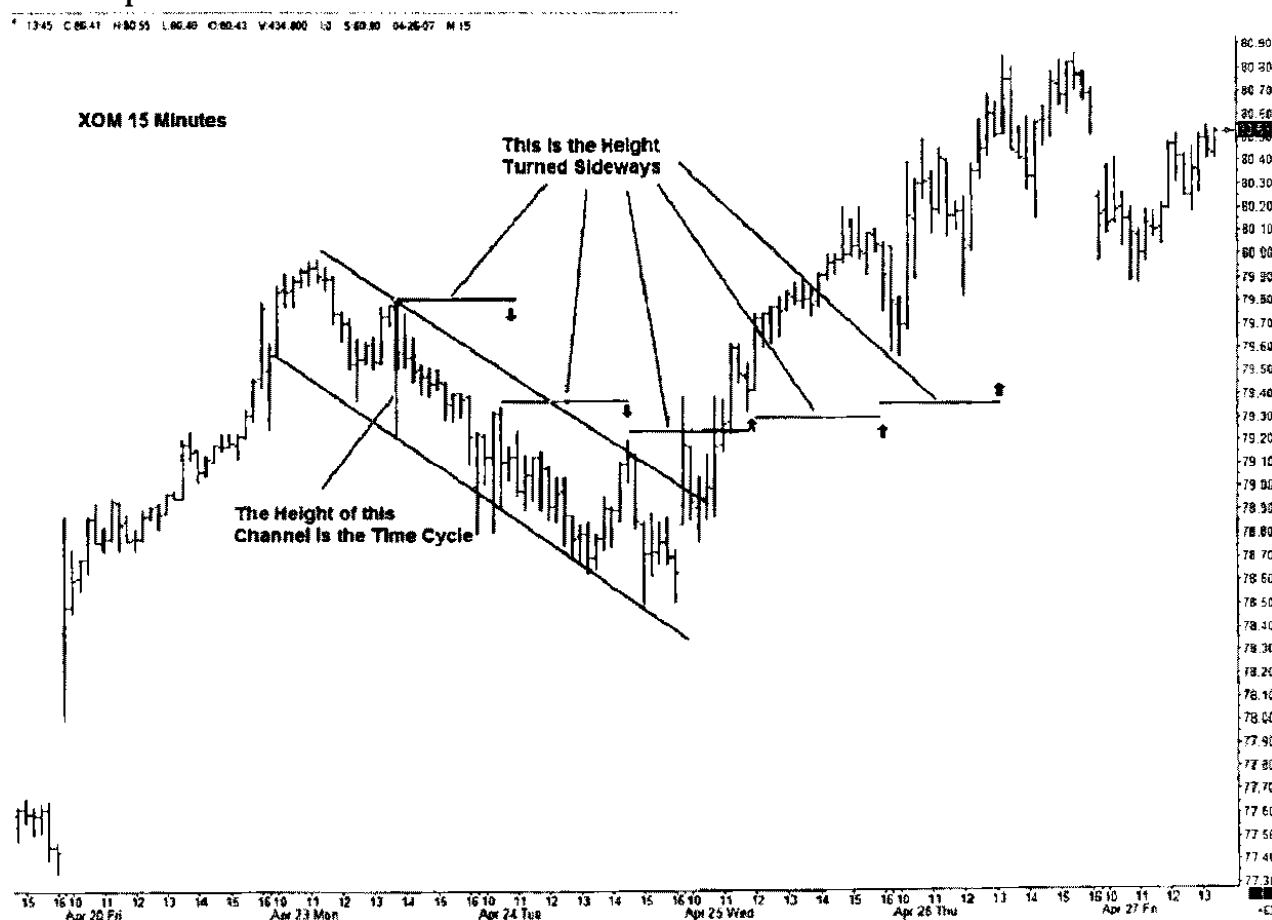


It is to be remembered that these quick scalps have little to do with real technical analysis and are considered gimmick trades. The idea is to quickly exploit the running of stops and repositioning of traders after a base or trendline break and so the trade must be taken off in only a few minutes at most, whether successful or not. The charts above all were executed, in and out, *within one trading bar*. Sometimes a quick scalp can quickly turn into a much bigger potential swing trade and you could use a trailing stop rather than a scalp, but you must be keenly aware at all times why you went into the trade in the first place and not start mixing strategies together.

Pattern Trades

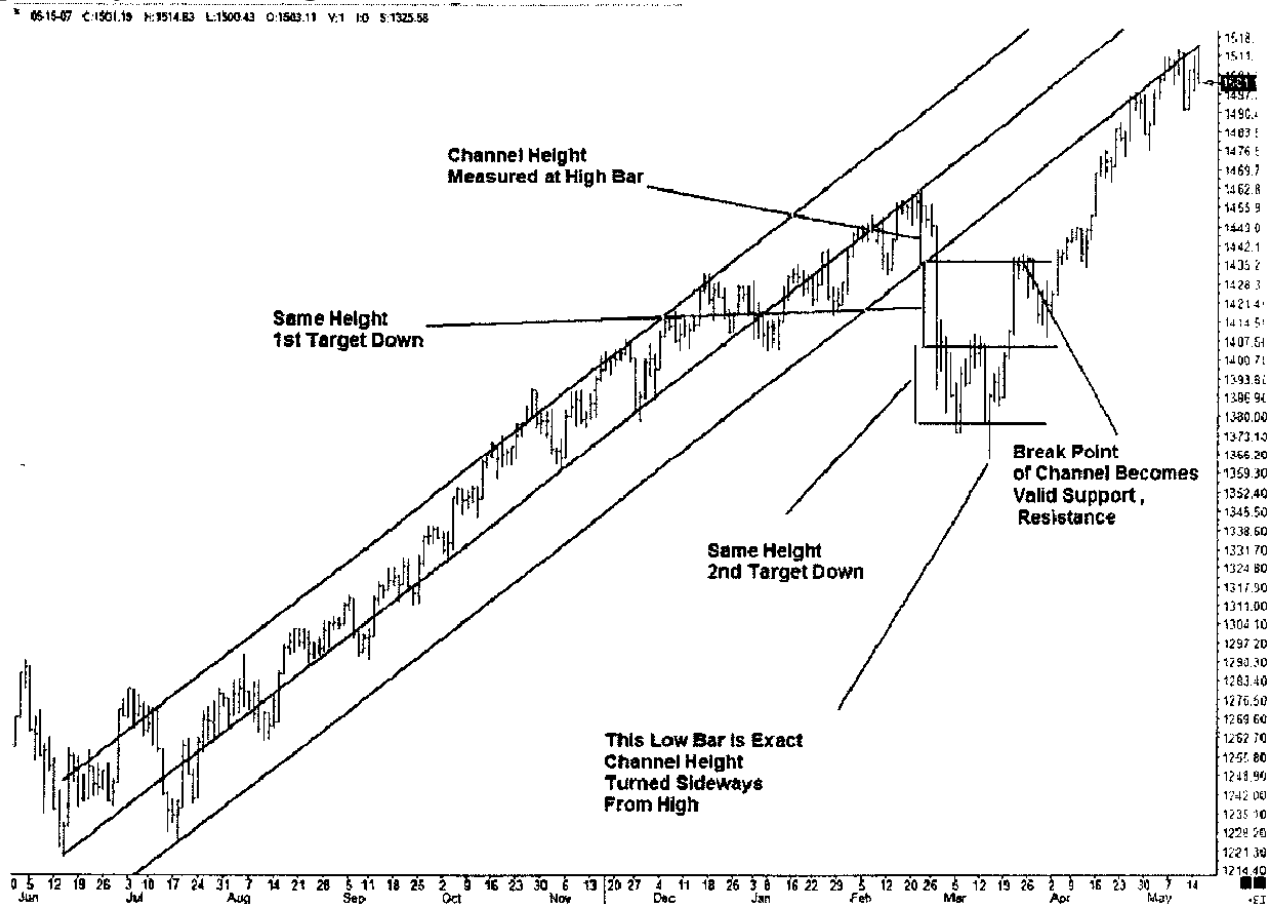
In a way a pattern trade is a type of 'gimmick' trade since it is not entirely based on supply and demand reversal points but probable repeating patterns from the past that seem to work a lot and we are often trading off of other peoples perceptions. Similar to obvious bases are channels. Parallel channel lines can be seen ascending, descending, or just flats. The thing to note about parallel channels is that the 'height' of the

channel is also the TIME CYCLE that is operating. In other words if you measure that height and turn it horizontally, you will see where the turns in the stock or future come out. It is the rhythmic time cycle that causes these tight formations and because of that, they can be quite reliable. This very short-term chart of Exxon shows a descending channel with its height turned sideways to show cyclic time cycles. The cycles that operate in markets operate in all vector directions and we can see this by drawing a radius circle around the cycle length. This has a number of trading implications that we can exploit. The cycle length is also a type of 'measured move' in all directions, so once we have it defined we can trade at its extremes. The typical rule used with a parallel channel is that when you break out of the channel you go a distance equal to the channel height (because there are multiple parallel channel lines above and below). Take a look at the chart again and look where the stock broke out above the top line of the channel. The first bar top after that was the exact height of the channel. If you measure one and two more heights up, you will see the next top bars.



Another thing you can do with channels is put on my offset angles. Channels define very well the actual slope of the advance or decline, so

offset angles from the channel give good forecasting angles, and remember the strongest angle is the 90 degree one, so as soon as that breaks you can reliably reverse your trade. The basic principle, however, is that you should think, and trade with the height of the channel as the primary measuring tool.

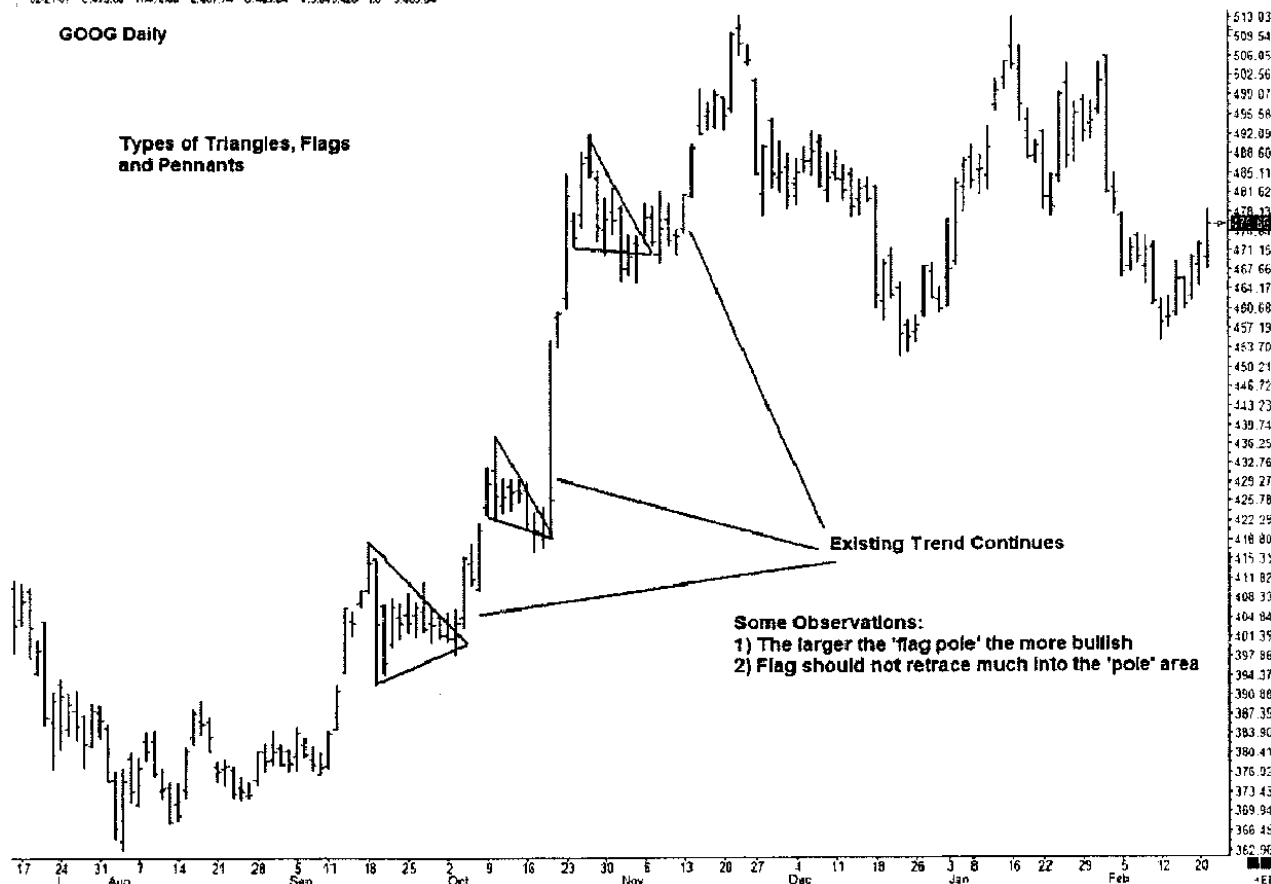


in that a very strong advance is due to very strong supply demand imbalances and after a brief pause the advance will start again.

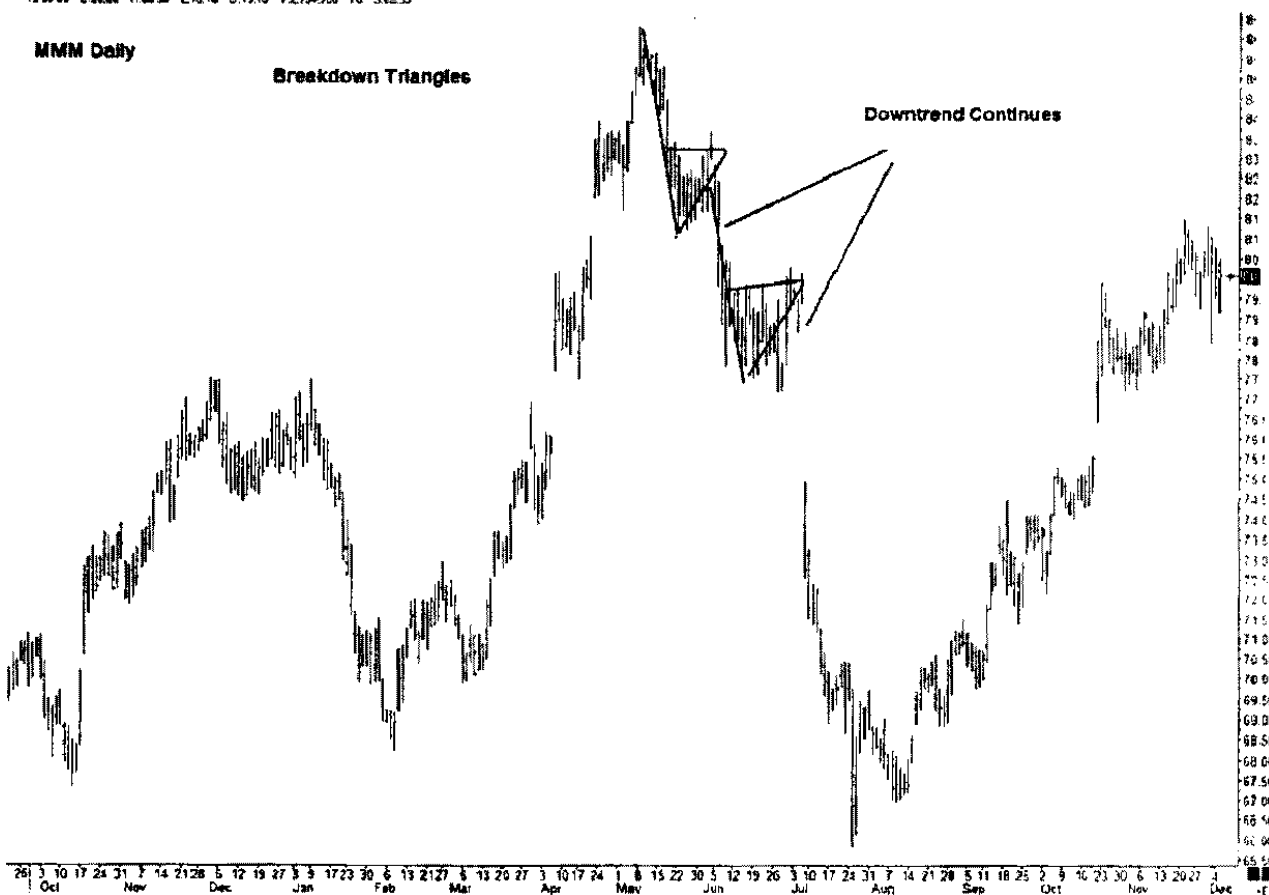
02:21:57 C:475.86 H:478.68 L:467.74 O:463.84 V:5,643,426 I:0 S:489.54

GOOG Daily

Types of Triangles, Flags and Pennants



Flags point up explosive market opportunities so they should be examined carefully. They usually occur as a larger time frame is undergoing a breakout so the appearance in the smaller time frame is that the market is 'extended' and it's a short, when the opposite is true. The *key point is do not get complacent* when you see a flag. Something big is about to happen. That's why they are waving a flag!



Flagpoles and flags arise from common bar characteristics. The pole is the 'elongated' or 'big' bars we see in impulse waves and as the flag forms we see little overlap on the downside from the last bar up (they can break one, but not two bars). This shows great strength. The other part is the flag or pennant shape. Some are 'symmetrical' triangles where the two horizontal sides are equal angles that converge to a point, and the other type is a 'wedge' with a flat side and a converging angle side. Usually 'wedge' formations are stronger since the flat wedge side is always stronger and shows a firm solid bid or offer to the market and the declining angle side shows anxious competitor sellers who dry up before the 'flat' side of the wedge buyers are filled. Then the next leg gets underway. The length of the flagpole is usually a measured move distance and sometimes a weekly or monthly range distance. The flag size is a quarter or third retracement area of the pole, which shows strength. My basic advice is to look for patterns that have one side as a level flat, and the other an inclining angle. Most times the inclining angle side will be broken out of. Then you will get another measured move leg.

Characteristics of Market Players

The movements in the market are caused by various buyers and sellers, and a knowledge of who they are, and why they do what they do is necessary to properly understand the market. Most of the big bull markets, and bear market liquidations, are due to mutual funds and pension funds that have very Long term capital to employ. They are 'buy and hold' investors by necessity, and rarely sell except for individual issues that disappoint on earnings. A long standing phrase on Wall Street is 'distribution is done after the top is in'. This means they sell on rallies *only after they are sure the final top is past*. This accounts for the chief method they use to buy- they buy at all new highs, and they buy relative strength issues. Traders who short tops make the classic mistake all beginners make. They try and predict the one and only one top. In truth a bull market lasts for years and only one solitary day is the final top. Shorting the other 500, 700, or 900 days that make new-highs on the way to that one single day is a basic losing proposition. On the other hand, buying new highs will almost always make you money if you can wait for three to four days since that's about all the pullback you see normally in a strong advancing market before another seven or eight day run to another small three day pullback. If the market goes sideways for a week or two and then hits a new high, a huge amount of new buying will come in sending it up another two or three weeks.

Most institutions know this and they develop lists often just taken from daily newspapers that show the top 100 relative strength stocks or a list of stocks hitting new highs every day. I have known day trading firms that will fire traders who frequently short stocks making new highs since it shows a basic lack of understanding of how the market works. Although I myself do short highs occasionally, I only do so based on cyclical analysis and usually wait for a signal reversal bar breakdown with a stop at the high. I also use the 'overlap' strategy for small scalps only. Most institutions that buy new highs look to improve their odds by looking for a stock that hits a new high and bidding \$3 under that price or waiting for a 3-day dip. The odds are great that at least a test of the high will be made and then they can use a stop at their entry price. Most aggressive day traders filter stocks by short term moving averages and find those that are

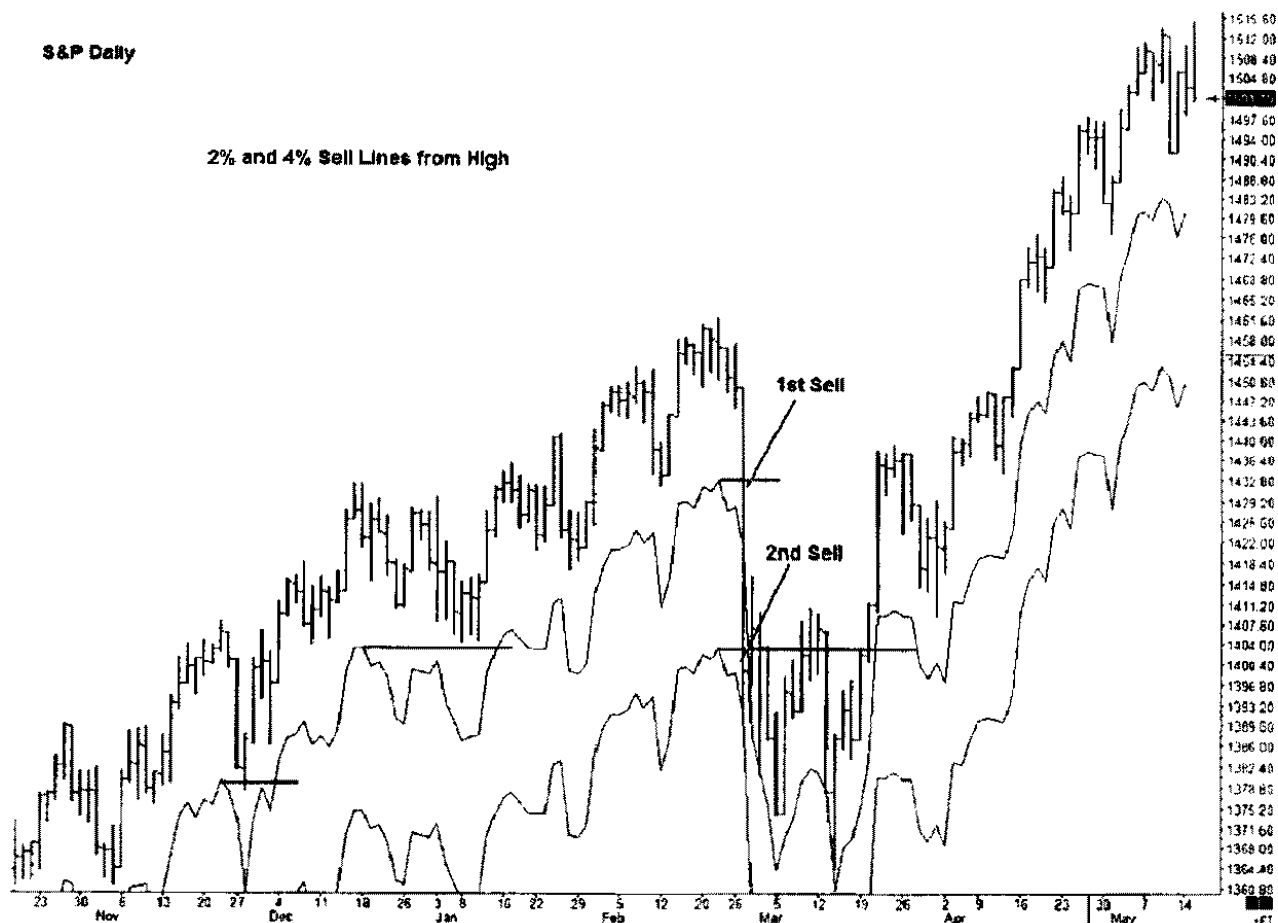
the greatest distance above the moving average because those are the ones in heavy demand. So we see that buying highs is the primary method of investing, but how do they sell? Most institutions never sell unless they get a fundamental earnings deterioration in which case they often sell on the spot. Because of the tax laws on mutual funds most funds *can't sell at a gain* unless they have held it *for at least three months* after they purchased it. They can sell at a loss, however, so they may sell soon after a new purchase if the market goes back down. The legal tax problems for mutual funds with selling stocks held for less than 90 days, is why after a sharp decline, once the volume dries up the market usually goes right back up and we don't often see tests of the lows anymore. The funds can't sell unless the market goes down and it usually won't go down unless they sell. There is also a new algorithm being used by many institutions, which recognizes the fact that volatility *only* increases when there is uncertainty and the market is in a downtrend. Under this algorithm the funds continue to sell as long as the volatility increases, and once it starts to decline they stop selling and resume buying. The VIX volatility index is usually the one they watch for signals and you should too as it accurately reflects the changes in option premiums and that always means someone big is buying or selling a lot of options and knows something. All crashes in history are accompanied with volatility increases so this new mathematical algorithm fits much better than the old, 'sell on a break of a 200-day moving average method'.

On a day-to-day basis the big institutions only perceive market corrections as 5% to 7% with a rare 10% one and a bear market a 20% one. As a result they do nothing on a dip of 1% to 3% but use a formula method to sell if the market goes down 4% since that may mean a drop of 5% to 7%. If the market correction exceeds 5% they sell a little more and if 7% they sell more until 10% is reached. You can take advantage of this by using 3% to 4% envelopes on your trendlines and parallel channels. If the market goes lower than 2% off a high, a major correction may be underway.

Envelopes around your chart prices often point up numerical sequences at play and the common Fibonacci sequence of 1, 3, 5, 8, 13...etc. can also be used as percentage envelopes. Always keep in mind the 'vector' nature of the market and when viewing these envelopes remember to turn the vertical price distances horizontally to get time cycles based on the envelope width.

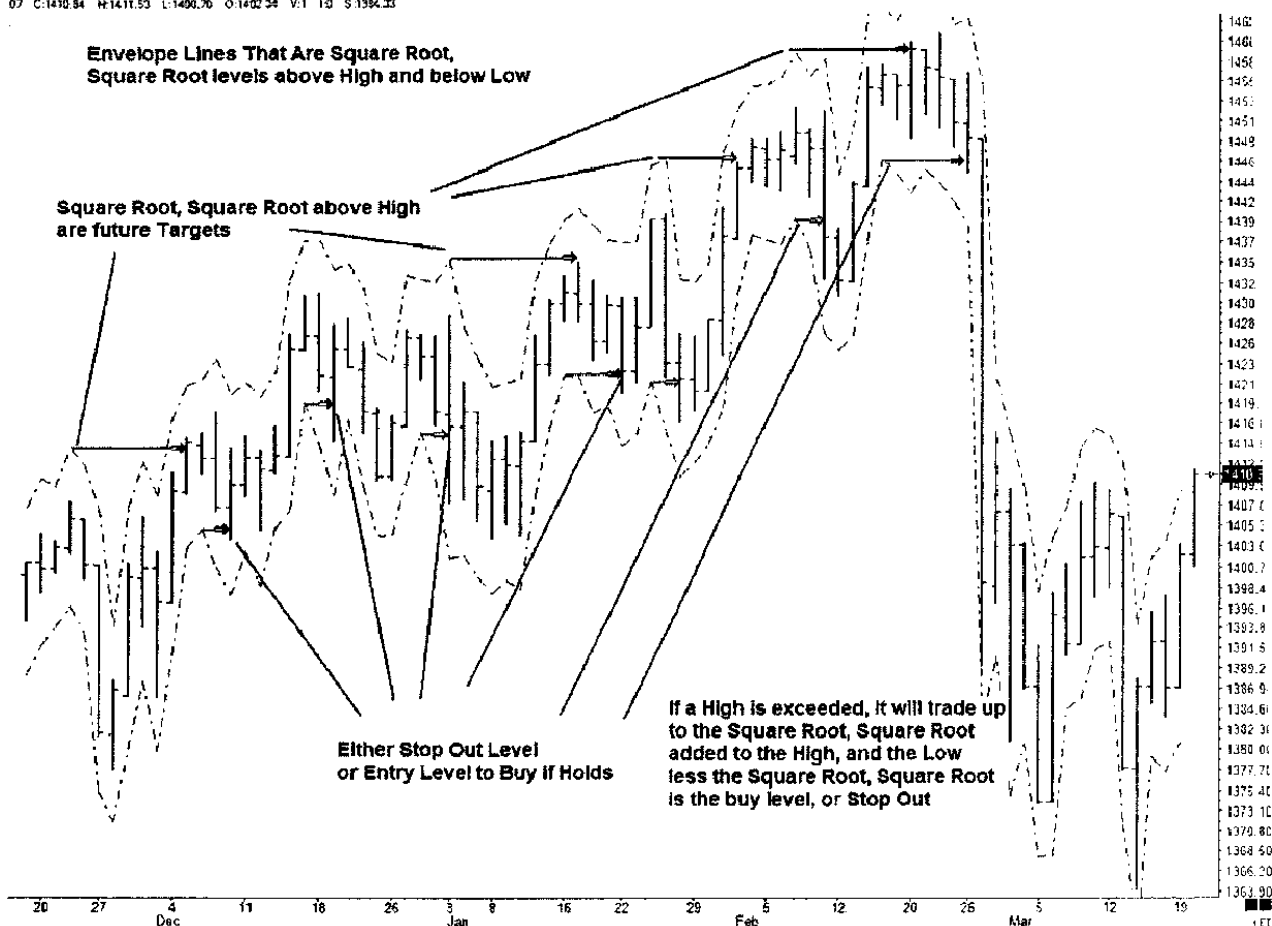
S&P Daily

2% and 4% Sell Lines from High



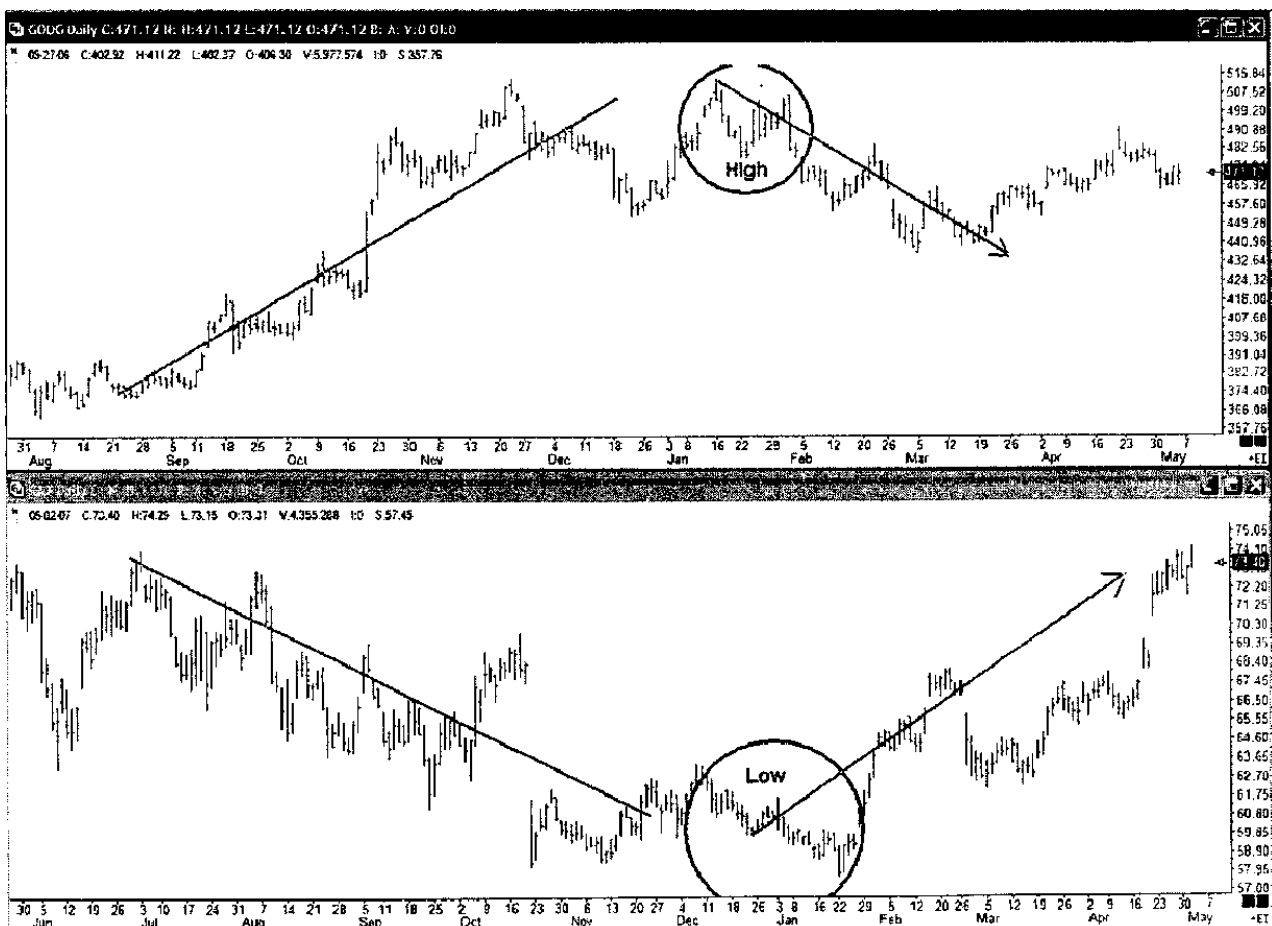
This chart shows trailing lines of 2% and 4% down from the high bars. You look at any high *established for several days* and draw a horizontal line across the 2% trailing line to get the trigger point. Another trigger cuts in at 4%. Also note that the 2% isn't hit in strong trending markets very much and you can equally use it as an entry point to go long with a stop if the market bounces up from that level.

While the institutions like to use simple percents, I have mentioned previously how I use the exact 'scientific' levels for support and resistance and these are related to the square roots of the highs and lows. This next chart shows envelopes of the square root, square root, of the high added back to the high to get a future target once that high is exceeded, and the square root, square root, subtracted from the low as a target to either buy a correction, or if exceeded, to stop out longs and go short.



Big institutions usually are restricted to being fully invested in the market at all times because, at least for mutual funds, they have filed a prospectus with the SEC stating their investment style and that is rarely 'market timing' and mostly long term investing.' They have to produce quarterly snapshots of the portfolio on the last day of each calendar quarter (but this is THEIR fiscal quarter and many funds have 'oddball' year ends, especially October) and this snapshot had better show near 100% investment or they'll get complaints from the SEC. Of course the day after quarter end, nobody will see what they have for another 90 days so they often liquidate huge amounts of the portfolio the next day at year-end and quarter end if they get nervous. To liquidate, they use the old Wall Street maxim 'they take them up to sell them down'. What this means is that the big brokerage firms that are hired to liquidate these portfolios will usually put on a big buy program the day before with house capital and they will establish scale up shorts during this rally along with buying out of the money puts and shorting S&P futures. The next day or so the real liquidation begins. You should watch for these patterns **two to three days after** an important quarter end that has just seen a rally.

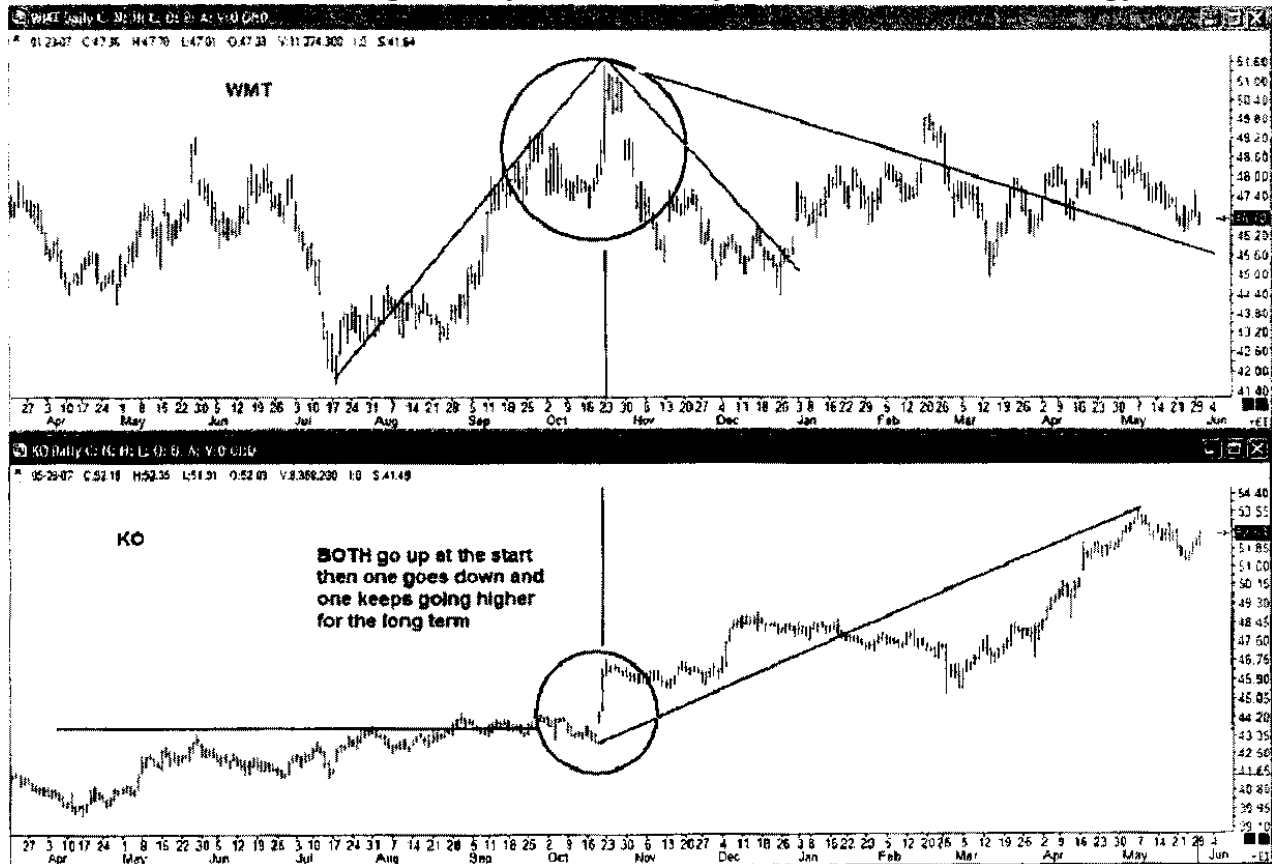
Even though mutual funds and pensions like to stay fully invested they often do 'rotate' their portfolio names around at different times. One of the really big keys a trader must learn is how to spot this rotation. This almost always occurs coming out of a big bottom correction where the 'new' names go up quickly and with great relative strength, while the older traditional leaders of the past several months only get a token bounce. Using relative strength scans on a list of stocks can be of benefit coming out of these lows as opposed to everyday where it is of little use. Sometimes it's easy to set up two or more identical windows to look at the patterns to see these changes in trend. Below are GOOG (top) and CAT (bottom). I also keep lists of dates of tops and issues topping on those dates.



Remember when this takes place the general market may be flat with little noticeable change while the individual issues could change dramatically. Coming from a past career as a mutual fund manager I can tell you the daily fear of all managers: Don't let the N.A.V (net asset value) Drop A PENNY! Each night after the close all mutual funds calculate their net gain and losses for the day and calculate the NAV and then send it to the newspapers. If it drops it will bring in redemptions, especially if the

market was down big and the public is scared. Many funds employ devious methods to make sure their NAV's outperform a big market break by adding to their largest positions at the bell on a big down day, but often they just rotate. Prior to aggressive rotation the fund manager quietly accumulates a new position at a limit price for several weeks, or he cleans up an existing seller liquidating at a big discount low. He won't go off the limit until he has several million shares or at least a meaningful position that will impact the bottom line of the fund. On the date of a market top or bottom he will then start to aggressively sell down the big winners he's getting rid of and at the same time recklessly buy up the new position so that the net change in both prices and the amount of shares of each exactly offset themselves and the NAV therefore stays flat. Sometimes this will require taking the new name up \$2 and the old down \$1. Also remember that 'distribution' is always done after the top is in. This means that after a big rush to a final high on a leadership name, there will be a very dramatic break of perhaps 10 points on heavy volume as the fund quickly tries to get out. By taking it down very hard like \$10 it will generate a thousand small fry bargain hunters who missed the stock on the run all the way up but now will eagerly buy it since it looks like a bargain, well off its high. The rally back will be labored with very heavy volume as the fund sells out. At the same time he is also aggressively marking up the new name to get it as high as possible as quick as possible. This accomplishes two things. It makes his NAV go up since the old stock is being sold on a rally, and the new name is also going up. The other thing it does is it advertises his position and he gets latecomers to the stock to push his position behind him. In other words he is now getting sponsorship that will work for him and never let his competition get as good an average cost as him, hence he'll have a better annual return, and he smashes down his old name which also traps his unwary competitors forcing them to liquidate after him again reducing their annual returns. This of course only takes place at the level of the largest most competitive firms but it is a standard method that can be seen on the tape and identified. One of the old time great mutual fund managers had the nickname 'the mad bomber' since he always placed 'at the market' orders for sometimes many millions of shares of a thin stock and would place the orders competitively with several different firms so they would all fight themselves to do the order. His sales of stocks would often crash the stocks down \$3 to \$4 or more on the first day. That way he could insure he would destroy his competitors

who didn't follow immediately and still had millions of shares long in a scary looking market losing its confidence with every firm on the street selling. I always thought he should have gone to jail for that stuff but it lasted a good decade before he stopped either because he got too big or the SEC said something. In any event many still do use the strategy.



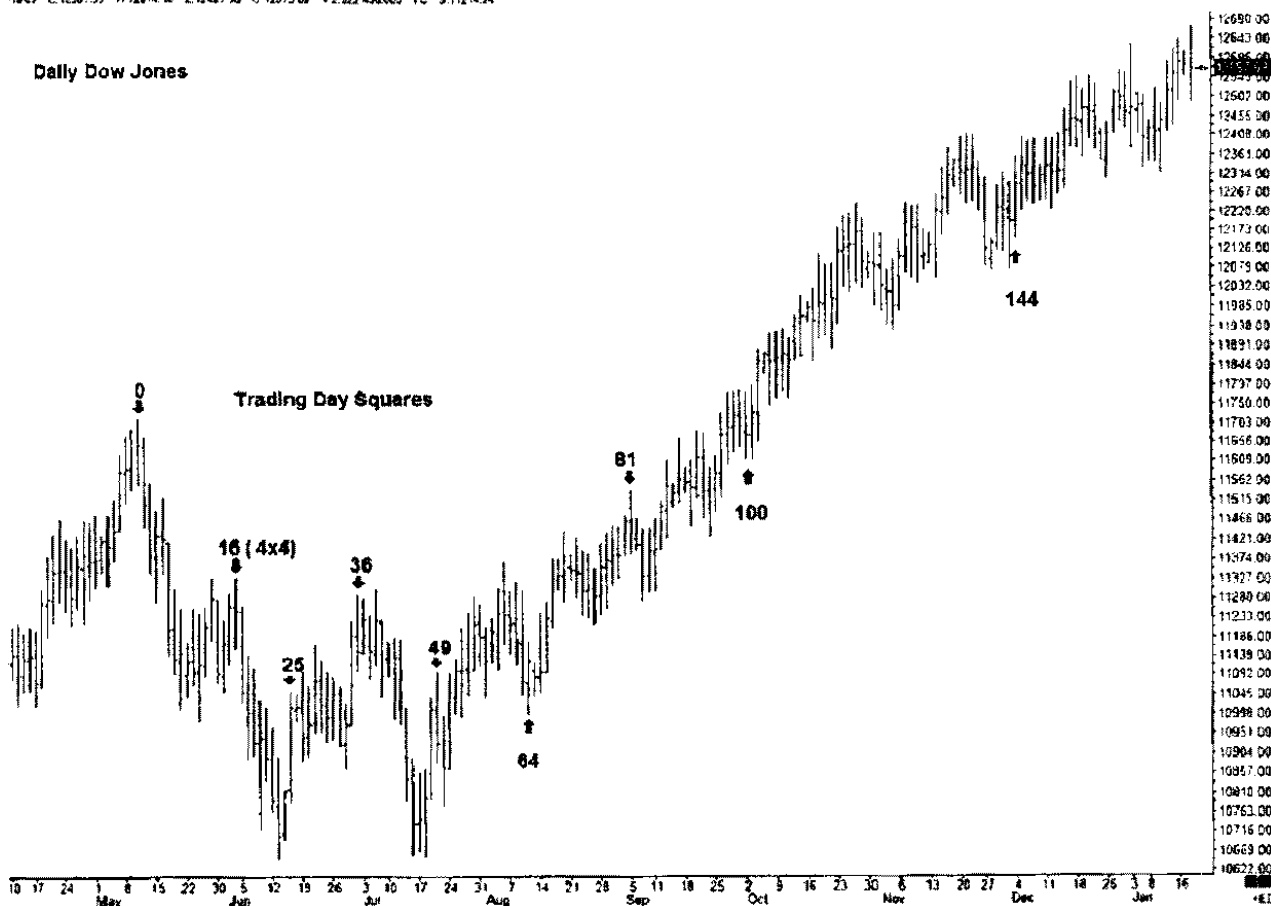
Institutions always invest with a fundamental bias. They look at growth in earnings and on a rough theoretical basis if a company grows its earnings by 20% a year, the stock should go up 20% a year. The price to earnings ratio (P.E.) can vary under different interest rate scenarios with higher interest requiring lower P.E.'s and low interest rates supporting high P.E.'s. Most institutions screen a universe of stocks to find those with the highest growth rates, best balance sheets, and quality managements. Most will concentrate in the 'best of breed' stocks, which are the leaders in their industry and will gather a larger percentage of the industry profits. When you trade you should start by selecting your particular universe of stocks from among these leaders. It doesn't pay to discover new ideas. They take too long to find sponsorship and can't go anywhere. Also keep away from cheap stocks. Many institutions are prohibited from buying stocks under \$5 and sometimes \$10, and many pension funds can't buy stocks that don't have a dividend. Don't be afraid to buy expensive stock

either if they are making new highs. Fundamentals always spawn differences in opinion on what something is worth and stocks that grow at 50% a year can often do so for 5 years at a time. The compound growth on such a return cannot be understated and long term investors will frequently buy such names with *no intention of selling* for at least five years. This can make the stock extremely 'thin' and volatile but it rarely makes it go down unless there is a clear earnings blow up. Your first job is to select a first class group of stocks with great earnings and visibility, and try and diversify into several groups like health care, drugs, semiconductors, chemicals, computer and technology, internet, etc. You should stick with these same stocks for the rest of your trading life. Then you will learn all their particular patterns and nuisances and you will have a few going up and going down all the time with the various economic cycles. The other advantage with sticking with what you know is that there is a lot of work involved in counting time cycles and trendlines and once you do this on a long term chart like over 10 years, most of your work will be done for the next several years and you will always be prepared.

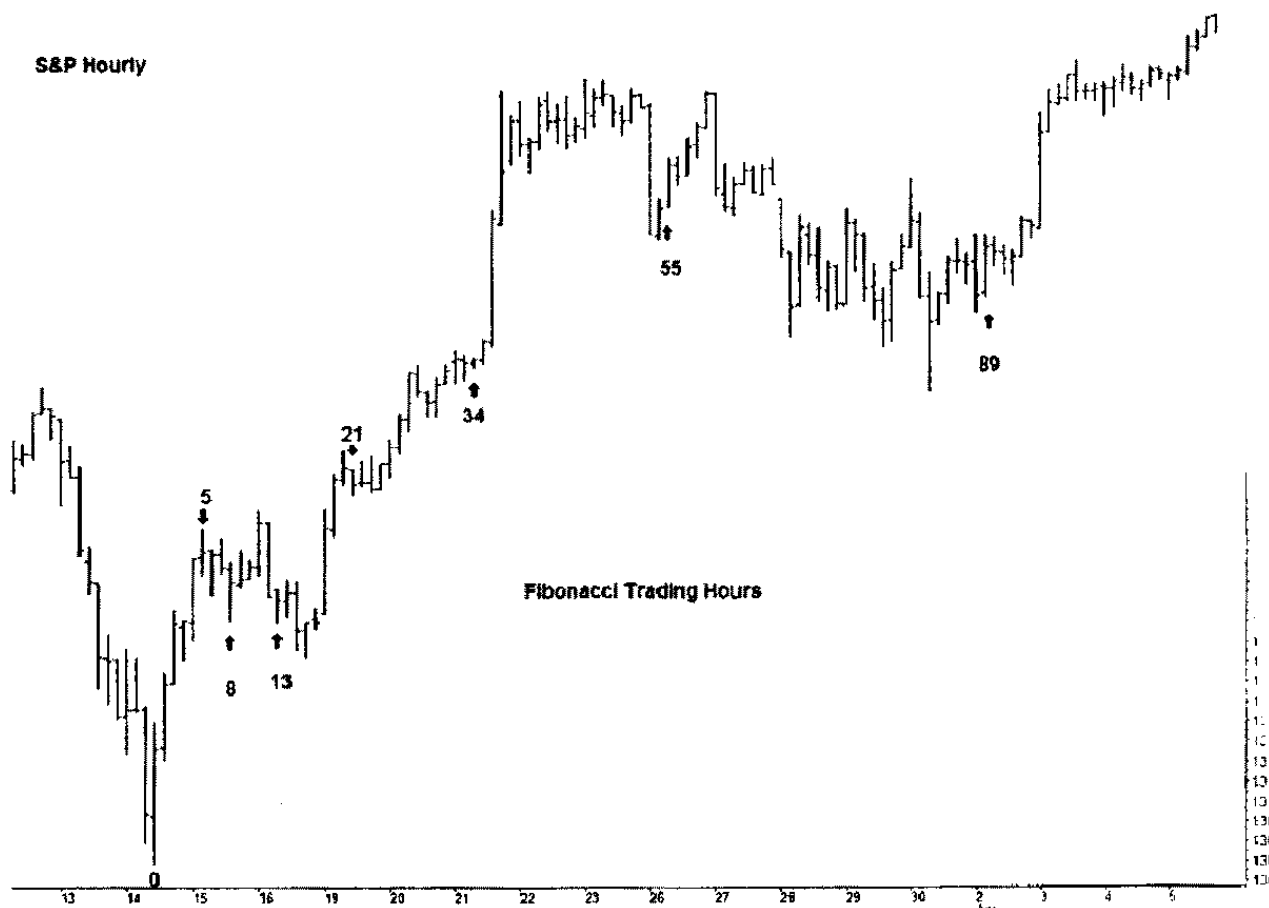
Basic Time Cycles

A basic knowledge of time cycles frequently operating in the market is a great help when trading. These cycles can be big yearly ones like the decennial 10 year patterns or the 4-year cycle or daily and hourly ones used for day trading purposes. For most day trading purposes simple Fibonacci hourly counts are important as well as the squares of numbers. Fibonacci numbers are an additive series with each number added to the number before it to get the next. All additive series eventually converge to the Fibonacci ratio of 1.618 between each number and its neighbor. On daily, and hourly charts these series can be seen clearly as well as the natural squares. I've talked about the square roots of highs and lows but in terms of time the full squares show up very well. Numbers like $2 \times 2 = 4$, $3 \times 3 = 9$, $4 \times 4 = 16$...etc. These cycles come out on all time frames and it's a good practice to keep track especially when a long move starts to mature. Most computers have various cycle finder tools and it's always a good practice to check them every few days just to make sure you don't over look something.

Daily Dow Jones



These trading day squares come out but so do calendar day squares so watch for both. Not shown in these charts but integral to them is *the fact that most times when you see a square date, the price on that date will also be a square increment from the starting price*. This is why it is so important to keep running totals each day for both the number of days or bars from the last low or high, and also a running total of the net price change from that starting point to the prior days close. The one point per day trendline can do that easily, but sometimes traders find it just as easy to have a tabular sheet of net differences. If you can get organized enough to do this, it will greatly improve your trading results.



Keeping track of the hours from a low or high will give you a 'heads up' on potential reversals approaching. These Fibonacci numbers often turn the market (as do squares). What's important, however, is to note how far along you are *in a trend* with the hourly counts and as you near key numbers watch for signal reversal bars.

In the simple reversal bar section I said that they reversed quite often and if you take every signal reversal you would get chopped up quite a bit. Waiting for extended runs on the hourly chart and then looking for reversal bars is a much more productive exercise.

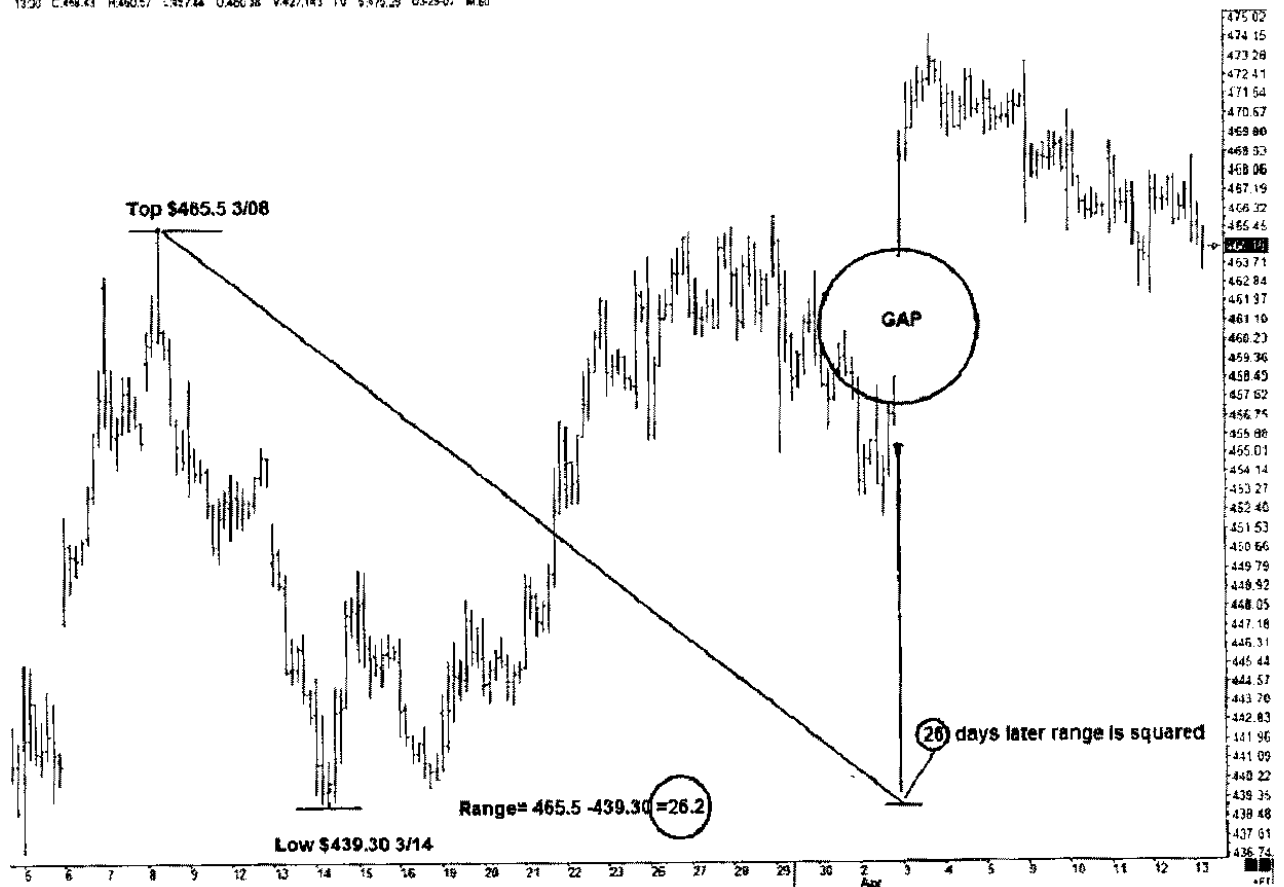
The chart below shoes how a steep advance holds a trendline until just about the 55th Fibonacci hour and then breaks. It then has a decline phase that lasts a Fibonacci 34 hours and breaks out again. Also note the break going into the 55 hours merely pulled the price down to a 1 x 1 angle so the price was up 55 points from the low on the 55th hour, a perfect square out so the trend turned back up at least for the very short term. The angle of descent from the high was both a natural 60 degree angle but note it was also a 90 degree offset angle to the slope of the advance angle.



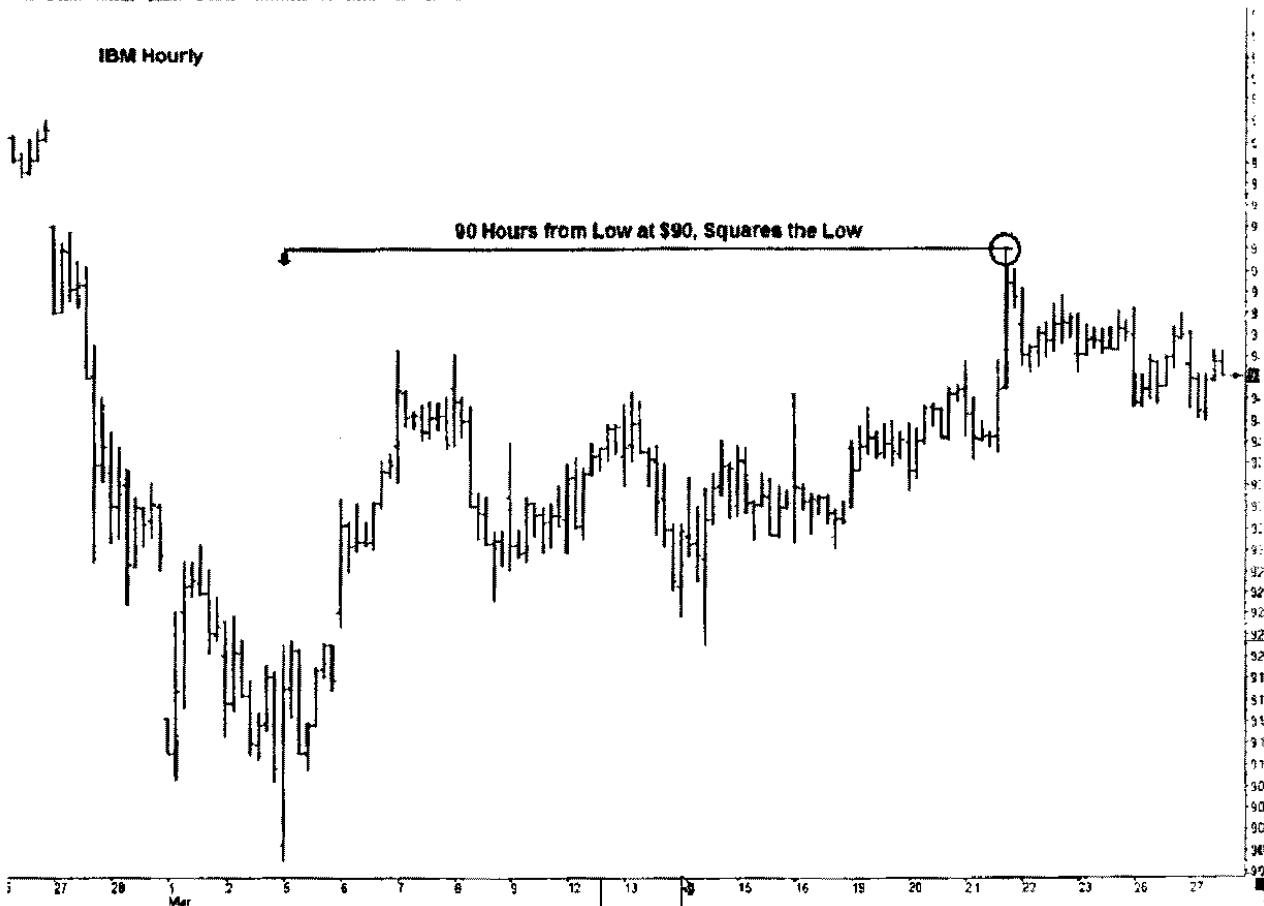
While not technically 'cycles' there are various time and price relationships that change the trend in prices and require keeping track of the passage of time. There are three basic squaring techniques that make stocks change directions. They are 1) square the high, 2) square the low, and 3) square the range. What we mean by 'square' is create an equality of time and price. This would be the case if a top at 50 is now 50 days or hours or weeks later. Then the passage of time would equal the price. The easy way to do this is with a 'timing' line or an angle that moves at the rate of one unit of price for one unit of time. The same angle can square the range by going down from the high and when it intersects the low price the difference between high and low, or the range, is squared. The thing you must do is keep track of the days or hours passed from the origin and the number of points gained or lost. This next Google chart shows two timing angles, one moving 4 points per day, and one moving at 1 point per day. Big turns occur when the price rests exactly on the angle showing the equality of price and time.



On this chart I show the equality of calendar days equal to price advance but trading bars would work just as well. The key idea of a 'square out' is that change can only occur on a date with equality of price movement and time duration movement. Sometimes that 'change' is another strong leg up in an existing trend, while sometimes it is a complete reversal in trend. Watch for signal reversal bars, or momentum 'big' bars to know the difference. These reversal bars will coincide with the time count.



Here, Google's top 'squares' the low on the number of days later that the range was equal to, i.e. a one point per day trendline. A huge up gap in the chart shows the result.



This IBM hourly chart shows a high on the 90 hour from the low price of \$90. Also note the 89th Fibonacci prior bar was the big up move. I have identified the 90th time count with a 'horizontal' line but note that in actuality it is a 'zero' angle starting under the origin date and reaching \$90, 90 hours later. That zero angle is hard to draw on a computer chart without vastly distorting the price scale but if you calculated it and drew it you would be able to identify more support and resistance when the price hit such angle. Also of note is the 'symmetry' of the 90 hour high bar and the 90 dollar price low bar. Both were extremes of the same 'height' telling you they were connected.

Very early in this book I mentioned how the 6.5 hour NYSE day could be divided into eighth's and tenth's. These can easily be calculated from the free program found on my website. These natural time cycles can either be started from the beginning of the day i.e. 9:30 AM for NY, or from any major high or low within the day.

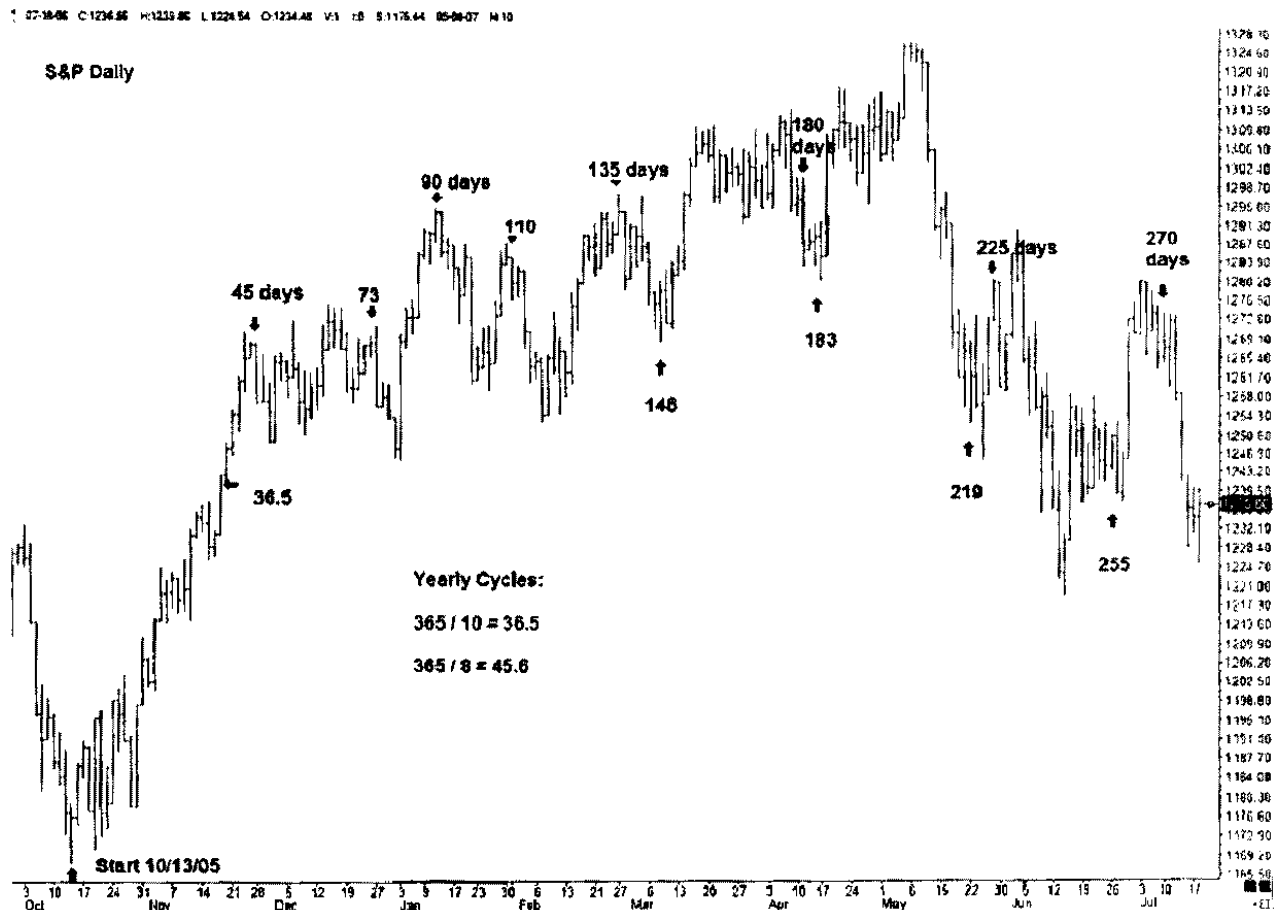


This is an hourly chart with the 10% and 1/8th of a full day cycles shown. These cycles shown start at the 9:30 start of business *but its better to displace them to a major high or low* if the opening of the market was not a major change in direction.

Yearly cycles work the same way i.e. 365 days divided by 10 and 8 to give cycles of 36.5 calendar days and 45.6 calendar days. The chart bellows shows why you should care.

You should also be familiar with THE BASIC PATTERN of the market. This is the weekly trend. In an up market, Mondays and Tuesdays are UP and corrections are Wednesday into Thursday morning, with Friday closing at the high of the week. Basically, strong Mondays and Fridays, and weakness mid week. The bear weekly pattern is the opposite- down Mondays and down Fridays, and strength mid week. The Friday weekly close is always the most important and usually closes at the high or low of the weekly trend. These simple rules will keep you out of trouble, and it will be a help if you take a moment each day to see what happened the day before and how today opens.

The intra-day patterns are similar, just like a 'mini' week. On bullish days an up opening, mid day pullback, and close at the high. Down days-down opening, short squeeze till mid day, then down into the close. When looking at the hourly chart each morning before the open remember these weekly and intra-day patterns to see what is the likely pattern for the day you are trading.



If there's one thing the past few charts have demonstrated it is that you must be *organized*. It takes planning to be prepared. Trading is a very stressful endeavor and you can't think straight when you see your life savings going up and down like a yo-yo unless you are prepared and have trained your subconscious mind to react to your commands and not the wiggles on the tape at the emotional extremes. If you do the same techniques everyday, pretty soon your mind will calm down and you can buy and sell stocks as if they were heads of lettuce. After all, this is a business and stocks are just inventory to be turned over. Hopefully at a profit, but sometimes stale merchandise must be sold at a loss to make room for better inventory with a better markup. You must trade according to rules and a business plan, and that will consist of angles, time periods, and support and resistance.

Putting Our Game Plan Together

Our actual decision-making comes down to three major processes:

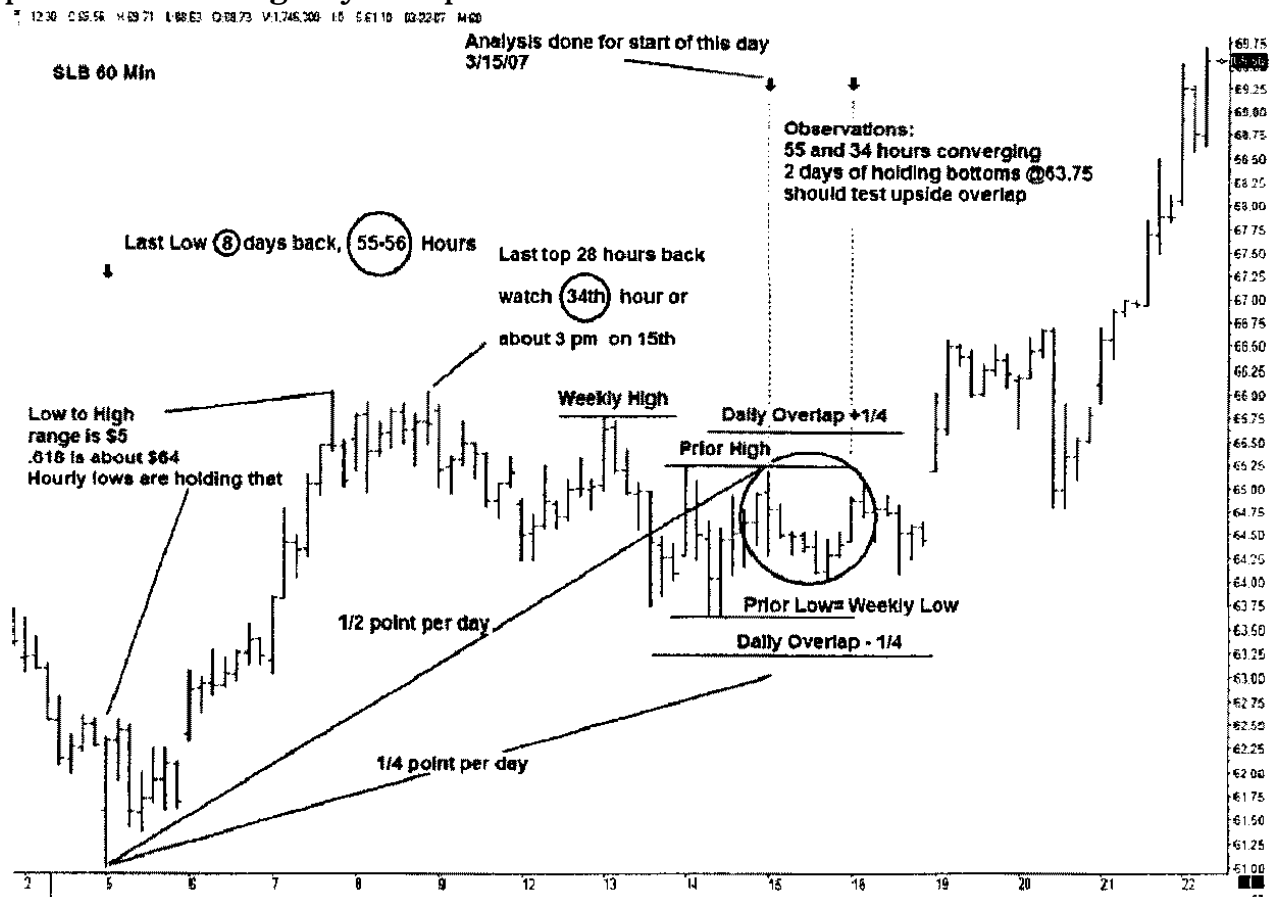
1. Gather the data
2. Determine the trend
3. Determine entry and exit points, and placements of stops

Each day before we can trade we must review the markets' position in terms of time and price. We must find our support and resistance numbers as well as prior day's and week's ranges and the time counts from the last major and minor highs and lows. This can be easily done with a worksheet like below. This may look like a lot of work but most swing numbers only change every week or so, and its good practice to force a review.

Last Major Low:	Date:	Price:	# days back # hours back	# points gained
Last Major High:	Date:	Price:	# days back # hours back	# points lost
Last Minor Low:	Date:	Price:	# days back # hours back	# points gained
Last Minor High:	Date:	Price:	# days back # hours back	# points lost
Yesterday's High:	Time:	Price:		
Yesterday's Low:	Time:	Price:		
Last Week's High:	Date:	Price:		
Last Week's Low:	Date:	Price:		
Up Angle Location:	1 point per day	1 point per hour		
Down Angle Location:	1 point per day	1 point per hour		
Support & Resistance High Down	Square Roots:	Natural ratios:		
Support & Resistance Low Up	Square Roots	Natural ratios:		
General Trends:	Up or down Weekly?	Up or Down Daily?	Up or Down Hourly?	

Yesterday's Trend 3 PM to 4PM	Strong or Weak?	What did London do?		
Daily Bar Overlap:	Up:	Down:		
Rough Strategy	Buy? Where	Sell? Where	Stops:	

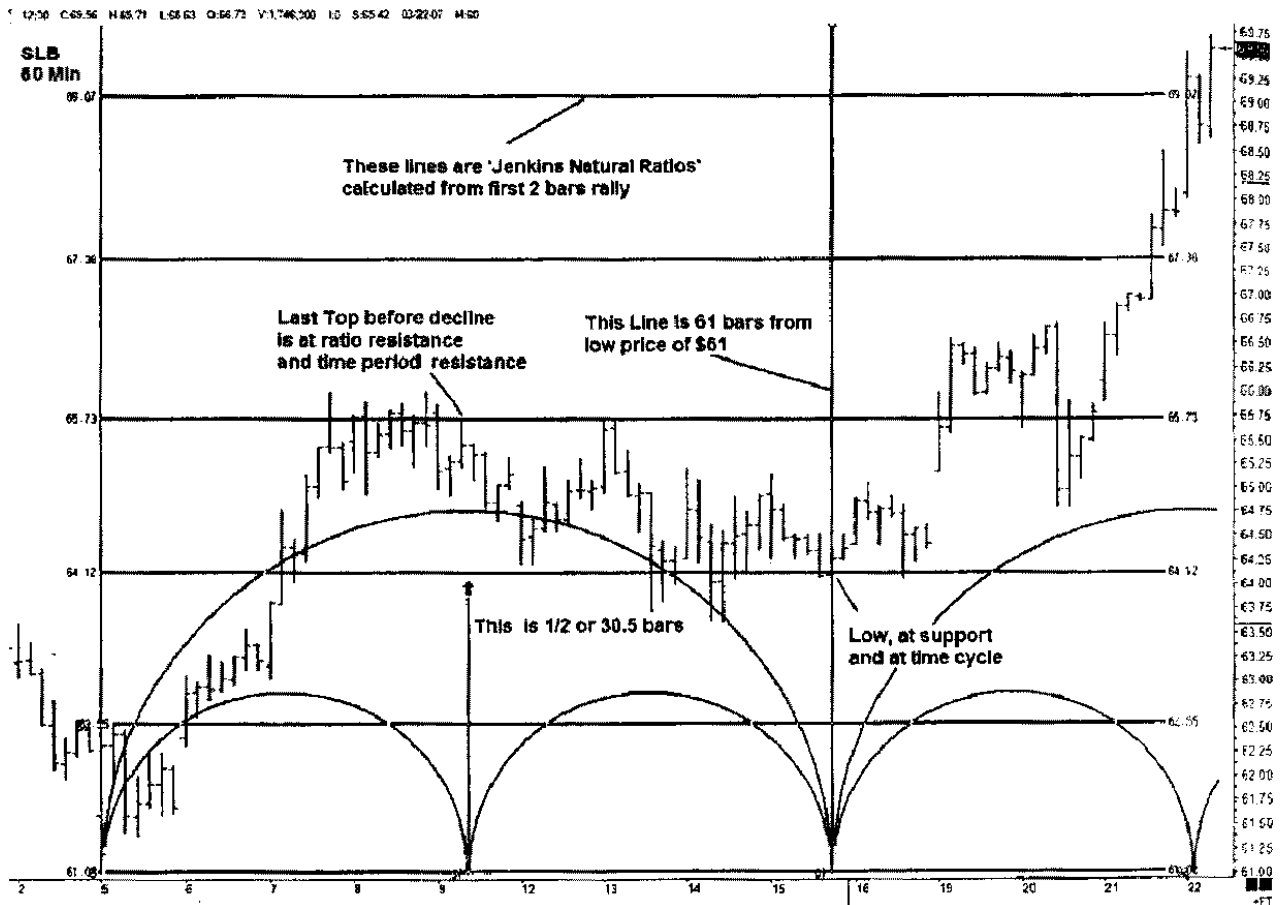
Let's now look at the hourly chart for a stock entering 3/15/07 as a potential trading day and put some of this stuff on the chart.



When looking at this chart from the 3/15 opening perspective, we see that an initial leg up from the 5th is consolidating at a support level that is approximately a .618 of the advance, a bullish omen. Resistance for the open will be at that 1/2 point per day trendline and the prior high or the overlap. While the opening will be a Fibonacci 55 hours from the low, 6 hours into the day will be 34 hours from the last top. Not shown on this chart but very important is the 1 point per day trendline from the \$66 top late on the 8th. *This will square the low at 61, 5 days later* or late on the 15th. Since all these time cycles point to the 15th-16th, as long as SLB holds above \$64 we'd scalp long and crossing the weekly resistance near \$65.75

should turn the stock up and we'd buy with a stop. Note in particular that the initial low near \$61, if incremented on its square root, and .25 added and re-squared is \$65, close to the high made, and if incremented by .50 would be \$69 and that would be our target for the next leg up if \$65 is regained.

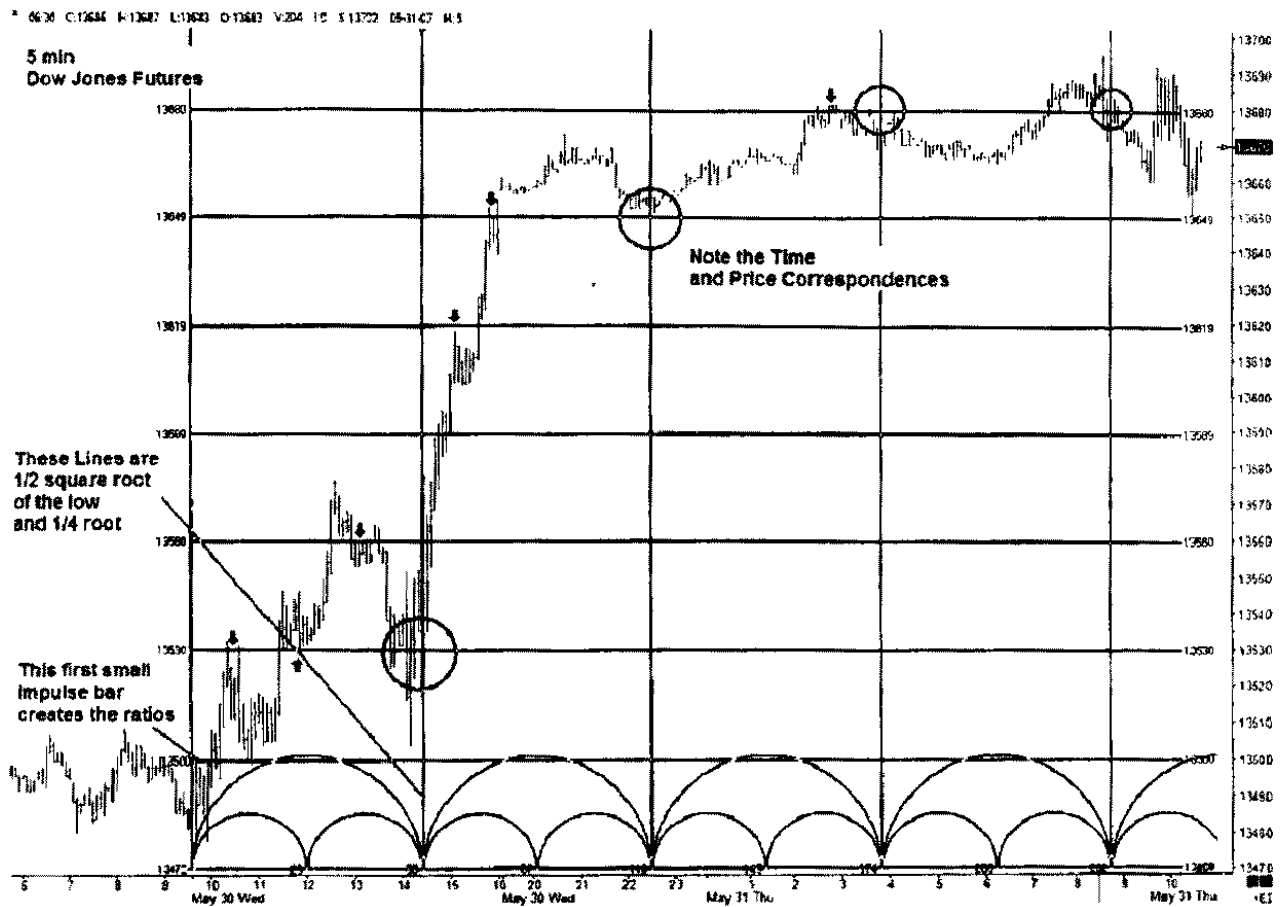
This next chart is the exact same chart but with my 'Jenkins Natural Ratios' added for support and resistance, and time cycle bars equal to the low of 61 and half that amount.



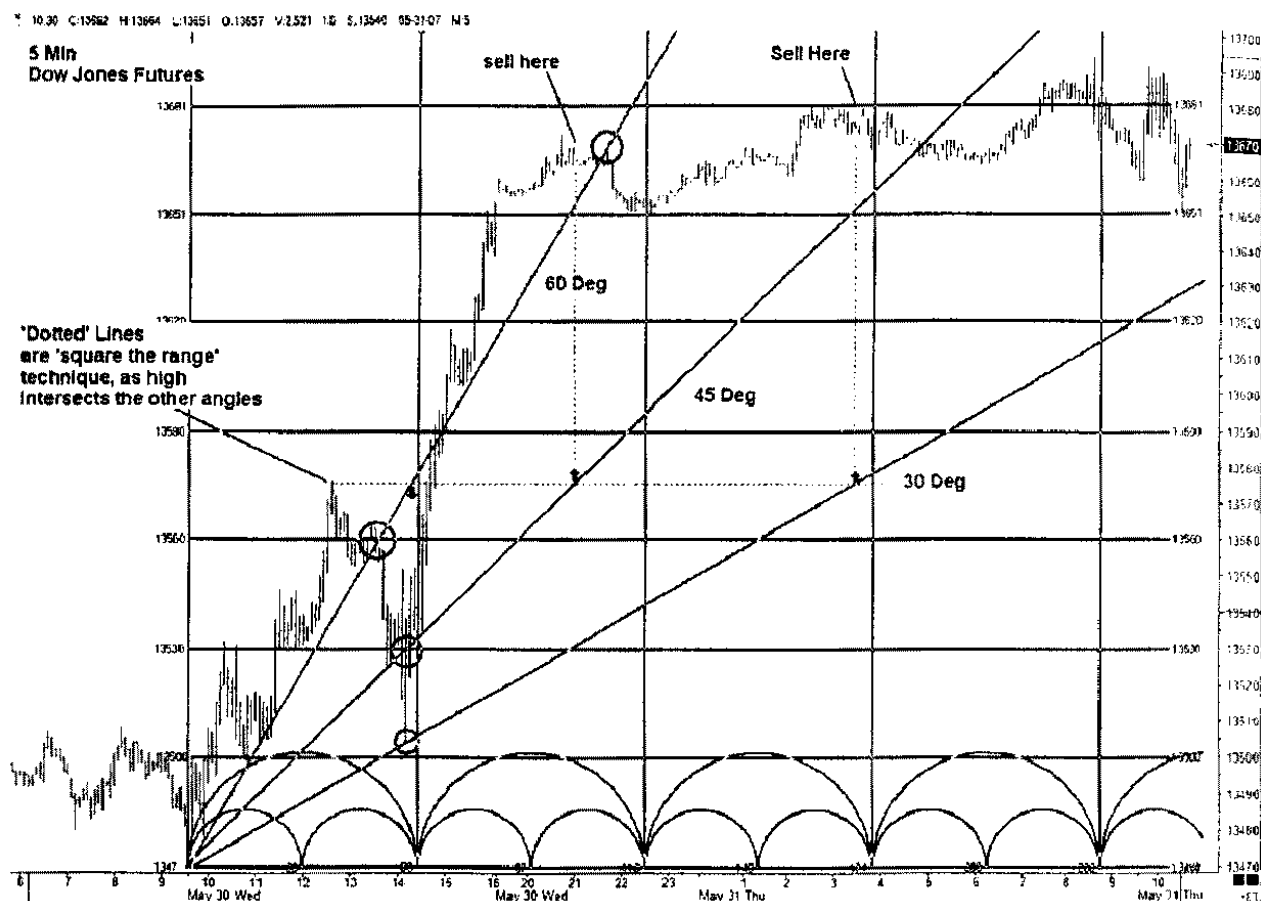
Here we can see much more clearly just what is going on. The first two small bars up create a wave of ratios that expand into support and resistance levels and the bar counts are harmonics of the low in time. The first rally goes up to the 2nd ratio and pauses until 14 the time cycle runs out and then the stock declines. It bottoms at support on the first ratio line on the full cycle of 61 bars, squaring out the low and causing another low.

These Jenkins Natural Ratio Lines are the easiest way to trade a fast moving market as shown in this next 5-minute chart of the Dow Jones futures. Here you can just buy or sell against these very reliable resistance

levels, especially when combined with cycles like the square roots of the low price.

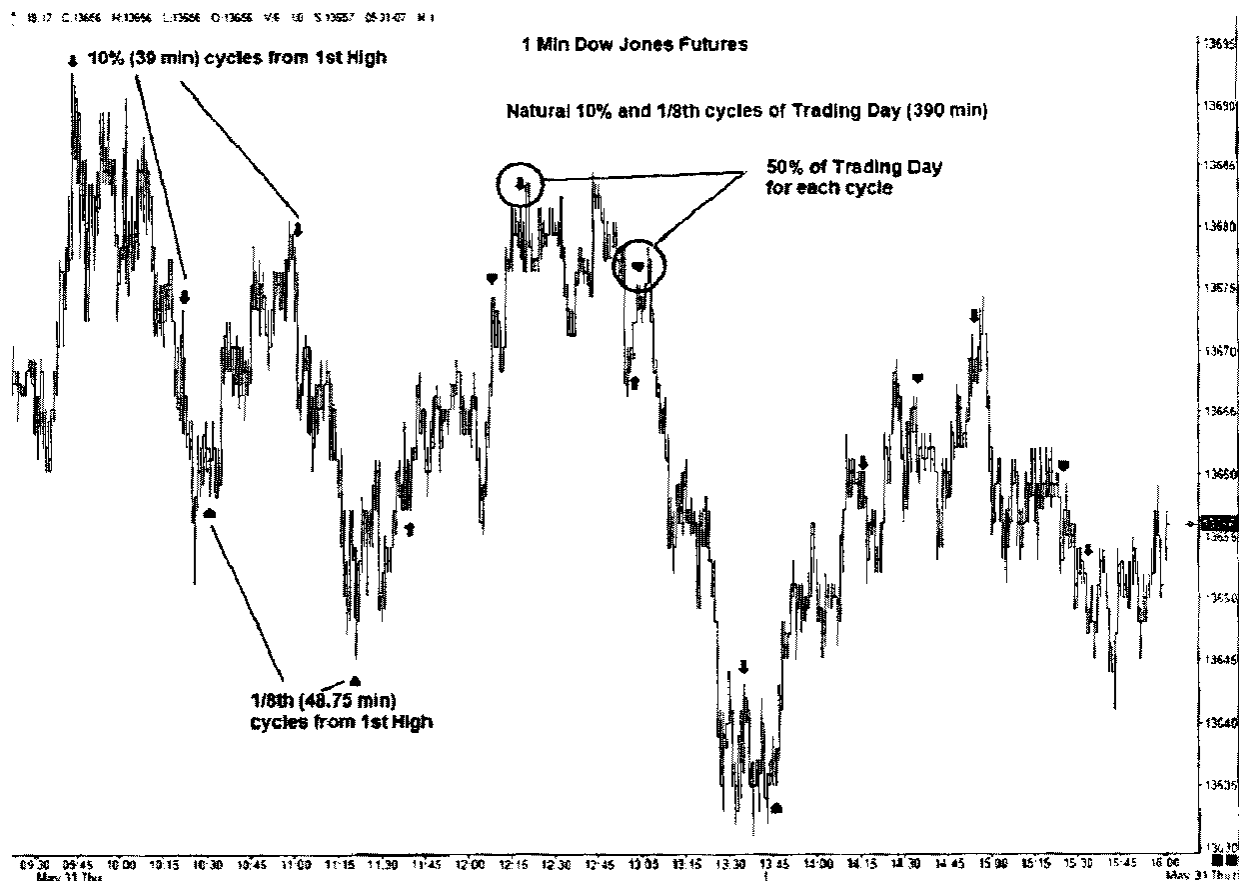


These Jenkins Natural Ratios are very easy to use and you may wonder how to get them on your software. They are easy to program if your software allows you to capture mouse clicks in which case you just divide the first top price by the base and then take the resultant ratio and keep multiplying it by that first top to get the next, then multiple the ratio by that next top to get the next, etc. If you don't have programmable software you can just calculate the ratio by hand and draw horizontal trendlines at each of the levels, or you can buy the Jenkins Module with the Market Analyst Software. The charts above I programmed with Ensign Software. The beauty of the automatic method, however, is that you can check for perfect fits in only seconds and do three or four initial impulse waves to see which one is the actual one the market is responding to. Now we can add our angles to the chart to watch for square outs and highs and lows on the angles.

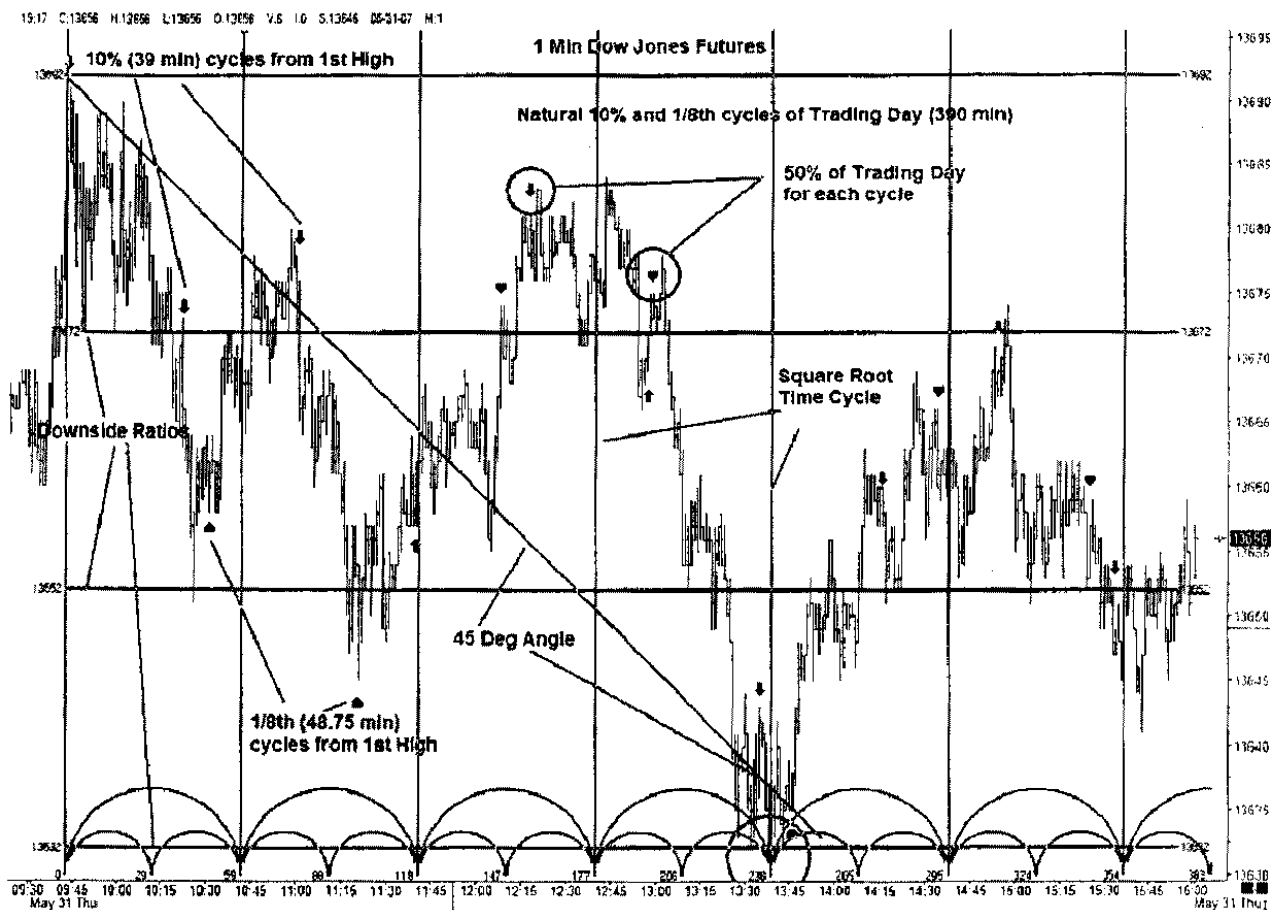


When trading futures always remember the break points in the intra-day cycles and pay close attention to $\frac{3}{8}$ th and $\frac{1}{2}$ of the day. These times can come other than at the $\frac{1}{2}$ point of the day, for example, if you start from an offset time from the open like the first high near 10 am. Then the various proportions of the day will hit at different times than just the mid point of 9:30 AM to 4 PM. These cycles are to be used in conjunction with other techniques like angles, patterns, and support and resistance numbers. These intra-day breakpoints are shown below. I know many of you think this is an awful lot of stuff to keep track of, but in truth these time cycles only take a mouse click second on my website software or your own spreadsheet, and then you merely have to look at the clock every half hour or so.

You're staring at the tape anyway, so you might as well check the clock every 15 minutes.



Note on this chart in particular that often the time cycles will coincide with intra day 'measure moves' or little wave counts like 5 waves or A, B, C patterns. At those points the timing is most accurate. Also note that there is a common denominator between 39 minutes and 48.75 minutes and this is approximately 195 minutes (5×39 , 4×48.75). This means that from any major high or low you will see a 'cluster' about 195 minutes (3.25 hours) later. This is why 1 PM is important each day ($9:30 \text{ AM} + 3.25 \text{ hours}$). This is easy to memorize so just add 3 hours and 15 minutes to any daily high or low and see what happens.



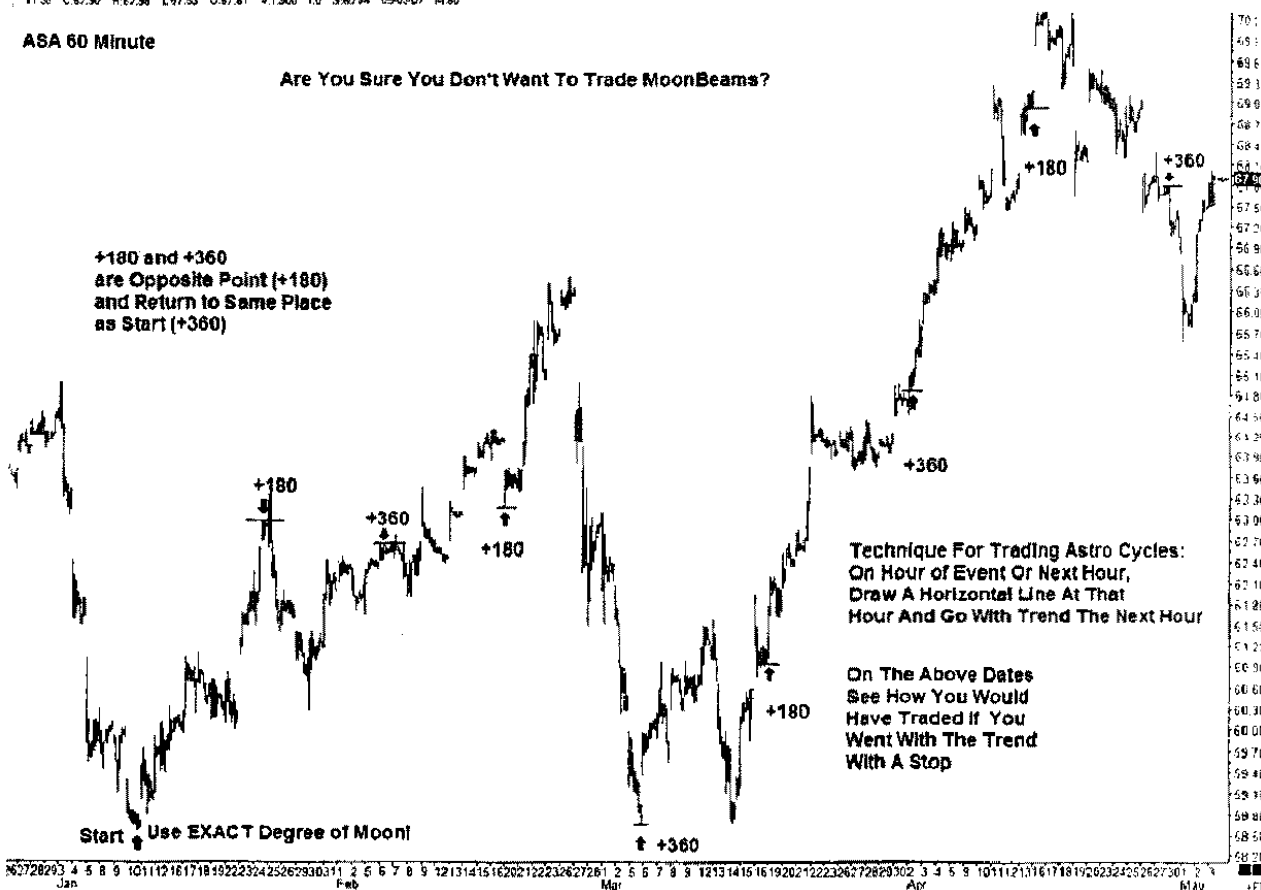
This is the exact same chart with other techniques added in. Note the use of Jenkins Natural Ratios *going down* by calculating from the high to the first impulse down to get the ratio. Also note the day's major low was 1) on a ratio line, 2) on a square root time period from the high, 3) on a 10% and 5/8ths time cycle, and 4) on a 45 degree angle down from the high. Although the chart looks cluttered, once you get used to a few of these they are very easy to keep track of. You can also have multiple time frame windows with a different technique in each window.

Moon Cycles

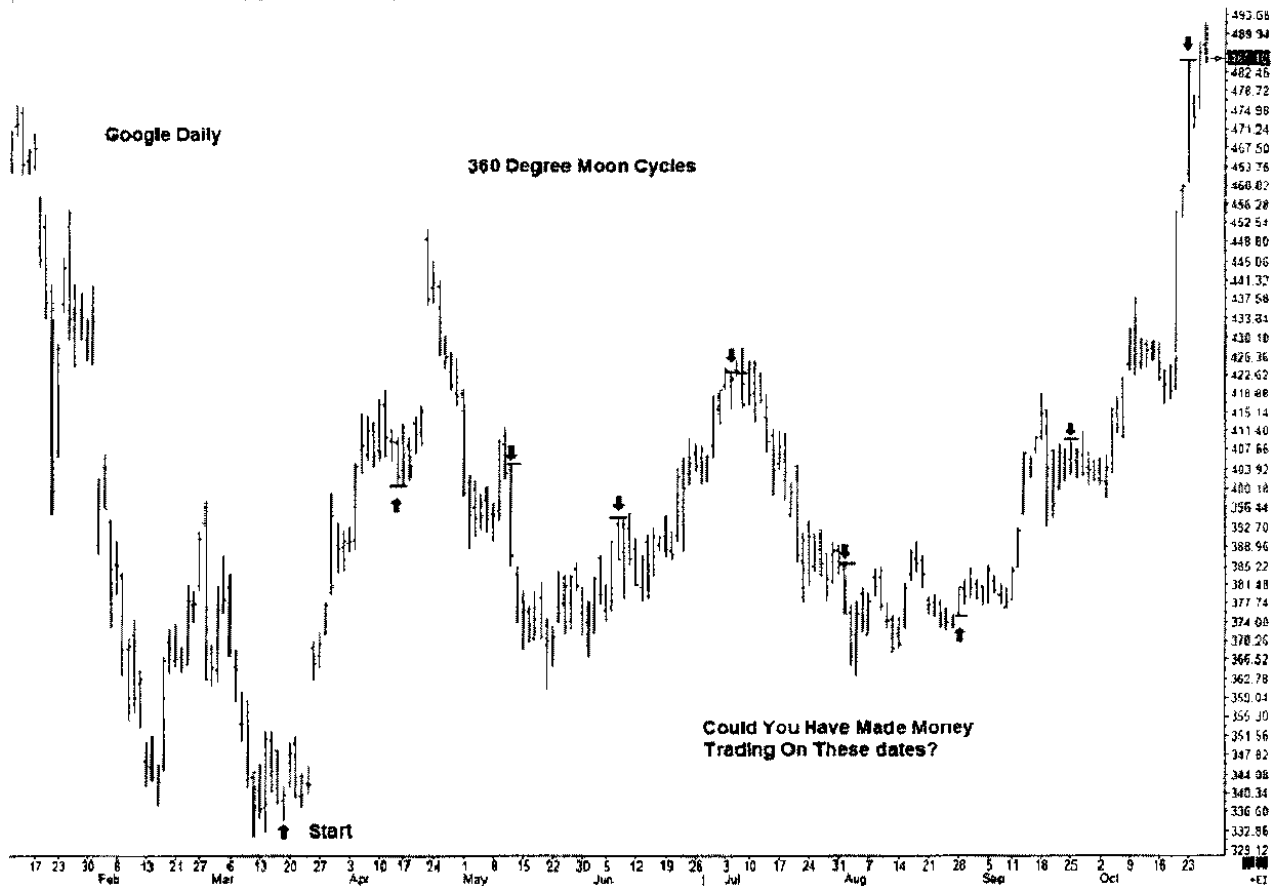
Having studied cycles all my life and becoming quite familiar with the methods of the great W.D. Gann, I do look at the astro stuff because it clearly works. I have no need to debate the issue and I am happy more people don't use it because it gives me a great advantage over all the 'black box' methods chopping people up with moving averages and stochastics. In its simplest form the cycles of the Moon are easy to use and of great help in day trading. The moon returns to the same place against the backdrop of the fixed stars every 27.33 days. Since the Earth is moving, however, the combined cycle of the sun and moon creating full moons and new moons takes 29.5 days. These are roughly 656 calendar hours and 710 hours respectively (but they do vary slightly) and you can take $\frac{1}{4}$ and $\frac{1}{3}$ of these and get good results on hourly charts if you use my calculator on the website to get your exact hours. Astro timing is exact. You are either 100% wrong or 100% right in your calculation, so the technique is to wait for the exact moment of the event and *use horizontal support and resistance at that moment* to determine what is the trend emerging over the next few periods. I usually 'draw a line in the sand' at the moment and use a filter like the 'square root of the square root' or such to *objectively* determine which direction the trend is going. In the chart below I find the EXACT degree of the moon on the hour of the low. This is important and is the primary reason most software products don't work and give astrology a bad reputation. Each and every single degree has meaning and different stocks have different degrees. Just using a full moon cycle won't work unless your high or low falls exactly on the full moon which it usually doesn't. It will also help to buy a good astrological program to calculate these exact degrees, although you can get by with approximations, and there are some free programs on the web to do astro calculations.

ASA 60 Minute

Are You Sure You Don't Want To Trade MoonBeams?



The above chart is an hourly and accuracy can be down to 5 minutes or less if you do the detailed work, but this next chart is the daily moon cycle return to the exact degree it was at the low. In summary, these charts speak for themselves. If you couldn't make money with these dates, you probably can't make money trading. Combined with any other technical buy or sell system, your use of these dates will be an infinite help! I frequently *look backwards* 27.33 or 29.5 days before I trade to see what *that* pattern looked like. Often the same fractal pattern repeats. Remember you are looking above at those horizontal lines that were placed exactly on the calculated moment of the return. Note that the market rarely whips back and forth through these levels *but a strong trend develops and goes away from these levels* so you just follow along with a trailing stop that will rarely be hit.



This chart of Google is a daily and you could have noted the dates and then watched for an hourly chart breakout to go long or short. Note that this only shows the 360 degree return to the same place as the 'start' but you could also find breakpoints in the chart by subdividing these time periods into $\frac{1}{4}$ and $\frac{1}{2}$ for the 90 degree and 180 degree moon cycles.

I won't show more of the astro methods here as I reserve that for my personal seminars, but using simple Moon cycles works well and has the advantage of being a very precise cycle length with little variability so you can make good rough estimates with calendar day counts and hourly counts for most purposes. Naturally you always want to tie in these natural cycles with other trendlines and normal technical buy or sell signals and when you do both, your odds of success are greatly increased.

Review of Charts: Entry and Exits

Now we'll go through a number of different charts of varying time frames to see what you should be thinking and doing as you prepare to make a trade. First we'll look at a very extended bull phase on the weekly chart.

* 06-01-07 C: 1539.50 H: 1543.00 L: 1512.50 O: 1517.50 V: 5,261,448 I: 2225204 S: 1265.74

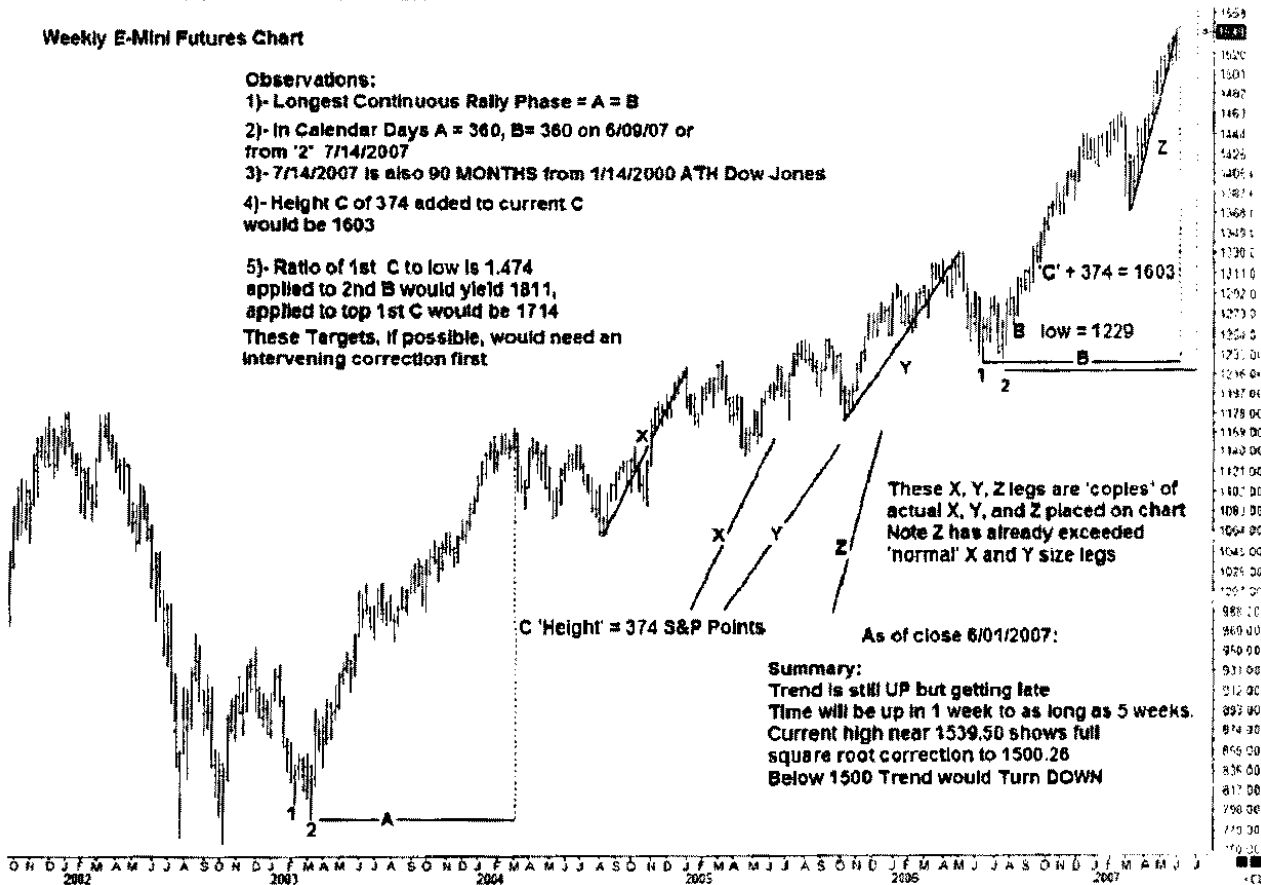
Weekly E-Mini Futures Chart

Observations:

- 1)- Longest Continuous Rally Phase = A = B
- 2)- In Calendar Days A = 360, B = 360 on 6/09/07 or from '2' 7/14/2007
- 3)- 7/14/2007 is also 90 MONTHS from 1/14/2000 ATH Dow Jones
- 4)- Height C of 374 added to current C would be 1603

- 5)- Ratio of 1st C to low is 1.474 applied to 2nd B would yield 1811, applied to top 1st C would be 1714

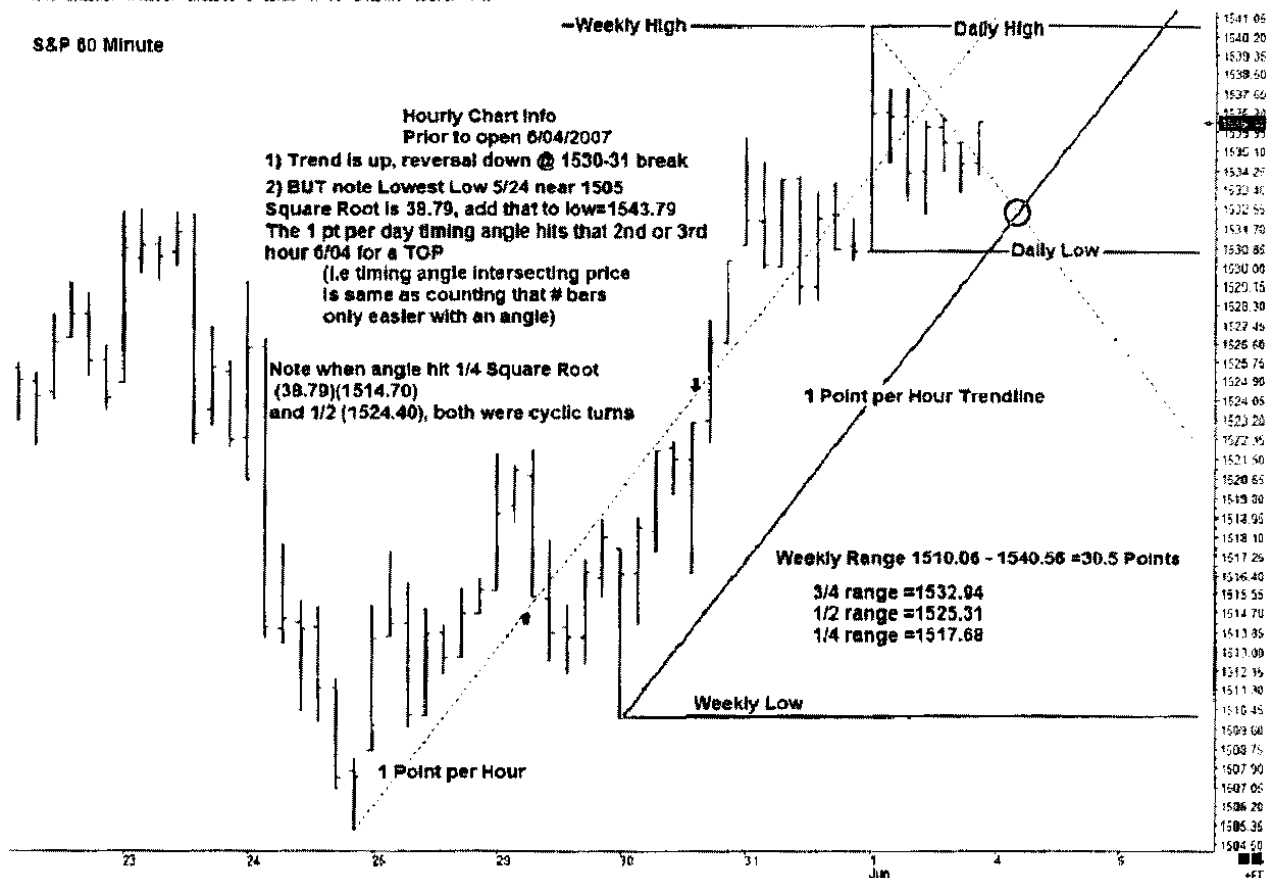
These Targets, if possible, would need an intervening correction first



This weekly chart is still going straight up parabolic so its hard to think of shorting, and dips can be bought but only ones holding above midpoint of prior day since corrections at this level could easily run 20-30 S&P points if a signal reversal bar on the hourly, then daily, is broken.

Let's zoom in to look at the hourly chart to see where support and resistance can be found keeping in mind this big picture of a strong up trend bias, but knowing that a big break on the hourly chart could result in a big break on the daily, so hourly support is very important to use for stop and reverse levels.

S&P 60 Minute

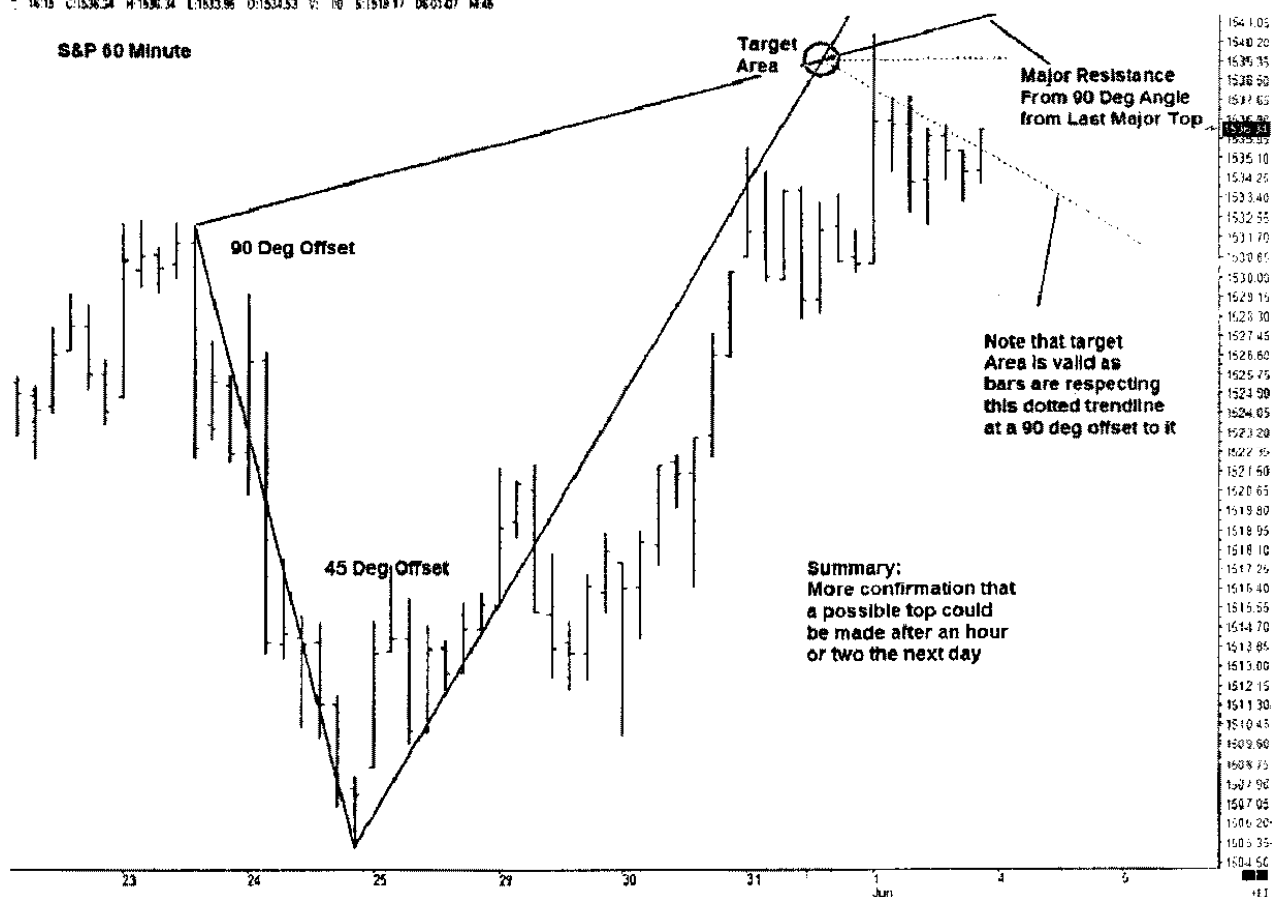


I always start by putting on the prior day's high and low lines, and the last weekly low and high. Subdividing the weekly range is good to have on hand. 'Timing Lines' or angles of 1 point per hour are essential to keep track of the passage of time for potential square outs and resistance. Remember angles, better called 'timing lines' are a fast and easy way to keep track of the passage of time. Instead of counting every bar by hand, a slope of one bar per hour will intersect a price that is that many bars above the low. In this case we want to keep track of the square root of the low (38.70). By adding 38.70 to the low of 1505 to get 1543.70, we only need to look to see our trendline hit that level to know the required numbers of bars has elapsed. This is very helpful over very long periods of time when the count is easily forgotten as we rescale our charts and move into a new day. In this case the square out from the low will take place in a few hours into the next day at a price very near the daily and weekly high resistance. Since the square root of a low is usually a top my bias would be to look for a failure near the weekly high and if a signal reversal bar is made I'd scalp short looking for a test of the last low trendline coming up about 10 points lower. Also note the intersection of that up angle and the angle going down from the weekly high and that would serve as a magnet for prices if

they break. If that angle from the last low should break then a major 2-3 day correction of 15-20 points or more would be possible.

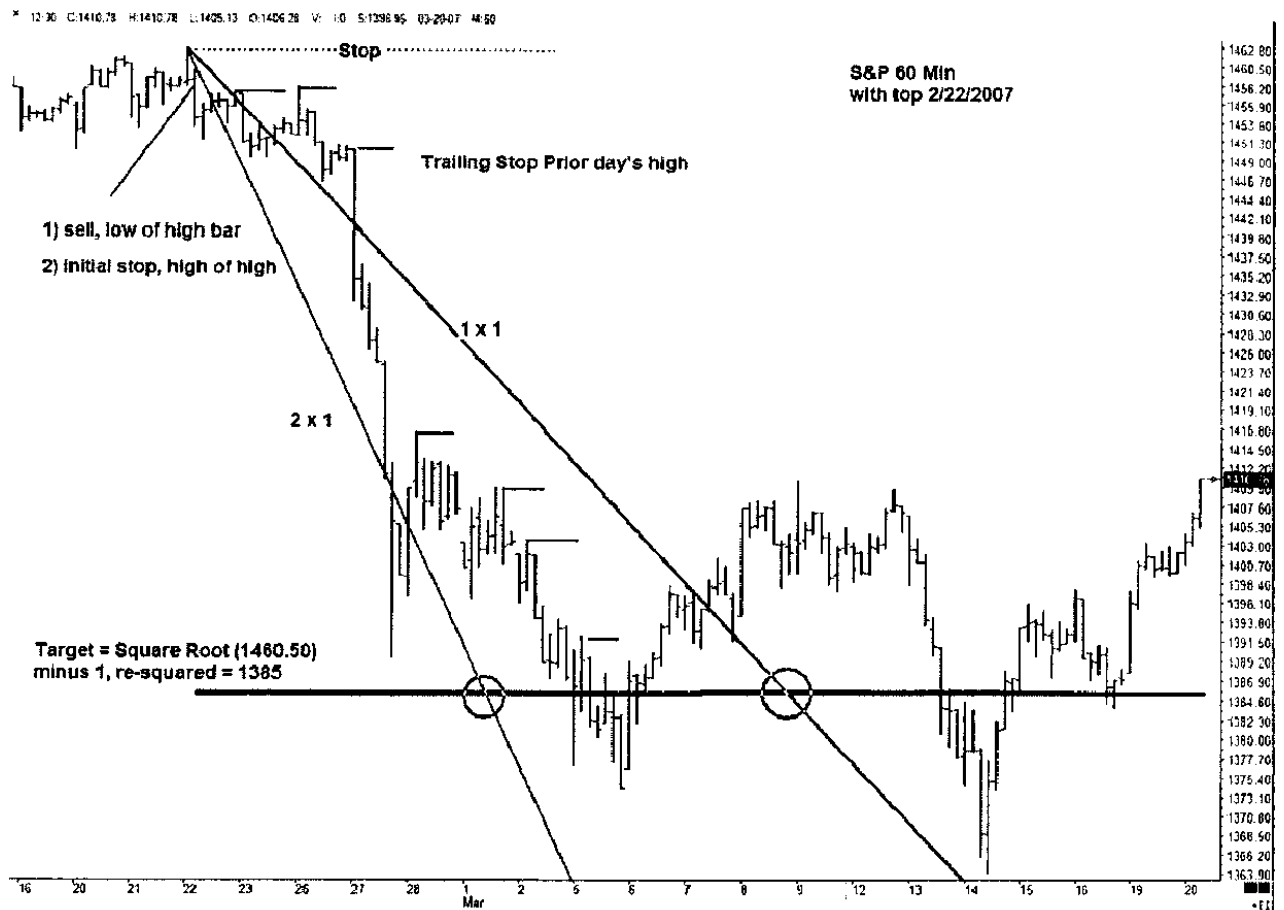
There are always multiple signs of an impending top and you can also use my 'adjusted angles' method. Also *note that each high and low is directly correlated with the last major low and high*. If you can construct the relationship between those past two pivots and the current day, then you have much higher probabilities.

16:15 C:1536.24 H:1536.34 L:1533.86 O:1534.53 V: 10 S:1518.17 O6:01:07 M:45



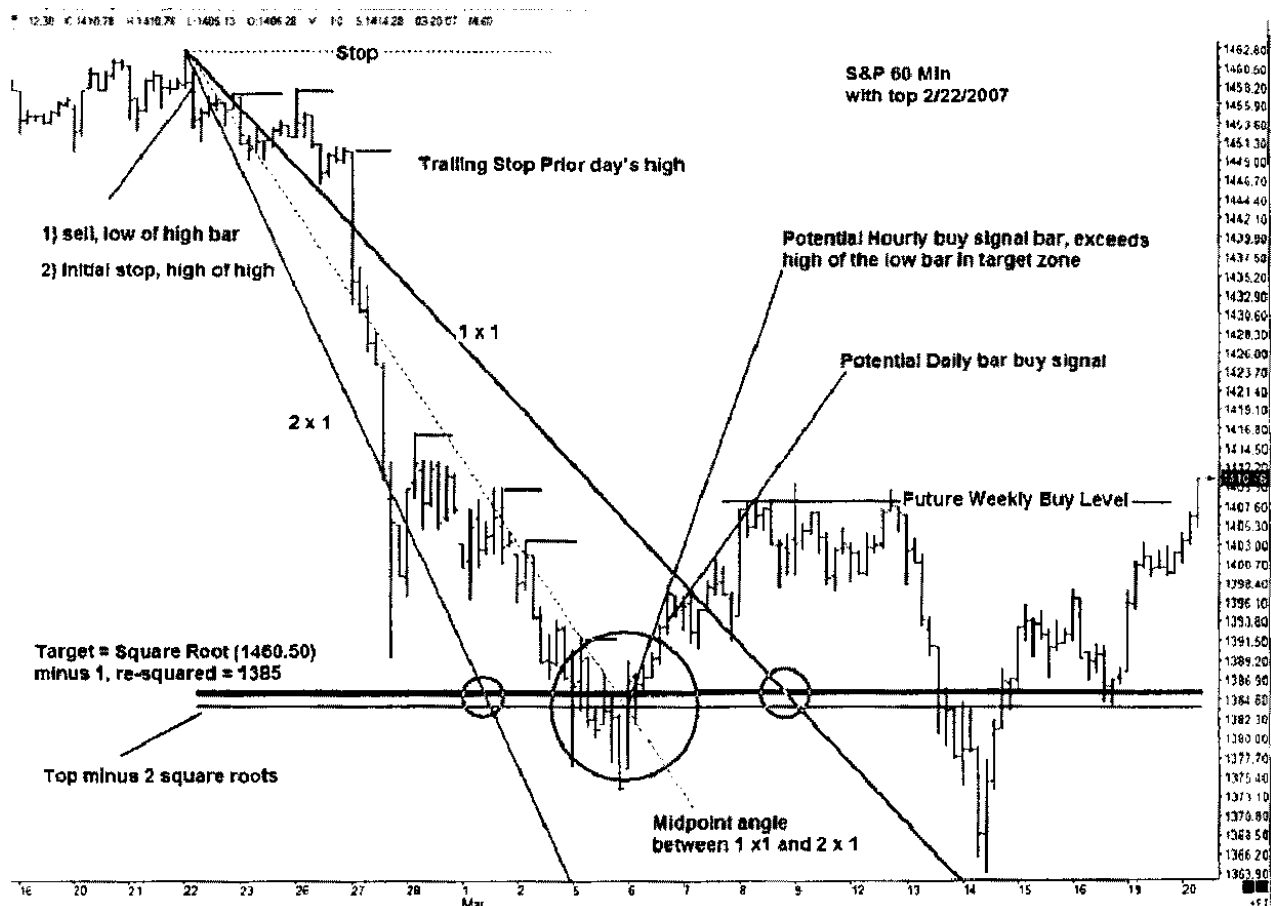
These adjusted angles or offset angles show true vectors so their intersecting corners can often be used for time and price forecasting. In this case the angle up from the last top coincides with the angle up from the last low to give us a 'quick and dirty' estimate of both time and price within reasonable tolerances but more refined methods can tune the forecast even better.

Lets follow some of these methods over a several day period to see how they evolve. We'll start with a top and go short on the break of the low of the high bar and use a stop at the prior days high or the high two days back. The declining 1 x 1 and 2 x 1 hourly angles should point to the potential low if we can find some support numbers and angles from the prior correction as targets.

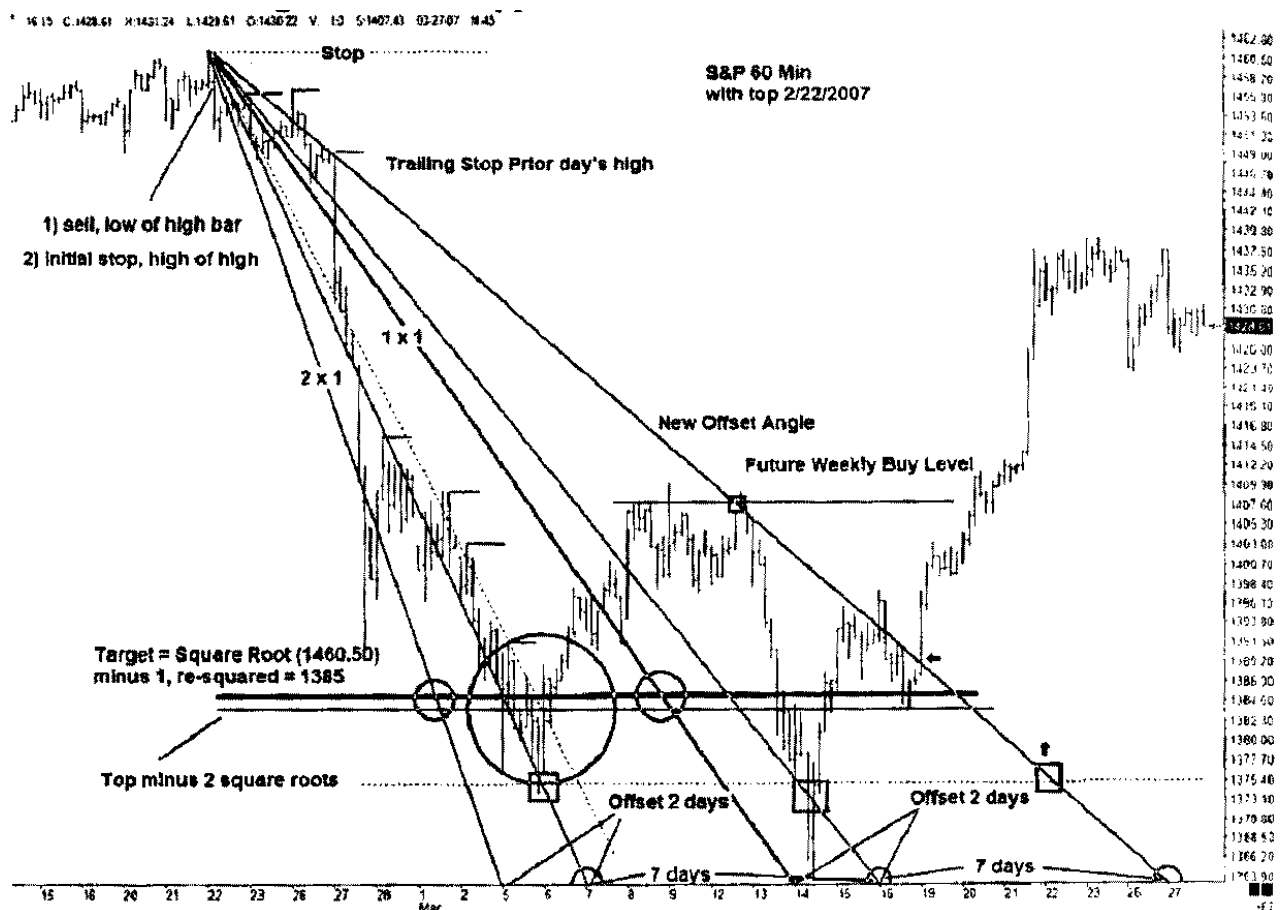


In order to get a clearer picture of what's happening we need to back off a bit and get a bigger perspective. This next daily chart shows the dynamics of the current high and coming low in relation to the prior major high and low. Our first long term estimates will involve angles offset to the major line of advance to the current top. The up coming low will also be related to the last low by some kind of angle so we can use and offset one from the current high (60 degree here) or what I have done is use a Fibonacci angle of .382 from the last low to the current high to possibly find support at a Fibonacci ratio. Our hourly chart using a square root decrement of 1 gives a 1385 target area, while if we use a plain square root (which is 38.21) and subtract two of those then we get 1384.

111



Take a look at the dotted bisecting angle in this chart between the two 2 x 1 and 1 x 1 angles. Note how the two angles on either side of the low missed it. But did they? If you measure with your fingers the distance between those two small circles and shift them right, they will both be spot on. What this means is that our 'theoretically' perfect 2 x 1 and 1 x 1 angles *should be offset* by a certain angle. You must train your eyes to try and see these relationships. You can offset geometric angles by shifting them an equal distance because they are really sides of a subdivided square. I have done this in this next chart, which shows the two original angles shifted two trading days right. I then added a third angle shifted another seven days right at the bottom, which was the distance between the two original angles. This third angle was the key to the real trend of the market as you can see what happens each time the prices touch that line. The 'square' boxes around the angles show the important time periods and since they all resulted in big turns we can assume that the horizontal price level at that point is very sensitive and will be good future support.

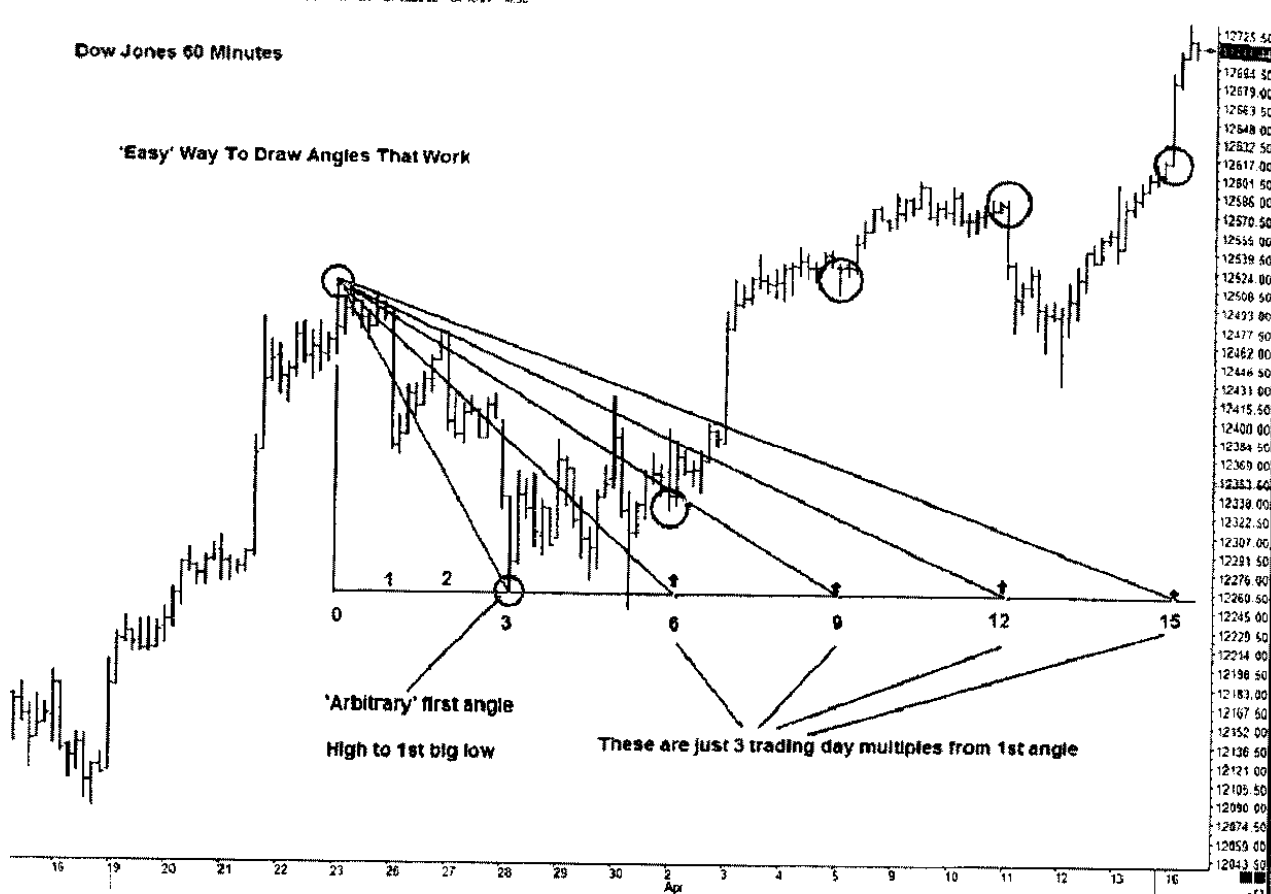


This chart looks a bit confusing but the point is to look at those "1 days" notations at the very bottom. That's where the original lines were shifted right for two days and the third angle put in 7 days shifted right from the last one. Now you can see those little squares, and how time and price squared out at that point.

I might digress here for a moment to show you a very simple method to draw angles that always work and give quick and accurate square outs. *You use the chart itself to tell you* what angles are important. Since every high and low MUST square out, all you need do is draw a line from a high to a big low and turn that angle into its multiple harmonics. This next chart demonstrates this simple idea that can very easily be drawn on the fly on a 5-minute or hourly chart with great utility.

Dow Jones 60 Minutes

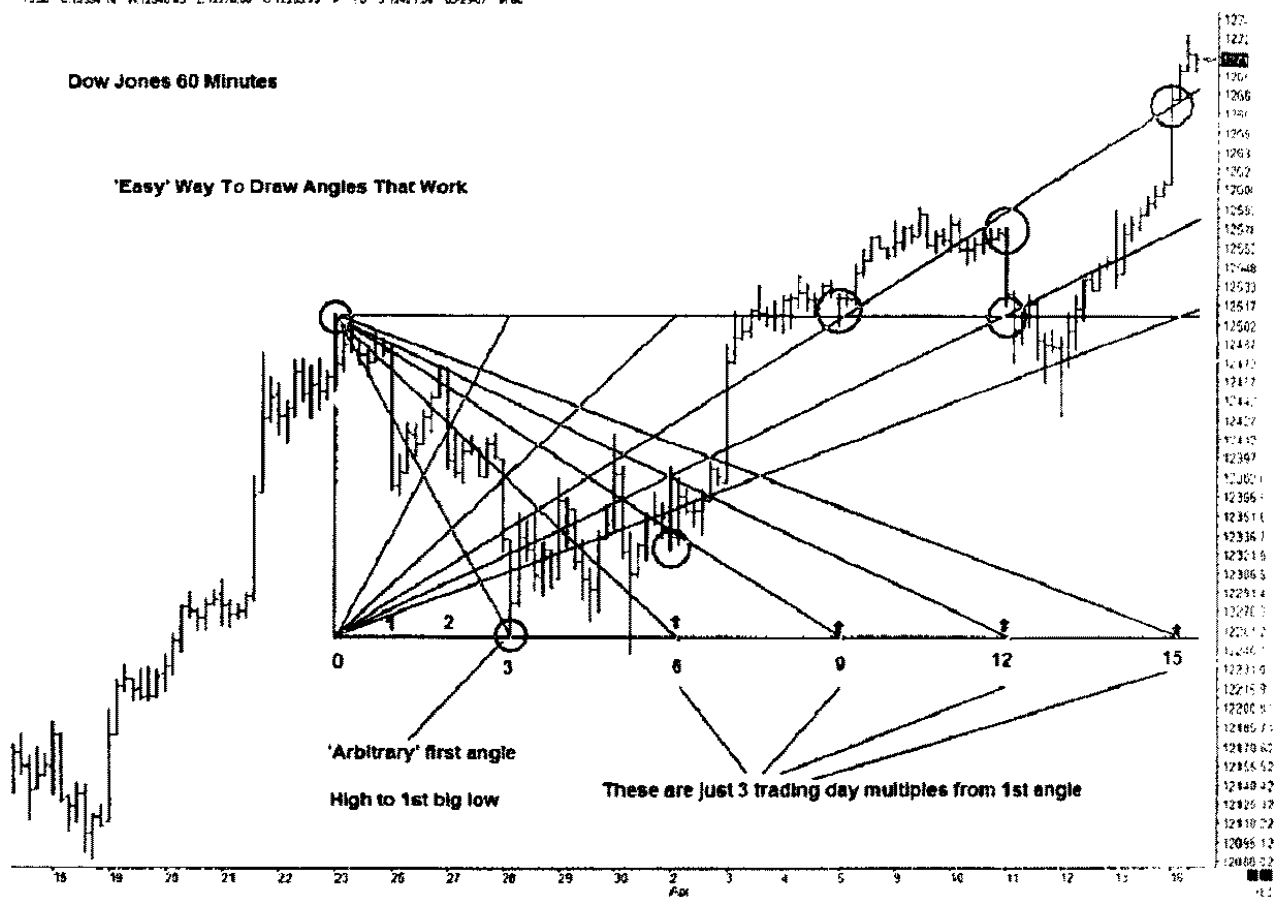
'Easy' Way To Draw Angles That Work



Of course these are just static fixed length cycles and those numbers 3, 6, 9, 12 can easily be found by taking a 'cycle finder' tool *from the initial 0 to 3 first angle*, and set that length to get the next multiples. This way you'll see all the harmonics in less than 30 seconds of work. Since all highs and lows are connected and prices 'gravitate' to angles on cycle dates, with a little non conventional thinking you can take this chart and make it into this next one:

Dow Jones 60 Minutes

'Easy' Way To Draw Angles That Work



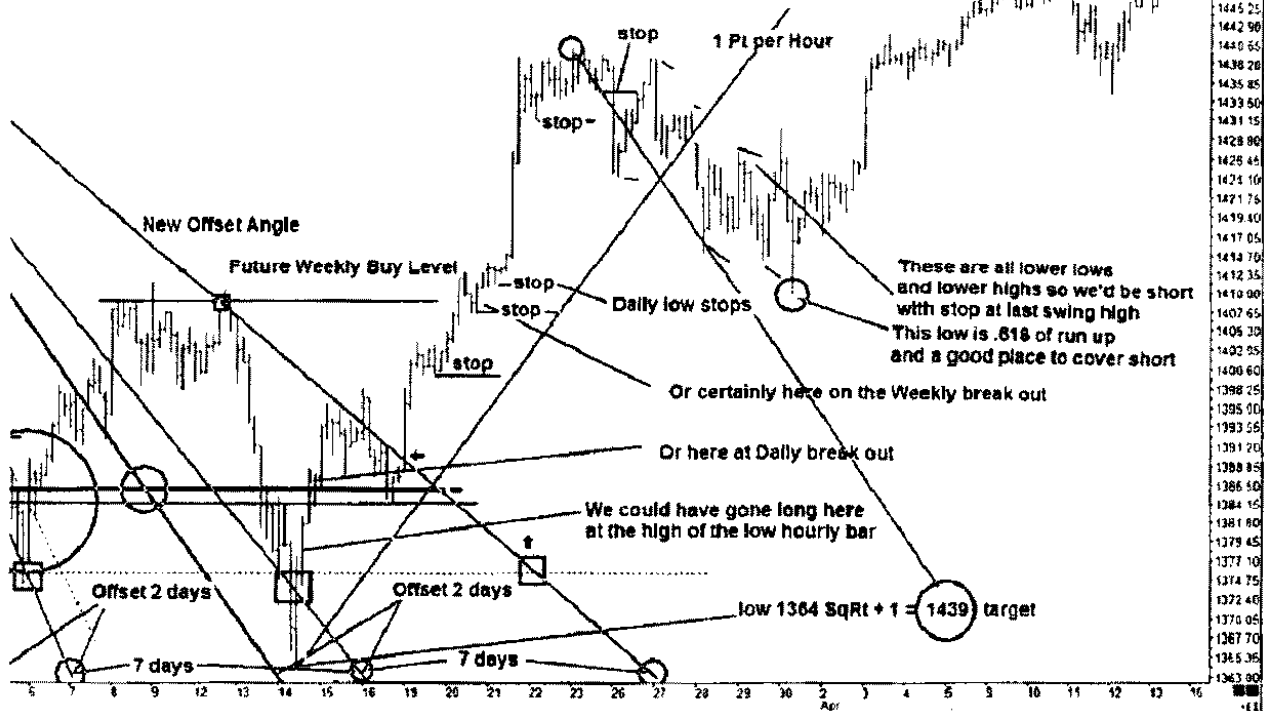
The circled areas show time and price targets which usually result in reversals on an angle at that point. In any event this is an easy method when you are at a loss as to why the market is trading in a certain range.

Remember when trading we instinctively sell or buy at time and price hesitations like those circled areas if a measured move has taken place, and we see a signal reversal bar form.

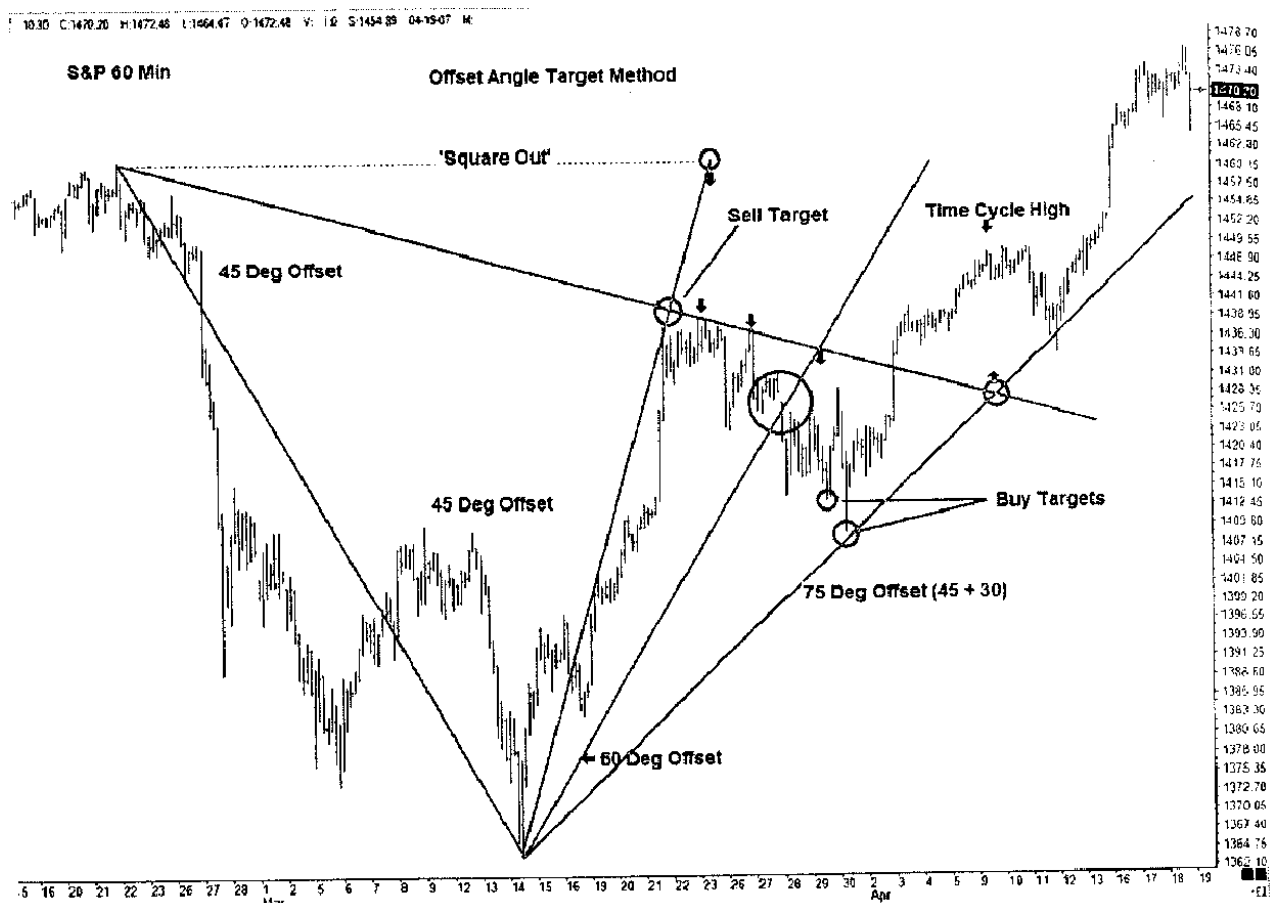
Getting back to our example again for shorting a high and getting to the low we now find ourselves long and need to forecast where we are going and what our targets and stops will be.

S&P 60 Min
with top 2/22/2007

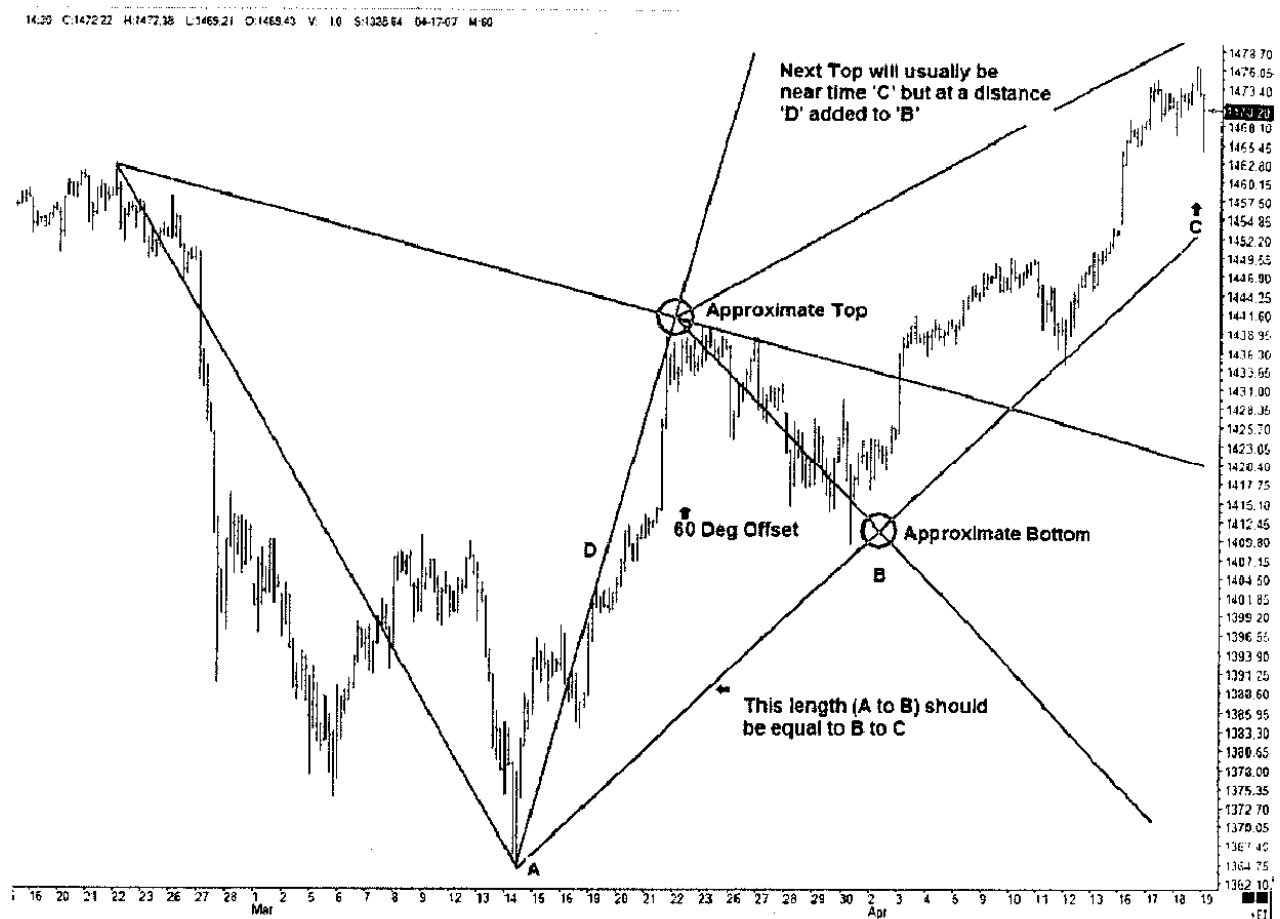
prior day's high



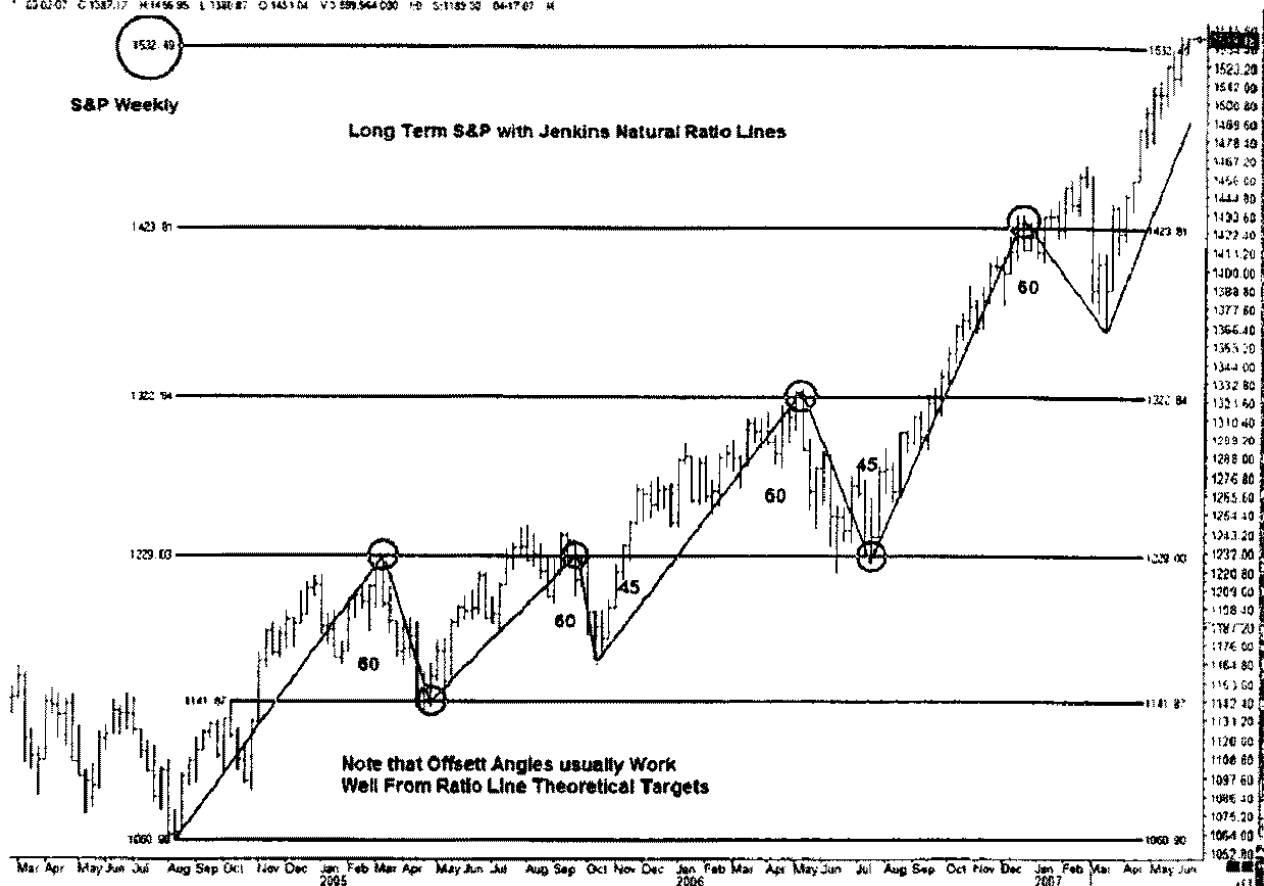
The above chart shows that several methods can get you to the right place. Targets can be made with square root increments and momentum trendlines of 1x1 or 2x1 points per hour, day etc, can give forecast targets and prices, and retracements of rallies can point out correction areas. Stops can easily be placed at the low of the prior day to two days back, for the initial purchase. I've shown several of these methods on these charts so you won't get lost trying to find something that makes sense out of a chart pattern. I still prefer, however, a method I published over a decade ago in my 'Chart Reading' book. This is my 'Adjusted Angle Method'. This clears up the 'clutter' of charts and gives a very straightforward estimate of targets and objectives and all you need do is determine your stops and the amount of time you want to stay in the trade. This next chart shows the same example from above in a much more simplified manner. You just need the first high and then major low to start your projections up from that low.



This is the initial projection up to a top from our primary low. Now we need to project a correction and then a potential next leg up. That circled 'sell target' is just that - a target. When we arrive there we look for distribution to take place so the market can go down. After we see distribution and a small topping phase we look for a signal reversal bar to go short.



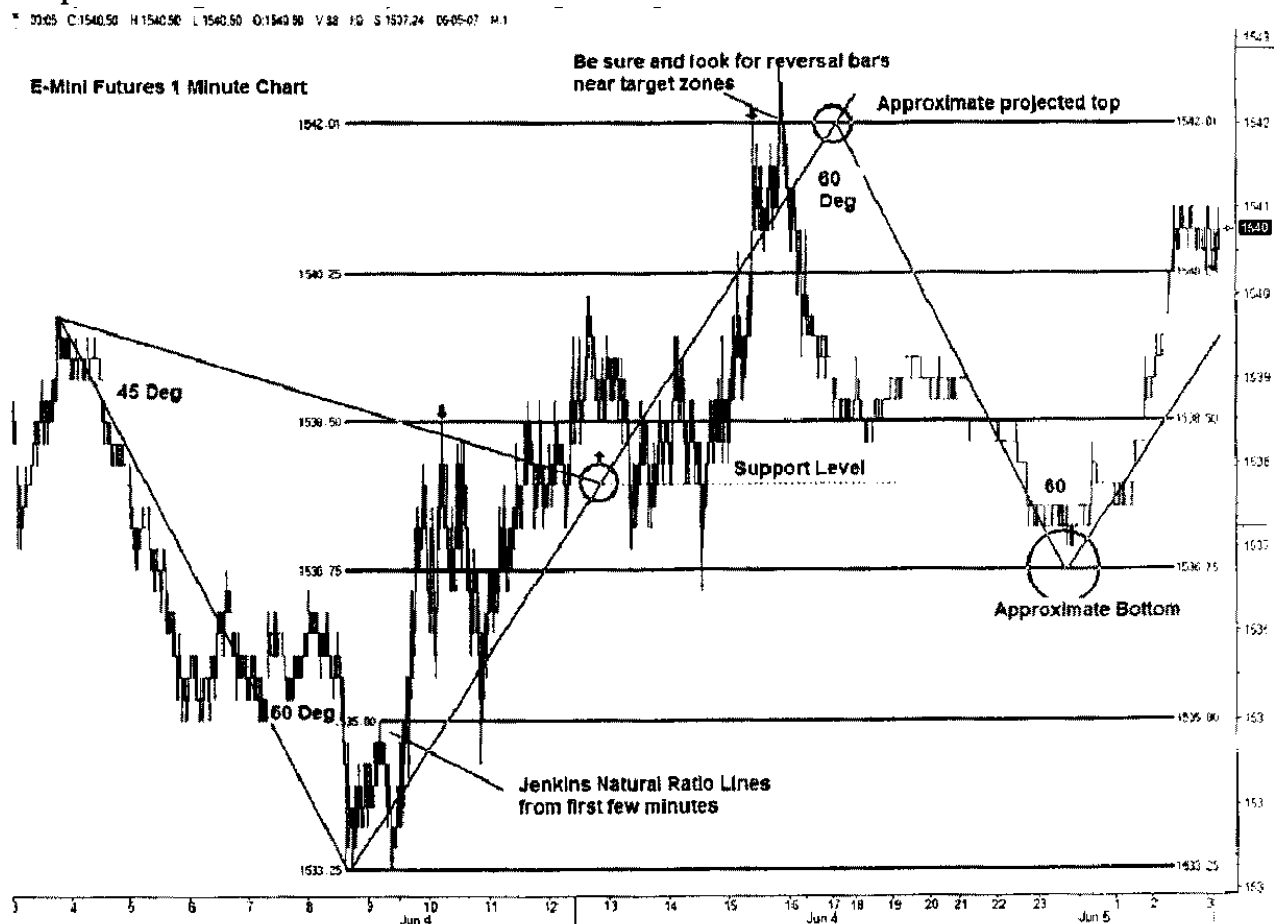
These are all valid offset angle projections and the slope of the angles near our prices will be the valid ones and where those angles intersect price levels related to harmonics of the low, we can expect highs. In the chart above intersection 'B' is the place to look for a low since it's a normal retracement level expected from a low to a high retraced, and the prices seem to be following the angles. As you near that point, remember *it is the signal reversal bar you are looking for*, not the hit of the angle per se. These angles are very close approximations but the bars themselves show the trend. Now since most market movements form 'waves' of 1, 2, 3, 4, 5 or 'A', 'B', and 'C' corrections, we need to find these patterns in our intersections of angles projection. We can construct some long term scenarios from these early angle projections and they often work out quite well. Remember that if you start to get 'confused' with all the patterns just step back into a larger time frame like daily or weekly and apply you primary angles and that should clear things up.



These long term charts are naturally for long term investors but many of you like to trade futures and options on very short term frames. These techniques will work better than most but when trading very short terms like 1 minute or 5 minute time frames, remember that these are 'scalping' trades that should have holding periods no more that a few bars length of the period you are trading. A 5 minute trader *should expect to make at least 10 trades a day*. The 'slippage' on short term trades is so great you need a dozen trades to guarantee a profitable day since half will be stopped out at break even or small losses. In this kind of environment your strategy is to instantly buy and sell at key support and resistance areas and let the angles project possible future trades that are setting up. *Never wait to see the chart fulfill your expectations*. When an S&P future hits or nearly hits your target just 'pull the trigger' and execute. 'Analysis Paralysis' is the biggest problem with cautious traders. You have to believe in the support and resistance numbers. Just execute and let the numbers do their work.

The best support and resistance levels are of course the Jenkins Natural Ratios, or the square root increments. Gann geometric angles also work if accurately drawn with the earlier box method shown. Most intra-

day short time frame charts respect 'measured moves' so you should measure each of the first few swings of the day to get the average volatility of the move and apply those measured move lengths to highs and lows to sell or buy against without thinking. Just 'copy' those first advance trendlines into the future to get your measurements. Just remember -the single most dangerous thing you face with a 1-minute or 5-minute trade is that you could be approaching or crossing a much larger frame resistance area such as an hourly chart breakout or a daily bar reversal point. Always try and put on your short term charts, these horizontal resistance levels, where 'big' moves could instantly take place. *Obviously the best place to trade a 5-minute scalp is in the middle of a big range that won't be violated anywhere near where you are currently trading and hence you won't get surprised.*

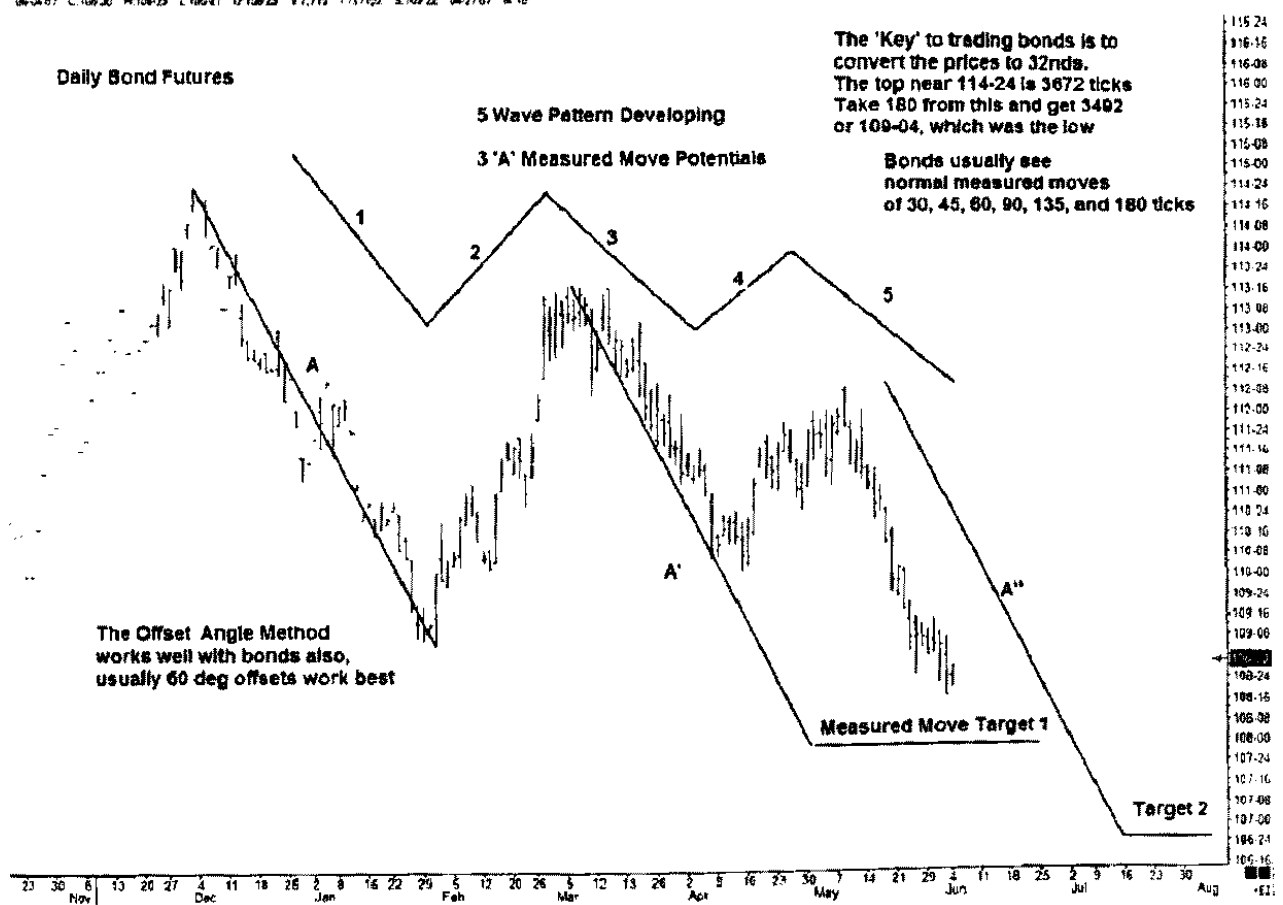


The above 1 minute chart is choppy but the ratio lines work well, and note that the 'approximate projected top' line is also exactly 2 distances of the first rally to that first circle. Usually when you get through one of those circle points you go another measured move amount.

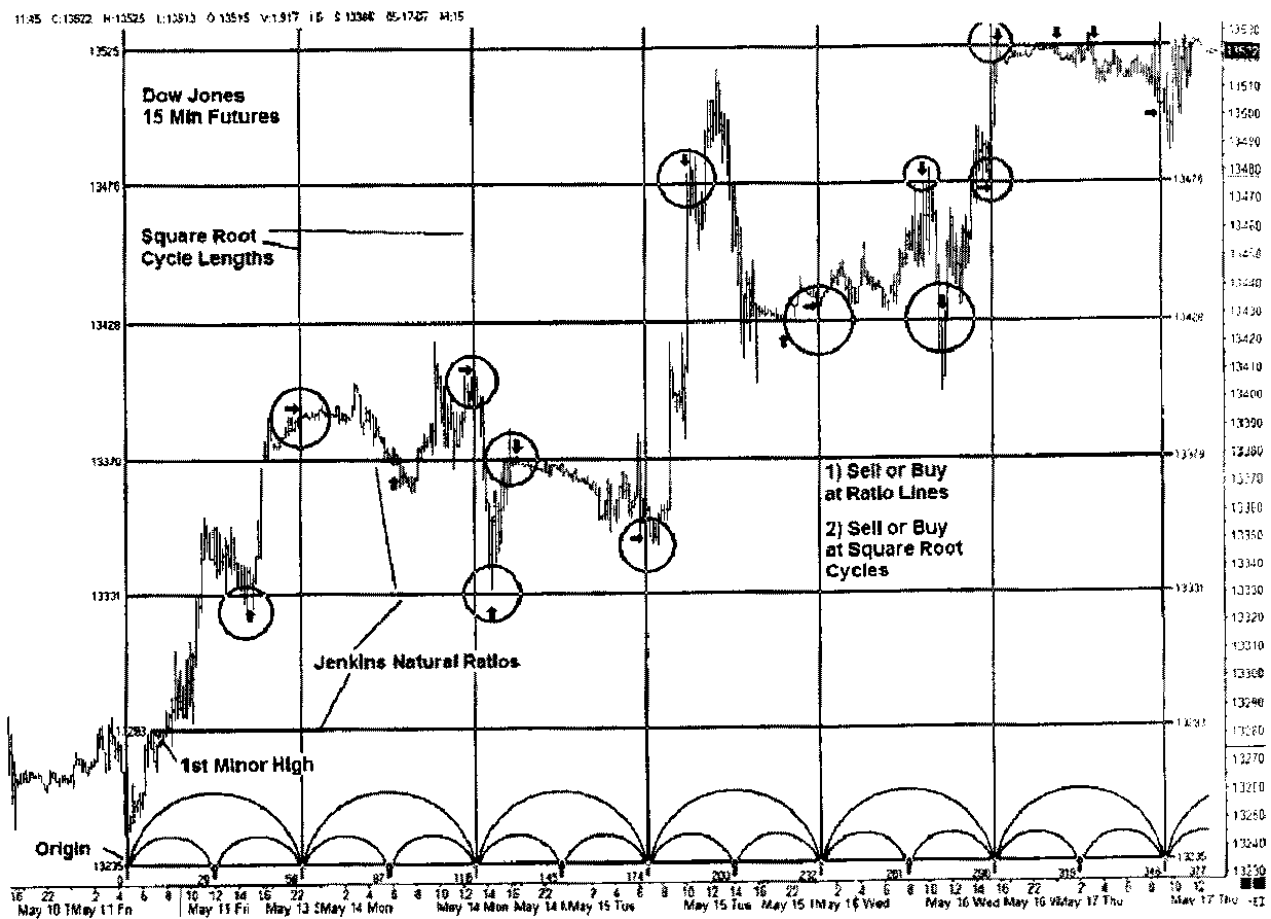
Although many traders want to trade S&P futures or Dow Jones futures, I try and get them to try the other commodities which don't have

as many arbitrage plays in them. Currencies and bonds like to move in 'straight lines', at least relative to the S&P jumps, and the offset angle method works great with them. Just remember that the key to support and resistance is the lowest tick the commodity trades for. Stocks are decimalized as are currencies, but bonds use 32nds so those are the basic unit to manipulate with square roots or fractional parts. If you trade currencies and want to use square roots on a 1.30 priced currency it's usually best to move the decimal point to get a three digit number before using roots. For example 1.30 would move to 130 and then the square root would be 11.40, and then added to 130 would be 141.4 and then you move the decimal back to get 1.414 as your target.

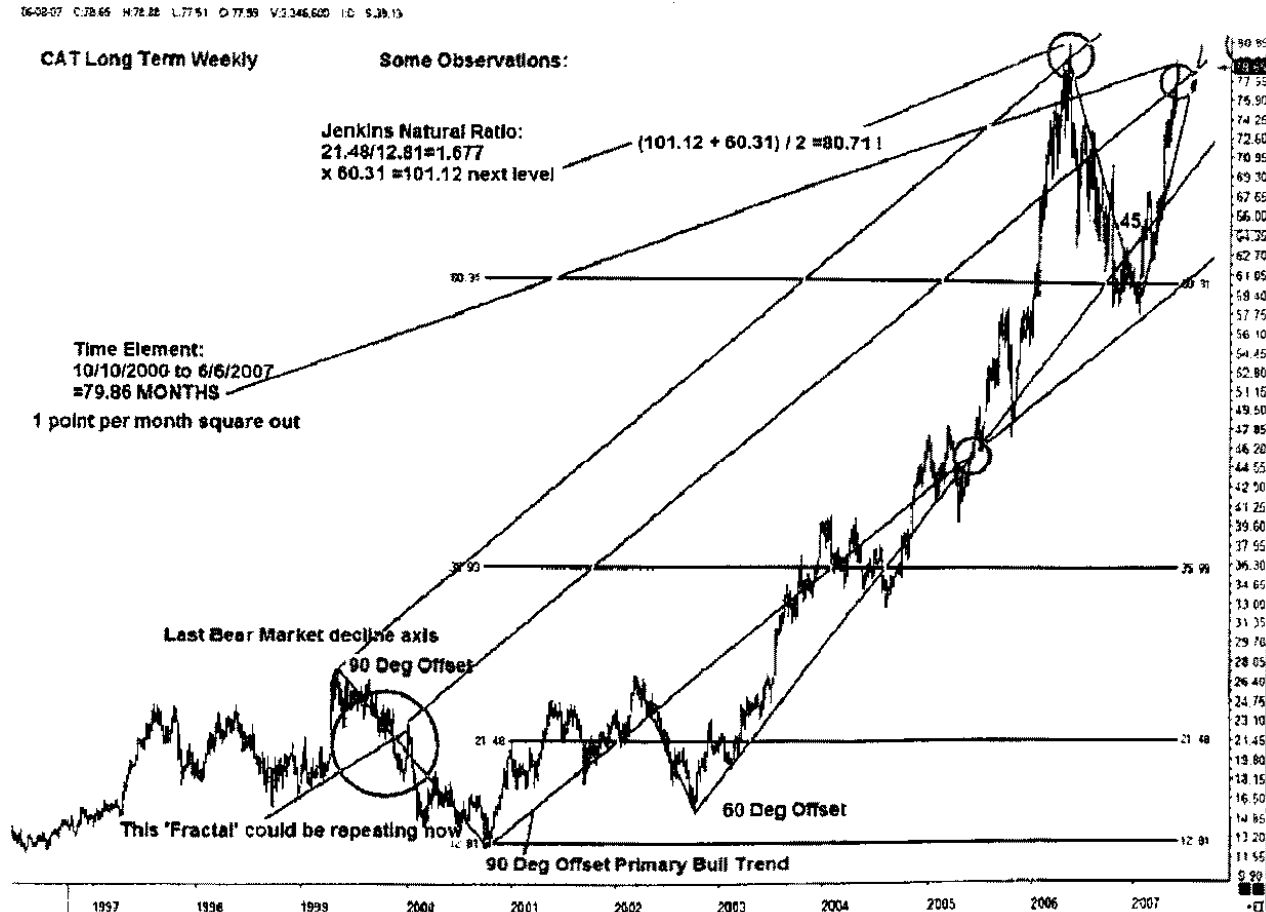
06-04-87 C:106.20 H:106.25 L:106.21 O:106.25 V:7,715 S:109.22 06-27-87 H:10



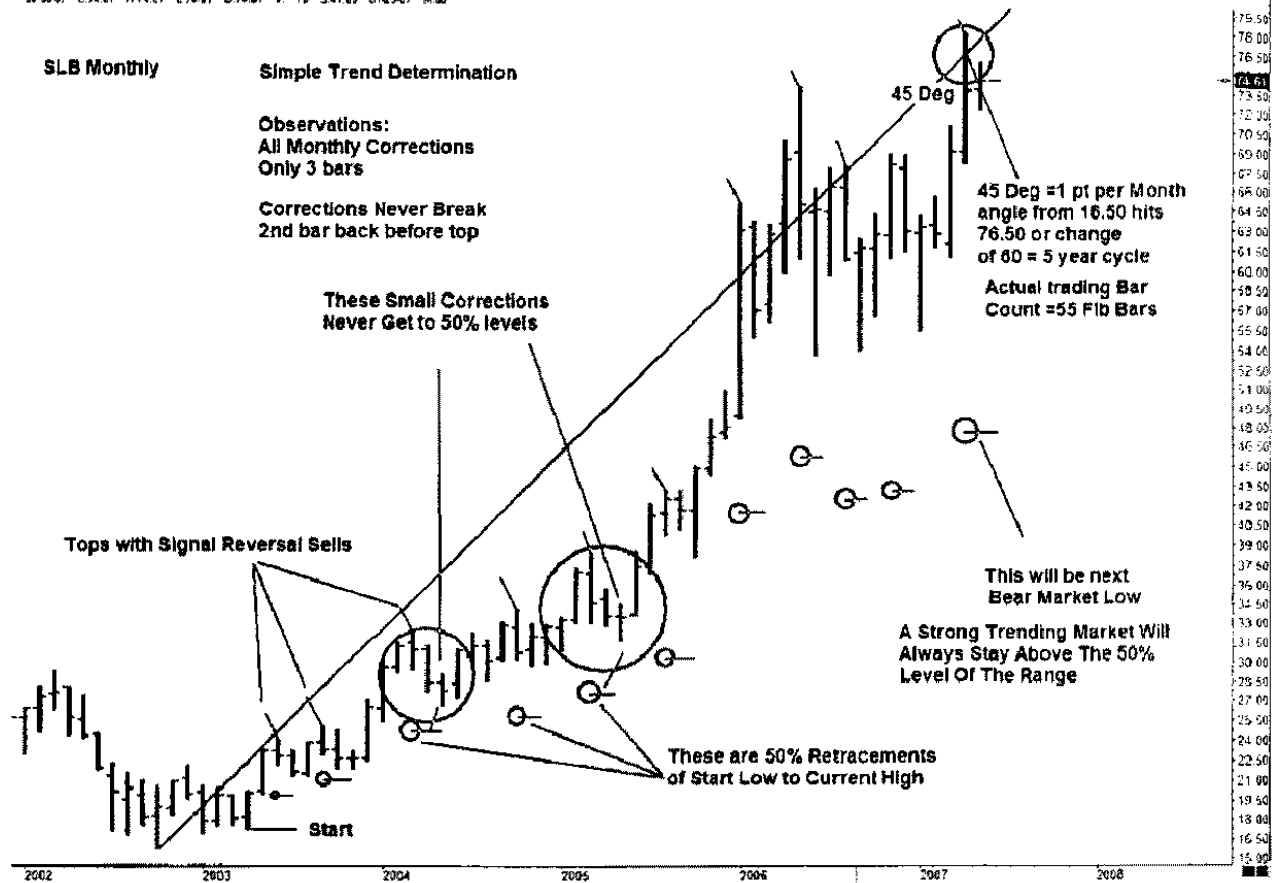
Here's a daily bond chart showing nice straight line moves with anticipated measured moves of length 'A' for potential bottoms. Not drawn in are the offset angles, which work quite well here. Most numerical support and resistance is done after converting the normal price say 114-24 to 32nds or 3672 as the basic unit to work with. If you do that you will see great results. These 'tick' counts also apply to minutes, hours and days, so use my time calculators to see 3672-minute time squareouts!



Very simple but efficient techniques - 1) take Jenkins Natural Ratio Lines from first few minutes of impulse to get good support and resistance, 2) Measure square roots and $\frac{1}{2}$ roots of low and use as time cycles in trading bars. Trade instinctively by just buying and selling at those levels with a stop.



Here's a few long term observations on a stock nearing the end of a bull market. Offset angles provide strong trend lines with targets being ratio lines or square root increments of the low. In this case of CAT we note that the very important long term angle of one point per month from the origin is now at the price the stock is trading at for a potential top so any signal reversal on a weekly chart would be a short. Note, however, that the one point per month angle is 79.86 and 81 would be a natural square so it may have another month of life in it. The 'timing line' from the middle section near the low hits the current price and the 'fractal pattern' at the low is very similar to the big blow up fractal pattern this stock has traced out over the past year. If the fractal repeats a dramatic crash would take place very soon. Most times the top is a mirror of the bottom so always look for patterns from any low that seem to be repeating at a high.

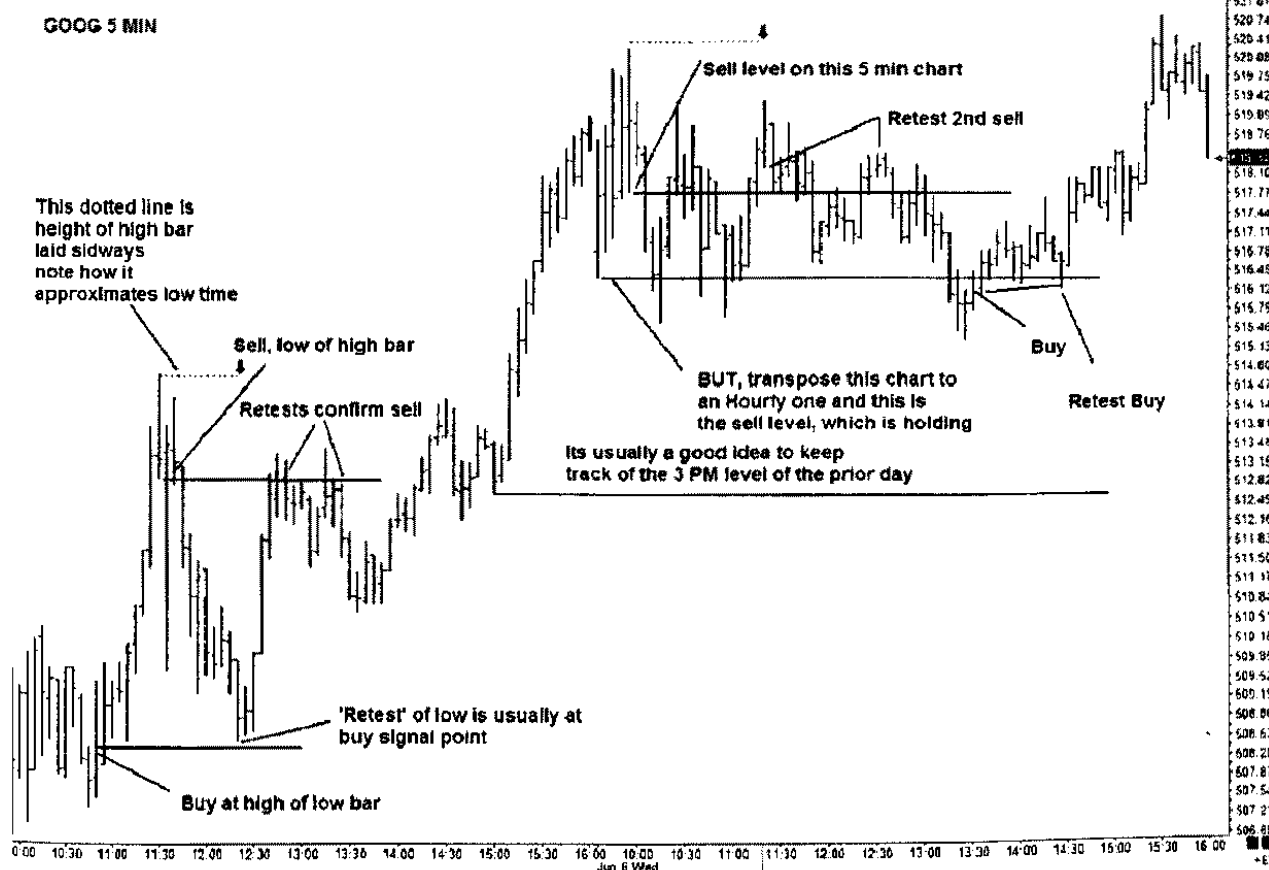


This long term monthly chart simply shows why institutions like 'buy and hold' strategies. Most declines in this stock have only lasted about three months and few swing lows were broken. In the most conservative method you would keep track of the 50% retracements of each successive high compared with the starting low and future bear markets would only get back to that 50% level.

The Jenkins Time Conversion Bar

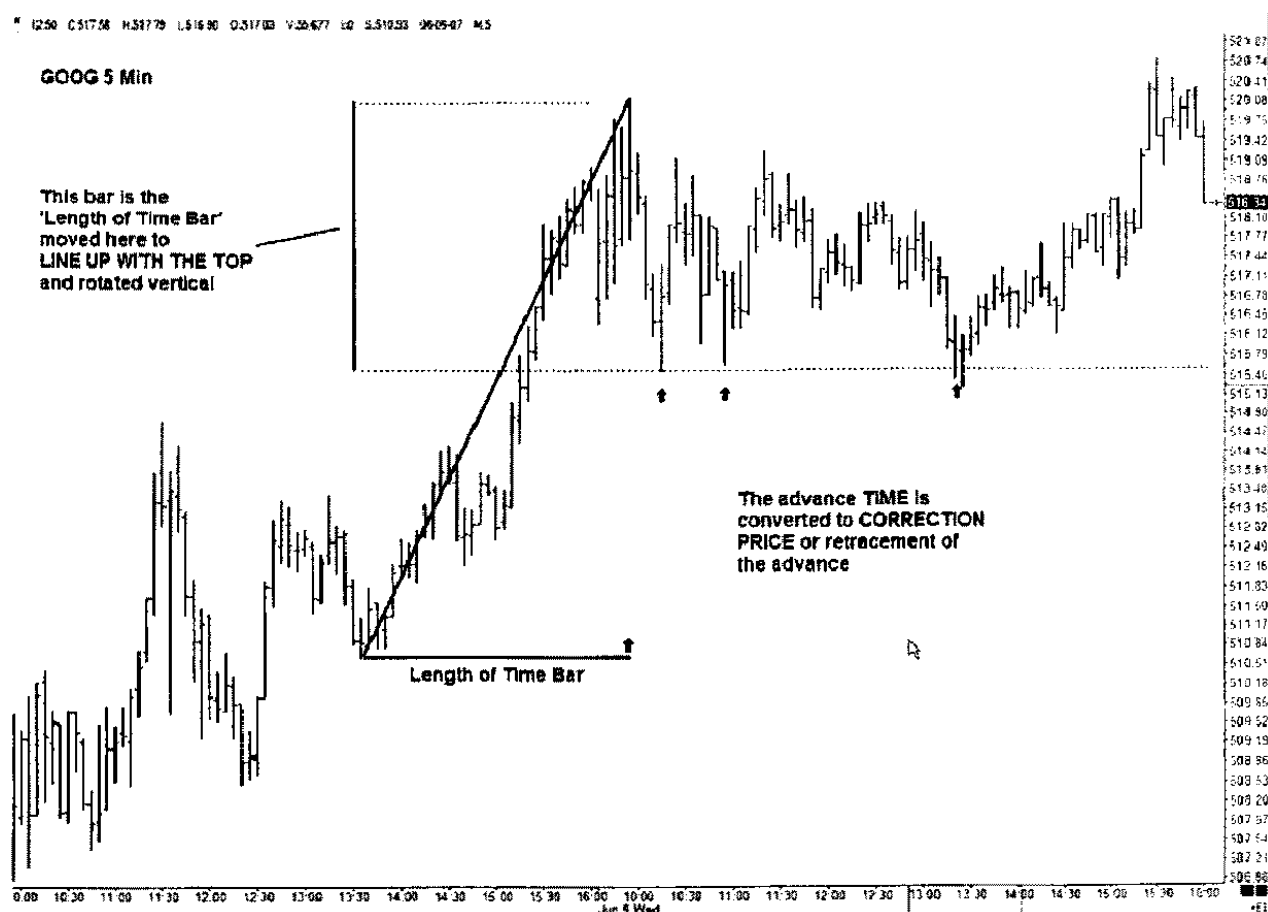
The individual bars on a chart can give us a lot of information. The top of the bar is resistance and the bottom support and when those levels are exceeded we get reversals. The actual length or 'height' of a price bar, however, has very important information in it and I liken it to the technical equivalent of biological DNA. When these high or low bars are turned sideways they are now 'time' bars and not 'price' bars. The support and resistance of the price bar is now translated into time cycle support and resistance. For instance, if you turn the signal reversal high bar sideways, it will often give you the date of the projected low in time. This will not always work because of distorted bars and slippage but as a general rule if you increase your size from 5 minutes to 15, to an hour, a day, etc., you can refine your accuracy.

* 16070 C1518.34 H51473 L513.34 Q41947 v. 10 S515.07 260687 NA

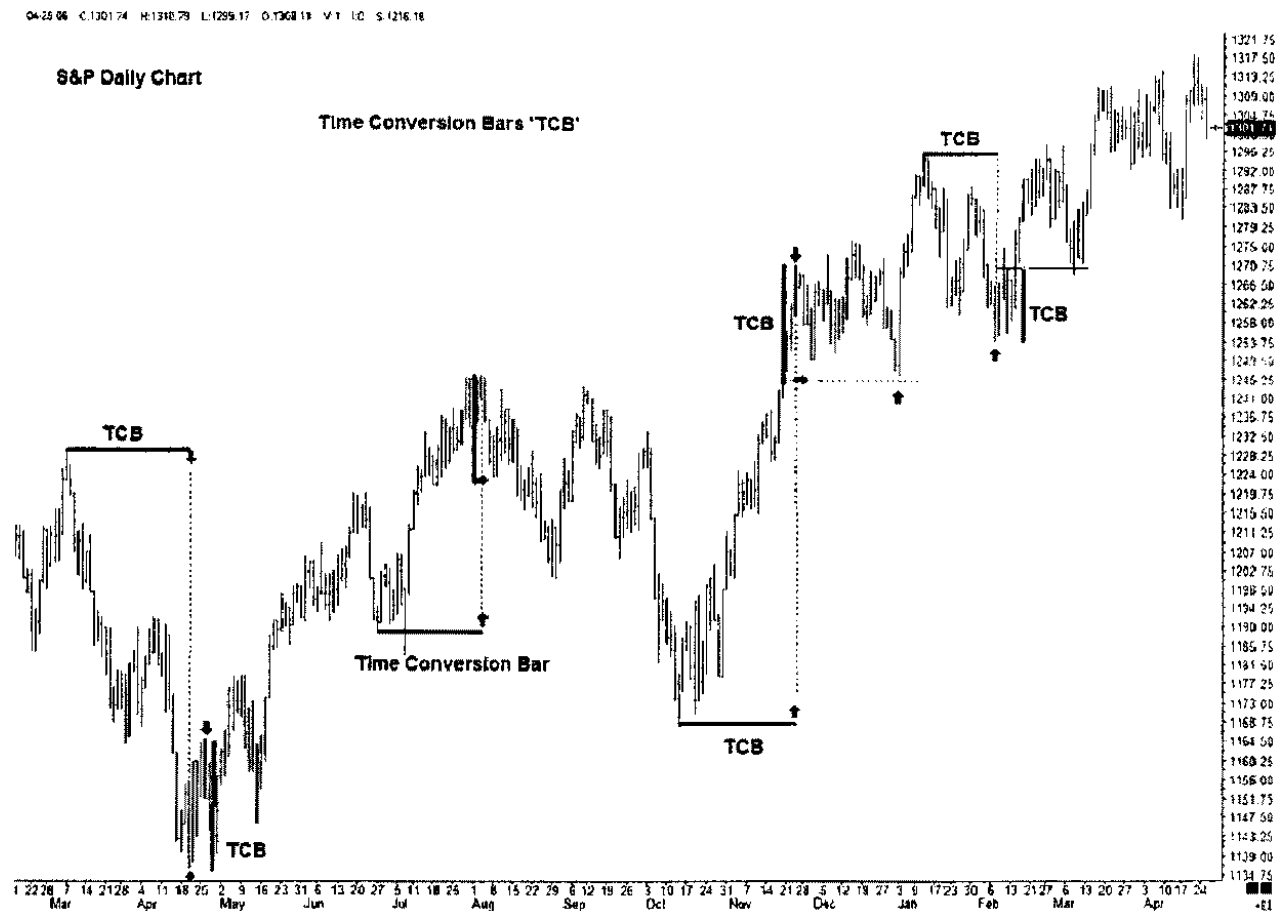


This 5 minute chart of Google shows the first two major tops with horizontal 'dotted' lines that represent those individual high bars turned sideways. The first yields a corrective low time target, while the second a

double top indicated with those 'arrows'. If you need a rough estimate of the duration of a correction or advance try flipping these bars 90 degrees. Also note the 'retest' idea. If the low of the high bar is the breakdown point where the support is gone, then a future rally *should fail at that point and not the high of the old top* but the bottom of the high bar. On a decline, price should stop at the high of the low bar breakout point, not the low of the low. One implication of this time and price interchangeability is shown below. Here we take the sum of time of the advance to the top, and convert it to a bar length rotated into a price bar. The correction down from the high is now price proportional to the time of the advance! This is a major discovery of mine I call 'Time Conversion Bars'.

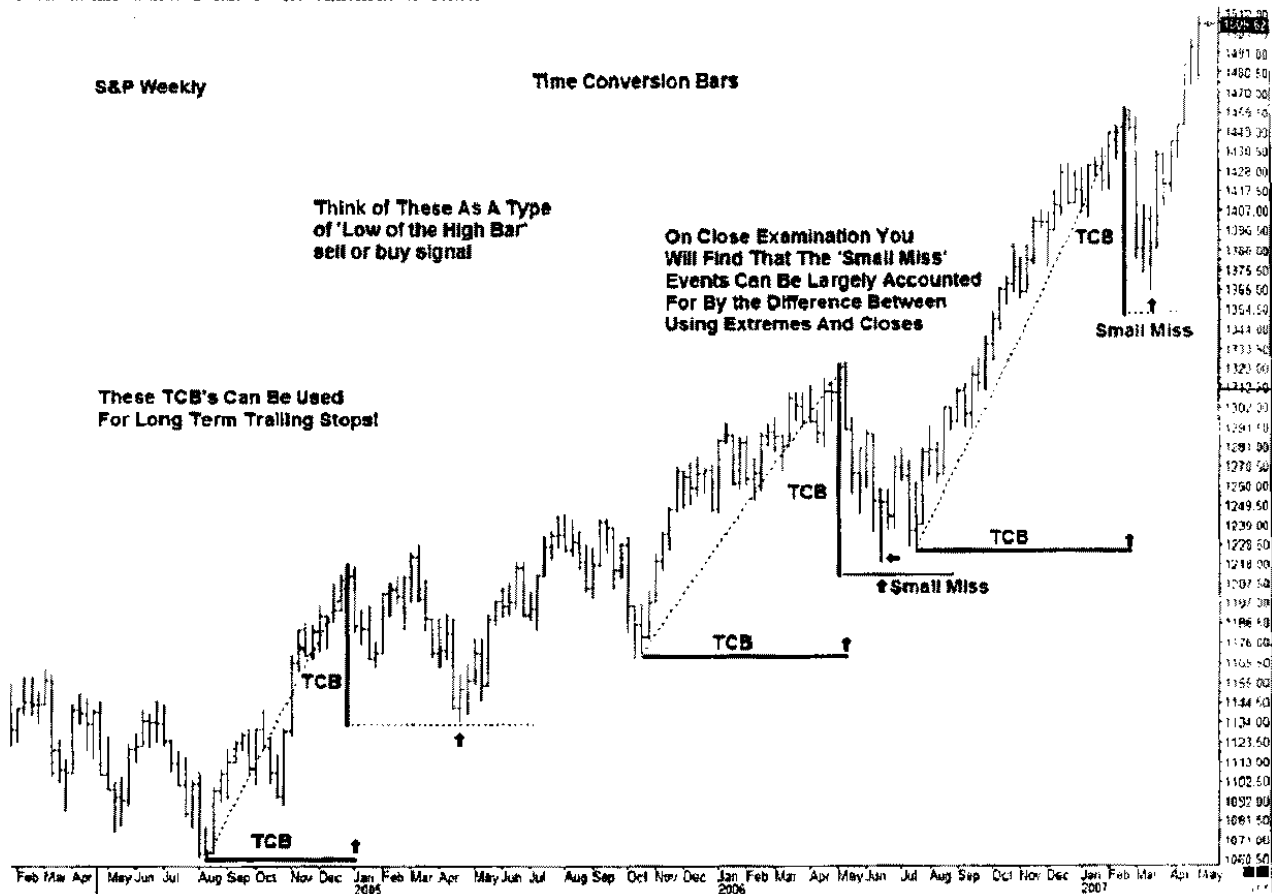


The chart below shows the daily S&P with a number of Time Conversion Bars on it. Note that they almost always give the precise *first impulse wave up or down* for the correction.



Here we see the time of an advance or decline is exactly proportional to the initial reaction off the subsequent end reversal. Bigger reversals are just larger time frames consolidated as shown below.

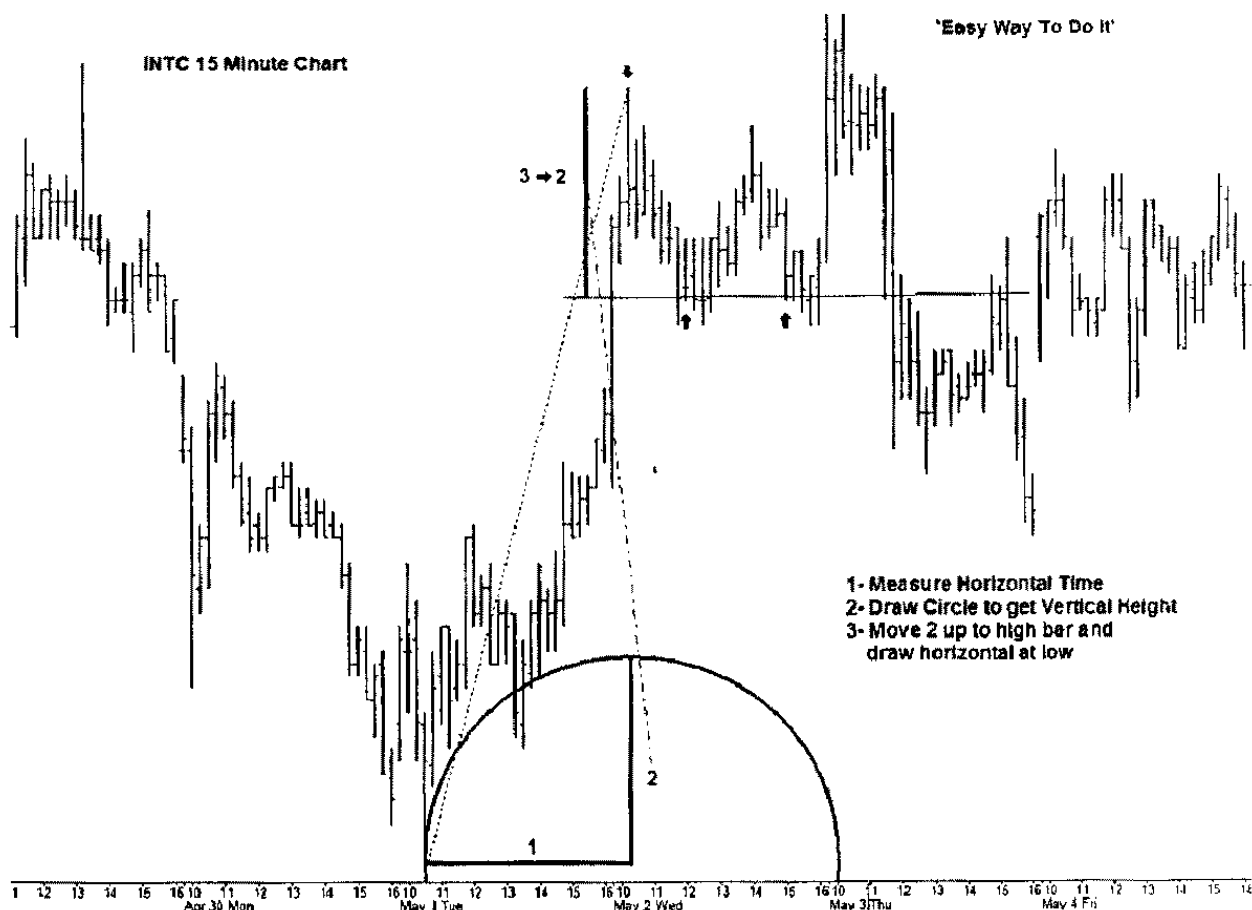
The next chart shows the S&P weekly time frames proving that the technique *is a valid principle* and can be used on anything. In cases where a 'small miss' in accuracy takes place, consider the difference in measuring the extreme high and low and the closing levels and also note whether the origin was an extreme 'panic' bar or a routine normal move. These are basically a conversion of the high bar into *a high bar that represents the entire advance* so to that extent, the correction forecasted is like a sell signal, if the Mow of the high bar' is exceeded. If that low is not exceeded, then it becomes support just like the low of the high bar.



If the TCB truly is a valid bar we should be able to use it with trendlines and forecast into future space, hits and support and resistance. Note above that on a long term basis these bars were perfect trend stops, and as long as each advance generated a decline that stopped where predicted, the long term trend continued higher. As we apply trendlines to these 'stair step' pattern bars, we will be able to forecast the trend quite easily. The trendlines also clear up the concern about not being accurate all the time. This next chart shows just that application and now fully accounts for those troubling 'small misses', which disappear with the trendline approach. We can now apply all those other techniques explained in the early parts of this book to this new trendline.

The 'circled' areas are the trendline hits





Here's a 15-minute stock chart demonstrating an 'easy' way to make the forecast. Just measure the horizontal time distance with a trendline, and if you have a circle tool (or Fibonacci Tool and you set radius to 1 only), circle that time radius (number 1) to get your vertical component (number 2) of the estimated high bar size. Then drag that bar up to the top for the measurement of the expected correction. Here we see the initial reaction from the high holds well enough to buy against for several rally attempts before it fails. But **NOTE**, after that, there is a bigger high, and we can expand our (number 1) base to **THAT** top and get a bigger bar that then gives us the next correction low from that bigger top. Try and measure it yourself, it's amazing!

Recap On Basic Trading Steps

Day trading stocks and commodities should be a fairly mechanical exercise. If you know how to apply valid *principles* and accurate trendlines and calculated support and resistance, then the actual trading is simply a function of entry and exit. You buy on support and sell at resistance. This support and resistance can be in terms of TIME as well as price.

Your first step is always to review the existing trend. Look at the weekly, then daily, then hourly charts. Put on some angles to get you connected with your charts. The subconscious mind can work much better if it gets involved in drawing angles and counting bars. It won't get scared when you trade if it knows it is based on science. Always try and find the 1-point per time unit trendline that seems to be working and place those on your charts. Check the range for square outs by ... looking at your trendlines intersecting price levels, indicating an amount of time has passed which equals a price increment. Look for signal reversal bars- the high of the low bar, the low of the high bar. Once you see the most recent ones estimate how far the new trend should go based on measured moves. These can be simply 'copied' trendlines taken from the last similar advance or decline and moved to the current buy or sell signal. See if that length of a copied measured move ties in with 1) an angle, 2) a square root resistance level, or 3) a Jenkins Natural Ratio Line. Now check for time cycles. Look for square roots in time, circular arcs swung up or down going 'vertical', indicating the end of a move. Fibonacci numbers and natural squares of integers frequently show up as time counts.

All the above can be done in about 30 seconds to a minute or two by seasoned traders. You do the same things over and over and over until it becomes instinctive. Once you have your targets set, place your orders at **YOUR PRICES**, not at the market. Trading is dependent on small margins and sloppy buys and sells take too much from your wins. The market moves every minute, but you don't have to trade every minute. You wait for the best minute that looks familiar to you to trade. If you use precise angles or pivots like the overlap method, don't second-guess yourself. Just put the order out there. They will work a great percentage of the time. Stops are meant to be hit on the occasions that the angles and pivots don't

work. If I am trading stocks for example, I can put in several dozen orders at precise limits before the market opens and I do not care what that opening is going to *look like*. Individual stocks don't even know about the other stocks. They just follow their own course. If you put limit buys and sells at their specific pivot points they will respond to those points appropriately. Don't read the tape to adjust your orders too much. Just let them get filled at any time during the day and then put in your sell limit and your stop order. If you are a scalper as opposed to a several day swing trader, use time stops on your trades and get out if you are not making money after a few bars of the time frame you are trading. If you aren't making money and you put the order at the right level it usually means you made a mistake in your calculations. If you are in a trade for several bars duration and you are profitable, raise your stop to break even. There *is absolutely no excuse* to let a profit turn into a loss just because you have a stop. Remember the stop is only used because we *are uncertain if our entry point will work* and it's usually a counter trend trade like buying into a dip or shorting a rally into resistance. Once you are in the trade you should know if you were right or not. Leaving a trailing stop out there at a loss level will only compound losses. There is no fault in breaking even most of the time if you let your winners 'run' for a while.

Letting your winners run is supposed to be the basis of long term 'buy and hold' strategies that Wall Street is always trying to sell you on. Yes, you certainly can become a millionaire buying and holding stocks, and salesmen will always point out the chart in the book that went up for 12 years with hardly a pull back. Unfortunately the chart books no longer carry issues that many held until they went bankrupt or went dead at \$1. Only the winners are kept in the chart book service. The whole idea of buy and hold *assumes you are doing so at a profit*. If you are a retail mutual fund investor you must make sure your fund is not breaking weekly lows and certainly not breaking monthly lows. As long as your funds or stocks make higher weekly lows it's okay to hold. In an extreme situation you could hold as long as each upward swing holds a 50% retracement or higher, of the advance.

On short term horizons like intra-day, you must watch the daily patterns and remember those 10% and 1/8 daily breakpoints. The market frequently reverses at those intra-day breakpoints so have a strategy of not letting profits run too long if you are a scalper.

Scalping techniques like 'length of the base is equal to the height of the move' is one of the most common trading plans. Most may not realize it but that's what you are doing when MSFT breaks out of a 15 minute chart base, formed over two hours. Buying breakouts only happens when accumulation or distribution is complete. Remember to ask yourself if the big money had enough time to get in or out before you assume a quiet chart is suddenly going to do something. Believe me when I tell you the arbs can hold a stock or future flat for long time periods while they arbitrage options to get their positions (By the way, I use the term 'arbs' to indicate most big Wall Street firms trading for their own account, and not necessarily a traditional arbitrage firm doing takeover deals). Even on a huge up day when they plan on buying 300,000 S&P contracts, they will run them up fast for 50,000 contracts 'to get their feet wet' and every few minutes bash them right back down selling 5,000 contracts to run the stops while they have scale down buy orders picking up all the pieces. Those 'wild' swings you see a lot in the futures is just such action and it only looks wild. They are buying with an average cost mentality and will buy them up, buy them down, and also do some selling to run stops and get a better average price. The extreme high or low for the whole day is often in by 10 AM or 10:20 AM and those swings are just to shake you out and keep you guessing. It's best to follow the trend after 10:30 AM. If you trade during those opening times try and find a stop level based on the prior day's ranges rather than the current 5 minute chart ranges.

Patience is a virtue and waiting should be what you do most of the time. If you are having a hard time grinding out \$500 or \$1,000 a day, do you think it will be easier if you trade 30 times every hour? Chances are good that you will do much better if you just pick three potential time points in the day that are not in 'traffic zones' (first and last hours) to trade and go with the existing trend. Just because you buy and later sell at a profit doesn't mean you have to buy immediately again. Let the trade 'set up'. Wait for a level at major support or resistance with distribution complete before you go in. Try and preplan your trades with the crossing of important hourly chart angles of 1 point per hour to point out potential trades you can wait for, and don't watch the tape to 'see' trades that have little chance of making money. If the S&P's are in a mini 'waterfall' and stop exactly on your secret number, think twice about buying just then. The *momentum* of a waterfall pattern usually means much bigger time frames are at work and it does take basing time to arrest the downside

momentum. Watch and wait for a signal reversal bar to go long in that case and know that if it's a big break, you may have to wait for signal reversal bars to give buy signals on several time frames like 15 minutes, and hourly, as well as the 5 minute one you are watching. Remember, a base or top must be commensurate with the move. That includes a breakdown, which requires a big base before going back up, and when shorting a top, you need a big enough distribution area to guarantee some downside momentum. Most traders get into trouble with these kinds of momentum waterfall trades that have exceeded the usual measured move but look tempting nevertheless. That's usually a prescription for disaster. Look for a measured move. Wait for prices to base at the measured move amount, then buy or sell on the signal reversal bar coming out of that base.

There are many more strategic plays to the market but if you are 'trading' then that is what you should be doing- buying and selling at support and resistance. Our basic bar chart will show the trend if you follow it and don't listen to advice from the 99% of the people who don't really know what they are talking about but are just 'talking up their book'. They already have a position by the time they tell you about it. Their plan is to get you in behind them. Do your own thing. The trend doesn't listen to opinions, and stops are your only friend.

Matt 7:7-8

Ask, and it shall be given you; seek, and ye shall find; knock, and it shall be opened unto you: For every one that asketh receiveth; and he that seeketh findeth; and to him that knocketh it shall be opened.