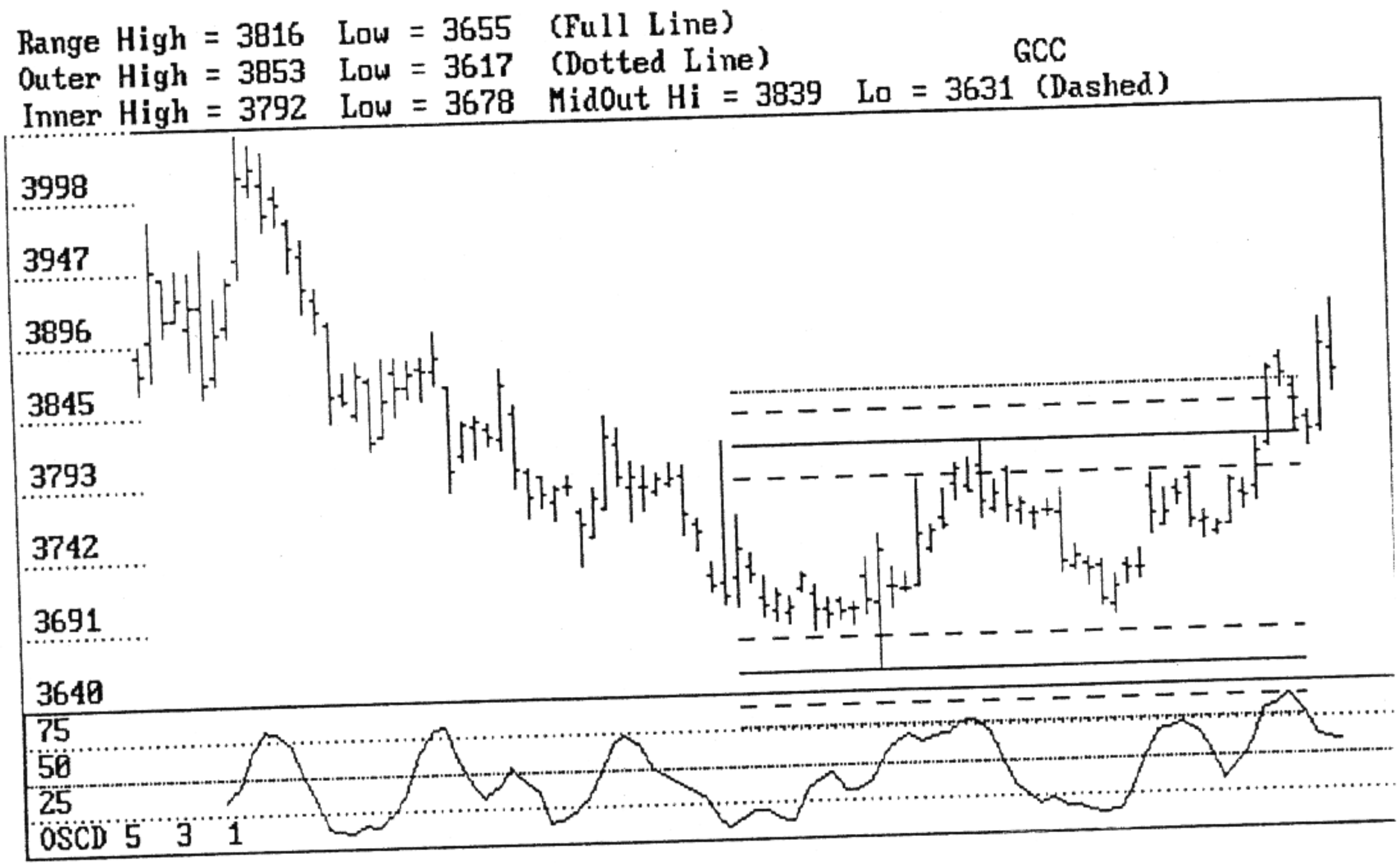

2

TRADING BY THE BOOK

by JOE ROSS

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PREFACE

This is a book about trading futures. Specifically, it shows ways the futures markets have been successfully traded for many years.

My family started trading in the futures markets over one hundred years ago. Much of the knowledge acquired since then is shown in this manual.

Until the present time, this manual has been privately sold to those willing to master its secrets. It is not a get rich quick scheme. A lot of time, work, and effort has gone into its writing. A similar effort is needed to learn how to use it.

From time to time, I rewrite various sections of the manual, in order to keep it up to date. However, its concepts are timeless.

Each part is in itself almost an entire trading manual. Yet the parts complement and supplement each other and should be taken as a whole. The parts really are interdependent.

As new or better insights evolve from my trading, I will include them in revisions c the manual. Clarifications will also be included as needed. This manual is intended to be a living, growing type of work. Its next revision is already planned.

Notice also that the charts in this revision are somewhat different in appearance. The cursor bar is now a dotted line and thinner than before. Comments and pointers are now placed on the charts by computer, rather than by hand. All charts shown are now produced by the Market Detective trading program written by my good friend George Damusis at Microforce.

The Market Detective trading program, besides doing a great many clever things, is specifically geared towards <u>Trading By The Book</u>. It does each and every study discussed.

INTRODUCTION

"To learn you must want to be taught"

This is an unusual manual. It doesn't tell what YOU should do. Instead it tells what I should do, and what I try to do as a professional futures trader. I'm writing it in the first person because I'm writing it as much for myself and my family as for anyone else.

Hopefully you won't think I have some sort of large inflated ego because the wor "I" is used so much. If you do, I apologize for that.

This manual contains what I believe to be true, based upon my experiences and what I have learned and continue to learn. Like so many good things, my success in th markets has come through much mental and emotional pain and anguish. A lot of hanc wringing and self-flagellation was and continues to be involved. This manual explains why I trade the way I do.

Do I expect to be trading exactly like this next year? Probably not! I hope that r trading will evolve beyond what I do now. But the trading I do now is very profitable. can't stand still, I must grow!

I have come to believe that the greater part of success in trading is not in being able to pick tops or bottoms, not in being able to always pick the right trade and enter and exit at the right time. These are important, but far more important is self-discipline and self-control. Managing yourself so that you can manage your trades is, in my opinion, at least 80% of the job. In fact, the subjects of managing yourself, managing your trades, risk, and money, are all far more important than the trading method you us

A person needs wisdom to be able to trade successfully in the markets! Why wisdom? Because contained within wisdom are all of the traits that can make anyone winner - in anything they attempt to do that is physically possible for them to do!

My need for wisdom in trading futures, or any market for that matter, is very gre Wisdom tells me that in order to succeed I need self-discipline, knowledge, patience, se control, resourcefulness, diligence, flexibility, concentration, decisiveness, persistence, discretion, perseverance, and consistency.

In addition to all of these virtues, I need to be totally honest and truthful with myself, know myself and my weaknesses, be emotionally, mentally and physically fit, a ready to take fast and immediate action when needed. I must overcome greed and ha an intensity about me that enables me to control both my thoughts and emotions.

I must also become a top notch manager - planning, directing, organizing, controlling, and delegating.

This is a tall order. Few are the individuals who can measure up to such a yardstick. But then, few are the individuals who succeed in the trading of futures! I k trying to be that individual, but I know I'll never be perfect at it.

How to Get Wisdom

The Book says that everyone who reads and FOLLOWS its instructions will be given wisdom and common sense. It says that if I want greater discernment and insight and am really searching for them diligently, then I will receive them.

The Book says that I can learn to find the right decision every time. It says that wisdom and truth can be an integral part of my existence, and fill my life with the joy of success at whatever I do. Following the Book can make me a better trader. It can make me a winner!

Determining to Be Wise

Because successful trading requires the results of wisdom and common sense, I'v made up my mind to be wise. In trading, wisdom is one of my goals! It's been said tha someone who knows right from wrong and has good judgment and common sense is happier than someone who has immense wealth but lacks discernment and understanding. When I trade I try to achieve both - wisdom and wealth - realizing that wealth can be a result of wisdom.

But wisdom can bring more than just wealth. It can bring a long and healthy life, riches, recognition, pleasure, and peace of mind. Wisdom is its own reward, and if I reject it I will be hurting only myself!

Determining to be wise is the first step toward becoming wise! My objective ther is to be wise, and to develop sound judgment and common sense.

Of course, I can choose to trade without wisdom. I can trade just for the thrill of it. There's plenty of excitement to be had doing that. I'll even get my share of wins, perhaps just long enough to really get hooked. But, eventually I'll lose all my money. Trading without wisdom is not trading, it's gambling.

The Book says that only a fool refuses to be taught. It says that if I trade withou wisdom I am laying a booby-trap for myself that will result in my annihilation as a trader

It says that without wisdom I'll suddenly find myself caught up in a storm of terrc engulfed by anguish and distress. It will be too late to seek wisdom then, in my anxiety I'll never find it. It's then that I will experience the full horror of the path I will have chosen as I see my money flow into the hands of those who were diligent in being wise My own complacency will have "killed" me!

The Book says that only wisdom can save me from the self-flattery that might make me think that I am better than I really am. Only true discernment can save me fro the false flattery that will be given to me by those who want to take my money.

It's wisdom that will save me from shooting off my mouth and then having to lie t cover up my foolishness. How will I ever hide my embarrassment when I've lost all of r money?

WISDOM VERSUS FOOLISHNESS

Wisdom keeps me on the track. It lets me focus in on my goals. Without it I am serious trouble, I'll be fumbling in the dark. I'll stumble and fall. Wisdom dictates that I stick to the straight and narrow - that I watch my step and be safe. Without wisdom I'll become sidetracked. I'll stray from my goals. I'll be in constant danger of losing it all. I'll have sleepless nights as I ponder my foolishness. I'll make stupid mistakes as I try t extricate myself from the traps into which I have fallen.

If I'm wise and find myself in serious trouble in the markets, I'll realize that it may be that I have trapped myself. Prudent thought will help me to be quick to get out of it, if I possibly can. I'll be able to swallow my pride and admit my mistake. I won't let embarrassment stand in my way. I'll call my broker and get out of a bad trade as soon possible. I'll be persistent and urgent in getting out.

But, if I'm foolish, I'll be slow to take action. I will have told others about my gre moves. I'll be embarrassed to let my broker know that I have made a mistake. I'll be prone to lie to myself, failing to admit even to myself that I'm wrong. I'll persist in the false hope that the market will prove me right after all.

Wisdom will help me to realize that I have to work for what I want - that's right, labor hard for the rewards that I seek from the market. Trading is hardly a get rich quic scheme! Only a very few have been willing to work hard enough to get rich in the markets. A fool may believe otherwise. A fool will lose his money to those who have persevered in learning how to trade.

I think that I can describe a fool. A fool is a constant liar - lying to both self and others.

A fool blabs his intentions to all who will hear, he campaigns for his point of viev

A fool wants to teach everyone else what he thinks he knows.

A fool does not know how to keep his own counsel.

A fool's heart is full of rebellion. He is going to beat the system. He pits himsel against the overwhelming forces of the market.

A fool can't admit to himself the possibility that he has been wrong - he takes it personal failure.

A fool doesn't heed sound advice, but all too often he listens to and acts upon t opinion of others.

A fool spends his time scheming about the wrong way to do things.

A fool spends his money on trading systems that hold little chance of working fo him, because he will never follow them exactly - and even if he did, he fails to realize these mechanical systems were created out of a different orientation from his own. H not the one the system may have worked for. That is not to say that a mechanical system won't work, but the fool will not work it according to its rules.

A fool is lazy, not willing to make the effort required to really learn how to trade.

A fool is impatient, unwilling to take the time needed to apply the knowledge he might have learned if he ever were willing to work and study.

A fool is proud, vain, conceited - when in fact he needs to be humble in order to be successful in the markets.

A fool is daring when in truth he should be terrified.

A fool plunges at the very time he should hesitate.

Wisdom will keep me from being a fool! Wisdom will also keep me from being greedy. Greed will keep me in the market too long, when in fact it is better to get out of the market too soon - but with a profit. Greed will cause me to dream of all the things that paper profits will buy, when in fact paper profits are worthless until and unless they are cashed in. Greed will cause me to commit all of my capital at once to a position instead of carefully adding to my position only when my earliest commitments have become profitable.

Wisdom will keep me from letting my desires for wealth get out of hand. I can't let myself fall for the promises of easy riches that may be held out to me. I can't let such promises seduce me. Wisdom dictates that I run from them. They have been the ruin of many just like me. Trouble comes when you go looking for easy money.

There are reputable brokers and managed accounts to be had. Wisdom will help me to find them, when I need or want them.

Wisdom is the opposite of pride, arrogance, corrupted thoughts and self-deceit. Wisdom welcomes good advice and common sense. Wisdom is power, it lets me judge between right and wrong.

All too often I've been a fool. I can leave foolishness behind and begin learning to be wise. I have a choice and the choice is mine!

The Book

The Book referred to is my own collection of proverbs and other gems of trading wisdom that I have gathered over the years. Much of it comes from the Holy Bible. Books on trading tactics and strategies, and books that contain wisdom should be studied on a regular basis by anyone who seeks to better his own trading results.

I have said that there are certain results of learning and applying wisdom to trading markets. I now repeat them so that they will be recognized when they are utilized throughout the remainder of this manual. They are:

Self-discipline Knowledge
Patience Self-control
Resourcefulness Diligence
Flexibility Concentration
Decisiveness Persistence
Discretion Consistency
Perseverance

In addition to the above attributes, there must be total honesty and truthfulness. I must know myself and my weaknesses, be emotionally, mentally and physically fit, and ready to take action when needed - without procrastination. I must overcome greed and have an intensity about me that enables me to control not only my emotions, but my thoughts as well. As stated previously, that is a tall order, but it is still not enough. I must also become a top notch manager - planning, directing, organizing, controlling, and delegating.

Hopefully this manual will point out these virtues while at the same time showing how I trade successfully.

How I Trade

I believe that if I am going to trade, I must have the best tools I can afford to purchase, and that I must thoroughly learn to use them.

Trading futures is a zero sum game only to the extent that for every buyer there is a seller, and for every seller there is a buyer. Consequently, within the same time frame, for every winner there is a loser and vice-versa in the marketplace. I don't like to lose, so I want everything that I can possibly have working in my favor.

I assume that on the other side of my trade is a well capitalized, astute, electronically equipped professional. We have a difference of opinion as to which way the market will go. We may even be working in a different time frame. I may have a shorter term point of view as to which way prices are headed, or I may have a longer term point of view. We may both be right within our individual time frames, but for whatever the time frame that I am in the trade, I want to be right.

I use a computer in my trading. I download price data each evening after the markets close. I also use my computer for daytrading. I use the computer for displaying and printing charts for analytical purposes. But the techniques I will show in this manual do not require the use of a computer, they can be done by hand, or from charts purchased from a charting service. I traded that way for quite some time.

I believe that the only successful way I can trade these markets as an individual is based on an analysis of the price data I can see on my charts. Since I don't have the billions of dollars needed to acquire and trade from fundamental information, my only choice is to become the best "situational" trader I can possibly be. For my purposes, the price charts, along with a couple of simple indicators, tell me everything I need to know about the markets in order to trade them successfully.

I trade the contracts found on the CBOT, CME, and the New York exchanges. I find more than enough opportunities to trade on these exchanges, so I am unwilling to spend the money needed to acquire data from any other exchanges.

I trade daily charts and intraday charts. The daily chart is where I do most of my analysis, but I select my opportunities based upon the trend of the weekly charts.

I use the daily charts to enter, monitor, and exit from a trade. I add to my position from the daily charts. I also use monthly charts when I want to get a look at the bigger picture of where prices are in relation to where they were, and to visualize major support and resistance. I do this in order to keep in tune with my own temperament. I cannot stand to wait an entire month to see one bar appear on a chart. Nor can I stand to wait a week. I want to see it today.

The methods by which I trade enable me to trade from daily and weekly charts as well as intraday charts. It is my firm belief that a chart is a chart, and the truth is the truth. Given sufficient movement (volatility), I can use my methods in any time frame. My trade, risk, and money management techniques make this possible.

The main analytical tool I use is the ordinary bar chart showing open, high, low, and close.

I have been intimately involved in the ongoing development of a computer program that I use in my trades. I use that program because it is able to automate the simple studies I use and which are shown in this manual. This computer program is used strictly for end of day analysis and is available for a modest fee. I find that after looking at my daytrading software for the best part of a day, my end of day software gives me a fresh perspective on what I have been viewing throughout the day.

With the exception of "high-low bands" (now known as Bollinger bands), I don't use elaborate technical studies because none of them really gives me a more accurate picture of what is going on in the market than what my eyes can see on a price chart. It seems that there are more and more profound technical indicators, with more and more complicated and secret formulas for figuring them out, but not a single one of them is forward looking for the most part, and not a single one of them can tell you what is going on in the market place until it is too late.

There is a beauty and a symmetry to the markets that is at the same time simple and profound. The closest anyone has come to reducing it to technical terms is found in the Fibonacci series of numbers which, when properly used, can help define that beauty and symmetry so that it can be used to trade the markets. However, this is not a book about Fibonacci trading. **I am <u>not</u>** a Fibonacci trader. But I am aware of the effect of such trading upon the markets. In some situations I use Fibonacci numbers to project short term objectives. As often as not, I use them to fade those traders who trade as though there were something divine regarding those numbers.

The reason I use my own software, written for me by George Damusis, is that all of the studies available at this time are simple and forward looking. They are what I would call a best and realistic attempt at seeing into the near future. As stated previously, these can be done by hand. This software also provides me with the basic tools I need to draw lines on my charts, illustrate moving averages and oscillators, and to work with Fibonacci numbers although sometimes it is easier and faster to do all these by hand.

A computer is not needed for what I will show in this manual. It can all be done simply with a ruler and a calculator. In this manual I will be showing these tools and hov I use them.

For me, selecting a trade USUALLY consists of finding an entry situation, selecting a protective stop, and delineating an objective point or points. Wisdom dictates that I should be extremely careful in selecting a trade to enter. I want to have the greatest possible chance of success. There are only a few situations that will cause me to enter into a market. I'll discuss and amply illustrate them throughout the various parts of this manual.

To identify these trades, I'll have to exercise patience. It means that I might not necessarily trade every day. Self-control will play a big factor as I wait for the right opportunity to come along. I'll be flexible. The trade has to look right and feel right or I won't enter it. I'll be cautious about entry. Once in it I'll be extra careful and flexible, ready to move my stop at a moment's notice - ready to bail out if anything doesn't look or feel right - this is hard to do, but I'll try. I will not be greedy and try to milk a trade fo all it's worth. I will be content to get my share of the profits should the trade go my way. No one can really pick tops and bottoms - I won't even attempt it.

I have to be disciplined as I wait for my chance, and then act on it when I do see it. And when I see my opportunity, I must further exercise discipline by selecting a protective stop, and an objective for my trade.

Throughout this book, I show trading of a contract set. The reader needs to be aware of the way I actually trade for my own account when considering the results of th trades and the actual exit points and exit tactics.

I normally trade in contract sets. That means I put on positions of three, four, five ten, fifteen, twenty, etc., contracts at a time.

My management technique is the same regardless of the time frame in which I trade. I cash from two thirds to three fifths of my position when I see a certain number of dollars or points in a trade. This covers costs, and gives me a small profit to boot. The final one fraction of my position is then left to ride as far as it will go. However, I will not, if I can help it, give back more than one half of the unrealized paper profits that have in the trade. Where warranted, I add continuation contract sets, ever mindful of th additional risk being incurred by adding on.

It is by the gradual accumulation of winnings on a steady basis that I have had enormous success in the markets. I seldom make a big killing in the market. I prefer to take a steady stream of profits from the market on a regular basis.

It is essential to my trading to pay low commissions, certainly not more than $35 per round turn commissions. If you are paying more than that you need to negotiate a new rate with your broker, or get a new broker. There is no reason in today's markets t pay any higher than $35, and many can obtain lower rates. If you are calling your own trades, then you should be paying bottom line.

If there is a desire on your part to pay $35 or less per round turn, I will be happy t recommend one of several brokers who will accommodate you.

Trading By The Book - Part I

CHAPTER 1

My First Opportunity

This manual is, in a sense, an anatomy chart of the markets. It shows how to identify each type of market formation and then how to go about trading that formation. A market consists of trading ranges, trends, ledges, and hooks. Each of these in turn is made up of lesser formations.

This particular portion of the manual is the first of several parts. Each part will cover essentially one aspect of trading, because each aspect of a market is different and requires differing entry and exit techniques and even different tools. I will be covering the breakout from congestion first because it is the easiest trade to make, and can be monitored while still trading other market situations in other markets, and other market situations even within the same market.

This part of the manual is the chronology of entries into both a Gold trade and a Wheat trade I made and am making as I write this part of the manual. I expect to be out of these trades before I finish writing, but for the sake of consistency they will be presented throughout as though I were still in them.

One of the most reliable trades I can make is based on the breakout of a range or, as some call it, a breakout from congestion.

Whether I'm looking at a five minute chart or a monthly chart makes no difference apart from the magnitude of the price bars. What I'm looking for is a range of twenty-one to twenty-nine or more bars. The more, the better. But never ever less than twenty-one, with the average being twenty-five. I'm diligent in counting them.

There's more to it than that. I must know what constitutes a range. For my purposes, a range consists of prices falling within a well-defined upper and lower limit, as I perceive my chart in the way that I usually look at that chart. That is to say that both the vertical and horizontal scaling of the chart is consistent with the way I normally view it from whatever source of charts I may have.

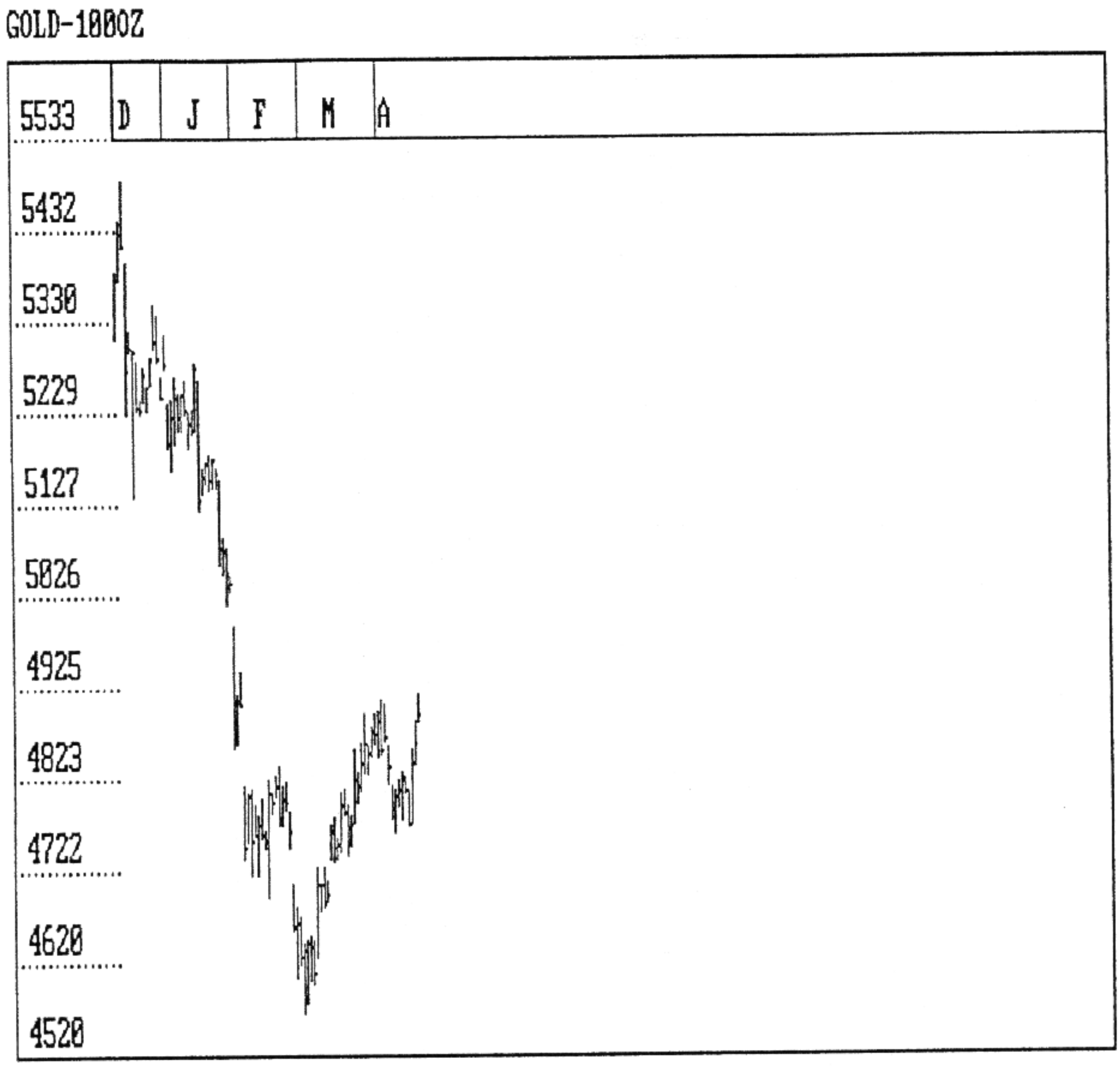


Figure 1

To illustrate what I mean, look at Figures 1, 2 and 3. These are all charts of August Gold. But the scaling on each is different! Since Figure 3 represents the way I usually see my daily charts, I have selected it for making most of my trading decisions.

The type of screen shown above is good for getting the larger, overall picture of a market.

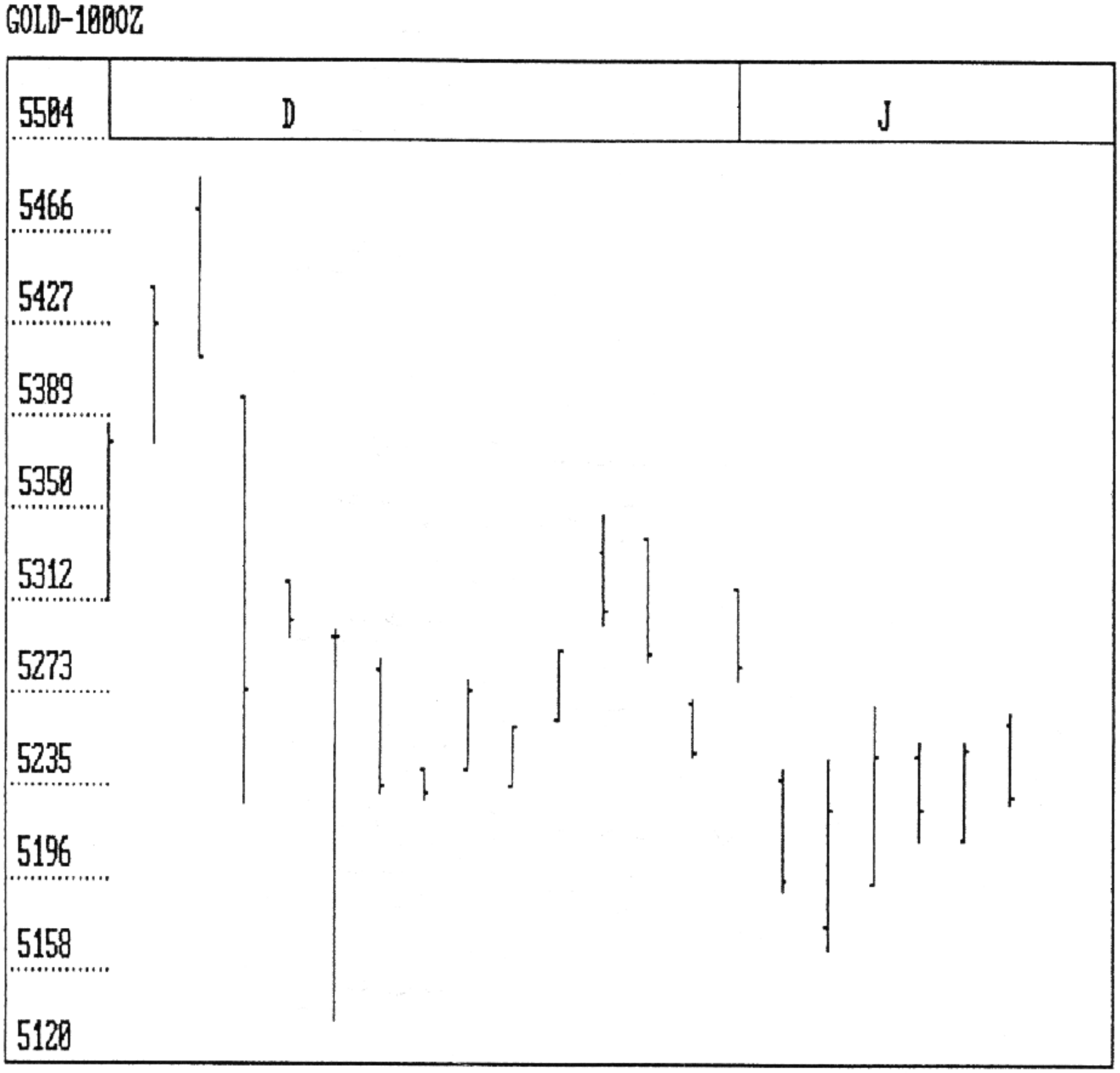


Figure 2

The only time I use this sort of screen is when I want to really home in on the detail of a particular group of price bars.

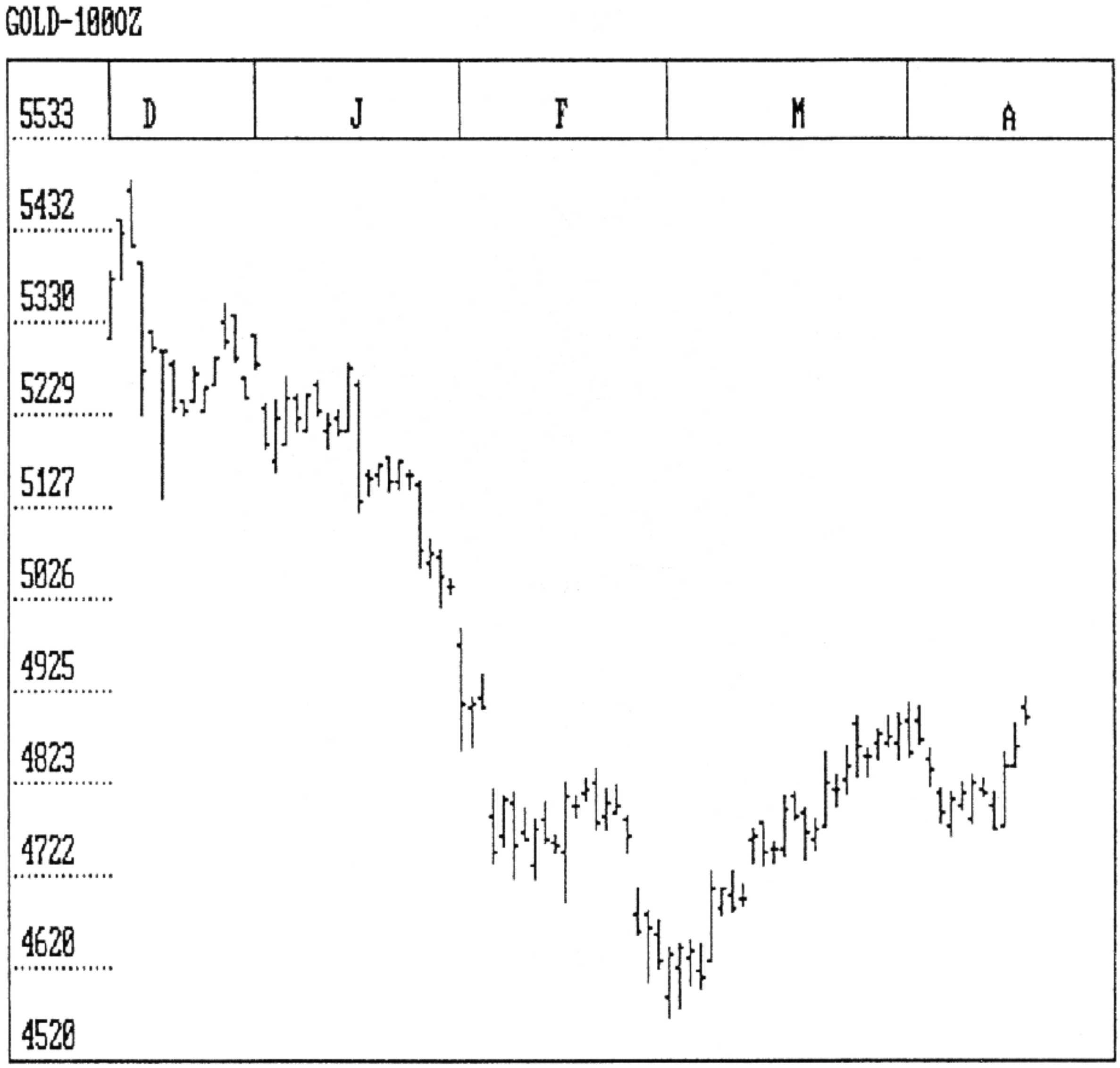


Figure 3

This is the way I normally view my screen for end of day decision making.

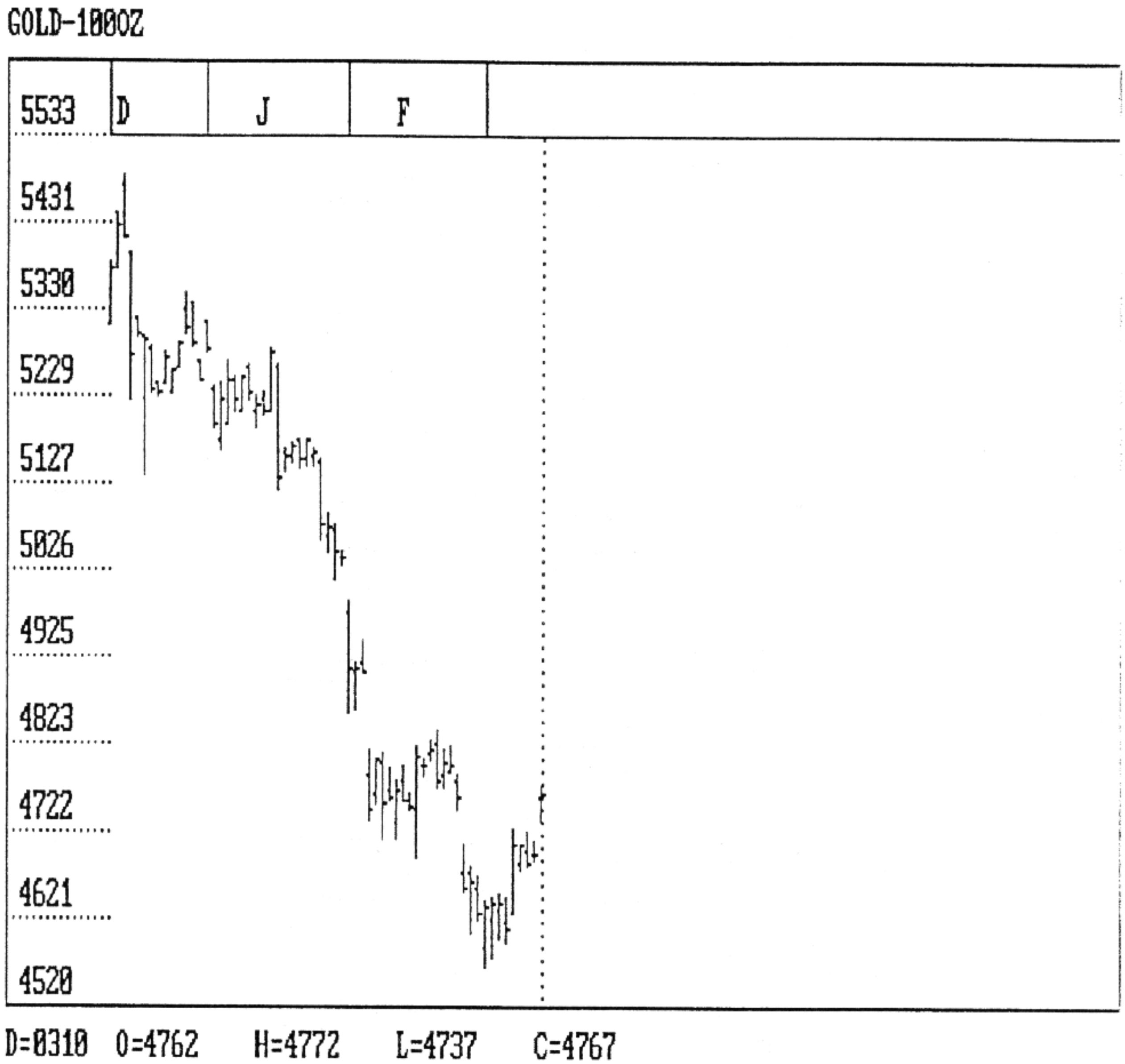


Figure 4 Looking at the chart for August Gold, there are several points I want to make.

On March 10, prices gapped upward to what would become the low of a trading range at 4737. There was no way at that time to know for sure that such a trading range would develop. Interestingly, this gap up was at almost the same level as the prior gap down which, as I'll show later, is a warning that the down move is about over.

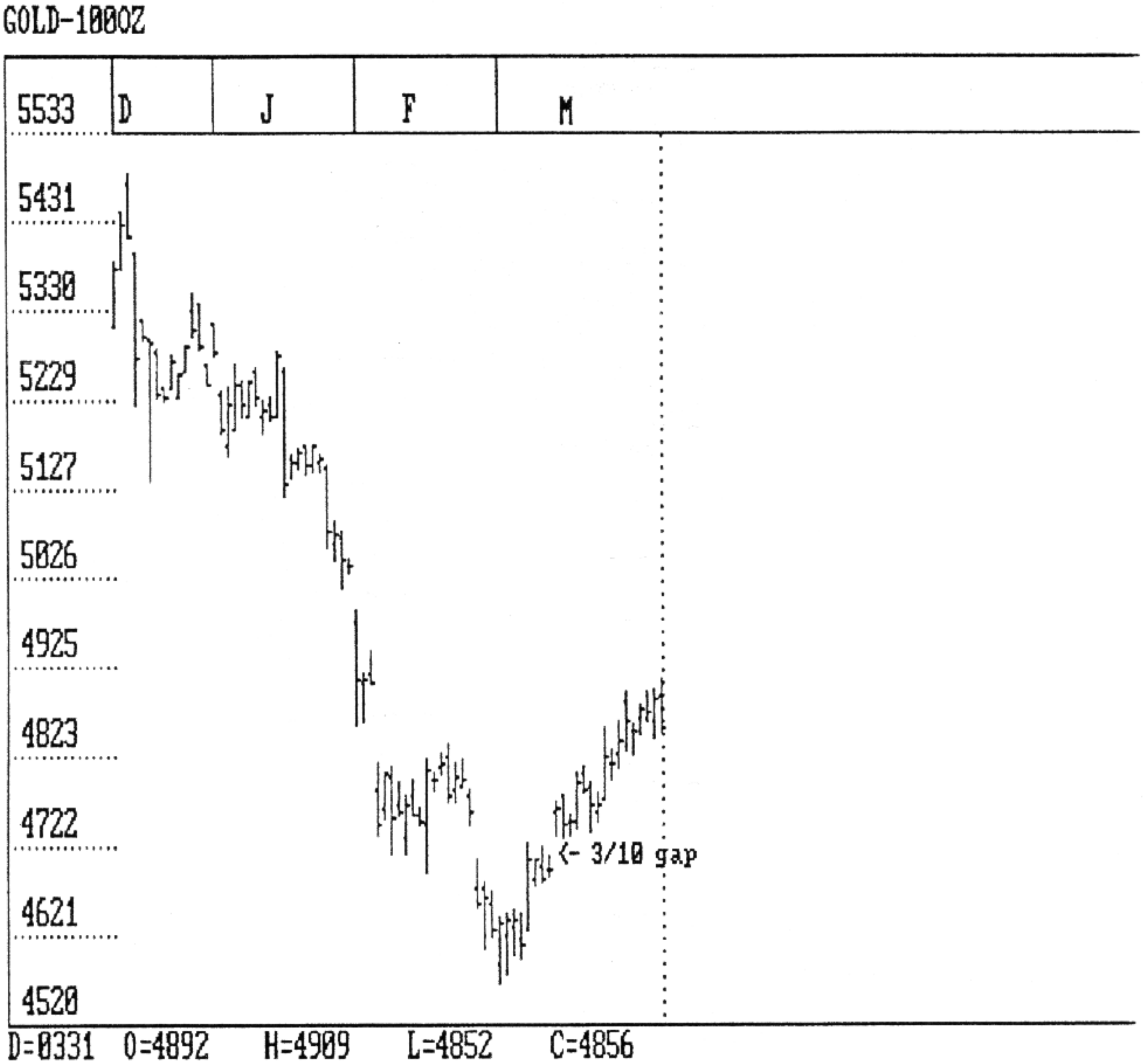


Figure 5 From there prices trended upward, undulated up and down, and ranged between the low of 4737 and a high of 4909 made on March 31.

The initial high and the low for the range have been established, but it is not yet clear that this is a trading range, because a trading range is characterized in this book by a minimum of two swings and looks like this /\/\ or this \/\/. In Figure 5, prices are still very much in an uptrend.

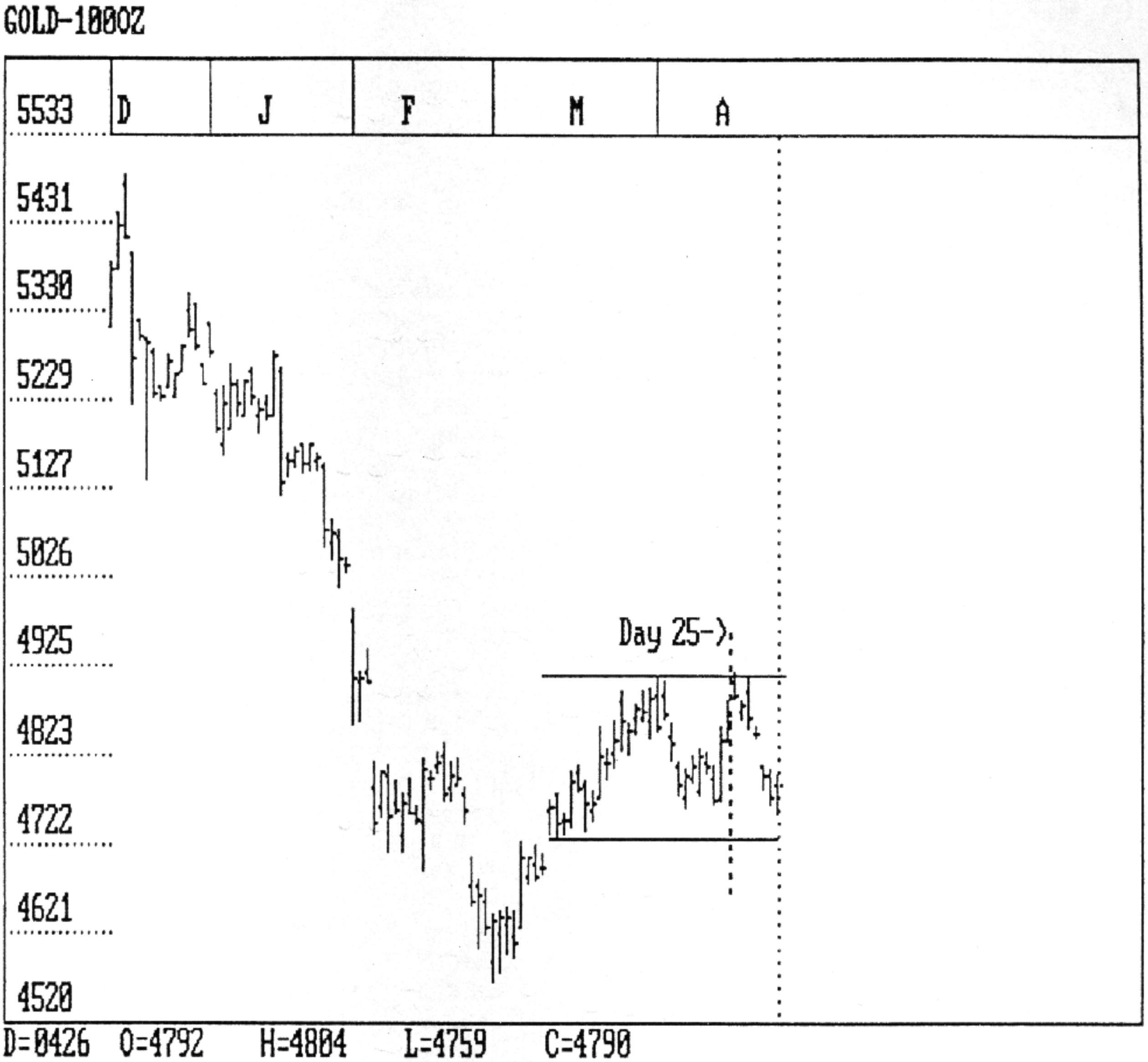


Figure 6 When is it clear that prices are in a trading range? The fact that it was a trading range became clear only as prices turned down from the high of April 19 toward the minor low of 4759 on April 26. That last leg down formed an /\/\ on the chart.

Breakout of a Range Defined

By "breakout of a trading range" I mean any close that is equal to or greater than a .236 expansion of the initial magnitude of the range of prices once the range has been established.

I'll show the calculation in a moment. What I have done is to create an "envelope" surrounding the congestion at plus or minus .236 of the initial height from the low to the high of the range.

The reason for using the initial height is that some ranges widen as they age, which tends to make their breakouts less emphatic. I am not concerned with those congestions that narrow as they age because they break out with great force from the envelope, and the purpose of the envelope is to avoid false breakouts.

Range Expansion

The formula for computing the expansion is as follows and is quite simple:

Highest high minus lowest low for the initial range, multiplied by .236.

The result is then added to the initial high of the congestion and subtracted from the initial low of the congestion area.

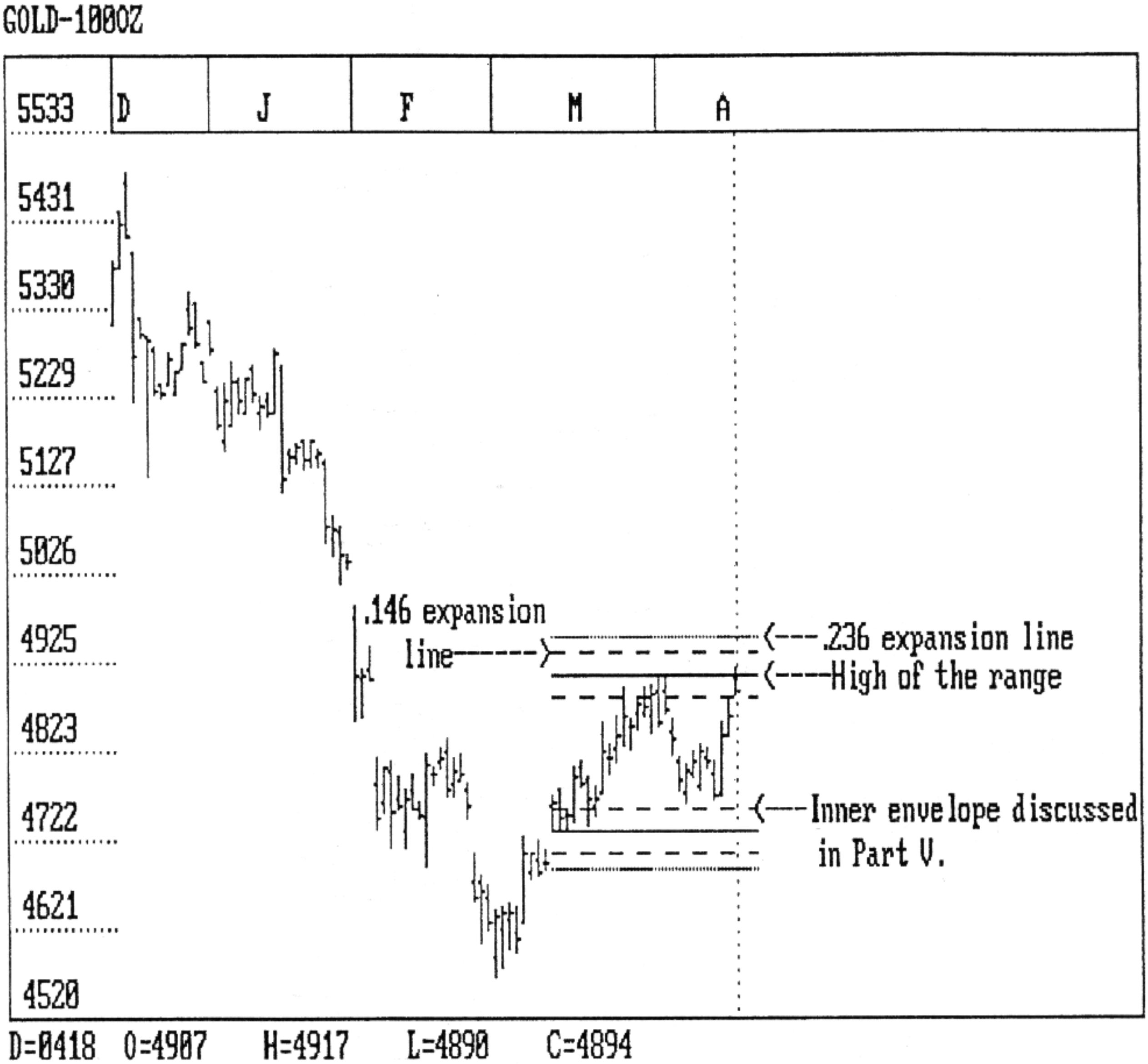
For the situation at hand I now have a low of 4737 on March 10, and a high of 4909 on April 19. Subtracting the low from the high I have a height for the range of 172. Multiplying this by .236 gives 40.59. Adding 40.59 to the high of 4909, I get 4950 rounded to the nearest tick (which for Gold is 10) as the upper limit of my envelope. Any breakout on a close at or over 4950 will cause me to be a buyer of Gold DURING THE CLOSE OF THE DAY ON THE DAY OF THE BREAKOUT, OR AS LOW AS I CAN BUY IT the day after the breakout!

The lower limit of my envelope is calculated as the low of 4737 minus 40.59 which gives me a lower limit of my envelope equal to 4696 rounded to the nearest tick. Any close at or under 4696 will cause me to be a seller of Gold DURING THE CLOSE OF THE DAY ON WHICH IT BROKE OUT OR AS HIGH AS I CAN SELL IT the day after the breakout!

CATASTROFICO Range Stop Placement

When trading the breakout of a range I place my initial stop above or below whatever price constituted the opposite extreme of the envelope. If I sell Gold at 4696, I will place my initial protective stop at 4950. If I buy Gold at 4950, I will place my initial protective stop at 4696. This is only a catastrophic protective stop at the time I call in the order. I determine this stop placement prior to my entering the trade!

Once the range has been established, it is essential to call my broker and place my order.



The anatomy of the envelope from outside to inside is:

The outermost lines are the .236 expansion lines.

The next set of lines are .146 expansion lines, called mid-out lines.

The next set of lines are the original range lines.

The final set of lines are for an inner envelope explained in Part V.

In this series of Gold trades I will be using the .236 expansion. In the series of Wheat trades that follow, I will be using the .146 expansion. The choice of which to use will be explained a little later.

Figure 7 On 4-18, there is a minor breakout of the top of the range, but because of the envelope, I am saved from a false breakout.

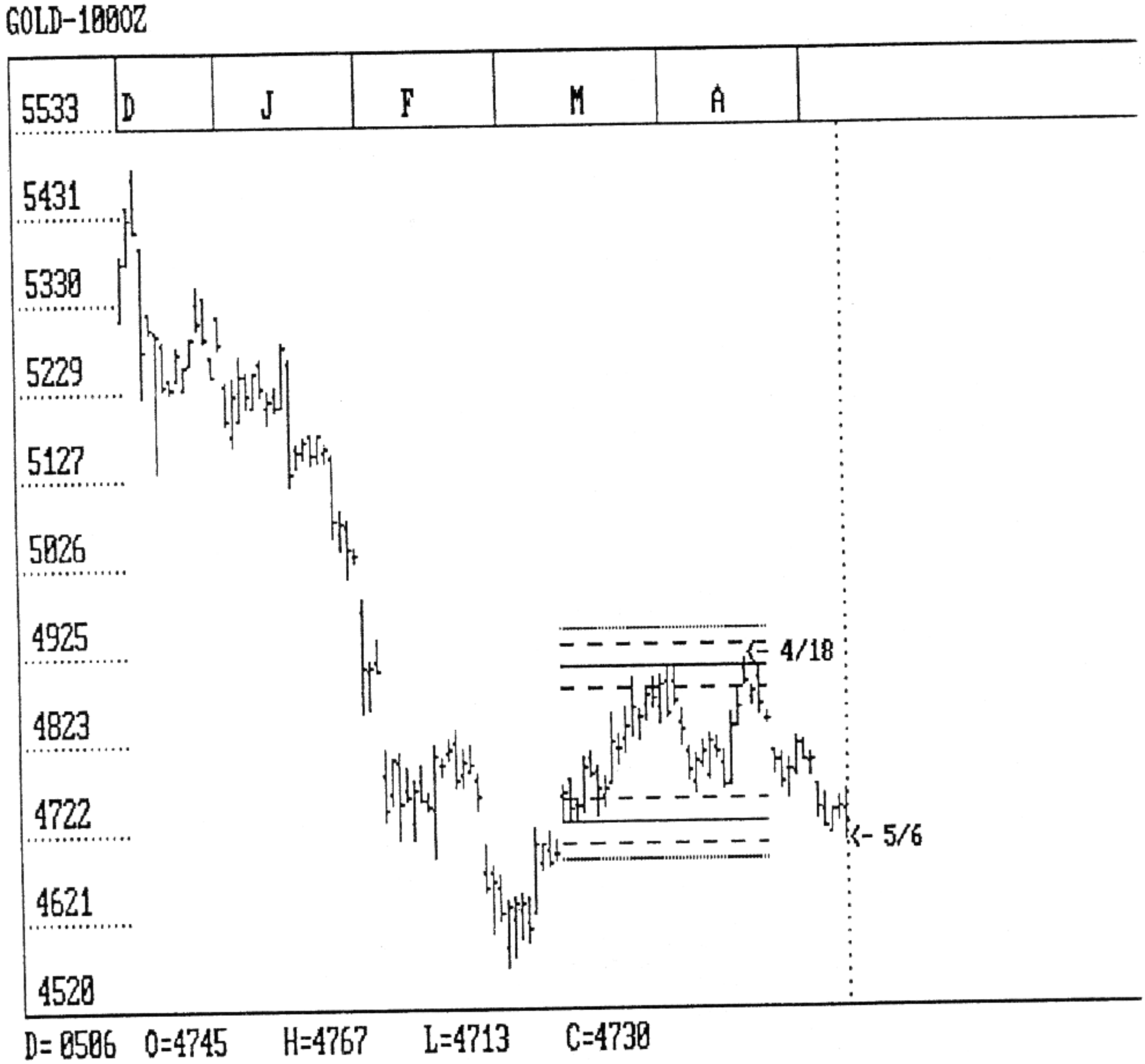


Figure 8 On 5-6, although I didn't get a fill on my order, it did result in a new lov for the range. However, it is important to note that even though there is a new low, I'll stick with the original parameters of the range, with the low at 4696 and the high at 4950.

Again my envelope has saved me from a false breakout.

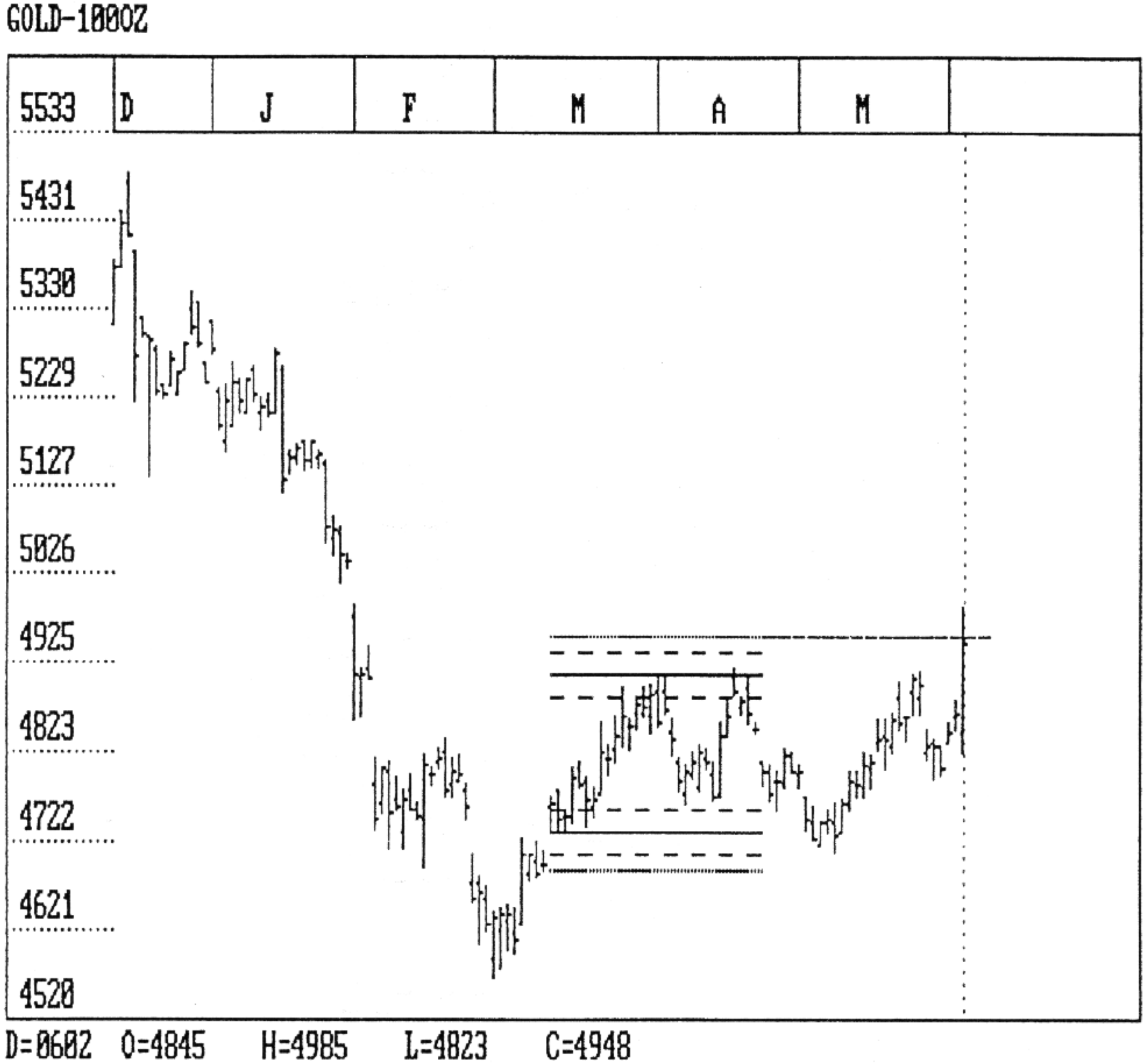


Figure 9 On 6-2, the close constituted a breakout of the range to the upside. Again the breakout did not result in a filling of my order. It did, however, establish a new high for the range, which was evident when I realized in the days ahead that the market was going back down.

While the expansion envelope doesn't always work (nothing in this business ALWAYS works), this time it once again saved me from a false breakout, and from entering a bad trade.

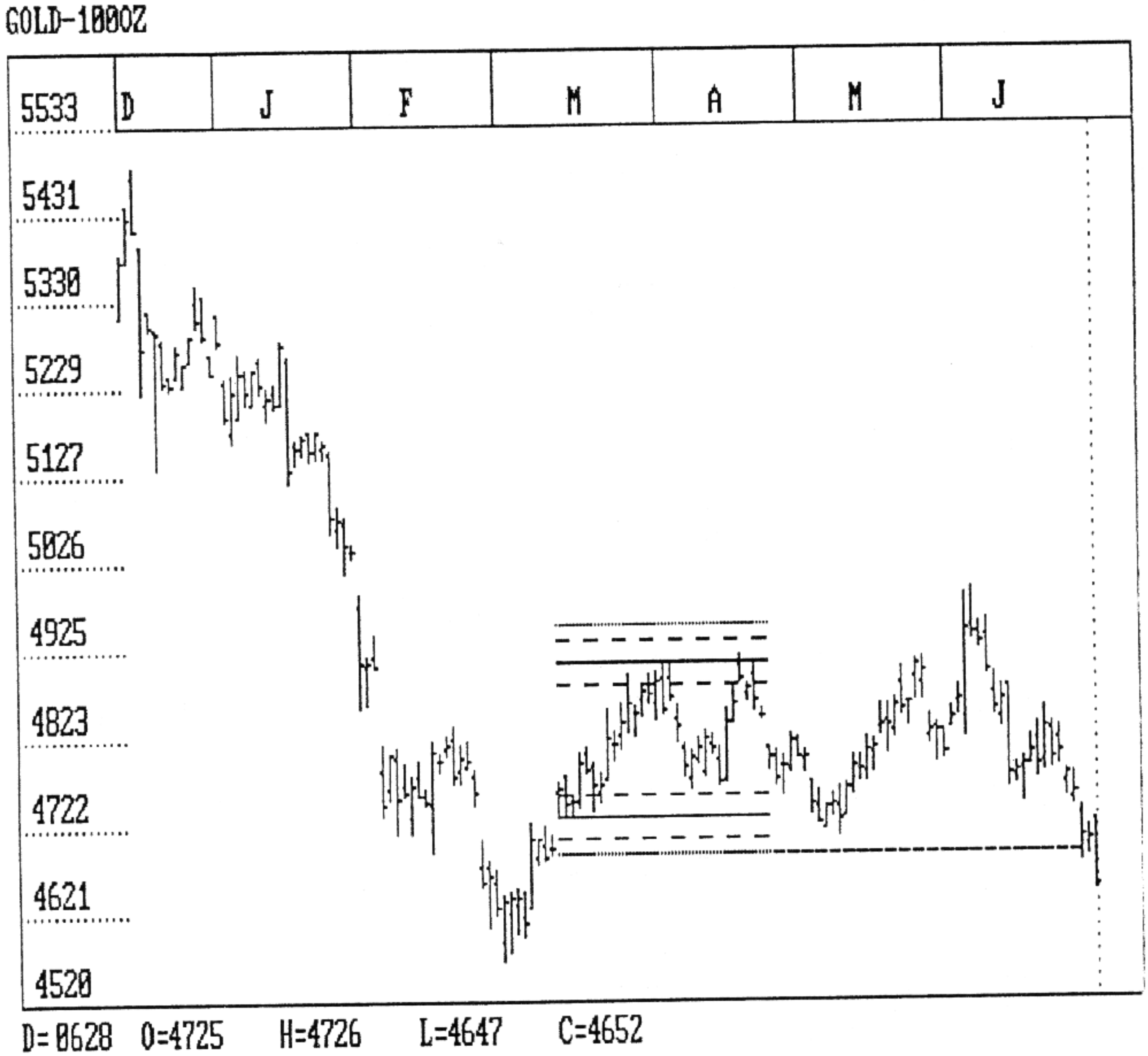
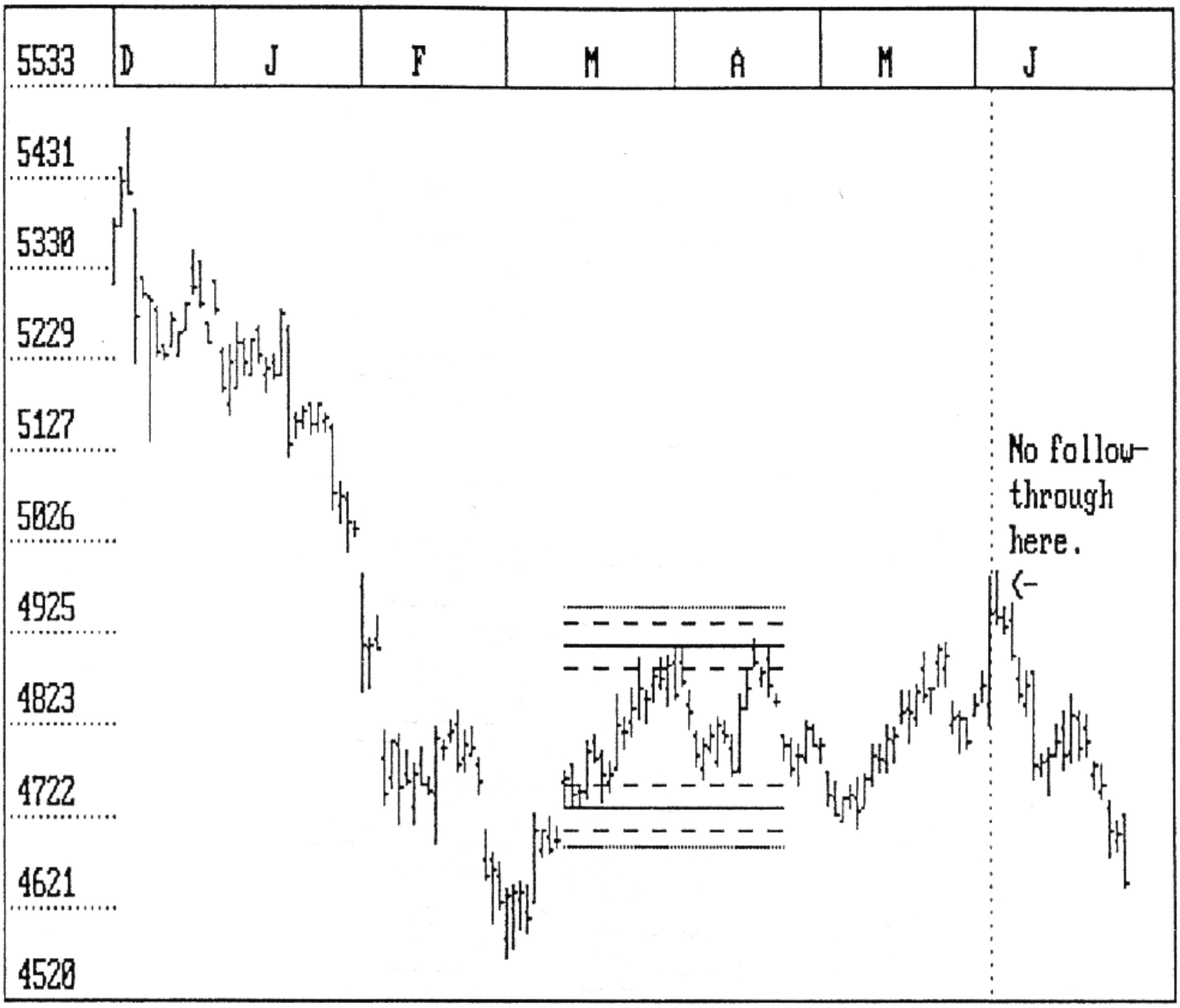


Figure 10 One of the attributes a good trader must have is that of being FLEXIBLE, flexible enough to make major or minor changes in the plan when opportunity strikes. On 6-28 such an opportunity occurred. Prices dropped out of the range to the downside. I had already called my broker and instructed him to sell Gold at 4696 stop. I was filled at 4696 on the day prices closed out of the envelope. What indications did I have that this might be a true breakout? There were several, and they point up why I don't like to simply trade a trend-following system. They point up why, when I trade, I must be thinking all the time.

GOLD-100OZ



D=0602 O=4845 H=4985 L=4823 C=4948

Figure 11 Looking back a few days to 6-3, I noticed that after the breakout of that day by the high, on low volume, there was no real follow-through. In fact, prices had re-entered the range and had headed down.

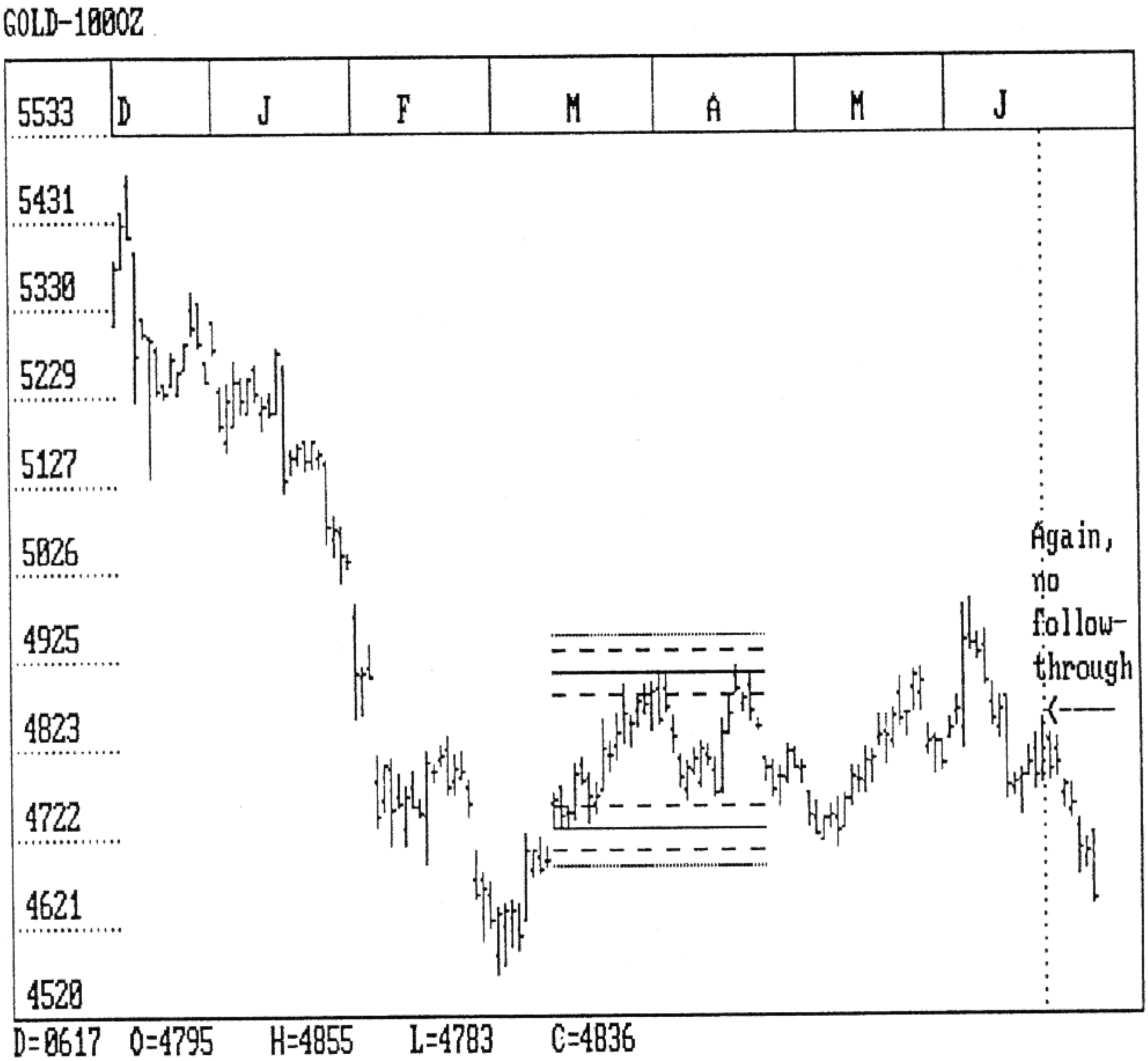


Figure 12 Looking back at 6-16, I noticed that prices had moved up strongly but again there had been a failure to follow through, and prices had turned down.

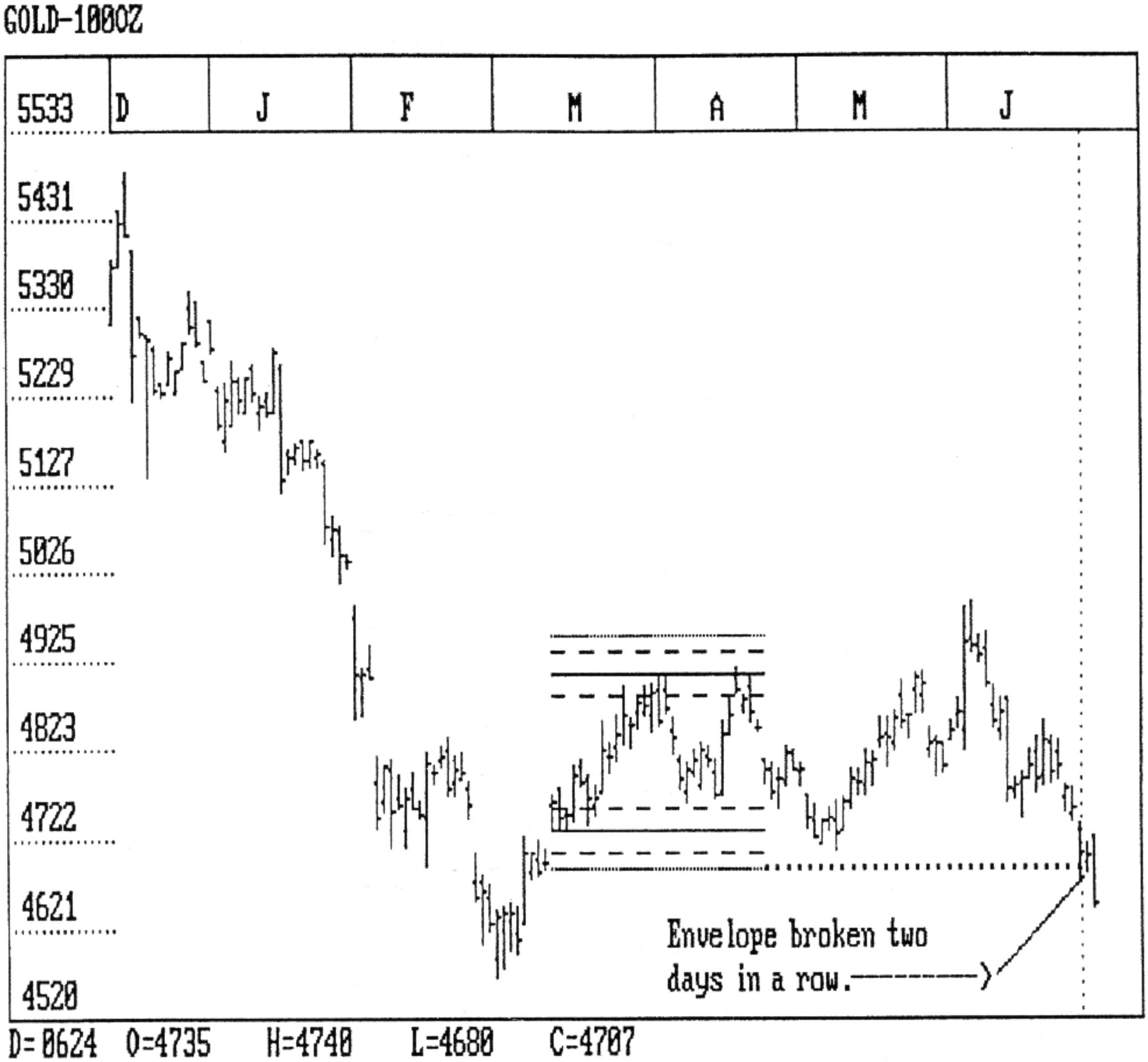


Figure 13 Looking back at the two days prior to the actual breakout, I see that the envelope was penetrated two times.

So when prices did finally break through, I was ready for them. I prefer second time through breakouts of envelopes.

CHAPTER 2

As concerns the initial stop, I want to emphasize here that it is exactly that - an INITIAL STOP, a catastrophic protective stop. As soon as I am in the trade, I will be looking to move it closer to the price action as quickly as possible.

The Possibilities

I want to back up for a moment to explain something that I usually do right after placing my order with my broker when I'm trading the breakout of a trading range. I say usually, because I don't always get the job done.

If my order is filled and I enter the trade, I attempt to plan what my actions will be. There are two things I try to do:

1. I try to have a set of objectives for this trade. This isn't always possible or practical. Sometimes I just let myself get stopped out, with my objective being no more than the taking out of a profit protecting stop. At other times, I set a profit objective of x number of points that I'd be happy with, and get out at that point. Another way that I sometimes exit trades is by the penetration of a moving average.

As illustrated in this part of the manual, I will show how to compute and use Fibonacci objectives for both the Gold and the Wheat contracts shown. I like to utilize Fibonacci objectives with them because their trend lines between trading ranges are often of short duration. My purpose here is to show that objectives can be projected utilizing Fibonacci expansions. I also need to say that this is not the only way I trade.

2. I attempt to think out the major possibilities as to the course this trade may take, and what I would do in each case.

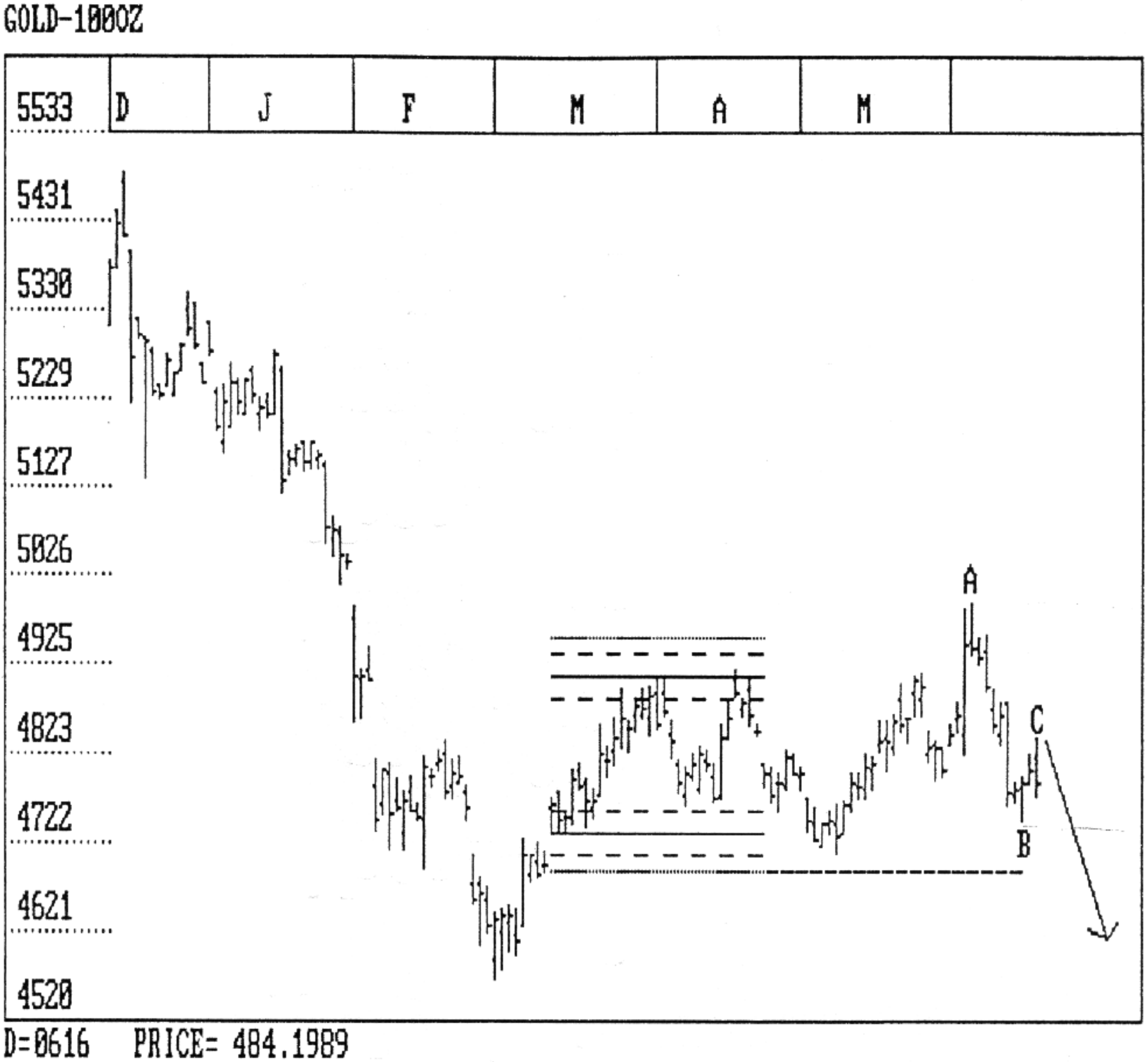


Figure 14 The first requirement is easy. My Objective Point (OP) for the trade will be equal to an expansion of the last A,B,C swing prior to the breakout. The formula for this expansion is: OP = B - A + C. The price at B is 4748. The price at A is 4995, and the price at C is 4855. B - A = -247.

4855 + (-247) is the same as 4855 - 247 = 4608. My objective for this trade is 4608. If it is reached, I will exit the trade. I will then stand by and wait for a retracement in order to reestablish a position.

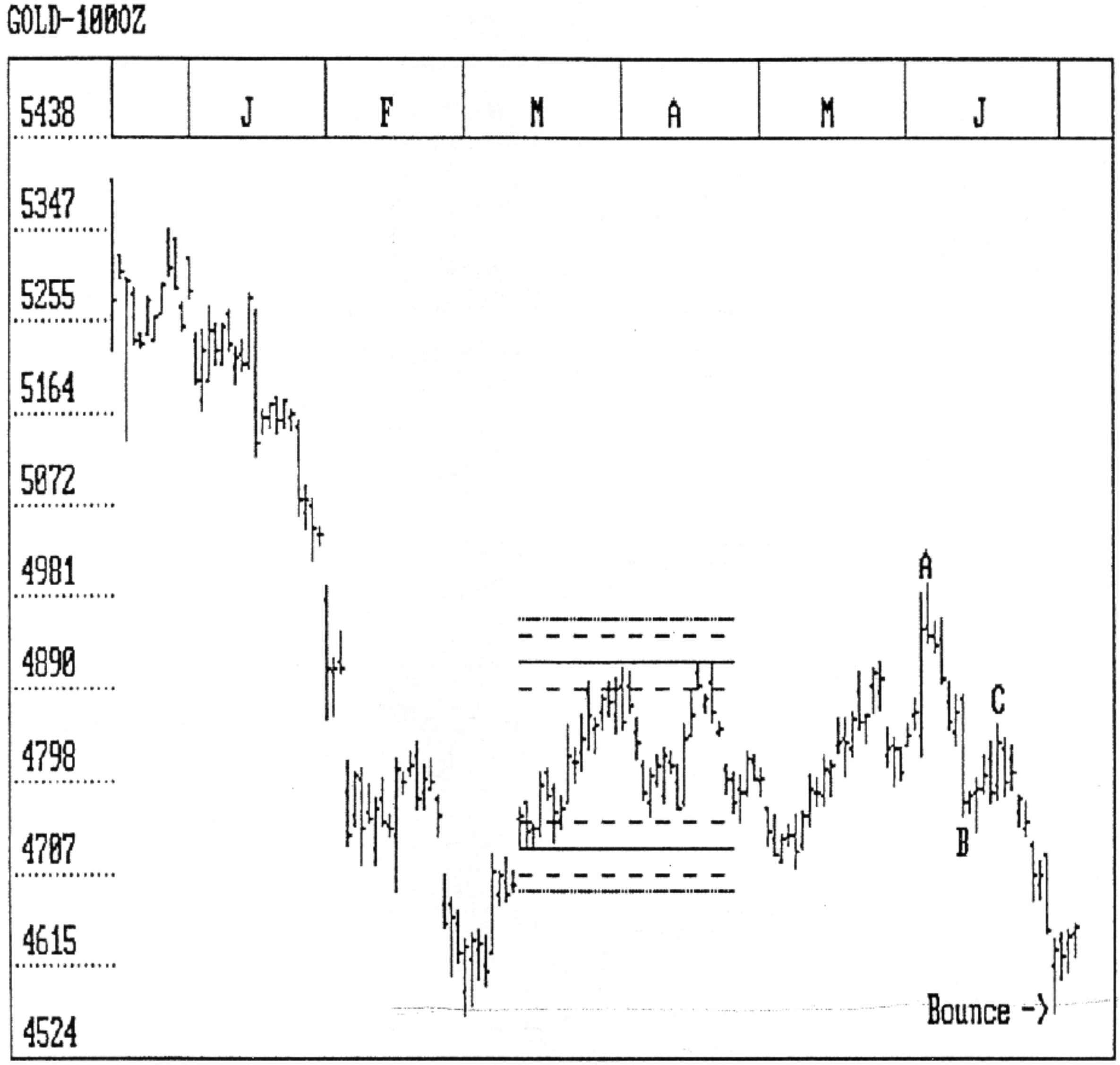


Figure 15 What I can expect at this expansion is some sort of congestion, correction, or support to come into play in the market. The truth of this statement is clearly shown above.

Possible Events after Breakout

I have been CONSISTENT in following the rules I have learned through experience. I have PLANNED out the entire entry for the trade.

Recalling that my order was filled at 4696, it is now time to consider the possibilities that might occur since the trade has been entered. This action is part of managing my trades. I have ORGANIZED my possible trade by identifying the range, and selecting entry points above and below the range. I have placed a CONTROL on possible losses by selecting a protective stop. I have DIRECTED my broker by communicating to him the conditions for the trade. I have DELEGATED to him the authority to exercise this trade on my behalf in the event the conditions are met. Now, I must PLAN my actions in case my order is filled. I must be DILIGENT in doing this. It is part of being CONSISTENT.

Probable Situations after Breakout

What are some of the situations most likely to happen?

1) Gold has broken out of its range, and my order was filled. What if it moves back into the range?

2) Gold has broken out of its range, and my order was filled. What if it turns around and moves across the range taking out my protective stop and then stays in the range?

3) Gold has broken out of its range, and my order was filled. What if it turns around and moves across the range taking out my protective stop and then keeps going on out of the range on the opposite side of the original breakout?

4) Gold has broken out of its range, and my order was filled, and it's moving down, but what if it never reaches my objective?

5) Gold has broken out of its range, and my order was filled, and it's moving down. What if it reaches my objective?

Situation 1

1. Gold has broken out of its range, and my order was filled. What if it then it moves back into the range?

I then ask myself this question: How many times has Gold tried to break out of its initial range in this direction? If it is 3 times or less I will immediately exit this trade, take a small loss and cancel my open order stop at the opposite extreme of the range. Then I will establish a new range boundary and wait for the next breakout, while continuing to trade within the range as will be outlined in part V of this manual.

If this was the fourth attempt at breaking out, I will wait as long as it takes to retrace to one tick above a .618 retracement of the initial range from top to bottom before exiting the trade. In other words, I will move my protective stop to a point that is one tick above a .618 retracement of the initial range from top to bottom. Fourth time breakouts usually are good and signal a sizable move in the direction in which they break out.

Situation 2

2 Gold has broken out of its range, and my order was filled. What if it turns around and moves across the range taking out my protective stop and then stays in the range?

I am looking at the possibilities and certainly this is one that might occur. In this event I take my loss, but I must not lose my cool. I must exercise SELF-DISCIPLINE and SELF-CONTROL. Experience has shown me that my trading methods work. I must TAKE ACTION. I CANNOT PROCRASTINATE. If situation 2 does occur, I now have a new upper or lower limit for the range and will call in a new set of orders to my broker. I'll take my loss in stride and if it seems logical, continue to trade within the range, as outlined in Part V of this manual.

Situation 3

3 Gold has broken out of the range, and my order was filled. What if it turns around and it moves across the range taking out my protective stop and then keeps going on out of the range on the opposite side of the original breakout?

This situation represents a failure. Any time prices breakout on one side of a range and then reverse and breakout on the other side of the range, the odds are overwhelmingly in favor of an advance in the direction of the secondary breakout. As a friend of mine says, "This is the time to sell the store!" The action to take here is to take my loss and immediately reverse my position. The Book says "It is pleasant to see plans develop. That is why fools refuse to give them up even when they are wrong." This is no time to be a fool. My plan has failed. I must be FLEXIBLE and reverse position. I will quickly calculate new objectives, a new protective stop, and call my broker with my new orders.

Situation 4

4. Gold has broken out of its range, and my order was filled, and it moves in my direction. But what if it never reaches my initial objective?

If Gold never reaches my initial objective, then I may be looking at a false breakout. My concern here would be that Gold is weaker in the direction of the breakout than I had anticipated.

When a market has been in a trading range for a length of time represented by, on average, 25 bars on the chart - if it then does not have the momentum on the breakout to reach the objective I have computed, but instead begins to correct or congest, I will immediately exit the trade with any profit I can get.

In the case of a breakout to the downside as with Gold, I would have been worried if, before reaching my objective, the market did this:

```
        \
         \
          \  /
           \/, (move two bars against me) I would immediately
                       exit the trade.

        If the market did this: \
                                 \
                                  \/, (move one bar against me) I would
        immediately tighten up my stop to within a tick or two of the
        price action.

        If the market then did this: \
                                      \
                                       \/\, I would stay with the trade
        but move my stop to just above the  /\.  If the market did this:
        \
         \
          \/\/, I'm out of there.  I don't want to see a bunch of
    overlapping value areas after a breakout.
```

Situation 5

(5) Gold has broken out of its range, and my order was filled, and it's moving down. What if it reaches my objective?

This is my hoped for situation. If Gold reaches my objective, I liquidate. My order to buy it back would have been resting at that price and I'm out on as close a fill of my order as is possible. I don't care if Gold then plunges far beyond where I exit the trade. I have received my piece of the action and I'm satisfied. Naturally I will look for a retracement and then reenter the trade if possible. How I do that is described just ahead and also in Part II of the manual.

Once the breakout is established and my order is filled, I will then cancel my initial protective stop in favor of establishing a trailing stop. More of this in Part II of this manual.

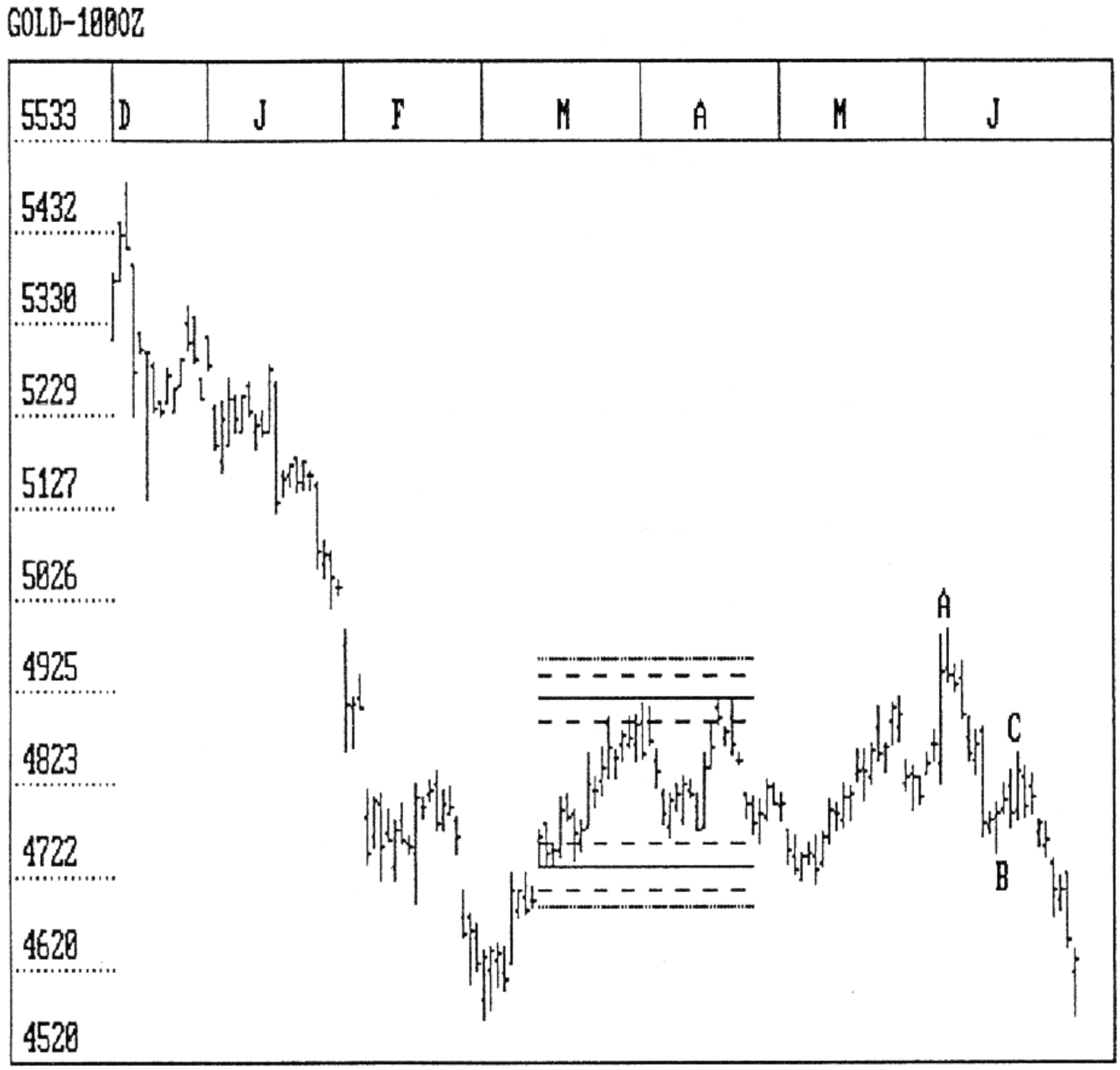


Figure 16 But markets don't go straight down indefinitely. There are reactions and consolidations to contend with. I can see the beginning of some sort of reaction on the chart. Planning for just such a reaction will automatically take care of my trailing sto; and at the same time possibly enable me to add to my position.

CHAPTER 3

Reactions to Range Breakout

Usually when there has been a breakout from a range on good volume and with follow-through for two or three days, some amount of consolidation will take place. This consolidation or correction is what I mean by a reaction.

For purposes of clarity, a reaction in a downtrending market is an upward, or even a sideways movement of prices. In an uptrending market, a reaction is a downward, or even a sideways movement of prices.

Swings Defined

A swing looks like this /\, or this \/. The legs of a swing look like \, or /, but are usually not of equal length.

What I'm looking for here is a reaction that constitutes either a .382 or .618 retracement of the latest leg of a swing. At or between these two points there will almost certainly be some sort of resistance.

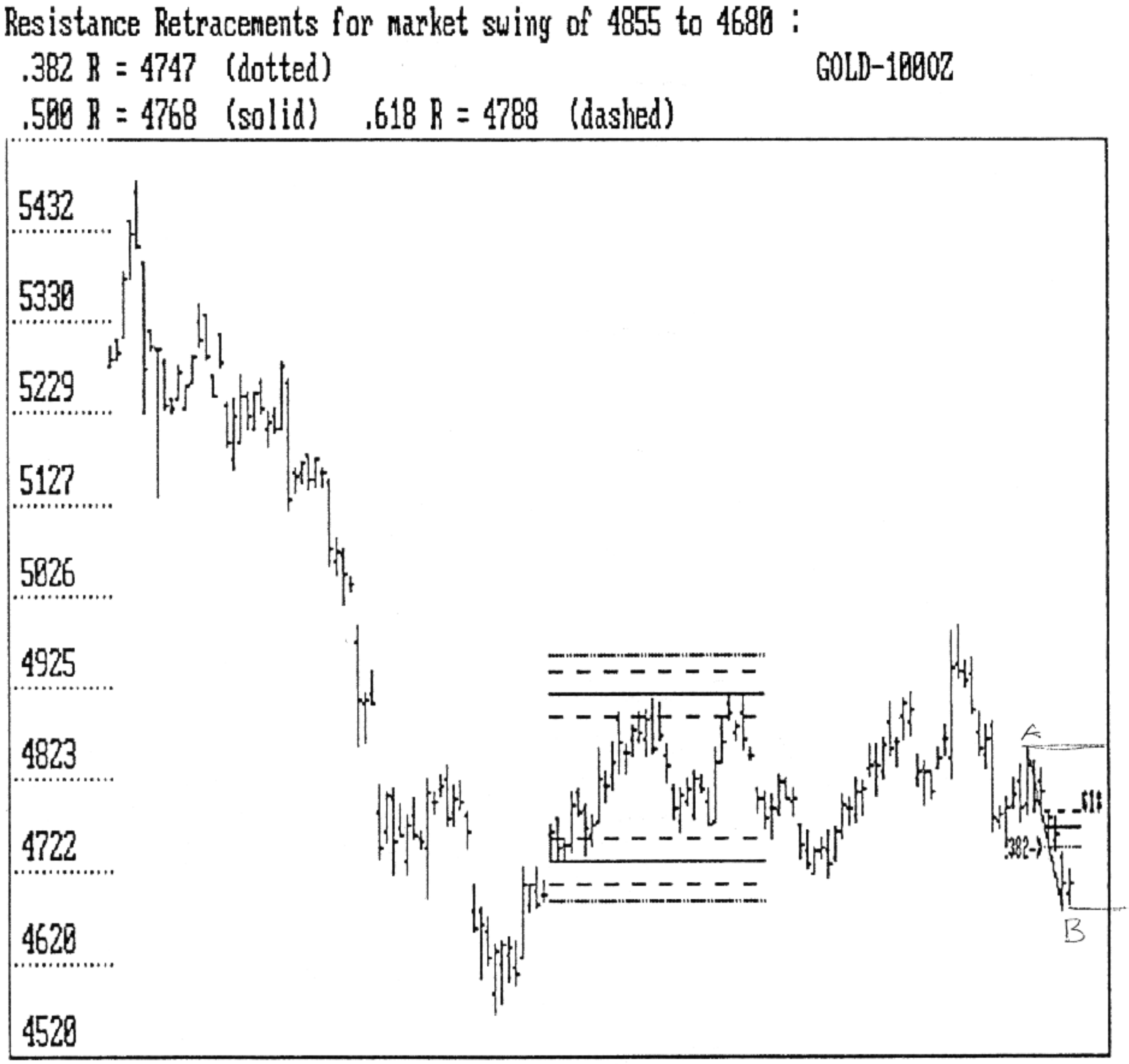


Figure 17 I can see that the leg of the swing from 6-16 to 6-29 covered a range of prices from a high of 4855 down to a low of 4680. The formulas in a downtrending market for my calculations are as follows:

.382 Retracement = B + (A-B).382 and,
.618 Retracement = B + (A-B).618 where:

A = high of the Swing and B = low of the Swing.

Substituting into the formula, I have:

4680 + (4855 - 4680) .382 = 4747
4680 + (4855 - 4680) .618 = 4788

Note: In an uptrending market the formulas would be:

.382 Retracement = A - (A-B).382 and,
.618 Retracement = A - (A-B).618

My Trailing Stops For Breakouts

Now I have a choice to make. I can set my trailing stop one or two ticks above either of these prices. It's a matter of preference and that choice is based on my level of tolerance for getting stopped out. I choose to place my stop at 4748 (one tick above 4747). I got my order filled at 4696. If I get stopped out, I can always get back in later on.

Adding to My Position after Breakouts

There are two ways that I would consider adding to my position:

1. I can sell Gold at 4747 if it holds at the .382 retracement and then starts back down.

2. If I get stopped out at 4748, I can sell Gold at 4788 if it holds at the .618 retracement and then starts back down.

Closing Out My Last Position

Of course I will close out my position immediately if it reaches my objective. That way I will not have to rely on my protective stop to take me out of the trade. In the case of this trade, I am stopped out of the trade at my objective of 4608 for a profit. I am then looking to possibly get in again on a retracement to one of the Fibonacci points explained above.

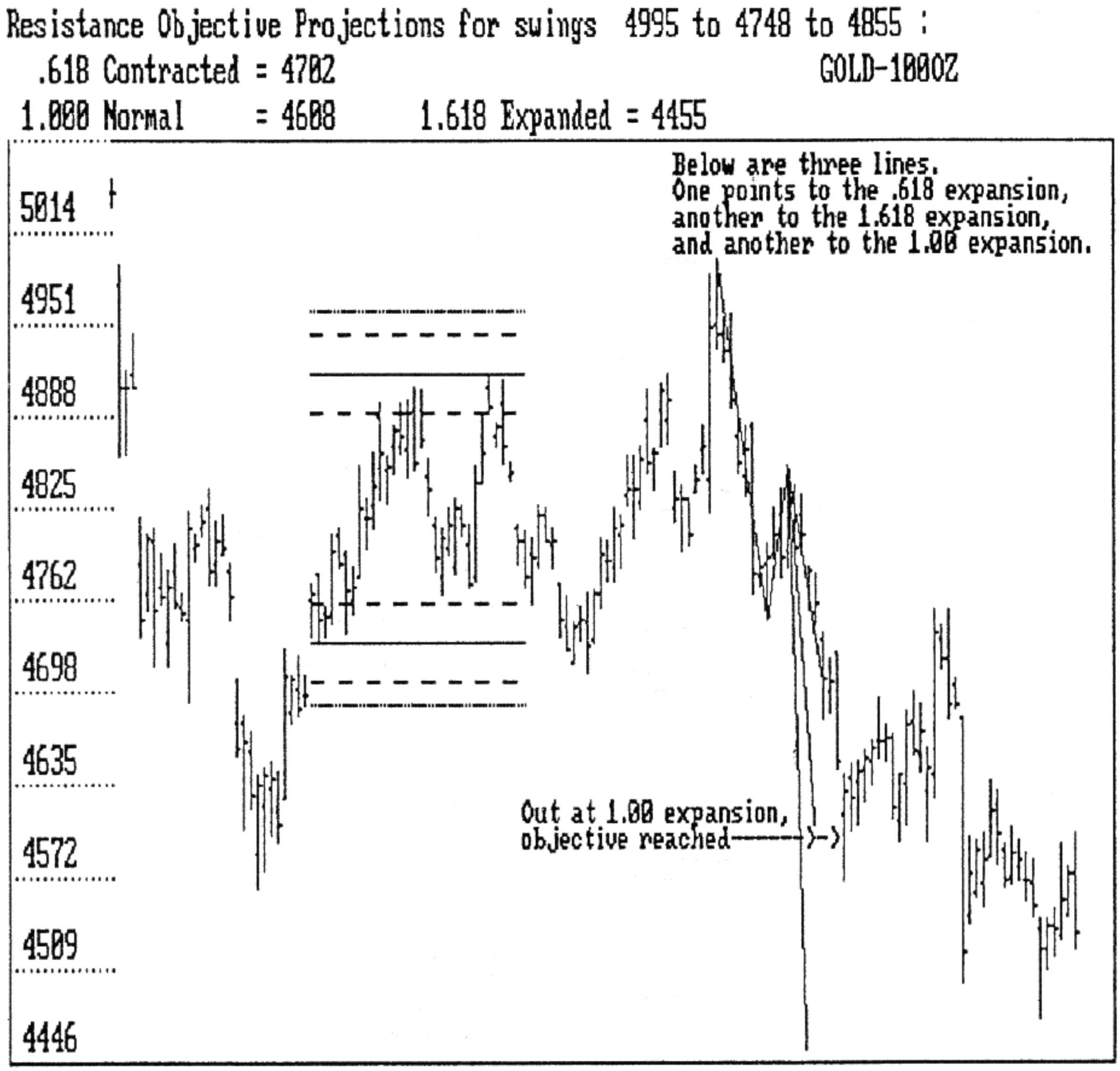


Figure 18. Just as expected, Gold went into a congestion phase that lasted more days than usual, indicating that there was a lack of strength behind the breakout. During the congestion, Gold took out the .382 retracement at 4747. On a short breakout from the congestion, Gold even took out the .618 retracement at 4788 entering again into the previous congestion area. How to short the market again at the retracement will be the subject of part II of this manual. Next I will look at another breakout from congestion as shown in the December Wheat trade that follows.

The trades in Wheat that are shown are actually a series of trades that I made and am still making as of the time I am writing this.

CHAPTER 4

Wheat Trading

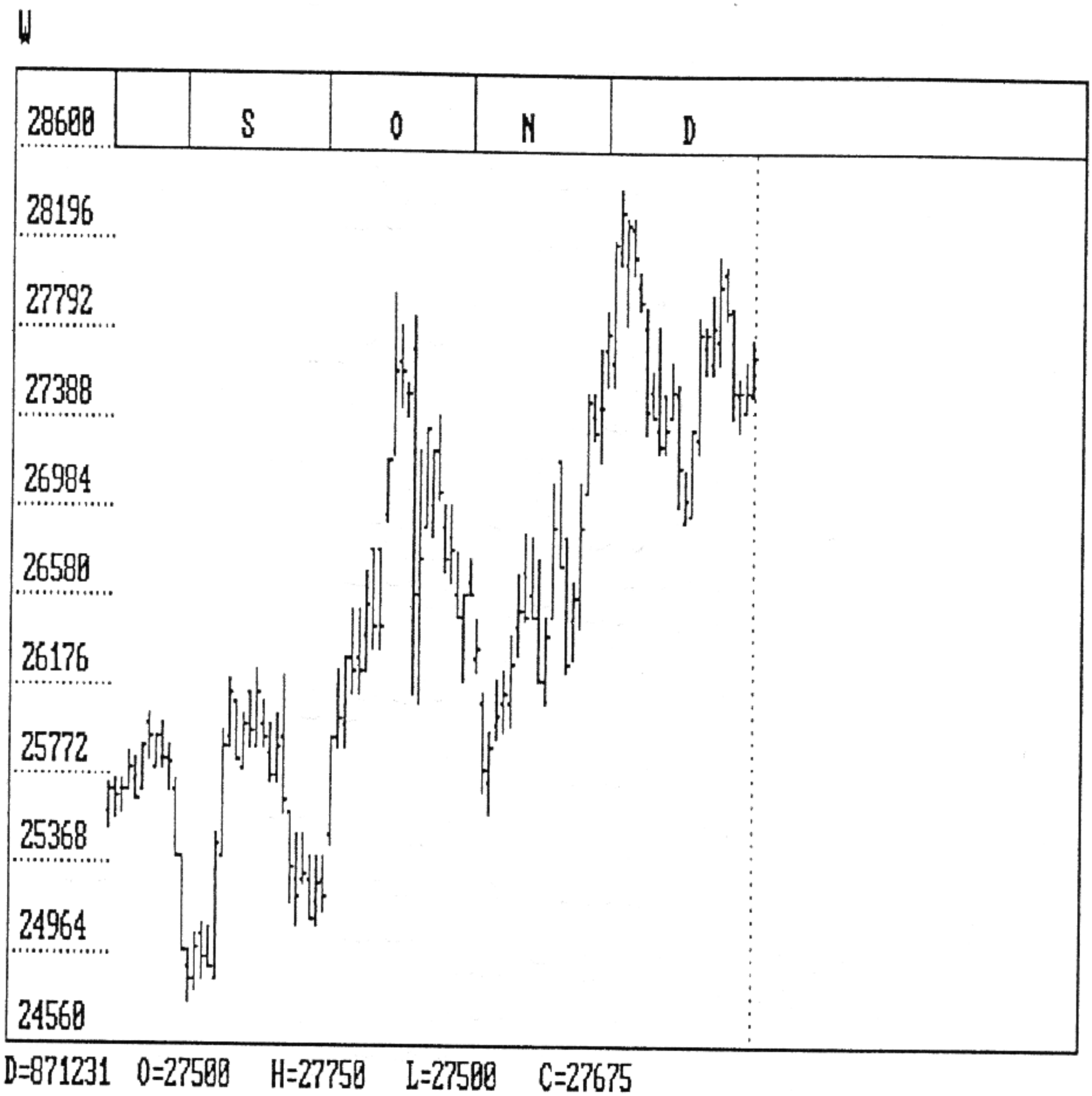


Figure 19   It began as I was watching July Wheat.

After a lengthy stay in the hospital, during which I was unconscious most of the time, I began to look at the markets again on December 31. At that time I noticed that Wheat was in a congestion phase.

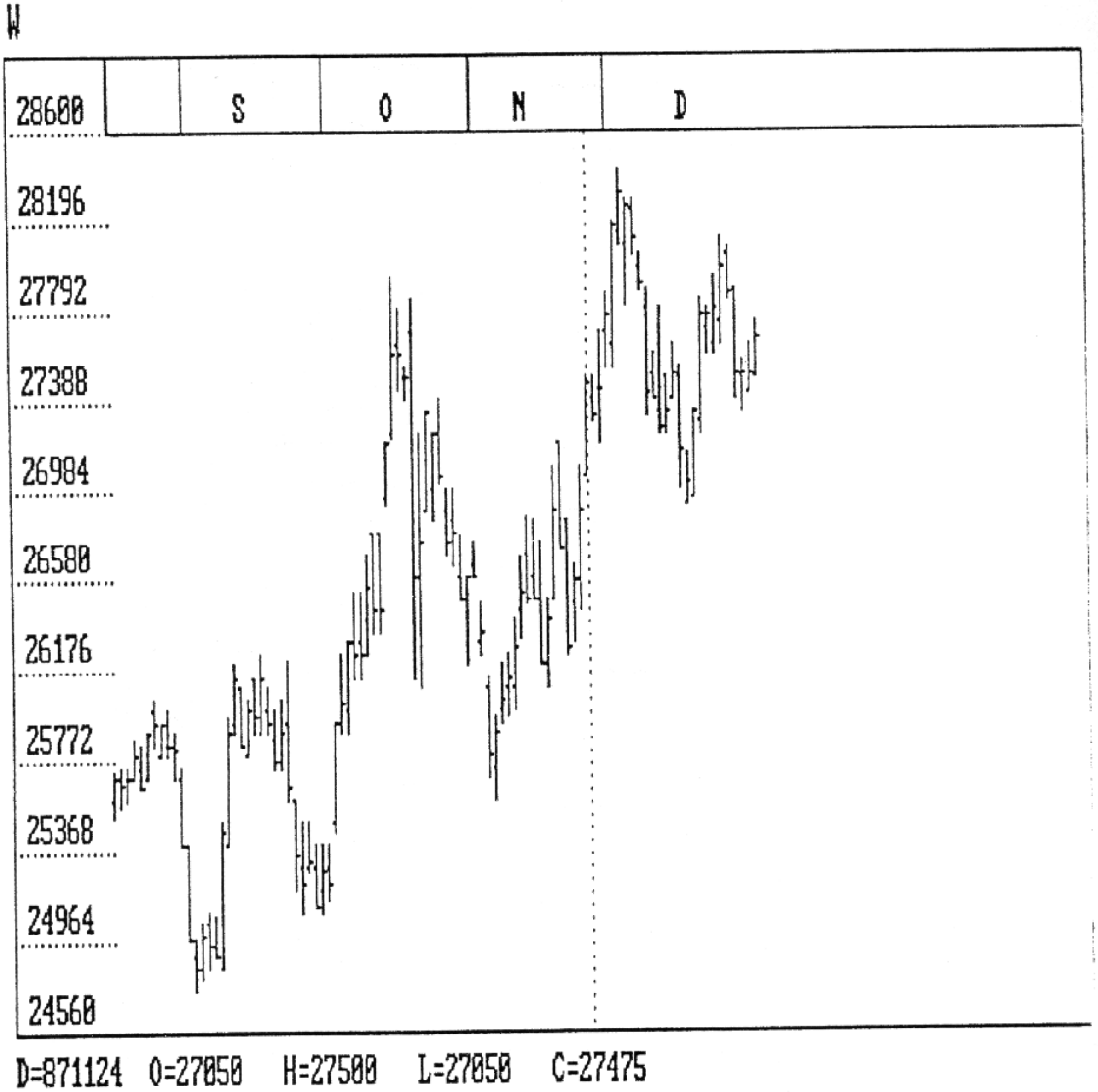


Figure 20 On November 23, it had moved into what was to prove to be a congestion area that would last 26 days counting the day that it first moved into th trading range.

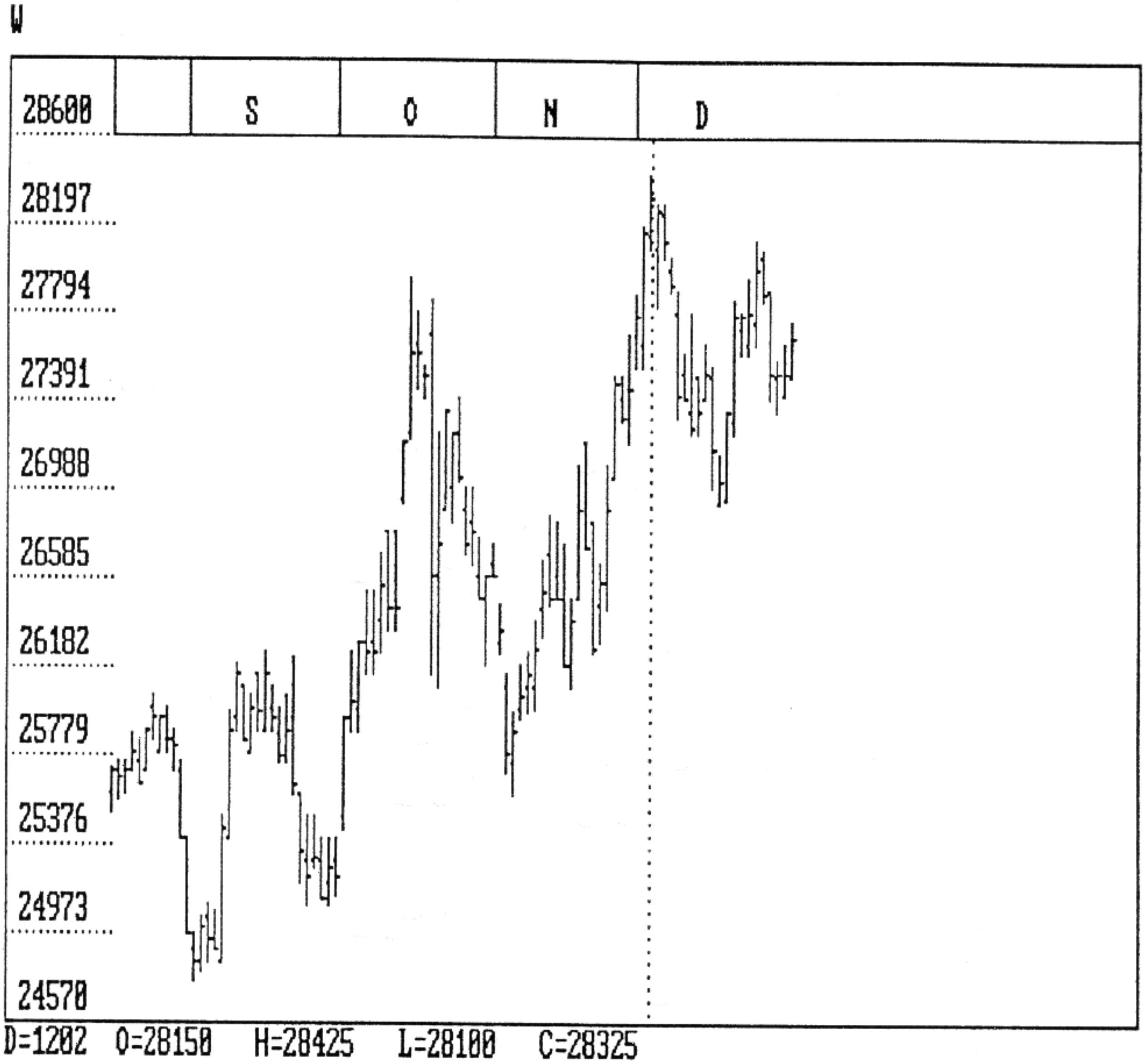


Figure 21 On December 2, the high for the range was established at 284.25.

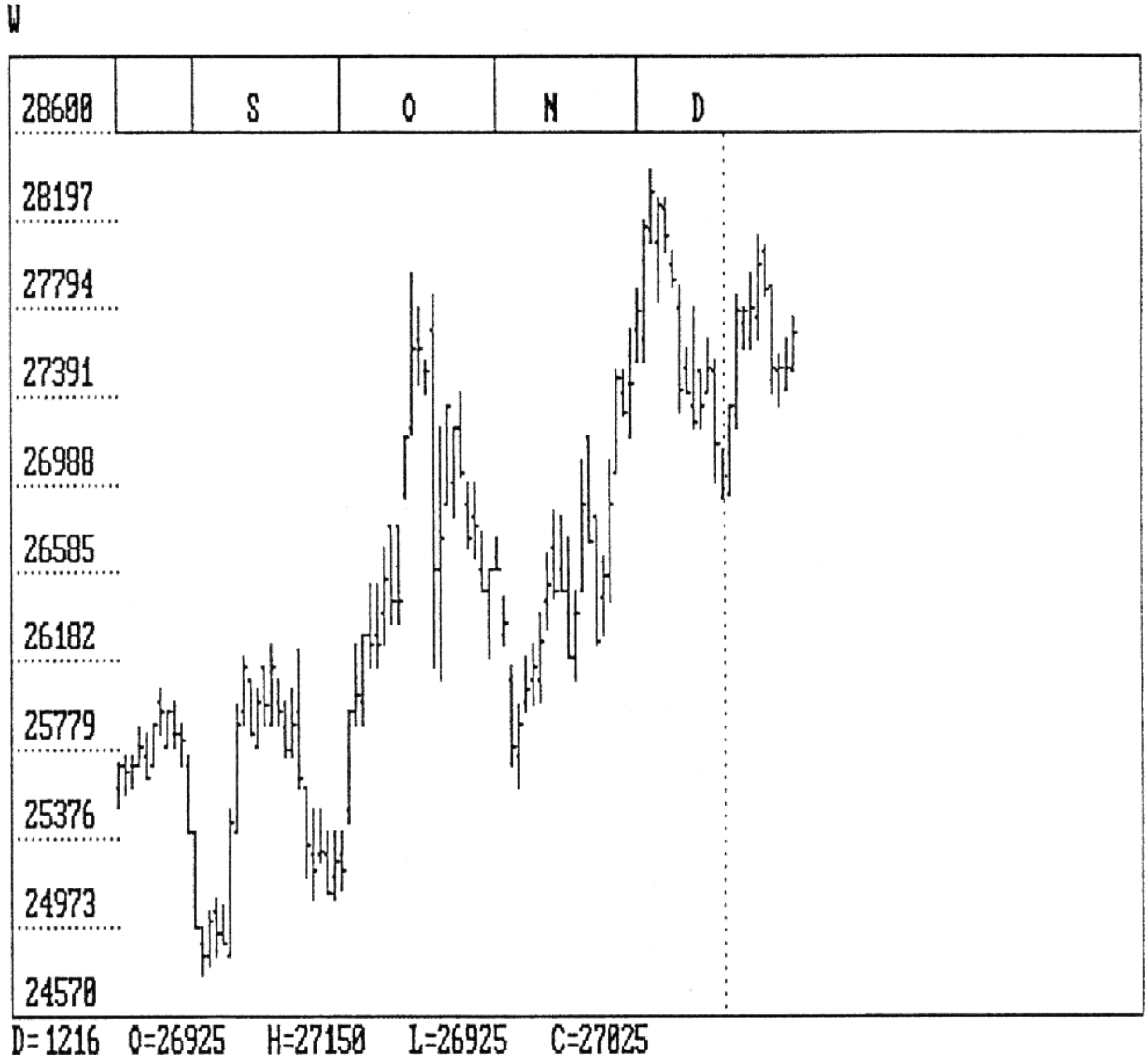


Figure 22 On December 16, the low for the range was established at 26925, although at that time it was not really clear that this was a congestion area.

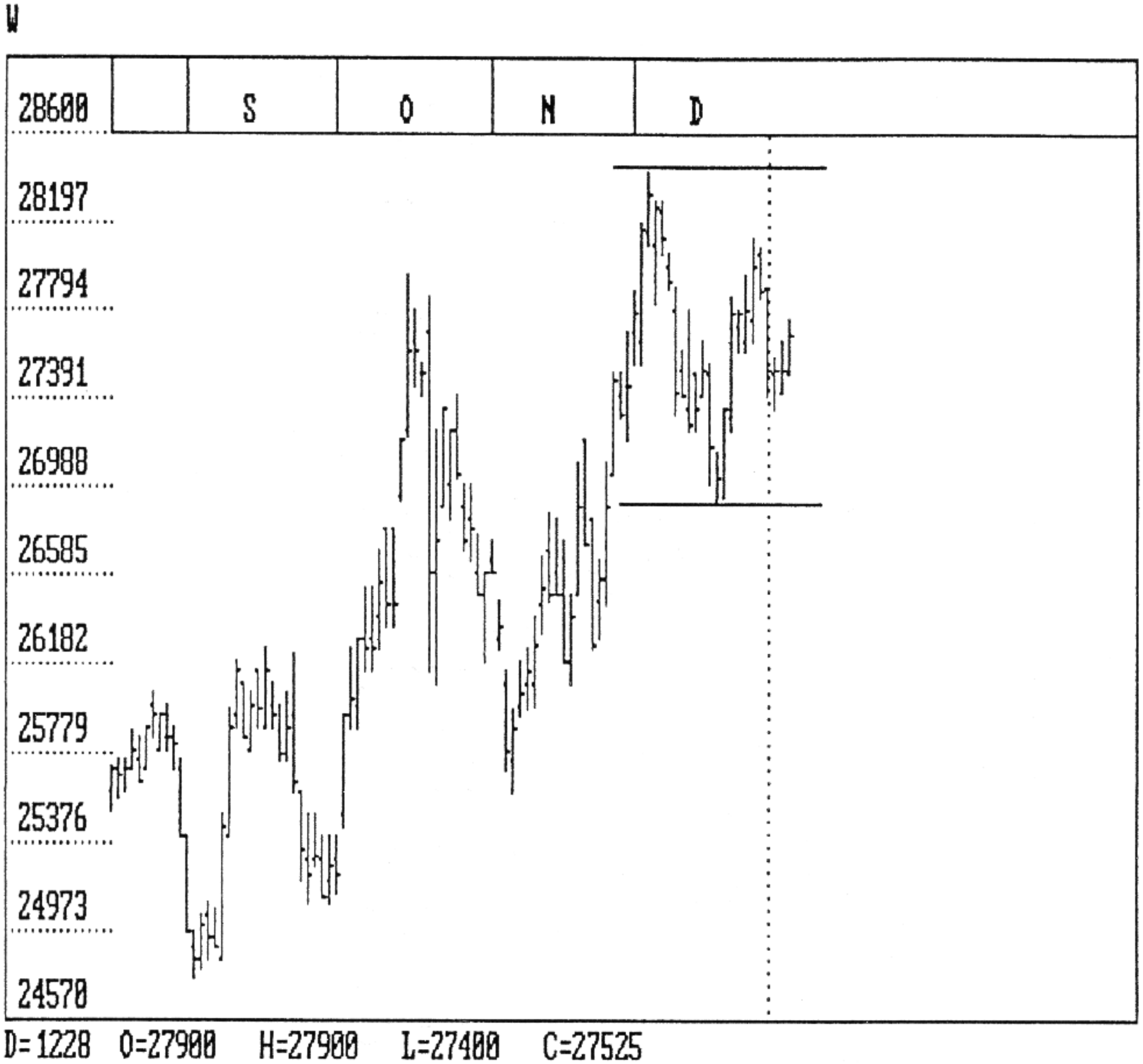


Figure 23 It wasn't until December 28 that the congestion area was fully established, and I could say that Wheat was in a well defined trading range.

Now it was time to establish an envelope around the congestion area.

Why the envelope, and why a .146 expansion rather than a .236 expansion of the magnitude of the range? Because experience has shown that most of the time it takes a movement of price (momentum) sufficient to penetrate and cross the envelope barrier to really establish a breakout. Coincidentally .146, a Fibonacci ratio, has through experimentation proven to be an adequate numeric measure of price expansion sufficient to quantify the amount of movement needed for a true breakout of Wheat. Each trader has to experiment for himself on whether to use .236 or .146 for any given market.

A general rule would be that the longer the length of time for the trading range, th more momentum prices will need to escape. Therefore a .236 expansion is preferred for very long trading ranges, and a .146 expansion is preferred for trading ranges lasting 10 20 days, or those that are in relatively tight trading ranges. By tight I mean relatively narrow from top to bottom. Note that in this case I am writing about congestion areas that are not as mature as those lasting 21-29 days. At any time that a .146 expansion will clear all nearby previous support or resistance, it's okay to use it. When I say nearb previous support or resistance, I refer to that which I can see on my chart with the 140 bars showing.

A good rule is to examine both, and then see which breakout would get the trade past major support or resistance areas from time periods prior to the trading range that i currently to be established.

Recalling that the envelope is developed by taking the difference between the high for the range and the low for the range, multiplying that difference by .146, and then adding the result to the top of the range and subtracting it from the bottom of the range I get:

28425 - 26925 = 1500.
1500 x .146 = 219
219 + 28425 = 28644 or 28650 rounded to the nearest tick.
26925 - 219 = 26706 or 26700 rounded to the nearest tick.

My envelope has an upper limit of 28650 and a lower limit of 26700. These numbers are called the midout-hi and the midout-lo for purposes of reference.

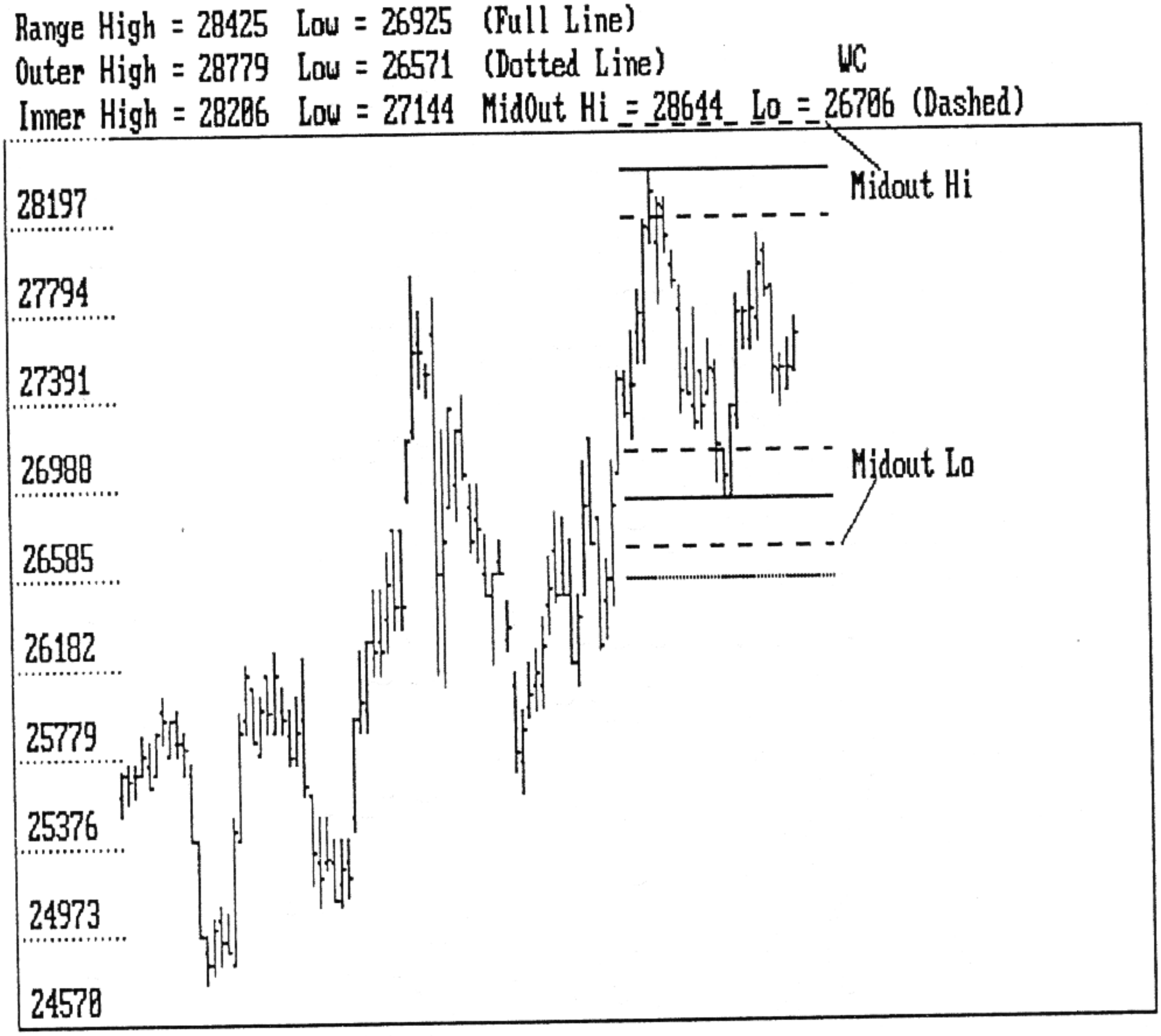


Figure 24. If I buy Wheat on a breakout of 28650, my initial stop will be at 26875, which is 2 ticks below the low of the range. If I sell Wheat on a breakout of 26700, my initial stop will be 28475, which is 2 ticks above the high for the range.

All that is left to do is to call my broker and place my orders. It is important that I do it as soon as possible.

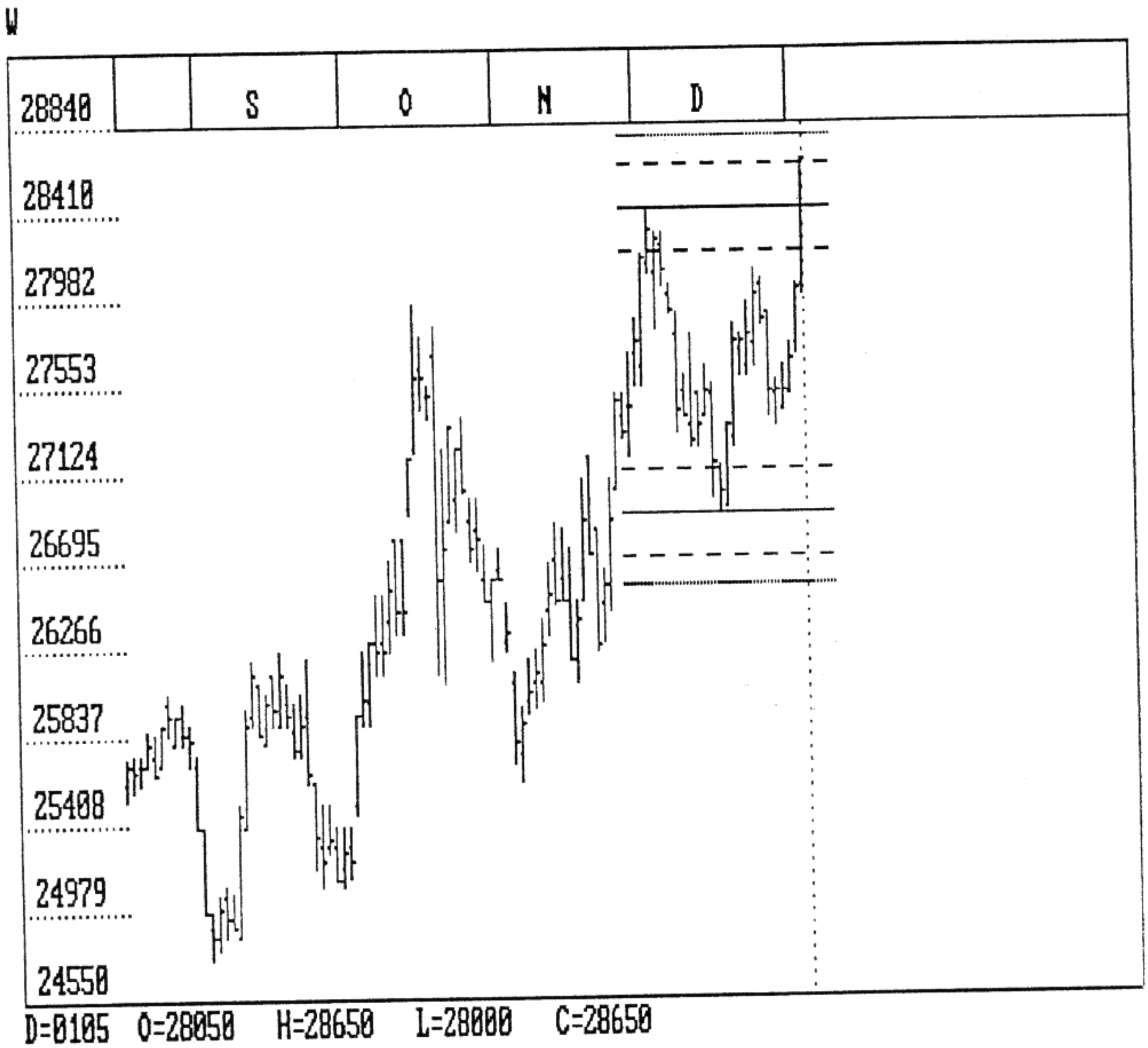


Figure 25 On January 5, Wheat closes at 28650 which fulfills the entry requirement to go long on a close at or above 28650, and my order to buy is filled. My stop is in place and my broker cancels my open orders involving the sale of Wheat should it have broken out to the downside.

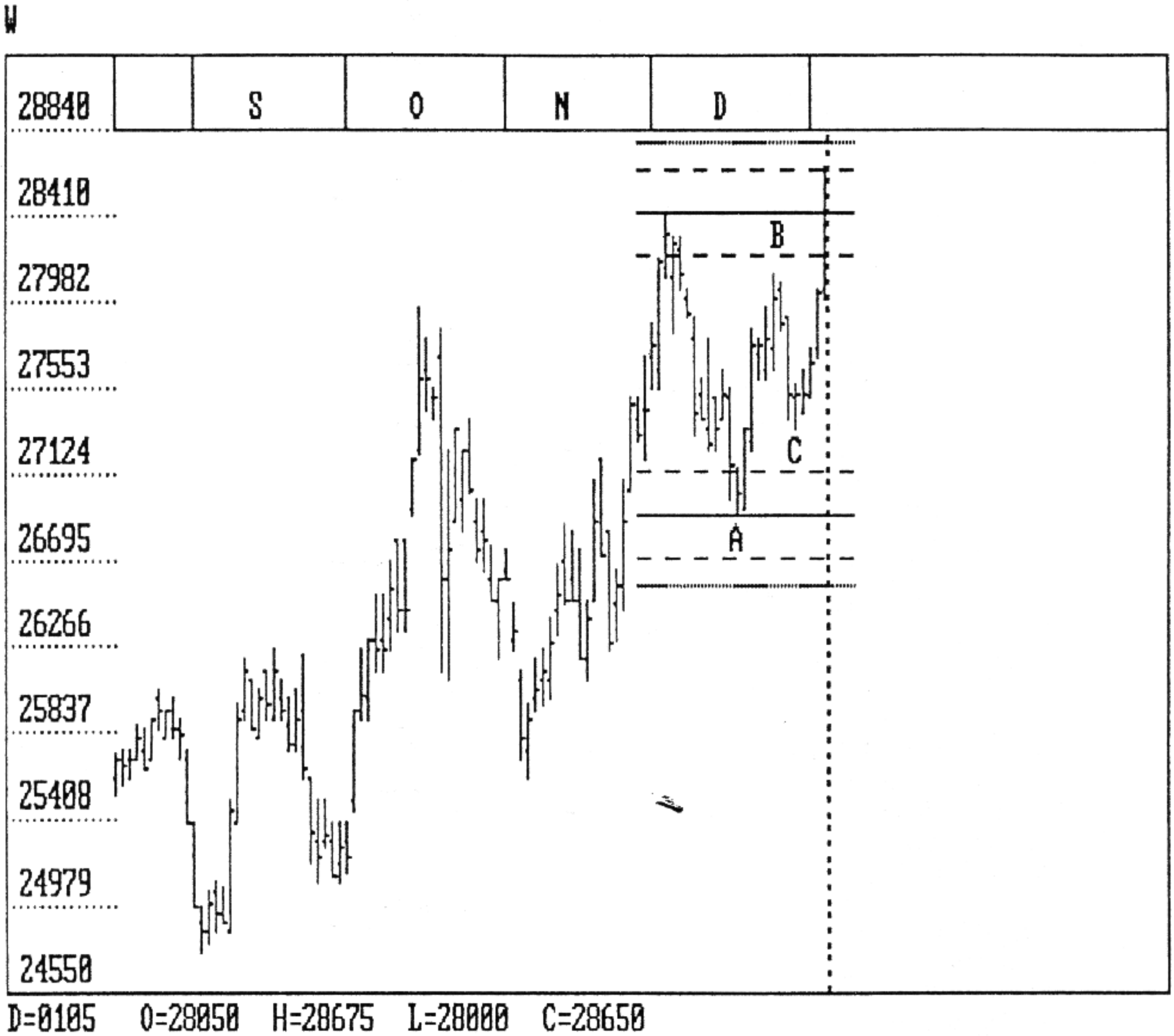


Figure 26 Now, what is my objective for this trade? As shown previously I am looking for a 1.00 expansion of the last A,B,C swing prior to the breakout. The formula will be B - A + C = Objective.

The last A,B,C swing prior to the breakout was from the low at A of 26925, to the high at B of 28125, and then back again to the low at C of 27350, for a projected objective of 28550.

However, the projection has already been surpassed by the close at 28650. My objective for this move will have to be greater. If I am going to use a Fibonacci objective projection, then I will need to increase the magnitude of the expansion. To do that I will use a 1.618 expansion of the three point swing from A, to B, to C. The formula for this expansion is 1.618 (B - A) + C. The result is an objective of 29300 rounded to the nearest tick.

At that point I would expect some sort of congestion to occur before prices move on.

I want to point out here that it is important to take profits when they are available. I refuse to do top or bottom fishing when I am in a trade. As soon as I have my anticipated piece of the market, I am quick to get out. I am perfectly willing to let others have the rest of the market. Wisdom dictates that I get out too soon rather than too late Wisdom will keep me from being greedy and losing what I already have. I recall the fable about the dog and the bone. The dog had a bone in his mouth when he saw a reflection of himself in the water. He then opened his mouth to grab the bone away from the dog he saw in the reflection. Oops! There went the bone, into the water. It's the same thing in the markets. I take what's mine and run for safety. The market is bigger and stronger than anyone. I want to be a commando. I fight with guerrilla tactics. Hit and run. Take a piece out of the middle and quickly run to the bank. Do this consistently anc I pile up the winnings. I'm patient, wait for opportune moments, and then strike. I wait for the market to come to me. I never chase a market. I'm consistent, I'm diligent. I strive for self-control. If the market turns on me and goes the wrong way, I get out! I get out NOW! I'm urgent to get out. I can't let paralysis set in. I don't sit there and watch myself take a bath. I have developed a low tolerance for pain. I lose my commission and get out. I can afford many small losses. I will make them all back and more, on one good move.

Very often I reverse a losing trade and turn it into winner. More often than not, I can substantially minimize my losses by reversing. Learning to reverse, which will be discussed more fully later, is a concept that I think every successful trader should learn. I know of no one who will not benefit from learning do that.

I have to be humble (umile) to reverse. I have to be willing to admit that the market knows more about where it is going than do I. I can't force a market to do my bidding. I have to be flexible and yield to its greater power.

Projecting objectives is worth learning because it forces me to really think about where a market might be going. Then if it doesn't go my way, or falls short of my projection, I know sooner than others that the market is not behaving in the anticipated manner. Very often this lets me get out sooner. It's better to be out with a profit than a loss. It's better to reverse and recoup than to eat your hat.

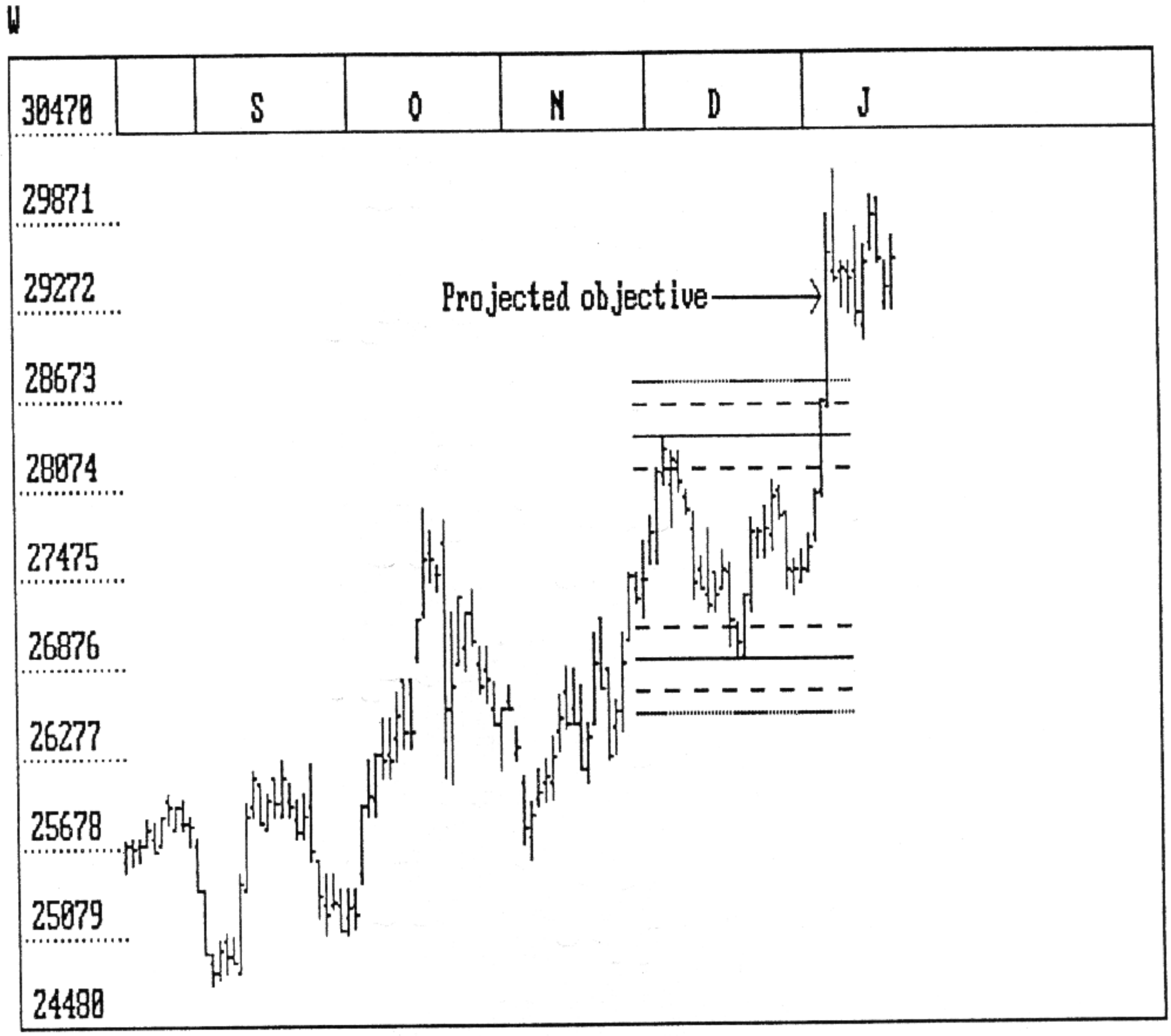
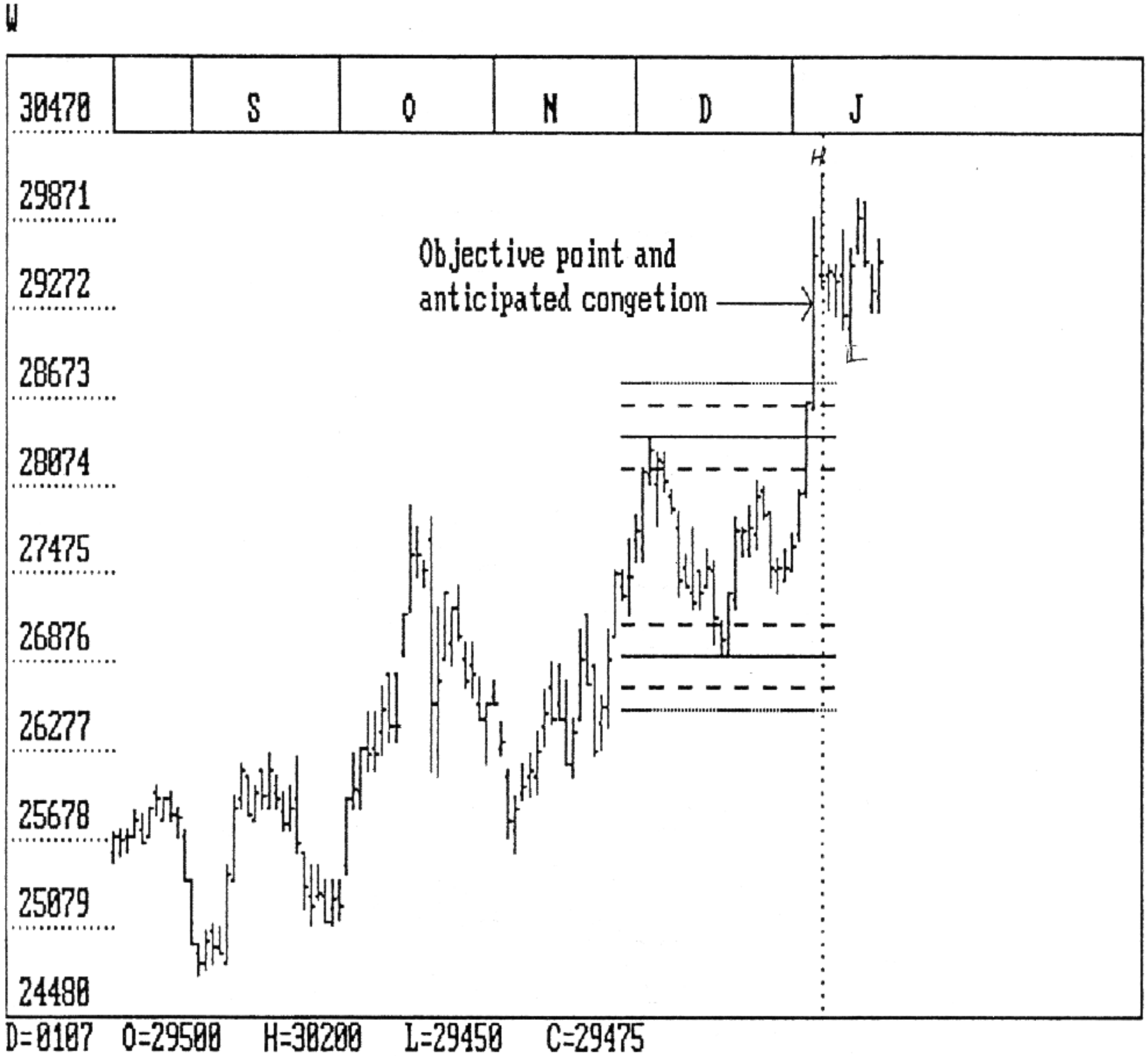


Figure 27 I'm out at my projected objective, awaiting my next opportunity. I can trade other markets while I wait. My next opportunity in Wheat comes when, on January 19, I realize that Wheat is once again in a congestion phase.



Notice that even though prices exceeded the projected objective, they retraced and went into congestion almost exactly where I anticipated.

Figure 28 The high for the range was established at 30200, on January 7.

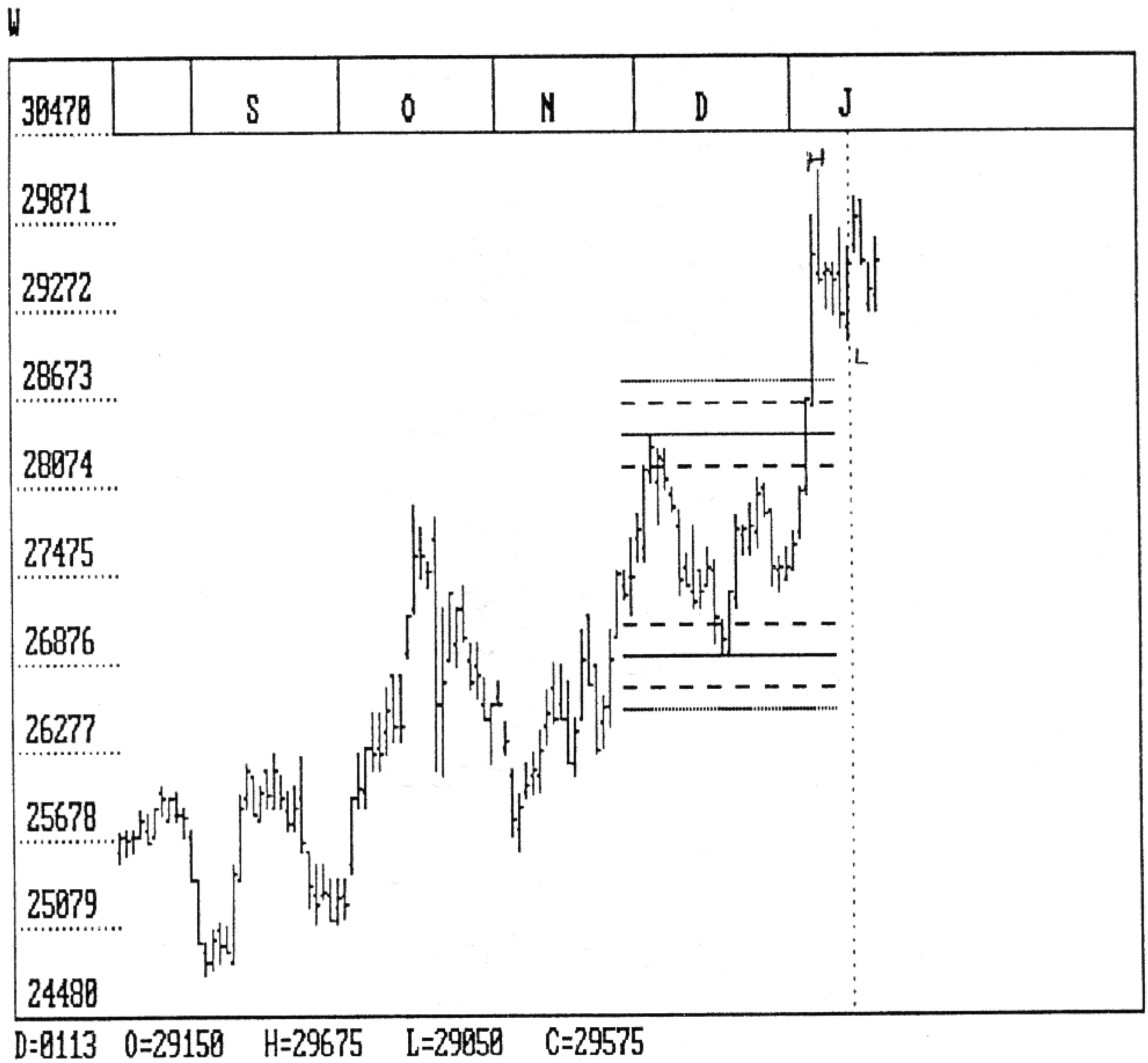
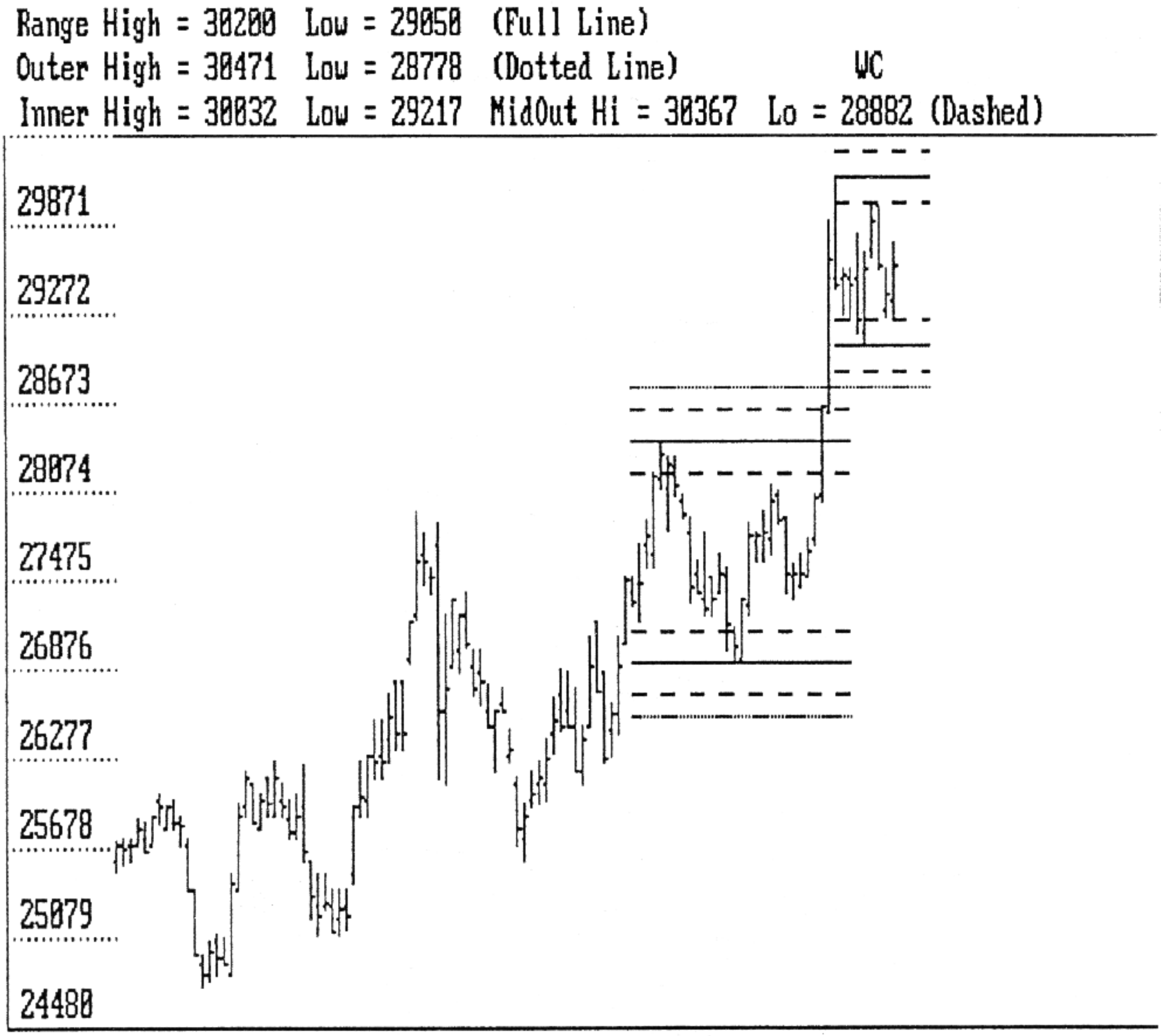


Figure 29 The low was established on January 13 at 29050.



Interestingly, the outer low expansion of the envelope almost exactly matches the outer high expansion of the previous envelope. Perhaps there is some order to the market after all.

Figure 30 The difference between the high and the low of the range is 1150. Multiplied by .146 = 167.9. Adding 167.9 to 30200 gives 30375 rounded to the nearest tick for the midout-hi limit of the envelope. Subtracting 167.9 from 29050 results in 28875 rounded to the nearest tick, for the midout-lo limit of the envelope.

I call my broker and place my order to buy Wheat on a close at or over 30375 with an initial protective stop at 30175, and to sell Wheat on a close at or below 28875 with an initial protective stop at 29075. These are not where I would normally set my initial stops. Normally, they would be set at the opposite side of congestion, but I always reserve the right to use my judgment and discretion. Because of the circumstances at the time, I placed the stops as indicated above.

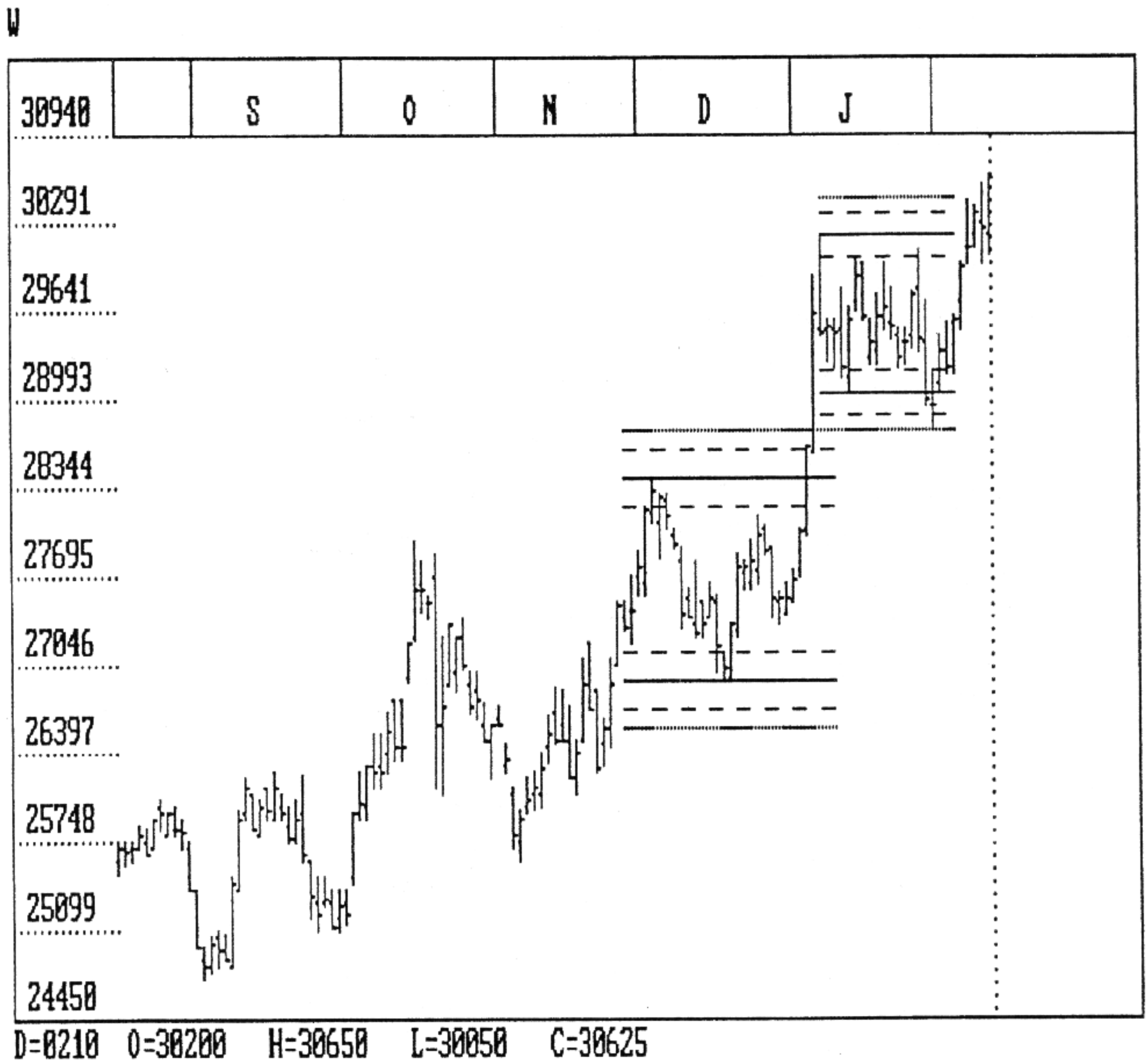


Figure 31 On the 22nd day of the congestion, Wheat moves up out of the envelope, but does not close outside. The next day when it closes, it just misses again. The third day, it moves outside the envelope again. This time I call my broker and tell him to change the order from stop close only to stop. I get my order filled the following day at 304. It is the twenty-fifth day.

Definition of a Trading Range

I often enter a trade based upon the establishment of the envelope when prices have been in congestion for fewer than 25 days, and that will be discussed in the second section of this manual. But here we are talking about what constitutes a trading range for purposes of trading by this method. For my purposes, the definition of a trading range is that prices are in congestion for at least 21 to 29 days. This may happen only two or three times a year for any given market. It may not even happen once in a year for any particular market. When it does, you may have to wait far longer than an average 25 days for the breakout. The point is that when trading the breakout of a range, it is hard to be wrong. Most of the time I will be right if I follow these rules! I can never be wrong about which way the breakout has occurred. Whether prices break out to the upside or the downside, I will be right. My order will already be in place, and the market will have come to me, to where I was waiting for it. The only thing that can go wrong is for a false breakout to occur. If that happens, and it does, I will have to grin and bear it as I take my loss. If prices reenter the envelope, I have a choice. I can exit immediately, or I can grit my teeth and hope they will break out again. While I am suffering, if I can't stand the pain, I can move my protective stop even closer.

Usually, as soon as the trade has been entered, I move my stop to just below the original range high for a long position, or just above the original range low for a short position.

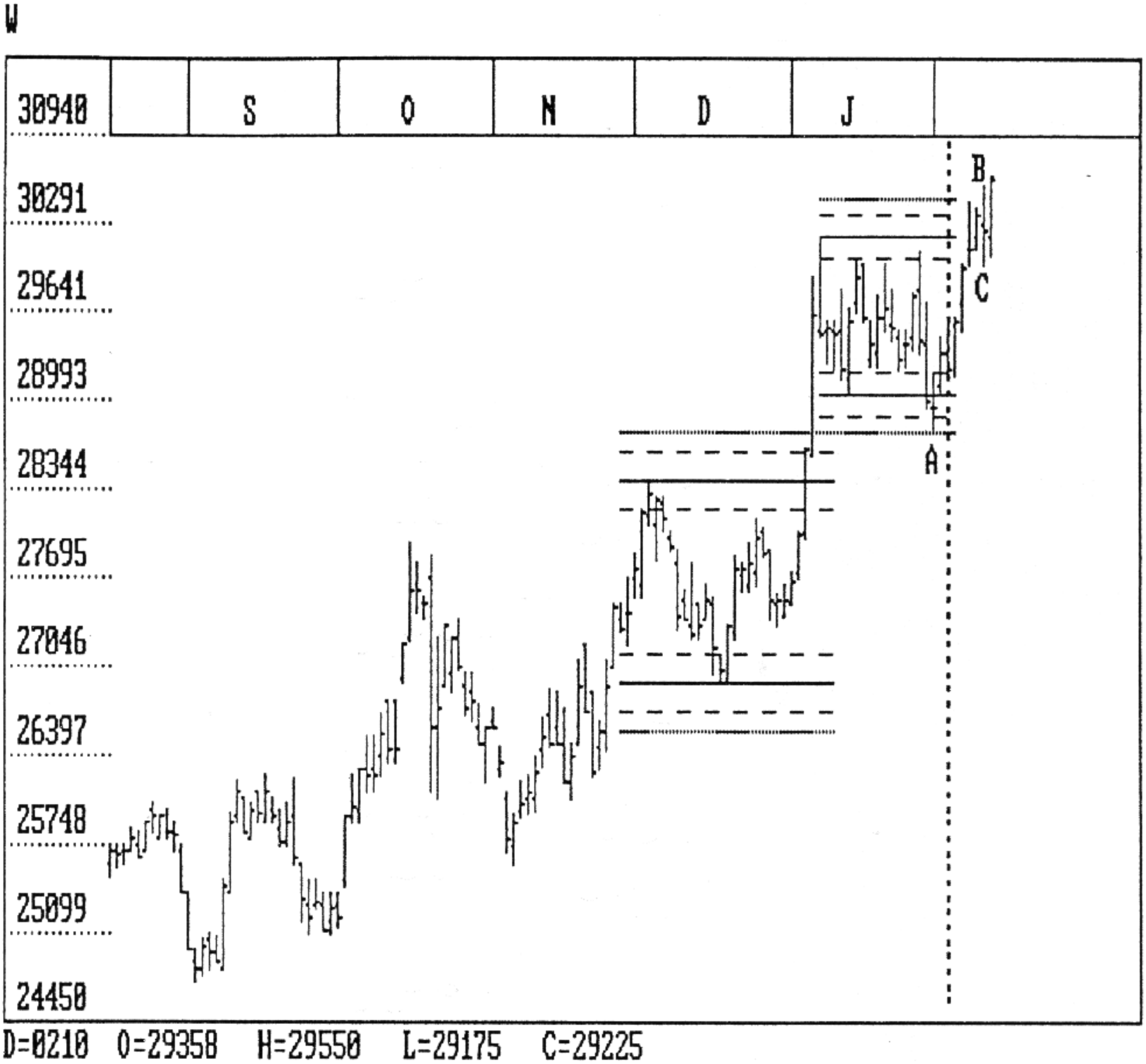


Figure 32 Calculating the objective for this trade is the same as it was for the previous trade. I take the A,B,C swing before the breakout. The formula is 1.00 (B - A) + C.

B is 30575. A is 28750. C is 30000. My projection is 31825. Note that B and C occur the same day.

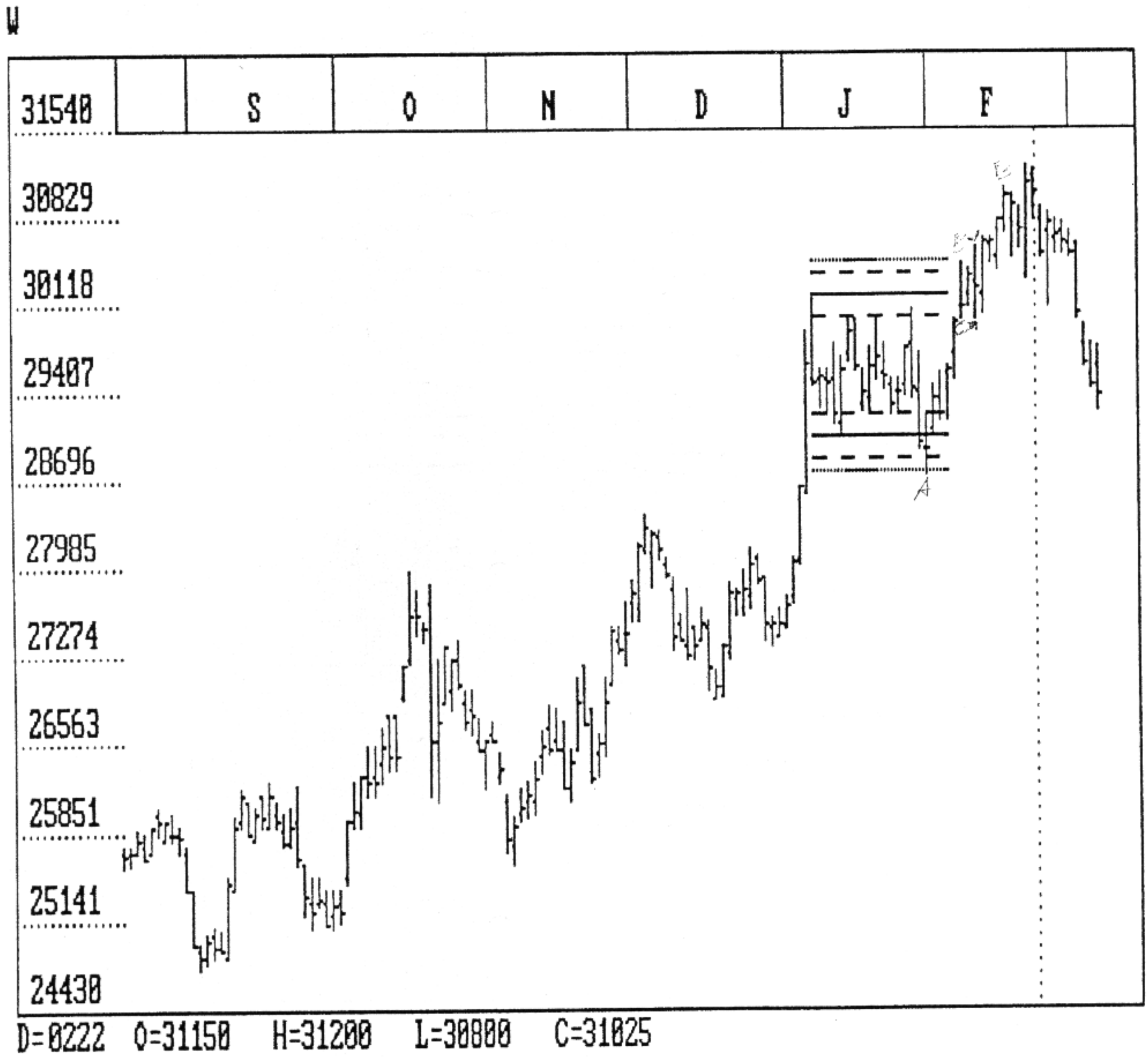


Figure 33 Prices move up but fall short of my projection at 31825. That failure should alert me to trouble, but I am either too preoccupied, or have too wrong an anticipation (greed) to act upon what I am seeing. Prices then start to move down. That makes me nervous and so I start a new calculation. This new calculation is based upon a Fibonacci expansion calculation that follows the formula: .618 (B - A) + C.

In this case, A is 28750, B is 30575, and C is 30000. The result of the calculation is 31125 rounded to the nearest tick.

Because I am nervous about this trade, I will be happy to get out at 31125.

Now I've shown the fallibility of human reasoning under an emotional strain. I have to ask myself, "Two bars against you and a gap down on day 3 and you're not out of there? How many times must you make stupid mistakes like that before you learn?"

I want to take a moment now to talk about Fibonacci expansions.

Normally I calculate all three of the above expansions. I want to know where prices might be going so that I can be on guard at the various expansion points.

Congestions, corrections, and retracements can be expected at any of these points. This is especially true where prices have met support or resistance at these points in the not too distant past.

Since most of the money to be made is made in the trends that connect congestion areas, I'd just as soon be sitting on the sidelines in all but the most minor, short term congestions.

I've shown these expansion calculations one at a time up until now, but if Fibonacci expansions are to be used as profit objectives, it pays to compute and keep track of all of them. You might even want to project a 1.500 expansion as well.

As you will see later on, most of the time I don't actively use these expansions, as I have a tendency to extricate myself from a trade based more upon what I see on the chart, as opposed to getting out at a fixed number.

But unless you are an experienced chart reader and interpreter, I would strongly advise getting your piece of the action based upon fixed expansion objectives.

If you are trading a small account and are trying to build it up so that you can trade more comfortably, then you should initially get out at the .618 expansion. Let that be your piece of the market.

Later, when your account is in better condition, you can enter multiple contracts. Exit one of them at the .618 expansion and let the other run until you exit at the 1.000 expansion.

In instances where you have a truly plush account, you can use all three profit objectives. Exit one trade at the .618, another at the 1.000, and for your final trade hang on until you see a 1.618 expansion or are taken out of the market by a penetration of a moving average, an /\/\, a \/\/, or some other method of your choosing.

There are times when it is not possible to project a logical profit objective when trading the breakout of a trading range. This can happen when there is no logical A,B,C swing to project from.

If a market has been trading sideways, on a fairly even basis, with no prominent highs or lows, then you will not be able to make a projection.

In that event, it is important to have a method other than Fibonacci projections in order to facilitate your exit.

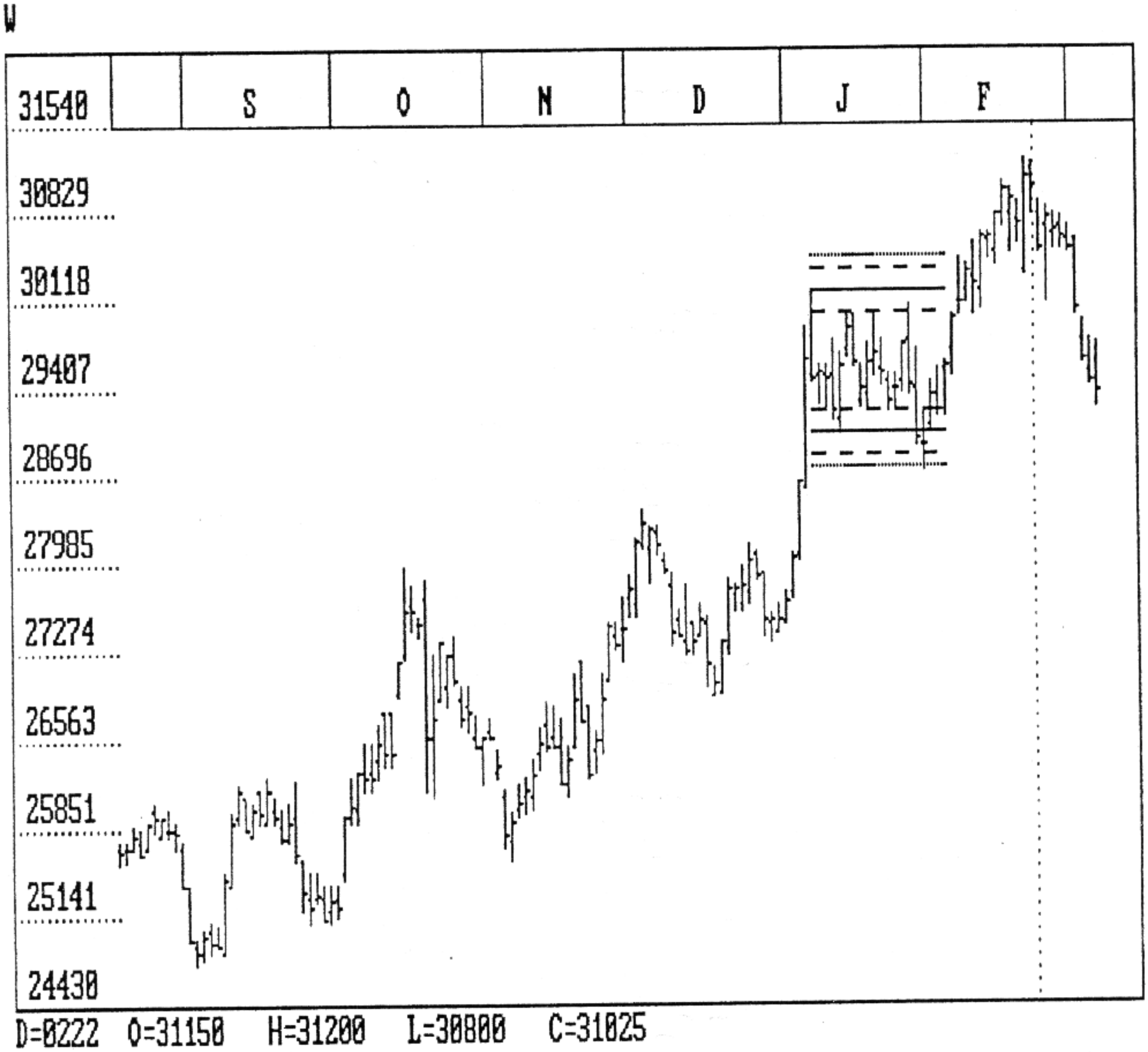


Figure 35 In this trade I am lucky and get out at the projected objective. I'm out on a blowoff day. Prices could easily have gone down and stayed there after the gap down opening.

Sometimes, even though you break a trading rule, you win. In this case I won getting out at the .618 expansion of 31125. But in the greater sense I lost. I should have kept my discipline. I should have been out much earlier. This win is a hollow victory for me.

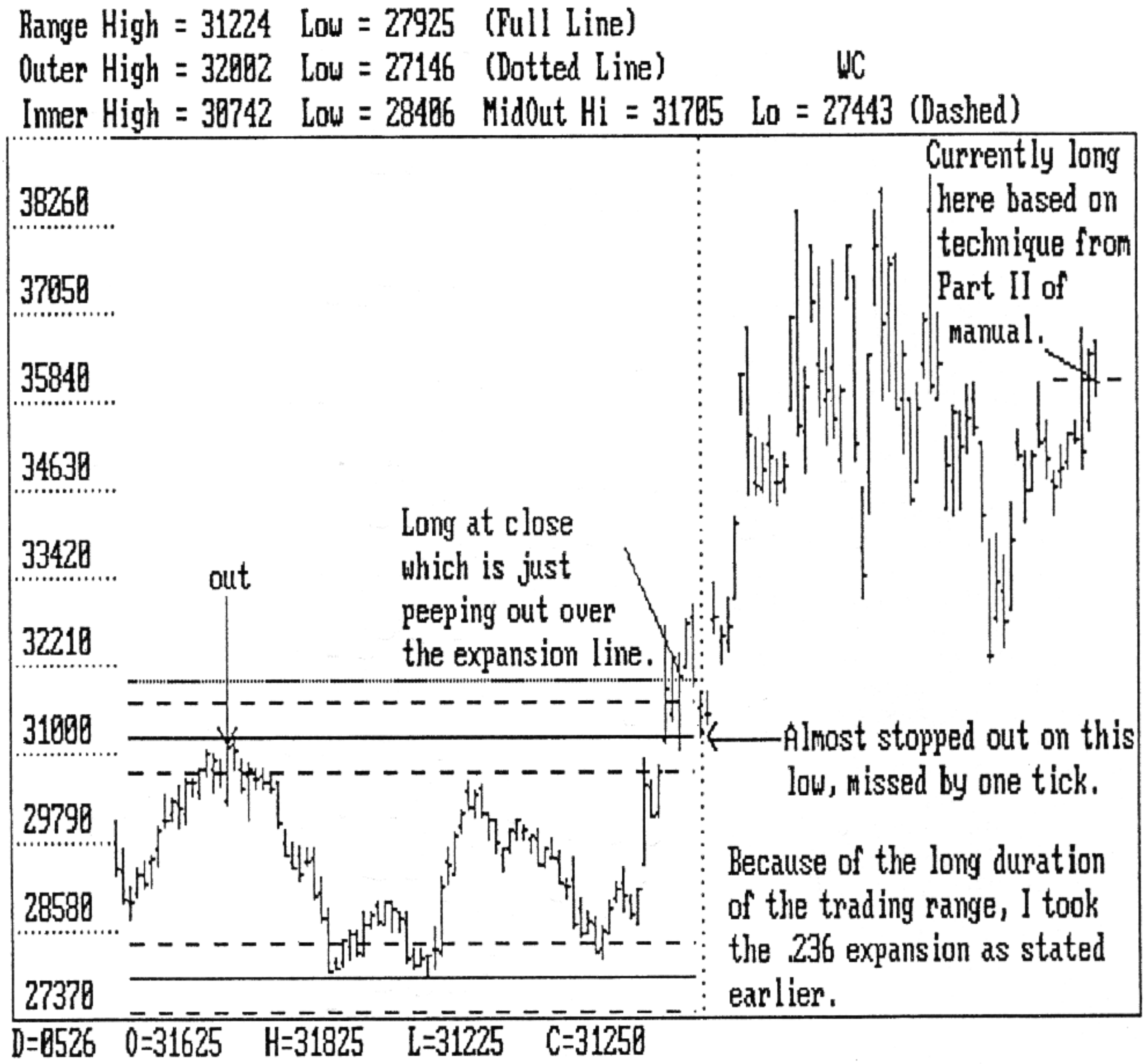


Figure 35 I've shown what happened to the Wheat contract over subsequent weeks. It entered another congestion phase. Practice for yourself how you would have traded this congestion phase. I didn't. I stayed out, other than to daytrade.

CHAPTER 5

Comments

After the run-up, Wheat entered a wildly congestive phase prior to the beginning of what I feel will be a test of the 420.00 area. I am as of this writing in that market attempting to take profits from the climb to the anticipated 420.00 area. I am in there based on a technique that will be shown in Part II of this manual.

I want to point out here that I am very careful to avoid trading in wildly emotional congestive markets such as are seen at the tops of grain markets when they are greatly affected by weather. These are dangerous markets, and trading them is not in accordance with prudence and wisdom. When a market is making price moves such as seen at the top of the wheat market in a drought year, stand aside.

Final Comments on Trading the Breakout from Congestion.

This is the first part of a multi-part manual. Read it and practice it dozens of times, maybe even hundreds. Prove to yourself that this is a sound way to trade the breakout of a range. I'm convinced that it is! It constitutes a method, but only for that one situation. If you try to beat the method, you will lose. Yet that's the first thing that human nature will cause you to do. Resist that temptation. If a method works DON'T FIX IT! When you have lost a few hundred or a few thousand dollars by trying to make it just the slightest tad bit better, you will have blown it. Remember that I told you so. Do you have that kind of self-discipline? You will soon find out. Go ahead and start trading the markets using this trading technique. It works! Even if you only have time to pick out one or two markets and follow them, do that. Enter the prices every day and then study your charts. Try to spend some time every day going over any charts that you can obtain and practice spotting congestion areas and trading the breakouts as I show in the manual. There will be losers and false breakouts, there is no such thing as a perfect method. Get used to the idea of taking losses, but never learn to "love" them.

When I owned a paint contracting company years ago, we knew that sooner or later we would spill a bucket of paint. It might be a quart can, which is equivalent to a small loss in the market, or it might be a five gallon pail, which is equivalent to a big loss in the market. In any event, knowing that sooner or later we would spill the paint, we were prepared for such an eventuality. When it happened, which it inevitably did, we had the equipment, etc., to deal with it.

The same is true for trading; sooner or later you will take a hit. Small or large, it will happen and you have to be prepared. That is the purpose for stops. A painter uses drop cloths so that the paint will spill onto the drop cloth. That is his "stop". He also has plenty of rags and the right solvents just in case the paint flows over the drop cloth and onto someone's brand new rug.

Your drop cloth is your stop-loss, your rags and solvents are your margin account, or your option premium which defines your loss should it spill over past your stop.

I have had a market move to within one point of my stop and close there. The next day, guess what? It gapped up past my stop and wasted my account for an extra $1,000 per contract loss. It can and will happen to anyone, so I am prepared. One of the best traders I know had a $15,000 profit in the bag when he stepped out to use the bathroom. When he came back, he was looking at a $30,000 loss. This is not a business for the faint of heart. Be a good scout, be prepared. Inure yourself to losses by paper trading, or trading the mini contracts at the Chicago Board of Trade or the Mid America. You've got to learn not to panic when the going gets tough. You have to think your way out of bad situations. The best way to avoid them is to have the right tools that keep you out of those bad situations. Those tools are what I'm trying to give you here. The main one is wisdom.

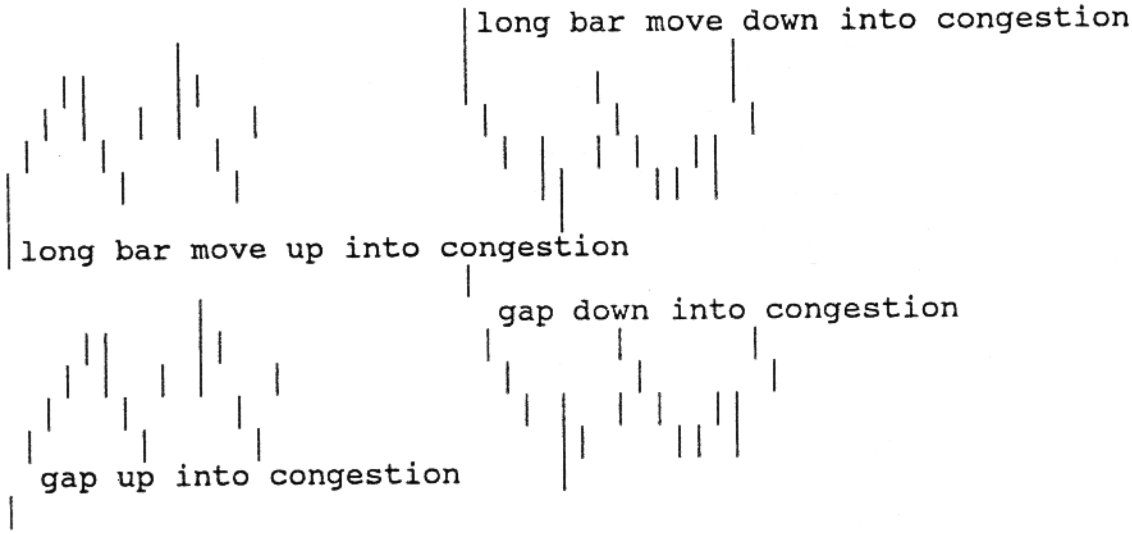
I can easily make what for many would be a year's pay just trading the breakout of congestion, but I have to wait for the markets to come to me. I must be very, VERY patient. I do not jump the gun, I do not get in too soon. On the other hand, I do not chase a trade. If I miss it, I miss it! So what? Another one will come along soon enough.

Anticipating Congestion

Is there a way to anticipate congestion areas? There certainly is!

Congestion areas can always be expected (previste) at Fibonacci retracement levels and previous support and resistance levels even if they don't match up with Fibonacci numbers. There's nothing magic about Fibonacci ratios. This will be explained in a subsequent part of the manual. Always anticipate that congestion may occur after a gap or a large magnitude, one bar move. Not that it will always occur, but that it MAY occur. The lengthiest congestions, more often than not, will occur after just such a move by price.

magnitudo = altezza della barra



Recognizing Congestion

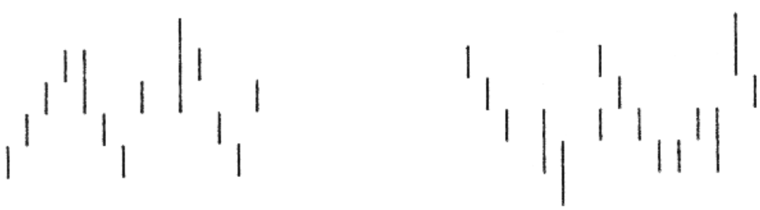
The easiest way to recognize congestion is to realize early that the characteristics of a trending market are no longer in existence.

When the progression of higher highs and higher lows in an up-trending market and lower highs and lower lows in a down-trending market is no longer happening, then you know that something else must be happening. Either a correction is taking place, or the market is entering a congestion area.

The difference is that an **overall** congestion area will take more than one market swing to identify.

Corrections

Congestions



There are a couple of things that need to be said about congestion areas and the envelope:

Envelope Adjustment

It is possible and acceptable to move the upper limit of the envelope higher when a new high that does not equal or exceed the upper limit of the envelope is made. However, it is important to remember to move the upper limit only, by an amount that is .236 of the incremental change on that side of the envelope. Do not - DO NOT change the lower limit of the envelope unless a new low takes place. For example:

The upper limit of an envelope is 340 and the lower limit is 300.

340-300=40 .236(40)=9.44

340+9.44=349.44 = upper limit of envelope.
300-9.44=290.46 = lower limit of envelope.

A new high is made at 348. The difference or increment between the old high at 340 and the new high at 348 is 8.

8(.236)=1.89 + old upper limit of envelope 349.44 = 351.33 new upper limit of the envelope. NOTE the old lower limit of the envelope is still in place at 290.46. It will not be changed unless a new low is made.

The reverse is true where a new low and no new high is made. The lower limit of the envelope may be extended by .236 of the incremental change in that side of the envelope.

This is a somewhat more conservative approach to trading the breakout. It will reduce profits to the extent that the envelope is now larger. However, it will filter out more false breakouts.

Envelope Contraction

It is also possible to take a more liberal approach to trading the breakout from congestion. It will increase the profits to the extent that the envelope is now smaller. However it will not filter out as many false breakouts. This technique sets a .146 envelope around the trading congestion. Simply substitute .146 for .236.

The best way to utilize the narrower envelope is in congestion areas that are shorter in duration than 25 days. In this case the shorter the better. The shortest possible definition of a congestion area is one that lasts only two market swings, that is a market that looks like this:

/\/\ or ||||

or one that looks like this:

\/\/ or ||||

As stated, a great deal of money can be made by just trading the breakout from a range. By placing sufficient contracts per trade on each breakout, I have been able to earn considerable profits without the sweat and hassle of in and out trading.

In fact I do some of both because I enjoy trading.

When to Draw the Envelope

This is a most crucial question as will become evident in Part II of the manual.

I become extremely suspicious as soon as there is a gap of any kind or a large magnitude of move on a price bar between high and low. That sets off an immediate alert in my mind that a trading range may be just around the corner.

I draw the envelope as soon as I see /\/ or \/\ on a chart. That is also when I determine what the high and low limits of the trading range are. However, I usually don't utilize the envelope until 21-25 price bars are on the chart. I say usually because there are times when I do it in fewer days according to my perception of what is happening in the market. Sometimes the /\/ or \/\ are not all that clear to me. For example, the high limit on the Gold envelope would have been more properly set on the twenty-sixth day of the range, but if you look closely you will see that I was looking at /\/ prior to the twenty-sixth day. After the twenty-sixth day, I could have restructured the envelope, but I presented the example exactly the way that I actually traded it. Recognizing trading ranges takes practice, but I have become extremely adept at it over the years.

The symmetry of /\/ or \/\ is not always quite as clear as I have shown here, one or more of the three legs may be more extended. One or more of them may be flatter than what I've shown. Experience will dictate when they occur.

One final thing about trading ranges is that sometimes they are much larger from top to bottom than I care to believe. This is where extreme patience comes into play. It looks like prices could never move so far as to breakout of the envelope. Yet they invariably do, and when they do the moves are stunning. How to trade after the breakout is the subject of Part II of the manual.

Obviously if I took only breakouts of trading ranges on daily charts, I wouldn't get to do much trading. But I had to begin this manual some way, and at some point. Trading the breakout of a range is a fundamental concept on which some of the remaining parts of the manual will be built. I trade regularly, using other concepts under different aspects of the markets, while I'm waiting for the breakouts from trading ranges.

In the subsequent parts of the manual, I will be looking at virtually every aspect of a market and showing how I trade it. Part II will show what to do at tops, bottom, highs, and lows. It will show how, when, and which kind of moving average I use. It will also show how to use Fibonacci expansions and objectives, among additional concepts too numerous to mention here.

In Parts III through VI I introduce many concepts, each of which treats a different aspect of markets. Some of these will seem truly amazing. All of them are money makers.

Before we leave this section of the manual, I want to make one thing very clear. When an envelope breakout occurs, I anticipate a reaction. This reaction may take place as soon as the envelope is penetrated, or it may take place a few periods later. I am not averse to taking first time through breakouts of the envelope. I trade at very low commissions, and am almost always able to cover costs, and even realize a small profit on these breakouts. However, most traders will do well to wait for the reaction to the breakout and enter the trade at that time. The reaction may be sufficient for prices to reenter the envelope. If they do, trade the subsequent breakout of the envelope. Often prices will retrace to the original trading range lines. There, they will test support which was the prior resistance. As soon as prices appear to turn around in the direction of the breakout enter a trade in the same direction. At other times prices will retrace, but not all the way back to the envelope. In that case, enter the market via a Ross hook or enter via an established trend. Both techniques will be shown later in this manual.

CHAPTER 1

Market Harmony

I have tried to bring in the various approaches to the markets as needed, weaving them together with trading wisdom, repeating where necessary in order to get the point across.

I also firmly believe that a picture is worth a thousand words, as will be shown. But first I have to write my thousand words.

The philosophy behind my method of trading is this: Within reason and as ascertainable by the human mind, markets will follow the natural order of things. I want to be in harmony with the natural order of the markets.

Until proven wrong, I will also believe that with few exceptions, and for the most part, traditional technical analysis is wrong for most traders and that fundamental analysis is a waste of time for all but the very large traders and the commercials.

Why do I believe this? Because there is a tendency to make a god of this approach. Unfortunately, technical analysis turns out to be a false god. Let's look at technical analysis.

Technical Analysis

Technical analysis looks at the market action. It tries to reduce to numbers and make objective certain things that are not really reducible to numbers and are somewhat subjective in nature. It tries to measure such things as:

Momentum, how fast or how forcefully a market is moving.

Price, where it is today relative to where it was some number of days ago.

Trend, trying to fit a mathematical curve to the price action to see if a market is going up or down.

Thrust, moving averages, volatility, statistical incidence and a whole slew of other things are measured and graphed as oscillators, point and figure charts, smoothed averages, moving averages, stochastics, relative strength indexes, percent of range indexes, overbought/oversold indexes, and various combinations of those things.

Unless the technical tools utilized are thoroughly understood as to what they mean what they depict, what their strengths are, and what their weaknesses are, they shouldn't be used. In this manual I will always try to clearly define the technical tools I use.

There are even more ways to do technical analysis than I have mentioned, in what seems to be an infinite and ongoing attempt to predict what WILL happen in the markets, or what SHOULD happen in the markets.

Unfortunately, none of these methods is able to directly measure the emotional human reaction to price movement.

Technical analysis will work some of the time in some of the markets, but there are no absolutes, no perfect systems. There are far easier methods to follow than technical analysis that yield as good or better results.

I know of no human being now or past who, unless under the direct inspiration of God, can predict the future. It is not within the power or the realm of man to do so, so why waste time trying? Why strain at an exercise in futility?

Fundamental Analysis

Fundamental analysis tries to take into consideration such things as the weather, plantings, inventory on hand, production rates, inventory in process, labor situations, political events, or any known fact that might affect the supply or demand of a particular market.

This is done mostly by the large commercial houses who have a vested interest in obtaining such information, and by some of the largest traders for the same reason. They can afford to do it.

I have not the time or the resources to compete with them in the search for such fundamental knowledge. By the time I read or hear about these things they are no longer "NEWS", they are "OLDS", their effect on the market has already been taken into account in the price.

To trade in the futures markets, I have to realize that for me there is only one major reality - PRICE! Open Interest and Volume are secondary only and are in the "nice to know" category. By the time I get them they are too old to be of much value.

The best way to trade markets is by learning how to harmonize with observable market phenomena. That is what I will be trying to show in this manual - how to get in step with the OBSERVABLE PHENOMENA. I am reminding myself about harmony, rhythm, and being in tune with reality.

I have come to realize that the price of a futures that I see on any given day, at any given moment, is the only usable reality. Even it is not necessarily true, due to the nature of the reporting.

As an interested party in futures markets, I will be tempted by all manner of technical and fundamental considerations. I must develop and maintain the discipline and willpower to ignore all of what I hear from the outside, I must develop the self-confidence and the self-control to ignore all of the experts and what they are saying, doing, and/or advising. The only reality that I can work with is the latest price information that I have.

I must not give in to my human nature, which will cause me to try to find a system that will beat the markets. I must not give in to the human tendency to want to reduce everything to numbers in some kind of magical "holy grail" formulation. If I give in, I will only end up a loser. I must remember that at all times only ten percent of those who trade futures end up as winners, the other ninety percent are losers. I can succeed at the expense of the losers, but only if I DO NOT DO what they do.

I do not need a moving average of the prices to see if prices are going up. I can just look at my price chart. If prices are going up they are going up, I can see that for myself. If they are going down they are going down, I can see <u>that</u> for myself. The only other way that they can go is sideways, and that, too, I am able to see. If I can't tell which way they are going, I must stay out!

When prices are going up, the others will all be looking for a top, for a place to sell - I will be buying as prices go up. When prices are going down, the others will be looking for a bottom and a chance to buy - I will be selling when prices go down. It will take guts. I must have them. If I don't have them I must develop them by developing confidence in myself and in the only truth there is in the markets that I can use - PRICE. Price is reality and price is truth.

I must learn to surrender to the markets. I cannot make them go my way or where I think that they should go. I cannot be a prophet. I cannot believe anyone else who says he is one. I must not believe any of the countless ads claiming that I can pick tops and bottoms. They are not true, but I have been tempted mightily to satisfy my curiosity. I need to remember this, anyone can pick the tops and bottoms some of the time. The only certainty is that I cannot pick them all of the time. I have to put that knowledge to my advantage. My method is usually wrong when it comes to picking a top or bottom. I can count on that and make money from that certainty.

What I want to do is to learn how to take my piece out of the middle, the way the greatest traders traditionally have done and are still doing.

I have come to see that those having the most patience, the most self-discipline, and the most self-control, are the biggest winners in the markets.

I must also learn to lose. I cannot always be right, even when I have learned to harmonize my trading with the markets. I have to learn to keep my losses small and to maximize my gains - this is the most important part of trading and it is a part of money management.

However, I do not have to learn to love losses as some have stated. My effort must be in the direction of never losing, that way my mind-set will be toward always winning.

CHAPTER 2

The Waves (Not Elliot) Have It

When I was a teenager, I frequented the beaches from Santa Monica to Malibu, California. It was there that I found the thrill and enjoyment of body surfing.

There are a great many analogies that can be made between body surfing and trading markets. When I trade I never fail to picture myself as riding the big wave. Although there is not a perfect analogy between surfing and trading markets, the similarities are many, and a great many lessons can be learned in the comparison.

When I first looked at the charts depicting the price action of markets, I immediately, as I'm sure others may have, noticed the similarity between price action and ocean waves. Ocean waves are mainly affected by the pull of the moon and to a lesser extent by other celestial bodies. The wind also greatly affects the surface action. There is a great deal more research that needs to be done in this area. Why? Because human beings are made up mostly of water. Markets are made up of actions, based upon the decisions of human beings. In some of the large markets, like Bonds, Eurodollars and the S&P, that's an awful lot of water.

Technical Analysis

In the area of technical analysis, there are a few things that are helpful in making trading decisions:

Cycles, which although subject to interpretation, do reflect natural phenomena. Unless there is something clearly cyclical as concerns a market, I don't use cycles in futures trading, but I can see some value in them for those who do. There are many good technicians who use them. There are some who have very successfully used cycles to filter and trade Ross hooks.

Seasonal tendencies which are observable and can be useful. I don't use these very much either. For some they are good because of the way that they trade. Seasonality, when a market is making a major low, can be very useful, and seasonality may have good consistency when it comes to trading seasonal spreads.

Certain mathematical relationships which have been historically proven as accurate may help. I use these from time to time in the form of Fibonacci numbers. They give a best guess in some situations. My greatest use for Fibonacci numbers is in knowing what other traders will do. I anticipate some sort of congestion, support, or resistance at the Fibonacci ratios. In markets where many traders use them, Fibonacci ratios tend to be self-fulfilling.

Wave theory is of some small use, but I don't use it because it confuses me. I can never figure out which wave I'm in. It is not a very reliable predictor of the actions of others, because few wave traders can agree as to which wave they are in.

I reject moving averages except in a few situations which I will be describing. The way that I trade, they hold little value and I can go a long time without ever using one and not miss it. I never enter a market based upon the crossing of two moving averages, but in the past these have been good for fading the trades of those who do use them.

I reject most oscillators except for the simplest ones and then only to be used as a crutch until one learns to read a market via the bar chart. I will show how I use them in another part of the manual. For the most part, oscillators are just not worth the trouble to compute. I don't use median lines, trend lines, Andrew's pitchforks, speed lines, Gann angles, etc.; they are not worth drawing on paper or on the computer screen with the methods I use to make my money in the markets.

I do keep track of the more popular studies so I will have a good idea of what others may be doing.

With the exception of, at times, using high-low bands, an offset moving average, and a simple oscillator, I use nothing that cannot be seen by just looking at a price chart showing a graphic representation of open, high, low and closing prices.

I am very interested in gaps as they relate to the magnitude of the movement of price from one price bar to another. Gaps and large magnitude price bars set off an immediate alert that something important is going on. I may not know what it is, but I can put on the brakes and go slow until I see what it means.

As concerns fundamental knowledge, I find it of no use at all in my trading, and if anything it throws me off track. I did not invent any of the things that I use in trading, with one exception, and that is the envelope around the breakout of a range shown in Part I of the manual. There is nothing new here except perhaps in the blending of useful things discovered by others and incorporated into my method of trading. Many of the methods I use were invented before the turn of the century, when there were no computers, calculators, or any of the technical analysis used today. Yet vast fortunes were accumulated using those techniques; they worked then and they work now - they have stood the test of time.

Current intraday news items can be useful. I have made many good trades by watching the early financial news, and then anticipating how a market will react.

When I write about my trading, I often quote from my collection of proverbs and trading wisdom. The wisdom of old is still the wisdom of today. I try to utilize that wisdom in my trading. It works!

As each section of the manual unfolds, my trading methods will be seen to the extent that they incorporate what was learned in Part I of the manual plus all of the new material in this part of the manual. But I have specifically designed the flow of the manual so as to force a review of its parts one by one, and to ponder each concept as it is revealed. The parts are literally built concept by concept, and principle by principle. Parts III-VI reveal many more of these concepts.

This manual unfolds my trading methods in the way that a novel unfolds its story. I cannot jump into the middle of a novel and expect to know what is going on. The parts of this manual are not necessarily written by subject. They are a weaving together of the elements that make up good trading. Perhaps in that way these sections are different from any book I've ever read. I read and re-read this manual periodically. Each time I do I continue to learn from it.

CHAPTER 3

Selecting a Market

There are various ways to select a Market for trading. Trading can be long term, intermediate term, short term, or intraday.

At this point I want to define what I mean by long term, intermediate term, and short term trading.

Long term trading is done from a chart that is one magnitude greater than the chart that I'm going to trade from. In the case of daily trading, long term means the weekly price chart.

Intermediate term trading is done from the chart that I am studying the most. In the case of daily trading, intermediate means the daily price chart.

Short term trading is done from a chart that is one magnitude lesser than the chart that I'm going to trade from. In the case of trading from day to day, it is the very last price bar on my daily chart because that bar represents the most current trading range that I have at my disposal. That last bar shows me the previous day's intraday open, high, low, and close.

There is no law that says that these definitions are absolute or that anyone else would even define long, intermediate, or short term trades the same way. These are my definitions, given so that I can communicate my methods.

I expect my trades to last from a few minutes intraday, to two days to about two weeks on the daily chart. Sometimes a trade will last longer. That can be either very good or very bad, depending on why the trade is taking longer.

The bottom line to my trading and in my selection of a market is that I want to succeed. Success in the markets is measured in money and in happiness in doing things I like. I am interested in both enjoying myself and making profits.

Does that sound obvious? It's not! I have found that there are many traders who trade for the thrill. It is a known fact that there are many who trade not wanting to win. There are traders who enjoy punishing themselves in the market. There are also the outright gamblers who are just out for a good time, win or lose. There are all kinds of people trading in the markets, but I am in there to make the most profit that I can.

The desire to make profits greatly influences my selection of markets. I hate to lose! I want as close to a sure thing as I can get, therefore I am very patient and very conservative in selecting my trades.

I don't have the physical makeup for blindly following any system, although I believe in being systematic. I want to use reason and logic in determining the trades I will make. That is why this manual is about methods of trading, not a system of trading.

I will now describe some consistent patterns of selecting a market that I have found to be of value to me for any time interval of trading. This is not to say that there are not others equally as good. These are the ones I usually will trade.

A breakout from a range, which I covered in Part I.

A breakout from a 1-2-3 high or low, which I will cover in this part of the manual, along with a variable outgrowth of 1-2-3's which I call a "hook."

An entry into an established trend, which I will cover in Part III of the manual, along with my weekly oscillator.

In Part IV of the manual, I show how I can trade combining a daily oscillator with my weekly oscillator.

In Part V of the manual, I will cover trading within a trading range.

No matter whether the trade is perceived as long, intermediate, or short term, I try to use methods that have the highest percentage of probability of success. Not only that, but I try to trade situations that occur quite frequently, so that there are almost always markets in which to trade.

I will be more specific about these market patterns as they are covered, but first there are some more things that need explaining about my methods.

When I trade a market there are two things that are essential to my entering a trade.

1. I must be ready.
2. The market must be ready.

Only when both of these are satisfied, will I enter a market.

I Must Be Ready.

Here is an analogy. I can't ride a wave if I'm up on the beach. I have to be in the water to catch the wave that I want to ride. The same is true of trading, I have to be in the water. That means I have to have an account, with sufficient margin in it to enter th trade. That is part of being ready. I have to decide which wave I want to ride, and I have to decide which market I want to enter. That, too, is part of being ready.

I have to decide just when or at what point I'm going to get on that wave. Likewise, in a market, I must have decided at which point I will climb on for the ride.

Finally, once I am in and surfing, I cannot jump out of that wave in hopes of catching a bigger wave that might be right behind. If I do, I will probably get knocked o my head, lose the wave I was in, and probably the wave behind, because I am not reall ready.

It is the same in the market. I must stick with the trade I'm in, and ride it out to the end, or I may miss the best part of its action and miss the bigger one behind as well the one I was not really ready for. There's an old folk saying that goes, "Dance with th one that brung yuh!" I remember that when I'm trading.

The Market Has to Be Ready

When is a market ready? When it is behaving in a way that is comfortable for me to climb aboard. It is ready when I can perceive that now is the time for me to get on, start paddling, enter that wave, and go for a ride. It is ready when it is doing the things that I expected it to do. It is ready when its behavior is predictable enough for me to feel safe entering it.

If a market is extremely volatile, making large unpredictable swings and moves, I may not feel comfortable entering that market, so I DON'T!

If a market is flat and not giving me the kind of action that I would expect or want for a trade, I stay out. I only enter a market when I AM READY and THE MARKET IS READY!

Here is another analogy. Many times a surfer will let many waves go by looking for the one big one that will yield the longest ride. A lot of fun-type small waves go by. But the surfer will ignore those. Intermediate, strong waves will go by, but the surfer will ignore those. The surfer is looking for the big wave, the one that will carry all the way up past the water mark.

So, when the smaller waves come along, even though they may be ready, the surfer is not ready. When the good intermediate waves come and are ready to ride, the surfer is still not ready. He wants the big action, the big wave.

This is what it is like to trade long term. If and when I trade long term, I'm looking for the big action, bypassing the lesser action.

That doesn't mean that the surfer only rides the long waves. Moods change. On another day at another time it's fun to ride the small or the intermediate waves. Sometimes there are not enough big waves to ride, so the surfer might want to master the skill of riding the smaller waves.

When I trade, I do the same thing. Big wave, intermediate wave, or small wave, all are interesting - as long as they are profitable.

When I ride the small waves I have to get in and out of the surf a lot. I pay a price in energy expended and wear and tear on my body. When I trade the short term trend of the market I have to get in and out of the market a lot. That gets expensive, because I have a commission and face possible slippage every time I do it. The short term trader has a much higher overhead than the longer term trader, but he does get more action.

I have a friend who is a short term trader. He is a day trader. Once I asked him why he day trades. His answer was that he couldn't stand leaving all that money on the table. In other words he couldn't stand watching all of those small waves go by and not taking a ride. Is that OK? Sure, everyone has to trade within his own personality, using his own judgments, based on his own perceptions. If he doesn't he will not be ready! He will lose.

A long term trader may leave 50% of the intraday market move on the table, but that is more than offset by the sizable gains from the daily trend, and the fewer commissions that he pays and the less slippage that he experiences. I have read that long term traders make more money than short term traders overall.

By the way, I should explain here that slippage occurs because I can't always buy at the exact price that I may want, or sell at the exact price that I expect. In other words, my orders are not always filled at the prices I anticipate.

As both a daytrader and a position trader, I know that it is the daytrader who leaves most of the money on the table. A market can trend wonderfully, making fabulous profits for the position trader, while the daytrader is getting clobbered having to fight his way into the market each day.

Harmony

This manual is in part about harmony. One objective is to show how to get in harmony with markets. There are a number of ways to state this concept, none of them are new. Here are some different quaint ways I have heard it expressed: "The trend is your friend." "Ride with the tide." "Go with the flow." The fact is that they are all correct. I cannot emphasize this strongly enough.

No one of us is big enough to resist the forces of the market. I cannot make the market come my way. The very best I can do is to harmonize with the market - get in step with it.

I have tried to surf out to sea! I can for a short time! I can paddle along with, and ride the outward surge until I run into the first incoming wave, and then I have to duck under quickly or be pounded into the sand. The choice is mine to make. If the incoming wave is big enough, it may pick me up and smash me onto the bottom (ouch I've done it). Numerous surfers have been injured and even killed trying this stunt. Somehow they get the notion that they are bigger than the relentless and crashing waves.

There are traders who do the same thing. They think they are bigger than the markets. They think they can get in a quick thrill by going against the tide. Sometimes they are badly hurt, and sometimes they are financially killed by the magnitude of a market move that knocks them for a loop. Sooner or later they will be out of the markets one way or another.

That is why I trade in harmony with the markets. I want the market to clearly tell me which way it is going. Then, I hope that by skill I can go along for a profitable ride.

When a skillful surfer is waiting for just the right wave, he observes every wave. Unless the wave forms just right for a ride, he will let it pass by.

So it is in the market, unless the wave comes my way in just the right way, I let it go by. There will be plenty of other waves.

If the surf is not up the way it should be at one beach, then a good surfer will go to another beach.

If the market I'm watching is NOT doing the right things, then I go to another market and look there. There are plenty of markets to choose from. I capture data on over twenty of them.

I can't make the market do what I want it to do. It is relentless. It will do what it will do and I cannot change that fact.

CHAPTER 4

Little Things Mean a Lot

It has always astonished me that so many people who trade, busy themselves with all kinds of complicated and magic formulas, arcs and circles, Gann lines and fan lines, various and sundry indicators and oscillators, cycle projections, pitchforks, pennants, flags, heads and shoulders, speed lines and many other "tools" that are supposed to tell them how to trade, while ignoring totally what is right there under their noses.

What I am going to show in this section of the manual is so simple that most have a hard time believing it. The natural tendency will be to laugh to scorn such utter simplicity. How can trading be this easy? Yet it is easy, when you know how. This section of the manual is not going to be as long as I might have made it. It is not the number of pages that it contains that make it worth while. I could make it 500 pages long if that were important, but it's not.

What I will show here occurs frequently on all charts. This is a high percentage trade. It comes from paying attention to the little things.

Rather than try to describe in words what I am talking about, let me first show a number of illustrations. Then I'll explain what it's all about. I think that it's astounding! Really study the charts that follow. Here are some clues: Look for 1-2-3 lows and I-II-III highs. I look for this pattern on at least somewhat well-defined turning points. Some of it, of course, is in the eye of the beholder:

```
                                 I
     2    | <buy breakout        |
     |   |   of #2 point        | |   III
    | | |   <uptrend               |   |
   |   |                            | | |   <downtrend
| |    3                             |   |
 |                                  II    | <sell breakout
 1                                           of #II point
```

I will put some rules around these trades as I go, so that they make sense.

A) Gaps or long magnitude price bars will give an alert

B) /\/ or \/\ will cause me to start an envelope.

C) /\/\ or \/\/ will cause me to exit all positions of a trade and also to take extreme caution until 25 price bars are reached. These usually mean a congestion area has been reached.

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```
        2     | <buy breakout
        |   |    of #2 point
       | | |    <uptrend
      |   |
    | |   3
     |
     1
```

```
  I
  |
 | |   III
    |   |
     | | |   <downtrend
      |   |
     II    |  <sell breakout
               of #II point
```

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Trading By The Book - Part II

It's As Easy As 1-2-3

By now what I'm doing ought to be as clear as mud, so let me explain.

The following illustrations by themselves would leave a lot of questions. For instance, where is the stop placement? What is the objective? What exactly constitutes 1-2-3?

I will now start providing all of the answers to those questions. I will pay close attention to detail. I want to dissect these trades. I want to see and understand their anatomy, because it is literally the anatomy of the market. Other than the price chart itself, I will need only one simple tool - the envelope which was described in Section I. These trades can be done by anyone with a set of charts. No computer is needed (but it's nice to have).

TBONDS

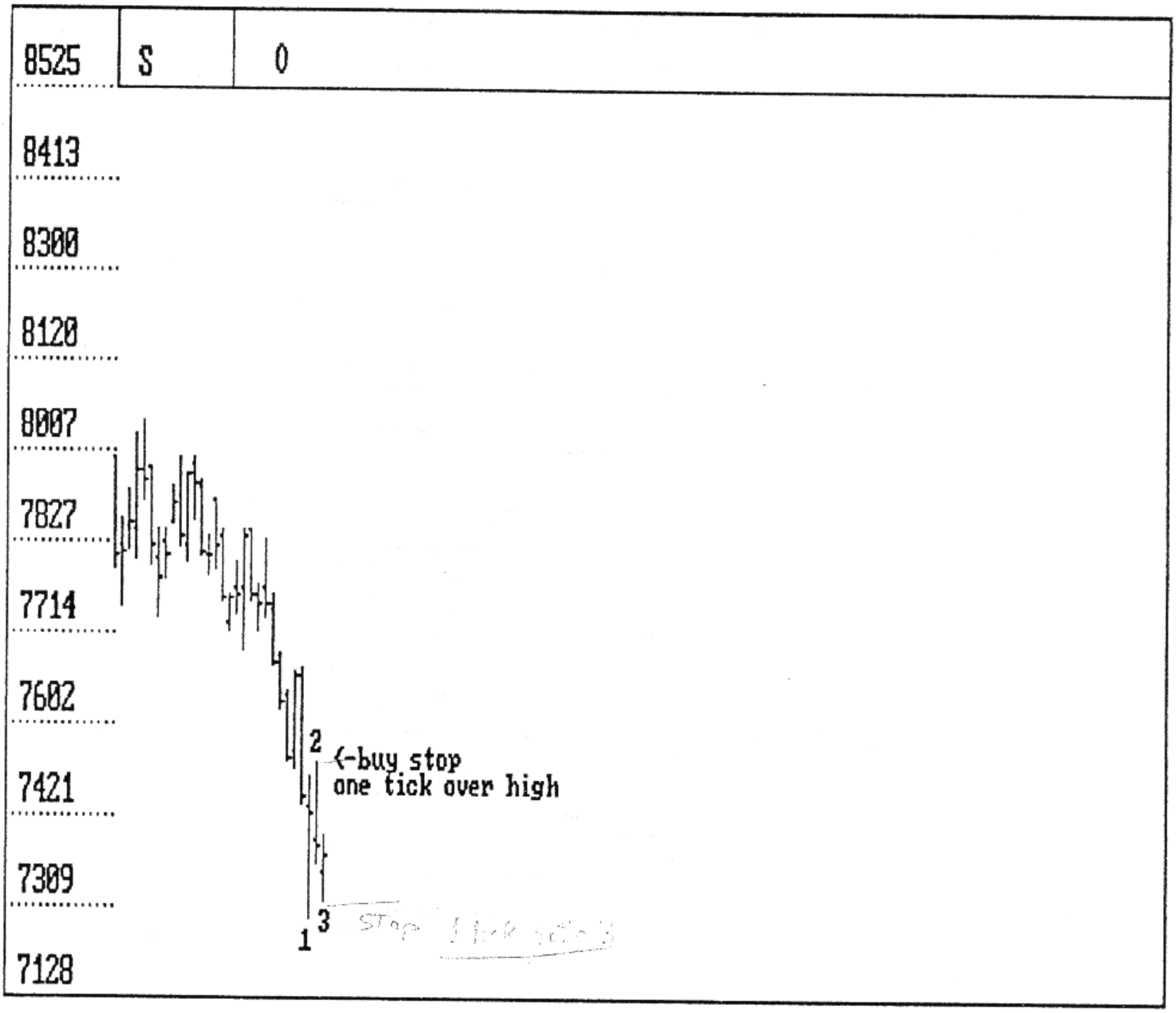

Figure 1 There is a low at the point marked "1". There is a high marked "2", followed by a lower immediate low, marked "3". I am now in position to make a trading decision. I will enter this market if prices reach one tick higher than the number 2 point. My stop will be placed one tick lower than the number 3 point. It's time to call my broker and place my order. I place the buy order as a Buy Stop and the sell order as a Sell Stop. Both are day orders and the Sell Stop is conditional upon the Buy Stop being filled.

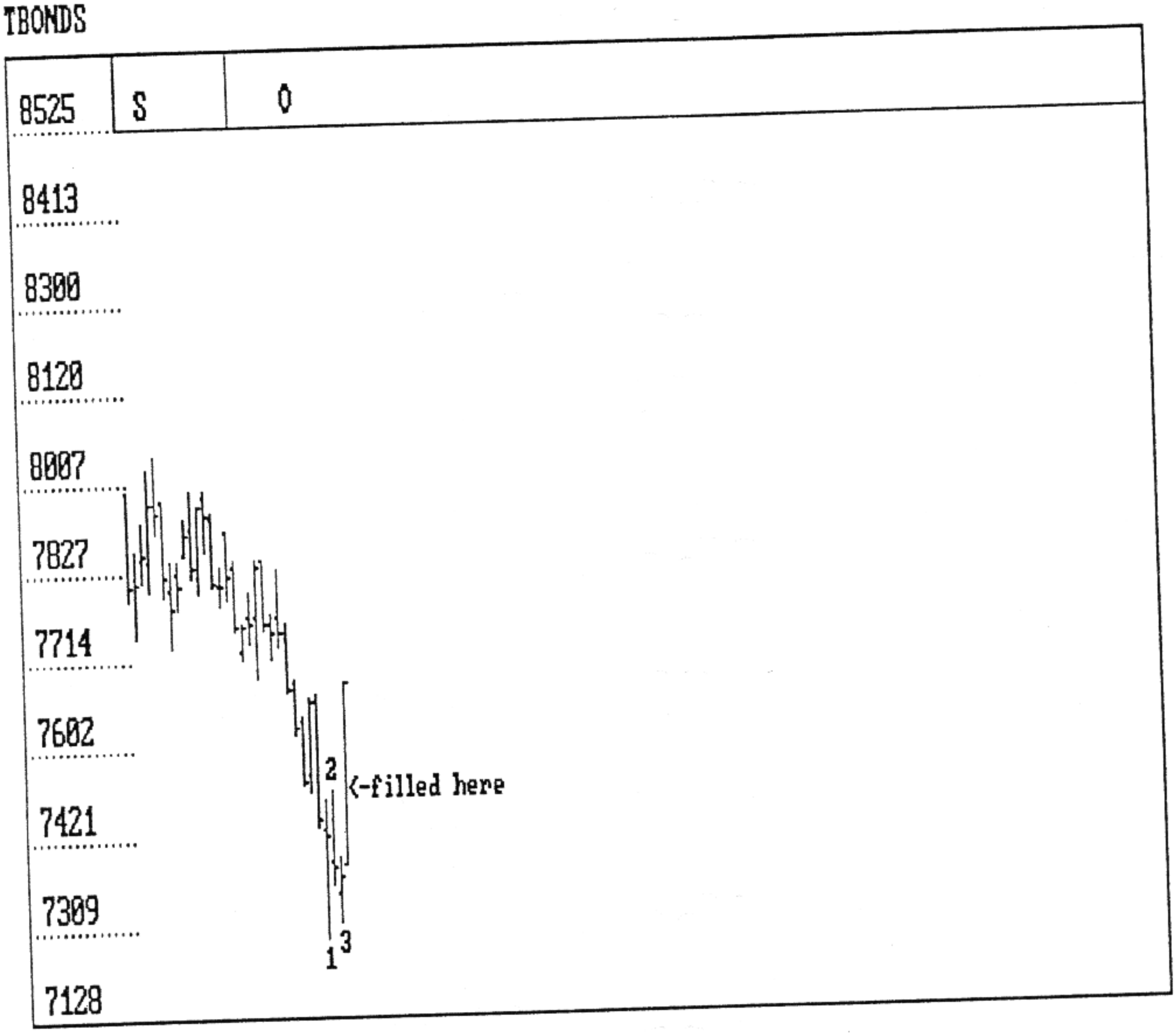

Figure 2 My order was filled as indicated, because I utilized a Buy Stop, which became a Market Order the instant that prices touched my buy point.

Prices passed my buy point and ended up in a large magnitude day. This automatically sets an alert in my mind. I remember that quite often congestion areas and market turns are preceded by long bar moves.

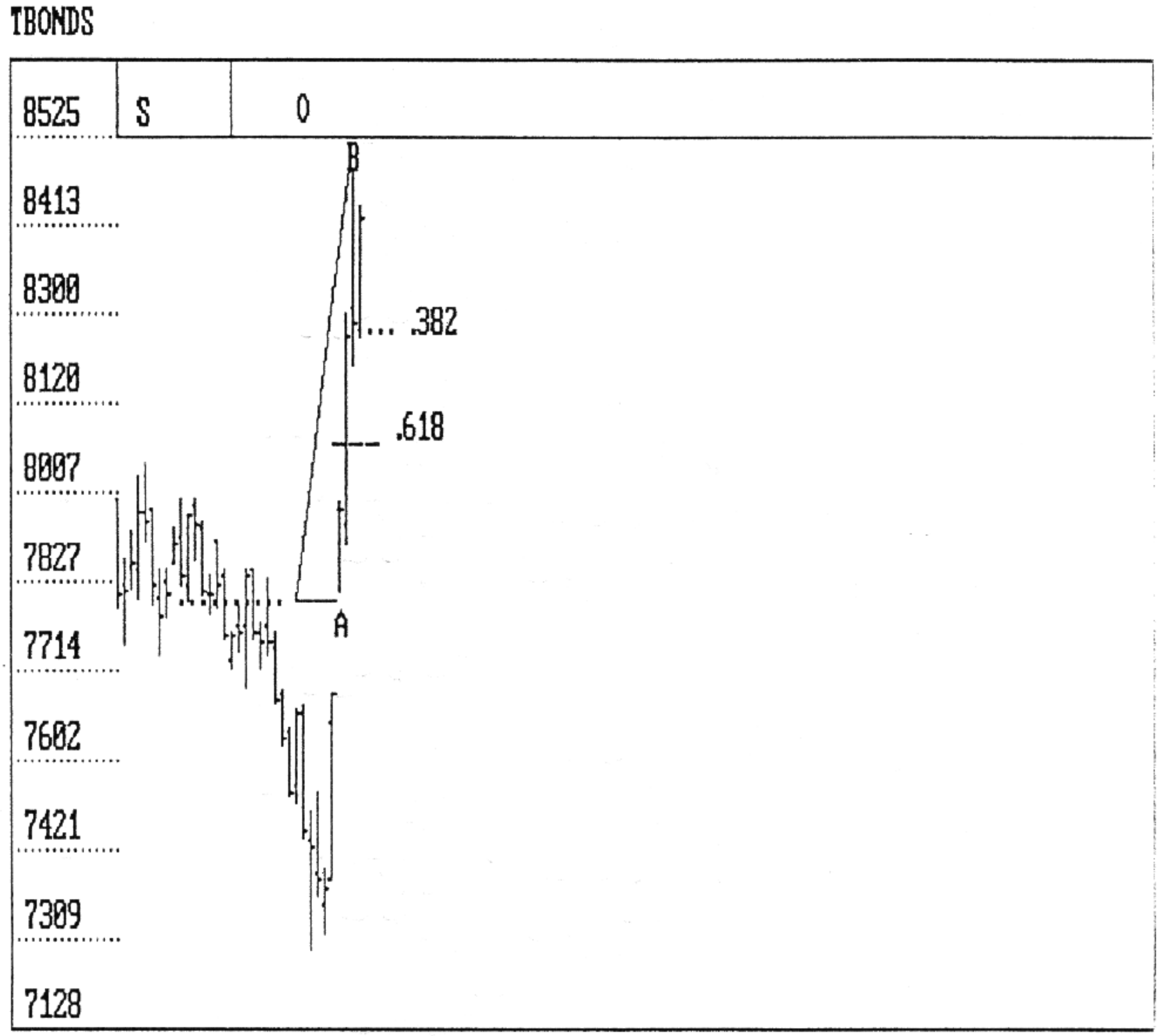

Figure 3 Sure enough, an event comes four days after my order was filled. Time will tell if this is the beginning of a congestion or otherwise. Just to be sure, I move my stop to a profit point that is just below a .618 retracement of the market swing that carried from point "A" on the chart to the latest market high. I also compute a .382 retracement of this swing in case the retracement only reaches to that point. Often a market will retrace somewhere between the .618 and the .382 points. If it does, that is fine with me because it shows a market that is doing what I might have expected it to do.

For point "A," I chose the top of the last gap. This is because it represents a point that was approximately the middle of the prior congestion, and prices have supported there in the past.

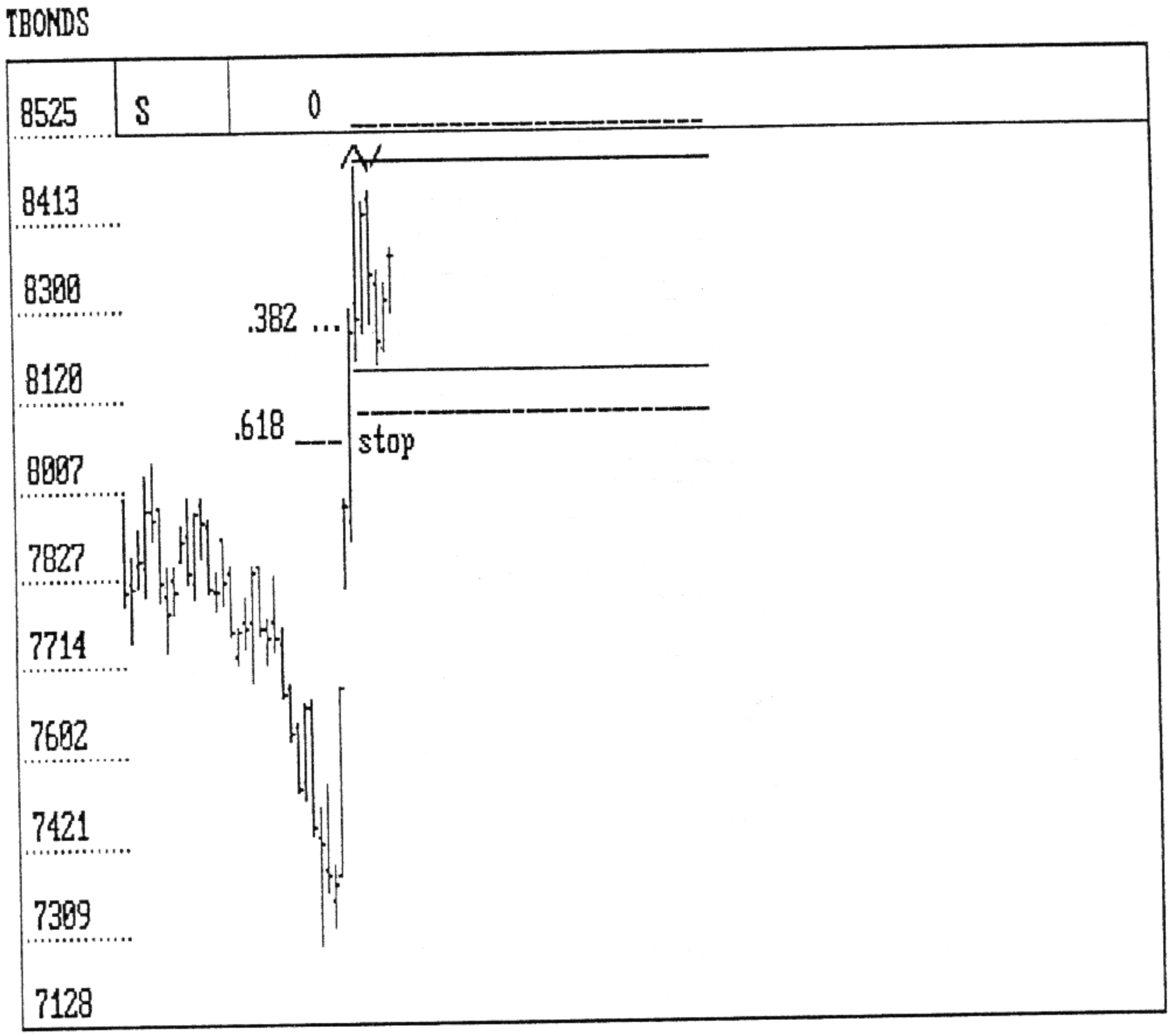

Figure 4 As expected, prices moved to just past a .382 retracement and then headed back up. I now have /\/ on the chart in front of me based on the original leg up /, a leg down \, and another leg up /, so I compute and draw the envelope. I will not use the envelope yet because the trading range is not yet 21+ days old, but I want to know where it is as a point of reference in case I need it. If prices breakout of the envelope then I will discard it in favor of a new one, or discard it entirely.

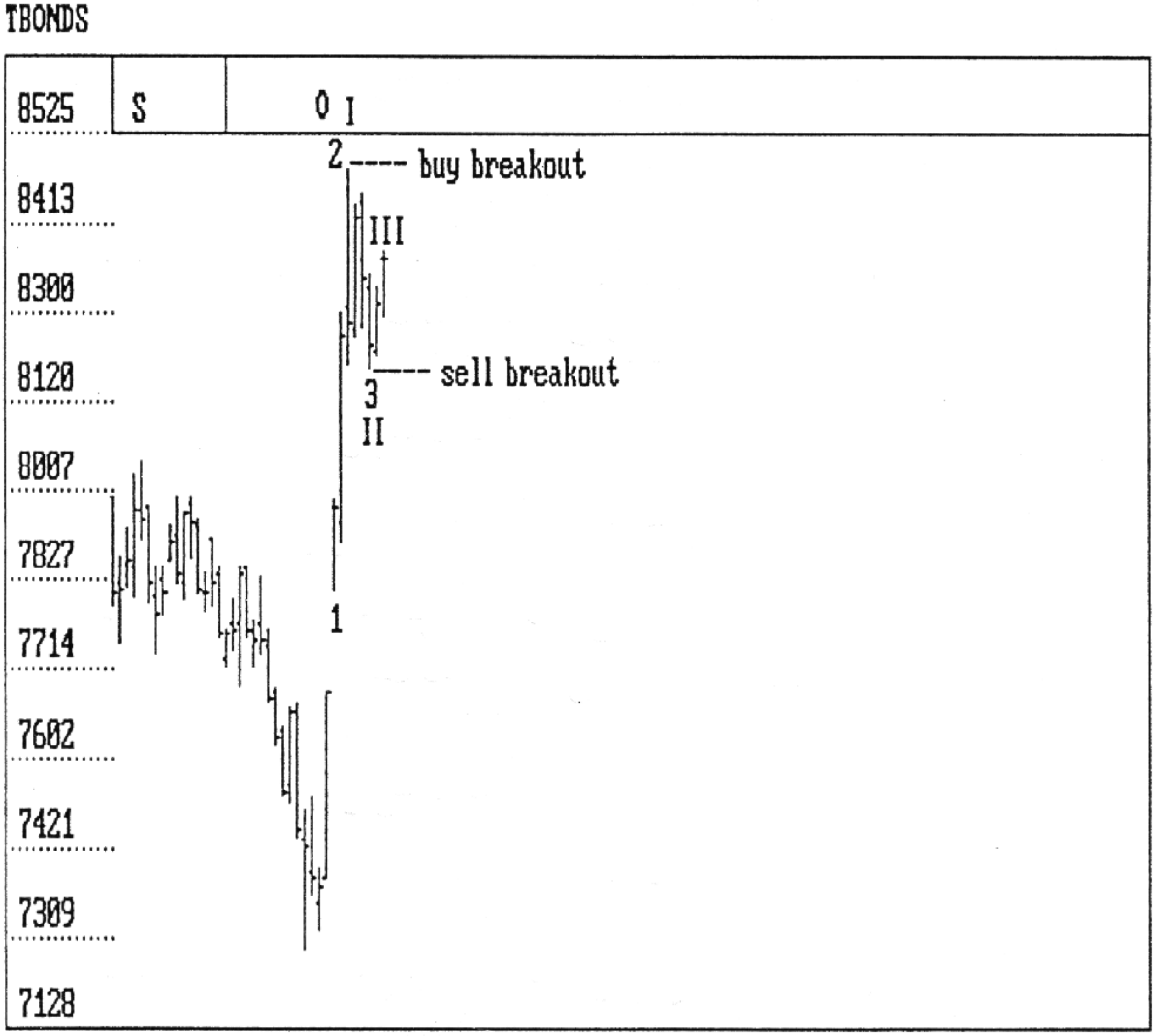

Figure 5 I also have a new opportunity to place both a buy and a sell order. A buy order would be based upon a breakout of the 1-2-3 low, and a sell order would be based upon a breakout of the I-II-III high shown on the chart.

For the present, I will label this formation as having a 1-2-3 low. It's okay to mark the #1 point at the top of the gap. The #1 point is there merely for reference. Later, when I describe how to trade a Ross hook, I will show similar formations with the focus on the #2 point, which is really a Ross hook.

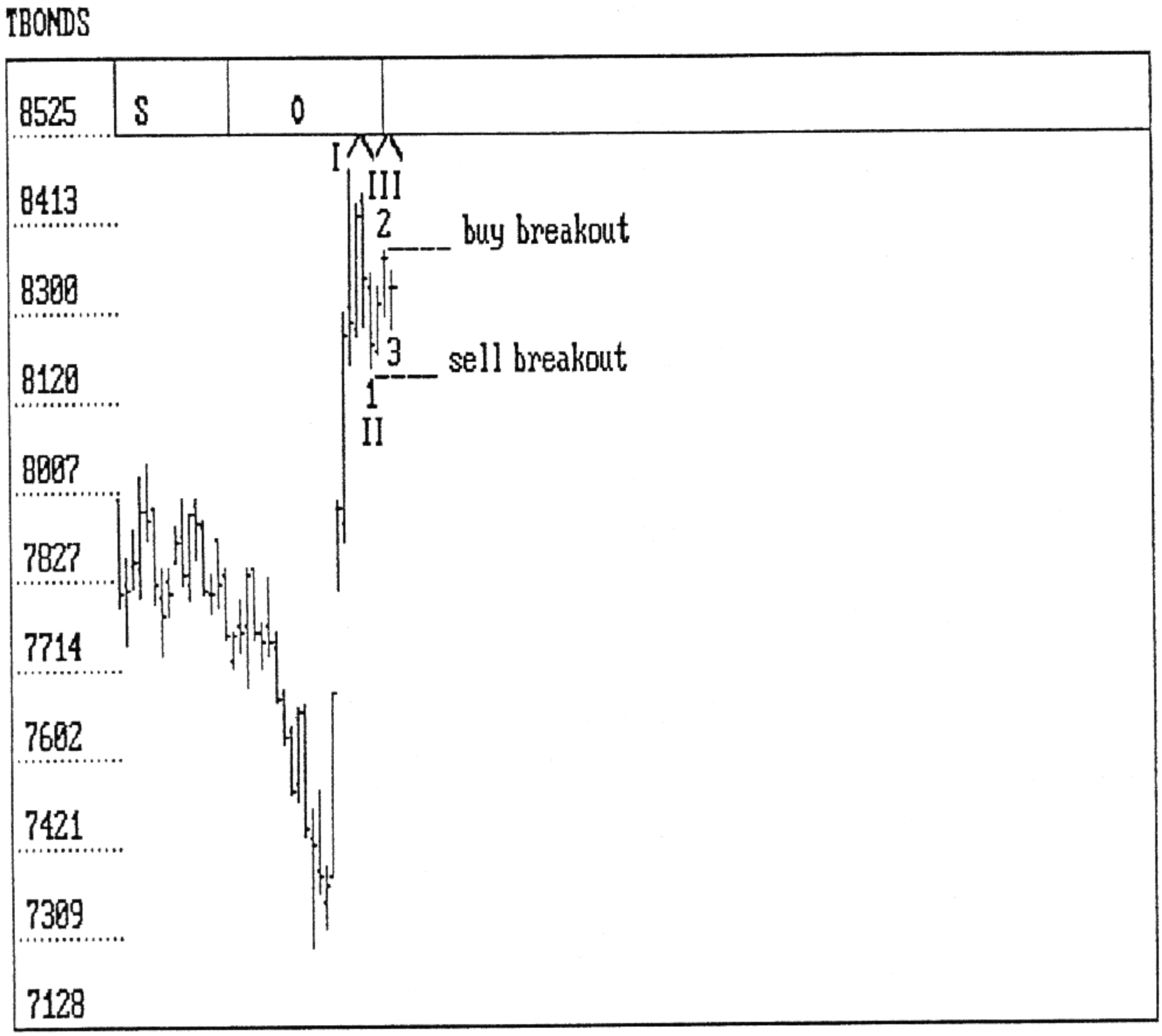

Figure 6 The following day, prices move down somewhat. I now have /\/\ staring at me on the chart. Prices are in congestion. I don't know if they'll stay there for 25 days, but until then I will be very cautious. The closer it gets to 25 days, the more significance the envelope will have.

However, I notice that I now have a new 1-2-3 that is much tighter than the old one, and which gives me a lower risk trade. This 1-2-3 was created by the low of the last leg down which gave me a new #1 point, the high of the last leg up which gave me the #2 point, and today's price action which has given me the #3 point.

TBONDS

Figure 7 Shows a breakout of a 1-2-3 low. I'm long where my buy stop was. My initial protective stop is one tick below the start of the leg up that resulted in the breakout, which is a new #3 point brought about by today's price action.

Since the #2 point is in congestion, a breakout may go only as far at the old #2 point. I must be careful to cover my costs and pull to breakeven as soon as possible after entering the trade. That way I will not be penalized if the breakout is false.

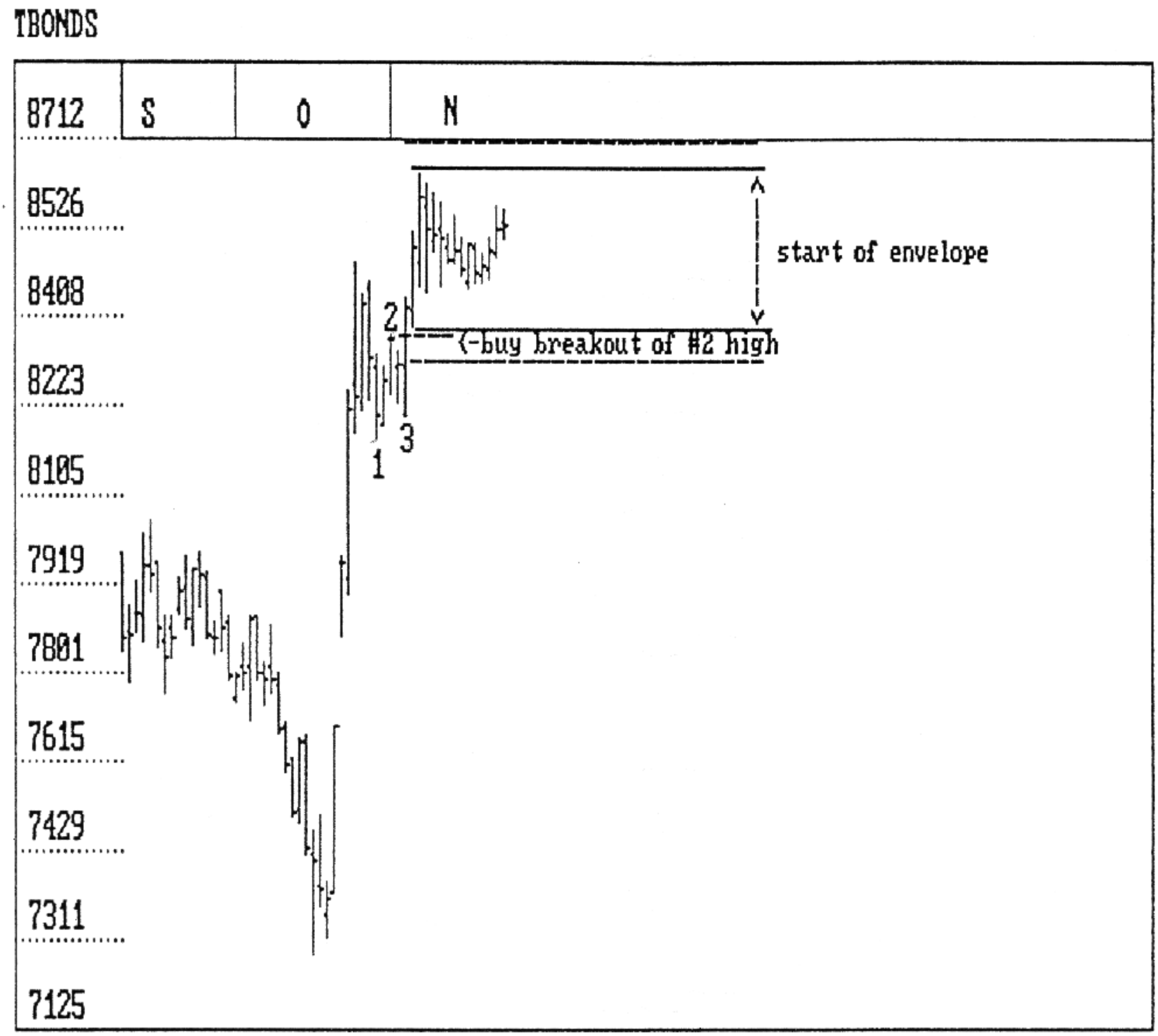

Figure 8 Prices advance for two days and the very next day prices drop back down again and for several days they flirt around with the area. I have numerous opportunities to extricate myself with a profit as prices stay mostly above my entry price.

I now have a new potential trading range. From the breakout of the previous very abbreviated congestion, there has been a gap up to the present congestion. I find myself looking at /\/ again, so I draw in the envelope lines. I start the envelope with the large magnitude day that had its closing price right in the middle of where all the congestion centered in the days that followed.

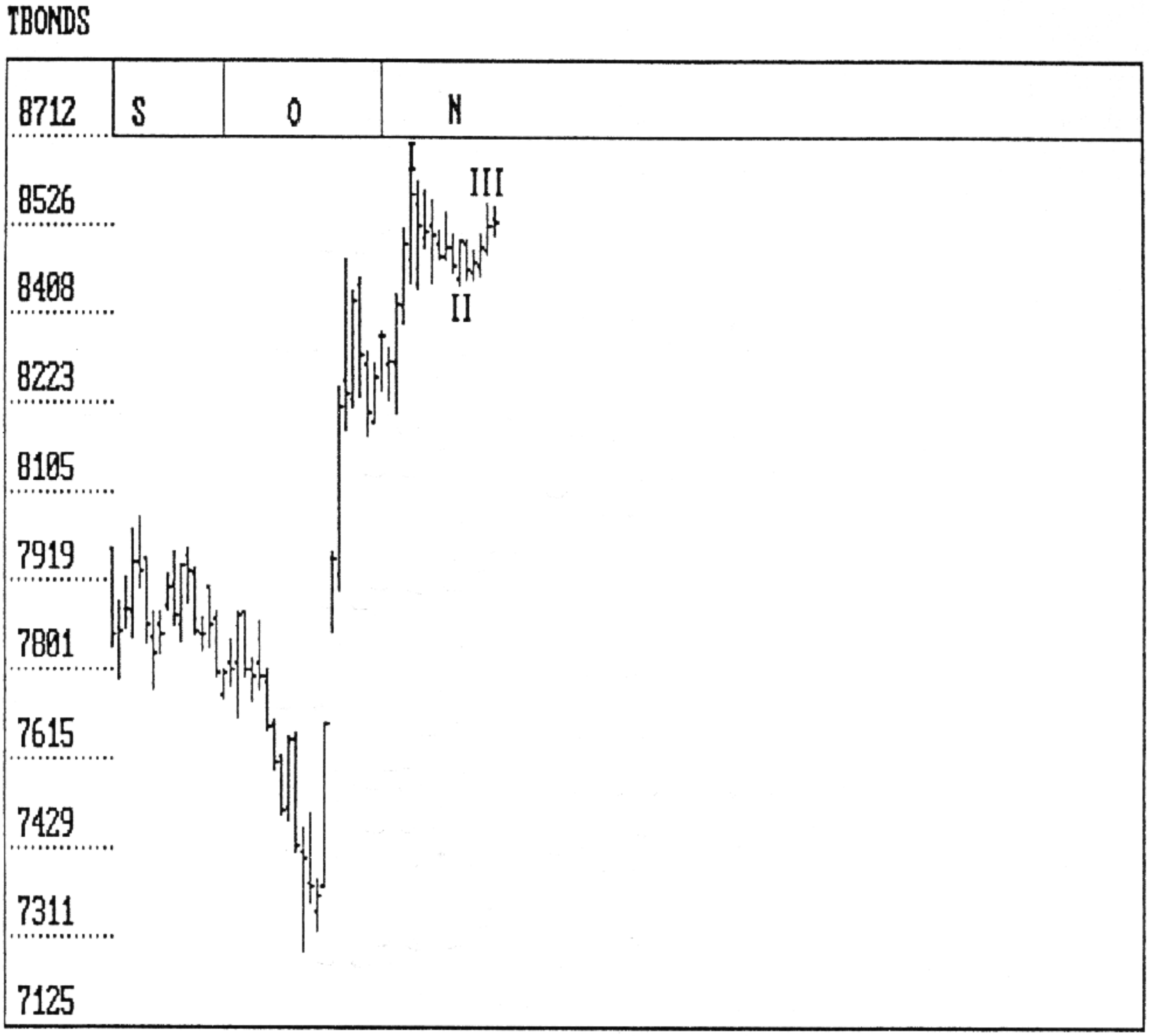

Figure 9 I also have a new opportunity with a I-II-III high. If prices break below the number II point, I will go short on a sell stop. In the meantime, I had exited the trade due to a lack of follow-through to the upside. The market has gone into a congestive phase.

What we've seen here is the transition from a 1-2-3 low to a I-II-III high.

CHAPTER 5

The Offset Moving Average

So far I have shown the 1-2-3 low formation, and shown that the initial stop is placed just below the #3 point. The I-II-III high formation is the opposite in that the initial stop is placed just above the #III point. The initial stop is what I call a catastrophic stop. It offers some measure of protection while the trade develops. I want to move this stop closer, as soon as possible.

But what about the objective? Should I use some sort of projection to tell where the trade might go? I could, and sometimes do use the same sort of projection as shown for Gold in Part I of the manual. It is a 1.00 projection of the latest A,B,C swing (i.e., B - A + C = objective). But my own trading preference is to let the market take me out of the trade. That way my stop and my objective become one and the same thing.

Rather than try to predict the future, or where prices ought to go, I would rather use magnitude of move and gap alerts along with the /\/\ and \/\/ formations to determine when to get out. /\/\ and \/\/ tell me that the market is finished going my way for awhile. Until I see /\/\ or \/\/ I will not exit the trade, with one exception. I will exit when I see /\/\, \/\/, or when prices at the close penetrate a moving average that has been offset forward by "x" number of bars. Whichever occurs first will cause me to exit a market. In the case of Bonds, I used a 7 day MA offset by 5 days. To the extent that I use an offset MA for entering or exiting a trade, I will utilize curve fitting. This moving average is shown in Figure 10.

Uh-oh, I have said a bad thing. Curve fitting is wrong, right? No it's not! Curve fitting is right when it is used correctly, it's only wrong when it's used incorrectly. Incorrectly means using it blindly without rhyme or reason. Incorrectly means using it all the time and building a trading system around it. Incorrectly means making it a standard and then suffering the consequences of having to live with that standard.

A market can reasonably be expected to behave in the near future in a manner somewhat similar to the near past. I always fit the moving average to what would have been the optimum MA in the last couple of swing legs that have moved in the direction that the market now appears to be headed. If a 4 x 3 fits best I use that. If a 25 x 5 fits best I use that instead. I always reserve the right to change the number of bars in the MA and the offset, and to adjust it as I go along. This is difficult to do by hand, but it's quite easy with a computer.

The way I use it is to see which kind of MA best fits the market I'm in, in the recent past. I then set that as my initial MA. If the market then changes its angle of ascent or descent, I change the MA accordingly. That way I'm not stuck with an MA that blindly has to work all the time. I do not believe that there is a "holy" and perfect MA that will always work in all markets at all times. I do not believe that there is an optimum MA for all markets at all times. Markets change, and I want to change with them. Harmony is what I'm trying to achieve.

I am continually amazed at how some traders always buy or sell when two different MA's cross each other, or blindly buy or sell when price penetrates an MA in one direction or the other as though those actions constituted some immutable law that would then make a market go their way.

Offset Moving Average of the Close

A moving average is at best a lagging indicator because it always is computed on history. Unfortunately, all of the things that we can compute in trading are based upon what has already happened. No one I know has yet figured out what tomorrow's numbers will be. Yet it is possible for me to be forward-looking in my thinking. That is where the offset moving average comes into play. Although it is still a lagging indicator, it is forward-looking.

Per comodità

For the sake of ease, I will compute a three-day moving average and offset it three days in time. Here is how I compute it, and it is quite simple:

```
Day 1 Closing price = 453.20  |  Moving average = 0
Day 2 Closing price = 450.80  |  Moving average = 0
Day 3 Closing price = 445.80  |  Moving average = 0
  .                                   .
  .    Total          = 1349.80        .
  .    Divide by 3    = 1349.90 /3 = 449.97.
  .                                   .
Day 6 Closing price = XXX.XX  |  Moving average = 449.97
```

An offset moving average has a number of benefits over that of a non-offset moving average.

- The main benefit is that it does a better job of visual containment, and thereby protects against whipsaw actions. Buy and sell signals can be taken from price penetration, but only with great caution. Penetration should be treated as you would a gap, it is an alert. A double penetration of the moving average by the price is an especially strong signal of a failure. Another way it can be used is to take alert signals when a non-offset moving average crosses an offset moving average.

Finally, an offset moving average keeps me much closer to the price action than a non-offset moving average, because it is projected forward in time.

velocemente

I use the 3 day moving average offset 3 days when a market is moving steeply. If a close penetrates the moving average it is a signal of imminent change. If it then turns around and re-penetrates in the opposite direction, then an extra strong signal is given to trade in the direction of the close.

For trading the daily charts, I favor offsetting the MA by 5 days. This moving average gives excellent containment of prices enabling me to stay with the trend for a longer time without being prematurely stopped out. The number of days in the MA will be my curve fitting technique.

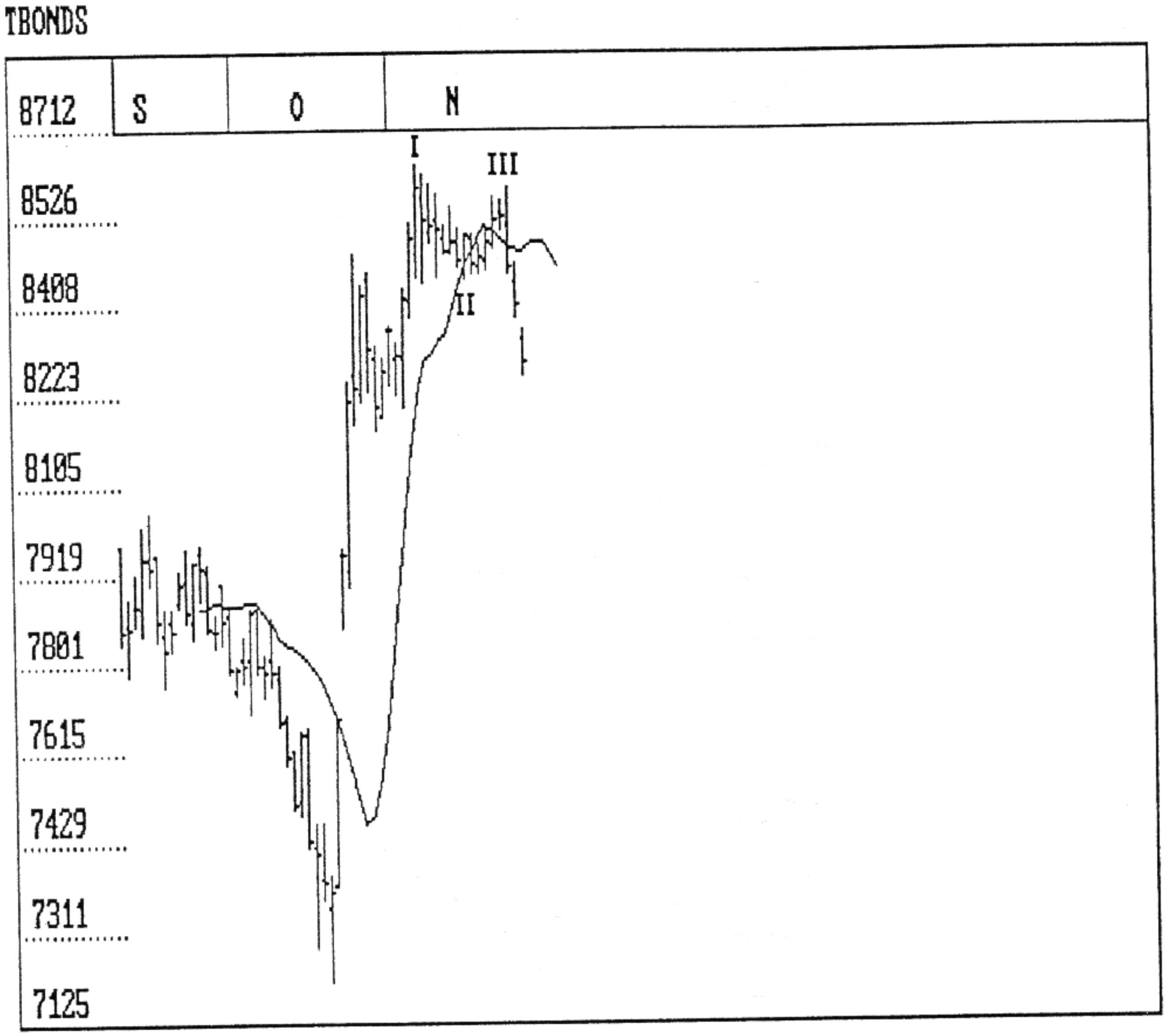
TBONDS
8712
S
O
N
8526
8408
8223
8105
7919
7801
7615
7429
7311
7125
I
II
III

Figure 10

Look at Figures 11a, 11b. The offset MA gave excellent visual containment of the price action, and the trades were able to be optimized by getting out of them when the close penetrated the MA. Looking back at Figure 10, it's possible to see that exiting the bond trade on a close under the MA would have gotten me out approximately where /\/\ got me out.

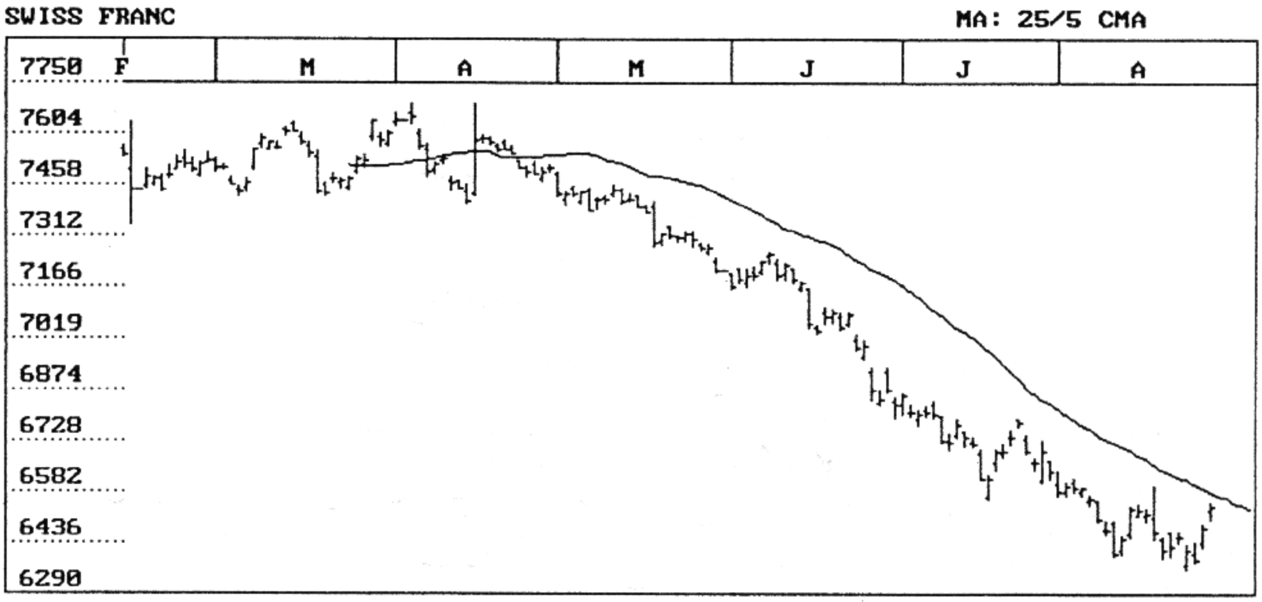

Figure 11a

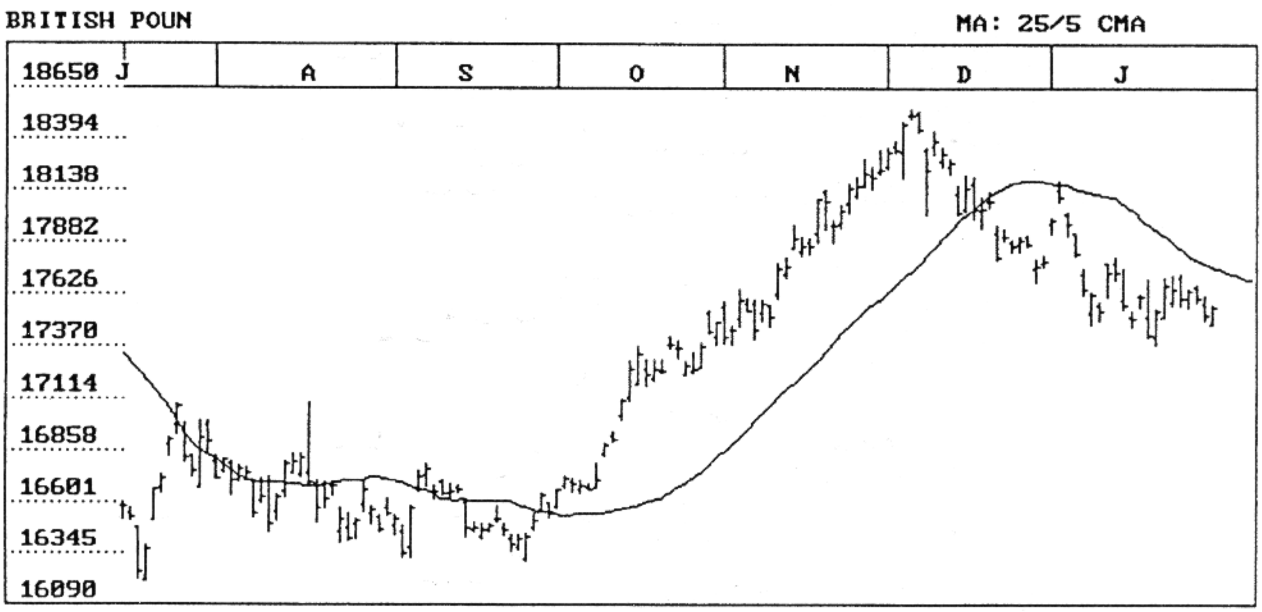

Figure 11b

Now, I want to get back to some serious trading.

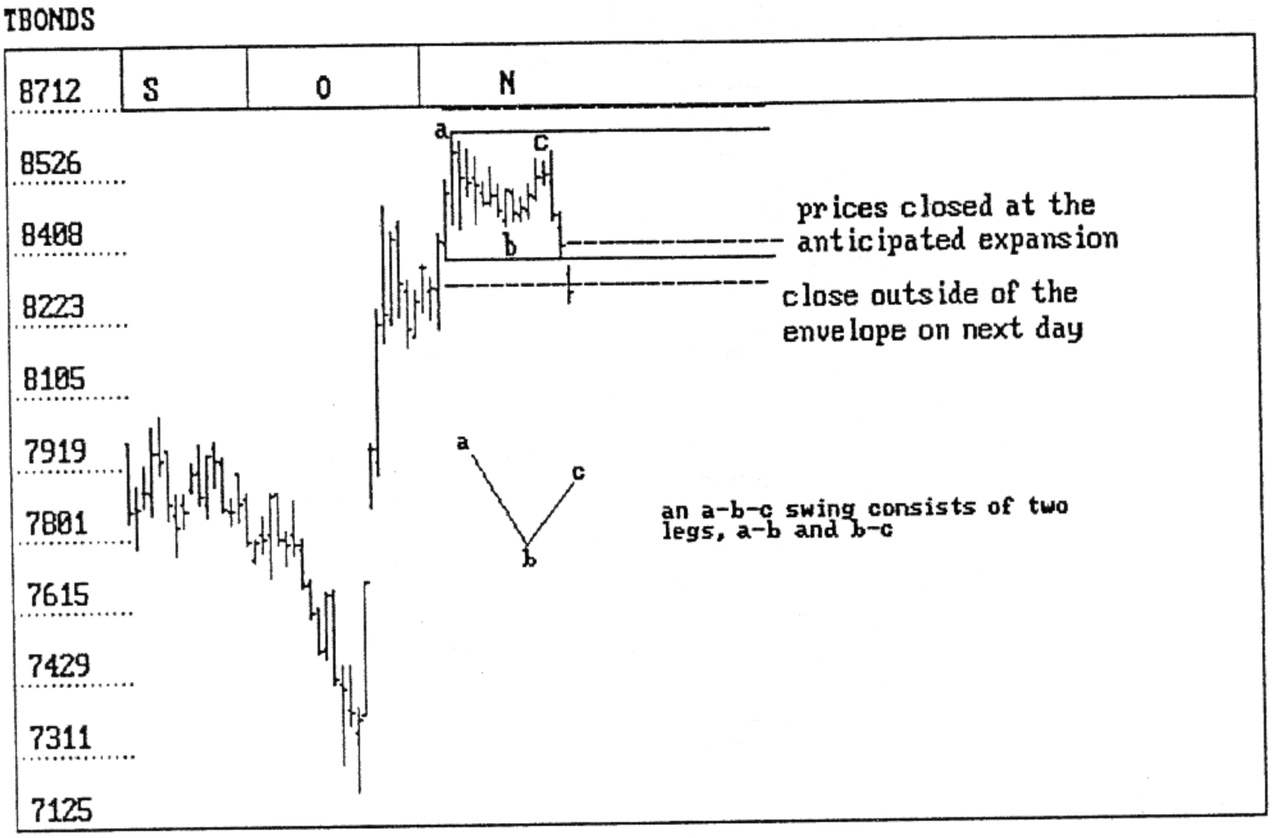

Figure 12 shows the breakout from the I-II-III high (labeled a-b-c for purposes of the next paragraph). My sell stop was at 84-24 which is one tick below the #II point. The next day prices move down, and my order is filled. It is also a penetration of the MA shown in Figure 10.

That penetration helps me to have the courage of my conviction for entering the trade.

The next day prices move on out of the envelope which further convinces me of the momentum behind this move. However, after two days of movement this explosive, I will be cautious with my stops. Why? Because some sort of retracement can be expected that will give a better opportunity to again enter this market to the short side.

When a market breaks from a congestion, I can expect it to move to a distance that is a 1.00 projection of the latest a,b,c swing [(b - a) + c]...remember the Gold trade in Part I. That swing is shown in Figure 12.

I 'm going to increase the chart sizes so that it's easier to see what I'm talking about as the trades progress.

What kind of a retracement am I looking for? Remember the Gold trade in Part I - I'm looking for a .382 or a .618 retracement of the a-b leg of the swing that carried the breakout, from the high of the leg to the low of the leg.

TBONDS

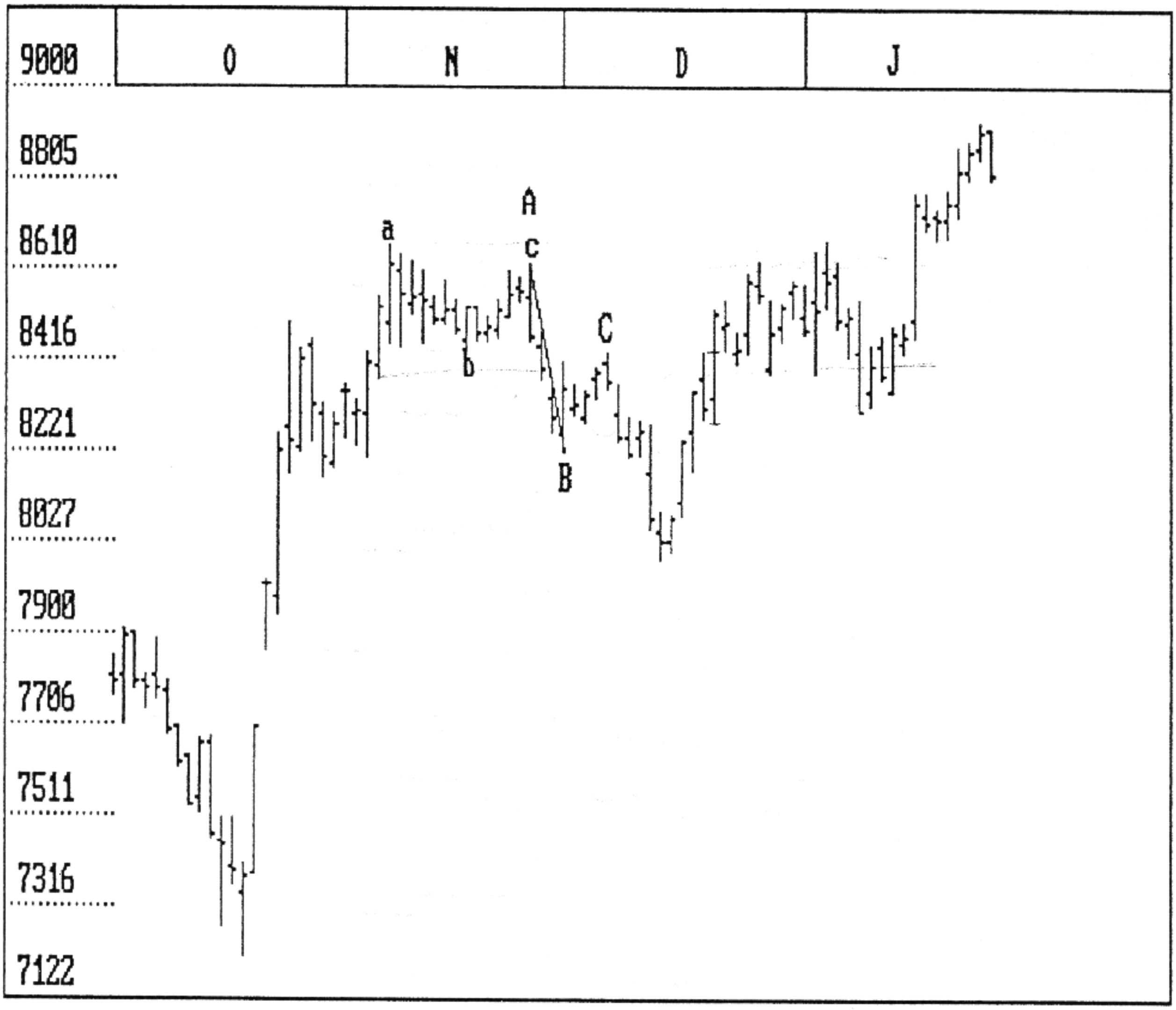

Figure 13 shows what this market did over the next couple of months. I have labeled each point in lower case letters. From A-B shows the last leg of the a,b,c breakout. C shows the retracement to exactly .382 of the ~~a-b~~ A-B leg.

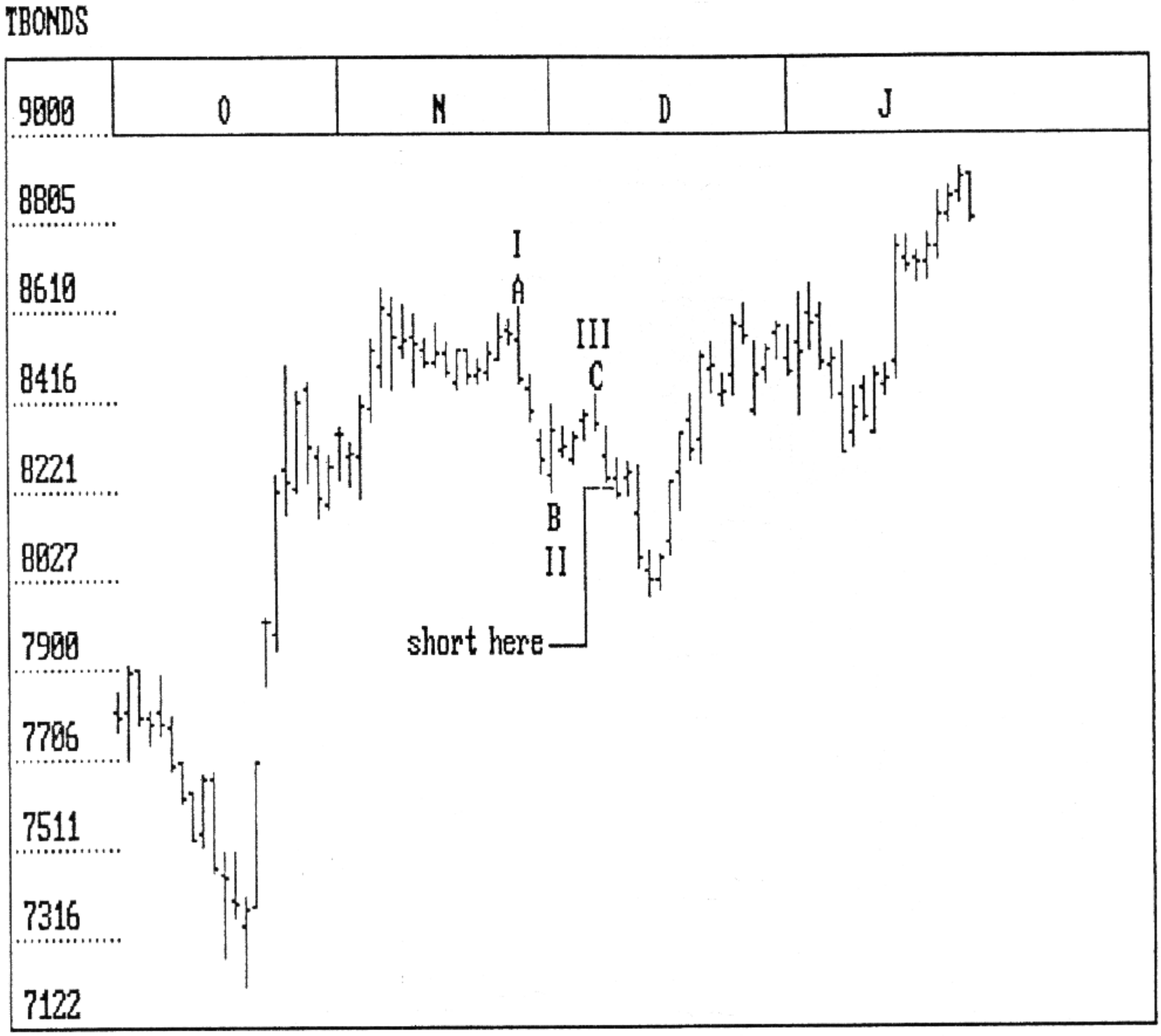

Figure 14 A-B-C is synonymous with a I-II-III high. I'm short another contract one tick below B in Figure 13. I'm now short three contracts: One from the I-II-III high of Figure 12; One from the breakout of the short-term envelope of Figure 12; One from the most recent I-II-III shown above.

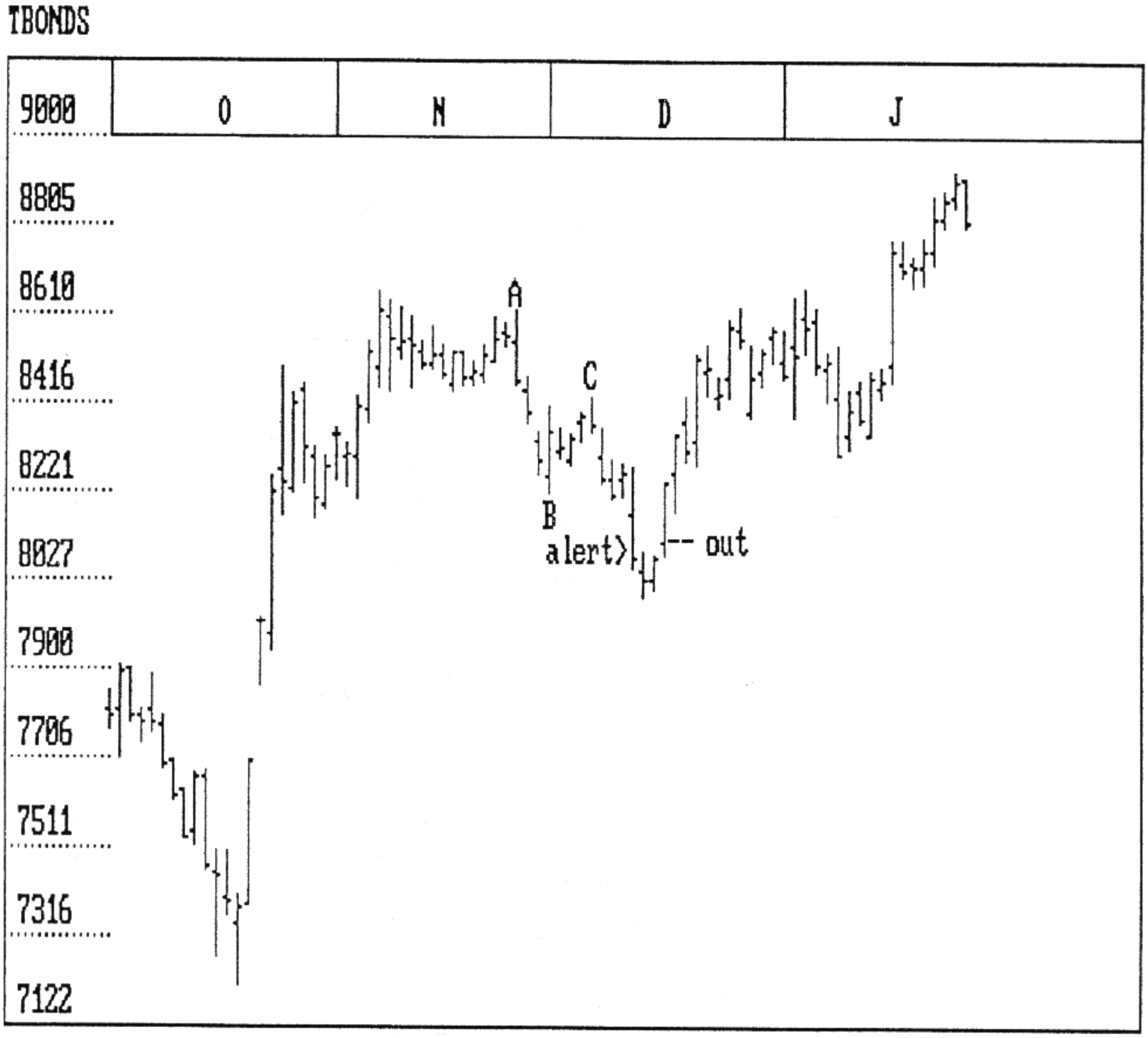

Figure 15 A large magnitude day gives me an alert to move my stops up tight, trailing them 1 day back until I am stopped out of all 3 trades as shown. I got my piece of the market, so I'm happy.

By large magnitude, I mean a day that has a trading range from high to low that is greater than the days immediately preceding it. In a sense, it is a matter of perception. It is a day that indicates much movement by price and therefore it gets my attention. When I see a day like that, I anticipate a reaction. At times, it portends a trend change. At other times, it affords a one day scalp in the direction opposite to the large day.

Figure 16 The 1-2-3 low causes me to go long 1 tick above #2, but with great caution because of the magnitude of the move that day. My initial stop is one tick below #3. The #3 point is created by the fact that prices moved lower than they were the previous day.

Clearly formed 1-2-3 patterns do not necessarily perform better, but are much easier to spot, and leave less doubt as to what they are. I anticipate a reaction to the breakout of the #2 point. Often a market will retest this point before continuing higher. On the daily chart, I prefer to see at least four bars making up the formation from 1-3.

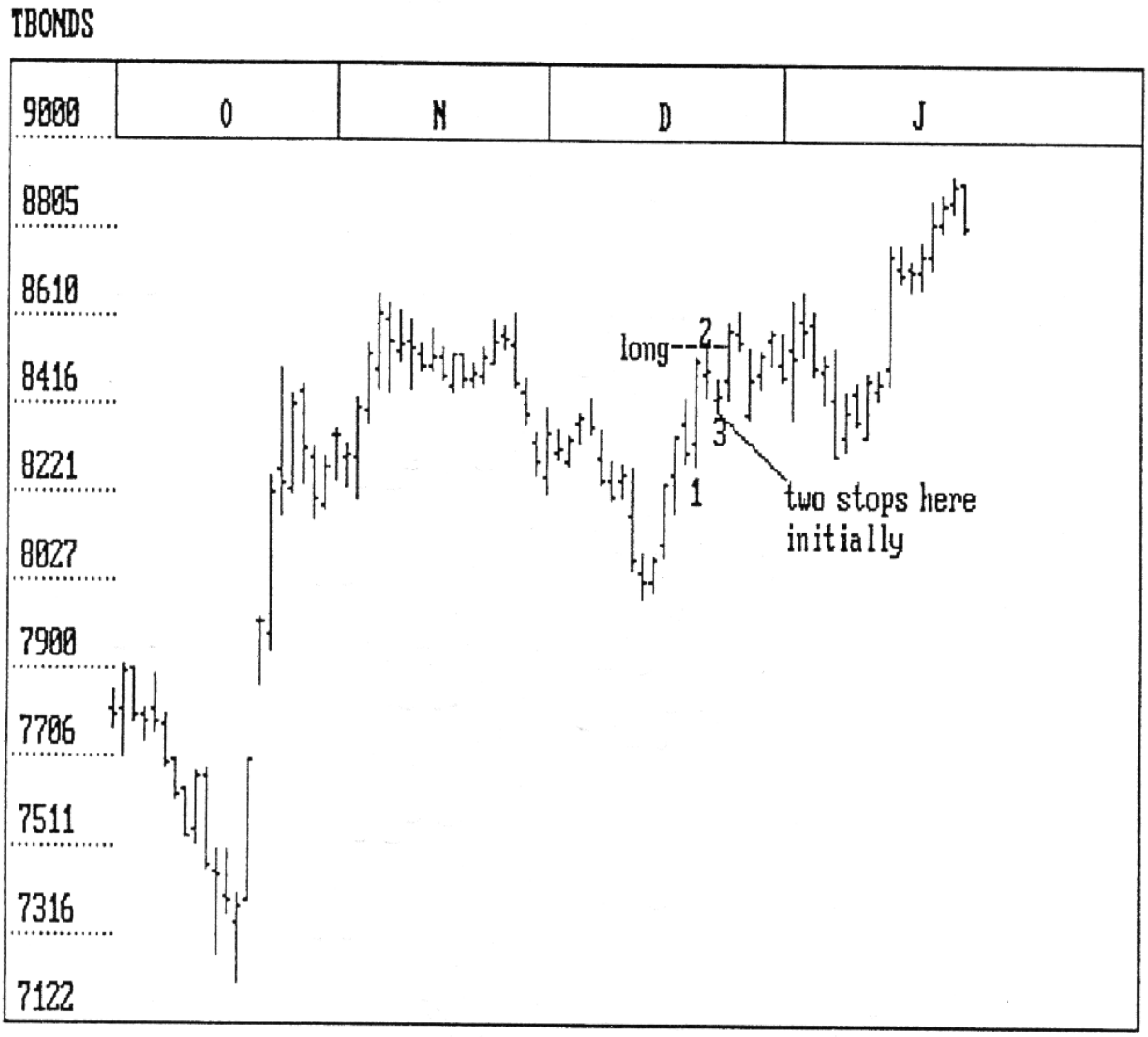

Figure 17 This leg gives me another 1-2-3 low and causes me to be long 1 tick above the #2 point with two stops now 1 tick below the #3 point.

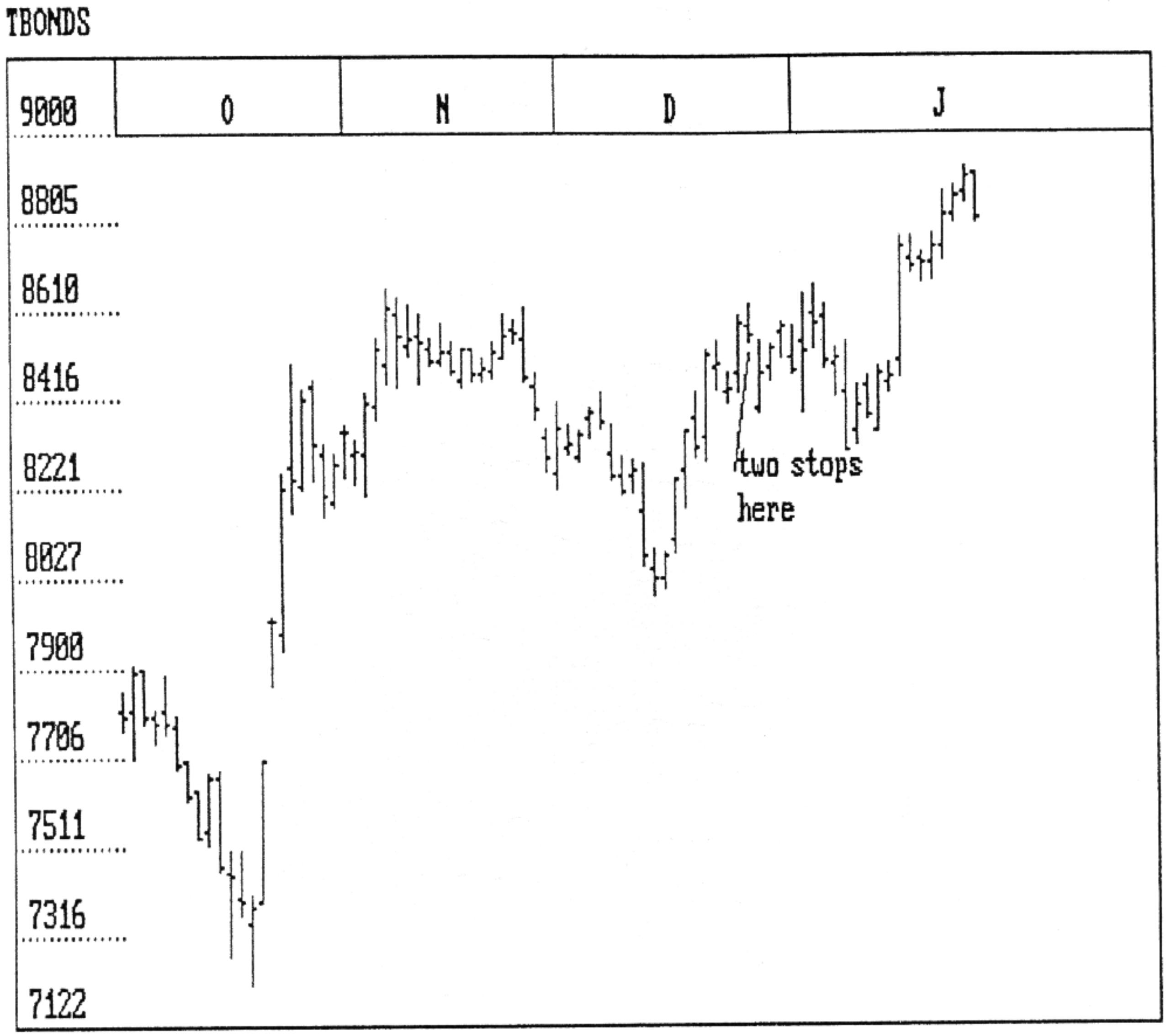

Figure 18 The large magnitude of the fill day, coupled with a lower close the next day causes me to move my stop up tight against the low, and I'm stopped out of both trades the following day on a large move down.

Figure 19 Another short leg up and a short leg down gives me /\/\ and the realization that this market is in a giant trading range between the initial large magnitude day that first brought prices to this level, to the present. I therefore draw a new envelope.

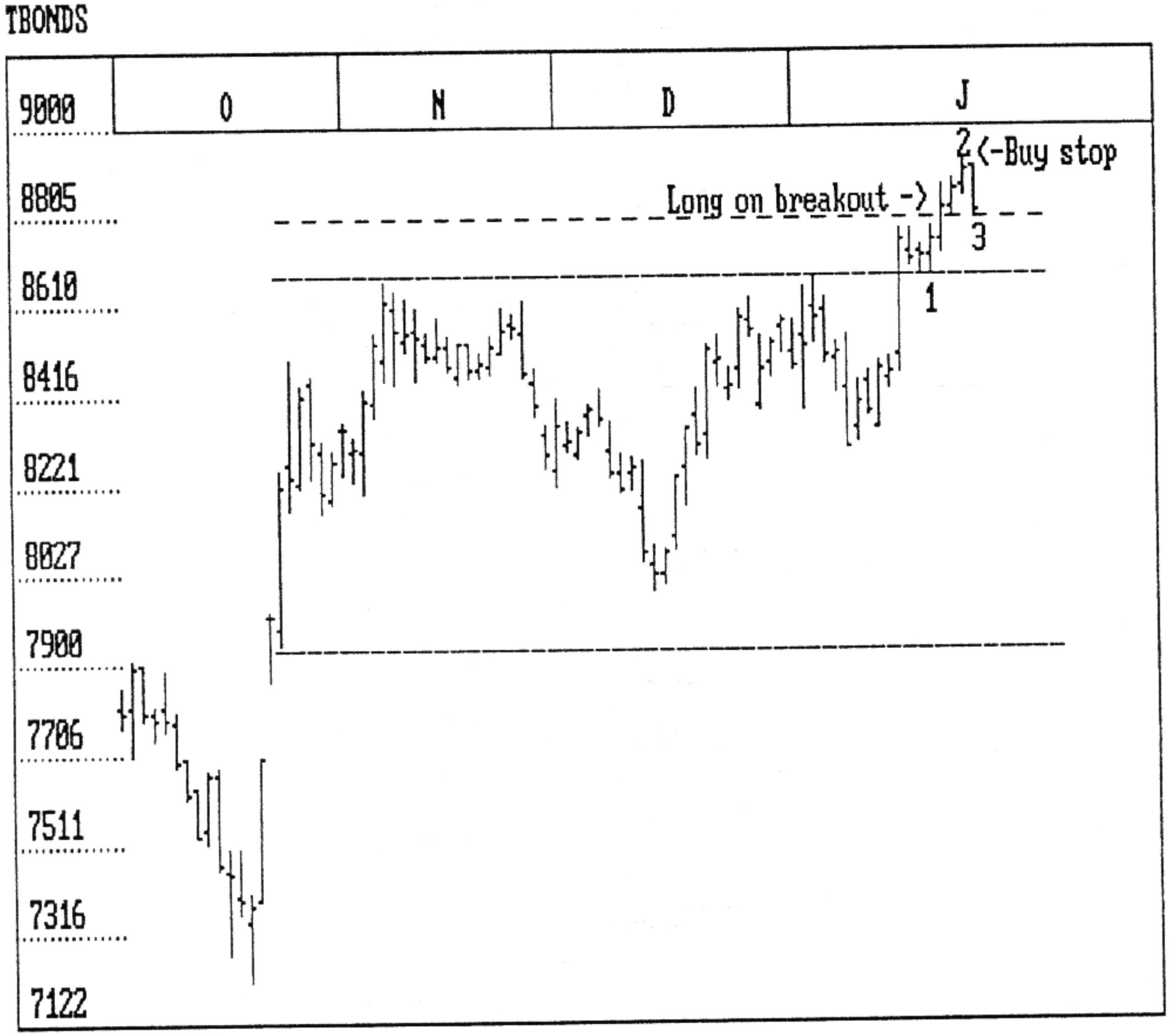

Figure 20 My next trade is to be long on the breakout of the envelope as shown.

Three days later, I am back in a 1-2-3 low situation, so I add to my position on a buy stop, 1 tick above the #2 point.

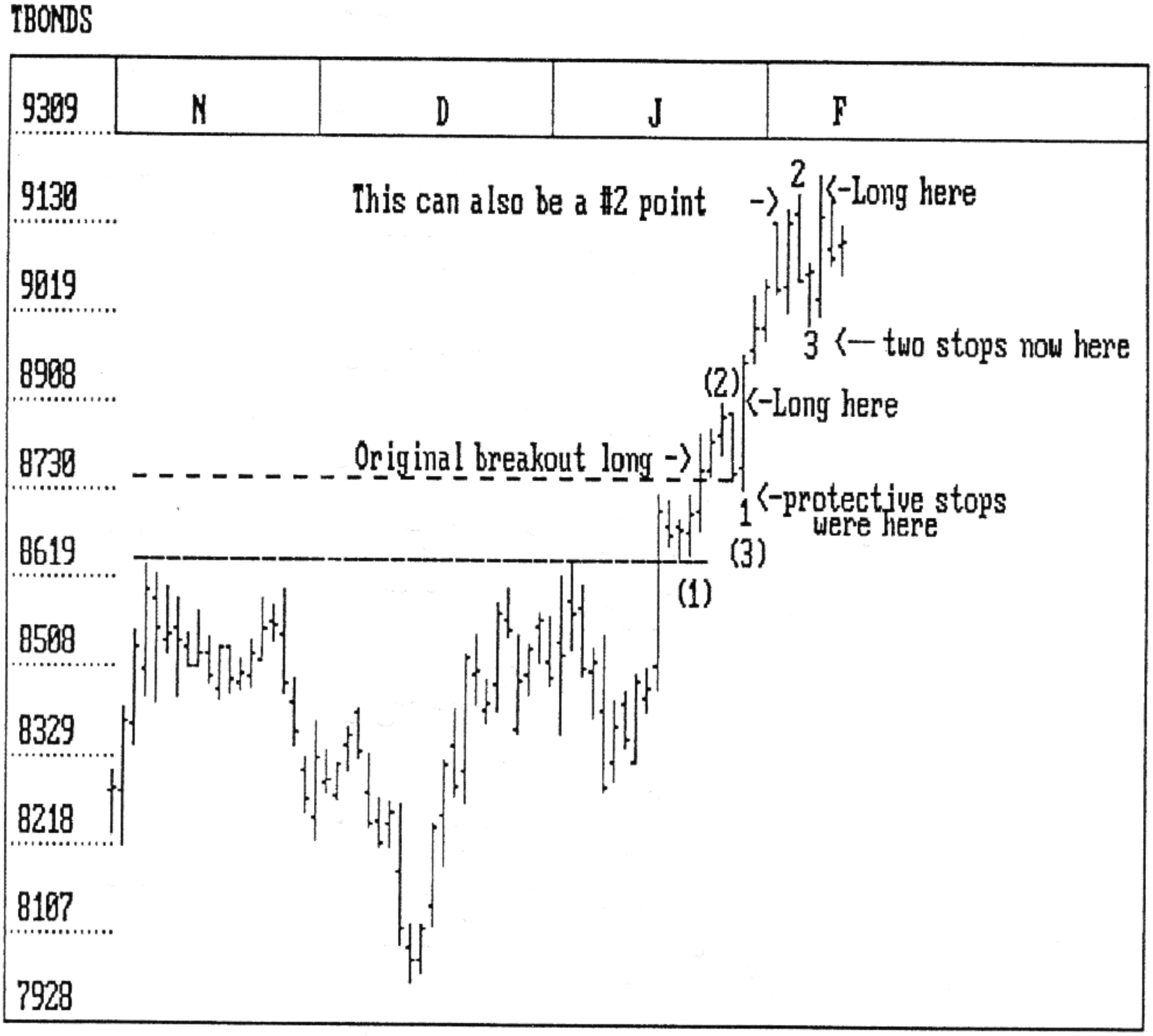

Figure 21 shows my next opportunity based on a 1-2-3 low. I want to be long on the breakout of the #2 point, with three stops 1 tick below the #3 point. I'm filled and immediately get in trouble.

Notice that the price bar before the #2 point also would have qualified as a #2 point, but I didn't notice it at the time. A #2 and a #3 point can occur on the same day if the day is an outside day. Also, #1 and #2 points can occur on the same day and for the same reasons. Unless there are at least four bars in the entire formation, I tend to leave it alone and wait for something more definitive. Very often, a larger, overall 1-2-3 will occur which encompasses and includes the smaller 1-2-3.

The point above labeled (2) is also a Ross hook. This concept will be covered later in the book.

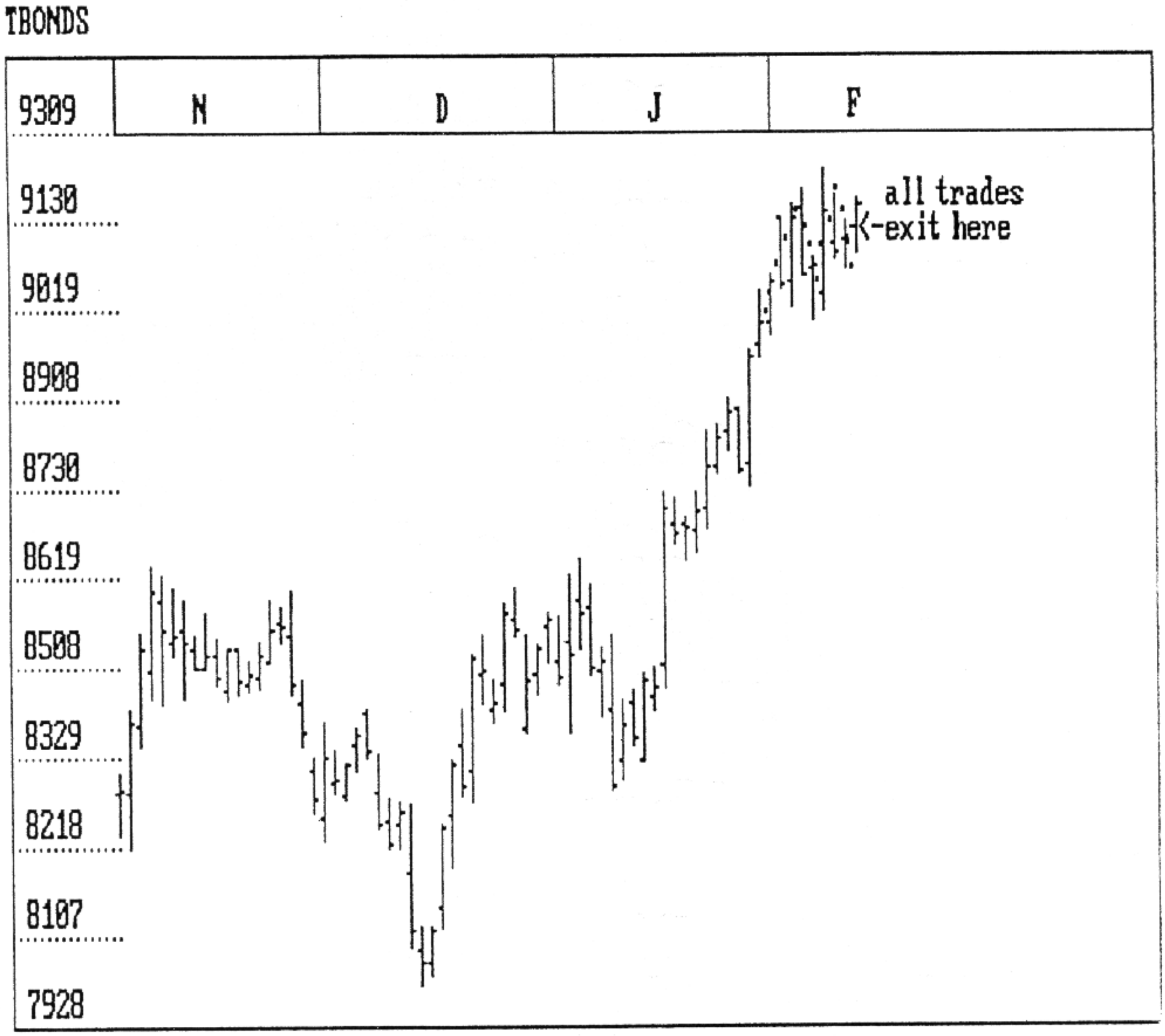

Figure 22 From the time I entered the last breakout prices corrected making me nervous. I wanted to protect profits from my two earlier entries and salvage what I coulc of my latest entry. The chart shows that the formation of an /\/\, was sufficient to get me out. By now it should be obvious what's coming next!

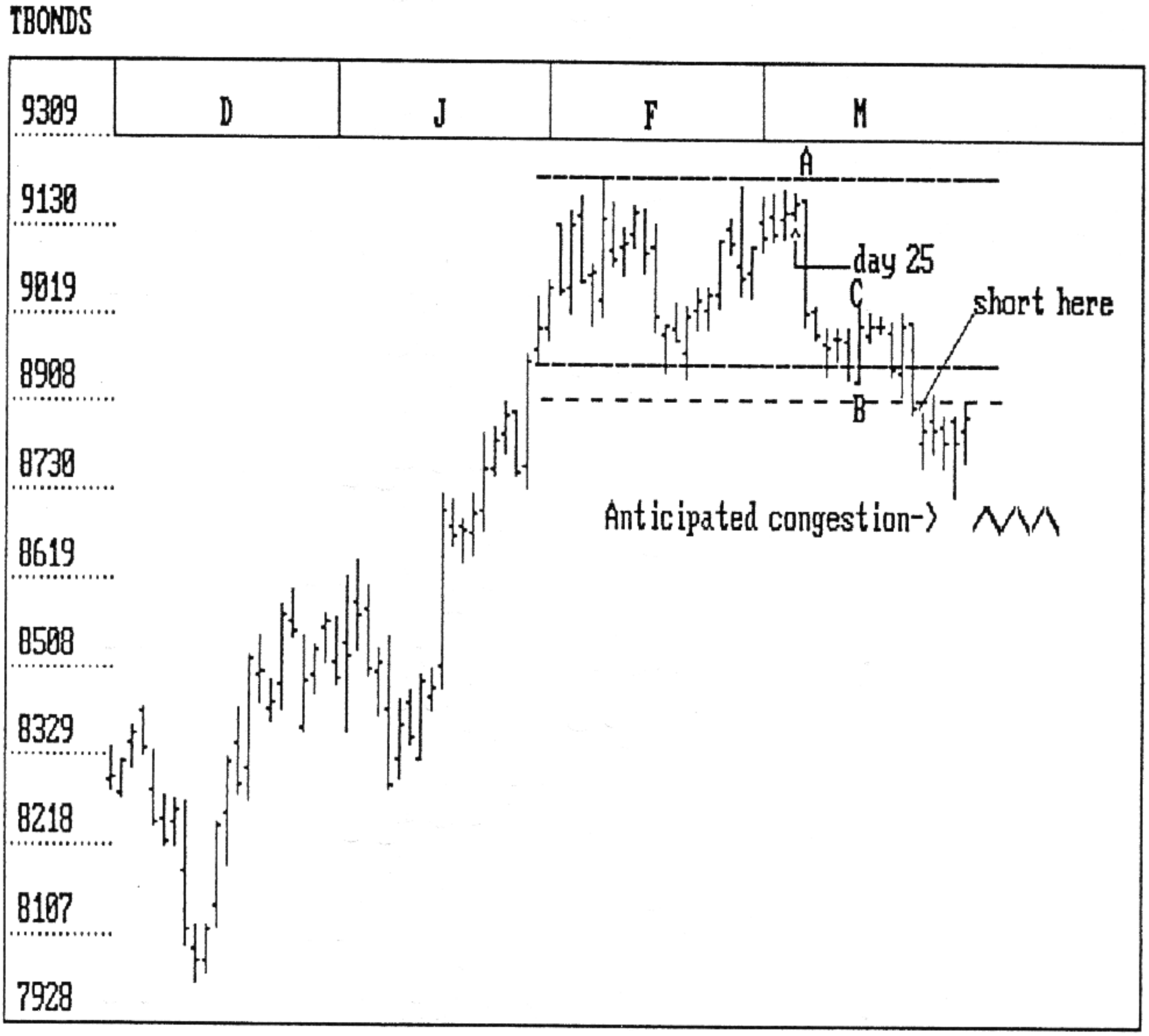

Figure 23 That's right, another trading range. I'm short at the close, on the day of the breakout. Computing the anticipated expansion [(B - A) + C], shows where it is most likely to fall. How to trade inside a range will be shown in Section V of the manual.

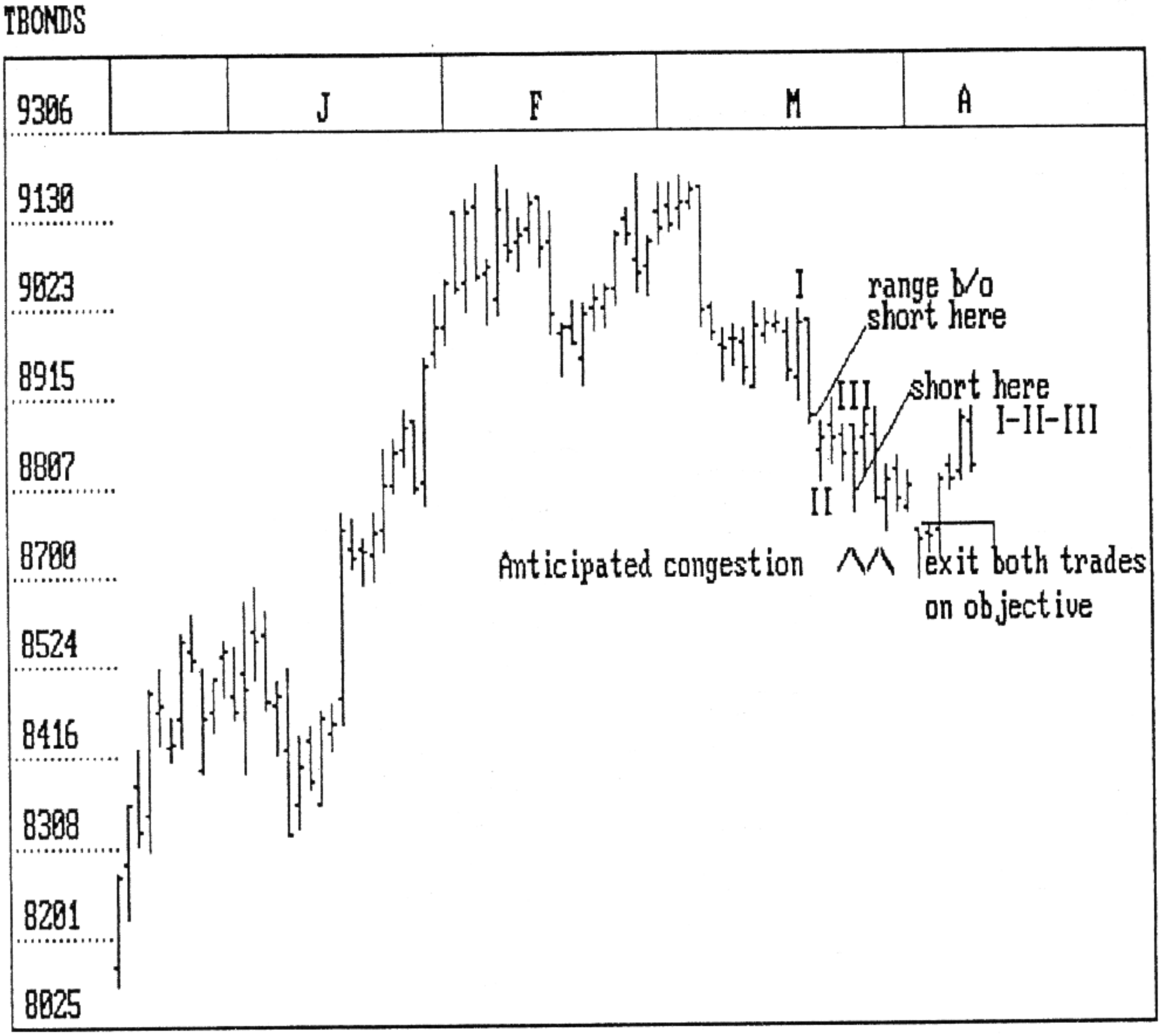

Figure 24 Shortly after the range breakout, there is also a breakout from a I-II-III high. I sell another contract and within a few days prices reach my expansion goal for this trade on a gap opening and I'm out of both positions because I now anticipate a correction.

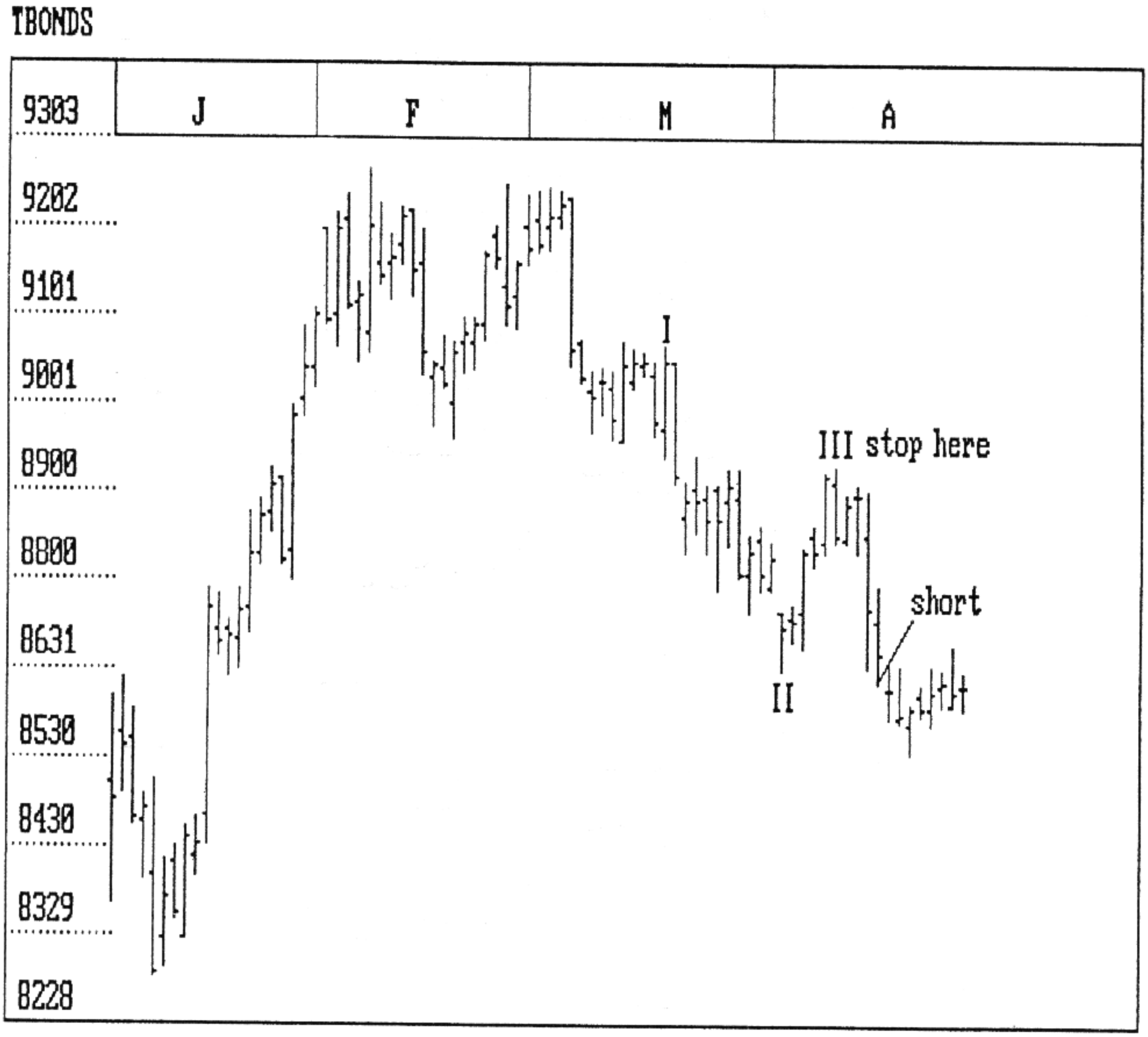

Figure 25 My next opportunity is from a I-II-III high and I'm short 1 tick below the low of the #II day. My stop is now 1 tick above the #III point.

Four days later the market is in congestion again.

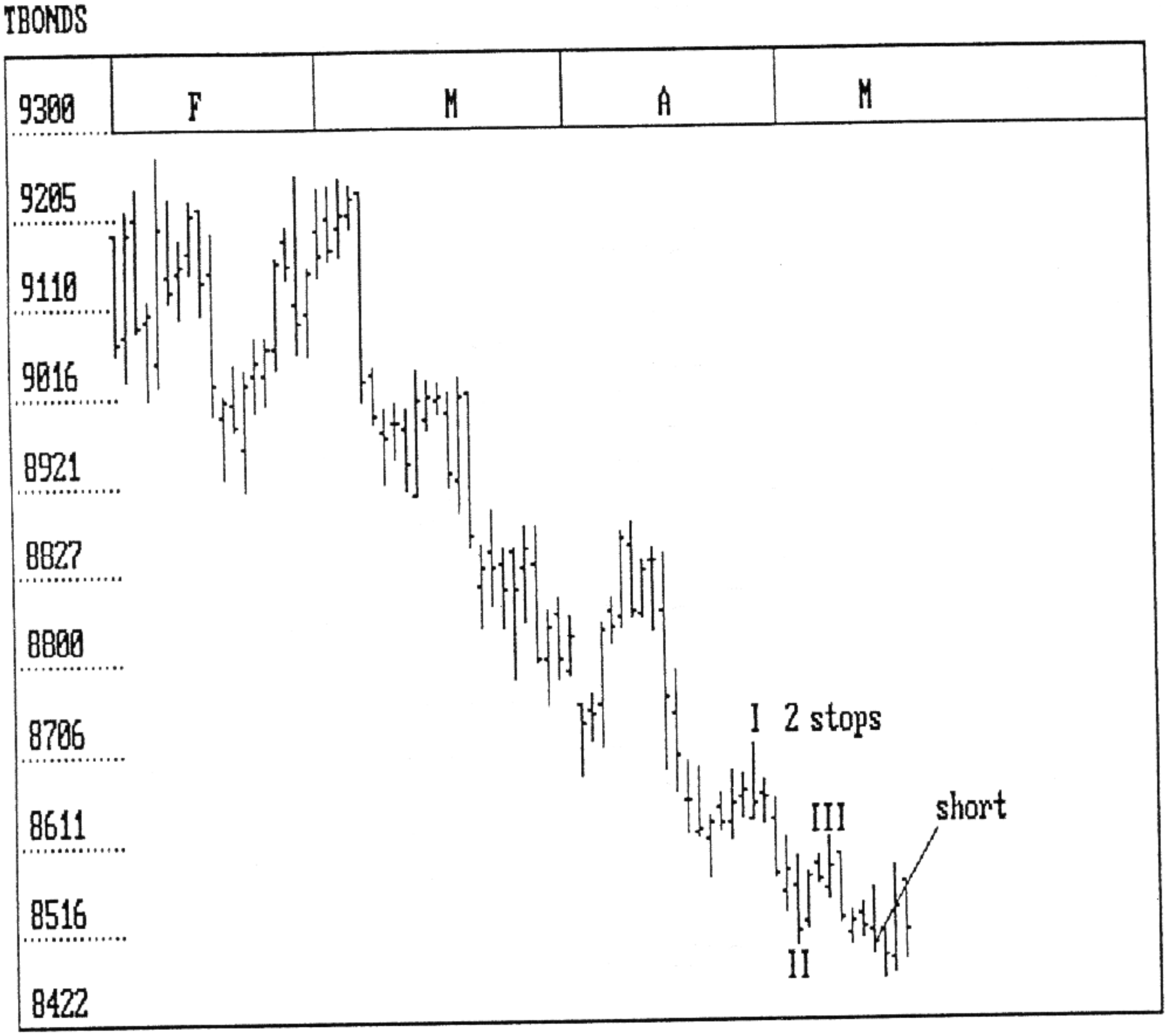

Figure 26 shows an opportunity to increase my position. I get another I-II-III high shown on the chart. I am short 1 tick below the #II and all Stops are now 1 tick above the #III point.

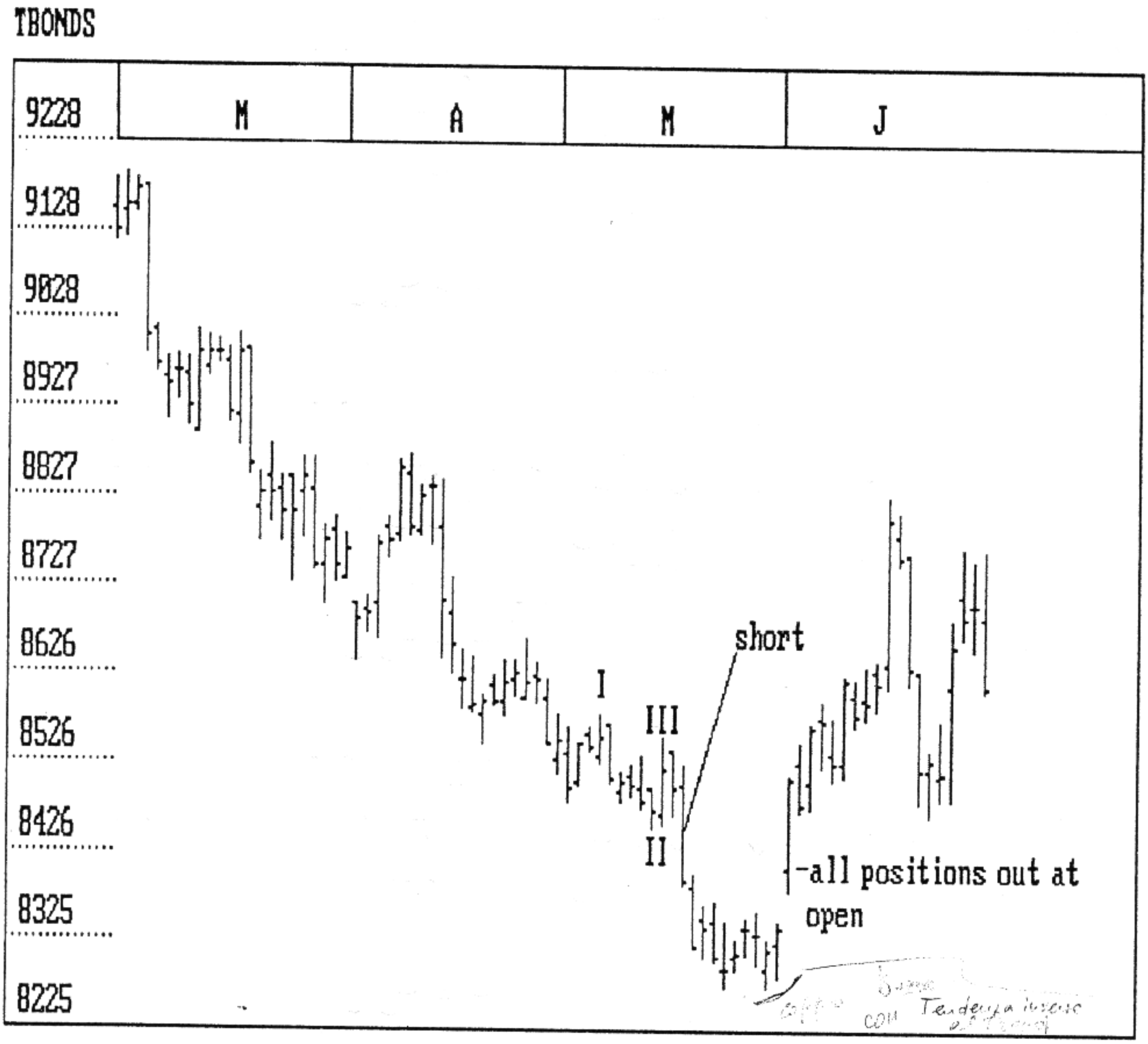

Figure 27 illustrates yet another opportunity from a I-II-III high. I'm short one tick below the #II point and all stops are placed 1 tick above the #III point.

The market takes a good drop on the day I go short, which is also an alert day, and then starts trading sideways.

The alert gap following the alert day convinces me to get out of the market as soon as possible. I exit just after the opening on the day of the gap.

The alert day is the one labeled "short." It has a relatively large magnitude. Following that there is a congestion area ending in a couple of reversal bars. The closes are higher than the opens two days in succession. These combined with the gap up are fairly convincing of a trend change.

An honest question arises here.

What percentage of the time does a large magnitude day alert to congestion or reversal as opposed to a launch day for an established trend? The answer is that I must look at what else is happening in conjunction with that large magnitude day, and its location relative to the other bars. If it is taking place in a trend, and the trend has not had a long life, with possibly one or two corrections, then the chances are 50-50 that following a correction, a new leg of the trend will follow.

If the large magnitude day occurs at what appears to be a beginning of a new trend, for instance, following an exhaustion gap of a previous long term trend, then the chances are the large magnitude day will be followed by a gap day in the same direction as the large magnitude day.

The most common occurrence that takes place is that large magnitude days are followed by a correcting day.

If the large magnitude day occurs in congestion, it may portend a breakout from the congestion. More often, it will be followed by some sort of correction.

There is no way to know for sure. The best strategy is to consider these large days as alerts, and then view what has taken place before, and when possible after, to see them in context.

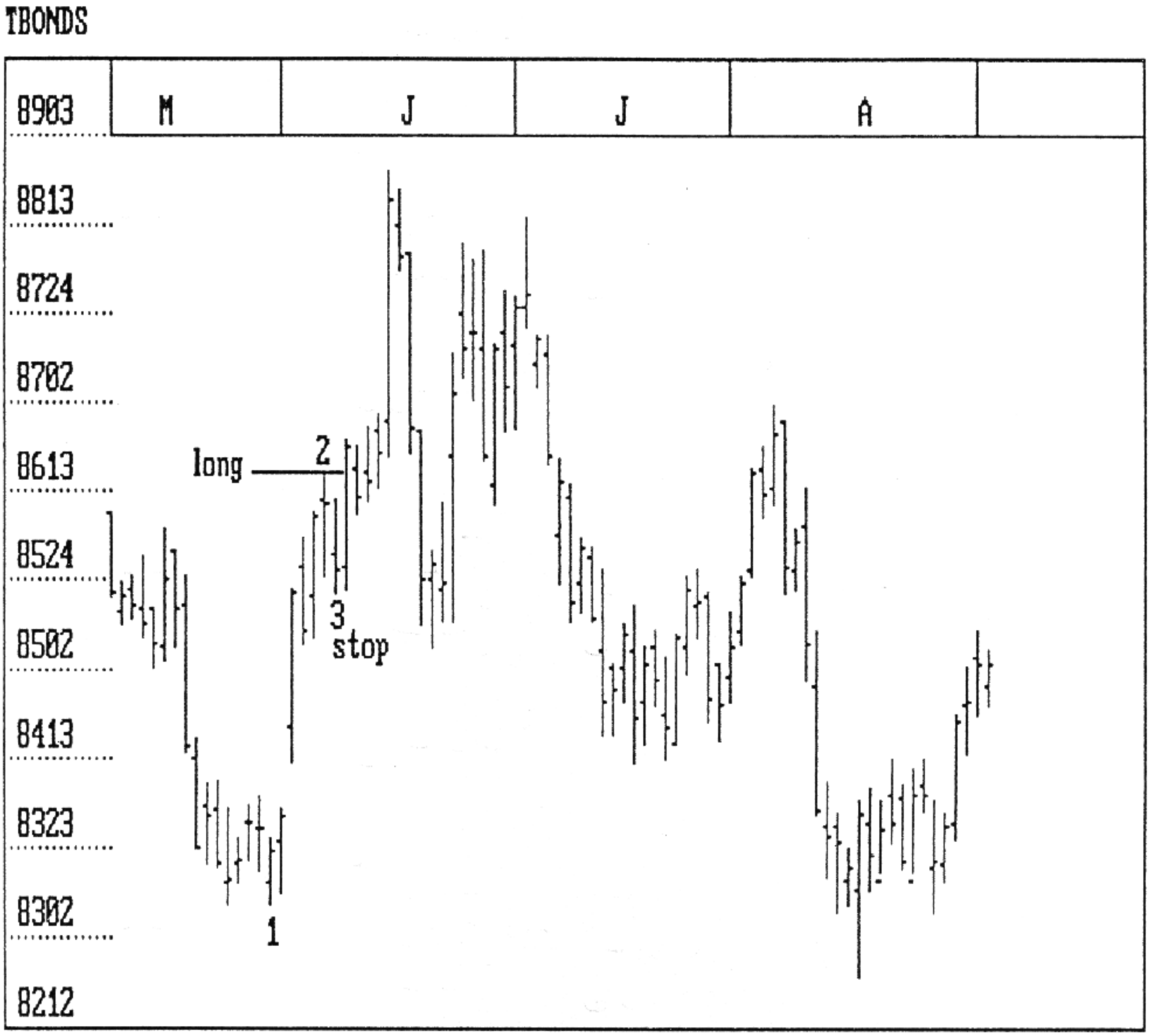

Figure 28 A few days later brings a 1-2-3 low. I am long at the breakout of the #2 point. My stop is 1 tick below the #3 point.

TBONDS

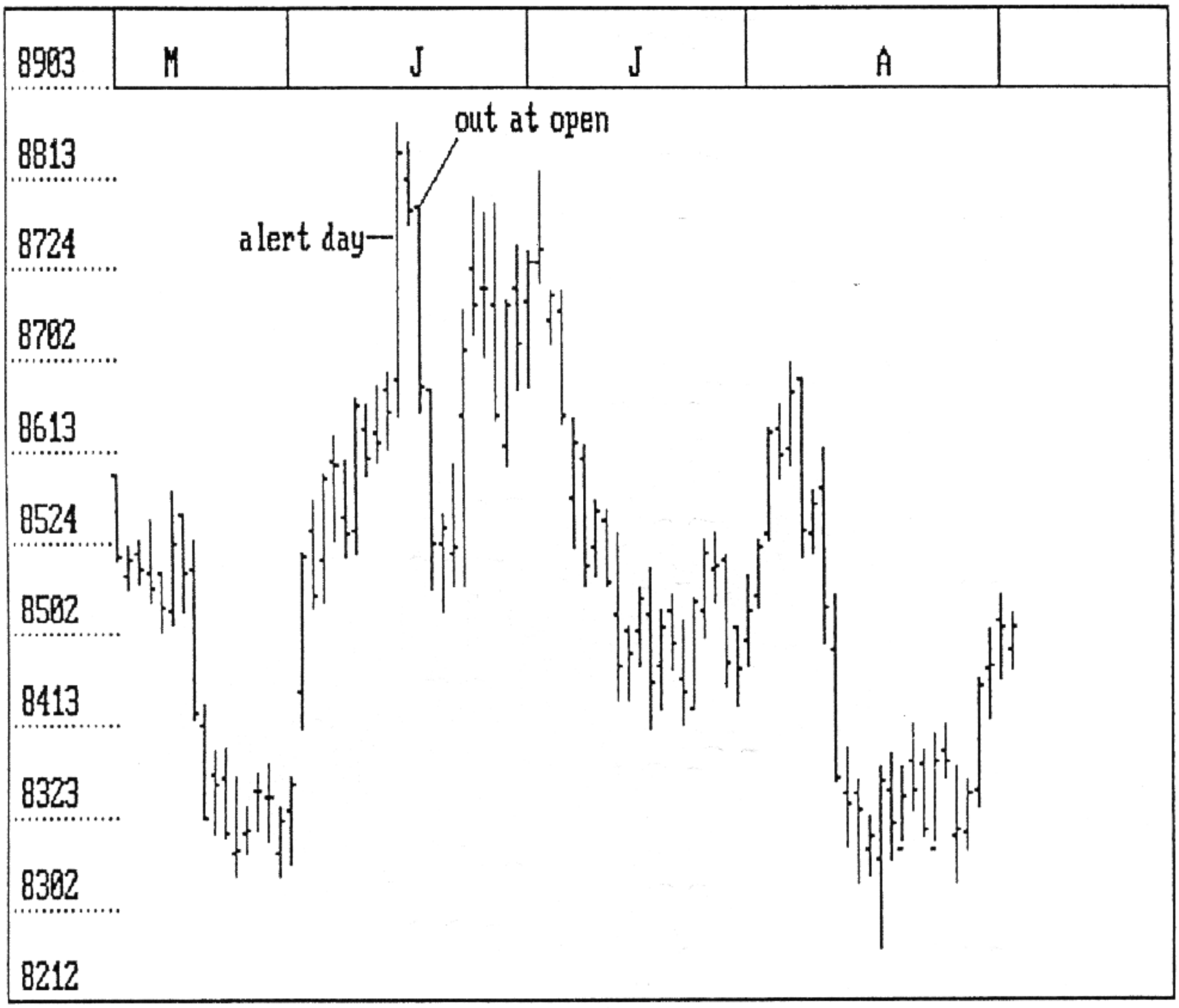

Figure 29 Four days later there is an alert day and the caution light is on. The next day there is an inside day with a narrow trading range. I exit just after the open the following day. I'm quite content with this kind of profit.

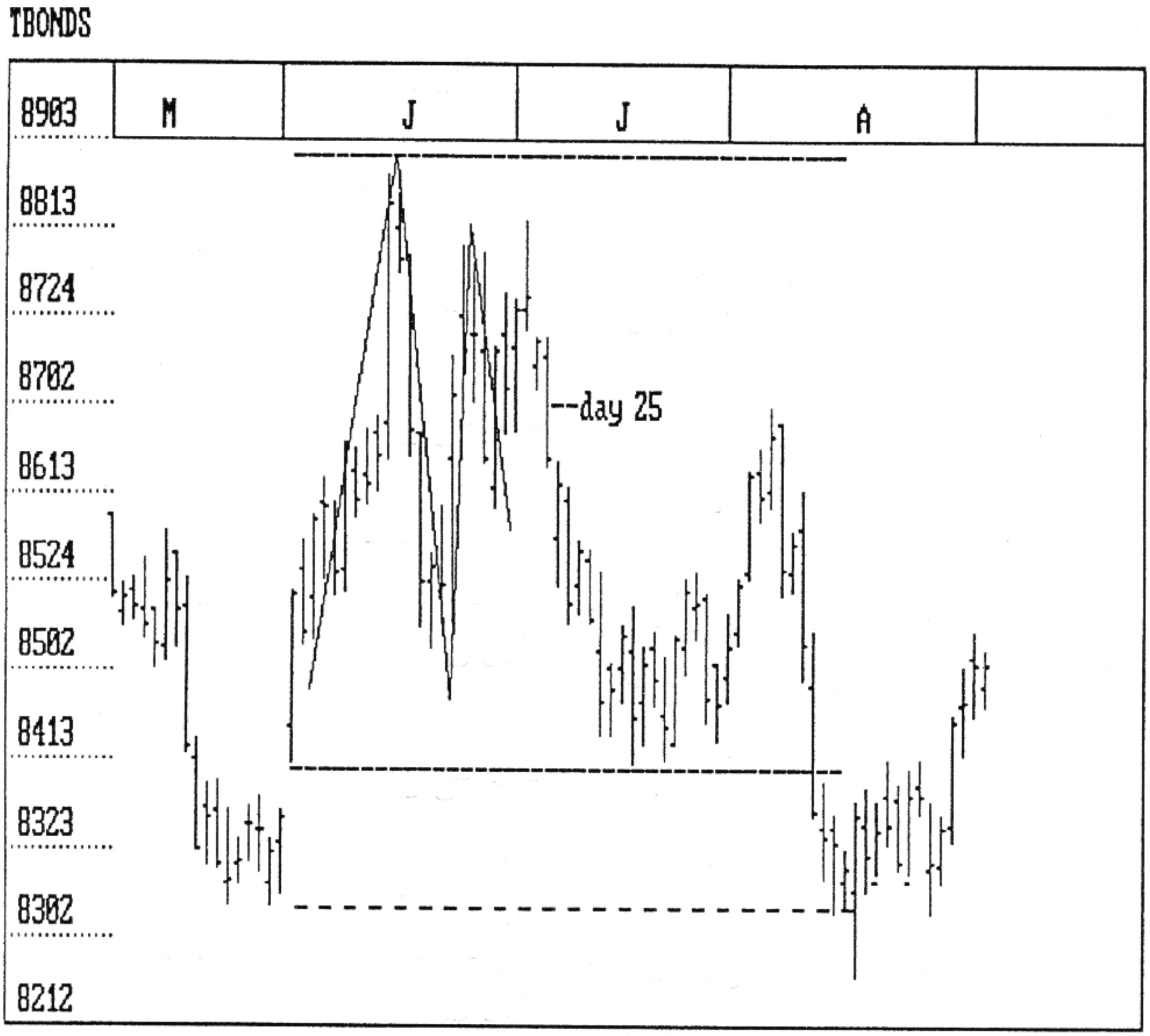

Figure 30 In 4 days I'm looking at /\/. On the sixth day I'm looking at /\/\. Guess what? Bonds are back in a trading range. I draw the envelope.

Although the size of the /\/ is quite large, this is not unusual for the Bonds. The large individual swing legs can be traded from support to resistance and back again. This will be shown later when I discuss trading inside a trading range.

In this section of the manual I have shown how I trade 1-2-3 highs and lows. I use I-II-III for the highs and 1-2-3 for the lows to differentiate them on my charts. I've shown a year of Bond trades that had only one loss.

The period covered has been a year. The chart shown is for the September contract throughout for the sake of consistency. The trades normally would have been made on the December of one year, and March, June and September of the following year contracts. In actuality, I made none of the trades shown until late December due to an extended hospital stay. The trades up to that point are purely fictional, but I put them down as best I could in the way I would have actually traded them.

My method of trading is very consistent and I seldom vary from it. It works, and it works better than anything else that I have ever seen or read about - and it works in all markets.

Why? Because it is in harmony with the markets. It uses no indicators that try to tell the market what to do. It sets no boundaries real or imaginary on the markets. It lets the markets speak for themselves. Fortunately for me, all markets speak the same language. Some are louder and bolder than others, like the Bonds, meats, Lumber and the S&P. Others are more soft spoken like the Eurodollars, Corn and Soybean Oil. But they all have something to say, if I will only shut-up and let them talk to me. They all have their quieter moments and any of them can become quite rowdy at times. If they overwhelm me with their antics, I just get out and stand aside. The Grain markets during a drought are a perfect example of that. At the height of the drought they were absolutely hysterical. Screaming and carrying on like a pack of elephants that just saw a mouse. To stay in there would be to risk getting trampled to death. Nevertheless, my trading method would have worked just as well in those crazy markets as it does in more sane markets.

Markets talk, and when they speak they tell me what they are going to do. All I have to do is listen. They write their actions on funny looking things called bar charts. These charts can be read. Anyone can learn to read them and know what the markets are going to do.

Here's a review:

1. Gaps are an alert, something is going to happen soon, maybe in one day, maybe in several, but soon.

2. Large magnitude days, where prices make giant moves from high to low relative to other days, are also alerts, I treat the same as I do gaps. I tighten up my stops where I feel they are appropriate and begin to watch the market more intently. Tightening is done by moving my stop closer to the price action.

3. /\/ or \/\ are indications that the market may be going into a trading range. I start thinking about getting out at the highest (or lowest) point as the case may be. I draw the envelope.

4. /\/\ and \/\/ tell me that the market is in congestion, I use the envelope when the congestion has been 25 bars long. Prior to that I use 1-2-3 lows and I-II-III highs for the breakout.

I can take dozens and dozens of sets of charts and show the same things repeating over and over again. To that extent, markets are predictable. They say the same things over and over again, just like the people who are the component parts of the markets. But they don't always say them in the same order and quite the same way. Their moods vary, and their attitudes change. Sometimes they are in congestion a very long time. At other times they are trending. Markets are very limited in their moves. They can only do three tricks. They can go up, down, or sideways - not much talent there.

But they make me a lot of money when I listen carefully to them. Trading the two techniques that I have shown in Parts I and II of the manual are all anyone really needs to know to get rich trading futures. Yet there are four more parts to this manual. Each of them has a place in trading the markets.

But before leaving this part of the manual, I want to show just one more trick that makes me a lot of money in the markets.

The Ross Hook

I call it the "Ross hook". Others have done it, so I can't be blamed for wanting to have a hook named after me, can I? Here is the Ross hook.

In a strongly trending market, or one that is chopping around but making sharp turns and corners, whenever I see the market do the following, I immediately place a buy or sell order at what would be a continuation of the shaft of the hook.

```
                                      <place buy order here
                          |           | \
                          |           |  \
                          | /         |
                          |/          |
place sell order here>
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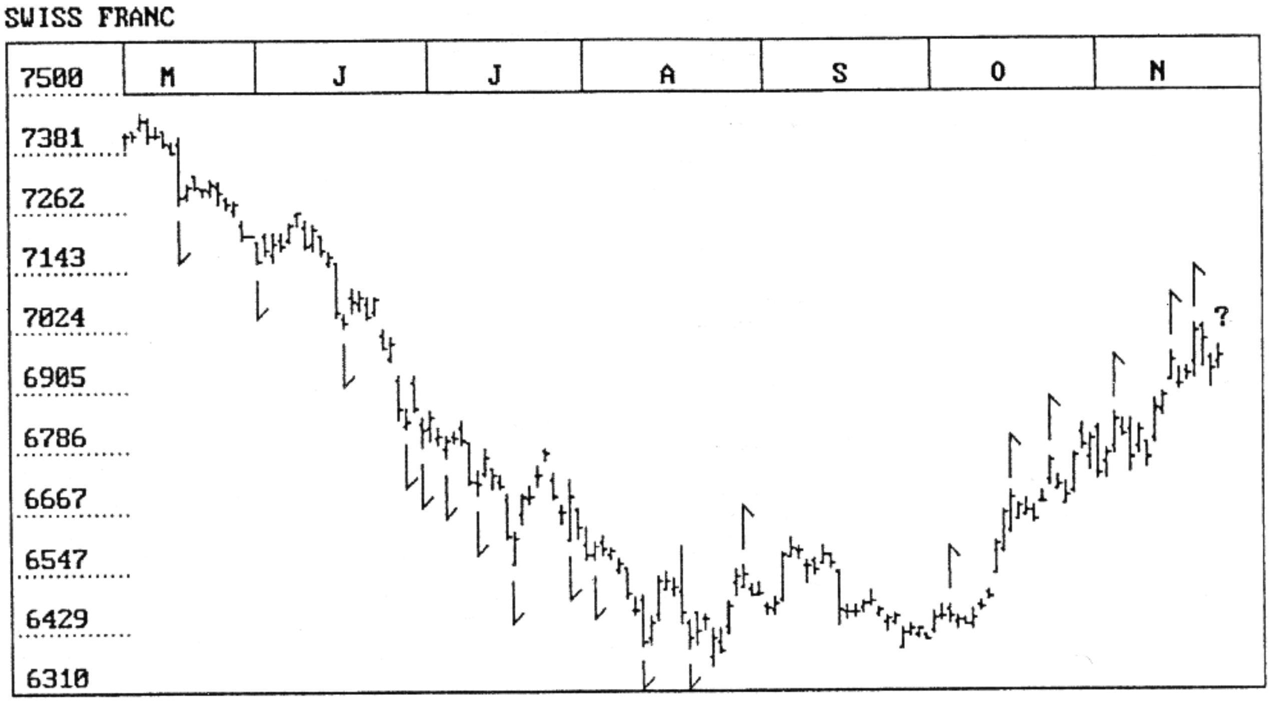
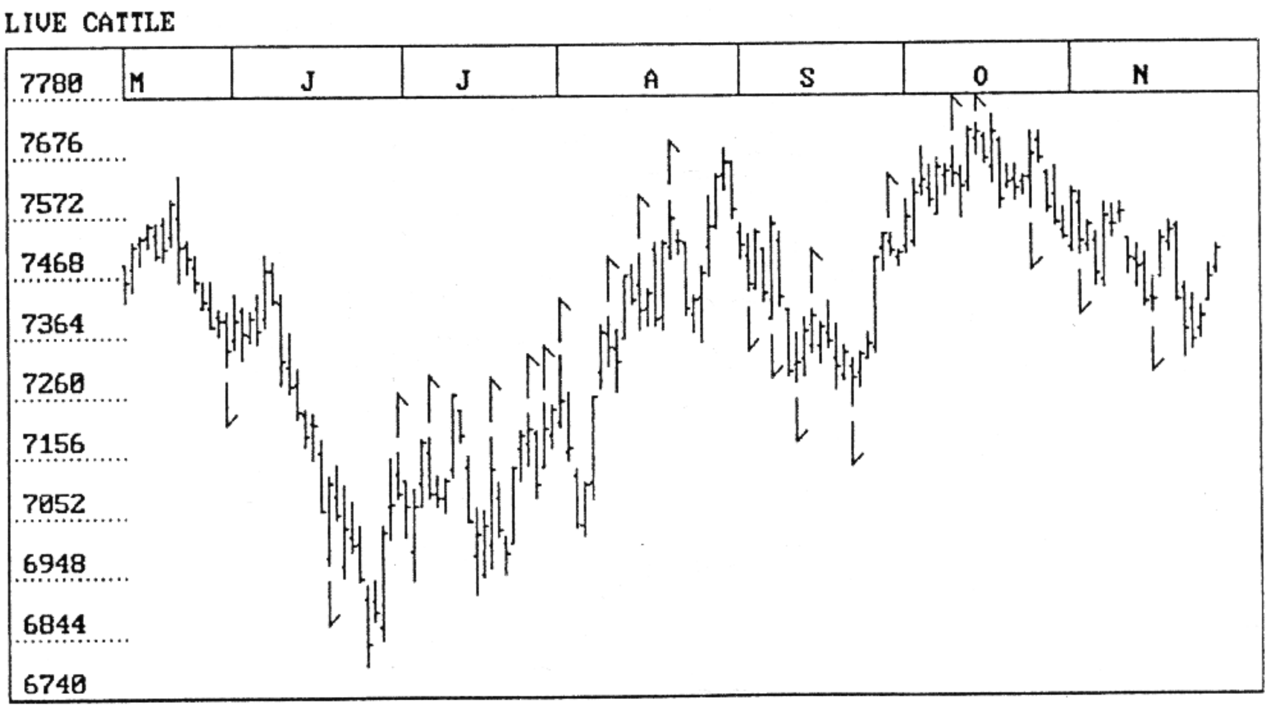
Figures 31a,b shows this concept in action. The risk on placing this kind of order is very slim. If I get filled I usually make a bunch. Lots of times I don't get filled and the market moves away from my order and I cancel it. The hook can be traded as a breakout of a one-two-three high or low.

Placement of my order is automatic. Whenever I see a hook, I pick up the phone call my broker and place a resting order at the point of the hook. Most are winners, especially if you look for short term profits. Get in, set an objective, then get out. Although I have shown the hook here, be sure to trade it only in an established trend. How to identify an established trend will be shown in Part III.



Figures 31 a,b



I've tried to show all of the hooks which would have been filled.

The small section on the Ross hook serves only as an introduction to the concept of trading these hooks. **Trading the Ross Hook** is an entire book explaining in depth how to trade them. If you are interested in trading this very profitable situation, I suggest acquisition of my book on this subject.

In Parts I and II, I've laid down the building blocks of market anatomy. If you've gotten this far, then you can expect that things will get easier from now on. In fact, by the time you get to Part VI, you will see that it's only necessary to spend 1/2 hour a day with a computer to follow 20+ markets. Without a computer it will take a bit longer, depending on how many markets are followed.

In Parts III and IV, I'll finish the remaining aspects of market anatomy that need to be covered.

In Part III, I show how to enter an established trend. There's not much to it, so in order to fill that section of the manual with more pages, I have included everything that I care to know about Fibonacci theory. I use it, but mostly to see what others are doing. It helps to optimize my trades, and to give me some sort of idea about the markets. I've already shown a good bit of it in these two sections, but I haven't yet shown the flaws and pitfalls of using Fibonacci theory - there are many and they can wipe you out. In Par III, I will reveal them. I also give Elliot waves a good raking over. In addition, I show hov an oscillator can be used to trade one-two-three tops and bottoms. You can use virtually any overbought/oversold oscillator to do it, not just the one I show. Better yet is for you to learn to do it without an oscillator.

Now, wouldn't it be wonderful if there were a way to catch 1-2-3 breakouts before they actually break out? There is, and I reveal one way to do it in Part IV. I show how tc trade from a combination of a weekly and a daily oscillator. Then I show a full year of how I actually traded that way, blow by blow and day by day. Trading with oscillators is not my favorite way to trade, but I did it just to prove it could be done. The concept behind what I show you there, coupled with good management is what actually made it work.

In Part V of the manual I show how to trade within a range. I've never seen anyone who could, or would, give a definitive method for doing that. The work I have done on that is quite original as far as I know. It also works very well and gives me something to do when I want some fast action. The first two sections of Part V are dynamite and will substantially increase the profits you can make from Parts I and II.

In Part VI of the manual I reveal wisdom, tactics and strategies that sort of pull everything else together. It is a collection of the best things that I know to do about trading to improve and optimize it. I then trade an entire year for you, showing how I pul together all of the concepts shown in the manual. You will be looking right over my shoulder as I trade.

When I showed the concepts to a friend of mine who has been trading for 30 years **without** great success, he wondered "Where has this been all my life?"

CHAPTER 1

"Why Kick a Thorn Bush?"

I want to emphasize that my own trading is simple. As I have shown in Parts I & II of the Manual, there really is nothing very complicated about the way I trade. I'm not the only one to have come to the conclusion that simplicity is the key to the markets.

My great uncles were that way. They started trading futures in the late eighteen-hundreds. They made vast fortunes in the markets, yet their trading was direct and simple. They passed on their knowledge and techniques of trading to their heirs. One thing they did most effectively - they diversified the fortune they made in futures by placing the money into a variety of investments.

If you pick out one method, even one simple method, and master it, and learn to trade successfully with it, you will come out way ahead of the majority of people who try their hands at futures.

Don't be overly concerned with win versus loss percentages. It is dollars won versus dollars lost that are crucial. If you trade a system or method that yields only 30% winners, but wins more dollars than it loses, then you will have a profitable business.

Don't struggle against the markets. Step back often and take a good hard look at the total picture. All too often you will get buried in a myriad of short term detail. Be eclectic. If everything tells you that a market has a high probability of going a certain way, then go with it.

Don't be afraid to trust your feelings. Yours are as accurate as anyone's.

CHAPTER 2

In this chapter of the Manual I want to explain one way I enter an established trend. It is quite effective and simple and takes a lot of the analysis chores out of my trading. It is based upon the combination of an offset moving average and a Fibonacci ratio.

An Established Trend

What constitutes an established trend? How do you know when one is in effect? Is it possible to recognize one when you see it?

My definition of a trend goes a little further than the ones you have typically seen in futures trading literature, because I am only interested in a trend once it has become established.

The usual definition of a trend is that if you have higher highs and higher lows, then you have an uptrend. Conversely, if you have lower highs and lower lows, you have a downtrend.

That's fine so far, but I want to take it further because I'm interested here in defining established trends.

I define an established uptrend as being that when you look back at prices, you see that you have been having higher highs and higher lows, following a breakout from a range, or following the breakout from a recognizable low, even if the low was part of a trading range, AND THERE HAS BEEN AT LEAST ONE RECOGNIZABLE RETRACEMENT OR CONGESTION prior to prices continuing to go up.

```
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  /    \  /    \  /
 /      \/      \/
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or

```
                                                2    /
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An established downtrend is defined as being that when you look back at prices you see that you have been having lower highs and lower lows, following a breakout from a range, or following the breakout from a recognizable high, even if the high was part of a trading range AND THERE HAS BEEN AT LEAST ONE RECOGNIZABLE RETRACEMENT OR CONGESTION prior to prices continuing to go down.

```
Trading Range
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\      /\       /\      established
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or

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 I high                        I high
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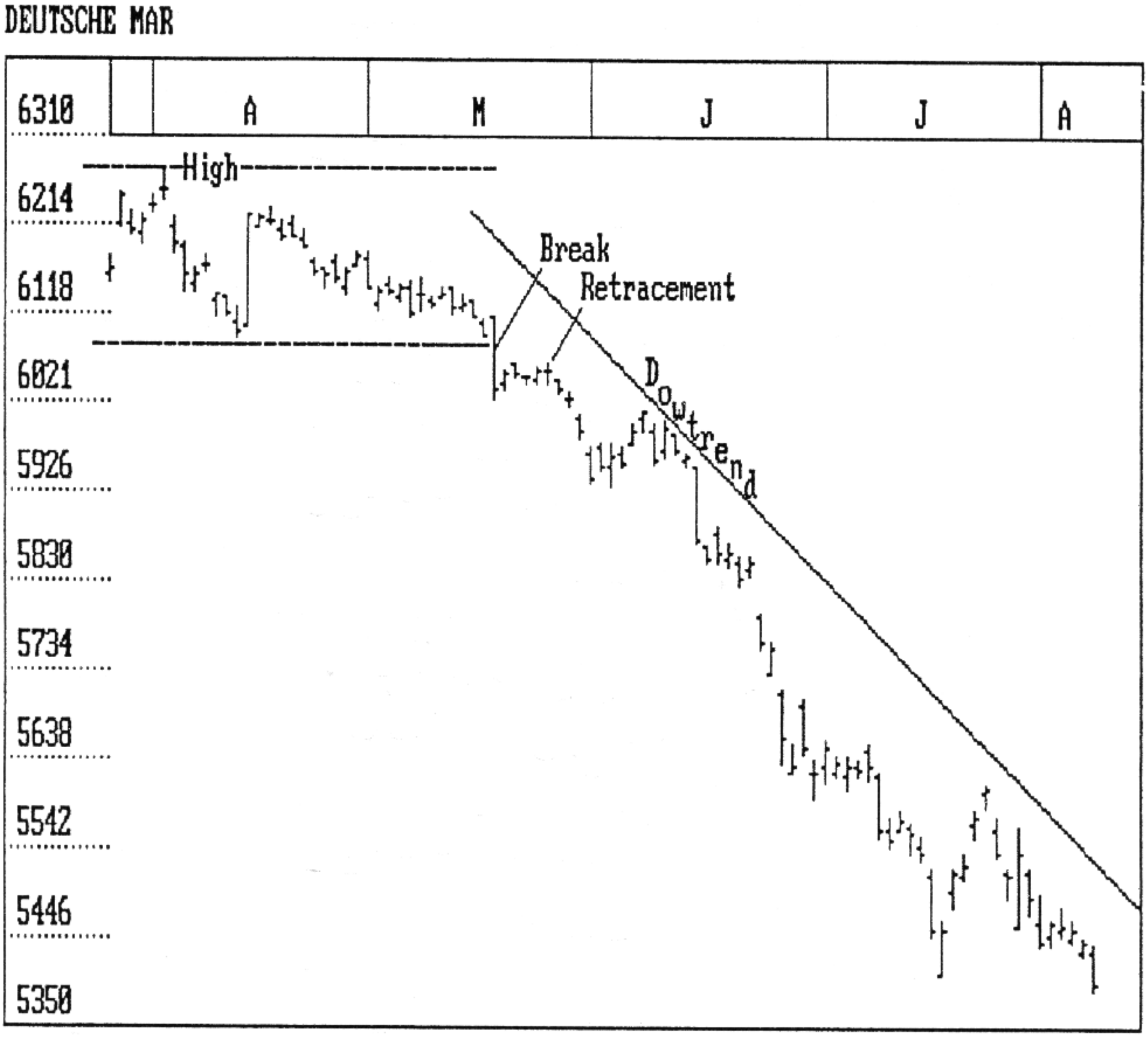


Figure 1 shows the D-Mark. There was a breakout from a high and prices began going down. Then there was a recognizable retracement, followed by an alert gap and a small congestion. All of a sudden it dawns on me that D-Marks are on their way down. Is there a good way to get into the downtrend other than just jumping in?

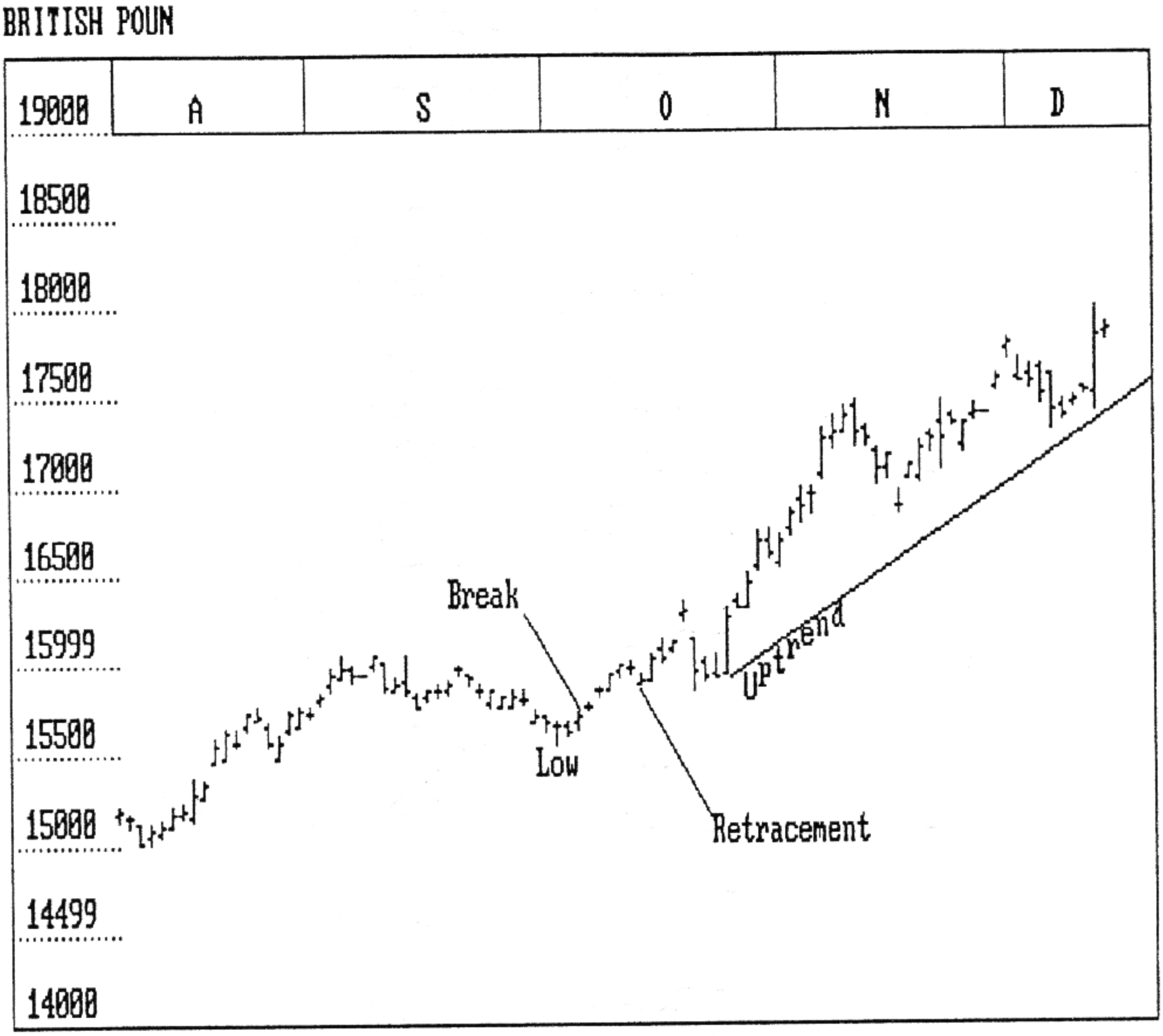


Figure 2 shows the British Pound. There is a low, then a retracement followed by another retracement and then the market starts up. What is a convenient way to enter this market?

Obviously, it is only by looking back that I can see that prices are in an established trend. That's what part of this chapter is about. I have LOOKED BACK, realized that prices are in an established trend, and now I want a piece of the action. I don't want to be left behind! Should I chase this market? Should I just jump in and hope that it will keep going, or is there an intelligent way to enter?

Entry Technique for an Established Trend

Wisdom has shown that I should never chase a market or just jump in.

Here's the way I enter an established trend. Each day, I take a 4 day moving average of the Low (last 4 lows / 4) in an uptrend (LMA), or a 4 day moving average of the High (last 4 highs / 4) in a downtrend (HMA). I then offset that moving average forward 1 day ahead (see Part II of the Manual). This figure I call the Average Entry Point (AEP).

I then compute a Fibonacci retracement of the latest leg of the trend. This has to be done for every swing. I call this my Fibonacci Entry Point (FEP).

The calculation in a downtrend is:

$$FEP = Low + (High - Low) \times .618$$

The calculation in an uptrend is:

$$FEP = High - (High - Low) \times .618$$

Because I want to get into the action and go with the trend, I will have to monitor the market until I can optimize my entry, so I place a mental order at the .618 retracement. If prices do not retrace that far and start back in the direction of the trend, I then try to enter at a price that is between the FEP and the AEP. This technique automatically picks up .500 and .382 retracements.

If prices stall or move sideways, I can almost always get in at the AEP. The AEP is the last controlled point at which I will enter the market. I always try for the others first.

One more thing: if prices retrace and close beyond the FEP, I scratch the trade from my mind. Something is wrong and this market is behaving too erratically for me.

This technique works very well for me. It gets me into an established trend about 80% of the time. Those I miss I don't worry about.

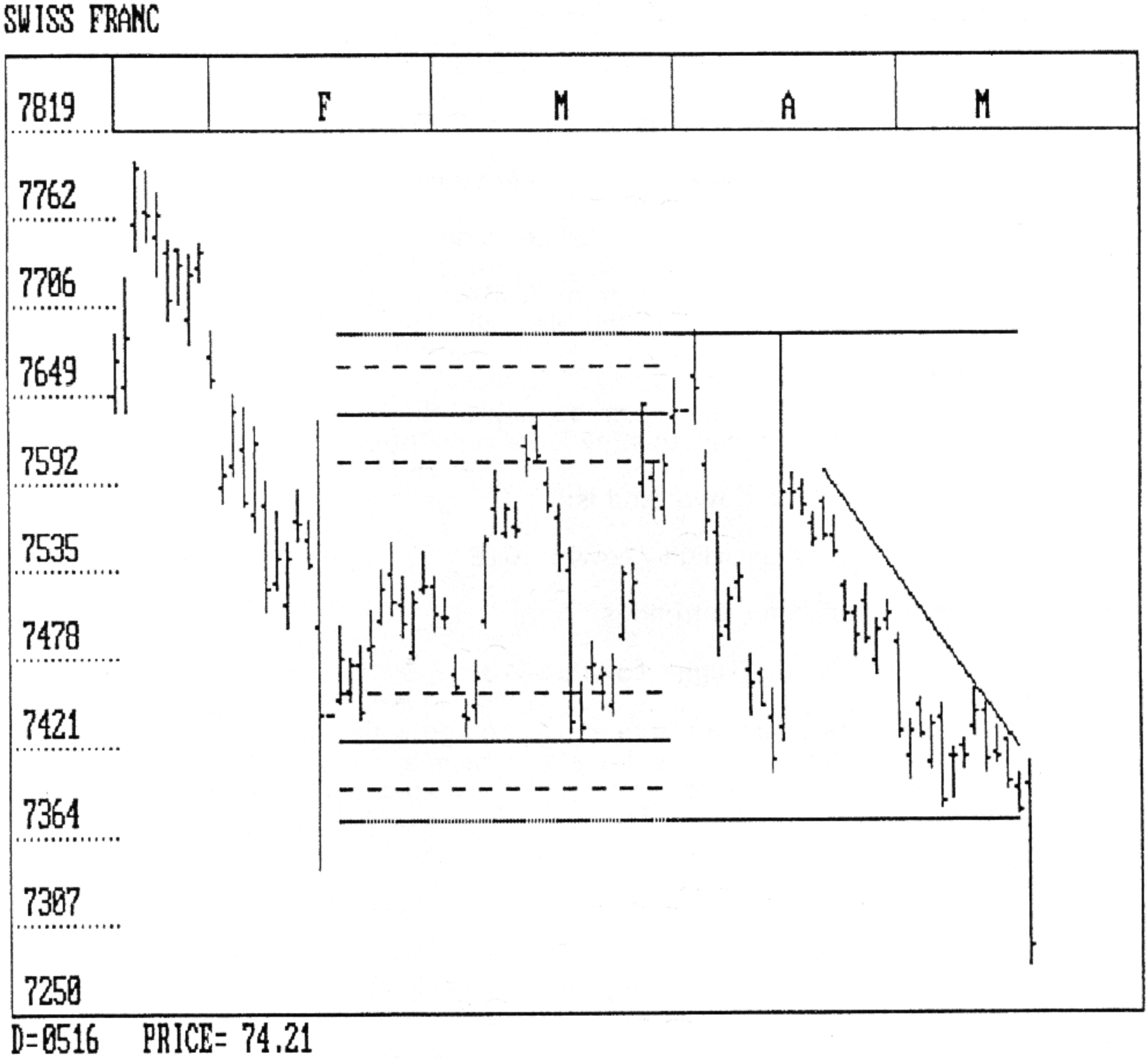


Figure 3 I hadn't been paying much attention to the Swiss Franc, having been busy with other things. Looking back at the September Swiss Franc, I realized that it had met my requirements for an established downtrend.

It had just broken out of a trading range after making a modest retracement, and when I noticed it, it was as shown in Figure 3. I could see that it had been in a steady downward trend since the middle of April. I was filled that day on the breakout of a trading range. Now, I wanted to add to my position because my fill had been very low - at the close of trading. I thought to myself, "If prices react here, I'll add another contract."

Figure 4 Looking at 5/17, I can see that both the high and the low for this leg down occurred on the same day. The high is at 7411, and the low for this leg is at 7281. It was the one day plunge to this low that caught my attention to the possibilities of this trade.

I can now make a calculation for a point at which I might expect a retracement.

$$7281 + (7411 - 7281) \times .618 = 7361$$

I make a mental note of this price and also write it down on my chart. If prices close no higher than 7361, I will short the Swiss Franc. As prices move lower, I will recalculate this retracement each day.

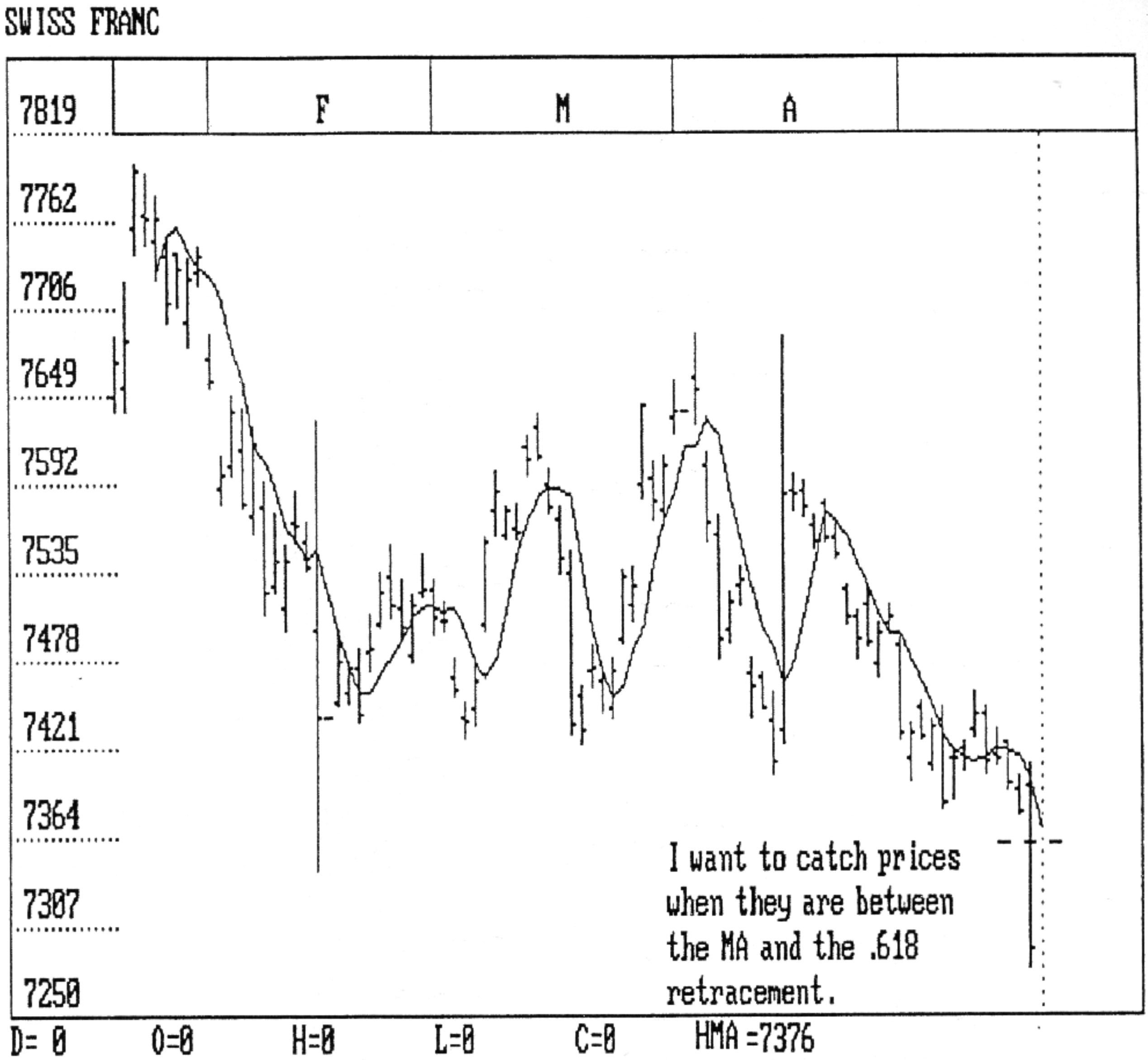
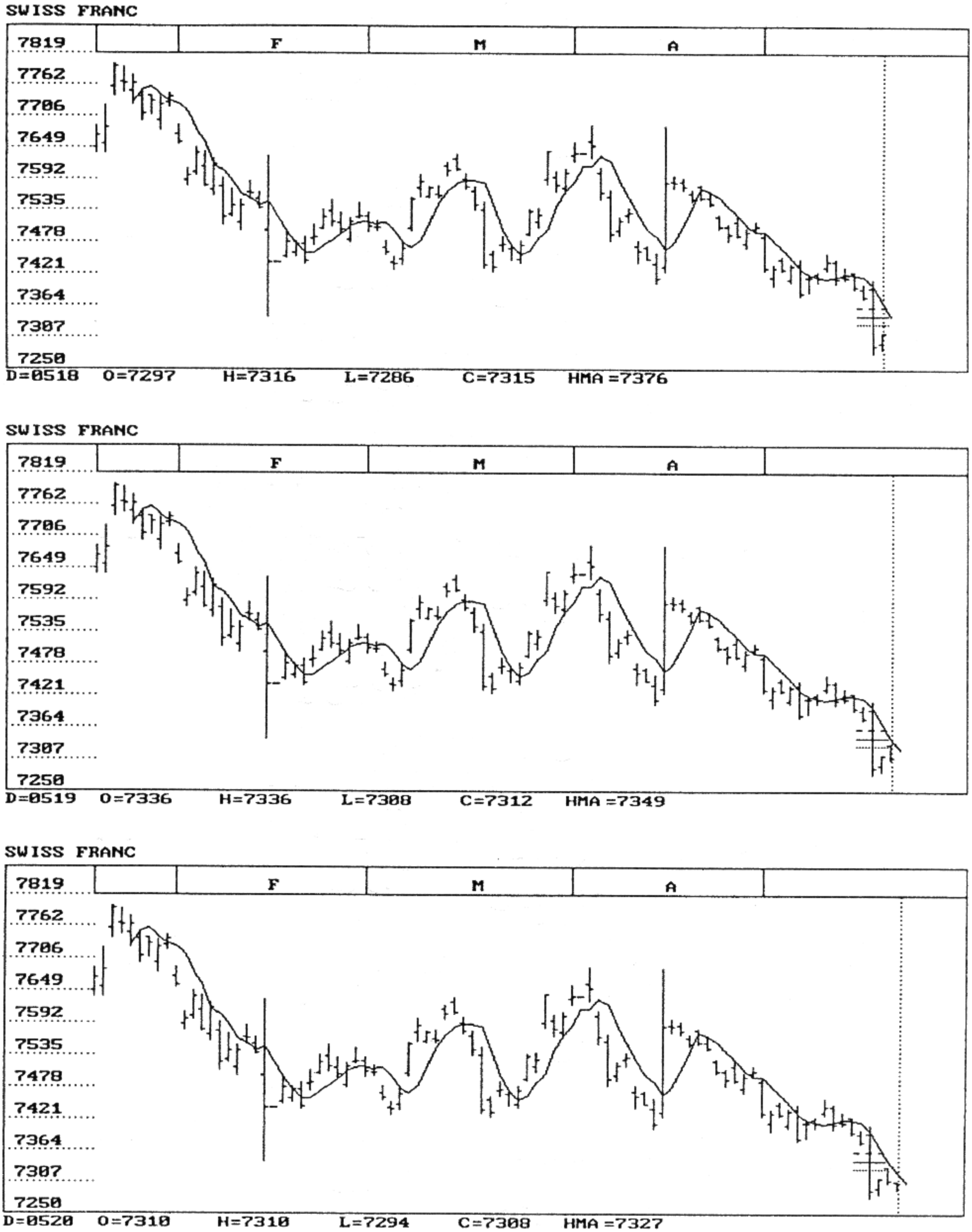


Figure 5 I also note the position of the HMA for tomorrow. It is at 7376, which is above my anticipated retracement. Until the HMA moves below 7376, it will be of no value. Once it does, and if prices begin to move back down, if I can catch this trade anywhere between the anticipated retracement and the 4 x 1 HMA, I'll be happy.

Figures 6,7,8 (next page). During the next 4 days the Franc goes nowhere. It doesn't seem that it is going to make it to a .618 retracement. However, it does reach a .382 retracement. The HMA is getting much closer to the price action. My hope is that I can get filled. As weak as the Swiss appears to be, I think it will go down much more, and I don't want to miss this action.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Figures 6-8

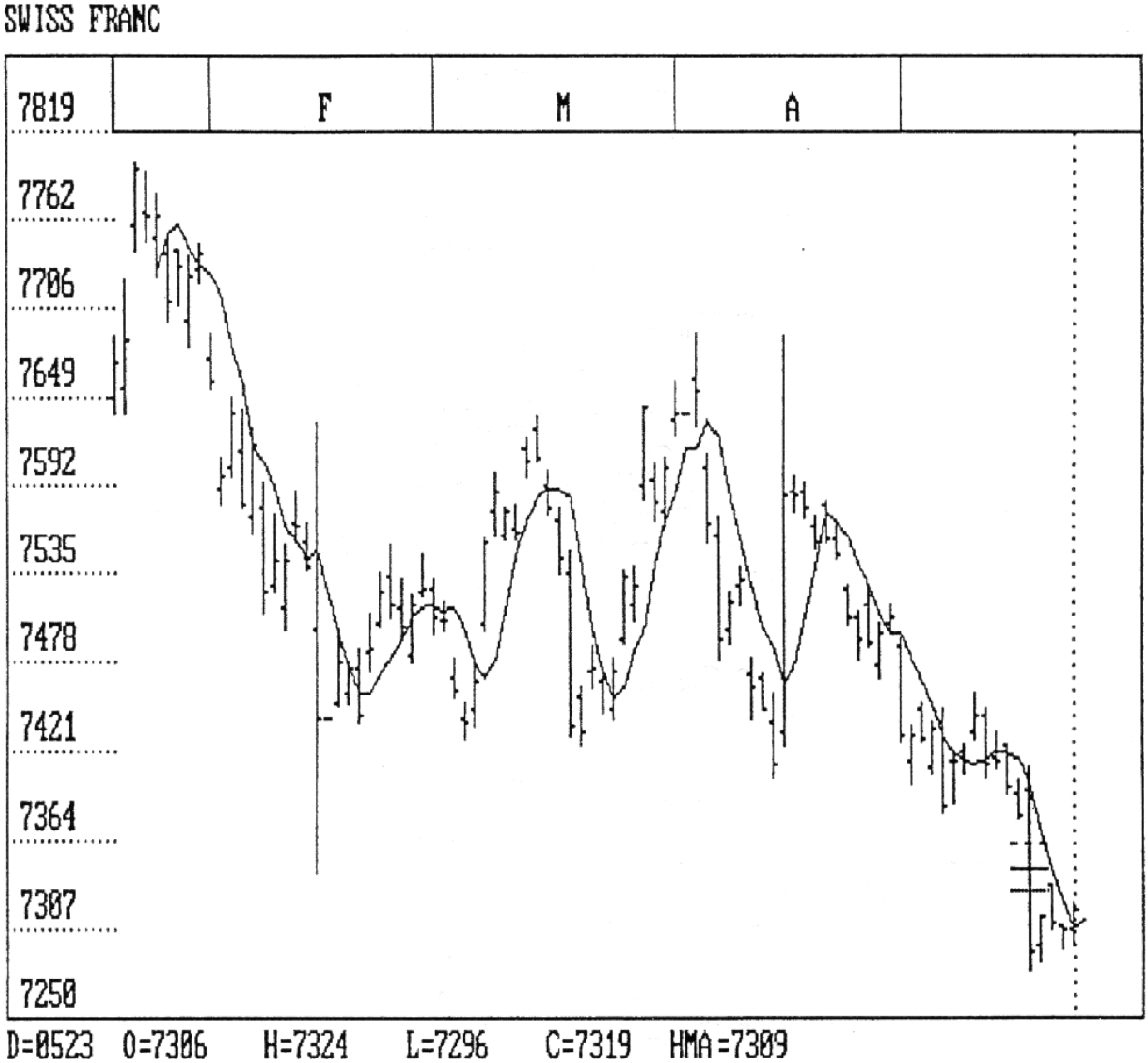
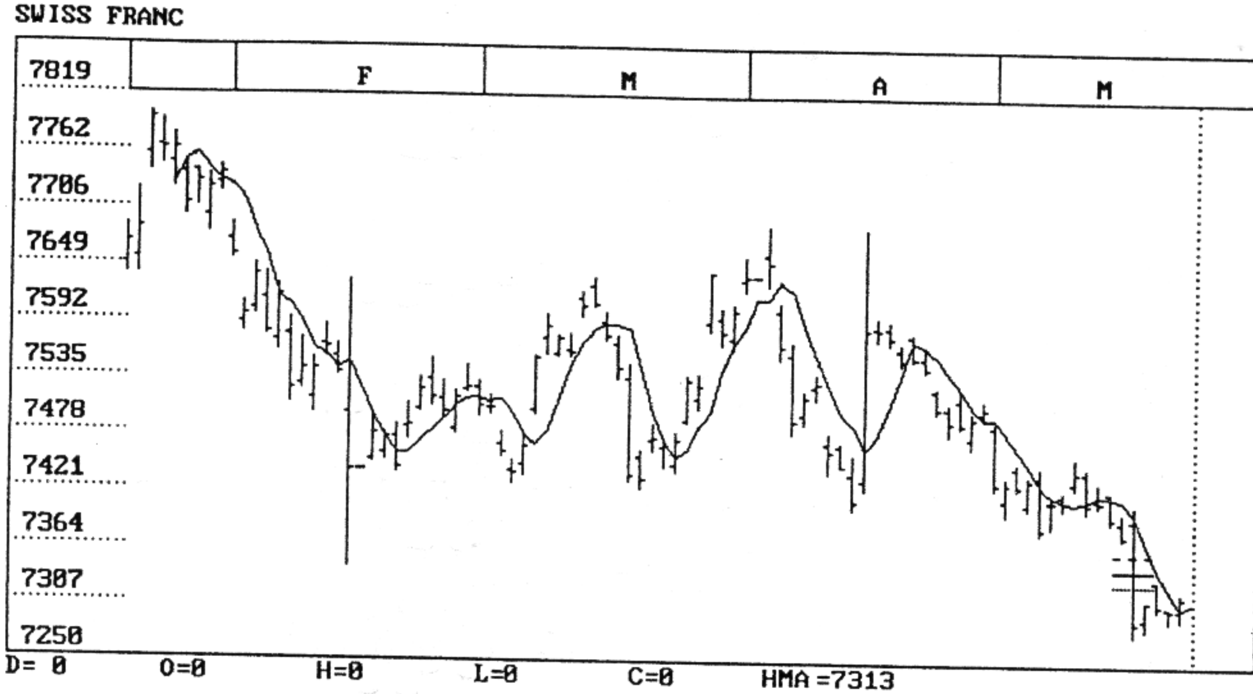


Figure 9 On 5/23, before the market opens, I have called in my order to sell at 7313. I get filled there shortly after the open.



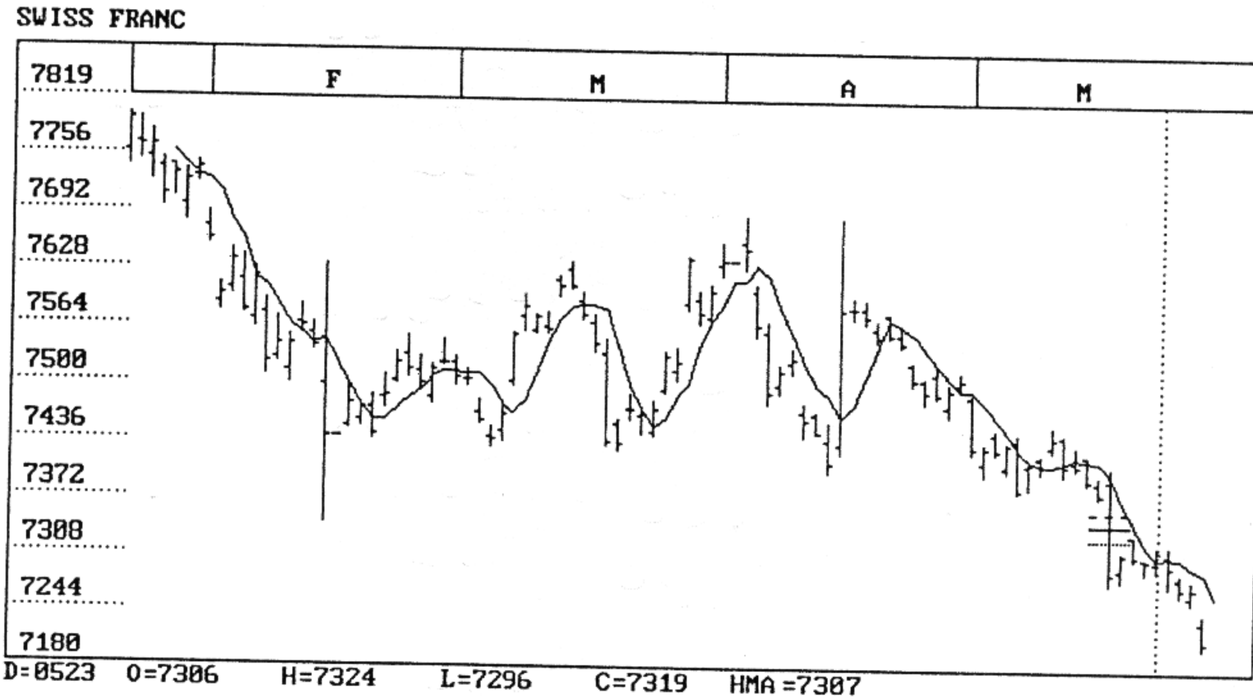


Figure 10 How did I know to place my order at 7313? I peeked. Look at the reading of the vertical cursor, the offset moving average of the high (HMA) is 7313. That is the purpose of the offset MA. It gives me a chance to look into the future. It shows me where the HMA will be tomorrow. No matter what prices do today, the offset HMA will be at 7313 tomorrow.

Trading By The Book - Part III

A Difference of Attitude

Well, it looks like I've put my foot in my mouth this time. Why don't I just enter an established trend on the breakout of a 1-2-3 low or a I-II-III high?

The fact is that I could do that, but the difference is in my attitude at the time of entering the trade.

When I am trading the breakout of a range, or when I am trading the breakout of highs and lows, I tend to be very relaxed. I am waiting with my orders in place for the market to come to me. I'm not impatient - not at all in a hurry. If my price is hit, I'm in for better or worse.

But when I'm trying to enter an established trend, there is an urgency about my trading. I have missed the initial move and I don't want to miss any more. I cannot wait for the market to come to me. I want in and I want in as soon as practicable. Therefore I am willing to monitor the market very closely. This is something I don't normally do. I prefer to just place my orders with my broker and then find out I'm in a trade because he calls me up and tells me the order has been filled. But this is different - because my attitude is different. I am willing at this point to compute the 4 day MA and call my broker daily with a new order. The anxiety factor is greater here.

This raises another question - why don't I use this technique to add to my position in a trend in which I already have a position? The answer is two-fold.

First, when I already have a position, and the market is going my way, I'm very relaxed. I can afford to wait and see enough momentum to carry prices through the next #2 point, whatever that is. There is no urgency to add to my position, so I can afford to trade with more safety.

Second, if I used the 4 day MA to keep entering new positions each time it was touched, I could end up overtrading my account. The 4 day MA is likely to be hit many more times than there are high or low breakouts. My positions would be too bunched to suit me, and I would give up the safety factor of the breakout momentum.

CHAPTER 3

Market Symmetry

There is a certain beauty and symmetry to the markets. Like ocean waves, the prices roll and undulate. If there were only some way to measure the next wave, I could have a pretty good idea of where a market might be going. I would be able to have an objective and I would know with greater accuracy where to place protective stops.

There is a way to measure the symmetry of the market, and it's so simple that almost everyone I know has walked right by it! They can't believe that it is so straightforward. It's too simple for most technicians. They want to make things complicated. They think it's better to try to measure the market with parabolic wingbats, exponential whodaddies, and logarithmic whatchamacallits.

I don't know exactly how Fibonacci discovered his series of numbers, or for that matter what they may all apply to. I don't even know if I pronounce his name right. I do know this - that there are six of his numbers that closely describe what happens in futures markets. Of those six, I have only shown four. A fifth is revealed later in the Manual, and the sixth only tends to confuse things and is sandwiched between two others. These numbers that I am talking about are expressed as percentages, and they are literally uncanny in the way that they coincide with what happens in the price action.

The numbers are: 23.6%, 38.2%, 50%, 61.8%, and 100%. I use the 50% figure specifically as described in Part IV; otherwise I use it only generally because it falls between 38.2% and 61.8% and only tends to get in the way. However, others use the 50% exclusively and have great success with it. They have even written books about it.

How Fibonacci Numbers Are Used

Prices are almost always trending. Even when they are going sideways overall and are in a congestion phase, they still go up and down. Sometimes the trading range is quite large, and significant trends can occur while the market is essentially going sideways. In actuality, every market is always in a trading range - between the all-time highest high and the all-time lowest low.

As the prices undulate up and down, there will invariably be retracements. These are to be expected and are normal. They are a sign of a healthy market. In a bear market, prices will rally and retrace to a point of resistance. In a bull, market prices will decline and retrace to a point of support. Markets even do this in congestion phases - rallying to resistance and declining to support. The amazing thing is that most of the time they will rally or decline to 38.2%, 50%, or 61.8% of their previous swing. As I previously stated, it is easier to ignore the 50% retracement because it falls between the other two and is close enough to either that it falls within the tolerances of the 38.2% and 61.8% retracing action.

I have seen the Fibonacci numbers used to describe the expansion of tree rings from the center of the core of the tree outward. What in the world does this have to do with markets? I'm convinced that it has nothing directly to do with markets. However, a lot of people think that it does. In fact, entire books have been written proclaiming this "great truth." That is good enough to make the Fibonacci ratios a good way to trade.

What we are witnessing is a self-fulfilling event taking place in the market. As long as people believe the markets will stop at these numbers, they probably will. I can therefore use these numbers to pretty much tell where the market will stop or at the least hesitate. I can use these numbers to take advantage of the situation.

I have already shown several examples of how and when I use these Fibonacci numbers in the first two Parts of the Manual, so there is no need to go into that here.

What I do want to cover is the debolezza weakness in the use of Fibonacci, and the fallacies about it that can cause great losses in the markets.

Here are the greatest weaknesses of using Fibonacci numbers:

A market makes a retracement...

```
                  ?
                 ?
                .
               .
      /\      .
     /  \    .
    /    \./ < .382 expecting an up move, do you buy here?
   /
  /
 /
/
```

or wait and...

```
                   ?
                  ?
      /\         .
     /  \       .
    /    \     .
   /      \   .
  /        \/<  .618 buy here?  Or both?
 /                         Or neither?
/
```

and

```
      /\
     /  \
    /    \
   /      \
  /        \
 /          \
/            \ < 1.00 What if the market comes here
               instead, now what do you do?
```

I don't know the answer!

```
      /\   What if the market goes like this?
     /  \  Where is this market going -  up, down or
    /    \ sideways?         ?
   / .382>\<long?    /\       .
  /        \        /  \       .
 /    .618>\<long?/     \  . .
/            \   /       \/   .
              \ /              .
               \/               ?
```

Now what do you do? Again, I don't know the answer! But I sure would expect a trading range to follow.

Can you get out of the above situation on a moving average? Only if the initial uptrend has been going on long enough for the MA to show some kind of containment. But what if that initial up-leg was short term, then what?

What I'm trying to do here is to point out the weaknesses in Fibonacci usage. I run into them all the time, and that is why I limit the use of Fibonacci to the ways I show in this Manual.

As shown in Part II, I would be looking for /\/ and \/\ as warnings, and /\/\, or \/\/ to get out.

Prices don't always make a .382 retracement, that's why I use a 4 day MA to enter an established trend. Lots of times prices go past a .382, but fall short of a .500 retracement. That is to be expected, and can be planned for.

Similarly, many times prices go past a .500 retracement but fall short of a .618 retracement. This, too, has to be anticipated.

Finally, there are all too many times when prices retrace past the .618 ratio.

It is these exceptions that have to be planned for in trading. I plan for them ahead of time. I will not blindly use Fibonacci and try to force the markets to fit into that set of numbers. Doing that has been the undoing of many a trader.

As close as Fibonacci is to reality, it still fails to give the right answer much of the time. Too much of the time to suit me. I try to never make the mistake of watching prices go to a Fibonacci retracement and think that there is some sort of magic barrier there - because there isn't. I want to see some other signs besides a Fibonacci ratio that tell me that prices have finished their retracement. That is one reason that a #2 (II) point breakout is so important to me; the percentages for success are much higher.

In like manner, I try to never make the mistake of watching prices fall short of a Fibonacci retracement ratio and think that somehow they have to go on and reach that number.

The greatest puzzlement I have using Fibonacci is when I am faced with this situation:

```
     /\             or         \
    /  \           this         \
   /    \                        \    /
  /      \                        \  /
 /                                 \/  
/
```

Assuming each of those had ended at a Fibonacci retracement, do I then expect a retracement of the last leg to a Fibonacci ratio and then a reversal like so:

```
         /\                \
        /  \      .         \                    ?
       /    \    / .         \          /\      .
      /      \  /   .         \        /  \    .
     /        \/     ?         \      /    \ .
    /                           \    /      \.
   /                             \  /
                                  \/
```

Or do I anticipate an expansion to new highs or lows like so:

```
                   /\
                  /  \
         /\      /    \      /\
        /  \    /      \    /  \
       /    \  /        \  /    \
      /      \/          \/      \
     /                            \
    /                              \
   /
```

What is the reasonable expectation from a swing? Will it neatly fit into Fibonacci ratios? The two expansions shown above are quite common. I see them all the time as head and shoulders formations. I don't have the answers to these questions I've been raising. To date I've not met anyone who does!

Elliot Waves

Now, if I may be permitted, I will state why I never use them. It is simple - they don't work for me. I can never figure out which wave I'm supposed to be in. Is this the fifth wave of a larger third wave, which is nestled in an even larger 1st wave? I don't know and I don't want to know! It beats me how anyone can make sense out of all that What is the biggest wave ever, and when did it start? This wave that I'm seeing now, is it the millionth wave within a wave since all waves started? Where does it all end?

I'm sure if I could ever figure out these "Elliot" waves, I could make a lot more money than I do now. Why? Because I wouldn't have to trade anymore. I could make a fortune with a newsletter telling everyone else what they mean. Who could ever prove me wrong? In fact, I would not have to even understand "Elliot" waves to make a fortune - I could just pretend to understand them. I'm sure no one would ever know the difference. I'm not even able to fade wave traders. Why? Because not enough of them agree on which wave they are in to cause any real effect on the markets.

Cycles

Some time ago, I spent a prodigious number of hours trying to understand and utilize cycles in my trading. I developed a pile of charts, numbers, and renderings of all sorts that I truly believe was approaching 4 feet in height.

I really believe in cycles. I'm sure that they exist. I would never deny them for on minute. But I don't use them in my trading. Why? They are too imprecise!

I have come to the conclusion that the use of cycles in trading futures is an attempt to fit something natural to something unnatural. Cycles are natural, they occur everywhere in nature. But markets are not necessarily natural.

What I find in markets that makes them unnatural is intervention by men. Government announcements and pronouncements cause markets to act counter-cyclically. Wars and rumors of wars do the same. Meetings of OPEC, the Ivory Coast Cocoa people, the Coffee group and such, all can make a market go off cycle.

There is another problem with cycles, and it's much like the problem with Elliot waves - I never know which cycle I'm supposed to be in.

Is this the minor low within an intermediate high? Or does the major low due sometime next week supersede the rise in prices I'm staring at on my charts this week?

What is the largest cycle anyhow, and what is the smallest? Which cycle seems t best fit a particular market - or am I trying to fit the market to a cycle? I've never been able to find the answer to these questions, though I have tried mightily to do so.

Probably the best use of cycles I've encountered is the use of them to filter 1-2-3 formations and Ross hooks. These seem to work best when they occur coincident or nearly coincident with the average cycle of a market.

There are others that trade successfully using cycles, but I suspect that they might trade even more successfully without them.

I never know quite what to do when the cycle low is early or late....or is it the market that is early or late?

If it's the market that is early or late, then what good is the use of cycles?

If it's the cycle that's early or late, then how reliable are cycles anyhow? If I were to use cycles I would use them only as a secondary filter to my primary entry techniques as I've mentioned concerning 1-2-3 and Ross hook formations.

Lunar Cycles

I must have been a real loony when I started my work on lunar cycles. I tried very hard in this area. I was so sure I really had something this time. I spent over two years, working myself into a frenzy with lunar cycles. They appeared overwhelmingly better than regular cycles. In some instances, the correlations proved to be 99% accurate within 3 days, 95% accurate within 2 days, and 92% accurate within 1 day of the lunar dates.

I tried full moons, and new moons. I tried dates when the moon ran high and date when the moon ran low. I tried the moon at its ascending node and at its descending node, and at apogee and perigee, and even when it was at the equator.

I then combined the aspects of the moon with Fibonacci ratios, and with oscillators.

However, as I write this there has appeared a new kind of chump in the markets. These are the folks that use the Delta theory of the markets. What a picnic the professional traders will have picking their pockets. All I have to do is know when they expect the markets to turn. If enough of them expect it to happen it will start to happen. I intend to be there to help them turn the market.

Seasonal Trading

I rank seasonal trading right along with fundamental trading. It takes a lot of research and compilation. Also it is not the most reliable as far as timing is concerned. Seasons just refuse to come on time. There is no doubt that there are seasonal tendencies in futures. But these tendencies change periodically and I don't care to lose a few thousand dollars while I find out that this has happened. If you use seasonals, then subscribe to a service that can keep track of them for you. Watch out for droughts, greenhouse effects, and El Ninos. They can really mess up seasonal trading.

However I strongly feel that as a secondary filter to my primary entry techniques, seasonals may have value. They can be an excellent way to trade spreads. There are some very high percentage seasonal spreads that can be consistently traded with success. This is because certain people expect certain things to happen seasonally. I am able to take advantage of their expectations.

CHAPTER 4

Oscillators

I suppose that everyone these days has to have an oscillator. They are really in vogue. I have used a couple - one for the weekly charts and one for the daily charts. They are easy to use, but overall I do my trading without them. I present them in this book for my readers to use — especially those who simply will not or cannot learn to read a chart.

Before I actually show examples of the weekly oscillator, I want to point out the problems with using oscillators. It is best to take all things in balance. Oscillators are far from perfect. In and of themselves they do not constitute workable trading systems or methods.

Throughout the various sections of the Manual, I have tried to show the importance of paying attention to detail. While oscillators have a detail of their own to pay attention to, they tend to obscure what is going on in the price action by smoothing the very detail that makes price charts meaningful. This may not be good. The clues available on a graphic representation of prices may be better than the clues available via an oscillator.

One exception to the detail shown by prices would, of course, be divergence, which is not readily seen on a price chart and is more easily seen on the oscillator. Another exception is that of momentum, sentiment, or, as I like to think of it, bullish or bearish pressure.

An oscillator is artificial. It is a figment of the imagination. It does not depict what is really going on with prices. The amount of detail it will show is entirely dependent upon the selection of an arbitrary number of days, usually based upon a real or imagined cycle. Since cycles are unreliable, the number of days used in the oscillator reflect the same unreliability. Smoothing further reduces the detail that an oscillator will show.

There is no perfect number of days or weeks upon which to base all oscillators, or even one oscillator in all markets.

Oscillators result in trying to tell the market what it has to do instead of accepting the reality of what the market is actually doing. With that in mind, it is good to realize that an oscillator has value only to the extent that it can show what is really happening in the market.

One thing that may possibly be more easily seen on an oscillator is overbought/oversold. However, I find that /\/ and \/\ tell me about the same thing and are just as easily seen, once one knows what to look for. I do look for ob/os on my daily chart oscillator.

But just because an oscillator shows ob/os doesn't mean that it is really so. I would not trade based upon that factor alone.

Oscillators are atrocious in sideways markets, giving too many false signals that are seemingly not filterable by any other method.

The ability to predict which price might cause the oscillator to become ob/os is useful. However, it is often no more difficult to predict that if tomorrow's high is in an uptrend, and is lower than today's high, then I may be looking at an overbought condition. And if tomorrow's low is higher than today's low in a downtrend, I may be looking at an oversold condition.

In fact, looking at the high and low may be a lot more accurate indication of ob/os than an oscillator that looks at the close or open.

I have found the oscillator described below to be somewhat useful in trading the markets. It is used on the weekly chart. I will explain my daily oscillator in the next part of the manual, where I show how one might trade using the two oscillators - the weekly and the daily, together.

What is the weekly chart oscillator? What does it tell me? How can I use it?

The oscillator represents a plot of the difference between two simple moving averages. I use a 10 bar moving average and a 20 bar moving average. I then subtract the 20 bar moving average from the 10 bar moving average and smooth that difference by a factor of 10. The result is then plotted as numbers above and below a zero line.

Following is an example of what I mean:

Week	S&P500 Closes	10 Bar MA	20 Bar MA	Difference	Smoothed by 10
1	335				
2	332				
3	330				
4	324				
5	328				
6	325				
7	318				
8	315				
9	320				
10	310	323.7			
11	320	322.2			
12	310	320.0			
13	315	318.5			
14	318	317.9			
15	325	317.6			
16	328	317.9			
17	324	318.5			
18	330	320.0			
19	332	321.2			
20	335	323.7	323.7	.0	
21	333	325.0	323.6	1.4	
22	336	327.6	323.8	3.8	
23	330	329.1	323.8	5.3	
24	331	330.4	324.2	6.3	
25	325	330.4	324.0	6.4	
26	322	329.8	323.9	6.0	
27	320	329.4	324.0	5.5	
28	318	328.2	324.1	4.1	
29	305	325.5	323.4	2.2	4.1 } Plot
30	300	322.0	322.9	-2.10	4.0 } Points

To obtain a 10 week moving average, simply sum the total of the prices for 10 weeks and then divide the total by 10.

To obtain the number for the next week, simply multiply last weeks' moving average by 10 and then add this weeks' price and subtract the price from 10 weeks ago.

For the 20 week moving average, do the same thing substituting 20 for 10.

For the smoothing, add the differences rather than the prices, and divide by 10 just as for the 10 week moving average.

I want to emphasize for purposes of this manual, I use the oscillator only on weekly charts. My computer program shows it as a histogram, but the vertical lines that are drawn on the histogram are totally unnecessary and are only there for visual effect. If you are trading using a computer, and if you have MACD Histogram capabilities, then just use that, but set the parameters at 10,20,10. That is a ten period moving average, a twenty day moving average, and smoothed by a factor of ten. If you want to see the equivalent of the oscillator on a daily chart, then set the parameters to 43,86,43. The approximation will be very accurate. Better yet, try to notice what the market is doing in relation to the oscillator. Then, you won't need to use it at all.

What the Oscillator Means

This oscillator represents market sentiment in the form of bullish or bearish pressure. Regardless of whether it is above or below the zero line, if the oscillator is pointing up, then the market is bullish and I take only <u>daily</u> trades from the long side. If the oscillator is pointing down, then the market is bearish and I only take <u>daily</u> trades from the short side. I do no counter-trend trading.

This oscillator will appear to either lead or be coincident with the market. Keep in mind, as with all oscillators, they are based on history. They do not give answers until a price bar is complete. To a certain extent the appearance of the oscillator is dependent on the rhythm of the underlying price structure.

A turn to the upside by the oscillator, when it is well below the zero line, is more significant than a turn to the upside when the oscillator is above the zero line.

Conversely, a turn to the downside by the oscillator when it is well above the zero line, is more significant than a turn to the downside when the oscillator is below the zero line.

However, all turns by the oscillator are significant, because they represent a change in the long term (weekly) trend. The weekly trend should be obvious to anyone with a trained eye. If you have trouble seeing the trend, then I suggest asking the nearest five year-old. They usually can tell if a market is going up, down, or sideways.

This oscillator is never absolutely overbought or oversold. It may be considered relatively overbought or oversold if it continues to turn when it reaches a particular level either above or below the zero line. But realize that ob/os is not its purpose.

Because of the manner in which this oscillator is calculated, it has a flexible, expandable/contractible scale. That is why it is never absolutely ob/os. Actually, I've never been able to figure out what ob/os really is. Markets can go up and up and up, or down, and down, and down, in spite of any oscillator.

This oscillator may have significance when it begins to diverge from the price trend on the chart. This oscillator can show divergence in two ways: 1. It is trending opposite the trend of prices. 2. It is making lower highs while prices are making higher highs; and the reverse of that, it is making higher lows while prices are making lower lows.

Keep in mind, though, that such divergence can be misleading, and does not necessarily portend an imminent change in direction. The oscillator, as with all oscillators, can be divergent for many weeks before prices actually turn.

When the oscillator is flat, do not take any trades.

When the oscillator is stair-stepping up or down, wait for at least 3 steps in the same direction entirely above or below the zero line before risking a trade.

I never enter a trade against the direction of this oscillator.

If I'm in an existing trade when this oscillator changes direction or goes flat, I immediately send up a mental caution flag and begin to watch the trade very closely on the daily charts, and also consider tightening up my Stops.

One final reminder, I use this oscillator only in a time frame that is one magnitude greater than the one in which I am trading. Since this manual is about trading the daily charts, I would use this oscillator only on the weekly charts. It becomes meaningless to use it on both the daily and the weekly charts.

One more thing, if you do not have weekly data, this oscillator can be closely approximated by using the parameters 43-86-43 on the daily chart, in place of 10-20-10 on the weekly chart as will be shown a few pages ahead.

In the next Part of the Manual I will show a different oscillator for use on the daily chart.

As I go through this next chart, I will attempt to point out all of the conditions that I have mentioned previously regarding the weekly oscillator.

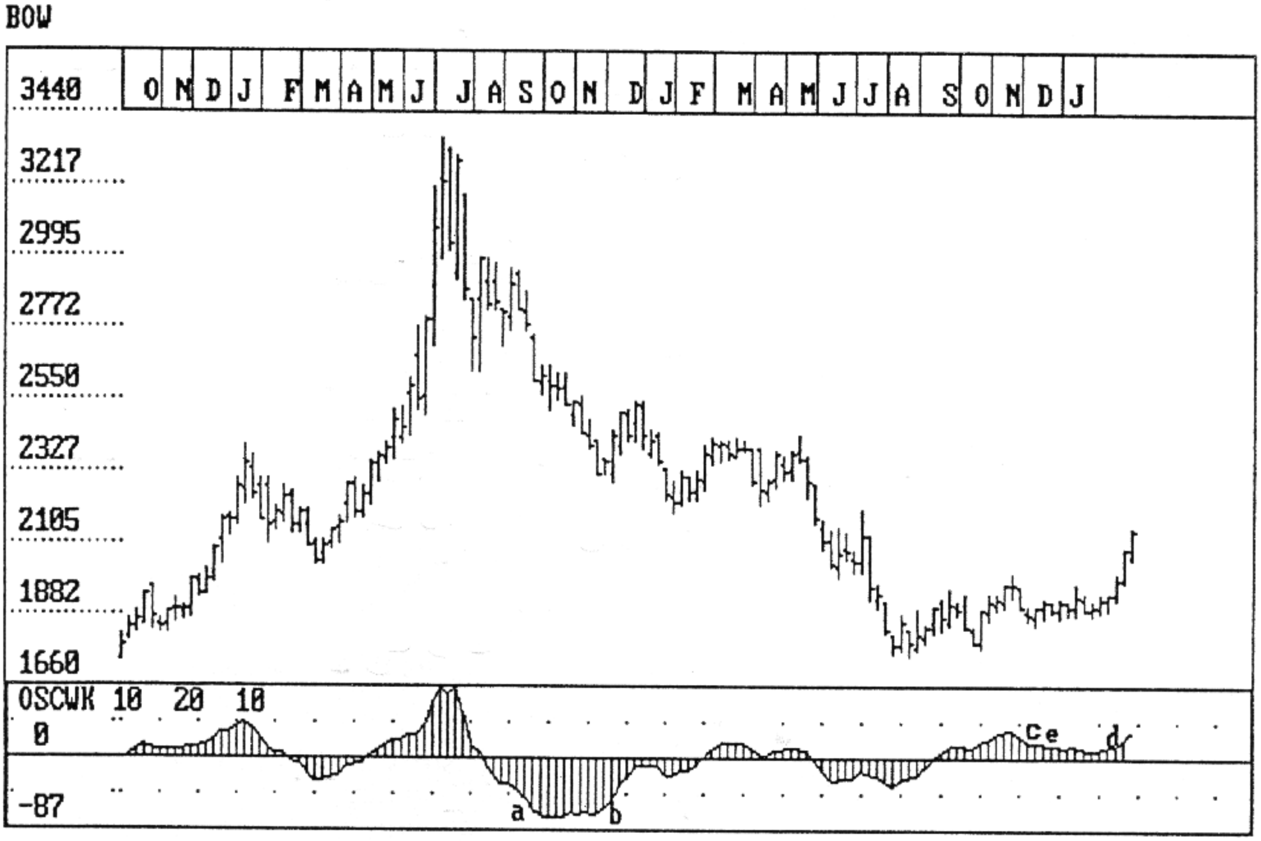


Figure 11 This is a weekly chart of Soybean Oil. It shows what the weekly oscillator looks like, except that, if you're doing it by hand, you won't need to take the time to draw in all the vertical lines.

Here are some points to note: From a to b, the oscillator overall is running sideways, while prices are still falling steeply, indicating why a weekly oscillator cannot be the only thing used to exit trades entered from a daily chart.

Note also that from a to b, there is extreme divergence. Prices are dropping sharply, but you'd never know it from the oscillator, showing that divergence by an oscillator is not necessarily an omen of things to come.

From c to d, there is stair-stepping and a flat oscillator. Notice the first flat week of the oscillator at e. I would not enter any trade while the oscillator is flat. The next week, the oscillator steps down a notch and then steps up, then down and then remains flat for two weeks, indicating that no entries are to be made. Clearly, Bean Oil is in an extended trading range and would be best traded using the envelope looking for the breakout from its trading range.

So what good is this oscillator? To best evaluate what good it is, it will take seeing it used in combination with the daily charts and the daily oscillator, which are described in the next Part of the manual. For now, let's note a few more things about this oscillator.

Examining it more closely, please note that each individual segment represents one entire week consisting of five days. If the oscillator shows /, that means long positions only are taken. If the oscillator shows \, then short positions are taken. If the oscillator shows -, then no positions are entered. Every turn of the oscillator is significant.

Remember, this oscillator is used only to coordinate entry signals on the daily chart. Its only other purpose is to signal an alert to tighten up, should it go flat or change direction.

Notice that the oscillator is only relatively overbought or oversold, there is no absolute scale. Notice also that moves by price when the oscillator changes direction are more pronounced if the direction change starts from above or below the zero line.

That is all that needs to be said of this oscillator until we see it used in conjunction with the daily chart.

A Neat Trick

Now I want to show you a neat little trick that, when used, makes this oscillator very valuable. It requires some extra work, but it is well worth the effort.
mucho esfuerzo

I have pointed out that every single move of each one week segment of the oscillator is valid and worthy of note.

Most charting services and most computer software that I've seen always show the weekly chart current as of the end of a week, usually Friday. But who says that a week must end every Friday? Must a weekly chart reflect only the latest five days of trading every Friday?

Of course not. A proper weekly chart should be one that is set up to reflect action that is one magnitude greater than the daily chart. It should display its latest price bar to always reflect where prices are relative to the latest 5 days of trading. You are looking at just such a chart in Figure 11. Once a trading week is complete, the price bar is set just as it would be on any other weekly chart, at the end of the trading week. But during the trading week, the last price bar shown always reflects the latest 5 days of trading.

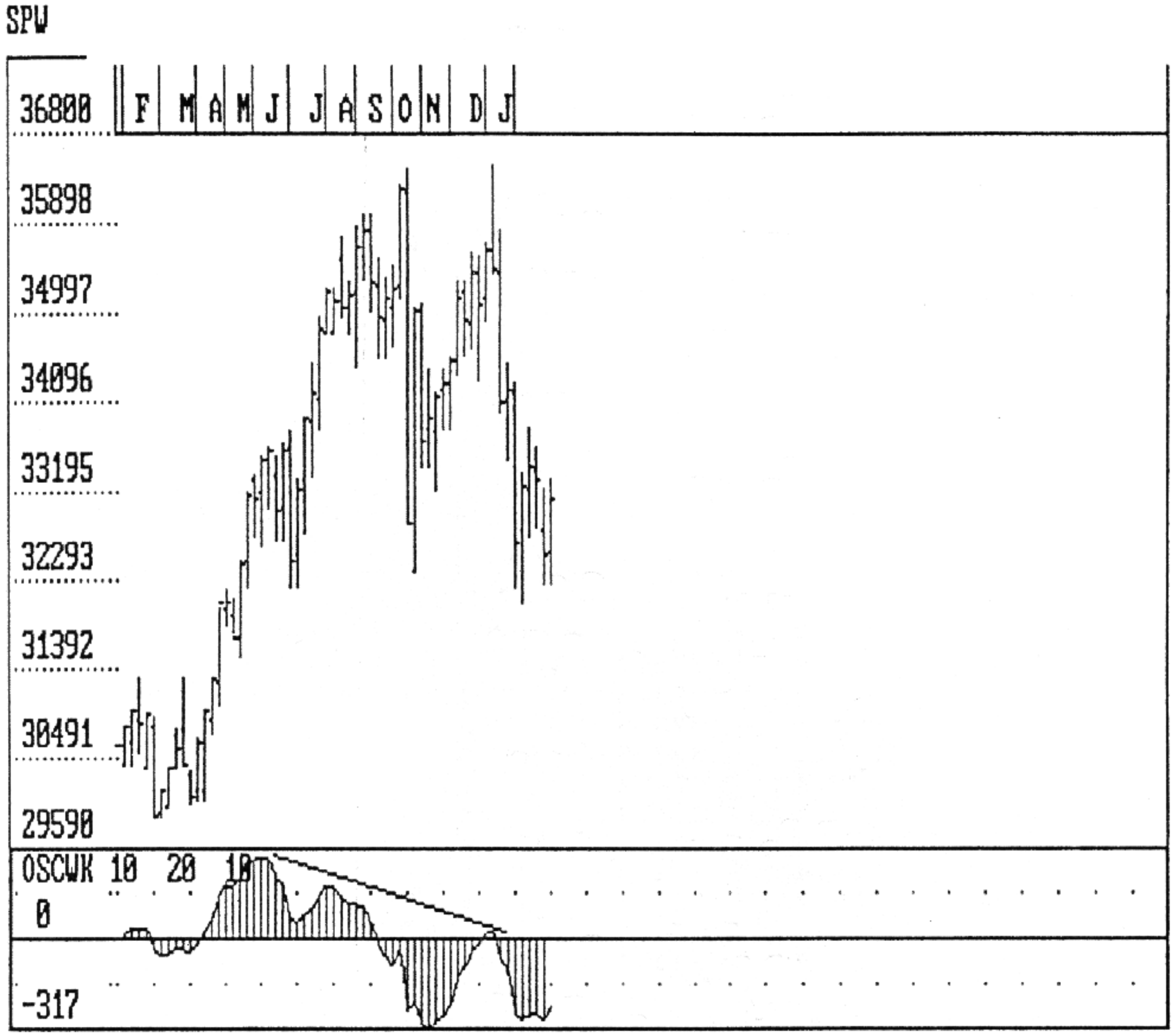
Consequently, during the course of the week that price bar might look like ┌, or └, or ├, or something in between. It changes every day to reflect the latest 5 days of trading. Why is this important?

When you have an oscillator that is so sensitive that it either leads or is coincident with prices, then each and every segment becomes important. I can't afford to wait until the end of the trading week to find out if the oscillator segment has changed direction. I need to know today. Since the oscillator is computed based upon the difference between two moving averages of closing prices, I need to know if today's price action has caused the oscillator to change direction.

So, when I compute the weekly oscillator, I take the time and effort to make the latest segment reflect the last 5 days of trading. Here's how I do that:

Week	S&P500 Closes	10 Bar MA	20 Bar MA	Difference	Smoothed by 10
1	335				
2	332				
3	330				
4	324				
5	328				
6	325				
7	318				
8	315				
9	320				
10	310	323.7			
11	320	322.2			
12	310	320.0			
13	315	318.5			
14	318	317.9			
15	325	317.6			
16	328	317.9			
17	324	318.5			
18	330	320.0			
19	332	321.2			
20	335	323.7	323.7	.0	
21	333	325.0	323.6	1.4	
22	336	327.6	323.8	3.8	
23	330	329.1	323.8	5.3	
24	331	330.4	324.2	6.3	
25	325	330.4	324.0	6.4	
26	322	329.8	323.9	6.0	
27	320	329.4	324.0	5.5	
28	318	328.2	324.1	4.1	
29	305	325.5	323.4	2.2	4.1 } Plot
30	300	322.0	322.9	-2.10	4.0 } Points

```
          ^---^
I change    |   price every day and recalculate my plot point.
          this
          last
```



Divergence

Figure 12 Shows the Weekly S&P 500. I've shown it for one important reason. Look at the progressively lower highs above the zero line being made by the oscillator just prior to the crash. This is a form of divergence that should be strongly heeded when seen. Even though the market was moving sharply up, the oscillator showed that there was less and less bullish pressure, indicating that there were fewer and fewer buyers in the market.

Prices were making new highs, but the oscillator was making lower highs. The final "low" high, was made just above the zero line at the beginning of September. That was the signal to absolutely be out of any long positions in the Stock Market. I took my profits and ran. I let people who are more brave than I am have those last ticks up in October.

CHAPTER 5

The Greatest Lesson

Now, before going on to part IV, I want to reveal the greatest single lesson that I have ever learned in trading. This one concept, if mastered, can make virtually anyone a winner the vast majority of the time.

Learn to Reverse a Losing Position

The best way I can express what I mean is to relate a true story I witnessed recently. I am going to change the names of the person and the contract traded in order to avoid slandering anyone, but otherwise every bit of it really happened.

Trader Tom puts out a periodic trade bulletin, and between bulletins he has a regular hot-line. The Canned Lion's Tongue contract for April (otherwise known as LTJ) had been making new highs and was steady up due to an agreement by the lion's tongue cartel to cut production. Finally, LTJ made a new high for the year, topped out, and began to go down. The new high was at 12.50 a can (1,000 can lots), and prices dropped to 10.50 a can before rallying to a high of 11.50, thus forming a I-II-III high. Trader Tom spotted this as such and put out an open sell order to all of his followers to sell LTJ at a breakout of the number II point at 10.50. Trader Tom, who trades all of his own recommendations, got his order filled at 10.48, which turned out to be the low of day. Trader Tom and his followers placed their stops at the number I point of 12.50, which by this time seemed pretty safe as it was $2,000 away from the current price action.

The next few days saw the LTJ contract rally away from the low at 10.48. In fact, prices never got close to it again. On the fourth day there was a reaction, and the LTJ contract made a slightly lower low and a slightly lower high.

Surely the market must be going to break now and come on down. However, after that day's close a report came out from the Lion Tongue Slicer's Institute that showed a rather large drop in the U.S. stocks of canned lion's tongue. The next day, prices resumed their upward climb. Prices moved up for a few days, and then a correction came. Trader Tom felt sure that now the big break was certainly going to come. Prices moved down for a couple of days, but not by much. Then came an announcement that lion tongue producers outside the cartel had agreed to cut production in order to keep the price of lion's tongue at more acceptable (to them) levels. Lion's tongue began to move up once more, and at 11.75 there was no more any logical resistance except at 12.50 where trader Tom and his followers' stops were neatly bunched together waiting for the axe to fall (or should I say rise?).

Sure enough, within a few days prices climbed up, took out the stops at 12.50, and continued rising well beyond the 12.50 level. Trader Tom and all his followers lost $2,000 per contract. WHY? Because Tom was too arrogant, stubborn, stupid, vain, and mechanical to reverse his position. This could easily have been done when the institute reported lower than normal stocks were on hand. Again, it could have been done when the producers outside the cartel announced a cut in production. Certainly it could have been done on a technical basis as prices broke past the number III point, and again when it was clear that there was no more resistance between 11.75 and 12.50. But Trader Tom was paralyzed. His system was going to have to work, and if it didn't he and his followers would eat $2,000 - which is what they did.

If The Basis For The Trade No Longer Exists - Reverse!

If I am trading the breakout of a number 2 (II) point and prices start going the other way, the basis for my trade no longer exists. It is time to exit or reverse.

If I am trading the breakout of a trading range and prices turn and go the other way, I must reverse my position. If I am trading from a ledge, a hook, or a wedge, (as will be discussed in Parts V and VI), and prices turn and go the other way, I must reverse my position.

NOTICE!!! I did not say close out my position. I said REVERSE my position. Eight or nine out of ten times that a position is reversed, it will either break even or go on and make money, as opposed to taking an outright loss.

What It Takes

It is totally against human nature to reverse a position. It takes complete humility to do it. It is an admission that the market knows where it's going and the trader doesn't.

It takes a cast iron stomach to reverse. It is something to which I had to inure myself. I practiced it on paper for a long time. Then I practiced it with real money on the mini contracts, until I became steeled to doing it. It is unnatural, but it must be done. Anyone who wants to consistently make money in trading futures must become hardened to the fact of reversals.

Study charts and see how often this situation occurs. Keep accurate records of what happens when you don't reverse and when you do. There is no reason to sit and watch yourself get killed in the markets. No one has to be paralyzed, sitting there waiting in agony for the terrible loss that is bound to come. I used to think that if I were wrong, that I should get out - take my loss and get out. Many books teach this. Sometimes I moved my stop closer, so that the loss would not be so big, and then let myself get stopped out. It was like the chicken running to the butcher and saying, "Please chop my head off."

Trading By The Book - Part III

How to Turn Lemons into Lemonade

Now, I want to show one of the best trades that can ever come my way. It doesn't matter whether it comes on a one minute chart or a one month chart, or any kind of chart. It amounts to the aggressive use of the greatest lesson I ever learned, and that is reversing my position.

When a market goes like this:

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/\/\/\/\/\/\/
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Whether it be for a few minutes or a few months, and then breaks out like this:

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             /
/\/\/\/\/\/\/
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And then does this:

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             /\
/\/\/\/\/\/\/  \
                \
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Sell it as it breaks the lows of that congestion or range.

The opposite is equally true.

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                /
/\/\/\/\/\/\  /
             \/
```

Buy as it breaks the highs of the congestion or range.

It doesn't matter how short or long the congestion is, as long as it can be seen to be moving sideways. Normally, this will take a minimum of 3-4 bars on the chart.

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       /          /\
/\/\  /        \/\/  \
    \/                \
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What I'm doing here is to avoid taking the first breakout of a congestion or range. Instead, I'm opting for the situation in which everyone else has gotten burned by the false breakout and now prices have crossed the sideways area and have broken out on the other side. I miss many trades this way because many of them never reverse and come back through the congestion. But when they do, it is dynamite, a trade well worth waiting for.

This is particularly effective in daytrading, since I don't have to wait for a long time to see many of these situations happening on a regular basis.

When position trading on hourly, daily or greater (time interval) charts, I take the first breakout, and then reverse if I'm still in the trade as it comes through and breaks out on the other side of the congestion. If I'm not still in the trade when the reversal comes, then essentially I have the situation described above and can enter the breakout in the appropriate direction as it occurs.

NATURALLY, IF I'M ALREADY POSITIONED INCORRECTLY DUE TO THE FIRST BREAKOUT, I SHOULD HAVE A REVERSING STOP ORDER RESTING IN THE MARKET!

My general rule for reversing is, if my protective stop is able to be fairly tight upon entry, then I usually make it a reversing stop. Or, if a market has had a long run and the weekly oscillator turns in the opposite direction while prices are still moving the way they were, and if my stop is tight, protecting profits, then I may make it a reversing stop.

There is no hard and fast rule here. The reversing stop is intuitive, and the feel for it comes with practice. Start practicing immediately!

Before closing this part of the manual, I want to make something very clear. I've shown you a weekly oscillator. In Part IV I will be showing you a daily oscillator. However, I want to state here and now that I'm not all that thrilled with "Technical Trading." Why? Because the majority of traders use technical analysis for their trading. The majority of traders lose in the markets. Remember that as you go through Part IV.

No matter what form the technical analysis takes, whether Fibonacci, oscillators, moving averages, or whatever, the only thing I have ever seen work is the concept that I will now explain.

The odds are that whenever prices begin trending, they will continue to trend for some time. Let's call that the major trend. In technical analysis, the important thing is to find the major trend. Next, it is important to find the intermediate trend. Whenever the intermediate trend begins to go counter-trend to the major trend, there is a entry opportunity coming at the point that the intermediate trend reverses and begins again to go in the direction of the major trend. The entry signal will then come from what is considered to be the short term trend. Memorize this concept, it will be further revealed in Part IV. I am continually amazed at how few technical traders actually understand this concept. Yet if technical analysis is to be done, it is mandatory to understand the major trend / counter-trend process.

I'll repeat it once more. If the major trend is up, then wait for the intermediate trend to turn down. When the intermediate trend begins to turn up, then consider entry into the market based upon a signal from a short term indicator, or simply from the fact that prices are correcting. The opposite is true if the major trend is down.

You most certainly do not need an oscillator to tell you which way the market is going. In an uptrend, wait for the intermediate correcting price action. Attempt to buy into this correcting action, short term, at the time the market appears to be resuming the longer term trend.

The Oscillator combination I will be showing is nothing more than a crutch. You should learn to see these things with the naked eye.

What's Ahead

In Part IV, I will show how I trade a daily oscillator in conjunction with the weekly oscillator. Keep in mind that this is a crutch to be used only until you can read a chart.

In Part V, I will answer questions about what to do during congestion. Specifically, I will show what to do when congestion is less than 21-29 bars long on the chart. I will also show how to trade within a trading range. This technique will produce about 55% winners. Finally, I will reveal how and when to trade one-two-three tops and bottoms from a congestion area, so that it's possible to get a jump on the breakout of a trading range.

In Part VI, I will put it all together and show on some continuous charts an entire year's worth of trading. It's so relaxed and easy that it is truly amazing!

CHAPTER 1

The Daily Oscillator

The daily oscillator, unlike the weekly oscillator, is placed on an absolute scale. I want to know when the oscillator is overbought or oversold.

I defined the long term trend as being how I see prices trending on the weekly charts. The intermediate term trend is the trend that prices are making on the daily charts, and the short term trend is the trend prices are making intraday. All I need to know about intraday prices are reflected by the open, high, low and close that I see reflected in the last bar appearing on my daily charts.

In keeping with the orders of magnitude I previously explained, it can be seen that the long term trend (1 week), is 5 times the length of the intermediate term trend (1 day). The short term trend represents one order of magnitude less than the intermediate term trend. The short term trend represents approximately 5 hours of intraday trading. this varies from market to market but is close enough for my purposes. There is nothing magic about orders of magnitude.. If I were trading on an extended long term basis, I would use the monthly charts long term, the weekly charts intermediate term, and the daily charts short term. In fact, when I am trading mutual funds, that's exactly what I do.

When trading intraday, I would use the daily chart as my long term chart, the hourly chart as my intermediate term chart and a 10 or 15 minute chart as my short term chart. This method will work in any time frame.

For a daily oscillator, it is possible to use any of the popular oscillators that are available, as long as they show overbought/oversold.

It doesn't matter whether stochastics, RSI, %R, etc., is used as long as it has an absolute scale. Whichever one is picked must be used consistently. No switching back and forth. Learn to use it and to read it with all its particular idiosyncrasies. For computer trading, pick one and stay with it.

There is one other requirement RSI, %R, etc., must be set to reflect 5 days, otherwise the signals will come too late. That means that most of these studies as shown on charts coming from chart services will be unusable. They tend to show longer term oscillators for their daily charts.

If a computer program containing Stochastics is used, then set the parameters for the Stochastic as closely as possible to 5,3,3.

The object of using this methodology is to learn to see the movement of prices without the need for such an oscillator. Stochastics measures the grouping of closes. When closes group in the upper portion of a series of bars' individual trading ranges, then Stochastics will rise. When closes group in the lower portion of each bar's trading range then Stochastics will drop. These are things that can be seen by a trained eye in a manner better than what an oscillator can show.

Without a computer, here's how I calculate my daily oscillator - it is one-half of the Stochastic called %D.

$$\frac{\text{close - 5 day low}}{\text{5 day high - 5 day low}} = \%K$$

$$\text{sum 3 \%K) / 3 = \%D}$$

Enter high in column 1.
Enter low in column 2.
Enter highest high of last 5 days in column 3.
Enter lowest low of last 5 days in column 4.
Enter today's close in column 5.
Subtract 5 day low from today's close and enter it in column 6.
Subtract 5 day low from 5 day high, and enter it in column 7.
Divide the number in column 6 by the number in column 7. This is %K.
Enter %K in column 8.
Sum last 3 day's %K. Divide sum by 3 and Multiply by 100. This is %D.
Place %D in column 9.
Plot %D on the daily chart above and below a 50% line, on a scale from 0% to 100%. 70% or above is overbought. 30% or lower is oversold.

1	2	3	4	5	6	7	8	9
H	L	H5	L5	C	C-L5	H5-L5	%K	%D

Here's an example (figures rounded to two places):

Day	1	2	3	4	5	6	7	8	9	
	H	L	H5	L5	C	C-L5	H5-L5	%K	%D	
1	4213	4184								
2	4255	4190								
3	4240	4181								
4	4215	4150								
5	4195	4157	4255	4150	4191	41	105	.42		
6	4220	4163	4255	4150	4167	17	105	.16		
7	4184	4145	4240	4145	4164	14	90	.16	25	<-plot 25.

If desired, %K may also be plotted and then used as a full Stochastic. I don't use it that way because I'm not interested in when one line crosses the other. However there is nothing wrong with trading using the full Stochastic.

I utilize a short term daily oscillator because I want it to be responsive to the time frame in which I'm trading. I'm looking for a move that will last from two days to two weeks. If I can stay in longer, that's fine.

%D will be my daily oscillator. It tracks the position of daily closing prices within the recent range.

By trading from prices and the daily oscillator in conjunction with the weekly oscillator, I avoid the problems that come from blindly buying oversold signals and selling overbought signals as some traders do. The daily oscillator may give some good buy and sell signals when prices are in a trading range, but all too often they give too many signals and I end up getting whipsawed. Also, oscillators give premature signals when a market is trending.

I'm filtering the daily oscillator signals against the weekly oscillator signals. Then I will filter the daily oscillator signal against an intraday signal.

In effect, what I'm going to do is to give a market three tests before I enter any trade.

To show the daily oscillator and the intraday breakouts, I'm going to use a continuous chart for illustrative purposes, so that I won't have to keep changing contract months. The continuous charts accurately reflect the way the market looked at the time the trading was done. The only difference is that the prices have been adjusted to blend the months together. Each price bar from high to low is the same magnitude as it was during the months it was traded, and each price bar is exactly as it was in relation to the ones prior and subsequent to it.

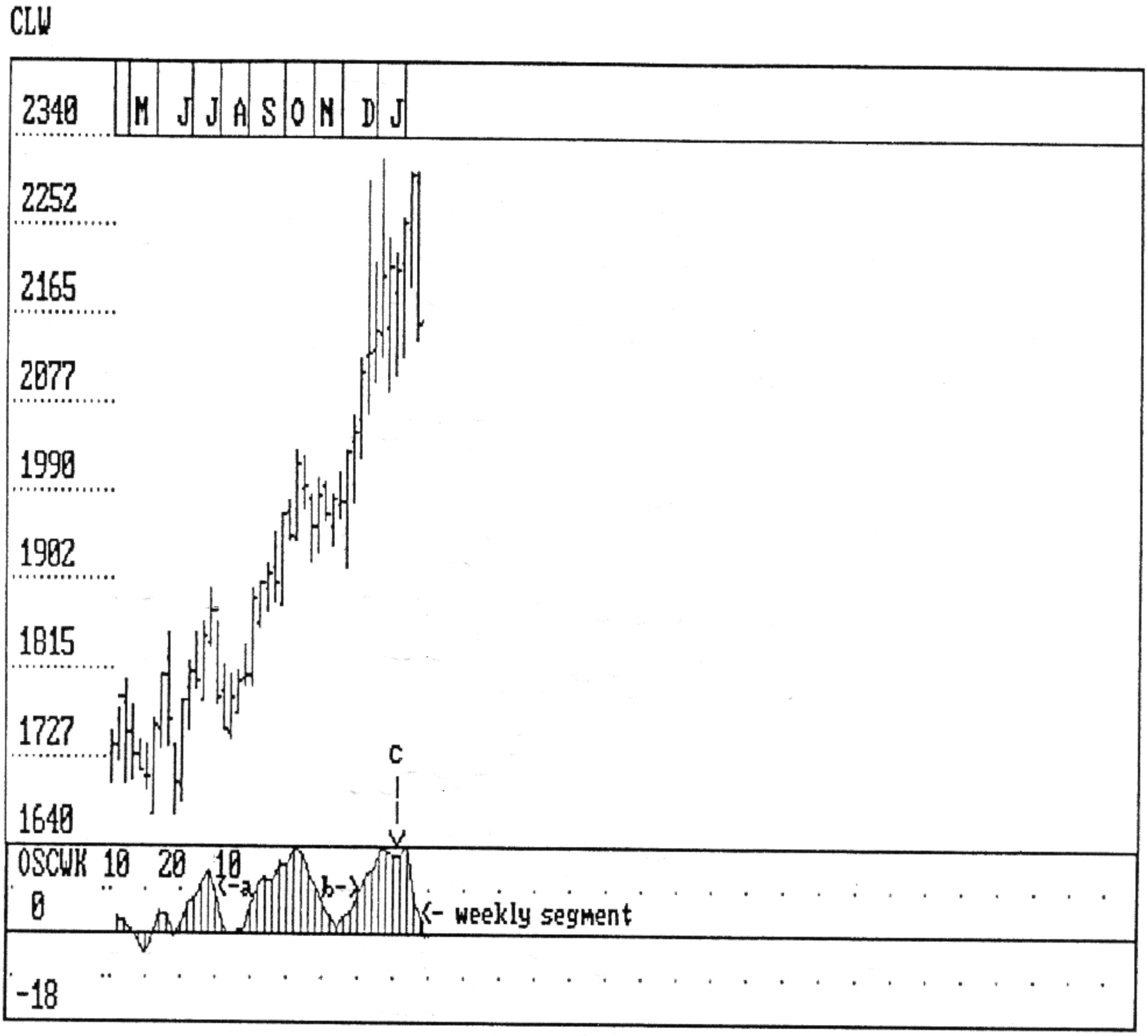

Figure 1 The first test examines the long term trend, or flow of the market. I will enter a trade in the direction in which the long term trend is pointing as labeled (a,b), if it is not flat (c). I will never trade against the long term trend. It is my primary filter. It shows direction. I will examine each weekly segment (distance from one vertical line of the histogram, to the next vertical line of the histogram) of the oscillator, computed current to date as was shown in Part III. This first test will be my primary filter. If there is no trend long term, I will not enter any trade based upon this oscillator. I will examine the overall weekly oscillator looking for divergence - divergence of trend and divergence of tops and bottoms as was shown in Part III, Figures 11 and 12.

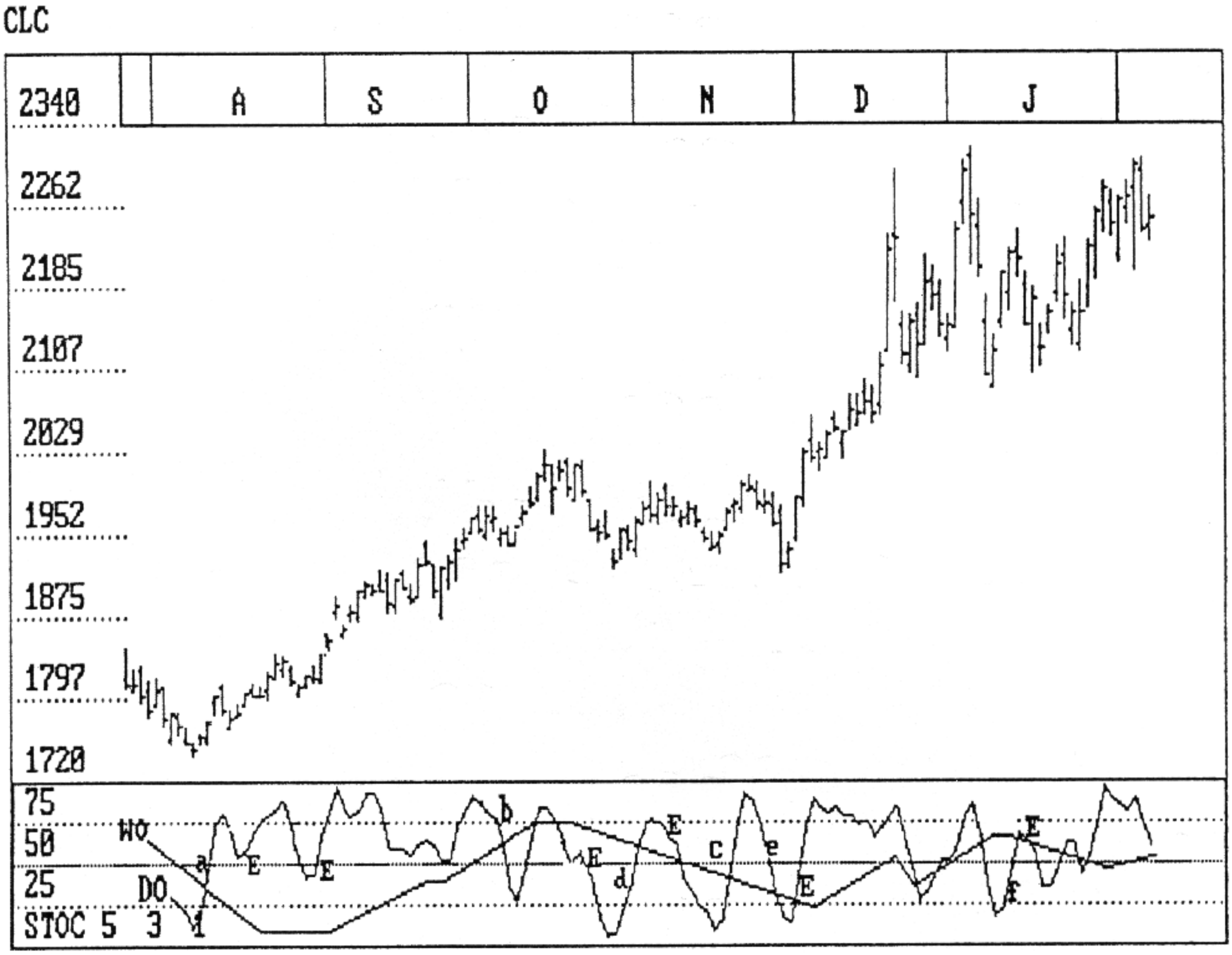

Figure 2 The second test will examine the intermediate term trend. Criss-crossing the oscillator, I've shown what the weekly oscillator (WO) segments were showing while the intermediate term trend was oscillating.

The long term trend indicates the flow of the market. The intermediate trend indicates the waves that make up the flow. I will be looking at the daily oscillator. What I will be looking for here is overbought/oversold, and direction. The daily oscillator indicates the waves that go <u>with</u> the major trend and those that go <u>against</u> the major trend.

As long as the long term trend is indicating the same direction, I will take trades in which the daily oscillator is in conformance with the weekly oscillator. However I will look carefully at the waves that go against the major trend (labeled a-f), because they are my alert to get ready to enter a trade or add to my position in the direction of the major trend.

The probability is that the long term trend will reassert itself, and so daily oscillations that go against the long term trend are excellent signals to get ready to enter a market. I've marked the approximate entry points with the letter E.

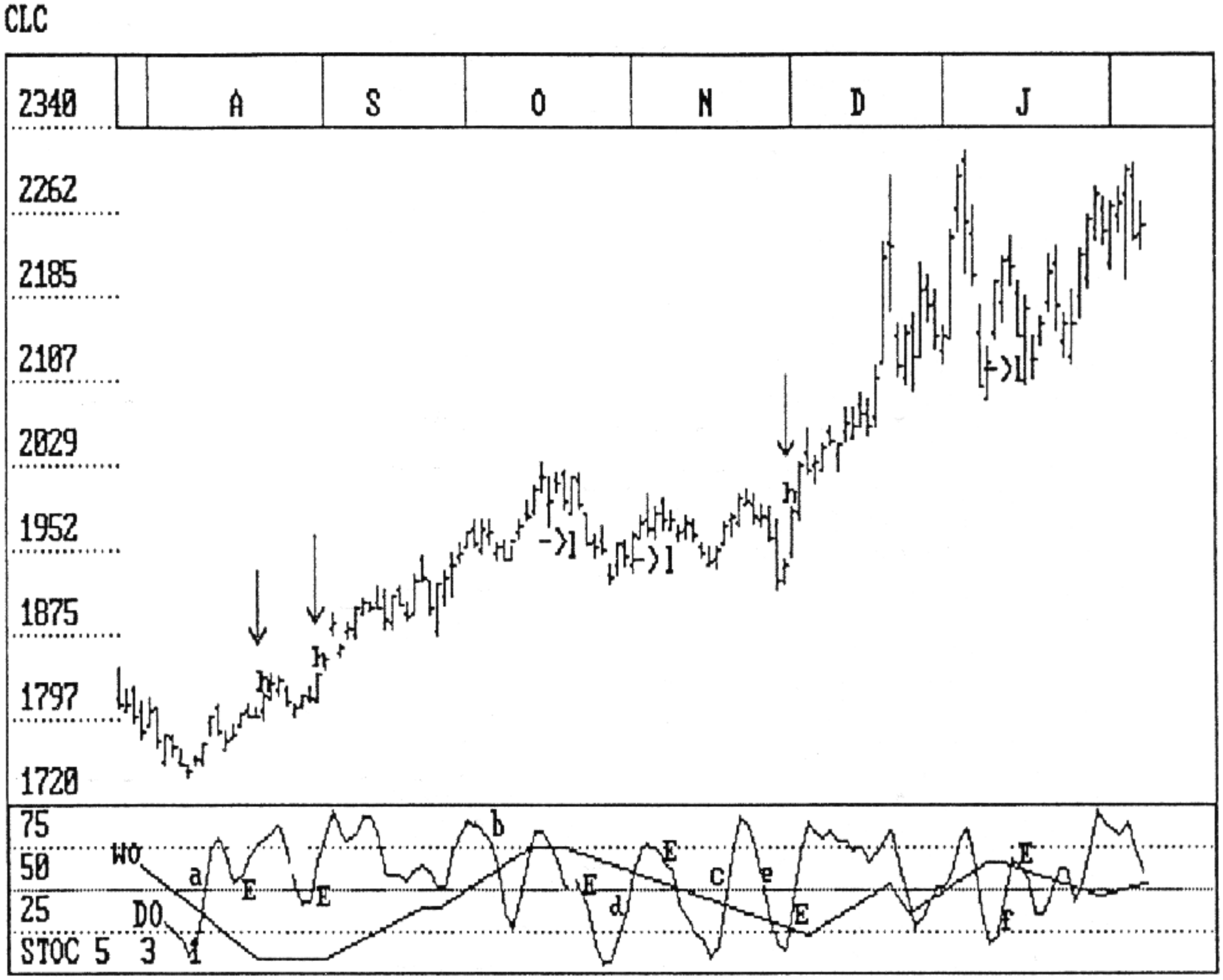

Figure 3 The third test comes from the last price bar on the daily chart, each day, as they occur. I'm looking for a breakout of either the high or the low of the last price bar for my entry. I've marked the days when that occurred in the past with the letters h(igh) and l(ow).

A breakout constitutes a passing of all three tests, and gives me the highest probability for success. Amazingly, as will soon be seen, a large percentage of the trades will approximate 1-2-3 breakouts, and breakouts of Ross hooks, but in many instances I will get a jump, a head-start on the breakout. This head-start means a great deal of extra money in my overall trading. I've marked the chart to show which breakouts were actually used to enter the trades.

This same advantage of getting in ahead of the 1-2-3 breakout is just as easily accomplished by learning to read the detail on the price bars of a chart. I suggest beginning to study the relationships of closes to overall price action as soon as possible, as well as studying the relationship of long, intermediate, and short term trends. The two oscillators I use should help in accomplishing that. Keep in mind that such oscillators are no more than a crutch. The objective is to throw away the crutches as soon as practical.

Review of Three-Way Testing

My strategy will be that when the oscillator segment is pointing up, but the daily oscillator falls, it will give me a signal to get ready to enter a buy order. When the weekly oscillator segment is pointing down, but the daily oscillator rises, it will give me a signal to get ready to enter a sell order. In other words, every wave that goes against the major trend alerts me to an opportunity to get aboard that trend if it continues.

A segment of the weekly oscillator is up or down when it moves .01 or more in value.

If the daily oscillator has already been ob/os when the signal comes from the weekly oscillator segment, I will immediately enter the trade provided that the daily oscillator has not already gone ob/os at the other extreme, that is, in the direction of the trend.

The short term trend is the third and deciding factor in entering a trade. By examining the breakout of the latest intraday trading range, I can get help in making a timely entry into the market. In this case, I'm using intraday action to point out logical entry points.

The weekly oscillator shows me the direction of the flow of prices - the major trend. The daily oscillator alerts me to the wave that is moving counter to the flow of prices - the intermediate trend. Now the intraday breakout highlights a logical entry point and shields me from the risk of entering the trade too soon.

My orders are placed strictly at the breakout points - either high or low. Initial stops are placed as protective stops, or even reversing stops, and when going long are placed one or two ticks below the low of the day, or the low of the previous day, according to amount of risk I am willing to take. When going short, protective or even reversing stops are placed one or two ticks above the high of the day or high of the previous day according to the amount of risk I am willing to take.

As a rule, these stops will not be hit because I'm trading in the direction of the major trend. If they are hit, it reflects a fundamental change in the market and I will want to try to make a profit from the new direction, or at least recoup some of my losses. I don't want to give the trade much room to work itself out. It has to succeed quickly or I want out, either with a reduced loss or a profit.

Taking profits. I move my protective stop to breakeven as soon as possible. If the trend continues to move in my favor, I move my stop progressively to the number 3 (III) points (Part II of the manual). What I'm doing then is waiting for a retracement to take place, and then when the trend continues, I place my stop in proximity to where the retracement ended and the trend began to continue. I can also add to my position at the continuation of the major trend.

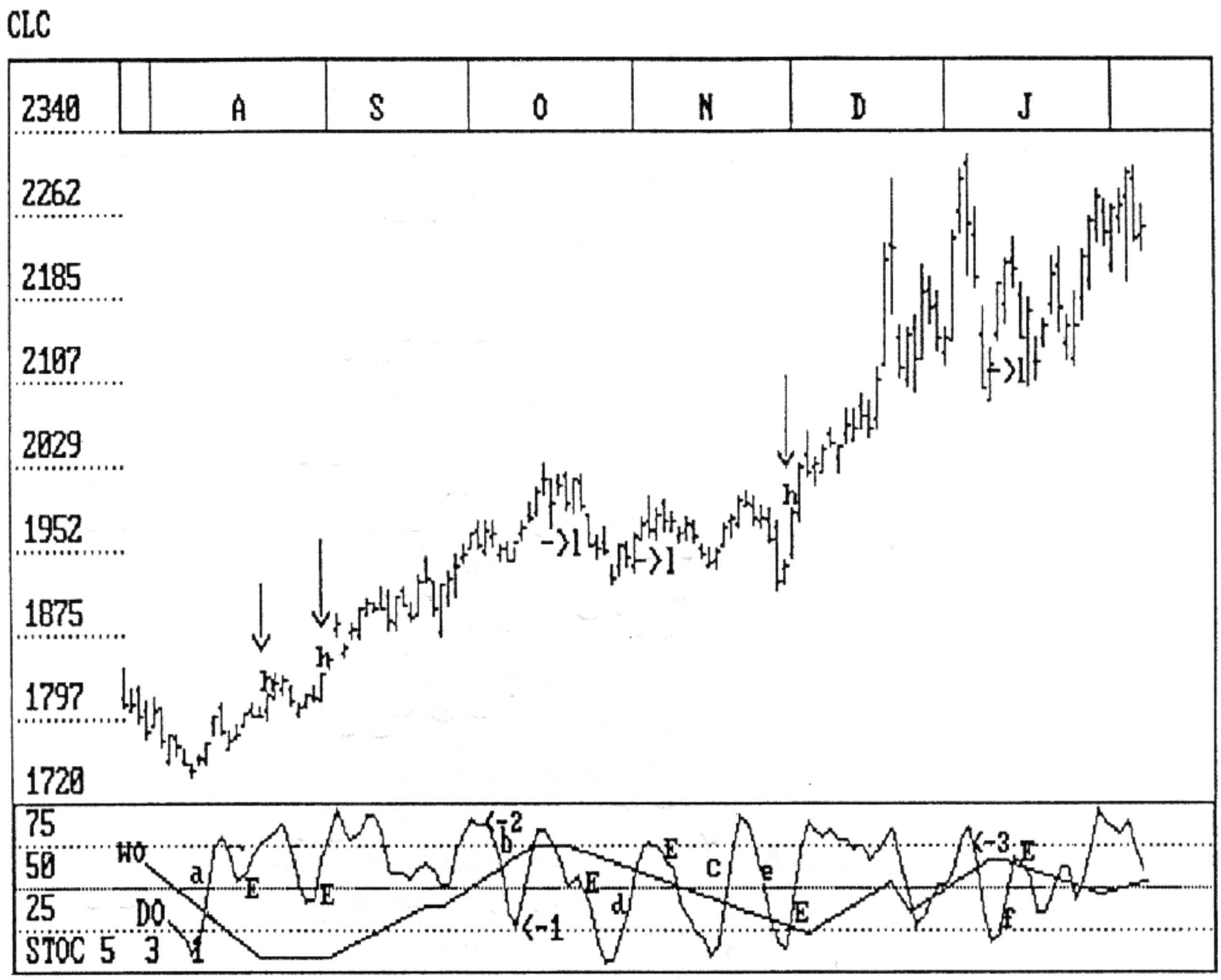

Figure 4 Shows the continuous daily Crude Oil chart. The additional trades using the rules for the refinement are the ones marked 1-3. I've shown the rules that applied to these trades.

Rule #1, If the weekly segment is pointing up, and the daily oscillator is in oversold territory and is pointing up, or is coming out of the oversold area, I place a buy stop order just above the previous day's high. I simultaneously place a protective sell stop 1 tick below yesterday's low.

Rule #2, If the weekly segment is pointing down, and the daily oscillator is in overbought territory and still pointing up, or is flat, I start placing day orders to sell just below the previous day's low. I simultaneously place a protective buy stop 1 tick above yesterday's high.

Rule #3, If the weekly segment is pointing down, and the daily oscillator is in overbought territory and is pointing down, or is coming out of the overbought area, I place a sell stop order just below the previous day's low. I simultaneously place a protective buy stop 1 tick above yesterday's high.

CHAPTER 3

Three Test Method In Action

Now that I've shown the basic rules for my three-test method, I will demonstrate it in action.

Notice how closely it approximates 1-2-3 breakouts. In most cases, other than the refinement mentioned in the previous chapter, the result I will get amounts to my getting a jump on the breakout of a 1-2-3. This "head start" will, in effect, place more profit dollars in my trading account.

In this demonstration, I will be trading strictly from the weekly and daily oscillators. In the last Part of the manual, I will blend all of the techniques together in order to show how it is that I actually trade.

For this demonstration, I have picked a little over a year of trading Comex Gold. Beneath the price bars on the chart, I've shown the status of the weekly oscillator for each week throughout the year.

Where I show ——, it means the oscillator for that segment(s) was flat. Where I show \, it means the oscillator for that segment(s) was pointing down, and where I show /, it means the oscillator for that segment(s) was pointing up.

Beyond that, I have given the status of the weekly oscillator on the day pertinent to the trade.

Remember that the prices have been adjusted for purposes of creating a continuous chart. However, the price bars are the same relative to one another, and of the same magnitude from high to low as they were when they occurred.

These trades are for real, the way I traded them, win or lose.

Throughout these charts, there appears "STOC 5 3 1". The "1" is what I do to tell the computer to eliminate showing %K as a separate line. Because of that, %K and %D will always have the same value as you see them on the charts.

In my trading I tend to use 70% as overbought and 30% as oversold. There is no magic in those numbers, often I fudge and go in slightly ahead of those numbers.

CHAPTER 2

A Refinement RAFFINATEZZA

To this point, I've shown the basic concept. Now I will show a refinement that results in additional trading opportunities. This refinement requires repeated study in order to fully grasp what I'm doing.

The refinement is not necessary to the basic method. It not only increases the number of times I win, but also the number of times I lose. However, it increases the dollars won more than it increases the dollars lost. To win with this refinement, I have to be quick. Many times the trade is good only for a day or two.

Here are the rules for the refinement:

If the weekly segment is pointing up, and the daily oscillator has exited overbought territory and still pointing down, or is flat, I start placing day orders to buy just above the previous day's high. I simultaneously place a protective sell stop 1 tick below yesterday's low. In this case I have not waited for a full correction of the daily oscillator all the way down to oversold. Prices may not have fully corrected.

If the weekly segment turns up while the daily oscillator is in oversold territory and is pointing up, or is coming out of the oversold area, I place a buy stop order just above the previous day's high. I simultaneously place a protective sell stop 1 tick below yesterday's low. I have not waited for the daily oscillator to correct to oversold and then come back out. Prices may not have fully corrected.

If the weekly segment turns up while the daily oscillator is in oversold territory and still pointing down, or is flat, I start placing day orders to buy just above the previous day's high. I simultaneously place a protective sell stop 1 tick below yesterday's low. Again, I have not waited for a full correction of the daily oscillator to oversold and then back out of oversold. Prices may not have fully corrected.

If the weekly segment is pointing up, and the daily oscillator has previously entered and then exited the oversold area, but is still short of being in the overbought area, I place a buy stop order just above the previous day's high. I simultaneously place a protective sell stop 1 tick below yesterday's low. This may take place without a prior correction of prices other than that they have moved sideways.

The totality of these four refinements is that I will start placing orders to buy a breakout of today's high as long as, or as soon as, the weekly oscillator is pointing up, even though prices have not fully corrected yet as seen on the chart, or as shown by the daily oscillator.

Of course, I do just the opposite for shorting the market.

With the plain vanilla version of this method, when I want to go long, I wait for a full correction of the oscillator into oversold and then back out again before entering buy orders. As the daily oscillator approaches oversold, that is my signal to get ready to buy. With the refinement, I start trying to buy a breakout of the high as soon as the daily oscillator has corrected from overbought.

With the plain vanilla version of this method, when I want to go short, I wait for a full correction of the oscillator into overbought and then back out again before entering sell orders. As the daily oscillator approaches overbought, that is my signal to get ready to sell. With the refinement, I start trying to sell a breakout of the low as soon as the daily oscillator has corrected from oversold.

There is no absolute rule as to when everything seems right to do this, or as to just where the daily oscillator might be when I start entering the orders. I start placing orders as soon as I feel that the market will start correcting, and that it is safe for my account. Part of my decision will be according to how long the major trend has been going, how steep has been its ascent or descent, whether or not the daily oscillator is in overbought or oversold, and how long it has been there.

The refinement is as much a judgment call as you care to make it. The main thing is that you are trying to trade in the direction of the major trend. You can build your own set of rules around it based upon your own comfort level and experience.

The refinement will yield a great many more trades. Without the refinement many good moves will be missed.

Some have asked, "Will I ever see a weekly oscillator pointing up at the same time the daily oscillator has corrected and has also turned up?" The answer is yes, but it may happen only a few times in a year for any market -- maybe not at all for some. However, when it does happen, it means that the trend is relatively longer term for that particular market and the vast majority of your trades will be successful. If that is your comfort level, then I suggest you trade it that way.

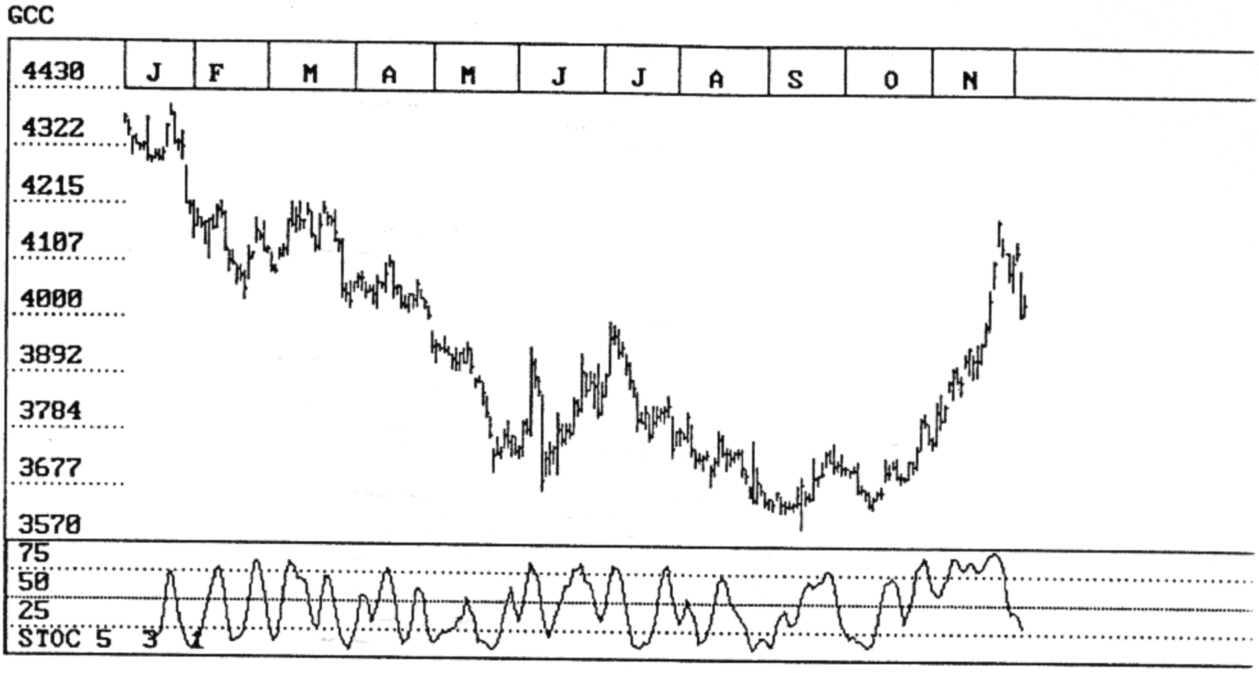

Figure 5 I've shown approximately the entire year of Gold prices. Here's how the oscillator segment looked at the week endings:

1230-0106 /
0109-0120 -
0123-0217 \
0220-0303 -
0306-0310 /
0313-0323 -
0326-0407 \
0410-0421 -
0424-0505 \
0508-0512 -
0515-0519 \
0522-0609 -
0612-0707 /
0710-0915 \
0918-0929 /
1002-1020 -
1023-1201 /

The status of the weekly oscillator, up /, down \, or flat -, is shown as of the week ending e.g., 0106. Sometime during the range of dates shown, the weekly oscillator turned to that position.

Usually a large magnitude daily move, a gap, or four successive higher or lower daily closes, with at least one of the days being a larger than normal move, will cause the weekly oscillator to change direction. Sharp turns in the market will also cause the weekly oscillator to change its direction.

From here on I will state what the weekly oscillator segment looked like on the day the trade was entered or exited as is appropriate.

From 1230-0106, the weekly oscillator is up. No trades are considered. I have no other trades on because I don't like to trade during the last two weeks of December or the first week in January. Very often I don't trade at all in December unless I already have a trade working. The markets are just too thin to suit me.

The weekly oscillator is flat from 0109 to 0126. At that time I get a signal from the weekly oscillator to go short, but the daily oscillator is already oversold. I do not enter any trade, but I'm alert to the fact that the daily oscillator is oversold.

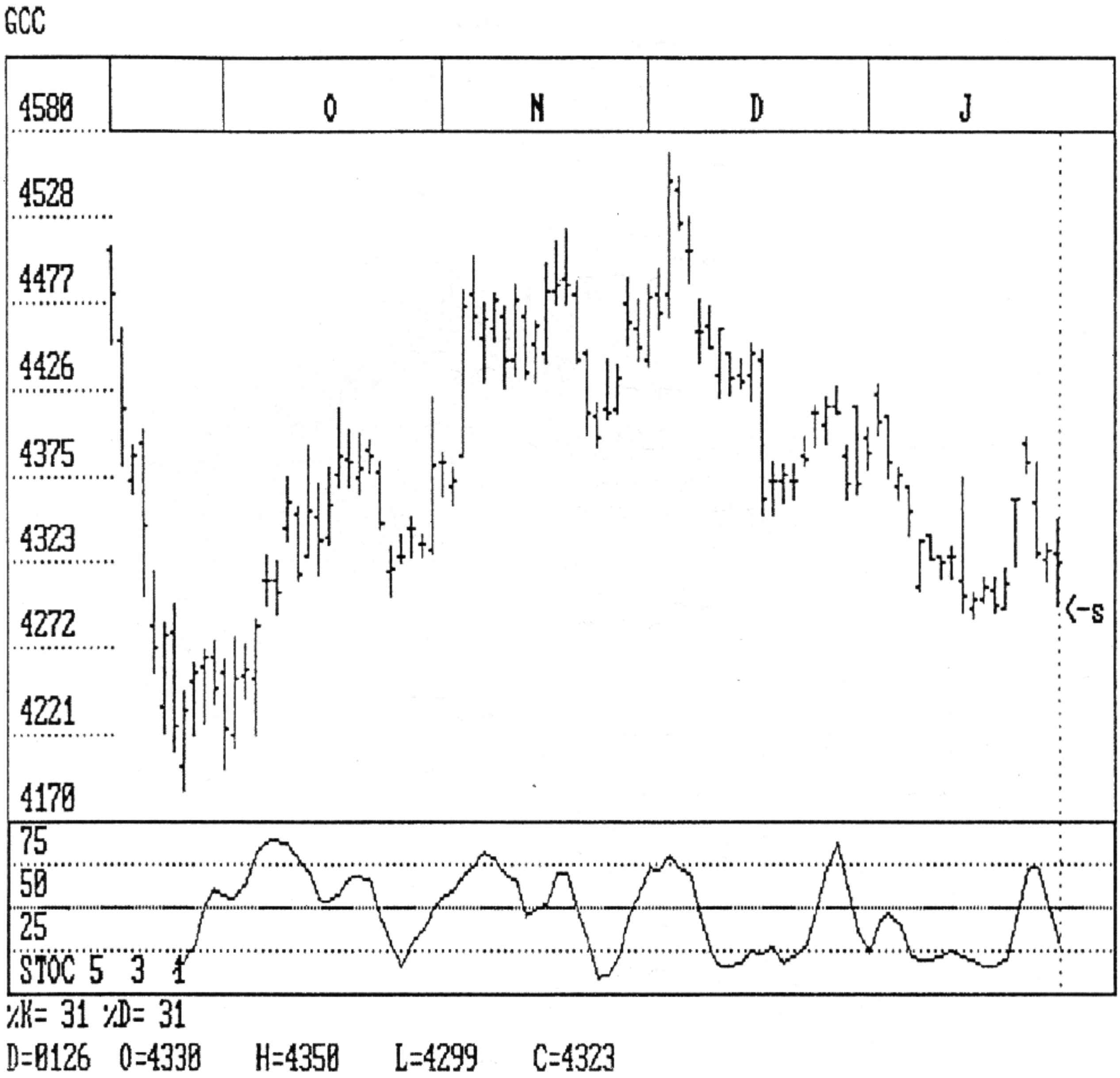

Figure 6 From here on I will show the pertinent trading days one, two, or a group at a time.

On 0126, the weekly oscillator segment turns down after a sharp turn in prices. The daily oscillator, which has been strongly up, has already turned down and is plunging towards oversold. I place a sell stop at just below the low of 0126.

I've shown what the chart looked like when I placed my order to sell.

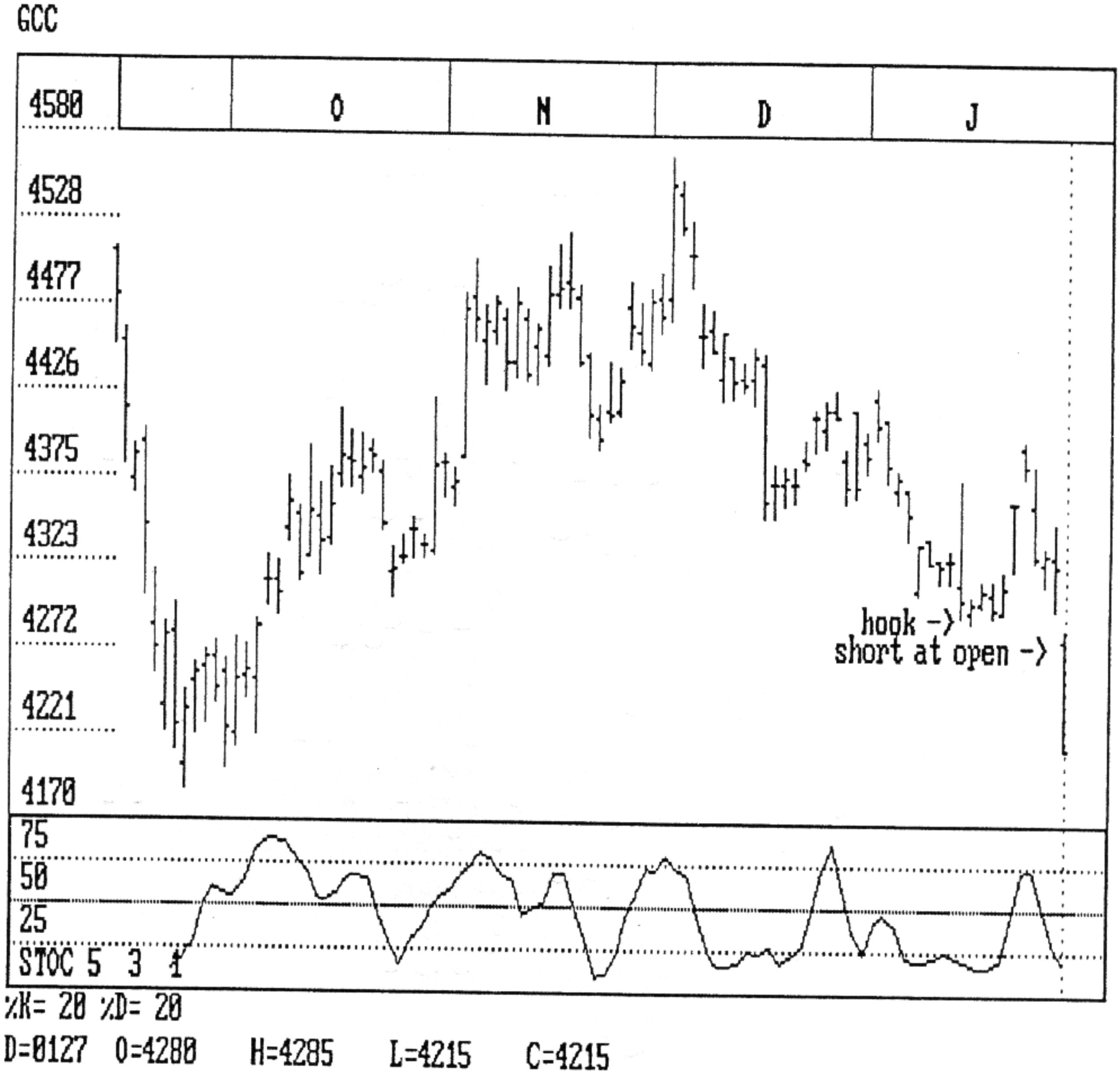

Figure 7 0127. I'm filled on the open at 4280 (428.00, the decimal is implied). In keeping with safety, I place a catastrophic reversing initial stop at 4351. At the end of trading that day, I move that reversing stop to 4286, which is just above today's high. I often do that on a large magnitude move. I've shown how the market looked the day I entered it. Notice that the breakout also took out the low of the prior (lowest low on the chart) Ross hook.

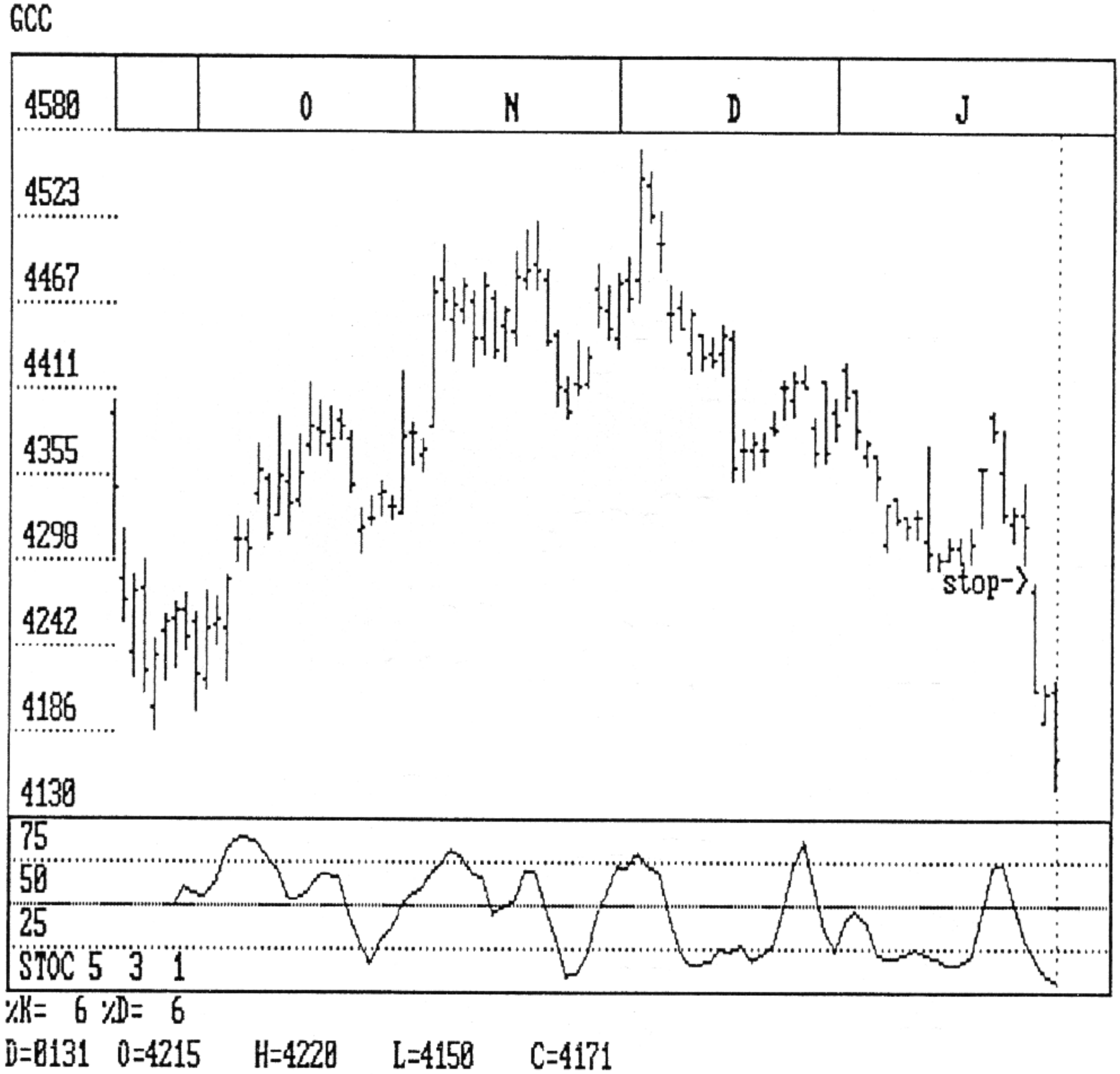

Figure 8 The following three days, I'm richly rewarded, but on 0131, the daily oscillator shows as extremely oversold. I expect a correction of some sort and perhaps another chance to sell. My reversing stop is now at the bottom of the gap, just above the high of the breakout day.

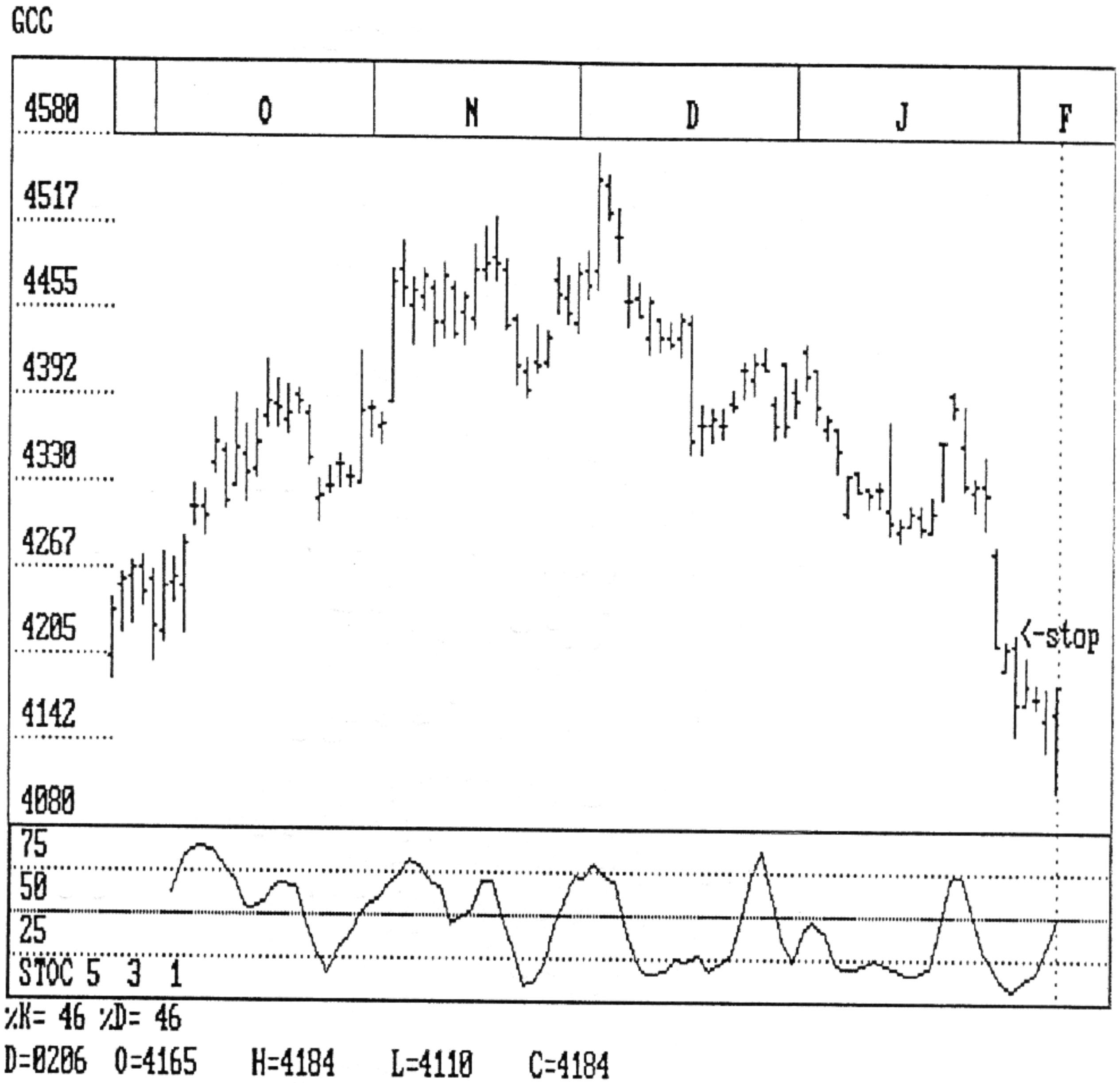

Figure 9 Sure enough, the market slows and the daily oscillator begins a retracement. 0206 is what I call a "blowoff day." (That may not be true for others). The market makes an outside day, with a lower low and a higher high than the previous day. And then, it closes on its high, indicating bullish pressure. Because of that, I tighten up my stop and move it from the bottom of the gap to just above the high of the day after the day following the gap day. I then watch and hope. I'm a little nervous, too. The weekly oscillator remains pointing down.

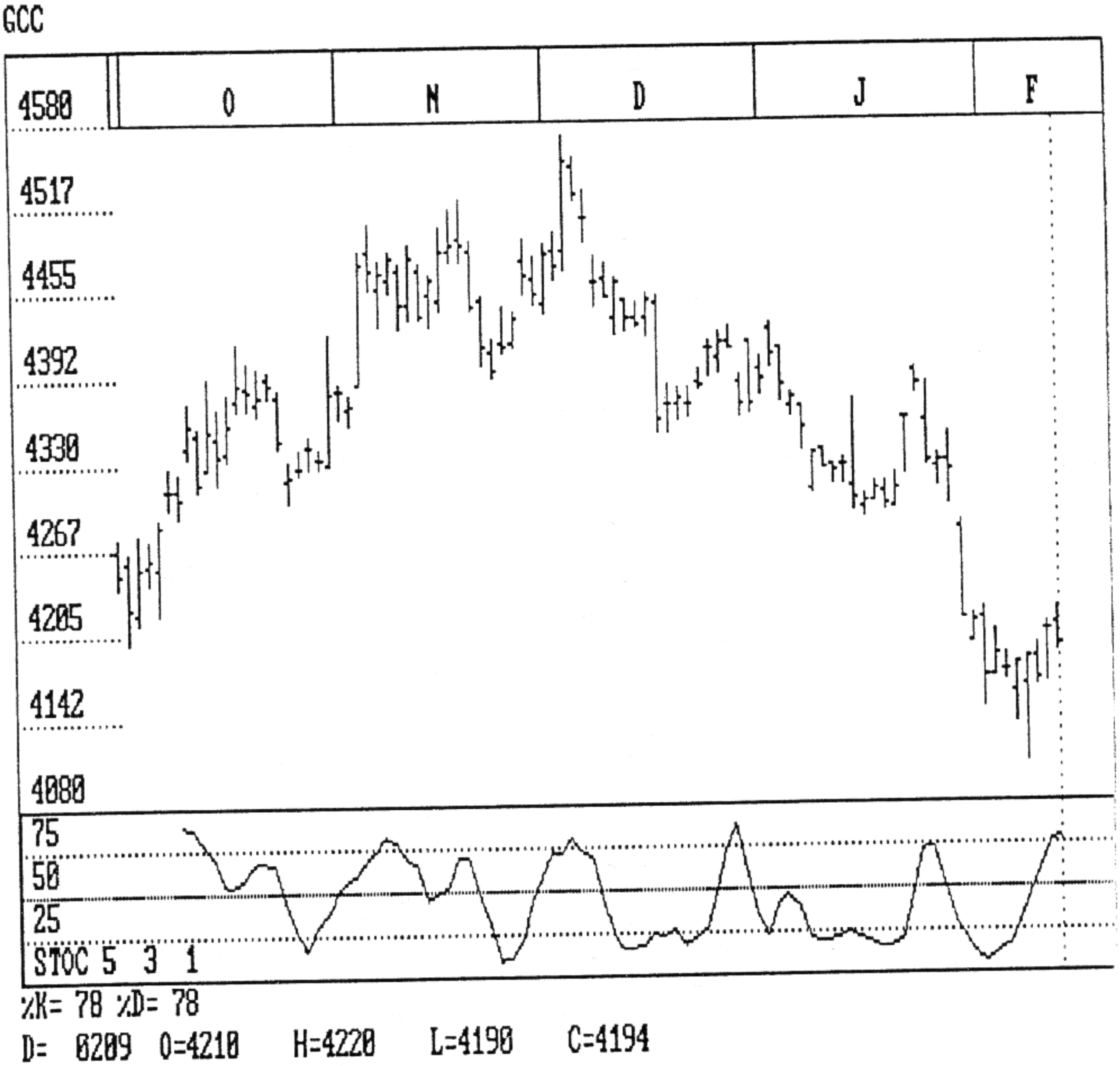

Figure 10 It's 0209. The market moves higher and the daily oscillator enters the overbought area. The high that day comes within 1 tick of my stop, but prices close nea the low of the day. The weekly oscillator is still pointing down. I place an order to sell a second contract at 4188, just in case I don't get stopped out and the market moves lower.

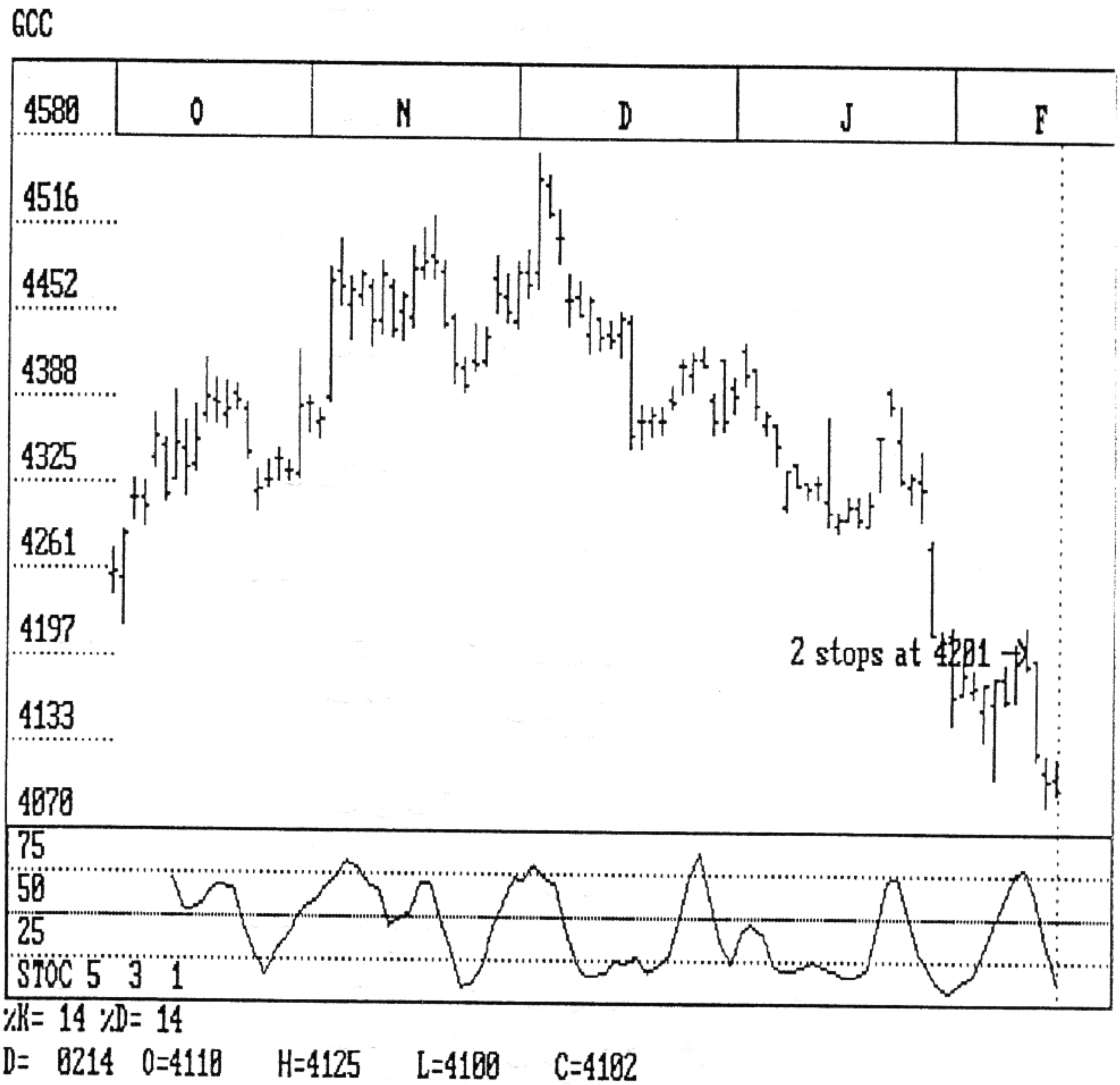

Figure 11 As luck would have it, prices drop like a bomb on Friday, 0210. The next day, Monday 0213, they take out the number II point of a very large I-II-III high, which coincides with a Ross hook. Then on Tuesday, 0214, there's a small correction and the daily oscillator is deep in oversold territory. Because of that, I move my protective stops to 4201.

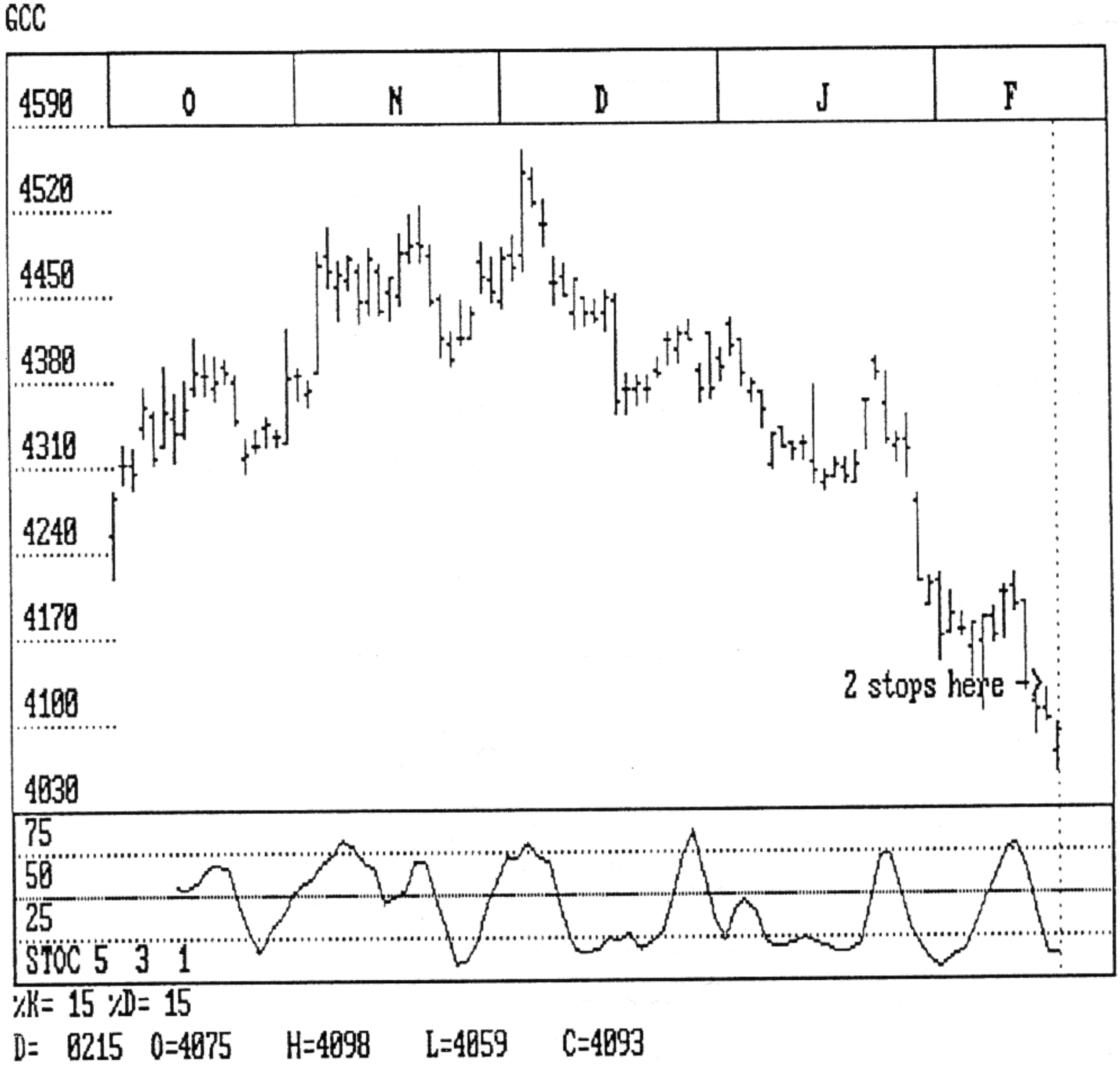

Figure 12 Prices continue down, but on 0215 they close near the high of the day, indicating an almost certain retracement is in the offing. I move my stops to just above the close of the previous day, at 4103.

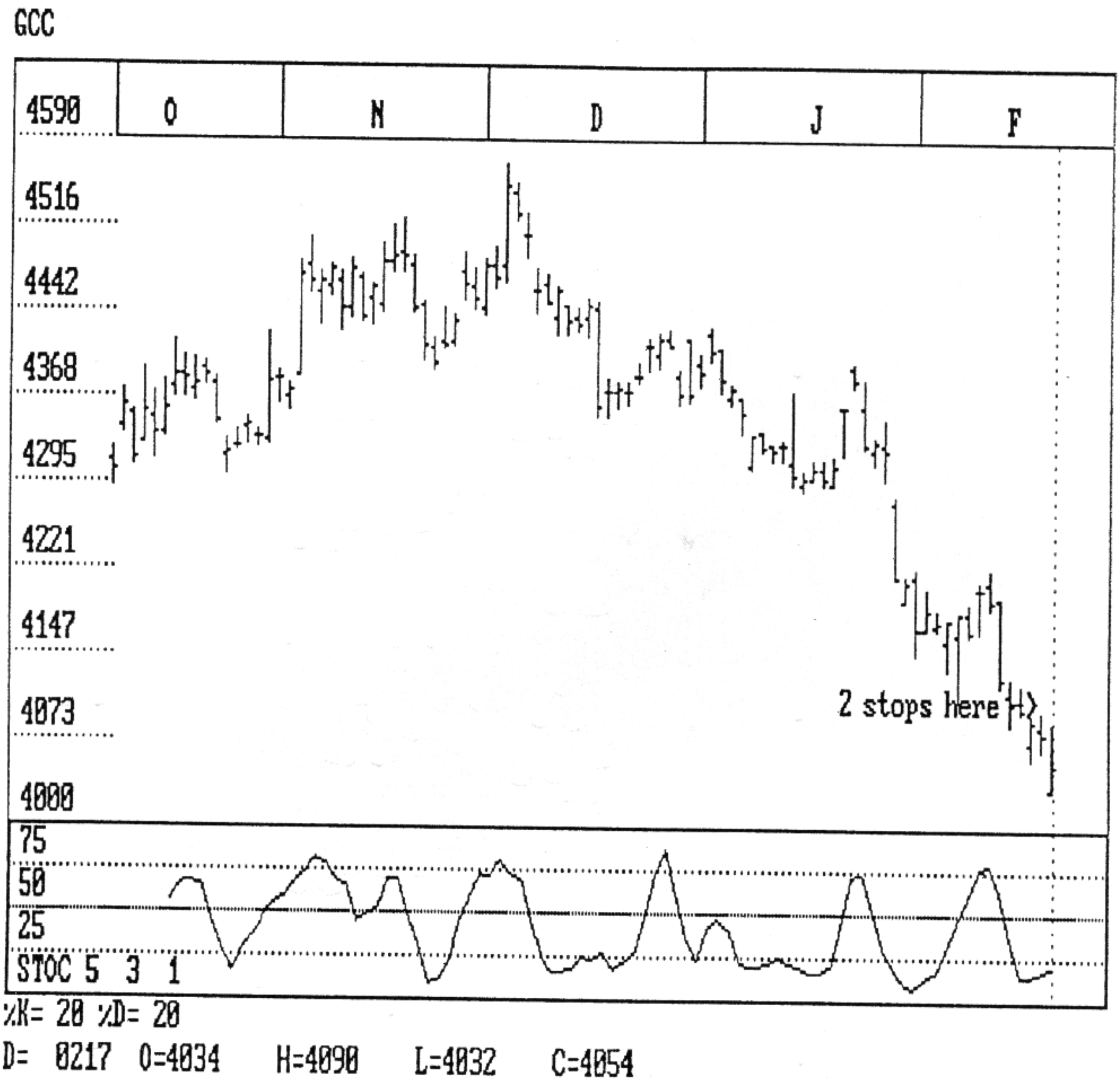

Figure 13 My luck continues to hold on 0216, as prices make a high at 4100. The next day, 0217, they continue to move down again. I think to myself, "Maybe the oscillator will turn down, and I'll get a double bottom." I move my stops to 4091.

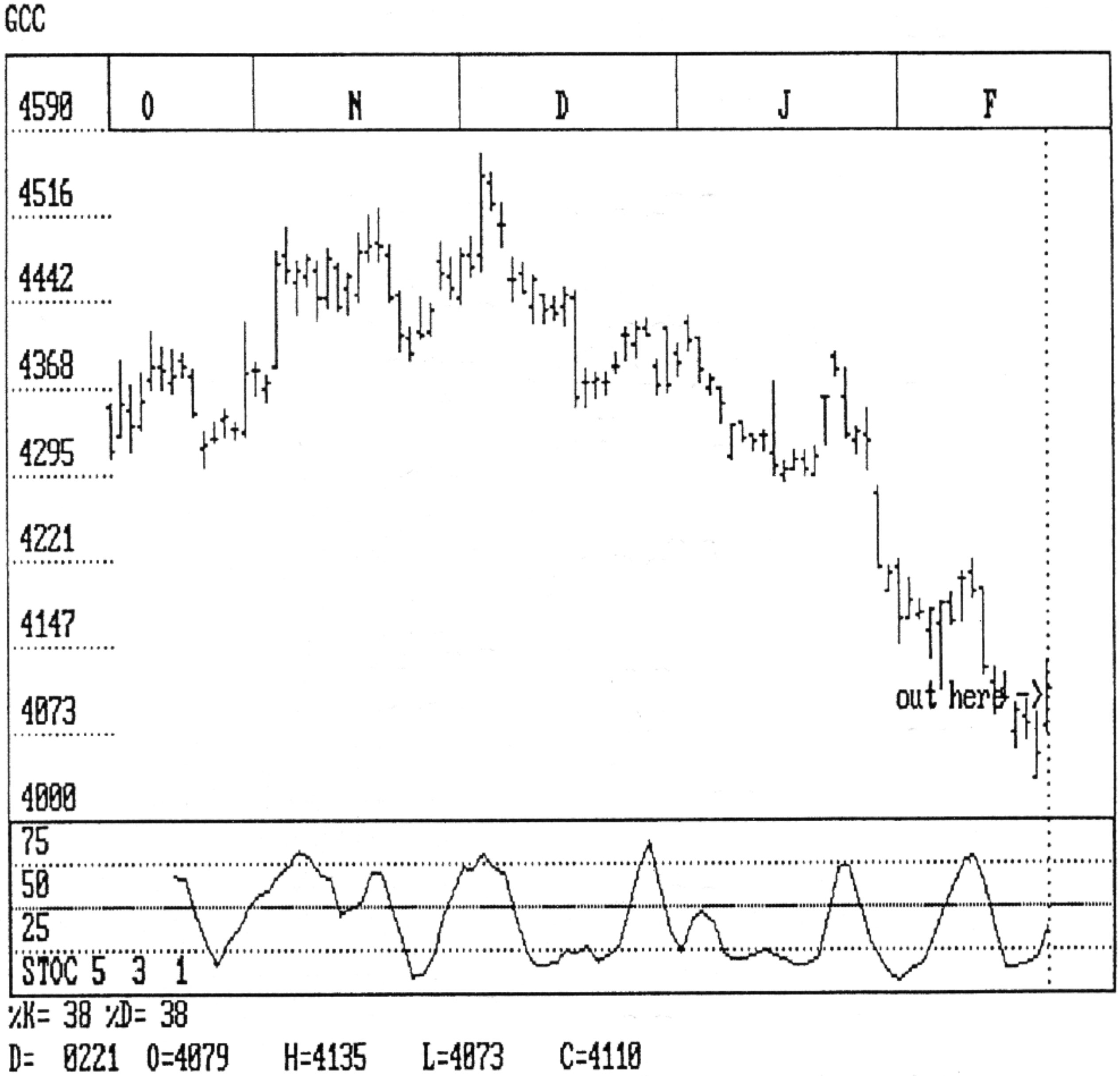

Figure 14 It's 0221. Prices move sharply up, taking out my two stops. I thought, "Perhaps this is another correction." But the weekly oscillator has turned flat.

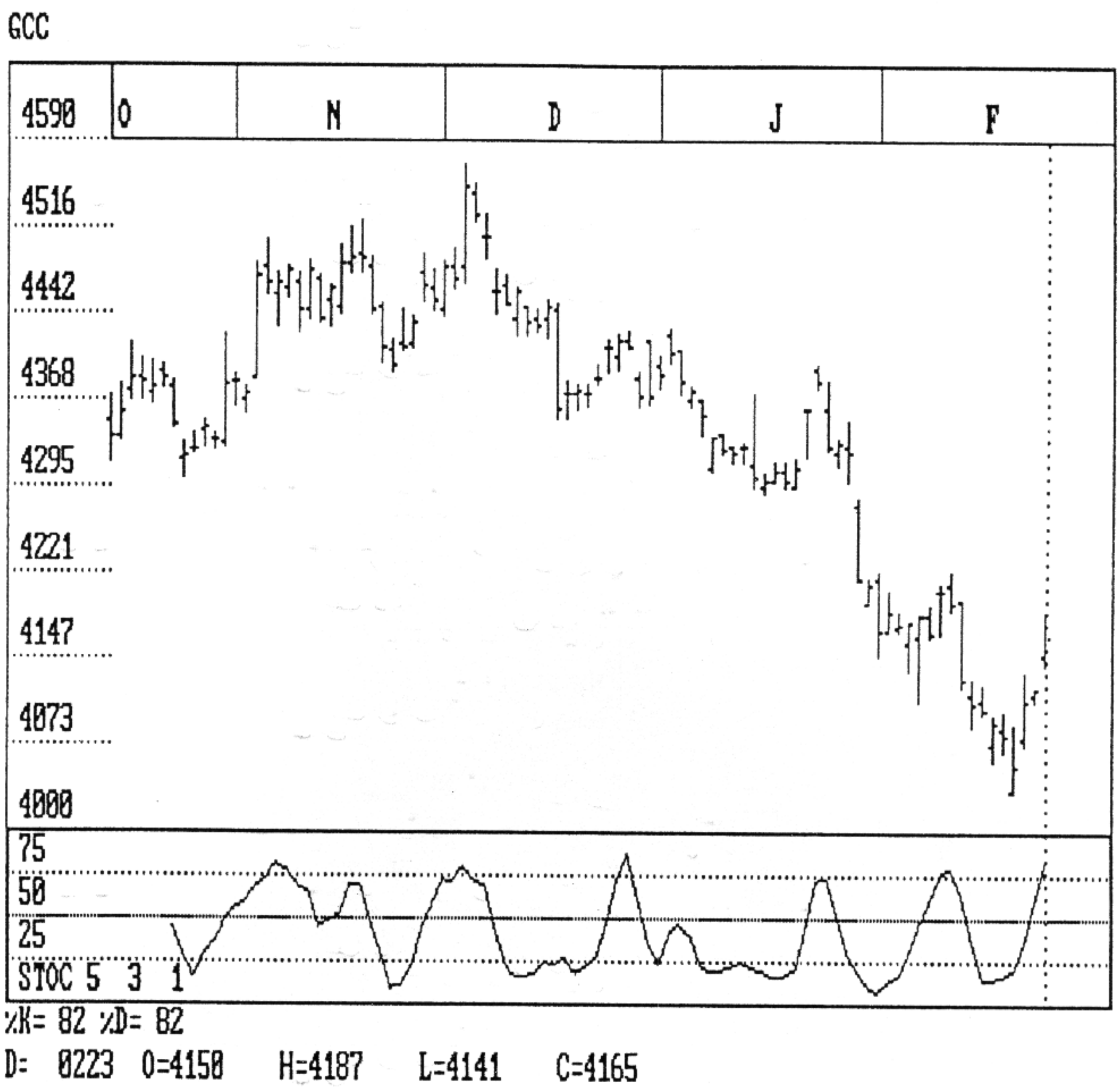

Figure 15 On 0223, the weekly oscillator segment turns up briefly, but I skip trying to enter the market because the daily oscillator is overbought at 82%. I'll have to wait for a correction, and then try to enter long if the weekly oscillator remains pointing up. In the meantime, I trade in other markets.

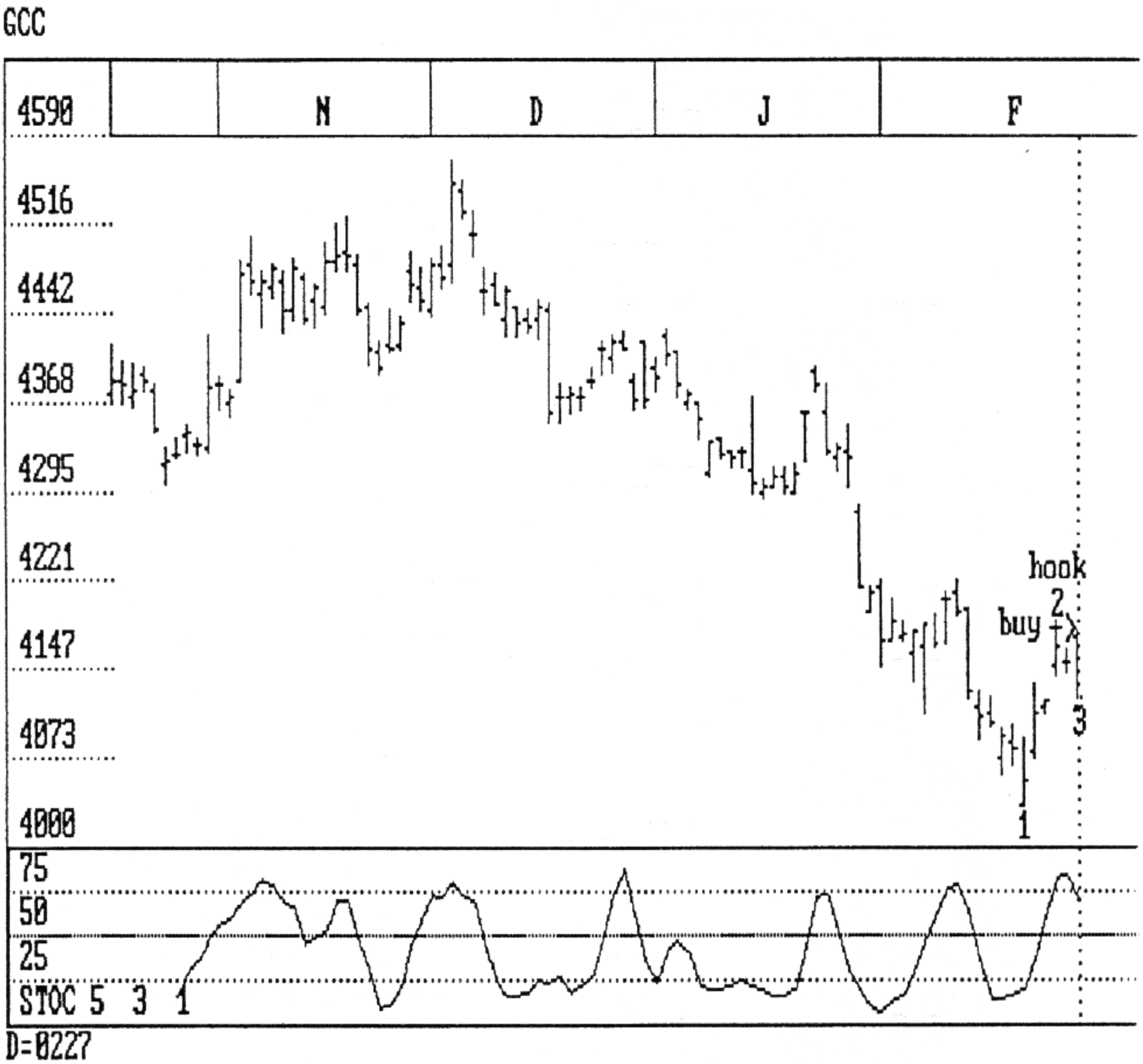

Figure 16 On Friday, 0224, the market begins to make a correction, with an inside day. On Monday, 0227, it corrects further, and the daily oscillator moves out of the overbought area. The weekly oscillator again signals "go long." I place a buy order one tick above the high shown for 0227. Notice that if my order is filled, it gives me a small jump on a 1-2-3 formation and the Ross hook of two days ago.

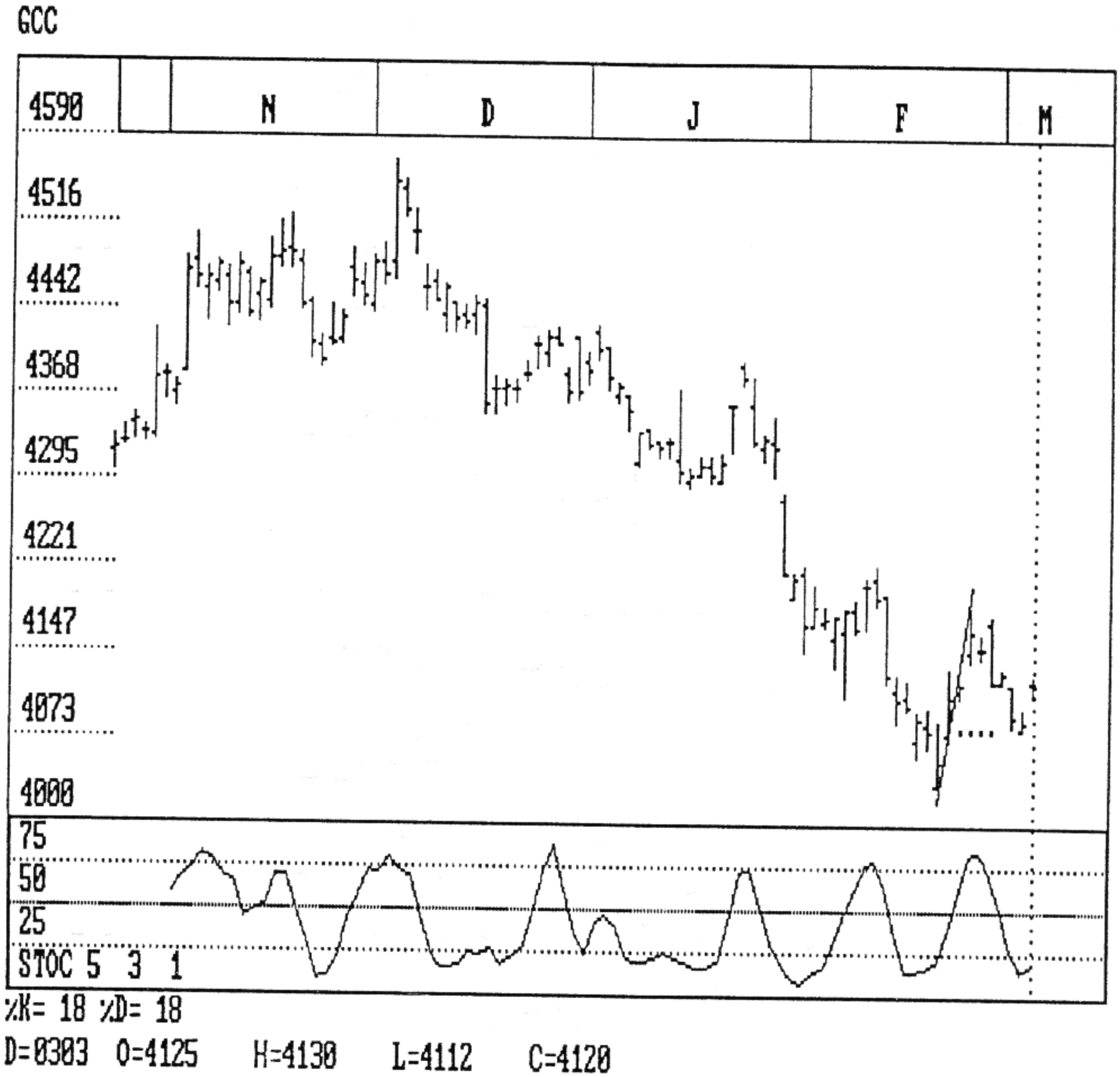

Figure 17 The market continues to correct on 0228, 0301, and then again on 0302. The weekly oscillator has gone flat. At that point the market is deeply oversold again, and has made, of all things, a Fibonacci correction.

On 0303, the correction is over. Prices gap upward and the daily oscillator turns, but the weekly oscillator is flat so I cannot enter the market.

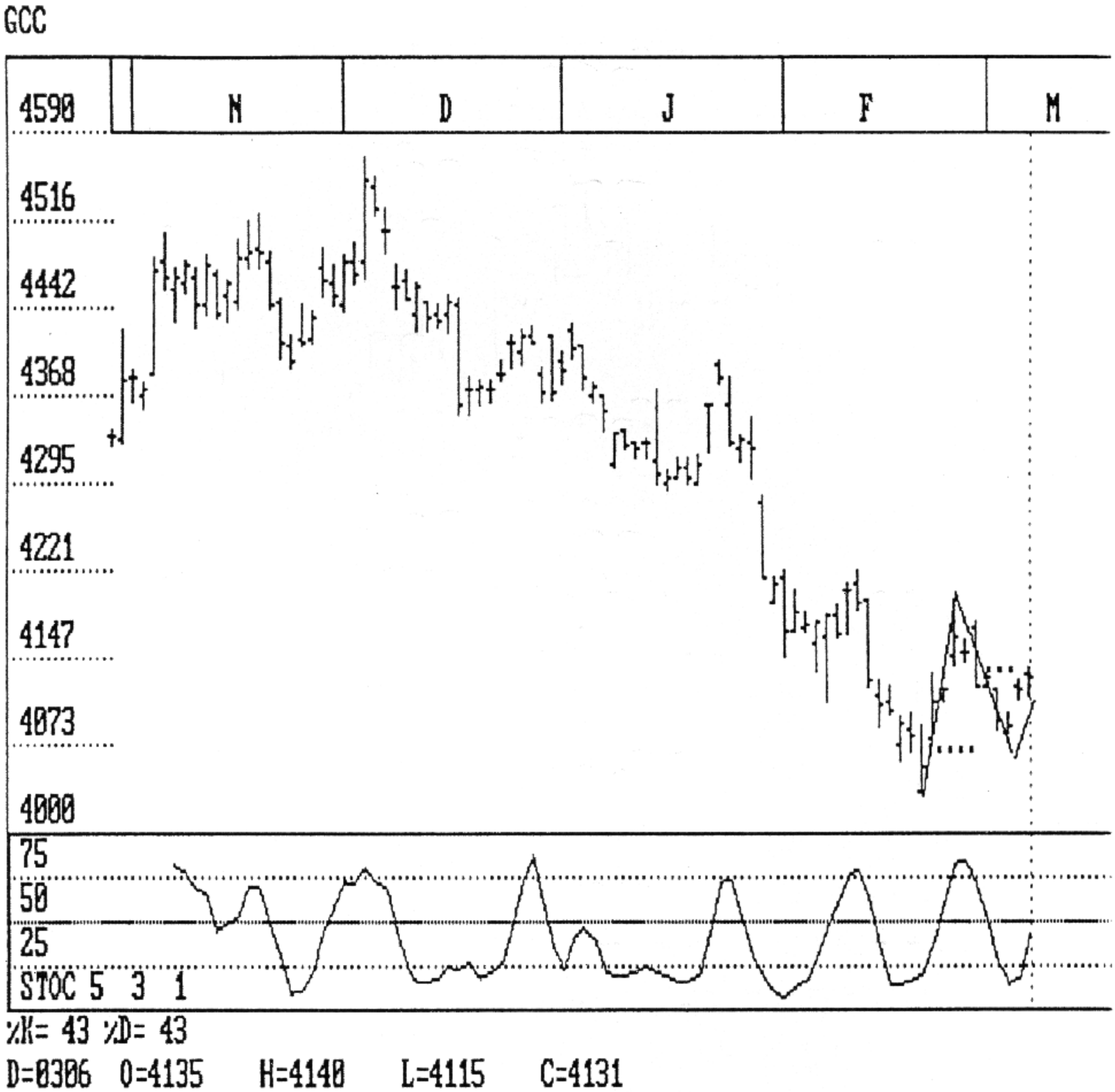

Figure 18 0306. The market moves up slightly, putting prices in a no man's lan Is this a Fibonacci correction of the previous Fibonacci correction? Is this market gettin ready to move sideways? Those two prior gaps, one in each direction bother me. There is no signal from the weekly oscillator yet. I'm unable to do anything but sit tight and wait.

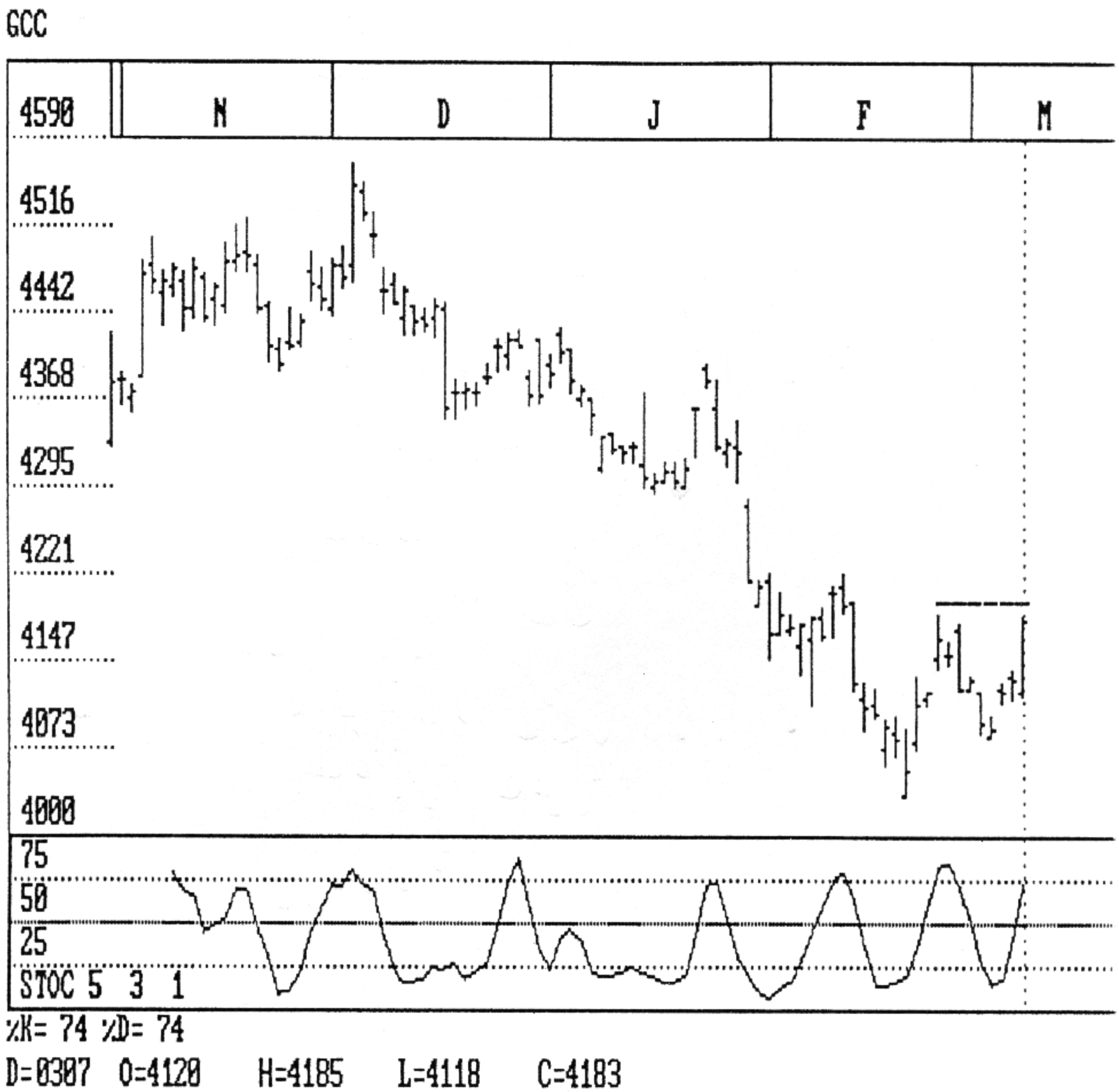

Figure 19 0307. The market shoots up! I would like to enter it, but am still bothered by those two gaps. It looks to me like a trading range may develop. The daily oscillator is one tick from being overbought. Technically, I could place a buy stop just above today's high, but because of the two gaps, and the large magnitude day today, I decide to continue to wait. The daily oscillator has been overbought every time it has been at this point, so I really expect some sort of congestion or correction. As I draw a line across the two highs, the sideways nature of this market becomes more apparent. It's best to wait.

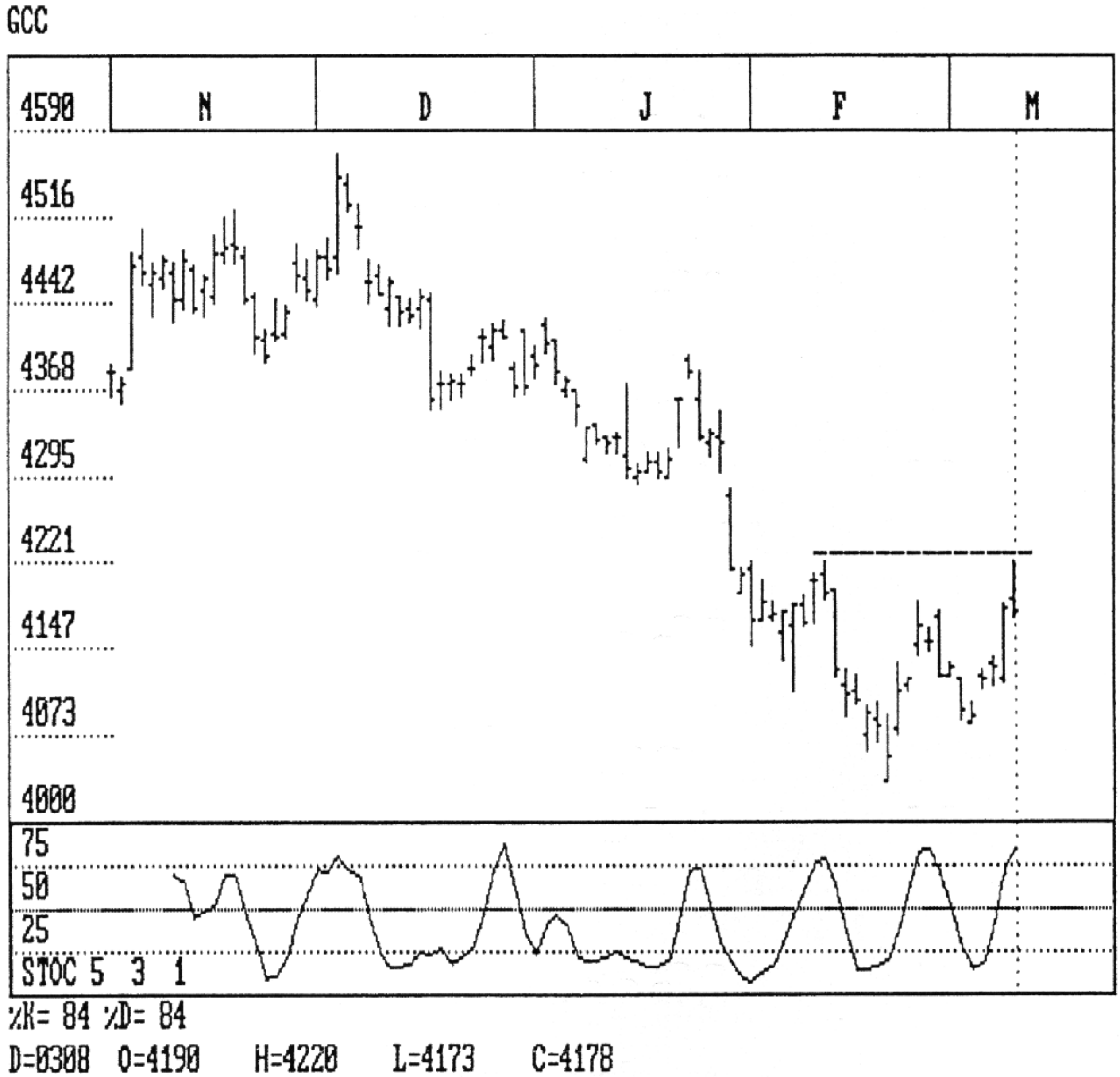

Figure 20 0308. The market moves up, but I am suspicious of that close. The daily oscillator is in the overbought area. Prices had bounced off that previous high made in February.

I'm more convinced than ever that a congestion of some sort is taking place.

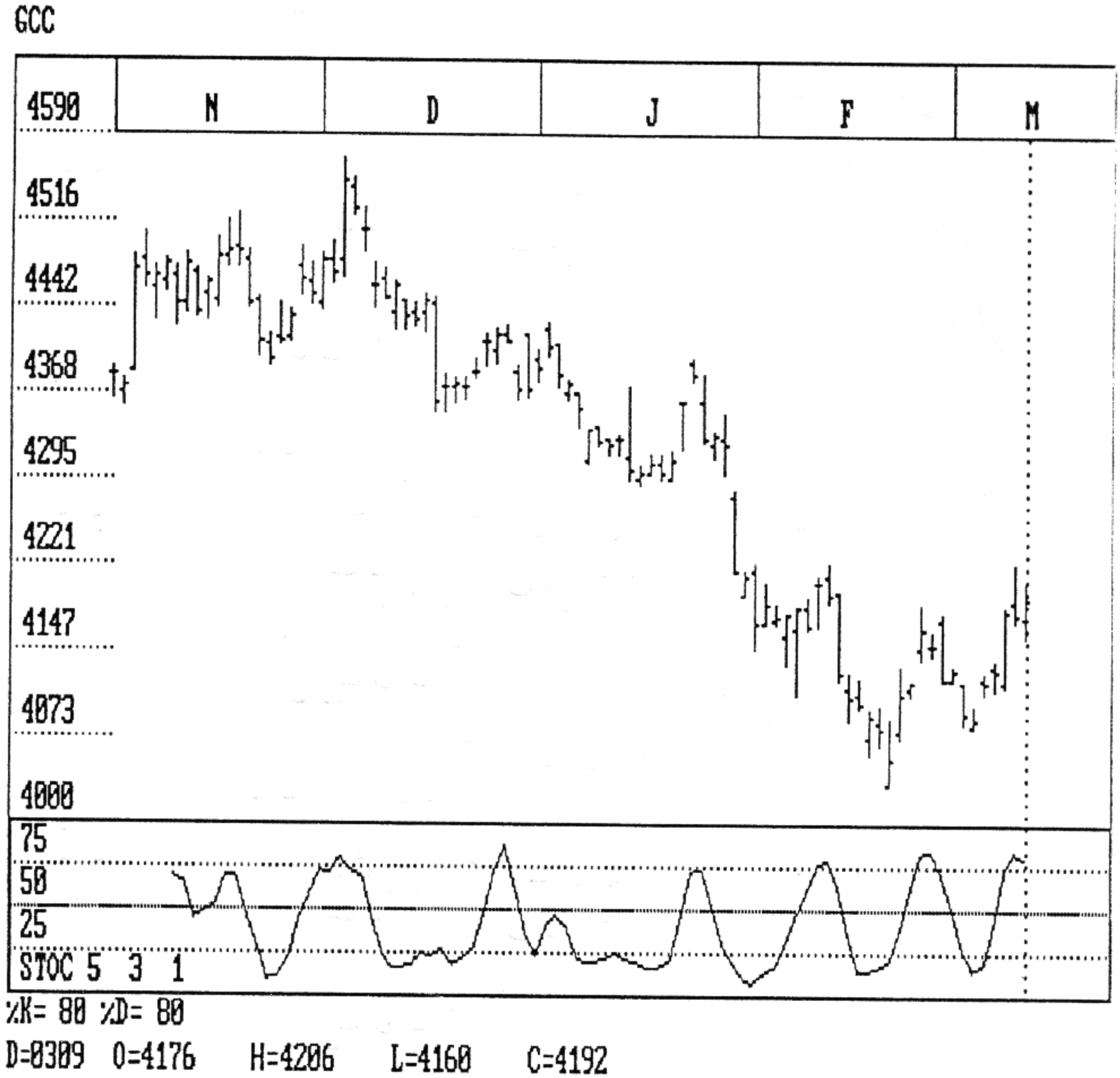

Figure 21 0309. The weekly oscillator is still showing that a long position is favored, but the daily oscillator is overbought and is beginning to turn down. When I consider that prices have dropped every other time the daily oscillator has previously beer overbought, I do not enter any orders.

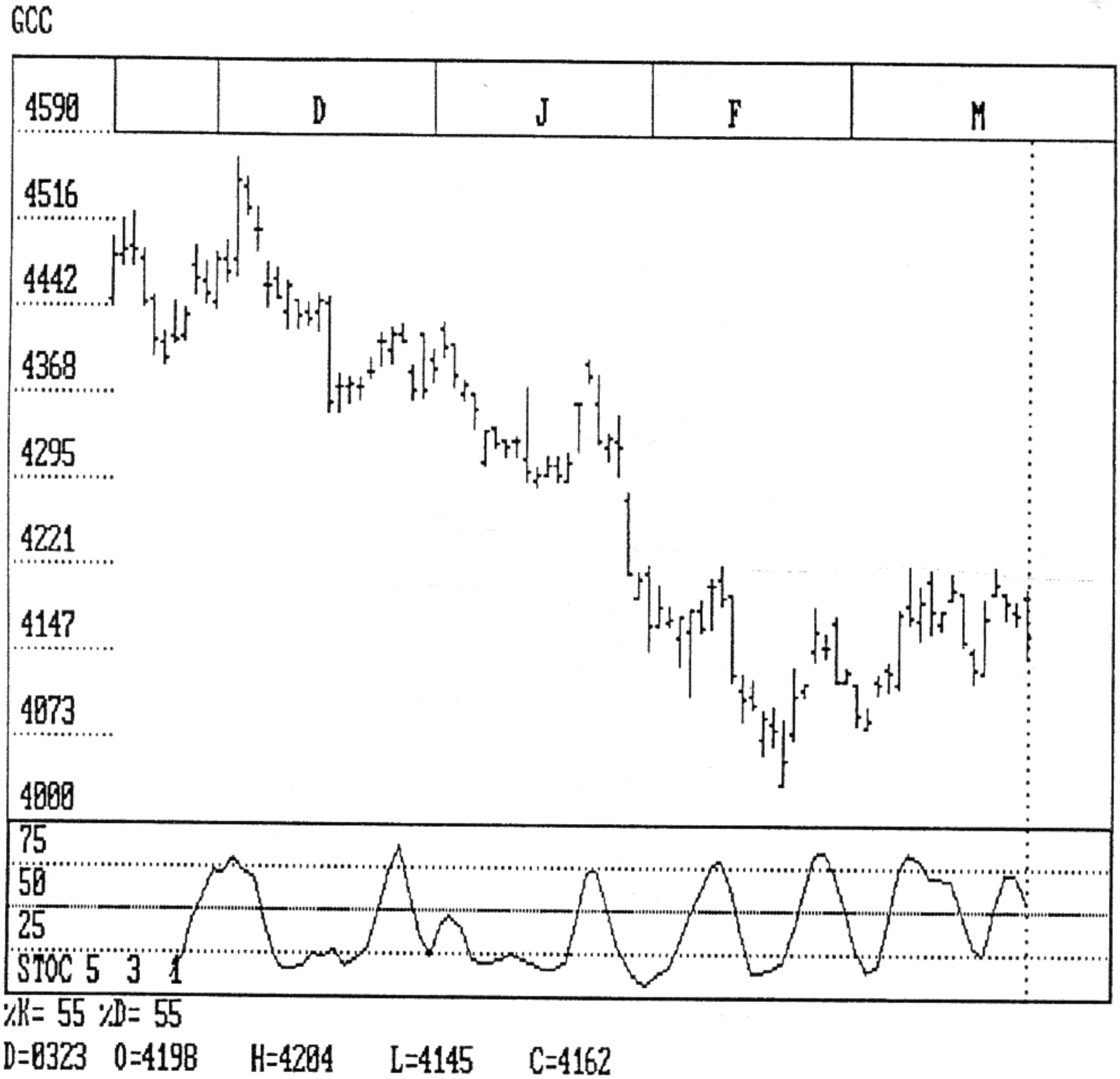

Figure 22 The weekly oscillator remains flat from 0313 through 0323, indicative of the suspected congestion which followed.

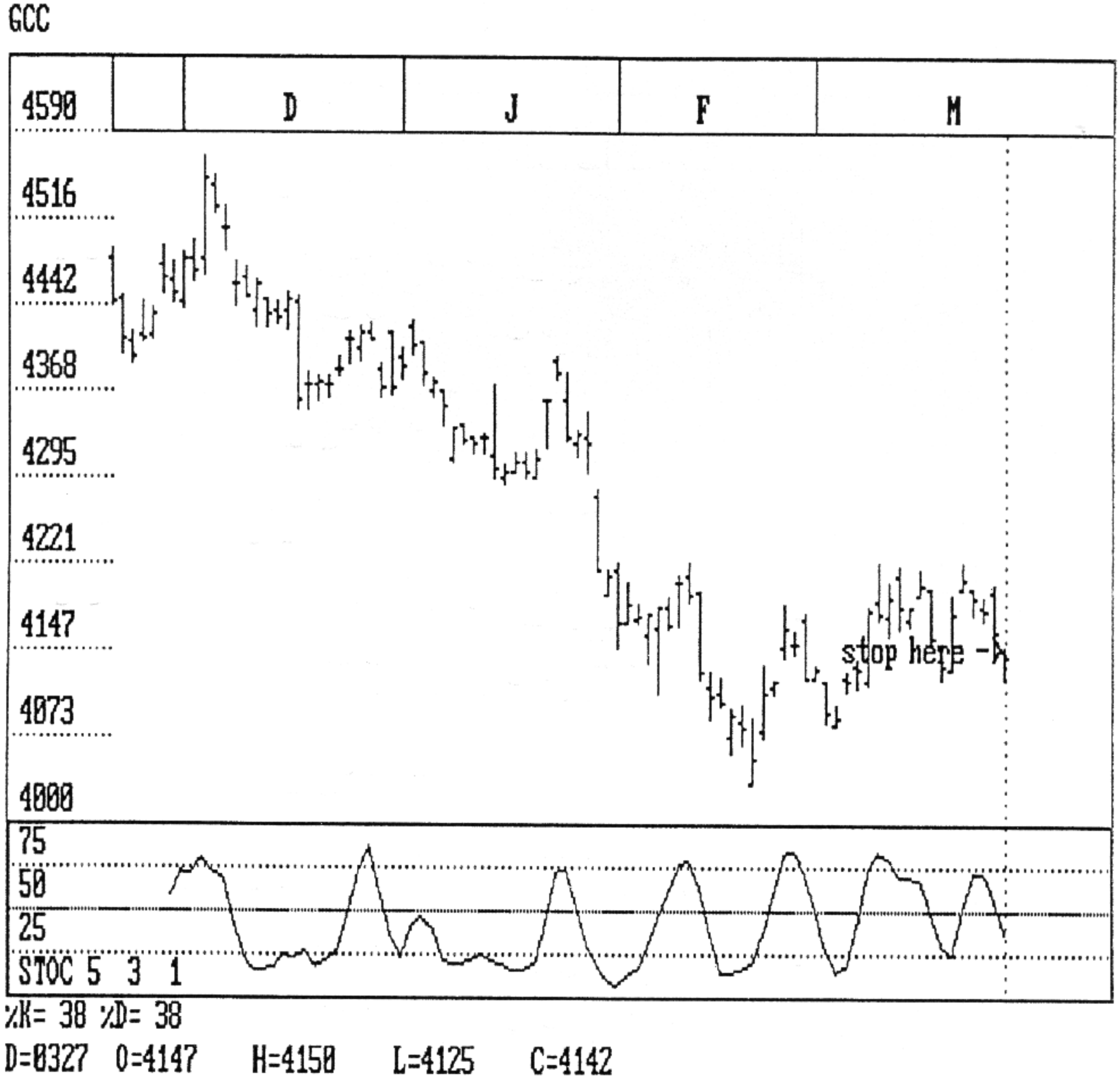

Figure 23 On 0327, the weekly oscillator turns down after 4 successively lower closes. I place an order to sell just below the low of the day at 4124. Because of the close near the high, I'm not totally convinced that a true breakout is in the offing, so I bend the rule about stop placement, and place a tight reversing stop just above the high at 4151 as soon as the market closes.

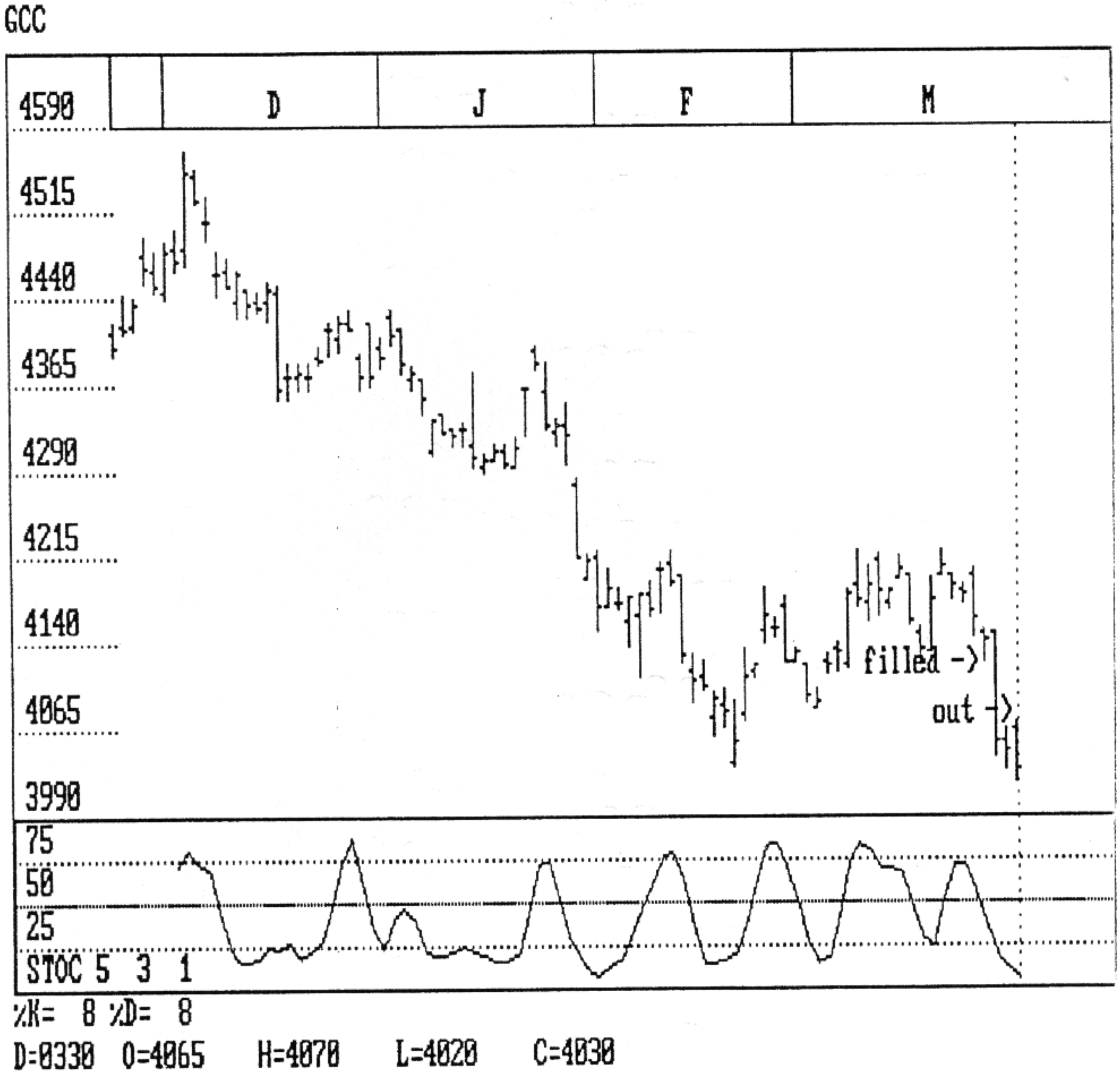

Figure 24 I'm filled at my price of 4124, and the market moves wonderfully lower. I move my stop down to breakeven including commissions and fees. On 0329, the market is definitely oversold, so I move my stop to just above the high at 4066. The weekly oscillator is pointing down. On 0330, I'm stopped out, but with a profit. I'll wait for a retracement, and if it comes with the weekly oscillator still down, I will short this market again.

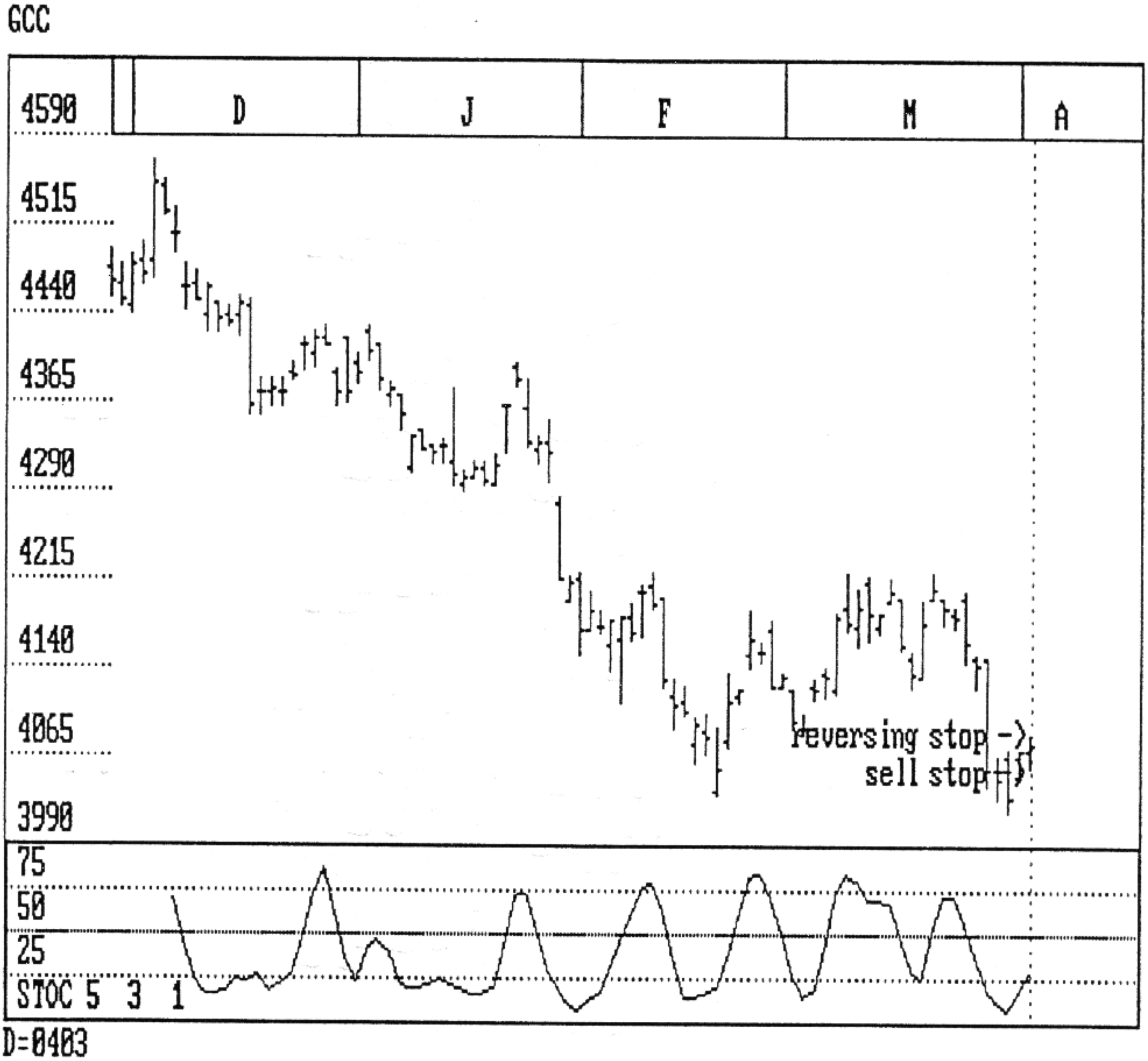

Figure 25 On 0331, the daily oscillator turns up, beginning a correction. On 0403, it moves out of the oversold area. Prices are at about a .382 Fibonacci correction of the last swing down. The weekly oscillator is still pointing down. I place a sell order at 4056, with a reversing stop at 4085.

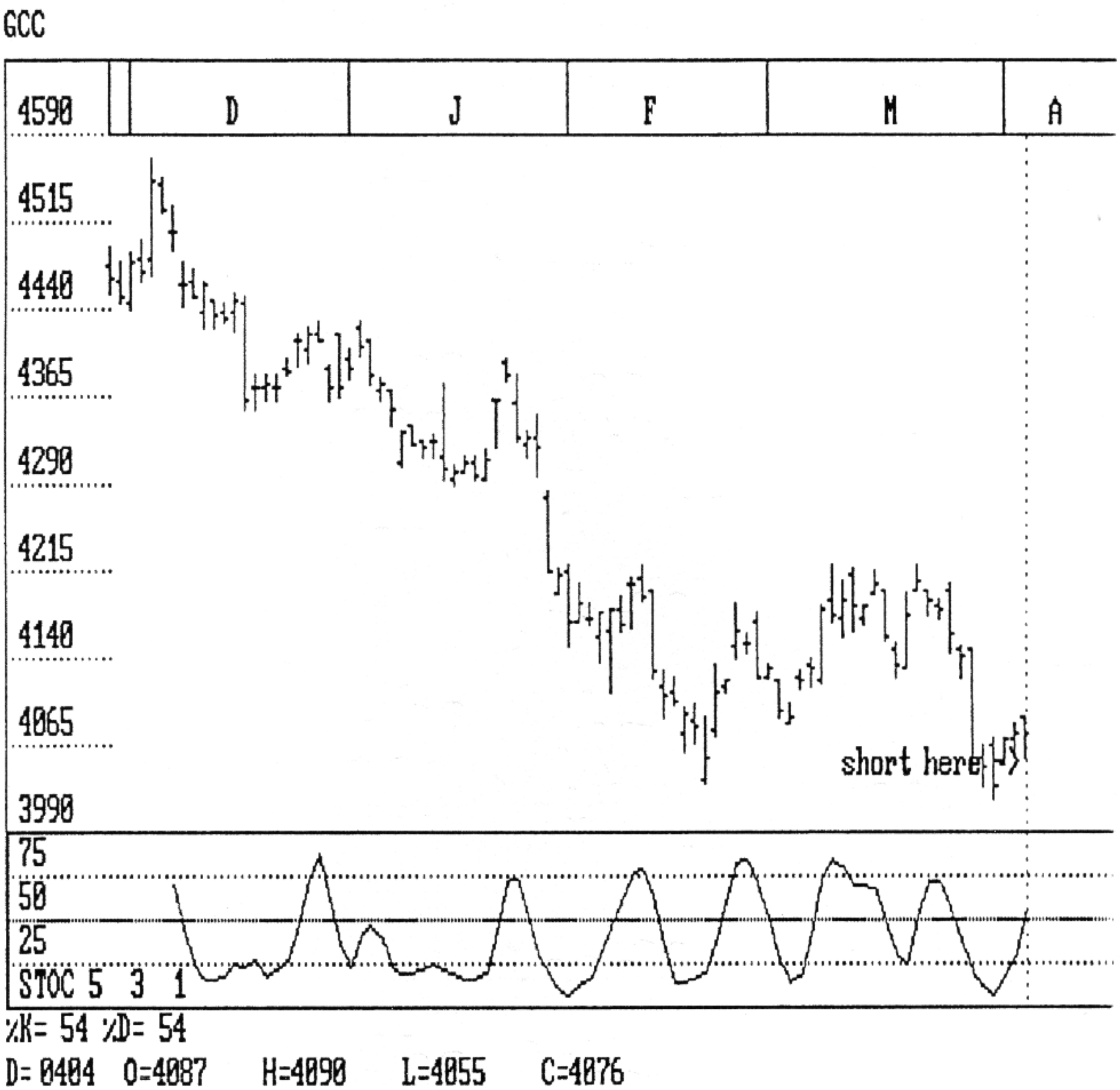

Figure 26 0404. Prices open at 4087, well above my sell order. They then mov to the high of the day, then to the low of the day, filling me along the way, and finally closing above my entry point. This is a small blowoff day. Possibly the major trend would now continue.

What I call a blowoff day is what other traders call an outside day.

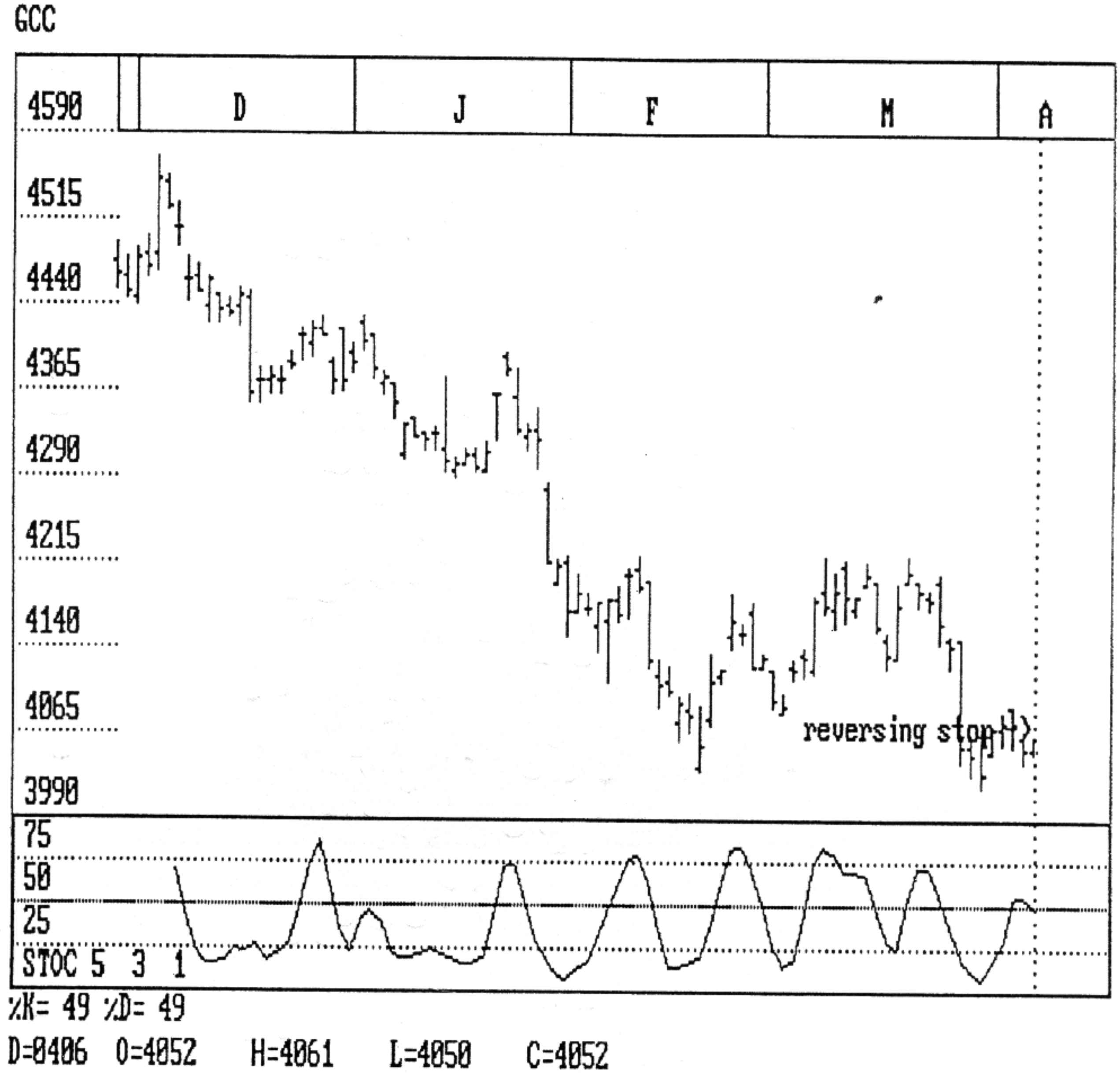

Figure 27 0405. Prices move lower. The daily oscillator, now at 56%, begins to turn on 0406. Prices now stand at a retracement of a retracement, a Fibonacci enigma, which often indicates another possible congestion. I move my reversing stop to 4062, just above the high of the inside day of 0406.

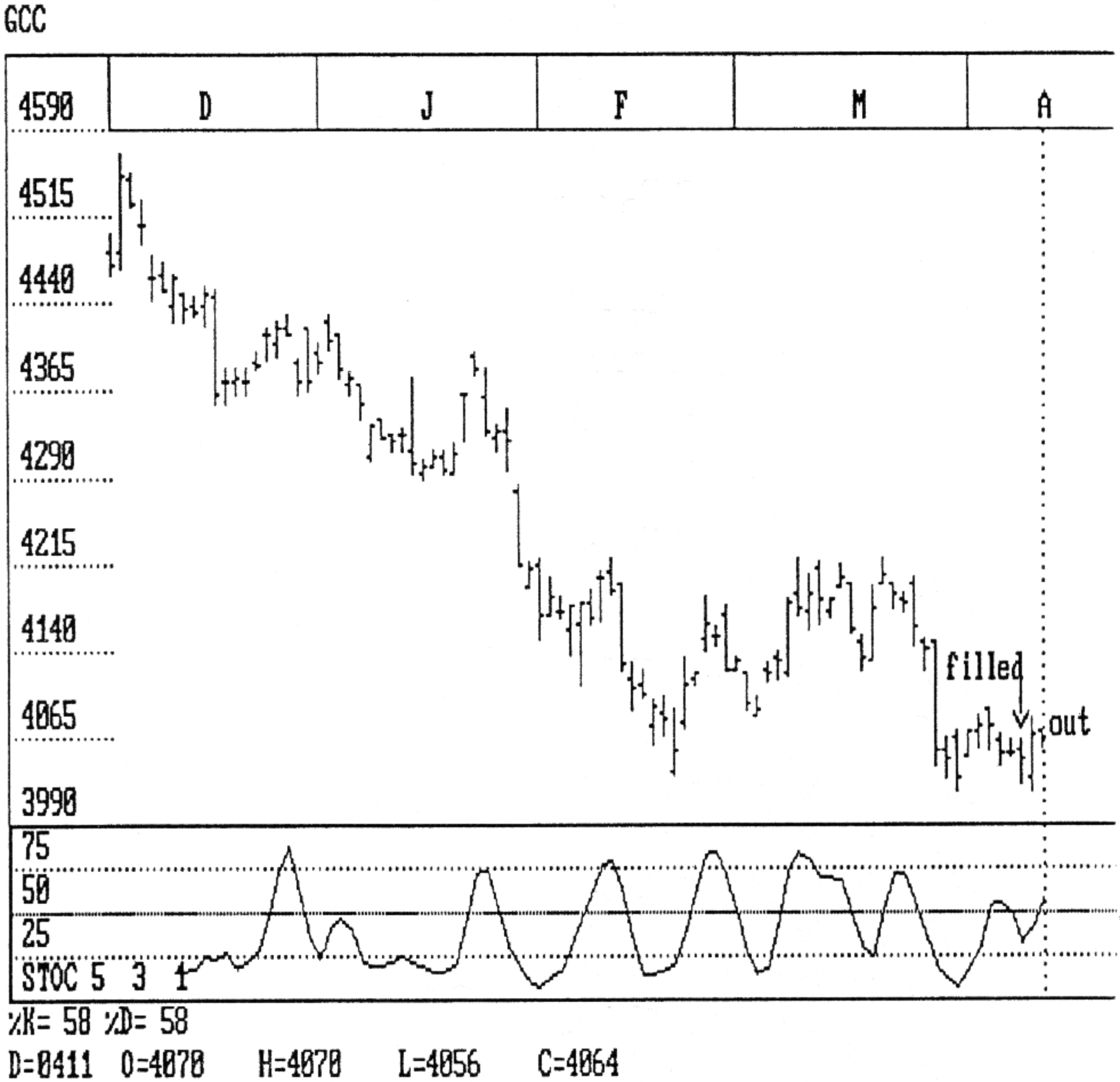

Figure 28 Friday 0407. I'm simultaneously stopped out of my short position and am long this day, as the high fills my reversing stop at 4062. I've lost 6 points on the original trade. On Monday, 0410, there is another blowoff day and prices close higher. The weekly oscillator is stair-stepping, so I figure I'd better get out as soon as possible. I place an exit sell stop at breakeven and get out at 4070 on Tuesday, 0411.

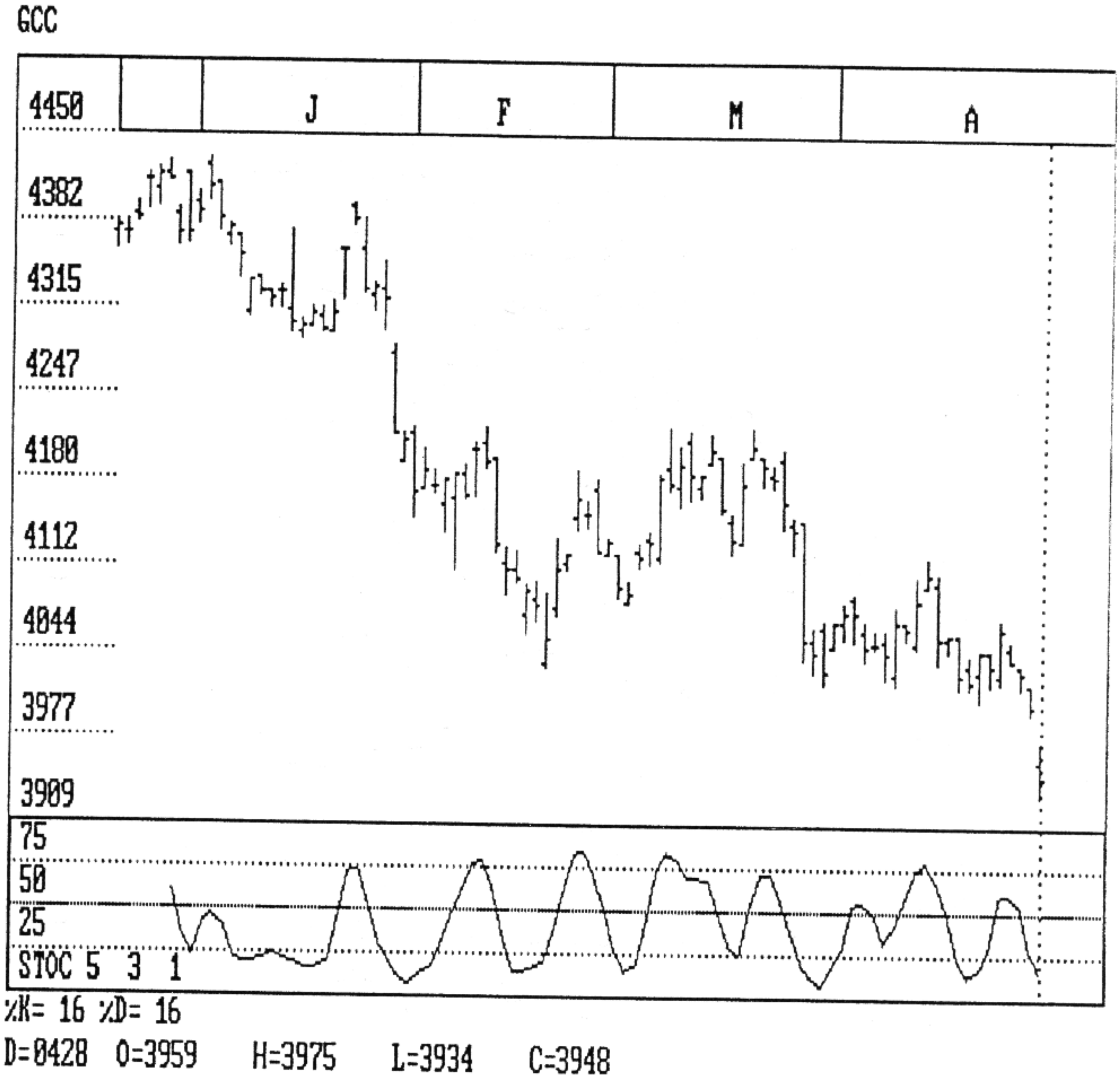

Figure 29 The weekly oscillator stays flat until it turns down on 0428, which is caused by falling prices and a strong gap breakout to the downside. Since I've had no previous signal from the weekly oscillator, I've had no basis for entering a trade. Additionally, the daily oscillator was well into the oversold area due to the breakout. I'll have to wait for another opportunity.

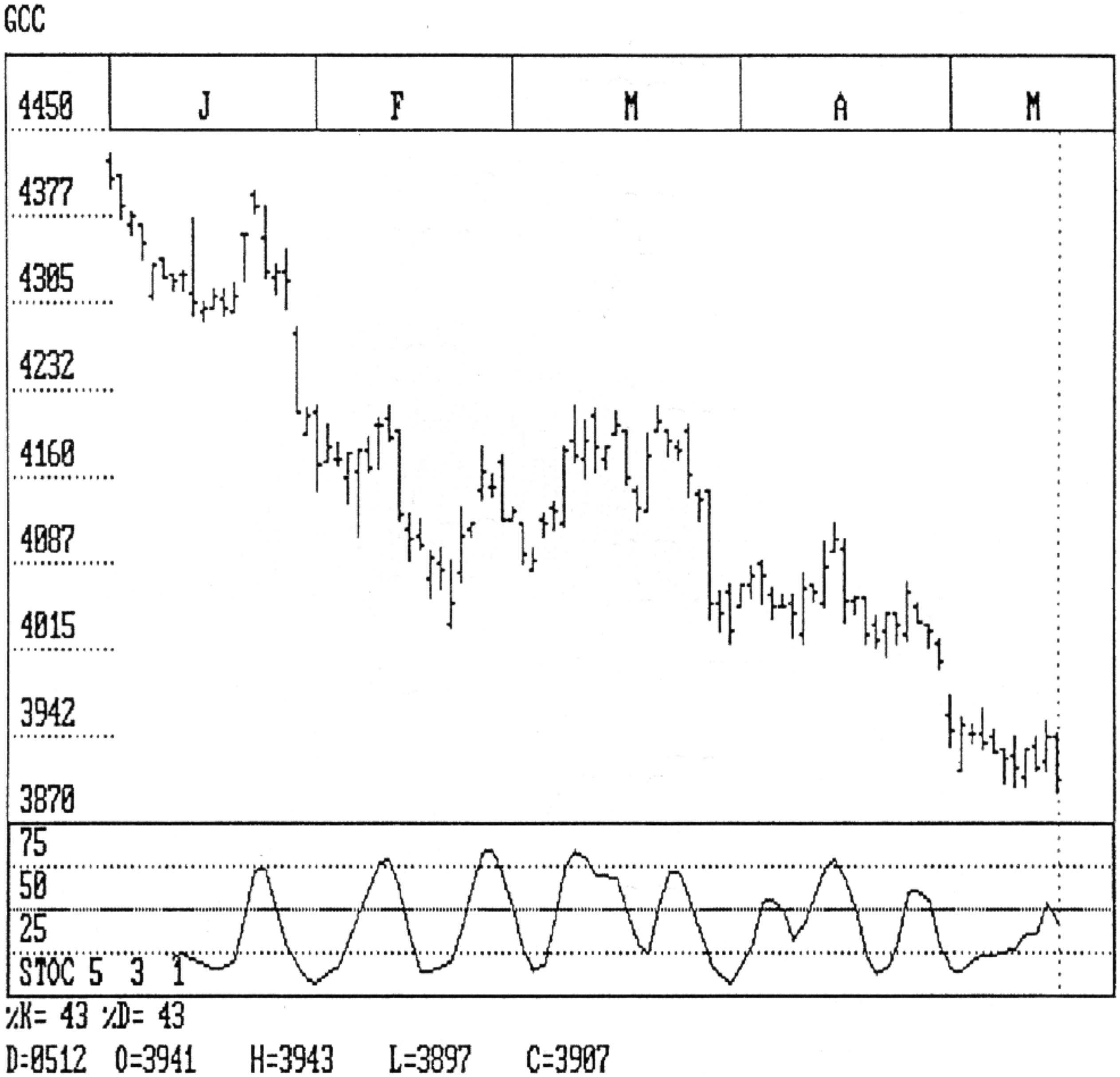

Figure 30 The weekly oscillator ended the week of 0512 as flat as a pancake, due to the congestion area that developed subsequent to the previous gap breakout. The daily oscillator showed this as a correction by moving up out of the oversold area, prior to hooking and moving down again.

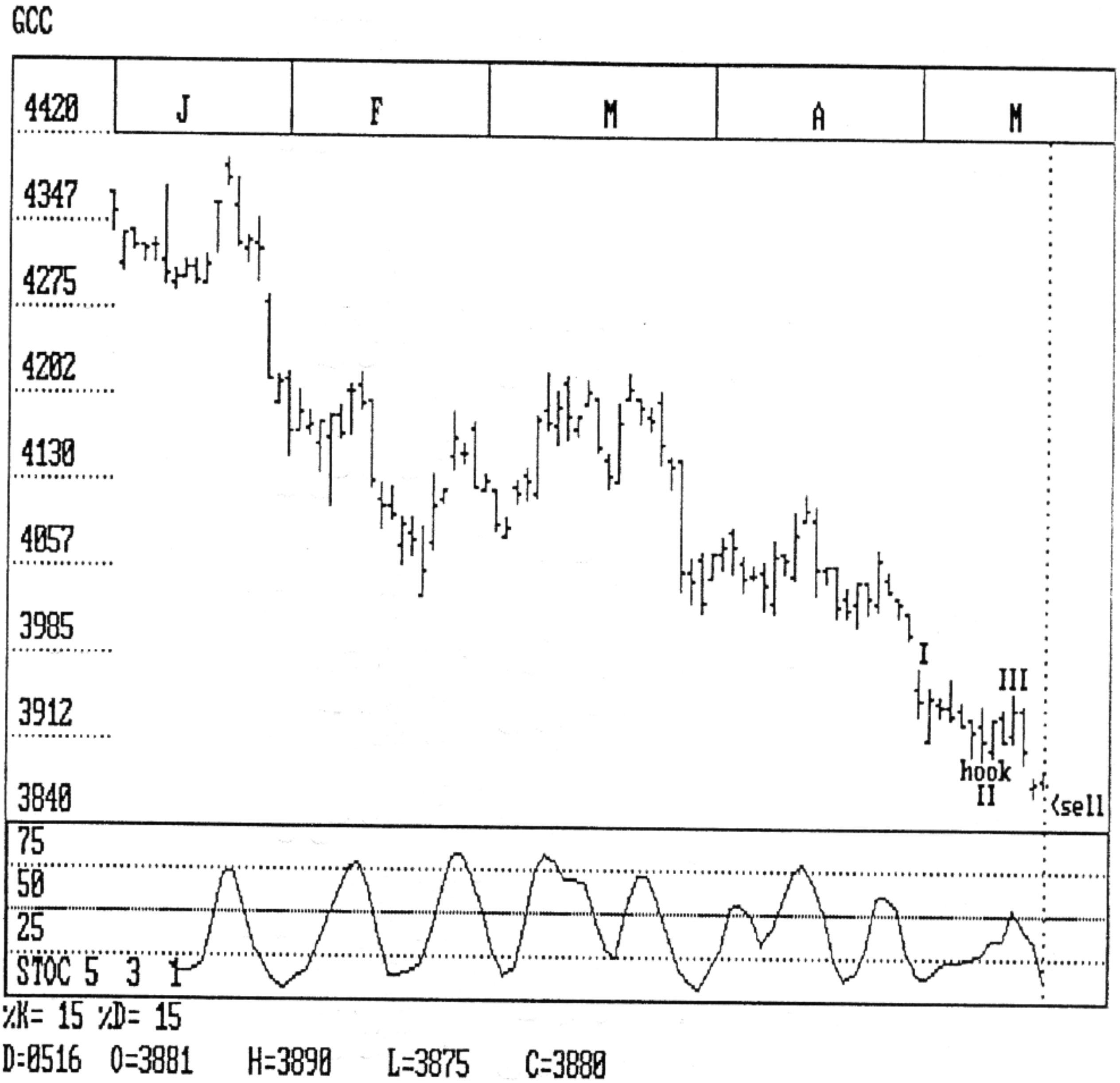

Figure 31 On 0515, the weekly oscillator turns down again due to another down gap. I place a sell stop at 3867, below the low of the day. On 0516, I'm not filled, but I leave my sell order in place. I'm violating one of my rules by doing this because the daily oscillator is already oversold. But I'm trying to be flexible and bend to the market flow. Here's my thinking: The gap day took out a previous Ross hook. It also constituted the breakout of a I-II-III high. Although prices went up that day, they closed near the low of the day. If they break out of yesterday's low, they almost surely will continue down for a couple of more days.

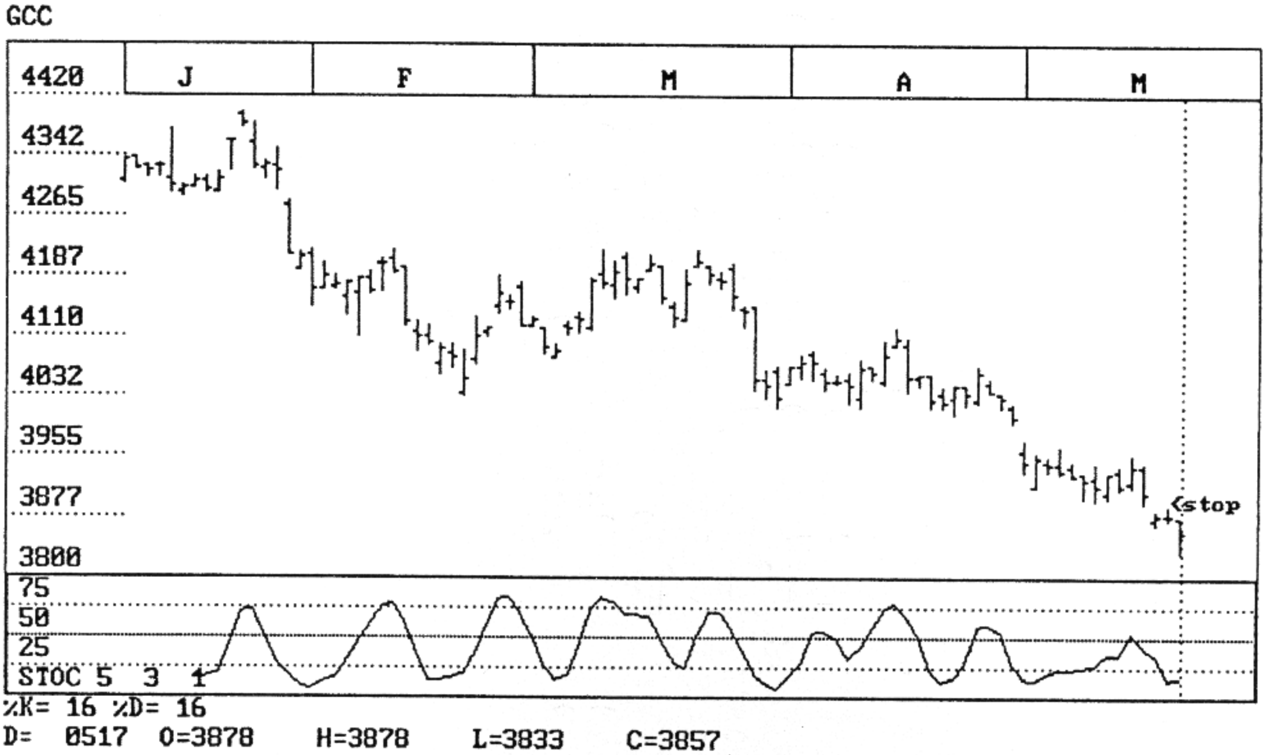

Figure 32 0517. Prices drop down and I get a fill. I'm not happy with the fact that they've closed in the upper part of the daily trading range. I'm not getting clear signals from this market. I place my stop just above the high that filled the gap. I think to myself, "You jerk, why didn't you stay with your rule?"

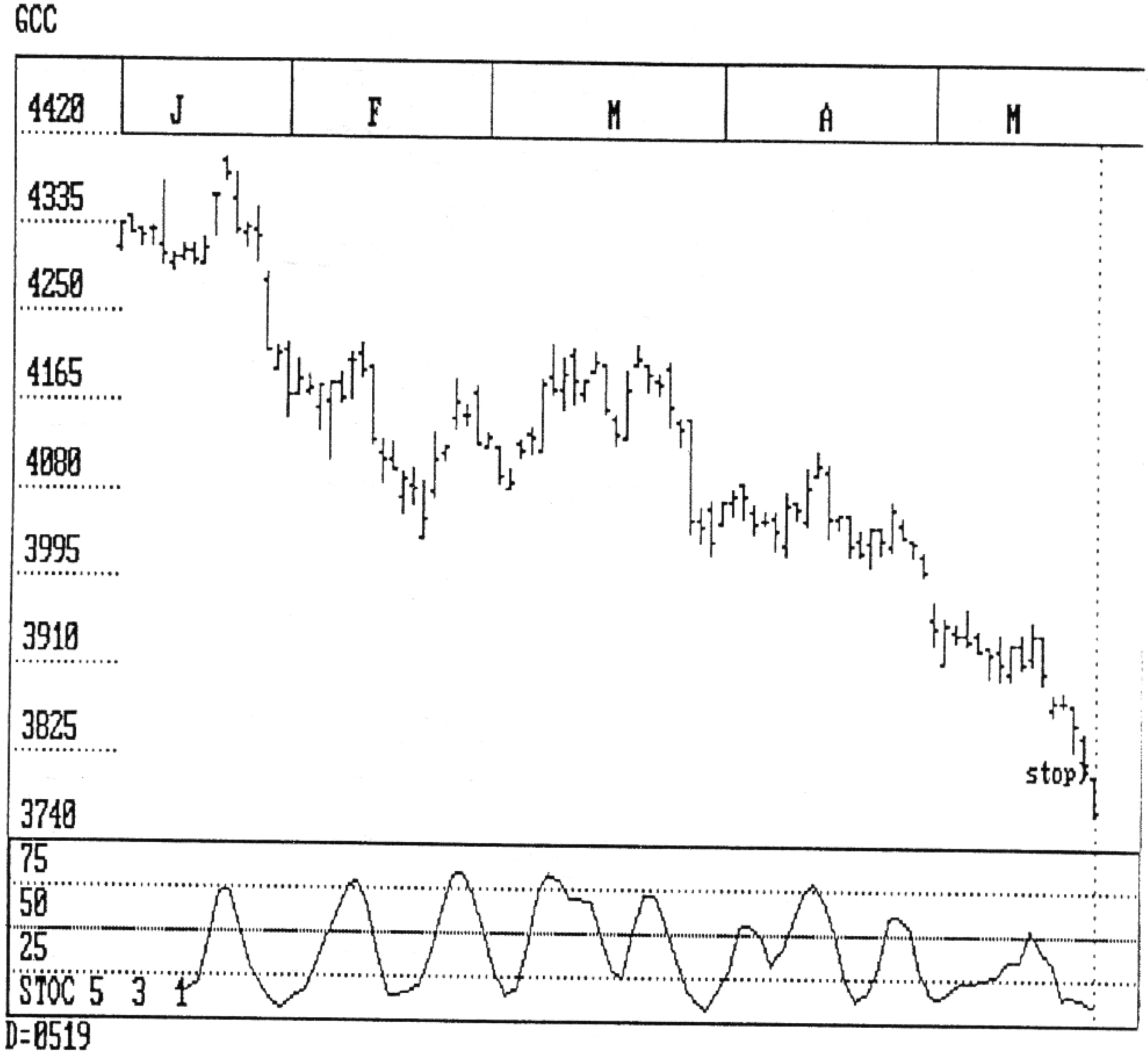

Figure 33 0518. Prices continue to move down. Just to be safe, I move my stop to 3851, above the high of the day. I think to myself. "A correction must be due soon. Now that I'm in the money, I'm going to play it tight." The weekly oscillator is still pointing down. 0519, prices plunge again. This is really great! And look at that close, right near the low. I move my stop above the high at 3810.

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%K= 9 %D= 9

D=0522 O=3728 H=3750 L=3709 C=3739

Figure 34 0522. Prices gap down once again. This is the kind of trade that warms my heart, and fattens my bank account, too. I know that there has to be a correction soon. I move my stop to just above the previous day's close at 3776. That gap might be filled, especially since prices closed near the high, and the daily oscillator is more than oversold. The line of descent is very steep now, almost vertical.

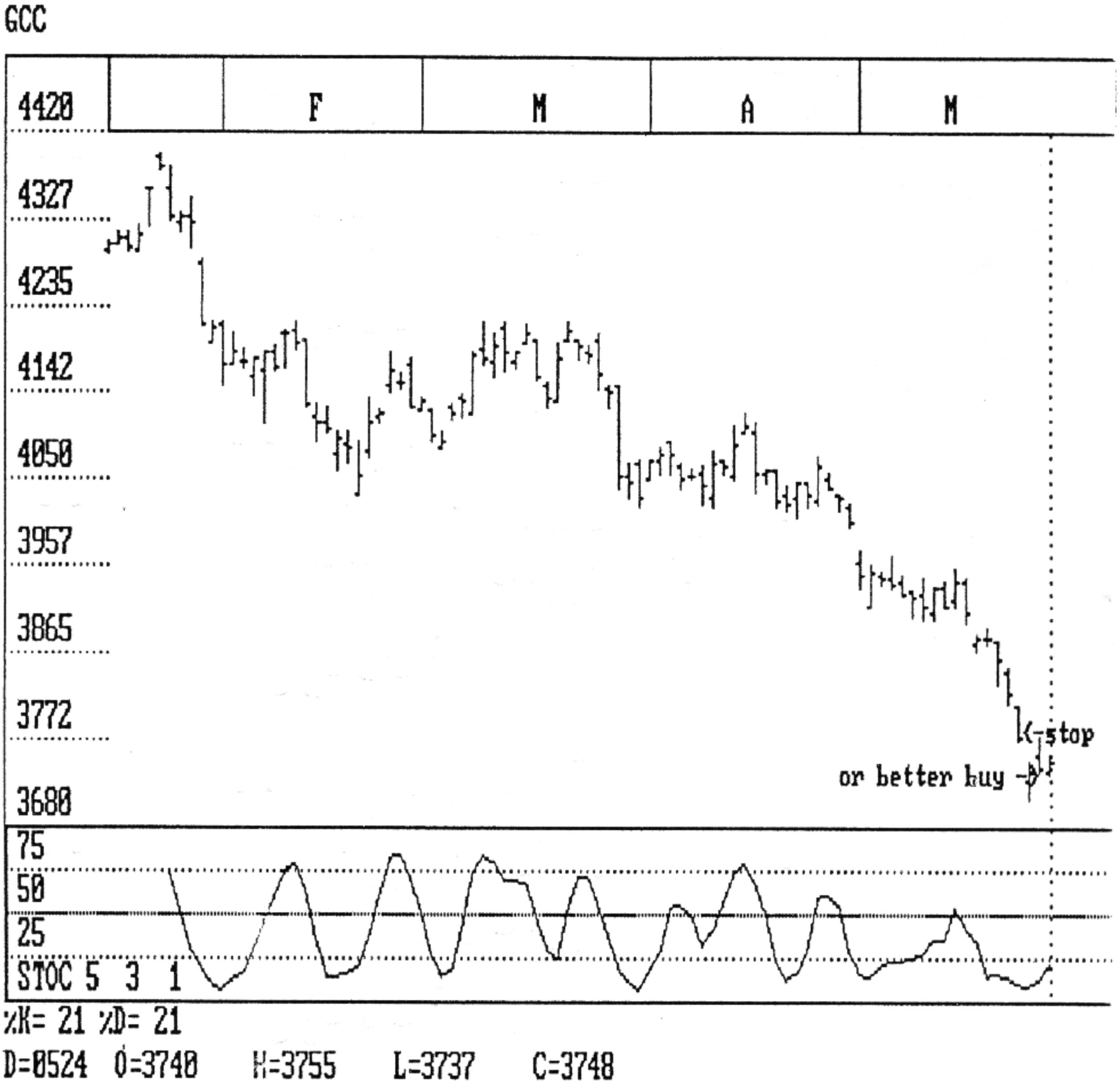


Figure 35 0523. Sure enough, the gap is filled. The high, at 3775, just misses my stop at 3776. Gold closes near its low of the day. I feel sure that a correction, probably a sideways congestion, is overdue. I decide that tomorrow I'll get out. I leave my stop at 3776, and place a buy order at today's close 3743 or better, order cancels order. Maybe I can pick up a few extra bucks. The weekly oscillator is beginning to go flat.

The next day, 0524, prices open at 3740, and sometime during the day my order at 3743 or better is filled. So I'm out of the market with a nice profit.

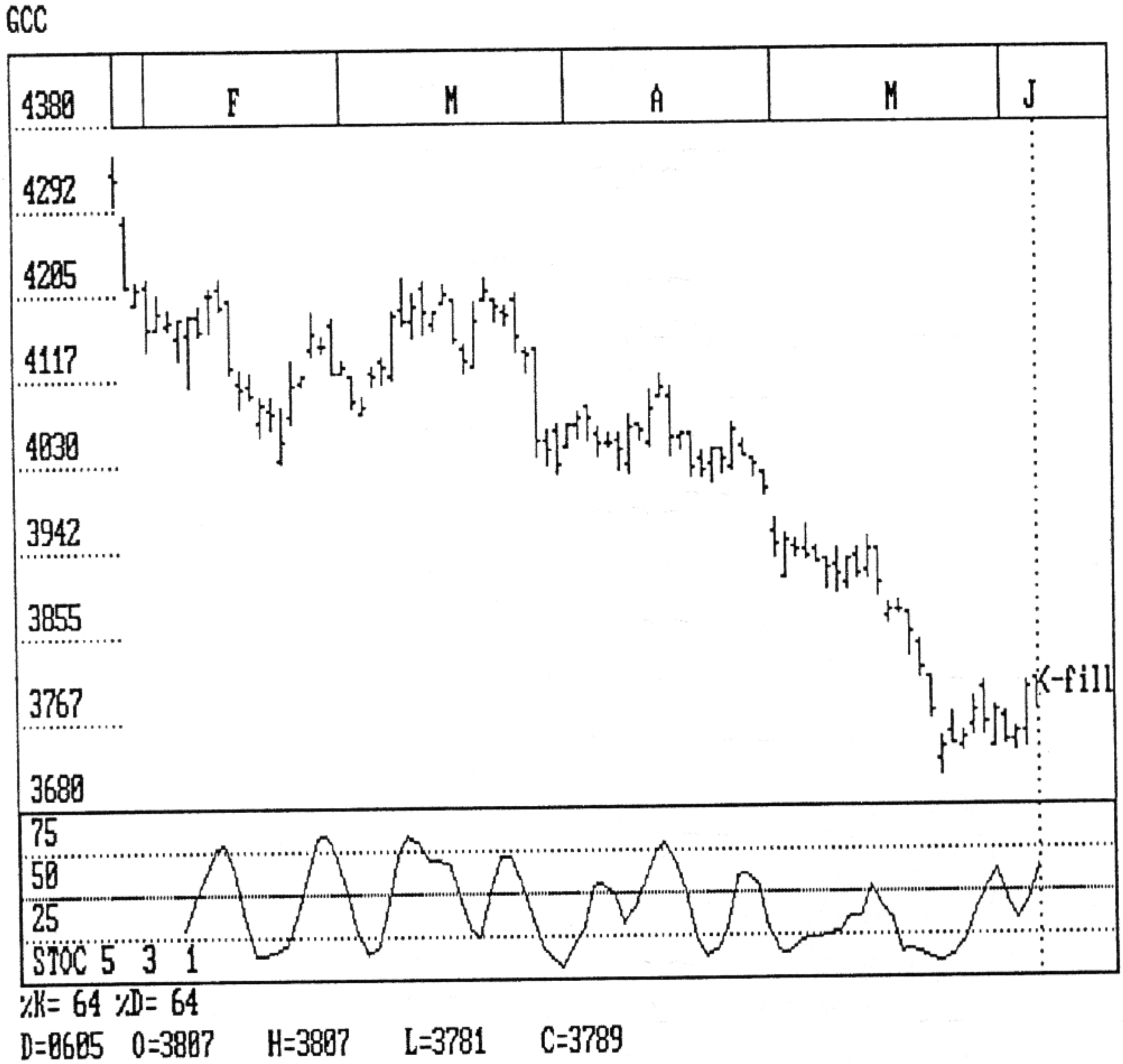


Figure 36 The weekly oscillator segment stays flat until Friday, 0602, at which point it turns up. Since the daily oscillator is not yet overbought, I place an order to buy one contract at 3806. That would represent a breakout of the double high at 3805. The next day, 0605, I'm filled, with my catastrophic reversing stop just below the low of the previous two days. Prices close below my entry price.

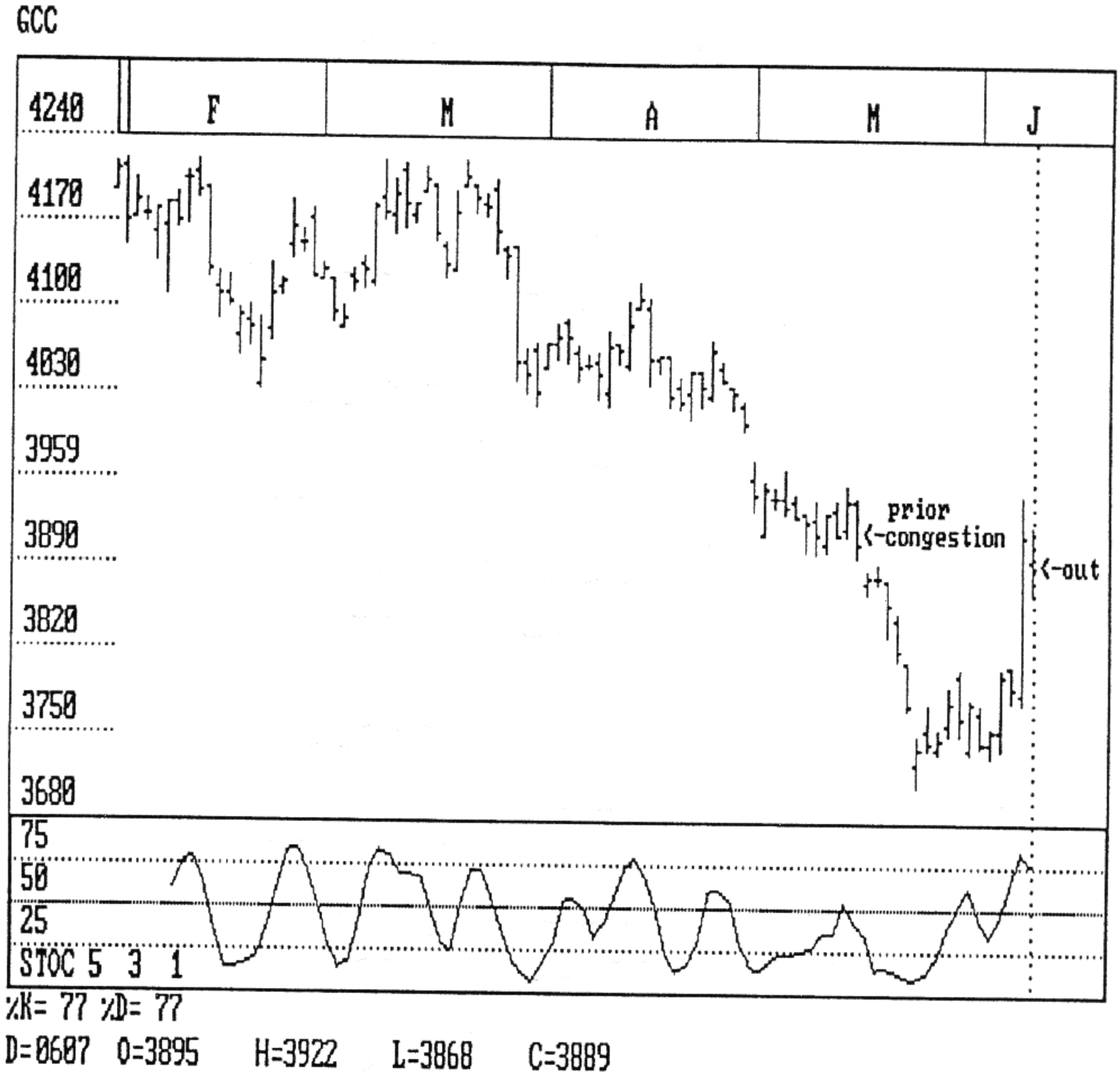


Figure 37 0606. Prices soar upward on a large magnitude day. Naturally, the weekly oscillator is up. The daily oscillator moves into overbought territory. I really have to think about how I want to handle this situation. Where should I place my stop? This day wiped out a lot of shorts in the market, and I'm sitting here with a fat profit. Almost certainly there will be a correction tomorrow. If I only knew how much???? I decide to place my stop just below the congestion that took place opposite today's close. Maybe prices will hold there. I place my stop at 3896, below the low of the day shown in Figure 30. On 0607, I'm stopped out at the open at 3895.

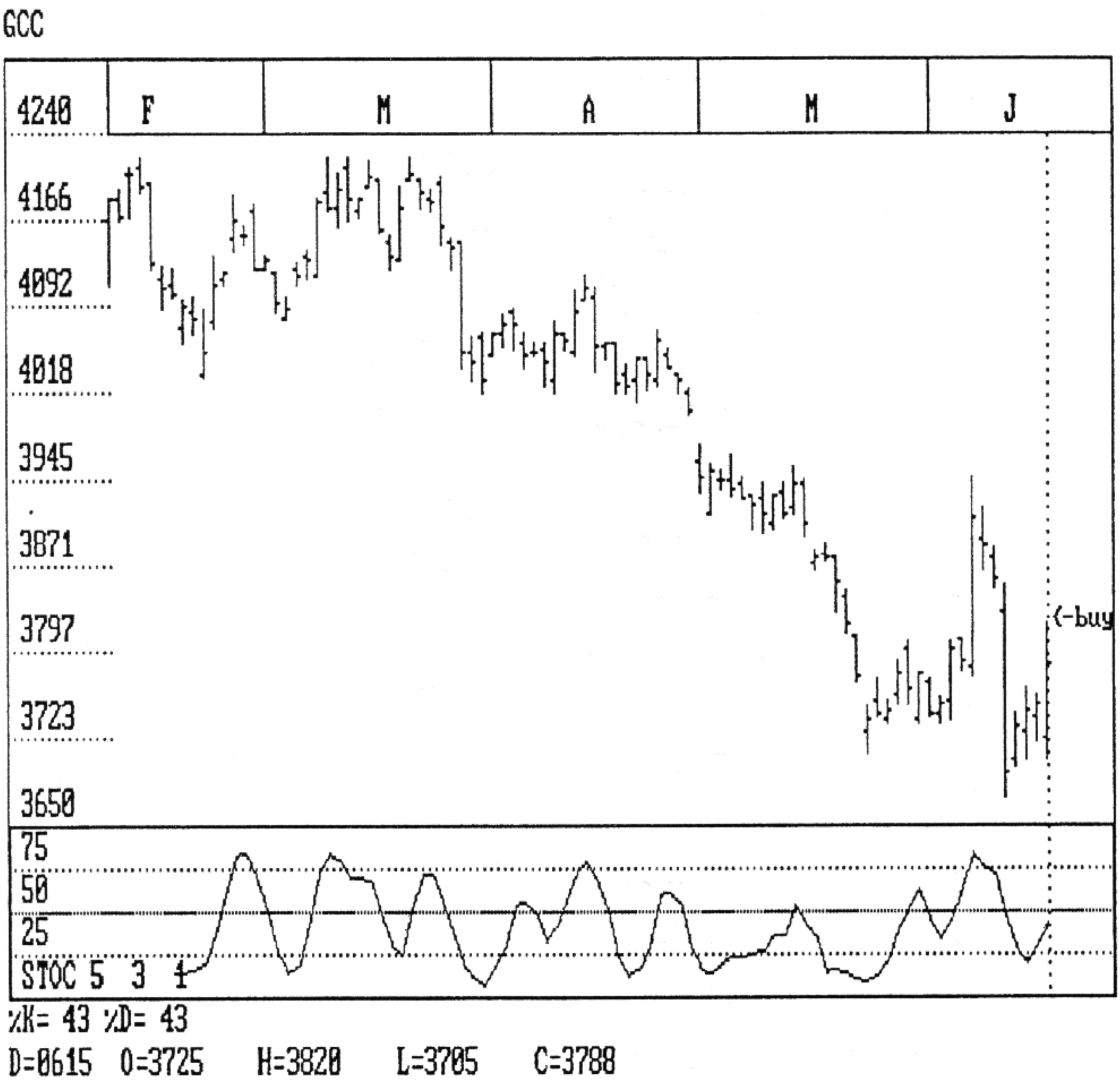


Figure 38 The weekly oscillator segment stayed flat until 0615, at which point it turned up. Looking back, I was thankful to be out of my previous long position with a profit. Two days after having gotten out, prices plummeted. Then they began a recovery, closing up four days in a row. This was enough to change the weekly oscillator so that it pointed up. Since the daily oscillator is not overbought on the fifteenth, I place a buy order above the high at 3821, and wait for developments.

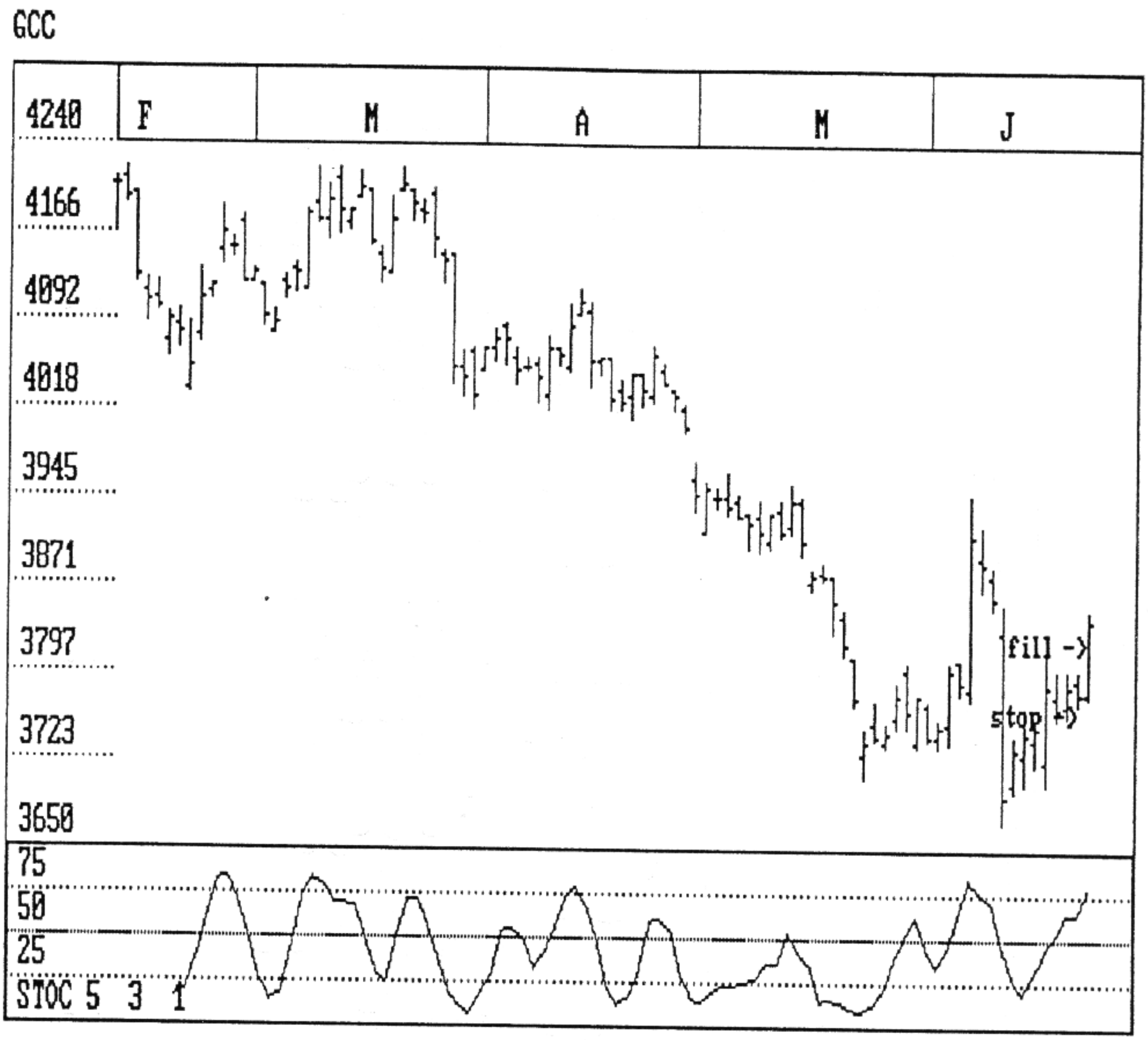


Figure 39 0621. I'm not filled for three days, while the daily oscillator corrects, but with the weekly oscillator still up I'm filled on the fourth day at my price of 3821. I place my stop below the lower of the two days at 3772. The daily oscillator is just into the overbought area.

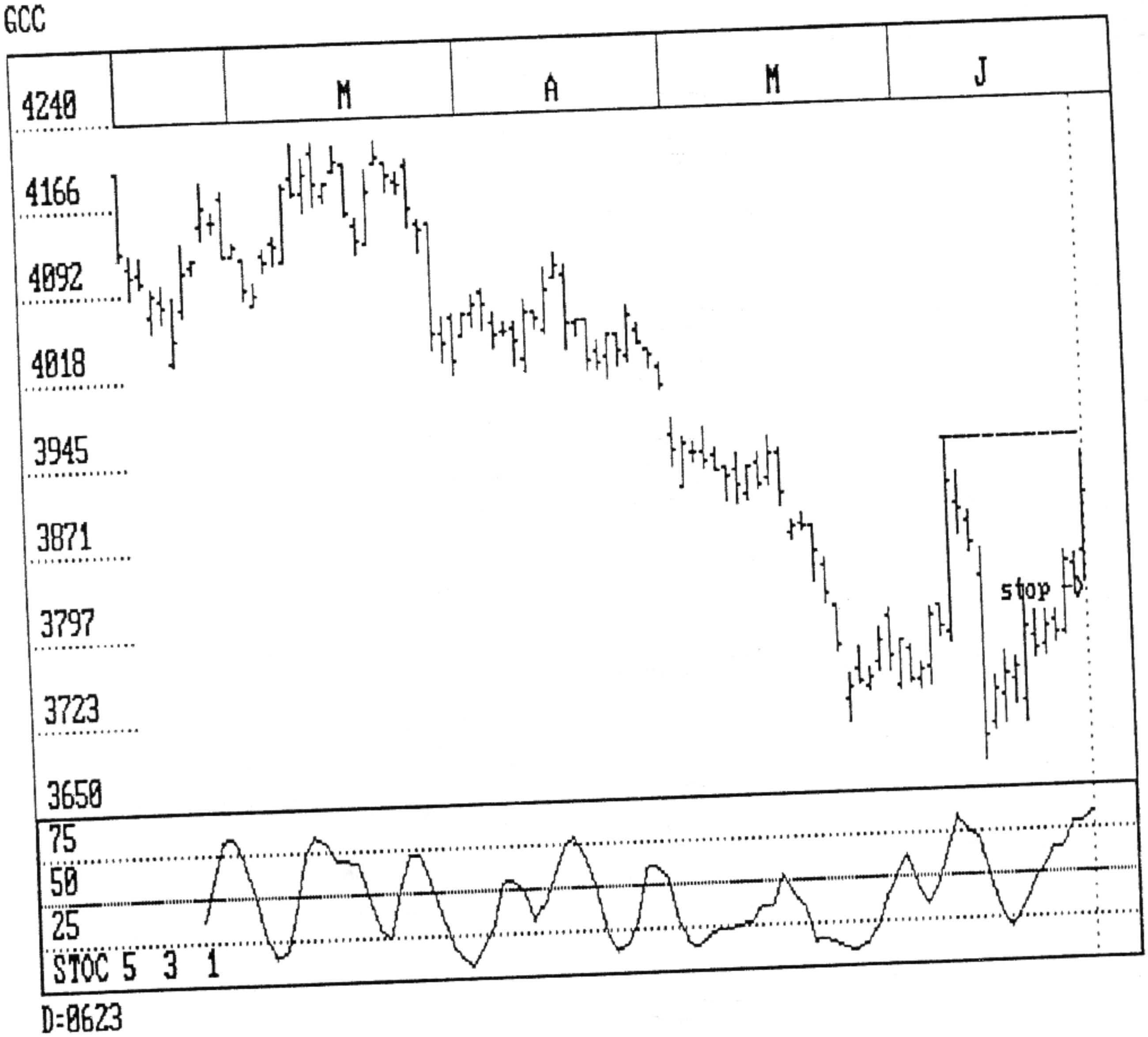


Figure 40 On 0622, I move my stop up a few ticks to below the low of the day I got in. On 0623, prices move sharply up and I move my stop to just below the low of that day, to protect profits. I debate whether I ought to move it even higher, but decide to be patient and see if prices move up one more day, at least to that previous large-day high.

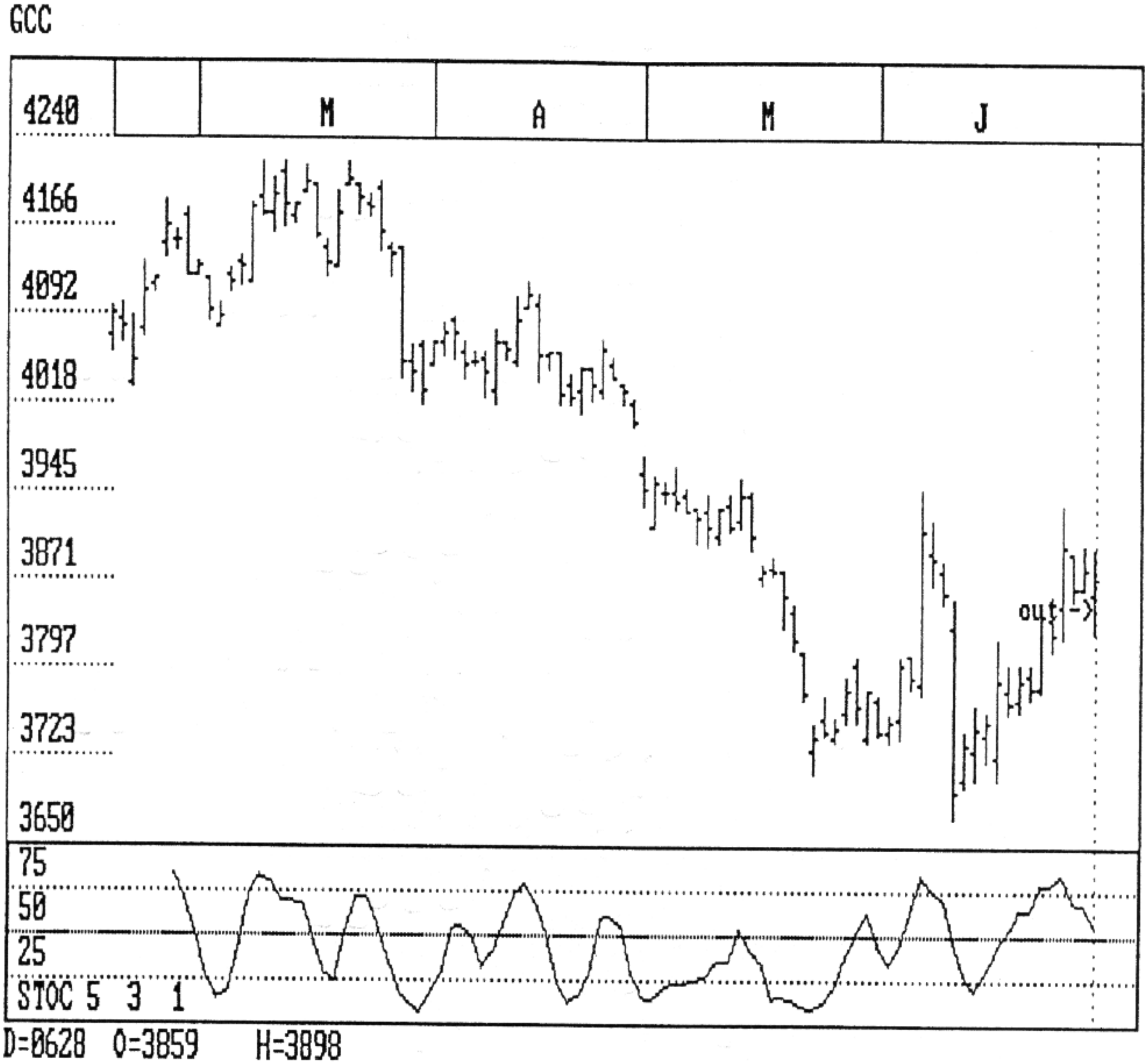


Figure 41 0626. When prices fail to make a new high, and close in the lower half of the daily range making an inside day, I move my stop to just below that day's low to 3854. 0627, prices move up a bit more, so I leave my stop at 3854. Finally, on 0628, I'm stopped out at 3854. The weekly oscillator segment has gone flat.

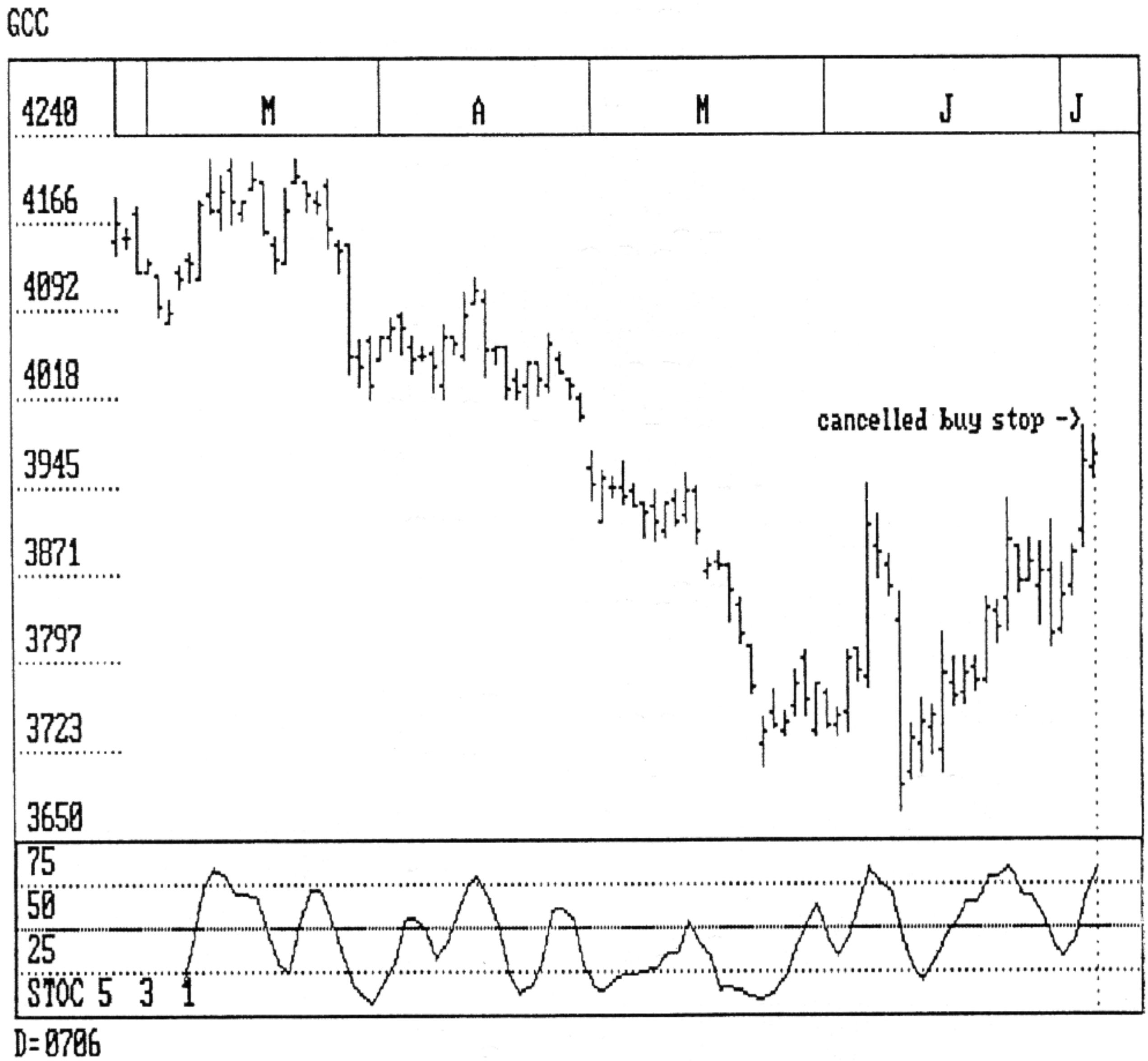


Figure 42 The weekly oscillator remains flat until 0705, at which point a sharp upmove causes it to turn up. I place a buy order just above the high of the day at 3996. On 0706, my order is not filled, and since the oscillator is now showing overbought, I cancel my buy order and decide to wait for a correction. The weekly oscillator is enough to keep me from trying any further just now.

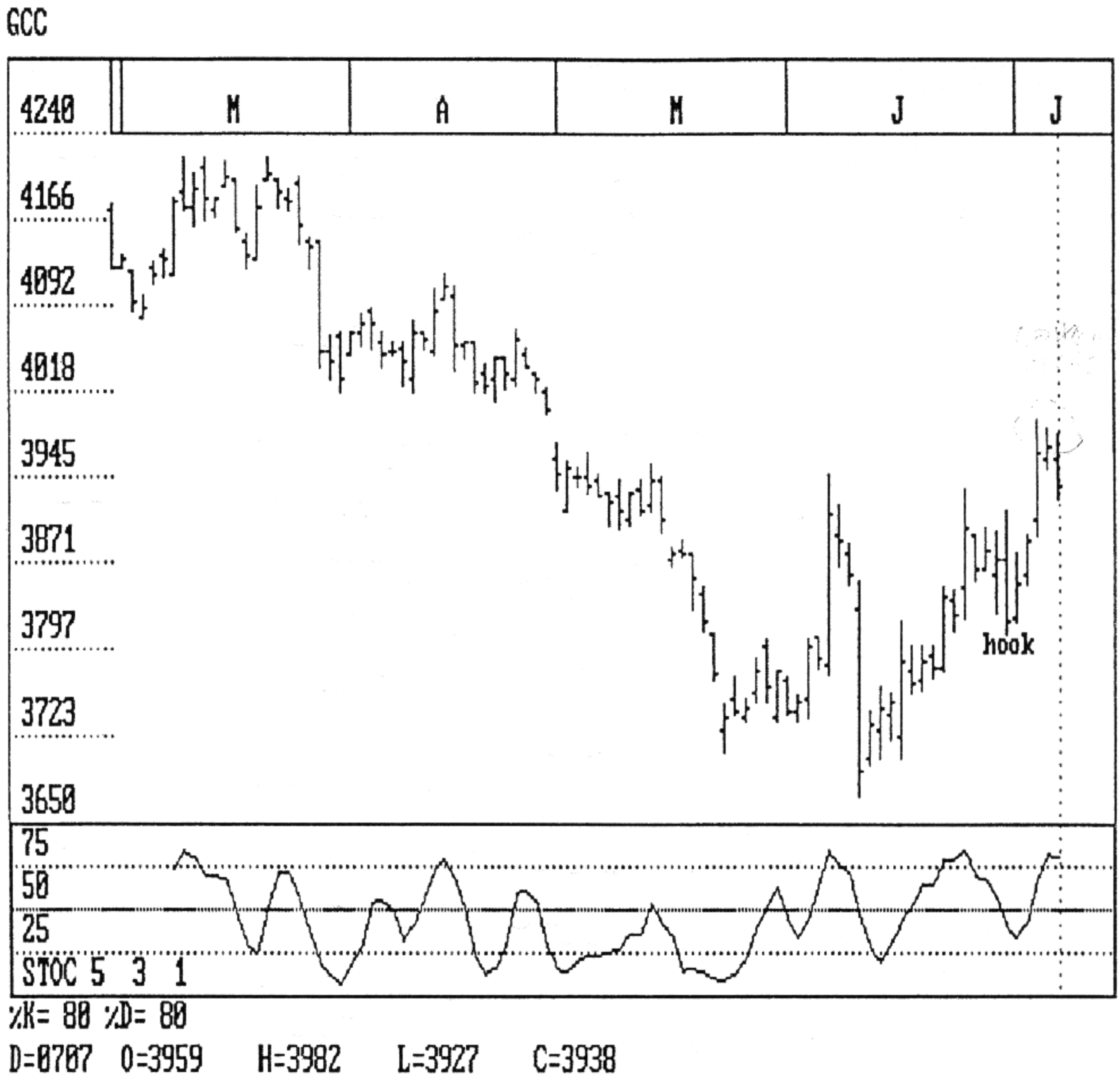


Figure 43 On 0707, prices move down to about a third of the previous leg up. There have now been two lower highs in a row, the daily oscillator is beginning to turn down, and the weekly oscillator, although pointing up, is beginning to stair-step. I would love to short this market, but will wait until the weekly oscillator turns down. I notice that if prices do break to the downside, they may take out a previous Ross hook.

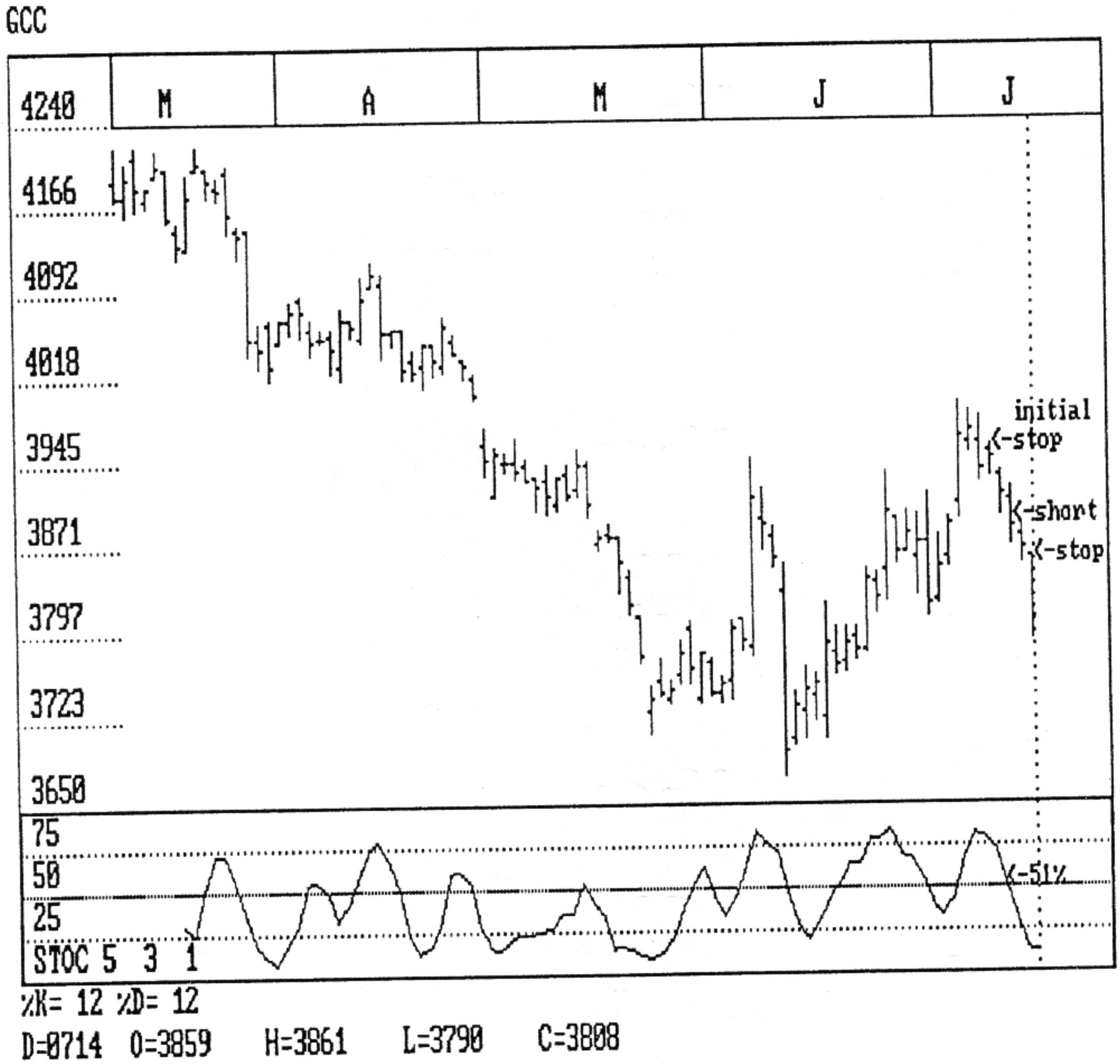


Figure 44 On 0711, the weekly oscillator segment turns down. The daily oscillator is at 51%. I place an order to sell at 3897. My sell order is filled at 0712. I place my stop at 3960, just above the high of 0710. Prices continue to move down on 0713 and 0714. I move my stop to 3862, which is above the high of that day. The daily oscillator shows oversold and the weekly oscillator segment is pointing down.

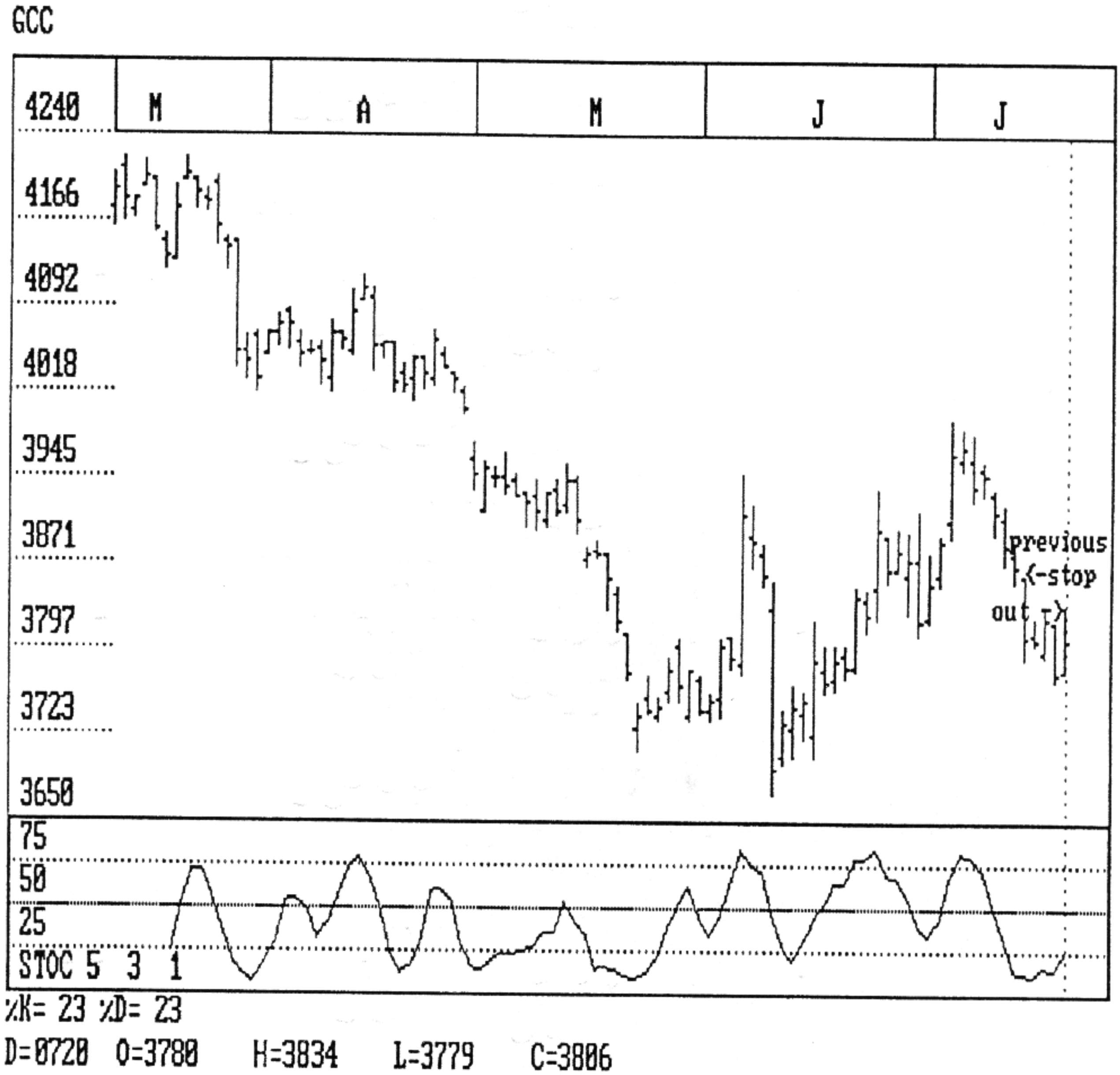
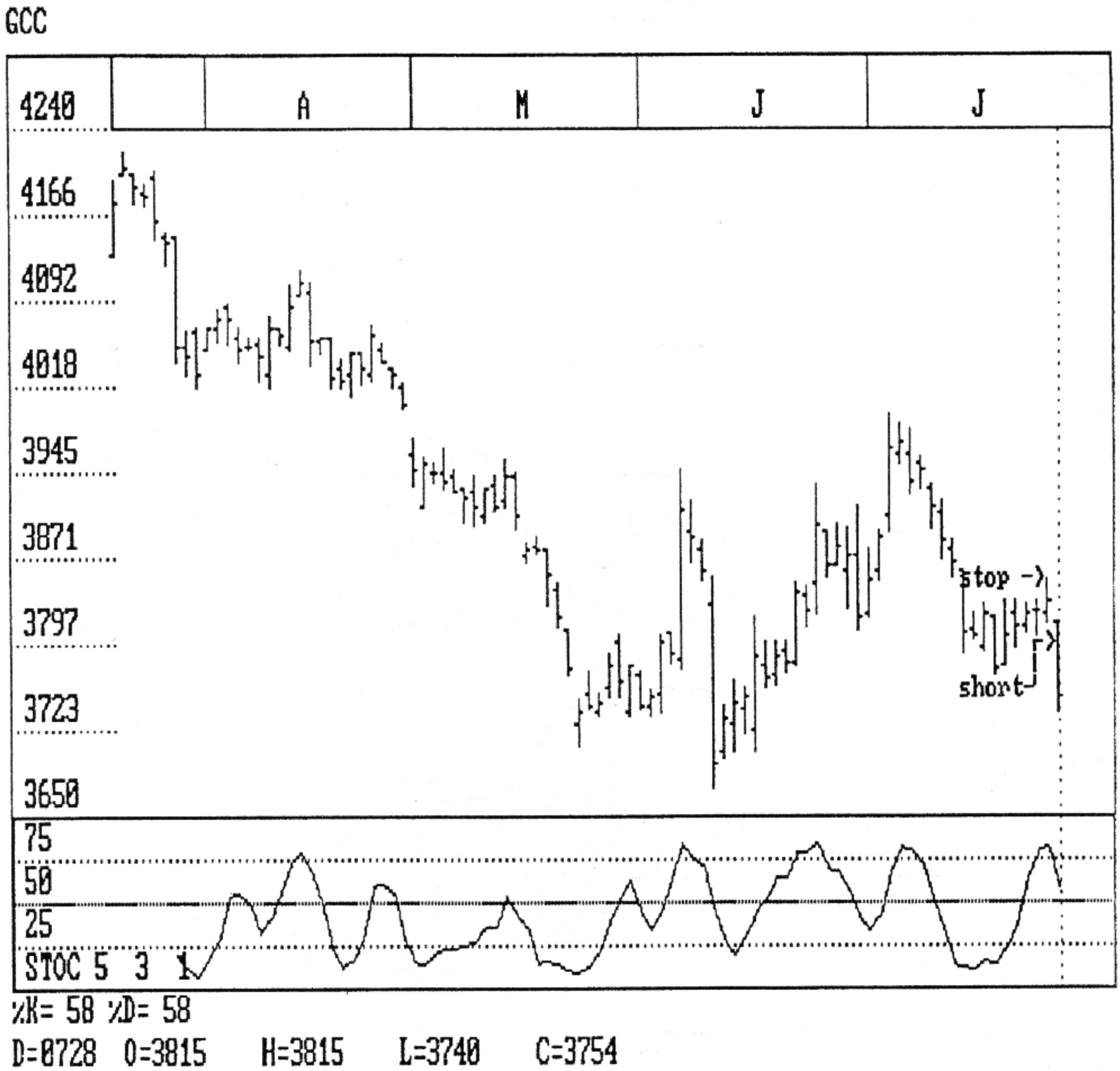


Figure 45 On 0717, there is an inside day, but prices close right near the low of the day, so I sit tight on my stop. On 0718, the daily oscillator is beginning to turn up, but the weekly oscillator is still pointing down. I get antsy and move my stop to 3834, which is above the high of the day. On 0719, prices drop back down again, and so I leave my stop in place. On 0720, I'm stopped out at 3834, the high of the day. The weekly oscillator is still pointing down. I'll try to sell on a correction if the weekly oscillator remains down.



Prices enter a small congestion area, and on 0725 they reach overbought on the daily oscillator. The weekly oscillator is still pointing down. I place an order to sell the breakout of the low for the day at 3804. If prices do break out and take out the recent low, it will again be a breakout of a Ross hook. On 0726, prices breakout to the upside, but close at the level of the congestion. On 0728, prices shoot downward and I get a fill on my sell order. I place my stop above yesterday's high. I figure that prices should fall another day just on momentum, and will test support at or near the major nearby low.

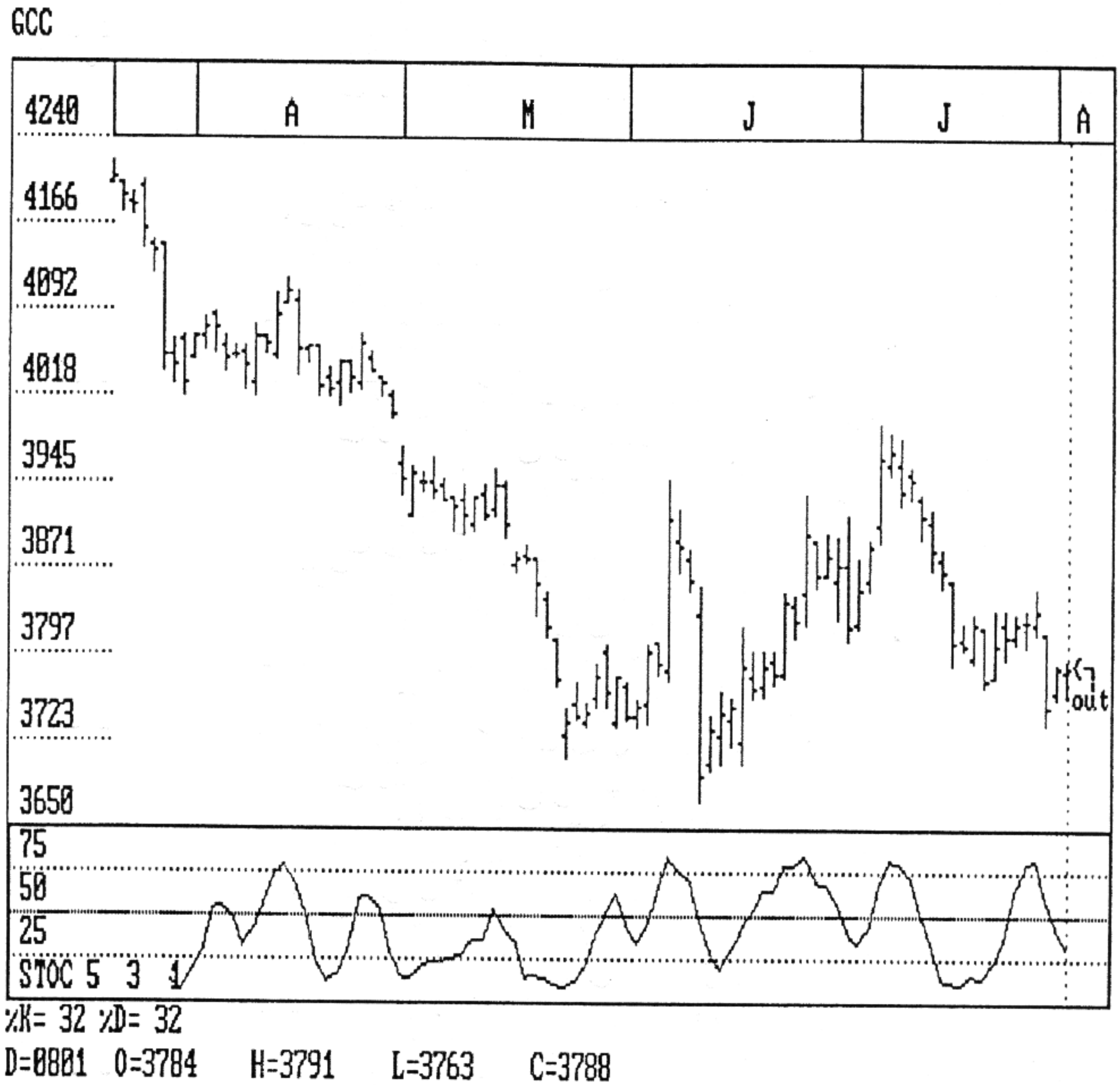


Figure 47 0731. There is an inside day. I move my stop to just above the high at 3790. That will give me a little better than breakeven if there is no further follow-through to the downside. On 0801, my stop is taken out. I'm out of this market for the time being. The weekly oscillator has gone flat.

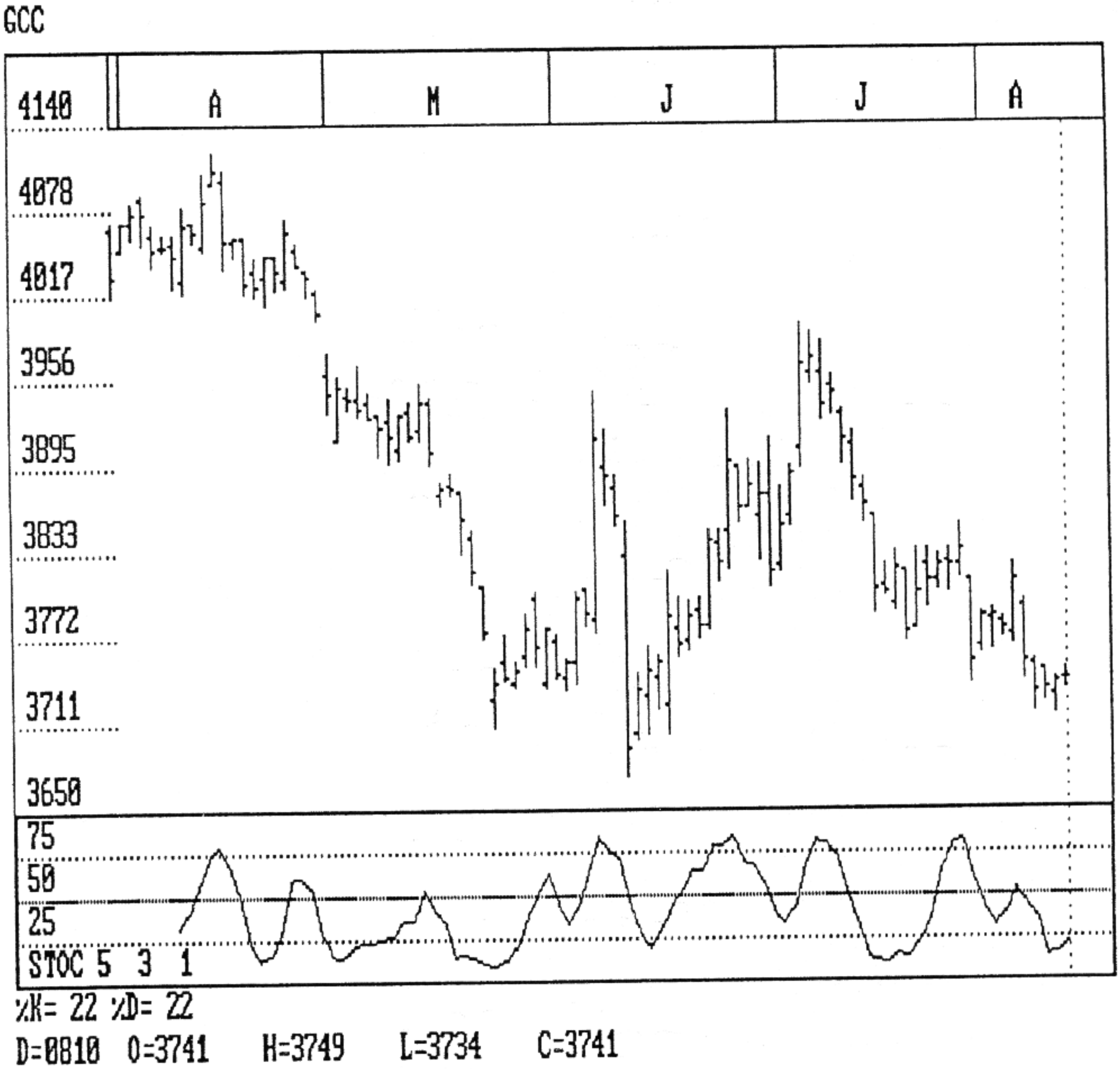


Figure 48 The weekly oscillator remains flat until 0811, when sure enough, prices drop down and test close to the major low. The daily oscillator has drifted into oversold and then bounces the same day that prices do. At that point, the weekly oscillator turns down. If it stays down, I'll wait for a correction and then go short again. Perhaps prices will take out the major low.

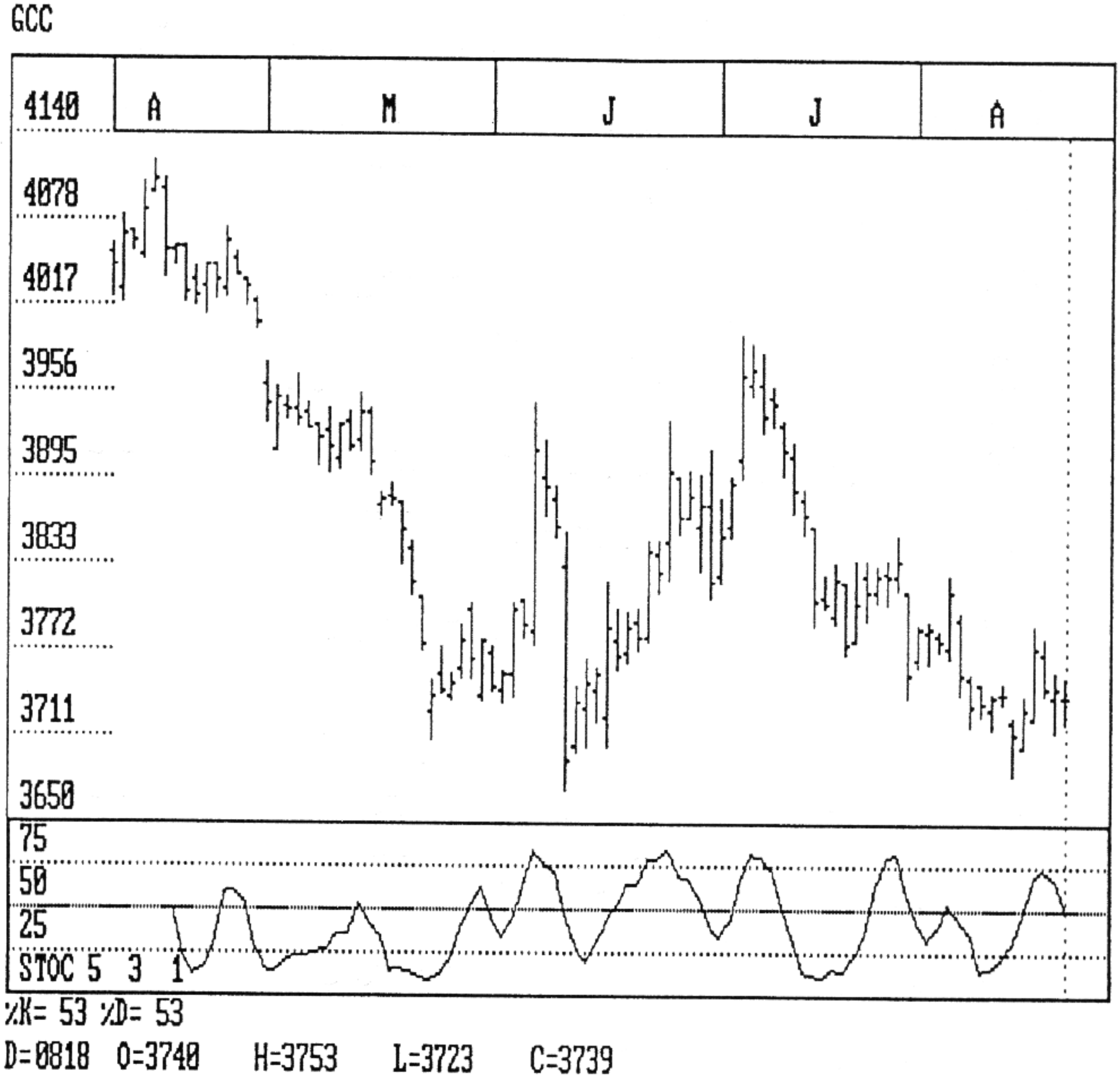


Figure 49 The weekly oscillator stays flat until 0818, at which point it turns up. If the daily oscillator goes to oversold and the weekly oscillator stays up, I will enter a long position. Right now, it looks more like a congestion is building than anything else.

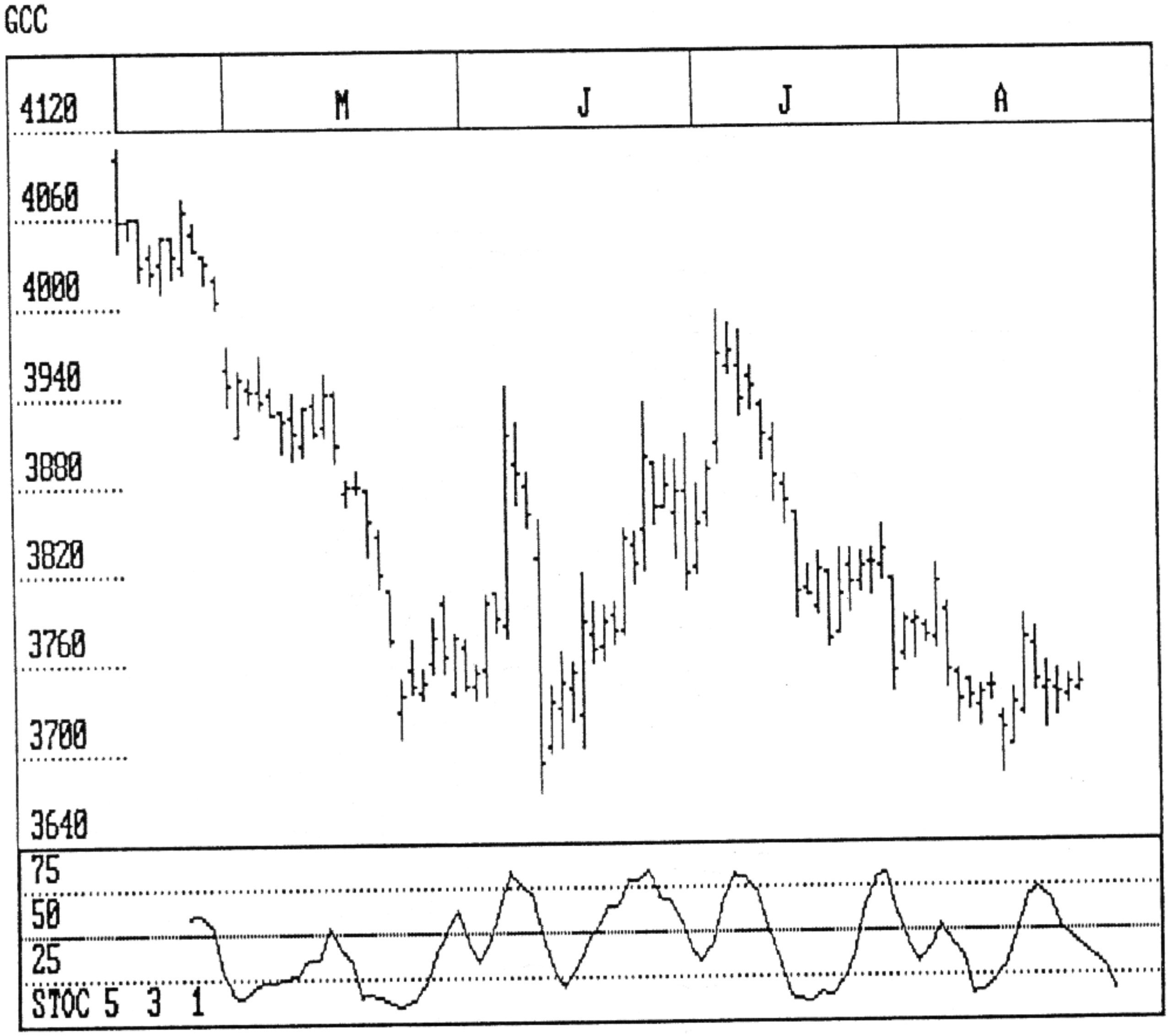


Figure 50 Prices do congest until 0824. The weekly oscillator is flat from 0821 to 0825. On that day, prices gap down causing the weekly oscillator to also turn down. However, the daily oscillator is already oversold, so I will have to wait for a correction.

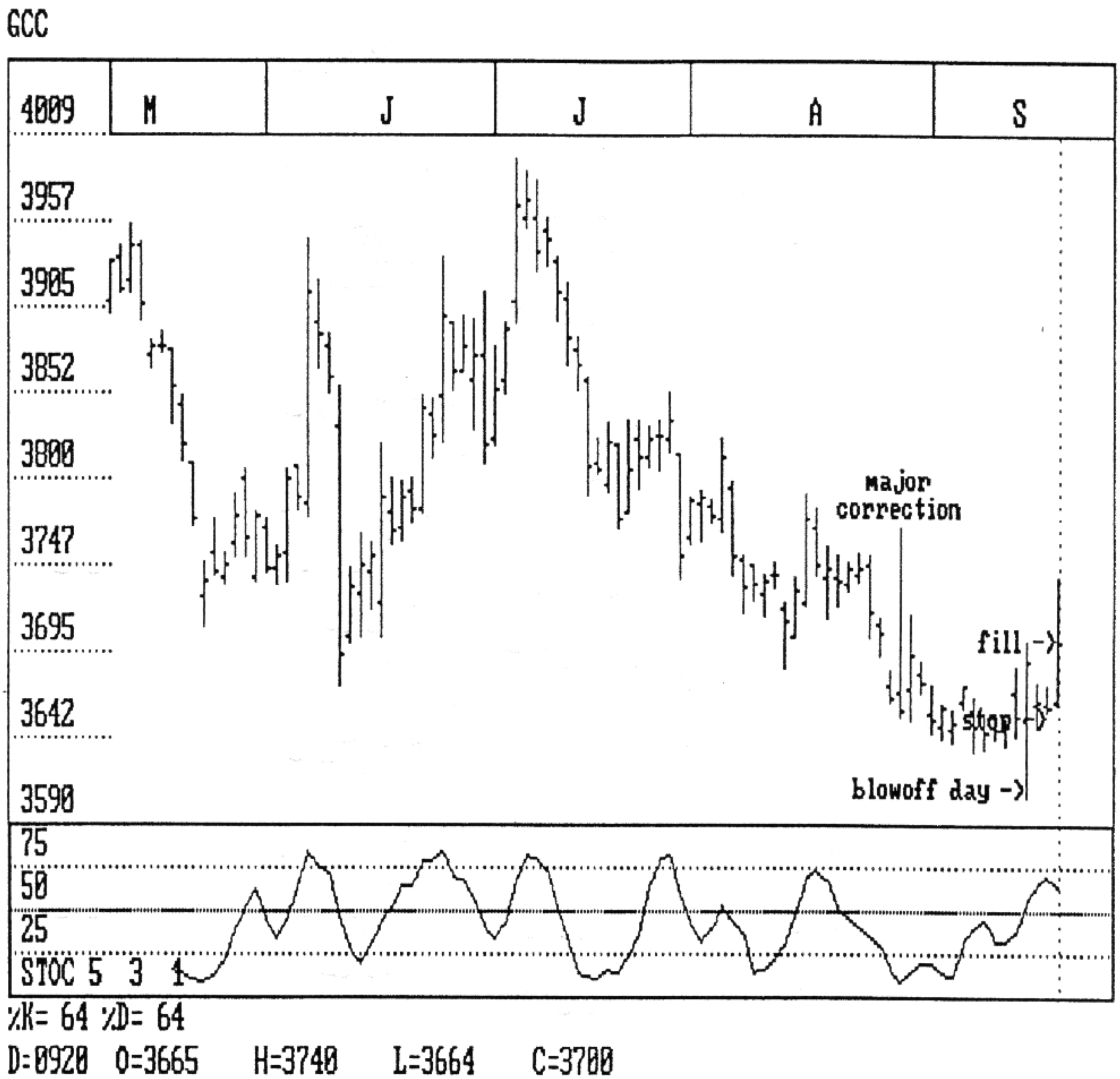


Figure 51 I didn't have to wait long. On 0828, prices make a major correction all in one day, then close near the lows. The daily oscillator is oversold, and the weekly oscillator is flat and stays basically that way until 0915, at which point a blowoff day makes it turn up. I place a buy stop just above the high at 3701. 0920. My buy stop is hit and I'm in this market again. My stop is 3658, below yesterday's low.

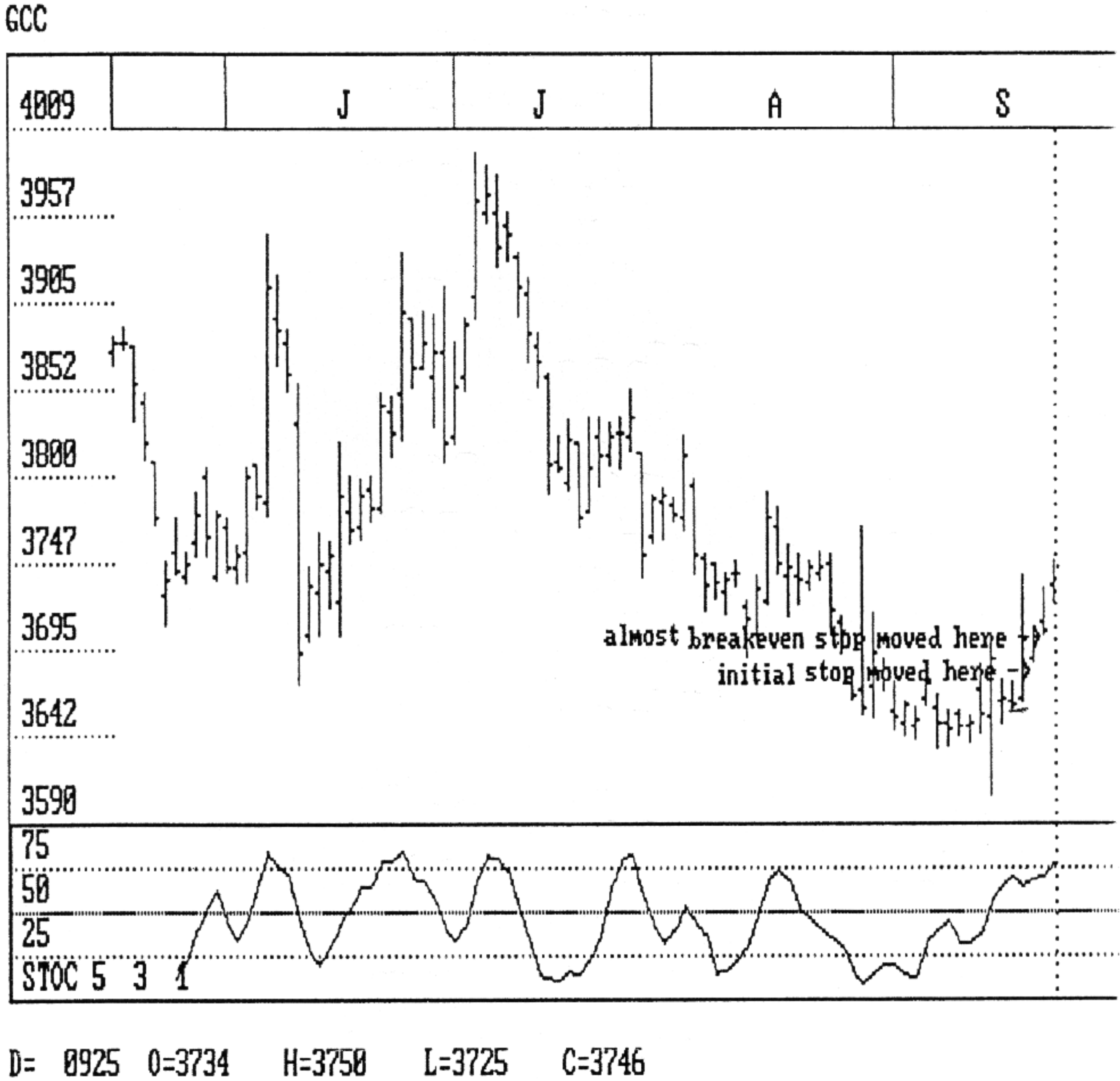


Figure 52 The following day, 0921, is an inside day, but it closes near its high. 0922, prices move up but close near the low of the day. I move my stop up to below the low of the inside day. 0925, prices move up again closing near the high. I move my stop up near the low of 0922, which is just about breakeven. The weekly oscillator is pointing up. The daily oscillator is just into the overbought area.

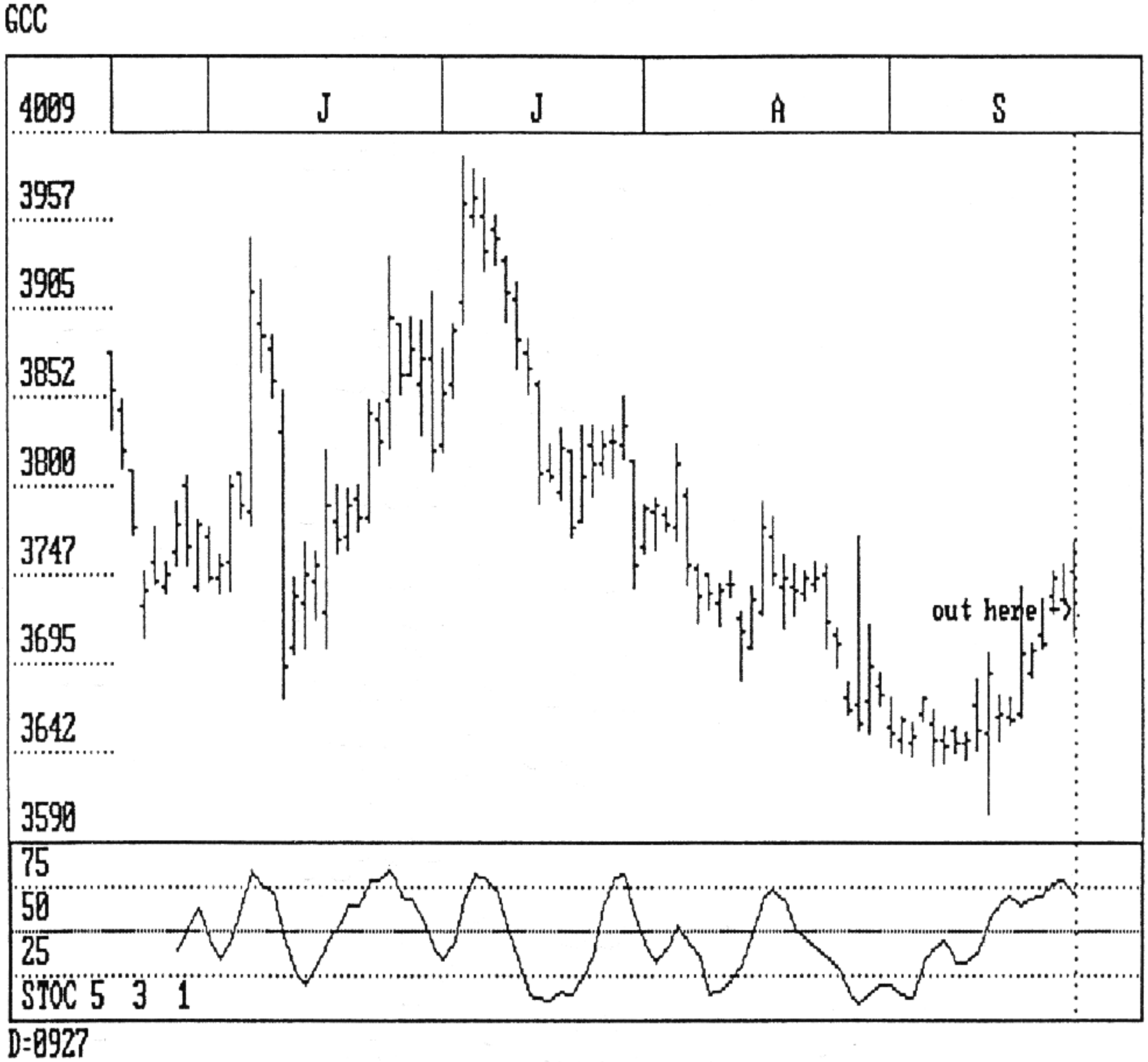


Figure 53 0926. This is looking less and less like a real upmove. I move my stop up another notch to below yesterday's low, at 3729. On 0927, my stop is hit and I'm out. I have a gain of 28 points on this trade. The daily oscillator has turned down, and the weekly oscillator has gone flat. I think that the market may now retrace, making a 1-2-3 low. If it does, the weekly oscillator will turn up and I'll have a chance to go long.

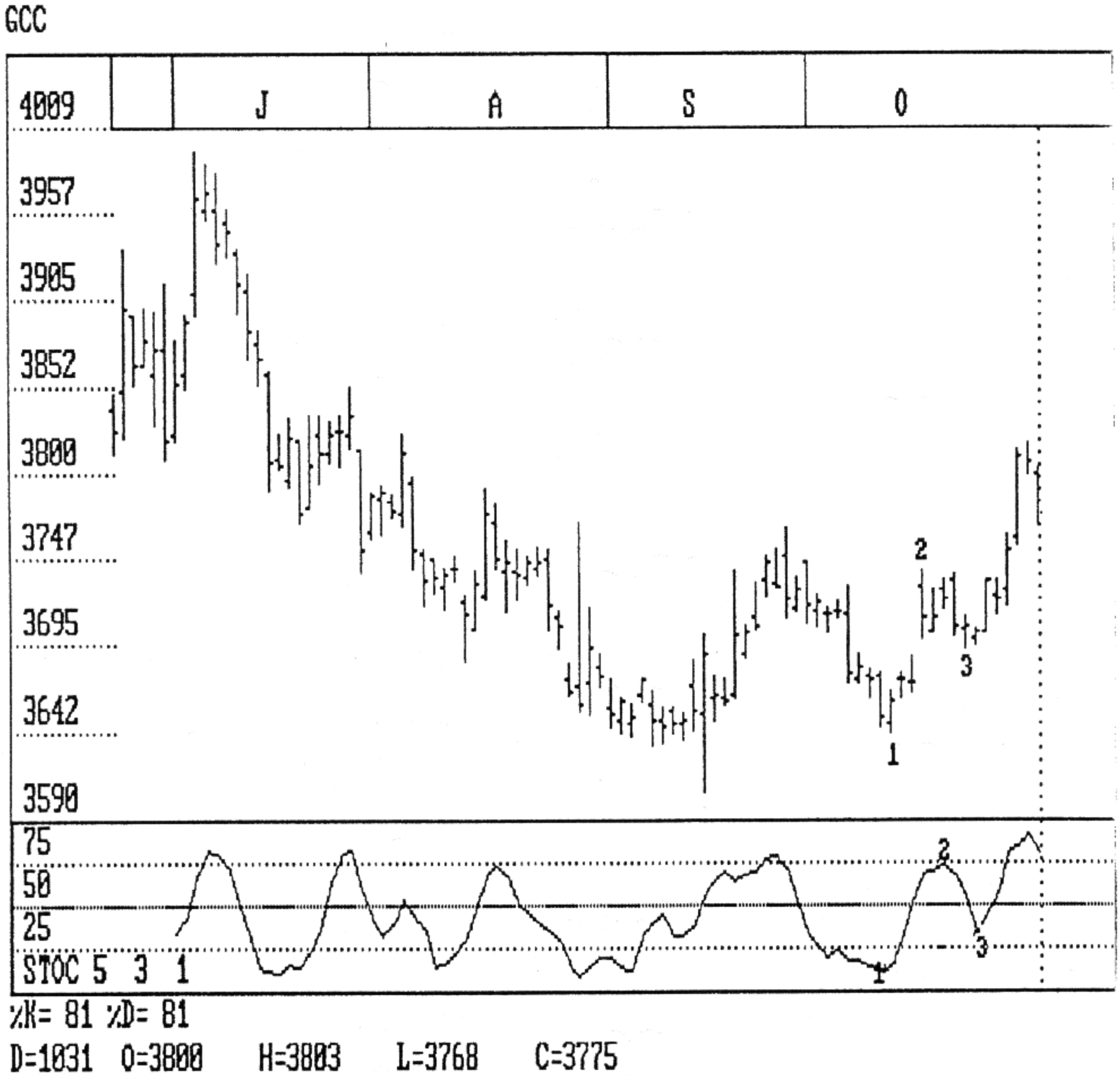


Figure 54 On 0929, the weekly oscillator segment turns up. The daily oscillator is not yet oversold. On 1004, the weekly oscillator turns flat again. From then until 1025, it yo-yo's between flat and down, never giving me a chance (thankfully) to enter. On 1026, the weekly oscillator turns up. I can't place an order because the daily oscillator is already overbought. By 1031, prices have taken out the 1-2-3 low and have started to make a retracement. Maybe soon I'll get a chance to get into this market.

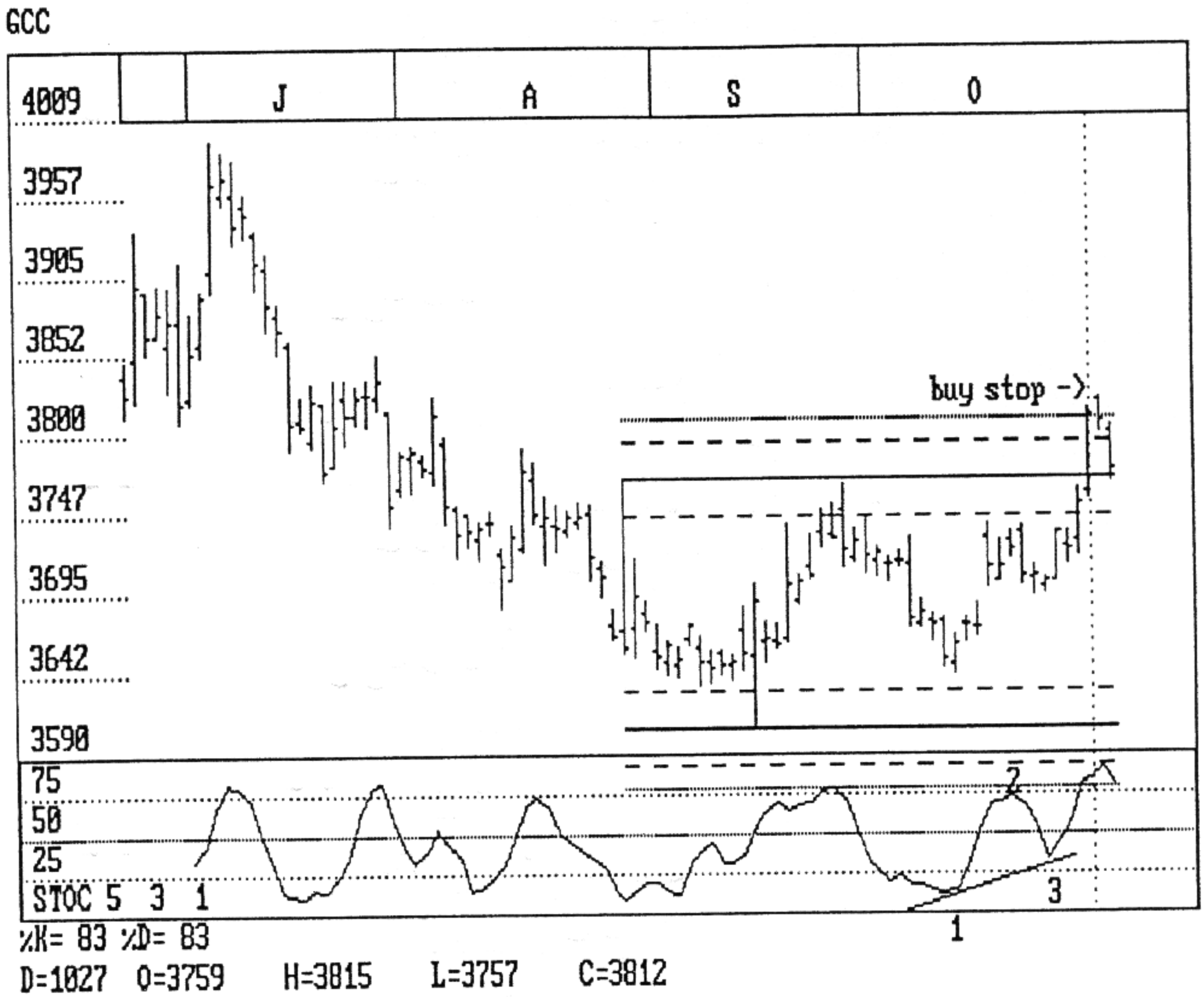


Figure 55 1031. At this point I want to show you something about the daily oscillator that occurs from time to time. It's difficult to state as a rule, so I'll demonstrate with the chart what it is that I want to explain.

The weekly oscillator is pointing strongly up. The daily oscillator shows rising bottoms.

Prices have taken out a 1-2-3 low. The recent high has taken out the upper range of an envelope, and prices have closed above the envelope.

When the daily oscillator gets in this kind of situation, it may not fully retrace to oversold. In fact it may not even leave the overbought area. That's why I can't totally believe in oscillators, they are not always right. But it's possible to learn to read and know their idiosyncrasies when viewed with respect to the price action.

From time to time it happens like this. In fact, as I write this paragraph, it just happened in Soybean Oil contracts.

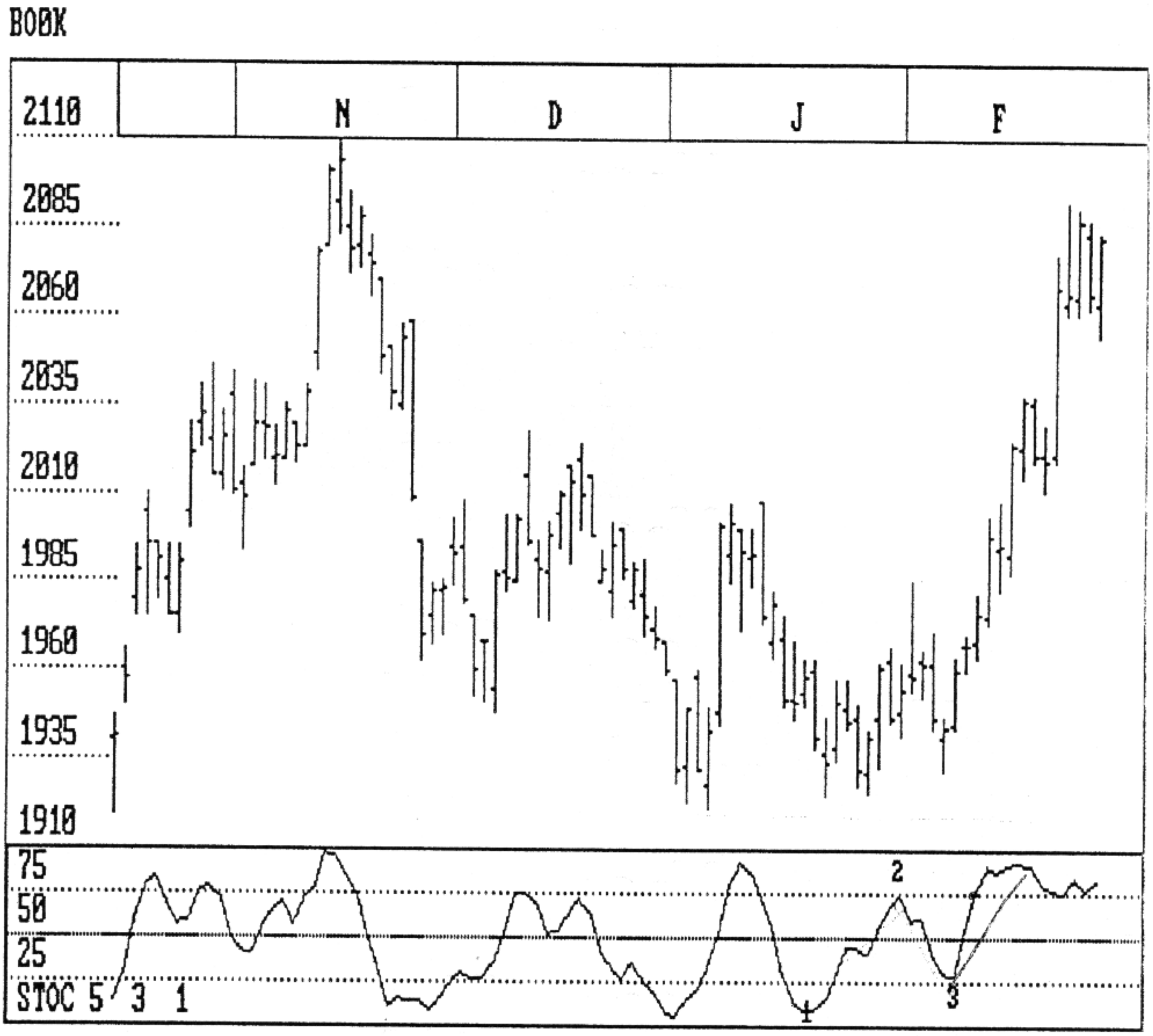


Figure 56 How does the daily oscillator tell me that it's doing this? It's as easy as 1-2-3! Yes even oscillators make 1-2-3's. The reverse is true of down markets and their oscillators when you see them.

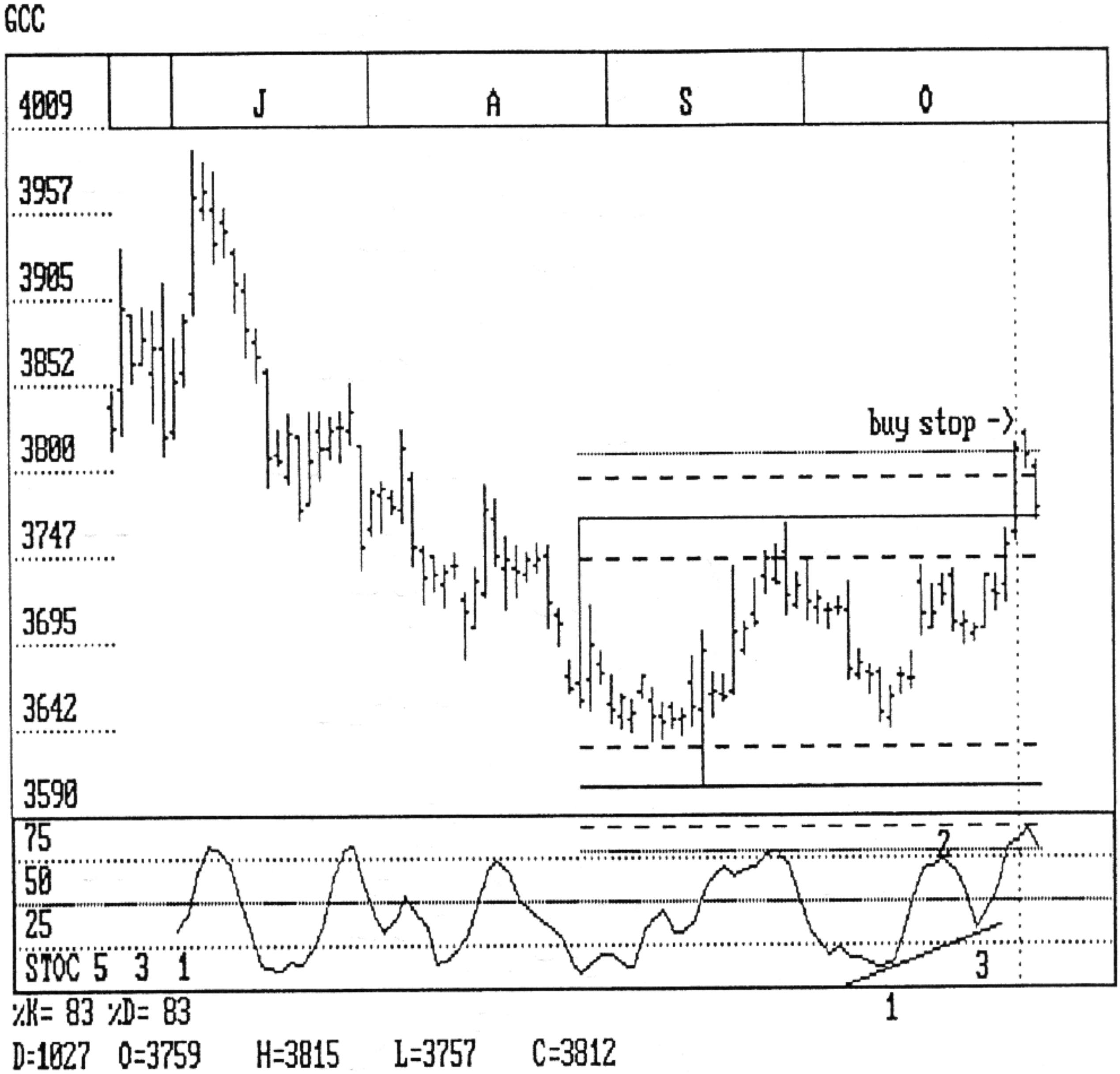


Figure 57 Although I normally would have been in this trade via a breakout of the 1-2-3, and again via a breakout of the envelope, my purpose in this series of trades is to show how I trade just using the oscillators. I place my buy order just above the high of 1030, and wait for the correction to finish.

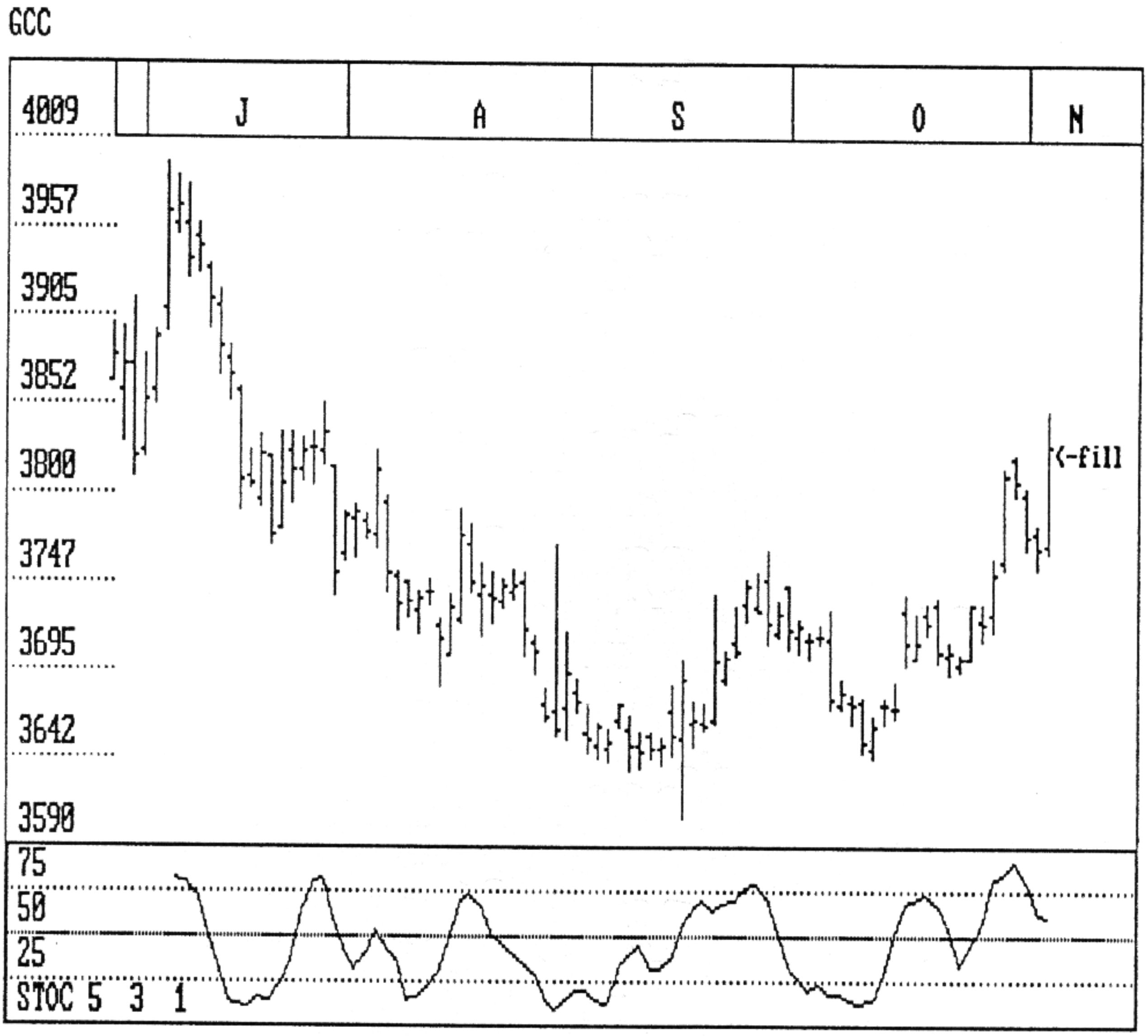


Figure 58 1102. My order is filled at 3824 on the next large magnitude up-day that occurred right after a brief two day correction.

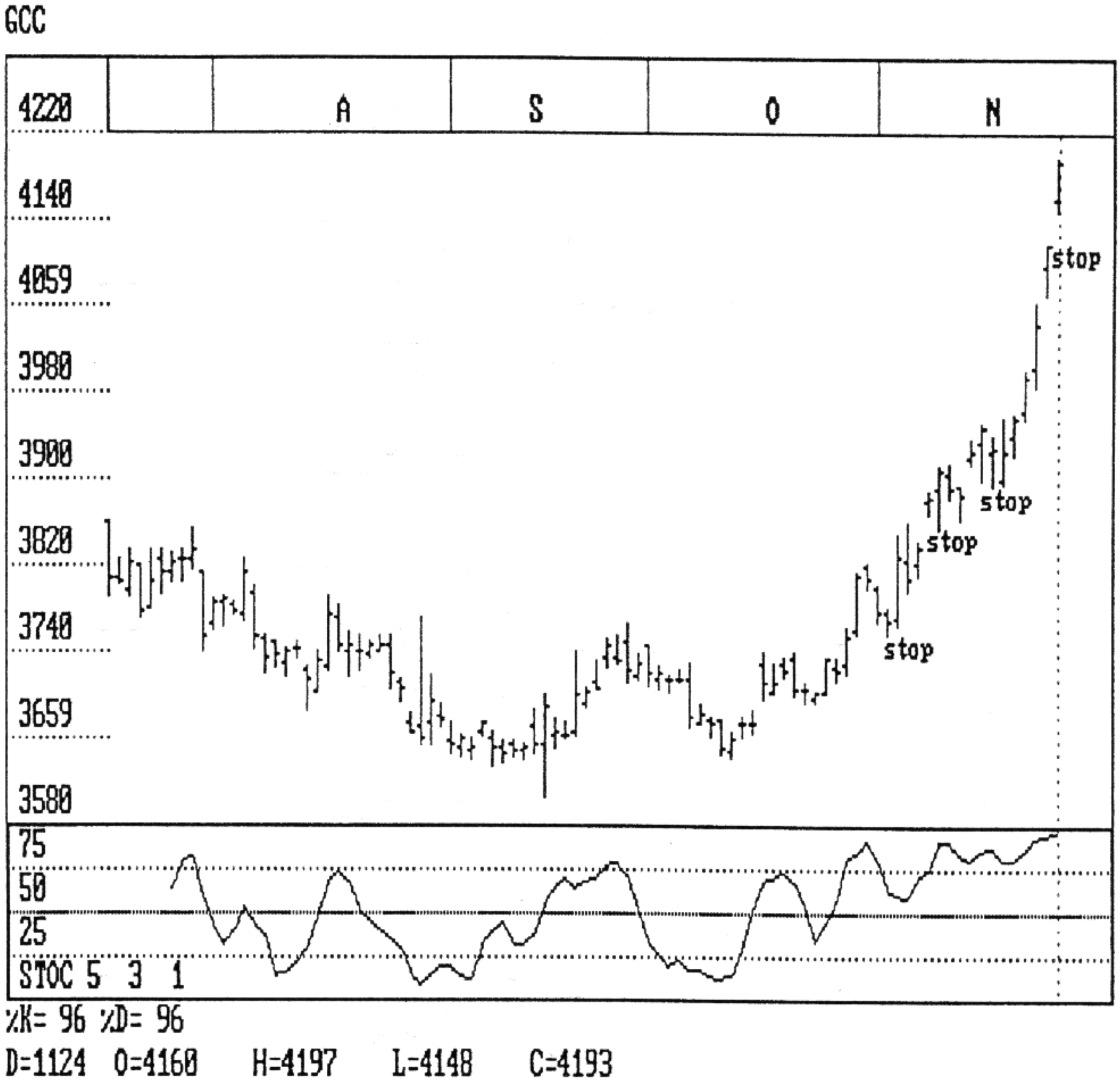


Figure 59 Prices continued to surge upward. Because of the excellent angle of the upward move, I kept my trailing stop at the base of each correction as prices moved upward. On 1124, the day after Thanksgiving, the market was very thin, and the pit bulls drove prices straight up. When a market changes angles and begins to get vertical, I start tightening my stops. I moved my stop to just below the close of 1122 at 4115.

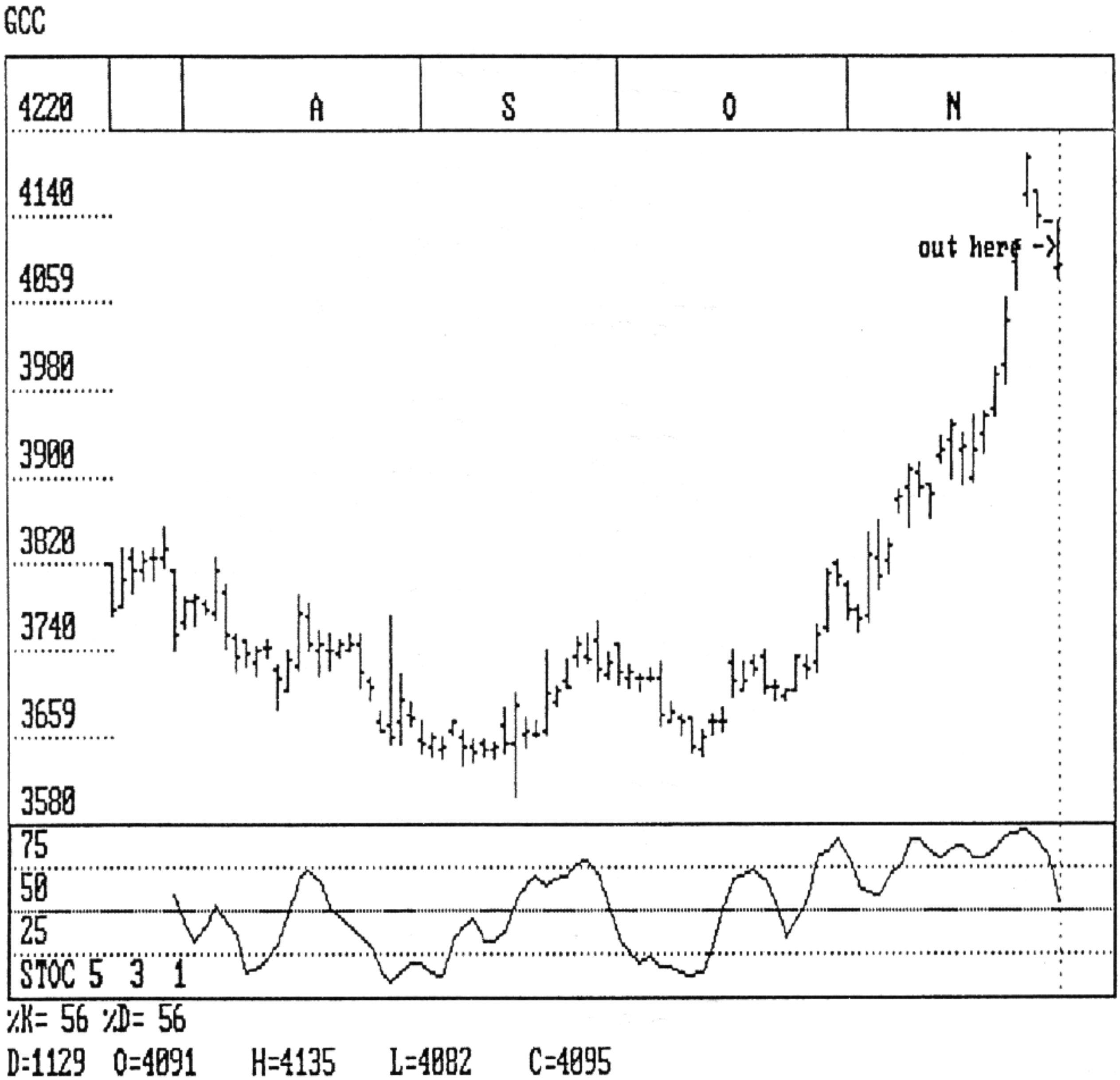


Figure 60 On 1129, prices take out my stop shortly after the open. The weekly oscillator is sharply down and, of course, so is the daily oscillator. Since it is almost December, I decide to take my profits to the bank.

I kept an eye on Gold clear through to the end of the year. The weekly oscillator pointed down from 1129 all the way to 1229. I don't like to trade in December, but I've shown the rest of the chart and the daily oscillator to that time in Figure 61. I'm glad I didn't try to trade in that mess. But just for grins, I placed an envelope around the whole thing.

Range High = 4197 Low = 3984 (Full Line)
Outer High = 4247 Low = 3934 (Dotted Line) GCC
Inner High = 4166 Low = 4015 MidOut Hi = 4227 Lo = 3954 (Dashed)

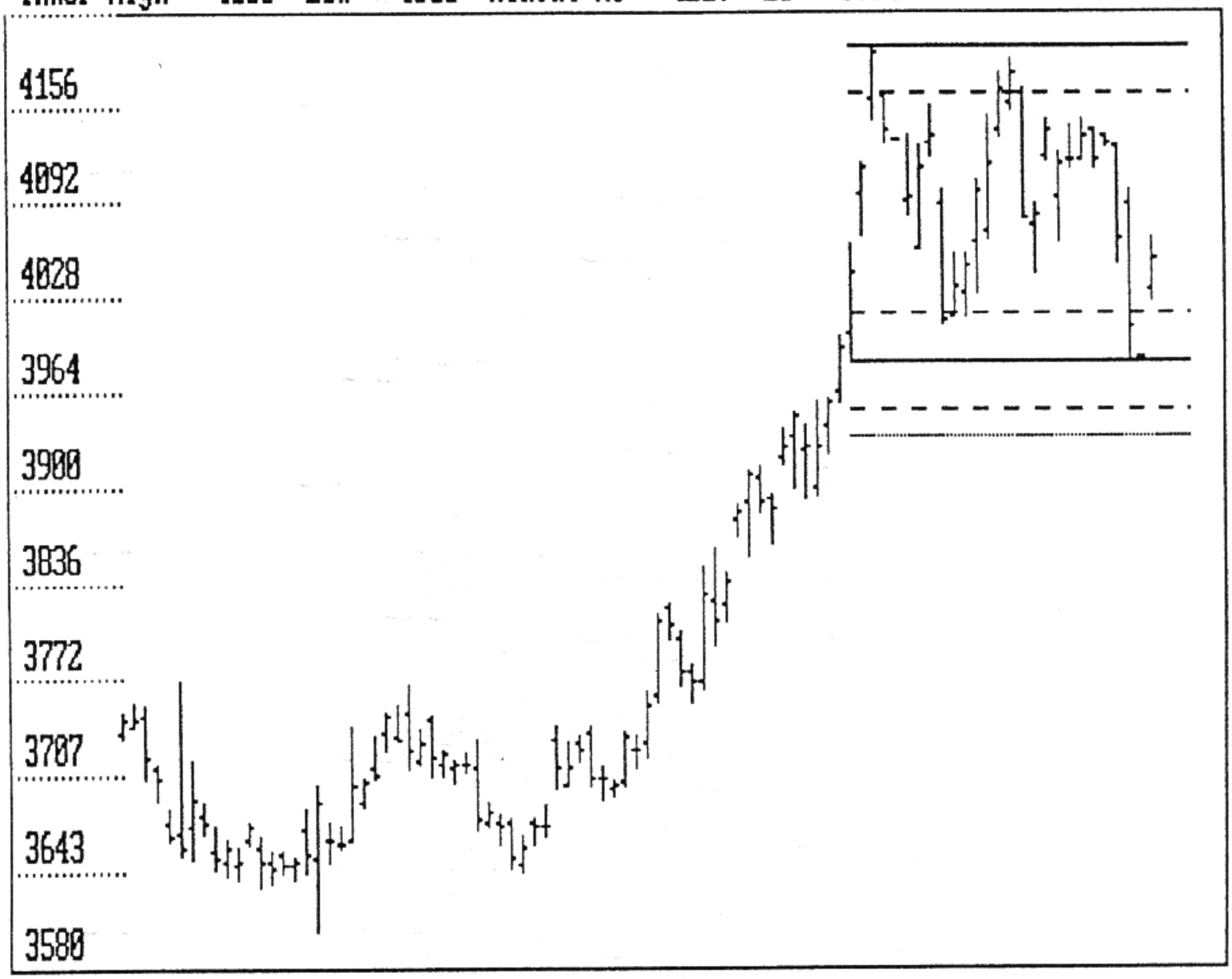


Figure 61

CHAPTER 4

The Anatomy of a Market

This is a market:

Please study it carefully. What can be said about this market? What do you see in this market? What truth can be found in this single pictograph of a market?

Would you agree that it has a high? Would you also agree that it has an open, a close, and a low? If you do agree, then you also would have to agree that this market is in a trading range. It's trading in a range between the high and the low.

Isn't that true of all markets? Every market in existence is in a trading range between the highest high and lowest low that it has ever experienced.

As depicted above, the market had an opening price and it had a closing price. However, the open and the close were not necessarily precise. Instead, they represent a consensus of what the open was and what the close was.

Some sources report the first opening price, some report the second opening price. Some report both. By the time trading closes at the end of a day, the open may reflect a far different price than that which was shown originally at the start of trading.

The close is merely an opinion. The close may change drastically from where it was seen to exist at the end of trading to where the "officials" call it after the close of trading. I have stood in the wheat pit at the board of trade and seen and heard the last bid accomplished at $320.25. The tote board said $330.25. The close was called at $329.75, and that is what was reported.

Have you ever looked at the way they call the back months of a market? Do you wonder why the low is higher than the close, or the close is higher than the high? There is an explanation for those crazy figures, but I won't go into it here.

Although in the pictograph we seem to know where the high and the low were, we have no idea of how many trades (volume) were made at each of them, or if the market ever transacted any trades at all at those levels.

We also don't know what the total volume was for this market, and we don't know what the Open Interest was either. At best they will be a guesstimate and will be available only after it is too late to do us much real good in our trading.

Yet these "truths" are a good part of what we have upon which to base a trading decision, should we choose to place an order in this market. Our decision, if we make it, can hardly be said to have been made on scientific evidence or hard facts.

If we look at a market and realize that it is in a trading range between the all time high and the all time low, then we can also realize that within this overall trading range there exist many lesser trading ranges. These lesser trading ranges occur over time at virtually every level of price activity that a market has.

But these trading ranges don't exist in a vacuum. Normally they are connected. The formations that connect them are called trends. A market, over time, has an anatomical structure. What we see are trading ranges, connected by trending formations. Trending formations, in turn, are made up of shorter trading ranges, gaps, large magnitude moves, and progressively ascending or descending price bars.

Excuse me if all this seems overly simple, but we have to start somewhere, and what I'm attempting to do is to lay out a basic foundation for what is to follow.

What I'm showing here is that a market can be dissected - divided up into its component anatomical parts. There are ways to trade each of these component parts. There are ways to trade from trading ranges. There are ways to trade progressively ascending or descending trend formations. There are ways to trade from small congestion areas. There are ways to trade trend reversals, breakouts, retracements, and corrections.

This book is about how to trade the various situations that occur in the market place. The things that I show in this book may be valid in any time frame, but the emphasis will be toward daily and weekly charts.

In the preceding chapter on Gold trading, I showed a typical futures market. It had some extended trading ranges, and some smaller congestion areas which I call ledges. It had short uptrends and longer uptrends, and short downtrends and longer downtrends connecting the various sideways actions which are ranges, ledges and congestion areas. Some of the sideways areas were narrow in magnitude, others were wide.

What I've tried to show in the Gold trading is that the most relaxed, most profitable, and highest probability-for-success trades come during extended moves from one congestion area to another.

The purpose of three-way testing the trades is to avoid having to trade in congestion, and to avoid trading trends which are short term. The most money made on a single trade is when a market runs. The most money that is made when a market runs is when a market runs long term.

By running the trade through three tests, if you paid attention carefully, I eliminated most of the unprofitable trading that could have been done. The three tests eliminated whipsaws and most of the short runs that often get you stopped out with little or no profit, and many times with a loss.

Why is this true? Even though the weekly oscillator is seemingly coincident or leading in nature, it is still much slower than the daily oscillator in registering what is happening in the market. It is measuring a longer time period.

Consequently, when the daily oscillator has already changed direction and turned, reflecting daily price action, the weekly oscillator may be flat or pointing the opposite way. It will take the weekly oscillator five days, current-to-date, of new information, in order for it to change. The opposition of the two oscillators keeps me out of the market until there is agreement. In essence, that would constitute two segments on the weekly oscillator - or ten days current-to-date of progressive price action in a trending direction.

If the trending action, as shown by the weekly oscillator, manages to last for ten days current-to-date, then when the daily oscillator becomes overbought or oversold, in opposition to the weekly oscillator, representing a correction, there is an excellent chance that the trend will continue. That is because a market set in motion, one that is really going to run, will have the momentum necessary to carry it back into the direction of the trend of the weekly oscillator.

Three-way testing will miss some trades, even some excellent trades, but the ones it gives are good and of high probability for success. Should the trade prove to be incorrect, it reflects that something fundamental is changing in the market, and it would be better to be out of there. If that's the case, then any losses will be small relative to profits.

Because market fundamentals do change, the three-way filtered trades may at times last only one or two days. One or two days is not my objective, but sometimes it is reality. That is why, in this method, stops must be kept close to the market action. If the trade is wrong, I want to be out of it as soon as possible.

Statistics have proven conclusively that if my stop is situated in such a way that I would take a loss, then reversing will more often than not result in either substantially cutting my losses, and, quite often, reversing will result in a profit.

At this point, I've completed showing the basics of market anatomy. The basics are the underlying foundation of what will be revealed in Parts V and VI.

In this part of the manual, I've traded Gold as if it were the only game in town and as if I only had two oscillators to work with. In Part VI of the manual, I'll show how I trade several markets at one time, combining all of the techniques that were possible to use, including most of those just ahead in Part V.

In part V, I will set forth a concept for trading short congestions (ledges) in a trending market. Nothing more than the human eye is needed to trade this method. In fact, learning how to trade ledges can bring fantastic success to anyone who takes the time to study what I will show. Although difficult to master, it's one of the best ways to successfully nibble away at a trending market. You will definitely get your piece of the action, and with low risk.

INTRODUCTION

This part of the manual will cover several more areas of my trading. I've divided each aspect into chapters. The chapters are:

Trading one-two-three breakouts from within "range-trading" areas.

Trading from a ledge.

Trading within a trading range.

None of the techniques I will now show would have made much sense without the prior methodology. Part V of the manual relies on the previous four parts.

CHAPTER 1

One-two-three Breakouts of a Trading Range

The following is a technique that seems to fit in better in this part of the manual than in any other. It is sort of a combination of some of the things that have been covered so far.

It involves a 1-2-3 low or a I-II-III high that comes within a trading range, but ONLY IF THE BREAKOUT COMES ON OR AFTER 21-29 BARS ARE SHOWING WITHIN THE CONGESTION AREA. I sometimes fudge by a bar.

This technique allows me to get a jump on the breakout of a trading range before prices actually break out of the congestion.

I definitely do not to use oscillators with this technique. The oscillator can be dangerous to use in congestion areas. There are far too many false signals to contend with. To use an oscillator here would be trying to get a double jump on the breakout by prices.

I'll define the technique here, and then show some examples.

If, after 21-29 price bars have occurred there forms a new 1-2-3 low or a new I-II-III high within the congestion area, it is permissible to trade the breakout of the one-two-three, just as you would trade any one-two-three breakout discussed in Part II of the Manual.

Now let me show some examples. As I present the various charts, I will explain any detail to help clarify the intricacies involved.

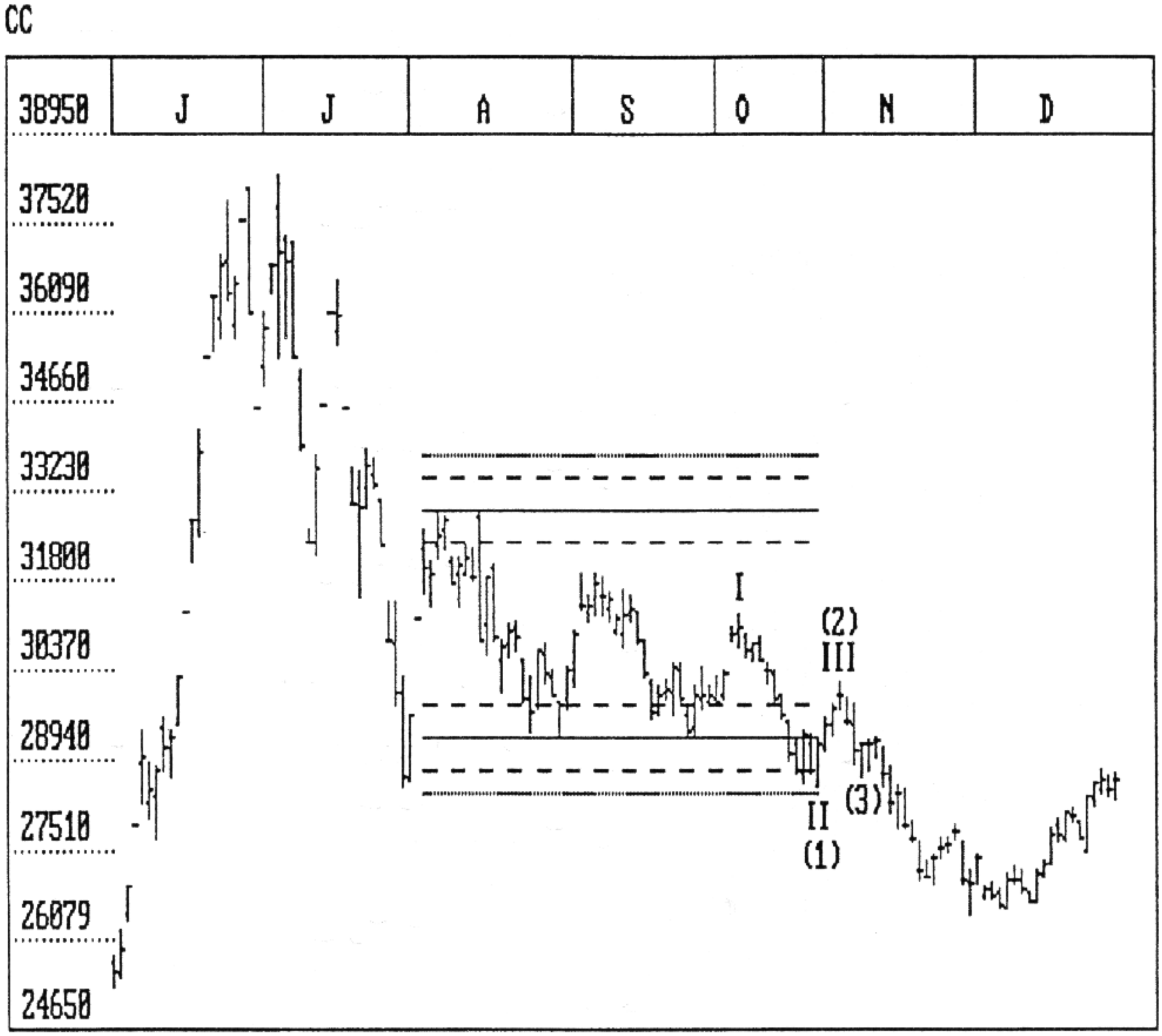


Figure 1 March Corn has been in a trading range for quite some time, and in this figure it appears to be making either a 1-2-3 low or a I-II-III high. Since I don't want to second guess this market, I will place a Buy Stop just above the high and a Sell Stop at the breakout of the envelope, since the low is so near to the bottom of the envelope anyhow.

Notice that Corn is also in a trending channel. I will be discussing the breakout of the trending channel in another section of this part of the Manual.

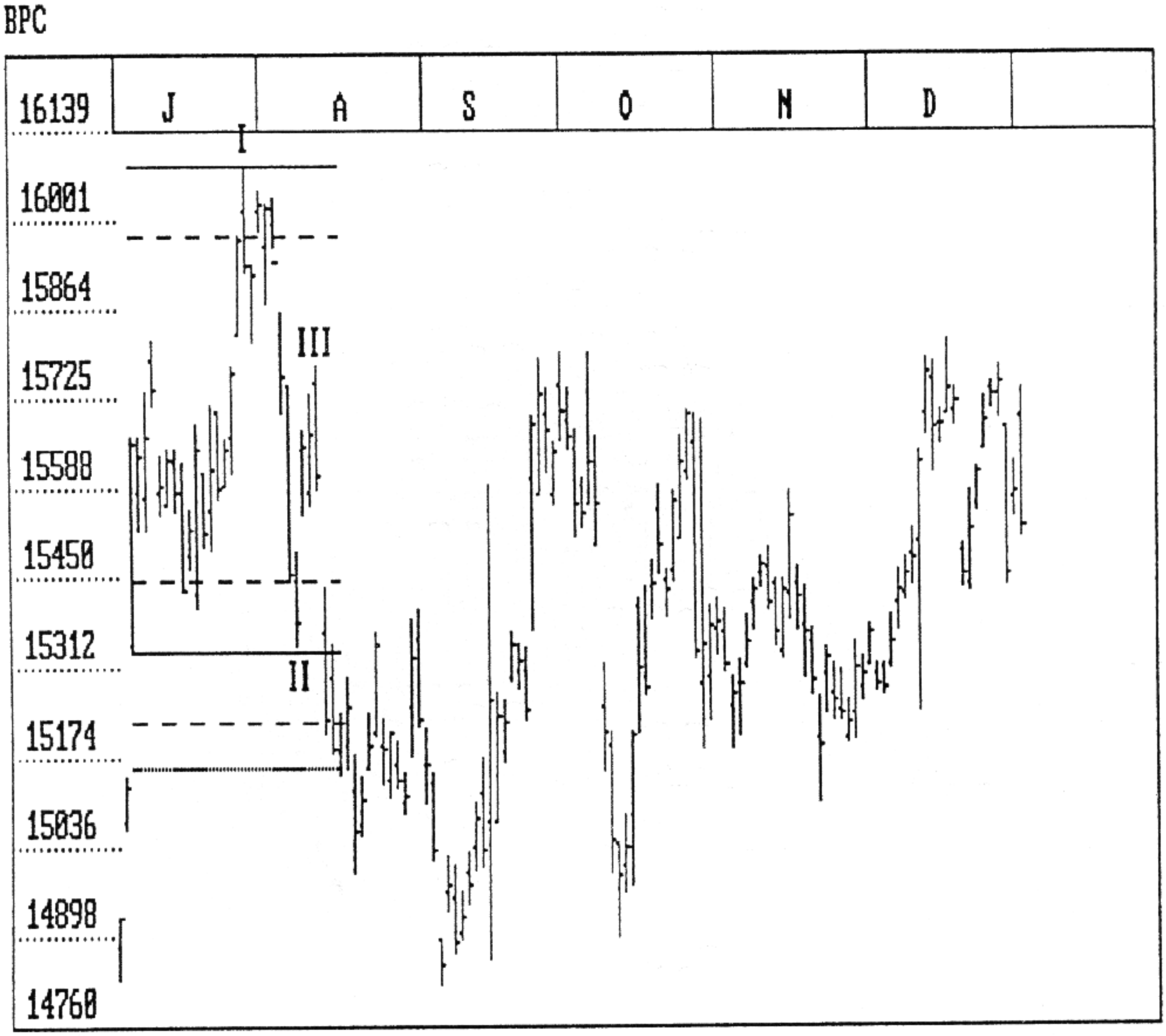


Figure 2 The British Pound had made a major bottom and traded within a rather large trading range for a number of weeks. Trading the breakout of the envelope, while still a good trade, could have been improved upon by trading the breakout of the number 2 point as shown.

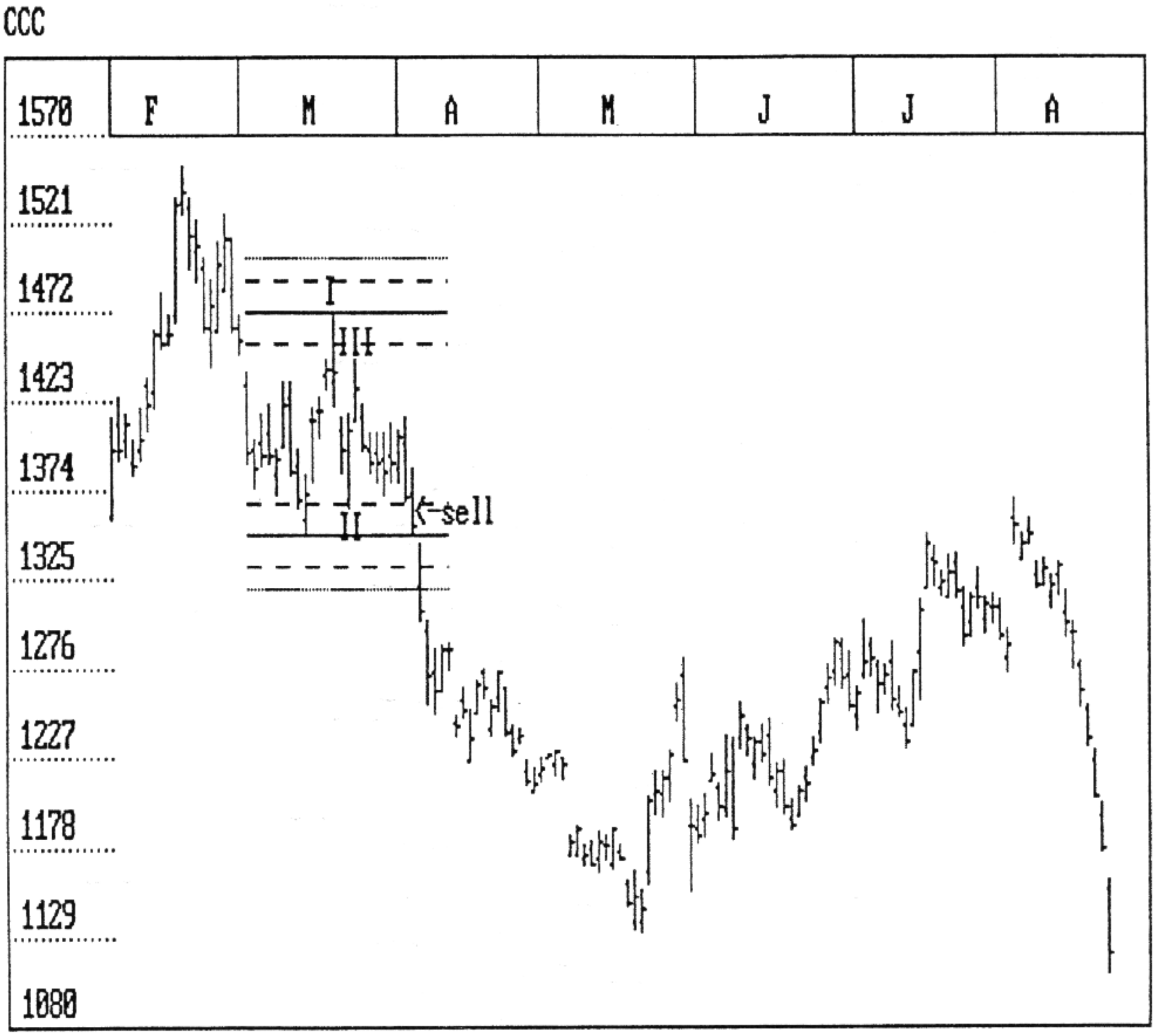


Figure 3 March Cocoa was in a trading range for 25 days. It broke out of a I-II-III high on the twenty-fifth day.

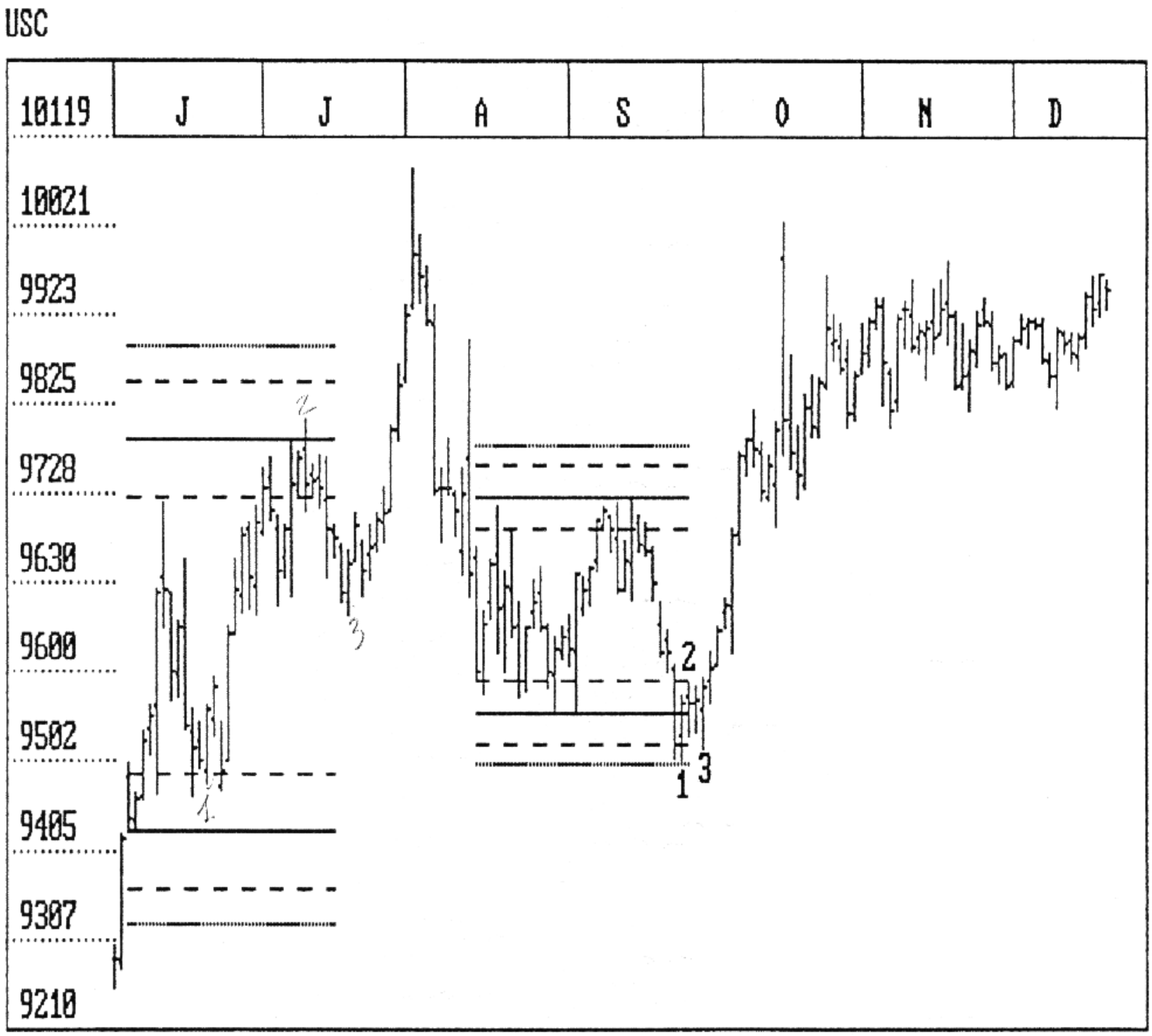


Figure 4 The bonds made a monstrous trading range, the kind that is profitable for trading within a congestion. A breakout of the envelope would have placed the entry point fairly far away. But the breakout of a 1-2-3 low would have been very profitable indeed, while affording a relatively small risk for the bonds.

The 1-2-3 shown above might have been taken by a day trader. It was only on an intraday basis that the #3 point could have been realized and the breakout taken.

A position trader trading within a trading range could have lucked into this situation by buying support within the congestion as will be shown later.

I could go on and on showing chart after chart where this happened, but the message should be clear by now - there is money to be made by trading one, two, three's.

It's somewhat like a waltz, isn't it - getting in step with the market? I take a few spills now and again, but overall it's still the best business in the world. I like to waltz.

Trading these possible one, two, three breakouts is one of the best ways to trade inside a congestion area.

CHAPTER 2

Trading from a Ledge

My family started making money in the futures markets over 100 years ago. As far as I know, I am the last of my family line who still actively trades futures.

I have many trading secrets and techniques. Some have been developed painfully over the years.

This manual contains one of those amazing techniques that is over 100 years old. It has been a part of the trading heritage I have received, and one that virtually anyone can use. All that is really needed is a newspaper or other source of yesterday's high and low prices.

I call this technique "Trading from a Ledge." It is a scalping technique that you can do from home or your place of employment.

It's great for times when you want to trade and are away from home. As long as you have the high and low prices, and are near a telephone so that you can call your broker, you can use this technique.

I've been told that markets are in congestion 85% of the time. Is that true? Yes and no!

I believe it is true that markets are in congestion 85% of the time, but they are not necessarily extended-length sideways congestions. Many times the congestion consists of minor corrections and reactions. It is one type of these minor reactions that are what make up ledges, and this is what gives us the ability to scalp the market without the need for daytrading.

The reactions in which we are interested are such that I think of them as "pauses". The market moves sideways for awhile. (un po')

anche

PAUSA There are small congestions even in the strongest trends, as the market takes a breather. These "congestions" may be only two or three bars on the chart. Are these small sideways moves counted as a part of the 85%? I don't know the answer to that one. But I suspect that (chiunque) whoever decided to count congestion areas must have included these reactions and corrections to be within the 85%.

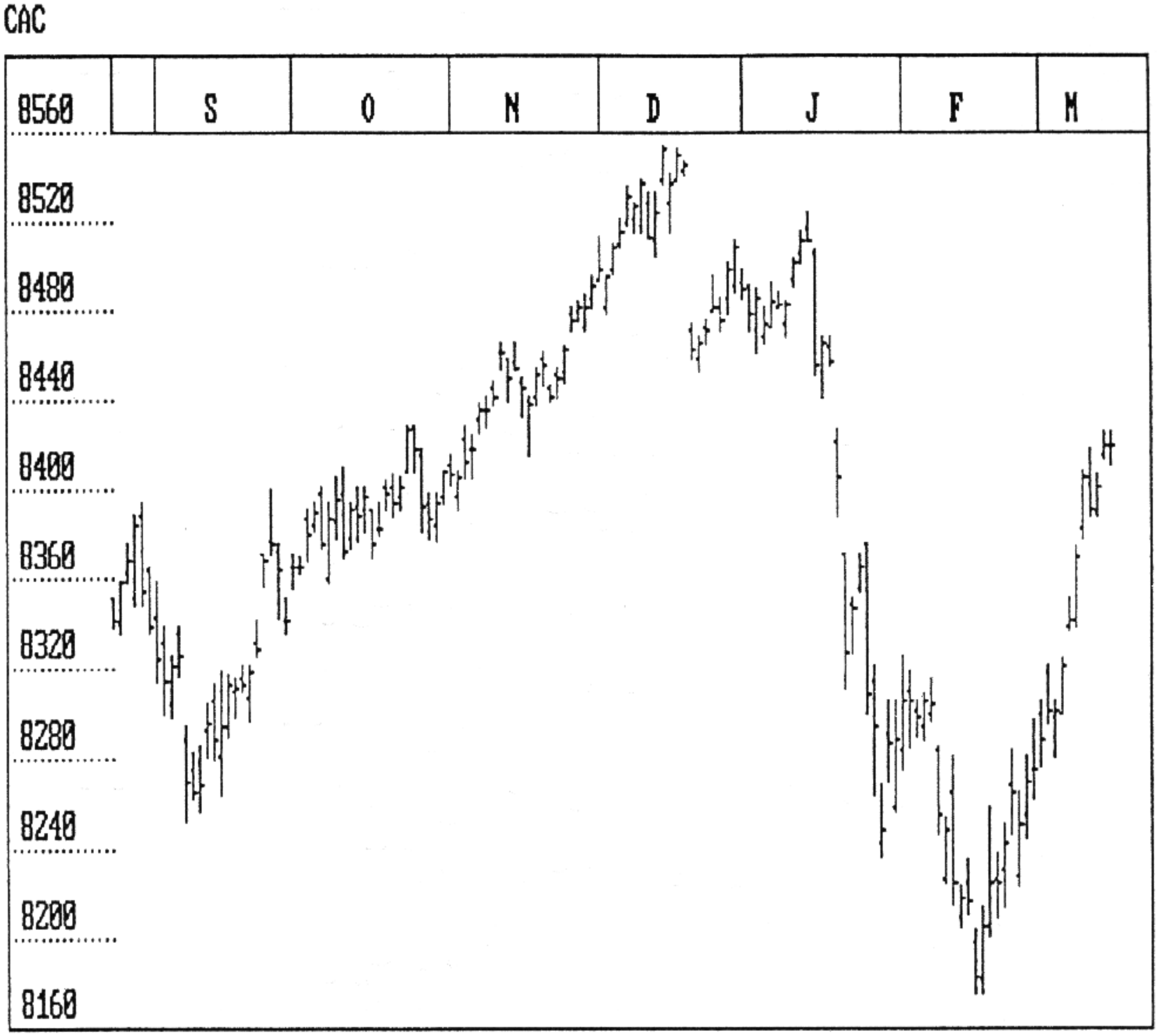


Figure 1 shows the December Canadian dollar. Could it be said that it was in congestion 85% of the time?

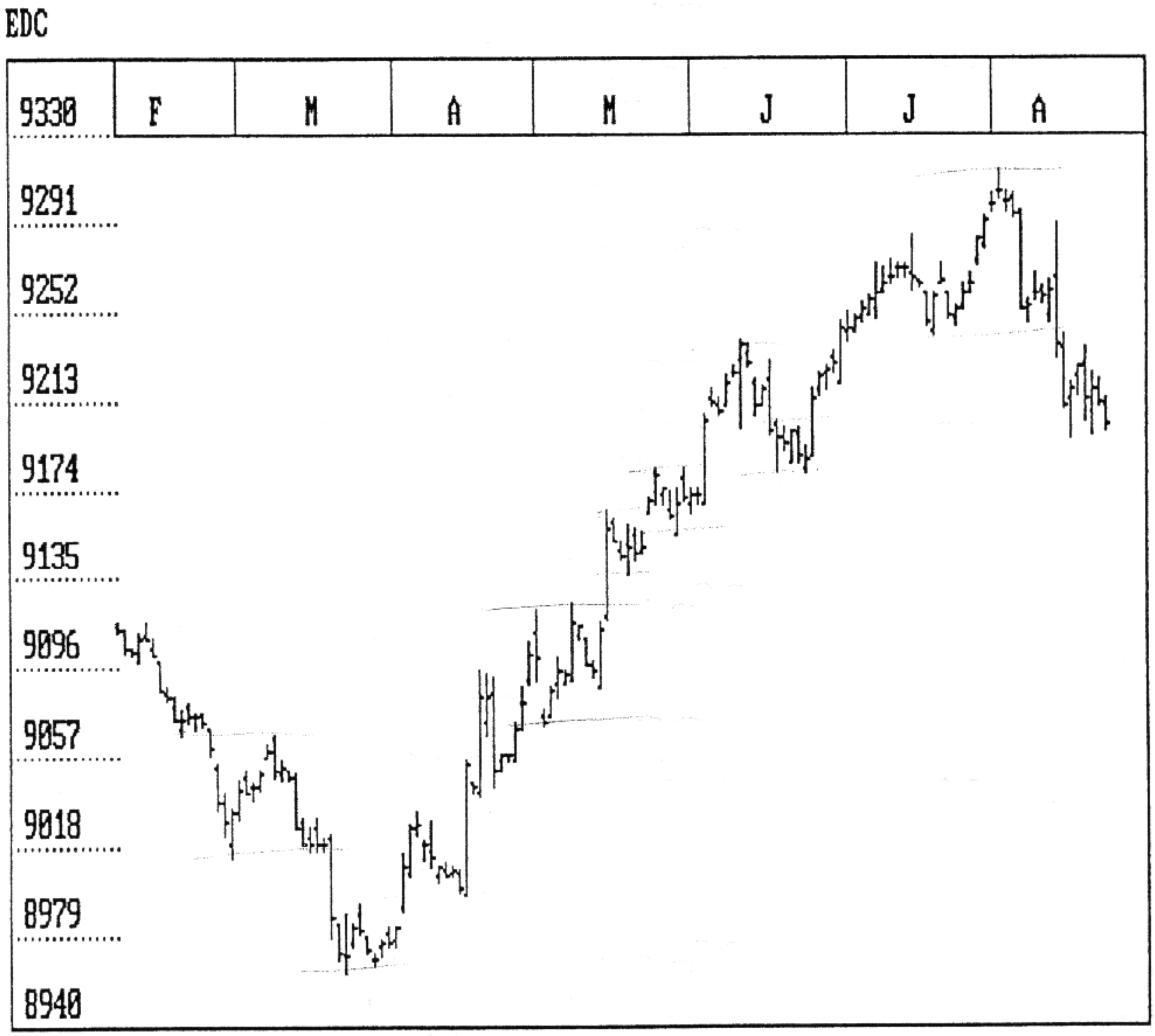


Figure 2 shows the December Eurodollar. The Eurodollar was relatively flat most of the year; yet, could it be said that it was in congestion 85% of the time?

I guess what I'm getting at is that congestion is somewhat of a conceptual matter. Congestion is largely in the eye of the beholder. That is what makes it difficult to master.

I believe that the majority of congestions run only three to ten bars or so on the chart.

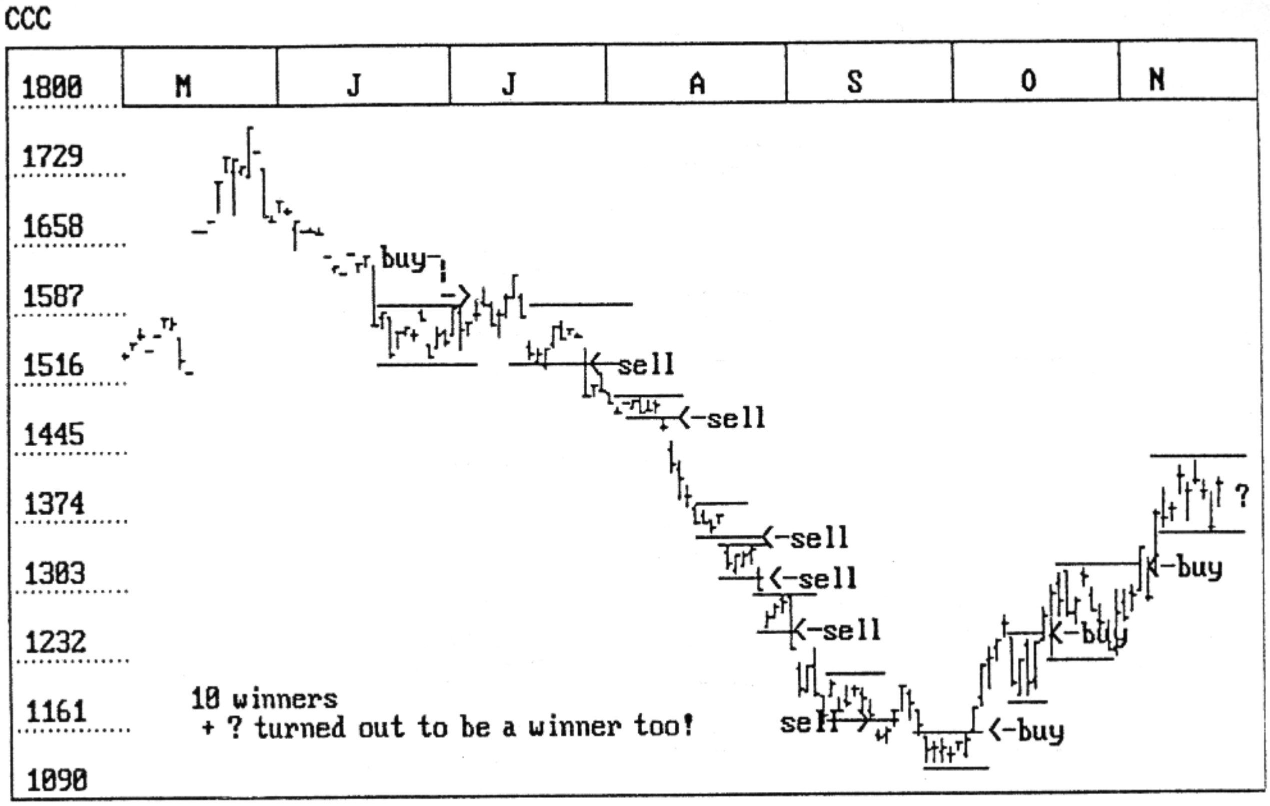
So, what can I do about these congestions? Is there a way to trade small congestions, ten bars or less in length, and make money?

What I'm about to reveal next is one of the most dynamite concepts I have ever done in trading. What I will show happens often, and trading it alone can make anyone all the money he ever cares to have. But remember, as I've previously pointed out, it is difficult in its deployment. Not everyone can master this way of trading.

Perhaps it will look too simple. Perhaps you will doubt the truth of what I am going to show you. This technique presupposes that you know how to place an order with your broker and how to trade once the entry is made. I'm convinced that it will change the way anyone trades - forever!

There are few days when this signal is not happening in some market somewhere. It should be done in conjunction with your other trading and it occurs on all charts in all time frames. But its best application occurs on the daily charts because of the risk to reward ratio. Additionally, ledge formations occur too often on intraday charts, and not often enough on the weekly charts.

They say a picture is worth a thousand words. The pictures I'm going to show next are worth thousands upon thousands of dollars. Look at all of the pictures first (Figures 3-7). I have made a few notations on the chart. Don't worry if you can't figure it out immediately. These examples and the technique will make more sense when I discuss the rules for trading these "ledges." Get set for a SHOCK!!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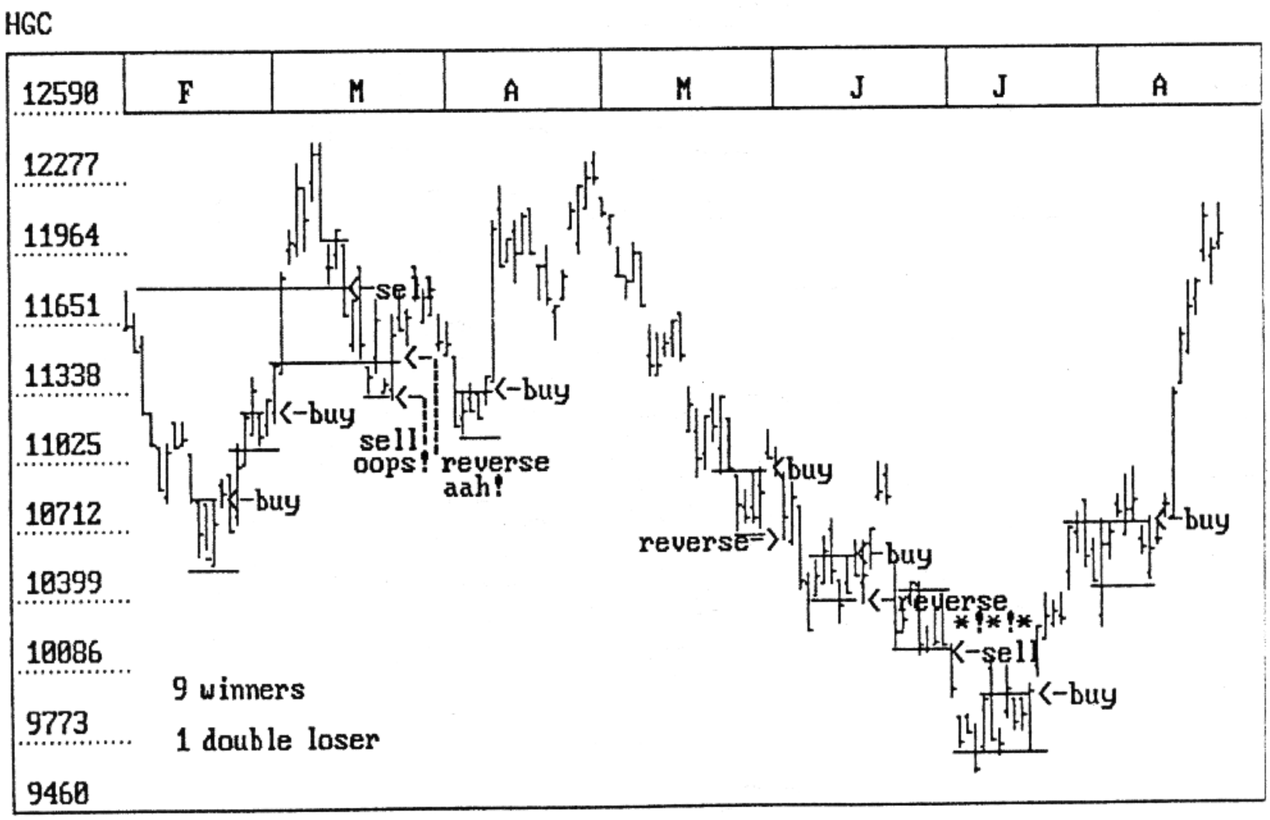
buy
?
10 winners
+ ? turned out to be a winner too!

Figure 3


HGC
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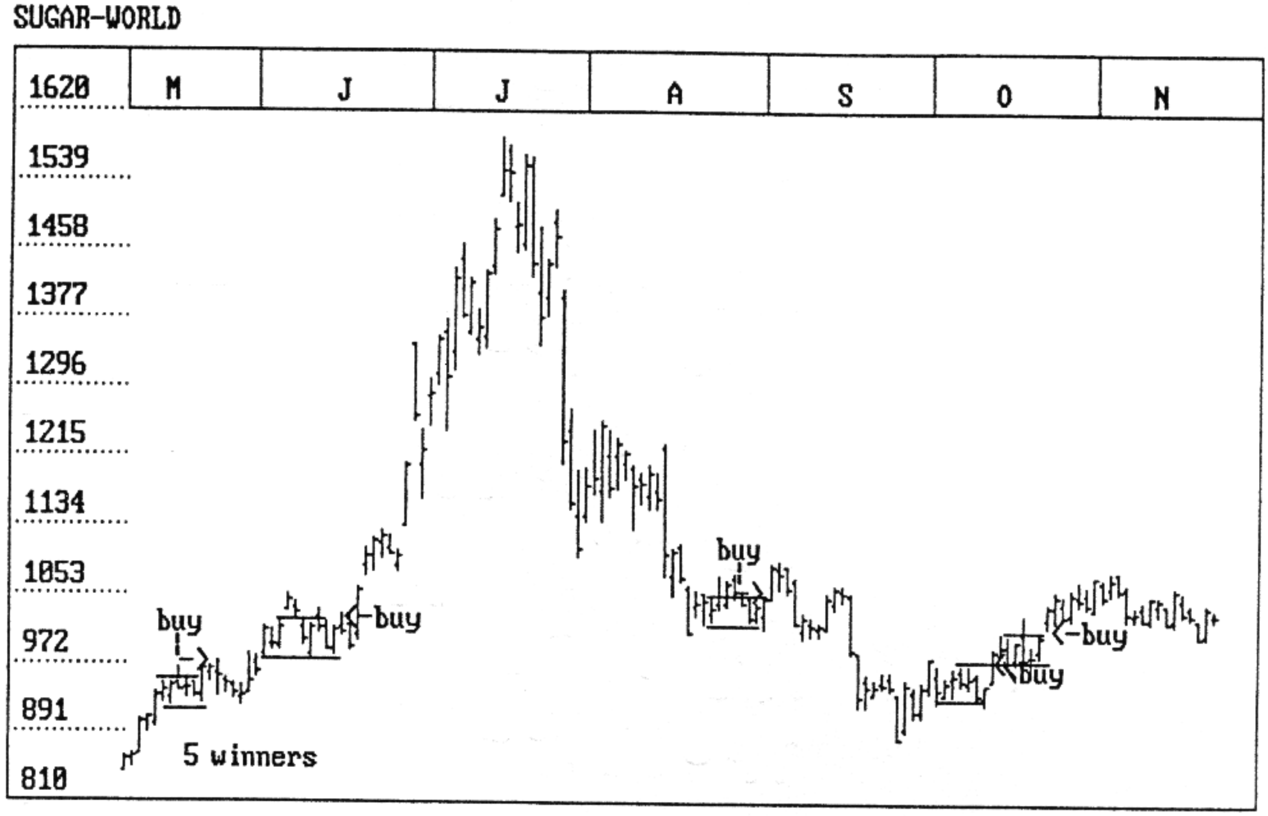
9 winners
1 double loser


SUGAR-WORLD
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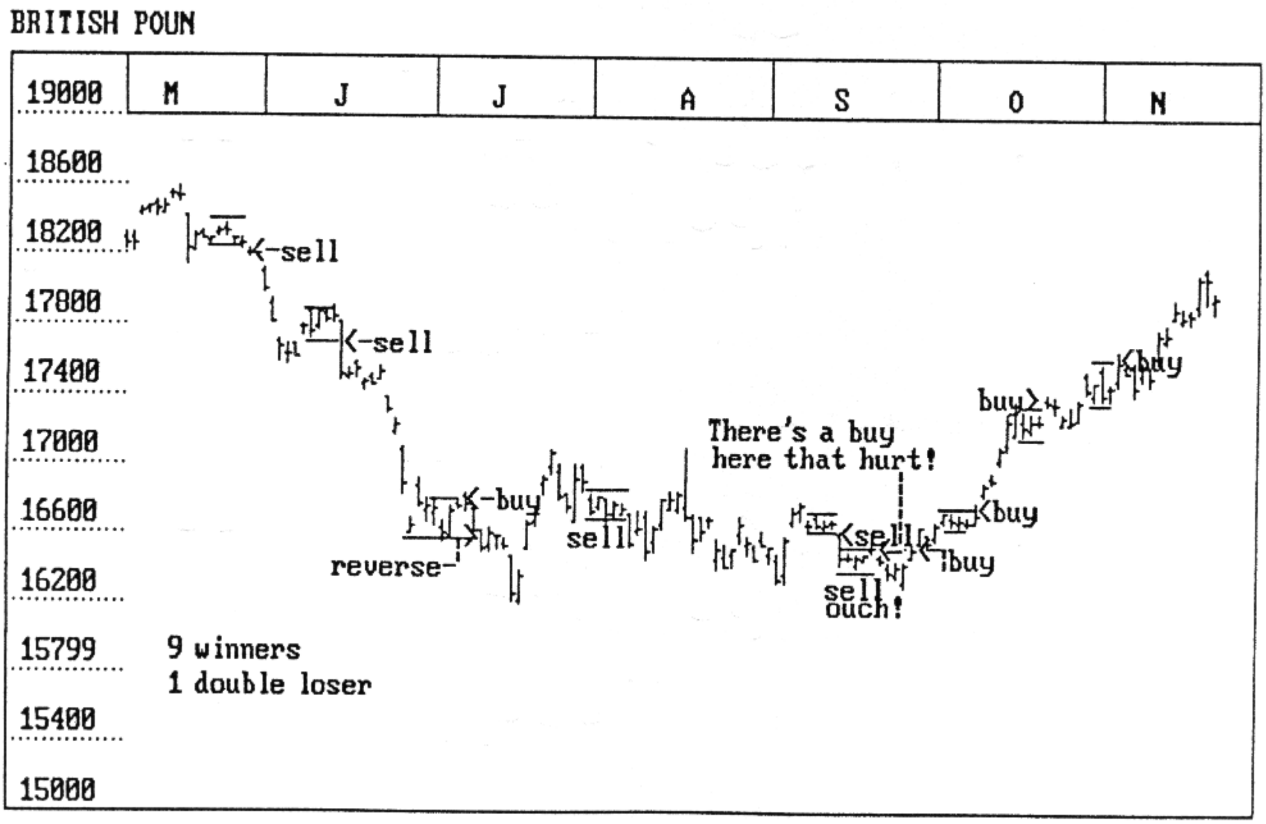
buy
buy
buy
buy
5 winners

Figure 4


BRITISH POUN
19000
M
J
J
A
S
O
N
18600
18200
17800
17400
17000
16600
16200
15799
15400
15000
sell
sell
buy
reverse
sell
There's a buy
here that hurt!
sell
sell
ouch!
buy
buy
buy
buy
9 winners
1 double loser

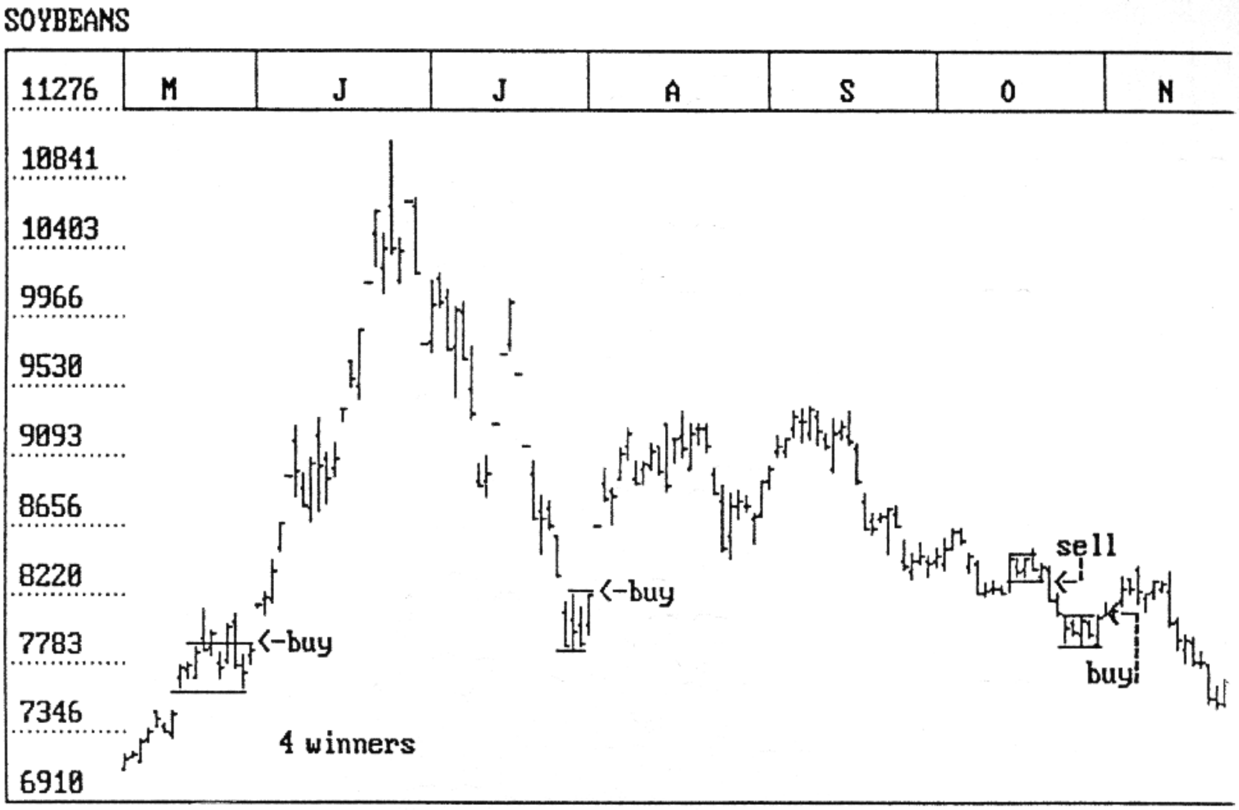
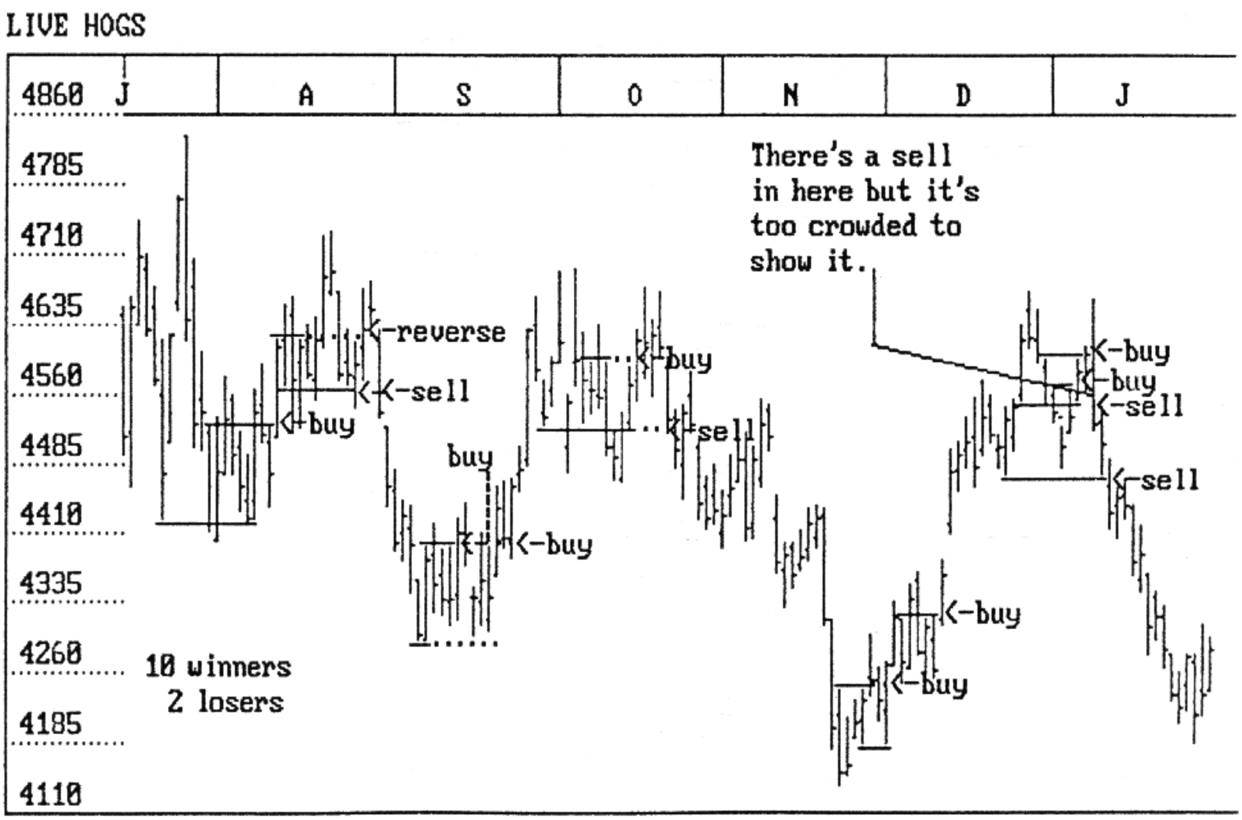

SOYBEANS
11276
10841
10403
9966
9530
9093
8656
8220
7783
7346
6910
M
J
J
A
S
O
N
<-buy
<-buy
sell
buy
4 winners

Figure 5


LIVE HOGS
4860
4785
4710
4635
4560
4485
4410
4335
4260
4185
4110
J
A
S
O
N
D
J
There's a sell
in here but it's
too crowded to
show it.
<-reverse
<-sell
<-buy
buy
<-buy
<-buy
sell
<-buy
<-buy
<-sell
<-sell
<-buy
<-buy
10 winners
2 losers

SWISS FRANC

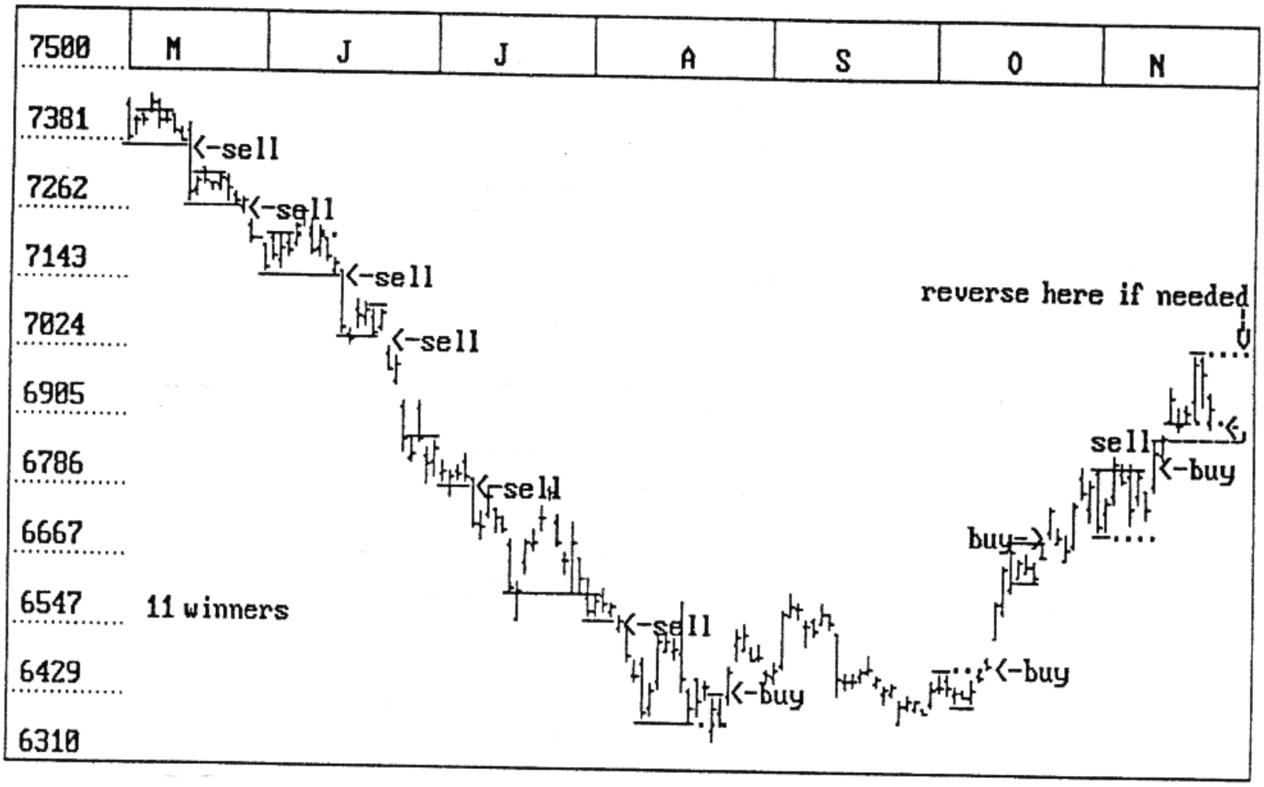
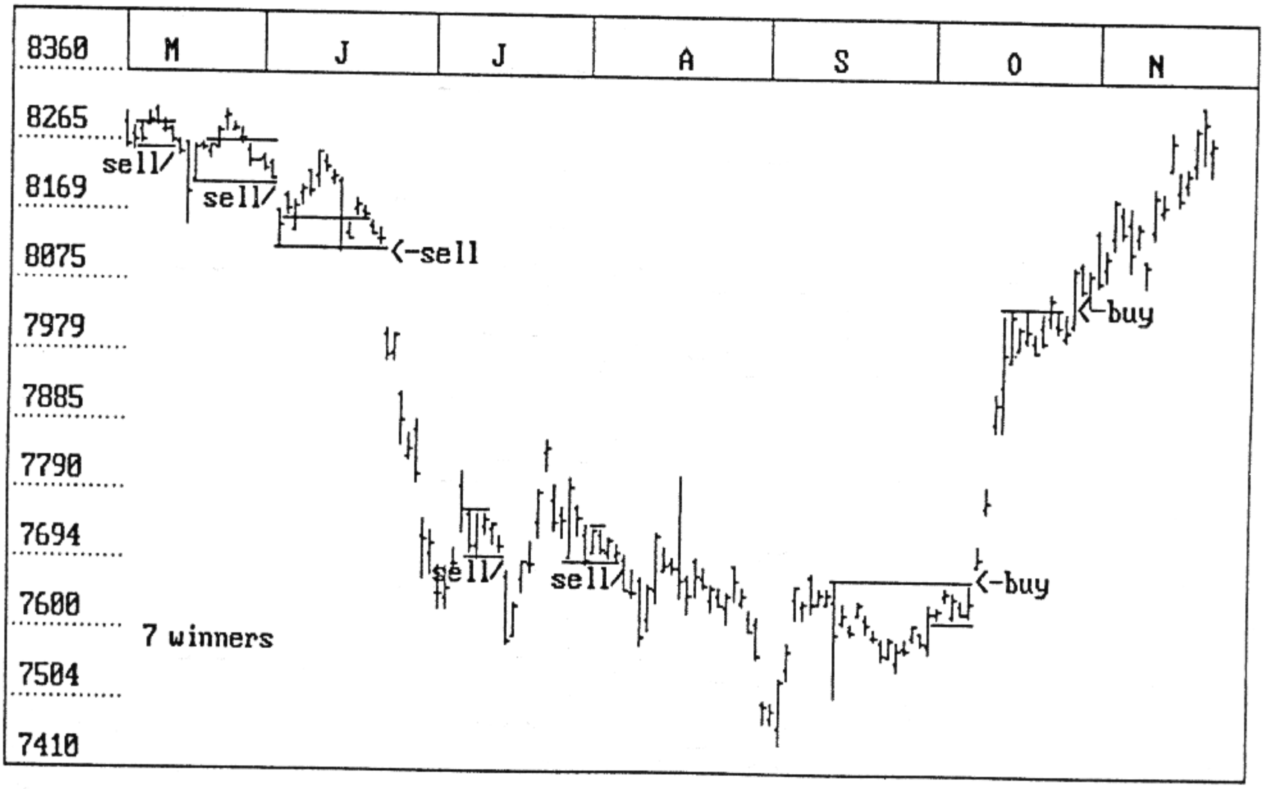


Figure 6

JAPANESE YEN



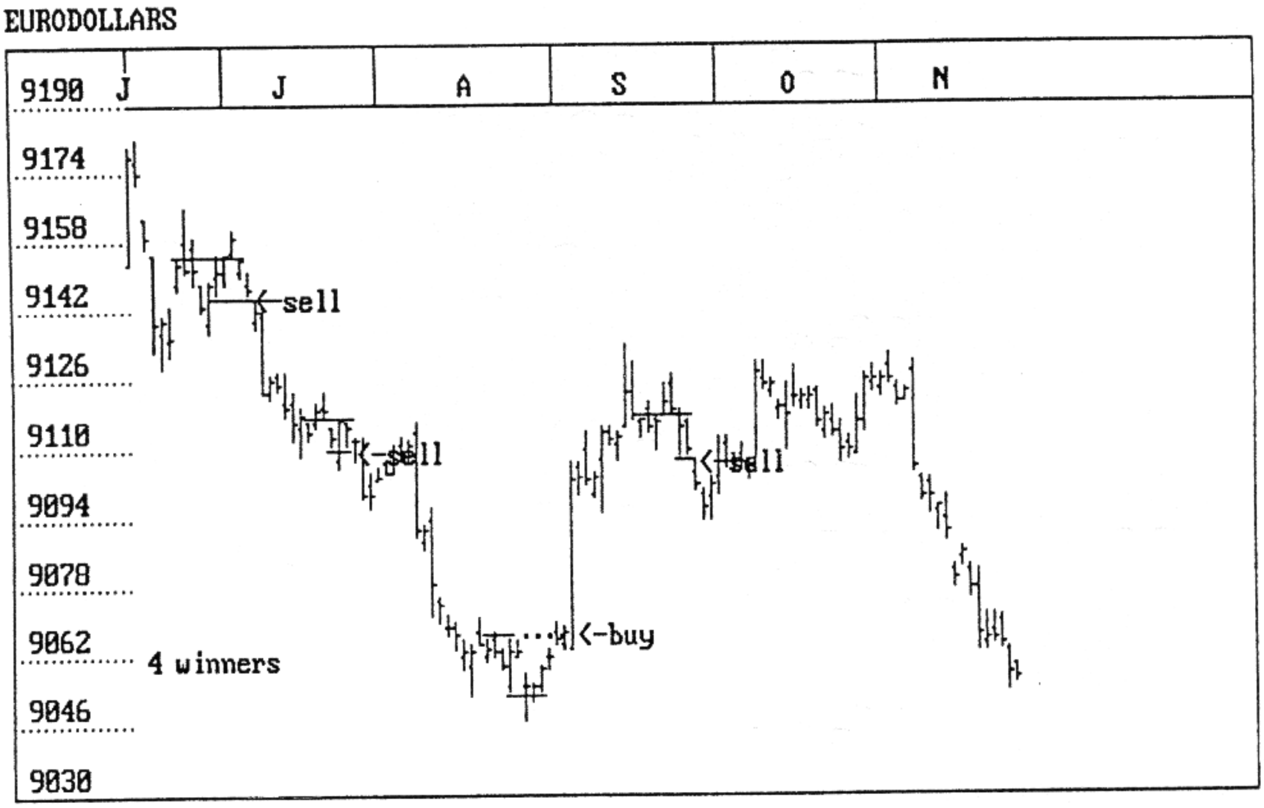
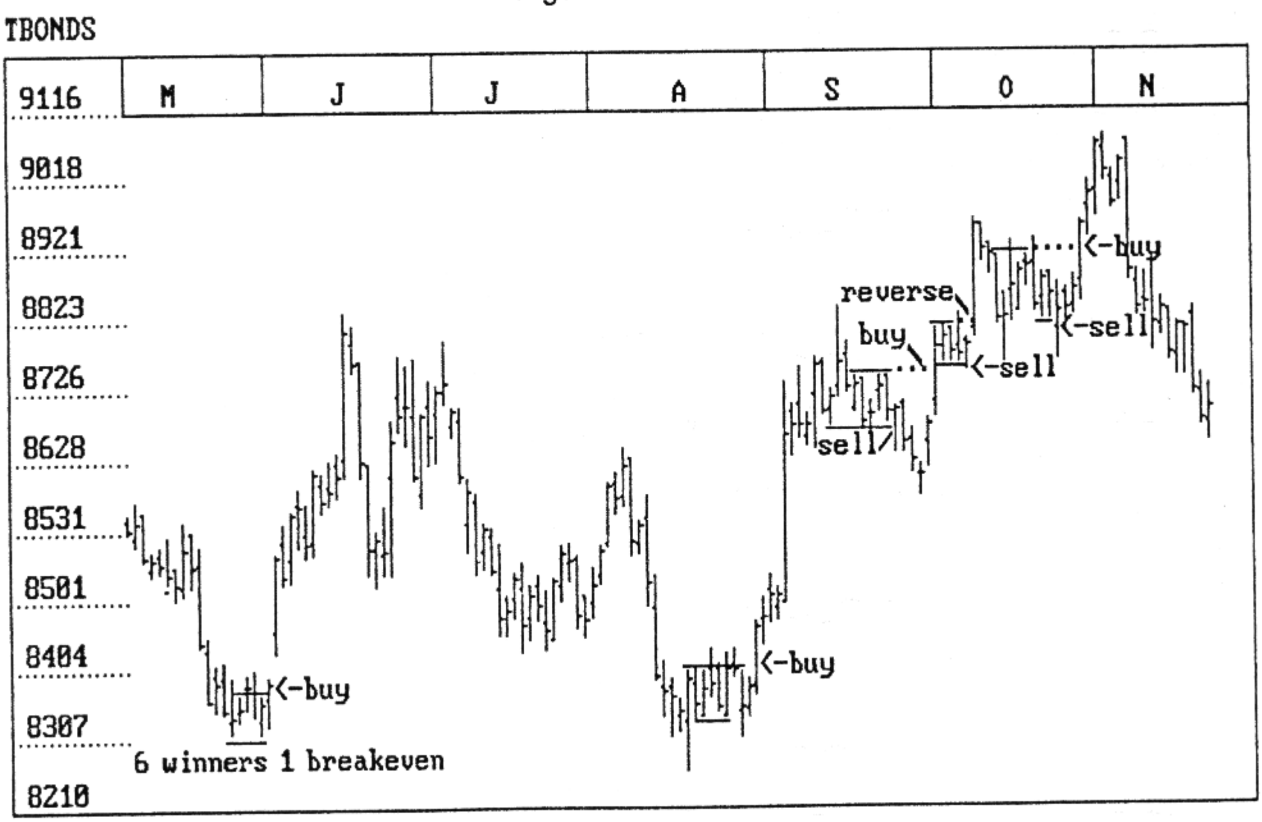

EURODOLLARS
9190
9174
9158
9142
9126
9110
9094
9078
9062
9046
9030
J
J
A
S
O
N
<-sell
<-sell
<-sell
<-buy
4 winners

Figure 7


TBONDS
9116
9018
8921
8823
8726
8628
8531
8501
8404
8307
8210
M
J
J
A
S
O
N
<-buy
<-buy
reverse
buy
sell
<-sell
<-buy
<-sell
6 winners 1 breakeven

At this point you may be saying, "Amazing isn't it? Now why, oh why, did I never see that before? There were 75 winning trades shown, 1 breakeven, and only 6 losing trades."

On the other hand, you may be saying "Just what in the world is this nut doing? How can I make money doing that?"

Sometimes I miss a few of these, they are not always easily seen. They take looking at several times to spot them on your charts. In fact, it may be even better to trade these "ledges" without a chart. Just use the newspaper prices as I will show later.

I'll put some rules around this concept that will make it come alive and make more sense than just the pictures. It's the way I handle the many, many small congestions that I suspect make up the 85% congestions I've read and heard about.

Rule 1: I look for a correction or congestion that is at least three bars in length, but no more than 10 bars in length. DA 3 A 10 BAR

QUADRATO MAX ALTI e/o MINIMI

Rule 2: The congestion is characterized by a "squaring off" of highs and/or lows, the flatter the better. Perfect squares are best.

Rule 3: I trade the potential breakout in either direction. Opinion CANNOT be allowed to enter the picture. I do NOT know which way the breakout will occur! For every trade shown there was an opposite trade entered at the other side of the ledge. That order automatically acted as my catastrophic stop. Whenever possible within my margin account and according to what I am willing to risk, once I am filled, the opposite side order is doubled to create a reversing stop.

Rule 4: I anticipate that I will be in the trade for only as long as it takes to place two bars on the chart - that is usually two days. If the congestion area is re-entered, it nullifies this rule.

Rule 5: I call in the order each day. The buy stop goes 1-3 ticks above the high of the congestion and the initial sell stop goes 1-3 ticks below the low of the congestion. Whichever way the breakout occurs, the other open order stop becomes my initial protective stop.

Rule 6: I expect to trade the breakout that is in the direction of the current leg, but it often doesn't happen that way. I place my order 1 tick above or below the breakout point. The order for a counter-leg-trend breakout is placed at least 3 ticks above or below the breakout point. If the trade is "antsy", where I'm not sure of just where to place the order, then I tend to place my order 3 or more ticks above or below regardless of the trend. There is no magic in 1, 2, or 3 ticks. You trade where you are comfortable.

Rule 7: As soon as two bars on the chart are out of the congestion, I move my stop to one tick above the high of the second bar if the breakout is to the downside, and one tick below the second bar if the breakout is to the upside.

Rule 8: I do not move my stop to one tick above or below any bar after the second bar, that in itself is an inside bar. By an inside bar, I mean one having a lower high and a higher low than the previous bar.

Rule 9: If the market breaks out in one direction, and I enter the trade and am then stopped out, I immediately reverse my position and trade the breakout in the new direction. This is done only when my account balance can afford a possible double hit.

Rule 10: I can go back only as far as the first leg of the previous market swing to find a matching high or low.
uguaglianza MAX MIN.

```
1° leg /\                                 \_      /
      /  \  <-These are swings->           \     /
     /    \                            leg  \   /
    /      \                                 \/
```

```
          /
         /  <-These are the legs of the swing ->  \
        /                                          \
       /                                            \
```

```
                                   /\      /\        \       /\       /
I can go back only as         /  \  /  \        \  /  \    /
far as these legs       ----->/    \  /    \ ----->\  /    \  /
No matter how short the leg /       \/      \       \/      \/
is. (It may be only one bar long at times).
```

NOW, THE MOST IMPORTANT technique of this kind of trading: I must have the courage to take a hit, keep my wits, and then reverse positions. The reversal is contrary to human nature, so it must be practiced over and over until it becomes automatic. If it looks as if I'm going to get hit, I must call my broker and double my stop order so that I am automatically reversed and going with the market in its new direction.

The above rules are as close as I've ever come to trading a mechanical system. I don't always follow the rules exactly because I try to use judgment in my trading. At times I wish I had followed the rules, and at times I'm glad I didn't.

What I have done here is to allow the market to tell me what it is going to do. In a sense, this technique is a "straddle". It's probably not a straddle in the sense of the word as used in the stock market or as used in option trading.

The straddle I use becomes possible because the market decides to move sideways for a number of bars on the chart, thereby making it possible for me to straddle the prices with my buy and sell orders at natural support and resistance points.

The philosophy behind the trade is that I want to get, and will be satisfied with, my piece of the action. I don't expect to get all of the action! Greed will have to play second-fiddle to the success I achieve by getting my part of most major moves.

Once I am in the trade, and if it continues in the direction of the breakout, I can then trade it as I would any other breakout. For this reason, I often trade two or more contracts - one to make a quick two/three day scalp of the market, and the other to stay in the trade should it continue in my direction. I can trail a stop at each prior retracement, as I would with any continuing trade, and I can add to my position on retracements.

To a certain extent, it is arbitrary as to the choice of where to mark the boundaries of this type of situation. The most conservative choice is to wait until at least two non-consecutive highs, or two non-consecutive lows, are equal. Then mark off the range of the congestion.

Personally, I mark these off as soon as I can draw a line with a ruler across two highs, two lows, a high and a low, or a low and a high, just so long as they match.

The dollar win/dollar loss record for this type of trading is very good. Usually the losses are small and the wins are small to very large. Most of the time losses can be reversed and turned into winners. Most of the time you can make "lemonade" from these "lemons."

PIATTE

I try to choose markets that are making lots of little sideways "shelves." I try to choose markets that are trending.

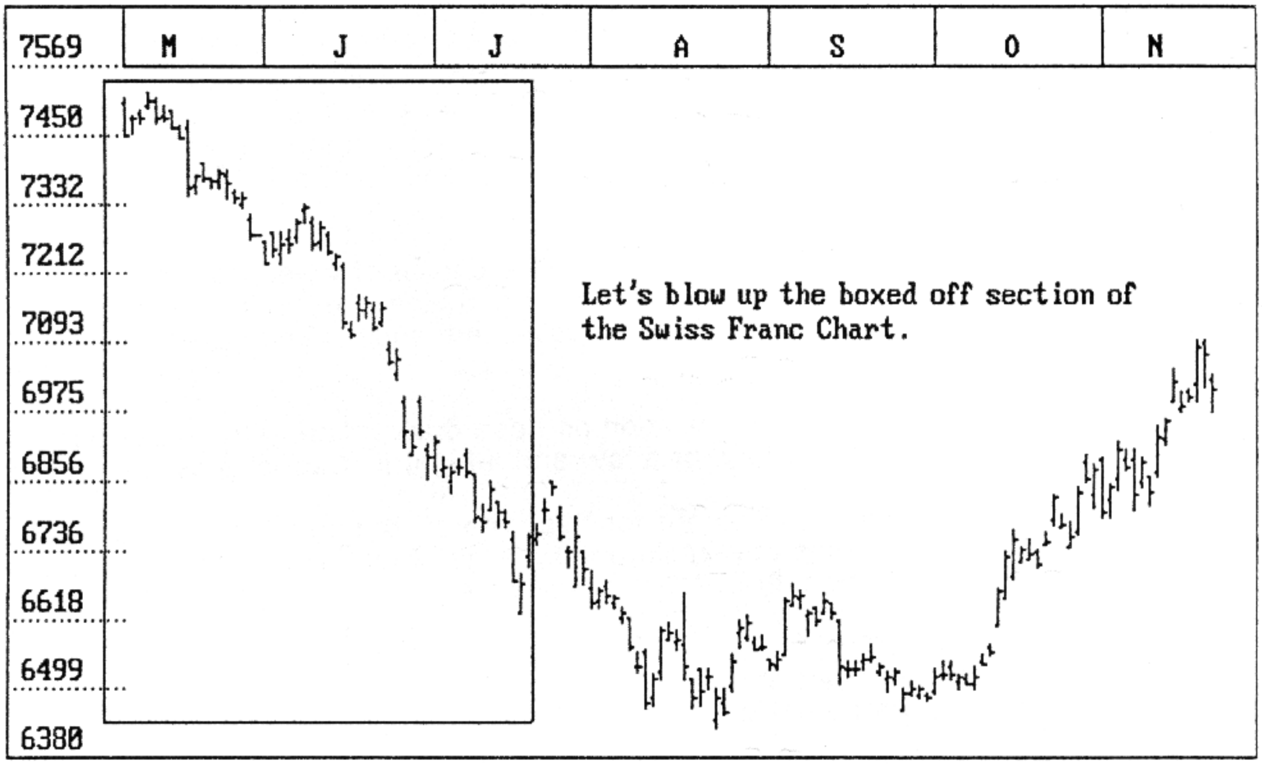
Once there are more than ten bars in the ledge, I stop trying to trade the ledges. I wait for the market to start trending again.

Why does this technique work so well? The reason is that it takes advantage of natural support and resistance points. A breakout of a natural support or resistance point will usually carry good momentum. There should be enough explosive force to give a profitable short term trade. Remember these trades are usually 2-3 days. Anything beyond that is pure luck.

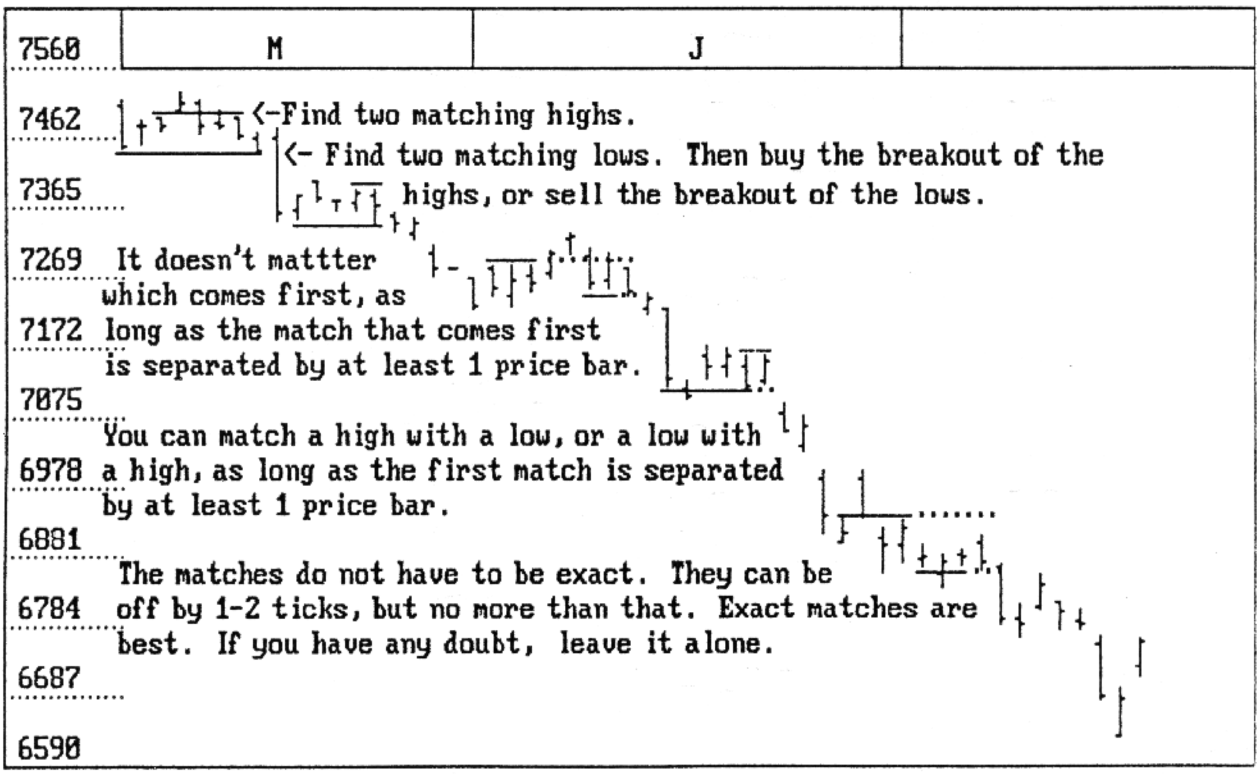
It will take a lot of study to decipher exactly what it is I've done on these charts. The effort will be extremely worthwhile. It was very difficult for me to get used to trading ledges, because most of the time there are no clear cut signals from any other technical tools that I use. There doesn't seem to be any way to filter these trades - no way to get any kind of confirmation. You just have to see them and jump on them. Practice them until you get the hang of it.

In order to help you see what I'm doing with this technique, let's look more closely at the Eurodollar and Swiss Franc charts.

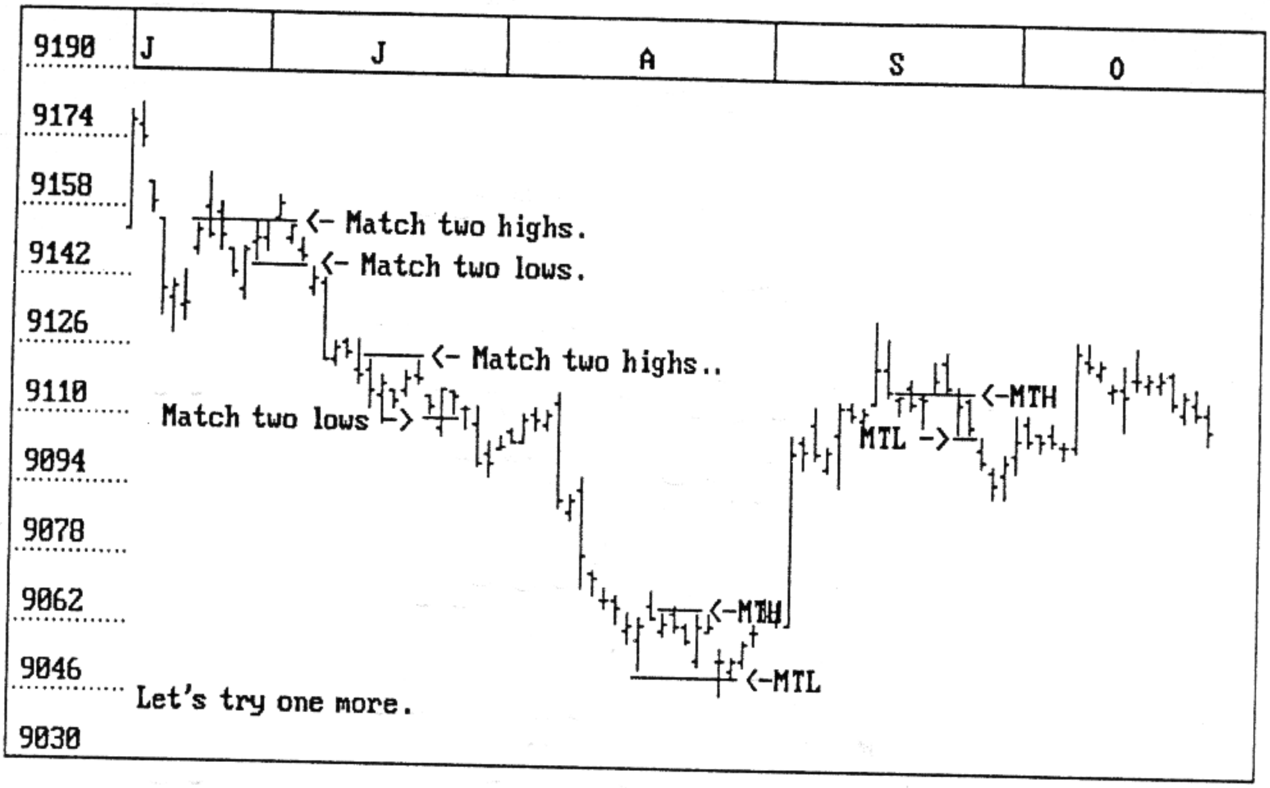
SWISS FRANC



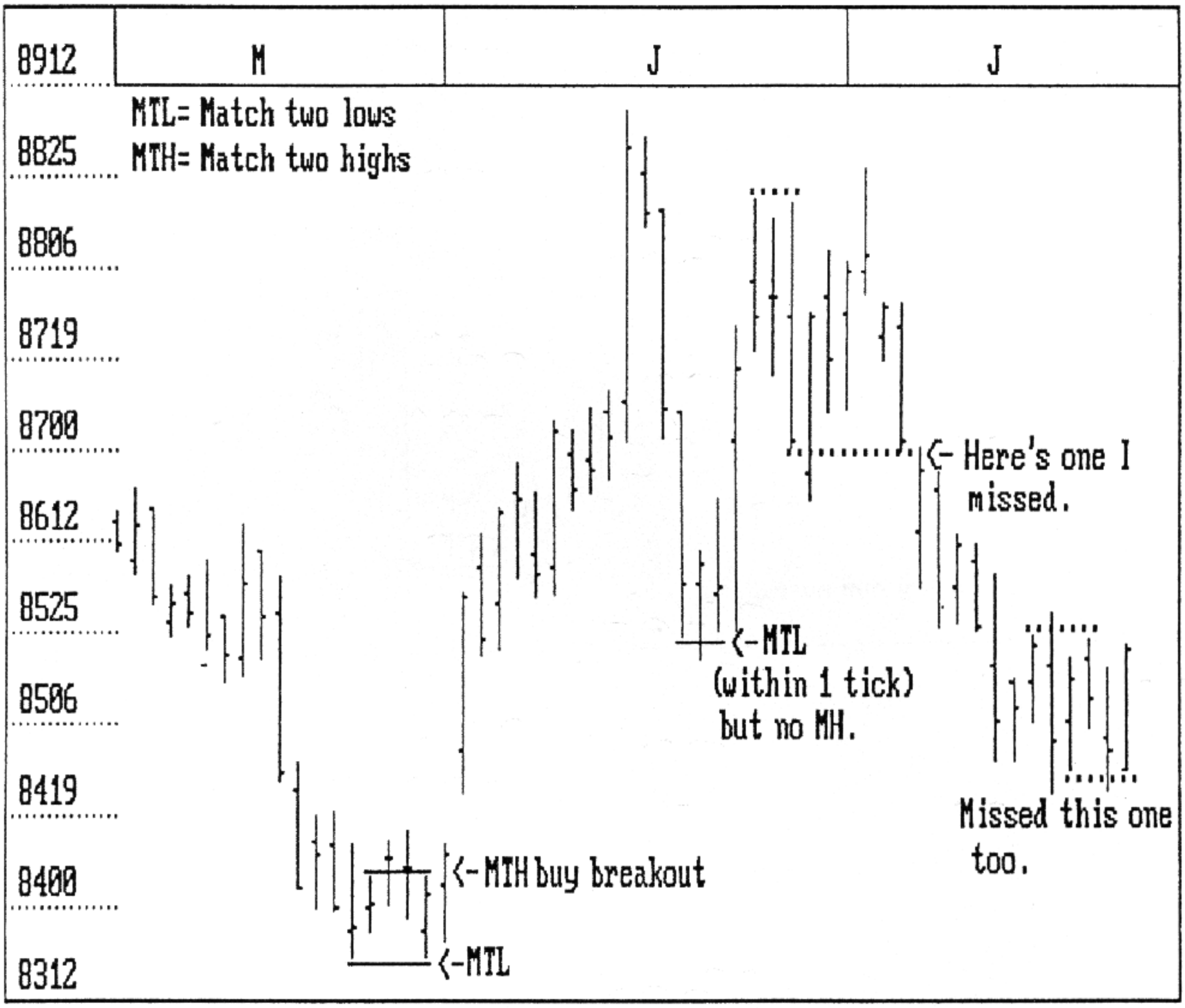
SWISS FRANC



EURODOLLARS



T. BONDS



Now, I promised you that you could trade this from a newspaper, or any source that shows the high and low prices for the day.

Okay, here is a recent S&P trade I made. I already had positions in other markets, when I spotted this ledge. Ledge trading rarely interferes with my other positions because as a rule I'm in the trade for such a short time.

Here is the section of my chart that is pertinent to the trade. Following the illustration, I will show you how I kept track of the trade prior to and subsequent to entering. I did it from a newspaper as I was traveling to and from a private tutoring. Naturally, I had started recording the prices before leaving home.

I've gone back in time further than necessary in order to show you a few things. Here is what they looked like:

Note: I trade from continuous contracts. All prices have been adjusted to September prices, although I traded the June contract at the time.

DATE	HIGH	LOW		
0301	34025	33630		
0302	34120	33825		
0305	34205	33830		
0306	34405	33855		
0307	34450	34125	Leg up #1 Rising highs and lows	
0308	35045	34585		
0309	34970	34545		Market swing #1
0312	34865	34480	Leg down #1 Falling highs and lows	
0313	34755	34365		
0314	34700	34330		
0315	34825	34540		
0316	35090	34805		
0319	35255	34725	Leg up #2	
0320	35390	34880		
0321	35145	34675		
0322	34855	34105	Leg down #2	
0323	34615	34370		
0326	34860	34575		
0327	35070	34500	Leg up #3 - discard up leg #1	Market swing
0328	35150	34850		
0329	35030	34735		
0329	35005	34585	Leg down #3 - discard down leg #1	
0402	34695	34335		
0403	35265	34680	Leg up #4 - discard up leg #2	
0404	35255	34775	This high will be matched.	
0405	35140	34800	This low will be matched.	
0406	34950	34620	Leg down #5 - discard down leg #2	
0409	34950	34790		
0410	34990	34800	Matching low.	
0411	35095	34815		
0412	35300	34970	Leg up #5 - discard up leg #3	
0416	35500	35080		
0417	35250	34870	Matching high by 1 tick (.05 points)	
Place orders -			Buy counter-leg-trend breakout at 35265 Sell leg-trend breakout at 34795	
0418	35260	34670	Breakout filled at 34795=day 1	
0419	34760	34390	day 2	
0420	34500	33930	Out at objective 34545=day 3	
0423	34060	33640	Continue with optional additional contracts.	

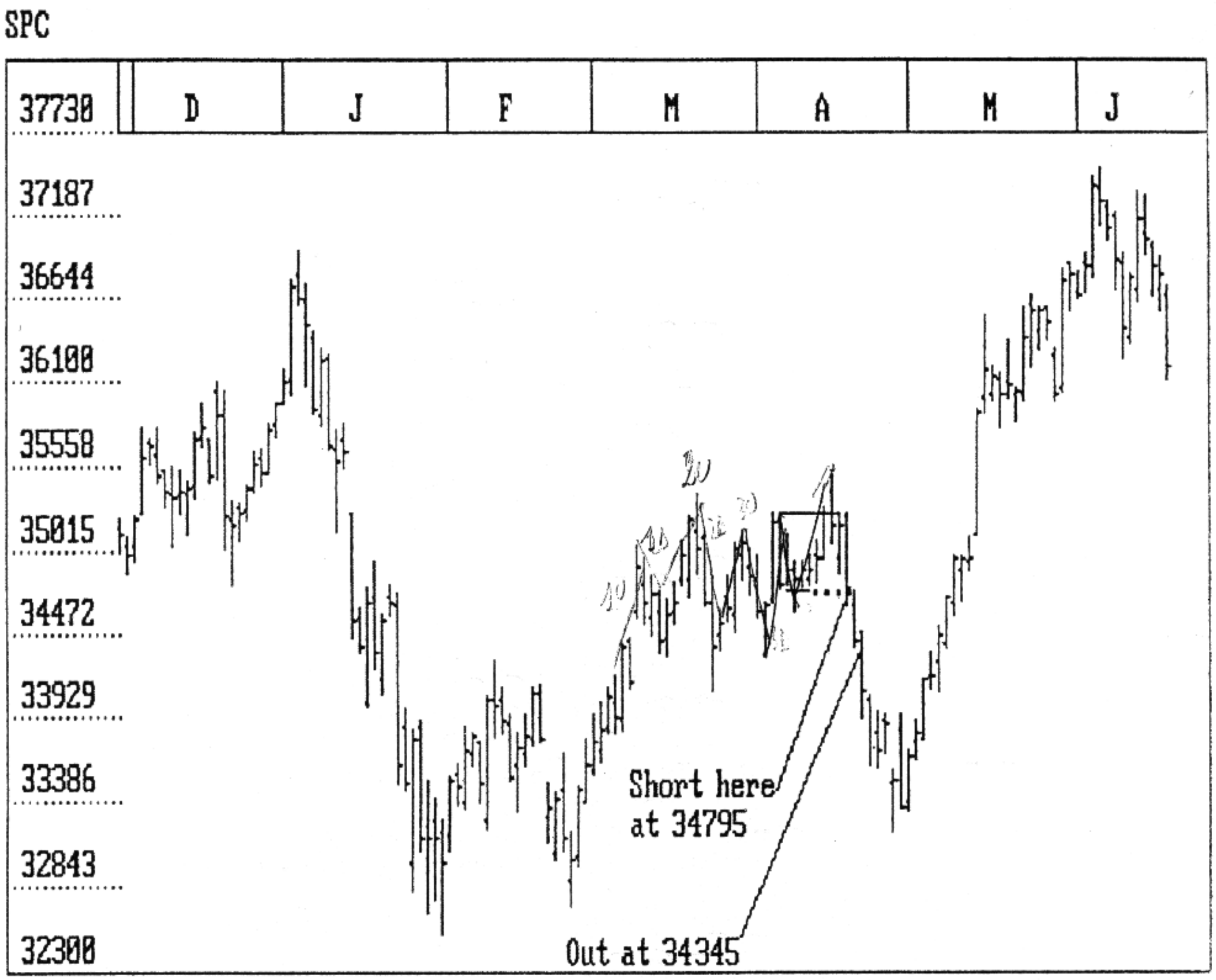


Figure 8 Is a picture of what happened. Let's notice a few things.

We start looking for matching highs and lows when a market shows signs of congesting. Legs of swings are getting shorter and shorter. The market is chopping around. A leg may consist of only one day.

We discard the oldest leg in a direction whenever a newer leg in that direction is being made.

We look to enter the trade with a tighter stop in the trend direction in which the current leg is moving. We use a wider entry stop in the direction that is counter to the direction of the latest leg. We call in our order every day because the leg-trend can change daily.

If one of our stops is hit, we are in the market and the opposite side of the ledge is our initial catastrophic stop. If we can afford it we then double our stop, so that if the market goes against us before we get out, we will automatically be entered in a trade simultaneously with being stopped out.

Our profit objective is an amount equal to the height of the ledge. In addition to our catastrophic stop, we place a stop order beyond the point of present price equal to the number of points that are in the ledge from top to bottom. This is done as "Order cancels order" so as to eliminate our catastrophic stop if we get a fill.

In the example above, the height of the ledge was 35255-34800=455. We place an exit stop at 34800-455=34345.

Our entire day order entry is: Buy one June S&P 500 contract at 35260 stop limit, and buy one June S&P 500 contract at 34345 stop limit, order cancels order. Sell one June S&P 500 contract at 34795 stop limit.

We move our stop as quickly as possible to breakeven. If we move our stop, we automatically cancel our catastrophic stop, and so there is no point in making a reversal entry out of it. If we have doubled the catastrophic stop so as to obtain a reversal, we remember to cancel both orders if we happen to make the change during the day. Otherwise, as a day order it will be canceled automatically after the market closes.

If our target objective is not hit on the third day, we place it as a regular market stop order the fourth day. That way we will automatically be filled on or about the open if prices haven't reached our objective. Make this order on an order cancels order basis if a reversal order is also being called in.

A warning is in order: Do not attempt to reverse on the intraday charts. There is generally not sufficient room to make back your losses plus overhead.

One last thing, a ledge remains in effect until the leg that created it is canceled.

That's it! That's all there is to it. The win ratio is very high in this method of trading. You can scalp the market consistently for small to major profits on a regular basis. I've not found a market in which this technique doesn't work. The only differences are in how often these situations occur. Use this technique along with your regular trading. However, it can be used on a stand alone basis if you are unwilling or not able to trade longer term.

P.O.
PROFIT OBJECTIVE = ALTEZZA CORNICE da aggiungere o sottrarre al punto di breakout dei matching Highs o Lows

Se al terzo giorno il P.O. non viene raggiunto il quarto giorno l'operazione va chiusa in apertura.

CHAPTER3

Trading Within a Trading Range

So, what about the no-man's land of 11 to 21 bars on the chart? For that answer, read on.

In this section I will show a way to trade in a congestion. It is not my favorite way to trade because it takes much patience, but I have done it successfully. The method I use places the odds about 55%-65% in my favor.

To trade in congestion takes a lot of judgment.

For those who trade single markets such as S&P daytraders, and for those finding themselves trading in periods where the markets they watch simply do not trend, I will be writing a book entitled Trading in Congestion. This book will go into great detail about how to trade inside congestion areas. The methods I show there will expand upon the concepts shown in this part of the manual. There have been years in which markets overall simply went sideways. Trend traders suffered greatly in those years. Anyone wishing to become a complete trader, one able to trade in all markets, will need to read that book.

What I will present here is the essence of how I traded the sideways markets of the 1970's. Those were tough years, and many traders lost heavily — especially those using trend following systems.

It seems as though now, with the advent of fund trading, the markets are trending less and less and we are seeing more and more that markets are in large trading ranges. A look at the weekly charts will bear me out.

Markets used to trend for months to years. Now they trend for weeks to months. This is going to be very hard on long term traders. The only markets that trend long these days are the minor markets, those with insufficient open interest to attract the fund traders.

Fund trading affects the markets with large open interest because when the trading models used by the funds perceive a market to be overvalued, they issue a sell signal. When markets are perceived to be undervalued, these same models issue buy signals. The result is that the major markets chop up and down sideways in response to the enormous positions put on by these funds. Fund trading and managed pools are becoming more and more common and are thus affecting the markets to a greater and greater extent.

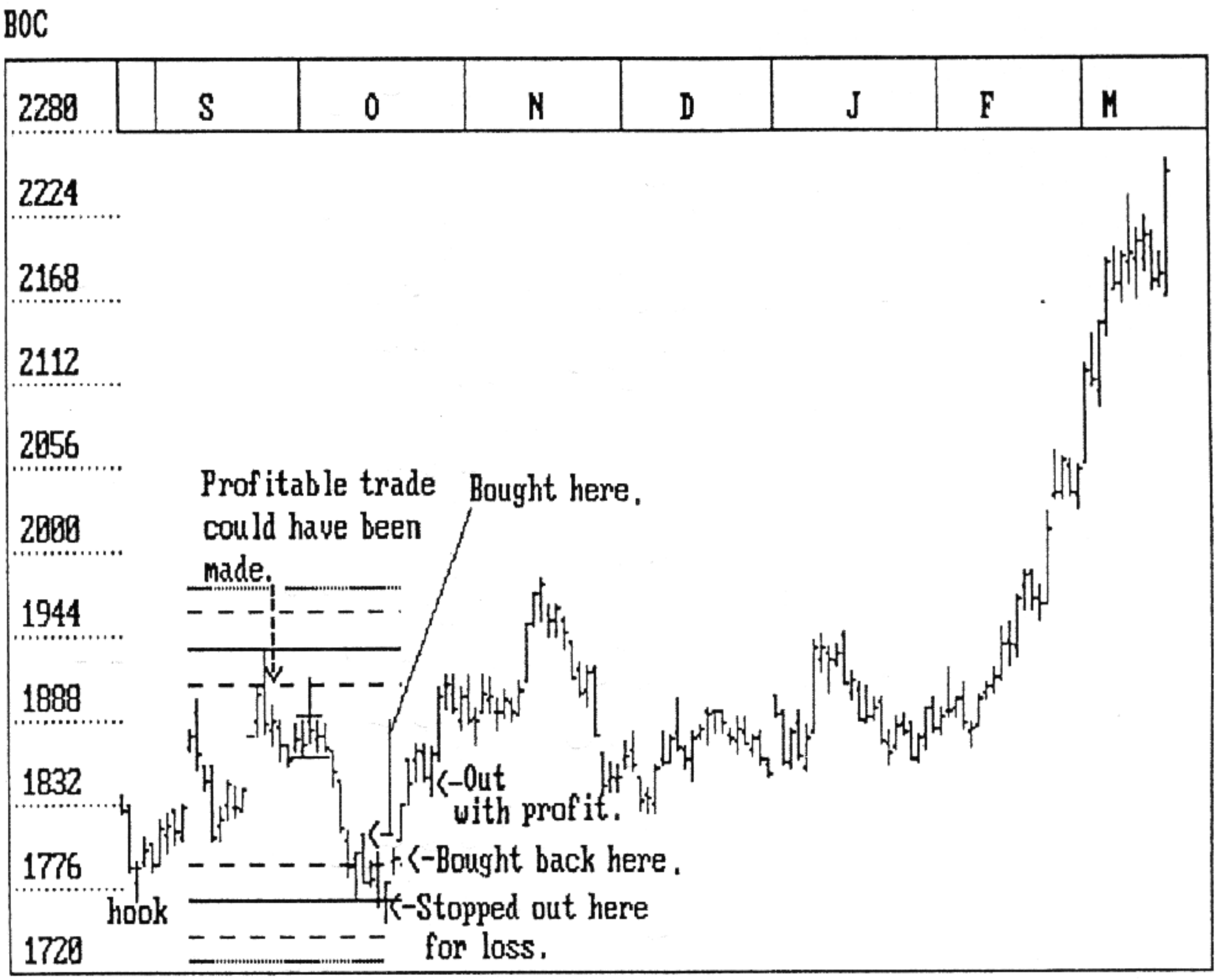


Figure 12 The Bean Oil chart shows that Bean Oil went into an extended trading range that lasted several months.

I've also shown the envelope that I would normally place around a congestion that has lasted 25 or more days. But what about days 10 through 24, could any profitable trading have been done there?

Just before the beginning of the range there was a (Ross) hook, but it never came to fruition as prices gapped up.

Subsequently, prices made a ledge which was traded as such, and which produced a profit.

Still, there was another way that this congestion could have been traded.

After the tenth day, if prices were to enter into the inner envelope (dashed line) and then come out again, a profitable trade could have been made.

The problem here would have been that right after the tenth day it was not clear at all that prices were in a trading range, and certainly not in the trading range that is shown in Figure 12.

It wasn't until the day 23 bounce that I figured out the true extent of the range, and on that day Bean Oil entered the lower part of the inner envelope but closed back up between the two inner envelopes.

Now this is a high risk trade, one I don't highly recommend, but I placed an order prior to the opening of the next day to buy the Bean Oil, on a buy stop, at one tick above the lower part of the inner envelope. I ended up being filled at the open. Prices moved back down. I placed a protective stop just below the low of the range which is the solid line just above the mid-out low of the envelope.

The inner envelope is determined as .146 above the range low and as .146 below the range high.

To compute the envelope, I subtract the low of the range from the high of the range, and multiply the difference by .146. The result is added to the low of the range and subtracted from the high of the range.

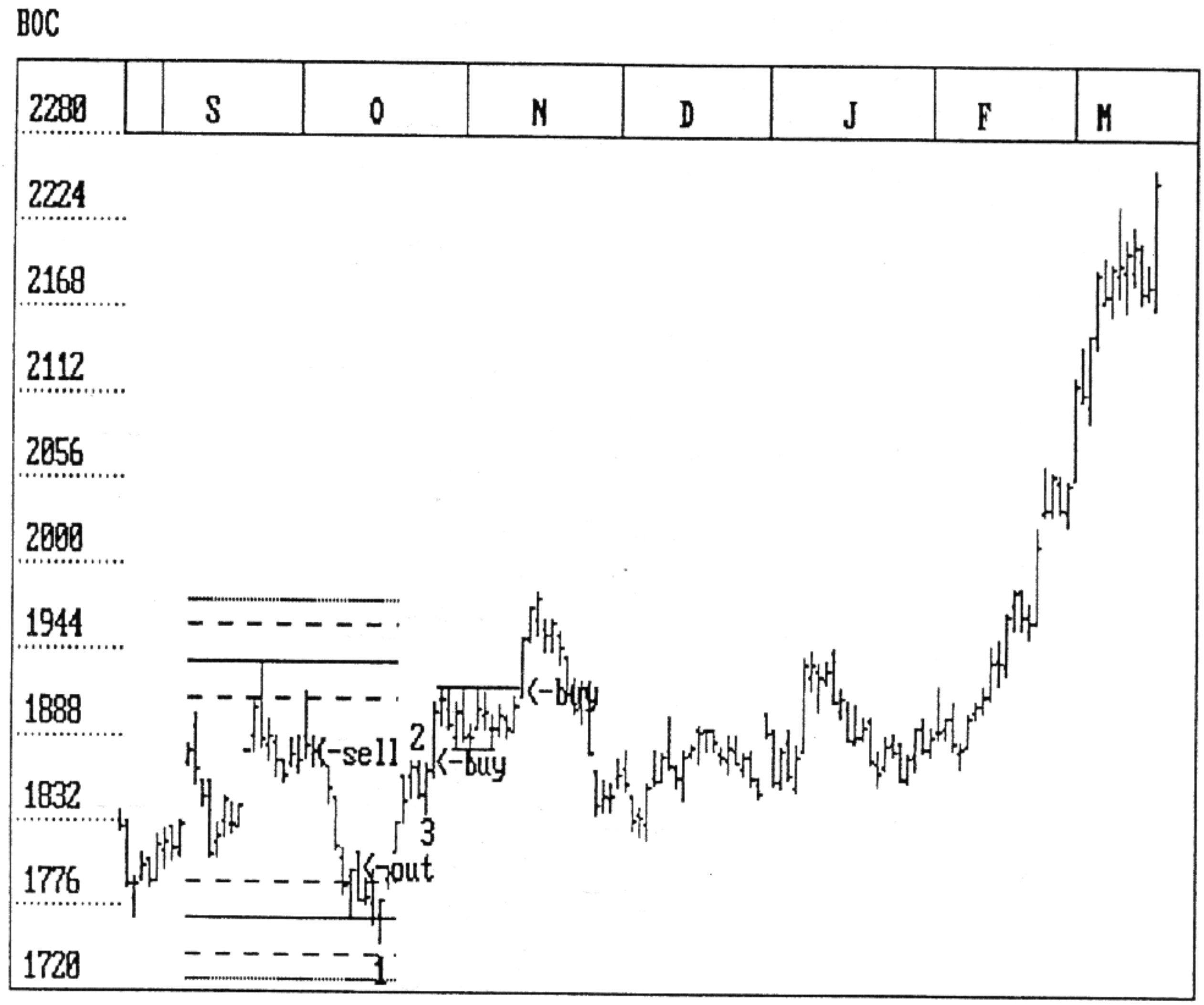


Figure 13 shows another way this area could have been traded. I didn't do it that way, but the results would have been better. Once a triple top had been made with the third top penetrating the inner envelope, I could have sold the next day and would have been stopped out with a nice profit the same day that I made the losing buy shown in Figure 12.

The initial objective for these trades is always 50% of the distance between the upper and lower extremes of the inner envelope. If the trade reaches the 50% mark, then the stop is moved to the low of the bar that reaches the 50% objective. The stop is then trailed by moving it to each new higher low on long positions, and each new lower high on short positions.

The final objective is to exit at such time as the opposite inner envelope is penetrated, and prepare to reverse position.

If the trade makes a one-two-three high or low in the middle of the range, then I trade the breakout, but I am prepared to stay with the trade a very short time.

2 pisui.

I'm ready to reverse positions entirely if the trade breaks through the outer envelope as it would have in Figure 13.

Generally, I have to day trade the extremes of the range.

The best type of market to trade in this manner is where there is sufficient profit potential to warrant the risk. Since the initial objective is only 1/2 way across the inner envelope, I would never trade a tight range in this manner. 50%

The preceding chart of Bean Oil and the following charts of the Bonds, the Deutschemark, and the Yen will illustrate what I mean. I want to have plenty of room for trading the "bounce" from high to low and vice versa.

RIMBALZO

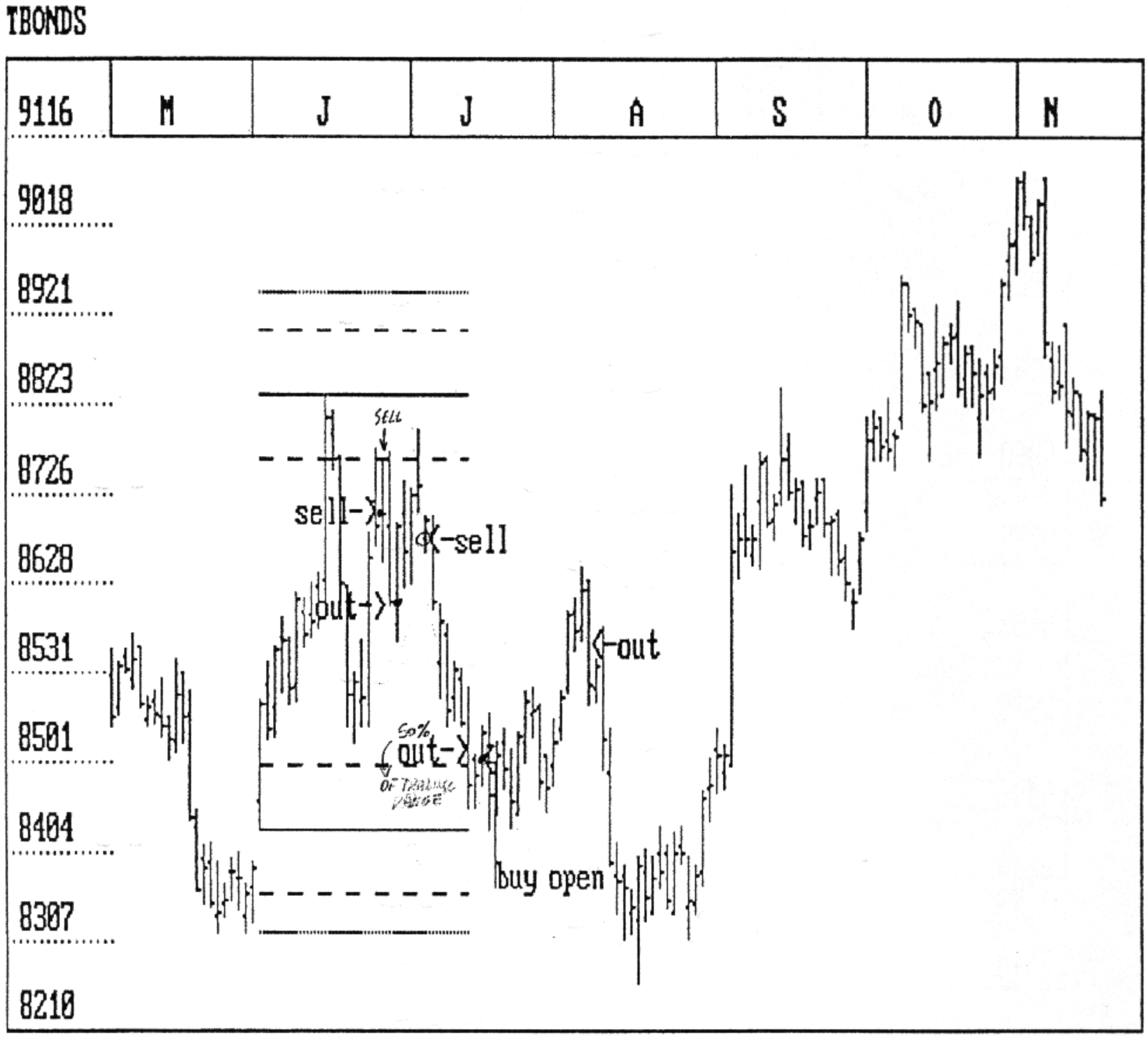


Figure 14 The Bonds formed a very broad trading range as shown by the envelope. The distance from top to bottom is 145 ticks or $4,531.25. Now that's trading room!

I've marked the trades once the M formed on the seventeenth day of the chart and it could be known that the Bonds were probably in a trading range.

After exiting the trade on the last "stopped out," I could have reversed and gone short....but I didn't. However, I am short as described earlier on the breakout of a ledge.

There are also ample illustrations here of Ross hooks, ledges and 1-2-3 highs and lows. Look for them.

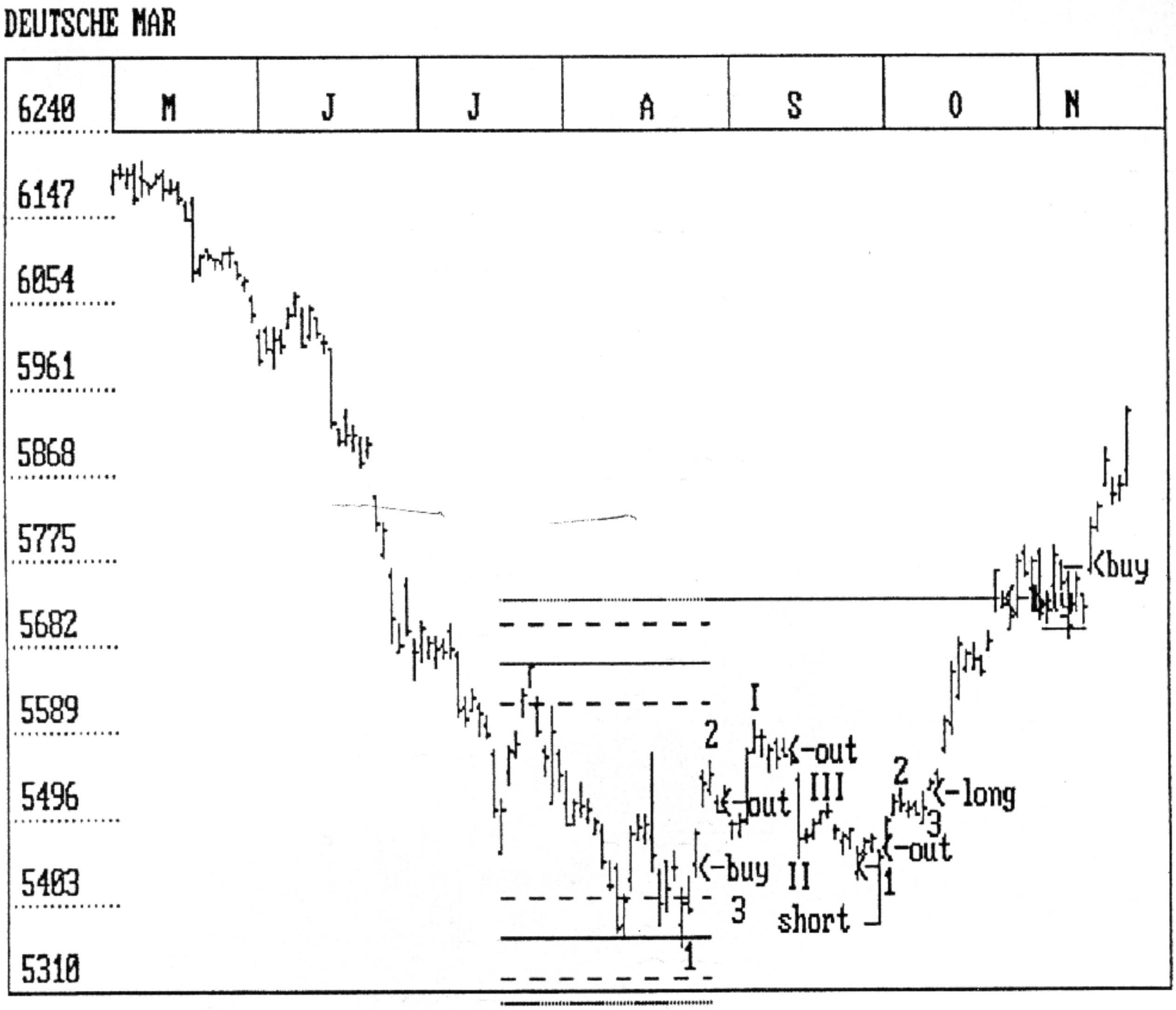


Figure 15 The Deutschemark made only one tradable entry into the inner envelope.

Then I got long on a 1-2-3 low, got caught in the chop and whipsawed about a bit until I finally traded my way out of this mess. I hate this kind of trading series even if I did eventually come out on top. It is one of the dangers of trading in a range. It also shows how to hang in there until you can trade your way out. I was lucky. Sometimes these ranges can go on for months. I barely escaped with a profit. Usually if you can keep your cool and continue to trade according to the book, you can get out with your hide intact. I wish that I could truly share the agonizing defeats, panic, and sheer terror I experienced before learning to trade my way out of whipsaw situations.

I hope anyone reading this Manual will recall that in Part I of the Manual I stated that I would rather have multiple contracts on a low risk trade such as the breakout of a trading range, than I would to trade high risk trades such as those in a congestion area. Please, please, please look at Figures 14-16!!

Some have asked, "What do I do while I'm waiting for the breakout of a range?" My answer is simply enjoy the money you made from the last breakout of a range, or trade the oscillators, ledges, and 1-2-3's.

One of my students had an order to buy 40 contracts on the breakout of the range for the Japanese Yen. Check the next chart. Need I say more!?

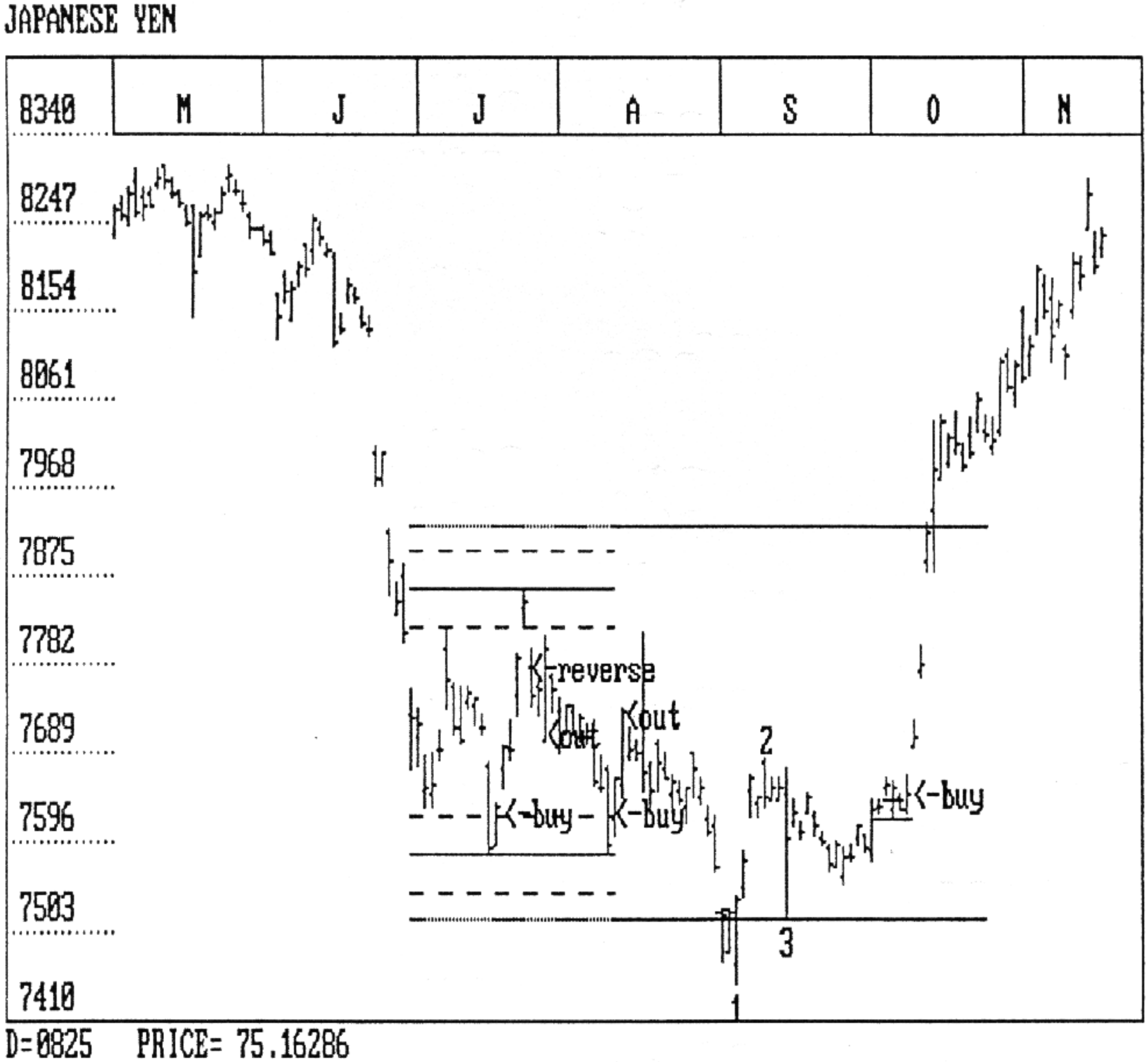


Figure 16 The Japanese Yen gave me a trading opportunity when it completed its M formation. I made a profit above the 50% objective, reversed and made another profit.

I got long the next time it dipped into the inner envelope and got out a tad better than my objective.

I then tried to go long at the breakout of a 1-2-3 low. The Yen then slipped and slid back down for awhile, finally made a ledge, then roared to a new high taking out the top of the envelope. It just kept on going from there for quite awhile.

Trading within a range is not what I like to do. There are plenty of better opportunities elsewhere. Yet, one must learn to trade in trading ranges. At times there no better choice.

I hope that I have shown enough of what it's like to cause you to proceed with great caution.

Up to now I have covered a number of overall trading situations. There are two more aspects of the market I want to cover. They have to do with channels and some thoughts I have on them.

CHAPTER 4

Channels

The two situations I want to cover concerning channels are: trading the breakout of a trending channel, and trading within a trending channel.

I've been asked how I handle these situations.

Actually, I never trade these two situations as channels per se. I trade them as I would trade any established trend, picking up the breakout of one-two-three situations, hooks, and ledges, and getting out on /\/'s, /\/\'s, \/\'s, and \/\/'s, or upon penetration of an offset moving average.

But I recognize the fact that many people who are not dyslexic like myself, do not feel comfortable unless they can draw trend lines on charts in order to gain perspective.

With that in mind, I will show how I would handle the breakout of a trending channel and trading within a channel. What I show is by no means complete, I offer it only hypothetically.

There are entire books out there on how to properly draw a trend line. I cannot possibly say which, if any, are correct. I don't know if I've drawn them where others would have done so.

As I've tried to do throughout the manual, I will use pictures to describe what my actions would be.

When trading with a channel, I would sell the overbought signals on an oscillator in a downtrending channel, and buy the oversold signals in an uptrending channel.

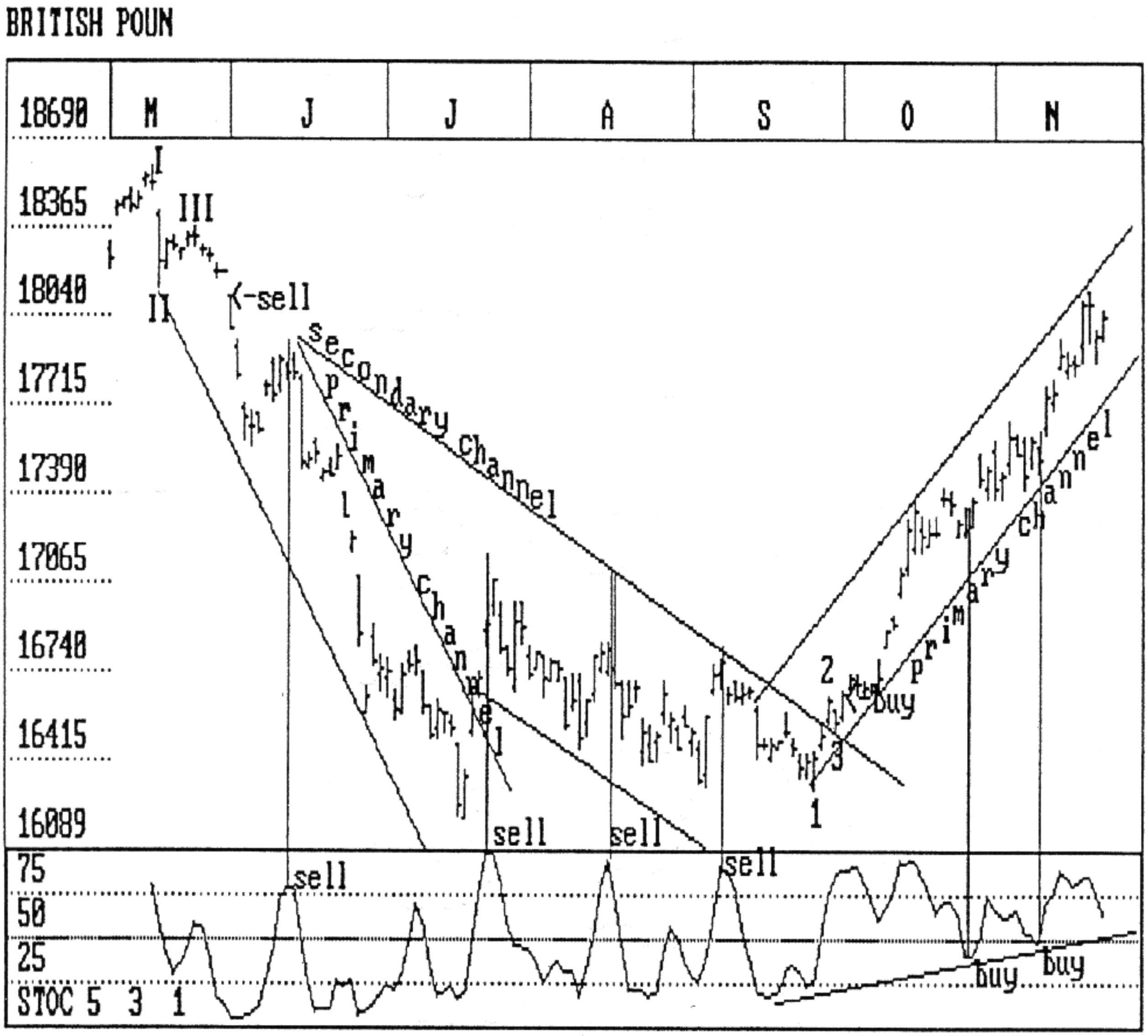


Figure 17 The things to keep in mind while viewing this figure are:

That an oscillator can at times give a jump on the breakout of the number two point;

That an oscillator will not give as many signals as there are opportunities to trade one-two-threes, ledges, and hooks; ob/os is at 25%-30%/70%-75%.

CAC

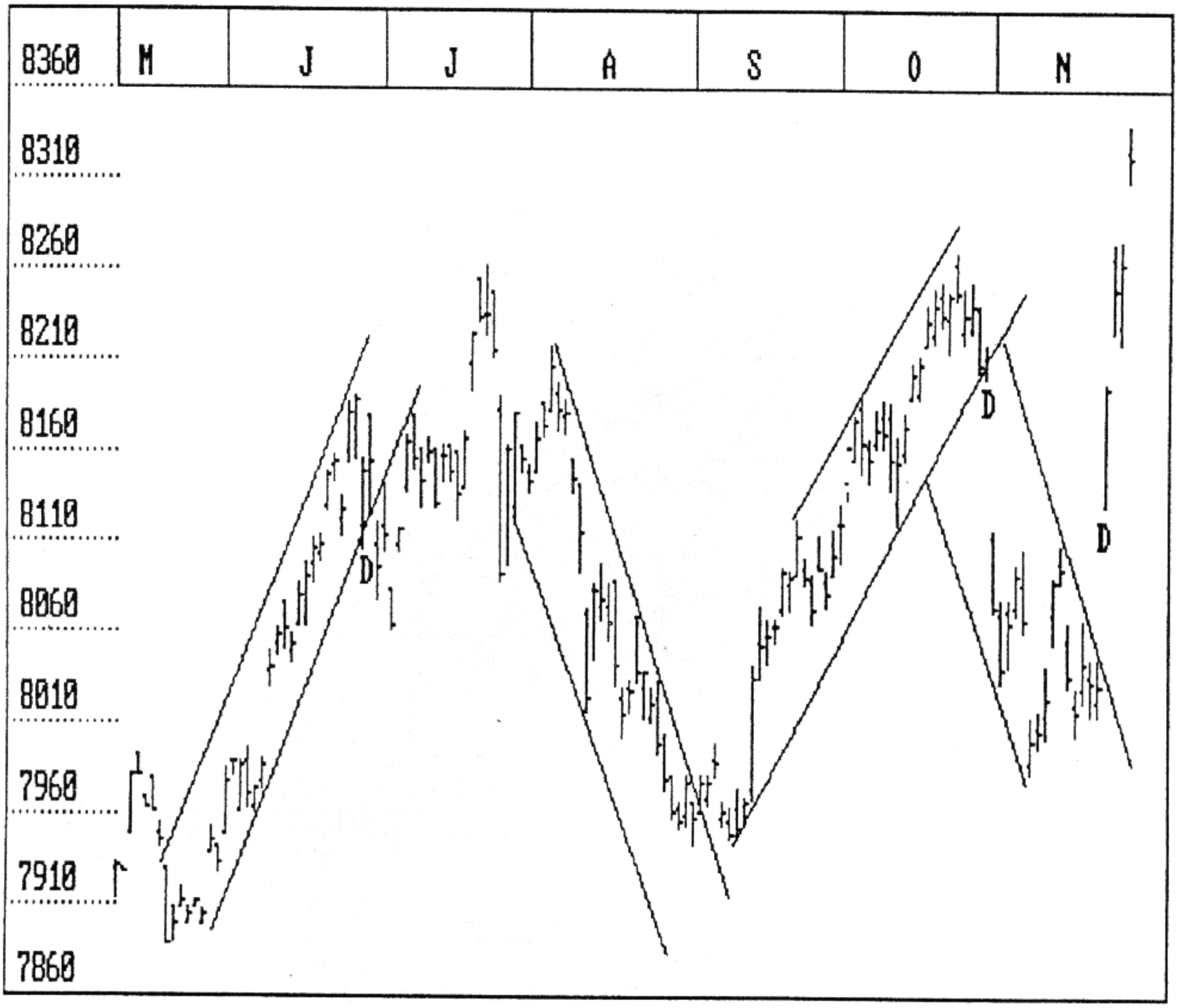
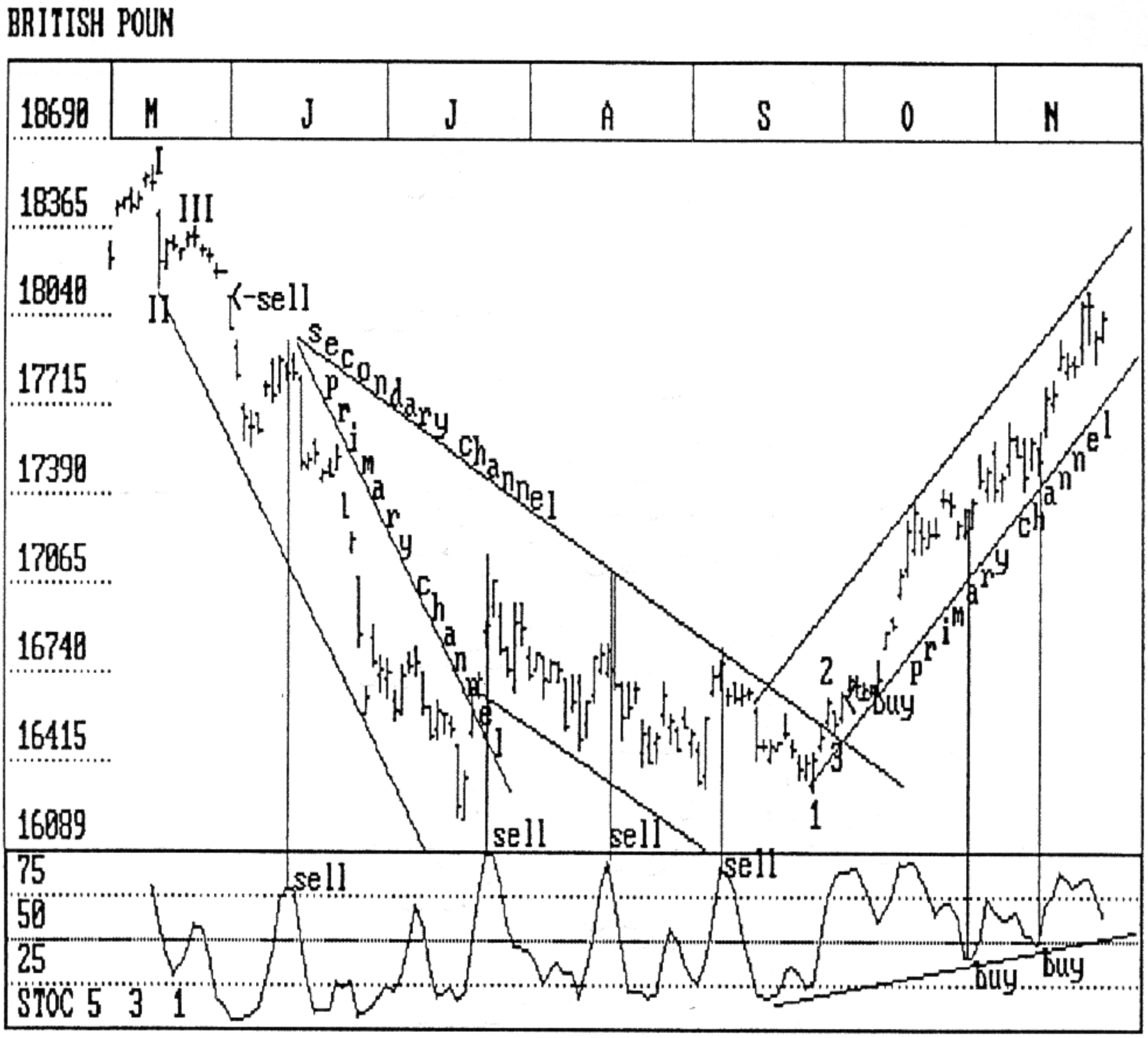


Figure 18 shows the Canadian dollar with a breakout of the channel at the end of June. In this case, the lower channel line becomes an uptrend line, and I would exit on any penetration of the trend line. There are some traders who would exit only on a close outside the channel line. I have marked with a "D" on the chart three places where this would have been disastrous to do.

Also, it should be noticed that anyone not having their stop in place ahead of time would have lost a great deal of money per contract on the breakout at the end of October.

The only way that I know of to handle channel breakouts on sudden reversals is to reverse and go with the tide. I know a trader who didn't and got smashed on all three of those sudden reversals in the Canadian dollar. It takes a lot of guts and a lot more cool to trade this kind of situation than are possessed by 99% of all traders.



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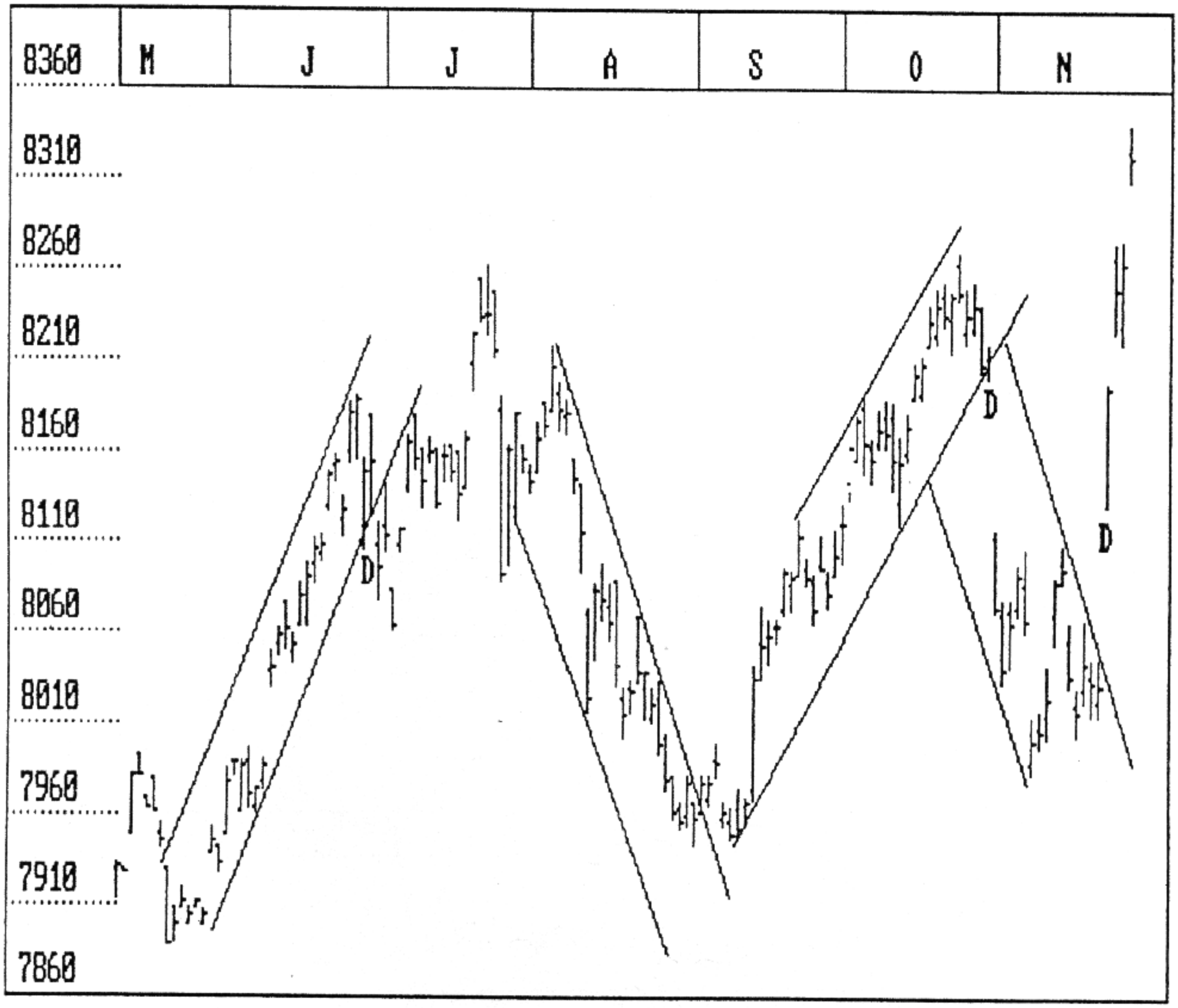

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CHAPTER 5

Selecting Trades

In the final chapter of this part of the Manual, I will be discussing methods for selecting trades.

To end this part of the Manual, I want to show several methods for entering trades. They are all based upon things that I have already shown for position trading.

Flag of the Week

The flag of the week method simply stated says that I always look to trade the short side of a market when the trend is down, and I look to trade the long side of a market when the trend is up.

That is too great a simplification and needs some refinement. The first refinement is one I've shown earlier. I call it the "signal of the week."

The flag of the week comes from the weekly oscillator. How to compute the weekly oscillator has been discussed in an earlier part of the Manual. The concept of the weekly flag is that as long as weekly segments are rising, positions on the long side are favored. Conversely, as long as weekly segments are dropping, positions on the short side are favored. Why? Because the flag of the week helps keep me in tune with the larger overall trend of the market. It keeps me in mind of the weekly price action.

Flag Of The Day

The flag of the day is a 7 day moving average set forward 5 days in time (7 bar offset 5). How to compute an offset moving average has been discussed in an earlier part of the Manual. The concept of the flag of the day is that as long as prices remain above the 7 bar offset 5, positions on the long side are favored. Conversely, as long as prices remain below the 7 bar offset 5, positions on the short side are favored. Why? Because the 7 bar offset 5 helps keep me in tune with the intermediate term daily trend of the market. It keeps me close to the intermediate price action.

Now I know a lot of good stock market traders who trade successfully from a 39 week moving average. I also know some good long term futures traders who trade successfully from a 25 week moving average.

So the 7 bar offset 5 represents a quite excellent medium range moving average by which to gauge daily futures trades.

The idea, then, is to look for strongly trending markets (45° or greater) and trade them in the direction of the trend as long as they are on the correct side of the 7 bar offset 5 and/or the weekly oscillator segment.

The 7 bar offset 5 can be an excellent tie breaker when the weekly oscillator segment is flat and the daily oscillator (the five period stochastic) is giving a buy or sell signal.

What do I mean by strongly trending markets? I mean markets that are moving at no less, and preferably better than a 45 degree angle to the horizontal line at the bottom of the daily price chart. I want steeply angled trends that show good containment by the 7 bar offset 5.

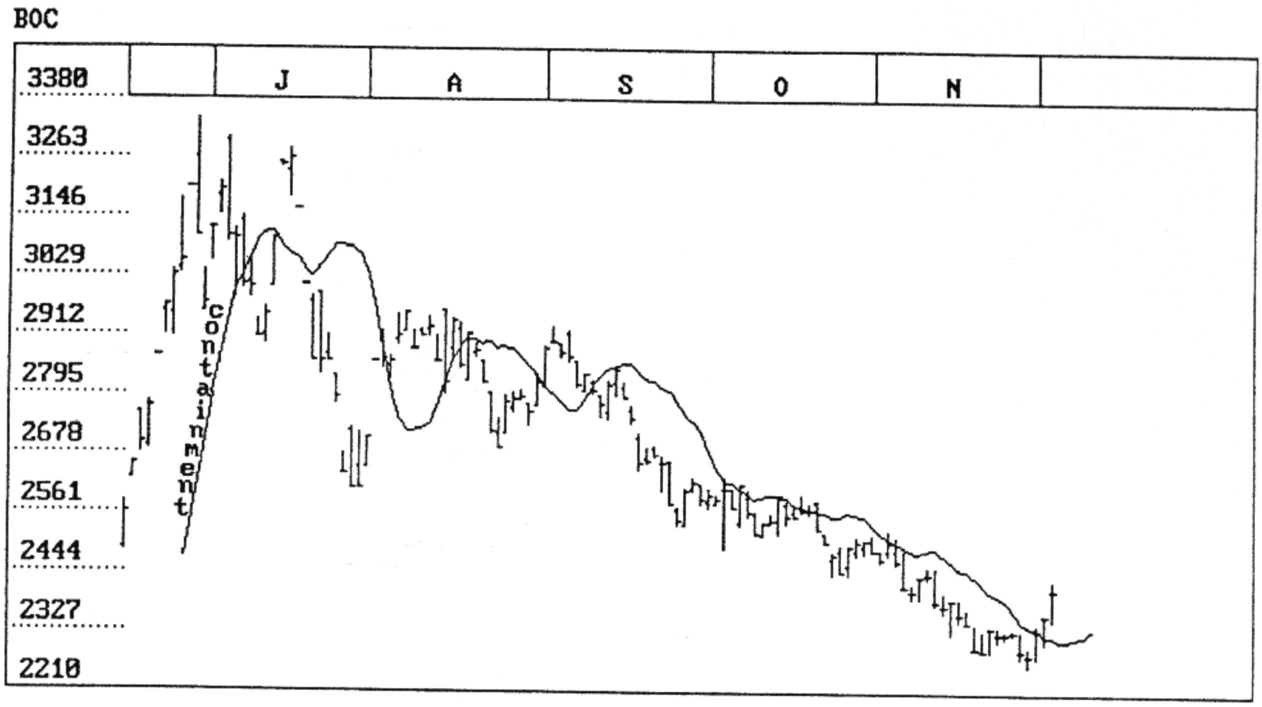


Figure 19

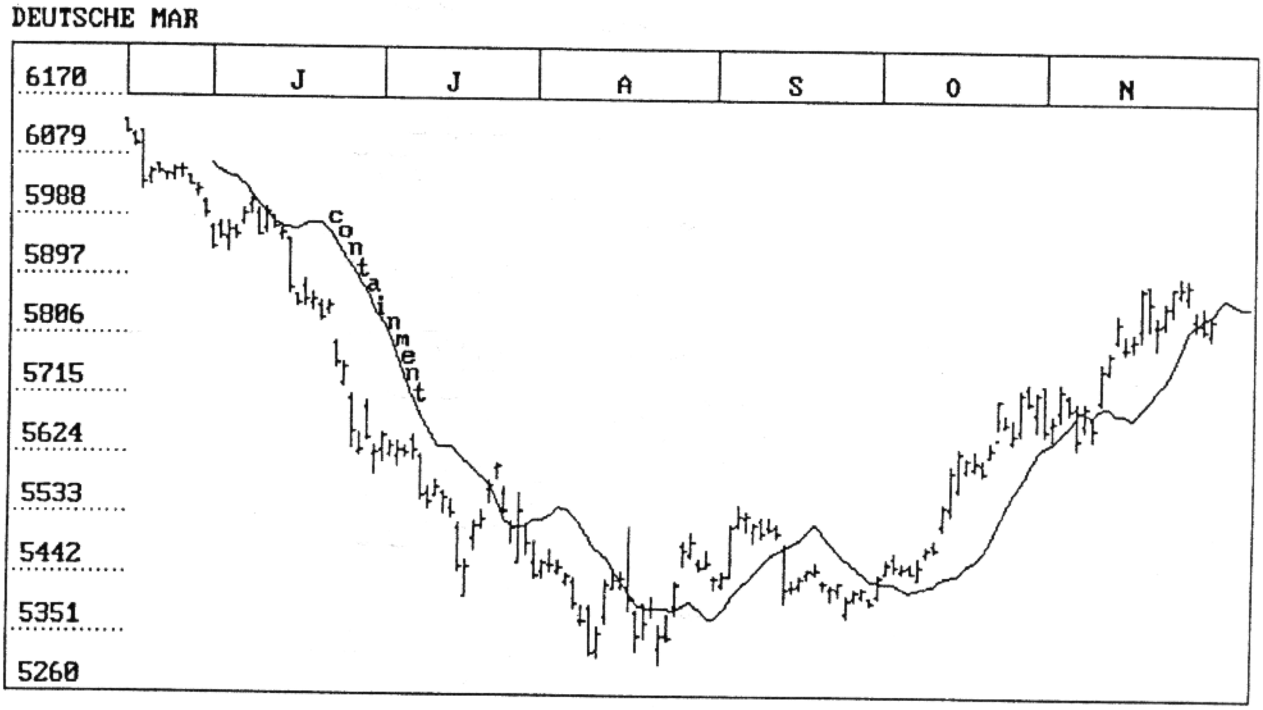
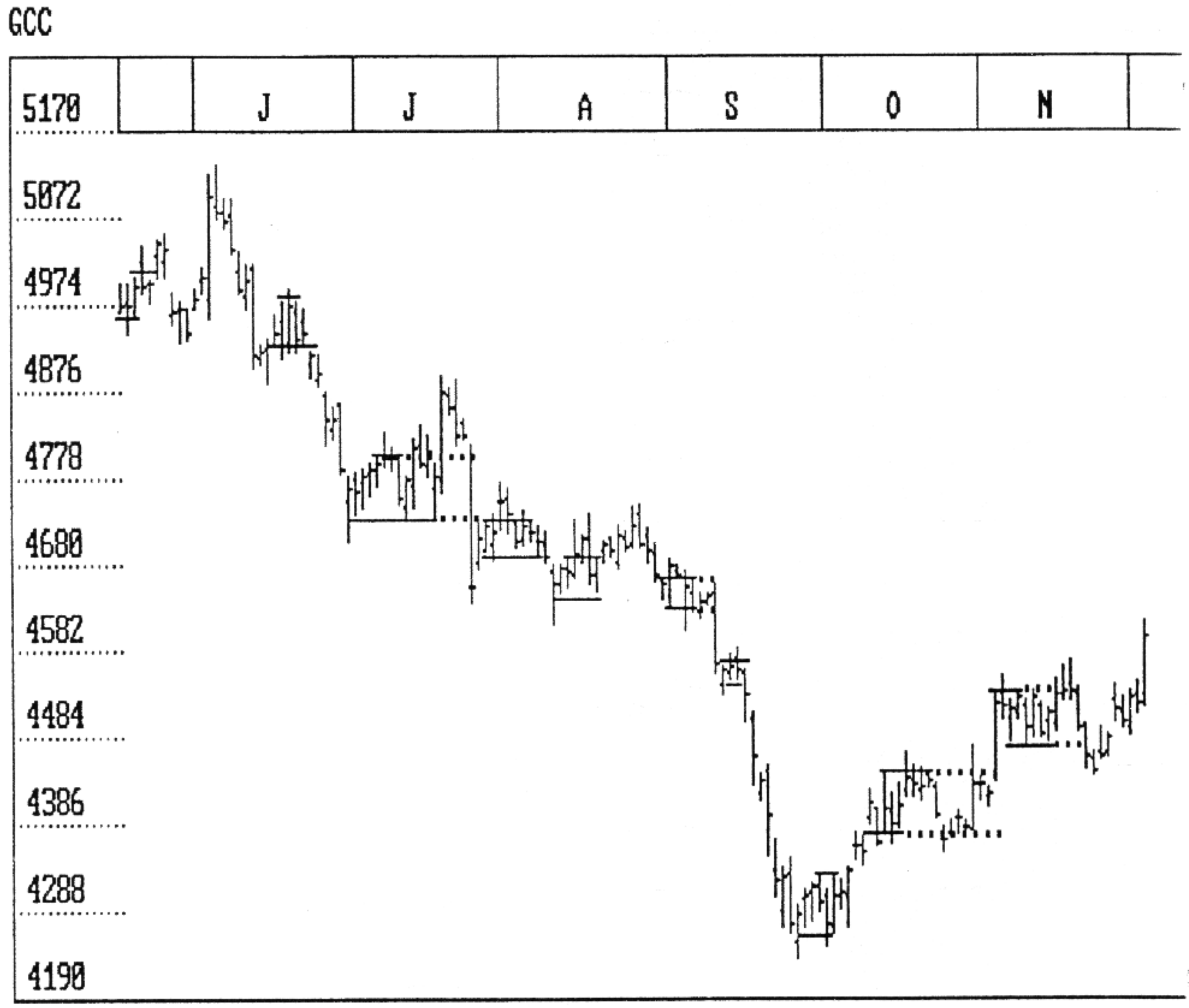


Figure 19 This figure shows what I mean by a sharply angled trend as opposed to one that is moving along at less than a 45 degree angle. Notice also that there are many penetrations of the 7 bar offset 5 on the low angled trend, while there is good containment by the 7 bar offset 5 on the sharply angled trend.



Ledge Method

Figure 20 Any time there is a breakout from a ledge, I have a good trading situation. As mentioned earlier, I position trade the breakout of a ledge by straddling both sides of it and having my order in before the market opens.

Whenever possible I will trade the breakout of a ledge. The Gold chart in Figure 20 shows several tradable entries of the breakout of a ledge.

Good one and two day profits were made on most of these trades. The trick here is to take profits and run. I try to place extra positions on these trades to hold for the near or intermediate term, since they often have the momentum behind them to continue in the general direction of the breakout. Practice will help determine this. The more strongly the market is trending, the longer you can expect to stay in. Please, please, please, remember that these are short trades. Set a profit stop by the second day. Then take your money and run. These trades are a way to scalp the market without being a floor trader.

Breakout Method

This method for selecting a trade is based on volatility change. There is not necessarily any recognizable pattern to this kind of entry.

What I'm looking for is a market that has had a violent breakout or is suddenly changing volatility, the kind of market that has been moving sideways for an extended period of time, well over 25 days. The trick here is to catch them when they go from low volatility to high volatility. That is the whole purpose of the envelope. I place an open order and then wait. Sooner or later the market will break out and begin to trend.

Any of the grains during drought years would have constituted such markets.

The next figure shows what I mean, and why these markets are well worth waiting for.

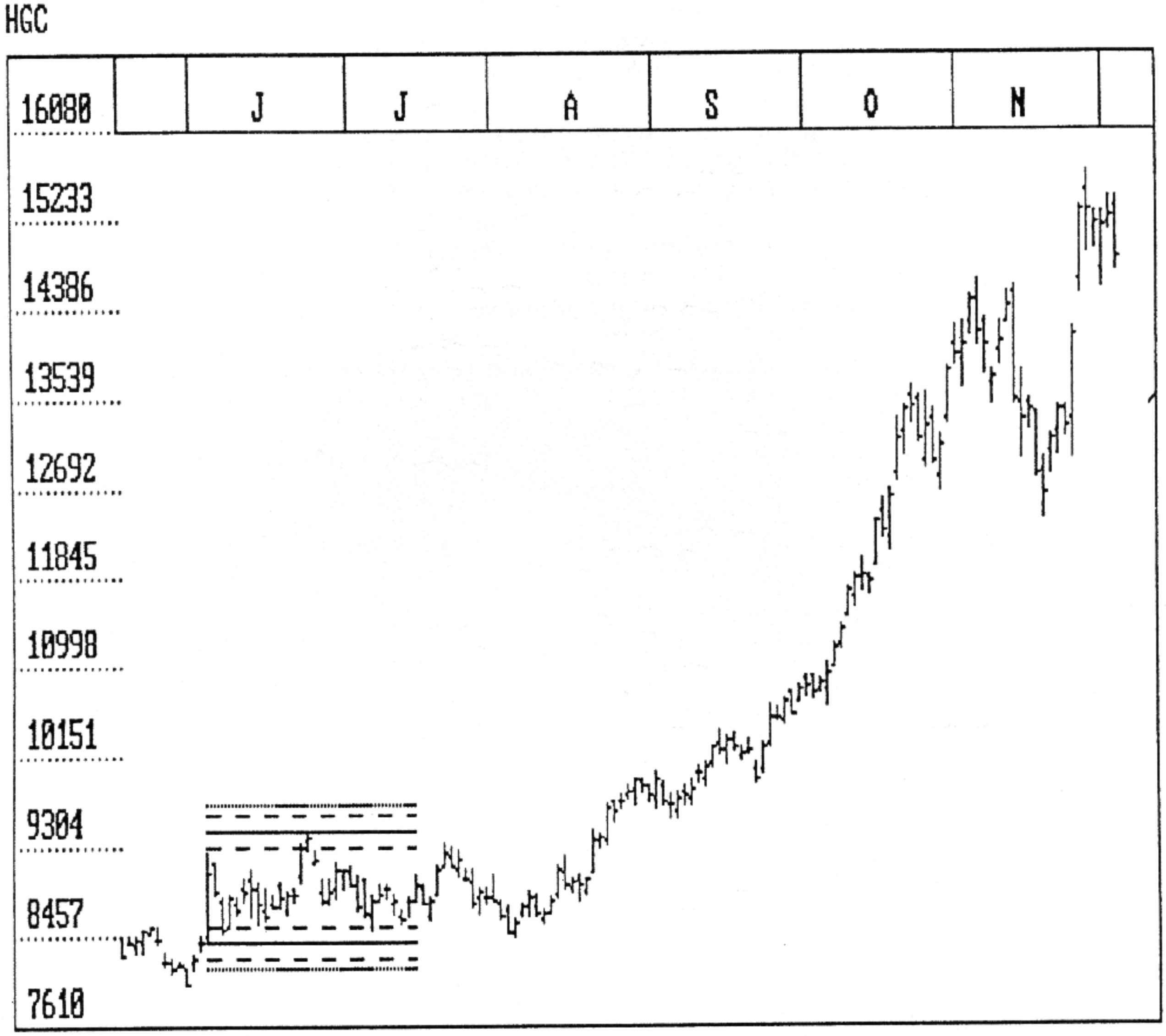


Figure 21 Copper really took off. When it finally broke the envelope it made a fortune for those willing to wait.

In Part VI of the Manual I go into tactics and strategies for trading. I also go into stop placement.

There is a lot of experience and wisdom in Part VI. Also I go through an entire year's trading of a futures portfolio.

I know that many traders will trade only the large volume, large open interest contracts. That is not true for me. I will trade anywhere and any time I feel the opportunity is good for making such a trade.

Also in Part VI, I discuss trading as a business, and why I am in it as a business and not a game. There are a great many other things discussed in Part VI, too numerous to mention here.

I'm sure that Part VI of the manual will make excellent profits for anyone interested enough to study it and put into practice the things that I have shown.

The hardest thing for me to do was to develop the faith needed to trade what I saw occurring before my very eyes time, after time, after time.

These concepts were hard to believe. It all seemed too simple. How could anything be so easy? And yet, it is that easy to trade by the book.

CHAPTER 1

Strategy and Considerations

What follows is an accumulation of thoughts and ideas that have been involved in my trading. I have tried to group them by related items. Some, however, will fit into a number of categories. In the last part of this section, I show how I traded a portfolio of markets for an entire year.

Statistical and Dollar Advantages

Trading the concept using the oscillator combination gives a high probability of winning dollars over losing dollars. Not that you need the oscillators to do it, but the concept of major trend, intermediate counter trend, and short term entry via the intraday breakout is what gives the high percentage of winning dollars over losing dollars.

My studies show that trading the breakout of a range or congestion area, in the way shown in Part I of the manual, has an excellent amount of dollars won over dollars lost. Even though this doesn't occur as often as the other trades, when it does occur I want to be a part of it. Now why is that important to me?

I would much rather load up on contracts in an infrequent high-dollar win situation than to trade more often with fewer contracts in a low-dollar win situation. Wisdom dictates that I don't have to work that hard. Why trade every day? Why be glued to your charts, or computer screen, when you can make good profits trading less frequently? I like to have time to spend, and enjoy the money I make in the markets.

Another high percentage of dollar-win trades comes from the trading of 1-2-3 lows In fact, it runs a very close second to trading the breakout of a range. It occurs much more frequently, and again the same strategy applies. Instead of trading more frequently as in daytrading, I just add more contracts.

Trading by entering established trends is also a high-dollar win trade. All I want out of any trade is a piece of the middle. By carefully selecting established trends, I can get that piece. Here again, if I think I am fairly early in the trend, I can load up on contracts.

Trading from a ledge is about equal in success to entering established trends, but has much fewer dollars won. This is because the trades have a short life. Trading from ledge gives a great many more trades. These are strictly short term trades. Sometimes, by pure chance, they will result in going more than 2-3 days.

Trading from I-II-III highs is quite a bit more risky than the first four methods. This is because markets move down roughly three times faster than they move up. The breakout from the number II point is apt to occur when a major part of the move is already over. Its value lies in that I can get fast profits and then get out. Markets usuall fall much faster than they rise. What may take months to reach on the way up can ofte be retraced in only a few days. I-III highs at market tops are trickier to trade than 1-2-3 lows, and caution is in order at every step.

The easiest trades to take are the hooks. This is because they are so easy to see. All that is required is a correction occurring during a trend. Trade them in trending markets. Look for a minimum objective of 2-3 days of profit. Once that is secured, bail out only when you are convinced the trend is coming to an end.

A wonderful combination covered in my book Trading the Ross Hook, is to wait for a 1-2-3 (I-II-III) breakout followed by a Ross hook. Ignoring the #2 (II) point and taking an early entry ahead of the hook. An excellent way to do this is to use the Slaughterbeck entry technique, or the Trader's Trick entry techniques described in the above book.

Trading in congestion gives a slightly lower win percentage than trading in a trend. There is usually a market somewhere that is either breaking out of congestion, in an established trend, making a 1-2-3 low, or making a I-II-III high. If you must trade in congestion, and we all do sooner or later, I suggest you purchase my book Trading in Congestion.

Although I would love to give you exact statistical percentiles for success in each type of trade, I have found that they vary according to the amount of margin available, and the person doing the trading. The less the margin, the more often you will be stopped out because you have to keep your stops close. Throughout the manual I have tried to show how to keep tight stops. For the trader with a small account, trading with tight stops on the mini contracts is a way to build an account to where the full size contracts can be traded.

Another way to trade with a small account is to purchase options where you would have bought or sold futures. That way, you can completely control the risk to your account.

Trading with any of my techniques gives a greater dollar won to dollar lost ratio trading a $40,000 trading account, than it does when trading a $10,000 account. It enables one to gain greater diversification in the markets. Everything is not riding on a single position. I have found that when scalping, it is much easier to take a few ticks and run with a larger lot size, than with a single contract.

I have never traded fewer than three contracts, one or two to cover costs as soon as possible, and either one or two to let run for profits beyond costs.

It has been argued that a larger account allows for placing stops further away. In my opinion, this is false reasoning. Stops should be placed the same whether trading a one lot or a fifty lot. The risk is proportionate for each contract. Trading single lots places one at great disadvantage. The single lot position must do double duty work. It has to cover costs and remain in place to take profits.

It is important to remember that when trading a breakout, either from congestion or a number two point, to be especially careful trading the breakout into a prior congestion. This is especially true when prices are near a major top or bottom. Even though you may successfully trade that breakout, you will not normally get any mileage out of the trade if it immediately runs into prior support or resistance. To ascertain if this is the case, sometimes it's necessary to look to a chart showing a larger time-frame.

When I trade the daily charts, I look to the weekly and even monthly charts to see where prices are in relation to where they have been in the past.

A similar constraint is needed when trading from the daily oscillator. Avoid trading into extremely overbought or oversold oscillators. The bottom line of all your trading should be the dollars won over dollars lost ratio.

About Advisors, Brokers and Such

I never listen to my Broker(s). I use a minimum of two. They love to chatter and do Monday morning quarter-backing. I am firmly of the opinion that everything I need to know about a market is sitting right there in front of me on my chart. Here is an example: After coming out of an hysterical, weather driven trading range, Wheat made a 1-2-3 low. Following my plan for 1-2-3 lows, I entered the market. One of my brokers let me know that I ought to be buying Wheat Puts. The other warned me that I was in a congestion area and was taking my life in my hands. Both advised me to get out or get killed. Yet, there was Wheat rising nicely along a beautiful 45 degree trend line, well above the offset moving average, making higher highs and higher lows and very predictable Fibonacci retracements.

I don't listen to the news when I'm calling my trades via my methods. It throws my trading off. When I am contemplating a trade, I avoid CNBC-FNN, CNN, PBS, and any other source of opinion on the markets. I do NOT want to know what they or any of their guests think. I want to emphasize that everything I need to know is right there in front of me. The only thing that can mess up my plan is a Chernobyl incident, or an "act of God." Then I have my stop in place to bail me out as quickly as possible. No human can predict such incidents.

I cannot stand to watch the weather reports, the crop reports, the consumer price index, the producer price index, the wholesale price index, the trade balance, the money supply, the discount rate, the prime rate, or any of the host of other reports spewed out by dozens of government agencies and the like. These reports (and they are forever increasing) cause huge blips, gaps, runs-up and runs-down on the intraday charts. It's enough to give anyone ulcers. Hardly a day goes by that someone, somewhere, isn't releasing a report that makes the market jump. It's too nerve-wracking for me. That's why I ignore all these reports, and all the opinions concerning their implications. However, I am aware of them as a matter of safety and self-protection.

I have come to realize that my own opinion of the market is as good as any. One of the advantages of longer term trading is that these reports are not important to the longer term trend. Outside influence serves only to take away the courage of my convictions, therefore I ignore such influence as much as possible.

That is not to say that these reports are not valuable. They are important at the right time and in the right place. However, they are of no value to me in futures trading when I am utilizing the methods that I use to enter and exit futures markets.

I'm convinced that the small trader should trade as long term as possible to avoid the lumps and bumps seen in shorter term market moves. Trade the mini contracts, or use options until you build an account.

I am dead set against all prognosticators, prophets, most advisors, and anyone who tells me that they "think" the market will do such and such. I have enough trouble getting rid of my own "I thinks" which invariably lead me into trouble. I don't want to know what they think when I'm busy making my own decisions based on my own methods.

I do my best when I follow my method, diligently working like a good mechanic, showing myself adept at following what I know works. It's like golf. All you have to do is to hit that little ball into the hole, but few there are who can do it well. Few, too, are the traders who can diligently, with persistence and consistency, follow a trading system or method that works. I hate myself when I don't follow my method. I aggravate, go into self-abasement, call myself all kinds of names, feel ashamed, and get terribly depressed. Yet it happens all too often to suit me. Here are a few things I do to help out. They, too, are hard to do:

I keep a log of all my trades, why I made them, and what I was thinking about when I made the decision to enter them. I do this in part to help me with future trades, and in part to keep myself too busy to overtrade. I have a tendency to take too many trades.

I keep a fake account of all my trades, real and paper (yes I still paper trade). I chart an account equity. It is made up of every trade I make, real or paper. When my fake account equity goes below the 3x3 MA, I begin to pull my real trades out of the market. I ease up on my commitment to the market. I get out when my fake account equity goes below the 7 bar offset 5 MA.

I get away from the markets for at least a week, preferably two. When I return to trading, I paper trade until my fake account equity reaches back above the 7 bar offset 5 MA. At that point, I start lightly trading again. When my fake account equity goes above the 3 bar offset 3, I make a full commitment to the market. That way I paper trade away my losing streaks, and tend to be in the market only when I am winning.

I force myself to take at least two vacations a year, far from any knowledge of the markets.

If I have been trading intensively, I try to take one day a week off, besides the weekends. If not, then I try to take one week out of four away from the markets.

Good Advisors

I used to think it might be a good idea to trade from an advisory. I would still get to do the trading, but someone else would do the research and the grunt work for me. I no longer feel that way. I have not found an advisor in the futures markets who is worth following.

The feedback I receive from my many friends, students, and fellow traders has overwhelmingly set me against all advisors and advisory services.

I strongly urge anyone to learn to do his own thinking. It is virtually impossible to truly follow an advisory.

What is wrong with using an advisory? Invariably you do not enter exactly as the adviser does. You miss some trades. You are tempted to take trades the advisor has not advised. You are not able to execute in the same way the advisor does. You may find it difficult to place stops where the advisor recommends placing them.

You do not have the same mind set as the advisor, you do not have the same comfort level, and you do not necessarily know the rationale behind every trade.

For many reasons, the results are not the same as they are for the advisor.

If you want to use an advisor, use one who will teach you to trade his way and then follow along with his trades until you can do it on your own.

I have attempted using advisory services as my system, blindly following every trade exactly as they called them. It can work, but usually only for awhile! Few advisors have consistently good years in the markets.

I have not found many advisors who will teach you their methods so that you car truly trade as they do.

One way to use an advisor is to use one in an area in which you have a lack of knowledge.

For example, I know practically nothing about seasonal spreads. I don't have tim to follow them, chart them, or make decisions about them.

Yet there are many good seasonal spreads. For variety's sake, I like to try them from time to time.

One advisory that I receive in the mail (when I can get my broker to send it) is or spread trading. Offered are spreads that have been successful 75% or more of the tim Some are even 100% winners - and that is over a period of 12 years.

I trade those spreads when I am able and if I get bored and need a change of pac They have been profitable.

In the past I knew little about options. I am in the process of remedying that situation. I have used options and am starting to use them more than previously.

I had always felt that options are for people who are a lot intelligent smarter than I am. Th are all kinds of strategies involved with options. I did not have the time, patience, or ability to figure out most option strategies, but I'm learning that they can be valuable.

I've always thought of myself as a checker player, not a chess player. My opinio of that is changing. Trading futures is like playing checkers. All I wanted was to just march down and get kinged. Options trading is like chess; there are many strategies, plays, and intricate thinking. I'm beginning to find out there is great value in becoming chess player, or at least learning some of their tricks.

Part of being a good trader is in knowing yourself and your strengths and weaknesses. Know your comfort level.

I have an option on right now. Two different advisories called this one. It is base on a cyclical low in the Hog market. Who knows, maybe they're right. It's going to co me only $210 to find out.

About Managed Accounts

There is nothing wrong per se about managed accounts. I know professional traders who trade regularly and still have an account managed by someone else in addition to their own trading. If there is someone who is successful at daytrading the S&P, for instance, and I don't have the time or the inclination to trade the S&P, it might be a good idea to hand over an amount of margin money to someone who is doing well at trading the S&P.

The decision here is whether to be a trader or an investor. These are two completely different animals. The economics are totally different. Instead of selecting a market to trade, you must select a CTA or broker to invest with/in. The commissions for a good CTA or broker successfully trading a managed account are typically about $100 per round turn and/or a percentage of earnings. A good CTA or broker who is making you money is worth that. The problem is trying to locate a competent person to trade your money for you. I have known of people searching high and low for such a person and never finding one. All too often, the stories that come from managed money trading are horror stories involving huge losses.

If your account is small, I feel you would be a lot better off being in a commodity pool as opposed to an individual managed account. The problem is where to find one. Personally I know of none that are worthwhile unless you have about a million dollars you wish to put at risk.

Also, instead of full margin to position trade the S&P, you need only a fraction of the margin in a managed pool account. This is because some pools will trade the S&P collectively for you and others with an original investment of much less than you would have to come up with on your own. I'd be very careful in selecting with whom to place the money, but once that job is done, you must basically forget about it and let them trade. The worst thing you can do is to look over their shoulder.

The reason for having a managed account when trading on one's own is, as stated above, to trade in a market that you don't normally trade. Another reason for doing this is to take a rest from the markets. If you are going away on an extended business trip, you can have a managed account working for you while you attend to other things. The same is true for extended vacations. If you place money to be managed, you stay with it for an extended period of time. You don't want to catch a trader only when he is having a drawdown period.

I know of traders who place their money in a managed account when they get into a trading slump. In every instance of managed money, be extra careful to fully check out the track record of the person who will be doing the trading.

About Stops and Risk

One of my primary exit techniques is to watch for /\/ and \/\ as alerts, or ob/os on the daily oscillator. When these occur, I move my exit stops up close to the price action. When /\/\ or \/\/ occur, I look for the first opportunity to get out. Usually this will occur within a day or two. What will happen is /\/\/ or \/\/\. I try to get out at the high or low of that last leg. Most of the time that last leg will occur and I escape at that point. I will not risk that the last leg is a continuation leg. Usually it is not. If it turns out I'm wrong, I can always re-enter the market.

Another exit technique is to utilize the offset moving average, especially when the angle of the trend is steep. I move my stops up closer as prices approach the moving average line. Penetration of the moving average by the Close will cause me to exit at the first opportunity.

I have shown where to place the initial stop trading the breakout of a range. This stop is only "initial," it is only temporary. It gives me some insurance while I observe what the market is doing. It is much further away from the price action than I care to have it. But it will suffice until prices show where they are really going. As soon as possible I move my stop to 1 tick below or above a #3 (III) point if prices look like they may break out of the range. If they turn around and come back, I cancel the stop involved and move the opposite side stop. I juggle these, canceling one and then the other, reinstating either when appropriate, until the breakout occurs.

I have been criticized for placing stops only one tick above resistance or 1 tick below support. However, it has been my experience that if stops are going to be run, they will be hit no matter if they are placed 1, 2, 3, or 4 ticks below support or above resistance. Why risk the extra points?

Also, as soon as possible I let the MA take over to show containment. When I am trading from 1-2-3 highs and lows, the initial stop is placed 1 tick away from the #3 point. Again, this is only the initial stop, it is temporary. It may also be too far away from the price action. I want to get over to using the MA as soon as possible for my trailing stops and have it in place, updating daily as I go. The MA is usable when it shows containment of prices.

I have heard of all kinds of methods for placing stops. Some say "x" number of ticks away. Others say a certain percentage away. Some say to risk no more than a certain percentage of account equity. None of these methods makes any sense to me. I can afford to lose only so much on a trade.

In some cases, even though I can afford to lose a certain amount, I am unwilling to lose that much. Why? Because it is too painful. I will be unhappy if I lose that much, so I set stops according to what I can be happy with. Peace of mind and happiness are what I want from the markets. They are the fruits of wisdom, and wisdom is one of my overall goals.

The best stop strategies take into account the volatility of a market, account equity, anticipated winning percent, turnaround time, comfort level, and any other factors one might feel pertain to proper trade management. Certainly a stop method should be based upon sound money management.

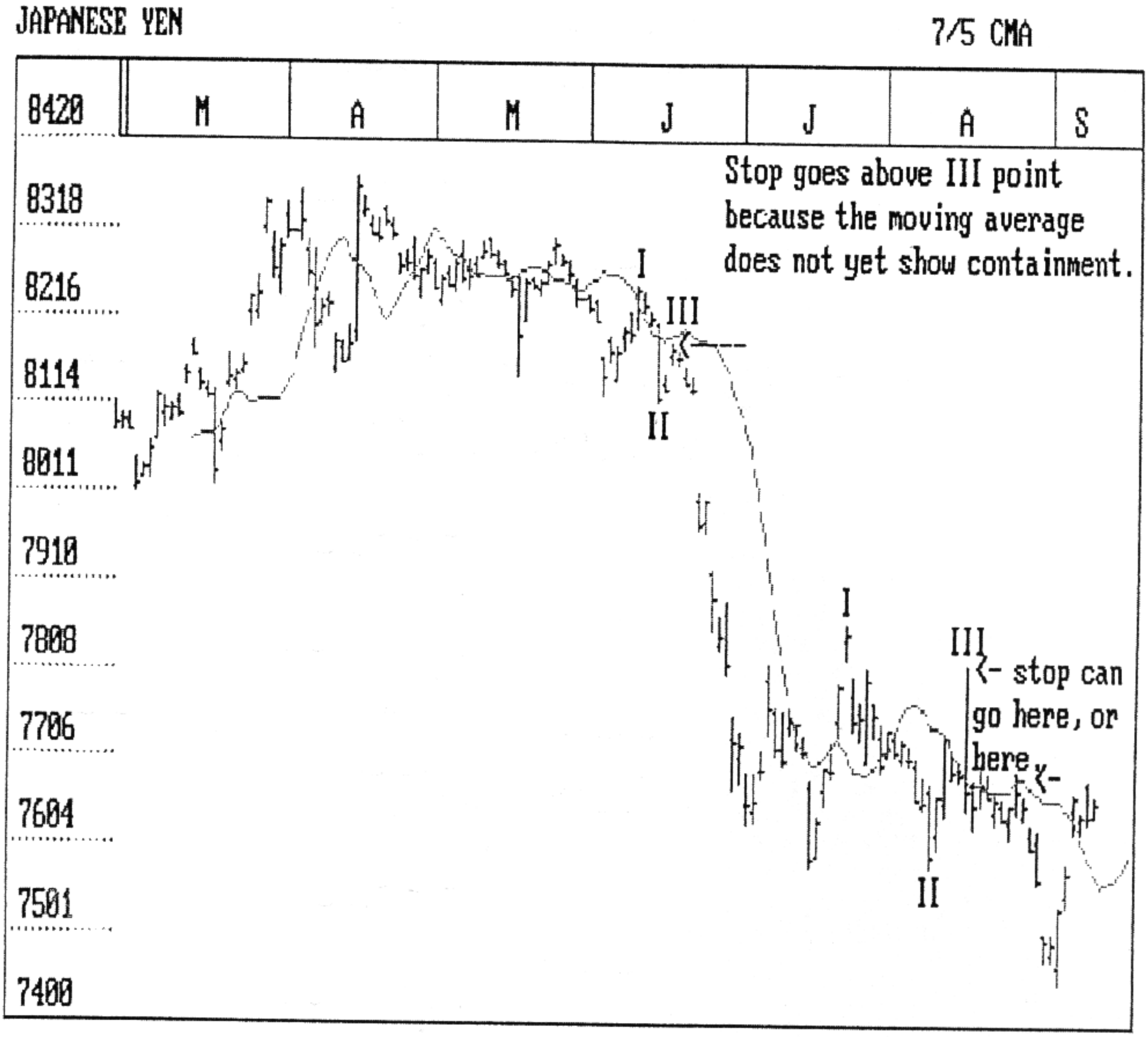


Figure 1 shows my stop philosophy. If I can afford the loss as I enter the trade, my stop will be 1 tick above the #III point. If I cannot afford to place it there, on a $x,xxx account, then my stop goes just above the MA. I can then exit on the /\/\ or when prices take out my stop 1-3 ticks above the MA.

CHAPTER 2

TRADING IS A BUSINESS OF PERCENTAGES. TOO MANY TREAT IT AS A GAME, IN FACT THEY CALL IT A GAME. IF YOU WANT TO BE A LOSER THEN TREAT IT AS A GAME. IF YOU WANT TO WIN, TREAT IT AS A BUSINESS.

Now what do I mean by that? I mean I don't "play" the "game" of trading. I want to be like the baseball manager. The players "play" the game, but the manager is all business. He has firmly in mind the percentages for or against making any move that strategy may dictate.

Sound management in placing stops says that I can risk no more money on a single trade than is a multiple of the number of successive losses I can expect from the method of trading I use.

If I have a $10,000 trading account and with my method of trading I can expect no more than 10 trading losses in a row, and if I'm willing to see it go down to $5,000 before I've had all the pain I can take, then I can afford to risk $500 total per trade made.

When I am trading within a congestion area, I use very close stops. I have to throw out the MA on these trades. My stops are mostly mental throughout the trading period. However, I do give my broker a stop placement just in case something unexpected happens and I'm not able to monitor the trade. The stop I give my broker is usually too far away - at least further away than my mental stop.

About Commissions

Since I make all of my own decisions and require nothing of my broker other than to call my trades to the trading floor, I do not feel that I should have to pay full commission. If I daytraded all the time on large contract lots, I would expect to pay well under $20 per round turn. Since I usually do not daytrade, I feel that $20-$35 per trade is a fair amount to pay. I feel that I should use a reputable broker, one who is a clearing member. I am happy to recommend any of my own brokers to anyone should they be interested.

About Placing Orders

Correct order placement is crucial to good trading. There are many times I will not enter a trade on the CBOT because they do not take a variety of orders. If the type of order placed can make the difference between a winning trade and a losing trade it is best to bypass a trade that would have been good with one type of order but bad with another. Here is an example: Recently I wanted to enter the Wheat market at 402.75, no higher and no lower. Wheat was at 399.00 at the time. Although I didn't know it, the government was to release the crop report the next day. What I wanted was a stop limit order at 402.75. If I bought Wheat at 402.75 on a buy stop, and then it gapped up over my order, I would have been filled at the Open. So, because I couldn't get the kind of order I wanted, I didn't place any order at all.

As it turned out, due to the government crop report, wheat opened at 408.00 and then shot up to 409.50. If my order had been in there it would have been filled at or around 409.00. I then entered the market later that day at my price of 402.75 as the market traded down to 390.50 and closed at 393.00. Over the next few days the market traded back up to my goal at 418.00, and I was out. An alternative to this, which I was sorely tempted to do, would have been to place the order at the Minneapolis Grain Exchange. There, all orders are accepted. The trade-off is a lower Open Interest, and so less liquidity. As it turned out, that is what I should have done.

The Business of Trading

Trading futures is a business. To my mind, it is the best business in the world - for a great many reasons! It has a very high profit potential against a very low overhead. Risk can be tremendously reduced by taking only high probability trades. In fact, futures trading is a relatively low-risk business when approached with the right attitude and the right planning.

Trading is eclectic. I can pick and choose which market to be in, I can choose when to be in it, and generally under what circumstances my entry will be. If Crude Oil is making money, I can make money in it too. If I want to trade the Bonds because they are moving, I can. Any trending market is making money for someone, so I can have a piece of the action too. I can be a bull or a bear as the mood suits me. I can be a happy bull or bear if I'm going with the trend.

I earn my living in what is probably the last vestige of true capitalism in the world - a "free" marketplace. I can live by my wits, and reap the fruit of my labor.

I have no customer problems: no customer relations, no customer complaints. No customer theft, no customers returning anything.

There are no employee problems other than myself. No unions to contend with, no negotiations, no strikes. No employee benefit plans other than what I give to myself. No employees stealing from me. No collective bargaining, and no stockholders.

There are no merchandising costs, no damaged goods, no vandalism, no service calls, no repairs to make and no guarantees to honor.

I don't have to advertise, and I have no marketing headaches. There is almost always a buyer if I want to sell, and almost always a seller if I want to buy. No purchasing and procurement problems, and no salesmen making mistakes.

There are no manufacturing problems, no production schedules to meet, no shipping, no receiving, and no product liability.

I don't have storage problems either. No warehouse, no spoilage, no items to discontinue or mark down. No bills of lading, no freight or freight damage, no trucks to load or to unload.

I'm free of invoicing, accounts payable, payroll, inventories, accounts receivable, billing, dunning, bad checks, and bad debts.

There are no salesmen who call on me, although occasionally an investment salesman will call on the telephone. As soon as I tell them that I am a professional trade doing quite nicely in the market they quickly excuse themselves and hang up. This only reinforces my perception of them as wolves waiting to tear apart some poor unsuspectin suck...whoops...prospect.

I have no competition. What? How can that be? Yet it's true. I have only to dea with someone who is of a different opinion than I am. We settle our difference of opinic with money. If I'm right, then he pays up, if I'm wrong, I pay up. We resolve our difference of opinion in polite and courteous fashion, by putting our money on the line according to the rules. We don't know each other. The exchange acts as the neutral party.

The person on the other side of my trade can't cut prices as a competitor can. He can't offer better service, he can't scoop me in the marketplace with a new innovation c an existing product or get one-up on me with an entirely new product. He can't steal m customer lists, because I don't have any. He can't lure away my best salesman either. He can't even plant a spy to discover my trade secrets, because I don't have any to hid and because he doesn't know who I am. He can't seduce my top research scientist, an I can never be the victim of a hostile take-over. I never worry about corporate spies.

Now I ask myself, "Self, where else can you find a business like this?" The answ is an overwhelming "nowhere"! It's the most perfect business in the world!!

About Charts and Charting Services

Everything I do on my computer can be almost as easily done by hand, using today's financial section and a good set of charts. There are many of these charts around. As long as I ignore their moving averages, oscillators, and such, I can do quite well. All that is needed is a chart that is "markable." Is that a word? It is now! I just put a dot where today's MA is, and write in the number. I draw my envelope lines with ruler, which is quicker than drawing them line by line with a computer.

When I was using a chart service, I just put a dot where the high, low, and close were. Usually I didn't even bother drawing a connector between them unless that was the market I was currently trading. Open Interest and Volume are there on the chart. I've never plotted them.

I do think that it is important to trade a chart from the perspective that I'm used tc Whatever the vertical and horizontal scaling is, I stick with it. Most of the time, I can make any market look like it's in a trading range if I set the vertical scale large enough, c I can obliterate the fact that it is in a range by setting the vertical scale small enough.

CHAPTER 3

Chart Perspective

Figure 2 Look at the Copper charts on the next page. You can see Copper snaking along in a trading range. But then look at the magnitude of the vertical scale. It is quite large going from the lows of the 76.10 area to the highs of the 128.30 area. Anyone can see from this chart that Copper was in a trading range (Upper chart).

But it was a bit more difficult to see at the time Copper was between 77.70 and 95.30 (Lower chart).

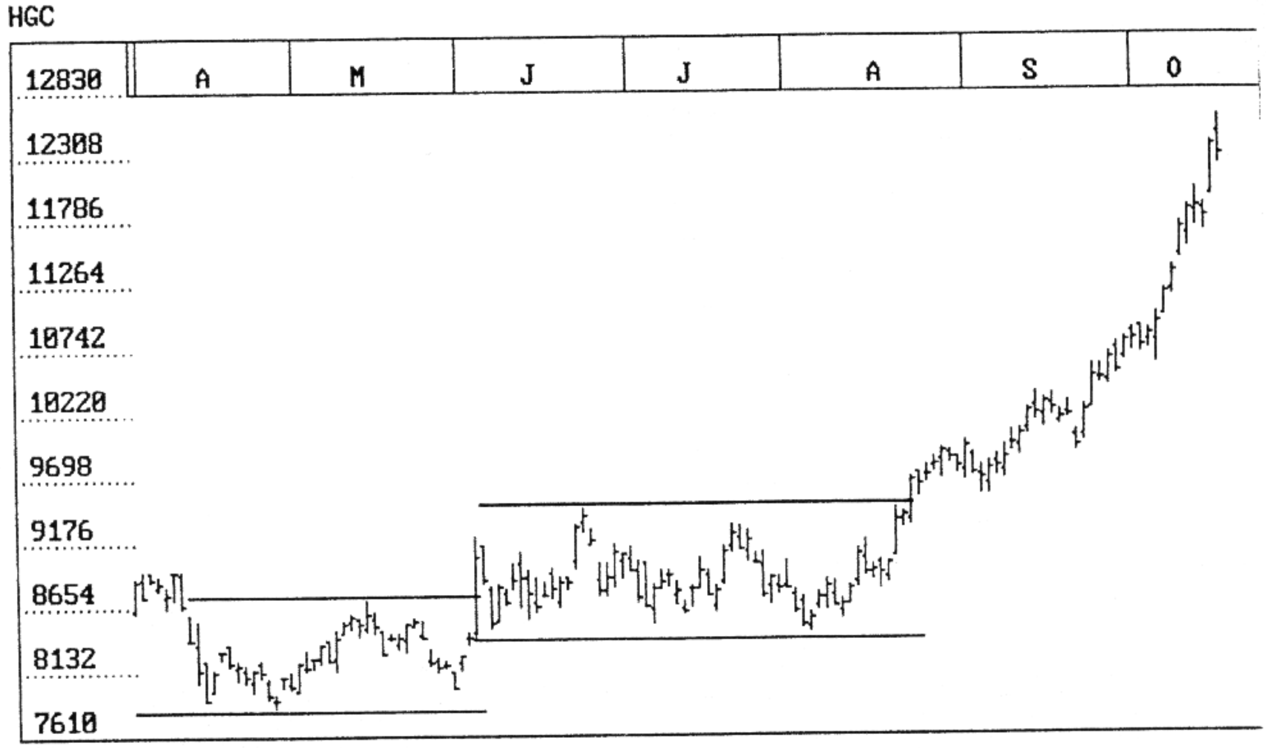

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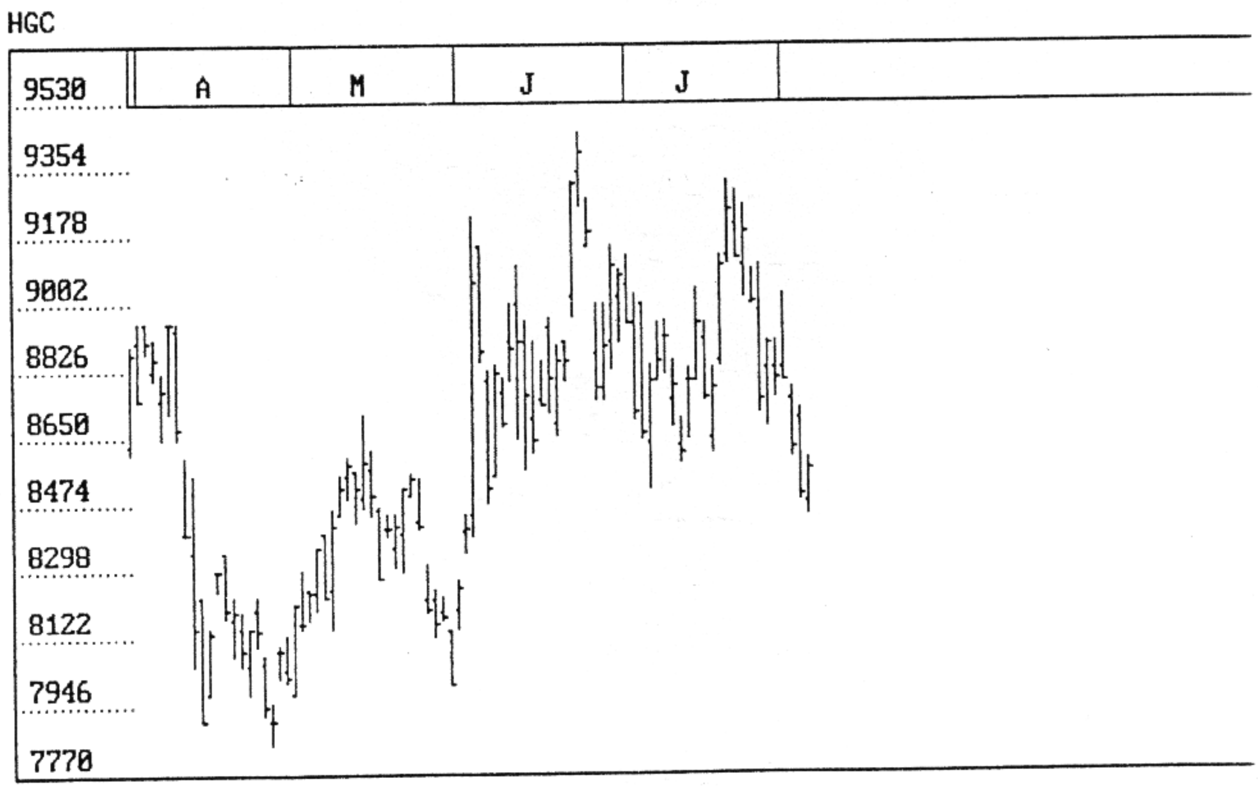
Figure 2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System VS. Method

Here is my definition of the difference between a trading system and a trading method. I base this on over 30 years of being involved with both systems and methods analysis.

A system is extremely mechanical, and leaves little room for emotion, personal thought and intervention. A trading system is something that is traded mechanically. To make it work, one does what the system dictates and that is all. Deviation from the system results in failure. Judgment is not involved.

A trading method is different in that it allows for human intervention. Judgment, wisdom, and personal thought are all able to enter into a trade. The allowance for emotion is the weak point in a trading method. It requires self-control. However, the ability to intervene and use wisdom and sound judgment, in my opinion, more than makes up for the risks of emotion, provided that a trader has established self-control. I'm convinced that any trading method that shows a win-to-loss ratio of 55% or more, with a profit to loss ratio of 3-1 or better, will result in success if one's emotions are under control and self-discipline is exerted. The trading methods in this manual all have the necessary win-to-loss and profit ratios needed for success. The methods shown have worked with only small modification since before the turn of the century.

A trading method, of necessity, involves creating a trading plan. I hate to be trite, but one of the wisest sayings is "plan your work and work your plan." This is essential to good trading. Planning and working a trade keeps me from "willy-nilly" trading, trading on whims, and trading from emotion. "Perfect love drives out fear." I love trading enough that I am willing to work my plan and stick with it. With a plan it is possible to have the courage of your convictions. That courage has turned many a loser into a winner for me. I know where I'm going, why I'm going there, and when I might get there.

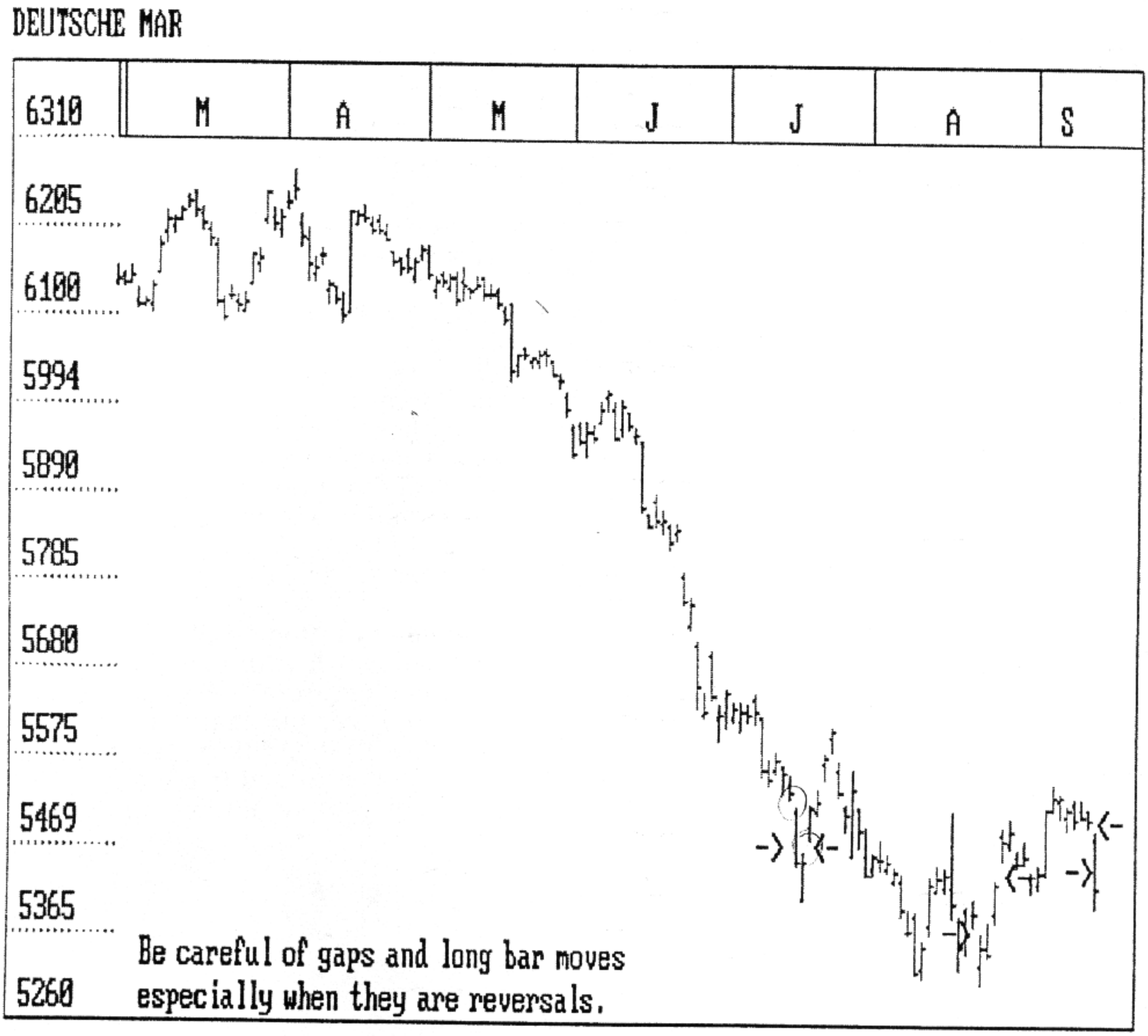


Figure 3 shows a double alert - A gap down followed by a gap up a few days later. To me that says get out, don't wait, get out now because this market is going to change direction. The problem is, I don't know for how long. Is this a change in the major daily trend? I don't know, so I get out and wait for developments. The second gap could be the start of a trading range, in which case I can trade within a range, wait for the breakout of the range to occur, or if it is not there long enough, wait for a 1-2-3 bottom.

The same action would occur by a gap in one direction followed by a large magnitude of move in the opposite direction, or a large magnitude of move in one direction followed by a gap in the other direction.

Don't Get Angry at a Market

I never get angry at a market. After all, it's an inanimate although dynamic thing. I do get angry with myself. I am sure that no one has a weaker character than myself. It seems as if I make every mistake in the book, and never seem to learn to avoid them. I want so desperately to have my wits about me when I trade - to think of all the possibilities, and to see what's really happening. All too many times this just isn't the case. I repeatedly break my own rules.

Becoming angry with a market very often leads to wanting to take revenge on that market. This is when some of the greatest losses take place, because of the emotional reaction in trying to get even. It is just childish and immature and a poor way to try to make profits.

Being angry with a market can result only in lost opportunity, yet I know brokers who will not trade Wheat because they are angry with the Wheat market due to losses they have had in trading it.

I know a broker who will not trade Cotton for the same reason.

Somewhat akin to being angry with a market is holding a market in disdain. I know so many traders and brokers who will not trade oats because it is too small. Yet I have made as much money trading oats as in any other market I have traded.

Now there are legitimate reasons for avoiding markets like Kilo Gold and Oats, and that is when you are a large lot trader and can't reasonably expect to get satisfactory fills. They are also poor for daytrading because of their illiquidity. But for most traders, even the smallest markets can and do offer satisfactory opportunities that should not be passed by.

I used to worry about these smaller markets because they had low open interest, and because everyone else said to keep away from them, but now I trade them with as much pleasure, reward, and success as any other market.

Objectives

There can be no more important topic that I can discuss in this manual than that of objectives. Until I learned this lesson, it cost me many dollars in lost profits. Never, NEVER, never enter a trade unless you have an objective for the trade and are prepared to get out when that objective is reached. I cannot recall how many times I have had profits in the bag, only to lose them because I failed to tell my broker in advance the price at which I wanted to get out.

When an order is called in, either at market or at some specified price, or even a limit order, give the broker a protective stop order and an OBJECTIVE stop order if possible. Have an objective in mind, even if it is only to be stopped out later on with a profit.

If I am selling Gold at $415.00, my protective stop is at $420.00 and I have an objective for the trade of $409.60, I tell my broker to sell Gold at $415.00, and if that is filled I want to place two open order stops - a protective stop at $420.00 and an objective stop at $409.00. I do not wait to see which way the market is going to go. All three orders must be placed at the same time. If the objective is hit I am happy and content. I don't care what that market does after my objective has been met!

This is the approach I have to a trade when I am trying to scalp a market. Hit the objective and get out!

When scalping, without an objective there is no real reason to trade. Where is this trade going? Am I in business or am I just gambling? If I'm in business then I'd better have some sort of goal.

Of course, when not scalping, if the objective is to be stopped out using a trailing stop, I have the benefit of allowing a trade to build profits before having to get out.

About Technical Indicators

Why am I so against the wrong kind of trading with technical indicators? I can best answer that with a question.

Who in their right mind would carve an idol out of wood, then place this work that they have fashioned with their own hands on a pedestal and worship it and have faith in it? One might think, "No one." Not so! Every single day traders, both stock and futures, do this very thing. How? By worshiping and having faith in the work of their own hands - the indicators, moving averages, and oscillators that they themselves have created or that other humans have created for them.

Imagine that! How can anyone have blind faith in these "tools" as compared with the reality that faces them every day on their charts?

Is it not human beings that choose how many days are in the oscillators or moving averages? Is it not humans who decide when overbought or oversold occurs? Who says that 75% is overbought, or that 25% is oversold?

I have heard people say that the markets are cruel, unreliable, merciless, and undependable. But it is faith in these false technical gods that is cruel, unreliable, merciless, and undependable. It is misplaced faith. Markets are neutral, they of themselves have no emotional capabilities. Markets cannot be cruel. Disappointments come from relying on man-made tools and having faith in them, when the markets clearly show something else.

All technical tools are good only when they confirm what is actually going on in the market. At the very best, they follow the action. No one yet has invented a technical study or tool that can predict the future.

I have had people tell me that such and such an oscillator leads the market. How preposterous! How can any something based on history lead a market? No oscillator in the world knows what tomorrow's price will be.

Placed in the proper perspective, technical tools are usable. They can point out divergence, they can indicate that everything is going along within "normal" parameters. They can act as confirmation that what is seen in the price action is really so. These tools are all filters for what is seen reflected in the prices on a chart. They are never anything more than that - no, not even Fibonacci numbers, or Gann angles, or Elliott waves are ever more than reflections of reality, and sometimes they do not mirror reality at all, or are so far behind that they are of no use in trading.

People have a way of camouflaging these false gods so that they seem real. They use all manner of mathematical window dressing and make up all sorts of rules so that one would think that they really have something. But in the end, no matter how complex, they always fail when you need them most. That is why a trader has to learn to read the only reality that is available on a regular, day by day basis - that is the reality of price.

Throughout this manual, I have tried to show how I see the price action on charts. But there are some things I cannot show in a manual. These are the things that make up trading sense. A person can learn these only by getting their lumps and bumps in the market place.

Runs

A very important concept to grasp when trading is that of the run. All markets, in all trading time frames, have runs. Markets have runs up and runs down. In order to take advantage of these runs, one has to be in a position in the market. It's as I explained in Part II, one has to be in the water ready for the wave.

Here's a technique I have seen used that will explain what I mean.

I know a trader who takes a position in the S&P every day at the Open. She is a professional trader and CTA, and trades a managed account that makes money for her investors. She has spent six years in developing her technique, and it explains everything anyone needs to know about runs.

Based on the direction of the Open, she waits for a retracement of that Open and then takes a position in the direction of the Open. She also places a very tight protective stop along with her position. Some days she makes a few hundred dollars and other days she loses a few hundred dollars. Most of the time her account hovers around break-even. But, every so often the S&P will make a run. If the run goes against her position, she is out with a small loss. If the run goes her way, "bingo!"

One of the things that I am invariably asked by others is, "Do you daytrade"? My answer is, I used to daytrade a lot. But, because of a present physical handicap, I am not able to do it any more to the extent I did. It takes great energy to daytrade. It involves a great intensity of concentration.

I used to daytrade intensively for a few days, but then I had to rest and get away from the markets. The funny thing is that I didn't always know when I'd had enough. Unfortunately, I would find out or realize that I'd been at it too long when I would wake up to the fact that I'd lost a lot of money in the market.

A friend of mine daytrades only two or three days out of a month. He says that is all he is able to stand of it. He has been a full-time professional in the business for 24 years, and owns a seat on the CBOT.

Because daytrading is so intense, and because I personally can't handle it as much any more, I am essentially a situational trader based upon the price action of the daily and weekly charts. Just because I can't physically work hard at daytrading doesn't mean that my money shouldn't be working for me.

Position trading more or less takes care of itself. I don't have to pay much attention to it. I call in my orders, and when they are filled all I have to do is monitor the trade closely enough to move the stops and get out at my objectives.

Anyone who is not full-time at trading should not attempt to be a daytrader. Anyone having another business to attend to or a job to go to is not in the situation where daytrading can be accomplished successfully.

There are, of course, exceptions to this rule. Anyone able to take the time away from business to concentrate on daytrading can engage in daytrading.

Anyone who works at night can daytrade in the mornings if he is alert. Even day workers can daytrade the Bonds and Gold at home in the evening if they have a data feed from a CBOT registered vendor. I suspect that in the future there will be more of this kind of trading going on, with eventually the ability to trade anywhere in the world on a twenty-four hour a day basis.

The biggest mistake I see people making once they have learned to trade is that they trade too much. Such an amount of overtrading destroys them and they never really figure out what went wrong. What they fail to realize is that greed has taken hold of them and they are trying to make it all at once.

I have read countless times a thing that is true: "Take steady profits out of the markets. Don't try to make the big killing. Be content with a modest return on your money on a regular and continuing basis." The meaning of a modest return is going to differ from one trader to the next.

Avoid Foolish Moves

I try to avoid what are obviously foolish moves. Don't sell into support and don't buy into resistance. The odds are against it.

I have watched traders sell right into major and obvious Fibonacci support areas. They didn't understand anything about Fibonacci. If nothing else but how to find them is learned from this manual, it will be worth the price.

Look at the charts that are one magnitude greater than the one on which you are trading. Look for long time support and resistance areas. Look for Fibonacci support and resistance areas. Don't trade into those areas. Just cool it and wait to see how things develop.

One of the biggest mistakes I make is that I get so wrapped up in my trading that I fail to realize soon enough that prices are in a trading range. Learn to step back once a week and take a broad overview look at all the markets. You want to be trading the ones that are truly trending.

Sometimes that means not trading at all. One good clue to the fact that you are in congestion areas is that all of a sudden you stop making money. Trades stop working out. You find that you are struggling in the markets. You start taking hits. If this starts to happen, stand back, be eclectic. Virtually every time you will see that the market overall is going sideways.

That is the time when you have to have the maturity to stop trading. No one is looking over your shoulder. Be wise. Stop calling in orders. You don't have to trade all the time. Wait for the right times. Place envelopes around a market and wait for things to start popping again.

CHAPTER 4

A Year Of Trading

In my personal day to day trading, I accumulate data and trade a representative group of markets. Naturally I don't trade them all at one time, although I have to admit at times I have come close.

The markets I monitor are: Bean Oil, British Pound, Corn, Canadian Dollar, Cocoa, Copper, Crude Oil, Deutschemark, Eurodollars, Gold, Heating Oil, Japanese Yen, Live Cattle, Live Hogs, Silver, Soybeans, Soybean Meal, Swiss Frank, Treasury Bonds, Coffee, Unleaded Gas, Wheat, S&P 500, NYFE, and World Sugar #11.

Some of the currencies, Crude Oil, S&P (or NYFE), and Gold I trade on the one and five minute charts as well.

If I were to show the trades I made during the year with one chart per trade as I did for Part IV of the manual, you would need a porter to carry them all. Instead, what I've done is to select a basket of six markets, representative of the various futures groups. I'll be showing you what the weekly oscillator segment looked like for each market traded at the pertinent time for each trade. "Weekly oscillator segment" refers to the way the weekly oscillator was pointing on the day that was pertinent to the trade.

I'll be showing the daily charts for each market in which I made a trade and have labeled each trade that I made. For the sake of clarity, there is more than one daily chart for each market traded, because I have widened them out so that they show only four and one-half months of trading, but are more easily read.

I traded the markets according to their individual personalities. Now what do I mean by that?

Markets have personalities. Although on the surface of it they all look about the same, upon closer examination they are quite different from one another in the way they trend, the duration of their trends, the way they form bottoms and tops, and the way they break out of congestion.

To continue with my analogy of the markets to waves, you may recall that I stated earlier that if the waves at one beach were not to a surfer's liking, the surfer might try those at another beach. Why? Because at each beach the slope of the underlying shore upon which the waves roll and break may be quite different, causing their breaking action to also be different. The underlying shore may also differ considerably in its composition. Some beaches are quite muddy - sand over a mud base; others are very sandy - sand ove a deep sand base; still others are sandy over an underlying rocky base. All of these factors make a difference in how the waves behave.

Some of the best surfing beaches in the world are found in Hawaii. There the waves are huge as they break upon a wonderfully gradual incline. Because of this they roll for hundreds of feet, giving a truly long ride. This is analogous to being able to ride the long term trend. The waves are huge and they travel far.

In California, the incline of the shore is steep and the waves, by comparison with Hawaii, are small. The ride is excellent but relatively short. This is analogous to trading the short term trend.

Every trading method will differ in the way it works with the various markets. A great Bond trading system may be just horrible when trading Corn. A system that makes big bucks trading Bellies may not work with anything else at all. This is why you see specialty systems. You've seen the ads, "Make money trading the Meats," "Use my system to make a fortune trading the Metals," etc.

There is a lot of mythology that has arisen from the personality differences of markets, so I'd better give some examples of what I mean. By the way - none of what I have to say concerning market personalities is always true, but understanding how to trade using these personality differences will greatly affect loss-protective and profit-protective stop placement, exit timing, and your sense of urgency.

Here are some that I've noticed. Cocoa tends to make rounded, saucer bottoms, so I give it time to make those bottoms. There is less urgency about getting in, and I can keep my stop far back.

Sugar is a market where the pit jockeys love to go fishing for stops. When I trade sugar, I place my stops where they are least likely to find them.

Stock Indexes - give them room. They can trend wonderfully and long, especially intraday. High margins keep most traders out. This is a daytrader's market, typically if you don't have big bucks.

Bonds - I use tight stops and trade for points on the Bonds. To trade the Bonds by the Book, you either have to be well capitalized and able to keep your stops far back - giving the Bonds lots of room, or you have to jump in for a quickie, and use a profit stop. Try to pick up 5, 10, or maybe 15 ticks and then bail out. The quickies are one and two day trades. The Bonds can trade sideways in huge trading ranges for months on end. The Bonds will make large daily moves and wipe out several day's worth of tight stops.

Coffee - the same as the Bonds. Trade in and out quickly, unless you are well capitalized. Good fills on one or two contracts. Don't try four.

Cotton - treachery underlies this market. Bad fills, stop fishing, thin trading. I stay away. Ditto for lumber.

Currencies - long trending, when they finally do trend. Extremely choppy and dangerous when moving sideways. Lots of gaps due to overseas trading.

Wheat - lots of trading ranges that are large in size from top to bottom. Short explosive trends. Get in and out quickly when the Wheat trends. Trade the Wheat with great care. Just when you think you have a profit, Wheat will move counter-trend and take out 3-4 day's worth of highs or lows and your $500 dollar profit will be a $200 dollar loss.

Soybeans - explosive, fickle, emotional. Subject to wild gyrations just when you think they are making a market turn. The Beans have a hard time making a bottom or a top. Excellent long term trends. Stay away during weather markets unless you really know what you are doing.

Corn - good long, very slow trends. Also very prolonged sideways moves. Corn likes to drift. It will slowly drift up, or slowly drift down. Seasonally and in weather markets, it can explode.

Orange Juice - thin market but trends wonderfully and long. I've had good fills when trading. Explosive and emotional in weather markets.

Silver - stair steps down for long periods. Explodes up for very short periods. Full of spikes. Moves sideways a great deal.

Gold - lots of trading ranges, short term explosive trends, good long term trends.

Oil complex - sharp narrow bottoms, broad choppy tops. Excellent trends.

Copper - a fooler. Trends nicely, but watch out where you place your stops. Makes large magnitude trading days. Knocks out two or three day's worth of highs or lows or both.

Cattle - lots of broad trading ranges, lots of ledges, short explosive trends.

The above is how I see these markets. They love to make a liar out of me. Naturally my personality descriptions are colored by more recent history. I tend to forget their personalities of years ago.

I will surely incur someone's wrath on each of my opinions. I apologize if anyone is offended. Hey, consider the source.

One last thing, since I actually trade the markets from continuous charts, I have used those to illustrate these trades. When I look at all of the trades I made, I realize why my brokers love me so much.

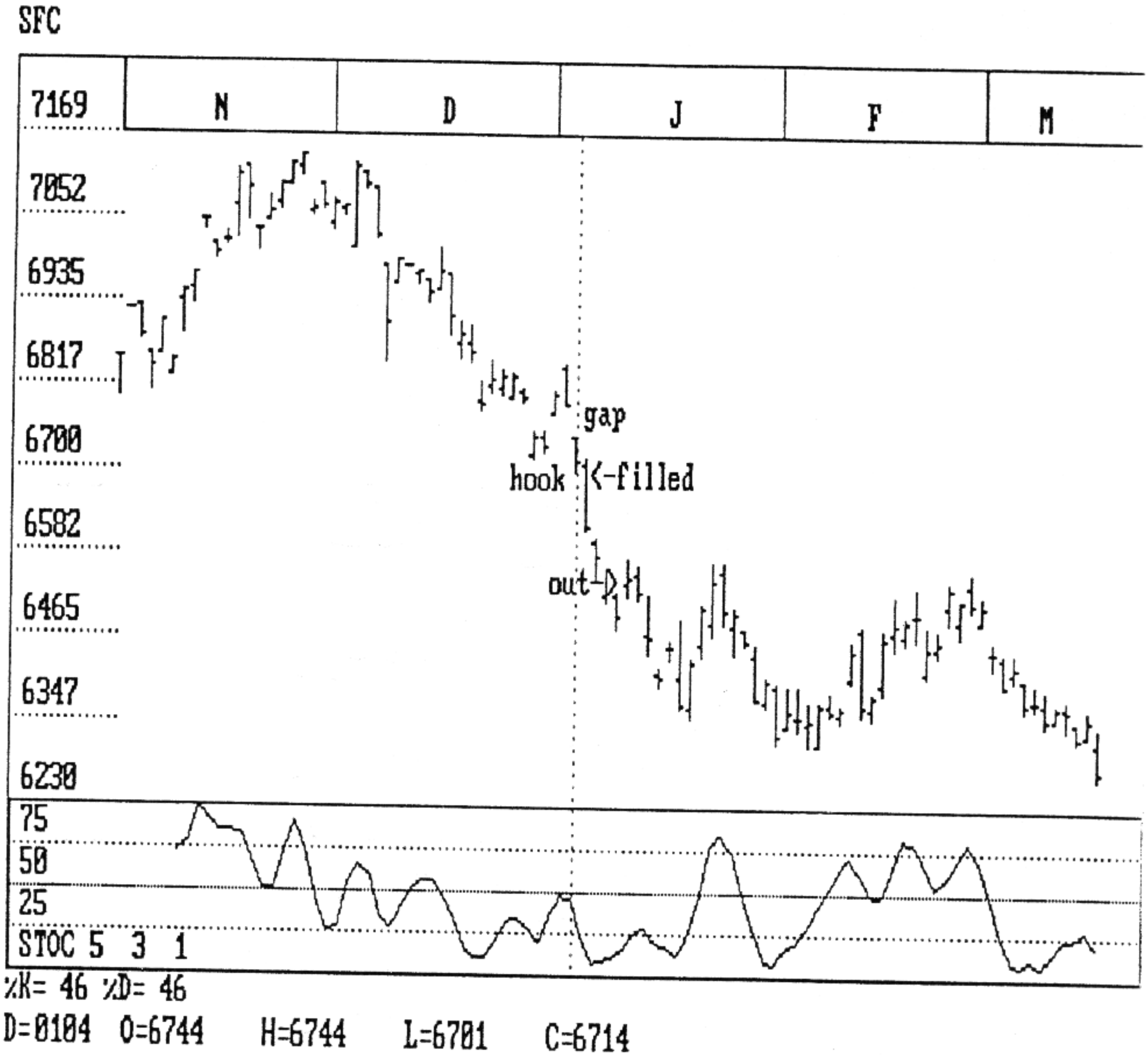


Figure 5 0104. The weekly oscillator for the Swiss Franc had been falling and was pointing down. The daily oscillator had corrected and was beginning to turn down. Prices gapped down and took out a Ross hook.

I placed an order to sell a breakout of the low at 6699, and was filled the next day as prices made a large move down.

I called in a stop at breakeven. The next day prices dropped down on a gap opening. I moved my stop to just above the close of the day I got in.

Prices moved down again the following day and closed at the high. I moved my stop to just above the close of the previous day.

Again prices dropped and so I moved my stop to just above the high of the day. I was stopped out there the following day as prices rallied.

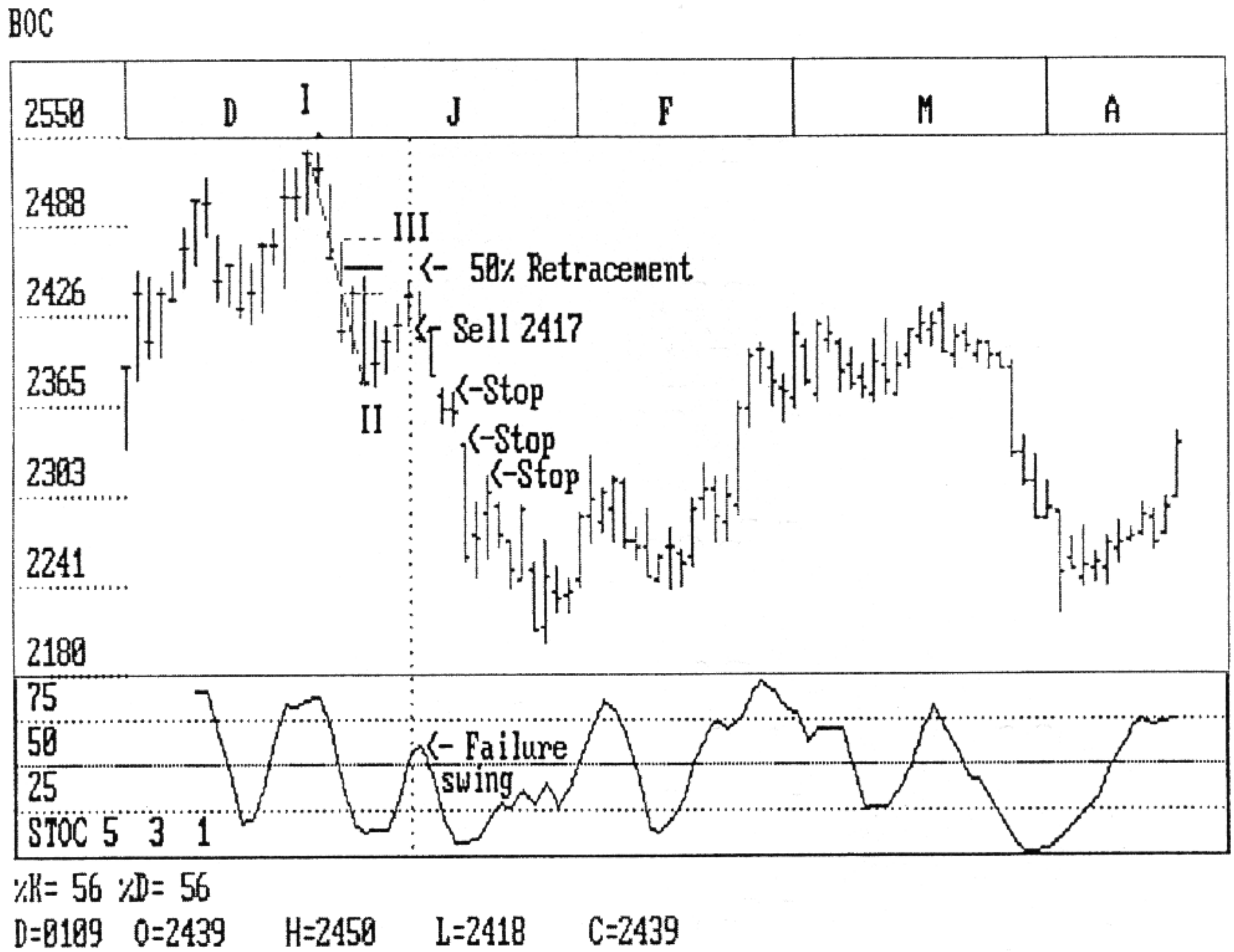


Figure 6 0104. Bean Oil has made a leg down and then almost a 50% Fibonacci retracement. I began by selling a breakout of the low of 2418, by placing a sell stop order in the market at 2417, with a reversing stop at 2451.

If I would have been stopped out, prices would probably test those old highs and I'd have a chance to recoup all or part of my losses.

As is shown, I was filled the next day at the open which was at 2410. The daily oscillator had retraced out of the oversold area and the weekly oscillator was definitely pointing down.

I've shown the level of the Fibonacci lines and I've noted the failure swing of the daily oscillator. I like to see failure swings approach the 50% line before entering or adding to a trade, but it doesn't always happen that way.

I've indicated where my stops were as I trailed them along. Notice that I was able to get a jump on the breakout of what turned out to be a I-II-III high formation.

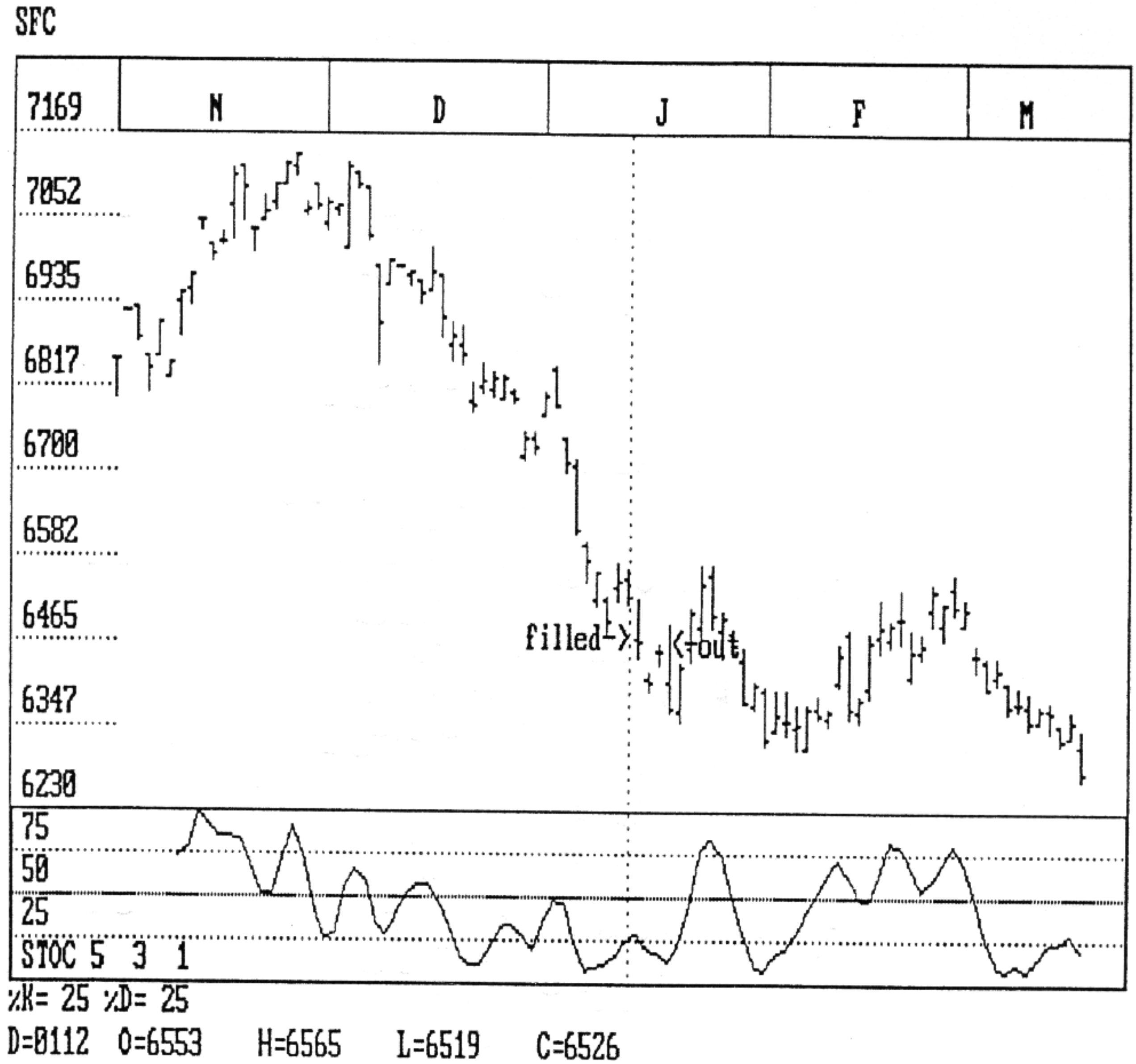


Figure 7 0112. After rallying only one day, prices for the Swiss Franc made a lower high and a lower low. The weekly oscillator was still pointing down. Even with prices continuing to move down, the daily oscillator would come out of oversold giving me room for another short sale. I placed an order to sell the Swiss if it took out the day's low.

The next day I was filled on a gap opening at 6469. Prices closed at 6464, after rallying earlier in the day.

My luck held out the next day as prices once again gapped down. I moved my stop to 6464, and was almost taken out there. I moved my stop to 6462 when prices gapped up the next day.

The following day was a blow off day, and I was out having made seven points.

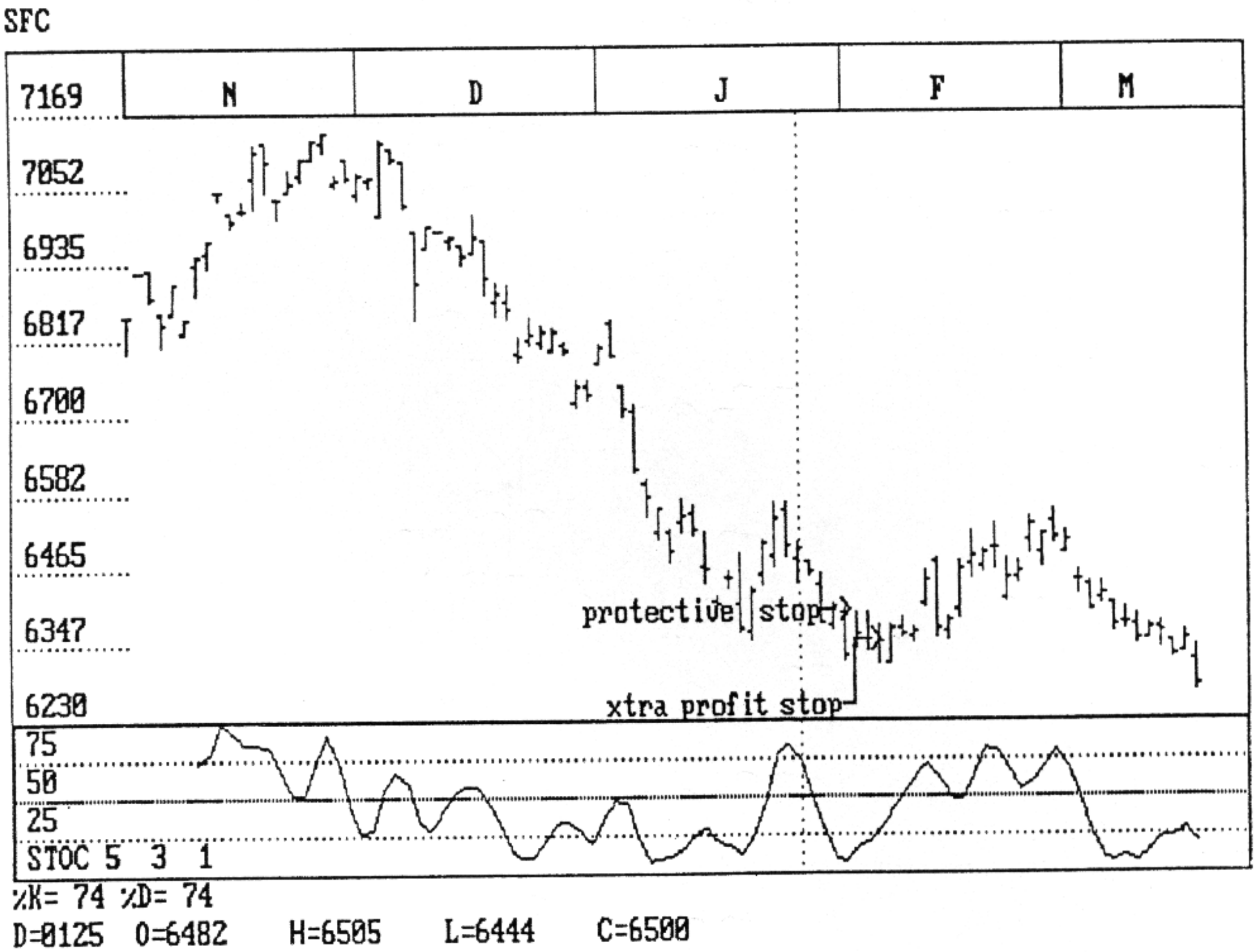


Figure 8 0125. The weekly oscillator for the Swiss was still basically pointing down although somewhat flat. The daily oscillator had corrected to overbought. Prices made a lower high and a lower low.

I called in an order to sell a breakout of the low at 6443.

The next day was an inside day so I left my order in place and was filled the following day as prices dropped and closed at the low. I placed a stop at breakeven.

Two days later prices dropped again, so I moved my stop to the high of the preceding day.

Next, prices made an inside day, so I moved my stop to just above the high of the inside day, where it came within one tick of being hit.

I didn't like what I was seeing so I left my stop where it had been and also placed a stop where the market had last closed. I did this as "order cancels order." Either way I had a profit locked in unless prices made an enormous gap up at the open. Instead they moved a bit lower, but I was out of the trade on the open having made a bit more profit than I would have had prices moved up.

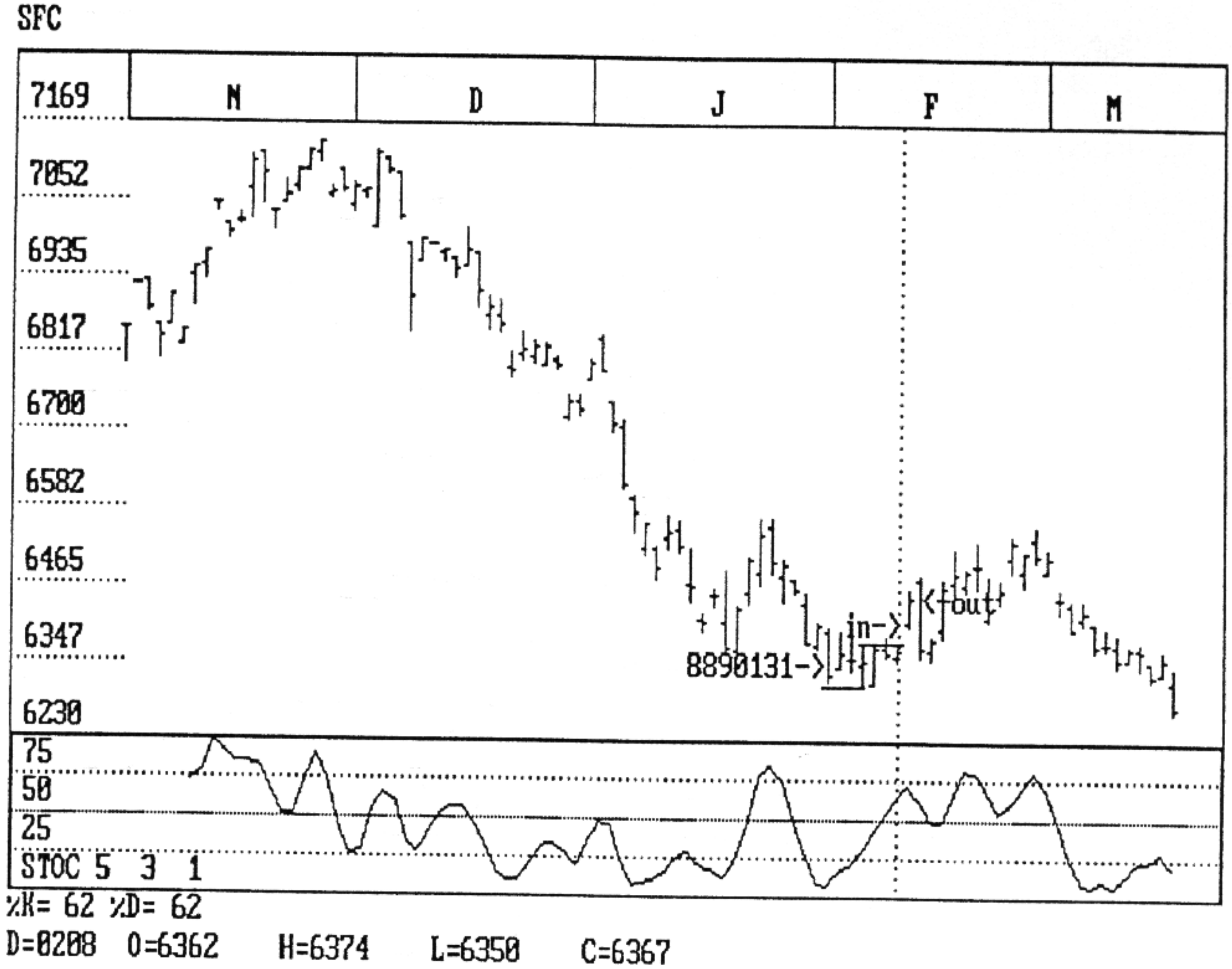


Figure 9 0208. Let's back up a minute to 0131. The Swiss Franc made a new low at 6321. Three days later there was a low at 6320, and the high that day was 6375. I connected the two lows which could be the bottom of a ledge. Three days later a high (where the vertical cursor is) was made at 6374. I now had two lows that were one tick apart and two highs that were one tick apart. I drew a line across the two highs. I now had a bona fide ledge.

I placed a sell stop at 6319 and a buy stop at 6376. With two previous tight little days, it looked like something might explode.

The next day the explosion came. Prices gapped up and I was filled at 6409, just below the open. My stop was below the low of the same day since I expect to be in these trades a short time.

On short trades like this in the currencies, I try to scalp 20 points and then get out. There would be time to get back in later on if this was truly a trend change. I put a profit stop at 6429 and was filled and out the next day. My profit stop canceled my protective stop. When scalping, I exit more quickly than otherwise, and am willing to risk less.

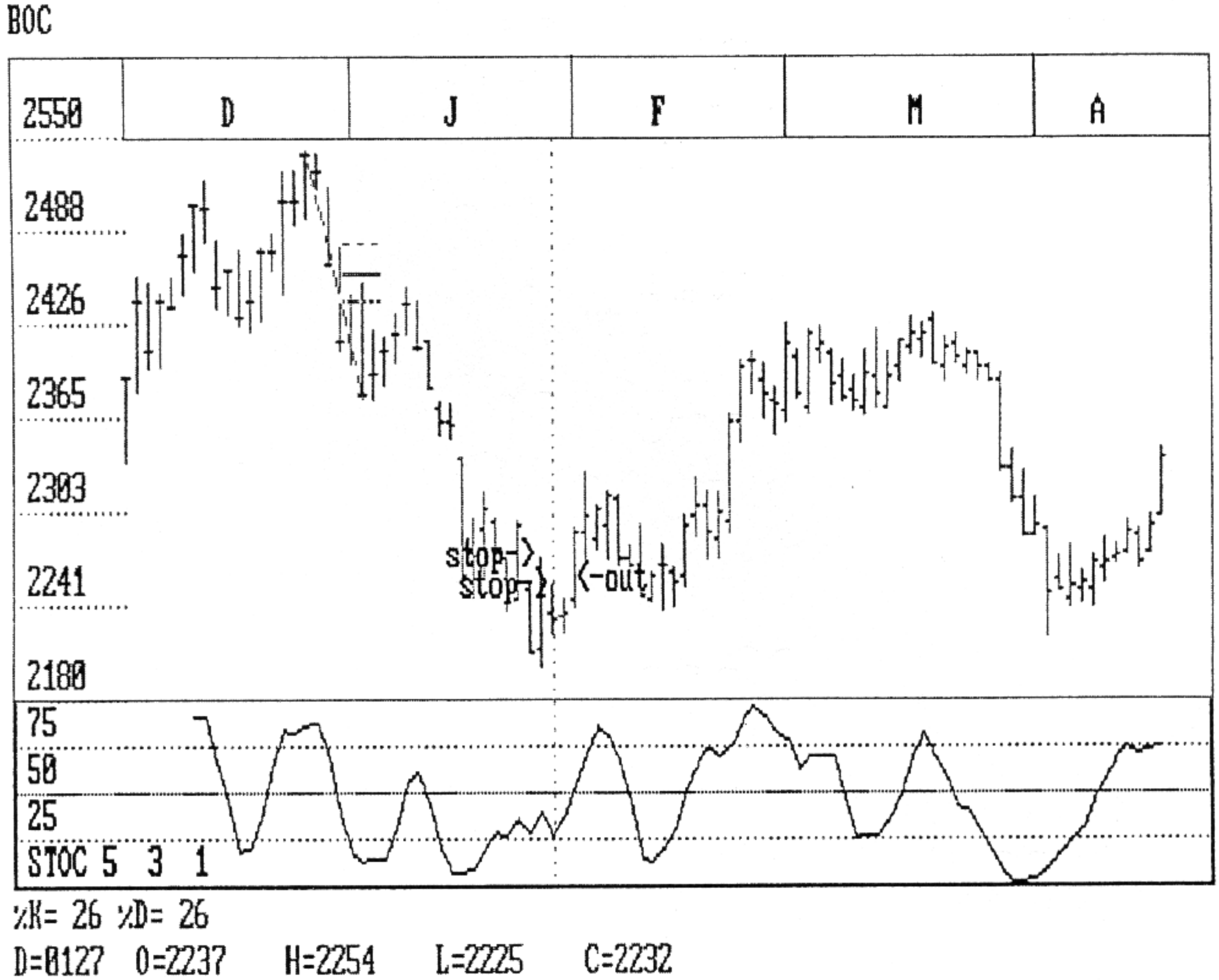


Figure 10 My final stop for Bean Oil was at 2255 as shown by the cursor bar. Two days later, on 0131, I was stopped out. The weekly oscillator had gone flat. The daily oscillator was of no help in going long because it didn't make a true 1-2-3 breakout. The #3 point was lower than the #1 point.

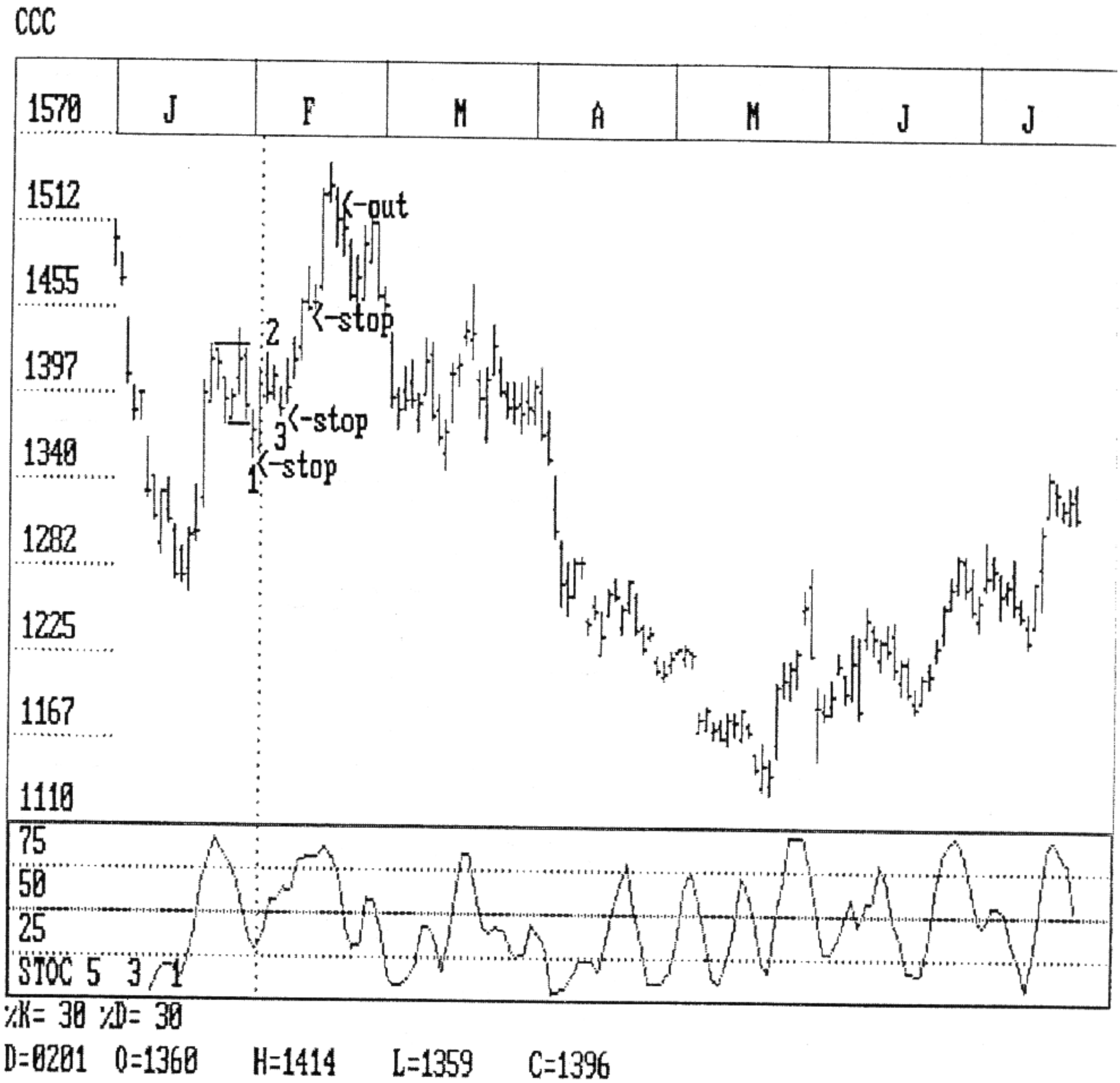


Figure 11 0131. Cocoa formed a ledge, but since the weekly oscillator was rising and pointing up, I let it filter out the breakout to the downside.

On 0201, the daily oscillator had corrected to 30 while the weekly oscillator was still rising. I entered a buy order at 1415 with my stop at 1358. The next day I was filled and prices rose gradually to the high made on 0215. I've shown how I trailed my stops as the market rose. Notice that the trade took out the high of the previous ledge and gave me a jump on the 1-2-3 breakout pictured on the chart.

I concluded the trade on 0216, the day after cocoa made its high. I did not enter another Cocoa trade until 0222.

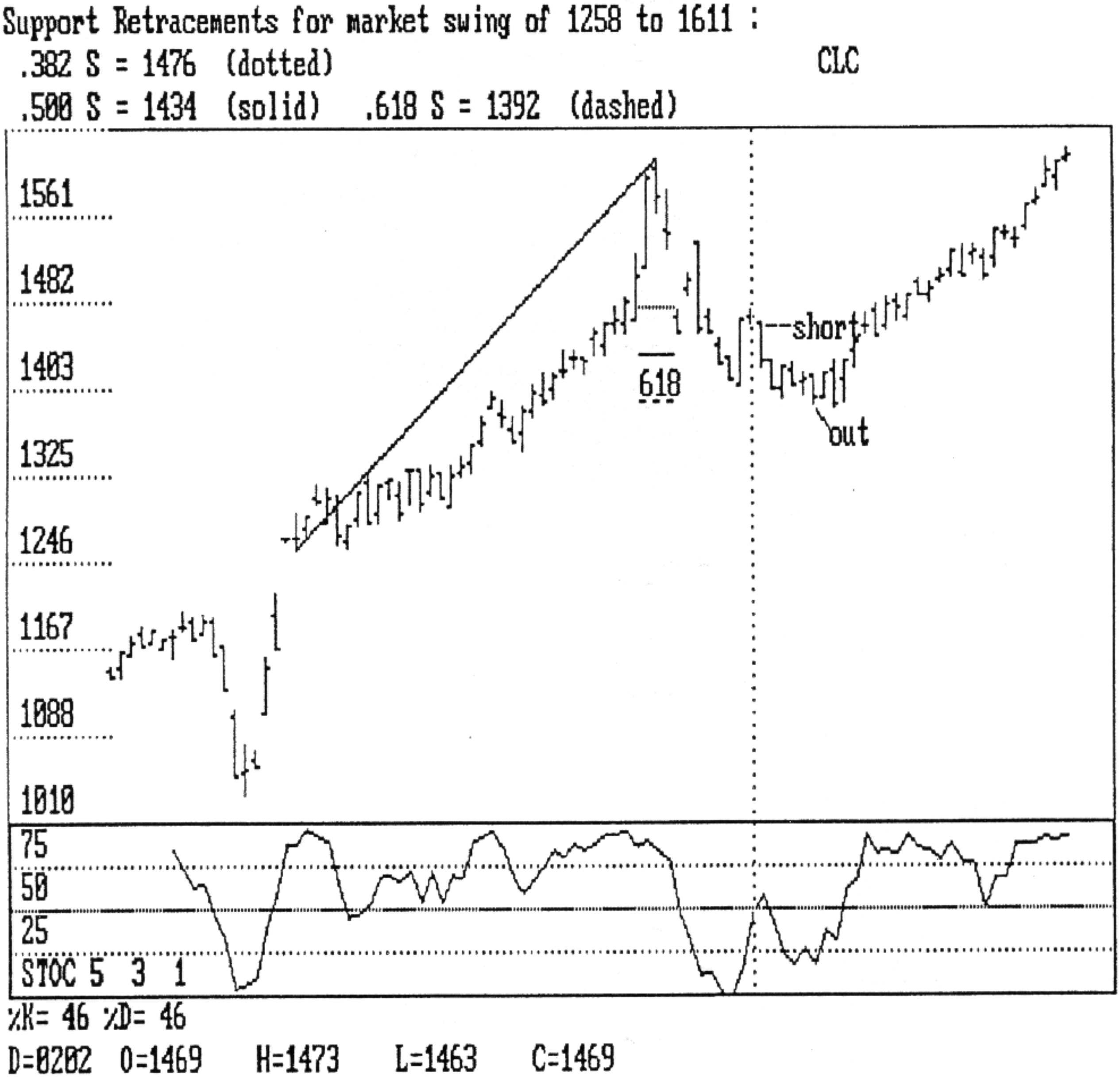


Figure 12 0202. The weekly oscillator for Crude Oil was pointing down after a rather large overall drop in prices. The daily oscillator had corrected and was back out of the oversold area. I phoned in an order to sell a breakout of the low at 1462 and was filled the next day.

Since prices were rather close to a Fibonacci support level, I decided to keep my stops fairly tight. I figured out where a .618 retracement of the latest main swing would be and placed a profit stop there. If prices would hit 1392 I would take my profits and run.

Six days later I was out, having made my profit objective.

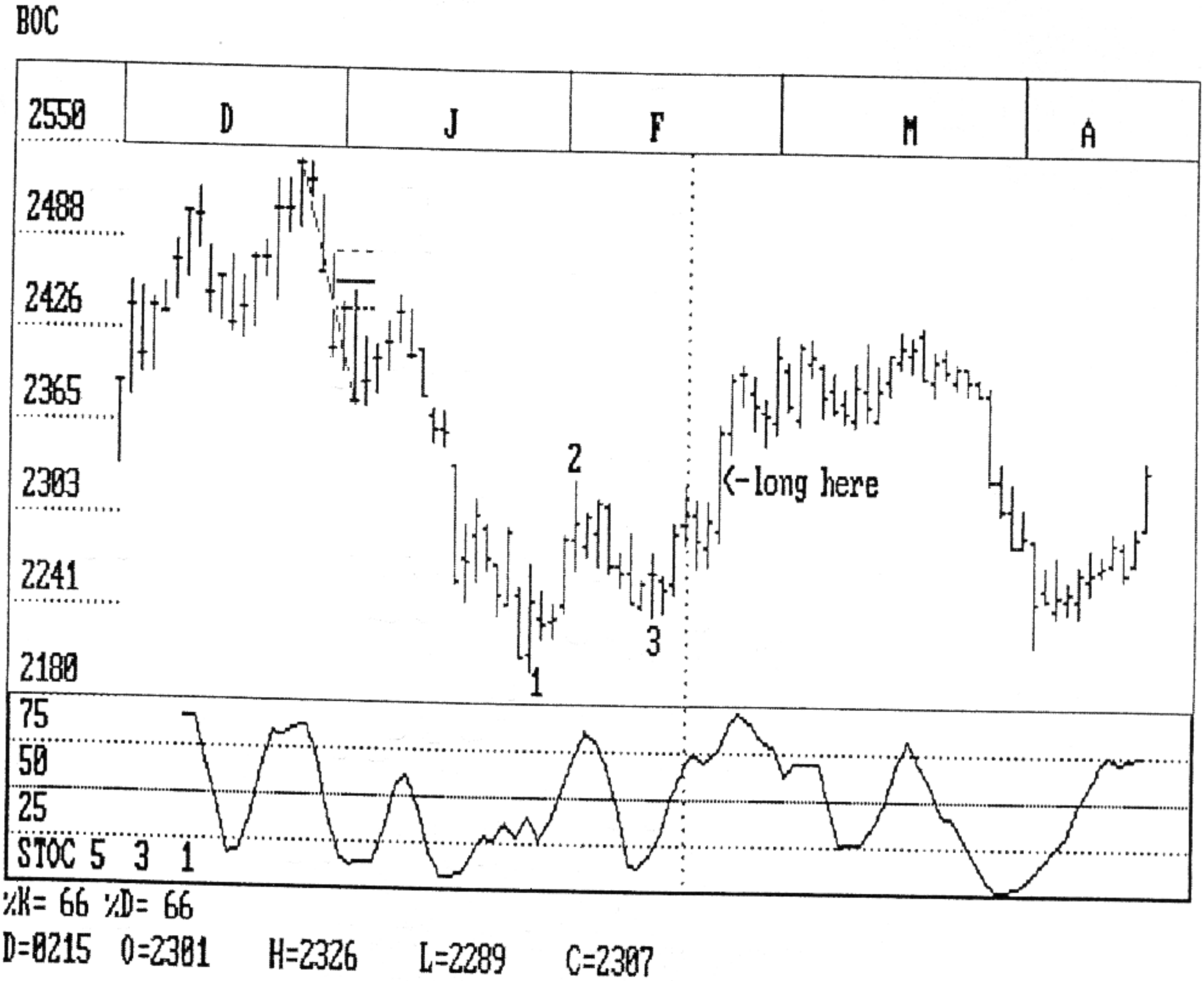


Figure 13 My next Bean Oil trade came on an upturn of the weekly oscillator. The trading opportunity came clear on 0215. I placed a buy order at 2330 which constituted a breakout of the #2 point of a 1-2-3 low and which was a bit higher than the high on 0215.

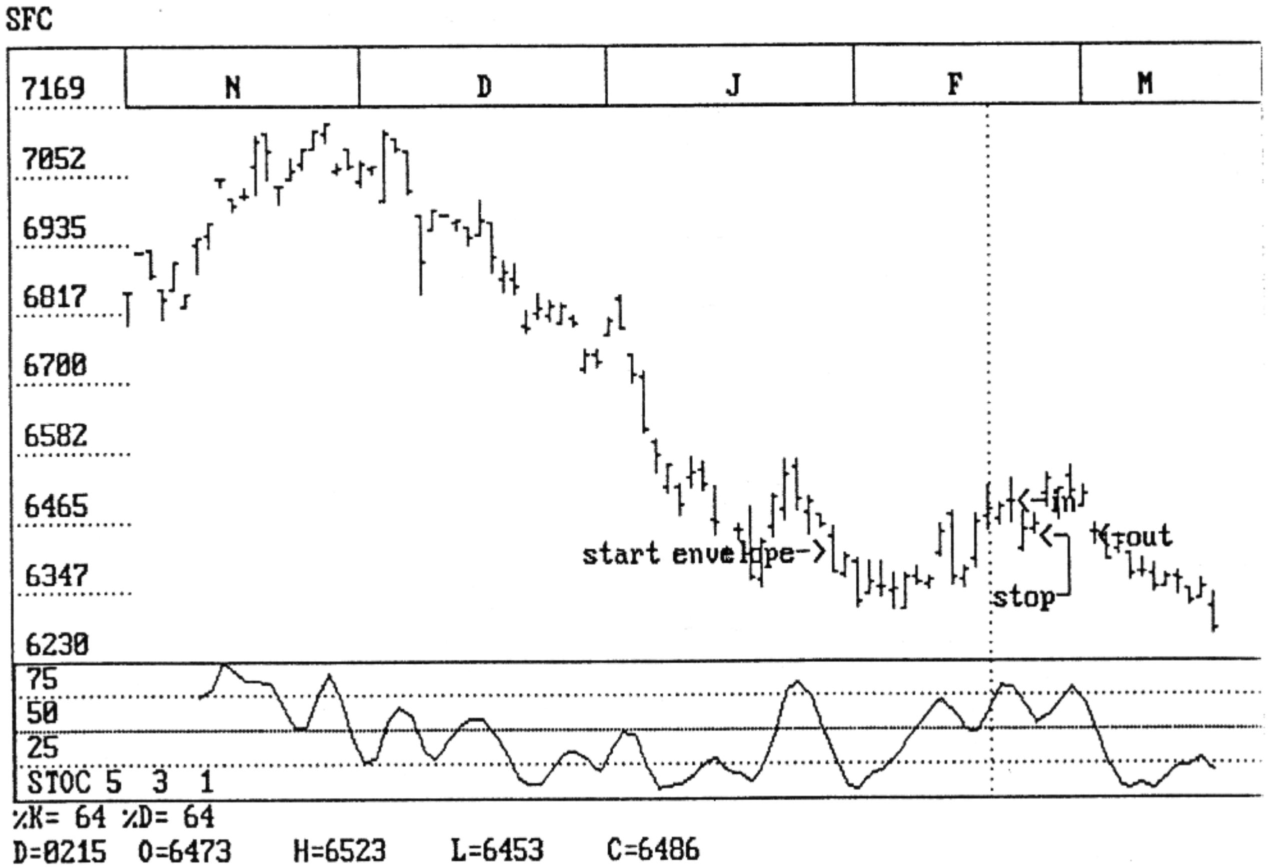


Figure 14 0215. The weekly oscillator for the Swiss Franc had turned up. The daily oscillator had made a correction and was headed back up. I placed an order to buy a breakout of the high for the day at 6524, but the next day brought an inside day.

Looking back I could see that a trading range had formed. It just hadn't been clear to me previously. I drew the envelope (see Figure 18) and placed open orders "stop close only" on either side of the envelope. Counting back to a representative plunge down by prices, I could count exactly 25 days.

I now had a 1-2-3 inside an envelope with rising bottoms on both price and the daily oscillator, so I also placed a buy stop above the day's high at 6497, and was filled the next day.

The following day, prices gapped down at the open but then rallied somewhat by the close. I began to sweat. I gritted my teeth and decided to wait for the correction to correct. The next day was a bit better. I moved my stop to just below the correction low, and the following day prices gapped up. I inched my stop up a bit, and prices inched up too. Six days after having entered the trade, I still couldn't pull my stop up to breakeven. On the seventh day, I was stopped out for a 55 point (ouch) loss. I decided I'd never eat Swiss cheese or yogurt again. Not only that, but I missed the ledge that would have let me reverse and go short instead of just being stopped out. I called myself a few names (in Swiss), for stupidity.

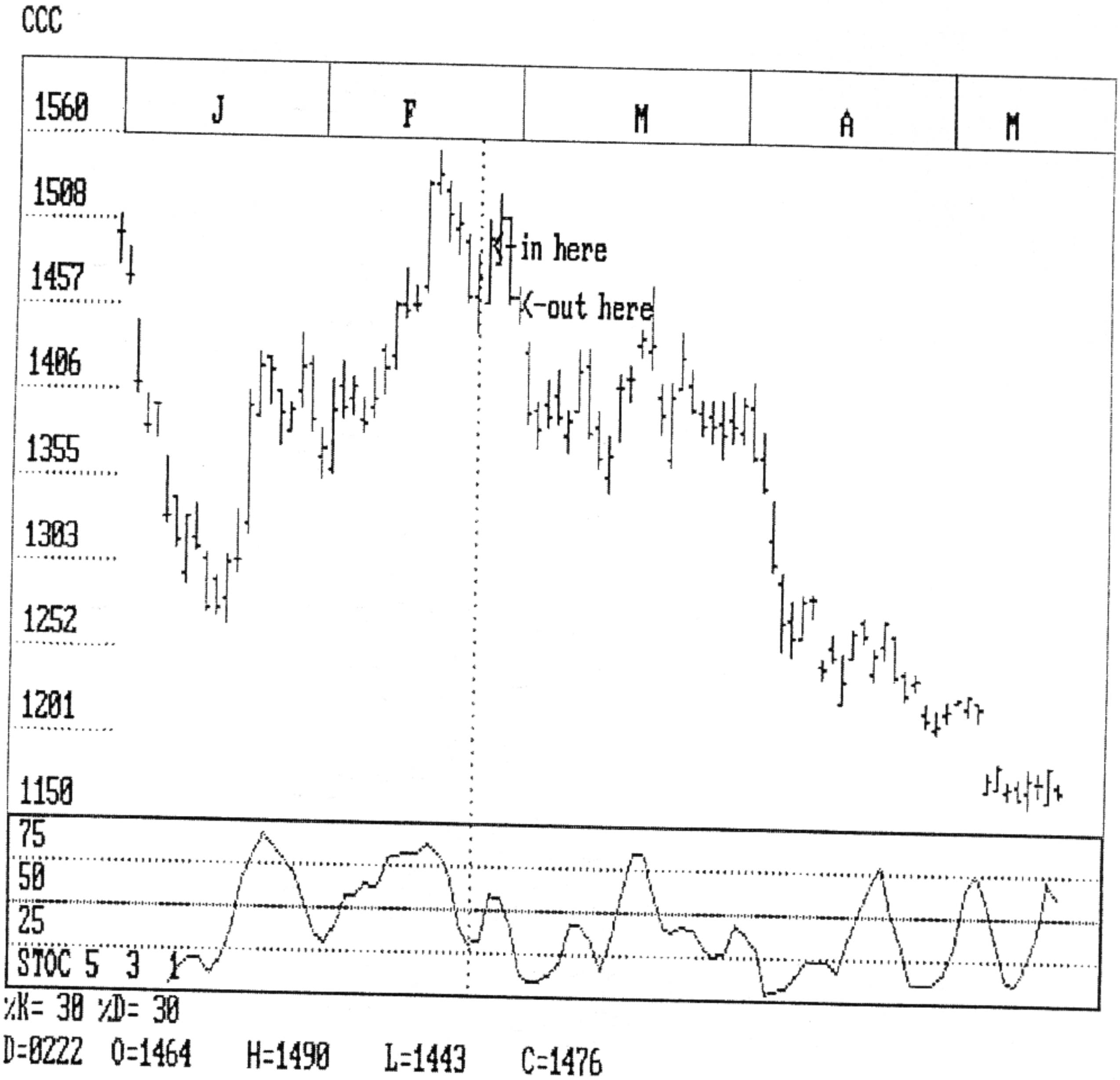


Figure 15 0222. The daily oscillator for Cocoa had reached 30. I placed a buy stop at 1491, with a protective stop at 1442.

I was filled on 0223. Prices moved up for two days, then dropped sharply. I moved my stop to the low of the down day and was stopped out for a loss of 30 points the following day.

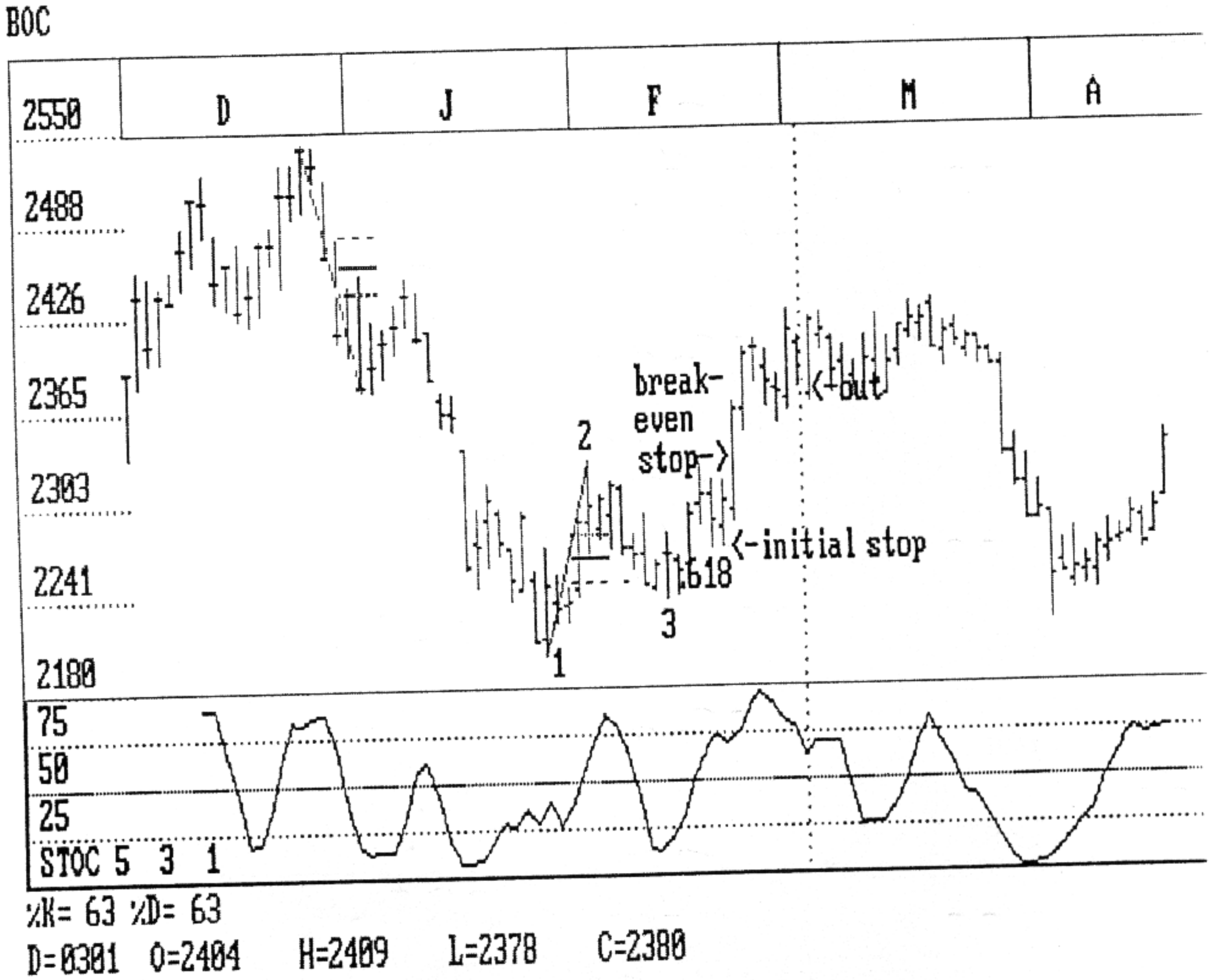


Figure 16 0301. This 1-2-3 formation for Bean Oil had exceeded a .618 retracement of the #1 point, but had never closed below the .618 retracement line. I've shown the Fibonacci lines.

My fill came on the third day after placing my order. Due to the large magnitude move day, I was able to place my stop at breakeven after the market closed. Also due the large magnitude of the move, I expected and subsequently got a trading range.

I've shown my initial stop, my breakeven stop, and the stop that took me out of the trade, which was below the low of the inside day, right after the market topped out.

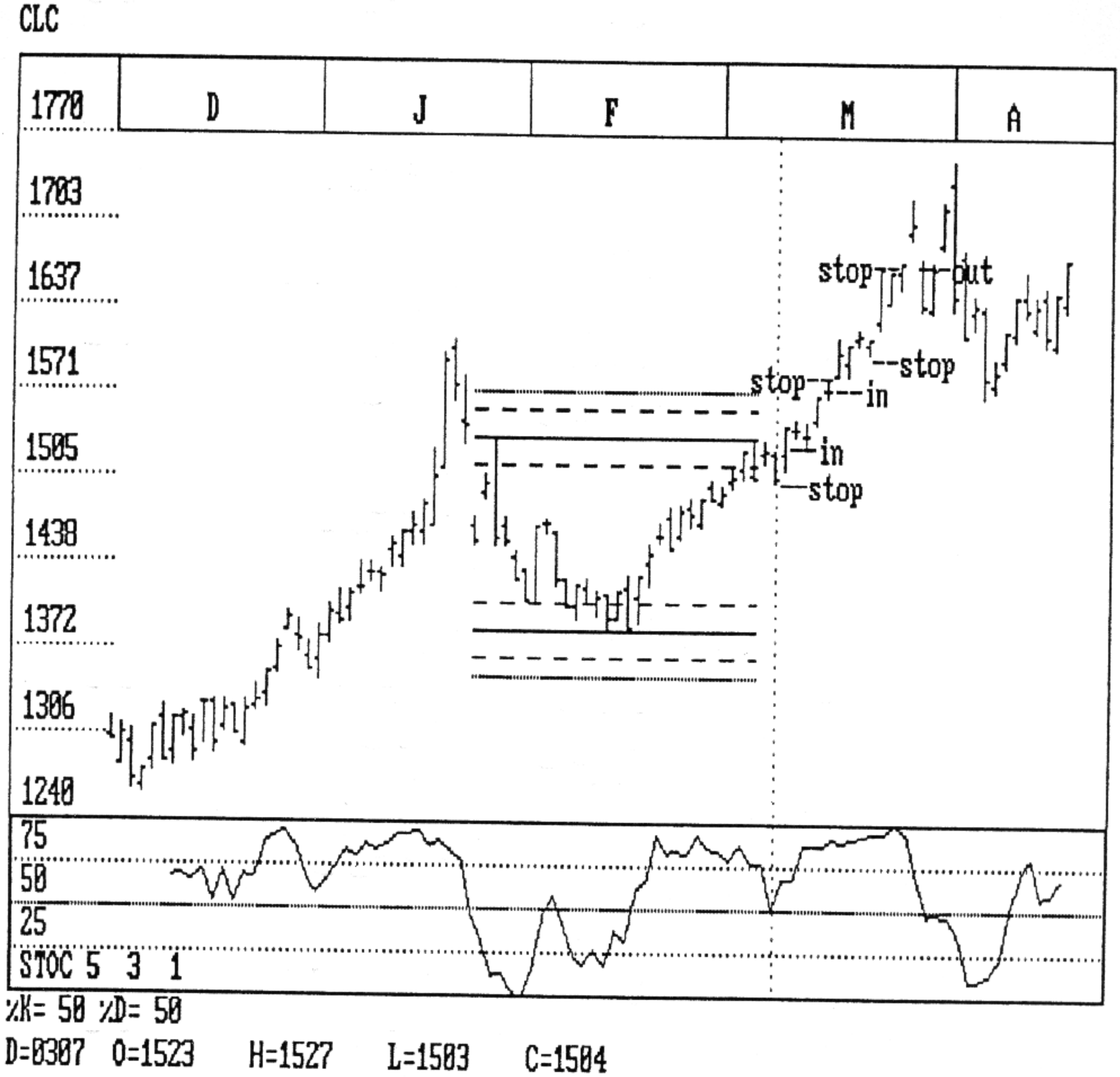


Figure 17 0307. The weekly oscillator for Crude Oil was pointing up as Crude had been trending for a couple of weeks. The daily oscillator had corrected, and was out of the overbought area.

I decided to try to buy a breakout of the high and called in an order to buy at 1526 with a stop at 1502. I was filled the next day.

0314. Prices exited the upper limit of the envelope (1571) closing at 1574. I was filled at that price.

I set my stop in place along side of the stop for my previous entry, and was out of both trades at the opening of the day shown on the chart. My final stop was just below the close of the day before the big gap, placed there on the day prices made the gap.

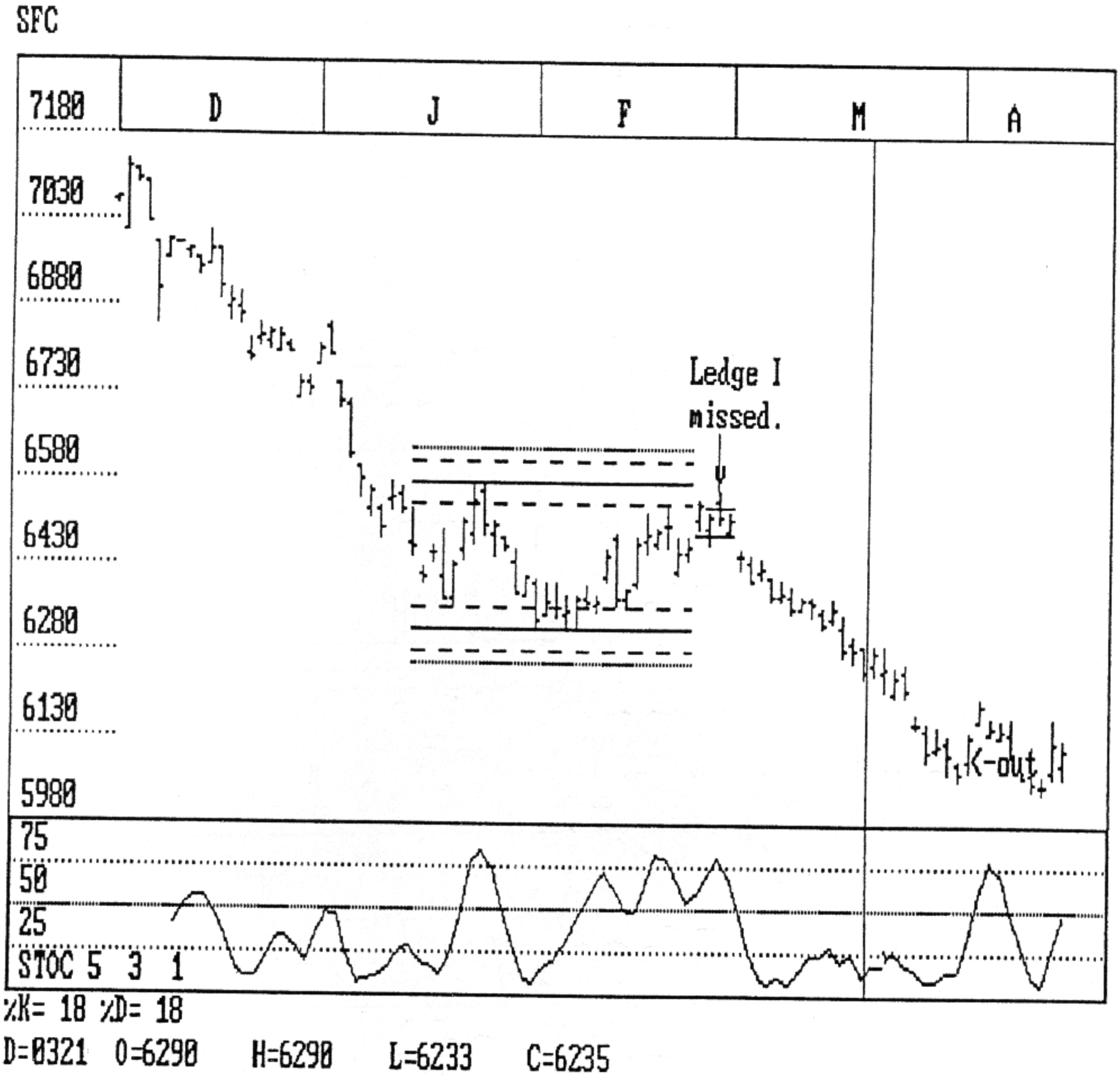


Figure 18 0321. Prices for the Swiss Franc closed outside the envelope and I was filled "stop close only" at 6235. Prices dropped on down and I trailed my stop to where I was stopped out as shown on the chart. Neither oscillator was of much help on this trade.

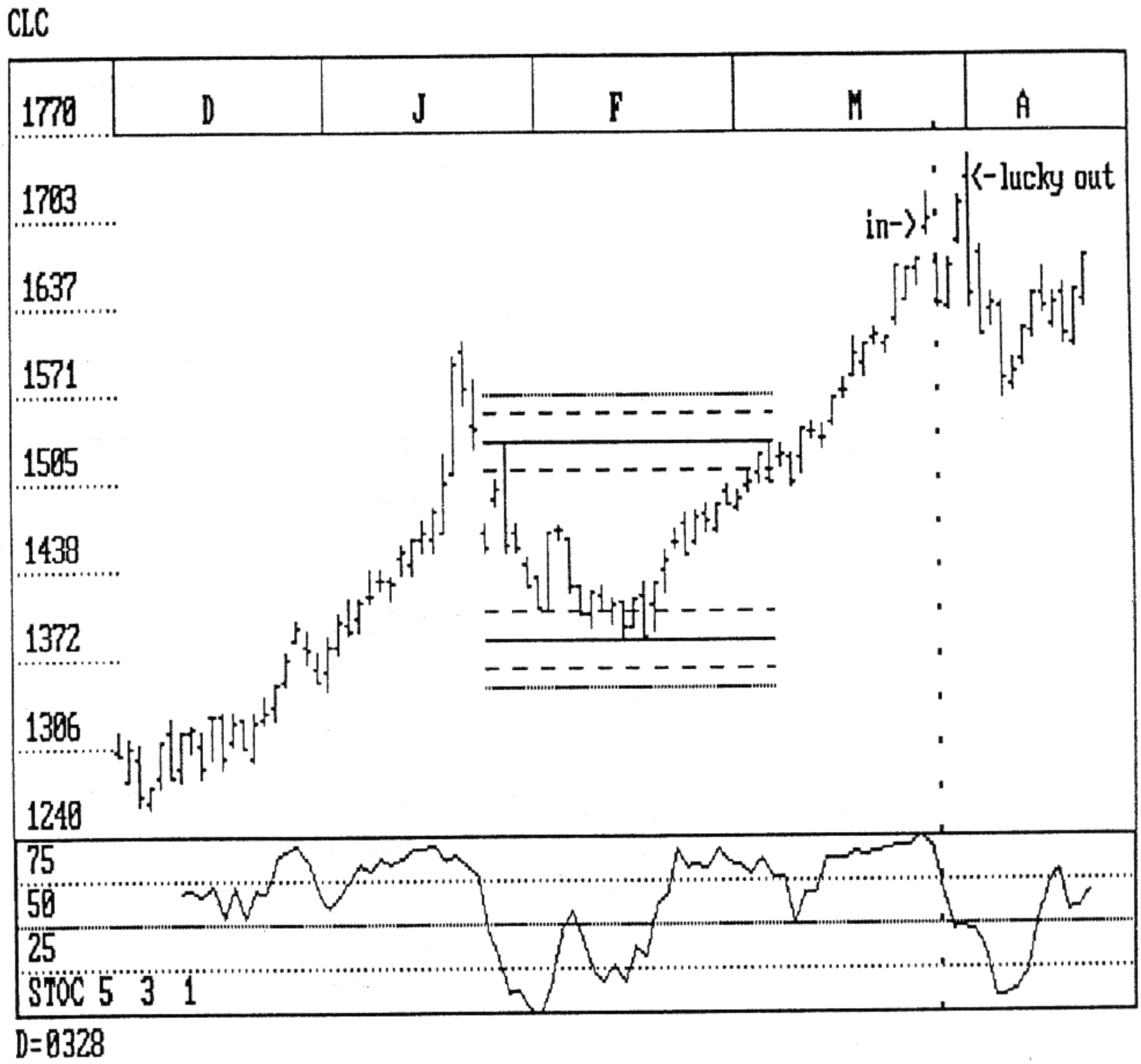


Figure 19 0328. The weekly oscillator was still pointing up after the long run up in prices. The daily oscillator was correcting from overbought. This day I was stopped out of my previous two trades.

I called in an order to buy a breakout of the high, but was not filled. The next day, I called in a order to buy the breakout of that day's high and was filled the following day at an opening price of 1687.

The gap up opening following the gap down of two days back made me nervous and so I decided to try for a profit making sell stop at 1716, which was the close of the gap up day. I also called in a sell stop at 1687 in case prices opened lower. The sell stops were called in as order cancels order.

I got lucky and was filled at my profit stop as prices gapped up at the opening and then retraced, taking me out of the market.

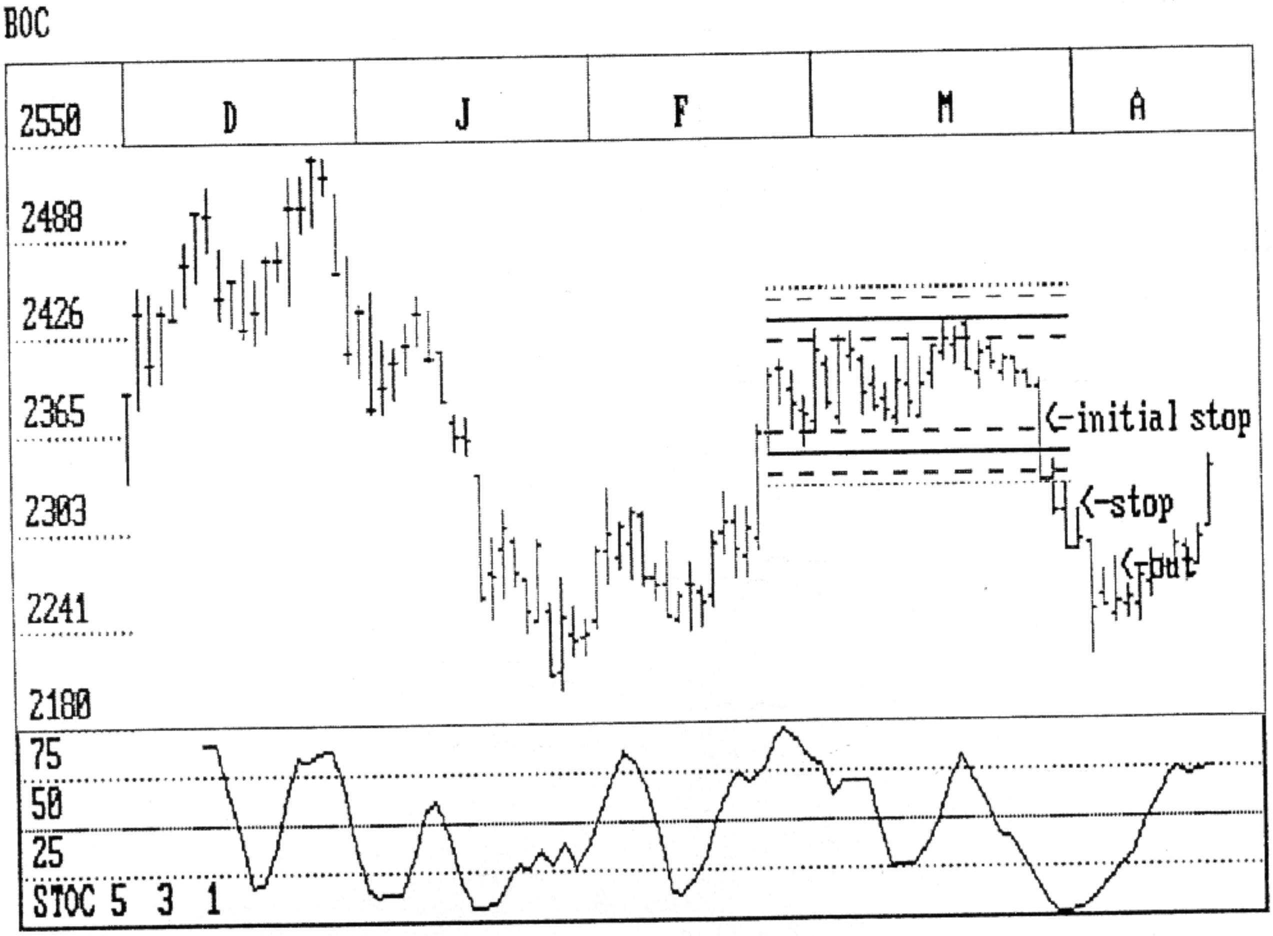


Figure 20 0328. Bean Oil prices went into a trading range which lasted 23 days. I took the .164 envelope breakout to the downside because the weekly oscillator had turned down in spite of the fact that the daily oscillator was oversold. I pay much less attention to the daily oscillator when prices are breaking out of an envelope.

Another factor in my thinking was the momentum behind the explosive down-move of that large magnitude day.

I was short, stop close only, at 2332 which was five points below the mid-out low of 2337. Obviously prices had come into the envelope like a lion and were now exiting like a lion. I've marked my stops as they occurred and was stopped out at the high of the inside day that occurred right after the alert causing, large magnitude day that marked the bottom of the turnaround to higher prices.

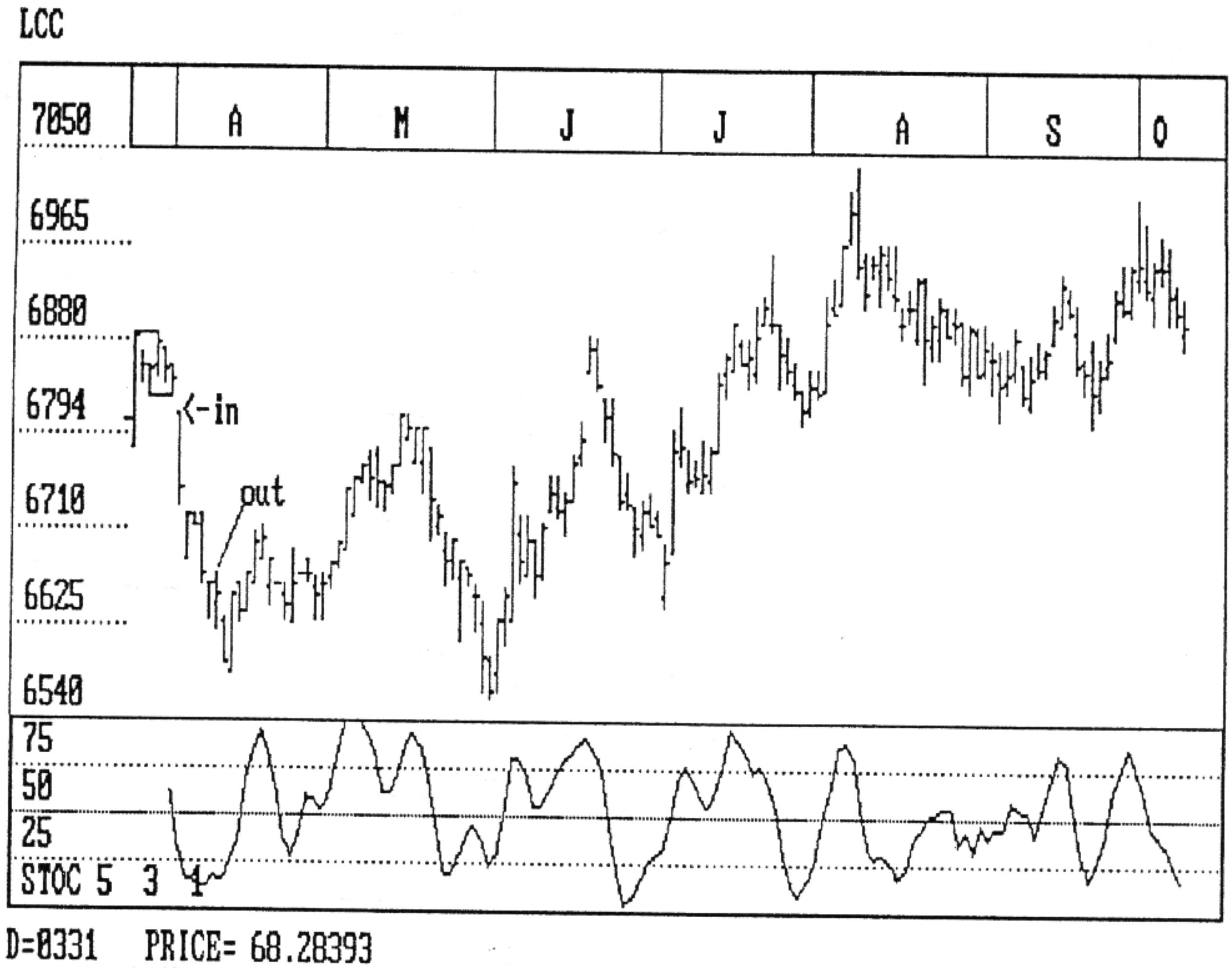


Figure 21 0331. Live Cattle prices formed a ledge, so I called in an order to buy a breakout of the high at 6883 or sell a breakout of the low at 6831. Whichever way I was filled, the opposite side of the ledge would constitute my protective stop.

I was filled the next day at the open as prices gapped down.

I trailed my stop on down for four days and was stopped out as shown on the chart.

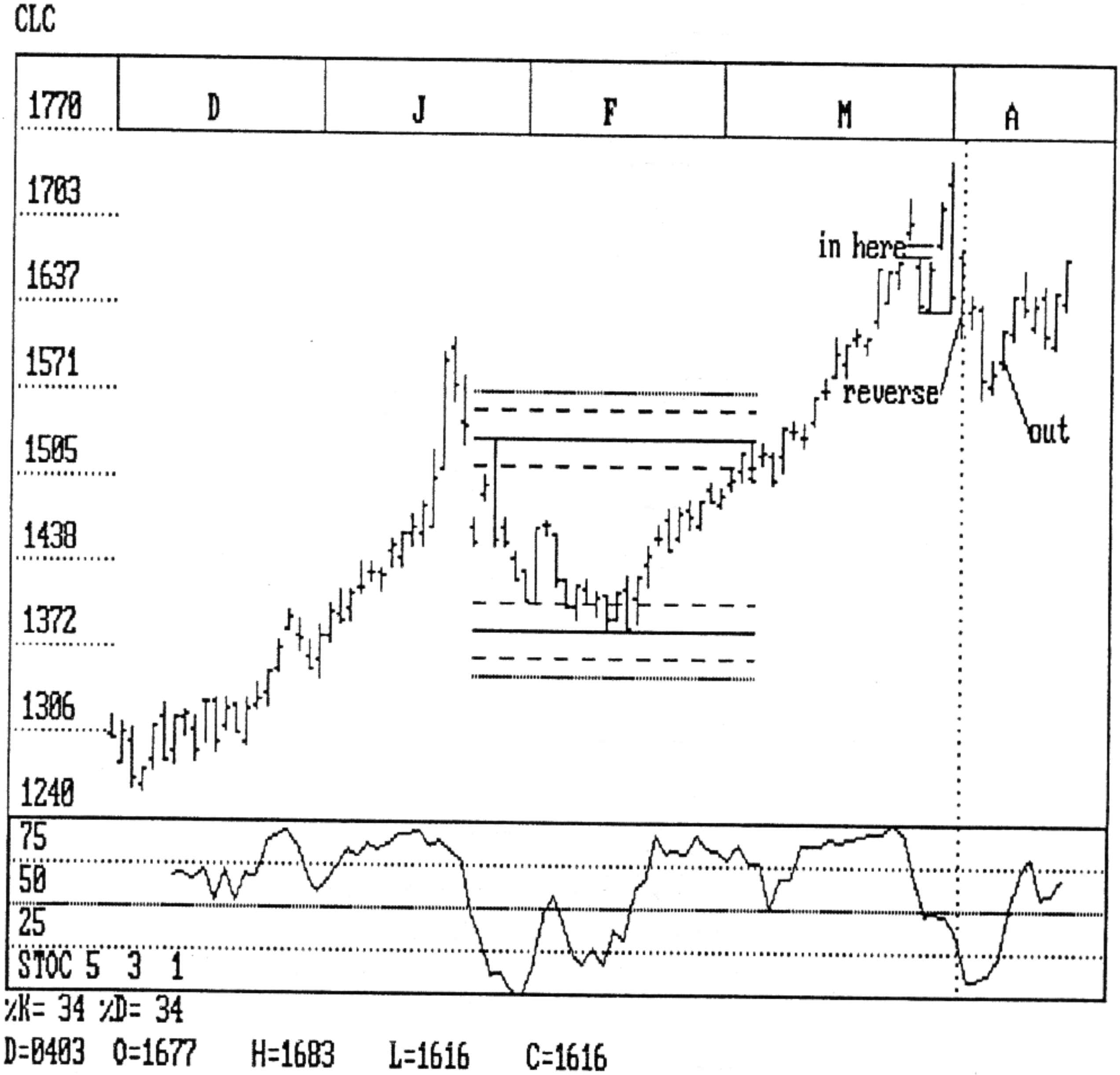
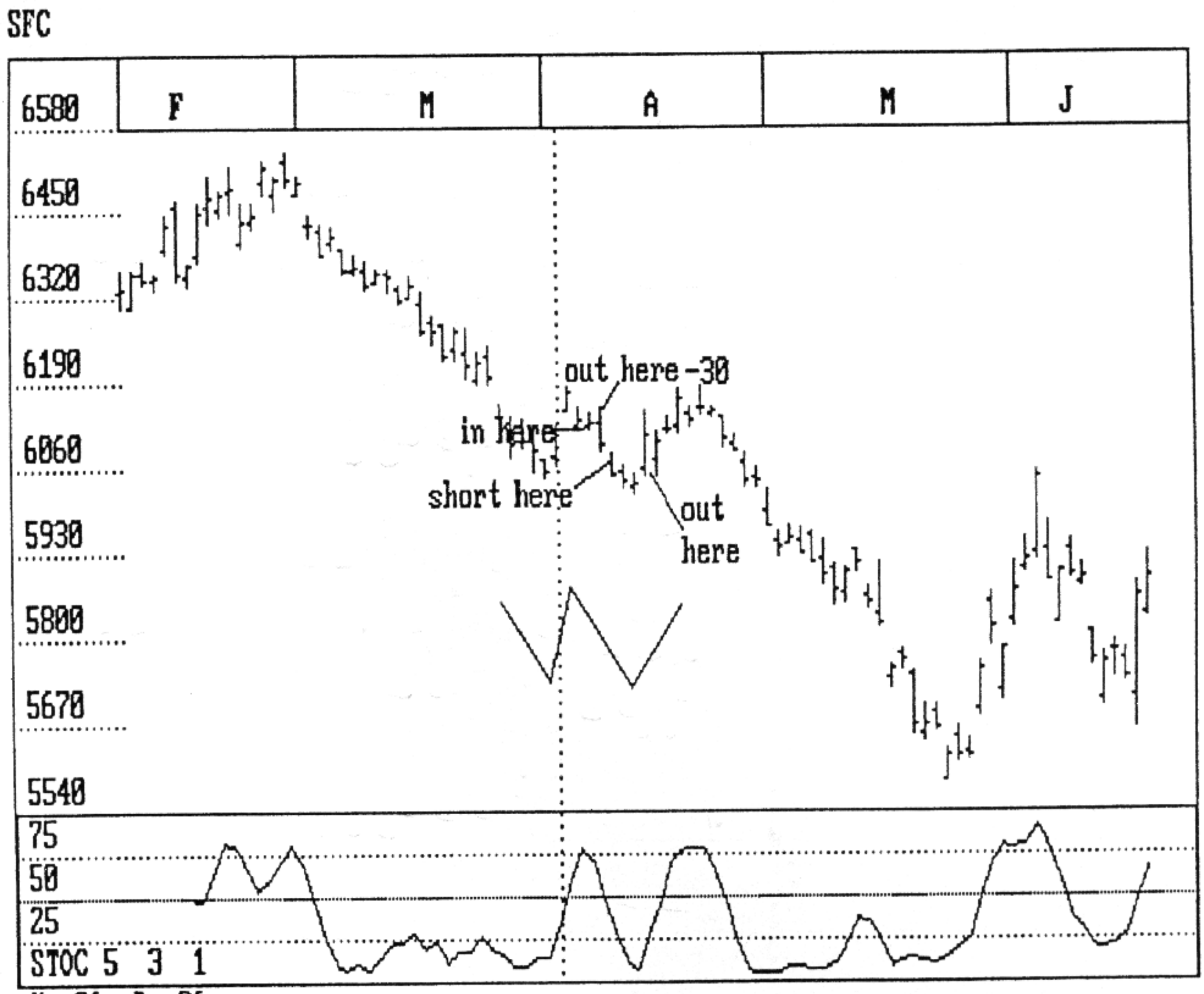


Figure 22 0331. The same day that I got out of Crude Oil with a lucky profit, the low for the day formed a perfect ledge (two matching highs and two matching lows) as shown on the chart.

I phoned in an order to buy a breakout of the top of the ledge (1675), or sell a breakout of the low (1636). Whichever side would be filled would have the other side as its protective stop. When I am trading from a ledge, as soon as I am notified of my fill, I double the opposite side order (if it is not too far away) so as to make it a reversing stop.

I was filled to the upside shortly after the opening, and my reversing stop (down 39 points) was hit later that day. Four days later I was out, having made back all but one point of what I had lost.



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D=0403 O=6076 H=6126 L=6064 C=6121

Figure 23 0403. The weekly oscillator for the Swiss Franc was still down. The daily oscillator and prices began to make a correction. The following day prices gapped up so I didn't try to sell a breakout of the low.

The next day prices gapped down at the opening and filled the gap made the previous day. The daily oscillator was now overbought. I placed an order to sell a breakout of the low at 6138 and was filled the next day as prices made a low of 6137. The following day I was stopped out as prices made an outside day. I took a 30 point loss and placed an order to sell a breakout of the low. I was filled the next day at the open, at 6084.

Prices went down for two more days, and I moved my stop to 6054 hoping to make back at least my previous loss.

The next day prices gapped up at the open, taking me out of the market with only a 7 point gain. I was now looking at a big \/\/ on the chart, so I started an envelope.

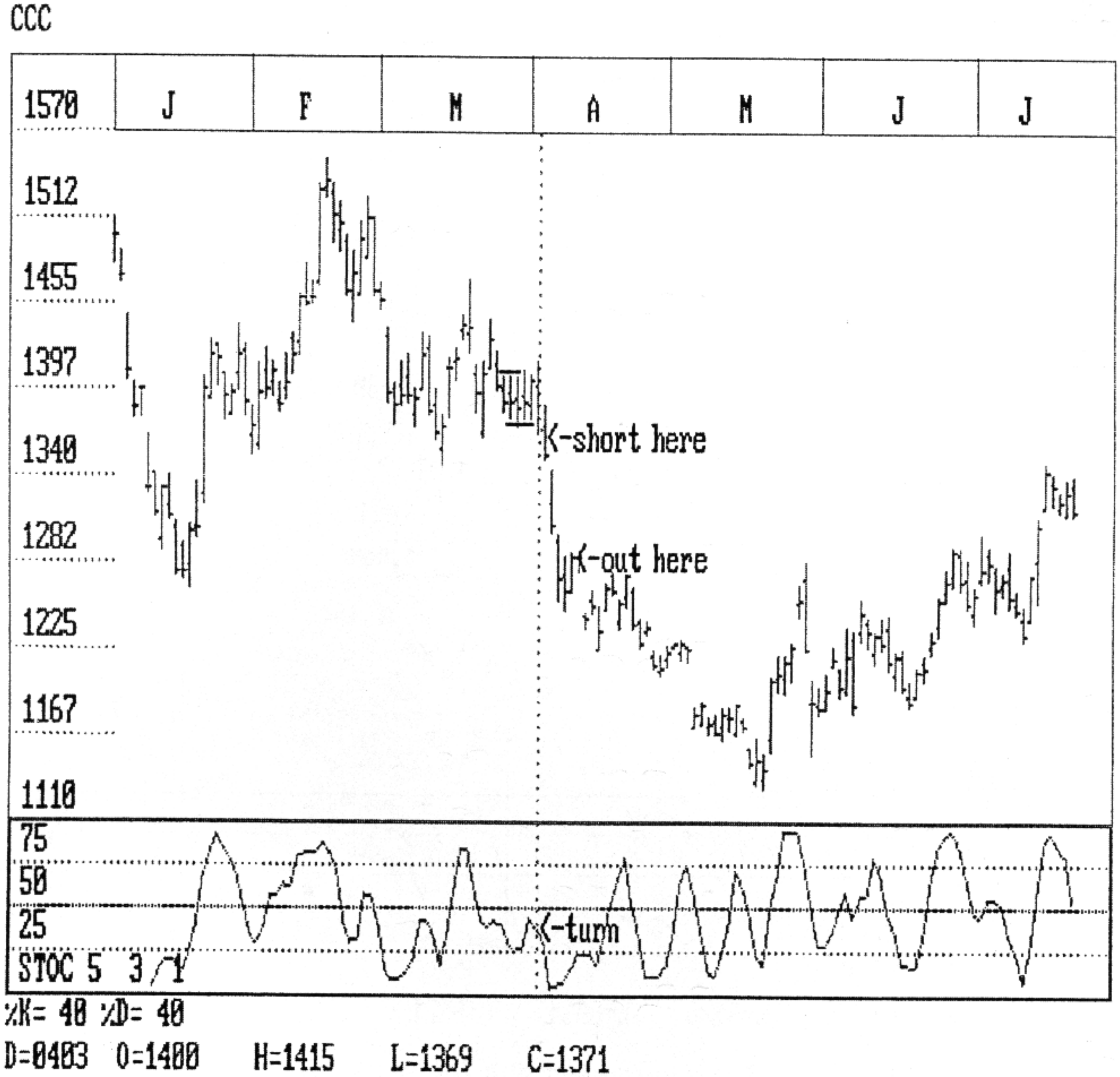

Figure 24 0403. Cocoa prices formed a ledge. The weekly oscillator was dead flat. The only indication available was from the daily oscillator. It had been signaling an upside breakout. Then the daily oscillator turned down and prices just broke the bottom side of the ledge. I place an order to short below the low of the breakout day, and was filled.

Prices fell nicely. I took profits on one contract at my objective and I trailed my stop on a second contract keeping it tight. I've shown my entry point and the level at which I got out with a profit.

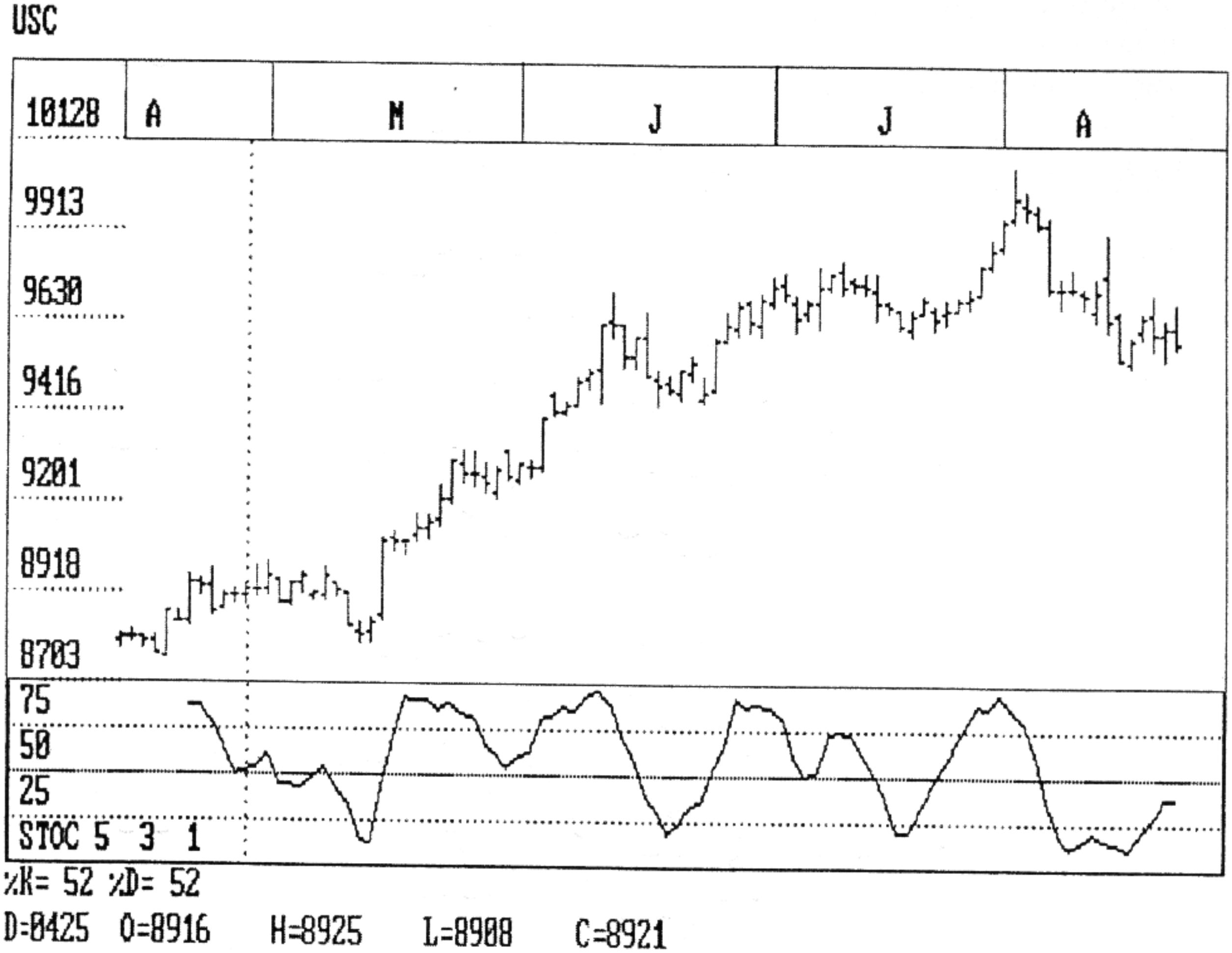

Figure 25 0425. The weekly oscillator segment for Bonds had been pointing up for three successive days.

The daily oscillator had been overbought, had made a correction, and was beginning to turn back up. I placed a buy order at 89-26, looking to go long on the breakout of the high at 89-25.

Since I use commando tactics with the Bonds, I placed a contingency profit stop order ten ticks higher at 90-03, along with my protective stop.

On 0426, I was filled. Prices moved up, filled my profit objective, and I was out of the market. I didn't like the close (too low), so I didn't place any more orders

On 0427, prices moved up and closed near the highs. Both oscillators were giving a long signal, so I placed a buy stop at 90-12, a contingency profit stop at 90-22, and a protective stop at 89-15. I wasn't filled and the daily oscillator turned down, so I placed no more orders even though the weekly oscillator was still pointing up.

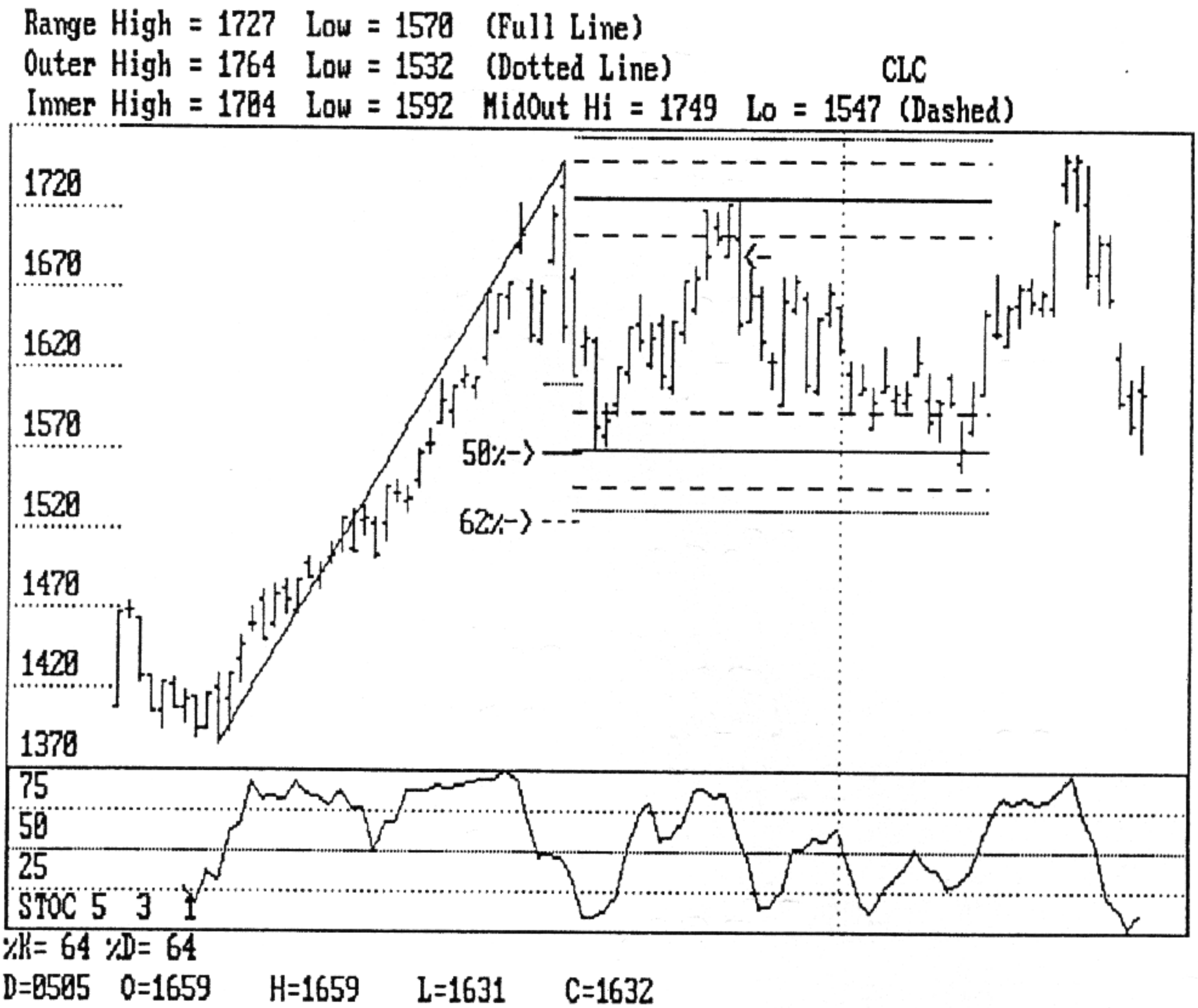

Figure 26 0505. There are some important things about market symmetry that I want to point out on the Crude Oil chart.

By this date (25 days) it was clear that prices were in a trading range. I had already had the basis for an envelope and had drawn one based for its inception upon the day after the large magnitude move that had made the high of the last leg up. Interestingly, the bottom of the trading range was just fractionally above a 50% Fibonacci retracement of that last leg up, while the outer low of the range was slightly above a .618 retracement.

Because I had already drawn the envelope 7 days earlier, I began to very carefully scrutinize all possible trades in Crude Oil.

For example, on 0424 (shown with arrow), the weekly oscillator notched down based on a large one day drop. The daily oscillator was not yet oversold. Normally I would have tried to sell a breakout of the low. But because that low was already half way across the trading range, I skipped taking the trade.

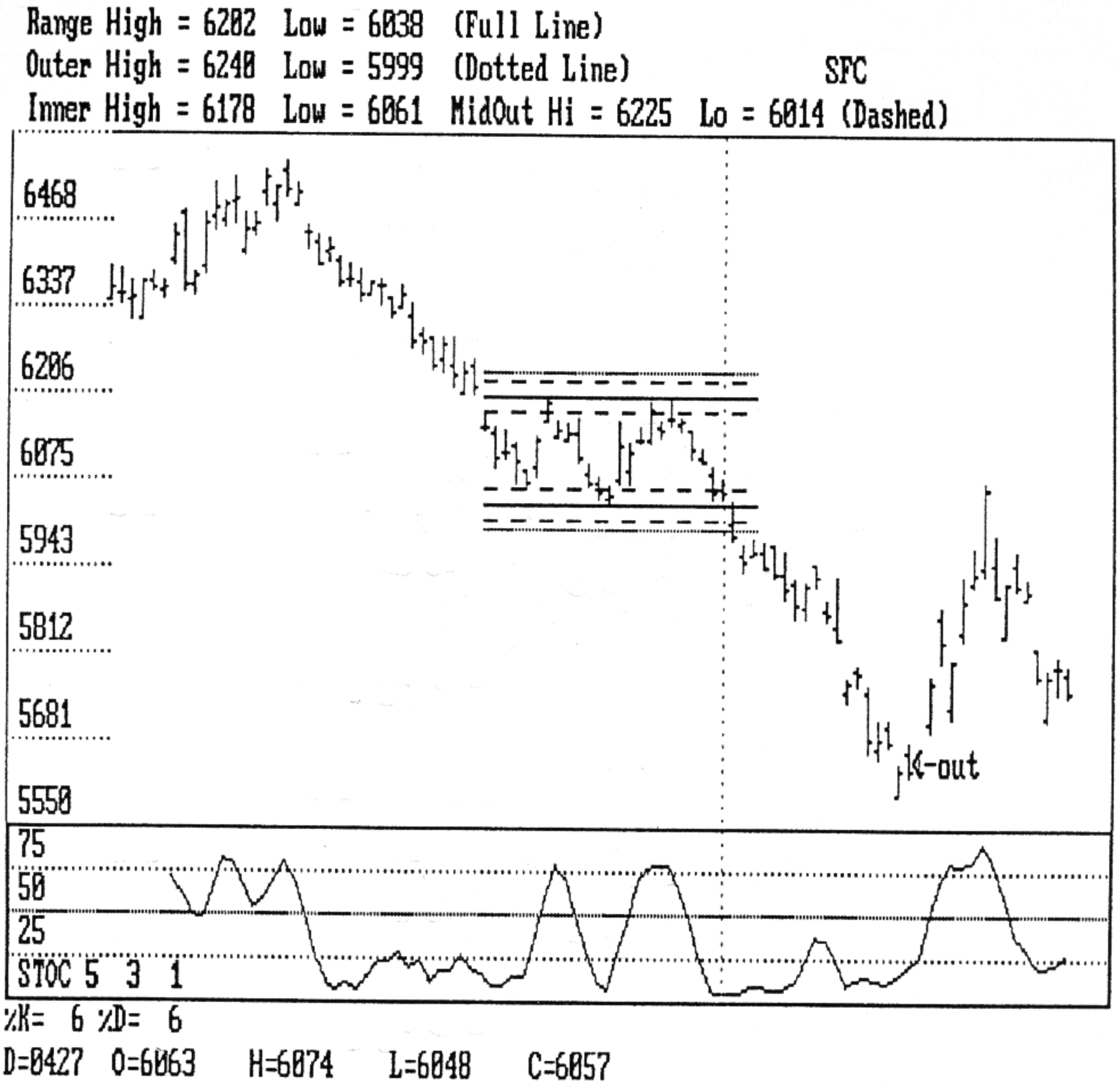

Figure 27 On 0427, the Swiss Franc had been in the envelope for 24 days. My buy stop was at 6241 and my sell stop was at 5999. On the twenty-fifth day, prices gapped down on the open, rallied a bit, and finally closed at 5989. My fill, "stop close only," was 5990.

I had no Fibonacci projection for this trade. I figured that this breakout might be a continuation of the previous downtrend, so I kept my stop at 6039 and held my breath for a couple of days. Then prices started down in earnest. I trailed my stop as shown on the chart, and was stopped out the day after the lowest low.

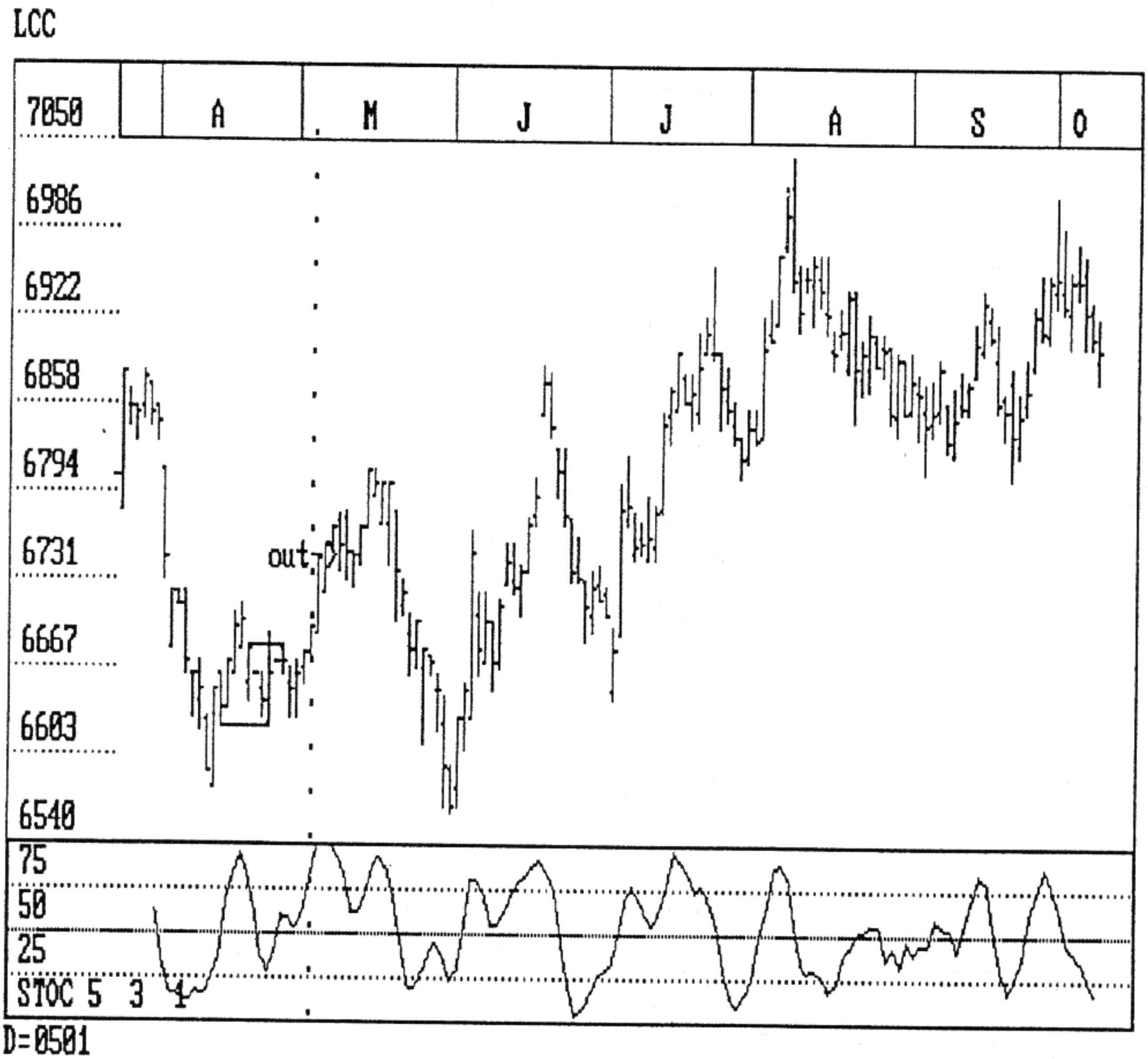

Figure 28 0501. With the weekly oscillator for Live Cattle starting to step up, and the daily oscillator making rising bottoms, I called in an order to buy a breakout of the ledge that had previously formed. I had called in the same order the previous two days.

I was filled on the day shown by the cursor, with my stop below the low of the previous day. I then trailed my stop until I was stopped out on an outside day as shown.

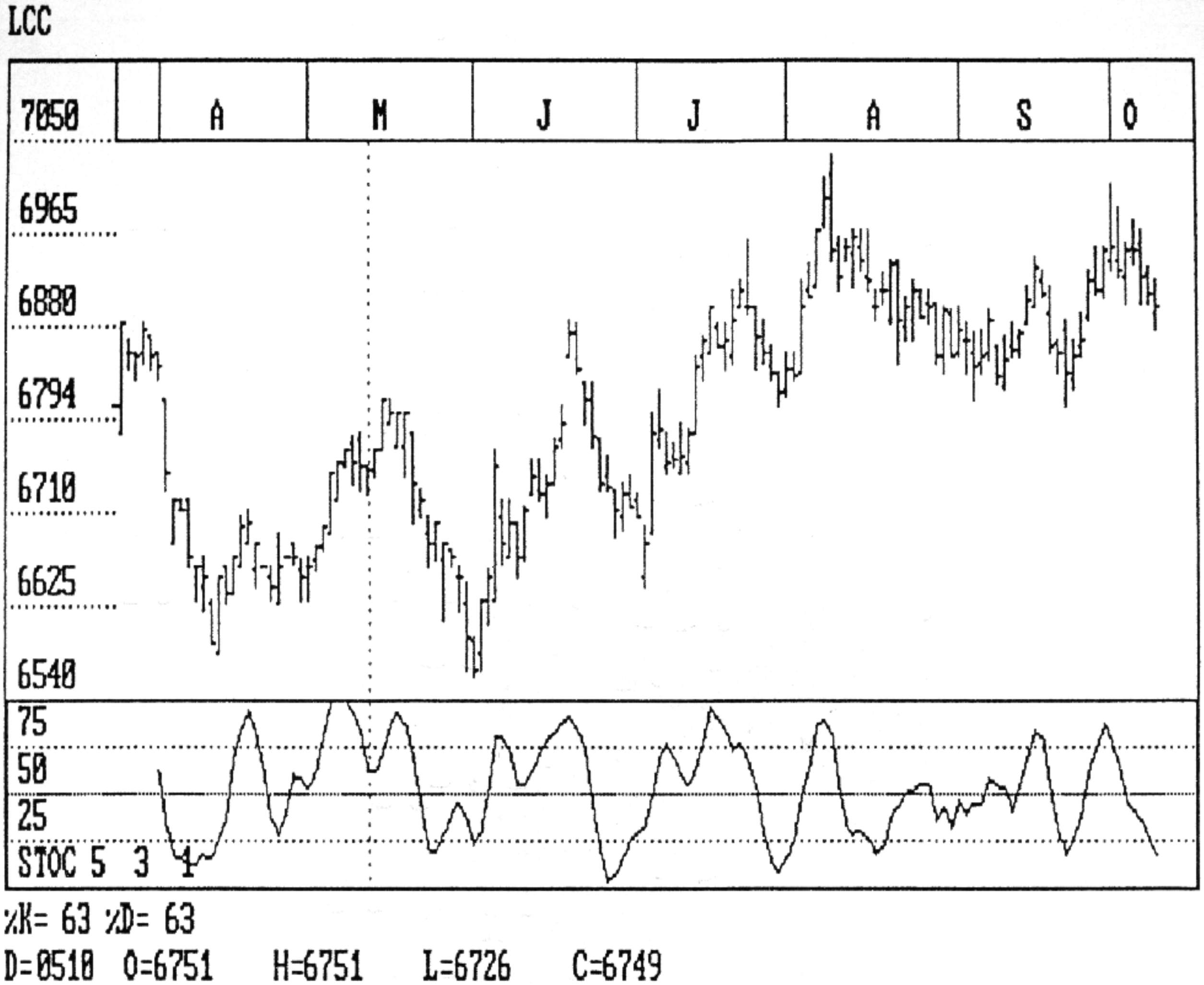

Figure 29 0510. With the weekly oscillator for Live Cattle still pointing up, and the daily oscillator having corrected out of overbought, I put in an order to buy a breakout of the daily high. My order was for 6752, and the next day I was filled, with my stop below the low of the previous day.

Prices closed on their highs, and the next day there was another large move up. I moved my stop to the low of that day. It turned out to be the high of the swing.

When the following day failed to make a new high, I moved my stop to one tick below its low, and was stopped out the following day at the opening with only a 20 point profit.

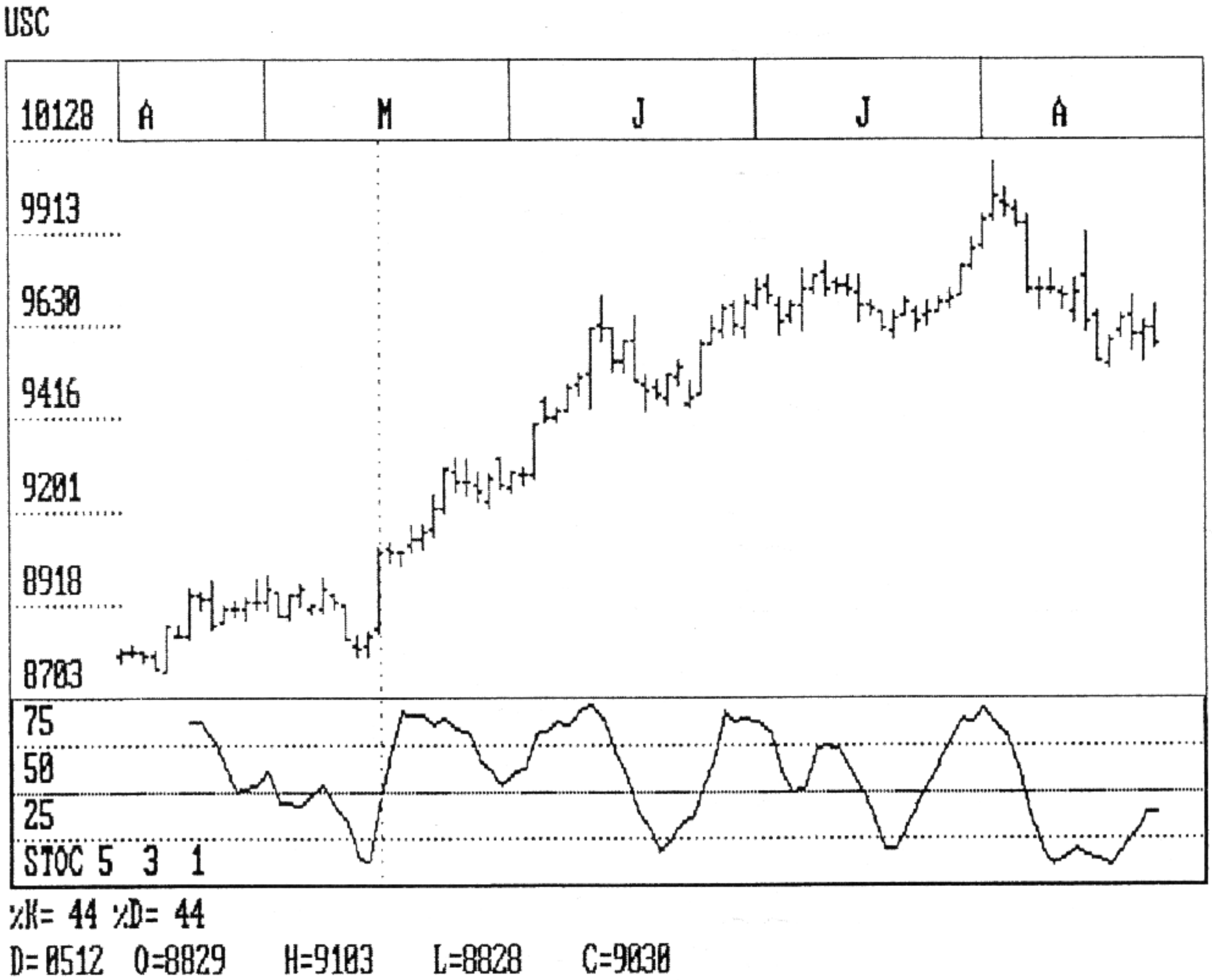

Figure 30 0512. The daily oscillator for Bonds turned up on a large move upward by prices.

0515. The weekly oscillator had been steady up for two days. The daily oscillator was not yet overbought.

I placed a buy stop above the day's high at 91-08 with a protective stop at 90-23 and a profit stop at 91-18. The next day I was not filled and the daily oscillator had gone to overbought.

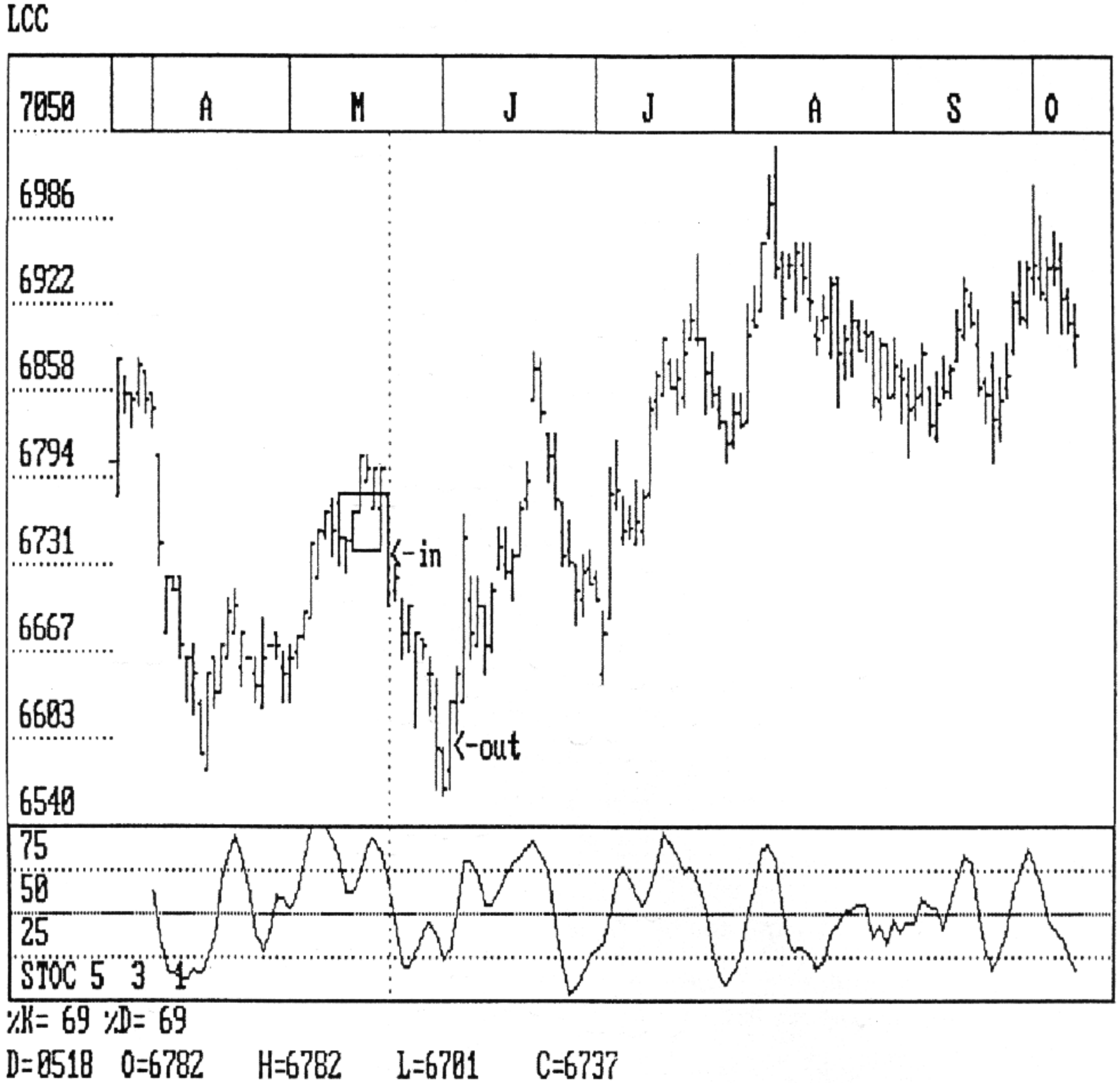

Figure 31 0518. Prices for Live Cattle formed another ledge. The weekly oscillator was flat and the daily oscillator had turned down and had come out of overbought.

I sold a breakout of the ledge shown on the chart and trailed my stop right on down to the high of the day that made the low of the swing, where I took my profits.

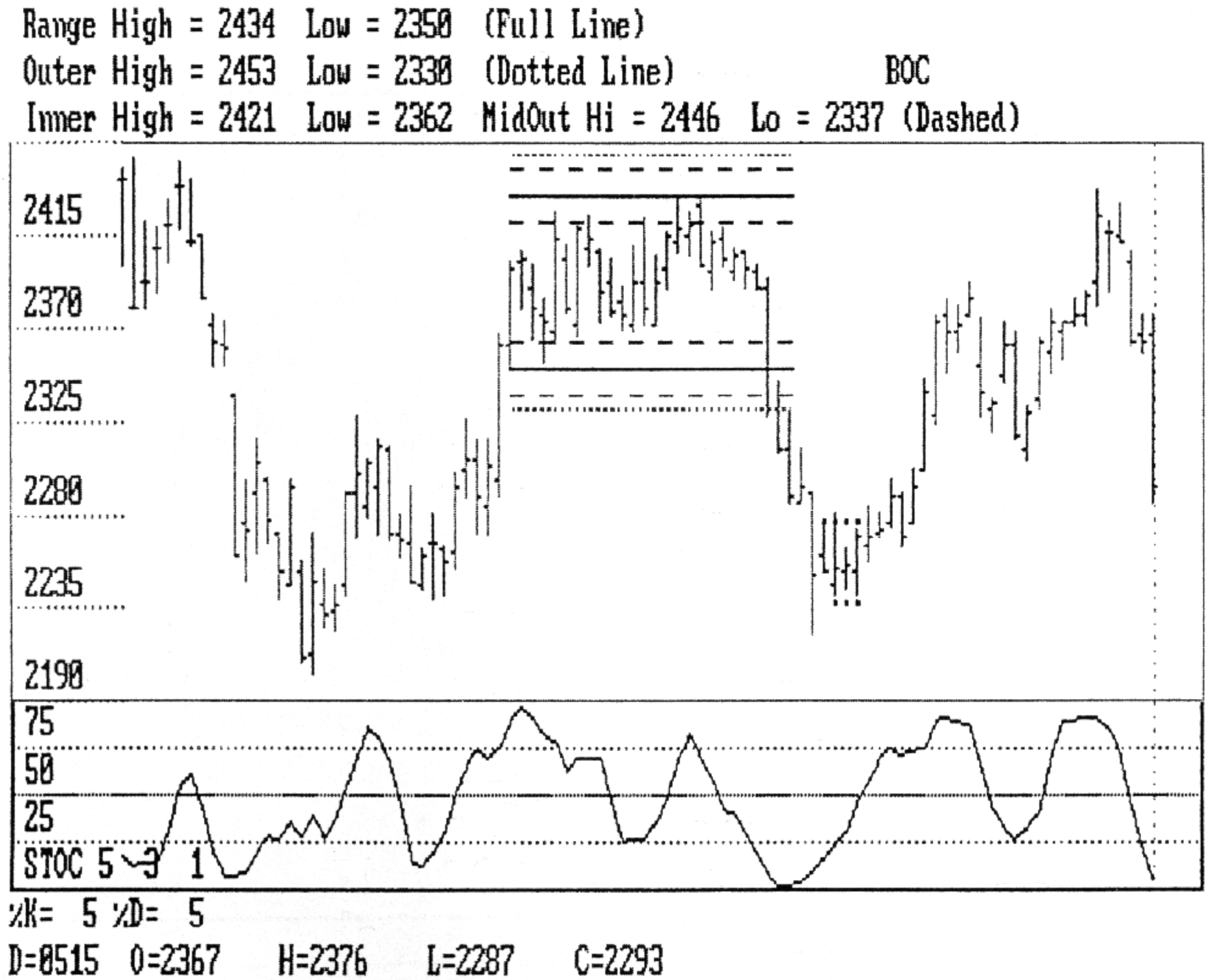

Figure 32 0519. By not seeing the ledge that would have enabled me to participate in the up-move that followed in Bean Oil, I missed the entire move because the weekly oscillator kept pointing down. By the time it pointed up, the daily oscillator was well into overbought. Since I had no further basis for entering a trade to the long side, I stayed out.

The weekly oscillator went flat, and by the time it pointed up, the daily oscillator was again overbought.

When the weekly oscillator finally gave a signal to go short, the daily oscillator was oversold.

I really didn't mind because, over all, Bean Oil was just in a huge sideways trading range. But I regretted missing that upmove although I was thankful that my methods were keeping me out of these possible whipsaw moves by the market.

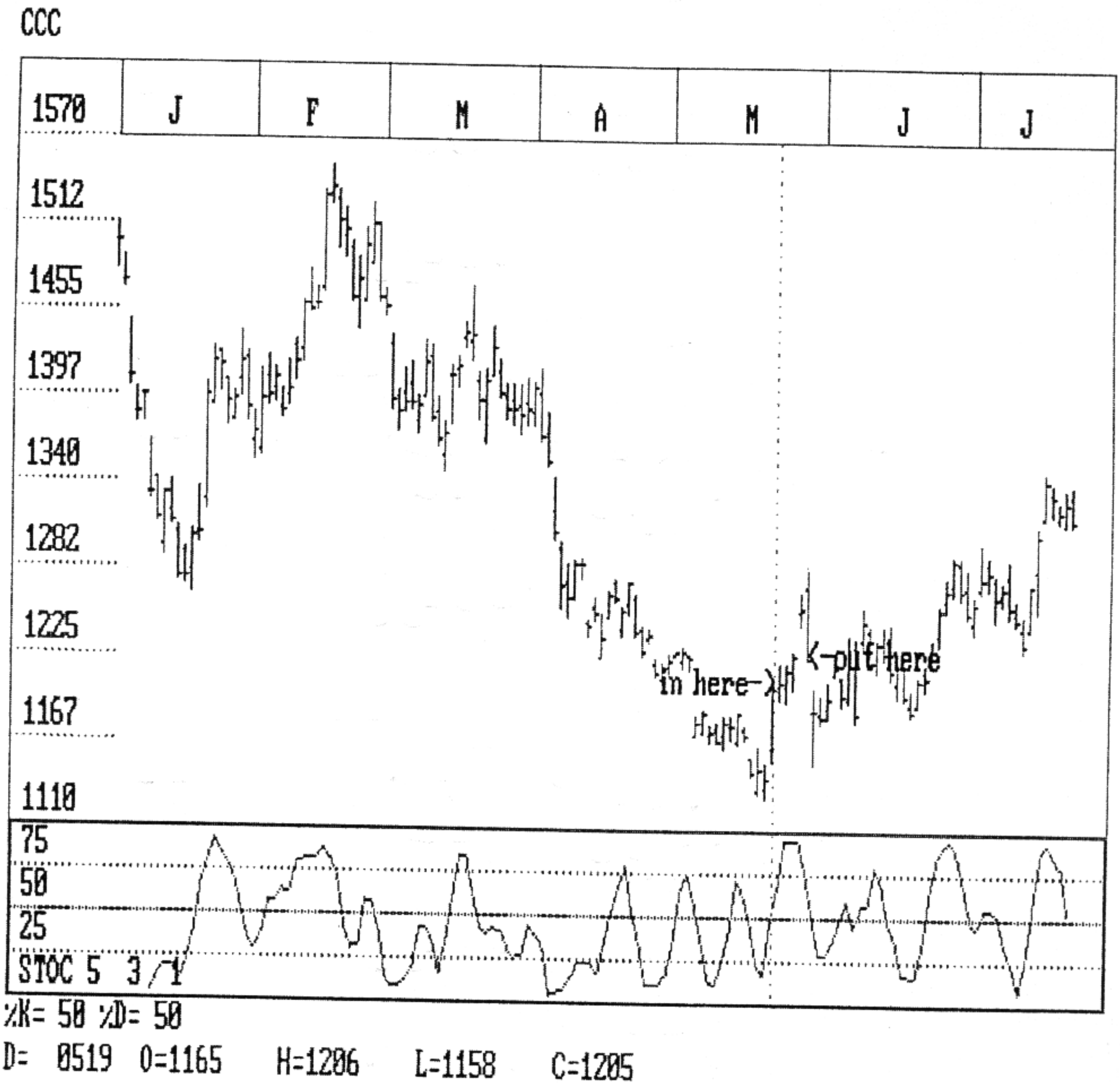

Figure 33 0519. The weekly oscillator for Cocoa had been flat, but began pointing up on a breakout day which brought the daily oscillator out of oversold. I placed a buy stop at 1207 and was filled the next day at that price. My initial stop was below the low of the previous day's low, far from the price action. I would have to wait a couple of days before I could move it up.

Finally prices gapped up. I moved my stop to just below the close of the day before the gap. The next day, I was stopped out at that price for about a 20 point gain.

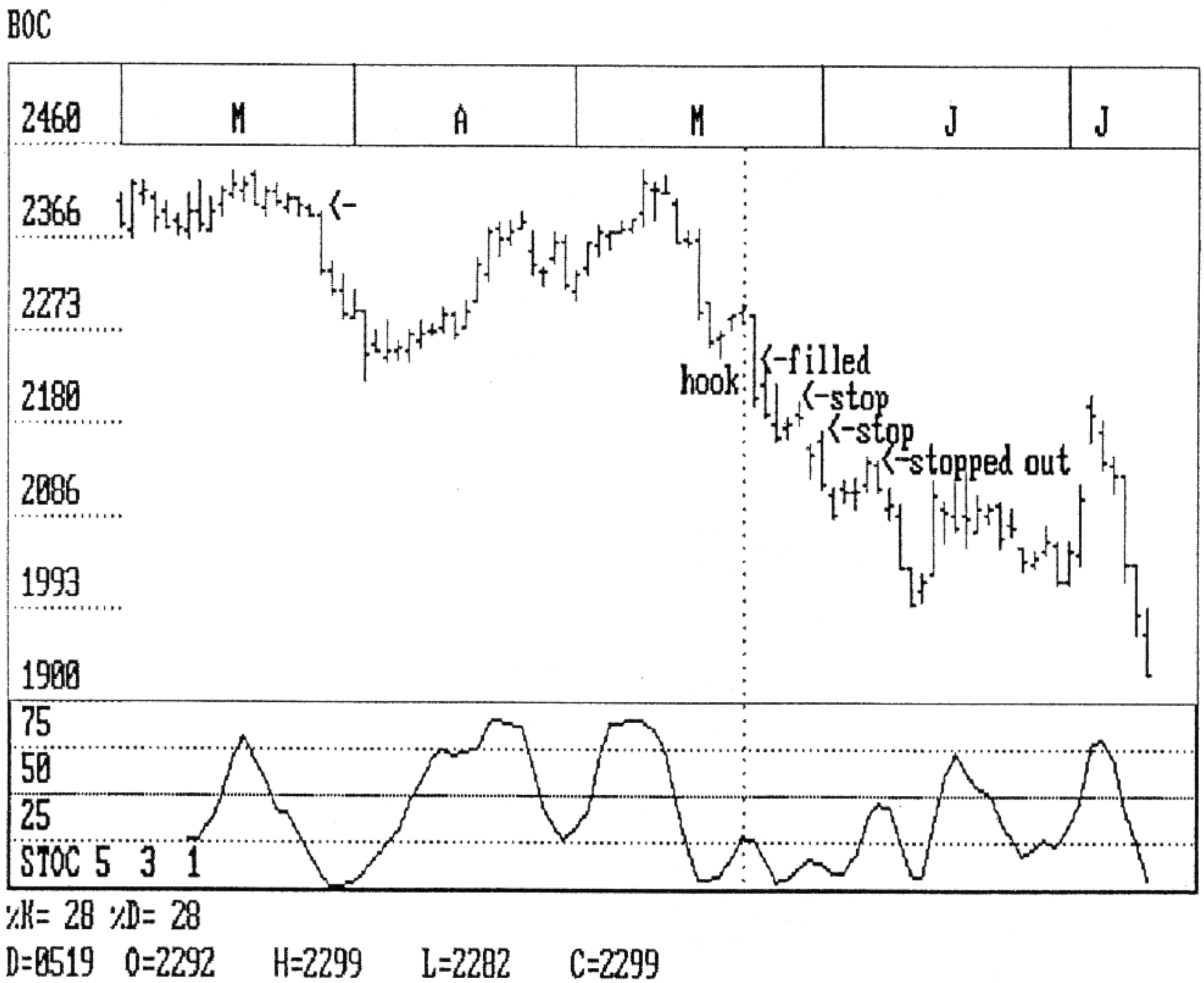

Figure 34 I've shown with the arrow where the previous envelope for Bean Oil had been located. I had been unable to enter any trades via the oscillators, as they kept on being out of synch with each other. Nor did I see any other basis for a trade during April and May while prices retraced back up into the range of the previous envelope and stayed there until about the third week in May.

On 0519, the weekly oscillator had been steadily dropping, and the daily oscillator had just come out of the oversold area. In essence, what I had in front of me was a Ross hook. If prices dropped below the recent low, chances are it would be a good short. I placed an order below the low of the day at 2281, and was filled the next day as prices dropped sharply. I moved my stop to breakeven.

I've shown the ensuing stop placements, until I was finally stopped out on 0605, in the six or so days of congestion that took place in the first week of June.

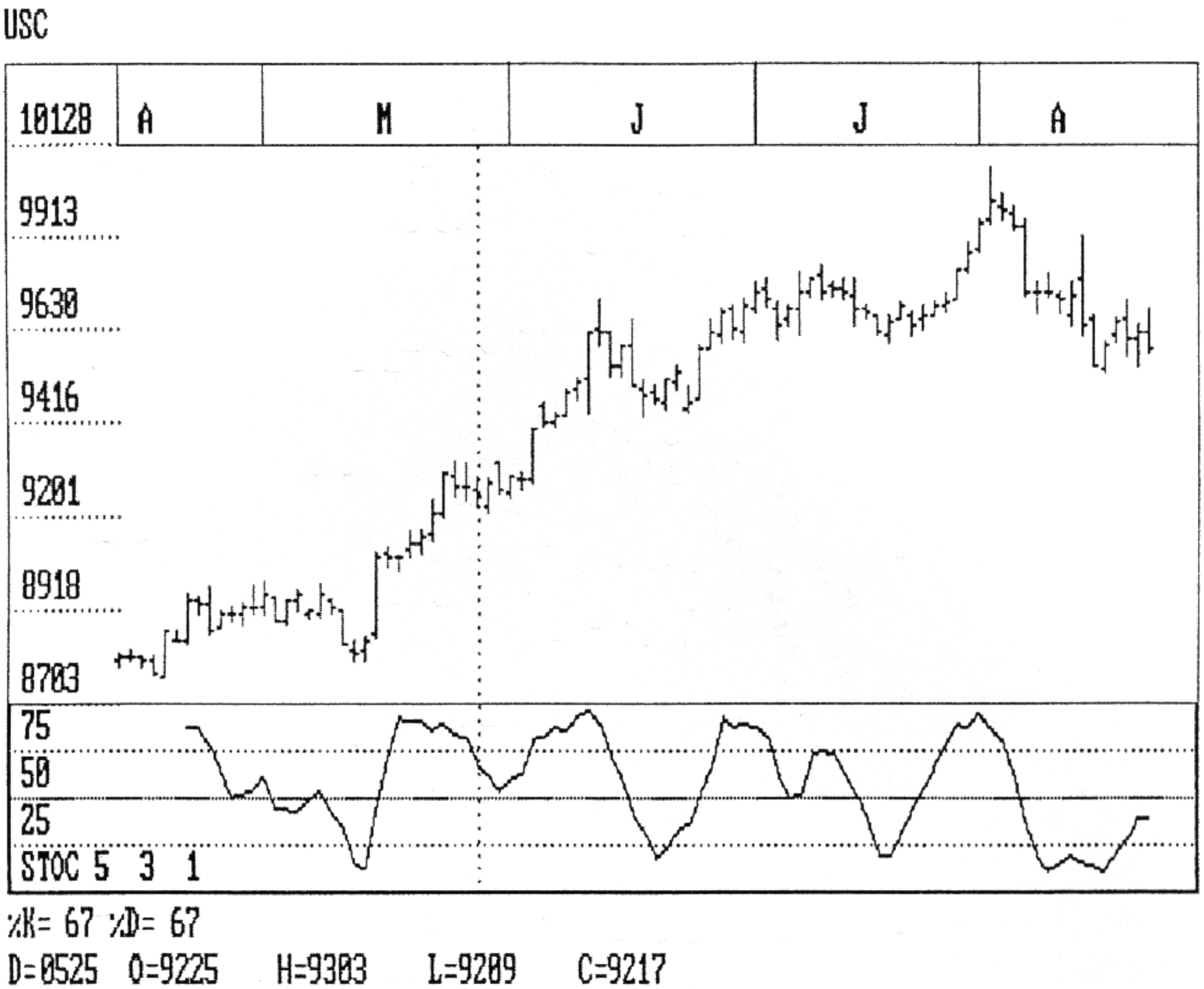

Figure 35 0525. The daily oscillator for the Bonds came out of overbought. The weekly oscillator was up. I placed an order to buy the breakout of the high for the day, but was not filled.

On 0526, I placed an order above that day's high at 93-02 with a contingency profit stop at 93-12 and a protective stop at 92-04.

I was filled on 0530 (the next trading day), at 93-13 on the open, and immediately stopped out at 93-12, thereby losing 1 tick. I didn't like the low close so I didn't order any Bond trades for the next day.

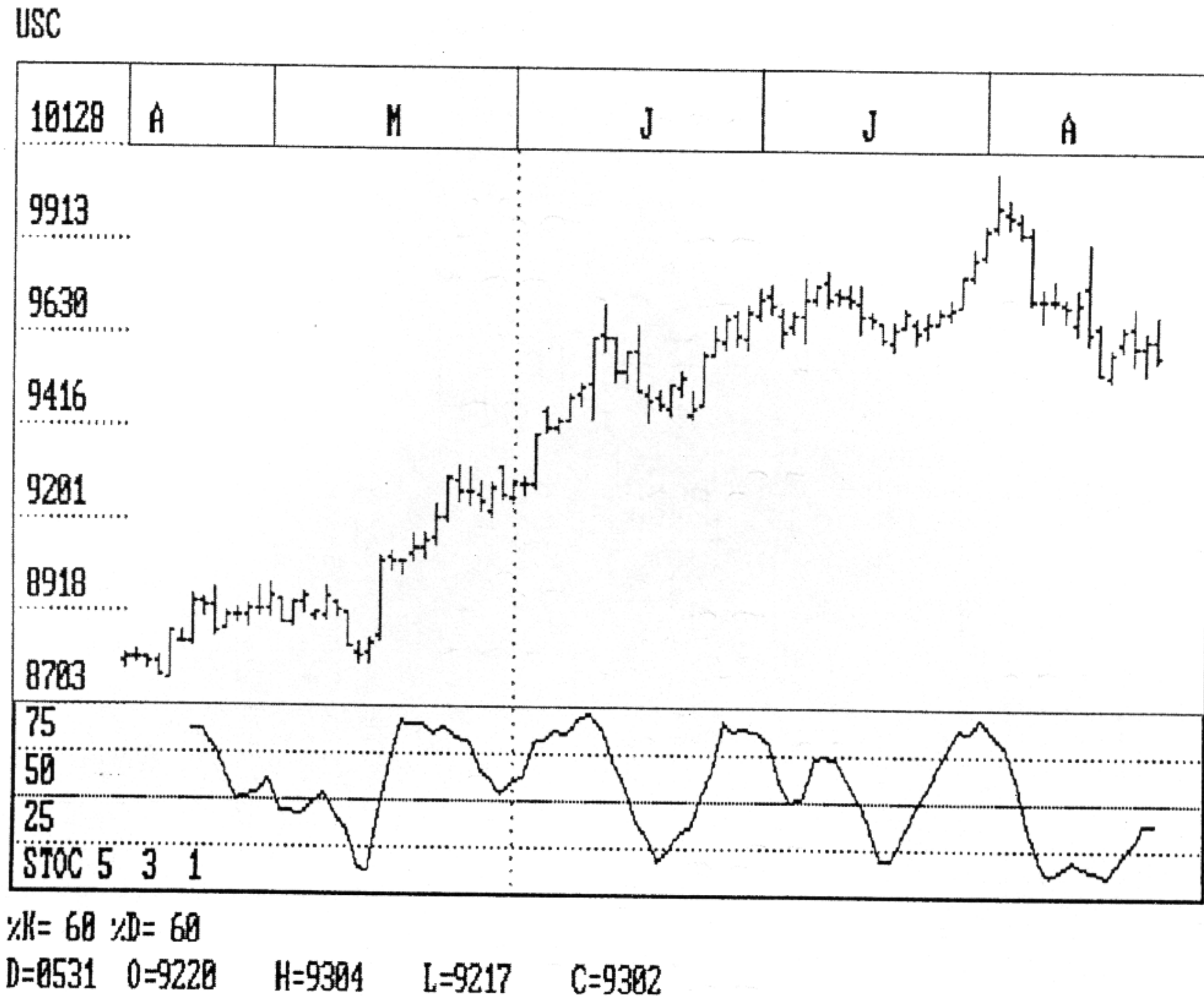

Figure 36 0531. Bond prices closed near the high for the day. The weekly oscillator was still up. The daily oscillator had turned up.

I placed a buy stop at 93-05, a contingency profit stop at 93-15, and a protective stop at 92-16.

On 0601, I was filled at the high of the day. When the market closed, I called in a protective stop at 92-22, just under the low of the day.

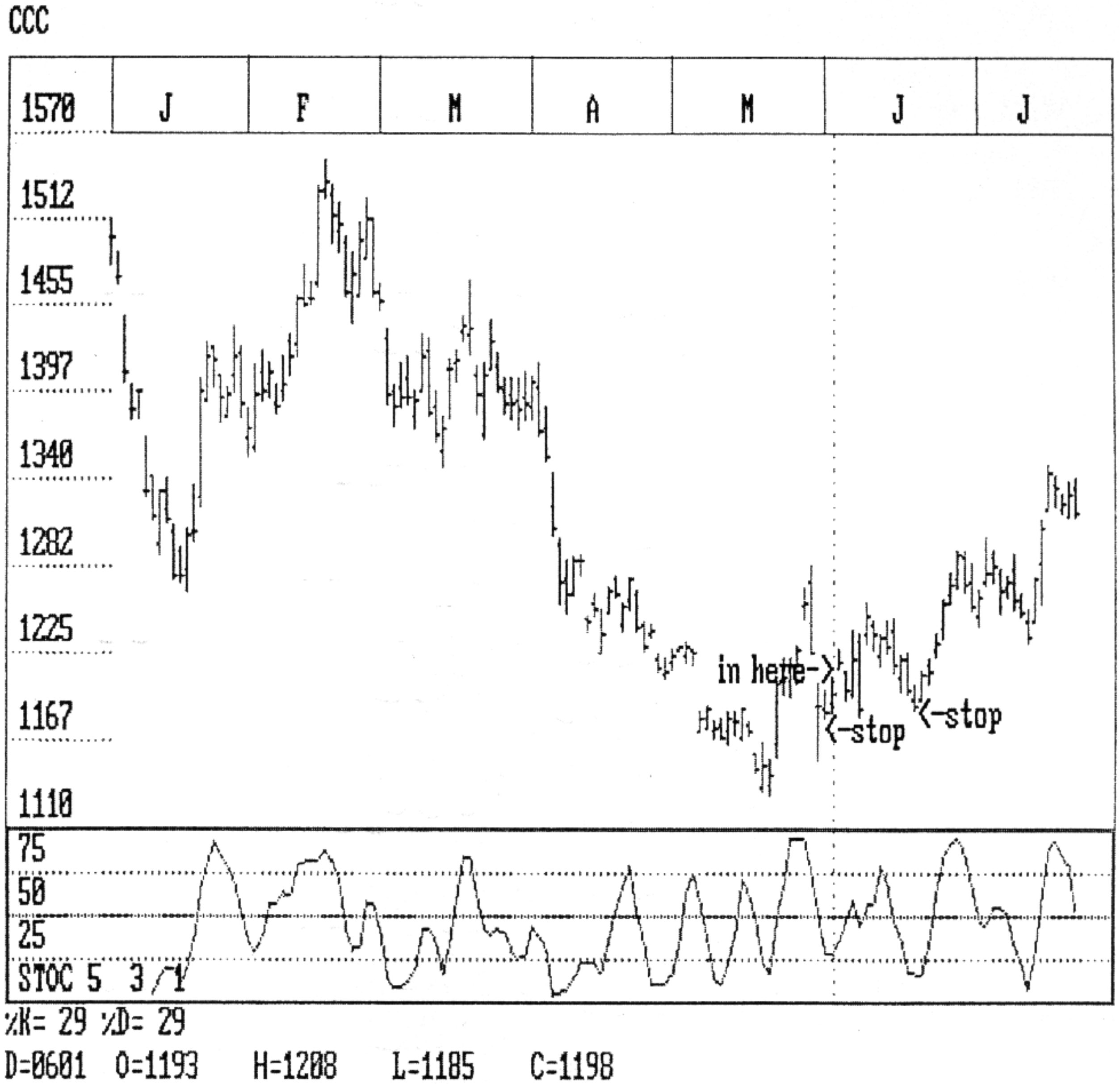

Figure 37 0601. The weekly oscillator for Cocoa had been flat for two days. It then notched up, and the daily oscillator stopped correcting.

I placed an order to buy above the high at 1209, with a protective stop at 1181.

The next day, 0602, prices gapped up. Prices chopped around for a few days, and came within 1 tick of taking out my stop.

Then prices jumped up only to start down again, and then up again. I gave Cocoa lots of room because it likes to make saucer bottoms. Finally, prices began a steady uptrend for 6 days. I moved my stop up to 1187. See Figure 45 for the conclusion of this trade.

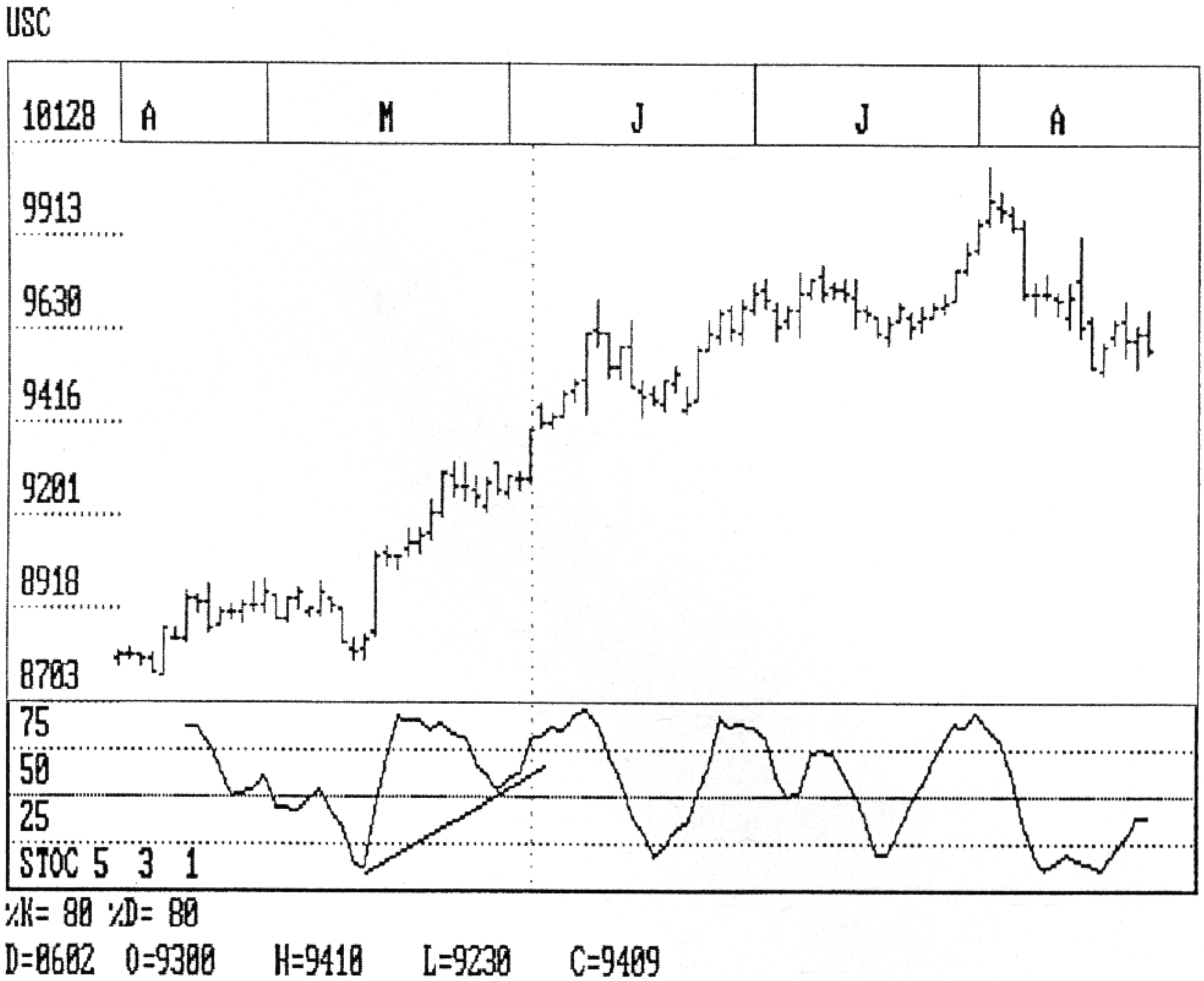

Figure 38 0602. Bond prices moved sharply up and I was out with a ten point profit. Since the close was strong, I figured there might be follow through, and since the daily oscillator was barely overbought, I placed a buy stop at 9411, a contingency profit stop at 9421, and a protective stop just under the close at 9408.

I was filled at the open the next day, at a price of 94-30 and stopped out at 94-21, for a loss of nine points. Prices closed near their lows, so I didn't place another order for Bonds.

The daily oscillator was now definitely overbought, and I mumbled a few words to myself about not ever buying into overbought again. Yet the daily oscillator had been showing rising bottoms, and when that happens I usually ignore the daily oscillator to a certain extent.

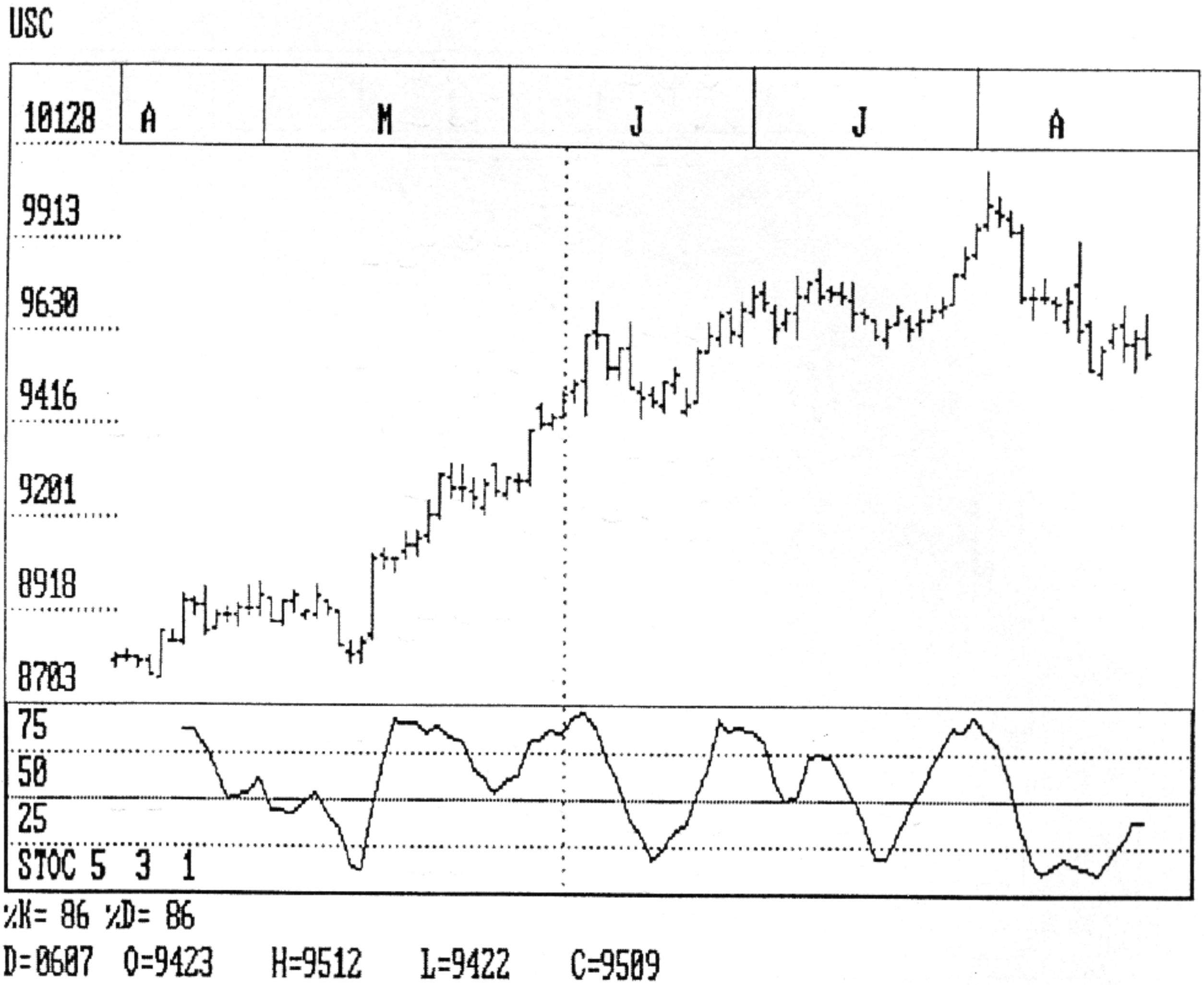

Figure 39 0607. The daily Bond oscillator made another blip down and started up again. I decided to try again because this was a strongly rising market.

I placed a buy order at 95-13, a profit stop at 95-23, and a protective stop at 94-21.

I was filled the next day at the open at 95-13, and almost made my profit. Because prices closed near the high, I left everything in place.

The following day, 0609, I took my profits and ran. That looked like a blowoff to me and so I didn't place any more Bond orders. By now the daily oscillator was right about at the top of overbought, and it was not allowed to go much higher, was it? I waited for a correction.

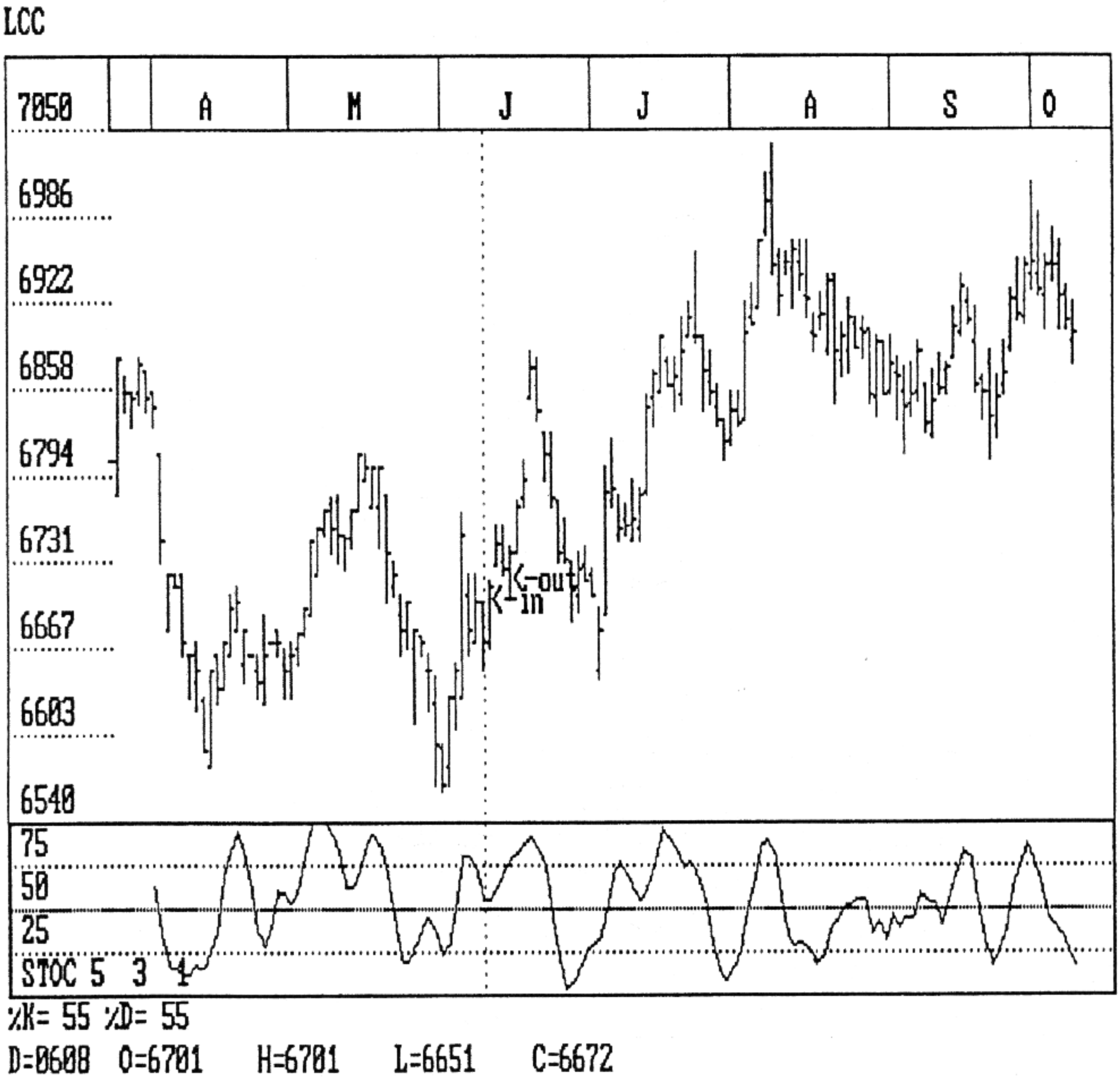

Figure 40 0608. The weekly oscillator for Live Cattle was pointing up and the daily oscillator had corrected from overbought.

I tried to buy a breakout of the high and was filled the next day with my stop below the low of 0608. When prices gapped the following day, I moved my stop to just below the close of the previous day.

The following day saw a small double top, and so I moved my stop to just below the low of that day, and was stopped out there for a 20 point profit.

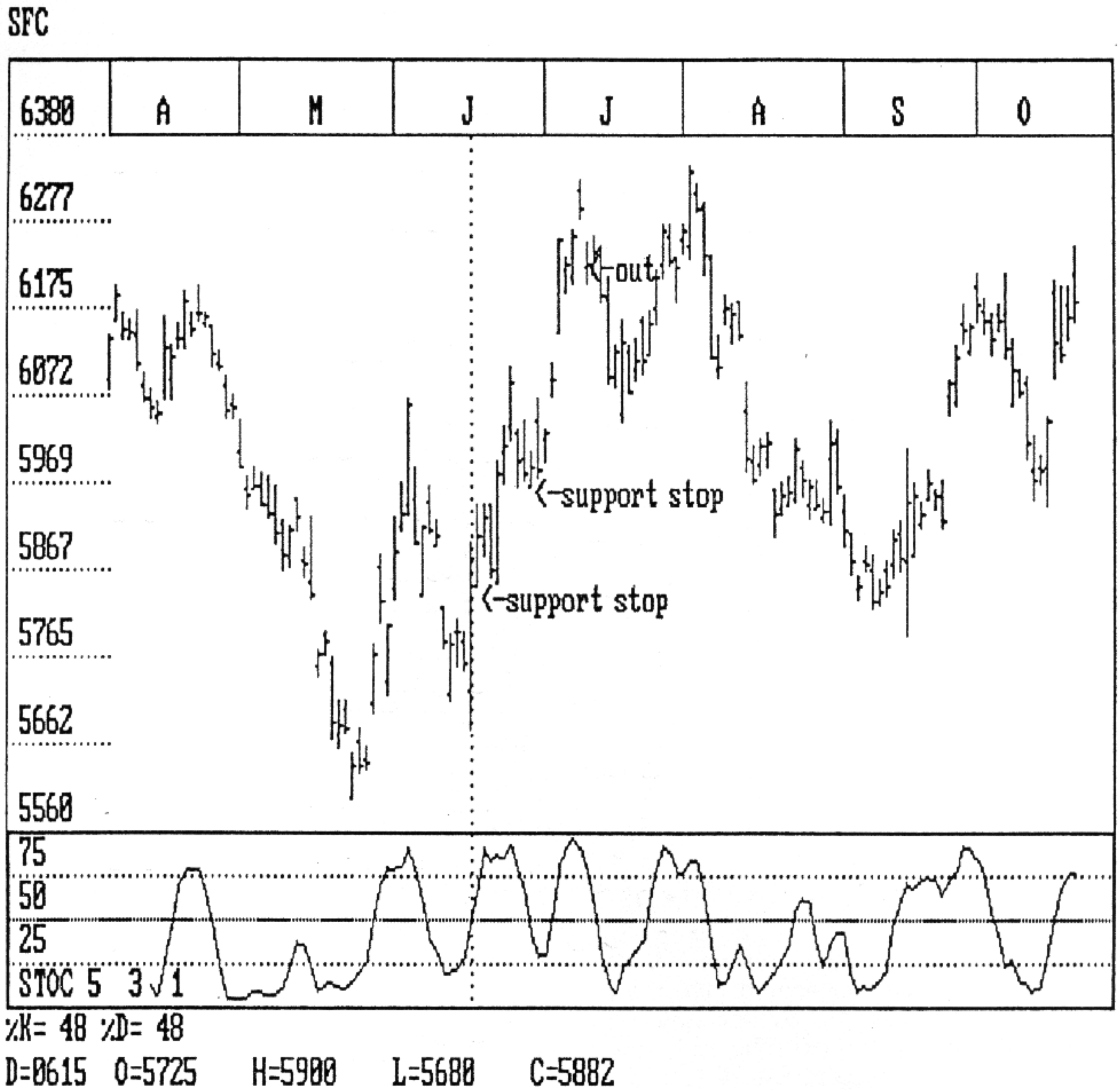

Figure 41 0615. The Swiss Franc blew off on a large magnitude move, closing near its highs. The weekly oscillator was pointing up and the daily oscillator had come out of oversold. I placed an order to buy a breakout of the high, and was filled the next day. I placed a protective stop 3 ticks below the low of my fill day. Prices messed around for two days and then started to move up.

I've shown how I trailed my stops. When prices became really volatile, I trailed my stop to the low of each day, and was stopped out as shown.

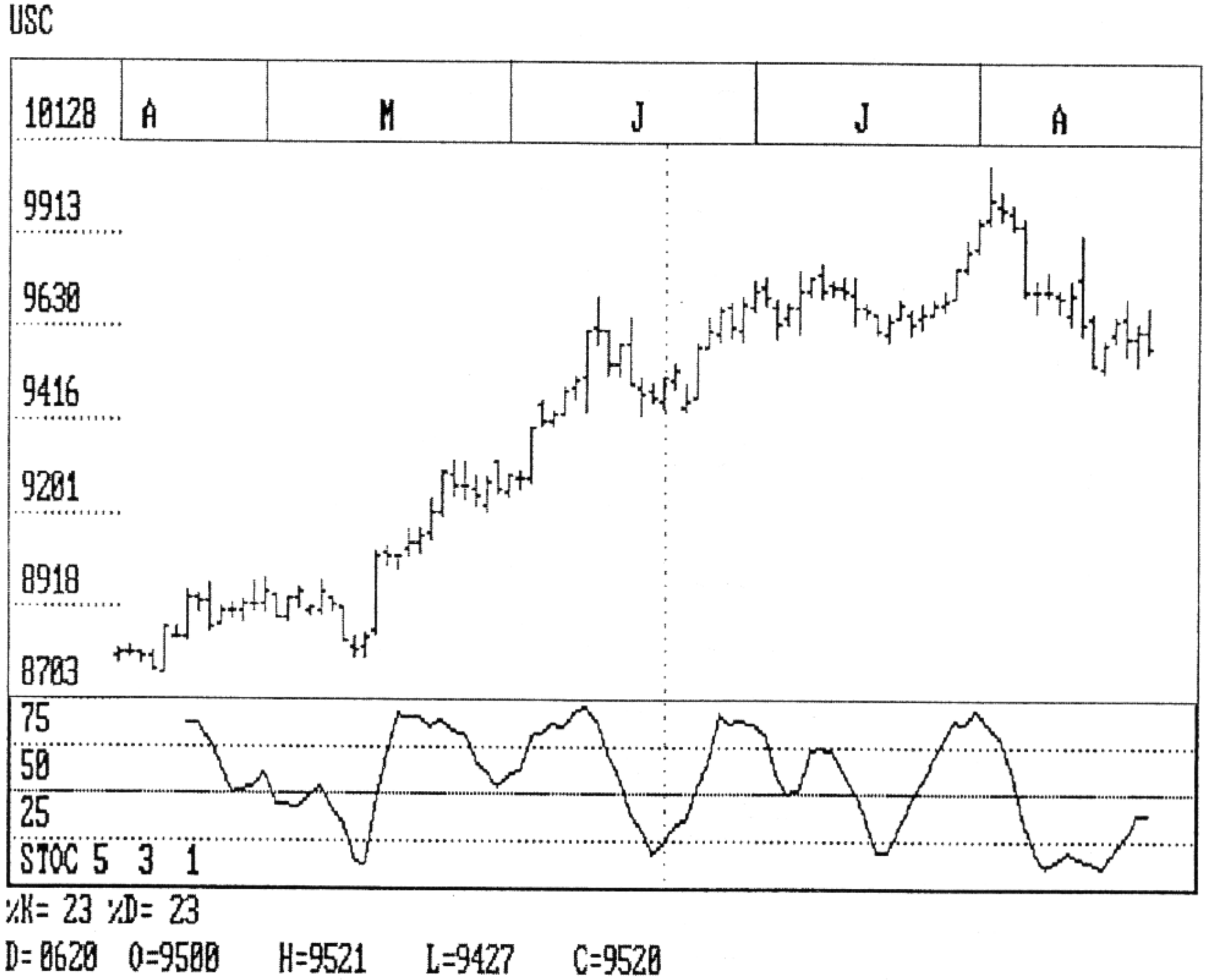

Figure 42 On 0620, the weekly Bond oscillator had been pointing down for two days. Another down day would give me my third segment down. The daily oscillator, which tends to be a lagger by one day, would come out of oversold unless prices really plunged. I decided I had nothing to lose by selling the low. I placed an order to sell at 94-26, with a profit stop at 94-16, and a protective stop at 95-22. The next day, prices moved up and closed near their highs. I placed no Bond orders for the following day.

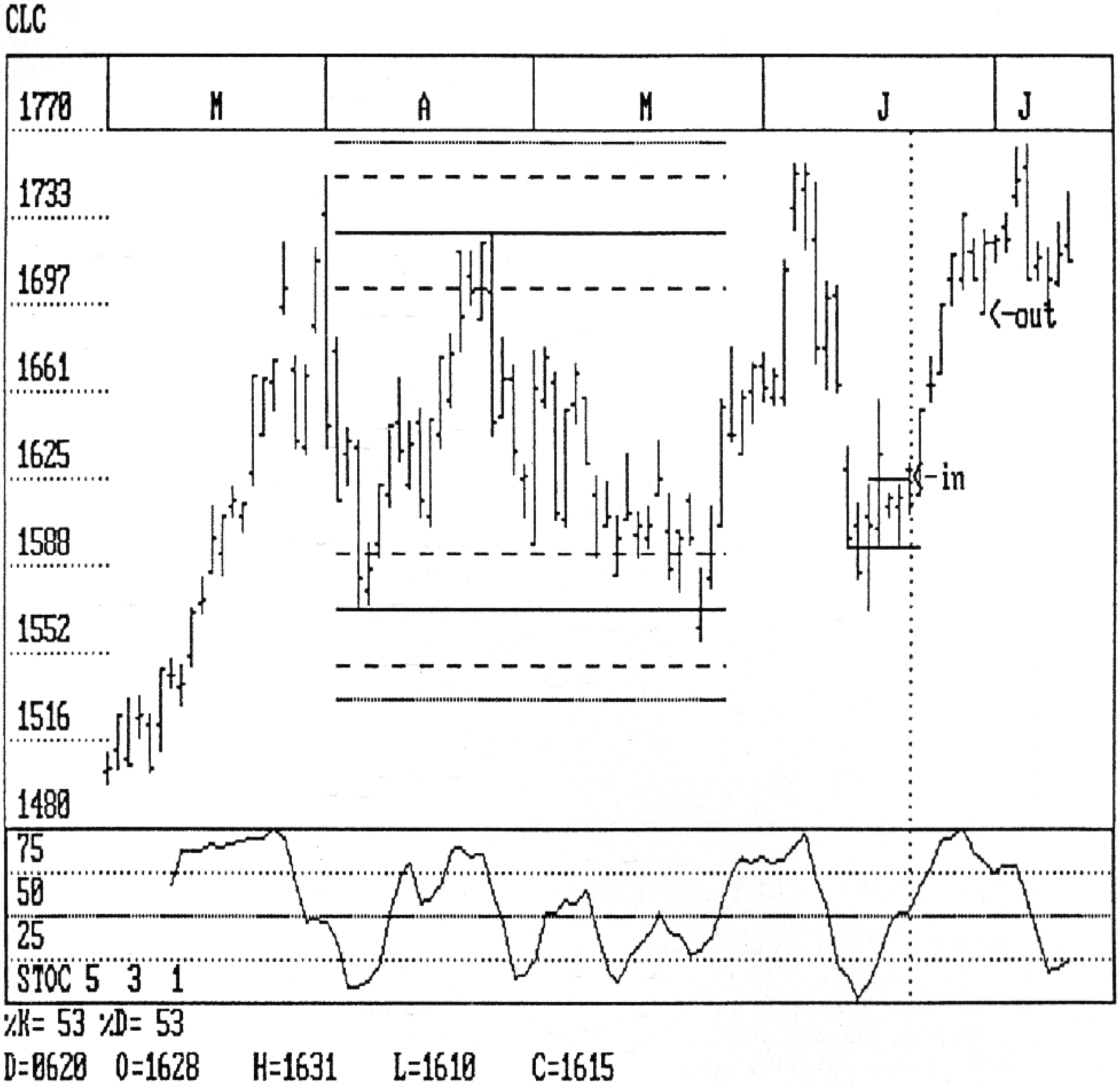

Figure 43 0620. The weekly oscillator for Crude Oil was flat and the daily oscillator was rising. Prices had formed a ledge.

I called in an order to sell a breakout of the low of the ledge (1597) or the high of the ledge (1624).

I was filled the following day, and one day later prices took off. I trailed my stop and was out where shown on the chart.

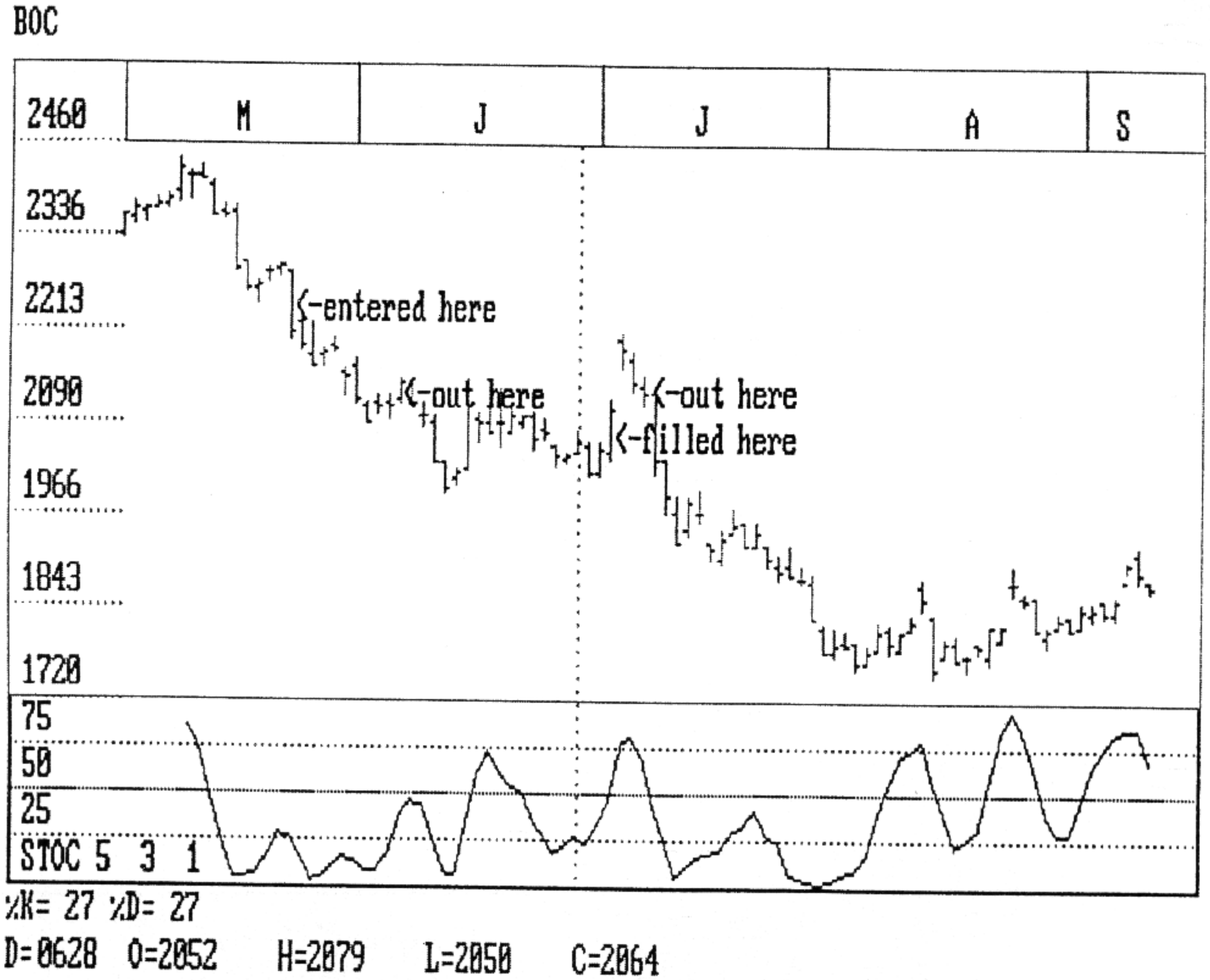

Figure 44 I've shown where I previously entered and exited the Bean Oil market.

On 0628, the weekly oscillator was rising and the daily oscillator had been oversold and was just peeping out of that area. I placed a buy stop above the high at 2080. It was not filled until two days later on a pretty decent size move up.

I placed my protective stop at breakeven, and the next day there was a gap up.

As can be seen, it didn't hold. I've shown where I was stopped out with a small profit.

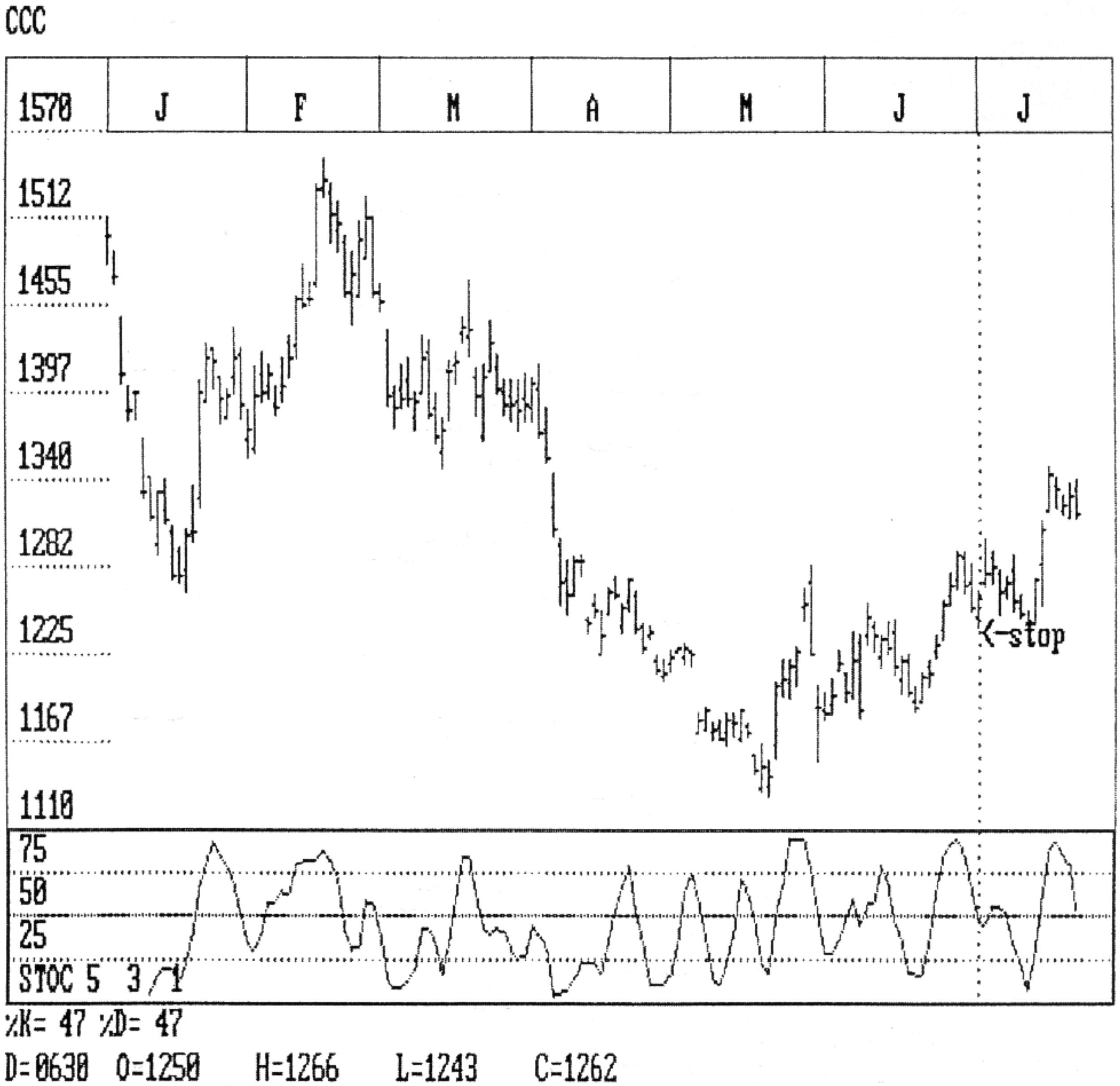

Figure 45 0630. I moved my Cocoa stop up to 1242 and was stopped out at that price 7 days later.

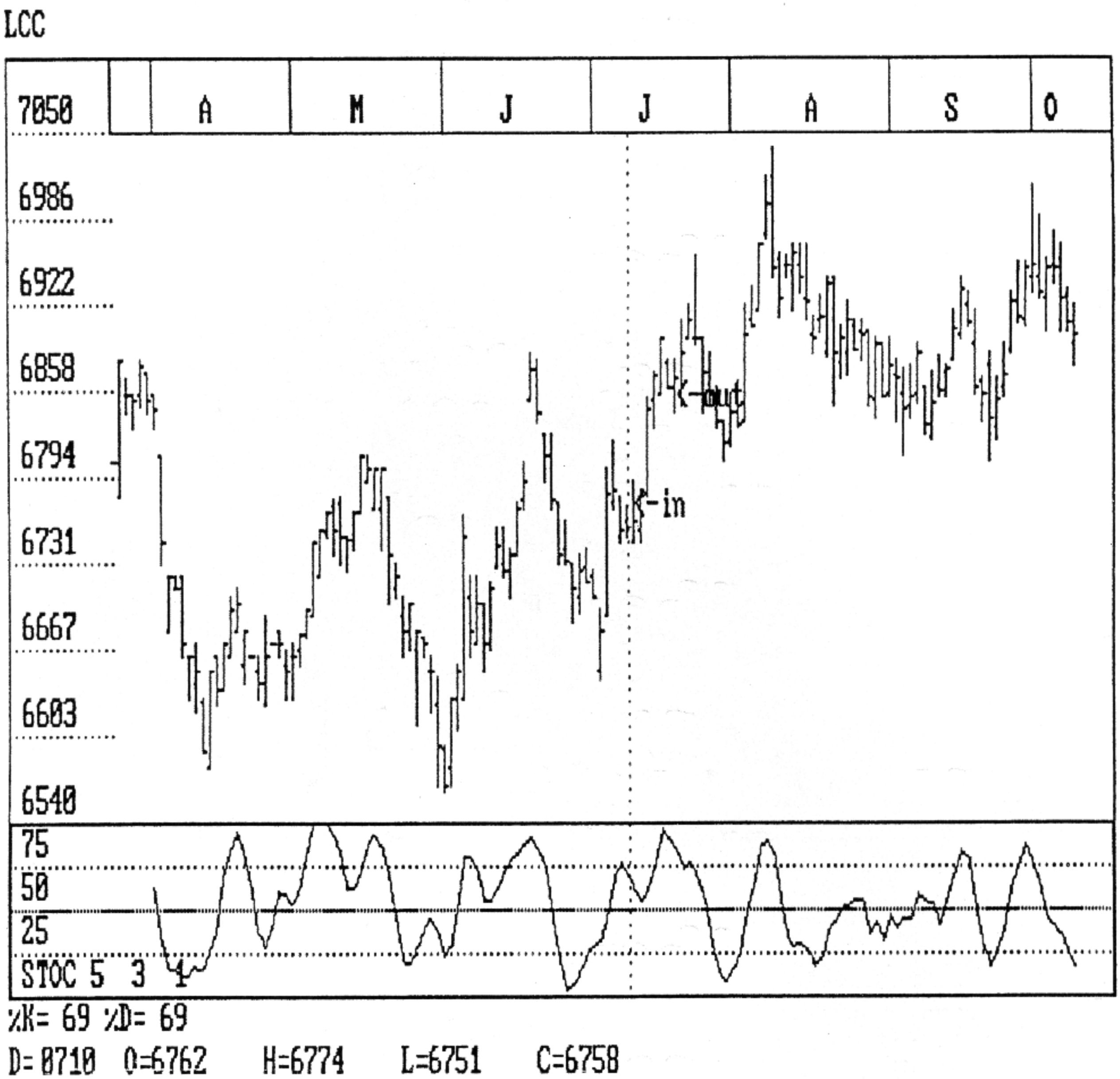

Figure 46 0710. With the weekly oscillator for Live Cattle pointing up, and the daily oscillator correcting from overbought, prices made an inside day. I called in an order to buy a breakout of the high at 6775, and was filled the next day with prices closing below my entry. I placed my stop three ticks below the low of the fill day.

Prices seemed to be finding support with three out of four days supporting at the same low. I left my stop in place as prices closed near their highs.

The following day, prices took off and I moved my stop to a profit position below the low of that day. Then I trailed my stop at the low of each day until I was stopped out as shown.

CCC

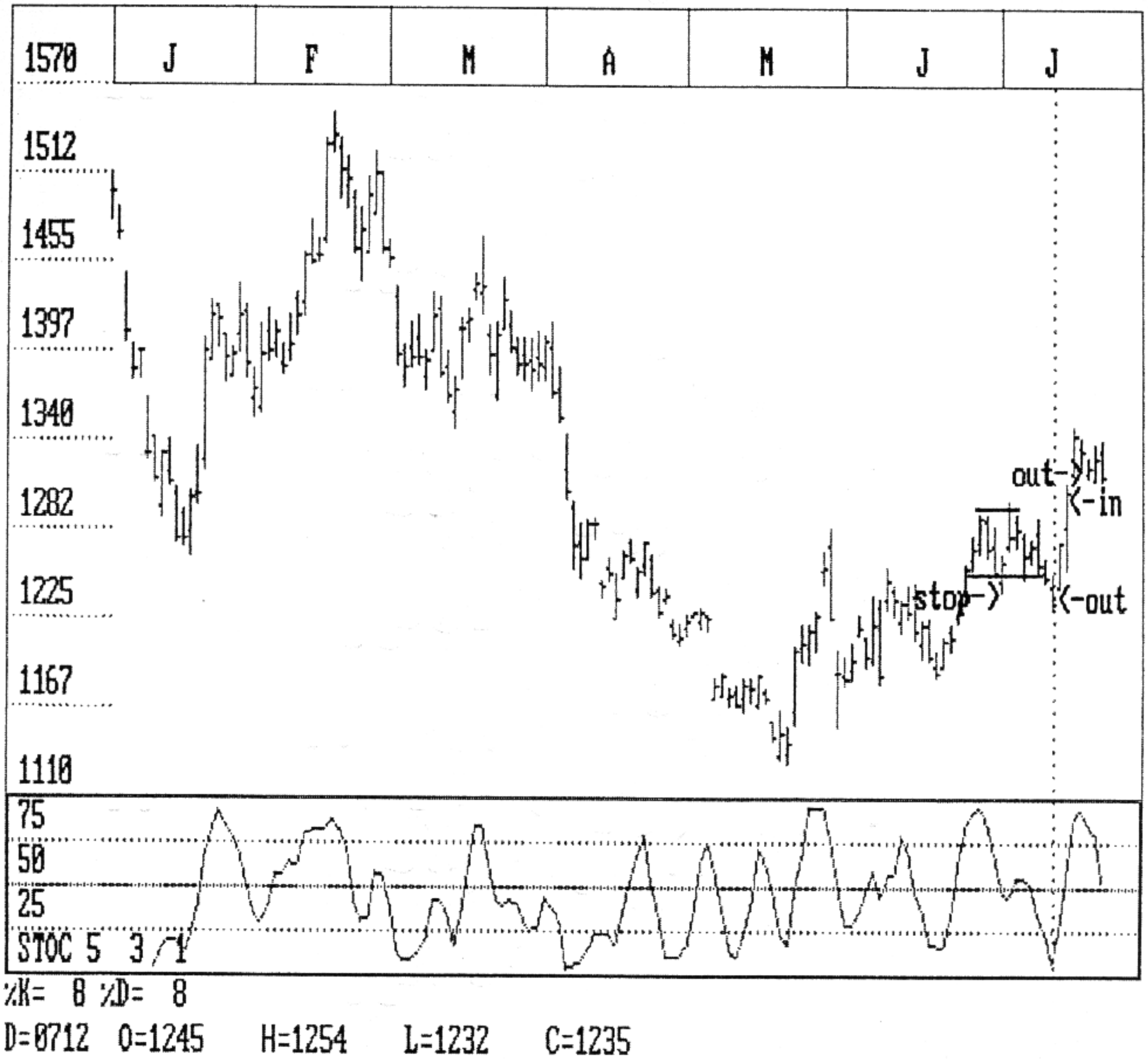

Figure 47 On 0712, the weekly oscillator for Cocoa was flat. The next day it notched up as prices rose. The daily oscillator came out of oversold on that day, and so I placed an order to buy a breakout of the high side of the ledge that had previously formed.

I was filled on 0714, and the weekly oscillator pointed up when that day was over, because of a sharp rise in prices. This was a breakout of a ledge, and so I was looking for quick short term profits. I kept my stop tight, and was out with a small profit in two days.

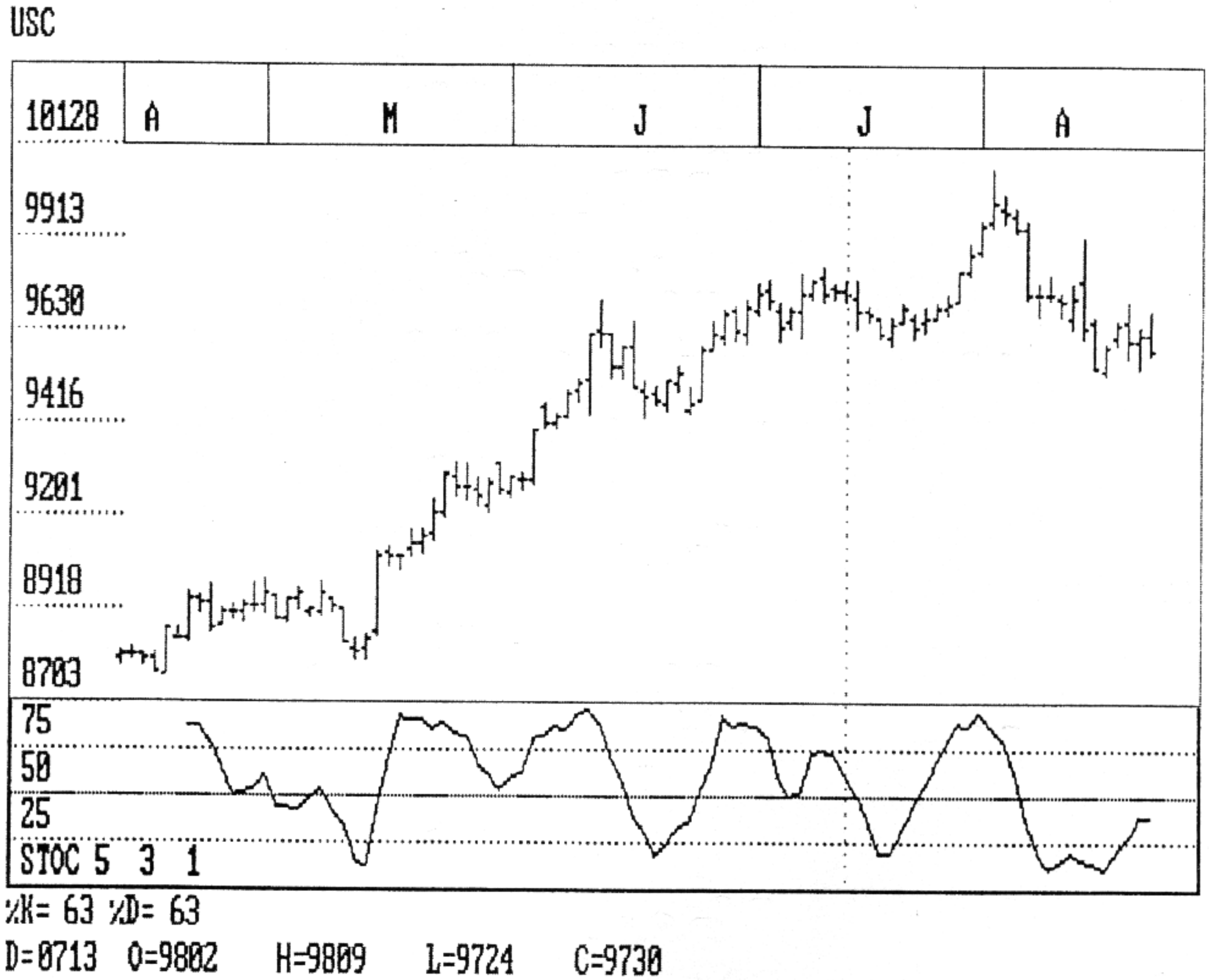

Figure 48 0713. The weekly Bond oscillator had been down two days. Another down day would make the third day down. The daily oscillator was not yet oversold, and had falling tops.

I placed a sell order at 97-24, a profit order at 97-14, and a protective stop at 98-09. The next day, I was filled at 97-24, and out at 97-14 with a ten point profit.

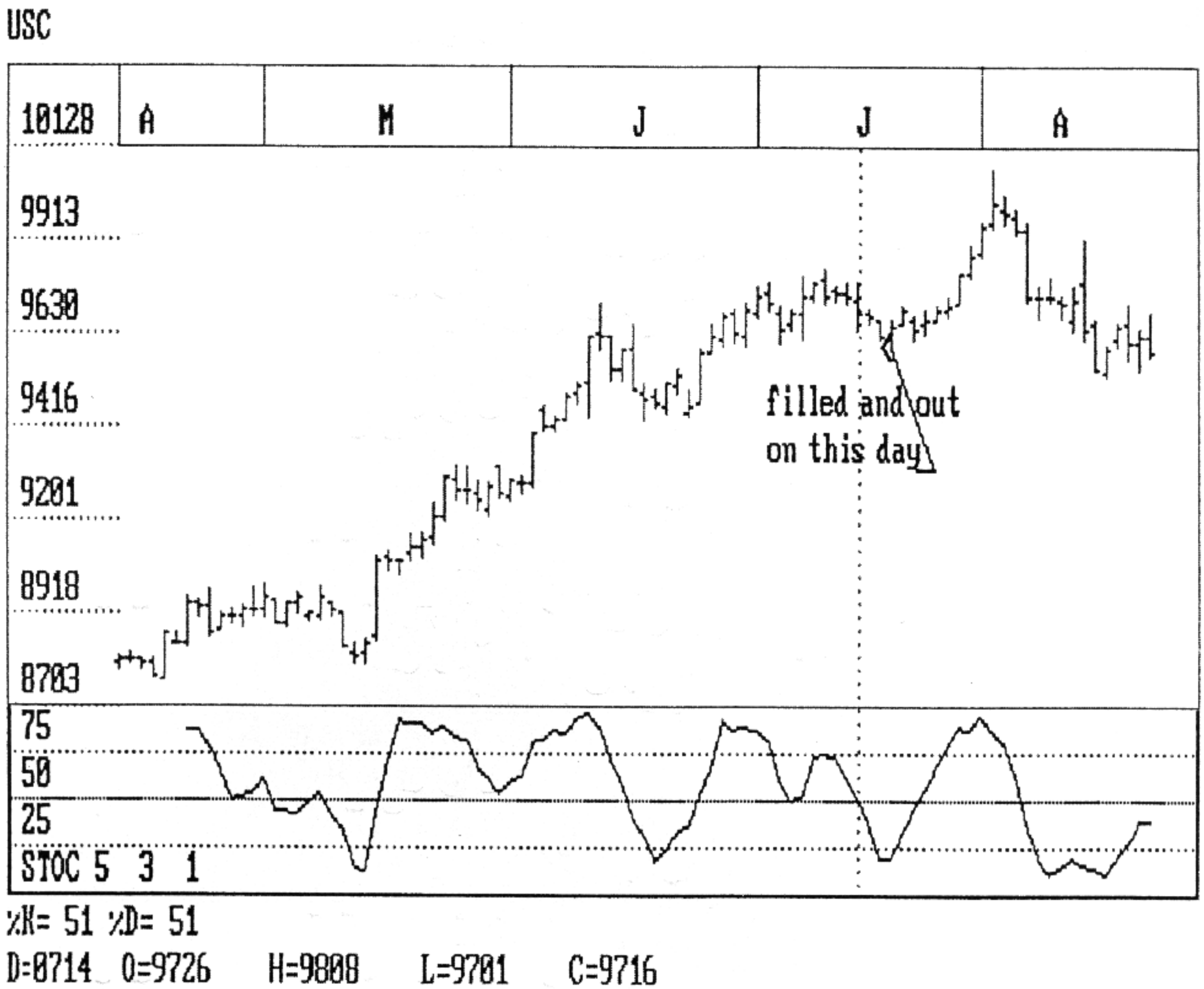

Figure 49 0714. Since everything still looked like a short for the Bonds, I decided to go for it. I placed a sell stop at 97-00, a profit stop at 96-22, and a protective stop at 98-09. The next day was an inside day, but everything else looked good.

I moved my sell stop to under the low of the inside day, at 97-06.

I placed a protective stop at 97-19, and a profit stop at 96-29. Everything was tight and this trade appeared to be low risk.

The following day I was filled and then out with a profit.

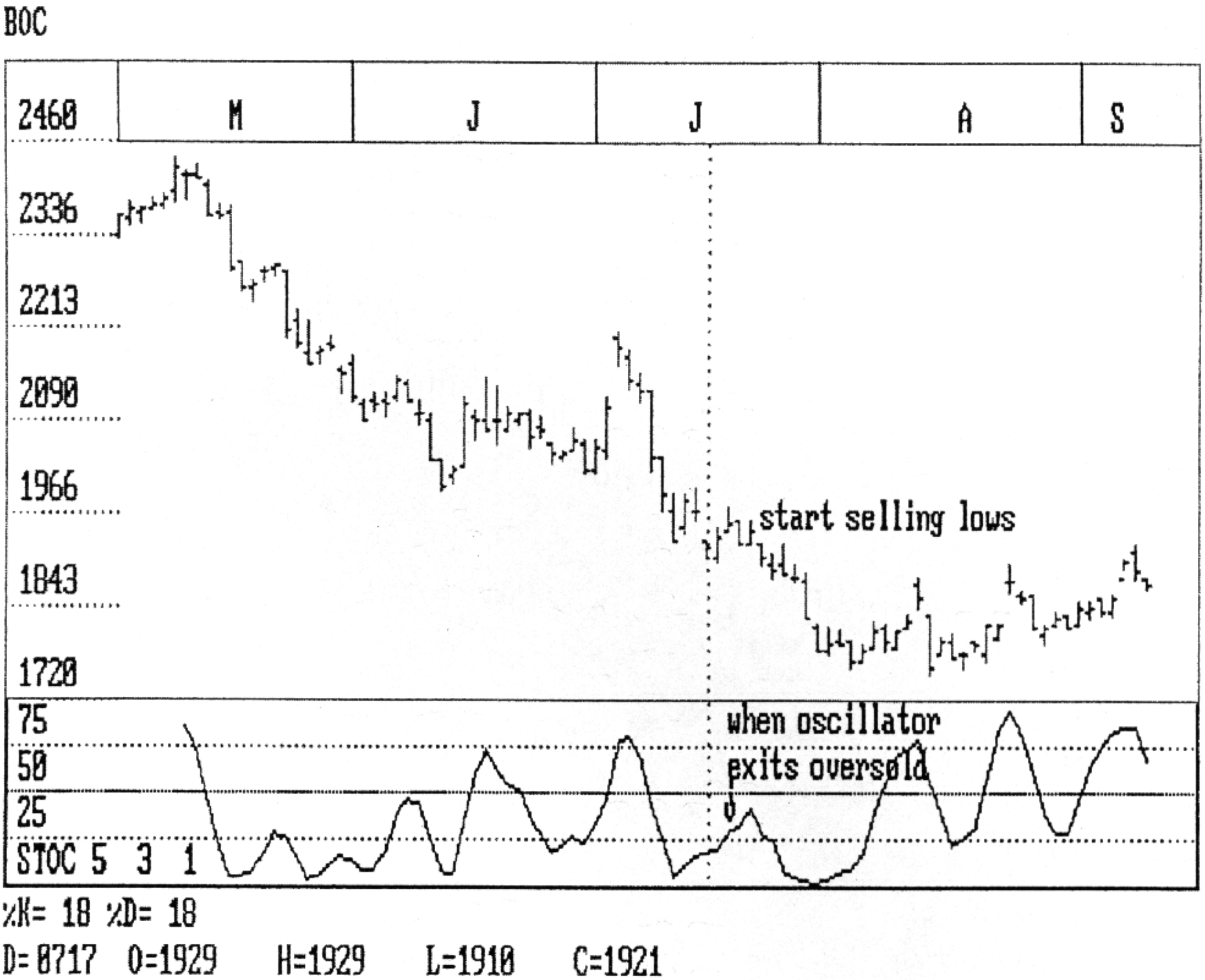

Figure 50 By 0717, the weekly oscillator for Bean Oil had moved down for three days, and the daily oscillator was correcting. If it would move out of oversold, I would start selling the breakouts of the lows.

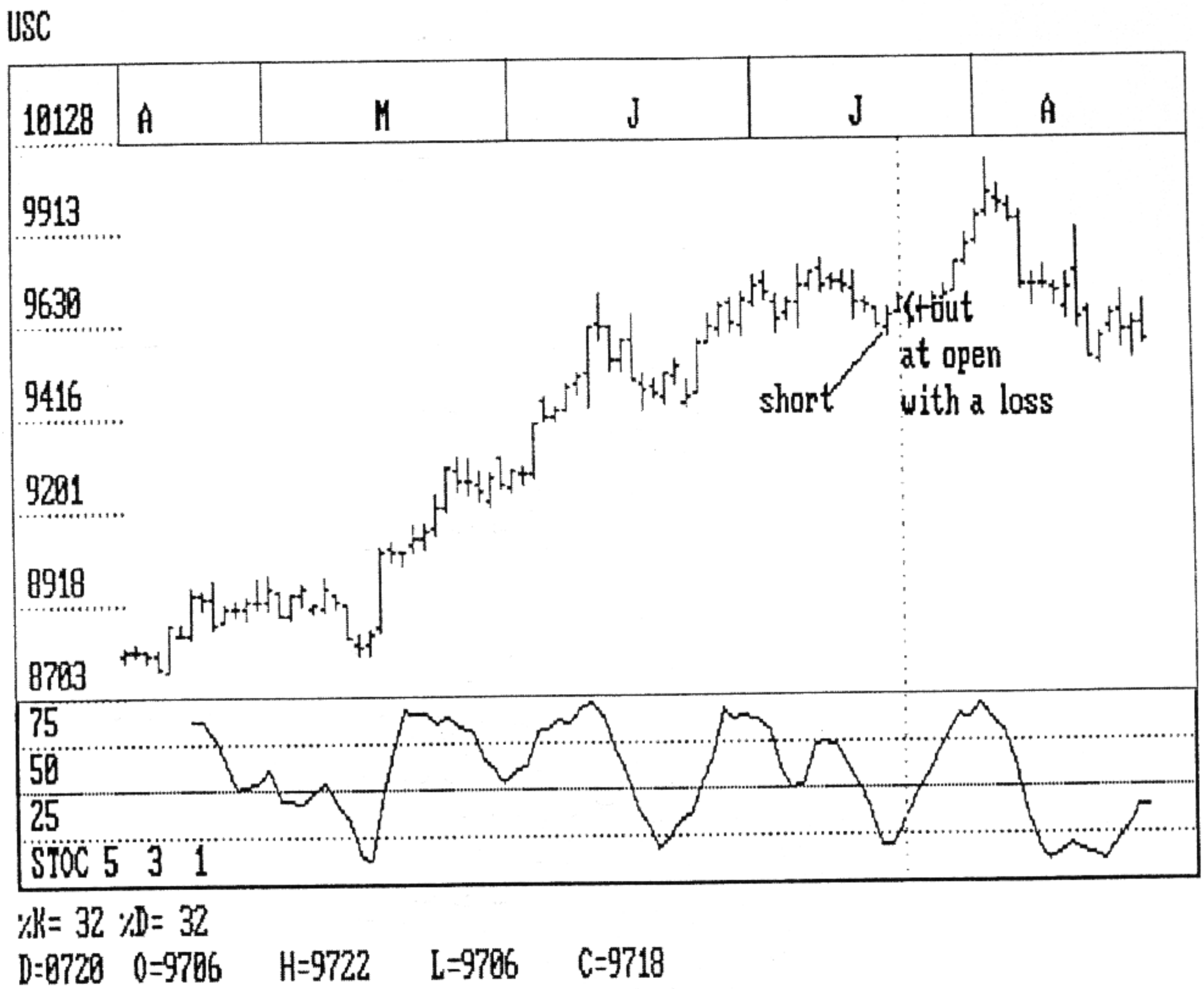

Figure 51 0718. I decided to go for it again on the Bonds. I placed a sell stop at 96-23, a protective stop at 97-12, and a profit stop at 96-13.

I was filled the next day, but suddenly I was not a hero. Prices closed near the highs of the day. The daily oscillator went flat.

I decided to take a shot at still making a profit, or at least reducing my loss. I placed a buy stop at the hoped for 96-13. If prices opened above me I'd be filled at the open, if not I may have a chance at making some money.

Prices opened above my stop and I was out with a loss of 12 points at 97-05.

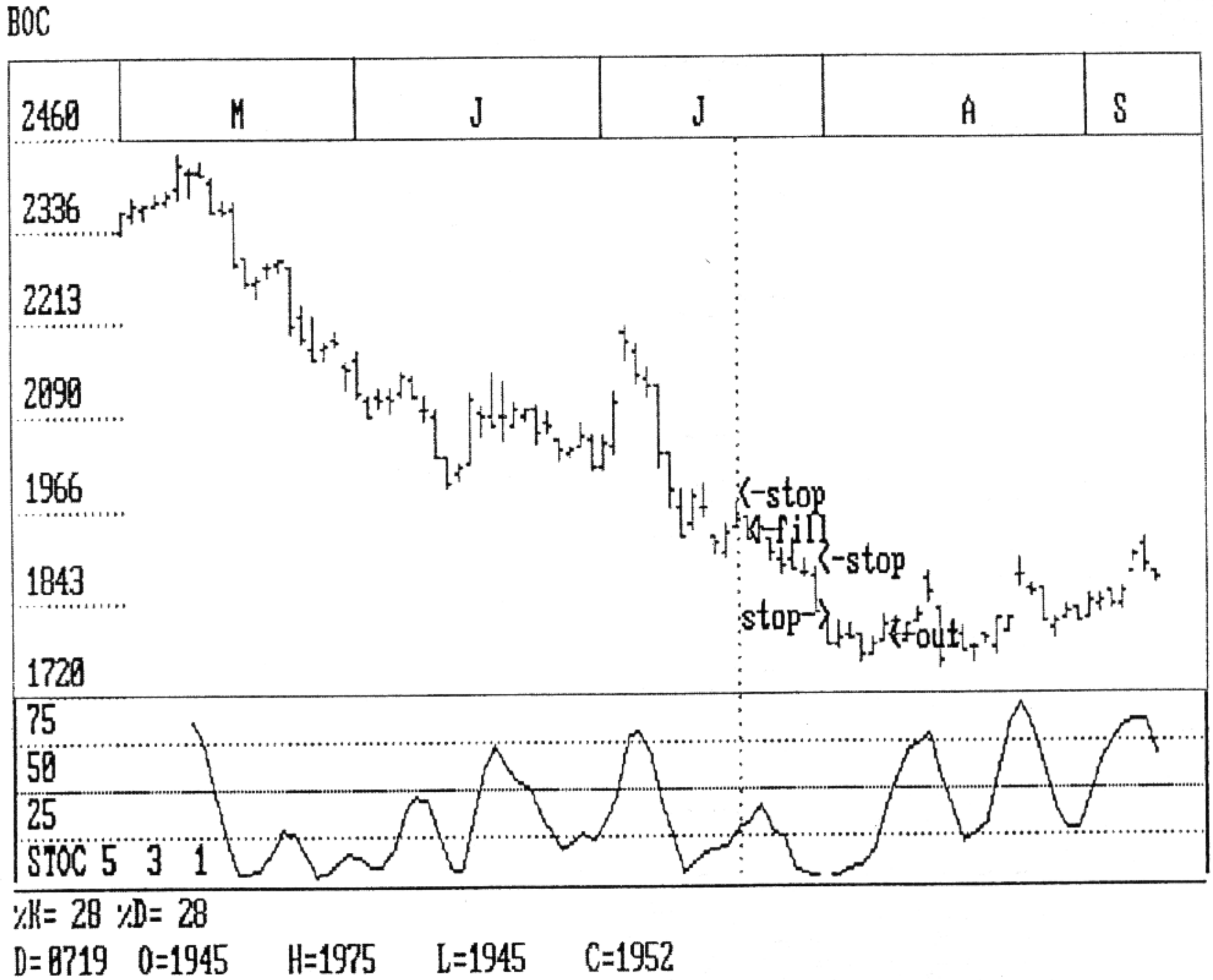

Figure 52 On 0719, the daily oscillator for Bean Oil broke out of oversold, so I placed a sell stop in the market at 1944. It was filled the next day with my stop at 1976.

After one more day, the market started down again and I've shown my trailing stops, and where I finally got out, which was two days after the low of that market move.

The cursor is sitting where I started contemplating my next move.

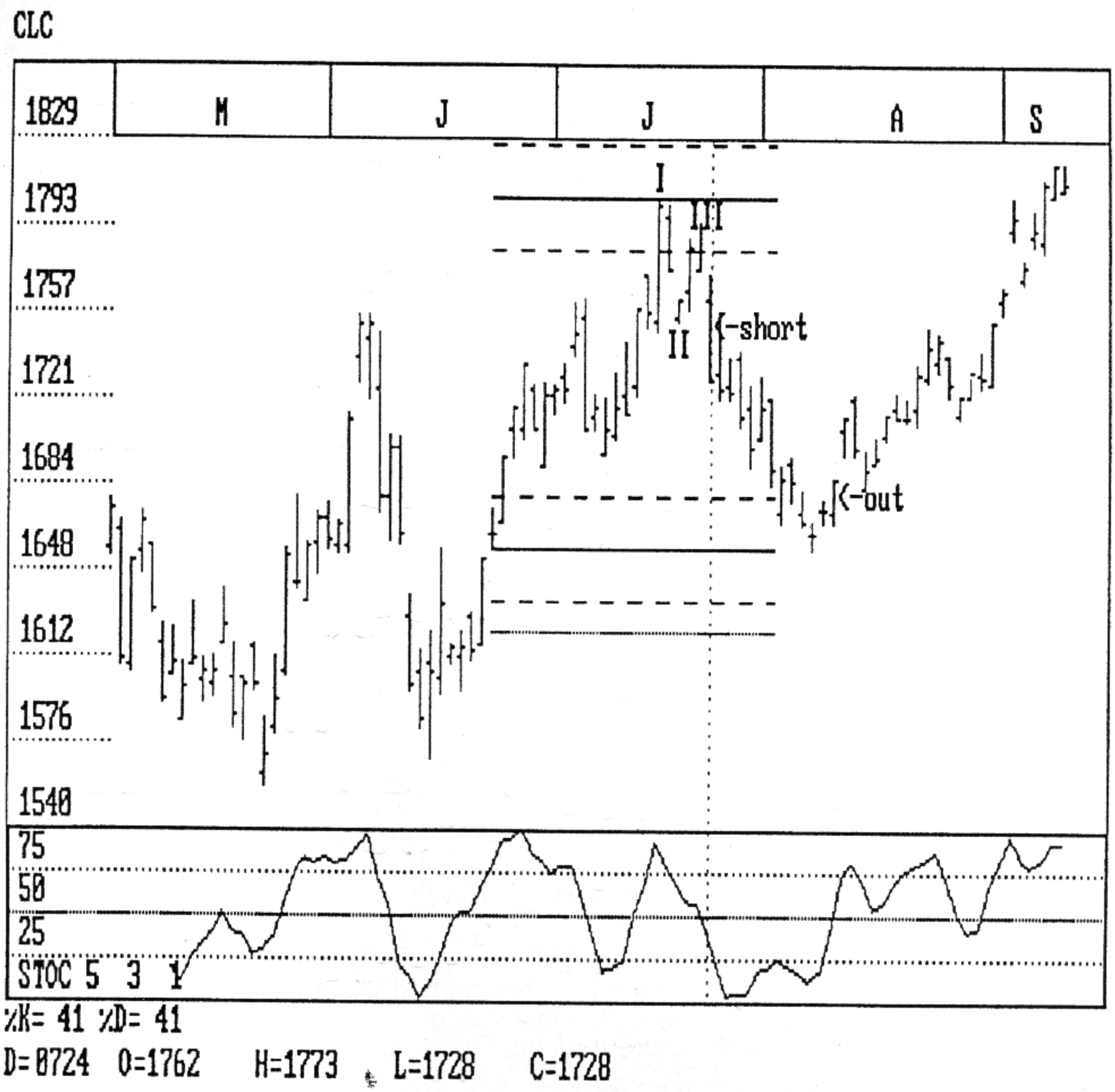

Figure 53 0724. Crude Oil had been in a wide, sideways trading range for several months. I kept drawing new envelopes as I went, trying to wrap them around what seemed to me to be the main trading range. I've shown where the envelope was at the time I entered my next trade.

Prices had made a I-II-III high formation, and so I called in an order to sell a breakout of the number II point. I had no indication from the weekly oscillator as to which way to go, but the daily oscillator had been falling.

I was filled on the day shown, and trailed my stops two days back until prices approached the opposite side of the envelope. Then I got nervous and stayed only one day behind until I was stopped out as shown.

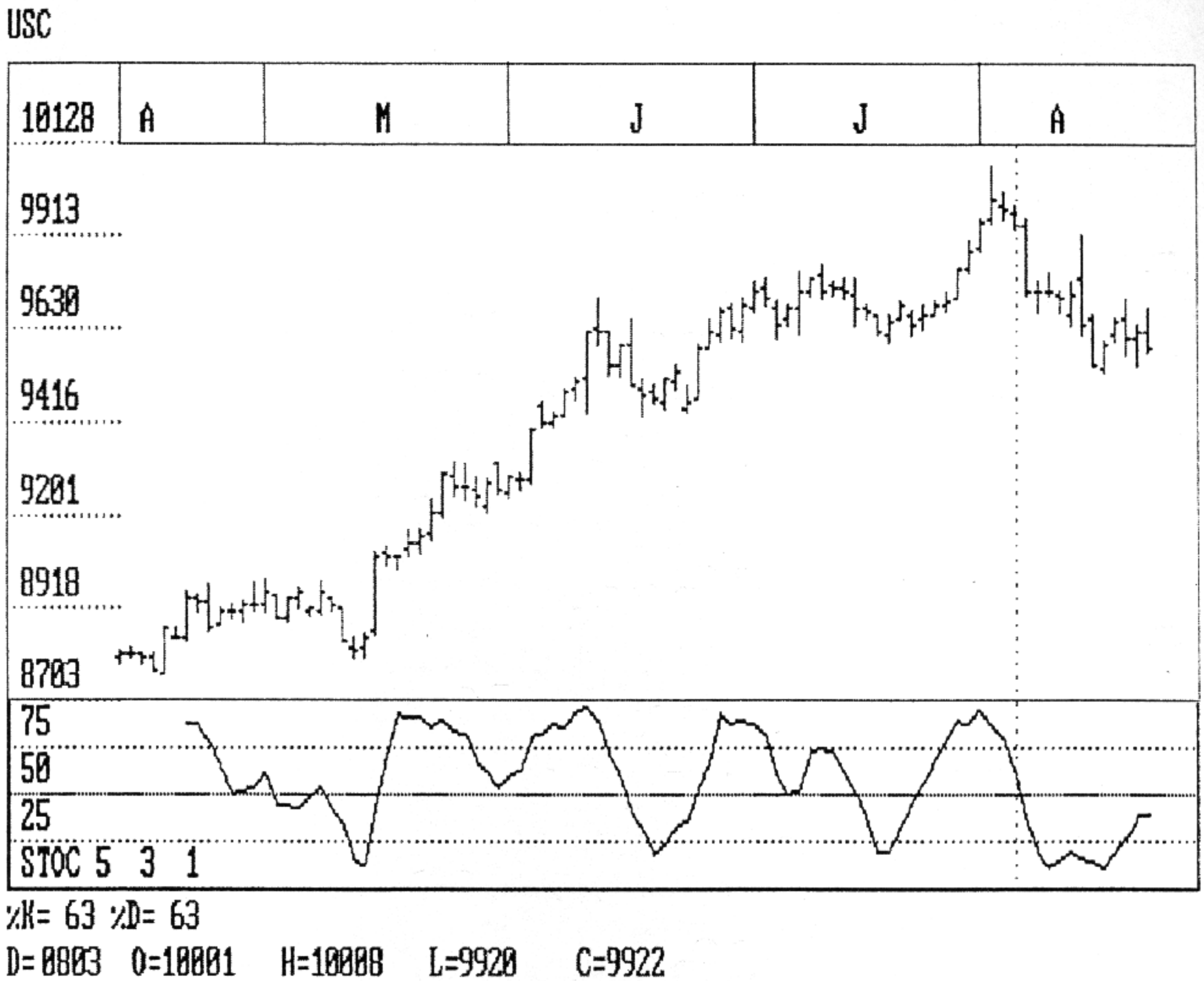

Figure 54 0803. On this day, with having had three up days on the weekly oscillator for Bonds, and the daily oscillator having corrected from overbought, I unsuccessfully tried to buy a breakout of the high.

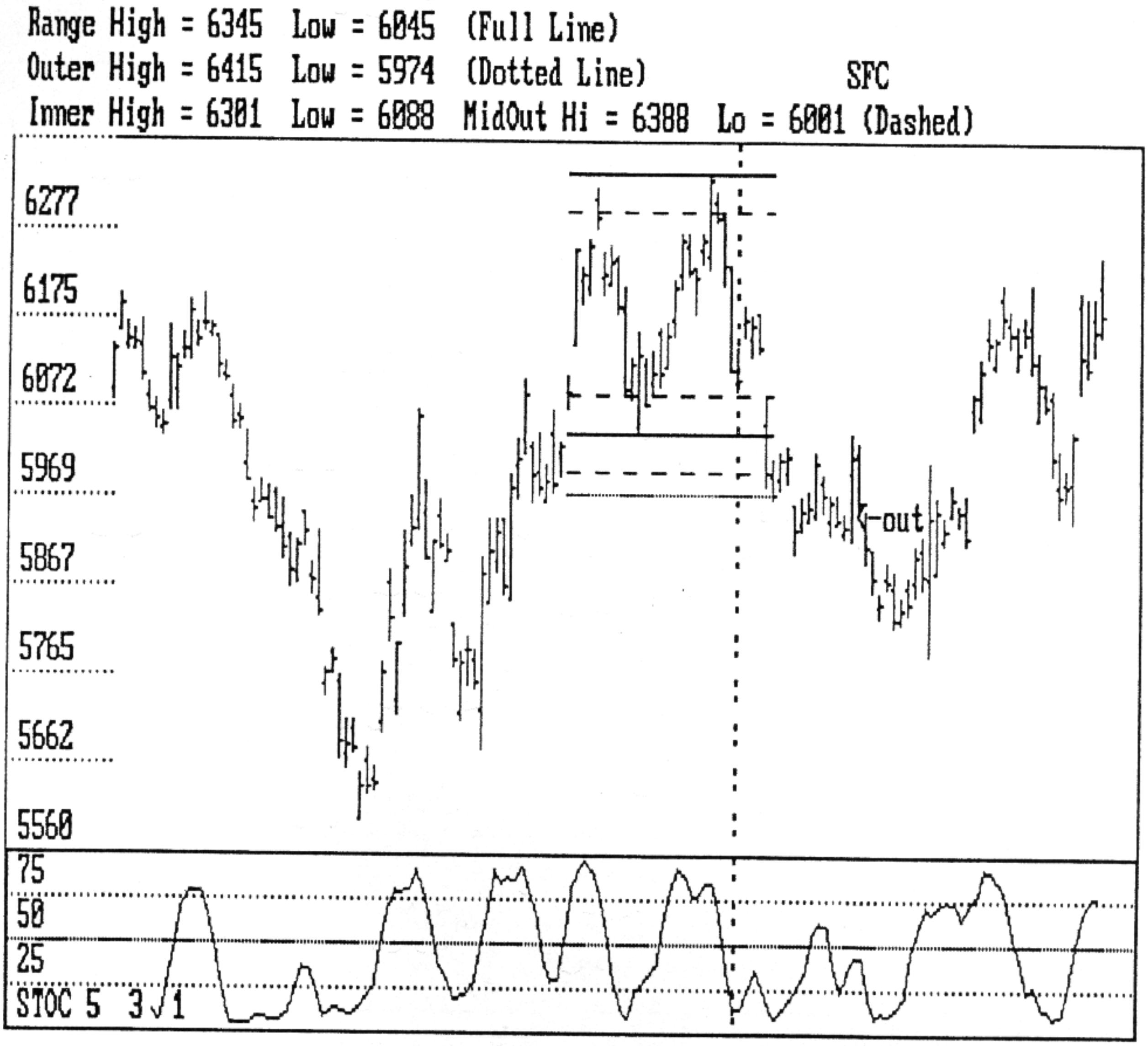

Figure 55 0807. Here's how the Swiss Franc chart looked. The previous volatility had resulted in a trading range. The cursor is sitting on the twenty-fifth day.

I had a buy stop in at 6416 and a sell stop in at 5973. Both orders were stop close only.

On the thirtieth day, prices closed out of the range. I placed a protective stop at 6046 and waited. Sure enough, a reaction took place and I was almost blown out of the water on the last day of the correction. Then prices started down and I trailed my stop closely. I was stopped on a scary outside day as shown. That scary day made me take a much closer second look at this market.

I've shown what I found in Figure 59.

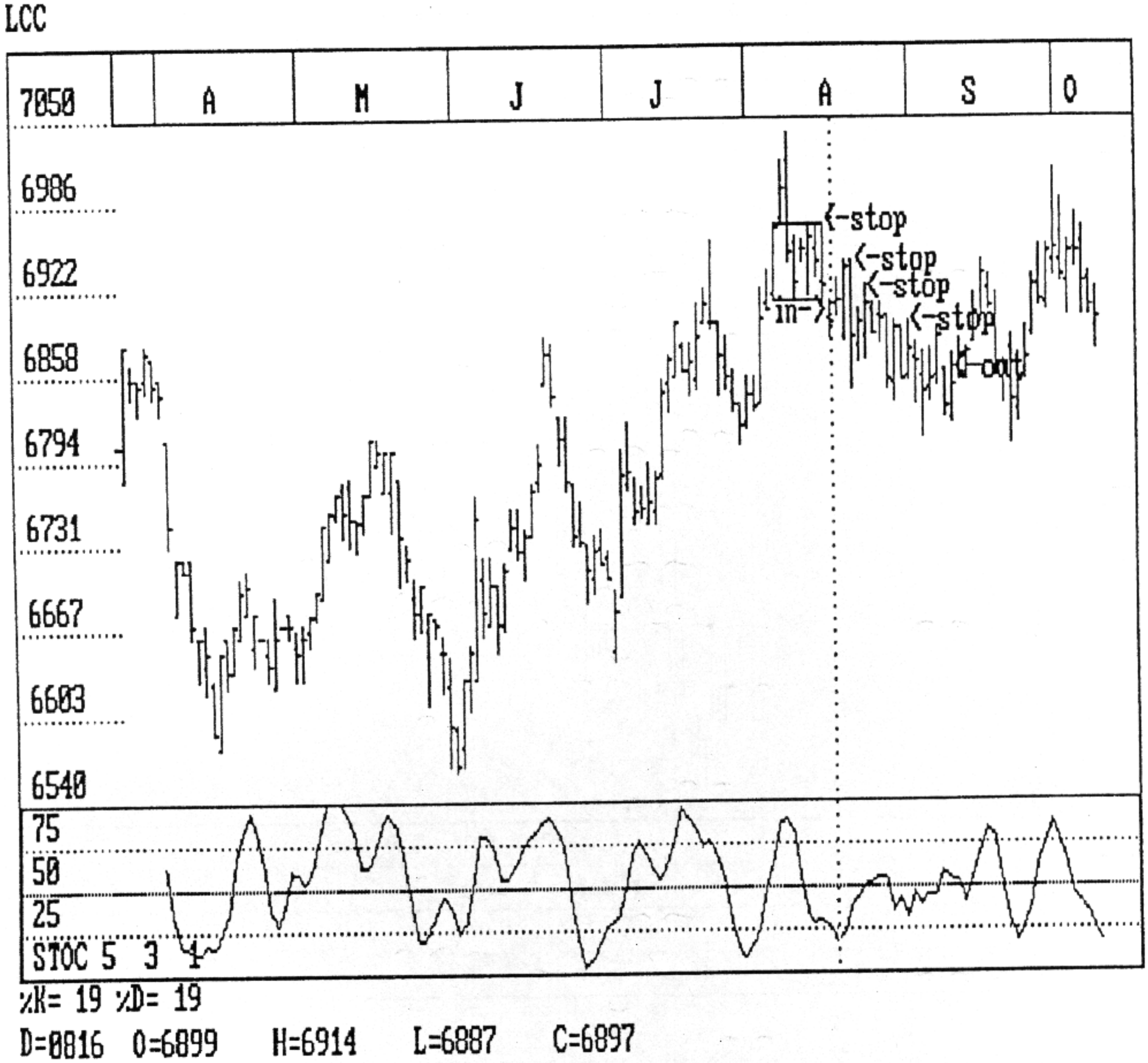

Figure 56 0815. Live Cattle prices had formed a ledge. The weekly oscillator segment had peaked and its value had dropped somewhat. The daily oscillator had just entered oversold. It was anybody's guess as to which way the breakout would occur.

I placed orders on each side of the ledge and was filled the next day as prices gapped down at the open. Then there were a couple of reaction days, and I truly didn't know what to do with my stop, so I left it where it was above the ledge. The third day after my entry, there was a large magnitude day with prices closing lower. I moved my stop above the high of that day. From there on, I trailed my stop on down as shown until I was stopped out with a nice profit.

Figure 57 (below) This was my last Live Cattle trade for the year. I drew an envelope around the price action, but prices never broke out for the remainder of the year. There were also a couple of ledges, but they were not clear and I missed them.

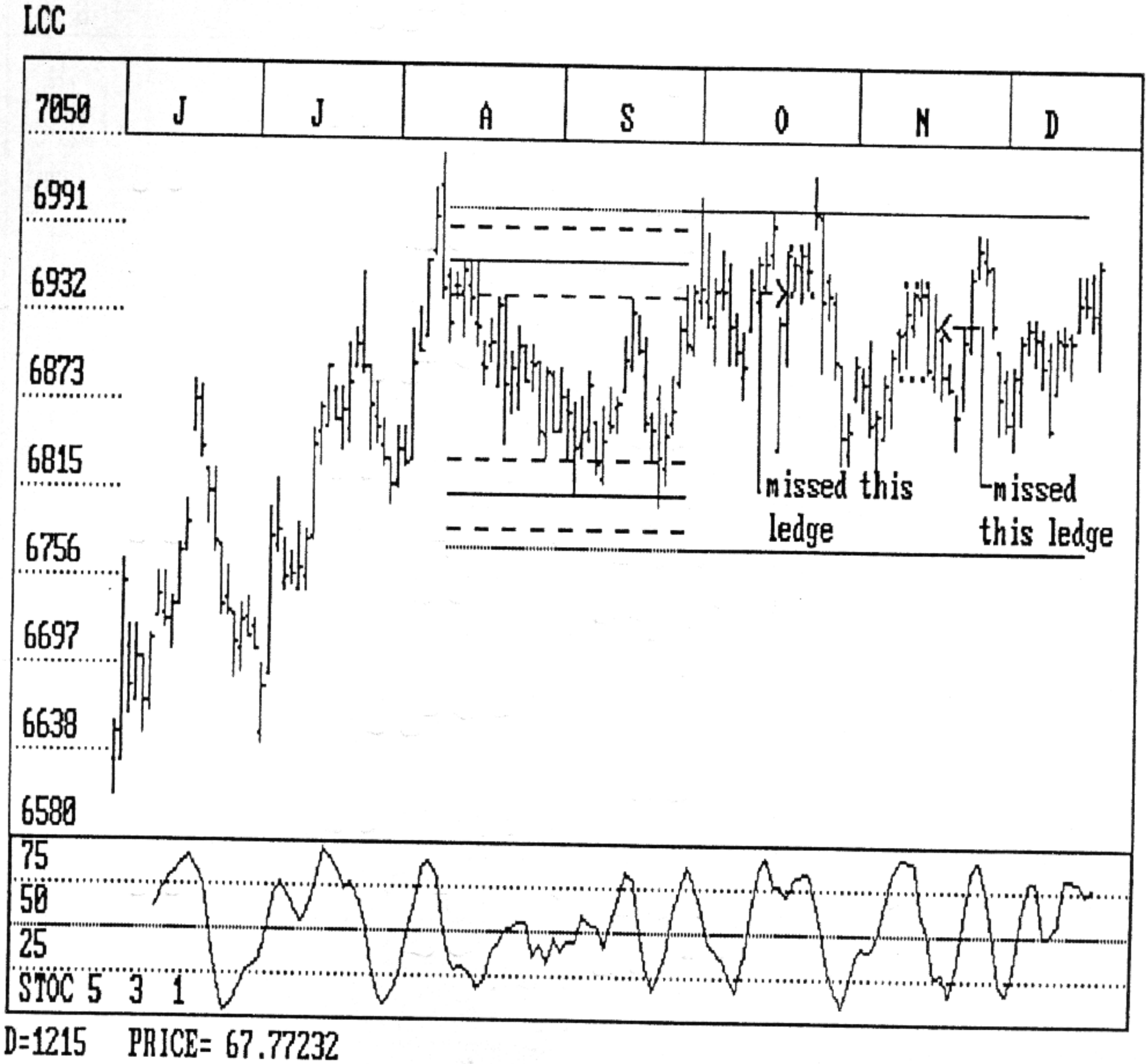

Figure 57

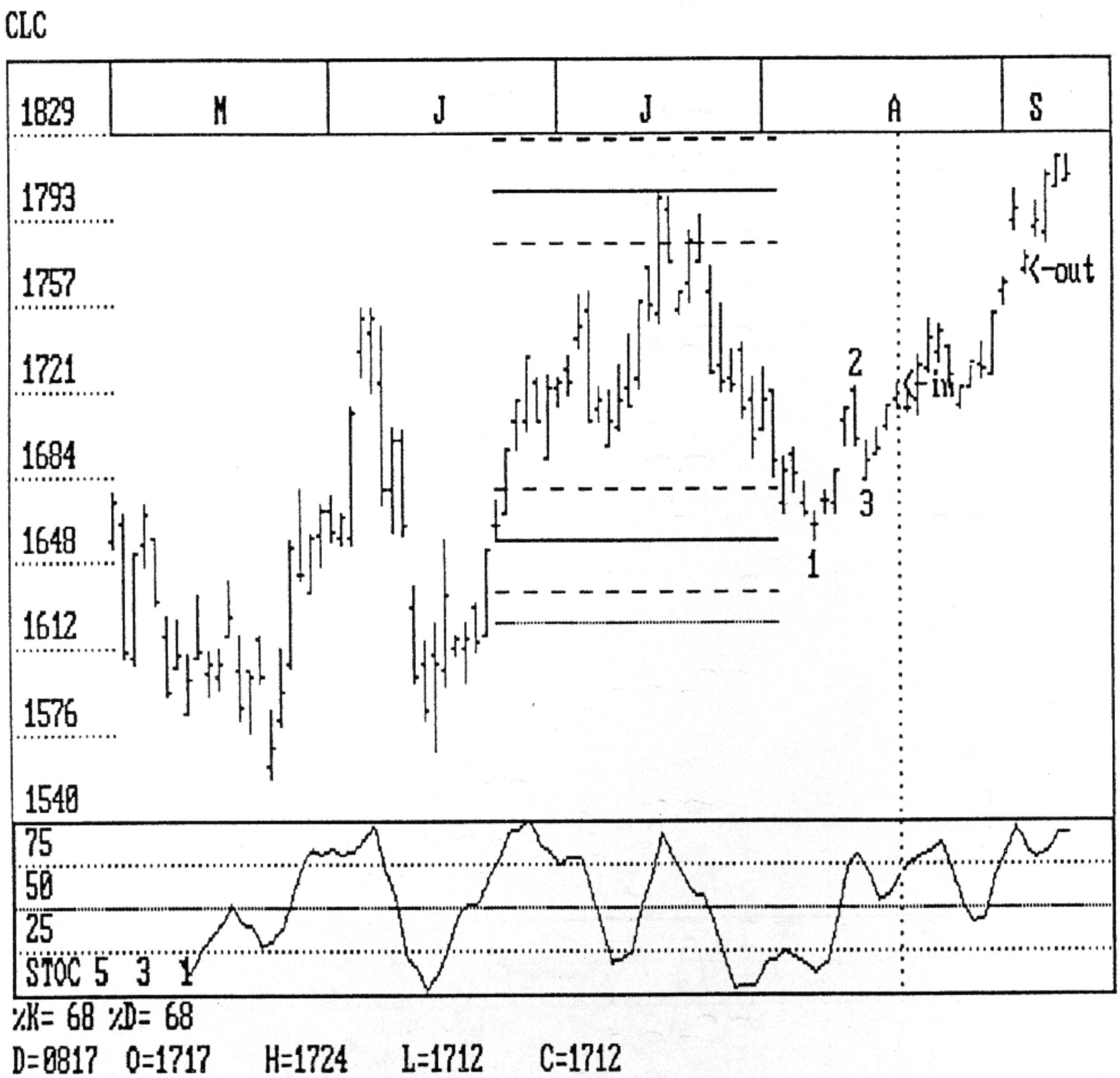

Figure 58 0817. I called in an order to buy a breakout of a 1-2-3 low formation for Crude Oil, and was filled at 1724.

I trailed my stop at each retracement, and was stopped out the day after the triple gap when prices dipped down below my stop.

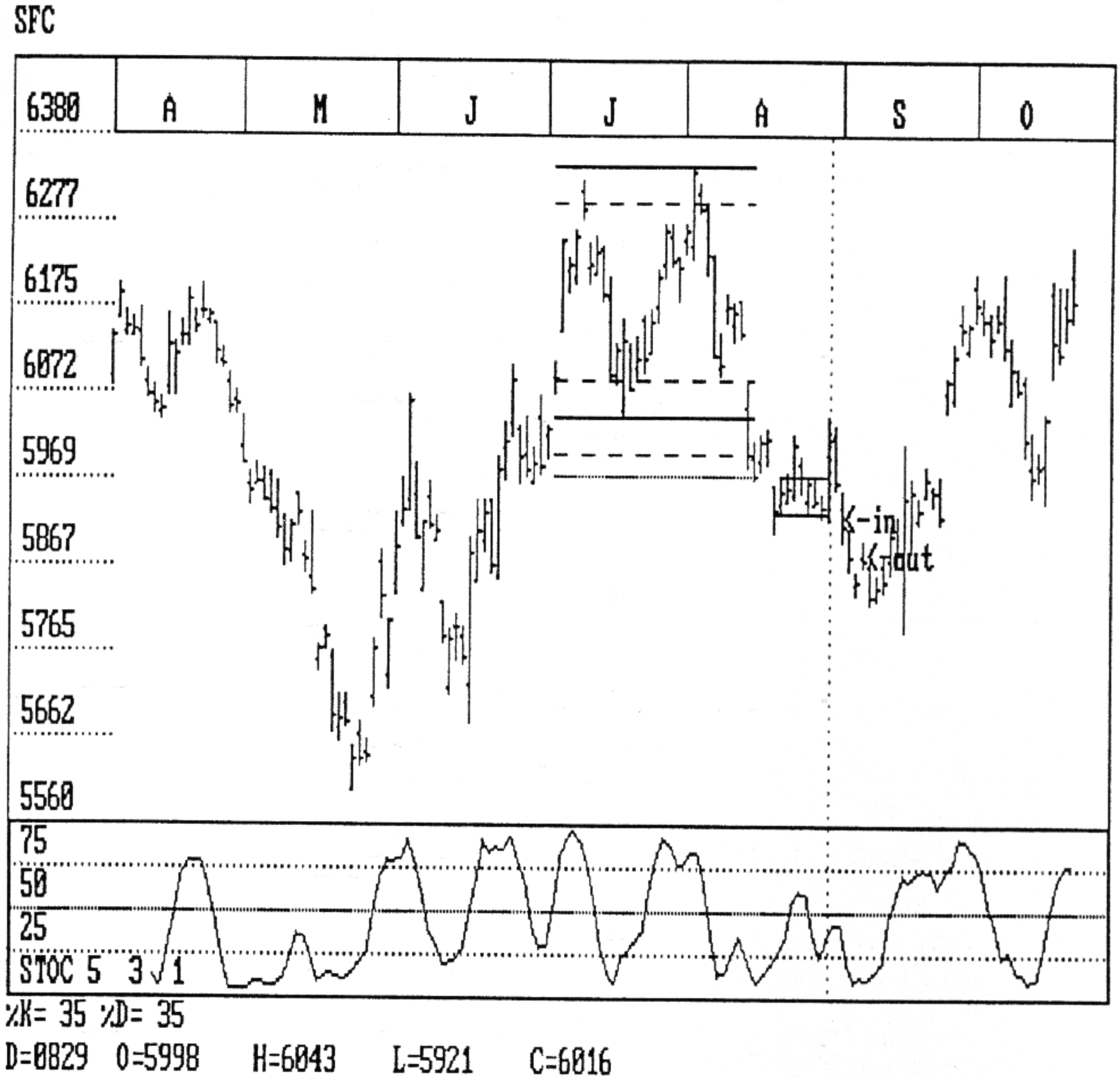

Figure 59 0829. I should have been ready to take my profit on the Swiss Franc that day, and also to buy the upside breakout of the ledge. I'm not saying whether the trade would have worked out, because I didn't make it. But I want to point it out because I want this to be a truthful book.

But, because I did take a third look the next day, I was ready when prices came crashing down through the ledge. I was short the market at the bottom of the ledge, and out 3 days later at the open as prices gapped up past my stop.

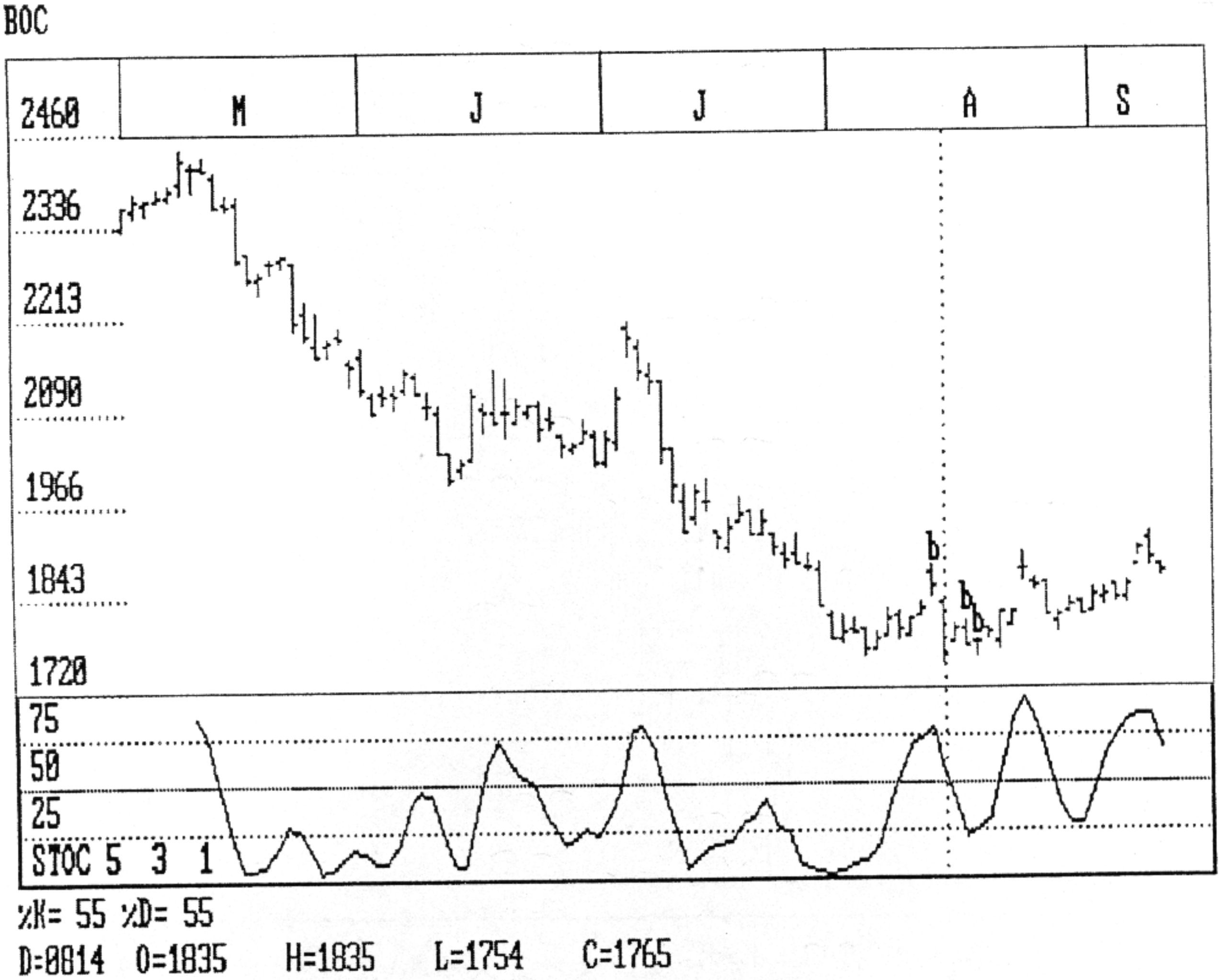

Figure 60 On 0814, the weekly Bean Oil oscillator had been pointing up for three days. The daily oscillator had corrected but was not yet oversold.

I placed a buy order above the high at 1836. The next day was an inside day, so I left my buy stop in place while the daily oscillator corrected some more.

The following day, the daily oscillator reached oversold, and so I moved my buy stop above the high of that day.

Another day passed, so I moved my buy stop down another notch. By this time both oscillators were pointing up.

I've marked as "b" the places where I attempted to buy.

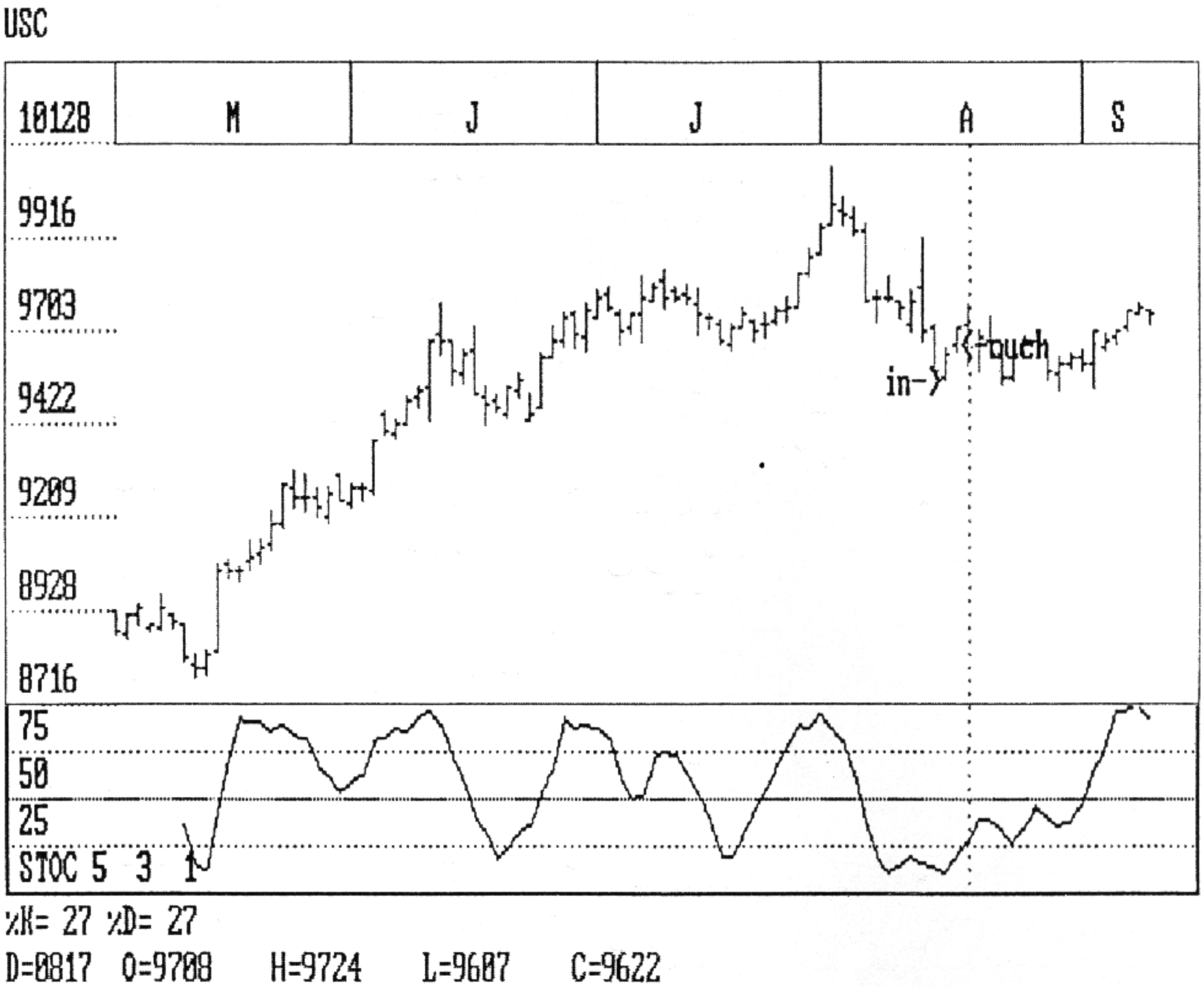

Figure 61 0817. I placed an order to sell Bonds at a breakout of the low at 96-06. My protective stop was at 97-25 and my contingency profit stop was at 95-28.

I was filled the next day, but prices closed near their highs. I tried my previous strategy again. I placed a buy stop at 95-28, hoping to make a profit. The following day I was stopped out at the open for a loss of 12 points.

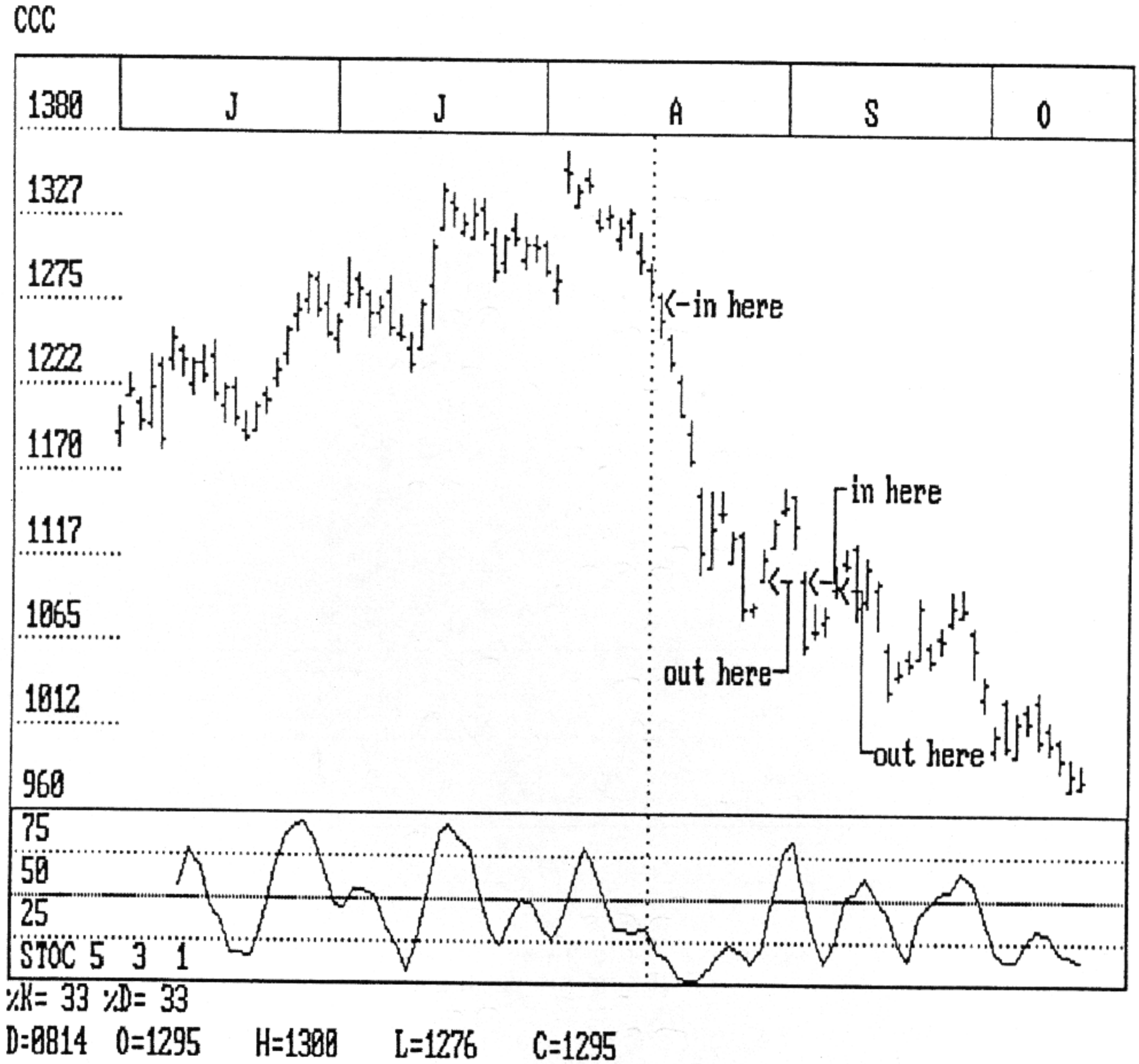

Figure 62 0814. The weekly oscillator for Cocoa was stepping down. One more down day would create a clear cut sell signal. Since the daily oscillator was not yet oversold, I had a low risk opportunity to sell a breakout of the low. I was filled the next day at 1275.

Prices dropped like a rock, in an almost perfectly vertical fall. I trailed my stop above each high and was stopped out on 0828 as shown.

On 0901. With the weekly oscillator still pointing down and the daily oscillator at overbought, I placed an order to sell the breakout of the low and was filled on the open at 1105.

I trailed my stop down and was stopped out at 1098 on the open the day after an inside day, when prices gapped up.

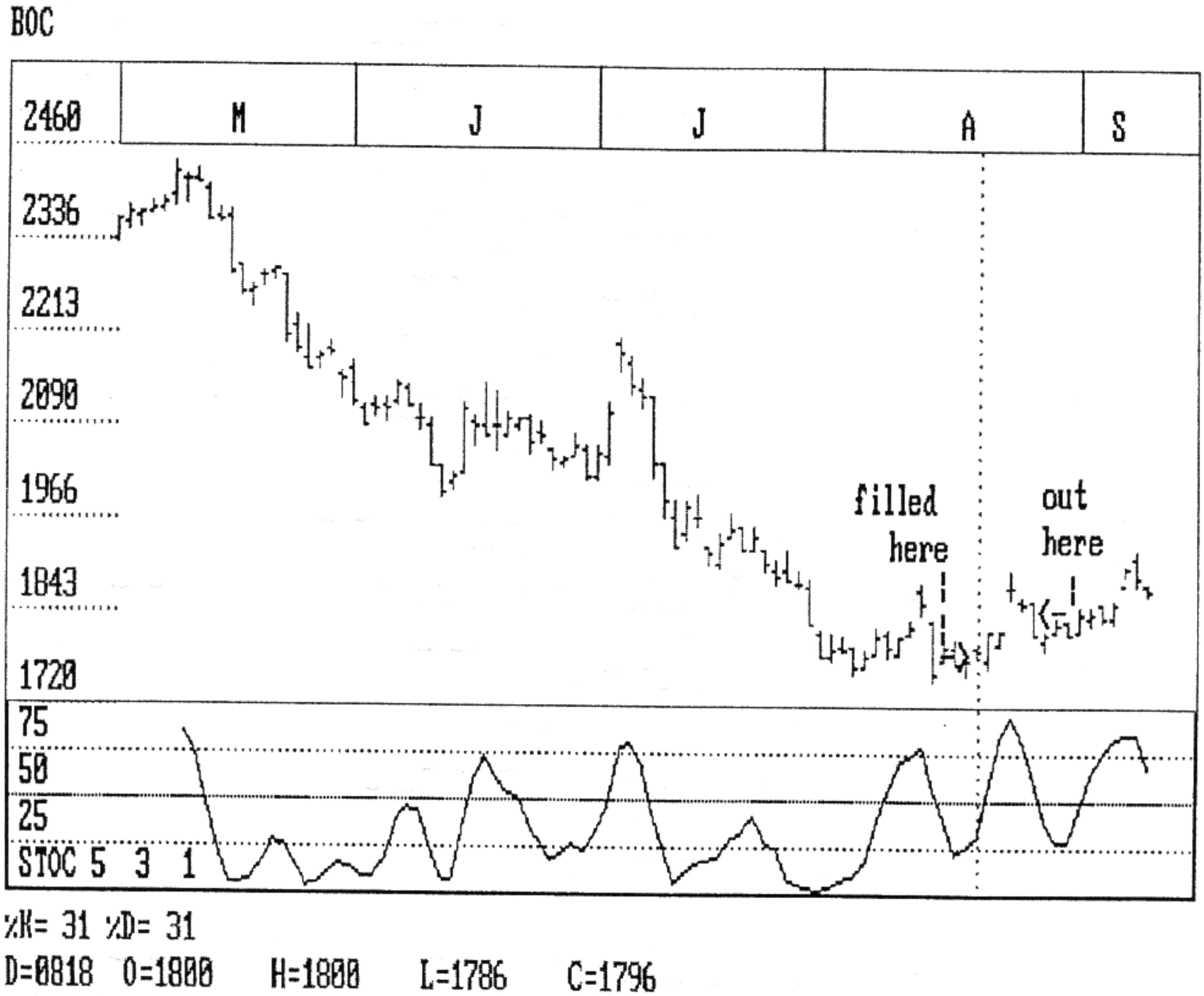

Figure 63 0818. I was filled on Bean Oil at the open of the day shown by the cursor. My stop was under the previous day's low. Prices moved up for two days and then gapped up on the third day, placing the daily oscillator well into the overbought area.

The day after the gap-up high, prices closed too low for me with a much lower high and a lower low. I didn't like what I saw, so I moved my stop tight under the low of that day and was stopped out on the day of the large move down.

The only thing I could do now was to wait for a correction in the Bean Oil.

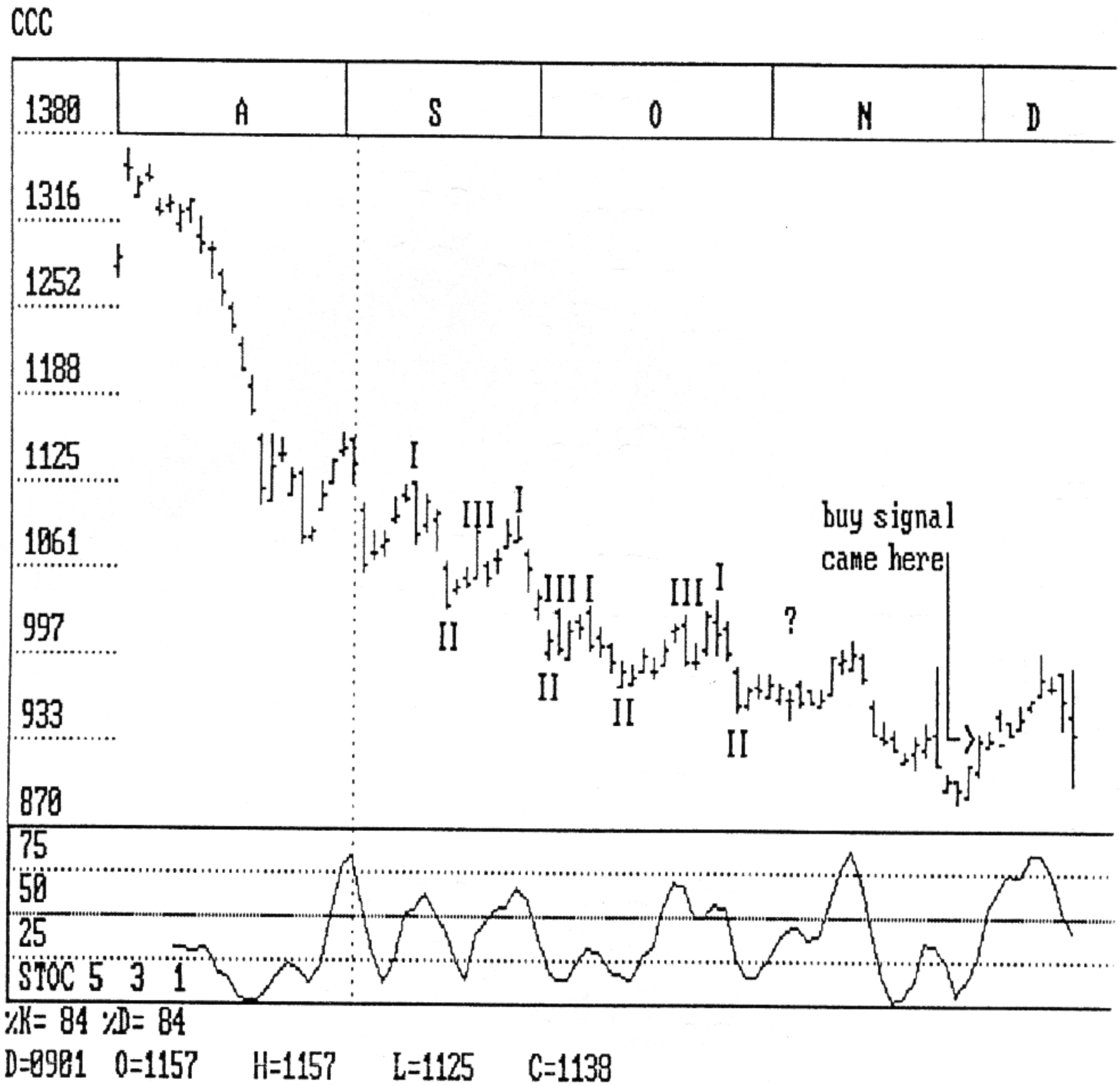

Figure 64 0821. I made several attempts to trade Cocoa over the next few weeks, but could never get any clear cut signals that were to my liking.

There were a series of I-II-III highs, but they were not confirmed by either the daily or the weekly oscillator. I wasn't able to trade Cocoa again until November 30. Since that was so close to my trading cut-off date of December 1, I didn't take the trade. I've shown the market, the I-II-III highs, the trade that could have been entered at the end of November, and the daily oscillator. During this time, the weekly oscillator was flat during all of September and half of October. The weekly oscillator then began a slow rise, while prices continued to drift down until the end of November.

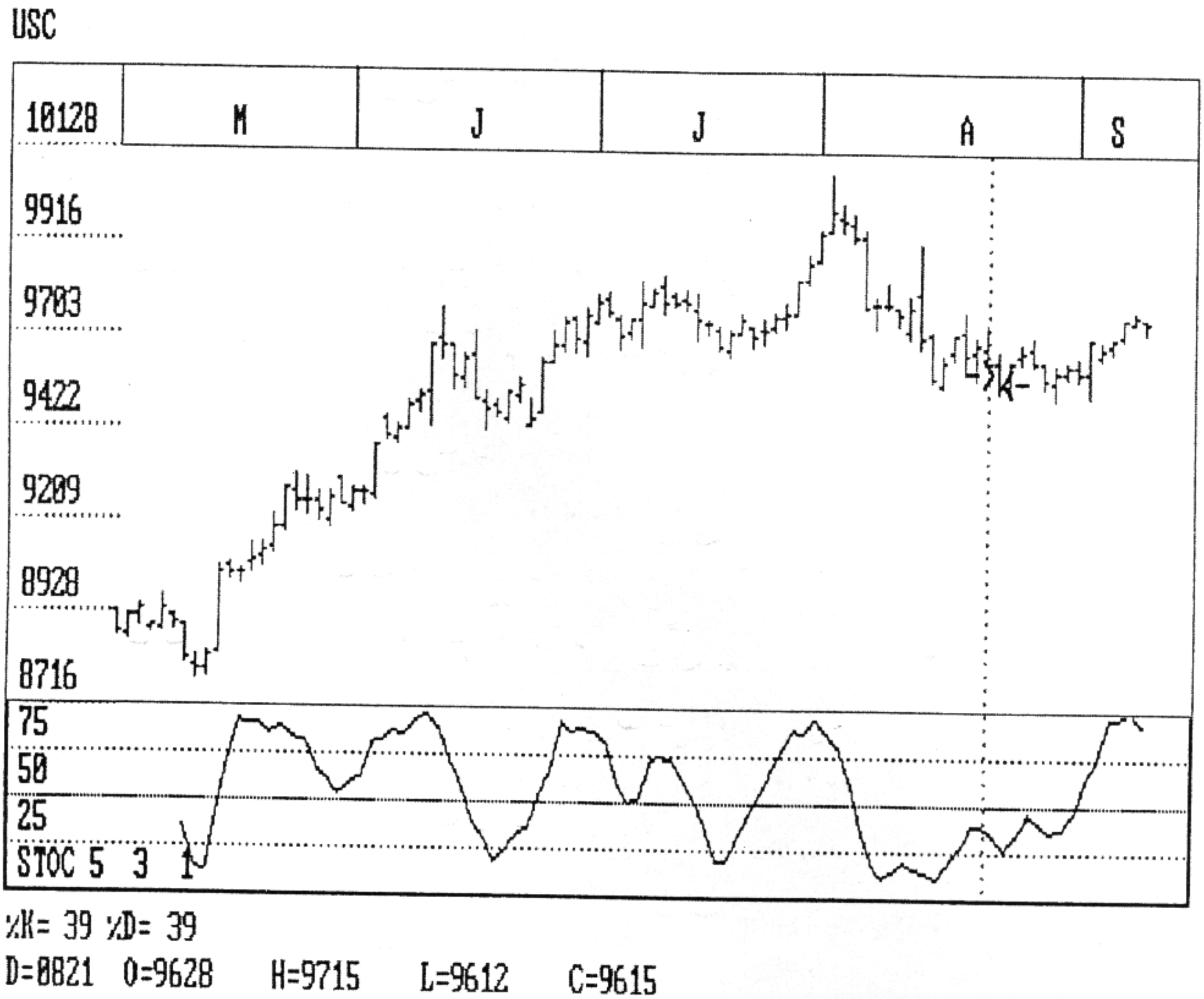

Figure 65 0821. Since everything looked to be fine for a Bond trade, I placed an order to sell at 96-11, with a protective stop at 97-16, and a profit stop at 95-28, in order to try for a few extra points.

I was filled and out with my profit the next day. I then tried to go short again the following day, but couldn't get filled.

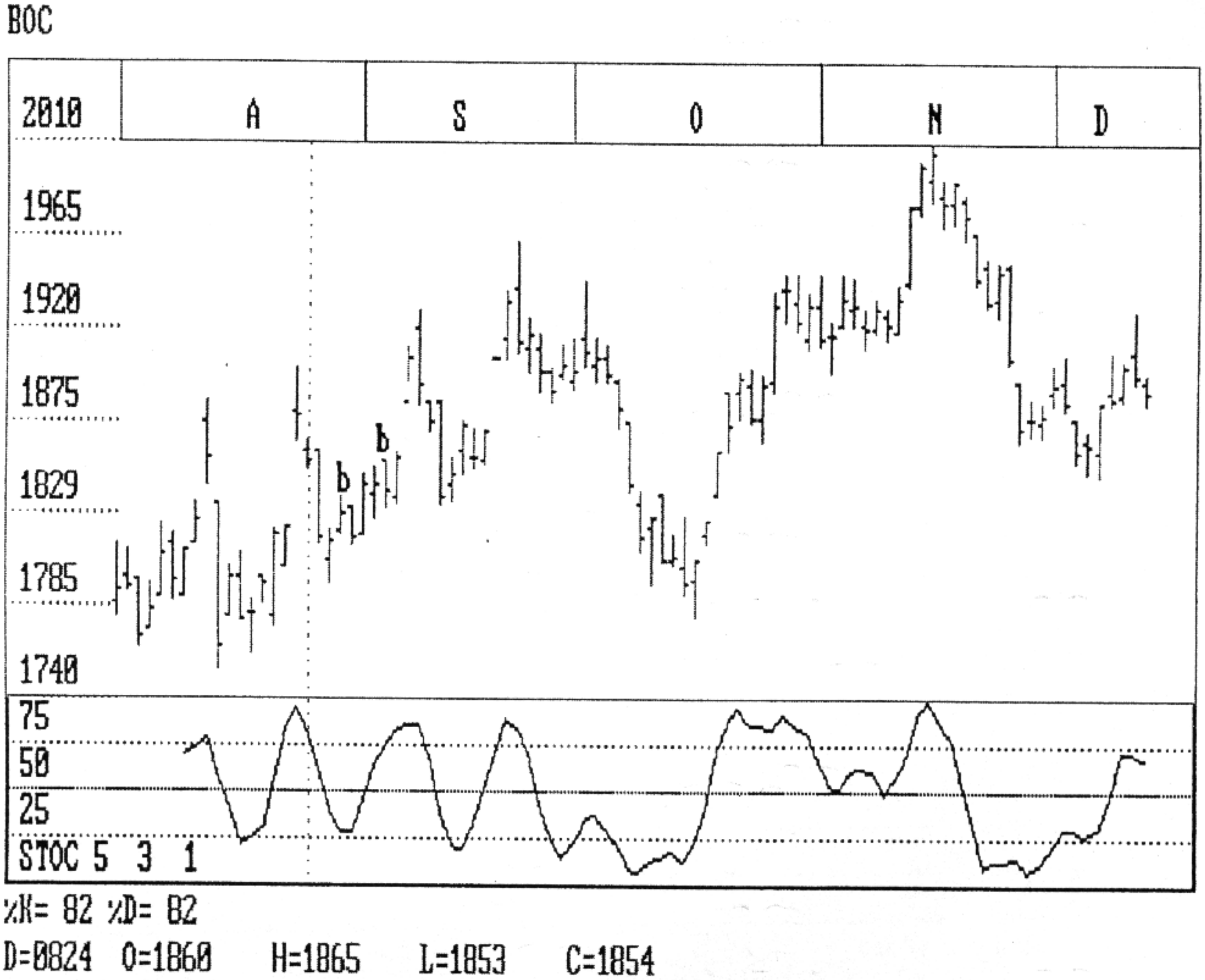

Figure 66 I've shown where the last Bean Oil trade ended on 0824. The day I got out, the market began to correct. The weekly oscillator went flat for the next three days and then moved up one notch.

I placed an order to buy the breakout of the high on the day the market turned up. The next day there was no fill and the weekly segment moved down a notch, while the daily oscillator went flat.

I withdrew my buy order.

The following day there was an up tick on the weekly oscillator, and then another. The daily oscillator was not oversold, so I placed an order to buy the breakout of the high. I've marked with a "b", the high breakout I was trying to buy.

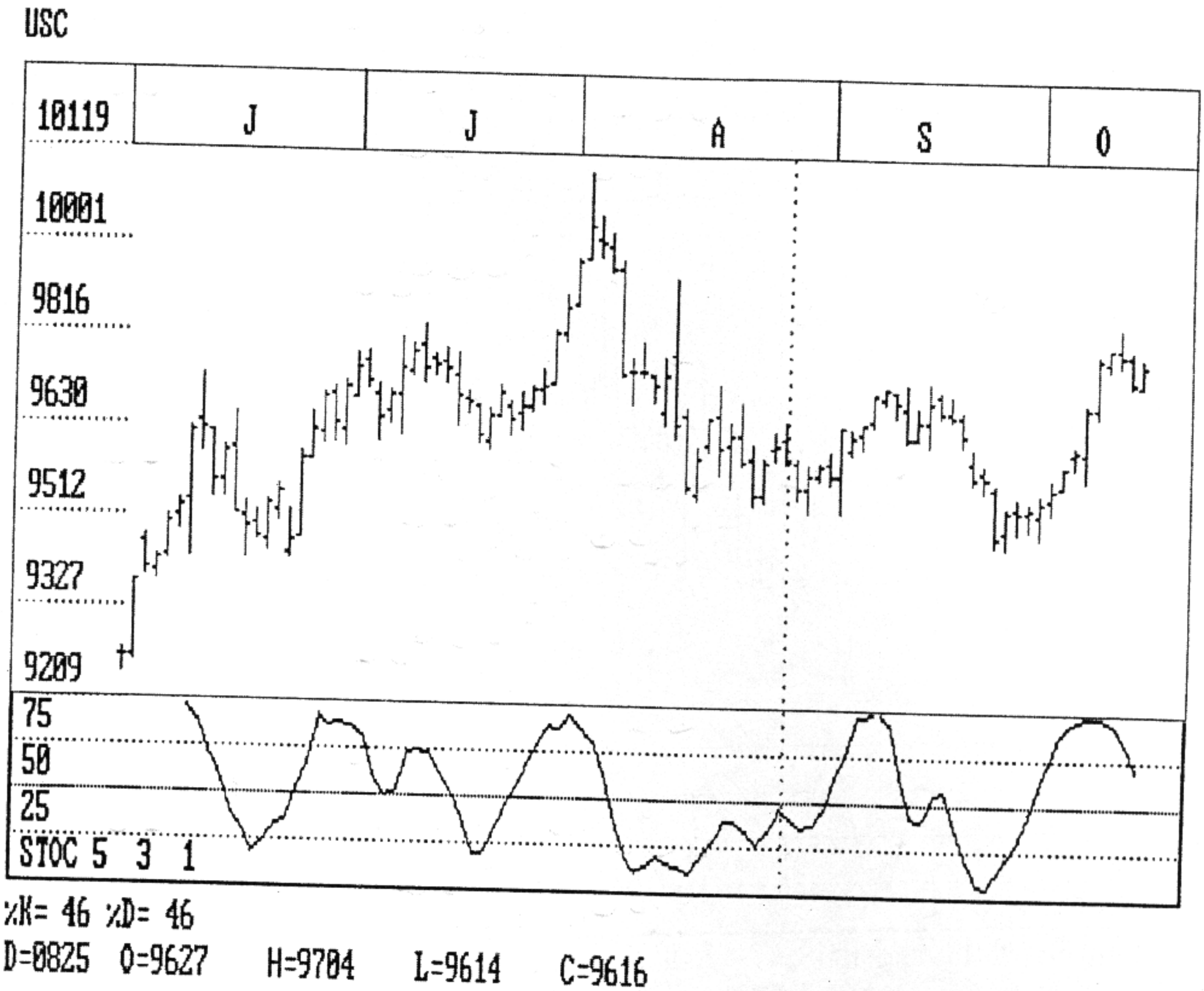

Figure 67 0825. Even though the weekly Bond oscillator showed down, with the daily oscillator making rising bottoms, I didn't dare go short. Too bad, it would have been a good ten point trade.

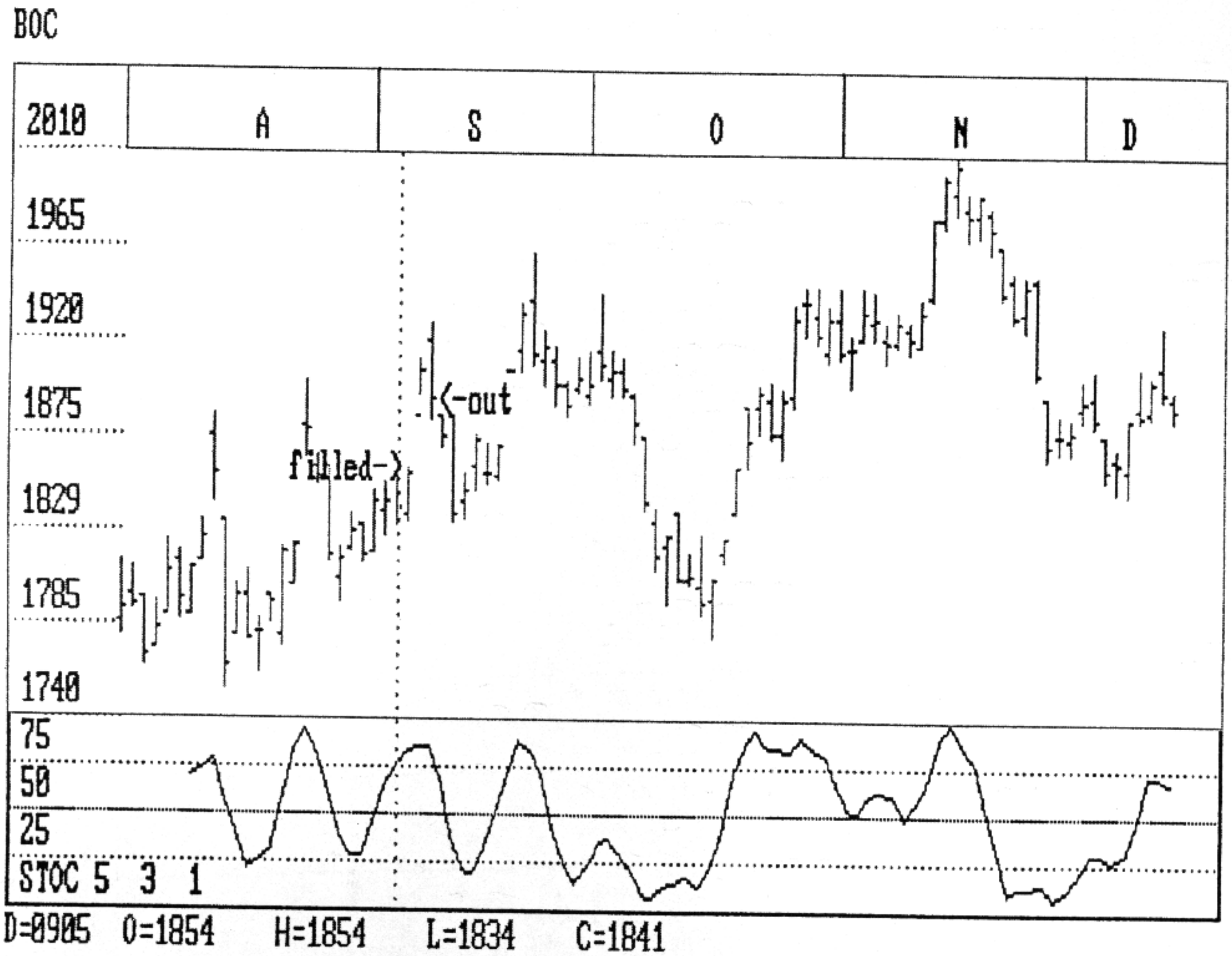

Figure 68 0905. I was filled on my Bean Oil trade at the open. My stop was under yesterday's low.

The market moved up, then gapped limit up, followed by another gap up.

I moved my stop to below the low of the day following the limit move, and I was out of the market on the blowoff day, waiting for prices to correct.

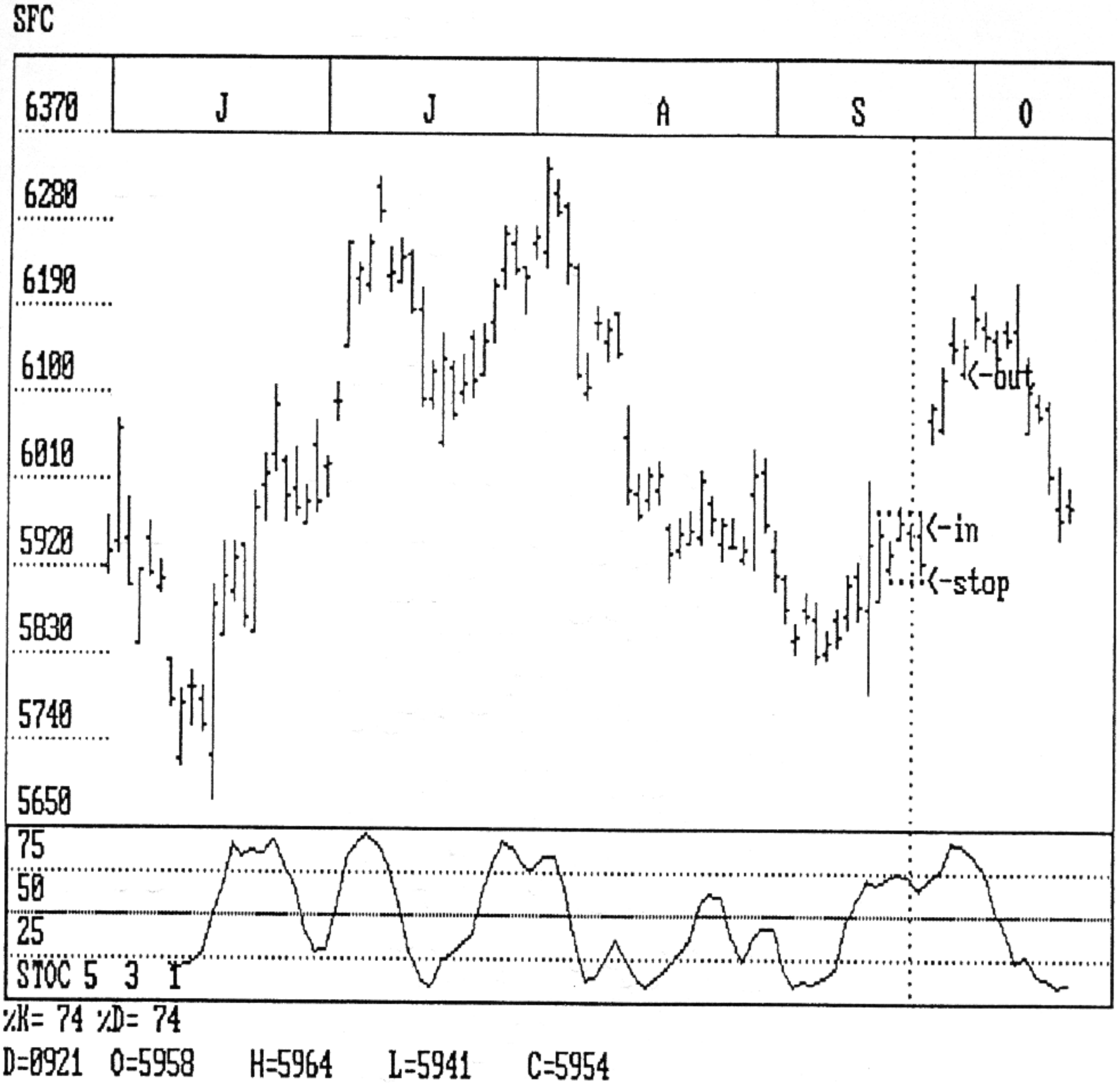

Figure 69 0921. My next opportunity to trade the Swiss Franc started when the weekly oscillator turned up. The daily oscillator had reached overbought and was flat. I tried to buy a breakout of the high of the day, and was filled the next day. After my fill, prices closed much lower on the day.

I placed a protective stop at the low of the day I was filled and was uncomfortable about the trade until the next day, when prices made a 163 point move up. I was tickled pink.

I moved my stop to the low of gap day, and the next two days prices moved on up some more. I've shown where I was stopped out on 0928.

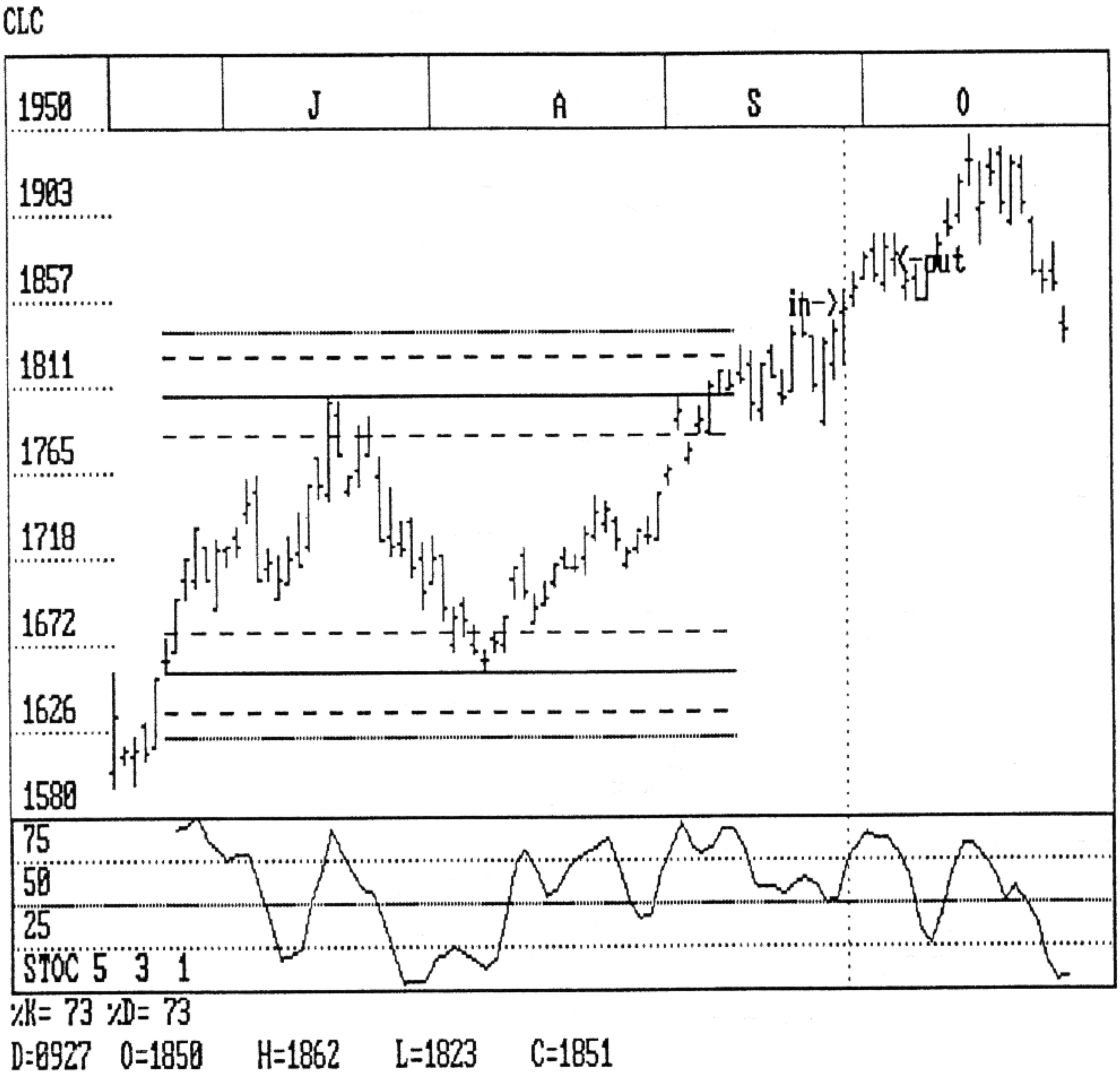

Figure 70 0927. Crude Oil prices closed outside of the envelope for the first time in months. The weekly oscillator was flat to rising at the time, and the daily oscillator had just entered overbought. Crude had just been in a 17 day sideways range within the envelope shown on the chart. I was filled that day at 1851.

I've shown where I was stopped out for a modest gain.

This was my last Crude Oil trade for the year. Prices then formed an envelope that lasted into December, at which time I wasn't trading.

I've shown the trading range in Figure 71.

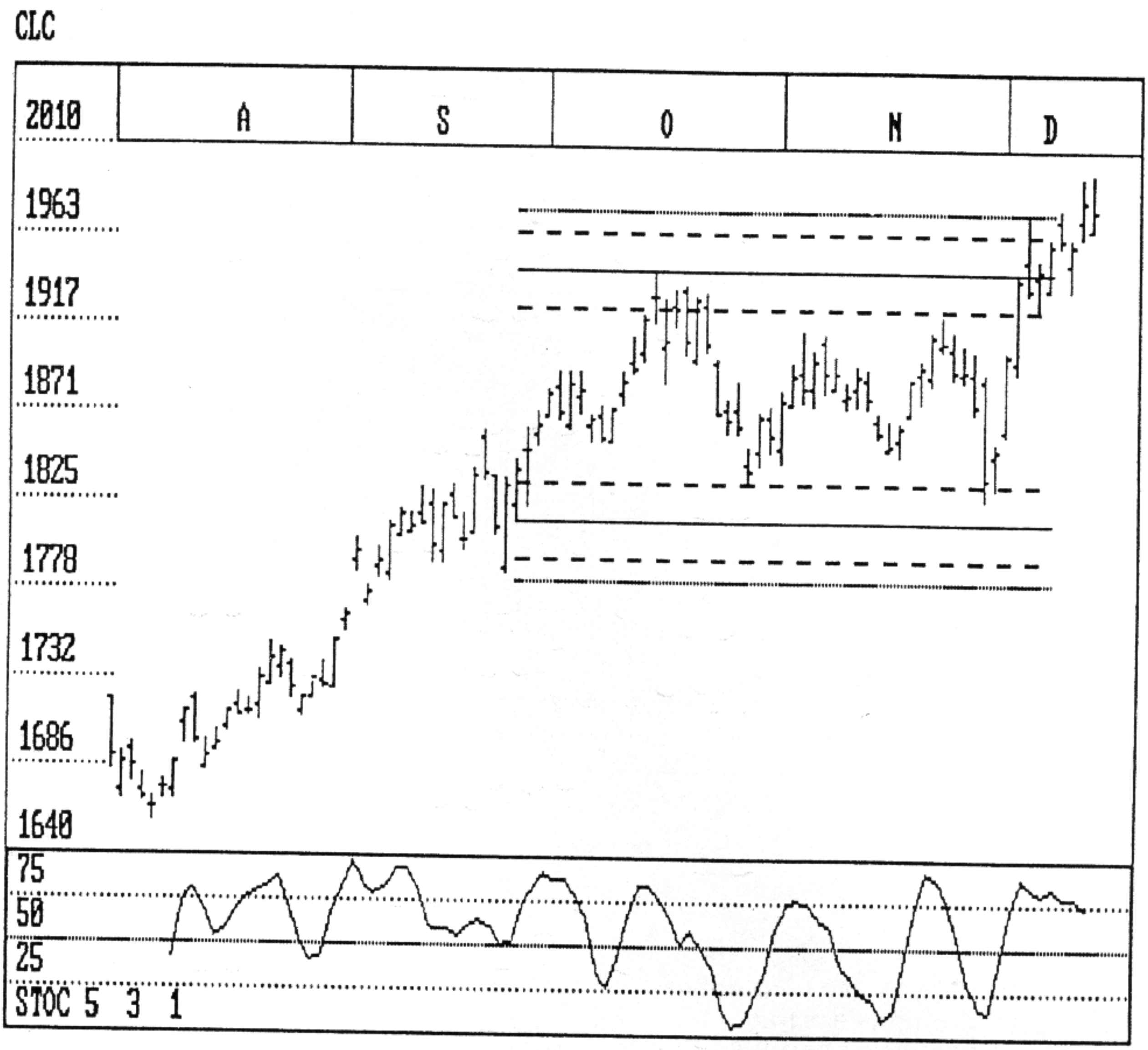
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Figure 71

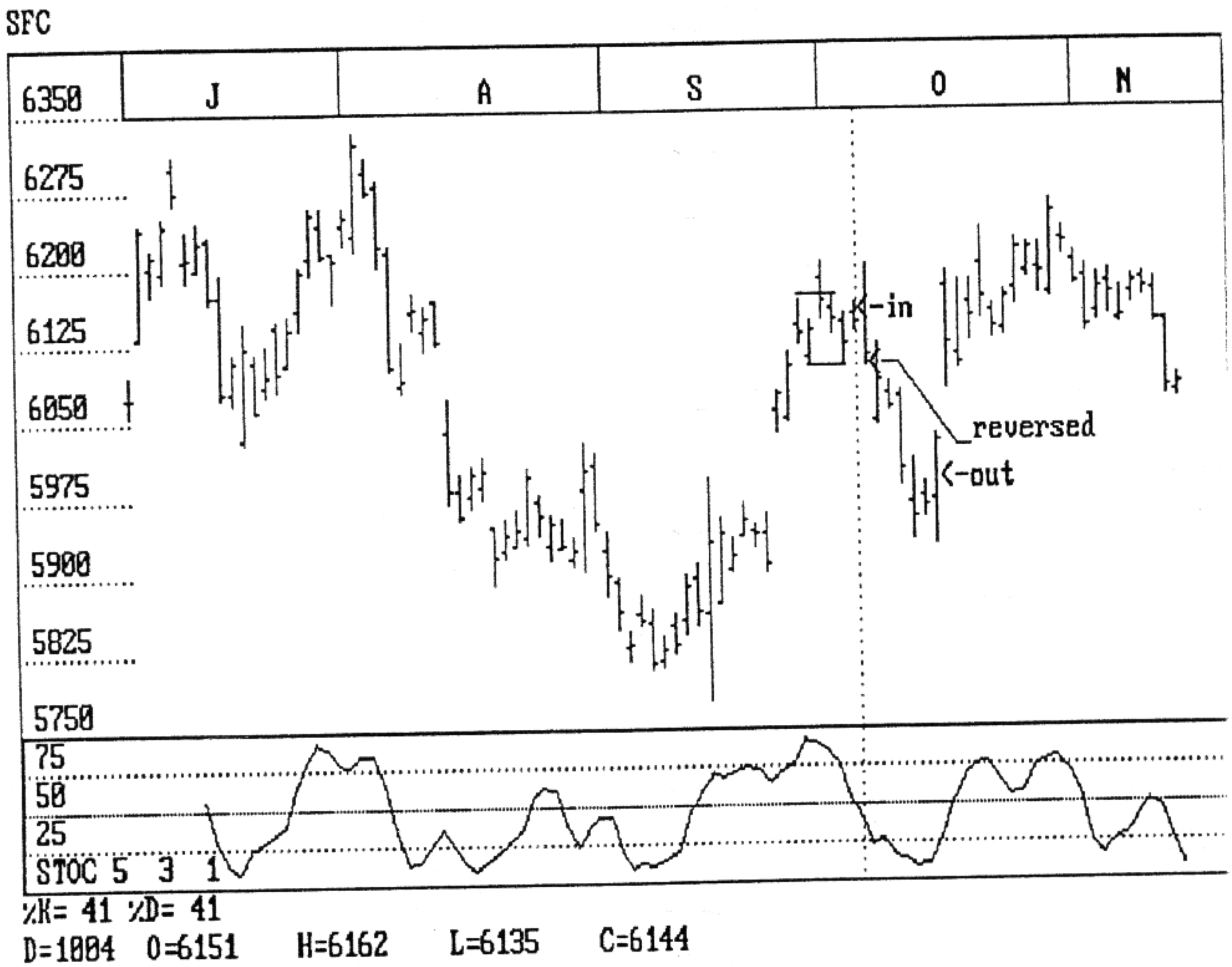

Figure 72 1004. My next chance to trade the Swiss Franc came only four days after taking profits on my last trade. The weekly oscillator was pointing up and the daily oscillator was correcting. I had tried to buy a breakout of the highs for the previous two days, but couldn't get filled. Finally on 1004 I was filled shortly after the open at 6154, with my stop below the low of the previous day at 6102.

When the markets had closed and I was going over my charts, I realized a ledge had formed between 6103 and 6153. I didn't care if the breakout came to the upside a that would have strengthened my position. But because of the ledge, I changed my protective stop to a reversing stop. The next day, prices broke to the upside, but then crashed and took out my reversing stop at 6102, actually filling me at 6101, the low of the day. I was down 53 points (6154-6101).

I placed a protective stop just above the top of the ledge for my new short position. The next day, prices gapped down at the open, but closed near the midpoint. moved my stop to the high of the day. Then prices moved down repeatedly for four mo days. I trailed my stop behind the high of each day, and was stopped out as shown aft the inside day. I had regained all my lost points plus another 58 points to boot. Then somebody said something about looking like the cat that swallowed the canary.

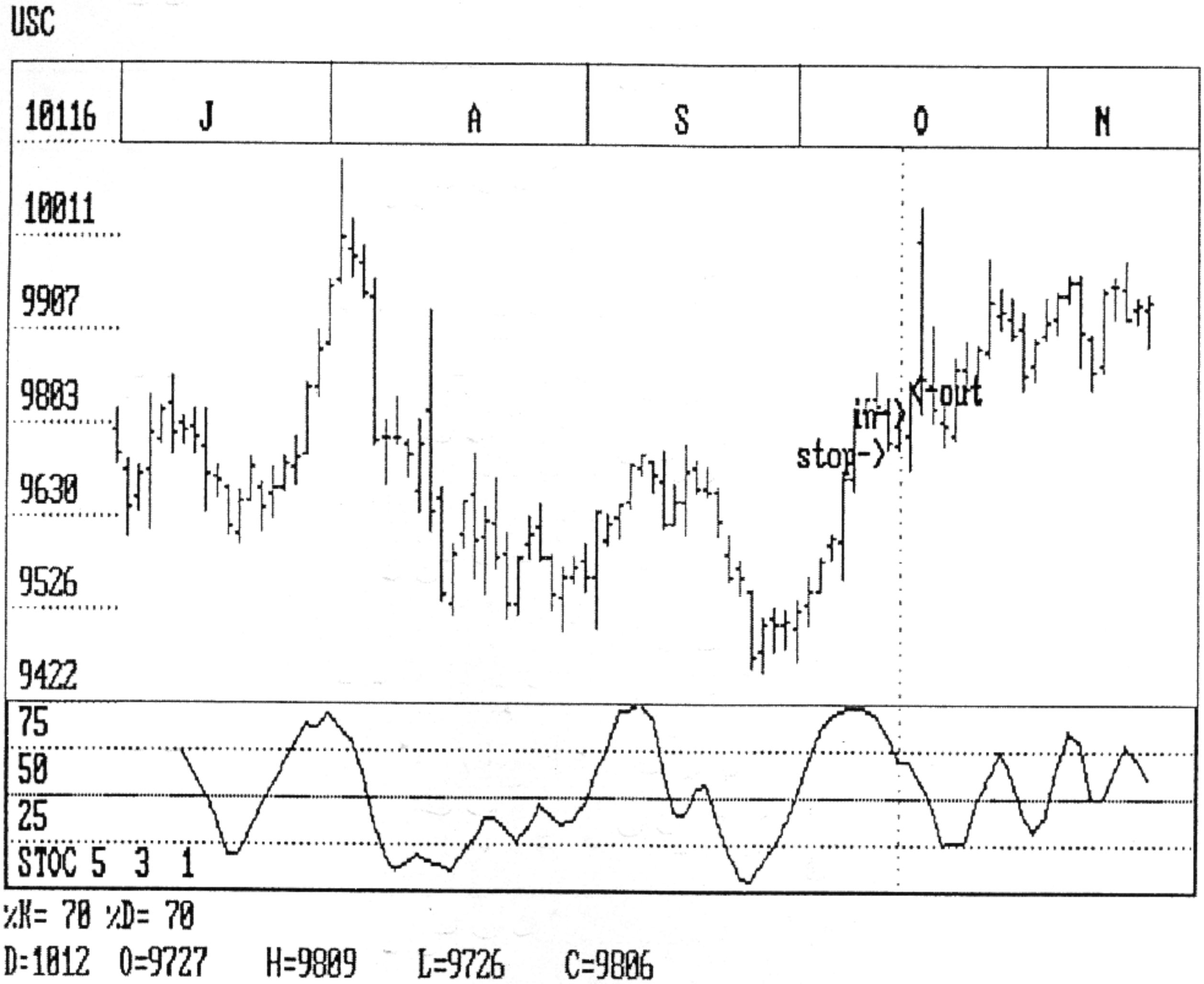

Figure 73 10112. My next chance to trade the Bonds came in October. The weekly oscillator was pointing up. The daily oscillator had corrected out of overbought, and I decided to buy the breakout of the high at 98-10. My stop loss was at 97-22 and my profit stop was at 98-20. I was filled and out with a profit the next day.

Because I was filled on a blowoff day, I decided to wait rather than go for it again the following day. Boy, was I ever glad that I did that.

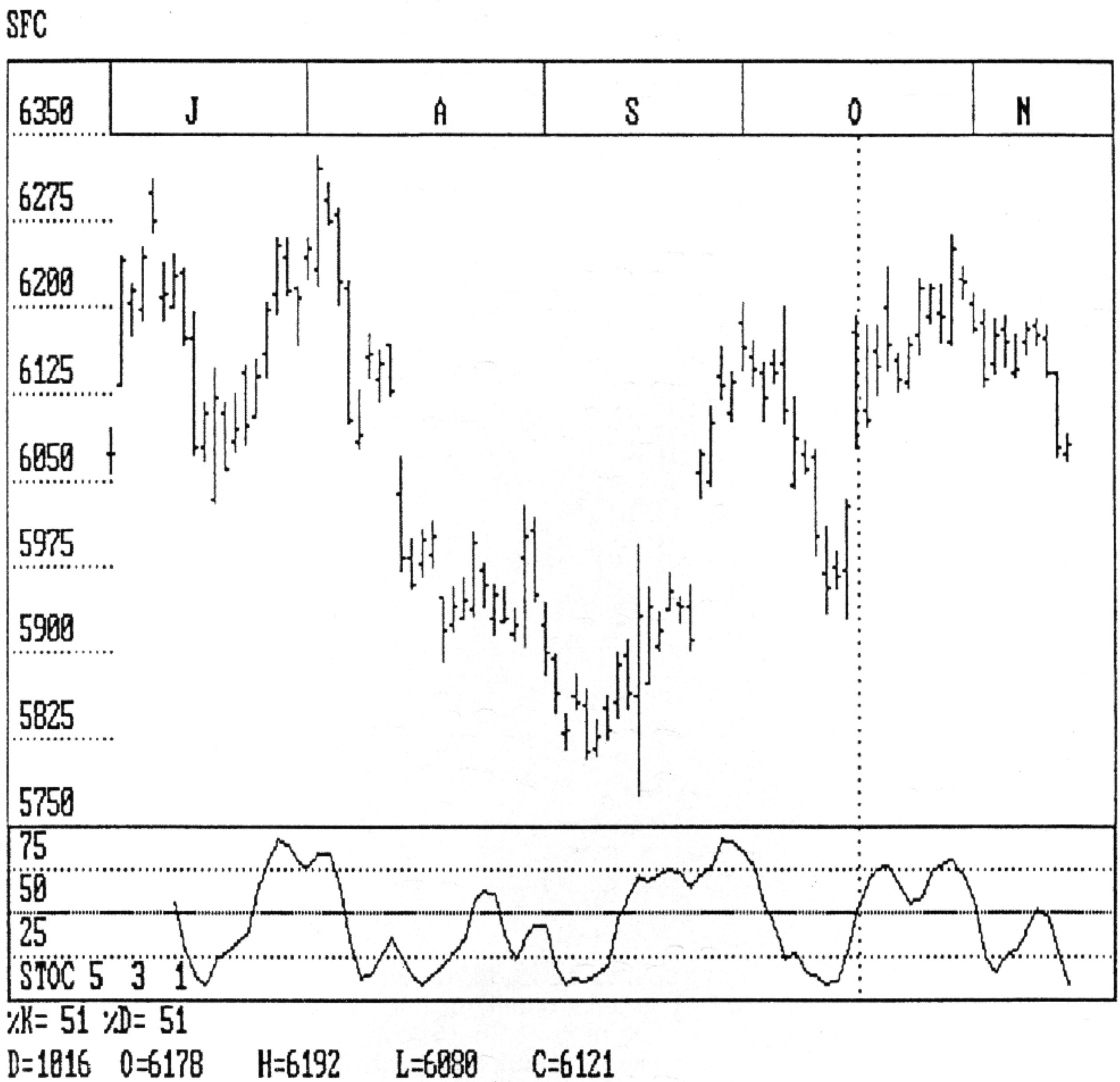

Figure 74 1016. The weekly oscillator for the Swiss Franc was pointing up and the daily oscillator was not yet overbought. Prices had moved up on two large magnitude days coupled with a gap.

I placed an order to buy a breakout of the High, but was not filled. As prices seemed to stall, the daily oscillator reached the overbought area and so I canceled any further trades.

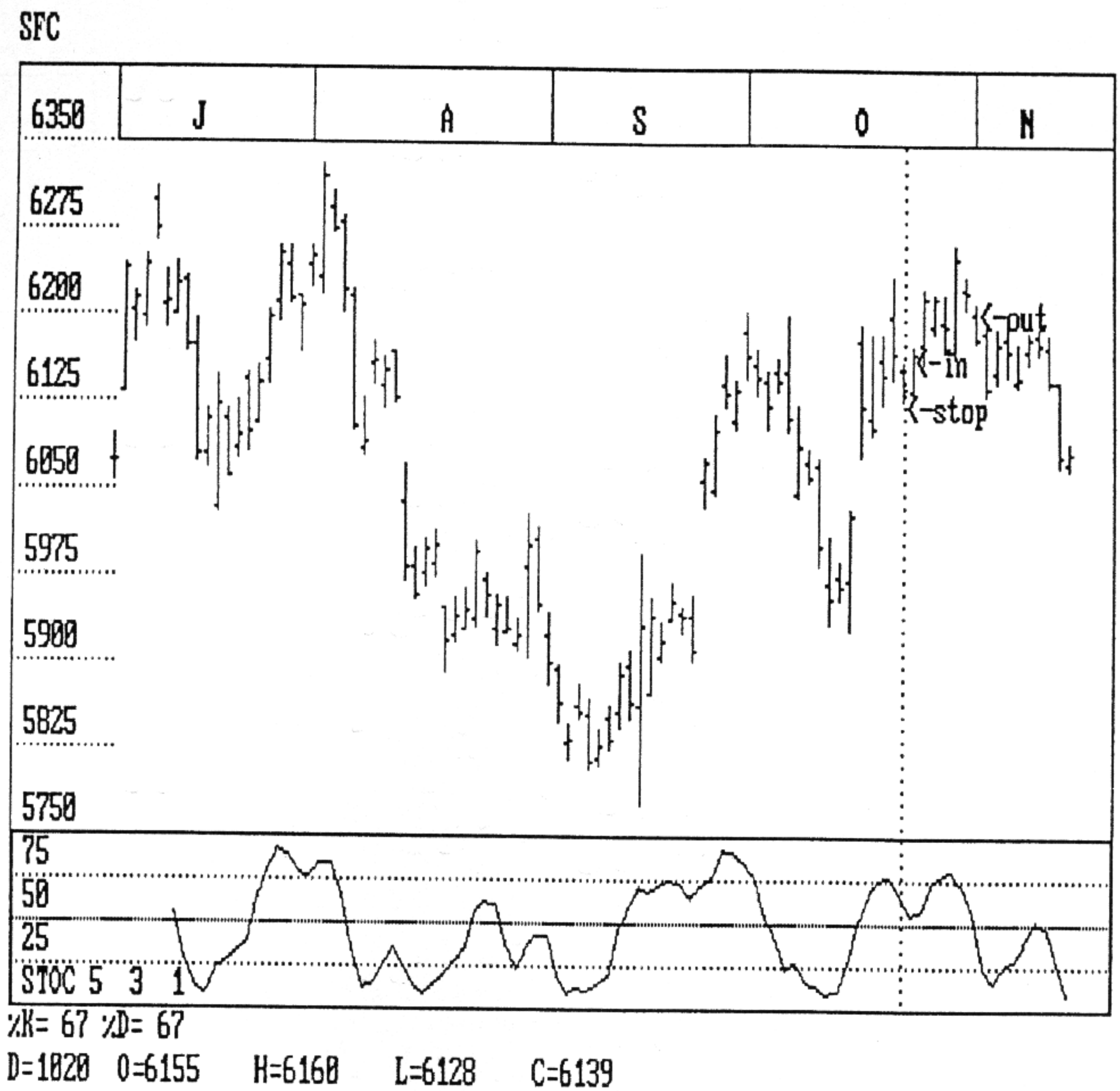

Figure 75 1020. The weekly oscillator for the Swiss Franc was still rising and pointing up, while the daily oscillator was correcting.

I placed an order to buy a breakout of the high of the day and was filled the next day at 6161, with my stop at 6127.

Prices moved up somewhat and I was able to move my stop to breakeven. Then came a blowoff day. I moved my stop up a few notches so that I would show some profit, and the next day was an inside day.

I then moved my stop to just below the low of the inside day and was stopped out at 6203 as prices gapped down at the opening the following day.

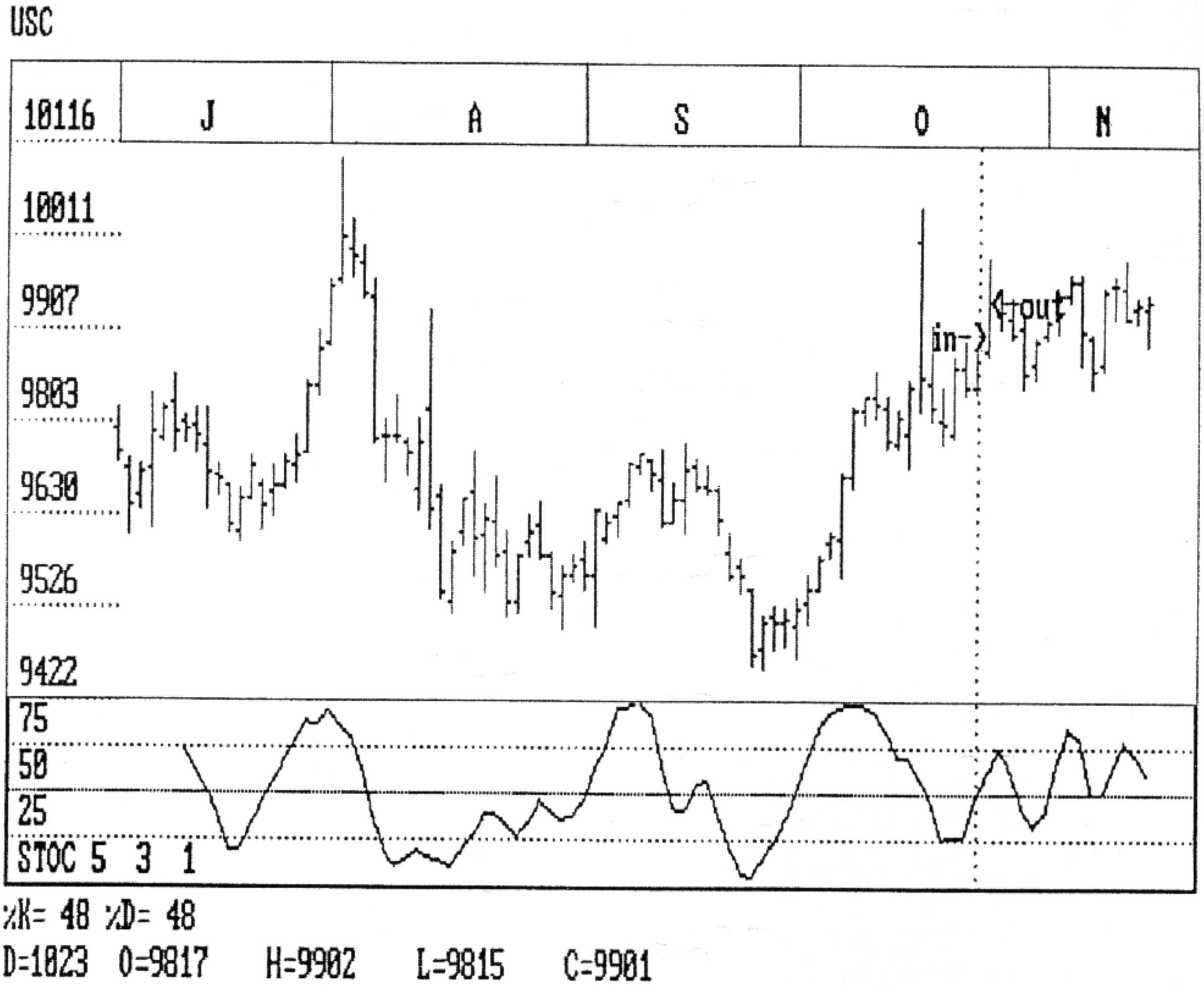

Figure 76 1023. With the weekly Bond oscillator still up and the daily oscillator having corrected and now headed back up, I placed an order to buy the breakout of the high at 99-03. I placed a stop loss order at 98-14 and a profit order at 99-13. I was filled and out with my profit the next day.

I placed an order to buy that day's high, but was not filled. Nor was I filled the following day. At that point the daily oscillator failed, so I quit placing orders.

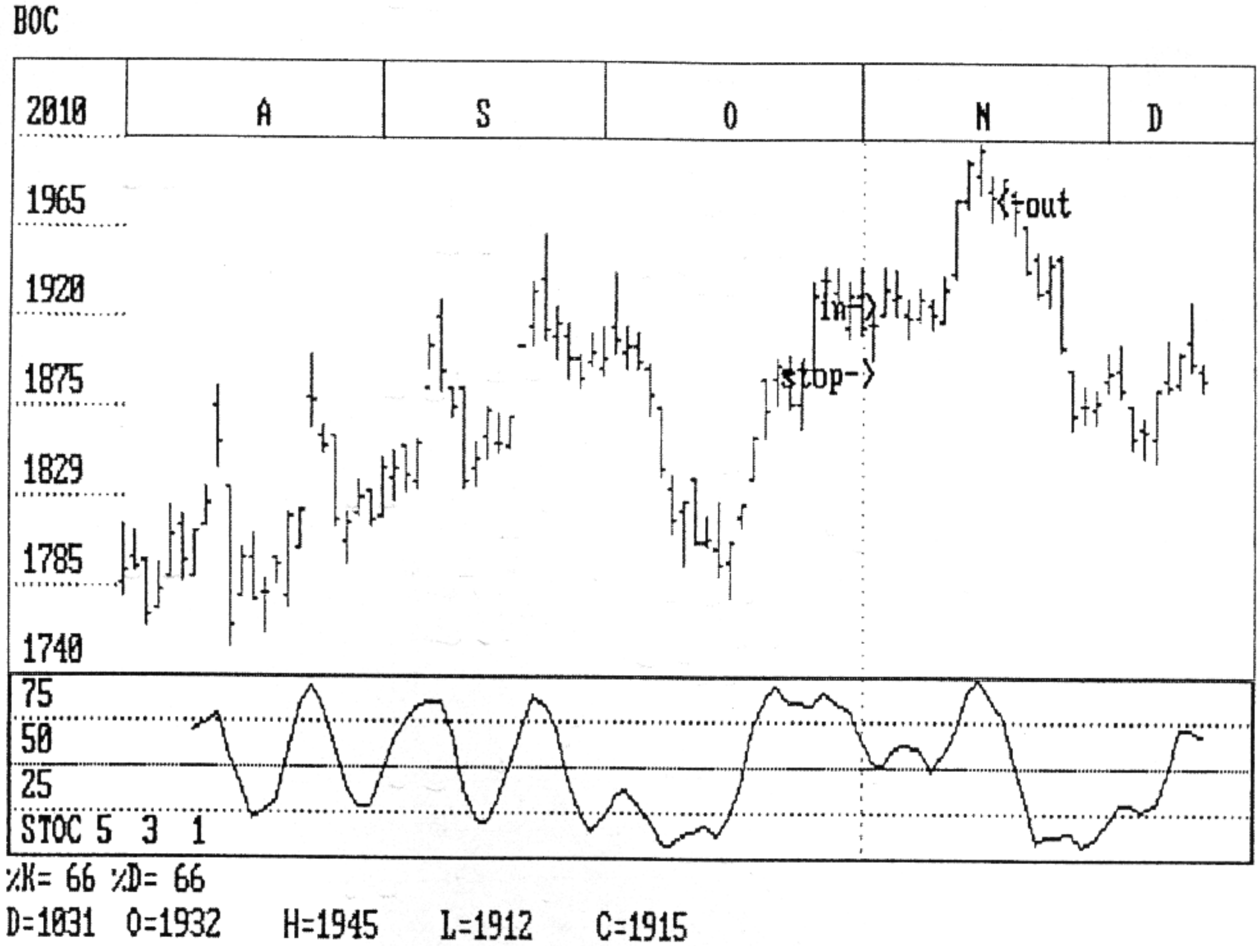

Figure 77 1031. Prices did correct for the Bean Oil, taking the weekly oscillator down a notch for two days and then up a notch for two more days.

Then a limit up day took the two oscillators up, but the daily oscillator was at 71%.

I started to place an order, but then thought to myself, "This market is too crazy for me - just too many gaps and limit days." The market was acting very emotionally and so I withdrew until cooler heads would prevail.

There were no trades available until the market corrected on 1031. At that point I started trying to buy a breakout of the high.

The next day, I moved my buy stop to just above that day's high and was filled the following day with my protective stop as shown.

In two days prices started up. On the day of the large magnitude move, I moved my stop to breakeven, and then trailed it a day behind until I was stopped out as shown the day after the high.

That was my last Bean Oil trade for the year.

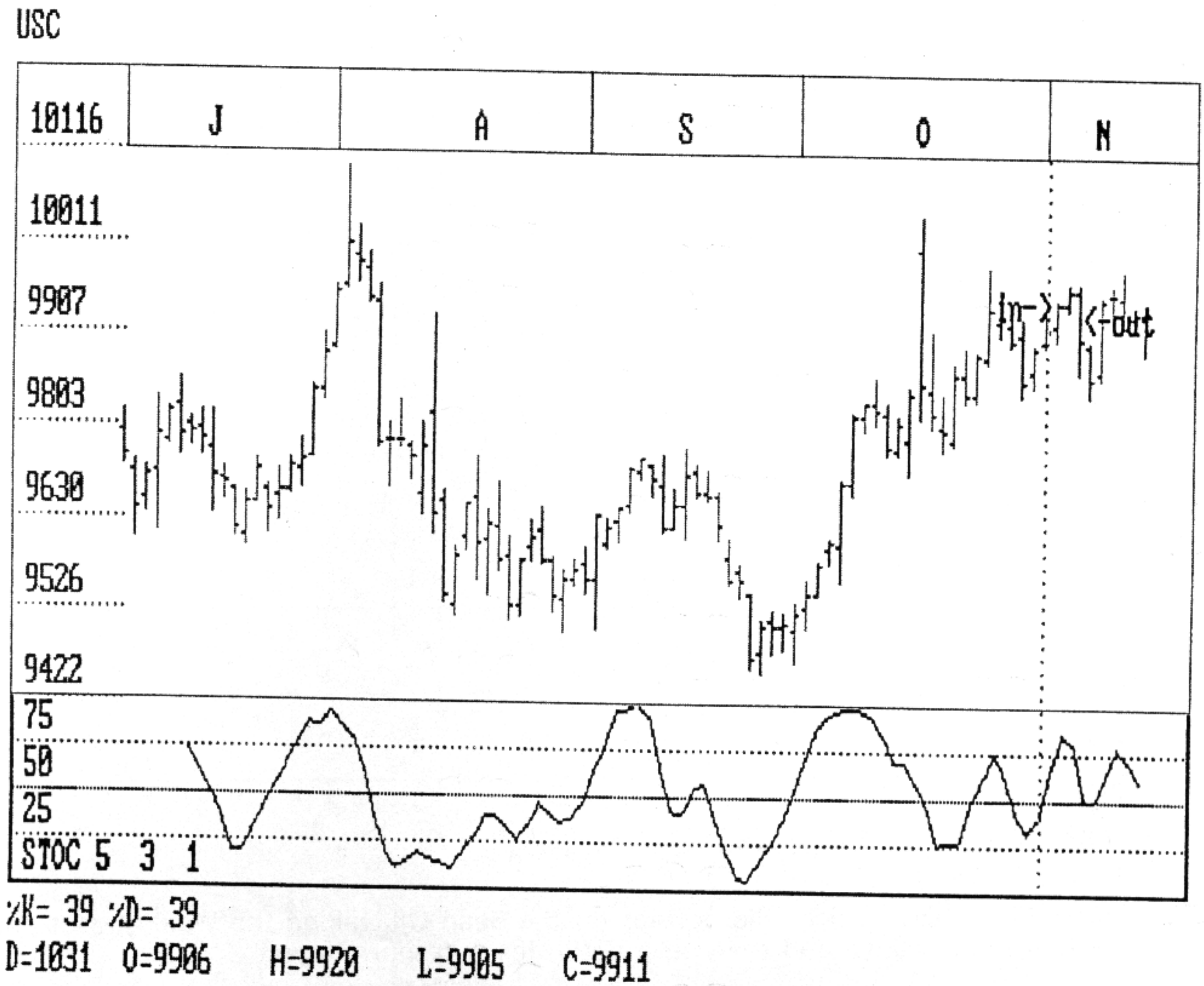

Figure 78 1031. With the weekly Bond oscillator still up and the daily oscillator correcting and making rising bottoms, I placed an order to buy at 99-21, protecting 99-04, and with a profit objective of 99-31. I was filled the next day with prices closing near their highs.

I moved my stop loss to 99-06, and prices moved up and closed high.

I move my stop to 9918 and was stopped out the following day at that price for a 3 point loss. I then called myself a few choice names and vowed never again to stay in a Bond trade for 3 days.

That was my last Bond trade for the year.

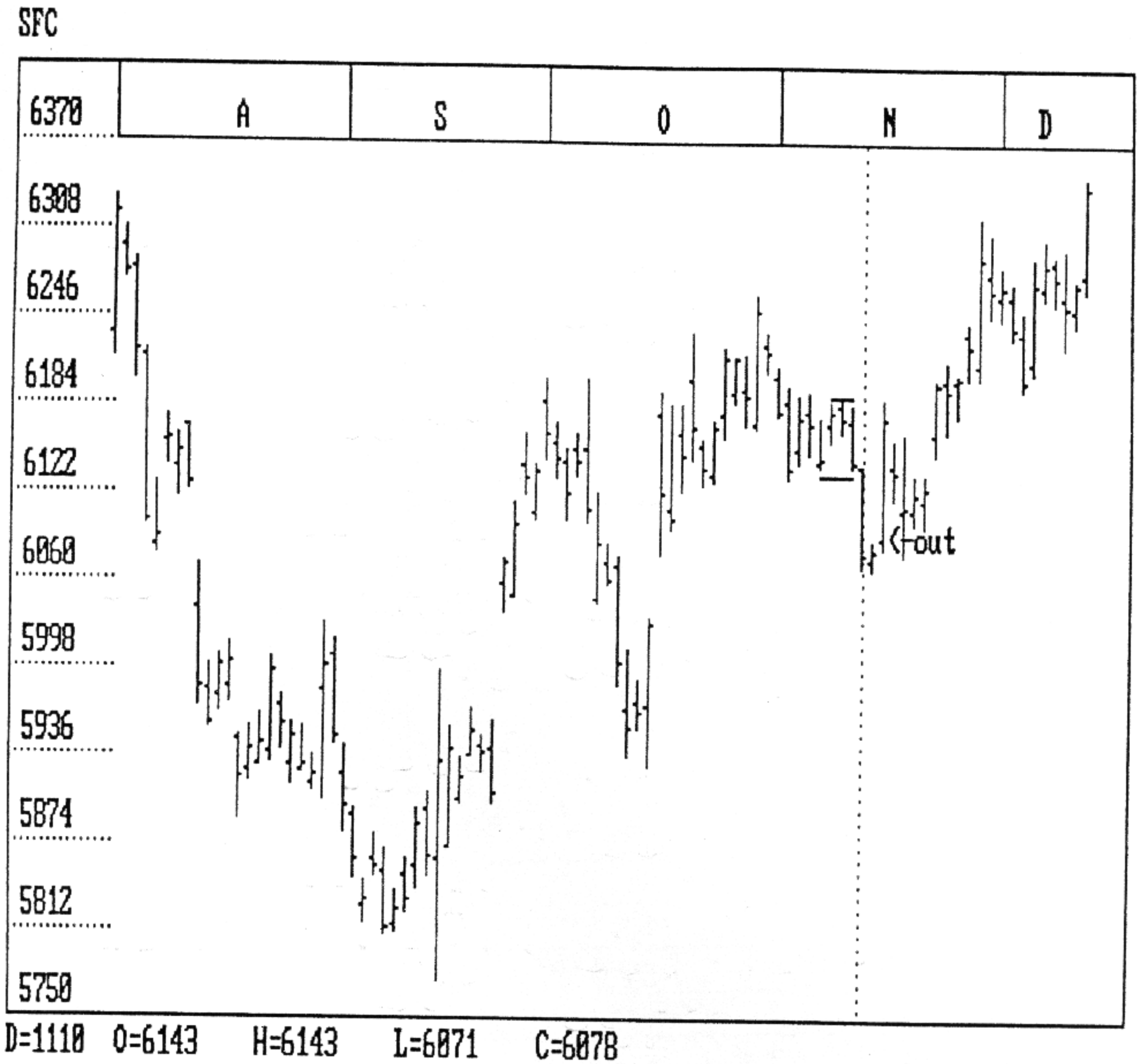

Figure 79 1109. Prices for the Swiss Franc drifted sideways until they formed a ledge between 6185 and 6141 as shown on the chart.

I called in my order to buy 6186 or sell 6140, with the opposite side of the fill becoming my initial stop.

I was filled shortly after the opening and prices moved down nicely. I then moved my stop to just above the high of the following day and was stopped out the day after that, at the opening.

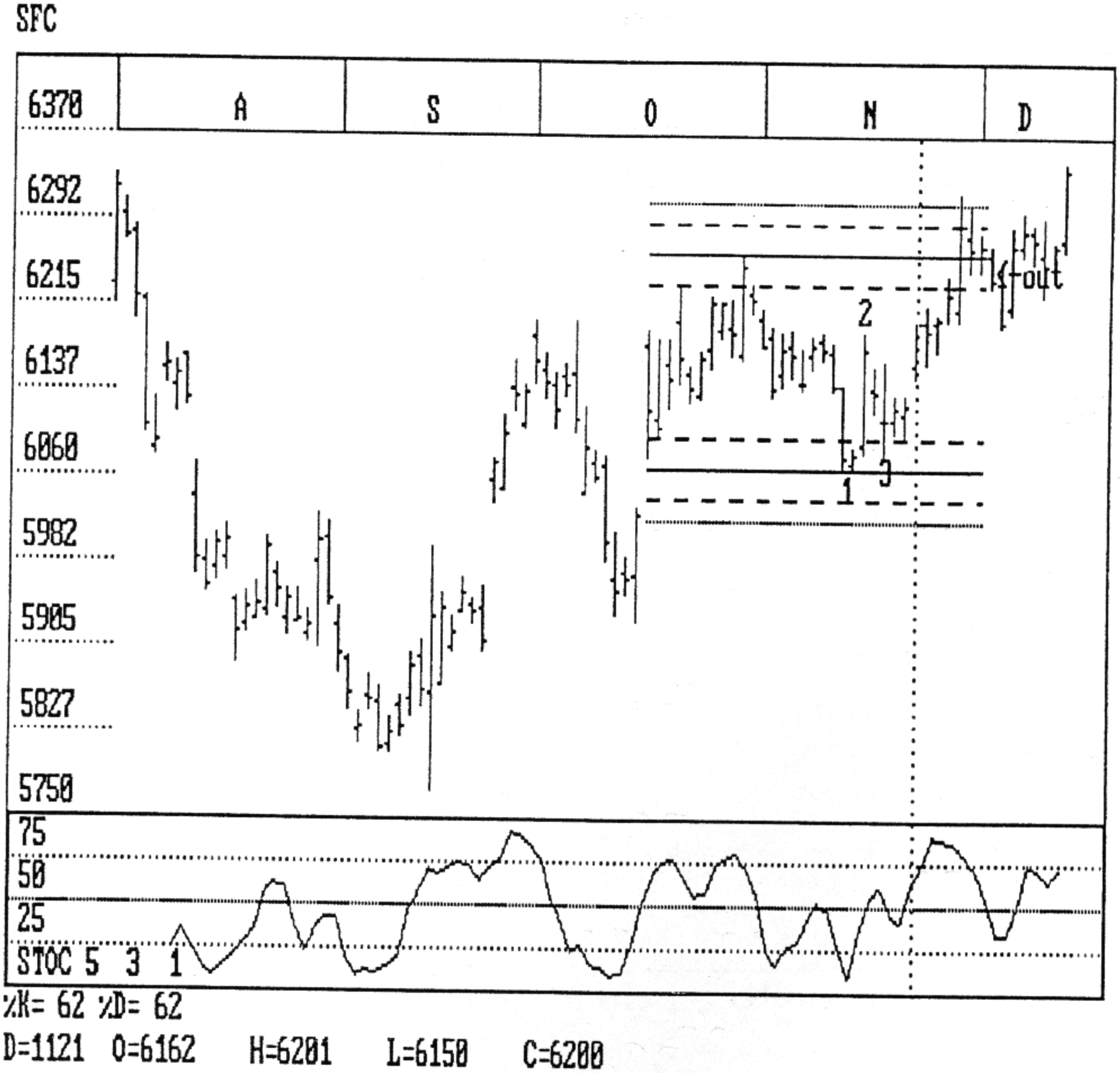

Figure 80 The weekly oscillator for the Swiss Franc had gone flat, but the daily oscillator was showing rising bottoms. I had drawn an envelope around the Swiss Franc, and I took a breakout of the 1-2-3 low shown on the chart. I was stopped out at a profit as shown, concluding my Swiss Franc trading for the year.

CHAPTER 5

Wrap-up — Clarifications and Comments

Q. Do trading ranges always start with a gap or a large magnitude move?

A. Overwhelmingly so. It seems that very few people have ever realized this, but if you look back over countless charts, as I have, you will see that most trading ranges begin with a gap or a price bar that is very large from top to bottom.

Q. Could you clarify "magnitude of range?"

A. Magnitude of range is simply the measurement from high to low or conversely, from low to high, of a single price bar, or from the highest high to the lowest low of a group of price bars.

Q. What exactly do you mean by Initial Stop?

A. My initial stop is always a Fail-Safe or catastrophic stop. I don't want to be stopped out before I'm ready. Yet, if there were a catastrophic move in the market against me I wouldn't want to be wiped out. Therefore, my initial stop is placed as far from the price action as is affordable for my trading account, or as far away as I'm willing to risk on this trade - sometimes that is quite close to the price action. Often my initial stop is a reversing stop, especially if it is close to the price action. My intention from there on is to move it as quickly as possible to either get myself out of a bad trade, or to protect profits on a trade that is going my way.

Q. In Chapter 1 of Part I, you shorted Gold before the Close was outside of the envelope. Is that what you meant by "changing your plan?"

A. Yes. The momentum of the gap down, with the low actually breaking out of the range, coupled with the facts already given, were enough to cause me to enter an order. There is one other significant reason, and it is covered in Part V of the manual. That reason alone is enough to cause entering the trade on the day that the gap down occurred, as will become clear at that time. Using the principle in Part V, there would not have been a change of plan - the plan in that case would have been to enter on a break-out of the local low from a I-II-III formation.

Q. Gold didn't make much of an initial move downward after breaking out of the envelope. Does your method give a reason?

A. The reason as stated in Chapter 1, Part I, is that this was an expanding envelope. Notice that it made one new low and two new highs during the course of its life. Expanding envelopes tend to weaken over time. Therefore, look for short term profits on breakouts from expanding envelopes.

Q. You say to reverse your position if prices break out on the side of the range opposite your position. Wouldn't that take a lot of guts after suffering a sizable hit by being stopped out clear across the width of the trading range?

A. First of all, unless there was a catastrophic one day move against the trade, my stop would have been moved up as soon as it became clear that the trade was going my way. If it immediately went against me but not to the point of a catastrophic move, I would have been stopped out long before prices moved clear across the width of the trading range. If indeed there was a catastrophic move and prices broke out on the other side of the range, I would certainly want to reverse and go along for the ride. Such a move is bound to make money. Finally, over the years I have proved conclusively that reversing losing trades results in a far better trading record than just taking a loss and getting out. If the trades have been picked according to the Book, the percentages are that reversing will lessen over 95% of losses incurred, and will, in 80% or more of the cases, result in an actual winning trade!

Q. Is it accurate to say that a fully established trading range is defined as consisting of a leg up, a leg down, a leg up, and a leg down?

A. Yes, that would give an /\/\ formation. The reverse is also true \/\/. Of course the leg usually constitutes more than one price bar in each direction. Anything short of 4 legs would not constitute a fully established trading range. For example, a leg up, a leg down, and a leg up /\/ constitutes the ingredients for a 1-2-3 low as discussed in Part II. A leg down, a leg up and a leg down \/\ constitutes the ingredients for a I-II-III high as discussed in Part II. Finally, a leg up and a leg down /\ make up a hook, as does a leg down followed by a leg up \/. Trading hooks are discussed in Part II.

Q. How would you define your approach to the markets, defensive or offensive?

A. Trading by the Book is based on the philosophy that a good defense is the best offense. The method and tactics used in Trading by the Book are aggressive. I'm always attacking the markets, trapping it so that it can't get away from me without my being in on a move. The envelope is a trapping technique, so are one-two-three breakouts, hooks, ledges, etc. The triple testing concept of the Oscillators is aggressive and anticipatory, as are offset moving averages. I'm always trying to put myself in a position where, when a market breaks out, I'm along for the ride. This makes my approach conservative as well.

Q. With regards to Figure 32 of Part I of the manual, can you be more explicit about how to select the proper A,B,C swing?

A. You must go back far enough to project a swing that will give an objective outside of the trading range, and at least one leg of the swing must be inside the trading range. Normally a swing will have an easily identified top and bottom and look like this:

```
   /\
  /  \
 /
```

However, because we are not dealing with an exact science, sometimes you have to realize that a swing will look like this:

```
    B
   /\
  /  \/\/\/\
 /          \
/            C
A
```

In that event, you measure from the first low to the highest high, and then to the lowest low of the sideways movement in order to calculate the projection. If it's not possible to get a swing with both legs within the trading range, pass up the trade on the basis of the envelope.

Q. You said that congestion could always be expected at Fibonacci retracement levels, but never really explained it when you told us about Fibonacci.

A. Congestion can always be anticipated to occur at a .382, .50, and .618 retracement of the latest swing. Observe market swings for awhile, on one minute charts to weekly and monthly charts, and you will see the following types of congestions at those levels:

```
     /\
    /  \/\/\
   /  .382 retracement
  /
 /
/

     /\
    /  \
   /    \/\/\
  /     .50 retracement
 /
/

     /\
    /  \
   /    \
  /      \/\/\
 /        .618 retracement
/
```

Which way the market will go after such a retracement is not known. Will it break out from a .382 and go down to a .50 or .618? Or will it break out to a Fibonacci projection even higher than the recent high? No one knows for sure. However, in the manual where I show how to trade from a ledge, you can see how I take advantage of this situation.

Q. How exactly do you define a 1,2,3 low or a I,II,III high?

A. A 1,2,3 low is any low that is the result of a 3 leg swing, where the second leg of the swing fails to come as equal to or lower than the low of the first leg (#1 point):

```
     2
    /\
   /  \/
\/     3
 1
```

It is at or before the break-out of the number two point that I want to enter the trade.

A I,II,III high is the opposite. It is a three legged swing where the number III leg fails to equal or exceed the most recent high (#I point):

```
 I
/\    III
  \  /\
   \/
   II
```

The number two point does not have to be a "significant" high or low, any high or low will do even if it's in the middle of a trending market.

Q. Sometimes I get confused about how one point can be both a #2 point and a number I point?

A. Here is how it works and, as you can see, it gives both a buy and sell opportunity. It is this formation that is the dilemma of the Fibonacci purist:

```
    I
    2
    /\  III (potential if it turns down tomorrow)
   /  \  /
  /    \/
\/      3
I       II
```

In this situation you would buy the break-out of the #2 point, but you also have the capability of selling the break-out of the #II point should the market turn and go down. This formation presents a dilemma to the Fibonacci purist because he doesn't know if the number II point is a retracement of the swing from 1 to 2 leg, or if the potential III point is a retracement of the 2 to 3 leg.

Q. Instead of using an offset moving average, couldn't I accomplish the same thing by using a longer term non-offset moving average?

A. No. It's not the same thing. The minute you lengthen a non-offset moving average sufficiently to approximate an offset moving average, you will have smoothed the fluctuations (visible in the offset moving average) to the point that they will disappear. Notice that I said "approximate." At best there will be an approximation. Usually it will cause the moving average to lose all meaning for the time frame you are trading in.

Q. How can anything be so simple as the Ross Hook and actually work?

A. The Charts I've shown ought to be sufficient to answer that question. I once took an entire year and did nothing but trade the Ross Hook. Every time a hook formed I placed an order in the market in the direction of the hook. I made a bundle that year until it got boring. I had one of the highest winning percentages of my trading career. All you have to do is to find a market that is trending and ride the trend via the breakouts of the hook. In Part IV, I show how to identify an established trend. It's really easy to do when you know what to look for.

Q. How can I stay with the trend longer than trading it the way you do? It seems as if you are in and out an awful lot.

A. It's true that I'm in and out a lot. There are a couple of reasons for that. One is my experience as a day trader. I day traded the markets for some time before my illness. That experience gave me a hair trigger approach to trading.

Another reason is _my_ comfort level. If you noticed, when I traded the Bonds, I grabbed quick 10 point profits. My comfort level will not allow me to stay in the Bonds for much more than that. So I do the closest thing to scalping the Bonds that I'm able to do. I trade Coffee and Ledges the same way.

I fully believe that if I can get one-half of a market move, I've done well. Most of the time that is what I get.

If you want to stay with the trend longer, here's what you can do:

Use a 7 bar offset by 5 moving average, or even a 25 bar offset by 5 moving average to "contain" the trend. Stay with the trade until there is penetration of the moving average. As the angle of the trade steepens, switch from a 25 bar offset 5 to a 7 bar offset 5, or from a 7 bar offset 5 to a 3 bar offset 3.

Curve fit a moving average to the angle of the trend and stay with it until there is penetration. This is regularly done by mutual fund and stock traders. They hang in there until there is penetration of a 200 day moving average.

Use the charts for the next magnitude of time. If you are trading daily charts, then make your projections from the weekly charts. Draw a trend line on the weekly chart and stay with the trade until there is penetration, or use a moving average on the weekly chart, or even curve fit a moving average to the weekly chart.

Another reason that I'm in and out a lot is my philosophy of trading a $5,000 account. I trade each contract as though I had $5,000 behind it. When you trade a small account, you cannot afford a large amount of risk. Most of my readers, in fact most traders, trade accounts that are around $10,000. That means they cannot afford to trade long-term.

The more long-term you desire to trade, the more money you need in your margin account to withstand the choppiness of the markets. If you had a big enough account you could virtually assure that you would rarely lose. You could just sit tight and wait for the market to prove how "right" you are. You could wait for the market to go your way. It's like a hen sitting on an egg. Most of the time that egg will hatch.

I personally know a trader who has been sitting on the silver market for two years, waiting to be "right." He knows that if he sits on that egg long enough, it will hatch. One of these days, silver will make its move and he will take millions to the bank. In the meantime, he has several hundred thousand dollars tied up in margin money and he has had to roll over his contracts every few months. But as he says, "If you have enough money, you are always right."

Q. Do you keep a diary or journal of your trades?

A. Absolutely. That is how I was able to write this book. Here is what I keep track of every day after I have posted my data to my charts:

- The futures contract and month in which I'm trading.
- How the weekly oscillator segment looks, e.g. \, /, or —.
- If I have a position on:
    - My current position Long/Short.
    - Where the stop(s) is(are).
    - Today's Close.
- If I've called in an order:
    - Buy/Sell
    - Where the stop(s) is or are to be placed.
    - Status of the order, e.g., open order, day order.
    - Nature of the order, e.g., stop, stop limit, etc.
- If I'm contemplating the breakout of an envelope, I mark down the envelope limits like this: (34130 33320).
- If I'm contemplating the breakout of a ledge, I mark down the upper and lower limits like this: [2240 2180].
- My score. +/- points, and +/- $.

Once a month I total my winning points, losing points, winning dollars, and losing dollars. I compute the ratio of points won to points lost, and the ratio of dollars won to dollars lost.

I also compute the largest draw-down that I've had. Finally, I compute the percentage of win/loss dollars to margin.

Q. It's not entirely clear as to when you create the ledge. When do you do it?

A. As soon as you notice that two price bars separated by at least one day have highs or lows that are separated by not more than two points. Then you draw a line connecting them. Then you wait for the opposite side to come either even, or not more than two points apart. In some cases, looking back you will see that it has already happened. (I prefer that at least one side of the ledge be even, but that is not a hard and fast rule.)

Quite often you will notice that two highs or two lows separated by at least one bar have occurred that are within one or two points of each other. If it happens that way, make a note of it, and then, as soon as the opposite side comes even, draw the ledge.

You have to get used to doing this. At first you will not have much faith in it. You will be hesitant, and your heart will be in your mouth every time you do it. That is because very often the breakout will be counter trend. After awhile, when you see how often this works and how well it works, you will do them all the time.

Q. I don't have a computer (and don't want one), and I don't have time to keep moving averages and oscillators on more than just a few markets. How can your book help me?

A. Futures trading takes work and effort, but I have given you at least three methods that can be done just by looking at a newspaper and never even drawing a graph. And another that can be done just by subscribing to the least expensive charting service that you can find. They are:

1. Trading the breakout of a trading range.
2. Trading 1-2-3 breakouts - needs chart.
3. Trading from a Ross hook.
4. Trading from a ledge.

Here's how to trade the envelope from the newspaper:

Look up the contracts for the markets that you want to trade. Then select the contract month with the second largest open interest.

Mark down the season high and the season low. Multiply each figure by .236, and that is your envelope. Place an open order with your broker to buy 1 tick over the high of the envelope, and to sell 1 tick under the low of the envelope. Then sit back and wait for the market to take its course. You can do that for every market listed. The whole exercise won't take more than an hour. Sooner or, later some of those markets will break out, and then you can monitor them on a daily basis. When the back month becomes the front month, then slide back to the month with the second highest open interest, cancel all your open orders, and then call in new orders for the back month. Don't forget to put a stop loss at a point that you can be comfortable with. Also, put in a profit objective type of stop, 10 points, etc. You will be pleasantly surprised with the results.

Here's how to trade from a ledge using the newspaper:

Record the daily high and low for all of the contracts that you want to follow. When two of them come either equal or within two points of each other, note it down. Then, when the opposite side comes equal or within two points of each other, call in an open order. Be sure that you keep in mind that you will be in the trade only a couple of days, so keep a tight stop. Place a profit objective order for however many points you think you can make. When filled, double your stop on the other side so that it will be a reversing order, in case the trade goes against you.

You will win more often than you lose.

Here's how to trade from a Ross hook using the newspaper:

Record the daily high and low for all of the contracts that you want to follow.

Notice when a contract is making consistently higher highs. As soon as the contract makes a lower high, you have a Ross hook. Call in an order to buy 1 tick above the highest high. Place a profit objective order for however many points you think you can make. Place a protective stop one tick below the lower of the last two days, including the day you enter the trade.

Notice when a contract is making consistently lower lows. As soon as the contract makes a higher low, you have a Ross hook. Call in an order to sell 1 tick below the lowest low. Place a profit objective order for however many points you think you can make. Place a protective stop one tick above the higher of the last two days, including the day you enter the trade.

Q. Are you totally against seasonal or cyclical trading?

A. No! I'm not against them. I simply don't use them as my primary entry or exit criteria. I see absolutely nothing wrong with adding them as an additional filter to the ones I am already using, especially if it helps my confidence level. In fact, anything that helps anyone to have more confidence in trading is a good thing.

Probably the reason why more traders don't win is lack of confidence. Why? They simply don't have the courage of their convictions when entering and monitoring a trade. This is because they don't really know why they are in the trade in the first place. Either they are blind-trading a mechanical system, or they are blindly following someone else's advise. It may be an advisory, or their broker, or whatever. They don't understand the basis for the trade, and so they have no real faith. Faith comes from experience. You see the same thing happening over and over again. You begin to sense the reliability of what you are doing. Then when you enter a trade where everything says "Go," you have the courage of your convictions. You can take the losses, even strings of losses and still have the courage to go on.

A good example of this is my nephew. Together we have developed a horse racing method. By betting this system at the track, he has come to see and experience as many as 12 losses in a row. Yet, through the proper money management set forth in the method we advocate, he has seen the method come back time and time again, and that over all he is a net winner. By starting out small, with a small bank and small bets, he has accumulated enough money that he is now earning $3,000 a month at the track. That will grow, as his bank increases and the courage of his conviction - faith - grows.

I expect that shortly I will give him a bank of my own, so that he can bet for me. Then I will trade the markets for him. It's a way to diversify. Our method produces as high as 83% winners, and is available in book form from Trading Educators Ltd.

Trading By The Book is not a get rich quick scheme. It is a method of rationally trading futures markets. The methods shown throughout are good for a lifetime once they are mastered. You will never need to know any more than this to make a lot of money in the markets.

I urge you to read and re-read the material. Study it and check it out. It's worth mastering.

The biggest problem will be realizing the simplicity of what is being done here. Everyone wants a magic formula that they can plug in and make money. Such a formula doesn't exist.

I recently visited one of the gentlemen who bought this manual and is now making money for the first time in 30 years. I was there to tutor him in the finer details of trading - things that you just can't get into a book.

When I got to his trading room, my mouth fell open. That man had virtually every book that had ever been written on trading. In addition to that, he had purchased virtually every "magic" trading system that has come along. These had cost him $2,000-3,000 apiece, and he had a shelf full of them. In 30 years he'd never had a winning year.

Now he is teaching his wife how to trade from my manual, and they are both making money.

As I write you this note, I have received a phone call from a friend who trades by the Book. He has been riding the Gold and Silver contracts on the recent rally, and has banked thousands of dollars by taking profits based upon projections. Both trades started their moves on 1,2,3 breakouts.

He told me an interesting thing. He said that this very morning he again read Parts I & II. This is his eleventh reading of just those two parts, and he said he was amazed at how much more he learned from them.

You now have all of the parts in your possession. Master them and you will have mastered the markets.

CHAPTER 6

For You

In this manual I have revealed the way I trade. I've shown what I do day in and day out. I've described the tools I use, and how, where, when, and why I use them. I do make my living as a trader, not as an author.

I will gladly respond to any phone calls or letters that I receive regarding the material presented. For more information about other services, books, and seminar that I offer my readers, please continue reading.

Software

If you have an IBM compatible computer, and would like to have software that will enable you to prepare charts with all of the studies you have seen in the manual and then some, I'm pleased to tell you that it is available through my office. Simply call (512) 259-0727 or FAX (512) 259-0747 for information on how to order.

Seminars

At times a manual is not enough. Some need more help than I am able to present in a manual. For this reason, I regularly hold two entirely different seminars for the purpose of tutoring those who need and can afford the additional help.

If you want to learn to run your trading as a profitable business, you will benefit from either of my three day private seminars. I give these several times a year. Enrollment is severely limited. It is suggested that you read Trading is a Business plus this book prior to attending either of the two seminars. There is a prerequisite for taking either seminar. Upon receipt of your seminar deposit, you will be sent a seminar preparation package. This package is considered essential to your understanding of what is presented at the seminar. Please familiarize yourself with the material contained in the package. For information on the details of the seminars, call (512) 259-0727 or FAX (512) 259-0747.

I offer a money back guarantee: If you are dissatisfied with what I am teaching or what you feel you can learn from me after the first day of attendance, you will receive a full refund of any money you have paid for the seminar. We will part friends.

I attempt to answer any and all questions concerning the material in my books. I then go on to present material beyond what is contained in the books.

Once you have taken the seminar, you may take it again as often as I hold them for a period of two years. There will be no charge other than what it costs you for travel, lodging, and meals. There is a discount available for those wishing to take both seminars.