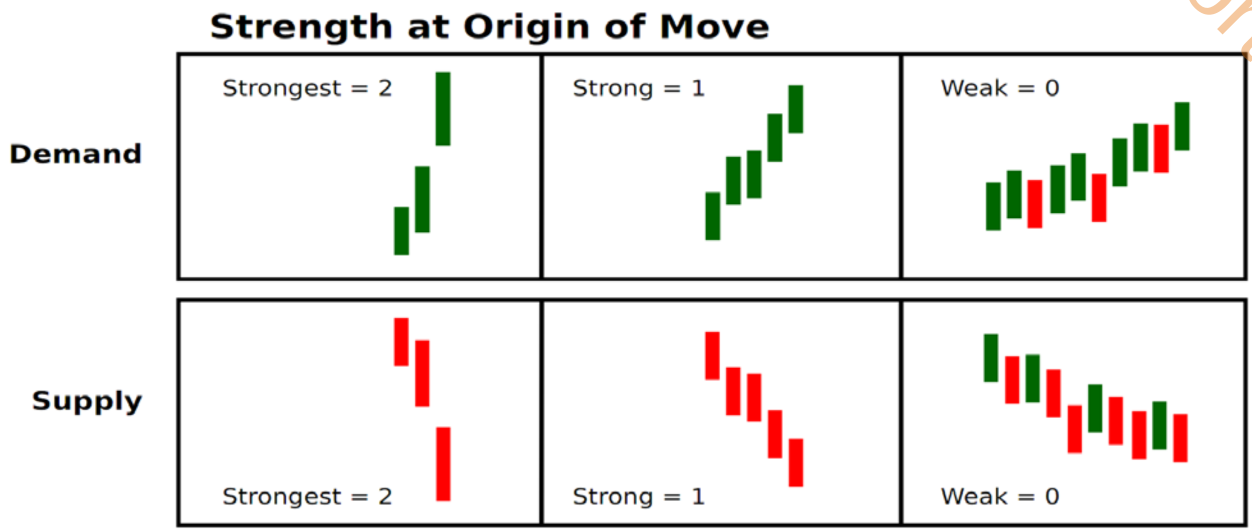
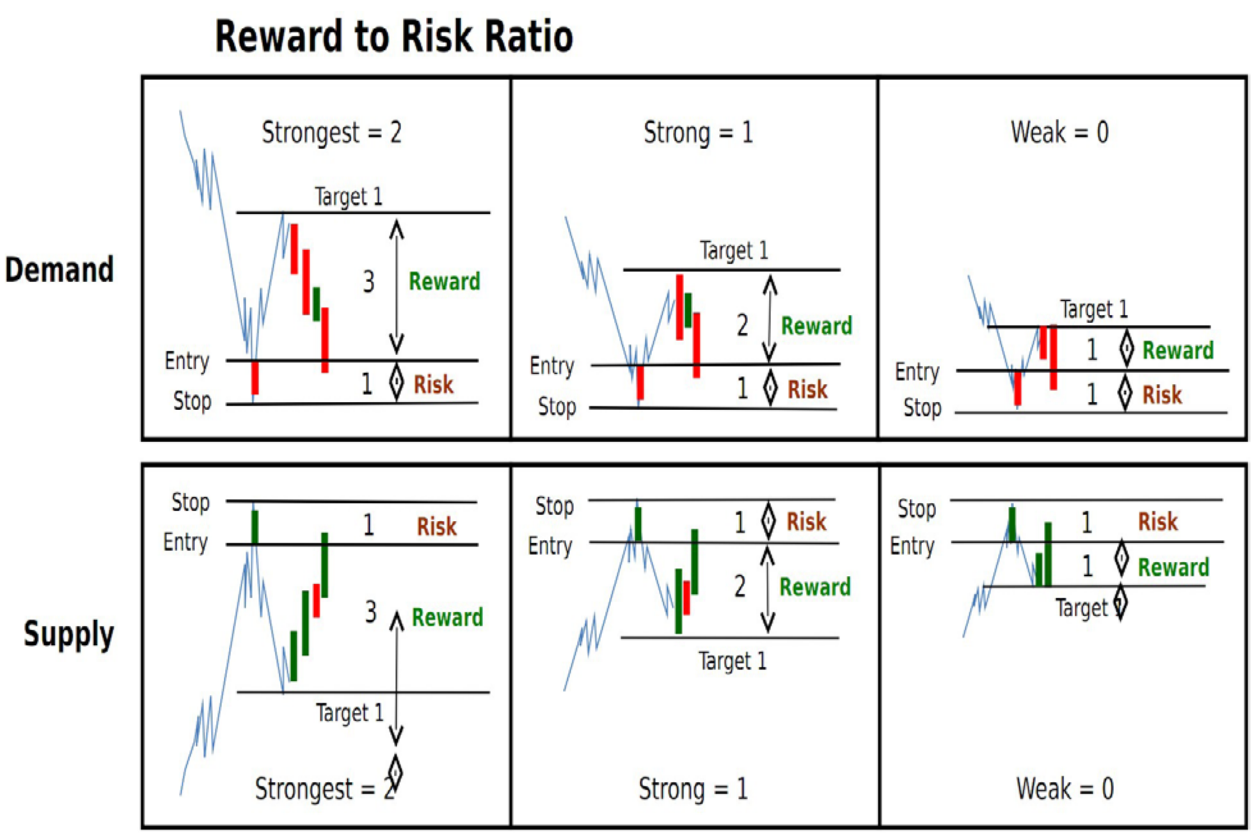
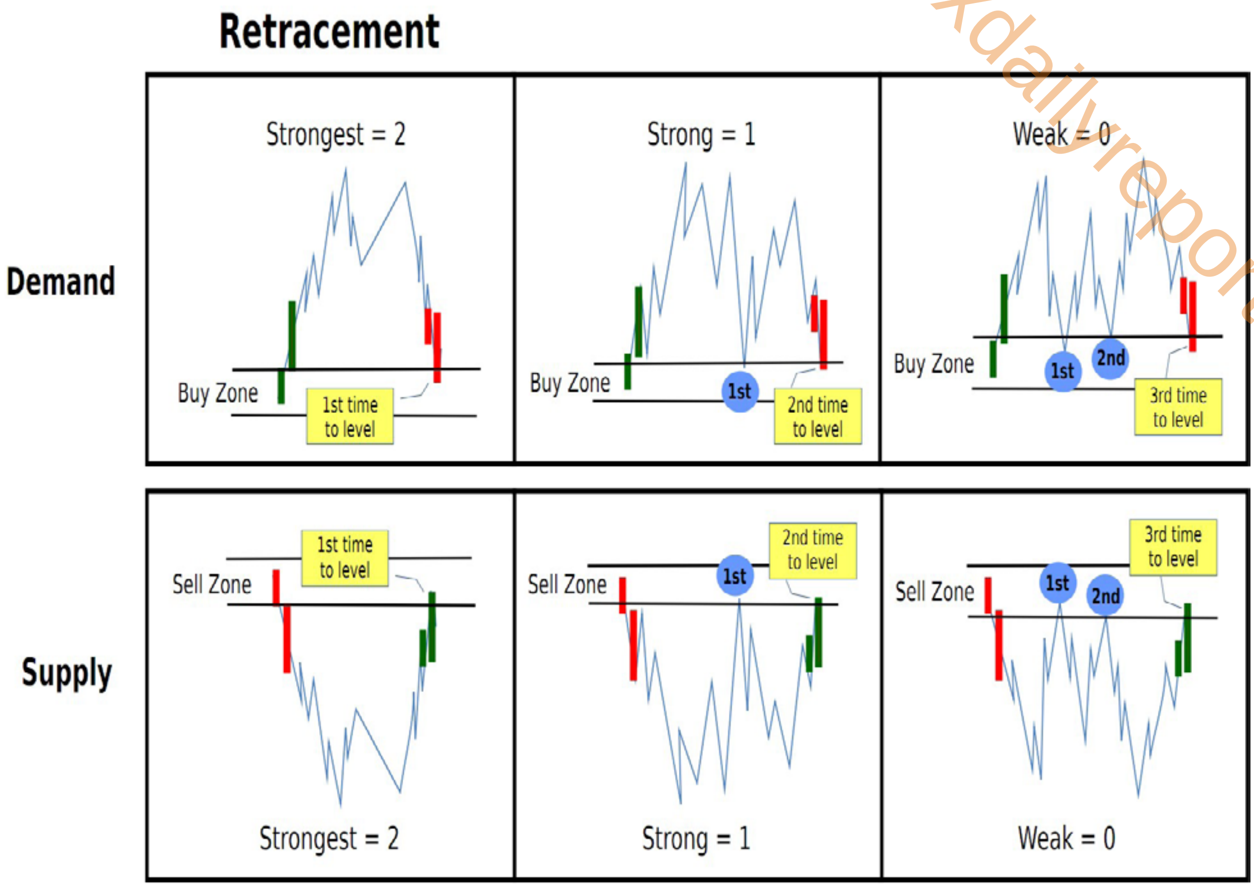
1- PROBABILITY ENHANCER







PROBABILITY ENHANCER Score Max

Strength of the Move (max 2)

Strength of the move (max 2): How did prices leave the level: strong fashion, or a more gradual move away from the level. Gives clues to supply and demand imbalance at the level. Strongest turn in price level is where supply and demand is most out of balance. So our quest is to look for price levels where supply and demand is most out of balance. The biggest clue in how in balance or out of balance prices are at a level, is how quickly they leave. The more quickly they move, the more out of balance they are.

Reward/Risk (max 2)

1. How far did prices rally up from demand level before coming back to it. That is

initial profit margin.

2. If buying at support or demand, where is the nearest area of supply. If risking 20 cents on trade, is nearest supply level 60 cents or farther away? If not, we are not interested in the trade.

Support and demand levels all around, we only want to take the best.

Big Picture (max 2)

Looking at daily charts for big picture. Most of Sam's trades are intraday, but he still looks at daily chart for big picture. Big picture is important to day trader for two reasons:

1. big picture trend up or down - determines which side we want to be on
2. Where are big picture support and demand levels? We dont want to short right above a demand level. We only know that from the big picture.

If we are taking shorter time frame short positions in context of a big down trend, then this gets a 2. If we are shorting during a bigger picture uptrend, and we are close to big picture support, it is a 0 or a 1.

Retracements / Tests (max 2)

We may look at this different than conventional wisdom. Once prices have left a level, (example of picture explanations), sell zone with a lot of candles - we want to enter on the first retracement, it is highest probability entry. First time entry is a 2. second time is a 1. Third time is a 0.

This is all just motion into mass. The mass is the supply and demand, the big stack of orders.

Chopping tree example: Every swing removes some of the mass. The more swings, the more chance to go through.

Time at Level (max 1)

Very much in line with first enhancer - strength. At price levels with supply and level out of balance the most, price will spend the least amount of time at the level. The textbooks talk about this in the opposite way.

At price levels with the most imbalance, price will spend the least amount of time: few candles.

If price is in balance, price will stay there a long time. it is equilibrium, we dont want to trade there. We want to trade at the extremes.

Question: How many candles in what time frame: Be very careful about coming up with a specific number. Changing time frame will change the number of candles. At your time frame, compare the number of candles to time spent at other levels, dont get hung up on specific number.

Arrival (max 1)

How did price arrive come back to the level. We want to be anywhere near other levels. We don't want new resistance levels before we buy, or new support levels to form right before we sell. Strong arrival usually means strong departure at the level.

- Total score:

o The worst possible case is an 8 - This can be a confirmation entry.

o Here are the scores:

- If it was a 9 or 10, it could be a limit order. - limit order
- 8 confirmation entry
- 7- No trade if less than 7
- Another odds enhancer for short term traders: Time of day that trade is meeting entry. The opportunities that we point out that meet entry in first 45-1 hour of the day, these are usually golden opportunities. Later in the day is often not as great.

o Coming from the institutional side of trading, you know, because you see the order flow. Time of day odds enhancer is, in any market, supply and demand is most out of balance at or near the opening of trading in any market. I saw this day after day. Given that, if you are good at picking out levels and turning points, those will be most profitable. If entering in the first hour of the day, the best day traders make their money in the first hour of the day. I don't know anyone who makes money just trading in the afternoon. If they are trading in the afternoon, they didn't make money in the morning, and it will be tougher. After all the orders get processed, usually supply and demand are back in balance.

o If you don’t know what you are doing, don't trade at the open. But if you do, trade because that is the time when most of the transfer between accounts occurs.

Morning is the golden opportunity.

2-Trading notes

- Supply: Rally, Base, and Drop.
- Demand: Drop, Base, and Rally

How to join the up trend without taking a lot of risk.

- If there is an uptrend, buying a pullback to a quality demand level. In an uptrend, buy dips.
- If a downtrend, because a market is basing and dropping, reverse is shorting rallies in a downtrend
- Sideways markets - sell rallies into supply, buy pullbacks into demand

That is important, for everyone trading the futures market.

- The more time price comes up to the level, and chances to trade at the level, the more likely there is a turn.

- focus on trends by four stages of the market book: "secrets for profiting in bull and bear markets" by stan weinstein

trading range after sell off - stage 1 accumulation

- Shown by 30 weighted moving average. - after sell off - institutions start to accumulate shares - people feeling the pain and selling. The institution is accumulating shares for next stage, stage 2 uptrend

stage 2 uptrend - prices rise, then trade in a trading range. - end of '07 violent trading range - institutions selling high to john q public - selling by "upgrading" the stocks, and talking about super spikes, to let them unload their positions.

stage 4 decline - ugly looking decline

Big picture (Monthly, W, D,H & 5min)- work down from the big picture. 2 reasons:

- Where are we in the big picture support and resistance levels
- We want to know what the bigger picture trend is

One of the key things that is done in the XLT, we don't cut through candles. We want to see supply and demand equation in real time. We can not cut through candles. A lot of people put in support and resistance levels by cutting through candles.

Entries - understanding where the turning points are is everything.

- Usually the real problem in trading is the entry. when you think you have a problem with targets or stops, the problem us usually a poor entry.
- 3 ways to enter into a position
    1. Limit entry
    2. Confirmation entry
    3. Breakout entry

What determines the type of entry we take?

- It's all in the odds enhancer score sheet

  Focus on Odds Enhancer #1: Strength of the move - This helps us understand what kind of entry to take. Want to be very mechanical.

  In confirmation entry: Let prices enter the level, then we buy as they leave the level.

  If prices come into the level, and go through it, then you cancel your entry.

  0:12:00 - May use confirmation entry because move out of a level isn't fast. But many XLT members never take confirmation entries, because they only want to take the very strongest trades.
- Confirmation - make a rule, it could be 0.01 cent, 0.05 or 0.10 outside the level. Or it could be a trigger within the level. The most important thing is if it is a rule. If making it 0.10 outside the level, and it destroys the risk reward, then don’t take the trade.
- There is no perfect answer, no perfect rule. More important is that you have a rule and make it rule based.
- We want to buy at the bottom after someone is selling from a drop in price, and demand level exceeds supply.

how to enter trades:

- if it goes too deep in the level, if it hits your trigger, be prepared to get in if it leaves the level. keep it mechanical. if your trigger is hit, you then have your entry price active, if entry price gets hit enter, if stop price hit before entry price, cancel the trade, don’t get in. that is about as mechanical as you can get
- your entry for supply or resistance level, when prices hit the trigger price, you sell short as price leaves the level. the only time you don’t do that on a confirmation entry, if the price goes through the level, and hits the stop price (where your stop is going to be) before leaving entry, then there is no trade. after hitting trigger, either enter and put in stop price, or your stop price is hit, and you are never getting in.

240 chart - 2 candles - Rule of thumb for time at level - go down to smaller time frame, like 60 minute chart, find base. 3-6 candles is probably the best on any time frame. The key is how did price leave the level? There must be a fast leave of the level, or I won't look at the level.

- If the market is not able to go up and test a supply, then it has no choice but to go back to the next demand level and test it to see if it will hold. This is what to look for on any time frame. If it can't break out to the upside, the stock will go down and test the lows.
- This is just in regards to big picture time frames - there are other things to also consider. But it is important to identify these levels.
- If the market breaks up, then we need to look to the left side of the chart to look for other potential areas
- If this market keeps going up and doesn't make a turn at a supply level, we look for the next level.

- Only two reasons for the market to have a turning point:

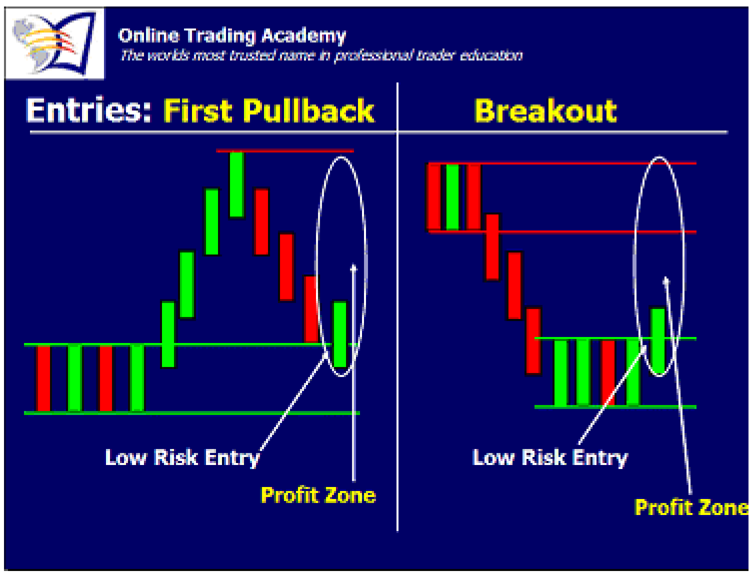
  At a top, supply level, the sellers exceed the buyers, and prices move lower. At the supply level at a number of buyers that were exceeding the number of sellers. The second things that can happen is the buyers went away, and the sellers exceeded the number of buyers and drove price lower.

  At a bottom, demand level, the buyers exceeding sellers, and prices move higher.

A Key Factor for Trade Success

Education

A Key Factor For Trade Success:



Though I have discussed entries before, many emails I receive deal with entries so I thought it would be a good idea to revisit this topic. "Profit Margin" is the term we use when referring to the objectively derived potential profit of a trade. We calculate the profit margin by measuring the distance between the supply (resistance) level and the demand (support) level. In the chart above, the profit margin is the circled area. There are only two types of entries someone can possibly take, the pullback entry and the breakout entry. A key factor in determining whether the trade will work out or not is this: Is there a profit margin or not? All you have to do is look to your left. When you are about to buy, look to your left and make sure supply is far above. When shorting, look to your left and make sure demand is far below. How far? For me, the initial profit margin must be at least 3 times the stop. In other words, I am looking for a reward to risk of at least 3:1 to the first profit target.

Most of the time, price will go well beyond the first target but 3:1 is a good margin to get the trade started and in your favor.

You need to quantify the demand and supply accurately and make sure the profit margin is substantial. A losing trader is just like the individual who wants to open a business, doesn't do the research, buys inventory at $4.00 (supply) but finds out too late that the market will only bear $3.00 (demand). This is literally what happens in every market every day. It's incredibly simple and the vast majority miss the whole game being played out because of the illusions presented to them by those who have more to gain by obscuring reality.

<u>Trading Ideas</u>

10 Year Note Futures

Here we will revisit one of my favorite markets, the 10 year note. It is one of my favorites because of the huge volume and significant profit margins. Notice the supply (resistance) level above, labeled by the red lines. This level is ideal because of the strong initial decline from the level. This suggests a large supply/demand imbalance at the level which means that price is likely to fall fast the first time price revisits the level. Something I teach in the Online Trading Academy stock, futures, forex, and options class is to focus on that initial decline in price from the level. This subject is a whole section in the class so don't feel bad if you don't get it here. The fact that it moves down to the low it does before returning to the supply level shows us what the initial profit margin is. Traders can look to sell short in the supply area as the initial profit margin is greater than 3:1. Email me with any questions on this or see me at a class in the future.

S&P E-Mini Futures

Above is the S&P with a demand (support) level a bit below. There is also a strong move out of this level suggesting that we may see a nice trade if and when price revisits the level for the first time. There is one issue with this level, however, that does not make it a high probability level. In the larger picture, this demand level is not well placed on the supply and demand curve. Therefore, day traders will likely see a bounce higher from this level but this is not an ideal area to initiate a swing trade.

Newell Rubbermaid (NWL)

NWL is a stock that has recently traded into supply (resistance). This is a large level which is not always a good thing. The strong rally into the level on no basing does make this trading opportunity one to watch. Volume on this stock is good but not great so you may just want to watch this one as an educational watch idea. What we have here at the supply level are buyers who are buying AFTER a large advance in price and at a price level where supply EXCEEDS demand. The laws of supply and demand tell us that this buying is not a consistently profitable trader so we would want to find this buyer and take the other side of his/her trade. Keep an eye on this one.

Goldman Sachs (GS)

Goldman Sachs has been moving higher for a while now from the August low. Notice however that we are now getting the big green candles and "gap up's" <u>after</u> the advance in price. The key word here is "after". Consistently profitable traders don't buy after a large advance in price so we can conclude that novice buyers are starting to enter this market. If price gets up to the supply level, we would be selling to the buyer who is buying after an advance in price and into a supply level.

Success in the 30-Year Bond

Education

Last week, one of the charts I put in under the trading ideas section was of the 30 year bond. I used strong words to describe the opportunity saying that the demand and supply levels on the chart were a "dream" for active traders. Typically, I don't use words like that unless I am very confident about the opportunity based on years of trading experience. I received some emails asking about the quality of a level so we will deal with that a little bit here. One of the most important things about a quality level is how price originally leaves the level. If price moves away from an area of equilibrium in strong fashion, it is moving away strong because there is a large supply and demand imbalance at the level. If price slowly drifts away from the level, it still may be a trade we will take, just understand that the supply and demand imbalance at the level is not that out of balance. The higher the "imbalance" at the level, the higher the probability of the trade working out well. The 30–year bond supply level in last week's letter triggered right away and paid about 3:1 the first day. If you're a trader that took this trade, send me an email and let me know. Congrats!

30 Year Bond Supply from Last Week's Letter

Trading Ideas

Russell Futures

The Russell will start the week off with a supply level just above current price. Notice the significant and strong initial decline from the level suggesting a strong supply/demand imbalance at the level. Active traders can look to take short term shorts from the level. Keep in mind that the Russell is $100 per point per contract and it can move very fast. As always, keep your trading low risk. The supply and demand levels are designed to help you do that.

SMH (semiconductor sector)

This is a chart of the SMH, the ETF for the semiconductor sector. Notice where current price is on the chart. Not far above, we have a supply level that has not been revisited. Further below, we have a demand level that has not been revisited yet. The distance between them is the "profit margin" which in this case is large. You can certainly trade this ETF at the levels shown here but also, you can use this chart as a guide for semiconductor stocks this week such as XLNX, NVLS, KLAC, NSM, and others…

Silver is not as popular as Gold but it certainly has a significant demand level below current price. This level is ideal for a few reasons. First, it is well placed on the supply/demand curve. Second, it has a decent profit margin which we need if we are to get paid. Traders can look to buy the first pullback in price to the demand level shown here with a protective sell stop just below the level.

A Lesson on Supply and Demand

<u>Education</u>

Last week on September 4th, the QQQQ rallied into our supply (resistance) level and declined $2.00 from that level. Why do I focus so much on turning points in markets as areas to enter trades? Why not just jump in the trend when it's well under way and/or buy breakouts? Simple… The trader who can pick turning points in markets based on the objective and simple rules of pure supply and demand typically derives his or her income from the trader who enters trends well after they are under way and from the breakout traders who buy after a period of buying and sell after a period of selling. Many people forget the simple fact of how you make money buying and selling anything.

When you buy, many others must buy after you at higher prices for you to profit. When you sell short, many others must sell after you at lower prices for you to profit. Our entry below from last week was at the pre-determined turning point which did two things for us. First, it allowed us to obtain a short entry VERY close to our protective stop which keeps trading low risk. Second, it allowed us to sell short far from demand levels below which would be profit targets. In other words, our supply area allowed us to sell short when the profit margin was largest and about to decrease. Never forget… The longer you wait and let prices decline before selling short, the more risk is increasing and your reward (profit margin) is decreasing. Instead of desiring lots of confirmation of lower prices before selling short, the desire should be the benefits of a low risk entry at supply (resistance).

QQQQ Supply from Last Week

Trading Ideas

NASDAQ Futures

This is a monthly chart of the NASDAQ. To put things into perspective, it's always a good idea to look at supply and demand in the big picture. This chart shows us that this market is not that far from supply. It also shows us that price has not been able to move into this level at all as of yet, suggesting there is plenty of supply at that level. This area can take quite some time to get through and a turn lower is likely before a significant rise through the level. While we can certainly see NASDAQ prices rise, longer term low risk buying opportunities are lower in this market.

30 Year Bond Futures

Having just taught the Online Trading Academy Forex Class during the night session, producing a letter this week was a bit difficult. However, don't think for a second that quality trading ideas were hard to find. This chart of the 30 year bond futures is an active traders dream, having such a quality supply level above current price and just as quality a demand level below current price. Active traders can look to take low risk reversal entries at both these levels the FIRST time price revisits them. If you have never traded bonds or notes, these markets are loaded with volume, liquidity, and fantastic low risk/high reward trading opportunities.

Lastly, why do I only look at price and price alone when performing market analysis? First, any and all influences on price are reflected in price. Second, almost anything you add to price (a moving average for example), lags price. Anything that lags price in your decision making process increases RISK which is not ideal. I am not suggesting we should eliminate all indicators and oscillators. I am strongly suggesting however that there is a right and wrong way to use them

What Happens When You Stick To the Rules

Education

Last week we focused our education on the importance of having rules and having the ability to stick to rules. This week, I wanted to highlight a trade from a mentoring student of mine from last week. While it has taken some time, he is now much better at sticking to the rules. I attribute my trading success to two reasons. First, I have developed a mechanical set of objective rules based on the laws of supply (resistance) and demand (support). Second, I have learned that it is one thing to have rules and another thing to actually follow rules.

AAPL Day Trade Short – Online Trading Academy Student Trade

This was a day trade short from last week. What we spend most of our time on in the mentoring program is identifying TRUE support (demand) and resistance (supply) levels in any market and any time frame. This student has been doing a fine job. Here is his trade. First, he identified a demand and supply level that had an ideal "profit margin" between them. Once he found that, he simply shorted right at the supply level and bought back the short at the demand level for a nice gain. While the gain was good, he is learning that the low risk entry associated with that gain is much more attractive than the gain itself. You see, entering short at the supply level, before you have a big red candle is key. It allows us to be first in line at the right time. By selling short at supply, he is selling short very close to his protective buy stop if he is wrong so the risk is low. He is also selling short far from the demand below, allowing for a large profit margin. The more he lets price drop before selling short, the higher the risk and lower the reward so he does not wait long. How does he know price is going to turn at that supply level? No one knows for sure but that is life in the trading world. All we can do is use objective information to stack the odds in our favor. Here is how we do that.

Notice the initial decline in price from the supply level. Price basically free falls from that level which tells us objectively that there are many more willing sellers than buyers at the supply level. The first time price revisits that level is when my student sold short. Who did he sell to? He sold to the buyer who is making the same two mistakes any novice market speculator makes. First, he sold to the buyer who is buying after a move up in price. Second, he sold to the buyer who is buying at a price level where we already knew supply exceeded demand. The odds were stacked against that buyer so the high probability trade is to simply take the other side of that trade and sell short. The exit is simply taken at the opposing demand level which is shown here on the chart.

Trading Ideas

NASDAQ ETF (QQQQ)

This is a chart of the QQQQ, the ETF for the NASDAQ. The nearest demand and supply levels have been identified on this chart with green and red lines. Remember, these areas are "zones" which is where we would look to buy and sell. Active traders can look to take positions in these areas when price reaches them for the first time. The reason we only take a position the first time price revisits these levels is because this is when the risk is lowest and the reward is highest. With each pullback into a demand or supply level, the probability of the trade working is decreasing so make sure you focus on that first pullback.

CEPH

CEPH is a stock that is nearing a significant supply level as seen on the chart here. Notice the dramatic decline in the stock from the supply level. This dramatic decline tells us that there is likely a large supply and demand "imbalance" at the level. Therefore, if and when price revisits that level for the first time, we would look to sell short. We would be selling to the novice buyer who is buying after an advance in price and buying at a price level where supply exceeds demand. This is the same opportunity as the one outlined in the education section above.

EURUSD (cash forex)

Here we have a chart of the EURUSD. The supply level above is an ideal level to potentially take a short position for the active trader. Intra-day, price will likely turn lower from this level, offering the day trader a low risk shorting opportunity. Again, the initial decline from the supply level was strong suggesting the first time price revisits the level, it will likely drop again.

Important Rules to Follow

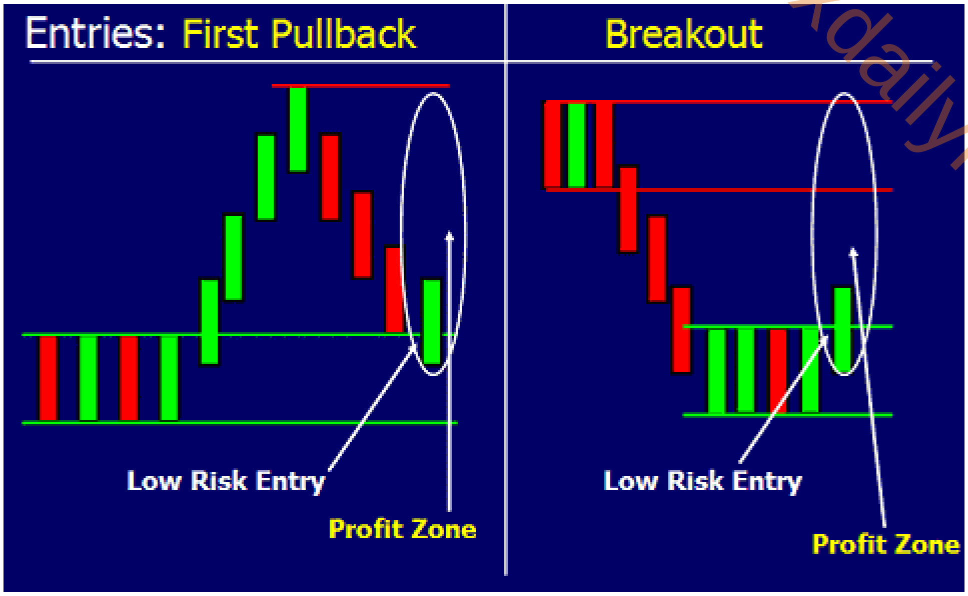
Last week, I pointed out that the markets received some medical treatment from the Fed and that this is typically just a band aid so we should watch for lower prices in the equity markets such as the S&P, NASDAQ, and so on. The markets did rally on the FED move but have now declined as we expected. Our job now is to look for low risk/high reward price levels to short at.

Education

Today's education will focus on some day trading rules. The most important thing in any type of trading is to have a solid set of rules and then to have the self control to follow those rules. Day traders especially need to have rules to follow as emotion can and will have you buying and selling at the wrong time.

Day Trading Rules:

1) Only enter trades when price is at a support (demand) or resistance (supply) level, no matter what time of day or night.
1) Two types of entries: Breakouts and first pullbacks (see below).
2) Each day, identify one demand and supply level in each market, using a larger intra-day time frame. Always know where the market is in the larger picture with regard to supply and demand.
3) Only trade opportunities that offer at least a 3:1 profit zone to the first target.
4) Pre-plan and pre-set: Entry, Stop, Target/s.
5) Don't get fooled by: News, Lagging indicators, Subjective information. Remember, any and all influences on price are reflected in price… Price is all we need.



Here are the only two types of entries you will ever need. The First Pullback entry is the lower risk/higher reward entry though many people are not comfortable with it. Most will use Breakout entries which are fine when executed properly. What determines whether each entry will work or not are two things. We will use demand as an example in this case as both examples here are moves from demand. First, the demand area must be a fresh demand level meaning that price has not revisited the level. Second, the Profit Zone (profit margin) must be significant as seen in the chart above. In other words, there must be room for price to move after you enter. We will revisit the topic of "entries" next week.

Trading Ideas

Russell 2000 (Futures)

This a chart of the Russell Futures. After yesterday's decline, we will look to sell short after a rally in price to the nearest supply (resistance) level above. The first supply level will be found in the area shown above here on the chart. The reason we select this circled area is because there was a cluster of trading which gave the appearance of supply/demand equilibrium. When price then declined from the level, this decline tells us that supply actually exceeded demand. This can be the only reason for the decline in price from the level. Therefore, we will look to short the first rally back to this level which can happen as soon as today.

Euro/Pound (Cash Forex)

After a dramatic decline in this market, price has stabilized and found support (demand). The dramatic decline tells us that there is likely a large supply/demand "imbalance" at that level above, suggesting a high probability opportunity. This market is a very active market and is a non-dollar currency pair which is ideal.

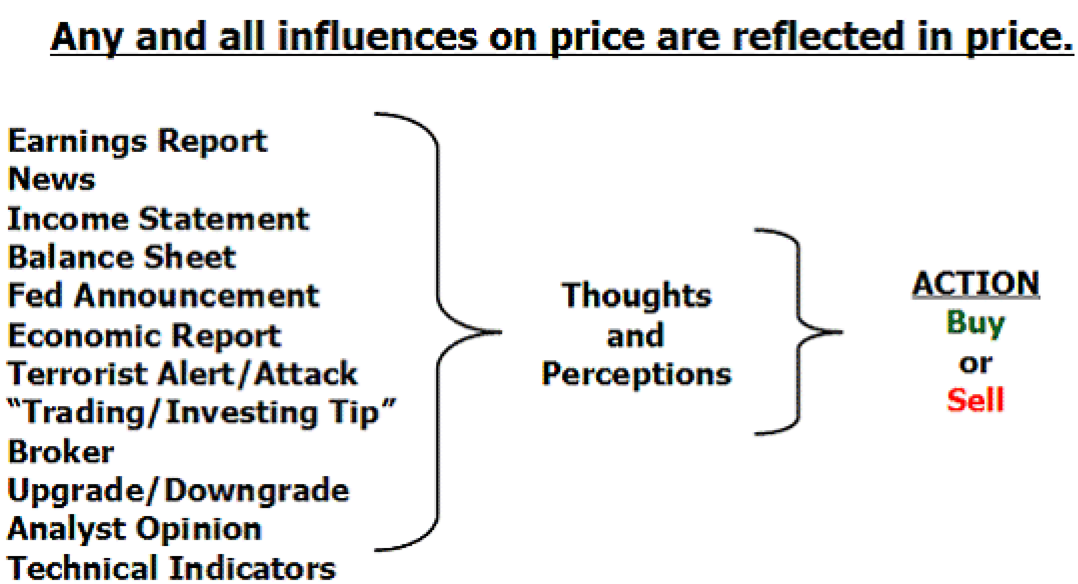
10 Year Note (Futures)

This is a chart of the 10 Year Note Futures. The green lines are around the demand (support) level. This is the nearest demand level below current price and is a price level we would look to buy at the FIRST time price revisits this level. The strong initial rally out of the level and gap suggests a strong supply/demand imbalance at the level. Watch for this opportunity in the next day or so.

Take Advantage of the Equity Market Volatility!

With the equity index markets experiencing high volatility, we will look to take advantage of that volatility in the coming week with proper supply and demand analysis. If you have any questions about the various global markets or any of these trading ideas, I can be reached by email at sseiden@tradingacademy.com. Typically, I will respond to emails quickly. On weeks where I am teaching an Online Trading Academy class, it may take a bit longer to respond.

Education



At any given moment, there are tons of financial information being created and passed on around the planet. This information can be in the form of all the examples listed here and many more that are not listed. All this information creates thoughts and perceptions that are different for everyone depending on their personal BELIEF SYSTEM. Most people assume their belief system is the same as their own. This is certainly not true. Each of us has our own set of filters that turn the same information into different "perceptions" for everyone.

These beliefs lead to ACTION and in trading and investing, action is either buying or selling. Each action to buy or sell takes place at a specific price. Therefore, price is all the consistently profitable trader and investor needs to focus on. Adding any other information will distort your perception of what is real according to the laws and principles of supply and demand.

Lesson: Any and all influences on price are reflected in price.

Trading Ideas

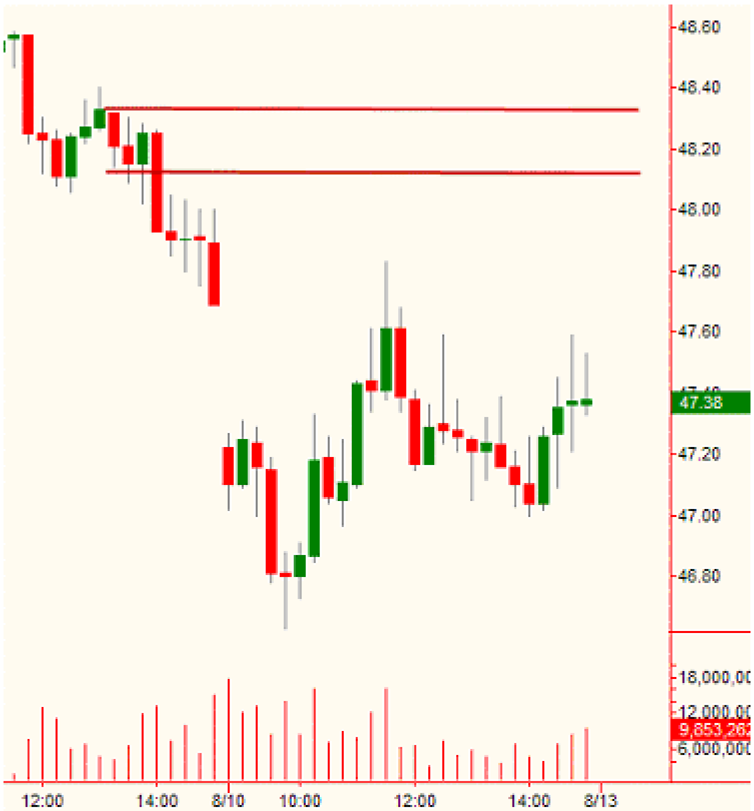
DOW Mini (CBOT Futures)

The DOW Mini has declined significantly from the all time highs. There is however plenty of room below for further declines. We would not look to be a buyer until prices reach the demand level on the chart (green demand lines). Why is this a demand level? Notice the area where the level originates (where the green lines start on the left). Price appears to be in balance for a couple candles but then gaps up from that level. This gap higher can only happen because there are many more willing buyers at the demand level than sellers. If and when price revisits this demand level, we will have sellers selling after a decline in price and at a level where demand exceeds supply. Day traders and swing traders would ideally be waiting to take the other side of the novice seller's trade and buy when price revisits the demand level. We will watch for this in the coming week.

DOW Mini Intra-day (CBOT Futures)

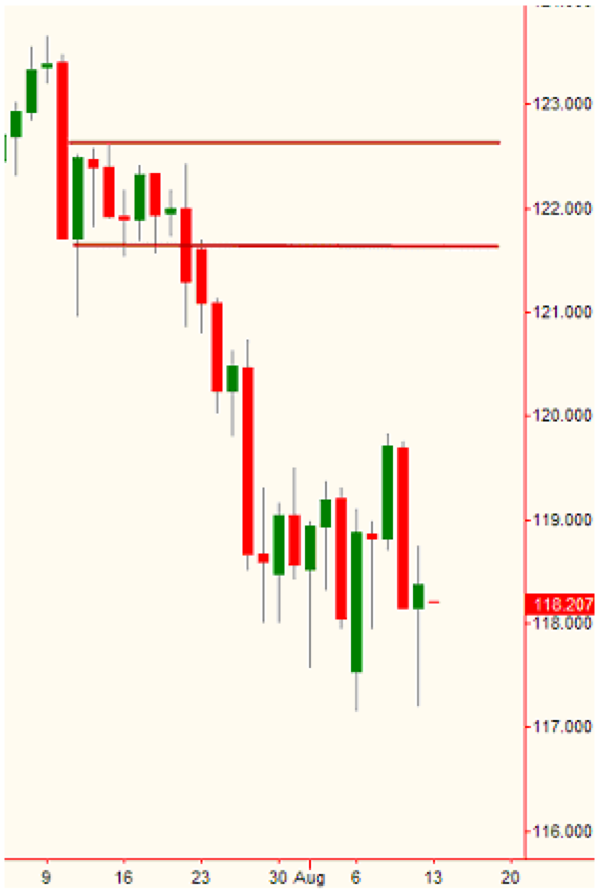
While we are set with a demand level in the Dow should the market decline further, we must also have a supply level to trade off of this week as volatility is very high. The steep decline from this supply level suggests there are many more willing sellers than buyers at the level. Day traders can look to take a short position at this level. While the supply level may appear far away, the recent volatility suggests price can get there very quick. If it does, we will have buyers buying after a rally in price and at a price level where supply exceeds demand. This would be very novice action according to the laws of supply and demand. We simply want to take the other side of the trade and take advantage of the novice action of the buyers at that level.

QQQQ (ETF)



For those who don't trade the futures (yet), here is a similar shorting opportunity in the QQQQ. The QQQQ (ETF for the NASDAQ) has a supply level not that far above the current price. Traders can look to take a short position should price reach this level this week. Notice the significant decline from the supply level. This suggests a strong supply and demand imbalance at the level meaning there are likely many more willing sellers than buyers in that area.

US Dollar / Yen (Cash Forex)



This supply level in the USD/JPY is a bit far from current price however the currency markets are extremely volatile as well. This opportunity offers a very large profit margin as it is well placed on the supply and demand curve in the big picture. If and when price reaches the supply level, we will look to take a short position as a swing trade. Make sure you always adjust your position size to an amount that ensures you are only risking whatever percentage of your capital you are comfortable with

Online Trading Academy Futures

Last week we focused on stocks, this week we will apply the same supply and demand principles to the futures markets. If you have any questions about the various global futures markets or any of these trading ideas, I can be reached by email at sseiden@tradingacademy.com.

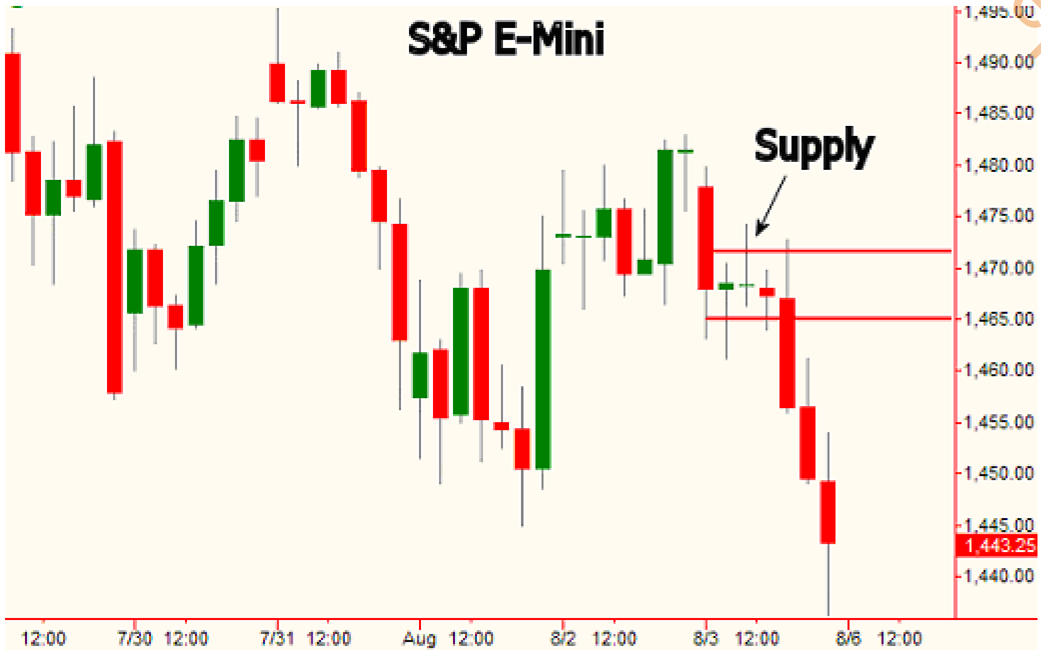
Education

Before we look at some trading ideas for this week, let's go over the logic and process of assessing an objective demand (support) level which is where we want to buy at in any market. In the S&P chart below, area "A" represents temporary price stability which gives the appearance of supply and demand equilibrium. Once the rally in price occurs "B", we know that area "A" was really a price level where supply and demand were out of balance. "B" can only happen because there is much more demand than supply at price level "A". **News and everything else that accompanies the price action (rally "B") does not offer any benefit that price is not already telling us.** Therefore, if and when price revisits price level "A" for the first time "C", we can say that price is revisiting a level where demand greatly exceeds supply "C". In any market, when price reaches a level where demand greatly exceeds supply, prices rise. "C" is the low risk / high reward time to buy into any market.

Let's now quantify supply (resistance) objectively. Area "A" again represents temporary price stability which gives the appearance of supply and demand equilibrium. The price drop "B" tells us that area "A" was really a price level where supply greatly exceeded demand. It simply took a period of time for this "unbalanced" equation to play out. "B" can only happen because of a supply and demand imbalance at price level "A". Therefore, if and when price revisits price level "A" for the first time "C", we can say that price is revisiting a level where supply greatly exceeds demand "C". In any market, when price is at a level where supply greatly exceeds demand, prices decline. Notice in this example, the initial decline "B" is very dramatic. This tells us that there is a very large imbalance at "A" which means we would expect a similar decline at "C". "C" is where we would find our objective low risk/high reward entry to short the S&P.

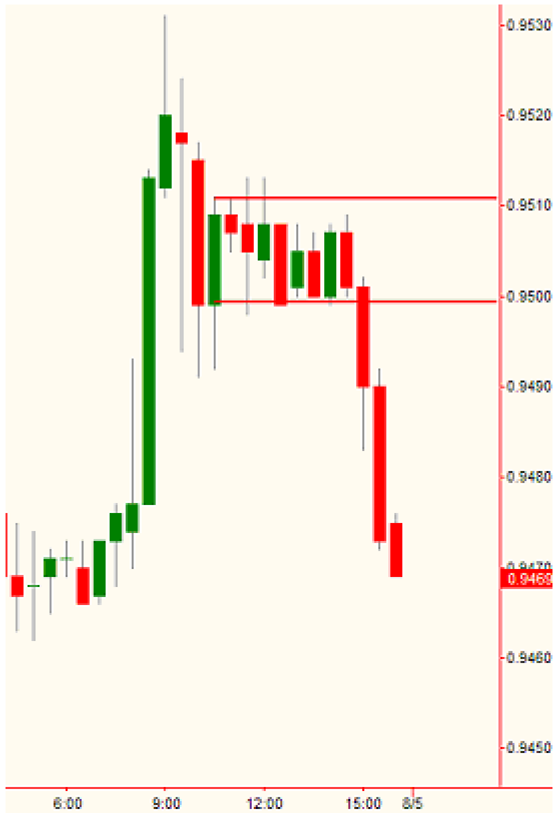
Trading Ideas

S&P E-Mini (CME Futures)



The S&P has declined significantly in the last two weeks. While price can certainly drop much further, the low risk / high reward area to short the S&P is higher, in the area marked as supply on the chart shown here. Notice the sharp decline from the supply level. This suggests a strong supply / demand imbalance at that level which is ideal for shorting. Day Traders and Swing Traders should let price rally into the supply level (1465 – 1471.50) and then sell short if and when it declines from the level (around 1464 or higher). An ideal stop would be just above the supply level (1472). Demand in the S&P can be found below in the 1430 area.

Canadian Dollar (CME Futures)



The Canadian Dollar is a very ideal shorting opportunity for two reasons. First, it is very high on the supply / demand curve in the big picture. This suggests the profit margin on this trading idea is huge. Second, notice the dramatic initial drop in price from the supply level. This suggests a large supply / demand imbalance at the supply level meaning there are likely many more willing sellers than buyers at the level. Because of these two ideal features, we would look to take this trading opportunity as more of a swing trade than a day trade as again, the profit margin is huge on the downside from the level. As with the S&P trade, we will look to let the Canadian Dollar trade into the level (.9500 – .9515) and then short it if and when it declines from the level (entry around .9495-.9498). Remember, the closer our entry is to our stop, the larger the position size we can have while still having very little of our trading capital at risk. An ideal stop for this trading idea would be .9517.

Crude Oil (NYMEX)

Crude Oil is also very high on the supply / demand curve in the big picture. Because of that, we would look at this short trading idea as more of a swing trade than a day trade. Let price rally up into the level (75.85 – 76.30) and then look to sell short once price declines from the level (entry around 75.80 – 75.85). An ideal stop would be 76.35). Again, the profit margin is big because of this supply level's location on the supply / demand curve in the big picture.

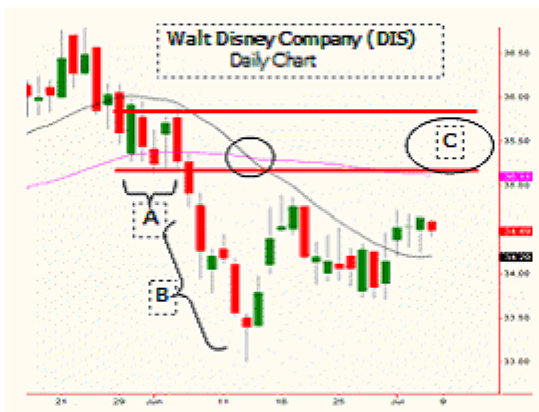
Next week, I will update these trading ideas should they meet entry. As time goes on, we will expand into many markets. I trade over 30 futures markets and stick to a very mechanical set of objective rules based on the laws of supply and demand.

New Newsletter for Online Trading Academy Swing Traders…

Online Trading Academy is constantly improving the ways we support our clients. Soon, we will be releasing a new and exciting weekly swing trading letter covering stocks, futures, forex, and options. In the meantime, we are pleased to offer you some swing trading ideas and continuing education for the coming week. All charts are courtesy of Tradestation.

<u>Education</u>

Before



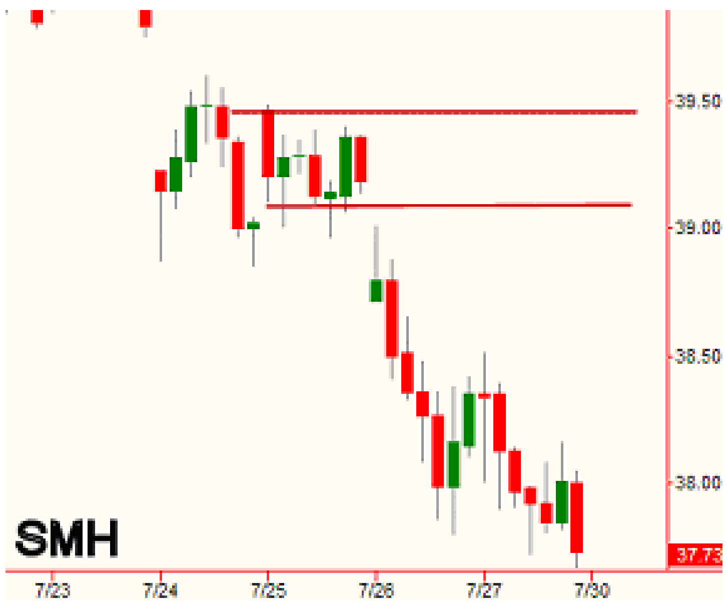
After

In an Online Trading Academy stock class two weeks ago, we suggested that a potential short position was likely in Disney for swing traders. The charts above are both daily charts of Disney (DIS). This trading idea not only represented a quality swing trading opportunity but also a good example of another way to use Moving Averages as guides to true support and resistance, not faulty text book definitions of support and resistance. Area "A" represents a price level where supply (resistance) exceeds demand (support). We know this because for a period of time at "A", price was stable and then, a steep decline ensued, "B". Once "B" happens, we can say that area "A" has more supply than demand. This can be the only reason for the drop from "A". The first time price revisits level "A", we will have buyers buying after an advance in price and at a price level "A" where supply exceeds demand. The odds are stacked against that buyer so it's our job to simply take the other side of the trade and be the seller to that ill-informed buyer. Also notice the cross of the moving averages (circled). They cross at the origin of the supply / demand imbalance. This happens most of the time and really has to if you think about it. At area "C", we will be selling to a buyer who is buying after a rally in price and at a price level where supply for Disney shares exceeds demand. This trade worked out great for our Online Trading Academy swing traders and option traders as you can see from the chart on the right. After meeting entry, price declined to our first target. The trade was low risk and high reward and most importantly, it was taken and planned based on a set of objective and mechanical rules.

Online Trading Academy Lesson: *Often, the first time price revisits a moving average cross, there is demand (support) or supply (resistance) in that area. When moving averages cross, simply extend a trend line to the right and wait for price to come back to that level.*

Trading Ideas

SMH



The SMH is the ETF (exchange traded fund) for the Semiconductor sector. It declined considerably last week with the market. It does however have a significant supply level above current price, the area within the two red lines. While we can certainly short the SMH, we will use this as a guide for semiconductor stocks this week. Consider shorting semiconductor stocks if and when the sector rallies into the level shown here.

NVLS

NVLS is a semiconductor stock that also has a significant supply level above, shown with the red lines. If and when NVLS rallies into this supply level and the SMH rallies into its supply level, we will have a high probability trading opportunity on our hands. Look to short NVLS $31.00 - $31.35 with a stop at $31.46. Initial Profit Objective: $1.50 - $3.00.

IBM

IBM has been strong during the recent market decline. If IBM declines, there is a significant demand level below as seen with the green lines on on the chart above. Look to buy IBM $108.10 - $109.10 with a stop at $107.75. Initial Profit Objective: $3.00 - $6.00.

Are You Prepared to Trade in 2008?

Often, people take a new year as an opportunity for a fresh start. For the trader, perhaps that means deciding that you will always focus on risk first and take every stop loss according to plan. Others may conclude that they are going to increase share size because they have been doing well. From some recent emails, I have noticed that some traders are going to add futures trading to their plate in 2008. Whatever you decide to do in 2008 as a market speculator, there is one governing dynamic to markets that you had better make sure you understand: Supply (resistance) and Demand (support). Average market volume is not likely to be back to normal until Monday so there should be no big hurry to jump back into the markets. This means there are three full days to ask yourself some simple questions. If you are not sure of any of these questions, why would you be willing to put a dime of your hard earned money at risk? Believe me, the market speculators on the other side of your trades know the answers to these questions without even thinking.

1) Do you have a trading plan?

a. The best traders always have a plan and more importantly, stick to the plan.

2) Is there discretion in your plan?

a. If there is discretion in your trading plan, this means there are unanswered questions. It is best to turn those questions into RULES.

3) Is all your analysis based on objective information or is some of it subjective?

4) Do you understand how to quantify supply (resistance) and demand (support)?

a. Or are you focused on a lagging indicator which can lead to high risk and low reward trading?

5) Have you reviewed your trading results such as average win to average loss and your winning percentage?

While I have many more important questions for you, it is best to address these one at a time as this will allow you to really deal with the main issues and get on the path toward your goals. As a concerned educator, I would suggest you NOT even think about trading until all these issues are taken care of. As a market speculator, go ahead and ignore the questions and keep on trading. Never forget, in trading, it's almost always the novice trader providing income for the consistently profitable trader.

Let's review some markets:

Above is a chart of the SPY, the ETF for the S&P. As I have tried to point out over the past few weeks, this market has plenty of room on the downside for a decline. While there appears to be support at the lows marked support 1, be careful buying at that level if and when price reaches it again and here is why. Price has revisited this level a number of times already as seen on the chart. Each time price revisits this level, more willing buyers that make up the demand (support) get to buy. This means support is getting weaker, not stronger. A lower risk and higher reward area to buy would be the lower support level marked support 2. This is really the origin of the demand, the 200 MA is in this area, and price has not revisited this level yet.

This is a chart of the QQQQ, the ETF for the NASDAQ. Above current price, we find a resistance level that has not been revisited yet. Swing and day traders may find a low risk/high reward shorting opportunity in this range. Also, notice the dramatic decline in price from this level suggesting that supply and demand are very much out of balance at the resistance level. The down sloping 200 MA shows the downtrend which means it's okay to sell short at the resistance level seen above. If you don't know how we enter these trades and where we put our stops, join us in our Pro Trader course where we spend plenty of time on this issue. You can always email me as well.

This market, the XLF (ETF for the financial service sector) has been declining at a very rapid rate due to all the credit related problems with lenders. While the selling is likely to continue, there is a demand (support) level below that has not seen price revisit it even once. This suggests a move higher when price reaches it. If you're trading financial stocks, it may be a good idea to time your longer term buys in those stocks with the demand level seen on this chart.

Trading and Time

In last week's letter, I showed a chart of the XLF which is the ETF for the financial service sector. I showed a demand (support) level and suggested this would be a low risk area to buy the XLF for a bounce, not a long term trade. After receiving many emails on this trading opportunity from people who bought the XLF as planned and from those who didn't, I thought it would be a good idea to revisit the chart as the questions in the emails were all the same.

As you can see below, price in the XLF touched our level yesterday. For those who bought it then, the trade had a gain of $2.00 in the past two days, congrats. You can certainly move your stop to breakeven at this point and consider exiting some or all of the position at or near the circled area seen on the chart as that represents some supply (resistance). Keep in mind that while the gain is nice, the low risk entry taken to get that gain is the key point in this trade that needs to be understood. Obtaining gains in trading is one thing. Obtaining them with the lowest possible risk is another story.

Let's get back to the email question…

The Question

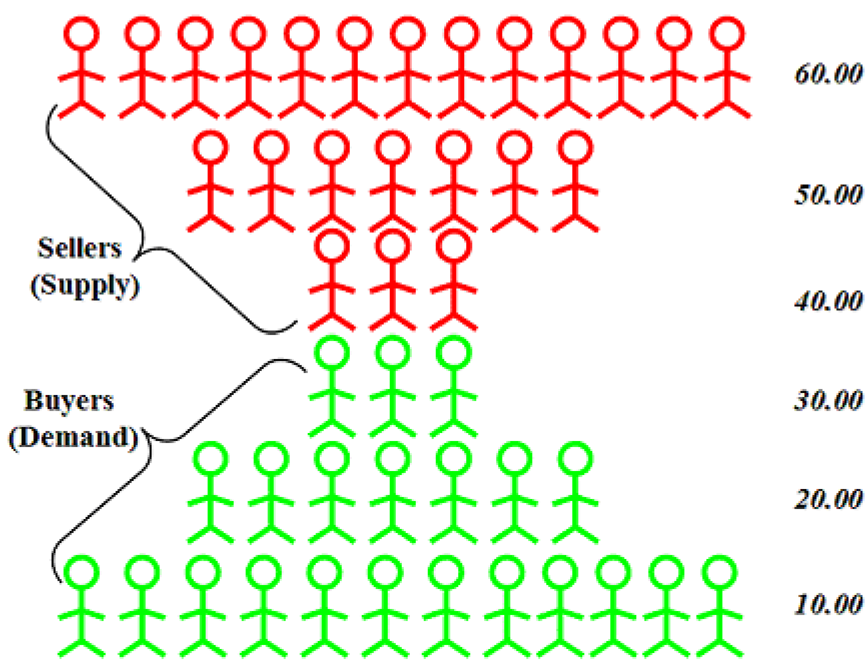
How can this demand level that dates back to the year 2003 mean anything today? A couple of emails actually sounded annoyed that I would even have the nerve to do such a thing but I guess that is what makes a market. They went on to ask if the buy orders that made up the demand back in 2003 were the same orders that caused the demand on Wednesday.

Back To Basics

Before we get into specific answers, it is important to understand how markets work and why prices move. Price movement in any free market is a function of an ongoing supply and demand relationship within that market. Opportunity exists when this simple and straight forward relationship is out of balance. Put quite simply, a market is made up of three components: buyers, sellers, and a widget being bought or sold. These widgets may be shares of a stock, S&P futures, foreign currencies, bonds, and many more tangible and intangible "widgets". For example, let's say the widget is a stock like the XLF. This stock has some value. That value or "price" as we call it is determined simply by the supply and demand for the stock, which is the ongoing interaction of all the buyers and sellers taking action with regard to that particular stock.

A market is always in one of three states:

1. It can be in a state where demand exceeds supply which means there is competition to buy and that leads to higher prices.
2. It can be in a state where supply exceeds demand which means there is competition to sell and this leads to declining prices.
3. It can be in a state of equilibrium. At equilibrium, there is no competition to buy or sell because the market is at a price where everyone can buy or sell as much as they want. However, as the market moves away from equilibrium, competition increases which forces price back to equilibrium. In other words, competition eliminates itself by forcing market prices back to equilibrium. At equilibrium, there is little to no trading opportunity.



The picture above is how a chart would look if you removed time from the equation. You would see at each price level, how many willing and able buyers and sellers are present. We can certainly derive the same information when viewing time based charts. This is done by identifying supply and demand levels as I did with the XLF and others. Not every cluster of trading is a supply or demand level and not every high or low is a demand level. This is all based on an objective set of rules based on the laws of supply and demand. I cover this extensively in our courses at Online Trading Academy.

The Answers

The fact that this demand level dates back to 2003 does not at all mean it is less relevant than a demand level from a week ago. Typically, supply (resistance) and demand (support) levels from a long time ago are going to produce much better trades than recently produced levels. The reason is that when price is revisiting a level from long ago, price will be far from equilibrium which means the level is ideally placed on the supply and demand curve (large profit margins).

As far as the same willing and able buyers from 2003 still having their orders in the market at that level in the XLF, I think not. As you can see above, these are certainly not the exact same buyers and sellers at levels from the recent and distant past, this is pure supply and demand at work. If you drop the price of most common appliances, you will invite more and more buyers at each price level as you drop price. Conversely, as you raise the price of that item, demand will decline, supply will increase.

Find The Novice Trader

Aristotle and Plato had it right, they found every way to lose and fail. Once that was achieved, they were left with the right answers. In trading, it is easy to get the information on how to trade properly, just read a trading book, take a seminar, or listen to the "experts" on CNBC. The only problem with this is, the numbers tell us that most of those approaches don't work. Let's instead try and keep things extremely SIMPLE and REAL to arrive at a method of trading and analysis that works consistently. How do we make money trading? Trading opportunity comes when the novice trader has entered the market as they typically buy after a period of buying and into resistance and sell after a period of selling and into support. Therefore, all we have to do is consistently find the novice trader (picture of novice trading).

The way to do this is to focus on what the masses are doing wrong. Novice traders consistently make two mistakes as I mentioned above. First, they buy after a period of buying and sell after a period of selling. Second, they buy into areas of resistance (supply) and sell into areas of support (demand). The laws of supply and demand say that they will consistently lose doing that.

Let's walk through the chart above. In doing this, we will keep everything "objective" and "simple". Area "A" is what trading books will call sideways trading. We will call it what it is, a period where supply and demand is in balance. Candle "B" can only close below this range because there was too much supply and not enough demand in area "A". Therefore, prices have to fall. By the time the selling gets underway, shorting is late and high risk. Candle "C" represents the novice group of traders we are looking for. They are buying after a rally is underway, on above average volume, and into an area that we already know has too much supply in it. Notice that this is the first rally into this area, none of the supply has been absorbed yet. The close of candle "D" is our confirmation to enter on candle "E", below the low of candle "D's" body. This scenario happens each day, it is the essence of the turn in price.

I started on a trading floor and worked on a trade desk handling order flow. This experience was key for me as it showed me exactly how and why prices move as they do. This was on the floor of the Chicago Mercantile Exchange (CME), not looking at a screen-based chart for the first year. On top of that, from an early age, I was always taught not to accept something as true just because someone says so. What I do is apply simple logic to everything that presents a challenge, and trading presents a challenge second to none.

At the CME, I could have taken a variety of classes and started reading all the books, but personally chose another means of gaining knowledge about trading the markets. I had two very good friends on the floor of the exchange. One worked for a firm, and the other traded for himself and was one of the more successful traders on the floor. I was young and ambitious and just wanted to learn how he was doing it and, fortunately, he was willing to give me advice.

As I stood next to him, he pointed out a trader in the pit and instructed, "Sam, see that guy over there? Let me know when he makes a trade." I stood and watched the man, and when he raised his hands to bid for some contracts, I alerted my friend.

It was loud in the pit, as prices had been moving higher for some time. My friend pointed out to me how desperately the gentleman in question wanted to buy. He stood on his tiptoes, yelling at high volume to anyone who would sell to him. Seconds after pointing out these human behavior traits to me, my friend gladly filled his order by taking the other side of his trade, and we had a short position open; little did I know that my lesson had just begun. A few minutes later, the market fell, and we had a winning position. Being new at the game, I was impressed. In fact, it seemed too easy and very hard all at the same time. We had just profited from a position in minutes, which made it appear easy. The entry, however, came on the short side when it seemed everyone else wanted to buy in a very bad way, and this didn't make much sense at the time.

My friend explained, "That guy is somewhat new in the trading pits and consistently loses. Turns in the market happen when the novice trader has entered the market; therefore, all I have to do is find the novice trader and take the other side of his trade consistently."

I could not believe that this was how my friend had become so successful. There had to be more to his strategy! But, indeed, this was the essence of his trading approach, and he had little else to tell me. He was right. That novice trader was making his decision to buy based on emotion, not objective information. Had he looked at objective information, he would have seen that he was buying after a period of buying (late and high risk), into resistance (supply) (and low odds), and in the context of a market whose average price was falling (downtrend) (very low odds). In essence, he was entering a position when the odds were completely stacked against him. A profitable trader would never do that; the laws of supply and demand say you can't consistently profit while entering positions when the objective odds are stacked against you.

Keep in mind that my friend was not using charts and neither was I at the time. He simply found people who consistently lose and took the other side of their trades, period. I took that simple knowledge and figured out exactly what that looks like on a price chart. For those who like indicators and oscillators, no problem, we can see the same information with them. For example, I wrote a piece on CCI a few weeks ago that you can read, it's archived. The entry outlined in that piece is the same thing, we are taking the other side of a very novice trader's trade.

For humans in general, it is emotion that drives behavior, not intellect. Traders who make trading decisions based on emotion versus objective information are facing high-risk/low-reward trading situations.

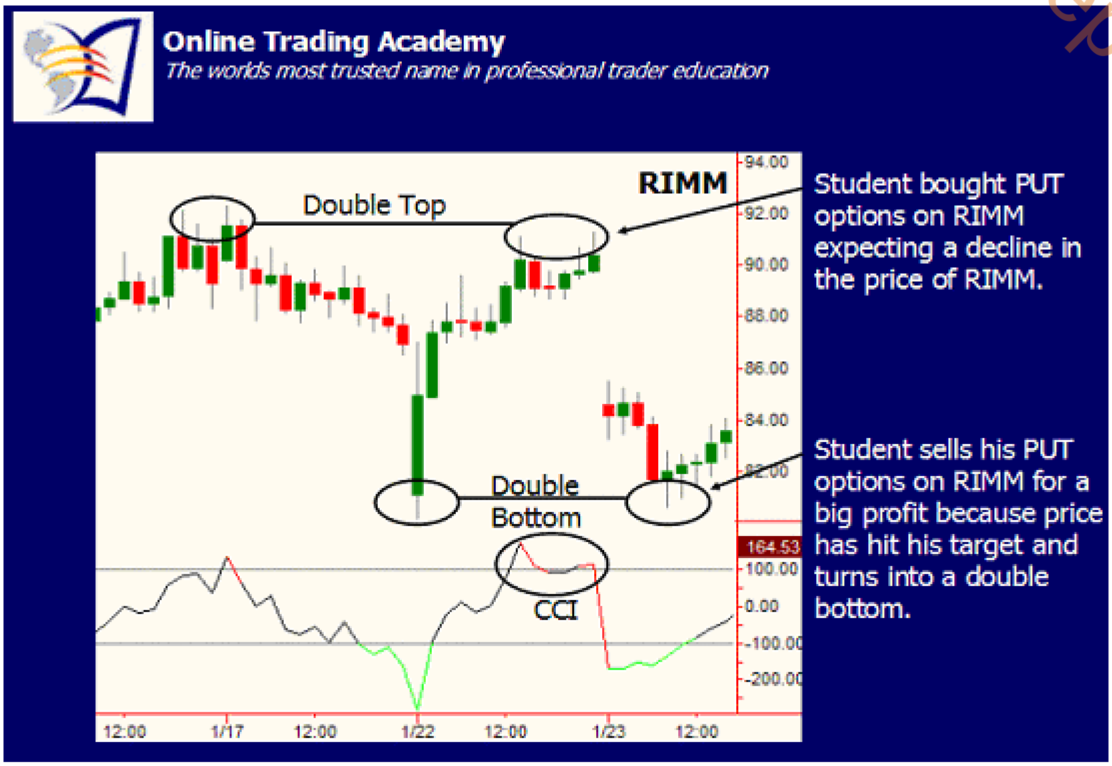
Others' mistakes allow you to profit. In profiling this type of floor trader, two mistakes come to light. Again, they buy after a period of buying and sell after a period of selling, which is late and high risk.

Second, they buy into areas of resistance (supply) and sell into areas of support (demand), which always is a low-odds trade. The laws of supply and demand and how one makes money buying and selling anything indicate that the odds are completely stacked against the trader who trades this way. Consistently finding this type of trader entering the markets would stack the odds in your favor.

The laws and principles of supply and demand, of course, have been around much longer than the markets themselves, and they apply to much more than just trading strategies. I was learning the core concepts of markets and how and why prices move and turn. All that was required was to first understand exactly how money is made trading anything. Additionally, it was about learning how to properly analyze the supply/demand and human behavior relationship (emotion) in any market at any time.

Further, it's important to notice that the focus is on the loser – what the majority of losers do wrong over and over again. The approach of discovering how to do things wrong in an effort to learn how to do something right has some impressive results. It worked for Plato and Aristotle, so why not apply it to trading?

Find The Novice Trader, Part 2 (we found some last week)



Status	Action	Quantity	Symbol	Type	Price	Act. Price	Expiration	Reported
Filled	Sell to Close	10	+RFYNR	Limit	11.00	--	--	11:22:35 01/23/08
Filled	Buy to Open	5	+RFYNR	Limit	6.50	--	--	13:16:29 01/22/08
Filled	Buy to Open	5	+RFYNR	Limit	6.50	--	--	13:16:17 01/22/08

01/22/2008 13:16:17	Bought 10 RFYNR @ 6.5	-6,517.49	$2,786.97
01/23/2008 11:22:35	Sold 10 RFYNR @ 11	10,982.34	$11,269.31

In all of our classes, there are rules that students are expected to follow. One of them is to NOT trade your own account in class. While we as instructors tell this to students on day one, students sometimes do it anyway.

Last week, I was in Dallas instructing an options class. Even though I told students not to trade personal accounts in class, some were set on doing it anyway so for me, it was very important that they did it the right way which means LOW risk and high reward trading. As I was covering market direction for the class, one student pointed out that RIMM was moving strong to the upside and that we should take a look at it. When we did, it was clear that RIMM was flying, up over $8.00 from the morning low (see the chart above).

As price rallied into the prior days highs which are resistance, I asked the class who was buying here. We had covered this extensively at this point so they all knew the answer: The buyer who is buying is buying RIMM after a large move up in price AND at price resistance. Not only was price at resistance but CCI was very overbought and we were looking at a potential double top. This buyer could not be a consistently profitable buyer because a consistently profitable buyer and seller of anything would never do that. This must be a novice buyer who always buys when the risk is high and reward is low. The student simply looked at the objective reality of all this and took the other side of the novice buyer's trade. He took it in the options in his own account which meant buying a put option when they were VERY cheap and about to become expensive and sold the put when the put was very expensive and about to become cheap - this my friends is trading.

The numbers above are screen shots of the student's real trading account. Could price have gone higher and stopped him out? Of course it could and that is why our goal is to keep trading low risk. This is why we focus on direction and always zoom in on the basics of how and why prices move and turn. While he took this trade and made lots of money on it in two days, the benefit of a low risk entry is the only reason he was able to enjoy that gain.

There is major risk of loss when you trade in the markets. It is well known that most people that attempt to trade fail. While this may seem depressing when thinking about taking a trading class or getting involved in the trading markets, think again. What is great about that statistic is that if you just look at the main two reasons why most people fail, all you have to do is the opposite of what they do, when they do it which is clear as day on a chart. When you see someone buy after a significant advance in price and at resistance, you may want to consider selling to that buyer. When you see someone selling after a decline in price and at support, you may want to consider buying from that seller.

Almost every trade we found in class worked out as planned which made this look easy to some of the students. While learning the information and rules is easy, emotion will make applying the rules one of the hardest things you will ever attempt to do. Emotion and faulty trading education is why the novice trader is a novice trader in the first place.

Lastly, if you think the student made a nice profit on that trade, he took the same trade in two other stocks at just about the same time and exited those around the same time as RIMM, all in his real trading account. The key is not to be impressed with the gains but to be impressed with the low risk he took on to get that gain. In other words, all the answers to trading are not going to be found by focusing on what the student did. The real key is to focus on the trader who was on the other side of the student's trades, that is where all the answers to profitable trading are.

Again, don't trade in class! However, if you are one of those students in class who sneaks to the washroom to call his or her broker and place a trade, do it when the risk is low, the reward is high, and the probability of success is stacked in your favor

The Qualifier – Support (demand) and Resistance (supply)

Last week, we looked at indicators and oscillators and wrapped some very logical rules around them. We did this because if you take every buy and sell signal an indicator produces, your trading career is guaranteed to be short lived. It is not that the indicator is not working properly, they always work exactly as they are programmed to work. The issue is that most traders don't use indicators properly. Today, we will apply some more simple yet important logic to conventional chart patterns.

There are many chart patterns such as Triangles, Flags, Pennants, The Cup and Handle, The Head and Shoulders, and many more. While I chose to stick to pure demand (support) and supply (resistance) in my trading, many new traders like these conventional chart patterns. One thing all these patterns have in common is that the entries are all "breakouts". No matter how much you like these patterns however, whether each trade taken ends up in a gain or a loss depends 100% on the supply and demand equation at the price levels to which price is breaking out into. In other words, before pushing the buy or sell button to enter the breakout, you must assess the "profit margin" to make sure there is room for price to run, after you enter. Let's look at some examples.

Here we have an intra-day chart of RIMM. Notice the Descending Triangle. While it looks to be a picture perfect pattern, whether we take it or not depends on the profit margin. In other words, where is the first support (demand) level below our short entry point, which is a break of the bottom of the triangle? We can see here that there is plenty of room to the first target and a little more room to the second target. In this case, shorting that breakdown from the triangle is fine. Had support below the triangle been too close, this trade likely would not have worked out.

Let's now look at a daily chart of DRYS. Here again, we have a picture perfect Descending Triangle. The difference in this case is that the support level below the triangle is somewhat close meaning our profit margin is not ideal. In the RIMM example, our reward to risk was about 5:1. In the case of DRYS, our risk reward is much less because support is much closer to our entry point. This profit margin may still be fine for some traders but the point is, you must know what that profit margin is. To quantify your profit margin, you must be able to quantify demand (support) and resistance (supply) based on objective information. Keep in mind that the task of quantifying supply and demand is beyond the scope of this article, however, we do cover it extensively in class.

Here we have the popular "Bear Pennant". This one seems to be a class favorite and that's great, as long as you know where your objective targets are. In the case of EBAY, we can see that the support level gives us a decent profit margin as it is well below our entry point. This pattern, just like the descending triangles is a continuation pattern. Notice in this example, price spends very little time in the pattern. This is typically a very good sign. With all these patterns, the less time price spends in the pattern, typically the better the outcome.

Why write about conventional chart patterns you might wonder? Along with my trading, I teach the Stock, Futures, Options, and Forex classes for Online Trading Academy and in all of these classes, I always find some people looking for the conventional chart patterns. The two issues that they fail to consider are the difference between profits and losses and they are as follows:

Almost all the entries for conventional chart patterns are "breakout" entries. This means you are going to have a hard time getting a good fill on your entry order so be careful not to chase price too much. If you miss the low risk entry, let it go. There is always another trade.

People need to realize that you can have a picture perfect chart pattern and it can still fail miserably. When this happens, it is because the breakout entry was right into a support or resistance level.

There are many ways to trade and keep your trading low risk and high reward. You can use chart patterns, indicators, Moon and Star patterns, and much, much more. The one governing dynamic that will determine the outcome of all these types of trading, however, is how well you can quantify supply (resistance) and demand (support).

The Morning Gap, Low Risk Opportunity for the Astute Market Speculator

Whether I am trading or instructing a stock, futures, or options class at Online Trading Academy, our lowest risk and highest reward trade each day is typically the opening gap entry. As soon as I suggest the trade to the class, someone always says: "I was told we are not supposed to trade the open because it is not for the novice trader". That is not exactly what we say at Online Trading Academy. What we say is that the open is not for the novice trader. It is, however, a fantastic opportunity for the astute trader who knows how to identify a novice trader. Most of the time, our entry is within seconds to minutes of the opening bell. There is a reason for this…

Why do prices gap up? They gap up because there are more buy orders at the open than there is available supply at the prior day's closing price. They gap down because there are more sell orders at the open than willing demand at the prior day's close. Therefore, market prices are almost always at price levels where there is a supply and demand imbalance (opportunity) at the open. Never forget, the successful market speculator simply finds markets where price is at levels where supply and demand are out of balance and trades them back to price levels where supply and demand is in balance. I started in this business on the floor of the Chicago Mercantile Exchange, handling institution and retail order flow. Watching that order flow made it easy to see where prices were going to turn. For example, if we had 10 buyers and 5 sellers at a price level, as soon as the 5th seller sold, price had to rise. Having the orders in your hand makes this easy to see. Knowing exactly what this picture looks like on a price chart makes it even easier.

This week in the markets represented obvious opportunities related to gaps and order flow. We took advantage of them in class here in Chicago each day. We will do the same thing in Boston next week as two things never change. First, order flow works the same way it did 100 years ago and never changes. Second, novice traders are always present and are only growing in numbers. Here is how it all works…

Below we have a chart of the S&P as seen through the SPY, the ETF for the S&P. "A" represents a resistance (supply) level. We know this because price could not stay at that level, it had to fall because there are more willing sellers than buyers at that level. "B" is a day this week where price gapped right into that resistance (supply) level at the open. Here, the novice trader buys and the astute trader sells to that buyer. Remember, a supply level is a price level where there are more sellers than buyers. The last thing you want to do is buy at that price level and that is exactly what the novice trader did that morning on the open. In class here, we sold to that buyer and profited on the decline in price. We know this is a novice buyer because only a consistent losing trader would buy a gap up, after a rally in price, and into an objective supply level. The very next day at the open "E", price gapped down into an objective demand level "D". Only a novice trader would sell a gap down, after a decline in price, and into an objective demand (support) level, "D". We simply bought from that novice seller and profited nicely on the trades. The very next day at the open "C", price gapped up right into an objective supply level, "A" and "B". That short entry at "C" was very low risk and high reward but you had to be trading at or near the open to get that low risk short entry which was true for all the gap entries for the week.

The key is to not look at candles on your screen as red and green pictures and patterns. You must understand what is happening behind the scenes. Whether you're trading stocks, futures, options, or forex, the logic and rules never change.

Again, the market imbalances are greatest at or near the open of trading in all markets. By the end of the first hour of trading each day, a large amount of novice trading capital is simply transferred into the accounts of the astute trader. If you can't see the novice trader in markets, you likely are the novice trader.

The Dollar, In Real Money Terms

I have been trading and writing about trading for more than 15 years. Most of the pieces I have written apply the laws and principles of supply and demand to different markets and different topics in an attempt to arrive at true value. I typically use the pure governing dynamics of supply and demand in an attempt to expose the vast array of illusions in global markets and the movement of price. How to identify, quantify, and benefit from supply and demand imbalances to identify value are the goals of my work. Why spend all my time exposing illusion and dealing with touchy subjects knowing that some of the email I will receive might not be that friendly? Because once we sift through the cloud of illusion, we reach a point where we can truly engage in the discovery of truth.

There is a major battle brewing on planet earth that has nothing to do with weapons or physical fighting. It is a most interesting battle that will likely change the shape of global financial dominance here on earth for generations to come. One side has been happy to have this battle while the other side does not even realize they are in a major war. Here are the players:

<u>The World Producers and Savers</u>

- East Asia, China, Japan
- OPEC Hydrocarbon Exporters

VS

<u>The World Consumers and Borrowers</u>

- U.S. Government and U.S. Public

For all of 2006, the United States had a goods deficit of over $800 billion. We in the United States borrow 2 billion dollars a day from the world savers and they expect to be repaid. To look at it another way, we borrow 80% of the world's savings to finance our conspicuous life style. We are 5% of the world's population yet we consume 30% of the world's goods. One of the many ways we do this is to use our home as an ATM. Hard working Asians and oil producing countries consume much less than they produce. Americans on the other hand, produce much less than we consume. The savers and spenders do have something in common however. The workers/producers are happy to receive dollars and the consumers are more than happy to print them. The obvious problem is that this cannot go on forever or foreign companies will own our entire wealth. When we withdraw dollars from our various "ATM's", we are essentially directly depositing them into the ATM's of the worlds producers and savers. When our ATM runs dry, be prepared for major life style changes.

Most Americans have read about this issue or hear about it in the news but they don't realize we are fighting the economic conflict of our lifetime and losing fast for two reasons. First, they are blinded by the illusion of stock market wealth and purchasing power. Second, few in America care about the free falling value of the US Dollar because few understand the US Dollar. The mighty U.S. dollar has tumbled over the past five years and is likely to keep falling. When it comes to illusion in the global financial markets, we are again talking about the difference between the reality of value and the illusion of value. As with trading, those who view value through the eyes of reality typically derive wealth from those who view value through the fog of illusion.

The Illusion of Dow Wealth

Do you receive your monthly statement from your investment broker and smile each time you see the rise in the equity value due to the Dow making new highs month after month? This gain in wealth is an illusion second to none because there is one important number that is missing from your monthly statement. It is the REAL value of the Dow after factoring in the collapse of the U.S. Dollars Global Purchasing Power Parity. What the United States public sees each month is the value of the Nominal Dow which is an illusion of wealth. Let's do the Dow "Real Money index" reality check. How we do this is take the Dow nominal value which is what you see in your monthly statement and multiply it by the U.S Dollars trade weighted index. Before we do this however, please make sure you're sitting and prepared for a disturbing piece of reality. In 2000, the Dow top was 11,700 nominal times 1.24 which was the dollars trade weighted index. This equals 14,508 Global Purchasing Power Parity (GPPP) points. In 2007, the Dow at 13,500 nominal multiplied by a dollar index of .81 equals 10,935 GPPP points. 14,508-10,935 = 3573 points divided by 14,508 = 25% real constant stock market decline!

Despite its recent eclipse of 14,000, the Dow (after accounting for the collapse of the U.S. Dollar) now buys more than 30% fewer Euros than it did back in 2000 when it was priced at approximately 11,700. It also buys 35% fewer gallons of milk, 40% fewer bushels of corn or wheat, 65% fewer ounces of silver, 70% fewer barrels of oil, 80% fewer pounds of copper, and so on. Do the simple math and figure out what the Dow will buy today in terms of other necessities such as housing, insurance, college tuition, or hospitalization. Anyway you measure it, Dow value that most Americans view as great wealth today is worth far less than it was in January of 2000. What about the NASDAQ real money "invisible" crash? Let's do the math:

NASDAQ 2000 Top: 5000

Dollar Weighted Index: 1.24

5000 X 1.24 = 6,200 pts

NASDAQ 2006: 2,500

Dollar Weighted Index: .81

2,500 X .81 = 2,100 pts

6,200 – 2,100 = 4,100 GPPP pts. Divide this by 6,200 at the peak and we have a decline of 66% in real money terms. This is reality!

Understanding the Dollar

The dollar is a "faith based" currency. The unsystematic world monetary system we live in today is a new arrangement. Up until 1971, the dollar was collateralized by gold. If you were a central bank, $35 would get you an ounce on demand. The system gave good, durable service until the U.S. started to run out of bullion. On August 15th, 1971, the dollar became uncollateralized as Richard Nixon took us off the gold standard. Exchange rates started to float, sink, or be pegged. Governments made it up as they went along and still do in many respects today.

I have been trading currencies for around 15 years. For the average person, an easy way to understand how and why they are valued against each other like they are is to think of them as different publicly traded companies. For example, there is typically plenty of demand for the stock of a growing solid company. This demand creates higher valuations for the stock which leads to wealth and strong buying power for the company. There are other companies however like Enron a few years back that were operating under mass illusion. When the public became aware of this fraud, everybody sold the stock which eventually went to zero and the company filed bankruptcy.

What happened to the main people responsible for the Enron illusion and fraud? One is serving a long prison sentence and the other died of a heart attack during court proceedings. The Enron illusion was nothing more than risk disguised as opportunity. Currencies are valued the same way. The perception of growth and higher interest rates for a country is going to invite global investors to buy that country's currency which will drive up the value of that currency. The higher the value of the currency, the greater that country's real Global Purchasing Power Parity. If the U.S. and our Dollar were a publicly traded company today, we would be considered much more an Enron than a Microsoft. The currencies of the world producers and savers are much more the Microsofts of the world. Global currencies seek safe and strong returns on investment, the U.S. Dollar is not it and the currency markets have been telling us this for years.

Gold as a Measure of Value

Gold has been the world's real money for 2000 years. In 1932, a man could by a nice suit for $20. We were operating under the gold standard back then, and an ounce of gold cost you $21 in 1920. Today, $20 will not even buy you a decent tie, let alone a nice suit. The one ounce of gold however will still buy you a very nice suit. Gold has held its value; one ounce today is over $700, plenty for the suit.

Gold vs. paper money

Paper money increases (printing money) lead to inflation, inflation leads to higher interest rates, rising interest rates mean a weak bond market, a weak bond market leads to a weak stock market. This is a simple road map based on the past 120 years.

Gold and the Dow

How many ounces of gold (real money) does it take to buy the Dow? Consider this… In 2000, the Dow was at 11,700 and gold was at $250 an ounce. When we divide the Dow value by the price of gold, we get a ratio of 47:1. In 2007, we have the Dow at 14,000 and Gold at $740 an ounce. When we do the simple math again, we end up with a Dow/Gold ratio of 19:1 in 2007. Did the Dow change? No, it's an index of 30 stocks. Did gold change? No, it's an inert element. What changed is the purchasing power of a fiat dollar to buy each asset class. Don't ask yourself: "What is the Dow trading at?" Instead, ask yourself: "What is the REAL Dow trading at?" This may be a radical difference from what you hear from traditional media. They want to have a televised party each time the Dow makes a new nominal high. Why would they cover the issue discussed in this piece? Simple, there is no party when you look at the Dow's decline in real money terms.

An Objective and Preemptive Solution

Now that we are in this mess, how can we fix it, what can we learn from it, and how can we prevent it in the future? There is one answer that takes care of all three questions. Objective supply demand analysis is the key to making sure your quest for true valuation is realistic. Whether you have any intention of trading bonds, currencies, or gold, or not, everyone has a vested interest in knowing how to objectively assess the ongoing supply and demand relationship in these markets. If you have any dollars in the bank, you have every reason to learn how to read a chart of the Dollar. If you have a mortgage on your home, you do have a position in the treasury market and a strong reason to learn how to see supply and demand on a chart of the 10 Year Treasury Note. If you have never looked at a price chart before and feel intimidated by the thought of doing it, be assured that this task is much simpler than you think.

Charts provided by TradeStation.

Area "A" in both occasions on this chart of the US Dollar represents temporary price stability which gives the appearance of supply and demand equilibrium. The decline in price from the levels marked "A" tells us that area "A" was really a price level where supply of U.S. Dollars greatly exceeded demand for them. The initial decline from that level can only happen because of a supply and demand imbalance at price level "A". In other words, there were many more willing sellers of U.S. Dollars than buyers at level "A". Therefore, if and when price revisits price level "A" for the first time "B", we can say that price is revisiting a level where supply greatly exceeds demand "B". In any market, when price is at a level where supply greatly exceeds demand, PRICES DECLINE. When the U.S. Dollar trade weighted index declines, Americans Global Purchasing Power Parity declines. Notice in this example, the initial decline from the first area "A"" is very dramatic. This tells us that there is a very large imbalance at "A" which means we would expect a similar decline at "B". All the answers we need to view markets and discover valuation objectively are incredibly simple, yet the vast majority misses the whole game being played out right in front of them because of the illusions presented to them by those who have more to gain by obscuring reality.

Charts provided by TradeStation.

Here we have a chart of the 10 Year Treasury Note on the left and the U.S. Dollar during the same period on the right. The most attractive trait for a currency is high interest rates. Let's take a look at the chart on the left, the 10 Year Treasury. Area "A" again represents a price level where supply exceeds demand. Again, we know this because price declines from level "A" which can only happen because there are more sellers than buyers at level "A". The first time price revisits that level is at "B" and price declines as we would expect. When treasury prices fall, interest rates are increasing, the relationship of price to yield is inverse.

Now let's look at the chart on the right. Area "A" on this chart of the US Dollar represents temporary price stability which gives the appearance of supply and demand equilibrium. The advance in price from "A" tells us that area "A" was really a price level where demand for U.S. Dollars greatly exceeded supply for them. The initial advance from that level can only happen because of a supply and demand imbalance at price level "A". In other words, there were many more willing buyers of U.S. Dollars than sellers at level "A". Therefore, if and when price revisits price level "A" for the first time "B", we can say that price is revisiting a level where demand greatly exceeds supply "B". In any market, when price is at a level where demand greatly exceeds supply, PRICES ADVANCE. When the U.S. Dollar trade weighted index advances, Americans Global Purchasing Power Parity increases. Let's put this simple relationship of interest rates and the value of the U.S. Dollar together. At the same time interest rates begin to increase, the U.S. Dollar was beginning to turn higher from the demand level. Remember, higher interest rates attracted foreigners to buy dollars (demand). We can see this play out on price charts all the time and well in advance if your point of view is reality based and void of illusion.

The Illusion of Value and The Value of Illusion

Whether we are talking about long term prosperity in financial markets, the true benefits and dangers of the foods we consume, or the health of our most personal relationships, the common denominator in achieving the best outcome lies in your ability to identify the difference between reality and illusion. In the financial markets, quantifying supply and demand objectively will not only allow you to consistently discover TRUE valuation, it will also open a door to low risk/high reward opportunity in the global financial markets. What benchmark are you using to calculate your estate? Is your benchmark a "true" measure of value? My advice would be to use a benchmark void of illusion when determining your global purchasing power and wealth. Even the slightest illusion in the search for truth ensures truth will never be found.

Secular Bear Market

We have had a secular bear market since 2000 in the "Real Money Dow, Nasdaq, and S&P indexes" in terms of Global Purchasing Power Parity. The model of printing dollars and nearly free credit is not the model that built America but it is certainly a model that can destroy it. If we can't sustain our Global Purchasing Power Parity, our standard of living will fall very quickly. In many ways, it already has. You see, illusion teases reality… Don't let the shadow of illusion darken the reality of a trend that may very well change your standard of living soon.

The Morning Gap, Part 2…

A few weeks ago, I wrote a piece on morning gaps and how to trade them. Last week I happened to be in LA instructing a stock class and on the 19th, a morning opening gap in the US stock markets offered us a very low risk and high reward opportunity. Our morning prep work basically consists of finding stocks that are opening at price levels where supply and demand are out of balance in a large way and then simply trading them back to balance. Once the traders understand the whole supply (resistance)/demand (support) concept and the rules, we use two sources to find these opportunities which typically present themselves right at the open of trading or shortly thereafter. One of our sources offers us the morning broker upgrades and downgrades. An upgrade that jumped out at us was Citigroup who was upgrading shares of Imclone (IMCL) with a "Buy" recommendation. While we are trading real money in class, you might think we would want to listen to this upgrade and do exactly what it is suggesting to do as Citigroup is one of the largest banks in the world and we are just 20 people in a trading class in LA. Well, it really depends on your point of view. Citigroup likely had good fundamental reasons to upgrade the stock and looking at the chart below, MANY people listened with both ears and bought IMCL on the open which is what caused that gap up in price. If your point of view is that of a smart buyer and seller of anything who has an understanding of the laws of supply and demand, not only were you not buying like everyone else was, you were selling to that huge group of buyers (at least we were).

Notice the price action on 3/7. There was a dramatic price decline from the $45-$46 price level. This can only happen because there is much more supply at that level than willing demand. When this happens, price must decline. The dramatic rate of decline suggests a strong supply and demand imbalance at that level. Now, notice what happens the morning of the upgrade on 3/19. Citigroup upgrades the stock and price opens right into that supply level. While the rest of the world is buying in a strong way, we had our plan in place well before the open that told us to sell to anyone who wanted to buy at that level. Why? Because we knew that if we sold to the buyers at that price level on the gap up, we would be selling to novice buyers who likely are consistent losing market speculators. How do we know this? Only a novice would buy AFTER an advance in price and INTO a price level where supply exceeds demand. Our job is to find this novice trader and simply take the other side of his or her trade.

When you enter markets at price levels where supply and demand are out of balance in a big way, especially at or near the open of trading, moves in the market are typically very fast. There were many other stocks this day that did the exact same thing and those who did the 15 minutes of morning prep work that we do each day were rewarded with low risk/high reward gains.

This trade and the thoughts and rules that went with it are not meant to impress you. I mean to impress upon you the importance of looking at markets for what they really are which is simply an ongoing supply and demand equation. Opportunity exists when this simple and straightforward relationship is out of balance. Everything else in and around markets is just "noise" that is meant to invite you into markets at the wrong time and in the wrong direction. As an educator, I say that is unfortunate. As a trader, I love it - the more noise the better

Think Like A Goose

After teaching a course at Online Trading Academy, I always feel the need to revisit this topic as sooooo many people come into courses looking at and thinking about markets completely backwards.

Consistent low risk profits from trading and investing is a challenge many millions of people take on, yet only a select few are ever able to attain. The objective and mechanical rules for consistent low risk profits are very simple, yet the layers of illusions keep most from ever seeing what is real in trading and investing.

The main form of analysis in trading and investing is fundamental/news analysis, and it's very real. However, thinking that mastering this form of analysis will lead to consistent low risk profits is an illusion second to none. The more an individual attempts to master this type of analysis, the more they may be layering subjective complex illusions on top of each other. This is a recipe for consistent failure.

What many beginning traders don't realize is that they are driving from LA to NY trying to reach Mexico. No matter how hard they work, the goal they desire is not attainable as the path they are on is an illusion. Trading strategies that work don't change with time or changing market conditions. Quite frankly, to think market conditions ever change at all is a strong illusion that can only be removed when one focuses on the foundation of price movement: supply and demand. A simple and minor shift in perception to what is real can lead to a monumental shift in trading and investing performance.

Beliefs and Behavior Patterns = Actions

Let's move backward one step at a time. Actions stem from behavioral patterns, and behavioral patterns stem from beliefs. It is at the level of beliefs that decisions are made, and moreover, where your ability to differentiate reality from illusion lie. It's time to start considering where your beliefs come from about what works and what doesn't. The strongest illusions in the trading and investing world are found at the core of fundamental analysis. Within this form of analysis lie many levels of illusion.

Figure 1

The News

The Illusion:

The news illusion is the most powerful illusion in trading and investing as strong news leads to strong emotion (faulty beliefs). Most successful traders and investors have, at some point in their journey to consistent profits, fallen prey to this illusion. How many times have you seen bad news turn into a positive day for the markets? The thought of a major terrorist attack in London led many to believe that prices would fall, and that belief drove the majority to sell. Once the last seller sells at a price level where there are more willing buyers than sellers, the laws of supply and demand tell us prices rise.

Lesson: No matter how bad the news is, when the last seller sells at a price level where there are more willing buyers, prices rise. There can be no other mathematical outcome.

The Reality:

Area "A" on is an objective demand price level as the origin of the supply/demand imbalance is at the point in which prices move higher from area "A."

Area "B" represents the day of the London bombings. The news of the London bombings was very real, very bad, and prices fell. However, once they reached area "A" where there was objectively more demand than supply, prices turned higher.

The Lesson: Strong news actually creates powerful turns in the market, opposite of what the majority expects because one side (buyers or sellers) exhausts itself into a price level where an objective supply or demand imbalance exists.

Figure 2

Fundamental Analysis

The Illusion:

In some cases, there are a number of illusions at work at once, severely clouding reality. Figure 2 shows QLGC, a technology stock most people are familiar with. The rally in price in QLGC as the stock revisits the area of imbalance is accompanied by good news on earnings. An "uptrend" in price is seen, which is accompanied by a number of brokerage upgrades (source: Yahoo Finance). The illusions here are many and create strong beliefs. These beliefs lead to action (buy or sell) and this action (buying and selling) is all we need to be concerned with. No matter who is telling us to buy the stock and why, all we need to know is this: Are prices at a level where there is objectively more demand than supply? If the answer is no, there is no reason to buy.

Not only is the answer no at the time of the brokerage upgrades in Figure 2, but the laws of supply and demand tell us we should be selling here, not buying. These upgrades which invite the masses to buy are given right into an objective supply area where we know there are more willing sellers than buyers. The eventual drop in price from this level is fast and strong for one simple reason. The number of willing buyers at this price level became zero while the number of willing sellers was still significant (supply/demand imbalance).

All this information was available to us months prior to the rally. But most market participants didn't see it, as the illusions were strong both in substance and number. Adding to the illusion was the uptrend, the higher prices advanced, the more people desired to buy into it. We are humans: there is comfort and safety in numbers. Again, many illusions come into play in this example. The illusion-based trader saw a high risk/low reward buying opportunity while at the same time the reality-based trader saw a low risk/high reward shorting opportunity.

The Reality:

The objective supply (resistance) area is labeled as such on Figure 2, because it is a price level where supply and demand is out of balance. Put simply, there is too much supply. Again, prices can only drop from that area because there are more willing and able sellers than buyers, there can be no other reason for the decline in price. Objectively, the worst possible action to take is to buy anywhere near this supply area, especially on the first rally into it. Many illusions however invite the masses to buy at the absolute worst time and there is a reason for this...

The Lesson: When perceived risk is lowest, actual risk is often highest. When perceived risk is highest, actual risk is often lowest.

Illusion: Everything in the company is good; therefore the stock is a quality investment.

Most people require specific criteria in order to feel comfortable buying a stock. These criteria likely include:

When all of the illusions are true, where do you think the price of the stock is? If you said "high," you are correct most of the time. If you buy when everyone else is taught to buy and when the stock price is high, who is going to buy from you? Remember, the only way you can derive a profit from an investment or trade is when someone buys from you at a higher price than what you paid. This is no different than buying and selling anything, which includes real estate, automobiles, computer, and much more.

The many illusions are nothing more than risk disguised as opportunity. Falling prey to a variety of market illusions makes it possible to disguise irrational behavior as "safe," "proper," or "accepted." An illusion is an erroneous perception of reality. Illusions lead the average trader and investor to commit two consistent mistakes:

- Buying after a period of rising prices;

- Buying at a price level where we objectively know there are more willing sellers than buyers.

Both of these actions are completely inversely related to how you profit when buying and selling anything. They go completely against the laws of supply and demand. However, we don't want illusion based traders and investors to go away. Why? We need them as they consistently buy after the reality-based trader buys. In short, the reality- based trader typically derives his or her profit from the actions of the mass illusion based crowd.

Act Like A Goose

The human mind is not wired to trade properly. Our decision making process is not like most other animals. Most people don't focus on reality when deciding to take action, we make decisions based on emotion, not intellect. Not only is it very difficult to live in complete reality. But, consistently making actions based on reality is an even harder task many times. A goose on the other hand would make an excellent trader and investor. When autumn approaches in the north, the geese don't wonder if winter will come or not. They certainly don't call a goose meeting to figure out a way to stave off winter. They simply act like a machine and fly south for the winter and repeat this process each and every year flawlessly for their entire life, without questioning their choice.

A successful trader's path must be reality based, not driven by illusion. The reality is that markets are nothing more than pure supply and demand at work; human beings reacting to the ongoing supply/demand relationship within a given market. This alone, ultimately determines price. Opportunity emerges when this simple and straightforward relationship is "out of balance." When we treat the markets for what they really are, and look at them from the perspective of an ongoing supply/demand relationship, identifying sound trading and investment opportunities is not that difficult a task.

Supply and Demand Q&A With Sam Seiden

Often I receive emails with questions about the articles. For today, I thought I would share some recurring questions and answers with you for your benefit. Just a note before we begin: My email has been down for three days so if you have sent an email during that time, I didn't receive it. Please resend as it is working fine now.

The questions and answers for today all have to do with supply (resistance) and demand (support). We will use a chart of the DOW today to help illustrate the Q&A as this has been a demand setup people have been asking about.

Some of our more astute supply and demand Online Trading Academy graduates have been sending emails about this daily chart of the DOW over the past few weeks. They were pointing out that there was a demand level that offered a low risk buying opportunity for the more active day/swing trader. For those who emailed about this setup, nice job. As you can see above, once price moved above the cluster of trading activity, that area became a significant demand level for a couple of nice trades to the long side. Consider that the only thing that can cause price to move above that area is the fact that demand for DOW stocks exceeded supply at that price level, a supply and demand imbalance. Once price declined back into that area, we know we have a seller selling at a price level where demand exceeds supply. This is the novice seller we want to buy from.

Below are some questions that come up frequently. Here are some answers that will hopefully not only help you but also provoke more thought and questions if needed.

Question: Hi Sam: I've recently come across your site and have read many of your articles which I find to be very good. I've been trading for about 10 years, unfortunately, not as consistent as I would like. I find your support and resistance information to be great. I wanted to ask you a question about some of the charts you have posted when talking about this. At the areas on the charts where you have indicated there to be support/resistance, the lines drawn in sometimes appear to go right in the middle of the bar; in other words, it doesn't look like it's at a high or low within that particular cluster. Where or how do you determine where you draw your support/resistance lines? Are you sometimes using opens or closes?

Answer: It is a good idea to make sure that the vast majority of trading is between your two lines. While it would be easy for me to say "include wicks" or "not", the truth is that each time you change the time frame, some wicks become bodies and some bodies become wicks. Take a look at that area on two different time frames to determine where the majority of trading is and draw your lines there. Using the highs and lows of the candles are fine but often that makes for a very large stop which is not ideal. In the example above, I have drawn the lines around the entire price action as this is how one successful student drew the lines when they sent the chart to me. This is fine as well. While you would have a larger stop drawing lines like this, you would simply reduce your position size to keep your risk within your maximum risk parameters.

Question: Hi Sam, your articles in Online Trading Academy are not only illuminating but also contain gems of trading truths. I hope you could add to my understanding. You have noted that true demand and supply levels are found in "bases, pivots and gaps". How do you actually quantify demand and supply levels? Very often, these demand/supply levels denote a price range (say 15.20 to 15.50). How do we know at which price within this range should we buy or sell? You have given clues like a momentum bar followed by a reversal bar, slow stochastic crossing and the incision of the +/-100 CCI line. Are there any other specific criteria?

Answer: Thanks for the kind words. While I talk about supply and demand all the time, I certainly didn't invent it and don't claim to own any of it. I am actually just repeating the things Adam Smith said a few hundred years ago and showing you what that looks like on a price chart. I am also repeating what Issac Newton said when he spoke of his three laws of motion. The governing dynamic behind trading is not a bit different. The "mass" as Newton would say is the order flow in markets. Were these really Newton's laws of motion or had they been here all along? Were Smith and Newton really saying anything different at all? I would argue that they were saying the exact same thing with regard to how and why prices move in markets and the laws of motion. It's the SAME equation and it has not changed one bit today. These two were great minds and I am a big fan; too bad they didn't have charts like we do today, they would have been great traders.

Back to the question… Trying to pick exact turning points can be a challenge that will not add much profit to your trading even if you're able to do it. Instead, it's a good idea to use two lines as I have on the chart above to identify your supply (resistance) and demand (support) levels. This way, you don't care exactly where prices turn, you're just betting that they will turn in that area. Above, you would buy once price reached the upper demand line (circled areas) and once that order is filled, you would put your protective sell stop just below the bottom demand line. Again, use a position size that ensures you are not risking more than you are comfortable with.

Other specific criteria that you mention in your email can be in the form of anything you want. A momentum candle followed by a reversal candle AT a demand or supply level is a good entry signal. A CCI overbought or oversold reading AT a demand or supply level is a good entry signal. In other words, you can use any signal you like, just make sure you're using it at a price level where demand likely exceeds supply or vise versa. We spend tons of time on this in the Professional Trader classes.

Question: I found your description of support, resistance and time to be very interesting and I eagerly look forward to your articles. However, it is my understanding that prices are manipulated by Market Makers and Specialists and often the price does not reflect true supply and demand. Stocks are often purchased by MM to drive prices higher--then the public steps in and prices move even higher. At some point, the MM sells. This can't be a reflection of supply and demand but only manipulation. Is this right? Your insight would be appreciated.

Answer: Good question. I go over this in class all the time as I spent years on a trading floor watching this very event happen all the time. I handled order flow and if I saw that there was a large amount of supply at a price level and current price was below that, institutions would bid the price up to that supply level, inviting the public in to buy, buy, buy, creating the illusion that price was going to the moon. As soon as price hit that supply level however, the institution often dumped a huge sell order on the market, catching the public on the wrong side of the trade and price would collapse. Welcome to trading J. When you compete at anything, you must understand how the game is played. Those that understand best will get paid from those who understand least. In trading, most people derive their education from books written by people who write books but don't really trade. As a trader, you will learn to love that. While I am not a big fan of middle men or market makers, I don't blame them. If you are a market maker, your job is to price things so you make money, not the person on the other side of your trade. The one place a market maker or institution can't hide is the price chart which is why that is always where our focus is. Instead of looking at candles on a screen as red and green signals, start looking at them for what they represent, they are the footprints and TRUE intentions of buyers and sellers.

The Most Popular Entry Strategy in Forex Trading

Over the past weeks, I have focused my weekly articles on strategies. I have tried to share with you the various strategies I see traders using and finding success with. Today, we will end the strategy series with far and away the most popular entry strategy at Online Trading Academy, the "breakout". The Forex markets are markets that move. In a market that has significant and consistent movement, using breakouts is very appropriate. As with any strategy, there is a right way to understand and use it and a wrong way. In this piece, I will discuss the two most popular breakout entries; Support and Resistance Breakouts and Trend Line Breakouts.

Support and Resistance Breakouts

Once in a while I hear someone say that breakout trading worked best in the late 90's in the stock market. Well, someone who learned to trade in the late 90's and who does not understand breakouts might say that. In those days, you could buy anything at almost any time and make money. Today, breakout trading is where you see most of the money being made in Forex trading by those who truly understand the structure behind a true breakout getting paid from those who don't.

The chart above is the EURUSD. Notice the horizontal resistance line and let's work left to right in our understanding of what's really happening behind these candles in the chart. The first circled pivot high on the left becomes that pivot high because supply in this market greatly exceeds demand at that price level. When price reaches the line, some of the sellers that make up that supply get to sell but there is still much more supply than demand so price has to fall. The drop from that first circled area is significant as we would expect. The next time price revisits that level, it declines again but this time, the decline is shallow compared to the prior visit. This is because each time you revisit the level, more sellers that make up that supply get to sell so the supply and demand equation is becoming more in balance. The analogy here is the chopping down of a tree (not a great example, I know). With each chop, you are removing mass from the tree and therefore, the tree is more and more likely to fall with each chop. In trading, the mass is the supply and demand. Moving left to right, price comes back to that level a third time and falls but again, the decline is shallow suggesting that there are simply not many sellers at that level remaining. Next, price revisits that level a fourth time but this time, instead of declining from that level, it bases sideways suggesting there are no longer more sellers than buyers. This is when you get ready to buy because in Forex trading (and any other market for that matter), price is likely to move higher. One would feel comfortable taking a low risk entry on a breakout here as the objective price action tells us that there are simply few sellers if any left at that price level. This is a trade we take in the Forex Trader Part 1 and 2 classes all the time. This is also a trade you will see taken very often in our Extended Learning Track (XLT) – Forex Trading class . Does every trade work? Of course not, that's trading. This is why it is so important to understand what is driving the movement of these candles. This in turn helps you understand the structure of a breakout. For shorting, we would just do the opposite of what I am suggesting here. If you want to see an example of a shorting opportunity just like this one, print this page out and turn it upside down.

The Trend Line Breakout

Trend line breakouts and breakdowns are a very popular entry in Forex and other markets. Much of the time, this is the only type of entry a student will practice in class all week long because they become comfortable with it as it is simple to understand and can produce some strong moves for a trader.

This again is a chart of the EURUSD. The down trend line is drawn once we have two points on a chart which is what is always required when drawing trend lines. Once we have this, we simply draw the line and wait for price to breakout above the line for a long entry. The logic here is that price is trending down because it is at price levels where supply exceeds demand. We want to buy this market when it reaches a price level where demand exceeds supply (more buyers than sellers). Instead of trying to guess at where this might be, the price action on the chart will tell us this if we just wait and watch. When price eventually breaks out above that down trend line, it happens because it has reached a price level where there are more willing buyers (demand) than sellers (supply). This is where we would want to take a low risk entry and buy. While there are many profit taking targets that we cover in class, one logical target for profit is the origin of the decline in price that started the whole downtrend in the first place. This is shown as the dashed red line on the chart above.

Here we have a steep uptrend as shown by the price action and our uptrend line. Instead of guessing as to where this dramatic advance in price might end or at what price level is all the supply, we can simply draw an uptrend line by connecting the pivot lows and look to sell short on a breakout (breakdown in this case) of that line. As in the last example, a natural target can be the origin of that rally in price as shown by the dashed red horizontal line on the bottom of this chart.

Keep in mind that the most important part of trading is managing risk properly. We focus on this extensively in class. The focus of this piece was to help with entries as that is the beginning of a good risk averse strategy. The breakout entries discussed are equally appropriate in any and all markets so don't think this is just for Forex. Never forget, whether the candles on a screen represent a chart of stocks, futures, Forex, options, football trading cards, rare coins, or anything traded… They are all just people and price. We would quantify a breakout in price the same way in any and all of these markets. If you are watching the buying and selling of a David Beckham rookie card and you see that the last one available at the current price level just sold, what is about to happen to price?

Trading and Time Part II

Today we will discuss an issue that raised many questions a few weeks ago, trading and time. Before we get started, I wanted to mention a couple things. First, I was in London last week (5/19) and what a week it was. This was a week of great education and very successful trading based on the education. From day one, we were trading to the short side and all week as the market declined, we kept shorting. I actually don't think we had one day where we were interested in longs. Why only trade short? Simply, the supply and demand equation in the market the week of 5.19.08 (our class) suggested the global equity markets would decline and they certainly did. I am in no way patting myself on the back. I would love to say I own this strategy or have some super power insight into markets but the truth is, supply and demand have been around much longer than people have walked the earth. For those in Europe or elsewhere, I will be in London again July 12th – 16th where we will again, quantify supply and demand in the global futures markets and trade markets around the planet from our fingertips; what an amazing occupation, I love it! This class is either full or almost full so give Online Trading Academy London a call if you are interested.

Second, during my time in the UK, I discussed the US Dollar and other currencies quite a bit and this is because of a timely event. Without going into why, let me just say that this turn higher in the dollar over the past two weeks is something we went over in class extensively, suggesting that the turn was coming. Now that it has turned a bit, don't be surprised if this Dollar rally continues after a slight near term pullback. It is likely to strengthen against the Euro and the Pound more than other major currencies so watch for that if you are a long term Forex speculator like me. If you're thinking of shorting the Euro against the dollar, it is a good idea to wait for short term rally against the dollar to do this. Specific prices are reserved for our students but you can certainly email me if you desire more details.

Trading and Time Part II

The last time I touched upon this topic, many questions came up. Let's get right into the chart and discuss. Trading comes down to one of two styles - catching reversals or trading with the trend. Both can be low risk and work if you do them properly. When catching reversals, what determines whether you will be successful or not is your criteria or definition of support (demand) and resistance (supply). While there are many different definitions, the one that is closest in line with raw supply and demand is typically the one that pays. Notice area "A". Here we have a series of "pivot lows". Let's ask ourselves why price can't stay at price level "A". Why do we get pivot lows and no basing? The answer is because at that level, supply and demand are so "out of balance" that it is impossible for price to stay at that level for a long time. Therefore, that level is a very strong support (demand) level and we would look to buy the low risk entry at "C". "C" is the first pullback into demand area "A". Now focus on area "B". This is not a pivot, it's a "cluster" of trading followed by a decline in price. Again, let's ask the question, "why was price able to stay at that level so long and create the cluster of candles?" The answer is that supply and demand are not that out of balance. "D" represents the first rally back into what might look like resistance (supply, B) but price just rallies right through it like a hot knife through butter. When price declines from "B", this certainly happens because there is more supply than demand at "B" however the supply and demand imbalance is not that great and that's the point I am suggesting in this piece.

I am not saying that "B" never works as a level of support or resistance, I am simply suggesting that there is a hierarchy when it comes to levels of support and resistance and the "pivot" areas such as "A" by definition are most of the time (if not always) stronger levels than a cluster of trading activity. This is exactly how we teach it in class, whether it's our Pro Trader class, Forex Trader class, Options Trader class, or E-Mini Futures class.

Lesson: The greater the supply and demand imbalance, the greater the opportunity.

Three Simple Principles

I have been involved with trading and investing for more than fifteen years. The consistent low-risk profits I have produced are a function of trading what is real, not what I feel. I'm able to eliminate subjective emotions from my trading by basing each and every decision on a simple mechanical set of objective rules that quantify supply and demand. These simple rules stem from three principles of price movement I crafted for my own trading long ago. These three principles form the foundation upon which my whole strategy for trading and investing is based. While everyone's trading strategy will always be different, perhaps today's article will help set you on a path that allows you to focus on what is real and not what you feel…

The first principle states that "Price movement in any free market is a function of an ongoing supply and demand relationship within that market". The second law states that "Any and all influences on price are reflected in price." Lastly, the third law says that "The origin of motion/change in price is an equation where one of two competing forces (buyers and sellers) becomes zero at a specific price." First, understand that there are always two competing forces at work in the market, buyers and sellers. Our goal is to quantify those forces and identify price levels where the imbalance is greatest as this creates change, or movement in price.

Let me tell you a quick story… Years ago, I was speaking at a university in California. My lecture showed how to quantify supply and demand in the markets. During a break, I stepped outside for some fresh air. While I was standing there, a gentleman who was attending the lecture mentioned to me that he had been actively educating himself on proper investing for years and still felt he had more to learn as nothing he had come across made much sense. He mentioned that he was really enjoying my material and asked me a couple questions. I asked him to briefly explain his background as that would best help me assist him with his question and help move him toward his goal. One of the first things he mentioned was that he had studied earthquakes in his past; it was what he did for a career many years ago.

I stopped him right there. I asked him if he knew exactly what causes an earthquake. He replied, "yes, of course", as if I was asking him if he knew how to tie his shoes. I then looked him in the face and told him that I was about to give him the most valuable trading information he had ever received. I explained that with his earthquake knowledge, he had all the tools he needed to trade or invest properly and achieve consistent low risk returns in any market. I explained that there is absolutely no difference in how one quantifies a potential earthquake to how someone quantifies a potential trading/investing opportunity. In an earthquake, two competing forces (in this case two giant plates of earth) press against each other until a threshold is met that creates change (the earthquake). When one mass of earth overwhelms its competitor (the opposing plate of earth), the earth moves and we have an earthquake. The two competing forces in trading/investing are buyers and sellers. How we quantify these two forces is no different from how the we quantify the two competing forces that lead to an earthquake, or any other example where two opposing forces come into play.

Principle 1: Price movement in any free market is a function of an ongoing supply and demand relationship within that market.

Put quite simply, a trading and investing market is made up of three components: buyers, sellers, and a widget being bought or sold. These widgets may be shares of a stock, S&P futures, foreign currencies, bonds, and many more tangible and intangible "widgets". For example, let's say the widget is a stock. This stock has some value. That value or "price" as we call it is determined simply by the supply and demand for the stock, which is the ongoing interaction of all the buyers and sellers taking action with regard to that particular stock.

A market is always in one of three states:

First, it can be in a state where demand exceeds supply which means there is competition to buy and that leads to higher prices. What does this look like on a price chart? A "pivot low" is a perfect example.

Second, it can be in a state where supply exceeds demand which means there is competition to sell and this leads to declining prices. What does this look like on a price chart? A "pivot high" is a perfect example.

Third, it can be in a state of equilibrium. At equilibrium, there is no competition to buy or sell because the market is at a price where everyone can buy or sell as much as they want. However, as the market moves away from equilibrium, competition increases which forces price back to equilibrium. In other words, competition eliminates itself by forcing markets back to equilibrium. Even though equilibrium is where the majority of candles are, we don't necessarily want to trade in that area.

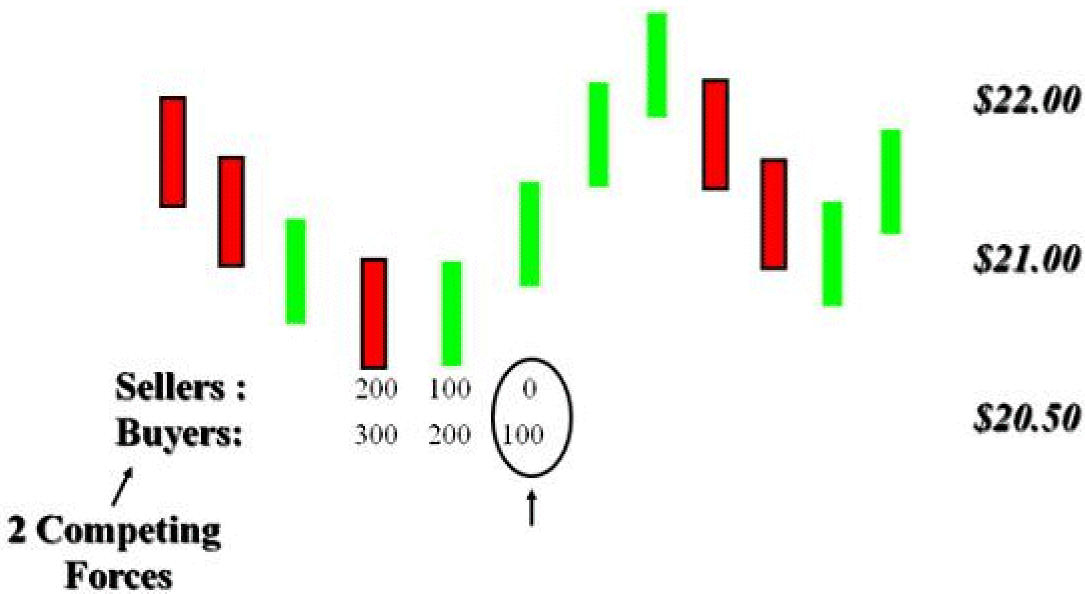
How you quantify the supply and demand in any market is always the same. Exactly what this looks like on a chart and the mechanical rules to take advantage of a low risk / high reward / high probability trading opportunity are a topic for another article.

Principle 2: Any and all influences on price are reflected in price.

At any given moment, there is tons of financial information being created and passed on around the planet. This information can be in the form of an earnings report, news, income statement, analyst opinion, economic report, terrorist attack, and so on. All this information creates thoughts and perceptions that are different for everyone depending on their individual BELIEF system. Be careful to notice that most humans assume others' belief systems are the same as their own. This, of course, is simply not true.

As I have said before, beliefs lead to ACTION and in trading and investing, action is either buying or selling. Each action to buy or sell takes place at a specific price. Therefore, price is all the consistently profitable trader and investor needs to focus on. Adding ANY other information will distort your perception of the supply/demand reality of any given market.

Principle 3: The origin of motion/change in price is an equation where one of two competing forces (buyers and sellers) becomes zero at a specific price.



Let's now put numbers to the simple supply and demand I keep mentioning. Here, we have 300 buyers and 200 sellers at $20.50. Price will remain stable, meaning supply and demand will appear to be in equilibrium until the 200th seller sells. Price will begin to increase or CHANGE when the last seller has sold. It is when the last seller sells that we are left with 100 buyers and no sellers. One of the two competing forces has exhausted itself. In this case, it was the sellers. What appeared to be supply/demand equilibrium was actually disequilibrium or imbalance. <u>It just took a certain amount of time for this unbalanced equation to play out.</u>

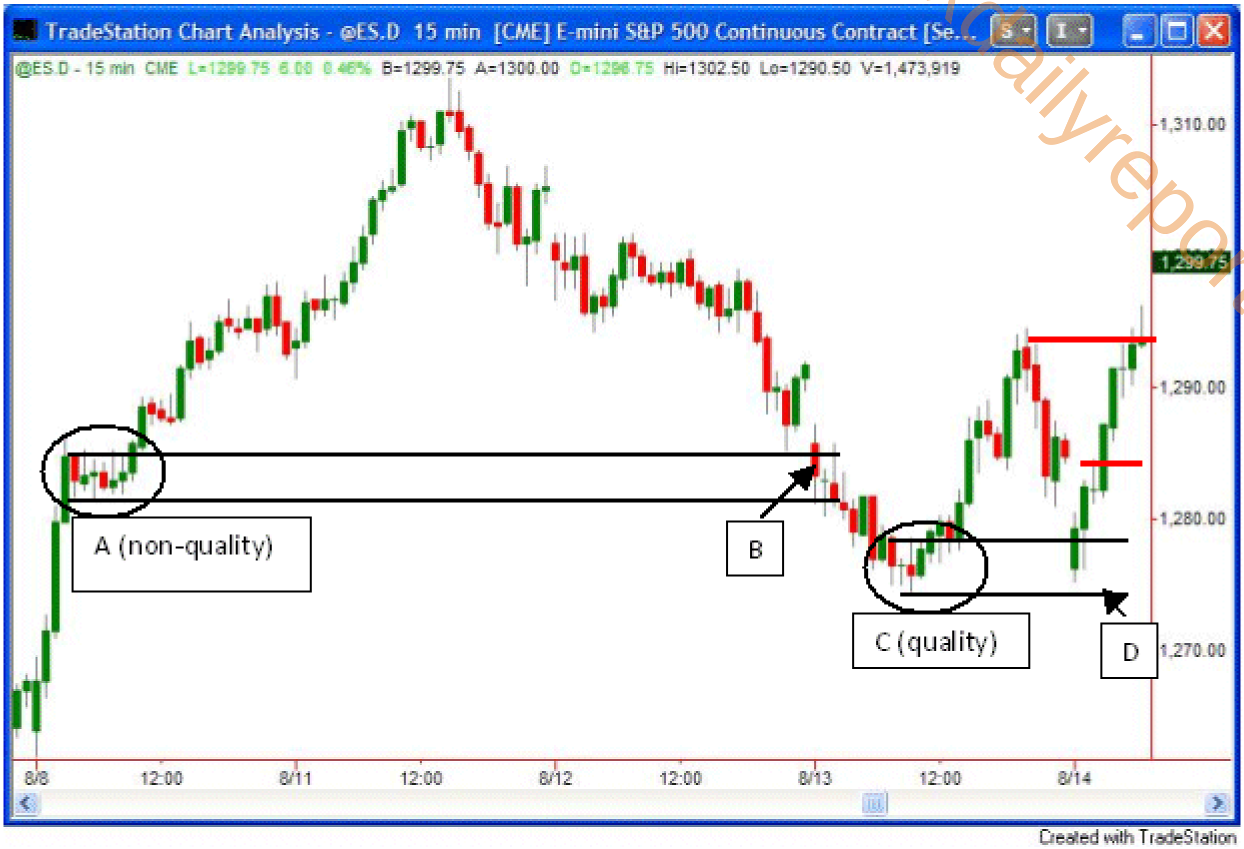
In other words, motion (of price) occurs when one of the two competing forces becomes zero. The two competing forces are, again, supply and demand. The time it took for that imbalanced relationship to produce movement is purely a function of the actions of the two competing forces.

While everything in this piece only means something if you know what supply and demand looks like on a chart, the goal of this piece was to get you to turn back the clock and focus on the foundation of your trading strategy. If there is any illusion or subjective information in your quest for truth, truth will never be found.

The Morning Gap, Part 3

It's been a busy week of transition here at Online Trading Academy. I am now the XLT (Extended Learning Track) instructor for Futures and Forex. Instead of only interacting with students in classes once in a while, we are now able to interact during the high volume market hours four days a week in an ongoing learning/trading experience. This new venture will also serve as a good idea factory for my weekly letter as I plan on highlighting important points we cover in the XLT program for you here each week.

I have written articles in the past entitled: "The Morning Gap, Part 1 and Part 2". Last week's morning gaps in the equity markets provided very low risk, high reward, and high probability opportunity but only if you understand the difference between quality support (demand) and resistance (supply) and non-quality support and resistance. Understand that the words support and resistance have different meanings for many people. For some, Fibonacci levels are support and resistance. For others, moving averages are what they count on as support and resistance. And others, pivot lows and highs or clusters of candles on a chart are what they look for. Let's take a deeper look into this topic and combine it with the opportunities that opening gaps provide.



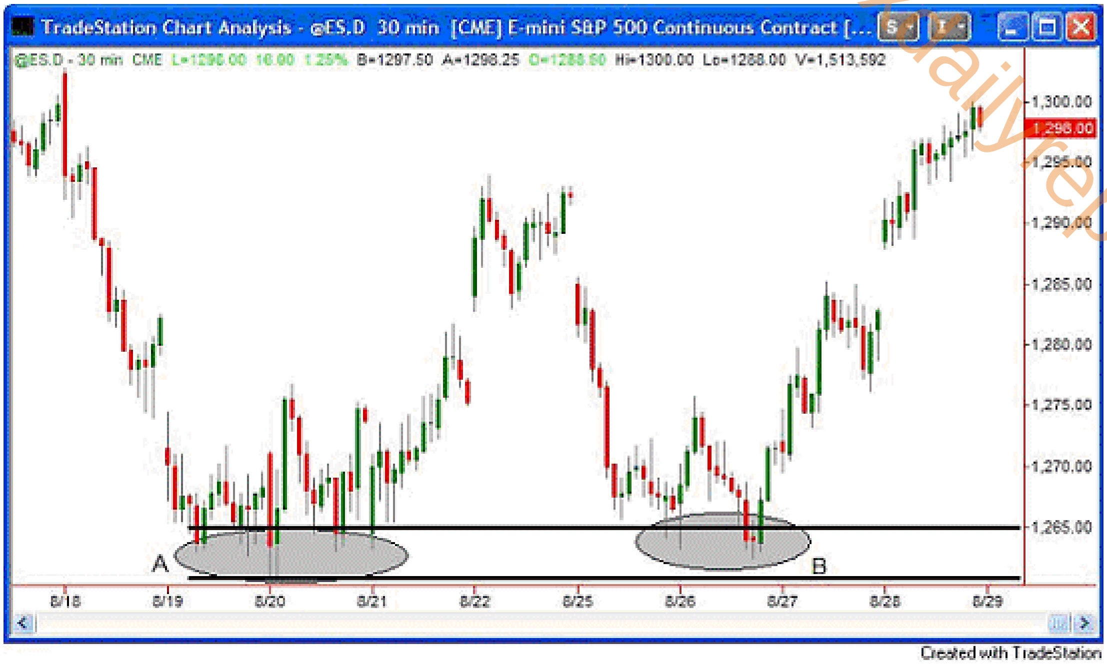
Here we have a chart of the S&P futures including some days from last week. Area "A" on the chart is what some people would call a support (demand) level and sometimes, price does turn at these levels (not often). Notice at "B", the S&P opens right into this support level and falls through it like a hot knife through butter. This is because area "A" is not the quality support level we are looking for, at least not in the XLT. One of the reasons it is not quality is because it is in the middle of a move. That sideways trading range is preceded by a rally in price and followed by a rally in price meaning it's in the middle of a move. Now let's take a look at area "C". This is a pivot low and represents the higher quality demand (support) we are looking for. Notice how price explodes out of that pivot low. This can only happen because at "C", demand greatly exceeds supply. At "D", we were in the XLT going over the potential opportunity with the gap down into demand (support). Someone mentioned that it may be high risk to buy a gap down at "D". My question would be, "who is selling on that gap down"? Is it a consistently profitable trader or not? When we focus on the action of the seller at "D", we know that they are selling AFTER a decline in price and INTO a price level where demand exceeds supply. A consistently profitable trader would never do that, they would not be consistently profitable. The laws of supply and demand ensure that the trader who consistently takes that novice action will consistently lose over time. They may have a winner here and there but over time will lose. Therefore, we want to be sitting at "D", ready to buy from that novice seller on the gap open. If we are wrong, it's a small loss as the risk is low. The two red lines you see on the chart were our targets as they represented price levels where we may have some supply. The lower target was the origin of the gap and the higher target is the nearest pivot high.

Planning out all your trades based on simple and objective market logic allows you to get paid from those who don't. Understand the difference between quality and non-quality support (demand) and resistance (supply) and then think about who is on the other side of your trade. That combination can make you a powerful morning gap trader with some practice.

Note: Our long dollar, short British Pound and Euro position trades are doing well. While I would expect the dollar to strengthen much more against these two currencies, now is not the time to enter into these positions if you are not already in. That low risk / high reward opportunity was weeks ago when it was suggested. The dollar is nearing some supply (resistance) and the Pound and Euro are nearing some demand (support) which is where we could see a bounce. As this plays out, there will be more opportunities to enter these positions if you are not already in them. Look for updates here.

Keeping it Simple in XLT

In the XLT Futures and XLT Forex classes, we educate through lessons, analysis, and trading. What I find interesting is that when people come into the program, they tend to be looking at so many things, processing so much information, and asking questions that suggest their mind is going in so many directions. This week was a good example of the mental cleansing that I try to facilitate in the XLT. Let's take a look at the chart of the S&P futures below, just as we did all week in the XLT.



Notice area "A". The shaded area represents the 1263 – 1264 demand range we focused on coming into this last week of trading. Why is area "A" so special? Let's go over it as we did at the beginning of the week. Here is a hint: Area "A" is special not because of what happened at area "A", it is special because of what didn't happen. This price action was important demand because PRICE COULD NOT GO TO OR PAST AREA "A". It actually did go to 1262.50 during that time but when it did, it quickly moved higher. This can only happen because at area "A", demand exceeded supply. Therefore, when price revisited that level last week (area "B") on the 25th and 26th, we had a low risk / high reward and high probability trading opportunity on our hands. Some in the futures XLT bought at that level with targets of 1270 and higher, congrats. For this lesson, here are the two simple thoughts you want to focus on:

1) Focus on price levels where price can't go to or stay at.

2) Understand why this happens, think of order-flow and the buyers and sellers, not just red and green candles on a chart.

When price revisited the demand (support) level, I always have students ask themselves the same question. "Who is on the other side of your trade?" At "B", when we focus on the sellers, we know that we have some novice sellers entering the market. How do we know this? Only a novice seller would sell AFTER a decline in price and INTO a price level where demand exceeds supply. A consistently profitable market speculator would never do that. The laws of supply and demand ensure that the speculator that takes that novice action consistently will lose over time. We simply want to focus on the reality of what the price action is telling us and be the buyer to that novice seller. As always in any market, those who focus on the reality of what is happening get paid from those who don't.

The Bigger Picture

If you are a one time frame active trader, you are like the one trick Pony. As soon as another Pony comes along with two tricks, the one trick Pony can't compete. In trading, one time frame active traders simply can't compete with those who view and quantify the market's entire supply (resistance) and demand (support) picture.

Often I hear active traders talk about the time frames they look at when they trade. I hear many different things like "I trade off of a 2 minute chart", "I like the 466 tick chart", and so on. When I ask them what other time frames they look at, I can pretty much tell if they are profitable or not and here is how. For those who trade using JUST the small time frames, I have yet to see anyone make consistent profits doing that. For those who trade using the smaller time frames and also look at the larger time frames, that is a recipe for profits.

You may have the best buy setup you have ever seen on a 5 minute chart but if that is anywhere close to larger time frame resistance (supply), that buy setup is not likely to work. Conversely, you may have the "picture" of what appears to be a very high probability sell setup on the 15 minute chart but if that is anywhere near larger time frame support (demand), that trade is not likely to work.

There is another reason to focus on more than just a small time frame or two, trends. Larger time frame trends begin and end at larger time frame support (demand) and resistance (supply) levels.

In the XLT Futures and Forex, we look at weekly and daily charts each week to identify larger time frame demand and supply level for three reasons:

1. To know where existing trends are likely to end and new ones begin
    a. We want to be first in line, at the right time, when the risk/reward is ideal
2. To know what side of the market carries the greatest odds for an active trader
3. To identify longer term swing trading positions
    a. Such as the Pound Dollar short from May of this year...

After hearing from soooo many people about how crazy the markets were this week with unprecedented news and unprecedented price movement, I thought I would share with you how we look at things in the Extended Learning Track (XLT) - Futures Trading and Forex Trading programs as they pertain to today's topic.

1. We don't take news into account when trading the global markets, we focus on price and price alone as that tells us the real time demand and supply equation. In other words: *Any and all influences on price are reflected in price. Opportunity exists when this simple and straight forward equation is out of balance.*
2. By focusing on the reality of what is happening in a market, we are able to profit from those who don't. In other words, when you focus on news and find yourself chasing trades on a 5 minute chart and losing money, understand that you are simply depositing your account into someone else's.

3. WHEN PRICE REACHES LARGER TIME FRAME DEMAND, IT IS LIKELY TO MOVE HIGHER…

Over the past week, some of the biggest and most popular markets around the world reached larger time frame demand levels. The strong bounce from these levels should be no surprise.

Above, the Dow reached larger time frame demand and is enjoying a nice bounce higher. If you are unclear as to what a supply and demand "imbalance" looks like or how to trade it, please see prior articles from me or see me in the Extended Learning Track program.

Gold also reached a larger time frame demand level. We look at the larger time frames in XLT at least once per week, and you should also.

Crude oil reached a larger time frame demand level as well and has seen a very strong bounce from that level. By looking at this chart each week in XLT, we are able to know which side of the market we should be on for our active trades and also our swing and position trades.

From today's article, my hope is that you understand two things:

1. The importance of reviewing the larger time frames no matter how short term a trader you are.

2. The importance of seeing price action for what it really is.

Closing thought: Was there plenty of big news this week and this month? Of course there was. If we as traders never heard any of it, would we have traded any different? Nope, not one bit…

Trading and Gambling

Most people don't like to mix the words trading and gambling. For many, this somehow gives the impression that trading is like some secret poker game in someone's basement, a dark alley game of dice, or weekend trip to Las Vegas. While these three examples may not sound glamorous, they all share the important aspects of trading. Whether you are playing a poker game for money, trading one of the various markets we trade, or Pepsi buying commercial time on television, money is being put at risk with the intention of a desirable return on that investment. In any of these examples, there is no certainty, there is only the opportunity for better odds and the astute trader (market speculator) knows this. Even Pepsi doesn't know what kind of return they will get when they buy commercial time on a network. They have an idea but they never know the exact return; it's a gamble.

You see, when you keep it real and understand that trading is gambling, you will then understand that it is the ultimate form of gambling. It happens to be the type of gambling where we the trader can STACK the odds in our favor, much better than Vegas can. Imagine you are playing a card game in Vegas only this time, you can decide whether you want to put your money down on the table AFTER you see your cards and the dealer's cards and also bet as much money as you like on this hand. That's trading my friends and that's why it is the premier form of speculating on the planet. I have a friend who always tells me that the trading I do is just gambling and I tell him he is right only that it happens to be the type of gambling where you can absolutely stack the odds in your favor. Caesers Palace, Mandalay Bay, and the others don't enjoy the odds we are able to attain in trading.

With objective supply and demand analysis, I have the ability to clearly determine probability, risk, and reward and only put my money at risk when the odds are stacked in my favor. Here is an example:

<u>When to buy:</u>

A Pullback in price to demand (support)

Odds enhancer:

1) In an uptrend

2) With a substantial profit margin of at least 3:1 (reward/risk)

3) A Quality demand (support) level

a. Strong rally in price from demand suggesting a big supply/demand imbalance

b. A demand level that has not been retested yet which offers the greatest odds

c. A demand level that is near larger time frame demand

d. A demand level that is a pivot low, well placed on the larger supply/demand curve

4) Is the decline in price to demand a stair step decline suggesting a low odds buy or is the decline a sharp drop in price to demand suggesting a much higher odds buying opportunity

Each odds enhancer increases the probability of your potential trade (and there are more quality odds enhancers when you include the indicators and oscillators). After objectively assessing your odds based on the setup you see on your chart, you can then decide how much of your capital you want to risk on the trade. Vegas would LOVE to have these odds but they don't come close. The one thing Vegas does, however, that brings them consistent riches is that they don't change their rules when they lose. They know they are going to lose money every day but at the end of the day, they almost always come out ahead with profits. They have a system that tilts the odds in their favor so they know that all they have to do is stick to the plan and they will profit. Imagine if they became emotional and changed the rules each time they lost. If they did that, they would not enjoy the profits that they do.

With the ability you have in trading markets as we do, make sure you have a set of rules that stacks the odds in your favor. If you don't have that set of rules, don't trade because you are competing with traders who do and you will lose. If you are in search of rules that carry better odds, email me, take an Online Trading Academy course, join one of the powerful XLT programs, and so on. Once you have that set of objective and mechanical rules that help stack the odds in your favor, make sure you stick to it and understand you will still have losses sometimes but that's okay; think of the casino and all the times they lose in a day. Remember, in trading, gambling, speculating or whatever you chose to call it, the one thing that is certain is the lack of certainty. Instead of searching for certainty, become a part of the consistently profitable group that only searches for better odds.

Trends, Gaps, and Probabilities…

Last week, I wrote about trading and gambling. Specifically, how trading is the one form of speculation on the planet that allows you to stack the odds in your favor before putting any of your hard earned money at risk. That discussion was fine but this week, let's begin to qualify the difference between some higher probability opportunities and lower ones as knowing the difference is a key to success.

In the Extended Learning Track (XLT) – Futures Trading and Forex Trading programs, a market situation we are often faced with is a gap. We use a simple checklist based on objective information to determine exactly what action to take (or not to take). The checklist helps us determine the probabilities, risk, and reward. Here is how some of it works:

Downtrend:

1) Gap up into an objective supply (resistance) level

In a downtrend, selling short on a gap higher into supply is likely the highest probability trading opportunity there is. This is because only your most novice trader would buy after a gap up in price, into a supply level, and in the context of a downtrend. Therefore, we want to be the seller to that buyer which means the odds are stacked in our favor. This type of gap is likely to get filled very quickly.

2) Gap down into an objective demand (support) level

One might think a gap down into demand is a buying opportunity right on the open of trading each time we see it. However, when we consider this action in a downtrend, this trading idea becomes a bit lower probability. While this gap is likely to fill and almost always does, it typically takes a bit longer than gap scenario #1.

Uptrend:

1) Gap up into an objective supply (resistance) level

This gap up into supply is a trading opportunity that we consider shorting as long as the risk is low and reward (target) is high. However, this is not one of our highest probability trading opportunities because we are shorting in the context of an uptrend. This gap will typically fill within the day or soon after but the higher probability gap trade to take in the context of an uptrend is scenario #2.

2) Gap down into an objective demand (support) level

In an uptrend, buying on a gap down into demand is likely the highest probability trading opportunity there is. This is because only your most novice trader would sell after a gap down in price, into a demand level, and in the context of an uptrend. Therefore, we want to be the buyer to that seller which means the odds are stacked in our favor. This type of gap is likely to get filled very quickly.

If you have not figured it out yet, the key factor in determining which gap scenario offers us the greatest odds is a direct function of identifying who is making the biggest mistake. Someone buying a gap up, into supply (resistance), and in the context of a downtrend is making a very big mistake which means they are buying when the odds are stacked against them. Therefore, we want to take the high probability trade and be the seller to that novice buyer. To summarize, the two highest probability gap trades are selling short when there is a gap up into supply in a downtrend and to buy on a gap down into demand in an uptrend. Of course, there is a little more to it than that when it comes to trading. With any of these scenarios, the risk must be low and the reward must be high and this is objectively determined off of the price chart (and a topic for another article).

Where Is The Dow Going?

As a market speculator, my answer would be: Who cares as long as it keeps moving. For others that have longer term positions in the Dow or other global equity index markets, be it a retirement account or something else, long term direction is important. This outlook along with a built-in lesson is the focus of today's piece.

Let's have a look at the monthly chart of the Dow.

Recently, the Dow has found some buyers around the 8000 mark. We see when looking at the past that there is some demand in this general area so it's no surprise that the market turns a bit higher in the 8000 area. Before placing any big bets in equities in this area, let's discuss a lesson I go over in the Online Trading Academy Extended Learning Track (XLT) each month. Notice the shaded areas on the chart. These are where price has declined to support, found demand with no supply above, and price has bounced higher. Most trading books will tell you NOT to buy the first time price reaches a support (demand) level. They will go on to say that you want to let the support level be tested once or twice before buying. I completely disagree with this. I disagree so much so that we make it a rule in XLT NOT to buy at a support level if it has been tested more than once. As I give you my explanation, don't just take my word for it, think the simple logic through for yourself and you will understand.

From my days handling big order flow on the floor of an exchange, how the whole supply / demand dynamic works is crystal clear. At the trade desk right outside the pits, I had the buy and sell orders right in front of me. If we were at a price level the stack of buy orders was much larger than the stack of sell orders, price would rise once the last order to sell was filled, it had to. This is the most objective definition of support (demand). You can't get any more basic than that. Other trading desks around me had the same type of orders. It is Newton's motion into mass in action. The demand and supply is the mass.

Now look back at the chart above. Price keeps bouncing off of that 7500 – 8000 level because there is demand in that area. Each time we revisit that level however, more and more of that demand gets to buy, hence, reducing the number of willing buyers (demand) at that level. Now I am not saying the Dow is going to crash through that level to the downside anytime soon. I am simply pointing out the fact that each time we move down to this level, the odds of price moving down past that level increases according to the basic laws of supply and demand. Another component we cover in XLT is the depth of penetration into the level for quantifying the existing demand and supply but that is beyond our discussion today.

Here is an idea…

First: Make sure you are quantifying demand (support) and supply (resistance) properly on your price charts as that is the key component to the foundation of your strategy.

Second: Make sure you are buying the first or second time price revisits your demand and supply levels as that (and a desirable profit margin) is the low risk / high probability time to get in.

The next time someone tells you NOT to buy at a quality support level and to wait for that level to be tested a couple times, understand that the reality of what they are saying is to NOT take the low risk high probability buying opportunity but instead, wait for the low probability time to buy. Next, politely say "no thanks".

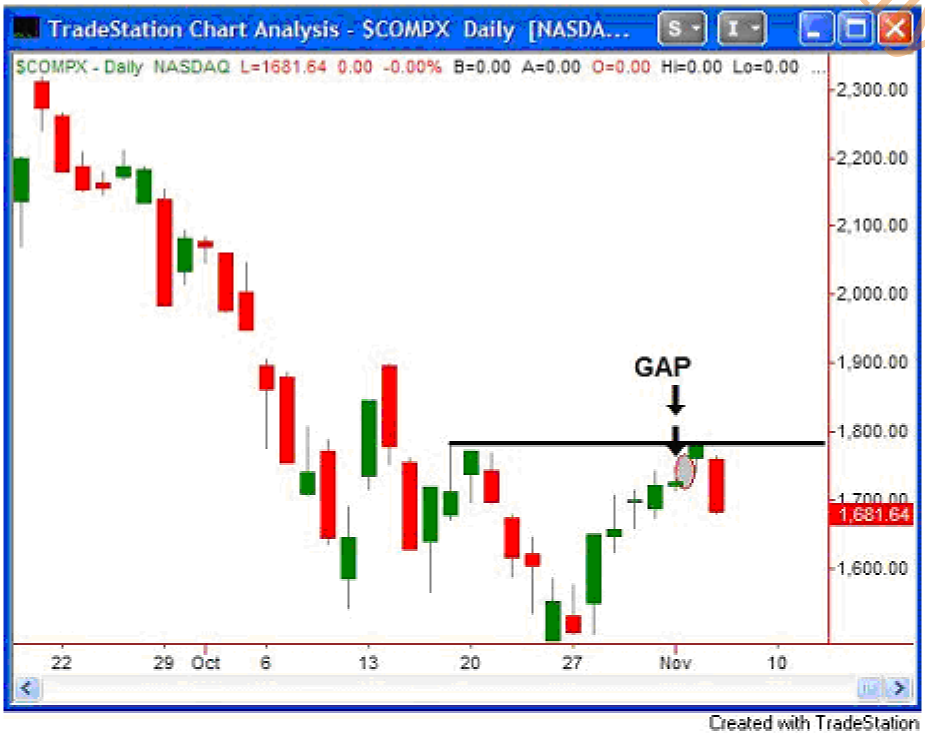
The Dow can move higher from this level but again, understand that the more times price revisits it, the likelihood of price going below it increases so caution on buying the Dow or any equity index market until price reaches "fresh" demand levels which is where the buying opportunities are very low risk, high reward, and high probability

Gaps, The Novice Trader Exposed…

Printable Version

Why do I write about gaps so much? Why do I make gaps such an important part of the Extended Learning Track (XLT) program? Simple, because gaps are the most obvious way to spot a novice market speculator. Remember, if you can't spot the novice, consistent losing trader in a market, it is probably you. Just like the game of poker. If you sit down at the table and can't figure out quickly who will pay the table that night, it is likely you.

Gaps in price are great because they are the picture of the ultimate supply and demand imbalance when you understand them. Not every gap sends the same message so we structure them into an understandable checklist. Once this is done, we can use this information to spot the novice market speculator and be there to take the low risk, high reward, and high probability trade from that novice trader.



Above is a chart of the NASDAQ including yesterday's price action. In the XLT that morning, BEFORE (the big red candle) the market opened and collapsed, we were going over the stock market. We do our analysis when the market is not open and moving so we can be very objective and plan our trades in advance to take care of the emotion issues related to trading. <u>I pointed out that just the day before, there was a gap up in the market (noted on the chart above) AFTER a rally in price, in the context of a downtrend, and INTO an area of supply (resistance). This is the most potent novice trader signal because it represents such a huge mistake.</u> Anyone who buys after a period of buying and at price levels where supply exceeds demand is going to lose over time; the laws of supply and demand ensure that. The only action worse than that is when that person is buying a gap up and that is what we had above. What we did next was look at where the demand was below and determined it was much lower. This set up a scenario that suggested the path of least resistance is down and Wednesday proceeded to turn into a very down day once the market opened. Could I have been wrong? Of course, that's trading which is why we focus on risk so much. Our goal in trading is not to create certainty because that never exists. Our goal is to become masters at objectively assessing the odds and that is what we did.

Let's get back to gaps… In the XLT, we keep it simple. Here are some rules to keep in mind when you have a gap:

1) A gap up in price, in the context of a downtrend is a VERY high odds shorting opportunity.
2) A gap up in price, in the context of an uptrend is a lower odds shorting opportunity and actually can be a buying opportunity when there is a significant profit margin.
3) A gap down in price, in the context of an uptrend is a VERY high odds buying opportunity.
4) A gap down in price, in the context of a downtrend is a lower odds buying opportunity and may in some cases be a shorting opportunity when there is a significant profit margin.

While there is much more on gaps than one can write about in a short piece such as this one, keep in mind that the picture of the ultimate supply and demand imbalance is a gap. When you are ready to take a trade, simply ask yourself "who is on the other side of my trade?" and make sure you are trading with someone who is making a big mistake according to the laws of supply and demand, motion into mass, or whatever version of this basic governing dynamic you want to call it. Instead of looking at red and green candles on a chart and following a conventional Technical Analysis book, start looking a little deeper and begin to understand the order flow that is responsible for the creation of those candles. These basic thoughts will likely give you an edge over those who are on the other side of your trades and having that edge is the key to trading anything. If you are tired of transferring your account into someone else's, stop looking at the market the same way everyone else does.

Markets and Market Timing

Printable Version

This morning I was listening to a cable news network and in the span of about three minutes, I heard that home foreclosures increased 25%, job losses were on record pace, and Congress was meeting today to figure out where the 700 billion dollar bailout was actually going. This was enough to make your head spin so I turned off the tv.

Homes are being foreclosed at a record pace because people borrowed more than they could afford and lenders lent more than they should have to people who could not afford the loans - this is what happens. This is not news, we were expecting this more than a year ago at Online Trading Academy. People are losing their jobs because people in China and other parts of the world are willing to do the same work an American does for a fraction of the hourly wage - this is what happens in free markets. This is not news, we were talking about this over a year ago at Online Trading Academy. The 700 billion dollar bailout program is not working. The money is going to the corporate elite with no restrictions on what they can do with it. This is not news, in the Extended Learning Track (XLT) Futures and Forex classes that I lead at Online Trading Academy, each time a country announces a bailout, it is a hard and set rule for us to find resistance (supply) and short the stock market either by shorting stocks or the futures.

You have two choices during these challenging times. One is to give in to fear and to take no action, or worse yet, take ill-informed action. It is easy for the government to pass ridiculous bailout packages and hand our hard-earned money over to the corporate elite and special interest groups because they know the public is experiencing extreme fear and will agree to almost anything. Your other choice is to rise above the fear, rise above the risk, observe the reality of what is happening, and understand that with the most challenging times come the most outstanding opportunities. More on this subject later in this piece.

As market speculators, volatility is at record levels and we love this because we are experts at identifying turning points in markets based on the laws of supply and demand. Volatility is tremendous because the distance from our demand (support) levels to our supply (resistance) levels is big, that's all. When these areas tighten up again, volatility will decrease. Whatever the scenario and whatever markets we speculate in, we always apply the same set of rules.

For stock traders, one of the most important functions of your routine needs to be proper analysis of supply and demand in the S&P and NASDAQ prior to doing any analysis on stocks. Why? Simply because stocks ebb and flow with these broad markets. Thursday of this week in the Extended Learning Track (XLT) Futures class, we used our rule-based supply and demand analysis to attain a very low risk, high reward, and high probability trade that worked out very well. I will explain for your review using some of the rule based information we use each day in the XLT. This opportunity was found in the NASDAQ futures using a very small time frame. Area "A" on the chart shaded in yellow represents an area of supply (resistance). We know this because when price was at area "A", it could not stay there, forming candle wicks which are the footprints of sellers. Price only declines from "A" because there are more sellers than buyers at area "A". Another factor that made that level an ideal supply level is that 1175 also happened to be the overnight (globex) high price that morning in the NASDAQ futures. Why was it the high? It was the high because that is where all the supply was. Area "B" represents the first time price revisits supply level "A". Our rules tell us here that novice, consistent losing traders are buying (at "B"). We know this because these buyers are buying AFTER a period of buying, mistake number 1, and they are buying AT a price level where supply exceeds demand, mistake number 2. The objective laws of supply and demand ensure that the trader who commits these two mistakes will consistently lose. We simply sell short at the lower black line with our protective buy stop just above the upper black line. The lines represent the "supply zone". As active traders, we determine these zones each day. When we swing trade, we do the same thing in the larger time frames.

Let's now discuss the key point that made this trading opportunity so high probability. Notice the area shaded gray. It is a strong rally built with NO DEMAND levels during the rally, just nice big green candles. This means that as soon as price reached supply, it was likely to fall very quickly through that gray shaded area. We require strong rallies in price such as this one to our pre-determined supply levels as that increases the odds of our short position working dramatically. In other words, price reached our supply level and we shorted at "B" for a move down to "C" because of the very clear and large PROFIT MARGIN (the gray space).

Some might say that we traded too close to the open of trading and that is risky. This all depends on your definition of risk. Why trade near the open? Because if you really understand how markets work, you know that the largest imbalance of order flow demand and supply is at or near the open of trading in any market which means high probability opportunity. I would much rather take on risk when the odds are stacked in my favor then later in the day when the odds are not that great. In this trade, people who bought from us at "B" fell for the emotion "trap" called "greed". In the Extended Learning Track (XLT) Futures and Forex program, we don't fall for those traps, we set them.

Created with TradeStation

For those who only trade stocks, your odds dramatically increase when you time your equity trades with the S&P and NASDAQ. Instead of spending hours scanning through hundreds of stocks for setups when starting your daily analysis routine, spend five minutes creating buy and sell zones in the S&P and/or the NASDAQ markets. Then, trade a handful of stocks at most and TIME long and short positions with the S&P and NASDAQ supply and demand levels.

As for the global bailouts and comical intervention, don't expect these to have any positive effect on your financial well being. You see, markets do a fine job of making everyone's lives better in time, if left alone. In a free market with NO bailouts or intervention of any kind, banks and lenders who make bad choices that lead to insolvency simply fail. This removes the bad banks from the system and we are left with quality banks that don't make these same bad choices and this outcome is good for all. In other words, the strongest foundations have no cracks, they are strong and solid. Banks that would otherwise be insolvent due to bad business practices are kept in the system with bailouts. These bad banks are cracks in the foundation of our economy. When a government saves a bank with our tax dollars, it does not make the bank better. Instead, it ensures the crack in the foundation of our economy will remain, until it is removed. If you reward a thief for stealing, the thief will steal again. If you reward a child for bad behavior, they continue to behave poorly. When governments attempt to intervene with bailouts and other forms of intervention, this futile action ensures that cracks in the foundation of our economy will not only remain but get worse.

Free markets naturally force change. They force cheaters to be honest, they force market prices to be at levels that are acceptable for all willing and able workers and producers, they reward the educated with direct deposits from the uneducated which forces education on those who wish to survive. When left completely alone, free markets create a wonderful economy and life for all. It's really natural selection at its finest. When governments stop intervening to save those who would otherwise fail and begin to dramatically reduce taxes world-wide, expect the markets to begin to recover nicely.

Whose Supply and Demand Is It?

Printable Version

When I use the terms "supply" and "demand", I am simply replacing them with the terms "resistance" and "support". Why do this? Understand that the words resistance and support mean many different things to different traders. For one trader, support may be a Fibonacci price level. For another, support might be a pivot low, and for someone else, support may mean a pullback in price to a rising moving average. There is really only one definition of supply and demand, however.

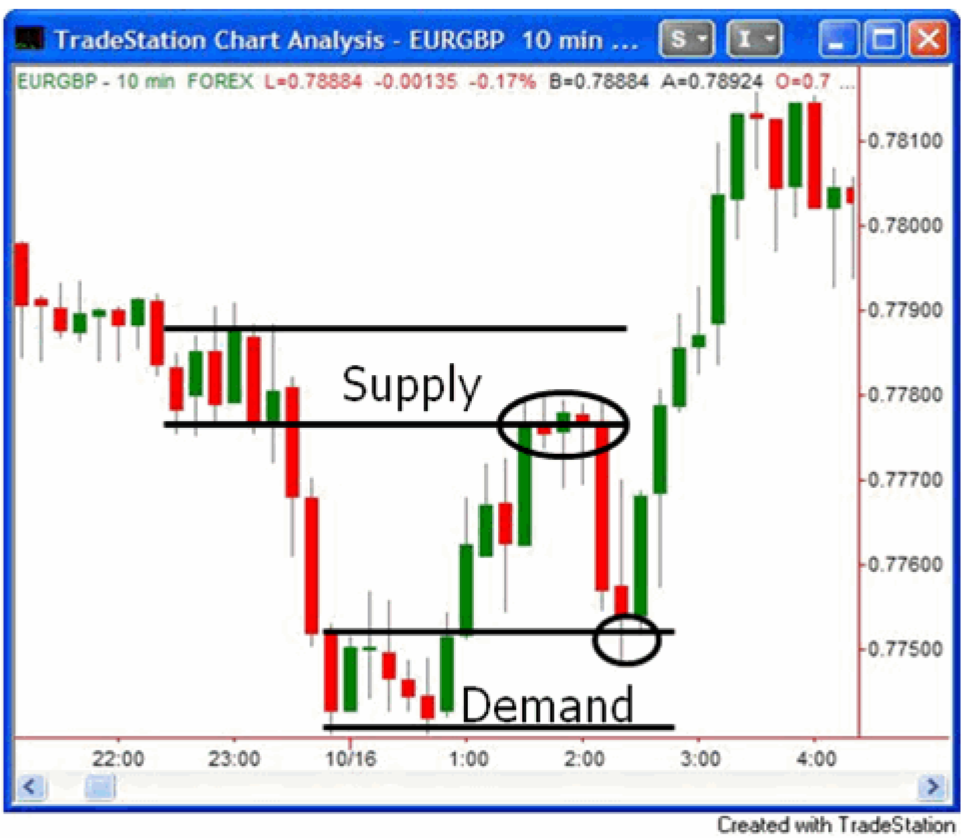
Demand: A price at which someone is willing and able to buy something.

Demand = (Support) = where to buy.

Supply: The price at which someone is willing and able to sell something.

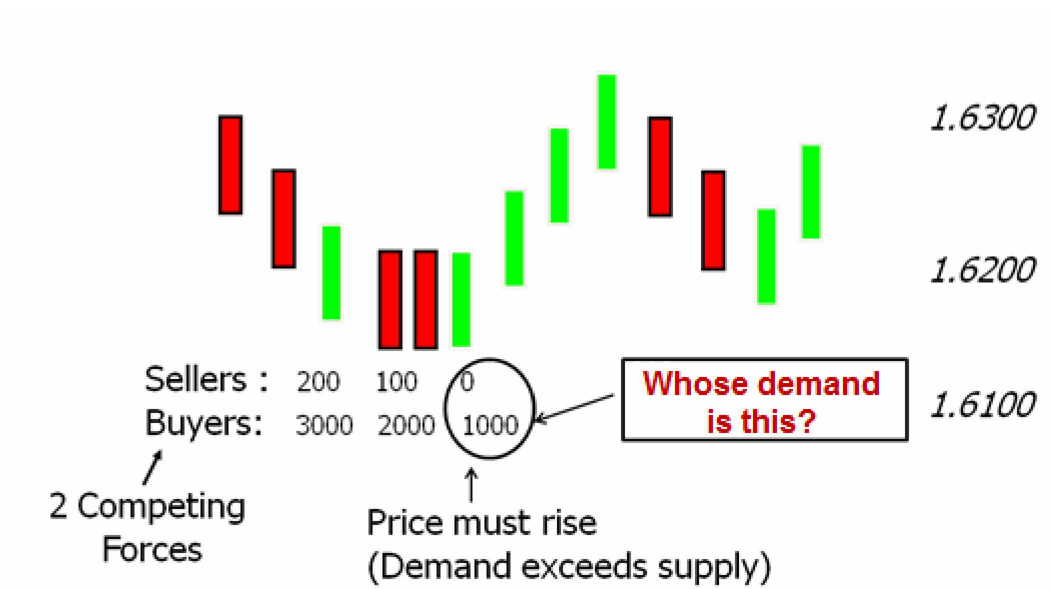
Supply = (Resistance) = where to sell.

The markets are purely a function of supply / demand, and human behavior. Trading opportunity exists when this simple and straight forward equation is out of balance. The logical question is: What does this look like on a price chart?



In the Online Trading Academy Extended Learning Track (XLT) class, I make sure students learn to look beyond the green and red candles on the screen and instead, understand the supply, demand, and order flow responsible for the creation of the candles. This takes the trader to a deeper level of understanding and helps them attain an edge in a career where owning the edge means the difference between success and failure.

Having started my career on the institution side of trading, I can confirm what you already know: Institutions derive profits from retail traders and investors. Therefore, wouldn't it be nice to know where institutions are buying and selling? Most traders are in search of sophisticated, expensive software and fancy algorithms to help them identify where all the large banks and institutions are buying and selling. If you know what you are looking for, simple price action on charts reveals everything you need to know.



Notice the three candles that are basing sideways just above the numbers 100 (for sellers) and 2000 (for buyers). That sideways price action gives the illusion that supply and demand are in balance at that price level. The truth is, that equation was always out of balance. It simply takes a period of time for that unbalanced equation to play out. Once the last seller sells and you have buyers left at that price level, price must rise. Who is the main source of demand at that level? It's not retail, I can assure you of that. Retail traders don't have the buying power to cause a rally in price like that. Institutions certainly do, however. How do I know this? My career began on the floor of the Chicago Mercantile Exchange handling institutional order flow. I quickly learned to spot what bank/institution/central bank demand and supply looks like on a price chart. Ironically, where the smart money buys is where retail sells. Where smart money sells is where retail buys.

Have a great day.

Translating Floor Trading Emotion into Screen-Based Trading

Printable Version

Years ago, I wrote an article in SFO Magazine. Today, I still get emails from people who read that article. Today, I have included some of that article in this piece along with more information and a lesson from a trade we took Friday in a webinar. I pieced this information together for your benefit.

Movement in price is based simply on supply, demand and the human behavior relationship that exists in any market. And, clearly, opportunity always arises when this simple and straight forward equation is out of balance. Whether trading the S&P, Bonds, Currencies, buying a house, a car or trading a Michael Jordan rookie card, how we make money buying and selling anything never changes.

My Path

Let me begin by saying that I have never read a trading book from cover to cover. Also, I started my career on the floor of the Chicago Mercantile Exchange (CME), not looking at a screen-based chart for the first year. On top of that, from an early age, I was always taught not to accept something as true just because someone says so. What I do is apply simple logic to everything that presents a challenge, and trading presents a challenge second to none.

At the CME, I could have taken a variety of classes and started reading all the books, but personally chose another means of gaining knowledge about trading the markets. I had two very good friends on the floor of the exchange. One worked for a firm, and the other traded for himself and was one of the more successful traders on the floor. I was young and ambitious and just wanted to learn how he was doing it and, fortunately, he was willing to give me advice.

As I stood next to him in the pit, he pointed out a trader across the pit and instructed, "Sam, see that guy over there? Let me know when he makes a trade." I stood and watched the man across the pit, and when he raised his hands to bid for some contracts, I alerted my friend.

Lessons from the Floor

It was loud in the pit, as prices had been moving higher for some time. My friend pointed out to me how desperately the gentleman in question wanted to buy. He stood on his tiptoes, yelling at high volume to anyone who would sell to him. Seconds after pointing out these human behavior traits to me, my friend gladly filled his order by taking the other side of his trade, and we had a short position open; little did I know that my lesson had just begun. A few minutes later, the market fell, and we had a winning position. Being new at the game, I was impressed. In fact, it seemed too easy and very hard all at the same time. We had just profited from a position in minutes, which made it appear easy. The entry, however, came on the short side when it seemed everyone else wanted to buy in a very bad way, and this didn't make much sense at the time.

My friend explained, "That guy is somewhat new in the trading pits and consistently loses. Turns in the market happen when the novice trader has entered the market; therefore, all I have to do is find the novice trader and take the other side of his trade consistently."

I could not believe that this was how my friend had become so successful. There had to be more to his strategy! But, indeed, this was the essence of his trading approach, and he had little else to tell me. He did, however, give me a knowing smile at the end of the day. What was conveyed was something much more powerful than I realized at the time.

He was right. That novice trader was making his decision to buy based on emotion, not objective information. Had he looked at objective information, he would have seen that he was buying after a period of buying (late and high risk) and at a price level where supply exceeded demand (resistance, low odds). In essence, he was entering a position when the odds were completely stacked against him. A profitable trader would never do that; the laws of supply and demand say you can't consistently profit while buying after a period of buying and at a price level where supply exceeds demand. The objective odds are stacked against you.

For humans in general, it is emotion that drives behavior, not intellect. Traders who make trading decisions based on emotion versus objective information will almost always be invited to enter a position when the objective risk is high and reward is low.

Others' Mistakes Allowed Me to Profit

In profiling this type of floor trader, two mistakes come to light. First, they buy after a period of buying and sell after a period of selling, which is high risk and low reward. Second, they buy into areas of resistance (supply) and sell into areas of support (demand), which is always a low-odds trade. The laws of supply and demand and how one makes money buying and selling anything indicate that the odds are completely stacked against the trader who trades this way. Consistently finding this type of trader and taking the other side of his trade would therefore stack the odds in my favor.

The laws and principles of supply and demand, of course, have been around much longer than the markets themselves, and they apply to much more than just trading strategies. I was learning the core concepts of markets and how and why prices move and turn. All that was required was to first understand exactly how money is made trading anything. Additionally, it was about learning how to properly analyze the supply/demand and human behavior relationship (emotion) in any market at any time.

Further, it's important to notice that the focus is on the loser – what the majority of losers do wrong over and over again. The approach of discovering how to do things wrong in an effort to learn how to do something right has some impressive results.

Somebody Has to Pay More Than You

The only way we can make money buying something is if someone buys what we have at a higher price. For shorting, it's the other way around. Sound simple? Think again. When we view a trading floor, a screen-based chart, or the account statements of tens of millions of investors, we quickly see that the actions of the majority of traders and investors are completely backwards on this concept.

On a trading floor, the person taking the other side of a trade is right in front of other floor traders. Seeing emotion is a tool that can help stack the odds in favor of those who recognize what to look for.

But What about Finding Clues on a Screen?

In time, much preferring the comforts of my own home and a computer screen, I realized that the trading floor was not for me. The only question was, how does one read the markets if it's not possible to actually see and hear the people trading? How can the emotion be witnessed? After all, it seemed that valuable information comes with physicality.

When I first looked at a chart, I knew exactly what I should be looking for – as mentioned before, the trader who consistently makes the two mistakes. Though at first I didn't know quite what this would look like on a price chart, I did know the exact information I was seeking. One need not look past price on a chart in their quest to identify an emotional opportunity in the markets in the form of a supply and demand imbalance.

Price Alone Reveals Buyers and Sellers

It became time for me to begin translating human emotion on the trading floor to the computer screen. I chose Japanese candlesticks, as they make it easy to see which group – buyers or sellers – is controlling the market and, also, which group is about to lose or regain control. Candlesticks (price) represent traders' beliefs and expectations and hold the true objective information traders need when trading.

US Dollar/Swiss Franc Chart

Let's take an objective look at the chart above, US Dollar / Swiss Franc. This intraday chart shows a scenario that happens each day. Last Friday during a live trading session I did with FXstreet.com, we were looking at this market as there was a quality trading opportunity setting up. Area "A" represents a price level where supply exceeds demand. We know this because of the pivot high at "A". Price could not stay at level "A" because there were simply too many sellers and no buyers and when that happens, price declines. As price falls from "A," we can objectively conclude that we have a supply and demand imbalance. At "B", one can objectively conclude that the majority of traders who bought on that candle are not consistently profitable. They are buying after an advance in price, and just as important, they are buying right into a price level where objectively, supply exceeds demand (supply / demand imbalance). We simply want to sell to these novice buyers. Selling short at "B" is the low risk / high reward / and high probability trading opportunity.

Bringing in Lessons from the Floor

My friend from the trading floor would be glad to sell to this group of buyers as, objectively, the odds are stacked against them each time they take action. The laws of supply and demand tell us that consistently profitable traders can't consistently buy in this situation and profit over a career. When buying after a period of buying and into resistance (supply), the odds a trader will profit on a long position are very low. When we add human behavior into the equation, it is easy to see why the majority of market speculators over and over are on the wrong side of the market. The short entry for this opportunity comes on candle "B".

The Task:

1) Objective anticipatory analysis: We must enter before others at the right time. In trading, we get paid when others do what we do, but after we do it.
2) Low-risk entries: Low-risk (low-stress) entries are a key to profitable trading and allow us to maximize money management strategies and the largest potential reward.

The Tools:

1) Candlesticks (price)
2) Proper trend analysis
3) Proper support (demand) and resistance (supply) analysis

The Analysis:

1. What is the current trend of average prices? Answering this question objectively tells us what side of the market currently carries high odds. In an uptrend (average prices rising), the odds are with the buyers. In a downtrend (average prices falling), the odds are with the sellers. Trading with the prevailing trend always carries the better odds. However, proper trend

analysis is about objective anticipation of the next trend, not conventional trend analysis.

2. Where is support (demand) and resistance (supply)? Answering this question objectively will lead us to our low-risk / high reward entry areas, which are always found at or near support for longs and at or near resistance for shorts. These areas are where the smart buyers and sellers enter positions. Entries in these areas carry the greatest positive odds.
3. Is there a profit zone (profit margin)? This is the distance from supply to demand, or vice versa, at the time of potential entry. For longs, this simply is calculated by subtracting the support area from the resistance area. The opposite is done for shorting.

Many traders' first impressions of trading will come from a book or a seminar, not real person-to-person emotional trading. It is the first impression to markets and trading that is the most hard-coded into who you are as a trader. Books teach how to trade based on chart patterns, not generally on human emotional patterns. Trading seminars teach how to use indicators and oscillators on the chart, which can lead to faulty trading, as indicators and oscillators are very lagging. Most books discuss chart patterns and exactly how to enter them. The problem is that these patterns are based on the premise that traders need a bullish picture to buy and a bearish picture to sell. In fact, an astute trader gets interested in buying well before pretty green candles appear on a chart.

As mentioned earlier, I have never read a trading book cover to cover. Why would I want to learn how to enter and exit positions with others if the only way I can consistently profit is to enter before they do?

Also, the way to make money trading and human nature are inversely related. People, in general, are only comfortable buying if others have bought. They avoid taking risk unless others are willing to share the risk. Traders and investors tend to buy on good news and sell on bad news. Trust me, good news and nice comfortable green candles don't bring prices down to areas of support (demand), which is where the astute traders buy. Unfortunately, it usually is the bad news that tends to offer the low-risk/high-reward buying opportunities.

If this information is as good as it sounds, why write about it? In my years of trading and educating, I've learned that one can spoon feed the core concepts of trading to people and, yet, most will not be able to apply the simple concepts. Why? The power of human emotions that drive our decisions are too strong. Having been in both floor-trading and screen-trading environments for years, the advantage is now largely with the screen-based trader…as long as they know what information they are looking for on a chart.

Set It And Forget It

Printable Version

From birth, we are conditioned to trade incorrectly. We naturally run from things we are fearful of and are drawn to things that make us feel good. If you take this action in trading, you are headed for trouble which in the trading world means losses. For example, if your invitation to buy into a market comes only after an uptrend is well underway, all the indicators are pointed up, and the news is good on that market, where do you think price is in that market? Yep, it's likely very high. To buy here completely goes against how you make money buying and selling anything and is very high risk. Never forget, when you buy, many people have to buy after you and at higher prices or there is no chance you will profit in your trade. To obtain an entry that allows you to buy before others and at price levels where the risk is low, most of the time (if not all the time) you are buying at the end of a downtrend, when most indicators are pointing down, and when the news is bad. This action is completely against our mental make-up.

As I said before, we are conditioned from birth to trade incorrectly. That action or belief system is often reinforced during the many years of traditional finance/economics high school and college education. For example, most college courses on markets teach to us to do plenty of research on a stock before buying into that market. The general rule is to make sure the company has good earnings, good management, is a leader in its industry, and has a stock price that is in an uptrend. Again I ask you, where do you think the price of the stock is when all this criteria is true? Almost always, the stock price is very high when this criteria is true which ensures that if you buy now, you are simply paying everyone else who bought before you.

In my opinion, there are two things that you must have if you are to succeed at trading for a career. First, you must have a solid understanding of how the market really works and a rule-based strategy based on the objective laws of supply and demand. Due to very little regulation in the trading/investing education industry, most people learn to trade completely wrong from someone who is good at marketing but not so good at trading. This ensures that perhaps as much as 80% of people who attempt to trade will fail as they never learn how a market really works and instead, are poisoned with trading education and information that has them buying high and selling low. This path is fraught with lagging indicators and oscillators and conventional technical analysis information that leads to high risk, low reward trading and investing. Second, you must have the discipline to follow your rule-based strategy. So, of the roughly 20% of hopeful traders who actually obtain proper trading education, the lack of discipline factor likely eliminates 80% of them which adds up to a select few that ever make it. Before you stop reading this piece and throw it into your fireplace because it is so negative, sit tight and read on; help is on the way…

I am the head trader/trainer for the Extended Learning Track (XLT) Futures and Forex classes, which are live virtual classrooms at Online Trading Academy. I have been trading Stocks, Futures, Forex, and Options for many years and being around new traders in the XLT, I see so many people come into the program not having the two most important pieces of the trading puzzle mentioned above. Let's go over some very recent trades in the XLT program in hopes that you will get closer to having a solid understanding of how a market works and then I will show you how we handle the discipline issues that can be so challenging for new traders in the XLT.

Futures XLT Trades 12/17/08

Created with TradeStation

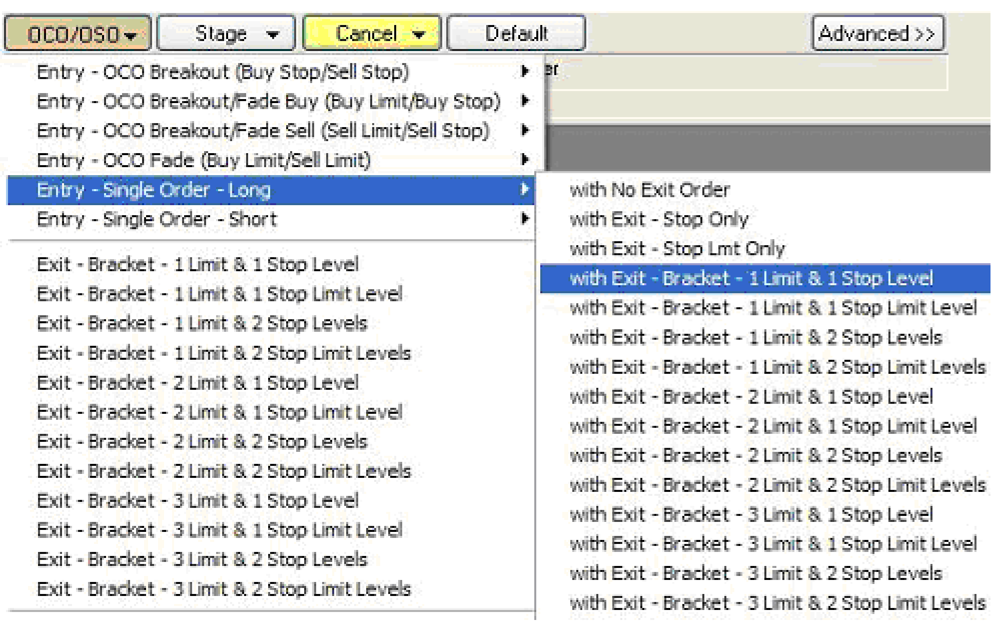
Here are two typical day trades in the NASDAQ (or S&P) that we pre-planned and took. Before the opening of the market, we simply marked off the demand (support) level below where the market was trading in the pre-market which is before the opening of the U.S. Stock market. At the same time, we marked off the supply (resistance) level above. Once the Stock market opened, we were very happy to buy from someone who wanted to sell after a decline in price and at our pre-determined demand level as that is the low risk / high reward / high probability time to buy. Understand that the laws of supply and demand ensure that the seller who sells after a decline in price and at price levels where demand exceeds supply will most often lose so we use our rule-based strategy to make sure we are there to take the other side of that trade and buy from the ill-informed seller. Next, as price rallied to our pre-determined supply level above, some XLT traders sold their long position or initiated a short position. Who did we sell to? We sold to the trader who is making the same two mistakes every consistent losing buyer and seller of anything makes. First they are buying after a big rally in price, mistake number one. Second, they are buying at a price level where the chart is suggesting that supply exceeds demand (more sellers than buyers). Why would someone buy at that price level? They would buy because they are conditioned to buy when the news is good, a solid uptrend is underway, and simply because the basic human brain is wired to buy when everyone else is buying.

XLT Trade 12/10/08

Above is a chart of Crude Oil futures. We first identified the demand level, drew our lines on the chart, and then planned our trade. Notice how price arrived at our demand level. The decline that preceded our entry was severe. Price falls with big red candles, likely associated with bad news, and declining indicators. Most traders and investors are invited to sell when price declines, especially as it did with Crude Oil in the chart above. These realities of declining prices can make it very scary for the new trader to push the buy button where we did at demand.

The Answer

If you think I or members of the XLT are able to take these trades because we have somehow de-humanized our brains and have some super powers that only successful traders have, think again. We think and feel much of the same things everyone else thinks and feels. The key is that I realized years ago that my human brain is flawed when it comes to proper trading and has the potential to be my own worst enemy so I make sure I do my objective rule-based analysis based on the laws of supply and demand and then take full advantage of today's fantastic order execution capabilities to make sure emotion never even has a chance to come into my trading world. Below, I have taken a picture of what type of order I would use in a trade like the NASDAQ and the Crude Oil buying opportunities. By selecting the "OCO" (order cancels order) order below, I am able to enter an order to buy at demand (support), enter a protective sell stop order to limit the risk because you (and I) will have losses from time to time, and also enter a sell limit order to take profits, all at the same time. Once I set up that order and execute it, I am hands-off for that entire trade from start to completion. This accomplishes two things for me and people in the XLT. First, it takes care of the emotions and second, it means we don't have to sit in front of the computer screen all day, life is way too short to do that anymore! I call this "set it and forget it" trading.



Today, just about any type of order you can think of is available. I use a custom API which is a custom version of what you see above from Tradestation. I encourage you to begin to take advantage of the opportunity to set and forget your day, swing, and position trades. There are too many types of orders and features to share in this article so email if you have questions.

As always, never forget that those who know what they are doing in the markets simply get paid from those who don't so make sure you have the two issues discussed in this piece figured out before you put your hard-earned money at risk.

Lastly, for more information on the supply and demand concepts, please review some of my prior articles which can be found on our website.

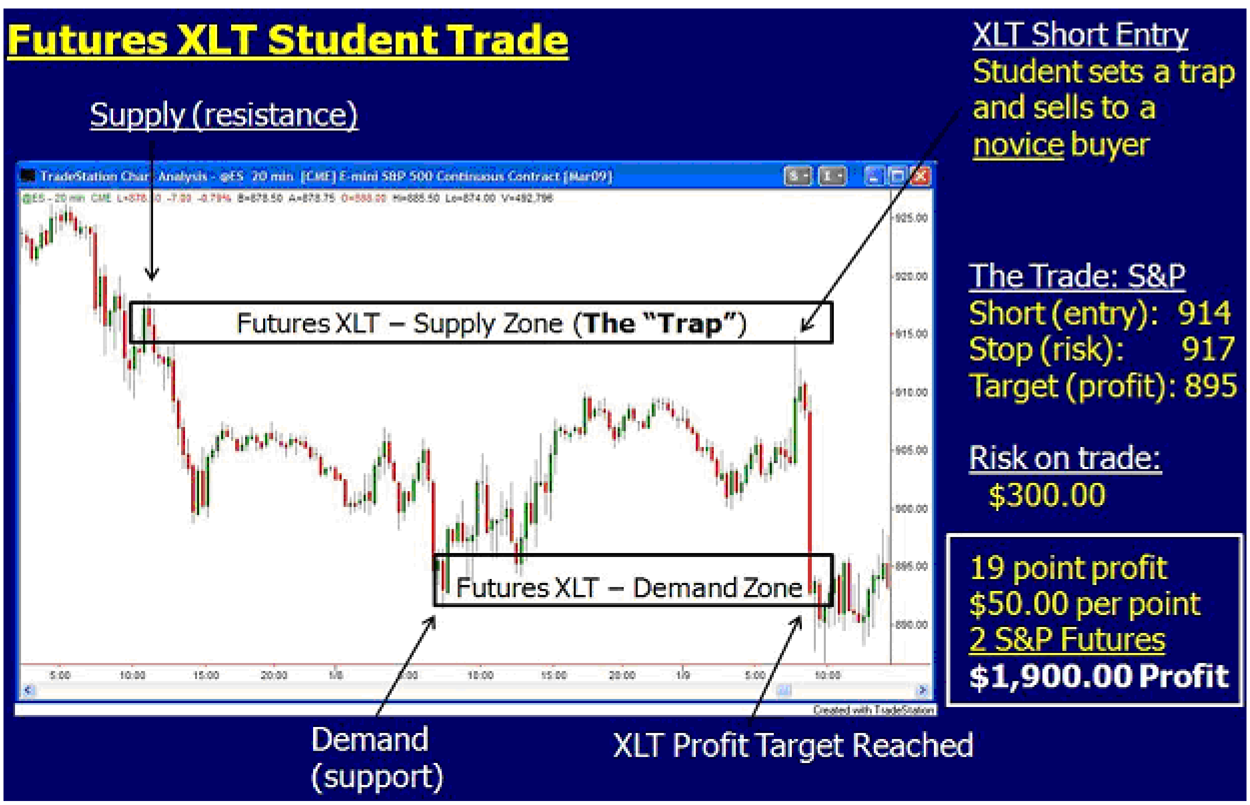
Setting the Trap

Printable Version

Have you ever received a letter in the mail saying you are a finalist for a large financial prize? Typically, all you are required to do is call an 800 number, give them your credit card number, and you then get a chance to be one of three people who may win a multi-million dollar prize. If this sounds too good to be true, it almost always is. Truth is, there is no prize and there are no finalists, it's all an illusion. If you end up calling the 800 number and giving them your credit card information, you have likely just bought something and don't even know it; you just fell for the "trap." The hope of the trap-setter is that the illusion of the prize is so great that you will not realize the financial trap you are about to fall for. Companies in many industries make fortunes because they are good at setting all kinds of traps for prospective buyers. They are good at it for two reasons. First, because they are good at setting the traps, which means they are masters of disguising risk as opportunity. Second, they are very good at identifying the weakest prey.

Have you ever watched one of the late night infomercials touting an automated buy and sell signal trading and investing system that generates huge returns every month? Testimonial after testimonial telling you how great it is and you can have it for a small investment of $1,900? Again, the goal of the infomercial is to create such a strong illusion of success that you will fall for the trap and buy the system. After all, if you see a testimonial of someone making $5,000 in a month, why wouldn't you pay the $1,900 for the system? Truth is, if they really created such a great automated trading system, do you think they would be selling it to you? Of course not, but the masses will always fall for these traps.

Trading is really no different. In the Online Trading Academy Extended Learning Track (XLT) program, we set traps all the time. While it sounds awful to talk about it this way, the truth is that traders who don't understand how markets really work fall for the traps set by those who do. In other words, those of us who spend the time and attain the education necessary for consistent profits get paid by those who don't. In trading, there are no 800 numbers or infomercials, it's a much quicker transfer of accounts. Let me better explain with some student trades from the Extended Learning Track (XLT) Futures program.



Above is a chart of the S&P Futures. An XLT Futures student identified the supply level above and to the left and set a trap. She laid a sell short order at 914 because the chart suggested at that level, supply greatly exceeded demand. She used our rule-based analysis to come to this conclusion. A couple days later and right before her short entry, price broke out of the 905 area and a strong and quick rally ensued. This rally took price up to the supply level of 914 – 917. A short-term trader who bought the breakout early could have profited from that trade but anyone who bought after the strong rally was underway and into that objective supply level was in trouble. These two mistakes are a lethal combination for any trader. This novice buyer who bought from the XLT student at supply believed that at 914, the S&P was a value and could move higher from the 914 area. Why wouldn't they believe that? You have a strong breakout, price was moving fast, nice green candles, and so on. The reality is that this buyer fell for the trap set by the XLT student. In this case, the student that knew how to really value a market got paid from the one who didn't.

This is a chart from a live XLT session where we identified a demand (support) level. That demand level is strong demand because of the explosive move up. We simply create a demand zone with the two black lines and carry that level forward. We want to make sure that we are there and ready to buy when price revisits that level in the future. Now, notice the red line on the chart. This line connects the two pivot lows above our demand zone and creates what most would consider a demand level at that red line. Let's move to the next chart to see how we handled the first pullback in price to the demand level. There was no way to get the demand level and the entry on one chart as the level was created a while back and would have scrunched the chart too much.

In our XLT session January 15th, price finally declined back into our predetermined demand zone created many days before. We focused on the red line as well because that created a strong trap for the novice trader. Here is how it works: as price was declining towards our demand zone (black lines), it reached the red line, which were those two pivot lows from a while back. Most traders are going to buy or get bullish at that red line because of those pivot lows, but not us. This sets up a common trap we love in XLT. If and when price trades below the red line, those who were bullish and bought, get very bearish and sell as they think support is not holding. What they don't realize is that they are selling right into our predetermined demand zone which is exactly what we want - the trap is set. As soon as the masses sell at our demand level, price moves higher and typically moves very quickly as you have caught the masses on the wrong side of the market. Those who fell for the trap simply transferred some of their account into our Boston XLT student's account.

One of the most important reasons to focus on high probability turning points in any market is to be able to limit your risk properly. We all have losing trades from time to time, which is why it is so important to enter markets close to your protective stops.

If you can't recognize a market trap clearly on a chart, chances are you are still the prey, so be careful

Market Timing in the Extended Learning Track (XLT) Course

Printable Version

There is a brand new format in the Extended Learning Track-Momentum Intraday Trading course. This new format allows us to work together with our students to identify and capture high probability trading opportunities in equities.

Having the opportunity to provide leadership and direction for the XLT program going forward, I would like to share how we have modified the XLT-Momentum Intraday Trading course in order to better prepare our XLT students for each trading day before the market opens.

New Session Times

Previously, XLT-Momentum Intraday Trading sessions started after the stock market opened, which was fine and safe for new traders. With our new format, trading and analysis sessions start thirty minutes before the stock market opens and here is why. It is VERY important that our student-traders set up as many of their day trades in advance as they can. The process that leads to low risk and high probability trading is to first identify support (demand), resistance (supply), and the trend in the S&P and the NASDAQ. Once we know where these high probability turning points are in the governing markets (S&P and NASDAQ), we then scan for stocks with demand and supply levels that line up with the S&P and NASDAQ to help stack the odds in our favor.

Finding Market Turning Points

Step one is to identify high probability demand and supply levels in the governing markets. Let's take a look at a day last week in the XLT-Momentum Intraday Trading. During a recent session on January 21st, we identified that the S&P was going to open just below a supply level. We marked the level with two lines to create a "supply zone". Given that we now knew where the high probability turning point was in the S&P, our next task was to look for stocks with supply levels that also lined up with the S&P supply level.

Finding the High Odds Candidates

Below is a chart of Google. After identifying the S&P supply level, we found that Google had a supply level that lined up with the S&P area. Google was opening well below its supply level but that's okay. The Google supply level was very ideal. Notice how price initially collapsed from the level. This rapid decline suggests a major supply and demand imbalance at that level meaning many more willing sellers than buyers. In the XLT, we pay close attention to the demand and supply levels that have a rapid move away from them as that means very high probability.

The Trade

When the S&P rallied up to its supply level, so did Google and in strong fashion. This created a very high probability shorting opportunity which worked out very well and very quickly. Again, timing your equity trades with the S&P or NASDAQ supply and demand is the key to high odds trading.

RIMM was another shorting opportunity that lined up with our S&P supply. For those who wanted the same opportunity as Google but in a much cheaper stock, RIMM was a perfect choice. RIMM also had a nice profit margin as demand was around $1.50 below our entry point to sell short. Risking $0.50 to make at least $1.50 to our first target gave us an ideal reward to risk of 3:1. The probability of this trade working out was huge because this supply level lined up with S&P supply.

Learn, Trade, Learn, Trade…

Another change to the XLT-Momentum Intraday Trading course structure has been to alternate between lesson-based sessions and trading-based sessions. We learn, then we trade, then we learn, then we trade, and so on. The lessons are a series of building blocks that first teach our XLT students how to quantify demand (support) and supply (resistance) and then move into rule-based strategy lessons. XLT-Momentum Intraday Trading, and all of our XLT courses for that matter, are not about working harder and learning tons of information. It's about working smarter and taking all the information students learn in the physical classroom at their local center and applying these concepts and tools in such a way that will result in becoming a consistently profitable trader.

Gaps, Pro versus Novice

Printable Version

Price gaps in markets are events that successful traders understand very well. This is because when you really understand gaps - why they occur, and how to trade them - you realize how powerful and opportunistic these events really are. Gaps represent the ultimate supply and demand imbalance, which is key when attempting to identify market turning points. Whether we are talking about Stocks, Futures, Forex, or Options, the logic and rules for gaps don't change.

Gaps occur when there is a supply and demand imbalance. Specifically, when there is more demand than supply at the prior day's closing price, the market will gap higher the following day. When supply exceeds demand at the prior day's closing price, the market will gap down the following day. Let's take gaps a little bit deeper and dive into part of a lesson from the Extended Learning Track (XLT).

While we have a big lesson on gaps in the XLT that covers all the significant gap opportunities, today I will share one set of gaps that you may want to pay attention to, Professional Gaps versus Novice Gaps. Later in this piece, I will explain where these gaps get their names from. For now, here are the definitions and proper actions.

Professional Gap: A gap that occurs after a move in price, in the opposite direction of that move. These gaps occur at the beginning of moves and ignite them.

Professional Gap High Probability Action: Join the gap on a pullback in price to the origin of the gap so long as the opportunity has a significant profit margin.

Novice Gap: A gap that occurs after a move in price, in the direction of that move. These gaps tend to be found at the end of moves and lead to reversals.

Novice Gap High Probability Action: Fade the gap when price reaches a support or resistance level so long as there is a significant profit margin.

Figure 1: S&P Chart

Above is a chart of the S&P. Identified by the grey shaded areas are a Professional Gap and a Novice Gap. As you can see, the Pro Gap is after a big rally in price, in the opposite direction of that rally. This gap ignites the move lower in price. After the gap open to the downside, often price will quickly rally and fill the gap and then proceed lower. The astute trader can look to sell short near the origin of the gap as that is the low risk / higher reward way to join that gap down in price.

Lower on the chart, we have the Novice Gap. This one is a gap down in price, after a decline in price. We call this a novice gap because someone is selling AFTER a decline in price and DURING a gap down. This combination is a very novice move and typically leads to losses for the seller (and gains for the buyer). The proper action on a novice gap down is to first identify the nearest support level and look to fade this gap down with a long position. This is the low risk / higher reward trading idea with the presence of a novice gap.

There are other types of gaps to consider when trading the open of a market. Typically, it is at the open of a market that prices are at levels where supply and demand are most out of balance. I witnessed and facilitated this for a long time handling institutional order flow at the Chicago Mercantile Exchange. Translating these areas of imbalance onto a price chart helps attain an edge over your competition. Only put your money at risk when the odds are stacked in your favor and the risk is low, which means identifying novice action in a market and taking the other side of the novice's trade.

Lastly, trading the open of a market is not for a beginner or novice trader. However, once you have attained the ability to quantify demand and supply in any market and any time frame, you are likely to find trading the open a very opportunistic time to trade.

Q & A With Sam Seiden

With the many emails I receive, there are always a few common questions people have. Some of the questions are not key questions for trading but others certainly are. Of that key group of important trading questions, I thought I would share some with you today.

Khoi – XLT Student

Hello Sam,

I really enjoy your teaching. It helps me a lot. Would you please explain how we can identify and distinguish a pro-gap vs a novice gap in an uptrend?

Sam –

Hi Khoi,

Thanks for the email. In an uptrend, a novice gap would be a gap up in price, after a strong rally in price. This is novice buying as consistently profitable buyers don't buy after a strong move up in price and they certainly don't buy on a gap up. The laws of supply and demand ensure they will lose over time if they do. During an uptrend, a professional gap would be a gap down in price, after a rally in price. This type of gap typically occurs at price resistance, ends the uptrend, and ignites a downtrend. Below are two charts with illustrations for your review. Hope this answers your question.

Figure 1: Professional Gap in an Uptrend

Figure 2: Novice Gap in an Uptrend

Tom - XLT Student

Hi Sam,

What are the best times of the day to trade if I am an active trader in equities? Thanks for any help .... your articles are always informative ...

Sam –

Hi Tom,

The best time of the day to trade for an active trader in equities is at and around the open until about 2 hours into the trading day. The reason is because at and around the open of trading, markets are at price levels where demand and supply are MOST out of balance. Quantifying demand (support) and supply (resistance) in the pre-market allows us to trade markets "back to balance" at and around the open. This is when market direction is MOST predictable. I began my career on the floor of the Chicago Mercantile Exchange handling institutional order flow. In doing this, I was able to see each day how out of balance things were at the open. In the classroom at Online Trading Academy, we always tell people not to trade the open. If you're a new trader going through our entry level courses, it is a good idea to NOT trade the open as prices move fast and it's not safe for the newer trader. However, once you know what you are doing, you absolutely want to be trading the open when low risk / high reward / high probability opportunity presents itself. In the Extended Learning Track (XLT) programs where we trade stocks and futures, we begin our trading sessions 30 minutes to an hour before the market opens to prepare for these opportunities.

Lisa - XLT Student

Hi Sam,

What do you mean by the term "profit margin?"

Hi Lisa,

Please see the chart below. This is a trade we set up in the Extended Learning Track (XLT) - Momentum Intraday Trading program. Notice the shaded areas on the chart. These areas represent the supply and demand levels we use for entries and exits. For review, a demand level is a price level where the number of buyers exceeds the number of sellers. This is where we expect price to rally (rise). A supply level is a price level where the number of sellers exceeds the number of buyers and this is where we expect price to decline. The top shaded area on the chart is supply and the bottom shaded area on the chart is demand. To answer your question, the area in BETWEEN these levels represents the "profit margin." The plan for us was to sell short at the supply level and take profits at the demand level. While we had two nice levels, that's not enough. We also need a significant profit margin and in this trading opportunity, we certainly had that. Without the presence of a significant profit margin, there is no trading opportunity.

Figure 3: Profit Margin Example

From time to time, I will use student emails in the weekly article for your review and for your benefit. Hope this was helpful

Three Ways to Managing Risk

Printable Version

One thing that is certain in anyone's trading career is losses. Even the best traders lose from time to time. What the best traders have in common, however, is that they are very professional losers. Knowing how to lose properly is a must in a long and prosperous trading career. This theme is also the backbone of the Online Trading Academy success. From the classroom to the Extended Learning Track (XLT) program, a main focus for us is showing traders how to reduce risk with three important tools. The first is the proper use of protective stop orders, the second is proper position size and the last, but maybe most important tool, is to keep losses small.

Protective Stop Orders

Protective stop orders to the trader are as important as the oxygen tank to the astronaut in outer space. Without them and proper use of them, you're in big trouble. Protective stop orders in trading are meant to help limit your potential loss. There is more than one type of protective stop order and it's very important that you understand the difference between them.

Stop Market Orders: This is an order to buy or sell once price surpasses a particular point. Once price surpasses a pre-defined price, the order becomes a market order. This type of order can be used to enter or exit positions. Typically, this order is used for protection. While execution of this order is typically guaranteed, the price at which the order is executed is not guaranteed. This is because the order being triggered is a market order. The benefit with this order is that if price surpasses your stop price, the market order will take you out of the position. The negative is that if the market is moving fast, you may see some slippage and not get filled at the price you desire. This certainly is the ideal order however if your goal is to protect yourself. As a trader, I always use this order for protection.

Stop Limit Orders: This type of order combines the features of a stop order with the features of a limit order. Once a pre-defined stop price is reached, the stop limit order becomes a limit order to buy or sell at the limit price or better. The benefit of this order is that the trader has control over the price the order will execute at (it is "limited" to the stop price). The negative factor with this order is that it does not in anyway guarantee protection which is what most traders/investors want in a stop order. For example, if you bought a stock at $41.00 and have a sell stop limit at $40.50 and price reached $40.50 but there are no buyers, price will keep declining and your loss will grow with no protection. In short, if you are looking for more guaranteed protection, the stop market order is a much better choice. As a trader, I NEVER use this order for protection.

Where to place protective stop orders?

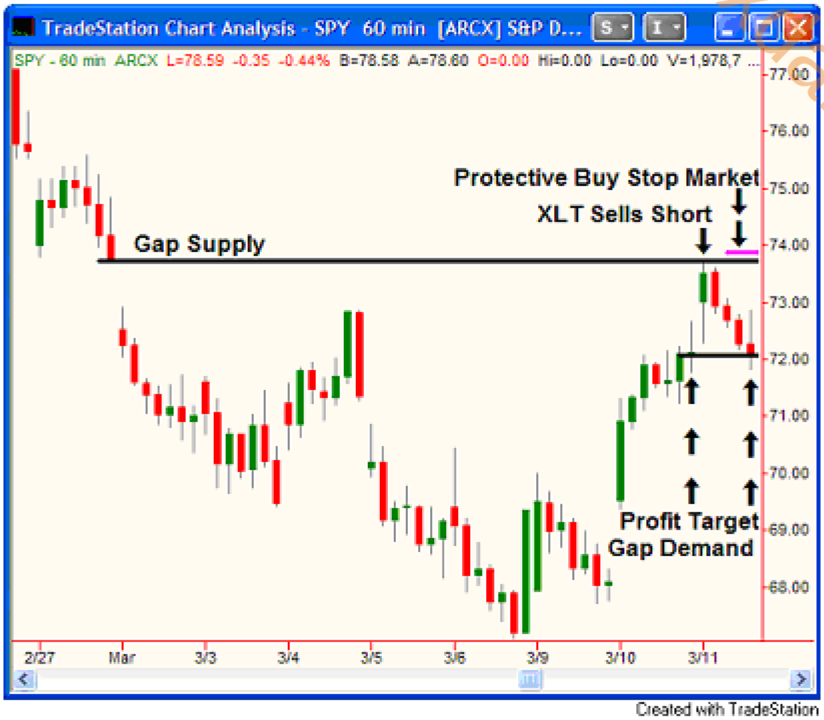


Figure 1

This is a shorting opportunity we identified in the Extended Learning Track (XLT) in the S&P. On this day, the market opened and rallied right up to our pre-determined supply (resistance) level where some XLT members sold short. To protect the short position if we are wrong, we use a "buy stop market" order. The initial protective buy stop order was placed just above the black resistance (supply) line. The purple line is exactly where the buy stop market order should be placed. We place the stop at that price because it is just above where all the sellers are according to the chart. We know this is where all the sellers are because price could not go to that level, there was too much supply. This was our "initial" buy stop.

Figure 2

The next chart is a smaller time frame look at our S&P short trade. We go to the smaller time frame to identify where to place our "trail stop". A trail stop is simply the act of moving a buy stop down with price during a short position or moving a sell stop up with price during a long position. The benefit of a trail stop is to capture the majority of an intended move in price so as to not "give back" profits. While there are a number of different types of trail stops, I will focus on one of the more objective ways we handle trail stops in the Extended Learning Track (XLT). As price is falling and we are in our short position, we want to bring our protective buy stop down as price falls to protect our profit. The circled candles on the chart represent strong declines in price. Once price declines from a price level, the origin of that decline becomes new resistance (supply). Therefore, we can move our buy stop down to just above the new resistance area. What we are doing is protecting our short position with these new resistance levels. If the market is weak, price should not rally above these resistance levels and continue to decline which is what we want for our short position. The circled candles drop as they do because supply is greater than demand at the origin of the decline. This again is one of the more objective ways we use real time supply and demand analysis to trail stop our positions.

Position Sizing

Figure 3

Proper position sizing is another key component to managing risk properly. Here we have a pivot low support (demand) level and then a decline in price to that level for a low risk buying opportunity. If we buy at the top of the support zone and place our protective sell stop below the support zone, we can do some simple math to ensure we are not going to lose more money than we are comfortable losing by using proper position size. In this example, let's assume we have an account with $100,000.00 in it and we decide that our maximum risk is going to be 1% of the account ($1000.00). If this trading opportunity requires a $0.40 stop and we do the math, we see that we can buy 2,500 shares. This means that if the trade does not work out, we will only lose the amount of money we are comfortable losing, the $1,000.00. Having a position sizing grid like the one you see here when trading any asset class also helps your trading become more mechanical. The key is that you don't want to be "thinking" much when the markets are moving. You simply want to follow a logical rule-based plan based at its core on the laws of supply and demand.

Keeping Losses Small

The cornerstone of Online Trading Academy is risk management. Knowing how to minimize risk is the most important thing in trading. There are really only four possible outcomes to a trade or investment: A big win, a small win, a small loss, or a big loss. As long as we ELIMINATE the big loss, we can live very comfortably with the other three. Let me share an email from one of my XLT members with you. He is somewhat new to trading and the education path at Online Trading Academy. As you can see below, in the last two months, he only had profitable trades about 30% of the time. The other 70% of the trades were losing trades. However, by keeping the losses small and holding on to the profitable trades to the pre-planned targets, his account is up around 50% in the first two months of this year. While we will certainly work with him in the XLT program to increase his winning percentage, his results are fine with the winning percentage he has now. The key for him is following the risk management rules we focus on.

Sent: Friday, March 20, 2009 6:57 AM

To: Sam Seiden

Subject: Re: Futures XLT

Sam,

I wanted to share some stats with you. This is since the beginning of the year. Roth IRA Performance

Stat	Value
Ticks	952
Profit	$13,185.73
Wins	7
Losses	17
Avg. Win	$2,528.29
Avg. Loss	($265.43)

Biggest Winner	$4,369.30
Biggest Loser	-$925.50
Win %	29.17%
P / L Ratio	9.53
Max % Risk	2%
Max $ Risk	$827.35
Start Capital:	$28,182.00
End Capital:	$41,367.73
Net Gain %:	46.79%

As humans, we always want to be right and we hate being wrong. You can't think this way in the world of trading and investing because the truth is, you will have losses. Embrace those losses as a part of your trading and keep them small. I have losing trades sometimes but I really don't care. On the emotion side of trading, I don't feel any different about a winning trade or a losing trade. Perhaps the fact that I have been doing this so long is a factor but the reality is, I am simply executing a profitable plan over and over and over. Las Vegas has huge losses every day but they don't care. In fact, they are perfectly comfortable with them like our XLT member because they know the losses are small compared to the winners and this is all just part of a very profitable plan that does not allow for big losses.

News and Price, A Relationship Often Misunderstood

Printable Version

Each day in the morning, the global equity markets are flooded with more news than anyone can possibly read, let alone process. To make matters worse, the news is often conflicting which only complicates the trader's task of processing news into a trading plan for that day, week, or month. New traders I meet either at an event or in the Extended Learning Track (XLT) program tend to have one more layer of confusion when it comes to news which seems to create the most complicated illusion of all. They think that when news is bad, market price must fall so they look for shorting opportunities in markets. Conversely, they think that when news is good, market price must rise so they look for buying opportunities. Much of the time, the thought of good news leading to higher prices and bad news leading to lower prices is completely false and there is a very specific reason for this. Instead of walking deeper down this confusing path, let's step out of this box and into the world of real trading of markets.

It never fails, I will be leading an XLT session during week one of our curriculum and some bad economic news will come out during one of our pre-market sessions and I will say, "Let's look for a low risk area to buy the S&P and/or related stocks." Right away, a new XLT member will say, "The news is bad, the market should go down, why are we looking to buy?" It is then that I welcome them to the world of real trading. What exactly happens when bad news hits the broad market? Depending on how strong the news is, stronger or weaker perceptions will be created. The strongest perceptions lead to trades or investments made in the market. Those end up being the red and green candles on your charts. So, we can conclude that "any and all influences on price are reflected in price."

Let's take a look at an example right out of an XLT session from April 1st. Below I cut and pasted a news headline and story for your review:

ADP Report Shows Bigger Than Expected Drop In Employment
4/1/2009 9:25 AM ET

(RTTNews) - Private sector employment fell by much more than expected in the month of March, according to a report released by Automatic Data Processing, Inc. (ADP) on Wednesday, with the data likely to raise concerns about Friday's Labor Department report.

The report showed that non-farm private employment fell by 742,000 jobs in March following a revised decrease of 706,000 jobs in February. Economists had expected a decrease of 663,000 jobs compared to the decrease of 697,000 jobs originally reported for the previous month.
- RTTNews

This negative news story came out right before the opening of the U.S. Stock market and it was very bad. It showed that more jobs in the U.S. were lost than was expected. Jobs are one of, if not the most important part of the economy right now. It is the key report that people around the world are focused on at the moment. How does this relate to market price? Let's look at a chart of the NASDAQ that day, just as we did in the XLT.

Figure 1

The grey shaded circle on the chart is April 1st, right around the time of that news release. The news was REAL BAD, and many people SOLD. These sellers that heard the bad news sold and prices declined. When we look to the left of that shaded circle, we see that price declined right into our pre-determined demand (support) level. That level is demand because the chart tells us there are many more willing buyers than sellers at that price level, that's why price rallied so strong from the demand level in the first place. It represents the pattern we identify as demand: Decline – Base – Rally (pivot low). So, what exactly happens? When many market players heard that bad news, they sold after a drop in price and right into a price level where demand exceeded supply (Demand: more buyers than sellers). As soon as the last seller sells at a price level where demand exceeds supply, market price shoots higher, which it has to when that equation is true. The key here is to filter your perception of the news through the objective supply and demand equation from the chart. In other words, before you sell based on the news, make sure price is at a level where supply exceeds demand, not at a price level where demand exceeds supply.

The strong move up in the NASDAQ from that level happens because so many people are caught on the wrong side of the market and the news event was the invitation that led sellers to take that novice action.

Be careful putting any of your hard-earned money at risk before thoroughly understanding how markets really work. As you can see, if you are still in the camp that falls for the illusion trap often set by news, you may very well be providing income for astute traders whose buy and sell orders help set the trap.

Identifying Turning Points Begins With Proper Focus

Printable Version

Today I want to discuss an issue I am asked about on a regular basis. It has to do with the most important component of trading or investing. This key component is identifying turning points in markets. This is far and away the most important piece of the puzzle because if you can't identify specific low risk, high reward, and high probability turning points in the market on a consistent basis, you will never be able to manage risk properly. Often, I receive emails from traders who talk of problems with placing their protective stops, trade management, risk management, and more. Some say they enter trades in the right place but they have other issues such as the ones I just listed. What they don't realize is that the REAL issue is that they are not entering the market in the right area even though they think they are. In fact, almost every trading problem someone has that is sent my way is directly a function of poor entry points in the markets they trade.

When I begin the process of showing someone how to identify low risk, high reward, and high probability entry points on a chart, I go over the supply (resistance) and demand (support) information you may have read about in my prior articles. Today, I will make that process much easier for you with a slight shift in your focus.

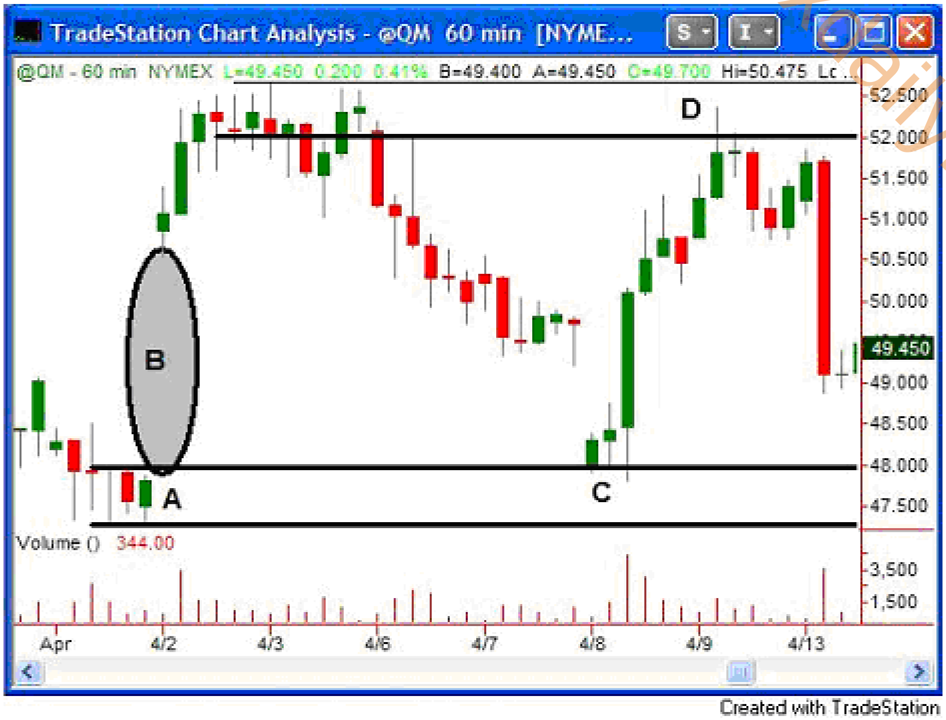


Figure 1

Here is a Crude Oil trading opportunity I pointed out in the XLT which a few students took according to our rules and profited nicely. Notice area "A." Area "A" is a series of three or four candles basing sideways. "B" is the circled area on the chart which represents the STRONG move higher in price from area "A". That strong move higher during "B" happens because there is much more demand at "A" than supply, more buyers than sellers. Therefore, we want to buy when price revisits area "A" which is at "C." When we buy at "C," we are buying from a seller who is making the two crucial mistakes that every consistent losing trader makes. 1) The seller is selling after a decline in price. 2) Selling at a price level where demand exceeds supply. We want to buy from that novice seller at "C" as the risk is lowest, reward is highest, and the probability of the trade working is very high. For our regular readers, you have heard all this before, I know. Here is the KEY piece of information I want you to focus on that you have not heard before. From what I just wrote about this chart, most traders will begin the process of identifying a strong demand level by FIRST, looking for area "A," the basing before the rally in price. <u>Don't do that! If your first focus is searching through charts and looking for areas of basing like "A," you will see those all over the place. Instead, make the FIRST</u>

thing you look for area "B," the STRONG move in price. Then, follow price down (or up) to the origin of that move and that is likely where you will find your key demand or supply level. Understand that the strong move in price, "B," can only happen because of a supply and demand imbalance at the origin of that move and that's where opportunity is.

Steps to Finding Market turning points:

Step 1: Identify strong momentum moves on a chart.

Step 2: Find the origin of that strong move and THAT is likely where your demand or supply level will be found.

Let's take a look at another chart showing the steps that lead us to identifying a quality supply level. This time, however, let's do it the right way, focusing FIRST on identifying the strong move in price that will lead us to our quality supply level.

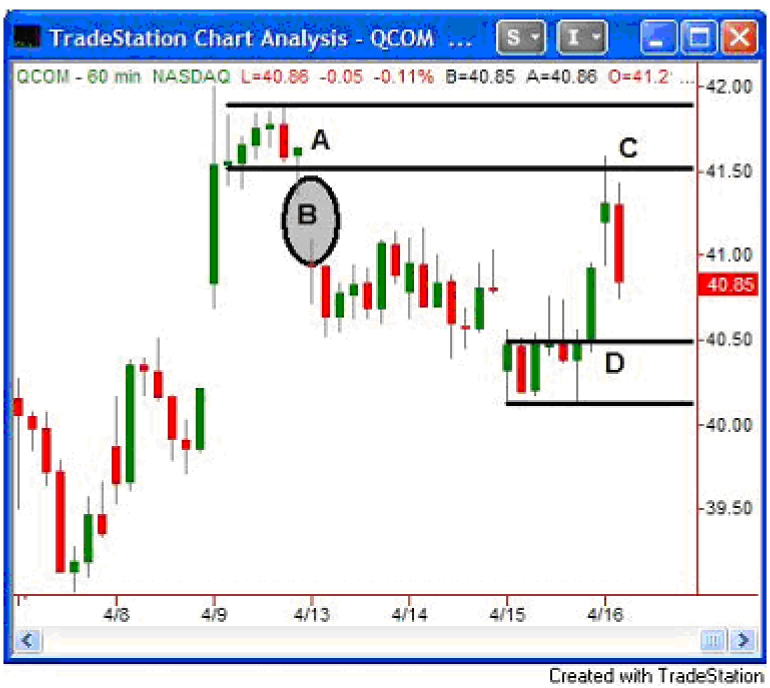


Figure 2

First, our eyes should easily recognize area "B" as that is a strong drop in price. When we then go to the origin of that drop, we find a nice supply level, area "A." We then follow our XLT rules, wrap some lines around this level, and look to sell short when price revisits this supply level, at area "C." "D" is the demand level below "C" which makes "D" our target.

Focusing on strong, momentum moves in price in a market makes it easy to identify the price levels where demand and supply are MOST out of balance. Never forget, the movement in price in any and all markets is a function of an ongoing demand and supply relationship/equation. Low risk, high reward, and high probability trading opportunity exists at price levels where this simple and straight forward equation is out of balance.

Scanning for Opportunity, the Old-Fashioned Way

Printable Version

I have been in the trading and trading education world for many years. My path began on the floor of the Chicago Mercantile Exchange and included writing a daily trading advisory letter for three firms, managing funds for clients and myself, lecturing to thousands of traders and investors around the world, and more. I remember the very early days when I became interested in charts. There was no manual or book to teach you how to build a chart or anything like that. Often, the one machine on the trading floor that provided charts didn't work so I would build my own charts using graph paper and colored pencils. I really enjoyed that and believe me, when you're building your chart with colored pencils, you really get to know where the significant buyers and sellers are in the market you are charting.

Old-Fashioned Reality Based Analysis

As I began writing trading advisory letters, I would go through the same "top down" scanning process each afternoon after the market closed to find trading opportunities in the stock (and Futures, Forex, and Options) market for the following day. For stocks, I would first identify the support (demand) and resistance (supply) levels in the S&P and NASDAQ. If these two markets closed near demand, I would know to look for opportunities to buy the next day as price was likely to rally from that demand level. The next step was to look at charts of a few of the large sectors to find some that are also trading near demand as those sectors would likely rally from that demand level with the broad (S&P and NASDAQ) market the following day. Out of the few sectors, I would always find one or two that were setting up very well with the broad market. The final step was to look at a handful of high volume stocks within that sector and that is always where I would find a VERY quality trading opportunity. There would always be a few stocks that were also trading right near demand just like the sector and broad market, ready to move higher the next day from that demand level. If I found more than three or four of these quality opportunities to put in the letter, I would choose the stocks that had the largest profit margins. When I say "profit margin," I mean the stocks trading at or near demand that are farthest from supply (resistance). This was a VERY profitable three-step scanning process that I repeated day after day, month after month, year after year. For years, I produced these letters daily for some of the largest firms in the industry who would distribute the letter to clients worldwide.

The Technology Boom

As the years went by, the technology boom really took off. This led to faster and faster trading platforms and super, high-powered scanning software. I began to use all the latest scanning software to find low risk and high reward trading opportunities for readers. I tried everything that was out there in the industry. If it scanned for stocks, trust me, I have tried it. I would put in the filter parameters I was looking for, hit "enter," and watch all the stock symbols that met my criteria populate a quote box. Next, I would scroll through each of these hundreds of stocks looking for the setup I was in search of, either a decline to demand for a buying opportunity, or a rally to resistance for a shorting opportunity. I would scan and scan and scan, often for hours with these automated machines. I remember many nights where I would fall asleep at the key board in the middle of this scanning process. I kept at this for some time as I figured technology would certainly speed up the process and let's face it, I was on the high-tech bandwagon like everyone else. After trying every scanning software product you can think of, I realized that I was not only wasting time, I had also made what was such an easy and profitable process VERY difficult. One day years ago, I got rid of every automated scanning tool I had and have never used one since. I went back to doing my market analysis the old-fashioned way and it was one of the most profitable and time-saving choices in my trading career. What triggered this realization that day was a visit to a quiet little library I would go to when I had to write an article for a magazine. I was walking to my favorite corner spot in the library and I walked by a table where two children were coloring some pictures. They were using colored pencils and as soon as I saw those colored pencils, it hit me: The power of my profitable trading letters was easily attained from doing my market analysis the old-fashioned way. Quality charts replaced colored pencils but the analysis was still my basic three step, top down approach to stock market analysis.

The "Top Down" Approach

These days, instead of producing a daily advisory letter, I spend my days trading and providing live market trading, analysis, and education in one of two graduate programs at Online Trading Academy, the Extended Learning Track (XLT) - Momentum Intraday Trading Extended program and the Futures Trading program. During a live session with XLT members on Monday April 20th, we focused on finding potential low risk, high reward, and high probability trading opportunities for the following day. We first analyzed the S&P to determine where prices were likely to go the next day.

S&P 500

Figure 1

When we quantified supply and demand in the S&P (chart above), we noticed that there was a quality demand level, the unfilled gap from days before. We determined that if the market were to trade lower the next day, it would likely turn higher at the origin of that gap as that is where the buyers were, demand exceeded supply. Sure enough, that is exactly what happened. The market gapped down right into that price level where demand exceeded supply and rallied strong for most of the day.

Financial Service Sector (XLF)

Figure 2

After quantifying demand and supply in the broad market, I then looked at three or four sectors and found that the XLT (financial service sector ETF) also had a quality demand level that lined up with the demand area in the S&P. In the XLF chart above, notice the gap, area "A." Price gapped higher because there was so much more demand than supply at the origin of that gap. Therefore, if that sector was to return to that price level, price was very likely to rally which would carry the stocks within that sector higher as well. The next day, just like the S&P, the XLT (financial service sector) opened right into that demand level "B" and rallied strong all day.

Bank of America (BAC)

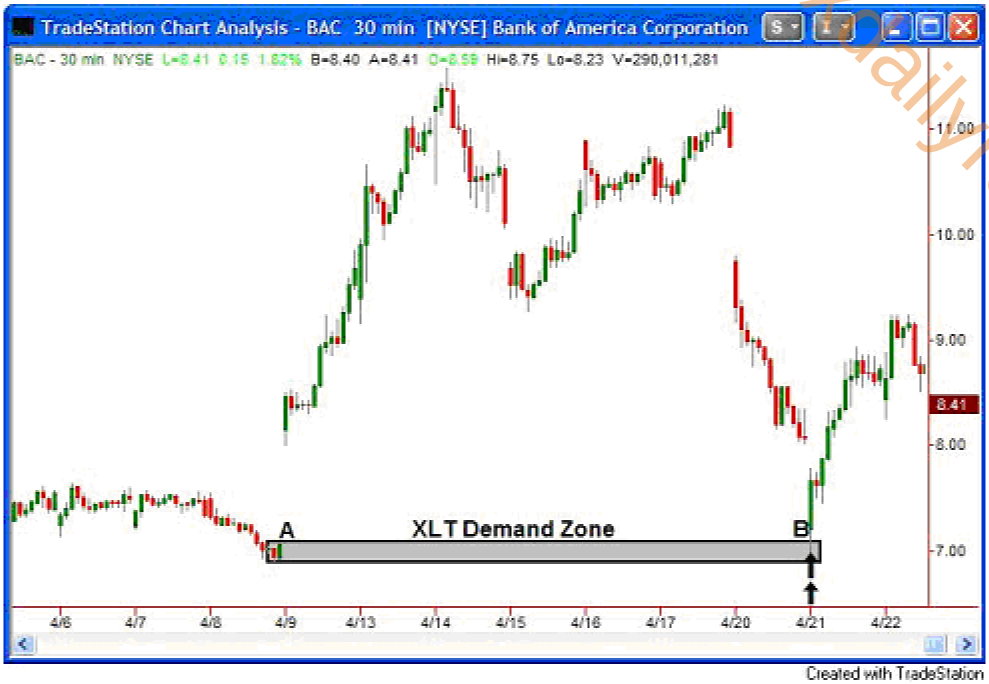


Figure 3

After determining that the financial service sector had a demand level that lined up well with the S&P 500 demand level, we then looked at three major bank stocks and found Bank of America (BAC). We found the demand level marked on the chart, area "A." This was considered a very quality demand area because of the strong gap away from area "A." You need to understand that the stronger the move away from a price level, the greater the demand and supply imbalance at the origin of that gap. All this analysis was done on April 20th. The next day, price gapped down right into our pre-determined demand level offering us a very low risk and high reward entry. The trading idea was also high odds because at "B," a group of novice sellers were selling BAC. How do we know this? The sellers at "B" were committing the same two mistakes that every novice trader makes. First, they were selling after a decline in price which is not a smart action to take. Second, they were selling right into a price level where demand exceeded supply. As an astute market speculator, you have to recognize this novice action and be the buyer to that novice seller. Had we been wrong and lost on the trade, the risk was only $0.15. We followed our profit-taking strategy and the trade worked out well. Congrats to XLT members who took this trade and the others from that day.

Finding this trading idea the day before only took a few minutes as I used the old-fashioned "top down approach." Had I used one of the many automated scanning tools, I would have spent much more time and likely never found BAC anyway. As strange as it sounds, for me, scanning for opportunities in markets the old-fashioned way saves me plenty of time as my objective rule based analysis leads me right to the gems quickly. Will computers someday be able to do this faster than me? Maybe, but I don't really care. If I had a little more time in my life these days, I'd love to dig up my old colored pencils and some graph paper and get to work. Keep in mind that this simple top down analysis was all done the day before prices revisited the demand areas noted on the charts. Planning your trades in advance and timing your trades with the broad market as we did with BAC is important whether you are an active trader, swing trader, or longer-term position trader.

Advanced Price Action Analysis

Printable Version

Today I wanted to share part of a lesson right out of the Extended Learning Track (XLT) program with you. It deals directly with identifying high probability turning points and if you are not a member of the XLT, you have not heard it before. This information is not in books, articles, and so on. Keep in mind that the XLT is the graduate program where we transform theory into real world trading and investing. The lesson and information is titled: "Odds Enhancers." Many people think that every prior turning point in a market is a support or resistance level suggesting price will turn at that level again in the future. While that line of thinking may sell many books, it certainly is not how things always work in real world trading.

Let's take a step back for a moment. Price will stop falling and turn higher at price levels where demand exceeds supply. It will stop rallying and turn lower at price levels where supply exceeds demand. This is a basic principle that I think we all can agree with. In other words, price will turn at price levels where the demand and supply equation is most out of balance. Given that there are different levels of imbalance at different price levels, we want to find the price levels where demand and supply are most out of balance. To identify low risk, high reward, and high probability turning points, let's take our level of understanding price action deeper than just red and green candles on your computer screen and begin to understand the order flow that is taking place behind the scenes that is responsible for the creation of these candles.

The Odds Enhancers

The Odds Enhancers are a simple set of criteria we apply to our analysis that help us arrive at key turning points (demand and supply levels) and equally help us ignore demand and supply levels that are not high probability. In other words, this simple rule-based exercise forces us into quality trades and keeps us from not so quality opportunities. Here is an email that came in a while back. Notice what the XLT member writes at the end of the email: "This setup is a 9." What does that mean? Let me show you.

Futures XLT Member Email:

From: Linnea M.

To: Sam <sseiden@tradingacademy.com>

Sent: Tuesday, January 13, 2009 8:27:21 AM

Subject: GOLD!

Sam,

Here is the ZG trade I mentioned to you. Got in on the pullback at 864 and took it down to 835 where I saw some demand creeping in. I had two contracts on...got out of the first one at 852 and the second at 835. But I did follow my trade management rules...pulled up my stop and made sure I would still make some money if it decided to retrace. Thanks for the help...you and XLT are the best! **I will be able to spend more time with my kids doing things that are so much more rewarding and important.** I can't thank you enough!

This setup is a "9."

With much gratitude,

Linnea M.

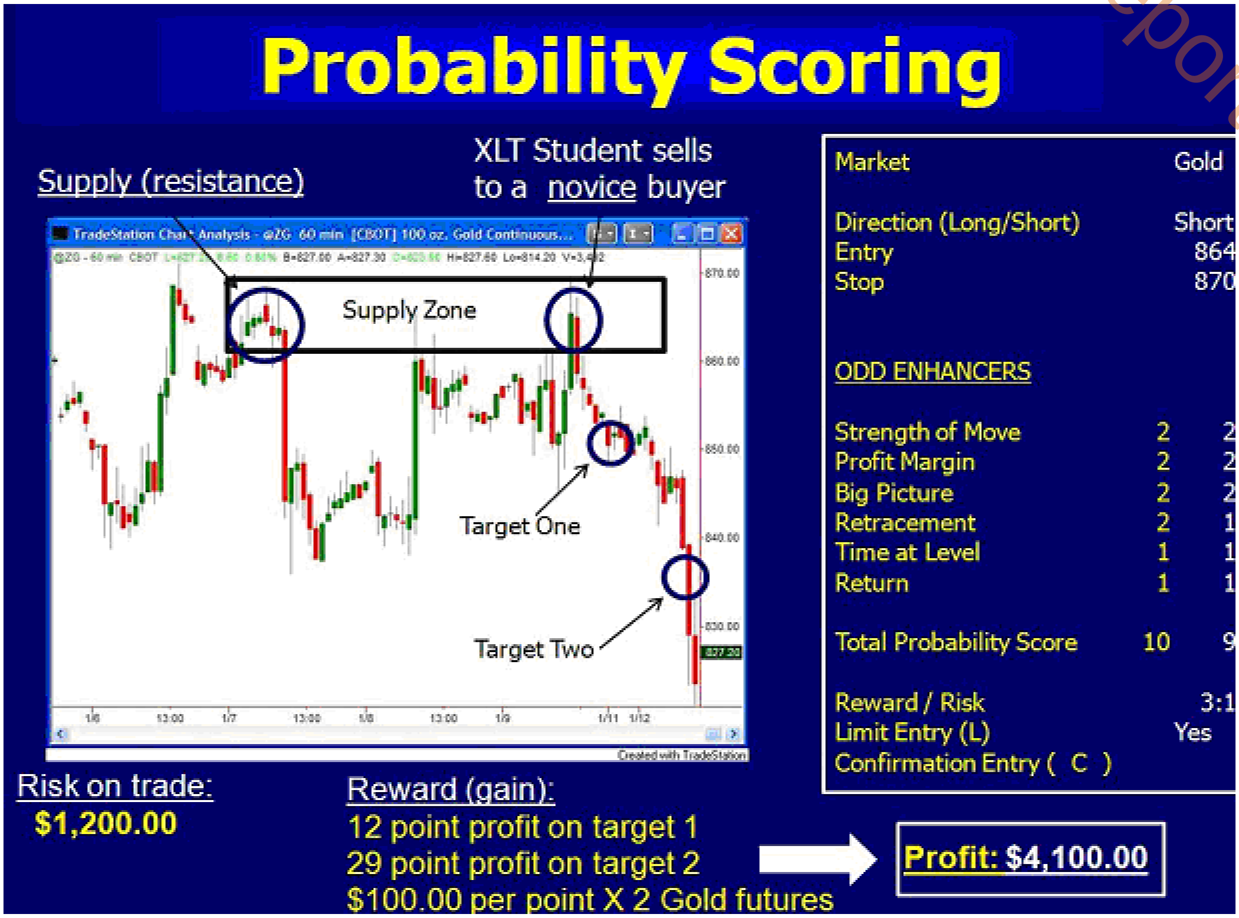


Figure 1

Here is the chart from that XLT member trade and the Odds Enhancers analysis that went with it. The Odds Enhancers help us arrive at an objective probability score for potential trading opportunities. The highest score possible is a 10. These numbers are reflected in the yellow column next to each Odds Enhancer. In white are what the student determined the score for each specific Odds Enhancer was based on our simple rules for scoring. Without going into too much detail, I will explain some of these odds enhancers for you.

1. Strength of a Move

   This Odds Enhancer is key and deals with probability. With it, we look at how price initially left the area. Did price leave in strong fashion as was the case with the trade above suggesting a STRONG supply and demand imbalance at the level or did it leave with a gradual decent suggesting a small supply and demand imbalance at the level? The fact that the initial decline from the supply level was fast and strong, the XLT member gave that a 2 (in white) out of 2 (in yellow), the highest possible score for this Odds Enhancer.

2. Profit Margin

   This crucial Odds Enhancer deals with risk reward. Here, we look at how far away demand (support) is from our supply (resistance) area. We measure the distance from our entry to protective stop and compare that to the distance from our entry point to the nearest demand level (profit target 1) below. In this case, the student went through our rule-based analysis and determined that the reward to risk was at least 3:1, which means that Odds Enhancer gets 2 out of 2, the highest possible score for this important Odds Enhancer.

3. Big Picture

   This important Odds Enhancer deals with probability again. While this setup was found on the hourly chart, we still need to know if we are considering a short position on the correct side of the curve in the big picture. For this trading opportunity, we would go to the larger time frame and find our "fresh" demand and supply levels and make sure we are not selling short anywhere near larger time frame demand and ideally, selling short much closer to larger time frame supply. This student performed this analysis and determined that the shorting opportunity is well placed on the supply and demand curve and gave this Odds Enhancer 2 out of 2, the highest possible score for this key Odds Enhancer.

As you can see, there are three more Odds Enhancers in our simple probability scoring system that I can cover at another time. Our student ended with a 9 out of a possible 10 which means she was taking this trade with a limit entry and putting all the orders needed for this entire trade in, before the trade took place. This exercise is one I suggest new XLT members use for a period of time but not forever. After some time, you should be able to "eyeball" these crucial Odds Enhancers and take the appropriate action or non-action in many cases. The probability score will tell you what to do. Risking $1,200.00 on the trade, our XLT member enjoyed a profit of $4,100.00 on this trading opportunity in Gold, one of the many markets we trade in the Extended Learning Track (XLT) - Futures Trading program.

Why don't we focus on all the information that is in the many trading and investing books, trading expos, and weekend seminars? Simple, why in the world would we want to be buying and selling when everyone else buys and sells? There is no edge when you take that herd mentality action buying and selling anything.

While the gain was nice for our XLT member, your focus should be on the mechanical and rule-based steps we take to arrive at these key trading opportunities. The most important part of this email however is the sentence I highlighted for you near the end of the email. If you're trading with the simple focus on building up that account, just looking at the numbers, you're missing the grander vision. Our XLT member is focused on trading to help create a better life for herself and her family. This focus allows her to have the discipline to wait for low risk / high reward opportunities to come to her as she is focused on the grander vision, not the urge to trade, trade, trade. Without a core focus on a grander vision, you will NOT be able to have the discipline required to attain that grander vision; they go hand in hand. Those who focus on the realities of markets and price, simply get paid from those who don't

Some Thoughts on Trading Psychology

Printable Version

Trading psychology is a subject most books and so-called professionals keep separate from the mechanics and strategies of trading and investing. A reality largely misunderstood is that the underlying mechanics and strategies within trading and investing are a direct function of your psychological belief system. At any given time in the stock market, there are buy and sell invitations sent out in the form of news events, technical indicators, earnings reports, company announcements, brokerage upgrades and downgrades, and much more. These invitations are then received by the belief systems of tens of millions of traders and investors worldwide. What separates the consistently profitable market player from everyone else is a psychological belief system that filters all these invitations to buy and sell through the markets ongoing supply (resistance) and demand (support) relationship. When this is done properly, you will quickly realize for example that often, a buy recommendation from a brokerage firm and/or a good earnings report from a company do not equate to market demand or higher prices for the company's stock. Conversely, negative news or a brokerage downgrade may actually be a low risk / high reward buying opportunity. Some of the most common and popular invitations to buy and sell occur with stocks. Providing awareness of the various buy and sell invitations for stocks, demonstrating how to mechanically filter these invitations through the stock market's true supply and demand equation, and providing rule-based tools for taking advantage of these frequent red flags and opportunities is the focus of this article.

A psychological belief system that enjoys consistent low risk / high reward profits is one that identifies and accepts an invitation to buy into a market when objectively, market price is at a level where demand greatly exceeds supply. A belief system that suffers consistent poor results is one that identifies and accepts an invitation to buy into a market when objectively, price is at a level where supply exceeds demand. There are two types of buy and sell invitations. The first are the market's buy and sell invitations which are based only on the irrefutable governing dynamics of supply and demand. The second includes everything from good and bad news to positive and negative earnings reports to brokerage upgrades and downgrades and many more. The first has you focus on reality while the second has you focus on everything but reality.

April 21st - "We continue to face extremely difficult challenges, primarily from deteriorating credit quality driven by weakness in the economy and growing unemployment," Bank of America CEO Kenneth Lewis said.

Figure 1

On April 21st, More bad banking news came out for Bank of America. We bought at demand (support) on that day even with the bad news while the sellers on the 21st sold because of the bad news. These sellers made the same two emotional mistakes every novice trader makes. They sold after a decline in price and at a price level where demand exceeds supply. Why would someone make such an obvious mistake? Simple, the belief system that drives their behavior/action is flawed. <u>When you understand that your psychological belief system IS your trading and/or investing strategy, you will realize how important it is to align your belief system with reality. You are essentially searching for truth so beware of illusion. The addition of even the slightest amount of</u>

illusion into your belief system ensures truth will never be found.

Often, the focus of poor trading and investing results is a lack of discipline when attempting to follow the rules of a strategy. What keeps people from not following rules is not a lack of discipline, it is because their invitations to buy and sell are not in line with their psychological belief system. There is internal conflict when it is time to take action. Don't punish yourself for not acting when the market calls you to action. Instead, take a step out of the box that is your belief system and make sure it is only filled with objective information and reality.

Any and All Iinfluences on Price are Reflected in Price

All the news and market information is filtered through your belief system. Your belief system is responsible for the thoughts and perceptions created from the news and information. Every thought and perception leads to ACTION and in trading and investing, action is either buying or selling. Therefore, all the consistently profitable trader or investor needs to focus on is price. Whatever the news and information for the stock is, your belief system MUST filter that information through a filter that quantifies the market's TRUE supply and demand relationship before a perception is created and action is taken. This will ensure you will not fall into the trap that the sellers of Bank of America did on April 21st. It will also allow you to profit from the many that consistently fall into that trap.

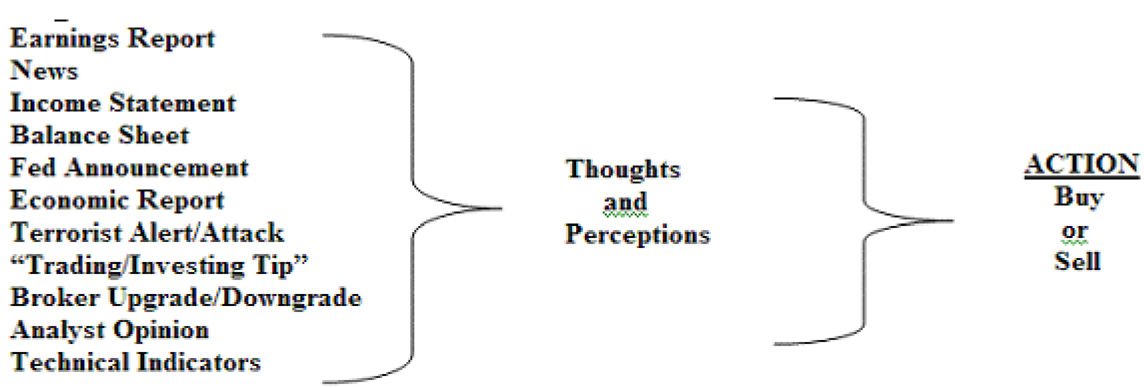


Figure 2

Once you understand that any and all influences on price are reflected in price at the level of your belief system, your next step is to know what true supply and demand look like on a price chart. If you're not careful on this step, illusion can again creep into the equation if you let it. If you think the conventional technical analysis definitions of support and resistance are the answer, think again. A cluster of trading activity above and below current price is not necessarily true supply and demand. There is a very unique and simple chart pattern that represents peak demand and peak supply. While the details of this are beyond the scope of the article, the chart examples I have provided should help guide the way. Once you are able to identify true supply and demand on a price chart, simply follow these two rules:

- A negative news event or negative stock market information which brings price to a level of peak demand is typically an opportunity to buy, not sell.
- A positive news event or positive stock market information which brings price to a level of peak supply is typically an opportunity to sell, not buy.

Governing Dynamics

Printable Version

Last week, I wrote a piece that explained the importance of being aware of the psychological traps that lead to poor trading and investing decisions. I received many emails thanking me for writing on the psychology topic and asking for more. Thanks so much for those emails, keep them coming. What I try to focus on most in articles are the irrefutable laws and principles of supply (resistance) and demand (support). Furthermore, I attempt to show with real trades from our students and myself how adding any derivative of this simple and straight forward concept to your decision making process is tricky and dangerous. While it can be done, the foundation of a trading decision must be in line with the laws of supply and demand. This is the only way to buy low, sell high, and sell high, buy low and keep your trading low risk and high reward.

In the Extended Learning Track (XLT) program, we make this concept the foundation of our rule-based strategy. This concept and the rules to our strategy in XLT are simple; executing the strategy is the challenging part. The challenge typically lies in the trader's inability to keep things simple. The main reason traders and investors of all types have problems when it comes to speculating in markets is because they can't keep things simple, straight forward, and reality based. As humans, we are masters of complicating everything. Also, as I have mentioned before, another human flaw is the ability of our minds to deceive us by way of illusion. Letting these two natural human flaws creep into the world of market speculation typically leads to losses in your account.

So often, traders want to add more strategies to their trading tool kit, add more indicators, more information from the latest best selling trading book, and so on, it never ends. What most people fail to see is that there are a few basic principles that don't change. Gravity is one that comes to mind and there are a few more. At the core of any significant economic, political, scientific, social, medical, psychological or cultural theory lies a quest to understand and quantify the forces of change, action, or energy. The theories that attempt to quantify "force" that have stood the test of time date back centuries and are extremely simple. In 1686, noted physicist Isaac Newton suggested in his laws of motion that an object will remain in motion until it is met with an equal or greater force. Noted economist Adam Smith suggested hundreds of years ago in his book, "The Wealth of Nations," that when supply exceeds demand at a price level in a given market, price will decline. Smith and Newton didn't create or invent the laws and principles for which they are famous. Supply, demand, motion, and the relationships therein existed long before Smith and Newton, long before humans walked the earth for that matter. What these two individuals did, however, was to look mass conventional perception in the face and challenge it with a reality that had been there all along. They were able to discover what no one else had because of a belief system that allowed them to open doors others never knew existed. If you notice, Newton and Smith didn't figure out one specific issue. They had a belief system that allowed them to rather easily apply the core principles of their knowledge to a host of issues, producing answers the rest of the world still considers "ingenious" centuries later.

Mathematician John Nash's Nobel Prize winning idea became famous in the movie, "A Beautiful Mind." He directly challenged a theory set forth centuries ago by Adam Smith. Smith suggested that the best outcome is derived when everyone in a group does what is best for them. Nash argued through simple logic and mathematics that the best outcome actually comes when everyone in a group does what is best for themselves, and the group. In the years that followed his breakthrough at Princeton, the Nash theory has been responsible for major global peace treaty negotiations, strategic corporate pricing models, and much more. While John Nash has a brilliant mind, his theory, like Newton's and Smith's, had been a part of life as long as man has walked the earth, actually, much longer than that. For example, let's take a look at how dolphins feed and behave in a group. Dolphins jump out of the water because they want to see where birds are feeding on a school of fish. When the dolphins spot the flock of birds feeding, they race over to that area as fast as they can to eat. What is most interesting is that the first dolphins to arrive at the school never eat right away. While the first few dolphins can easily swim right into the school of fish and have their meal, they never do. Instead, they begin swimming around the school of fish to create a tight ball of fish, called a "bait ball." As the rest of the dolphins arrive on the scene, they all swim around the bait ball to keep it nice and tight so no fish can escape. Then, one by one, they take turns swimming through the bait ball and rather easily, eat as many fish as they like. What the dolphins have been doing for millions of years is exactly what John Nash suggested not all that long ago; in a group, dolphins do what is best for themselves, and the group. As with the Newton and Smith theories, Nash simply exposed a simple reality that had been right in front of us all along.

Many other economic and scientific minds have come along over the years and presented the world with a new twist on the basic principles mentioned in this piece and have won a Nobel prize for it. However, in almost every case, within a few months of winning the Nobel, that person is proven wrong. You can't change what can't be changed. Certain things in the world only work one way.

Governing dynamics are governing dynamics. Were Newton and Smith really saying anything different or is the mathematical equation behind their breakthroughs exactly the same? The supply and demand in markets is Newton's mass and the motion is the movement of price from price levels where demand exceeds supply to price levels where supply exceeds demand. The point is that the ability to keep things real and simple can have very positive results while complicating simple realities can drain your trading and investing accounts quickly. Those who can't keep things simple typically pay those who can.

Note: In last week's article, the sentence: "… will ensure you will not fall into the trap that the **buyers** of Bank of America did on April 21st." This should say: "…will ensure you will not fall into the trap that the **sellers** of Bank of America did on April 21st." Hope this clears things up.

Governing Dynamics and Trading Psychology

Printable Version

Today, I wanted to continue my discussion from last week's piece on governing dynamics with a live market trade from the Extended Learning Track (XLT) class. On Wednesday, May 20, we had a live trading and analysis session in the XLT - Momentum Intraday Trading program. Before getting into that trade, understand that price movement in any market is a function of an ongoing demand / supply and human behavior relationship. Low risk / high reward / high probability trading opportunity is present when this simple and straight-forward equation is out of balance.

During our trading and analysis days in the XLT - MIT, which is the equities trading program, I scan the broad market, sectors, and stocks for demand and supply imbalances. Some newer members think it's our job to wake up each day and trade. I often remind them that our job is to wake up each day and search for low risk, high reward opportunity. Coming into our session on May 20th, the market had been going up for days. Some new XLT members that morning began discussing where we should buy into the rising market that day. When we suggested to them that we would not be looking to buy at all at current price levels and instead that we would be looking for a shorting (selling) opportunity, that didn't sit well with new XLT members. They asked… "Why not buy if we are in an uptrend?" My answer was that we do look to buy when we are in an uptrend but we were nearing a big supply (resistance) level and that is where almost all uptrends end. This is also where new downtrends begin and we ALWAYS want to stay ahead of the masses when it comes to speculating in markets. While they seemed to understand this, the natural, emotional urge was still to buy that morning, not think of selling. While we (XLT instructors) were confident in our analysis, we felt the strong urge to buy into this rising market from some of the newer XLT members. Below is an intra-day chart of the NASDAQ. Once the market opened, prices again began rising, supporting and feeding the buying urge for those that were bullish. As you can see on the chart, during the first 30 minutes or so of our session, candle "A" forms and more people begin to question our bearish outlook more and more as price shoots higher. Price begins to move so fast that the bulls in the group almost become a distraction. This urge to buy as price moves up is so strong that most can't fight it and buy. The emotion is seen below in the candle marked "A." Anytime you have a series of rising green candles and the largest candles are after the series of rising green candles, that is a clear sign of novice, emotional buying. As we were pointing out the major supply above these prices on a chart we will look at soon, it was almost like some were ignoring it. It's like telling someone to step on the brakes because there is a brick wall just ahead and they don't believe it's there because it was not there in the recent past. Fasten your seat belts…

Figure 1

As we hit the supply level that we pointed out an hour before the market even opened, it was no different than hitting that brick wall. Those who ignored it and had bought, got hurt. Those who focused on the reality of pre-determined overhead supply, not only didn't get hurt, they profited nicely from a low risk / high reward and VERY high probability short position. As you can see on the chart below, those who jumped on the novice bandwagon and bought around "A" were in trouble just a short time later as price fell far and fast.

Figure 2

Combining your objective (reality) rule-based demand and supply analysis with the realities of human behavior are the keys to market speculation. Let's take a step back and look at how we arrived at that bearish outlook in the face of a very strong rally in price. The chart below is a daily chart of the NASDAQ and shows the before and after for our pre-determined shorting opportunity. Notice the supply level marked on the chart. This pattern which we look for is a Rally – Base – Drop. Price drops from that level initially because there is more supply than demand at that level. We mechanically wrap a couple lines around this level to create a "supply zone" and wait for price to return to this level. When price returns to this area "A", as seen here and in the charts above, we know that novice buyers who ignore stop signs are making the same two mistakes novice traders make. First, at "A," they are buying after a rally in price and second, they are buying right at a price level where supply exceeds demand. We want to sell to those buyers.

There is a time and a place to sell short during an uptrend. The time and place is when price reaches a level where supply exceeds demand according to price.

Figure 3

As I mentioned above, combining your objective (reality) rule-based demand and supply analysis with the realities of human behavior are the keys to market speculation. This skill set is what allowed some of our veteran XLT members to profit from this shorting opportunity. The larger time frames will show you where the key turning points are and the smaller time frames will show you the picture of novice traders jumping on the bandwagon at the wrong time. Your challenge is two-fold. First, know exactly what low risk / high reward / high probability opportunity looks like on a chart. Know where those brick walls are so you can not only avoid getting hurt, but also profit from them. Second, have the self control needed to not jump on the novice bandwagon and enter trades when everyone else is.

Plan, Execute, and Then Go Do Something Else More Important Than Trading

Printable Version

It has been many years of writing articles, market commentaries, and trading advisory letters. I wanted to take this opportunity to thank you for your support and feedback. While I always try to respond to each and every email, occasionally I miss some and I apologize for that. Your feedback is always appreciated.

Today's piece will focus on a shorting opportunity we identified in the S&P during a live Extended Learning Track (XLT) - Futures session, Wednesday, May 27th. Many active traders think it is their job to wake up each day and trade. The astute trader knows it is their job to wake up each day and search for low risk, high reward, and high probability trading opportunity. If that opportunity is found, the astute trader applies their rule-based strategy and executes like a robot, very little thinking (if any) involved. Successful trading is not all that glamorous and exciting after you have been doing it for a while. You are simply taking the same successful action over and over, winning and losing, just like Las Vegas. Also just like Vegas, your gains should be larger than your losses. This is actually what got me started in writing. I was trading successfully in my early 20's and because I was so rule-based, I had plenty of extra time on my hands. One day I was asked to write an article about a trade I had in the Japanese Yen and that article led to others and so on. Even before I ever wrote my first article, I spent very little time in front of the computer looking at my trades. Once I had a trading routine, I found my opportunity, entered my entire trade and left to do something else like a good workout, a round of golf, spending time with family, or some project around the house.

Taking this approach gave me two important benefits. First, I became completely emotionally detached from the market and my trades as my focus was on other things that were so much more important. Second, I began "smelling the roses" early in life, spending most of my time doing things that were so much more important than sitting in front of a computer screen all day. Sitting and watching your trades keeps the largest risk in your trading world alive which is human emotion (you). Eliminate that risk with proper rules based on the objective laws of supply and demand and disciplined execution. This means planning your entire trade and letting an unbalanced supply and demand equation naturally move price back to balance.

Let's take a step–by–step look at our trading opportunity. The chart below is a small time frame chart of the S&P futures. This market is the mother of all global equity index markets as most stocks around the world move in the direction of the S&P. Whether you trade futures or equities, properly identifying quality trading opportunities in the S&P is equally important.

Area "A"

Area "A" represents a supply (resistance) level. This is an area where the chart tells us supply exceeds demand. We know this because price could not stay at level "A" and had to decline from it. If my statement about supply exceeding demand at level "A" was not true, price never would have declined from level "A." It would have kept trading at that price level, but the key point for you to understand is that it could not, it had to decline because supply exceeded demand. The exact pattern we look for that represents supply is a Rally–Base–Drop as seen on the chart, "A." This is not a Drop–Base–Drop; we don't look at that as supply as these are found in the middle of moves and typically don't work well.

Area "B"

The decline in price as mentioned above confirms the supply level at "A." More information about the level of supply/demand imbalance at "A" can be gained from observing the rate of decline during "B." The more rapid the decline in price, the greater the supply/demand imbalance at "A." This is key information as it helps us quantify probability.

Figure 1

Area "C"

"C" represents the rally in price back up to supply level "A." Notice the strong rally in price with no sign of demand within that rally. This was a great invitation to sell short when price rallied back up to supply level "A." The reason is because the steep rally almost always means that price will fall back through that level at nearly the same rate once it turns at the nearest supply level above "A." The strong rally during "C" was actually the most inviting aspect of this shorting opportunity.

Area "D"

The trading from area "A" through area "C" happened mainly from May 21st through May 26th. The vertical line on the chart marks the opening of trading on May 27th. Shortly after the opening bell in the US Stock market, the S&P rallied right up into supply area "A." "D" is the time our rule-based strategy had us selling short. Why sell short here? Simple, we have novice buyers entering the market at "D" who are committing the same two mistakes that every novice trader makes. Mistake number 1: They are buying after a rally in price. Mistake number 2: They are buying right at a price level where supply exceeds demand. The laws of supply and demand ensure you will lose consistently if you commit these two mistakes. Can this novice buyer be right once in a while? Sure, just understand that in trading and investing, money always ends up in the hands of its rightful owners. The short entry was at "D" at a price of 911, selling to a novice buyer.

Area "E"

"E" represents the price level just above our supply level "A." This is exactly where our protective buy stop is placed in case our trade does not work out in our favor. The price was 915. This is how we limit the risk and ensure that we are not putting more capital at risk than we are willing to. The buy stop order is placed here because the last time price was in this area "A," price was not able to go above that level. This is because there is way too much supply at that level which makes for an ideal placement of the protective buy stop. With a stop of 4 points in the E-mini S&P Futures, that means that we are risking $200 for each contract. Trading five contracts, we would have a risk here of $1000.

Area "F"

The blue line at "F" is at 899. This is 12 points from our short entry at 911. If we are risking 4 points on the trade, we want to make sure we have at least a solid 3:1 profit target which means we are looking for at least a 12 point gain. "F" is where that 12 point gain was reached which is where the rule-based robot trader would exit some or all of the position if the plan is 3:1. With those 5 contracts, that is a gain of $3000. Risking $1,000 for a gain of at least $3,000 is solid risk/reward trading. Keeping your goals to at least 3:1 or greater also increases the probability in your trading, but that is a topic for another time.

While there is a little more to it that we go over in the XLT class, I wanted to really walk you through a real trading example, explaining how and why prices move and how and why the astute trader does what he or she does. Furthermore, I want to impress upon you how having a solid understanding of the foundation principles that allow you to see where the "real" buyers (demand) and sellers (supply) are on a price chart allows you to have a rule-based strategy. Having a rule-based strategy is the key to not spending your life in front of the screens but instead, spending it doing things in life that are so much more important

Pay Attention

Printable Version

I say those words often lately to Online Trading Academy students. It's not that I am asking them to pay attention to me, though I am happy when they do. What I am suggesting is that they (you) pay attention to the reality of what is happening around you. Being aware of the simple things in life that most people ignore is one of the most important components to desirable outcomes and achievements.

If you think what I am suggesting is a waste of time and just another article on trading psychology, think again. Think of one or two of the biggest mistakes you have made in your life. It could be in trading, a failed relationship or marriage, a bad choice that cost you your job, losing part of your nest egg to a bad investment, and so on. I bet the ultimate reason you made this mistake is because you were not paying attention to a reality that was right in front of your eyes. Do you look back on that mistake these days and say "how could I have done that?" "How did I not see that coming?" It all seems so obvious after the fact. It all comes down to simply paying attention to what is happening all around you, being aware.

We talk about this in the Extended Learning Track (XLT) program. We focus more than anything else on paying attention to the reality of what the PRICE ACTION is telling us. Not thinking too deep but more importantly, paying close attention to the simple supply and demand information the market is always conveying to us. What is important for you to understand is that this important market information is only given to those who listen.

Live XLT Futures Session, June 16, 2009

Figure 1

This picture is a screen shot of the XLT on June 16th, very early, hours before the US stock market opened. We were looking at the S&P E-mini Futures and discussing this market during the session. In the first part of the trading and analysis session, we go through the markets we trade and show people how we find and set up low risk, high reward, and high probability trading opportunities. The two lines on the chart are drawn around a cluster of trading. During that period of trading, price was not moving much, supply and demand appeared to be in balance. All of a sudden, price collapsed from that level with a big red candle, as you can see above. What the market was telling those who were willing to listen at that time was simply that supply greatly exceeded demand at the origin of that decline in price which is why we drew two lines around the cluster of trading at that origin. This is where the sellers were. In the XLT, we call this a "supply zone" or "sell zone." This set up a quality trading opportunity in the near future, for those who were paying attention.

Figure 2

Once the market got going that day and well after we planned out the low risk, high reward, and high probability shorting opportunity in the XLT, price eventually rallied up to that level where we drew our lines. This is where we look to sell short. What makes this a high probability shorting opportunity is best understood when you focus on who is on the other side of your trade, the buyer in this case. The buyers who bought when price revisited our supply zone were making two key mistakes. First, they bought after a rally in price and second, they bought at a price level where supply exceeded demand. These two actions tell us that these are novice traders who take action when the odds are stacked against them. By taking the other side of that low odds trade, we are taking the high odds trade. The S&P short went on for big gains for our XLT Futures members who took the trade. Not every trade works out, this is why we first and foremost focus on objectively assessing risk and then reward. Below is part of an email from one of our hard working XLT members who took this trade in his account:

Email from Zak, an XLT Futures Student

ES 923.00 Short s/o at 923.75 -0.75 points (it looked like it was going to hit my stop at 924) closed the trade manually looking for a better price,

The market was choppy and I could have gleaned a few points on these 2 trades but was expecting a drop and ended by stopping out.

I didn't get a better price so I re-entered. Prices after opening the next trade ranged from 923-919 to 924.25 then down to the close at 909.75 WOW!

ES 923.00 Short- out at 909.75… ***+13.25 points***

Zak

Being able to consistently identify turning points in markets is the key to low risk and high reward market speculation. This begins with being able to objectively quantify demand and supply in any market. To get to that point, you must be able to do something most people can't and that is pay attention.

Instead of reading all the trading books and learning to buy and sell in markets when everyone else buys and sells (no edge)…

Instead of acting on the advice of others who likely get paid from that advice, not from trading…

Pay attention to what is happening in front of your eyes. Pay attention to what is happening around you.

Oh, and one last thing. If someone tells you that you can't do this (or anything), they are telling you that because they can't do it. Success is a choice. If you want something in life, anything, just go get it, period

Demand and Supply and Your Nest Egg

Printable Version

Owning the skill to identify turning points in markets is the key to low risk, high reward, and high probability market speculating. Actually, it is a skill that offers benefits far beyond simple market speculating. Today, I wanted to go over two other benefits that proper demand and supply analysis offers us. For those who pay attention to this simple yet powerful skill, it may mean the difference between a healthy financial nest egg and disaster.

First, let's not forget how and why prices in any markets move. It is because of an ongoing demand, supply, and human behavior relationship. Opportunity exists when this simple and straight-forward relationship is out of balance. Getting back to market turning points in price, understand that the strongest turns in price that also see the largest moves happen at price levels where demand and supply are MOST out of balance. In the Extended Learning Track (XLT) program, we know exactly what this picture looks like on a chart and focus on that more than anything else. Let's apply the demand and supply criteria I write about so often here in the articles to two other parts of your financial livelihood, mutual funds and hedging.

Mutual Funds

While mutual funds are not typically an investment vehicle for the astute market speculator, many people still have them so let's discuss. Did you know you can chart mutual funds? You can chart just about anything that has a value and people buy and sell. Below is a chart of the Schwab Tech Fund. Notice area "A," this is a price level where the chart is telling us demand exceeds supply. This is a "pivot low support" level like we teach at Online Trading Academy. Given that demand exceeds supply at "A," who is selling at "B?" Simple, a novice investor who is not considering the laws of demand and supply. How do I know this? Because they are making the same two mistakes that every novice investor/trader makes. They are selling AFTER a decline in price and AT a price level where demand exceeds supply. As an astute market speculator, we want to buy from this novice investor at "B." Whether you know the difference between "Tech" and "Shrek" is irrelevant. Price in this market, which happens to be a Tech fund, is about to rise at "B."

Schwab Tech Fund

Figure 1

Let's assume you buy into this fund based on your demand and supply analysis and price goes up as it does. This means you are making a good return on your investment, you account is growing… Or is it? If you bought into this fund, you did it with US Dollars. The buying power of the US Dollar constantly fluctuates so you have risk here. This fund can go up as it did and you can still see the buying power of this increasing account decrease. Trust me, this happens often yet people ignore this risk because they think it's a complicated topic. This can be as complicated or as simple as you like. I am not smart enough to complicate it so I will stick to the simple and reality based demand and supply method. Consider the chart below. This is the US Dollar Index which is a basket of a few major currencies against the US Dollar, the Euro taking up the largest chunk of that pie. Here we have "A" as the supply level and "B" is the first time price revisits this supply level. "B" is where we expect price to decline. If you have any US Dollar based assets at "B," the buying power of these assets is about to take a big hit. If you are in the Tech fund position at the time the Dollar reaches "B" and your Tech fund is going up in price, you're not making any money. In fact, you may very well be losing. What is really happening is this… By ignoring your currency risk, you are going to lose buying power to those who don't ignore this risk. It again is a transfer of accounts only in this case, we are talking about your buying power, retirement, and so on. The good news is again, we can use our simple demand and supply analysis to help guide us through the challenging global financial puzzle that determines when we can retire, how much quality healthcare we can afford, what schools we send our children to, how much house we can buy, and so on.

Figure 2

Below is a chart of the SPY. This is the Exchange Traded Fund (ETF) for the S&P. The S&P is the mother of all the global equity index markets which means if you have any stocks in your portfolio or retirement plan, you had better have a good idea where the S&P is going. Let's dip into our demand

and supply analysis and see if we have risk here and what we can do about it. "A" again is the supply level. There is more supply than demand at "A" which means when price revisits "A" at "B," we expect the market to fall. If a decline in price from "B" occurs like it did, global stock prices are declining as well which means any stocks you have in your retirement account are likely to fall in value. We can hedge this risk in one of many ways. We can:

1. Sell the SPY short at "B"
2. Sell the S&P Futures short at "B"
3. Buy Put options on the S&P at "B"
4. And more…

Figure 3

The key, however, is understanding how to objectively quantify demand and supply in any and all markets. Next, understanding that opportunity (or risk) is present when this simple and straight-forward equation is out of balance.

By observing demand and supply to reduce risk, you are using a timeless strategy to ensure our buying power remains stronger than your neighbors. The people that live next door and those who live across the world are who we compete with. This is a global economy and all that matters at the end of the day is your BUYING POWER. Keep it simple and stick to the reality of what the charts are telling you. The REAL demand and supply equation is always right in front of your face. Those who see it attain buying power from those who don't.

Simple Logic Always Beats Complex Illusion

Printable Version

Occam's Razor is an old scientific principle that suggests the simplest answer is typically the right answer to a given question. Often, the obvious can stare you right in the face and you will never realize it, the illusive obvious. The problem is not that illusion is distorting reality and creating confusion. The problem is that for most, the illusion is reality. As humans, we often look deeper into issues when attempting to resolve them which often ends up making the issue more complicated. Ever notice when you get into an argument with a loved one, the most heated part of the battle is typically filled with details? Then, by the next day, you realize that those details have nothing to do with the problem and the real yet simple issue becomes so clear? How many times have you said to yourself: "That was so simple, why didn't I think of that?" The illusive obvious is all around us if you think about it. I focus on the simplicity of markets and trading when writing articles and leading class rooms and Extended Learning Track (XLT) sessions for our Online Trading Academy graduates, but let me tell you something. Due to how complex most perceive this business to be, my job is not that easy. I spend more time peeling away the layers of illusion than I do delivering objective rules most of the time.

The Lemonade Stand

Recently, one of our XLT members (Shawn) sent in an email with a trade he took. He is one of our consistently profitable market speculators and understands the complex illusion traps that eat up trading and retirement accounts. Instead of falling for these traps, Shawn gets paid from them. One analogy I recently used in the XLT to describe how to properly think the trading markets is the simple Lemonade stand. Did you ever have a Lemonade stand when you were a child? Selling a cup of lemonade that costs you maybe $0.05 to produce for $0.50? Maybe even selling that same cup for $1.00? I am sure you didn't realize it then but you were taking some great trades, some real solid buying and selling. Remember how simple it was… You spent maybe $2.00 on the lemons, added some basically free water and ended up with $15.00 or $20.00 depending on the traffic at your street corner location.

Fast forward… Today, instead of being 8 years old, you're 40 and you're having a hard time with your trading, watching your 401 K turn into a 201 K, or worse yet, your retirement account is falling like a rock from the top of the Empire State Building and you don't know what to do. The way to fix this is not to seek the advice of so-called professionals who get paid not on performance but rather from giving you advice. Aren't these the same individuals that got you into this mess in the first place? Instead, bring yourself back to the days of the Lemonade stand. Remember the simple logic behind how you reaped huge profit margins and treat all these trading markets that appear to be so complex with that level of simplicity. I will use Shawn's real trade as an example of using simple logic to derive consistent income and build wealth.

Part of Shawn's Email:

Hello Sam,

Today I made two short entry trades and would appreciate your input on these trades. I believe they were both good trades but I would like a second opinion.

The first is on AA, it came right into a supply level on the daily chart where I shorted it. My entry price was 12.08. My first target is at 10.85 which is 3:1 and my second is 10.03 which is 5:1.

Thanks You,

Shawn W.

Shawn's Trade

Figure 1

The supply level above is supply because of the pattern, Rally – Base – Decline (a pivot high). The fact that price can't stay at that $12.00 area marked supply in the upper left means that supply exceeds demand. When this is the case, price declines. Over to the right, Shawn understands that someone who buys after a period of buying and right at a price level where supply exceeds demand is making the same two mistakes every consistent losing market speculator makes. This group of novice buyers who bought from Shawn when he sold short are caught in that world of complex illusion. The last thing they are thinking about is the Lemonade stand. This faulty thinking is rampant in the financial world and the people who get paid from this illusion-based thinking are those who realize that the action you take when speculating in markets is EXACTLY the same as the action you take in other parts of your life when buying and selling.

Focus on Those Who Bought From Shawn

1. They bought AFTER a rally in price. This is a big mistake. This is like walking into a car dealership, seeing a $30,000 car they like and offering the dealer $40,000. I am sure these buyers who bought from Shawn would never take that crazy action when buying a car. They likely would offer the dealer $25,000 but because they are in the trading markets, they throw all simple logic out the window. The lesson here is to treat these markets the SAME as when you go buy a car.
2. They bought at a price level where the chart told us supply exceeds demand. Let me ask you… When driving a car and you see that 500 feet in front of you is a huge concrete wall that is very thick. Question: Do you step on the gas pedal or the brakes? Simple answer of course. I don't even think you need driving lessons for that one. Why then would you buy a stock or into any market at price levels where supply exceeds demand? It does not make logical sense to take this action which is why the simple logical mind typically gets paid from the complex illusion-based mind.

What is also ironic is today's lemonade vs. the lemonade from years ago. For those over 30 years old, we know lemonade as lemons and water. Today's lemonade is a packet of 30 chemicals that may very well cause your insides to glow some blue/green color mixed with plastic bottled water that comes from who knows where. There are some real benefits in keeping things simple and real.

Breakout Entries

Printable Version

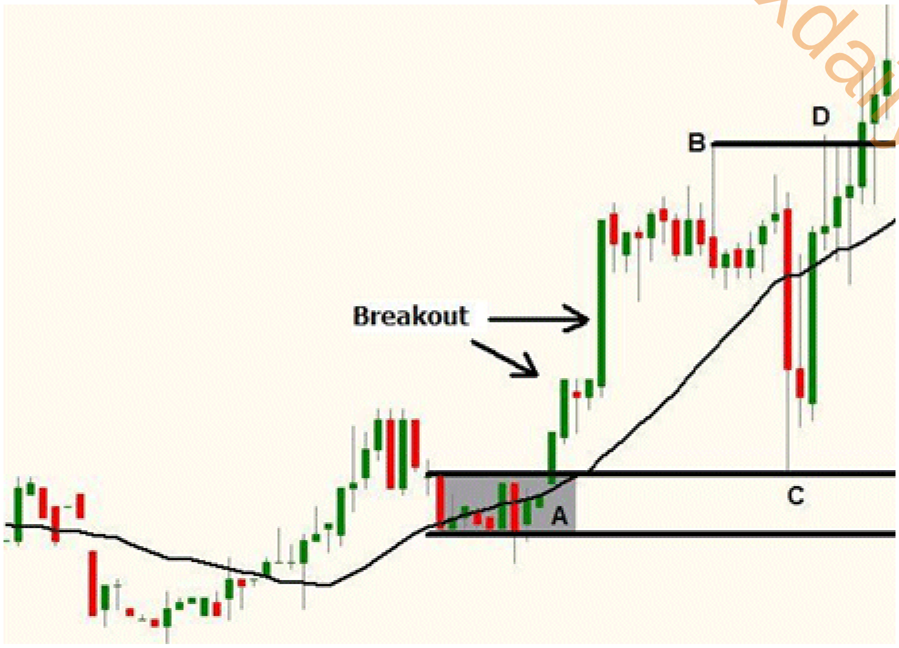
I have been in the trading business for over 15 years as a trader, fund manager, and trainer, beginning on the floor of the Chicago Mercantile Exchange. While I feel like I have seen it all, the one thing that still surprises me is how most traders handle breakouts. Most traders seem to let emotion complicate what can really be a simple, rule based, and very profitable strategy. Trading breakouts can be high risk, high stress, low reward, and low probability or this strategy can be low risk, low stress, high reward, and high probability. The difference lies in how you enter into this type of position.

Before getting into the details of the strategy, it's important to understand two key components of markets.

1. **Why do prices move in any market?** Price in any market turns at price levels where demand and supply are out of balance. The consistently profitable trader is able to identify a demand and supply imbalance which means knowing where the REAL buyers and sellers are in a market.
2. **Who is on the other side of your trade?** Trading is simply a transfer of accounts from those who don't know what they are doing into the accounts of those who do. The consistently profitable trader makes sure a novice trader is on the other side of their trades.

The Logic

Notice area "A" in Figure 1 below. Area "A" is the origin of a strong rally in price. Most breakout traders will look to buy as price breaks out to the upside from area "A". This type of breakout entry is typically the "sucker bet". Traders see price moving higher from area "A" and they give in to emotion and buy into that initial rally. The problem is that by the time you buy the breakout of area "A", price has moved so far that it becomes a high risk and low reward trade. Instead, I sit back and let the breakout happen because that breakout tells me that there is a demand and supply imbalance at area "A", this is exactly where the buyers are. Next, I wait for price to return to area "A". When it does at "C", I am a very interested buyer as I am confident I am buying from a novice seller. I know this because the seller at "C" is making the two mistakes that every consistent losing (novice) trader makes. First, they are selling after a period of selling and second, they are selling at a price level where demand exceeds supply.



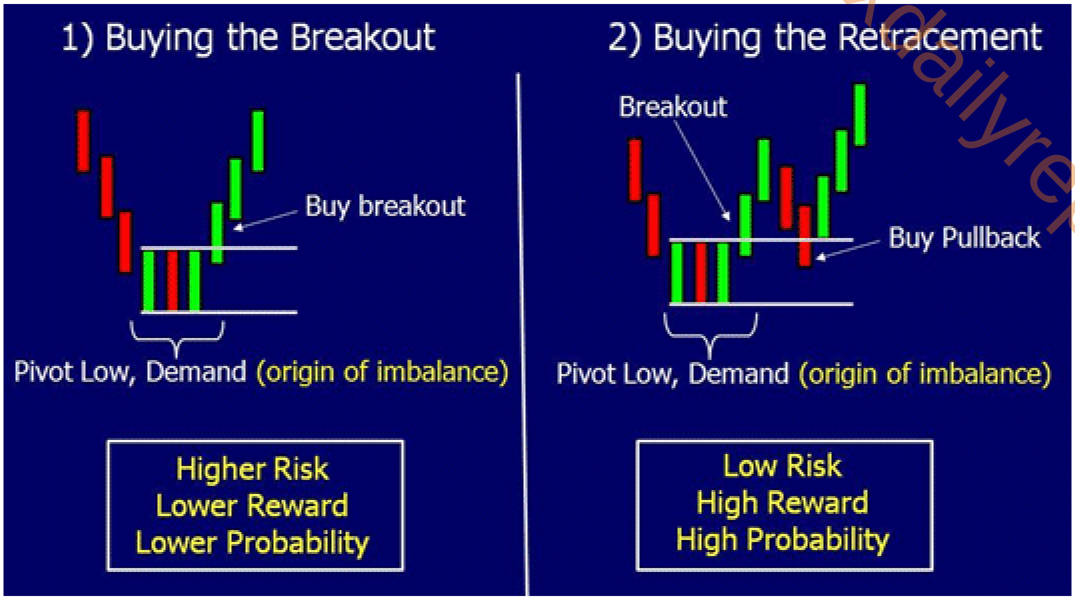
The Setup

For longs, identify a market in an uptrend by using a 20 period moving average. Next, identify the origin of a strong move and draw two lines around the price action to create a demand zone (area "A"). Make sure the demand level has the pattern "Drop-Base-Rally" as that is key. In other words, area "A" should be preceded by a decline in price which makes it higher probability. Then, make sure there is a significant profit margin (profit target). This would be the distance from area "A" to "B", the highest high of the initial breakout before price returns to "A" at "C."

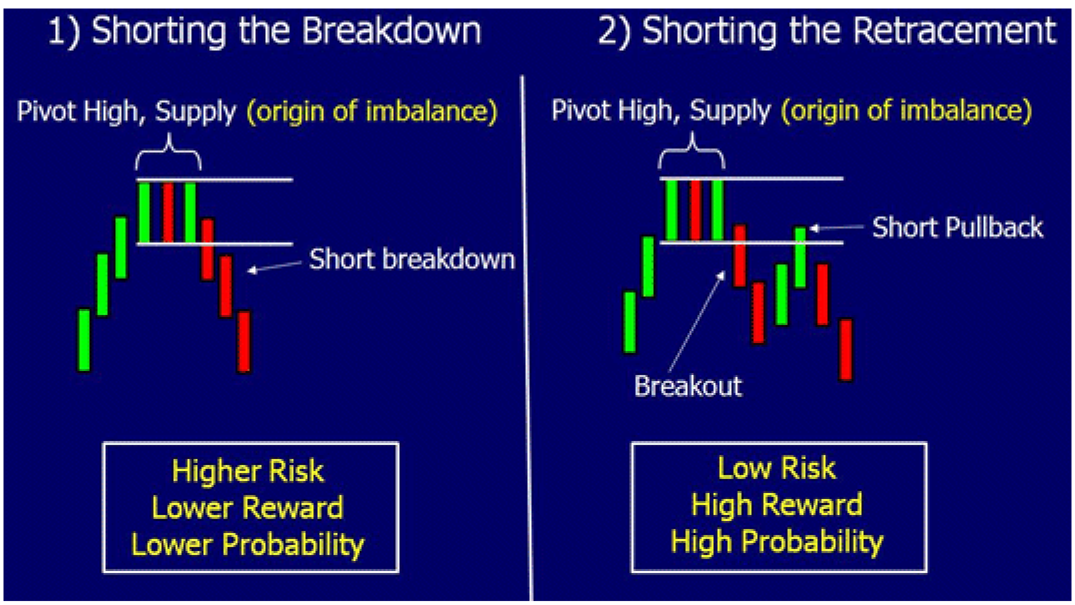
The Action

Buy at "C" when price touches the top black line and place your protective sell stop just below the lower black line. Adjust your position size so that you are not risking more than you are willing to lose. Place your profit target based on the high of the initial breakout "B" which in this case would have you selling for a profit at "D."

The Breakout: Two types of entries, very different odds



The Breakdown: Two types of entries, very different odds



The proper breakout entry works in any market and any time frame. A key component to making these work that is beyond the scope of this article is this: When taking any buy or sell entries in markets, make sure you know exactly where price is with regard to the larger time frame supply / demand curve. Whether you trade Stocks, Futures, Forex, or Options, understand that behind all the candles on your screen in all these markets are people and their emotions. Most will fall for the emotional trading traps set by fear and greed, others get paid from this novice group.

The Straight Answers to the Most Frequently Asked Questions

Printable Version

I thought I would use this week's piece to answer some important questions that many people likely share. Getting the right answers in an industry that is fraught with misleading information can be a daunting task for the new market speculator so I will do my best to give you the straight answer to some of the most frequently asked questions.

Question: How long will it take me to become a successful market speculator?

This is a frequently asked question. After being in the business for so long and seeing so many new market speculators, the answer is crystal clear to me. Typically, what determines how long it takes to achieve consistent profitability in trading is the amount of experience you have BEFORE you get the proper training. As an instructor, I tend to have the easiest time training someone who has little to NO experience. This is because they have not been poisoned with bad information which means money losing "decision filters" floating around in their head. The new market speculator that has been to many seminars and read all the trading books tends to take the longest to reach their trading goals.

The key piece of information here is to make sure that when you are ready to get educated on how to properly speculate in markets, you get the right information the first time. This is key because it is that first impression with any information that is engrained at the cellular level. Once it's there, it takes lots of effort to remove and replace with proper information. For the new market speculator, knowing proper trading education from bad is easier said than done. If you have no experience, how do you know the difference? The answer I always give is to use your simple logic filter. If information seems too complex or doesn't make sense to you, chances are great that it is poisonous information that will drain your trading account. Think about it, you already know how to buy and sell things properly in other parts of your life, don't you? If you said yes, you're already a good trader. All you need is someone to show you exactly how to do what you already do by looking at a price chart.

Email Question:

Hi Sam

Could you please help me with the attached chart for GENZ. I am a little confused. Today, August 3rd, the price opened up at 51.99. I had a plan to take the trade long at 51.35 based off the July 23 demand level or which I thought was a good demand level, with a stop at 51.00.

It was a stock that was "down graded". There was also bad news on the stock. I don't normally look at news and try to focus on the chart alone. I went back later after I was kicked out to see why there was such a huge sell on the stock and found out there was really bad news.

I looked for the drop base rally with a huge move out from that area which brought me to the July 23rd level.

Was I looking at this correctly?

I really would appreciate your help with this!

Figure 1

This email came in and the mistakes made here are common so let's go over them. The areas marked "supply" and "demand" are what the student/trader marked on the chart. The circled area was a pocket of sellers that the student didn't notice.

Hi – Thanks for the email…

1) It looks like there was supply level not that far above which limits your potential profits and also tells us there are some sellers close which is not ideal when thinking long.

2) This was the third time price came back to this level so caution on that. The more recent rally was not that strong. This combined with the supply just above means low odds.

3) The S&P is not at support (demand). Timing your trade to the S&P is not everything but it sure is important.

Just some thoughts to help increase your odds and low risk profits.

Sam

Question: What is a good trading book to read?

If I had a dollar for everytime someone asked me this question, I don't think I would need to trade. Here is the straight-forward (but not popular) answer. In my opinion, everything you need to know about how markets really work and when to buy and sell in any and all markets is found in two books. The first is your Economics 101 book from high school or college. This book has everything you need to understand demand and supply. Second, revisit your Psychology 101 book which is likely sitting on your bookcase, near the Economics book, loaded with dust. This book teaches you what you need to know about people and how we think. Specifically, how most people make decisions. I have written about this much in the past but it's all in that book on your bookcase that you have not read since your teacher made you. This is not a joke, try it and let me know what you think. There are some good trading books out there, don't get me wrong, but the vast majority are written by people who, well, write books and don't trade.

Once you have done this, come see us at Online Trading Academy and we can show you how to see demand, supply, and human emotion on a price chart. When you understand this, the low risk, high reward, and high probability trading opportunities in any and all markets become very clear.

Same Tools, Different Thoughts

Printable Version

I have made my mark in trading and trading education by thinking differently. One of the things I am always fascinated with is how we are taught to do certain things and how we learn, specifically when it comes to anything that has to do with competing. In the United States for example, we compete for jobs, money, better this, and better that… Have you ever realized that in the biggest democracy in history, our school systems don't teach classes on how to compete? In capitalism, there is typically a winner and a loser unfortunately, yet people in this country are never taught in school how to compete. In fact, it's the opposite. The natural education path of our school systems train everyone to think the same way. This is bad news for those who have those herd mentality blinders on and great news for those who focus on the art of competition. It all begins with thinking differently. If you bring herd mentality mindset to competing in the trading markets, you will likely hand your account over to those who think different and think the markets properly.

The books that teach conventional Technical Analysis tend to teach it the same way which offers little to no edge. Be careful taking the same action the masses do in the markets; they are not the ones who consistently profit, they lose. Let's take a look at two ways to use these same conventional principles a bit differently than conventional thought.

Trend Analysis

Most people know all about assessing a trend. Typically, people look to see if the market in question is making higher highs and higher lows for up-trends or lower highs and lower lows for down-trends. Others use moving averages to determine whether they are sloping up for up-trends or down for down-trends. These are the two most popular ways to assess a market's trend. Another way to assess a trend is to look at the pivot lows in up-trends and pivot highs in down-trends. Let's take the up-trend for our example. Looking back at recent prior data in any market on a price chart, it is easy to see what the current trend is. What is equally important is to assess how healthy the current trend is and when and where it may end. One way to do this is to measure the distance between the lows of the pivots that make up the up-trend. Notice the up-trend in the chart below; the distance between the pullbacks (pivot lows) is decreasing as the trend moves higher. This means the trend is becoming weak and is likely to end soon. The logic behind this is that a strong trending market does not pullback often. If it does, it is not a strong trending market anymore. Keeping with our constant supply and demand theme, remember that a trend on any time frame is really a supply and demand imbalance moving back into a price level of temporary balance. This is a larger time frame chart but the assessment can be done in any market, and any time frame.

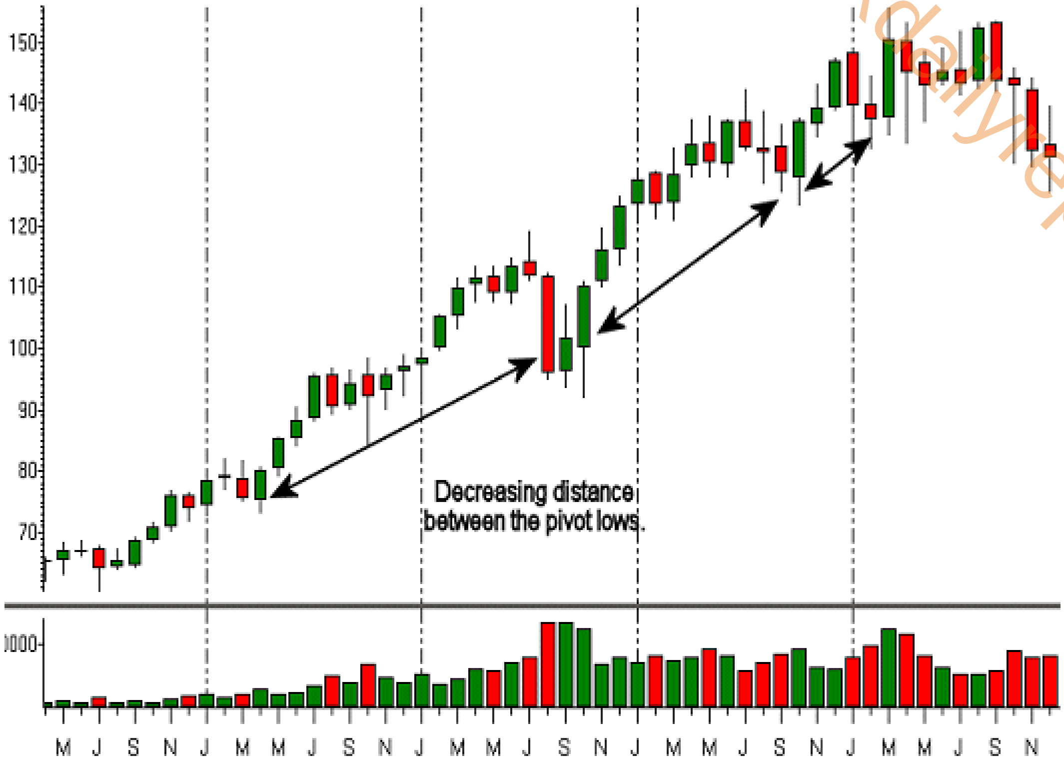


Figure 1

Moving Averages

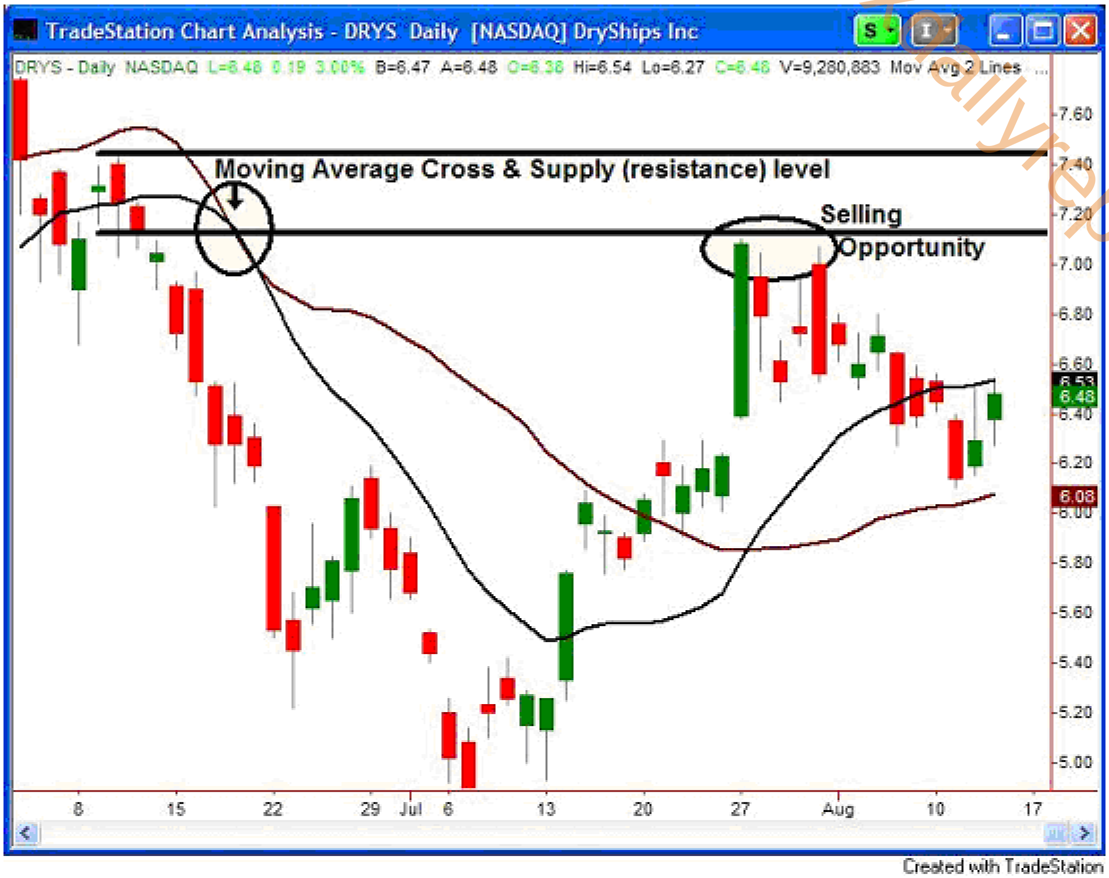


Figure 2

Moving averages are another common piece of conventional Technical Analysis. The two ways most traders use them are first, to determine trend by looking at the slope of the moving average. Second, they use the moving average cross to time an entry (buy or sell signal) into a position or an exit out of a position. This technique is very flawed in that moving averages by definition will lag price; they have to. Adding any tool that lags price to the execution portion of your trading plan adds risk and we don't want that. Again, instead of thinking the same way as your competition, let's take a slightly different view of moving averages in a way that may help us gain an edge over our competition. Notice in the chart example, I have circled the moving average cross. Moving averages cross because there has been a relatively strong move in price. At the origin of a strong move in price, demand and supply are out of balance. Price levels where demand and supply are out of balance are where we typically find low risk, high reward, and high probability trading opportunities. So try identifying moving average crosses in the past and let that lead you to investigate the price action in that area. Chances are high that you will find a key demand or supply level there. In other words, when you find a moving average cross above or below current price, look slightly to the left of the cross and investigate the price action as that is where the origin of the strong move likely was which means a demand / supply imbalance.

These are two examples of how you can take conventional Technical Analysis, look at it and use it slightly differently than your competition in hopes of attaining an edge over them. While I don't use these two examples in my own trading, I make sure that my tools and strategy are VERY different than my competition, almost opposite. This is the only way to be consistently profitable speculating in markets. The purpose of today's piece was to encourage you to think differently and not follow the herd and their very flawed thought process.

Where Most People Get It Wrong

Printable Version

The world of market speculating is made up of everyone from the active day trader to the longer term investor, speculating in all kinds of markets and asset classes. People all around the globe pushing buy and sell buttons each day in hopes of achieving income and wealth. Never in history has there been so many books written on how to speculate in markets. Each weekend in many cities around the world, there are educational seminars given on how to "get rich" from trading. With so much education on how to properly speculate in markets out there, why is it that most people lose money? How can this be? The answer is twofold and is the focus of this piece.

First, it's because of most of the books and seminars. Most books and seminars are loaded with conventional Technical and Fundamental analysis which tends to teach you how to buy when everyone else buys and sell when everyone else sells (herd mentality) which is high risk, low reward, and low probability. Conventional Technical analysis is based on pattern recognition that has people buying after price has rallied and also offers buy and sell signals based on indicators and oscillators that always lag price which means high risk buying and selling. Conventional Fundamental analysis offers buy signals only after good news is present and company numbers are solid. Where do you think the price of a stock is by the time this good news is offered to you? If you guessed high, you're correct almost always. Remember, the only way to be consistently profitable when buying and selling in markets is to have a strategy that has people buying after you buy, at higher prices than you paid and selling after you sell, at lower prices than you sold at. Conventional Technical and Fundamental analysis do not help us in this regard; the basic principles of these two ways of thinking ensure you will buy and sell with the herd when it's too late which means high risk and NO EDGE. Come on, if proper market speculating was as easy as reading a book, wouldn't every librarian be a millionaire?

The second reason most people lose money in the global trading markets, which is really part of reason number one, is that they throw all simple logic out the window. When you go to buy a car and you're at the dealership and see the car you have your heart set on, you see the price and it's $20,000. Do you go to the dealer and say, "I like this $20,000 car so much, I want to pay you $30,000 for it?" Of course you don't do that, you likely offer $17,000 or something like that. In trading, most people wait for confirmation of higher prices and then buy which is the opposite of how they buy things outside of trading; this makes no sense.

I once had a gentleman go through my training program and I will never forget the day I met him and spoke to him about the program. He approached me and said he wanted to learn how to trade and join my program. I said, "Before we commit to this, let's have a conversation or two and make sure this is right for you." You see, I always want to make sure whoever is coming into the training program has the best chance in succeeding. I don't want to waste their time or mine. My first question was, "What do you do for a living now?" He happened to own and run a pizza chain that he had just sold. As soon as he said that, I knew he had the best chance at doing this because he already knew how to make money buying and selling. In fact, there was nothing about buying and selling in a market that I could teach him that he didn't already know; I will explain this in a minute.

Our first lesson went like this… I asked him to tell me about his business and he did. He explained that the whole business comes down to the price of cheese. I asked him three simple questions: 1) What is the average price of cheese? "Around $2.00 a pound," he said. 2) If the cheese you buy is selling at $4.00 a pound, how much will you buy? He said, "As much as I need." 3) If the cheese is selling at $1.00 a pound, how much will you buy? "As much as I can and store it," he said. I then told him that he was already a great trader and that there was nothing I could teach him about trading that he didn't already know. What I could teach him however is EXACLTY what this proper buying and selling looks like on a price chart. He was already buying and selling in a market properly, he just didn't know what that looked like on a price chart. This was an easy task for me because he already had the foundation of how you make money buying and selling down and had made plenty of money from it. The most important part of today's article for you to understand is this:

The more you can bring the mind set and rules that you use each day to purchase everyday items at the grocery store, appliance store, and so on into your market speculating, the better you will do. Do you ever use coupons to save some money? If you do, you already know how to buy at a low price. Take that same exact mind set and action into your trading world. The mass illusion is that proper trading is somehow different than how we properly buy things in everyday life.

Many so-called professionals like to complicate the process with smoke, mirrors, curtains, and sleight of hand. They do this to trick you so that you will transfer some of your account into theirs without you realizing it. The key for you is to keep everything "real." Use your simple logic filter to ensure you will not lose some or all of your account to illusion. For your review, let's walk through a real trade we took in the Extended Learning Track (XLT), the graduate program at Online Trading Academy.

Extended Learning Track (XLT)– August 19th

Figure 1

Above is a screen shot of a live XLT Stock trading session on August 19th. This trading and analysis session began an hour before the US stock market open. This is so we can scan the markets using our "top down analysis" approach, quantify supply and demand, and pre-plan our trading opportunities. The NASDAQ market seen above was gapping down right into a price level where demand exceeded supply (circled area). Simple logic translation: The NASDAQ was briefly on sale and was about to become more expensive. We assume there is demand at that price level where the lines are drawn because when price was at that level previously, it rallied quite strongly from that level. This rally can only happen because there is more demand than supply at that price level. Why then would someone sell at that level, on the gap down in price, thinking price is going lower? Perhaps there was some negative fundamental news in the market. One thing the seller on that gap down failed to consider are the basic laws and principles of supply and demand and the simple logic we use when buying and selling things in other parts of our life, outside of the trading markets.

QQQQ (NASDAQ)– August 19th

Figure 2

As you can see above, the market opened, price moved considerably higher, and our pre-market demand and supply analysis paid off as many XLT members enjoyed low risk profits from this work. The key, however, is that we didn't fall prey to the many Conventional Technical and Fundamental analysis traps that many market speculators fall for. Instead, we applied the same simple logic we use to buy and sell anything in other parts of our life, outside of trading.

Below, Cisco (CSCO) was a stock we also found that morning that had a nice demand level that lined up well with the broad market (NASDAQ) Demand. Had we focused on the bad news at the open of trading, we would not have been interested buyers in CSCO. Using the same logic we use when we buy our favorite avocados at the grocery store, we see that CSCO was selling at wholesale prices that morning and that these prices were not likely to be offered too long. This low risk opportunity to buy CSCO on sale, based on the CSCO chart and its alignment to the broad market opportunity on Aug. 19th, worked out well. These wholesale prices we enjoyed quickly turned into retail prices.

Figure 3

There is nothing wrong with following the rules of a trading book, just make sure you are the author and that your strategy has you buying at wholesale prices and selling at retail prices. To do this, start with using all the powerful buying and selling knowledge you already possess and use on a daily basis outside of the trading world. Bring this key but simple strategy into trading and you will soon be spotting "blue light specials" all over the place

Foolsville, Part 1

Printable Version

Growing up, I tried to do what I was told to do much of the time, whether I agreed with it or not. After all, what did I know, I was just a kid. In school, I was taught what everyone else was taught and therefore, learned what everyone else learned. To be honest, this never really felt right to me. At the time, I didn't know why it felt uncomfortable but something didn't sit right with me about how I was learning. I ended up spending as much time in school as I needed to in order to keep those around me happy, but nothing more. I have a very close relative (whose name I won't mention) who did very well in school, much better than I, almost straight A's in college and grad school. In the end, he had about 5 more years of schooling than I. He then went into the corporate world and ended up becoming a manager for a tech firm. I ended up becoming a trader, money manager, and trading educator. We are 5 years apart in age, have a good relationship, and speak all the time.

So what is the difference between him and me these days? He is not happy with his job; I love mine. He spends most of his days working, traveling for work, sometimes late into the evening. I tend to spend my mornings working, the rest of the day doing other things outside of trading that are important to me. He makes an average annual salary, I make more than six times his annual income. Before I go on, please know that I don't value quality of life with money. A strong income does, however, buy more life choices and allows you to spend more of your life smelling the roses instead of working to grow someone else's roses. He is incredibly book smart and has a knowledge base that far exceeds mine. While he has all the fancy degrees framed and hanging on his wall, it is he who calls me for career advice, not the other way around. He can't understand why he has trouble finding a job that pays him well and a job that he enjoys. When we talk about this, I always give him the same advice. I tell him, "If you want to command a higher income, simply learn how to do something others can't do." He has the hardest time comprehending this concept and the reason is because in order to attain the ability to do something others have a hard time doing, you have to think differently than others and this is the issue. He spent his entire childhood and young adult life in conventional school, learning to think how everyone else thinks. So much so that it as if he almost has blinders on and does not even realize he is stuck in the world of conventional thought. Let me take you deeper into his life so you can understand better what separates the people who tend to reach their financial goals from those who don't.

The biggest difference between he and I is where we live. He lives in a town called Foolsville. In case you have never heard about this very interesting town, I will explain. People in Foolsville all do the same thing. They eat the same food, wear the same clothes, drive the same cars, read the same books, and so on. The list is endless but everyone in the town does the same thing. I asked my relative about this and asked him why everyone does everything the same way? He said, "Why not?" I then asked why everyone in Foolsville buys the same type of car? He said, "Because that's what everyone drives." They all have an i-Phone and download the same Apps; it's really quite funny. He also showed me where Foolsville was on a map. Now this was interesting; it's actually shaped like a perfect "box." Another thing I found interesting is that when you are inside Foolsville, you never realize that you are in the box. All this strange information got me thinking...

Given my profession, I asked him how trading and investing is handled in Foolsville. He filled me in on their strategy and told me I would love it because it was so easy. He said the strategy was the exact same one he had learned in school. He explained to me that once there is good news in a market, price is going up, and all the indicators are pointing up, everybody in Foolsville buys at the same time. I then asked him if they made money with this strategy and he said, "No, not really." When I asked him if he as ok with this, he replied, "Not really, but no one here makes money with their trades and investments here so it's fine." He went on to tell me that each day, there is this giant pile of money that is transferred out of Foolsville and directly deposited into the accounts of the those who live elsewhere. I was shocked and had to ask him how he felt about this. He replied, "We don't like that but we can't do much about it." I started to really think and realized something profound. In my trading world, which consists of my trading and the education and guidance I provide in the Extended Learning Track (XLT) program at Online Trading Academy, I am buying from those in Foolsville when they sell and I am also selling to Foolsville residents when they are buying. Yikes! I couldn't tell him this; it might ruin our relationship. To explain better, let me show you a recent trade from the XLT - Stock Mastery program.

SPY (S&P), September 1st, pre-market

Figure 1

On the morning of September 1st, I was leading XLT members through our pre-market analysis which is when we plan out our low risk, high reward, and high probability trading opportunities. We noticed that the S&P had a supply (resistance) level above current price. This is the area above, the price level marked by the two black lines which create the "supply zone." The reason we call this a supply level is because when price was there, it could not stay at that level and gapped down from that price level. Understand that the only reason this happens is because there is too much supply and eventually, no demand. When this happens, price declines. This means that when price rallies back up to that area, we would have a low risk, high reward, and high probability shorting opportunity offered to us at the supply level. The only issue was that price was opening lower than that level. September 1st, we needed a rally in price. We not only needed a rally in price for our shorting opportunity, we needed someone to buy after a rally in price and right at that supply level. Then I remembered the strategy those who live in Foolsville use to buy into markets. All we needed in the XLT was for price to rally and then the Foolsville folks would likely buy from us at the supply level.

Financial Service Sector (XLT, C, GS, MS, COF)

Figure 2

During the same XLT trading and analysis session, after finding the S&P supply level, I noticed that the whole financial service sector had the same supply level. Above is a picture of that live session. Inside the sector, I noticed specifically that Goldman Sachs and Citigroup were the prime candidates as they had clear supply levels just above that morning's opening price. These levels and the S&P supply level suggested that the odds were stacked in our favor for our shorting strategy that morning, once the market opened. Again however, in these stocks, we needed buyers to buy right at these supply levels so we could sell to them and obtain the low risk short position we desired.

SPY (S&P), September 1st

Figure 3

Shortly after the market opened, price began to rally and reached our S&P supply level. This is exactly where those who live in Foolsville buy which happens to also be where we sold short. It wasn't just us. You see, it's quite simple. Members of the Foolsville financial committee and residents of Foolsville are the buyers at that supply level. Everyone who lives outside of that strange looking box on a map are the sellers. Why would someone buy after a rally in price and right at a price level where the chart is telling you supply greatly exceeds demand? Because that is how they are taught, which means that is how they think and thoughts lead to actions and repeating actions build habits. Anyway, price declined quickly and strong after we sold short to the Foolsville buyers. This is how money is transferred out of Foolsville and directly deposited into the accounts of residents outside the Foolsville box.

Goldman Sachs (GS) and Citigroup (C), September 1st

Figure 4

As the S&P reached its supply level, so did the Financial Service Sector. Goldman Sachs and Citigroup met our XLT entry criteria and dropped like a rock. Foolsville buyers bought right into supply because that is when their strategy has them buying which offered us very low risk shorting opportunities in the S&P, this sector, Goldman Sachs, and Citigroup. By the way, for those interested in a real estate investment, Foolsville is a booming town. The population never stops growing, guaranteed, it's amazing!

The interesting but sad truth is that the people who live in this town don't even know it. My hope in writing this piece is not to gloat about gains or beat up my relative; it's to open your eyes to the reality of how wealth is transferred from those who think like everyone else thinks, into the accounts of those who think in reality-based terms. Instead of believing everything you are told and read, try thinking about how and why prices move in any and all markets (hint: supply and demand imbalance). Next think about how you make money buying and selling anything. Then, combine these two thoughts and you are on your way. There is nothing wrong with reading a book on money and markets, just make sure that you are the author.

Have you ever lived in Foolsville? Worse yet, do you live there now? For some, Foolsville is a permanent address which is unfortunate. There are two things I can tell you that will help ensure you never end up a resident in Foolsville. First, look at a map and look for the perfectly shaped "box;" it's easy to spot. You see, you have to be outside the box to understand that there is a box. When traveling or thinking of a place to move to, avoid this area of the map at all costs. Don't worry though, if you can see the box, you will never end up in it. Second, realize that market speculation, just like life, is a competition and the only way to succeed when you compete is to have an "edge" over your competition. This can only be attained by THINKING DIFFERENTLY, outside the box.

If you have ever spent some time in Foolsville, send me an email and let me know

Motion Into Mass

I wonder if Isaac Newton realized when drafting his laws of motion and mass that these principles also precisely defined the movement in price in any and all markets? Newton first described the relationship of forces acting on a body and the motion of that body in his work, *Philosophiæ Naturalis Principia Mathematica*, Latin for, "Mathematical Principles of Natural Philosophy." Below are Newton's first and second laws in Latin from the original 1687 edition of *Principia Mathematica*.

Figure 1: Source - Wikipedia

Does this look like a trading plan to you? Well, it depends on your point of view. I would argue that within the pages of Principia Mathematica lie the most key ingredients of a successful plan for speculating in markets. This important topic can turn into an entire book. Therefore, I will focus in on last week's trading from an Online Trading Academy Futures course I instructed and cover motion and mass in the S&P. While every trade didn't turn into a profitable trade, most trades did work fine and the week was very profitable. We accomplished this using nothing more than Newton's simple and straight-forward logic.

Mass = Demand and Supply

When I was on the trading floor of the Chicago Mercantile Exchange, how and why prices move was very easy to see because I had the orders right in front of me. In front of me on the trade desk, the largest stack of sell orders (supply) above current price is where price would stop rising and then decline. The largest stack of buy orders (demand) below current price is where price would stop declining and then rise. In other words, when price reached levels where demand exceeded supply, price would rise. When price would reach levels where supply exceeded demand, price would decline. *Mass = Demand and Supply, motion occurs between demand and supply.*

SPY (S&P) (30-minute chart)

Figure 2

Above is the S&P chart from our class last week. Notice the initial supply level in the upper left corner of the chart. This supply level is the "Mass"... It is a price level where supply exceeds demand. When you look at the level, we see that price gapped away from the level which means supply greatly exceeds demand, this is why price gapped away from the level. "A" represents the first time price revisits the Mass (supply). This is when the odds are very high that price will decline, motion into mass. In the Extended Learning Track (XLT) class, we shorted the S&P market at this level and price declined after our low risk entry. A week later, I was instructing a Futures course and price rallied back up to that level (B). This was the second time price rallied up to that level which means there is less supply (Mass). You see, each time price moves into the mass, some of the mass is removed (absorbed) by the demand (buyers). The short trade at (B) was taken because price gapped into that level suggesting a very novice buyer was entering the market, someone who was buying after a rally in price and right into a price level where supply exceeds demand. This buyer obviously never read *Principia Mathematica*.

Mass Removed, Motion Occurs

At (C) and (D), price again revisited the supply level and notice, the declines in price from this level were more and more shallow. This is because the shift in supply and demand is slowly taking place. Some of the mass (supply/sell orders) is removed with each rally into this level as mentioned earlier. At (C) and (D), we didn't enter trades at these points because objectively, the supply / demand relationship at this point suggested shorting was high risk as price was now likely to move higher, through this once powerful supply level.

The next day in class, price began to move deep into this level which was hardly a level anymore (E). Given that the mass was removed, motion higher was likely to occur. Therefore, we looked for Demand (Mass) levels below current price on smaller time frames for low risk buying opportunities. One student shouted across the room, "Sam, look at the 5 minute chart, quick." As I looked, I saw price crashing down, right into a smaller time frame demand level. The risk was low because our entry was very close to our protective stop and the reward was high because the supply had been absorbed above. In other words, the mass was removed which allowed for motion. The trade worked out well for our student. Newton would have bought as well, I think.

SPY (S&P) (5-minute chart)

Figure 3

At the end of the day, this is all a supply and demand numbers game at each price level. Newton had it right and still does. As humans, we love to complicate things that are really quite simple. Newton didn't invent one thing or master one concept. He had a "belief system" that allowed him to figure out many things that most people never consider because of a belief system that focused on the reality of how things work. A minor shift in your thought process to what is real is the answer. Instead of looking for picture-perfect candlestick formations and patterns, learn to quantify demand and supply in the market and understand that it is nothing more than the simple laws of motion into mass. Proper trading is easy; having the proper belief system is the hard part. Keep in mind that most people don't see the simple realities that are right in front of their faces every day.

For those expecting Foolsville Part 2, this week, look for it in the next week or two. I have decided to take a quick trip to Foollsville to have a look for myself. I have set up a meeting with the Mayor and some of the financial advisors of Foolsville for next week. Foolsville Part 2 will be a summation of my findings and experiences during this most interesting journey

Losing To Win, It's All In Your Perception

I am a winner

My whole life, I have been very involved in sports. Ice hockey, soccer, golf, and tennis are the sports I love to compete in. Playing hockey at such a high level, I learned how to win, consistently. There were always teams in the league that would win consistently and others that would lose. When we would play a team that had a bad record, sometimes they would be leading the game for a while but I never worried. It was almost like we could be down by a few goals and we knew we were going to win. This is because of attitude. Sure enough, most of the time no matter what the score was during much of the game, we would come back and win. The winning attitude almost always beats the losing attitude. The winning teams play with one thought, that's "to win." The losing teams also play with one thought, "not to lose." The latter equates to a lack of confidence and fear and that is a recipe for consistent failure.

Like many of you, I love the game of golf. I have a childhood friend whom I play with sometimes. While our skill levels are near equal, I almost always beat him. What happens is that as soon as he hits a bad shot, and I mean a really bad shot, he can't recover mentally. He allows this shot to have such a big impact on his game that the rest of the round of golf is a disaster for him. I, too, have a bad shot once and a while; we all do. The difference is that I don't let it have anything to do with my next shot. I know the bad shot will happen sometimes which means it's actually a part of winning the game. As soon as my friend hits a bad shot, he is finished, I win, game over.

I love to win, I hate to lose

Having so much success in a sport growing up, you feel like there is nothing in life you can't do. No matter what the task, not succeeding is never an option or thought. So, you can imagine how shocked I was when I entered the trading world and was told that you have to be a good loser in order to win. HA!! That had to be a joke I thought... There is no way I am going to lose because I hate losing, I hardly ever lose. It didn't take long to realize that this was 100% true, I had losses and that didn't sit well with me. I tried to eliminate them but as I did, I also eliminated the winning trades, as well. This was not good; I hated losing. Slowly though, I figured out the secret to trading from experience and a friend of mine. It all depends on your definition of losing. In my early trading days, I had the wrong definition of the word "loss."

Perception is everything

Think about all the setbacks and losses you have had in other parts of your life; financial, relationships, job promotions, and more. Haven't they always made you stronger and led to something "better?" Losing is a very necessary part of winning in my humble opinion. As our founder at Online Trading Academy, Eyal Shahar says, "Life is all about perception." If I had a dollar for every time I have heard him say that, I wouldn't have to trade. He is so right... The key is to categorize. If I perceive each trading loss as a loss or losing, it's not going to sit right with me; I can't stand losing! However, if I put each trading loss in its proper place which is in the "winning" category, all of a sudden a trading loss is a must for winning.

Apple Inc. (AAPL)

I was in the Extended Learning Track (XLT) class, leading a session and I pointed out a trading opportunity in a popular stock, Apple. I went over the factors that led me to this conclusion and everything seemed fine.

Figure 1

I pointed out that area "A" on the chart appeared to be a resistance (supply) level where we may have some sellers. As price rallied back up to that level at "B," I was an interested seller. Some of the 300 or so people in the XLT asked about area "C." I said that was also a supply level and could be a good one but price was going to hit area "A" first. At "B," price touched the level and actually fell for a bit; the trade was profitable. A couple of days later, the unthinkable happened; AAPL rallied through the level and stopped out for a loss. How could I have been wrong? How do I deal with this loss? What is wrong with my trading plan? I better email an Online Trading Academy instructor and figure out my mistake.

Well, if you're thinking along the lines of the last four or five sentences, you are on the wrong mental path. That loss should be NO big deal and small. It should represent a tiny percentage of your account. Your position size should be such that you are not risking more than what you determine to be a truly acceptable loss. You should make sure this number, which is really your ultimate risk, is a number you are very comfortable with. In one of my lower risk accounts, I keep the losses to $1000 or less. Let's take a look.

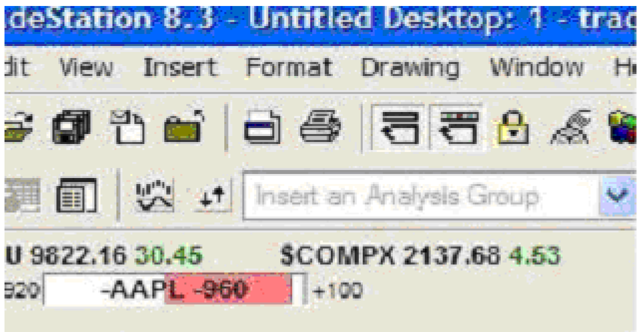


Figure 2

Here is a picture of the AAPL profit and loss window just as the loss was taken. If that $960 dollar loss appears scary to you, then that is simply too much risk for your comfort level. If the loss itself makes you cringe with anger or fear, you simply have the wrong perception of losing. You have "losing" in the wrong category. The loss is taken and we move on. While Area "A" represents the picture of a supply and demand imbalance that typically causes price to turn, this one didn't have as much supply as I thought. As price went past supply area "A," it quickly zoomed up to supply area "C." Applying the very rule-based strategy that I employ, it was time to short again.

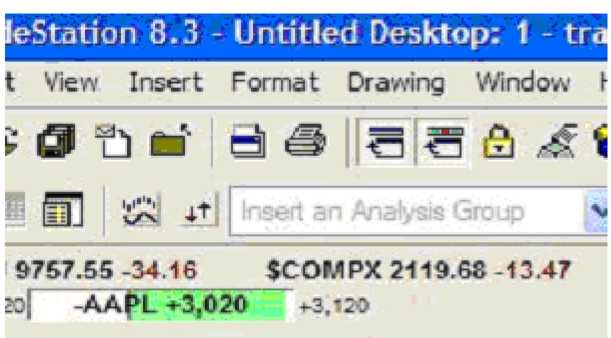


Figure 3

As price reached that level, there were plenty of willing sellers; supply exceeded demand. Price quickly turned and reached a 3:1 reward/risk profit threshold. Based on rules, the protective buy stop was moved to breakeven which meant this was a free trade, the risk was minimized to no loss. Taking another "bite at the apple" was profitable. Had I focused on the first loss being a losing activity and felt bad about it, the gain on the second trade never would have happened because of a fear of being wrong. Taking a small loss in trading is not wrong at all, it's the right thing to do and a MUST if you are ever to enjoy gains.

While I was writing this piece, a couple of trading opportunities in the S&P Futures came up. With no fear of losing when trading because the action is not losing, it's winning, the trades were taken.


Fill Window

	Time	Exch	B/S	Qty	Price	Product	Contract
1	10:42:04.95	CME-P	S	5	106375	ES	DEC09
2	10:42:04.96	CME-P	B	2	106500	ES	DEC09
3	10:42:04.96	CME-P	B	3	106500	ES	DEC09
4	10:42:04.96	CME-P	B	5	106475	ES	DEC09
5	10:42:04.96	CME-P	B	2	106375	ES	DEC09
6	10:42:04.96	CME-P	B	2	106375	ES	DEC09
7	10:42:04.96	CME-P	B	1	106375	ES	DEC09
8	10:42:04.96	CME-P	S	10	106800	ES	DEC09

Exchange	Product	Contract	BuyQty	SellQty	NetPos	P/L (Last)	AvgE
			15	15	0	1562.50	

Figure 4

This is a picture of one of my Futures trading accounts that I use more for demonstration. This is live and real money, however, not a simulator. At the end of the day, the account had a gain of $1,562.50 from two trades taken during the trading session. There were two trades taken this day, one was a loss and the other was a win. Like Las Vegas, I don't care at all that I was only 50% accurate that day. I know that as long as I stick to my rules, I am running a strategy that is very profitable because the odds are stacked in my favor and the risk management is proper. I know that I will only achieve profits if I include and accept losses. When you shift your attitude and understand this, the word "loss" all of a sudden means the same thing as the word "win." On this day, the first of the two trades was the loser. Just like AAPL, if you go and beat yourself up over a loss or think you did something wrong and become paralyzed by fear and failure, you will stop executing your plan and never see the gains.

From my experience, the rules that truly stack the odds in your favor are not that difficult. I go over these rules each week in the Extended Learning Track (XLT) program. This is the easy part of my job in the program. The hard part is helping people shift perception of loss to the win category. I meet people often that actually think I and other instructors hardly ever lose. They want to take our classes because they think they will learn to never lose and only have winning trades all the time. We have a high winning percentage but we certainly have losses. None of us like to lose, I know firsthand from competing in sports. Just like in sports, however, falling down in practice is a must if you are going to skate faster. Striking out from faster pitches is a much if you are going to make it to the big leagues. Swinging your driver harder and slicing the ball 100 times is a must if you are ever going to hit a 300 yard drive straight.

Imagine what would happen to the casino if they tried to eliminate the losses. They would be out of business and none of us would have a playground in the middle of the desert to enjoy. Losing in trading is great as long as it's proper losing. To become a professional winner, you have to first become a professional loser. This is a road block that many people never overcome which is why many people fail at market speculating. It's the few market speculators with the proper perception that get paid from those with the wrong perception, the transfer of accounts. If you want to change, change your perception of loss

Questions and Answers – Things You May Want To Know

Printable Version

It's been a busy few weeks but I do have a little break in my schedule. I am going to use this time wisely and take that trip to Foolsville. I was able to reschedule my meeting with the Foolsville Mayor and the finance board so I will get some questions answered and report all this to you soon. When I called to make my travel arrangements, they suggested an airline I never heard of before. When I checked prices, I realized that this was the most expensive way to get to Foolsville. I quickly called my Foolsville contact and asked them why I would want to take that airline if they are the most expensive. He said "because that's the airline we all use." This is going to be a strange trip but I am really looking forward to it. By the way, thanks for all the great emails about the Foolsville article, they were fantastic and very funny.

Today, I thought a question and answer piece would be beneficial. Let's go over some frequently asked questions from your peers.

Hi Sam,

I wanted to start trading FESX so I can trade the gap fill at 11pm CA time. Where can I learn more about the market? For example, is there a pre-market or does it just open at 11 CA time with no premarket?

And, if so, is there a way to pick levels before the open?

thanks,

Andrea

San Diego

Andrea - Great choice! The FESX (Euro Stocks 50) is one of the best Futures markets in the world to trade in my opinion. This market is a Eurex product. More information can be found on the Eurex website: www.eurexchange.com. We also cover this market often in the XLT - Futures Trading class. FESX does not have an overnight session so it does actually close for a period of time each session, much like the U.S. stock market. This creates a unique benefit for Futures traders as almost each day, FESX has a gap. As astute market speculators, we love gaps. The price point in this market is ideal, as well; each point has a value of 10 Euros. Spend some time on the website and email any questions you may have.

Hi Sam,

I have read your newsletter today and would like to ask you a question regarding that AAPL trade you have described. Looking in the chart I am seeing three potential shorting opportunities that you have highlighted - area A, C and D. One could think that if you sell near A and price moved high - it is very likely that price will not move above C and then not above D.

So, why not to keep short position at A and take another short position again at C? Then cover both positions when price drops to the target level. I see that kind of set up pretty often - would it be considered adding to loser position, but some people may call it scaling into the position? I am kind of confused what makes the difference between adding to a loser and scaling into the position. Please clarify.

thanks,

Alex

Alex, great question. The answer is all about your trading plan. I think your question/suggestion for scaling into the position is great, it's a very smart thing to do but here is the most important part: Make sure you have a plan for this. It will only work if it is built into your plan. I have one strategy I use that has me scaling into a position for entry and it works well. The "plan" is key because you have to know exactly how you are going to manage the risk. If you scale into a position without a clear plan, you run the risk of digging a deep hole on the risk side. You have to figure out where the entries will be and exactly where your protective stop will be placed. Then, you will be able to figure out your position size so that you are not risking more than you're willing to lose. To answer the part in your email about "adding to a losing position," this action would only be adding to a losing position if it was not planned in my opinion. Lastly, when scaling into a position, don't think you need to add in equal parts. In fact, I add larger size the closer I get to the protective stop. Just some thoughts to keep in mind if you decide to go this route.

Hope all is well -

Quick question for u - I think I have a good feel for how to find (1) intraday buy and sell points (2) swing buy and sell points.

What do u do differently to find "Position" buy and sell points?

Many tx.

Kind regards,

Philippe

Philippe - Like all your emails, good question. The answer is really simple, "nothing." When we buy and sell anything in any time frame, we are looking for price levels where demand and supply are out of balance. We are looking specifically for these imbalances that are also associated with large profit margins. When you are looking for "position" buy and sell points, you are looking at larger time frames, that is the only difference from intraday and swing trading. To keep it low risk, high reward, and high probability, make sure you are looking for LARGE profit margins. Think of some of the British Pound trades we have taken in the XLT, the S&P buying opportunity we found in March, and others you have found and sent in email. The key piece they all had in common was "large profit margins".

Sam,

During your swing trading class your workstation uses the VIX as an indicator. Since I don't have that data I cannot get a VIX chart. Is there another indicator I can use instead?

Thanks,
Sam

Hi

The VIX (CBOE Volatility Index) is a great "odds enhancer" for short and longer term trading. It offers much needed insight into the current fear and greed in the stock market. When the VIX is high and reaching a supply (resistance) level, and the stock market is low and reaching a demand (support) level, odds are strong that the stock market is going to turn and trade higher. Conversely, when the VIX ix low and reaching a demand level, and the stock market is high and reaching a supply level, odds are strong that the stock market is about to decline. The VIX really shows us who is buying protection for their long biased positions in the stock market. What happens is that the masses don't buy the "insurance" until after the car accident which is too late. As astute market players, we can take advantage of this by monitoring the VIX chart. If you don't have the feed in your platform, you can always Google "VIX chart." I just did and found a nice chart of the VIX on yahoo: http://finance.yahoo.com/q/bc?s=%5Evix. This free chart is delayed but that's fine, we are not looking for perfect entry points on this chart. Instead, you should take a look at this chart once a day if you're a day trader and once a week if you're a swing or position trader to time your entries.

Hello Sam!

I really appreciate all your great instruction!

I'm a Swing Trader and have been taught to look at Support and Resistance and number of touches in the past days, weeks, months, to determine the strength of the S/R. In listening to you, Michelle and Steve, it seems you are only concerned with the most recent Supply and Demand levels to the left of price and do not look back any further than that to see if there are any S/R levels that fall between the most recent Supply/Demand. Is that correct and if so why are historical S/R not important?

Thank You Much!

Cheers!
Joe

Great question Joe. I don't look at recent supply and demand levels as better levels that those found in the past. The key for us at Online Trading Academy is to find the "fresh" levels. These are levels that have NOT been revisited since they were formed. Often, these will be recent levels but sometimes we have to look very far back to find "fresh" levels. I would argue that levels found farther back in time are better and there is a reason for this. First, I have the experience from many trades over the years but even if I didn't, think the simple logic through. If price is revisiting a "fresh" demand or supply level from long ago, that means the price is really far out on the supply and demand curve, way out at an extreme in other words. The rubber band is very stretched so to speak... This means that the odds are stacked in your favor for these opportunities. Often, levels found from long ago will warrant a little more risk for me in my personal trading as the probability of success and profit margin associated with a distant level are so ideal.

Foolsville, Part 2

Printable Version

Typically, I write these articles from the comforts of my home, when things are nice and quiet, and after plenty of thought. Not this time... As I am writing, I am on an airplane cruising at 34,000 feet on my way home from Foolsville. This trip was such an experience, I could not wait to start writing and sharing it with you. I was there two days and really made the most of my time. In the end, I finally figured out something I have been wondering about for a long time. I will go over that in a bit.

Day 1

I arrived and immediately went to pick up my rental car. I had a meeting with members of the finance committee. Being the Director of Online Education at Online Trading Academy, I was able to land this high-level meeting with them. When I got to the car rental counter, I asked what types of cars were available. They told me they only had blue, four-door sedans. "You must be very busy," I said to the desk clerk. He replied, "No, those are the only cars we rent." When I asked why, he replied, "That's the car everyone drives;" I knew I was in Foolsville... I thought it was a bit strange that all the rental cars were exactly the same until I drove out of the parking lot and onto the main road. The more I drove, the more I realized that all the cars on the road were blue, four-door sedans - amazing!

I arrived at the Foolsville Finance Committee Center, all ready for my big meeting with the smartest Fools in town. The agenda for me was to gather information on their trading and investing strategy and let them know what I thought of it. One of the gentlemen informed me that the only thing that would interrupt the meeting was if a buy or sell signal came up in the markets. Other than that, I had their full attention. Before we went over strategy, they informed me that the entire town pools their funds when it comes to trading. I asked them what the purpose of this was and they replied, "Since everyone is taught to buy and sell at the same time and we all have the same philosophy, we decided it made sense to combine all our funds and make one big trade at a time." The Foolsville trading strategy is a very rule-based scoring system; let me explain. They have seven pieces of criteria that may or may not be present for a trading opportunity. Each one of the seven criteria is worth ten points. The higher the score, the better the trading opportunity according to their strategy. So, a seventy pointer was the best trading opportunity they could have. I will explain using an example of a Foolsville Sell Setup, where the action is betting on a down side move in price, selling short.

Foolsville Sell Setup

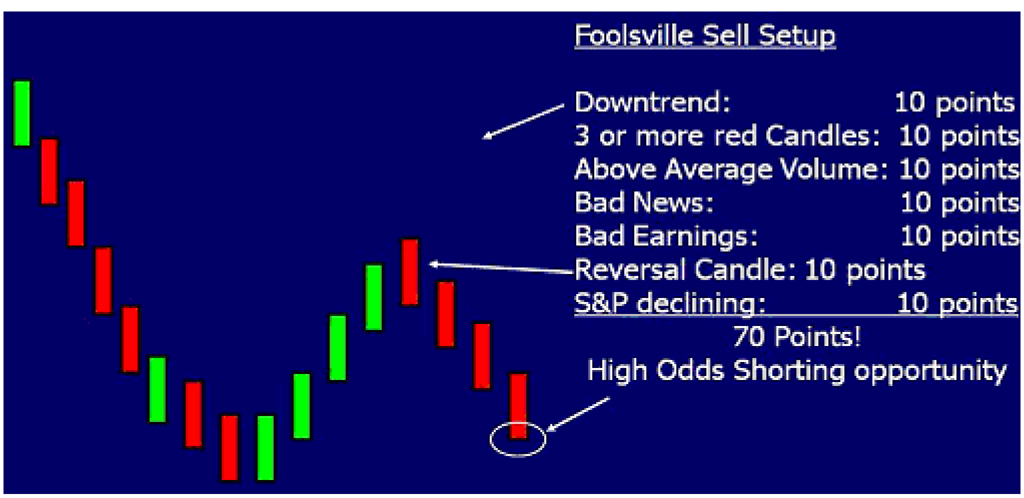


Figure 1

After explaining the sell setup to me, they went on to explain the buy setup which was just the opposite of the sell setup. While this was certainly not a strategy I would ever consider using, I did connect with it for some reason, though at the time, I could not figure out why. I had some questions... Why would you Fools buy after a period of buying? "Because others are buying, the candles are green, there is an uptrend in price, good news, and good earnings," they said. I asked them where price was when an opportunity scored out to be 70, a really high odds trading opportunity, according to the Foolsville trading strategy. They replied "very high." Next, I hit them with a bombshell question which was this: "If all your criteria are true, your buying opportunity is a 70, price is high, and you Fools buy, who buys from you?" As I looked across the table at these nice and friendly Fools, they were all speechless with this question. It was as if they thought the world was flat and someone just walked in the room with proof that it was actually round. They began to look around the room at each other, searching for an answer. As I sat during this period of confused and uncomfortable silence, I thought to myself - "These poor Fools have never considered the basic principles of how you profit buying and selling anything!" When you buy, others have to buy after you at higher prices or there is no way to profit. Finally, one committee member said, "We don't really care Sam as long as we are entering the market allllllllllllllllllllllllllllll together." At that point, the meeting was coming to an end and it was time for me to give them my opinion of the Foolsville strategy. As we stood up, I thanked them for a most informative meeting. My final words to them leaving the meeting were, "Fantastic strategy, keep up the great work."

Day 2

I really didn't sleep well, tossing and turning much of the night. This is odd because I always fall asleep in a matter of minutes and sleep very well. I could not figure out why but I had this restless energy ever since my meeting with the finance Fools. Anyway, it was my last day. The plan was for me to lead an Online Trading Academy Extended Learning Track (XLT) session from an office near the Fools' finance office from the day before. It was a day trading session in the XLT - Stock Mastery class. As I began to do my pre-market analysis, one of the finance Fools poked his head in the office and said "Good morning, Sam. I am monitoring our accounts in the office next door, let me know if you need anything." I then put my headset on and began walking our XLT members through our market analysis, setting up trading opportunities for the morning. That morning, there was some pre-market news about a trade dispute between China and the U.S. and this was causing some pre-market selling in the S&P and NASDAQ markets.

Pre-market News – September 11, 2009

This morning's stock futures are pointing to a lower opening on Wall Street amid reports of an escalating trade dispute between China and the US. - Source: Zachs

I took a picture of the XLT that morning to share with you here. As I was going over the markets with my students, I pointed out that the NASDAQ (QQQQ) had a clear demand (support) level a bit below the prior day's close, the chart from my trading workspace seen below. If price reached this demand level once the market opened, we would be interested buyers. This is our low risk, high reward, and high probability buying opportunity for a day trade.

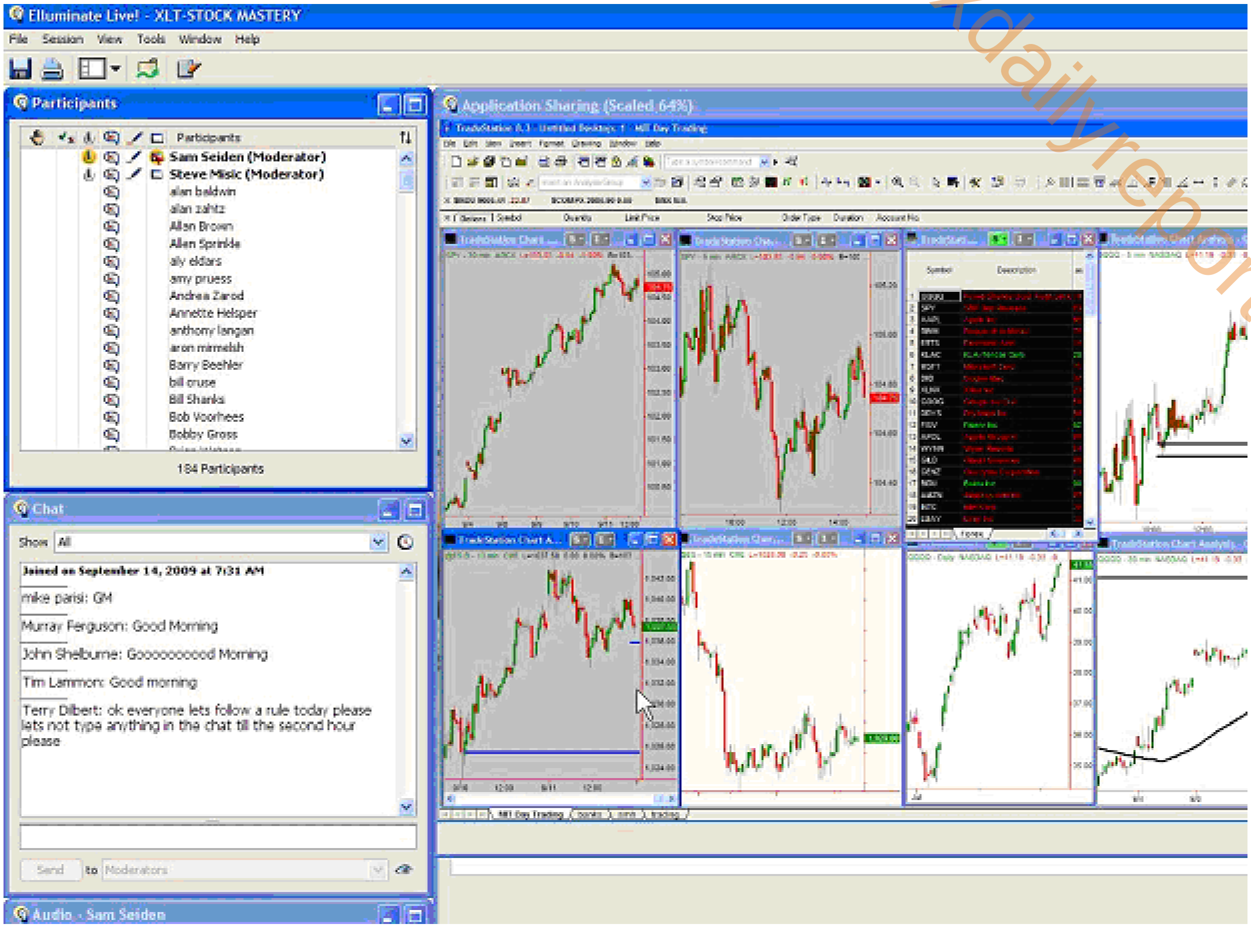

Elluminate Live! - XLT-STOCK MASTERY
File Session View Tools Window Help
Participants
Sam Seiden (Moderator)
Steve Misic (Moderator)
alan baldwin
alan zahtz
Allan Brown
Allen Sprinkle
aly eldars
amy pruess
Andrea Zarod
Annette Helsper
anthony langan
aron mirmelsh
Barry Beehler
bill cruse
Bill Shanks
Bob Voorhees
Bobby Gross
184 Participants
Chat
Show All
Joined on September 14, 2009 at 7:31 AM
mike parisi: GM
Murray Ferguson: Good Morning
John Shelburne: Goooooooood Morning
Tim Lammon: Good morning
Terry Dilbert: ok everyone lets follow a rule today please lets not type anything in the chat till the second hour please
Send to Moderators
Audio - Sam Seiden
Application Sharing (Scaled 64%)

Figure 2

Figure 3

As the market opened, price moved around quite a bit. Eventually, it began to decline, moving closer and closer to our pre-determined demand level which is where we want to buy. All of a sudden, it reached our demand level and just as it did, I heard a scream from the room next door. "Sell Short," said the Fool. "Sell Short quickly," he yelled again, "The market is going lower!" This is when it hit me; I instantly figured out what was festering in my mind this whole trip. After so many years of wondering who was on the other side of my trades, I had finally figured it out - it was the Fools! They were selling when we were buying, right at demand. This question has been in my head for more than 10 years. Who exactly would buy after a period of buying and right into an objective supply level? Who exactly would sell after a decline in price and right into an objective demand level like the XLT NASDAQ trade above? It was my new friends, the Fools from Foolsville. Finally, after all these years, all my trading questions had been answered. Price hit our demand level and moved significantly higher. Our trade worked out well and the Fools lost money quickly. As I mentioned in Foolsville, Part One, these foolish trades are how and why money is transferred out of Foolsville and into everyone else's accounts.

Before leaving, I had a chance to sit down with the Mayor of this town filled with friendly Fools. He was an ancestor of a great line of Fools. His name was Mayor Franklin Fool IIII. He was a proud man who loved his town and the people he served. We spoke for a bit. I thanked him for having me as a guest from Online Trading Academy for a couple days. As we were wrapping up our chat, I asked him what the key component of his leadership was? I wanted to know more about the belief system that was leading this town of Fools. After all, he had been the Mayor for a long, long time. He put his arm around me and pointed to a plaque on the wall which had written on it, "The Foolsville Belief System." It read: "*Make decisions based upon the actions of others, after they make it.*" After reading this message, all I could think about was getting out of this place as fast as I could. After all these years, I had finally found the people who are on the other side of our trades. The people that I write about, talk about, lecture about in XLT. I actually shook their leader's hand! This was a huge experience for me.

I arrived at the Foolsville Airport and as I entered the check-in area, I noticed there were two check-in counters. One had a huge line, and the other had no line at all. I asked someone in the big line why everyone was in this long line and no one was going to the counter where the attendant was free? He replied, "Because everyone is in this line, silly." "Yikes," I thought, "Get me out of here!"

If you happen to live in Foolsville and want to change, it's not going to be easy, but here is what you need to do to get started. You have to start with changing your thoughts. You have to think like you have never thought before. Then you will act like you have never acted before. Don't think in conventional terms, think in reality based terms.

Instead of reading all the trading books and learning to buy and sell in markets when everyone else buys and sells (no edge, that's Foolsville)...

Instead of acting on the advice of others who likely get paid from advice, not from trading...

Pay attention to what is happening in front of your eyes. Pay attention to what is happening around you. Pay attention to all the simple realities of how markets really work and how you profit from buying and selling anything; this is what most people never see even though it is always right in front of their faces. It is fascinating how people tend to focus on the past and think about the future, yet ignore the simple realities of the present. In the highly competitive world of trading, what side are you on? Do you trade like a Fool or do you trade with a Fool?

If you have a Foolsville story, I would love to hear it. Hope this was helpful, have a great day

A Smart Trading Group, Getting Smarter

I can always tell how much someone knows about trading and markets and how well they are doing by listening to their questions. With each new year, questions, in general, have become more and more intelligent which means the competition is getting stronger. Recently, some important questions have been sent to me by Online Trading Academy students. For your benefit, I thought I would share them and the answers with you in this piece.

Good Morning Sam,

This AM I took 2 trades a minute into the open as both hit lower levels while the S&P had a big green candle. I managed the trade moving the stops to 2:1 and exited when the corresponding ETF was .10 away from a 60 minute zone. Made 3:1 & 5:1. But both stocks had not hit their respected 60 min zones and did so when the SPY and S&P hit their 60 min zone. The ETF went thru its zone to a previous premarket high. Was I too impatient or is this a shoulda/coulda?

Thanks,

Barbara

Sam –

Nice trading, Barbara. It sounds like you stuck to your rules and had two very nice trades but are wondering if you could have gotten more profit out of the trades. First, it looks like you took these trades very early, near the open of trading. This is a smart move so long as price is opening into a demand or supply level; sounds like that was the case. This is most often when prices are at levels where demand and supply are most out of balance. You took your profits because the sector/broad market was nearing a 60 minute level; this is also a smart move. While price ended up going past that level offering you more profit, I would still say you made the right choice by *sticking to your plan. Take a moment and realize how powerful your plan is as it gave you 3:1 and 5:1 payouts that morning. If you never did any better than 3:1 and only had winning trades 40% of the time, you would be making a fantastic income; almost any trading institution in the world would hire you right away. Could you have gone for more gain? Sure. However, that action would also likely hurt your gains and invite more losses. You're trading supply and demand and catching the moves. No one will ever get the entire move, all the time. Great job and have a nice day.*

Sam,

I was in the Sunday Forex XLT yesterday. I took the long position on the GBPCHF that we reviewed in class. I took 2 contracts and was happy to find myself up about $2,800 at 6:00 am Tuesday morning. The only negative with the GBPCHF is that I entered the trade at about 7:00 pm with a market order and got about 10 pips slippage. The price hit my level and started back up. I continually tried to get in with a limit order and could not get filled so was forced to use market if I wanted in. Still the trade worked out great. Thanks for the class and for pointing out the setup on the GBPCHF because usually I don't look at any but the majors.

W. Jones

Sam-

Nice trading. Slippage will occur sometimes for two reasons. First, you're trading spot Forex. Taking the proper XLT entry that you took meant you were buying at demand when price was about to turn higher. This means that the broker who is on the other side of your trade had to sell at demand and they don't want to do that; they know they will lose. Therefore, they are going to make sure they sell to you (for your long entry) at a price that ensures they will not lose. The second reason is because this is not one of the "major" markets and slippage is more likely to happen in this group as it can be a bit thin. Great trade and profit while you were sleeping. Using the technology to set and forget your trades is so important. It means you don't have to sit in front *of your computer all the time and it also takes the human emotion out of trading which is key.*

Good morning Sam,

In an XLT you mentioned that if there is a price turn with volume in the morning session, you'd play that level every time. This morning price rose to 1052 and turned south. That price turn honored RBD from yesterday afternoon. As price rose back towards that 1052 level again at 9:15 am, would you look to short that level? If yes or no, could you explain why?

I opted not to because the move was so small but I just want your thinking on this.

Thanks so much,

Tim

Sam-

Either I misspoke or you heard me wrong. Understand that the most significant turns in price happen with low volume most of the time. While the trading books suggest high volume at price turns; I disagree for a logical reason and because I have watched and traded the markets for so many years. The logic: Price turns at price levels where demand and supply are out of balance. The most significant turns in price happen at price levels where demand and supply are most out-of-balance. The more out-of-balance demand and supply is at a price level, the fewer the trades you will get, hence, low volume. Price spends the least amount of time at levels where the imbalance is huge; again, the volume will be low in this case. So, I look for lower volume turns as that suggests a larger imbalance of willing demand and supply.

Hello Sam,

My name is Jermal, I just want to start of by saying that I have listened to all of your lessons on FxStreet over and over again. I've been trying to tame this FX market for about two years now with no luck. I've been funding somebody else's account. But with your way of teaching, I really feel like

I understand now; but my problem is I'm having trouble entering the market. First, I go to the daily and mark down levels to make sure that I'm not running into any larger time frame levels, then I go to the 30 min to set up my trades for the day, and finally, to the 5 or 15 to enter once the market hits a 30 min level - but I'll get the go ahead signal on the 5 or 15 and hesitate. I'll start thinking what if my levels are wrong? Any advice would be greatly appreciated. Thanks.

Sam-

Thanks for the honest email. Trading is a very emotional career, if you let it be that is... I wrote an article about 3 or 4 weeks ago entitled, "Losing to Win, It's All In Your Perception." This piece should really help with the issue you speak of above. The answer you're looking for is to know whether the level (trade) is going to work or not, before the trade happens. Obviously, we don't have crystal balls and there is no certainty. Once you realize this, and I mean really get that concept, your mind will quickly shift into a mode of searching for "better odds." Have a rule-based plan that stacks the odds in your favor and then simply execute. Today, even that is easier with the ability to set and forget your trades with technology.

Hi Sam,

I had my best day ever today – unfortunately, I was only trading 10 shares at a time but at least it's real money.

BBBY Long at 39.75, out at 39.97 – profit/share 22 cents
BBBY Short at 39.99, out at 39.93 - profit 6 cents (Shouldn't have taken this one – target too close but it did work out)
BBBY Long at 39.97, out at $40.17 – profit 20 cents.

Total on BBBY = 48 cents or $480 – that would work for me as a day's income, especially in 1 hour.

Also:

QLD: Buy: 52.18, sell 52.43 – profit 25 cents

So that's $480 + $250 = $730 if I were moving 1000 shares instead of 10!

Any suggestions on how to scale up, Sam? For me, it's much harder with 1000 shares – I am more likely to get nervous!

Anyway – thanks so much for your part in helping me.

Keith

Sam-

Nice job! You're obviously seeing the levels and also executing properly. The issue is fear of moving to larger size. This is very normal. Don't move from 10 to 1000. Instead, move from 10 to 100 and make sure you are rule-based. One of the biggest issues losing traders have is they scale up too fast. Often, that is a recipe for complete failure; I have seen that happen. Because you made such a smart choice in trading 10 shares during your development process, you are very likely to handle the scaling process well, also. If and when you move to 100 shares, please keep me posted. This is a process. Those who take your proper development action with position size typically get paid from those who don't. Lastly, be happy with those profits. The next time you go to Starbucks and order that fancy latte, keep in mind that the person on the other side of your trades paid for it.

Keep those questions coming! This road to self-empowerment in the financial world is a marathon, not a sprint. There are no cutting corners or shortcuts if you want to succeed. Astute market speculators are the ones who asked the right questions, both to themselves and to the right people. When you get an answer, make sure the answer makes logical sense to you and also make sure it's a simple answer

Market Traps, Novice Traders Beware

There is a hand signal we use on the trading floor. The signal is to put your hand to your throat like your choking yourself. The name for this signal is "hung." Not a pretty visual I know but its meaning is just as uncomfortable. A trader will do this when they are stuck in a very bad losing position. Most often, it was someone buying right into supply (resistance) right before price collapsed, or selling short right into demand (support), right before a strong rally. Whether the action was a mistake or simply foolish trading like they do in Foolsville, the result can be catastrophic which is where the floor trading hand signal, hung, derived its name.

A more common name for this in the world of technical analysis is the Bull Trap and Bear Trap, two of my favorite market opportunities. Before diving in and learning what this looks like on a chart and how we trade this, it is important that you understand how to properly think this setup.

The Logic

When there is a news or economic event that invites the masses into the market to buy and price happens to be into an objective supply level with a significant profit margin below, we have a Bull Trap scenario. What happens is that an above average number of buyers buy after a rally in price and right into supply with plenty of room for price to fall below. So, once the last buyer buys, the masses are stuck buying the high price, no more buyers, price collapses. Most of those buyers now have to sell for a loss which only helps price slide lower. It was, however, the combination of the positive event and price being at a level where supply exceeds demand that was key. An "event" can be in the form of news or a popular chart pattern such as a breakout, for example.

The Setup

Figure 1

The charts above are the S&P; small time on the left and a weekly chart on the right. This picture was taken during one of our XLT - Stock Mastery sessions. The topic of that session was "Advanced Bull and Bear Trap Strategies." On this day, a Bull Trap trading opportunity was at hand; here is how it worked. Notice the chart on the right, the S&P, was trading right into the origin of that gap down from last year. Keep in mind that gaps represent the picture of a strong supply and demand imbalance. In this case, it was a gap down which meant that supply exceeded demand. Knowing where price is at in the larger time frames will always be a big help when short term trading or swing trading. It lets us know which side of the market is carrying the best odds. Knowing that the S&P was reaching some larger time frame supply, let's now focus on the smaller time frame chart on the left. The supply level shaded in white is the area that represents the origin of that gap. The circled area on the chart is a high that is higher than the prior day's high, here is where the Bull Trap begins. When price breaks out past that prior day's high, the majority of market speculators are going to become very bullish because of the breakout. This is a trap because what these masses don't realize is that price is breaking out into a price level where supply is likely much greater than demand. Instead of jumping on that novice bandwagon, it is typically a better choice to be the seller to these buyers as they are falling for a trap. The demand level below was the first target; the trade worked as planned. As always, had it not worked, the risk was small and as I always say, proper risk management is the key to long-term success.

The Rules

- When a significant event invites buyers into the market and price is at supply and you have an appropriate profit margin below, sell short.
- When a significant event invites sellers into the market and price is at demand and you have an appropriate profit margin above, buy.

Mastering the Mental Side

If you own a car dealership and are in the business of selling cars for profit, who do you want walking through your doors? Choice A: people who work at other car dealerships and sell cars. Choice B: people who are buying a car for the first time. Of course, we are going to choose choice "B." People who work in the car industry know the real value of cars which means it will be harder to sell to them at desirable prices if you're the dealer. The new car owner knows much less about the true value and will also give in to emotions such as greed. This individual will bring your dealership a much higher profit. Make sure you are trading with market speculators that have no idea what they are doing. Sell to them when price is at a level that you know is too high. Buy from them when price is at a level that you know is too low.

Conventional Technical Analysis Strategies, A Flawed School of Thought

Conventional technical analysis strategies have been around a long time. Some say this school of thought dates back more than one hundred years. While it is popular with traders and its rules and beliefs fill entire sections at all major book stores, I would argue that this school of thought really offers little to no edge in the world of market speculation when it comes to strategies. I have written on this topic before and each time, I receive some not so happy e-mails from those who disagree with me, but that's ok. If we all agreed, we would not have markets that move. Everyone would be willing buyers and sellers at the same price.

Before we dive into this topic, I want to review part of an email with you, sent to me from one of our very good Extended Learning Track (XLT) members, Shawn. He wanted to share a swing trade he had made in the stock, Alcoa (AA).

From: Shawn W.

To: Sseiden@tradingacademy.com
Sent: Fri, Jun 12, 2009 1:34 pm
Subject: Trades I Made Today

Hello Sam,

Today I made two short entry trades and would appreciate your input on these trades. I believe they were both good trades but I would like a second opinion. The first is on AA, it came right into a supply level on the daily chart where I shorted it. My entry price was 12.08. My first target is at 10.85 which is 3:1 and my second is 10.03 which is 5:1.

Thank you for your time and I look forward to the XLT sessions next week.

Thank you,
Shawn W.

As you can see in the upper left corner of this daily chart, Shawn identified a clear supply level. There was a nice pivot high which was followed by a gap down from that pivot high suggesting a huge supply and demand imbalance; much more supply than demand. A while later, moving over to the upper right side of the chart, price eventually rallied back up to that supply level which is where Shawn sold short. He took this trade exactly according to our rules... Selling short to the novice buyer who was buying after a rally in price and at a price level where supply exceeds demand. As price fell, Shawn took profits on his profitable short position at the circled areas on the chart. This means he covered his short position by buying at the circled areas.

Now, let's take off our supply and demand hats and think in terms of conventional technical analysis. If you look at the whole chart, you will see the pattern that is in every conventional technical analysis book ever written. It's one of the most popular chart patterns in history, the Double Top. Let's stick to the conventional rules of the double top and see how the double top pattern/strategy would work for us in this example. First off, according to the books, when can we say we actually have a double top? It's not where Shawn shorted at, it's much lower. Most would agree that according to the technical analysis books, the double top becomes official at near the low of the chart. I will be generous and make it official at the Neckline seen on the chart. The Neckline is what the books tell us to draw and this tells us where to sell short. The rule is to sell short once price breaks below the "neckline." I have pointed an arrow at that level in the illustration below. Now I ask you... Does this strategy that has been around as long as technical analysis itself make ANY sense to you? If you said no, I agree. Why in the world would we want to sell after a decline in price which is the entry point of every double top and in this case, also sell short right into an area of demand (support)? The answer is simple. No consistently profitable trader would do that. Why not sell short where Shawn did which is where supply exceeds demand? That is the low risk, high reward, and high probability time to sell short. Lastly, as our XLT member was buying back his shares in the circled areas on the chart, who do you think was selling to him? It was probably the folks who read the books. This is exactly how trading and investing accounts get transferred daily from those who follow the herd and don't know what they are doing, into the accounts of those who do.

The big flaw in conventional technical analysis strategies are that they ignore how you profit when buying and selling anything. Almost every rule for entering a market has you entering the market well after the move is underway. A successful buyer and seller of anything doesn't take that novice action. As I discussed a couple of weeks ago in my piece, "The Avocado," you would never be willing to pay the grocery store $4.00 for an avocado when they are selling them for $1.00, no matter how much you like guacamole. Ice cream may be a different story but I think you get the point. The trap is that this flawed school of thought ignores the reality of how markets work and money changes hands.

Figure 1

Just because something has been written about the same way for decades and sells millions of books, does not mean it is correct information. Just because almost every conventional technical analysis book ever written teaches the double top the same way, does not mean it works. As we can see, this conventional pattern makes absolutely no sense. You would never take this foolish action when buying or selling something in any other part of your life outside of trading. Leave this novice action to the residents of Foolsville. What you can do is take this conventional strategy and customize it, wrapping real demand and supply rules around it and now you have a strategy that gives you the edge to enter this trade before the novice double toppers.

If you are unfamiliar with the double top and want to learn more about it and its rules, Google it. I just did and found 110,000,000 links for this obviously popular pattern. After you read the first million, you will see that they all offer the same conventional rules which give traders the same conventional results. Instead of reading all the trading books and learning to buy and sell in markets when everyone else buys and sells (no edge)... Instead of acting on the advice of others who likely get paid from advice, not from trading... Pay attention to what is happening in front of your eyes. Pay attention to what is happening around you. Pay attention to all the simple realities that others (your competition) never see.

To get what you want in life, you must do what you have never done before. This begins with thinking like you have never thought before. This is what leads to results that you have never experienced before. Don't think in conventional terms, think in REALITY based terms and when it comes to money and markets, wrap the time-tested laws of pure supply and demand around every action you take. Lastly, never forget this ever-important point. You can't be consistently profitable buying and selling where everyone else does; it's not possible. You have to have a strategy that gives you the edge that allows you to enter BEFORE everyone else, at the right time and when the risk is low and reward is high.

Mixed Feelings

As I write this piece, I am sitting with Brandon Wendell and Sam Evans, outside at our hotel, in Dubai UAE, 20 feet from the warm Persian Gulf waters. We are here for the Online Trading Academy All-Star event which always gets me thinking a thought I don't often share with anyone. As long as I have been trading and investing, I have been a bit worried about creating my own competition. Proper trading means having an edge over your competition. Without it, there is absolutely no way to profit, you will lose your account to someone who has a better edge than you. Specifically, you must have a rule-based strategy that has you buying before your competition buys and selling before your competition sells, consistently.

At All-Star events, many people join our Online Trading Academy family and end up in the Extended Learning Track (XLT) Program. While I am happy when someone new joins our community, I am just as happy when they don't. We can't have everyone buying at demand and selling at supply like we do. We need plenty of people to take the other side of our trades. It's great that people sell at demand and buy at supply, what a gift! Don't get me wrong, I love our members and work hard every day to make sure we are giving our best effort in helping them achieve their goals.

Toward the end of our all day education event, we play the "hard right edge" game. This is a fun game for attendees as they get to make a trade and try to win one of two prizes worth over $2,000. The game goes like this… We start with the opening candle of the day on a chart. As I scroll forward one candle at a time, attendees raise their hand when they are ready to either buy if they think the market will go up or sell short if they think the market will decline. They are only allowed to make one trade and we record it. One more note, the event is two days. The first day is for Online Trading Academy graduates and the second is for new prospects who have never taken an Online Trading Academy course but who are interested in learning more about us. For the past few events, we have used the same chart and an interesting pattern of behavior has emerged.

Figure 1

Here is the chart. I explain to the crowd of more than a hundred people that we are starting the game with a Doji candle, “would anyone like to enter the market, the game begins now.” If it is the graduate day where many of the people in the audience are already in the XLT, most people jump right into the game and sell. After all, we have a gap up in price, into an obvious supply level to the left, and a Doji candle. The second day of the event when the audience is all people who are new to Online Trading Academy is often very different with this same chart. Every time the first trader decides that they want to buy, many hands go up and most of this group buys as well. What I find is that whatever the first trader does, buy or sell, others who decide to place a trade on this first candle do whatever that first trader did. It’s herd mentality live in action. Typically Brandon is sitting next to me on stage, entering everyone’s trades into our spread sheet and we always look at each other in disbelief. The fact that this market is opening right into a high odds supply level with a Doji candle means less to this group of new market speculators than what the actions of others is. It's an amazing thing to witness. Most of the time, more than half the audience enters a trade (buying) on this first candle that you see in the chart, even though I announce over and over that they don’t have to enter the market on the first candle and should be patient. This group of new traders who have never taken a course with us buys and buys and buys, only because they see others buying and buying and buying. Keep in mind that this has nothing to do with reading a chart. This has everything to do with people not having the ability to think and act on their own and instead, simply doing what others do.

Figure 2

As you can see, price declines and fills the gap below. Those who shorted the Doji candle at supply profit and those who bought lose. After I scroll the chart forward a few candles from the opening Doji, the group who bought that open become silent and stoned faced, as if they were just hit between the eyes. Later, after the game is over and we are mingling with the audience, this group of people always tells me the same thing: “I knew I should have sold short and not bought, it was a Doji into resistance (supply)”. When I ask them why they bought, many have the same answer. They shrug their shoulders, look around and say “I don’t know.” Anyway, you get the point.

We analyze the statistics as well. The graduates' performance is more than 400% better than the new folks' performance. It’s the same story over and over. Those who have proper trading education derive their trading income from those who don't.

In the Extended Learning Track (XLT), I have noticed over the past year from feedback that the list of consistently profitable XLT members has grown quite a bit. This means that each time I buy the S&P at demand (support) for a long entry, I am likely competing with XLT members for the limited number of contracts (or shares) available at that price. Yes, these markets are huge and volume is high but I do think about the issue of creating my own competition.

As for my issue of creating my own competition, I am less worried than ever and if I can help a few people achieve their goals by teaching them how money and markets really work, I am happy to lead an instructor team and do that. There are plenty of markets to trade and even if there weren't, the powerful human emotions of fear and greed will keep plenty of people from buying where I buy and selling where I sell. In fact, these emotions typically have people buying where I sell and selling where I buy. In a perfect world, everyone would win and be profitable, there would be no losers, no frustrated traders. Unfortunately, this is not how the world works. Before you put your hard-earned money at risk in the competitive world of market speculation, make sure you know what you're doing. Learn how markets really work, practice on a demo account, start small and low risk, and so on. If you're thinking of taking a course at Online Trading Academy, great. If you're not, that's great as well, we have equal love for all.

Three Ways to Speculate the Markets, Which is Best For You?

During my many years in the trading and trading education world, I have been a day trader, swing trader, and longer term position trader. While my strategy has never changed, the time horizon for finding opportunities and holding positions has changed a bit over my career. Also, I have the benefit of watching so many traders within Online Trading Academy attempt to become successful day, swing, and position traders. The focus of today's piece is to explain the differences between day, swing, and position trading, and also explore the advantages and disadvantages to these different styles.

Day Trading

Day trading is typically described as the action of entering a position in the market with the intention of exiting that position before the close of the trading session, that day. Day trading requires fast connection speeds, powerful computers, back-up systems, real time data, direct access execution systems, and multiple monitors.

The Pros

For those with high energy, looking for action, yet also have very good discipline, day trading is for you. In general, profitable day traders are not the ones taking 10 – 100 trades a day. The consistently profitable day traders are the ones who tend to take the 1 – 3 quality opportunities offered to them, typically near the open of the trading session. Those who are very good at making key decisions on the fly can do well here. Day trading also allows traders to take advantage of the many short-term imbalances in the markets each day.

The Cons

For many, day trading is attractive due to the "get rich quick" mindset. While some will do very well in a short period of time, most end up losing money in this venture. Emotions tend to run very high when day trading, making rule-based execution difficult for those who have any issues with discipline. There is also the added difficulty of competing with market makers at the day trading level. Lastly, day trading is the the most time-consuming style of trading as it requires you to be in front of your computer screens each day while you're trading. Those who are not good at making quick decisions are not likely to succeed at day trading.

Swing Trading

Swing trading is typically described as the action of entering a position in the market with the intention of holding that position for one day to a couple weeks, or even longer in some cases. Swing trading does not require real time data or direct access execution though it is recommended.

The Pros

From my experience, swing trading is where I see the largest number of aspiring traders succeed. Swing trading captures the market niche with the least amount of competition. It's a time frame too large for day traders and too small for longer term investors and institutions. Proper swing trading does not require a big time commitment. Spending an hour or so performing your market analysis two or three times a week will suffice. Typically, swing traders will take advantage of today's technology and use the "set it and forget it" approach when entering positions into the market. Not having to be in front of your computer to enter positions with precision timing and manage them live helps take the biggest risk to trading out of the equation, you and your human emotion. Swing trading offers the benefit of pre-planning every part of the trade no matter when you are doing your analysis. In fact, the best time to perform your swing trading analysis is when the market is closed.

The Cons

Swing trading is somewhat boring to the active day trader as opportunities are not present each day. For those swing trading stocks, you will find opportunities come in bunches. For example, when the S&P is in an uptrend and price has temporarily declined to a demand (support) level, most stocks will be set up as buying opportunities at that time. As soon as the S&P rallies from that level, most of the swing trading low risk entries will be gone. This is not necessarily a bad thing, but the waiting game is unattractive to most people in general.

Longer Term Position Trading

This style is typically described as the action of entering a position in the market with the intention of holding that position for weeks to months. There is no need for real time data or direct access executions.

The Pros

Longer term position trading to most people is "buy and hold." This may be the best style there is assuming (and this is important) you buy and hold AT THE RIGHT TIME. This style is very hands-off in that every part of the trade is pre-planned, well in advance. Longer term position trading is the least time-consuming type of speculating there is which leaves you plenty of time to enjoy other things in life outside of markets and trading.

The Cons

Many long-term market speculators use news and professional opinions as their primary decision-making tool. Typically, this will lead to buying high and selling low which means losing money. Ideally, price charts, demand, and supply should be your primary set of tools. This style takes time to produce results. Successful trades may take place over a multi–week or month period and some people are not fine with this. As humans, we typically want instant gratification. Also, this style requires capital to be tied up for longer periods of time than day and swing trading, so opportunity cost may be a concern.

Whatever type of trader you are, keep in mind that your rule-based strategy will not change. A strategy that works in one market or time frame should work in any market or time frame. Whether you are day trading on a one minute chart, or taking three trades a year off opportunities found on the weekly chart, the way consistently profitable market speculators derive consistent income is from buying low and selling high, or selling high and buying low. This means you must become proficient in identifying market turning points, which comes down to the ability to objectively quantify demand and supply in any and all markets. Once you can do this, identifying price levels where this simple and straight-forward equation is out of balance is not that difficult and that is where low risk / high reward opportunity lies.

As for me, the most profitable and comfortable trading has always been swing trading. While the other two styles are fine and I still trade them all, I find that the swing trading niche is best for me. If you have any other questions on these different styles and need help figuring out which one is best for you, email me anytime.

Important Questions Answered on Trading Styles

Last week, my article focused on the differences, pros, and cons, of the three main styles of trading. Day, swing, and longer term position trading (investing) are all fine ways to speculate in markets, but they are very different from each other in many ways. While I often participate in all three styles, if I was forced to choose one, it would be swing trading. This is still a niche style that is less crowded than the other two. It is a time frame that is too long for the day trader yet too short for the longer term investor. There are other benefits to consider as well. Last week's piece drew plenty of feedback and important questions. Today, we will answer some of those questions and look deeper into the issue of trading styles.

Hi Sam,

I have been an avid reader of your regular postings on Online Trading Academy for a while now, I really enjoy your articles on trading. In particular, I like the down-to-earth style you write about in trading. I have earnestly tried to follow whatever you have said and they have brought me success. In your last piece on trading time horizon, I too am a swing trader, never holding a position more than a month but never too short as well. I think once the trade setup is done with the proper stop loss or trailing stop, the system carries on its own without emotions coming to play. Thank you for affirming what I have being doing all these years. And keep those articles coming in. We all need them to jolt ourselves to reality sometimes!!! Fads come and go, the *basics never die.*

Regards,

R. M.
Singapore

Dear R.M. –

Thank you for the email and kind words. The last line of your email is something most people don't realize until it's too late. Somehow, you have figured out those key four words, "the basics never die," congrats on that. Most of my articles are in some way shape or form related to the irrefutable laws of demand and supply. After all, the movement of price in any and all markets is a function of an ongoing demand and supply equation. Trading opportunity exists when this simple and straight-forward equation is out-of-balance. My life's work in trading and trading education is to quantify this equation on a price chart and show people how to take advantage of an objective supply and demand imbalance. At the core of any significant economic, political, scientific, social, medical, psychological or cultural theory lies a quest to understand and quantify the forces of change, action, or energy. The theories that attempt to quantify "force" that have stood the test of time date back centuries and are extremely simple. In 1686, noted physicist Isaac Newton suggested in his Laws of Motion that an object will remain in motion until it is met with an equal or greater force. Noted economist Adam Smith suggested hundreds of years ago that when supply exceeds demand at a price level in a given market, price will decline. Smith and Newton didn't create or invent the laws and principles for which they are famous. Supply, demand, motion, and the relationships therein existed long before Smith and Newton, long before humans walked the earth for that matter. What these two individuals did however is look mass conventional perception in the face and challenge it with a reality that had been there all along ("The Basics"). They were able to discover what no one else had because of a belief system that allowed them to open doors others never knew existed. If you notice, Newton and Smith didn't figure out one specific issue. They had a belief system (centered around "the basics") that allowed them to rather easily apply the core principles of their knowledge to a host of issues, producing answers the rest of the world still considers "ingenious" centuries later. Lastly, were Newton and Smith really saying anything different? I would argue that they were saying exactly the same thing. Both would have made great traders in my opinion. Thanks for the email.

Hi Sam,

I'm an Online Trading Academy grad and the one thing I haven't gotten clear about swing trading is on what time frame do you do swing trading, and what moving averages are best to use? I plan to make swing trading my personal style of trading.

Thanks,

E. B.

Dear E.B –

Great choice on the swing trading. As I have said, day trading is fine, as well, but you are likely to find swing trading less stressful and time consuming. As for time frames, ideally you want a combination of a larger time frame and a smaller time frame. The larger time frame can be your daily or weekly chart. You will use this larger time frame to help quantify where price is in the larger time frame supply/demand curve. This will tell you what side of the market you want to be on, buying or selling (expecting higher prices or lower prices in the near future). In other words, if you are looking at a stock, for example, and current price is near a weekly demand level, there is probably a quality swing trading buying opportunity at hand. You would also want to use a smaller time frame chart such as a 60–minute chart (but no smaller) in your swing trading analysis. The reason for this is to pinpoint your entry price. Let's go back to our example of a stock at a weekly demand level. By going down to a smaller time frame and taking an x-ray look at that weekly demand through the lens of a 60–minute chart, you should be able to reduce the risk on that trading opportunity by reducing the size of the stop loss. Focus on where the majority of the trading activity is in that demand level as that is where the turning point is likely to be. Thanks for the email.

Sam,

I read your article today re. three types of speculative trading (day, swing, long-term). I am new to trading and have been simulating day trading. My results are not good enough to start real trading.

My question is: Does swing trading require any different analysis (charts, reading, etc) than day trading? I was interested in your conclusion that you personally find swing trading the best for you. However the training that I have received has focused on day trading. If I went to swing trading, so I need different analysis techniques?

Thanks for your help and your articles,

B. L.

Dear B.L. –

Swing trading does not require a completely different type of analysis. Since you are comparing it to day trading, let me point out the small difference in analysis. When properly day trading, you will be looking at multiple time frames and making decisions very quickly, while the market is open and moving much of the time. This is fine for some people, but difficult for most. When swing trading, you must also look at the larger time frame / smaller time frame combination, but it's a slower pace and you don't have to perform your analysis when the market is open and moving. The advantage here is that performing swing trading analysis while the market is closed takes the emotion out of trading which often, is the biggest risk you will face. The techniques are no different. Find your demand and supply levels, assess the trend, then plan and take your trades according to your rules. Thanks for the email.

Out-Thinking Your Competition

Often, I write articles about the importance of having or owning a competitive edge. It is amazing to me that people in general focus very little on this most important topic. With most things in life, trading for sure, there is a winner and a loser. The consistent winner has an edge over the loser that includes two things:

1. **Mental**: Having a mental edge is a combination of proper reality-based thinking (void of illusion), having extreme self control, and focus.
2. **Strategy**: Having a strategic edge means owning a rule-based strategy that ensures success over your opponent.

The purpose of today's piece is to give you a solid understanding of how a competitive edge works in the world of trading and investing. I will use real trading examples from the past couple of weeks in the Extended Learning Track (XLT) program to help you understand the importance of owning a competitive edge. During the second half of November and early part of December, the S&P 500 had a number of days where new highs were reached. These are reflected in the circled areas on the chart below. Most of these new highs were news related events that invited the mass investor crowd into the market to buy. These "breakouts" to new highs were an event we watched closely and traded in the XLT Stock and Futures programs at Online Trading Academy. The only difference from what we were doing compared to the masses was that we were not buying these breakouts like everyone else, we were the sellers to the breakout buyers, on each new high (circled areas on chart). During this time, there was better news on jobs, some good earnings news, and one of the highest-rated financial television show's host told the world that Apple Inc. was likely to go to $300 a share (it's trading about $200 a share as of December 10th). So why would we not buy like everyone else? After all, the news was good, the S&P was breaking out to new highs, and the talking heads on television were mainly bullish. The reason why we were the sellers to these buyers was because of our competitive edge.

Many XLT members took advantage of these opportunities, here is part of an email from one of our

XLT members who took advantage of the shorting opportunity. He took this because of a mental and strategic edge over the buyer...

From: *Scott H.*

Sent: *Friday, December 04, 2009 4:00 PM*

To: *sseiden@tradingacademy.com*

Subject: *Trading Success*

Sam,

I've made over $10K in the last month while price has been bouncing off overhead supply in the @ESZ09. It's funny, though, there's a process that must be followed to succeed. First you start with a clean chart. No lines or indicators. Next you put the levels on just the way you've shown us a hundred times. Then...

The email goes on to explain more of the strategy but that is not important for this piece.

Figure 1

There were three factors that told me selling for day and swing trades was the smarter choice than buying. They are as follows:

1. The chart on the left shows the S&P supply area formed back in October 2008. The precise level is better seen on a smaller time frame but that's not important for this piece. We expect that price level to have much more supply than demand because it is the origin of a strong decline in price. This means that supply and demand are very much out of balance. When we identify a price level where supply and demand are very much out of balance, we want to remember that level. On the chart to the right, I used two black lines to carry that supply level forward. The black circled areas on the chart are the times that price rallied back into that supply level. This means, objectively, that a buyer is buying AFTER a rally in price and INTO a price level where supply exceeds demand. Only a novice market speculator would make these two mistakes. The market speculator with a competitive edge, both mental and strategic sells to that novice buyer. My words in the XLT for two weeks never changed. I repeated that I am an interested seller when price comes into this level, no matter what the news was, and so on. Price declined many times from this level for profitable trading opportunities. Of course, this opportunity was only for those whose trading plans accepted this risk and reward associated with this setup.
2. Notice on the chart to the right that each time price rallied up to this XLT Supply level, it made new highs. These "breakouts" were key for our successful short trades (betting to the downside). The reason is because when the average trader observes price breaking out to new highs, they want to buy in the worst way. This is herd mentality trading, not competitive edge trading. An upside breakout is a very bullish event to the novice market speculator. After the first time price rallied into that supply level, I repeated a statement several times in the XLT to our members: "I would be bearish and a seller on BREAKOUTS TO NEW HIGHS within this supply level." The logic here is that novice buyers are buying breakouts right into a price level where we already know supply exceeds demand. This means that the breakout is most likely to fail, yet the novice buying is blinded by the illusions of conventional technical analysis and the lack of a competitive edge.
3. Factor number three is also a key component of the edge that allowed for these very profitable

shorting opportunities. It made the opportunities a bit higher odds, in my opinion. Once a week, I spend a few minutes reviewing some of our competitor's market advisory services. I do this not to join them but instead to see what the herd is thinking. Sometimes, when I have identified a potential market turning point, I see that another advisory service or two is also pointing it out to people and that's not good because that means more competition for shares or contracts at that price level. This time, however, with our supply, I could not find anyone else in the industry that noticed it. To me, this is important information that added odds to the shorting opportunities. In fact, most seemed very bullish, both on the technical side calling for a breakout to new highs, and the fundamental side with good news and calls for Apple Inc. to rally another $100. The logic here is this... The fact that most were bullish at or near our supply level meant that many would buy which is exactly what we want when we are going to sell short. After all, when we sell short, we want many to buy so that there are no more buyers which makes it easy for price to fall. Another way of thinking about this is the "trap" I often write about.

My hope from this piece is that you understand how important it is to have a competitive edge when putting your hard earned money at risk. Each day, wealth is transferred from those without a mental and strategic edge into the accounts of those who have that important edge. Where do you think the $10,000 profit came from for our XLT member?

The Many Ways to Benefit from Proper Supply and Demand Analysis

Often, I speak with people inquiring about Online Trading Academy. The perception is that we are a firm that teaches people how to trade. With our name being what it is, why would anyone think any different? While this is true, there are so many other ways to apply our education and information, outside of trading. I consider some of these reasons to actually be more important than trading. Whether I am trading, talking about trading, writing about trading, or instructing a trading session in the Extended Learning Track (XLT) program, I am applying the foundation concepts of supply and demand to identify low risk and high reward opportunity in markets. As I have said before, the movement of price in any and all free markets is simply a function of an ongoing supply and demand equation. Low risk, high reward, and high probability opportunity exists when this simple and straight-forward equation is out-of-balance. In today's piece, I want to expose you to other ways in which you can benefit from proper supply and demand analysis. When you have a rule-based strategy that allows you to fairly accurately predict where price is going next, a world of opportunity is at hand. Here are two of the many ways to take advantage of this.

Let's revisit a recent swing trading opportunity we identified and took advantage of in the XLT Futures. The chart below is a daily chart of Crude Oil. The first opportunity was to sell short at the supply level marked on the chart with a target of the demand level below, also marked on the chart. The risk / reward on this XLT short in Crude Oil was ideal and the trade produced over a 12 point gain. As mentioned, the demand level below was the target for the short trade, but the demand level in this case was also a buying opportunity for another swing trade, in the opposite direction, and some XLT members took advantage of this. As far as trading goes, there is not much else to say about these two XLT trades. Now, let's think a little deeper and explore any other ways in which we could have benefited from the opportunities our strategy offered us in Crude Oil.

Figure 1

1. If we focus on the demand level, as a trader, we are buyers. If you are a two parent working family whose funds are very tight and you both drive to work each day, the cost of gas to drive your cars can be a hefty expense. Knowing that price is likely to rise once it reaches the demand level, it would be wise of you to take both cars to the gas station and fill up your tanks. Why? Because the price of gas is about to go up from that demand level. If you have some extra gas cans in the garage and funds are really tight, you may want to fill them up, too, with cheap gas that is about to become more expensive.
2. If you are an airline, the biggest expense to your business is jet fuel. Airlines who not only hedge fuel costs but "properly" hedge fuel costs have a huge competitive advantage over the competition. A smart airline would benefit from buying crude oil Futures at the $68 a barrel XLT demand level as the price of fuel is about to increase. When they actually go to buy the fuel at a later date, after price is high, they will pay the higher price but that increase in price is offset by their gain in the Futures position in Crude. So, effectively, they would be flying at $68 a barrel while their competition is flying at $73 a barrel which is a tremendous difference to the bottom line.
3. Do you drive a truck for a living and wish to increase your profit margin? Buy as much fuel as you need for the near future when crude prices are at demand. In doing this, your fuel expenses will not increase as the price of fuel increases. Maybe you drive a taxi cab or limousine and so on. The point is, there are many other ways proper supply and demand analysis can have a direct, positive impact on your life, and the financial well-being of you and your family.

Another swing trading opportunity that came up for us recently was in the ten-year note, one of my favorite markets. The chart below is a daily chart and represented a low risk, high reward, and high probability shorting opportunity. In the XLT, we saw that price was rallying up to a clear supply level that was very well-placed on the larger time frame supply and demand curve. Another key piece of information we had in this opportunity was the presence of a novice gap up, just before price reached the supply level. This meant that a very novice buyer was buying a gap up in price, AFTER a strong rally in price, and into a supply level that was way up on the curve. These factors suggested the odds of price turning lower from that supply level were very high. The trade has worked out well for XLT members who took advantage of this opportunity. As for the trade, I really don't have much else to say about it. Let's again think a little deeper and explore any other ways in which we could have benefited from the opportunities our supply and demand strategy offered us in the Ten Year Note Futures.

Figure 2

This market is one of the biggest and most important treasury markets in the world. This is the free market that determines key interest rates. In case you don't know, price and yield are inversely related in this market. In other words, when price goes up, the interest rate goes down. When price goes down, interest rates go up. The Fed and other large institutions can do and say what they want, but no one entity controls this market. What causes price to move is simple supply and demand.

1. Are you thinking of taking on a loan for a home? Interest rates are lowest and about to turn higher at supply levels on the price chart. Remember, price and yield are inverse here. When price hits supply and turns lower, interest rates go up.
2. Perhaps you are considering refinancing your home. Timing that refinance with a key supply level means the difference of money staying in your pocket or going into your loan company in the form of interest. Again, when price in this market reaches supply and falls, interest rates go up. This is not something that may or may not happen, this is the market for interest rates.
3. Maybe you are someone with an adjustable rate mortgage. If you are, you are constantly at risk of higher interest rates. By knowing how to quantify supply and demand, you can manage that risk stress-free yourself. Again, knowing that price is reaching a major supply level on a larger time frame, very high on the supply / demand curve, with a big profit margin on the downside, you may want to consider locking in a fixed rate before rates go up.

These are just some of the many ways in many markets proper supply and demand analysis can help you in other parts of your financial life, outside of just trading. Owning an edge in chart (supply/demand) analysis that allows you to predict market turning points with a high degree of accuracy is how the astute market player derives profit and financial well-being from the novice.

My hope is that this piece opened your mind to the many risks and opportunities you may be facing today and not even know it. If you have any questions on this or other topics, email any time

Don't Be a Blind Donor

I have been writing articles each week to Online Trading Academy members for over two years. My goal is to slowly help the misinformed public gain an edge that levels the playing field in the trading and investing world between the novice hard working public and the "Wall Street" professional. As I have said many times, money is simply transferred from the misinformed novice who does not understand the reality of how money and markets work to those with proper "edge-building" education on the reality of how money and markets work. This is nothing new; this transfer of wealth from those who "don't know" to those "in the know" has been going on since before the Babylonians. While they were the ones credited with the first use of paper notes and receipts, forms of currency had existed for quite some time already and if currency existed, it was changing hands. My hope is to help readers gain enough of an edge to become a recipient of the transfer, not a blind donor. Make no mistake about it, my articles are not about me, not about Online Trading Academy, not about money and markets, they are about you and your development. As we close out 2010, one more time, I wanted to share some email questions with you from readers. As you read any of our articles, always be aware of the goal of attaining more of a reality-based edge.

Question:

For someone who is REALLY just beginning, is there a good book you would recommend for orienting oneself with the terminology and basics? (I read what you wrote about not reading too many books).

Answer:

It depends; there are two buckets here. One is "learning the mechanics of trading and investing." The other is "learning how to be a profitable market speculator." The first is information that I would recommend obtaining from a book. This includes trading platform tutorials, information from an exchange on the specifications on the products you will be trading, and much more. The second bucket, learning how to become a profitable market speculator, is a topic I would be very careful with. To start with, find your old "Economics 101" book. Dive into the basic concepts of supply and demand. Make sure you thoroughly understand this simple yet important dynamic. Your next logical quest will be to quantify supply and demand on a price chart. I have thoroughly explained this many times in prior articles that I encourage you to read and reread if you need to. The focus here is taking the basic laws of how you profit when buying and selling anything and transferring this onto a price chart. If you think about it, most who read this piece already know how to be a smart buyer and seller in our everyday life, at the grocery store, when we buy a car, and elsewhere. The goal of learning how to become a consistently profitable market speculator needs to begin here, not with faulty pattern recognition and high risk indicator-based conventional technical analysis which is exactly what you will find in books at the book store so caution. Simply learn to see the difference between retail and wholesale prices on a price chart. For this information, you can go back and read about this in my prior articles for free. If you need more, send me an email.

Question:

Regarding identifying the supply and demand balances I noted from your articles that a) It cannot be in the middle of a move and b) the more times it hits the balance, the less reliable it becomes because the supply has not yet been absorbed. Are there additional criteria for identifying the supply and demand balances?

Answer:

Yes. This is a topic I take very deep in the Extended Learning Track (XLT) class as there are a few key points in identifying key price levels where supply and demand are out-of-balance in a big way. One thing you may want to consider in your search for supply and demand imbalances when looking at a chart is a focus on "how price leaves a price level." Consider this… The more out-of-balance supply and demand is at a given price level, the stronger price will move away from that level. The less out-of-balance supply and demand is at a given price level, the more gradual price will tend to move away from that level. So, when looking at a chart, you may want to start your search for quality supply and demand imbalances with looking for periods of momentum and then focusing on the origin of that momentum as that is likely where the supply and demand imbalance is.

Question:

I have a question regarding daily supply/demand zones concerning trend. I am using a 50 period sma on the daily chart to tell me what side of the market to be on in the 4 hour and 60min charts. In your trading, do you trade all supply/demand levels on the daily chart, or are you using another moving average to gage trend for the daily charts. It seems that if the R:R is good, then I could *still buy in a downtrend on the daily's. I use set and forget entry orders so perhaps I should bypass price moving out of a zone on the dailies.*

Answer:

Using a moving average to quantify trend is ok but be careful; I would use this as a secondary decision-making tool. As a primary consideration with trend, focus on where price is with regard to larger time frame demand and supply levels. The reason is because of where every uptrend and downtrend begins and ends. They begin and end at supply and demand levels. With that said, I don't take every supply and demand level on a chart as a trading opportunity. I only focus on the opportunities that offer the risk / reward I am looking for, the ones that meet the minimum requirements in my trading plan. When I find it, trend is a distant consideration.

Again, as we close out 2009, I want to thank you for being a loyal reader. Thank you for the email feedback year after year. Moving into 2010, look for series-based articles, deeper lessons, and more of a focus on international markets and opportunities. Of course, the purpose will never change which is to help you obtain an edge in the marketplace with the goal of living a happy and healthy life today, tomorrow, and during retirement.

A Key Rule, Often Overlooked

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All market speculators share the same goal which is to enjoy consistent low risk profits. To accomplish this goal, you must be able to identify market turning points as this is the only way to attain low risk and high reward entries into market (trading) positions. Whether you are a short term day trader or a longer term investor, nothing changes. Identifying key market turning points is the only way to attain the ideal risk / reward opportunity. Leading the Extended Learning Track (XLT) classes for so long, I have come across many people in the program. Occasionally, I receive an email from a member that is not satisfied with their results and desires better returns. Most of the time, they are not necessarily losing money, but they are not making money or not making enough money, and desire more. One of my first questions to them has to do with strategy. I ask them, "Do you have a plan and are you following that plan?" Half the time the answer is no, so we dive into creating a proper plan and the importance of following that plan. The other half says they do have a plan and for the most part, follow it much of the time. For this group, my questions turn to the details of their plan, the strategy, where I look to see if their rules are proper or not. Sometimes, there is a rule or two that is incorrect and the student doesn't know it, so we correct it. In my many years of experience, I have found that most of the time, there is one specific and crucial rule that is missing from people's plans more than any other and that is the focus of this piece.

Before we discuss this rule and its importance, let's first turn our attention back to market turning points. Where are market turning points? Price movement, in any and all markets, is a function of an ongoing demand and supply equation. Market prices turn when this simple and straight-forward equation is out-of-balance. Therefore, price in any market turns are price levels where demand and supply are out-of-balance which means the strongest turns in price occur at price levels where demand and supply are most out-of-balance. So, the question for us is this: What exactly does this picture look like on a price chart?

When I ask students this question, they quickly describe the picture of demand that I have shown in articles for years which is a "Drop – Base - Rally." They then describe supply which is "Rally – Base – Drop." These are the two pictures that clearly show price levels where demand and supply are out-of-balance which is what we as market speculators are looking for. Next, students go right into their rules for entries, targets, and stops and this is where I stop them as they are ignoring perhaps the most crucial rule that should be included in their trading plan. Drop – Base – Rally may be the picture of a price level where demand exceeds supply, a demand level. But, what EXACTLY is a demand level for you and your trading plan? I find that most people don't quantify this with numbers. Quantifying exactly what "demand" (or supply) is to you and your plan is a key component to a trading plan that has an edge over other trading plans that don't. To explain this further and dive into the details, let's look at two recent XLT trade setups I identified with students during our swing trading sessions.

Figure 1

The chart above is a daily chart of Crude Oil Futures. In the lower left portion of the chart, we identified an XLT demand level. As you can see, it is clearly Drop – Base – Rally, the base is in between the two black demand lines which creates our demand zone. Just because it represents the pattern/picture we are looking for does not at all mean we have a low risk / high reward trading opportunity. One of the most important questions that comes next is whether there is a significant profit margin associated with this demand level or not. The presence of a significant profit margin is key for two reasons. The first is that it quantifies the risk and reward. Second, the larger the profit margin, the higher the probability. This is because a big profit margin means price is far from equilibrium and out at price levels where the demand and supply imbalances are greatest. The rule most people fail to consider is illustrated in the grey shaded area on the chart. It shows us how far price was able to rally from that demand level before returning back to that demand level for our low risk, long entry. Compare that rally to the area between the two black demand lines. The distance between the two black lines is the distance from our entry point to our protective stop loss price. We buy at the top black demand line and place our stop just below the lower black demand line. This measures our risk. The grey shaded rally represents our potential profit margin. The logic is that if price was able to rally that far, this means there is no significant supply until the top of that rally and higher. That initial rally "opens up" a profit margin for us as we are willing buyers when price revisits that level which it did in mid-December. Back to our rule...

Rule: *A demand level only becomes a demand level if the initial rally from the demand level is at least three times the demand level (1:3 Risk/Reward). Meaning, if the distance from entry to stop is two points in a market, the initial rally from that level has to be at least six points or it does not qualify as a demand level for me. I will ignore any demand levels that don't meet this minimum requirement.*

While I require a 1:3 as a minimum requirement for the demand level to actually meet the definition of a demand level, it may be different for you. You may require 1:4, or whatever. In this example, the length of that initial rally from demand was much more than three times the distance from entry to stop and that's good; we only needed the 1:3. What this suggested was the probability of price hitting our first target (T1) of 1:3 was very likely. This does not mean that my target has to be the top of that rally. It simply means that this opportunity is offering me at least three times the move that I am risking. As you can see on the chart in our XLT trade, target one (T1) was nowhere near the top of that rally, and that's fine. Price ended up reaching target one and two for a low risk and high reward trade. One of the most important factors for this successful trade was the length and speed of the initial rally away from the demand level, and this is a rule many market speculators fail to consider.

Let's look at another swing trading opportunity we identified and took in the XLT. The chart below is a daily chart of the 10 Year Note. Again, notice the grey shaded area. This represents how much of the demand below our supply level was absorbed by the sellers during the initial decline in price from supply (grey shaded price action). The fact that price declined so far so fast was the reason our short position was able to rather easily reach target one (T1). Remember, compare the distance between the two black lines that make up the supply level to the distance of the decline in price from the supply level (grey shaded price action). Make sure it meets your minimum requirement before you can even call it a supply level.

Figure 2

Many people talk about supply and demand when trading and writing trading plans. Few actually define what supply and demand levels are to them. This is another step in building the edge required to get paid from your competition instead of paying them.

Planes, Trains and Automobiles

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One of my favorite John Candy movies of all time. When I was a teenager, I was an extra in another one of his movies and got to meet him, big funny guy just like I expected. As funny as the movie is, there is a real story in it that all traders need to be aware of. I go through periods where I travel quite a bit. Air travel can be draining because air travel means airports. Being an Executive Platinum member, knowing all the short cuts and tricks with lines and special seating, I still find the experience long and draining at times. Once you're airborne, however, there is little to complain about. Just sit back, relax, and reach your destination. Driving to your destination is another story.

Long airport lines are often replaced by stand still traffic. You are also now the pilot so there is much more responsibility than flying. However, heated seats and a good sound system make driving a pleasure these days. Train travel is something I have not experienced much. My limited experience left me with the perception that it's long (which is fine if you're ok with that), relaxing, and you get to see plenty of nature. Whether your destination is Florida or the North Pole, a plane, train or automobile can get you there.

Just like travel, there are many ways to reach your desired destination in trading. The chart below shows a recent swing trade from the Extended Learning Track (XLT) - Futures class. The supply level was well-placed on the curve (this is a daily chart). Our "odds enhancers" exercise suggested this was a high probability opportunity, as well. When price rallied up to our supply level for a short entry, it actually gapped into the level which made the shorting opportunity very ideal as the gap told us these were very novice buyers. Price proceeded to fall to our target and the trade was complete. When I went over this opportunity with XLT members, I used the chart you see here which has only price and volume on it. All the information we needed to identify and take advantage of this low risk and high reward opportunity is clearly seen with price and price alone.

Figure 1

Some traders, however, are either not comfortable using only price action analysis or they desire more confirmation to take a trade. For this, people tend to use indicators and oscillators as the confirmation crutch. Let's take a look at the same trading opportunity only this time, let's add Bollinger Bands.

Figure 2

At the time of entry for our short position, we see that price has actually pierced the upper Bollinger Band suggesting an overbought condition for the Ten Year Note on the daily chart. Price piercing the upper band and reaching an objective supply level with a large profit margin below, this suggests higher odds. Adding Bollinger Bands to this trading opportunity makes the trade more attractive and also points out a key ingredient when using Bollinger Bands. Don't just sell short because price is piercing an upper or lower band. Take action because price is piercing an upper or lower band AND price has reached a supply or demand level. In the Options XLT, for example, our options expert Eric Ochotnicki calls this setup an "All Star" setup.

Figure 3

Let's again look at the same shorting opportunity and add the Commodity Channel Index (CCI). This is an overbought (+100 or greater)/oversold (-100 or greater) oscillator. Notice at the time of our short entry, CCI was giving an overbought reading again, suggesting this was a high odds opportunity to sell short. Notice the overbought CCI reading I circled. This is in line with our short entry which makes CCI look attractive as a decision-making tool. However, look just to the left of that circle and you will see other overbought readings and price didn't turn lower. The reason is because price does not turn lower because CCI is overbought; it turns lower because it has reached a price level where supply exceeds demand. As for using it for confirmation, it's a decent secondary decision-making tool. The second red circle shows CCI oversold which lined up well with our profit target for this trade. Again, are we taking profits because CCI is oversold? Look just to the left of that circle; there are other oversold readings but price didn't stop falling. Price stopped falling because it reached our target which was a demand level. If CCI was our primary decision-making tool here for entry and exit, we would have entered the trade early and likely stopped out for a loss and we also would have taken profits way too early.

Figure 4

Last but not least, let's add Slow Stochastics to our successful Ten Year Note trade. Stochastics are a very popular overbought/oversold oscillator. The typical buy and sell signal are a moving average (red and blue lines) cross in overbought and oversold territory. Did the Stochastics sell signal line up with our price action sell signal? Yes. Did the Stochastics buy signal line up with our price action profit target demand level? Yes. Did we need Stochastics for this trading opportunity? No.

The most important point here is that while indicators and oscillators can assist in one's "comfort" level, these can't be used as primary decision-making tools. These tools don't know anything about supply and demand. It's not that they are broken or don't work. They are mathematical-generated lines on your chart. The math is always correct. Whether that math leads to profits or losses in your trading account is the question most novice traders never ask and it happens to be the only question that matters. As John Candy showed us, there are many ways to reach our destination. Trading is only slightly different. While you can use indicators and oscillators as confirmation tools, if you are NOT filtering these buy and sell signals through real demand and supply levels, you are traveling east and west, trying to reach the North Pole; good luck with that. If you must use indicators and oscillators, go ahead and use them. Again, just make sure you filter those signals they spit out through proper supply and demand analysis. If I just repeated myself three times, it's only because it's so important and we at Online Trading Academy care about you and your financial well-being

Trade What is Real, Not What You Feel

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Remove the Veil of Illusion from Trading and Investing

Consistent low risk profits from trading and investing is a challenge many millions of people take on, yet only a select few are ever able to attain. The objective and mechanical rules for consistent low risk profits are very simple, yet the layers of illusions keep most from ever seeing what is real in trading and investing.

The two main forms of analysis in trading and investing are technical and fundamental analysis, and they are very real. However, thinking that mastering these two forms of analysis will lead to consistent low risk profits is an illusion second to none. The more an individual attempts to master these types of analysis, the more they may be layering subjective, complex illusions on top of each other. This is a recipe for consistent failure.

What many beginning traders don't realize is that they are stepping onto an airplane, flying from Chicago to California, trying to reach London. No matter how hard they work, the goal they desire is not attainable as the path they are on is an illusion. Trading strategies that work don't change with time or changing market conditions. Quite frankly, to think market conditions ever change at all is a strong illusion that can only be removed when one focuses on the foundation of price movement: Supply and demand. A simple and minor shift in perception to what is real can lead to a monumental shift in trading and investing performance.

The focus of this piece is to identify and remove the veil of illusion from trading and investing. How? By realizing that the movement of price in any market is based, at its core, on an ongoing supply/demand and human behavior relationship. We will quantify a supply/demand imbalance for objective opportunity in this article. As most traders are well aware, the overall goal is to decrease risk and increase profit potential. But many novice traders' strategies actually accomplish the opposite. Results for everyone from the active trader to the casual investor follow from taking various actions. Instead of focusing on changing our actions, it's time to notice where those actions come from.

Beliefs and Behavior Patterns = Actions

Let's move backward, one step at a time. Actions stem from behavioral patterns, and behavioral patterns stem from beliefs. It is at the level of beliefs that decisions are made, and moreover, where your ability to differentiate reality from illusion lie. It's time to start considering where your beliefs come from about what works and what doesn't. The strongest illusions in the trading and investing world are found at the core of fundamental and technical analysis. Within these two forms of analysis lie many levels of illusion. In this piece, I will focus on three major illusions.

Figure 1

Moving Averages

The Illusion:

The chart above is a daily chart of the S&P 500. The information most people will perceive from this chart is an illusion that will likely lead to high risk/low reward trading and investing. The illusion here is that moving averages (MA) somehow act as support or resistance. There are many conventional ways in which some traders use moving averages. These include using moving average crosses for entries and exits, measuring the slope of a MA for a "trend filter," or using a MA as support or resistance. However, the notion that MA's actually offer a benefit when used in these conventional ways is completely false. It is an illusion.

In this chart, a 20-period and 200-period moving average are seen. These are widely used moving averages both in the trading and investing community. Notice the slope of the 20-period MA at the areas labeled "B." The *slope* of the 20-period moving average is *down* in both cases, suggesting a downtrend is underway. During this period, however, the low risk/high reward buying opportunity is greatest and right in front of you!

Those who use a MA as a trend filter would never buy when the trend is "down." This group of illusion-based traders and investors would likely conclude and say, "I don't want to buy now, the MA tells me this is a downtrend." The illusion created by using a MA to determine trend ensures you will ignore the lowest risk/highest reward opportunity each time it is offered. Furthermore, this illusion is likely to encourage a trader to take the opposite action of what the objective information (reality) suggests he or she should do.

Moving Averages Lag

MA's are averages of past data. They can only turn higher after price does. Let's focus in on the 200-day moving average. Specifically, notice area "B" that is below the 200-day MA. Most traders and investors either see the 200-day MA on a chart or hear about it from some financial news TV program. They perceive the mighty 200-day MA as some magical line that when crossed, suggests some valuable information. As we can see, waiting for prices to rise above the 200-day MA before buying ensures three things. First, risk to buy is *high*, as one would be buying far from the demand level. Second, profit potential is decreased. Third, those who wait until prices have crossed back above the 200-day MA to buy will likely provide profit for the reality-based trader/investor who bought at "B," the low risk/high reward entry area. The objective supply/demand imbalance is at "B," and the 200-day MA has nothing to do with it. When a moving average lines up with *true* demand or supply, the moving average will appear to work. Believing that the moving average actually has anything to do with a turn in price is an illusion.

The Reality:

Let's now explore reality through the eyes of objective logic. The areas labeled "A" are objective demand (support) price levels. How can I claim they are objective demand price levels? Simple, while prices are trading sideways, supply and demand are in balance. In both instances, prices rose dramatically from those areas. The only thing that can cause a price rally from that area is when the supply and demand equation becomes "out of balance." In other words, there were many more willing and able buyers at "A" than there were sellers. The laws of supply and demand simply tell us this is true.

The areas labeled "B" represent the first time prices revisit these two areas of "imbalance." In other words, prices have declined to an area where we objectively know there are more willing buyers than sellers. "B" is the low risk/high reward opportunity to buy. Buying in these two areas ensures three important musts in trading and investing. First, your protective stop must be as small as it can be, which offers a trader proper risk management/position sizing. Second, your profit potential, which is the distance from the entry to the supply area above, is as large as it will ever be for this opportunity. In other words, as price moves higher from the objective demand level, it is moving closer to the supply level (target) above, decreasing your profit potential. Third, the probability of success is highest because supply and demand are out-of-balance.

The Lesson: Indicators and oscillators are nothing more than a derivative of price and volume. Price is all that needs be considered when performing objective, reality-based analysis.

Figure 2

The News

The Illusion:

The news illusion is the most powerful illusion in trading and investing as strong news leads to strong emotion (faulty beliefs). Most successful traders and investors have, at some point in their journey to consistent profits, fallen prey to this illusion. How many times have you seen bad news turn into a positive day for the markets? The thought of a major terrorist attack in London led many to believe that prices would fall; that belief drove the majority to sell. Once the last seller sells at a price level where there are more willing buyers than sellers, the laws of supply and demand tell us prices rise.

Lesson: No matter how bad the news is, when the last seller sells at a price level where there are more willing buyers, prices rise. There can be no other mathematical outcome.

The Reality:

Area "A" on Figure 2 is an objective demand price level as the origin of the supply/demand imbalance is at the point in which prices move higher from area "A." Area "B" represents the day of the London bombings. The news of the London bombings was very real, very bad, and prices fell. However, once they reached area "A" where there was objectively more demand than supply, prices turned higher.

The Lesson: Strong news actually creates powerful turns in the market, opposite of what the majority expects because one side (buyers or sellers) exhausts itself into a price level where an objective supply or demand imbalance exists.

Figure 3

Fundamental Analysis

The Illusion:

In some cases such as the chart above, there are a number of illusions at work at once, severely clouding reality. This example shows CTXS, a Nasdaq stock. The rally in price in CTXS, as the stock revisits the area of supply (imbalance), is accompanied by good news on a brokerage upgrade. A gap up in price is seen, which is accompanied by the brokerage upgrade (source: Yahoo Finance). The illusion here creates strong beliefs. These beliefs lead to action (buy or sell) and this action (buying and selling) is all we need to be concerned with. No matter who is telling us to buy the stock and why, all we need to know is this: Are prices at a level where objectively, there is more demand than supply? If the answer is no, there is no reason to buy.

Not only is the answer *no* at the time of the brokerage upgrade in CTXS, but the laws of supply and demand tell us we should be selling here, not buying. This upgrade, which invites the novice market speculator to buy, is given right into an objective supply area where we know there are more willing sellers than buyers. The eventual drop in price from this level is fast and strong for one simple reason. The number of willing buyers at this price level became zero while the number of willing sellers was still significant (supply/demand imbalance).

All this information was available to us prior to the rally in price (the gap). But most market participants didn't see it, as the illusion was too strong. Adding to the illusion was the gap up in price, the bigger the gap, the more herd mentality people desired to buy into it. We are humans:There is comfort and safety in numbers. Again, trading is simply a transfer of accounts from the novice market speculator who does not know what they are doing, into the account of someone who does. The illusion-based trader saw a high risk/low reward buying opportunity and took action to buy while at the same time, the reality-based trader saw a low risk/high reward shorting opportunity and took action to sell.

The Reality:

The objective supply (resistance) area is labeled as such because it is a price level where supply and demand is out-of-balance. Put simply, there is too much supply. Again, prices can only drop from that area because there are more willing and able sellers than buyers; there can be no other reason for the decline in price. Objectively, the worst possible action to take is to *buy* anywhere near this supply area, especially on the first rally into it. Many illusions, however, invite the masses to buy at the absolute worst time and there is a reason for this...

The Lesson: When perceived risk is lowest, actual risk is often highest. When perceived risk is highest, actual risk is often lowest.

Illusion: Everything in the company is good; therefore, the stock is a quality investment.

Most people require specific criteria in order to feel comfortable buying a stock. These criteria likely include:

- Good earnings
- Strong balance sheet
- Solid management
- Stock price moving higher
- Brokerage upgrade
- Strong economy

These create the illusion of a quality investment.

Figure 4

Buying High?

When all of the illusions in the box are true, where do you think the price of the stock is? If you said "high," you are correct most of the time. If you buy when everyone else is taught to buy *and* when the stock price is high, *who is going to buy from you*? Remember, the only way you can derive a profit from an investment or trade is when someone buys from you at a higher price than what you paid. This is no different than buying and selling anything, which includes real estate, automobiles, computers, and much more.

The many illusions are nothing more than risk disguised as opportunity. Falling prey to a variety of market illusions makes it possible to disguise irrational behavior as "safe," "proper," or "accepted." An illusion is an erroneous perception of reality. Illusions lead the average trader and investor to commit two consistent mistakes:

- Buying after a period of rising prices;
- Buying at a price level where we objectively know there are more willing sellers than buyers.

Both of these actions are completely inversely related to how you profit when buying and selling anything. They go completely against the laws of supply and demand. However, we don't want illusion-based traders and investors to go away. Why? We need them as they consistently buy after the reality-based trader buys. In short, the reality-based trader typically derives his or her profit from the actions of the mass illusion-based crowd.

Act Like A Goose

The human mind is not wired to trade properly. Our decision-making process is not like most other animals. Most people don't focus on reality when deciding to take action; we make decisions based on emotion, not intellect. Not only is it very difficult to live in complete reality, but consistent action based on reality is an even harder task many times. A goose, on the other hand, would make an excellent trader and investor. When autumn approaches in the north, the geese don't wonder if winter will come or not. They certainly don't call a goose meeting to figure out a way to stave off winter. They simply act like a machine and fly south for the winter and repeat this process each and every year, flawlessly for their entire life, without questioning their choice.

Throughout history, people that pioneered original reality-based thought on certain topics often paid for it with their lives. An example that comes to mind was the crazy thought that the world was round. Though your life is certainly not in jeopardy with illusion-based trading and investing, the growth of your hard-earned capital sure is.

The Three Laws of Price Movement

I have been involved with trading and investing for more than ten years, and the consistent low risk profits I have produced are a function of trading what is real, not what I feel. I eliminate subjective emotions by basing each and every decision on a simple mechanical set of objective rules that quantify supply and demand. These simple rules, which are beyond the scope of this article, stem from three laws of price movement I crafted long ago. These three laws form the foundation upon which the whole system of proper trading and investing lie.

Laws of Price Movement:

1. Price movement, in any free market, is a function of an ongoing supply and demand relationship within that market.

2. Any and all influences on price are reflected in price.
3. The origin of motion/change in price is an equation where one of two competing forces (buyers and sellers) becomes zero at a specific price.

A successful trader's path must be reality-based, not driven by illusion. The reality is that markets are nothing more than pure supply and demand at work; human beings reacting to the ongoing supply/demand relationship within a given market. This alone ultimately determines price. Opportunity emerges when this simple and straight-forward relationship is "out-of-balance." When we treat the markets for what they really are, and look at them from the perspective of an ongoing supply/demand relationship, identifying sound trading and investment opportunities is not that difficult a task.

Trading Tools You May Not Find in Books

Printable Version

As I have mentioned many times, at the core of any successful trading and investing strategy is an "edge." Few traders and investors ever attain the significant market edge they desire and there is a simple reason for this. Most new market speculators begin their quest for edge-building information and education at the local book store or online. They naturally are drawn to reading best sellers and popular authors with many books on the market. The problem with learning how to properly trade and invest with the needed edge from reading these books is that everyone else is reading the same books. Your competition is learning the same strategies you are. They are learning to buy and sell exactly where you are learning to buy and sell and therein lies the trap. Simply put, if you are processing market and strategy information the same as others (your competition), you can't possibly have an edge. For this reason, I typically focus my articles not on conventional trading, technical analysis, and market information but instead, on edge-building, reality-based concepts that you won't find in the book store. In today's piece, I will cover two of many simple tools that may help you in your quest for that needed edge when speculating in markets.

Trends

Looking back at recent prior data in any market on a price chart, it is easy to see what the current trend is. Most of you are very familiar with the conventional concept of higher highs to identify uptrends and lower lows to identify downtrends. I strongly disagree with this conventional way of assessing trends. It is a lagging school of thought that typically leads to high risk, low reward trading and investing. Instead, I choose to use very mechanical "real time trend analysis" as this offers a huge edge, but this is a topic for another day. A little tool I can share today has to do with assessing the strength of a trend. It is important to assess how healthy the current trend is and when and where it may end. While we typically use supply and demand levels to determine this, there is another way... One way to do this is to measure the distance between the lows of the pivots during the uptrend. Notice the uptrend in the chart below; the distance between the pullbacks (pivot lows) is decreasing as the trend moves higher. The logic behind this is that a strong trending market does not pullback often. If it does, it is not a strong trending market anymore. Keeping with our constant supply and demand theme, remember that a trend on any time frame is really a supply and demand imbalance moving back into balance. This is a larger time frame chart but the assessment can be done in any market, and any time frame.

Logic:

<u>Uptrend:</u> *When the distance between the pivot lows is decreasing, this suggests price is nearing a supply level, the trend is becoming weak, risk to buy is increasing, and profit potential for buying opportunities is decreasing. The uptrend is likely almost over.*

<u>Downtrend:</u> *When the distance between the pivot highs is decreasing, this suggests price is nearing a demand level, the trend is becoming weak, risk to sell short is increasing, and profit potential for shorting opportunities is decreasing. The downtrend is likely almost over.*

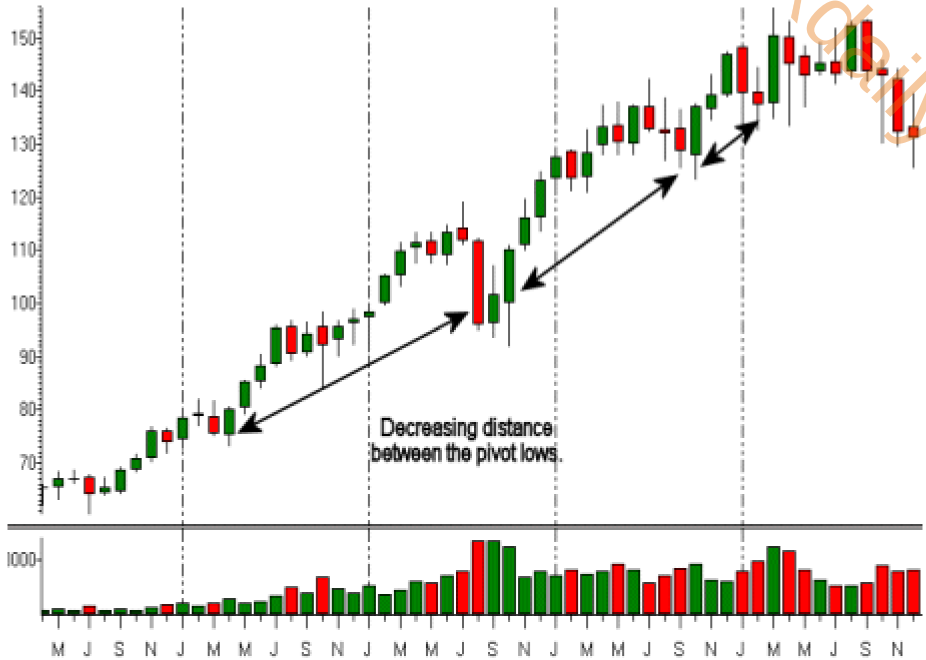

Figure 1

Volume

Volume, in my opinion, is one of the most misunderstood pieces of information when used for assessing trading and investing opportunities. While there are many misunderstandings with volume, I will focus on one today. Most of the books say, "Look for above average volume turning points." In other words, most books on trading suggest that a major turn in price should always be accompanied by high or climactic volume. My short comment - don't believe everything you read. If you think the simple logic through and focus on the real concepts of supply and demand, you will find that the exact opposite is actually true. Your most significant turns in price are almost always accompanied by low volume. Price movement in any and all markets is simply a function of an ongoing supply and demand relationship. Low risk, high reward trading opportunity exists at price levels where this simple and straight-forward relationship is out-of-balance.

Logic:

The most significant turns in price will happen at price levels where supply and demand are "most" out-of-balance. The more out-of-balance supply and demand is at a given price level, the *less time price spends at that level. The less time price spends at a level, the fewer the transactions (trades) at that price level. The fewer transactions, the lower the volume. So, the larger the supply and demand imbalance at a given price level, typically, the lower the volume.*

As you can see in the example below, at the turn in price, there is actually very low volume and this is because supply and demand are soooooo out of balance. Again, don't take my word for it; put your conventional technical analysis book down and think the simple logic through on your own. Then, go back and look at charts and you will see this is the case. When I use volume in the Extended Learning Track (XLT) class and for my trading, often I will want to see below average volume at my demand or supply entry point as that suggests a strong supply and demand imbalance.

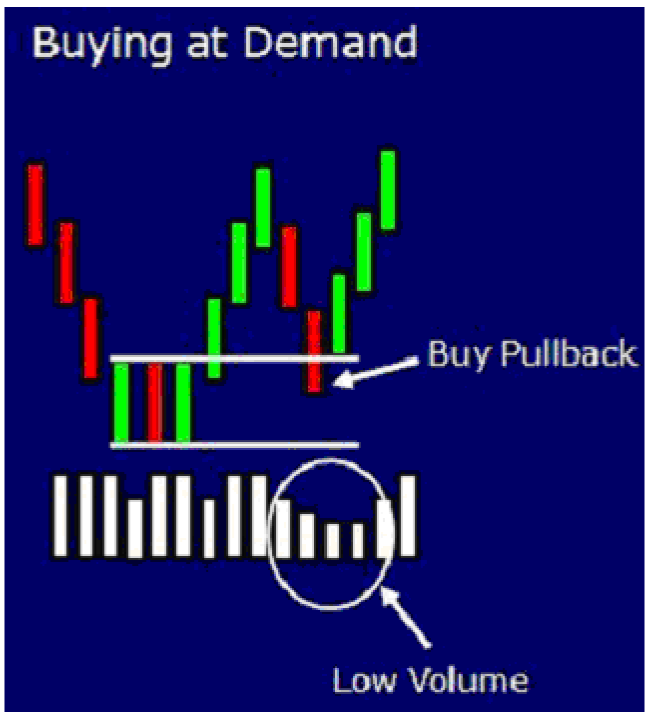

Figure 2

Instead of reading all the trading books and learning to buy and sell in markets when everyone else buys and sells (no edge)... Instead of acting on the advice of others who likely get paid from advice, not from trading... Pay attention to what is happening in front of your eyes. Pay attention to what is happening around you. Pay attention to all the simple <u>realities</u> that others never see.

Changing your ways and getting what you want out of life requires two difficult tasks for the individual. First, you must think like you have never thought, which will lead to doing what you have never done. Life is too short for you to stay in the comfort zone of conventional thought. Think in reality-based terms and build a life edge that delivers the positive results you desire

Your Questions Answered

Printable Version

Hi Sam,

Enjoyed your insightful article on 1/26 about supply & demand but my question is: Which chart time frame is most useful? As you know, different time frames will show different pictures so which do you recommend?

Thanks for the email. There are two parts to this answer. First, this depends on what type of market speculating you are doing. Are you looking to day trade, swing trade, or trade with a longer term time horizon? Maybe you will do all of the above. Whatever the answer is, you need to have a set of time frames that is appropriate for the type of trading you do. Second, make sure you use more than one time frame; typically two or three are perfect. We use a larger and smaller time frame for specific reasons. The larger time frame shows us clearly where price is at with regard to the larger time frame supply and demand curve. This tells us whether we should be looking for longs or shorts. Then, we use a smaller time frame to find our low risk / high reward supply and demand opportunities. Let's use a swing trading example to tie this all together. In the Extended Learning Track (XLT) - Futures swing trading sessions, I use weekly and monthly charts to quantify where price is at on the supply and demand curve. If price is near larger time frame demand, I will then go down to my smaller swing trading time frames, the daily and hourly, to look for demand levels with big profit margins. This approach gives me the real probabilities and true profit margins. Hope this was helpful.

Hi Mr. Seiden,

I have been trying to form a strategy since coming to Online Trading Academy last year that would give me the opportunity to raise enough money to take the XLT course. I have not been confident enough to implement it. My strategy was to play one stock, namely Rimm . My goal was to buy or sell it at the high/low after the first 15-min candle using the 1/3 of the high or low as my stop with a profit exit of $.90 -$1.00/sh. However, I also tried to combine that with my attempt to identify the supply and demand zones which I seem to not do correctly. I am using a 5-min chart for entry and a 15-min chart to follow and exit. Would you please tell me if this seems like a strategy that is sound or not?

Thanks for the email. There are three important things here you may be missing. First, if you are going to trade one stock, it is very important to analyze the appropriate index, as well. For RIMM, consider first performing your supply and demand analysis on the NASDAQ, perhaps the QQQQ (ETF for NASDAQ). Once you find your supply and demand turning points, then find the corresponding supply and demand turning points in your stock, RIMM. This will help you filter out supply and demand levels that are not quality. Second, your time frames may be an issue. Even a day trader needs to look at a larger time frame to determine whether longs or shorts have higher odds that day. By only looking at a 5 and 15-minute chart, as you say, how do you know where price is in relation to larger time frame demand or supply? For example, you may have the best-looking buy setup on a 5-minute chart at a demand level, but what if it is occurring right at larger time frame supply, seen maybe on a daily chart in this example? Chances are that this buy setup will fail, but you would only know that by including a larger time frame (60-minute or daily perhaps) in your analysis. Lastly, make sure you are identifying true demand and supply levels. Many people have the wrong definition of what a quality level looks like or what the requirements are. In the XLT, we use a checklist called "odds enhancers" which helps us quantify and qualify potential levels. Hope this was helpful.

Hi Sam,

As always thought-provoking. I have agonized over how to determine the trend for a decade and now have five methods including using trend lines but unconventionally. Regarding your last *article, thanks for adding number five.*

Thanks for the email. I can literally write a full day course on your email. There is a reason why you have been agonizing for a decade over the topic of Trend. Conventional trend analysis consists of higher highs and higher lows for uptrends and lower highs and lower lows for downtrends, up–sloping moving averages for uptrends and down sloping moving averages for downtrends. As you say, I can go on and on with these conventional ways of identifying uptrends and downtrends, but you have already spent ten years doing that so "stop the presses," let's not waste any more time. In short, conventional trend analysis is very faulty at best for use as a method of attaining the low risk / high reward, and high probability entry into a market. It is a very high risk, low reward, and low probability method that makes no sense to the astute market speculator. Think about it this way if you don't agree with me. Imagine if you used conventional trend analysis to buy things in every other part of your life. For example, only buying a car after the price went up, only buying your house after others bought similar houses in your area and price was now rising, ignoring sales at the grocery store and instead, only buying items when price was moving higher. If you used conventional trend analysis that is written about in almost every trading book to buy things in other parts of your life, you would be broke. On the other hand, your neighbors would love you for driving their property values higher, the car dealer would give you a big hug and thank you, and the grocery store owner would welcome you with a red carpet and some free coffee perhaps. So, there is a trade off - money for love, I suppose. Of course, I am kidding (though this would really happen), but you get the point. The biggest misconception in the world of market speculation is that somehow, the proper logic and rules are in any way shape or form different from the logic and rules you use to buy things in everyday life. The short answer is to set a date where you will no longer focus on your quest for "trend information". End the ten year cycle and focus instead on key supply and demand levels. Every trend begins and ends at price levels where supply and demand are out-of-balance. Identifying these levels is not that difficult once you have a solid understanding of the concepts and rules. That picture of higher highs and higher lows that you likely wait for to buy into a market, many buyers have always bought before you each and every time. Why can't that be you? Why does it always have to be someone else? When you shift your focus from conventional trend analysis to the reality of how and why market prices change direction, you will then have a strategy that has you entering before all the book readers and conventional buyers. We love the conventional concept of trends, we just want to be in the market before that group pushes the buy button. Again, I can go on forever with this topic but I will save that for another day. Hope this was helpful.

As always, thank you for your feedback and questions. Also, thank you for your loyal readership. It is really a privilege to share market information with you.

System Trading – A Complex World with Simple Answers

Printable Version

Recently in the Extended Learning Track (XLT) - Stock Mastery class, we had a lesson on trading systems. While I can't go over all the information during that session in this piece, I wanted to share some of the important aspects of that lesson. I have been in the business of market speculating and market/trading education for over 15 years. While Futures and Forex have always been the main markets I trade and manage accounts in, I have also spent plenty of time trading stocks and options as well. My path began on the floor of the Chicago Mercantile Exchange, well before the average retail client had access to online trading. After years on the trading floor, I left and pursued a trading career from the friendly confines of home. Back then, I was faced with shaky data and charts at best and the task of phoning in orders to a trade desk. Needless to say, change and growth have been explosive in this industry since my early days.

The Birth of Trading Systems

Advances in technology have been the driving force behind the change and growth. One of the many recipients of faster and stronger technology is system trading, as high speed computers now help retail and institutional traders develop systems, crunch numbers, and back test hypothetical results in seconds. In the world of professional money management, I have seen plenty of trading systems. Ironically, most don't seem to work and of the ones that do, they typically work for a bit and then fail. Being on the education side of the industry as well, I have seen hundreds of automated systems yet, I can only say that I have seen less than a handful actually produce a consistent profit year after year. I often get emails from people who have read an article I wrote that want to share an automated strategy with me. They are sending it so I will help them review it and perhaps improve it. Traders will send me back tested hypothetical performance reports from these strategies that suggest they have the holy grail of trading systems. Most of these will show 80% winning trades or better and huge profits. Most of the time, however, when they take the next step and trade the system with real money, they lose and lose fast. With explosive advances in technology and market information, why is system trading so difficult for most who give it a try? There is a very simple reason I will discuss later. In this piece, I will focus on the foundation of a profitable trading system, offer specific tools and rules of a profitable system, and expose the dangerous traps that lead to system trading failure.

The Most Important Aspect of a System

As much change and growth has occurred due to technology, there is one component to trading that has not changed one bit, and that is how the consistently profitable trader derives consistent low risk / high reward profits. The key to a proper trading strategy all comes down to the foundation of that strategy. To have the proper foundation, you must have a solid understanding of how markets work and why price moves as it does. If you have one flaw in your thought process, you can be sure it will lead to poor trading results. The reality is that markets are nothing more than pure supply and demand at work; human beings reacting to the ongoing supply/demand relationship within a given market. This alone, ultimately determines price. Opportunity emerges when this simple and straight-forward relationship is "out-of-balance." When we treat the markets for what they really are, and look at them from the perspective of an ongoing supply/demand relationship, identifying sound trading opportunities is not that difficult a task. Market speculators who understand this simple concept and what this opportunity looks like on a price chart typically derive their income from market speculators who don't. In other words, those who "know" get paid from those who "don't know."

Who is on the Other Side of Your Trade?

If we want a consistently profitable trading system, we had better make sure that the person on the other side of our trades is a consistently losing trader. Our system had better be an expert at finding a novice trader or we are in trouble. We don't need to know the exact person on the other side of our trade, we just need to know if they are a consistently profitable trader or a consistently losing trader, and the chart will give us most of this information.

Let's face it, when it comes to charting and technical analysis, most active traders use indicators. While many people including myself have often beaten up the indicators, they are actually a fine tool when used properly for automated or semi–automated trading systems. The problem is that people tend to take every buy and sell signal an indicator produces and this is the last thing you want to be doing. Those who take each buy and sell signal an indicator offers are likely to lose their trading capital fast. It is not that the indicators are doing anything wrong. They will always do what they are programmed to do. The key for the trader is to use them in conjunction with proper trend analysis and the proper foundation based on the laws of supply and demand. One of the benefits to using indicators and oscillators the right way is that they allow you to trade based on a mechanical set of rules. Let's use a single moving average and stochastics in our attempt to use indicators in our system to find the consistent losing trader to trade with.

Figure 1

Above is a chart of the QQQQ. On the chart is a 50-period moving average and a slow stochastic oscillator. To begin with, we must assess the trend of prices in this market. For this task, I use a 50-period moving average. Notice that the slope of the moving average is up, suggesting we are in an uptrend. Once we know this, we only want to buy pullbacks in price. The mechanical signal to buy comes when the stochastic produces a buy signal in oversold territory (moving average cross, circled above). While this turned into a nice low risk buying opportunity, notice the price action just prior to this buying opportunity in the QQQQ. During the uptrend, the stochastic was very overbought, producing sell signals during much of the uptrend which would have led to many losses had you sold short at those times. This is a trap new traders can fall into when using these tools without reality-based, logical rules.

<u>Buy Rule:</u> When the moving average is sloping upwards, take the stochastic moving average cross in oversold territory as a buy signal. When the moving average is sloping upwards, IGNORE EVERY sell signal the stochastic moving average cross in overbought territory produces.

<u>The Reality Based Logic:</u> When prices are moving higher, we want to find a buying opportunity when things are on sale. <u>Most importantly, our buy signal told us objectively that someone was selling after a decline in price and selling in the context of an uptrend.</u> This can only be the action of a novice seller. A consistently profitable trader would never sell after a decline in price and in the context of an uptrend. So, we want to buy from this novice seller.

As you can see, this is a two-part process and it's important to understand this when building your trading system. The two parts are as follows:

The "Switch": The switch is an on/off switch that says it's either "ok to buy" or "ok to sell," but not both at the same time in this case. For example, when the moving average is sloping upwards, the switch is turned on that says "it's ok to buy" which means it's not "ok to sell."

The "Trigger": The trigger is the actual entry. So, if the moving average is sloping upwards, the "switch" is turned on that says it's "ok to buy." This means that the buy signal produced by the stochastics cross in oversold territory (the trigger) is turned on. If the moving average was sloping down, however, that buy signal trigger would be turned off and the sell signal trigger would be turned on.

Perhaps your trading system is not going to include indicators and instead, will focus on supply and demand levels. In this case, you would still have a "switch" and "trigger." Your switch would be price reaching the supply or demand level and your trigger would be the actual entry which may be a reversal candle at the level, price reaching the level, or one of many more triggers. Whatever the strategy, there is always a "switch" and "trigger."

Figure 2

On this chart, we also have a 50-period moving average and a slow stochastic oscillator. Here, the slope of the 50-period moving average tells us the trend is down. Once we know this, we only want to sell to a novice trader who is buying after a move higher in price in the context of a downtrend. The mechanical signal to sell comes when the stochastic produces a sell signal in overbought territory (moving average crosses, circled above).

<u>Sell Short Rule:</u> When the moving average is sloping downwards, take the stochastic moving average cross in overbought territory as a sell signal. Also, when the moving average is sloping downwards, IGNORE EVERY buy signal the stochastic moving average cross in oversold territory produces.

<u>The Reality-Based Logic:</u> When prices are trending down, we want to find a shorting opportunity when prices are high. Furthermore, we want to sell short to the buyer who is making the mistake of

buying after a rally in price and in the context of a downtrend (a novice buyer).

Is this or any trading system perfect? Certainly not, there is no perfect trading system and there doesn't need to be. If there was, that person would have all the world's money. However, wrapping some simple rules and logic around your trading is the key to stacking the odds in your favor. Even Las Vegas does not win all the time, nor do they want to. They do well over time because they realize they don't have to always win. They just need to stick to their rules that allow them to keep the edge which means betting against people who don't have the edge.

Any Market and Indicator Will Do When You Think the Markets Correctly

Figure 3

This is an intra-day chart of the NASDAQ Futures with the same 50-period moving average. In this example, I simply switched the stochastic for the Commodity Channel index, better known as CCI, and we will get almost the same signals as discussed above.

Technical Reason for Shorting:

1. The down sloping 50–period moving average suggests this market is in a downtrend.
2. A CCI Overbought reading (circled on the chart).

Logical Reason for Shorting: Sell short to a buyer who buys AFTER a rally in price and in the context of a downtrend. The only type of mindset that would take this action is someone who makes decisions to buy and sell anything based on EMOTION, not simple and proper logic. This is the pedigree of the trader we want on the other side of our trades.

Trading strategies that work don't change with time, markets, or changing market conditions. Quite frankly, to think market conditions ever change at all is a strong illusion that can only be removed when one focuses on the foundation of price movement, pure supply and demand. The systems I see working are very simple. The example below is an intra-day chart of the Dollar/Yen. Let's apply our same basic principles.

Figure 4

Technical Reason for Buying:

1. The up sloping 50–period moving average suggests this market is in an uptrend.
2. A CCI Oversold reading (circled on the chart).

Logical Reason for Buying: Buy from a novice seller who sells AFTER a decline in price and in the context of an uptrend.

Summary	
Uptrend/Oscillator Overbought: **Ignore**	Downtrend/Oscillator Oversold: **Ignore**
Uptrend/Oscillator Oversold: **Buy Signal**	Downtrend/Oscillator Overbought: **Sell short Signal**

Figure 5

Turning Failure Into Success

I see the vast majority of traders that go down the system path spend years form-fitting indicators and oscillators and crunching numbers based on back tested, hypothetical results (numbers). I see very few people develop strategies based on the simple logic of how and why price moves as it does in any market. From my reality-based market experience, trading is a simple transfer of accounts from those who don't understand simple market logic into the accounts of those who do. Trading systems just expedite the process.

As I mentioned earlier, most traders who develop trading systems don't take this approach or think in the simple terms I am suggesting. Why? It is because of how most people learn about markets and trading. Most will not begin their learning path as I did by handling institutional order flow on the floor of an exchange. The vast majority of market players will start with a trading book or seminar written or delivered by someone who writes books and delivers seminars, NOT a real market speculator. These books are filled with conventional uses of indicators and chart patterns that simply don't work. If they did, the author would certainly not be selling the book to you. This leads to a novice trader thinking they can take a trading system short-cut and add a few indicators and oscillators to a price chart and let the computer find the parameters for each of those indicators that would have produced the best results in the past (back testing). Typically, when the novice system trader begins trading with real money based on those quality hypothetical results and begins losing money, they take the next wrong step - they begin adjusting indicator settings and worse yet, they add more indicators. This is a path that leads to trading disaster, yet the novice system trader does not even know it. They say, "How can a system with such great back tested numbers not work?" It doesn't work because the system is based on number crunching and curve-fitted back testing results. The reality of how markets work is ignored. When designing your trading system, make sure you bring your foundation back to the basics of how and why price moves in any and all markets

Got Questions? Sam has Answers!

Printable Version

I am an Online Trading Academy stock trading graduate and soon to be futures class attendee (with XLT hopefully to follow if I like futures). Thank you for this week's "Systems Trading - A Complex World with Simple Answers" article; it was very enjoyable, well developed and perfectly explained. The only thing that I would ask is how you use these trade rules for "sideways" markets like we have now? I trade the "SPY" and I am having some difficulties with lack of movement. I often opt out of trades or get stopped out with small but annoying losses. How would you add another box in the summary boxes you created for this situation?

Thank you in advance for your response.

Dan J.

Thanks for the email. If you want to use the indicator for trend and oscillator for entries, add a setup that calls for the moving average to be relatively "flat." In other words, from the article, you need to have a specific slope of the moving average to know you're in a trend. That slope is defined by a number. So, any number less than what you require for uptrend, and greater than what you require for downtrend, means that the moving average is not sloping up or down, sideways trend. When this is true, you can take both oscillator buy and sell signals as entry points. Once the moving average begins to slope up or down again, go into trend trading mode as discussed in the article. Hope this helps.

Sam,

First I want to thank you for your willing to share your knowledge and wisdom to help the want-to-be traders all over the world. Personally, I took some courses and read about 20 books, but always had the feeling that something was missing and that some theories seem faulty. I read your articles and watched your webinar at FxStreet, and can tell you gladly, that it was enlightening. It helped me a lot in arranging my thoughts and rewrite my trading plan to one that I can feel comfortable with and that seems logical to me.

I have a question regarding gap up as a demand. When a gap up occurs in the middle of the move, will you consider the origin of the up as a valid demand, or ignore it and wait for the price to reach the pivot low?

Thank you very much,

Ben

Thanks for the email. Be careful with those gaps in the middle of moves. I have two answers for you. First, go back and read a prior article I wrote on "Gaps, Pro versus Novice". This will help you focus on the highest probability opportunities around gaps. Second, when you see a gap up in price from an area, your next step should be to identify the nearest demand (drop base rally) level to the origin of that gap. Much of the time it will be found at the origin of the gap, but not always. Sometimes, it is just below the origin of the gap and that is where we find the low risk, high reward, and high probability entry at. The opposite is true for the gap down and where the real supply is.

Hi Sam,

I've wanted to ask you about this monthly Nasdaq supply that you have been telling us about. You rightly pointed out that it would stop prices going higher and it certainly has which surprised me as the novice because the S&P seems to have further to go before it hits supply yet it has turned, too.

But my question is more to do with the longer term like my IRA... I heard you say that prices would have to go a lot lower before the supply/demand imbalance would be cleared out – which to me sounds like it would have to fall to at least 50% of the move up from the March lows last year, like the Qs dropping back to $35-ish. Well so far the market has pulled back and then started to rally a bit. I guess my question is, do you think it's headed back to the January highs again or is it more likely to fall way lower from where we are now before it goes back to the January highs?

This is important to me because I have some HPQ Employee stock options that I have to sell before 5/31 so I would like the market to go back to the highs or even higher so I can get the best price, but then again if it's going a lot lower, I should act now at the price that HPQ is at now.

I know you can't give advice and I'm not looking for that, just help in interpreting the monthly supply level.

Thanks so much Sam.

Keith

Thanks for the email, Keith. The S&P does have room to fall but when you look at the larger time frames, daily and weekly charts, there are demand levels not that far away. From your question, you are focused on where the demand below is as that may dictate your IRA actions. What you may not be considering is the other side of that equation which is just as important. It's the NASDAQ and S&P supply above. Just because price declines to one of the key demand levels below does not mean it's going to move past that big supply above. There are two things to consider equally: 1) Identify the demand level below current market prices that has a significant upside profit margin (distance from demand to supply). 2) Wait for some, if not all, of the supply above that we have been talking about to be absorbed, traded through before investing capital for a big move to the upside. I know you're in the Extended Learning Track (XLT). Lets discuss this further during a session.

Hi Sam,

Another good article!

I think about the traders of yesteryear, Gann, Elliott, Dow etc and realize they traded without computers or indicators, but they developed a feel for the tape, i.e. supply and demand. They did develop some simple indicators but my understanding is they didn't rely on them in the same way we have been conned into by the "trainers" of today. If people did a short spell of hand charting maybe some would become better traders as they would see patterns as they were developing. Computers are great tools but we have allowed them almost to become our masters by our over reliance on indicators.

Regards,

John P.

Thanks for the email, John. I could not agree more. In fact, at one time, I did use graph paper and colored pencils and let me tell you... You become very aware of price levels where demand exceeds supply and vice versa. People's reliance on computer-generated decisions in the trading world have just helped the old school traders get wealthier. When watching the "tape" and price rises significantly from a price level, why did it rise? Simple, demand exceeds supply at that price and that is where the low risk, high reward buying opportunity is. Today's fancy computer models never tell people to buy at that level. Instead, people wait for computer-generated lagging buy signals to get them into a high risk, low reward trade and ultimately, pay the tape reader who bought at demand. Sounds like you have figured out the big secret to success. Don't worry about telling others; most will go with the high risk entry - people are people.

Patience and Probabilities

Printable Version

Supply and demand, two simple words that have determined price for as long as man has walked the earth. These are two words people learn about first in middle school, then high school, and again in college. If you have ever read my articles and stories, you are likely bored to tears of hearing the supply and demand repetition. If the concept is so well-known and supply and demand pattern recognition on a chart is such a simple picture, you would think profitable trading should be very easy. Unfortunately, there are also two other words that are required for profitable trading, they are "discipline" and "patience." While these two words are just as well-known as supply and demand, they are two of the most difficult human behavioral traits there are.

Lightning fast technology and user-friendly trading platforms can be a recipe for disaster for the trader working from home with too much time on their hands. The desire to push the buy and sell buttons on a frequent basis are so strong that patiently waiting for the ideal trading opportunity becomes a difficult task. You have to remember how markets work. Markets, in general, spend most of their time at price levels where supply and demand are in relative equilibrium. When supply and demand are in relative balance, there is little low risk, high reward, and high probability trading opportunity. They spend the least amount of time at price levels where supply and demand are very much out-of-balance. At these levels of extreme imbalance, risk is low, reward is very high, and the odds are stacked in your favor (if you know what you are doing, of course). So, as you can see, patience and probabilities go hand-in-hand.

Figure 1

The screen shot above is a trade from the Extended Learning Track (XLT), our graduate program at Online Trading Academy. The opportunity was to short Google (GOOG). I was leading the swing trading session on Friday, March 12th and going through our rule-based supply and demand analysis. We noticed that the S&P (circled grey chart upper left) was nearing a supply (resistance) level. We also noticed that the VIX (CBOE Volatility Index, circled grey chart lower left) was nearing an area of demand. This suggested the stock market was likely to stop moving higher at the rate it had been and that the next likely move would be lower. While that supply level was big and there was room for the S&P to move a little higher into it, the rate of advance was very likely to slow down. Given that the S&P was nearing supply, it was time to look for some individual stocks for low risk, high reward, and high probability shorting opportunities. As I went down our watch list, I landed on a daily chart of Google (GOOG). On this day where the S&P was trading right up into supply, GOOG was gapping up into a very ideal supply level itself. The opportunity had a number of "odds enhancers" associated with it.

Odds Enhancers

1. S&P nearing Supply
   - This suggests the whole market is likely to decline which means most stocks will decline as well
2. Novice buying in GOOG
   - We have evidence that novice market speculators are buying GOOG on March 12th. We know this because they are making the same two mistakes all novice market speculators make. First, they are buying a GAP UP in price AFTER a strong rally in price. Second, they are buying right into a price level where supply exceeds demand. We want to buy and in this case, sell to novice market speculators (this is how Wall Street makes billions).
3. Gap down from supply in GOOG
   - The gap down from the supply level (circled area below) tells us that supply and demand are out-of-balance in a big way. As a rule, the stronger price moves away from a price level, the more out-of-balance supply and demand is at the origin of that move.
4. VIX (CBOE Volatility Index) demand
   - The VIX is a great sentiment indicator. When the VIX is moving higher, this means that people are scared and are buying put options on the S&P. When the VIX is moving up, the stock market (S&P) is moving down. The opposite is true as well. When the VIX is low and near a demand level like the chart above (grey chart in lower left), people are complacent, and few think the market will fall. This means that most people have bought and when everyone has bought, the market has to fall (no more buyers). So, the VIX near demand supported our GOOG shorting idea.
5. Large GOOG profit margin
   - As price gapped up into our supply level for a shorting opportunity, it did so with demand far below. This means there was a large profit margin at hand. Also, it's important for you

to understand that with large profit margins come higher probabilities. This is because the larger the profit margin (distance from supply to demand and vice versa), the more the rubber band is stretched, so to speak. We only want to enter positions when the distance from demand to supply is substantial. This again, means that we are trading far out on the curve, away from equilibrium where supply and demand is most out-of-balance.

These odds enhancers are not present at every opportunity we find. In fact, often many of them are not present. To only trade when the odds are stacked in your favor takes patience and discipline. As you can see on the screen shot below, we entered a swing short position in GOOG on the gap up in price into demand, as the odds were stacked in our favor, the risk was low, and the reward was high.

Figure 2

On the day we entered GOOG short, that day ended as a red candle at supply. The next day, price gapped down and hit our first target. The key was entering at the level, before we had the big red candle at supply, when the risk is low. Most people will wait for "confirmation" of a red candle before shorting the next day. The astute market speculator is already short when that red candle (confirmation candle at supply) invitation goes out to the masses. When they then sell short, they are helping the rest of us who already shorted at the turning point.

Proper trading is much like a game of chess. You need to have an objective set of rules that has you anticipating the market's next move. This is easy to do at the right times, supply and demand levels. What this requires is the patience to wait for price to reach key supply and demand levels before taking action. The GOOG trade from the XLT Stock Mastery program was found on a daily chart. We needed to wait a few days for price to reach this opportunistic price level. With patience comes high probabilities

Patience and Probabilities, Part 2

Printable Version

Last week, I discussed the relationship between patience and probabilities. I used an Extended Learning Track (XLT) swing trade (GOOG) as an example. This week, let's go over another aspect to patience and probabilities. I will use a stock day trading example from the XLT, setup during a session I was leading Wednesday, March 24th.

When we day trade stocks in the XLT, we always make sure we time our entries into stocks with key turning points in the S&P and/or NASDAQ. When you do this, the probability of your stock trade working out is dramatically increased. The issue is that you have to have the patience to wait for this high probability event to line up. As always, those who do typically get paid from those who don't. The markets do a great job of properly allocating capital to those who should have it. Below is a picture of what we were looking at in the XLT - Stock Trading class March 24th. The grey charts are charts of the cash S&P and the S&P futures. The white charts are three different time frames of Intel (INTC). The yellow shaded areas on all the charts are supply levels. How do we know they are price levels where supply exceeds demand? They are the origins of price declines. Having started my career on the floor of the Chicago Mercantile Exchange facilitating institutional order flow, I learned very quickly why price can't stay at certain price levels and has to rally or decline from that level. It is because at that level, supply and demand are out-of-balance.

Given that supply exceeds demand at those price levels shaded in yellow, we wanted to be sellers if and when price revisits the supply levels. As you can see, when price in the S&P rallied back up to that supply level, some XLT members sold the S&P short like I did, and others decided on a short position in INTC. The key to the INTC short opportunity working out was that when it reached supply, the S&P was also reaching supply with demand lower giving us an acceptable (not great) profit margin. Selling INTC short when the S&P or NASDAQ is not at a supply level is a very low probability trading opportunity. Timing your entries in stocks to the S&P and NASDAQ supply and demand levels is the key to stacking the odds in your favor.

Figure 1

The trades worked out fine because of our patience and proper planning. Your job as a market speculator is not to turn on your computer and look for something to trade. That's what the novice market speculator does. Our job as astute market speculators is to turn on the computer and search for low risk, high reward, and high probability opportunity. If and when we find it, we take action. If there is no low risk, high reward, and high probability opportunity at hand, we must have the patience to wait for it.

An XLT "Edge" Building Rule to Better Your Odds

Printable Version

There is only one reason why someone should read articles on trading, take courses, attend seminars, read books on trading and strategies, and more. The only reason is to gain an "edge" over your competition that allows you to produce the low risk profits/income you need to live the lifestyle you desire to live. This is also the goal of the Extended Learning Track (XLT) program. While we can't give away everything we do in the XLT because that would not be fair to XLT members, I can share another "edge" building rule we use with you today that you will not likely find in the conventional trading books.

Recently, I took advantage of a trading opportunity in the S&P. While I took the trade in the S&P futures, let's look at a chart of the SPY (S&P ETF) as that is the same chart/market. I also attached my trading statement for that day to the chart for your review and confirmation of the trade. The edge-building rule I want to go over with you today has to do with the strength of a supply or demand level, the probability of the trade working or not.

On the chart below, we have two supply levels on top of each other. This is not always the case as much of the time, supply levels (and demand levels) are not right on top of each other. When you do have this scenario, a level on top of a level, the odds of the trade working out in your favor increase. Think of it this way... Would you rather have your money in a bank vault that had one steel door, or would you rather have your money in a vault with two steel doors? When price is reaching a supply level with another supply level just above, price is reaching a very "thick" area of supply. Given this information, I was very interested in selling short at this level.

Figure 1

When you have this scenario, a question will often come up so let me go over it before you run into this dilemma. The question is how to enter this position? Do you sell short at the bottom supply level, the top supply level, or both? You can do one of two things. In the XLT, we either scale into the position by entering some of the position at the bottom supply level and the rest at the upper supply level with the stop above the upper level. Or, we enter the entire position at the upper supply level. What we never do is enter the entire position at the bottom level with a buy stop above the bottom level. If you did that, you would be putting your stop right where you should be entering short, and we don't want to do that.

Back to the "level on top of level edge," from a logic perspective. Given that this concept offers higher odds of prices turning lower at the supply area, who in their right mind is buying at that level? It is not only a novice trader, but a VERY novice trader who clearly does not own an "edge" when it comes to market speculation. The buyer I sold short to bought after a strong rally in price and right into that level where supply exceeded demand, in a big way. This buyer was trying to get through the two bank vault doors with a plastic hammer, thinking the doors were made of paper.

Lesson: *A supply level that has another supply level sitting just on top of it is typically stronger than a supply level with no supply level near it.*

Lesson: *A demand level that has another demand level sitting just below it is typically stronger than a demand level with no demand level near it.*

It wouldn't be right of me to not tell you the whole story with this trade; there is more. About an hour before the entry took place, I received a phone call from the mayor of Foolsville. He called to tell me about a big buy signal in the S&P and that all traders in Foolsville were buying. I thanked him for alerting me and asked him if he was willing to tell me at what price level they were buying at. He responded, "Of course I'll tell you, the more that know and buy, the better." He went on to say the price they were buying at was $119.00 in the SPY. I found that interesting because that is exactly where I was going to sell short. Knowing that the Foolsville traders consistently lose money because of their "copy – paste" belief system, I knew the odds were stacked in my favor. I thanked Mr. Foolsville mayor and let him know I would be out to see him sometime this summer and would gladly buy him lunch - what a great guy.

All joking aside, traders live in a world where certainty does not exist. I would argue that trader or not, we all live in a world where certainty doesn't exist. Given this fact, we must not search for certainty, but instead search for better odds. This search begins and ends with objective rule-based analysis based on the laws of supply and demand. If any laws have stood the test of time, it's the law of supply and demand (motion into mass). Not every trade is going to produce profit; some will produce a loss. When you are searching for price levels where demand and supply are strong, levels on top of levels dramatically increase your odds. I hope this "edge" building rule was unique and helpful for you.

Where is the Stock Market Going?

Printable Version

Before looking forward, let's take a quick look back to help understand how our longer term supply and demand analysis works. Back in March of 2009, the S&P was reaching a significant demand level as seen on the monthly chart below. I alerted the Extended Learning Track (XLT) program members on March 4th and we took long-term action on the buy side. When we looked at the profit margin at that time, it was significant, giving us an ideal risk and reward scenario. When we assess profit margin by way of charts, we look at the distance between the "fresh" demand level and the "fresh" supply level. Back in March of 2009, the distance from that demand level to the supply level seen on the chart was huge. Below the chart is an email and statement from one of the many XLT members who took action and bought into the stock market back in March 2009. His action specifically was to buy a basket of stocks that were also reaching larger time frame demand levels. His email was sent two months after we pointed out the buying opportunity at larger time frame demand and already, he had some nice double-digit percent returns going. The key to attaining the low risk, high reward, and high probability entry into the market, however, was timing the market based on real supply and demand analysis. Stepping out of our XLT world, the Wall Street experts tell the public "You can't time the market." Obviously, I don't agree with that at all. Perhaps they tell the public this because Wall Street would generate fewer fees if the average person believed they could time the market. Or, perhaps Wall Street says this simply because they don't know how to time the markets' key turning points themselves. Maybe it's both, who knows and who cares.

Figure 1

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-----Original Message-----
From: Shawn C
Sent: Thursday, May 6, 2009 5:04 PM
To: 'Sam Seiden'
Subject: Gains

Hi Sam,

Most of the positions were entered during the week of 3/9 - 3/13. This was one of my IRA accounts which was sitting all
in cash until the end of Feb. after I started putting some of the XLT pieces together.

Shawn
```

Figure 2

List Update | Edit Delete Create

Entry	Trade	Symbol	Last	Chg	%Chg	Bid	Ask	B Size	A Size	Volume	News	%GL	52 Hi	52 Lo
1	Trade	DRYS	[illegible]	[illegible]	[illegible]	$5.18	$5.19	[illegible]	[illegible]	[illegible]	10:30 am	[illegible]	$116.43	$2.72
2	Trade	AA	$7.95	0.23	2.98	$7.94	$7.95	185	136	20,372,236		35.07	$44.77	$4.97
3	Trade	FDRXX	$1.00	0.00	0.00	$1.00	$1.00					N/A		
4	Trade	HYG	$70.09	0.42	0.60	$70.09	$70.10	2	7	178,249		5.05	$100.82	$61.50
5	Trade	NUE	$41.04	1.96	5.02	$41.03	$41.05	2	4	2,574,248	11:14 am	9.36	$83.56	$25.25
6	Trade	OLN	$15.245	0.755	5.21	$15.27	$15.29	8	3	608,015		59.26	$30.39	$8.97
7	Trade	PBT	$10.64	0.0866	0.82	$10.63	$10.64	3	21	73,628		7.94	$27.80	$7.38
8	Trade	PBR	$34.33	[illegible]	[illegible]	$34.33	$34.34	13	19	9,827,182		36.24	$77.61	$14.73
9	Trade	TBT	$46.17	0.06	0.13	$46.17	$46.18	11	15	1,273,417		4.37	$75.00	$35.51
10	Trade	PCU	$18.73	0.64	3.54	$18.72	$18.74	12	5	1,350,667		36.24	$41.93	$9.12

Trade Selected Symbols | Chart Selected Symbols

Figure 3

Fast-Forward

Now, let's fast-forward to today, thirteen months after that market bottom. As you can see from the monthly chart above, price is not that far from a significant supply level which is where we would expect prices to not only stop rising, but also decline. Could I be wrong? Sure, but I am just as confident in that market call as I was picking the market bottom last March. Also, if I am wrong and price just rallies past that monthly supply area (I would be very surprised), we can simply buy pullbacks to new demand levels. That area of supply on the monthly time frame is large. What we often do in the XLT is investigate larger time frame levels by looking at those areas on smaller time frames. This is similar to when a doctor takes an x-ray of a broken bone. For example, they never take one picture when taking x-rays. If you break a bone in your elbow, they are going to take two or three pictures. When you look at each of these pictures separately, they look different but, it's still the same elbow.

Below is a weekly chart of the S&P (SPY – S&P Exchange Trader Fund, ETF). Looking inside that large monthly level, we see two clear supply levels on the weekly time frame. The lower (proximal) one is not far away at all and the upper (distal) supply level is sitting just above. The chances of price moving up past both of these levels any time soon is not likely.

Figure 4

The News

The news is an interesting ingredient in our analysis as well. If you remember back in March of last year, the news was not good. In fact, if you listened to it even a little, we were being told that the world was basically about to come to an end. We had the worst jobs reports since 1945, home foreclosures were at record levels, and AIG was about to cause the global financial world to "collapse" as the government put it. Given this news, who in their right mind was going to buy into the stock market that was in a free fall at the time? The answer is this: Anyone who understands two simple facts was very excited to buy into the stock market:

1. Understanding how you make money buying and selling anything. The only way to obtain consistent low risk, high reward, and high probability opportunities in the markets is to identify market price turning points in advance and buy low and sell high. In other words, buying at "wholesale" price levels and selling at "retail" price levels.
2. Understanding how to quantify and qualify supply and demand in a market with a price chart. This is the key to identifying those market turning points in advance.

Now, think about the news in general today with regard to the economy, corporate earnings, upgrades and downgrades, and more. Overall, it's good and getting better each week. Real bad news and price at or near demand (wholesale prices) equates to a turn higher in price. Real good news and price at or near supply (retail prices) equates to a turn lower in price.

Conclusion

Back in March 2009, considering best use of investment capital and opportunity cost, it made clear sense to allocate funds to the stock market. Today, at current stock market prices, I would not expect anything close to the same returns from the stock market that the past thirteen months has delivered. Is price likely to revisit the March 2009 lows? This is not likely in the near term. When we look at that thirteen month rally on the weekly chart, we see that some demand levels were created on the way up. The price charts contain all the information we need when you know what you're looking for and at. The trick is to keep your analysis "real" and "simple." People, in general, have a very hard time accomplishing one of these tasks, let alone both of them together. This leads to another very quantifiable equation... Those who can accomplish these two tasks simply derive income and wealth from those who can't. If you feel you need help with this, start by reading my piece from last week, "Free Resources to Help Gain an Edge," which will lead you to plenty of "free" information that should help you. If that is not enough, send me an email and we will take it from there. As for the markets and longer term predictions, we will revisit them when the charts tell us a major turn in price is likely

The All Star Entry (Lite)

Printable Version

Many of my articles deliver a message about the concepts of Supply (retail prices) and Demand (wholesale prices). This week, I want to share a rule-based strategy from the Extended Learning Track (XLT) program that is quickly becoming one of the most popular strategies we use. We call it the "All Star" entry. It was given its name due to its potency as a high probability entry technique. Before I go on, you may be wondering about the word "lite" in the title; I will address this later in this piece.

The All Star entry combines two high probability tools that, when used together, help us identify a high probability event which in trading terms means "opportunity". These tools are:

1. Supply and demand
2. Bollinger Bands

To illustrate the setup (entry), let's look at two recent live trades from the XLT. The first trade was from the Stock XLT in RIMM (Research In Motion). Notice the supply level shaded yellow. I chose this supply level because price moved lower from that point in strong fashion suggesting a significant supply and demand imbalance (lots of supply). For those who are new to the concepts of supply and demand, we look to sell short at supply levels. Next, notice that when price rallied back to this supply level, it also pierced the upper Bollinger Band. This suggested two things. First, price was reaching a price level where the chart suggested there was more supply than demand. Second, the fact that price was also piercing the upper Bollinger Band suggested that statistically, price was at an extreme and likely to revert back to the mean. Both of these pieces of information suggested price was very likely to turn lower at that supply level. The combination is what makes this a high probability event.

Figure 1

The profit target for this shorting opportunity is represented by the blue line below. The placement of that line is a function of where the demand is. Notice the demand is just below the blue profit target line. We do this, as a rule, because we want to buy back our profitable shares just before price reaches demand, not at demand. The logic behind this is simple. At demand, there is competition to buy. Therefore, if we desire to buy shares in that area, we don't want to buy at a price level where there is competition to buy. We want to buy just before that demand level to avoid the competition and have a better chance of meeting or getting filled on that order. Back to the All

Star entry and some simple rules:

- When price reaches a strong demand level, is piercing the lower Bollinger Band, and there is a significant profit margin above, we have a high probability buying opportunity.
- When price reaches a strong supply level, is piercing the upper Bollinger Band, and there is a significant profit margin below, we have a high probability shorting opportunity.

Let's look at another recent trading opportunity from the XLT, INTC (Intel). For those who listen to "Hour With The Pros," I also went over this opportunity then, as well. Again, we had a significant supply level (yellow shaded area). We know this because price declined from the level in very strong fashion and also because of how far it declined before returning back to the level. Over to the right, we see that when price rallied back up to that supply level for our short entry, it was also piercing the upper supply level. This combination again suggested we had a high probability trading opportunity at hand. What was different about INTC was that the day it rallied and met entry for us at supply, it did so with a good earnings announcement. I remember thinking that people would think I am crazy for suggesting that price would decline after the company just announced real good earnings. However good the news is, when price reaches a price level where willing supply exceeds demand, price will fall. As expected, mean reversion happened quickly and target one was reached.

Figure 2

You may still be wondering why the word "lite" is in the title. The reason is because there are two more rules to the All Star entry technique not discussed in this article. The reason for not discussing them is a challenge I deal with each week when writing Lessons From The Pros. I always walk a fine line between trying to give quality edge-building education that can really help people and impact their lives, and at the same time, not giving away all the key edge-building information that XLT members put the time and effort into attaining. This would not be fair to XLT members and I respect that. Today's information should be a good first step in helping you identify higher probability opportunities in the markets. If you are looking for more information, you can always email and we will do our best to meet your needs.

You Have Questions - Sam has Answers!

Printable Version

Over the past few days, some emails with good questions have come in that I wanted to share with you, for your benefit. In our quest to attain an "edge" in market speculation, it is important to "think" the markets very differently from others, our competition.

Hi Sam,

Thanks for the great presentation of Market Traps today. You have pointed out 4 important questions to ask when looking at charts. For some reason (distractions at home), I didn't get the significance of questions 2 to 4. Can you fill me in on why they are important questions?

1. *How did price leave the level?*
2. *How much time did price spend at the level?*
3. *Levels on top of levels?*
4. *How far did price move before returning to level?*

Thanks in advance for your help. - John

Sure, these questions help us quantify and qualify supply and demand in any and all markets. One of the most common questions I get is "why did you take that level but not these others?" The answer is because those other levels are not levels at all when you consider some or all of these questions. I will go over 2 and 4 for you again here:

2) How much time did price spend at the level? This is a key question that helps us quantify how "out-of-balance" supply and demand is at the level. At a price level where supply and demand are out-of-balance in a big way, there will be very few transactions. There is potential for many transactions, but the actual number of trades will be low because of the big imbalance. So, what does this picture look like on a price chart? It is very few candles, not many in base/cluster. This goes against what many trading books say. Most suggest the best turning points happen with strong or climactic volume, but think about it. If demand and supply are out-of-balance in a big way, there can't be many transactions because you have a large amount of one side and very little of the other. So, when looking for strong levels of supply or demand, look for levels with fewer candles in them instead of many.

4) How far did price move before returning to the level? This question helps us quantify profit margin. The distance of a move higher from a demand level, for example, shows us that the supply during that rally has been absorbed. When price comes back to that demand level for our long entry, we have a good idea where the sellers are (the supply) and just as importantly, where they are not. So, the farther price moves away from our level before returning back to the level, the greater the profit margin. If you have a chance, review my video recordings on the website. Go to www.tradingacademy.com and then Resources, then Recordings and find mine. There is a lot more info on this concept and its all free on the website.

Hello Sam: I have a question about the CCI and Trading Analysis Strategy. To find and define the trend, I use three to six-month daily charts; to decide to buy or sell, I go to a 5 day chart (60, 30, 15, 5 minutes). Many times the trend changes from the larger time frame to the very small time frame. I mean in the larger time frame the trend and MA line is UP, but when I go to the smaller time frame the trend is either going sideways or slightly down. I don't know how to decide. Should I go ahead and trust the larger time frame or what? Please help me understand this dilemma. I'll be forever grateful. – Gloria

Sure, it seems as though you may be looking at too many things here. Trends are a source of confusion for many people. An uptrend in one time frame might be a downtrend in another and so on. Conventional trend analysis is confusing enough because it goes against how we buy and sell anything else in our life outside of trading. Think about it, before you buy into a market, we are told to wait for an uptrend which in your case is a larger time frame moving average pointing up. Well, for this to happen, price has to move significantly higher before you buy. Yet, when you go to the store, you know to look for a sale or good deal. So, when you're shopping, you look to buy things when they are cheap, but in trading and investing, you wait for things to be expensive and then buy? This makes no sense. This is what moving averages lead you to do when you are using them to quantify trend. Instead of staying in this vicious cycle of lagging trend indicators, identify where the trend begins with supply and demand levels. Using a larger time frame moving average as a general guide for trend is ok, but make sure it's not your primary indicator.

I would like to ask this question in reference to your recent email on buying low so as to sell high at a profit: what if support changes to resistance and vice versa, wouldn't then someone buy at old supply which has now become demand and vice versa? Susan

Sure, let's talk about old support becoming new resistance and vise versa. This happens all the time. Once demand eventually absorbs all the supply at a price level and price breaks through what was a supply level, that level becomes demand so long as there is a significant profit margin associated with that new demand level, the breakout was strong, and the new demand level is well placed on the larger time frame supply and demand curve. Without one of these criteria present, the new level is weak.

Hi Sam,

I am a newbie in trading. So my questions here are:

1. *Which instrument should I start to learn to trade? Stock? Futures? Options (tough to understand)? Forex?*
2. *What will be the recommended starting capital to trade, as a newbie?*

I have invested in Singapore stocks (Strait Time Index stocks, very small compared to NYSE), mainly in local banks, property, oil and gas sectors stocks, but they give good dividends.

However, I am trapped due to 2008 Global financial crisis and waiting to break-even, so call me a long-term investor.

I have been regularly reading your "Lessons from the Pros" emails and I admire your vast experience in trading and deep insight in the financial markets; hope you can advise me where I should start the journey of trading to transform my life, and which instrument I should go into.

Ray, from Singapore

Sure, first of all, decide what type of trading you want to do. Is it day trading, swing trading, or longer term position trading? Whatever type it is, make sure you use a simulator first to make sure of three things:

1. You get comfortable with the trading platform.
2. You can execute your strategy as planned.
3. Your strategy and rules are profitable.

If you can't accomplish these items, you are going to have a hard time trading your real capital. Once you have proven on a simulator that you have these three down and are ready to trade real money, it may be best to start trading the stock market itself. The QQQQ is the exchange traded fund that represents the NASDAQ. It is a relatively low price point market that trades as a stock. Let's face it, if you can't become profitable trading the QQQQ, you will never make it trading an individual stock. The volume is also enormous with the QQQQ so liquidity is not an issue. Lastly, start small with position size. There is no reason, in my opinion, to take on much risk until you have proven to be a consistently profitable market speculator with small position size. Remember that there are very good traders out there just waiting to take your money. Don't jump in and compete with them until your data suggests you are ready

The Check List

Printable Version

There are many aspects to short-term and longer term trading. Where to enter, where to place your protective stop loss order, where to take profits, trade duration, risk management, position sizing, trade management, and much more are key considerations when trading. In my humble opinion, I would argue that the key to doing any of these things correctly comes down to where you are "entering" the market. Entering the market correctly means entering as close to the turn in price as possible. This allows you to put on the largest position size with the least amount of money at risk. And, by entering at the turn in price, you are farthest away from your profit target which means the "reward" side of the equation is as great as it can be.

So, the question is, how can we determine where the market is going to turn with a high degree of accuracy? In short, price turns at price levels where supply and demand is most "out-of-balance." So, what does that picture look like on a price chart? The following are some (but not all) things to look for when identifying a price level where you should expect the market to turn in the future:

1. **How did price leave the level?**

   The Logic: *The stronger price moves away from a price level, the more out-of-balance supply and demand are at the level.*

   Price can move away from a level in one of three ways. First, it can be a gradual move away from the level. Second, it can be a strong move away from a level with big red or green candles. Lastly, price can gap away from a level. Obviously, the gap away from a price level is the strongest and represents the biggest supply and demand imbalance.

2. **How much time did price spend at the level?**

   The Logic: *The less time price spends at a level, the more out-of-balance supply and demand are at the price level.*

   This is contrary to conventional thought. Most trading books want us to look for price levels where lots of trading activity took place and price levels with lots of volume. Think about it... If price is able to spend lots of time at a level, supply and demand can't be that out-of-balance. The more out-of-balance supply and demand is at a price level, the fewer the transactions will take place. Less transactions means lower volume. So, we should look for levels where very little trading activity took place with less volume. Don't believe everything you read. Most thought the world was flat at one point; look where that herd mentality thinking got us.

3. **How far did price move away from the price level before returning back to the level?**

   The Logic: *The farther price moves away from a price level before returning to that level,* *the greater the profit margin and probability.*

When price moves far away from a price level before returning to that level, this means that the supply or demand level is typically far out on the supply and demand curve, far from equilibrium which is exactly where we want our entries to take place. When supply and demand levels are far out on the curve, this means the rubber band is stretched and the more it is stretched, the more likely it is to snap back. For example, if there is a supply level and price initially falls a great distance from it, two things make this a high probability and strong profit margin opportunity. First, because price fell far from this level, when it rallies back, we would be selling short to someone who is buying after a very large rally in price which is a big mistake for the buyer. This is good news for the seller and increases the odds on that short entry. Second, we measure the distance from the supply level to the lowest low before price rallied back to the supply level (for our short entry) and this becomes one of our profit targets which makes the reward side of the equation ideal.

When it comes to identifying low risk, high reward, and high probability trading opportunities, a solid understanding of the core concepts of supply and demand are the key to identifying where the most ideal entries into markets are. For more information on this, here are five resources I can point you to:

1. Read my articles in Lessons from the Pros and SFO Magazine
2. Listen to the recordings on our website: www.tradingacademy.com, under Free Resources, then Recordings
3. Wipe the dust off your old Economics 101 book and turn to the basic supply and demand information
4. The Extended Learning Track (XLT) program - this is where we learn and practice live in the markets
5. Find a copy of a book titled: *The Wealth of Nations*, by Adam Smith. This will likely be the oldest book you will read and find at the bookstore after the Bible. However, translating the information in that book onto your price charts is a key to identifying market turning points. The

book is a few hundred years old and still holds its value, there is a reason...

Sam Answers Your Questions

Printable Version

With a strong stream of email questions coming in lately, I thought it would be a good idea to answer some of the popular ones for you here in Lessons from the Pros. I hope this is helpful for you.

Sam,

I really like your simplistic approach to trading, makes a lot of sense keeping it simple. I have one question, when you are looking for levels on index charts, do you include any that may have formed in the afterhours time frame?

Thanks,

Joe

Sam – Thanks for the email and good question. Yes, it's a good idea to include afterhour's supply and demand levels in your analysis. Having said that, you will find that most of the key afterhour's levels also line up with key day session levels, which is fine. It is important to consider these levels in the S&P futures market when trading stocks. Often, what appears to be a good supply or demand level on a smaller time frame stock chart is really NOT a good level because overnight, price in the S&P futures has moved well beyond that level. The only way you would know to ignore that faulty level is by analyzing the afterhours S&P futures chart. No matter what time a level is created, if the market is open, supply and demand are at work. As I always say though, make sure your definition of supply and demand is correct. In otherwords, not every level is a level we would want to take a trade at. The supply or demand level needs to meet our minimum standards to even be considered a level. Part of that filtering process can be found in last week's article entitled: The Check List. Hope that was helpful.

Sam,

Thanks for all the knowledge! You've really helped me a lot! My question is: I live in America, so I trade the American market. I was wondering, if I were to move to another country, does the concept & rules of "supply and demand" apply to all markets? (eg: Asian markets NIKKEI, HANG SENG, CHINA, etc.) Looking very forward to your response!

Sam – Thanks for the email and good question. The answer is a solid YES. The concept of supply and demand applies everywhere. Whether it's "supply and demand," "motion into mass," and so on, it's all the same underlying equation. This equation is responsible for how and why things move. Whether we are talking about determining where price is going to stop rising and begin to fall, or predicting when an earthquake is going to happen, we are still talking about competing forces that can be measured. Sorry for getting a little off topic but yes, whatever market you are trading, the concepts of supply and demand apply equally. Remember, behind all these markets around the world and different asset classes are just people pushing the buttons.

Sam,

I have taken the Online Trading Academy Power Trading Class and the Options Trading Class. I went to the ProActive Investor workshop yesterday in Denver and signed up for that class.

Till I saw your webinar talk on supply/demand levels, I thought that support/resistance levels were pretty much the same thing. Tony De Santis, my Education Advisor, helped disabuse me of that notion. What are the rules for finding supply/demand levels? Where can I find them?

Thank you,

John

Sam – Thanks for the email and good question. I am glad the Education Counselor was able to help you. Let me take a moment and try and take that to another level for you. I use the terms supply and demand instead of resistance and support. Sometimes I think people have the perception that I am just using those to sound fancy and different, but this is not the case. I stay away from the terms support and resistance because I know that most people have very different definitions of support and resistance. To one person, it may be a pivot high or low, to another it may be a Fibonacci retracement level, another person may use Elliot Wave, or maybe an up or down sloping moving average as support and resistance. So, instead of reinforcing something that may not be accurate or correct, I choose to stay away from the conventional terms of support and resistance and instead, I call it what it really is, demand and supply. As far as your question on the "rules" for finding supply and demand levels, there are a few ways you can get those rules.

1. Go back and read the archived Lessons from the Pros. Specifically, search for my articles that have something related to supply and demand in the title. There are books' worth of this information in those articles. This is a free resource.
2. Go to our home page, click on "Free Resources" at the top, then click on "Recordings" and scroll down and you will find plenty of recordings that teach the concept and some of the rules. This is a free resource.
3. Join the Extended Learning Track (XLT) program. This is not a free resource. This is a paid service where we teach the concepts and rules of supply and demand and also execute the strategy in the live market 3 or 4 times a week. Of course, I can only cover so much in the free resources. Going over too much of our strategy in the free resources would not be fair to our XLT members.

On that last point, this is a weekly struggle for me with writing these articles. If I go over too much proprietary detail in the articles, XLT members get mad and I totally understand that. If I go over too little, people that read the articles, but are not an Online Trading Academy member, are unhappy. I try and do my best to facilitate both groups, but it's never perfect. Hope this was helpful

Government Intervention and Market Price

Printable Version

I started my career on the floor of the Chicago Mercantile Exchange facilitating institutional order flow. This means taking large buy and sell orders from banks, institutions, money managers, hedge funds, and more, paying close attention to market price, and then making sure those orders get executed and filled at the proper prices. I started in the currency quadrant and was specifically responsible for the Japanese Yen, Canadian Dollar, British Pound, Deutsch Mark, and Swiss Franc markets. The highest volume and most volatile market of this group back then was the Japanese Yen, so that's where much of my focus was.

One of the main reasons for the high volume and volatility was the Bank of Japan (BOJ) as they were very active in this market. As you may know, Japan has been primarily an export economy which means they have desired a weak currency (Yen). A weak (cheap) currency makes their goods and products attractive to the rest of the world. Often, because of a strong economy due to strong export sales, the Japanese Yen would strengthen and the Japanese government and BOJ would not like this. Their solution almost always was to "Intervene" in the currency market to help weaken the Yen. They would put hundreds of millions to work in the market, selling the Yen against other major currencies to drive down price of the Yen. I witnessed this and was a part of it many times. They would surprise the market to achieve the biggest effect, news wires would start informing the world that the BOJ was intervening to weaken the Yen, and this would cause many traders to exit long positions and sell. The outcome of this intervention was always the same, but it may not be what you think it is.

What would happen quickly was the value of the Yen would decline to levels the BOJ was aiming for which is no surprise. However, soon after, not only would the Yen rally back to pre–intervention levels, but it would then rally a ton more. I found this fascinating and realized one of the most important lessons from my time on the exchange floor: Intervention in free markets never works. What is most interesting is that the BOJ and other central banks have the power to print money and they can't even control a truly free market. The "invisible hand" always brought market price to where it should be, not where someone wanted it to be, even with the ability to print money.

There are many types of government and central bank intervention and to be honest with you, I have NEVER seen it work for more than a short period of time. In fact, from my experience, the opposite price action occurs from the goal of the intervention. For example, take the pre–March 2009 S&P low downtrend in the global markets. During this time, government "bailouts" were the theme and seemed to happen every other month. In the Extended Learning Track (XLT) program at Online Trading Academy, I created a rule in the XLT that every time a bailout was announced, students were to look for a supply (resistance) level in the S&P and get ready to sell short. Sure enough, the market would rally on the bailout news, reach a supply level, and decline.

This line of thinking for me has been very profitable over the years. A recent example happened on June 21, 2010, three weeks ago. Early in the morning US time, a news headline was released: "US equities rally up on Yuan intervention." China suggested that it was going to ease its currency's peg to the US Dollar and allow it to float more freely. As you can see in that news release, the global markets gapped up and rallied strongly on that news. All I had to see was the word "intervention" and that was a sell signal for me.

"US equities rally up on Yuan intervention"

Mon, Jun 21 2010, 14:18 GMT
http://www.fxstreet.com

FXstreet.com (Barcelona) - US benchmark indices tracked the wide-spread positive tone seen in financial markets, as investors embarked upon a quest for higher yielding corners across the market place. The aggressive shift targeting upside levels is primarily attributed to the PBoC's vow to unpeg tight oscillations between the Renminbi and the US Dollar. The investing community rose its global outlook on the basis that the action taken by Chinese's officials will likely rise demand for exports and commodities.The Dow Jones Industrial Average logged in substantial gains through the first hour of trading as the index jumped above 1.30%. The Nasdaq Composite surged by more than 1% while the S&P 500 rose by 1.50%.

Figure 1

The chart above is a small time frame chart of the S&P Futures. To the left, but NOT seen on the chart, is a huge gap up in price. As soon as I saw a little supply level form, it was time to sell short and bet on a downside move in the market. The reason is threefold. First, the cause of the rally was novice buying due to the intervention news. Second, price had reached a level where the chart clearly suggested supply exceeded demand which meant the shorting opportunity was low risk. Third, the gap up in price meant that there was a clear, large profit margin below as in the gap, there is no demand to stop price from falling. For more information on this last point, see my recent article entitled: "Motion Into Mass." While the gain on this trade was small, the risk / reward opportunity was very ideal.

Remember, to me, "intervention" means someone is trying to artificially alter free market price and this is not possible in my opinion. The reason the opposite desired price action ultimately occurs is because the act of intervention itself is a clear signal that something is wrong or broken in the market. It is actually a tip that while price may move in one direction initially, the big move is ultimately in the opposite direction. Those that understand this and can quantify supply and demand in markets enjoy huge opportunity when intervention occurs. They are given this opportunity by those who don't understand

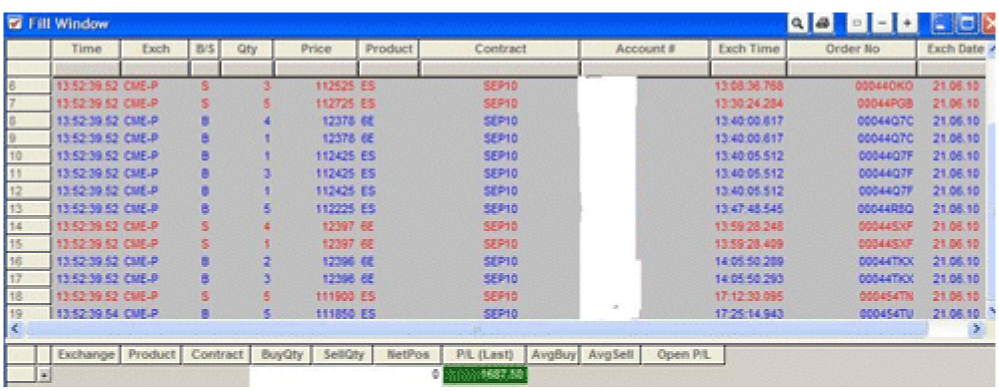
Motion Into Mass: Your Questions Answered

Printable Version

Last week's article entitled, Motion Into Mass: An Example Trade, generated some good questions that I will address in this piece. Never be afraid to ask questions as they can hold answers that can change the way you think about little things as well as major, life-changing thoughts. The trick is to ask the right questions to the right people; easier said than done sometimes. My answers always stem from the basic laws of supply and demand, motion into mass, or whatever you want to call it. The mathematical equation behind these two concepts is the same and has stood the test of time, so I make sure every action I take in the markets is in line with supply and demand. This line of thinking helped us predict the 2009 stock market low in March in the Extended Learning Track (XLT) program. It also helped us predict the 2010 high this year in my "Lesson from The Pros" article from April 27th, Where is the Stock Market Going, so I will stick with this line of thinking and rules.

Last Week's S&P Chart

Figure 1



Fill Window

	Time	Exch	B/S	Qty	Price	Product	Contract	Account #	Exch Time	Order No	Exch Date
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7	13:52:39.52	CME-P	S	5	112725	ES	SEP10		13:30:24.284	00044PGB	21.06.10
8	13:52:39.52	CME-P	B	4	12378	6E	SEP10		13:40:00.617	00044Q7C	21.06.10
9	13:52:39.52	CME-P	B	1	12378	6E	SEP10		13:40:00.617	00044Q7C	21.06.10
10	13:52:39.52	CME-P	B	1	112425	ES	SEP10		13:40:05.512	00044Q7F	21.06.10
11	13:52:39.52	CME-P	B	3	112425	ES	SEP10		13:40:05.512	00044Q7F	21.06.10
12	13:52:39.52	CME-P	B	1	112425	ES	SEP10		13:40:05.512	00044Q7F	21.06.10
13	13:52:39.52	CME-P	B	5	112225	ES	SEP10		13:47:48.545	00044R8Q	21.06.10
14	13:52:39.52	CME-P	S	4	12397	6E	SEP10		13:59:28.248	00044SXF	21.06.10
15	13:52:39.52	CME-P	S	1	12397	6E	SEP10		13:59:28.409	00044SXF	21.06.10
16	13:52:39.52	CME-P	B	2	12396	6E	SEP10		14:05:50.289	00044TKX	21.06.10
17	13:52:39.52	CME-P	B	3	12396	6E	SEP10		14:05:50.293	00044TKX	21.06.10
18	13:52:39.52	CME-P	S	5	111900	ES	SEP10		17:12:30.095	000454TN	21.06.10
19	13:52:39.54	CME-P	B	5	111850	ES	SEP10		17:25:14.943	000454TU	21.06.10

Figure 2

Your Questions

Sam,

In your latest article referring to the 15 min. es chart, you mention that in the circled areas at the *left of the chart that you did not see too much demand. That puzzles me because, as you mentioned, there was an upward gap as well as a couple of long up-bars. Do they not denote pretty strong demand? I would appreciate it if you could expand on this when you have some time.*

Thanks again, JP

Thanks for the email and good question. The big green candles and gap area represent price movement to the upside obviously. However, it is the area of the origin of a strong move higher that we are interested in most. The reason is that the origin of a strong move up in price is where supply and demand is out-of-balance, meaning more demand than supply. So, why not be interested in the origin of the "gap up" in the chart from the article? A key piece of information when price reaches a supply or demand level is "profit margin." As price reached the origin of that gap up in price, there was supply level after supply level on the way down, meaning no profit margin on the upside. This is a sign that suggests not to be a buyer at the origin of the gap up as price is likely to keep declining.

Sam,

In your article, there is a big red candle at the end of that price drop. I see this happen all the time but I don't understand why that happens at the end of a move. Thanks in advance for your answer.

Beth

Thanks for the email and good question. You will see this happen often. The simple answer is that you are identifying the "bandwagon" on a price chart. The majority of traders and investors aggressively buy after a rally in price and into supply levels. Conversely, they aggressively sell after a decline in price and into demand levels, and the picture on a chart that represents this is always the same - a big red candle AFTER a decline in price. Remember how people are taught to buy and sell in markets? They are told to wait for a strong uptrend before buying, and to wait for a strong downtrend before selling. Obviously, the strategy I am proposing in the articles has us entering the market when the risk is low, well before this group as suggested in the chart.

Sam,

Quick question on last week's article if you have a minute. The supply level you shorted at doesn't look like a strong area based on my understanding because there was not a strong drop from the level to tell you it is a strong level. What am I missing?

Thanks much! Philippe

Thanks for your email and good question. You are correct, ideally, we want to see a very strong move away from the level as that would suggest that supply and demand are out-of-balance, in a big way, at the level. We didn't have that here and in fact, the original move away from that supply area was very weak. Three things to remember about this one: First, the rally that day was huge and more importantly, it was all news driven and this brought price way up on the supply and demand curve. Second, there was plenty of room below, meaning a big profit margin which was one of the main points in last week's article. Third, we had a case of "levels on top of levels" which is a strong "odds enhancer." These three things, but primarily the big profit margin below, in my mind, made up for the fact that you mentioned in your question, the lack of a strong move down in price from the level. Had we also had that, it would have likely been an even better level to short at, but it was fine as is.

One thought to be aware of when it comes to questions I think are important is... when I started my journey in the business of trading, I didn't have anyone to ask questions to when it came to charts. I did, however, know that I needed to buy low and sell high if I was going to make this work. What I needed to know was when and where to buy low and sell high. For this information, I asked many questions and answered them by looking at the chart. The price chart gave me the answers I was looking for. The only reason I got the right answers is because I was asking the right question. For example, if I know I need to buy low, where would that be? That would be at a price level where price turns higher. So, what does that picture look like on a chart? Answer: A demand level. I could go on and on, but the answers to some of the most difficult questions in life are really not that complicated. As humans, we love to do things that will kill your trading account. We like to complicate things and we like to do what other people are doing. Ask the right questions, get the right answers and life is good.

News, Price, Supply, and Demand

Printable Version

During our developmental years, we are taught/conditioned to think certain ways. Our years in grammar school, high school and college are key belief system building years. One of the major conflicts during these years occurs when we are taught how to buy stocks and then how we are taught to buy and sell anything else in our life.

The basic principle of buying low and selling high or selling high and buying low is how we derive profit when buying and selling anything. When we buy cars or houses, we never offer what the dealer/seller is asking. We always offer a lower price and typically end up somewhere in the middle. Smart shoppers look for deals where they can buy what they are looking for at a lower price than others pay. We all typically try or desire to buy at "wholesale" prices. At this point, most of you are thinking that I am wasting your time because you know this already and that's true, you do take this smart buying and selling action in every part of your life. However, during the years that we are conditioned to buy low and sell high, we are almost always taught to take the opposite action with our investments either long-term or in short-term trading.

For example, at every level in school when we are taught to buy stocks as investments, we are told to wait for certain criteria to become true BEFORE we buy. These criteria include but are not limited to:

1. Good company
2. Strong earnings
3. Healthy balance sheet

4. Quality management
5. Stock price trending up
6. Moving averages sloping higher

When all these criteria are true, WHERE DO YOU THINK THE PRICE OF THE STOCK IS? It will almost always be high when these criteria are true which means you will be paying $50,000 for the $30,000 car and the seller is the big winner, not you. The way we are taught to buy stocks is completely opposite of how we are taught to buy and sell anything else. And therein lies the major conflict... A conflict that is single-handedly responsible for ruining the investment savings of millions.

Recently, during a live "Hour With The Pros" session, I was presenting to 300 Online Trading Academy graduates and discussing this very issue. This was a timely topic because of where the stock market was and some key earnings releases came out that afternoon. The biggest earnings report came from Intel Corp. (INTC):

*"**Last night, Intel (NASDAQ: INTC)** said quarterly earnings quadrupled to 43 cents per share, topping the consensus view of 38 cents per share. Revenue rose 44% to trump forecasts as technology spending has increased among consumers and corporations." – AP*

This was a fantastic earnings report from Intel and as you can see from the chart below (circled area), many people bought the stock and price gapped up. Most of the criteria listed above were true with Intel and we are all taught to buy when this criteria is true, so the gap up in price was no surprise. The only question that matters, however, is this: Should you be the buyer or the seller?

April 15th Hour with the Pros

Figure 1

Price gapped up on that great earnings news. However, when we look to the left, we see that it gapped right into the origin of a huge decline in price. When we keep things "real" and "objective," we understand that price originally declined from that level because supply exceeds demand, at that price level. Not only did it decline, but it declined in strong fashion suggesting a big supply and demand imbalance. Therefore, we then know that the buyers who are excited about Intel earnings and buying on the gap up are making two mistakes that every losing market speculator makes. First, they are buying after a rally in price. Second, they are buying right into a price level where supply exceeds demand. Instead of focusing on what is "real," these buyers ignore the simple reality of how we make money buying and selling anything and buy at a time when price is most likely to fall.

May 6th

Figure 2

During that Hour with the Pros session, I planned out a swing trade shorting opportunity for graduates with clear profit targets below (blue lines). Price eventually fell to our targets, but the most important thing to remember here is how to properly "think" the markets. Most people are so consumed with pattern recognition, conventional technical and fundamental analysis, that they forget the simple buying and selling action they take at the grocery store each week where they regularly try to buy low and sell high. The next time you are considering buying a stock as a trade or investment and all the criteria listed in this piece are true and the price of the stock is high, ask yourself one simple question: "If I buy the stock here, will someone buy it from me higher"? The price charts do an excellent job of answering this question.

News, Price, Supply and Demand, Part 2

Printable Version

As I have written about so many times, the movement of price in any and all free markets is simply a function of an ongoing supply and demand equation. Feel free to read my article on May 11, 2010, News, Price, Supply and Demand. Trading opportunity exists when this simple and straight-forward equation is "out of balance." Meaning prices turn at price levels where supply and demand are most out-of-balance in any market. The key for the market speculator is to have the ability to identify what this picture of opportunity looks like on a price chart. The lowest risk, highest reward, and highest probability time to buy into a market, for example, is to buy at price levels way down on the supply/demand curve where demand exceeds supply. At these price levels, profit margins to the upside are huge and the risk is low. Unfortunately, price does not fall to these types of desired levels as much as we would like and when it does, it doesn't stay there long. Of course, this is because demand exceeds supply in such a big way.

Another thing to consider is how and why prices in markets fall to these desired sale prices. Most of the time, a stock, for example, reaches demand levels low on the curve on very bad news. The worse the news, the lower the price. The most recent publicized example is British Petroleum (BP). This is not an easy stock to write about as the news is very bad and very real. Being an animal lover myself, it is very hard to witness what is happening in the Gulf and think about the long-term ramifications to the environment.

In the Extended Learning Track (XLT) program, we have been watching BP as the news has really helped push price far down on the supply/demand curve for BP share prices. As price was falling, we identified a price level where the chart suggested demand exceeded supply, which is where we expected price to turn higher. This demand level is seen on the chart below in the $26 - $28 range. The opportunity was to buy at that level for a move higher to targets identified in the XLT. I chose that level and not the area shaded grey because one of our rules for finding key levels kept us from buying at that level shaded grey. The rule states that the demand level in question must be a "fresh" demand level, which that area clearly was not. Therefore, I went with the lower demand level which met our criteria for a low risk, high reward, and high probability buying opportunity.

While this may seem simple, I would argue that the logic and rules actually are very simple. However, taking the proper action is NOT easy for the average person. This is because the news is so bad and people are not comfortable buying when the news is bad. Have a look at the news at the time we decided to buy shares of BP in the XLT.

BP shares fall to new low over Gulf spill – AP, Thursday June 24th, 2010

Worries over Gulf of Mexico oil spill push BP shares to new 52-week low in U.S .

Shares of BP dropped to a new 52-week low in the U.S. on Thursday, to levels not seen in 14 years, as the two-month-old oil spill in the Gulf of Mexico continues to weigh on the company's stock. BP lost 93 cents, or 3.1 percent, to close at $28.74. Shares dipped as low as $28.56 during the trading session. Analyst Phil Weiss of Argus Research said there didn't appear to be a particular reason for Thursday's decline. "There's still a lot of downward pressure on the shares, so, in general, I expect more down days than up days at least until the relief wells are successful or something else positive develops," he said.- AP

Figure 1

BP fell hard on the news, right into our demand zone. The reason for that demand zone is because that area is the origin of a strong rally in price. That rally only happens because demand exceeds supply in that area. In reality, price simply dropped down to deep discount, wholesale prices which is where anyone would be an interested buyer if you look at it that way. Think of it this way... You walk in the store and your favorite item is on sale for half price. Naturally, you're going to get excited and probably buy more than you typically do. Your emotions are going to drive you to buy more of this item and so on. The greatest mental edge in trading and investing is to realize that this is EXACTLY how you have to think when trading or investing. Amazingly, most people take the exact opposite action when putting their hard-earned funds at risk in the markets. Below is one of our many XLT members that bought BP at that level from our XLT analysis and trade planning. Who did he buy from? He bought from a seller who focused on the bad news as a buy/sell indicator. Whether our XLT student below is trading the markets, shopping at the grocery store, buying a car, or anything for that matter, he realizes that how you properly buy and sell things in any other part of life is EXACTLY the same as how you should be buying and selling when it comes to trading and investing.

Sam,

I sold my shares of BP yesterday @ 38.47 for a realized gain of eleven dollars. I'm doing an average of 800 a day now. I would like to personally thank you. Thanks a ton.

Mark H.

Wall Street tells us that you can't time the markets' turning points and that it's a waste of time. Of course they tell us that. If the average person could time the markets' turning points, no one would need Wall Street. I would argue that the average person can time the markets' turning points like we did with BP. It's not that we are always right and can pick every turning point in a market. With our rules, however, I would argue that the average person can time the markets' turning points with a very high degree of accuracy. For more information on the topic of market timing, please see my prior articles

The Psychology of Trading and Investing

Printable Version

Trading psychology is a subject most books and so-called professionals keep separate from the mechanics and strategies of trading and investing. A reality largely misunderstood is that the underlying mechanics and strategies within trading and investing are a direct function of your psychological belief system. At any given time in the stock market, there are buy and sell invitations sent out in the form of news events, technical indicators, earnings reports, company announcements, brokerage upgrades and downgrades, and much more. These invitations are then received by the belief systems of tens of millions of traders and investors worldwide. What separates the consistently profitable market player from everyone else is a psychological belief system that filters all these invitations to buy and sell through the market's ongoing supply (resistance) and demand (support) relationship. When this is done properly, you will quickly realize, for example, that often, a buy recommendation from a brokerage firm and/or a good earnings report from a company do not equate to market demand or higher prices for the company's stock. Conversely, negative news or a brokerage downgrade may actually lead to a low risk / high reward buying opportunity. Some of the most common and popular invitations to buy and sell occur with stocks. Providing awareness of the various buy and sell invitations for stocks, demonstrating how to mechanically filter these invitations through the stock market's true supply and demand equation, and providing rule-based tools for taking advantage of these frequent traps and opportunities is the focus of this article.

A psychological belief system that enjoys consistent low risk / high reward profits is one that identifies and accepts an invitation to buy into a market when objectively, market price is at a level where demand greatly exceeds supply. A belief system that suffers consistent poor results is one that identifies and accepts an invitation to buy into a market when objectively, price is at a level where supply exceeds demand. There are two types of buy and sell invitations. The first are the market's buy and sell invitations which are based only on the irrefutable governing dynamics of supply and demand. The second includes everything from good and bad news to positive and negative earnings reports, to brokerage upgrades and downgrades and many more. The first has you focus on reality while the second has you focus on everything but reality, and that is a trap.

US equities rally up on Yuan intervention

Mon, Jun 21 2010, 14:18 GMT

http://www.fxstreet.com

FXstreet.com (Barcelona) - US benchmark indices tracked the wide-spread positive tone seen in financial markets, as investors embarked upon a quest for higher yielding corners across the market place. The aggressive shift targeting upside levels is primarily attributed to the PBoC's vow to unpeg tight oscillations between the Renminbi and the US Dollar. The investing community rose its global outlook on the basis that the action taken by Chinese's officials will likely rise demand for exports and commodities. The Dow Jones Industrial Average logged in substantial gains through the first hour of trading as the index jumped above 1.30%. The Nasdaq Composite surged by more than 1% while the S&P 500 rose by 1.50%.

Figure 1

For example, China announced positive news recently regarding the unpegging of its currency as seen in the news release above. That morning, as the news came out, global stock markets like the S&P above rallied strong, gapping up as much as 1.5% on the news. The moment this "positive buying invitation" into the stock market was delivered to your belief system through your television screen or the news feed on your computer, there are two questions you can ask yourself.

First: What did the news suggest I should do? In this case, whatever the details of the news are, the release of it pushes the positive button in your brain and most people will be invited to buy.

Second: What would a consistently profitable buyer and seller of anything do at this price based on the irrefutable laws of supply and demand? When we objectively assess the market's supply and demand equation after the news was released and price gapped up, the invitation sent to the reality-based belief system is to do nothing or sell, not buy.

Notice the price action near the top of the chart. A couple of times, price is basing, sideways but can't stay at those levels and declines. The only thing that can cause the drop in price is more willing supply than demand. Therefore, when price revisits the supply level marked on the chart where the short entry was taken, we know two things: First, the buyers, at the point I shorted, are buying after a significant advance in price. Second, they are buying at a price level where supply exceeds demand. A consistently profitable buyer and seller of anything would never make these two mistakes. If they did, they would not be consistently profitable. The laws of supply and demand ensure that the buyer who buys after a period of buying, and at price levels where supply exceeds demand, will consistently lose their capital over time.

Had you taken the news event as an invitation to buy, you would have let illusion distort the reality that is always right in front of you, and losses, or drawdowns, to your hard-earned capital would have followed. Had you filtered that invitation through the laws of supply and demand, you would have been a seller like I was.

Why would that novice buyer make such an obvious mistake? Simple, the belief system that drives their behavior/action is flawed. When you understand that your psychological belief system IS your trading and/or investing strategy, you will realize how important it is to align your belief system with reality. You are essentially searching for truth so beware of illusion. The addition of even the slightest amount of illusion into your belief system ensures truth will never be found.

Often, the focus of poor trading and investing results is a lack of discipline when attempting to follow the rules of a strategy. What keeps people from not following rules is typically not a lack of discipline, it is because their invitations to buy and sell are not in line with their psychological belief system. There is internal conflict when it is time to take action. Don't punish yourself for not acting when the market calls you to action. Instead, take a step out of the box that is your belief system and make sure it is only filled with objective information and reality.

Any and all influences on price are reflected in price.

All the news and market information is filtered through your belief system. Your belief system is responsible for the thoughts and perceptions created from the news and information. Every thought and perception leads to ACTION and in trading and investing, action is either buying or selling. Therefore, all the consistently profitable trader or investor needs to focus on is price. Whatever the news and information for the stock is, your belief system MUST filter that information through a filter that quantifies the market's TRUE supply and demand relationship before a perception is created and action is taken. This will ensure you will not fall into the trap that the buyers of the S&P did. It will also allow you to profit from the many that consistently fall into that trap

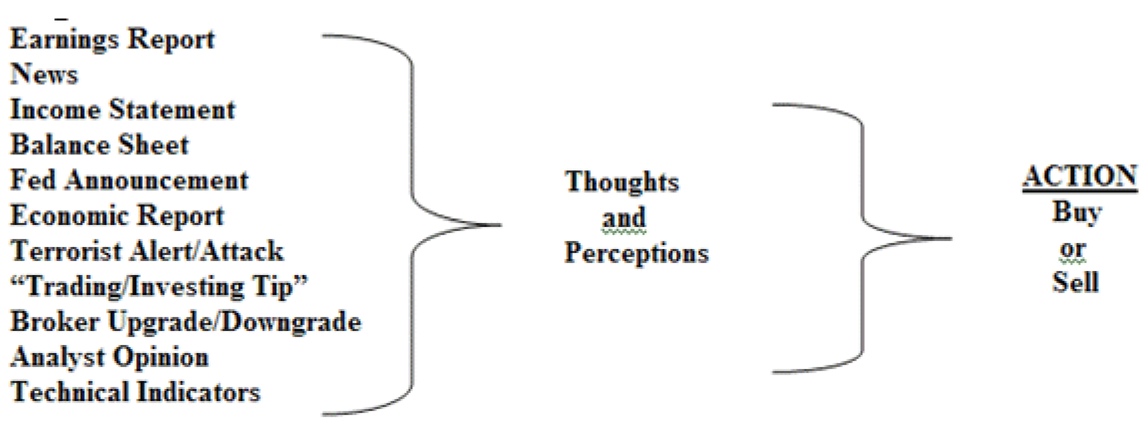

Figure 2

Once you understand that any and all influences on price are reflected in price at the level of your belief system, you next step is to know what true supply and demand looks like on a price chart. If you're not careful on this step, illusion can again creep into the equation if you let it. If you think the conventional technical analysis definitions of support and resistance are the answer, think again. A cluster of trading activity above and below current price is not necessarily true supply and demand. There is a very unique and simple chart pattern that represents peak demand and peak supply. While the details of this are beyond the scope of this article, the chart examples I have provided should help guide the way. Once you are able to identify true supply and demand on a price chart, simply follow these two rules:

1. A negative news event, or negative stock market information, which brings price to a level of fresh demand is typically an opportunity to buy, not sell.
2. A positive news event, or positive stock market information, which brings price to a level of fresh supply is typically an opportunity to sell, not buy.

"Last night, Intel (NASDAQ: INTC) said quarterly earnings quadrupled to 43 cents per share, topping the consensus view of 38 cents per share. Revenue rose 44% to trump forecasts as technology spending has increased among consumers and corporations." - AP

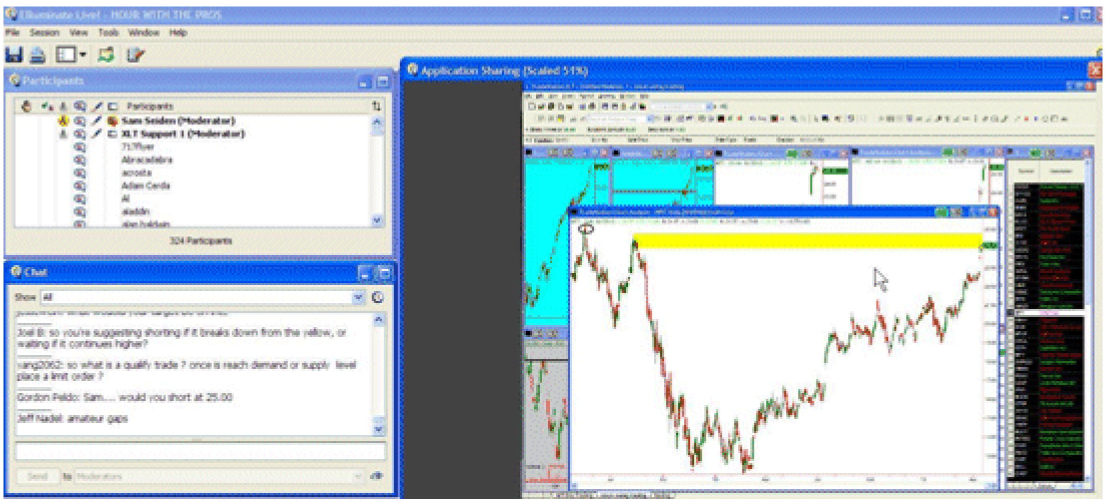

Figure 3

Beware of good news when price is at fresh supply.

Above is a VERY positive earnings report for Intel Corp. (INTC) along with a daily chart of the stock. This picture and opportunity was identified by me and presented to Online Trading Academy graduates during a live Hour with The Pros session, April 15th, 2010. Price opened after that report, with a huge gap to the upside from the prior day's close. While the news was very real and the stock was in a strong uptrend, that equated to major losses for those who bought based on the news of the strong earnings report for INTC. How can a real positive news announcement for the company equate to such a severe drop in price for the stock? Simple, price reached a level where objectively, supply exceeded demand as seen on the chart. We know supply exceeds demand at that level because of the strong decline in price from the level to the left. When price revisits that level on the right, this is the first time price advances back to the supply level. Again, we can now say that these buyers are buying after an advance in price, and at a price level where supply exceeds demand, the two mistakes novice market speculators make.

Figure 4

Had you taken the good earnings news as an invitation to buy like so many did, you would have let illusion again blur the reality that was right in front of you and lost your hard-earned capital. Had you filtered that invitation to buy through the laws of supply and demand, you would have done nothing or recognized the opportunity to sell short. To be blunt, over time, the capital of those who fall for the illusion trap typically ends up in the bank accounts of those who focus on the reality of pure supply and demand in markets. The objective supply and demand relationship in markets is revealed most clearly in price and price alone.

What you perceive to be a rational decision-making process is actually your emotions reflected by a set of behavioral patterns you likely don't even know exist. The process that all humans operate under is a process whereby emotions are reflected from ingrained patterns of behavior. The buyers of INTC shares have a belief system that has them thinking they were making a rational decision to buy. As rational as it seemed to those buyers, it certainly was not logical. That rationale, again, is due to a faulty belief system that is not in line with the reality of how markets really work, nor how you profit from buying and selling anything. The reality was that INTC share prices were at extreme retail (supply) levels which means the low risk, high reward, and high probability opportunity was to sell short and profit from a downside move in the stock. Selling short at that supply level meant finding a buyer who "believed" INTC was worth buying at that level. The earnings report helped send that illusion.

How can we benefit?

BP shares fall to new low over Gulf spill – AP, Thursday June 24th, 2010

Figure 5

BP fell hard on the news, right into our demand zone. The reason for that demand zone is because that area is the origin of a strong rally in price. That rally only happens because demand exceeds supply in that area. In reality, price simply dropped down to deep discount wholesale prices, which is where anyone would be an interested buyer if you look at it that way. Think of it this way... You walk in the store and your favorite item is on sale for half price. Naturally, you're going to get excited and probably buy more than you typically do. Your emotions are going to drive you to buy more of this item and so on. The greatest mental edge in trading and investing is to realize that this is EXACTLY how you have to think when trading or investing. Amazingly, most people take the exact opposite action when putting their hard-earned funds at risk in the markets. This is because they are focused on the bad news from the oil spill. Don't get me wrong, that news is very real and very awful! It is truly a horrible event, but that is a separate conversation from the buying opportunity that news presented.

Below is an email from one of many Extended Learning Track (XLT) class members who took advantage of this low risk, high reward, and high probability opportunity and bought shares of BP at the demand (retail) price level. Who did he buy from? He bought from a seller who focused on the bad news as a strong invitation to sell. Whether our XLT student below is trading the markets, shopping at the grocery store, buying a car, or anything for that matter, he realizes that how you properly buy and sell things in any other part of life is EXACTLY the same as how you should be buying and selling when it comes to trading and investing.

Sam,

I sold my shares of BP yesterday @ 38.47 for a realized gain of eleven dollars. I'm doing an average of 800 a day now. I would like to personally thank you. Thanks a ton!

Mark H.

The natural invitation to buy is completely inversely related to how you make money buying and selling anything. It is certainly not in alignment with supply and demand. Most people, however, are not naturally invited to buy when the objective low risk / high reward buying opportunity is in front of their face. As you can see in this last example, PRICE MUST DECLINE in order for it to reach an objective fresh demand level. The vast majority of people are only comfortable buying after a period of rising prices, not declining prices. Also, most people are not comfortable buying when the news is bad. <u>Remember, pretty green candles, uptrends, and good news rarely if ever bring price down</u>

to price levels where demand exceeds supply. This is all quite ironic if you think about it because if you take your average trader or investor out of the market environment, they act almost opposite when buying and selling anything else. For example, when we go and buy a car, we try and get the best deal we can. The astute car shopper finds a car and knows what price he or she is willing to pay and attempts to get that price. If that dealership is not willing to drop the price to the desired price of the buyer, that potential buyer typically goes from dealership to dealership to find someone willing to sell the car at the lower price. In trading and investing, however, people for some reason wait for good news and higher prices before deciding to buy; this makes absolutely no logical sense if your goal is to buy low and sell at a higher price. It is completely inversely related to how we profit when buying and selling anything.

Whether you trade or invest in stocks, bonds, futures, currencies, options, or anything else, how you profit in these markets and how you quantify supply and demand never changes. Furthermore, a trading and investing strategy that works is one that is not market-specific or time-period-specific. The strategy that offers consistent low risk returns is one that mechanically filters the vast amount of illusion creating information by objectively quantifying fresh supply and demand in any market and at any period in time. Don't let the shadow of illusion distort the reality of a governing dynamic that is always right in front of you.

The good news is that you already have a belief system inside you that knows how to properly trade and invest in markets. You use it every day at the grocery store, appliance store, car dealership, and so on. Think about how you operate when buying and selling anything in your life outside of the trading and investing markets. You try to get deals and buy things as cheap as you can. The key is to now use this exact same belief system to make decisions in the trading and investing markets. If you happen to be someone who actually cuts coupons, you have a belief system capable of producing above average returns as a trader or investor.

Key Trading Nuggets Q&A

Printable Version

Over the past couple weeks, some very good questions have come in that I think may be on the minds of a few of our readers. Whether they are or aren't, the goal of this piece is to enlighten you through Q&A with key trading nuggets that can help you reach your financial goals.

Sam,

You mapped out today the levels for ES and stated that the level around 1083-1085 wouldn't be a good one and that you are more interested in the 1073-1075, and afterwards, the 1063-1065 levels. As I check the current trading levels, the ES just swooped through the 1083 and is now resting at 1075. Here is my question: What was the logic for you stating/anticipating the 1083 is a 'weak' level?

Thanks in advance.

Mat

Thanks for the email and good question. I see the ES had a 13 point rally off of our Extended Learning Track (XLT) class 1073 – 1075 demand level; hope you were able to profit from that trading opportunity. The reason I was not excited about the 1083 – 1085 area was because if you looked to the left of that level, there was plenty of recent price action already, which means that was likely not a fresh demand level. Also, the 1073 – 1075 demand was lower on the curve which carries higher probability and a greater profit margin. Lastly, the move away from that area (the initial rally) was very strong, stronger than the rally from the 1083 – 1085. Having said all that, the 1073 – 1075 was not a "perfect" demand level either, but remember in trading, we are not looking for perfection, we are looking for better odds and large profit margins. Also, let's say you bought at both those levels and traded like a robot with stops and targets. You would end up with one losing trade and one profitable trade and plenty of profits after both trades are complete. Picking the best levels gives you a big edge but again, you can be very profitable not being right all the time in trading which is great. Hope that was helpful.

Sam,

I have 2 Questions for you if you have a minute. On the last Webinar, I asked you about the way prices return to a level, so thank you again for extending my list with that :-) Is there any other odds enhancers you typically do not talk about? Pointing me in the right direction would be greatly appreciated.

Also, I am struggling a little bit with "how much time did price spend on a level." You do teach "the shorter, the better, s/d is more out-of-balance then". But looking at the last webinar where you talked about "path of least resistance," and also your article where you talk about "motion into mass," I understand it is a big resistance / a big mass if price spends a lot of time at a level. I am a little confused here (actually love being confused; tells me I am learning something new).

Could you clarify?

Thanks again,

Jakob

Thanks for the email and good question. I hope the odds enhancers are helping you in your trading efforts. Another one you can add to the list is "levels on top of levels." Think about this... If you were on a trading desk and you saw the largest stack of sell orders in the market was at 1070 and current price was at 1060, you would obviously be comfortable selling short at 1070 as you have plenty of supply at that level. Is there anything that would make you more comfortable selling short at 1070? How about if there was another even larger stack of sell orders at 1071? Now you are selling short at a strong supply level with another strong supply level one point above it. If this logic makes sense to you, then the only question left is: What does this picture look like on a price chart? The answer is levels on top of levels. So, when you have two supply levels (or demand) on top of each other with a big profit margin, that is better than having one supply level. Next, you asked about "time at the level." Most of the trading books and theories state that the more trading activity at a price level, the stronger that support (demand) or resistance (supply) level is. I would disagree with that statement and suggest that the opposite is true. In a market where price is at a level where supply and demand are out-of-balance in a big way, you get very few transactions at that level. This is because of the extreme imbalance. Few transactions mean few candles on your screen and low volume, yet most people look for many candles and heavy volume when looking for a strong support (demand) or resistance (supply) level. So...the less time price spends at a level, the more out-of-balance supply and demand typically are at the level. Hope this was helpful.

Dear Sam,

Greetings from United Arab Emirates! I am one of the new students of Online Trading Academy here, and finished my Forex Trader's course in July. I am still quite new to this business, and find your articles very helpful. In the last one, you were referring to the rule / definition of "fresh demand level" while explaining your decision on entering the trade with BP shares. Can you please elaborate more on what this rule is about?

Thank you very much in advance for your help.

With best regards,

Olga

Thanks for the email and good question. Also, welcome to the Online Trading Academy community. You will find that we are one giant family, so welcome. The term "fresh level" is very important. At each support (demand) level, for example, there are a certain number of willing buyers. Think of a trade desk and a big stack of buy orders which is what demand really is. Each time price declines to that price level where all those orders are, some of those willing buyers will get to buy as their orders get filled. With each decline in price to that demand level, the number of willing buyers is decreasing as the orders get filled. So, we want to buy when the demand is strongest, which is that first or sometimes second time price declines to that demand level. After that, the level is not "fresh" anymore and the odds of price rallying again from that level are decreasing rapidly. To better your odds, focus on entering a position at a supply or demand level the first time price revisits that level, assuming it has a significant profit margin associated with it. Hope this was helpful.

If there is one thing I notice over the years of writing articles, it's that readers are getting smarter and smarter, so keep the questions and comments coming and I will do my best to get you proper answers.

Who Can You Trust?

Printable Version

When it comes to trading and investing, everyone desires to know where the market is going to turn, before it turns (market timing). The only way to successfully predict market turning points is to know where the real willing buyers and sellers are in a market. After all, if you know where the real buyers and sellers are in a market, does anything else really matter? For me, there is only one real way to do this - properly quantifying supply and demand based on price and price alone. Most traders, however, think there are other ways to do this, thanks to the trading industry. Specifically, Level II data, Total View and the Matrix show ladders of bids and offers that most people think gives them an advantageous view as to where the real willing buyers (bids) and sellers (offers) are. The purpose of this piece is to investigate whether any of these "windows" into bids and offers tell you where the real buyers and seller are, or not.

When I started my career on the floor of the Chicago Mercantile Exchange (CME), I worked on a very big and busy trading desk. My job was to facilitate institutional order flow. I got to the floor an hour before the markets would get going and took big orders from banks, institutions, money managers, hedge funds, and so on. These were all willing buyers (bids) and sellers (offers) and most of the time, the orders didn't get pulled, they were there to stay and get filled. I would put these orders in stacks according to price, putting the buy orders to my left and sell orders to my right and off we would go. If I wanted to know where price was going to stop falling and begin to turn higher, all I would have to do is find the largest stack of buy orders below current price and that is where price would turn higher. These were real bids, real DEMAND.

Years later, things like Level 1, Level 2, Total View, and the Matrix are invented and developed. The pitch is that they show you what I had in front of me on the trade desk, a "cheat sheet," the real willing buyers and sellers. Could it be this easy? Would trading platforms, brokers, Wall Street really make it this easy for the average person looking at a Level 2 screen? Has Goldman Saches now opened doors to exactly where they are buying and selling? Instead of giving my opinion, let's investigate together and draw some conclusions. Below is a live trading example taken right from the Extended Learning Track (XLT) program; the stock is Apple. Take a look at the chart on the left which is side-by-side with the Matrix, which is showing bid and offer size. This is a 2-minute chart of AAPL. Notice the supply level circled. We know this is supply (resistance) because price could not stay at this level and had to decline from it. So, when price rallies back into that supply level a bit later, this is where we want to sell short and bet on a downside move. This is the lowest risk, highest reward, and highest probability time to sell short in this market. However, at the very time that our rules tell us to push the sell button, take a look at the bid size compared to the offer size - 1600 on the bid and 200 on the offer. If you have ever read a trading book, the book tells you that when the bid is that much bigger than the offer, you buy. Logic would tell you that this is true. After all, once the 200 on the sell side is gone, you have 1400 on the bid side with no more sellers (offers), so price has to go up right? Well, the answer depends on whether those numbers, the bid and offer data, are "real." What happens seconds later if you look at the chart on the right, price collapses? How could this happen? This defies all basic math and science. Again, it depends on whether these bids and offers truly represent real buyers and sellers.

Think of it this way... Do you or I have account sizes that can cause a supply level like that in AAPL - probably not. So the question is, whose supply is it at that level; who is the real seller? The answer is profitable institutions, but they have a problem when price originally falls from the supply level. The problem is that they have too much to sell and there are not enough buyers at that level. What has to happen if they or I or you are to sell at that supply level is this: Someone needs to be convinced that AAPL is worth buying at that supply level. One easy way to invite novice buyers is to show a bid much larger than an offer. Anyone who reads the trading books will likely be a willing buyer when they see that. They are trained to buy when that picture occurs. What they lack is an understanding of "real value." Also, if the bid was really that much larger than the offer, would price collapse like that seconds later?

Figure 1

For those who trade Futures, let's talk about the S&P E-mini. On any given trading day, there are always a few hundred to thousands on the bid and offer during the day, it's very consistent. Why is it then that most of the time, only one or two contracts are actually trading, sometimes a little more. The answer is simple, these bids and offers are not exactly real!

Whether it's stocks or Futures, you may be wondering how this can happen? If you read the fine print and understand the rules, market makers and such can put bids and offers out there and pull them with almost free rein. Of course, we go much deeper into this topic in our trading courses, but I think you get the point.

Another point to consider is this... If you were really given an unfair advantage in seeing bid (buyers) and ask size (sellers) on a Level 2 screen and the others, you would not be allowed to trade your account, it would be illegal. Think about it, when I was working on the trade desk and did have the real buy and sell orders in front of me, I was not allowed to trade my own account. I had to sign papers saying I would not have any influence over any accounts that traded any markets at the Chicago Mercantile Exchange or related exchanges. I had many cameras pointed at me watching every move that I made. Each and every phone line at the trade desk was recorded and monitored live. Why was the security so tight? Simple, these were REAL buy and sell orders with the intention of really buying and selling. Had I been allowed to trade my own account, it would be free money, I could not lose. Truth is, there is an unfair advantage when looking at Level 2, Total View, the Matrix and so on, but it's not on your end, it's on the side of the big money market maker or institutions showing their bluff, not their real intentions.

In conclusion, if you think that any of these fancy windows created by the industry are a real window into seeing where the real willing buyers and sellers are in a market, I have some really good land in the desert to sell you. Seriously, it's going to rain every month starting next year and there's a ton of gold under the sand in this area. I know there hasn't been consistent rain since the Cretaceous period, but my very accurate computer model, developed by industry experts, says the monthly rain fall starts in January, so buy this land quickly before the price gets even higher. I am getting lots of bids of $10,000 per square foot already so hurry, send me your money now and it's yours!

To answer the question, "Who can you trust?" The answer is simple. Trust price.

Educational Trading Idea: Xilinx Inc. (XLNX)

Figure 2

XLNX has been rallying with the NASDAQ and is nearing a supply level ($27.75 entry, $28.50ish stop) on the daily chart. This is where we would expect XLNX to stop rising and turn lower. Timing the market's turning points based on supply and demand analysis is the key to low risk, high reward, and high probability trading and investing. This is an area where we would be interested in selling short, buying puts, or initiating a credit spread in XLNX. We would be looking for a swing move down to the $25.50 area, given the chart does not develop another supply or demand level. Another thing that suggests this may be an ideal opportunity to catch a turn in price in XLNX with a low risk entry is seen on the NASDAQ (QQQQ) on the left. The NASDAQ is also approaching a supply level which makes the XLNX shorting opportunity higher odds.

Price and Time

One thing I have paid close attention to in my many years of writing articles is making sure I did not spend much time writing about concepts and strategies that everyone else writes and talks about. If I did, there would be no point in reading the article. To accomplish this, however, means suggesting ideas, concepts and strategies that sometimes fly in the face of conventional wisdom.

What I have found over the years is that simply questioning anything conventional often exposes a flaw and most importantly, opens the door of opportunity so many search for but never find.

Today, let's question conventional wisdom when it comes to price, market timing, volume and time itself. Specifically, I am referring to what happens to price at key market turning points. The goal of any market speculator is to identify where and when the market is going to turn, before it turns. That is the only way to truly attain a low risk, high reward, and high probability entry point into a market. To make a long story short, markets turn at price levels where supply and demand are "most" out-of-balance. In other words, the more out-of-balance supply and demand is at a price level, the stronger the turn in price. So, how do we identify these levels on a price chart? A deeper lesson on this can be found in many of my prior articles. Today, let's focus on one specific issue when it comes to identifying key supply and demand levels, as we know this is where prices turn. Time and volume are two important issues when it comes to conventional Technical Analysis. For example, the Technical Analysis books tell us when looking for key support (demand) and resistance (supply) levels, we should look for areas on the chart that have "plenty" of trading activity and "heavy" volume. They strongly suggest we should look for support and resistance levels that have many candles in the area and above average volume. This type of level on a chart to the eye does look good, but is this the best answer when attempting to identify key market turning points?

When you think the simple logic through, I think you will find that actually, conventional Technical Analysis has it wrong and the real answer is actually the opposite. We just concluded that the most significant turns in price will happen at price levels where supply and demand are most out-of-balance. Think about it, at price levels where supply and demand are most "out-of-balance," will you see a lot of trading activity or very little trading activity? If you said very little, you are correct. This is because of the big supply and demand imbalance. At that same price level, you have the potential for the most activity, but the reason you don't get much trading activity is because all that potential is on one side of the market, the buy (demand) or sell (supply) side. So, what does this picture look like on a price chart? It's not many candles on a screen like conventional technical analysis suggests, it's actually very few. Furthermore, this picture is not going to include above average volume, it's going to be very low volume.

The example below is an Extended Learning Track (XLT) class trade that represents exactly what I am suggesting in this piece. Notice the supply level circled. This is supply because price could not stay there and had to decline away. But look at the number of candles in the supply level. It's not ten, twenty, or more... It's four little candles, and then price drops. Ask yourself why price could only spend such a short amount of time at that level. The answer is because supply and demand were out-of-balance in a big way. If supply and demand were not so out-of-balance at that level, price would have spent more time in that area. Given that price spent so little time at that level, I concluded that there was a big imbalance and sold short when price retraced back up to that supply level. I sold to a buyer who thought the S&P was worth buying at that level. Maybe that buyer read the trading books and ignored that supply level because the books say it's not a key level due to such little activity. As you can hopefully now understand, that lack of activity is what makes it such a strong supply level.

Figure 1

As I have said before, don't be afraid to question something everyone believes to be true. If something doesn't make logical sense, there is probably a better answer that does. By thinking the simple logic through, you will almost always arrive at truth.

Educational Trading Idea: S&P 500 (SPY)

Figure 2

This larger time frame chart of the SPY suggests there may be a pause in the rally, and perhaps a reversal very soon. A few things lead us to this conclusion. First, price has rallied quite a distance and is nearing a Supply level (shaded yellow). The initial decline in price from the supply level was strong, suggesting a big imbalance at that level. Also, if we apply the logic taught in today's article on "time," we see that price didn't spend much time in that supply level again, suggesting a big imbalance. Lastly, the circled area on the right side of the chart is an area with hardly any trading activity in it, no demand. This suggests price should have a rather easy time trading down into that area. So, the combination of near term overhead supply and the lack of solid demand below suggests this rally may take a break if not reverse.

Ten Year Treasury Note Futures

Printable Version

One the many questions traders have once they have learned how to trade is, which market or markets should I trade? While there are many things to consider when making this decision, I wanted to share with you today a market that I consider to be one of my favorites, the Ten Year U.S. Treasury Note (TY) Futures. This is one of the biggest and most important global treasury markets. Interest rates that affect all of our lives from a financial perspective are determined here. In other words, this is the free market for interest rates. There are other bond/treasury markets as well but this is one of the biggest.

This market is attractive for a few reasons. First, the Ten Year U.S. Treasury Note Futures market has tons of volume making it a very liquid market. This means that quality Supply and Demand levels are very solid and easy to identify. Below is a recent short term trade I took in this market; let's have a look.

Figure 1

Notice the Supply level on the 15-minute chart in the Ten Year Futures. Prices were trading sideways in the yellow shaded area. This suggested Supply and Demand were in balance. The truth is, it is never a balanced equation. It simply takes time for this unbalanced equation to play out. When price initially fell from that level, this told us that Supply exceeded Demand in that area shaded yellow. This is the ONLY reason why price fell from that level. These are retail prices at that level and to profit when buying and selling anything, we want to be a seller at retail prices. A short while later, price rallied back up to that supply level which means I sold at retail prices to someone who is trained to buy at retail prices. Anyway, I had to catch a plane to Miami so I treated it as a very short-term trade and walked away with a small profit of $750. More importantly, notice how clear that supply level is, how you can almost draw a box around that level. This is one of the benefits of the Ten Year Treasury Note Futures, a fantastic trading market, if you know how to trade properly.

Where can you find more information on this market, you may ask? While this market is covered and traded in detail in our Extended Learning Track (XLT) - Futures class, there is a free source where you can get all the information you need to know about the details of this market. Go to www.cmegroup.com as this is the website for the Chicago Mercantile Exchange, the largest exchange in the world. Find your way to the Interest Rate products and there you will find the Ten Year U.S. Treasury Note Futures. Click on "Contract Specifications" and you will see the information below. Contract specs gives you the important facts such as the value of the contract, expiration months (these are not options), value per tick (how much you will make or lose per tick, per contract, settlement procedures, trading hours, ticker symbol, and more... Make sure you understand that this information tells you everything about how this market operates and trades. The information does NOT tell you where to buy and sell or how to make money trading this or any other market.

10-Year U.S. Treasury Note Futures

Quotes | **Contract Specifications** | Performance Bonds / Margins | Product Calendar | Learn More

Futures | Options

10-Year U.S. Treasury Note Futures

Underlying Unit	One U.S. Treasury note having a face value at maturity of $100,000.	
Deliverable Grades	U.S. Treasury notes with a remaining term to maturity of at least six and a half years, but not more than 10 years, from the first day of the delivery month. The invoice price equals the futures settlement price times a conversion factor, plus accrued interest. The conversion factor is the price of the delivered note ($1 par value) to yield 6 percent.	
Price Quote	Points ($1,000) and halves of 1/32 of a point. For example, 126-16 represents 126 16/32 and 126-165 represents 126 16.5/32. Par is on the basis of 100 points.	
Tick Size (minimum fluctuation)	One-half of one thirty-second (1/32) of one point ($15.625, rounded up to the nearest cent per contract), except for intermonth spreads, where the minimum price fluctuation shall be one-quarter of one thirty-second of one point ($7.8125 per contract).	
Contract Months	The first five consecutive contracts in the March, June, September, and December quarterly cycle.	
Last Trading Day	Seventh business day preceding the last business day of the delivery month. Trading in expiring contracts closes at 12:01 p.m. on the last trading day.	
Last Delivery Day	Last business day of the delivery month.	
Delivery Method	Federal Reserve book-entry wire-transfer system.	
Settlement	U.S. Treasury Futures Settlement Procedures	
Position Limits	Current Position Limits	
Block Minimum	Block Trade Minimums	
All or None Minimum	All or None Minimums	
Rulebook Chapter	CBOT Chapter 19	
Trading Hours (All times listed are Central Time)	OPEN OUTCRY	MON - FRI: 7:20 a.m. - 2:00 p.m.
	CME GLOBEX	SUN - FRI: 5:30 p.m. - 4:00 p.m.
Ticker Symbol	OPEN OUTCRY	TY
	CME GLOBEX	ZN
Exchange Rule	These contracts are listed with, and subject to, the rules and regulations of CBOT.	

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Interest Rates >

CME Group

Figure 2

Are interest rates a part of your life? Do you ever borrow money or do you have money invested in interest bonds? If so, how would you like to have the ability to forecast where interest rates are going in advance with a very high degree of accuracy? This can have an enormous impact on your life when it comes to finances. Remember, the Ten Year is one of the largest free markets for interest rates. This is where interest rates come from. For those who don't know, when Bond prices go up, interest rates come down. When Bond prices come down, interest rates go up. This is where rates are determined. So, in the example above, by knowing where the real supply (retail price) is, we can time the change in direction in interest rates. When price rallied up to that supply level, price was about to decline, which means interest rates were about to go up. This is key information for someone with an adjustable rate mortgage or someone seeking a high rate of return from bonds. For investors, we would look at supply and demand levels in the larger time frames.

The purpose of today's piece is to expand your horizons beyond stocks. The markets that truly affect our standard of living most are markets related to interest rates, currency values, and food and energy prices. All these markets are found in the futures. Spend some time on the CME website, all these markets are found there, and then some... When it comes to learning how to either profit from trading these markets or hedging life's major expenses, read my prior articles at Online Trading Academy or join me in the XLT program.

Hope this was helpful, have a great day.

The Bull Trap

Printable Version

The Polar Bear and the Seal... The Crocodile and the Wildebeest... The professional trader and the novice trader... What do these three relationships have in common? One is the hunter and the other is the hunted... Polar Bears are white just like the icy snowy areas of the world they live in. Seals spend much of their time in water under a sheet of ice, but have to come up for air at some point. When they come up for air, it is typically through a hole in that sheet of ice. Each breath however is potentially a life or death action because often, there is a Polar Bear waiting at that hole in the ice for his or her dinner, the Seal. A Seal has choices as there is always more than one hole to choose from but they better choose wisely, for if they don't, the hole they choose will be a "trap" set by the Polar Bear, and that will be the last breath the Seal takes. Wildebeest live on land but have to find water to drink in order to survive. They, too, have choices as to which bodies of water to drink from. One lake or river is clean, cool water void of any danger. The other may very well have a Crocodile waiting just below the surface for the Wildebeest to come drink. One is opportunity to drink, the other is a trap that leads to a quick death for the Wildebeest and a nice hardy meal for the Croc.

When it comes to trading and investing, the hunter and hunted relationship is no different than in the wild, only the end result typically does not lead to end of life. Make no mistake about it, there is a winner and a loser, nothing in between. There are many invitations to buy into a market. Some are opportunities that lead to low risk and high reward buying opportunities that end up being very profitable trades. Others are traps that lead to losses for the hunted and profits for the hunter. One of the most favorite and high probability trades we like to take in the Extended Learning Track (XLT) - Futures class is the Bull Trap or Bear Trap. For today's piece, we will focus on the Bull Trap as that was a recent trading idea we offered to graduates in our new service, Pro Picks.

The new Pro Picks is a service for Graduates where we provide trading ideas daily in the Stock, Futures, and Forex markets. These are day, swing, and longer term position trades where we give the exact entry, stop, targets, and logic behind the strategy. Below is one of many recent trading ideas. The opportunity was to short the S&P E-Mini into a supply level. The specific strategy is the Bull Trap as noted on the chart, and in the trade strategy write–up section below. Notice the supply level on the chart, the yellow shaded area and origin of supply zone lines. This is a price level where willing supply exceeds willing demand. How do we know this? Simple, price could not stay at this level and had to decline away. Again, it declines because supply exceeds demand at that level. We wrap two lines around that level and carry that level forward because we want to remember where supply exceeds demand - that is where price is likely to turn lower in the future when it reaches that level.

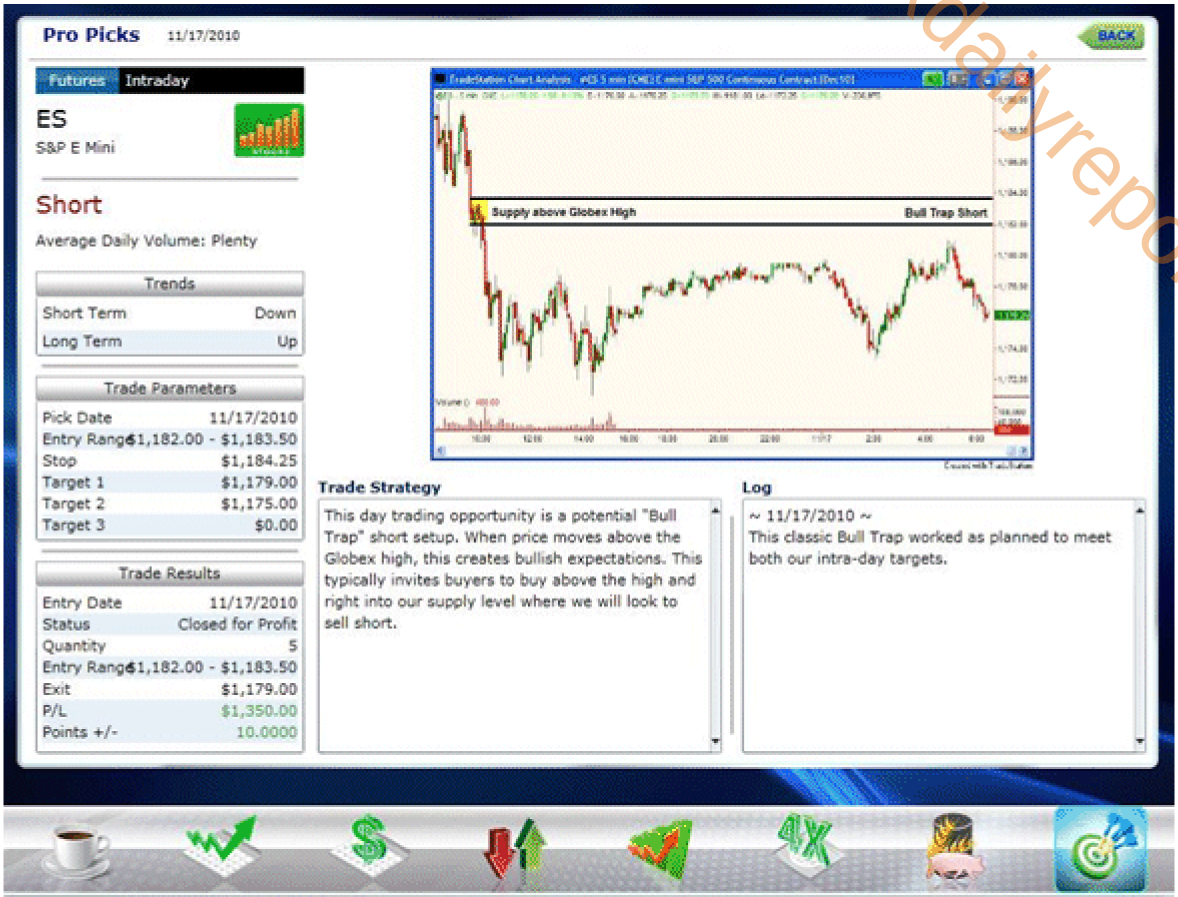

Figure 1

This is a Bull Trap shorting opportunity for the following reason. Notice the highest high on the right side of the chart just below the words, Bull Trap Short. That high was the "Globex" high which is the overnight high in the S&P. Remember, the S&P is the biggest and most popular equity index market in the world which means most traders are watching it. So, if and when price trades above that Globex high, during the regular session, this will setup bullish expectations for most traders. Traders are taught that when a high is broken, that is a breakout and price goes higher. Sometimes this is true, BUT when there is a fresh supply level just above, this bullish thinking is a TRAP. What we were betting on with this shorting opportunity was that when price traded above that Globex high, most people would become bullish and buy right into that fresh supply level. If this happened, we would be the willing low risk and high reward seller.

A bit later that day, the regular trading session got underway and price began to rally. Soon, it rallied above that Globex high and a rush of buying came into the market as expected. Our entry price in Pro Picks was to sell short at 1182 with a stop at 1184.25. Price rallied up a bit more and reached our supply level at 1182. That ended up being the high of the day and the S&P fell to meet our Pro Picks targets.

Figure 2

I took this trade in one of our accounts as well. In fact, I trade many of the Pro Picks in one of my accounts. Back to the Bull Trap strategy. The key factor that makes this work is knowing how everyone is trained to "think" the markets. Most are trained to buy on a new high of the day and buy at supply (retail) levels. I am trained to do the opposite. When prices are at retail (supply) levels, I want to sell to the buyer who is trained to buy at retail levels, just like this Pro Picks short from 11/17/10.

If you're going to compete in the game of trading, make sure you have an edge or you will lose your money to someone who does. This game is a transfer of accounts from those who fall for professional "traps," into the accounts of those who set the "traps." It's the old hunter and the hunted. I do apologize if I have offended anyone with what may seem like harsh analogies but the truth is, I meant to send a strong message because the average person loses money trading and that's not okay with me. They lose because they don't have the edge the professional does. Learn to spot the difference between traps and opportunities. For more information on the new Pro Picks, currently a free service from Online Trading Academy, find this information on the website or talk to your Education Counselor

Is it a Duck or a Lobster?

Printable Version

If it looks like a Duck, walks like a Duck, quacks like a Duck, smells like a Duck, it's probably not a Lobster. No matter what the leading research analyst on Ducks and Lobsters says. Even if someone wins a Nobel Prize because they have determined that a Duck is actually a Llama based on a sophisticated mathematical equation, it's still a duck. The bottom line, it's a Duck. Adam Smith, who many call the father of economics, laid out the ground rules for Supply and Demand hundreds of years ago. In his book, "The Wealth of Nations," supply and demand is explained in very simple terms. Smith, however, didn't invent supply and demand, it has been here all along and guess what, it hasn't changed; it never changes. When price is at a level where willing demand exceeds willing supply, price will rise. When price is at a level where willing supply exceeds willing demand, price will decline. Over the centuries, certain big name self promoting economists have tried to twist this simple equation with fancy math to make a name for themselves, sell some books, and win fancy prizes, only to eventually be proven dead wrong. The math works but it's the old garbage in, garbage out.

However, gravity is always gravity. There are certain principles of how the world works that NEVER change. In our world of proper trading, the only way to profit consistently is to buy low and sell high. This is how you make money buying and selling anything. A successful business buys or produces at wholesale prices and sells at retail prices. Good news, this is exactly how the profitable market speculator does it as well.

Figure 1

When you become a graduate at Online Trading Academy, you gain access to some powerful tools and hand holding services. One of these is Pro Picks. This is an educational service for Grads that produces daily trading ideas in the Stock, Futures, and Forex markets. These trades are given with exact entry, stop, and targets. Above is a picture of one of the Pro Picks created for students. The opportunity was to buy at a "fresh" demand level in the Euro Futures. Price had been declining and was nearing this demand level. At the same time, the Euro was nearing demand on the daily chart, the US Dollar index was nearing a supply level. This means that the odds were higher than normal for this opportunity. The price given for the long entry as seen above was at 1.3085.

A day or so later, price reached our demand zone and our trading idea met entry. As I said above, another word for demand is "wholesale." So, when price reached wholesale levels, I was also an aggressive buyer in some of my accounts. Who was I buying from? I was buying at wholesale levels from people who are trained and comfortable selling at wholesale levels. Why would someone sell at wholesale levels? They obviously don't understand that proper trading is no different than how the gas station profits on chewing gum. They buy the gum for $0.25 and sell it to us for $1.00. They just keep repeating that simple process over and over. If they sold the gum for $0.25 and bought it for $1.00, two things would happen. First, they would have plenty of very happy customers who love them (the buyers). Second, the gas station would be out-of-business at some point.

US Dollar – Daily Chart Euro/US Dollar – Daily Chart

Figure 2

The market ended up turning higher at the level which is when I started taking profits. While the trade was called a swing trade, I used the level to take a couple shorter term trades for a profit of around $4,400.00.

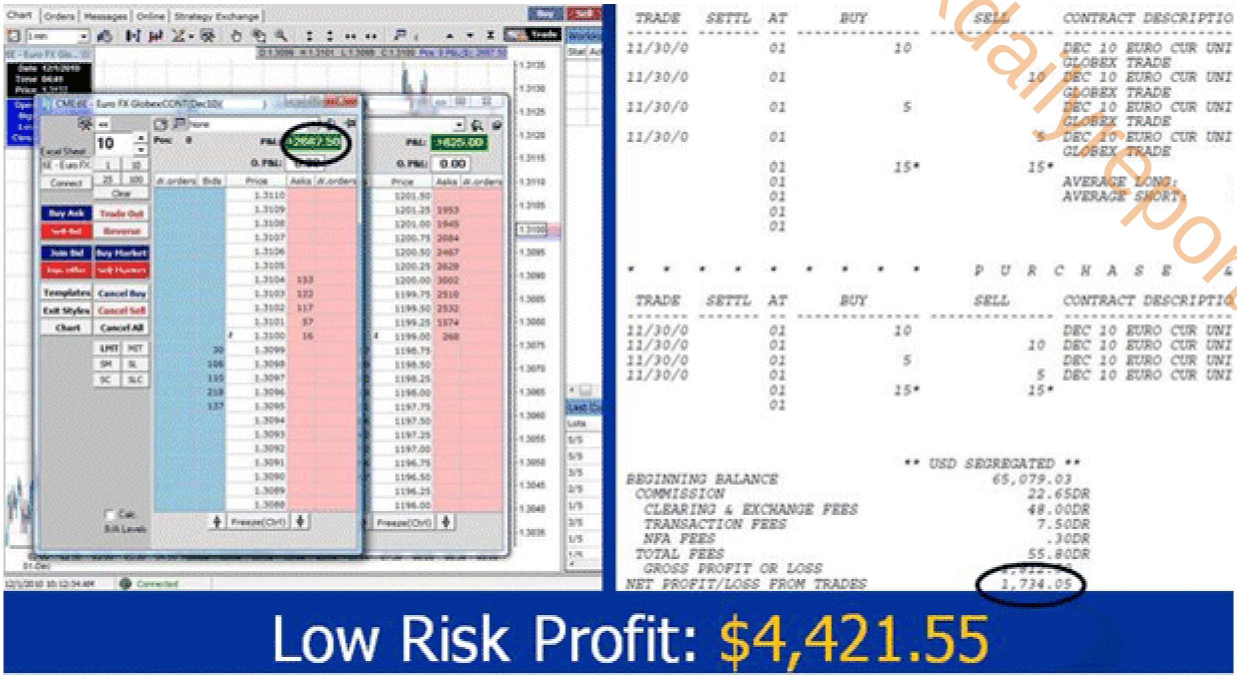

Figure 3

If you are an Online Trading Academy graduate and have not been using this relatively new service, I strongly encourage you to do so if you're looking for trading ideas that are delivered in a very educational format.

If you're having issues with trading and ready to pull your hair out with frustration, perhaps you're complicating something that is actually quite simple. Maybe you're trying to turn the reality of how markets really work into a way that they don't. Maybe you're really just looking at a Duck, thinking it's a Babboon. It's just a Duck...

Gain an Edge with the "All Star" Strategy

Printable Version

Lately, I have received email questions regarding a specific strategy we teach and employ at Online Trading Academy. Let's revisit this strategy today to hopefully give you the edge you need to succeed. Have you ever had a career in sales? If so, think about the times when you attained the most profit. The key to selling anything for a large profit is to sell to a novice buyer who does not know or understand the REAL value of what you are selling them. I know this doesn't sound nice and friendly but let's face it, this is how the world works. The best traders master this skill. In this piece, I am going to share a simple rule-based market timing strategy with you that focuses on buying from, and selling to, novice traders who don't know how to assess the real market value of something. The strategy was given the name, "All Star Strategy" due to its potency as a low risk, high reward, and high probability entry technique.

The All Star entry combines two high probability tools that when used together, help us identify high probability turning points in any and all markets. These tools are:

1. Proper supply (retail price) and demand (wholesale price) analysis
2. Bollinger Bands

The Setup:

Notice the supply level shaded yellow. This is a supply level because price moved lower from that point in strong fashion which tells me that supply exceeds demand at that level. Next, notice that when price rallied back to this level, it pierces the upper Bollinger Band. This suggested three things. First, price was reaching price levels where supply exceeded demand. Second, price was also piercing the upper Bollinger Band suggesting that statistically, price was at an extreme and likely to revert back to the mean. Third, a novice buyer was buying at the supply level. These pieces of information suggested price was very likely to turn lower at that supply level and that we should be the seller. The combination is what makes this a high probability event. The yellow area below is a "demand" level. This was the nearest demand level below the short entry point. The distance between supply and demand is the "profit margin." The profit targets for this shorting opportunity are the midline of the Bollinger Band (the mean, T1) and the demand level (T2).

Figure 1

The Logic:

When it was time to sell short at supply, who was the buyer? The buyer was a novice market speculator and we know this because they are committing the two mistakes every novice trader makes. First: They were buying after a rally in price and outside the upper Bollinger Band. Second: They were buying at a price level where supply exceeded demand (retail prices). These novice buyers don't know how to quantify real supply and demand in the market and these are the people we always want to trade with, just like selling anything in life outside of trading.

The All Star Rules:

- When price reaches a key supply level, pierces the upper Bollinger Band, in the context of a downtrend, and there is a significant profit margin below, sell short at the supply level with a buy stop just above the supply level.
- Profit targets are first the midline and then the opposing demand level.

- The opposite rules are true for long (buying) opportunities.

Profitable traders buy at wholesale prices and sell at retail prices, like Wall Street. Novice traders buy at retail prices and sell at wholesale prices. Learn to spot the novice trader to attain low risk, high reward, and high probability trades. Make sure that you sell to buyers who pay prices that you know are too expensive, and make sure you buy from sellers who sell at prices that you know are too cheap. This is proper trading.

Supply, Demand and Time

One thing I have paid close attention to in my many years of writing articles is making sure I did not spend much time writing about concepts and strategies that everyone else writes and talks about. If I did, there would be no point in reading the article. To accomplish this, however, means suggesting ideas, concepts and strategies that sometimes fly in the face of conventional wisdom. What I have found over the years is that simply questioning anything conventional often exposes a flaw and most importantly, opens the door of opportunity you never would have found had you not questioned the conventional thought or idea.

In this piece, let's take a look at the way conventional Technical Analysis teaches everyone to identify key support and resistance levels for the purposes of timing the market's turning points, in advance. Technical Analysis books tell us when looking for key support (demand) and resistance (supply) levels, we should look for areas on the chart that have "plenty" of trading activity and "heavy" volume. They strongly suggest we should look for support and resistance levels that have many candles in the area and above average volume. This type of level on a chart to the eye does look attractive, but is this the best answer when attempting to identify key support (demand) and resistance (supply) levels? Does this logic lead us to the best and most consistent turns in the market? To begin to answer this question, let's think the simple logic through for a moment and then come back to conventional thought.

To make a long story short, markets turn at price levels where supply and demand are "most" out-of-balance. In other words, the more out-of-balance supply and demand is at a price level, the stronger and quicker the turn in price. So, how do we identify these big levels of imbalance on a chart? When you think the simple logic through, I think you will find that actually, conventional Technical Analysis has it wrong and the real answer is actually the opposite. We just concluded that the most significant turns in price will happen at price levels where supply and demand are most out-of-balance. Think about it, at price levels where supply and demand are most "out-of-balance," will you see lots of trading activity or very little trading activity? If you said very little, you are correct. This is because of the big supply and demand imbalance. At that same price level, you have the potential for the most activity, but the reason you don't get much trading activity is because all that potential is on one side of the market, the buy (demand) or sell (supply) side. So, what does this picture look like on a price chart? It's not many candles on a screen like conventional Technical Analysis suggests, it's actually very few. Furthermore, this picture is not typically going to include above average volume, it's going to be very low volume most of the time.

The example below shows exactly what I am suggesting in this piece. Let's begin with Supply level 2. This is a level with many candles in it that appears to be very attractive because it's such a big level with many candles in it. Price also falls sharply from that area, suggesting it's a strong supply level. Conventional Technical Analysis loves levels like this for turning points. Next, notice that when price revisits this level over to the right, it doesn't turn and fall from the level like we would expect. Instead, it bases sideways for a bit and then breaks up through it. How can this happen if this is such a great supply (resistance) level? Well, whether this is a great level or not depends on your point of view. In the Extended Learning Track (XLT), we would never expect prices to fall from this level. In fact, our rules have us ignoring a level like this. To us, this is not a supply level at all. The reason is because price spent too much time which means supply and demand are not likely that "out-of-balance." Again, if the supply and demand equation was that out-of-balance at supply level 2, would price be able to spend so much time at that level? Shortly after that breakout and failure of supply level 2, price reaches supply level 1. Most people would ignore this level because it only has a few candles in it; it's hardly even noticeable. They would also ignore it because conventional Technical Analysis conditions people to ignore these levels (which is good for us). Ask yourself why price could only spend such a short amount of time at that level. The answer is because supply and demand were out-of-balance in a very big way. If supply and demand were not so out-of-balance at that level 1, price would have spent more time at level 1. Given that price spent so little time at that level, we conclude that there is a big imbalance and sell short when price retraces back up to that supply level (circled area on chart). When you do sell short at supply level 1 like I promote so often in the articles, you're selling to a buyer who thinks this market is worth buying at that supply level. Maybe that buyer read the trading books and ignored that supply level because the books say it's not a key level due to such little activity. As you can hopefully now understand, that lack of activity is what makes it such a strong supply level.

Figure 1

This edge building "nugget" is one we pay close attention to at Online Trading Academy. While there are other important "Odds Enhancers" that make a supply or demand level quality or not, the Odds Enhancer we call "Time" is important enough to deserve an article all to itself. As I have said before, don't be afraid to question something everyone believes to be true. If something doesn't make logical sense, there is probably a better answer that does. By thinking the simple logic through, you will always arrive at truth.

Remove the Veil of Illusion from Trading and Investing

Printable Version

Consistent low risk profits from trading and investing is a challenge many millions of people take on, yet only a select few are ever able to attain. The objective and mechanical rules for consistent low risk profits are very simple, yet the layers of illusion keep most from ever seeing what is real in trading and investing.

The two main forms of analysis in trading and investing are technical and fundamental analysis, and they are very real. However, thinking that mastering these two forms of "conventional" analysis will lead to consistent low risk trading and investing profits is an illusion second to none. The more an individual attempts to master these types of analysis, the more they may be layering complex, subjective illusions on top of each other. This is a recipe for consistent failure.

What many beginning traders don't realize is that they are walking east and west near the equator, trying to reach the North Pole. No matter how hard they work, the goal they desire is not attainable as the path they are on is an illusion. Trading strategies that work don't change with time or changing market conditions. Quite frankly, to think market conditions ever change at all is a strong illusion that can only be removed when one focuses on the foundation principle of price movement: Supply and demand. A simple and minor shift in perception to what is real can lead to a monumental shift in trading and investing performance.

The focus of this piece is to identify and remove the veil of illusion from trading and investing. How? By realizing that the movement of price in any market is based, at its core, on an ongoing supply/demand and human behavior relationship. We will quantify a supply/demand imbalance for objective opportunity in this article. As most traders are well aware, the overall goal is to decrease risk and increase profit potential. But many novice traders' strategies actually accomplish the opposite. Results for everyone from the active trader to the casual investor follow from taking various actions. Instead of focusing on changing our actions, it's time to notice where those actions come from.

Beliefs and Behavior Patterns = Actions

Let's move backward one step at a time. Actions stem from behavioral patterns, and behavioral patterns stem from beliefs. It is at the level of beliefs that decisions are made, and moreover, where your ability to differentiate reality from illusion lies. It's time to start considering where your beliefs come from about what works and what doesn't. The strongest illusions in the trading and investing world are found at the core of fundamental and technical analysis. Within these two forms of analysis lie many levels of illusion. In this piece, I will focus on three major illusions.

Figure 1

Moving Averages

The Illusion:

The chart above is a daily chart of the S&P 500, the biggest equity index market in the world. The information most people will perceive from this chart is an illusion that will likely lead to high risk/low reward trading and investing. The illusion here is that moving averages (MA) somehow act as support or resistance. There are many conventional ways in which some traders use moving averages. These include using moving average crosses for entries and exits, measuring the slope of a MA for a "trend filter," or using a MA as support or resistance. However, the notion that MAs actually offer a benefit when used in these conventional ways is completely false. It is an illusion.

In this chart, a 20- and 200-period moving average is seen. These are widely used moving averages both in the trading and investing community. Notice the slope of the 20-period MA at the areas labeled "B." The slope of the 20-period moving average is down in both cases, suggesting a downtrend is underway. During this period, however, the low risk/high reward buying opportunity is greatest and right in front of you!

Those who use a MA as a trend filter would never buy when the trend is "down." This group of illusion-based traders and investors would likely conclude and say, "I don't want to buy now, the MA tells me this is a downtrend." The illusion created by using a MA to determine trend ensures you will ignore the lowest risk/highest reward opportunity each time it is offered. Furthermore, this illusion is likely to encourage a trader to take the opposite action of what the objective information (reality) suggests he or she should do.

Moving Averages Lag

MAs are averages of past data. They can only turn higher after price does. Let's focus in on the 200-day moving average. Specifically, notice area "B" that is below the 200-day MA. Most traders and investors either see the 200-day MA on a chart, or hear about it from some financial news TV program. They perceive the mighty 200-day MA as some magical line that when crossed, suggests some valuable information. As we can see, waiting for prices to rise above the 200-day MA before buying ensures three things. First, risk to buy is high, as one would be buying far from the demand level. Second, profit potential is decreased. Third, those who wait until prices have crossed back above the 200-day MA to buy will likely provide profit for the reality-based trader/investor who bought at "B," the low risk/high reward entry area. The objective supply/demand imbalance is at "B," and the 200-day MA has nothing to do with it. When a moving average lines up with true demand or supply, the moving average will appear to work. Believing that the moving average actually has anything to do with a turn in price is an illusion.

The Reality:

Let's now explore reality through the eyes of objective logic. The areas labeled "A" are objective demand (support) price levels. How can I claim they are objective demand price levels? Simple, while prices are trading sideways, supply and demand appears to be in balance. In both instances, prices rose dramatically from those areas. The only thing that can cause a price rally from that area is when the supply and demand equation is "out-of-balance." In other words, there was much more willing demand at "A" than supply. The laws of supply and demand simply tell us this is true.

The areas labeled "B" represent the first time prices revisit these two areas of "imbalance." In other words, prices have declined to an area where we objectively know there is more willing demand than supply. "B" is the low risk/high reward opportunity to buy. Buying in these two areas ensures three important things. First, your protective stop is small which offers a trader proper risk management/position sizing. Second, your profit potential, which is the distance from the entry to the supply area above, is as large as it will ever be for this opportunity. In other words, as price moves higher from the objective demand level, it is moving closer to the supply level (target) above, decreasing your profit potential. Third, the probability of success is highest because supply and demand is very much out-of-balance at that level.

The Lesson: Indicators and oscillators are nothing more than a derivative of price and volume. Price is all that need be considered when performing objective, reality-based analysis.

Figure 2

From: Mark H.

Sent: Tuesday, July 27, 2010 12:06 PM

To: Sam Seiden

Subject: BP Trade long XLT

Hi Sam,

I sold my shares of BP yesterday @ 38.47 for a realized gain of eleven dollars. I'm doing an average of $800 a day now. I would like to personally thank you.

Thanks a ton,

Mark - Extended Learning Track (XLT) Member

Above is a monthly chart of British Petroleum. The 2010 oil spill disaster caused many to sell this stock as this was one of the worst spills the world has ever seen. In our trading room, the Extended

Learning Track (XLT), I suggested we buy BP shares for a longer term hold at $27.00 as this was a strong demand level on the chart. Also, above is an email from one of our XLT members who took the trade. The combination of a very negative news event and a quality buying opportunity brings us to our next illusion, the news.

The News

The Illusion:

The news illusion is the most powerful illusion in trading and investing as strong news leads to strong emotion (faulty beliefs). Most successful traders and investors have, at some point in their journey to consistent profits, fallen prey to this illusion. How many times have you seen bad news turn into a positive day for the markets? The news in the case of BP was very real and very bad:

***BP shares fall to new low over Gulf spill* – AP, Thursday June 24th, 2010**

Worries over Gulf of Mexico oil spill push BP shares to new 52-week low in US.

Shares of BP dropped to a new 52-week low in the US on Thursday, to levels not seen in 14 years, as the two-month-old oil spill in the Gulf of Mexico continues to weigh on the company's stock. BP lost 93 cents, or 3.1 percent, to close at $28.74. Shares dipped as low as $28.56 during the trading session. Analyst Phil Weiss of Argus Research said there didn't appear to be a particular reason for Thursday's decline. "There's still a lot of downward pressure on the shares, so, in general, I expect more down days than up days at least until the relief wells are successful or something else positive develops," he said.- AP

The thought of a major oil spill led many to believe that prices would fall, and that belief drove the majority to sell. Once the last seller sells at a price level where willing demand exceeds willing supply ($27.00), the laws of supply and demand tell us prices rise.

The Reality:

The demand level labeled on the chart is the point in which prices move higher from the consolidation. Also, notice how strong that initial rally was. This suggests there was a big supply/demand imbalance in that level.

When price came back to that level the first time, many were selling because of that bad news. This offered us an opportunity to buy BP shares on sale, at the demand level. The news of the oil spill was very real, very bad and prices fell. However, once they reached $27.00, where there was objectively more demand than supply, prices turned higher.

The Lesson: Strong news actually creates powerful turns in the market, opposite of what the majority expects, because one side (buyers or sellers) exhausts itself into a price level where an objective supply or demand imbalance exists. In BP, bad news + a collapse in price = a low risk, high reward buying opportunity. No matter how bad the news is, when the last seller sells at a price level where demand exceeds supply, prices rise. There can be no other mathematical outcome.

Figure 3

Fundamental Analysis

The Illusion:

In some cases such as the chart above, economic reports can severely cloud reality. This example shows the Euro. The rally in price for the Euro as the market reaches the area of supply (imbalance) is accompanied by a very good Euro economic report. When price reached the supply level, I sold short. But, who did I sell to? I sold short to the buyer who bought after a rally in price, and into a price level where the chart already told me supply exceeded demand. The odds are stacked against that buyer at supply who is buying because of the good news, which means the odds are stacked in my favor at that time, me being the seller. The illusion here creates strong beliefs. These beliefs lead to action (buy or sell) and this action (buying and selling) is all we need to be concerned with. No matter who is telling us to buy the Euro and why, all we need to know is this: Are prices at a level where objectively, there is more supply than demand? If the answer is yes, there is no reason to buy and every reason to sell.

All this is information was available to us prior to the rally in price. But most market participants didn't see it, as the illusion of a strong Euro economic report was too strong. Adding to the illusion was the uptrend in price; the stronger the uptrend, the more herd mentality people desired to buy into it. We are humans: There is comfort and safety in numbers. Again, trading is simply a transfer of accounts from the novice market speculator, who does not know what they are doing, into the account of someone who does. The illusion-based trader saw a high risk/low reward buying opportunity and took action to buy while at the same time, the reality-based trader saw a low risk/high reward shorting opportunity and took action to sell.

The Reality:

The objective supply (resistance) area is labeled as such because it is a price level where supply and demand is out-of-balance. Put simply, there is too much supply. Again, prices can only drop from that area because there are more willing and able sellers than buyers, there can be no other reason for the decline in price.

Illusion: Everything in the company is good; therefore, the stock is a quality investment.

Most people require specific criteria in order to feel comfortable buying a stock. These criteria likely include:

Buying High?

When all of the news and reports are good, where do you think price is? If you said "high," you are correct most of the time. If you buy when everyone else is taught to buy and when price is high, who is going to buy from you? Remember, the only way you can derive a profit from an investment or trade is when someone buys from you at a higher price than what you paid. This is no different than buying and selling anything, which includes real estate, automobiles, computers and much more.

The many illusions are nothing more than risk disguised as opportunity. Falling prey to a variety of market illusions makes it possible to disguise irrational behavior as "safe," "proper," or "accepted." An illusion is an erroneous perception of reality. Illusions lead the average trader and investor to commit two consistent mistakes:

- Buying after a period of rising prices;
- Buying at a price level where we objectively know there are more willing sellers than buyers.

Both of these actions are completely inversely related to how you profit when buying and selling anything. They go completely against the laws of supply and demand. However, we don't want illusion-based traders and investors to go away. Why? We need them as they consistently buy after the reality-based trader buys. In short, the reality-based trader typically derives his or her profit from the actions of the mass illusion-based crowd.

The argument I write about so often, exposing the glaring flaws of conventional Technical Analysi, is not all that different from the constant battle between those who follow the Austrian School of Economics and those who follow Keynesian principles. I, of course, clearly side with the Austrian

School and try to show how to apply these principles in the articles I write. A successful trader's path must be reality-based, not driven by illusion. The reality is that markets are nothing more than pure supply and demand at work; human beings reacting to the ongoing supply/demand relationship within a given market. This alone ultimately determines price. Opportunity emerges when this simple and straightforward relationship is "out-of-balance." When we treat the markets for what they really are and look at them from the perspective of an ongoing supply/demand relationship, identifying quality trading and investment opportunities is not that difficult a task.

Do you Have a Copy – Paste Mentality in Your Trading?

Printable Version

A while back in Dubai, I was walking in a Souk (shopping area) with a friend. For those who have never been to Dubai, it's a great place but many of the shops are the same shops we have in the United States. We walked by a Starbucks and I said, "There is another U.S. store." She said, "Yes, another copy - paste"… In the major malls in Dubai, most of the shops are U.S. brands; even Toys R Us is there. Don't get me wrong, you have never seen malls like this: aquariums the size of a big hotel with thousands of fish and full-grown whale sharks that you can scuba dive in, all in the middle of the mall. Another mall has a ski mountain with snow, moguls and a couple really fast runs… All this in the middle of the desert! But as you walk around and focus on the shops themselves, you realize that "copy – paste" is everywhere. I found my friend's comment simple yet powerful as it relates to those who are successful in trading and those who are not. As I have said many times, those who know what they are doing in trading get paid from those who don't. What most don't realize is that the first step in successful trading is to simply think different than most. The losing trader has a "copy – paste" mind. They simply see what actions others are taking, copy those novice actions and paste them into their belief system and bam, you now have the copy – paste mind that leads to a copy – paste life.

The copy – paste function for computers has not been around all that long. However, the copy – paste mind-set has been around forever. Think about how many people you know that make consistent low risk income from trading based on the information they read in conventional technical analysis books. I would be very surprised if you knew one or two. Yet, every day, more and more people buy the conventional "copy – paste" books and take the novice "copy – paste" action those books suggest. People who reach goals and achieve success don't care what others are doing. They ignore the "copy – paste" function in their brain and repeat the actions that lead to their success. They can do this because they are focused on what is REAL in life, money and markets. They understand the reality of how prices move in markets and realize that this whole game comes down to pure supply and demand analysis.

Let me walk you through an Extended Learning Track (XLT) trading opportunity in the QQQ (NASDAQ) from last week that I led for our students. This trade is a simple example of how simple reality-based logic works. Notice the supply level in the upper right portion of the chart that is highlighted. Supply and demand appeared to be in balance. Then, price declined from that level telling me that behind the scenes, supply was greater than demand. Once that decline happens, we wrap two lines around that level and carry those lines forward, creating a supply zone which is a potential turning point in the future. The plan in the XLT was to sell short when price rallied back up to that supply level. Once price rallied back to that level, it was time to sell short. The risk was low, reward was high and the odds of the trade working were very strong. The high odds came from having a good idea as to who was on the other side of our trade, the buyer. What I knew to be true was that we were selling to a buyer who was making the same mistakes every consistent losing trader makes. That buyer was buying after a rally in price and into a price level where supply exceeds demand. Only a market speculator with a "copy- paste" mind would do that and this is the group we always want on the other side of our trades at Online Trading Academy. Price touched that level and began to fall. As you can see at the bottom of the chat window, one of our XLT members shorted 2500 shares at the supply level based on our pre-determined plan.

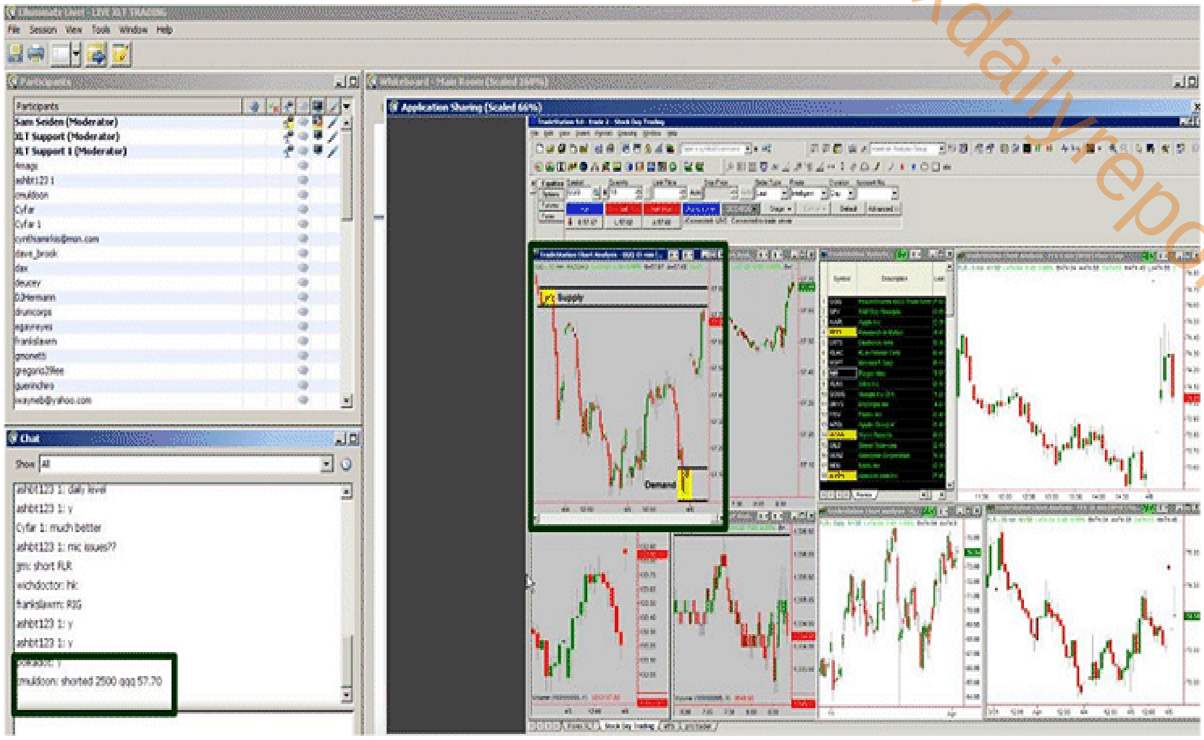
Participants
Chat
Application Sharing (Scaled 66%)
Supply
Demand
cmuldoon: shorted 2500 qqq 57.70

Figure 1

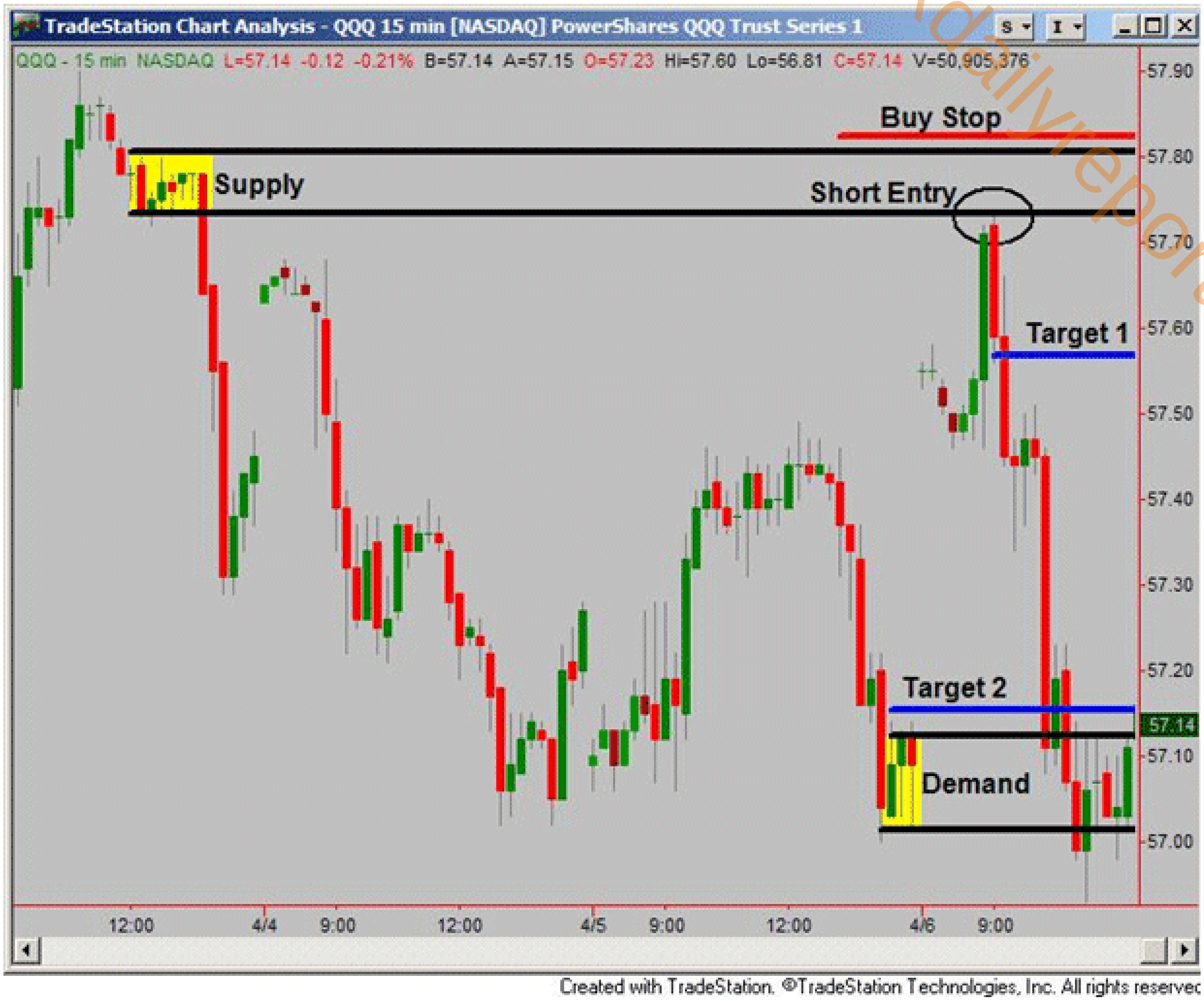

Figure 2

After selling at supply, price declined down to the demand level below. As expected, the "copy - paste" mind had come in and made the same two mistakes. They bought after a rally in price and into a price level where supply exceeded demand. This is where our short entry was. Then we closed our trade by buying to cover from the "copy - paste" sellers at demand. I wish I had more to say and write about to explain this trade and all the others, but the truth is, proper market speculation is simple; actually having the right knowledge and discipline to do it is not easy. What makes it most difficult and sometimes impossible is if you have a "copy – paste" mind and live a "copy – paste" life. Life is too short to settle for anything less than living the life YOU choose to live.

Do you live the life YOU choose to live or do you live a life of "copy – paste" and simply do what others do? Do you follow the paths of others or do your actions leave a path for others to follow? Take some time and think about your decision-making process and determine who you are. If you find that you "copy – paste," delete that function and send me an email when you do.

How Do You Find Market Turning Points in Advance?

There are many aspects and components to short-term and longer term trading. Where to enter, where to place your protective stop loss order, where to take profits, trade duration, risk management, position sizing, trade management and much more are key considerations when trading. In my humble opinion, I would argue that the key to doing any of these things correctly comes down to where you are "entering" the market. Entering the market correctly means entering as close to the turn in price as possible. This allows you to put on the largest position size with the least amount of money at risk. And, by entering at the turn in price, you are farthest away from your profit target which means the "reward" side of the equation is as great as it can be.

So, the question is, how can we determine where the market is going to turn with a high degree of accuracy? In short, price turns at price levels where supply and demand is most "out-of-balance." So, what does that picture look like on a price chart? The following are some (but not all) things to look for on a chart when attempting to identify a price level where you would expect the market to turn in the future. In the Extended Learning Track (XLT) class, we call these "Odds Enhancers."

1. How did price leave the level?

   The Logic: The stronger price moves away from a price level, the more out-of-balance supply and demand are at the level.

   Price can move away from a level in one of three ways. First, it can be a gradual move away from the level. Second, it can be a strong move away from a level with big red or green candles. Lastly, price can gap away from a level. Obviously, the gap away from a price level is the strongest and represents the biggest supply and demand imbalance.

2. How much time did price spend at the level?

The Logic: The less time price spends at a level, the more out-of-balance supply and demand are at the price level.

This is contrary to conventional thought. Most trading books want us to look for price levels where lots of trading activity took place and price levels with lots of volume. Think about it... If price is able to spend lots of time at a level, supply and demand can't be that out-of-balance. The more out-of-balance supply and demand is at a price level, the fewer the transactions will take place. Less transactions means lower volume. So, we should look for levels where very little trading activity took place with less volume. Don't believe everything you read. Most thought the world was flat at one point, look where that herd mentality thinking got us.

3. How far did price move away from the price level before returning back to the level?

The Logic: The farther price moves away from a price level before returning to that level, the greater the profit margin and probability.

When price moves far away from a price level before returning to that level, this means that the supply or demand level is typically far out on the supply and demand curve, far from equilibrium, which is exactly where we want our entries to take place. When supply and demand levels are far out on the curve, this means the rubber band is stretched and the more it is stretched, the more likely it is to snap back. For example, if there is a supply level and price initially falls a great distance from it, two things make this a high probability and strong profit margin opportunity. First, because price fell far from this level, when it rallies back, we would be selling short to someone who is buying after a very large rally in price which is a big mistake for the buyer. This is good news for the seller and increases the odds on that short entry. Second, we measure the distance from the supply level to the lowest low before price rallied back to the supply level (for our short entry) and this becomes one of our profit targets which makes the reward side of the equation ideal.

When it comes to identifying low risk, high reward and high probability trading opportunities, a solid understanding of the core concepts of supply and demand are the key to identifying where the most ideal entries into markets are. For more information on this, here are five resources I can point you to:

1. Read my articles in Lessons from the Pros and SFO Magazine.
2. Listen to the recordings on our website: www.tradingacademy.com, under resources, then recordings.
3. Wipe the dust off your old Economics 101 book and turn to the basic supply and demand information.
4. The Extended Learning Track (XLT) program. This is where we learn and practice live in the markets

Trading with the Trend

Printable Version

We have all heard the phrase, "Trade with the trend, the trend is your friend." While there is much truth to this statement, what specific rule-based action do we take to make money from this simple concept? To dive into the important details and make sure that by the end of this article, you are a better trader, I will use a recent Online Trading Academy Pro Pick in the Forex market to make my points. Pro Picks is the Stock, Futures and Forex picking service for Online Trading Academy graduates in the Extended Learning Track (XLT) program. The service is delivered daily, giving XLT members the exact entry price, stop price and target or targets. Each trade is also delivered in a very educational way with a detailed explanation of strategy so that users can learn to do this themselves. The core strategy at Online Trading Academy is the simple combination of supply (retail), demand (wholesale) and trends.

The Pro Pick trading idea below was a recent shorting opportunity in the US Dollar / Swiss Franc (USDCHF). Notice the trend on the chart is clearly down. This means we only want to look for supply (resistance) levels for our entry points as we are only interested in selling short when the trend of price is down. There may appear to be many supply levels on this chart and you may be wondering why we chose the one we did (yellow shaded area). This is because, based on our

"Odds Enhancers," that was the only supply level that met our criteria. In other words, our rule-based analysis told us that the supply level shown was a price level where there was a significant supply and demand imbalance. This means there was much more willing supply than demand. The reasons to sell at that price level should price rally back up to that supply level are as follows:

1. Quality supply level with multiple Odds Enhancers at play
2. Significant profit margin
3. Ideal risk / reward
4. Strong downtrend

Figure 1

As you can see below, price soon rallied back up to that supply level, stopped, and fell well over 100 ticks to meet our profit targets. This is key as we were only risking 25 ticks. Market timing is what we specialize in at Online Trading Academy and it is the sole reason why this trading opportunity was low risk, high reward and high probability. The professionals say you can't time the markets turning points; we say you can with a very high degree of accuracy. The key to doing this is the ability to truly quantify supply and demand in any and all markets. This means identifying price levels where supply and demand are out-of-balance as that is where price always turns.

There is another key component to consider along side with market timing. It is really understanding who is on the other side of your trade. We want to make sure the person on the other side of our trade is a novice market speculator. Let's use this USDCHF as an example and use simple logic to make sure that when we sold short, we were selling to a buyer who had no idea what they were doing.

Figure 2

The circled area on the chart is where Pro Picks had XLT members selling short into the supply level to the left. The key question is this, who was the buyer and what do we know about them? Novice traders always make two key mistakes. The buyers in this trade were making three and they are as follows:

1. **The buyers who bought from us were buying after a rally in price.** This is a big mistake in trading. Think about how you buy things in other parts of your life. Do you ever get excited about buying after prices rise? If you would not take this novice action when buying things in any other part of life, don't do it when trading and investing.
2. **They were buying at a price level where supply exceeded demand (big supply/demand imbalance).** The chart already told us that (yellow shaded area). This mistake is even worse than mistake number one.
3. **They were buying in the context of a downtrend.** This is not smart trading. During a downtrend, the odds are with the shorts which is why we focus on identifying supply levels as entry points during downtrends.

In that circled area which is where Pro Picks had us selling short, the buyer was buying after a rally in price, into a price level where supply exceeded demand and in the context of a downtrend. The odds are so stacked against the buyer which is why being the seller like we were meant that the odds were stacked in our favor, the risk was low and the profit margin was high. Understanding who is on the other side of your trade is a key factor in trading. Those who trade against the trend tend to pay those who trade with the trend. Again, this is how the transfer of accounts happens

The Two Most Important Parts of a Trade Setup

Printable Version

I was trading the other day and getting ready for a webinar where I was going to do some live Forex trading for a Group based in Europe. I entered the webinar about 30 minutes early and noticed there was a speaker before me going over the last few minutes of his piece. He was going over his analysis on the Euro and it was very deep analysis. He went over six factors that made the trading opportunity in the Euro that day compelling from his point of view. This made me think... I realized when it comes down to identifying the most quality trading opportunities/setups for me, I focus on two things only and if they are present, I take the trade; everything else is secondary. These two things are:

1. The quality of the Supply or Demand level itself - this tells me where price will turn.
2. The profit margin - this tells me where price will go to.

If both of these factors are present in a trade, I typically look at nothing else and consider nothing else.

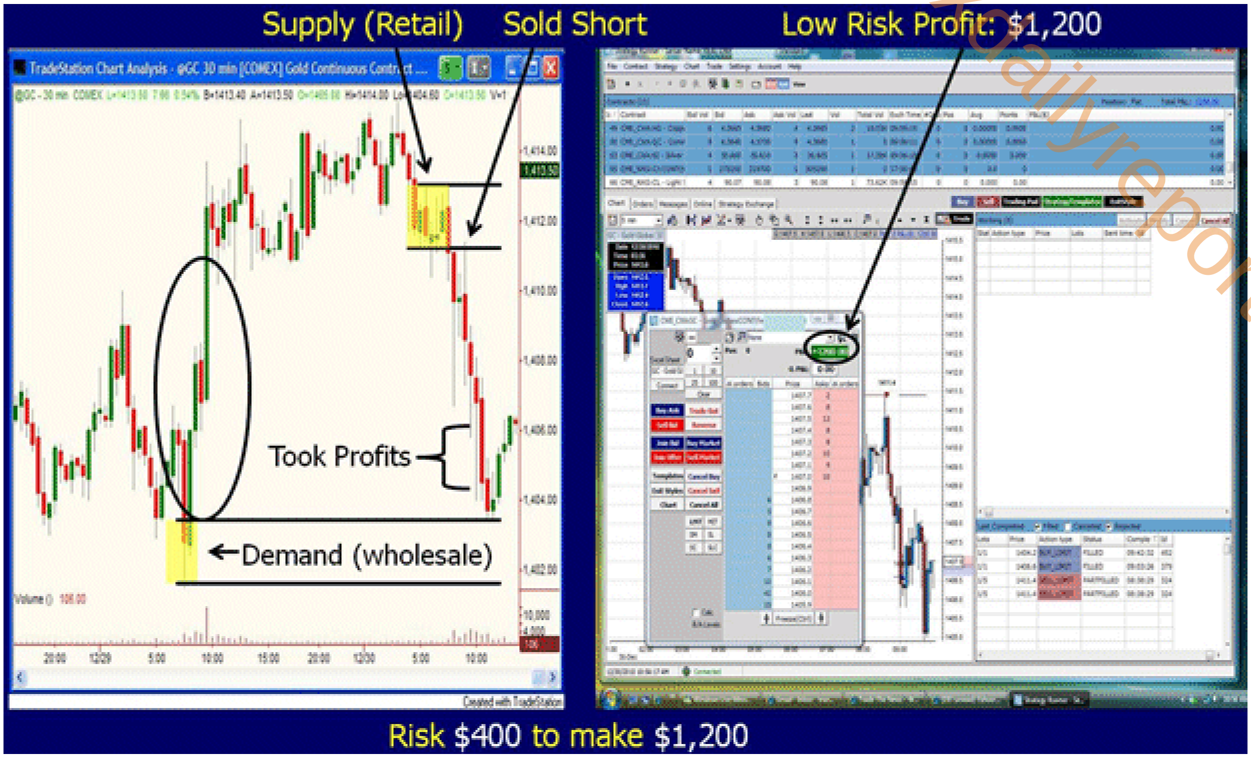

Figure 1

Let's look at this Extended Learning Track (XLT) trade above. The two things that make this trade so attractive prior to entry and make it work out so well after entry are the presence of a quality demand level and a clear profit margin. First, notice the upper yellow shaded area on the chart. This represents a quality supply level because price declined so quickly from it. This means willing supply greatly exceeds willing demand at that level. Second, notice the big circled area on the chart. This price action represents what is below the area of supply on the price ladder. Inside that circled area, there is nothing that suggests any strong demand. There is just a rally in price with no basing, meaning as fast as price rallied in that circled area, I would expect it to decline at the same rate the next time it was in that price range. In other words, once price rallied back to that supply level after the initial decline, it would likely fall fast through to the demand below and that is exactly what happened. By focusing on these two important pieces of information, I am able to determine everything I just mentioned before I take the trade which is what allowed me the low risk profit on this trade. Again, the key factors were the quality supply level to short against and the quality profit margin below that supply. If you were on a trade desk like I was on the floor of the Chicago Mercantile Exchange, you would see a big stack of sell orders at that supply level and no significant buy orders until many price points lower. I am simply sharing with you what that picture looks like on a price chart so you can benefit as well.

Figure 2

A couple months back, we all experienced the very unfortunate Japan disaster. On the 15th of that month, right at the height of the tragedy, Barron's/The Wall Street Journal called me and asked me what I thought would happen to the global stock markets. Prices around the world were collapsing, they wanted to know if I thought this was the start of a larger decline in price. Above is what the daily chart of the S&P looked like during the interview. While the news was very real, very awful, the trend was down, and everyone on TV was calling for lower stock market prices; I simply focused on the two items I am writing to you about today. First, price had declined to a quality demand level.

Second, there was a clear profit margin to the upside when you focus on the circled area on the chart. So, even though the trend was down and the books tell us to only sell in downtrends and the news was very real and bad, my analysis suggested we had a VERY quality buying opportunity in front of us.

Figure 3

Price proceeded to rally strong from that demand level and through that profit margin, and beyond. Trading and investing can be the most complicated task you will ever face if you let it be. Between all the schools of thought when it comes to conventional technical analysis and all the news and fundamental analysis to be done, this can be more than a full-time job. What I am suggesting is that you don't have to really focus on any of those items much at all. Instead, focus on how you make money buying and selling anything and apply those principles which you already do well to the trading and investing markets. This should drastically simplify your analysis and offer you consistent low risk, high reward, and high probability trading and investing opportunities

Learn the Answers to Your Questions on Strategy with Sam

Printable Version

Recently, I have received many questions about an article from a couple weeks ago entitled, "The Two Most Important Parts of a Trade Setup." The article seemed to have peaked interest in a very simple approach to trading which I employ for my own trading. Below are some of those questions and the answers to help you use the strategy rules.

Hello Sam,

I was in your class before; I would like to say thank you for writing the excellent articles. I have been reading a lot of your articles. However, this is the one I like best and will apply this method for my trading next week... "The Two Most Important Parts of a Trade Setup." But I am still confused about which time frame to use for this method? I trade part time intraday. I am looking to swing trade.

Thanks – Jacqueline

Seiden Answer -

Thanks for the kind words on the articles; I hope the articles are helpful. As that article pointed out, the two important components of the trade are a quality supply or demand zone and a significant profit margin. When day trading, it's a good idea to use a combination of a larger time frame chart, like an hourly or daily, and a smaller time frame chart such as a five minute chart. You want to use the larger time frame to identify where price is on the larger time frame supply/demand curve as this will tell you whether you should be looking for buy setups or sell setups on the smaller time frame. For example, if price is at or near larger time frame supply, you want to go down to the 5 minute chart and find quality supply levels with significant profit margins to short against. You would only know this if you first looked at that larger time frame like I am *suggesting. For swing trading, looking at daily and weekly charts should be fine.*

Hi Sam,

I have seen a lot of your webinars on fxstreet.com and I would like to ask you a question because I couldn't find an answer yet. When looking at supply and demand zones, we know that price is potentially revisiting the previous supply or demand area. What you say is that one should take the trade when price revisits the area for the first time. What I was wondering is... What happens with those levels after price has revisited it for the first time? Should we keep an eye on those levels for a potential new trade or do we have to deny the levels once price visited it for the first time?

Thanks in advance - Eliza

Seiden Answer -

Very good question. When I was on the floor of the Chicago Mercantile Exchange facilitating institutional order flow, the answer to your question was very clear. Let's say I was on the trade desk and had a large stack of buy orders (demand) in the S&P at a price of 1245 and the market was opening at 1260. Sure enough at some point, the market would come down to 1245 and some of my orders would get filled, depending on how much supply (sellers) there was when price reached 1245. The first time price would reach that large stack of buy orders at 1245, it would bounce higher. With each succesive decline in price to 1245, what is happening to that stack of buy orders? Is it increasing or decreasing? Is the demand getting stronger or weaker? If you answered decreasing and weaker, you are correct. Each time 1245 traded, more of those buy orders were being filled meaning demand was weakening. Layers of the "floor" (demand) were being removed so to speak. Once all the buy orders at 1245 were filled, price would then quickly fall to the next level of demand.

Hi Sam,

I have been enjoying your webinars very much and just have a question for you. When you enter trades based on daily/monthly charts at demand/supply levels, what percentage of these are winning trades? I am guessing they would be much higher than smaller time frames as there is less 'chop.'

Thanks and regards – Michael

Seiden Answer -

Typically, most people have a higher winning percentage in the larger time frames, you are correct. This is because you are only looking at daily/weekly/monthly charts and the levels are very clear. Also, larger time frame levels trump smaller time frame levels so when you find a nice demand level on the larger time frame with a significant profit margin, what is happening on the smaller time frames is not a big deal. The other way around is a different story, however. If a day trader finds a quality demand level on a five minute chart, for example, and supply looks to be much higher, that is not enough information. You still need to check the larger time frame to see where this smaller time frame setup is on the larger time frame supply and demand curve. For example, if that five minute buy setup is near larger time frame demand, that trade will typically work out very well. If, however, that smaller time frame buy setup is at or near larger time frame supply, that trade has very low odds of working. Day trading is fine and can be very profitable, you just have that extra step of looking at larger time frames so you're not blindsided.

Hi Sam,

I am a student of Online Trading Academy and took the Forex Trader course 2 years back. I have been reading your articles about Supply and Demand and how floor traders see the market. However, I have a few questions which I hope you can clarify.

1. Strong/Weak Support/Resistance

    How do you know when to take a reverse trend trade using the supply and demand concept? I mean how do you determine whether a particular support or demand is strong enough so that price does not simply punch through the level? This is the most difficult part for me if I want to trade using naked price action.

Seiden Answer – *This is based on the larger time frame "fresh" demand or supply level. Trends always end and begin at "fresh" larger time frame demand and supply levels so this is when and where we stop trading with the trend and trade against it as we are expecting it to reverse and change direction. Our anticipatory analysis allows us to then enter the new trend well before it gets under way which gives us a big edge. The key is identifying a "fresh" supply and demand level in the larger time frame. Before you attempt to do this, make sure your definition of a quality supply/demand level is proper.*

2. How many touches on a daily chart and a 4 hour chart of support or resistance will you consider before not taking a trade when the market comes back to test the support and resistance lines again. I have heard some traders using a 3 taps concept and anything more than 3 tests, they will not take a retracement trade no matter how good the trend is? What is your take on this?

Seiden Answer -

What we do in the Extended Learning Track (XLT) program is a bit more objective and logical than the textbook way of doing it which is "touch count." Try to focus on how deep price is moving into a supply/demand level each time it returns to that level. If price just touches the level the first time it returns and moves away in strong fashion, that suggests there is a big supply/demand imbalance at that level. Therefore, we would be comfortable taking a trade again at that level. If this happens the second and third time and so on, we would still take trades at that level. However, as soon as price trades 25% or more into that level, I would not suggest taking another trade at that level as this suggests the supply/demand imbalance at that level is not strong enough anymore to offer us a high probability trading opportunity.

3. Do you do counter trend trades?

Seiden Answer -

Only when that trend is reaching a larger time frame supply or demand level which means that trend is about to end and a new one is about to begin, as mentioned above.

4. Do you use Fibonacci retracement levels and pivot points in your analysis of supply and demand?

Seiden Answer -

No, I don't. Fib levels and pivot points don't often line up with a real supply and demand level. Fib lines, for example, are created with a mathematical calculation that does not take into account willing supply or demand so there is a huge flaw with this line of thinking. Also, if you use Fibs, you have a choice of a number of retracement lines to choose from. The one that will work with consistency is the one that lines up with real demand or supply. So, after taking the Fib line that lines up with real demand or supply for a while, you will eventually ask yourself, "Why do I need the Fib line when I am always taking the one that lines up with real demand or supply?"

5. Do you use Candlestick patterns in your trade analysis?

Seiden Answer -

Not conventional patterns. If we agree that price always stops falling and turns higher at price levels where willing demand exceeds willing supply and vise versa, don't we only want to focus on the picture that represents that fact? Also, conventional chart patterns almost always have you buying high and selling low; that's how they are setup. Think about the most popular ones like the Head and Shoulders and Double Top patterns. Neither of these patterns have you selling high, near supply. Both have you waiting for a significant decline in price before selling which makes absolutely no sense and these are some of the *most popular patterns in all the books; crazy if you ask me.*

I tried to be as detailed as I could in the answers to ensure a solid understanding of these concepts. The key answer to almost all the trading questions I ever receive is always answered by considering the reality of how you profit buying and selling anything in any marketplace. So the next time you are puzzled and looking for an answer, dig into your bag of "logic" and you will likely find the simple answer. If that doesn't work, send me an email and I will be happy to help.