Lance Beggs

YTC Price Action Trader

Intraday Swing Trading for the Forex, FX Futures and Emini Futures Markets

About the Author

Lance Beggs is a full time day-trader with a current preference for forex, FX futures and emini-futures markets. His style of trading is discretionary, operating in the direction of short-term sentiment within a framework of support and resistance.

As an ex-military helicopter pilot and aviation safety specialist, Lance has an interest in applying the lessons and philosophy of aviation safety to the trading environment, through study in human factors, risk management and crew resource management.

He is the founder and chief contributor to http://www.YourTradingCoach.com, which aims to provide quality trading education and resources with an emphasis on the 'less sexy' but more important aspects of trading – business management, risk management, money management and trading psychology.

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VOLUME ONE

INTRODUCTION

Chapter One - Introduction

1.1 - Introduction

Welcome to the YTC Price Action Trader.

I have two primary aims for this book.

1) To share with you the way that I view the financial markets and the way that I use price action to identify and manage trade opportunity.

2) To share with you the development process that I believe you need to follow in order to become a consistently profitable and professional trader, regardless of the strategy you choose to implement.

Of these two primary aims, the second is by far the most important.

New traders mistakenly believe success is all about the right knowledge and the right strategy. While this is important, they fail to understand that becoming a trader is really a process of growth and development. Success is not a result of one day finding the right combination of indicators or parameters and the right set of trading rules. Success comes through a process of learning to trust yourself as you operate within an environment of uncertainty. Trusting your ability to make effective decisions, to manage risk, and to identify and manage opportunity.

In drafting this book I initially placed this material at the beginning, prior to any discussion of strategy. My fears though, were that too many would be tempted to skip over this information in an attempt to get to what they perceived to be the higher value material – the strategy.

So, right or wrong, I've reworked the text to place this material at the end. And to be honest I feel it works better this way.

The real learning begins beyond the final pages of this book as you gain exposure to the uncertain nature of the markets. By structuring the book as I have, the routines and procedures required to ensure an effective learning process will be freshest in your mind.

If I have done my job well, you'll clearly understand the path that lay ahead of you and be approaching that journey well prepared for the challenges it will provide. You'll have a newly discovered interest in learning theory, decision making, trading psychology, as well as risk and money management.

But don't worry… we will discuss markets and strategy as well.

While not unique to me, you'll find the way I view the markets to be different to the way the majority approach this game. It was this change in perspective which resulted in one of the greatest advances in my own development as a trader. I hope it has the same impact on you.

The strategy shared within this book is a discretionary method of trading. It is not a simple *"buy on trigger A and sell on trigger B"* system. Such simple systems do not work, no matter how much we wish they did. Spend a day surfing any of the numerous systems forums and you'll see this for yourself. Many systems are presented which appear to offer great potential, generating excitement amongst the forum participants and a flurry of posting activity. Ultimately they fade away to nothing as the participants discover the system fails to deliver consistent results, or they become frustrated as it morphs into a completely different system as filter after filter is applied to try to overcome its limitations.

As you discover the way I view the markets you'll understand why these systems don't work. Typically they're based upon a false premise; a false understanding of the market environment and a false understanding of the reality of the trading game.

In the chapters which follow, you'll discover the reality of the market environment and finally understand what this game is really all about. And you'll be free from the illusion that leads to so many traders being stuck on the seemingly never-ending search for the Holy Grail trading system.

Unfortunately though, discovering reality doesn't make this an easy game. But at least you'll finally be on the right path.

I will be sharing the strategy that I use. However I can't guarantee that it will suit your needs and provide you with consistent profitability. It is a discretionary strategy. Hence the importance of understanding the key points within the disclaimer at the start of this document; understanding that trading does expose you to risk and that you'll most likely lose money as you progress through the growth and development process.

In applying the strategy, you'll be required to use your own discretion and intuition. Results will therefore depend on your own level of growth and development. You can't learn to ride a bike through reading a book; it requires experience. Trading is the same. This book will provide you with the underlying theory of the markets and a strategy which is designed to operate within that market reality. This is a starting point only; the real learning comes through exposure to the market environment.

Ultimately, I don't expect to create carbon-copies of myself. The reality is that we are all different people operating with different perceptual and decision making abilities. Your application of my strategy will be uniquely yours. So don't be afraid as you progress through the trader development phase to experiment with changes to the strategy. Take what works for you, and discard what doesn't; blending my approach with your previous knowledge and experience to create your own work of art. Provided the end result is based upon the reality of the markets, as we'll discuss in Volume Two, and the application of your strategy has been developed via the trader development process we'll discuss in Volume Five, you'll be on the right path.

1.2 – Scope – Strategy, Markets & Timeframes

The strategy presented in Volume Three of this book is simply called the YTC Price Action Trader.

It is a discretionary based, swing trading strategy, which involves analysis across three timeframes, in order identify and trade the swings on the intermediate timeframe.

Although the strategy is adaptable to any market and timeframe (provided sufficient liquidity), the examples and discussion will primarily focus upon one market and one set of timeframes. This will ensure simplicity as you will always know whether a particular chart relates to the higher, intermediate or lower timeframe.

The chosen market and timeframes for demonstration of the strategy are:

- 6B (British Pound FX Futures, equivalent to the GBP/USD)
- 30 min, 3 min and 1 min charts

Why this combination? Simply because it's one of my favorites!

Is it the only market and timeframe which works? Absolutely not!

Do not be too concerned if you wish to trade other markets and other timeframes.

Chapter Six will discuss the factors which need to be considered in adapting this strategy to alternate markets and timeframes, as well as offer chart and setup examples. In particular we'll look at the forex market, the emini futures markets, and stocks, as it's a simple process to adjust and adapt to these markets. And we'll look at higher timeframe considerations.

Where there are other considerations that go beyond the scope of this book, and I'm able to provide expanded and detailed information related to these markets or timeframes (essentially making the adaptation for you), I'll do so via a small supplementary ebook such as the currently planned:

- YTC Scalper

The strategy is the same; it's just the application in these environments which has a few unique characteristics. I've kept them separate from the main book as they're not going to be of interest to the majority of readers, who will simply trade the standard YTC Price Action Trader.

For those of you not too familiar with my website, and wondering what markets and timeframes I currently trade…

The majority of my trading over recent years has been in applying the YTC Price Action Trader strategy as follows:

- GBP/USD (spot forex) using 60 min, 5 min and 1 min charts

Then upon discovering the cost and execution advantages of FX futures over spot forex, this changed to:

- 6B (British Pound FX currency futures, equivalent to the GBP/USD) and the YM (emini Dow futures) using 30, 3 and 1 min charts

More recently though, my trading has undergone a further evolution, as I move away from my standard timeframes towards shorter scalping timeframes (5 min, 1 min and 20 tick charts) on the YM and TF. This has become known as the YTC Scalper variation.

Although scalping is where my current trading lies, and where I will likely have my focus for the immediate future, I have chosen to present the original YTC Price Action Trader markets and timeframes as the primary method discussed within this book.

The reasoning is simple - I recognize that the majority of readers will not be interested in scalping the markets. And those that are will still get value in learning the standard approach, prior to studying the scalping variation.

1.3 - Acknowledgments

Unfortunately I never found one person to act as a mentor. I consider myself to be self-taught, having developed my trading approach through trial and error.

That being said, I expect there is nothing new in my approach to trading that hasn't been discovered before by others. This is just my unique interpretation of a blend of information, which has been gained from exposure to many others throughout my trading journey.

Numerous traders and educators have had significant influence in my own trader development. There are too many to mention in full, however I would like to offer a special thanks to the following people:

From my earlier days; Dr Alexander Elder, Dr Van Tharp, Mark Douglas, Linda Raschke.

And those who currently provide inspiration and new insight: Mike Reed, Denise Shull, Davin Clarke, Don Miller, Sam Seiden, Toni Hansen and Dr Brett Steenbarger.

Study everything you can find that was written by these people.

Charting

Charts throughout the book have been produced using Ninja Trader (www.ninjatrader.com) and Think or Swim (www.thinkorswim.com).

1.4 - Prerequisites

This book is not written for a complete novice. It will not explain the basics of charting and technical analysis, which should be considered prerequisite knowledge.

If you are new to this game and are not familiar with charts, the creation of price bars or candles, or the use of common charting patterns and technical analysis indicators, then you need to delay reading this book until you've established this base-level of knowledge.

The following webpage will provide you with some recommended sources of this prerequisite knowledge, some low-cost and some free:

- http://www.yourtradingcoach.com/Trading-Resources.html.

1.5 - Feeback

Feedback is greatly appreciated, whether positive or negative. In fact, I absolutely encourage feedback if you disagree with anything presented in this document. I make no claims of being a Guru Trader who knows it all. I see myself as someone who's perhaps been where you are right now and who may be able to help you take the next step. I believe that no-one will ever master this game; rather it provides us with a never-ending process of learning. While I look back at my view of the markets even just five years ago, with a laugh at how naive I was, I would similarly be delighted to look back at this work in another five years and see further progress and growth. We can learn from each other.

Please send all feedback to: support@YourTradingCoach.com

I'd love to hear your thoughts.

1.6 - Contents Overview

The following provides a quick summary of the material to come…

Volume Two – Markets and Market Analysis

Chapter 2 of the series is where we discover the reality of markets and the trading game. We'll see the true nature of price movement and the way that I view markets that allows me to identify areas of trade opportunity. You'll come away with not only a new understanding of the markets, but also an understanding of why most traders lose and why most other systems are ineffective.

Chapter 3 of the series covers market analysis. You'll learn how I analyze price action within a framework of support and resistance. You'll learn to develop a bias for future price action, and update that bias as the market data unfolds bar by bar.

Volume Three – Trading Strategy

In chapter 4, we'll discover the YTC Price Action Trader. We'll find out where the opportunity for profit exists within the market structure we have created and analyzed in chapter 3. And we'll work through examples showing how to identify, execute and manage these trade opportunities.

In chapter 5, we'll review a number of trade examples, from start to finish. A common complaint with trading books is that authors always seem to show the best trade examples; those that move immediately from the entry trigger to great profits. Interestingly, I have also felt this temptation – ego is an amazingly powerful force. However I've seen enough trading books to know that this does not serve you well. Reality is never as neat as the textbook examples. I have therefore attempted to show you trades based on the reality of the markets – a mixture of different setups – some which do move to profits – but others which will stop me out, or even cause me to scratch the trade at or around breakeven due to doubt about future profitability. Hopefully this will provide greater benefit.

Chapter 6 will discuss implementation of the strategy in other timeframes; as well as other markets such as forex, emini futures and stocks.

Volume 4 – Your Trading Business

Volume 4 is where we approach our trading in a business-like manner. Chapter 7 and 8 ensure our financial survival, through establishment of our money management and contingency management plans. Chapter 9 discusses our goals and targets.

Chapter 10 aims to ensure our personal survival, through a practical application of trading psychology tools and techniques.

Chapter 11 sets up our trading platform.

Chapters 12 and 13 discuss the two primary documents used in our trading business – the Trading Plan which outlines our strategy for profiting from the markets; and the Procedures Manual, which establishes our daily pre-session, during-session and post-session routines, contingency management and review processes.

Chapter 14 will complete our discussion of documentation, outlining the numerous journals and spreadsheets that will be required, should you approach this challenge in a professional and business-like manner.

Volume Five – Trader Development

This is where we discuss the process of becoming a trader.

In Chapter 15 of the series we will reinforce the point that becoming a professional (and consistently profitable) trader is not an end-state, but a journey of growth and self-development.

Chapter 16 will talk about the learning process – the principles, tools and techniques needed to ensure efficient progress through your trader development journey. This is something you won't find in most trading books, but which I believe is of great importance.

Chapter 17, Taking Action, will provide you with some direction for the way forward, and will establish a plan for your progression through the four stages of trader development.

Volume 6 – Conclusion

Chapter 18 wraps up the series with a summary of the main concepts.

Before you begin, I recommend spending some time skimming through the six volumes in order to provide yourself with a bigger-picture overview and familiarize yourself with the structure of the contents.

Enjoy!

**“Since we cannot change reality,
let us change the eyes which see reality.”**

…Nikos Kazantzakis

VOLUME TWO

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MARKETS AND MARKET ANALYSIS

Chapter Two – Principles of Markets

2.1 – Principles of Markets

One of the key reasons most traders fail to achieve consistent success is that they do NOT understand the game they are playing.

- They fail to understand the true nature of the markets
- They fail to understand the true nature of the game of trading

In this chapter we aim to correct these errors.

Some of the discussion may appear extremely obvious; but stick with it. It sets a foundation that builds to give you a more enlightened view of the environment within which we operate and how that view of the markets allows us to profit.

Most trading books and courses focus on price movement and the resultant patterns and indicator based signals. They‟re missing a key fundamental concept that underlies this price movement.

At the end of this chapter, you‟ll have a clear understanding of:

- The true nature of the markets
- The true nature of the trading game.

You‟ll finally understand why all those systems you tried were ineffective.

You‟ll no longer be interested in systems.

You‟ll be free of the search for the Holy Grail trading strategy.

And the foundation will be set for correct analysis and correct trading of the markets, via the YTC Price Action Trader strategy, or in fact any other reality based strategy you may wish to develop yourself.

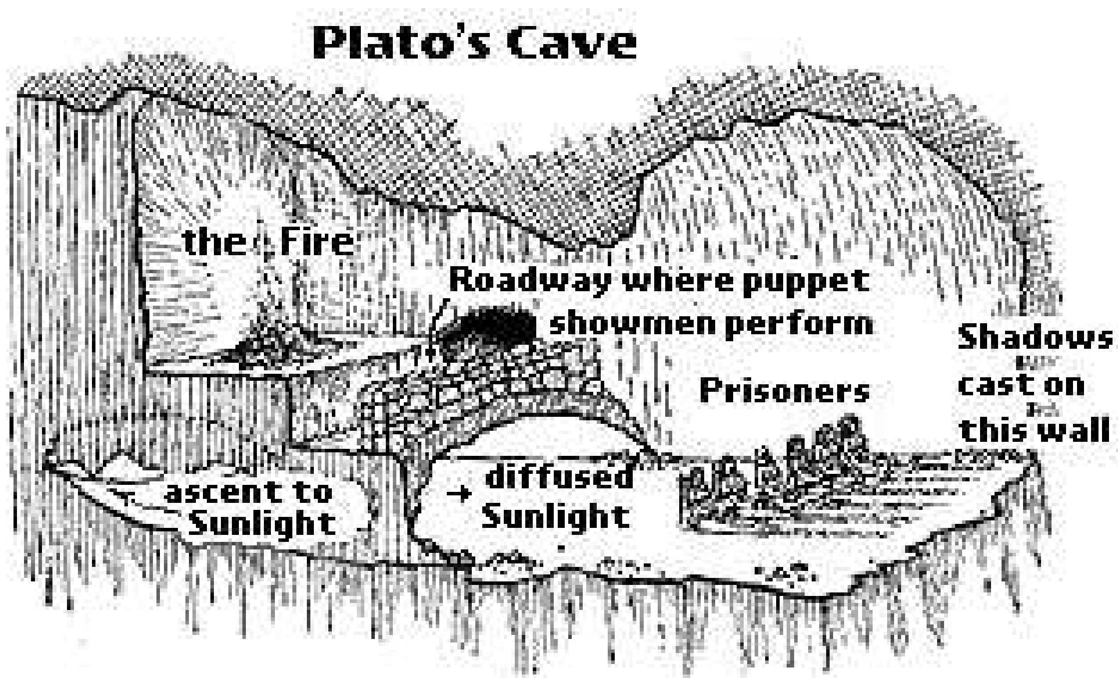
2.2 - The Reality of the Markets

2.2.1 Trading the Shadows

What did Plato know about Trading?

Probably nothing! But he has a great analogy which I‟m going to share in order to demonstrate some key concepts:

- Our reality is based upon that which we perceive.
- Often there is an underlying reality which we have just not seen.



- From *Great Dialogues of Plato: Complete Texts of the* Republic, Apology, Crito Phaido, Ion, *and* Meno, *Vol. 1*. (Warmington and Rouse, eds.) New York, Signet Classics: 1999. p. 316.

Figure 2.1 – Plato‟s Allegory of the Cave

In describing the scenario, I‟ll share a short passage from Wikipedia, as it discusses Plato‟s Allegory of the Cave…

> "…imagine a cave inhabited by prisoners who have been chained and held immobile since childhood: not only are their arms and legs held in place, but their heads are also fixed, compelled to gaze at a wall in front of them. Behind the prisoners is an enormous fire, and between the fire and the prisoners is a raised walkway, along which people walk carrying things on their heads "including figures of men and animals made of wood, stone and other materials". The prisoners can only watch the shadows cast by the men, not knowing they are shadows. There are also echoes off the wall from the noise produced from the walkway.
>
> Is it not reasonable that the prisoners would take the shadows to be real things and the echoes to be real sounds, not just reflections of reality, since they are all they had ever seen or heard?"

In other words…

What we perceive as reality is not necessarily so. Often there is a deeper reality which we have just not seen.

Or…

That, which is perceived to be reality, is actually an illusion.

The same applies to trading.

My belief is that most people do not understand what a market is.

They see a chart and perceive price movement and its resultant technical analysis patterns and indicator based signals.

And they assume this is reality. It‟s all they know. And it‟s all that‟s taught in the majority of books, websites and courses.

Unfortunately, these traders are like the prisoners in the allegory of the cave. Chained to their viewpoint, they falsely believe in their version of reality, which is in fact an illusion. They fail to perceive the fact that there is a much deeper truth to the markets.

A reality that I believe makes ALL the difference in trading.

Most traders are *Trading the Shadows**, usually with no understanding at all of the reality behind those shadows.

The reality of the markets (which we‟ll discover shortly) is projected as price chart patterns or their derivative indicators. These are the shadows, or the illusion. Most people perceive the shadows as the game. They think it‟s all about the price, or the patterns or the indicators, so they try to trade them. It‟s not about that – the game is about something else entirely.

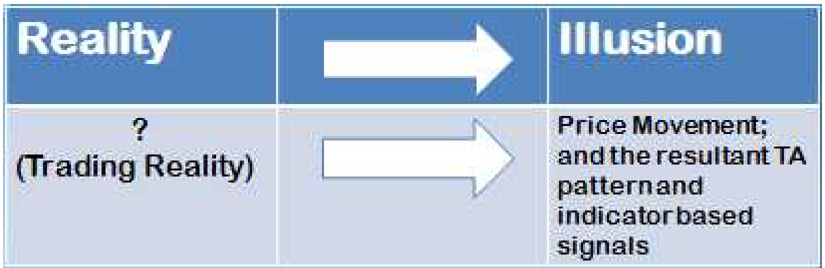


Figure 2.2 – Reality vs Illusion

Finding no success with their setups, or indicators, traders go on the search for new indicators, new setups, new parameters. But they‟ll never find the truth, because they‟re trading the shadows. They don‟t perceive the reality.

Successful trading requires seeing the reality that forms the shadows. That is, the reality that produces the price movement, then indicators and the patterns.

The reality is not just „price‟.

It exists at an even deeper level of understanding – that which creates price and price movement.

* Thanks to one of my newsletter readers, Stuart, who came up with the term, *Trading the Shadows*.

2.2.2 Cause and Effect

Just quickly, we‟ll look at this in one other way, which some of you may find more useful.

Let‟s look at price movement through a different lens – that of Cause and Effect.

Price movement and any resultant indicator and pattern based signals are the EFFECT. Most traders focus here. That‟s all they see and that‟s what they try to trade.

Cause		Effect
? (Trading Reality)		Price Movement; and the resultant TA pattern and indicator based signals

Figure 2.3 – Cause vs Effect

Instead, to truly understand the markets, we need to focus on the CAUSE.

What causes price to move? That‟s where we focus, because:

- Only then can we understand the reality of the markets.
- And only then can we understand how to identify when a move is likely to start, when it‟s likely to continue and when it‟s likely to end.

In analyzing the chart of figure 2.4 on the following page, most people focus solely on price. They observe the bearish breakout as price broke below a period of sideways consolidation, or a short-term head and shoulders patterns (marked by labels S-H-S).

If they‟re pattern based traders they‟d be looking to enter short either at the break of the head and shoulders neckline (point B), or on the first confirmed close below the neckline (point C).

Indicator based traders would also likely enter in the vicinity of C as their signals are typically based on a lagging derivative of price, which won‟t trigger entry until significant movement has occurred in the new direction.

Figure 2.4 – Chart Based Cause and Effect

The problem for these traders is they‟re focusing on price.

The price move is the EFFECT.

These traders are simply responding to the effect, entering in the **HOPE** that the momentum of this move continues in the bearish direction, long enough for them to attain a profit.

Hope is not good enough for me.

A better way to trade is to understand the CAUSE of price movement.

Although you don‟t see it yet, identifying the CAUSE in this example would have allowed you an entry in the vicinity of A, with an expectation that if price broke the area of B and the slightly lower support, movement would be clear until possible target areas in the vicinity of D and E. Had the move failed at B, sufficient opportunity would be available to scratch the trade for either a small profit or a breakeven result.

Understanding CAUSE allows you to identify potential moves before or as they occur.

Understanding CAUSE allows you to enter a price move earlier.

Understanding CAUSE allows you to understand why a price move is occurring.

Understanding CAUSE allows you to assess when a move is likely to continue and when it‟s likely to end.

Understanding EFFECT only, means that all you can do is react to what has already occurred, usually well after it has already occurred, and then simply hope that sufficient profit potential is still available in the move.

So, if the market is not price movement, patterns and indicators, then what is it?

What is the reality?

To understand the true nature of the markets we need to take a journey through a few steps.

Figure 2.5 – Discovering the Reality of the Markets

We need to start at some very basics – what is price and why does it move? That will lead us to a new understanding of the nature of the markets.

The nature of markets is not price. It‟s something else entirely different.

2.2.3 - What is Price?

Regardless of whether we‟re talking stocks, futures, foreign exchange, or any other product at all, price is the amount a buyer pays to acquire a product from a seller.

Any one transaction involves a product, and two parties – the buyer and the seller. The seller holds the product. The buyer wants to purchase it.

Price is the amount that they agree upon for the transfer of the product from the seller to the buyer.

The key word in this sentence is…

… agree… The buyer wants to buy at this price. . The seller wants to sell at this same price. They come together. There‟s a transaction.

So, what is price?

Yes, it is the dollar amount, or points value, that they agree to transact.

But that‟s not how I want you to view it.

Instead, view price as two parties making a buy and sell decision.

From a trading perspective…

Price is two traders making a buy and sell decision.

It‟s a subtle difference, but it‟s important.

Now, markets don‟t transact all at one price… they move. Thankfully, otherwise there wouldn‟t be profit opportunity.

As we mentioned before, most people are happy to just accept that markets are price movement.

I‟m going to take us deeper. Now that we view price as not just the dollar or point value of each transaction, but of **traders making buy and sell decisions**, we‟re going to look at how those decisions make price move.

This will lead us to our deeper, and superior, understanding of the nature of the markets.

2.2.4 - How Does Price Move?

Price movement is a function of supply and demand.

In fact, as we‟ll see it‟s deeper than that, again. We‟ll soon be discussing what drives supply and demand. But for now, I need to discuss supply and demand; to be sure you understand this basic concept.

Let‟s define the concept and the terms in simple (non-textbook) language: Supply

is the amount of a product which sellers want to sell at a particular price. Demand

is the amount of a product which buyers want to buy at a particular price. Price

will move with changes in supply and/or demand.

Let‟s look at some examples…

First we‟ll look at an example that most people will be familiar with - a housing auction. In this scenario, we have a fixed supply – one house for sale. And we have a variable amount of demand, depending on the public perception of value. For a very nice house in a great location during times of strong economic growth, there might be a large crowd of potential buyers, all competing for the property. For an overpriced house, in a down-turning market, there may be only a small number of potential buyers, or possibly even none.

For this example, we‟ll assume we have a large crowd of buyers, all desperate to take ownership of the property, all willing to buy at varying prices between say $650,000 and $750,000. The realtor opens the auction at $550,000. What happens next is that the bidders will compete with each other at ever increasing prices, hoping to be the last one standing at the end of the process. Initially price will increase rapidly, $575,000 - $600,000 - $620,000 - $640,000 - $650,000 - $660,000. As each bidder‟s maximum price is exceeded they‟ll drop out of the race. The rate of price increases may slow and bidders will typically take more time to consider their next move. If enough emotion is involved in the purchase, bidders may even exceed their pre-planned maximum price, desperate to ensure no-one else gets *their* property. $750,000 - $752,000 - $752,500 - $753,500. Eventually there will be no bidders left who are willing to pay a higher price, and the property is sold to the highest bidder.

In this example, demand consisted of multiple buyers all wanting to buy and willing to pay higher prices to do so. Supply consisted of a single seller, willing to allow price to increase until there are no more buyers.

Demand has overwhelmed supply, leading to price rallying. Price continued to rally until there were no more buyers willing to pay a higher price.

Now let‟s consider a hypothetical example where there are two desperate sellers, offering for sale two essentially identical properties. Let‟s say two apartments side by side, with similar quality fittings and fixtures and similar view; essentially identical value. And let‟s assume there is only one buyer interested in purchasing a property. The process would now work in the reverse of the previous example.

The buyer can afford to hold out, while the two sellers would be required to compete. The sellers would take turns lowering their asking price, until it reached a point at which one was not willing to go lower. Assuming the price was then acceptable to the buyer, a transaction could occur.

Supply has overwhelmed demand. Price has fallen until there is no-one willing to sell at a lower price.

Important point… it‟s not just the number of participants that is most important, but the desperation, or urgency, with which they are seeking a transaction.

Consider the original housing auction where buyers were once again willing to pay differing amounts up to a maximum of $750,000, but this time the owner was asking too much for the property. The auctioneer opened the bidding at $850,000. In this case there will be no bidding. No transaction will occur, despite multiple potential buyers and one seller. The only way for a transaction to occur is if either one or more of the buyers decide they absolutely must have the property, and are willing to pay a higher price by increasing their bid above their pre-planned maximum, or if the seller is willing to drop the opening ask price in an attempt to find buyers.

Let‟s assume the seller is desperate to offload the property. The auctioneer will be instructed to lower the asking price in increments, until a buyer can be found and a sale can occur.

In this case, despite only one seller, the desperation of that seller has been greater than the desperation of the buyers, resulting in price falling.

Supply has overcome demand and price has fallen.

Ok, let‟s consider the financial markets.

We now have what is known as a dual-auction process.

Multiple buyers competing to buy into the market, and multiple sellers competing to sell into the market; all at the same time.

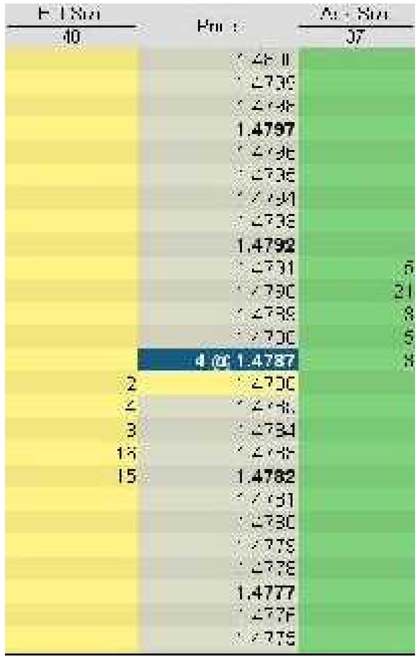


Figure 2.6 – The Dual-Auction Process

Figure 2.6 displays a depth of market (DOM) screen from Interactive Brokers TWS platform.

The centre column displays the price of the tradable item, in this case the market is 6B, the British Pound currency futures (equivalent to spot forex GBP/USD). The last sale price is the one in the centre, highlighted by the dark blue colour, currently 1.4787. The left column displays the Bid and the right column displays the Ask (sometimes referred to as the Offer).

So, looking firstly at the bid column, we can see that we have 2 contracts wanting to be bought at 1.4786, 4 contracts wanting to be bought at 1.4785, 3 contracts wanting to be bought at 1.4784, and so on, down to 15 contracts at 1.4782. It goes further, but the DOM screen here only shows 5 layers of depth. Please note that each of these bid quantities is not necessarily just one trader. The 15 contracts bid at 1.4782 could be from one trader, but are equally as likely to be from multiple traders, for example, 5 traders bidding 1 contract each and 2 traders bidding 5 contracts each, totaling 15 contracts being bid at this price.

On the Ask side, we have 3 contracts offered for sale at 1.4787, 5 at 1.4788, and so on, all the way up to 5 contracts offered at 1.4791.

So, the Bid column on the left shows the current demand, or what I sometimes refer to as Bullish Pressure.

And the Ask column on the right shows the current supply, or what I sometimes refer to as Bearish Pressure.

At the moment, the highest someone is willing to pay in order to buy a contract is 1.4786, the highest bid price being represented by the top of this column of buyers.

And the lowest price at which someone is willing to sell a contract is 1.4787, the lowest ask price being represented by the lower end of this column of sellers.

So, someone wants to buy at 1.4786, but someone else wants to sell at 1.4787.

Can a transaction occur? No. The only way for a transaction to occur is for one of the buyers to be willing to raise their price and accept the current ask price, or for one of the sellers to lower their price and accept the current bid.

Or alternatively some other trader not currently waiting in these queues decides they want to get in or out of the market at whatever price they can, and so uses a market order, which will automatically buy at the current ask price or sell at the current bid price.

Let‟s assume that buyers are more desperate than sellers, so they‟re willing to pay higher prices.

Buyers are desperate to get into this market, so they‟ll raise their bid and accept the asking price. The last sale price remains at 1.4787 until all three contracts at that level are bought. At this point, with no contracts remaining at 1.4787, buyers will have to buy at 1.4788. The last-sale price rises to 1.4788. Other buyers, seeing price rise, will also raise their bid in desperation or simply buy via a market order accepting whatever ask price they can get. They feel they have to get into this market. Once the 5 contracts at 1.4788 have been bought, buyers will then have to be willing to pay 1.4789, which then becomes the new last-sale price. Supply at each level will be absorbed and buyers will be forced to bid even higher and higher prices in order to get their transaction filled. The last sale price continues to rally. Some sellers will observe this rally in price and pull their sell order from the market, replacing it at a higher price. Price will continue to rally while there are more buyers willing to buy at a higher price.

At some point, the buying demand will finish. Price will have rallied to a point at which the buyers are no longer willing to pay higher prices, or until the higher prices attract more sellers, adding to the quantities available in the Ask column, in sufficient number to absorb all the bullish pressure. The rally will stop. Some of the traders who have previously bought may now offer their contracts for sale in order to take profits and close out their transaction, effectively adding to the supply, or bearish pressure.

In the absence of further buying though, sellers will be forced to lower price in order to make a transaction. They‟ll reduce their ask price so that it matches a bid price. The last sale price will now fall. Seeing the last transaction price fall, other sellers will follow suit and lower their price, or simply sell via a market order accepting whatever bid price they can get. Desperation will have moved from the buying side to the selling. Bids will be absorbed at each price level and so sellers will then be forced to drop price further. Some of the potential buyers will see this falling price, and will withdraw their bid and replace it at an even lower price.

Price will continue to fall until we run out of supply. Either potential sellers will be no longer willing to sell for such low prices, or sufficient new buyers will be attracted to the market by the lower prices, in order to absorb all supply. The price fall will stop.

And then the process starts all over again.

That‟s how the market works from a supply/demand perspective. It‟s a dual-auction process, with price auctioning both up and down depending on which force is dominant at the time – demand or supply.

- **Price rises while demand is greater than supply, and while those buyers are willing to pay higher prices.**

- **Price rises until we run out of buyers, or until supply increases sufficiently to absorb all the demand.**

- **Price falls while supply is greater than demand, and while those sellers are willing to sell at lower prices.**

- **Price falls until we run out of sellers, or until demand increases to the point it absorbs all the supply.**

Price movement is a function of supply and demand.

Or more correctly…price movement is a result of supply/demand imbalance. And the supply/demand imbalance is created by trader’s sense of urgency to transact.

Let‟s look at how this dual auction process displays on a price chart, as demonstrated via figure 2.7 below.

Figure 2.7 – Dual-Auction Process Displayed on a Chart

Individual price bars are the result of the dual auction process operating within the timeframe of that price bar.

Each price swing is the result of the dual auction process operating for the duration of that price swing. Over a period of time, when the demand is consistently greater than supply price will rise as it did in swings 1 and 3. When the supply is consistently greater than demand price will fall as it did in swing 2.

Additional info: Note the gap at the start of the candle marked A. This is also a result of the auction market process. This occurred at the release of two GBP-related news events, the Claimant Count Change and the Average Earnings Index. The bullish reaction to the news means that all supply was withdrawn from the market, so those bulls wanting to participate in the market were required to seek higher prices to find a *seller. The first price someone was willing to sell becomes the open of the first post-news candle, leaving a gap on the chart of approximately 10 pips.*

Individual trader sentiment at any one time may be either bullish or bearish. The net effect though, when considering all traders operating within the market, will be either a net bullish, bearish or neutral sentiment.

Bullish sentiment leads to bullish orderflow resulting in price rising, as in swings 1 and 3.

Bearish sentiment leads to bearish orderflow resulting in price falling, as in swing 2.

Neutral sentiment leads to narrow range sideways price action.

Note that price within these swings is not moving in a straight line – it fluctuates constantly. The market is comprised of buyers and sellers all competing through different analysis styles, on different timeframes, with different reasons for wanting to enter or exit. We don‟t know their individual reasons. It‟s the collective sentiment that matters. And price moves with whichever crowd most desperately needs to act.

It comes down to sentiment of the market participants.

As individual traders become increasingly bullish, they add to the bullish sentiment of the collective group of buyers. If enough of them do this, the overall sentiment of the whole market becomes bullish, demand overcomes supply, and price rises.

As individual traders become increasingly bearish, they add to the bearish sentiment of the collective group of sellers. If enough of them do this, the overall sentiment of the whole market becomes bearish, supply overcomes demand, and price falls.

- **Price moves with changes in the forces of supply and demand.**

- **Supply and demand change as the sentiment of the crowd changes.**

- **And the sentiment of the crowd changes with changes in the bullish or bearish sentiment of the market participants.**

So, here‟s the key point…

Just as we discovered that price is two individuals making buy and sell decision, we have now established that price moves also as a result of the net effect of all market participants making individual trade decisions.

Some people use fundamentals to make trading or investing decisions. Others use technicals. Others may even use lunar cycles. It doesn‟t matter. At the core level, **it's all just people making decisions**.

Price doesn‟t move up or down because of fundamentals or technicals. Individuals form an opinion about market direction. Some of them will act on their opinion – they‟ll make a decision to buy or sell.

The sum of all the buy or sell decisions forms the collective sentiment of the crowd, which may be bullish or bearish. And this collective sentiment of all market participants, leads to a net bullish or bearish order flow, which moves price.

The most „fundamentally‟ bullish stock will still fall if the sentiment of the crowd is bearish, and they don‟t want to own it.

The most technically perfect breaking of a neckline of a head and shoulder pattern (which is supposedly bearish) will fail to reach its projected target, if the sentiment of the crowd at this point changes to bullish, and they all want to buy this stock.

It's not about the fundamentals or technicals.

It's about people… and the decisions they make about market direction.

Price changes as supply and demand change… supply and demand change based on the beliefs of market participants, or more correctly on the decisions of market participants to act on their beliefs.

Let‟s summarise this section – How does price move?

- Price movement results from a supply/demand imbalance

- Changes in supply and demand occur as sentiment changes within the market participants.

- Price therefore depends on the bullish or bearish sentiment of market participants.

- The net sum of all individual trader decisions and actions, form the Net Order Flow.

- When Net Order Flow is bullish (demand greater than supply), price will rise.

- Price continues to rise until we run out of buyers at higher prices, or until the higher prices attract sellers in sufficient quantity to overcome demand.

- When Net Order Flow is bearish (supply greater than demand), price will fall.

- Price continues to fall until we run out of sellers at lower prices, or until the lower prices attract buyers in sufficient quantity to overcome supply.

Or more simply:

- **Price moves as a collective result of all traders' bullish or bearish sentiment and their <u>decisions to act</u> in the market (buy or sell).**

Note: *Some common terms which you'll hear me use from time to time, in particular when conducting price chart analysis, are:*

Bullish Pressure *– sum of all demand in the market (forces attempting to push price up)*

Bearish Pressure *– sum of all supply in the market (forces attempting to push price down)*

Net Order Flow *– the resultant of bullish and bearish pressure. Net order flow (NOF) is bullish if price is going up, bearish if price is going down.*

2.2.5 - What Are Markets?

Most traders simply see markets as price movement. They look at a chart and they filter all the price action into what they consider to be significant movement, usually represented by either charting patterns or indicator based setups.

To return to Plato‟s Allegory of the Cave, these traders are trading the shadows; the illusion.

They‟re not considering the reality underlying the price movement.

Or if you prefer to use the cause/effect analogy, these traders are trading the effect.

They‟re not considering the cause of price movement – the underlying reality, or the nature of the market, which is…

Traders making trading decisions.

Traders make trading decisions; which leads to a net order flow; which leads to the effect – price movement.

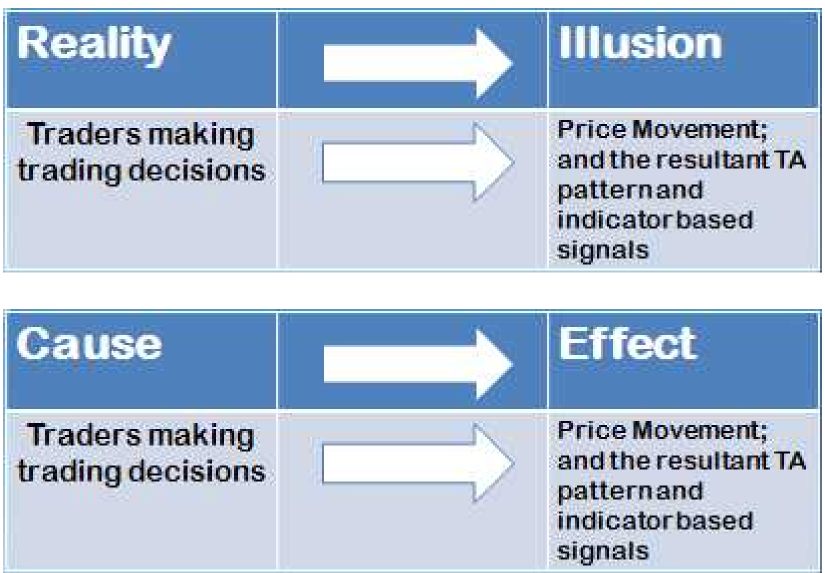


Figure 2.8 – The Underlying Reality of the Markets

We see markets as a collective group of traders all making trading decisions and taking action based upon their bullish or bearish sentiment. This leads to a net bullish or bearish orderflow, which leads to the effect – price movement.

You may think this is irrelevant. You‟d be wrong.

It‟s a subtle difference, but it‟s essential. Until you get the significance of this, you‟ll be stuck in the indicator and pattern-based TA treadmill, simply observing past price movement and trying to predict future price movement.

Markets are traders making trading decisions. Markets are not the resultant price movement.

When we look at a chart, don‟t see it as price movement. See it as traders making decisions whether to buy or sell or stand aside.

You need to see when they‟re in pain. You need to see when they‟re feeling greed.

Only then will you be operating in the real market, profiting from the traders who are operating under false assumptions and a lack of understanding of the game.

Let‟s look at some examples.

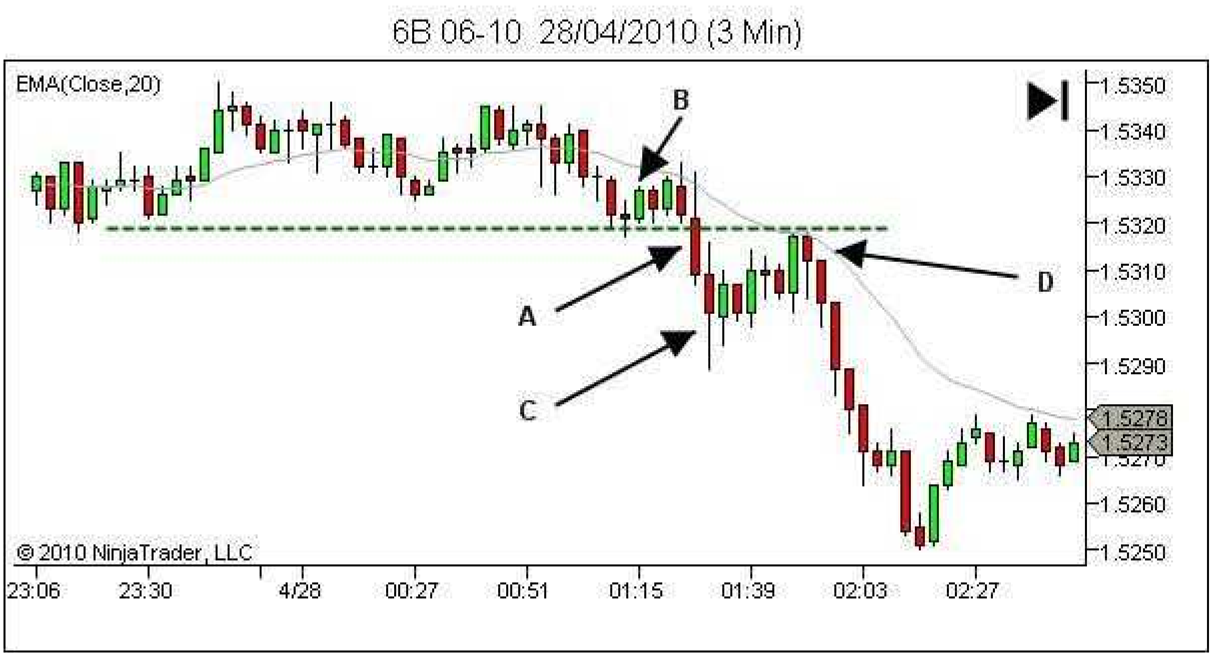


Figure 2.9 – Breakout Pullback – From the Perspective of Other Traders

Don‟t look at figure 2.9 and just see a breakout below support at point A.

Learn to view all price movement from the perspective of other traders, and how the price movement influences their decision making.

See the bears entering at point A with anticipation and greed, with their sell orders, expecting lower prices to follow the breakout.

See the bulls who bought at point B expecting support to hold. These people are panicking – they‟re in drawdown – the market is moving fast against them. Those bulls who aren‟t frozen will be activating their stops, adding to the bearish pressure, forcing price even lower.

Traders, making trading decisions.

When price stalls at point C, don‟t just see a swing low. See the shorter-term traders who caught the breakout, covering their position to take profits. This adds to bullish pressure and slows the breakout move. See also some new bulls deciding to enter long, in the hope of catching a breakout failure. These trader decisions, and their resultant buy orders, were enough to tip the supply / demand equation to the bullish side, causing a retrace.

Don‟t just see a breakout pullback at point D.

See the traders who missed the original breakout, enthusiastically selling as price gives them a second opportunity to enter short, or perhaps those who did catch the original move deciding to add to their position. Both scenarios adding to the bearish pressure.

See the traders who were long from point B, having suffered through the drawdown to point C, enthusiastically selling as the pullback offers them an opportunity to get out at close to their entry point for a reduced loss. Once again, adding to the bearish pressure.

See the more astute short-term traders who entered long at C in anticipation of a scalp back to the breakout point taking their profits via a sell order, further adding to the bearish pressure.

Then as this bearish pressure causes price to move down again from point D, see those longs who bought at C in expectation of a breakout failure and longer term reversal back to new highs, having to sell in panic as they realise that the breakout failure did not occur and they‟re stuck in a losing position.

All these trading decisions lead to a bearish sentiment, bearish pressure, bearish net order flow, and therefore a price fall.

One more example…

[Www.ForexWinners.net](http://www.ForexWinners.net)

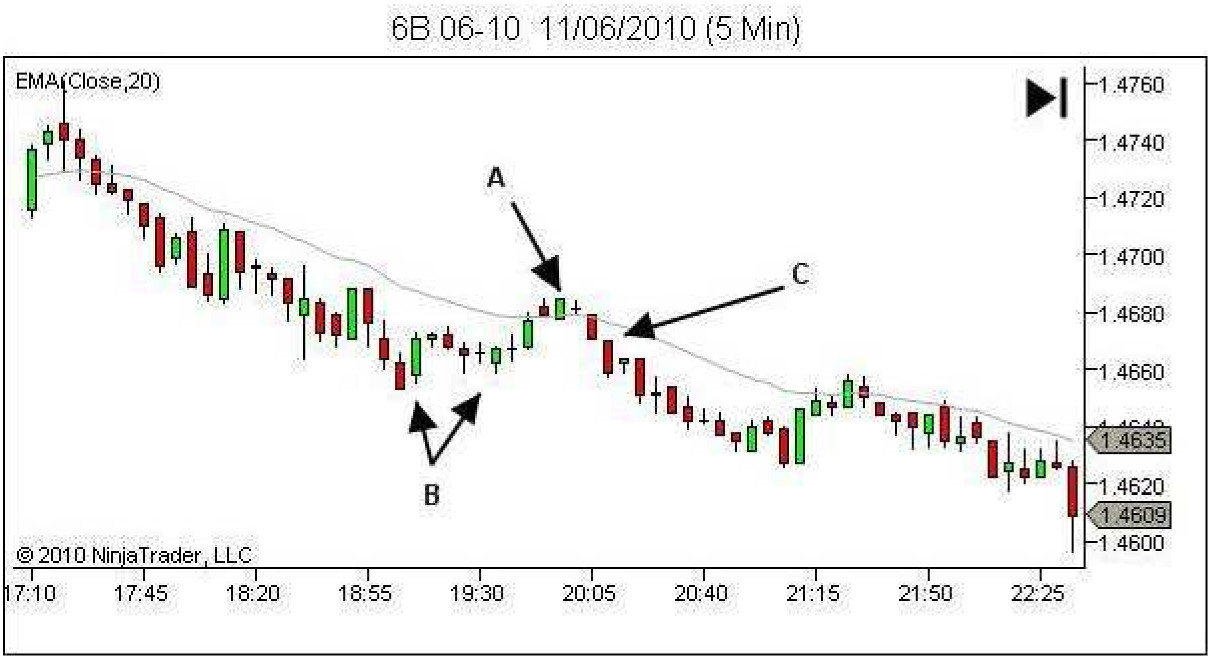


Figure 2.10 – Trend Pullback – From the Perspective of Other Traders

Don"t look at figure 2.10 and see a pullback within a trending market at point A.

Learn to view all price movement from the perspective of other traders, and how the price movement influences their decision making.

Large numbers of traders have a natural tendency to try to fight a trend. These people will be looking for any opportunity to enter long, in the hope of catching the reversal.

See these hopeful bulls entering in the vicinity of B with anticipation and greed, with their buy orders, expecting higher prices and an opportunity to brag to their friends about how they caught the reversal. Their bullish orderflow, added to the pressure of those shorts who take profits at new lows (also a buy order), being sufficient to overcome the downward price movement and commence a pullback.

As price gets to the area of point A, see the fear levels rise within the longs who bought at B, as price stalls for three candles.

See the more astute traders trading with the trend and taking the pullback to point A as an opportunity to enter short, creating bearish pressure which opposes the short-term pullback.

The see the panic set in at point C as the market thrusts back downwards, and the longs from B bail out of their positions, some smarter ones at breakeven, but most at a loss as they watch in disbelief as the market takes out their stops and their reversal is proven to be just a pullback within the trend.

2.2.6 - Summary – The Reality of the Markets

Figure 2.11 – Markets are Traders Making Trading Decisions

The reality of the market is traders making trading decisions.

It‟s all about people, not price.

Individual traders make trading decisions based on their perception of the market.

The net effect of all traders operating within the market will result in a net bullish, bearish or neutral sentiment, which leads to bullish, bearish or neutral orderflow and its corresponding price movement.

Learn to view all price movement from the perspective of other traders, and how the price movement influences their decision making.

When we look at a chart, don‟t see it as price movement. See it as traders operating through a foundation of fear and greed and all of the perceptual limitations and heuristics and biases which influence their decisions and subsequent actions.

You may feel this slight change of perspective is minor, and perhaps irrelevant. You‟d be wrong. It‟s vitally important to defining the way we trade, and has great relevancy to the next section, where we learn what the game of trading is really all about.

2.3 - The Reality of the Trading Game

2.3.1 – How Do We Profit?

First an apology… like the previous section, this is going to appear ridiculously basic to anyone who has been around markets for a while. Please don"t skip it. There"s a good likelihood, especially if you"re not consistently profitable, that you"ve missed some key concept. In order to understand the reasons WHY my strategy works, you need to get the foundation right.

Let"s assume our objective with trading is to profit from the markets.

For the majority of us (with the exception of some options traders) profit comes from capturing price movement. In figure 2.12, this may be via buying at A on the trend pullback and selling at the overextended highs of B. Or it may be via selling short at the downtrend pullback C and covering at the stall at point D.

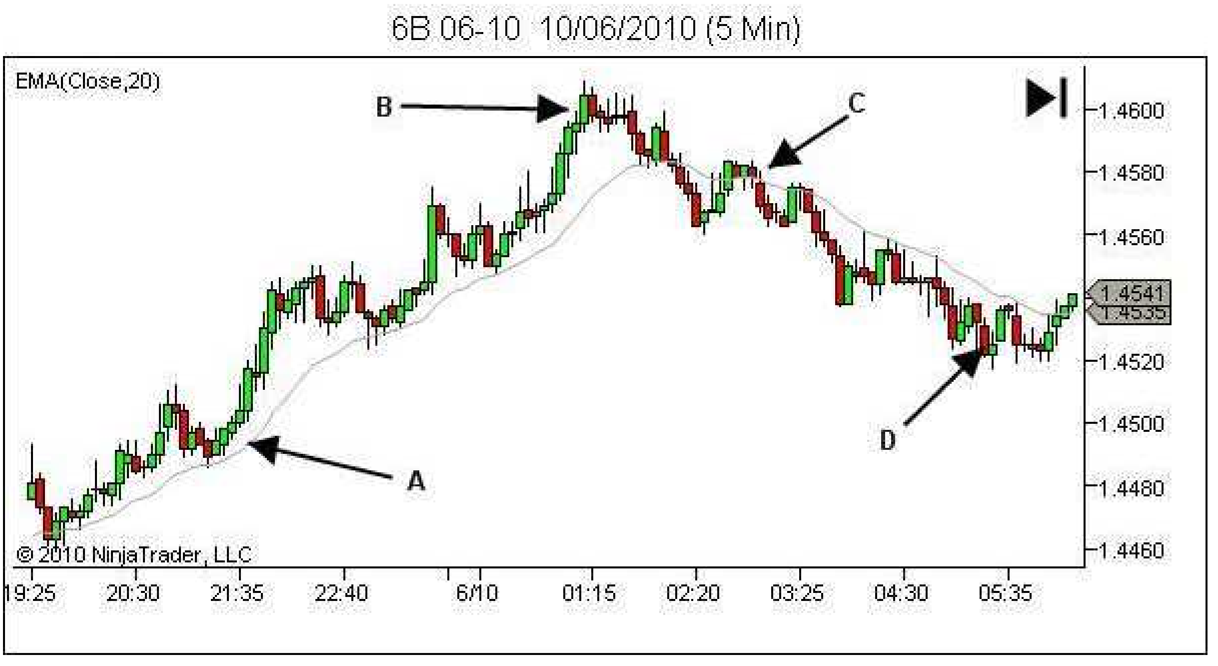


Figure 2.12 – Opportunity for Profit Requires Price Movement

Profit comes from movement of price and your ability to buy lower and sell higher, or sell higher and buy lower.

Here"s an important point though. Profit requires movement of price <u>AFTER</u> your point of entry.

Let‟s consider this from the perspective of other traders and our new understanding of the nature of the markets and price movement.

Consider a long position. For it to profit, you must have bullish price movement after your entry point. Bullish price movement comes from bullish orderflow which comes from net bullish sentiment – traders making buying decisions. So to profit, other traders must be making their buying decisions at the same time as, and after, you make your buying decision.

The concept is the same for a short position. For it to profit, you must have bearish price movement after your entry point. Bearish price movement comes from bearish orderflow which comes from net bearish sentiment – traders making selling decisions. So to profit, other traders must be making their selling decisions at the same time as, and after, you make your selling decision.

Without that continuing orderflow supporting your decision, and coming after your decision, price cannot move in your favour and you will not profit.

2.3.2 - Analysis for Profit

The True Basis For Profit

The aim of your analysis then MUST be the following:

- **To buy at areas where you KNOW others will buy after you, because their buying will create the net orderflow or bullish pressure to drive prices higher, allowing you opportunity to profit, or**

- **To sell at areas where you KNOW others will sell after you, because their selling will create the net orderflow or bearish pressure to drive prices lower, allowing you opportunity to profit.**

Or more simply; buy at areas where others will buy after you, and sell at areas where others will sell after you.

To do that, your analysis must focus on areas of trader decisions.

What are other traders thinking? Where will they be making their trading decisions?

Identify areas at which others will be making buying decisions, and you can profit.

Identify areas at which others will be making selling decisions, and you can profit.

The most effective analysis is not analysis of price, but rather analysis of trader decisions.

> If you haven‟t read it before, please review the following article on my website:
>
> - Rock Paper Scissors – A Trading Analogy
> - http://www.yourtradingcoach.com/Articles-Strategy/Rock-Paper-Scissors-A-Trading-Analogy.html
>
> This is by far one of my favourite articles on the site. It examines another game which is commonly believed to be random. However the reality is far different. An edge can be gained in Rock Paper Scissors through analysis of your opponents thought processes and likely actions.
>
> If you know what your opponent is thinking, you can beat them.
>
> Trading is the same. If you know what the other traders are thinking, you can profit from their actions.

But Can We Know What Other Traders Are Thinking?

Individual trader decisions and actions cannot be known. We all trade for different reasons. We all make our trading decisions for different reasons.

There are so many different external influences on our decision making at any particular time… fundamentals, technicals, intermarket themes, general market sentiment (risk appetite / aversion), comments by media, economists, company CEOs, monetary officials, and so on.

Combine that with the internal factors which impact on our decision making… memory limitations, information processing limitations, perceptual errors, decision making heuristics & cognitive biases, our emotional state, values and belief systems, our susceptibility to distraction, and even our susceptibility to crowd psychology influences such as group think, and it‟s just not possible to know how any one person will think or act.

Price is not a true representation of fundamental value, but is a representation of the sentiment of the crowd, which is based upon flawed analysis of market information and irrational decisions.

Price movement is therefore based on psychology. It is emotional, rather than mathematical. It cannot be forecast or predicted with current mathematics or physics, and I expect it never will be.

Individual trader decisions are unknown.

And we can conclude from that statement that the collective sentiment at any one time should also be unknown.

However, our cause is not lost.

While that generally is true, remember that an imbalance of supply and demand doesn‟t actually mean greater numbers on one side, but rather an imbalance in desperation, or urgency.

We can, through our analysis, identify areas where significant groups of traders will be under extreme stress, and therefore feel forced to act in a reasonably predictable manner.

In times of stress, human decision making and actions become a lot more predictable, and are typically carried out with greater desperation and urgency. Exactly the qualities we‟re seeking.

This is not guaranteed, but generally quite reliable.

Consider human nature, in particular crowd behavior, at other times of stress. Imagine a shopping centre. Movement of any individual within that shopping centre will be largely unpredictable. And collectively, movement of all shoppers will appear essentially random.

Contrast this with their movement upon activation of a fire alarm. Their movement will now be somewhat more predictable, as all shoppers move (hopefully in an orderly manner) in the direction of the nearest exit.

We apply this same concept to our market analysis.

When are traders most under stress?

- When a position has moved against them and they‟re in drawdown. At some point they‟re going to reach maximum stress at which time they‟ll finally accept they‟re wrong and exit their position.

- When a position in profit starts to move against them. At some point they‟re going to reach maximum stress at which time they‟ll accept their trade is no longer right, and exit their position before the market can take the remainder of their profits.

In other words, at the point where they perceive they‟re wrong and are forced to act (in order to either minimise losses or minimise further reduction of profits.

We aim to enter before or at the point of maximum stress, where traders are coming to accept they're wrong.

Their decision to exit is a means of relieving themselves of stress. This creates orderflow that takes our position to profit (provided of course you manage the trade well).

The Real Trading Game

The real trading game is one of analysing other trader decisions.

Aim to understand all price action from the context of other traders‟ decisions and actions.

Aim to determine where large numbers of traders are going to be wrong in their decision making. The theory being that the point where they know they‟re wrong will contain an increase in orderflow as their stops are executed. I aim to profit from this orderflow by entering at exactly this point, or earlier.

To put it simply, I try to find the losers on the chart.

It‟s a mercenary game – I profit from their loss. But that‟s the nature of this game and I accept that.

It‟s so basic, but most traders just do not get the significance of this. Trading is all about people, and the decisions they make.

2.4 – Effective vs Ineffective Trading Strategies and Systems

Chapters 3 and 4 will present you with a method of conducting market analysis, setup identification, and trade entry and management which are based upon the principles that we have discussed so far.

This is an effective trading strategy as it"s based on the true nature of the markets and the trading game.

An effective trading strategy is one based upon the analysis of the forces of supply and demand within the market, and assessment of how that will influence other traders' decision making.

Knowing how and why price moves allows us to identify areas on charts where, if price should go there, significant numbers of traders will be trapped in stressful situations and be forced to act. The resultant orderflow will create price movement.

Effective analysis allows us to identify areas of potential higher probability setups, which provide lower risk if wrong and higher reward if right.

Effective analysis allows us to actively manage our trades – holding them when price action confirms the other traders response is in accordance with our expectations, or allowing us to exit prior to our stops when price action does not act as expected.

Effective analysis allows us to manage our price targets, through identifying areas on the chart where opposing orderflow will come into the market to limit any further profit opportunity.

Figure 2.13 shows effective analysis. On price bar A, price broke below support level B. Breakout traders, and those operating off indicator based continuation signals, will likely enter on the move down, however effective analysis identifies the fact that this move occurs into an area of support in the vicinity of C and within the context of larger timeframe upwards trend (not shown). The lower prices into support are likely to bring bullish orderflow, opposing the breakout. We assess that, should the breakout fail these breakout traders will be forced to exit, creating a surge of bullish orderflow. Our entry triggers at D, with a stop below A and initial partial target at E where we expect some of the longs to take profit and therefore slow or halt the rate of climb. Partial profits will be taken here, with the remainder targeting the next level F.

Figure 2.13 – Effective Analysis

This is not the way the masses trade. Typically, their decision making is based on the common teachings of technical analysis, involving little or no analysis of the forces of supply and demand, and absolutely no thought as to how this is influencing the decisions and actions of other traders.

Common application of technical analysis involves overlaying charts with numerous indicators, and then trading indicator based signals.

Think about how your favorite indicator based setups work. What are they actually indicating?

A trend following indicator such as a moving average cross (or any variation of this no matter how complex) is simply identifying the fact that price has already moved a certain distance, that distance being dependent on the formula and parameters defining the indicators.

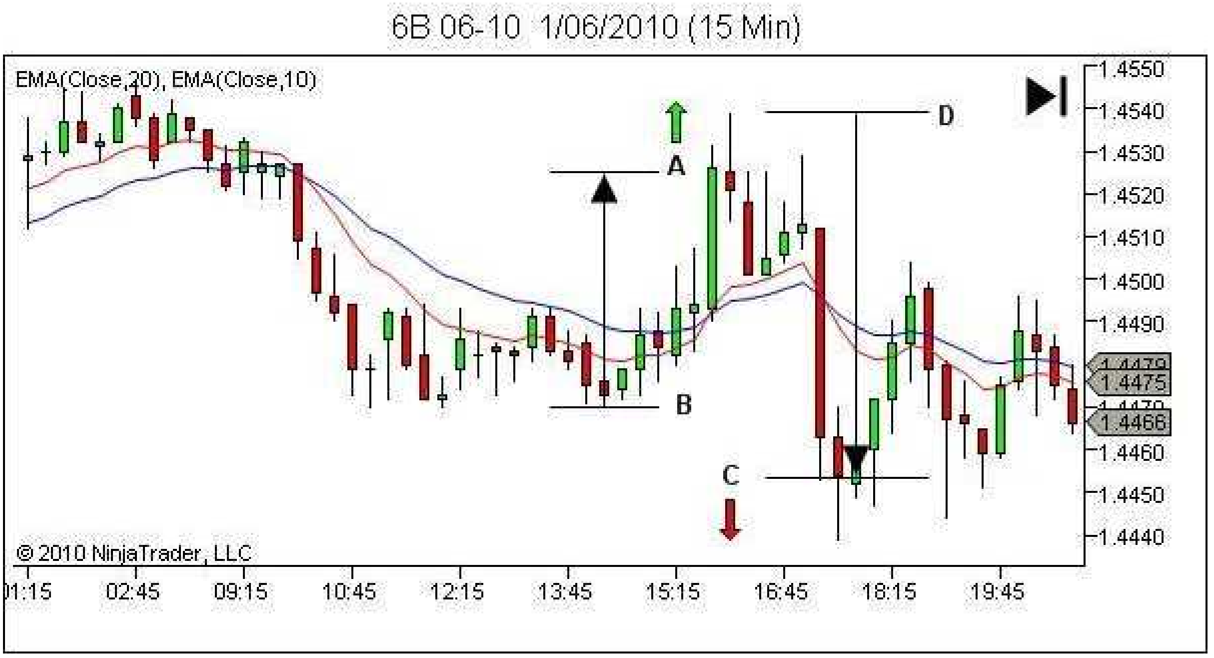


Figure 2.14 – A Moving Average Cross Identifies Price Movement in a Certain Direction

This is demonstrated in figure 2.14, where the EMA 10/20 cross enters long at price level A, after price has moved sufficient distance in the long direction (AB) in order to trigger the cross. The EMA 10/20 cross enters short at price level C, after price has moved sufficient distance in the short direction (CD) in order to trigger the cross.

For most traders, entry is usually taken on these signals, or after further confirmation such as the breakout of the crossing candles.

The more confirmation required, the greater the trade risk; as the entry point is further from the point of initiation of the move (and ideal stop location). And the lower the profit potential, as the entry point is closer to the end of the move.

Price movement a certain distance from its turn point is not a guarantee of further price movement. In some cases that movement will continue. In other cases it won‟t. Novice traders enter these trades simply because the setup triggered, in hope that the price movement continues. They convince themselves that this is acceptable, simply because it‟s a probabilities game and they need to therefore take all signals. They fail to even consider the fact that more effective analysis techniques are available, which not only identify higher probability, lower risk entries, but also provide information about the potential opportunity available in the move.

There is no thought put into context. Where did this signal occur within *higher timeframe* structure? Is there any area which is likely to create opposing orderflow, limiting the extent of any move and therefore limiting the profit potential? What profit potential is available, and does this offer an acceptable reward:risk ratio.

Figure 2.15 – Moving Average Cross – Failure to Consider Context

Failure to consider context is shown in figure 2.15, the same price action as displayed in figure 2.14. We see here that the cross long at point A has occurred right into area B resistance, and the cross short at C has brought us straight into area D support.

Of course, your strategy may be more involved than just a simple moving average cross.

The point is the same though. All indicators are lagging. They"re derivatives of price movement and have no future predictive ability at all. It"s mathematically impossible.

They simply identify the fact that price has moved a certain distance, and entry is then taken simply in the hope that further price movement occurs, based solely on the fact that it occurred enough times in the past to prove profitable in that historical sample. As the disclaimers correctly state though – past performance is no guarantee of future performance. The fact is that the probabilities will change across different samples of data, so future samples are unlikely to match your historical samples.

Oscillator based entries are not much better. Rather than identifying price movement, they signal changes in momentum. The way that is calculated varies from oscillator to oscillator, but essentially they are designed to identify changes in the *rate of change of price* (ie. price slowing or speeding up).

In one common application, entries are taken on an oscillator cross, or movement out of an *overbought* or *oversold* area. The oscillator pattern has signaled a slowing of price movement. The trade is taken in the expectation that this change of momentum will continue and result in a reversal of direction. Unfortunately though, price slowing in one direction is not necessarily an indicator of a reversal.

Like with the trend following indicator, you may actually use a setup and trigger that‟s a bit more advanced than a simple oscillator signal, but the principle is the same. Recognition of a change in indicatory-based momentum is not necessarily an indicator of change in price direction.

Once again, these setups fail to consider context. Where did this signal occur within *higher timeframe* structure? Is there any area which is likely to create opposing orderflow, limiting the extent of any move and therefore limiting the profit potential? What profit potential is available, and does this offer an acceptable risk:reward ratio.

The simplest example of failure to consider context is where an oscillator signal tries to fight a clearly strong trend, as demonstrated in figure 2.16 below.

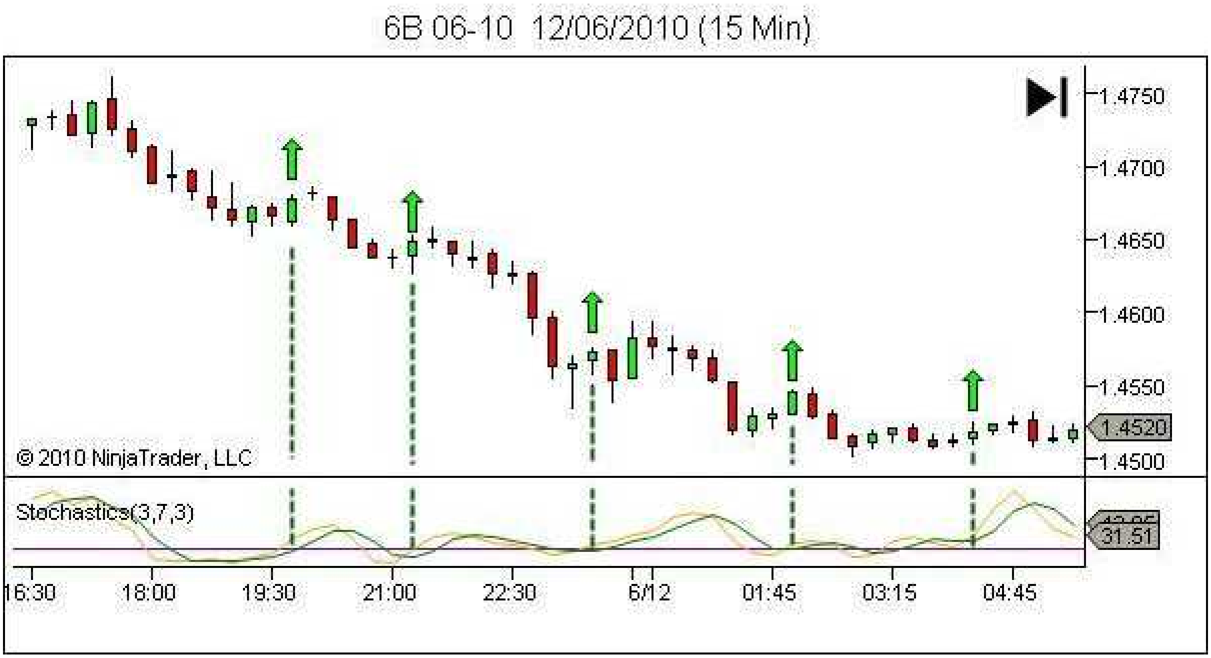


Figure 2.16 – Oscillator – Failure to Consider Context

Human beings are pattern recognition creatures. A natural human tendency is to see the patterns that worked and the huge profit potential they created, and filter out the patterns which fail.

Price movement sufficient to trigger a trend-type signal (such as MA cross) is a feature of all large market moves. However it‟s not a predictor of such a move.

Said another way… all large market moves have an MA cross, but not all MA crosses lead to a large market move.

Likewise, all reversals come from a slowing of momentum, but all slowing of momentum does not lead to a reversal.

Be careful if you wish to trade blindly off indicators. Quite likely, I‟ll be on the other side of your trade.

Pattern based signals are typically better, in my opinion, as they usually involve breakouts of clearly identifiable patterns, which should coincide with at least some orderflow in the breakout direction. However the reality is that a large percentage of these signals fail. False breakouts are a common occurrence in the markets. Blindly taking pattern breakouts leaves you susceptible to these false breakouts. Effective analysis of the forces of supply and demand, and what that means for trader decisions, will allow you to more readily identify and react to potential breakout failure.

This is not to say that all indicator or pattern based signals will fail – obviously they work on a probabilities basis – typically though, when they work is simply because the trade area just happened to align with an area in which trader decisions were such that significant orderflow would occur within that area. Some are better than others. Oscillator signals or trend-type signals which happen to be taken in the direction of the trend, will provide higher probabilities simply due to the fact that they align with a pullback within a trend, an occurrence which will attract some new with-trend orderflow. Other signals may also prove reasonably effective, but the problem is still a lack of context or real consideration of the true nature of markets and price movement.

Is it not better then to conduct your analysis with thought as to the forces of supply and demand, and how that affects trader decisions?

In assessing the validity of any other trading strategy, or in developing your own strategies, be sure to consider the following:

- Has any explanation been provided as to why the strategy should work?
- Does it identify areas at which other traders are likely to make trading decisions?
- Does it consider the context within which this entry setup is occurring? In particular, does the *higher timeframe* structure and trend support the trade, or is it likely to create opposing orderflow and therefore limit the extent of any move and limit any profit potential?

There are some good strategies and good educators, available in the marketplace. They are based upon these principles, although they may not talk about it in the way I have presented it. My website resources page (http://www.yourtradingcoach.com/Trading-Resources.html) will share links to other quality strategies, or sources of education, as I come across them.

But in my experience it is a rarity. I‟d suggest most strategies are ineffective, failing to consider these factors at all.

Certainly the never-ending supply of trading systems presented in the popular forums are clearly ineffective, having no consideration at all to the reality of this game – we need to be trading at areas where others will trade, after we do.

Effective trading strategies do not simply recognise price movement, entering after it occurs, and hoping it continues.

Instead, knowing that price movement is the effect of trader decisions, they work to identify the areas on the chart at which traders will be making decisions that are likely to be net bullish or bearish.

Most other traders aim to find the effect of price movement. We seek the cause, and enter before them, allowing their order flow to add to ours to move our position into profit.

We aim to enter with the professional traders, well before the retail public.

And we aim to hold the position while the premise that led to this move still exists, until price reaches an area on a chart where we know traders will be making the opposite decision, creating an opposing force that could limit further price movement.

2.4.1 – Principles of my Effective Strategy

Let‟s review the key principles or beliefs upon which my whole strategy, an effective trading strategy, is based:

- Profits on a single trade come from identifying potential directional price movement before it occurs, and acting on that belief. Profits therefore require price movement.

- Price movement represents changes in supply and demand. Whenever demand exceeds supply, price will rise. Whenever supply exceeds demand, price will fall.

- Changes in supply and demand occur as sentiment changes within the market participants.

- Price movement therefore depends on the bullish or bearish sentiment of the market participants.

- Price action is determined by human decision making. While individual trader decisions are generally unpredictable, as we cannot know the factors and limitations that apply to that individual‟s decision making potential, this is not necessarily the case when under extreme stress.

- Human action in times of stress is somewhat predictable (on a probabilities basis, not a certainty), in particular those times when our analysis is proven inaccurate and we‟re in a losing trade. At some point, we‟re going to have to exit to minimise the pain.

- Therefore, by identifying times at which a large enough segment of the trader population will be experiencing stress, we can identify areas of potentially higher probability setups.

- Because you will not win 100% of trades, success has to come from a series of trades, which result in a profit after subtracting the losses and expenses from the wins.

- Consistent profits over a series of trades can only occur if the strategy contains an edge, such that:
    - Analysis is skilled enough to identify these areas at which traders are under stress, therefore presenting higher probability setups.
    - Trader focus, discipline, confidence and psychology are sufficiently developed to identify the lower risk entries within these setup areas and take appropriate action to enter the trade.
    - Position sizing and risk management are clearly planned in order to minimise damage to the equity balance in the event that this trade is one of the many which will lose (whether due to our analysis being wrong, or the sentiment changing within the market).
    - The trader has sufficient experience to manage the trade in such a way as to minimise loss and maximise any gain.

- It is possible to develop a strategy that identifies higher probability setups. We‟ll discuss that in future chapters.

- It is possible to learn appropriate position sizing and risk management.

- It is possible to gain experience in the markets, improving our efficiency with trade management and exits, although due to the uncertainty within the market this area will never be mastered.

- It is possible to master our trading psychology, such that fear provides minimal disruption to our ability to follow our planned processes and routines.

- As a result, it is possible to profit from the markets.

2.5 - Conclusion

This chapter has provided you with a new way of viewing the markets, and the way to profit within this environment.

Markets are not price movement. They are traders making trading decisions.

The way to profit on a consistent basis is through finding those opportunities where there is a higher probability of a sufficient number of traders making trading decisions, which will lead to net order flow in a particular direction, and then acting to trade with this orderflow.

We‟ve seen that individual trader decisions are usually unpredictable, leading to no or minimal edge in the markets. However at times of stress they become much more predictable.

Our trading approach therefore needs to be based on this fundamental understanding of how to profit from the markets:

- We identify areas at which traders will be experiencing stress, and will make trading decisions to relieve them of that stress, and then act before or with them in order to profit from the resultant orderflow.

That is the basis behind the strategy we‟ll cover in the next few chapters.

Or if you prefer to develop your own trading strategy rather than use mine, this should be the principle upon which it is based as well. Anything else, in my humble opinion, is vastly inferior.

Find the areas on a chart where other traders will make trading decisions and you've got yourself an edge.

Enter at or before the change of net order flow, and you've got a great opportunity to profit (provided you manage the trade well).

Chapter Three – Market Analysis

3.1- Introduction to Market Analysis

3.1.1 - The Aim of Our Market Analysis

This chapter is where we learn about market analysis. Do not think about trading yet. This chapter has NOTHING to do with trade setups, entry or exit.

What we‟re doing through our market analysis is developing situational awareness and maintaining focus.

Understanding where price has been, assessing the strength or weakness of the current price movement, and developing a feel for where that is likely to lead future price.

Or just simply:

- Where has price been?
- Where is price likely to go?

Figure 3.1 – The Aim of our Analysis

In order to answer these questions we'll be covering the following:

- How to structure the market in order to conduct your analysis. You'll learn how I analyse price action within a framework of support and resistance.

- How to analyse the direction of the trend, as price moves within our market structure.

- How to develop a feel for strength and weakness within the market, and project that forward to identify the likely future price trend.

- And finally, how to update your bias as new market data appears bar by bar.

3.1.2 – Subjectivity vs Objectivity in Market Analysis

The market is an emotional creature.

Trader decisions cannot be defined by fixed rules, and so price movement cannot be defined by fixed rules.

Attempting to define a market by fixed and objective rules will result in an approximation that will fail to represent reality at critical times.

The human mind excels in subconscious pattern recognition, and will develop its own feel for supply/demand interaction and likely future price direction.

The end result of trying to overlay objective rules upon market movement is mental conflict, as your subconscious analysis differs from that of your objective model.

Conflict in thought and emotion results in poor trade execution, poor trade management and sub-optimal results.

The answer is not in having a better and more objective model. You need to get comfortable with subjectivity. You need to trust your intuition.

You will most likely resist this idea. If so, take some time to consider why.

What are you afraid of? Why do you demand objectivity in rules, when you know these rules do NOT define the market price action?

You may accept that objective rules cannot define market price action, but argue that they‟re close enough; that all you need are rules for the exceptions. That sounds reasonable, until you discover that the exceptions themselves change.

It‟s better to embrace subjectivity and learn to operate within the uncertainty that is the market.

Of course, danger occurs when subjectivity is not based upon an open read of the market, but instead is based upon some preconceived bias. Success requires being in sync with the market flow. If you‟re biased towards a particular direction, and it opposes the actual market flow, your results for that session will likely be a dismal failure.

I guarantee, if you approach your market analysis with a preconceived and unchangeable bias, you‟ll find numerous trade opportunities and signals that support your bias, all of which look great at the time, but continually fail. Upon reflection post-session you‟ll clearly see that you were fighting the market the whole way.

If your results are not in accordance with expectations mid-session, it pays to exit the market and print a chart and determine whether your trades were taken in accordance with the flow, or whether you were actually fighting the dominant trend.

You need to embrace subjectivity and *feel* the market.

Let the market action tell you where it‟s going. Don‟t try to tell it where to go.

Our market analysis is a subjective process. The following sections will involve subjectivity in many areas, in particular in the definition of our framework and of our trend. More discussion will be provided in the appropriate sections on how that subjectivity is applied.

3.2 – Past Market Analysis

3.2.1 – Support and Resistance

Support & Resistance Principles

In order to conduct our market analysis, it"s essential to understand and to be able to identify support and resistance (S/R).

S/R are areas on the price chart which form barriers to price movement. Support acts as a floor, limiting further downward movement. Resistance acts as a ceiling, limiting further upward movement.

Figure 3.2 – Support and Resistance

S/R are formed through the actions of traders in the market.

You will recall from our discussion of the nature of markets that price movement is a function of supply and demand.

- Price rises due to net bullish sentiment and continues rising until we run out of buyers, or until supply increases sufficiently to absorb all the demand.

- Price falls due to net bearish sentiment and continues falling until we run out of sellers, or until demand increases to the point it absorbs all the supply.

In figure 3.2, note the multiple price rallies towards the upper resistance area, around 1.4600. Price rising implies bullish sentiment and bullish orderflow. However on multiple occasions the rally was halted at that level and price fell. The only way the price could fall from this level was if either one of both of the following occurred:

1) Traders were not interested in buying at higher prices. Demand had dried up and there was no longer any urgency to get long into this market.

2) The higher prices were attractive to those selling the market. Longs took profits on their position. New shorts entered the market. The increase of supply (selling) has absorbed any remaining demand.

The end result of these two causes is that the bullish pressure which caused the price rally is no longer able to overcome the bearish pressure. Price will fall, creating a new swing high at resistance.

In figure 3.2, note the multiple occurrences of price falling towards the lower support area, around 1.4420-25. Price falling implies bearish sentiment and bearish orderflow. However on multiple occasions the fall was halted at or just above that level and price rallied. The only way the price could rally from this level was if either one of both of the following occurred:

1) Traders were not interested in selling at lower prices. Supply had dried up and there was no longer any urgency to short this market.

2) The lower prices were attractive to those buying the market. Shorts took profits on their position. New longs entered the market. The increase of demand (buying) has absorbed any remaining supply.

The end result of these two causes is that the bearish pressure which caused the price fall is no longer able to overcome the bullish pressure. Price will rise, creating a new swing low at support.

But what causes these swing highs and lows to occur at the same levels, or at least in the same area? And what causes the change of polarity, where old areas of support become new areas of resistance, once broken, or old areas of resistance become new areas of support?

Not surprisingly, it‟s traders making trading decisions.

It‟s a function of how we‟re wired as human beings; of how we assess *value* with regards price, and how we make buy and sell decisions.

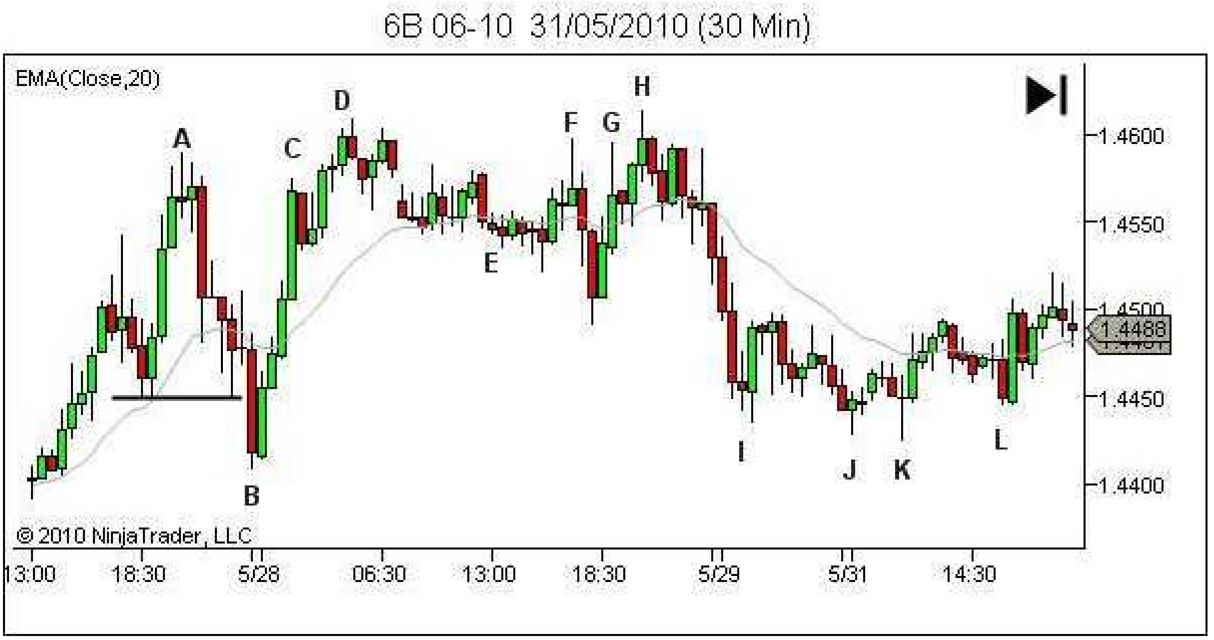


Figure 3.3 – Creating S/R through Trader Decision Making

Let‟s work through an example using the price action of figure 3.3, which reproduces the figure 3.2 data but also shows a little of the prior action. Price had been in a slow grinding uptrend for two days (not shown), prior to accelerating up to swing high A. Swing low B took price back to the point where acceleration commenced up to A, affording those who missed the initial move a second opportunity to enter long.

For the purposes of our discussion, consider initially the thoughts and fears of those traders who established a long position <u>prior</u> to the initial move to A.

Some will be concerned at the strength of the fall from A to B. Note how the rally to A took three price swings, while the fall back to B was one swift move, even breaking below the previous swing low marked via a horizontal line. This is quite a bearish swing. Profit taking at A, combined with the possible introduction of new shorts, has driven price back quite strongly.

Seeing such a strong bearish move, traders in a long position will naturally experience some regret that they didn‟t take profits at A, when price was much greater than it is now. Then they could have bought again as B held (the point of initiation of the accelerating swing up to A) for a second opportunity to profit.

Regretting this missed opportunity to sell at A, the trader will resolve to not miss that same opportunity if it should once again present itself. If only price can get back to A, they‟ll be ready with their sell orders.

This creates the pause in the rally at point C, as profit taking again places a cap on upwards movement, even if just temporarily.

However, you‟ll note that swing from B to C was also quite bullish. Some traders who had initially decided to take profits at C will change their mind and hold, with renewed (albeit cautious) confidence.

New longs, who took the second chance entry at B will likewise hold with confidence.

However this confidence is seriously dented as point D fails to push any significant distance above A. Inability to push higher implies either a lack of new buying at these higher prices and/or the introduction of new selling as the bears position themselves short expecting a reversal. The market sentiment is clearly not bullish at these levels, otherwise the break above A would have led to another strong leg upwards.

Additional longs will take profit at the pause at D, adding to selling pressure and further capping prices.

Consider now the *late* longs, who entered at the top of the move right into swing high D, as price broke above swing high A. These traders are quite frustrated; having missed the great profit opportunity up to A, and between B & C, they now find themselves in a painful, extended drawdown as price grinds sideways through area E.

These traders will be looking for any opportunity to salvage the situation, swearing that if price can just get back to their entry point, they‟ll take the opportunity to get out at breakeven.

The market affords them that opportunity at points F, G and H.

This selling adds to any bearish orderflow from new bears, creating what appears on the chart as resistance within this one common area.

The resistance has been created due to the traders within the market perceiving prices around 1.4600 as being high, and therefore a selling opportunity.

Let‟s reproduce figure 3.3 (now 3.4) below, to discuss the support.

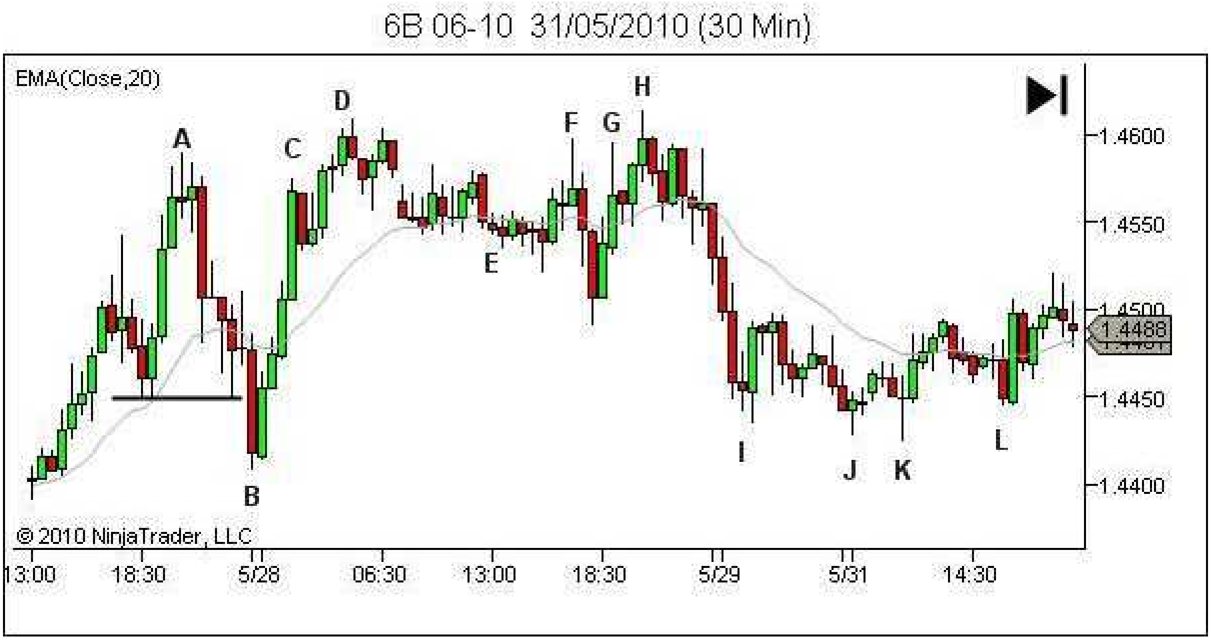


Figure 3.4 – Creating S/R through Trader Decision Making - 2

Consider the move downwards from point H, and in particular the mindset and thought processes of those holding a short position.

Where are they expecting buying to again come into the market, which might limit any further downside movement? They‟ll observe swing low B and note the rapid rate at which price last rejected that level and exploded back up to C. Expectations are that if traders previously perceived great buying opportunity at point B (vicinity 1.4400/20), then they may do so again.

Shorts will be looking to take profits, or at least cover part of their position, as price approaches abeam B. This bullish demand (buy orders to cover the short) will add to any other buy orders from new longs on the retest of B, to halt the downward move.

Trader expectation of support abeam B has produced support at areas I, J, K and L.

Let‟s look at an example of a change of polarity (figure 3.5), in this case support becoming resistance. In doing so, we‟ll once again consider the thought processes and emotions of traders and how that influences their decision making.

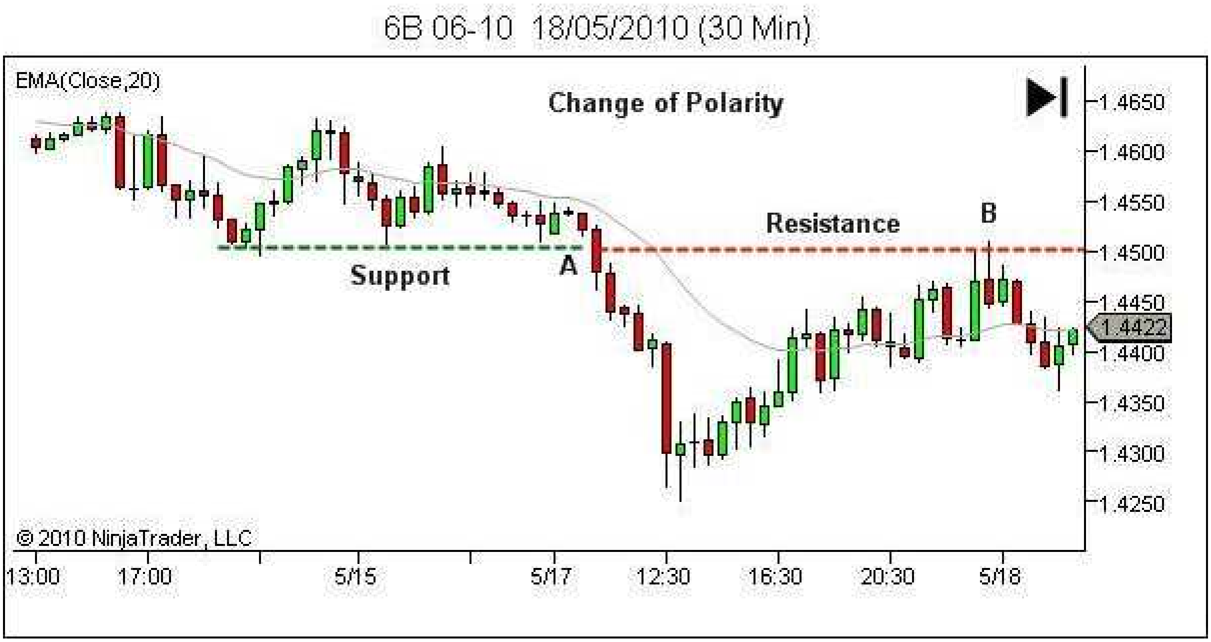


Figure 3.5 – Creating a Change of Polarity through Trader Decision Making

It‟s all once again trader fear, hope and regret.

Prior to point A we had an established area of support, marked by the green line. Bullish demand was entering the market here, limiting downside movement. Stops were placed below the area to exit the long positions (for those smarter traders who use stops). Entry orders were also placed below the support area where the breakout traders hoped to enter short.

The break below support at A experienced a surge of bearish pressure, as all these sell orders were executed, pushing price down to new swing lows.

Consider the different parties involved at this point.

Firstly, consider the longs from prior to A, who were not so smart and held onto their position. Right now they‟re in extreme drawdown and much stress, praying for any opportunity to get out at breakeven or at least as close as they can. If price gets back to the point of breakout, they promise to sell their position, just as they should have done at A.

Now consider the shorts who missed the move down from A, cursing their incredibly bad luck at missing yet another good breakout. They will be praying for price to retest the point of breakout again, so that they can have a second chance at entering short. They promise themselves that if they get this opportunity, this time they‟ll sell for sure.

Now consider the smarter breakout traders who caught the initial move. They‟ll plan to take some profits at the stall at the swing lows, and look for an opportunity to reestablish their position at higher prices again, the absolute best opportunity being the point of initial breakout.

All these decisions lead to the upper tails at point B, where bearish orderflow quickly rejects any higher prices abeam point A.

Trader decisions have led to previous support now acting as resistance.

The reverse process applies to previous resistance now becoming support, following a breakout upwards through that resistance. I encourage you to find an example on a chart and work through the same thought processes.

Support and resistance are created by the decision making of market participants, as they operate within an environment of uncertainty.

Decisions to buy or sell are made through referencing current price against previous areas which caused significant emotional response, in particular those areas which led to regret of missing out on opportunity, or those areas which trapped traders in losing positions.

There are other factors involved, not least of which is the simple self-fulfilling prophecy.

Assume a chart displays a solid area of resistance. If price ever moves back to that area, traders will be expecting resistance to again hold. Buying will dry up and selling will increase. Bearish pressure will overcome bullish pressure leading to price falling. The expectation of resistance leads to orderflow which restricts further upward movement, thus creating resistance.

The same applies to clearly recognisable areas of support. If price moves back to that support area, traders will again expect support to hold. Selling will dry up. Buying will increase. Bullish pressure will overcome bearish pressure leading to a price rally. The expectation of support leads to orderflow which restricts further downward movement, thus creating support.

Support is an area in which demand overcomes supply, limiting downward price movement.

Resistance is an area in which supply overcomes demand, limiting upward price movement.

Identifying Support and Resistance

S/R are areas which have provided a barrier to further price movement. In most cases, this will display as turning points in the market (swing highs and lows).

Let‟s look at how I define these swing high and low areas.

Swing Highs and Lows

A swing high is simply any turning point where rising price changes to falling price. I define a swing high (SH) as a price bar high, preceded by two lower highs (LH) and followed by two lower highs (LH), as per the following diagram:

Figure 3.6 – Swing High

Referring to figure 3.6, the Swing High is candle C. All other candles reference this one.

- Candle A has a high which is LOWER THAN candle C's high.
- Candle B has a high which is LOWER THAN candle C's high.
- Candle D has a high which is LOWER THAN candle C's high.
- Candle E has a high which is LOWER THAN candle C's high.

Note that candle A‟s high does not have to be lower than B. All highs only reference the high of C, as per the examples below in figure 3.7.

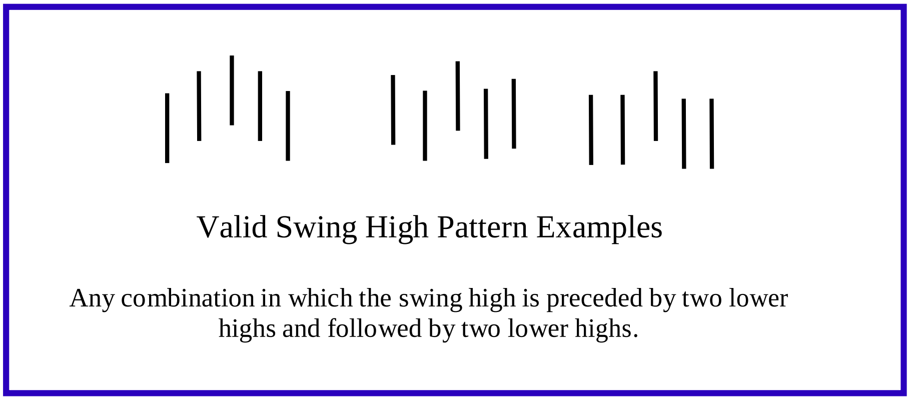


Figure 3.7 – Example of Swing High Variation

In the event of multiple candles forming equal highs, this will still be defined as a swing high, provided that there are two candles with lower highs both preceding and following the multiple candle formation, as shown in figure 3.8 below.

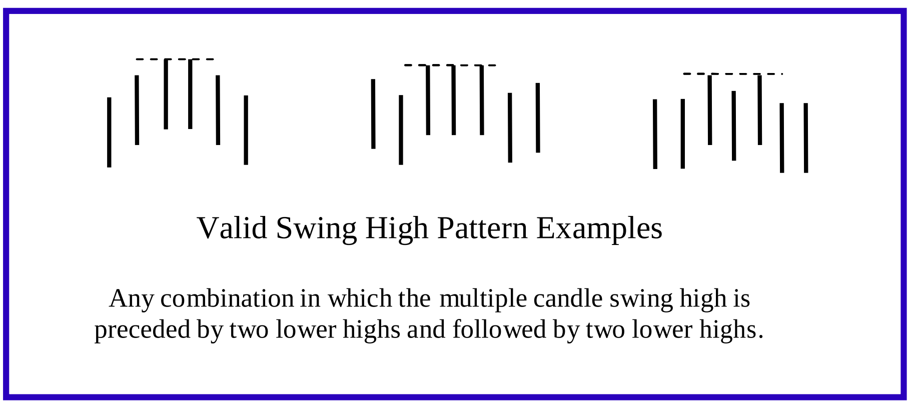


Figure 3.8 – Example of Swing High Variation – Multiple Candle SH

Likewise for the swing low.

A swing low is simply any turning point where falling price changes to rising price. I define a swing low (SL) as a price bar low, preceded by two higher lows (HL) and followed by two higher lows (HL), as per the following diagram:

Figure 3.9 – Swing Low

The Swing Low in figure 3.9 is candle C. All other candles reference this one.

- Candle A has a low which is HIGHER THAN candle C's low.
- Candle B has a low which is HIGHER THAN candle C's low.
- Candle D has a low which is HIGHER THAN candle C's low.
- Candle E has a low which is HIGHER THAN candle C's low.

Again note that candle A‟s low does not have to be higher than B. All lows only reference the low of C, as per the examples below in figure 3.10.

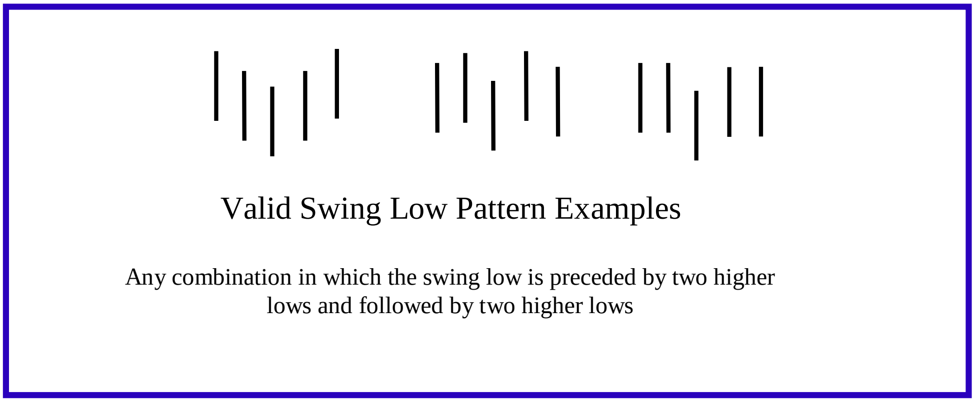


Figure 3.10 – Example of Swing Low Variation

In the event of multiple candles forming equal lows, this will still be defined as a swing low, provided that there are two candles with higher lows both preceding and following the multiple candle formation, as shown in figure 3.11 below.

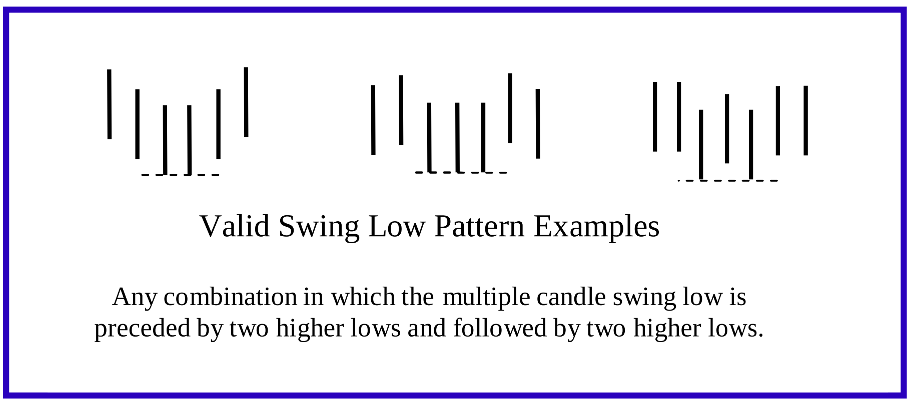


Figure 3.11 – Example of Swing Low Variation – Multiple Candle SL

<u>Additional Areas of S/R</u>

The vast majority of my S/R are defined by swing highs and lows, as described. However there are additional means of identifying S/R which you may wish to consider if they‟re prevalent in your chosen market.

As an example, your market may produce gaps which also define S/R areas. These are not so prevalent in forex or FX currency futures, so let‟s look at an example from the emini-Dow futures, YM.

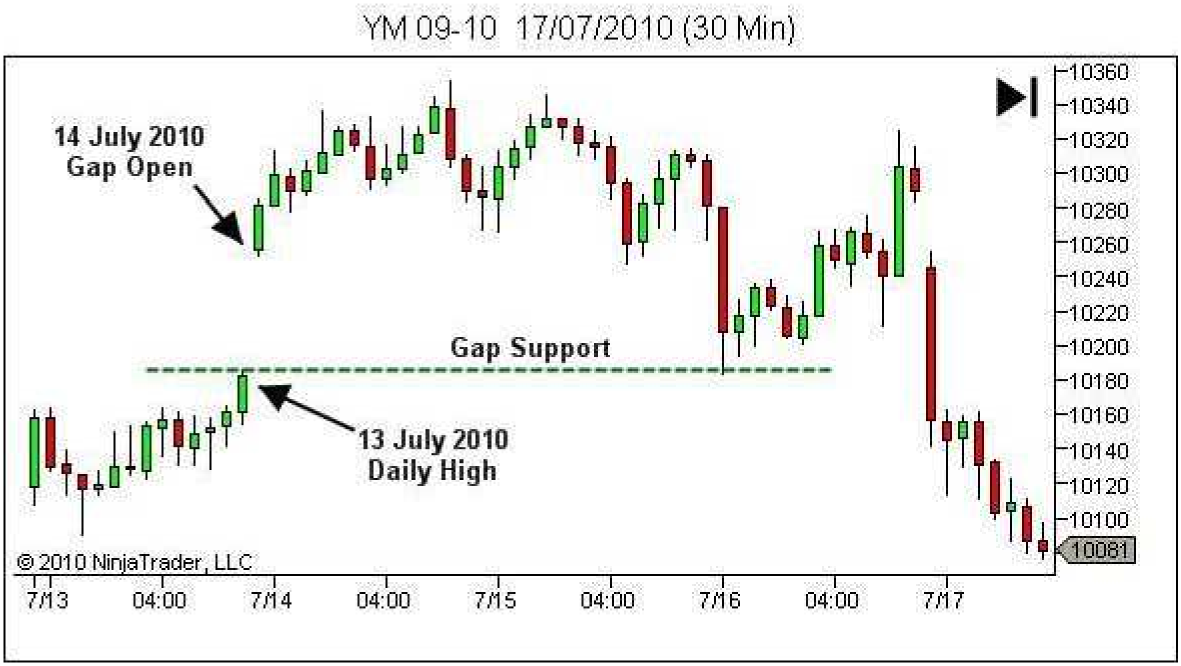


Figure 3.12 – Gap Support

Drawing S/R – Areas NOT Lines

When I display my S/R areas on a chart, it will usually be done via a straight line.

You‟ll note however that when price returns to this line it does not always stop at the exact price defining this S/R line. S/R is an <u>AREA</u> in which traders make decisions. Different traders will make their decision at different prices, and will act on that decision at different times within that area.

As such, during the conduct of your analysis it is imperative that you remain aware of the whole area, even though your chart may show S/R represented by a single line. Be aware that price may turn before the line; and that a break of that line does NOT necessarily constitute a break of the S/R level.

Figure 3.13 - S/R as an Area

S/R lines are usually drawn at the high/low of the swing H/L candle, as shown on the left hand side of figure 3.13. However it may be drawn in other locations, with tails protruding above/below the line, if that location better defines the area of S/R.

An example of this variation would be when the swing H/L has penetrated a significant round number level by a couple of pips; I‟ll usually place the S/R line at that round number level rather than a few pips above or below.

You may prefer to display your S/R as a box, rather than line, during the learning process.

Typically I‟ll be visualising the area as if it included the upper or lower tails and body of the swing high/low candle. This is demonstrated in the right hand side of figure 3.13 above, where the area encompasses the upper tail and body of the red swing high candle.

For small candles at swing high/low points, I may include the whole candle range as the area of S/R.

Or if the candle has too large a range, then I‟ll look at either market structure or a lower timeframe, in order to find an appropriate region.

That being said, even this is an approximation of the area boundaries. Fixed rules don‟t apply here. An S/R area is not like a brick wall. It‟s a price region which has some emotional attachment to traders, as a result of a previous supply/demand imbalance, which is expected to possibly be an area of future trader decision making. The boundaries of the *area of emotional influence* cannot be exactly defined.

The key is not to get too concerned about exactness and don‟t be afraid of subjectivity. It‟s an area.

Later when we discuss trading, you'll note that we don't just assume these areas will hold. They become areas of interest where we'll be looking for opportunity –sometimes expecting the area to hold, other times expecting a break.

So if you‟re out by a few pips or points, it doesn‟t really matter.

Enjoy the subjectivity. It takes a little practice, but you‟ll get comfortable with it in time.

Let‟s review a couple of examples, in which we discuss the *area* that I‟d typically expect to find support or resistance orderflow…

Figure 3.14 – Which Part of the Candle Forms the S/R Area – Example 1

The candles at swing high A, in figure 3.14, are too large to completely define a resistance level. In this case I would use the area from the top of swing high A to the point of breakout above swing high B.

Resistance at C is defined by the upper tails.

Support at D is defined by the lower tails.

Swing low E has quite large tails. Rather than encompassing this whole area, I"d mark the support area as being the portion of the tails which broke the low side of the area of congestion at F.

Figure 3.15 – Which Part of the Candle Forms the S/R Area – Example 2

In figure 3.15, an area of resistance is defined by swing high A, and the top of a subsequent area of sideways congestion. I would mark this area simply as the upper tails.

Support is defined by swing low B. I"d draw the support area enclosing the whole range of the narrow-range candle at swing low B.

3.2.2 – Multiple Timeframe Analysis

Markets operate in the now – the current transaction. The concept of multiple timeframes exists only through the way we choose to view past and present market action.

The higher the chosen timeframe; the greater the *bigger-picture* available to the trader.

The lower the chosen timeframe; the more *detail* available to the trader.

The challenge for us is that the market is composed of numerous market participants all operating via different timeframes. So, which timeframes should we choose for our analysis?

I"ve seen traders attempt to operate with half a dozen timeframes on their screen at once; everything from weekly down to one minute. Their attempt to gain a complete picture is impressive, but for me it"s just too much data for one person to absorb during their development phase; at least until they"ve learnt what to filter out.

Likewise, I"ve seen traders attempt to operate on only one timeframe in an attempt to limit the information. I think this is preferable to too many timeframes. I can certainly trade this way, mostly because I can *see* the higher timeframes within the lower timeframe data.

My preference though, and certainly what I recommend for all traders while learning to trade, is to operate with three timeframes.

I may be aware of others; certainly I"ll glance at the daily chart during my pre-session preparation; but the focus during my market analysis is on three timeframes only.

These are the *Trading Timeframe* and then one timeframe higher (*Higher Timeframe*) and one lower (*Lower Timeframe*).

Figure 3.16 – Three Timeframes

A common error with newer traders who attempt multiple timeframe analysis is to try to find alignment of trend on all timeframes. That is, they try to identify an uptrend on all three timeframes (or a downtrend on all three timeframes) and then trade only in the direction of that trend. This seriously limits opportunity, while still being rather ineffective.

In reality, these traders are quite likely the same ones who‟ve entered based on a lagging, indicator-based signal in the direction of the trend, simply hoping that the trend continues long enough to profit. Recognising that trends don‟t go on forever, they‟ve simply filtered their trades to only take those which exist within multiple trends in multiple timeframes, in the hope that this greater force will push their trade to profit.

There is no consideration as to what **barriers** might be in place to stop the existing trend, thereby limiting their opportunity. There is also no consideration of the fact that markets spend a lot of time moving sideways.

We aim to operate differently. Figure 3.17 defines our three timeframes.

Primary: 30 min Alternate: 60 min	To provide structure to our market, by identifying a framework of support and resistance, which act as barriers to *trading timeframe* price movement.	Higher Timeframe
Primary: 3 min Alternate: 5 min	To analyse the market trend and determine the likely path of future price action, as it moves within the *higher timeframe* market structure framework.	Trading Timeframe
Primary: 1 min	To fine-tune the *trading timeframe* analysis; and to time trade entry and exit.	Lower Timeframe

Figure 3.17 – Trading Timeframes

The *higher timeframe* places a structure or framework over the market. Through identification of areas of support and resistance, we identify areas in the market which will form barriers to the *trading timeframe* trend. We‟ve defined our battlefield.

The *trading timeframe* is the one we trade, hence the name. Our aim is to trade the swings within this *trading timeframe*, regardless of whether the market is trending or ranging sideways. We do this through understanding past price movement, assessing the strength or weakness within that price movement, and determining the likely path for future price action.

The *lower timeframe* provides us with finer detail in order to fine-tune our *trading timeframe* analysis, allowing us to *zoom in* to see the internal forces of supply and demand; plus in allowing us to time our entry and exit (more on entry & exit in Chapter 4).

We trade the *trading timeframe*. But we do so by placing this price action within the context of *higher timeframe* structure.

A trend within our *trading timeframe* may simply be a price swing within a *higher timeframe* sideways market. Multiple timeframe analysis allows us to be alert for a potential trend reversal at the area of *higher timeframe* barriers.

A breakout through resistance on our *trading timeframe* may simply push us deeper into a *higher timeframe* resistance area. So we‟ll be watching the shifting bullish and bearish sentiment for signs of breakout failure.

Multiple timeframe analysis is all about placing *trading timeframe* market action within the context of the bigger picture, *higher timeframe* action.

The timeframes we will use for the majority of examples throughout this book are:

- **Higher Timeframe: 30 min**
- **Trading Timeframe: 3 min**
- **Lower Timeframe: 1 min**

This is what I use as standard YTC Swing Trader timings for my trading of 6B or YM.

Although, it is flexible! Sometimes if I don‟t feel like I‟m in sync with the market on these timeframes I‟ll find a better *feel* for price action using alternate *higher* and *trading timeframes* of 60 min and 5 min respectively. Spot forex pair GBP/USD, for example, is always more comfortable on these slightly higher timeframes.

We‟ll talk more about alternate timeframes and markets in a later chapter.

Let‟s work through an example using our three timeframes. We haven‟t yet covered analysis of trends, nor the creation of our *higher timeframe* S/R structure, so just accept this analysis for now.

The key at this point is just seeing how the timeframes interact. In particular, how the *trading timeframe* price action is placed into the context of the *higher timeframe* support or resistance.

While with-trend trades are always preferable when possible, I‟ll give a counter-trend example here, simply so that you can see how it works without requiring all timeframes in trend alignment.

Figure 3.18 – Multiple Timeframe Example – 30 min

Figure 3.18 displays a *higher timeframe* (30 min) chart. Resistance areas are displayed via the red lines. Support areas are displayed via the green lines. Note the area which changes from green to red. Previous support has become potential resistance once price dramatically broke through the support at point A. The area we‟re interested in for the purpose of this example is marked as point B, where price returns to test the area of resistance.

Figure 3.19 (below) shows the *trading timeframe* (3 min), where we analyse price action and seek trading opportunity. Ignore earlier opportunities (because we haven‟t yet learnt analysis or strategy) and focus solely on the retest at point B.

Our analysis of the *trading timeframe* (3 min) shows an uptrending market pushing into the area of resistance, and in fact slightly breaching the level. We‟ll be watching for one of two primary opportunities here – highest probability being a break of the level which quickly fails, second likely being a breakout which holds then continues in the breakout direction.

Again, just accept the analysis for now.

Figure 3.19 – Multiple Timeframe Example – 3 min

The *lower timeframe* (1 min) of figure 3.20 displays finer detail, allowing us to see a clear slowing of momentum on breaching the previous swing high, the 1.4500 level and the resistance area.

Figure 3.20 – Multiple Timeframe Example – 1 min

Consider the traders who have bought on a break above these areas. With price reaching 1.4510, their stops will likely be somewhere just below the zero‟s level. That‟s where we want to enter short, aiming to trade the overextended 3-min chart back downwards. Noting that it‟s counter-trend, we‟ll be looking for an initial target just above the prior swing low, in the vicinity of 1.4470.

Entry occurs on failure at the resistance area and price easily moves to our target over the next 6 to 7 minutes.

Key points from the example – The *trading timeframe* (3 min) was traded within the context of *higher timeframe* (30 min) structure, with the *higher timeframe* resistance providing a barrier to our *trading timeframe* trend. The *lower timeframe* (1 min) was used to fine-tune analysis as well as timing our entry and exit decisions.

Multiple Timeframe Support and Resistance

In discussing and trading my strategy, I will refer to two primary types of S/R, as follows:

- S/R identified on the *higher timeframe* chart is referred to as **Support** or **Resistance.**

- S/R identified on the *trading timeframe* chart is simply referred to as **Swing High or Low**.

Note that the *higher timeframe* S/R will also be evident on the *trading timeframe* chart, while *trading timeframe* swing highs and lows will often be insignificant on a *higher timeframe* chart.

Numerous chart examples will follow in the remainder of this chapter, displaying both S/R and swing highs and lows.

NOTE:

In viewing my earlier videos and reading the articles on my website, you may have seen me refer to S/R as either *Major S/R* or *Minor S/R*. These were the names I used for several years, simply because that‟s what I was taught.

My use of these terms was simply based upon timeframe. S/R identified on the *higher timeframe* chart was referred to as Major S/R. S/R identified on the *trading timeframe* chart was referred to as Minor S/R.

In preparing this book and discussing this issue with other traders, I have decided to change the names I use for these S/R levels. I will (from now on) be referring to my S/R levels via the simpler names, S/R and Swing H/L.

The reason for this change is simple. Firstly, Major S/R and Minor S/R are quite common names used by many traders; however there is no standard definition and you will find many different interpretations and definitions. The new names are simpler and will hopefully result in less confusion when reading other educators material. Secondly, Major and Minor tend to give the false impression that Major S/R are stronger than Minor S/R. Although sometimes the case, it‟s not necessarily true.

Common Abbreviations Used on Charts:

- S/R – Support and Resistance (any type)

- Spt – Higher Timeframe Support
- Res – Higher Timeframe Resistance

- Swing H/L – Trading Timeframe turn points
- SL – Trading Timeframe Support
- SH – Trading Timeframe Resistance

3.2.3 – Market Structure

Market Structure Principles

Our Market Structure operates in accordance with two principles:

- Principle 1 – Price moves within a structural framework of support and resistance.
- Principle 2 – A breakout of the structural framework support or resistance will lead to price movement in the next area of the framework.

Through identification of areas of support and resistance, we identify areas in the market which will form barriers to the *trading timeframe* trend. We"ve defined our battlefield.

Price then moves within the framework defined by these levels, back and forth between levels of support and resistance, based on the decision making of traders.

These S/R barriers are not impenetrable. They are *decision areas* for price, which will then either reverse or breach the barrier, depending on sentiment.

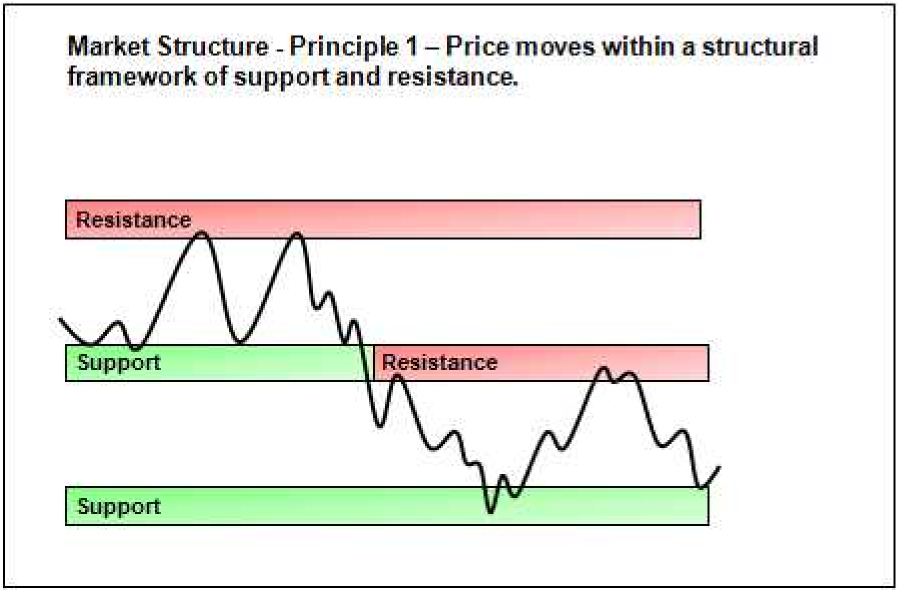


Figure 3.21 – Market Structure – Principle 1

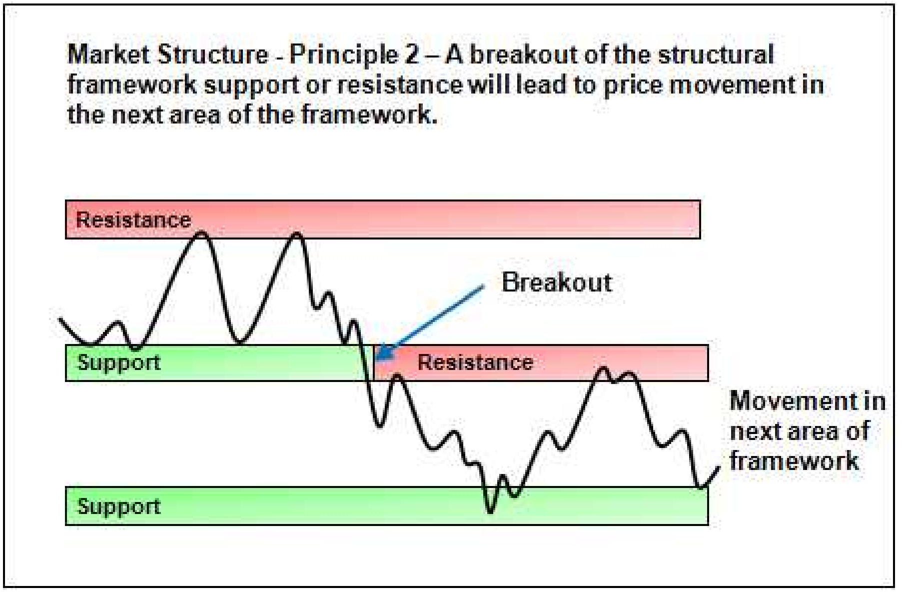


Figure 3.22 – Market Structure – Principle 2

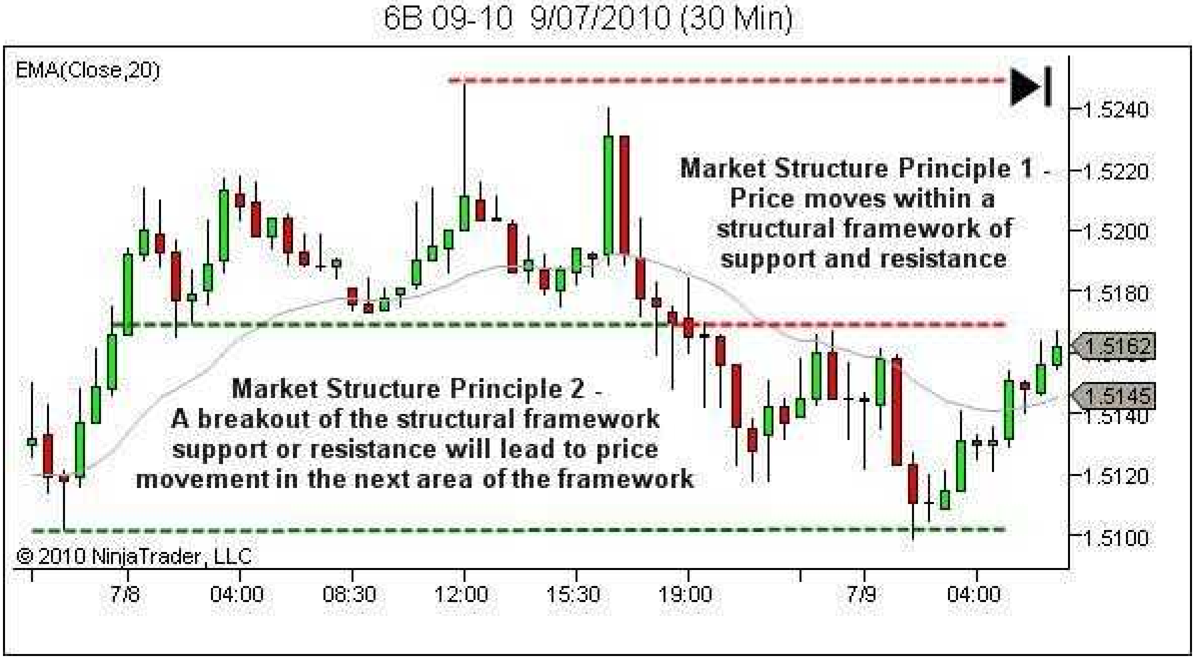


Figure 3.23 – Market Structure Principle 1&2 – Chart Example

Creating the Structure

The process for creating our *higher timeframe* structure is simple.

- **Open your *higher timeframe* chart**
- **Identify and mark areas of S/R**

Subjectivity

While the rules for identifying S/R are quite objective, not all S/R levels will be marked on charts.

If price is flowing in a smooth and orderly manner as identified below in figure 3.24, then all identified S/R may be marked on the chart.

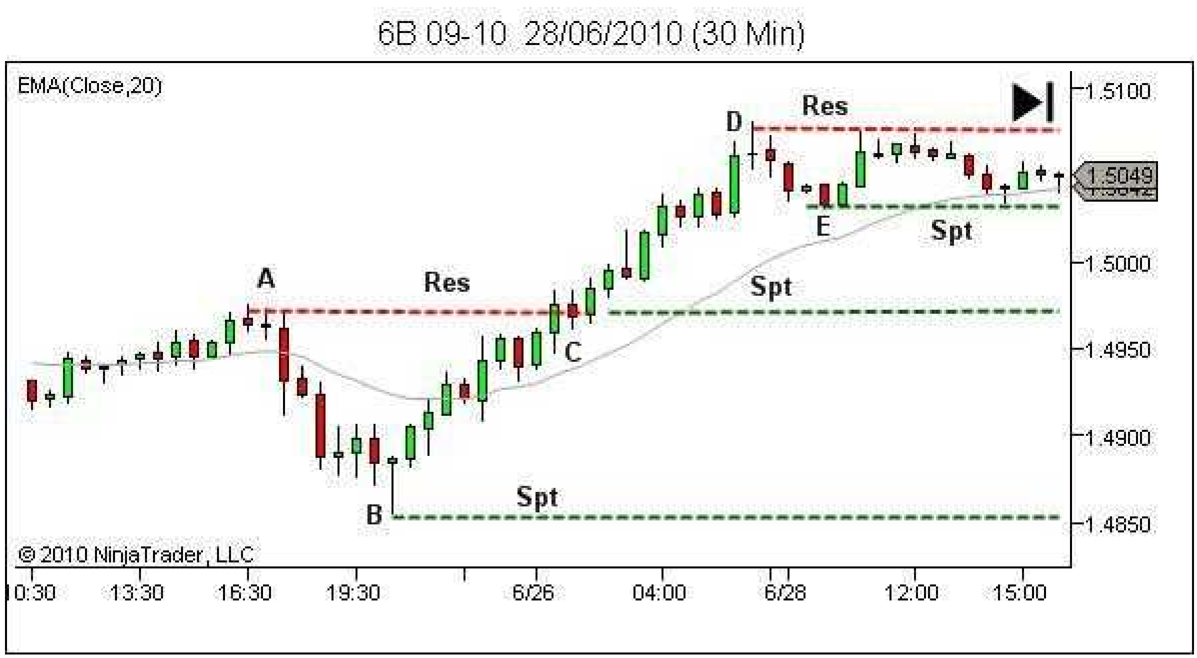


Figure 3.24 – Smooth Flow

Swing high A clearly defines an area of resistance, which temporarily halted price at area C. Swing low B clearly defines an area of support.

Swing high D forms a new area of resistance, which holds price for the remainder of the displayed chart. Swing low E forms a new area of support, which once again holds price for the remainder of this chart‟s price action.

However, more often than not, price action is choppy with much overlap between candles. Strictly following our definitions for swing high/low would leave us with a market structure that is just unworkable.

Figure 3.25 – Choppy Action - Unworkable

This is demonstrated in figure 3.25, where strict adherence to the definitions of swing highs and lows provides a chart with support and resistance lines showing every 10-20 pips.

In these cases, we‟re required to *mentally* zoom out and select only those most relevant levels.

Our intent is simply to identify those <u>key turning points which stand out on the chart as the most obvious levels</u>, and therefore offer potential barriers to future price action.

Figure 3.26 below demonstrates how I would mark up the choppy price action of figure 3.25.

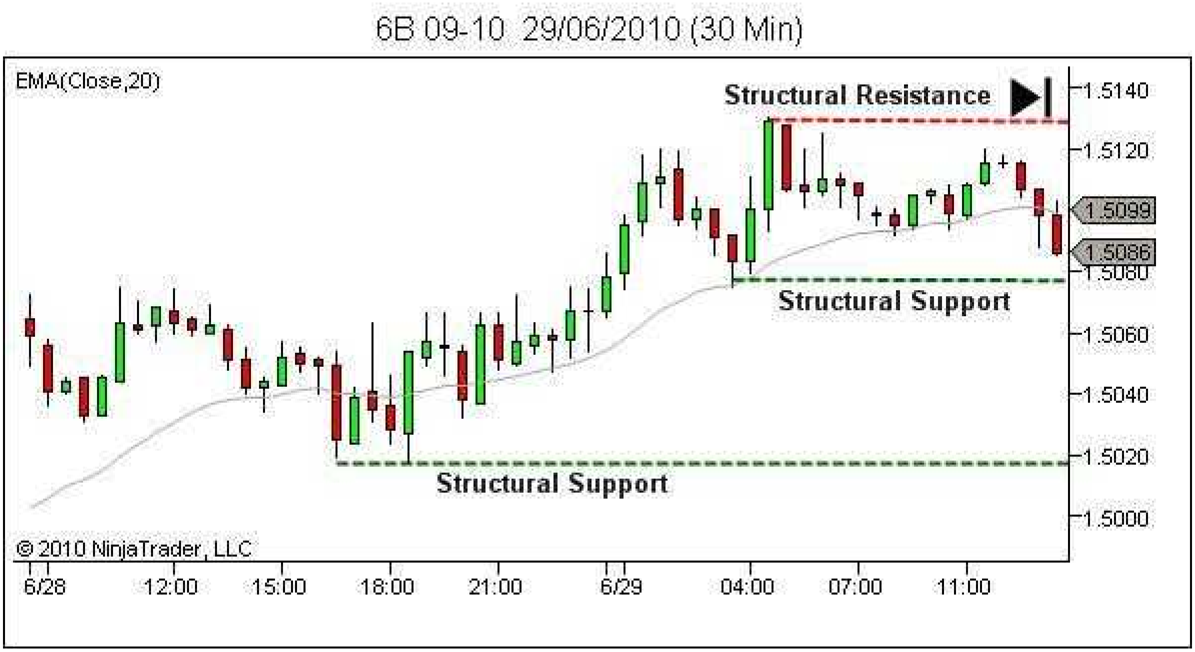


Figure 3.26 – Choppy Action – Selecting Key Levels Only

Don"t try to make this too complicated. It really is as easy as, *"If it looks like a relevant S/R level, then it probably is"*.

The Best S/R

The absolute best S/R, which should NOT be missed in your creation of market structure, are those levels which displayed the greatest supply/demand imbalance when price last left the area.

That is, those times when the difference in urgency between the bulls and bears is greatest, leading to RAPID price movement.

This will be evident at swing highs and lows which show a rapid reversal of price; and at areas of congestion which lead to a sudden and strong breakout with good follow-through.

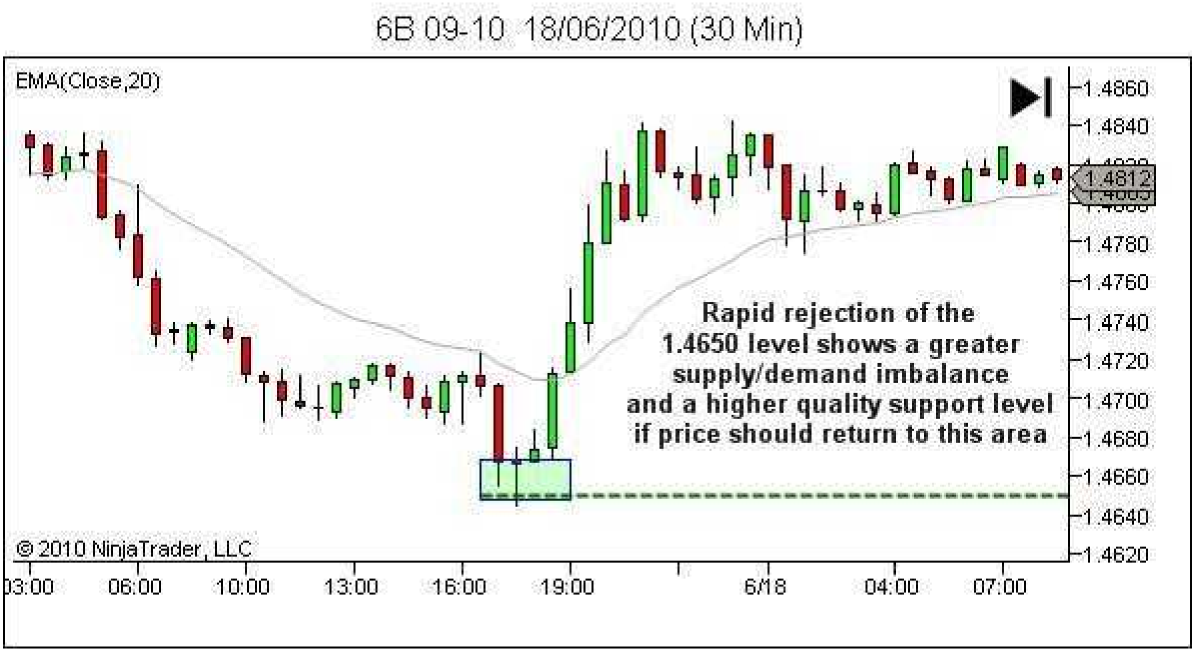


Figure 3.27 – Rapid rejection provides a higher quality S/R level

Be sure to include all such areas when defining your market structure.

Market Structure Examples

Let"s finish up our discussion of Market Structure with a couple of examples, in which we define our support and resistance framework and then see how future price action reacts to those levels.

Figure 3.28 – Higher Timeframe (30 min) Structure Example 1

Figure 3.28 shows the market prior to the open of the UK forex session on 25 June 2010.

Resistance R1 exists above the market at swing highs between 1.5000 and 1.5015, which capped the upside of the 24 June UK and US sessions.

Support S1 exists below the current price action in the area of 1.4920-30, based upon the early Asian session congestion and breakout.

Support S2 exists at 1.4850-70 based upon the 23 June US session swing low tails.

Support S3 exists at 1.4800 based upon the 23 June Asian session swing low and congestion (just off the left of the chart). Note that the area of potential support in this case would extend right up to 1.4840 where the momentum really exploded to the upside

Let‟s look at how the UK session progressed over the next six hours…

Figure 3.29 – Followup to Higher Timeframe (30 min) Structure Example 1

Figure 3.29 shows further *higher timeframe* (30 min) price action.

Candle A marks the open of the UK session. Note the lower tail on this candle (marked B) showing some support being provided by our 1.4900-20 support area. Once price broke that area, where does it go next? Straight to our next support area S2, identified by the lower tail of candle C.

The intent of our *higher timeframe* structure is to define the framework within which price moves. If we do this accurately, subsequent price action will move between your areas of *higher timeframe* support and resistance.

Another example…

Figure 3.30 –Higher Timeframe (30 min) Structure Example 2

Figure 3.30 shows the market structure prior to the UK session of 17 June 2010.

Resistance R1 appears above price in areas 1.4840-60, based on the tails at the top of the previous US session. Resistance R2 exists at 1.4825-35, based on the swing high prior to the breakout downwards. Resistance R3 and R4 define one resistance area of 1.4720-40 based upon the late US session congestion, the lower level of which capped price during the followup Asian session).

Support S1 exists at 1.4685-95, based upon swing lows of both recent and prior price action. Support S2 exists at 1.4645-65 based upon previous swing low and congestion to the left.

Let‟s now look at the price action over the next few hours…

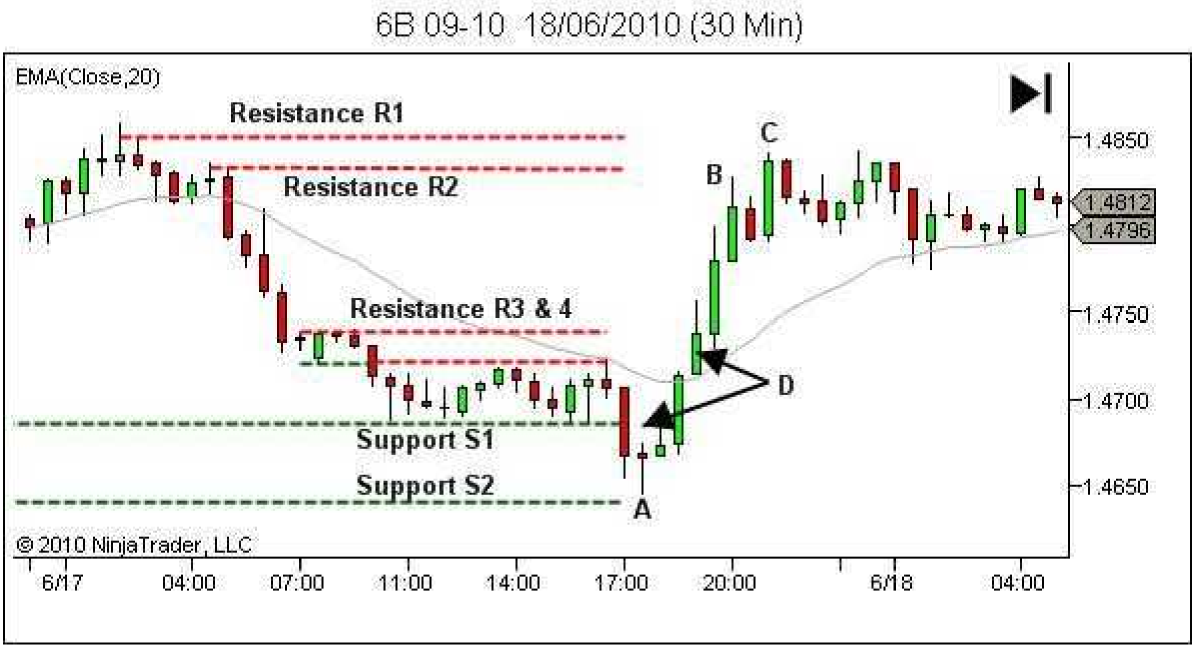


Figure 3.31 – Followup to Higher Timeframe (30 min) Structure Example 2

On the open of the UK session on 17 June, price blew straight through support S1 which defined the lower edge of Asian session range, to halt at the next support area, S2. On the 30 min chart this shows a failed breakout, as it then reversed and travelled back through the Asian session range to the upside.

Resistance R2 slowed price initially at B, before the next higher resistance area at R1 provided a final barrier to higher prices at C, defining the highs for the remainder of the UK and US sessions.

Points D show a great example of why we do not automatically place buy orders at support and sell orders at resistance. These are just areas at which we watch the *trading* (3 min) *and lower timeframe* (1 min) price action with interest. How price reacts there will define our bias for future price action and our actions with respect to trade opportunity.

This is particularly so for areas such as those at D which define the upper and lower edges of the Asian session range. These S/R areas are commonly watched in the forex world, with many traders aiming to play any breakout from this range. Once again, we don‟t automatically trade a breakout. We watch these areas for opportunity, which may eventuate as a successful test of the area, a breakout or a breakout failure (more to follow later when we learn to trade – at the moment we‟re just defining the structure).

Market Structure Practice

Take a break from reading, open your platform and display a chart using your selected *higher timeframe*. If you‟re not sure which market you‟ll be trading, or which timeframes, just practice on the 6B or GBP/USD 30 minute chart.

Scroll back through your historical chart data to the earliest date available and position the start of a trading session on the right hand side of your screen. For 6B or GBP/USD this will be the start of the UK forex session (0800 GMT)

Identify and mark the areas of S/R, using the data to the left.

Step forward through the data bar by bar, updating the S/R as new areas come into play and old areas lose relevance.

Repeat until you‟re comfortable with this process.

Common Question:

How far back in time should we go to find S/R?

As far back as necessary!

Realise though, the further back you have to go, the more time has elapsed since price was last there. As S/R is a result of trader decisions and actions, more elapsed time usually means it will have less influence.

Of course, significant levels on daily charts will be visible to these higher timeframe traders for many months and may still have some influence.

And areas which have historical significance may remain relevant for years, such as the 2003 Dow and S&P lows.

Summary

Higher timeframe structure is created by marking support and resistance levels on the higher timeframe chart.

This support and resistance structure forms the framework within which our trading timeframe price action will move.

A breakout of the structural framework support or resistance will lead to price movement in the next area of the framework.

3.2.4 – Trends

Having defined our *higher timeframe* structure, let‟s now see how price moves within that structure. We‟ll start with the objective, rule-based method with which I define a trend. And we‟ll then follow that up with a talk about applying subjectivity over top of our objective definition.

Trend Definition

Trend Support and Resistance – Swing Highs & Lows

The principles governing price movement are the same on all timeframes. Price moves as a function of supply and demand. It moves between areas of previous supply/demand imbalance, which are defined as support or resistance.

On our *higher timeframe* (30 min) we defined a structure based upon *higher timeframe* support and resistance.

Within that structure, price still moves between areas of shorter timeframe support and resistance. On the *trading timeframe* (3 min) I simply refer to them as swing highs (SH) and swing lows (SL), as demonstrated in figure 3.32 below.

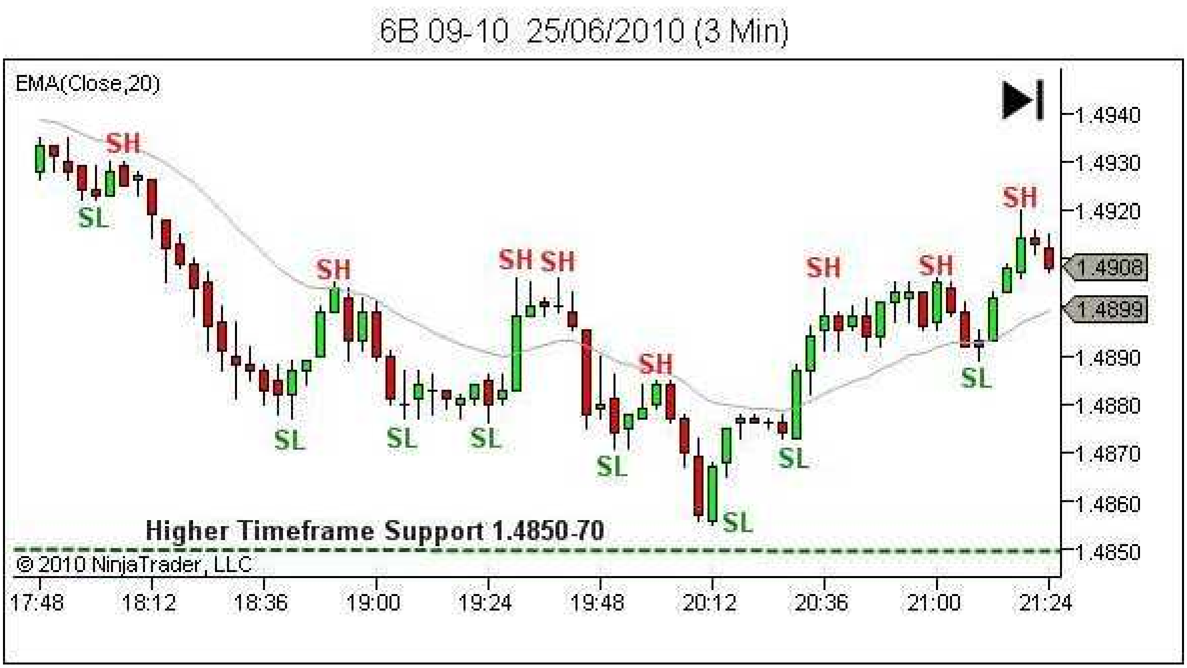


Figure 3.32 – Trend– Swing Highs & Lows

It‟s important to remember that these swing highs and lows form *trading timeframe* S/R, and could potentially impact future price action, as demonstrated below. Swing H/L are areas of previous supply/demand imbalance which will be referenced by other traders when they make their trading decisions.

Figure 3.33 – Trend– Swing Highs & Lows as S/R

Although I‟ve marked the swing H/L with labels and lines, in the chart above, this is for demonstration purposes only. Typically my charts will not display the labels or lines, as these swing H/L areas are usually visible to the eye. The only time I may mark a swing H/L line on a chart while trading is when the line extends from price action off the left hand side of the chart.

While learning to trade, you may choose to initially mark the swing H/L and corresponding line on your chart, until experience is gained in seeing these areas without the extra visual cue.

As with *higher timeframe* S/R, in a choppy market with much candle overlap you may need to mentally step back from the noise and <u>select only those most obvious levels</u>. Don‟t be afraid of a little subjectivity. Like S/R on the *higher timeframe*, if it looks like a significant swing high or low, it probably is.

Trend Direction

Price movement between these swing H/L will form into trends; either as an uptrend, downtrend or a sideways trend (trading range).

Uptrend - Definition

An uptrend comprises a repeating sequence of:

1) An upward extension
2) A swing high
3) A downward pullback
4) A swing low

This is demonstrated below in figure 3.34, where you‟ll also notice a few other key observations:

- The price extensions are longer than the pullbacks.
- Extensions will break above previous swing high, reaching new price highs for that trend.
- Pullbacks will not break below previous swing lows.

This results in a series of higher swing highs and higher swing lows.

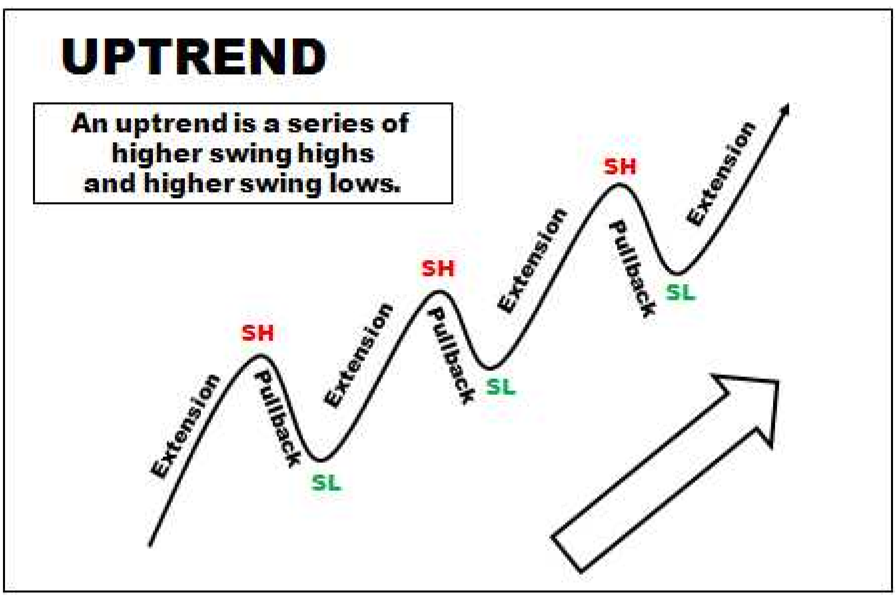


Figure 3.34 – Uptrend – Diagram

Figure 3.35 – Uptrend - Chart

An uptrend ends when price breaks the <u>swing low which leads to the highest swing high of the trend.</u> We‟ll demonstrate that in figure 3.36 below.

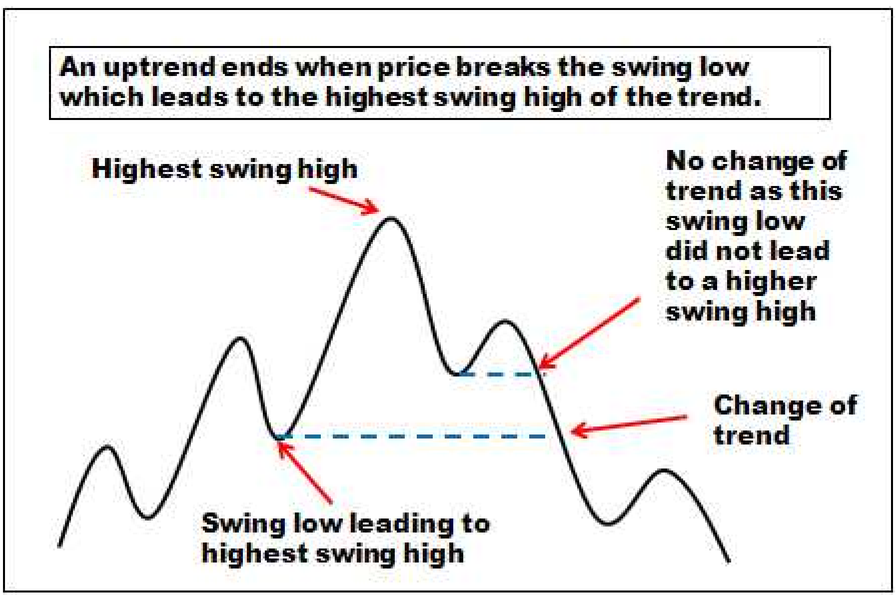


Figure 3.36 –Uptrend End

Failure to break the swing low that leads to the highest high, could simply indicate a complex pullback rather than a reversal, as demonstrated below in figure 3.37.

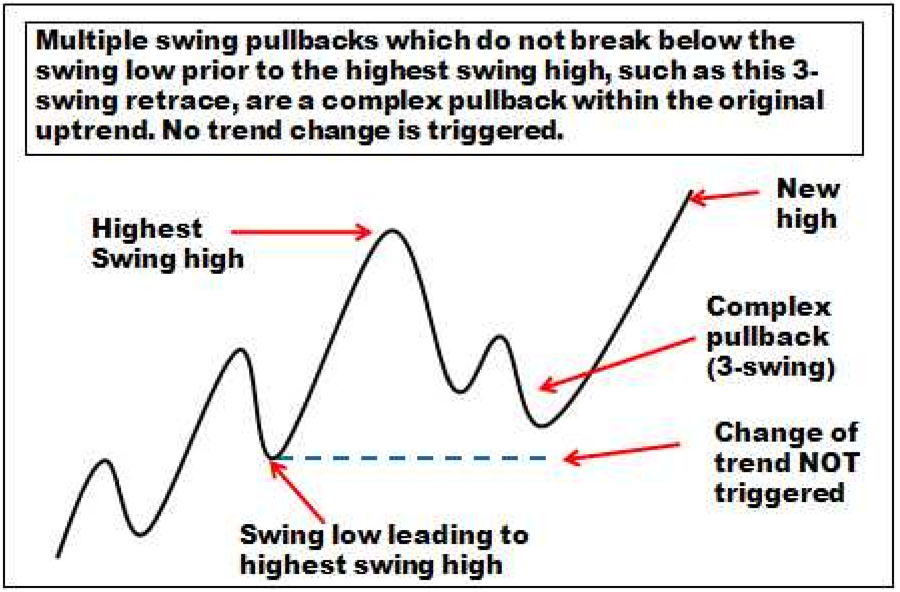


Figure 3.37 – Complex Pullback Leading to Uptrend Continuation

<u>Uptrend – From the Perspective of Supply & Demand and Trader Decisions</u>

An area of support has formed as traders, for whatever reason, have determined that the swing low is good value. New long positions are established and bullish sentiment results in rising prices.

An upwards extension develops due to bullish pressure overcoming bearish pressure. Traders continue making buying decisions and are willing to continue buying at higher prices in order to get into this market, pushing price to new highs.

At some point, short-term longs will take profits and new shorts will be attracted to the market by higher prices. This increase in bearish pressure will overcome the bullish pressure and form a topping pattern; an area of trend resistance forming as a swing high.

The fall below the swing high attracts more bearish orderflow, as more longs will take profits (having recognized the swing high resistance) and more shorts are attracted to the market.

The price pullback involves bearish pressure temporarily overcoming the bullish pressure to drive price downwards. Traders are making selling decisions and are willing to continue selling at lower prices in order to get their order filled.

This is not necessarily an indication of a trend reversal. The lower prices that occur as a result of the bearish sentiment are unable to attract sufficient bearish orderflow to break the previous swing low and result in a trend reversal. Rather, these lower prices attract more buying, sufficient to match the bearish orderflow and halt the pullback. Sentiment changes again to bullish as more buying is attracted and as shorts cover their position, recognizing that the downwards price swing is simply a pullback and not a reversal. A new area of trend support forms as a higher swing low.

Bullish sentiment again leads to a rally from this swing low area and the process repeats.

Interestingly, the bullish pressure within an uptrend is not just from new buying decisions. Remember, each transaction involves both a buy and a sell. Price movement is a result of the net trading decisions of all traders, and the urgency with which one side is more desperate to transact than the other side. Much of the bullish pressure within an uptrend comes from shorts (who tried to pick the reversal) exiting out of their losing positions.

Consider the psychology and thought processes of the majority of traders (those who consistently lose). Having failed to catch the uptrend and now seeing rising prices, these traders are consumed by negative thoughts and emotions – regret, anger and ultimately revenge. Knowing a price swing can‟t go on forever they enter short at the first sign of potential stall or resistance, hoping to gain an early entry into the trend reversal. Usually they‟re wrong. Even if they‟re right and have managed to time an entry at or near a swing high, it‟s usually only temporary as the down swing proves to be a pullback within the continuing uptrend rather than a trend reversal. Our emotionally influenced trader is then forced to cover their short position (buy order) as their stops are hit; contributing once again to their net loss situation through another poorly managed losing trade.

A significant portion of the bullish pressure within an uptrend is the losing short exiting their position (via a buy order). In many respects, the uptrend is fueled by the losers on the bearish side.

Downtrend - Definition

A downtrend comprises a repeating sequence of:

1) A downward extension
2) A swing low
3) An upward pullback
4) A swing high

This is demonstrated below in figure 3.38, where you‟ll also notice a few other key observations:

- The price extensions are longer than the pullbacks.
- Extensions will break below previous swing lows, reaching new price lows for that trend.
- Pullbacks will not break above previous swing highs.

This results in a series of lower swing lows and lower swing highs.

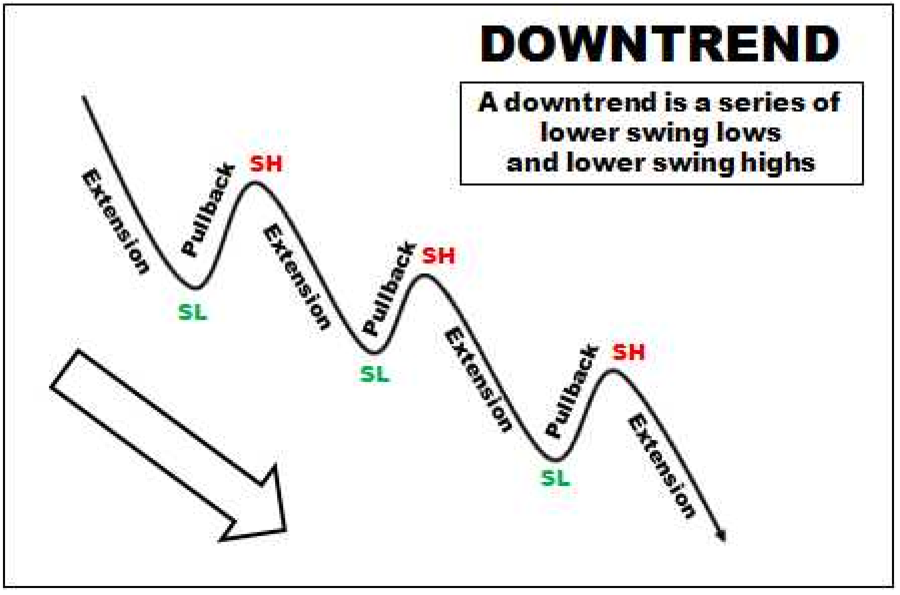


Figure 3.38 – Downtrend – Diagram

Figure 3.39 – Downtrend - Chart

A downtrend ends when price breaks the <u>swing high which leads to the lowest swing low of the trend</u>. Let"s demonstrate that below, in figure 3.40.

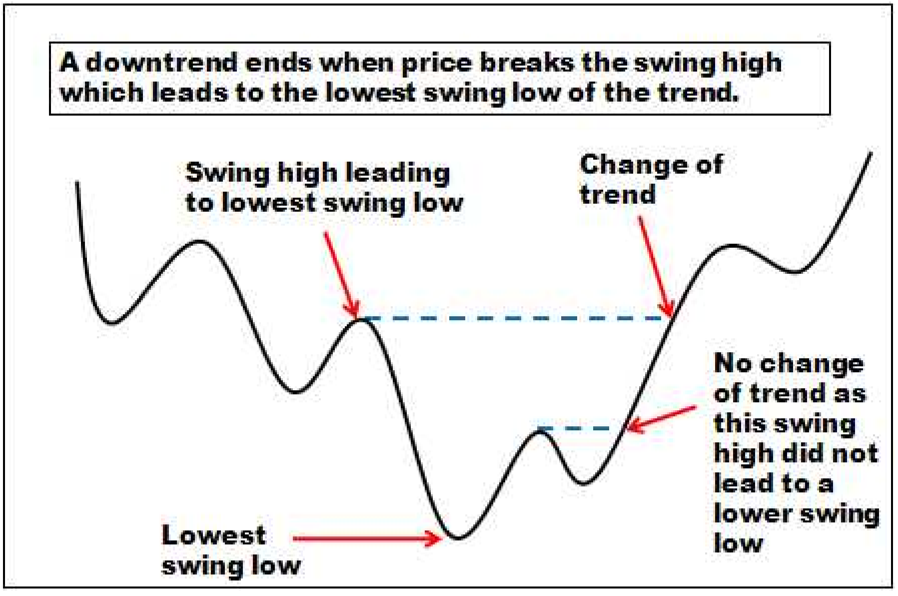


Figure 3.40 – Downtrend End

Failure to break the swing high that leads to the lowest swing low, could simply indicate a complex pullback rather than a reversal, as demonstrated below in figure 3.41.

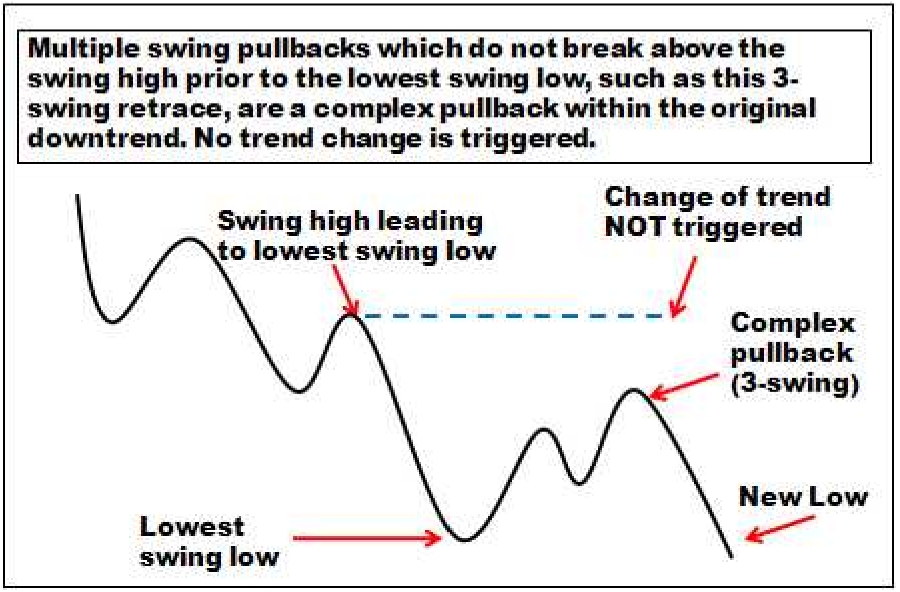


Figure 3.41 – Complex Pullback Leading to Downtrend Continuation

Downtrend – From the Perspective of Supply & Demand and Trader Decisions

An area of trend resistance has formed as traders, for whatever reason, have determined that the swing high is overvalued. New short positions are established and bearish sentiment results in falling prices.

A downwards extension develops due to bearish pressure overcoming bullish pressure. Traders continue making selling decisions and are willing to continue selling at lower prices in order to get into this market, pushing price to new lows.

At some point, short-term shorts will take profits and new longs will be attracted to the market by lower prices. This increase in bullish pressure will overcome the bearish pressure and form a bottoming pattern; an area of trend support forming as a swing low.

The rally from the swing low attracts more bullish orderflow, as more shorts will take profits (having recognized the swing low support) and more longs are attracted to the market.

The price pullback involves bullish pressure temporarily overcoming the bearish pressure to drive price upwards. Traders are making buying decisions and are willing to continue buying at higher prices in order to get their order filled.

This is not necessarily an indication of a trend reversal. The higher prices that occur as a result of the bullish sentiment are unable to attract sufficient bullish orderflow to break the previous swing high and result in a trend reversal. Rather, these higher prices attract more selling, sufficient to match the bullish orderflow and halt the pullback. Sentiment changes again to bearish as more selling is attracted and as longs cover their position, recognizing that the upwards price swing is simply a pullback and not a reversal. A new area of trend resistance forms, as a lower swing high.

Bearish sentiment again leads to price falling below this swing high and the process repeats.

Interestingly, the bearish pressure within a downtrend is not just from new selling decisions. Remember, each transaction involves both a buy and a sell. Price movement is a result of the net trading decisions of all traders, and the urgency with which one side is more desperate to transact than the other side. Much of the bearish pressure within a downtrend comes from longs (who tried to pick the reversal) exiting out of their losing positions.

Consider the psychology and thought processes of the majority of traders (those who consistently lose). Having failed to catch the downtrend and now seeing falling prices, these traders are consumed by negative thoughts and emotions – regret, anger and ultimately revenge. Knowing a price swing can‟t go on forever they enter long at the first sign of stall or potential support, hoping to gain an early entry into the trend reversal. Usually they‟re wrong. Even if they‟re right and have managed to time an entry at or near a swing low, it‟s usually only temporary as the upswing proves to be a pullback within the continuing downtrend rather than a trend reversal. Our emotionally influenced trader is then forced to exit their long position (sell order) as their stops are hit; contributing once again to their net loss situation through another poorly managed losing trade.

A significant portion of the bearish pressure within a downtrend is the losing long exiting their position (via a sell order). In many respects, the downtrend is fueled by the losers on the bullish side.

Sideways Trend - Definition

A sideways trend comprises a series of price swings existing within the range of a significant upper resistance area and a significant lower support area. The range support and resistance boundaries (range lower and upper boundaries) may be formed from either *higher timeframe* S/R and/or significant *trading timeframe* swing highs or lows.

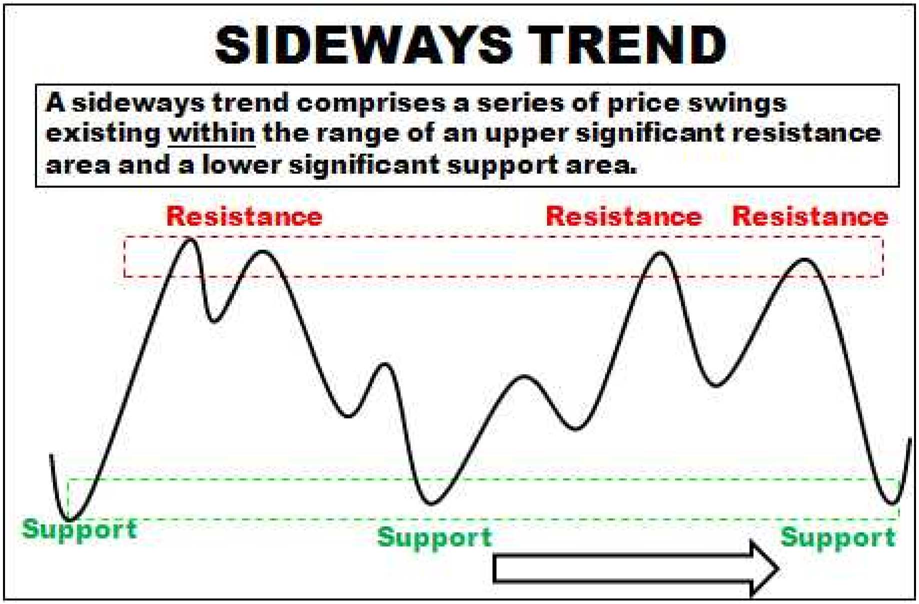


Figure 3.42 – Sideways Trend – Diagram

Figure 3.43 – Sideways Trend - Chart

I define the official start of a sideways trend as follows:

A sideways trend starts when four trend turning points (SH and SL) develop within the range of a previous price swing.

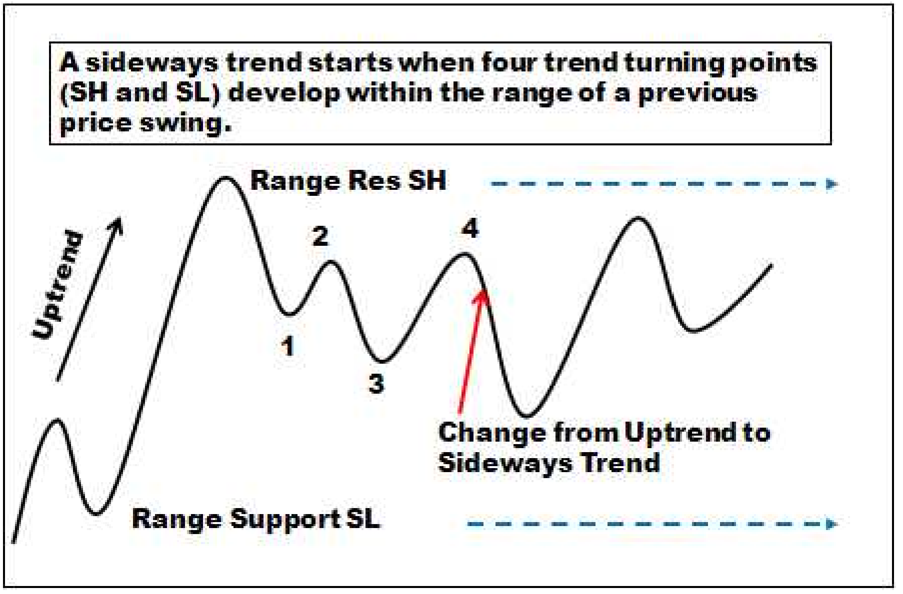


Figure 3.44 – Sideways Trend Start

Less than four turning points may simply be a complex (three swing) pullback rather than a change of trend. Four turn points are required to indicate a change to a sideways trend.

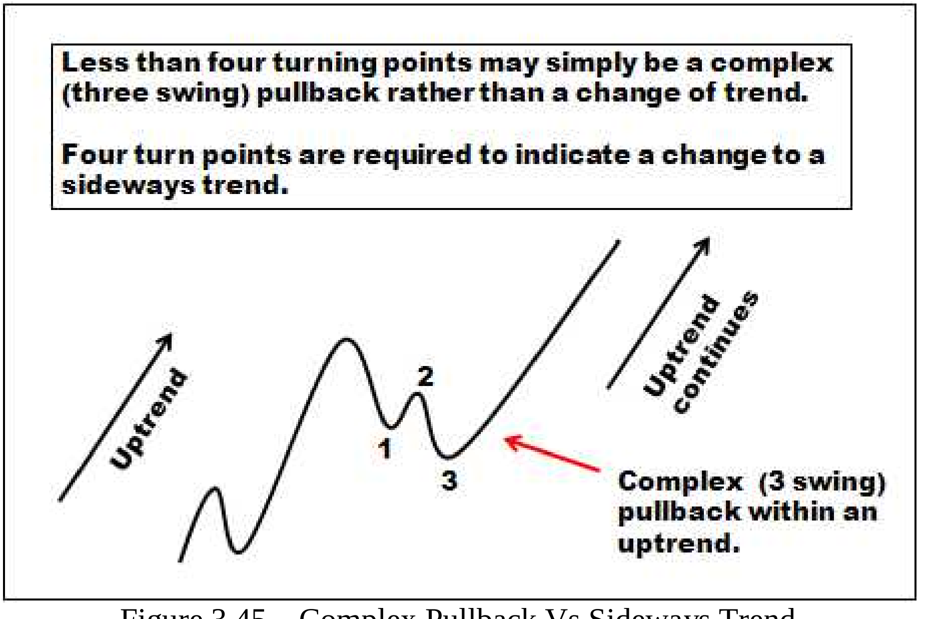


Figure 3.45 – Complex Pullback Vs Sideways Trend

I define the official end of a sideways trend as price breaking either the high or low which define the sideways trend.

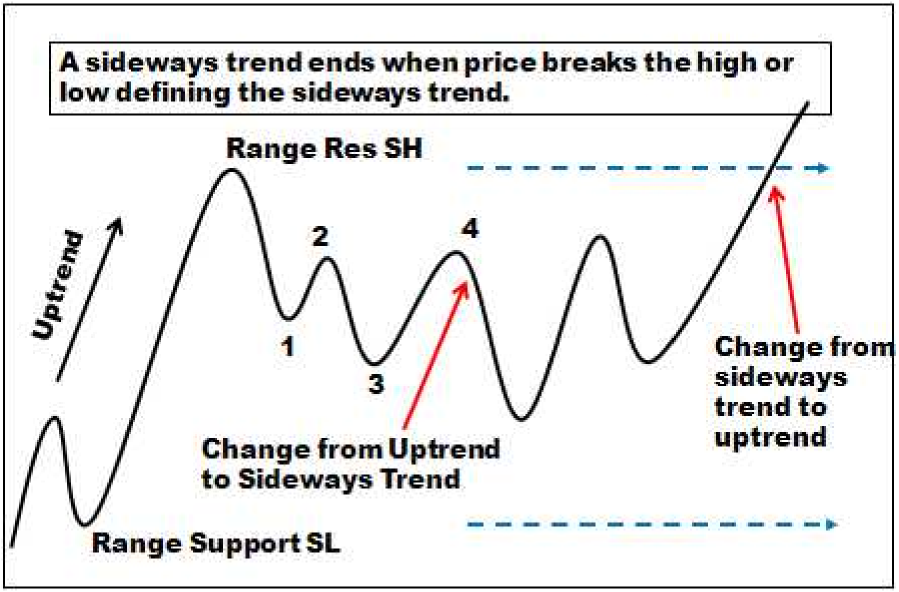


Figure 3.46 – Sideways Trend End

<u>Sideways Trend – From the Perspective of Supply & Demand and Trader Decisions</u>

The defining price swing has established a lower price area (support) at which traders perceive a good buying opportunity. Until sentiment changes within the market, price movement towards this area will result in new longs entering the market, and shorts taking profits after having profited from the move down. This bullish orderflow will overcome any bearish orderflow and price will rally to remain within the defined range.

The opposite occurs at the upper price area (resistance) which traders perceive as a good selling opportunity. Until sentiment changes within the market, price movement towards this area will result in new shorts entering the market, and longs taking profits after having profited from the move up. This bearish orderflow will overcome any bullish orderflow and price will fall to remain within the defined range.

Trend Definition – Alternates

People looking at my charts often see either an EMA(20) or an EMA(9/18) cross, and assume I use those as a trend definition. Not so.

Trend direction depends on the supply/demand imbalance. And this is dependent on traders‟ decision making. And traders‟ decision making is influenced largely by areas of previous supply/demand imbalance.

The areas on the chart which are important for defining trend change or continuation are the areas of previous supply/demand imbalance – the swing lows and highs which define the trend. It‟s not some line overlaying the chart.

Otherwise, which moving average should we use? Why the EMA(20) or EMA(9/18)? Why not the EMA(19) or EMA(8/21)? Why not an SMA? Why not a WMA?

Price causing an EMA cross simply indicates that price has moved sufficiently in that direction in order to cause the average lines to cross. Where that does define a trend change, it will be because the market has also crossed a critical S/R area (or swing H/L) and found acceptance of price in that new area.

The crossing of critical areas of previous supply/demand imbalance, and acceptance of price in that area, is the indicator of trend change. Nothing else.

So, why are these EMAs displayed on my charts?

Firstly, they are not essential to the strategy – hence you‟ll usually see them as faint grey lines on my charts – sort of background information.

Secondly, they are (partly) a hangover from previous trading approaches.

Thirdly, they act as a quick reference visual guide to my trend analysis – an *easy-to*-see <u>approximation</u> of trend. The majority of time the EMA will define the trend quite accurately.

The EMA on my charts are a guide only. A support tool! Use it if you wish. Or leave it off if you prefer. Either way it won‟t impact the strategy.

An EMA system won‟t tell you when the trend has changed. An EMA system won‟t tell you when the market is ranging sideways. However an EMA cross system does provide a good *approximate* trend indicator, when it is trending.

If you do use an EMA on your chart, be sure to use it as a guide only – not as your actual trend definition.

Trend Definition – Applying Subjectivity

As we discovered earlier, the market cannot be defined by fixed rules or mathematical models. It‟s an emotional beast.

Every attempt to objectively define a trend will break down at some point in time. Regardless of how you define the trend, at some point in time it will produce a pullback that goes just far enough to trigger an *objective trend definition change*, before reversing to continue in the original trend direction.

Subjective definitions are superior, although difficult for newer traders to accept.

A pullback against a trend that triggers an *objective trend definition change*, but then fails, may not change the subjective trend definition.

Let‟s look at an example…

We have here what is visually easy to identify as a downtrend. Following the strict definition of swing highs and lows, and trend change, we find that the trend changed from a downtrend to an uptrend by one tick (at point 3), before reversing and continuing downwards again.

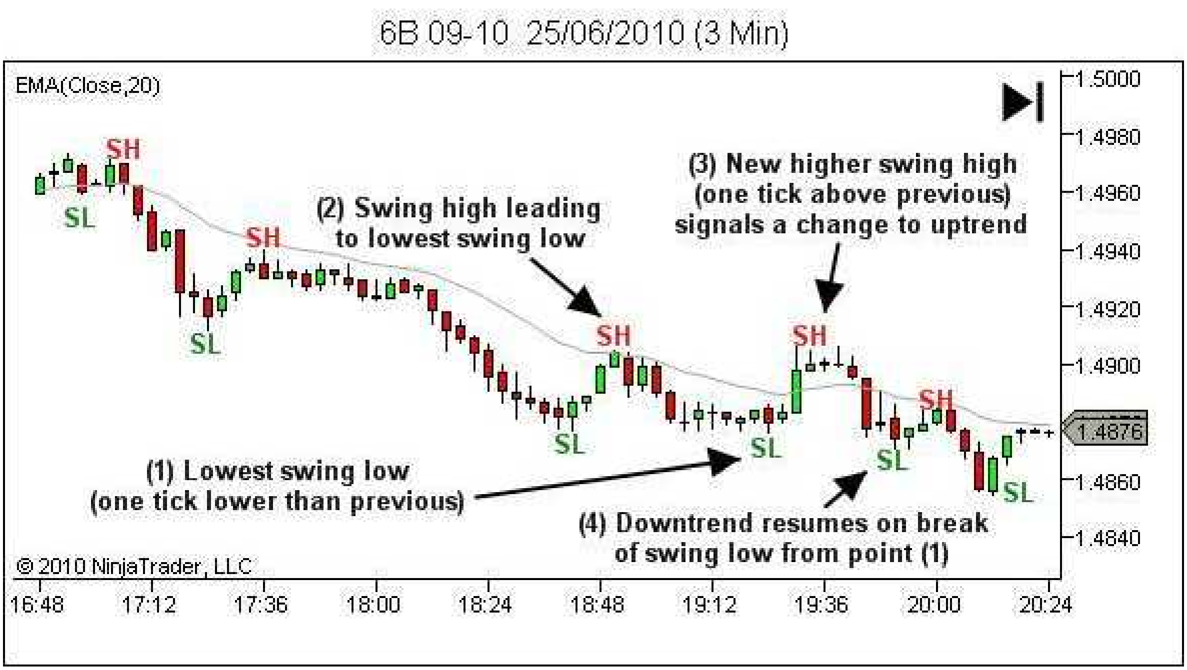


Figure 3.47 - Trend Definition Failure – Swing H/L

EMA definitions of trend fail even more often – resulting in whipsaw price action and poor trading results. This is demonstrated in figure 3.48 which defines the trend by the slope of the EMA(20); and demonstrates an inability for that trend definition to cope with the back-and-fill sideways price action at the bottom of a downtrend.

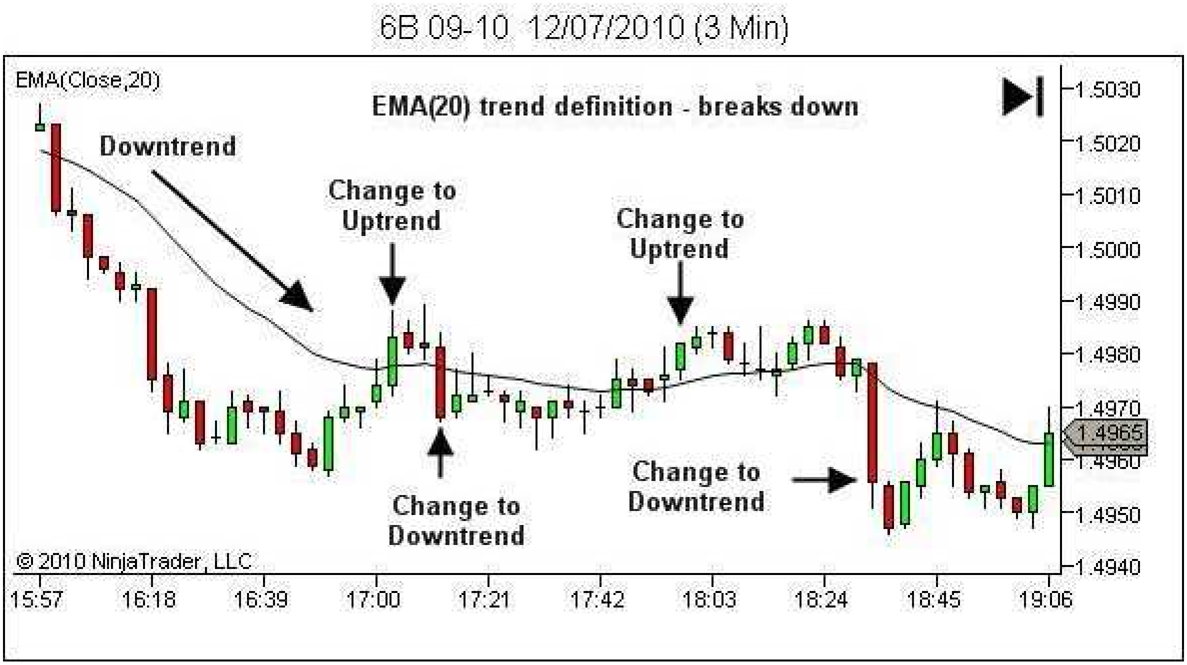


Figure 3.48 EMA trend definition failure

The inability for an EMA system to adequately define a sideways trend is one of its major problems. The swing H/L trend definition is vastly superior (in my opinion). But let‟s see if we can improve it…

Every objective trend definition breaks down at some point.

The problem is in relying on fixed objective rules in an environment that does not work in that manner.

The solution is in allowing some subjectivity, which allows for breaks of the objective definition. We allow price to test the levels of potential trend change. We even allow price to exceed these levels. Trend change, though, is not triggered by the break. Rather it‟s a result of price acceptance in this new area.

Upon making the break, does price quickly reject this new area and return back to the original trend definition, or does price hold the break and then continue?

Let"s reproduce the price action from figure 3.47, now 3.49.

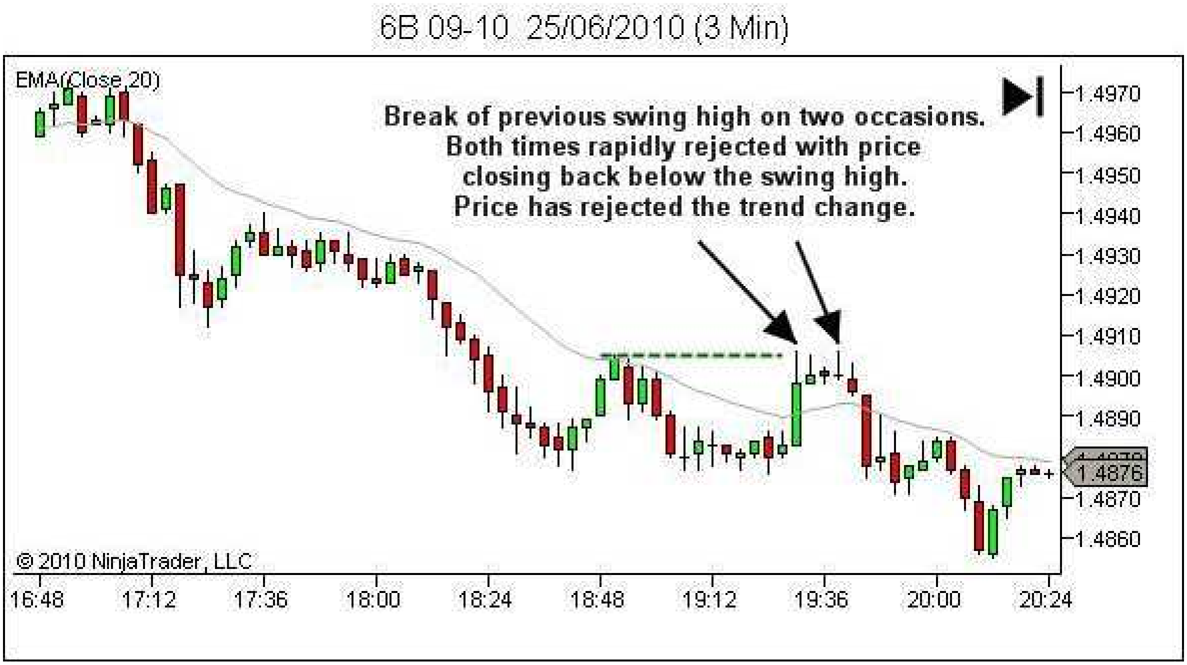


Figure 3.49 - Defining Trend Change through Subjective Assessment of Acceptance or Rejection

In this case, the downtrend now remains intact, as we see no evidence of acceptance of breakout prices. The trend will not be considered to have changed, until we see confirmed evidence of a behavioral change.

Subjectivity allows for breaks of definition – relying on these breaks to show the way forward, through how price reacts at these key times.

Will it hold beyond that level (price acceptance) or fail (price rejection)?

Tests of the areas of *objective trend change* are great sources of information about the *future trend*.

When you think about it, we can take this even further. A subjective assessment of price acceptance after the break of trend definition, really means that the trend is simply whatever it appears to be visually.

This doesn‟t mean we‟re totally guessing the trend. We are aware of our swing high/low trend definition, but then apply some subjectivity over top of that.

Essentially, if it looks like an uptrend (price appears to be moving from the lower left to the upper right) it is an uptrend. If it looks like a downtrend (price appears to be moving from the upper left to the lower right) it is a downtrend. Anything else is a sideways trend.

All other rules are secondary to this.

Through practice you will become comfortable with a subjective assessment of trend direction, and also a subjective assessment of which swing highs and lows you consider significant. Our discussion (coming shortly) on assessing the strength or weakness of the trend will assist greatly in your ability to subjectively assess the trend direction at the points of objective trend break.

Don‟t make this more complex than it needs to be.

A trend is a general tendency for price movement in one direction. Your mind is much more capable of identifying this trend, than any objective definition.

And if you get it wrong – price behavior will very quickly alert you to this fact.

Trend Examples

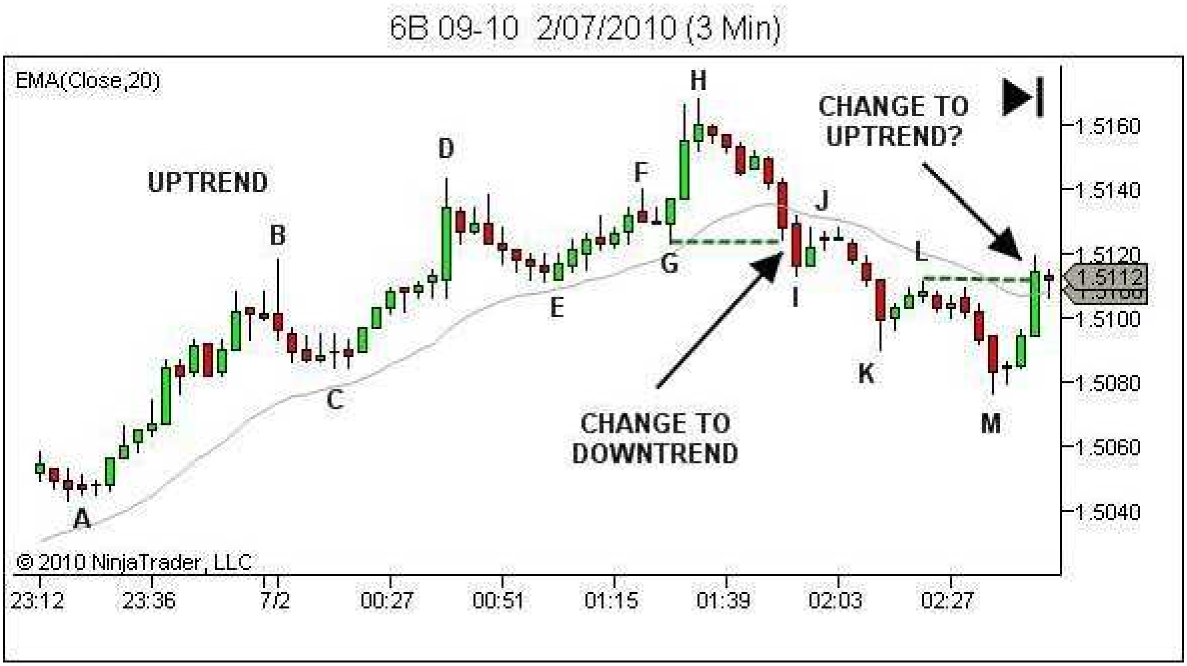


Figure 3.50 – Uptrend – Downtrend - Uptrend

In this first example, we have an uptrend defined by swing low A, swing high B, swing low C, swing high D, swing low E, swing high F, swing low G and swing high H.

I marked F and G due to the significance of G. As a candle which initially moved downwards continuing the move lower after F"s retest of D, it then reversed quickly to rally back upwards. The speed of this move will have trapped some shorts in losing positions. It"s a significant area and therefore suitable for selection as a swing low. Should price break below this level it indicates a change in the supply/demand dynamics of this market.

Swing low G is therefore the last swing low before the highest swing high H. The change of *objective trend definition* from uptrend to downtrend therefore occurs on the break of the lows of swing low G, as marked.

Applying some subjectivity though, we want to see evidence of price accepting this change. The first close below the trend change level was strongly bearish, and it was followed by three weak bullish candles, indicating a lack of demand (if there was significant demand, price would have rejected the breakout and rallied back up through the level). Continuation lower confirms our trend change.

Also, applying our "if it looks down, then it is down" rule, the acceleration down to I followed by the weak pullback to J, just makes this look like downward strength to me.

The downtrend continues from swing high H to swing low I, congestion J, swing low K, swing high L, swing low M.

Swing high L was the last swing high before swing low M. Price breaking above L indicates a change back to uptrend, in accordance with our objective trend definition.

The next candle shows a pause. Subjectively, a trend change looks a possibility given the rapid move up into the area of L, but more information will be needed in the next candle or two, to accept a change to an uptrend, or reject this and continue down.

In this next example, figure 3.51 below, we have an uptrend defined by swing low A, swing high B, swing low C, swing high D, swing low E and swing high F. Note that swing low E does NOT lead price up to new highs, as swing high F does NOT exceed the highs at D. This means that price breaking below E does NOT trigger a change of trend, but rather a complex pullback. Price would need to break below C in order to trigger a change to downtrend, which of course did not occur in this example.

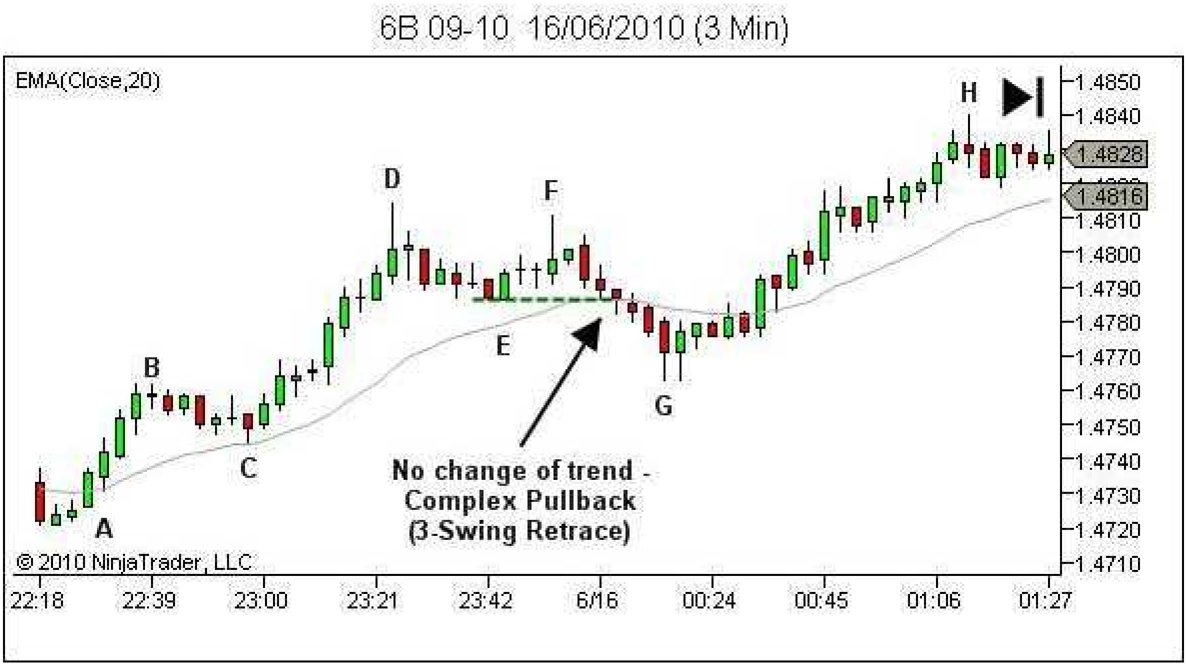


Figure 3.51 – Uptrend with Complex Pullback

The 3-swing retrace through E, F and G was followed by a continuation of the uptrend through to new highs at H.

You‟ll often find a 3-swing retrace or other form of complex pullback following a larger extension such as occurred from C to D (note the distance with which price pulled above its average line indicating possible over-extension – another visual advantage of having an EMA overlaying the price action as a support tool).

In figure 3.52 below, a downtrend exists at the start of the UK forex session, through previous price action, leading into swing high A, swing low B and swing high C. Swing low D is a higher swing low. The trend does not change on confirmation of the higher swing low, nor on the break of swing high C, as it did not push prices down to new lows. The trend change occurs when price breaks swing high A, as indicated on the chart, as swing high A was the swing high which preceded the lowest swing low B.

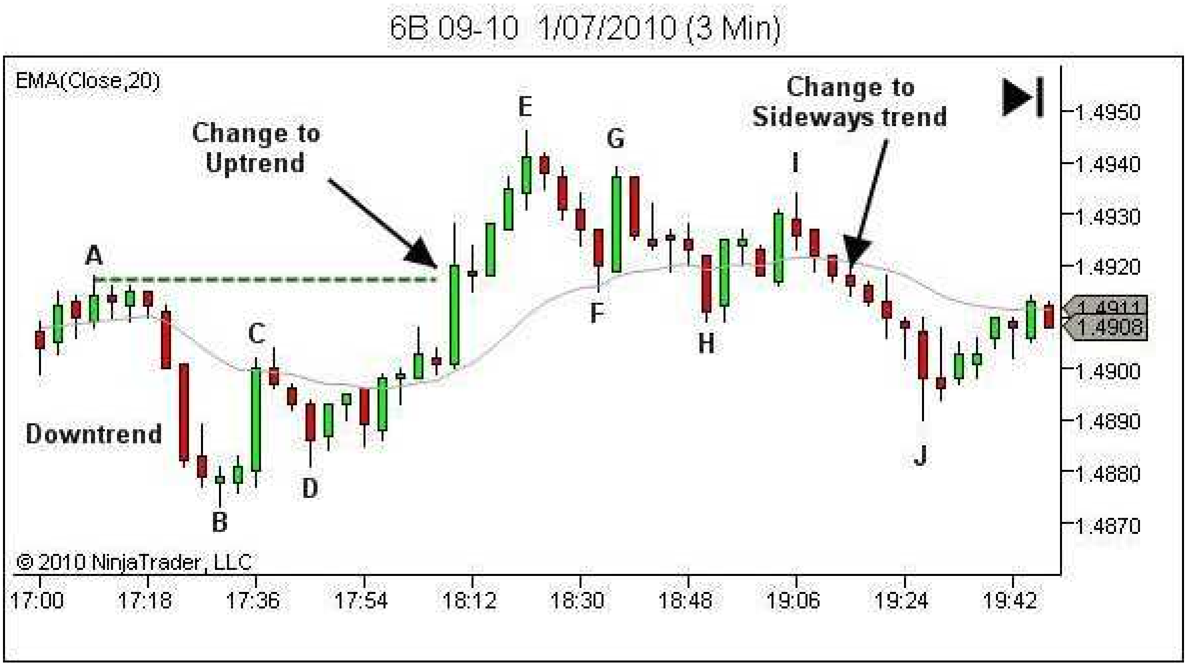


Figure 3.52 – Downtrend – Uptrend – Sideway Trend

Price accepts the breakout and change of definition. The uptrend then moves on to swing high E and swing low F. Swing low G provides a lower high, followed by a lower low H. At this point, the trend has not changed, as move F-G-H could simply be a complex pullback within the continuing uptrend. This would be proven on continuation back above E.

In this case, price was not able to exceed E, creating another swing high at I. At this point we now have four swings or turning points (from E to F, G, H and I), confirming a change from an uptrend to a sideways trend. The upper resistance area defining the sideways trend or trading range will be the swing high at E. The lower support area defining the sideways trend would be swing low D, according to the definition, however given the proximity of swing low B, and the fact that it also defines the lowest prices of the UK forex session, I‟d personally define swing low B as the range support area which needs to be broken to trigger a downtrend. This is an example of the subjectivity that you should apply to your analysis.

From a subjective visual perspective, I‟m also happy to define this as a sideways trend. Earlier demand has clearly been exhausted, and price is not rallying to new highs. Similarly, there is no great strength on the downside either. Until I see a change in behavior in which one side starts to dominate, it‟s likely that the early UK session range (B to E) will define the upper and lower boundaries of the remainder of the session

In figure 3.53, A and B mark the lower support and upper resistance following the 2 July 2010 Non-Farm Payroll (NFP) economic release. Price established itself clearly within a sideways trading range following the short period of post-NFP volatility. The sideways trend is in force until either price breaks below A, or above B.

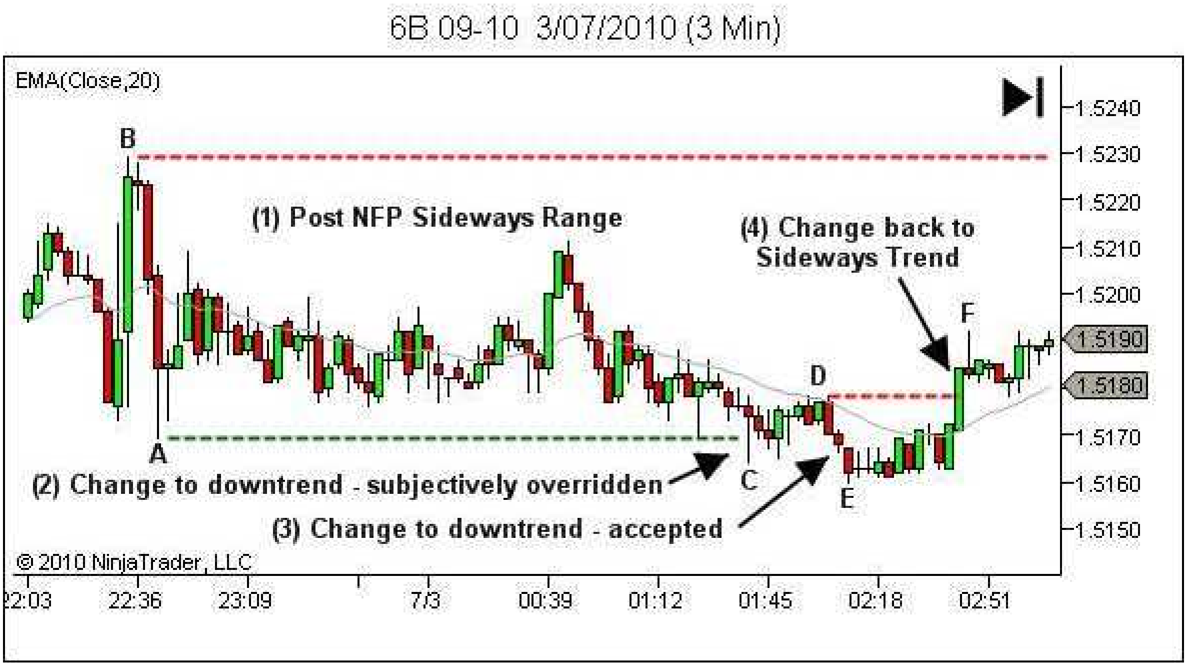


Figure 3.53 – Sideways Trend – Downtrend – Sideways Trend

At point C, price broke the lower support on two occasions, however was not able to accept and hold these breakout prices. The objective change of trend was overridden and the trend assessed as remaining sideways (not entirely unexpected either, in the leadup to the 4th July long weekend).

The initial break swung back within the trading range to form swing high D. Note though that the move to D was very weak, unable to produce a higher swing high. Price collapsing back below the level of A was enough for me to subjectively change the trend to a downtrend.

A new swing low E was established, followed by some grinding sideways action which shows neither side really dominant. Continuation below this congestion would be required to continue the downtrend. A break back above the level of D would indicate further rejection of the levels below A and a return to the sideways trend environment.

The second scenario proved to be correct, from both a subjective and objective perspective.

Swing high D was the last swing high before the lowest lows. The strong move from E up to F breaks through swing high D, invalidating the downtrend. The sideways trend is reestablished, as the break of swing high D takes price back within the bounds of the original sideways trend.

The upper sideways trend resistance would remain at point B. The lower support would be defined as the swing low which led to price returning to the sideways trend, in this case swing low E.

Trend Practice

Take a break from reading, open your platform and display a chart using your selected *trading timeframe*. If you‟re not sure of which market you‟ll be trading, or which timeframes, just practice on the 6B 3 minute chart or GBP/USD 5 minute chart.

Scroll back through your past chart data to the earliest date available and position the start of a trading session on the right hand side of your screen. For 6B or GBP/USD this will be the start of the UK forex session (0800 GMT).

Identify the pre-session trend, if applicable for your market.

Step forward through the data bar by bar identifying the trend, noting new areas of swing highs and lows, and the points of trend change.

Repeat until you‟re comfortable with this process.

3.3 Future Trend

3.3.1 – Strength and Weakness

We established earlier that the aim of our analysis was to develop a feel for the strength and weakness within a trend, and a feel for where that is likely to lead future price action.

Or just simply:

- Where has price been?
- Where is price likely to go?

Defining our market structure and conducting trend analysis allows us to identify where price has been.

We now work to identify where price is likely to go.

Figure 3.54 – The Future Trend – Where is Price Likely to Go?

I call this the *future trend*.

The concept in determining *future trend* is as follows:

1) Price action leaves clues as to the strength or weakness of the two opposing forces (bullish and bearish pressure); allowing us to see which side is winning control of the price flow.

2) Future price action is likely to be in the direction of whichever force is showing greater strength, or opposite to whichever force is showing weakness.

That is, we‟re feeling the strength or weakness of the market as both bullish and bearish pressures compete, and projecting that forward to identify possible future price action.

The market moves in the direction of strength, and against the direction of weakness.

A quick example follows. We haven‟t yet discussed the process for identifying strength and weakness. So, as we work through this example you‟ll need to accept the analysis. The point of this example is in seeing how future movement is in the direction of strength and against weakness.

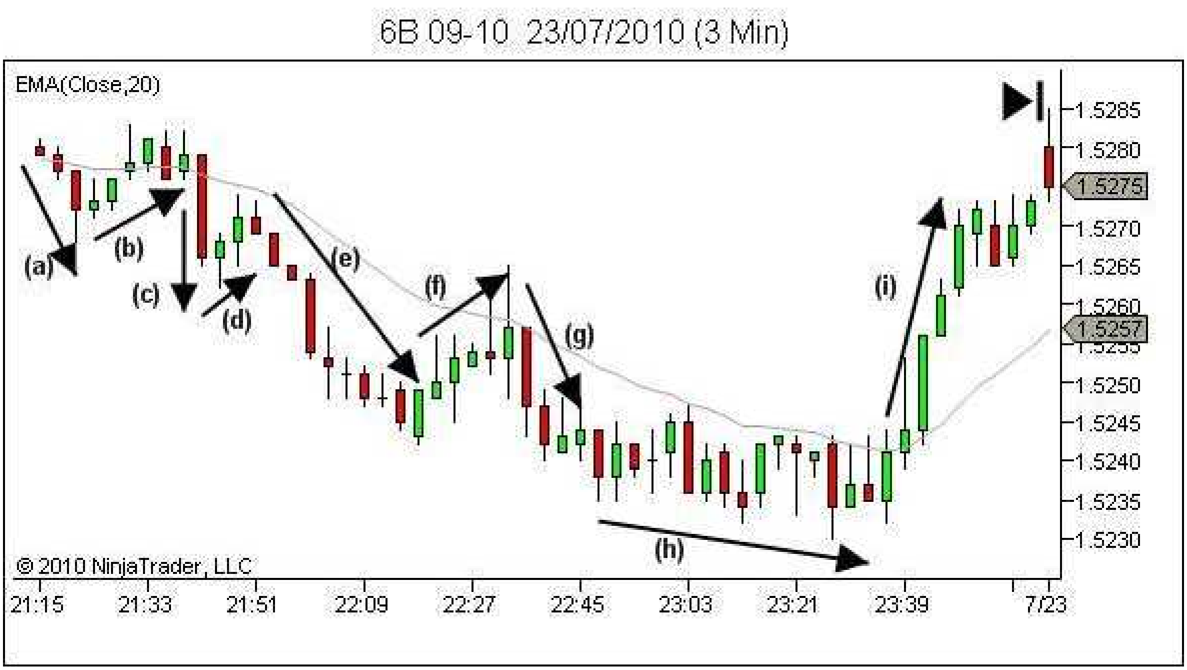


Figure 3.55 - The Market Moves in the Direction of Strength;
and Against the Direction of Weakness

Figure 3.55 shows strength in downtrend swing (a) and weakness in pullback (b).
The downtrend continues in the direction of previous strength (a) and against weakness (b).

Continuation occurs with a strong extension (c) and a weaker pullback (d). Strength is still to the bearish side.

Extension (e) shows continued bearish strength, while pullback (f) is again weaker. The downwards move once again continues as strength remains in the bearish direction.

Extension (g) initially shows strength, but then weakens considerably through (h). Bearish pressure shows signs of having weakened considerably, through extension (g/h) – certainly weaker than the previous extension (e) and weaker now than the last pullback (f).

The next move is in the direction of last strength (f) and against weakness (h). Price swing (i) rallies quite strongly.

It‟s not always as easy as this example makes it appear. Often clear signals are not available. Many times the bullish and bearish price swings will show similar strength.

However sudden changes in the strength or weakness in any direction are almost always evident on the chart, as occurred here when the momentum of swing (g) flattened out through (h). Changes in the strength or weakness are often easy to identify. And these sudden changes provide great clues as to the way forward.

So, how do we identify strength and weakness?

3.3.2 – Identifying Strength and Weakness

We identify strength and weakness within a trend through analysis of various properties of price movement, in particular through analysis of **momentum** and **projection & depth**.

This analysis is primarily conducted on our *trading timeframe* (3 min), but fine-tuned as necessary through the *lower timeframe* (1 min). Examples will follow.

Momentum

What is Momentum?

- *Mechanics.* A quantity expressing the motion of a body or system, equal to the product of the mass of a body and its velocity, and for a system equal to the vector sum of the products of mass and velocity of each particle in the system.

Ok, forget that!

What is Momentum, as far as we‟re concerned?

- **Observing price action in order to note changes to speed and acceleration; and assessing the meaning of this change with respect to potential future orderflow and potential *future trend* direction.**

Momentum is a poor name, in my opinion. I‟ve used it simply because it‟s the name most commonly used for this property of price movement.

Momentum should really be two separate properties, called Speed (rate of change of price) and Acceleration (rate of change of speed).

Please note that we are not talking about any of the common momentum indicators (or oscillators) such as Stochastics, MACD, RSI, ROC, Williams%R or even the one called Momentum.

Momentum is not an indicator, but a property of the price movement.

We are simply observing price action in order to compare the current speed and acceleration of price movement with historical speed and acceleration.

Momentum is visible on a chart through observing the <u>slope</u> (angle) of price movement.

Figure 3.56 below demonstrates a graph which displays price on the vertical axis and time on the horizontal axis (just like a price chart does). The graphs on the left and right of this diagram both represent <u>upwards price swings</u>.

The slope of a straight line represents the speed of price – the rate of change of price per unit time.

A more shallow line (in blue) represents less price increase for the same period of time as the steeper line (in red). The blue line therefore represents less speed than red. The blue line shows less bullish momentum than the red line. The blue line shows bullish weakness when compared with the red line. The red line shows bullish strength when compared with the blue line.

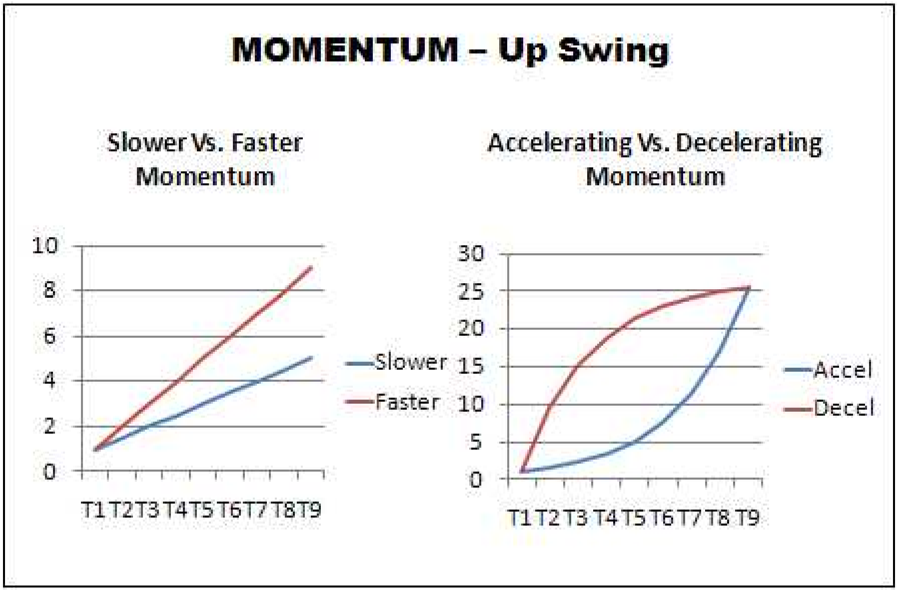


Figure 3.56 - Graphical Representation of Momentum Changes – Up Swing

The slope of a curved line represents acceleration or deceleration – the rate of change of speed.

Increasing slope (the blue line) shows increasing speed. Momentum within this price swing is increasing, showing increasing bullish strength.

Decreasing slope (the red line) shows decreasing speed. Momentum within this price swing is decreasing, showing weakness developing in the price swing.

Figure 3.57, below, shows the same concept for a downwards price swing.

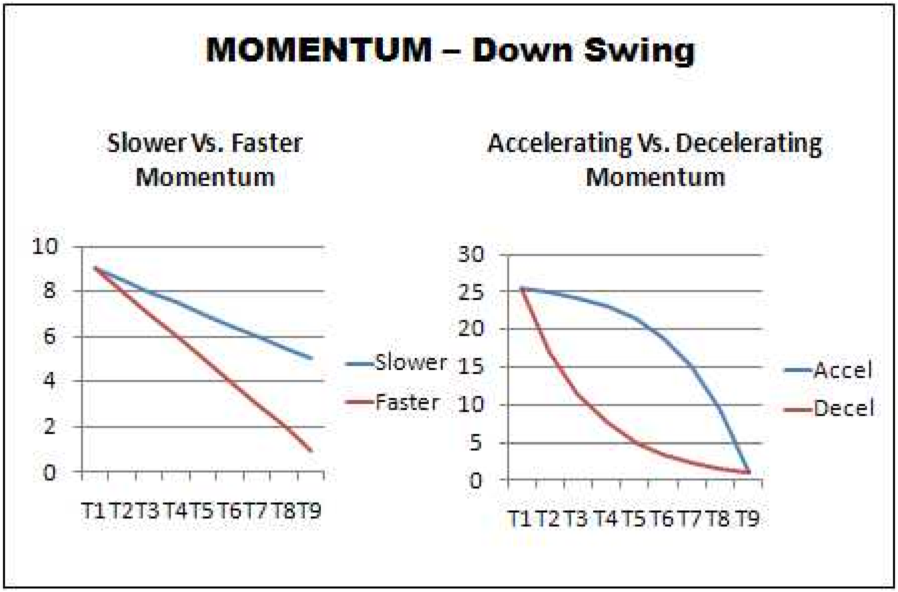


Figure 3.57 - Graphical Representation of Momentum Changes –Down Swing

Look first at the straight lines on the left hand side of the diagram.

A more shallow line (in blue) represents less price decrease for the same period of time as the steeper line (in red). The blue line therefore represents less speed than red. The blue line shows less bearish momentum than the red line. The blue line shows bearish weakness when compared with the red line. The red line shows bearish strength when compared with the blue line.

The right hand side of the diagram represents bearish acceleration and deceleration.

Increasing slope (the blue line) shows increasing speed. Momentum within this price swing is increasing, showing increasing bearish strength.

Decreasing slope (the red line) shows decreasing speed. Momentum within this price swing is decreasing, showing a weakness developing in the price swing.

The same concept applies to price action on charts. Changes in momentum are observed through changes in the slope (angle) of the price action, as we‟ll demonstrate through some diagrams and chart examples below.

As we look through these diagrams and examples, please take note of the following important point…

Analysis of momentum is not about measuring any absolute value of momentum, but in making a comparison of current price action momentum with prior price action momentum.

- Compare the momentum of the current price swing with the momentum of the previous price swing in the same direction? Is price faster or slower than before? What does that mean?

- Compare the momentum of the current price swing with the momentum of the previous price swing in the opposite direction? Is price faster or slower than before? What does that mean?

- Is the current price accelerating or decelerating? What does that mean?

Let"s quickly examine each…

1) Compare the momentum of the current price swing with the momentum of the previous price swing in the same direction? Is price faster or slower than before? What does that mean?

Refer to the left hand side of figure 3.58, where we see a downtrend weakening and reversing direction to become an uptrend.

Compare the slope of down-swings (a), (c) and (e). Note the decreased speed on each of these legs, indicating a reduction in bearish momentum. Weakness is appearing on the bearish side.

Compare the slope of upswings (b) and (d). Note the increasing speed on each of these legs, indicating an increase in bullish momentum. Bullish price swings are showing signs of strength.

Price movement is more likely to continue in the direction of strength and against the direction of weakness. The market reverses as strengthening bullish momentum overcomes the weakening bearish momentum.

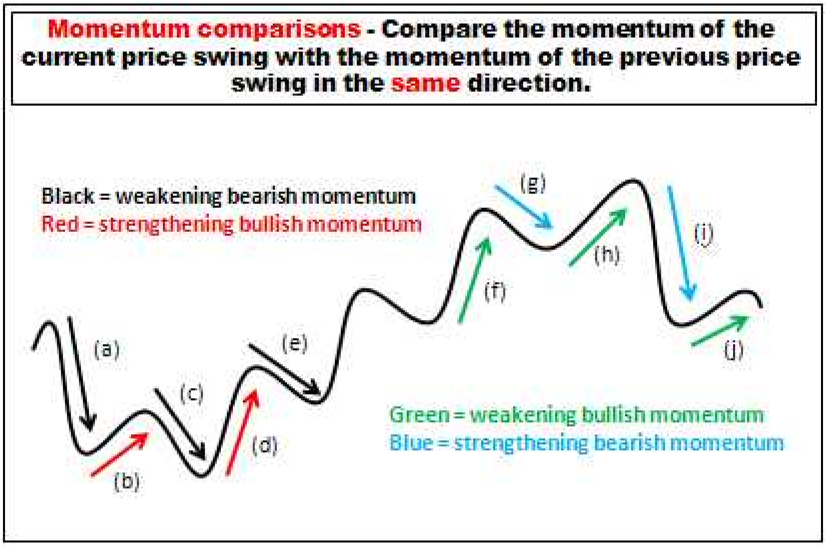


Figure 3.58 - Momentum Comparison – Same Direction Swings – 1 of 2

Refer now to the right hand side, where we see the uptrend weakening and reversing to a downtrend.

Compare upswings (f), (h) and (j). Note the decreasing speed on each of these legs, indicating a reduction in bullish momentum. Bullish price swings are showing signs of weakness.

Compare the downswings (g) and (i). Note the increasing speed on each of these legs, indicating an increase in bearish momentum. Strength is showing on the bearish side.

Future price direction is more likely to continue in the bearish direction, with the bearish strength and against the bullish weakness.

Of course, not every price swing provides clear signals such as described by the „perfect" trend of these diagrams.

Often there is no significant difference between the speed of price swings, indicating no change to the current strength or weakness of the price movement.

Referring to figure 3.59 below, you"ll see that a comparison of the speed of price swings (a), (c) and (e) show comparable momentum. No change is noted in bullish strength.

Likewise, no change is observed in bearish momentum through downswings (b), (d) and (f).

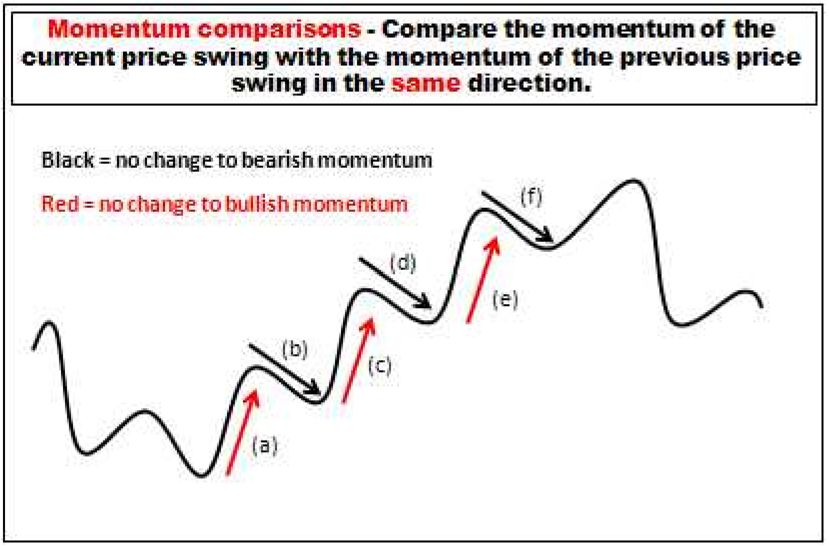


Figure 3.59 - Momentum Comparison – Same Direction Swings – 2 of 2

In the absence of any observable changes in momentum, we expect a trend to continue in its current state.

This will continue until the price action shows evidence of changing momentum; ie. strength or weakness.

2) Compare the momentum of the current price swing with the momentum of the previous price swing in the opposite direction? Is price faster or slower than before? What does that mean?

Another means of identifying strength or weakness comes through comparing the strength of a price swing with the previous swing in the opposite direction.

That is, comparing the current bullish swing with the previous bearish swing; or comparing the current bearish swing with the previous bullish swing.

Refer to figure 3.60 below. Note the slope of (a) is quite steep (almost vertical) compared with the slope of (b) which is at more of a 45% angle. The latest upswing (b) has shown weakness compared with the previous downswing (a). Strength is still in the bearish direction.

Downswing (c) shows downwards speed comparable to the speed of the previous upswing (b); if anything perhaps slightly stronger on the downside. While strength is still to the bearish side, there"s not a great deal of difference between the bearish and bullish sides. More information is required to identify any change in sentiment.

Bullish upswing (d) shows very slight increase in speed compared with the last downswing (c). While the strength is now to the bullish side, it"s once again a very small difference.

Bearish swing (e) however shows greatly reduced momentum, compared with bullish upswing (d). Note the shallow angle of (e) compared with the steep rise of (d). Strength is now clearly on the bullish side.

Price movement is expected in the direction of strength and against the direction of weakness. The trend has changed to upwards; and further price movement is expected in this new trend direction.

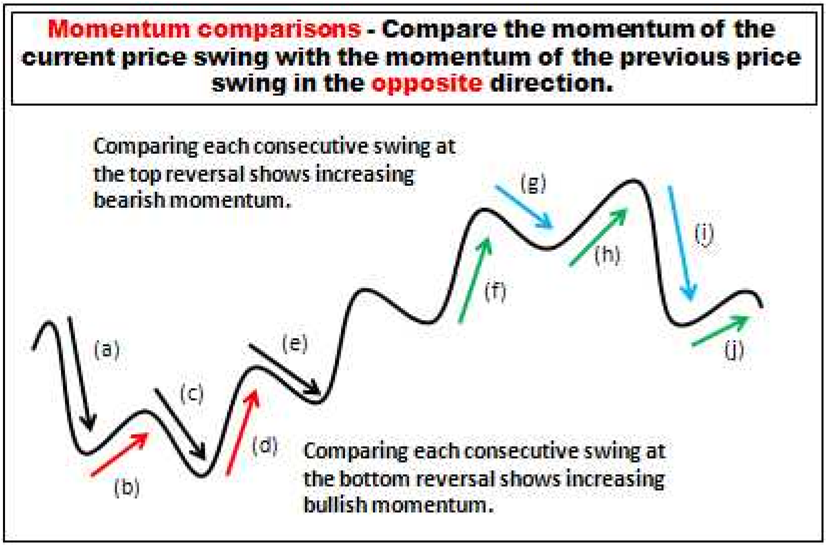


Figure 3.60 - Momentum Comparisons – Opposite Direction Swings – 1 of 2

The same analysis techniques can be applied at the top reversal.

Comparing (f) and (g) show greater upswing momentum than downswing momentum. Strength is still in the direction of the trend.

Swings (g) and (h) show comparable momentum. Further information is required.

Swings (h) and (i) show a change of state. Momentum has strengthened to the bearish side.

This is now confirmed when comparing the momentum of (i) and (j). The momentum of upswing (j) is quite weak when compared to the momentum of downswing (i). Further price movement would be expected in the direction of the new downtrend.

Figure 3.61 below demonstrates why a comparison with the opposite-direction swing can sometimes provide information that is not available through a comparison with the previous same-direction swing.

When comparing the speed of downswings (b), (d) and (f) we note no change to bearish momentum. There is no evidence of weakening or strengthening in the bearish direction. Similarly when comparing the speed of upswings (a), (c) and (e) we note no change to bullish momentum. There is no evidence of weakening or strengthening in the bullish direction.

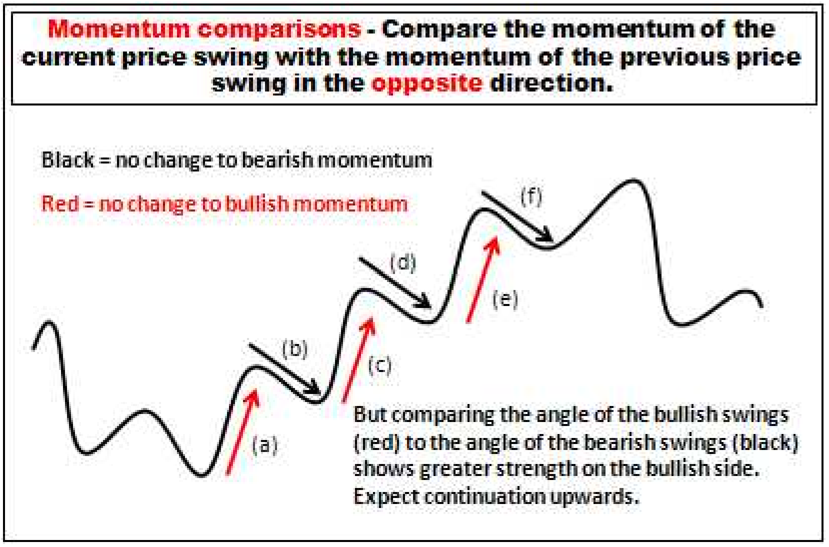


Figure 3.61 - Momentum Comparisons – Opposite Direction Swings – 2 of 2

However, comparing swings in opposite directions does provide us with useful information.

Comparing (a) and (b) we see a steeper bullish swing than bearish swing. Strength is on the bullish side.

The same is evident with all other pairs (b/c, c/d, d/e, e/f) which also show strength to the upside.

3) Is the current price accelerating or decelerating? What does that mean?

Figure 3.62(a), shows price deceleration on an upswing. Momentum is weakening. Note that this does not necessarily indicate a coming reversal. It"s simply an indication that the current price swing is weakening and a downside correction is likely. Whether or not that develops into a full trend reversal will depend on subsequent price action.

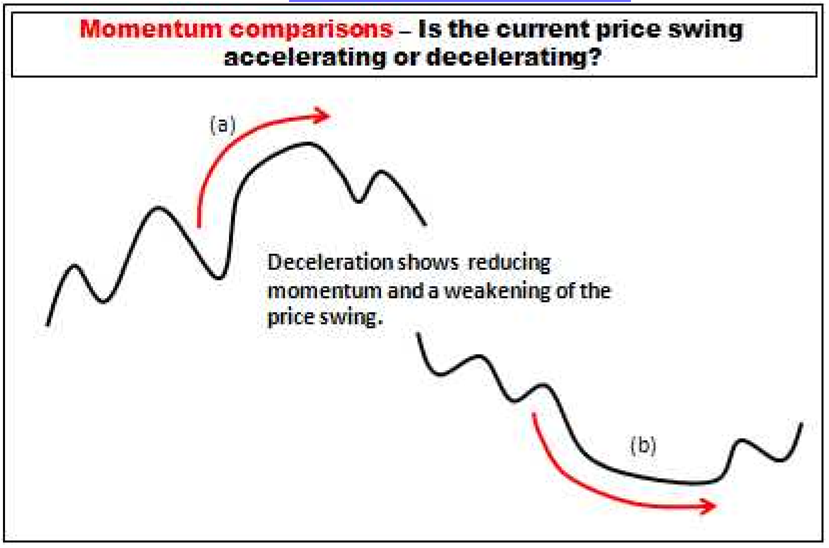


Figure 3.62 - Momentum Comparisons – Deceleration

Similarly, price swing (b) shows a deceleration of the downmove. Momentum is again weakening in the direction of the trend. The next move is likely to be a correction upwards.

Acceleration on the other hand can be much more difficult to analyse.

As demonstrated in figure 3.63 it may indicate a strengthening of the momentum in the current price swing direction, and a greater likelihood of price continuation in that direction.

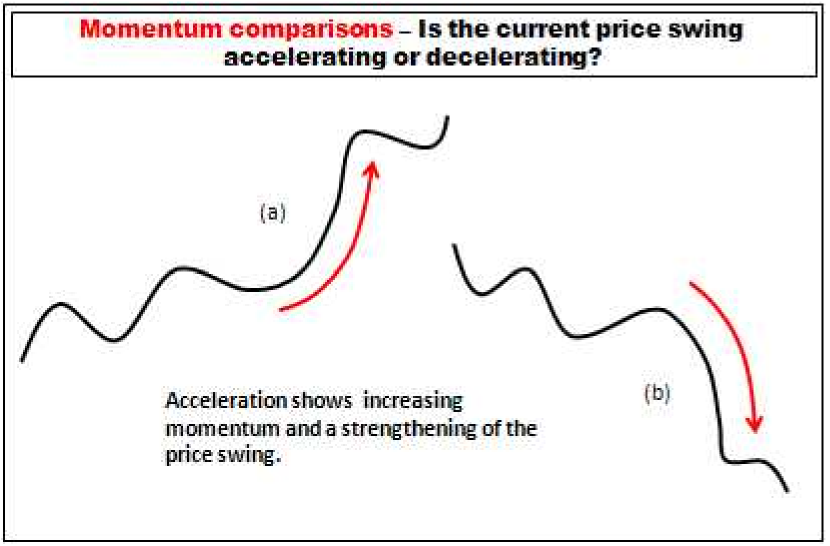


Figure 3.63 - Momentum Comparisons – Acceleration

However, extreme levels of acceleration can indicate weakness from the point of exhaustion of the acceleration, as shown below in figure 3.64. These climactic moves often end violently, forming (at the very least) a strong area of support or resistance, and occasionally a rapid reversal.

These price swings are usually associated with greatly increased price bar range, extension well above or below any average lines, and extremely high volume when compared to prior action.

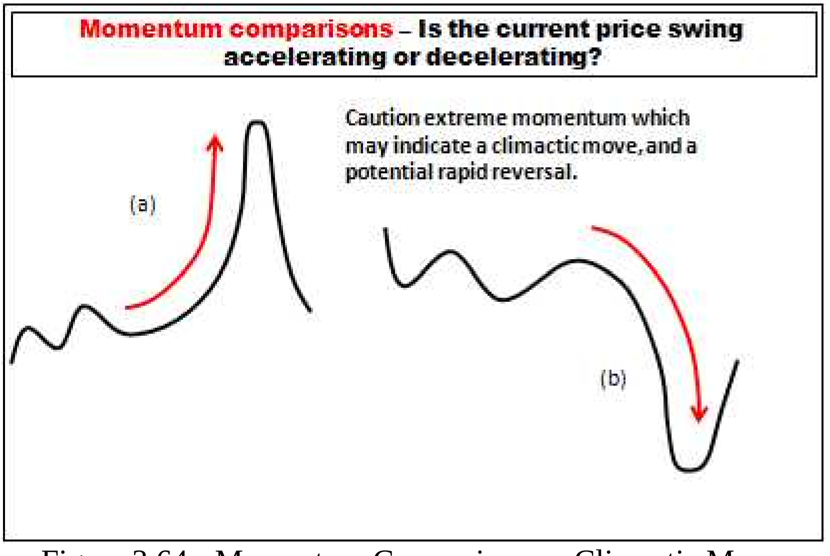


Figure 3.64 - Momentum Comparisons – Climactic Move

Climactic moves such as the bullish price swing (a) represent the last of the emotionally-influenced public, desperate to buy into the market at whatever price they can, chasing price higher and higher. When there are no buyers left and the price rally halts, selling into the market reverses price, trapping all the late longs. The reversal can be quite rapid, as these longs are stopped out of their position (sell order) and more shorts are attracted to the market.

Climactic move (b) represents the same process to the downside. Late shorts desperately chasing price lower and lower in panic, along with previous longs in an extreme drawdown exiting at the point where they just can‟t take the pain any longer. Once the selling is exhausted, the professionals will be buying, driving prices higher and trapping the late shorts into a losing position. Any reversal may again be quite rapid, as the trapped shorts are stopped out of their positions (buy order) and more longs are attracted to the market.

So, price acceleration does indicate strength. But excessive acceleration is unsustainable, and likely to end in climactic exhaustion and potential reversal. Placing the degree of acceleration into the context of background market action will usually identify which of these scenarios is playing out.

Let‟s examine some charts…

Figure 3.65 - Changing Momentum

Figure 3.65 above demonstrates changing momentum on consecutive price swings of the same direction.

Compare both the extensions, swing A and swing C. Note the slope of swing C is shallower than swing A, indicating reducing upwards momentum. The speed of the price extensions has slowed from swing A to swing C. Bullish momentum is weakening.

Compare both the pullbacks, swing B and swing D. Note the slope of swing D is steeper than swing B, indicating increased downwards momentum. Bearish momentum is strengthening.

Both observations show evidence of a weakening of our trend.

Note the trend has not yet changed. A downtrend would not be triggered unless the price swing continued down and broke swing low E (previous swing high resistance and breakout point, now support).

The trend is still upwards. However momentum analysis says it has weakened considerably.

The *future trend* will be determined via the processes to be discussed shortly. For now, we have identified weakness in the uptrend; and given the potential for support at E there is a good likelihood of sideways action from this point on.

Let‟s review the example from a *trader's decision making* perspective.

The rapid extension of price swing A will lead to a lot of traders jumping on this uptrending bandwagon, quite excited about the potential for higher prices. Pullback B would be a little deeper than they‟d like to see, at approximately 50% of the previous extension, but that‟s not entirely unexpected given the speed of the extension. The pullback also affords other bulls the opportunity to enter long, had they missed the original move.

However, the majority of the novice traders are usually late to these parties, entering towards the end of any move. Many would have bought late into extension A at the area which subsequently formed the swing high. These traders would be under extreme stress during the extended pullback and likely looking for any opportunity to get out at breakeven or close to it. Given the slower rate of climb in C, it‟s unlikely the original enthusiasm would be restored, and these traders would likely add to bearish orderflow as they take their exit towards the highs of C (if they‟re lucky), or more likely as it accelerates down through the second pullback D.

Likewise anyone who missed the original move in extension A and entered into extension C after the pullback, will likely bail out at breakeven or have their stops hit as price falls in D, further adding to the bearish pressure and weakening the likelihood of future bullish orderflow.

This has led to where price is now. From here, we expect more bearish pressure in the next candle, as price continues its break of the B-C swing low and even more stops are hit.

However any bearish move is expected to be short lived. Shorts will be taking profits approaching E. Longs will be entering at this area, which last time showed extreme bullish pressure (they won‟t want to miss this opportunity again). Bullish orderflow should overwhelm bearish orderflow, creating support.

Another example…

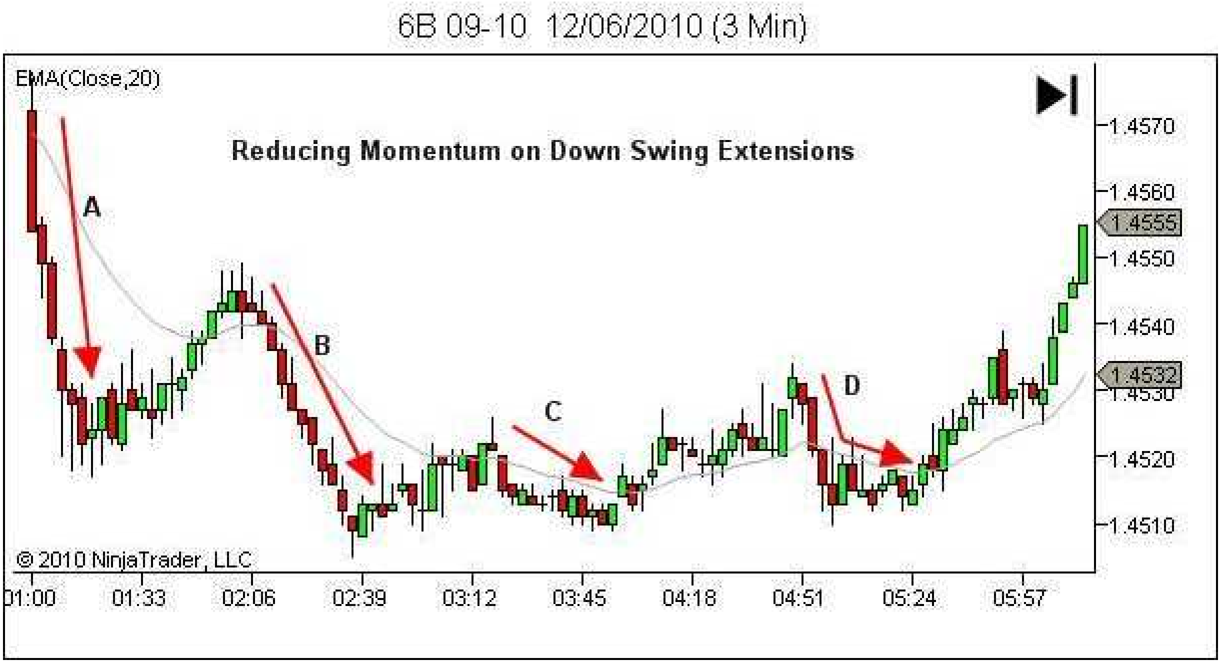


Figure 3.66 - Reducing Momentum

Referring to figure 3.66, note the reducing momentum on each down swing extension, as price forms this rounded bottom formation and creates new support at the 1.4510 level.

As the third swing (C) moves down towards the prior swing low, the reduced momentum should have alerted you to a changing bias. Supply was no longer overwhelming demand to the degree displayed by the initial two drops. Either there was a lack of selling, or it was being absorbed by an increase in buying.

Either way, the balance of power has shifted and the bears are no longer the dominant force they once were.

The downtrend has weakened. Further price movement is more likely against the direction of the weakness (ie. in the long direction).

As stated before, the important point is not any absolute value of momentum, but the comparison of one price swing with another. In this case, reducing speed on each price swing is evidence of a weakening of the downtrend.

Figure 3.67 - Decelerating Price Swing into an Area of Support

Figure 3.67 demonstrates deceleration. Note how the price falls quite rapidly at the beginning, but the rate of fall slows towards the end.

This is an example of initially strong bearish pressure – supply overcoming demand as traders exit their longs and shorts enter on break of the high candle (shooting star). This initial bearish pressure was not able to be sustained. The further price falls, the less other traders become interested in shorting. And the more price approaches the area of support, the more traders are interested in searching for an entry long. After all, last time price left this area (17:12) it did so quite quickly.

Rapid price movement from an area of S/R makes it a higher quality area if tested again. We expect it to hold.

Traders who enter short late into this move downwards are taking a very low odds trade.

The end result is that the price action in this case (deceleration) confirms weakness in the downwards price swing; and increases the likelihood of the area of support holding.

Figure 3.68 below demonstrates the same concept, although this time involving deceleration of an upwards price swing into an area of resistance.

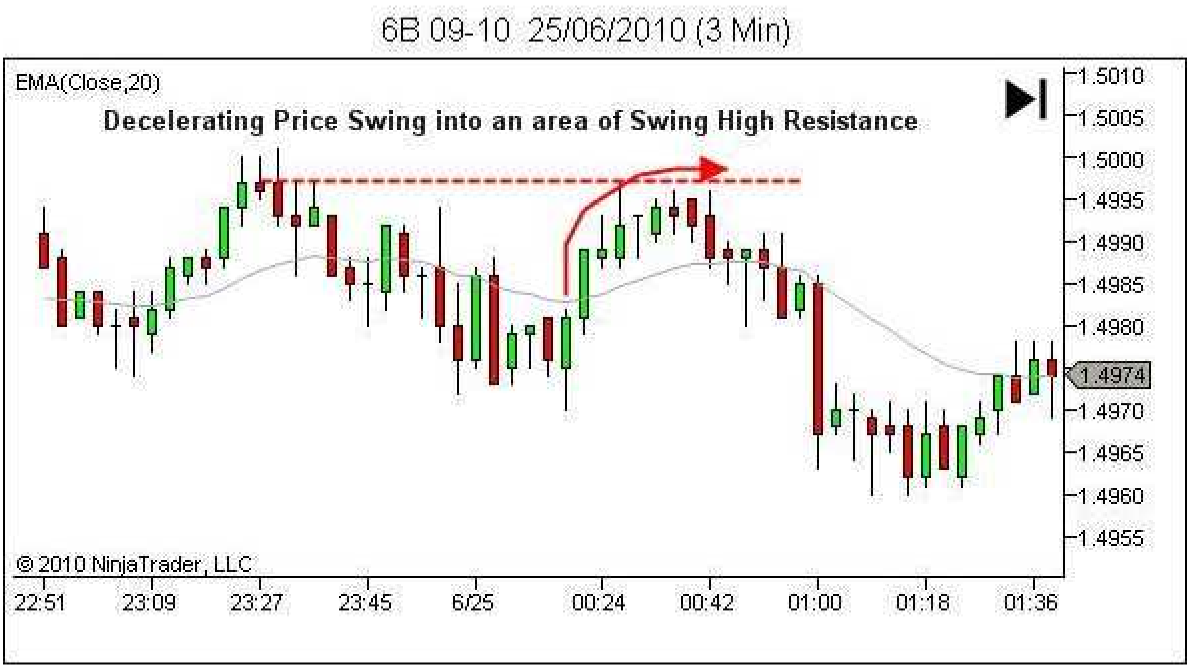


Figure 3.68 - Decelerating Price Swing into an Area of Resistance

Deceleration in this example is evidence of bullish momentum gradually weakening as bearish pressure overcomes any bullish pressure.

Traders who buy late into this move are once again taking a very low odds trade. The smarter trader will have identified the weakness at resistance and so will look for an opportunity to enter short, in order to profit from the losers orderflow.

Of course, we"re not considering trades yet – just identifying signs of strength or weakness.

In these last two examples, we"ve demonstrated the concept that decelerating price into an area of support or resistance indicates weakness; with the level quite likely to hold price.

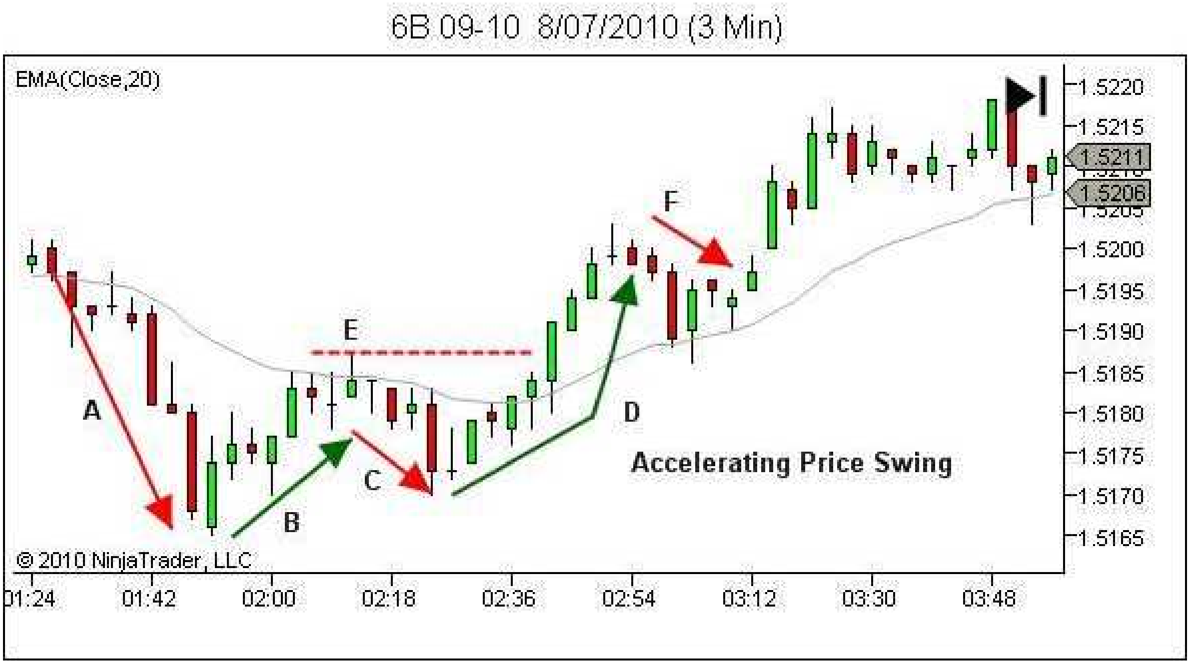


Figure 3.69 - Accelerating Price Swing

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Figure 3.69 shows acceleration on swing D; a sign of strength. But first let"s look at the prior price action.

Comparing swings A to C we see weakening bearish momentum due to the reducing slope.

Swing D initially shows comparable momentum to swing B, but then accelerates just prior to breaking swing high E.

This price acceleration shows strength in the bullish direction.

The next pullback F shows weakness, in comparison to the accelerating bullish swing D.

Strength is clearly in the bullish direction; weakness is clearly in the bearish direction. Future price action is likely in the direction of strength and against the direction of weakness.

But what about extreme climactic acceleration?

Figure 3.70 - Extreme Acceleration (Climactic)

An accelerating price swing, as shown in figure 3.70 represents extremes of emotion. Bullish pressure vastly exceeds bearish pressure as everyone chases price higher and higher, desperate to get into this market before they miss out on what they perceive to be guaranteed profits.

This type of move is often associated with increasing price bar ranges and a much greater than average volume.

While this clearly shows strength during the period of acceleration, the nature of this type of move is such that it accelerates until a point of exhaustion, at which there is no-one else desperate to get long and willing to pay higher prices.

The swing high then forms an area of resistance. If no-one is willing to pay higher prices, then price cannot rally. The path of least resistance is down. The market will display weakness beyond the point of exhaustion.

Sometimes, these climactic moves will result in a very rapid reversal. Price falling will trigger trailing stops; leading to further price falls which trigger more stops; and on and on.

Other times, a retest of the point of exhaustion will precede the reversal (creating a great trade opportunity in the process).

At the very least though, price should be expected to form S/R which will hold price at least for the foreseeable future, as occurred in this example.

One final example; including a look at the *lower timeframe* chart to confirm and fine-tune our analysis…

The *lower timeframe* chart is made from exactly the same data as the *trading timeframe* chart. However it allows you to zoom in on the price action to get a closer look. Kind of like a microscope for the *trading timeframe* action.

The *lower timeframe* chart will be monitored throughout your analysis, but there are some key times when extra focus will be placed on this chart. Such as:

1) When clear signals are not available through the *trading timeframe* (3 min), such as within areas of sideways congestion.
2) When price is at a critical decision point – such as the break of a swing high/low.
3) When price is in a trade setup area.

Figure 3.71 shows our *trading timeframe* (3 min) chart, as the market has decelerated into an area of sideways price action (shown by the blue box). Is this sideways action an indication of potential reversal? Or simply a pause before continuation?

Figure 3.71 - Trading Timeframe Deceleration into Sideways Action

Zooming in to the *lower timeframe* (1 min) allows us to more clearly see the changes in momentum within the price swings.

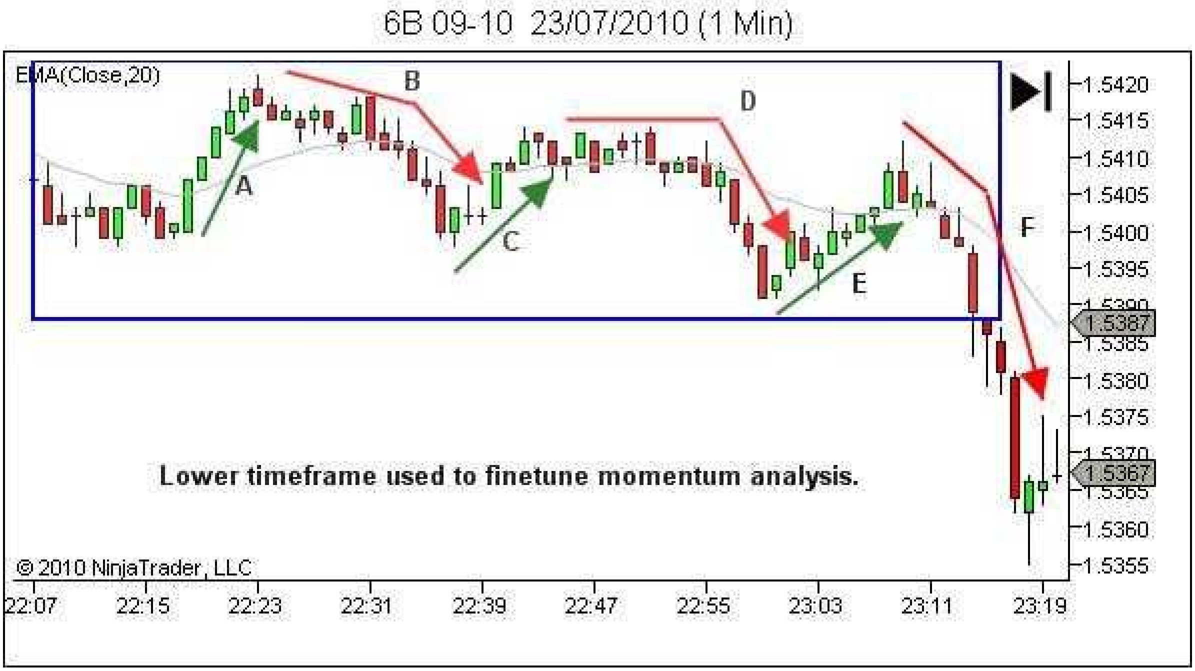


Figure 3.72 - Lower Timeframe Deceleration into Sideways Action

On the *lower timeframe* (1 min) we can clearly see that bullish momentum is weakening within each upswing, evidenced by the decreasing slope from swings A to C to E.

We also see downswings B and D, accelerating to lows, with D showing more bearish strength than B. Bearish momentum is increasing from one swing to the next.

Although the data does not show one side dominating the other, the balance of power is slowly shifting from the bulls to the bears, as the bullish momentum weakens and the bearish momentum strengthens.

Swing F resumes the *trading timeframe* (3 min) downtrend as the bears finally overwhelm any remaining bullish pressure.

From the perspective of supply and demand, each price swing is showing reduced demand and encountering greater supply. In the absence of any external factor introducing new demand, the likelihood is for supply to exhaust any demand and force price lower.

From the perspective of traders and their decision making processes…

This market deceleration has offered some tempting entries long, which will attract many traders who are hoping to capture an early entry to a reversal. There are numerous entry opportunities, but for the sake of simplicity let‟s consider just one group – those who missed the rally at A, suffered great frustration at the fact that they missed such an obvious entry, then were overjoyed to see the second entry opportunity at C. This time they didn‟t miss out. Entering at C, they become frustrated as price stalls sideways for a good 10 minutes or so, before accelerating downwards. Some will stop out on swing D, as it breaks the swing C lows. Others will hold, overwhelmed by fear initially, but then with relief as swing E takes them back into profits (possibly also with a slight feeling of satisfaction, knowing how smart they are for holding during the drawdown).

These traders do not perceive the signs of weakness that are evident through simple momentum analysis.

As the bearish strength overwhelms the weaker bullish pressure, the market collapses, triggering the stops of these very frustrated and angry longs.

As YTC Price Action Traders, we aim to profit from these losing traders. Recognising the strength shifting to the bearish side, gave us an opportunity to work an entry short, in the direction of strength, allowing us to profit from the orderflow of the losers who tried to trade in the direction of weakness.

Let‟s wrap up momentum…

Not every price swing will provide useful information through analysis of momentum. However we monitor momentum as price moves in order to note any significant changes. These may display via a change in speed from one swing to another (changing slope), or a change in speed within one price swing (acceleration or deceleration).

- Compare the momentum of the current price swing with the momentum of the previous price swing in the same direction? Is price faster or slower than before? What does that mean?
- Compare the momentum of the current price swing with the momentum of the previous price swing in the opposite direction? Is price faster or slower than before? What does that mean?
- Is the current price accelerating or decelerating? What does that mean?

Noting these changes, we consider the meaning from the perspective of supply & demand, and from the perspective of traders making trading decisions.

Momentum analysis allows us to sense changes in strength or weakness of the price swings within a trend; thus allowing us to assess the strength or weakness of the trend itself.

Price movement will most likely continue in the direction of strength and oppose the direction of any weakness.

This ability to assess the strengthening or weakening of a trend gives us an edge over those traders who fail to see this information, despite it being openly presented right in front of them.

Projection & Depth

Strengthening or weakening of a trend may also be observed through analysis of **Projection** and **Depth**.

Projection refers to the distance with which a price extension projects past the previous swing high (in an uptrend) or swing low (in a downtrend).

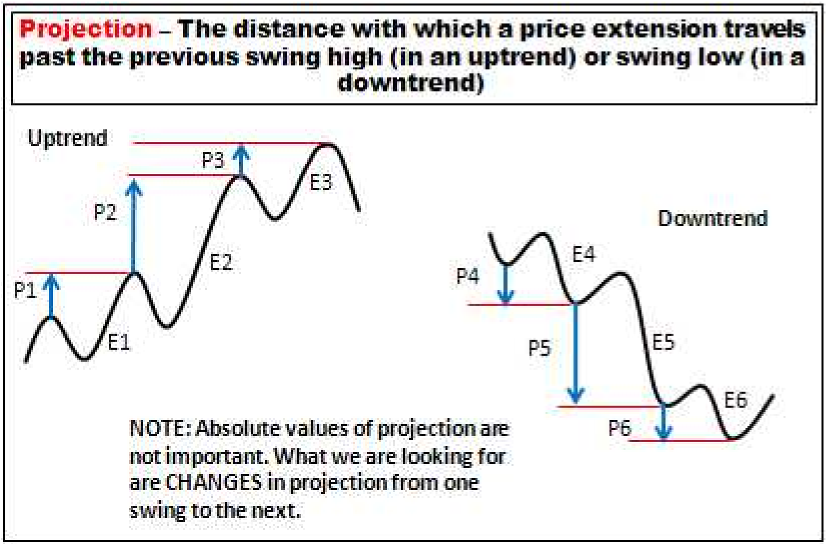


Figure 3.73 - Projection

Referring to the uptrend within figure 3.73, we see the price action shows three price extensions E1, E2 and E3. The projection of each is displayed as P1, P2 and P3. P1 is the distance with which E1 projects (or travels) beyond the previous swing high. P2 is the distance with which E2 projects beyond the previous swing high. And P3 is the distance with which E3 projects beyond its previous swing high.

The important information is not so much the distance, but changes when comparing one projection with the next.

Note the increased projection of E2 (P2) when compared with E1 (P1). Extension E2 projects much further than E1 did, indicating greater strength within the trend.

P3 is then much shorter than P2, indicating weakness developing with the trend.

The downtrend shows similar information. Projection P4 is the distance with which Extension E4 travels past its previous swing low. And so on for P5 and P6.

P5 shows greater distance than P4, indicating increased downtrend strength. P6 shows a decrease in projection compared to P5, indicating possible downtrend weakness.

Increased projection is a sign of potential trend strength. Decreased projection is a sign of potential trend weakness.

Let"s see a chart example:

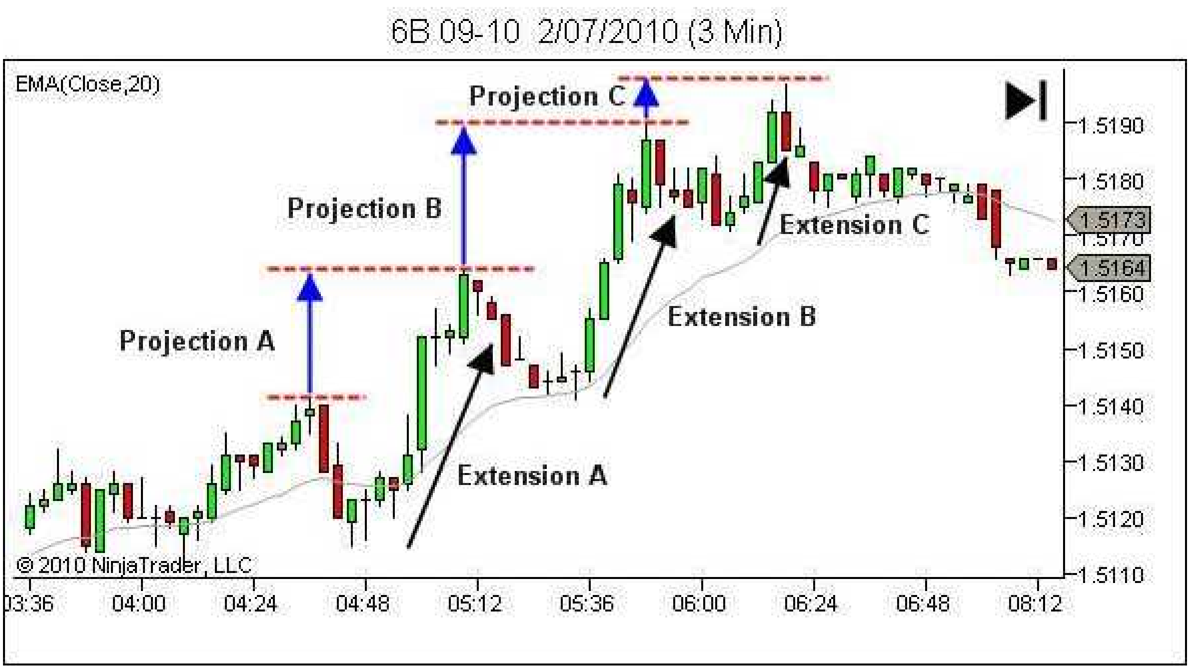


Figure 3.74 - Projection on a Chart

Projection A is the distance with which Extension A carries past the previous swing high. In this case the projection is equivalent to 45% of the whole Extension A range.

Projection B is the distance with which Extension B carries past the previous swing high. In this case the projection is equivalent to 52% of the Extension B range.

Projection C is the distance with which Extension C carries past the previous swing high. In this case the projection is equivalent to only 25% of the Extension C range.

In conducting analysis you do NOT have to work out percentages. We are not concerned with absolute values of projection, but simply looking for changes which are visually obvious.

In this example, Extensions A and B are easily able to break and move to new highs. Extension C though is unable to project to the same distance. Something has shifted in the balance of supply and demand. If there was no change from previous sentiment, then the extension should have carried through approximately the same distance as previously occurred. The fact that the market was unable to do so indicates either a decrease in bullish pressure and/or an increase in bearish pressure.

The uptrend is showing signs of weakening.

Depth refers to the distance with which a pullback retraces the previous extension.

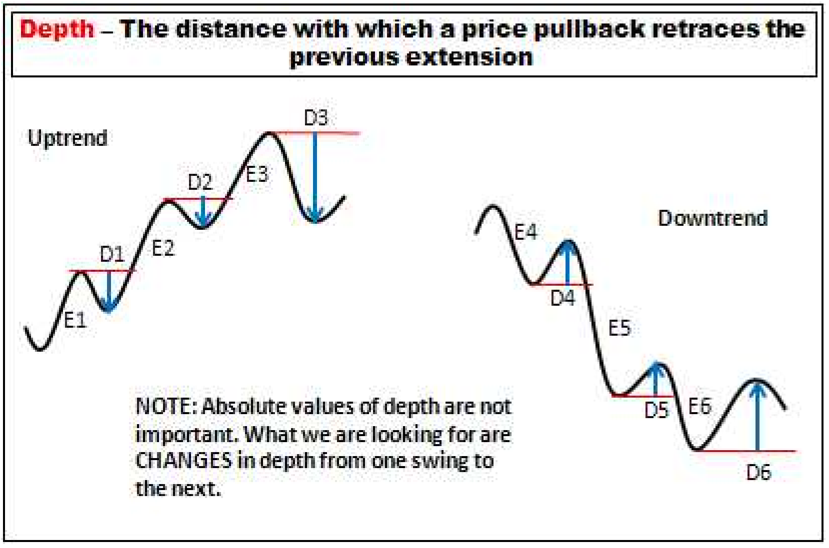


Figure 3.75 - Depth

Looking at the uptrend in figure 3.75, we see three extensions E1, E2 and E3.

Depth D1 is the distance with which the pullback retraces E1 (think in percentage terms, rather than price values).

D2 is the depth with which the pullback retraces E2. And D3 is the depth with which the pullback retraces extension E3.

As with projection, we are not greatly interested in the absolute values of depth; rather we note significant changes of depth from one price swing to another.

Note that D2 is a much smaller percentage of its extension E2 (approx 20%), when compared to D1 (approx 40%). D2 has smaller depth than D1, indicating a potential weakening of the bears, and therefore strength within the price trend.

Note that D3 is significantly larger than D2, indicating potential strength within the bears, and therefore potential weakness within the price trend.

The same concept applies to the downtrend.

D5 is showing greatly reduce depth when compared with D4 (remember we compare D5 as a percentage of E5 (approx 20%) with D4 as a percentage of E4 (approx 60%)). Reduced pullback depth in a downtrend is a sign of potential weakness in the bulls, and therefore potential strength in the downtrend.

D6 is showing a much greater percentage depth than D5, indicating potential strength in the bulls and therefore potential weakness in the trend.

Increased depth is a sign of potential trend weakness. Decreased depth is a sign of potential trend strength.

Let‟s now examine depth on the same chart we used for projection, displayed again as figure 3.76 below.

Depth A is the percentage with which the pullback retraces the range of Extension A. In this case Depth A is a pullback equivalent to 45% of the Extension A range.

Depth B is the percentage with which the pullback retraces the range of Extension B. In this case Depth B is a pullback equivalent to 40% of the Extension B range.

Depth C is the percentage with which the pullback retraces the range of Extension C. In this case Depth C is a pullback equivalent to 85% of the Extension C range.

As with our projection analysis, we‟re not interested in absolute quantities, but rather in observing changes within the depth when comparing the current swing with previous swings.

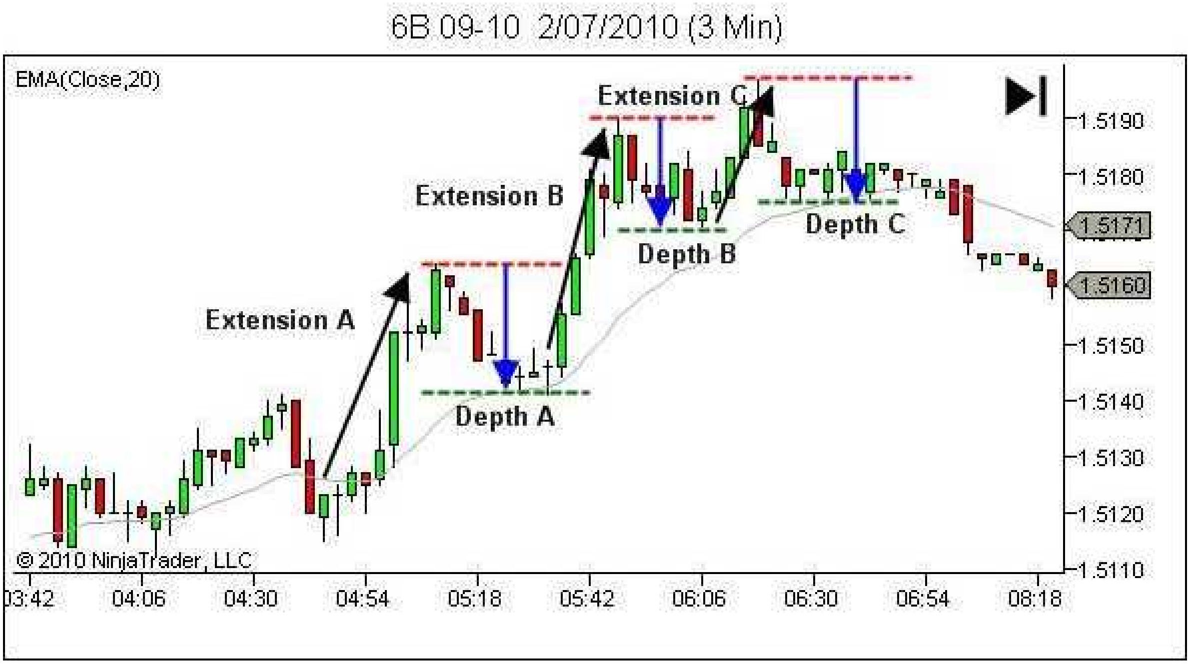


Figure 3.76 - Depth on a Chart

The increased depth of pullback C indicates increasing bearish pressure and a potential weakening of the trend.

It‟s wrong to make assumptions such as a 38% pullback is shallow, a 50% pullback is normal and a 62% pullback is extreme. The depth of pullback that should be considered normal is dependent on the current market environment.

In a volatile trend environment, deep pullbacks may be the norm, as demonstrated below in figure 3.77.

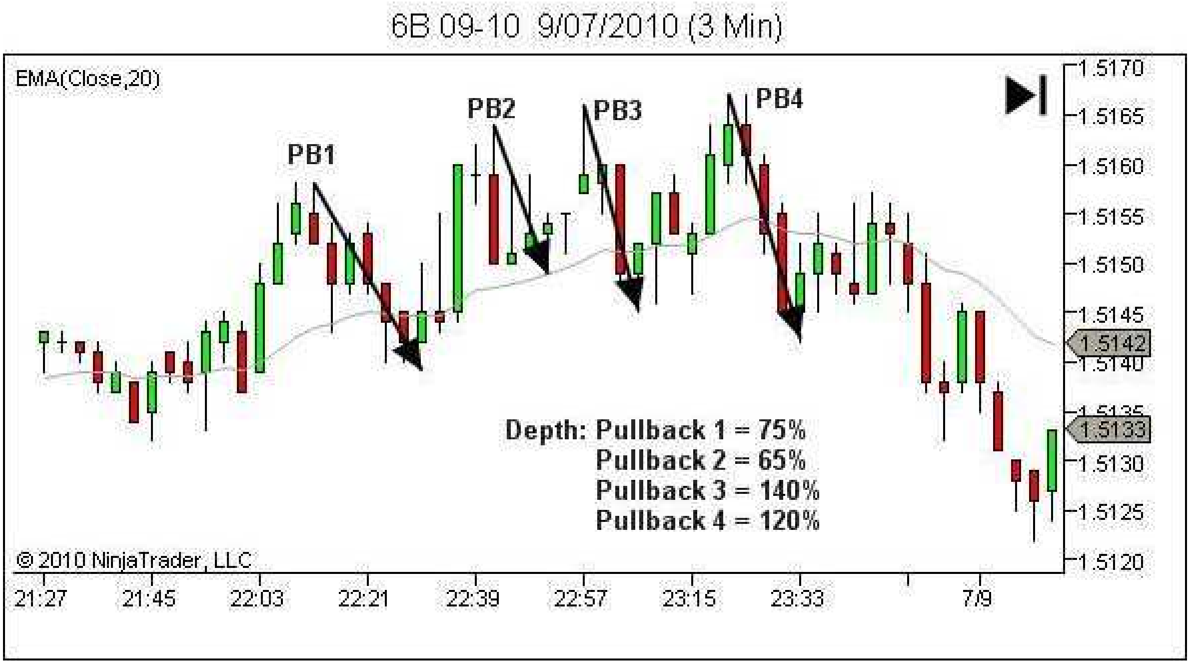


Figure 3.77 - Deep Pullbacks within a Volatile Trend Environment

In this trend, pullback depth of 65-75% was considered normal. Weakening of the trend was observed only when we had deeper pullbacks, PB3 and 4, which exceeded the length of their extensions. This was a clear sign of the balance of power shifting towards the bearish side. The trend is showing clear signs of ending.

To summarise projection and depth…

What we‟re seeking through our analysis is evidence that something has changed – a shallower or deeper pullback or extension. If sentiment had remained as before, then the pullback or extension would have been in line with previous pullbacks and extensions. The fact that something has changed in the market indicates a change in sentiment. Analyse the change – what does it mean from the perspective of supply and demand? What does it mean from the perspective of other traders and their decisions, thoughts and emotions?

While these changes are often evident through your momentum analysis, it‟s not always the case. And in many cases analysis of projection and depth is the easiest way to spot shifting sentiment within the price action.

Failure to Continue

Closely related to momentum and projection/depth, is a concept which I call *Failure to Continue*.

You"ll often see patterns on the chart which create an obvious expectation (within the uninformed crowd) for future price movement. When that future price movement fails to meet expectations, the market provides us with clues as to the strength or weakness of the underlying price trend.

Refer to figure 3.78 below for an example.

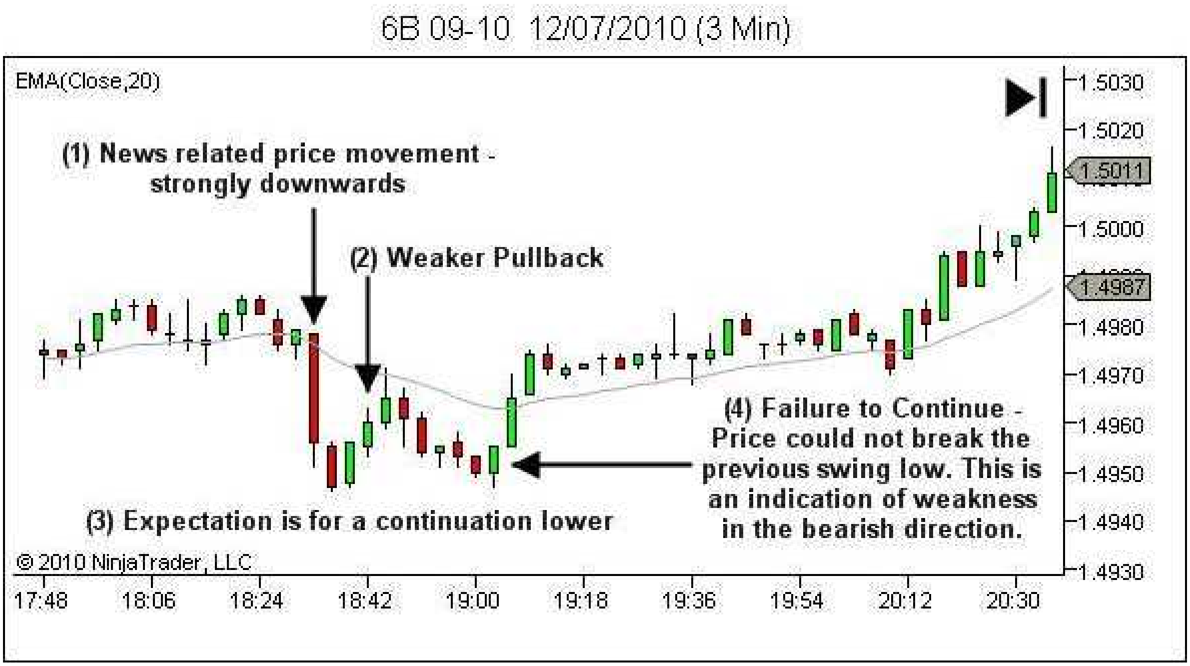


Figure 3.78 - Failure to Continue

Following a strong fundamentally-influenced impulse downwards, and a weaker pullback, the obvious expectation is for a continuation of the move down breaking to new lows.

Failure to meet that expectation demonstrates weakness in the bearish direction.

This weakness may be easily observed through analysis of price swing momentum, or analysis of projection and depth. Often however, the easiest way to observe this weakness is through a simple failure to meet expectations, or *failure to continue*.

Failure to Continue doesn"t only involve failure to break a high or low, as in the above example. It might also display as a break of that level which quickly fails.

Any time obvious expectations fail to continue, the market has given you a strong clue as to *future trend* direction.

Miscellaneous

Momentum, Projection/Depth and Failure to Continue are not the only analysis methods available to identify shifting sentiment (strength or weakness) within a market. Additional analysis tools such as volume or market internals may be incorporated, depending on your experience levels and your chosen markets.

What we are seeking in our analysis of price action is evidence of change in sentiment – a strengthening or weakening of the trend.

With my background primarily being in forex, these changes had to be determined solely through price action, as demonstrated already. Volume and market internal indicators were not available.

With my trading now being primarily in the futures markets, additional analysis tools are available. I will not be detailing their use in this book, as they are not considered an essential part of the strategy. Change in sentiment is evidenced through price action – any other analysis tools provide secondary indications only.

That being said, if you have these tools available you may wish to consider their use.

For volume analysis I would recommend studying Volume Spread Analysis, perhaps starting with the book, "Master the Markets" by Tom Williams.

For market internals, I would recommend studying the YTC Scalper supplementary ebook. Alternatively, try "Read the Greed – Take the Money" by Mike Reed, to see his use of the NYSE Tick indicator. Refer to the Resources page of my website for links.

The key point to remember should you use these additional tools is that we are using them solely to find changes in the sentiment of the market – something that is different, such as an NYSE Tick that has struggled to break above the zero level for the last 2 hours suddenly spiking up to 1000.

3.3.3 – Principles of Future Trend Direction

Having analysed the past trend direction and identified any signs of strength or weakness within that trend, we now work to determine the likely *future trend* direction.

Most traders simply operate on the assumption that an existing trend will continue in its current state, until a break of their objective trend definition – *"the trend is your friend"*.

While that‟s generally good advice, as the higher probability is most often for a continuation of the trend, I feel it‟s wise to also recognise the true nature of this *friendship*. If the trend is your friend then it‟s certainly not the nicest one you‟ve got; more like one of those friends who will stab you in the back at the first opportunity if you don‟t take care.

Signs of strength and weakness within the trend alert us to those times when the trend is not our friend, and higher probabilities are available through counter-trend corrections or reversals.

We assess the likely *future trend* direction in accordance with the following principles:

Within the S/R framework:

- **First Principle –** We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

- **Second Principle -** When an up or down trend shows evidence of weakness, we expect a higher likelihood of a complex correction* rather than a reversal, until such time as the market shows both price acceptance and strength in the new trend direction.

  (a complex correction being one of extended duration, or multiple swings)*

- **Third Principle –** A sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

- **Fourth Principle -** When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behaviour of price post-breakout for clues as to future direction:

  - Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range

    - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

At the edges of the S/R framework:

- **Fifth Principle** – We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary.

- **Sixth Principle** - If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behaviour of price post-breakout for clues as to future direction:

    - Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.

    - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

These principles are demonstrated below in figures 3.79 to 3.90.

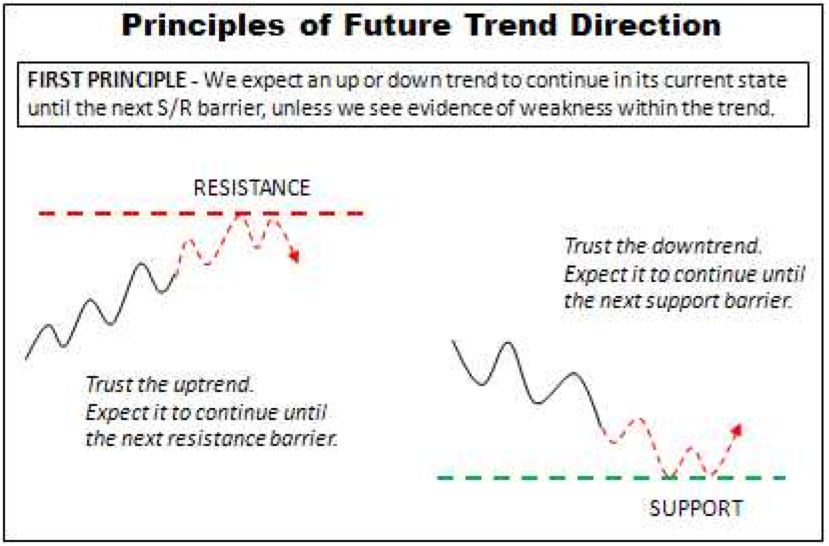


Figure 3.79 - Principles of Future Trend Direction – First Principle

Figure 3.80 - Principles of Future Trend Direction – First Principle – Chart Example

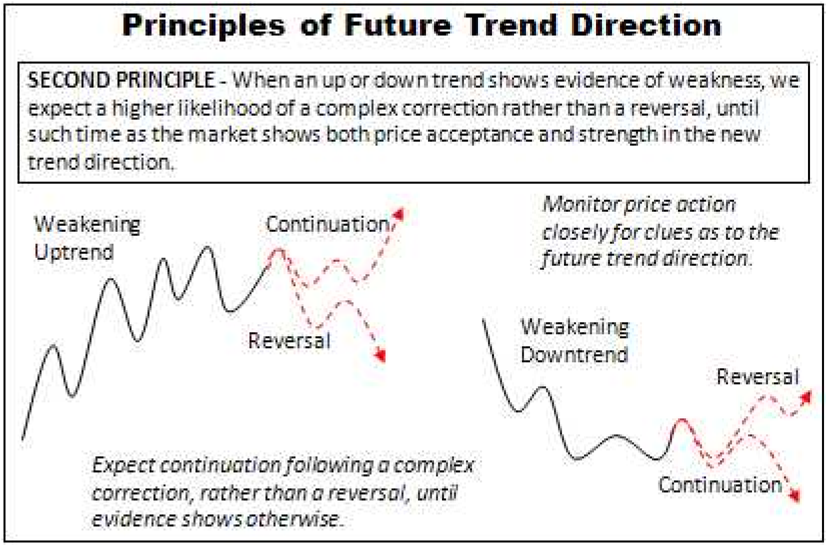


Figure 3.81 - Principles of Future Trend Direction – Second Principle

Figure 3.82 - Principles of Future Trend Direction – Second Principle – Chart Example

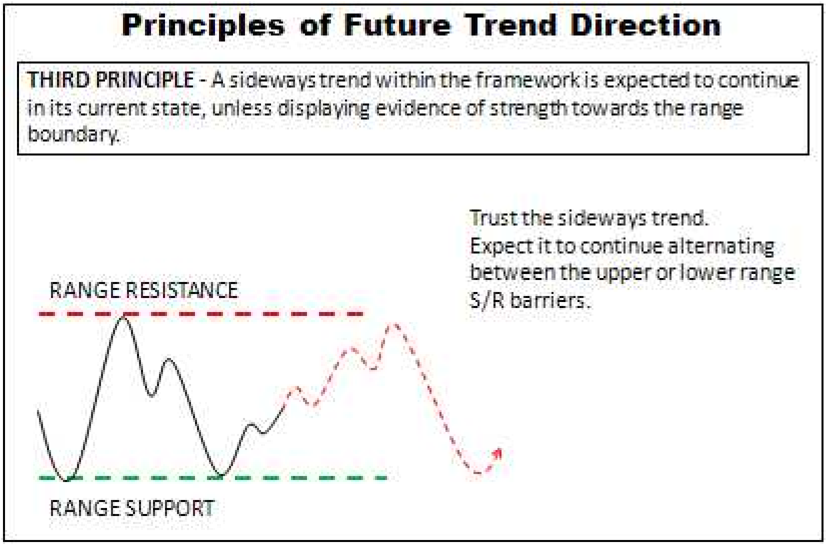


Figure 3.83 - Principles of Future Trend Direction – Third Principle

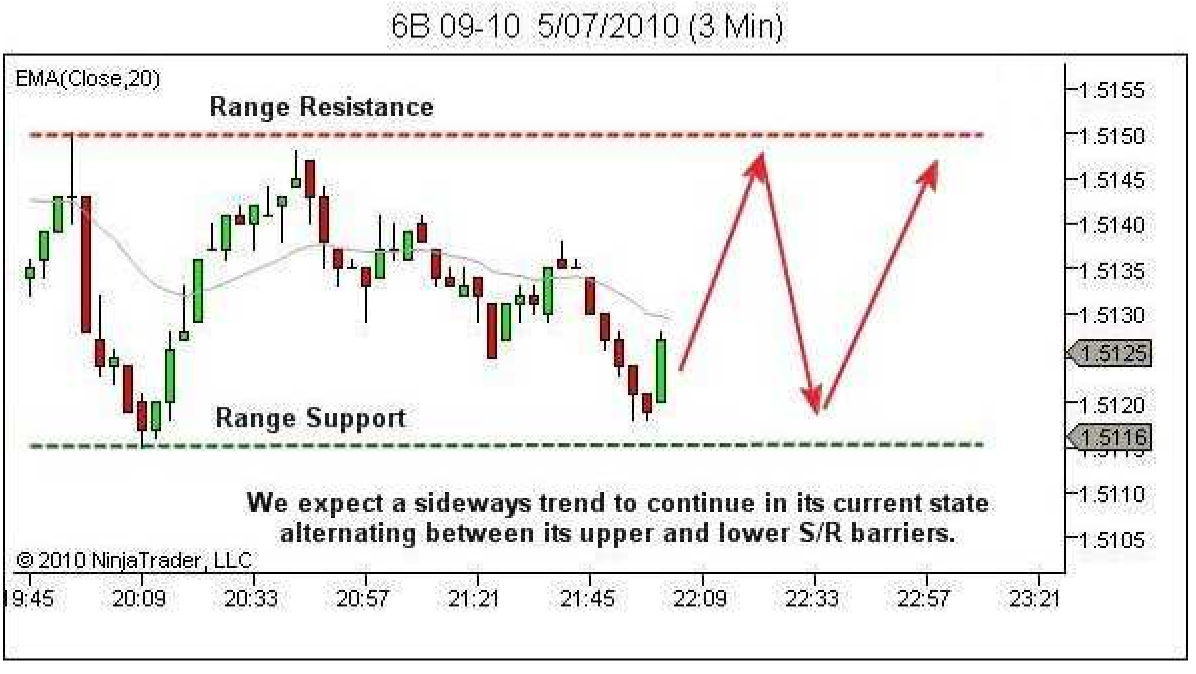


Figure 3.84 - Principles of Future Trend Direction – Third Principle – Chart Example

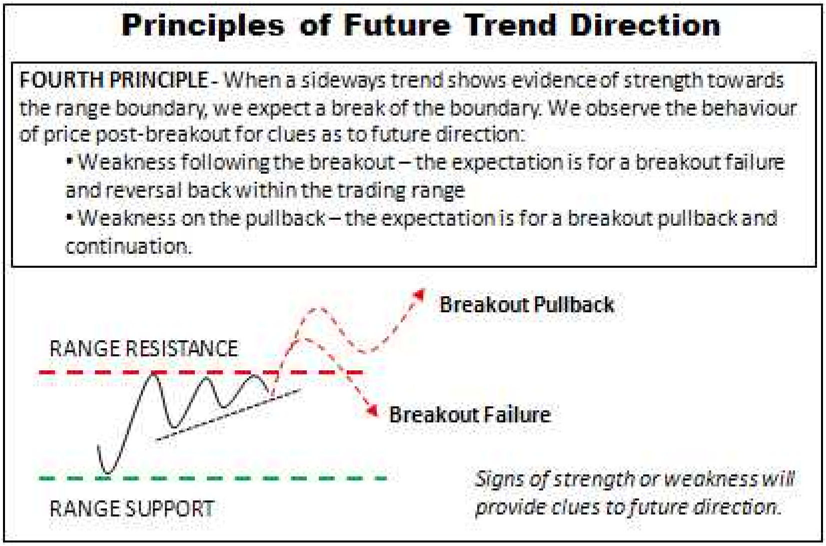


Figure 3.85 - Principles of Future Trend Direction – Fourth Principle

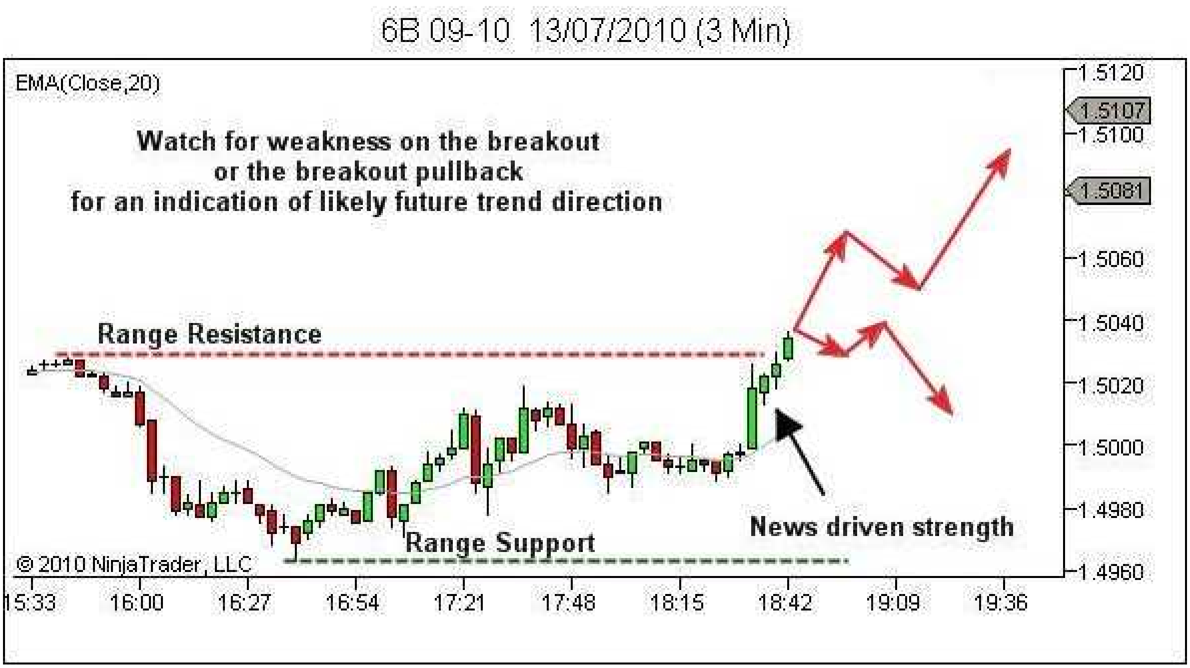


Figure 3.86 - Principles of Future Trend Direction – Fourth Principle – Chart Example

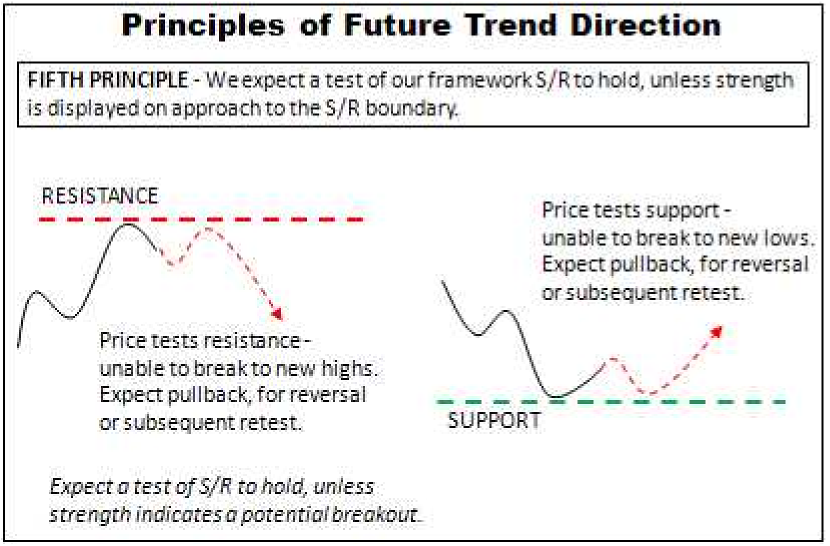


Figure 3.87 - Principles of Future Trend Direction – Fifth Principle

Figure 3.88 - Principles of Future Trend Direction – Fifth Principle – Chart Example

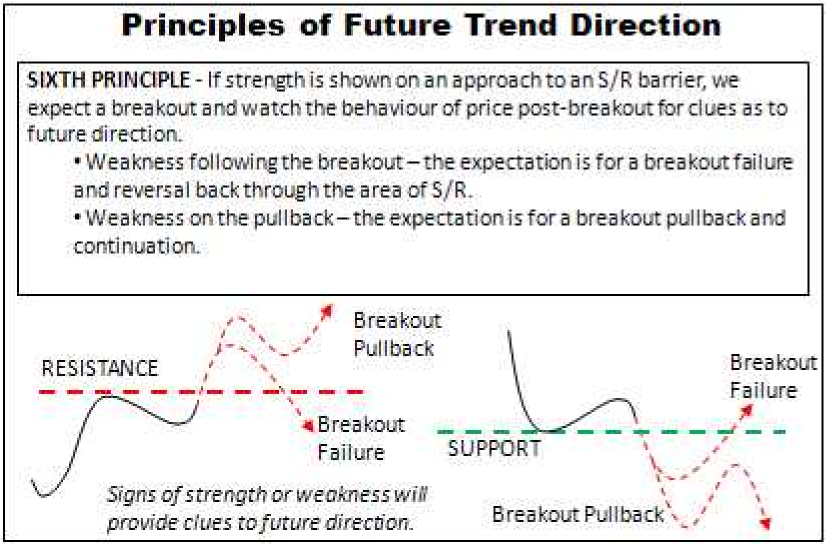


Figure 3.89 - Principles of Future Trend Direction – Sixth Principle

Figure 3.90 - Principles of Future Trend Direction – Sixth Principle – Chart Example

These six principles will provide you with your initial assessment of *future trend* direction.

Remember though – this is only an <u>INITIAL</u> assessment.

Keep it simple; and don‟t stress too much about getting it wrong. We‟ll soon be updating our assessment bar-by-bar as more price action unfolds on the right hand side of your charts.

You‟ll soon know if you got it wrong, as new signs of strength or weakness will confirm or reject your previous assessment, and provide you with opportunity to update your assessment of *future trend*. To make this easier though, it helps to visualise the future…

3.3.4 – Visualising the Future

Having established our bias for *future trend* direction, we will shortly be reassessing the bias as the market prints new price bars (or candles). Will the new data confirm our bias remains intact, or will it provide some new information which alerts us to potential changes within the supply/demand relationship?

In order to make this assessment easier, we should have some expectation of future orderflow.

How do you expect future price action to behave?

This is simply a process of considering the following:

- **What price action would validate your assessment of *future trend*?**
- **What price action would invalidate your assessment of *future trend*?**

Let‟s demonstrate this through asking these questions about some of our earlier charts…

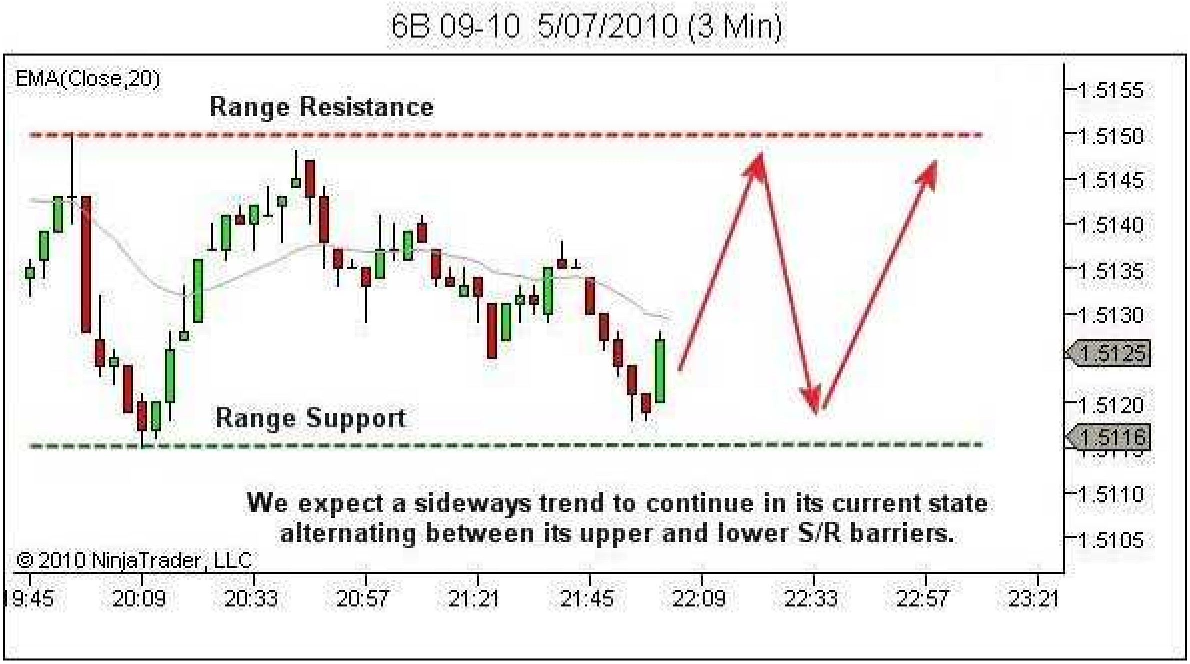


Figure 3.91 - Visualise the Future – Example 1

In figure 3.91, we expect a continuation of the sideways trend.

What price action would validate my assessment of *future trend* direction?

The large-range bullish green candle off support should lead to initiation of the move back up towards resistance. I expect to see further follow-through to the upside, with slowing momentum leading into resistance, as happened in the earlier upswing towards the left of the chart. Traders in a long position off support will be targeting the upper resistance. Their sell orders, along with shorts entering at that area should be sufficient to hold price and prevent further rally.

What price action would invalidate my assessment of *future trend* direction?

If price fails to follow through, and falls below the latest green bullish candle, I"ll need to reassess the bias. Potentially the bearish pressure is stronger than anticipated and it"s time to consider a potential break downwards. This occurrence would shock anyone in a long position and have them standing by for a quick exit if the lows should then break, adding to bearish pressure and aiding the breakout.

I"m now prepared for the future price action – aware of what it should look like if my assessment of the *future trend* is correct – and aware of what it will look like if my analysis was wrong.

Figure 3.92 - Visualise the Future – Example 2

In figure 3.92, price has broken a resistance level for a second time. This second break, although initially weak, is now displaying strength. This is likely showing price acceptance of the breakout area, and I expect the breakout to hold and continue higher.

What price action would validate my assessment of *future trend* direction?

The upper tail is showing some evidence of supply. I expect a pullback to commence within the next candle or two. However that pullback must be showing weakness, through either a shallow slope (weak bearish momentum) and/or reduced depth.

What price action would invalidate my assessment of *future trend* direction?

Strength on a pullback would indicate supply coming into the market at these higher prices. If that occurs, it‟s likely the strength shown on the second breakout was simply stops getting triggered, and the market has not attracted sufficient new longs to support continuation. A strong pullback would have me reconsidering my expectations, with a breakout failure confirmed by a break below the large green breakout candle.

As you can see, visualisation is just a simple process of asking what you are expecting to see happen in the immediate future. We don‟t remain fixed to this viewpoint – in fact, we even consider what price action would invalidate our plan, ready to dump it at the first sight of it no longer describing the current market.

This process is simply a result of experience. More examples will be provided, covering the whole process of analysis. The real learning though, will occur as you work through your charts. As you gain more and more screen time, your ability to read the market and accurately assess future orderflow (and update that assessment in real-time) will improve.

3.3.5 – What Happens After S/R Holds?

Having provided the six principles which I use to define future price action, there is one area on the charts that often causes people some difficulty. So, let"s address it here before we go on with the analysis process and examples.

What happens after a successful test (Fifth Principle) or a successful breakout failure (Sixth Principle)?

Is price expected to form an immediate reversal and change of trend?

Or do we expect the trend to remain intact, and set up another test of S/R?

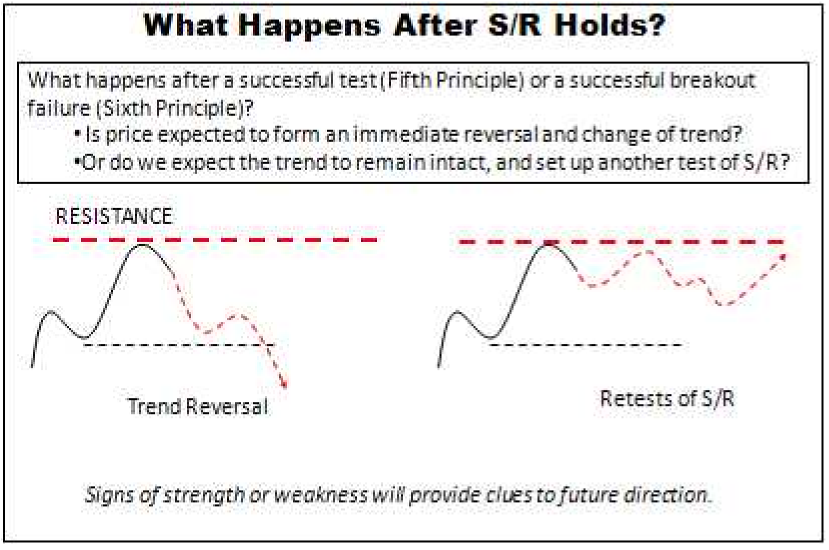


Figure 3.93 – What Happens After S/R Holds

I consider S/R as barriers to the trend. They provide some counter-trend orderflow, but are NOT automatically assumed to reverse the trend, until we see evidence of likely (or confirmed) reversal.

Evidence of a reversal obviously requires price acceptance past the point of trend change; a sign of strength in the new trend direction.

Evidence of a likely reversal occurs when we see price swings showing clear strength in the reversal direction, and weakness in the original trend direction, even though price has not yet past the point of trend change.

Until we see these signs, we assume the trend will prevail and return for either another test, or attempt at a breakout.

So… following a successful test or breakout pullback… we watch price action for clues as to which side is showing greater strength, the bulls or the bears. Signs of strength or weakness will alert us to the likely *future trend* direction.

And if for a period of time we‟re a little unsure… so be it. In this case though, my advice is to always trust the trend.

Let‟s approach this from a slightly different perspective, and I‟ll try to make it simpler.

- In the absence of weakness in the trend (when having tested S/R) expect a continuation of the trend (First Principle) which will take us back for another test of S/R (Fifth or Sixth Principle).

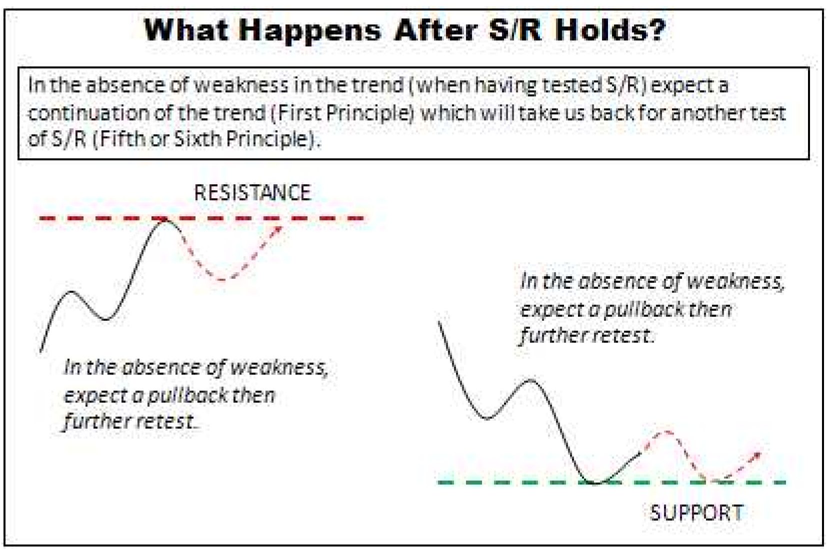


Figure 3.94 – What Happens After S/R Holds – In the Absence of Weakness

- If weakness is present in the trend (when having tested S/R), but there are no signs of strength in the reversal direction, expect a complex pullback (Second Principle) prior to taking us back for another test of S/R (Fifth or Sixth Principle).

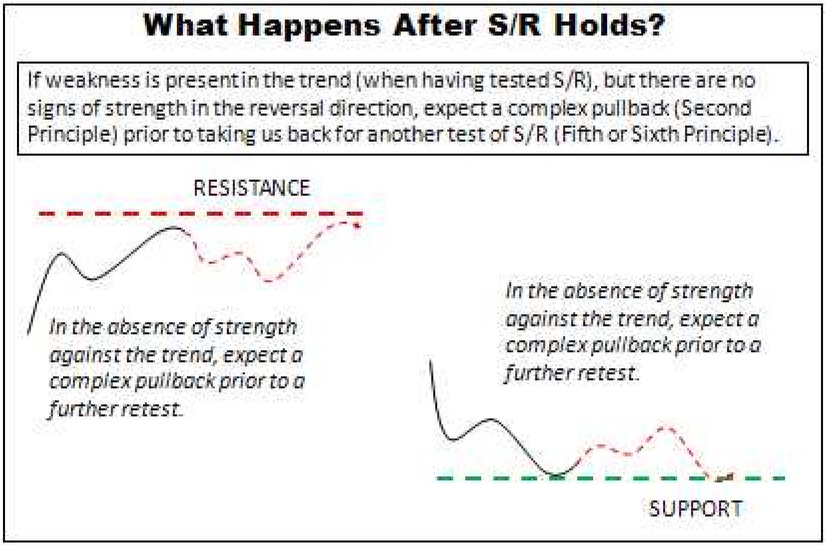


Figure 3.95 – What Happens After S/R Holds –
In the Absence of Strength Against the Trend

- If strength shows against the trend, expect a reversal. In this case, any retest of the S/R can be treated like a pullback in the direction of the new trend (First Principle).

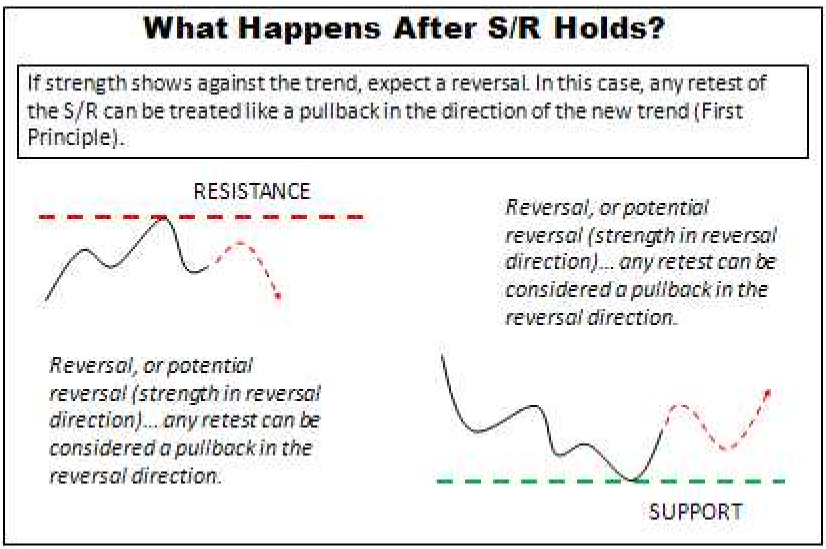


Figure 3.96 – What Happens After S/R Holds –
In the Presence of Strength Against the Trend

This post-S/R area can be a little confusing at times. Sometimes it takes a whole price swing or two to work it out. Remember though… you‟ll be updating your assessment bar by bar. Just make your best assessment, knowing that if you get it wrong you‟ll soon know and be able to adjust your bias.

And if in total doubt, always trust the trend until it is broken.

I‟ll be sure to include an example in chapter 5, Trade Examples.

3.4 – Initial Market Analysis Process

Having looked at the theory behind our initial analysis, let‟s combine it all into one Initial Market Analysis Process. A checklist will be produced which will also later become part of our Procedures Manual.

3.4.1 – Initial Market Analysis Process Summary

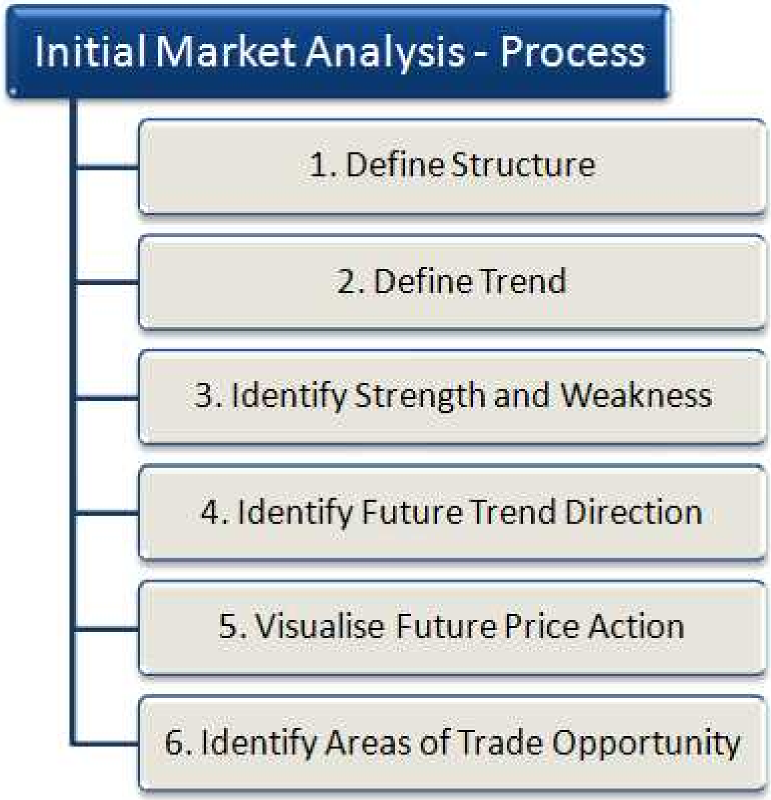


Figure 3.97 - Initial Market Analysis Process

Initial Market Analysis involves a six step process, as per figure 3.97.

The following checklist will walk you through the actions required for each step.

3.4.2 Initial Market Analysis Checklist

Step 1 - Define Structure

Define a structural framework within which our *trading timeframe* price action will move.
.
Actions:

- Identify areas of Support or Resistance on the *higher timeframe* (30 min) chart
    - Swing highs and lows

Step 2 -Define Trend

Assess the movement of past price action within our market structure framework.

Actions:

- Identify significant swing highs and lows on the *trading timeframe* (3 min) chart.

- Identify the trend direction
    - Up, down or sideways.

Step 3 - Identify Strength & Weakness

Analyse price movement within the trend to identify signs of strength or weakness.

Actions:

- Analyse momentum of recent price swings
    - Compare the momentum of the current price swing with the momentum of the previous price swing in the same direction? Is price faster or slower than before? What does that mean?
    - Compare the momentum of the current price swing with the momentum of the previous price swing in the opposite direction? Is price faster or slower than before? What does that mean?
    - Is the current price accelerating or decelerating? What does that mean?

- Compare projection and depth of recent price swings

    - Increased projection is a sign of potential trend strength. Decreased projection is a sign of potential trend weakness.
    - Increased depth is a sign of potential trend weakness. Decreased depth is a sign of potential trend strength.

- Identify signs of *failure to continue* (ie. failure to meet expectations).
    - Failure to continue is a sign of weakness

- Identify signs of strength or weakness via any miscellaneous methods
    - Volume analysis
    - Market Internal indicators

Step 4 - Identify Future Trend Direction

What is the likely path of future price action?

Actions:

- Determine the likely path of future price action, in accordance with the following six principles:

    - Within the S/R framework:

        - **First Principle** – We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

        - **Second Principle** - When an up or down trend shows evidence of weakness, we expect a higher likelihood of a complex correction rather than a reversal, until such time as the market shows both price acceptance and strength in the new trend direction.

        - **Third Principle** – A sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

        - **Fourth Principle** - When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behaviour of price post-breakout for clues as to future direction:

        - Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range
        - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

- At the edges of the S/R framework:

    - **Fifth Principle** – We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary.

    - **Sixth Principle** - If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behaviour of price post-breakout for clues as to future direction:
        - Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
        - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

Step 5 - Visualise Future Price Action

How do you expect price to behave? Visualise the future price action, based upon your expectations for *future trend* direction and its interaction with the market structure S/R levels.

Actions:

- What price action would validate your assessment of *future trend* direction?
- What price action would invalidate your assessment of *future trend* direction?

Step 6 - Identify Areas of Trade Opportunity

- Coming soon. ☺

I‟m perhaps jumping the gun a little here, as we haven‟t talked about how to do this yet. But I‟ve decided to include the step heading now, as it is part of your initial analysis process.

As to how to do that, well… that‟s for Chapter 4.

For now, we‟re just learning how to read price as it moves across our screens.

Next Process Step?

That concludes our initial analysis.

From here we conduct our ongoing analysis process - an ongoing process of updating our assessment of likely *future trend* and areas of trade opportunity, based upon new information provided by each and every candle.

That"s the subject of sections 3.5 (Ongoing Market Analysis - Theory) and 3.6 (Ongoing Market Analysis Process).

Before we look at that though, let"s look at an example of the full process of initial market analysis – defining the structure, identifying the trend, and determining the expected *future trend* direction.

KEEP IT SIMPLE

The initial analysis process has taken many pages to describe, as I"ve attempted to do so in as thorough a manner as possible (for an ebook). As you"ll see in the following example though, the process itself is quite simple and should take no more than a minute or so on initial opening of your charts.

Be careful not to get caught up in complexity. The process should be SIMPLE. If it"s not, then you"re probably trying too hard to predict exactly where price is going. This is not about prediction. We"re simply assessing the likely future path. We"ll then be monitoring ongoing price action to confirm that path, or amend it.

Don't be afraid to get it wrong. Ongoing analysis will be self-correcting.

If you"re finding it too hard, just refer back to our simple checklist steps…

That"s all there is to it.

3.4.3 – Initial Market Analysis Example

Figure 3.98 - Initial Analysis Example – Define Structure

Figure 3.98 shows the *higher timeframe* (30 min) chart for the market on July 28th, 2010, right at the UK session open (08:00 GMT, 17:00 my timezone).

Step 1 – Define Structure

I"ve placed the support and resistance areas on the chart above in order to define the market structure.

You"ll note they"ve been labeled as Spt A, Spt B, Spt C and Res A. Please note that while conducting my own analysis and trading, I don"t usually label S/R levels with names. This has been done in order to make it easier to refer to the S/R levels during this example.

We have support (Spt A) below price at around 1.5560, formed by the previous Asian session lows.

Further support is lower at Spt B (1.5505) from the prior US session lows, and Spt C (1.5440) which defined the prior UK session lows.

I"ve placed resistance Res A at 1.5625. Although this does not yet meet the definition of a swing high (due to only one lower candle high to the right of the swing high), it is the Asian session high point and will therefore be a potentially significant level.

The market has been in a longer timeframe uptrend (for two months now), so the 30 min chart shows no higher resistance; with the next daily chart resistance not being until 1.5820.

Step 2 – Define Trend

The *trading timeframe* (3 min) (figure 3.99 below) shows a recent change from uptrend to downtrend as swing low B formed below swing low A (the last swing low before the highest high at Res A).

Swing low B was followed by lower high C. And price has now broken below B.

Classic lower highs and lower lows!

The market is in a downtrend.

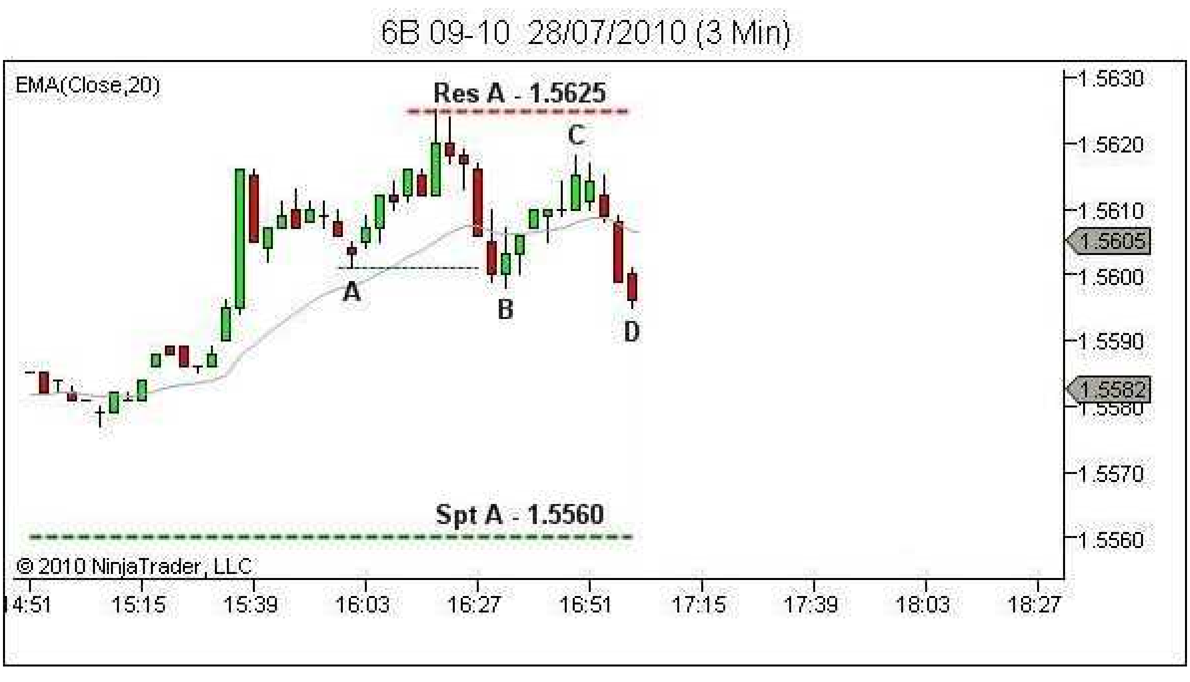


Figure 3.99 - Initial Analysis Example – Identify Trend

Step 3 – Identify Strength and Weakness

Analysis of momentum on the *trading timeframe* (3 min) (figure 3.100 below) shows strength initially on the bullish side, through stronger momentum on swing (a) and weaker momentum on swing (b).

However the sentiment has since changed. Comparison of swing (a) with (c) and (e) shows a reduction in bullish momentum. Comparison of (b) with swings (d) and (f) shows a clear increase in bearish momentum.

Figure 3.100 - Initial Analysis Example – Identify Strength & Weakness – Trading Timeframe

This is confirmed on the *lower timeframe* (1 min) chart shown below as figure 3.101, in which bearish swings (d) and (f) both show greater strength than bullish swings (c) and (e).

This places the strength on the bearish side and the weakness on the bullish side.

Figure 3.101 - Initial Analysis Example – Identify Strength & Weakness – Lower Timeframe

Of note though is the weakness of the projections P1 and P2 in comparison to the much greater depth D1, displayed on the *trading timeframe* (3 min) below in figure 3.102.

Figure 3.102 - Initial Analysis Example – Identify Strength & Weakness – Projection & Depth

Seemingly contradictory, this is not unusual just prior to the open of the major trading session of the day.

Strength is to the bearish side, but not by a great margin.

Step 4 – Identify Future Trend Direction

Price action is not currently near any of our S/R levels.

The trend is down.

The strength is still to the down side as well, albeit not showing great strength.

My expectation is in accordance with the First Principle of *future trend* direction:

- **First Principle** – We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

My expectation is for price to continue its current trend state, until reaching the area of Spt A at or around 1.5560, as displayed below in figure 3.103.

Figure 3.103 - Initial Analysis Example – Identify Future Trend

Step 5 – Visualise Future Price Action

How do I expect future price action to behave? What price action would validate this analysis?

- We need to see a continuation of strength on the bearish swings and weakness on the bullish swings.

- The opening of the UK session is a time of critical importance. It may result in short-term volatility. Any push higher on the open should be quickly and strongly rejected, and should not break above the last swing high.

What price action would invalidate this analysis?

- Further analysis will be required if the market shows any sustained strength on the open of the session, in particular if it breaks the last swing high.

An important point to note here is that the opening of a forex session is often a difficult time to conduct analysis (as is the opening of any other instrument, such as the daily emini futures open). Volatility can increase dramatically for a short period of time, as new traders establish themselves both long and short. Some traders will stand aside for the first five minutes or so of a session, to allow price to determine its proper direction. I prefer to conduct my analysis anyway, allowing me to be prepared for any trade opportunity that should develop during the opening few minutes, however I always show greater caution.

In this example though, it‟s fairly simple. Any push to lower prices should hold its level easily, as stops are triggered from the pre-session longs, adding to bearish orderflow. Any push higher will not benefit from extra „stops‟ orderflow until it breaks to new highs above Res A. So a push higher should fail quickly, or else will provide evidence of potential new buying (bullish strength), and therefore require a reassessment of my analysis.

Analysis should be conducted pre-session with expectation of possible short-term volatility, and consideration as to who will be trapped and/or stopped out if that volatility eventuates.

Step 6 – Identify Areas of Trade Opportunity

Sorry, not yet… We‟ll get to that in Chapter 4.

We now move on to ongoing analysis.

Remember – the analysis we have conducted so far is just my initial assessment of likely *future trend* direction. I‟ll be updating that assessment bar by bar as new data unfolds. So, if I‟m wrong I‟ll see it in a very timely manner, allowing me to reassess and adjust my expectations. And if I‟m right, I‟ll be prepared for any trade opportunity that will present, as price follows my expected path.

3.5 – Ongoing Market Analysis – Theory

Our initial analysis resulted in an initial assessment of the *future trend* direction. Ongoing analysis requires a bar by bar reassessment of our previous analysis, as more price action unfolds on the right hand side of our chart.

New data will arrive, one candle at a time. Each new candle being a source of information; most of which will offer nothing new or relevant; but some of which will alter our analysis, either strengthening or weakening our assessment of market sentiment and future price direction.

Every new candle is potentially significant.

Failing to monitor price with each new candle means we will be forced to be reactionary – surprised by price action developments and chasing setups and entries after they"ve become obvious to the crowd.

Ongoing monitoring ensures we maintain focus and maintain situational awareness - staying ahead of the current price action – assessing where it"s likely to travel, how that will impact the decision making of other traders, and where that will create trade opportunity.

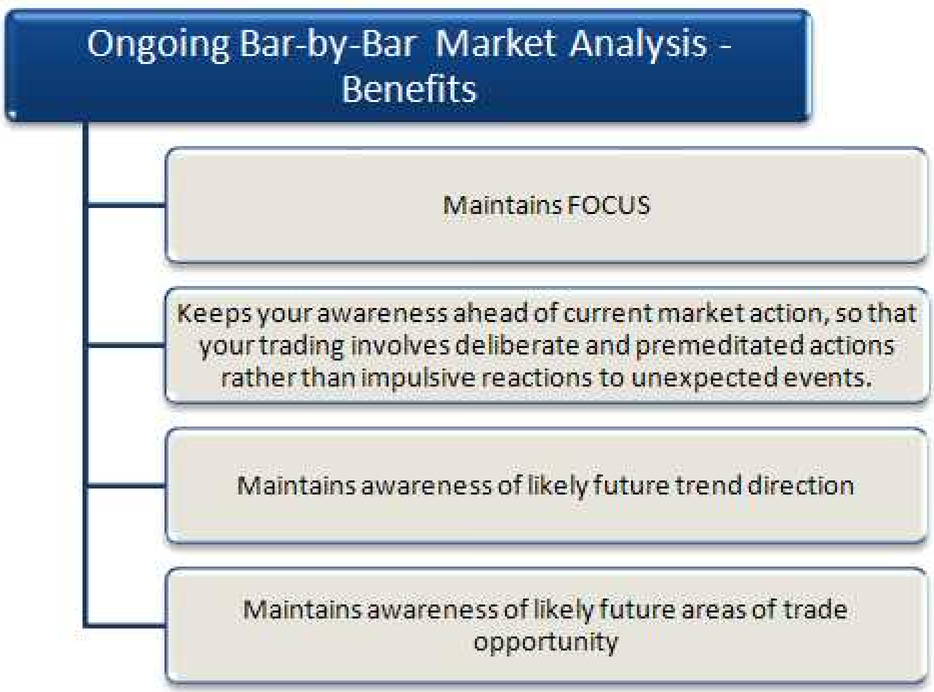


Figure 3.104 - The Benefits of Ongoing Price Action Analysis

Ongoing price action analysis can be conducted on all timeframes, however our main interest is with the *trading timeframe*. We question EVERY candle, to determine what it means with regards to the shift in sentiment between the bulls and the bears; and whether or not it changes our expectations for the future.

This is a step by step process, the first part of which is assessing the sentiment of the current candle pattern.

3.5.1 - Determine Candle Pattern Sentiment

We define each candle as one of nine types, as demonstrated in figure 3.101 below:

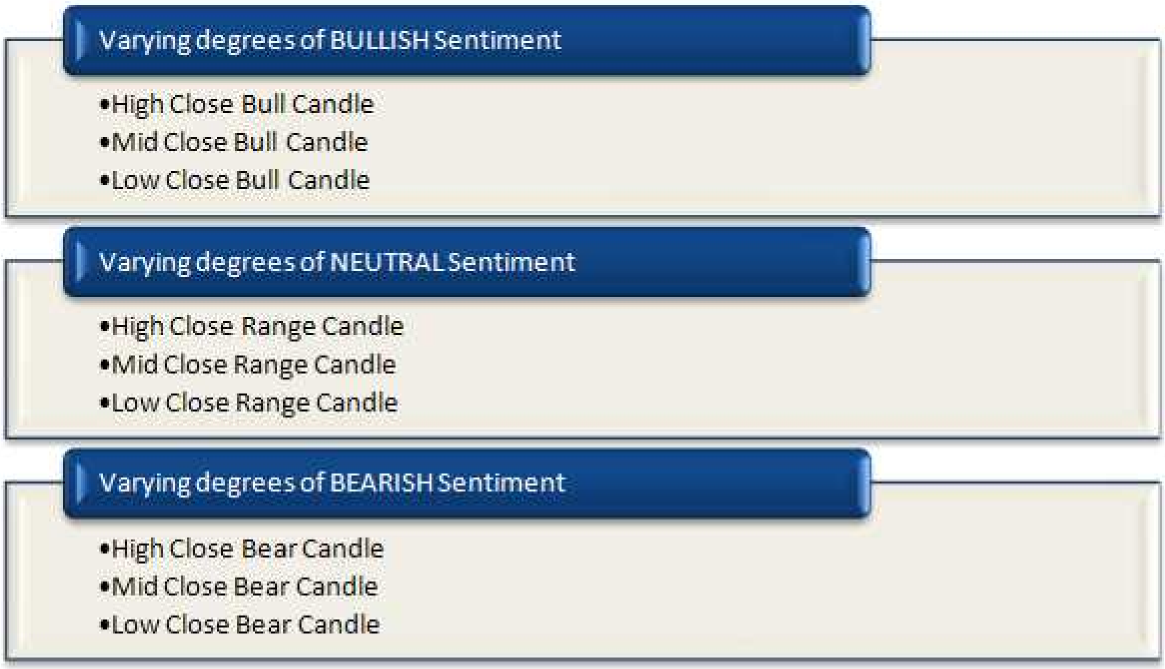


Figure 3.105 - Candle Classification and Sentiment

Classifying the candle in this way gives us an immediate feel for the sentiment of the short-term candle pattern.

All Bull Candles are bullish, but the sentiment varies slightly depending on its close position (high, mid or low).

All Range Candles are neutral, but the sentiment varies slightly depending on its close position (high, mid or low).

And the same applies to Bear Candles, which are bearish, although varying slightly in sentiment depending on their close position (high, mid or low).

The classification is made through observing the following characteristics of the latest candle:

- Close Comparison
- Close Position

Let‟s learn how to read candles in a way that I consider **superior to standard candlestick analysis**…

Close Position

The Close Position allows us to determine the sentiment of a single candle.

We define a candle as a High Close candle, Mid Close candle or Low Close candle, depending on where price closes within its high to low range.

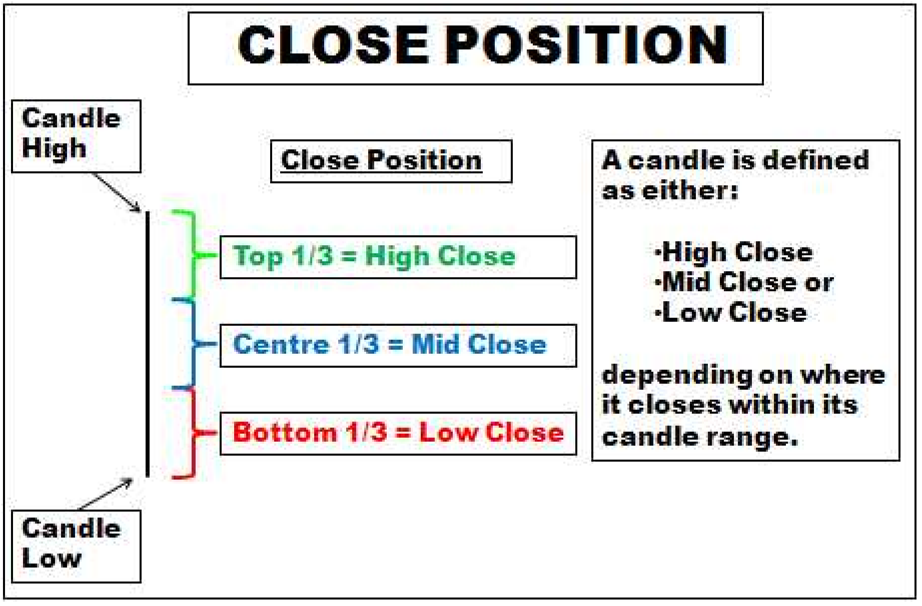


Figure 3.106 - Close Position - Definition

A **High Close candle** is one in which the closing price is within the upper third of the candle range. Examples of high close candles are demonstrated via candles (a) to (f) in figure 3.107 below. Note that all candles close in the upper third.

A high close candle displays bullish sentiment, for the period of that candle. However, you"ll note different degrees of bullishness within each candle. For example, comparing (a) and (b) we see that (b) was able to drive prices higher from its open, showing very little resistance from the bears, whereas (a) initially fell from its open before being able to fight its way back higher. Candle (a) is potentially a little less bullish than candle (b).

All of these candles from (a) to (f) are bullish; with a small difference in degree of bullishness.

A **Mid Close candle** is one in which the closing price is within the middle third of the candle range. Examples of mid close candles are demonstrated via candles (g) to (l) of figure 3.107.

The sentiment of a mid-close candle is considered more neutral, as price has been driven both higher and lower, before closing somewhere mid range.

Note again the slight difference in sentiment between candles. Although all are neutral, (i) for example is more on the bullish side of neutral compared with (l) which is on the bearish side of neutral.

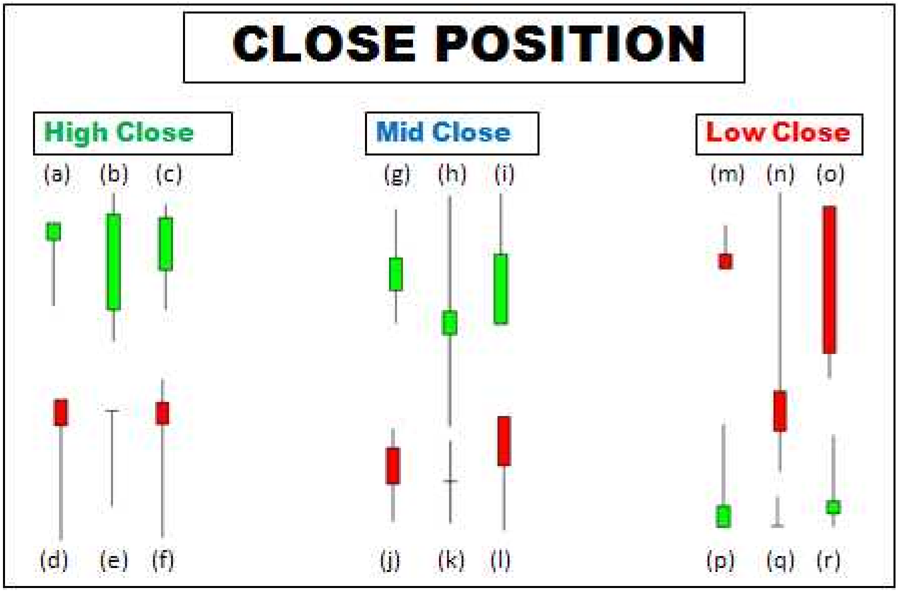


Figure 3.107 - Close Position - Examples

A **Low Close candle** is one in which the closing price is within the lower third of the candle range. Examples of low close candles are shown in figure 3.107 as candles (m) to (r).

The sentiment of these candles is bearish. Again note the slight difference in sentiment. While all indicate bearish sentiment, candle (m), for example, was only able to achieve a narrow range, while candle (o) demonstrated significant bearish pressure which drove price down a significant distance.

Observing and classifying the candle in accordance with the Close Position, provides us with a quick assessment of the sentiment of that <u>individual candle</u> – bullish, neutral or bearish. And the path taken by price within the candle creates slight variations in the degree of bullish/neutral/bearish sentiment.

We now improve on this classification of sentiment, through considering the relationship between the last two candles.

Close Comparison

We define a candle as a Bull Candle, Range Candle or Bear Candle, depending on where price closes with respect to the previous candle‟s range.

A **Bull Candle** is one which closes above the high of the previous candles range. This is demonstrated via (a) to (c) in the examples shown below (figure 3.109). Note that all three candles close above the high of the previous candle. A Bull Candle is considered to be displaying bullish sentiment.

A **Range Candle** is one which closes within the range of the previous candle. This is demonstrated via (d) to (f) in the examples below. Note that all three candles close within the range of the previous candle. A Range Candle is considered to be displaying neutral sentiment.

A **Bear Candle** is one which closes below the low of the previous candles range. This is demonstrated via (g) to (i) in the examples below. Note that all three candles close below the low of the previous candle. A Bear Candle is considered to be displaying bearish sentiment.

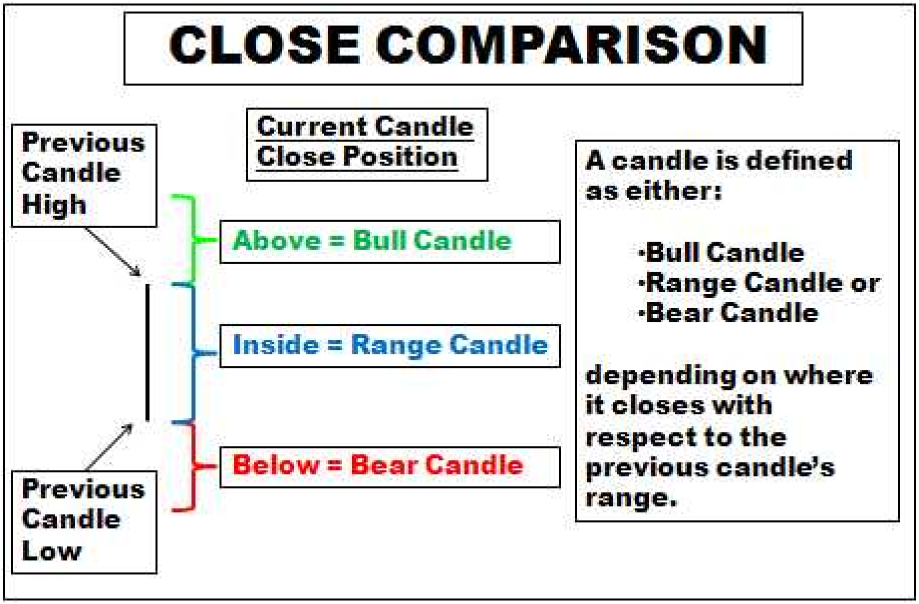


Figure 3.108 - Close Comparison - Definition

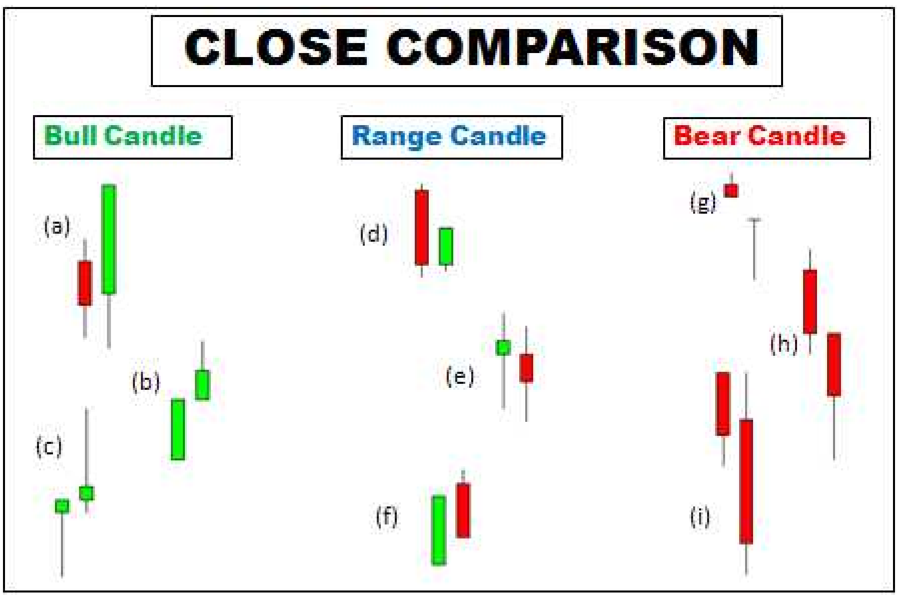


Figure 3.109 - Close Comparison - Examples

Determining Pattern Classification and Sentiment

Let's determine the sentiment of the latest 2-candle pattern. The starting point is simple. We look at the Close Comparison:

- Bull Candle = bullish 2-candle pattern sentiment
- Range Candle = neutral 2-candle pattern sentiment
- Bear Candle = bearish 2-candle pattern sentiment

The Close Position (single candle pattern) will then be considered in order to determine the different degrees of bullishness or bearishness.

Refer back to the examples in figure 3.109 on the previous page.

While (a) to (c) all demonstrate a Bull Candle, and therefore bullish pattern sentiment, there are varying degrees of bullishness in each, which become obvious when adding in the Close Position to the pattern definition.

Candle (a) is what I refer to as a **High Close Bull Candle**. Both the high close and the bull candle components represent bullishness. Combined, these two indicate strongly bullish sentiment.

Compare this with (b) which shows a **Mid Close Bull Candle**. Price once again closed above the prior candle, but this time with a neutral close at mid-candle. Although still bullish, sentiment is less bullish than example (a).

In (c) we see a **Low Close Bull Candle**. Yes, it closed above the previous high, but higher prices were clearly rejected driving price to close near the low of the last candle. We have bullish sentiment (bull candle) combined with a bearish sentiment (low close). This is a weak bullish move.

Combining our close position analysis with our Bull Candle provides us with varying degrees of bullishness.

The same concept applies for our Range Candles, demonstrated via examples (d) to (f) above. A range candle on its own implies neutral sentiment, but by also considering the Close Position we gain some greater insight into the varying nature of that neutral sentiment.

Looking at (d) for example, we see a **High Close Range Candle**. The latest candle is a high close candle, closing right on the highs. Individually this appears bullish, but comparing it with the previous candle we see fact that the high close candle is simply retracing approximately 50%

of the previous strongly bearish low close candle. Combined, this is probably slightly on the bearish side of neutral.

Likewise with example (f), **a Low Close Range Candle**; this combination is more on the bullish side of neutral.

While example (e), a **Mid Close Range Candle**, is clearly neutral with price testing higher and lower twice now before settling closer to mid-range of both candles. Neither side is showing dominance.

A Bear Candle is one which closes below the lows of the previous candle. On the surface, that sounds bearish, but the degree of bearishness will vary when also considering our Close Position analysis.

Example (i) is a **Low Close Bear Candle**, demonstrating extremely bearish sentiment, as both the Close Position and Close Comparison components imply bearishness.

Contrast that with example (g), a **High Close Bear Candle**, which has clearly rejected lower prices and closed up at its highs. Still bearish, but showing some sign of bullish orderflow opposing our bearish sentiment. This 2-candle pattern displays weak bearish sentiment.

Whereas example (h) is somewhere in-between, demonstrating a **Mid Close Bear Candle**. Once again we have some bullish orderflow pushing price off the lows and opposing our bearish sentiment, but to a lesser degree than example (g).

The next step... consider our 2-candle pattern sentiment in the context of current market price action.

But What About Candlestick and Price Bar Reversal Patterns?

If you"re a fan of candlestick reversal patterns, or price bar reversals, take note of these as well. They"re a great way to determine sentiment. My aim, through defining every candle based upon its Close Position and Close Comparison, is to have you assessing sentiment after <u>every</u> candle. Reversal patterns don"t allow you to do this. For this reason, I believe this form of analysis is superior to simple candlestick analysis.

However, if you relate particularly well to these candlestick reversal patterns, by all means use them.

Please refer to my free video series, if you wish to study these patterns:

- Candlestick Reversal Patterns: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Candlestick-Charting-Videos.html

- Price Bar Reversal Patterns: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Complete-Price-Bar-Reversal-Video-Series.html

Miscellaneous

Feel free to also consider any additional analysis tools which you may choose to use, such as volume or market internals. What are they telling you about the sentiment of this particular candle or candle pattern?

Candle Pattern Sentiment Wrap-up

The process of ongoing price action analysis starts with determining the sentiment of the current candle pattern. We do this through the process of analysing the Close Position and the Close Comparison applicable to that pattern.

As demonstrated in the previous examples, this is a quick process that should take no more than a couple of seconds.

It provides us with a feel for the short term sentiment of the current candle pattern. Who is in control of price – the bulls or the bears? And to what degree are they in control?

Chart based examples will follow shortly, once the whole process is defined.

3.5.2 – Consider the Context

„Consider the Context‟ means we consider where the current price pattern appears with respect to the background market environment and price action, and what that means.

The same pattern can have numerous meanings, depending on where it occurs in the market.

Referring to figure 3.110 below, we can see that the Low Close Range Candle on the left hand side is occurring after a weakening of an uptrend right into an area of resistance. The first bullish candle broke above recent price action and penetrated the resistance area by a couple of pips before being rejected. Trapped longs will be exiting on any break below this candle. Although a low close range candle is generally considered to display neutral sentiment, when we consider the location of the pattern it has reasonably bearish connotations.

Compare that to the low close range candle on the right hand side, which is occurring within the middle of a period of narrow range sideways congestion. The occurrence of this pattern in this location shows absolutely no sign of any potential change to market sentiment. This is clearly neutral.

Figure 3.110 - Placing the Pattern into Context with Background Market Structure and Price Action

In considering the context of background market structure and price action, I primarily look at where price is in relation to three main areas – the location within the S/R structure, the location within the trend, and where we are in reference to key swing highs or lows.

You"ll note as we discuss these areas of influence that they simply raise a lot of questions rather than provide you with answers. Fixed rules don"t apply here. There is no rule that states "if a bullish sentiment pattern occurs at position xyz on a chart, then it means …"

Every occurrence of every pattern is unique.

By placing the pattern into the context of background structure and price action, we are ultimately attempting to gain a *feel* for how it impacts upon the strength and weakness of the underlying trend, and how that might impact upon our expected *future trend*.

While many elements of a price pattern can be objectively seen on a chart, determining the influence that pattern will have on *future trend* direction is a purely subjective process.

You gain that *subjective feel* through questioning what you see on the charts.

Where is price in relation to S/R? Where is it in the trend? Where is it in relation to key swing highs and lows? And what does this mean?

Support and Resistance

- Where is the pattern occurring with respect to *higher timeframe* support and resistance?

- Has the market shown strength or weakness on approach to the S/R area? Is the current candle pattern sentiment continuing this strength or weakness, or has something changed?

- Is the pattern showing signs of orderflow opposing the move into S/R, such as tails rejecting price at or near the S/R level?

- Has the pattern breached the area of S/R? If so, is it now showing signs of acceptance or rejection of this new area?

Trend

- Where is the pattern occurring within the current trend?

- Is it on an extension? Is it early in the move, or late and overextended? Has it projected past the previous swing high/low?

- Is it on a pullback? Is it early in the move, or has it continued deeper than anticipated? Is it a single swing pullback, or is this pattern a part of a multiple swing retracement.

- Or is the pattern within a sideways trading range or other form of consolidation pattern?

Swing Highs and Lows

- Is price testing any areas of swing highs or lows? Of particular importance are those which lead to a change of trend definition; how is price reacting at those swing highs or lows?

For an uptrend:

- Pullbacks to previous areas of swing low support should be watched closely. We expect them to hold. Is the price action showing signs of the level holding, or is it threatening to break? If it breaks, is price showing signs of rejection (opposing orderflow / difficulty continuing) or is price accepting this new area?

- Pullbacks to previous swing highs (within an uptrend) are not as critical, but should still be watched for their reaction.

- Extensions are expected to break the previous swing high. Is price action supporting that premise, or is the candle pattern showing weakness. If it can‟t exceed the previous swing high, we need to be alert for further signs of weakness which may forecast a complex correction or reversal.

For a downtrend:

- Pullbacks to previous areas of swing high resistance should be watched closely. We expect them to hold. Is the price action showing signs of the level holding, or is it threatening to break? If it breaks, is price showing signs of rejection (opposing orderflow / difficulty continuing) or is price accepting this new area?

- Pullbacks to previous swing lows (within a downtrend) are not as critical, but should still be watched for their reaction.

- Extensions are expected to break the previous swing low. Is price action supporting that premise, or is the candle pattern showing weakness. If it can‟t break the previous swing low, we need to be alert for further signs of weakness which may forecast a complex correction or reversal.

For a sideways trend:

- Is price testing a range boundary?

- Has the market shown strength or weakness on approach to the boundary? Is the current candle pattern sentiment continuing this strength or weakness, or has something changed?

- Is the pattern showing signs of orderflow opposing the move into the range boundary, such as tails rejecting price at or near the level?

- Has the pattern breached the area of range S/R? If so, is it now showing signs of acceptance or rejection of this new area?

3.5.3 – Does it Support our Premise?

Having considered the sentiment of the pattern, and where that is occurring with respect to our market structure, we now ask whether or not it supports our premise?

By premise, I refer to our expectation for *future trend* and the price action that would support that trend.

Is this pattern meeting our expectations for future price action?

- Yes… We await the next candle.
- No… Decide whether to hold for the next candle, or to reconsider from the start of our Initial Market Analysis.
- Unsure… Just wait… there will be a new candle along shortly.

You‟ll know when something is not right – the price action will surprise you.

Expecting a slow crawl into an area of resistance, you‟ll suddenly see a strong impulse right through the area closing on its high.

Expecting a breakout of a level, you‟ll observe a second failure to push through the level. Unexpected weakness!

Expecting continuation of an uptrend, the next price extension stalls at the previous swing high, showing unexpected bearish orderflow.

Evidence of something surprising does not necessarily invalidate your plans for future price trend – but it should put you on high alert and have you watching the following price action closely.

Figure 3.111 - Expectations Invalidated

In figure 3.111 above, assume we had expectations for the *future trend* to continue pushing resistance and eventually breaking through to higher prices.

Then, to our surprise, the next candle is a low close bear candle, displaying strong bearish sentiment. Even more so in this case, as placing the latest pattern into the context of the market structure and previous price action, we see that price has pushed with strength off the resistance area and dramatically forced a change of trend by breaking and holding below the recent swing low.

Clearly, this does not support our original plan.

We‟re out of sync with the current price action. It‟s time to revise our expectations.

3.6 – Ongoing Market Analysis Process

We‟ll now summarise the process and provide a checklist, as we did with the Initial Analysis.

3.6.1 – Ongoing Market Analysis Process Summary

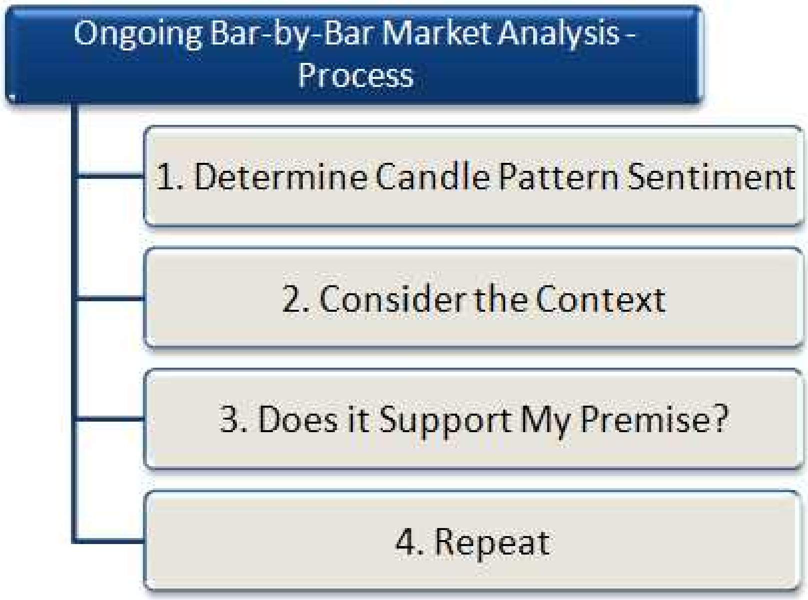


Figure 3.112 - Ongoing Market Analysis Process

Ongoing (Bar by Bar) Market Analysis involves a four step process, as per figure 3.112.

The following checklist will walk you through the actions required for each step.

3.6.2 - Ongoing Market Analysis Checklist

Step 1 – Determine Candle Pattern Sentiment

Classify the candle pattern and determine the short-term sentiment of price.

Actions:

- Classify the candle pattern

    - High / Mid / Low Close
    - Bull / Range / Bear Candle
- Determine the sentiment of the pattern

Step 2 – Consider the Context

Every pattern is unique and MUST be considered in the context of the background market environment in which it occurs.

Actions:

- Where is the current price action in relation to key market structure features:
    - Support or Resistance
    - Trend
    - Swing Highs and Lows
- What does this mean with respect to the sentiment of the pattern and the potential future price action?

Step 3 – Does it Support my Premise?

Is the market action continuing as expected, or is something indicating we"re out of sync with market flow?

Actions:

- Does the current price action and sentiment support our previous expectations for future price action?
    - Yes
        - Await further price information.
    - No
        - Decide whether to hold for the next candle, or to reconsider the Initial Market Analysis.
    - Unsure
        - Wait for further price information.

Step 4 – Repeat

Actions:
- Repeat the process as new information appears on the chart.

KEEP IT SIMPLE

As with the initial analysis process, this ongoing analysis has taken many pages to describe. However, what may appear to be quite a complex process is in actual fact quite simple to perform.

My analysis has developed over the years as a subjective and intuitive process.

The complexity appears as a result of trying to get the essence of that process into writing, in as reproducible form as possible.

Once again, the ongoing analysis should take no more than maybe 10-15 seconds. Any more than that and you‟re trying too hard to find certainty, where there is none.

Experience will rapidly improve your ability to read the market flow. And in time you‟ll do so without checklists. In the meantime, use them as a prompt.

- You already have an expectation for where price is going.
- Is the latest price action supporting that premise, or does it need to be reconsidered?

That‟s the two sentence summary version of „Ongoing Bar-by-Bar Market Analysis‟.

Keep it simple. And as before, don't be afraid to get it wrong. Ongoing analysis will be self-correcting.

3.6.3 – Ongoing Market Analysis Examples

Let"s continue with the example used in section 3.4.3, Initial Market Analysis Example.

The following chart reproduces our expectations for *future trend* direction.

Figure 3.113 - Ongoing Analysis Example – Future Trend Expectations

My expectation is for price to continue its current trend state, until reaching the area of Spt A at or around 1.5560.

What price action would validate this analysis?

- We need to see a continuation of strength on the bearish swings and weakness on the bullish swings.
- The opening of the UK session is a time of critical importance. It may result in short-term volatility. Any push higher on the open should be quickly and strongly rejected, and should not break above the last swing high.

What price action would invalidate this analysis?

- Further analysis will be required if the market shows any sustained strength on the open of the session, in particular if it breaks the last swing high.

Let‟s now see the following price action

Figure 3.114 - Ongoing Analysis Example – Bar by Bar Analysis (1 of 3)

We‟ll progress bar by bar through the chart considering the first three steps of the ongoing market analysis process:

1) Determine Candle Pattern Sentiment
2) Consider the Context
3) Does it Support my Premise?

Where a candle shows significant information, I‟ll go through this three step process. When a candle provides little new information, or provides similar information to surrounding candles and can be grouped together, I‟ll just summarise my thoughts in order to save time.

As you read through this, please recognise that it‟s not a mechanical process I go through with a checklist on the completion of each candle. The notes here are an approximation of the thought processes when a checklist is followed. The reality is that with experience, much of the analysis occurs in real-time as the candles are being formed – not just at the end of each candle.

In any case, although it‟s lengthy, my hope is that it helps you see how the process modifies your premise candle by candle, and helps to maintain focus.

Candle A

- High Close Bull Candle – Very bullish opening move
- Not near S/R. No change to trend definition. Of note, the candle *failed to continue* below the low of the previous candle, and rallied sufficient distance to retrace two previous low-close bearish candles. It has not exceeded the recent swing high.
- While more bullish than I‟d like to see, potential volatility was anticipated at the session open. The premise is not invalidated unless the swing high is broken. However I am on high alert and need to see this rally stall quite quickly.

Candle B

- Mid Close Range Candle – Neutral sentiment; bullish side of neutral due to the bullish close position of candle A and the tail below candle B.
- No change to trend definition. Failure to continue higher. The pullback has shown some selling and has potentially stalled.
- This is supports my premise. Failure to continue higher shows a lack of commitment from the initial opening bulls. Ideally, this weakness will continue and price will fall from here. However, price action may continue for a second thrust higher. The premise remains valid unless the swing high is broken. *Future trend* direction remains down.

Candles C & D

- Both Mid Close Range Candles - showing neutral sentiment and continued weakness in the bullish direction.
- Pullback has stalled. Price tested below B and attracted some buying, but only sufficient to get to a mid-close.
- Premise remains. Still expecting the trend to continue down.

Candle E

- Low Close Bear Candle – Strong bearish sentiment.
- Downtrend continues through a push to new lows. Previous swing low broken, as expected. This candle will have trapped longs who failed to get out on the break below the session opening candle A. This will provide some short-term resistance at around the 1.5590 level.
- This supports my premise beautifully. I expect the downtrend to continue to lower support.

Figure 3.115 - Ongoing Analysis Example – Bar by Bar Analysis (2 of 3)

Candle F (summary)

No change from Candle E.

Candle G

- High Close Range Candle – Neutral sentiment, slightly bearish.
- Downtrend remains intact. Narrow range showing no commitment from the bulls but short term profit taking by the bears.
- This is supports my premise. Strength continues in the bearish direction. Any pullback forming from G will need to display weakness. Expect some resistance from the lows of A due to trapped longs. Price should not exceed 1.5590/600.

Candles H & I (summary)

No change in premise from Candle G. The pullback has confirmed weakness in the bullish direction.

Candle J

- Low Close Bear Candle – Bearish sentiment continues as per E and F.
- Downtrend continues with a break to new lows.

- Price action still supports my premise. Strength still exists on the bearish side. Pullbacks are still weak. Expect a slowing into support. If we have another pullback it should be weak again.

Candle K

- High Close Bull Candle. Well that one was a surprise. Bullish sentiment.
- Complete reversal of previous low close bear candle. Did not break the highs of I, which would be significant, although change of trend would not be triggered till a break of A. Shorts now trapped which will slow any retest of the J lows.
- My premise was for strength on the downside, with weak pullbacks. This strong pullback will need to fail quickly in order to maintain my expectations. I am on high alert. Further follow through to the upside will require a reassessment of my *future trend* direction. Immediate reversal lower is required to confirm my current plan.

Candles L to Q (summary)

Candles L to Q failed to continue higher. Bullish candle K was unable to overcome the bearish downtrend orderflow. The fall to Q was weak; not surprising given the trapped shorts from the J/K reversal.

The strength of K followed by the weakness of L to Q would have me tentatively watching for a reversal in the vicinity of Q (retest of J lows). Had a reversal occurred there, I would have changed my expectations to a complex retracement, possibly back up to the vicinity of A (in accordance with the second principle of *future trend* direction).

Candle R

- Low Close Bear Candle – Bearish sentiment.
- Candle R continues the move to support. Although there is some acceleration through R, it is most likely due to stops and breakout entry orders below J.
- As we are approaching S/R, the original premise has played out and it‟s time to find the future path. It‟s time to reconsider our analysis from first principles. The approach to S/R is not overly strong, so I am looking for a test which holds (in accordance with the fifth principle of *future trend* direction). If I‟m wrong and price does breach the support level, I expect the breakout to be rejected, although I will watch the breakout price action for further clues.

Figure 3.116 - Ongoing Analysis Example – Bar by Bar Analysis (3 of 3)

Candles S to U (summary)

- The market tests the level to the pip on candle T. The premise was for a test which held. That has occurred. Price action needs to be watched CLOSELY here, as always in an area of S/R. Any break above the low candles will bring in a new premise; expecting a correction higher involving either a complex retracement before setting up a retest of support, or if showing signs of bullish strength then a possible reversal expecting the *future trend* to rally up to overhead resistance Res A.

Candle V

- High close bull candle – bullish sentiment
- Bullish pressure rallies price, breaking above the recent 3 candle congestion at lows. Note that it has not changed the trend definition, and won‟t do so until a break above L. A small tail at the top of the candle shows some selling, not entirely unexpected as we‟re in the vicinity of R‟s break below the J/K reversal.
- Does this support my premise? As mentioned above, the break above the lows has given me a new expectation for *future trend* – expecting continuation higher for a complex pullback, or potential rally to Res A. Given the fact that V has hit a small pocket of resistance (J/K swing

low) I‟ll expect a short pause before continuing. Any pullback should be weak in order to confirm my premise. A break below T will invalidate the premise and require reassessment.

Candles W to a (summary)

Candles W to Candle (a) form a weaker retest. This bearish price swing has low momentum and an inability to retrace the whole body of V. Support has been found at the lows. We now have strength on the move up from T to V, and weakness from W to (a). Strength is on the bullish side and weakness is on the bearish side. My premise is supported and I expect price to soon display a continuation higher.

Candle b

- High Close Bull Candle – very bullish.
- Stops triggered above X helping to propel the market higher.
- This is very much supporting the premise for trend reversal and a move to resistance Res A.

Candles c to e (summary)

Strength has come into the market. A change of objective trend definition has been confirmed to upwards. Although a pause or pullback is likely before the resistance level, my premise is for continuation to resistance. If strength continues like this right to resistance, I‟ll be anticipating a breakout. Post break-out price should be watched closely for signs of weakness on either the breakout or the breakout pullback.

This example so far has been one in which the premise (our expectation of *future trend* direction) proved valid. Let‟s quickly review a situation where the premise is proven invalid and requires amendment.

Figure 3.117 - Ongoing Analysis Example 2 – Initial Market Analysis

Figure 3.117 above shows the market on August 3rd, 2010. Support exists below price at 1.5900. Resistance is above at 1.5695.

An earlier attempt to breach resistance had failed (just off the left of the chart), followed by a period of weakness as price held an extended pullback. Recent bullish strength has come into the market and set up for a second test of the resistance area.

Our premise for the *future trend* direction is a continuation of the trend to the area of resistance.

Given the weakness developing in the last two candles (low close range candle & mid close bull candle), I‟ll expect a pullback prior to the test. Pullback price action should show weakness, ideally holding above the upper level of the previous congestion (in the vicinity of 1.5935), for the premise to remain valid.

Let‟s look at subsequent price action and talk through the significant candles.

Figure 3.118 - Ongoing Analysis Example 2 – Candle by Candle

Candle A

- Low Close Bear Candle – bearish sentiment, although the lower tail is a positive sign, showing buying pressure on the pullback.
- This candle has commenced our pullback. Note it is also testing the point of initial impulse upwards (the low of the large green candle). Some support can be expected here, as evidenced by the lower tail.
- This price action supports my premise. I"m expecting strength on bullish extensions and weakness on bearish pullbacks, continuing the trend to resistance.

Candles B to D (summary)

Candles B to D all display neutral sentiment and confirm the weakness of the pullback. Price action should be rallying from here, to support our premise of a second push to the resistance area.

Candles E to G (summary)

This pullback is holding at the lows for longer than I like, however Candles E to G are showing increasing bullish sentiment, from bullish/neutral for E and F (both high close range candles) to bullish for G (high close bull candle). The key feature of these three candles is the tails, in which lower prices were tested and rejected. If it can"t go down, it"s going up!!! The initial analysis bullish strength has been followed by a weak pullback to G, and although longer in duration, it appears to be over now with some strength coming back into the market. Continuation is expected from here to the resistance zone.

Candle H

- High Close Bull Candle (just) – Bullish, but weak.
- Did not break swing high at A.
- No change to the premise, although I would have preferred to see a stronger push and a break of the candle A highs within this or the next candle. Continuation of the extension should have more strength than this.

Candle I

- Low Close Bear Candle – bearish sentiment.
- Price reversed, breaking and closing below candle H lows. Swing high A and swing low G have not been tested yet. We have a potential 123 pattern forming, with H producing a lower high unless price rallies strongly in the next candle.
- This latest candle does NOT support my expectations. The rally should have occurred on strength. The momentum of G to H is observed to be shallower than the large green candle surge prior to A. Weakness has appeared on the rally. My expectation is now for a complex pullback (second principle); a second leg down holding above the G lows, before again resuming the push for resistance. To support my premise price must show reducing strength into the lows of G, then reverse. To invalidate my premise, price will break the lows of G.

Candle J

- Low Close Bear Candle – bearish sentiment.
- Price has just broken the G lows (by one pip). Note that the trend has not changed yet, until breaking the lows of the earlier extended pullback / consolidation.
- At this stage I have no real premise. I need more information. I"ll wait to see a test of these lows, which will establish either a sideways range if they hold, or a downtrend if they break.

Candle K

- Low Close Bear Candle - Sentiment is bearish.
- The lows have failed and the trend has changed to down.
- The last bullish move (G-H) showed weakness. The current bearish move is showing strength. *Future trend* direction is down, with an expectation of a continuation of the downtrend to the support level 1.5900.

It‟s a pretty simple process really. As mentioned before, if you feel you‟re getting stuck with too much complexity, drop back to basic principles

- **You already have an expectation for where price is going.**
- **Is the latest price action supporting that premise, or does it need to be reconsidered?**

The process will also get easier with experience. Volume Five – Trader Development will discuss ways to maximise your learning. But you don‟t have to wait till then. Practice now as much as you can.

3.7 – Practice

Market Analysis should be practiced as much as possible. The practice never ends, as there is always more to learn. It‟s a process of constant growth and personal development, as we gain more experience in reading the flow of the market through years and years of exposure.

- Experience leads to a better read and a more accurate assessment of likely future price direction.

- A more accurate assessment of likely future price direction leads to better identification of trade opportunity.

- Better identification of trade opportunity leads to greater profitability.

Live trading provides us the opportunity to continually practice our analysis; and our market review sessions and simulator replays provide the opportunity to compare our performance with hindsight perfection. Replaying the patterns of market behavior reinforces our intuitive ability to read and follow the flow of price.

However you don‟t need to be trading live to benefit from this. Practice can be achieved right now through conducting live market analysis (with no expectation of trades). Just follow price action. Determine where it‟s going next through applying your Initial Market Analysis process. Then adjust your expectation of future price action bar by bar as new candles appear on the right hand edge of your charts.

Take some time out to practice. Just follow price action. Decide where you expect it to go from here; and adjust that through bar by bar ongoing analysis.

Once again, I would like to reiterate the importance of SIMPLICITY. Don‟t make this more complicated than it needs to be. Just question each bar – does it support your initial assessment. If so, great! If however it does something unexpected, then decide whether to change your expectations for future price direction, or wait for more information. If you‟re unsure, then just wait. Another candle will be along shortly.

And do not concern yourself with setups or trades. Just follow price action.

3.7.1 Market Structure Journal

There is a free ebook available on the YourTradingCoach website, titled “The Greatest Trading Book – Ever!” Download a copy from the following address, read it, and start creating your own Market Structure Journal.

http://www.yourtradingcoach.com/products/ebooks/the-greatest-trading-book-ever.pdf

A Market Structure Journal is a folder of chart printouts, annotated with market structure observations. This document will be a key part of your practice.

Keep charts and notes demonstrating any key observations you make about how your market reacts at certain points.

- What signs does the market give, that indicate a trend will just keep running?
- How does the market behave on retests of climactic reversals?
- How does the market react at key times of day, such as the open of each new forex session?
- How does the market react on testing daily highs and lows?
- How does a typical pre-FOMC or pre-NFP range day react? Are the tests of the range boundaries typically single touch clean rejections, or are they spiky with multiple tests of the S/R region before reversing?

And so on!

Record any observations on the charts.

I also recommend adding any key observations into a single “Lessons Learnt” spreadsheet. This is a great review and study tool, for strengthening your read of market action.

Implement a Market Structure Journal now. Become a student of market analysis. Study it. And make it a regular part of your practice.

Repetition and reinforcement will greatly improve your ability to intuitively perceive patterns of market behavior, as they occur; vastly improving the quality of your analysis and your assessment of likely future price action.

3.8 – Conclusion

In this chapter we learnt how to analyse market movement. There was no expectation of how or where to trade – that comes later – this chapter was about just getting in sync with price movement. Seeing where it has been; and getting a feel for where it"s going to go.

We observed where price has been through placing our price action into a framework of support and resistance; and identifying the trend within that framework – either up, down or sideways.

We learnt how to assess the strength or weakness of the trend, through analysis of momentum, projection & depth and failure to continue.

We learnt how to determine the likely path of price, based upon the six Principles for identifying the *future trend* direction.

And we learnt how to update our analysis bar by bar; through analysing the internal sentiment of individual candles or candle patterns, in order to determine whether they support or reject our initial assessment.

Once you are comfortable with this process, it"s time to start trading.

3.9 – Addendum to Chapter 3 – Alternative Questions for the Conduct of Price Action Analysis

Over the years I"ve trialed numerous other methods of discretionary analysis; the best by far comes from bar by bar assessment of price action in order to (a) maintain focus and (b) maintain your assessment of the likely path for future price action.

The process described in Chapter 3 is the process I use on a daily basis. However there are other ways to do a bar by bar assessment.

You may wish to incorporate other methods you currently use (preferably not lagging indicator based methods). Or you may wish to consider some of the following list.

While these aren"t part of my *official* process, I do make use of these questions from time to time, in particular when I"m just not feeling in sync with the current market action.

Alternate questions are useful in that sometimes they trigger a different understanding of price action; allowing you to see the market in a new and better way.

There is some overlap in questions; but each is asked in a slightly different way.

If you like any of them, use them. If not, just stick to the normal process.

Alternate Questions and Methods for Price Action Analysis

1) **Winners and Losers in the Market**

    a. Who is dominating the current swing, bulls or bears?
    b. Are they correct?
    c. If they"re wrong:
        i. Where is this move likely to stall? Where is the opposite order flow likely to enter the market?
        ii. Where will these traders have positioned their stops?
    d. If they"re right:
        i. Where are these traders targeting? Where are they going to take profits or lighten their position?
    e. If they"re in the right direction, but late:
        i. Where is the worst place to be entering late in this move? Where will the late traders be stopped out?

2) Trapped Traders

a. Where is the last group of trapped traders?
b. Where are they hoping to get out? How will that affect price?
c. Where will they give up and bail out? How will that affect price?

3) Expectations - Most Likely Price Movement

a. What do you expect the market to do from here?
    i. Why do you expect that?
    ii. How would price have to behave prior to that move occurring?
    iii. Is price behaving this way?
b. If the most likely scenario does not eventuate, what else could the market do?
    i. How would price have to behave prior to that move occurring?
    ii. Is price behaving this way?
c. Is there a third possibility for a potential market move?
    i. How would price have to behave prior to that move occurring?
    ii. Is price behaving this way?

4) Expectations – Bullish, Bearish, Neutral

a. What would a bullish market do here?
    i. How would price have to behave prior to that move occurring?
    ii. Is price behaving this way?
b. What would a bearish market do here?
    i. How would price have to behave prior to that move occurring?
    ii. Is price behaving this way?
c. What would a neutral market do here?
    i. How would price have to behave prior to that move occurring?
    ii. Is price behaving this way?

5) Bulls Vs Bears

a. Who is in control – the bulls, the bears, or neither?
b. Why?
c. How dominant are they?
d. What beliefs led to this current market action?
e. Is control changing?
f. What would have to happen to indicate a change of control between the bulls and bears?
g. What would cause the maximum fear in the current dominant power?

6) Professionals Vs Novices

a. Where did the professionals enter?
   i. Where‟s their stop?
   ii. What will happen if price hits their stop?
   iii. Where‟s their target?
   iv. What will happen if price hits their target?
b. Where did the novices enter?
   i. Where‟s their stop?
   ii. What will happen if price hits their stop?
   iii. Where‟s their target?
   iv. What will happen if price hits their target?
c. Where will the professionals enter?
   i. What does it mean if price reaches this area?
   ii. What does it mean if price doesn‟t reach this area?
   iii. Where will they place their stop?
   iv. What will happen if price hits their stop?
   v. Where will they place their target?
   vi. What will happen if price hits their target?
d. Where will the novices enter?
   i. What does it mean if price reaches this area?
   ii. What does it mean if price doesn‟t reach this area?
   iii. Where will they place their stop?
   iv. What will happen if price hits their stop?
   v. Where will they place their target?
   vi. What will happen if price hits their target?

7) Best vs. Worst

a. Where is the best place to be entering, or adding to a position?
b. Where is the worst place to be entering, or adding to a position?

8) Market Structure

a. Where did we open today relative to yesterdays close, low and high? What does this mean?
b. Where are we trading relative to yesterdays close, low and high? What does this mean?
c. Where are we trading relative to today‟s opening price and the opening price range? What does this mean?

VOLUME THREE

TRADING STRATEGY

Chapter Four –
Strategy – YTC Price Action Trader

4.1 - Strategy – YTC Price Action Trader

We‟ve prepared our battlefield. We‟ve conducted our market analysis; defined our structural framework and the trend that moves within that framework. We‟ve established a bias for the likely *future trend* direction and monitored price action bar by bar to update that bias as new information comes to light.

Now it‟s time to find and manage the trade opportunity within this market action – high probability, low risk trade opportunity.

In this chapter, we‟ll examine the YTC Price Action Trader strategy.

And we‟ll work through examples showing how to identify, execute and manage these trade opportunities.

4.2 - Setup Concept

4.2.1 The Expectancy Formula

All traders should be familiar with the expectancy formula:

- Expectancy = (Win% x Average Win) – (Loss% x Average Loss)

The expectancy formula provides a means of quantifying your edge over a series of trades. A trading strategy that makes money over the sample of trades will have expectancy greater than zero. A losing strategy will have a result less than zero.

Consistent success requires a positive expectancy.

A positive expectancy requires your trading strategy (and your implementation of that strategy) to maximise the following two ratios:

- Win%
    - Win% = number of winning trades divided by total number of trades in the sample.
    - We aim for our percentage of winning trades to be as high as possible.
    - Note that maximising this ratio also minimises the Loss%.

- Win/Loss Size Ratio (WLSR)
  - o WLSR = average win divided by average loss
  - o We aim for our average win to be larger than our average loss.

Most traders focus all their energy on maximising their Win%. Very little effort is devoted to maximising their WLSR.

As professional traders we must be aware at all times of the need to maximise **both** ratios.

The YTC Price Action Trader manages this through the following means:

- Win%:
  - o Setups designed for immediate price movement in our trade direction, as a result of orderflow created by human emotion and decision making. *(Section 4.2.2 – Principles Behind the YTC Price Action Trader Setup Locations)*
  - o Early entries within the price swing in order to increase the likelihood of securing a profit before the inevitable reversal. *(Section 4.4.3 – Entry)*
  - o Active trade management strategy in order to ensure any profits are retained rather than given back to the market when the market bias changes. *(Section 4.4.4 - Trade Management and Exit)*

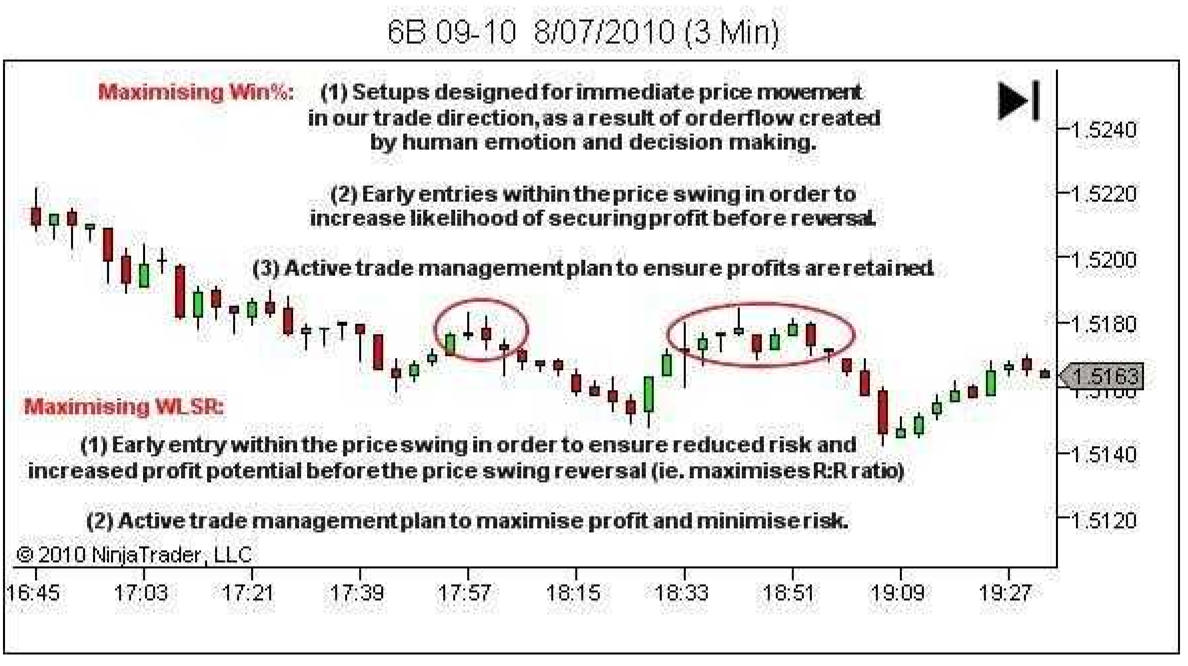


Figure 4.1 - Maximising Expectancy Formula Ratios

- WLSR:
    - Recognising that each price swing only has limited movement available, an early entry minimises risk and maximises potential reward (ie. Increased reward:risk ratio). *(Section 4.4.3 – Entry)*
    - Active trade management strategy in order to maximise any profits and minimise any risk. (*Section 4.4.4 - Trade Management and Exit)*

4.2.2 Principles behind the YTC Price Action Trader Setup Locations

You should recall the following from Chapter 2:

Markets are not price movement. They are traders making trading decisions.

The way to profit on a consistent basis is through finding those opportunities where there is a higher probability of a sufficient number of traders making trading decisions, which will lead to net order flow in a particular direction, and then acting to trade with this orderflow.

We"ve seen that individual trader decisions are usually unpredictable, leading to no or minimal edge in the markets. However at times of stress they become much more predictable.

Our trading approach therefore needs to be based on this fundamental understanding of how to profit from the markets:

- We identify areas at which sufficient numbers of traders will be experiencing stress, and will make trading decisions to relieve them of that stress, and then act before or with them in order to profit from the resultant orderflow.

That is the basis behind the YTC Price Action Trader strategy and setups.

Find the areas on a chart where other traders will make trading decisions and you've got yourself an edge.

Enter at or before the change of net order flow and you've got a great opportunity to profit (provided you manage the trade well).

Another way of looking at this is that we are fading those who fight the market bias. Chapter 3 taught us a method of identifying the market bias – the path of least resistance – the likely *future trend* direction.

We now aim to find places on the chart where other traders are fighting the bias. We identify the areas where they realise they‟re wrong and are forced to exit.

There are two primary concepts behind all my setups – fading weakness and fading trapped traders.

Fading Weakness

The *future trend* moves in the direction of strength and against the direction of weakness.

We therefore aim to always trade in this direction – with strength and against weakness.

We don‟t do this by identifying new strength, and jumping aboard in that direction – typically that will be too late an entry. Instead we prefer to identify weakness and enter in the opposite direction at or before the point when weakness gives way to more strength.

This is the point at which those who are trading with the weakness will realize they‟re wrong and be forced out of the market, either by a discretionary exit decision or by their stops being triggered.

Chapter 3 already showed us how to identify weakness. We now use the same analysis concept to identify our areas of trade opportunity. We look for weakness in several key areas – around S/R (higher timeframe S/R, range S/R, key swing H/L) and at pullbacks in a trend.

- Traders entering in the direction of weakness, right into an area of S/R, are taking very low probability trades. The push into this region is most likely to fail.

- Traders entering into a breakout which shows weakness are taking very low probability trades. The breakout is likely to fail.

- Traders fading a breakout, which shows weakness on its first pullback, are taking very low probability trades. The breakout pullback is likely to fail, leading to continuation in the breakout direction.

- Traders trying to catch a trend reversal, entering against a trend on a weak pullback, are taking very low probability trades. The pullback is most likely to fail, leading to continuation of the trend.

You‟ll notice how our understanding of *future trend* direction has also provided us with the areas of trade opportunity.

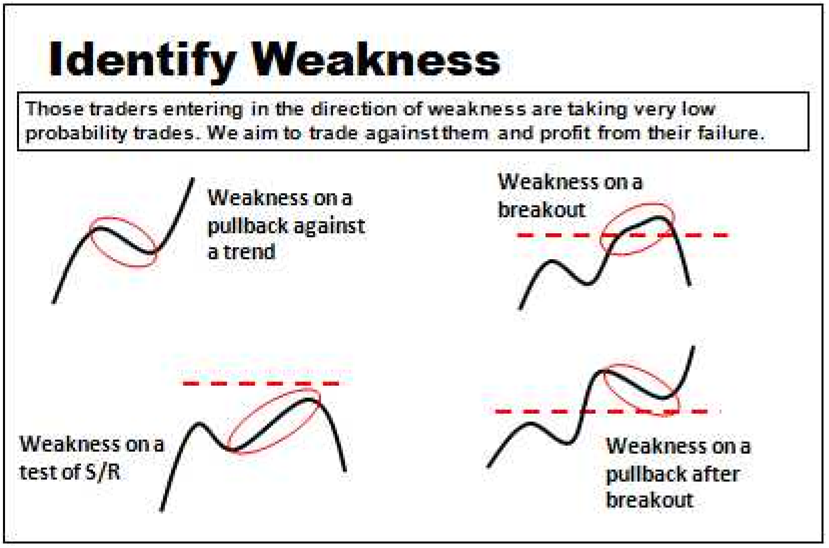


Figure 4.2 - Identify Weakness

The YTC Price Action Trader strategy is a contrarian approach to trading.

You may have heard the term contrarian, when used with regards to investing or trading. It means to go against the crowd, and is often mentioned as the basis for many successful trading approaches. Novices then assume that the way to succeed is to simply trade against any market move. This is not the way to succeed through a contrarian approach. It‟s just stupidity. The way to succeed through a contrarian method of trading is to be selective. Do not just blindly oppose every market move; just those when the crowd is taking a very low probability position. We selectively identify those times when the move is weak, aiming to enter when they are overwhelmed by the greater force of strength.

Fading Trapped Traders

Another way to look at the concept behind our setups is that we are identifying and trading against trapped traders.

We aim to find places on the chart where other traders are fighting the *future trend* bias. We identify the areas where they are (or will be) trapped in a drawdown, realise they‟re wrong and are forced to exit. I call these people *trapped traders*.

The concept of the trapped trader is important to this strategy, and should be on your mind throughout your trading session. Watch out for traders getting trapped in a losing position.

You know what this feels like. We‟ve all taken these trades. Remember your entry into the picture-perfect breakout which suddenly reverses back below the breakout point, placing you instantly in a drawdown and a low probability trade. Panic sets in as you watch price threaten your stop; you hold on in hope of a recovery; but more often than not stopping out seems an inevitable outcome.

Trapped traders show on the chart in numerous ways. You‟ll see them in every YTC Price Action Trader setup.

To introduce the concept though, two examples have been provided in figure 4.3 below.

On the left hand side, we see an uptrending market with a strong bullish bias. A pullback occurs against the bias, showing a strong bearish candle (low close bear candle) followed by a break below a swing low support area. Shorts will enter here hoping to catch a reversal.

However, much to their disgust, the breakout candle turns out to be a narrow mid close bear candle. Momentum has not carried through to the downside. This is followed by a high close range candle. Still no sign of continuation downwards! And then the market traps the shorts with a massive move back upwards (high close bull candle). The large range of this green candle is a result of the first of the stops being executed as trapped shorts are forced out of the market. The new bullish pressure drives price up to new highs.

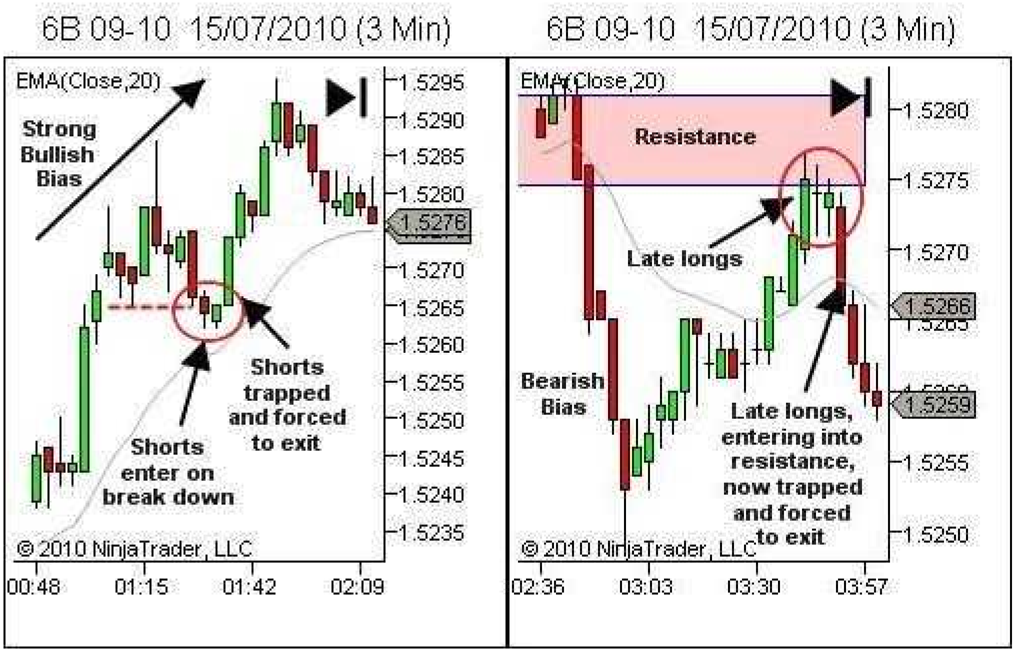


Figure 4.3 - Trapped Traders

On the right hand side we have a different type of trapped trader situation. The market has a bearish bias as price breaks below an area of consolidation, and then crawls back upwards towards the point of breakout.

The bulls who enter the market long, late in the rally and right into the area of resistance, are taking a very low probability trade. Quite likely these are the traders entering on lagging indicator based triggers. These are the traders who pay our wages.

The rally pauses and then breaks back downwards. The strong low close bear candle is a result of the first of the trapped longs‟ stops being executed, as they‟re forced to exit at a loss.

There are other trapped traders in this same example. Consider those traders who bought in the resistance area, prior to the original break downwards. They suffered through an intense drawdown and much psychological pain, desperately holding out for price to come back to at least breakeven. Hope was growing brighter as the rally brought price back to the breakout point. If they were smart, they got out there for a small loss. Most won‟t though; the small hope they hold for continuation through resistance and into profit is enough to keep them holding just a little longer. They‟ll then be forced to bail out as price falls again from resistance – angry with themselves and the market for denying them a breakeven exit.

So, you see how this one setup includes two sets of trapped longs – those from prior to the original breakout, and those entering late in the rally.

As you look at <u>any setup</u>, throughout the remainder of this book, then throughout your future trading, always be on the lookout for the trapped trader. Identify them and trade against them; be part of the orderflow that springs their trap.

These trapped traders provide your trading edge. Learn to love them.

An important point before we continue...

Don‟t get caught up in looking for setups. The <u>most important task</u> in your market analysis is maintaining awareness of the structure of the market and a feeling for the bias and likely path of future orderflow.

Maintain situational awareness and trade setups will show themselves to you. The trapped trader patterns will jump out at you.

Go searching for setups and you‟ll lose situational awareness with respect the bigger picture structure of the market. You‟ll end up finding and taking setups and trades that are lower odds when considered within the context of *higher timeframe* market action.

You‟ll see what appears to be trapped traders, but instead find yourself getting trapped.

Figure 4.4 shows an example of this. Looking at the left hand side chart, it‟s easy to convince yourself you‟ve found trapped shorts. The market has moved down to the round number area 1.5100 and found support. Bullish pressure is coming into the market. You determine that the late shorts will be trapped on a break above this price action and place a stop entry order above the high of the last green candle, in order to get in early.

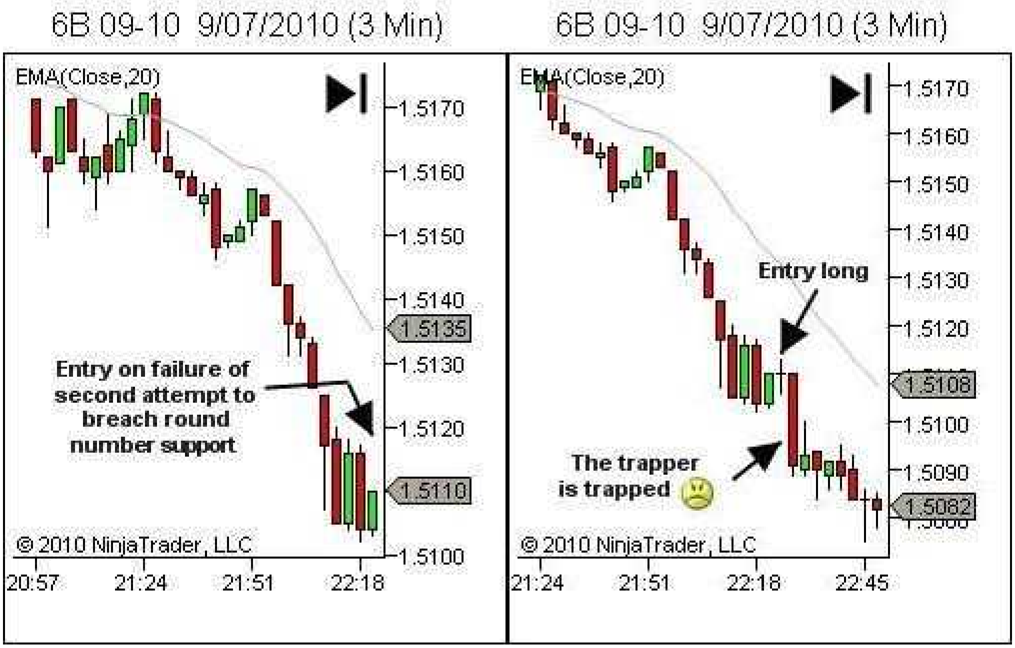


Figure 4.4 - A Failed Trapped Trader Pattern due to Poor Market Analysis

Bad Analysis!

The right hand side chart shows the quick loss, as the trapper becomes trapped. Market analysis failed to consider (1) the strength of the bearish bias, and (2) the fact that the 1.5100 level was not a significant support level (there was no evidence of past S/R or swing H/L support).

This trade failed to take into account the fact that we trade with strength and against weakness.

Typically I find myself doing this sort of trade when my focus has been off. Finding myself easily distracted with my attention diverted elsewhere, my mind somehow returns to the screen just in time to see a stall at the 1.5100 level, and a potential *entry* long. Rushing to place the trade, rather than pausing to conduct analysis from first principles, costs me money.

When might you take an entry in this area? Why not wait for the market to provide a clear reversal and then a weaker retest of the level? Then we‟re trading at a proven area of supply/demand imbalance and against weakness.

Don‟t rush into trade entries. Identify weakness. Identify trapped traders. Fade the weakness and be a part of the orderflow which springs the trap.

The most important factor in looking for your trade opportunities is… maintaining a good awareness of the structure of the market and the likely future trend direction.

Trading is not about objective analysis.

It‟s about identifying weakness in the market and then having the confidence to get in at a wholesale level fading that weakness.

It‟s about actively managing that trade, in order to maximise opportunity if you‟re proven right and minimise risk if you‟re proven wrong.

4.3 – YTC Price Action Trader Setups

Opportunity is found at S/R levels (higher timeframe S/R, range S/R, swing H/L) and on pullbacks within a trend. It is identified in these areas by weakness within the price action, trapping other traders into low probability positions.

Let‟s start by looking in detail at each of the setup types, and then following that up with some discussion about which setups we look for in each particular market environment.

Don‟t worry about entry and exit yet – just identify the locations for the trade setups.

4.3.1 – Setup Definition

There are five primary YTC Price Action Trader Setups.

Three which occur as price interacts with levels of support or resistance:

1) TST – a <u>test</u> of support or resistance which is expected to hold.
2) BOF – a <u>breakout failure</u>, as price breaches an area of support or resistance and then reverses.
3) BPB – a <u>breakout pullback</u>, as price breaches an area of support or resistance and it holds.

And two which occur within a trend:

4) PB – a simple (single-leg) pullback within a trend.
5) CPB – a complex (multi-swing or extended duration) pullback within a trend.

TST Setup

The TST setup is a test of support or resistance which is expected to hold.

The support or resistance will ideally be *higher timeframe* S/R or the upper or lower boundaries of a sideways trading range.

It may, in a weak trend environment be a *trading timeframe* swing high or low, offering a counter-trend entry for a short scalp pullback (and possible early entry to reversal if lucky) although this is a much lower probability setup.

When our principles for future trend direction lead us to expect an area of support or resistance to hold, we anticipate a TST setup in that area. We only trade if the setup provides acceptable R:R parameters and a wholesale entry trigger within the S/R area.

Figure 4.5 displays a diagrammatic representation of a TST setup at both resistance and support.

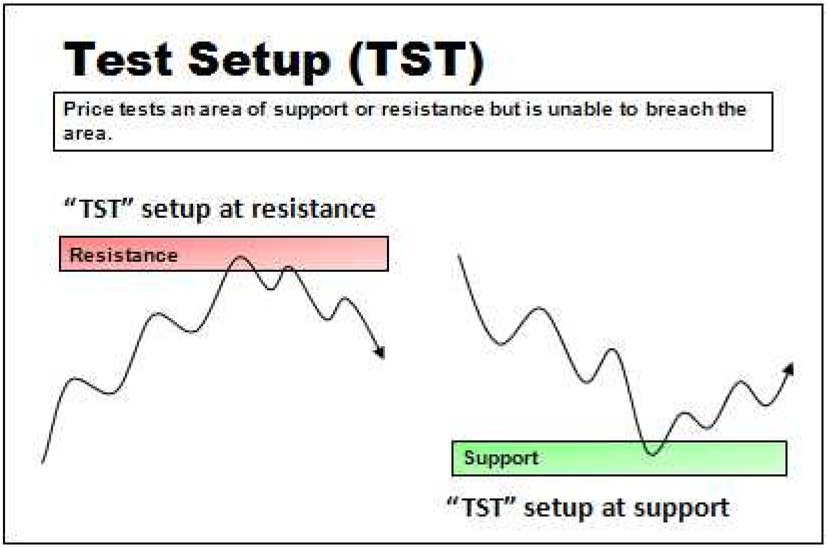


Figure 4.5 - Test Setup (TST)

This setup typically shows weakness into the area of S/R, although may be considered for any grossly overextended move into S/R. The traders entering late on this move into S/R are taking a low probability entry, and will become trapped should price stall and reverse.

This reversal will trigger their stops, adding to the reversal orderflow.

We aim to trade with the reversal orderflow, profiting from the action of the trapped trader stops.

Figure 4.6 (below) shows a chart example of a TST setup at *higher timeframe* (30 min) resistance.

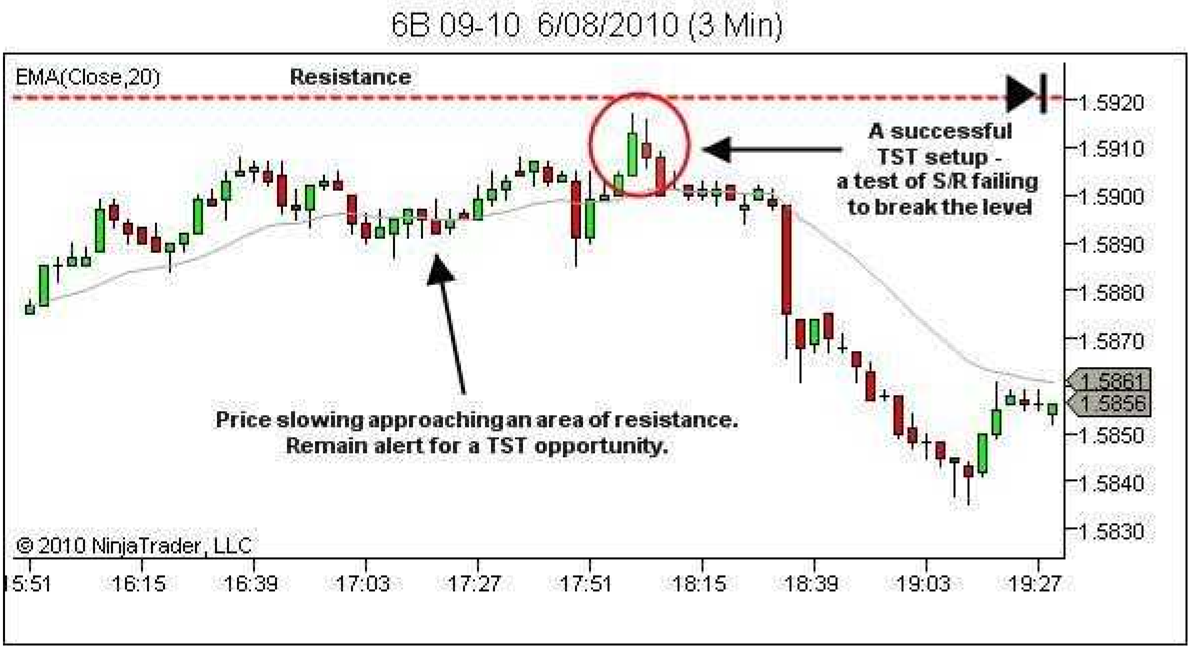


Figure 4.6 - TST at Resistance

As price approaches the area of resistance, we remain alert for the TST setup. Only if we achieve acceptable trade R:R parameters and an appropriate trade trigger (more on those later) will we actually trade. For now, just identify the setup locations.

Note that the setup price action does not touch my resistance line; but it does touch the resistance area. It‟s important to remember that S/R is an area, not a line. The lines on charts just alert us to the presence of S/R. Look left to find the actual area of influence.

Figure 4.7 (below) shows a chart example of a TST setup at *higher timeframe* (30 min) support. Once again, as price approaches the area of support, we remain alert for a TST setup. We trade if, and only if, we achieve acceptable trade R:R parameters and an appropriate trade trigger.

Note that in this case, the test involved two pushes into the area of support, and two potential trade entry locations.

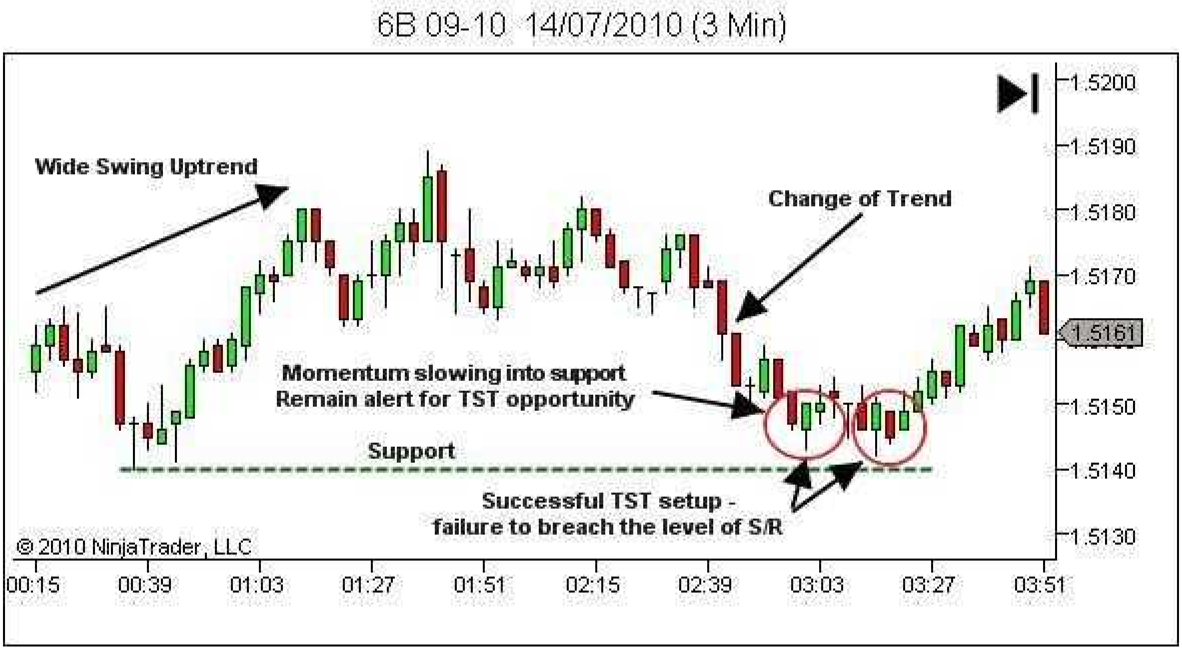


Figure 4.7 - TST at Support

BOF Setup

The BOF setup is a breakout of support or resistance which fails.

The support or resistance will be *higher timeframe* S/R or the upper or lower boundaries of a sideways trading range. In a weak trend environment it may also provide a counter-trend trading opportunity at a swing H/L (however this is a lower probability opportunity)

When our principles for *future trend* direction lead us to expect an area of support or resistance to possibly break, we watch price action closely on any breakout for further signs of weakness. Weakness on the breakout will alert us to a possible BOF opportunity. A trade is only entered if the setup then provides acceptable R:R parameters and a wholesale entry trigger.

Figure 4.8 displays a diagrammatic representation of a BOF setup at both resistance and support.

This setup works due to the break through S/R attracting the breakout traders. However, the breakout is unable to attract sufficient new orderflow to continue the move and therefore shows weakness. The breakout traders are trapped. Failure back to the area prior to S/R forces them to exit their position, adding orderflow against the original breakout direction. We aim to trade the failure, back into the area prior to S/R.

A common question is, "How many price bars will you accept beyond the breakout before you stop looking for a breakout failure?"

There is no fixed number. Every occurrence should be treated on its own merits, and considered from the perspective of how it appears to the breakout traders. Is the price action causing them fear and the potential to abandon their position? If so, it"s still a potential BOF setup regardless of how many price bars have printed.

An example is when the market makes two attempts to move price after the breakout. A second failure to do anything is often a good indication the market will do the opposite. If after a breakout I see two attempts to push higher fail, I"ll be trying to establish a BOF entry.

However, with all of that being said, I"d say it would be rare to see it hold beyond say 3-5 *trading timeframe* bars. The quicker the better!

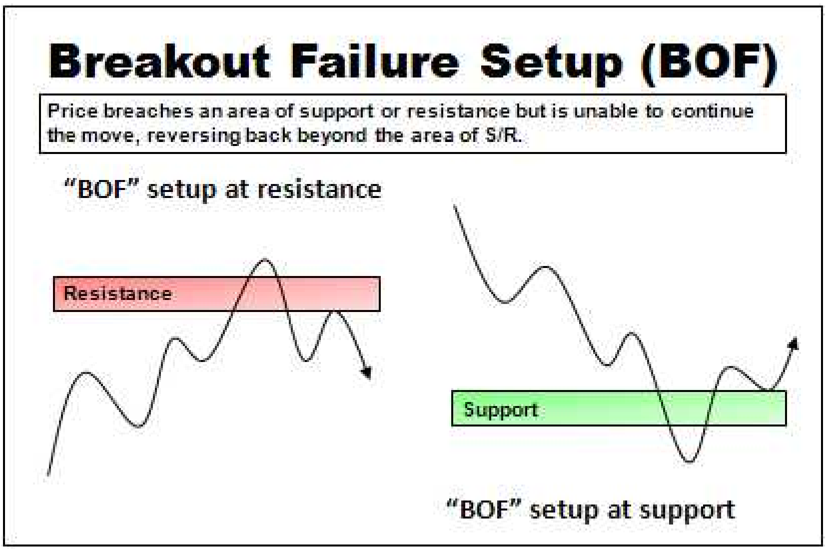


Figure 4.8 - Breakout Failure Setup (BOF)

Figure 4.9 (below) displays a BOF setup at resistance.

Figure 4.9 - BOF at Resistance

In this case, the breakout of a sideways trading range was initiated by a news event - the monthly non-farm payroll (NFP) release, which at the time of writing this book is considered the most potentially volatile of the monthly economic releases.

So, a breakout was considered a high probability.

Watching the breakout, we see price clearly stalled immediately above the resistance area. This is a sign of weakness. Had the breakout contained strength, it would have continued.

Provided we then have acceptable R:R parameters and a suitable entry trigger, we have found ourselves a trade.

Note: Caution is required on highly volatile news spikes. I recommend no entry until price has returned to normal rates of movement. In this case the setup occurred 6 mins after news release and had clearly stopped any post-release volatility.

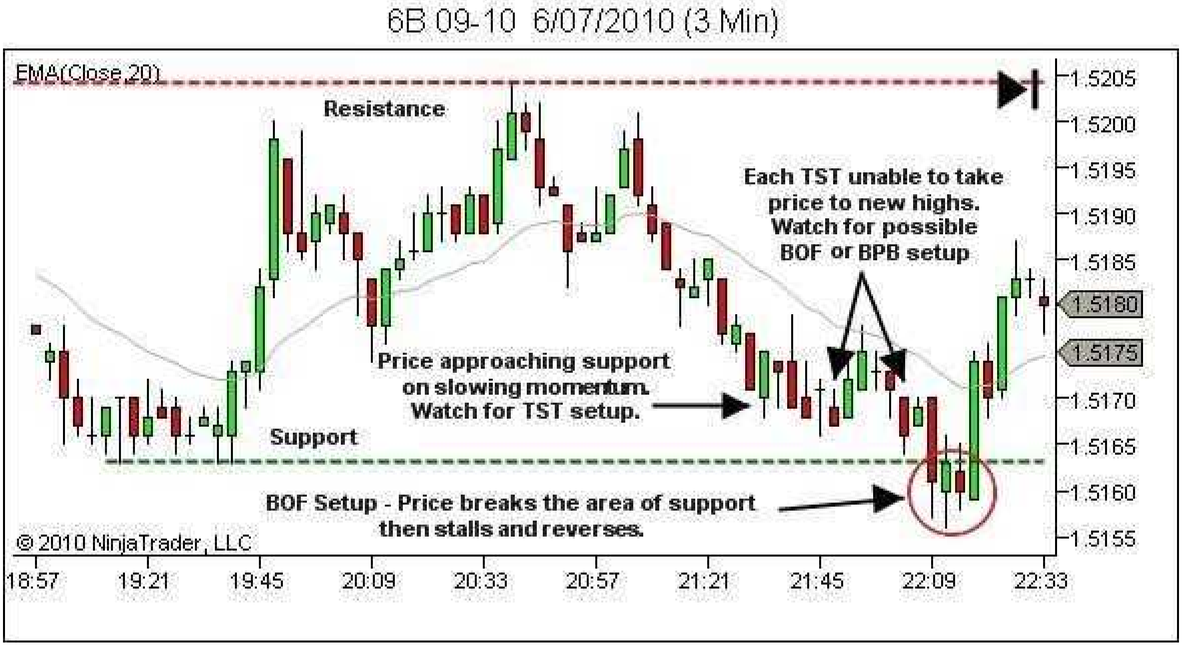


Figure 4.10 - BOF at Support

Figure 4.10 above shows a breakout failure at support.

While the price action was slowing into the area of support we would initially be looking for (and possibly trading) any TST setups.

However you‟ll note that each TST setup was unable to take price to new highs. This is showing weakness in the bullish direction. While not displaying great strength in the bearish direction, the *failure to continue* long is an indication that the stronger direction is down.

We remain alert for a breakout and any signs of weakness in the post-breakout price action.

In this case, the breakout was not able to attract sufficient bearish orderflow to continue. The orderflow that it did attract is now trapped short and will be forced to exit if price should break back above the area of support.

BPB Setup

The BPB setup is a breakout of support or resistance which shows price acceptance in the new area, through price holding beyond the breakout point and establishing a weaker pullback.

The support or resistance will be *higher timeframe* S/R or the upper or lower boundaries of a sideways trading range.

When our principles for *future trend* direction lead us to expect an area of support or resistance to possibly break, we watch price action closely on any breakout for further signs of weakness. Weakness on the breakout will alert us to a possible BOF opportunity. Weakness on a pullback will alert us to a possible BPB opportunity. A trade is only entered if the setup then provides acceptable R:R parameters and a wholesale entry trigger.

Figure 4.11 displays a diagrammatic representation of a BPB setup at both resistance and support.

This setup works due to the tendency for many traders to automatically fade a breakout, in expectation of its failure. If that failure is not sufficiently supported by other traders, any pullback will be weak and will itself fail. A failed breakout-failure is a breakout pullback (failed BOF = BPB).

Those trading the weak pullback will become trapped should the breakout continue. Their exit orderflow will assist in pushing the breakout to new highs/lows.

Note: Any BOF setup which you enter prior to crossing back over the S/R level must be managed quite aggressively. Remain alert for signs of weakness, and ready to scratch your position and reverse, should a BPB opportunity present itself.

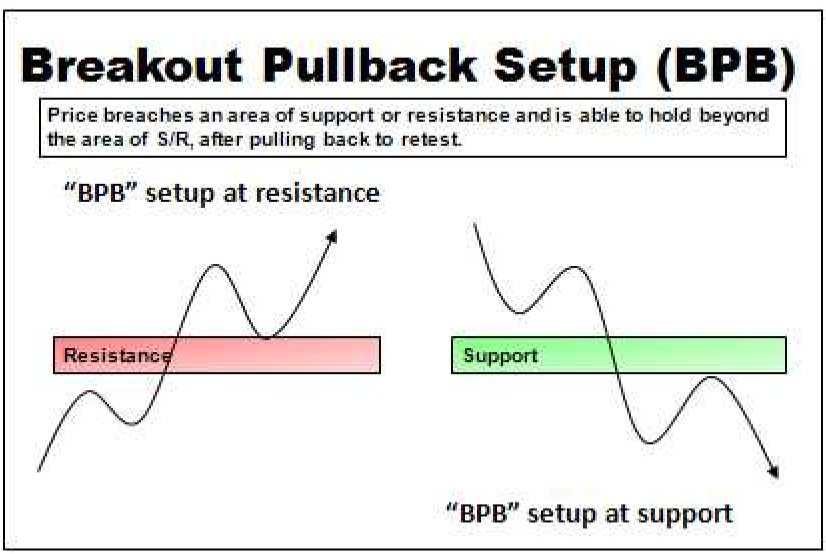


Figure 4.11 - Breakout Pullback Setup (BPB)

Figure 4.12 (below) shows two breakout pullback opportunities.

The first occurred within ten minutes of the initial breakout. The price action displayed weakness on breakout and would in all likelihood have had you searching for BOF opportunity. The pullback though was also weak. As noted previously, a failed BOF is a BPB setup. The scratched BOF would have provided a small loss. The first BPB then offered a small profit.

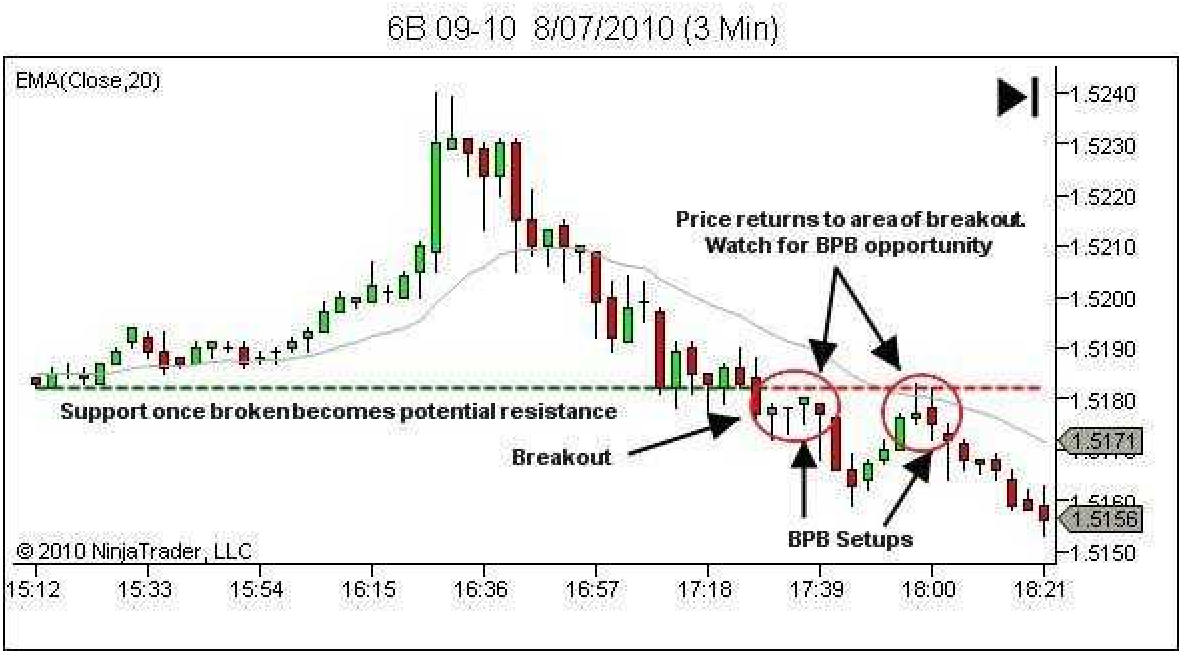


Figure 4.12 - BPB - Support becomes Resistance.

The second BPB opportunity presented approximately half an hour after the breakout, showing a much nicer stall into resistance, with upper tail rejection. This BPB setup provided much greater opportunity (assuming acceptable entry R:R parameters and wholesale trigger).

Figure 4.13 (below) shows a breakout which offers both a BOF scalp and BPB opportunity, for the more nimble trader.

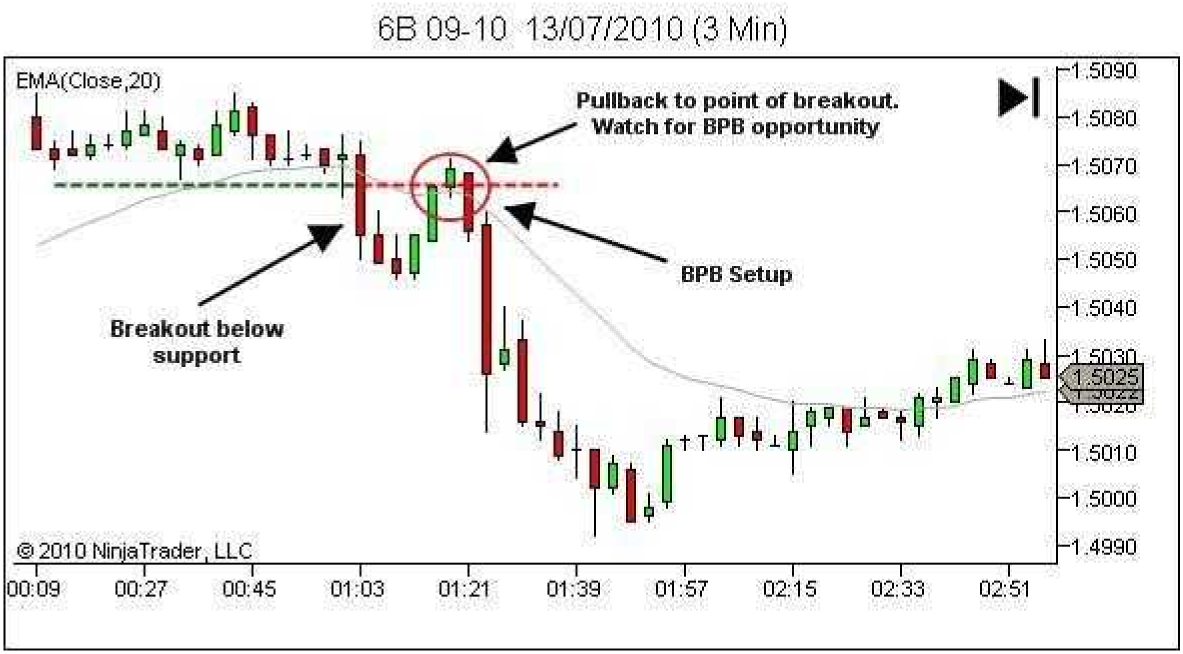


Figure 4.13 - BPB Support becomes Resistance

PB Setup

A PB is a simple (single-leg) pullback within a trend.

When our principles for *future trend* direction lead us to expect continuation of a current up or downtrend, we watch price action closely on any pullback for signs of weakness. Weakness on the pullback will alert us to a possible PB opportunity. A trade is only entered if the setup then provides acceptable R:R parameters and a wholesale entry trigger.

Figure 4.14 (below) displays a diagrammatic representation of a PB setup within a trend.

This setup works due to the tendency for MANY traders to attempt to pick reversal points. While everyone says they understand the saying, „the trend is your friend", human nature has the majority of us always seeking counter-trend opportunity.

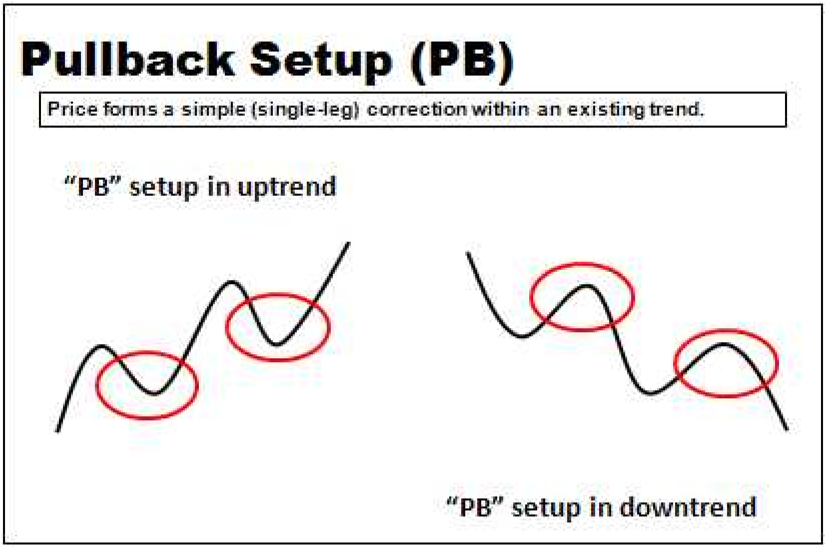


Figure 4.14 - PB Setup

The reality is that the market moves in the direction of strength and against the direction of weakness. We watch these weaker pullbacks for signs of failure, which will trap the *counter-trend* traders in a losing position and force their exit. Their exit orderflow helps take our PB trade to profits.

While a pullback may fail at any point, we watch price closely at areas of prior swing H/L. These areas will be sources of potential new orderflow and will provide clues as to the strength or weakness of the pullback and the timing of any failure. This is shown in figure 4.15 below.

This is not to say that these are the only places we expect pullback failure and trade entry. Simply that we watch these areas closely, observing the interaction of price with these swing H/L areas in the search for clues as to the way forward.

Ongoing bar by bar analysis of price action will tell you when the pullback is failing, and monitoring of the *lower timeframe* chart will provide your trade entry opportunity, should it arise before these swing H/L areas.

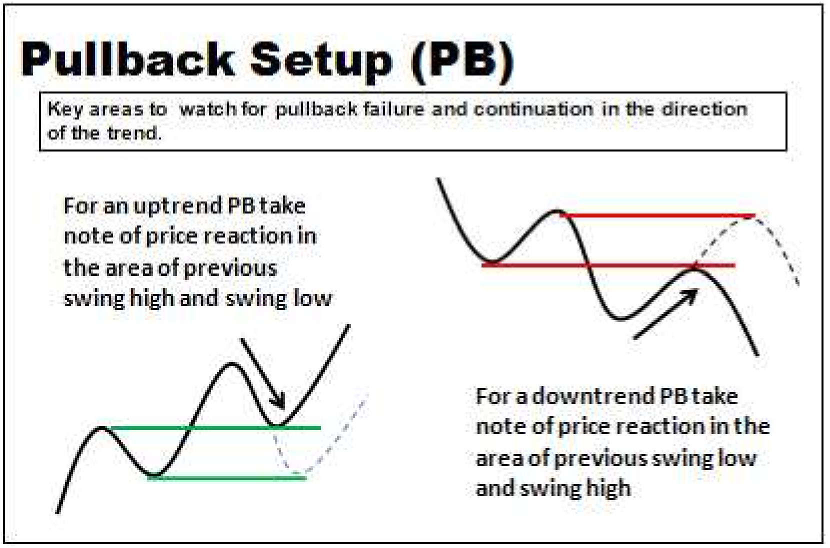


Figure 4.15 - Key Areas For Pullback Failure Clues

Figure 4.16 below shows a chart example of a PB setup within a downtrend.

Figure 4.16 - PB Within a Downtrend

Note that both pullbacks A and B are simple, single-leg pullbacks which lead to continuation of the downtrend.

Pullback A reaches the previous area of swing low support, now resistance, before price stalls and then resumes the downtrend. The stall is clear evidence of weakness within the pullback.

Likewise with B that also stalled prior to continuation of the trend. This time though price pulled back to the previous swing high area (remember that it‟s an area not a line; in this case pulling back to the lower part of the swing high area).

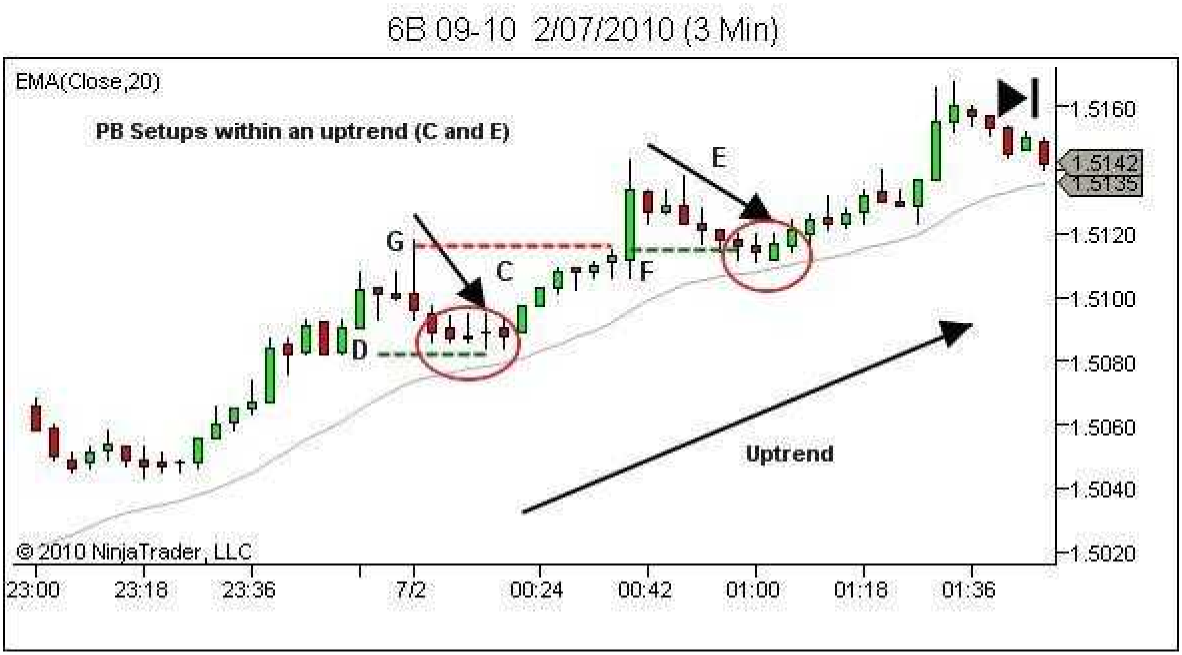


Figure 4.17 - PB Within an Uptrend

In figure 4.17 we see single-leg pullback C, which stalls abeam the area of congestion D.

And then pullback E which stalls abeam the previous swing high G. Note also the breakout above swing high G at F; evidence of a strong supply/demand imbalance. Any area of rapid price movement is worth watching for future support or resistance, should price return to that area.

CPB Setup

A CPB is a complex pullback within a trend environment – either consisting of multiple legs and/or an extended duration.

When we identify a weakening trend, our principles for *future trend* direction lead us to expect a complex retracement rather than a simple retracement. We remain alert during this complex retracement for a CPB opportunity.

In addition, a failed PB which does not reverse the trend can set up a possible CPB opportunity.

As always, a trade is only entered if the setup then provides acceptable R:R parameters and a wholesale entry trigger.

Figure 4.18 displays a diagrammatic representation of a CPB setup within a trend.

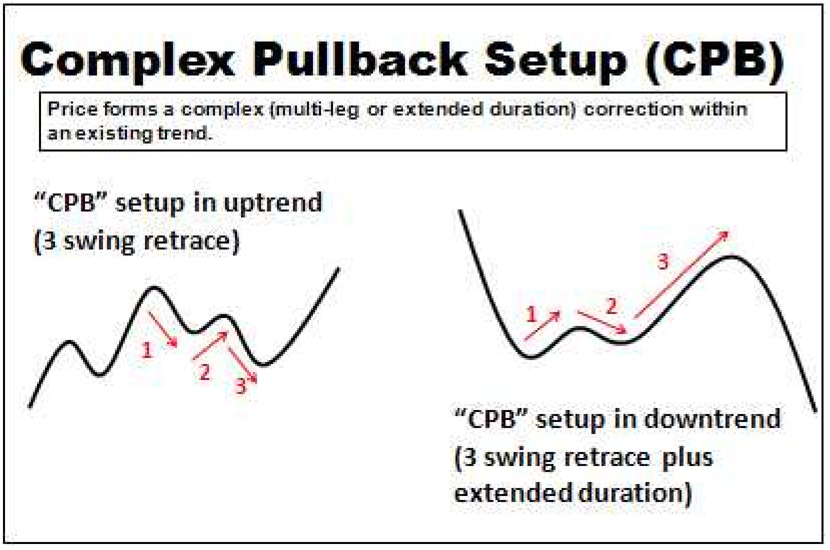


Figure 4.18 - CPB Setup

A multiple swing pullback can provide a quite powerful setup opportunity. In fact, a CPB is often a more powerful setup than a simple PB.

Consider the uptrend on the left hand side of figure 4.18. As price swing 3 breaks below the low between swings 1 & 2, it will attract shorts attempting to enter a reversal. The subsequent stall and reversal (continuation in the direction of the trend) traps these traders. Their exit orderflow helps propel our trade to profits.

How do we judge when to wait for a CPB rather than take a PB entry? A large part of it is you *feel* for the market flow. You‟ll gain some sense of this with experience.

As mentioned, weakness in the trend will usually lead us to expect for a CPB. But we often also expect them when a price swing has overextended in the direction of the trend. Quite likely it will need to correct this via a multiple swing pullback.

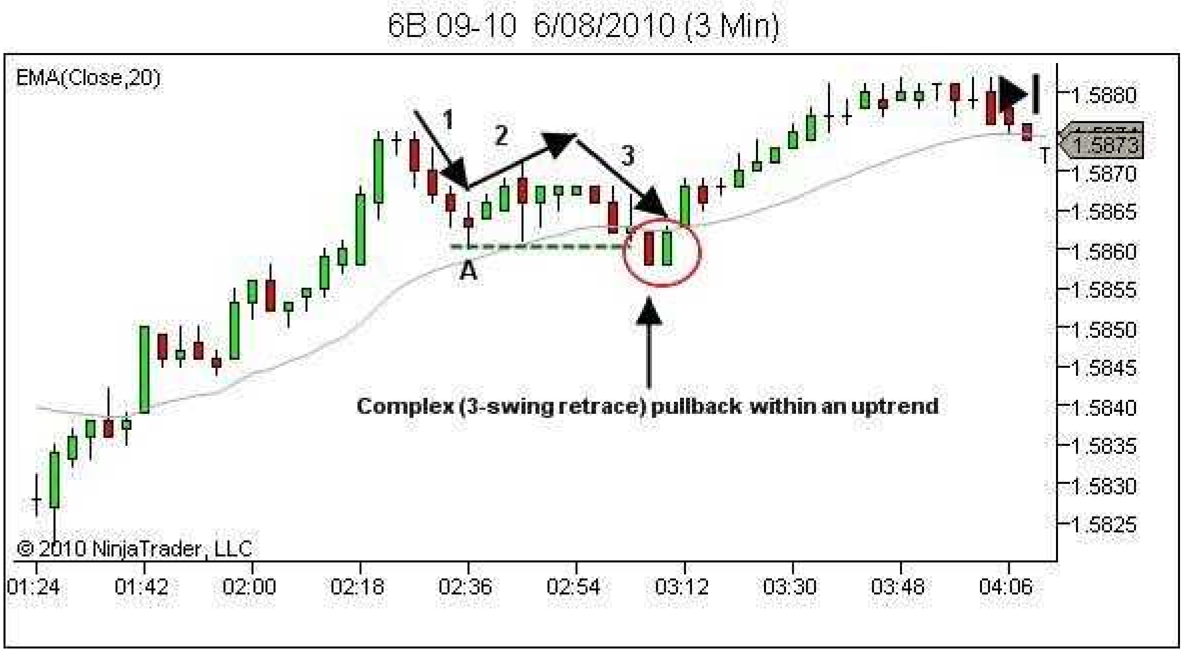


Figure 4.19 - CPB Setup – 3-Swing Retrace

Figure 4.19 demonstrates this concept through a price action chart.

Note the three swings of the pullback, in which the third swing breaks below point A. This will attract some shorts who are hoping to get an early entry into a reversal. To their disgust, they‟re quickly trapped as price breaks back above level A and triggers their exit order.

This 3-swing retrace trapped trader orderflow is often sufficient to kick start a stalled trend.

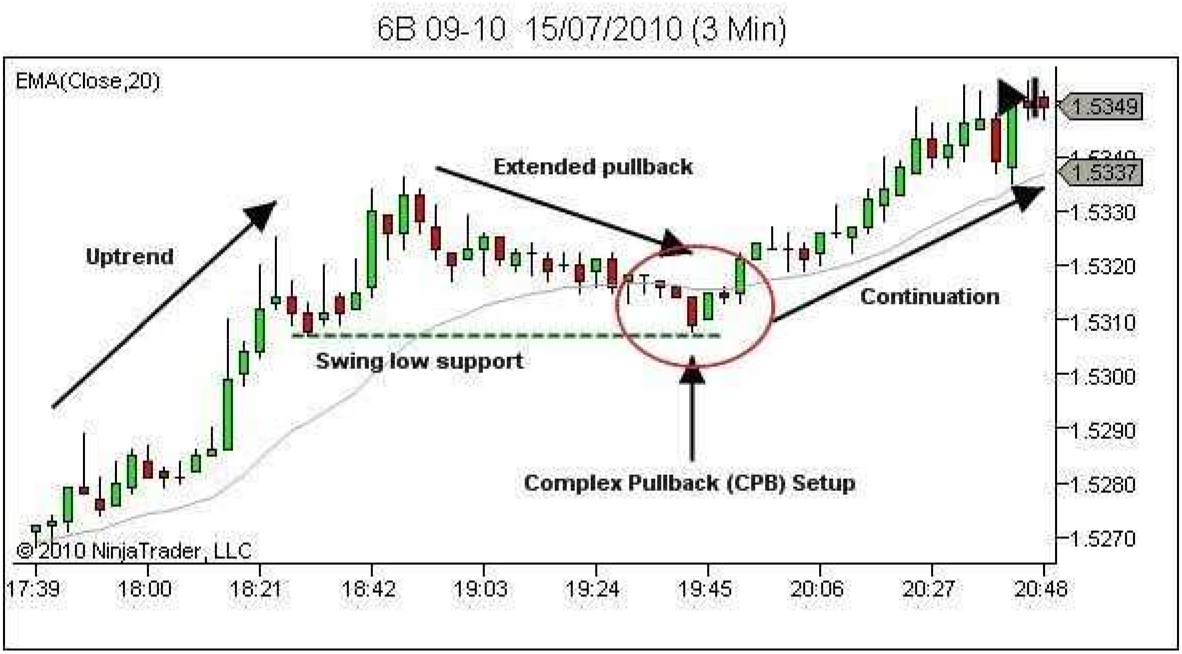


Figure 4.20 - CPB Setup – Extended Pullback

In figure 4.20 above we see an uptrend that pulled slowly back to previous swing low support.

Unlike the 3-swing retrace version of CPB‟s, which are easy to trade, these extended duration pullbacks are sometimes difficult to trigger into. There is always a temptation to hold for more grinding action and further pullback. Confidence should be provided when a *lower timeframe* (1 min) trigger occurs at previous swing H/L areas.

4.3.2 Setups Appropriate for each Particular Market Environment

Let"s discuss the setups that are typically traded for each particular market environment.

By *market environment*, I don"t mean the past trend, but rather our expectations for *future trend*.

Within the S/R framework:

First Principle – We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

- Opportunities will be via a PB or CPB setups within the trend, as demonstrated in the previous section.

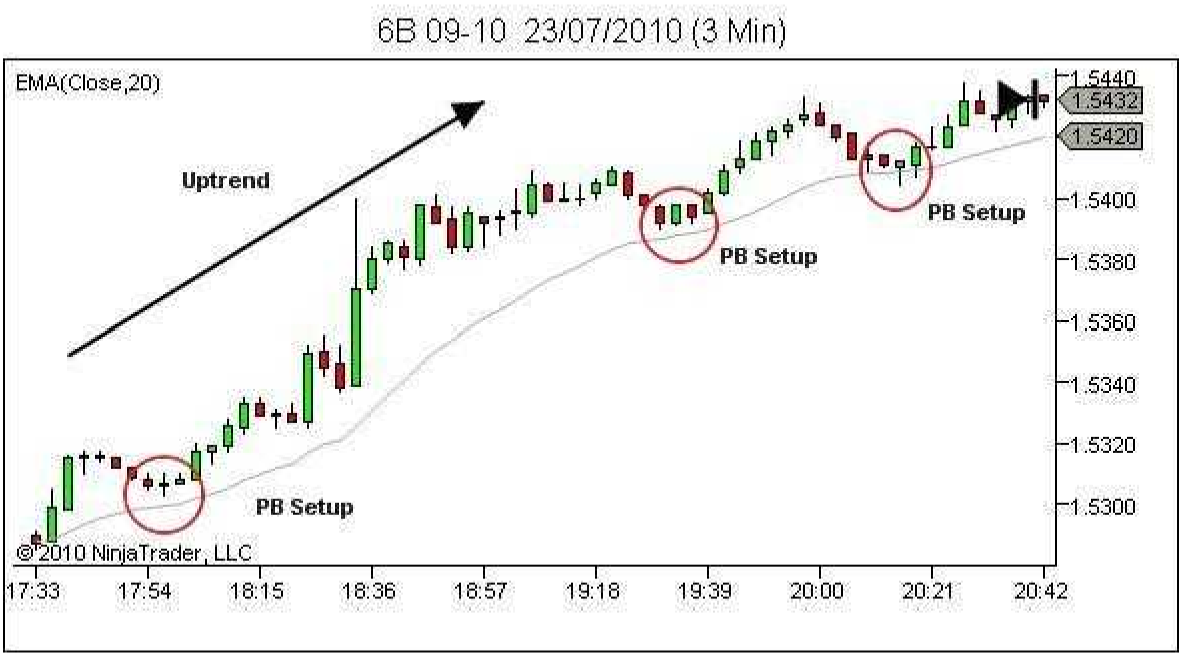


Figure 4.21 - PB Opportunity Within a Trend

- Trends that overextend well above an uptrend MA line, or well below a downtrend MA, will typically require a CPB correction before continuing, except in a very fast trend.

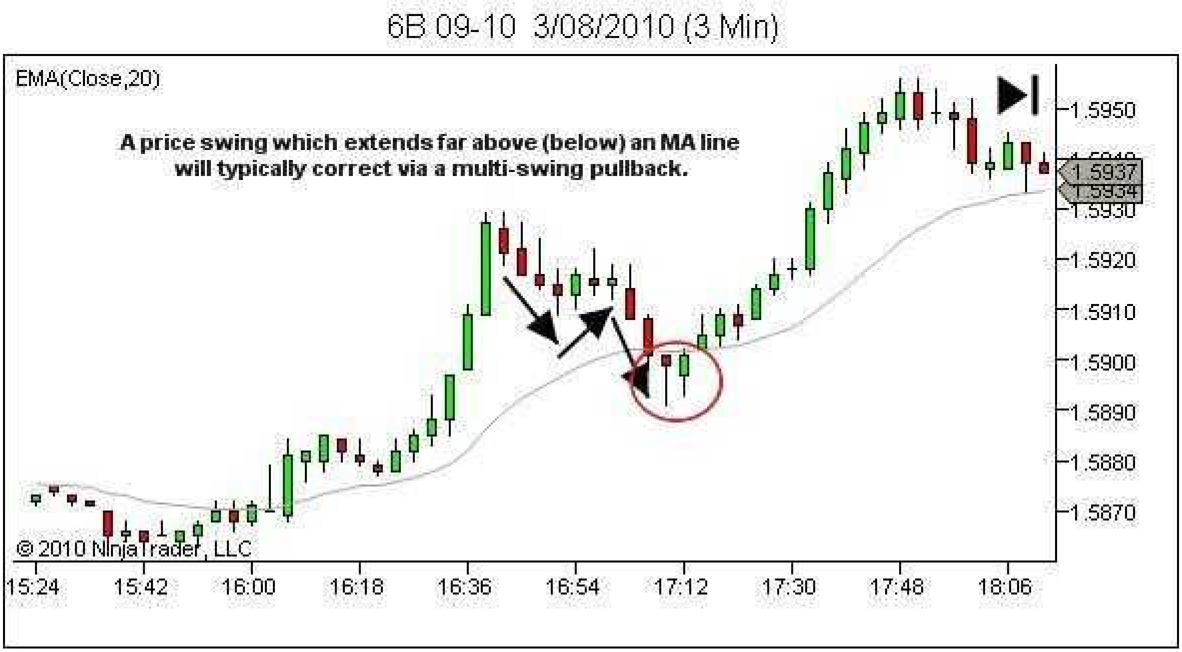


Figure 4.22 - Over-Extension Requiring a CPB

Second Principle - When an up or down trend shows evidence of weakness, we expect a higher likelihood of a complex correction rather than a reversal, until such time as the market shows both price acceptance and strength in the new trend direction.

- Primary opportunity, as mentioned, is via a CPB setup. PB setups should only be taken when price moves nicely into an area of lower swing low support (uptrend) or upper swing high resistance (downtrend), preferably breaking that swing low or high before failing. Otherwise, stick to the higher probability multi-leg CPB. By trading only these deeper PB or multi-leg CPBs, we have the advantage of greater trapped trader orderflow.

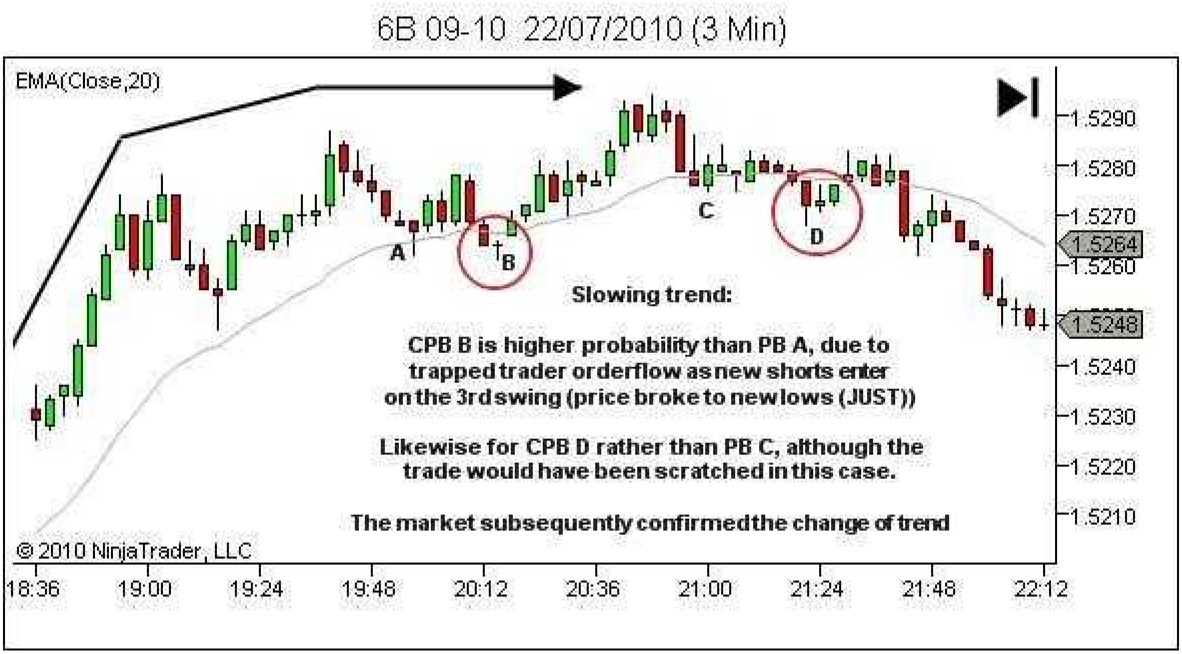


Figure 4.23 - CPB Opportunities Within a Slowing Trend Environment

- Lower probability counter-trend opportunities may be available via either a TST or BOF at previous swing high resistance for an uptrend, or swing low support for a downtrend. Typically these will only be considered in a wide-swinging slow trend, or a trend which is clearly slowing down, both showing relatively small projection. Manage these trades aggressively if you choose to take them. As shown in the example below though, they can offer an early entry into a reversal.

Figure 4.24 - Counter-Trend BOF Setups Within a Slowing Trend Environment

Figure 4.25 - Counter-Trend TST Setup Within a Slowing Trend Environment

Third Principle – A sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

- Higher probability trades at the boundaries will always be BOF setups, due to the presence of breakout trapped trader orderflow. However in the absence of any real strength showing towards the boundary S/R we need to be alert for simple TST setups.

Figure 4.26 - TST Setups within a Sideways Trend

- Where the intra-range price action shows a bias towards trending in one direction, you may consider PB/CPB entries within that trend. CAUTION: Lower probability trades.

Figure 4.27 - Trend Opportunity within Sideways Trend Trading Range

Fourth Principle - When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behaviour of price post-breakout for clues as to future direction:

- Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range.
- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

- The principle provides clear direction here – watch the post-breakout price action for weakness, for either a BOF and/or BPB opportunity. As discussed earlier, weakness may be evident on both legs. Any BOF trade should be managed cautiously until showing strength. Subsequent weakness on the pullback will indicate a likely BOF failure. Remain alert for any BPB trigger, allowing a BOF exit and reversal for BPB entry.

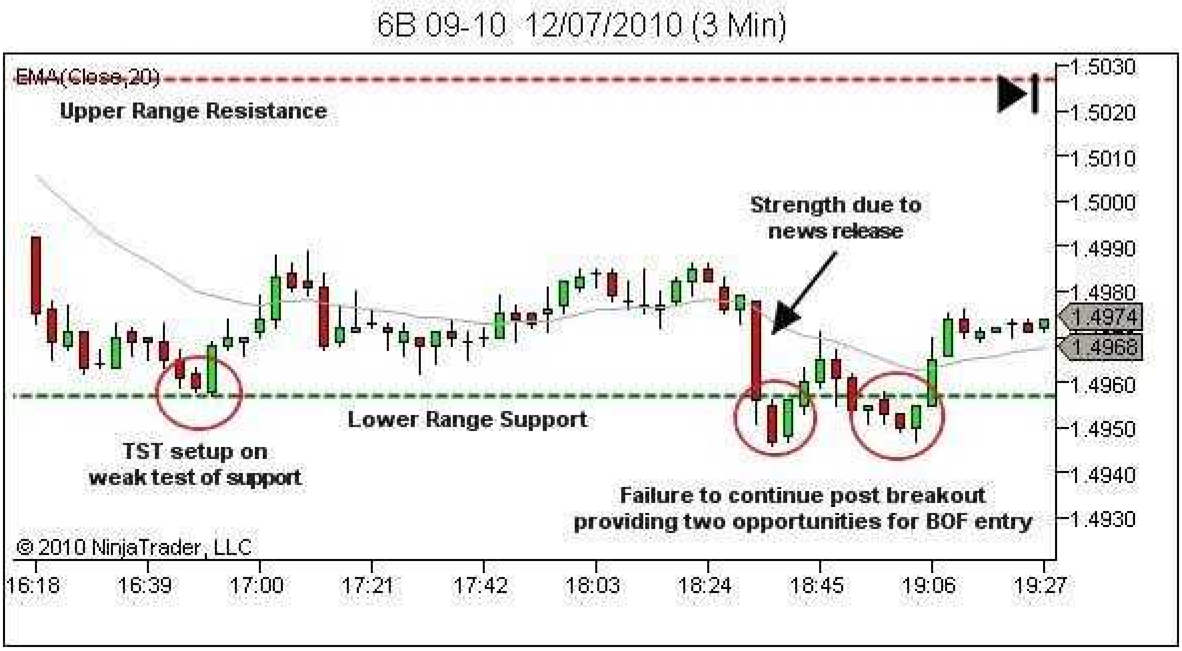


Figure 4.28 - Sideways Trading Range Providing BOF Setup Opportunity

Figure 4.29 - Sideways Trading Range Providing BPB Setup Opportunity

At the edges of the S/R framework:

Fifth Principle – We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary.

- The principle provides clear direction as to the expected setup. As price approaches the *higher timeframe* S/R level we remain alert for a TST setup.

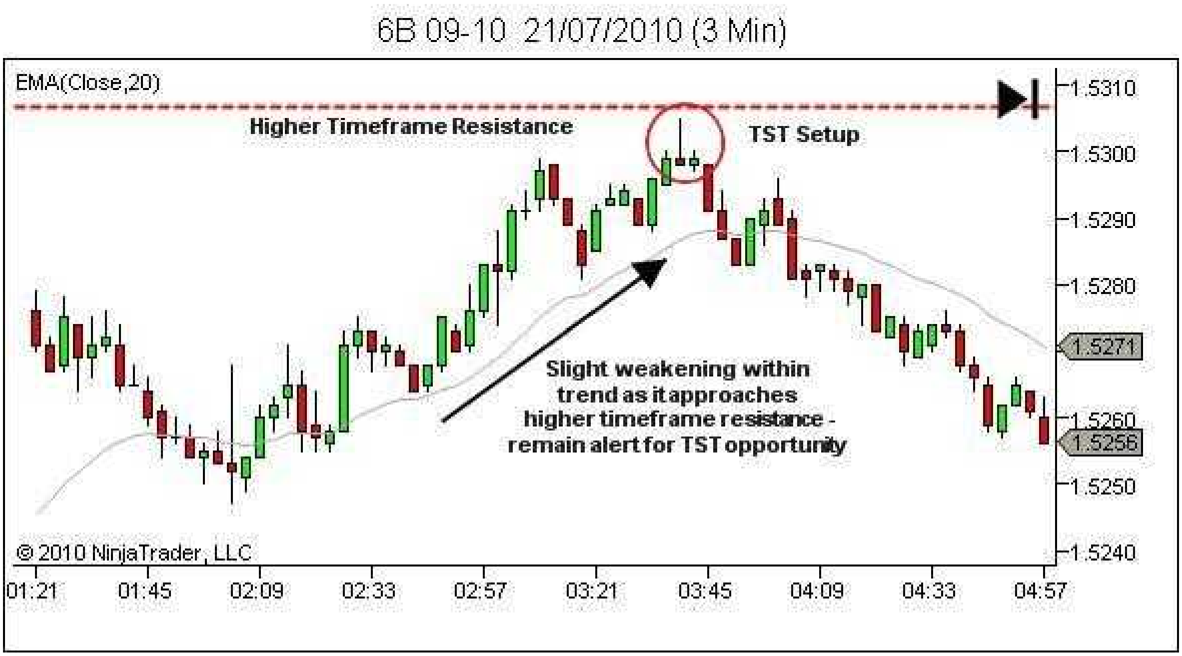


Figure 4.30 - TST Setup at Higher Timeframe (30 min) Resistance

Sixth Principle - If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behaviour of price post-breakout for clues as to future direction:

- Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

- The principle provides clear direction here – watch the post-breakout price action for weakness, for either a BOF and/or BPB opportunity. As discussed earlier, weakness may be evident on both legs. Any BOF trade should be managed cautiously until showing strength. Subsequent weakness on the pullback will indicate a likely BOF failure. Remain alert for any BPB trigger, allowing a BOF exit and reversal for BPB entry.

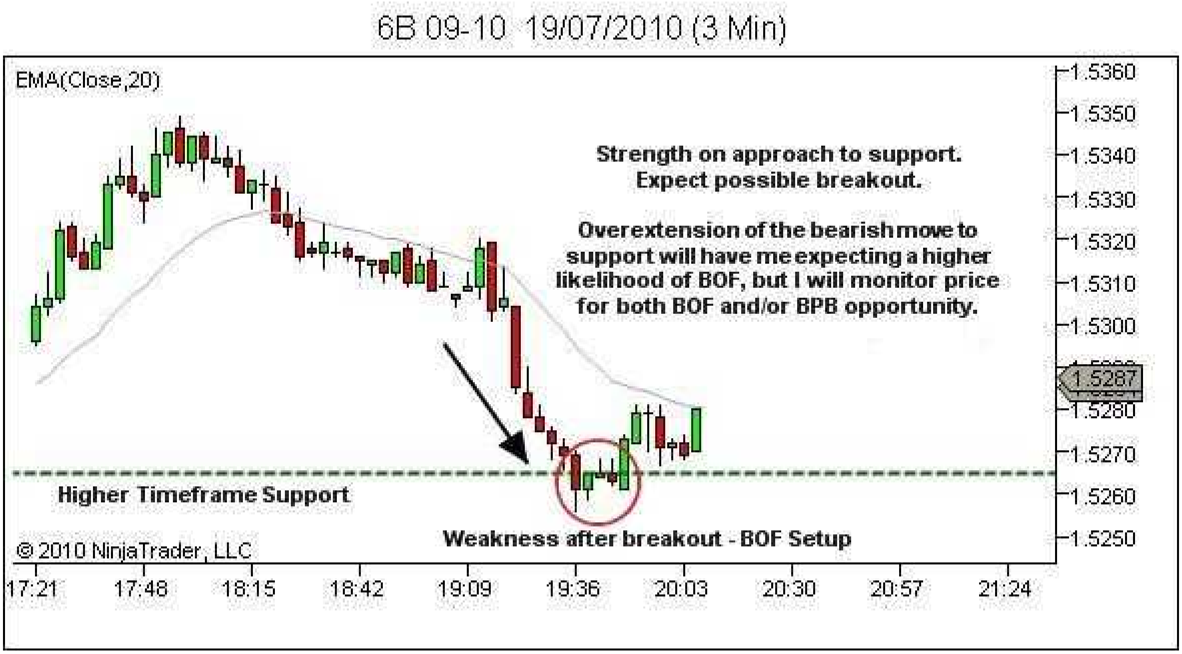


Figure 4.31 - BOF at Higher Timeframe (30 min) Support

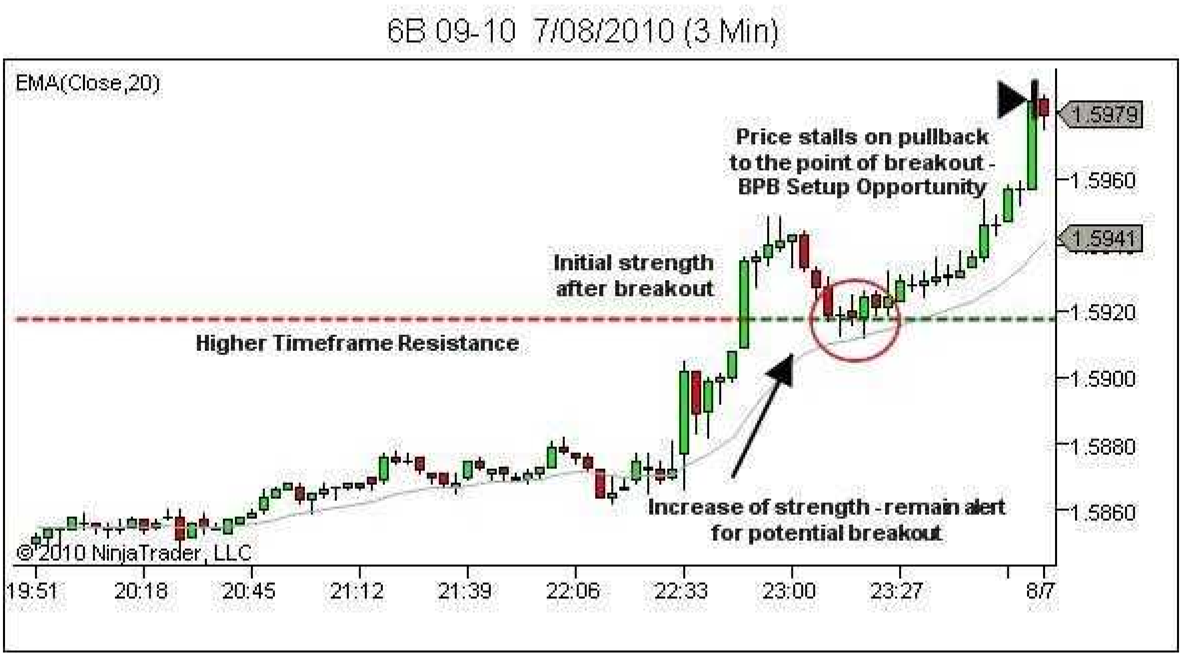


Figure 4.32 - BPB at Higher Timeframe (30 min) Resistance

Summary

Steady trend environment:

- Higher Probability
  - PB and CPB

Weakening trend environment

- Higher Probability
  - CPB
  - PB if they break a previous swing low (uptrend) or swing high (downtrend)
- Lower Probability
  - Standard PB (single leg; not breaking any prior swing low (uptrend) or swing high (downtrend))
  - Counter-trend TST or BOF of swing high (uptrend) or swing low (downtrend)

Within a Sideways Trading Range with a clear intra-range trend

- Lower Probability
  - PB and CPB

Approaching higher timeframe S/R or range S/R, with no sign of potential breakout

- Higher Probability
  - TST

Approaching higher timeframe S/R or range S/R, with strength showing signs of potential breakout

- Higher Probability
  - BOF or BPB

A Note on Counter-Trend Trading in a <u>Strong Trend</u> Environment

Counter-trend trades are ALWAYS going to be a lower probability trade when a trend is moving strongly.

Even more so for a climactic move!

Human nature is such that having hesitated and missed a good with-trend entry; our tendency is to seek revenge over the market through looking to catch the early reversal. The market will offer many counter-trend setups which will typically all look very tempting. But more often than not this will be a trap.

Trust the trend to continue, until it shows clear evidence of weakening.

Approach S/R barriers with the expectation they‟ll break. Watch for an opportunity on the first pullback after breakout.

Expect pullbacks to be shallow, possibly reversing even before they reach previous swing high/low areas.

If you find what appears to be a tempting counter-trend setup, pass on it with the knowledge that many others will also see it and take this low probability entry. Watch for subsequent the counter-trend setup failure and use that as your entry with-trend. Profit from the stop-out orderflow of those trapped counter-trend in a strong trend environment.

Avoid the temptation to trade counter-trend <u>until</u> the market has shown a clear weakening of the trend. Not just a pause or short term weakening – look for a strong and deep pullback (increased depth compared with previous pullbacks, on increased strength) followed by a weaker retest of the lows/highs. Even then the preference is for a BOF counter-trend entry rather than TST due to the greater short-term trapped trader orderflow. Treat all CT opportunities with caution.

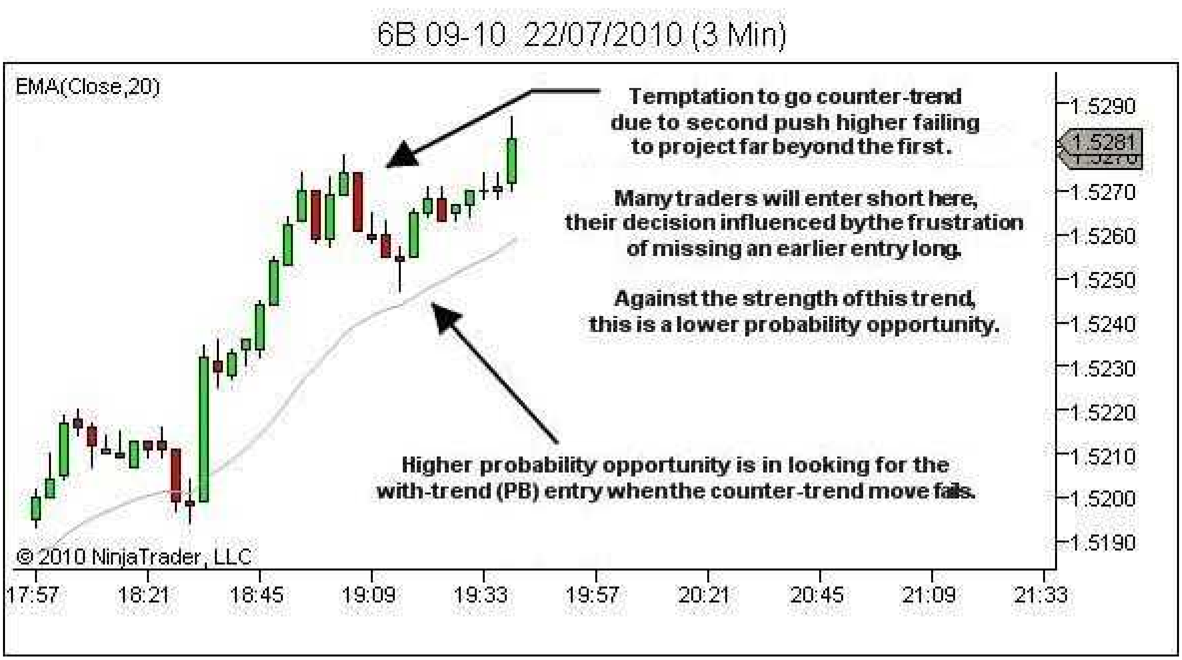


Figure 4.33 - Counter-Trend Failure Against Strong Trend

What Happens After S/R Holds?

You should recall in the analysis chapter, we discussed the period after an area of S/R holds (test or breakout failure). We observe signs of strength and weakness in order to determine the likely future trend direction – is the price going to form a reversal, or return for a subsequent retest.

The following diagrams show potential setups available following the original TST or BOF setup.

- In the absence of weakness in the trend (when having tested S/R) expect a continuation of the trend (First Principle) which will take us back for another test of S/R (Fifth or Sixth Principle). So, we look for both PB and a TST or BOF/BPB setups.

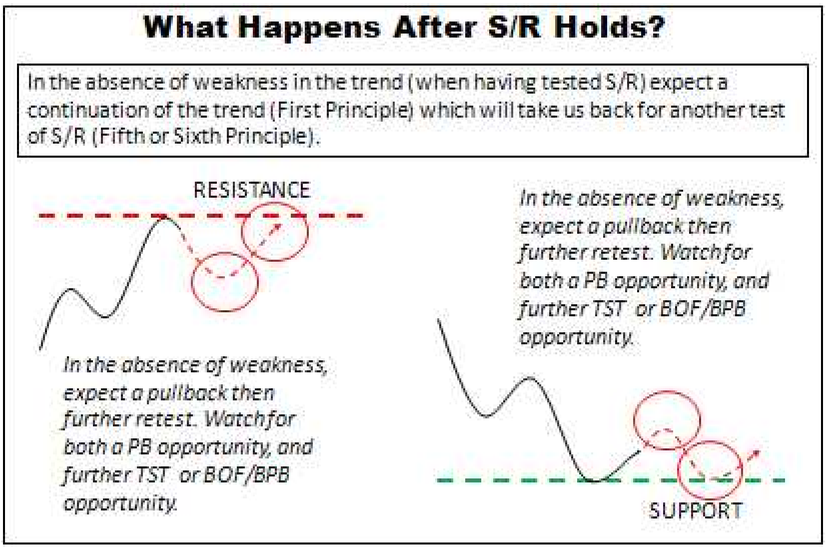


Figure 4.34 – What Happens After S/R Holds – In the Absence of Weakness

- If weakness is present in the trend (when having tested S/R), but there are no signs of strength in the reversal direction, expect a complex pullback (Second Principle) prior to taking us back for another test of S/R (Fifth or Sixth Principle). So, we look for both CPB and TST or BOF/BPB setups.

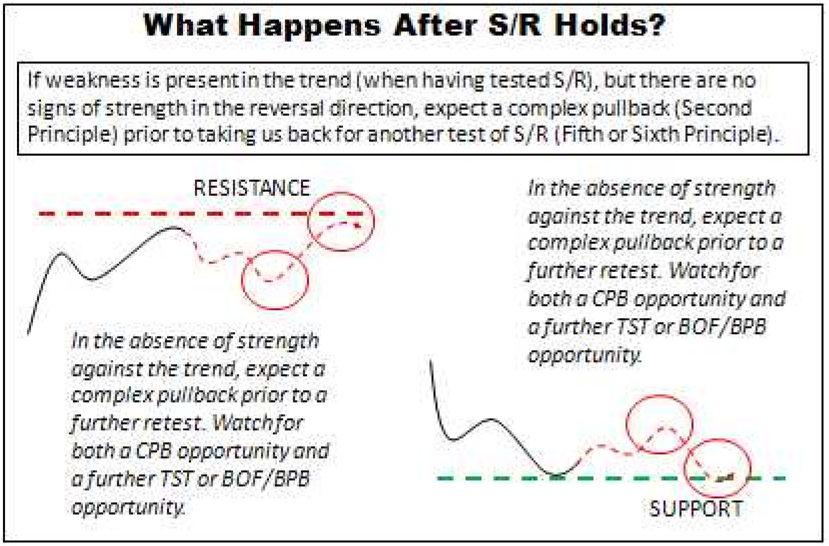


Figure 4.35 – What Happens After S/R Holds –
In the Absence of Strength Against the Trend

- If strength shows against the trend, expect a reversal. In this case, any retest of the S/R can be treated like a pullback in the direction of the new trend (First Principle). Watch for a PB setup in the new trend direction.

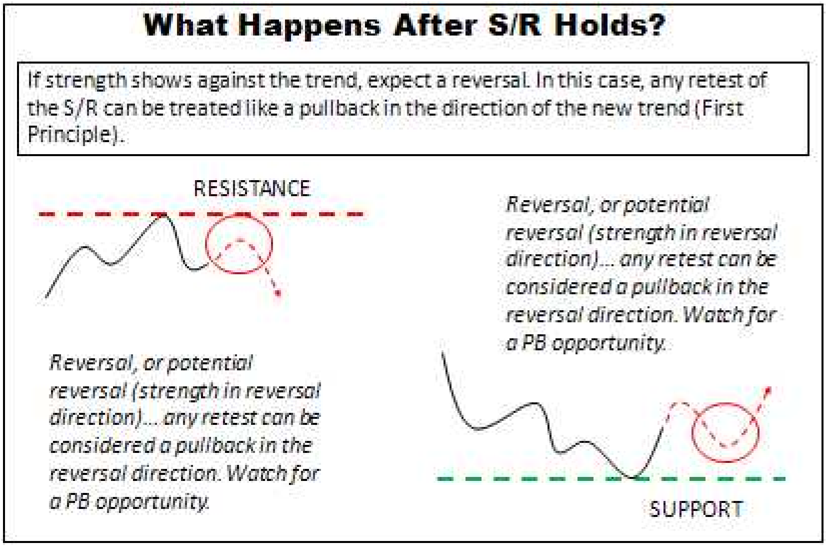


Figure 4.36 – What Happens After S/R Holds –
In the Presence of Strength Against the Trend

4.3.3 – Revisiting the Initial Market Analysis Process and Checklist

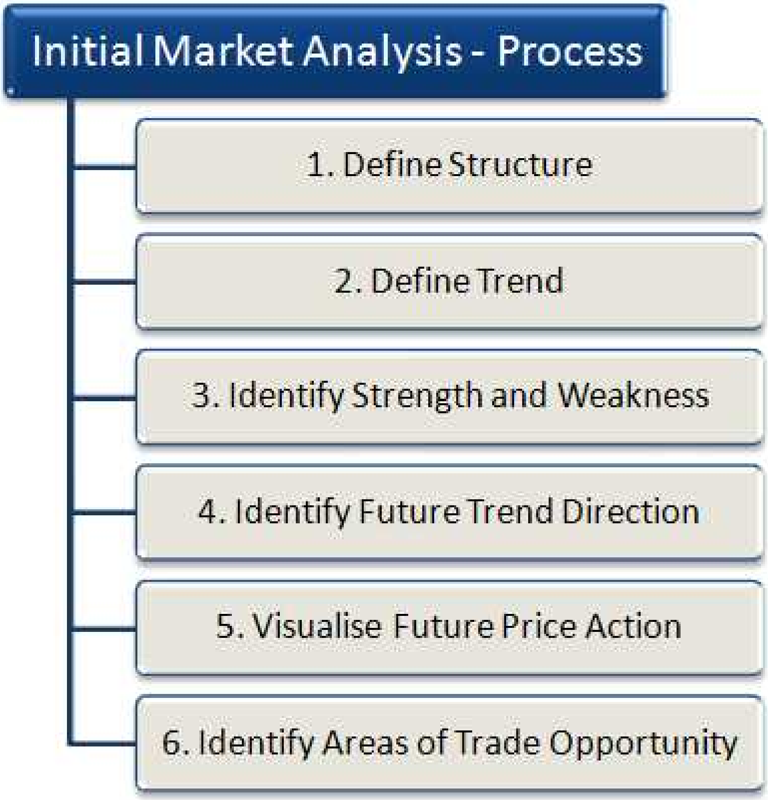


Figure 4.37 - Initial Market Analysis Process

You"ll recall this process diagram from the Analysis chapter. At the time we ignored step 6 – Identify Areas of Trade Opportunity.

We can now include the actions for step 6 within our checklist.

Step 6 – Identify Areas of Trade Opportunity

Based upon your expectations for *future trend* direction and how it should interact with areas of S/R and swing highs / lows, identify the next potential setup areas. Areas of trade opportunity are found where weakness plays out against S/R and swing highs / lows (TST, BOF, BPB), or within a trend (PB, CPB).

Actions:

- Identify potential future setup areas
  - Steady trend environment:
    - Higher Probability
      - PB and CPB
  - Weakening trend environment
    - Higher Probability
      - CPB
      - PB if they break a previous swing low (uptrend) or swing high (downtrend)
    - Lower Probability
      - Standard PB (single leg; not breaking any prior swing low (uptrend) or swing high (downtrend))
      - Counter-trend TST or BOF of swing high (uptrend) or swing low (downtrend)
  - Within a Sideways Trading Range with a clear intra-range trend
    - Lower Probability
      - PB and CPB
  - Approaching higher timeframe S/R or range S/R, with no sign of potential breakout
    - Higher Probability
      - TST
  - Approaching higher timeframe S/R or range S/R, with strength showing signs of potential breakout
    - Higher Probability
      - BOF or BPB
- Implement Trading Process if/when price enters the setup area.

4.3.4 – More Action – Trading In-between Setup Areas

The number of opportunities provided per hour will vary depending on your chosen market and timeframes. Using the timeframes shown in the examples within this book, I would expect around 1-2 setups per hour on average. Sometimes it will be more. Other times it will be less.

If you‟re using higher timeframes and find yourself bored and seeking more action, do not try to find additional opportunity in-between setup areas. If you want more action then I encourage you to stick to the same strategy but just reduce timeframes.

If you get down to timeframes less than those in this book, then I recommend you read the supplementary ebook – YTC Scalper – for additional considerations.

4.3.5 – When Price Enters Setup Areas

Price approaching a setup area is not a guarantee that we‟re going to trade. It is however a time to place yourself on high alert for trade opportunity. Remove any distraction and <u>focus</u>. Ensure you follow the price action bar by bar maintaining your feel for sentiment.

And remain alert for areas suitable for stop positioning, targets and entry point, as discussed in the following sections.

Before reading the following sections on Exits and Targets, please review the following information, which will provide a quite detailed overview:

- The Importance of Exit Strategy ebook
    - You should have downloaded a copy from the YTC Price Action Trader download page. It provides a consolidated copy of the three articles from my website on The Importance of Exit Strategy.
    - This is essential background information, required before proceeding with this book.
- Alternatively watch the video version here (four videos total):
    - http://www.yourtradingcoach.com/Videos-Risk-Management/The-Importance-of-Exit-Strategy-Vid-1.html

4.4 - Trading the Setups

4.4.1 - Stop Placement

Initial Stop Loss Placement

As soon as price is entering a setup area, I‟m searching for a stop location. This is something that should be done <u>before</u> seeking an entry trigger.

The initial positioning of the stop is always to be at a price level which invalidates your trade premise. Identify a point in the market to which price will NOT go if your expectation for future price action is correct.

Should you subsequently enter a trade and price triggers your stop, it indicates that either:

1) Your trade premise was wrong (or was right but the market sentiment has since changed and is now wrong); or

2) Your trade timing was wrong.

In either case, you WANT to be out of the market. Being stopped out is a risk management exit, designed to minimise loss and keep you in the trading game. It should be welcomed.

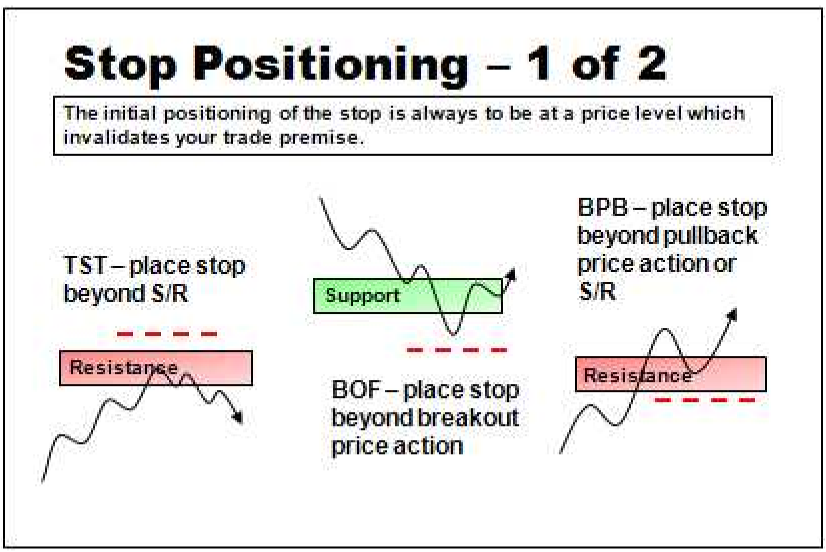


Figure 4.38 - Stop Positioning – TST, BOF and BPB

Figures 4.38 and 4.39 show the stop position for each of our setups.

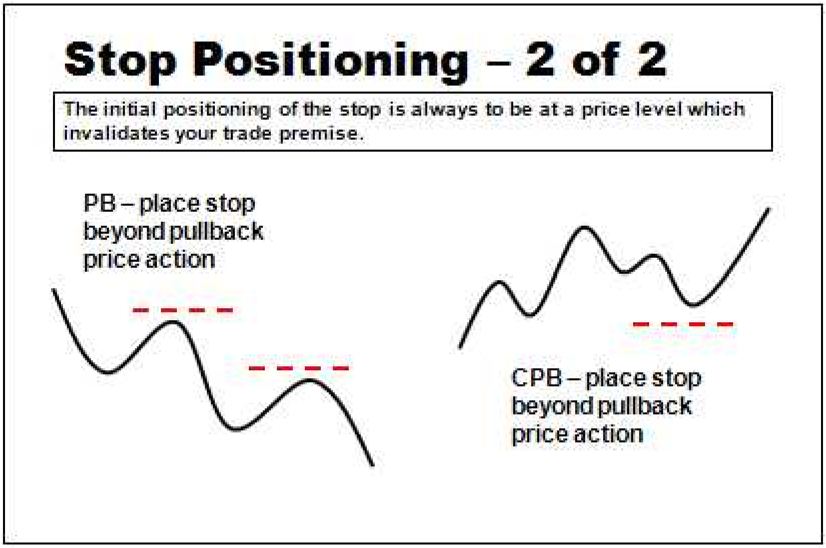


Figure 4.39 - Stop Positioning – PB and CPB

Stop positions will be clearly visible on the *trading timeframe* but I prefer to use the *lower timeframe* chart to identify their position. It allows us to see the inner workings of the *trading timeframe* candles, identifying strength and weakness on a lower time scale.

It‟s easy for a TST setup. If you‟re expecting a test of some type of S/R level, and price action does not show sufficient strength to suggest a breakout, then the stop position should be just beyond the S/R level extremes.

Figure 4.40 below shows price in a TST setup area at resistance.

If correct, price should not exceed the resistance area, so (if a trade was entered) we would currently plan to place the stop just above the resistance area.

Having identified a (tentative) stop location, we move on to identifying potential targets and an entry trigger. If price should fail to offer an entry trigger and continue moving higher, we‟ll adjust our expectations (and possibly adjust our premise and prepare for BOF or BPB setups).

If price should offer an entry trigger short, we then place our stop order at the position indicated. If we‟re subsequently stopped out at this level, it will indicate that our trade idea and in fact our whole premise were wrong. It‟s good to be out, having minimised loss. We then move on to look for the next opportunity.

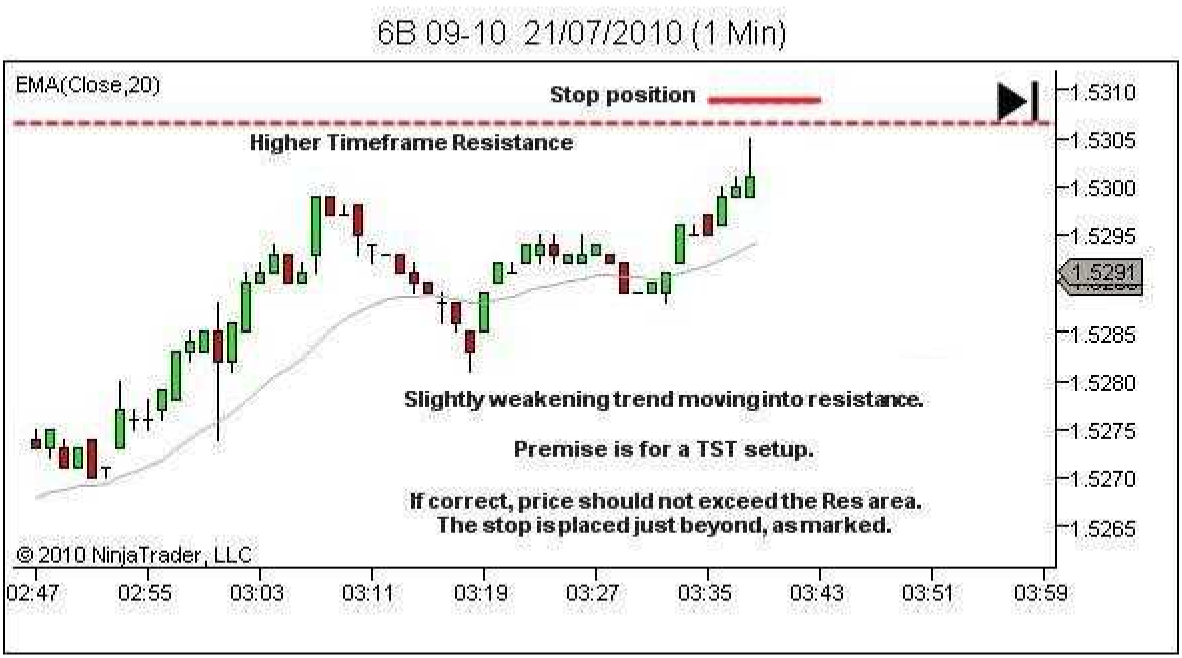


Figure 4.40 - Stop Positioning – TST Setup at Resistance

Another option in this case, had the trigger occurred immediately after the last candle shown, would be to place the initial stop lower, just above the upper tail. While this offers less risk it comes at the cost of potential stop-out, which may not have stopped out the original higher (above resistance) stop.

Please note in these examples… any stop order should be attached to an entry order. They‟re not placed in the market yet. We‟re just simply identifying its location, should a trade entry trigger.

All other setups (BOF, BPB, PB, CPB) are not so easy. There is not necessarily going to be a nice S/R line beyond which we can place our stop. Stop positioning will be dependent on price action.

The idea is the same though – we place the stop at a location where price should NOT go, if the trade premise is proven valid.

If you‟re waiting for a bullish trade setup, watch for the bears to show you all they‟ve got; then define your stop position as the place the bears could not reach.

If you‟re waiting for a bearish trade setup, watch for the bulls to show you all they‟ve got; then define your stop position as the place the bulls could not reach.

This may involve initial (tentative) identification of a stop level, adjusting it as more price action unfolds. The actual entry trigger may then also alter the stop location.

Other times you may just not have any indication of a stop position until the trigger candle.

Figure 4.41 below reproduces one of our earlier BPB setup examples, showing the 3 min setup on the LHS and the 1 min price action on the RHS.

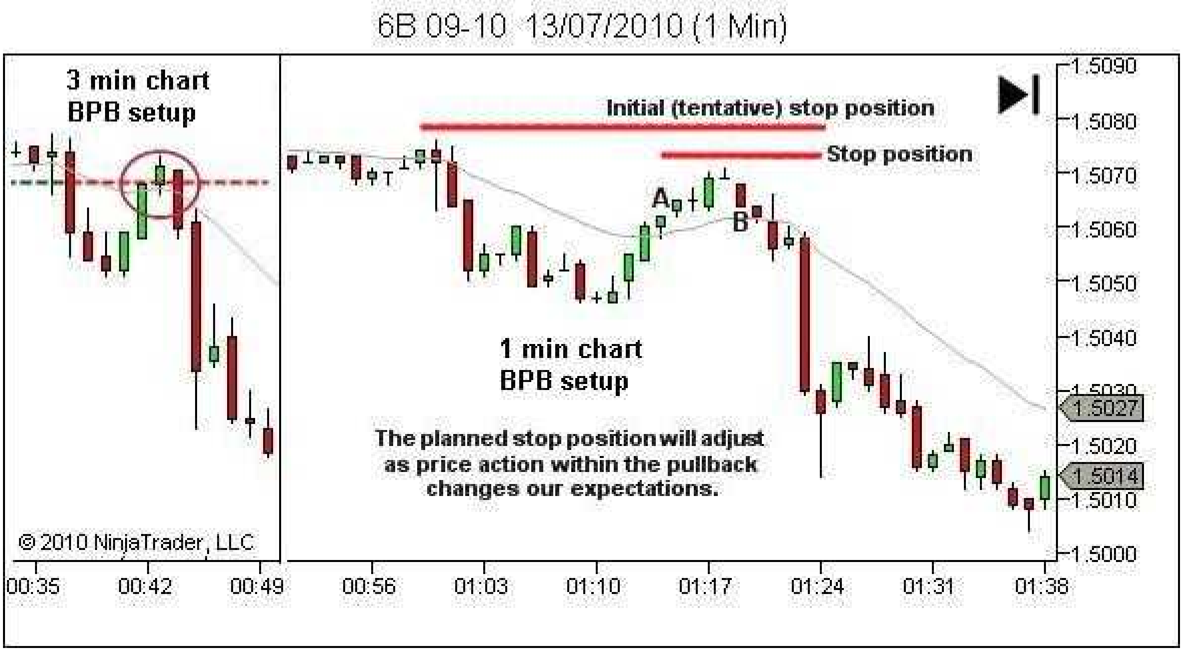


Figure 4.41 - BPB – Stop Positioning

Our expectation is for price to pull back towards the resistance area.

My attention diverts to the 1 min chart in order to see finer detail. Noting price slowing at A, I would tentatively identify a (potential) stop position above the pre-breakdown congestion as shown on the RHS above.

If price should get there at all, then the whole premise is wrong.

This doesn"t necessarily become my stop location though. I continue to monitor as more 1 min bars appear and adjust the stop if price action shows a closer area beyond which price should NOT go.

At B we have a clear sign of bearish sentiment. The tentative stop is moved above price action at the swing high (shown as „Stop position").

This is the stop position that would be placed in the market IF price subsequently triggers an entry, which it did on the following candles (we"ll get to entries shortly).

Figure 4.42 shows one of our earlier BOF examples on the LHS. 1 minute detail is shown on the RHS.

Figure 4.42 - BOF Stop Positioning

Looking at the first BOF…

A stop position would tentatively be planned for below the lower tail of candle A, should an entry trigger.

No entry triggered. Candle B then provided a lower low, again with lower tail rejection. Should a BOF entry trigger, the stop would now be planned for below candle B.

Still no entry triggered. Candle C provides a further low. The stop is now planned for below this low at stop position SP1, should the entry trigger,

As the trade entry is subsequently triggered, the order will be placed into the market at SP1.

Just quickly, looking at the further BOF opportunities…

Candle D shows a second opportunity. Note that had the stop been placed below the most recent swing low at SP2, you would subsequently be stopped out, while a wider stop at SP3 (equal to SP1) would not stop out.

SP3 is obviously the preference, below all recent swing low support areas. It will be the preferred stop location, provided it still offers suitable R:R. If not, SP2 is acceptable.

The third BOF opportunity was at candle E, with the stop placed below all price action at SP3.

Figure 4.43 below shows stop positioning for one of our earlier 3-min PB examples. The RHS shows the 1 minute detail.

Figure 4.43 - PB Setup – Stop Positioning

As price slowed in the pullback, initial planning for the stop would have been tentatively at SP1, below the pre-breakout price action to the left.

As candle A prints, we might move this to position SP2, which will then provide the stop location, should an entry trigger and the trade orders be filled.

That‟s all there is to it. Just position the stop at a place where price should NOT reach, if you get into the trade – ideally beyond some form of technical (price action) barrier such as *higher timeframe* S/R or *trading timeframe* swing H/L.

Two final points…

(1) A common question is… how far beyond these levels should the stop be placed.

The answer is that it depends on your premise. Referring back to the last chart in figure 4.43, if price action gives you sufficient confidence that SP2 should not be hit, then that is your stop – <u>immediately</u> below the recent lows.

If you don‟t have sufficient confidence, and expect a possibility that price may retest these recent lows, possibly even exceeding them by a pip or two, then place the stop further away. Maybe even as far as SP1.

Personally, 'immediately below' for me means two pips (or points). For no other reason than I absolutely hate those occasional occurrences of stop out, when price breaks the lows by one pip before moving in my direction. This of course comes at the cost of 1 extra pip loss when I am stopped out.

(2) Please note as well that we don‟t just simply place our stop and target orders and then hold till either is hit. I use an active approach to trade management and will attempt to exit any losing trades well before their stop. The stop loss position is a worst-case stop. More on that later!

Great email Q&A with a YTC newsletter reader:

Q. I keep hearing traders (and, I believe you have said this as well), say that they'll put their stop where "the market invalidates the trade" or where "they know they are wrong" or "where the market should not go". Who says that piercing a support/resistance level invalidates a trade and therefore makes it "wrong"? Can't quite wrap my mind around this! Maybe it just needed to go down a little bit lower than the reference level low before going off in the intended direction. The market does what it does. It is only us traders who put impositions on the market and claim such statements as "market goes here then I am wrong". Just wondering what your thoughts are on this.

A. Market movement is never right or wrong. It just is what it is. However, my trades are designed around my interpretation of market action. It's my interpretation that says a particular setup and entry are in place and the stop should be positioned at xxx because that level will NOT be hit. And if it is, then it's my interpretation of market sentiment that is wrong (or my timing that is out). It's not the market that's wrong. It's my read of the market. Two different things! And if my read of the market is wrong, then I should NOT be in this trade.

4.4.2 - Targets

At this point, price is in a setup area and we‟ve identified a potential stop location, a point to which price should NOT go.

We now aim to identify targets, should price trigger an entry.

Note that we do not wait for an entry, and then just simply target a reward 2 times our risk. Many people recommend simply placing a target such that it achieves a 2:1 reward:risk ratio, or even a 3:1 reward:risk ratio, and then simply walking away until price hits one or the other.

Absolute rubbish, in my opinion!

This amateur technique affords no consideration for where orderflow is expected to oppose future price action (ie. areas of support or resistance providing barriers to price movement). With our better understanding of the nature of markets and price movement, we will identify potential price targets based upon these areas of S/R.

And it fails to consider the fact that the market sentiment is constantly changing, and the premise they used for entry may not persist long beyond their entry.

Multiple Part Positions

I prefer to trade in two part positions, for reasons as described in the ebook, “The Importance of Exit Strategy”. *(If you haven’t read it, please do as it provides a lot of essential background information on stops, targets and trade management).*

Part 1 will always operate with a price target, T1.

Part 2 will have a tentative target, T2. However this part of the position may be allowed to run beyond T2 if price action shows the potential for a trending move. We‟ll discuss more on this when we talk about trade management. For now, let‟s just identify two targets, T1 and T2.

Identifying Price Targets

Our ultimate aim is to trade the swings on the *trading timeframe* chart, so we use it for defining our targets. Once again though, the *lower timeframe* may be used for fine-tuning if necessary.

The first price target T1 will be the next level which is expected to provide opposing orderflow.

The second target T2 will be just prior to the next level of *higher timeframe* S/R. If price is at all-time highs or lows (or at least long time highs or lows), and so offers no real „next level‟ of S/R, I will target the first area of *trading timeframe* price stall beyond T1, or allow the price to simply trend with a trailing stop (an example follows shortly).

Let‟s look back at some of our setup charts in order to identify appropriate targets.

Again though, remember that we don‟t simply set our stops and targets and then walk away. These are just initial areas we expect price to reach, based on our expectations for future price action. We‟ll be actively managing the trade and may take profits earlier if our expectations change and our premise is no longer believed valid.

In figure 4.44 below we show a BPB setup, with T1 identified at 1.5940, just short of potential swing high resistance, and T2 identified at 1.5955, just below the next resistance level. This is clearly (with the benefit of hindsight) one example which would have benefited from running part 2 rather than targeting T2.

Figure 4.44 - BPB Targets

Figure 4.45 below shows a CPB setup within an uptrend.

Initial stop placement is below the low of the pullback at 1.5890. T1 would be prior to the swing high, at 1.5920.

Price has been in a longer timeframe uptrend for over a month at this stage. The *higher timeframe* (30 min) chart does not provide any higher resistance areas which would serve as a potential second target. The daily chart provides potential resistance at 1.6070. Depending on my feel for price action I‟ll either exit at the first stall above T1, or trail a stop up to a T2 level of 1.6060.

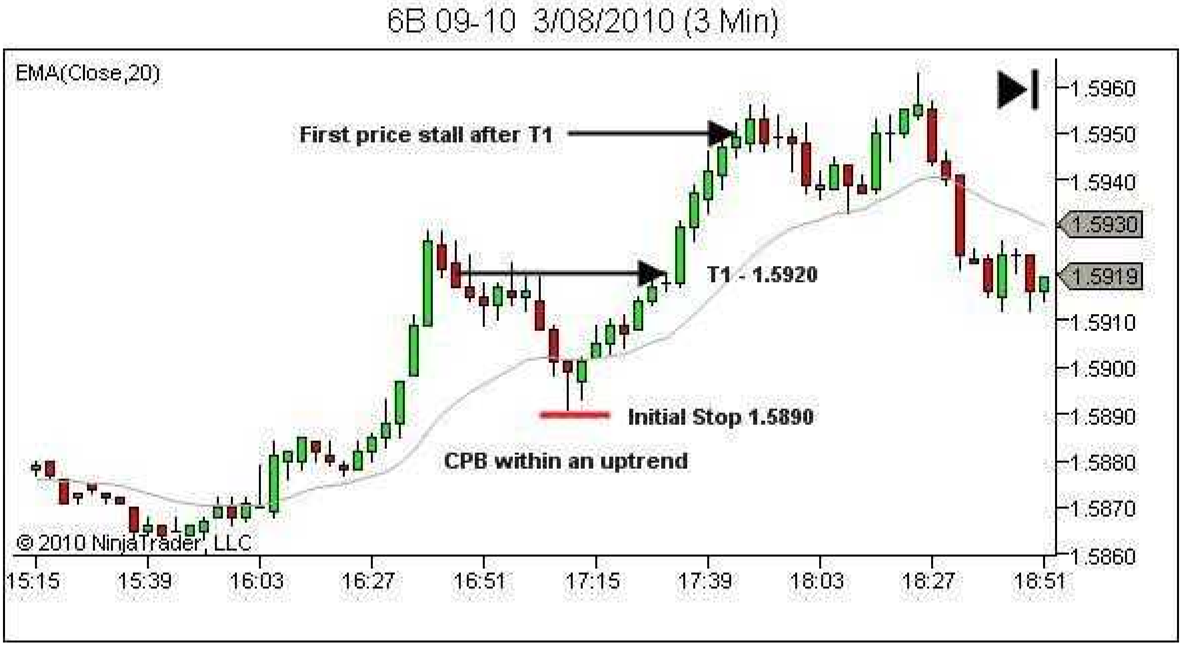


Figure 4.45 - CPB Targets

With the benefit of hindsight, targeting the first price stall got us out around 1.5945. The trailing stop would have exited at some lower point, depending on how tight it was held.

Figure 4.46 below shows a BOF setup, as post-NFP price action stalls and fails above the sideways trading range.

With us re-entering a sideways trading range, I‟d use the same target for both T1 and T2. T1 is just above the next support level. I don‟t have great faith in price getting to the next lower one, and would rather take T2 profits at the same place (T1) and look for another opportunity. In hindsight, T2 could have been a bit closer to the first support level, but that‟s trading – we rarely get it perfect!

Figure 4.46 - BOF Targets

The T1 and T2 position was fine-tuned on the *lower timeframe* (1 min) chart, placed just above the high of the lowest candle at the last swing low, as shown below.

Figure 4.47 - Fine-tuning BOF Targets on the Lower Timeframe (1 min) Chart

Figure 4.48 below shows targets for a TST setup at resistance.

Figure 4.48 - TST Targets

The initial stop is above the TST price action reversal. T1 is just above the next 3-min swing low, at 1.5023. T2 is above the next support at 1.4989.

As you‟ve seen, assigning targets is a simple process.

T1 is the next *trading timeframe* (3 min) area expected to provide opposing orderflow (swing H/L, S/R level).

T2 is the area of *higher timeframe* (30 min) S/R beyond T1, although much more flexibility is afforded with T2 and you can adjust it closer if you wish, or trail beyond it for (hopefully) greater profits.

4.4.3 - Entry

"Take time to deliberate,
but when the time for action has arrived,
stop thinking and go in."

…Napoleon Bonaparte

Entry Principles

Let"s start with some basic principles of entry.

<u>*Imperfection*</u>

Should we use a breakout style entry (stop entry order) or work a better price through a pullback style entry (limit entry order)?

Unfortunately, the best entry technique for a particular price action setup CANNOT be known until the trade is over and reviewed with the benefit of hindsight.

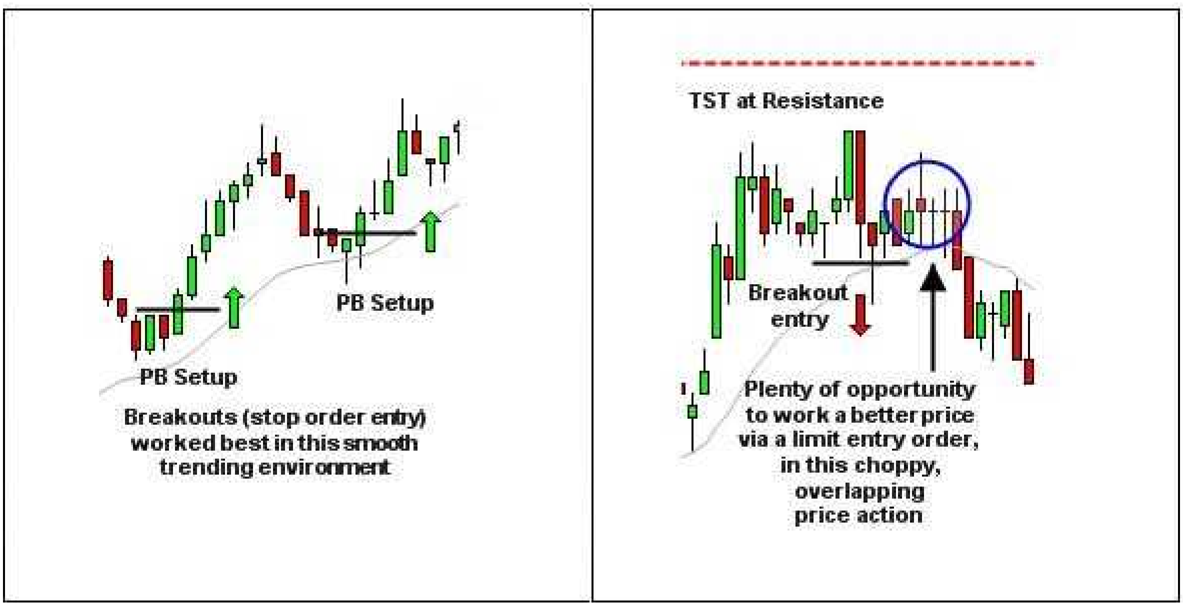


Figure 4.49 - Entry Uncertainty – Stop Entry or Limit Entry?

In figure 4.49, LHS, a breakout (stop order entry) was the best way to get into the trade. Price broke through the entry price and then didn"t look back. There was very limited opportunity to get into a pullback (limit order) entry prior to the trigger, and certainly no opportunity after the trigger. Those trying to work a better price risked missing this opportunity altogether. In this example, the breakout style entry was clearly the better option.

On the RHS, we see choppier action which provided significant opportunity to work a better limit order entry price, and gain increased profit potential and reduced risk compared with the breakout style entry. The limit order entry was the preferred option.

In figure 4.50, LHS, we see a breakout entry triggering us into a long position, right before price collapses and stops us out. Working a better pullback entry price via a limit order allowed us a small buffer, in which our trade was in profit, giving us the opportunity to perhaps scratch the trade at breakeven, or for a reduced loss. The limit order was clearly the best option in this case.

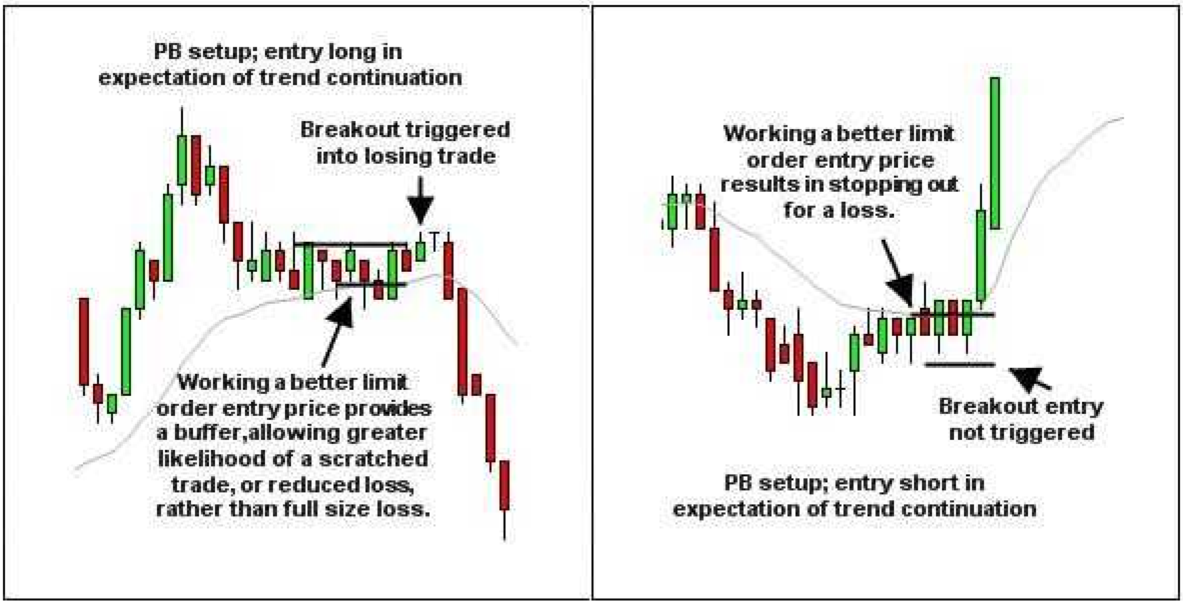


Figure 4.50 - Entry Uncertainty – Stop Entry or Limit Entry?

On the RHS though, we see an example in which we attempted a PB entry short. The market reversed, meaning the breakout order was never even filled, while the limit order provided us with a loss. In this case a breakout style entry was vastly superior, through avoiding a losing trade.

The nature of the market structure and price action environment can provide some good clues as to the preferred option. A smooth and flowing market may lean the probabilities towards a breakout style entry. A choppy and overlapping market may provide better opportunity through a pullback, limit order entry. However, that"s not always the case.

The fact is… **we cannot know what the best entry strategy will be until we review the trade with the benefit of hindsight.**

So, all we can do is ensure that price is within an area in which we‟re happy to enter, and try to get the best price possible within that area. Then manage the trade!

If it turns out to be the best entry possible – great!

If not, accept it. Review the entry, seeking clues as to how you could perhaps have identified the better option, but don‟t stress over it too much.

Find an area where you‟re happy to enter a trade, and just work the best entry you can. Provided it‟s within your entry zone, accept whatever happens and just manage whatever the market throws at you. (How you manage and exit the trade is far more important than entry!)

So… how do we define our entry zone?

Wholesale vs Retail

Wholesale entry is a term which has been popularised lately by Don Miller (in his excellent blog (http://donmillerjournal.blogspot.com/). It‟s a term he‟s used quite a bit to describe his entry locations. I don‟t believe my use of the term is the same as his (so I apologise if this causes any confusion), but it‟s just a great descriptor for this entry concept.

Its standard business principles – buy wholesale; sell retail.

Why wouldn‟t we want to trade the same way; entering at wholesale prices and closing the position at retail prices?

My aim is to trade the *trading timeframe* swings. As we see below in figure 4.51, price swings have limited profit potential. They only go so far before reversing. Of course, we don‟t know how far each will go with absolute certainty, but we know they must end eventually.

This is the space we have available in which to gain an entry and secure a profit, hopefully before the reversal takes away our gains.

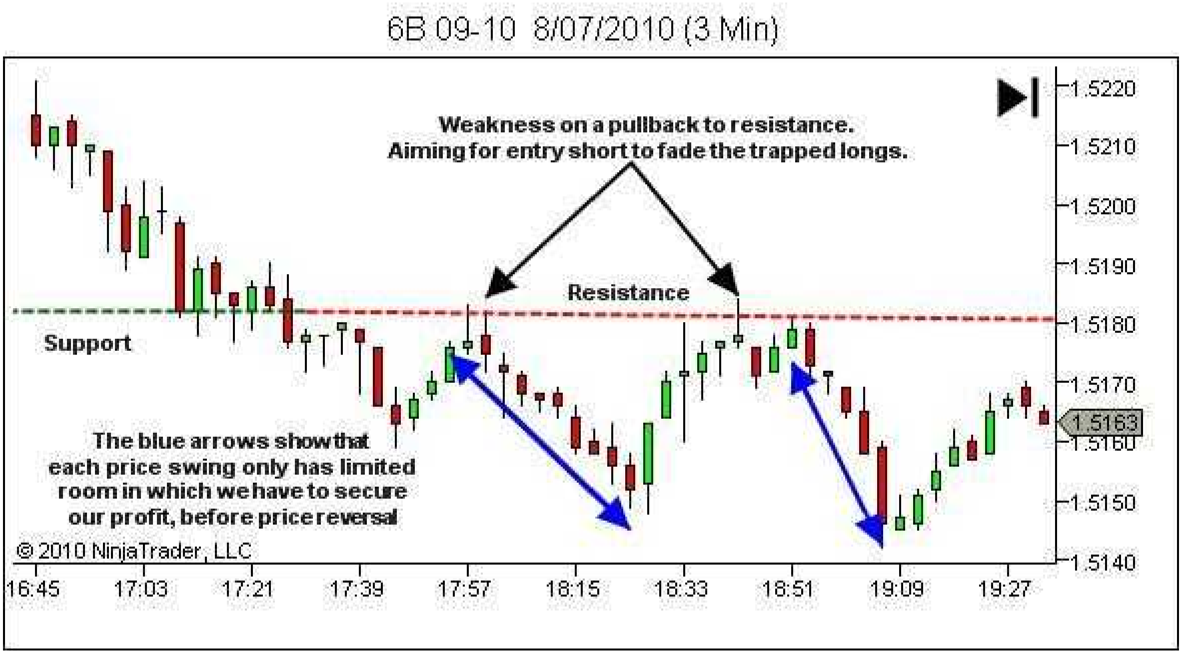


Figure 4.51 - Limited Profit Opportunity

Wholesale prices are early in each of the price swings; the professionals are entering short in expectation of lower prices where they can close out their position and secure a profit.

Retail prices are late in each price swing; the amateur, retail public are entering short in response to some TA trigger such as the break of the prior swing low, or a moving average cross. Quite likely it‟s the professionals who are on the other side of their trade, buying back to close out their short position.

My intent is to enter as EARLY AS POSSIBLE, along with the wholesale, professional crowd.

Some traders may argue that trying to enter as early as possible in a move is attempting to pick tops or bottoms. Absolutely! Why wouldn‟t you want to – that‟s where risk is lowest and profit potential is at a maximum!

Retail entries increase risk and reduce profit potential, as shown in figure 4.52 which demonstrates entry on a break of the previous swing low.

Wholesale entries ensure reduced risk and greater profit potential, as shown in figure 4.53.

Figure 4.52 - Breakout Style Entries are Often Too Late for Swing Trading

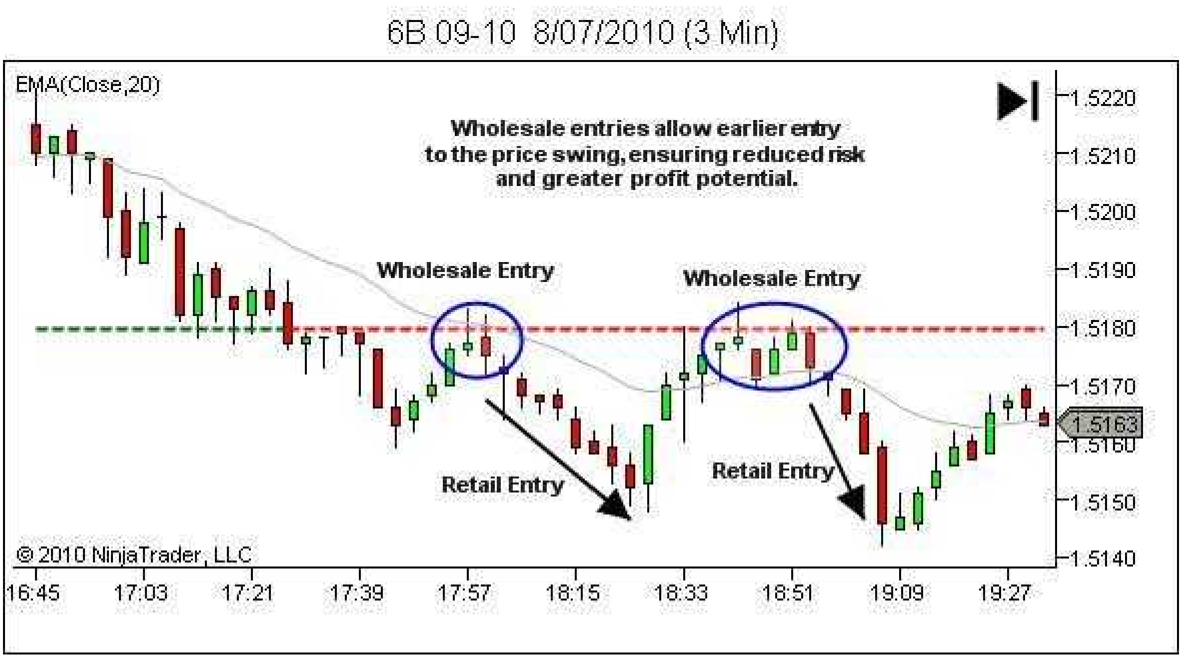


Figure 4.53 - Wholesale Entries – Reduced Risk & Greater Profit Potential

How do we define the wholesale area?

Consider the *trading timeframe* chart. Our setups are designed around identifying weakness moving into S/R, weakness moving into swing H/L or weakness in pullbacks within a trend. We identify the retail traders entering late in this move, becoming trapped in a low probability trade and being forced to exit. We aim to enter at or before point when the trapped traders realize they need to get out.

This point is really easy to identify. It's essentially a breakout of some form of reversal pattern or area of congestion at the setup area.

Anything at or before this point is wholesale. Anything after this point is retail.

I call this point the **Last Wholesale Price (LWP)**. I aim for entry at or before the LWP. I will not chase entry after the LWP under any circumstances, as to do so increases risk and reduces potential reward. If I miss an entry before it passes the LWP, I‟ll be patient and wait for any second-chance retest opportunities, or the next setup.

Please note, we do not simply enter at this point. We use the lower timeframe to try to seek a better price, if at all possible. This is simply the last price we will accept in order to ensure wholesale prices.

All examples below are taken from the *trading timeframe* (3 min).

Figures 4.54 and 4.55 demonstrate the Last Wholesale Price (LWP) for several setups. In example (A) we see a BPB setup. A breakout through support has occurred and price returns to the point of breakout before showing a change of sentiment – two bull candles followed by a low close range candle. Continuation below this candle will start to trigger stops (in this case both the late longs and also the trapped longs from before the original breakout downwards). This point is the last wholesale price. Entry must be achieved at or before the breakout below this low close range candle.

In example (B) we have a BOF; actually a second chance BOF entry. Price is testing the earlier lows. LWP is a break above the last low close bear candle. This will trigger a failure of two pushes down below support. The first of the stops will be triggered helping push our price higher. Entry must be achieved at or before the LWP, or else I will pass on this trade.

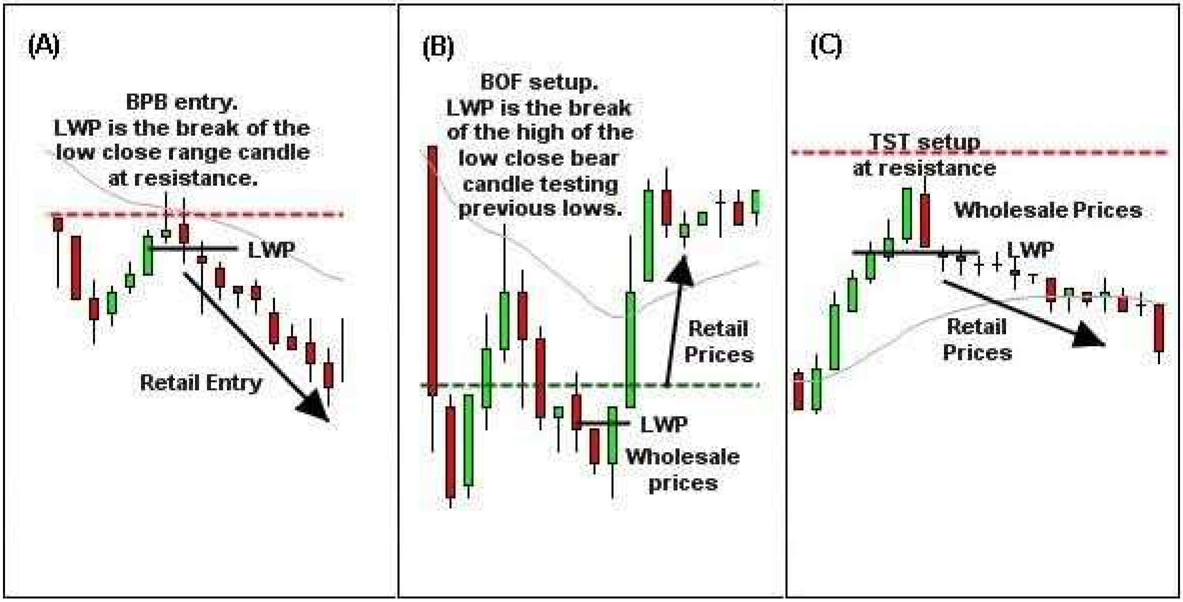


Figure 4.54 - Last Wholesale Price (1 of 2)

In example (C) we see a TST at resistance. A sequence of bull candles have suddenly given way to a low close bear candle, completely reversing the previous large high close bull candle. This is a rapid change of sentiment. Continuation lower will start to trigger the stops. This is therefore our last wholesale price (LWP).

Example (D) shows a PB setup within an uptrend. The last wholesale price (LWP) is above the green candle with lower tail that rapidly reverses sentiment. Entry must be achieved at or before this area.

Example (E) shows a CPB setup within an uptrend. The LWP is above the two candle pattern (low close bear candle followed by the high close range candle which completely reversed sentiment). Stops will be triggered on continuation above this pattern.

Example (F) shows a TST of lower range support from a sideways trend. Price is slowing into the support area, as shown by the lower tail on the mid close bear candle and then the mid close range candle. Stops will be tightened above this pause (along with new longs simply entering on a breakout of price at the lower support area). This is our LWP. Our entry must be achieved at or before this point.

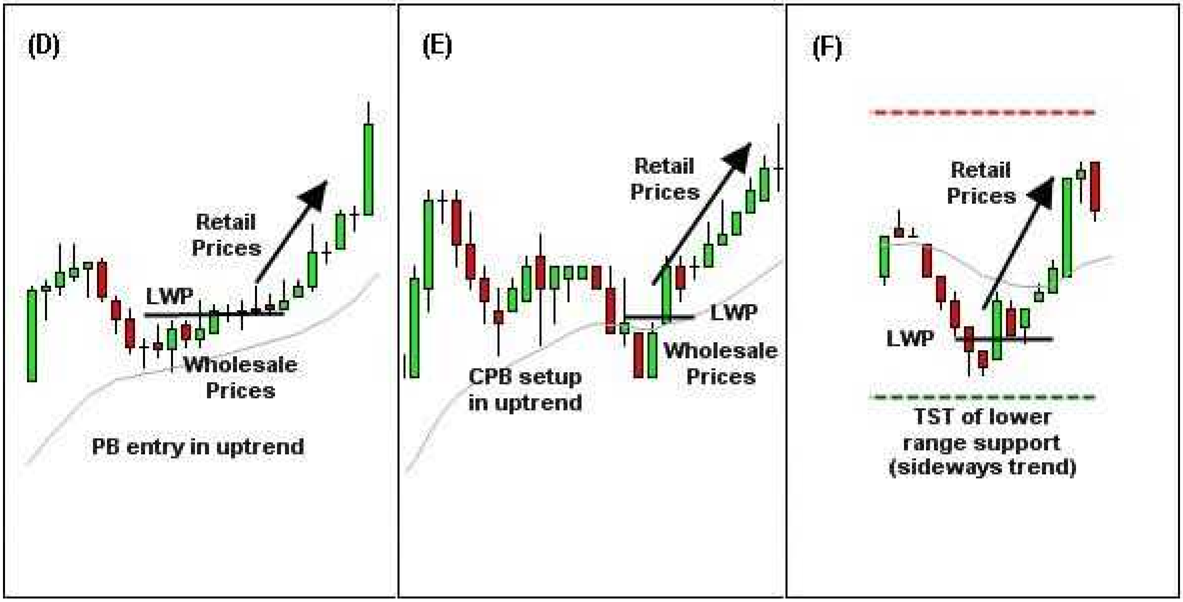


Figure 4.55 - Last Wholesale Price (2 of 2)

Our wholesale area is up to and including the breakout of the *trading timeframe* reversal price action; the point at which stops will start to be triggered by those trapped in a losing position.

We aim to enter at or before this area.

We do not chase price beyond this area if an entry is missed. We wait for either a second chance retest, or the next setup.

Reward:Risk Ratio

Figure 4.56 - Stop-Targets-R:R-Entry

Most traders find an entry trigger, then place their stop beyond recent price action swing H/L, measure their risk, set a target 2-3 times the amount of risk, and sit back and wait till either the stop or the target is hit.

Not good!

They don‟t even check market structure or price action to see whether or not that target is realistically achievable.

Market structure provides us with our setup areas – areas with expectation of orderflow from losers exiting their trades.

Price action provides us with a stop point – an area where price should NOT go, if our trade idea is valid.

Price action also provides us with a target – an area where orderflow will oppose our trade, which may just pause price temporarily, but which also may reverse it completely.

Why would you place a 3:1 R:R target beyond S/R barriers, and then just hope price breaks through them? That‟s just plain dumb.

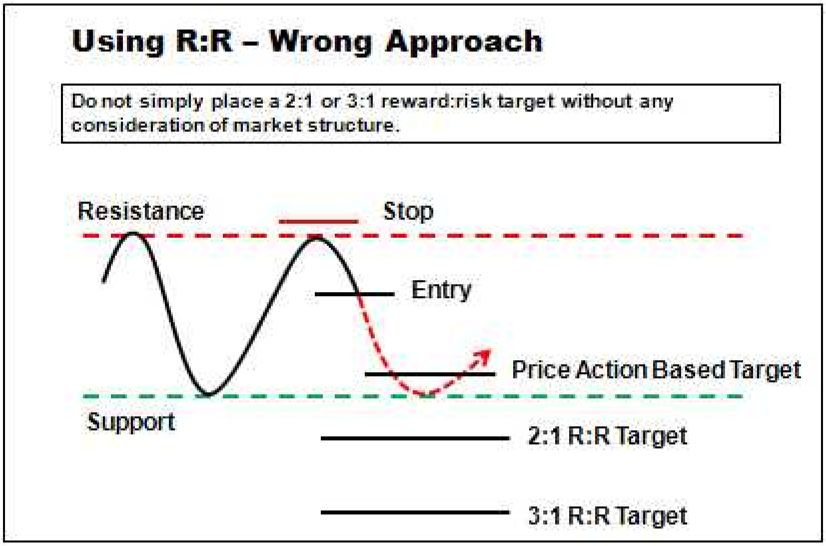


Figure 4.57 - Using R:R – Wrong Approach

Our approach differs. We start with our stop and target and then apply our desired R:R ratio over top of that, to define a Last R:R Price (LRP), beyond which we can"t enter.

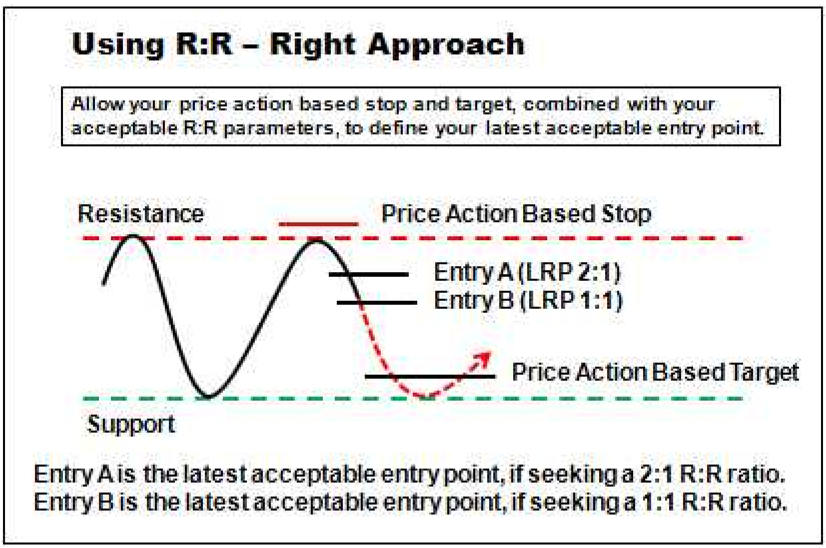


Figure 4.58 - Using R:R – Right Approach

What R:R ratio do I use?

I aim for a 1:1 R:R ratio for my part one entry. So, the LRP is defined as exactly half way between the stop location and the first target, T1 (the next *trading timeframe* swing H/L or area of S/R).

You might argue that 1:1 is insufficient. Remember, my active management strategy aims to ensure that I rarely exit my losers at the stop; I aim to scratch them before then if the premise is in doubt. If managed effectively, this will reduce the risk side of my actual R:R ratio.

Also, this is only part one. Part two is available to run to a further target (or till it hits a trailing stop), aiming to maximise the reward side of my actual R:R ratio.

Entry Zone

We now have two latest entry points. One defined by price action (LWP). And one defined by our risk management parameters (LRP).

The entry zone is between the stop and the closer of the two last entry prices (LWP or LRP).

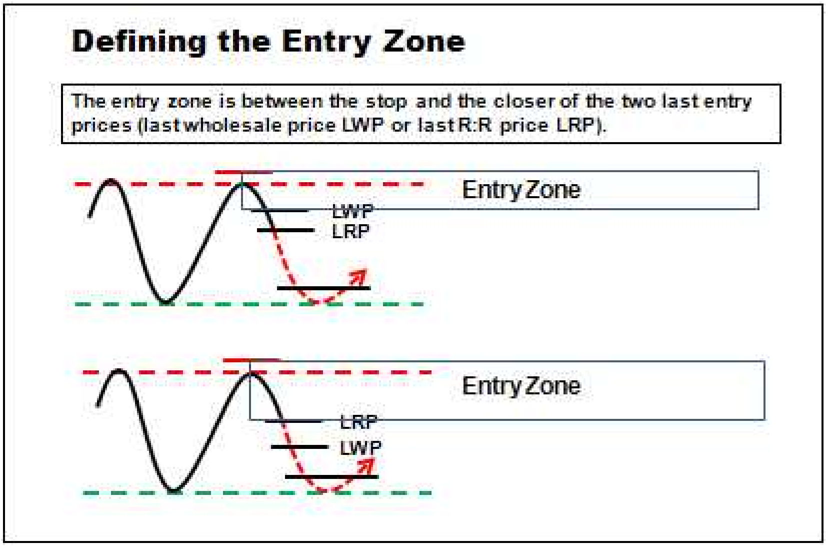


Figure 4.59 - Defining the Entry Zone

Aiming to work an entry within this Entry Zone ensures that (a) our entry price is within the wholesale price area and (b) our entry price meets our acceptable R:R parameters.

Please note: Everything in this book requires multiple pages to describe in detail. That doesn't mean it's complex. Don't get in the habit of calculating and recording your LRP and LWP. You can visually see your LWP (it's the breakout of any trading timeframe reversal pattern in your setup area) and you can visually eyeball the LRP (exactly half way between your stop and target). Don't create complexity when it's not needed. While fine-tuning our entry on the lower timeframe, we simply ensure we don't chase price beyond the closer of these two areas.

Entry Preconditions

- Price is in a setup area
  - We‟re fading weakness as price interacts with S/R or a swing H/L; or fading weakness on a pullback within a trend

- A stop has been identified
  - An area is identified beyond which price will NOT go, if our trade idea is valid.
  - Ideally S/R or swing H/L

- Targets have been identified
  - Next trading timeframe swing H/L or S/R

- The entry zone is identified
  - Having considered LWP and LRP

Once all this is in place, it‟s time to trade.

Fade the weakness!

Spring the Trap!

Entry Technique - Simplified Entry

The first option I will provide is the simplified entry technique. This is not my preference. I prefer to monitor the lower timeframe price action in an attempt to work a better entry price. We‟ll discuss that later.

However, many traders who are still working to achieve consistent profitability will find it difficult to make active entry decisions, while their decision making is subject to all kinds of negative psychological influence which lead to hesitation and second-guessing. The simplified entry technique will assist them in getting entry to trades.

The simplified entry technique involves placing a stop entry order at LWP, as soon as we have identified that position.

The order will be adjusted if not triggered, and subsequent price action offers a better LWP. And the order will be cancelled if subsequent price action invalidates the setup.

This is about as simple as entry can be made. Place a stop entry order and wait.

Important condition: this is only to be used when the entry offers a R:R of 1:1 or greater. If it doesn‟t, pass on the trade and wait for either a better entry or the next setup.

The simplified entry technique will of course come at the cost of a worse price, than may be achieved through working an entry, and therefore a reduced R:R. However, it is still effective. After all, the LWP is the point at which orderflow should be assisting our trades. Any entry before then may offer a better R:R, but this comes at the risk of LWP not being achieved.

You may wish to review figures 4.54 and 4.55, which offered examples of the LWP. In using the simplified entry technique, we would simply place a stop entry order at this price, await the market to trigger us into our trade, and then commence our trade management. Nice and simple!

As mentioned earlier, my preference is for attempting to work an improved entry price.

When you're comfortable with the remainder of the trading process I'd recommend that you start using the lower timeframe to try to work a better entry. Start this process using a market replay feature – play the entry first using LWP, and then play again several times working a better entry. Over time you‟ll become comfortable with the process.

Please note that all trade examples throughout the book will use the active entry process rather than the simplified entry, for education purposes. If you choose to use the simplified process, it will be obvious where the entry occurs – the explanation of the trade entry will identify the LWP.

Entry Technique – Working an Improved Price through an Active Entry Process

For those that wish to actively manage their entry through *lower timeframe* (1 min) price action, in an attempt to achieve a better price than LWP, this section will discuss the process that I use.

<u>*Entry Decision*</u>

You should recall these sentences from earlier:

> The fact is… **we cannot know what the best entry strategy will be until we review the trade with the benefit of hindsight.**
>
> So, all we can do is ensure that price is within an area in which we‟re happy to enter, and try to get the best price possible within that area. Then manage the trade!

In a perfect world, entry within our entry zone would be a result of our finely tuned intuition. Unfortunately most of us will never achieve expertise in that area. The best we can hope for is gradual improvement with experience.

During the learning phase most of us need some kind of trigger for entry. Some sign that will provide us with sufficient confidence to hit that buy or sell button.

Primarily I look for one of two signs in order to make my entry decision.

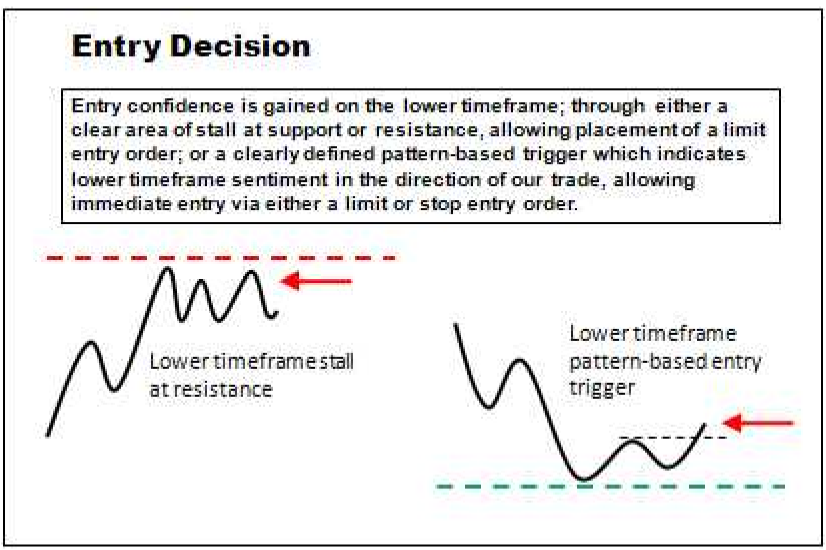


Figure 4.60 - Entry Decision Stall or Trigger

The first is a stall in price action. The second is a pattern based trigger. The stall is rarer, and more complex. We‟ll look at it first including some examples; then move onto the easier pattern based triggers.

<u>*Stall*</u>

A stall is evident when price displays a clear inability to continue beyond an area of setup support or resistance (whether higher timeframe S/R, swing H/L or range S/R).

The number of candles in a *stall* is difficult to define – every situation is unique, and you‟ll know it when you see it – but I‟d usually expect at least 3 *trading timeframe* candles.

Confidence in a level holding allows you to place a limit entry order close to the area of S/R. The stalled price action offers good potential for another test of that area allowing a massively discounted wholesale entry price. If you‟re subsequently proven wrong (or early) then the risk has been minimised. If you‟re right however, the reward potential has been maximised. Either way… assuming your setup area is valid, it‟s a great entry.

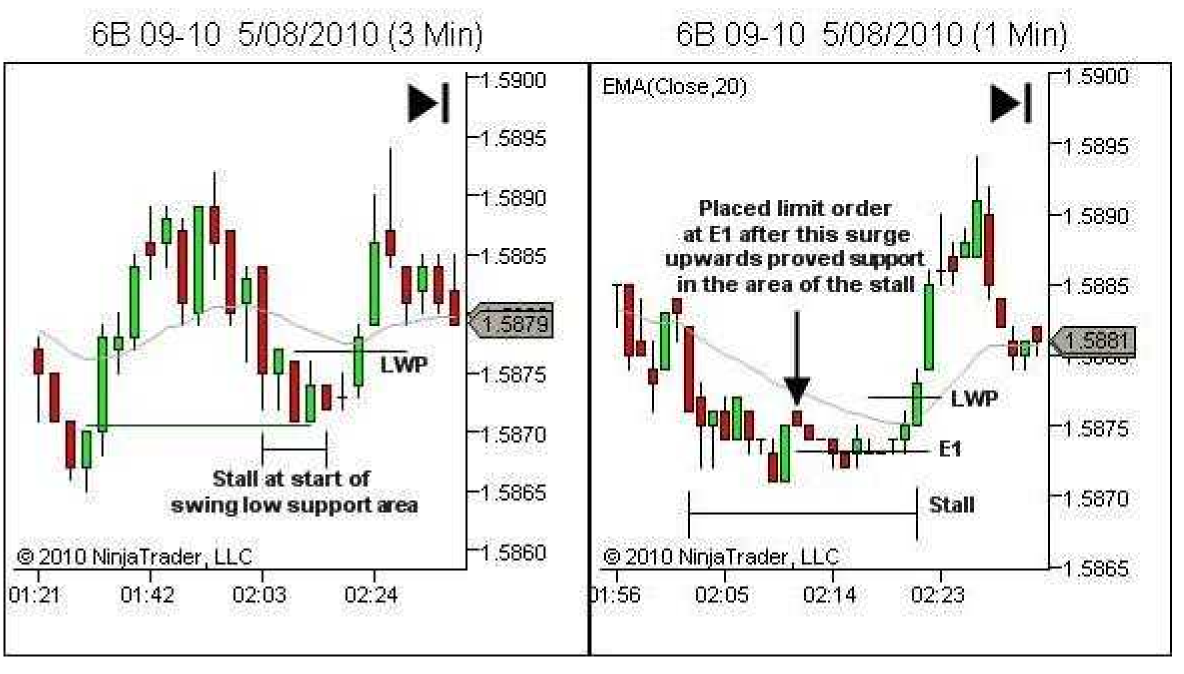


Figure 4.61 - TST of Swing Low – Entry Trigger via Stall

Figure 4.61 above shows a TST of a swing low in a wide swing uptrend. You could also call it a CPB if you wish. I prefer TST in this case simply because the last move from the area provided a stronger surge of momentum which led to a change of trend to upwards. This area would be expected to provide support, should price return to the area.

Price did return to the area just 45 mins later, demonstrating bullish pressure at this level of swing low support, through forming a stall pattern.

Looking at the *lower timeframe* (1 min) on the RHS, confidence in the stall was gained after the larger green (high close bull candle) allowing a BUY LIMIT order to be placed closer to the lows of the stall at E1. This provides a low risk entry with higher potential reward, well before the LWP entry point.

Note of course that the risk with this sort of entry is that, should the support level break we will have been triggered into a losing trade, which would not have been entered had we relied simply on a BUY STOP at LWP.

However, risk has been minimised, and profit potential has been maximised. Provided our analysis identifies a quality setup area and a clear stall in the area, this is a risk worth taking.

A second risk is of lost opportunity, should price not hit the BUY LIMIT order. We will later look at a way of ensuring that you don‟t miss these opportunities.

We have a much more complex example in figure 4.62 below, which displays a CPB setup in a downtrend.

Looking at the *trading timeframe* (3 min) on the LHS we have a clear area defined as a stop, S1 at 1.5619.

T1 caused some problems though. Normally, in accordance with the definition of a downtrend, we expect our extensions to break the next swing low. So in a nice orderly trend I‟d be happy to place T1 beyond the swing low. However in this case price action was not being orderly. I was not greatly confident in the fact that price would break the swing lows, so I placed T1 just above the swing low at 1.5603.

LWP was based on a break below the congestion, which places it at 1.5605. Clearly this is inappropriate (14 pips risk for 2 pips reward). LRP is midway between 1.5603 and 1.5619; or 1.5611.

I would NOT be interested in this trade unless I could get an entry at or above LRP, 1.5611.

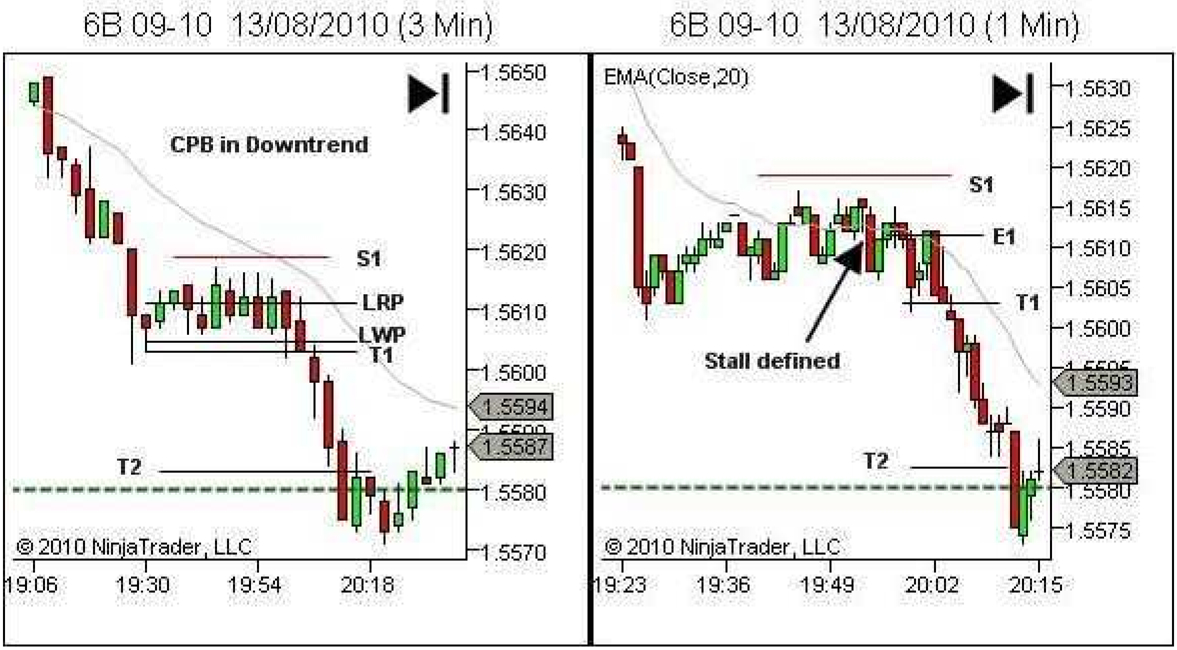


Figure 4.62 - CPB Setup – Entry via Stall

Looking at the *lower timeframe* (1 min) on the RHS, I am satisfied that a stall has developed after the second attempt to push the resistance area (which is the fourth candle at the stall on the *trading timeframe* (3 min) chart). An entry limit order placed at E1, 1.5611, would be filled within two minutes providing us with a wholesale entry that also meets our minimum R:R requirements.

Note that this trade offered an opportunity to take profits at T1 and then re-enter again at E1 for a second bite. Personally I would have passed on this second opportunity due to the price action at T1 resembling too much of a spring (*see next section for the 'spring'*).

Price did however continue down to T2 allowing greater profits on the second part.

Pattern Based Triggers

Now let"s consider the pattern based triggers. These include ANY *lower timeframe* (1 min) price action pattern which:

1) Confirms short-term sentiment in the direction of our trade premise, and
2) Indicates an area where price should NOT go. This area may then be used as our stop loss.

Examples include:

1) Any standard candlestick reversal pattern
2) Any standard price bar reversal pattern
3) Any trap pattern which proves the loser wrong
   a) spike & ledge
   b) double top or bottom
   c) spring or upthrust
   d) 3-swing retrace
   e) 123 top or bottom
   f) test of breakout point
   g) expansion bar

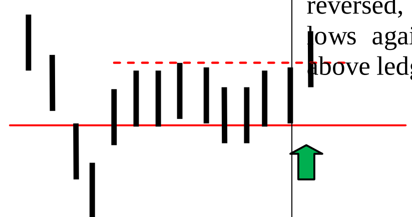
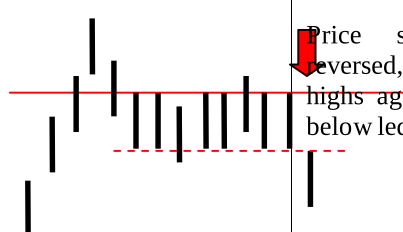
Refer to the video series at: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Candlestick-Charting-Videos.html	**Candlestick Reversal Patterns**
Refer to the video series at: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Complete-Price-Bar-Reversal-Video-Series.html	**Price Bar Reversal Patterns**
	**Spike and Ledge (bullish)** Price spike down, quickly reversed, then unable to meet lows again. Trigger = break above ledge.
	**Spike and Ledge (bearish)** Price spike up, quickly reversed, then unable to meet highs again. Trigger = break below ledge.

Figure 4.63 - Lower Timeframe Triggers (1 of 4)

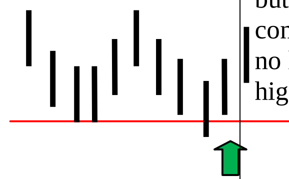
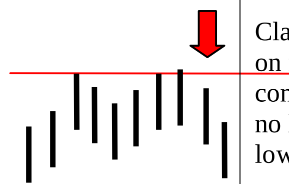
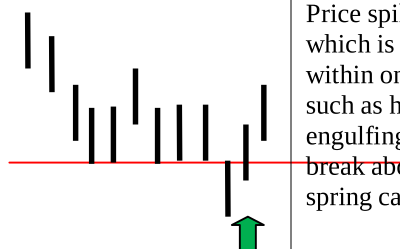
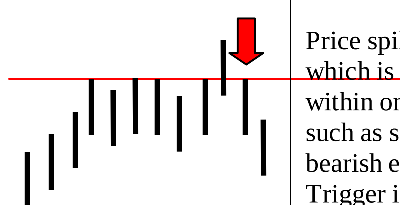
	**Double Bottom** Classic double bottom setup, but on micro scale. Enter on confirmation of second low, no later than break of swing high.
	**Double Top** Classic double top setup, but on micro scale. Enter on confirmation of second high, no later than break of swing low.
	**Spring** Price spike below support which is rapidly reversed within one or two candles, such as hammer or bullish engulfing pattern. Trigger is a break above the high of the spring candle.
	**Upthrust** Price spike above resistance which is rapidly reversed within one or two candles, such as shooting star or bearish engulfing pattern. Trigger is a break below the low of the upthrust candle.

Figure 4.64 - Lower Timeframe Triggers (2 of 4)

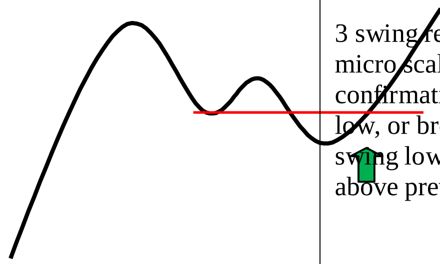
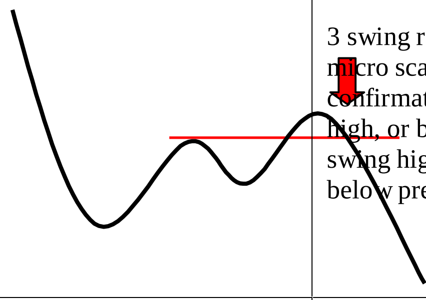
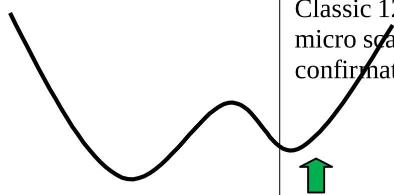
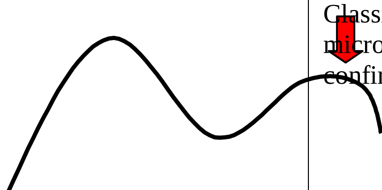
	**3 swing retrace (bullish)** 3 swing retracement, but on a micro scale. Enter on confirmation of second swing low, or break above previous swing low (or even close above previous swing low)
	**3 swing retrace (bearish)** 3 swing retracement, but on a micro scale. Enter on confirmation of second swing high, or break below previous swing high (or even close below previous swing high)
	**123 bottom** Classic 123 bottom, except on micro scale. Enter on confirmation of higher low.
	**123 top** Classic 123 top, except on micro scale. Enter on confirmation of lower high.

Figure 4.65 - Lower Timeframe Triggers (3 of 4)

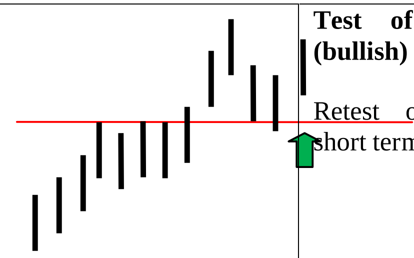
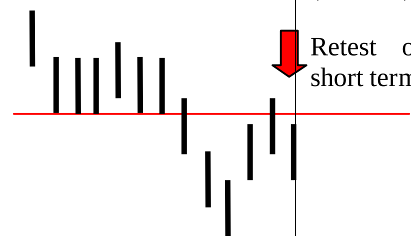
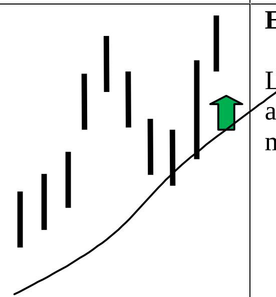
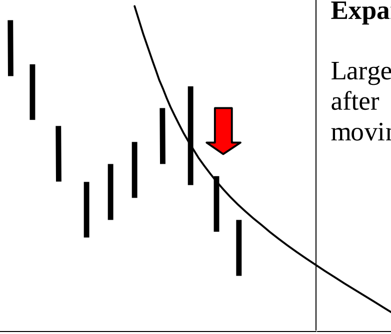
	**Test of Breakout Point (bullish)** Retest of breakout above short term resistance.
	**Test of Breakout Point (bearish)** Retest of breakout below short term support.
	**Expansion Bar (bullish)** Larger range momentum bar after retracement back to moving average area.
	**Expansion Bar (bearish)** Larger range momentum bar after retracement back to moving average area.

Figure 4.66 - Lower Timeframe Triggers (4 of 4)

My preference for entry order type is for a LIMIT order, trying to sell at the ask or buy at the bid. I"ll then adjust if required. However I"ll be careful not to chase price beyond the LWP / LRP.

You may prefer the use of a STOP entry order, to ensure entry. I do not ever recommend MARKET orders for entry, due to the risk of slippage.

The following charts display examples of entry decisions, showing the *trading timeframe* (3 min) price action and setup on the left and the entry decision trigger on the right.

In figure 4.67 below we have a quite aggressive setup in which we are taking a BOF against a swing low rather than any *higher timeframe* (30 min) S/R.

While lower probability, I do quite like these setups when there is a clear weakening of the trend, or in cases such as this which involve a weaker retest of a climactic low (or high).

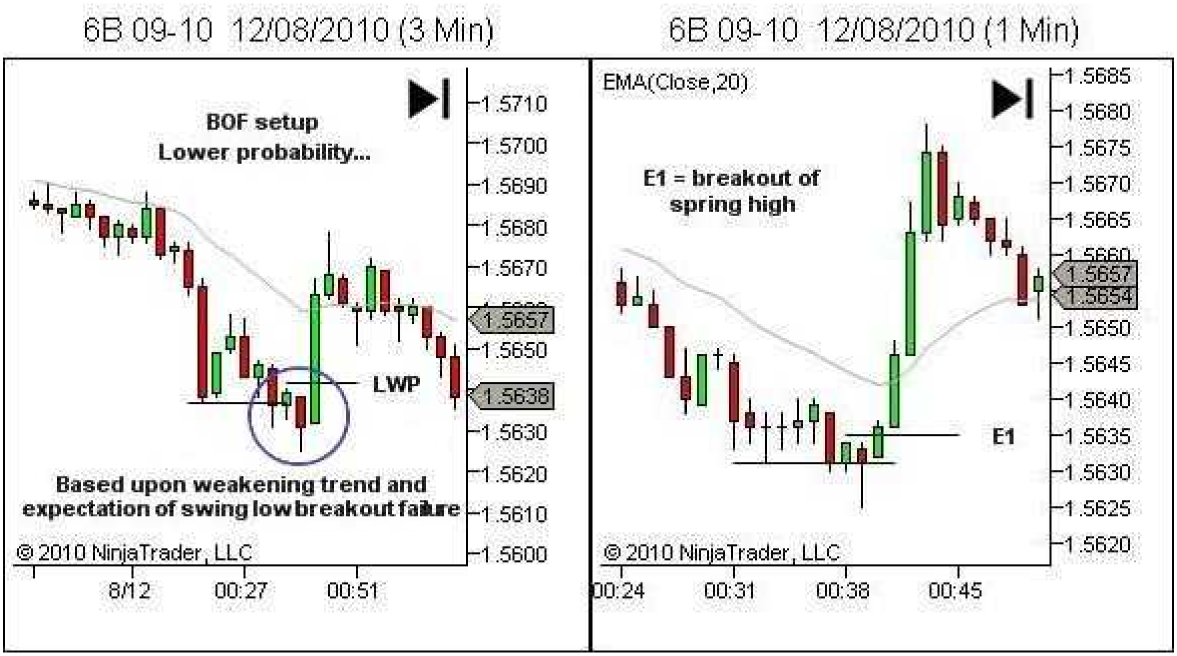


Figure 4.67 - BOF Setup – Entry Trigger via Spring

The *lower timeframe* (1 min) price action to the right shows an area of short-term support being formed at the lows, with a spring below that support rapidly failing. The entry would be on a break above the spring, at E1.

This is an example in which entering via the *lower timeframe* (1 min) entry trigger rather than at LWP gained us an extra six pips,

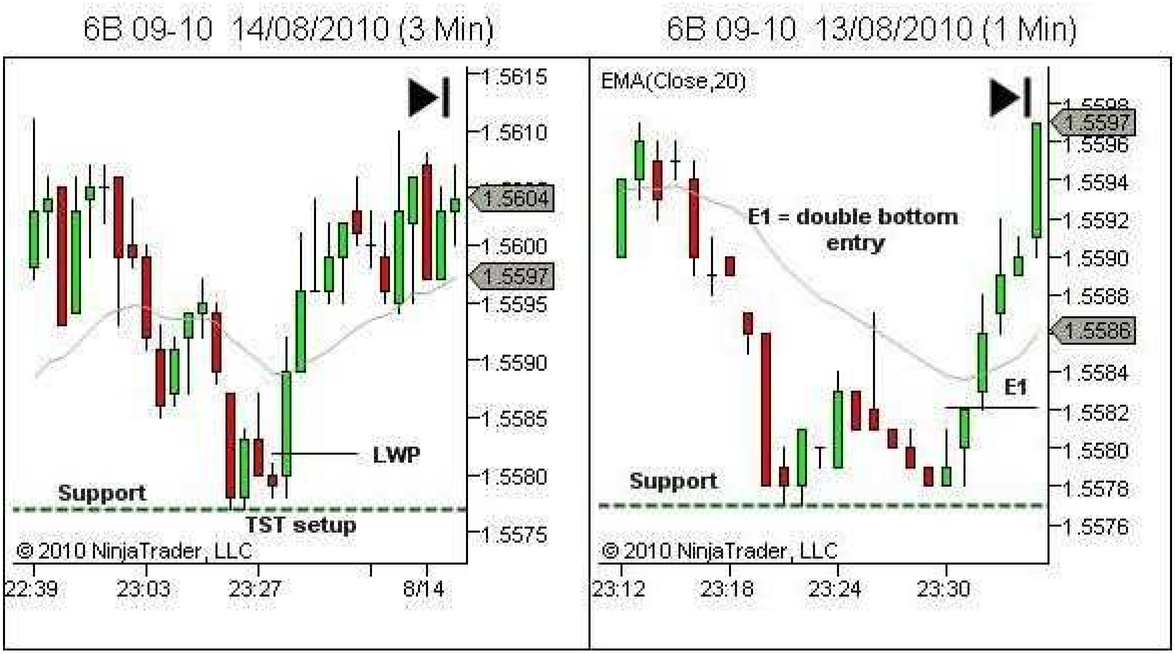


Figure 4.68 - TST Setup – Entry Trigger via Double Bottom Pattern

In figure 4.68 above, we have a TST of *higher timeframe* (30 min) support. Entry E1 on the *lower timeframe* (1 min) chart (RHS) is triggered on the close of the high close bull candle confirming the double bottom price pattern. Note that in this case you could not take an entry on the break of the swing high between the double bottom lows (the traditional double bottom entry location), as doing so would result in an entry beyond the LWP. While it would have worked fine in this case, to do so would lower the probability of the trade while also reducing the potential R:R ratio.

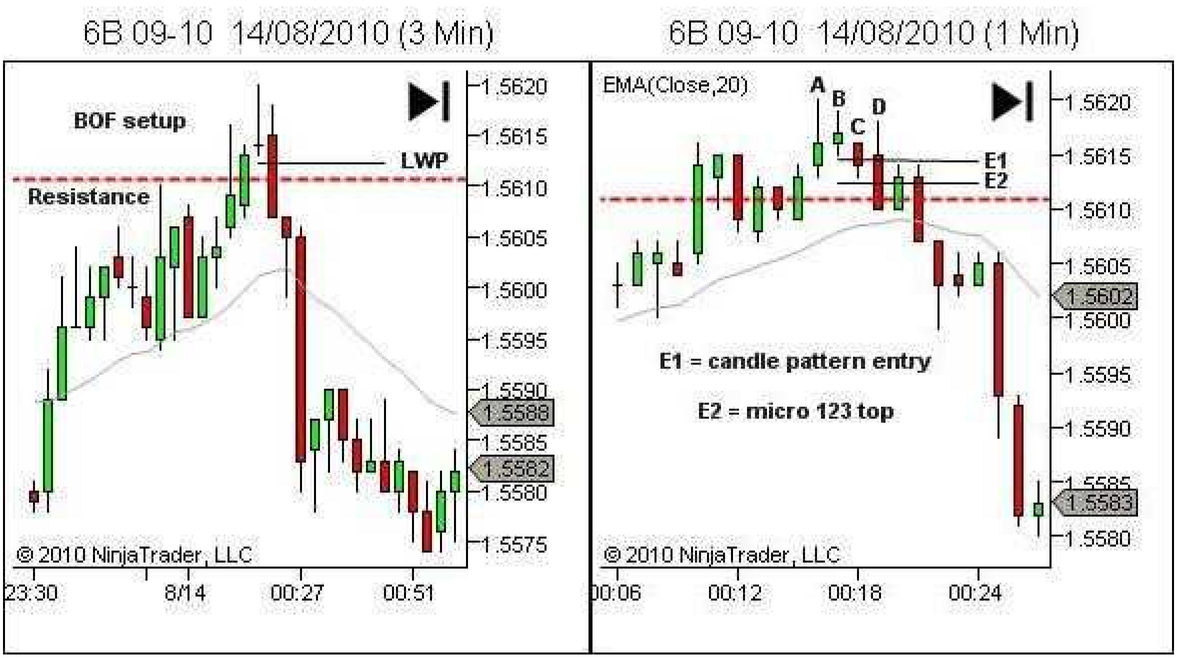


Figure 4.69- BOF Setup – Entry Trigger via Candle Pattern or 123 Top

In figure 4.69 above, we see a BOF setup offering two pattern based entry options. The first at E1 is a break below the low of candle B; a candle based pattern trigger based on candle A (kind of a shooting star!!) and candle B (spinning top). The second at E2 (in case you didn"t like E1) is a micro 123 top (lower high) formed by the move up to the high of A, to the low of C, then to the high of D, before breaking down below the low of C and continuing downwards.

This second (E2) entry option is also right at our LWP based on the *trading timeframe* (3 min) chart to the left. So, in this case, E2 offers no advantage over just entering at LWP, apart from possibly greater confidence in the entry through observing the *lower timeframe* (1 min) sentiment change.

Ensuring We Don't Miss an Entry

We have two competing requirements:

1) To work the best price possible; and

2) To ensure we do not miss the entry by having it rapidly move beyond our entry zone without us.

When the last wholesale price (LWP) is within our entry zone, we have an opportunity to ensure we do not miss the trade opportunity by bracketing price.

Bracketing works as follows:

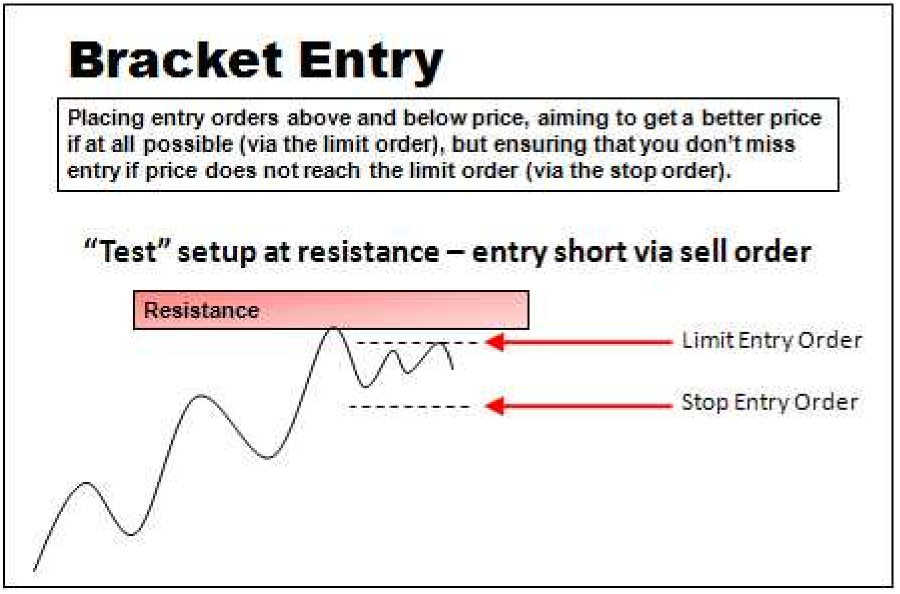


Figure 4.70 - Bracket Entry example – Test Setup at Resistance

In the example above, you would simply place both your limit and stop entry orders. The stop entry is placed at LWP (ie. our simplified entry technique) to ensure you are filled IF the market suddenly moves lower. Then you work the limit order as required to try for a better price against the resistance area.

Be sure that the other order is cancelled upon receiving a fill, otherwise you risk having two positions established.

If the LWP is beyond our entry zone, we don‟t place a stop entry order. To do so would risk an entry beyond our acceptable R:R parameters. And we don‟t place one at the last reward:risk price (half way to target), as to do so is not based on any technical level. In this case, we don‟t bracket price but simply attempt to work the limit order, accepting a missed trade if it happens.

<u>Missed Entries</u>

If you miss an entry, never chase it beyond acceptable wholesale or R:R limits.

Entries must **only** occur at the setup areas, as they exist at areas of proven supply/demand imbalance. The further we move from the areas, the less the likelihood of profit and the greater risk.

Take note of the missed opportunity in your journal to allow a post-session review and market replay – to identify any errors, review the setup with “hindsight perfect” performance, learn and improve.

Then wait for the next opportunity. Another will be along shortly.

<u>Alternate Entry Techniques</u>

My trading style involves multiple part positions. I prefer an all-in-scale-out approach, in which all parts of the trade are placed on at once, and each part is scaled out at different targets. We‟ll talk more about how I scale out in the next section on Trade Management. However you may also wish to test some means of scaling in, perhaps entering part one via a worked limit order and part two via a stop entry order at LWP.

Testing on a simulator (demo) platform will allow you to determine the method that is psychologically best for your own trading.

Entry Examples

The above sections offered several examples. Let‟s work through two more though; just to be sure we get it.

Figure 4.71 below shows a BPB setup – previous support becoming resistance. The *lower timeframe* (1 min) offers two great opportunities to enter the BPB, both triggering off candlestick pattern. Entry is at E1 below the bearish engulfing pattern, or E2 below the shooting star.

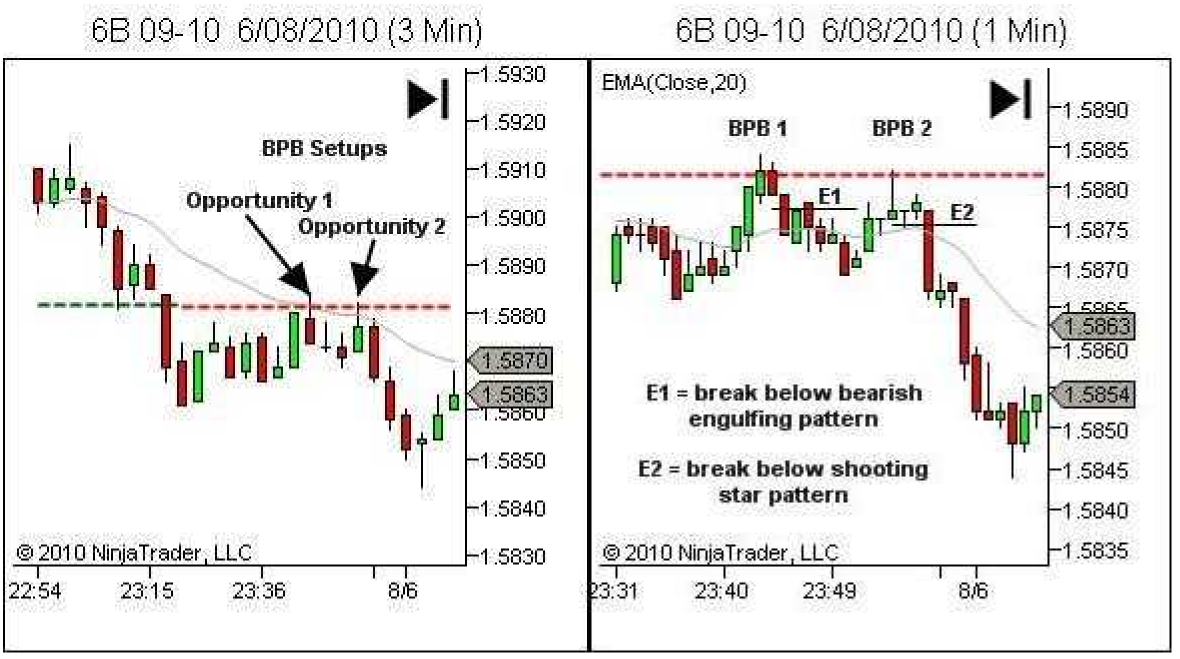


Figure 4.71 - BPB Setup – Entry via Candlestick Patterns

Figure 4.72 below shows a CPB in an uptrend, with the *trading timeframe* (3 min) chart forming a nice spring pattern. The LWP is the breakout of the spring candle, although (as is often the case) we don‟t know that till the close of that candle. Trade decision often comes quickly!

Looking at the *lower timeframe* (1 min), we see a breach of the short-term support area (formed by the swing low at the end of the first pullback swing). Entry E1 is on a break of these candles, effectively making this both a spring trigger and a candle pattern trigger (dragonfly doji and morning star).

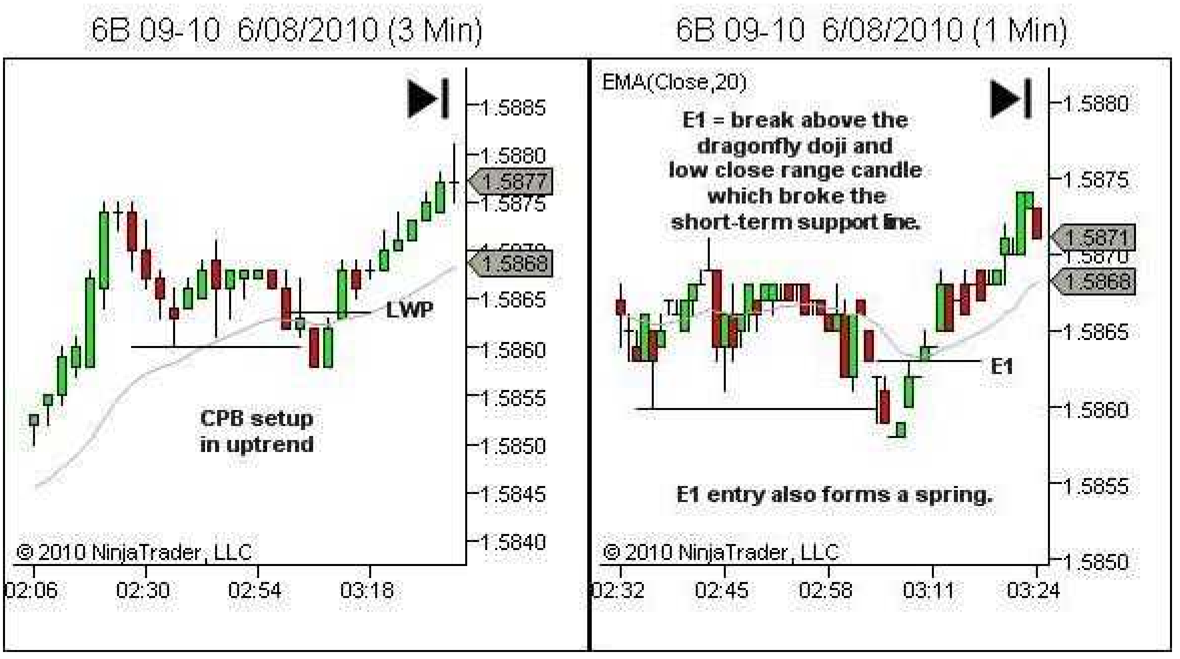


Figure 4.72 - CPB Setup – Entry via Spring and Candle Patterns

Entry Summary

The *Trading timeframe* defines the places we want to trade.

The *Lower timeframe* is used to time entry.

We note when price enters our *trading timeframe* setup zones. But we don"t automatically enter. We watch how price reacts. We search for weakness, and traders trapped in a low probability position. Entries are taken at or before the point where the losers realise they"re wrong.

We recognise that the optimal entry can never be known, except with the benefit of hindsight. So we simply aim for the best entry possible within our entry zone. We work a limit order for a stall or pattern based trigger entry. And we place a stop entry order at or near the last wholesale price, in order to ensure we don"t miss an opportunity.

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A final word of warning… the use of limit orders does come with risk. Price action may produce a nice looking setup, with a clearly defined stop area and entry zone, tempting you to work a *lower timeframe* entry at a great wholesale limit order price. It then may reverse rapidly only to stop you out BEFORE price even gets to the LWP.

Remember, the LWP is the *trading timeframe* point at which the losers will start exiting.

That"s where our orderflow enters the market, driving our trade to profit.

Caution needs to be applied to earlier entries as they do not yet have the benefit of this trapped orderflow. However, they do have the benefit of S/R or swing high/lows to their back, and if triggered based on stall or a *lower timeframe* pattern based entry, they still provide good odds.

The following section, Trade Management, will touch on the concept of scratching a trade. This will be particularly useful for our early entries, which then fail to follow through past the LWP.

4.4.4 - Trade Management

"Once you have taken a decision,
never look back on it."

…Field Marshal Viscount Allenby

Once you have taken a decision to trade, never look back on it. It‟s time to manage it.

Active vs. Passive Trade Management

I want to commence this section by sharing some email Q&A (also posted on my website) which explains my reasons for preferring an active trade management style to a passive (set and forget) style…

Excerpt from email received:

A couple of questions about stop and profit target management. I'm not a probabilities expert, but can't one make the "argument" that once the trade is actually put on, accepting anything less than the initial risk/reward outcomes actually interferes with the probabilities and in the long run can neither help nor hurt because even decisions to adjust are subject to probabilities and will even out over time?

In other words, tightening my stop may help me some and hurt me some, but isn't it likely to be a wash over the course of 1000 trades? Also, once the trade is set, even if stops are immediately adjusted, the full risk of the initial stop was incurred once the trade is entered, so the possibility full reward should be allowed to occur. As an example, with a 9 tick profit and 5 tick stop loss, as soon as I enter a trade, I am assuming a 5 tick risk. It doesn't matter that I tighten the stop, the risk was already undertaken. So, for my ratios and probabilities to work in the long run, shouldn't I just let the trade be what it will be?

Excerpt from response:

Should we use an active or a passive trade management style? This question really gets to the heart of who we are as a trader and how we believe the market works.

Are you a mechanical / systems trader or a discretionary trader?

A mechanical trader who has conducted extensive backtesting and identified a pattern which provides an edge over a larger sample of trades, should NOT be using any discretion to actively manage their trades. Their edge is based on the fact that historical performance shows a positive expectancy, so trade management should be conducted EXACTLY as in the testing. This will either be holding until the stop or target is hit, or will be in accordance with some fixed rules for stop movement.

If that works for you, great! Stick with it. It doesn't work for me.

Systems traders generally see this game as one of probability. Although probability is a feature of the game, my beliefs are somewhat different, and this difference means I'm (psychologically) a discretionary trader and therefore unable to trade this systems approach.

Systems testing is done over a very large sample, and while there are great methods of ensuring reliability of data through back and forward testing of different samples from different market environments, it's still a large sample; and within that large sample you'll find considerable variability - periods of underperformance and periods of outperformance. Systems traders need to persevere through the drawdown that comes from the periods of underperformance. Any one system may extend its period of drawdown for quite a while, maybe a whole week, maybe a month, maybe longer. And this could be quite normal - within the expected variability of results.

There are several problems with this, for me.

Firstly, I don't trade over a large sample. As a short timeframe discretionary trader, I'm aiming to grind out a living day to day. I hate a weekly drawdown. And even more so I hate monthly drawdowns. Each day I'm trading in a small subset of the larger sample. Whether it's a period of outperformance or a period of underperformance is unknown, until the market can be looked back at with the benefits of hindsight. My goal is to manage the day's opportunities as best I can at the time. If a better yearly result could statistically be obtained by sticking to the original stop or target, then that's just too bad for me. That doesn't help me today. So, I choose active management in order to get the best result I possibly can over a small sample. I'll leave the 'hoping' to achieve a longer-term statistical average result to those with more patience and deeper pockets.

Secondly, and perhaps more importantly, I just don't believe in the ability to apply a mathematical model to the markets. Yes, it does provide good approximations, but I'm just not happy staking my money on approximations. While systems traders believe in a probabilistic market, my belief is better described as an 'uncertain' market or an 'emotional' market. A subtle difference, perhaps! Yes there are probabilities, but the probabilities themselves shift.

To blindly trade systems or patterns and to hold till the preplanned stop or target, is to place your faith in the fact that the future market will be similar enough to the past markets in order for the edge to still be intact. Trade management is a matter of 'hope', based on trust in the power of the setups or patterns.

Market movement though is a function of orderflow imbalance, and this orderflow imbalance is the result of traders‟ decisions and actions. While future orderflow can be somewhat influenced by the setups or patterns, this systems method is limited in its ability to take into account the context of the market in which the pattern is occurring, or the psychology of the current market. Both are factors which will also have a great influence on future orderflow.

So, 'hope' doesn't work for me. Like in most areas of my life where I'm a bit of a control freak, my beliefs as to the nature of the market require me to actively manage my trades.

My entries are not based on any belief in the power of the setups, but rather on my assessment of the underlying forces of supply and demand, the market context within which the current pattern is occurring, the potential future actions of other traders, and my assessment of high probability and low risk opportunities within that environment. This gives me a trade idea which is then executed.

This is a key difference – the real power behind my entry is not a pattern based entry trigger, but rather a discretionary entry based on my read of the market and my 'feel' for the price movement. Therefore, my edge does not exist in just blindly holding till the stop or target. My edge exists only while my original trade premise is valid.

If I therefore enter a trade, and the trade does not act in accordance with my original idea, the edge is gone (or at least its likelihood is reduced). So, it's time for me to work the best exit possible and then reassess and/or wait for the next opportunity.

This is not blindly just moving the stop or target out of fear. It's a realisation that my original assessment of the future net orderflow is either no longer valid, or was perhaps even entirely wrong.

End result... I accept that sometimes I would have achieved better results by simply holding till either the stop or target. However, other times my active management approach will yield better results, because for example I'll recognise stronger than expected orderflow and be able to extend the target. Maybe it works out even over the next year or so, maybe not. It doesn't worry me either way. I don't actively manage my trades because it's optimised for better results. I do so because it's the optimal trade management approach for both my market beliefs and for my psychological needs.

Why hold a trade that moves to one tick from your target and then drives all the way back to your stop, just because taking it earlier would 'destroy' your edge? I just don't get that. If you assess the market environment has changed, and bearish pressure is reducing the likelihood of the price pushing that one tick further, take profits.

As with everything in trading though, there's no black and white. If the systems approach works for you, stick with it.

(end of email excerpt)

If you feel a passive style suits you better, then work out a way to make it profitable. It doesn"t work for me. That doesn"t mean it won"t work for you.

Thorough testing will be required.

However, if an active management approach is suited to your personality, the following outlines how I do it…

General Trade Management Concepts

- I trade with two part positions.

- The entry is all-in. That is, both parts are placed on at once.

- The exit is scaled out. Part one aims for a target at T1. Part two aims for either a T2 target, or continues until exited by a trailing stop, depending on market environment.

- All positions are managed via an active trade management approach.

Active Trade Management Principles

Remain in the Trade While the Premise Remains Valid

The idea behind active trade management is that you remain in the trade while your trade premise remains valid.

Exit (prior to achieving a target) is only to occur as a result of one of the following three scenarios:

1) Your bar by bar analysis shows evidence of a sentiment change which invalidates your trade premise; or
2) The market has failed to move in your required direction after a reasonable amount of time has passed, raising doubt as to the validity of your premise; or
3) You"re unsure about the current state of the market and future trend direction.

If none of these situations has occurred, hold the trade.

If (1) has occurred, work an exit and move on to the next trade opportunity.

If (2) or (3) have occurred, work an exit and reassess.

Note that (1) and (2) are different. In scenario (1), the price action invalidates your premise. In scenario (2) it fails to validate it. Scenario (2) does not mean that it won‟t work. Just that it‟s taking longer than it should so the odds of success have been reduced. It‟s best to get out and reassess.

Active trade management requires a constant bar by bar reassessment of short-term sentiment and the likely path of future price action.

Keep your awareness ahead of price. What will you do if price goes up from here? What will you do if price goes down from here? What will you do if price stalls? Pre-consider all scenarios, so that you are prepared for whatever eventuates.

Continue ongoing analysis to confirm price movement matches the behavior previously anticipated. If price action differs from expectations, adjust the management or exit plan as required.

Appropriate Timeframe

The real challenge you will face though is which timeframe chart to use for your bar-by-bar analysis.

If you conduct all your ongoing sentiment analysis on the *lower timeframe* (1 min) chart, you will be whipped in and out of the trade. I can offer no rules here, apart from my focus is initially on the *lower timeframe* (1 min) chart while at or around the initial entry zone, transitioning to the *trading timeframe* (3 min) chart as soon as I‟m comfortable that it will define further price action.

You‟ll probably find that the sooner you make this transition, the more comfortable you‟ll be.

If you find that you‟re scratching trades too soon, replay these trades after the session (use a replay feature if available, otherwise step through the chart bar-by-bar) in order to practice earlier transition to the *trading timeframe* (3 min).

Largely, it‟s a matter of trust, which will come through more exposure to setups and trade management. Practice, practice, practice!

Here‟s one hint though – if part one has achieved its target, and you have not yet transitioned to the *trading timeframe* (3 min), do so now for management of part two. While this obviously won‟t always provide the best outcome, it‟s generally good advice, helping to provide a little more wriggle-room for part two and preventing over-zealous management.

From Entry to Part One Exit

Psychologically Managing Drawdown

There is nothing more draining psychologically than seeing an entry almost immediately move to drawdown.

Here‟s something to consider though – do you really expect that you should be able to pick the optimal entry point every time?

In the section on entries we established that it was not possible to know the best point of entry, except with the benefit of hindsight, once the trade had come and gone. We identify zones in which we‟re happy to trade, and then work the best entry we can within that area.

Is it therefore not reasonable to expect that a good proportion of your trades will move to a worse price after entry? Absolutely!

Of course, that doesn‟t make it easy to accept when you‟re in a losing trade.

The best way to psychologically manage these situations is to expect them. In our analysis, we considered the nature of future price action – how should price look and behave if our premise is correct; and how should price look and behave if our analysis is wrong?

Use the same process here. On entry, consider the following… Assuming your trade entry is early and price will enter drawdown to retest the highs/lows, how should it look and behave if our trade idea is actually valid and our stop will hold? How should it look and behave if it is likely to take out our stop?

Pre-considering the nature of future price action prepares you for the worst case scenario, and helps you to hold during drawdown if price action is such that it still supports your trade premise.

Psychology of Trade Management

One of the greatest challenges I face is a tendency to over-manage my positions, especially around the entry zone.

Typically in hindsight (post-trade review) I find that more patience should have been applied.

I find a simple tool for improving my performance, is a set of action statements that I repeat during this phase of trade management.

- Patience
- Trust (myself and my strategy)
- Where‟s the strength?
- Where‟s the weakness?
- Hold while the premise remains valid

This provides a simple reminder for patience in my decisions and actions, and has me focusing on the important information – assessing changes in strength and weakness – rather than worrying about potential trade loss.

We‟ll talk more about this concept in Volume Four. I raise it now simply because, in my experience, the early stages of trade management provide some of the greatest challenges for many traders. You may wish to incorporate a similar concept.

Working an Exit - Scratching a Trade

I refer to the process of working an exit prior to T1 as scratching the trade.

Why do we scratch a trade?

We said earlier, exit (prior to achieving a target) is only to occur as a result of one of the following three scenarios:

1) Your bar by bar analysis shows evidence of a sentiment change which invalidates your trade premise; or
2) The market has failed to move in your required direction after a reasonable amount of time has passed, raising doubt as to the validity of your premise; or
3) You‟re unsure about the current state of the market and future trend direction.

So, we‟re exiting because either the trade premise is now believed to have changed, or is in doubt.

The real benefit of exiting is that it allows you to reassess the situation with the objectivity that comes from having no open position. Analysis while in a live trade can become clouded by emotions, in particular through fear of loss. Exiting removes you from that negative influence, allowing clear and objective analysis.

You have two options to choose from, depending on the urgency with which you need to exit:

1) Hit the CLOSE POSITION button to immediately close out any open position.

2) Make this an active process in which we try to gain a better exit price through movement of the stop loss and/or target orders.

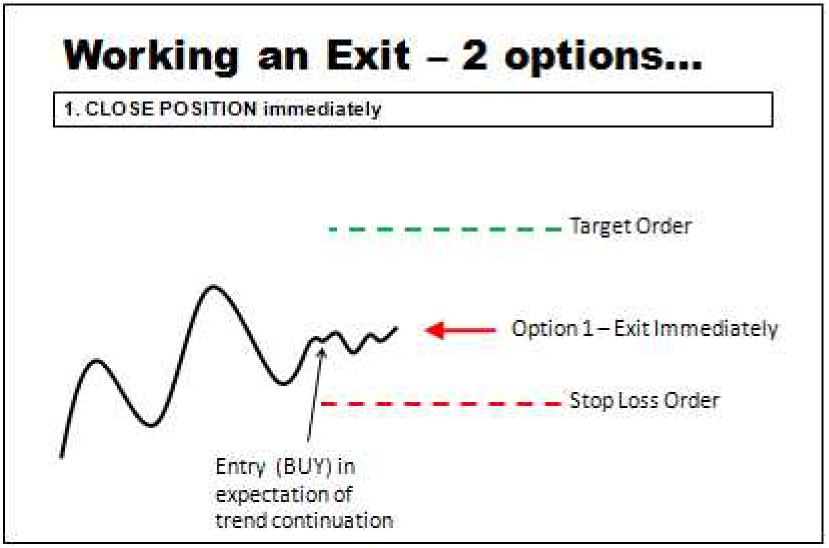

Figure 4.73 - Working an Exit – Option 1

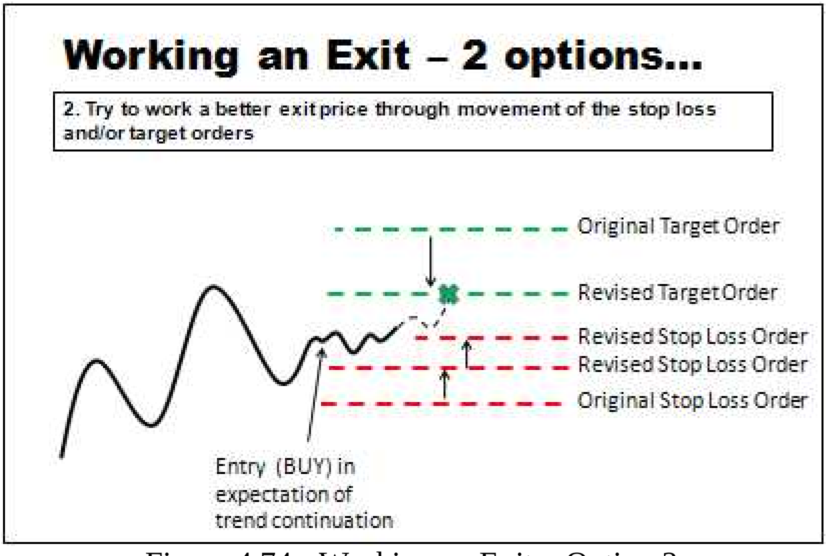

Figure 4.74 - Working an Exit – Option 2

The first option, immediately closing the position, is obviously used for the most urgent exits when the trade premise is strongly threatened and you want out immediately.

The second option is more discretionary. You‟re not immediately threatened, but you‟re ongoing assessment of market sentiment has you doubting the ability of price to reach the target area. In this case I‟ll use a combination of moving the stop order and/or moving the target order. The exact same principles apply – move the target to new areas which will provide limits to price movement – and move the stop to new areas where you‟d like to be out if it‟s hit. Reference to the *lower timeframe* (1 min) chart will provide these locations.

How do we handle multiple parts?

If the premise is proven invalid and I want out, I‟ll scratch the whole trade immediately.

However if I‟m working my exit orders then I‟ll usually manage both parts one and two separately. My intent will be to give part two more room, and more opportunity to prove itself.

So for example, let‟s say the trade is moving slowly in my direction but I now doubt its ability to break the next swing high. I‟ll tighten the target for part one to just prior to that swing high and aggressively trail the stop behind price, until exiting part one at the best price I can get. Part two however will have its target and stop orders remaining in their original location for now, in case my revised analysis is incorrect and price does subsequently break the swing high. Once part one is exited, I‟ll then reassess and manage part two.

Let‟s look at an example…

Figure 4.75 shows the sideways market in the leadup to the Aug 6th 2010 NFP release. With 17 minutes till the news release a BOF was entered long in anticipation of a test of the range highs.

The entry was on the close of candle A. The stop was placed below the BOF lows. The target was placed inside the upper range highs, both T1 and T2 located together due to the sideways trend action.

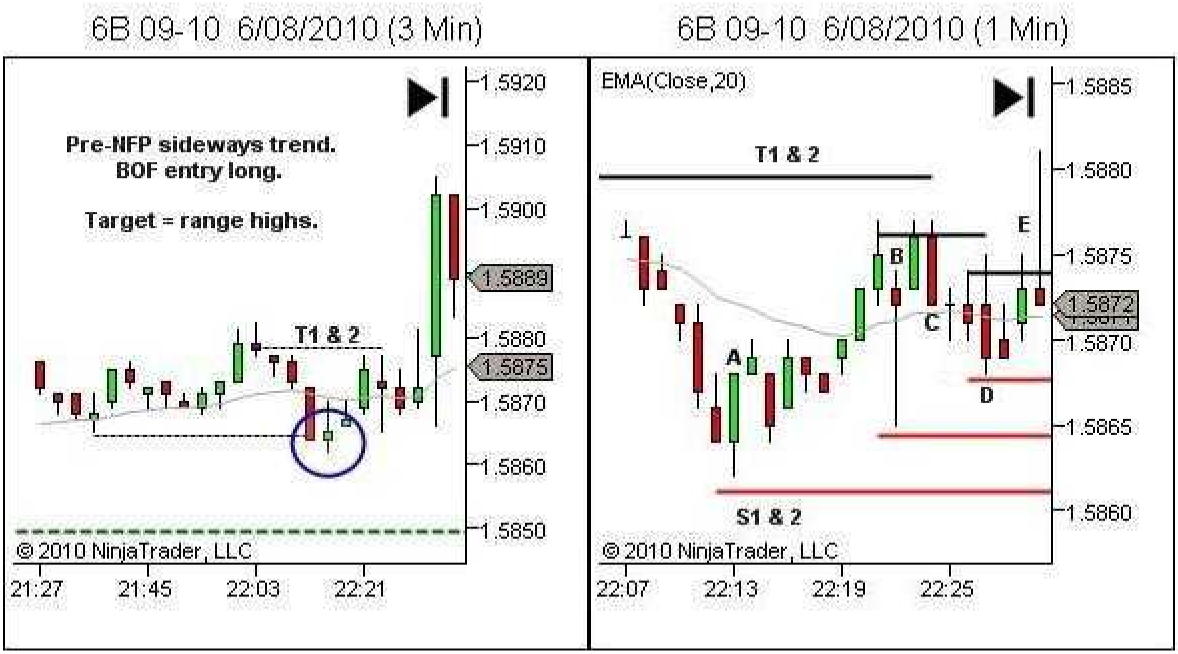

Figure 4.75 - Working an Exit Following a Change of Premise

Candle B was a concern intra-candle, but the close was strong (high close range candle). The stop was tightened below this candle, as a second push lower would indicate stronger supply than anticipated at a lower level.

Following candle C (low close bear candle), I no longer had expectations of price reaching the original target and it was time to work an exit (I needed to be out prior to the NFP release in 6 more minutes, in any case). The target was tightened to just below the recent highs.

Following the bearish strength of candle D (low close bear candle, initially teasing higher then trapping longs as it moved to new lows), the target was again tightened to inside the highs of D. The part one stop was moved for a breakeven exit (not shown) which occurred on the start of the next candle. The part two stop was held below the candle B position, then moved below D as candle E rallied. Candle E subsequently achieved the revised target, exiting the trade for part one breakeven and part two providing +5 pips.

Not enough to retire, but sometimes we just have to be happy with whatever the market provides.

Re-entry

Re-entry may be considered if you have scratched a previous trade for an objective reassessment of sentiment and market analysis, and decided that entry is again desirable.

However it‟s also an option at the following two times:

1) You have taken profits on part one (with part two remaining live) and the market has provided an opportunity to re-enter a new part one.

2) You were stopped out, and the market has again set up for another entry.

You should however ONLY reenter on a valid trigger. Price action should be such that this would be a valid entry if it was the first entry in this entry zone.

The number of entries per setup area is unlimited. You can scratch and re-enter as many times as you wish (provided the market offers valid entry triggers each time). However, I allow no more than two max-size losses per setup area.

If I have been stopped out twice for a full loss, or a greater number of losses adding up to an equivalent dollar or point loss, then my read of the market is obviously out of sync with reality.

Step back and let this one pass. Move on to the next opportunity.

Let‟s look at an example demonstrating a trade scratch and reentry.

Figure 4.76 below shows a BPB. We‟ve seen this one before in the Entries section.

The first entry is on the break below candle A at point E1.

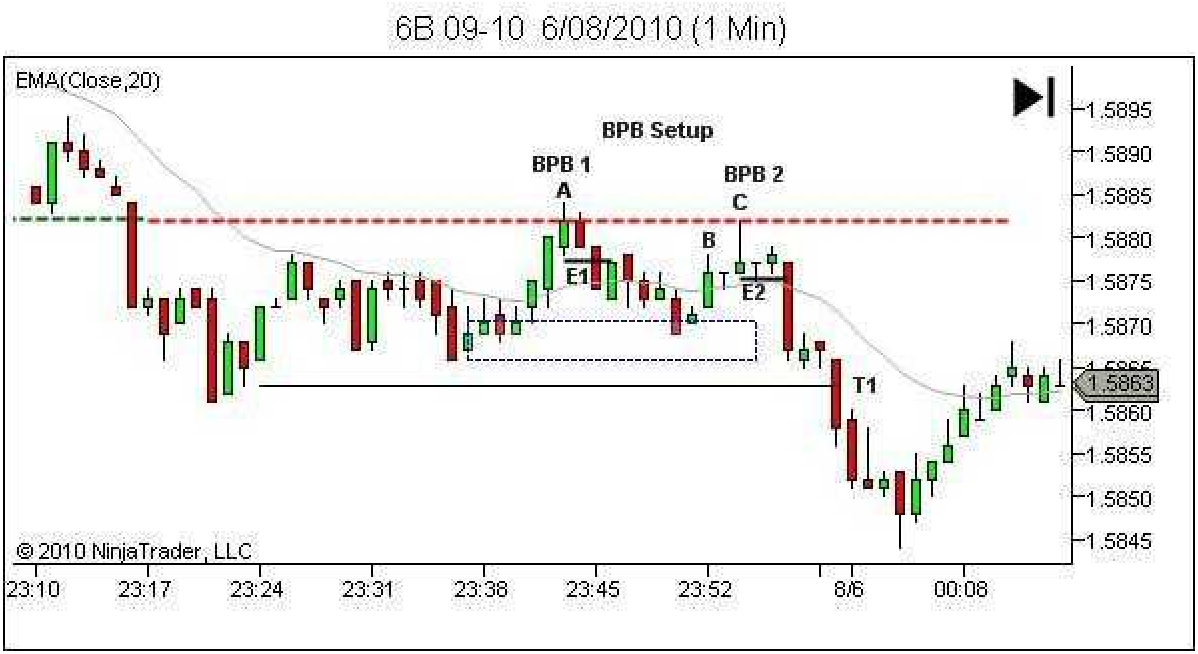

Figure 4.76 - BPB Setup – Re-entry

A BPB trade should provide reasonably quick movement to its target. However, recognising potential for some support to oppose my trade at the blue outlined area, I will be on alert for any signs of bullish strength coming off this support area. Candle B puts me on alert. The stop is moved to just above B to scratch the trade (both parts one and two) and allow reassessment. The following candle is reassuring, showing a pause in the upswing. Candle C breaks above B and scratches the trade out for a 2 pip loss.

Re-entry is taken on the break below candle C at point E2, before the market moves in the anticipated direction.

Had we just held, the move up to C would not have stopped out our position, but the precautionary exit allowed us the following advantages:

1) The ability to objectively re-analyse the market price action, without any negative emotional influence that comes with an open trade; and

2) A very minimal risk compared with that which would have occurred had the trade premise been wrong and the market stopped us out.

This is active management – making decisions to minimise risk and maximise opportunity.

<u>Movement of the Stop Loss to Breakeven and Beyond</u>

Movement of the stop loss to breakeven provides you with a free trade. There is no longer any loss potential (barring slippage on exit). However, if you do this too soon you will likely also have very limited profit potential, due to ensuring you get stopped out by normal market fluctuations.

When do we move the stop to breakeven?

The initial stop was placed in a position that invalidated the original trade premise. The same concept is used for stop loss movement.

As price moves in our favor, we move the stop to breakeven when we would no longer wish to be in the trade if price retraced to the entry point.

Note that part one and two can be managed differently. You may wish to be more aggressive with part one, moving its stop to breakeven while part two is given more room to prove itself.

The same concept again applies for any movement beyond breakeven.

As price moves further in our favor, we move the stop to new levels where we would no longer wish to be in the trade if price retraced to that point.

Key locations for movement of the stop would be beyond any new swing highs or lows, or beyond any large candles that reach new highs/lows (large high close bull candle in an uptrend, or low close bear candles in a downtrend).

Let‟s look at an example and consider the management of the stop for <u>part one</u> of our position.

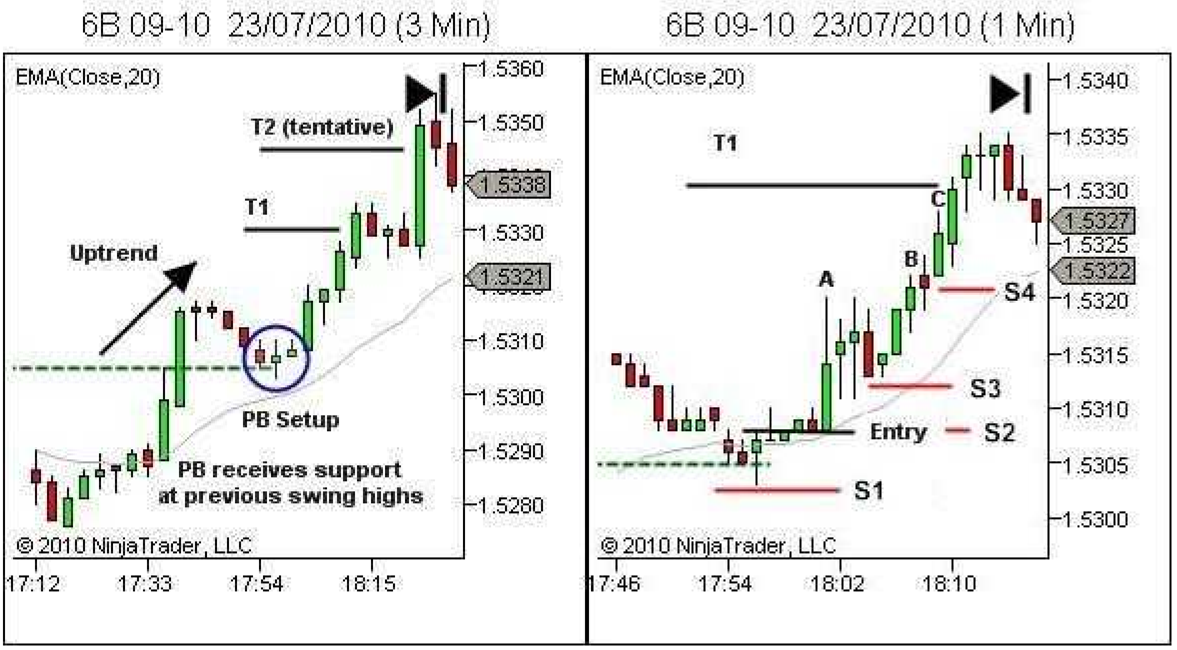

Figure 4.77 - Movement of Part One Stop Order

In the example above we see a PB setup within an uptrend.

Entry is on the break of the hammer which settled nicely on the previous swing high support. Entry price is 1.5309. Stops for both part one and two are below the hammer at 1.5301 (S1). Target T1 is at 1.5330, based upon price action to the left (not shown).

After the initial bullish surge and retracement of candle A I would move the stop for part one to breakeven (S2). While the bullish strength was welcome, the immediate pullback was not. Further retracement may indicate I was too early. The part two stop would remain in its current location.

The following range candles are reassuring though, and as candle B moves to new highs I"d move S1 to below the recent low close range candle (S3) (the last push down before new highs).

Further tightening of the stop to below candle C (S4) would occur as we approached T1, not for any technical reason, but simply to ensure acceptable R:R.

Active trade management requires a constant reassessment of the reward:risk ratio. How much are you risking if the trade should stop you out vs. how much more potential reward is there available to your profit target.

In the above example, as price approached the target at the end of candle C it only offered another 4 pips of potential reward, compared with 16 pips of risk to the stop. This R:R doesn‟t make sense, so I‟ve tightened the stop below the last bull candle.

This type of tightening the stop does increase the risk of premature exit, so needs to be considered carefully. The market in this case was showing great strength to the upside and I did expect continuation to the target. Had it stopped me out I would have been searching for the next PB re-entry.

In these R:R situations, you may also consider just taking profits.

For example, if price stalls a couple of pips from your target for a minute or so, is it worth holding on to try for that extra 2 pips, while risking 20 pips on drawdown to your stop? Even if your stop is nicely placed below an intervening area of support, it doesn‟t make sense from an R:R perspective.

If price stalls there, take profits.

Consider targets to be a zone, rather than an exact price.

Erroneous Entry

You will from time to time find yourself having made an entry in which you suffer immediate feelings of unease. Quite likely your entry decision was influenced by emotion rather than proper analysis.

You may also from time to time find yourself in an inadvertent entry, if using a one-click entry method.

Common advice is to just exit immediately. I would offer a different suggestion though. Pause for a second and consider – can you salvage something out of this trade?

It wasn‟t the best planned entry, but that doesn‟t mean you‟re immediately in a dangerous position. Review the price action; identify signs of *lower timeframe* (1 min) strength and weakness and assess the likelihood of price moving in a profitable direction, even if just a short distance. If there is some potential, then manage the position; but manage it very aggressively. Anything you can gain out of this will be a bonus. If there is no potential though, work a rapid exit.

Managing Part Two

Movement of the Stop Loss Beyond Breakeven

The principles for movement of the stop for part two are exactly the same as for part one, except that more room is typically applied. More opportunity is given for this part to prove itself.

As price moves in our favor, we move the stop to breakeven when we would no longer wish to be in part two if price retraced to the entry point.

As price moves further in our favor, we move the stop to new levels where we would no longer wish to be in part two if price retraced to that point.

Key locations for movement of the stop would again be beyond any new swing highs or lows, or beyond any large candles that reach new highs/lows (large high close bull candle in an uptrend, or low close bear candles in a downtrend). This time though, we will be primarily referencing the *trading timeframe* (3 min) rather than the *lower timeframe* (1 min) chart.

At all times we aim to remain in the trade while the premise is still valid.

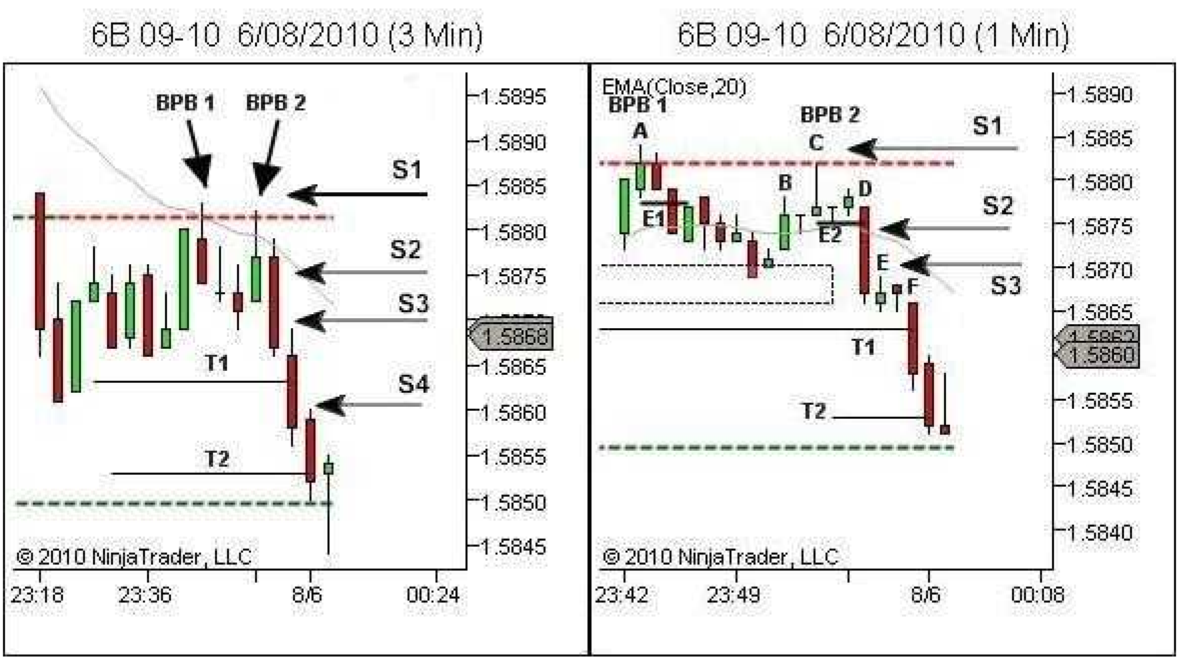

Figure 4.78 - Trade Management - Movement of Stop Loss

In figure 4.78 above we revisit the BPB setup that was used to discuss re-entry (previously figure 4.76). We‟ll look at the <u>second entry</u>, BPB 2, entering via the trigger E2 on the break below the shooting star candle (RHS), discussing management of both parts one and two.

To stick with the earlier convention, the *trading timeframe* (3 min) chart is on the left and the *lower timeframe* (1 min) chart is on the right. However, as our trade management starts with the *lower timeframe* (1 min) we‟ll need to start over on the RHS.

Using an all-in, scale-out approach, the initial trade parameters were as follows:

- Both part one and two entered at E2, 1.5875
- Stop loss for both parts at S1, 1.5884 (-9)
- T1 at 1.5863 (+12)
- T2 at 1.5853 (+22)

On the close of candle D (low close bear candle breaking to new lows), the stop for part one would be moved to breakeven at S2. Being a re-entry into this setup I will NOT tolerate a second failure at the blue boxed area. The stop for part two remains at its original location, S1, allowing it greater room for now, although will likely be tightened up as well if price action rallies.

Candle E (mid close range candle) shows expected support although support should fail quickly if the premise is valid. No change to the stops.

Candle F (low close bear candle) reaches T1. Part one takes profits. Part two stop loss is moved to breakeven at S2. From here, my focus moves to the *trading timeframe* (3 min) chart.

The initial low close bear candle from the trade open shows great support for our premise, expecting continuation to T2. The presence of subsequent low close bear candles makes trade management very easy. With such strong bearish sentiment shown within each candle, I should not expect to see it retraced. The stop for part two simply trails above these *trading timeframe* (3 min) candles, at position S3 on the close of its candle, and position S4 as price started approaching T2.

The stops were never threatened with T2 being achieved easily.

<u>Working an Exit - Tightening of the Stop and Target</u>

The principles for working an exit of part two are exactly the same as for part one.

Should weakening of the price movement place your premise in doubt, use a combination of tightening of either the stop and/or the target to work the best price you can under the circumstances.

Adapting for the Market Environment

Consider adjusting your plan for T2 based upon your read of the current market environment. Is it trending or ranging? Is it a volatile market, or smooth with shallow price swings?

For example, in a trending environment you should be more willing to allow part two to run. In a ranging environment, allowing part two to run is a low odds scenario. The higher probability is for a reversal, so stick to your T2 target, or even have both targets at the T1 price. Whatever you feel is necessary for that price action!

Consider also the impact of any key market structure features.

For example, if your current trade entry appears to have got you in near a potential high or low of the day, then hold for longer, especially in a trending environment. Provide the trade with more room. Be willing to take it all the way back to breakeven if necessary (within reason of course).

Adjust and adapt your plan, to fit the state of the current market.

Extension of the Target

Similarly, be ready to adjust during the trade.

If your original plan was to take profits at T2, but the market sentiment and your bias for future trend direction now show the market strengthening in the direction of your trade, with a good likelihood of breakout and continuation, then consider allowing price to move past T2. Reassess your bias beyond this point. If price does continue then trail a stop. If it doesn‟t, this may cost you money, but the increased gains when right usually make it a risk work taking.

We return to the example used for discussion of part one management (figure 4.77), which is reproduced below as figure 4.79.

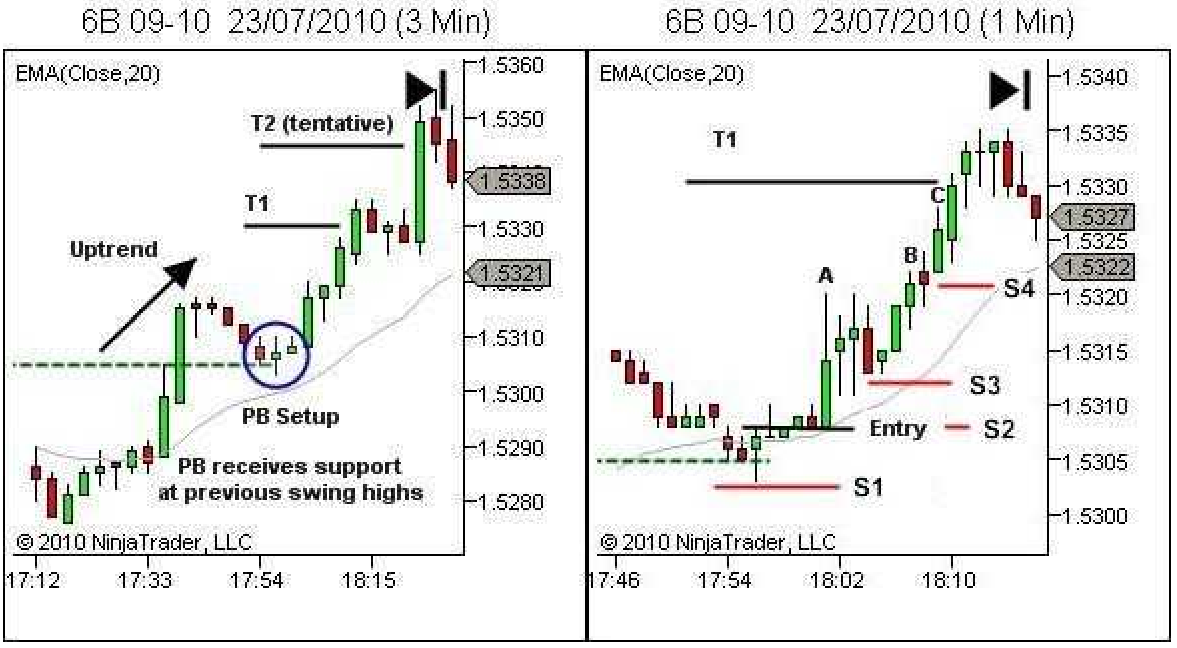

Figure 4.79 - Movement of Part One Stop Order (repeat)

When the part one stop was moved to its trailing position (S3) at 1.5312 (below the red low close range candle), I would have moved the part two stop to breakeven (S2). If this second push higher were to fail, I"d be happy to get out of the trade.

It would then remain at breakeven until T1 was hit.

My focus would then be moved to the *trading timeframe* (3 min) chart, if not already there.

The *trading timeframe* (3 min) is displayed below as figure 4.80.

You"ll note that the second part target, T2, was initially placed at 1.5345 based upon the next *higher timeframe* (30 min) resistance.

My analysis though identified good strength in the bullish direction and weakness in the bearish direction. My expectation was for this trend to continue.

The T2 target was removed (accepting risk of loss if I was wrong) with the exit now being defined by a stop trailing behind significant price action (swing lows and large bull candles).

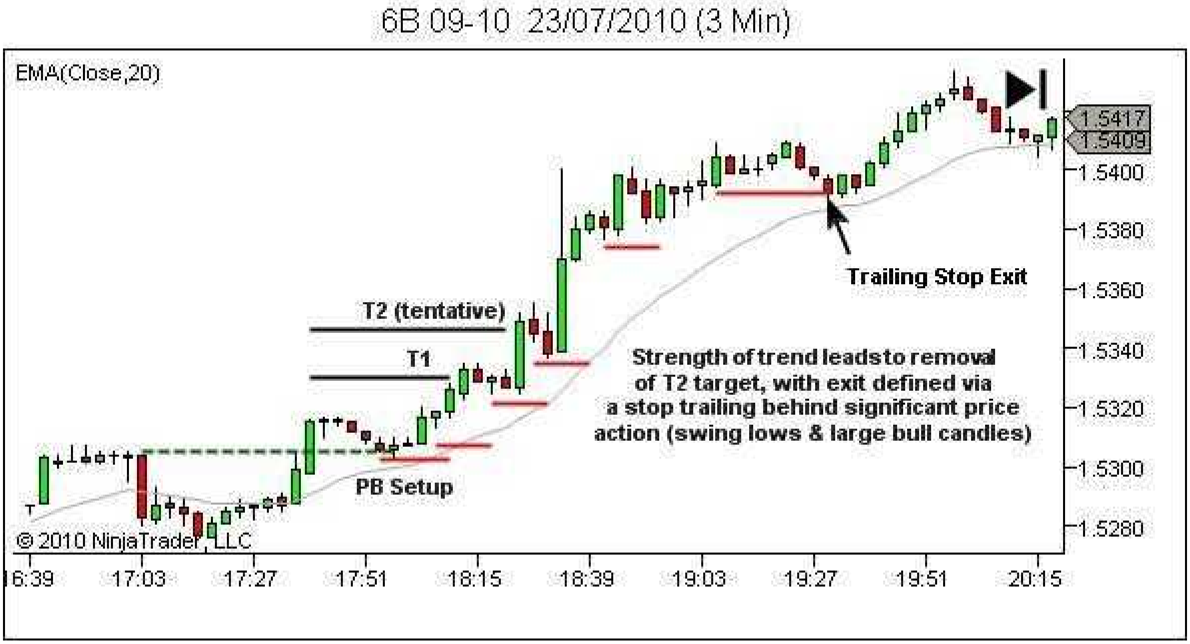

Figure 4.80 - Movement of Part Two Stop Order

The red stop lines demonstrate the movement of the part two stop order, behind significant price action.

On exit, our trade totals were:

- Part one: +21 pips
- Part two: +83 pips

4.5 – The Trading Process

Let‟s combine the above material into one summary diagram and process checklist. The checklist will later become a part of our Procedures Manual.

4.5.1 – Trading Process Diagram

Figure 4.81 - Trading Process

The trading process involves four steps, as per figure 4.81 above.

The following checklist will guide you through the actions required for each step.

4.5.2 Trading Process Checklist

Step 1 – Trade Preparation

Prepare for possible trade opportunity as price enters the vicinity of a setup area.

Actions:

- Monitor price movement confirming it matches the behaviour previously anticipated. If price action differs from expectations, return to the initial analysis and recheck premise and assumptions.

- Identify trade parameters
  - Stop loss location
  - Targets T1 & T2
  - Confirm entry zone
    - Consider both LWP (if identified) and LRP

- Identify preferred entry plan
  - Stop and/or limit order

- Final confirmation
  - The setup and trade is valid for this market environment
  - Price action is supporting the trade premise.

Step 2 – Trade Entry

Manage the entry into the trade, achieving the best possible price within the entry zone.

Actions:

- Monitor price movement bar by bar, until the entry locations are identified. Ensure price continues to support the trade premise.
  - Determine candle pattern sentiment
  - Consider the context
  - Does it support my premise

- If bracketing price, place a stop entry order at the LWP as soon as it‟s identified.

- If working an entry, place an appropriate order in the market as soon as the entry decision is made.
    - Limit entry order in area of stall
    - Limit or Stop entry order on price action trigger.

- Confirm pending order details are correct.
    - Entry price, direction, size,
    - Contingent stop and target orders

- On fill:
    - Cancel other no longer required pending orders.
    - Confirm full or partial position filled

- Post-fill confirmation (gross error check)
    - How do I feel about the entry?
    - Confirm the setup and trade are valid for this market environment
    - Confirm the price action is supporting the trade premise.

Step 3 – Trade Management & Exit

Manage an open trade in order to minimise risk and maximise opportunity. The trade should remain live while the premise remains valid.

Actions:

- Continue monitoring price movement bar by bar. Ensure price continues to support the trade premise.
    - Determine candle pattern sentiment
    - Consider the context
    - Does it support my premise

- Part One
    - While premise remains valid:
        - Move the stop to breakeven when we would no longer wish to be in the trade if price retraced to the entry point.
        - Move the stop to new levels where we would no longer wish to be in the trade if price retraced to that point.
    - When premise is threatened
        - Cancel position if immediate exit is required.
        - Else work an exit through tightening both the stop and target orders, based upon lower timeframe price action.

- Part Two
    - While premise remains valid:
        - Move the stop to breakeven when we would no longer wish to be in part two if price retraced to the entry point.
        - Move the stop to new levels where we would no longer wish to be in part two if price retraced to that point.
    - When premise is threatened
        - Cancel position if immediate exit is required.
        - Else work an exit through tightening both the stop and target orders, based upon lower timeframe price action.
    - When market shows increased strength
        - Consider extension of T2 or replacement with a trailing stop.

- On partial exit
    - Confirm order correctly filled.

- On total exit
    - Confirm flat.

Step 4 – Post-Trade

Conduct post-trade administration and recovery.

Actions:

- Reconfigure order entry screens or DOM.
- In the event of a loss:
    - Consider the need for a recovery process.
- Is price setting up for a possible re-entry or subsequent setup?
    - Delay any trade log entries and prepare for the new trading process.
- When time permits:
    - Update trade log.
    - Monitor and record significant observations:
        - Market structure or price action.
        - My trading process.
        - My physical and psychological state.

(Some of the post-trade actions are new… and will be covered in more detail in later chapters)

4.6 - Practice

The analysis chapter provided direction regarding the practice of both initial and ongoing market analysis, after explaining the theory behind the concept.

This chapter on strategy will differ. As much as I‟m sure you would love to get to charts, I ask that you don‟t at this stage.

Chapter 5 provides ten complete trade examples, from analysis to exit. I‟d like you to work through those first.

And then in Volume Five we‟ll talk about the process of becoming a trader, part of which will be development of a plan for the practice of the strategy.

4.7 - Conclusion

Our market analysis process had us identifying strength and weakness in the market in order to determine the likely *future trend* direction; the path of least resistance for future price action.

Our trading strategy makes use of the same principles.

Trade setups are based around the concept of trading in the direction of strength and against the direction of weakness, in areas where price interacts with support and resistance (higher timeframe S/R, range S/R or swing H/L) or where price pulls back against a trend.

The traders entering in these areas, in the direction of weakness, are taking very low probability trades. Price reversal will trap them in a losing position, forcing their exit as price again resumes its movement in the direction of strength.

We aim to profit from the exit orderflow of these losers.

We recognise that the perfect entry method cannot be known until the trade is over, so we identify an entry zone which satisfies our criteria (wholesale entry and acceptable R:R ratio) and then work the best entry possible within that area.

Exit targets are based upon price action and the market environment, targeting areas where orderflow is expected to oppose our trade, or running with a trailing stop whenever a trending market allows this possibility.

Like in our analysis phase, price action is monitored bar by bar, in order to maintain focus and situational awareness, remaining aware of the shifting forces of supply and demand, ready to identify any threat to our trade.

The trade should remain open while our trade premise remains valid. If threatened, we will work an exit of our trade and reassess for further opportunity.

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Ok, now some of you might be thinking, I‟ve just read through that massive number of pages just to be told to buy pullbacks in an uptrend, sell pullbacks in a downtrend, buy tests of support, and sell tests of resistance.

That‟s right. That‟s all it is. Of course, if you‟re asking that then you haven‟t really got the concept yet and I‟d suggest you repeat all the material. The trading plan, at a conceptual level, is very simple. It‟s the deeper understanding of why it works, that allows you to trade the setups. And it‟s the experience and intuition that develops from deliberate practice (coming soon in Volume Five) which allows you to gain experience in dealing with all the different nuances and variations of each setup; and in gaining trust in yourself to be able to manage these nuances and variations without causing irrepairable damage to either your financial or psychological capital.

If I had just said to trade a pullback in a trend or a test of S/R (which could probably be done in 10-20 pages), you‟d try it once or twice, get a loss or two, and dismiss the concept as yet another waste of money.

With the background material in Chapter 2 as to why this strategy works, and in fact why it‟s the underlying reality behind all successful trading approaches, you‟re now more likely to believe it. And in fact you‟ll probably find that you can‟t ever go back to your old indicator ways; you just won‟t believe them any more.

And with the analysis skills you learnt in Chapter 3, you‟re well placed to start to identify market sentiment and likely future trend direction, as well as modify that analysis as new information comes available, bar by bar at the right hand side of your screen.

It‟s all about identifying shifts in order flow. It‟s all about identifying shifts in sentiment. It‟s all about finding where some group of traders is wrong, and capitalising on the order flow caused by their exit. If you get that, then you‟ve progressed far. And you‟ll understand the value in this strategy. Well done.

Chapter Five – Trade Examples

5.1 – Trade Example 1 – BPB – T1 & T2 Achieved

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 18 Aug 2010
Time: 18:33 on charts (09:33 London)

We start this example right at 18:33; three minutes after release of the MPC Meeting Minutes; an event with significant potential to move the market.

Step 1 – Define Structure

Figure 5.1 – Example 1 – Define Structure

Support is below the market at 1.5500. Resistance is above at 1.5645 and 1.5690.

Note the last green candle. This is only three minutes in duration, with a high of 1.5612 and a close of 1.5604. As expected, the release of the MPC Meeting Minutes has provided significant volatility, smashing price straight through a congested area of resistance at 1.5565, 1.5580 and 1.5600.

Step 2 – Define Trend

Figure 5.2 – Example 1 – Define Trend

Prior to news release, at 18:15, price broke through the upper level of a sideways trend that had developed between 1.5500 support and 1.5535 swing highs, forming an uptrend.

The news release has continued this uptrend, breaking through three levels of higher resistance.

Step 3 – Identify Strength & Weakness

Momentum analysis on figure 5.3 below shows clear signs of strength on the bullish price swings and weakness on the bearish price swings.

The *lower timeframe* (1 min) chart is helpful in this case in confirming that the single *trading timeframe* (3 min) post-news candle was not one straight bullish move.

Rather, it consisted of a mid-close bull candle, a mid-close range candle, and a high close bull candle (although still within the range of the first post-news candle).

While showing post-breakout strength, there are signs of supply coming into the market, possibly a result of profit taking in the vicinity of the 1.5600 resistance.

Figure 5.3 – Example 1 – Identify Strength and Weakness

Step 4 – Identify Future Trend Direction

Figure 5.4 – Example 1 – Identify Future Trend Direction

The Sixth Principle of *future trend* direction states:

If strength is shown on approach to an S/R barrier we expect a breakout and watch the behavior of price post-breakout for clues as to future direction:

- Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

In this case, the bullish move has already broken through the resistance area. We‟re now looking for the direction post-breakout.

Given the strength of the post-news move, my expectation is for a breakout pullback and then continuation of the trend to the next higher resistance area at 1.5645.

I will monitor price closely for signs of weakness which may indicate a breakout failure. However it‟s unlikely to offer any great trade opportunity due to the three tightly grouped resistance areas (1.5565/80/5600) which would now be expected to offer potential support.

Step 5 – Visualise Future Price Action

Figure 5.5 – Example 1 – Visualise Future Price Action

In order to validate our premise (highest likelihood being a breakout pullback and trend continuation), price action will have to show a weaker pullback into support.

Potential support is available at any of the three previous areas of resistance.

Any signs of continued strength on the bearish side will invalidate the premise and demand a reassessment. Given the depth of potential support, any breakout failure will possibly set up for a period of sideways congestion (although it‟s all speculation at this stage).

Step 6 – Identify Areas of Trade Opportunity

Any weaker pullback into support will offer a potential BPB opportunity.

Figure 5.6 – Example 1 – Watching for BPB Opportunity

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

It‟s a little difficult to demonstrate an ongoing process through an ebook, without adding 2-3 charts per candle, and a significant amount of pages. As such, the following charts and description will attempt to provide a summary of thoughts, as price progresses through the next six *trading timeframe* (3 min) candles and we repeat all three steps of the ongoing analysis process.

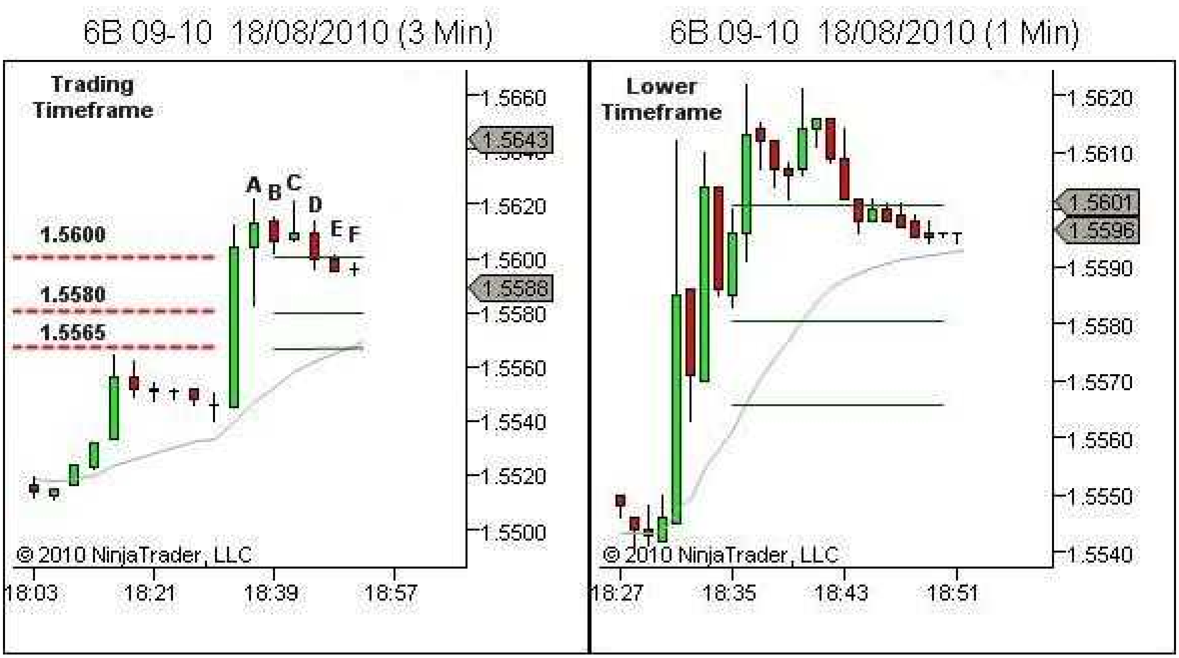

Figure 5.7 – Example 1 – Ongoing Market Analysis Process

Candle A is a high close bull candle, but it demonstrates both bullish and bearish pressure within the candle, as evidenced by the lower and upper tails. Its inability to project far above the previous candle shows an initial weakening of the post-breakout action.

Candle B and C (both low close range candles) confirm the breakout has stalled. This is supporting our premise so far – there‟s been no great strength in the bearish direction – and we now watch for signs of weakness in a pullback.

Candles D and E are both low close bear candles, which imply bearishness. But the reducing range and inability to project far in the bearish direction show weakness. Putting this into context, we see weakness appearing in the post-breakout pullback, confirming our premise.

Candle F is a classic candlestick analysis doji (mid close range candle), once again showing continued weakness in the pullback and supporting our premise of a breakout pullback and trend continuation, and a potential BPB setup.

The right hand side of Figure 5.7 displays the *lower timeframe* (1 min) price action, even more clearly showing the extent of stall in the pullback.

Trading Process

Step 1 – Trade Preparation

Let"s now prepare for a potential BPB setup and trade.

Note that the bar by bar ongoing market analysis process continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

Figure 5.8 – Example 1 – Trade Preparation

The current stall in price offers a potential stop location (S1) at 1.5592, two pips below the pullback price action.

The last wholesale price (LWP) is identified at 1.5603, as shown on the above chart. This is the area, which if hit, would trigger the first of the pullback stops and accelerate price upwards.

T1 is identified at 1.5616, just inside the previous highs. This confirms that the LWP also gives us just over 1:1 R:R (13 pts reward to 11 pts risk), allowing the LWP to define the upper limit of our potential entry zone.

T2 is positioned just inside the next resistance area at 1.5643.

Step 2 – Trade Entry

Continuing to reference Figure 5.8 above, I would place a stop entry order at the LWP, 1.5603, ensuring that I don"t miss an entry if price should surge upwards from its current level. The entry order would also have attached contingent orders for S1, T1 and T2.

I will now attempt to work a better entry than LWP.

In this case though, I will not simply place a limit order towards the lower part of the stall. Firstly, the recent stall action is only a couple of pips wide. And secondly, price could easily push lower for another swing down (producing a complex pullback down to maybe the 1.5580 or 1.5565 support areas.

Should it do so, this will necessarily involve a reassessment of both S1 and LWP.

So, we simply wait, for a better stall or a price action trigger.

Refer now to Figure 5.9 (below) for following price action.

Figure 5.9 – Example 1 – Entry

The left hand side of the above diagram shows us that the next *trading timeframe* (3 min) candle triggers our stop entry at LWP, 1.5603.

There was no opportunity to work any better entry. Had there not been a stop entry at this position, the 1 min candle (*lower timeframe*) would have triggered a pattern based entry based upon what could be called either a micro 3-swing retrace and/or an expansion bar off the MA.

Entry is at 1.5603.

Stops for both part one and two are at S1: 1.5592 (risk -11 pips)

Target T1 is at 1.5616 (reward 13 pips). Target T2 is at 1.5643 (reward 40 pips).

Step 3 – Trade Management & Exit

Figure 5.10 below demonstrates our management of part one of the position.

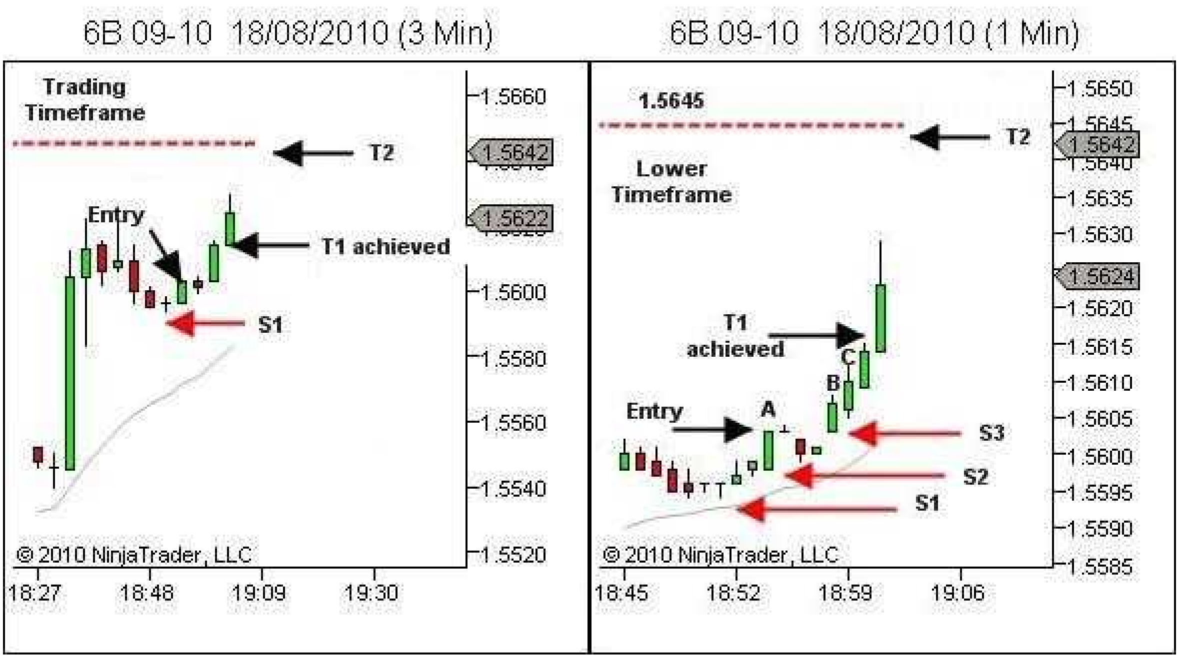

Figure 5.10 – Example 1 – Trade Management and Exit – Part One

Looking at the right hand side (*lower timeframe, 1 min)*, we see candle A showing the entry candle which triggered right on the close. The stop was at S1.

Price then stalled for three minutes. While price action does not demonstrate any real bearish strength, this is an indication that I was too early in my assessment of when price would start triggering the stops of the pullback / reversal traders.

Candle B started the real move higher. The stop was moved to position S2, below the recent post-entry pullback. If there is to be a surge of stop-induced bullish orderflow, price should not get back to this area.

Candle C gets to within 3 pips of the target, T1. The stop, if not already done, would be moved to breakeven (S3), or if you like to 1.5604, below candle C, and providing one pip to cover the cost of commission.

Target T1 is easily achieved.

The left hand side of figure of 5.11 (below) demonstrates the management and exit of part two of our position.

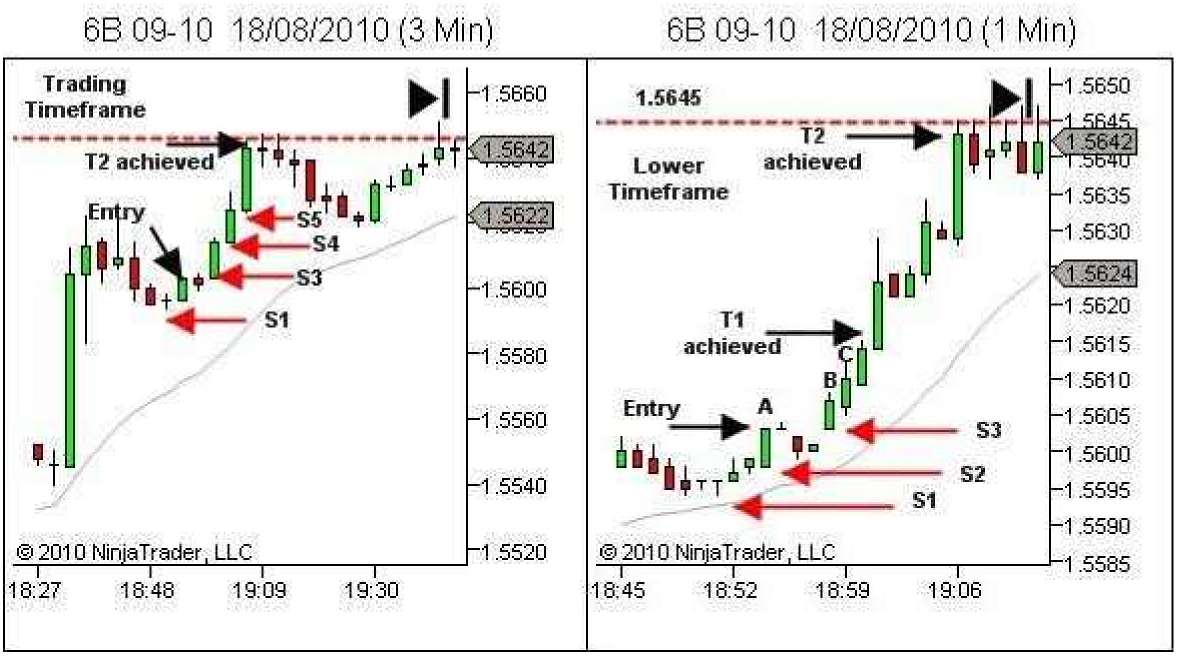

Figure 5.11 – Example 1 – Trade Management and Exit – Part Two

On achievement of target T1, the stop for part two is moved to breakeven (S3).

The left hand side demonstrates the *trading timeframe* (3 min), which is where the majority of our focus should remain.

The stop for part two in this case trails the *trading timeframe* (3 min) candles till achievement of T2, 1.5643, just prior to the next resistance area.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups as price now interacts with the next resistance level (watching for a possible TST setup, or a BOF/BPB if price continues with bullish strength and breaks through to higher prices).

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +13 pips (less commission)
- Part two: Achieved T2 +40 pips (less commission)

5.2 – Trade Example 2 – PB – T1 Achieved – Part Two Worked Exit

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 23 Aug 2010
Time: 24/8/10 00:27 on charts (15:27 London)

Most days will not offer nice trending price action. This session was a Monday in which there were no economic news releases planned in both the UK and USA. We start the following example midway through the UK/US forex session overlap, where we see a largely choppy and directionless market so far. The remainder of a session such as this is not expected to offer much different.

Sometimes though, if we display patience we"ll get clear signs of strength or weakness. Positioning ourselves to trade against the weakness will always offer higher probability trades.

Step 1 – Define Structure

Figure 5.12 - Example 2 – Define Structure

In this example we see higher resistance at 1.5575, 1.5595 and 1.5620. Note that the recent move up to the last swing high broke up through a previous resistance area at 1.5560 before failing and moving lower. 1.5560 is now invalidated.

Lower support exists at 1.5460, 1.5475 and 1.5520. Price is approaching the 1.5520 support area for the third time this day, the previous time having broken slightly through before failing (see the lower tail on the third-last candle).

Step 2 – Define Trend

The last candle has resulted in a change to a downtrend, as demonstrated in the *trading timeframe* (3 min) below.

Figure 5.13 - Example 2 – Define Trend

Step 3 – Identify Strength & Weakness

In the chart below we see earlier bullish strength in swings A and C, combined with bearish pullback weakness in B and D. Beautiful uptrend signals. However, swing E was unable to carry price any further. The breakout above the previous 1.5560 resistance (as demonstrated in step 1 above) was unable to attract sufficient buying to ensure continuation of the trend – not surprising on a quiet, news-free day.

Price then collapsed with swing F accelerating downwards as all the longs were stopped out of their positions and new shorts chased the market lower.

Momentum analysis shows weakness in the bullish direction (swing E) followed by accelerating strength in the bearish direction (swing F)

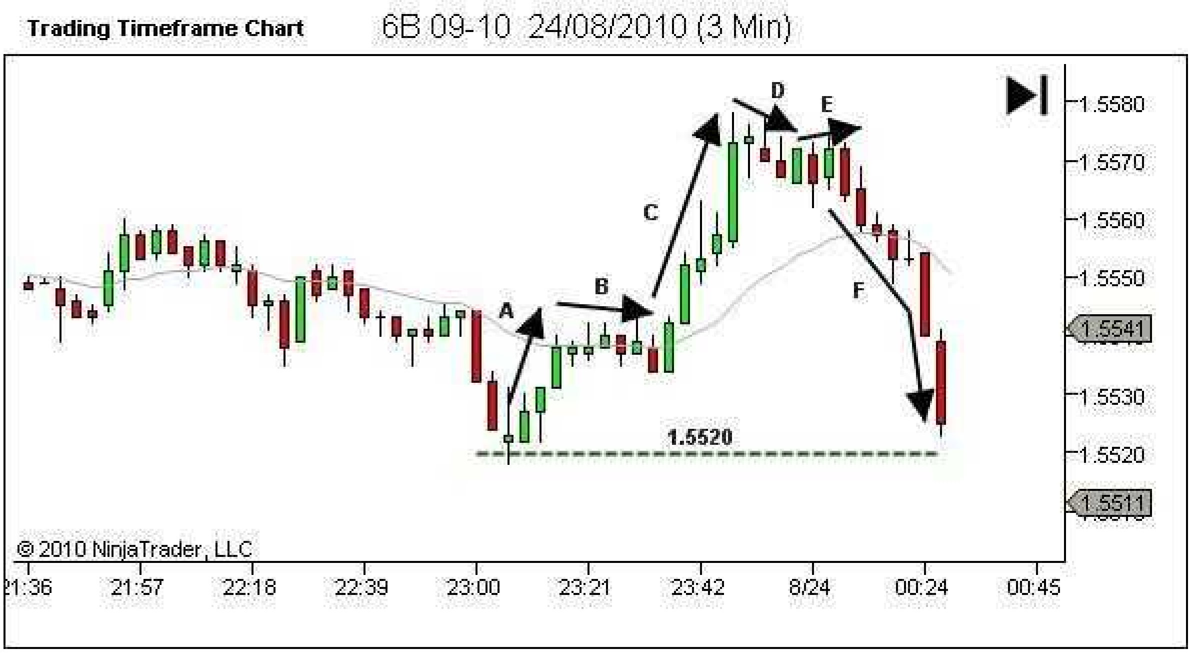

Figure 5.14 - Example 2 – Identify Strength and Weakness – 1 of 2

The *lower timeframe* (1 min) chart below shows beautiful signs of weakness appearing at the top reversal, with each extension unable to project to new highs, and each pullback extending to a depth of greater than 100%.

The chart also shows clear signs of strength in the subsequent move downwards.

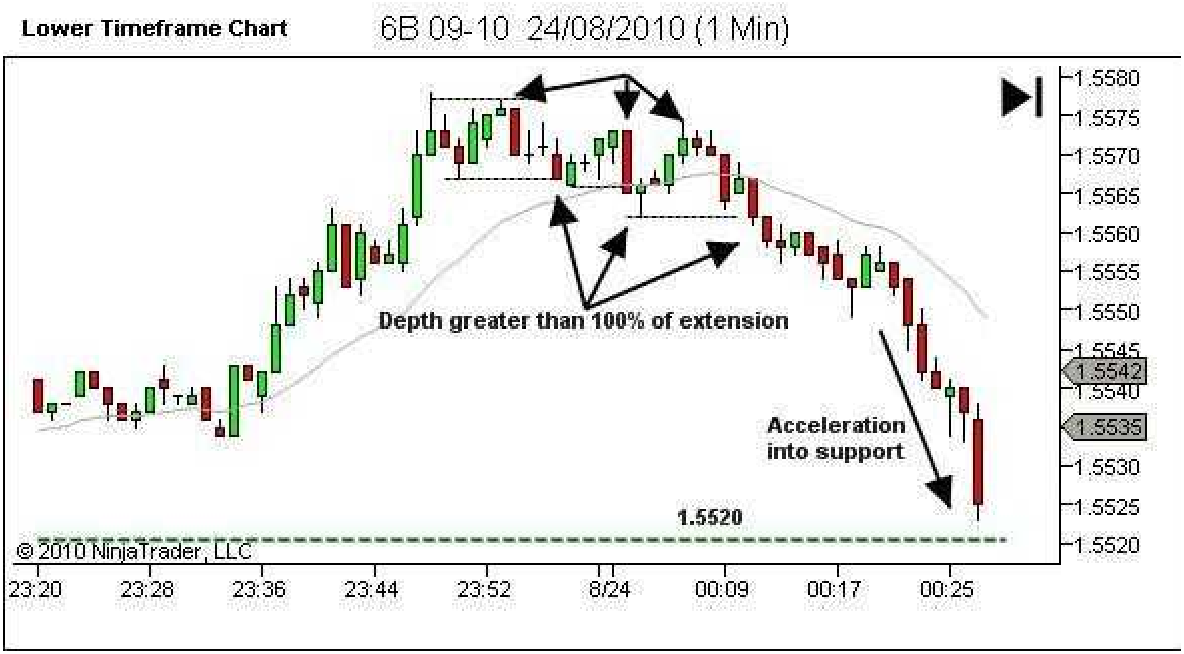

Figure 5.15 - Example 2 – Identify Strength and Weakness – 2 of 2

Step 4 – Identify Future Trend Direction

The Sixth Principle of *future trend* direction states:

> If strength is shown on approach to an S/R barrier we expect a breakout and watch the behavior of price post-breakout for clues as to future direction:

- Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

Given the strength of the move downwards, my expectation is for a breakout of the support area. I‟ll then watch subsequent price action for signs of weakness which may indicate a breakout failure or a breakout pullback opportunity. My gut feel is for a BPB opportunity due to the increasing downwards momentum.

Figure 5.16 - Example 2 – Identify Future Trend Direction

In general though, an accelerating move can be difficult – sometimes indicating strength and likely continuation of the trend (usually following some form of complex correction), other times leading to a climactic reversal with a strong area of support established at the reversal point.

In any case, the higher probability setups are in the direction of strength and against weakness. Higher probability opportunity in this case would be with either a PB or BPB entry (both with trend). Lower probability would be a BOF reversal (counter-trend). A better counter-trend entry would occur if a low was established, then a pullback (and possible PB opportunity), then a weaker retest of the lows for a TST or BOF entry.

Step 5 – Visualise Future Price Action

Assuming a BPB opportunity, I"ll be looking ideally for some strong extension below the support level, followed by a weaker pullback which fails in the vicinity of the support-turned-resistance area.

To invalidate the premise, extended weakness may indicate lack of new selling below the support area. This will look somewhat like the previous top reversal, involving 2-3 attempts to push lower which fail. In this case, I"ll need to reassess and consider the possibility of a low being established.

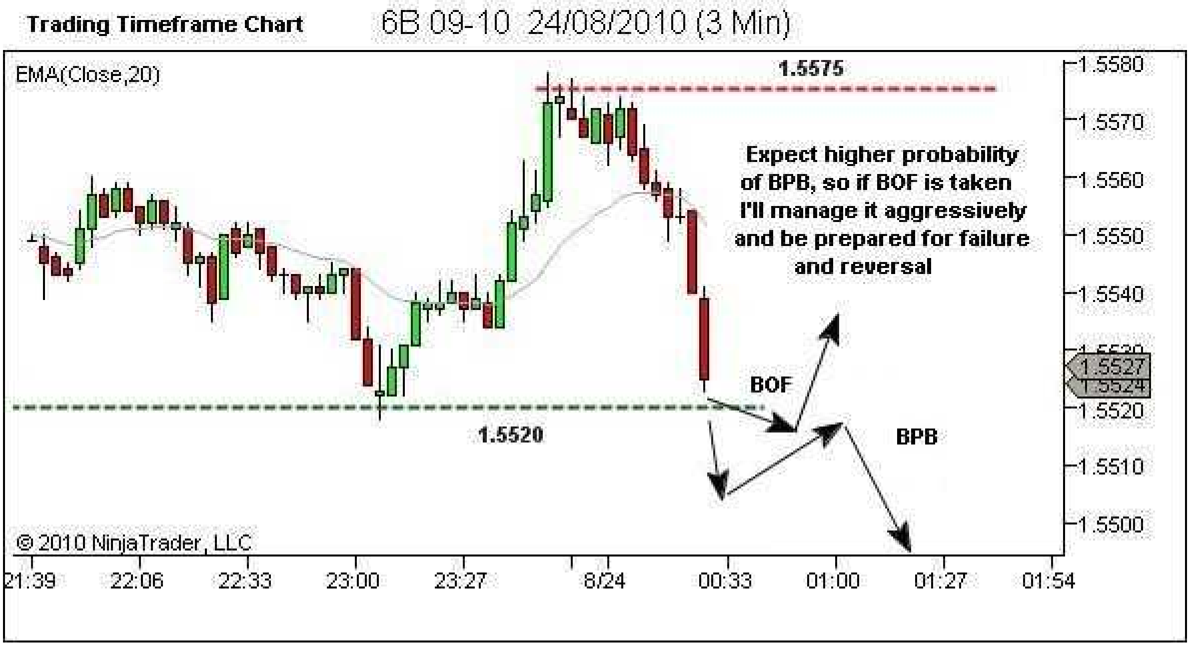

Figure 5.17 - Example 2 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

Our visualization of the future price action provides our possible setup areas (BOF and BPB); with BPB being the higher probability opportunity.

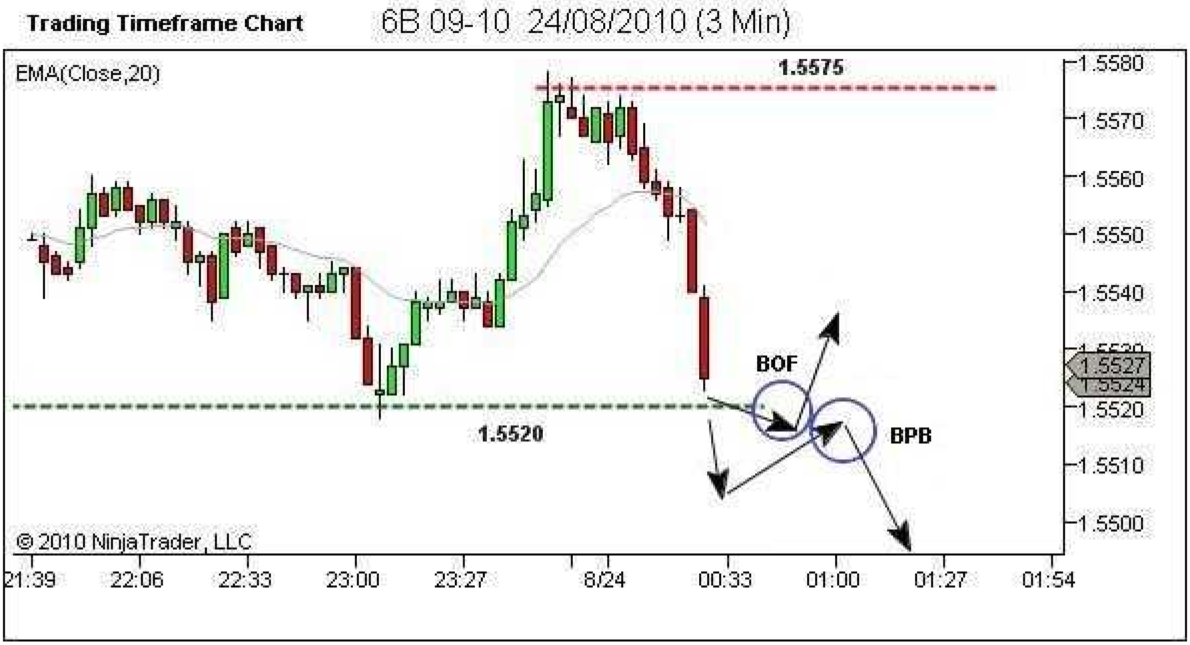

Figure 5.18 - Example 2 – Identify Areas of Trade Opportunity

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Once again, in summary form…

Let"s look at the following two *trading timeframe* (3 min) candles…

Figure 5.19 - Example 2 – Reassessment of Future Trend Direction

Candle A (low close range candle) followed by candle B (high close range candle) both show evidence of demand (bullish pressure) coming into the market right at the support area. I"m not interested in looking at a TST entry just yet, although may consider that if a second or third push to support both hold.

However, the next candle or two will be critical. Continuation lower will involve sticking with my original assessment of *future trend* direction, expecting a breakout below support. Continuation higher though will have me looking for a weaker pullback and a potential PB opportunity down towards support (in accordance with the First Principle).

First Principle - We expect an up or downtrend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

The next candle shows continuation higher. We"re now operating with a pullback premise, and searching for a PB opportunity short. Price action required to validate our new premise will be weakness on the pullback.

Candle C (mid close bull candle) displays an upper tail, evidence of selling coming into the market, which would be expected at our around the area of the black horizontal line.

Figure 5.20 - Example 2 – Ongoing Market Analysis Process

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

Candle D (high close range candle) continues the pullback. Again we see the pullback weakening, this time through the smaller range, indicating difficulty in the bulls overcoming any bearish orderflow.

We tentatively identify a possibly stop location above this candle at 1.5548 (marked as S1). Of course, this will be adjusted higher if price continues higher.

And we tentatively identify T1 as 1.5523, just above the support level, and T2 as 1.5478, just above the next lower support level.

Figure 5.21 - Example 1 – Trade Preparation

Assuming a break below candle D will trigger the first of the stops from those trapped long in a low probability trade; we will assign a break below D as the LWP, 1.5538. This provides 10 pips risk and 15 pips potential reward, easily meeting our 1:1 requirement. A stop entry order is placed at LWP, with S1, T1 and T2 attached as contingent orders. We now attempt to work a better entry.

Step 2 – Trade Entry

Entry occurred either on recognition of the *lower timeframe* (1 min) upthrust pattern, at 1.5540, or if not quick enough then on a stop entry at our LWP 1.5538.

When the *lower timeframe* (1 min) trigger is this close to the LWP stop entry order, be *very* careful you don‟t end up with two entries, for double your normal position size.

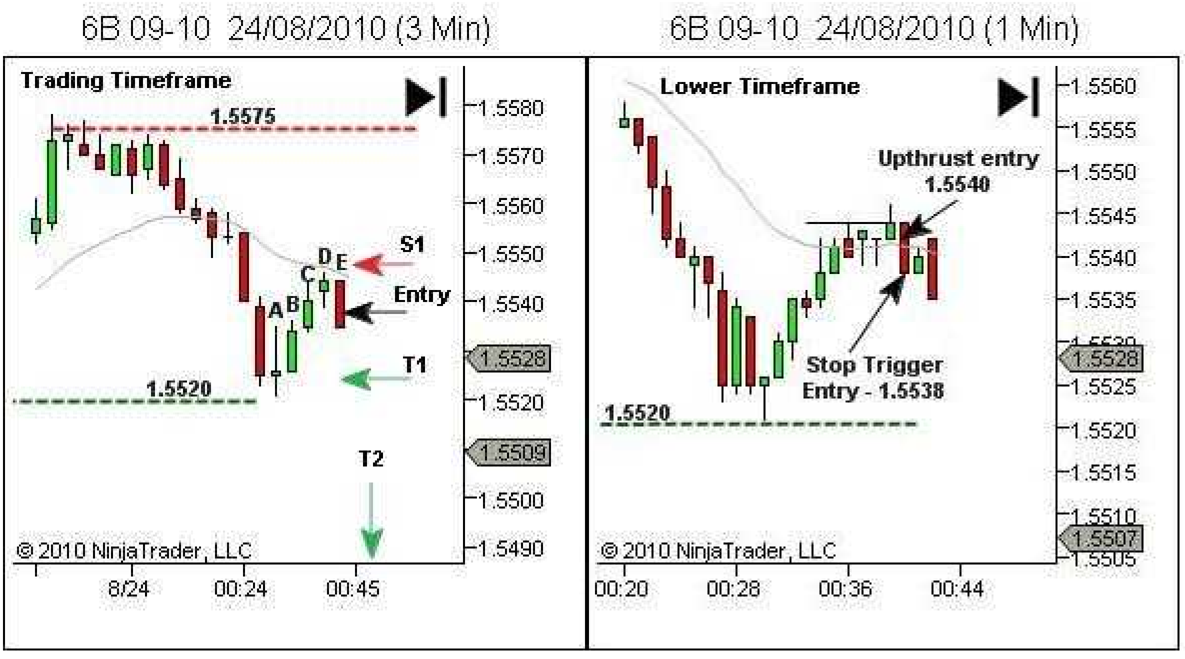

Figure 5.22 - Example 2 - Entry

Let‟s assume we missed the upthrust trigger and got in at LWP.

Entry is 1.5538.

Stops for both part one and two are at S1, 1.5548 (risk -10 pips).

Target T1 is at 1.5523 (reward +15 pips). Target T2 is at 1.5478 (reward +60 pips).

Step 3 – Trade Management & Exit

Trade management was quite easy in this example, as price moved reasonably quickly to the first target. The strength of the initial downswing has reasserted itself, overcoming the weaker pullback. The bearish orderflow created by the stops of the bulls (attempting to catch a reversal) helps drive our trade to profit.

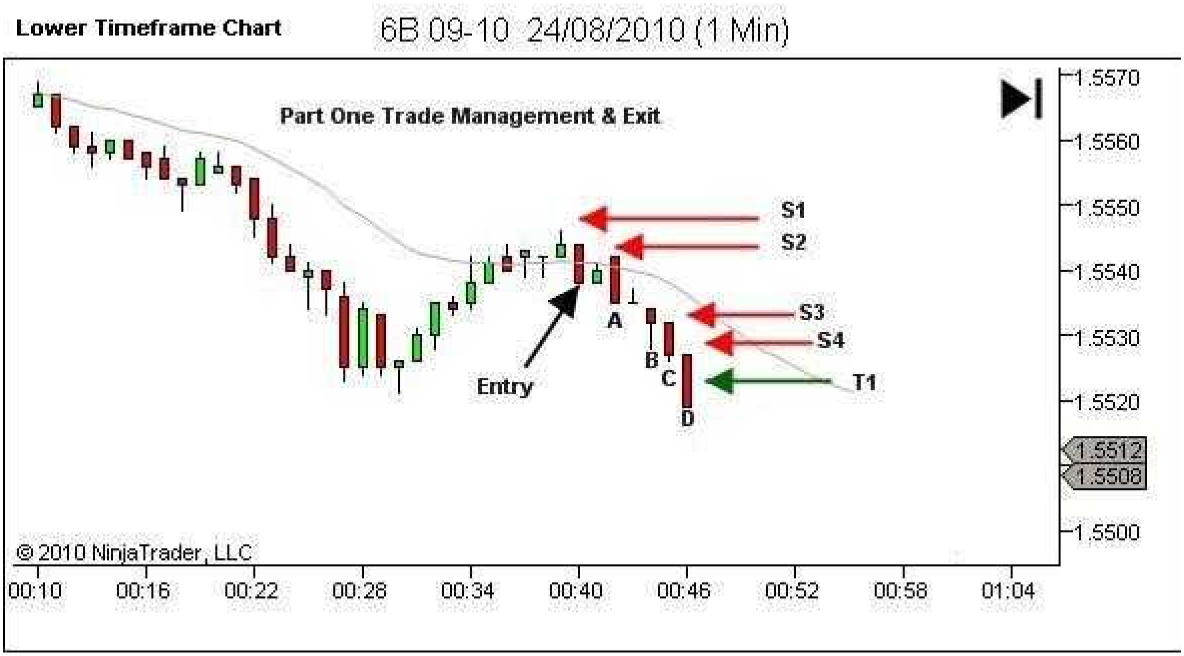

Figure 5.23 - Example 2 – Trade Management and Exit – Part One

The stop for part one was simply trailed behind significant bearish candles on the *lower timeframe* (1 min) chart. After the low close bear candle (A) the stop was moved to S2. Candle B (high close bear candle) caused a little concern, indicating potential for a retest of the entry area. Candle C (low close bear candle) closed at new lows, allowing us to move the stop to S3. As price approached the target, the stop was moved to S4 to tighten it up and ensure a more appropriate R:R for the remainder of the trade. T1 was easily achieved.

Part two was trailed behind candles as well, with focus initially on the *trading timeframe* (3 min) chart of Figure 5.24 below. On achievement of T1, the stop was moved to breakeven (S5). On the close of candle A it was moved above this candle to S6. On the close of candle B it was moved to S7. You can see here how I like to reassess the stop position after any bear candle in a downtrend (and the same for a bull candle in an uptrend).

Candle C caused some concern showing a real weakening of the trend. By candle D (if not earlier) you should be considering some way to work an exit, as downside momentum had disappeared and price shows potential to rally higher.

Figure 5.24 - Example 2 – Trade Management and Exit – Part Two – 1 of 2

Figure 5.25 (below) shows the *lower timeframe* (1 min).

Working an exit can involve two options – tightening the stop and/or the target. I chose to leave the target at T2 in this case, as any continuation lower which broke 1.5500 would possibly get enough breakout orderflow to move to T2. The area I wanted to protect though was the upside. Having seen three pushes lower all fail to take price towards T2, it"s quite likely that a break higher would occur, rather than a break down. The stop was tightened to just above current price action at S8.

The trade was stopped there at 1.5513.

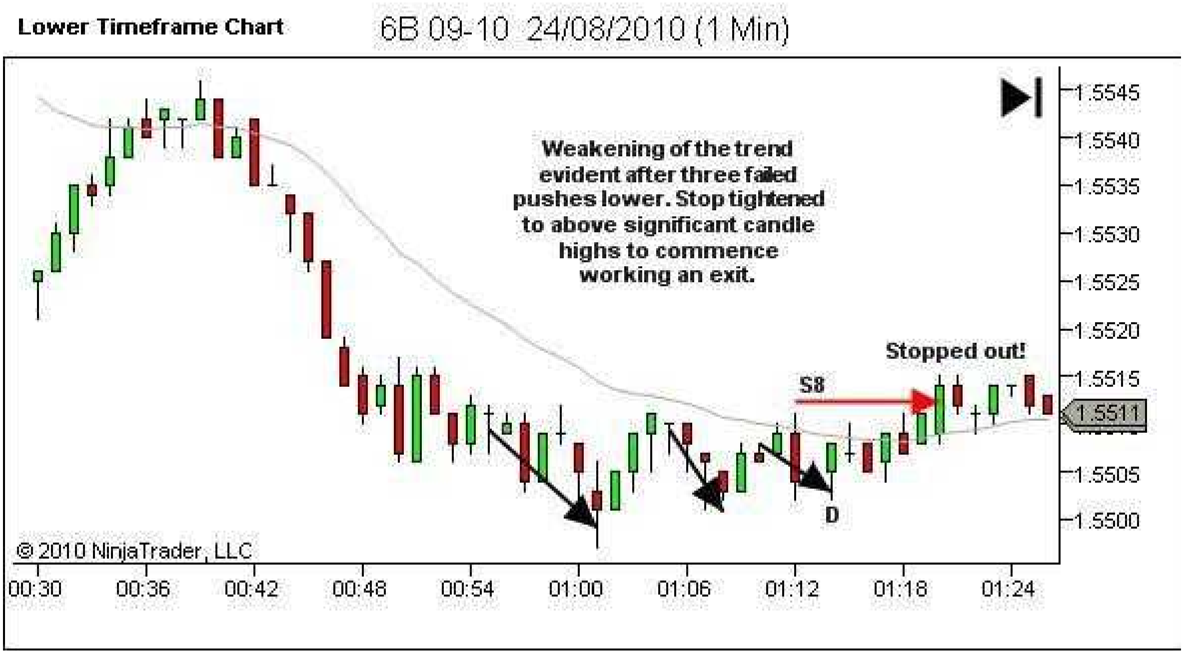

Figure 5.25 - Example 2 – Trade Management and Exit – Part Two – 2 of 2

In hindsight, it would have been best to also work the target price, perhaps getting us out towards the lower edge of the congestion, just above 1.5500. I didn"t do that in this case, as I was leaving the option open for continuation lower. Had price broken 1.5500, I felt confident it would carry on to the original target. Active management decisions don"t always provide the best outcome. Still, in this case, the outcome was better than simply waiting for the stop or target to be hit.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +15 pips (less commission)
- Part two: Worked Exit +25 pips (less commission)

5.3 – Trade Example 3 – BOF, BPB, TST – Sideways Trend within another Sideways Trend

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 26 Aug 2010
Time: 22:30 on charts (13:30 London)

Let‟s look at another messy example with sideways, choppy price action. This is the reality of the markets; it‟s not always smooth, flowing trends. Often we have to battle through grinding action. All we can do is to identify our setup areas, aim to achieve the best entry possible and then manage our risk.

Remember though – if in doubt, get out. If you're not reading it well, get out of the markets. You don't have to trade.

Step 1 – Define Structure

Figure 5.26 – Example 3 – Define Structure

Figure 5.26 defines our structure. We have identified two close levels of support below the market at 1.5370 and 1.5385; and two close levels of resistance at 1.5460 and 1.5475.

Note, you could also have identified other support and resistance at the swing lows and highs within the 1.5385-5460 area. This is an example of the subjectivity that can be applied to our structural definition. While technically correct, to do so would likely just crowd the charts with too many S/R levels. It‟s better to visually step back a bit from the charts and select those levels which stand out the most. If the other levels are significant, they‟ll still play a part in our analysis, showing up on the *trading timeframe* (3 min) as significant swing highs and lows (as we‟ll see below in this example).

Step 2 – Define Trend

Figure 5.27 – Example 3 – Define Trend

Our trend is identified as a sideways trend (trading range) between range support at 1.5400 and range resistance at 1.5435.

Interestingly, this trading range exists within the bounds of an outer trading range between *higher timeframe* (30 min) support at 1.5385 and *higher timeframe* (30 min) resistance at 1.5460.

Step 3 – Identify Strength & Weakness

Figure 5.28 – Example 3 – Identify Strength and Weakness

The *trading timeframe* (3 min) chart shows a sideways trend in which neither the bulls nor the bears are showing greater strength.

However, the time is 22:30 which is the scheduled release time for the potentially volatile US Core Durable Goods Orders. It is expected that the next candle or two will show clear signs of strength in one direction.

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

With the release of economic news pending, any identification of *future trend* direction, price action to validate it, and identification of setup areas, will have to wait. We will conduct this as part of our ongoing market analysis, based upon the first couple of post-news candles.

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Once again, in summary format; due to the fact that books are not the ideal medium for demonstrating ongoing processes…

Figure 5.29 - Ongoing Market Analysis – Post-News Release

The first candle post-news release was a high close range candle. More information required!

This was followed however with an explosion higher, producing a high close bull candle closing right on its highs.

Having no original premise, we now establish one as per the initial analysis process.

Strength is to the bullish side within a sideways trading range. We therefore anticipate a breakout, in accordance with the Fourth Principle of *future trend* direction.

> When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behavior of price post-breakout for clues as to future direction:
> - Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range.
> - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

The principle defines the price action required to validate our premise – we‟re searching for signs of weakness after the breakout.

The principle also defines the potential setup areas – a BOF and/or BPB setup.

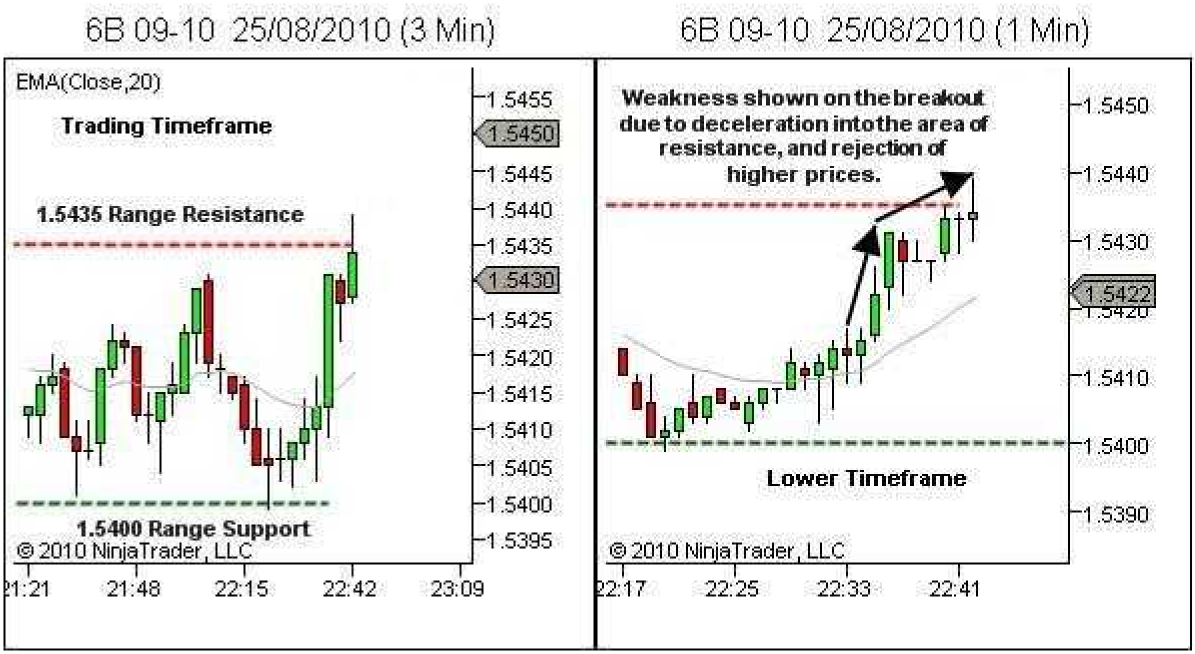

Figure 5.30 - Example 3 – Ongoing Market Analysis – Identification of Weakness

The following two *trading timeframe* (3 min) candles show weakness actually coming into price before it gets to the area of range resistance, through deceleration in the price swing. Price does breach the area of resistance though, however quickly rejects higher prices as shown by the upper tail.

We have a clear sign of weakness following the breakout; it‟s time to prepare for BOF trade.

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

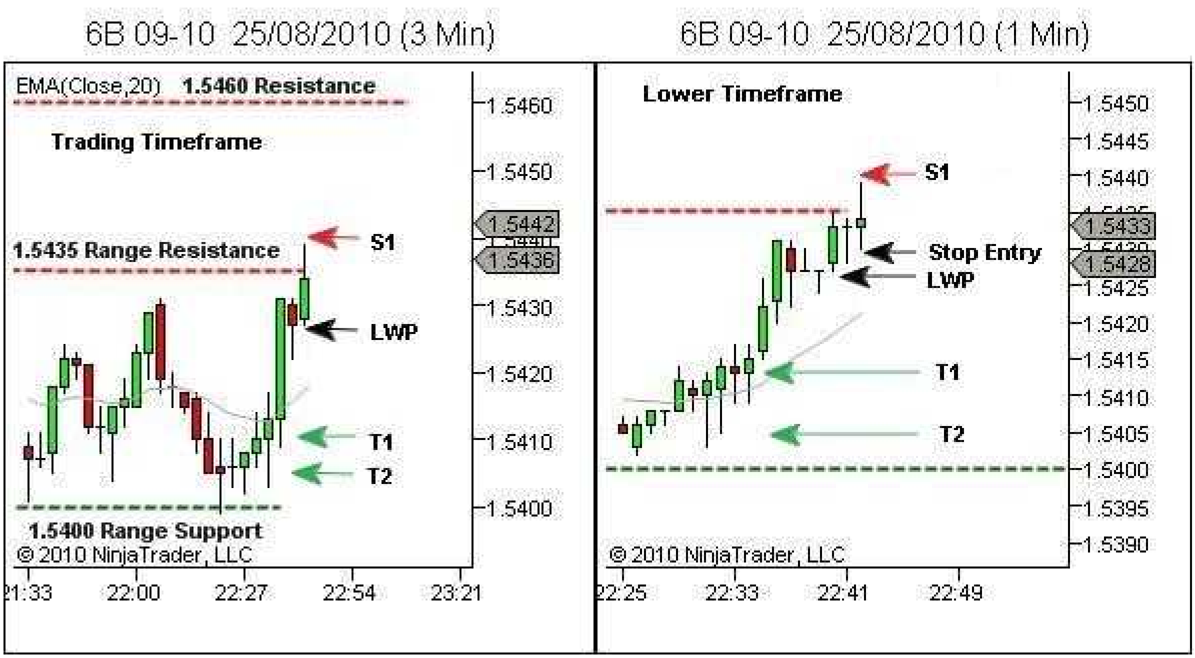

Figure 5.31 - Example 3 – Trade Preparation

S1 is tentatively identified as above the area of price rejection (upper tail) at 1.5441. LWP is the break of the 3 min candle low at 1.5426. T1 is identified as the open of the first candle post-news, 1.5413. T2 is just above range support at 1.5405. While T2 is usually placed at *higher timeframe (30 min) support*, that wouldn‟t be wise in this case with the 1.5400 support sure to oppose prices IF they should get there.

Risk is therefore 15 pips while potential reward for part 1 is 13 pips. This is unacceptable (although close). The LRP would be the price that offers 1:1, being 1.5427. Therefore I cannot take this entry unless I can achieve 1.5427 or higher.

Looking at the *lower timeframe* (1 min), a stop entry order on the breakout below the upper candle, would trigger at 1.5429, allowing risk of 12 pips and potential reward of 16 pips. This is acceptable.

A stop entry order is placed at 1.5429 (candle pattern trigger on break of the doji low at resistance; NB. Candle open to close is only one pip, so I‟m happy to call this a doji).

The stop entry order has attached S1, T1 and T2 contingent orders.

Note that all orders are *tentative* at this stage. If subsequent price action does not trigger entry, but moves higher, I‟ll be sure to adjust the entry and stop loss orders as required.

So, we now await the next candle, with the intent of trying to work a better wholesale entry price (if price should offer such an opportunity), safe in the knowledge that if price should collapse from here we will be triggered into our entry at 1.5429.

Please note: despite the weakness shown just prior to and on breakout, the market had shown some initial strength into the area of range resistance. This is an aggressive entry, and any BOF trade entered must be managed aggressively. If triggered, it should prove itself to us immediately through strength to the downside. If any signs of weakness display post-entry, we will prepare for either an exit or a reversal to BPB. This should be standard practice for any BOF setup.

Step 2 – Trade Entry

No opportunity was provided to work a better entry. The trade triggers on the next *lower timeframe* (1 min) candle (1 min candle pattern trigger; breakout of doji).

Entry parameters are:

Entry: 1.5429

Stop at S1: 1.5441 (risk -12 pips)

Target T1: 1.5413 (reward +16 pips)

Target T2: 1.5405 (reward +24 pips)

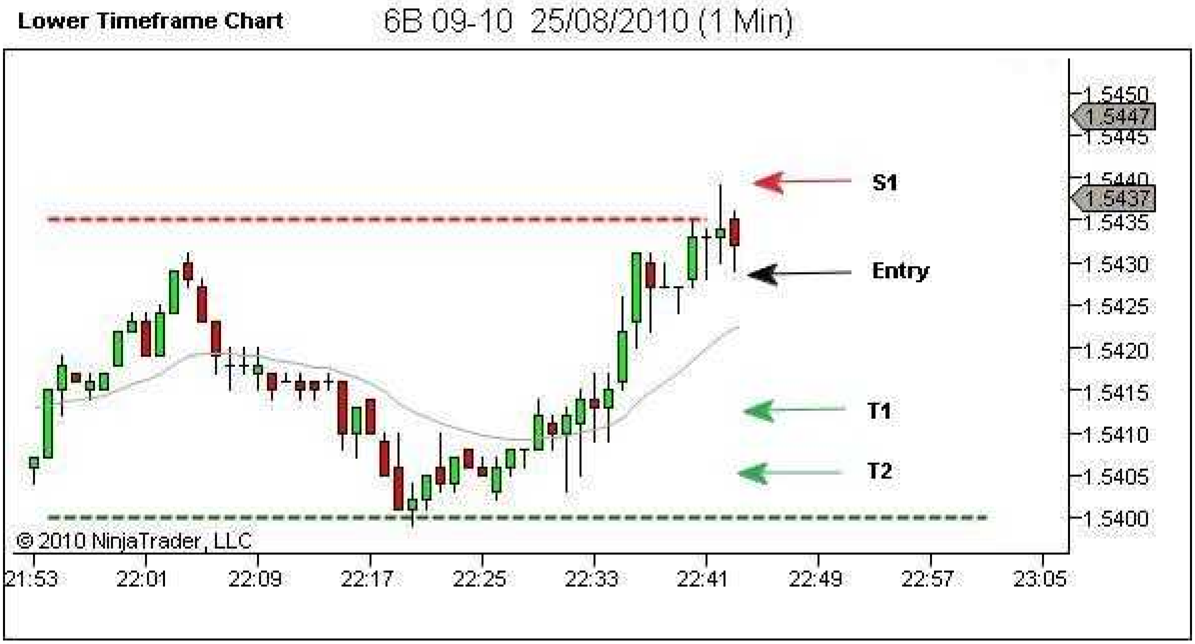

Figure 5.32 - Example 3 – Entry

Step 3 – Trade Management & Exit

Referring to the right hand side below, Candles A and B confirmed our plan, both offering low close bear candles. C then produced a low close range candle showing a slight pause in momentum. D continued lower but E then showed a further pause via a mid-close range candle.

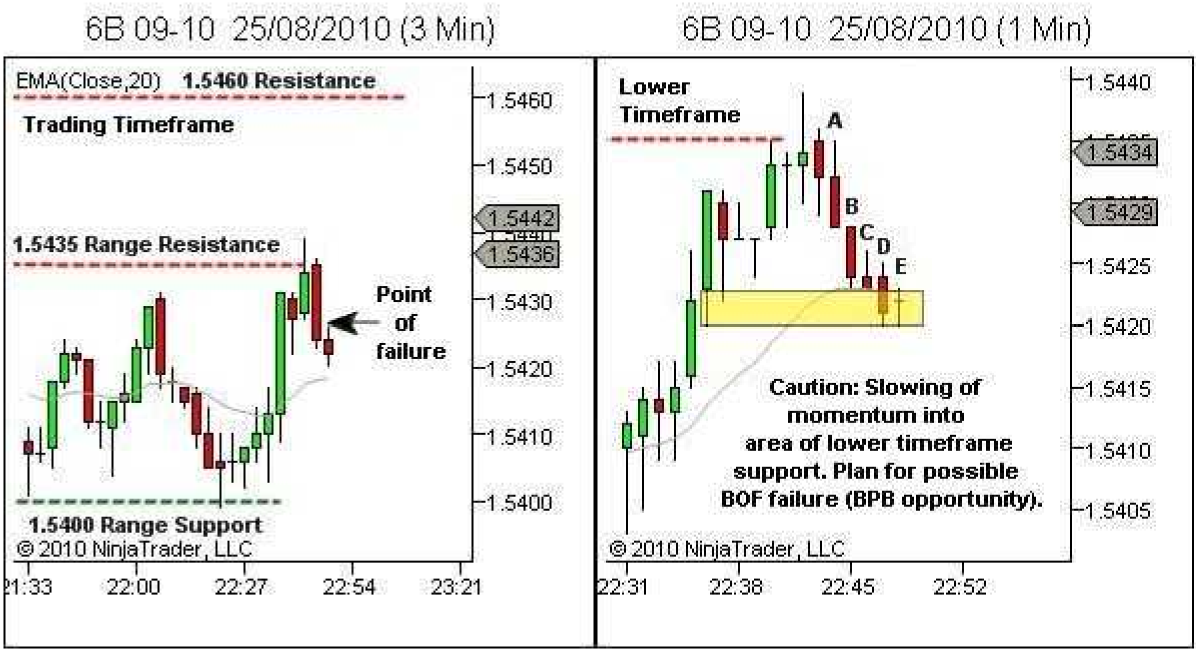

Figure 5.33 - Example 3 – Trade Management

Managing this one aggressively, I‟m seeing potential support at the lower tails to the left, on the *lower timeframe* (1 min) chart (yellow shaded area).

I‟m still trading the move down, but will move both stops to the point of failure, identified on the *trading timeframe* (3 min) (LHS) as above the last candle. If price reaches here it confirms a lack of strength on the downside, and should move to retest the highs again. This point of failure is above candle C on the *lower timeframe* (1 min) chart to the right, at 1.5427.

Step 1 – Second Trade Preparation

I also place orders to reverse to a BPB trade, with entry at 1.5427, stop loss below the D&E lows at 1.5419, target T1 at the highs of A, 1.5435, and T2 just below *higher timeframe* (30 min) resistance, 1.5455.

Please note that this may not be triggered if the down swing continues to new lows. It‟s simply placed in anticipation of a trade reversal, should price break the high of the last *trading timeframe* (3 min) candle and indicate weakness on the downmove.

Step 2 – Second Trade Entry

The original trade was stopped out at 1.5427, both part one and two achieving +2 pips each (before commissions). This is a good example of the benefits of FX Futures over spot forex. The commission (which should be less than one pip) still leaves you with two +1 profits, as opposed to a standard 3 pip spread on spot forex meaning your exit would have actually been at 1.5430, for two losses of 1 pip each. Small amounts, but they add up. We‽ll discuss more on that when we talk about other markets and other timeframes.

Trade reversal is seen below in Figure 5.34.

Step 3 – Second Trade Management & Exit

Post reversal price action clearly shows how strength exists in the bullish direction, both before and after the pullback, with weakness during the pullback.

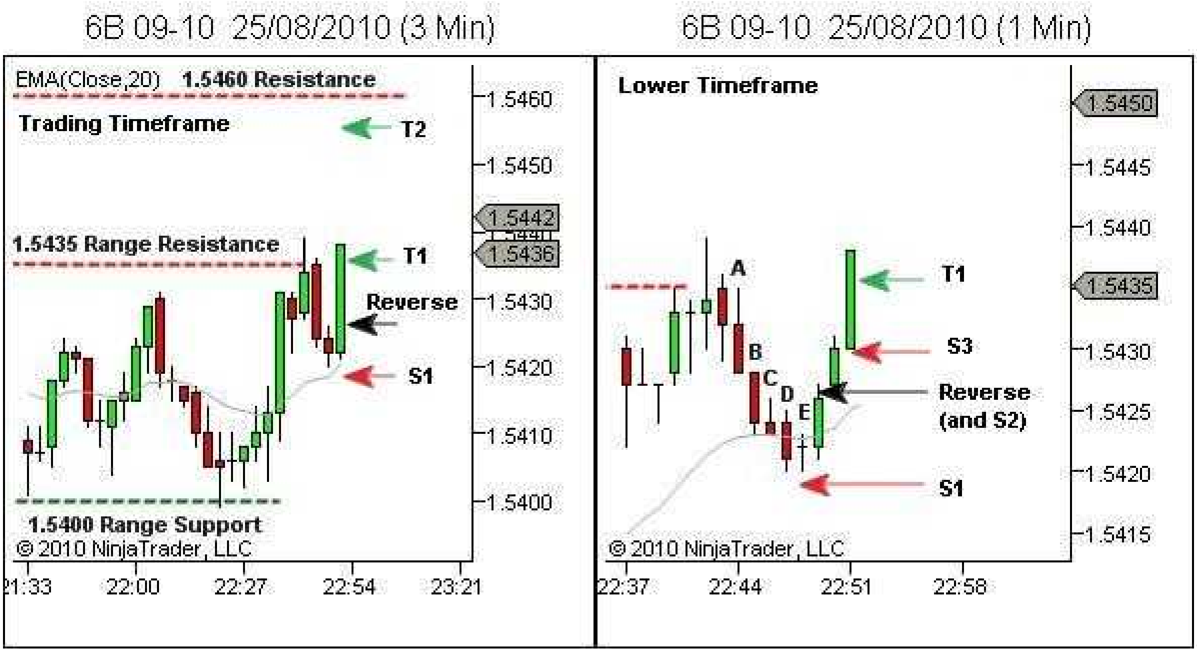

Figure 5.34 - Example 3 – Reversal, Trade Two Entry and Part One Management

Trade two quickly moved to the target T1 (1.5435), with the stop trailed behind the *lower timeframe* (1 min) candles at S2 (breakeven) and S3.

The stop for part two is moved to breakeven +1 (to cover commission). Given the new display of strength to the upside price should not get back to here again. If it does, we have evidence of supply coming in at the 1.5435 level for the second time and I have no further confidence in price moving up to the 1.5460 resistance.

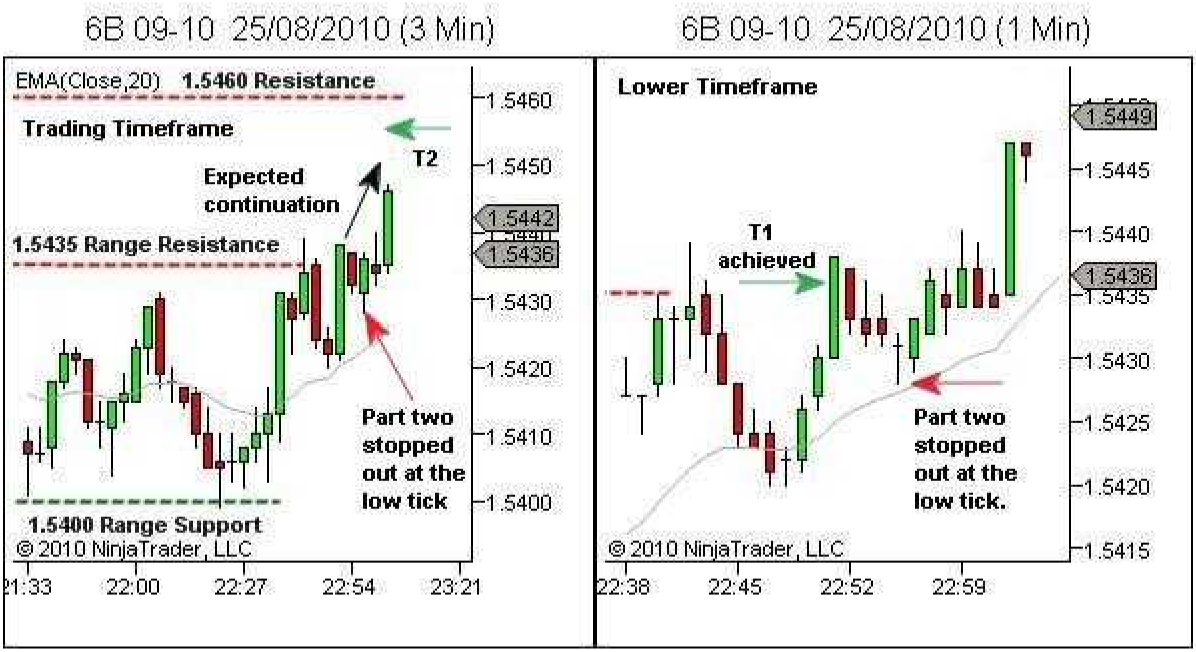

Figure 5.35 - Example 3 – Trade Two Stopped Out

Hmmm. Good plan, but part two is stopped out to the tick. No worries. It happens.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results – Trade One (BOF):

- Part one: Scratched +2
- Part two: Scratched +2

Results – Trade Two (BPB):

- Part one: Achieved T1 +8
- Part two: Stopped out +1

Let‟s continue this example, as follow-up price action appears to be offering another trade setup.

Step 1 – Third Trade Preparation

As shown below, price has continued higher towards to 1.5460 level. You‟ll recall from figure 5.27 that the 1.5460 resistance is actually the upper range resistance of a sideways trading range.

Candle A provided the only true display of strength, as price broke the upper range of the inner sideways trend. Candles B, C, E and F are all varying forms of range candles, showing either selling and/or some supply coming into the market as we approach resistance.

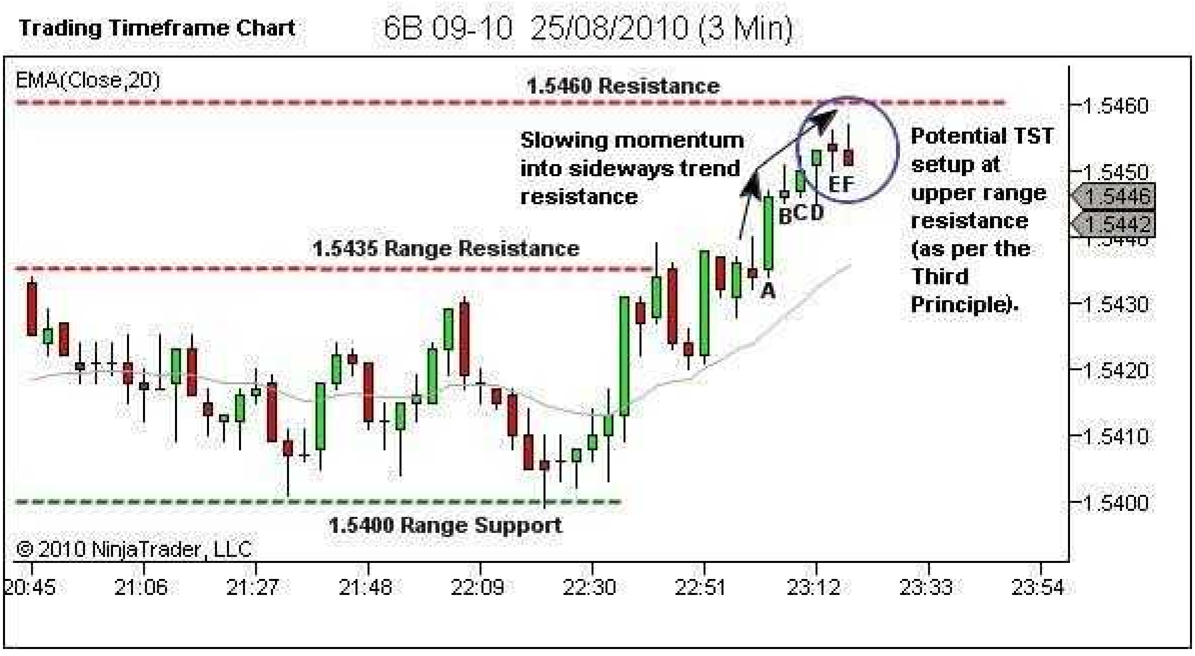

Figure 5.36 – Example 3 – Setup Area – Trade Three

Our expectation of *future trend* direction is for a test rather than a breakout, in accordance with the Third Principle; a sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

For price to validate this premise, we need to see continued weakness on approach to the resistance area, and a stronger fall.

We are on alert for a TST setup.

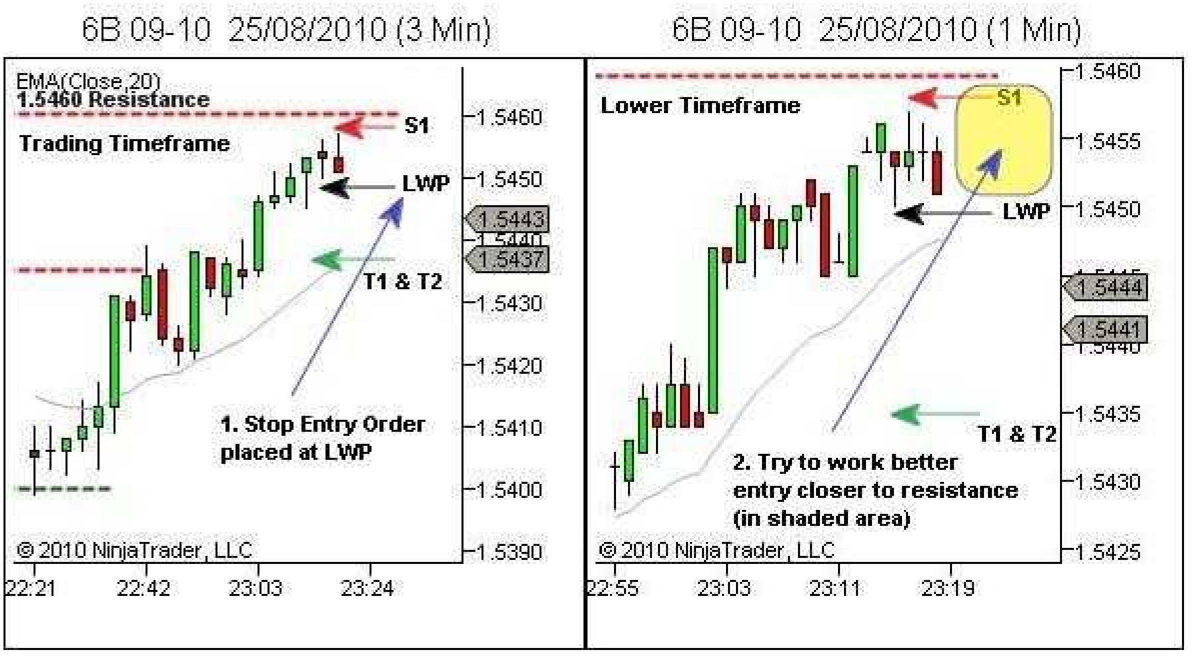

Figure 5.37 – Example 3 – Trade Preparation – Trade Three

Current price action on the *trading timeframe* (3 min) (LHS) shows a great LWP. The third last candle (high close bull candle) would have brought in more new bulls. Failure to continue higher through the next two candles will cause these people some concern. The first of their stop orders will start triggering on a break below the last two red candles.

A stop entry order is placed at LWP, 1.5449.

S1 is above the price action highs at 1.5459. T1 and T2 are both at the previous breakout area 1.5435.

We now try to work a better entry, closer to resistance, as shown in the shaded area above.

Step 2 – Third Trade Entry

There was no opportunity for a better worked entry, and we‟re triggered into the trade at LWP, 1.5449.

Step 3 – Third Trade Management & Exit

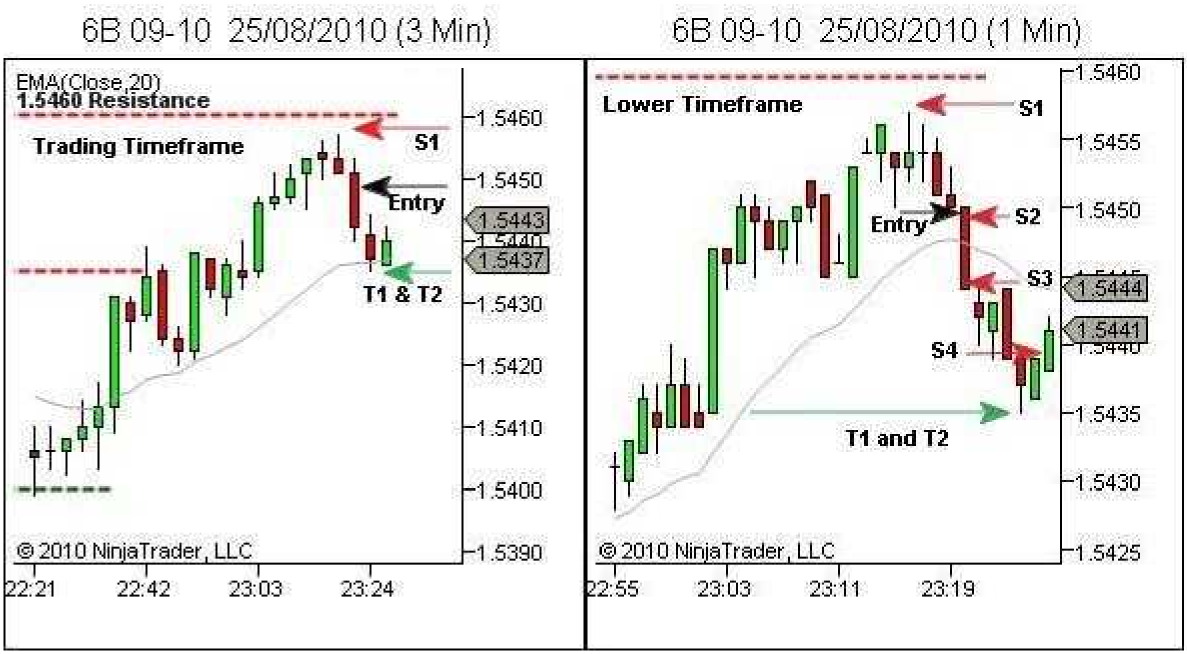

Figure 5.38 – Example 3 – Trade Three – Trade Management and Exit

The stop for part one was trailed behind significant candles (the low close candles), to breakeven (S2) and then S3. As price approached the target it was moved to S4.

The stop for part two was moved with the part one stop to breakeven (S2) and remained there until moved to S4 with part one (giving it a little more room intra-trade if necessary).

Although price touched our target 1.5435 we were not filled. Price stopped us out at S4, 1.5440.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results – Trade One (BOF):

- Part one: Scratched +2
- Part two: Scratched +2

Results – Trade Two (BPB):

- Part one: Achieved T1 +8
- Part two: Stopped out +1

Results - Trade Three (TST):

- Part one: Achieved T1 +9
- Part two: Achieved T2 +9

TOTALS:

- Part one: +19 pips (less 3 x round turn commissions)
- Part two: +12 pips (less 3 x round turn commissions)

A lot of work for only +31, but that‟s the way trading goes sometimes.

5.4 – Trade Example 4 – CPB – T1 Achieved – T2 Trailed

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 30 Aug 2010
Time: 23:55 on charts (14:55 London)

I like this example. It demonstrates the awkward period that can sometimes exist following a test of S/R (support in this example). Do we seek a pullback entry for a further retest of the support area? Or do we trade in the new counter-trend direction now?

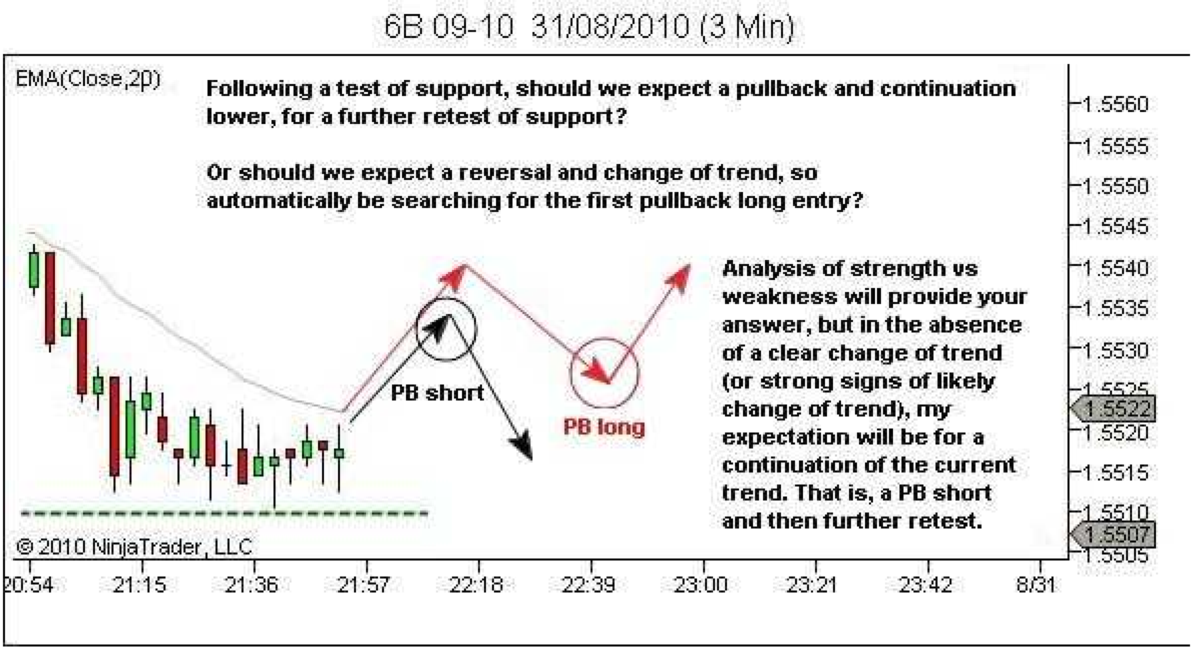

Figure 5.39 - Expectations following a test of S/R

As always, it depends on how the price action shows strength and weakness. The default decision though is the first of these options. Until there is a clear sign of change of trend, we continue with the First Principle, expecting continuation of the trend towards S/R. Until we have signs of a change of trend, we will keep looking for pullback opportunities (PB or CPB) for a further retest of S/R; and of course TST and BOF/BPB opportunities at the S/R level.

The Second Principle often applies as well, as in this case, where we do see weakness against the support area. As stated with the second principle, we expect a complex pullback rather than reversal, until clear signs of reversal are shown.

Don‟t be too quick to expect a reversal.

Sometimes several PB opportunities will be present as the trend tests the S/R level several times, before either breaking through or reversing.

Step 1 – Define Structure

The chart below shows our structure with resistance above price at 1.5575 and support below price at 1.5440, 1.5495 and the recently tested 1.5510 level.

Figure 5.40 - Example 4 – Define Structure

Step 2 – Define Trend

As shown in figure 5.41 below, at 23:55, price has broken above the recent congestion, but the trend is still downwards.

Technically, a change of trend will not be triggered until a breach of the 1.5548 level, the last swing high which preceded the recent swing lows.

This recent move is therefore a pullback within a downtrend.

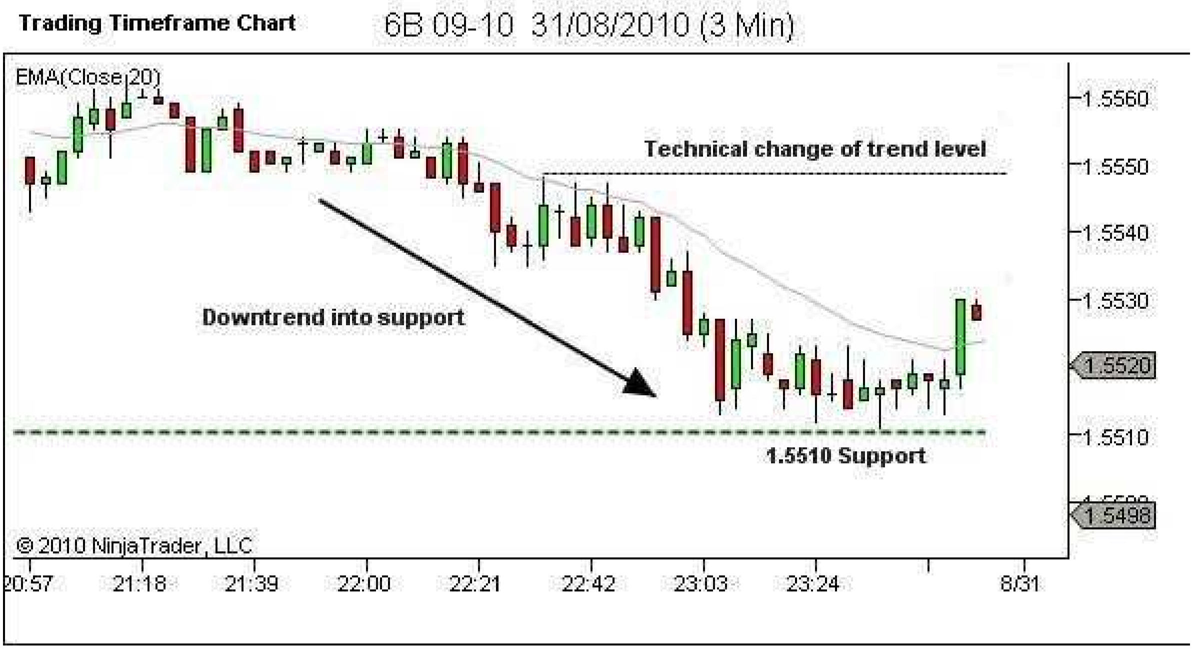

Figure 5.41 - Example 4 – Define Trend

Note: See if you can identify where you may have entered a TST long off support. This area would have provided a great opportunity to work a limit entry quite close to the support level. However, we are not considering any such trade in this example. We commence this example from the point displayed on the chart – two candles into the pullback.

Step 3 – Identify Strength & Weakness

Figure 5.42 below shows clear signs of weakness into the area of support.

We also have a surge of bullish momentum coming off support. While this could be a sign of strength, it"s really a little too early to tell. This surge of momentum is a result of breakout orderflow, as price broke above the area of congestion at support (breakout entry orders long combined with stops from anyone short).

Continuation of this bullish surge is required to confirm strength in the bullish direction. Failure to continue will show weakness.

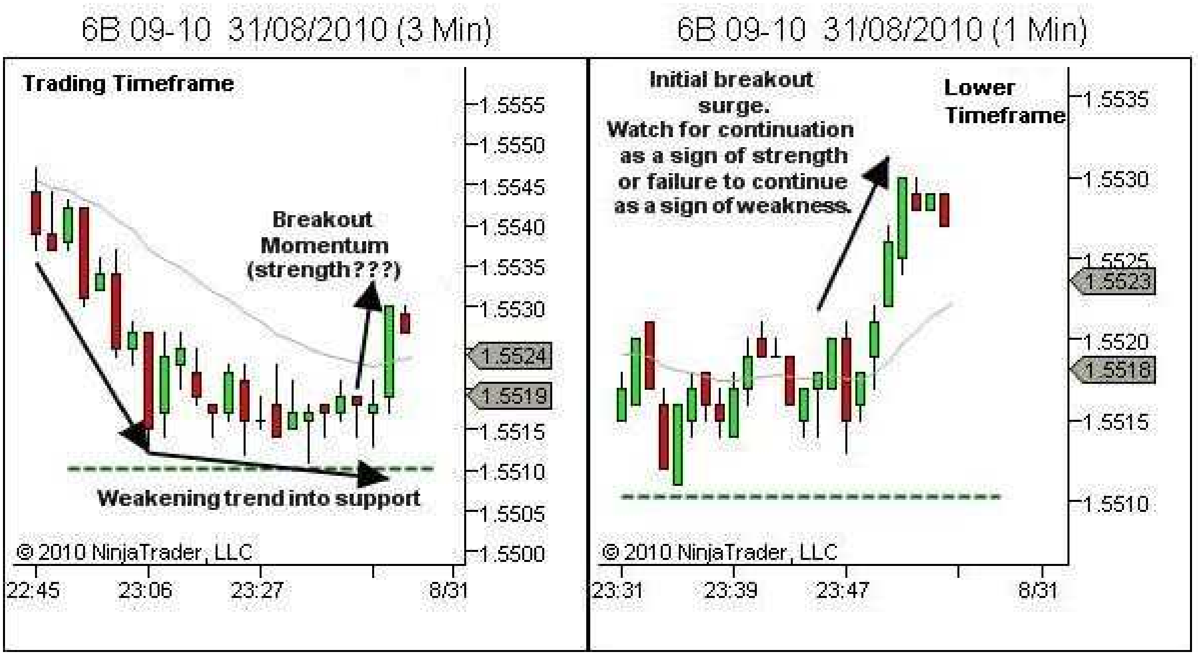

Figure 5.42 - Example 4 – Identify Strength and Weakness

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

Let"s combine some steps here in summary form.

Having seen weakness in the downtrend we expect some form of complex pullback, then continuation lower to again retest the support level, in accordance with the Second Principle of *future trend* direction.

Price action required to validate our premise will be some form of continuation of this current move to new highs which then fails to show strength (ie. a second push higher which fails).

This will provide our trade opportunity – a CPB entry on failure of the second push higher.

Price action showing continued strength higher and subsequent change of trend will invalidate our plan; requiring reassessment and identification of new trade setups.

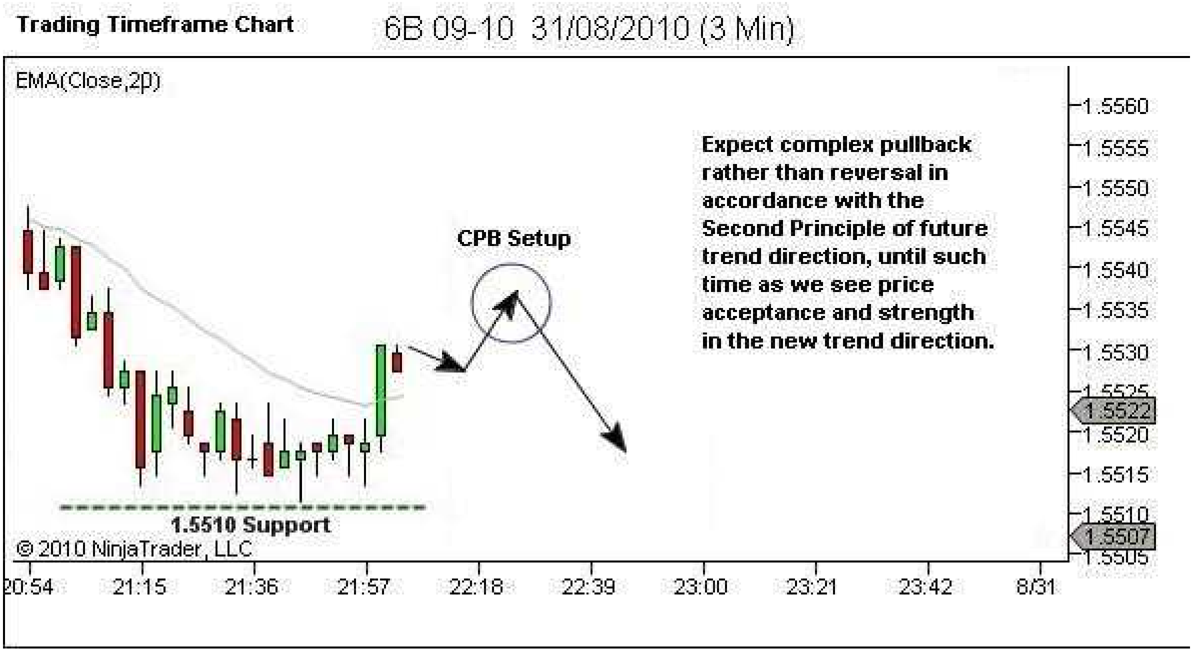

Figure 5.43 - Example 4 – Future Trend Direction; Future Price Action; Setup Area

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Sometimes setups and entries appear quite quickly. **Remain focused**.

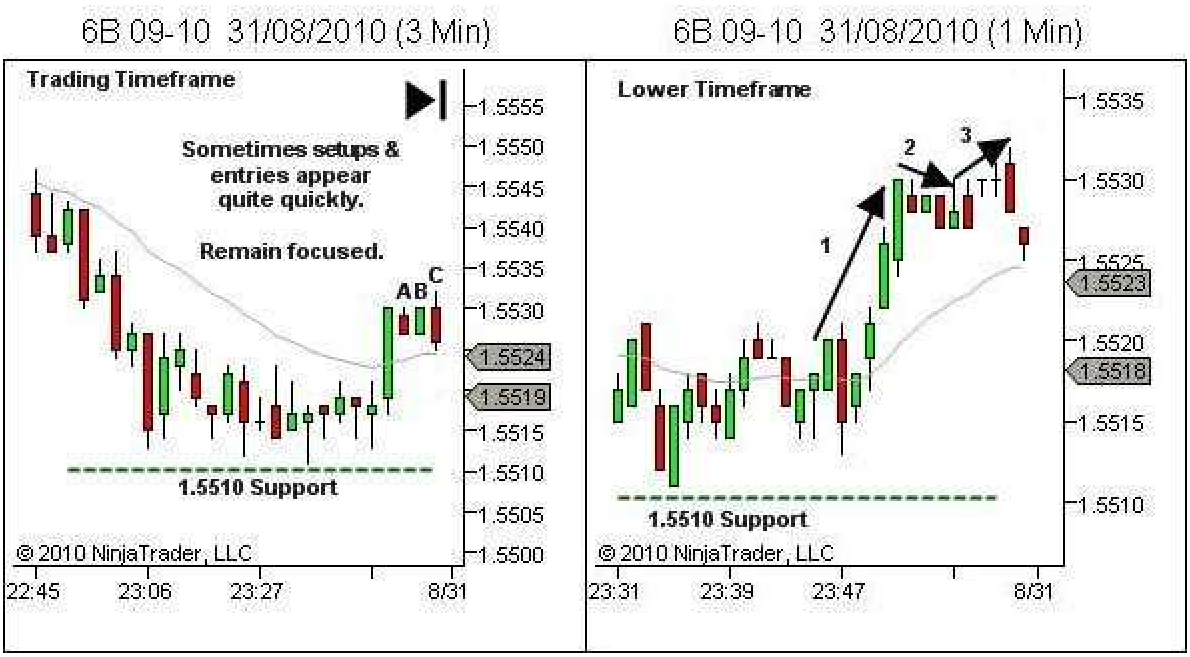

Figure 5.44 - Example 4 – Ongoing Analysis – Rapid Setup Identification

Candle A (low close range candle) provided our first pullback against the initial bullish surge.

Candle B (high close range candle) showed an end to the pullback, but certainly no continuation of strength due to the inability to break to new highs. We‟ve had six minutes pass since the initial surge, with no signs of continuation. This is possibly confirming weakness in the pullback.

Candle C initially moves to higher prices. If our analysis is correct, we expect to see this push higher show weakness, providing us with our opportunity to enter short at the CPB setup.

In this case, the failure to continue higher occurs a LOT quicker than expected.

The right hand side of our previous chart shows the *lower timeframe* (1 min) fine-tuning of our analysis, where you can clearly see the three swings of this complex retrace.

I was expecting swing three to carry further before failing, but sometimes these things happen quite quickly. You need to remain focused. Now let"s see if we can get an entry…

Trading Process

Step 1 & 2 – Trade Preparation & Entry

Price has broken below the previous two *trading timeframe* (3 min) candles after first moving to new highs, providing a CPB setup and entry (assuming it provides appropriate R:R and we can get a fill). The 1 min trigger pattern would be an upthrust.

While this may seem rushed, remember that the last *lower timeframe* candle is a whole minute in duration – plenty of time to confirm R:R and place an order.

S1 is identified at 1.5534. LWP (on break of the previous 2 *trading timeframe* (3 min) candles) was 1.5526. T1 is identified as 1.5515. This offers 1:1. An entry order is placed for 1.5526 and filled during the last one min candle.

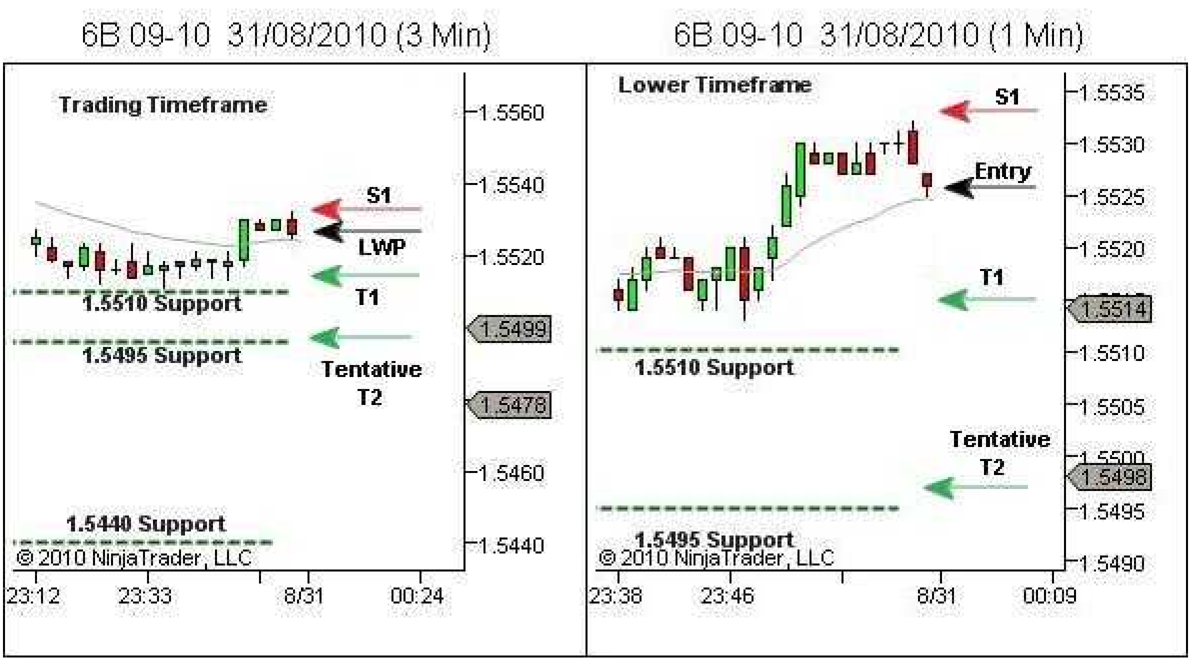

Figure 5.45 - Example 4 – Trade Preparation and Entry

T2 is tentatively identified as the next support level 1.5495. I say tentatively because there is potential for another breakout surge, this time below the congestion at 1.5510 rather than above it.

The T2 target order is in the system, but I‟ll watch price as it breaks 1.5510, and if surging lower I‟ll drag the target order to just above the next support at 1.5445, and apply a trailing stop down to that level (effectively bracketing the price).

Before we manage the trade, let‟s have final word on the speed with which this setup was identified and entered. While not ideal, this is the nature of the trading game. It‟s not always neat and tidy. Faith in your analysis and your ability to manage risk is essential, otherwise hesitation would likely have resulted here leading to a missed entry.

I have faith that the failure of the second push higher (albeit a short one) will lead to a continuation of the trend and a retest of the support level.

I was able to identify this setup and enter because I was focused, and actively watching for any sign of trapped longs, whose exit would provide an entry trigger short.

However I can‟t tell the future – any position is actively managed in order to minimise risk. If the push lower is a trap and price surges upwards again, my loss will be minimised via the stop for a loss of -8 pips. If price stalls, I‟ll work an exit. If I‟m right, I‟ll manage it as best I can to achieve maximum profits possible.

The confidence required to enter here only comes through experiencing lots of price action and lots of setups. We‟ll talk more about that in chapter 16, when we discuss the learning process.

Repeat of entry parameters:

Entry 1.5526
S1: 1.5534 (risk -8 pips)
T1: 1.5515 (reward +11 pips)
T2 1.5495 (reward +31 pips) (tentative) or trail to 1.5445 (+81 pips)

Step 3 – Trade Management & Exit

Candle A on the RHS of the chart below shows the power of a trapped trader pattern, as the first of the stops are triggered from those trying to get an early entry into a reversal. Bearish orderflow pushes price strongly down.

Part one stop is moved to breakeven on the close of candle A, and then to S2 after the small stall following A. T1 is then achieved.

Part two stop is moved to breakeven, then S2 after candle B. The acceleration as price continued falling led to movement of the tentative T2, to 1.5445. However a stop was trailed behind significant price developments, via S3 to S7.

Part two was stopped out at S7 for +44 pips.

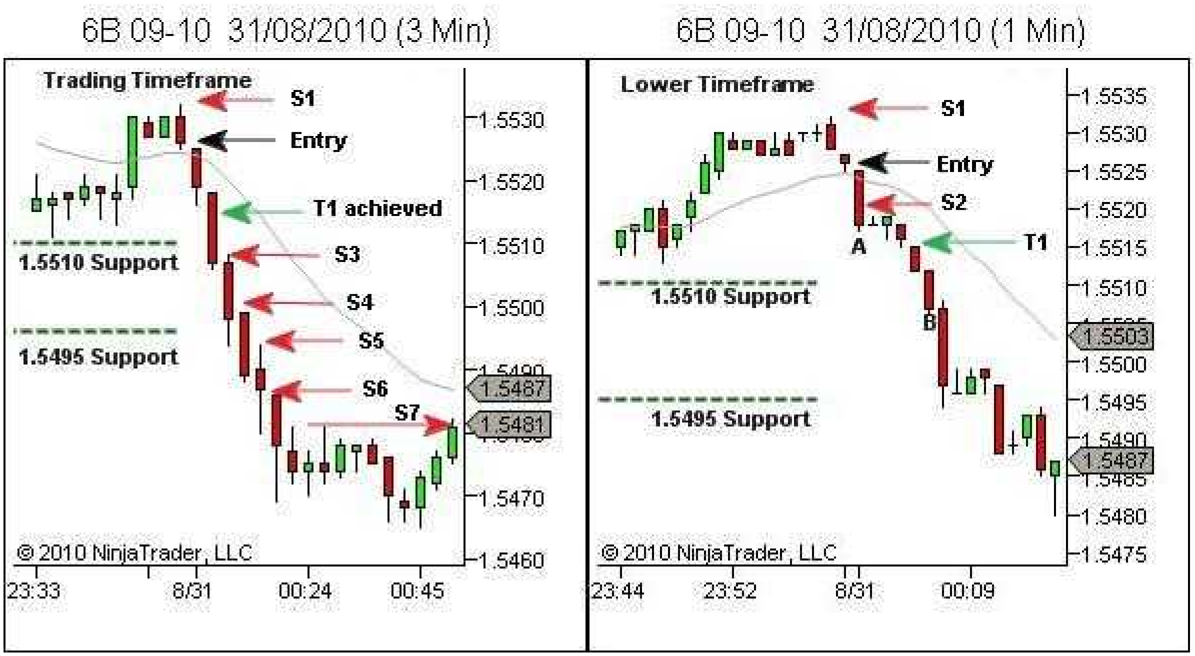

Figure 5.46 - Example 4 – Trade Management and Exit

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +11 (less commission)
- Part two: T2 Trailed +44 (less commission)

As Al Brooks says in his great book, "Reading Price Charts Bar by Bar", a trending market always offers what seems like great counter-trend entries. The higher odds trades though, are always for a continuation of the trend. Watch any counter-trend move for signs of failure. The point of failure provides a great entry for a continuation of the trend.

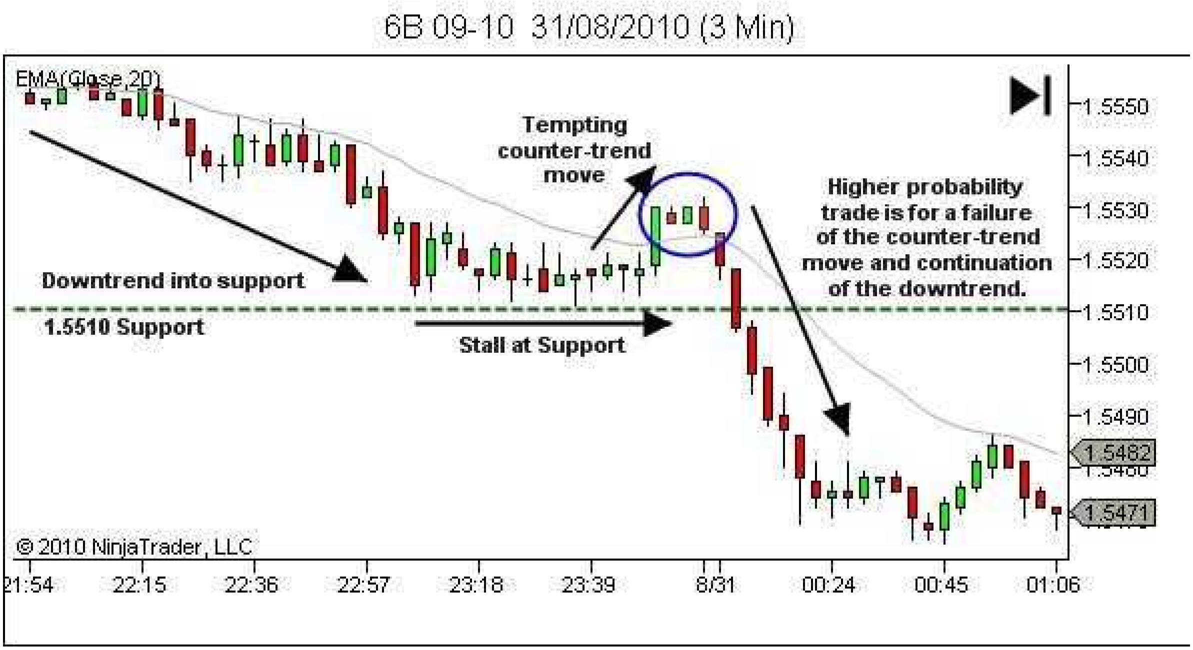

Figure 5.47 - Example 4 – Hindsight Review – Downtrend Continuation

5.5 – Trade Example 5 – TST – Part 1 Stopped Breakeven - Part 2 Trailed.

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 31 Aug 2010
Time: 18:30 on charts (09:30 London)

The last example showed a situation where a move off S/R did not lead to a reversal; rather it was simply a pullback before continuation of the trend.

As a reminder of the fact that every situation in the markets is unique, let‟s now look at an example where a test of S/R did offer a reversal.

Step 1 – Define Structure

We start with the *higher* timeframe (30 min) chart. Resistance is identified above current price at 1.5575, 1.5475 and 1.5450. Support is identified below the market at 1.5395.

Figure 5.48 - Example 5 – Define Structure

Step 2 – Define Trend

The *trading timeframe* (3 min) chart shows a change to uptrend. Price is currently on a pullback within that uptrend, although I‟m not watching for a pullback entry just yet due to the upcoming release of an economic indicator.

Figure 5.49 - Example 5 – Define Trend

Step 3 – Identify Strength & Weakness

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

As mentioned above, I‟m not watching for a pullback entry opportunity as news is about to be released. Similarly, I‟m not going to conduct analysis of strength and weakness, *future trend* direction or potential setup areas – my expectations are neutral. I‟ll reassess on completion of the first post-news candle. Being the UK Net Lending to Individuals m/m, it‟s only a medium impact report so not likely to offer any great volatility. However I‟ll hold any expectations for now.

Volume Five will identify my source of economic releases, including their expected impact.

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Ongoing market analysis steps are combined, as mentioned earlier, due to the difficulty in demonstrating a dynamic process in book form. Thoughts from these three continual steps are provided in summary form below.

The next candle (post-news release) is a large range high close bull candle, taking price right to the first resistance area, 1.5450.

We have no existing premise, so let‟s develop one now.

This push of post-news momentum clearly shows strength to the bullish side, within the timeframe of that candle. However the question is (as it is with all post-news candles) whether or not this move can be sustained.

Figure 5.50 – Example 5 – Identify Strength and Weakness

As shown above, while the large high close bull candle is bullish in nature, this candle takes price right into the lower boundary of a significant area of resistance, between 1.5450 and 1.5475 (we will consider this as one area).

Given the display of strength into resistance, my initial bias must be for a break of that level (ie. continuation through 1.5475), watching then for signs of weakness post-breakout for either a BOF and/or BPB opportunity. This is of course in accordance with the Sixth Principle of *future trend* direction.

Figure 5.51 – Example 5 – Identify Future Trend Direction

The price action required to validate this premise is a continuation higher through resistance. Strength will have to continue to be shown on the bullish side, with weakness on the bearish side.

That being said, I do have a great liking for areas of support which turn to resistance (and vice versa). The nature of trader decision making tends to make them particularly strong levels. Combining this with the width of the resistance area, I wouldn"t be surprised to see it hold. If weakness appears in the current push, prior to breakout, I"ll need to adjust my premise and watch for some kind of test opportunity short (in accordance with the Fifth Principle of *future trend* direction.

Let‟s look at the next candle - a mid-close range candle (LHS).

Figure 5.52 – Example 5 – Ongoing Market Analysis

Having shown a failure to continue higher, we see that bearish orderflow did enter the market at the resistance level. Price has pulled back. However the *lower timeframe* (1 min) action to the right shows some signs of bullish strength / bearish weakness, via the lower tails. The pullback so far still supports our premise – some bearish orderflow is to be expected. Continuation needs to happen soon though if this market is going to be able to push through the resistance area.

The next candle (LHS) is also a mid-close range candle, offering the same message – continuation of the pullback.

Figure 5.53 – Example 5 – Ongoing Market Analysis - continued

What is concerning though, is the duration of this pullback. The post-news bullishness has perhaps failed to attract a wider bullish following.

Strength needs to continue to new highs. Any weakness, through either a weaker retest of 1.5450, or a failure to exceed the previous swing high, will indicate lack of support for the bulls at this time and a greater likelihood of supply overcoming demand. In either case we will require an immediate reassessment of our premise, anticipating a test of resistance, and a possible TST setup.

The next *trading timeframe* (3 min) candle shows us a failure to continue higher.

Price rallied to again test the 1.5450 level, but was immediately rejected. Current price action is not acting how it should, if market participants were acting with a bullish bias.

Figure 5.54 – Example 5 – Ongoing Market Analysis - continued

The premise requires immediate adjustment. My expectation is now for a test of resistance (fifth principle), followed by at least a complex pullback (and retest in accordance with the second principle) or a complete reversal.

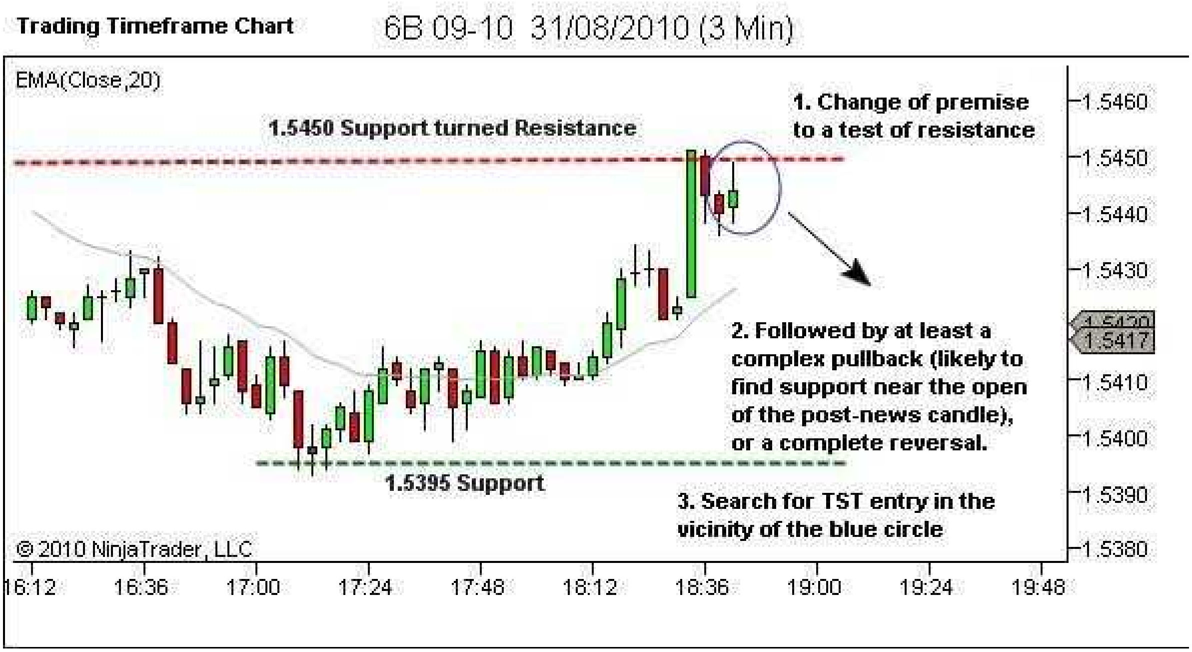

Figure 5.55 – Example 5 – Change of Premise

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

Price action is as per the *trading timeframe* (3 min) and *lower timeframe* (1 min) charts below.

Any immediate entry (if filled) would involve a stop at 1.5452 (S1) and a part one target of 1.5425 (T1), where the post-news bullish orderflow first appeared.

LWP is the point at which the first of the *trading timeframe* (3 min) stops would be triggered. This would be below the lowest candle in the pullback, at 1.5435. Entry here would incur a risk of 17 pips for a potential reward of 10 pips. Entry at LWP is therefore not wise – we‟d be entering too late in the move; too close to potential support at T1.

LRP is the mid-point; the price which allows us a 1:1 R:R. This is midway between S1 and T1, or at 1.4438. Entry must be achieved at or before 1.4438 in order to ensure a 1:1 ratio.

Figure 5.56 – Example 5 – Trade Preparation

Remember, on fast intra-day timeframes we don‟t need to be this accurate. The price which offers 1:1 is at the mid-point between the stop and target. It‟s sufficient to simply eye-ball it. LWP in this case is not within the first half of the stop-to-target price region. So, we search for an entry trigger which is.

Step 2 – Trade Entry

The *lower timeframe* (1 min) chart already provides a pattern based trigger, forming a 123 top. Movement below the current candle will signal a failure of the latest push towards new highs, the second push to resistance.

I am happy to enter on such a trigger, so place a stop entry order immediately below the 1 min candle as it approaches its close. Stop entry order price is 1.5443.

While recognising that it‟s likely to fill fairly quickly, having the previous candle close on its low, I am also prepared to work a better limit order if possible. I place a limit at 1.5447 (mid-range of the previous candle).

Figure 5.57 – Example 5 – Trade Entry

The stop entry order is filled on the next candle open. The limit order is cancelled.

Trade entry parameters are as follows:

Entry: 1.5443
Stop Loss: 1.5452 (risk -9)
Target T1: 1.5425 (reward +18)
Target T2: 1.5405 (reward +38)

Step 3 – Trade Management & Exit

Figure 5.58 demonstrates our trade management and exit. There is a whole lot of information on this diagram, so let‟s work through it slowly.

As with earlier convention, the *trading timeframe* (3 min) chart is on the left and the *lower timeframe* (1 min) chart is on the right.

Look first at the right hand side, where we manage part one on the *lower timeframe*.

Figure 5.58 – Example 5 – Trade Management and Exit

As will usually happen if you correctly identify trapped traders, price surges in our direction quickly, via candle A (low close bear candle). However it then stalled through candles B (again a low close bear candle, but with very little range) and candle C (mid close range candle). Candle D broke above the stalled area to commence a pullback. I became concerned here about a potential 3-swing retrace long which would retest resistance again before failing. I moved the part one stop to breakeven plus one (to cover commission), with the intention that I‟d try to work a better entry if price retested resistance. The part two stop remained at S1.

Part one stopped out to the tick before price moved on to T1 without me; and didn‟t offer a re-entry that I was happy with.

This happens. In hindsight, the stop was moved too early.

The setup was good, with a strong resistance area twice rejected. I was confident price would not get up there again. And it was obvious through watching the slow pullback of candles C, D and E that bullish pressure was much weaker than the bearish pressure shown in candle A.

Still, it‟s always easy to see in hindsight.

Looking at the left hand side for part two…

The stop was moved to breakeven on achievement of T1. It was then trailed behind significant price action – moved to S2 on the break to new lows; S3 then S4 on the close of the next two low close bear candles; then tightened up above price action as price approached our target (reaching 1.5407; two pips from our target).

You‟ll recall that I like to tighten up stops as I approach the target. I don‟t see value in keeping the stop at S4 where we risk 12 pips, just to get an extra 2 pips reward. That‟s a bad R:R.

The stop was tightened up, taking us out at 1.5412.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +1 pips (less commission)
- Part two: Achieved T2 +31 pips (less commission)

I particularly love this kind of setup – on a quick glance it appears we‟re trading against strength, which goes against the whole premise of our trading strategy which is to fade weakness at S/R or weakness in a pullback.

However, the news-initiated strength is short-lived. It moves against a larger timeframe trend (not part of our analysis, but clearly obvious on the 30 min *higher timeframe* chart), quickly moving into an area of resistance where it stalls. Failure to follow through indicates bearish pressure at that level opposing the bullish strength. An initial failure, followed by a slower momentum retest and second failure, provides us with the weakness at resistance that we like to fade.

We aim to enter with the first of the stops, as the post-news bulls are either stopped out or bail out after realising they‟re in a low probability position.

So, despite initial appearances, this is not going against strength.

Of note also, is the fact that this example produces 30+ pips that you would not have gained had you used the simple entry strategy (*trading timeframe* only; entering at LWP). The trade would not have been taken at all due to poor R:R. Once you‟re comfortable with the strategy concept, I do encourage you to start working to identify better entries on the *lower timeframe*. Provided they offer a clear stall, or a pattern based trigger, they‟re usually a risk worth taking.

5.6 – Trade Example 6 – BOF – T1 & T2 Achieved

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 31 Aug 2010
Time: 22:30 on charts (13:30 London)

One factor which makes trading so difficult is the seemingly infinite variations of the same themes. No one setup is the same as the others. Take the last trade for example, which was a strong test of S/R followed by a slower retest. Let"s look at another one; same idea, very different trade.

Step 1 – Define Structure

Our *higher timeframe* (30 min) chart identifies resistance above the market at 1.5475 and 1.5450. Prior support at 1.5395 and 1.5385 have been broken and invalidated, although the 1.5395 level is identified as possible future resistance.

The 1.5370 support level was broken on the second last candle, although the break failed. It has just been retested.

Figure 5.59 – Example 6 – Define Structure

Step 2 – Define Trend

Figure 5.60 – Example 6 – Define Trend

The market is clearly in a downtrend, based upon our *lower swing highs / lower swing lows* definition.

The current candle has broken to new lows, so the recent swing high must be taken out in order to change the trend to upwards. Until that occurs, we remain in a downtrend.

Step 3 – Identify Strength & Weakness

Figure 5.61 – Example 6 – Identify Strength and Weakness

Figure 5.61 shows a significant weakening of bearish momentum between swing A and swing B.

Approximately 45 minutes ago, price hit the 1.5370 support level with strength. While managing to break the level, there was no continuation of bearish orderflow beyond the breakout point and so the breakout failed. In swing B, price has now moved to retest this level, albeit on much reduced momentum.

The trend is weakening, and possibly failing at the 1.5370 region.

Once again we have moved to new lows (only just). The next few candles will be critical in defining the way forward – will the breakout fail a second time, or will price continue its march lower?

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

Combining these three steps on one chart…

Having broken the area of support, our expectations are in accordance with the Sixth Principle of *future trend* direction.

We will watch the behavior of price post-breakout for clues as to future direction:

- Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

That being said, my gut feel is for a breakout failure, given the weakness of the trend. If this eventuates, it will lead to either a complex pullback testing the recent swing high, or a reversal up to the 1.5395 resistance level.

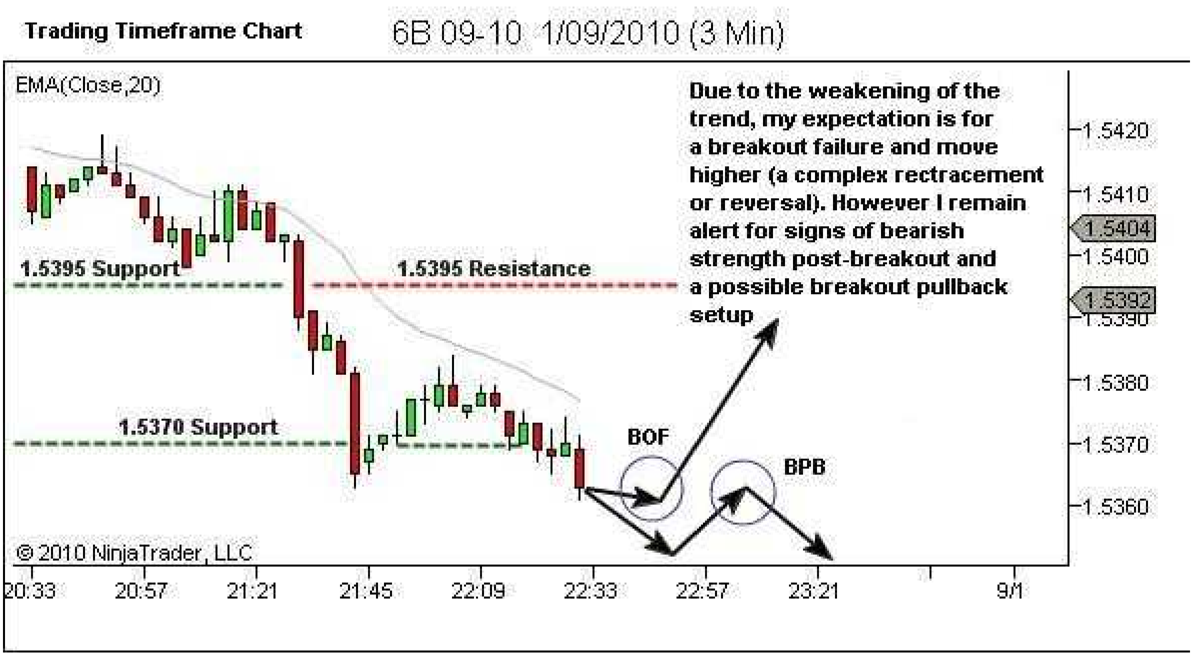

Figure 5.62 – Example 6 – Future Trend Direction and Areas of Trade Opportunity

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Combining these three ongoing steps into summary form:

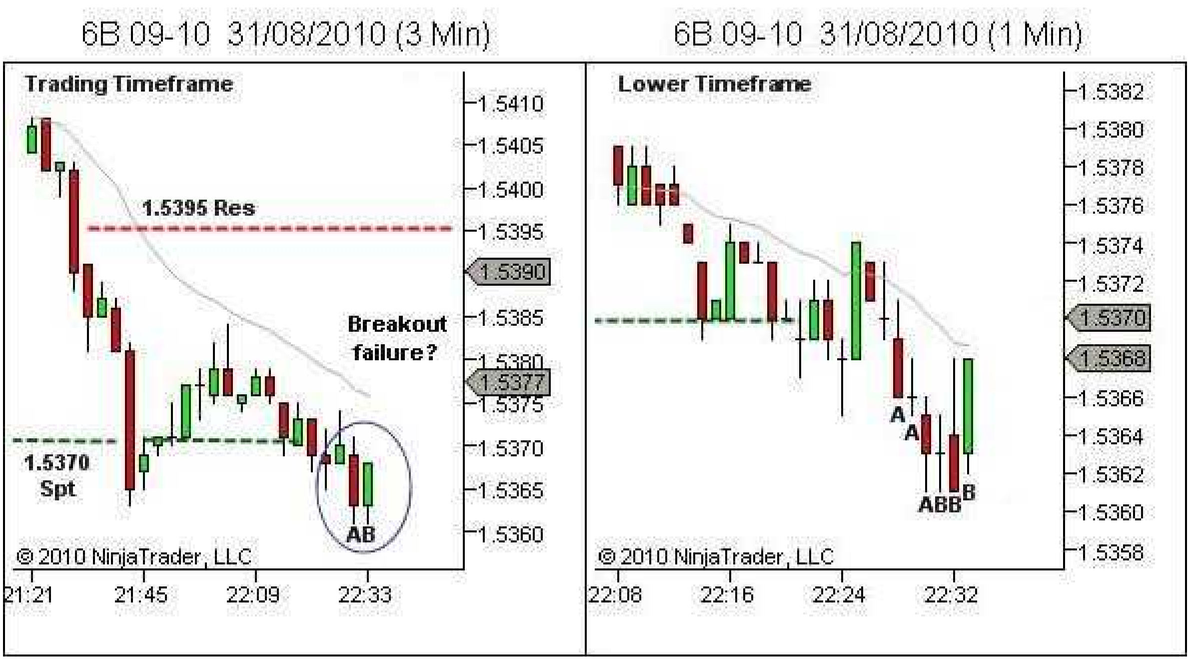

Figure 5.63 – Example 6 – Future Trend Direction and Areas of Trade Opportunity

The very next candle shows bullish orderflow. While a high close range candle is by itself only slightly on the bullish side of neutral, placing this candle into the context of a slow momentum retest of a previous breakout, once again failing to hold new lows, it‟s decidedly bullish.

It‟s time to prepare for a potential BOF trade.

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

The stop is tentatively identified as below the swing low at 1.5359. If I‟m entered into a trade, and price hits this level, I want OUT. My premise is wrong and price is possibly going lower.

T1 is identified as 1.5379, the highest 3-min close on the swing high. T2 is identified as 1.5393, just inside the potential resistance of 1.5395.

Stop (1.5359) to first target (1.5379) is 20 pips. LRP would be at midway, 1.5369. Any entry must be at or before 1.5369.

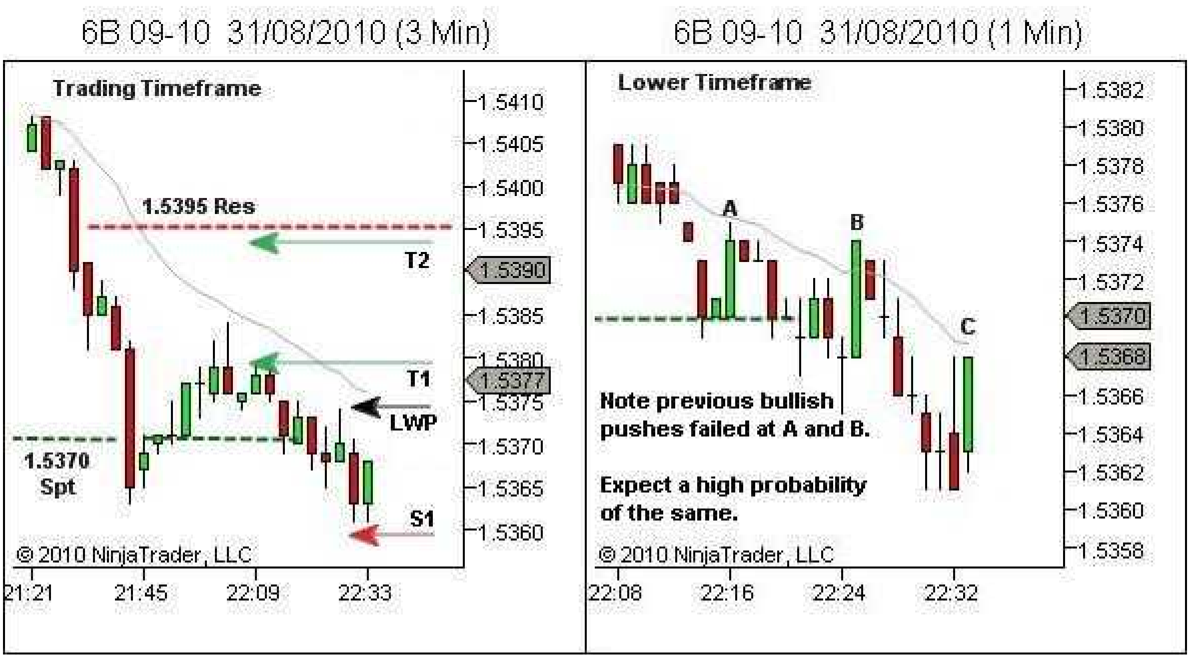

Figure 5.64 – Example 6 – Trade Preparation

LWP is a little harder to identify. Note how the 3-min price action is grinding downwards, with lots of candle overlap, but very little breakout above the previous candle. Placing a stop entry order above the high of the last 3-min candle would not necessarily be effective. Looking at the 1-min candles on the RHS, we can see that previous bullish thrusts were quick to fail. It‟s not likely that sufficient orderflow will enter on an immediate breakout from this point.

When in doubt, and when faced with grinding action such as this, it‟s best to think back to first principles. LWP is the last wholesale point, but we define it as the area at which the first of the stops will start being triggered, for anyone trading this low probability down-swing.

Sure, some may trigger on the break above the latest 3-min candle (high close bull candle). Some may trigger above the prior candle (low close bear candle). But for me, the place I expect most shorts would have their stop, is above the short upthrust formed by the third-last candle, as marked on the chart as LWP.

LWP is at 1.5375, outside of our entry zone which is formed by the stop to LRP.

As determined earlier, any entry must be at or before 1.5369.

Step 2 – Trade Entry

We‟re unable to simply place a stop entry order at LWP. To do so means we are too close to the first target; the first level which may provide opposing orderflow. An entry at this point would provide inadequate R:R; a losing proposition over the long haul.

So, we are left with trying to find a *lower timeframe* (1 min) entry. Ideally we‟re looking for a 1-min pattern based trigger (which will hopefully provide sufficient *lower timeframe* (1 min) orderflow to get the price to our *trading timeframe* (3 min) LWP, where we expect the orderflow to help push us to T1), or through identifying a nice stall against support allowing a limit order entry close to support and offering a great R:R.

Let‟s watch subsequent price action as it unfolds.

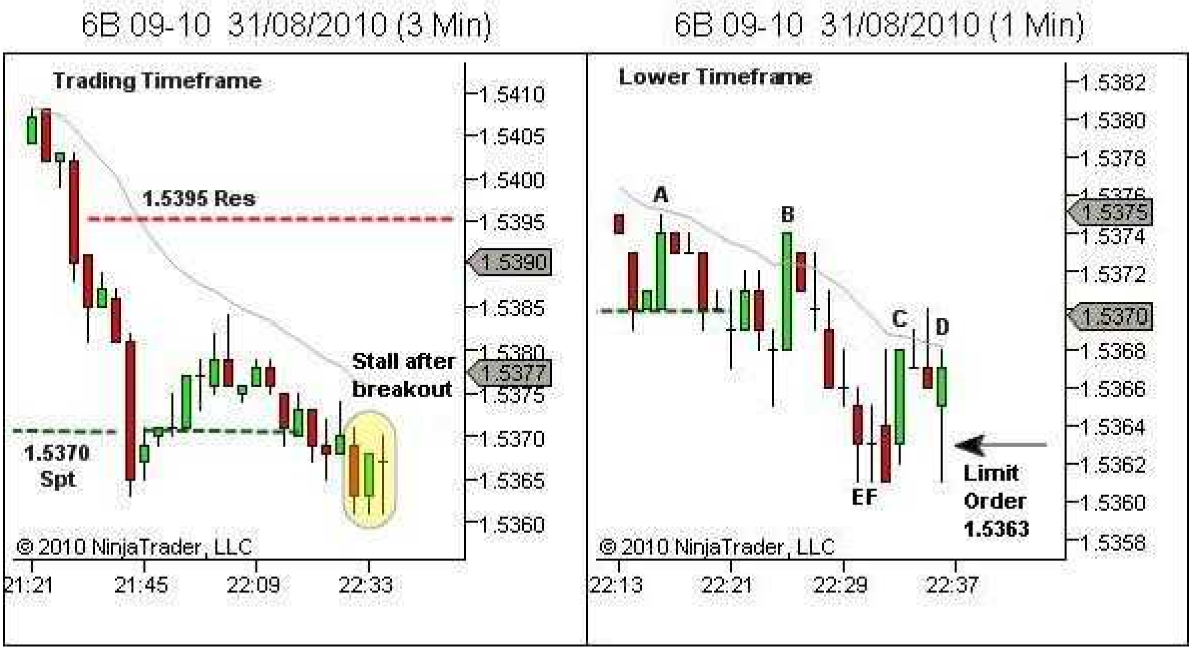

Figure 5.65 – Example 6 – Working a Limit Order Entry

The next 3-min candle produces a stall. We have 3 candles now, stalled at the same level.

Note on the 1-min chart we also have another bullish thrust with candle D. This time it initiated from the same level as the previous bullish thrust (C), not from a lower level as occurred with B and C. There is buying coming into the market at the lower levels.

I place a BUY LIMIT order at 1.5363, the lowest body open/close above the low point (ie. the body from candle E and doji F).

Note that if we get filled here it provides us with a risk of only 4 pips and a potential reward of 16 to our first target (and potential reward of 30 to our second target). This is the power of a limit order entry within a stall area, when it gets filled. Sometimes they may fail, but they offer great R:R when they work. They‟re usually a risk worth taking.

However, figure 5.65 below shows that we weren‟t filled during the following 3-min candle, with price missing our entry by one pip.

Candle G shows yet another bullish surge. Price is pushing higher. This thing is ready to go and we‟re at risk of missing an entry.

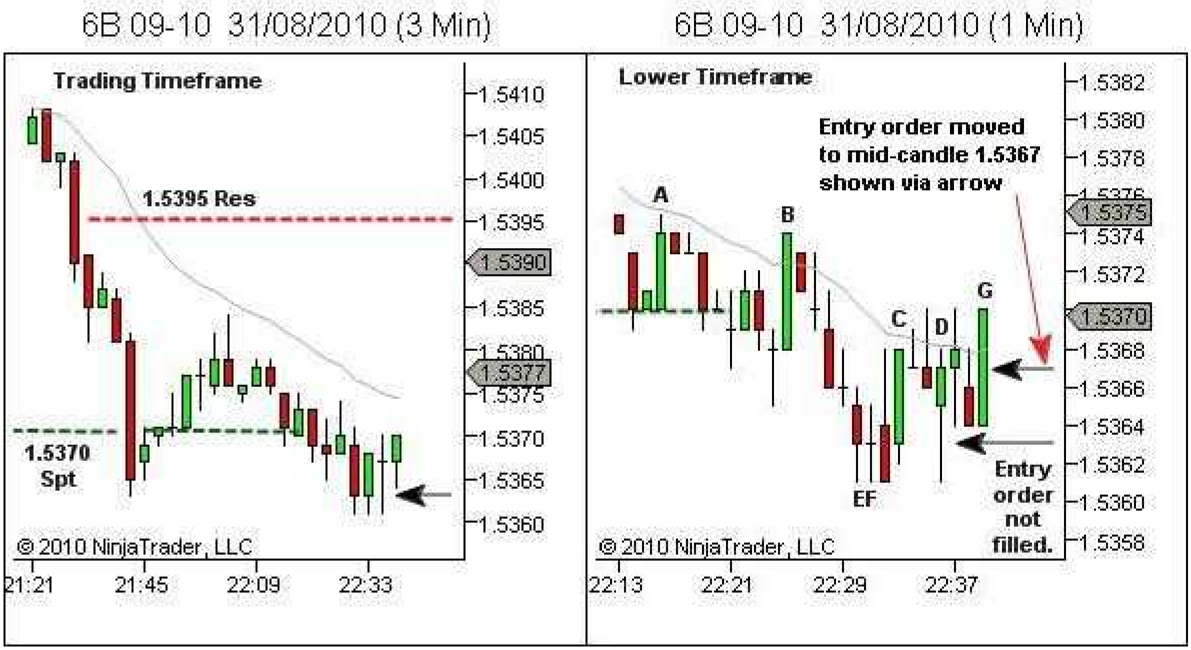

Figure 5.66 – Example 6 – Not Filled

[Www.ForexWinners.net](http://www.forexwinners.net)

The limit order is raised to the mid-point of candle G (1.5367), chasing price, but ensuring we do not exceed our LRP 1.5369. We‟re filled two minutes later at 1.5367.

Figure 5.67 – Example 6 – Filled

Lucky? Yes, perhaps. But through working the entry we have secured a fill which exceeds our required 1:1 reward:risk ratio, at a price which was never in drawdown for the remainder of the trade (as we‟ll see shortly).

Entry parameters are:
Entry price: 1.5367
Stop loss: 1.5359 (risk -8)
T1: 1.5379 (reward +12)
T2: 1.5393 (reward +26)

Step 3 – Trade Management & Exit

There‟s not much to say on trade management here. The stop was never threatened. The trade was never in drawdown. Price moved in an orderly manner towards both T1 and T2. Stops were simply trailed behind bull candles, on both the 1 min chart (part one) and 3 min chart (part two).

The traders entering short into an area of support (or in this case an area of previous breakout failure) are taking a low probability position. The first of their stops will start triggering on the break of LWP. Rather than trade with these consistent losers, we chose to fade the weakness. We chose to be part of the orderflow which springs their trap. And then we ride their bullish orderflow to profit.

Figure 5.68 – Example 6 – Trade Management and Exit

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +12 pips (less commission)
- Part two: Achieved T2 +26 pips (less commission)

So, there we have the same concept as the last trade – a slower momentum retest of S/R. But as you see, every trade presents its own challenges. While example 5 did not penetrate the resistance level, example 6 did break support. While example 5 occurred quickly, example 6 stalled at the support level for around 10 minutes. While example 5 offered a price at which we could place a stop entry order, ensuring we didn‟t miss the trade, example 6 did not allow this (with acceptable R:R), so required us to fight for a good entry.

Every trade is unique, and must be treated as such.

5.7 – Trade Example 7 – TST – Part 1 Scratched, Re-entered & Stopped Out – Part 2 Stopped out

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 31 Aug 2010
Time: 22:55 on charts (14:55 London)

Not every trade is a winner. In this example here, I take a loss due to some weak analysis. See if you can spot it as we work through the example. We‟ll talk about it later.

Step 1 – Define Structure

Our *higher timeframe* (30 min) chart shows resistance overhead at 1.5475 and 1.5450. Price is currently at an area of support turned resistance, 1.5395 (the level where we took profits in example 6).

Support is below at 1.5360, although we do not yet have sufficient candles to properly define a swing low. It‟s only tentatively noted at this stage.

Figure 5.69 – Example 7 – Define Structure

Step 2 – Define Trend

As we see below, the market was in a downtrend for most of the chart. The third candle from the right (high close bull candle) strongly broke above the swing high which preceded the lowest low; thereby causing a change of trend.

The market is currently in an uptrend.

Figure 5.70 – Example 7 – Define Trend

My feelings here though, are that this could be a form of complex pullback rather than reversal. Note the distance that price dropped below the moving average at about 21:40. This could be a form of 3-swing retrace (a messy one due to the second swing reaching new lows!!!). It"s likely that the 1.5395 resistance will hold price, which will then enter either a period of sideways action, or resume the downwards trend.

Step 3 – Identify Strength & Weakness

The *trading timeframe* (3 min) clearly shows weakening bearish momentum via swings A and C; and strengthening bullish momentum via swings B and D.

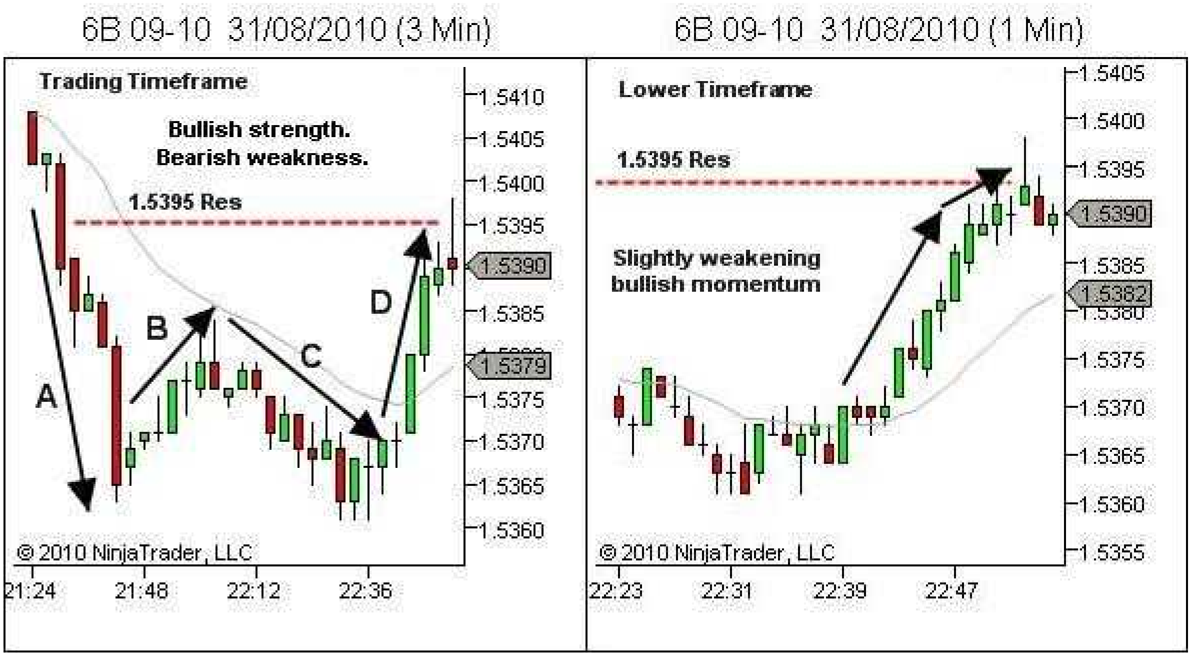

Figure 5.71 – Example 7 – Identify Strength and Weakness

Looking inside the price action to fine-tune our analysis, the *lower timeframe* (1 min) shows the latest bullish swing to be slowing as it reaches the 1.5395 resistance.

Strength however is to the bullish side.

Step 4 – Identify Future Trend Direction

As we are approaching a resistance area with strength, my expectations are in accordance with the Sixth Principle of *future trend* direction.

> If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behavior of price post-breakout for clues as to future direction:
>
> - Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.

- Weakness on the pullback – the expectation is for a breakout pullback and continuation.

Just a reminder – S/R levels are not a single price level, but an area. Looking left to prior price action, the 1.5395 level is actually an area within the range 1.5393 – 1.5402.

Step 5 – Visualise Future Price Action

My expectation then is for strength to continue through to above 1.5402. Any failure to breach the level will invalidate the premise and require reassessment.

Step 6 – Identify Areas of Trade Opportunity

Weakness through the breakout area will provide a BOF setup, allowing us to trade a failure of the resistance level short.

Strength through the breakout area with a weaker pullback will provide a BPB opportunity trading the first pullback after the breakout.

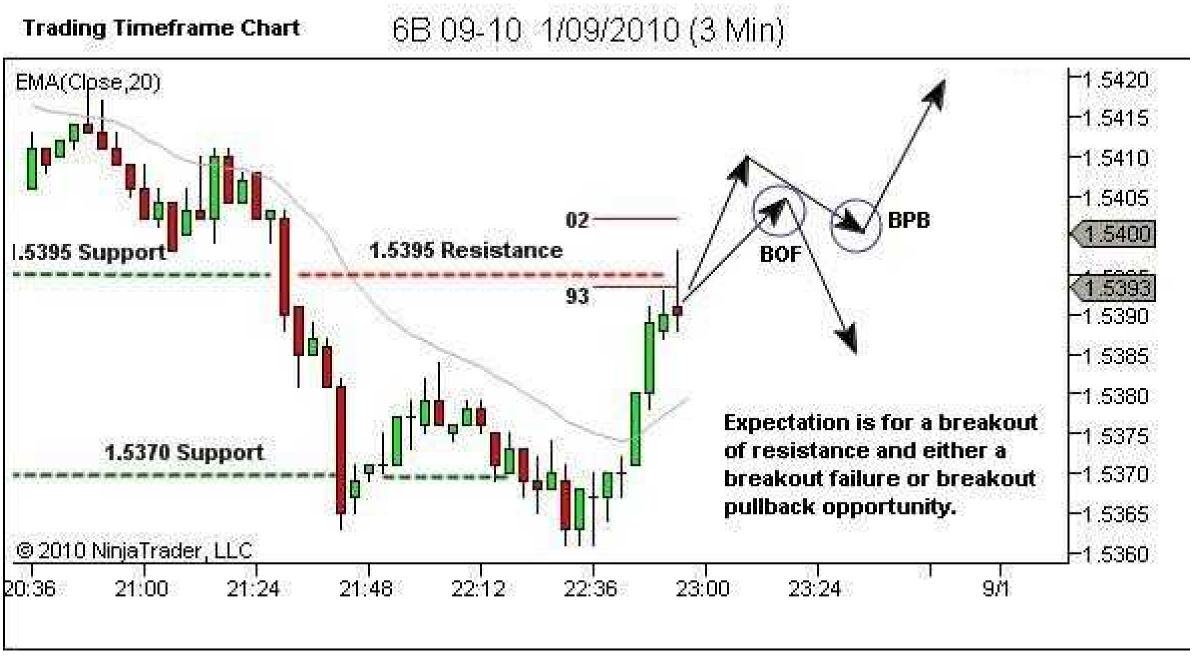

Figure 5.72 – Example 7 – Expectations for Future Trend Direction

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

This dynamic (bar by bar) process will be presented in summary form, as per the previous examples.

Moving on to the next *trading timeframe* (3 min) candle, we see a mid-close range candle. By itself a mid-close range candle implies neutral sentiment. But let"s put it into context. Price has rallied to a strong resistance level (recent support turned resistance), and now twice rejected the level producing long upper tails.

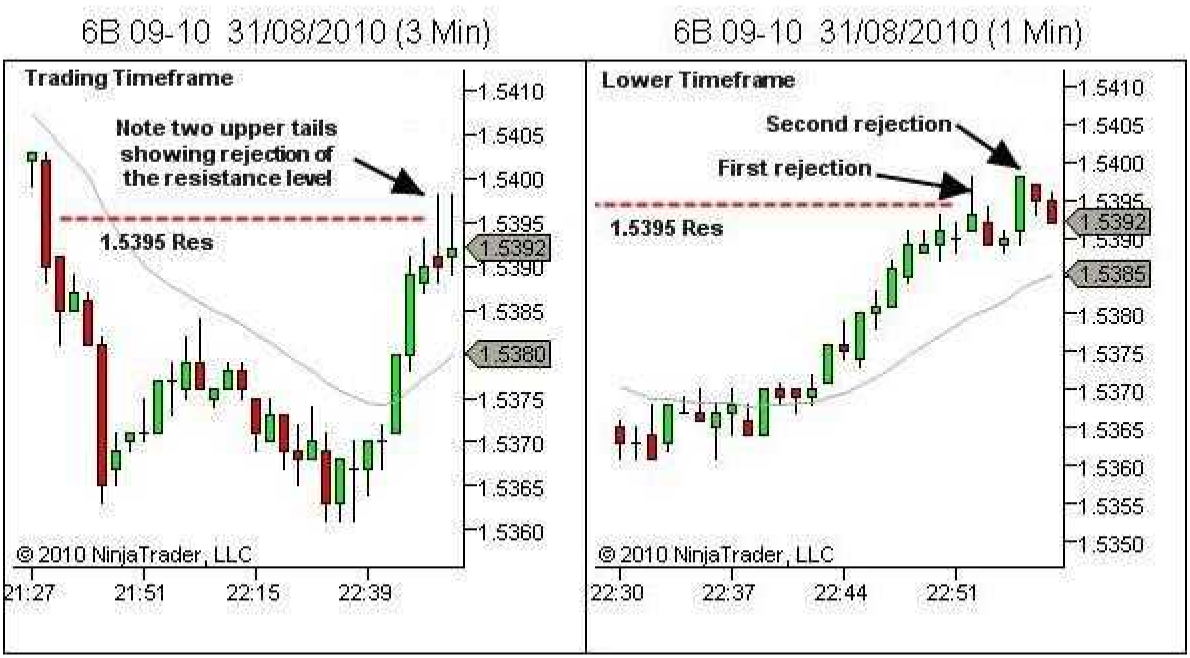

Figure 5.73 – Example 7 – Ongoing Market Analysis

This is a clear sign of weakness and does not support my premise.

I now reassess my expectations, believing that price will not break the resistance level. With weakness shown at resistance, I am expecting a test of the level only, and a potential TST setup, in accordance with the Fifth Principle of *future trend* direction.

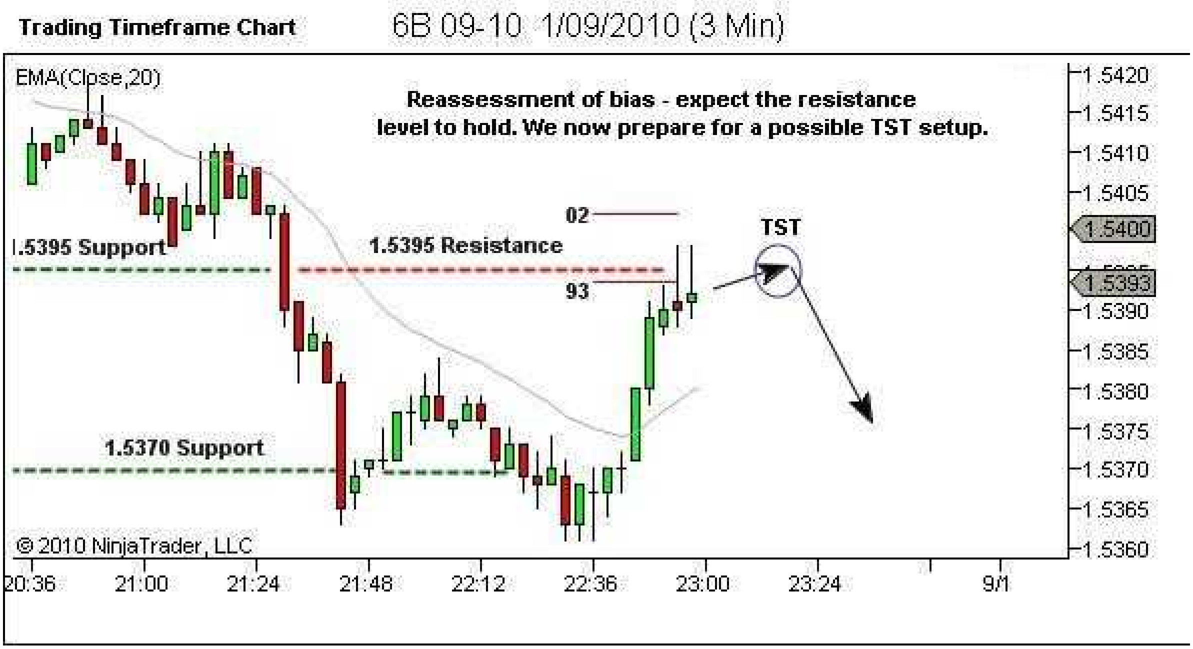

Figure 5.74 – Example 7 – Reassessment of Bias

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

Trade preparation is shown on the chart below.

The stop is easy (as always)… S1 is placed above the recent swing high which was twice rejected, at 1.5400.

The first target (T1) is at the start of the momentum move higher, 1.5371. The second target (T2) is a little lower, just above potential support at 1.5365.

The point at which I expect the longs to start exiting is the lows of the third-last candle (mid-close range candle). LWP is identified as one pip below this candle low, at 1.5386.

Risk at LWP is 14 pips. Potential reward is 15 pips. Entry at LWP is therefore acceptable, although I will try to work a better entry.

Figure 5.75 – Example 7 – Trade Preparation

Step 2 – Trade Entry

A stop entry order is placed at LWP, 1.5386, in case price continues lower from its current position.

I also place a limit entry order higher at 1.5395, the lowest part of the body of the highest 1-min candle.

The charts below show the next 3 minutes of data.

Entry occurs within the next 1-min candle at 1.5395. The stop entry order at 1.5386 was cancelled. Once again, note the improved entry available through the use of limit orders (a saving of 9 pips).

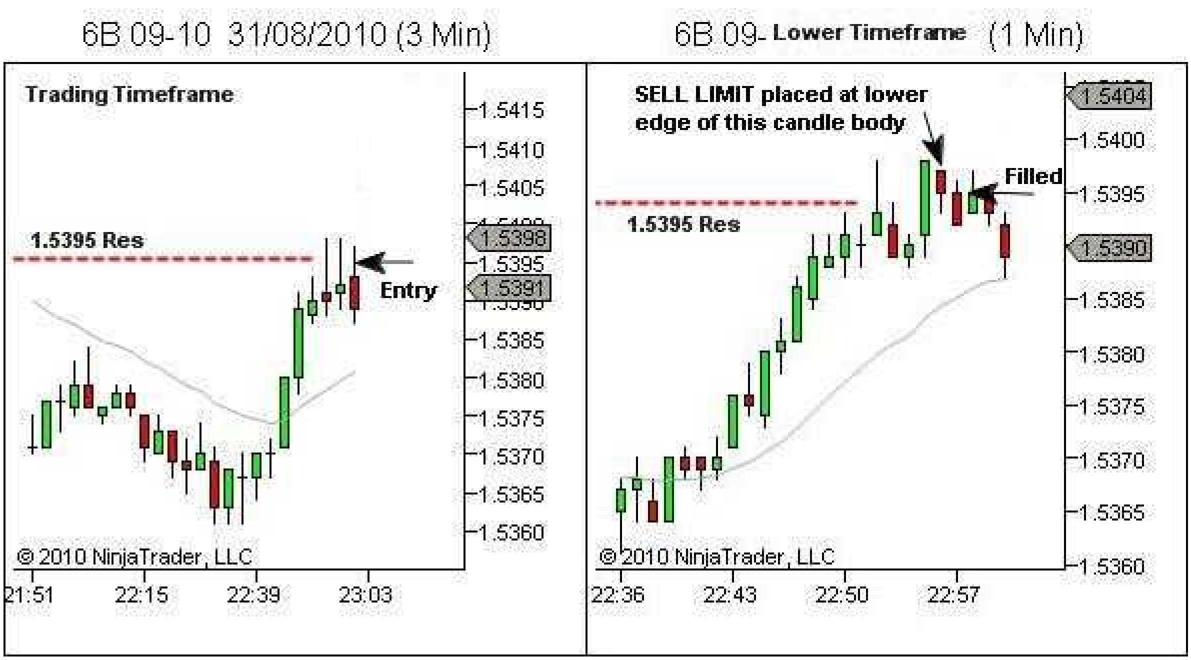

Figure 5.76 – Example 7 – Trade Entry

Trade parameters:

Entry price: 1.5395

Stop loss: 1.5402 (moved it just above the round number (comfort thing) due to better entry price allowing improved R:R) (risk -7 pips)

T1: 1.5371 (potential reward 23 pips)

T2: 1.5365 (potential reward 30 pips)

Step 3 – Trade Management & Exit

You‟ll get some trades during your career where you immediately feel unease upon entry. This was one of them. Despite the initial price movement going in my direction, something didn‟t feel right. Let‟s look at the 1-min chart to see the first few candles after entry…

While I was happy to get a limit entry, it was observed that the second "failure" did not continue lower at all. This didn‟t feel like a "failure" any more.

Price stalled for two minutes. I was very close to scratching the trade when it broke below recent congestion and fell.

The drop failed to continue; failing to reach LWP. The LWP is required to be achieved in order to gain confidence in the trade. That‟s where the loser orderflow should really start to kick in, driving our trade to profit.

The next candle reversed, and I decided to scratch part one at breakeven if touched.

Looking at the lower chart now, we see the next candle exited part one at breakeven (loss of commission only).

We now watch for signs of either strength or weakness, which will lead to either (a) scratching part two as well if we doubt the trade premise, or (b) re-entering part one.

The stop out candle rallied straight to 1.5397 (it‟s high price) and then found solid resistance there for the next 15-20 seconds.
Given this further evidence of support I reentered part one, achieving the same price 1.5395.

The next candle stopped out both parts for a loss.

Figure 5.77 – Example 7 – Trade Management (3 charts)

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Scratched at breakeven — 0 pips (less commission)
- Part one: Re-entered and stopped out — -7 pips (less commission)
- Part two: Stopped out — -7 pips (less commission)

Let"s conduct some review.

With the benefit of hindsight once completely out of the trade, it was easy to see the source of my uncertainty. I had convinced myself that I really liked this resistance area and was expecting it to hold. I was also partially influenced by the upper tails on the two 3-min candles, confirming my belief in this resistance area. I failed to accurately assess the strength and weakness within the market, and the impact that would have on potential future price action.

This example showed strength into the resistance area. Short-term weakness at the resistance area is to be expected (resistance should provide some bearish orderflow to at least temporarily stall price). But this is not evidence of weakness in the bulls.

The most obvious way to demonstrate this is to compare the setups for examples 6 and 7.

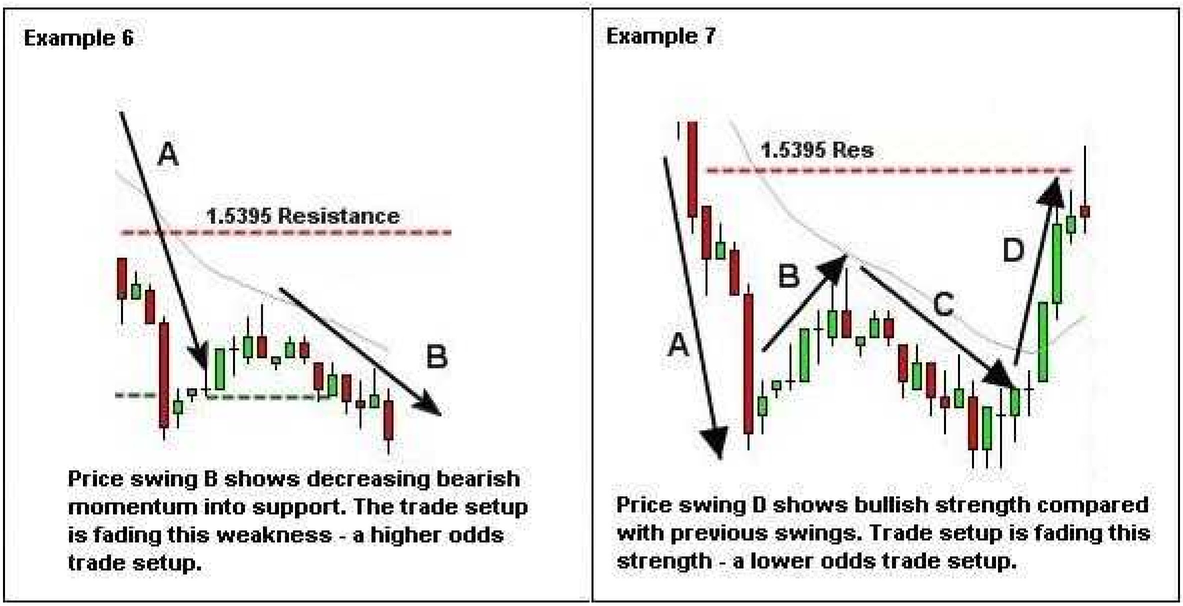

Figure 5.78 – Example 7 – Comparison with Example 6 Setup

Example 6 was fading a weaker move into support. Example 7 was fading a move of strength into resistance. The higher probability is always when fading weakness.

While fading strength can offer great R:R (when you get it right), they are lower probability trades and I‟ll usually only take them if they provide a much better one minute trigger (involving trapped traders). This example did not provide a great trigger.

If any trade was an option in this area, it was this one…

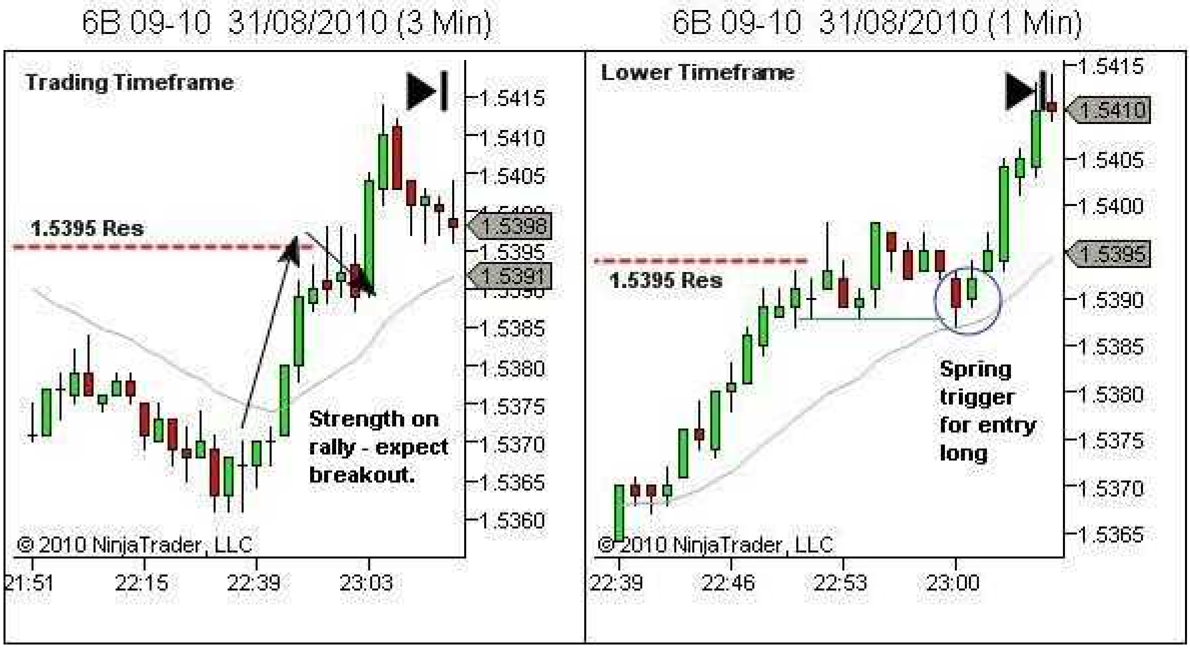

Figure 5.79 - Example 7 – A Better Trade Option

My analysis correctly recognised (initially at least) the strength into resistance, and an expectation of a breakout. In accordance with the First Principle of *future trend* direction (expecting a trend that shows no signs of weakening to continue in its current state), price action offered an excellent entry long via a 1-min spring pattern-based trigger. You had to be quick to see it – remaining focused and alert – as it occurred prior to the breakout. But it was a great opportunity.

In chapter 16 we‟ll talk about conducting setup and trade reviews via a market replay. This is a great example of a trade which will benefit from a good replay of price action, allowing us (with the benefit of hindsight) to re-feel the strength in the bullish moves and weakness in the bearish moves; allowing us to observe the signs that should have kept us out of the short opportunity; and experience the signs that may have led to an entry long. More on that later.

Here‟s another lesson (not for me, but for you)… even when stopped out of this trade, for the first couple of minutes I was watching patiently for a stall on the breakout, in anticipation of a re-entry short. It took that few minutes for me to realise that it wasn‟t coming, because the strength was to the bullish side.

Many traders have difficulty taking a loss, especially when they still expect they‟re right, but just slightly out with the timing. Some will question, “why didn‟t I just stay in and hold through the drawdown?”, or “why didn‟t I average into it and get a better entry price?”

To do so is a loser strategy. My entry short was due to the resistance level holding. When it didn‟t hold any longer, my premise was proven wrong. It‟s time to be out.

If price did subsequently fall from here, maybe I could have profited. But what about the times when it doesn‟t fall (as in this example)? How far do you let it go against you, in order to prove you‟re right?

ALWAYS EXIT WHEN YOU‟RE PREMISE IS INVALIDATED. NO QUESTIONS.

Enough of that!

To wrap up… poor analysis has led to a loss. However, risk was minimised, lessons were learnt, and it‟s time to move on to the next opportunity.

5.8 – Trade Example 8 – PB – Scratched – No Re-entry

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 2 Sep 2010
Time: 3/9/10 00:22 on charts (15:22 London)

Saving a loss can be as good as a win. It‟s still money in your pocket that could well have gone elsewhere. That‟s why I choose to operate with an active trade management policy, rather than just setting the stop and target and hoping for the best.

Step 1 – Define Structure

Figure 5.80 - Example 8 – Define Structure

At 00:22 we have support below the market at 1.5335 and resistance above at 1.5415, 1.5450, 1.5475 and 1.5490.

Step 2 – Define Trend

Price has been in a downtrend for the last two and a half hours, currently pulling back to the vicinity of the last swing high.

A break of the swing high, which then holds and shows price acceptance at these higher prices, would be required in order to trigger a change of trend.

Until then, the downtrend remains intact.

Figure 5.81 - Example 8 – Define Trend

Step 3 – Identify Strength & Weakness

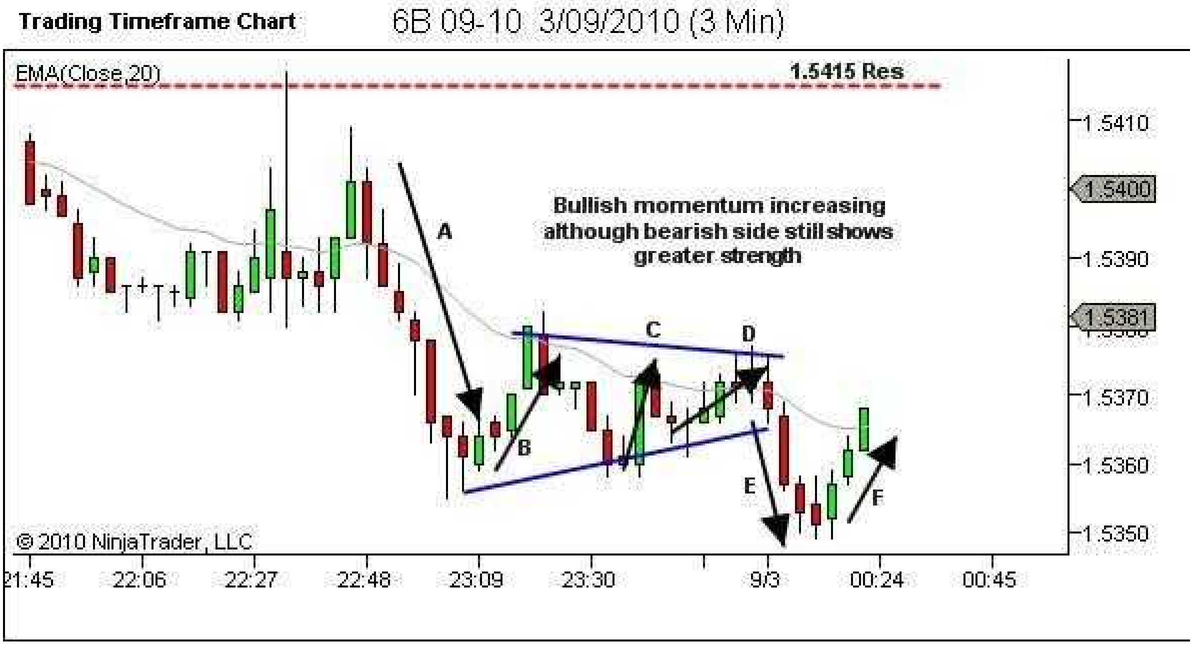

Figure 5.82 - Example 8 – Identify Strength and Weakness

As shown above, the recent down move has been via two bearish swings, A and E, separated by an area of sideways congestion.

Note the nature of bullish momentum within the area of congestion. You‟ll note that the steep slope of C indicates it was actually stronger than B, but it was short-lived, failing to project beyond B‟s swing high. Swing D then showed reduced momentum. Bullish pressure was weakening throughout this area of congestion. This is a great example of how the analysis of momentum within an area of congestion can provide clues as to the possible breakout direction.

The key price swings for me are the two bearish swings, A and E, both showing a steep slope and therefore indicating strong bearish pressure.

However we also note that F, while slightly weaker than E, does show increased strength in the bulls. Demand has entered the market at these lower prices. E also failed to project as far as A, once again showing evidence of buying.

Overall, strength is still to the bearish side of this market. However the bulls are showing some signs of life. The next down swing will be a key indicator of future strength.

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

Combining these three steps into one chart…

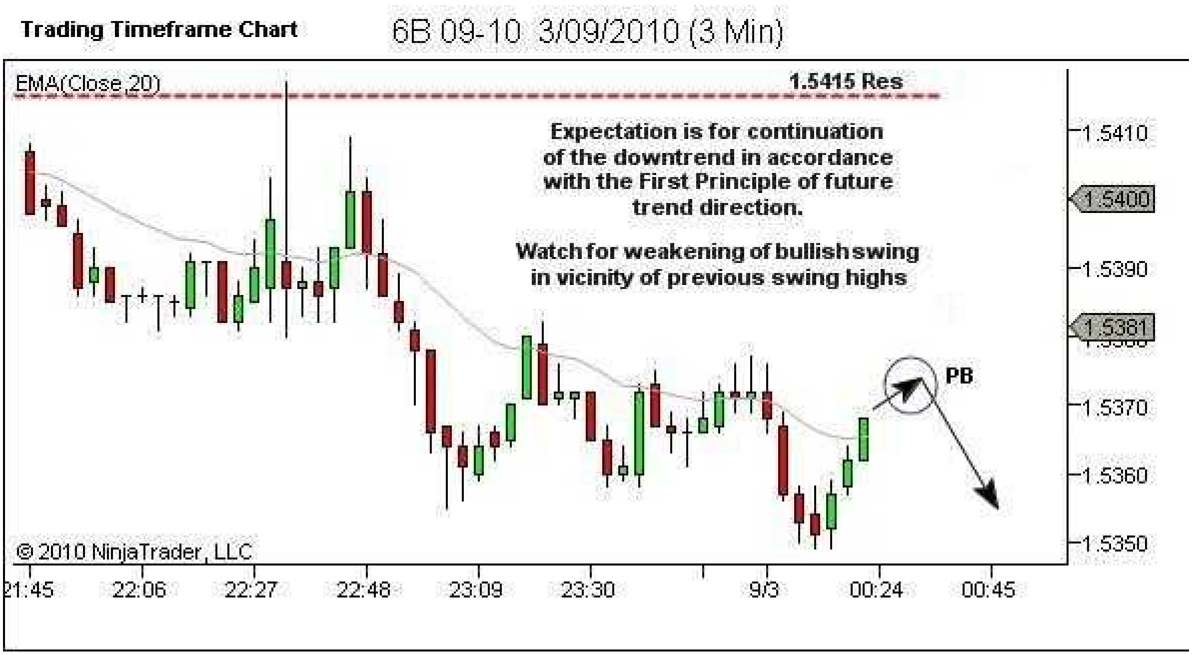

Figure 5.83 - Example 8 – Identify Future Trend Direction

My expectation is for continuation of the downtrend in accordance with the First Principle:

- We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

There are insufficient signs of weakness within the trend at this stage, to have me looking for a complex pullback. My expectation is for a single pullback to the vicinity of previous swing highs, then a continuation lower (at least for one more push).

To validate my premise, I will need to see signs of weakening of the current price swing within the next few candles, such as reduced candle range and/or upper tails. This will be followed by a break lower, offering a PB style entry (if not entered earlier at a stall or 1-min pattern based trigger).

To invalidate my plan, price will need to either continue its current strength right through the previous swing high, forcing a change of trend direction. Or price could stall at the area of swing high resistance, but fail to carry through lower. This would indicate a lack of bearish pressure and a high likelihood of continuing higher (if it‟s not going down, then it‟ll probably go up!!).

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

Let‟s look at the next two *trading timeframe* (3 min) candles. Candle A is a mid-close range candle, while B is a high close range candle. Both have reduced price range (distance from low to high).

These candles are evidence of price slowing into the area of swing high resistance, validating our expectations. A break below this recent action will likely trigger the first of the stops for the longs, as well as bring in new selling. We now prepare for a possible PB opportunity.

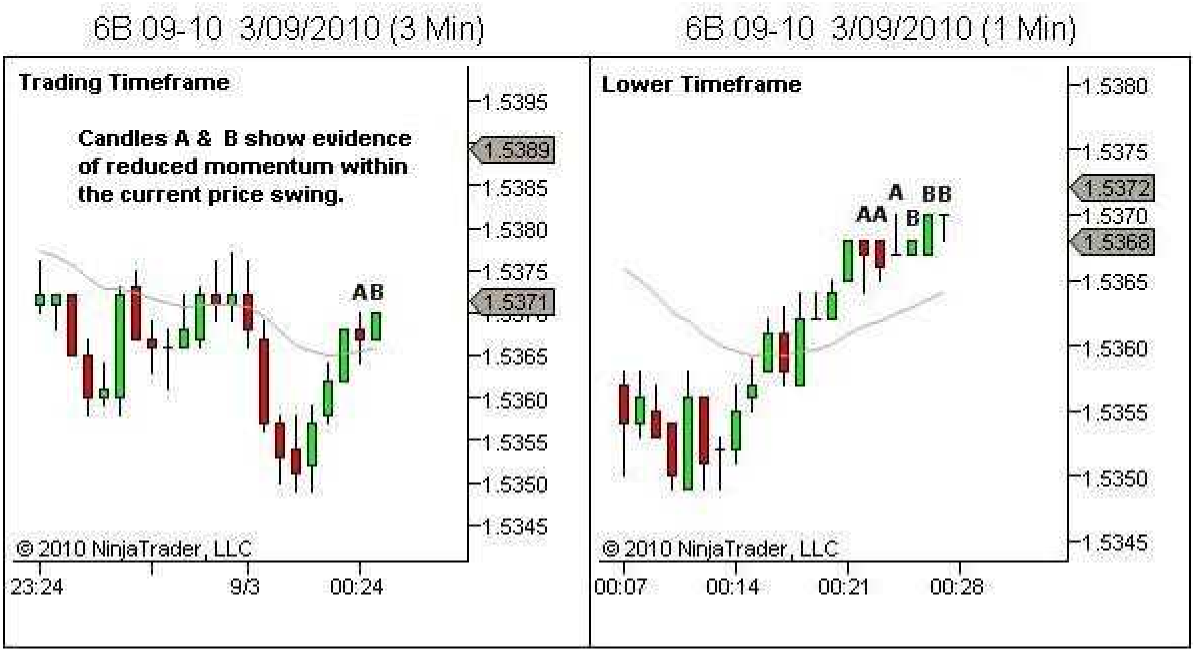

Figure 5.84 - Example 8 – Ongoing Market Analysis

Trading Process

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

Based upon current price action we have the following potential trade parameters:

LWP is the point at which I expect the stops would start triggering, for those trading long in the pullback. This will be below the second-last 3-min candle (red mid-close range candle; spinning top). The LWP trigger would be at 1.5363.

S1 is above price action at 1.5372, providing a potential risk of 9 pips. If price falls to the LWP from this point, I do not expect S1 to be hit, and would like to be out of any trade. My trade premise would be invalidated.

T1 is above the lowest 1-min candle (the doji), providing a target of 1.5354. This is a potential profit of 9 pips, allowing a 1:1 R:R. T2 is lower at 1.5340, just above the 1.5335 support, offering a potential reward of 23 pips (2.5:1 R:R).

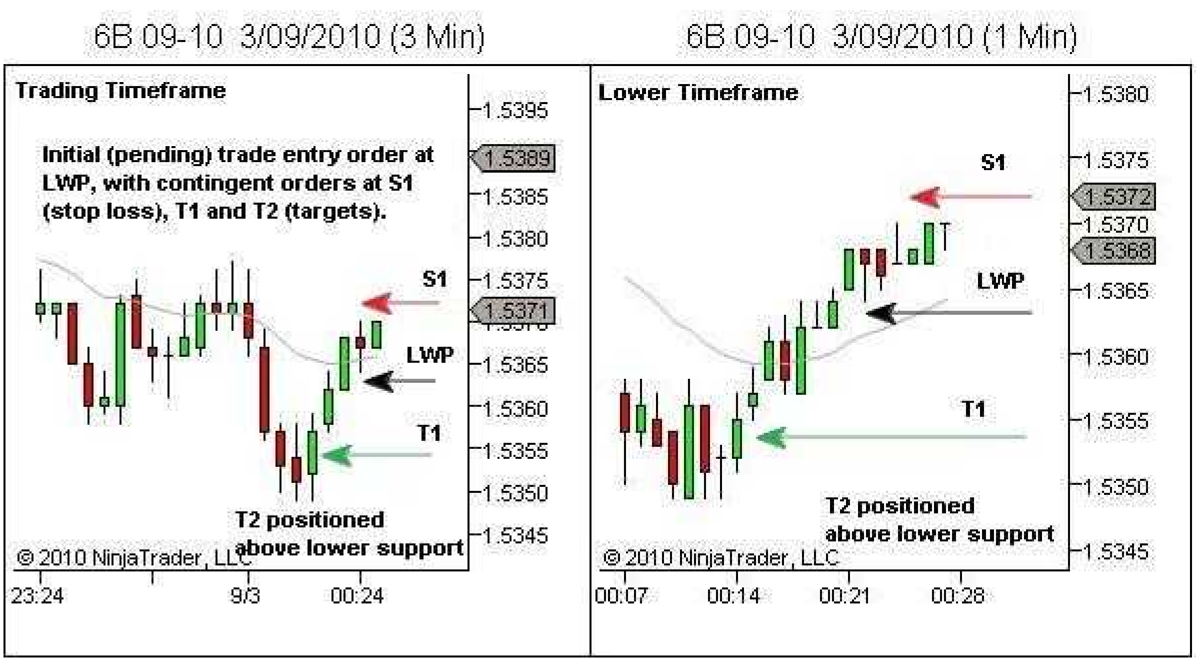

Figure 5.85 - Example 8 – Trade Preparation

Step 2 – Trade Entry

A stop entry order is placed at LWP, 1.5363, to ensure I don‟t miss entry in the event of immediately lower prices. While waiting for this to trigger, I will attempt to work a better entry through either a 1-min stall or pattern based trigger.

Let‟s look at the next 3-min candle.

Candle C has moved higher, above our previous high point. This has not yet triggered a change of trend, so I simply adjust my pending entry order as required, based upon this new information.

LWP moves up below the equal lows of candles B and C, to 1.5366. S1 is now 1.5378 (12 pips risk). T1 remains at 1.5354 (12 pips reward). T2 also remains at its present location 1.5340 (26 pips reward).

If price moves lower through LWP, I will be triggered into a trade.

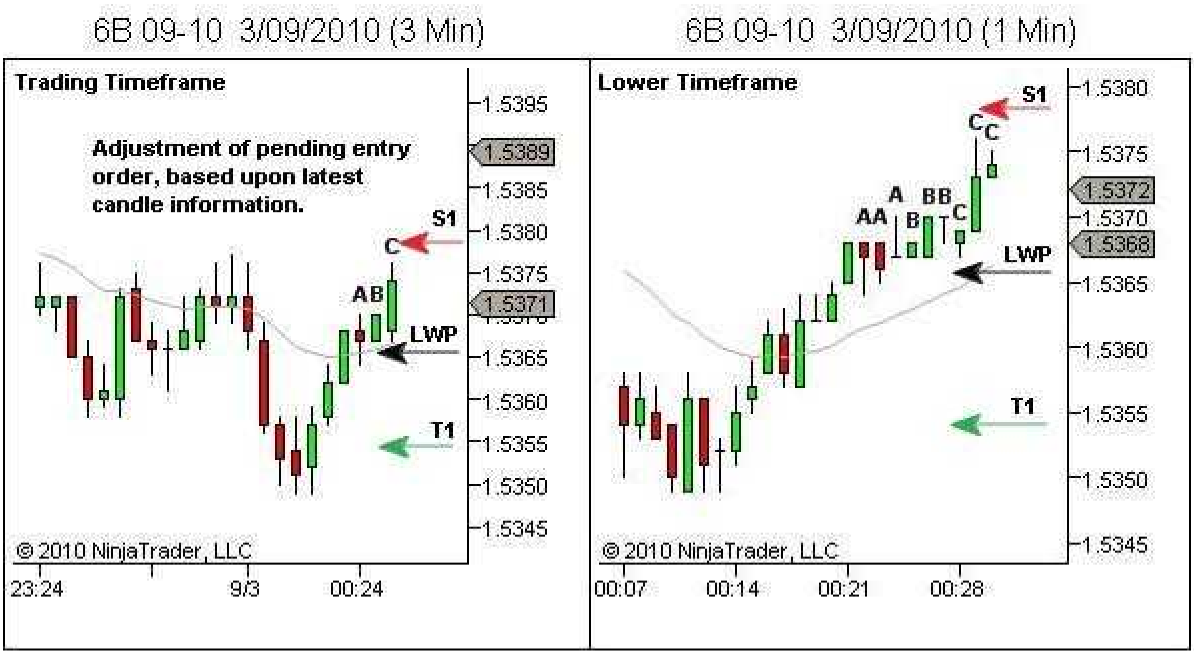

Figure 5.86 - Example 8 – Trade Entry Pending – Adjustment of Orders

Looking at the 1-min chart though, I see a potential pattern-based trigger.

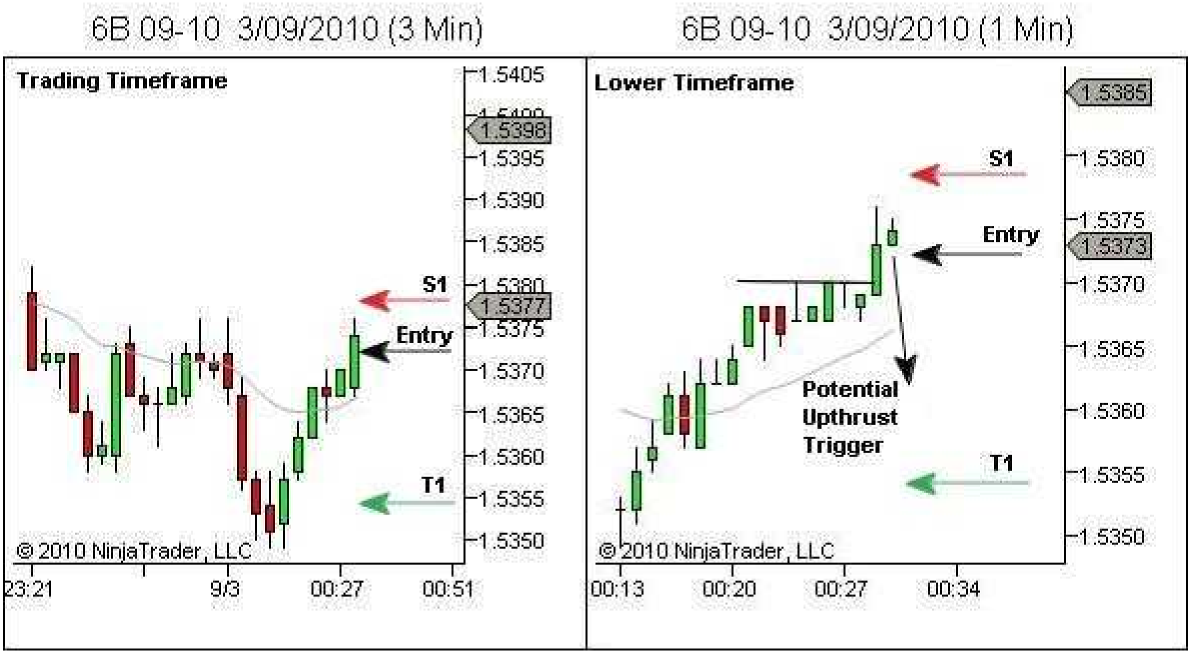

Figure 5.87 - Example 8 – Trade Entry – Potential Pattern Based Trigger

The latest 1-min price action shows a breakout of the recent highs which was unable to continue higher (upper tail, followed by mid-close range candle).

Although price has to move below the breakout candle to complete an upthrust pattern, it"s likely an entry below the latest mid-close range candle would benefit from 1-min chart bearish orderflow, as some of the early breakout traders exit due to the stall. I expect that this will be sufficient orderflow to complete the upthrust pattern. Subsequent upthurst orderflow will move price further to our LWP, triggering the move to T1.

So, I decide to move our stop entry order to just below the recent 1-min candle. Although this is an early entry (and therefore a little more aggressive), it benefits from greater R:R if it is subsequently filled.

Continuation above recent highs will indicate a potential change of trend. If the current high gets taken out, I"ll cancel my pending entry orders and reconsider my analysis.

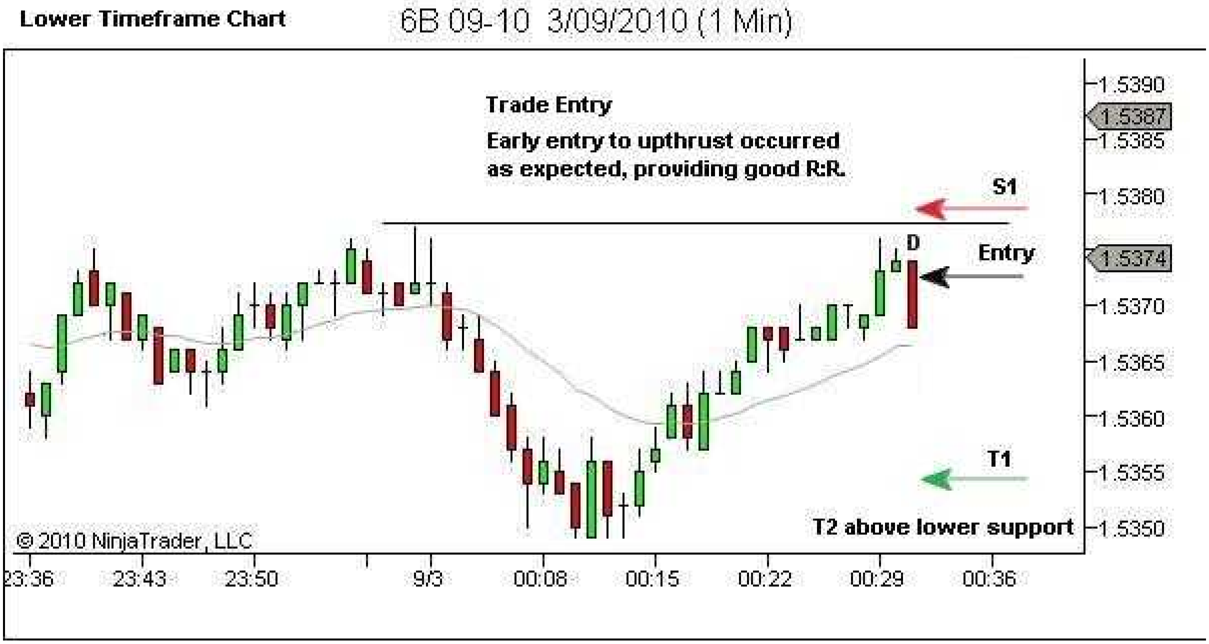

Figure 5.88 - Example 8 – Trade Entry

The next candle (candle D in the chart above) triggers the entry. As expected, this entry benefited from short-term bearish orderflow, driving our trade to immediate profit. Our expectation is for this bearish orderflow to continue lower, triggering more bearish orderflow as it passes through the LWP.

Trade entry parameters:

Entry: 1.5372
S1: 1.5378 (risk 6 pips)
T1: 1.5354 (reward 18 pips) (3:1 R:R for part one)
T2: 1.5340 (reward 32 pips) (5.3:1 R:R for part two)

Step 3 – Trade Management & Exit

Having not yet triggered LWP (which is required, to create the bearish orderflow to drive price to T1), this trade should be managed quite aggressively. Any failure to continue lower to LWP (or beyond), should raise some concern.

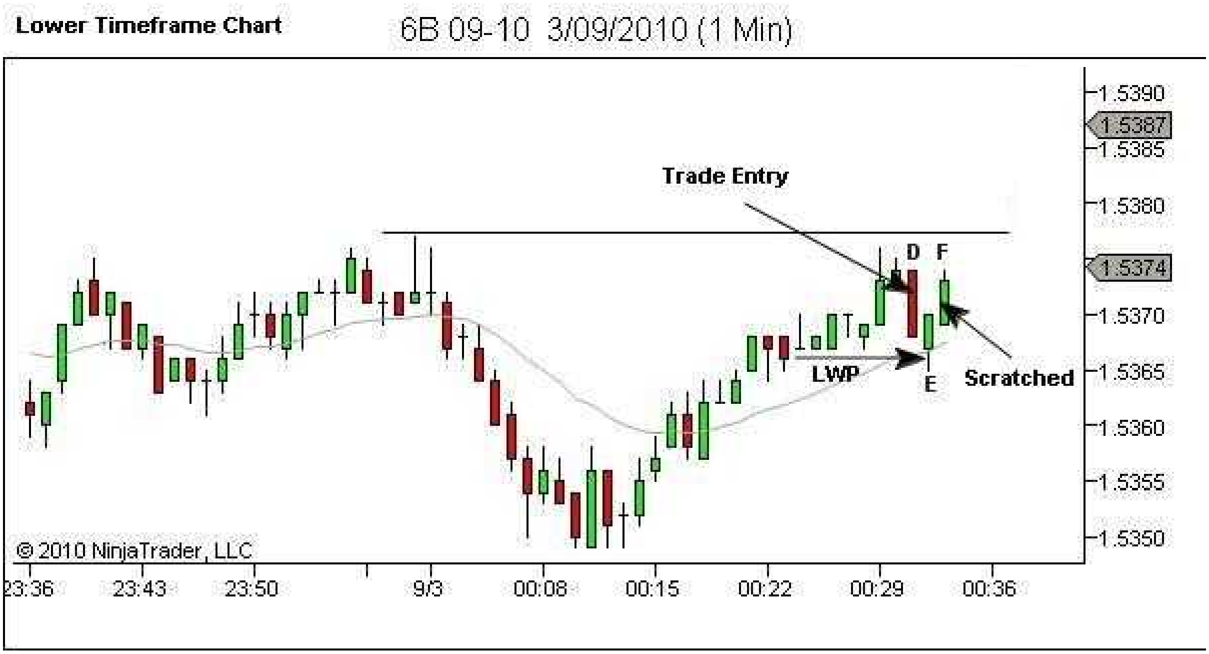

Figure 5.89 - Example 8 – Scratched

Candle E does exactly that… having moved through the LWP, price immediately rallied to close on the highs. Although a high close range candle is by itself considered slightly on the bullish side of neutral sentiment, this raises some concern at this point in time. It‟s a clear indication of a lack of bearish pressure. Price is not acting in accordance with our expectations, so the stop is dragged just above candle E and is quickly trigged by F.

The trade is scratched at 1.5371, for a total of +1 (less commission).

We now wait for a further entry trigger or stall.

Ideally at this point in time I‟d love to see a break above the swing highs which rapidly reverses…

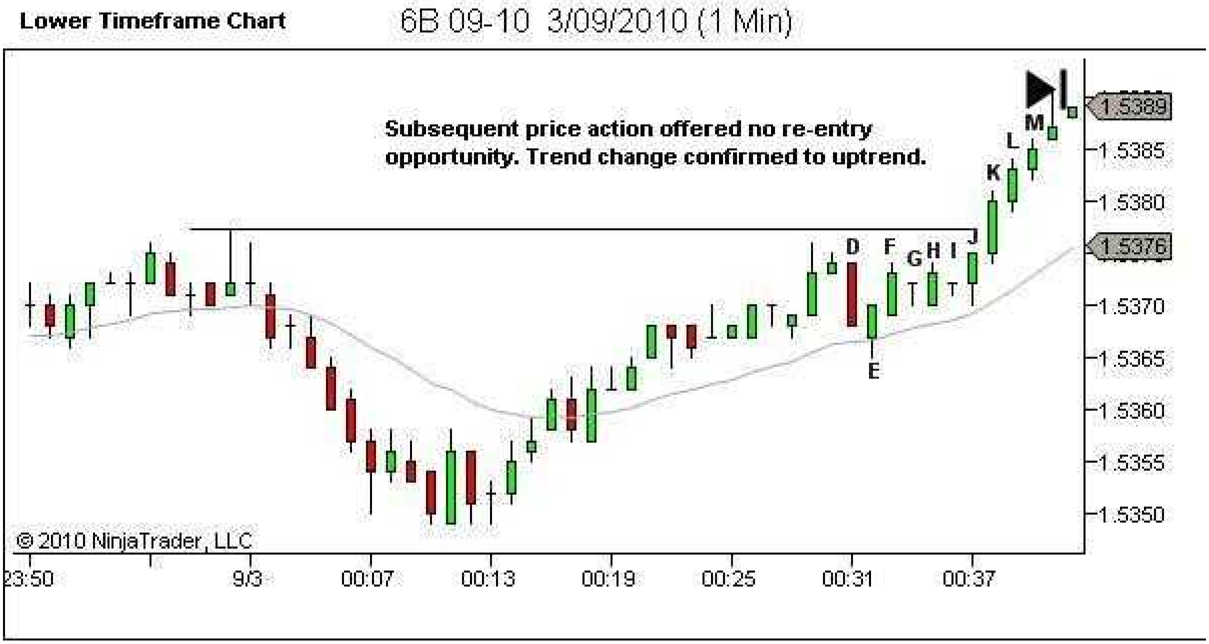

Figure 5.90 - Example 8 – No Re-entry Opportunity

Candles G through J continued a stall at the swing high resistance. The bullish nature of F and H had me continuing to wait for a second upthrust, ideally above the swing high, rather than searching for a limit entry towards the top of the stall region.

The breakout and potential upthrust occurred at K (high close bull candle).

Trade entry now requires a rejection of higher prices and break back below the lows of K. I tentatively plan for a stop entry order below K. However price continues higher showing acceptance of the change of trend.

The price action provides no re-entry opportunity.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Scratched +1 pips (less commissions)
- Part two: Scratched +1 pips (less commissions)

This is basically a breakeven trade.

It"s also another example where FX futures traders would have profited maybe a dollar or two, while spot forex traders would have lost a few pips due to the spread (more on that in chapter 6).

As mentioned in the introduction to this trade example, a scratched trade which saves us from a loss, is as good in my books as a win. It"s money in my account, rather than someone else"s.

Looking at the *trading timeframe* (3 min) chart for review purposes, we see that the setup was quite valid, however the increasing strength of the bullish swing leading into the setup, was followed by an inability for the bears to push price lower for one more swing. Their failure, followed by the subsequent break higher confirms strength now to the upside. We would now prepare for a potential long PB trade, following the weaker bearish pullback.

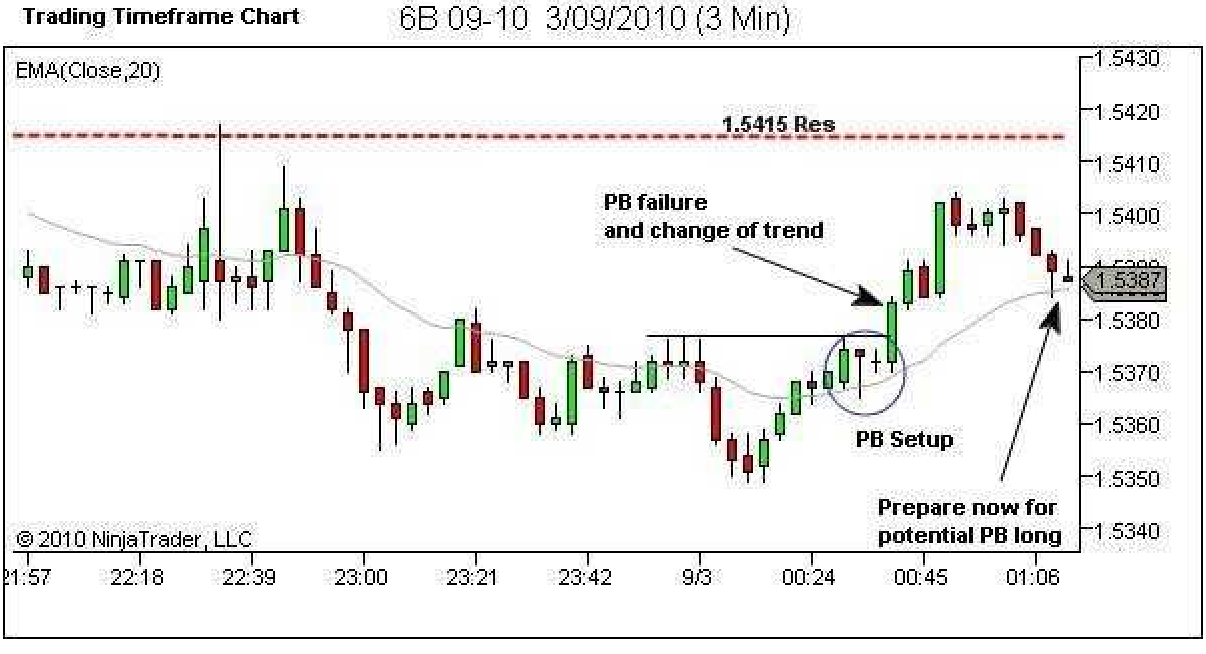

Figure 5.91 - Example 8 – Trade Review

5.9 – Trade Example 9 – CPB – T1 & T2 Achieved

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 6 Sep 2010
Time: 18:27 on charts (09:27 London)

Let"s look at a simple example. It"s an interesting one, as it occurs at a time when I usually won"t trade, unless a perfect opportunity presents itself.

In the event of a public holiday in the US I will only trade during the UK session, and even then ONLY IF a great opportunity presents itself. Likewise for a public holiday in the UK; I"ll only trade during the US session, and then ONLY IF a great opportunity presents itself. The default position in both cases is to NOT trade, as usually these sessions are dull and lifeless.

September 6th was the Labor Day Holiday in the USA. So, the UK session was open on the charts and glanced at from time to time (unlike my usual process which requires focus during every *trading timeframe* (3 min) candle).

Step 1 – Define Structure

Resistance sits above the market at 1.5490. Support is below at 1.5435, 1.5420 and 1.5390.

Figure 5.92 - Example 9 – Define Structure

Step 2 – Define Trend

Figure 5.93 – Example 9 – Define Trend

Following the open of the UK session, price tested the previous swing high and 1.5490 resistance area at A. Price was rejected at this level and so fell.

Had we been clearly focused on this session, this could have presented a great TST short opportunity at A.

The downtrend was confirmed at B.

Price is currently in a complex (3-swing) pullback after having tested the 1.5435 support area.

Step 3 – Identify Strength & Weakness

The *trading timeframe* (3 min) chart clearly shows greater momentum on the downswing, although the recent rally off support occurred on the largest range bullish candle we have seen since the start of the UK session. Being a high close bull candle, this has potential to indicate a change to bullish sentiment and an increase in strength to the upside.

However, it was followed by a mid close range candle (doji) indicating a failure to continue. We have mixed signals here.

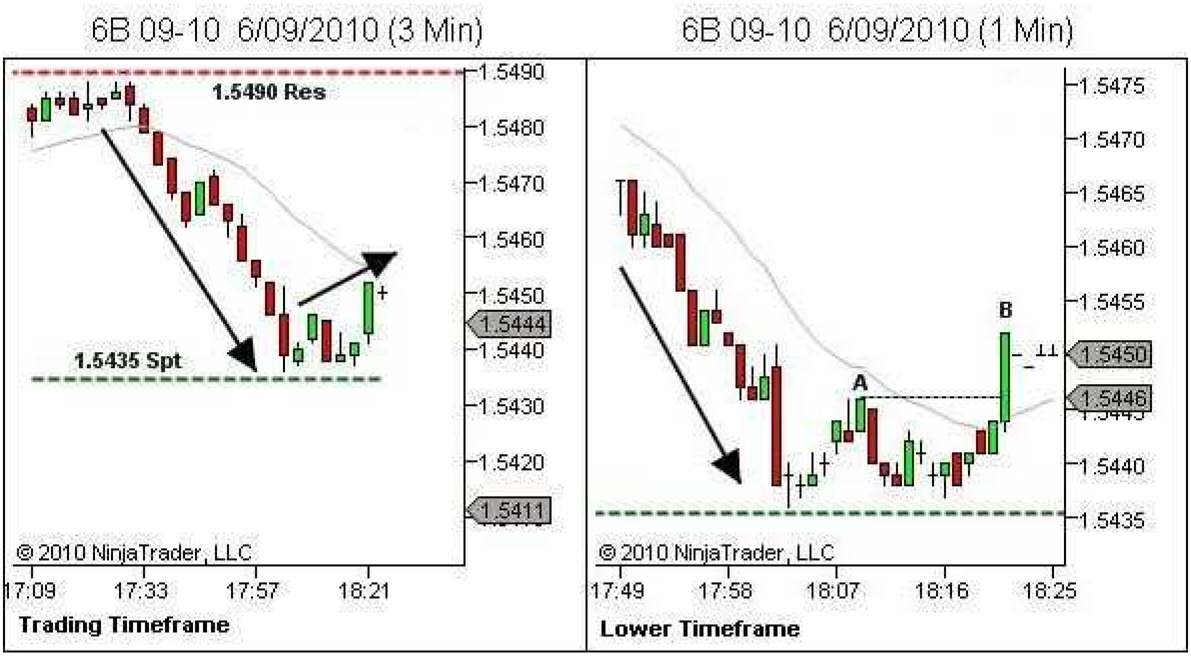

Figure 5.94 – Example 9 – Identify Strength and Weakness

The *lower timeframe* (1 min) chart shows that the break to new highs on the complex (3-swing) pullback occurred on one candle only. Candle B strongly broke above swing high A, and then stalled for the following four minutes.

I still assess strength to be to the downside, although any continuation higher may indicate a change in sentiment.

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

Steps 4, 5 and 6 are combined in one diagram.

As mentioned in the introduction to this example, I usually won‟t trade the holiday sessions, unless a good opportunity presents itself. A "good opportunity" is hard to define. But typically it involves a market that is moving (as shown via the strong momentum move from the 1.5490 resistance to 1.5435 support) and some sort of *textbook-perfect* trapped trader pattern, such as a complex (3-swing) pullback in the direction of the trend (as is setting up right now).

The market gained my attention during the fast downmove. The 3 swing retracement now has me focusing closely on price.

We‟re in that transition period after a test of support. Will price continue downwards to new lows (scenario A), return for a retest of support (scenario B) or continue higher confirming a reversal (scenario C)?

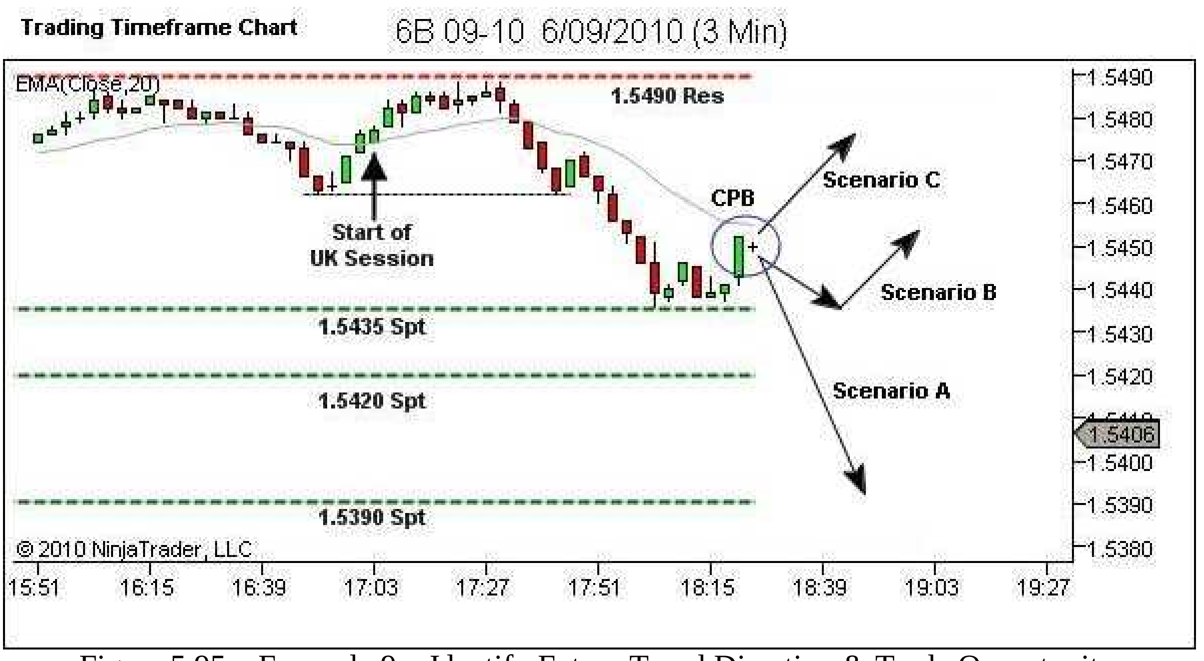

Figure 5.95 – Example 9 – Identify Future Trend Direction & Trade Opportunity

In accordance with the First Principle of *future trend* direction, I expect a continuation of our trend until I see evidence of weakening of the downtrend.

The strength shown on the downmove, and the pause after the recent push higher, has me expecting a scenario A or B, rather than C.

Any break below the recent pause (doji) will start to trigger stops from the longs, pushing price at least to retest the 1.5435 level (scenario B). A break of that level will trigger a much larger supply of bearish orderflow, as all the longs from the recent 3-swing pullback will exit, and new bears will enter short (scenario A). Scenario A is my expected outcome.

As such, I will skip the ongoing analysis and move straight to trade preparation.

Any break below current action will have me entering a CPB trade short. Any break higher will have me standing aside.

On CPB trigger, part one would only target the recent lows, in case I‟ve incorrectly assessed the strength to the downside. Part two will skip the weaker 1.5420 support, taking us all the way to the stronger 1.5390 support, due to my expectation for a second strong push downwards.

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

I don‟t expect much opportunity to work an entry here. It‟ll be a case of a break below the doji offering an entry short, or a break higher leading me to stand aside.

LWP is immediately below the doji at 1.5448.
S1 is tentatively placed above recent highs at 1.5454.
T1 is the lowest 1 min open/close above 1.5435 support, at 1.5438, offering greater than 1:1 R:R for part one.
T2 is above the next expected support at 1.5395 (part two reward 53 pips). The 1.5420 support is ignored, as I expect bearish orderflow to push price quickly lower for a second strong bearish price swing.

A stop entry order is placed at LWP, with S1, T1 and T2 attached as contingent orders.

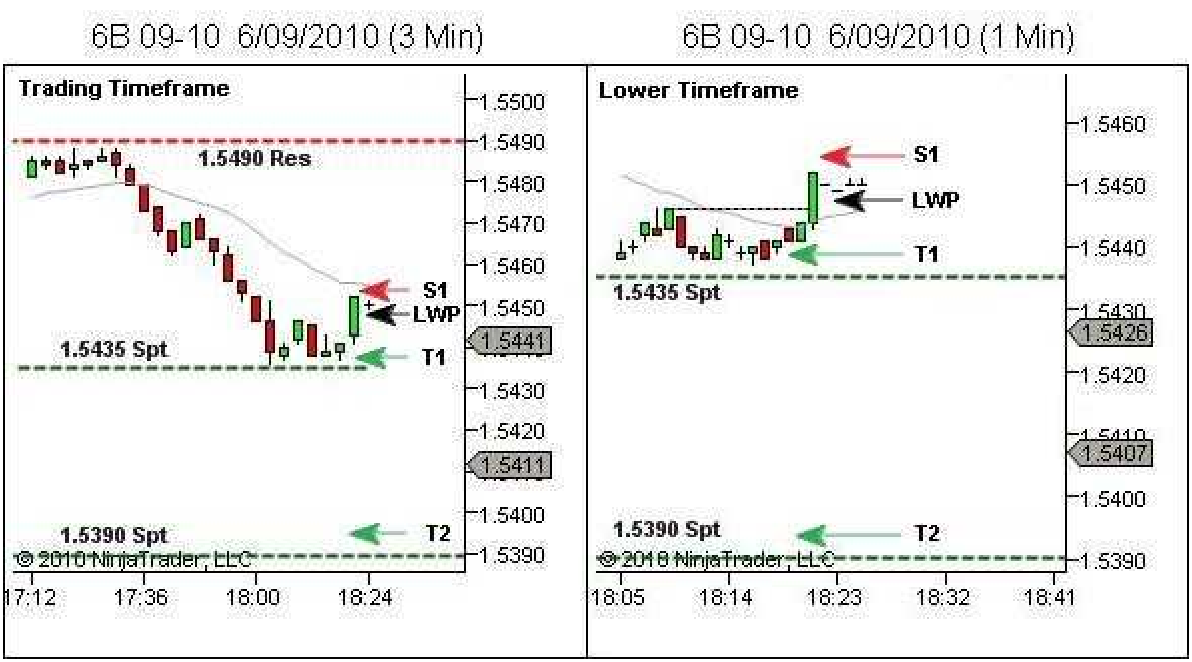

Figure 5.96 – Example 9 – Trade Preparation

Step 2 – Trade Entry

An entry is provided two minutes later as price reaches LWP 1.5448.

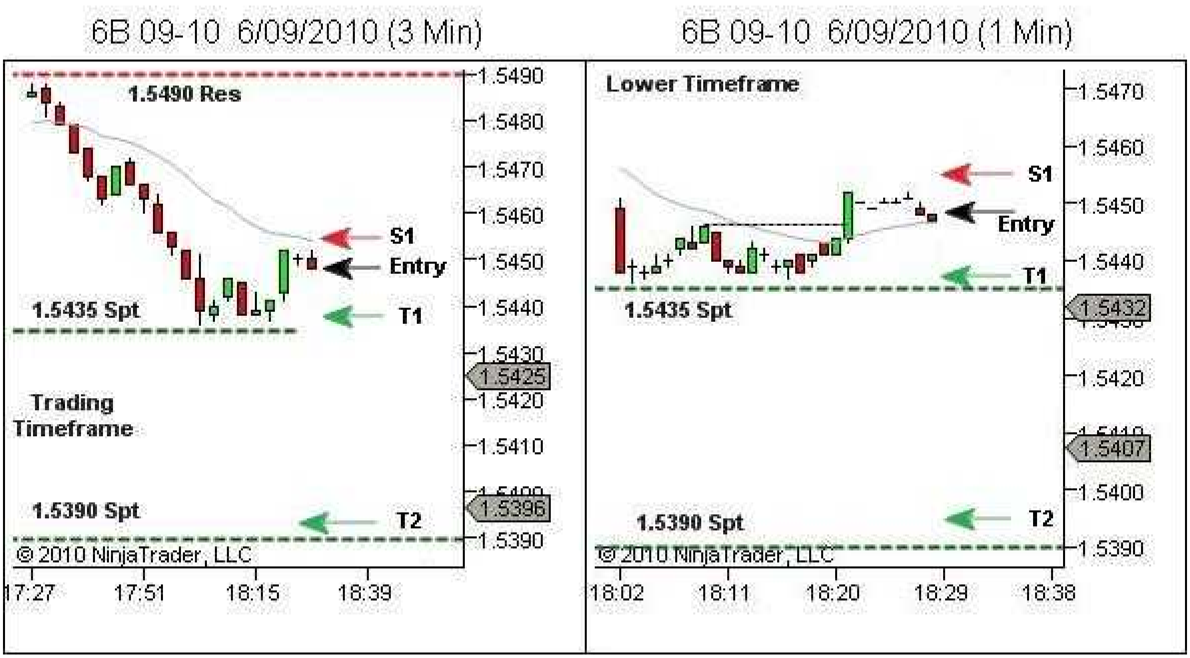

Figure 5.97 – Example 9 – Trade Entry

Trade entry parameters:

Entry: 1.5448
S1: 1.5454 (risk 6 pips)
T1: 1.5438 (reward 10 pips) (1.5:1 R:R for part one)
T2: 1.5395 (reward 53 pips) (9:1 R:R for part two)

Step 3 – Trade Management & Exit

As expected, the break below the doji has triggered the first of the pullback stops, pushing price quickly to T1.

The stop was moved from S1 to S2 (breakeven) after candle A (low close bear candle) closed 3 pips from the target.

T1 was achieved shortly after the open of the next candle.

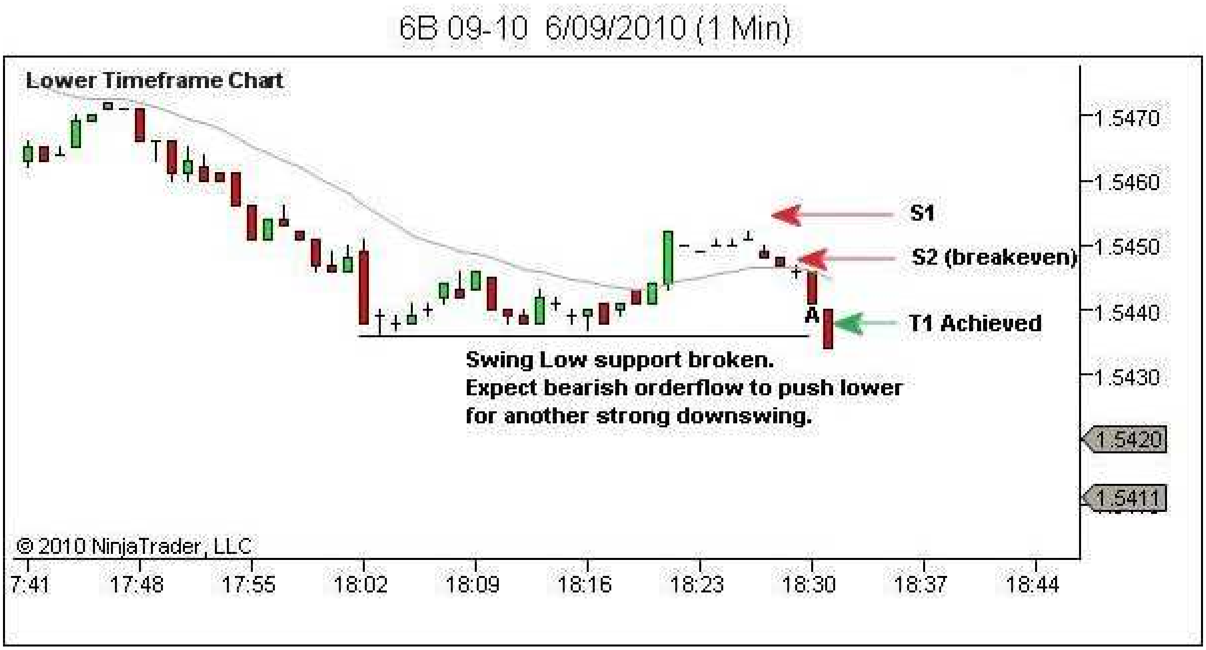

Figure 5.98 – Example 9 – Trade Management – Part One
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Price has also broken the previous swing low, as expected. Bearish orderflow should now push price lower for a second strong move downwards.

The part two stop is moved to breakeven (S2) on achievement of T1.

Like with part one, management of part two is quite simple, as the bearish orderflow met our expectations and continued strongly lower.

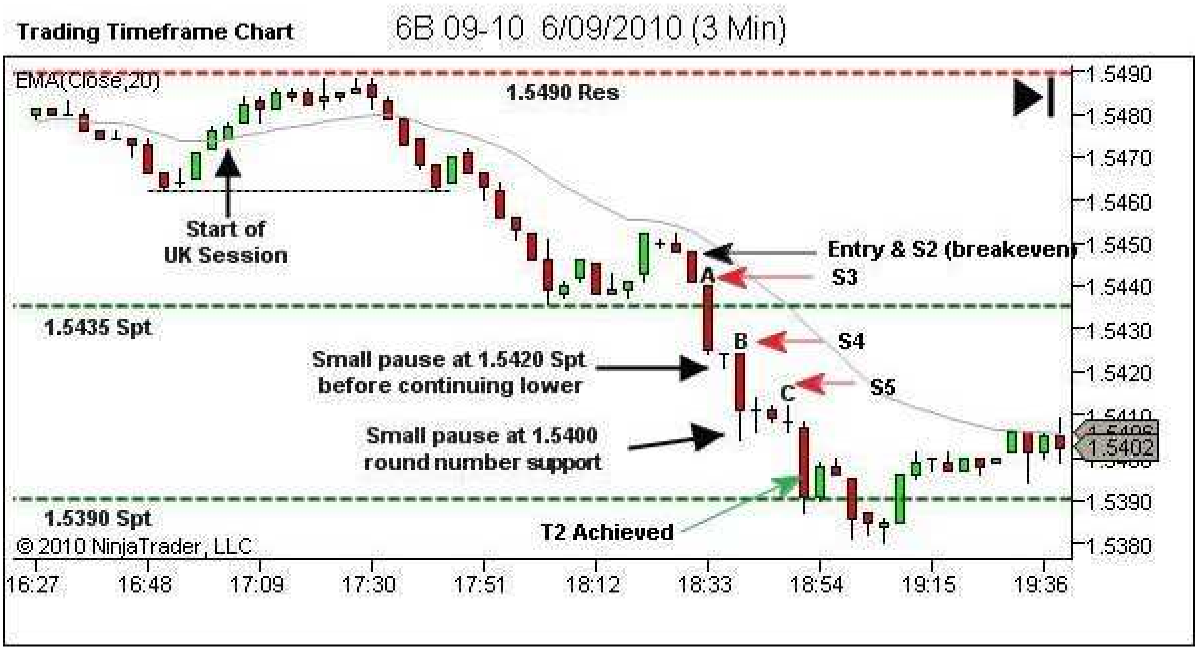

Figure 5.99 – Example 9 – Trade Management – Part Two

The stop was trailed above significant candles (those closing to new lows) or areas of congestion.

After candle A (low close bear candle), the stop was moved to S3, 1.5442.

After candle B moved below its preceding candle, the stop was tightened to S4, 1.5425. Note I did not wait for the close in this case. It was moved immediately the (weaker) 1.5420 support level broke. If price moved higher here, I would take this as a sign of unexpected bullish orderflow, and be happy to exit the market.

After the second doji at C, the stop was moved above the area of congestion to S5, 1.5415.

T2 was achieved in the following candle.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

- Part one: Achieved T1 +10 pips (less commission)
- Part two: Achieved T2 +53 pips (less commission)

5.10 – Trade Example 10 – TST – Scratched & Reversed – PB – T1 Achieved – Part 2 Stopped (Trail)

Initial Market Analysis

Market: 6B (British Pound FX Futures); equivalent to the spot forex pair GBP/USD.
Session: 10 Sep 2010
Time: 17:13 on charts (08:13 London)

In this example, we‟ll see price interaction with S/R, involving a scratched trade and reversal. I don‟t often reverse, as every trade has to stand on its own merits. A failure in one direction does not usually imply market movement in the opposite direction. However, in this case it did.

Step 1 – Define Structure

The *higher timeframe* (30 min) chart shows support below the market at 1.5335, with resistance above at 1.5410, 1.5440 and 1.5470. Note that the 1.5410 area is formed from Asian session price action, so is likely weaker than the higher resistance levels. Still, we watch price action at <u>all</u> levels to determine the likely impact on future trend direction.

Figure 5.100 – Example 10 – Define Structure

Step 2 – Define Trend

Figure 5.101 shows a *trading timeframe* (3 min) chart, allowing us to identify the trend.

Figure 5.101 – Example 10 – Define Trend

I would call this an uptrend, due to the UK session opening with price holding above the recent swing high at A.

However, the trend can be difficult to define early in a new session. If you called this a sideways trend, within the range of 1.5350 to 1.5410, I wouldn‟t have any problems with that at all.

As mentioned earlier, if in doubt just make a decision. Ongoing price action will correct it if you‟re wrong.

For me though, it‟s an uptrend.

Step 3 – Identify Strength & Weakness

The slope of the recent bullish move is much steeper than the slope of the previous bearish price swing, indicating strength to the upside.

However, it‟s worth noting that this is to be expected on the open of the UK session. The first price swing will more often than not be stronger than the last Asian session price swing.

Although we see bullish strength at this time, caution needs to be applied to our analysis. The next downswing will allow a more accurate assessment of momentum.

Note also, the upper tails on candles A and B, indicating some supply opposing our bullish price swing.

Figure 5.102 – Example 10 – Identify Strength and Weakness

The bulls are clearly in charge, but until we can make a more accurate comparison I will assess this as a normal rally, rather than a dominant sign of strength.

Step 4 – Identify Future Trend Direction

Step 5 – Visualise Future Price Action

Step 6 – Identify Areas of Trade Opportunity

As with previous examples, we will combine these three steps into one chart.

Based on current price action, my expectations are for a test of resistance which holds, in accordance with the Fifth Principle of *future trend* direction (We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary).

This provides a TST opportunity as demonstrated below.

Figure 5.103 – Example 10 – Identify Future Trend Direction and Areas of Trade Opportunity

The price action required to validate this plan is for continued signs of slowing momentum or bearish pressure as price rallies towards resistance. This will be evident by a reducing slope, further upper tails, and/or narrowing candles.

Should a TST trade be taken, trade management should be aggressive as price is at a critical area.

Strong continuation lower would confirm a reversal and quite likely lead to prices below the pre-session lows.

However a shallow or slow move off resistance would indicate a greater likelihood of a pullback rather than reversal, setting up for a further test of the resistance level. Should the price offer this scenario I will scratch and reassess, considering a potential PB entry long.

The premise will be proven invalid if the market continues strongly towards the level; likely indicating a breakout and then subsequent BOF/BPB opportunity.

Let‟s move on to the next few candles…

Ongoing Market Analysis

Step 1 – Determine Candle Pattern Sentiment

Step 2 – Consider the Context

Step 3 – Does it Support my Premise?

As previously, we will combine this 3-step dynamic bar-by-bar process into one summary discussion.

The next two candles are displayed below. Candle A is a mid-close bull candle showing some upper rejection. Candle B is a mid-close range candle, once again showing rejection of higher prices. In both cases, the range of the candle (high to low) is narrow.

Price is showing no signs of potential breakout at this stage. Our premise is supported by this action, and as price is now within the setup area we commence our pre-trade routine.

Figure 5.104 – Example 10 – Ongoing Bar-by-Bar Analysis

Step 1 – Trade Preparation

Note that bar by bar ongoing analysis continues throughout the trading process, both within the setup area prior to entry, and throughout the life of the trade.

The initial stop is defined as just above the resistance area at 1.5411. LWP is difficult to identify when price just grinds higher like this, but we should start to see some stops trigger below the last candle, so we place it at 1.5401. This trade is one that needs to work fast, or not at all. Price is at a level at which it should either reverse lower, or push higher through the weak Asian session resistance.

T1 is all the way down at 1.5368, just above the congestion at the swing low. The trade offers a great R:R. T2 is off the chart, at 1.5340.

We place the stop entry order at LWP and then work to enter at a better price if at all possible, based on a lower timeframe stall or pattern based trigger.

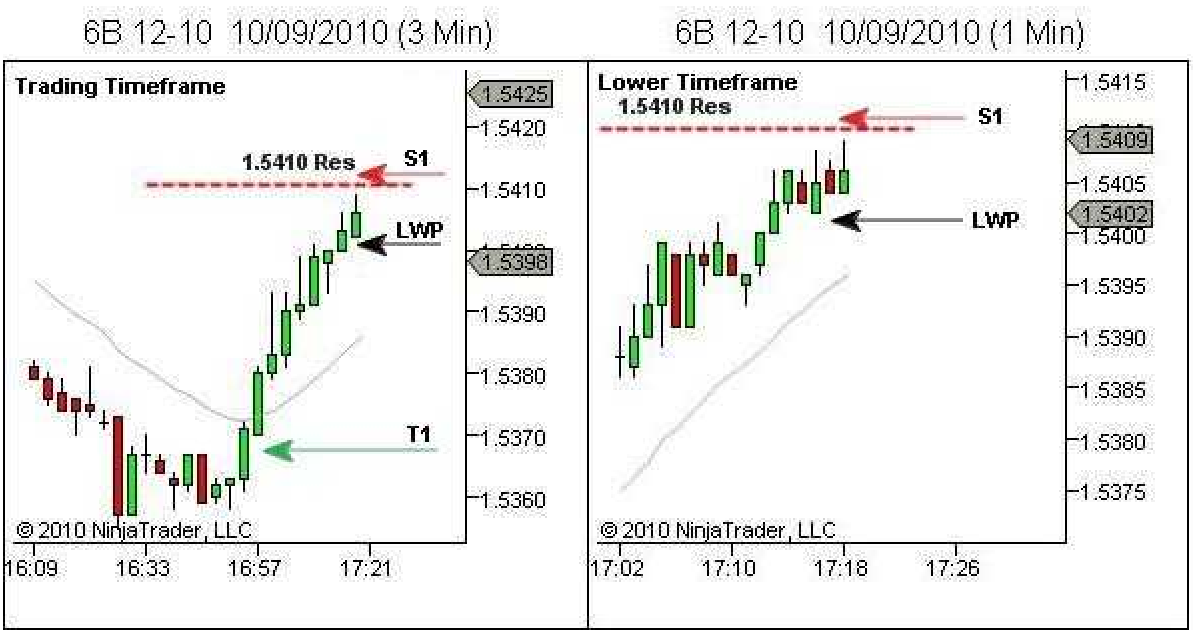

Figure 5.105 – Example 10 – Trade Preparation

Step 2 – Trade Entry

There is unfortunately no opportunity to work a better entry, as the trade is triggered at LWP.

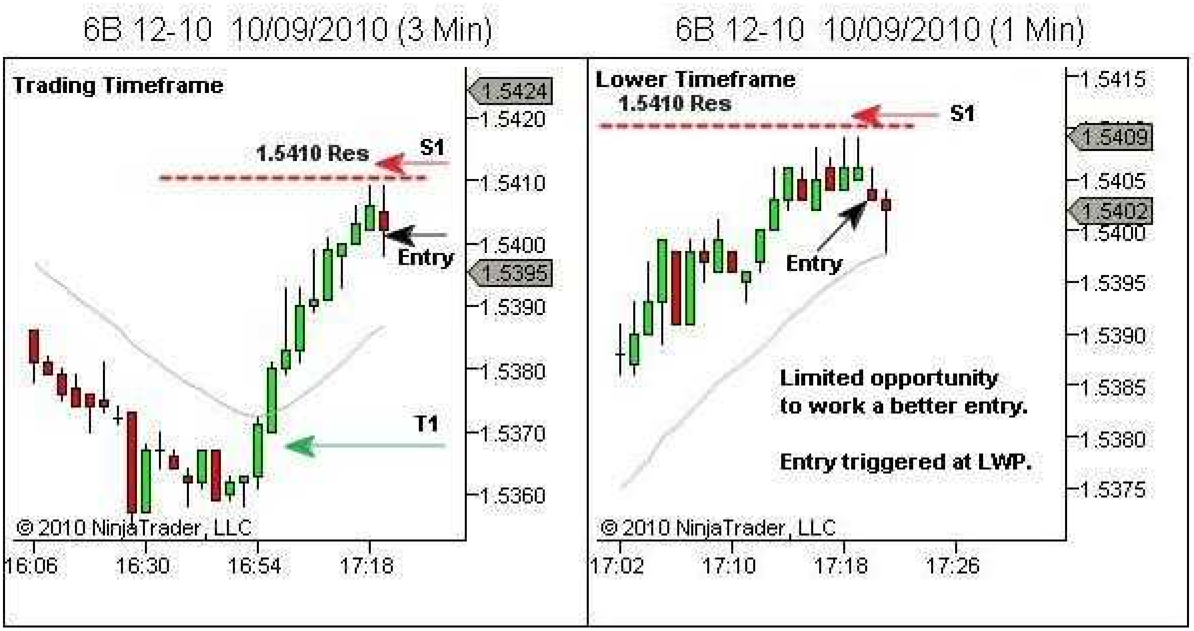

Figure 5.106 – Example 10 – Trade Entry

Trade entry parameters:

Entry: 1.5401
S1: 1.5411 (risk 10 pips)
T1: 1.5368 (reward 33 pips) (3:1 R:R for part one)
T2: 1.5440 (reward 61 pips) (6:1 R:R for part two)

Step 3 – Trade Management & Exit

Note the last candle on the RHS of figure 5.106 above. The initial break through LWP did profit from bearish orderflow driving price initially in our direction, but it was short-lived. The lower tail indicates there is more demand at lower prices. This is a sign of strength. The stop for part one will be moved just above this candle.

Let"s look at further price action.

The following three minutes failed to trigger the stop at S2, continuing lower. Candle A was able to reach new lows, however once again failed to bring in new selling, holding at this level to result in only a narrow range candle.

This lack of selling is a second failure to support my premise. The stop for part one is moved above candle A (breakeven).

Part one is stopped out on the next candle (the green high close bull candle).

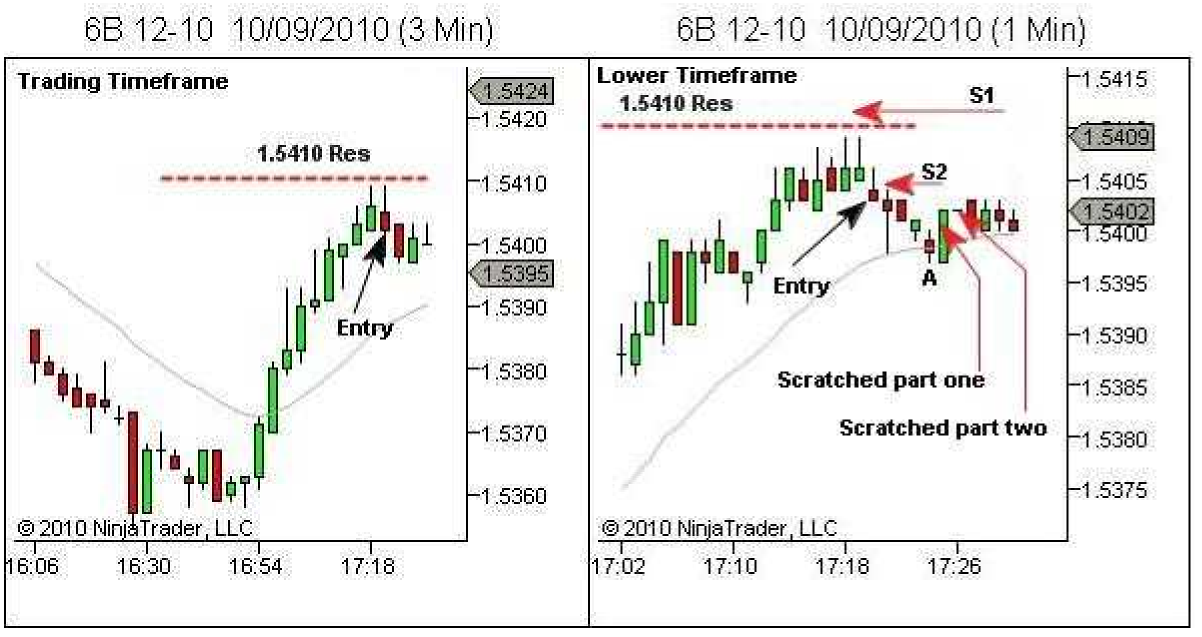

Figure 5.107 – Example 10 – Trade Scratched

Part two is held a little longer for reassessment. However I don‟t like this price action so scratch it within the next minute.

Part one scratched at 1.5401: 0 pips (less commission)
Part two scratched at 1.5403: -2 pips (less commission)

Let‟s look at the market analysis again, given the failure to push lower so far…

The original TST was treated cautiously, due to it occurring early in the session when direction has not yet been clearly defined. Testing the 1.5410 area of Asian session resistance, we expected either a quick and decisive reversal to lower prices, or a pause before continuing higher.

An entry was taken in order to profit if the first scenario occurred.

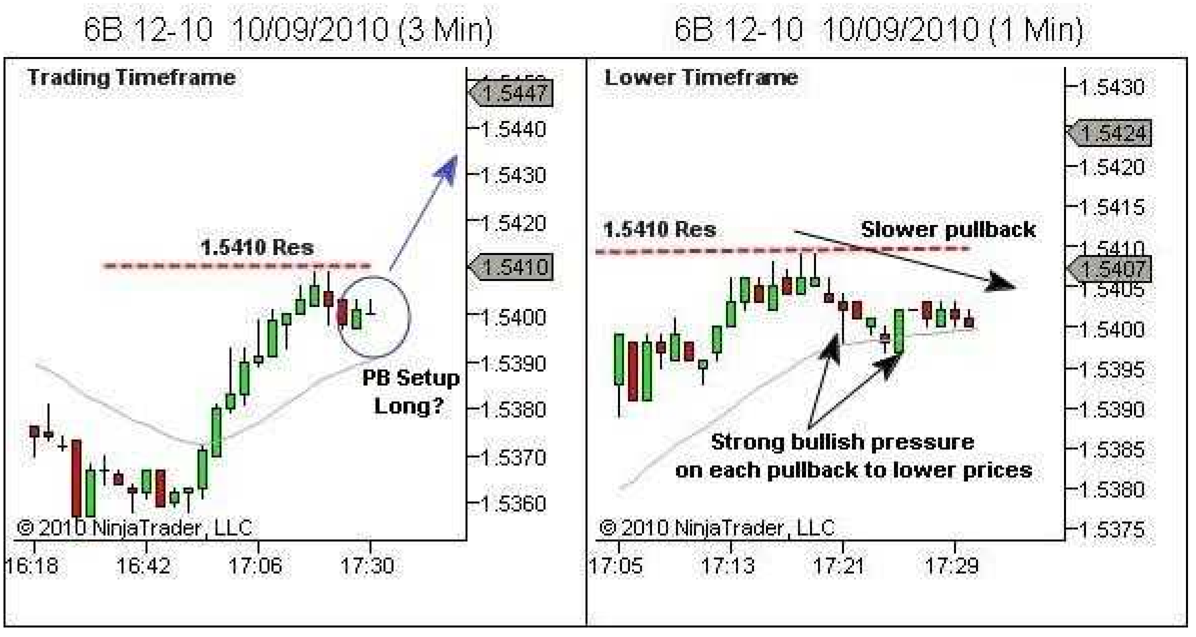

Figure 5.108 – Example 10 – Reassessment

The trade was scratched when (a) the pullback was slower than I liked, and (b) the lower timeframe action showed stronger bullish pressure entering the market whenever price reached new lows.

A failure to go down indicates stronger bullish pressure than anticipated, and a good possibility of continuation higher.

This would also offer a PB setup, which nicely demonstrates the way to enter a breakout, <u>before</u> the breakout occurs.

Should we take a PB entry long, and price does break out, I expect orderflow in this case will drive strongly to new highs. However, as always, price is watched closely following a breakout for potential breakout failure and/or breakout pullback opportunities.

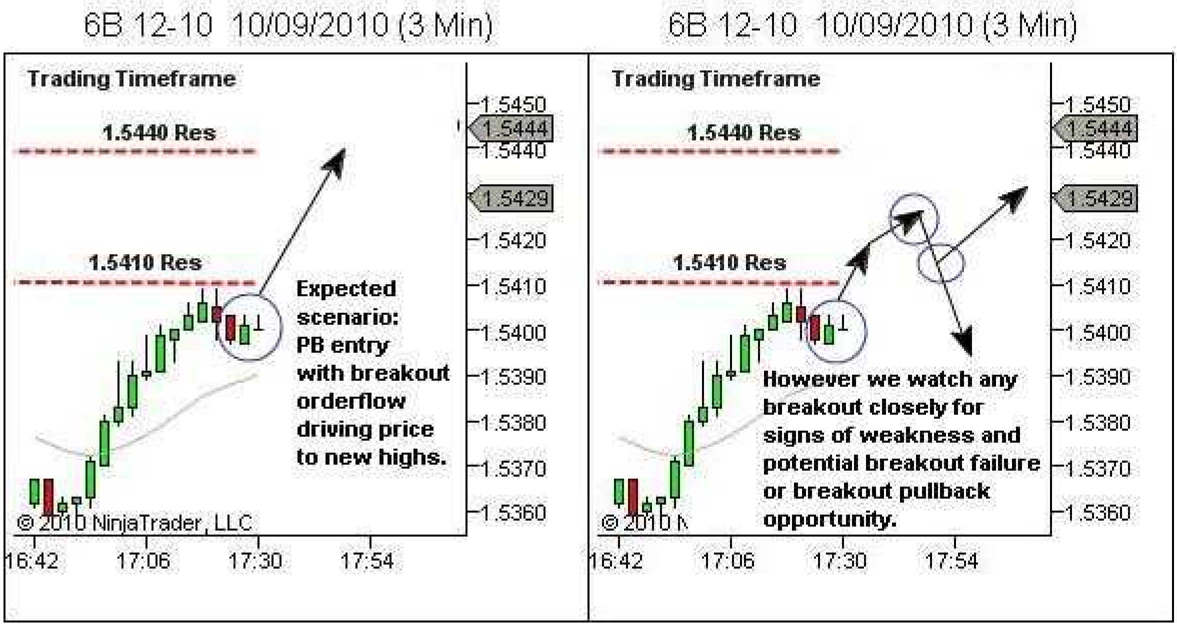

Figure 5.109 – Example 10 – Potential PB Opportunity – Entering Long Pre-Breakout

Step 1 – Trade Preparation

We now prepare for a potential PB opportunity, as shown below.

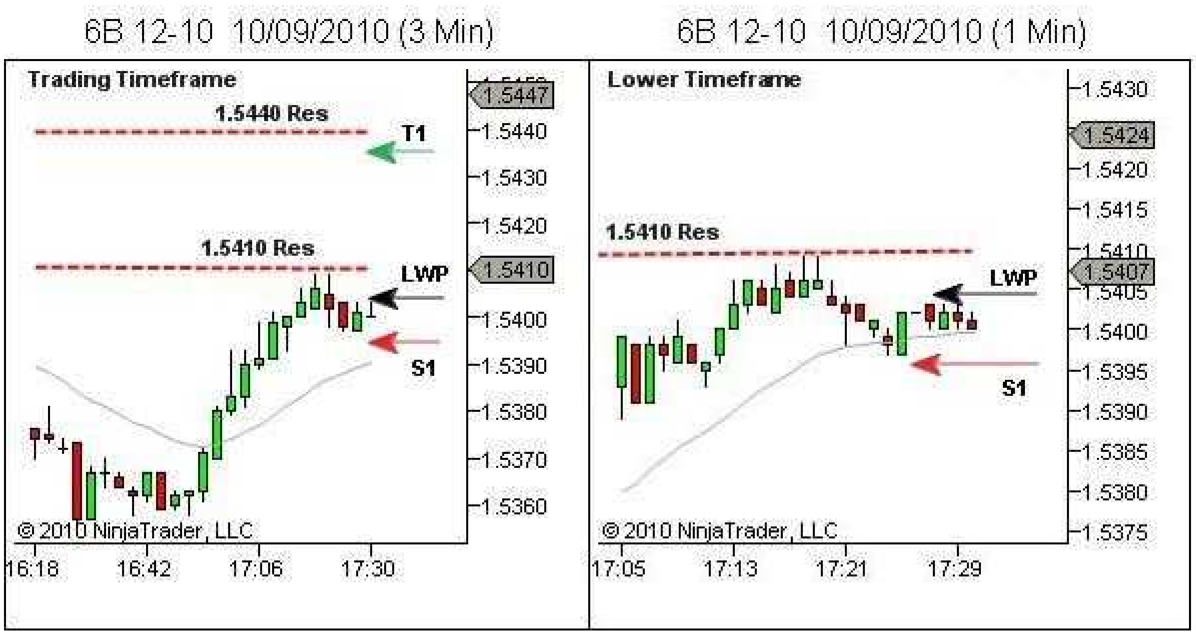

Figure 5.110 – Example 10 – Trade 2 Preparation

The stop S1 is placed below the pullback price action at 1.5396. If price hits this level then I‟ll exit and stand aside. After an attempt short and then another long, I‟ll need to step back from the market for a while and wait for clearer direction.

Target T1 is just below the 1.5440 resistance level, at 1.5435. Remember, I don‟t expect the previous 1.5410 swing high to offer much resistance – the scenario is for a pullback breaking to new highs.

T2 will be at 1.5464, just below the next resistance level (off the chart).

If price hits 1.5404, buy orders should be triggered sufficient to drive price to new highs. This will be our LWP.

A stop entry order is placed at 1.5404, and we watch for either the entry to trigger, or price to pull back further offering a lower entry (and requiring a possible reassessment of our analysis).

Step 2 – Trade Entry

Entry is triggered on the next candle.

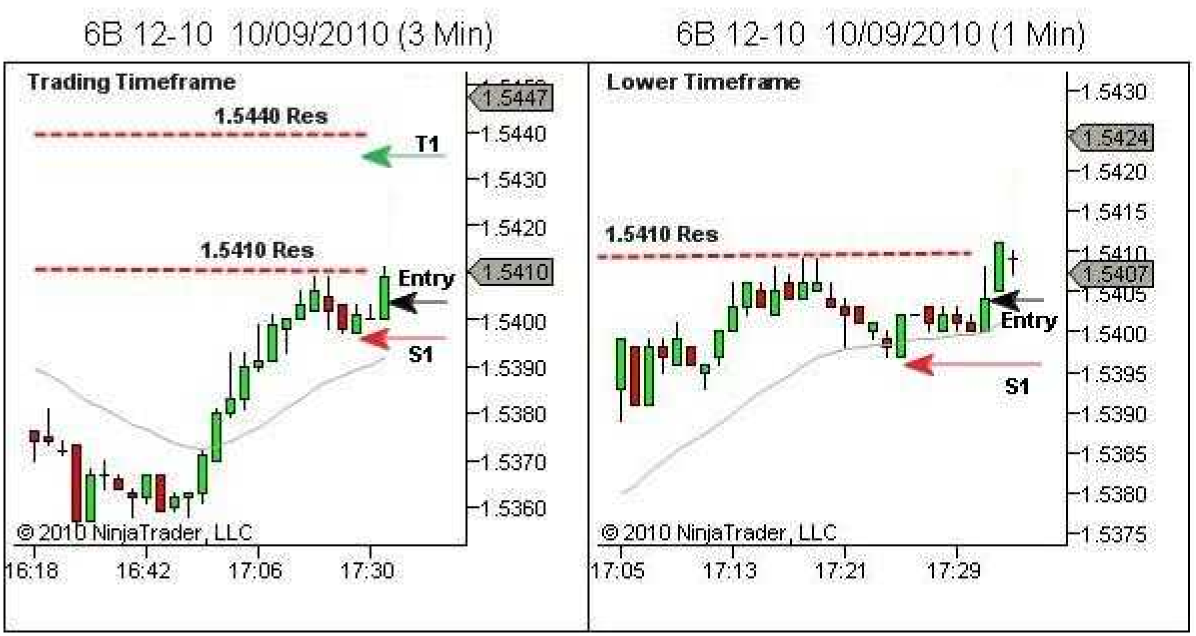

Figure 5.111 – Example 10 – Trade 2 Entry

Trade entry parameters:

Entry: 1.5404
S1: 1.5396 (risk 8 pips)
T1: 1.5435 (reward 31 pips) (4:1 R:R for part one)
T2: 1.5464 (reward 60 pips) (7:1 R:R for part two)

Step 3 – Trade Management & Exit

In figure 5.112 below, we see candle A triggering the entry, followed by candle B making the breakout to new highs.

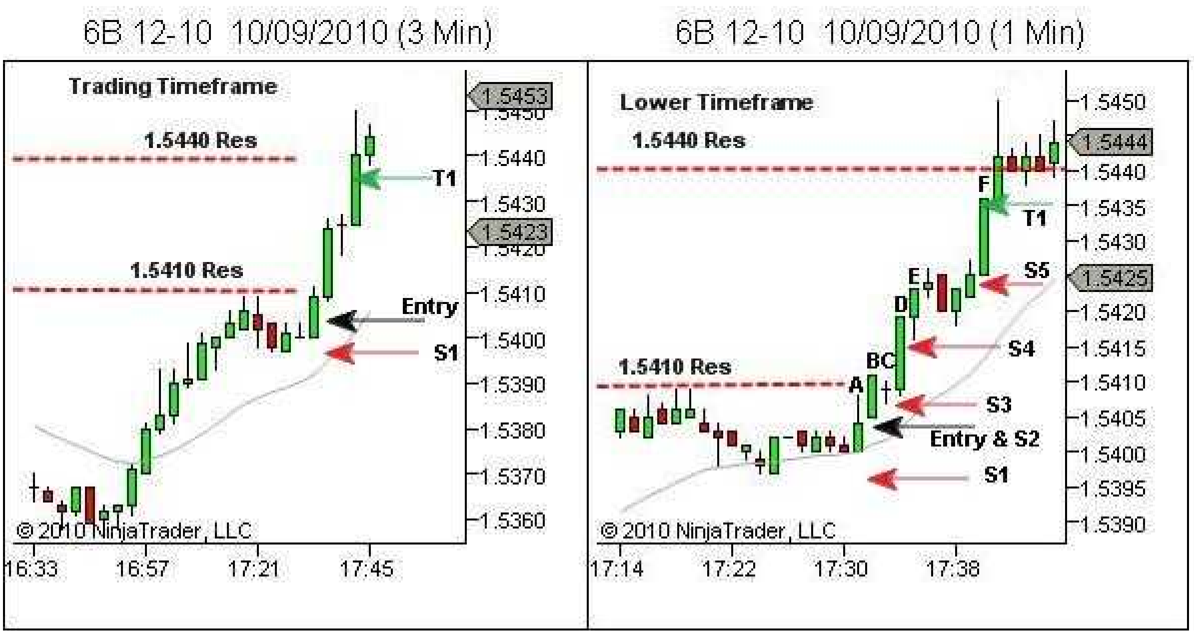

Figure 5.112 – Example 10 – Trade 2 Management & Part One Exit

Trade management involves moving the part one stop behind significant candles, in order to avoid giving back profits.

On achieving the breakout, the stop is moved to breakeven (S2).

On the close of candle D, the stop is moved to S3.

On the close of candle E, the stop is moved to S4.

And as price approaches the target in candle F, the stop is tightened up below that candle to S5. T1 is achieved for 31 pips profit on part one.

For part two, I actually moved its stop to breakeven on the close of the one minute candle D (figure 5.112). This candle confirmed the breakout. If the breakout should fail, and I remain long (failing to recognise or react to the BOF opportunity), I do not want to be in this trade below breakeven.

Trade management beyond breakeven (S2) was managed in much the same way – trailing the stop below significant candles or price action features (swing lows). Refer to figure 5.113.

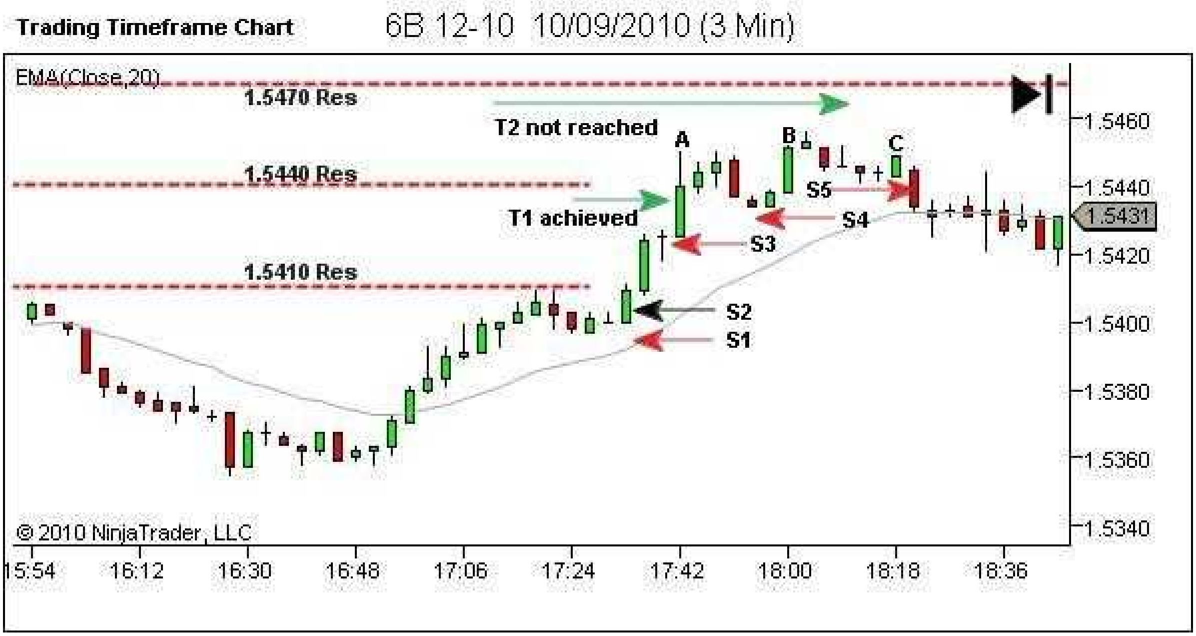

Figure 5.113 – Example 10 – Trade 2 Management & Part Two Exit

The stop was moved to S3 on close of candle A; S4 on the close of candle B and confirmation of the first pullback; and S5 on the close of candle C and confirmation of the second pullback.

As price clearly slowed through A to C, the exit was worked by moving the stop rather than pulling target T2 closer to price. This allowed control of risk while leaving the full profit potential available.

The exit was at S5, 1.5440.

Step 4 – Post-Trade

After reconfiguring our trading platform and confirming we are flat, our focus then returns to price in preparation for further setups.

When time allows, we update our trade log and record any significant observations regarding market structure or price action, our trading process and our physical and psychological state.

Results:

Trade One:

- Part one: Scratched 0 (less commission)
- Part two: Scratched -2 (less commission)

Trade Two:

- Part one: Achieved T1 +31 (less commission)
- Part two: Achieved T2 +36 (less commission)

5.11 – Trade Example Summary Notes

The previous ten sample trades have obviously not shown all possible market scenarios – I‟d love to be able to do that but it‟s just not possible.

They do however provide realistic examples of the analysis and trade process defined in chapters 3 and 4.

In writing a book such as this, the temptation naturally exists to provide example trades showing massive wins – every trade achieving T1, with T2 running to 50 or 100 pip exits. Every example would look like this…

Figure 5.114 – How Trading Systems are Usually Promoted

That‟s not reality though. Those trades are an exception, with the majority being scratched, small profit or small loss trades.

I‟ve tried to avoid temptation, and provide more realistic trade examples.

At the moment you have an understanding of the processes I use to trade – at least at a conceptual level. Real learning is yet to come. Through implementation of the Volume Four and Five processes, you‟ll develop trading competence and confidence, as you *learn to trade*, and perhaps even adapt the strategy to suit your own psychological and personality needs.

More on that in Volumes Four and Five!

A final word on the examples… as mentioned throughout, commissions are to be taken out of the results. For those not familiar with the FX Futures markets, as used in the example, these commissions will typically be less than one pip per round turn (buy/sell). If trading spot forex, this cost will not apply. However you‟ll incur potentially greater cost through the fixed spread and the requirement to buy at the ASK and sell at the BID. We‟ll discuss that more in the next chapter, *Other Markets, Other Timeframes*.

Chapter Six –
Other Markets, Other Timeframes

6.1 - Other Markets, Other Timeframes

The markets and timeframes discussed so far will not suit all traders.

Operating in the way I have presented the YTC Price Action Trader requires being present at the screen for at least half a session, if not a whole session, typically aiming for an average of around one trade per hour.

Not everyone is interested in this.

Some prefer longer timeframes. Some prefer shorter timeframes.

Likewise, not everyone will be interested in the markets that I enjoy trading (6B, YM, TF).

The good news is that the strategy can be adapted to any market and any timeframe, provided sufficient liquidity and sufficient price swing to allow profits much greater than costs.

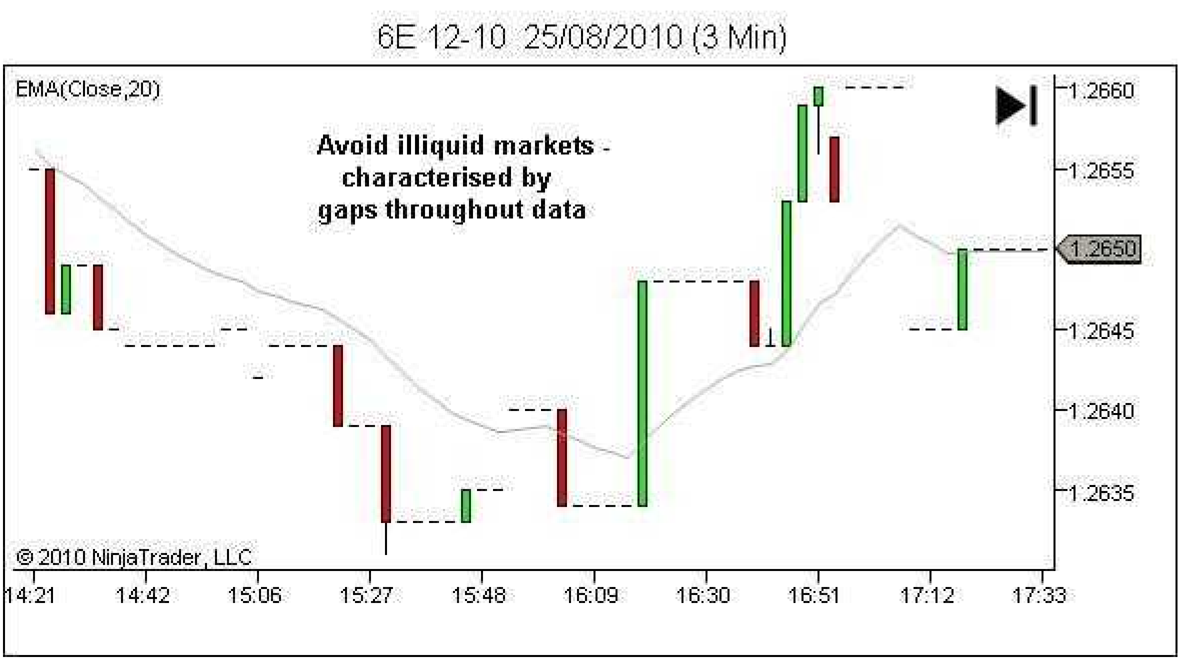

Figure 6.1 – Avoid Illiquid Markets

Avoid illiquid markets; easily spotted via charts which show many gaps throughout the data where trading has not occurred.

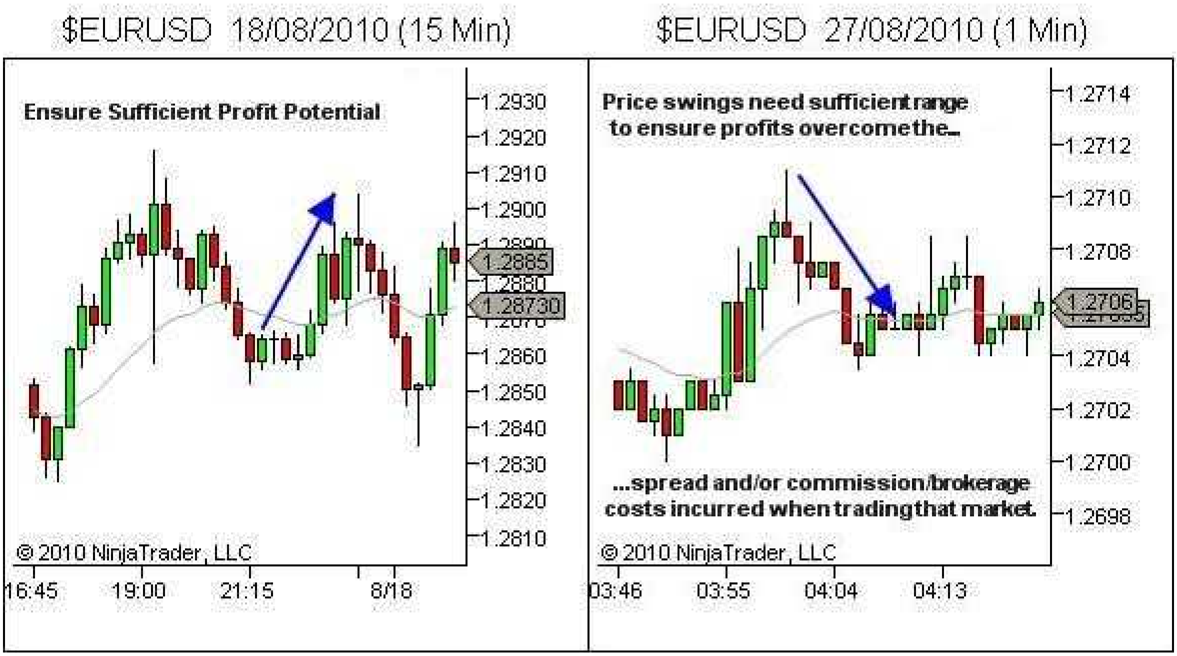

Figure 6.2 – Ensure Sufficient Profit Potential

Your *trading timeframe* chart also needs to provide sufficient profitability.

The 15 min EUR/USD chart on the left of figure 6.2 has average price swings in the vicinity of 30 pips, easily sufficient to ensure profit potential after taking the 2 pip spread into account.

The 1 min EUR/USD chart shown on the right hand side, provides average price swings of around 6 pips. With a 2 pip spread it‟ll take 2 pips of movement just to breakeven, leaving only 4 pips to achieve and take profits. This is not likely to be a long-term profitable business model.

The greater the cost of trading, the higher timeframe will be required to provide sufficient profit potential to overcome costs.

That being said, let‟s have a look at some examples of the strategy applied to forex, emini-futures and stocks.

6.2 – Examples - Forex

The examples used throughout this book have involved charts for 6B, the British Pound FX Futures market.

Given the explosion in popularity of the spot forex market over recent years, many of you will not be interested in FX Futures.

The good news though is that 6B charts are *essentially the same as* GBP/USD. This is demonstrated in the charts below, displaying 6B 3 min on the left and GBP/USD 3 min on the right (for the setup used back in Trade Example 1 of Chapter 5). Note the similarity.

Figure 6.3 - FX Futures vs Spot Forex

Every 6B example used throughout this book could have been replaced with a GBP/USD chart; accepting that the spread would have become a factor in the trade selection and trade management (more on that in a moment).

In fact, up until mid-2009 I was trading this strategy with GBP/USD, using the 60/30 min chart for higher timeframe structure, 5 min chart for trading timeframe and the 1 min chart for lower timeframe. The following chart displays the same BPB setup using the 5 and 1 min timeframes.

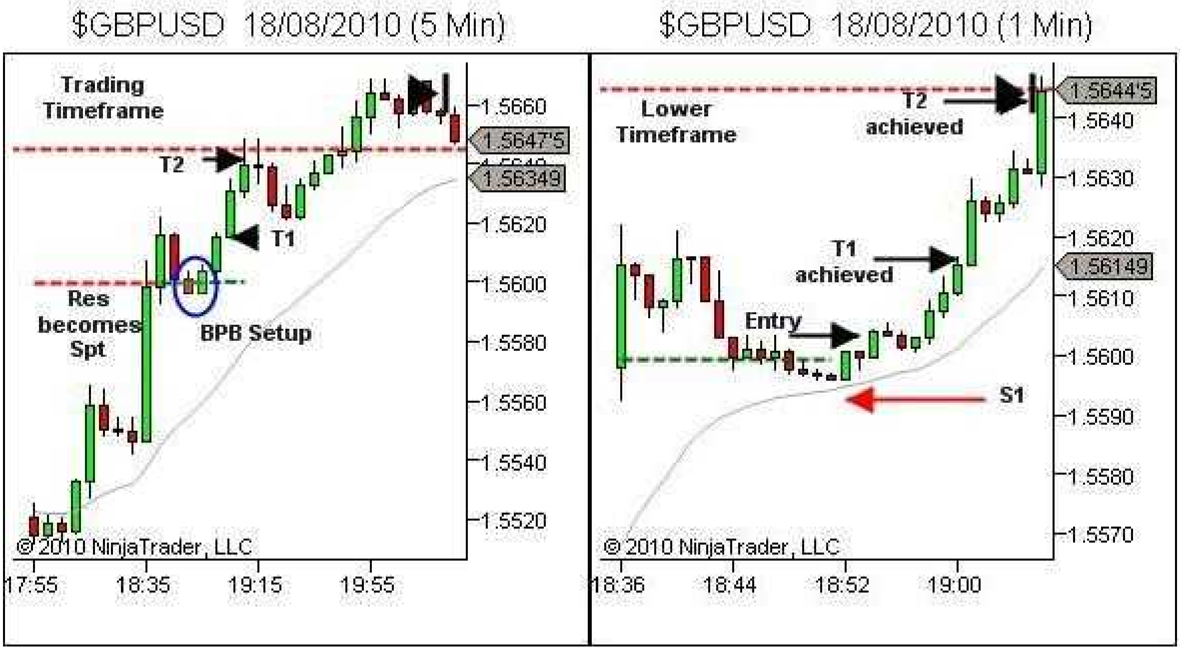

Figure 6.4 - GBP/USD – 5 & 1 Min Timeframes

Figure 6.5 below demonstrates slightly higher timeframes:

- Higher Timeframe: 60 min
- Trading Timeframe: 15 min
- Lower Timeframe: 5 min

Here we see the *trading timeframe* chart; a 15 min GBP/USD chart demonstrating five setups in the US forex session following release of the Existing Home Sales report (PB long with the trend; lower momentum TST of resistance; second PB long; second TST at resistance; and a PB short after change of trend).

Entry triggers would be taken from the 5 min timeframe.

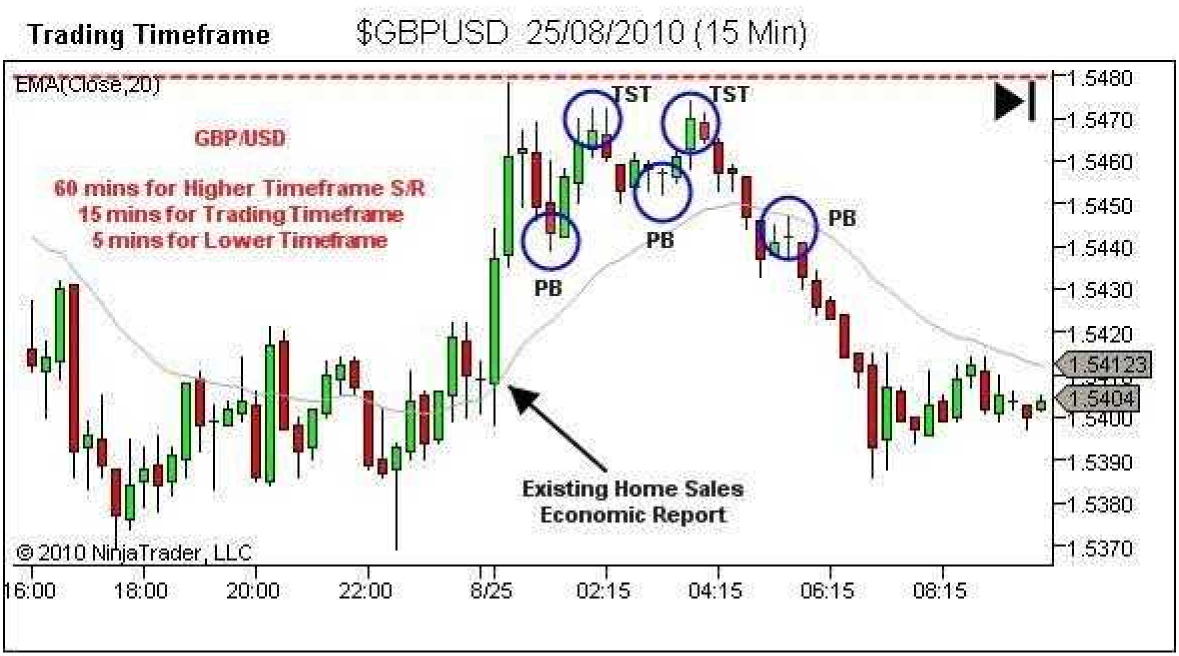

Figure 6.5 - GBP/USD – Trading Timeframe – 15 Min Chart

For those desiring larger timeframes, the following is a EUR/USD chart based on the following scenario:

- Higher Timeframe: Daily chart
- Trading Timeframe: 4 hour
- Lower Timeframe: 1 hour

The chart below demonstrates the *trading timeframe* (4 hours), showing a change to downtrend, with 3 pullback entries and one test of support.

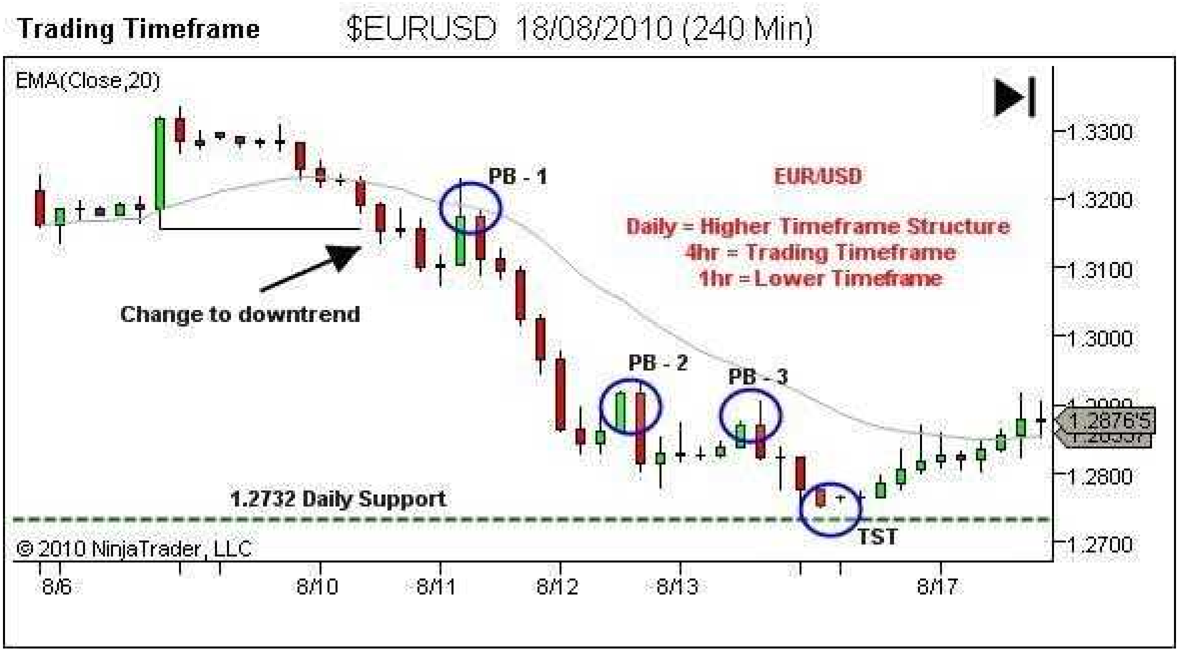

Figure 6.6 - EUR/USD –Trading Timeframe - 4 Hour Chart

As always, entry triggers are managed via the *lower timeframe*. In this case it‟s the 1 hour chart, as demonstrated in figures 6.7 and 6.8 below which reproduce our 4-hour setups PB-1, PB-2, PB-3 and TST.

Figure 6.7 - EUR/USD – Lower Timeframe - 1 Hour Chart (1 of 2)

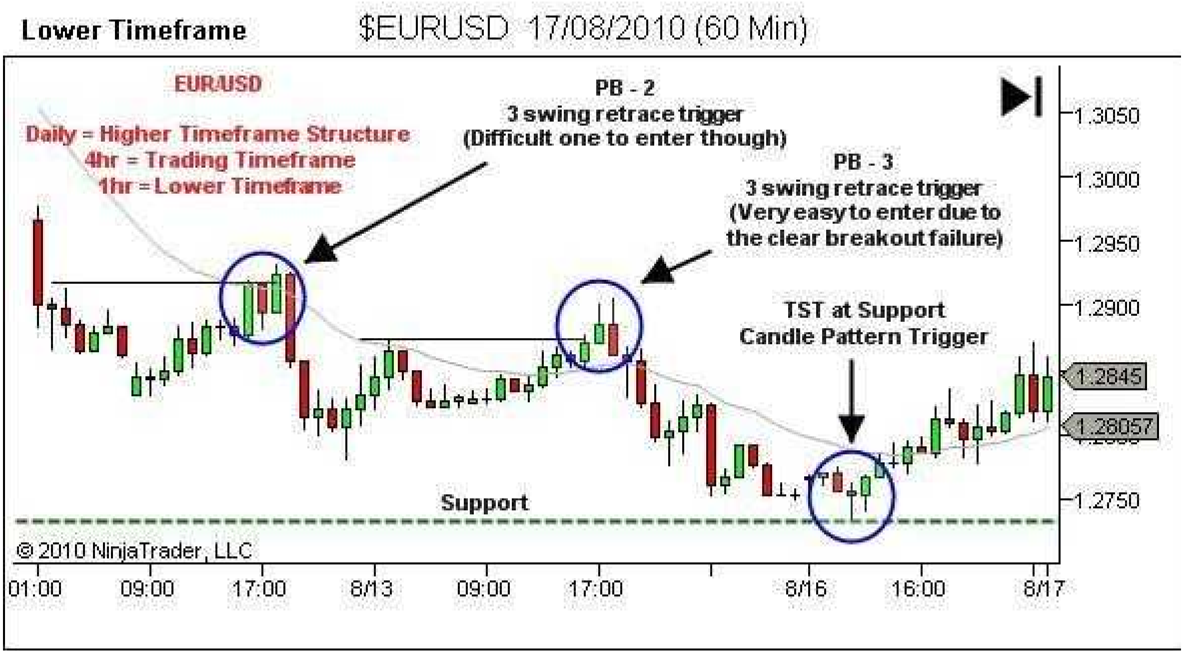

Figure 6.8 - EUR/USD – Lower Timeframe - 1 Hour Chart (2 of 2)

The following chart is based upon longer timeframes, likely suitable for those trying to fit their trading around a job.

- Higher Timeframe: Weekly chart
- Trading Timeframe: Daily chart
- Lower Timeframe: 4 hours

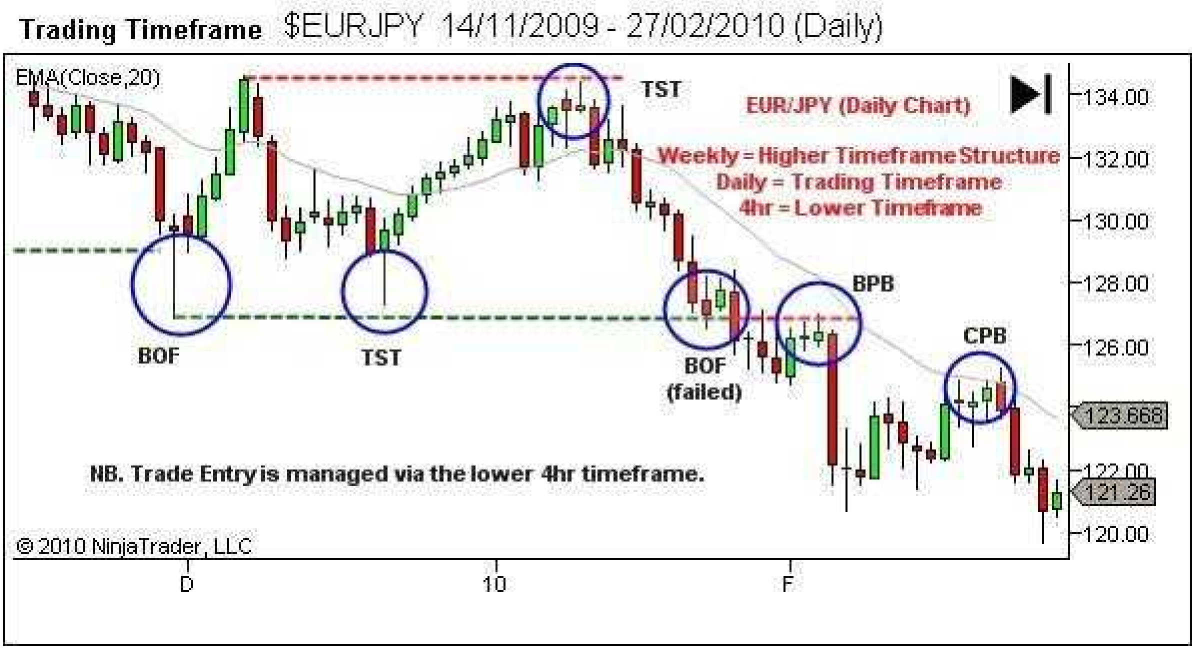

Figure 6.9 - EUR/JPY –Trading Timeframe - Daily Chart

This *trading* timeframe defines the trend and the setup areas. Entries would be timed off the 4 hour chart, assuming that suited your circumstances.

6.2.1 - Additional Forex Considerations

Spread

A further consideration for forex is the nature of the spread. Forex is widely advertised as being commission free, or having no costs. Nothing could be further from the truth. Your broker is not in the business of offering charity and helping you achieve trading success. They profit through offering retail spreads that are wider than the spreads they themselves pay.

In forex, you are limited to transacting at market prices – ie. you can only buy at the current ASK price and you can only sell at the current BID price.

This is in contrast to the FX Futures markets where you have greater flexibility through limit orders, and can (assuming filled by someone willing to take the opposite side of your trade) buy at the BID and sell at the ASK.

As such, forex traders start their trades at a disadvantage. Trading GBP/USD with a 3 pip spread for example, the market must move 3 pips before your trade gets to breakeven. Whereas that same 3 point movement in the FX Futures may have you at up to 3 points profit.

NOTE: This is not to say that FX Futures are necessarily better than Spot Forex. Each market has its advantages and disadvantages. It's beyond the scope of this book to discuss the pros and cons of each market. Carry out your own investigation in choosing your preferred market. However, in comparing FX Futures with Spot Forex, at very low timeframes, the reduced costs of FX Futures give it a clear advantage providing you can afford the larger position sizes. At higher timeframes, with greater profit potential in price swings, this fixed spread is less of a disadvantage.

In my own forex trading experience, I recommend absolutely no less than the 60/30, 5/3, 1 min timeframes in this market, and even then only for the pairs which offer a higher volatility to spread ratio. I"ve only traded GBP/USD on this short timeframe. I suspect EUR/JPY may offer sufficient movement as well (trial it if you"re interested). (NB. Maximum GBP/USD spread of 3 pips).

All other pairs (in my opinion) do not have sufficiently large price swings to overcome spread costs on these lower timeframes. Higher timeframes will be required.

Which timeframes you choose will largely depend on your own personal circumstances and lifestyle. Higher timeframe examples have been shown in figures 6.5 to 6.9 above.

NOTE: This is also applicable to CFD traders, who also incur a fixed spread with the requirement to buy at the ASK and sell at the BID.

Number of Pairs to Trade

Your selection of timeframe will also impact the number of currency pairs you can trade.

I personally find that using the timeframes in this book (30/3/1) I can only focus on one instrument at a time. Others might be able to manage two. I would suggest no more than this, otherwise your focus will be spread too thin leading to potential lost opportunity and frustration.

You may of course wish to monitor a larger basket of currency pairs. Then select the one or two that you‟ll monitor during the current session, based upon some selection criteria which indicates a higher likelihood of your preferred environment (trending or ranging). The key point is though, that you only monitor one to two (maximum) during the session hours.

Higher timeframe traders, on the other hand, will have sufficient time to monitor a larger number of currency pairs.

Forex traders have only a small universe of available instruments, so may choose to limit their exposure to a basket comprising the majors and other higher liquidity pairs, such as GBP/USD, EUR/USD, USD/JPY, USD/CHF, AUD/USD, USD/CAD, GBP/JPY, EUR/JPY.

Session Opening

You‟ll need to consider how you manage session openings, when trading forex at major session open times (UK forex open, US forex open, Asian forex open).

The opening of a session can involve an increase in trading volume and potential change of sentiment and market direction.

I obviously have an assessment of trend, strength and weakness, and *future* trend direction, from the pre-session data. However I will be prepared to adjust my *future trend* premise, by treating session opens as if they were an S/R area that had just been broken.

Just like watching a broken S/R area for signs of strength or weakness, to give us a feel for a potential breakout failure and change of direction, or breakout pullback and continuation, I‟m watching the initial few minutes of *new session* data to identify signs of strength and weakness. Future trend direction is likely to be in the direction of strength and against the direction of weakness.

Don‟t be in a hurry to trade though, until you have clearly established your bias for *future trend* direction. Sometimes it‟s immediately obvious. Other times the market can take a while for market sentiment to become clear.

News / Economic Releases

Lower timeframe forex markets are particularly susceptible to high volatility at times of regular news (economic) releases.

My current source of economic news events is listed on my Resources Page, http://www.yourtradingcoach.com/Trading-Resources.html, under the heading, Business Management.

You MUST be aware of the timings for release of these news events.

- My aim is to not initiate any trade just prior to a news release which is likely to move price (high or medium volatility), unless it‟s expected that the trade should be complete or showing significant profit, by the time the release occurs.

- If I have an open trade at the time of a regular news release, I will either close it out prior or tighten stops, as determined by my analysis.

Your number one priority is always risk management. These news releases pose significant risk if you‟re not aware of their timings.

6.3 – Examples – Emini Futures

The following charts demonstrate application of the YTC Price Action Trader strategy on various emini-futures charts, on a number of short daytrading timeframes.

First up, in figures 6.10 and 6.11 we see two examples of YM 3 min charts. This is the *trading timeframe*, based upon the same timeframes used throughout this book:

- Higher Timeframe: 30 min
- Trading Timeframe: 3 min
- Lower Timeframe: 1 min

Figure 6.10 - Emini Futures – YM Trading Timeframe - 3 Min Chart

Figure 6.11 - Emini Futures – YM Trading Timeframe - 3 Min Chart

Figures 6.12 and 6.13 below demonstrate two examples of ES 5 min charts. This is the trading timeframe, based upon the following plan:

- Higher Timeframe: 30 min
- Trading Timeframe: 5 min
- Lower Timeframe: 1 min

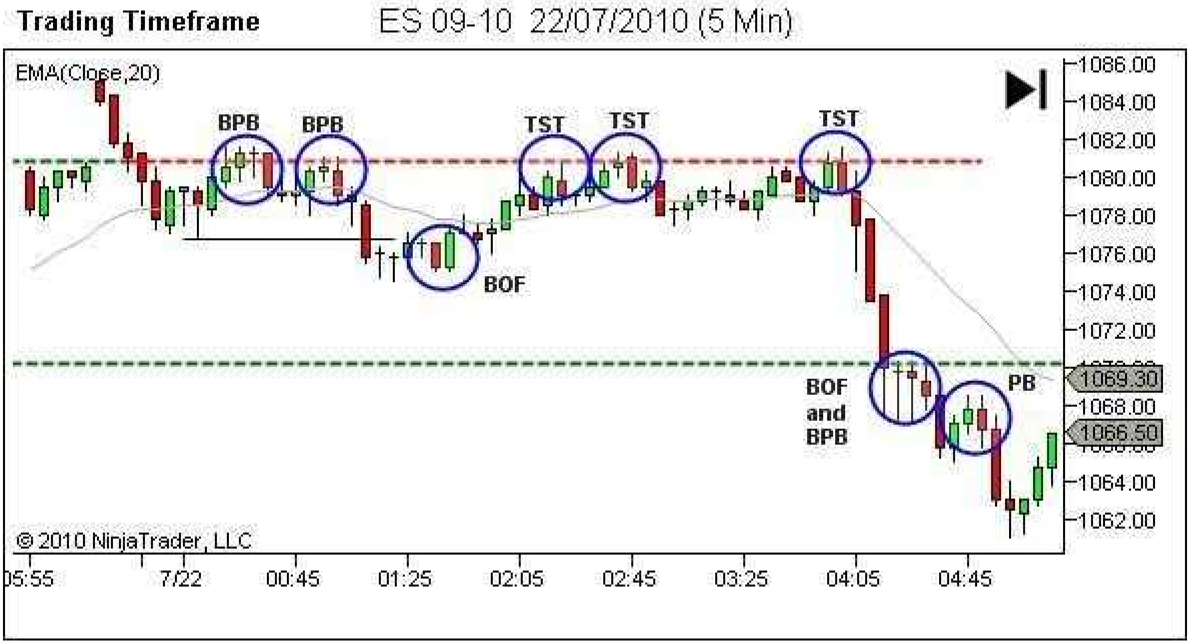

Figure 6.12 - Emini Futures – Trading Timeframe – 5 Min Chart (1 of 2)

Figure 6.13 - Emini Futures – ES Trading Timeframe – 5 Min Chart (2 of 2)

The following chart is an example on the TF (emini Russell) using the same timeframes.

Figure 6.14 - Emini Futures – TF Trading Timeframe – 5 Min Chart

For those desiring a more intense trading session though, the emini futures markets offer the ability to trade even lower timeframes.

The following charts show the TF *trading & lower timeframe* charts based upon the following selection of timeframes:

- Higher Timeframe: 5 min
- Trading Timeframe: 1 min
- Lower Timeframe: 20 tick

Note that the *lower timeframe* chart shows the BOF and BPB setups from the *trading timeframe*.

(The YTC Scalper supplementary ebook will outline additional considerations for trading at these lower timeframes, if this is something of interest to you.)

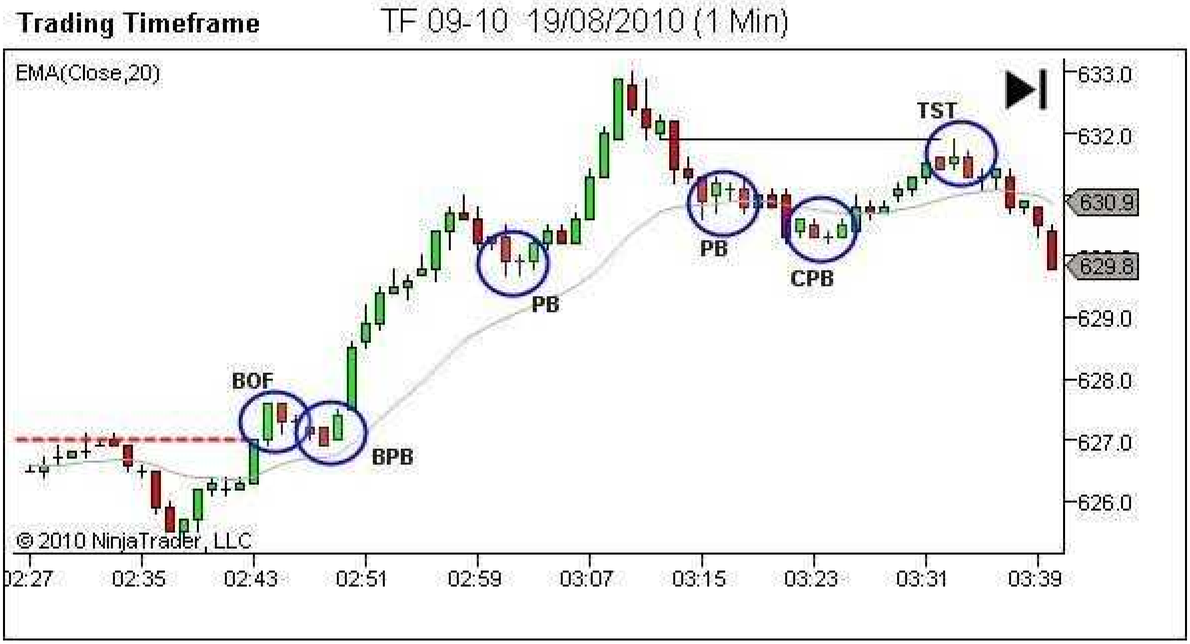

Figure 6.15 - Emini Futures – TF Trading Timeframe – 1 Min Chart

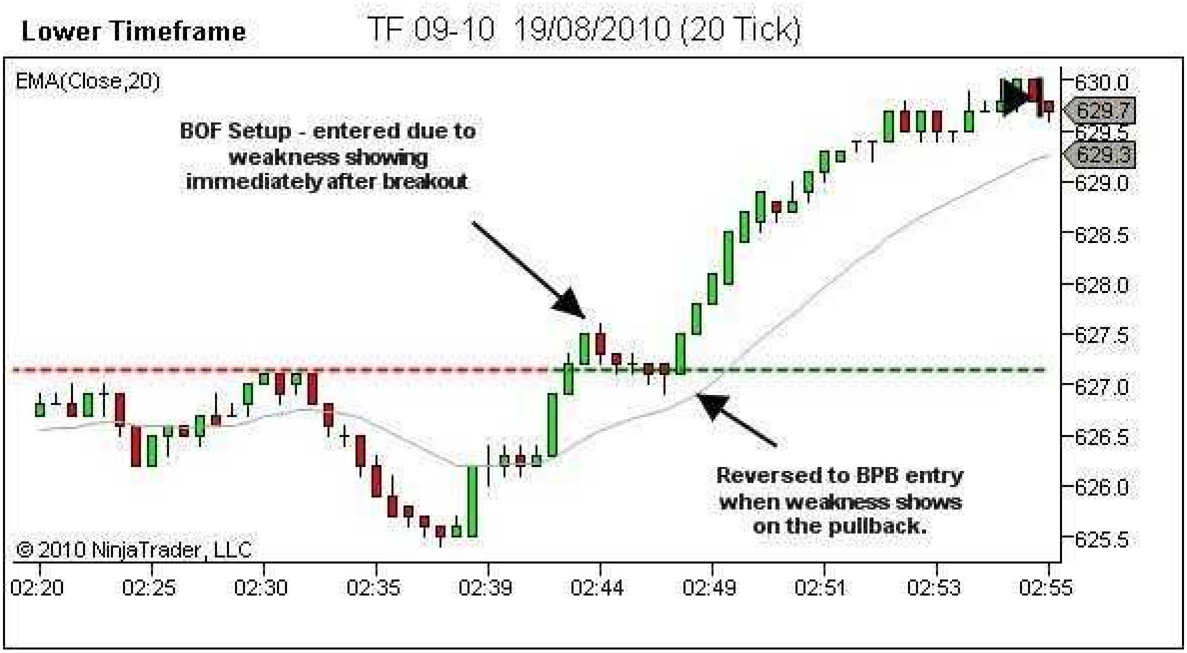

Figure 6.16 - Emini Futures – TF Lower Timeframe – 20 Tick Chart (showing BOF/BPB setups from figure 6.15)

6.3.1 - Additional Emini Futures Considerations

Session Opens

Like forex, you‟ll need to consider how you manage session openings.

I make my initial assessment of trend, strength and weakness, and *future* trend direction from the pre-session data. However I will be prepared to adjust my *future trend* premise, by treating the session open as if it were an S/R area that had just been broken.

Just like watching a broken S/R area for signs of strength or weakness, to give us a feel for a potential breakout failure and change of direction, or breakout pullback and continuation, I‟m watching the initial few minutes of *new session* data to identify signs of strength and weakness. Future trend direction is likely to be in the direction of strength and against the direction of weakness.

Don‟t be in a hurry to trade though, until you have clearly established your bias for *future trend* direction. Sometimes it‟s immediately obvious. Other times the market can take a while for market sentiment to become clear.

Gap Opens

If you‟re daytrading emini futures, you‟ll need to consider how to manage gap openings, and how to establish a bias from the open – do you expect price to continue in the direction of the gap, or should you be searching for opportunity to fade the gap?

You probably won‟t be surprised to find that I don‟t have fixed rules. I prefer to consider each opening on its own merits.

However, here are a few pointers for how I manage gap openings in the emini‟s:

- The market structure is based firstly off the „session only‟ chart, showing daily gaps. I then add S/R from significant overnight market data. Note that it must be a significant level or turning point.
- My pre-opening assessment of trend, strength and weakness and *future trend* direction are based upon the pre-session data.
- I then operate exactly as per any normal session open, adjusting my expectation for *future trend* direction based on my assessment of strength and weakness in the first few minutes of the trading session.

Fixed rules limit your ability to react to the current market environment. Treat each opening as unique and determine your analysis and future bias based on signs of strength and weakness.

Once again, don‟t be in a hurry to trade until you have clearly established your bias for *future trend* direction. Sometimes it‟s immediately obvious. Other times the market can take a while for market sentiment to become clear.

News / Economic Releases

As with forex, the lower timeframe emini futures markets are particularly susceptible to high volatility at times of regular news (economic) releases. While most reports are released during the overnight session, you will have some released from time to time during the US emini sessions, in particular at 10:00 ET.

Management is the same as discussed earlier in the forex section.

- My aim is to not initiate any trade just prior to a news release which is likely to move price, unless it‟s expected that the trade should be complete or showing significant profit, by the time the release occurs.

- If I have an open trade at the time of a regular news release, I will either close it out prior or tighten stops, as determined by my analysis.

Scalping

Additional considerations for scalping timeframes, as demonstrated above in figures 6.15 and 6.16, are beyond the scope of this book. If you‟re interested, they‟ll be covered in the supplement to this book, YTC Scalper.

Amongst the topics covered will be:

- Market selection
- Optimum trading times
- Abbreviated Analysis
- Market Internals
- Execution
- Missed entry
- And the many, many psychological problems encountered when decision time is limited.

6.4 – Example – Stocks & ETFs

With my usual trading platform not having an equities datafeed, we now feature charts courtesy of www.thinkorswim.com.

The first example is based upon daily trading of the SPY ETF, using the following timeframes:

- Higher Timeframe: Weekly
- Trading Timeframe: Daily
- Lower Timeframe: 1 hour

Market structure is taken from the weekly chart, as shown below. Note the circled areas, where price interacts with the S/R levels, which will be featured in the *trading timeframe* daily chart on the next page.

Figure 6.17 - SPY – Higher Timeframe - Weekly Chart

Figure 6.18 - SPY – Trading Timeframe - Daily Chart

The following example demonstrates WDC, traded via the same daily timeframe. Once again, lower timeframe triggers would be based off an intraday 1-hour chart, if your lifestyle allowed.

Figure 6.19 - WDC – Trading Timeframe - Daily Chart

The strategy is also applicable to daytrading of both stocks and ETFs.

The following three examples demonstrate *trading timeframe* charts for SPY, SBUX and OSX, using the following plan:

- Higher Timeframe: 1 hour
- Trading Timeframe: 5 min
- Lower Timeframe: 1 min

Figure 6.20 - SPY – Trading Timeframe – 5 Min Chart

Figure 6.21 - SBUX – Trading Timeframe – 5 Min Chart

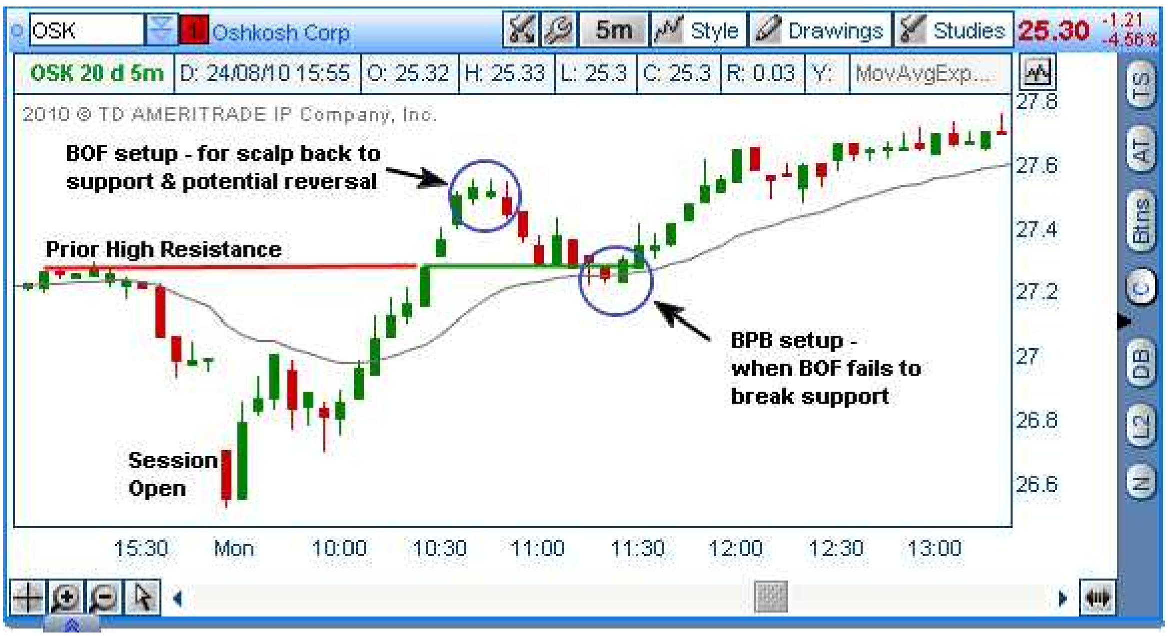

Figure 6.22 - OSX – Trading Timeframe – 5 Min Chart

6.4.1 - Additional Stock & ETF Considerations

Gap Opens

Like emini futures, you"ll need to consider how to manage gap openings and how to establish a bias from the open – do you expect price to continue in the direction of the gap, or should you be searching for opportunity to fade the gap?

As discussed earlier, I am hesitant to apply fixed rules to gaps, preferring to hold off on trading until I have clearly established a bias for *future trend* direction. Sometimes it"s immediately obvious. Other times the market can take a while for market sentiment to become clear. Don"t be in too much of a hurry.

The opening candles are monitored closely on the *lower timeframe* in order to identify signs of strength and weakness, and to therefore identify the likely future direction of price movement.

Trading Multiple Stocks & ETFs

As discussed in the Additional Forex Considerations, the greater the traded timeframe, the more opportunity we have to monitor additional instruments.

Unlike forex traders though, who are limited to a small universe of available currency pairs, stock traders have a much greater number of stocks from which to find their trade opportunities. You"ll need to develop your own way of narrowing this down to a smaller basket of preferred stocks.

Having not traded stocks for many years it would be wrong of me to tell you how to do it. The fact is there is no right or wrong way to do this and you need to find your own way. There is a significant amount of information on the internet.

Remember though, opportunity comes through price movement. So, as an example, you may wish to conduct a market scan to find trending stocks that meet minimum volume requirements. Then visually narrow the selections down to a list of the best 20-30 which show smooth trending price action. This 20-30 will be your daily watchlist. Update the list each weekend, discarding those that no longer meet your requirements, or replacing the worst with better ones as they become available.

You may also wish to just outsource this whole process, choosing simply to trade based upon a basket of stocks selected by a favourite website (such as the Most Active lists at www.investors.com, www.stocktwits.com or www.bigmovingstock.com).

A further factor with multiple stocks on larger timeframes is the fact that you will likely have multiple positions on at once. You‟ll need to consider this from a money management perspective – how much total exposure will you allow at any one time. We‟ll consider this in a little more detail in Volume Four when we discuss risk and money management.

News Events

Like forex or emini-futures, stock trading will incur risk during the release of economic reports or news events related to that particular stock, sector or market. It‟s beyond the scope of this book to identify sources of fundamental news and events for stock trading. If you choose to trade the equities market, ensure you conduct research in order to identify the relevant fundamental events and to manage the risk appropriately.

6.5 - Conclusion

The YTC Price Action Trader strategy is applicable in any liquid market and timeframe.

Examples have been shown, applying the strategy to forex, emini-futures and stock/ETFs, in everything from the 1 min to daily *trading timeframes*.

We have also discussed additional considerations that apply uniquely to these markets.

This ends our discussion of strategy.

Volume Four will discuss the business aspects of trading and our documentation of a trading plan and procedures manual. Volume Five will then continue with a discussion of the process that must be undertaken in order to maximise learning (and therefore maximise the likelihood of you achieving consistent profitability).

PLEASE NOTE: The markets and timeframes chosen for your application of the YTC Price Action Trader strategy, should be determined by your own testing (largely trial and error) in order to best match your lifestyle requirements and your trading personality and psychology.

The combinations I'm showing here are not recommendations; rather they are demonstrations of the fact that these setups exist on all timeframes.

VOLUME FOUR

YOUR TRADING BUSINESS

Chapter Seven – Money Management

7.1 – Ensuring Survival

The highest priority for your business must always be to ensure survival; through both your initial learning period and then throughout your ongoing career.

The only way to fail is to either quit or be forced to quit through loss of funds. Survival must therefore include two elements:

- Financial Survival – preventing drawdown of our account balance to a point which forces us to stop.

- Personal Survival – maintaining the passion for trading, and motivation to continue for as long as necessary.

This chapter and the next will address financial survival. Personal survival will be addressed in chapter 10 when we discuss the psychology of trading.

7.2 - Financial Survival

Financial survival is essential, although not just because of the money. After all, money can be regained from other sources. Financial survival is essential because of the impact loss of funds will have on our psychology. Typically we become very risk averse after having taken a large hit to our finances and our ego. This will make it increasingly difficult to be psychologically capable of effectively trading the markets, in order to recover the losses and move to new equity highs.

We‟ll aim to ensure financial survival through our money management plan (the remainder of chapter 7) and our contingency management plan (chapter 8).

7.3 – Money Management

To develop our money management plan, we‟ll look at financial survival from a risk management perspective. What are the risks as a result of trading?

1) Individual Trade Risk - a single trade loss which takes our account to levels which force us to quit.

2) Session Drawdown Risk – a single trading session which takes our account to levels which force us to quit.

3) Business Drawdown Risk - a sequence of trade losses over a longer timeframe resulting in drawdown to levels which force us to quit.

4) Increased Size Risk – an inability to psychologically manage the increased size as our account balance grows, leading to excessive drawdown.

5) Insufficient Income Risk - an inability to maintain lifestyle through lack of income, forcing withdrawal of account funds and our inability to continue trading.

These risks are managed through clearly defined controls within our trading plan.

The following is an example trading plan inclusion. Explanatory notes will follow. As always, feel free to adjust as you see fit (recognising that increased risk increases the likelihood of failure to survive the learning curve).

You"ll note that my recommended levels of risk are VERY conservative. The focus in this plan is not on capital growth, but rather on capital preservation during the learning phase. As such, we aim to ensure a low percentage risk at all times.

Once consistently profitable, if you wish to increase risk in search of higher gains then by all means increase the percentages, or do some further research on alternate money management strategies. Do so at your own risk though. The focus (in my opinion) should always be more on capital preservation than on growth.

Individual Trade Risk:

- Position sizing is to be such that maximum risk per trade is to not exceed 1% of account equity.

Trading Session Money Management

- Daily timeout is to occur at 2% drawdown from session highs
- Daily stop is to occur at 3% drawdown from session highs

- Percentage figures are calculated on the weekend as dollar amounts, based on the equity balance as at last week‟s close.

Business Money Management

- I will stop trading at 20% drawdown.

- I will take this trading halt as an opportunity to review my trading plan, review my trading performance with the benefit of hindsight, and return to a simulation platform until (a) consistent profitability is again proven in that environment, and (b) the account balance has been replenished via other sources.

A Graduated Approach to Increasing Size

- All increases in number of contracts will be (a) preceded by a profitable month at the previous position size; (b) only initiated when our equity balance allows the increase while still maintaining our individual trade risk of 1%; and (c) proven in a sim environment through demonstration of a profitable week of trading.

- If a session stop is hit, I will consider the need for a return to the previous size and/or sim environment. If two session stops are hit, with no intermediate equity high, I must return to the previous size.

Income to Maintain Lifestyle

- I am not in a financial position to allow full-time trading, however my work has accepted a reduction to a 20 hour per week part-time position. This, plus my wife‟s income, is sufficient to cover our expenses and maintain our current lifestyle.

- I will not transition to full-time until my trading has developed to a level which can regularly provide the equivalent of twice my working income, in order to allow for capital growth and income needs.

- This structure allows me to daytrade the forex markets from the 0800 GMT UK session open for a period of 3 hours, before attending work. In the evening I will allocate 1 hour for review.

Figure 7.1 - Example Trading Plan Inclusion – Money Management

Explanatory Notes:

Individual Trade Risk

- Treatments must be applied to our trading plan to ensure that no single loss can threaten the survival of our trading business.

- Individual trade risk will be managed through the use of stop-loss orders and position sizing, such that **individual trade risk will not exceed 1% of equity**.

- Most educators recommend varying levels between 1% and 5%, with the majority recommending 2%. I recommend 1% maximum. 2% is too great in my opinion during the learning process. If you have five full-size losses in a row, which will happen while learning, you‟ve lost 10% of your account. In my experience, this is too great a loss over too short a period of time for new traders, who still have not developed trust in their strategy or themselves.

- Experiment with greater risk if you wish, AFTER having proven consistent profitability. For now, individual trade risk must be no greater than 1% of equity.

- Note: When trading in two part positions, the maximum risk per part must therefore be 0.5% of equity.

- Under no circumstances will you allow a trade to continue past its stop loss point. Price hitting your stop means that either your trade idea was wrong or your timing was wrong. Either way, you need to be out in order to contain any risk.

- *One final word of warning! Please note that limiting risk through the use of stop losses does not guarantee the risk is limited to that amount. In most markets a stop loss order when triggered generates a market order designed to exit you from your position. As the intraday Flash Crash of May 6th, 2010 showed, in conditions of extreme market panic there may not be any orders taking the opposite side of your market order. Significant slippage can occur. A lot of traders lost a lot of money on that day. Be familiar with exactly how your broker executes and manages their orders. And accept that there will always be risk in the markets. Hence the often provided disclaimer that you should only ever trade with money you can afford to entirely lose. That being said, the 1% individual trade risk will provide a significant buffer of safety should you find yourself positioned against one of these extremely rare market events.*

Session Money Management

- Treatments must be applied to our trading plan to ensure that no one trading session drawdown can threaten the survival of our trading business.

  While our 1% maximum individual trade risk will assist here in slowing any rate of drawdown, our session survival can still be threatened through poor personal management. Such examples would include overtrading or revenge trading; desperately continuing to trade when in drawdown in order to salvage something out of the session. This will rarely ever work. Quite likely the initial drawdown is a result of poor market read or negative psychological influences. Our attempts to recover the session will be even further impacted by worse market read and psychological influences, as our perceptual abilities and decision making are impaired through fear of loss.

- **I recommend implementing a „timeout‟ at 2% session drawdown.**

  This is fairly small amount, but two full-size losses are a warning that perhaps you‟re not in sync with the market, or there are some external or internal distracters impacting your ability to execute your plan. Take a short break; then review the session so far. Continue only if you can confirm that the trades were appropriately selected, entered and managed in accordance with your plan; or if you identify errors and correct them.

  Note that 2% drawdown does not just mean two stop-outs. With an active trade management process, many stops will occur with reduced loss. It may take you 2, 3, 4, 5 or even more trades to hit a 2% session drawdown.

- **I recommend implementing a 3% session drawdown compulsory stop.**

  Something is not right. Walk away. Review at a later time. Capital has been saved to allow you to continue next session.

  The figures for 2% session timeout and 3% session stop are of course just recommended. I acknowledge however that they are very tight. You may be comfortable with more risk and may wish to increase these limits. I‟d recommend waiting till consistent profitability is proven first. Please though, not more than 3% session timeout and 5% session stop. Take some time out to reassess and start fresh next session.

- Your session P&L must operate with a session trailing stop.

  Do not get off to a great start in this session and then give back all your profits as you trade your way back down to your maximum session stop. Like we do with individual trades, we will implement a session trailing stop.

I recommend the same parameters we use for initial stops. Trail your session timeout 2% below equity highs. Trail your session stop 3% below equity highs.

- An additional session money management feature which I don‟t use, but which you may wish to consider, is the use of a session target. Is there a dollar or percentage value that you would be happy to pack up and take all profits, rewarding yourself with a break before the next session?

- Rather than calculate new percentage amounts each session, I recommend using fixed-dollar amounts for your trade risk and money management parameters. Each weekend, take the current equity balance, and calculate dollar or point values for your maximum trade risk (1%), the session timeout (2%) and session stop (3%).

- Let‟s look at an example:

  - Equity Balance $20,000

  - Individual trade risk: $200 (1%) (NB. Trading two parts will require max $100 risk per part)

  - Trading session timeout: Initial timeout at $400 (2%), trailing $400 below session equity highs

  - Trading session stop: Initial stop $600 (3%), trailing $600 below intra-session equity highs

Business Money Management

- Treatments must be applied to our trading plan to ensure that we stop trading at a certain level of drawdown and halt any further erosion of our equity balance.

- **I recommend a stop at 20% drawdown.** At this point, something is not going right. If you want more, then at the absolute most do not go beyond 30% drawdown. Beyond this it becomes more difficult to regain the losses.

- Take some time out to again study this document. Review your trading performance with the benefit of hindsight and return to simulation trading, until consistent profitability is again proven.

- New traders, with small account balances, should use this time out of the markets to replenish their account from other income sources, and should not start trading live again until the account balance is back to its original level.

A Graduated Approach to Increasing Size

- Size can only be increased as allowed by our percentage risk rule.

- As the number of contracts traded increases, you will reach levels beyond which the dollar risk is psychologically more and more difficult to accept. This will act as a source of fear to impact upon your trading results.

- We will therefore implement a graduated approach to increasing size.

- Success at the current size must be proven via at least one month of profitable trading.

- **All size increases must be proven in a simulation environment first.** My preference is to see a profitable week, before returning to the live environment. This may be done via market replay out of hours, in order to speed up the process.

- If a session stop is hit while live trading, you should consider the need to return to the previous size and/or the sim environment. If two session stops are hit, with no intermediate equity high, then you must return to the previous size.

Income to Maintain Lifestyle

- The timeframe to consistent profitability is unknown; varying for each individual. So our financial survival plan needs to be able to last as long as is necessary for us to achieve this goal.

- Too many books offer the suggestion of saving sufficient funds to allow you to survive for at least 12 months of live trading. This implies that 12 months will be sufficient time to achieve profitability. Rubbish. What if it takes you 13 months? What if it takes you 2 years?

- A better plan is to ensure financial survival for as long as is necessary to achieve your end goal.

- Until you have achieved consistent profitability, any funds withdrawn from your trading account to fund lifestyle expenses place your trading business at risk.

- A wiser plan is to therefore structure yourself such that you do not require any trading profits for lifestyle.

- If sufficient alternate income streams are currently available, such as through your spouse‟s income and investment or business income, then you are free to trade full-time while developing your skills.

- If sufficient alternate income streams are not available, and trading has not yet developed to a level of consistent profitability such that profits allow both capital growth and withdrawal, then you cannot yet trade full-time. It may not seem fair, but the reality is what it is. You need to:

    - Continue working in order to support your family and lifestyle.

    - Identify means of developing as a trader, around your work and life. While this is easier said than done, it can be achieved. Consider options to limit your trading time to a maximum of 2-3 hours per day, such as via longer timeframes (eg. daily charts), or daytrading only the opening session of a currency pair (eg. UK open, or US open) or the open of your favourite emini futures contract. With markets open 24 hours a day, there will be something available at a time to suit you.

The YTC Scalper supplementary ebook may be of interest to you, as it outlines my approach to trading the emini futures, for 1-2 hours per day.

Additional Considerations – Higher Timeframe / Multiple Markets

Higher timeframe traders will usually have multiple positions open at one time. This incurs an additional risk not faced by short timeframe daytraders such as myself – multiple position risk; an unexpected news event or market shock which stops out all positions at once.

- **Multiple position exposure must be limited to no more than 3%.**

- This does not necessarily mean you limit your portfolio to only three positions. You may wish to risk six positions at 0.5% risk per trade. Alternatively you may be willing to add additional positions as current positions move their stop to breakeven or beyond, accepting that there is no longer an account drawdown risk with these trades.

- In addition, take care to ensure that multiple positions are not in highly-correlated markets. A long position in GBP/USD and a long position in EUR/USD, both risking 1%, is really one trade short the USD with a risk of 2%, due to the (generally) high correlation of these pairs. A trade short the YM and short the ES, both risking 1%, is often a single trade short the US index futures with a risk of 2%, due to the high correlation of these markets.

- Unless you actively monitor market correlations and identify suitable conditions for these trades, it‟s best to just avoid highly correlated markets.

An additional consideration is the need to redefine the term “session”. In previous discussion, session timeout and stop limits related to my own daytrading, referring to one trading period, or one day.

For longer timeframe traders this won‟t be applicable, as your trades will often extend greater than one day. Redefine a trading session to whatever is applicable to your circumstances.

For example, you may wish to define timeout and stop criteria per week.

Money Management – Wrap Up

Some final points to wrap up money management…

There‟s a great difference between the session stop level of 3% and the business stop level of 20%. Some of you may wish to implement an intermediate level, such as a Weekly or Monthly percentages for timeout and stop. I don‟t, as I‟m typically aware of the fact that something is wrong and am able to conduct a review anyway, despite not mandating any stop levels. However it may be something you wish to consider.

And most importantly… I know some of you will not have sufficient funds to trade with a maximum of 1% risk. If that‟s the case, then rather than accepting additional risk, I recommend you continue with simulation trading only while saving additional capital, or find a market or timeframe which allows this level of risk. For example, forex traders may wish to consider mini-contracts rather than standard size contracts, or micro-contracts rather than mini-contracts.

Money management can be quite complex if you wish it to be so. My preference is to make it as simple as possible. Avoid all the mathematical models such as “Optimal f” or the “Kelly Criterion”. Stick to a simple approach.

The focus for most of you will not be capital growth, but capital preservation during the learning phase. So make it simple and make it safe. Minimise the potential for career-ending drawdown. Stick to a low percent risk model.

Once consistently profitable, if you wish to increase risk in search of higher gains then by all means do some research on alternate money management strategies. I don‟t recommend it though. For me, simplicity is always the best.

Chapter Eight – Contingency Management

8.1 – Contingency Management

There is one additional area needed to be considered, in order to ensure financial survival of your trading business. I call this Contingency Management.

Contingency Management procedures are documented within my procedures manual, and outline how I will react to ANY potential error or external threat which may impact on my trading results.

The process I use is based upon studies in Threat & Error Management (TEM). If interested, more information on TEM can be found in the article, *"Minimizing Trading Risk through Proactive Threat and Error Management"*, at the following link:

- http://www.yourtradingcoach.com/Published-Articles.html

The following will provide <u>examples</u> of Contingency Management procedures. Feel free to adapt as required for your own business. The process for developing your own procedures is quite straightforward:

1) Identify potential errors and threats
2) Document a treatment which acts to either avoid the error or threat, or minimise risk should it eventuate.

8.1.1 - Contingency Management Procedures

- Evidence of Illness, Stress or Negativity Impacting Trading Decisions
- External Distraction
- Incorrect Order Entry or Incorrect Fill
- Loss of Connectivity (ISP, Computer, Platform) While in a Trade
- Session or Business Drawdown Limits Hit
- Violation of Rules

<u>Evidence of Illness, Stress or Negativity Impacting Trading Decisions</u>

1) If I have live trades, immediately either:
   a) Close the trades and cancel any working orders; or
   b) If positions are in profit, confirm appropriate stop (not < breakeven) and target orders, and walk away.

2) If I have working orders, cancel them.

3) Record details of the occurrence, for consideration during the post-session review.

4) Consider the need for a break, or a relaxation or recovery session, or for cancellation of the remainder of the session.

<u>External Distraction</u> (which can"t be ignored)

1) If I have live trades, immediately either:
   a) Close the trades and cancel any working orders; or
   b) If positions are in profit, confirm appropriate stop (not < breakeven) and target orders.

2) If I have working orders, cancel them.

3) Deal with the distraction.

4) Record details of the occurrence, as soon as possible, for consideration during the post-session review.

5) Consider the need for a break, or a relaxation or recover session prior to restart.

<u>Incorrect Order Entry or Incorrect Fill</u>

1) Immediately cancel the order if it hasn't been filled.

2) If the order is filled, rapidly assess the situation.
   a) If analysis indicates potential for the market to move rapidly against the position, EXIT.
   b) Else set an aggressive stop to minimise loss and manage the position to try to work a profitable exit.

3) Record details of the error, for consideration during the post-session review.

4) Contact broker immediately if error is due to a broker-error (incorrect fill).

5) Consider the need for a break, or a relaxation or recovery session.

Loss of Connectivity (ISP, Computer, Platform) While in a Trade

1) Close any open trades and pending orders via whichever of these means is available and quickest:
   a) Connecting to the platform via a backup computer.
   b) Connect to the broker online via their web platform.
   c) Immediately contact the broker via phone and/or live chat.

2) Resolve the issue if possible and continue with the session. If not continuing, conduct the post-session routine.

NOTE: All orders placed into the platform should have an attached stop and target order.

Session or Business Drawdown Limits Hit

1) Immediately exit all trades.

2) Consider the need for a break, or a relaxation or recovery session.

3) Complete the post-session routine.

Violation of Rules

1) If I violate any part of my trading plan, I will do the following:
   a) Do not put on any new trades.
   b) Close trades that should be closed.
   c) Manage open trades until the exit.

2) Record details of the violation, for consideration during the post-session review.

3) Consider the need for a break, or a relaxation or recovery session.

Chapter Nine – Goals & Targets

9.1 – What Win% Should You Expect?

What win% should you expect? This is a very common question. The question should also ask (although never does) what win/loss size ratio (WLSR) should you expect, as your expectancy is a function of both win% and WLSR. (NB. WLSR is average win divided by average loss)

Here are my general thoughts...

This is an easy question for mechanical systems traders to answer, as their historical testing will provide target figures.

It's not so easy for discretionary traders. Your resultant win% and WLSR will be a function of two things - firstly the ability of the strategy to identify higher probability / lower risk setups which can provide a positive expectancy, and secondly your ability to read the sentiment of the market and to enter and manage the trades in such a way as to maximise opportunity.

That is, it's a function of both the strategy AND your personal performance.

This is why honest promoters of discretionary trading strategies are unable, or unwilling, to provide potential customers with an expected win% or WLSR. It's impossible to know the influence of the 'personal performance' part of the equation.

In fact, if they're being totally honest, they should say that there's a greater likelihood of a negative expectancy. After all, for most new traders the 'personal performance' part of the equation will erode any edge that a strategy has, resulting in a consistent net loss.

For the same reason, it's pointless trying to compare with another trader. Their level of performance is completely irrelevant to you, as their ability to trade the strategy will vary from yours. It's a function of their development as a trader, which will of course be different from your level of development.

The only figures that are relevant are your own current win% and WLSR.

Accept whatever figures you're currently getting, and then work towards gradual improvement.

Trade the strategy. Identify your current level of performance. Then implement a Trade-Record-Review-Improve process (chapter 16), working to increase your performance over time. Do not trade in a live market environment until your performance is showing a positive expectancy.

Win% and WLSR are not so much a function of the strategy; the much more important factor is your own level of development as a trader. My strategy works. I can trade it successfully. That doesn't mean anyone else can, without having gone through the process of learning to trade it.

9.2 – Ok… If I Absolutely Must!

Now, having said that any target figures are irrelevant, I know you'll want some figures anyway.

If you absolutely must have something to target, aim for a win% of 65% and a WLSR of 1.5 (average wins 1.5 times the size of average losses), AFTER excluding all breakeven trades.

Or if you don't like those target figures, adjust them to suit your own needs. Typically as the win% increases, the WLSR will decrease, and vice versa. Provided it gives a positive expectancy, it's a good target.

- Expectancy = (win% x average win) - (loss% x average loss)

But as I said, the only figures that are relevant are your own current win% and WLSR. Identify your current level of performance and just aim for gradual improvement.

9.3 – Stats

In order to know your win% and WLSR you‟ll need to keep accurate stats. This will require a spreadsheet for tracking your win% and WLSR for all trades.

The trading journal spreadsheet which I use is listed at the YTC Resources Page, under the heading Business Management: http://www.yourtradingcoach.com/Trading-Resources.html

I recommend also keeping these stats for subsets of your trade data as well.

- Track stats for each setup – TST, BOF, BPB, PB, CPB.
- If you trade multiple instruments, then track stats for each instrument.
- If you trade different sessions (eg. forex UK and US session), then track stats for each session.

- Track stats by day, Mon through Fri.
- And track stats for any other subset categories which are of interest to you.

Recording and monitoring these statistics over time allows you the following benefits:

- A means to confirm consistency of results and performance, when your win% and WLSR match your historical averages; and
- A warning that something is wrong, when win% and WLSR vary from your historical averages.

I recommend reviewing results on a weekly and monthly basis. Please note though, I recommend you ensure greater than 20 trades in each sample, in order to get reasonably consistent results. If you aren‟t achieving 20 trades in any particular week, carry those trades over to the next week (ie. this "week" will actually include a fortnight of trade data).

Adjustments can then be made to the way you apply the strategy, in order to improve any stats.

Typically if your win% is less than ideal, the most likely source of improvement will be in examining the quality of your setups. Ensure that the setups are trading with strength and/or against weakness. Ensure that someone is trapped.

Consider maybe limiting your setups to only those that have been producing the best results for you.

And remember, the absolute best setups are those in which someone is badly caught in a losing trade, and desperately needing to get out. Such as any PB or CPB which has broken a previous swing high/low and then reversed, or any BPB. Find someone stuck, and be part of the orderflow that springs the trap on them. Their loss provides you with the quality setups you need.

To improve your WLSR, examine your entry and your trade management / exit plan. Are you typically entering too late? Or are you having difficulty letting part one and/or two run to their targets?

Note: In some spreadsheet applications (such as the one I use) you may find WLSR called Profit Factor.

9.4 – Another Option – For the Consistently Profitable

Another option, but ONLY after you're already consistently positive...

Or maybe you‟ll prefer to run this in parallel with your individual trade stats…

Track results per session, rather than per trade.

This is what I do now and I find it much more relaxing.

I discovered this from some writing by Don Miller, way back when he wrote for the Trading Markets site.

I aim for the following targets:

- **70% of days are positive**
- **90% of weeks are positive**
- **100% of months are positive**
- **Individual trade results are irrelevant.**

There is great power in adopting this style of target percentages. It takes all the pressure off individual trades. After all, the only thing that matters is a rising equity curve over time, and so if you can end most days or weeks with a positive result, you're going a long way towards ensuring you meet this goal. It also takes the pressure off daily results. 7 out of 10 days are expected to be positive. This allows me 3 days a fortnight in which I expect to lose. Provided I contain the risk, it's not a problem.

Please note that these percentage targets will require a minimum 5 trades per day; and a minimum of 20 trades per week (allowing for public holiday weeks). Any less than this, and carry these trades over to the next day or week, as required.

As mentioned before, this is only to be adopted once you're achieving overall positive expectancy and have therefore got your risk under control. In the meantime, you may wish to use it alongside your tracking of individual trade results.

The Probabilistic Nature of Trading

I find the 70/90/100 goal to be a great way to remind myself of the probabilistic nature of trading.

The following graph (figure 9.1) is taken from an Expectancy Calculator that came with my Trading Journal Spreadsheet.

The horizontal axis shows the number of trades. The vertical axis shows the equity balance. The graph shows a rising equity curve over time, based on a series of randomly generated trade results using the figures entered into the yellow box.

At least that‟s the usual way of looking at it.

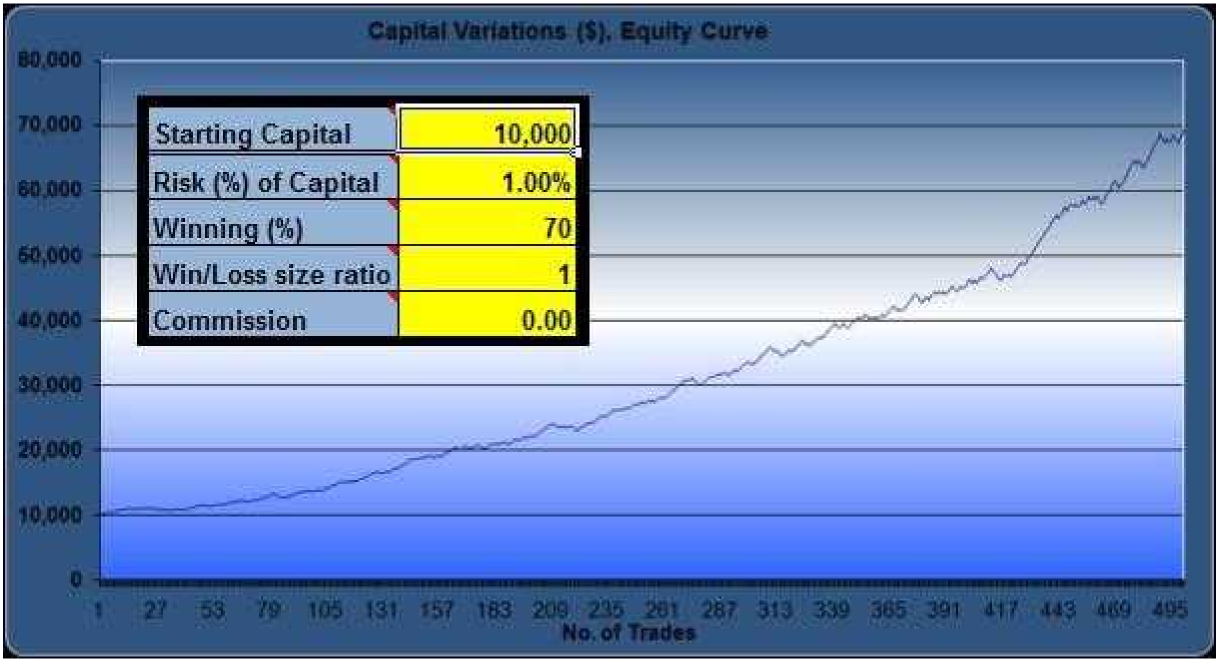

Figure 9.1 – 70% Winning Days – Rising Equity Curve

In reminding myself of the probabilistic nature of trading, I consider the horizontal axis to be the number of days, instead of trades.

So, in this diagram, we see how powerful the results can be when we have 70% winning days, such that the average winning day is the same size as the average losing day.

Individual trade results are irrelevant. Winning the session is what matters. And we don‟t even have to get that right every time. 7 out of 10 winning days are easily sufficient.

If you don‟t think that 7 days out of 10 is achievable, what about 6 days out of 10? That‟s only 3 profitable days per week, where your profits on these days are no bigger than your losses on your losing days.

Here‟s the equity curve based upon a random sample of trades, using 60% winning days:

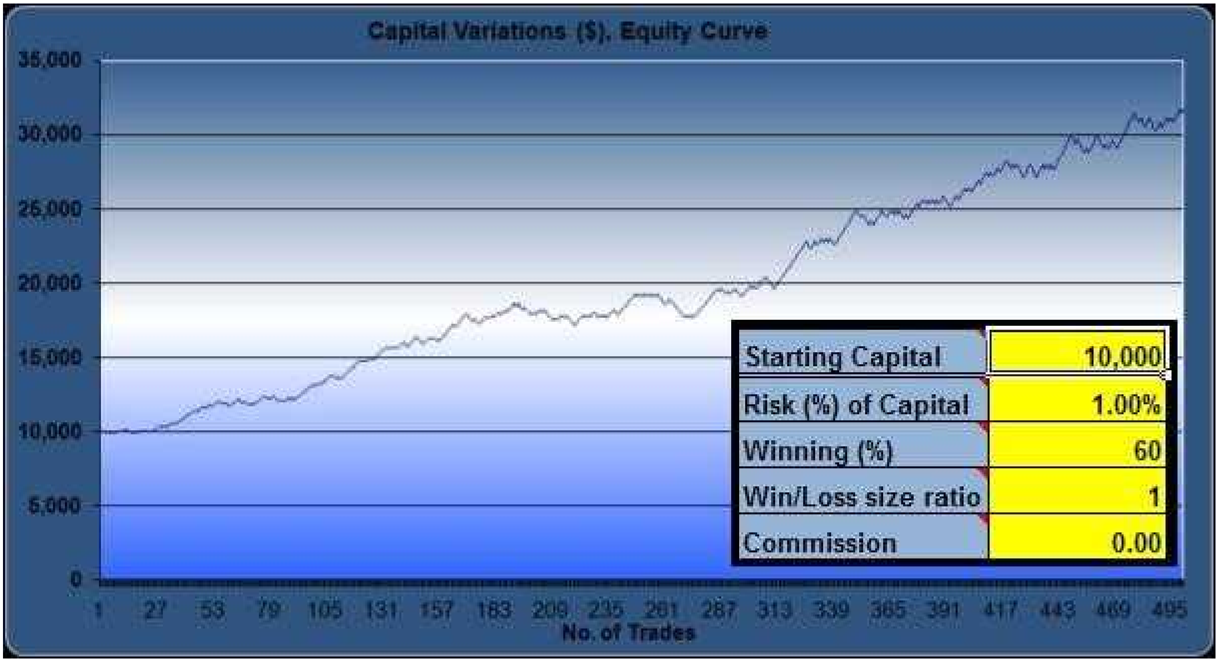

Figure 9.2 – 60% Winning Days – Rising Equity Curve

This reminds me that individual trade results are irrelevant. Even daily losses should not concern me, when they do occur. Provided I can contain risk and overall get more winning days than losing days, my equity curve will rise.

This is a powerful belief; greatly relieving the pressure on individual trades.

Chapter Ten – Trading Psychology – A Practical Approach

10.1 – Personal Survival

We established earlier that the success of our trading business requires both financial and personal survival. This chapter examines personal survival – both throughout the learning process and then our ongoing trading career.

Survival is a result of certain prerequisites being in place (without them you‟re going to struggle to even get started) and then maintenance of a peak performance mindset.

We will be touching briefly on the topic of trading psychology. A complete investigation of this topic is beyond the scope of this book (perhaps a future book or video course in itself). In particular, we will not cover the background theory – the cause and nature of the various psychological influences on your decision making and actions. While this theory is important, **I prefer to focus in this book on the practical**; sharing the tools and techniques which I use to manage my trading mindset.

10.2 – Prerequisites for Survival

Before we get to the tools and techniques for maintenance of a peak performance mindset, there are some prerequisites that must be in place:

- Realistic Expectations
- Motivation to take Positive Action
- Passion for the Process

Let‟s look briefly at all three.

Realistic Expectations

You must accept that this is a journey. There is no Holy Grail solution. It‟s a journey of personal growth and development. And it WILL take time.

It will be easier once we have a graduated plan for our development. We‟ll put one together in Chapter 17.

However the rate at which you will personally develop towards consistent profitability is unknown. If you already have experience, this book may provide the missing key that has you there in quick time. It may take you only a matter of months. But for the majority, it will likely take a number of years.

Accepting that it‟s a journey of unknown duration, you need to have realistic expectations. You need to display patience.

Your lifestyle needs to be structured such that success is not required within any deadline, and sufficient income is available for your financial survival throughout the learning process.

Without this, the stress will be too great. And you will most likely not make it.

Motivation to take Positive Action

I use a motivation journal for daily motivational reinforcement. We‟ll get to that shortly. In terms of prerequisites though…You absolutely <u>must</u> be 100% clear as to <u>why</u> you want to become a consistently profitable trader.

Your *reason why*, or your *purpose*, must be strong enough to get you up each day, excited, ready and willing to face the upcoming challenges.

Anthony Robbins says, “The only way we‟re going to make a change now is if we create a sense of urgency that‟s so intense that we‟re compelled to follow through.

Without a strong and clear *reason why*, I promise you will not make it in this game.

I recommend documenting your *reason why* in one of two ways. Try both, to see which works for you best.

The first option is to use the emotions of **pain and pleasure.**

You need to clearly identify the pain that comes from failure to achieve trading success. And you need to be crystal clear about the pleasure that you will derive from trading success.

Your reasons will change over time; that‟s fine. For now, ask yourself the following questions:

- “What will it mean for my life and my happiness if I **fail** to put in the necessary work to become a consistently profitable and successful trader?”

  Take some time to think of your response, and write it down.

  Then look deeper. Ask, “What does that mean?”, and again write down your answer.

Keep asking, “What does that mean?” until you get down to the very core feelings associated with the pain of failure.

- “What will it mean for my life and my happiness when I succeed, and can call myself a consistently profitable trader?”

  Take some time to think of your response, and write it down.

  Then look deeper. Ask, “What does that mean?”, and again write down your answer.

  Keep asking, “What does that mean?” until you get down to the very core feelings associated with the pleasure of success.

If you haven‟t done this exercise, take a break from reading now, get a piece of paper, and examine your pain and pleasure motivators.

The second option (and the one I prefer) based upon an article titled “The Four Emotions That Can Lead to Life Change”, by Jim Rohn. Do a Google Search and you‟ll find it, if interested.

Jim Rohn says there are four basic emotions which cause people to take decisive action – disgust, decision, desire and resolve.

Add to your previous *reasons why*, a sequence of new statements based upon each of these four emotions. You may get the same response as previously, when using pain and pleasure. That‟s fine. Sometimes though, you‟ll find some new insight through approaching the subject from this different direction.

Disgust

There is, in my opinion, no greater motivator than disgust. Absolute disgust at my job will keep me working towards trading success. Absolute disgust at my previous undisciplined attempts to trade will have me moving forward in a more disciplined and businesslike manner.

What is it that you‟re disgusted with? What is it that you wish to never experience again? What is it that has you saying, “No More! Never Again! Enough is Enough! It‟s Time to Change!”?

Decision

Life will provide you with many competing priorities. Your time is limited. There is only so much you can do each day.

Make a clear decision - trading is a priority. You will do this. You will do this properly. Document that decision. Put it in writing. And tell everyone close to you.

Desire

Write down a desire statement. What do you want to achieve from trading. There may be some overlap here with the previous *pleasure* statements. Be sure though that the desire statement is one based upon a feeling.

For example, it‟s not the money that you desire. It‟s the feeling that this money will give you.

Document your desire. What do you want to achieve from trading? Put it in writing.

Resolve

Resolve to do whatever is necessary to achieve your goals. You‟ve got the disgust to move away from. You‟ve decided to take action. You have the desire to move towards. It‟s time to resolve to do whatever it takes to make it.

Document your resolve statement.

Resolve to never quit, no matter what comes ahead.

Here‟s a great quote from Richard Machowicz which you may want to use:

> **“Not dead. Can‟t Quit.”**

Passion for the Process

Armed with realistic expectations and motivation to take positive action, the final prerequisite is a passion for the process of trading.

If you don‟t enjoy the daily routines, you will NOT survive.

You may hate your previous life, and greatly desire the rewards that come from trading success. You might be motivated for action. But if you don‟t absolutely LOVE the process of trading, I guarantee you will fail. The motivation, disgust and desire will not be enough.

So, take some time to consider whether or not you really love this game? Do you love the analysis? Do you love the challenge? Are you ok with making mistakes, reviewing your decisions and trading actions, and trying to find the way forward?

Are you willing to make mistakes? Forgiving yourself again and again and again?

If not… perhaps trading is not the right path for you? It‟s ok. It‟s best to admit that early, before damaging your financial and psychological capital.

You‟ve seen the strategy. You have a good idea of the degree of work required to conduct analysis and trade the markets. Are you excited by the challenge ahead? Take some time out to confirm your passion for this game.

10.3 – Mastery of Trading Psychology

A negative mindset, and poor trading psychology, does not directly lead to failure. There are a couple of steps in-between. A negative mindset, and its associated focus on fear, will result in poor decision making in an attempt to protect us from that fear. This poor and inconsistent decision making leads to inconsistent application of our plan. And it is the inconsistent application of our trading plan that leads to trading failure.

The process of changing our mindset from one of fear to one of confidence and self-belief will take time. While this is occurring we therefore need a plan to manage our decision making process, to ensure that any negative thoughts or emotions have minimal impact on our trading decisions, providing us with the maximum opportunity for consistent application of our trading plan **despite** our fears.

Our solution involves two main components:

- Focus on Process
- Peak Performance Mindset

10.3.1 –Focus on Process

In this component of our mastery of trading psychology, we aim to maintain our focus on the **process** of consistent trading, rather than on the fear or greed associated with the possible outcome of each trade.

We aim to achieve this focus through the following tools and techniques:

- Documented procedures
- Daily process goals
- Consistent Application
- Review and Improvement

Documented Procedures

Our procedures manual (chapter 13) provides standardisation and consistency in our daily routines, in order to minimise impulsive or unplanned behavior.

Daily Process Goals

There are many widely recognised benefits of goal setting, if used correctly:

- It provides clear direction, both long-term and short-term;
- It provides motivation in the short-term; and
- It provides a benchmark against which you can measure your performance, allowing you to identify and celebrate your successes, and to identify and correct areas of poor performance.

The purpose of this book is not to explain in detail the theory of goal setting. If you wish to do more study in this area then do some research on goal setting as it relates to sports psychology.

The end result of this study though is the discovery that **process goals are vastly superior to outcome goals.**

The difference?

- "I want to earn $500 today"
- "My GBP/USD target today is 50 pips profit"

… are all outcome goals.

They document a specific outcome or level of performance. The problem with outcome goals is that achievement of these goals is largely out of your hands. The market that day may not offer the opportunity for $500 profit, or 50 pips.

Process goals specify the process (or procedure, action, step, task) which must be carried out in order to achieve our desired outcome.

Process goal examples would include:

- "All entries must have an attached stop and target order."
- "For trading today, I will only take entries in the direction of the 5 min trend."
- "Today I will not scratch my part one positions while the NYSE Tick is still moving in my trade direction."

Essentially they involve an action, or a process. An action or process which, if carried out correctly, gives us the maximum chance of achieving a positive outcome. But the outcome is not important. Success in achieving our goals is related to success in following our process, not in achieving any outcome.

During our post-session routine we identify an area for improvement, which we will specifically target in the next session. We assign ourselves a **process goal** (or goals).

The goal is recorded in our trading log, and reviewed as part of the next pre-session routine.

While we may have longer term outcome goals (our reasons why), during the trading session our focus needs to be solely on our process (procedures) and our process goals.

Consistent Application

Of key importance is consistent application.

Your focus will drift away from process, as a result of all manner of internal and external distracters. You need some means of identifying this drift, and returning focus to its rightful place.

Most people find it difficult to maintain focus (including myself). So don"t be hard on yourself when you discover your loss of focus. Note it. Correct it. And aim for gradual improvement. Do NOT judge.

I use a simple tool to achieve consistent application. I set a timer to beep on the close of every *trading timeframe* candle, in order to attract my attention. If my focus has been diverted, this allows me to return it to the process of trading, conducting ongoing analysis based on this new candle information.

Review and Improvement

While trading, pause regularly to check your performance, in terms of both your ability to focus on process and your mindset. Use your trading log during the session to record any observations.

Review these notes during your post-session review, and consider the need for a process goal in the next session, to correct or improve any deficiencies in performance.

Use longer period (monthly) reviews to search through your notes for longer-term patterns of poor focus, and consider procedural change to manage this deficiency.

10.3.2 – Peak Performance Mindset

I often get comments from people stating that positive thinking is not the answer to trading – it‟s about effective strategy.

These people are missing the point.

It‟s not just about effective strategy, but about effective application of that strategy. And when discussing application, positive thinking is far more effective than negative thinking.

Let‟s look at some of the tools and techniques that I use for maintaining a peak performance mindset during my trading session.

- Relaxation / Breathing Session
- Visualisation
- Motivation Journal
- Action Affirmation Statements
- Recovery Procedure

Relaxation / Breathing Session

I conduct a relaxation / breathing session during all three phases of my trading day (pre, during and post-session). It‟s an incredibly powerful means of ensuring a clear mind and relaxed body.

Mind, body and soul in alignment, ready to face the challenges ahead!

You may replace this with any relaxation or breathing process. However if you don‟t have one, I recommend the following simple procedure:

- Sit on your trading chair, with your feet flat on the floor, arms relaxed by your side, hands resting on your lap, your shoulders comfortably back, and your back erect (do not slump)
    - This should be a relaxed position, not forced.
- Touch your tongue to the roof of your mouth, close your mouth, smile, close your eyes and breathe softly through your nose.
    - Keep your breath natural. Don‟t force it. Don‟t try to hold it longer than what is comfortable.

    - Breathe into the lower belly rather than the chest.

    - Make it one fluid motion – inwards and outwards, ensuring no pause between breaths.

- Relax your body.

    - As you breathe, focus on your body. Identify any sources of tension. Use the out-breath to consciously relax those muscles. Repeat until you‟re completely relaxed.

- Relax your mind.

    - Focus on your breath. Feel the breath entering your body as you inhale. Feel the breath leaving your body as you exhale. If you discover your mind wandering elsewhere, do not judge; simply return your focus to your breath.

    - Some people may prefer to consciously occupy their mind. Count each breath (inhale and exhale combined) from one to ten. Once again, if you find your mind wandering, simply return your focus to your counting.

- Continue for as long or as short a session as you like.

For a more in-depth study of breathing, I recommend the Taoist Longevity Breathing program currently available through http://www.energyarts.com/.

Visualisation

During my pre-session routine, I review my trading log to identify my daily process goal. This also includes a brief visualisation of the process goal being carried out successfully.

So for example, let‟s assume our daily process goal was, "Today I will not scratch my part one positions while the NYSE Tick is still moving in my trade direction."

- Visualise a trade entry and stall. Feel the unease and the desire to scratch the position. Visualise myself looking towards the NYSE Tick on my chart and observing it still supporting my trade. Visualise myself holding… and the trade moving on to T1. Feel the satisfaction that comes from having successfully achieved my daily process goal.

- Visualise a trade entry and stall. Feel the unease and the desire to scratch the position. Visualise myself looking towards the NYSE Tick on my chart and observing it still supporting my trade. Visualise myself holding. Visualise the stall continuing and the NYSE Tick turning, leading me to scratch the trade. Feel the satisfaction that comes from having successfully achieved my daily process goal – holding the trade to give it chance to move to T1 rather than getting scared out at the first sign of stall.

Note that in both visualizations – winning and losing trade – I successfully followed and achieved my process goal. This is a successful trade, in both cases.

Motivational Journal

A primary **pre-session tool** used in maintenance of my peak performance mindset is my motivation journal.

The motivation journal is simply a folder containing various pieces of text or image material which I find sufficiently motivating; the aim being to ensure I face each trading session with focus and commitment and, most importantly, confidence.

I‟ll share my contents list below; however feel free to create your own however you see fit. Make it a work in progress, always updating as you find new motivational material.

My motivation journal is a ring binder, allowing insertion of relevant material in the following five sections:

1) **Reasons Why**
    a) My four motivation statements – Disgust, Decision, Desire, Resolve.
        i) You may prefer to use the pain and pleasure statements.
    b) Any additional thoughts as to what trading success means to me.
    c) An image of my family.

2) **Current Reminders**
    a) Any current areas of focus, which need regular reinforcement and reminders
        i) For example, if you‟re hesitating at entry and having difficulty pulling the trigger, you might write a few sentences as follows:
            - Always remember, each trade is just one of many being traded that month. And each month is just one of hundreds that I‟ll have over the course of my trading career. So, I will take my entries knowing that it doesn‟t matter if I win or lose on this trade.
            - My quality, reality-based setups, with reward:risk ratio of at least 1:1 to the first target, combined with my strict application of risk and money management, mean that I have a positive expectance and I will profit over a series of trades.

- Nothing annoys me more than an entry not taken due to fear or hesitation. I‟d rather take the small 1R loss than miss the opportunity for >1R profit.

3) **Goals**
   a) My target goals – 70/90/100, as discussed in chapter 9.
   b) A reminder of the probabilistic nature of trading
      i) Here I insert the 70% winning days diagram from figure 9.1, along with some written notes reminding me that individual trade results are irrelevant.

4) **Proof of Success**
   a) A small sample of printouts of trades in which you performed in a professional manner (winning and losing), annotated with notes.

5) **Motivational Material**
   a) Any statements, quotes, excerpts from books or poetry or songs, or any images which you find motivate you to excel in both trading and in life.
   b) Examples:
      i) Ziad‟s motivational passage, from the comments section of the following blog post: http://www.eminiplayer.com/2009/06/learning-to-become-successful-trader.html (an absolutely brilliant passage – I highly recommend this one).
      ii) The Warrior Trader principles and Action plan, from "The Way of the Warrior Trader" by Richard McCall.
      iii) Optimists Creed – do a Google Search

Affirmation Action Statements (AA Statements)

Affirmations are short, positive statements that you repeat to yourself; typically in an effort to replace any negative self-talk with positive self-talk.

For example, "I am a successful and consistently profitable trader."

While I love this sort of affirmation, and use them myself, they do have some limitations. Especially when the goal of the statement has not yet been achieved! It‟s hard to believe a statement that you‟re a consistently profitable trader when you haven‟t got there yet.

This type of affirmation also offers little benefit <u>during</u> the trading process.

However there is another feature of affirmations which is very useful during the trading process – their ability to focus our mind.

Successful trading is largely a result of taking correct decisions and actions, ensuring we apply our trading plan as accurately as possible. To assist with this, and ensure I focus on the process of trading, I make use of what I call **affirmation action statements**.

These are short statements which provide either a reminder of appropriate behavior, or of an action which should be carried out.

Affirmation action statements are used for all primary areas of the analysis and trade process. They also used when my post-session review has identified an area which requires improved action or behavior in future. The affirmation action statements ensure my mind is appropriately focused, and reinforce correct behavior, as required to improve the application of my trading plan.

I currently have five primary affirmation action statements – Focus; Analysis; Trading; Management; Regroup. Others come and go as required.

You may wish to start with these and then adapt as required. And add any additional ones for areas causing significant difficulty.

Focus

- Breathing (slow and deep)
- Mind clear, body relaxed
- Trust (myself and my strategy)
- Focus

Analysis

- What is the trend?
- Where is the strength?
- Where is the weakness?
- Where is the next opportunity?
- Patience

Entry

- Confirm the weakness (against S/R or on PB)
- Who‟s trapped?
- Where will they exit?
- Trust (myself and my strategy)
- Fade the weakness! Spring the trap!
- Strike!

Management

- Patience
- Trust (myself and my strategy)
- Where‟s the strength?
- Where‟s the weakness?
- Hold while the premise remains valid

Regroup

- Confirm flat
- Clear my mind
- Review the trade
- Review any error
- Accept it
- Forget it
- Focus

Any bracketed text is not verbalised, but is documented in the statement as a reminder of the context.

Repeating these statements to myself ensures my mind is focused on what‟s important during each critical stage of the analysis and trading process. My actions will therefore be less influenced by doubt, second-guessing or any other negative distracters.

My affirmation action statements are documented as part of my procedures manual, as well as displayed on my trading wall.

Typically I"ll repeat them whenever my trading process advances to the next stage – analysis, entry, management etc. The *focus* AA statement is repeated any time my timer interrupts my diverted attention and allows focus to be returned to the process of trading.

In a way, they"re like procedures in themselves, although in summary form. Repeated like affirmations though, they focus the mind on the process of trading, rather than allowing it to be distracted by fear.

You"ll note also that they"re a form of process goals – typically an action, or a reminder of process.

Personally, the Entry AA statement has been particularly effective for me. I"ve associated the word **strike** with the requirement to place an order. If my analysis has identified weakness and someone trapped in the market, and I"ve identified a suitable entry zone, then I want to get in. I can"t afford to doubt myself and miss the entry.

It"s time to trust myself and **strike**!

Recovery Procedure

This is a clearing process, used whenever encountering a significant loss or some evidence of (worse than usual) negative emotions.

It may or may not lead to resumption of trading. That will be a judgment call based upon the circumstances.

Once again I"ll provide guidelines based around my procedure, but feel free to use it, adapt it, or create your own from scratch. It needs to be something you own, and you feel comfortable with.

The process involves three stages – relaxation, review and release. The whole process should take only 10-15 minutes.

Relaxation – Body & Mind

- Conduct a standard relaxation / breathing session.
- Conduct a short Chi Gung session.
    - This is a moving meditation session. If you"re not trained in or interested in Chi Gung, this step could be replaced with any other soft-form martial arts such as Tai Chi, or a simple guided meditation. The aim is a still and calm mind.

Review

- Consider the nature of the occurrence from the perspective of feelings
    - What feelings led to the decisions that were made, or actions that were taken?
    - How does this make you feel after the event?
        - The key here is to explore your feelings in a non-judgmental manner. Accept them.
- What does this mean? Where is the lesson?
- How will you behave in future when encountering the same circumstances?
- Visually replay the situation with the new improved behaviour. Confirm improved feelings.

Release

- Conduct a standard relaxation / breathing session.
- Forgive yourself.
- Completely let go of whatever happened.
- Review your motivation journal.

Consistent Application / Review and Improvement.

As with our focus on process, my trading timeframe timer will allow an interruption of thought, hopefully trapping any negativity and allowing a return to a positive peak-performance mindset through my Focus AA Statement.

Make use of the trading log for recording any mindset observations or challenges.

And review these notes to identify patterns of behavior which may be impacting results. If you can identify it, you can correct it.

10.4 - Maintenance of Peak Physical Condition

There‟s one key component still to go in ensuring that we achieve mastery of our trading psychology – physical health.

Too many people are quick to dismiss this; after all, trading is all about the mind not the body.

Remember though, they‟re both component parts of the one system. Your mind will function more effectively with a healthy body. It‟s that simple.

There are three components of a healthy body that will impact on your ability to function effectively as a trader, and in fact in all areas of your life:

1) Healthy diet,
2) Regular exercise and
3) Sufficient sleep.

I‟m not going to talk about diet or exercise. It‟s not my specialty and in fact improvements are really simple in concept – eat better than you currently eat and exercise more than you currently exercise.

Of course, while it‟s simple in concept, it‟s certainly not easy to do if you have the wrong habits in place. Kind of like trading, I guess.

What I would suggest is that you seek the guidance of a professional to assist in these areas; perhaps a general practitioner or weight loss specialist for diet and a gym membership or personal trainer for exercise. Or join a sports club!

I run and I coach soccer. Find something similar that you like.

Sleep though, is something I am going to talk about. If you think you currently get enough sleep, and are tempted to skip this part of the book, I encourage you to stay. It won‟t take much time and could in fact be quite valuable. The fact is that very few adults get enough regular sleep. And this **will** impact on your trading performance.

Fatigue Management

Fatigue management is a favorite topic of mine, due to my interest in aviation and in particular aviation safety. In military aviation, in both a training and operational environment, fatigue management is recognized as an essential function of command, in order to minimize risk and enhance operational effectiveness.

The same applies to the management of your trading business. As a trader, fatigue will reduce the quality of your work – your preparation, your market analysis, your trade execution, your trade management decisions, your focus, your patience, your ability to psychologically accept a loss and your ability to stick to the process of trading.

Here‟s a great quote on the dangers of fatigue, sticking to my military theme.

"Some of the COs were awfully heartless and brutal. A few had no idea about how to command men or judge a soldier's capabilities. Too often they would order young boys to lug a dead weight for miles, and when the young fellows reached the front they would be too exhausted to fight. I have seen them in tears, too tired to struggle on. They furnished an easy target for enemy gunners. More than one frail, green kid got cut down due to such incompetence in officer's ranks.
…PTE Vincent E Goodwin, WWI Diary

Ok, you‟re not at war and your life is probably not at risk from the markets, but the results can still be devastating.

As a retail trader, you‟re CEO of your own trading business, as well as the trader. As CEO, are you pushing your trader too far, trying to achieve too much too soon, without sufficient time for rest and recuperation? If so, if not managed properly, the results can be financially devastating.

Life is tough. There are many demands on an adult. For many of us, on top of a full-time job and a full-time family, we decide that we‟re just not happy and need to work at developing another income stream to replace that job we despise. For varying reasons, often the allure of easy money, we‟re attracted to the financial markets, and before we know it we‟re burning the candle at both ends - effectively working at a third full-time commitment.

Being so busy, sleep is the first thing that gets sacrificed.

But how does that affect us, and our trading results?

Let‟s look firstly at a quote from a publication, *„Beyond the Midnight Oil: An Inquiry into Managing Fatigue in Transport"* published in the year 2000:

"17 hours of sustained wakefulness leads to a decrease in performance equivalent to a blood alcohol content (BAC) of 0.05 per cent. The decrease in performance after staying awake for 24 hours is equivalent to a BAC of 0.1 per cent. A person with a BAC of 0.05 per cent is twice as likely to have an accident as a person with zero BAC, while a person with a BAC of 0.1 per cent is seven times more likely to have an accident."

For those in countries where Blood Alcohol Content is measured differently, in Australia a BAC of 0.05 is the legal limit for driving. So 17 hours of sustained wakefulness, leads to a reduction in performance equivalent to being drunk.

You wouldn‟t trade drunk, would you, so why would you trade fatigued?

Maybe you wouldn‟t start trading after being awake for 17 hours – the above example was quite extreme. And maybe in small doses the occasional late night may not be too much of a problem for you. After all, you can catch up on one or two late nights quite easily.

However, if lack of sleep moves beyond the occasional late night and becomes a habit, you WILL experience problems. Cumulative fatigue WILL directly impact your health, your mental well being and your trading performance. And the results won‟t be good.

The result of trader fatigue is a reduction in ability to focus or concentrate on the task at hand, and a reduction in the quality of your decisions. Both of which lead to inconsistent and undisciplined application of your trading plan processes, the end result being a drawdown in equity. Not good!

How much sleep should we get?

Typical advice is eight hours of uninterrupted sleep per night, however the actual requirements vary per person and may be anywhere from 7 to 9 hours per night for an average adult, with children and teenagers needing even more. Even then, lifestyle can demand further sleep. If you‟re involved in a physically demanding job or sporting activity, increased sleep may be essential to overcome the rigors of your daily routine and allow your body time to rest, repair and recharge.

The best way to work out your natural sleep requirements, and at the same time identify factors that may be affecting your sleep, is to use a Sleep Diary. For the next month, record the following information each morning:

- The time periods in which you slept in the last 24 hours (eg. 10pm to 6:30am)
- The quantity of sleep (eg. 8.5 hours)
- The quality of sleep - give it a score on a 1 to 10 scale
- Observed symptoms of fatigue or tiredness before bed (eg. irritable and stressed)
- Positive factors affecting your sleep (eg. extra layer of drapes added to keep out first light)
- Negative factors affecting your sleep (eg. had a coffee at 9pm, neighbor‟s dog barking at 6am)
- How you feel on waking? (eg. didn‟t want to get out of bed yet)

Ok, it‟s not too scientific. But it will allow you to identify your optimal sleep duration, and discover factors that are affecting your quality and quantity of sleep.

Fatigue Management for Traders

A general rule I‟ve used in the military which applies well for trading, is that you can consider yourself suffering from acute fatigue if you have experienced any of the following:

- Less than 5 hours sleep in the last 24 hours,
- Less than 12 hours sleep in the last 48 hours, or
- Currently been awake for longer than the amount of sleep you‟ve had in the last 48 hours.

If this applies to you, DO NOT TRADE.

This is not permission to live on such a small amount of sleep. This is just the absolute minimum, which forms your GO / NO-GO criteria for trading.

In addition to this, you need to monitor yourself. The effects of cumulative fatigue especially, can sneak up on you without you being aware. Be on alert for the following symptoms:

- Any physical symptoms such as generally feeling tired, having heavy eyelids or yawning.
- Blank stares at the computer screen (where did those last two candles come from?)
- Mood changes such as irritability or apathy. Seriously, you DO NOT want to talk to me when I‟m fatigued!!
- Difficulty in focus or concentration, showing up as a failure to follow your defined trading plan processes. This will often manifest as failure to carry out basic tasks, such as incorrectly positioning your stops, incorrectly setting your position size, or incorrect execution (there‟s nothing worse than going long when you meant to go short.)
- Difficulty in communication, both in deciding what needs to be said, and in how to say it. This applies not only to direct conversation with another person in your trading environment, but also to online chat, or any other means of communication.
- Difficulty in recording trade and personal performance parameters in your trading log or journal.
- A general lack of motivation.
- And of course, slow and confused market analysis.

These symptoms will of course also show up in tasks and activities conducted outside of trading. Along with another big one – difficulty getting to sleep and/or a restless sleep, as you just can‟t slow down your mind from its desperate attempt to solve all your problems.

Most important of all though, you need to understand that these symptoms are often difficult to pick up in yourself, and may be apparent to others well before you‟re willing to admit them. Certainly, my wife seems to „sense‟ my irritability and lack of patience, well before I do. And as annoying as it is to be told that you‟re not very nice to be around at the moment, it‟s a great indicator of potential fatigue.

If you need to operate with reduced sleep for a period of time, consider not trading, or at the very least seek the assistance of your partner or another person to provide an independent assessment of your behavior, and potential levels of fatigue.

If you find yourself with a sleep deficit, the only way to correct this is to get sleep. The strategic use of caffeine may help for a very short period of time, as does a relaxation or meditation session, but they‟re not viable long term solutions. The ONLY way to correct a sleep deficit is to get sleep. You need to cut down on non-sleep activities somewhere, perhaps even taking a day off trading.

The following factors though will assist in improving your quality of sleep. Consider implementing them into your normal sleep routine:

- Minimize daily stress and anxiety through relaxation exercises.
- Don‟t rigidly stick to your fixed bedtime. If you feel tired before that time, go to bed.
- If possible, allow yourself to wake naturally when your body is ready, rather than through the use of alarms. If this is not possible during the week, it should be over the weekend when you don‟t have to work.
- Have a pre-bedtime routine for 15 or so minutes, in which you relax and allow yourself to wind down. Consider having a notepad in which you write down any thoughts or concerns – they‟re on paper now, so they‟ll be there when you get up. You don‟t need to worry about them till then.
- Declare your intent for a good night‟s sleep when you first close your eyes.
- Ensure a quiet, dark, comfortable environment. Seek assistance from others in your house, or your neighbours, in minimizing noise that may affect your sleep. Consider the use of ear plugs if necessary, or an airconditioner to drown out external noise. Consider the use of an eye mask, or extra layers of curtains to keep out light. Set a cool but comfortable temperature.
- Ensure no caffeine is taken within the 3-4 hours prior to bed.
- Avoid cigarettes (or nicotine patches) or alcohol prior to bed.
- Ensure regular exercise is not conducted just prior to bed.
- Turn down your phone and answering machine.
- Turn your clock away from you so you cannot look at it during the night.
- And if you can‟t sleep after 15 – 20 minutes, consider getting up and conducting a relaxing activity until you feel ready for sleep again. Don‟t just lay there worrying.

- Have a regular „waking‟ routine starting with a stretch and a positive affirmation. Get the day off to a great start.

Of course, if sleep difficulties persist, and chronic fatigue begins impacting on your behavior and performance, seek advice from a general practitioner or psychologist.

And please, be sure to make sleeping pills or other medications an absolute last resort, and only under direction from a health care professional.

Sleep is essential for peak performance trading, so give it the priority it deserves in your trading business.

10.5 – Psych Wrap-up

This chapter provided a brief introduction to the topic of trading psychology, outlining the practical tools and techniques that I use on a daily basis to maintain my focus on process, and to maintain a positive mindset.

Remember, a negative mindset does not directly lead to poor trading results. A negative mindset leads to poor and inconsistent decisions and actions, which lead to poor trading results. So, we aim to improve the quality of our decisions and actions, minimising the influence of any negative mindset.

Many people will say that you need to trade without fear. Not possible – you‟re human. Allow your emotions and feelings to be whatever they will be. Accept them. Take note of them in your trading log. Review them and learn from them. There are great lessons to be learnt from accepting and observing your feelings during your trading session.

10.6 – Additional Study

This chapter has covered many topics which could be expanded to fill a whole series of books. I encourage you to consider this material as an introduction to these concepts and become a student of them through further research and education. In particular, the subjects of goal setting and trading psychology should be considered essential study for all traders.

Chapter Eleven – Trading Platform Setup

11.1 – Trading Platform Setup

How you set up your trading screens will largely be a result of:

1) Personal preference,
2) What degree of customisation your platform provides, and
3) How many screens you have.

I operate with a dual monitor setup, but that is not necessary. One is sufficient. I just prefer LARGER charts showing lots of back data.

However you set it up, I recommend the following… your *trading timeframe* chart must be the primary point of focus. Make it the largest, and if possible central to your field of view. Position it next to your DOM or Order Entry module.

The following is a screen shot of my current setup, and a suggested single-screen setup, but please experiment to find the right setup for you.

Figure 11.1 - Dual Monitor Setup - Left Side

A = Workstation
B = Higher Timeframe Chart
C = Lower Timeframe Chart

Figure 11.2 - Dual Monitor Setup - Right Side

D = Data Box
E = Time & Sales
F = Trading Timeframe Chart
G = DOM / Order Entry Screen

Figure 11.3 - Single Screen Setup

A = Workstation
B = Data Box
C = Time & Sales
D = Trading Timeframe Chart
E = Alternating Higher & Lower Timeframe Chart (as required)
F = DOM / Order Entry Screen

Chapter Twelve – Trading Plan

12.1 - Trading Plan

What is a Trading Plan?

Your Trading Plan is the principal document that guides all aspects of your trading business. If someone else wished to know how you run your trading business, this is the first place they should look. All other documents, plans or procedures are secondary to, and should be referenced by, the Trading Plan.

Creating Your Trading Plan

In many respects, this whole YTC Price Action Trader six-volume series comprises a part of your Trading Plan.

However this is not enough to allow you to start trading the markets.

Everyone‟s interpretation of the strategy will be unique. And as you work through the trader development stages outlined in chapter 17, you will very likely adapt and modify the strategy to suit your own psychology and trading needs.

Plus, everyone is different with respect to their personal and financial situation, their risk tolerance, and many other personal factors which need to be considered and documented.

You must therefore create your OWN trading plan.

The following sections will provide a general template and explanatory notes. Read through the chapter now; complete the remainder of volumes 4 to 6; and then come back to this section to draft your own trading plan using your word processor. The greater the effort you put into creation of your plan, the greater the potential rewards in your trading business.

I would love to be able to provide a completed plan. Unfortunately that wouldn‟t work. Your plan must be your own. So feel free to vary the template however you see fit. Remove sections which do not apply to your circumstances. And add additional information as required.

Living Document vs Static Document

Your trading plan should be viewed as a living document. It will grow and evolve, as your level of development grows and evolves. As such, I recommend you implement a regular review of the document to ensure it remains relevant. Prior to becoming consistently profitable, I recommend this review be conducted monthly. Beyond that stage, extend the time out to quarterly and eventually biannual or annual reviews.

Importantly, because your trading plan is a living document, do not stress if you have trouble putting one together at this point in time. Just do the best you can, and it will improve as you develop as a trader, provided you are disciplined with your reviews.

Detailed vs Simple

There is often much discussion and debate about whether a trading plan should be detailed or quite simple. There are pros and cons for both.

I"ve seen incredibly detailed plans comprising 50+ pages; and others comprising only a paragraph or two.

Whatever works for you is best.

However, I will suggest that during your development phase a single page plan IS insufficient. When you have a dozen years experience behind you then you may not need every aspect of your business documented. Most detail will then be internalised and your plan, while only one page on paper, is actually quite detailed when considering all your trading skills, knowledge, attitude and habits. Until you reach this stage, you need clear guidance. And the only way to do that is to make as detailed a plan as possible.

The problem most people find though is that they create a detailed plan but never refer to it – it"s too complex and unwieldy to refer to in the heat of the daily trading battle.

As such I recommend the following:

- A detailed trading plan – produced, not with the intent of being referred to day to day, but because of the clarity that the process of producing this document will provide to you with regards the operation of your trading business.

- A separation of the day to day procedures, into it"s own document – The Procedures Manual – which we"ll create in chapter 13.

The Trading Plan Template

Section 12.2 provides the template which I currently use. Section 12.3 contains explanatory notes.

12.2 - Trading Plan Template

Cover Page

- Heading
- Next trading plan review date
- Emergency contacts

Preface

- Aim
- Table of Contents

Introduction

- Mission Statement
- Goals

The Trader

- Responsibility
- Current State
- Health
- Further Education

The Trading Business

- Business Management
- Capital Management
- Resource Management
- Operations Management
- Contingency Management
- Review Process
- Trading Plan Review
- Time Management

The Trading Process

- Overview
- Market & Timeframe Selection
- Market Analysis
- Roles and Responsibilities
- Risk and Money Management
- Psychology
- Trade Strategy
- Further Development

Annexes

12.3 - Trading Plan – Explanatory Notes

12.3.1 – Cover Page

Heading

Self explanatory!

Next trading plan review date

Insert the date for your next trading plan review. As mentioned, I recommend initially reviewing your plan on a monthly basis, extending to quarterly and then biannually or annually as your consistency and profitability improve.

Emergency contacts

Enter contact details for your broker, including account numbers and account names and any other relevant details (NOT PASSWORDS). When something goes wrong and you need to contact your broker immediately, you"ll be happy that you took the time to include these details on the FRONT PAGE of your trading plan. It will also be included on the front page of your Procedures Manual (chapter 13).

12.3.2 – Preface

Aim

Enter a statement describing the aim of the trading plan document.

Something like, "This plan is intended to document the <u>general principles and strategies</u> that will allow me to produce income from the ___________ markets. It provides the foundation for the Procedures Manual, which details all information for day to day implementation of this plan."

Table of Contents

Self explanatory!

12.3.3 – Introduction

Mission Statement

One or two paragraphs briefly outlining:

- Why are you trading?
- What are you trying to achieve?

Here I recommend documenting your "reasons why", which we discovered when discussing the trading psych prerequisites in chapter 10.

Goals

Business Goals – document your target win% and WLSR, or your 70/90/100 plan, as discussed in chapter 9.

Daily Goals – include a note on the importance of process goals rather than outcome goals, during the heat of daily trading battle. Daily goals must not include any outcome or level of performance.

12.3.4 – The Trader

Responsibility

A statement of personal responsibility!

For example, "I alone am responsible for all trading outcomes. My success or failure is a result of my own decisions and actions. I therefore trade with a focus on managing risk. My number one goal each day is to ensure I survive to trade another day. Only I can ensure that occurs."

Current State

Successful trading requires an understanding and acceptance of our current strengths and weaknesses, in order to maximise our strengths and overcome or minimise the impact of our weaknesses.

List your current trading strengths and weaknesses, and your plan for managing these.

Health

Successful trading requires a healthy mind and body. It‟s essential to manage your personal health and to ensure a healthy work/life balance.

Outline how you will achieve this under three sub-sections:

- Mind
  - "I will achieve a healthy mind through the following means:"
- Body
  - "I will achieve a healthy body through the following means:"
- Social
  - "I will achieve a healthy work/life balance through the following means:"

Further Education

Consistent trading success requires ongoing education and growth. Outline your plan for further education. What will you currently work on? When? How often?

12.3.5 – The Trading Business

Business Management

Outline your plans for the following:

- Tax or Business Structure
- Accounting / Business Software
- Advisors (ie. accountant, bookkeeper etc)

Capital Management

What funds have you allocated to your trading venture?

Where are they located?

What is your maximum loss limit?

What is your reinvestment plan?

What is your plan for further contributions to your account equity, if any?

What is your plan for withdrawal of funds from your account equity?

Resource Management

List the trading resources you will use in your business, under the following headings:

- Broker
- Charting
- Data Providers
- Journals
    - Chapter 14 will discuss the various logs and journals used in our business.
    - List them here, along with a sentence describing their purpose:
        - Trading Log
        - Trading Journal Spreadsheet
        - Trades Journal
        - Market Structure Journal
        - Lessons Learnt Journal
        - Motivational Journal
- Economic Calendar
    - The economic calendar I use will be kept updated on the YTC Resources Page, in the section, “Business Management:”
    - http://www.yourtradingcoach.com/Trading-Resources.html
- Education Resources
- Additional Tools
    - Timers, screen-capture software etc?

That‟s all I list. Your business may require additional resources such as:

- News Sources
- Earnings Calendar
- Market Scan
- Back Testing Software
- Portfolio Management
- Instant Messaging

Operations Management

This will simply reference the Procedures Manual. For example:

- The Procedures Manual is to detail daily routines, including all pre-session, during session and post-session routines.

- The Procedures Manual is to detail the recording of trade and trade session stats, within both the Trading Log and Trading Journal Spreadsheet.

- The Procedures Manual is to detail a daily review process, for the purposes of personal growth and development.

Contingency Management

Once again, the trading plan will simply reference the Procedures Manual. For example:

- The Procedures Manual is to detail plans for dealing with any contingency which may occur during the trading session.

Review Process

When will you conduct reviews? How will you do it?

- Daily
  - Market Structure Review
  - Setups / Trades Review
  - Personal Performance Review
- Weekly
  - Trading Performance Review
  - Trading Log Review
  - Personal Performance Review
- Monthly
  - Trading Performance Review
  - Journals Review
  - Trading Plan Review
- Biannual / Annual
  - Goals Review

Reference the Procedures Manual for review procedures.

Time Management

Outline the time that you can commit to your trading business and your ongoing education.

What time can you allocate for trading (including pre and post-session procedures)?

What time can you allocate for your weekly, monthly and longer reviews?

12.3.6 – The Trading Process

Overview

Provide a short overview of your approach to trading. For example:

- I will be trading the YTC Price Action Strategy, with the following amendments:
  - For the current month I am limiting myself to with-trend trades only, due to…(reason)

Market & Timeframe Selection

Which markets are you trading? Why? Which timeframes are you trading? Why?

Market Analysis

I include here a simple reminder of the importance of price action, and then a reference to the Procedures Manual.

For example:

- Market analysis is to be conducted with a primary emphasis on price action. All indicators are a derivate of price and lag, and shall therefore be considered as decision support tools only.
- The Procedures Manual is to contain a step by step process for conducting market analysis.

Roles and Responsibilities

Optional section – I don‟t use it anymore, but did once with great effect. We‟ll talk more about this in chapter 17, when discussing challenges and difficulties.

- In order to minimise the negative psychological impact of „*being a trader who tries to make a profit*", I will not trade as a trader.
- Instead I will assume the following roles at various times within my trading business:
    - Market Analyst,
    - Order Entry Clerk,
    - Risk Manager,
    - Operations Manager,
    - Trading Coach, and
    - Compliance Officer.
- The Procedures Manual is to assign an appropriate role to each procedural step.

If using this, then you‟ll need to update the procedures manual to assign the appropriate role to each procedural step. I also recommend including a short job-description for each role within the trading plan.

Risk and Money Management

Risk management – every trade entered in the market MUST have an attached stop loss order.

Money management – include notes as discussed in chapter 7.

Psychology

For me, this section simply references the Procedures Manual:

- The Procedures Manual is to outline routines designed to manage emotions and trade with focus, consistency and discipline.

- This will include a plan for relaxation, a plan for clearing my mind and regaining focus following a trade, and a plan for recovery following any negative occurrence such as a significant error or loss, as detailed in chapter 10.

Trade Strategy

NOTE: This section may be duplicated within your trading plan, once per strategy, to cater for those of you who trade multiple strategies.

Describe your trading strategy. This is a chance for you to summarise the YTC Price Action Trader strategy.

It may be as simple as referring to the summaries I"ve provided in Volume Six.

However, great benefit will be gained through putting all you"ve read into your own summary words and diagrams.

You may wish to do so under several headings:

- Principles
- Screen Setup
- Position Sizing
- Analysis
- Setups – Description & Diagram
- Trade Entry
- Trade Management and Exit

Further Development

List areas of focus for further development of yourself and your trading strategy.

12.3.7 – Annexes

Add anything else you wish to add!!!

Chapter Thirteen – Procedures Manual

13.1 - Procedures Manual

My previous career was as a military helicopter pilot. Effective command of an S-70A-9 Black Hawk requires the use of checklists for all standard routines and procedures, in order to minimise the likelihood of error, and ensure maximum „brain space" available for mission management and maintenance of situational awareness.

Trading is the same. Consistent use of your checklists will minimise the likelihood of procedural error.

Plus, as you become more familiar with your checklists these procedures will require less conscious attention, allowing greater focus on price action in order to remain in sync with the shifting forces of supply and demand (ie. greater SA).

Trading success requires consistent and disciplined application of our trading plan. The best way I know of to turn your plan into disciplined and consistent actions, is to create a checklist of procedures you will follow in applying your plan.

My checklist is documented in a procedures manual.

13.2 – Sample Procedures Manual

The remainder of this chapter provides a **sample** procedures manual.

PLEASE NOTE: This is just an example. Consider using it as a template for creation of your own procedures manual, amending as required to suit your own circumstances and needs.

The procedures manual contains the following sections:

- Trading Plan Summary Details
- Emergency Contacts
- Screen Setups
- Routines
    - Pre-Session
    - During Session
    - Post-Session
- Contingency Management
- Action Affirmation (AA) Statements
- Longer Term Reviews

In most cases, the procedures have already been discussed in previous sections of the ebook series, and will therefore create some duplication in content. However, they‟ve been reproduced here in full in order to demonstrate the format and content of my procedures manual.

The procedures manual is quite detailed, and constantly referring to the manual can be quite distracting (I find that anyway!!). Please persevere though while you‟re first learning. As you gain experience, the intent is that you won‟t need to refer to these procedures for every step – they‟ll become habit. In time, you‟ll probably be able to operate with a 1-page summary checklist. Eventually they‟ll become internalised and you can trade without reference to any document.

PROCEDURES MANUAL (Next Review Date:)

Trading Plan Summary Details:

Market(s) Traded:

- 6B

Timeframes:

- 30 / 3 / 1 min

Trading Session:

- 3 hours from the open of the UK session
- 17:00 – 20:00 (my timezone)

Other Details:

Emergency Contacts

Other:	Backup:	Primary:	Broker:
			Account Details:
			Phone:
			Online Chat:

Screen Setups

Figure 11.1 - Dual Monitor Setup - Left Side

A = Workstation
B = Higher Timeframe Chart
C = Lower Timeframe Chart

Figure 11.2 - Dual Monitor Setup - Right Side

D = Data Box
E = Time & Sales
F = Trading Timeframe Chart
G = DOM / Order Entry Screen

Routines – Pre-Session

Personal Preparation

1) Initial Check of Physical and Mental Health
    a) If suffering from any ill health or stress, consider the need for cancelling the session, reducing the session, reducing position sizes, or implementing periodic checks of myself and my performance.
    b) Seek independent opinion from _________

2) Physical
    a) Ensure sufficient sleep, in accordance with the 5/12 fatigue management plan.
    b) Ensure sufficient and healthy food intake (sufficient to last till first break)
    c) Fill water bottle and place at trading desk
    d) Conduct a relaxation and breathing session

3) Psychological
    a) Review Motivational Journal

Trading Preparation

1) Platform & Computer Preparation - Part 1
   a) Virus check, clean & restart computer
   b) Open platform with sim account

2) Review the previous session.
   a) Trading Journal & Log
   b) Lessons learnt (from previous session Log)
   c) Sim trade (market replay) any key sequences from previous session
   d) Sim trade - execution drills
   e) Goals recommended for today
   f) Close sim account.

3) Prepare today's Trading Journal and Log
   a) Market
      i) Confirm no contract rollover (next date due: _________)
   b) Session timings
   c) Balance & position sizes
   d) Review Economic Reports
   e) Record daily goals

4) Platform & Computer Preparation - Part 2
   a) Open platform with live account
   b) Synchronise system clock
   c) Set alarms for prior to session start, or any potentially volatile news event I wish to watch prior to session start
   d) Set my candle timer
   e) Confirm order entry / DOM screen is correctly configured - contract, position sizes, order strategy (stop, limit parameters) and one-click order entry

Initial Analysis

1) Define Structure
   a) Define a structural framework within which our trading timeframe price action will move.
      i) Identify areas of Support or Resistance on the higher timeframe (30 min) chart based on swing highs and lows.

2) Define Trend
   a) Assess the movement of past price action within our market structure framework.
      i) Identify significant swing highs and lows on the trading timeframe (3 min) chart.
      ii) Identify the trend direction – up, down or sideways

3) Identify Strength & Weakness
   a) Analyse price movement within the trend to identify signs of strength or weakness.
      i) Analyse momentum of recent price swings
         (1) Compare the momentum of the current price swing with the momentum of the previous price swing in the same direction? Is price faster or slower than before? What does that mean?
         (2) Compare the momentum of the current price swing with the momentum of the previous price swing in the opposite direction? Is price faster or slower than before? What does that mean?
         (3) Is the current price accelerating or decelerating? What does that mean?
      ii) Compare projection and depth of recent price swings
         (1) Increased projection is a sign of potential trend strength. Decreased projection is a sign of potential trend weakness.
         (2) Increased depth is a sign of potential trend weakness. Decreased depth is a sign of potential trend strength.
      iii) Identify signs of failure to continue (ie. failure to meet expectations).
         (1) Failure to continue is a sign of weakness
      iv) Identify signs of strength or weakness via any miscellaneous methods
         (1) Volume analysis
         (2) Market Internal indicators

4) Identify Future Trend Direction
   a) What is the likely path of future price action? Determine the likely path of future price action, in accordance with the six principles listed below.

Six Principles of Future Trend Direction:

Within the S/R framework:

- **First Principle –** We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

- **Second Principle** - When an up or down trend shows evidence of weakness, we expect a higher likelihood of a complex correction rather than a reversal, until such time as the market shows both price acceptance and strength in the new trend direction.

- **Third Principle –** A sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

- **Fourth Principle** - When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behaviour of price post-breakout for clues as to future direction:
  - Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range
  - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

At the edges of the S/R framework:

- **Fifth Principle –** We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary.

- **Sixth Principle** - If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behaviour of price post-breakout for clues as to future direction:
  - Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.
  - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

5) Visualise Future Price Action
   a) How do you expect price to behave? Visualise the future price action, based upon your expectations for future trend direction and its interaction with the market structure S/R levels.
      i) What price action would validate your assessment of future trend direction?
      ii) What price action would invalidate your assessment of future trend direction?

6) Identify Areas of Trade Opportunity
   a) Based upon your expectations for future trend direction and how it should interact with areas of S/R and swing highs / lows, identify the next potential setup areas.
   b) Areas of trade opportunity are found where weakness plays out against S/R and swing highs / lows (TST, BOF, BPB), or within a trend (PB, CPB).

Steady trend environment:

- Higher Probability
  - PB and CPB

Weakening trend environment

- Higher Probability
  - CPB
  - PB if they break a previous swing low (uptrend) or swing high (downtrend)
- Lower Probability
  - Any other PB
  - Counter-trend TST or BOF of swing high (uptrend) or swing low (downtrend)

Within a Sideways Trading Range with a clear intra-range trend

- Lower Probability
  - PB and CPB

Approaching higher timeframe S/R or range S/R, with no sign of potential breakout

- Higher Probability
  - TST

Approaching higher timeframe S/R or range S/R, with strength showing signs of potential breakout

- Higher Probability
  - BOF or BPB

Final Preparation

1) Final Confirmation Check
   a) Again confirm my physical and mental health.
   b) If suffering from any ill health or stress, consider the need for cancelling the session, reducing the session, reducing position sizes, or implementing periodic checks of myself and my performance.
   c) Confirm again that my fatigue levels are within the limits as defined by the 5/12 fatigue management plan. No trading is to occur if I am classified as suffering from fatigue.

2) Final relaxation and breathing session

Routines – During Session

Maintain a Positive and Focused Mindset

1) Whenever focus has been distracted or minor stress is observed
   a) Log nature of distraction
   b) Office environment – quiet and serene
   c) Sitting – back straight
   d) Quick Relaxation / Breathing session
   e) FOCUS

2) Once per hour
   a) Conduct one or two Chi Gung forms
   b) Quick Relaxation / Breathing session
   c) FOCUS

3) Mid-Session Break (if conducting full session)
   a) Eat a small meal
   b) Full Relaxation / Breathing session
   c) Reflect on the opportunities that the trading day brings
   d) FOCUS

Recovery (Significant Loss or Negative Emotions)

1) Relaxation – Body & Mind
   a) Relaxation / Breathing session
   b) Conduct a short Chi Gung session.

2) Review
   a) Consider the nature of the occurrence from the perspective of feelings
   b) What feelings led to the decisions that were made, or actions that were taken?
   c) How does this make me feel after the event?
      i) The key here is to explore my feelings in a non-judgmental manner. Accept them.
   d) What does this mean? Where is the lesson?
   e) How will I behave in future when encountering the same circumstances?
   f) Visually replay the situation with the new improved behaviour. Confirm improved feelings.

3) Release
   a) Relaxation / Breathing session
   b) Forgive
   c) Completely let go of whatever happened.
   d) Review motivation journal.

Monitor Throughout the Session

1) Regular monitoring
   a) Throughout the session, take time to monitor and record any significant observations regarding:
      i) Market structure and price action movement
      ii) My trading process
      iii) My physical and psychological state

2) When?
   a) At key session times:
      i) Pre-Session, Mid-Session, Post-Session
   b) At key events
      i) After exiting every trade
      ii) After any structural changes
   c) Any other time that I feel I‟ve gained an insight into market structure, my trading process or my physical and psychological state.

Ongoing Analysis

1) Determine Candle Pattern Sentiment
   a) Classify the candle pattern and determine the short-term sentiment of price.
   b) Classify the candle pattern
      i) High / Mid / Low Close
      ii) Bull / Range / Bear Candle
   c) Determine the sentiment of the pattern

2) Consider the Context
   a) Every pattern is unique and MUST be considered in the context of the background market environment in which it occurs.
   b) Where is the current price action in relation to key market structure features:
      i) Support or Resistance
      ii) Trend
      iii) Swing Highs and Lows
   c) What does this mean with respect to the sentiment of the pattern and the potential future price action?

3) Does it Support my Premise?
   a) Is the market action continuing as expected, or is something indicating we‟re out of sync with market flow? Does the current price action and sentiment support our previous expectations for future price action?
      i) Yes
         (1) Await further price information.
      ii) No
         (1) Decide whether to hold for the next candle, or to reconsider the Initial Market Analysis.
      iii) Unsure
         (1) Wait for further price information.

4) Repeat
   a) Repeat the process as new information appears on the chart.

Trading

1) Trade Preparation

   a) Monitor price movement confirming it matches the behaviour previously anticipated. If price action differs from expectations, return to the initial analysis and recheck premise and assumptions.
   b) Identify trade parameters
      i) Stop loss location
      ii) Targets T1 & T2
      iii) Confirm entry zone
         (1) Consider both LWP (if identified) and LRP
   c) Identify preferred entry plan
      i) Stop and/or limit order
   d) Final confirmation
      i) The setup and trade is valid for this market environment
      ii) Price action is supporting the trade premise.

2) Trade Entry

   a) Monitor price movement bar by bar, until the entry locations are identified. Ensure price continues to support the trade premise.
      i) Determine candle pattern sentiment
      ii) Consider the context
      iii) Does it support my premise

   b) If bracketing price, place a stop entry order at the LWP as soon as it‟s identified.

   c) If working an entry, place an appropriate order in the market as soon as the entry decision is made.
      i) Limit entry order in area of stall
      ii) Limit or Stop entry order on price action trigger.

   d) Confirm pending order details are correct.
      i) Entry price, direction, size,
      ii) Contingent stop and target orders

   e) On fill:
      i) Cancel other no longer required pending orders.
      ii) Confirm full or partial position filled

   f) Post-fill confirmation (gross error check)

i) How do I feel about the entry?
ii) Confirm the setup and trade are valid for this market environment
iii) Confirm the price action is supporting the trade premise.

3) Trade Management & Exit

a) Continue monitoring price movement bar by bar. Ensure price continues to support the trade premise.
   i) Determine candle pattern sentiment
   ii) Consider the context
   iii) Does it support my premise

b) Part One
   i) While premise remains valid:
      (1) Move the stop to breakeven when we would no longer wish to be in the trade if price retraced to the entry point.
      (2) Move the stop to new levels where we would no longer wish to be in the trade if price retraced to that point.
   ii) When premise is threatened
      (1) Cancel position if immediate exit is required.
      (2) Else work an exit through tightening both the stop and target orders, based upon lower timeframe price action.

c) Part Two
   i) While premise remains valid:
      (1) Move the stop to breakeven when we would no longer wish to be in part two if price retraced to the entry point.
      (2) Move the stop to new levels where we would no longer wish to be in part two if price retraced to that point.
   ii) When premise is threatened
      (1) Cancel position if immediate exit is required.
      (2) Else work an exit through tightening both the stop and target orders, based upon lower timeframe price action.
   iii) When market shows increased strength
      (1) Consider extension of T2 or replacement with a trailing stop.

d) On partial exit
   i) Confirm order correctly filled.

e) On total exit
   i) Confirm flat.

4) Post-Trade

   a) Reconfigure order entry screens or DOM.
   b) In the event of a loss:
      i) Consider the need for a recovery process.
   c) Is price setting up for a possible re-entry or subsequent setup?
      i) Delay any trade log entries and prepare for the new trading process.
   d) When time permits:
      i) Update trade log.
      ii) Monitor and record significant observations:
         (1) Market structure or price action.
         (2) My trading process.
         (3) My physical and psychological state.

Routines – Post-Session

Immediately After

1) Relaxation and Breathing Session *(quick - 2 to 3 minutes max)*

2) Administration *(approx 5 mins)*
   a) Export transactions from broker
   b) Confirm my trade log matches the broker's transactions
   c) Complete any post-session trading log and spreadsheet entries
   d) Print charts and mark the trades *(usually completed during session, if it allows time)*
   e) Review P&L
   f) Update calendar with Green/Red profit or loss indicator

3) Trading Session Review *(approx 45 mins+; document any significant findings in the Trading Log under the heading Trading Session Review)*

   a) Market Environment Review
      i) With hindsight, how would you define the market environment?
      ii) How successful were you in identifying the market environment during the trading session?
      iii) What signs were present to indicate this environment?
      iv) What key pattern features were present and how could they have been used to identify the market trend and bias?
      v) Step manually through the chart bar by bar, or use a market replay feature to step through the chart at high speed, observing the market environment and the signals that identify that environment, trend and bias.
      vi) Print the chart and add appropriate notes to your Market Structure Journal.

   b) Trades Taken
      i) With the benefit of hindsight, was your trade based on a valid setup for that market environment?
      ii) If this was a valid trade:
         (1) Review the signals that led you to identify the trade opportunity?
         (2) What was the ideal entry point? How does that compare to your entry? What signals (if any) did the market provide, which could have led to an improved entry?

(3) Was the initial stop location appropriate? Was it in accordance with your trading plan? Where, with the benefit of hindsight, should the stop have been placed? What signals (if any) did the market provide to identify that location?

(4) What was the optimal trade management strategy, in order to minimize risk when wrong or maximize gain when right? How does that compare to your trade management strategy? What signals (if any) did the market provide for moving the stop to breakeven, or beyond?

(5) What was the optimal exit location or locations, in order to minimize risk when wrong or maximize gain when right? How does this compare to your exit location? What signals (if any) did the market provide to identify this ideal exit location?

iii) If this was not a valid trade:

(1) What signals were present that should have led you to avoid that trade?

(2) Having got into the trade, was the initial stop location appropriate? Was it in accordance with my trading plan? Where, with the benefit of hindsight, should the stop have been placed? What signals (if any) did the market provide to identify that location?

(3) What was the optimal way to manage this trade, in order to minimize risk when wrong or maximize gain when right? How does that compare to your trade management strategy? What signals (if any) did the market provide for moving the stop to breakeven, or beyond?

(4) What was the optimal exit location or locations, in order to minimize risk when wrong or maximize gain when right? How does this compare to your exit location? What signals (if any) did the market provide to identify this ideal exit location?

iv) Replay that portion of the trading session, making optimal decisions for valid trades and avoiding invalid trades, either by stepping manually through the chart bar by bar, or use a market replay feature.

c) Trades Missed

i) With the benefit of hindsight, where were the valid trade opportunities that were missed?

ii) For each of these trade opportunities:

(1) What signals did the market provide that should have alerted me to the trade setup?

(2) What was the ideal entry point? What signals (if any) did the market provide, which could have led to identify this ideal entry?

(3) Where, with the benefit of hindsight, should the stop have been placed? What signals (if any) did the market provide to identify that location?

(4) What was the optimal trade management strategy, in order to minimize risk when wrong or maximize gain when right? What signals (if any) did the market provide for moving the stop to breakeven, or beyond?

(5) What was the optimal exit location or locations, in order to minimize risk when wrong or maximize gain when right? What signals (if any) did the market provide to identify these ideal exit locations?

iii) Replay the trade, making optimal decisions, either by stepping manually through the chart bar by bar, or use a market replay feature.

d) Summarise this session's performance in the trading log.

4) Physical and Psychological Performance Review *(approx 2-3 mins; document any observations in my trading log under the heading Performance Review)*
   a) Were my fatigue levels appropriately managed?
   b) Was I in optimal physical condition? What can I do to improve?
   c) Was my ability to sustain focus at an acceptable level? What can I do to improve?
   d) Was I accepting of emotion during the trading session, without letting it unduly influence decision making? What can I do to improve?
   e) Was my mental state during trade execution one of confidence and self-belief, or one of fear? Why? What can I do to improve?
   f) Am I satisfied with my performance during this trading session? What can I do to improve?
   g) Do I feel I am making progress in my trading performance from day to day? What can I improve?
   h) Write summary notes.

5) Next Session Preparation *(approx 2 to 3 mins; document in my trading log under the heading Next Session)*
   a) Document any goals for the next session

6) Final Relaxation and Breathing Session *(quick - 2 to 3 minutes max)*

7) Completely let go of whatever happened during the trading session

Before Bed

1) Relaxation and Breathing Session *(quick - 2 to 3 minutes max)*

2) Visualisation of success - achievement of my outcome goals

3) Completely let go of whatever happened during the day

Contingency Management

Sources of Threat & Error:

- Evidence of Illness, Stress or Negativity Impacting Trading Decisions
- External Distraction
- Incorrect Order Entry or Incorrect Fill
- Loss of Connectivity (ISP, Computer, Platform) While in a Trade
- Session or Business Drawdown Limits Hit
- Violation of Rules

Evidence of Illness, Stress or Negativity Impacting Trading Decisions

1) If I have live trades, immediately either:
   a) Close the trades and cancel any working orders; or
   b) If positions are in profit, confirm appropriate stop (not < breakeven) and target orders, and walk away.

2) If I have working orders, cancel them.

3) Record details of the occurrence, for consideration during the post-session review.

4) Consider the need for a break, or a relaxation or recovery session, or for cancellation of the remainder of the session.

External Distraction (which can’t be ignored)

1) If I have live trades, immediately either:
   a) Close the trades and cancel any working orders; or
   b) If positions are in profit, confirm appropriate stop (not < breakeven) and target orders.

2) If I have working orders, cancel them.

3) Deal with the distraction.

4) Record details of the occurrence, as soon as possible, for consideration during the post-session review.

5) Consider the need for a break, or a relaxation or recover session prior to restart.

Incorrect Order Entry or Incorrect Fill

1) Immediately cancel the order if it hasn't been filled.

2) If the order is filled, rapidly assess the situation.
   a) If analysis indicates potential for the market to move rapidly against the position, EXIT.
   b) Else set an aggressive stop to minimise loss and manage the position to try to work a profitable exit.

3) Record details of the error, for consideration during the post-session review.

4) Contact broker immediately if error is due to a broker-error (incorrect fill).

5) Consider the need for a break, or a relaxation or recovery session.

Loss of Connectivity (ISP, Computer, Platform) While in a Trade

1) Close any open trades and pending orders via whichever of these means is available and quickest:
   a) Connecting to the platform via a backup computer.
   b) Connect to the broker online via their web platform.
   c) Immediately contact the broker via phone and/or live chat.

2) Resolve the issue if possible and continue with the session. If not continuing, conduct the post-session routine.

NOTE: All orders placed into the platform should have an attached stop and target order.

Session or Business Drawdown Limits Hit

1) Immediately exit all trades.

2) Consider the need for a break, or a relaxation or recovery session.

3) Complete the Post-Session routine.

Violation of Rules

1) If I violate any part of my trading plan, I will do the following:
   a) Do not put on any new trades.
   b) Close trades that should be closed.
   c) Manage open trades until the exit.

2) Record details of the violation, for consideration during the post-session review.

3) Consider the need for a break, or a relaxation or recovery session.

Action Affirmation (AA) Statements

Focus

- Breathing (slow and deep)
- Mind clear, body relaxed
- Trust (myself and my strategy)
- Focus

Analysis

- What is the trend?
- Where is the strength?
- Where is the weakness?
- Where is the next opportunity?
- Patience

Entry

- Confirm the weakness (against S/R or on PB)
- Who‟s trapped?
- Where will they exit?
- Trust (myself and my strategy)
- Fade the weakness! Spring the trap!
- Strike!

Management

- Patience
- Trust (myself and my strategy)
- Where‟s the strength?
- Where‟s the weakness?
- Hold while the premise remains valid

Regroup

- Confirm flat
- Clear my mind
- Review the trade
- Review any error
- Accept it
- Forget it
- Focus

Longer-Term Reviews

Weekly:

1) Trading Performance Review
    a) Review trading stats for the week for all trades, and all monitored subsets of trades
        i) Win%
        ii) Win / Loss Size Ratio
    b) Identify and analyse any deficiency or greatly improved performance
    c) Note any observations in the trading log

2) Trading Log Review
    a) Review the trading log for all sessions.
    b) Confirm all significant observations have been recorded in the lessons learnt, market structure and trades journals.

3) Market Replay Session
    a) Conduct market replay of any key trades or sequences of price action.

4) Personal Performance Review
    a) Consider my personal trading performance in the following areas:
        i) Health
        ii) Mindset
        iii) Focus
        iv) Discipline
        v) Attitude
    b) Identify areas for improvement.

5) Develop process goals for the next week.

6) Confirm money management figures for the next week.

Monthly:

1) Trading Performance Review
    a) Review trading stats for the month for all trades, and all monitored subsets of trades
        i) Win%
        ii) Win / Loss Size Ratio
    b) Identify and analyse any deficiency or greatly improved performance.

2) Study new entries in the lessons learnt, market structure and trades journals.

3) Complete trading plan review.

4) Develop process goals for the next month.

Bi-Annual / Annual:

1) Am I enjoying myself?

2) Have I achieved my trading goals? Why? Why not?
3) Are my trading goals still relevant?

4) Have I achieved my *reasons why*? Why? Why not?
5) Are my *reasons why* still relevant?

Trading Plan Review

1) Is my trading plan current? Does it accurately reflect how I trade?
2) What is the strongest part of my trading plan? What can I do to improve it?
3) What is the weakest part of my trading plan? What can I do to improve it? What can I do to minimise the risk or impact?
4) What is the area of my trading plan that I haven‟t really developed to its fullest potential?
5) Do I really know whether my plan provides a positive expectancy? How do I know?
6) What is one thing I could do right now to improve my pre-trading preparation?
7) What is one thing I could do right now to improve my identification of setups?
8) What is one thing I could do right now to improve my entries?
9) What is one thing I could do right now to improve my trade management?
10) What is one thing I could do right now to improve my exits?
11) What is one thing I could do right now to improve my post-trade review process?
12) What is one thing I could do right now to improve my record keeping?
13) What is one thing I could do right now to improve my longer term reviews (weekly, monthly, biannually)?
14) What is one thing I could do right now to improve my discipline?
15) What is one thing I could do right now to improve my consistency?
16) What is one thing I could do right now to improve my trading psychology?
17) What is one thing I could do right now to improve my money management?
18) What is one thing I could do right now to improve my risk management?
19) What do I fear most in my trading?
20) What am I embarrassed to talk to others about when discussing my trading?
21) What was the low point of the last period? What will I do to prevent that reoccurring?
22) What was the high point of the last period? What will I do to ensure that repeats again in future?
23) How do I plan to improve in coming months?
24) Review the layout of the supplementary journals and logs. Is there scope for improvement?

Chapter Fourteen – Additional Documentation

14.1 – Additional Documentation

In addition to our Trading Plan and our Procedures Manual, we make use of the following documents:

- Trading Journal Spreadsheet
- Trading Log
- Motivation Journal
- Lessons Learnt Journal
- Market Structure Journal
- Trades Journal

For all of these documents, make use of online storage if you prefer. However I find a paper-based system is best for all except the Trading Journal Spreadsheet. This is simply due to the fact that you‟re more likely to refer to an easily accessible paper-based journal. Your call though!

14.2 - Trading Journal Spreadsheet

This is a spreadsheet, used for recording and analysing your trade statistics. It‟s an essential tool for analysing your win percentage and win/loss size ratio, for all the subsets of trade data. We spoke about the need for this spreadsheet in chapter 9.

The Trading Journal Spreadsheet which I currently use will be listed on my YTC Resources Page, under the heading of Business Management:
http://www.yourtradingcoach.com/Trading-Resources.html

14.3 - Trading Log

The trading log is the primary document I use on a daily basis for recording anything and everything which occurs pre-session, during session and post-session.

I‟ve trialed different logs in the past – one for trading data; one for psych notes. I‟ve found it‟s too hard to switch back and forth during the session. I now put everything in one.

I use an A4 size lecture pad, which can then be inserted in a ring binder for archiving, once full.

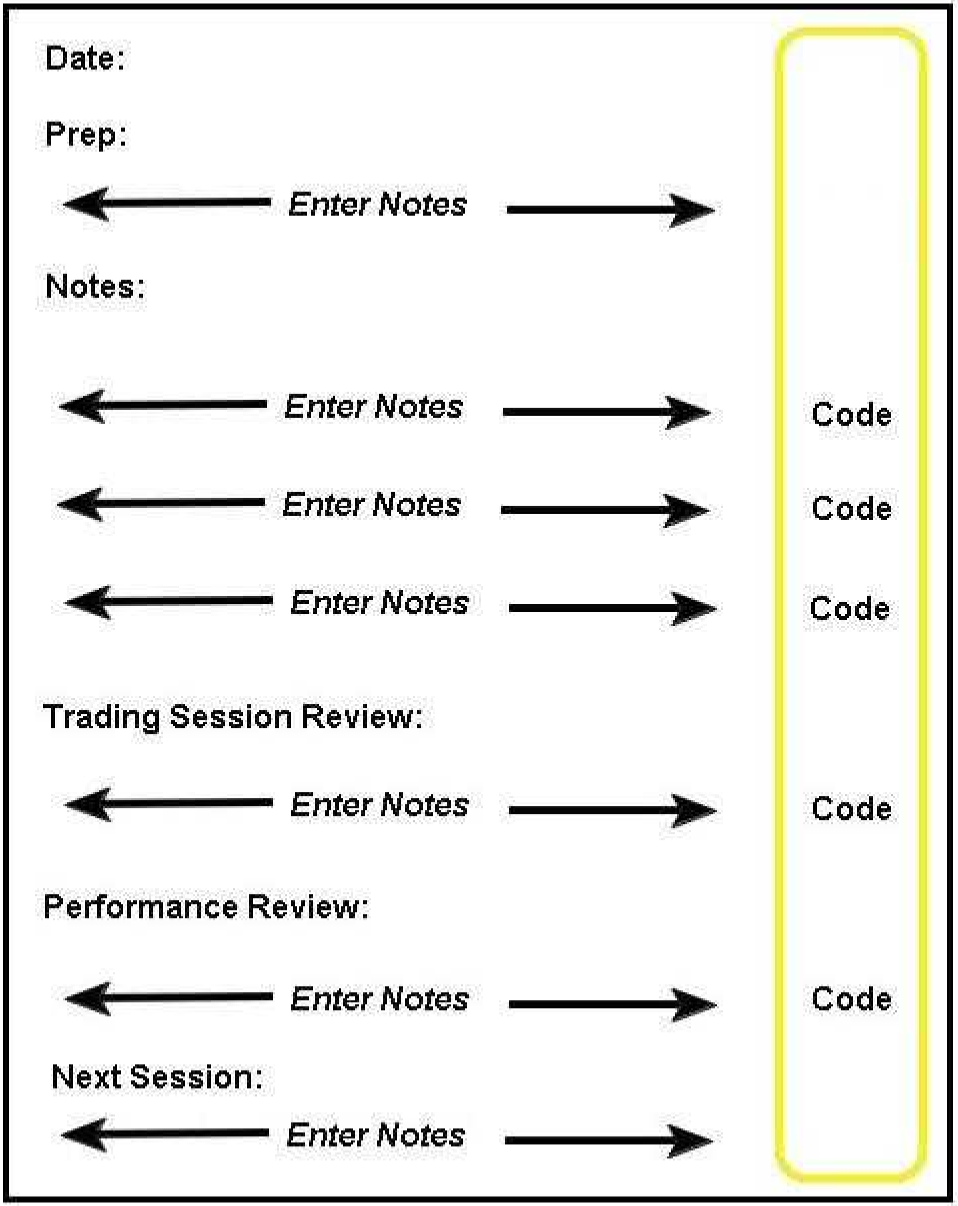

Figure 14.1 – Trading Log

Data is entered under headings of Date, Prep, Notes, Trading Session Review, Performance Review and Next Section, as guided by the procedures manual.

In the margin alongside any Notes or Review text, I place a short code to allow me to quickly identify the nature of this text. Codes are as follows:

- AN = analysis
- TR = trading
- MK = market structure observation
- LL = lesson learnt
- PERS = personal / psych observation
- ? = anything else of potential or unknown significance which needs to be considered during the post-session review

This coding of the trading log entries is not essential, but it makes it easier to find all data related to one topic, amongst the whole session"s log entries. For example, if I wanted to review any personal performance or psych observations, I just look for the PERS codes.

The prep section contains any pre-session information, such as date, market, session times, position sizes, key news events etc.

The notes section then contains anything I want to record during the session – key analysis observations such as slowing momentum or expected setups; trade entry parameters such as the entry, stop and target prices; psych observations such as your feelings the time of entry. And naturally, anything I feel should be reviewed post-session and anything which I feel is suitable for inclusion in our market structure, lessons learnt journals.

One final point… I find it beneficial for analysis and trade notes to preface each note with the current time, in case you wish to cross reference the notes with a chart.

14.4 - Motivation Journal

The motivation journal was discussed in detail in chapter 10.

14.5 - Lessons Learnt Journal

The lessons learnt journal is a loose-leaf folder containing the following sections:

- Market Structure
- Price Action
- Setups
- Trade Entry
- Trade Management / Exit

- Psychology
- Business Management
- Learning to Trade
- Miscellaneous

You may prefer to use a spreadsheet or some other form of online document. I have tried that for quite a while; however I found that I was not referring to it very often for study purposes. A paper-based system is preferable simply due to it being easily accessible.

Within each section I simply record ANY significant observation or lesson from the categories. This primarily occurs during the post-session review, but can also occur at any other time such as upon discovering a key lesson while reading a trading book.

Interestingly, you‟ll find that as you develop in your knowledge and skills, you‟ll review your lessons learnt journal and discover items that no longer have relevance to the way you trade or to your beliefs about the markets. When that occurs I simply cross them out. No problems!

14.6 - Market Structure Journal

I previously wrote about the market structure journal in a free ebook release, entitled, "The Greatest Trading Book – Ever!"

There was a copy available on the download page for this ebook series.

You can also find it at the YTC ebooks page: http://www.yourtradingcoach.com/ebooks.html

The market structure journal is an incredibly valuable tool for building your intuitive ability to identify the nature of the current market and identify structural changes in real-time.

The best format in my opinion is a folder, allowing loose sheets to be inserted after each trading session.

Print charts for the *trading timeframe*, and use a pen to document any key structural features on the printed price action.

You may prefer to just file each session sequentially, or you may wish to file them in sections, according to market environment:

- Trending / Volatile
- Trending / Non-volatile
- Ranging / Volatile
- Ranging / Non-volatile
- Combination

14.7 - Trades Journal

This is a loose-leaf folder containing printouts of trades.

I did try keeping them electronically for quite a while (saved as a .jpg), but found I was never referring to them. Paper takes up a lot of room, but at least they are easily accessible for review and ongoing learning purposes.

Importantly, there is no need to keep printouts of every trade (unless you wish to). I prefer to only keep those which I feel offer some learning potential – those particularly well managed, and those which were poorly managed.

I prefer to keep this as a separate journal. Sometimes I‟m just in the mood to look at some trades!

You may wish to keep them filed sequentially by date, or separate them into sections based upon the setup. I‟ve found I prefer the first. Trial both and find what works best for you.

If you prefer to cut down on the number of separate journals, you have some other options:

- If your trading log is a loose-leaf folder, insert your trade printouts following each session‟s trade log entries.
- If your lessons learnt folder is a loose-leaf folder, insert your trade printouts in a Trades section.

VOLUME FIVE

Www.ForexWinners.net

TRADER DEVELOPMENT

Chapter Fifteen – The Journey

15.1 – FACT: Most Readers Will Fail to Achieve Consistent Profitability

In previous volumes I‟ve presented my theory of the markets, my method of analysis and my trading strategy. Yet, I still expect most readers will fail to achieve consistent profitability.

Why is that?

Let‟s consider the failure rate within this industry. While I have no authoritative source to provide, the failure rate is often quoted as being anywhere from 80-95%. I‟d suggest it‟s possibly even worse than 95%.

While I hope to achieve much better than this, through the detailed explanations and examples I‟ve provided (and through other forms of ongoing education in future), I‟d be naïve to think that all readers of my ebook series will succeed. The reality is that most won‟t.

The strategy I've provided is simple in concept – fade weakness when price interacts with S/R, and fade weakness in a pullback within a trend.

The reality though is that it‟s hard to trade in the uncertainty of market price action. It‟s the infinite variations of the patterns that will have you doubting and second guessing your analysis.

Let‟s consider some variations we‟ve seen in earlier chapters, of price approaching an S/R level.

Every example provided in figure 15.1 (next page) is unique, just as every occurrence in the markets is unique.

As price approaches an area of S/R, should you take a TST entry? Or should you hold out for a break of the level and a possible BOF? As price slowed into the area of resistance in example (a), there was a great TST opportunity at the doji (mid-chart). Of course, this trade was stopped out as price continued to push just a little further to create a BOF setup. If you took the first, and were stopped out by the choppy price action, will you now have the confidence to take the second?

Example (b) produced similar price action – a weakening test of S/R which then stopped us out, broke S/R and then moved again in our original direction. While a similar scenario to (a), the questions it raises are very different. In this occurrence, price held below the support level for almost 10 minutes. Is this enough to show acceptance of price below the support zone? Should you be holding for a BPB, rather than taking any BOF entry? Will you trust the BOF trigger, or delay slightly and miss the rapid move higher?

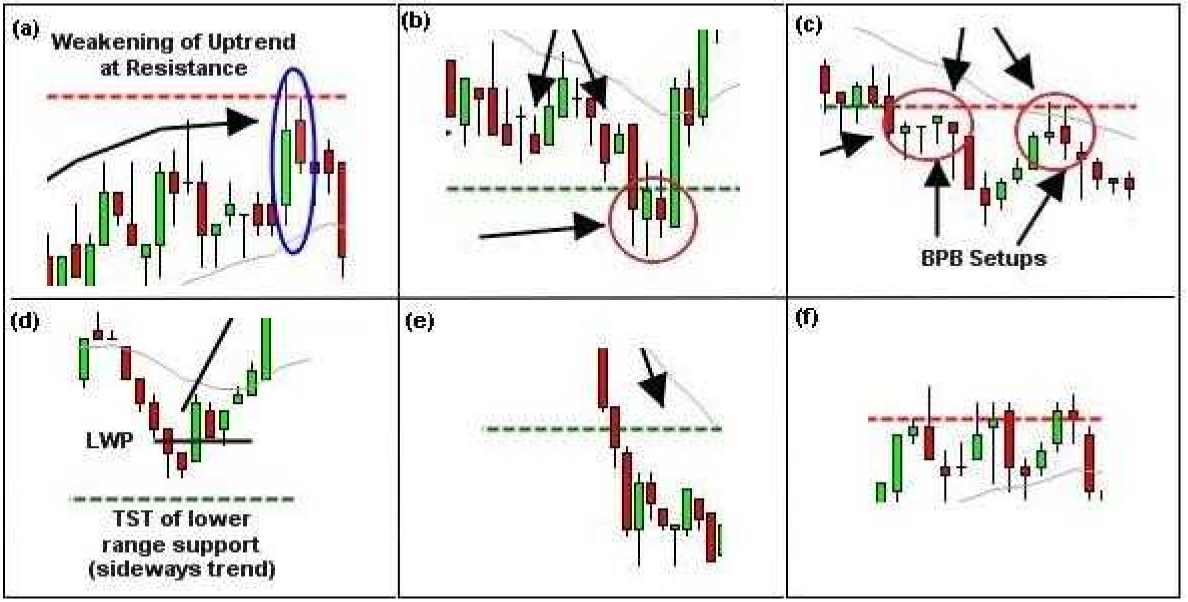

Figure 15.1 – Variation of Patterns at Price Interaction with S/R

Example (c) shows another variation. The nice tails below the post-breakout price action would have you jumping at the chance to take a BOF entry. But somehow there was never enough demand to drive price higher. Would you have had the ability to perceive the failure, and the courage to reverse into the first BPB setup? If you did, and then saw it scratched at breakeven when price returned to the S/R level again, would you have had the confidence to take the second BPB entry? Or would the recent loss and scratching have you a bit hesitant to re-enter?

Sometimes the market never quite reaches the level as shown in (d). Sometimes it smashes straight through it, as in example (e). Other times, as in (f), price just holds at the level and grinds sideways, allowing neither bulls nor bears the opportunity for profit.

Every situation in the markets is unique. That‟s what makes it so hard to trade.

Your results will vary anywhere on the scale from consistent loser to consistent winner, dependent on:

- Your ability to perceive the shifting forces of strength and weakness within the market, and place that within the context of higher timeframe structure, in order to identify the likely future direction of price action;

- Your ability to identify areas of trade opportunity within that price action, and to time entry and exit decisions in order to minimise risk and maximise profit potential; and

- Your ability to trust yourself and your strategy, with sufficient confidence to allow you to take the entry and exit signals without hesitation.

All three of the above are a result of experience. They don‟t come from reading this book. They don‟t come from watching a video of me trade. They come as a result of getting in the market and trading; making mistakes, identifying them, learning from them, and improving.

Learning to operate in the uncertain market environment, is a process (or journey) of gradual improvement.

So, why will most fail? Simply, because they won‟t last the journey! They‟ll quit before they make it.

15.2 - The Journey

Success in trading does not come from a *Holy Grail* strategy that you simply implement with discipline. You can't just GET a trading system or strategy; you have to BECOME a trader. It's a journey of trial and error; of two steps forward and one step back; of growth and development.

It‟s the infinite variations on the patterns, within an environment of uncertainty, being executed and managed by a trader, handicapped by fear based heuristics, biases and flawed decision making processes, that make this game so hard.

I can‟t give you a solution – its journey that you have to take; a process of growth and development. All I can do is point you in the right direction.

Learn to read the price action. Determine the market environment. Learn to place current price action into the context of the larger timeframe price action. Identify areas of opportunity within that environment. Find a low risk entry position. Get in. Manage the hell out of the trade, in order to firstly minimise risk and secondly maximise opportunity. Make a ton of mistakes. Review them. Learn from them. Repeat them over and over until it finally sinks in. Grow and improve.

It's not about simple, objective entry and exit rules. It‟s about knowing when to take the setup and when to avoid it (based on context and the current nature of price action). It's about knowing when to use a pullback (limit order) entry or when to take a breakout entry. It's about knowing when to scratch a trade, rather than hold on hoping for it to reach the target. It's about learning to be ok with being wrong. It‟s about learning to TRUST yourself. It‟s about learning to TRUST the strategy.

It‟s about forgiving yourself when you make mistakes. Again and again and again!

It‟s about being ok with losses, and with stopping out to the tick before the market moves on without you, because you‟ve seen this enough times to know that it‟s just part of the game, and you can simply move on to the next setup secure in the knowledge that new equity highs are just around the corner.

This all takes time - exposure to the markets - exposure to the process of making decisions and taking action - exposure to error.

It‟s not about certainty. It‟s about becoming comfortable operating in an environment of uncertainty. Knowing that you don‟t know what‟s going to happen next, and being ok with that. Knowing that even though you don‟t know where price will go next, you have proven through experience that you have the skills, knowledge and attitude required to manage the opportunity appropriately to minimise risk or maximise gain, regardless of which eventuates.

Learning to trade is NOT learning a price action setup. It is a process of BECOMING a trader.

It is a journey of growth and development – developing your perceptual abilities; developing your awareness of risk; developing your decision making abilities; developing your tolerance for uncertainty.

Learning to trade is a process of Trader Development.

Until you accept that, you‟ll never make it. You‟ll be stuck in the search for the simple trading system or strategy.

The analysis process in chapter 3 and the strategy in chapter 4 simply provided you with the tools for interacting with the market. Now you have to learn how to trade them.

It‟s not easy. But others have made it and so can you.

The following chapters will help you along your journey.

Chapter 16 will provide you with the tools and techniques to ensure you progress as fast as possible. And Chapter 17 will get you started on your first steps, laying out a roadmap for the journey ahead.

Chapter Sixteen – The Learning Process

16.1 – Effective Learning

We‟ve clearly established earlier that trading success does not come from any special set of rules or indicators.

Rather it comes from an ability to read the price action, identifying signs of strength and weakness, understanding what that means, projecting that forward to identify potential future price action, and being able to take advantage of the areas of wholesale trade opportunity within that action.

It‟s a dynamic, subjective and largely intuitive process.

Achieving mastery of that process is the result of **deliberate practice**.

16.2 – Deliberate Practice

Deliberate practice, also referred to as Deep Practice, is a motivated, solution-focused process of seeking improvement in any performance related activity.

It is practice, over and over again, in which we act, receive feedback on our results, identify potential improvement and then repeat.

As Daniel Coyle says in "The Talent Code":

"Deep practice is not simply about struggling; it's about seeking out a particular struggle, which involves a cycle of distinct actions.

1. *Pick a target.*
2. *Reach for it.*
3. *Evaluate the gap between the target and the reach.*
4. *Return to setup one.*

Essentially, it‟s a process of repeated exposure combined with a process of trial and error.

Most people accept that riding a bike is simple. But only because you went through the learning process of trial and error – falling off many times and getting back on.

Trading is the same. Maximise exposure; and learn through a process of trial and error.

The concept of deliberate practice is well demonstrated in this great extract from an SMB Capital blog post:

"… these patterns are most useful if you own them and make them your own. I have trained traders in the past and one of the exercises I had them do was literally to find several hundred examples of support / resistance both holding and failing on daily charts, and then to examine price action on intraday charts around those levels. You really do have to see many hundreds of patterns before you are comfortable with all the variations of holding and failing (and then failures of failures). I do not believe it is constructive, or even possible, to catalog all of the possible variations, but intuition will slowly grow from repeated exposure. Be aware that there is a tremendous difference between understanding patterns and trading, and this is but one of many important elements of price action."

http://www.smbtraining.com/blog/will-support-hold-or-fail-price-rejection-can-usually-tell-the-tale

Refer to "Cambridge Handbook of Expertise and Export Performance" by Anders Ericsson for more detailed study, or "The Talent Code" by Daniel Coyle for a great, easy to read introduction.

16.3 – Trade–Record–Review-Improve

As professional traders, we aim to implement deliberate practice into our daily routines. Not just during your learning phase, but continuing throughout your whole career. After all, in this game your learning will never end.

We do that through what I refer to as a *Trade-Record-Review-Improve* cycle.

Trade

- Self-explanatory… trade the markets in accordance with your trading plan and procedures manual.

Record

- Record results in your trading logs and journals.

Review

- Review your results, considering the four key questions:
  a. What did you expect to happen?
  b. What did happen?
  c. Why was there a difference?
  d. What can you learn from this?

Improve

- Implement improvements, either through setting process goals for the next trading session, or through amendment to the trading plan and/or procedures manual.

16.4 – Deliberate Practice Tools and Techniques

16.4.1 – Defined Trading Procedures

Defined trading procedures are the primary deliberate practice tool for the Trade stage (of our Trade-Record-Review-Improve cycle).

Chapter 12 documented our trading plan. Chapter 13 documented our trading procedures. By having clearly defined and documented procedures we ensure we minimise the likelihood of procedural error and maximise the likelihood of correct application of our trading strategy.

Our procedures manual also provides processes for ensuring we remain in a focused state with positive mindset.

Results will depend on our ability to correctly apply our plan and procedures; plus our level of expertise with regards to market analysis and decision making.

16.4.2 - Trading Logs and Journals

Chapter 14 outlined the numerous trading logs and journals which we use to record observations and outcomes during our trading process.

These logs and journals are the primary tools for the Record stage (of our Trade-Record-Review-Improve cycle), also featuring heavily during the Review stage.

Journals also offer the benefit of being easily accessible for further reading, whenever we have spare time.

16.4.3 - Documented Review Process

Our procedures manual, outlined in Chapter 13, provided a sample session review procedure.

The primary aim of the session review is, in my opinion, carrying out a ***comparison between your performance and perfect performance.*** That is, looking at the session with the benefit of hindsight and asking some hard questions about both your read of the market environment and your ability to trade that environment.

This post-session review procedure is therefore the primary tool in achieving an effective Review stage (of our Trade-Record-Review-Improve cycle).

You may also wish to refer to the following article series, titled, "How to Conduct an Effective Trading Session Review":

- Part One: http://www.yourtradingcoach.com/Articles-Business-Management/Effective-Trading-Session-Review-1-of-2.html
- Part Two: http://www.yourtradingcoach.com/Articles-Business-Management/Effective-Trading-Session-Review-2-of-2.html

The procedures manual also outlines processes for our longer-term reviews – monthly and annual.

The end result of the review process is a set of process goals for the next trading session; recorded in your trading log. This, hopefully applied with success in the next session, is the Improve part of your Trade-Record-Review-Improve cycle.

16.4.4 - Market Replay

Our session review process also includes recommendations for use of a market replay feature, if your trading platform offers such a tool.

Market replay allows you to replay the trading session in a simulated environment. Price bars appear tick by tick, exactly as they did when trading live.

It will typically offer controls, as displayed below for play, pause and fast-forward, as well as a slide control to move to any particular chart time period.

We are also able to re-enter and manage trades all over again, this time in a simulated environment.

This is an ideal tool for implementing deliberate practice.

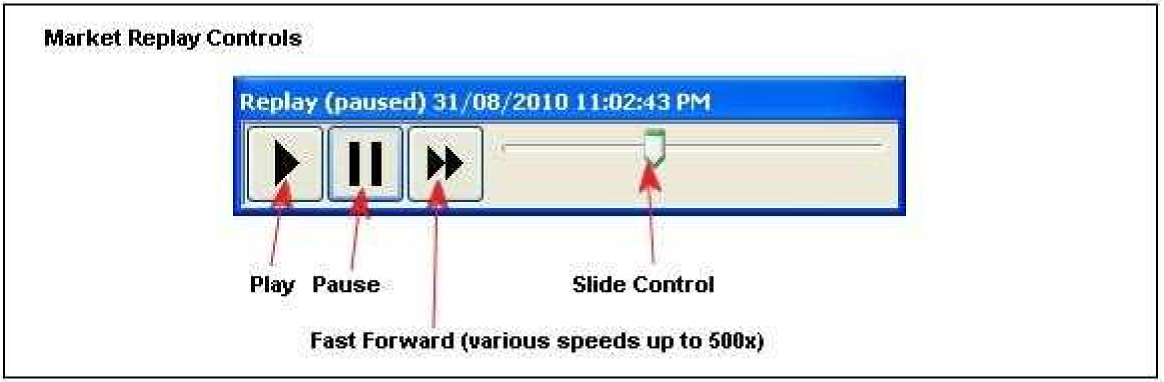

Figure 16.1 - Market Replay Controls - NinjaTrader

Our post-session review allows us to identify error within our analysis or decision making. The market replay then allows us the opportunity to re-trade our setups again with the benefit of perfect hindsight; reinforcing correct behavior, enhancing our intuitive pattern recognition abilities, and advancing us further along our path of trader development.

Let‟s look quickly at an example of the use of the market replay tool. You may recall the following trade from chapter 5, example 7.

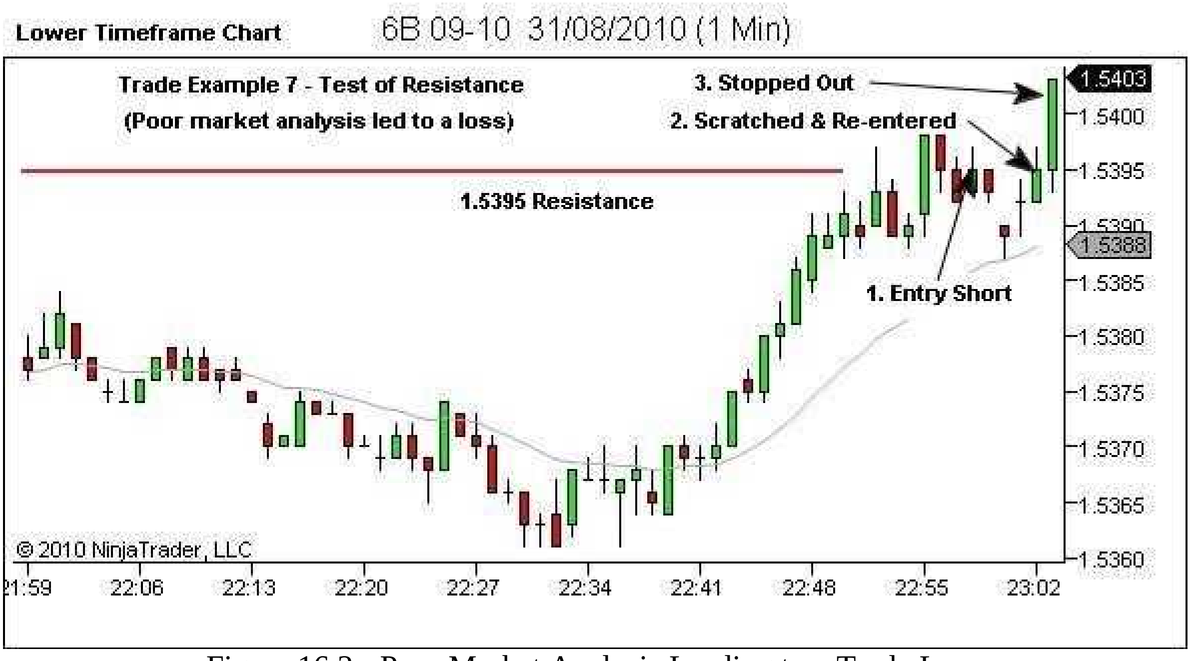

Figure 16.2 - Poor Market Analysis Leading to a Trade Loss

In this example, my expectation for a strong area of resistance led me to largely ignoring the signs of strength and weakness within the price action. I entered short in a low probability situation; and despite a feeling of unease, and further warning signs, I still managed to hold the trade for a small loss.

The use of a market replay after the session allows me to trade this setup again. I was able to start a couple of minutes prior to entry in order to feel the bullish pressure that existed in swing A, noticing the ease with which price moved higher. I then experienced the difficulty with which price fell during swing B; and the stall (and failure to follow through) when price dropped to the swing low area.

I also felt the ease with which price again moved upwards in swing C.

I did this again entering and managing in the same places as when I traded the original action, in order to feel how wrong it was.

I then repeated the action with „perfect hindsight‟ trade entry and management, entering long after the spring between swings B and C, when I should have entered long, or reversed my short if I had taken that original entry.

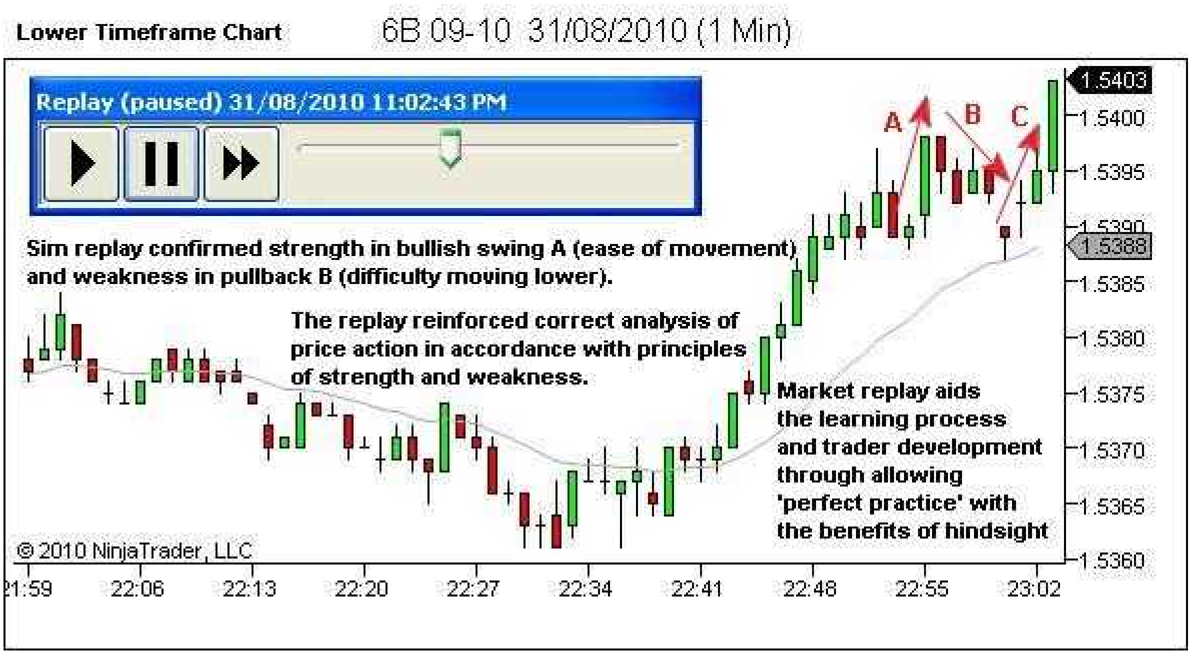

Figure 16.3 - Market Replay as a Trader Development Tool

While the exact price action will not occur again in future (every setup is unique), many very similar situations will occur over the remainder of my trading career.

Through taking these actions post-session, I have reinforced the lessons from this trade, as well as experienced perfect trade entry and management.

And I have taken another small step forward in my development as a trader.

16.4.5 - Market Replay Alternatives

If your trading platform does not offer a market replay feature, I highly recommend you consider changing platforms.

However there are alternatives.

1) Use video and audio screen capture software such as Camtasia, in order to record your live trades. This allows you to play back the video during your post-session review and compare your live trading decisions (supported by audio comments during the trade) with hindsight-perfect trading decisions. However this does not allow for re-trading the setup, as available through market replay.

2) As a last resort, simply step bar by bar through your charts, either on the screen or on paper, reviewing your trading decisions from the perspective of your hindsight-perfect analysis. It‟s not as good as market replay, but don‟t discount it if this is all you can do. It‟s still achieving deliberate practice – trading, seeking feedback, identifying the lessons, reinforcing correct behaviour, and repeating.

16.4.6 – Peer Review

One further option you may wish to consider for enhancing your deliberate practice is peer review.

It requires that you create a trading group – a small number of traders (I‟d suggest 4 to 6) who act to support each other through the learning phase.

This is not something I have been involved in (at least not in a way which worked). It can be quite difficult to find the right group of people if you don‟t already have a network of friends all interested in trading the same markets, timeframe and strategy.

However, if you do have an established network, or can create one, consider implementing the following review process.

After each session (if time allows), or at least one a week over the weekend, each person is to submit their journals to another member of the group for review and feedback.

You‟ll learn from reviewing their work. And you‟ll learn from reviewing the feedback they provide on your work.

As I said, it can be difficult to find the right group of people. I never did. But if you can achieve this I suspect it will be the next-best thing to having a personal mentor, and a whole lot cheaper.

Chapter Seventeen – Taking Action

17.1 - Taking Action

Our aim in this chapter is to put in place a process to follow as you progress from wherever you are right now, towards consistent profitability.

If you‟re a novice, start at the beginning. If you‟re experienced, start at the beginning as well, comforted by the fact that you‟ll progress faster.

As with anything I present, feel free to adapt it to your own needs. Although I will caution you; there are no short-cuts in this game. Learning is a process. Cut out or amend steps at your own risk.

17.2 - The Development Stages

We‟ll start by defining several stages of development.

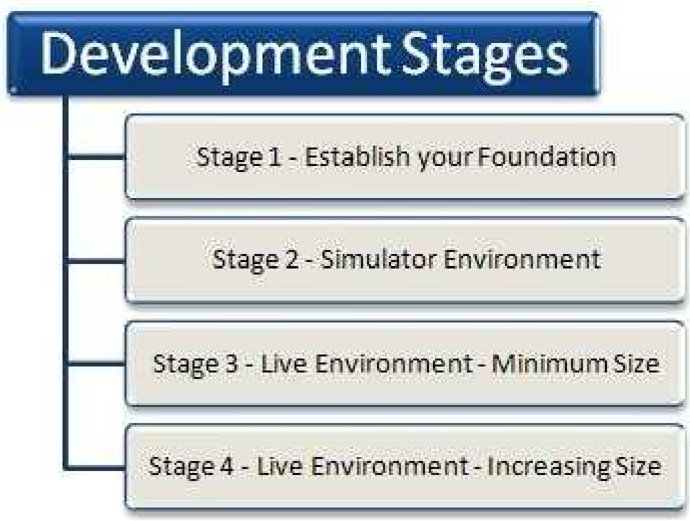

Figure 17.1 – Development Stages

We establish our foundation; we learn to trade in a simulated environment; we learn to trade live with minimum size; and we learn to trade live with increasing size.

Each stage must be clearly defined, with targets to achieve prior to advancing to the next stage. Let‟s do that now.

17.2.1 – Stage 1 – Establish Your Foundation

Foundation Knowledge:

1) Read the six volumes of YTC Price Action Trader.

Setup:

1) Choose your market and timeframe.
2) Document your trading plan and procedures manual – *Chapters 12 and 13*.
3) Establish your logs and journals – *Chapter 14*.
4) Set up your trading platform – *Chapter 11*.

Study price action – market structure and setup areas:

1) Print historical charts (all three timeframes) for 100 trading sessions.
2) Take the charts for one session, and study price action with the benefit of *hindsight perfection.*
   a) Where were the *higher timeframe* S/R levels? Mark them on the *higher* and *trading timeframe* charts, only to the point at which they become irrelevant. Then add new levels as they come into play.
   b) Study the nature of price movement within the structure. Define the changes of trend. How did it trend? Is it moving with ease, or facing opposing orderflow throughout? What does this tell you about the bullish or bearish sentiment of market participants? What clues were provided that could have alerted you to the nature of price movement? Note any significant changes in structure, such as key breakout points, or areas of smooth price trend vs congestion. Look for clues that could have alerted you to the changing environment. Record observations on the charts. Record significant observations within your Lessons Learnt Journal.
   c) Identify setup areas and mark them on the chart. How could you have identified these in advance? Where are the signs of strength and weakness leading into the area? How did price act within the area, to provide clues as to potential success or failure?
      i) Study price interaction with S/R. What clues did price offer regarding potential test, breakout failure or breakout pullback opportunity? How could you have seen this in advance?
      ii) Study pullbacks. What price action led to a simple, single-swing pullback? What price action led to complex (multiple swing or extended duration) pullbacks?

d) **Don't worry about trades at this stage.** Simply make observations of market structure, the nature of price movement and setup areas.

3) Place the charts in your market structure journal.
4) Repeat steps 2 and 3 for all 100 sessions.

Simulator practice – market structure and setup areas:

1) Trade a simulator (demo) platform with live or recorded market data.
2) Follow price action throughout the session while carrying out your initial and ongoing analysis processes. Make notes within your trading log throughout the session. Print (or screen capture) charts if necessary to record price action at the time of your trading log observations.
3) **Do NOT concern yourself with trade entry, management and exit.** Just aim to follow price; maintaining your assessment of likely *future trend* direction and areas of trade opportunity.
4) Following each session, conduct your post-session review process in order to compare your actual performance with *hindsight-perfect* performance.
5) Print charts and make notes for your journals – lessons learnt and market structure.
6) Repeat for as long as necessary to feel comfortable with the process. I recommend no less than two weeks (10 sessions). Make use of market replay if time is available, in order to reinforce any lessons learnt and build your intuitive mental model of the markets and price action.

Study price action – trade opportunity:

1) Return to your 100 session chart printouts.
2) Having become comfortable with identifying market structure and setup opportunities, you will now consider trade entry and management. Start with the printouts for the first session.
   a) Review the previously identified setups.
   b) How should you have traded these setup areas (in broad principle only)? Where was the ideal entry point? Consider the nature of price movement (smooth or choppy with much candle overlap, for example) – how could that have influenced your trade entry decision? How should you have managed the trade, with the benefit of hindsight? Should you have scratched? When should you have moved stops to breakeven, or beyond? Where was the ideal exit? What clues were provided with the price action to lead to this *hindsight-perfect* trade?
3) Repeat step 2 for all sessions.
4) Return the charts to your Market Structure Journal for future study.

Simulator practice (market replay) – trade opportunity:

1) For each of the previously recorded simulator sessions:
   a) Replay market data with the intent of again conducting your initial and ongoing analysis, this time also trading each of the setups.
   b) Following each setup, pause to review your attempts to trade it. Where did you correctly read the market sentiment and make correct trading decisions? Where should your decisions have been different? Record any lessons in your lessons learnt journal.

Target for Advancement to Stage 2:

1) Minimum 100 historical sessions reviewed in hindsight – market structure and setup areas.
2) Minimum 2 weeks simulator trading – market structure and setup areas – NO TRADES.
3) Minimum 100 historical sessions reviewed in hindsight – trade opportunity.
4) Minimum 2 weeks simulator trading (market replay) – trade opportunity

Yes, this will take at least a month! Or possibly a lot longer if you don"t have 100 sessions of historical data! You may wish to consider similar markets to make up the numbers, but I recommend at least 50 sessions from the actual markets you will trade.

Be patient. You will learn a lot during this process.

17.2.2 – Stage 2 – Simulator Environment

Initial Benchmark:

1) Review the Pre, During and Post-Session Routines – *Chapter 13*
2) Commence trading the strategy as if live, but within the safety of a simulator (demo) environment.
3) **Carry out all daily routines for one week.** Do not concern yourself with results, although all trading must be conducted in as professional a manner as possible. We are not playing here! This is serious business!
4) Record your trading stats. These set your initial benchmark. You will most likely not have achieved profitable results. Do not be concerned. This is merely your starting point.

Improvement:

1) Continue trading, aiming for gradual improvements through an effective review process.
2) Refer to the later section on Challenges and Difficulties, if necessary.
3) Repeat until achieving profitable results in each of four consecutive weeks.

Target for Advancement to Stage 3:

1) Profitable results in each of four consecutive weeks, within the simulator (demo) environment.

17.2.3 – Stage 3 – Live Environment – Minimum Size

Initial Benchmark:

1) Commence trading the strategy in a live market environment, with the minimum position size possible for each of your two part positions.
2) Carry out all daily routines for one week.
3) STOP TRADING if you lose 10% of your trading funds. Something is most likely NOT going right. Conduct a thorough review and return to the simulator environment. Note: You must be financially able to afford the loss of this 10% of your trading funds. If not, do not commence stage 3 until having saved a larger account balance. Alternatively, consider moving to a market that allows smaller accounts and smaller position sizes.
4) Record your trading stats. These set your initial benchmark. You will most likely not have achieved profitable results. Do not be concerned. This is merely your starting point.

Improvement:

1) Continue trading, aiming for gradual improvements through an effective review process.
2) Refer to the later section on Challenges and Difficulties, if necessary.
3) There is to be no consideration for increasing position size until achieving profitable results in each of four consecutive weeks. Size increase though is not compulsory. Remain at minimum size for as long as you need.

Target for Advancement to Stage 4:

1) Profitable results in each of four consecutive weeks, within the live market environment, with minimum position size.

17.2.4 – Stage 4 – Live Environment – Increasing Size

Proof of Ability:

1) Return to a simulated environment, trading the increased position size.
2) Carry out all daily routines for one week.
3) Do not transition to a live environment until demonstrating a profitable week. If you fail to achieve profitability, consider either returning to the previous size for additional time, or attempting a second week. If the second week is not profitable you must remain at the original size. You may only progress to the live environment if the combined fortnight is profitable.

Trading Increased Size:

1) Continue trading, aiming for gradual improvements through an effective review process.
2) Refer to the later section on Challenges and Difficulties, if necessary.
3) There is to be no consideration for further increases of position size until achieving profitable results in each of four consecutive weeks at each size level. Size increase though is not compulsory. Remain at the current size for as long as you need.

Target for Further Size Increases:

1) Profitable results in each of four consecutive weeks, within the live market environment, with the current position size.

17.2.5 – As You Progress…

NOTE:

1) All size increases must involve a gradual increase, not a large jump. There is no hurry. The number one priority is to ensure survival at each level, prior to advancing to larger size.

2) Throughout this development plan I have referred to trading for a week. Obviously different weeks will have different numbers of trades. The intent is that each week provides a minimum of 20 trades. If your week does not provide this, carry this week over to include the next. That is, group the trades from the fortnight and consider that as a single week, for the purposes of our development plan.

17.3 – Taking Action - Alternate Strategies

If having read this book you find the strategy does not suit your psychology, or your view of the markets, or whatever else, that‟s absolutely fine. You can develop your own approach, or refer to my Resources Page for recommended alternates:
http://www.yourtradingcoach.com/Trading-Resources.html.

This series of books will have provided you with a good foundation, and an understanding of the type of processes you‟ll need to develop.

You will need to clearly document the fundamental principles behind how you see the markets and price movement, and where that offers trade opportunity. From there you will develop your trading plan and your procedures manual. This will take time, via another process of trial and error.

To discover the fundamental principles behind your strategy, you will benefit greatly from a period of time just watching price action.

Study live markets for as long as necessary, to gain a feel for how it moves. Study the different environments and the way price moves within each.

When comfortable with the movement of price, only then look for the trade opportunity within that movement. How can you identify the opportunity in advance? How can you gain a wholesale entry within that setup area?

In my opinion, it‟s all about how price interacts with areas of previous supply/demand imbalance. You may not like my way of identifying and trading these areas, but by watching price as it interacts with areas of S/R, swing highs and lows, and pullbacks within a trend, you‟ll find your own patterns for future price movement and for possible trade opportunity.

Remember though, trading is NOT about fixed rules or simple setups.

I‟ve provided rules and structure within this book, as I‟ve attempted to define what was largely a subjective and intuitive process as clearly as possible, for learning purposes. But within my rules there is much room for subjectivity. You‟ll need to do the same. It‟s how the market works!

It's not about simple rules for providing certainty. It's about getting better at making subjective decisions in uncertainty.

Having defined your strategy, I then recommend implementing the same process defined in section 17.2, for advancing through the four stages of trader development.

17.4 – Challenges and Difficulties

There are potentially an infinite number of challenges and difficulties which you will encounter on your trading journey. It‟s not possible to list them all. Although it is my intention that as many as possible will be addressed through the free articles at the YTC website. Please check the archives.

The greatest tool you have for identifying and overcoming any personal challenges will be your review process. If you can identify it, you can overcome it. Set process goals for the upcoming trading sessions, or draft amendments to your trading plan or procedures manual.

In time, through trial and error, all challenges can be overcome.

In this section though, I wish to provide some guidance regarding a couple of methods which I personally found useful in overcoming challenges and difficulties.

Reduce Size

Always the best option – cut size to a level which is almost meaningless.

Cut to the minimum allowed position size if necessary.

If problems still persist, return to the sim environment.

Simplification

This is an idea that I believe is the best way to advance along the path towards consistent profitability - **simplification**.

Through effective record keeping and an effective review process, identify what is working well and what is not working well.

Find ways to do more of what is working, and completely disregard (if possible) what is not working.

Sometimes this will solve the problem. More often it will simply bypass it, leaving it for another day (if ever).

In other words, through trial and error and an effective review process, find your strongest setups and market environments, and specialise just in them. Find the weakest and drop them for now.

Adapt as required.

Do whatever is required to achieve consistent profitability.

Examples…

If your best results come from with-trend trades, limit yourself to ONLY with-trend trades.

If breakout failure setups provide your best results, consider limiting your trading to breakout failure setups only.

Advancement through most stages of our plan require only four consecutive weeks of profitability. Do whatever is required to advance.

Hopefully when you discover that you‟re achieving greater levels of consistency, and better levels of profitability, maybe you‟ll accept that you don‟t need to trade those setups which cause you challenges. Stick to what works, and maximise that opportunity.

Two Timeframes; Simpler Entries

Along similar lines (simplification), if you‟re having trouble with the *lower timeframe* entries, then just get rid of this timeframe for a while.

Just trade the *trading timeframe* within the *higher timeframe* structure. If the R:R is appropriate, then take your entry at the LWP based on a breakout of the *trading timeframe* price action. Forget about trying to time better entries through the *lower timeframe*, until you‟re more comfortable with the whole process.

Right Focus

In trading the YTC Price Action Trader methodology, the temptation can be to focus too much on the l*ower timeframe* chart. After all, that‟s where the most price action happens. If you find yourself taking too many lower probability trades, it‟s likely that this is where you‟re searching for them. You‟re excluding the big picture.

This was a great challenge for me.

The strategy is designed around the *trading timeframe* movement within the *higher timeframe* structure. The *lower timeframe* should only be used for fine-tuning your *trading timeframe* analysis and for timing entry and exit.

Improve focus on the *trading timeframe* chart, simply by making it larger and more central to your field of view.

A simple solution… but it works.

One Good Trade

I‟ll borrow this heading from the excellent book by Mike Bellafiore, "One Good Trade".

Success doesn‟t require a magical strategy. Simply that you ensure the next trade is a good trade. Then the next trade after that is a good trade. And then the next trade is a good trade.

Avoid the lower probability, speculative or impulsive trades. Just make "good trades".

It may as simple as confirming that the trade is in the direction of recent strength and against recent weakness. Or it may be more detailed than that. Set up your own checklist criteria for a "good trade" and ONLY trade those setups which match your criteria list.

Affirmation Action Statements

We‟ve mentioned them before. Create affirmation action statements for any areas causing you problems, to keep your mind focused on correct actions, rather than being influenced by fear and doubt.

Let‟s look at an example.

One of the most common challenges in early stages of our career is just getting a limit order onto the system. Price is in the setup area. The stop area is identified. The target is identified. The entry zone is identified. But you sit there waiting, paralysed by fear and doubt thinking, "what if it goes further?"

Recognising the fact that adjusting an existing order is easier than putting one on to start with, we might adopt the following affirmation action statements.

1) Confirm – setup, stop, target
2) Confirm – R:R
3) Trust
4) Confidence
5) Place Order
6) Work Order

On (5), we place the order on the platform, well away from price. Beyond the proper stop area if you need to. This should be much easier. Price should NOT get there. Now work the order closer as price action increases your confidence.

It"s simple. It"s short. It can be memorised, or placed within sight on the wall at your trading desk.

Treat the statements as an order – if you decide to verbalise the statements, then you must carry out any actions dictated by the statements. Place the order, and then work it closer.

Employ a Team of Traders

Ok, not actually a team of traders! But you may benefit from separating the functions of your trading business and taking on the persona of a particular employee with a particular role and job description.

Have your market analysis conducted by an Analyst. Their role is simply to identify likely future price action and trade opportunity.

Have your pre-trade preparation in the setup area, and your decision to trade, monitored by your Risk Manager. Someone who will never allow you to enter a trade which does not offer acceptable R:R parameters. And someone who will never allow you to exceed your session drawdown limits.

Have the trade entry carried out by an Order Entry Clerk. While you"re adopting this persona, you are NOT allowed to second guess any trades. The Risk Manager approved it. Your job is to simply execute, and then hand over to the Operations Manager who will manage the trade in accordance with the procedures manual.

Trade and session reviews are conducted by the Compliance Manager. Would you be happy with the performance of your trading team today, or will you be demanding improved performance in the next section, and achievement of some new process-based goals?

Review your performance assuming the role of your Trading Coach, as if you‟re providing a review of another person‟s performance. Typically we are less critical of other trader‟s decisions, than we are of our own.

Sounds stupid? It helps. Give it a try.

17.5 - The Target

How do you know when you‟ve made it?

One day you will have achieved sufficient consistency in your results to have met your *Reasons Why*, which you established back in chapter 10.

Celebrate! You deserve it.

However this is not the time to let down your guard.

The reality is that this game will never be completely mastered. You will never achieve perfection – just improved ability.

Continue with your Trade-Record-Review-Improve cycle.

Keep moving forward.

17.6 – Additional Study

This volume has covered many topics which could be expanded upon to fill a whole series of books. I encourage you to consider this material as an introduction to these concepts and become a student of them through further research and education. In particular, Learning Theory should be considered essential study for all traders.

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VOLUME SIX

CONCLUSION

Chapter Eighteen – Conclusion

18.1 - Summary

18.1.1 – Principles of Markets – Summary

Markets are traders making trading decisions.

Price movement is a result of supply/demand imbalance. And the supply/demand imbalance is created by the traders' sense of urgency to transact.

- Price rises while demand is greater than supply, and while those buyers are willing to pay higher prices.

- Price rises until we run out of buyers, or until supply increases sufficiently to absorb all the demand.

- Price falls while supply is greater than demand, and while those sellers are willing to sell at lower prices.

- Price falls until we run out of sellers, or until demand increases to the point it absorbs all the supply.

Price moves with changes in the forces of supply and demand. Supply and demand change as the sentiment of the crowd changes. And the sentiment of the crowd changes with changes in the bullish or bearish sentiment of the market participants.

Trading is not about the fundamentals or technicals. It's about people… and the decisions they make about market direction.

Price moves as a collective result of all traders' bullish or bearish sentiment and their <u>decisions to act</u> in the market (buy or sell).

Learn to view all price movement from the perspective of other traders, and how the price movement influences their decision making.

The aim of your analysis then MUST be the following:

- To buy at areas where you KNOW others will buy after you, because their buying will create the net orderflow or bullish pressure to drive prices higher, allowing you opportunity to profit, or

- To sell at areas where you KNOW others will sell after you, because their selling will create the net orderflow or bearish pressure to drive prices lower, allowing you opportunity to profit.

Or more simply; buy at areas where others will buy after you, and sell at areas where others will sell after you.

To do that, your analysis must focus on areas of trader decisions.

What are other traders thinking? Where will they be making their trading decisions?

Identify areas at which others will be making buying decisions, and you can profit.

Identify areas at which others will be making selling decisions, and you can profit.

Individual trader decisions are unknown. However we can, through our analysis, identify areas where significant groups of traders will be under extreme stress, and therefore feel forced to act in a reasonably predictable manner.

We aim to enter before or at the point of maximum stress, where traders are coming to accept they’re wrong.

Their decision to exit is a means of relieving themselves of stress. This creates orderflow that takes our position to profit (provided of course you manage the trade well).

18.1.2 – Market Analysis – Summary

Initial Market Analysis Process Summary

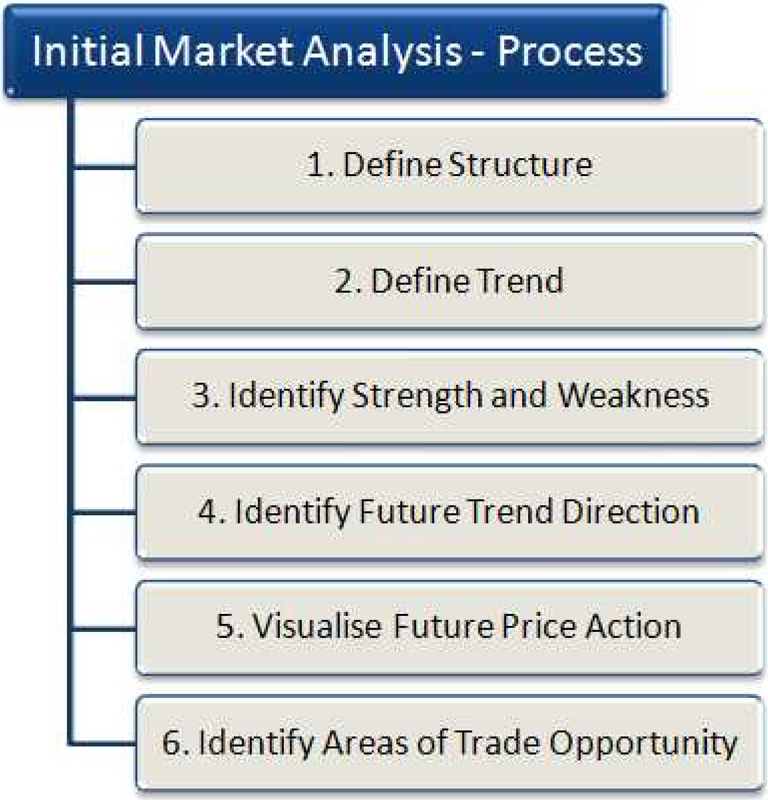

Figure 18.1 - Initial Market Analysis Process

Principles of Future Trend Direction

Within the S/R framework:

- **First Principle** – We expect an up or down trend to continue in its current state until the next S/R barrier, unless displaying evidence of weakness within the trend.

- **Second Principle** - When an up or down trend shows evidence of weakness, we expect a higher likelihood of a complex correction* rather than a reversal, until such time as the market shows both price acceptance and strength in the new trend direction.
  (a complex correction being one of extended duration, or multiple swings)*

- **Third Principle** – A sideways trend within the framework is expected to continue in its current state, unless displaying evidence of strength towards the range boundary.

- **Fourth Principle** - When a sideways trend shows evidence of strength towards the range boundary, we expect a break of the boundary. We observe the behaviour of price post-breakout for clues as to future direction:

  - Weakness following the breakout – the expectation is for a breakout failure and reversal back within the trading range

  - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

At the edges of the S/R framework:

- **Fifth Principle** – We expect a test of our framework S/R to hold, unless strength is displayed on approach to the S/R boundary.

- **Sixth Principle** - If strength is shown on an approach to an S/R barrier, we expect a breakout and watch the behaviour of price post-breakout for clues as to future direction:

  - Weakness following the breakout – the expectation is for a breakout failure and reversal back through the area of S/R.

  - Weakness on the pullback – the expectation is for a breakout pullback and continuation.

Ongoing Market Analysis Process Summary

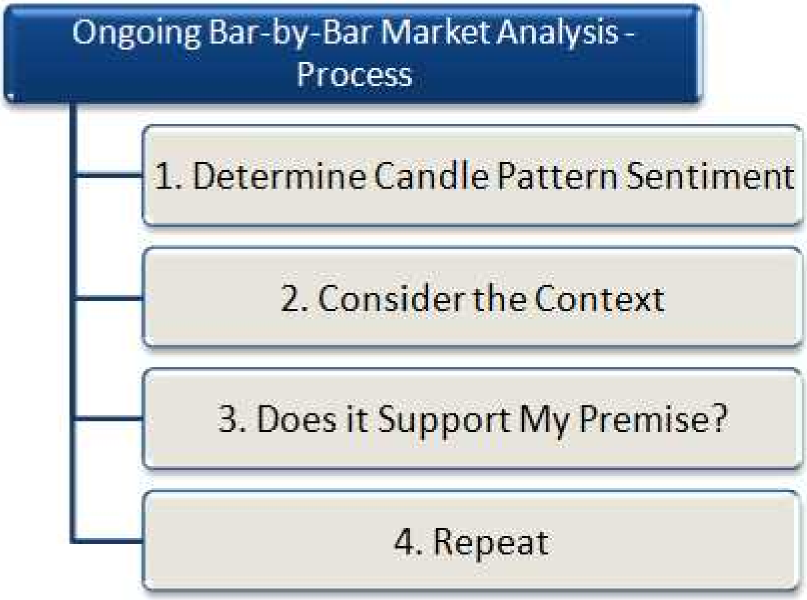

Figure 18.2- Ongoing Market Analysis Process

18.1.3 – Trading Strategy – Summary

Find the areas on a chart where other traders will make trading decisions and you've got yourself an edge.

Enter at or before the change of net order flow and you've got a great opportunity to profit (provided you manage the trade well).

Our trading approach therefore needs to be based on this fundamental understanding of how to profit from the markets:

- We identify areas at which sufficient numbers of traders will be experiencing stress, and will make trading decisions to relieve them of that stress, and then act before or with them in order to profit from the resultant orderflow.

We aim to find places on the chart where other traders are fighting the bias. We identify the areas where they realise they're wrong and are forced to exit.

There are two primary concepts behind all my setups – fading weakness and fading trapped traders.

Identify weakness. Identify trapped traders. Fade the weakness and be part of the orderflow which springs the trap.

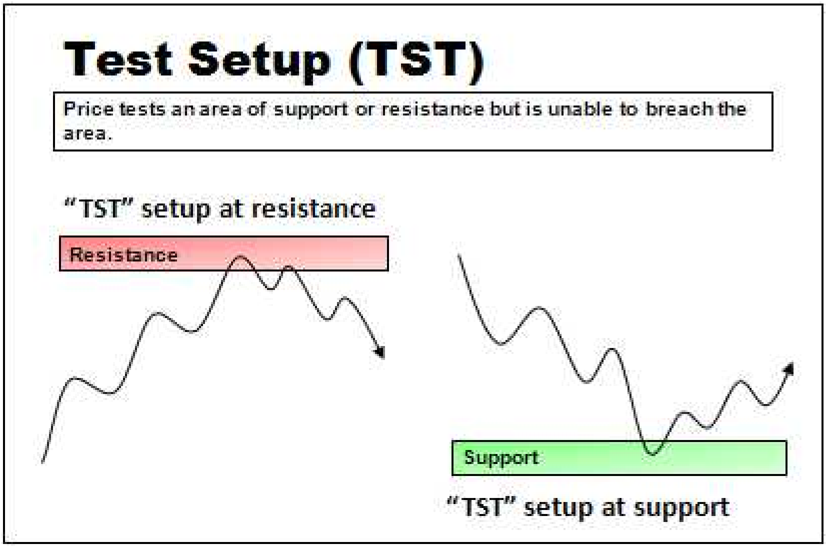

Figure 18.3 - Test Setup (TST)

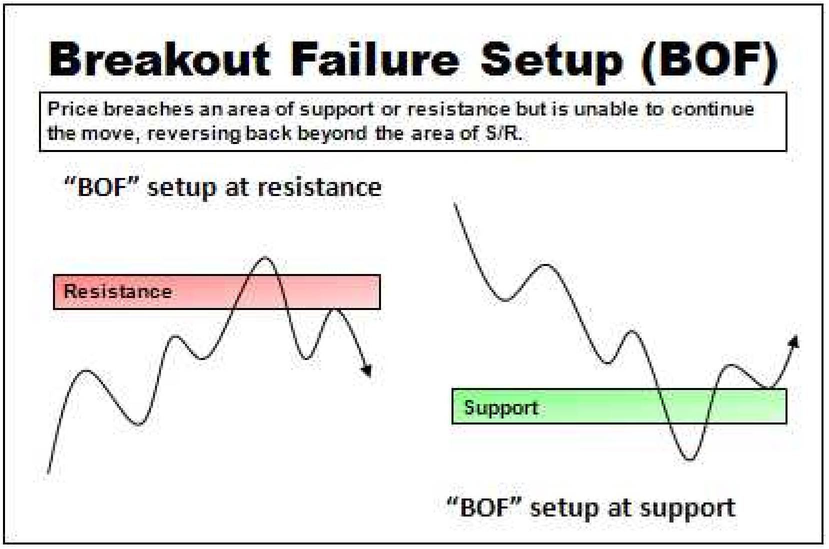

Figure 18.4 - Breakout Failure Setup (BOF)

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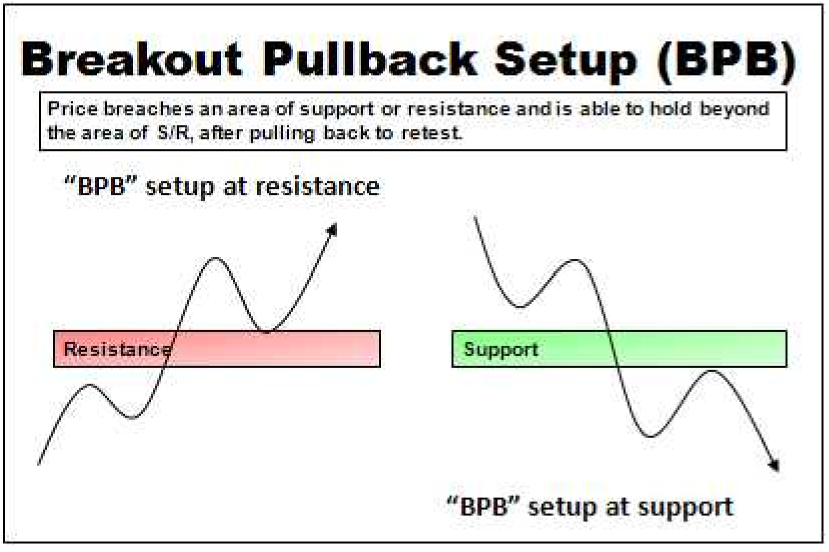

Figure 18.5 - Breakout Pullback Setup (BPB)

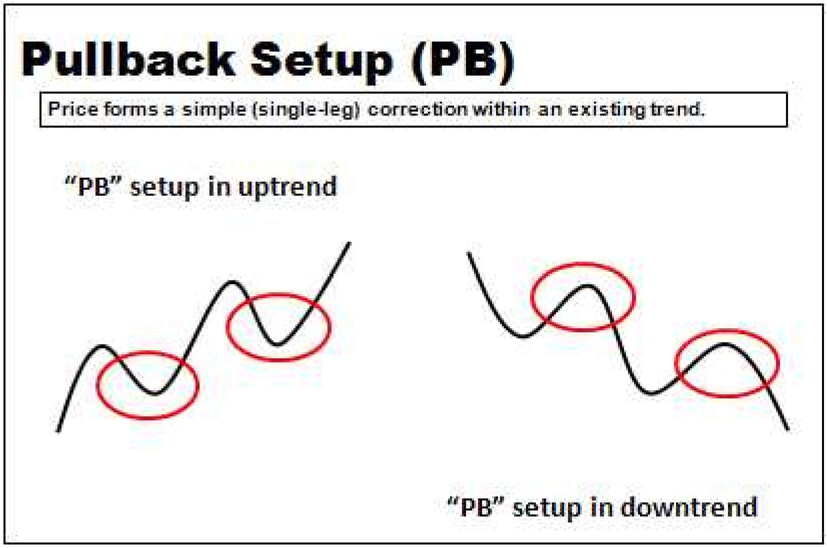

Figure 18.6 - PB Setup

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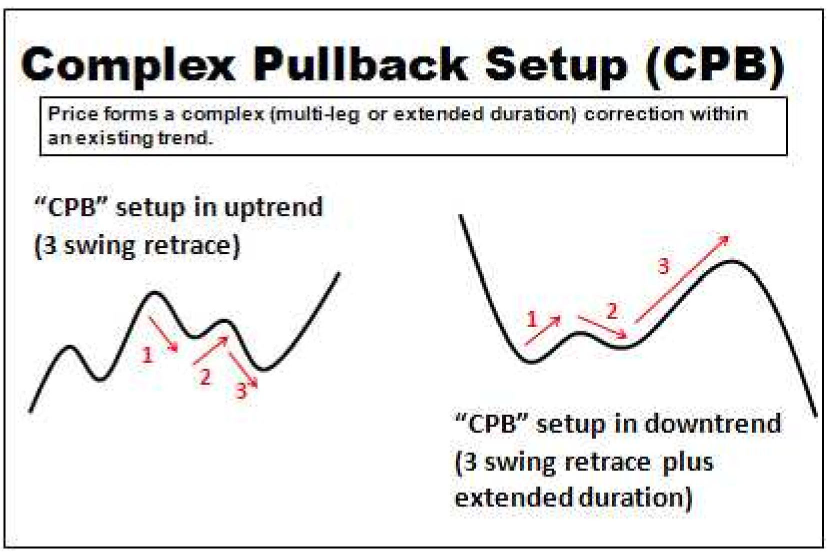


Figure 18.7 - CPB Setup

Setups Appropriate for each Particular Market Environment:

Steady trend environment:

- Higher Probability
    - PB and CPB

Weakening trend environment

- Higher Probability
    - CPB
    - PB if they break a previous swing low (uptrend) or swing high (downtrend)
- Lower Probability
    - Standard PB (single leg; not breaking any prior swing low (uptrend) or swing high (downtrend))
    - Counter-trend TST or BOF of swing high (uptrend) or swing low (downtrend)

Within a Sideways Trading Range with a clear intra-range trend

- Lower Probability
    - PB and CPB

Approaching higher timeframe S/R or range S/R, with no sign of potential breakout

- Higher Probability
    - TST

Approaching higher timeframe S/R or range S/R, with strength showing signs of potential breakout

- Higher Probability
    - BOF or BPB

Figure 18.8 - Trading Process

Lower Timeframe Entry:

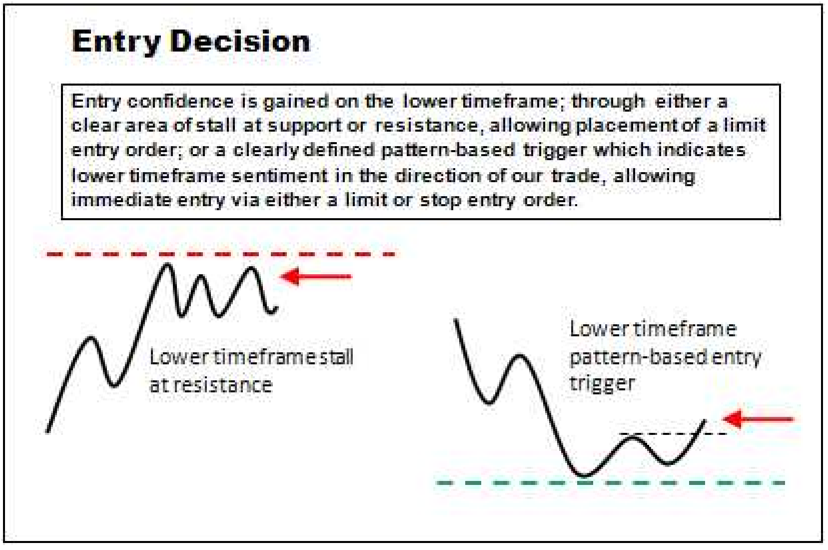


Figure 18.9 - Entry Decision Stall or Trigger

Pattern-based trigger examples include:

1) Any standard candlestick reversal pattern
2) Any standard price bar reversal pattern
3) Any trap pattern which proves the loser wrong
   a) spike & ledge
   b) double top or bottom
   c) spring or upthrust
   d) 3-swing retrace
   e) 123 top or bottom
   f) test of breakout point
   g) expansion bar

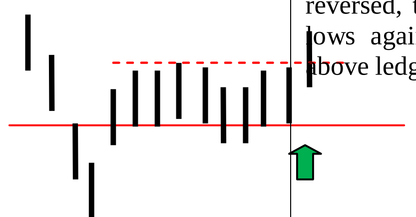
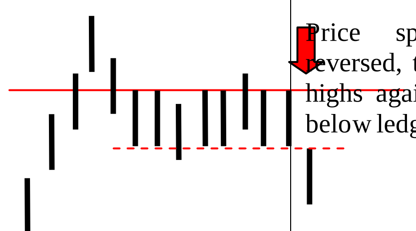
Refer to the video series at: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Candlestick-Charting-Videos.html	**Candlestick Reversal Patterns**
Refer to the video series at: http://www.yourtradingcoach.com/Videos-Technical-Analysis/Complete-Price-Bar-Reversal-Video-Series.html	**Price Bar Reversal Patterns**
	**Spike and Ledge (bullish)** Price spike down, quickly reversed, then unable to meet lows again. Trigger = break above ledge.
	**Spike and Ledge (bearish)** Price spike up, quickly reversed, then unable to meet highs again. Trigger = break below ledge.

Figure 18.10 - Lower Timeframe Triggers (1 of 4)

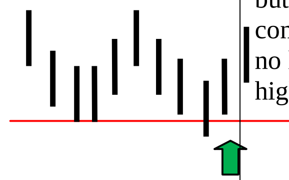
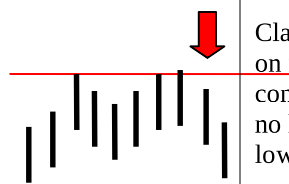
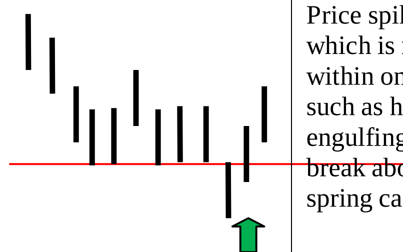
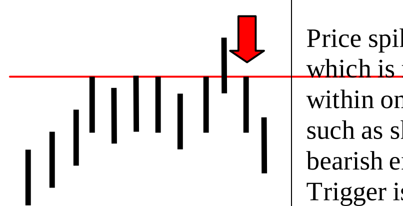
	**Double Bottom** Classic double bottom setup, but on micro scale. Enter on confirmation of second low, no later than break of swing high.
	**Double Top** Classic double top setup, but on micro scale. Enter on confirmation of second high, no later than break of swing low.
	**Spring** Price spike below support which is rapidly reversed within one or two candles, such as hammer or bullish engulfing pattern. Trigger is a break above the high of the spring candle.
	**Upthrust** Price spike above resistance which is rapidly reversed within one or two candles, such as shooting star or bearish engulfing pattern. Trigger is a break below the low of the upthrust candle.

Figure 18.11 - Lower Timeframe Triggers (2 of 4)

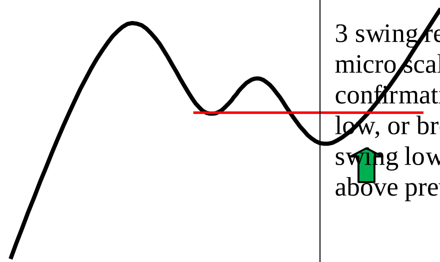
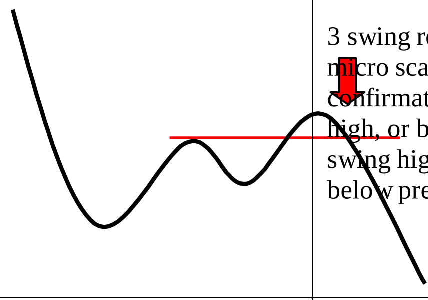
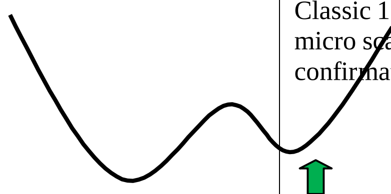
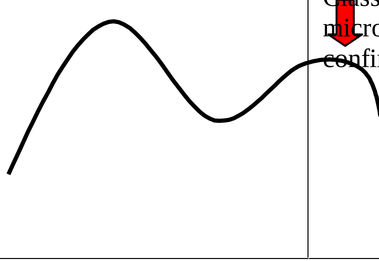
	**3 swing retrace (bullish)** 3 swing retracement, but on a micro scale. Enter on confirmation of second swing low, or break above previous swing low (or even close above previous swing low)
	**3 swing retrace (bearish)** 3 swing retracement, but on a micro scale. Enter on confirmation of second swing high, or break below previous swing high (or even close below previous swing high)
	**123 bottom** Classic 123 bottom, except on micro scale. Enter on confirmation of higher low.
	**123 top** Classic 123 top, except on micro scale. Enter on confirmation of lower high.

Figure 18.12 - Lower Timeframe Triggers (3 of 4)

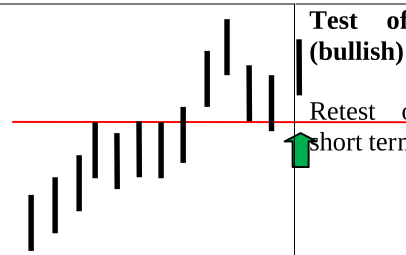
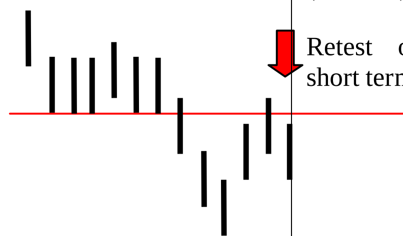
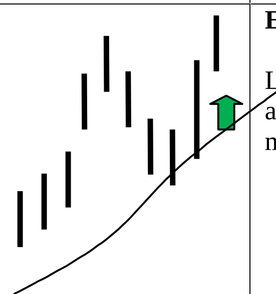
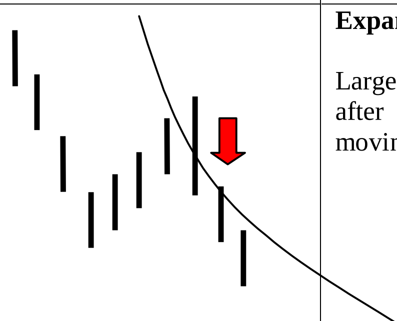
	**Test of Breakout Point (bullish)** Retest of breakout above short term resistance.
	**Test of Breakout Point (bearish)** Retest of breakout below short term support.
	**Expansion Bar (bullish)** Larger range momentum bar after retracement back to moving average area.
	**Expansion Bar (bearish)** Larger range momentum bar after retracement back to moving average area.

Figure 18.13 - Lower Timeframe Triggers (4 of 4)

18.1.4 – Setups Poster

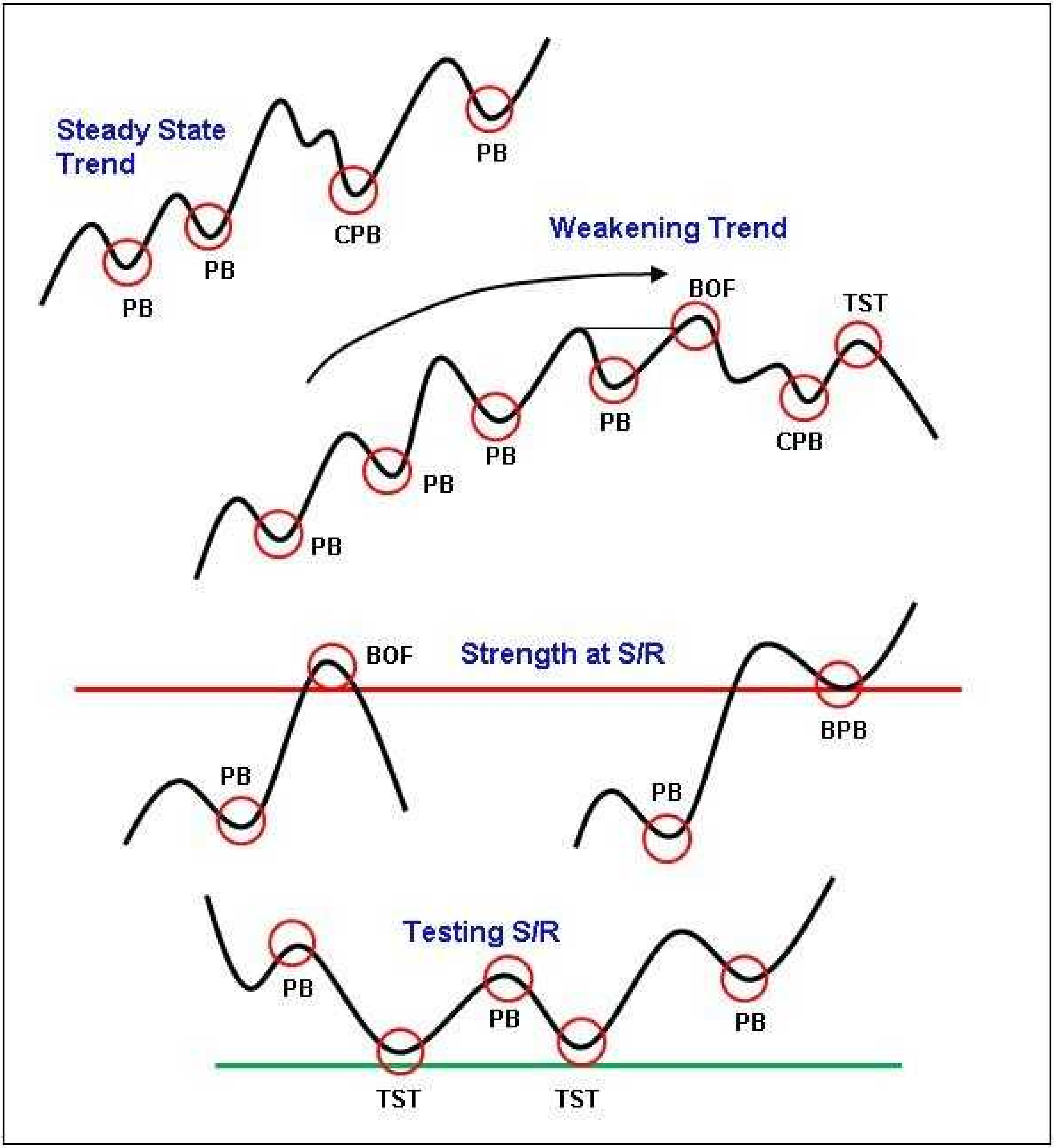


Figure 18.14 – Setups Poster

18.1.5 – The Learning Process – Summary

Deliberate Practice: maximise exposure and learn through a process of trial and error.

Trade-Record-Review-Improve cycle:

- **Trade** - self-explanatory… trade the markets in accordance with your trading plan and procedures manual.
- **Record** - record results in your trading logs and journals.
- **Review** - review your results, considering the four key questions:
  - What did you expect to happen?
  - What did happen?
  - Why was there a difference?
  - What can you learn from this?
- **Improve** - implement improvements, either through setting process goals for the next trading session, or through amendment to the trading plan and/or procedures manual.

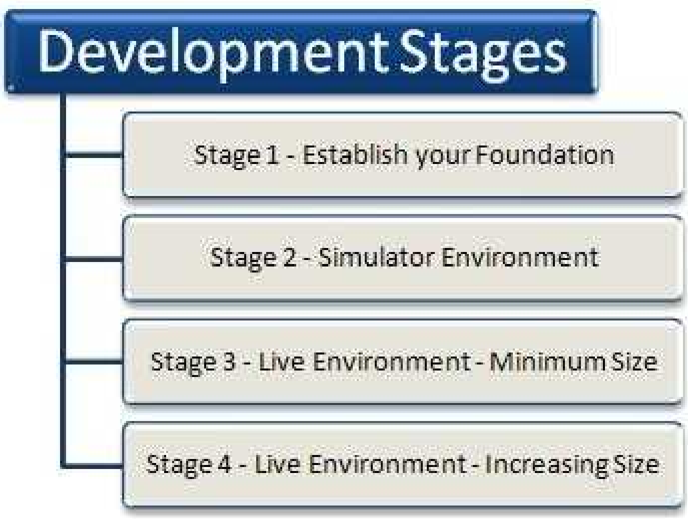


Figure 18.15 – Development Stages

18.2 – For Those Concerned That It Appears Too Simple

Trade weakness when price interacts with S/R. Trade weakness in pullbacks within a trend.

Can it really be that simple?

The fact is that while these concepts are simple to define, they're not simple to trade. That's why we have the trader development volume. It's a process of growth & development.

It's about learning to deal with the uncertainty at the right hand edge of the chart, and being ok with that feeling of insecurity and doubt.

It's about having confidence to get into a trade, despite the uncertainty that you WILL feel, because you know that whatever happens you have the skills and experience to appropriately manage the trade. The skills and experience to deal with those that don't work, in such a way as to minimise damage to both your account and your psychological capital. And the skills and experience to manage the winning trades, in order to squeeze as much reward as possible out of the market.

Yes, the strategy is simple to define. Considerable complexity could have been added. I could have added names for numerous patterns of price action, and classification of trend type or market environment. I could have labeled dozens of different types of S/R. I don't believe it's necessary though. Your mind will add complexity to the process of trading. It's best to keep the strategy itself as simple as possible.

18.3 – And For Those Who Perceive It As Too Complex

I expect many of you will be overwhelmed by the size of the task ahead of you. Don't be!

Do all you can to enjoy the process, and you'll get there in time.

I also expect many of you will have difficulty trading live, with the amount of detail within the procedures manual. Please note… this level of complexity will not be required for long.

Any complexity you perceive is a result of my having to try to explain these largely intuitive and subjective processes. Take the procedures and use them for now. In time you'll be able to simplify them.

The reality of this game is that, unless we're trading longer timeframes, we won't have time to refer to such detailed and comprehensive procedural steps. With a small amount of experience, I expect you'll be able to operate effectively with a short checklist, with each step referred to by a single statement (one or two words). You may even eventually have the whole process internalised, allowing you to operate without reference to any procedures manual.

Put aside any concerns about complexity – they'll disappear as you gain experience. Enjoy the process; and take action.

18.4 – Take Action

Success or failure… it's all up to you.

No matter where you are starting; you will progress if you implement deliberate practice through a Trade-Record-Review-Improve cycle.

Go back to Volume 4 and set up your documentation. And revisit Volume 5 to set up your development plan.

Then take massive action! Go for it!

18.5 - Wrap Up

Thank you for reading this book.

Well done if you actually made it all the way through. It turned out a lot larger than I anticipated!

I've enjoyed the process of writing it. I hope you've enjoyed reading it; and of course hope that it has provided some value to you, well beyond the cost in terms of dollars and time.

Feedback is greatly appreciated. Email me via support@YourTradingCoach.com

I'd love to hear your thoughts.

18.6 – Supplementary Resources

YTC Scalper

- Only available to purchasers of the YTC Price Action Trader ebook series, the YTC Scalper supplementary ebook explores the application of the strategy on shorter timeframes.

- All examples are based on trading the emini Dow (YM) and emini Russell (TF) on the following timeframes:

5 min Higher timeframe: ▪
1 min Trading timeframe: ▪
20 tick Lower timeframe: ▪

- The ebook discusses characteristics unique to these scalping timeframes, in particular regarding the mechanics of the trading process and managing the many trading psychological challenges that we face when decision time is limited.

- See here for more information: www.YourTradingCoach.com/Courses.html