TRADING SPREADS AND SEASONALS

Joe Ross

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Introduction

Joe has done it again in his seventh published volume: Trading Spreads and Seasonals: a down-to-earth, easy-to-read common sense book for the practical commodity futures trader.

Turn off your "black box" and computer, and learn about the real-live facets of trading spreads and seasonals, as Joe takes your hand and leads you through the sometimes tricky mechanics of intra and intermarket spreads and looks through the mostly predictable windows of opportunity offered in seasonal trading.

The answers to he whats and whys of spreading and seasonal trading are explained in plain, precise language which should be easily understood by old timer and new trader alike.

Joe's famous "Ross Hook" is used in great detail in the spread and seasonal examples, and his filtering processes, entry and exit signals, and other technical studies are well founded. The examples shown are excellent.

The use of "Bollinger Bands" and RSI, as applied to spreads are unique, and are as important as those used in open positions.

Joe pulls it all together: the fundamentals, the technicals, and the historics, to produce state-of-the-art solutions to the oldest of commodity trades, spreads and seasonals.

In reviewing my past 46 years of trading seasonals and spreads, and as publisher of a commodity futures spread newsletter for many years, I found Joe's Trading Spreads and Seasonals a refreshing, informative, and rewarding work.

Bob McGovern
Laguna Niguel, CA

Foreword

I have corresponded with Joe Ross for over a year, initially discussing several educational essays he kindly contributed to the monthly Moore Research Center Report. More recently our conversations have centered on an objective critique of this book as a work-in-progress.

Joe was always concerned with accuracy and validity. He wished not only to confirm the legitimacy of what he was presenting but also to be sure it was in no way misleading.

So, these first comments are directed more to the man than to the book. My impression of Joe Ross is that he is an honest man–tough but honest. I mean honest in a larger sense. He appears to be open and earnest in his efforts to share some of the vast trading wisdom he has accumulated in his nearly 40 years of trading futures. I mean tough because he views "trading as a business" not to be taken lightly.

He does not appear to one who wishes merely to avoid "fabrication of fact" and, therefore, regulatory wrath. Yes, he probably has an ego that hopes this book becomes a classic. Yes, he is likely a confirmed capitalist who wants his book to sell–but, I don't believe he merely wants to take the money and run. I think Joe honestly wants to help narrow a gap in knowledge.

Some may decry this in the foreword to a book about speculating in a dog-eat-dog industry. However, I would submit that the business breeds a certain degree of cynicism.

How many advertisements have you seen for the latest " 'must have' new system, guaranteed to ...?" How many seminars will unlock for the first time ever "the 'ultimate' secrets" to unlimited profits? How many times could you have spent several thousand dollars for a "breakthrough that reveals market destiny?" How many books offer "my insider strategy"–to which the author himself no longer adheres?

In Trading Spreads and Seasonals there may be no "black boxes," no "foolproof" techniques, no sophisticated complexity, but there are straightforward trading tactics. It may not be a literary masterpiece; but, in providing basics that every trader, both novice and professional, should know, it reads as though the author practices what he preaches.

After trading spreads and seasonals for so long, he still trades them. Why? Because they have always been excellent trading vehicles and they always will be. Furthermore, they each offer their own specific advantages, and once understood, neither is especially difficult.

Trading spreads fell out of favor in the early 1980's when revised tax codes removed favorable treatment for long-term capital gains. Funds don't concentrate on spreads, and very little literature on the subject has appeared recently. A generation of futures traders (time is compressed in this industry) have never learned either the art or the science of trading relationships.

Trading Spreads and Seasonals can help fill that void. Joe defines spreads, describes their various types, points out in which markets they are most viable, and discusses their advantages and disadvantages. This book is not a theoretical, conceptual treatise, however. It takes a hands-on, how-to approach in not illustrating only those spreads which succumb to his theories. He wants to educate readers for real-time trading–how to find spreads, filter them, analyze them, and place orders. He also shows how just a couple of well-known technical indicators can further filter and enhance entry and exit.

Old-time fundamental traders (pre-1970's) used to rely on seasonal tendencies for consistency in their trading approach. After the huge inflationary bull markets of the 1970's, the marketplace was flooded with a new breed of traders who had no knowledge of, no time to learn, and cared little about a market's own tendencies, the normal effect on prices caused by the annual rhythm in supply/demand. Computers, trading systems, and technical concepts ruled instead.

Even with their access to the most current market fundamental conditions, you may rest assured that commercial interests are aware of and often rely on seasonal tendencies. Their own market activity is dictated by shifts in supply and demand. However, those shifts which are annual in nature. (big new supplies at harvest, temporarily reduced monetary liquidity after April 15) must be anticipated by commercial firms who intend to stay in business. Therefore, those who are aware of a market's own historical trading patterns may more consistently be able to trade with, rather than against, the most knowledgeable and deepest pockets in the industry.

Joe is one of the few in recent years to consider how those historical tendencies can be analyzed for trading in current real-time. Historical tendencies are powerful tools, but in practice most traders need to maintain some flexibility and use some judgment. This book helps demystify seasonal price movement.

As you read through Trading Spreads and Seasonals and examine the ideas Joe discusses, you may broaden your knowledge and scope of understanding of the business of trading. As you begin to recognize that "trading is a business," you may become a more mature, patient trader. As your trading takes on the added dimensions of maturity and patience, you may become more relaxed; and as you become more relaxed, you may view markets–and life–with greater clarity.

Trade 'em,
Jerry Toepke, Editor
Moore Research Center, Inc.

Preface

I suppose I should have written this manual a long time ago. I have known about seasonal trend and seasonal spread trading for many years. Amazingly, this knowledge is just as valid in today's markets as it has ever been, and can be quite profitable for the trader who is willing to pursue it.

The concept of trading seasonal trends and seasonal spreads has been almost entirely overlooked by the hordes of daytraders who today riffle the markets with their almost frantic noise. It is also overlooked by the fund traders. By fund traders I mean those massive pools of managed money residing in hedge funds, commodity pools, pension funds, bond funds, securities funds, etc. In fact, with the exception of the large commercial interests, the whole concept of seasonal trend and seasonal spreading has been overlooked by most traders.

Seasonal concepts extend far beyond seasonality itself. They probe the very core of what trading is all about.

The fact that there have been only two widely read books written about seasonal trend and seasonal spread trading has not accomplished much in the way of dispensing knowledge in the area of this type of timely trading. It's as though this knowledge is a closely guarded secret, not to be taught. Such may well be the case. Some of the best, most profitable, and highly reliable trades come as a result of trading seasonally.

This book has been inspired in part by Techni-Seasonal Commodity Trading, a book by Everet Beckner. It is a book that has been in my private collection for many years, and one I have never hesitated to recommend. It is one of the two books mentioned above. Other works that may be helpful to the reader are listed in the Appendix C of this course.

In Trading Spreads and Seasonals, it is my purpose to teach you everything I can about the wonderful trading vehicles created by seasonality. I hope to go beyond anything you may have encountered in the past. This course is organized according to degree of risk rather than order of complexity. The first part of this course deals with seasonal spreads, the second part with outright seasonal trades in futures. In my opinion, spreads carry considerably less risk than outright futures trades.

For those who have read my other manuals and courses and are familiar with 1-2-3's, Ledges, Trading Ranges, and Ross Hooks, I have spared you from having to review (unless, of course, you want a review) these four basic trading formations for outright futures trades. For new readers, you will find them in Appendix A. Appendix B features seasonal Decision Tables courtesy of Moore's Research Center. Appendix C lists various resources that may be of interest.

Chapter 25 is special in that it deals with carrying charge spreads. Chapter 26 is another special chapter dealing with the concept of spreading day trades in order to keep them overnight. Neither the material in Chapter 25 nor that of Chapter 26 fits the concept of seasonality. However, I felt this book would not be complete without the inclusion of this important part of my own trading.

Before getting started, here is ***a special note to the ladies***: I tried to write this book in a way that is gender neutral. Ladies, it just didn't work. So please forgive the fact that I used the masculine gender throughout. It is not my intent to offend you in any way.

Chapter 1

What Is a "Spread?"

If you already know what a spread is, you may be tempted to skip this initial chapter. However, I advise against it. Besides being presented for those who know, it is presented here for those who are not sure, and also for those who know that they know that they don't know.

I have been amazed at the number of traders who show up at my seminars who do not know what a spread is. Additionally, they do not know its numerous purposes or its many uses.

A Spread is...

For purposes of this book, a spread is defined as the sale of one or more futures contracts and the purchase of one or more offsetting futures contracts. You can turn that around and state that a spread is the purchase of one or more futures contracts and the sale of one or more offsetting futures contracts. A spread is also created when a trader owns (is long) the physical vehicle and offsets by selling (going short) futures. However, this course will not cover the long physicals, short futures types of spreads.

Furthermore, for purposes of this course, a spread is defined as the purchase and sale of one or more offsetting futures contracts normally recognized as a spread by the futures exchanges.

This explicitly excludes those exotic spreads that are put forth by some vendors but are nothing more than computer generated coincidences which will not be treated as spreads by the exchanges. Such exotic spreads as long Bond futures and short Bean Oil futures may show up as reliable computer generated spreads, but they are not recognized as such by the exchanges, and are in the same category with believing the annual performance of the US stock market is somehow related to the outcome of a sporting event.

Either way, for tactical reasons in carrying out a particular strategy, you want to end up with simultaneous long futures and short futures positions or, if you prefer, simultaneously short futures and long futures positions.

The primary ways in which this can be accomplished are:

1. Via an intermarket spread.
2. Via an intramarket spread.
3. Via an inter-exchange spread.

Intermarket Spreads

An intermarket spread can be accomplished by going long futures in one market and short futures of the same month in another market. For example: Short May Wheat and Long May Soybeans.

Intermarket spreads can become calendar spreads by using long and short futures in different markets and in different months. These spreads are specialized and uncommon, but it may be profitable for you know they are available.

Intramarket Spreads

Officially, intramarket spreads are created only as calendar spreads. You are long and short futures in the same market but in different months. An example of an intramarket spread is that you are long July Corn and simultaneously short December Corn. Other unofficial methods for creating intramarket spreads are beyond the scope of this course.

Inter-Exchange Spreads

A less commonly known method of creating spreads is via the use of contracts in similar markets but on different exchanges. These spreads can be calendar spreads using different months, or they can be spreads in which the same month is used. Although the markets are similar, because the contracts occur on different exchanges they are able to be spread. An example of an inter-exchange calendar spread would be simultaneously long July Chicago Board of Trade (CBOT) Wheat, and short an equal amount of May Kansas City Board of Trade (KCBOT) Wheat. An example where the same month is used might be long December CBOT Wheat and Short December KCBOT Wheat.

Offsetting Contracts

Although both the long and the short futures may be entered simultaneously through a "spread broker," it is often advantageous to enter a spread one "leg" at a time. However, until both the long and short futures are in place, there is no offset and consequently no spread exists. Offsetting merely defines the difference between the futures contracts, i.e., simultaneously both long and short futures. A spread consists of two "legs." Each side of the trade constitutes one leg. Long futures is one leg and short futures is the other leg.

There are times when offsetting may be accomplished by using inter-exchange spreads employing differing numbers of contracts. Let's say, for instance, you are short 5,000 ounces of July Comex (CMX) Silver and would like to offset with an equal amount of June Silver. You could create the necessary inter-exchange calendar spread by purchasing five Mid-America Exchange (Mid-Am) June, 1,000 ounce Silver contracts. Currency positions at the Chicago Mercantile Exchange (CME) can be similarly offset by contracts at the Mid-Am. I can offset a long CME D-Mark contract with two Mid-Am D-Mark contracts.

Sources of Spread Information

All the major US exchanges publish materials on seasonal spreads. Generally this material can be had free or, at most, for a nominal charge.

For example, the CBOT and the CME are happy to send you lovely color brochures showing charts of their exchange-recognized intermarket and intramarket spreads dating back over a period of 12 years. If you call and ask, they will send them at little or no charge. Don't forget to ask for both their commodity and financial futures material.

Years ago, before the advent of computerized data bases, I used to obtain the CBOT's "Year Book." I am not aware if they still publish it, but it was chock full of tables giving actual prices for every contract for an entire year. It provided me with a complete data base of prices that at the time was incomparable. I used that data as a historical base for creating a history of which spreads worked best seasonally. It was laborious and tedious work, but I manually entered much of the data into my old Epson QX-10 computer so I could produce an historical graph. The public library where I lived carried the Year Book on its reference shelf and I made an arrangement with the head librarian to pick up last year's volume as soon as they received the latest, newest volume. Seasonal tendencies in futures change little, if any, over the years. I still trade the same seasonal spreads today as I did decades ago.

There are more seasonal spreads today than there were then because there are more markets in which to trade, and because computers are able to spot very short term trends in spreads that would have been difficult and impractical, if not impossible, to detect by manual methods. Today, you can trade not only agricultural spreads, but also exchange-recognized spreads in the currency, financial, energy, and metals futures.

There is also an abundance of non-seasonal, intermarket and intramarket exchange-recognized spreads. Many of these non-seasonal spreads do have some seasonal tendencies and can be traded as seasonal spreads as well as outright spreads based on an event, fundamental knowledge, or some observable chart pattern.

In addition to the material provided by the exchanges, there are also private sources of information on spreads. Some of these sources, with a brief description of each, are listed in the Appendix B of this course.

Markets Suitable for Spreads

When trading spreads, I am careful to trade in liquid markets and generally reject spreads in very thin markets. However, because there is essentially no such thing as "stop running" when trading spreads, I can afford to take them in markets that are a bit more illiquid than what I normally would consider appropriate for trading. I consider the following markets suitable for trading spreads:

Currency:

British Pound, D-Mark, Swiss Franc, Japanese Yen. Any of these, one versus the other, on an intermarket basis.

Energy:

Crude Oil, Heating Oil, Unleaded Gas, Natural Gas. Any of these on an intermarket or intramarket basis, along with the "Crack Spread."

Grain:

Corn, Chicago Wheat, Soybeans, Chicago Oats on an intermarket or intramarket basis.

Chicago Wheat and Kansas City Wheat on an intermarket or intramarket basis.

Soy Oil and Soy Meal on an intermarket or intramarket basis, and the Soybean "Crush" spread.

Financial:

US Treasury Bonds, Treasury Ten Year Notes, Treasury Five Year Notes, and Municipal Bonds on an intramarket basis and on an intermarket basis. (MOB spread, NOB spread, etc.)

Two year notes on an intramarket basis.
Eurodollars on an intramarket basis.
T-Bills and Eurodollars on an intermarket basis. (TED Spread)

Meat:

Live Cattle and Live Hogs on an intramarket basis. Feeder Cattle on an intermarket basis with Live Cattle entered only as a spread.

Metal:

Gold, Silver, Copper on an intramarket basis, and Gold, Silver on an intermarket basis.

Softs:

Cocoa, Coffee, Cotton, Orange Juice on an intramarket basis. (Caution: Coffee, Cotton, and Orange Juice in particular are among the world's most treacherous markets and I never trade outright futures positions in any of them. In this writer's opinion, trades in Cotton and Orange Juice should be avoided by non-commercial interests.)

Of the above named markets, I will not take any trade that involves legging into a spread in any of the following markets: Orange Juice, Heating Oil, Unleaded Gas, Copper, Coffee, Cotton, Live Hogs, T-Bills, and Feeder Cattle. I will leg out of any of these only in dire emergencies, preferring to liquidate the trade intact, as a spread, both legs at the same time at a specified spread differential. "Legging in" refers to a situation in which both sides of the spread are not put on simultaneously. "Legging out" refers to exiting the spread one side at a time and not exiting both legs simultaneously.

I will not take any trades that involve Lumber, Value Line, Canadian Dollar, or Pork Bellies. I tend to reject spreads in very thin markets or delivery months.

As a rule, I will not take any trades that involve spreads that are not recognized by the exchange as being a spread. However, I may take a non-recognized spread if it occurs in related markets such as Soybean Oil and Soybean Meal.

Chapter 2

Why Use Spreads?

There are certain advantages to using spreads. Stop for a moment and think about what they might be. I'll list them here and you will also see them discussed as appropriate throughout the course.

Advantages of Spreads

Spreads can be insensitive to the trend or lack thereof in the outright futures. Of course, there are execeptions. In a bull market, the front months usually outperform the back months, and in a bear market, the back months usually outperform the front months. Generally, the absolute direction of the underlying futures is of little concern. The important thing is whether or not the trend of the spread differential moves favorably in the direction you would prefer.

Exchange-recognized spreads carry lower initial and lower maintenance margin requirements. This is because spreads involve lower volatility. Most of the time true spreads do not move as frantically as do the underlying futures. A spread position is automatically a hedged position most of the time and therefore usually involves less risk. Some cases of "old crop" vs. "new crop" can refute this. They sometimes look like different animals.

Spreads serve to reduce the volatility impact of the underlying futures. In an intramarket spread, if the front month of a contract suddenly comes crashing down, it is highly likely that all the remaining months will also crash down.

The only thing the spread trader is interested in is whether or not a change in the spread differential has helped or hurt his position.

Spreads allow a trader to take a fractional approach when putting on a futures position. Did you think you could do that only with options? Let's say you want to get long Treasury Bond (T-Bond) futures. After speaking with your broker, you realize that the margin for a single T-Bond trade is greater than you feel you can handle in your account. You notice that on most days, Treasury Note (T-Note) futures generally move some fraction of the amount of T-Bond futures. You also notice that the long T-Bonds, short T-Notes spread is widening.

By going long T-Bond futures and short T-Note futures, you have created a fractional position in the interest rate futures. If T-Notes are moving 80% as much as T-Bonds, then your spread renders a move that is 20% of a long position in T-Bond futures. For example, if T-Bonds move up 10 points ($312.50), and at the same time T-Notes move up 8 points ($250), then the spread, T-Bonds/T-notes will have widened by 2 points ($62.50) i.e., 20% ($62.50 / $312.50).

Spreads have yet another advantage: they are convertible. It is possible to "leg out" of a spread, leaving yourself with an outright futures position. Conversion can work both ways, outright futures may be convertible to spread positions, and spreads are convertible to outright futures positions. Convertibility adds a great amount of flexibility to your futures trading. Don't tell them, but options traders think they're the only ones who can do this.

Spread trading helps the trader to avoid a lot of the noise created during the intraday market trading. Much of the intraday noise is that of stop running by the locals on the floor. There are no stops in the traditional sense with spread trades. There is no stop running available when there is no stop order in the market. Why is there no stop running in spreads? Because the stop exists in the spread differential, and can be obtained by a combination of any number of futures prices. This leads to another feature of spread trading, confidentiality.

When you are in a spread, and both long and short at the same time, you have no exit order in either market. If you are long Corn and short Beans, there is no exit order in place other than to exit at a certain difference between the contracts. Your trade is confidential. The locals have no idea of your true position or intent. They can't see both of your positions and have no reason to look.

Spreads, by their very nature, constitute a hedge. The economic rationale for the futures markets is to provide an arena in which risk may be hedged. A futures speculator can also hedge. His hedge is created by using an offsetting position. He creates the offset by putting on a spread. Have you ever wanted to hedge your position but didn't know how? Spreading can, at least temporarily, stop or lessen the pain of a bad trade.

There is one further, somewhat obscure advantage of spreads. It is possible in some markets to use far distant back months for the offsetting position. In other instances, where you might be involved in a back month, you can use closer-in months for the offsetting position. In a later chapter, I will show you an example of how this advantage could have been utilized to save what would have otherwise resulted in a disastrous situation in the Coffee futures.

Uses of Spreads

There are numerous reasons to use spreads. You might want to pause a moment to think about what they might be. Spreads are usually, but not always, used by speculators to reduce the risk of holding a position overnight or, indeed, to lower risk at any time at all. Spreads are used by traders to take advantage of historical seasonal tendencies.

Spreads are used by traders to trade sideways markets where the futures spread is trending at the same time outright futures prices are seemingly moving sideways within Trading Ranges. Spreads are also used to convert an outright futures position to a combination futures position where the trader feels for any number of reasons that it is better to carry the offsetting positions available by spreading.

Spreads are also used as outright intermarket and intramarket speculations. Spreads are used when there is a desire to remove the effects of futures directionality or trending from a trade. Spreads can be employed to reduce the amount of initial margin and maintenance margin required to trade a particular contract. Finally, spreads can be used to reduce and greatly eliminate the effects of volatility and the resulting uncertainty from a trade. Let's briefly look at each of the above situations in order to gain an overview and somewhat deeper insight into the reasoning behind each.

In later chapters, when I show how I trade the various spreads, I will probe the depths of the reasons for taking spread trades. In conjunction with the reasons, I

will also show you my strategies and the tactics by which I carry them out. **Keep in mind, it is entirely possible to lose on both sides of a spread.**

Reducing the Risk of Holding a Position

It is not uncommon in liquid or illiquid markets for a floor trader to hedge his position by "spreading off" against the same market in another month, or against a related market in the same month. I have seen this kind of floor trading tactic in such illiquid markets as the Value Line, and even in more liquid markets such as Soybeans, Eurodollars, and Bonds. In fact, arbitraging through spreads in distant back months by financial traders is commonly done while greatly reducing risk. If floor traders think it's important to "spread off," don't you think it's important for you to do the same thing?

Value Line floor traders, in an effort to make a market, will take the opposite side of an entry order coming in from off the floor. Then, because volume and liquidity are so terribly low in this market, the Value Line floor trader will offset his position by taking an opposite position in the S&P 500. By doing so, he has hedged his risk. It is not uncommon for a floor trader in the Soybean pit to offset and hedge his risk by taking an opposite equity position in Soybean Oil or Soybean Meal.

Financial floor traders will hedge risk by spreading intermarket contracts and intramarket back month contracts. Often these are not perfect spreads and often they are not spreads recognized by the exchange as such. Nevertheless, they are regularly used by floor traders and are illustrative of the use of spreading off as a means to reduce risk and thereby create a hedge.

Off-the-floor traders can also hedge risk by use of offsetting positions to be held overnight. Both daytraders and position traders can create spreads that considerably minimize the risk of a position that might be held overnight. Day trades can be converted to position trades by spreading. Position trades can be held considerably longer at less risk by spreading.

Taking Advantage of Historical Seasonal Tendencies

Probably the most common use of outright spread trading is for the purpose of taking advantage of the seasonal tendencies that occur in various futures markets. Trades with a high probability of being profitable can be entered this way. Trades with success probabilities in the 80th and 90th percentiles are quite common among seasonal spread trades.

Seasonal spreads are not exclusive to consumable commodity futures. They occur in the currency and financial futures markets as well. The proof of the reliability of seasonal trading is extensive. In fact, not that many years ago it was the mainstay of many a successful trader. Knowing when the markets are following their normal seasonal behavior and taking advantage of the fact is one of the safest and surest ways to trade the futures markets. One has to be patient and restrained from greed when trading seasonals. The reward is well worth the effort.

Trading in Sideways Futures Markets

It is not unusual for a particular futures market to be moving sideways. Experts have stated that markets spend approximately 85% of their time with their prices moving sideways and not trending. Whereas overall markets may be moving sideways, there is often a trend occurring between different months of the same underlying futures or the same or various months of related futures. Markets that tend to incur long periods of congestion may very well be trending when a front month is offset against a back month. One month may be moving sideways with an upward bias while another month is moving sideways with a downward bias. The difference gives rise to a spread trend and an opportunity to profit from the spread differential.

Converting an Outright Futures Position to a Spread

Quite often an outright futures position can be converted to a spread position. The result can be less risk and will require less margin. I have entered such conversions in my trading and have witnessed what would have been a loss, had I held outright futures, turn into a profit by way of conversion to a spread. Trades of this sort will be illustrated later in this course. Ending up in a spread has usually been the result of a need or willingness to hedge. The resulting profit has often been greater from the spread than it would have been had an outright futures position been maintained. Have you used this privilege in your trading?

Outright Inter-Exchange, Intermarket, and Intramarket Speculations

A spread trade is often entered without the benefit of seasonality as an outright spread position. This may be done as a counter-seasonal trade due to

backwardation in a market. Any news event, rumor, fundamental fact, or technical formation can cause a trader to enter a spread based on the merits of his ascertaining that a spread trade would be in his best interests. Outright spread trades may be entered when it is unknown which way a market will break from congestion. Once the break has occurred, the losing side of the spread is dropped and the winning side is maintained. Entire strategies and the resulting tactics needed to carry them out can be built around outright spread trades.

Any time a spread is trending, sufficient reason exists to consider entry via the spread method of trading futures. Should it become advantageous, any spread position can at any time be converted to an outright futures trade by simply dropping the losing side of the spread.

Removing the Effects of Directionality

Spread trades are not fully dependent upon the trend or lack thereof of the individual futures of which they are comprised. Rather, they are dependent upon the trend of the spread differential itself. This is why, even when markets are not trending, a spread trade can make money from the trend in the spread differential. However, spreads can also make profits in trending markets. If the long side of a spread trade trends higher and faster than the short side of that same trade, profits will be acquired by virtue of the upward trend in the spread differential.

In like manner, if the short side of a spread trends lower and faster than the long side of that same trade, profits will be acquired by virtue of the upward trend in the spread differential. This may seem confusing, but it points out the fact that the trend of a spread can be up even while the two legs of the spread contract are plunging down.

Both Sides of a Spread Can Win or *Lose*

While on the subject of directionality, keep in mind that directionality of profit or loss is another matter. It is entirely possible to be profitable on both sides of a spread as well as to be unprofitable and actually lose on both sides of a spread.

Reducing the Amount of Initial and Maintenance Margin

Exchanges recognize the reduced risk of spread trades and the corresponding reduction in the effects of volatility by making the margin requirements necessary to carry

spread trades much lower than those for outright futures trades. Spreads are generally fractionally less volatile than outright futures positions.

Every spread trade carries in it the elements of hedging, and the elements of risk. Hedgers require less margin to trade because they are both long and short the same or a related commodity. That is one reason why, with a few exceptions involving related markets, we do not advocate exotic, exchange-non-recognized spreads for purposes of this course. Lowered margin requirements are a major positive reason for entering spread trades. Lower margins can mean more opportunities to enter or add to positions in the same market or to diversify through additional positions in other markets. If you are trading a small account, are you aware that spread trading may offer a way to obtain more trading opportunities?

Reduce and Greatly Eliminate the Effects of Volatility and Uncertainty

As stated above, it is the hedging nature of spreads that can reduce risk and margin. This reduction is directly related to the lessened exposure to volatility that may be carried by spread trades. If you are both long and short the Japanese Yen and it explodes into a 500 point price rise in a single day, you may profit if the long side of the trade moves up more than the short side. If the opposite is true, you will lose only fractionally the amount you would have lost if you were holding an outright short futures position. The long futures will always mitigate the effects of any loss you might be taking on the short side of the spread trade.

Disadvantages of Spreads

Since I've been listing the advantages of spreads, it is only fair that I list the disadvantages of spreads. Nothing in life is perfect. Spread trading is not totally without some drawbacks. You wouldn't want me to pretend there are none, would you?

Probably the greatest disadvantage in the minds of some traders is that trading spreads limits profit potential. Of course, this is true. When you limit the risk in a trade, you usually end up limiting the amount of profit available in that trade. Limited profit potential must be weighed against the benefits and advantages that accrue to a trader who utilizes spreads.

Another disadvantage in spread trading is the limited amount of written information about spreads. There are few books indeed that cover the subject. One of the

reasons for my preparing this course is to provide an in-depth treatment of the subject of spread trading.

Ordering of spread trades is another draw-back for many traders. It takes a greater effort to place a spread order than other types of orders. Although the ordering of a spread trade involves no more than a few additional words, this seems to be an insurmountable obstacle for those not willing to make the effort. I believe this degree of reluctance derives from the fact that traders are not sure of themselves when it comes to placing spread trades. This lack of certainty revolves around not understanding the mechanics of ordering, and also a lack of understanding of how spread trades work.

Ignorance in this area is not solely in the realm of the trader. It also involves the broker. This leads to another disadvantage of spread trading, broker uncertainty. I've been amazed at how few brokers know anything about how to place a spread order. Therefore they are sometimes of little help to the trader seeking such information. That's too bad, isn't it?

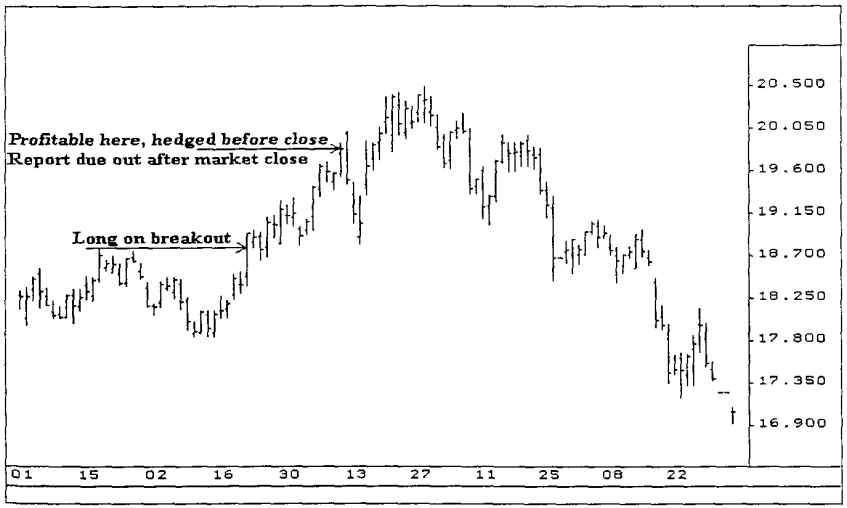
Perhaps the final disadvantage of spread trading is found at the spread desk itself. For spreads that involve the existence of an actual spread desk, i.e., spreads like the TED spread which involves a spread across two markets, and therefore trades at an official TED spread desk of the International Money Market, there is a loss of the confidentiality that is available were the trader to avoid the spread desk and simply leg into the spread trade.

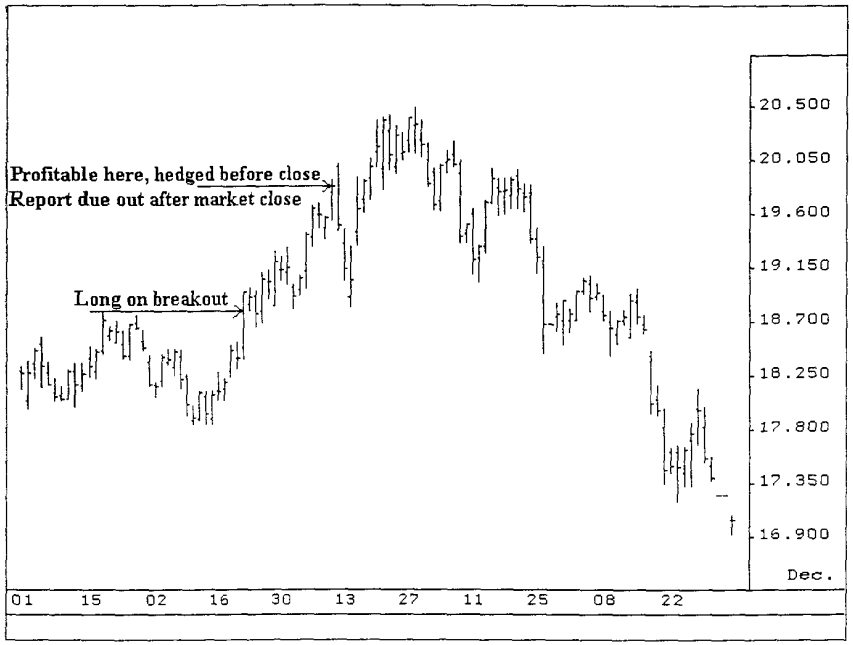
I feel that it is often better to leg into spreads, especially where the trader has the time and resources to observe the market and enter at a more propitious differential. The back office computer is oblivious to legging in. It cannot tell whether the spread was entered as a spread or was entered by legging-in.

Chapter 3

How to Trade Spreads to Reduce Risk

As previously stated, off-the-floor traders can hedge and reduce risk by offsetting positions to be held overnight. Both daytraders and position traders can create spreads that considerably minimize the risk of a position that might be held overnight. Daytrades can be converted to position trades by spreading (see Appendix C for an example). Position trades can be held considerably longer at less risk by spreading. Let's take some real examples so I can show you what I mean.

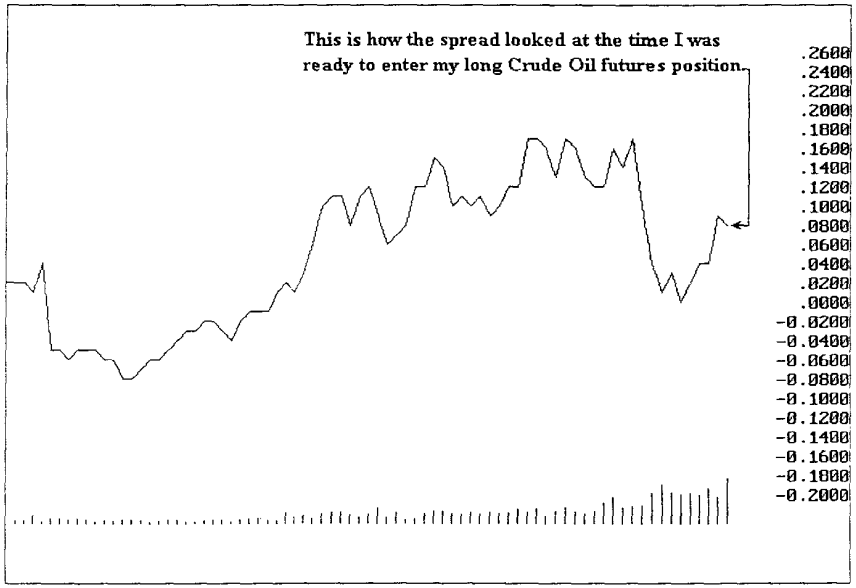




Some time ago, I was long Crude Oil futures based upon a position trade entry. After a few days, I was showing a nice profit. However, the report by the American Petroleum Institute (API) was due out. If the report were negative, I stood the chance of losing any profits I had made and possibly of incurring a loss. At times, the Crude Oil market reacts violently to the API report, and in my earlier years I often took a beating when such things happened. As an item of interest, another event that often rocks the Crude Oil market are the rumors (news?) that occur just before, during, and immediately after OPEC meetings.

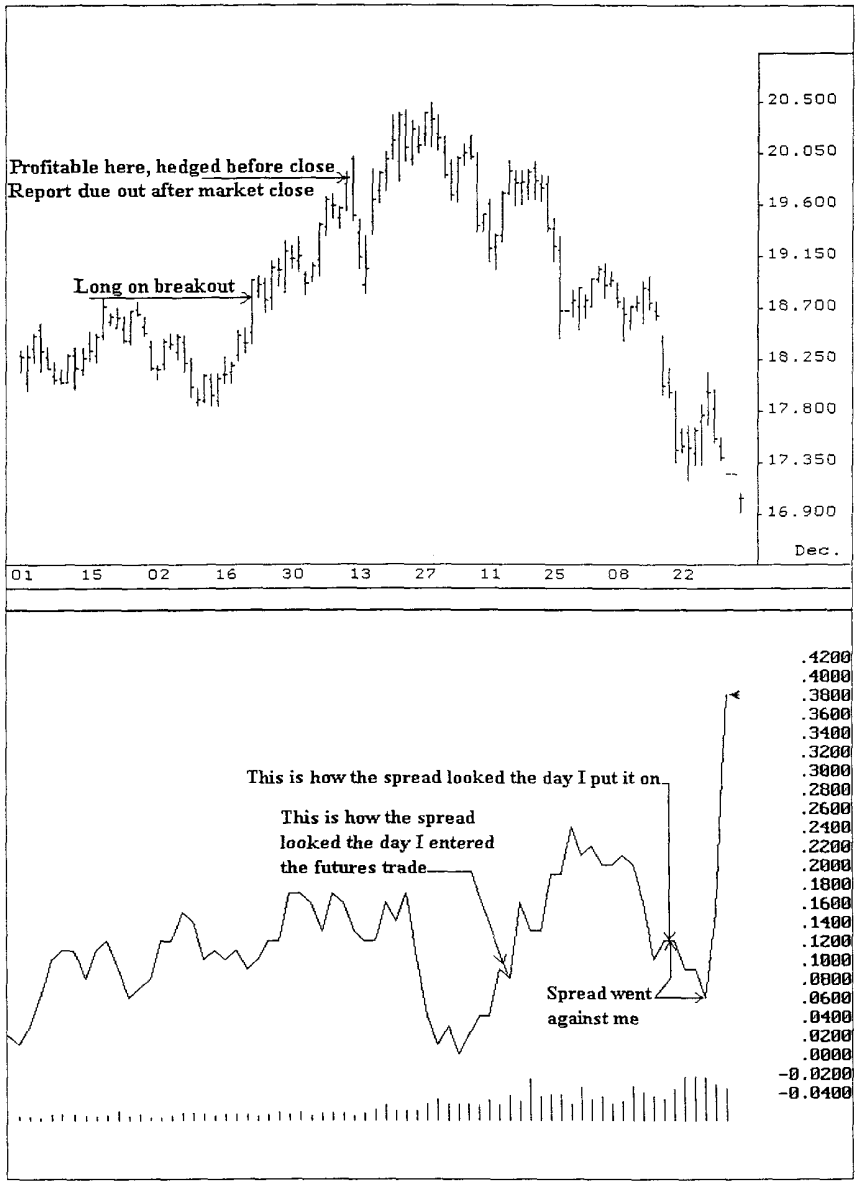
At this point, I need to back up somewhat and show you something I do on position trades in anticipation of the fact that I may at some time have to use a spread to reduce my risk. Prior to entering the Crude Oil trade, I looked at the spread among the most liquid Crude Oil contracts to see which, if any, were trending in a way favorable to me should I find that I need to offset my long Crude Oil futures with a short Crude Oil futures. Why do I do this?

I want to make sure ***before*** entering my outright long Crude Oil futures position that I have a possible way to hedge should the trade require such tactics. I knew before entry that the API report was due out soon. So prior to any entry, I ascertained that the spread was neutral or favorable to me should I need it to hedge and thereby reduce any risk I might have in the trade. So far as I knew, I might have to hedge the trade on the very first day, or on any subsequent day.

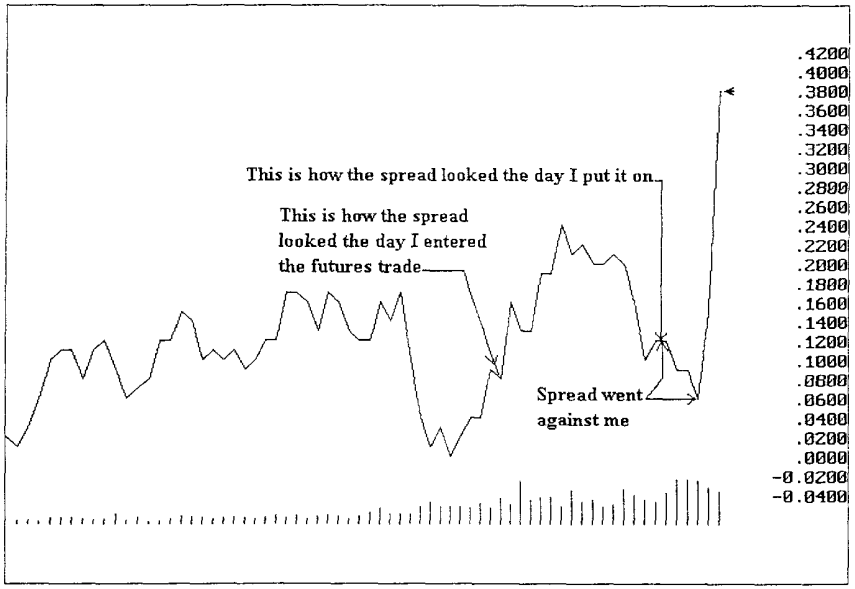


How to Chart a Spread

As you can see, at the time I needed to know about the spread, it was fairly neutral between the two contract months I decided to use. When you chart a spread you subtract the closing prices for the month you want to be short from the closing prices of the month you want to be long. The result should display a graph that is moving up, indicating the spread is working in your favor, or a graph that is neutral, indicating that, at least for the moment, the spread is not working strongly against you. Next, let's look at both the outright futures position and a continuation of the spread chart so you can see what happened at the time I needed to actually enter the spread in order to hedge my position.

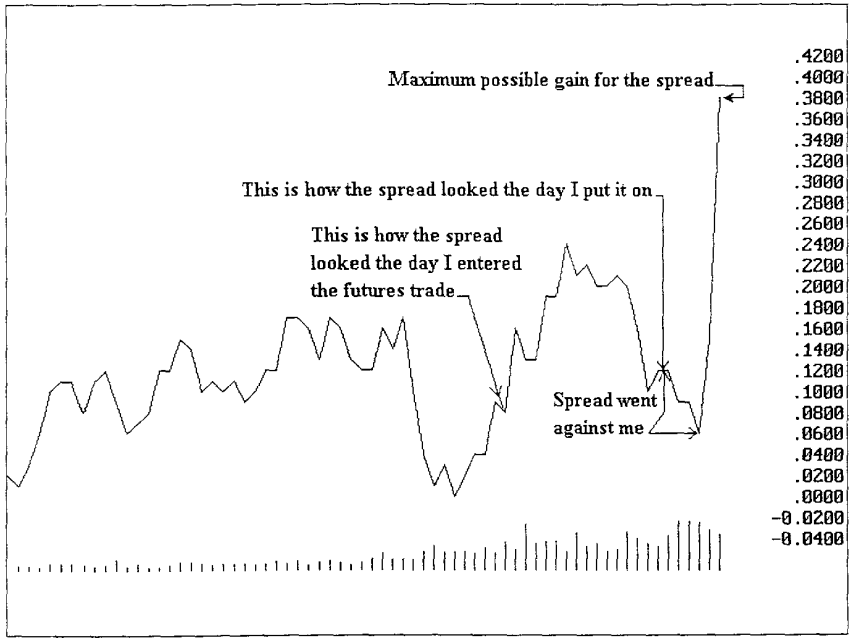


On the chart at the top of the preceding page, Crude Oil futures prices reacted negatively to the API (American Petroleum Institute) report. Prices went down for a period of three days following the report. During that time, the spread went against me for a few days. You can see it on the chart below. Did you notice how the graph line of the spread went down soon after I put it on? However, had I not hedged my risk by using the spread, I would have ended up giving back virtually all the profits I had previously made in the trade, and could very possibly have been stopped out with little or no gain.



In terms of numbers, I entered the spread when the difference between the long and short futures was 12 points ($120). The worst the spread ever moved against me was to a differential of 6 points ($60). My greatest risk for the entire time I held the spread was only $60. Had I remained long futures, it would have required me to maintain a protective stop of 124 points ($1,240) to prevent my being stopped out of the trade entirely. The futures numbers are as follows: I entered my long futures at a price of 1880. The market moved as high as 1996. At that point I had 116 points, ($1,160) of unrealized paper profits. After the API report came out, prices moved down to 1873.

I would have needed a stop at 1872 in order to stay in the trade. Instead of risking $1,240, the spread allowed me to risk only $60. Once prices moved my way again, I could have dropped the short side of my spread and stayed long futures for a maximum gain of an additional 57 points ($570). Had I not dropped the short side of the spread, my additional maximum possible gain would have been 26 points ($260). Of course, one rarely gets the maximum possible gain. The spread at its widest shown below was 38 points. Since I entered it when it was at 12 points, the most I could have gained was another 26 points.

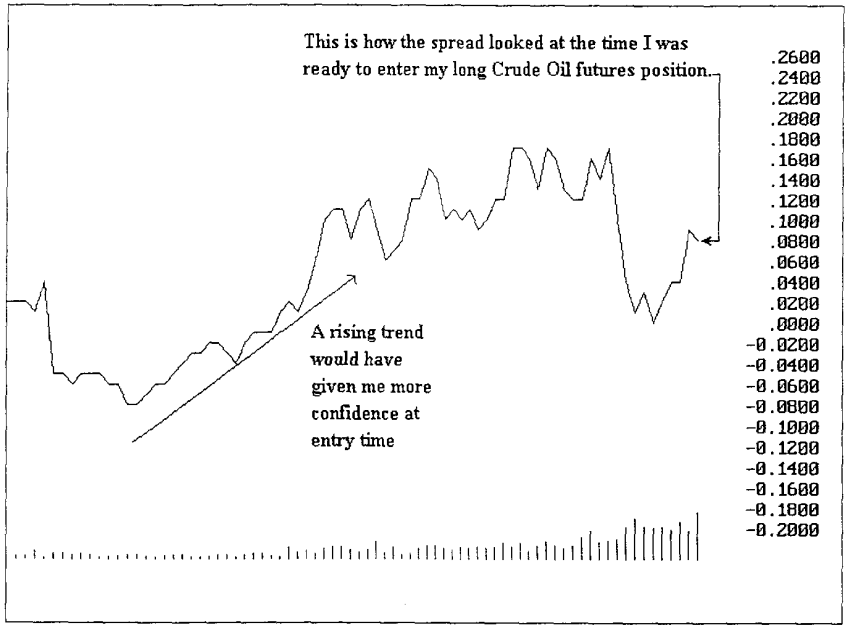


By hedging my long futures via the technique of "spreading off," I sharply reduced my risk. Admittedly, by staying in the spread I also reduced my potential profits to a degree dependent upon how long I stayed hedged. However, from the point in time that I entered the spread by shorting a back month of Crude Oil futures, my margin requirements had been greatly reduced. Directionality of my long futures was no longer a factor in the trade.

My main concern was the direction of the trend in the differential. The hedge itself was an intramarket calendar spread. Since markets were created for hedgers to be able to reduce risk, as a speculative trader I was also hedging risk, thereby fulfilling the economic purpose for which futures markets exist.

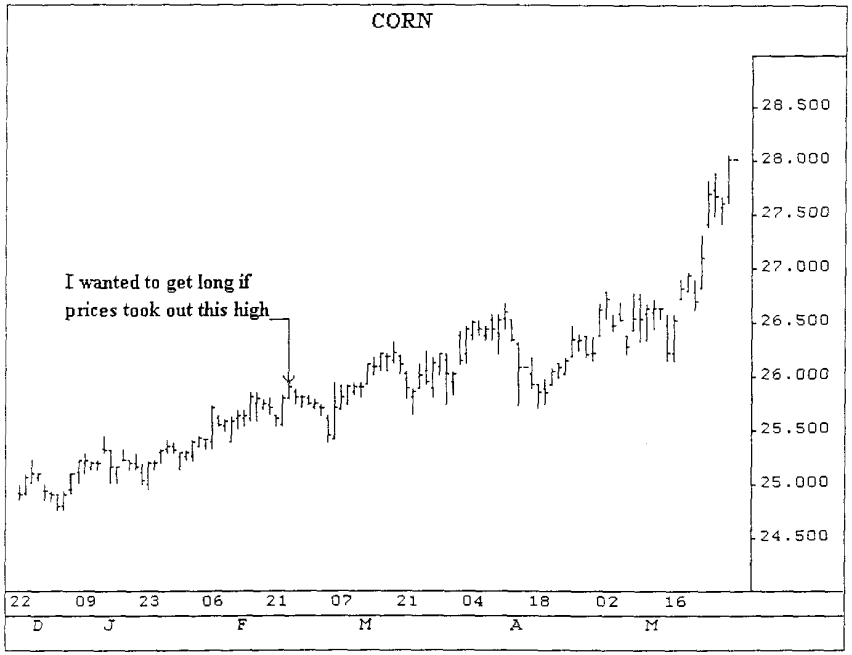
Risk Reduction Considerations

This particular trade worked out quite well. The only thing that could have been more reassuring at entry would have been to have seen a rising trend in the spread itself.



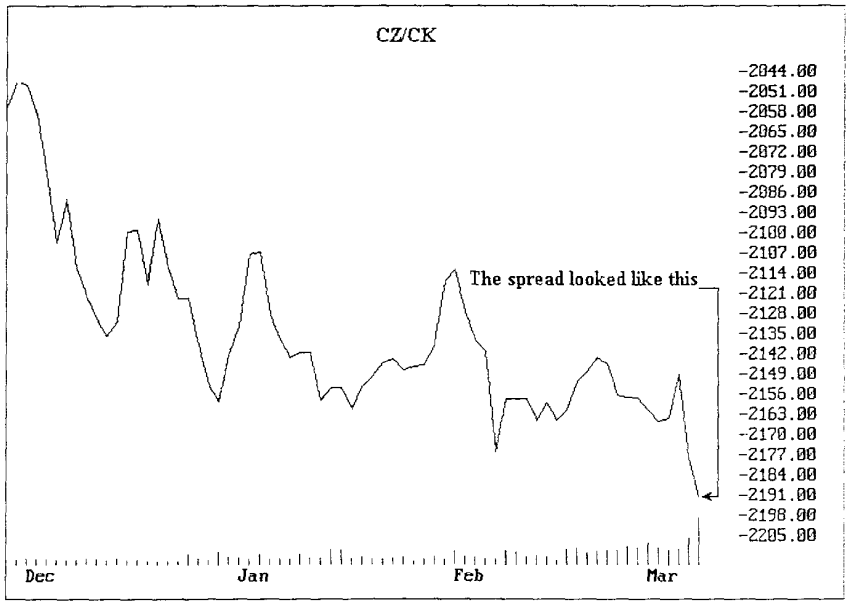
Many days may pass and the trend of the spread can change between the time I enter an outright futures position and the time I decide I need to spread off in order to hedge my position and reduce risk. However, at the time of entry I have no idea of when I will need to use the hedge. There have been many times when the hedge needed to be put on the very same day as the day of entry into my outright futures. So whenever possible, I look for the spread trend to be up.

If chart shows the spread trend is moving sideways and is only neutral, I will think a lot harder about whether or not I can use this technique. In turn, this will affect whether or not I choose to enter the trade at all. If at the time of entry the spread trend is opposite of what I need it to be and trending down, I may reverse the way I enter the trade and go long the month I would normally have sold short and go short the month I would normally have bought long. Let's look at that situation now. Here is a trade in Corn:



My intention was to go long December futures. During the month of March prices took out the high indicated by the arrow. As a precaution, I looked to see how I might protect myself and lower my risk should the trade go against me. The normal thing to do would be to buy December futures and look to short another month for a positive trend in the spread. I looked at the spread differential between the May and December contracts, and I looked at the spread differential between the July and December contracts. When I charted the possibility of creating a hedge trade, the spread appeared as you see it on the chart on the following page.

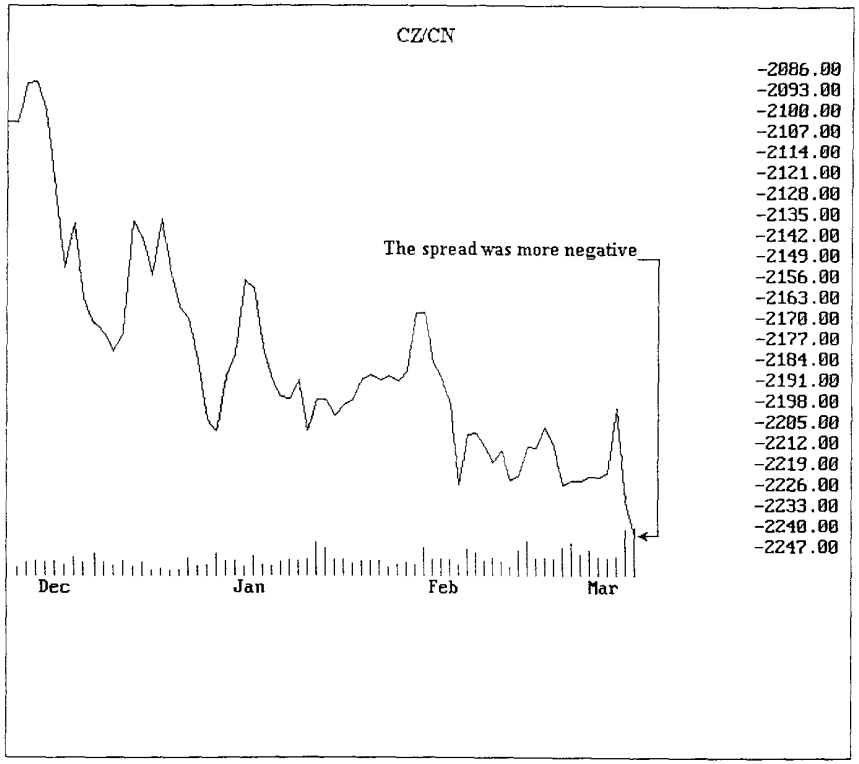
Do you see the pronounced downward bias to this spread?



CZ/CK was hardly conducive to my wanting to enter a long position in December Corn. It had been falling for quite some time, and the spread differential had just broken to new lows.

I then looked at CZ/CN to see if it would be any better.

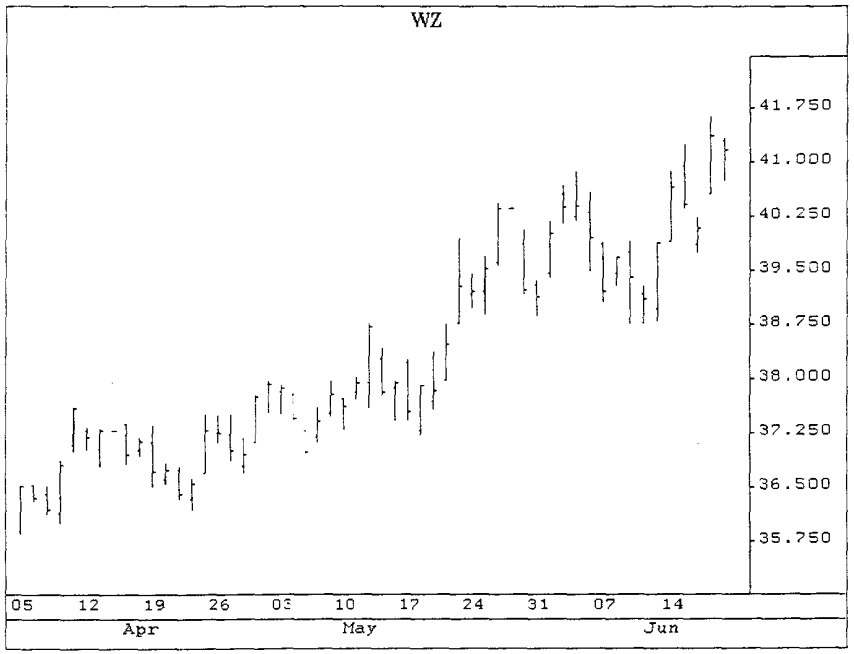
Based on a comparison between CZ/CN and CZ/CK, which spread would you have chosen to enter?



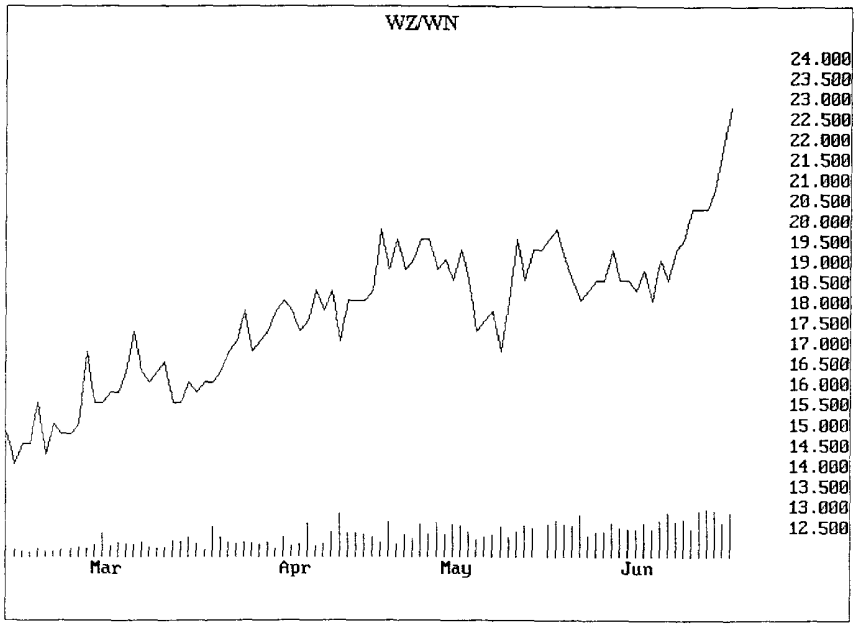
The spread CZ/CN appeared more negative than CZ/CN. On the basis of the spread chart, I decided to enter long July and short December Corn.

Although I never would have had to hedge my long July position, if I had, the spread kept going in favor of long July Corn until just a few days before first notice day.

When trading futures I like to have every possible element of the trade favoring my chances for success. Even with the precautions I take, things don't always work out the way I plan. Sometimes the trade goes against the best of my plans. Recently one of my students, I'll call him Jay, found himself in trouble on a trade. Let's look at that trade now.



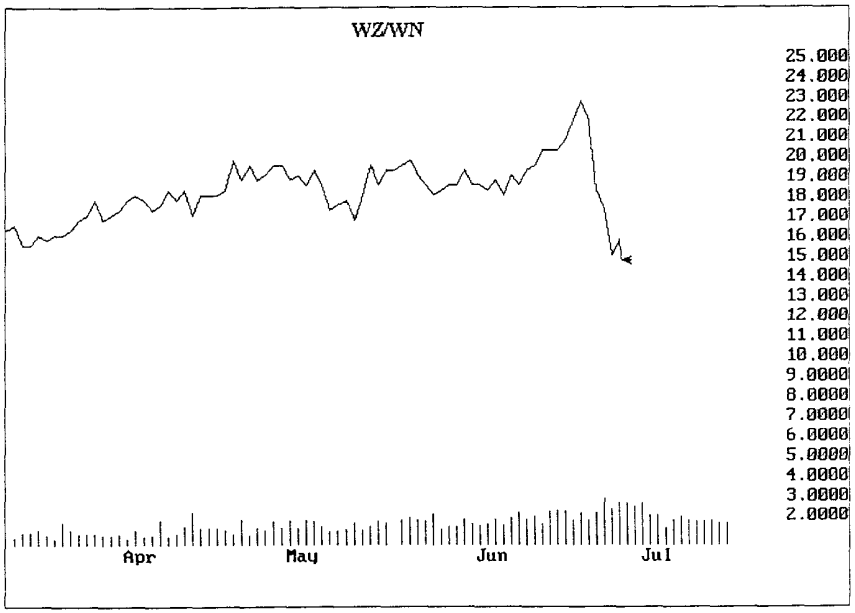
Jay was long December Wheat, and in late June the market looked as you see it on the above chart. Prices had begun to be more volatile with the daily range on average becoming greater. The market appeared to be choppy, and he feared that it was beginning to top out. Jay wanted to protect his position by hedging it via a spread in which he would offset his long December Wheat by going short July Wheat. At the time he originally entered the trade, the spread December over July was steadily working in his favor and looked as you see it on the next page.



That night, about 10 minutes before the close, Jay offset his long December Wheat by shorting the July contract. In his estimation, he stood to make money by dropping the hedge should Wheat continue to move up. He felt that if it stayed in a choppy trading range, or topped out, he would continue to profit from the spread, which had been working in favor of December over July for quite some time.

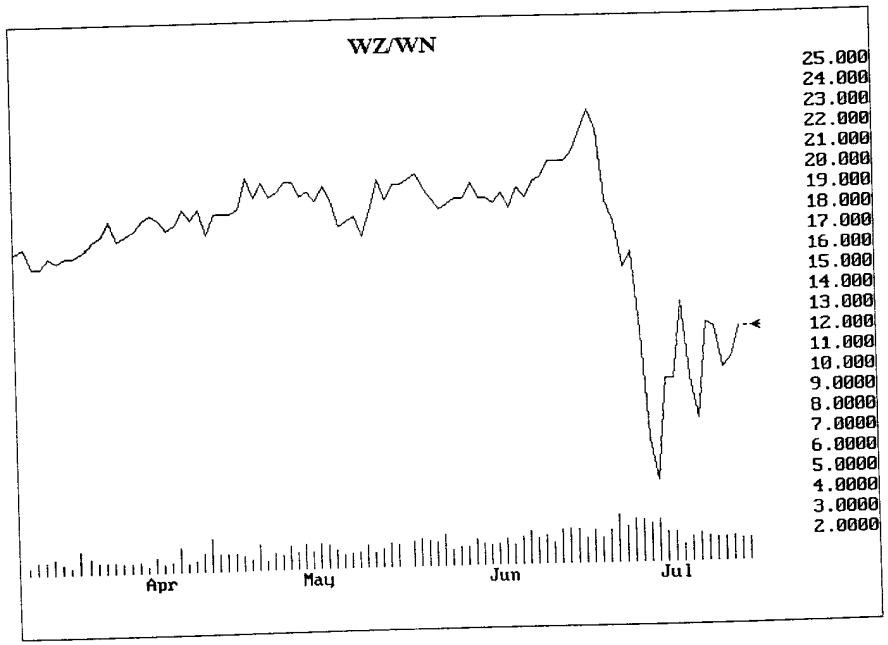
Unfortunately for Jay, the markets suddenly changed and the spread began to move rather strongly against him.

Within a few days, Jay found himself looking at a spread chart such as the one you see on the following page.

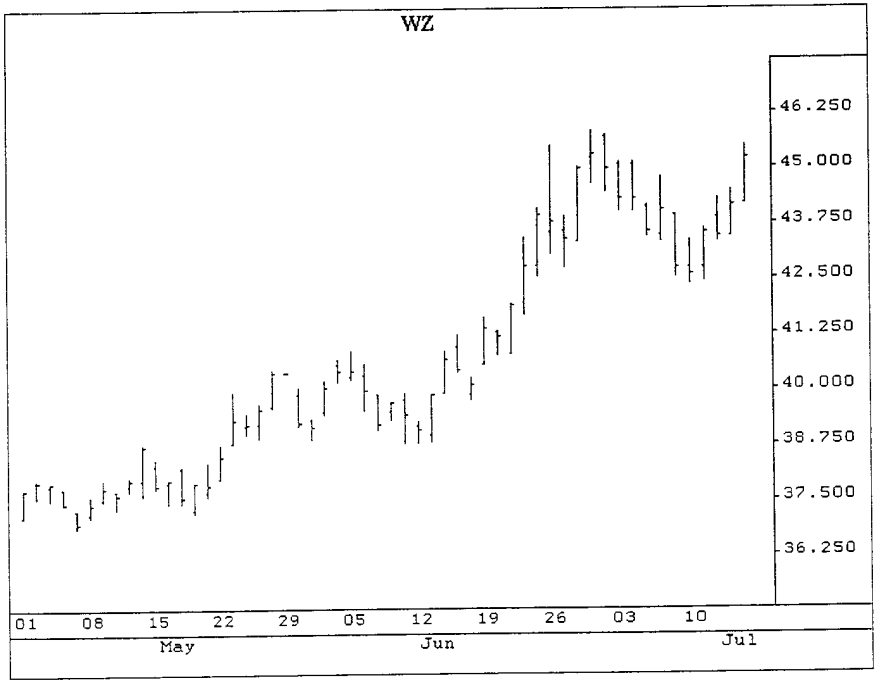


Jay now had an important decision to make. Since the spread was working against him, he **could** choose to exit the trade by liquidating both his long and short Wheat positions. He **could** choose to go back to his original position by dropping the short July Wheat position and staying long the December contract. His final choice **could** have been to stay hedged by continuing to hold the spread. Before I tell you what Jay did, let me ask you what you would have done?

In this case, Jay chose to exit the position entirely because he was no longer comfortable with it. That choice turned out to be a "middle of the road" decision. Had Jay stayed with the spread, here is what would have happened to him.



If Jay had chosen to stay long December Wheat, he would have made more money as Wheat prices moved 42 points higher before forming a Trading Range. Had Jay been able to get out at the very top, he would have made $2,100 more per contract than he did. However, Jay was correct in detecting that the move in Wheat prices was almost over. Would the additional gain have been worth being uncomfortable with the trade? Only Jay could have made that decision. We each have our own level of comfort. Jay traded within his comfort level. He had made profits and he took his profits. Any time a trader chooses to take profits, I will applaud that decision.



Summarizing Risk

I want to make sure you realize that spreads can be, and are used, to reduce risk. I also want to be sure you understand that it is possible to lose on both sides of a spread trade, once it is entered. It is entirely possible for the long side of a spread to begin to worsen your position relative to the short side of that spread. When that happens, under certain circumstances, you could find yourself losing more, by way of a spread trade, than you would have in an outright futures position.

Chapter 4

Seasonal Spread Trade Selection

Seasonal spreads are among the best trades possible for those who are willing to wait for these excellent opportunities to come along. They have the advantage of a very high degree of reliability over a period of many years. Trades that work 80% or more of the time are certainly worth taking. Many of these trades work 100% of the time for periods spanning 15 years or more.

Yet seasonal spreads must be filtered in order to obtain the very best results. A lot of money can be lost by blindly taking these trades based upon computer generated dates for entry and exit. Seasonal spreads can be heavy losers in those years when they fail to work as predicted by computer generated studies. Even in those years where a seasonal spread does what it is expected to do, it can also work strongly against a trader, resulting in substantial losses if it is entered or exited at the wrong time, or under the wrong conditions.

In the first chapter, I showed you ways to discover seasonal spreads. In this chapter I will show you how I filter them in order to get the best results. My filter is simple, as you will soon see. My entry technique usually gains me a better entry than one based solely on a computer generated date. I will also show you how I exit seasonal trades. My exit technique generally results in greater profits than those obtained by exiting the trade based solely upon a computer generated date. In all fairness to those private services which provide computer generated entry and exit dates, let me say that those dates are given by them as approximations with adequate warnings as to the fact that they do need to be filtered.

The Filtering Process

My filtering process is simple, and threefold:

> I check to see if there is any fundamental reason for the spread to behave abnormally. In the case of a consumable item, I want to know if there is a current supply shortage of one of the underlying commodities. In the case of all contract items, I want to know if there is any news or market situation that might affect the trade I'm about to enter.
>
> I enter a proven seasonal spread during a time window covering ten trading days prior through ten trading days subsequent to, the usual entry date for the trade, a total time window of twenty trading days.
>
> I enter the trade based upon a signal from a simple chart pattern. If such a signal does not appear, I refrain from entering the trade regardless of the probability of success. If I miss a good trade because of a failure of the chart pattern to appear, I simply consider that this seasonal trade did not have my name on it.

However, in order for you to appreciate my filtering process, I want you to understand what is involved with selecting a seasonal spread. The conclusion of the matter is that the simplest, easiest way is to employ computer generated seasonal spreads that have been proven to work over a period of many years. After all, my job is to spend my time making money ***trading*** seasonal spreads, not ***researching*** them as I had to do in the past.

Considerations in Manual Selection of Seasonal Trades

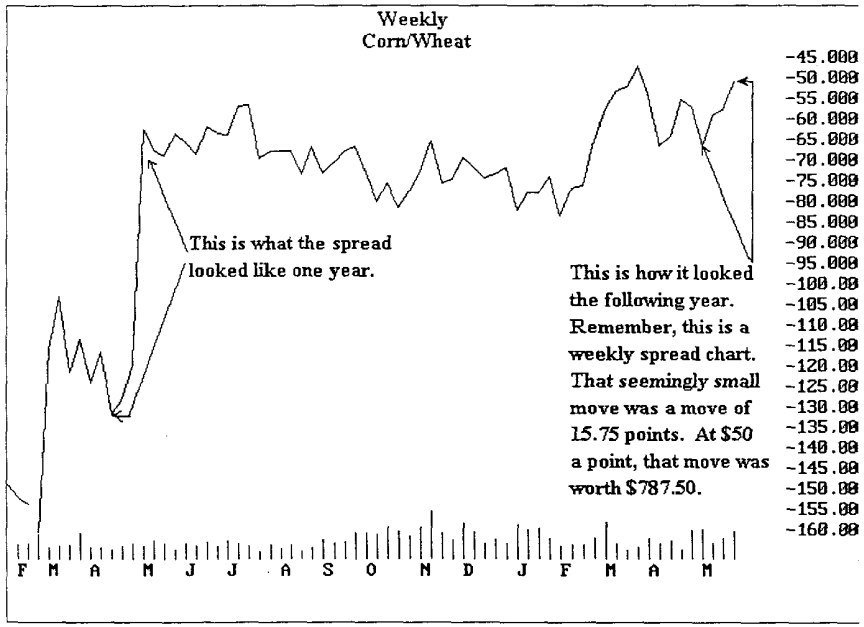
To identify a seasonal spread, it is necessary to ascertain the relative action of the underlying futures contracts. This is no easy task. To accomplish this, I must have charts or data of how the underlying contracts have behaved in the past. The exchange brochures are excellent for viewing past price behavior over a period of many years. Yet it is extremely difficult in some years to visually see the spread between two bar charts, unless prices are charted as a spread.

It is also possible to purchase computer databases containing daily prices going back for many, many years, in some cases as far back as the beginning of trading of a particular contract. Such data can then be massaged to show the outcome of spreading one futures contract against another.

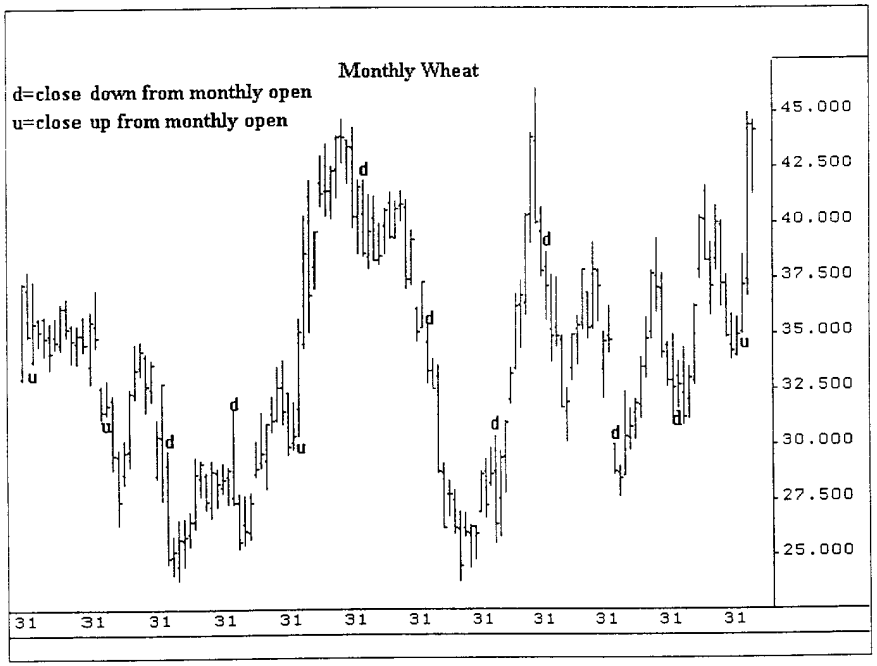
Here is an example of what is involved in identifying seasonal spreads.

A spread I've been familiar with for many years is to get long CBOT Corn and short CBOT Wheat around the first of May.

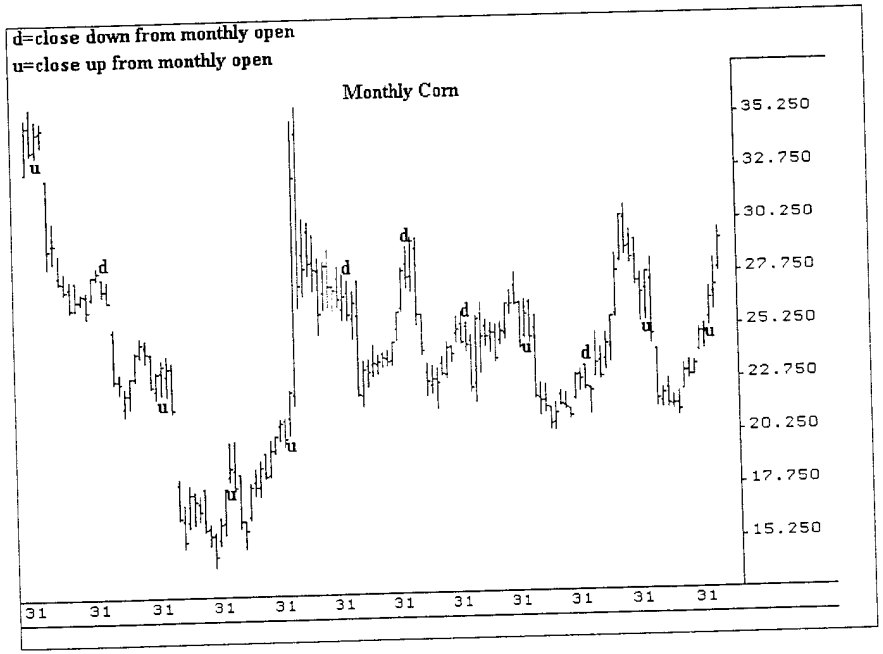
The reason for entry into this particular spread is that Wheat prices generally tend to be pushed down by the commercial interests, in May, just ahead of the harvest, while at the same time of year the quality and quantity of the future Corn harvest is unknown. This spread works more than 90% of the time over a period of years. The Corn/Wheat spread works even in years when Wheat prices are rising, as long as Corn prices are rising more strongly.



Looking over a multiple year period, I can see that Wheat prices generally dropped in the month of May, eight out of twelve years. On the sole basis of falling Wheat prices in the month of May, the spread would succeed only 66.7% of the times as long as Wheat prices fall faster than Corn prices. So just looking at falling Wheat prices is insufficient for determining the probability that the spread might work.



Looking at Corn prices over the same twelve year period, I can see that Corn prices generally rose in seven out of twelve years. From this we can see that in some years Corn and Wheat prices have a tendency to diverge during the month of May.



From that analysis, we can begin to see why this spread has a tendency to work as Long Corn, Short Wheat. However, were I to select this spread based only upon the years that Corn prices rose and Wheat prices fell, I would have had only a few opportunities to make the trade. The fact is, only four times in twelve years did Corn prices rise while Wheat prices fell.

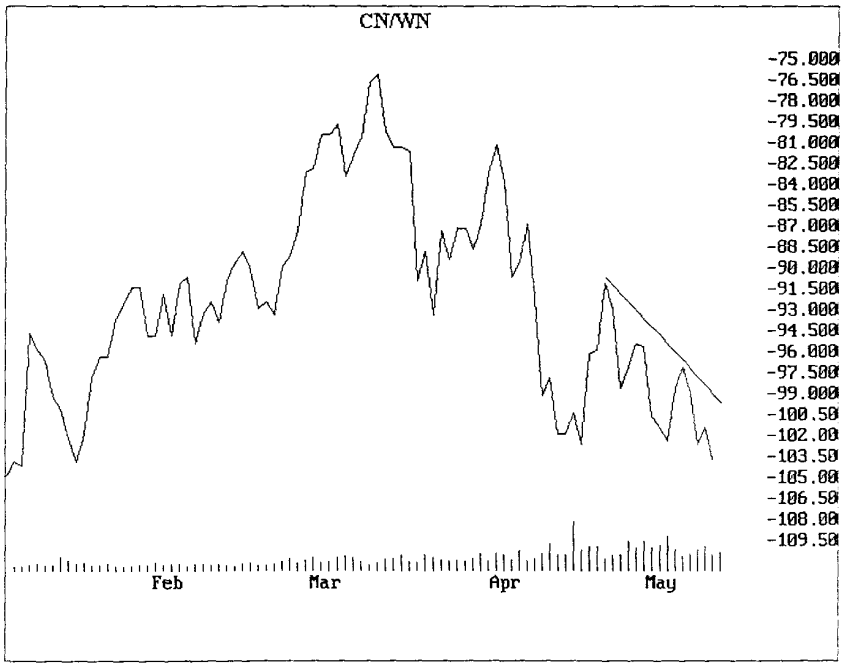
Analyzing the charts, can you see that there were three years where both Corn and Wheat prices rose, four years where both Corn and Wheat prices fell, and five out of twelve years where the trend in Corn and Wheat prices differed? Of those five, Corn prices rose four times while Wheat prices fell and Wheat prices rose once when Corn prices fell. Obviously, the safest trades came in the four years when Corn prices rose while Wheat prices fell.

However, that does not account for the high percentage (over 90%) of years when this spread worked. The only conclusion is that in years when both Corn and Wheat prices fell, Wheat prices fell more dramatically than Corn prices. In the years where both Corn and Wheat prices rose, Corn prices rose more dramatically than Wheat prices. As a matter of fact, the only year when the spread didn't work was the one year when Wheat prices rose and Corn prices fell during the month of May. The result is that if this spread trade were entered and exited correctly during the twelve years shown on the chart, the trade was successful 91.67% of the time.

The fact of the matter is that the two, Corn and Wheat, must be looked at together and the amount of rise and fall in prices must be looked at relationally. This is extremely tedious and difficult to do without the aid of a computer.

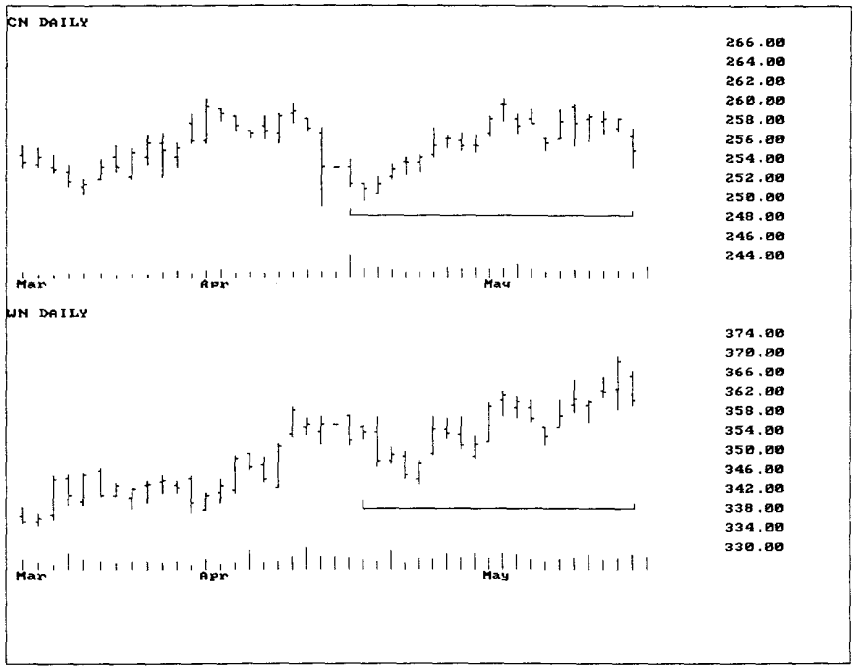
In the Corn/Wheat spread I will show, Wheat was in short supply from the previous year's harvest, and therefore the spread would not work. Could you see that this was going to be the case simply by looking at the spread trend prior to the time it is normally entered?

The chart is right below you, take a look.



When I consider the CN/WN spread, I look at a window in time beginning ten trading days before the first Monday in May, and up to ten trading days after the first Monday in May. Ten trading days prior to the first Monday, the spread was moving sharply upward. However, I did not see an entry signal during that time (I will be showing you my pattern entry signals a bit later in this course). By the time prices were five trading days prior to the first Monday, prices began moving down. From that time until ten trading days after the first Monday, the trend of the spread was counter-seasonal and no entry signal was given.

Looking at the two charts on the following page will show why the spread was not following its normal seasonal tendency.



During the twenty-day (bracketed) window in time when I considered entering this trade, Corn moved up 3.5 points. However, during that same period, Wheat moved up 8.25 points. The non-seasonal differential caused CN/WN to trend the wrong way.

Chapter 5

Filtering Process: Checking the Fundamentals

The first step of my filtering process is to check everything I can about the fundamentals of the underlying futures contracts relative to the time of year I propose making my entry.

For me, this means looking at the most basic of fundamentals. I've often said that as an individual trader I cannot hope to compete with the large commercial interests in gathering fundamentals. That statement remains true today. Why?

Because the large commercials can afford to have agents worldwide who can go out in the fields and examine crops, research intended plantings and actual plantings, pore over government and private reports of crop conditions, weather, soil conditions, insect infestations, etc.

However, there is certain fundamental information available to the individual trader and, in fact, with the news reports available via a live data feed, there is more information than I can possibly handle or want to know.

Checking Fundamentals: Weather

It doesn't take a great deal of effort to turn on the news and find out the weather, not only in one's own country, but all over the world. If there is flooding or drought in the Midwest that will affect the grains, it doesn't take much effort to find out about it.

If there is a freeze in Brazil that could affect coffee or soybeans, it doesn't take a lot of research to be informed about that either. I can quite easily find out if the Silver miners in Mexico are threatening a strike.

If there is trouble in South Africa that might affect the mining of gold, it will be part of the news. If OPEC is planning a meeting, energy prices are likely to be affected, and it's not difficult to find out. The news will carry tales of unrest in the Ivory Coast that might affect the supply of cocoa beans, etc.

The point I am making is as old as the hills, "LOOK BEFORE YOU LEAP." This point is in keeping with my old adage, "Trade what you see, not what you think." Any oddity in the weather is going to cause me to take a hard look at a proposed spread trade in a commodity that is eaten by someone or something. I am going to see if the underlying markets appear at all normal individually and relative to each other. I'm going to take a hard look at the inter-exchange, intermarket, and intra-market spreads as is appropriate. I may even consider entering the spread inversely. I'm also going to look for the next item.

Checking Fundamentals: Backwardation

One of the easiest things to spot is the reversal of the natural order of prices. This reversal is known as "backwardation" and can be seen in any newspaper that features a section carrying futures prices. For all futures contracts except interest rate contracts, the normal carrying charges (insurance, storage, interest) usually cause prices in the later (back) months to be higher than prices in the nearer (front) months. However, when some change in the fundamentals occurs to cause excessive demand in the front months, the prices in the front months may rise higher than those of some of the back months, causing backwardation. Backwardation can be caused when someone is willing to pay a premium today to get something that they fear may be much more costly later on. With regard to backwardation, the experts at Moore Research state: "In certain markets (live cattle, crude oil, heating oil, e.g.) this phenomenon provides the very foundation for some seasonal trading and spread strategies wherein deferred contracts tend to rise toward cash as front months expire. (We found this to be the case when analyzing contracts included in the CME's GSCI. Note how rarely cattle producers are able to place forward hedges without doing so at progressive discounts to cash)."

If I see backwardation in anything but interest rate futures (where it is normal for contract prices in the front months to be higher), I am immediately alerted to the fact that a normal seasonal futures trade may not be profitable. In fact, such a condition may cause me to consider going opposite to the seasonal tendency. Notice that I used the words *alerted* and *consider*. As stated by Moore Research, backwardation is the underlying cause for many seasonal futures trades.

Backwardation in the interest rate contracts is the opposite of that in the commodities. The back months become higher in price than the front months. Backwardation there will also cause me to be alerted to potential problems.

Checking Fundamentals: Position of Commercials and Large Traders

There are two sources I can look at to see the position of the major players in the markets:

1. The exchange issued "Position of Large Traders Report."

2. The open interest of Put and Call options on futures.

The normal position of commercial and large traders is to be short the various commodity markets, and long the interest bearing financial futures. What I am concerned with is if the "big guys" decide to get long commodity futures (short financial futures). This situation may or may not occur in conjunction with backwardation. Getting long commodity futures means the large traders are buying futures or selling Put options. Getting long interest rates means getting short financial futures. To do this the "big guys" are selling financial futures, and buying Put options.

If a major shift in open interest does occur, I will reconsider any proposed seasonal spread trades, and may even consider a reverse spread entry.

The Position of Large Traders Report

This report is issued once a month by the exchanges.

It is not a timely report and is issued two weeks after the data are known. It becomes increasingly less reliable as time passes and the next report is due. However, for purposes of spread trading, this report is fairly adequate. The Position of Large Traders Report is available by calling the exchanges and is available from data services that carry news reports.

Put and Call Open Interest

A current view of the position of commercial and large trader interests can be ascertained by looking at the Put and Call open interest in options for the individual contracts that are going to be included in the seasonal spread. The reason for checking this factor is that the large traders and commercials are the parties who write and sell most of the available options in any market. Put and Call open interest by month is not generally available in newspapers. As far as I know, it must be obtained commercially from data services that carry the daily reported figures. Availability probably includes every live and end-of-day data service, because the exchanges release open interest by contract along with volume and prices on a daily basis. (By the way, futures and options volume and open interest figures are always reported a day late.)

I'm going to show you what I see and what I look for on my computer screen .

Suppose I had a seasonal trade to get long the September contract for US 30 Year Bonds (T-Bonds) and short the September contract for US 10 Year Notes (T-Notes), also known as the NOB Spread (shouldn't it be called the BON Spread?).

Assuming there is no news that would prevent me from taking this trade, I would then begin examining the options open interest for bonds. First I would look at the open interest of the near and at-the-money strike prices in the September T-Bonds. Since the commercials are usually short interest rates, the normal position for them to be in the T-Bonds would be to be short Puts or long T-Bonds. Remember, interest rate markets are upside down from the commodity markets. For the market to be normal, there should be significantly more Put open interest than Call open interest. If this were not the case, I would be alerted that there may be something abnormal going on, perhaps something I have not picked up from the news.

ESC | COMMODITY OPTIONS | ← → ↑ ↓ PgUp PgDn

SYMBOL	USFP112	USFP113	USFP114	USFP115	USFP116	USFP117
LAST	2.0000	4.0000	9.0000	18.000	36.000	100.00
NET	+0.0000	+0.0000	+0.0000	-1.000	+1.000	+1.00
HIGH	3	4	10	20	36	100
LOW	2	4	8	18	36	100
OPEN	3	4	9	20	36	100
VOLUME	1043	4823	1526	2746	6370	2157
OPEN INT.	4552	7145	19351	7292	13008	9256
TICK VOL.						
TICK TIME						
BID						
BID SIZE						
ASK			10			100
ASK SIZE			355			355
52WK HIGH						
52WK LOW						
EX. DATE	12-15	12-15	12-15	12-15	12-15	12-15

With Treasury Bond futures at 117-15, Put open interest for the 117 down to the 112 strike prices totals 60,604 contracts.

Now let's look at the open interest for the same strikes on the September Treasury Bond Calls.

ESC | COMMODITY OPTIONS | ← → ↑ ↓ PgUp PgDn

SYMBOL	USFC118	USFC119	USFC120	USFC121	USFC122	USFC123
LAST	38.000	19.000	10.000	4.0000	2.0000	1.0000
NET	-1.000	-1.000	+0.000	+0.0000	+0.0000	+0.0000
	-------	-------	-------	-------	-------	-------
HIGH	39	20	10	4	10	1
LOW	37	19	10	4	2	1
OPEN	37	19	10	4	8	2
VOLUME	6003	6426	4188	2965	2435	400
OPEN INT.	11610	11199	10223	6399	6030	400
TICK VOL.						
TICK TIME						
BID	36				2	
BID SIZE	355				355	
ASK						
ASK SIZE						
52WK HIGH						
52WK LOW						
EX. DATE	12-15	12-15	12-15	12-15	12-15	12-15

The Call open interest for the 118-123 strike prices totals only 45861, showing that the Put sellers, usually the commercial interests in T-Bonds, are still short interest rates by being short Puts (in effect, long Bonds) by a substantial margin over non-commercial interests (generally the public).

Since this is the normal condition I would expect for the T-Bonds, I have only to ascertain that T-Notes are in a similar condition. An inspection of T-Note open interest shows 38,220 Calls and 48,176 Puts. There is obviously a much more balanced open interest condition in T-Notes than in T-Bonds. This is probably because the public does not usually get involved in T-Notes. Nevertheless, the T-Note open interest is in line with what I would expect it to be. The short Put open interest among the commercials is greater than the short open interest in Calls.

I would now be able to proceed with the trade based upon the factor of open interest provided everything else was correct. To repeat, I want a normal progression in T-Bond and T-Note prices from high front months to lower back months because this trade involves an interest rate spread.

Let's now look to see if there is any backwardation in my supposed NOB spread.

US TREASURY BOND PRICES

September	11106
December	11023
March	11008
June	10923
September	10907

The progression from high to low prices is normal for T-Bonds.

US TREASURY TEN YEAR NOTE PRICES

September	10824
December	10811
March	10802
June	10723
September	10711

The progression from high to low prices is normal for T-Notes.

Based upon any market moving news, a normal progression of T-Bond and T-Note prices, and a normal condition in open interest, I would be inclined to take this trade. The only remaining factor is an entry based upon an appropriate chart signal.

My chart entry signals will be discussed in a later chapter.

Chapter 6

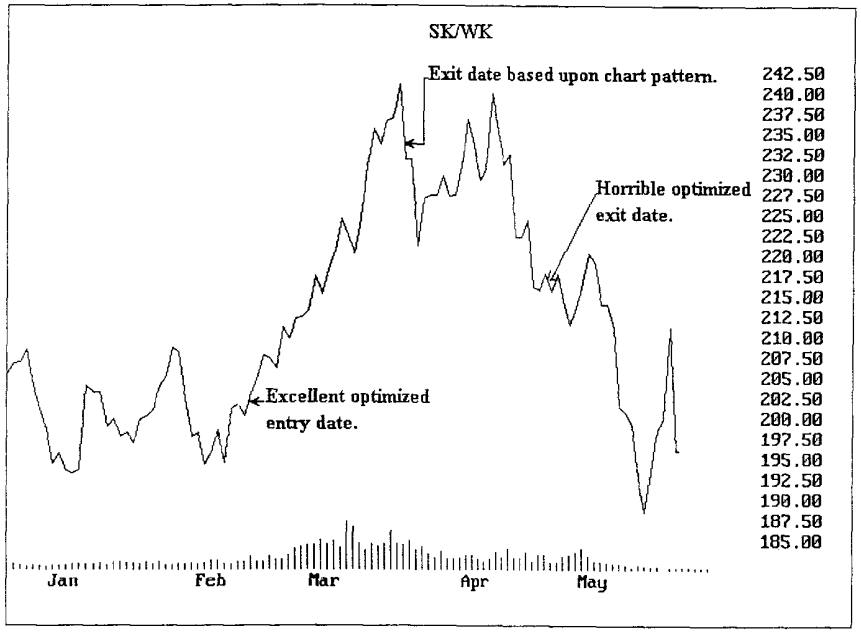
Filtering Process: Time Window

Seasonal spreads, no matter how they are derived, will pass through an optimal window in time when an entry is "best" made. There will also be an optimal "best" time for exit. These time windows were and are discovered by a process of iteration and averaging. Today, with the aid of high speed computers, they are fairly precise in their optimization. Yet the various services that provide seasonal spread trades will generally agree that blindly trading seasonal windows is not the best way to enter seasonal spread trades.

I have seen seasonal windows open in excess of one month on either side of the optimized best window. It is because of this variance, that some sort of technical indicator is needed as a filter to enhance the timing of entry and exit. One needs to see when prices are actually creating the conditions for entry.

Let's view some actual seasonal spread trades in light of the optimized seasonal windows and compare those seasonal windows with the period of time in which the best actual entry could have been made.

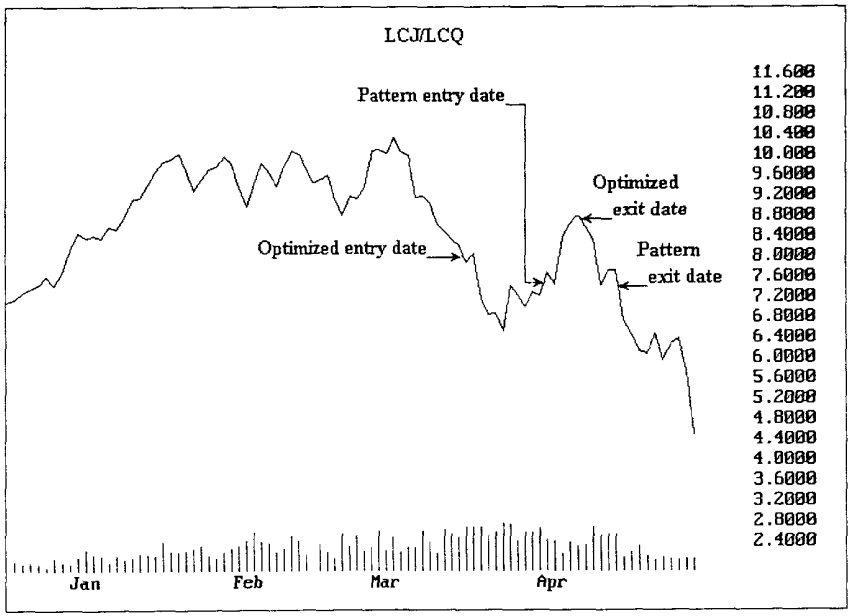
First let's look at a May Soybean/Wheat spread to be entered on about the third Monday in February. This trade is based on the fact that Soybeans tend to be flat to slightly up in the Spring, while Wheat prices are beginning to be depressed by the commercials going into the Wheat harvest. This trade generally works 13 out of 15 years.



Can you see that the optimized entry date for this trade was about as good as it gets? It harmonized perfectly with a chart pattern signal I will show you later. But look at the terrible exit this trade would have made if you were to follow the trade until the optimized completion date. Also note the position of the exit had you liquidated the trade based upon a chart pattern. The difference between the two exit dates was 18 points or $900. The chart pattern exit was good for a total gross gain on the trade of $1,525. The gross gain using the optimized exit was $625.00.

Taking the trade in the period shown above was obviously not typical of the best exit dates found in other years. I have proven repeatedly that it is much better to exit via chart patterns than on optimized dates.

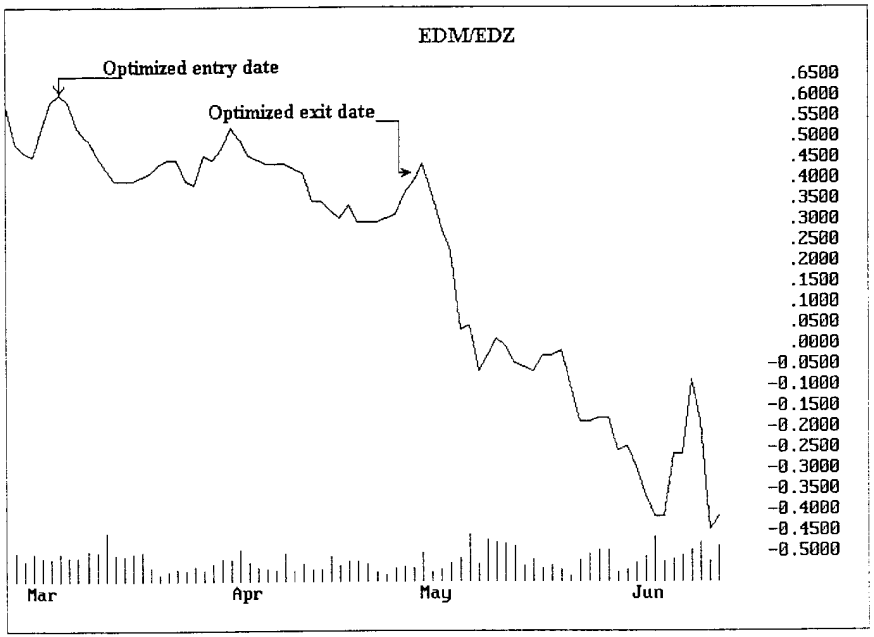
Next I want to show you a chart in which a great improvement over the optimized entry date could have been made.



The chart above shows the seasonal spread long April Live Cattle, short August Live Cattle. Years of testing has shown this spread to be 93% accurate. It is generally profitable 14 out of 15 years.

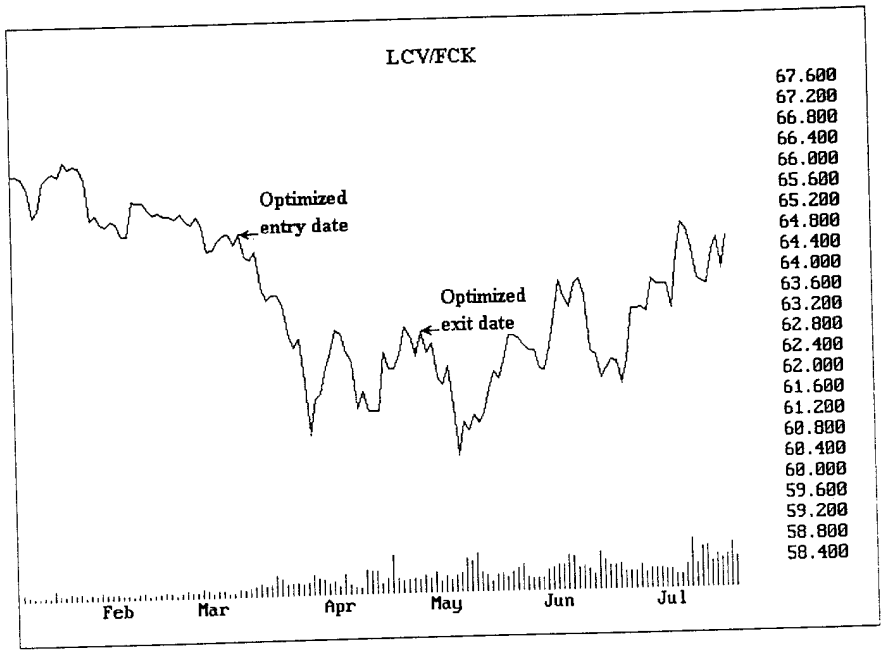
Optimizing the entry date would have this trade entered on about the third Friday in March. Did you notice that the optimized exit date could not have been more perfect? It hit the exact high of the very brief widening of the spread. In fact, this trade is an excellent example of how seasonality works. For most of the year, August Cattle gained on April Cattle. Research into seasonality through numerous computer iterations spotted that approximate window in time when April Cattle either rose in price more than August Cattle or decreased in price at a slower rate. In this particular instance, Live Cattle prices for both contracts were in steep decline at the very inception of the optimized window in time. By March 31, both contracts had made an abrupt turn and moved up sharply, ending the decline in Cattle prices. The chart pattern entry caught this turn around in Live Cattle prices one day after the turn. However, the optimized exit date proved to be far superior to the pattern exit date.

Let's look at a few more charts to see what we can learn about seasonal spreads. Then, if you haven't already figured it out, I'll show you my astoundingly simple pattern recognition entry technique.



The seasonal spread shown above involves long June Eurodollars/short December Eurodollars. This trade is entered approximately the end of the first week in March and exited the last week in April. It has been profitable, on average, 91% of the time. Did you notice that if you had entered and exited this trade on the optimized dates, you would have lost money?

However, using chart pattern entry signals, there never would have been an entry because there never was an entry signal within the time window I would use for any spread trade, i.e., ten trading days before until ten trading days after the optimized entry date.

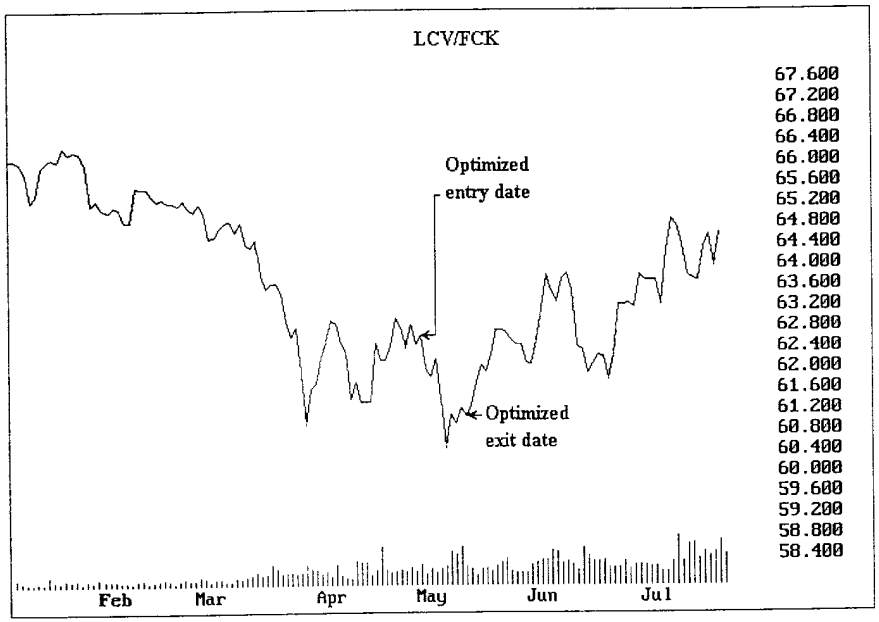


The spread pictured above involves long October Live Cattle and short May Feeder Cattle. The optimized entry date is about the second Friday in March. The optimized exit date is around the last Friday in April. Obviously the trade was a loser in the year shown, although this trade is profitable 93% of the time over a 15 year period.

Here we see a perfect example of a generally reliable trade losing because of fundamental conditions. In the previous year, there was a shortage of Feeder Cattle. Not many cattle had been brought to the feed pens. Feed lots did not have a sufficient number of feeders to sell to the slaughter houses. Simultaneously, there were plenty of Cattle still out on the farms and ranches. Therefore, the seasonal spread could only have worked in reverse, i.e. non-seasonally. Understanding how to trade this spread wasbased on knowledge of the fundamentals. Can you see that it's important to have such fundamental knowledge?

There is no pattern entry signal at or on either side of the entry date for taking the trade on a seasonal basis.

In fact, based on the fundamentals, there was a wonderful chart pattern entry signal for reversing this trade and doing the exact opposite of the normal seasonal spread. I'll show you this same trade done properly in Chapter 7.



A bit later, the situation changed and a normal seasonal spread window opened up right on schedule. It is the reverse of the trade on the previous page. It is long May Feeder Cattle/short October (or August) Live Cattle. The chart above shows where it happened. The optimized entry is the first Monday in May, and the optimized exit is the second Friday in May.

This trade gave virtually perfect entry and exit signals corresponding almost exactly with chart pattern signals.

The above chart gives an upside down view of the spread. You see it as LCV/FCK. Normally, one would graph the futures to show the spread FCK/LCV.

I suppose it's about time to show you these same charts and perhaps a few others to explain my simple entry and exit signals.

Chapter 7

Filtering Process: Entry and Exit Signals

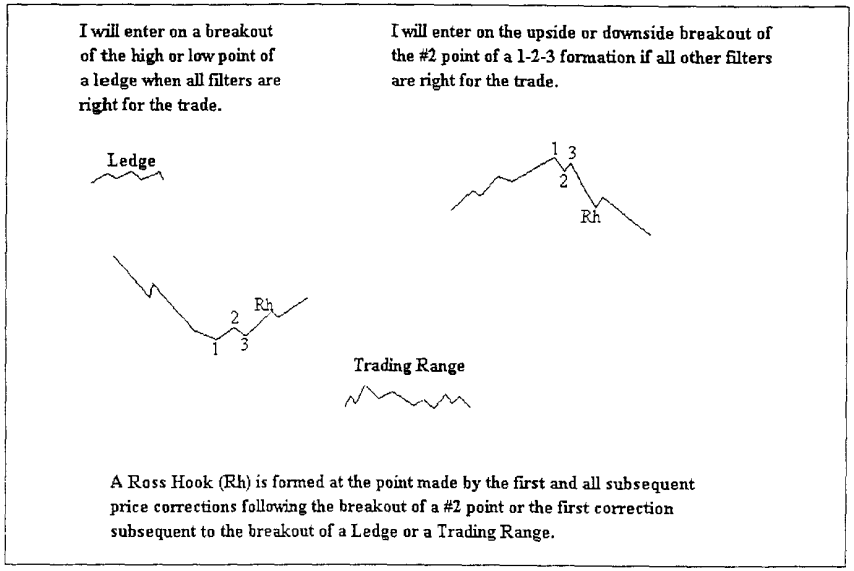
My entry and exit signals for spread trading are about the same as my entry and exit signals for outright futures trades. The main difference is that in the case of spreads I'm looking at a line chart of connected closes instead of a bar chart showing opens, highs, lows, and closes.

The Law of Charts

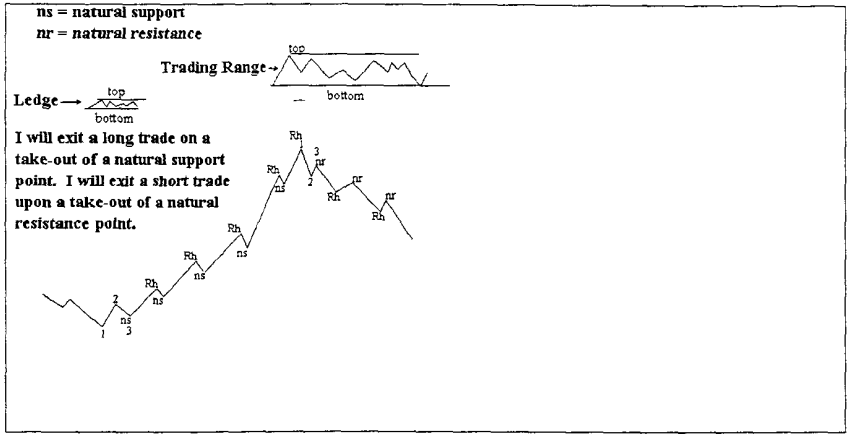
Over many years of trading, I have come to understand that there is an invisible law that governs anything that can be depicted as either a bar or line chart. All bar or line charts have certain things in common. They all make formations that I call "1-2-3's," "Ledges," "Ross Hooks," and "Trading Ranges." (See Appendix A for details on these formations when using bar charts.)

It doesn't seem to matter what is being charted. The chart can be of egg production by Leghorn hens in August, average gas meter readings in Pacoima, or typical mortgage loans in Eastern Pennsylvania for the past two decades.

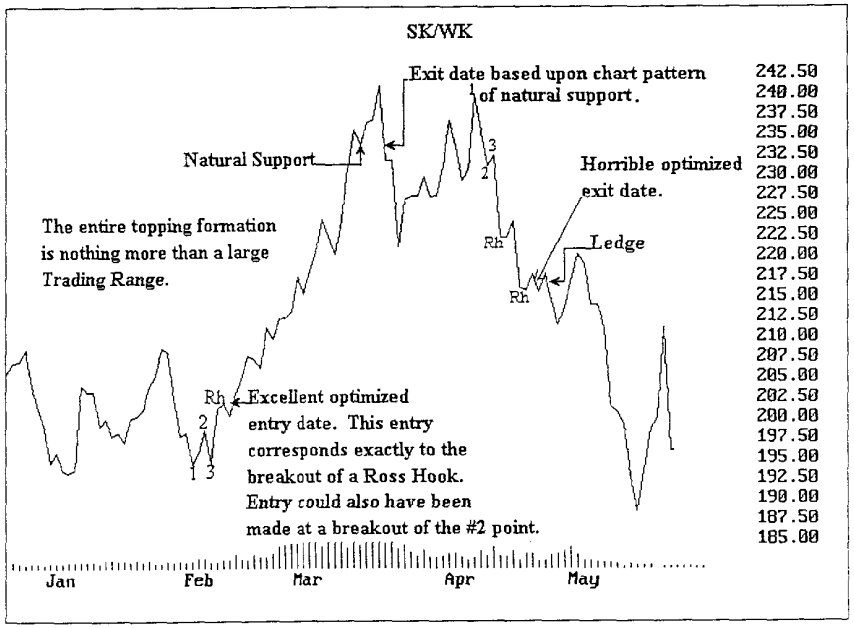
These formations are more easily spotted on a bar chart than on a line chart. Nevertheless, they exist on all charts. Here is what they look like on a line chart of spreads:



The chart patterns I use and my entry and exit signals are shown above and below. There is really no difference between them. An entry signal to go short is the same as an exit signal for a long position. An entry signal to go long is the same as an exit signal for a short position.



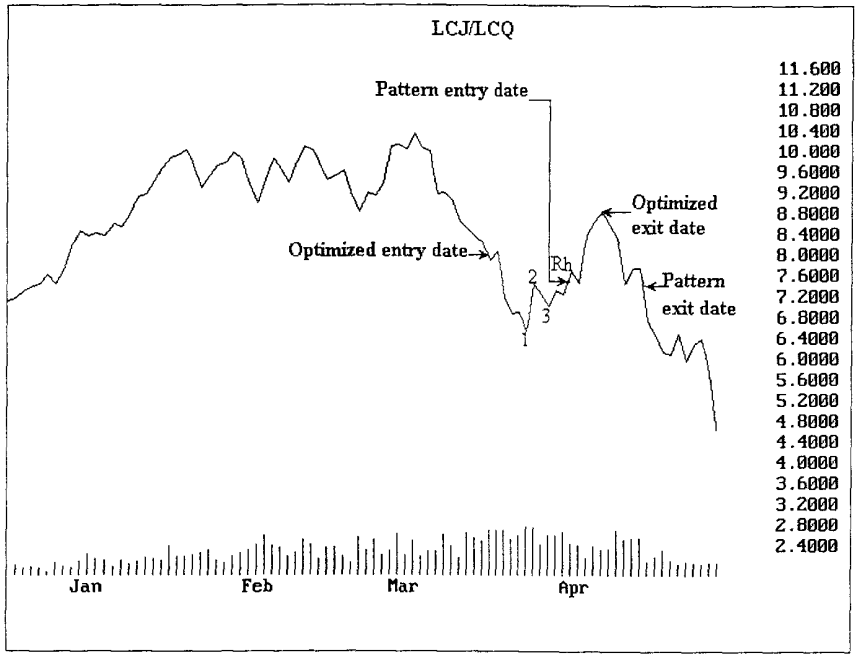
Now let's look at the charts we previously viewed. After that, we'll look at additional charts so you can see more of how everything works together.



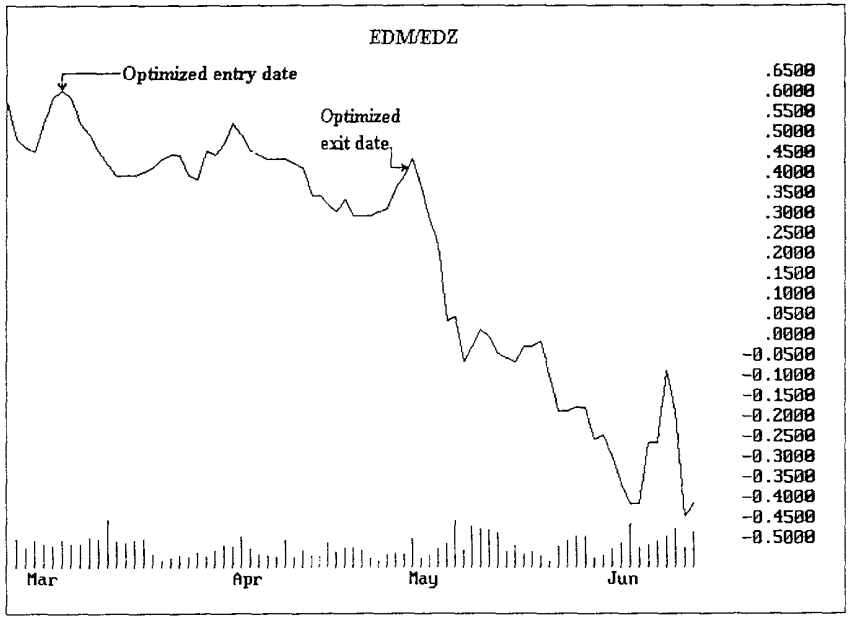
Here we see a 1-2-3 low coming during the window of time in which the trade might have been entered. A breakout of the #2 point is a satisfactory chart pattern entry signal. If the breakout of the 1-2-3 is not taken, then a breakout of the Ross Hook (Rh) also gave an excellent entry signal and was coincident with the optimized entry date.

The chart pattern exit signal of natural support was far superior to the optimized entry signal and factored into account the fact that the spread was no longer working.

Did you notice that prior to the optimized exit date, there was a 1-2-3 high followed by a series of Ross Hooks, and that the entire topping formation was a highly volatile Trading Range? There was a ledge forming at the optimized exit date.

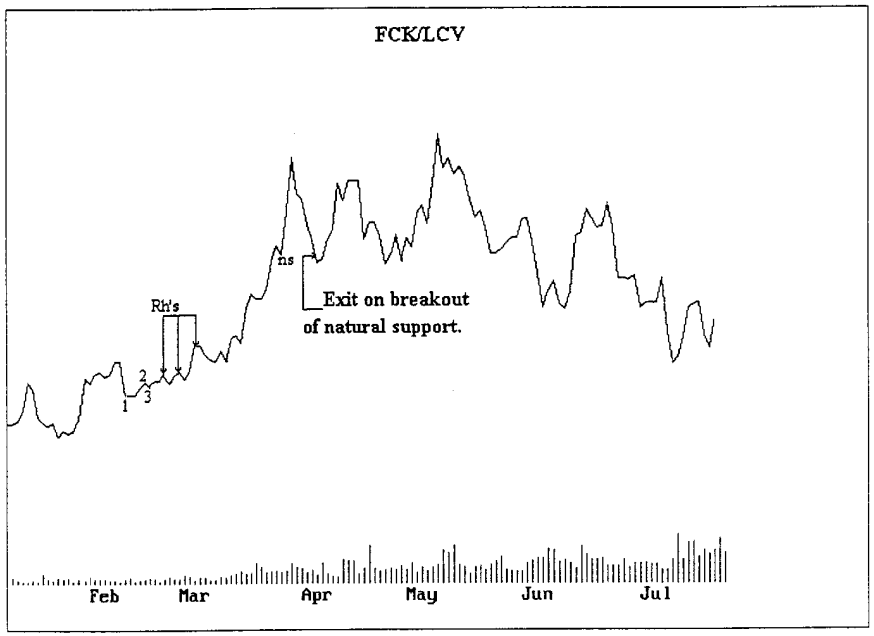


This trade presented a superior entry signal at a breakout of the #2 point of the 1-2-3 low. Even an entry at a breakout of Rh would have been acceptable. However, the natural support exit signal was much worse than the optimized exit signal. The exit based on the chart pattern signal would have resulted in a breakeven trade with an entry base upon a breakout of the #2 point, and a loss with an entry based upon a breakout of the Rh. In trading you have to take the good with the bad. There is no perfect way to trade. Later, when we get into "Contrarian Trading," you'll see that you could have reversed this spread and profited nicely by doing so. Do you see that the pattern exit date is really the taking out of a #2 point of a 1-2-3 high? Reversing the spread at the pattern exit point would have resulted in an excellent long term trade because the spread continued down beyond what is shown on the chart.



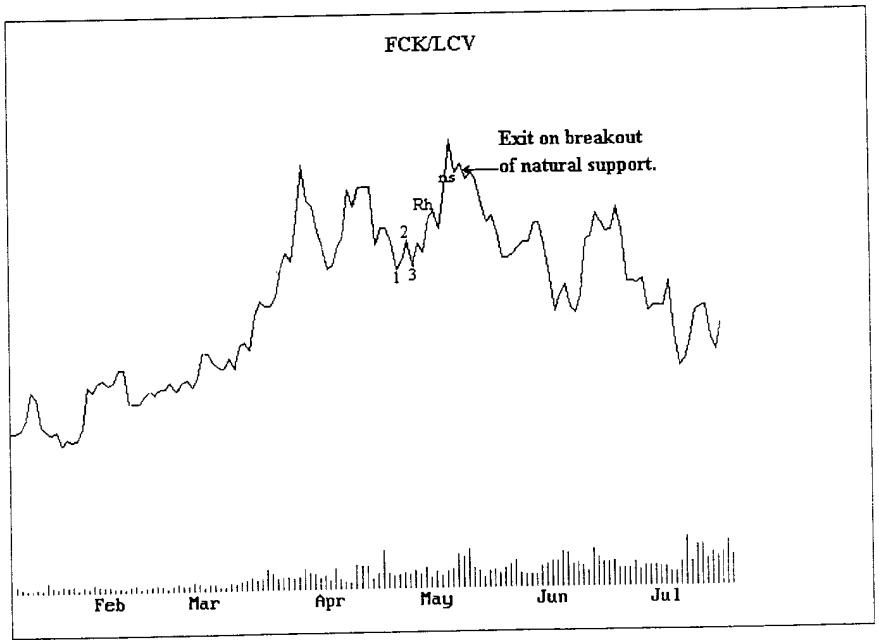
Entry via a chart pattern signal could not have been made on this seasonal spread. The trade was to go long the spread, but an entry signal never appeared within the allotted time window. The lack of a pattern entry signal filtered out what would have been a losing trade had entry been made solely on optimized dates.

Do you realize that during most of the time between optimized dates the spread was in a Trading Range? Reversing the spread as prices took out the low of that Trading Range would have yielded fat profits. When you notice that for fundamental reasons a spread is obviously not working, the best thing you can do is to reverse it and go the other way. That is what I call "Reality Trading," or the "Thinking Man's Way to Trade." Later on in the course we will delve more deeply into this kind of trading.



Do you remember this trade? Based solely on optimized entry dates, this trade would have been a big loser. This is the one where the fundamentals in Live Cattle versus Feeder Cattle should have had us going counter-seasonally. What I've done here is to show you how the chart would have looked if it had been graphed as FCK/LCV instead of LCV/FCK. You can see that a breakout of the #2 point, or even a breakout of the first or second Rh, would have resulted in a profitable trade. The natural support exit worked just fine and came 17 trading days before the optimized exit date on the last Friday in April.

Later on, the FCK/LCV trade worked again, only this time it was seasonally correct. We showed it upside down in the previous chapter. On the next page, you will see it right side up.



This is the trade that could have been picked almost perfectly by using optimized dates. The optimized dates in this case did a little better on both the entry and the exit signals than did the chart pattern trades.

It is not untypical for a seasonal trade to have entry and exit dates quite close to one another. In this case, the seasonally optimized days were only 10 trading days apart. Before the advent of the computer, it was virtually impossible to so closely pinpoint seasonal spreads. Seasonal spread profitability windows were much less specific.

When I learned these trades many years ago, the best I could do was to memorize the general time period in which the trade usually worked. These time frames typically covered at least a month and sometimes more. I had no way in the world to slice time windows as precisely as can be done by computer.

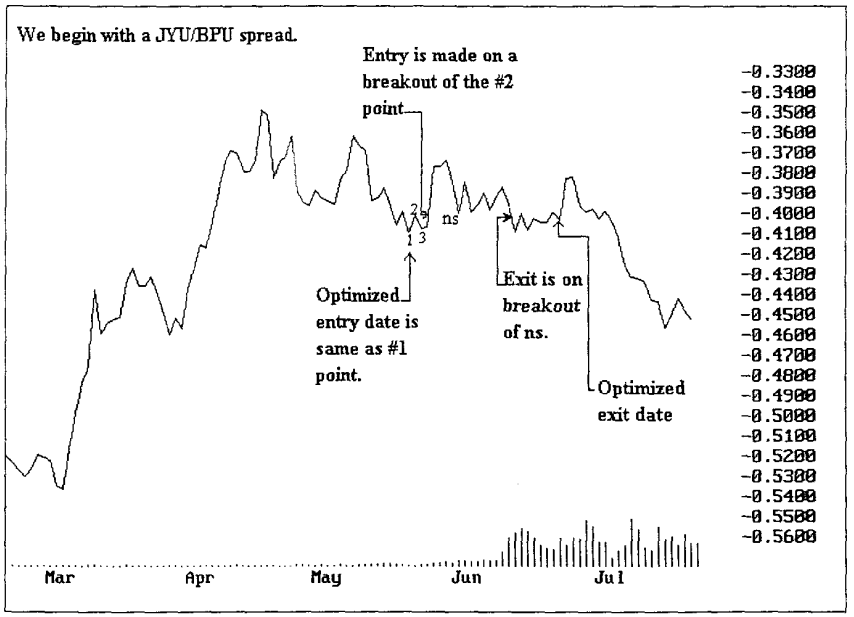
I believe that now is the time to show you some additional seasonal spreads. Once again, the computer has done something that would have been extremely difficult to do in years past.

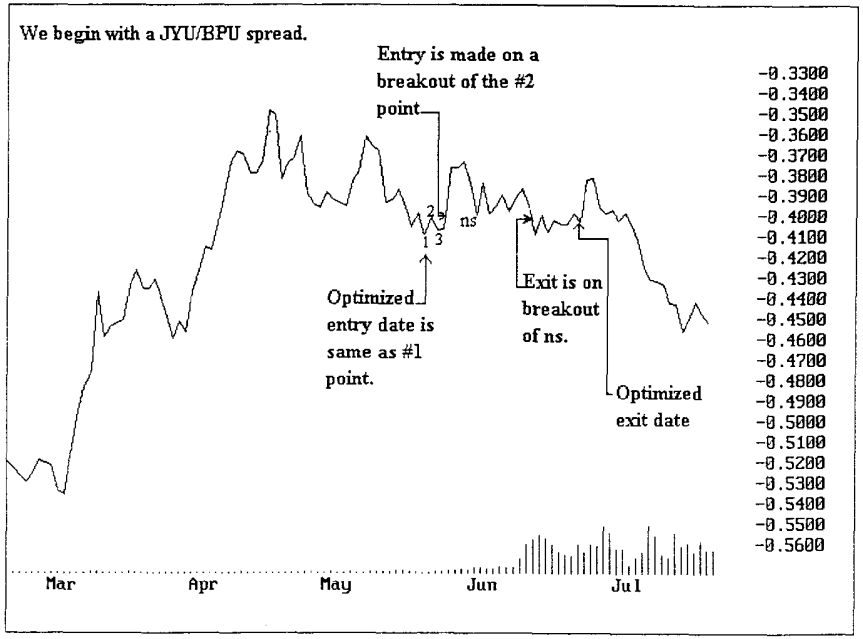
Some good examples of computer generated spreads are found in the currencies. How in the world would a person go about manually detecting a spread such as long Japanese Yen and short British Pound? Such spreads are difficult to think of as seasonal. Is there really a time of the year when J-Yen goes up against B-Pound? Apparently there is. We begin the next chapter with such a trade and others like it.

If at this point in the book you are not thoroughly familiar with my pattern entry signals, then I suggest you go back to Chapters 6 and 7, and review the charts in them. You might also take a look at Appendix A for additional help. From here on we're going to move right along with these seasonal trades. We'll also be introducing some other uses of spreads along with examples in subsequent chapters.

Chapter 8

Seasonal Spread Examples



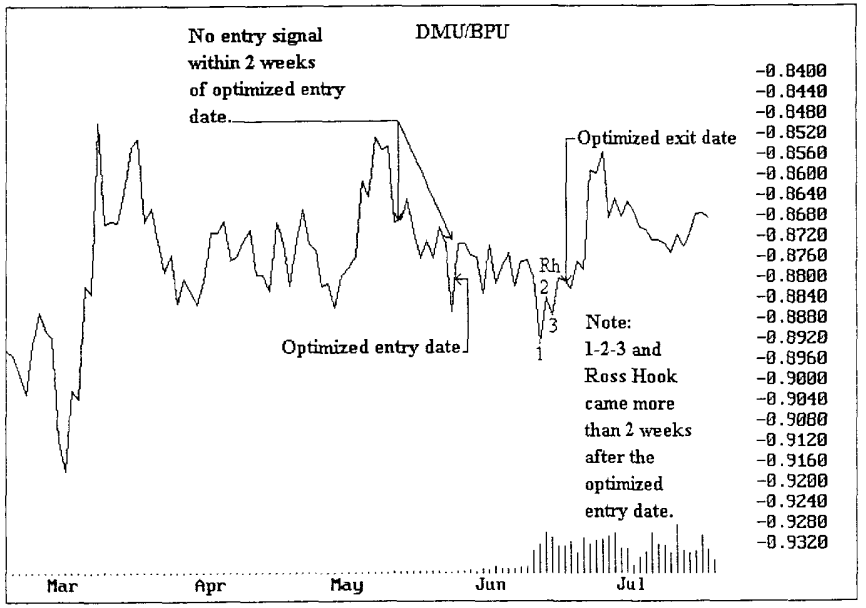


The first thing to notice is that, although this spread usually is profitable 12 out of 15 years, overall this doesn't seem to be one of the major winning years. The optimized entry was a little better than the pattern entry, but after much struggling, had you liquidated the trade on the optimized exit date, a very small profit was available. The same situation holds true for the pattern entry and exit dates. Virtually the same small profit was available. I show you this because I don't want to delude you into thinking that you will always win when trading seasonal spreads.

The fundamentals for this trade are based on the tendency for B-Pound to move lower against other currencies beginning the fourth week in May and continuing until the fourth week in June.

A spread trade in September currencies taken in May would be tenuous indeed. The back months of the currencies trade very thinly and truly lack liquidity. Spreads between national currencies were not common until recently. Now there is sufficient data to be able to compute a reliability factor for such trades.

Apparently, B-Pound did not want to go down against the D-Mark as well. This can be seen in the seasonal spread chart that follows. By the way, 1-2-3 formations can form within a Trading Range. I purposely did not mark every formation on these charts so that you could learn by marking them off yourself. It might be advantageous for you to be doing that as we go along through the course.

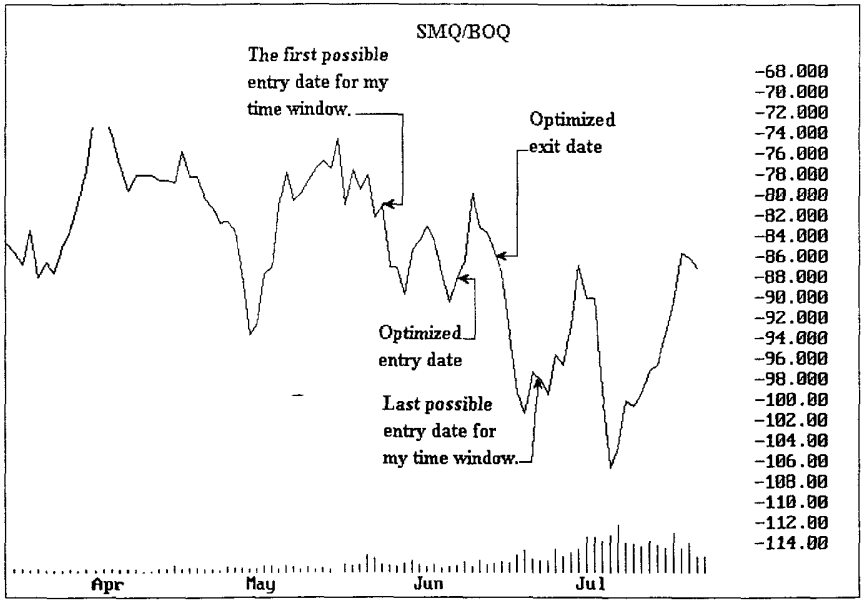


The reason I wanted to show you this trade is that my simple chart entry signals would have kept you out of the trade, whereas the entry from the optimized time window would have resulted in a breakeven or minimally profitable trade. The available profit was hardly worth the accompanying emotional and mental stress that were also available.

The lack of chart signals during the two-week window prior to the optimized entry date may seem to have given a hint that all might not be well with the seasonality factor of this spread. However, one cannot give too much emphasis to the chart patterns prior to and subsequent to optimized entry dates unless the patterns signal that the move is coming early or late and that entry is at hand. Seasonal spread trades do not need periods of accumulation or distribution to work.

They also do not need a top or bottom following a trend. They can occur suddenly and counter-trend to the previous spread action. What you are trading with seasonal spreads is the proven tendency for them to behave in a certain manner during a certain time period.

The following long August Soymeal/short August Bean Oil was an unusual trade in that the optimized entry date and the optimized exit date both fell within my own, in this case larger, window in time. The optimized entry date was the second Thursday in June. The optimized exit date was the third Thursday in June. In other words, the entire trade was to take place within a single week. If you'll remember, my own entry window is from ten trading days prior to the optimized entry date until ten trading days after the optimized entry date. That means the window in time I would be looking at would span in time from the last Thursday in May through the fourth Thursday in June. Let's look at that trade now.



The trade taken on the optimized dates made a small profit. No entry signal of mine occurred that would have gotten me into this trade.

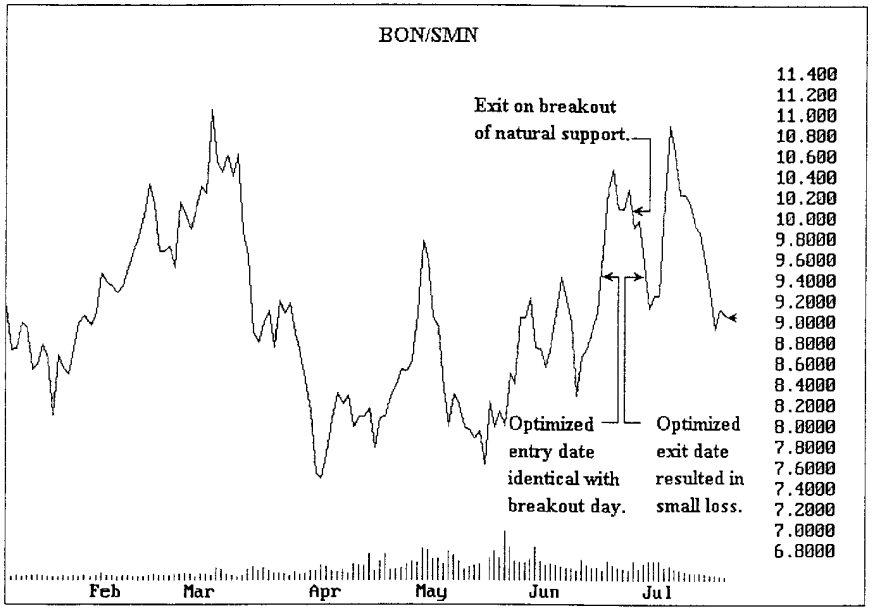
Perhaps you're wondering whether or not I miss a lot of trades. The answer is yes, I do. I want trades to be as near a sure thing as I can get them to be. I do not consider the small profit that was made on this trade to have been worth the effort. My entry signals are part of my filtering process, and I want them to keep me out of trades that carry more than an ordinary risk of not working. Taking every trade that comes along just because it is there has never worked for me. I want to be as selective as I possibly can. Taking every trade just because it exists or has proven profitable a high percentage of the time is, in my opinion, a form of overtrading. Far too many traders are overtraders. One sign of a mature trader is that he is able to judge which trades are worth taking and which are not. The mature trader typically has methods for filtering his trades. He seldom chases a trade.

Computerization of futures prices into databases has made possible many seasonal spread trades that in the past were not readily seen or even known. Some of these trades may eventually prove to have been solely a matter of time and chance. Sometimes it is difficult to see any known fundamental rationale for the trade. It is therefore all the more important to filter these trades by any practical means.

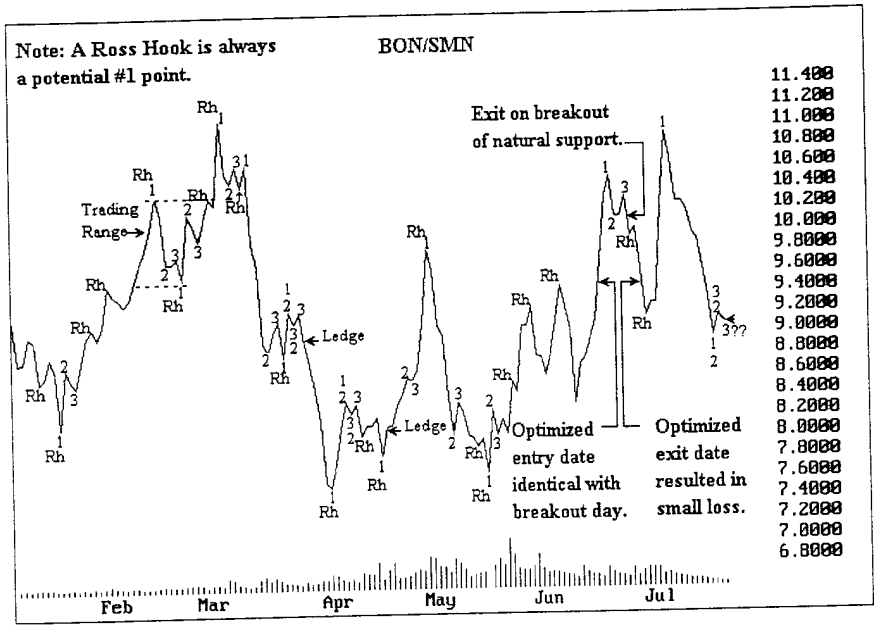
Two days after the optimized close of SMQ/BOQ another seasonal trade window was about to begin. This trade was BON/SMN, long July Oil, short July Meal.

You'll find it on the next page.

Before continuing with our discussion of this trade, it might be helpful for you to mark and label the various formations you see. This page is for you to use for that purpose.



What is the formation called that corresponds to the optimized entry date? How would you label the formation that created the natural support exit? What would you call the very last formation that is forming on the chart, the one next to the last arrow on the chart? Do you see any Ledges on this chart? Note: On the following chart, consecutive 1-2-3 formations, e.g. 1-2-3 low followed by 1-2-3 high or vice-versa, indicate congestion in the form of either a Ledge or a Trading Range. Every Ross Hook is a potential #1 point, but not every #1 point is a Ross Hook.



The optimized entry date and the chart pattern entry date were identical. However, the chart pattern exit gave far superior results to the optimized exit. Again, the optimized dates gave a very brief window of time for this trade.

The optimized dates for being both in and out were 10 days, from the third Friday in June through the fifth Thursday.

This trade finds its fundamental rationale in the greater demand for Soybean Oil over Soybean Meal in late Spring and early Summer. It has an 80% probability that it will work in any given year. It typically works 12 out of 15 years. It might interest you to know that in the years the trade works within the optimized dates, it averages $732.50 per contract. In the years in which it loses, the average loss is $170. Based on my pattern entry and exit dates, the trade made 24 points. However, this is an "equity" trade. An equity trade is one in which the contracts involved do not have identical tick values. In this case, Bean Oil has a tick value of $6 and Soy Meal has a tick value of $10. I'll show you how to handle this sort of trade. It's a bit tricky.

Computing Spread Equity

The problem is that we are confronted with two futures contacts having differing price values per tick. Because of that, we cannot calculate our profit or loss as simply the difference between prices. We have to make an adjusted calculation for this kind of trade. We can use the BON/SMN trade as an example.

For the trade on the previous page, let's assume that we entered the spread when July Oil was at a price of 2730 and July Meal was at a price of 1765. The spread differential is 965. In other words, we entered the spread at 965 points of difference. How do we value those 965 points on an equity basis? Oil moves at $6 and Meal at $10 per tick.

If the prices of each contract were to fall by 50 ticks, the price differential would remain the same 965 points, but what would happen to the trade equity? To find out, we have to compute an equity value for each of the two underlying futures in the spread.

Calculation

2730 x 6.00=16,380
1765 x 10.00=17,650
At entry, the equity value for the trade is 16,380 - 17,650 = -1270

If prices moved down 50 points on each of the underlying futures, we would have:

2680 x 6.00=16,080
1715 x 10.00=17,150
The equity value for the trade would be 16,080 - 17,150 = -1,070. Our equity is less negative and we are making money.

If prices moved up 50 points on each of the underlying futures, we would have:

2780 x 6.00=16,680
1815 x 10.00=18,150

The equity value for the trade is 16,680, - 18,150 = -1,470. We would be losing on this trade because we now would be more negative than when we first entered.
A brief examination of what is happening will further explain the equity situation.

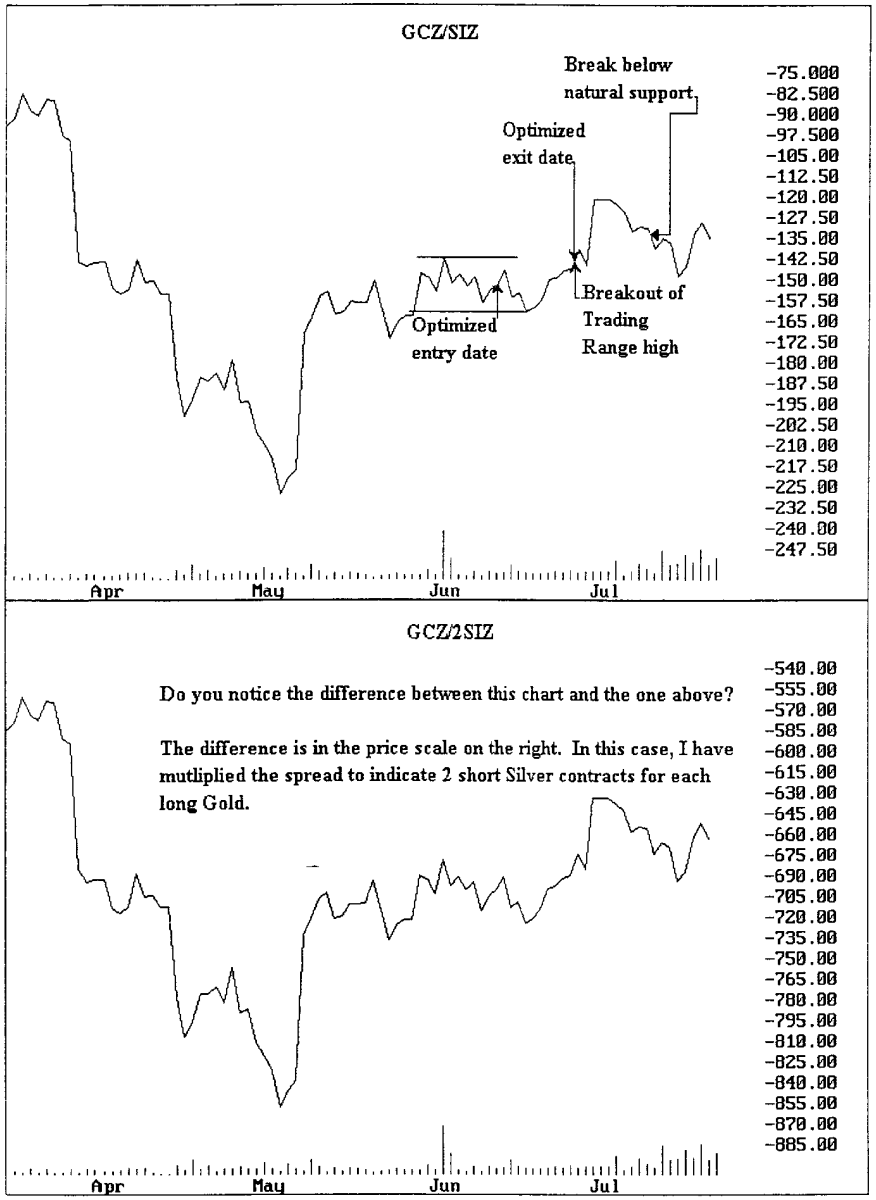
If both Oil and Meal are going down the same number of price ticks, Meal at $10 is going down faster than Oil at $6.00. Since the spread is long Oil and short Meal, Oil is moving down a lesser dollar amount than Meal and we are making profits.

When both Oil and Meal are going up at the same rate of speed in price ticks, Meal at $10 is going up a greater dollar amount than Oil at $6.00. Since the spread is long Oil and short Meal, Oil is moving up less distance in dollars than Meal and we are losing money on the spread.

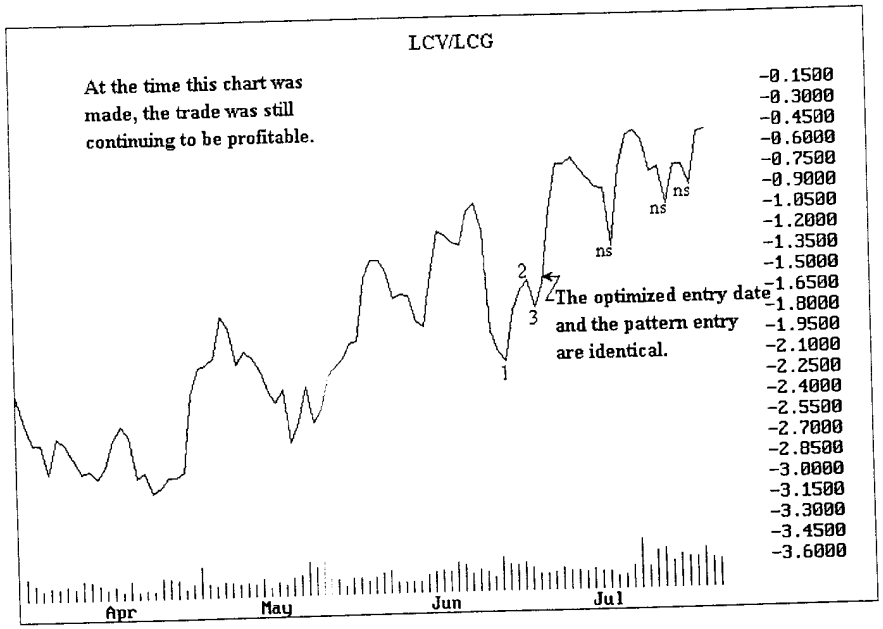
For those with sufficiently deep pockets, there is a solution to the equity problem when one doesn't want to compute the equity in the trade. The solution is to equate the position on a fractional basis. Since Bean Oil is 60% (3/5) as much per tick as Meal, it is possible that for every three Meal contracts sold, five Oil contracts would be purchased. This renders a perfectly even spread, provided that the two extra Oil contracts can be purchased at the same price as those for the remainder of the spread. Obviously, placing the trade in this fashion would require legging in on all contracts. Why? Because there is no way to know at what price Oil would be entered via a spread trade. The broker who fills a spread trade is interested only in the price differential of the spread and not in the actual price of the futures used. The broker is going to try to put that spread on at the specified 965 points. He may use any of a number of combinations of Oil and Meal prices to accomplish the job.

There are many exchange recognized equity trades that have been proven over the years. The Crush Spread and the Crack Spread are two of these. Gold and Silver also have proven track records as the underlying contracts for seasonal spreads. With that in mind, let's look at a spread between Gold and Silver. On an equity basis, I use two Silver contracts for every Gold contract. Silver moves at $50 per full point. A full point in Gold is valued at $100.

The spread we will be tracking is long December Gold and short December Silver. I'll show you how the spread chart looks on a one-to-one basis. I'll also show you how the same chart looks on a two-silver-to-one-gold basis. The trade is normally entered around the second Monday in June, with an optimized exit date around the last Wednesday in June.



Some seasonal spreads are based upon the fundamental relationship between an old crop and a new crop. Some Live Cattle seasonal spreads are based upon a similar condition. The fundamentals underlying Live Cattle spreads have to do with the gestation period of cows and when they drop their calves, and the availability of feed at certain times of the year. Also involved are the times of year when farmers typically bring cattle to the feed lots. In the following seasonal spread, we purchase October Live Cattle and sell the following year's February Live Cattle. The spread is put on late in the fourth week of June. This is to take advantage of the seasonal tendency for October Live Cattle to gain on the following February. This old time trade usually lasts for several weeks. The optimized exit date is at the end of the first week in August.



It will be interesting to see which exit technique garners the best results.

A Word about Optimized Exit Dates

Some optimized exit dates on seasonal trades occur after First Notice day. In fact, some of the dates come during the delivery period. In my own trading, I will be out of any spread trade within a day or two on either side of First Notice day. If past price action subsequent to First Notice day is what has caused the spread to be profitable, then I am not interested in such price action. Many seasonal spreads occur in already thin and illiquid markets. I do not want to jeopardize my capital by being in a spread trade after First Notice day when even the most liquid of contracts become very thin and illiquid.

Also on the topic of optimized exit dates, when they come before I get an exit signal, and if the spread is moving my way, I will stay with my natural support, natural resistance exit signals. Time and experience have proven these to be superior overall to optimized exit dates.

Exit from any trade, including seasonal spread trades, always involves a certain amount of judgment on the part of the trader. I would not find it unreasonable to see a trader using a money stop, a percentage stop, etc. At least some sort of catastrophic stop should always be used.

For years I have said and written that no one can tell ***you*** where to place ***your*** stop. In the case of seasonal spreads, your stop can be mental, or resting in the market as a spread order inverse to the trade in which you hold a position, based on the number of points in the spread differential.

Spread Order Entry

Order entry for spread trades is a bit different from orders solely for entry into an outright futures trade.

When putting on the trade as a spread, here is the usual way I enter the order:

Buy *number of contracts, month and commodity,* and sell *number of contracts, month, and commodity,* on a spread of *number of points* premium to the *buy/sell* side.

Premium refers to the amount of positive differential between the contracts to be spread. If the differential is a positive number, i.e. the price of the buy side is greater than the price of the sell side, then the premium is to the buy side. If the contracts to be sold are greater in price than the contracts to be purchased, then the premium is to the sell side. It is acceptable to tag the premium to the name of the commodity by saying "premium to the Wheat," or "premium to the Gold."

Here's an example:

With December Corn at 2.95 a bushel and December Wheat at 4.75 a bushel, if you wanted to buy Corn and sell Wheat, the price differential for the December contracts is a negative 1.80 a bushel. I would place the order like this:

> Buy one December Corn contract and sell one December Wheat contract on a spread, one-dollar-eighty, premium to the sell side, or premium to the Wheat.

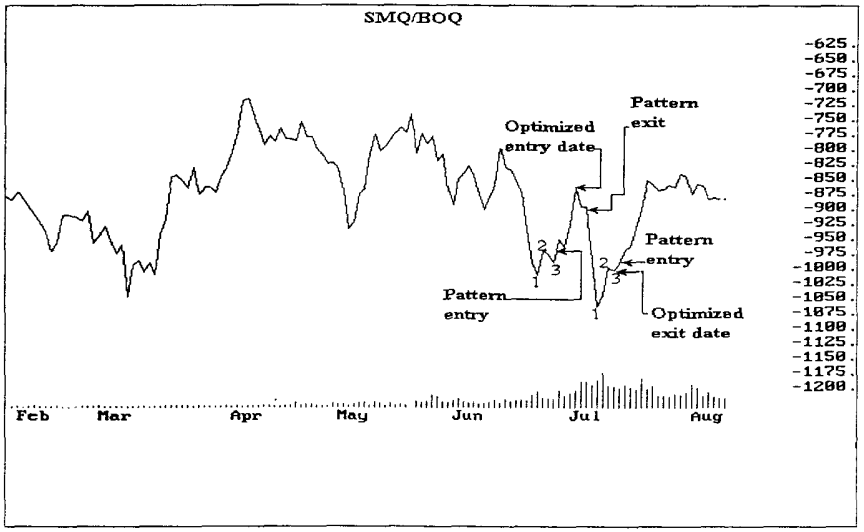
When putting on the trade one leg at a time, I place the entry order for both sides of the trade in the normal way I would enter any outright futures trade. For those of you who would like more information on ordering futures, options, and spreads, I refer you to the TOPS entry in Appendix C.

A Dual Entry Trade

Before ending this chapter, I want to show you a "dual entry" trade. This is a trade that gave more than one entry signal within the time window I allotted for the trade.

The trade took place via an SMQ/BOQ spread. Interestingly, the optimized entry and exit dates produced a sure-fire loser. The chart pattern entries produced two winners, with the second winner being even better than the first. Both trades had entries within the twenty-trading-day time window.

The following page contains all the details.



The optimized window was only five trading days in length, with the optimized entry date falling on the very high of the upward move.

Chapter 9

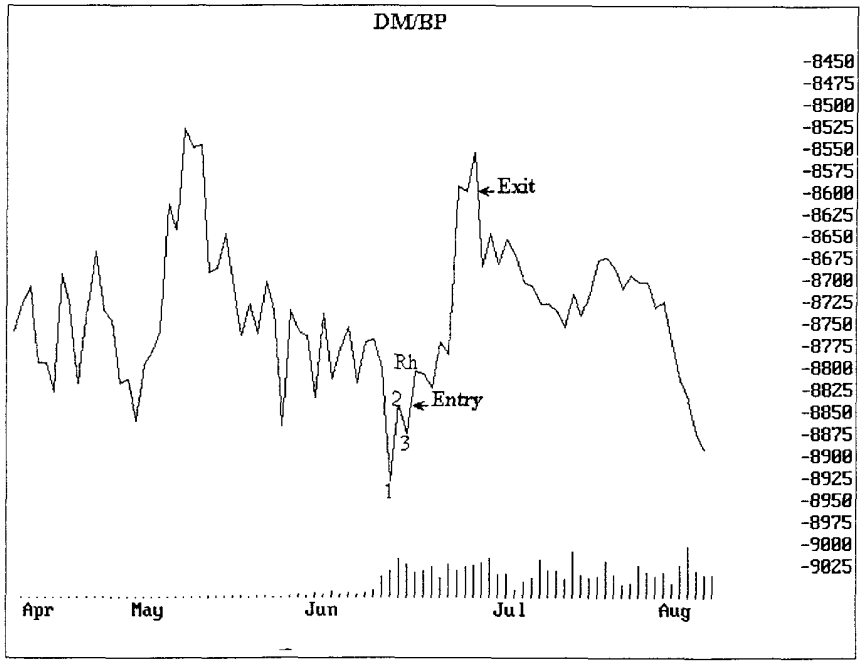
Non-Seasonal Spreads

Not all high probability spreads are seasonal. Many times simple common sense will unearth excellent spread trades. I usually find these through news stories and by staying alert to what is happening in agriculture, currencies and interest rates. Simple observation has given me many a winning trade spreading the D-Mark and the S-Franc.

I have also found many excellent spread situations in the NOB (Notes/Bonds) spread. When you are long Notes and short Bonds, you are long the NOB. When you are short Notes and long Bonds, you are short the NOB. A quick glance at the yield curve, a news story, a speech by some important dignitary, an unexpected event or unexpected outcome of a statistical report from a governmental agency, or any change in governmental interest rate policies can create remarkable trending in this spread.

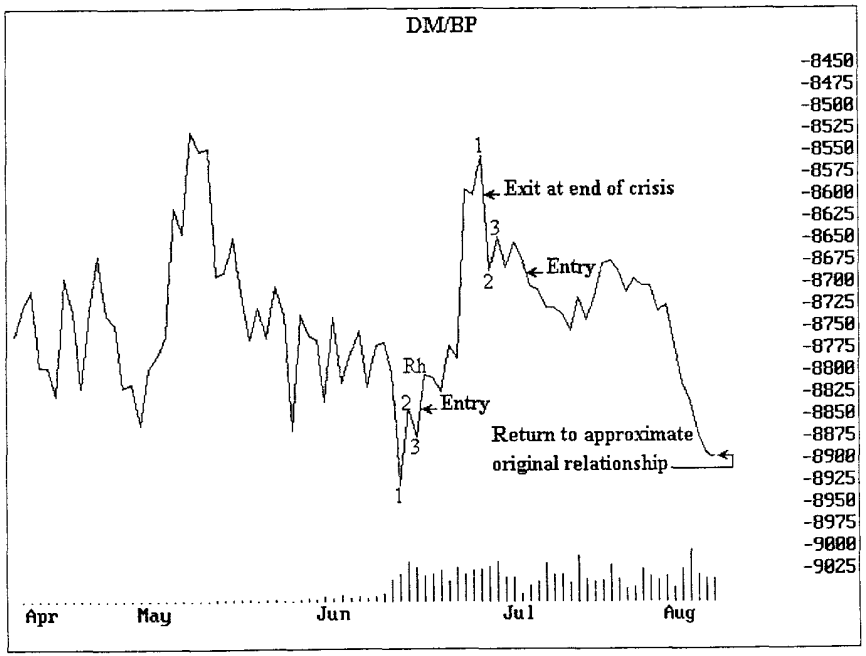
In earlier chapters I showed you an instance in which the LC/FC spread failed to work. Knowledge that Feeder Cattle were going up in price at the same time there was an oversupply of Live Cattle in the feed lots would have been sufficient information for the entry into a non-seasonal FC/LC spread. I also showed you a year in which Wheat was in short supply compared with the other grains. Long Wheat and short any other grain position could have been taken non-seasonally.

A news story that South African gold miners are going to go out on strike is more than adequate to justify entry into a long Gold/short Silver spread. If Mexican silver miners are rumored to be going on strike, you could use reverse logic for the spread. Let's look at some non-seasonal spreads that could have been taken based simply on common sense and a bit of knowledge of what was going on in the world at the time they could have been entered.



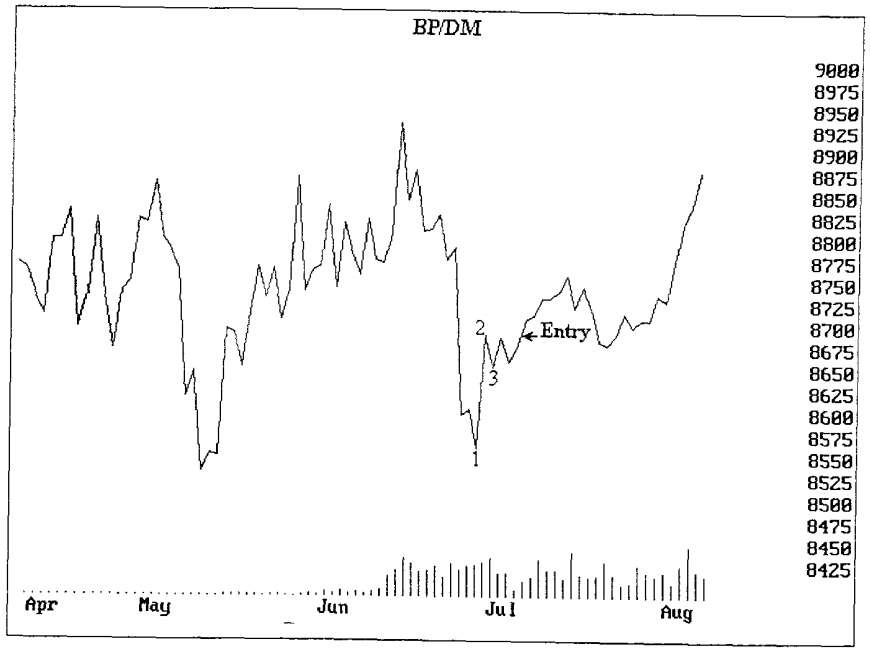
In June of 1995, there was a crisis in the British Government. The Prime Minister tendered his resignation, causing a vote in Parliament to have to be taken to see who would win as the next party leader. During this brief crisis, traders lost confidence in the British Pound due to uncertainty about the leadership in the United Kingdom. As far as I know, there was no seasonal trade that called for anyone to be long D-Mark and short British Pound at that time. Wouldn't common sense have dictated that you enter such a spread? Yes, simple logic dictates that when there is a crisis in leadership in any country, that country's currency is likely to take a hit.

In like manner, it should also have been just as clear that as soon as the crisis was over, if currency traders were satisfied that there would be no economic repercussions subsequent to the end of the crisis, there would be a good chance that the relationship between the D-Mark and the B-Pound would return to the proximity that was in effect before the crisis.



Indeed, that is exactly what happened. No insider information was necessary to take advantage of this situation. The story was all over the news. Simple understanding and observation were all that was needed to enter the spread and thereby profit from it. This sort of event is not uncommon. In fact, it is becoming increasingly more common to encounter news events that can cause markets to make sharp moves. Taking advantage of such situations is a thinking person's way to trade.

Of course, at the time the crisis in the UK was over, you would have entered the spread BP/DM. Then it would have looked as you see in on the chart below.



Sometimes an event occurs that does very little for a spread relationship between two contracts. In an earlier chapter I mentioned that quite often backwardation is a sign that opportunity may be just around the corner. In the chart that follows, you will see that Soybean Oil encountered backwardation, but did little in the way of giving a profit opportunity. Let's look at that now.

On the price page below, we can see that there is backwardation in Soybean Oil.

ESC — COMMODITY FUTURES — ← → ↑ ↓ PgUp PgDn

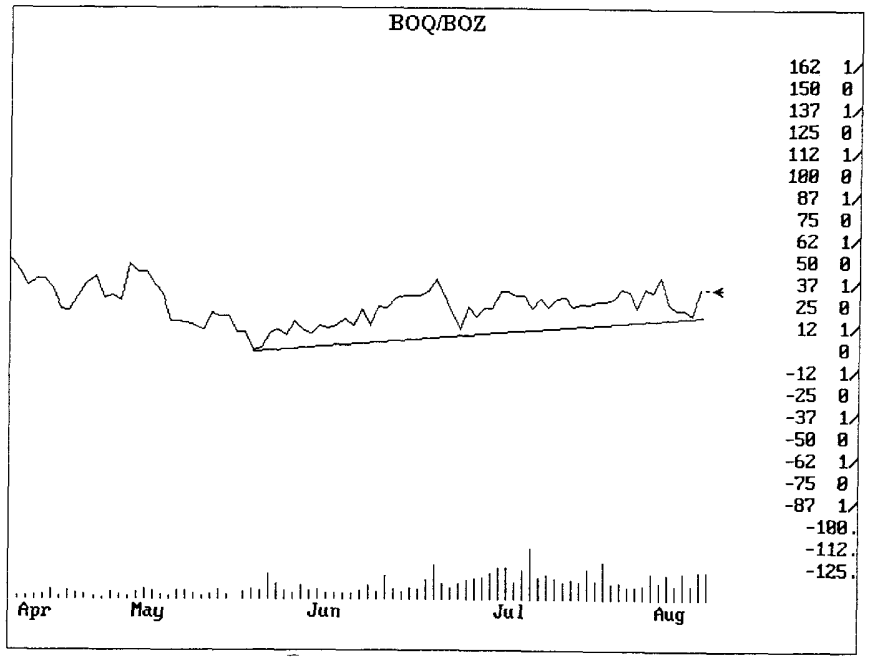
SYMBOL	BO5Q	BO5U	BO5V	BO5Z	BO6F	BO6H
LAST	.2624	.2617	.2605	.2591	.2595	.2595
NET	+.0000	+.0000	+.0000	+.0000	+.0000	+.0000
	↑...↑...	↑↑↓↑↓...	↓.....	↑↑↓↑↓...	↑.....	↓.....
HIGH	.2625	.2620	.2608	.2605	.2600	.2600
LOW	.2598	.2591	.2590	.2565	.2570	.2580
OPEN	.2608	.2608	.2602	.2590	.2580	.2588
VOLUME	1357	7305	2378	15478	362	1078
OPEN INT.	2803	15433	11929	36095	4636	5143
TICK VOL.	43	119	43	253	17	15
TICK TIME	2001	2001	2001	2001	2001	2001
BID	.2620	.2611	.2607	.2603	.2600	.2598
BID SIZE	2001	2001	1326	1336	1325	1326
ASK	.2607	.2615	.2605	.2598	.2580	.2585
ASK SIZE	1251	1336	2001	2001	1301	1301
52WK HIGH	.2625	.2620	.2608	.2605	.2600	.2600
52WK LOW	.2598	.2591	.2590	.2565	.2570	.2580
EX. DATE	08-23-95	09-21-95	10-23-95	12-20-95	01-23-96	03-21-96

The August contract BO5Q is priced at .2624. Each subsequent delivery month U, V, and Z are priced lower. It is only when you get to January of the following year BO6F that you see prices in a later month higher than those in the previous month. This situation means that somebody is willing to pay a premium in August to lock in a price for Bean Oil in case it goes higher in the future. Someone wants that Bean Oil now!

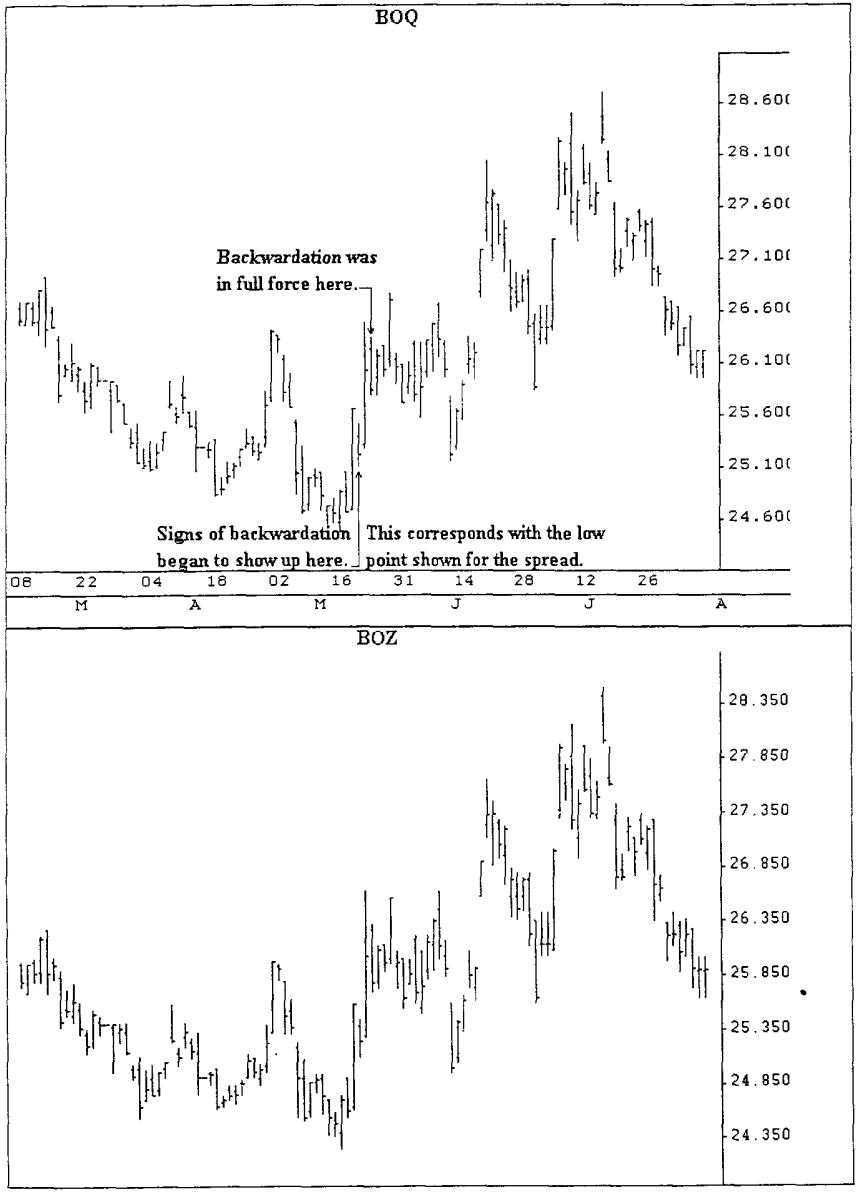
Backwardation is a situation that normally gives an alert that conditions are not normal in any particular market. When I take note of backwardation, I immediately begin to look at a spread, long the front month and short a back month. I would expect the demand for the front month to cause it to move away from the back months, thereby causing a widening of the spread.

However, in the case of Bean Oil the widening was minimal. It was certainly not enough to have made a really great trade. The chart on the following page shows the spread. The page after that shows the August and December Bean Oil charts. There is one other point of interest with this trade which I would like you to note. Although there was backwardation in Bean Oil, that backwardation occurred in a market whose prices were literally "all over the place." It is possible for that to happen. Even though someone urgently wanted the August Bean Oil and was willing to pay a premium to get it, during the period of backwardation the Bean Oil market overall moved strongly up and strongly down.

The spread moved from -2 to 33 for a total of 35 points and $210 as of the last date shown. However, it took from mid-May until early August to do so.



This spread did not offer the smoothest of rides. There were a number of times where, unless you used a relatively large stop, you would have been stopped out. As a trader, you never win them all. Yet trades like this compel the trader to take them when the opportunity arises. It is only by looking back that you realize that this trade didn't turn out as well as might be expected. At its widest the spread was 40 points, i.e., $240.



Chapter 10

Fractional Spreads

Fractional spreads may be created when a greater or lesser position is desired than what can be obtained through an outright futures position.

What is a Fractional Spread?

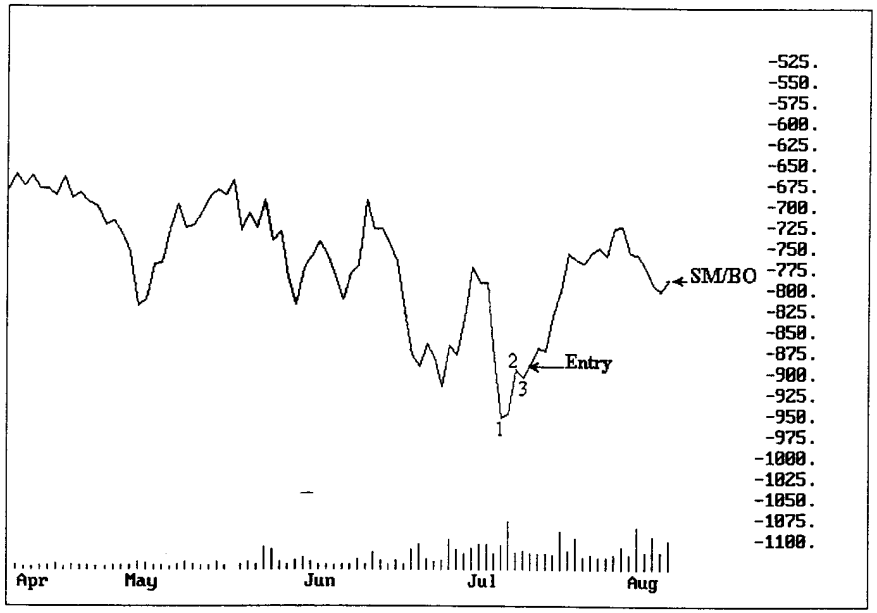
All that is necessary to create a fractional spread is to utilize exchange recognized spreads in futures that move radically differently from one another or which have different minimum tick fluctuations. Fractional spreads can be seasonal or non-seasonal. They can also be derived from hedging.

Differing Tick Fluctuations

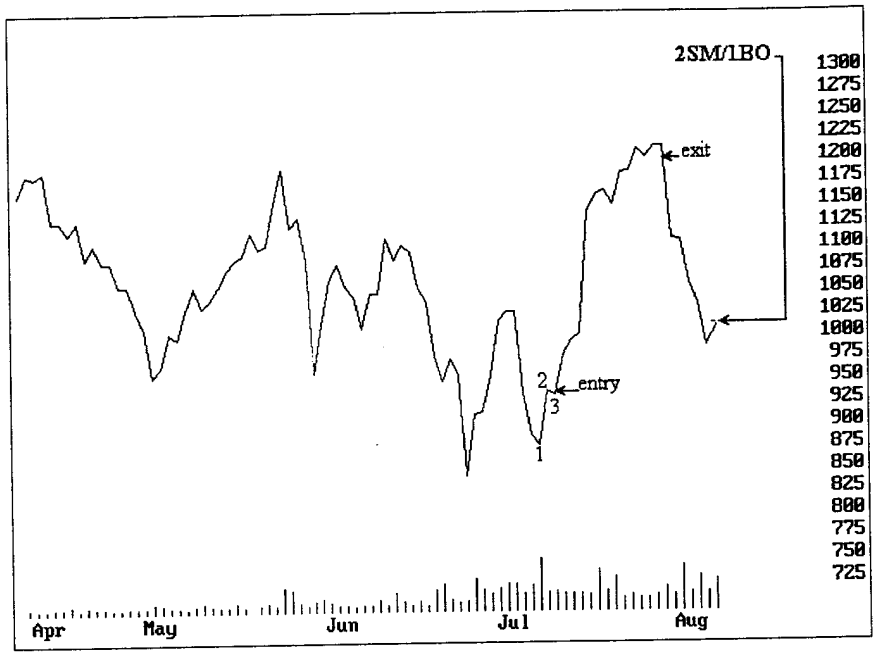
It is possible to spread Crude Oil with a minimum tick fluctuation of $10 against Heating Oil or Unleaded Gas, which each have minimum tick fluctuations of $4.20. It is possible to spread Soybeans with a minimum tick fluctuation of $12.50 against Soybean Meal with a minimum tick fluctuation of $10, or Soybeans against Bean Oil with a minimum tick fluctuation of $6.

Actually, we've already looked at these types of spread from the viewpoint of tracking equity. Now we want to look at them to see how we can take a fractional position rather than an outright 100% futures position.

I'll show you some examples of fractional spreads having differing tick fluctuations. Let's assume that in mid-July you decided to begin watching the spread Soymeal/Soyoil (SM/BO), and that you had information that convinced you that SM would move up strongly against BO. Let's also assume that you felt confident about this move, but that you did not feel that you could create total equity by buying 3 SM contracts and selling 5 BO. Instead you decide to enter a fractional trade, long 2 SM/1 BO. You would need to track this trade based on equity because SM ticks at $10 and BO ticks at $6. At the time of entry, you would have created a fractional trade.



The strong upward thrust in early July could have given you the confidence you needed to enter 2 SM for each BO contract. The chart above is plotted at a 1-to-1 ratio. The chart on the following page shows the same trade plotted at a 2-to-1 ratio.



On a 1-to-1 basis, the trade would move 135 points. On a 2-to-1 basis, the trade moves 262 points. As mentioned previously, you would track a trade like this one on an equity basis in order to know how much you are really making.

During the period of this trade from entry to exit, BO moved down by 8 ticks. SM moved up 129 ticks. Since the trade was long 2 SM contracts, a profit of 1290 x 2 = $2,580 would have been made on that portion of the spread. An additional $48 would have been made on the short Bean Oil portion of the spread, for a total of $2,628. Looking at the arithmetic as we did earlier we have:

Entry	Exit
SM–1833 x 10.00=18330	SM–1962 x 10.00=19620
BO–2731 x 6.00=16386	BO–2723 x 6.00=16338
At entry the equity value is 1944	At exit the equity value is 3282

Entry equity value 3282 - Exit equity value 1944 = 1338 + 1290 from second futures contract = $2,628.

Radically Different Movements

Ten Year Note futures often move much more slowly than do Long Bond futures. For some reason, the notes are less volatile than the bonds. I believe the greater volatility in the bonds is due to the greater number of speculators in the bonds.

There are similar situations in other markets but not necessarily for the same reasons.

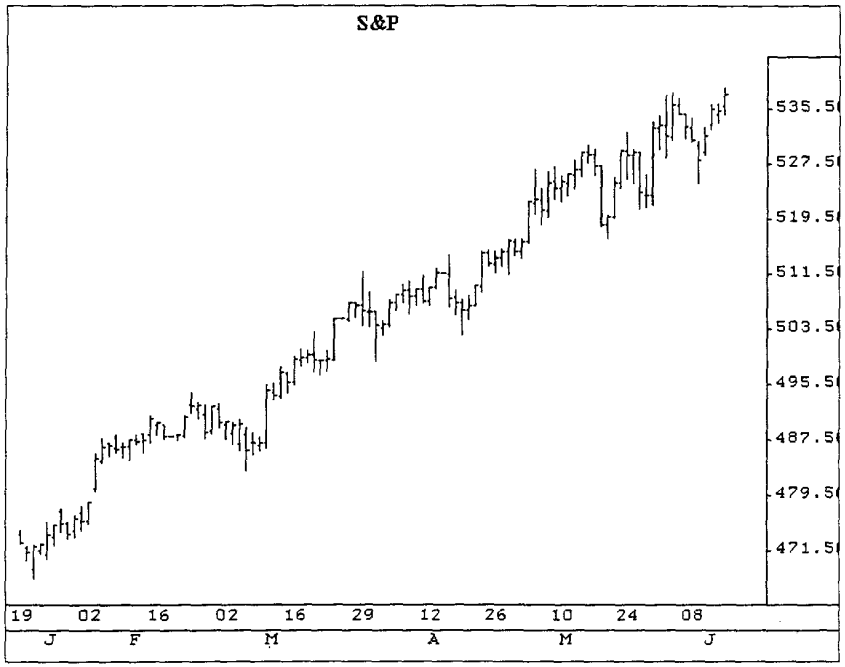
The New York Stock Exchange futures (YX) typically move 55%-65% as much as the S&P 500 (SP) futures, but it has nothing to do with volatility. In the case of the stock indices, the size of the base has a lot to do with how these indices move relative to one another.

In one particular year, with a robust first-half year for the US stock markets, an outright futures position in the SP would have required margin of $8,000. As time progressed, the market became more volatile, and the margin requirements rose to $12,000. The margin on a YX futures contract was considerably less. Depending on your broker, margins ranged from $4,000 to $6,000 during the same period. It was obvious to many from the previous year's events that the stock market was going to rise. In actuality, by mid-year it had risen more than many had expected.

It was also clear that investor money was going into the blue chip stocks more rapidly than into the broader market. Since the SP represents only 500 stocks versus YX which represents 1,500 stocks, it was clear that the narrower SP futures were going to rise faster than the broader YX futures.

Now let's say you had wanted to be long the US stock market futures, but you were unable or unwilling to put up the margin for an outright SP futures position. You could have made a fractional trade by purchasing long one S&P futures and selling short one YX futures. As mentioned earlier, YX moves approximately 55%-65% of the amount that SP moves. That means you could have created a position that moved fractionally as much as the SP, and you could have done it using the much lower spread margins of SP/YX.

Let's compare an outright futures position in the SP with a spread SP/YX.

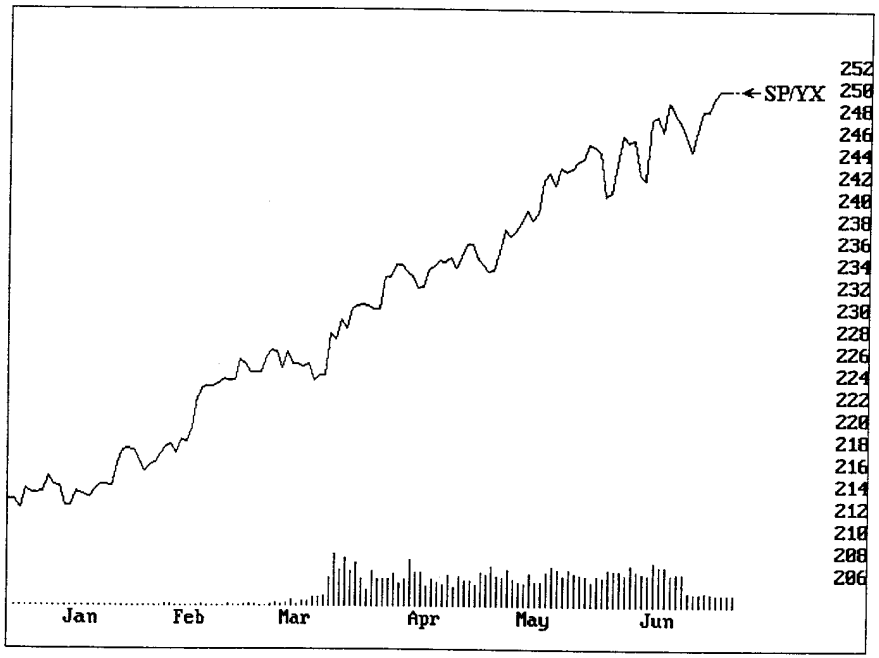


The move in the outright S&P futures from the low shown on the chart to the highest point shown on the chart was 6,620 points or $165,500. However, for the average trader it would have taken considerable margin to hold the position from January 23 until June 15.

An outright futures position in YX would have also required more margin than many traders are willing or able to put up, and would have resulted in a move of 3,285 points or $82,125.

In this case, the move by YX was far more disproportional to S&P than usual. It moved only 49.6% as much as SP.

Let's look a chart of the spread SP/YX.



The spread moved 3,378 points or $84,450. It actually did better than an outright YX futures position and it did it at much less risk and with lower margins. The spread moved a bit more than 51% as much as did S&P. In what way was there less risk? Because the short YX position acted as a hedge against a sudden crash in S&P. There are a lot of S&P traders whose fortunes would have been "saved" had they been spread SP/YX in the debacle of October 1987.

Do you realize that it is not difficult to benefit from stock index futures? Are you aware that many traders, who normally cannot afford the risk entailed in trading the S&P 500 from a daily chart, could more easily trade it by employing a spread? It is commonly known when the broader market is faring better or worse than the blue chip S&P 500. Usually, that particular condition will last over a period of months.

Chapter 11

Conversions

There are times when it becomes desirable to convert a spread trade into an outright futures trade. This is done by dropping one leg of the spread.

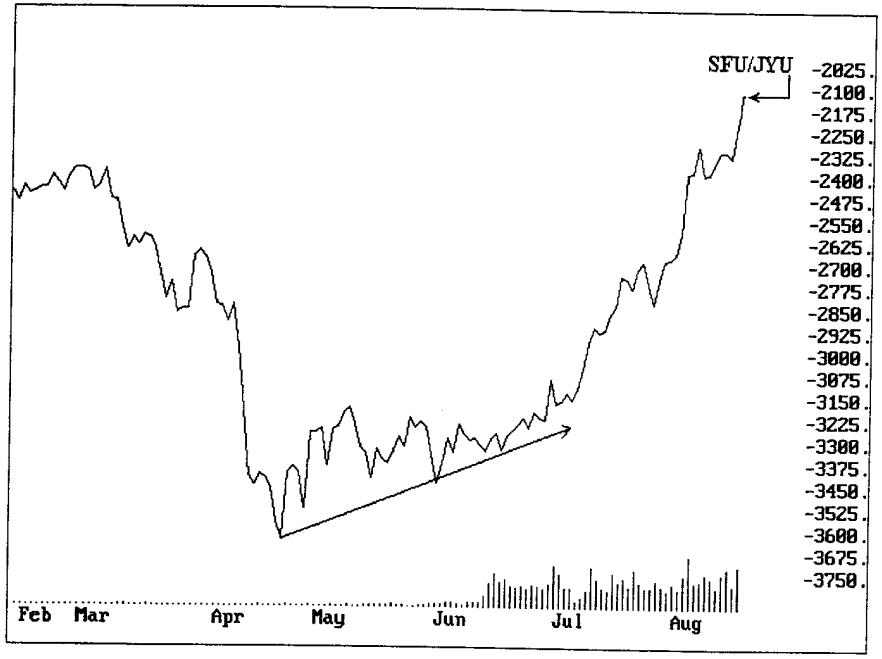
What are the conditions under which this might be done?

Let's say that two sides of a spread had been moving sideways, the long futures side with a slightly upward bias and the short futures side with a slightly downward bias. In such a case, the spread itself would be trending upward and hopefully it would be widening sufficiently to show a profit to the spread trader.

Then suppose that one or the other sides of the spread began to trend in the futures. It might become desirable to abandon the spread in favor of the trending futures.

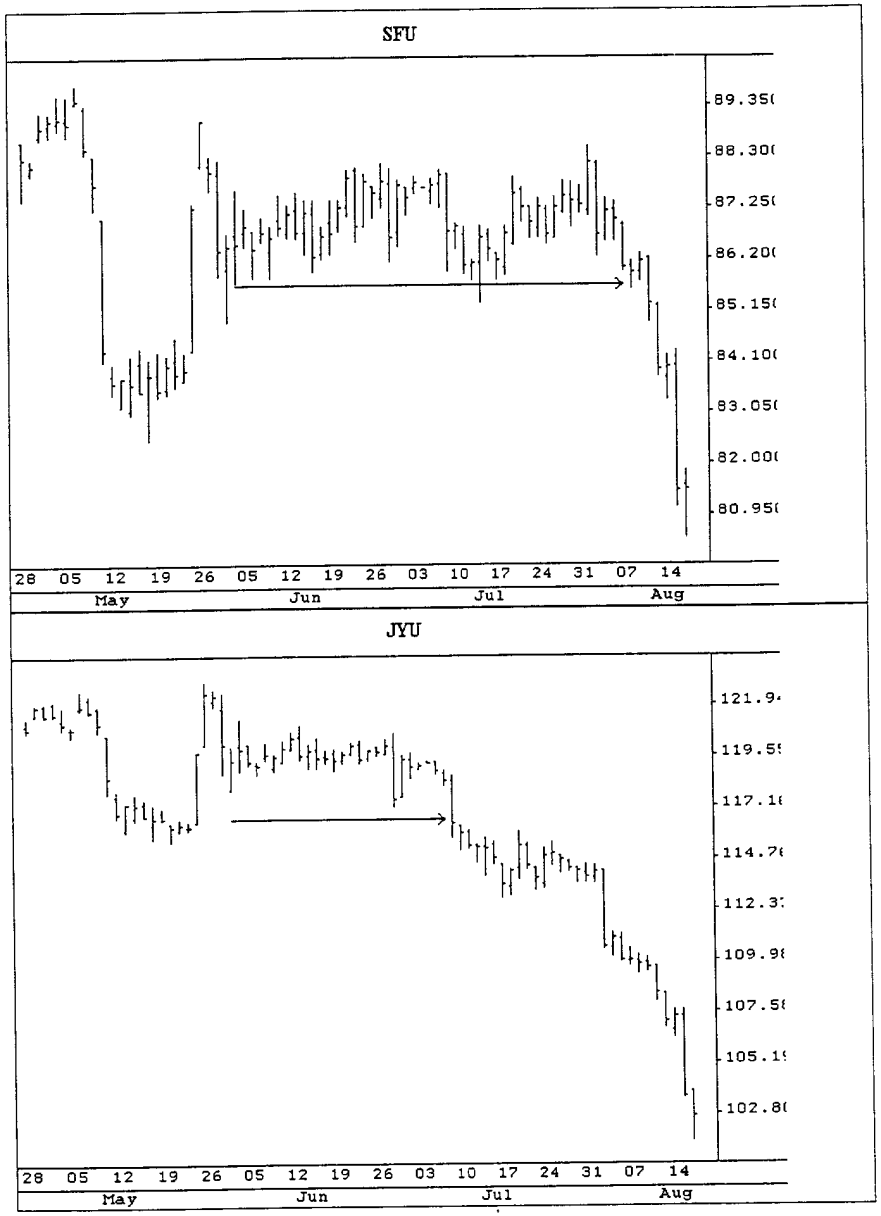
The series of charts that follow show just such a situation in the currencies.

The trade revolves around being long September Swiss Francs and short September Japanese Yen. The two markets were drifting sideways, but the Swiss Franc prices were moving consistently away from Japanese Yen prices, widening the spread between the two.



The spread was steadily making money until July when it began to widen markedly. The question is, would it have been better to stay in the spread, or to make a conversion to an outright futures position by dropping one side of the spread?

Let's look at the two futures contracts during the same period as the one shown on the spread chart above.



Up until the first Friday in July, the spread had been making money as the Swiss Franc slowly but persistently gained by narrowing the spread between Swiss Franc and Japanese Yen prices. It did so by stubbornly moving sideways and slightly up, while the Japanese Yen began to gradually drift down.

Do you see that, beginning the first Friday in July, the Japanese Yen broke downward out of its sideways pattern while the Swiss Franc continued to move sideways until the middle of the second Thursday in August?

Dropping the long Swiss Franc leg of the trade beginning with the first Friday in July would have resulted in substantially greater profits than holding on to the spread. Let's look at the numbers.

On the first Friday in July, the SFU/JYU spread stood at negative 2969. By the last day shown on the spread chart, the spread had narrowed to negative 2122 for a gain on the spread of 847 points, or $10,587.50.

Dropping the long Swiss Franc on the first Friday in July and retaining a short outright futures position in the Japanese Yen would have yielded a result as follows:

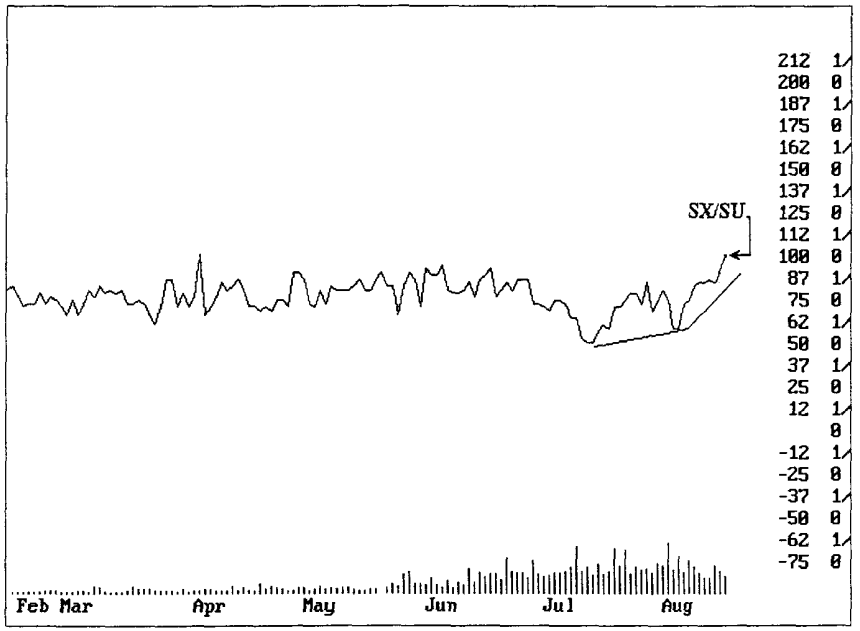
The Japanese Yen closed at a price of 11652 on the first Friday in July. It closed at 10269 on the second Thursday in August. A short futures position in the Yen would have gained 1,383 points, or $17,287.50.

In Appendix A I show you my entry patterns for outright futures. You will be able to see why it would have been appropriate to drop the long Swiss Franc and be short the Japanese Yen.

In this particular instance it worked out well to have dropped the long Swiss Franc, because the Japanese Yen moved down rapidly without a lot of chopping up and down and wild volatility. The transition from the spread to an outright futures position would have been relatively easy. At times, this is not so. Sometimes it is far better to stay with the spread than to give up the advantages of low margins, comparatively low volatility, and lower risk.

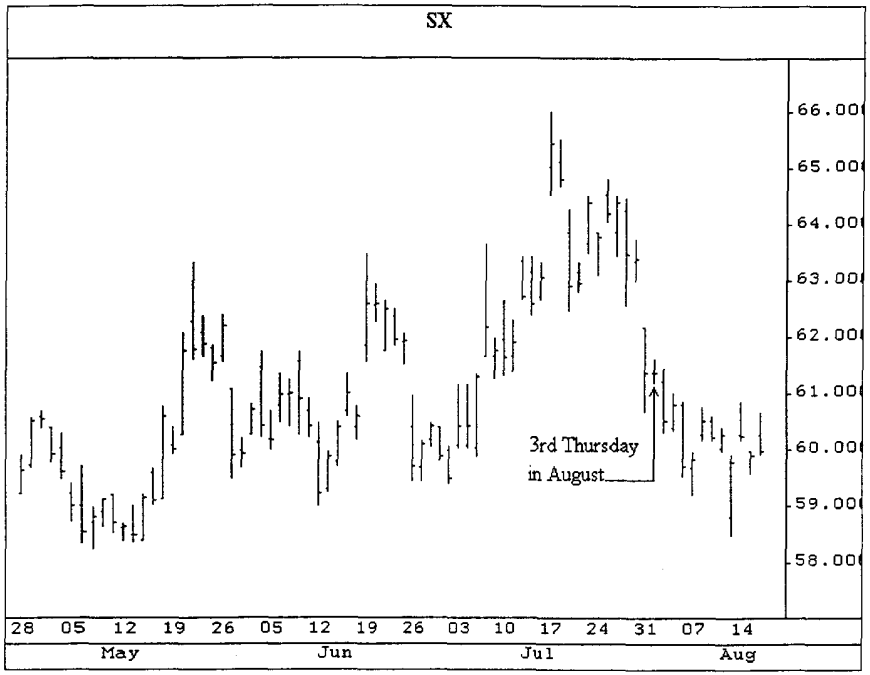
I'll give you an example of what I mean just ahead.

On the second Wednesday in July, the spread line between Long November Soybeans and short September Soybeans reached bottom. From there, it began to move up, until the first Thursday in August when the spread line began to move up more sharply.



The question is, would it have paid to drop the short September Soybeans and remain long November Soybeans in an outright futures position?

A quick look at the Soybeans chart will give us an answer.

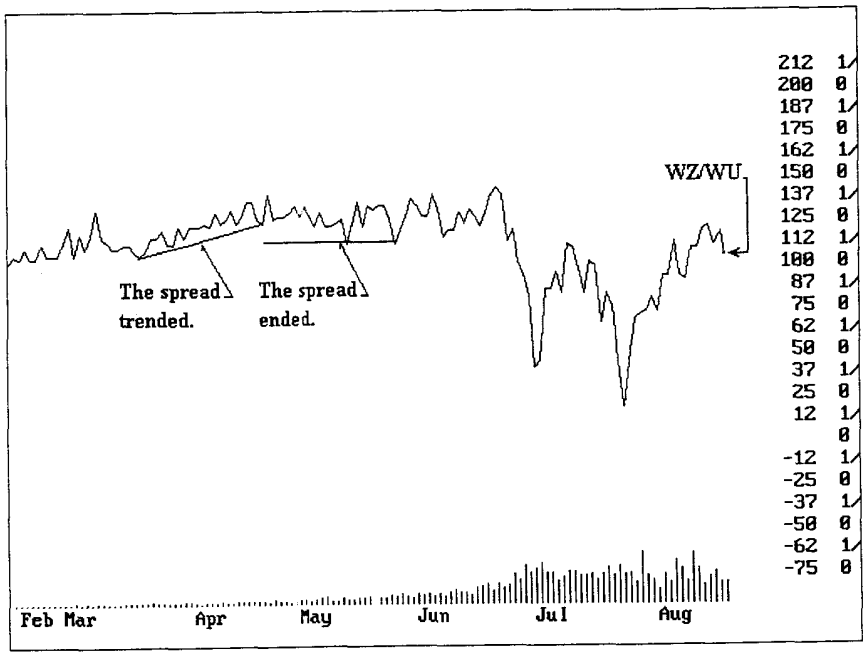


The chart for November Soybeans is shown above. September Soybeans were virtually identical in appearance. Would you have been willing to jump from the safety of the nicely trending spread into the chaos of the outright futures chart? Only you can decide that.

My preference would be to stay with the spread. A futures trade can be mercilessly whipsawed in a market that is chopping sideways as are Soybeans pictured above. Volatility is high and the market has no direction, while the spread is trending nicely. The risk in the outright futures is far greater than the risk in the spread.

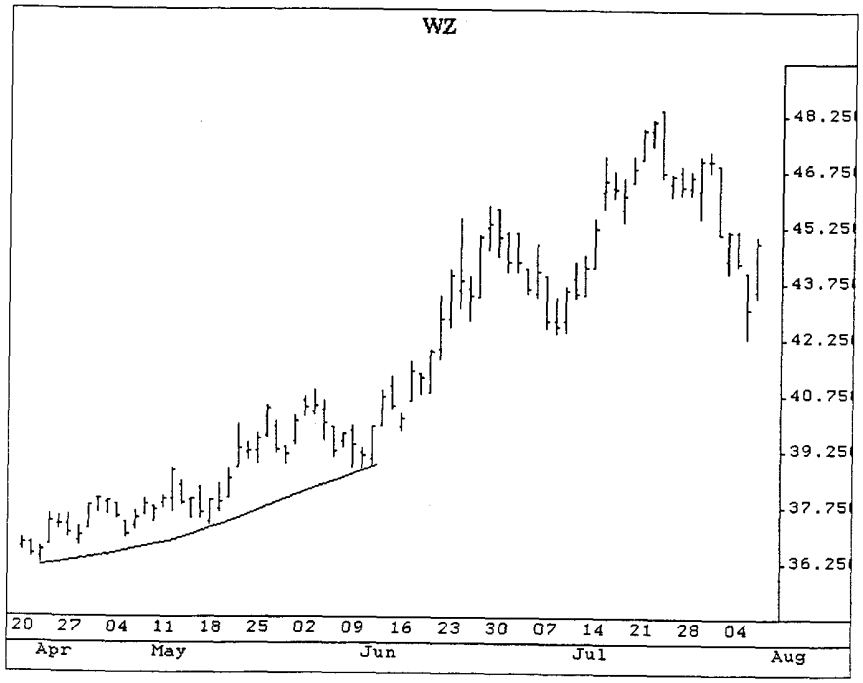
Profits for the spread will probably be less than in the futures, but not necessarily so. The outright futures trade may turn out to be a loser if the trade is whipsawed.

There is one additional conversion type trade that I want to show you before we move on to the next chapter. It involves the situation in which you are in a spread trade and the spread trendline goes flat. If, at that time, the futures are trending, you may want to convert the spread to an outright futures trade.
Here is a picture of that happening in a spread trade, WZ/WU.



From the third Friday in March until the third Friday in April, the spread line trended upward. The spread line then began to go sideways. What were the futures doing at this time?

They were beginning to trend!



Would you agree that in this instance, it would have paid to drop the short September Wheat and remain long December Wheat? The futures trended strongly, while the spread went nowhere until late in June. At that time, the spread would have turned against the position, long December Wheat and short September Wheat.

Chapter 12

Using Spreads to Reduce Volatility

One of the greatest threats to a futures trader can be price volatility in the futures market. Whereas an options trader can thrive on futures volatility, futures volatility materially increases the risk to any outright futures position.

That is not to say that volatility in and of itself is a bad thing. It is either good or bad depending upon your position and the way you trade. Tons of money have been made by trading short term volatility along a spread line. Yes, spreads themselves can become very volatile. This can happen even when the futures themselves are not particularly volatile.

A market can become extremely volatile almost instantly. Who can forget being long the S&P 500 when it crashed in 1987? How many of those traders are still around? Who can forget being short grains when the nuclear reactor at Chernobyl experienced a melt-down? Believe me, many a trader's account melted down right along with the plant at Chernobyl.

Prices for grains and other foodstuffs become extremely volatile during droughts, floods, or pestilence. Prices of Gold, Silver, or other metals become volatile during worker strikes, threatened strikes, political instability, threats of war, etc.

In like manner, Crude Oil and other petroleum based products can literally go wild before and after OPEC meeting, API reports, Middle Eastern disruptions, etc.

Government reports of all kinds or speeches by dignitaries and government officials can set off wild price gyrations in the currency and financial markets.

Extremes of volatility are increasing in both size and number. This is due to a major change in the composition of the markets. The markets now play host to large institutional traders, increasing amounts of managed money, and huge funds and pools. These very large market participants attempt to place large numbers of contracts into a market in their attempts to put on a position.

Since most of them use similar models and mechanical systems, they tend to get trading signals at virtually the same time. There are only a few measurable factors with regard to price. You can ascertain the open, high, low, and close. No matter how you analyze these four factors, there is bound to be correlation among the various analyses, and trading signals are bound to be similar among those who use them.

When a buy signal is issued on one model, it is bound to be issued on other similar models. This causes a mad rush to get long the market. The volume of buying increases dramatically, and prices begin to rise. In fact, they may explode. By the time most of the funds, pools, and institutional traders have put on a position, there is precious little left to buy. When the overwhelming majority of orders are buy orders, a market is precariously close to a collapse.

The reverse is true when a sell signal is issued by the various correlated models. Everyone is trying to sell at the same time. When there are too many sellers in the market, the market is liable to collapse or turn into a huge chopping Trading Range. Trading Ranges are extremely difficult for most traders to trade.

And so it goes. The markets have become more volatile than at any other time in my many years of trading, perhaps more volatile than at any other time in history.

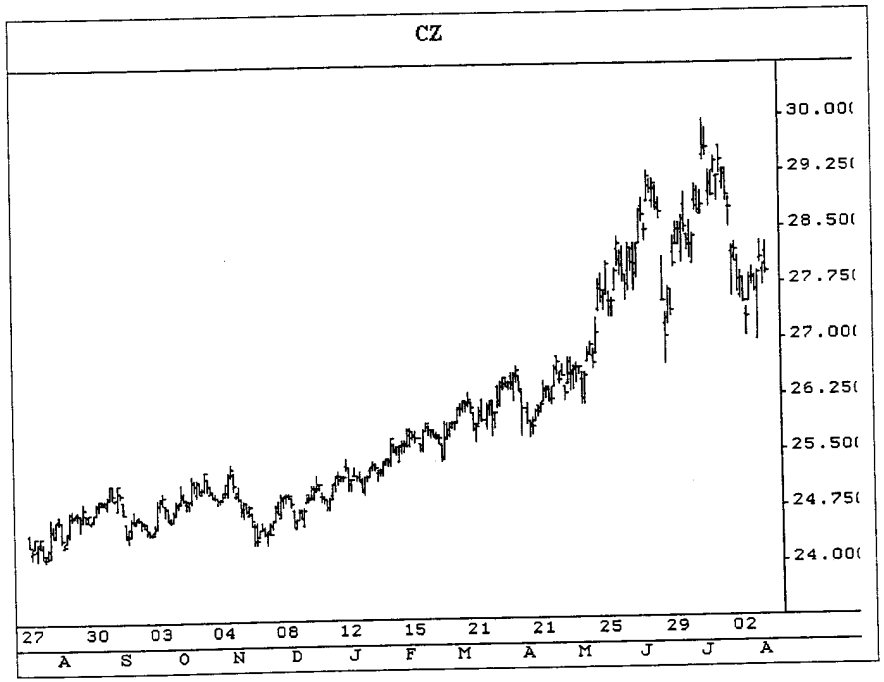
There are only two ways I know to take away the effects of price volatility at times when they are not wanted. One way is with options, which has been adequately covered in my manual and course Trading Optures and Futions, and has no place in this work.

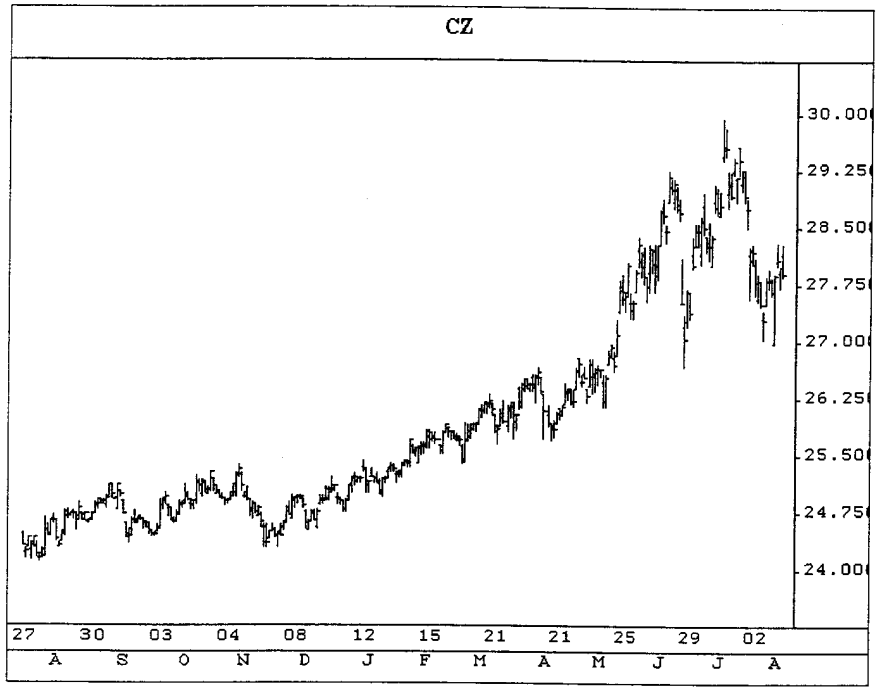
The other way to take the sting out of volatility is with futures spreads. We've already discussed this somewhat in previous chapters.

Now, let's take some specific examples and work them through so you can see to what extent spreading is effective as a technique for reducing volatility. There are a number of situations in which this technique can be used. Can you think of any?

In the first instance of using a spread to reduce the effects of volatility, I will be showing you how to enter a wildly volatile market via a spread. For whatever reasons one might have for entering such a market, this method will suffice.

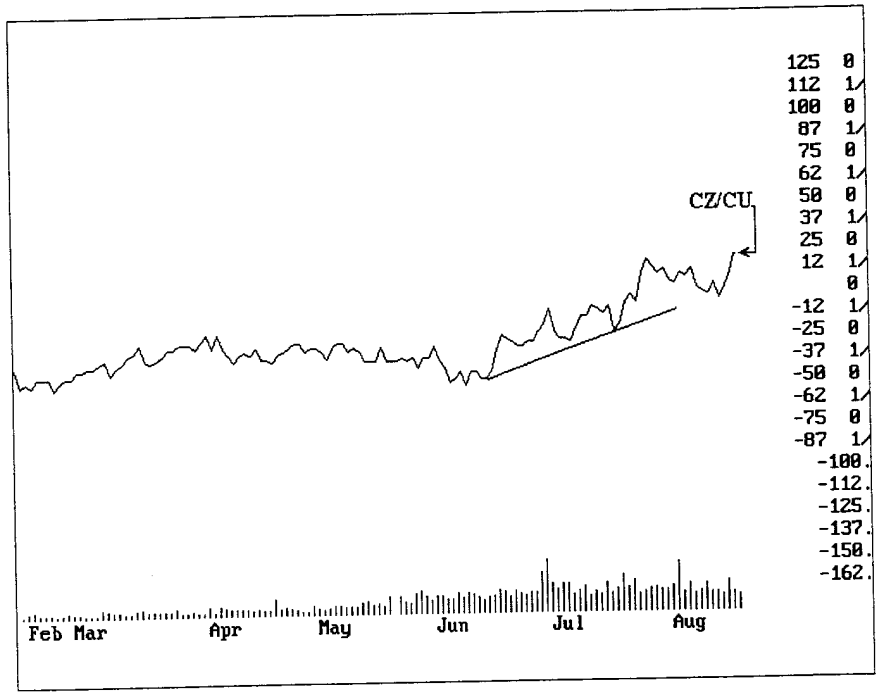
Here is a blow-off top in December Corn.





Let's assume that when you saw the top being put in place in late in June, you were sufficiently astute to realize there would probably be a second run to a top due to the fact that this first top was created by major profit taking by professionals. Your plan is to wait until a second top is attempted or actually made, and then to short the market with outright futures contracts. This type of trade typically occurs in mid-summer in the grain markets, and it occurs in many years.

You decide to look at the spread between September Corn and December Corn.



You note that at the time you want to enter, the spread line for long September Corn and short December Corn is rising, although subsequently the spread actually made money if held merely as a spread.

The tremendous amount of volatility as Corn made a top has been virtually neutralized. You would then be in position to either hold onto the spread, or drop the long September Corn and remain short December Corn, more or less at your leisure.

Now let's look at another situation.

Suppose you were short a market, and suddenly the market moved and locked limit up against you. Can a spread help in that situation?

One advantage in spread trading is the ability to extricate oneself from such a situation by offsetting the troubled trade using a distant back month. The reason this can work is that when you go out far enough, you are dealing with a different crop or market situation, one that is not yet affected by the conditions extant in the market that is making the limit move. This situation is true in many of the grains and foodstuffs such as sugar, coffee, cocoa, and the meats.

Conversely, if for some reason a trader is involved in the use of a back month for his outright futures trade, he may be able to offset by using a month that is closer to the front month, or even the front month itself.

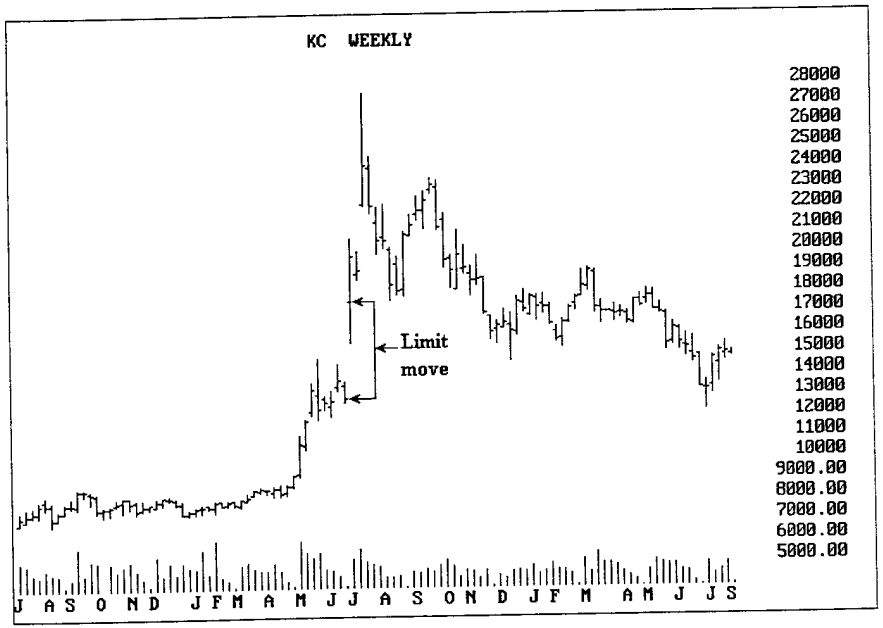
Just such a situation occurred in July Coffee futures, on a day in which prices for December Coffee futures moved limit up, and remained locked limit the entire day. Prices then proceeded to open locked limit on numerous additional days. Prices locked limit a sufficient number of days to have wiped out most trading accounts.

Had you been short December Coffee futures or short December Coffee Call options, the situation was sufficiently desperate and traumatic to cause you to flail around in an attempt to extricate yourself from this situation.

As mentioned, one solution would have been to try to offset in a far distant month. However, far distant months in Coffee are sufficiently illiquid that execution of such a trade may not have been possible without having to incur an unusually large amount of slippage. My understanding is that in this case the nearest *back month* that did not also make a limit move was late into the following year. Coffee futures that far out trade quite thinly if at all, but if they did trade, it might have been possible to trade in such a month and thereby be saved from almost certain disaster.

A better solution turned out to be an offset in September Coffee futures. I've included a weekly Coffee futures chart on the following page.

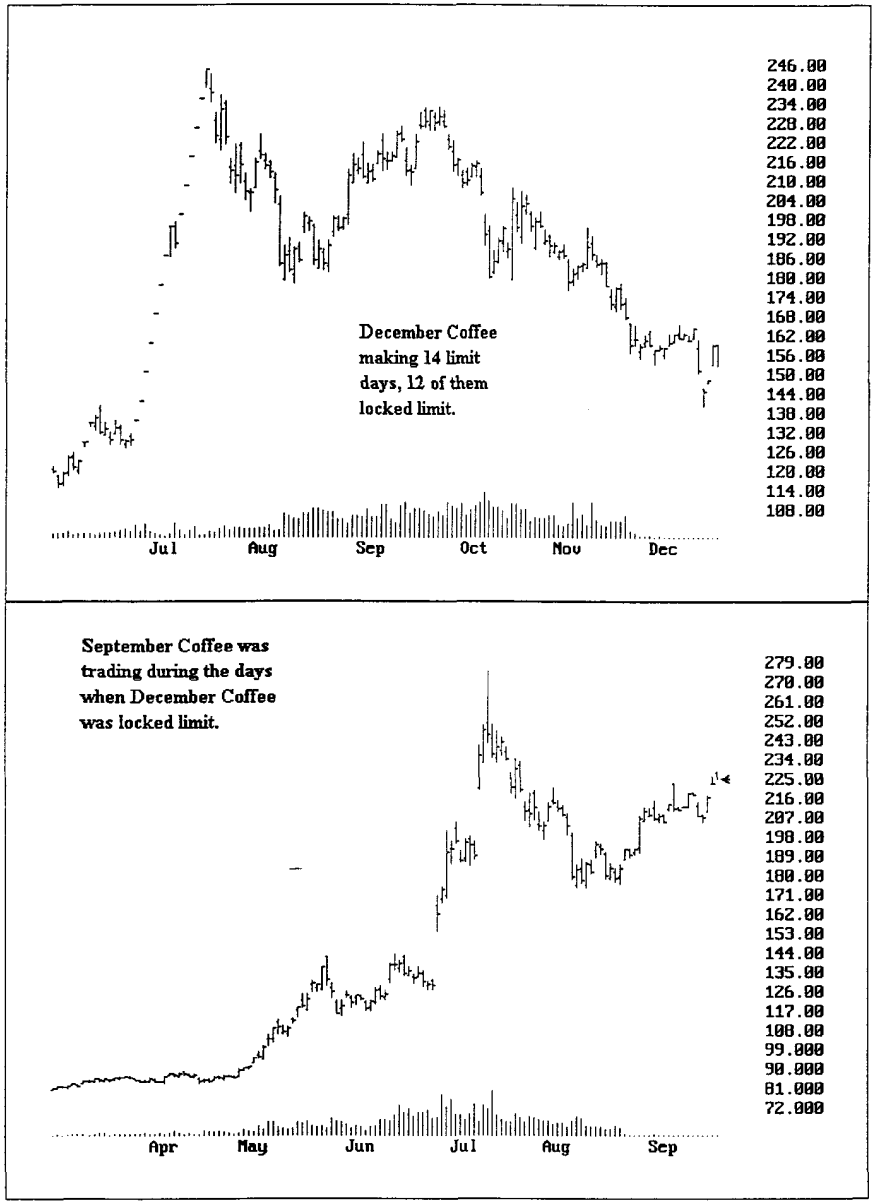
Keeping in mind that you are looking at a weekly chart, can you see the enormous explosion that took place in Coffee prices? Many a trading account containing a short position in Coffee futures or Call options was wiped out in this move.



In light of the fact that such situations can and do occur when trading futures, it is imperative for survival to plan for such contingencies. Plans must be made ***before*** disaster occurs. Prior to entering a short trade in Coffee, trial spread lines should have been examined in various other months in order to ascertain where a line of defense might have been set up.

If a trader is serious about this business, he will plan his trades so that he always has some sort of fall-back situation. If such a retreat is not available, then a trader is most unwise to entertain any position at all in the futures.

In case you're wondering how the daily chart for futures in December and September Coffee appeared, I've included them on the next page.



Chapter 13

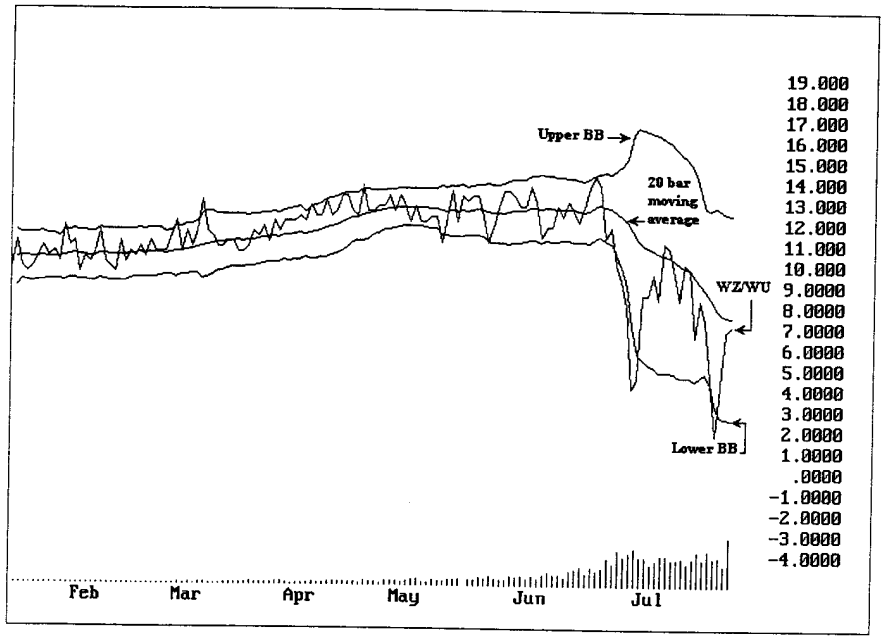
Trading Spreads Using Technical Indicators

Not all traders enjoy trading simply based on chart patterns. In my many years of trading, I have come to the conclusion that not all traders can see the formations I use in my own trading. Additionally, some technical indicators are able to help you see forces in the market that are unlikely to be clear without some sort of visual aid.

In the remainder of this chapter, I'm going to show you a technical indicator I have found useful in trading spreads whether they be seasonal or non-seasonal in nature.

The study that has evolved into what are now called "Bollinger" Bands is one that has proved to be most helpful in trading spreads. Bollinger Bands, when set with a 20-Bar simple moving average of the close and channel lines at two standard deviations, have the unique quality of containing approximately 95% of the price action for a spread. Since spread lines generally are drawn from close to close, one can expect that 95% of the spread line will be contained within the channel.

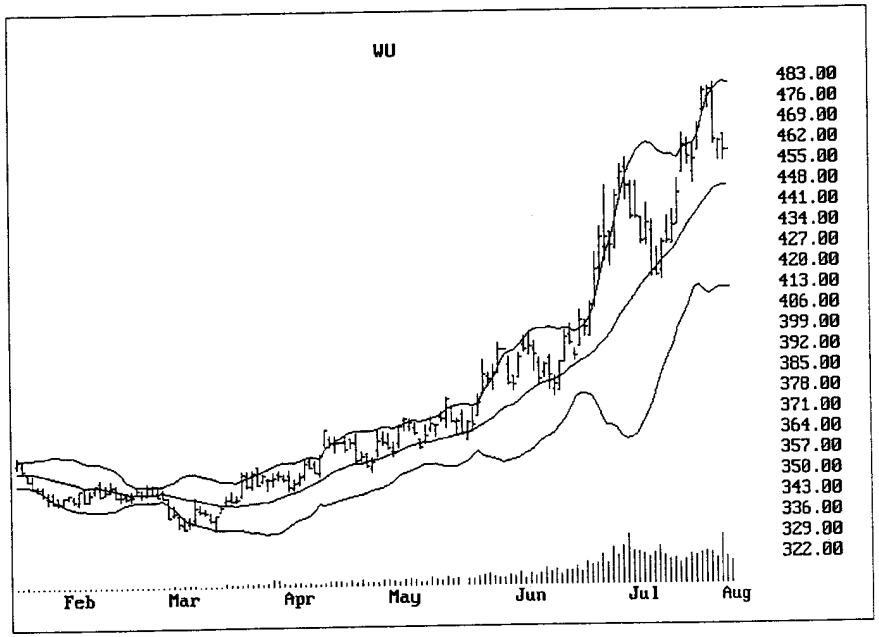
This ability of Bollinger Bands to contain most of the price action makes them exceptionally valuable as a measure of volatility. The wider the band width, the more volatile is the underlying price action. The narrower the band width, the less volatile is the underlying price action. Bollinger Bands are extremely sensitive to large moves, which gives them additional value. The bands are quick to react to price development.
With these features in mind, let's look at a few spread charts containing Bollinger Bands to see how they can work to help in the trading of spreads.



In the chart above, WZ/WU, we see that the Bollinger Bands remained fairly constant during most of the life of the spread. Spread volatility was quite moderate. During May and until the third week in June, spread volatility began to increase due to uneasiness about the supply of Wheat. Did you notice that the increase in volatility was reflected by a widening of the bands during that period?

Finally, when a shortage of Wheat became fully realized, September Wheat prices shot up as buyers wanted all they could get ***now***, fearing the shortage in Wheat would drive prices even higher. The grab for September Wheat caused the spread to invert and plunge downward. Notice the action of the Bollinger Bands in how quickly they responded to both price development and volatility. Do you see that the distance between the upper and lower bands became quite great? That condition is indicative of extremely high volatility.

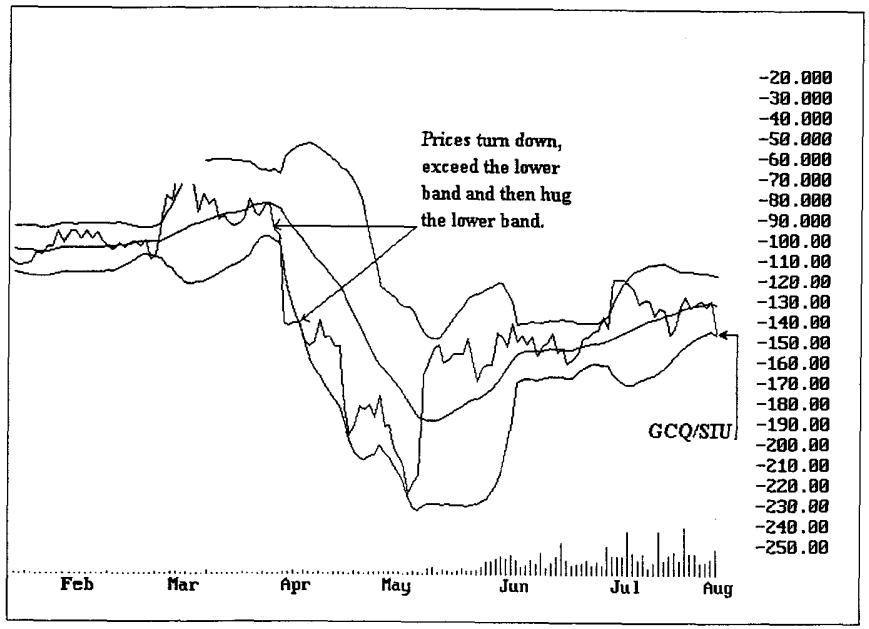
You might be interested in seeing the September Wheat chart during this same period of time.



Here you can see that during the time December Wheat was trending upward slightly faster than September Wheat, September was also in an uptrend. Then in late June, September outpaced December which resulted in a downturn of the spread line. Notice that in this case the futures volatility was almost identical to the spread volatility from late June to the last bar shown on the chart. This is not always the case, and it certainly wasn't prior to and during most of the month of May. A close look at the bands will indicate that they were quite different in the futures from those of the spread.

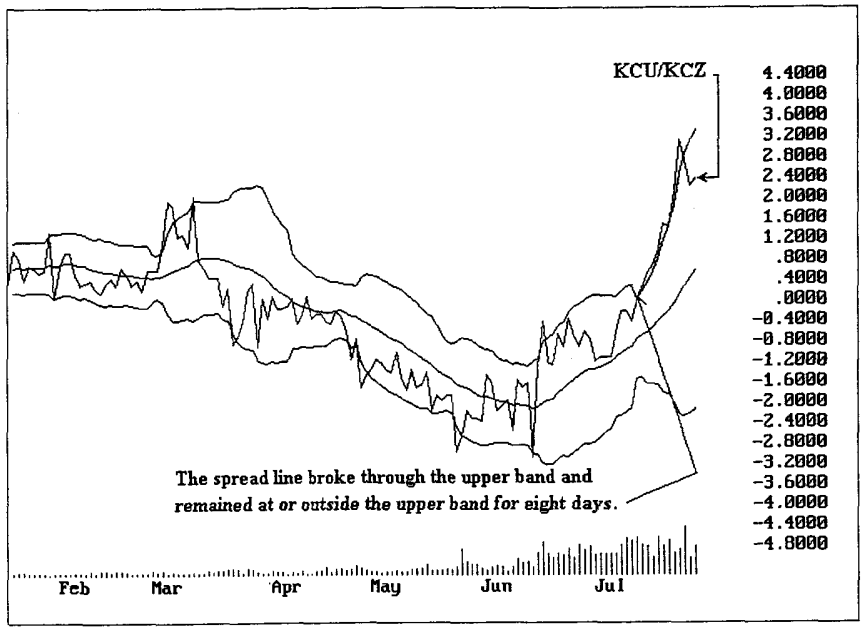
Bollinger Bands have other characteristics that make them useful. When the upper band begins to curve upward and the spread line hugs the upper band, this is indicative of a very strong move to the upside.

Conversely, when the lower band turns downward and the spread line hugs the lower band, it is indicative of a very strong move to the downside.



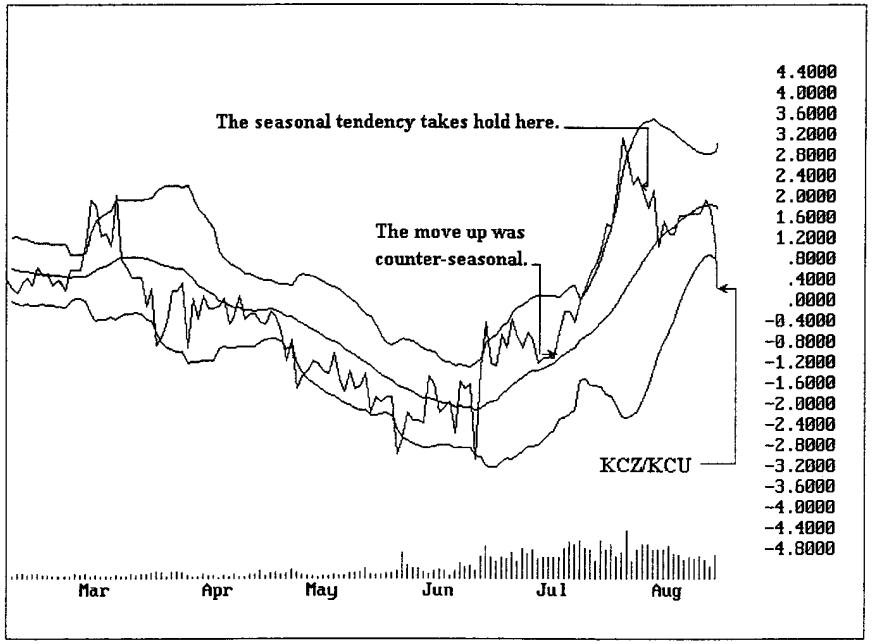
The chart above shows the spread long August Gold and short September Silver. Do you see that at first the spread was narrow, indicative of low volatility? Prior to making a strong downward move, spread volatility increased, reflected in the widening of the bands. At the end of March, the spread line dropped sharply below the lower band and remained outside the lower band for four days. From then on, prices tended to hug the lower band by consistently remaining in the channel that existed between the moving average and the lower band.

A Coffee spread, long September and short December, gives us a picture of how prices can exceed the upper band and remain that way for eight trading days.



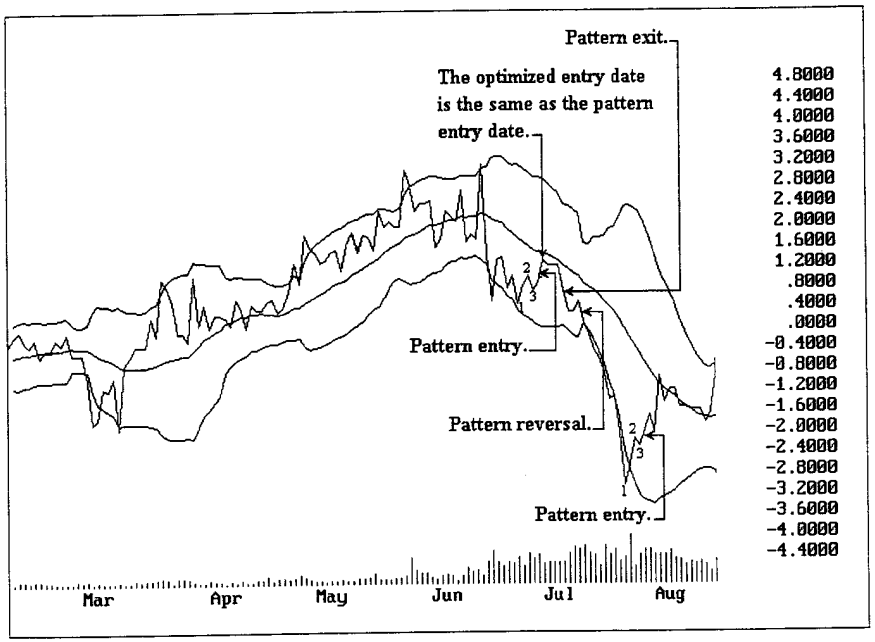
For the spread line to remain outside the upper band for a period of eight days requires a mighty strong move in the spread differential. Such a move is the equivalent of an outright futures trade in which futures prices begin to move almost straight up. Such a move is often indicative of a blow-off, and is generally followed by either a strongly chopping Trading Range, or a complete turnabout in the price action. Interestingly, this particular spread had a seasonal tendency to move in favor of December Coffee rather than September Coffee futures just three days before the beginning of the spread widening in favor of September Coffee. Anyone blindly following an optimized entry date would have sustained a considerable drawdown for almost a month, until the spread finally turned over in favor of December Coffee.

I've shown how that trade developed on the chart on the next page.



As you can see, the seasonal tendency for December Coffee to outpace September finally took hold, and the spread turned in favor of December. Immediately following the highest point of KCU/KCZ, the spreadline turned sharply down. It then proceeded to break through the lower band. Subsequent to what is shown above, the spread line continued downward, hugging the band, for an additional five days at which time the optimized exit date occurred. The turn in the spread line came too late for my seasonal window. Had it not, I would have coupled my 1-2-3 formation with the Bollinger Bands to give me an entry signal. But supposing I wanted to take an outright non-seasonal spread trade based upon an expected reversal after the blowoff? Let's see how that would have worked.

I'm going to turn the chart over so that it shows KCZ/KCU.



The chart shows what turned out to be bad entry on the optimized entry date. The trade is exited with a loss. Following the loss, there is a pattern reversal. The reversal and breakout to new lows on the spread line give an opportunity for an entry into the spread KCU/KCZ. The exit from KCU/KCZ comes in conjunction with the entry into KCZ/KCU. Such an entry can be anticipated following the very strong move in KCU as it counter-seasonally pulled away from KCZ.

However, supposing you wanted to make an entry into this trade based solely upon technical indicators? Could that be done? Is there any specific indicator that might work well in conjunction with the Bollinger Bands?

In the chapter that follows, we will explore the attributes of Bollinger bands. Following that we will examine Welles Wilder's RSI indicator in conjunction with Bollinger Bands. John Bollinger likes to use a 9 bar RSI together with the bands. Personally, I use both a 14 and a 9 bar RSI. Perhaps the two together, RSI and BB's, will provide just what you are looking for if you are a trader who prefers technical studies in your trading.

Chapter 14

Technical Filtering for Spreads

Throughout most of my trading life, my most important tool has been the formations on the price chart, insofar as what I need to see. Yet there are times when I do use technical indicators to assist me in seeing things that are not easily discerned just by looking at a chart. One of the things I am unable to visualize is the location of two standard deviations. Another is the whereabouts of the mean deviation of a moving average of typical prices. Technical indicators are able to graphically display certain market properties not otherwise easily seen. If you find charts confusing, then you may need help from an indicator. If you do use indicators, keep them simple and make sure you use no more than two, and that they present different aspects of the market. For example, Bollinger Bands and the Relative Strength Indicator (RSI) are a good combination. Keltner Channel or most any channel method combined with any one of a number of momentum oscillators is usually acceptable. Why? Because channeling usually presents you with a measure of volatility as well as other enhancements. You can see the channel change width, indicating more volatility or less volatility. All the oscillators with which I am familiar measure momentum, and to some extent, "overbought/oversold." How much is overbought? When is a market oversold? Who is to say? A market can be overbought or oversold for months, and that's why I really dislike those terms. When dealing with indicators, please realize that there are few things in the markets that are measurable. Moving averages of the open, high, low, close, or some combination thereof are the basis for most oscillators. This means that all oscillators are more or less correlated.

An interesting study is called "On Balance Volume" (OBV). Here the designer coupled volume with a momentum oscillator. OBV is useful in detecting signs of

accumulation or distribution. The indicator is created by taking a bar's volume and adding it to a cumulative sum of the volume when the closing price is higher than the close of the previous bar. The volume is subtracted from the sum when the closing price is lower than the previous bar's close.

OBV and a channel make a good combination that you might want to try. The reason for combining an oscillator with a channel is to gain differing perspectives of the price action. Confirmations of the two generally offer a strong entry or exit signal. However, remember that indicators are always presenting you with history. They are always late. They cannot possibly indicate that which has not yet taken place, nor can they ever be fully current. They cannot register their information until ***after*** prices are settled.

The closest I have ever come to making a technical indicator reflect what is current was when I created a pressure indicator based on the open rather than the close. The open is the most current fact available during any trading session. Why? Because the high, low, and close cannot be officially known until they occur, ***after*** trading has stopped. But the open is already history at the time when results from indicators based upon the high, low, or close have not yet been determined.

We'll be looking at a number of combinations to see how they may help in the trading of spreads. First, we'll take a look at the combination of RSI and Bollinger Bands as applied to spread trading.

We'll begin with a more thorough explanation of the assets offered by Bollinger Bands. Then we'll look at those offered by the RSI. After that, we'll see how to use them together to trade spreads.

Bollinger Bands

Bollinger Bands offer not only the visual aid of a simple moving average, but they also offer a continuing view of volatility as expressed through a moving average of standard deviation. Bollinger bands are sensitive to extremes of deviation. The result is that the bands are quick to register volatile or non-volatile movement in price action.
The distance between the bands will quickly widen once a large movement in price is underway. Conversely, the band width will quickly collapse once the market becomes less volatile and reaches a level of relative equilibrium. The number of bars

in the moving average (20) represents the intermediate trend. I have found that this adapts best to a daily chart of the spread line.

When using Bollinger Bands, I choose to use two standard deviations, because at that setting the bands contain 95+% of the spread line. Any movement outside the bands beckons the trader to take notice. It is movement in price that causes the spread line to make extremes. The most noteworthy movements of the spread line occur when the spread line comes close to or exceeds the bands.

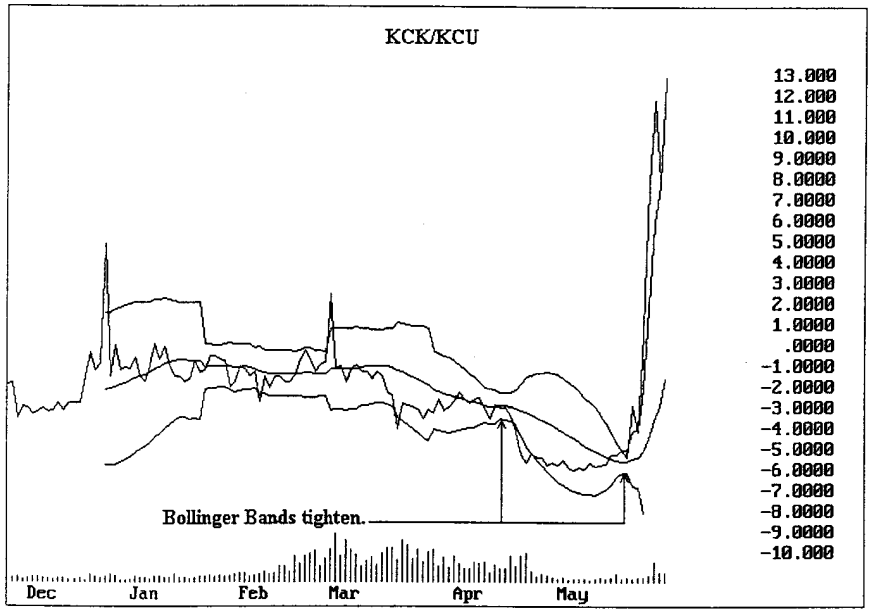
Neither Bollinger Bands nor other bands give entry and exit signals. They merely reflect whether the spread line is wider or narrower relative to where it has previously been. Bollinger Bands as well as other bands are best used in conjunction with a particular chart pattern, or with an oscillator that measures a different factor of the market action. For instance, I would not use Bollinger Bands together with Commodity Channel Index (CCI). Bollinger Bands measure standard deviation of price and CCI measures mean deviation of price. Used together, they are multicolinear. (How's that for a mouthful?)

Here are some comments taken from John Bollinger's Capital Growth Letter, available from Bollinger Capital Management.

1. Sharp moves tend to occur after the bands tighten to the average (volatility lessens). The bond market and foreign currencies are good examples of this.
2. A move outside the bands calls for a continuation of the trend, **not an end to it.** Often, the first push of a major move will carry prices outside of the bands. This is an indication of the relative strength of one side of the spread over the other.
3. A sharp move outside the bands followed by an immediate retracement of that move is a sign of exhaustion.
4. Bottoms (tops) made outside the bands followed by bottoms (tops) made inside the bands call for a reversal in trend.
5. The bands can help in diagnosing double tops and bottoms, especially when the second part of the top (bottom) is higher (lower) than the first and lower (higher) in relation to the bands.
6. The average should give support (resistance) during bull (bear) moves.
7. A move originating at one band tends to go to the other band. This is useful for projecting price targets early on and provides revised targets as events unfold.

Now let's examine a few spreads in conjunction with the bands in order to see some of the features mentioned above at work. Please keep in mind that Bollinger Bands in and of themselves are insufficient for giving entry and exit signals. They must be coupled with either chart patterns or a technical indicator.

Sharp moves tend to occur after the bands tighten to the average (volatility lessens).



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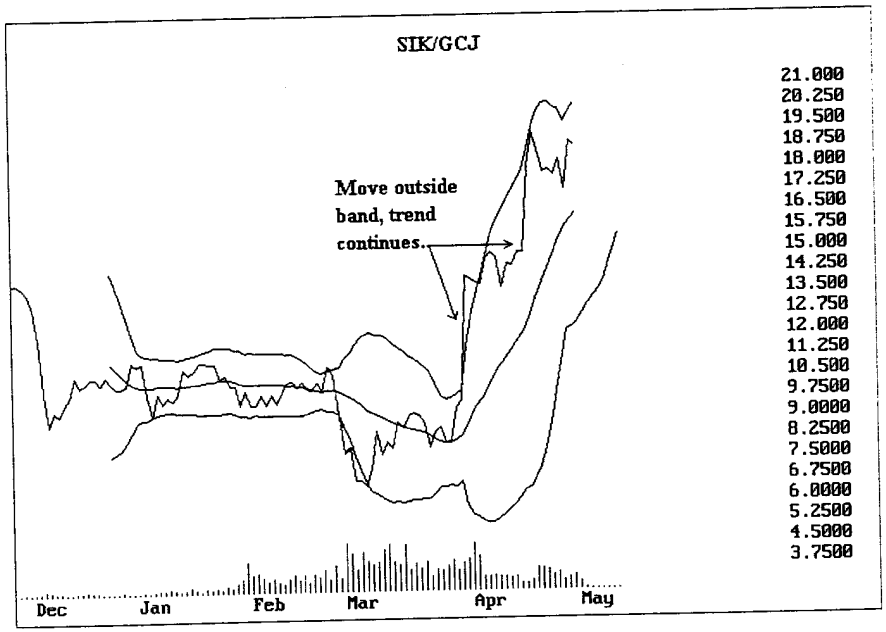
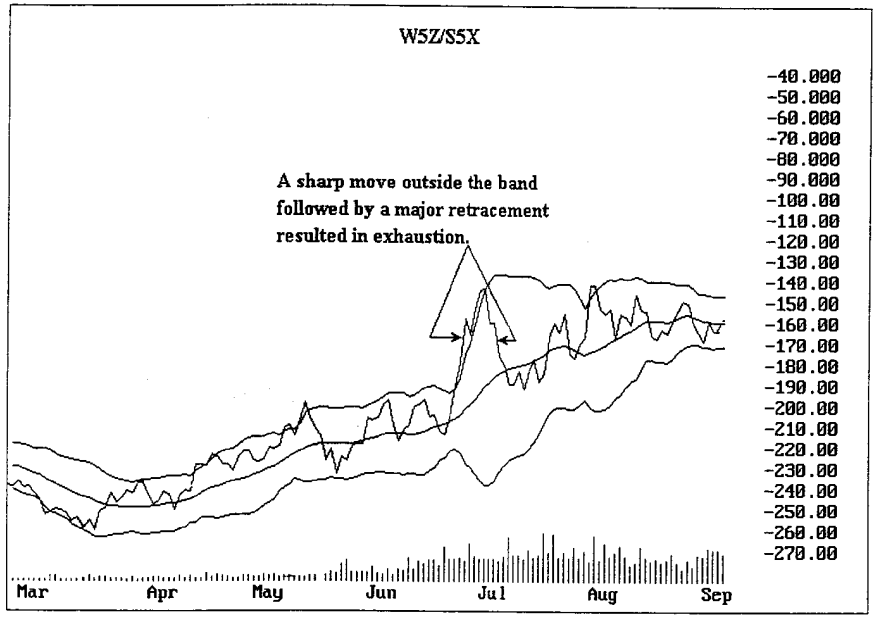
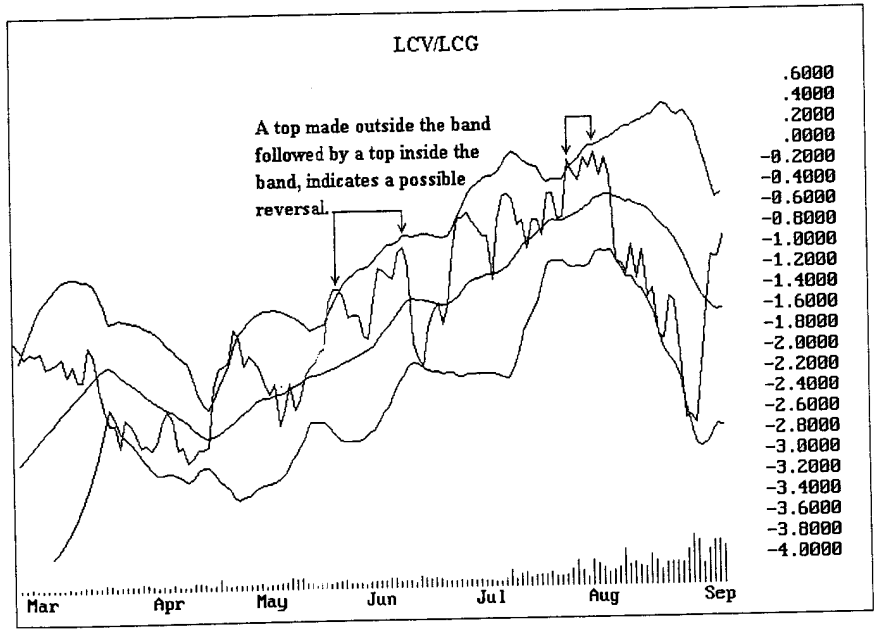


A sharp move outside the bands followed by an immediate retracement of that move is a sign of exhaustion.

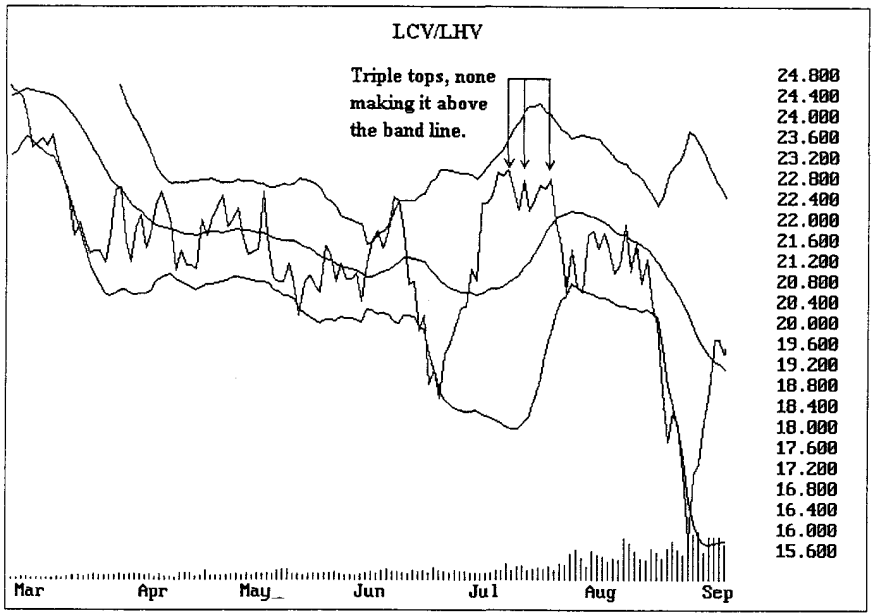


I might add based on my own observations, the retracement must be substantial for this to be true.

Bottoms (tops) made outside the bands followed by bottoms (tops) made inside the bands call for a reversal in trend.

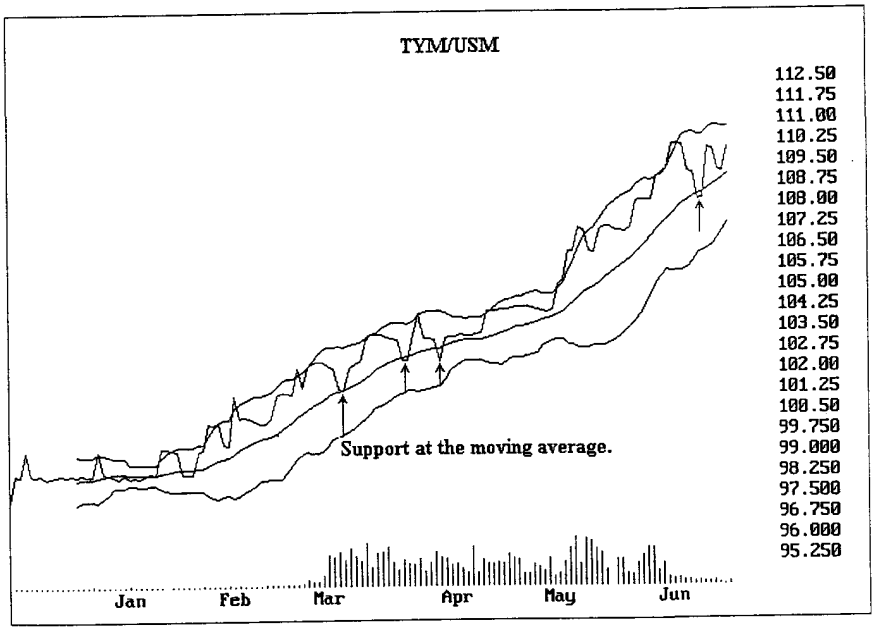


The bands can help in diagnosing double tops and bottoms, especially when the second part of the top (bottom) is higher (lower) than the first and lower (higher) in relation to the bands.



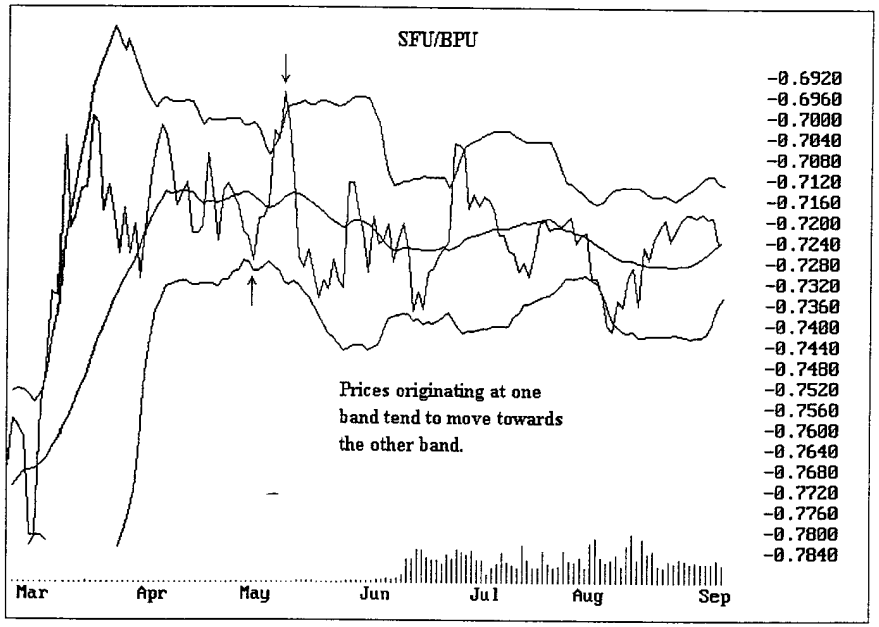
Double tops and bottoms of the kind described above are not generally encountered when trading spreads. I looked through dozens of charts to find the one shown above. Some chartists would have labeled this a double top.

The moving average should give support (resistance) during bull (bear) moves.

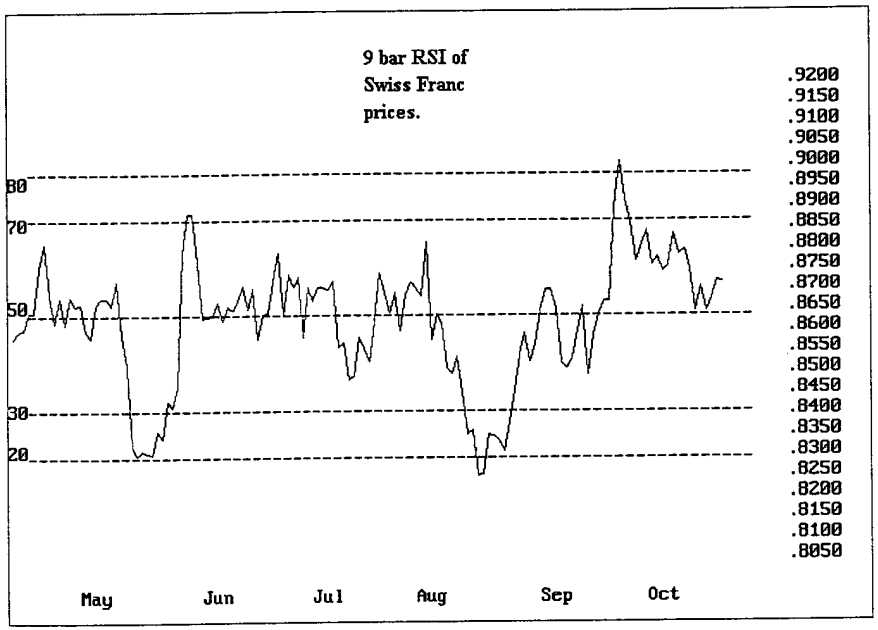


A move originating at one band tends to go to the other band. This is useful for projecting price targets early on and provides revised targets as events unfold.

I suspect that this would better be restated as: *A move originating at one band tends to go* ***towards*** *the other band. This is useful for* ***early*** *projection of spread differential targets and provides for revised targets as events unfold.*

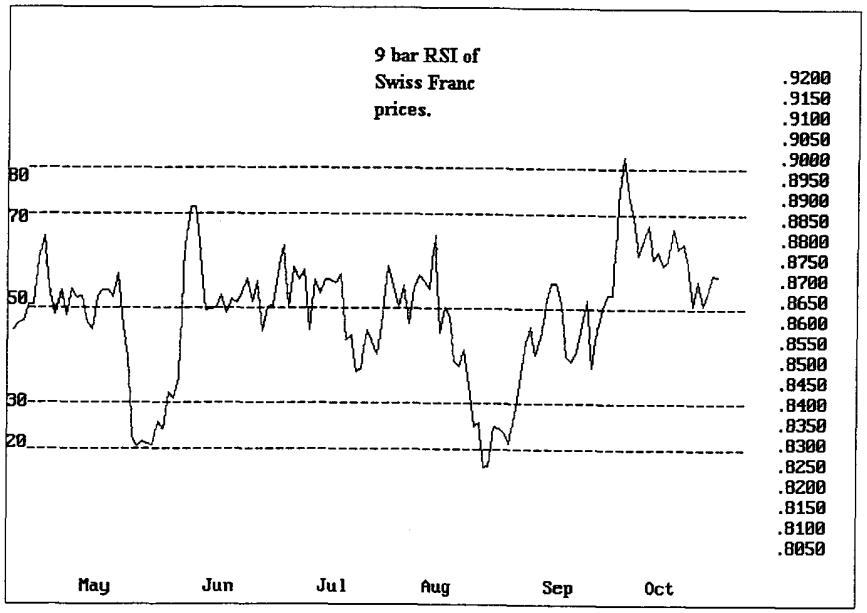


Now let's take a look at RSI and see what it has to offer.



Much has been written about RSI. There are many who teach it and are expert at using and interpreting it. To the best of my knowledge, Welles Wilder is the originator of RSI, and I present it here because John Bollinger has had good results using it in combination with Bollinger Bands. For more in-depth information about RSI, I suggest reading Wilder's book, New Concepts in Technical Trading Systems, available from most book distributors.

RSI presents a graphical view of a ratio that looks at the net change in price taking place during each time period for which it is invoked. The average net amount that price has moved up during that time is measured against the average net amount that price has moved down. Therefore, RSI purports to measure two things, price ***momentum*** and the (infamous) ***overbought/oversold*** condition of a market. In measuring overbought/oversold, it is no better (or worse) than any other indicator used to measure this somewhat fictitious condition of a market.



Another use for RSI is that of offering a visualization of divergence from its peaks and troughs relative to the highs (peaks) and lows (troughs) in actual futures prices.

RSI is plotted over horizontal grid lines indicating the 20%, 30%, 50%, 70%, and 80% levels of an absolute vertical scale that can go no higher than 100 or lower than zero.

Interpretations of RSI

It is said that when markets are choppy and generally moving sideways, you should consider being a buyer when prices diverge lower and RSI is rising, and consider being a seller when prices diverge higher and RSI is falling.

It is also said that when markets are trending, you should consider being a buyer when RSI crosses above the 50% RSI grid line, and consider being a seller when RSI crosses below the 50% RSI grid line.

Another interpretation of how to use a 14 bar RSI states that when a market is choppy and moving sideways consider selling when the RSI movement is above 70% (overbought), and consider buying when the RSI movement is below 30% (oversold). The percentages are increased to 80% and 20% when using a 9 bar RSI.

When a market is trending and a 14 bar RSI is being used, the 80% level becomes the overbought indicator and the 20% level becomes the oversold indicator.

I have underlined the word consider because too many traders blindly and mechanically trade the RSI according to the methods indicated above. Unfortunately, such trading is done to their own financial destruction.

It is important to recognize the strengths and weaknesses of RSI in order to properly use it.

Among its strengths are the fact that it smoothes distortions that would occur as old prices are dropped off and new prices added into the formula. In the opinion of some, a strength is found in the constant vertical scale. By fixing the amplitude of the scale from zero to 100, RSI provides a constant band for purposes of comparison. Other oscillators do not use a fixed scale and therefore make it possible to compare an extreme move relative to a previous extreme move.

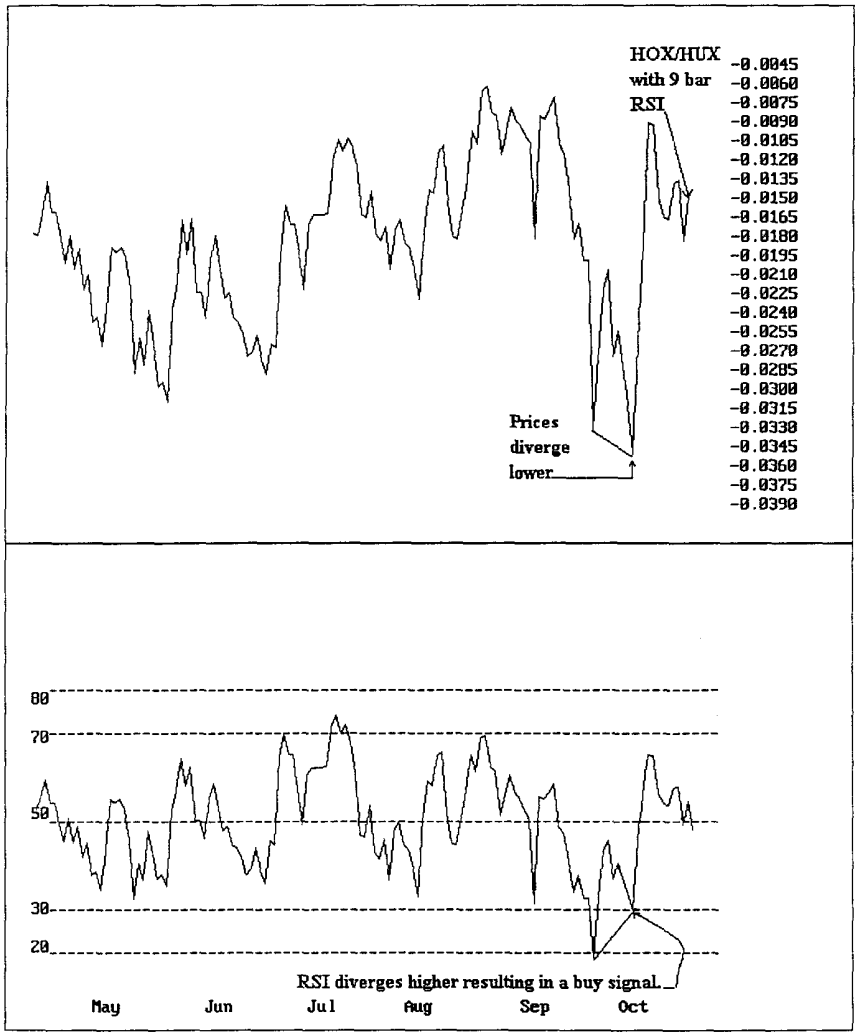
The weaknesses of RSI are identical with its strengths. How much *smoothing* is the correct amount? Should you use 14 bars of smoothing, 9 bars of smoothing, or some other number? Should you change the smoothing factor if prices begin to trend? Should you change the smoothing factor if prices cease trending? Obviously, a 9 bar RSI, at times, is going to give substantially different signals than a 14 bar RSI. You'll have to decide for yourself when to use 9, 14, or some other value for RSI.

Is a constant vertical scale the best way to view the net changes in price? There are those who would argue that a variable scale would be better. A constant scale causes an oscillator to scrunch up and become meaningless in a trending market. So called overbought/oversold readings become virtually worthless.

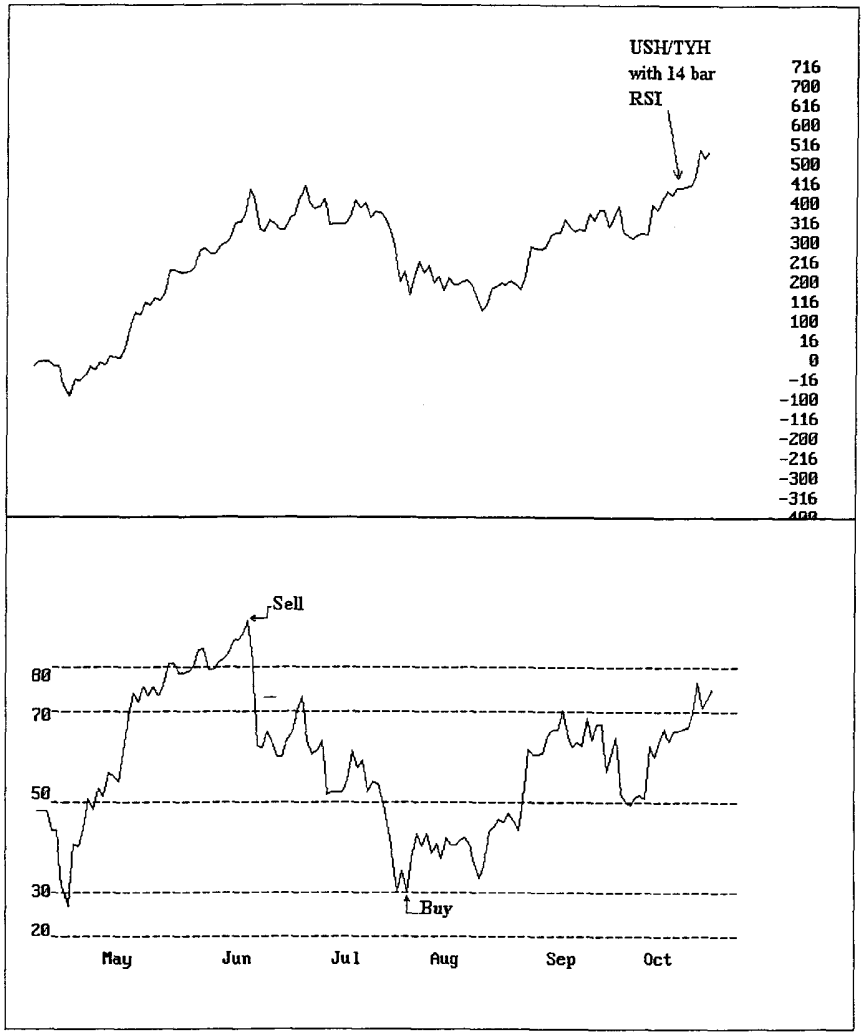
Since our purpose here is not to argue the merits and inadequacies of RSI, let's now view some RSI charts in order to show you the various interpretations and methods

of trading with RSI. After that, we can view how it works best in conjunction with the Bollinger Bands for profitable trading in spreads.

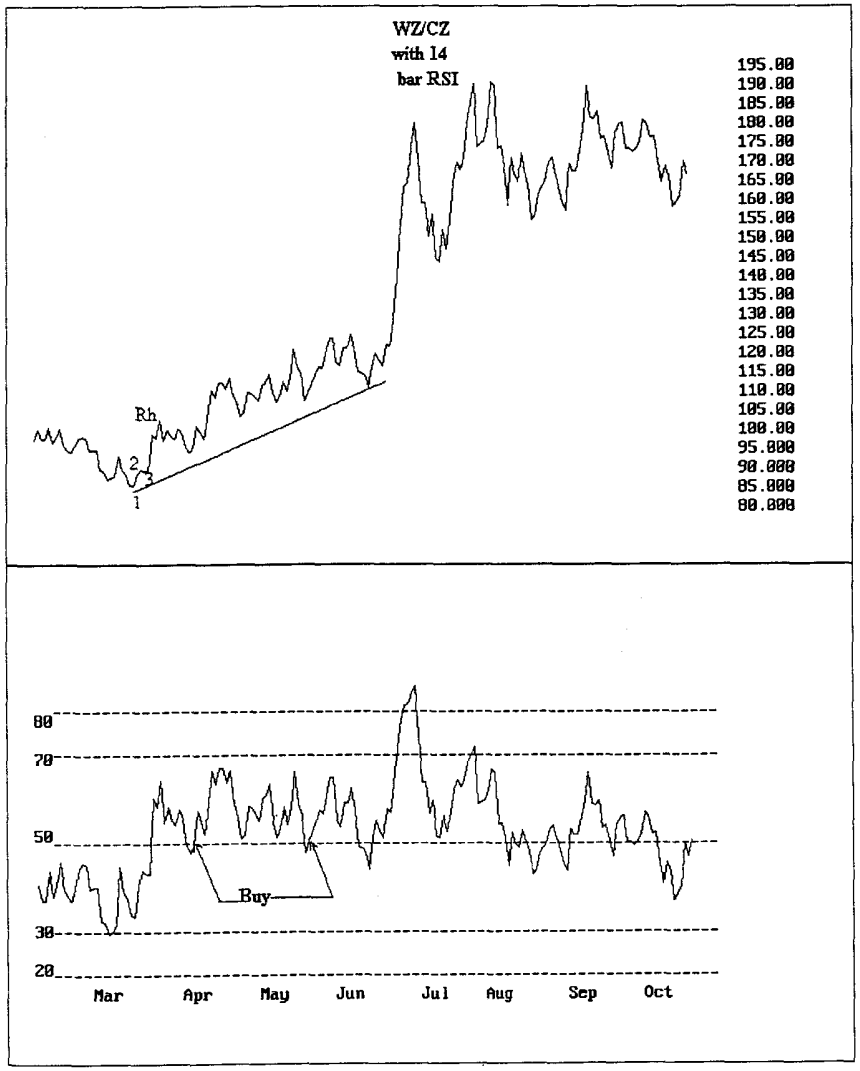
When markets are choppy and generally moving sideways, you should consider being a buyer when prices diverge lower and RSI is rising, and consider being a seller when prices diverge higher and RSI is falling.



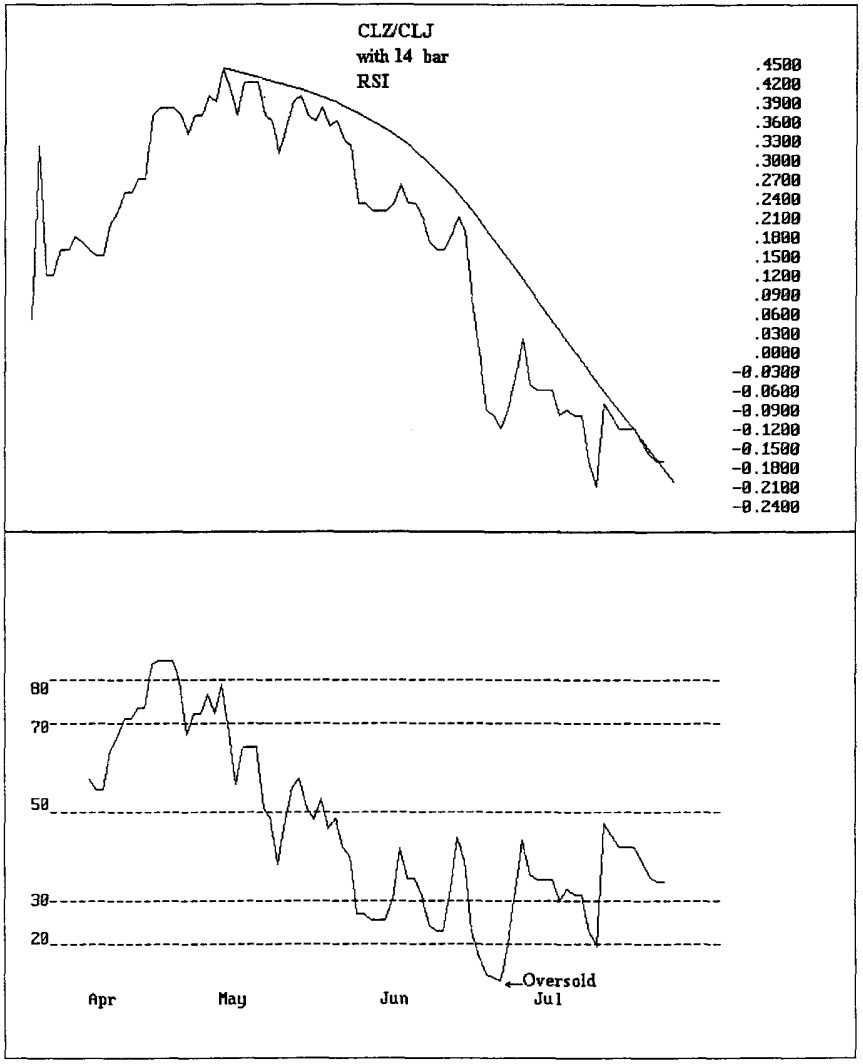
When a market is choppy and moving sideways, consider selling when the RSI movement is above 70% (overbought), and consider buying when the RSI movement is below 30% (oversold). The percentages are increased to 80% and 20% when using a 9 bar RSI.



When markets are trending, you should consider being a buyer when RSI crosses above the 50% RSI grid line, and consider being a seller when RSI crosses below the 50% RSI grid line.



When a market is trending and a 14 bar RSI is being used, the 80% level becomes the overbought indicator and the 20% level becomes the over-sold indicator.

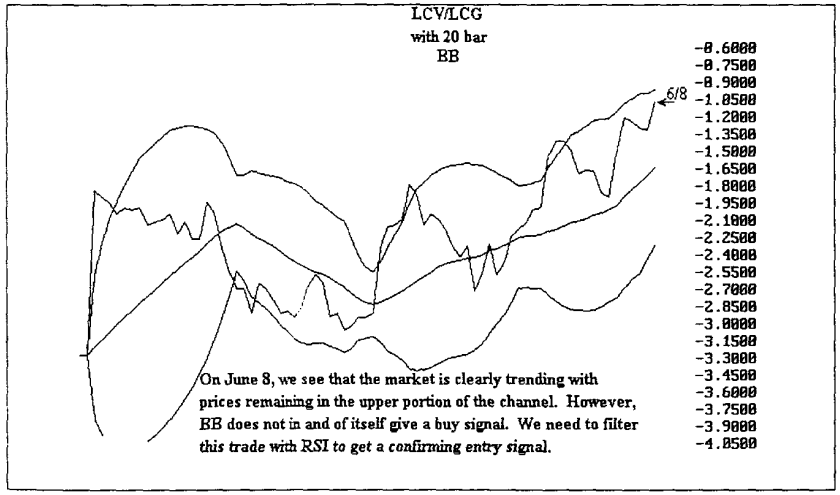


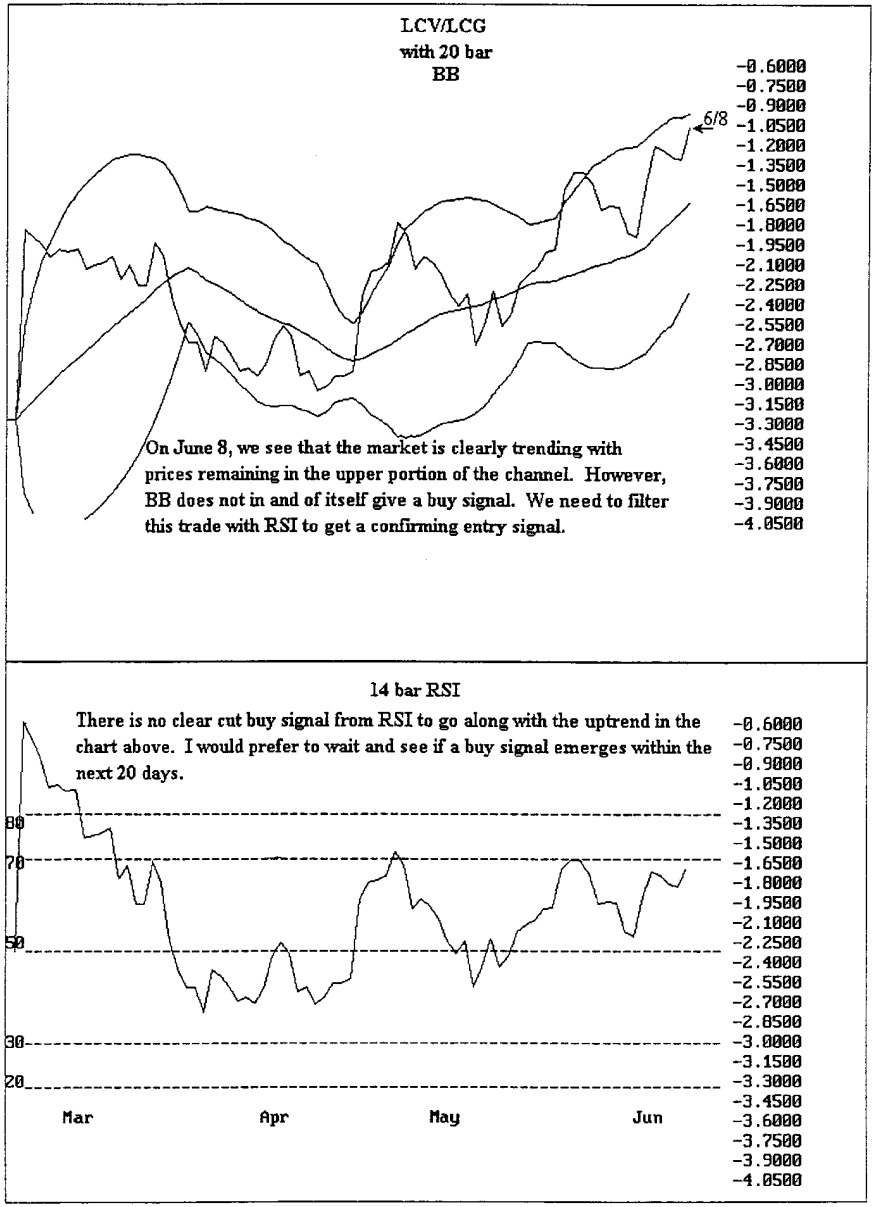
Now that we've seen some examples of how people interpret and use RSI signals, let's combine these signals with optimized entry dates, the 20-day window, and Bollinger Bands in order to see how technical indicators can work for spread trading.

Chapter 15

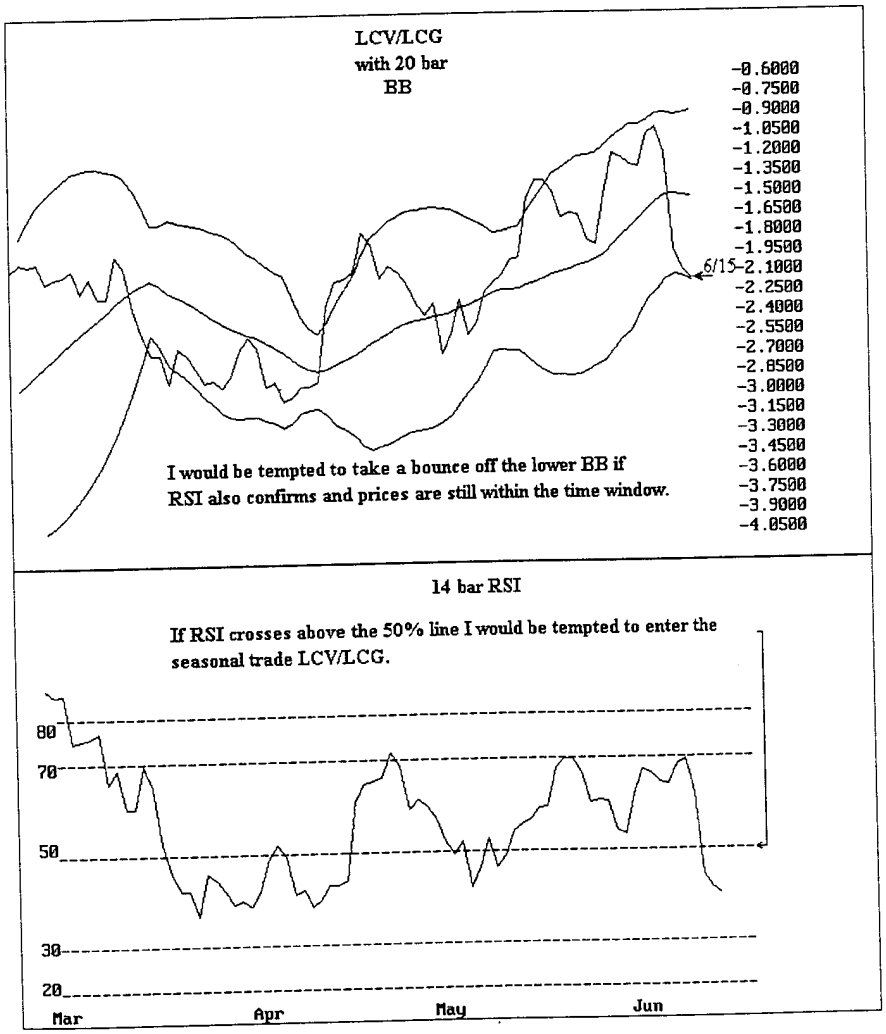
Seasonal Spread Trading with Bollinger Bands and RSI

A trade with which I've been familiar for many years is to get long October Live Cattle and short the following February's Live Cattle around the third week in June. Moore's Research Report lists the optimized entry date for the year shown at June 22. This means the window for this trade opened on June 8. The chart below begins with the way the chart looked on that date.





A few days later, with the Bollinger Bands holding fairly steady, prices begin a retracement falling below the moving average line and reaching across to the lower BB line. RSI crosses below the 50% line. It is now June 15. If prices were to begin moving up so that RSI moves above its 50% line, I would want to enter the trade LCV/LCG.



On the opposite page we see an actual entry signal. Do you see that RSI has crossed the 50% line, and prices themselves are a hair above the simple moving average line of the Bollinger Bands? It would be quite easy to make a mechanical entry here, but it is much better to enter based upon an understanding of what these indicators are telling us. The entry signal was given on the 20th and again on the 22nd, the optimized entry date.

The normal expectation for a trend is that it will continue. Are the indicators pointing to a continuation of the trend? Let's see.

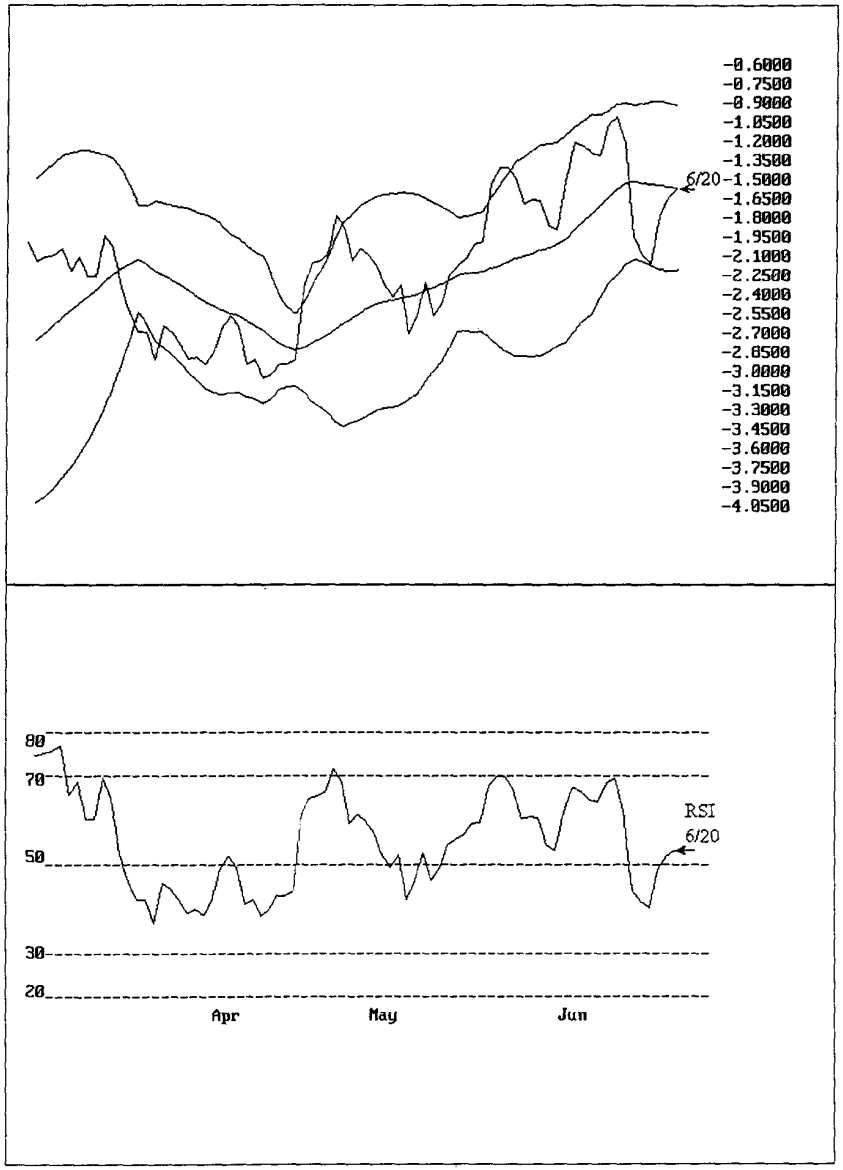
RSI is a momentum indicator. If prices were to cause this indicator to again rise above the 50% line, what do you think it would mean? In my opinion, this would be a clear indication of a reversal in the short term momentum and possibly a continuation of the longer term trend momentum.

Bollinger Bands give us a picture of volatility. Certainly there has been little change in the volatility depicted by the bands. The distance between them has remained fairly constant. If volatility were to drop off, might we not suspect that the move is weakening and that prices are ready to move sideways and not continue to trend upward?

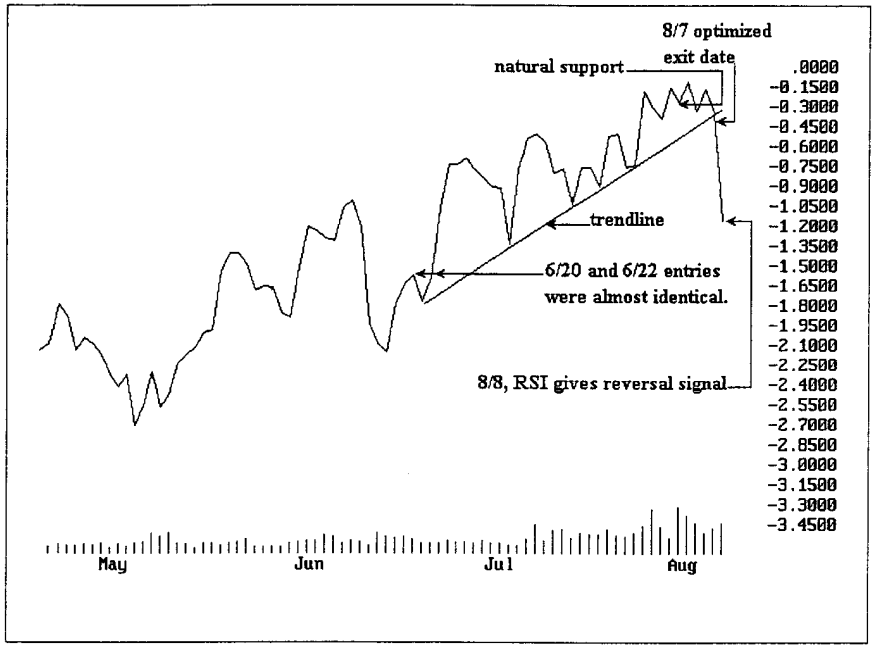
The 20 bar simple moving average of the Bollinger Bands is a trend indicator. This moving average is usually based on the close although you may want to base it upon the open or even an average daily price. Prices have moved just above the simple moving average. This means they now reside in the upper channel. This too is indicative of a continuation of the trend.

It is the combination of these technical factors in conjunction with the fact that we are in the seasonal window that make this a strong entry signal. At the very least, I would be willing to make an attempt. The fairly high reliability of the optimized entry date is a contributing factor. That date is only two days in the future.

How does one enter such a trade? If able to monitor the market intraday, I suggest that a software alert can be set to signal the event of RSI crossing the 50% line, prices moving above the simple moving average, or both. If unable to monitor the market intraday, an entry differential can be exactly or approximately (depending upon available tools) ascertained based upon the moving average. The order can then be phoned into a broker for execution should that price differential occur.



Below, you can see the results of this trade. If entry was not made on the 20th, it most certainly was possible on the 22nd or 23rd.



What about exiting from this trade? Certainly exit could have been made from the simplest technical indicator of them all, a trendline. My own preference is that of natural support (a chart formation), which gave the best exit in this case. Coincidentally, the optimized exit date also gave a profitable exit on the same day that exit could have been made via the trendline.

The worst exit would have been that of a crossing of the Bollinger Band moving average or the crossing of the 50% line of the RSI. Both occurred on 8/8.

I do not believe that using the same technical indicator for entry and exit necessarily makes any sense. However, this is exactly what most mechanical systems do. I also believe that is why most of them lose. By the time the cumulative forces that generated the entry signal reverse, most of the profit, if any, is gone. All too often the result is a net loss for the trade.

It is my firm belief that in order to maximize profits and minimize losses, entries and exits should be considered in completely different ways. If you are going to enter trades with technical indicators, you should exit them using a chart pattern. In a trending market, this technique has given the best results over a period of many years.

Let's look at one more seasonal spread trade using technical indicators before moving on to the next chapter.

Buying next year's May Sugar #11 and selling this year's October Sugar #11 is another high percentage seasonal spread that had worked 100% of the time in a succession of 15 years.

Both May and October contracts have good open interest, and both have adequate volume. World Sugar is one of the most widely traded commodities and it is traded well into the future as the commercials use vast quantities of it and have a need to hedge long term.

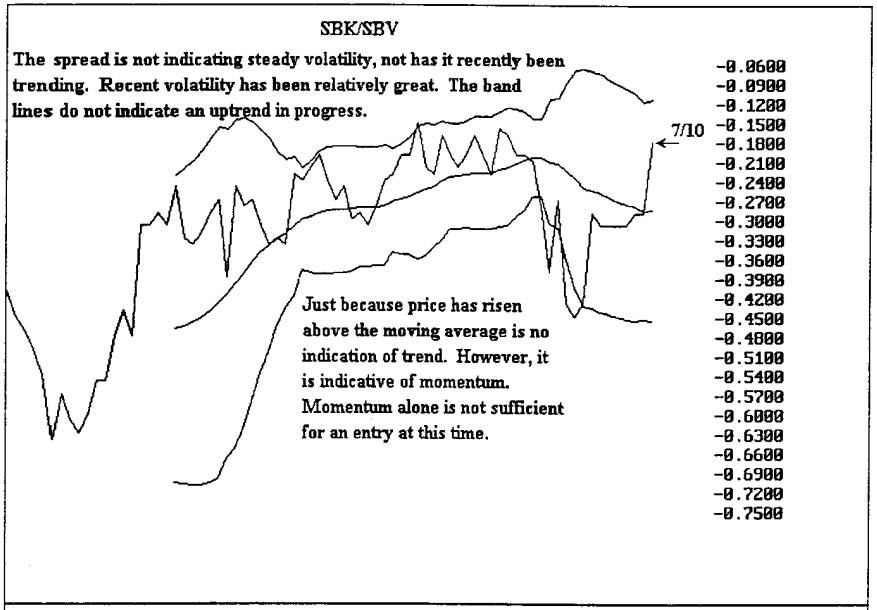
The trade is typically entered in the last week of July, and the Moore Research Center listed this trade's optimized entry date as 24 July, with an optimized exit date of 4 September.

Let's begin looking at this spread 10 days prior to 24 July. We will begin with 10 July, which is the opening of our seasonal window.

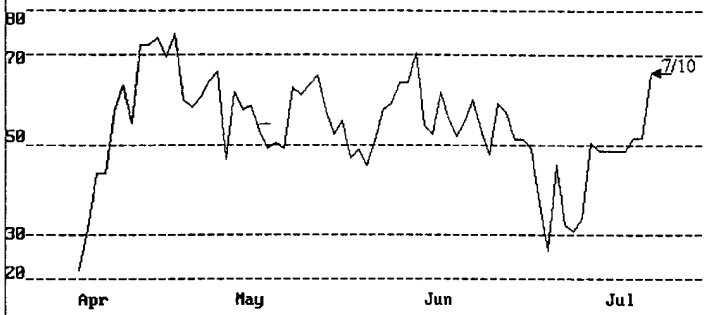
We want to coordinate any signals from RSI together with the status of the Bollinger Bands.

We want to keep in mind volatility, momentum, divergence, if any, and the so-called overbought/oversold condition of price in the event the market is moving sideways. These factors constitute the essence of trading spreads using technical indicators. In any event, we want to see clear cut signals from our indicators or we will not trade.

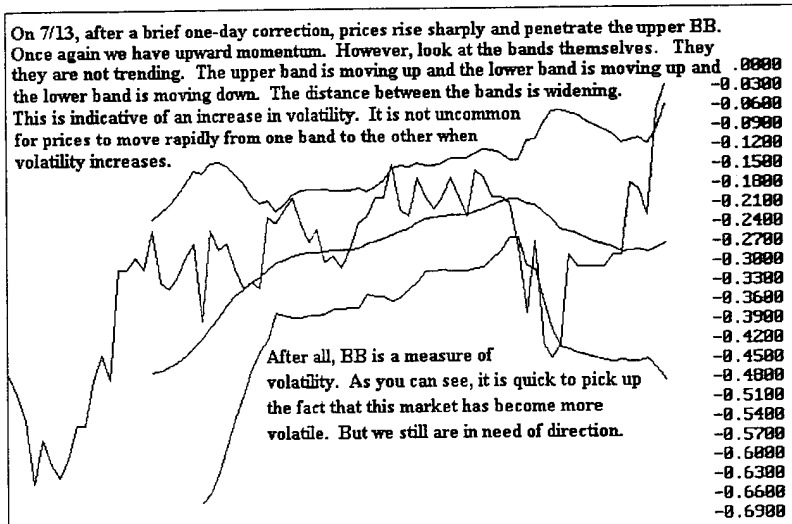
SBK/SBV follows on the next page.



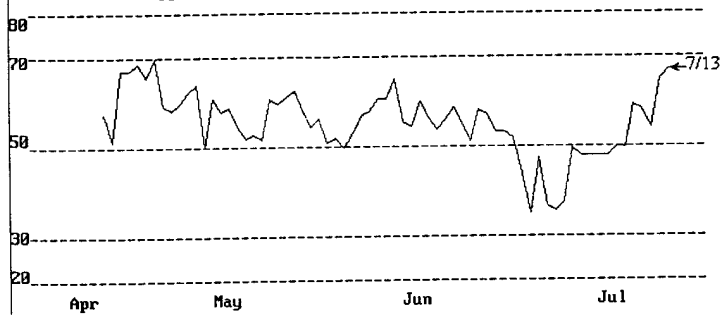
Neither the 9 bar RSI above or the 14 bar RSI show any divergence from price. RSI is showing momentum. It has crossed the 50% marker, but is well within the bounds of neutrality. It is moving sideways in a sideways market.



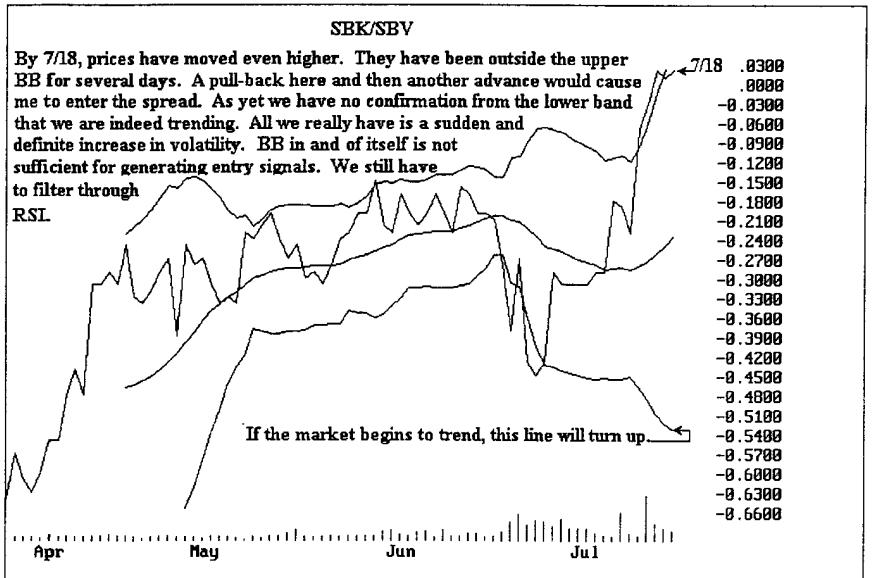
The 14-Bar RSI (not shown) is halfway between the 50% and 70% lines. Together, RSIand BB are indicative of a sideways market with prices bouncing from one extreme to the other. If anything, I would be tempted to short this spread on "overbought" condition of the RSI.

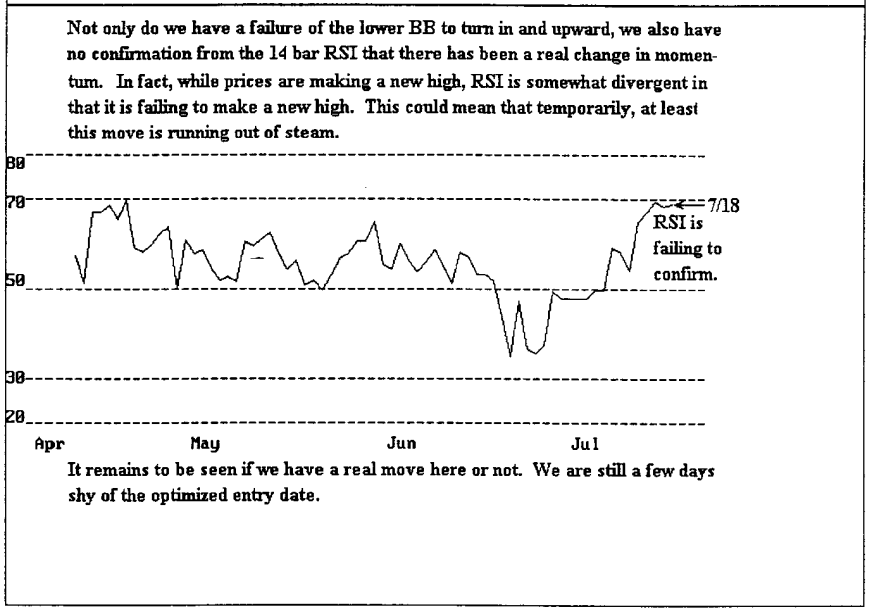


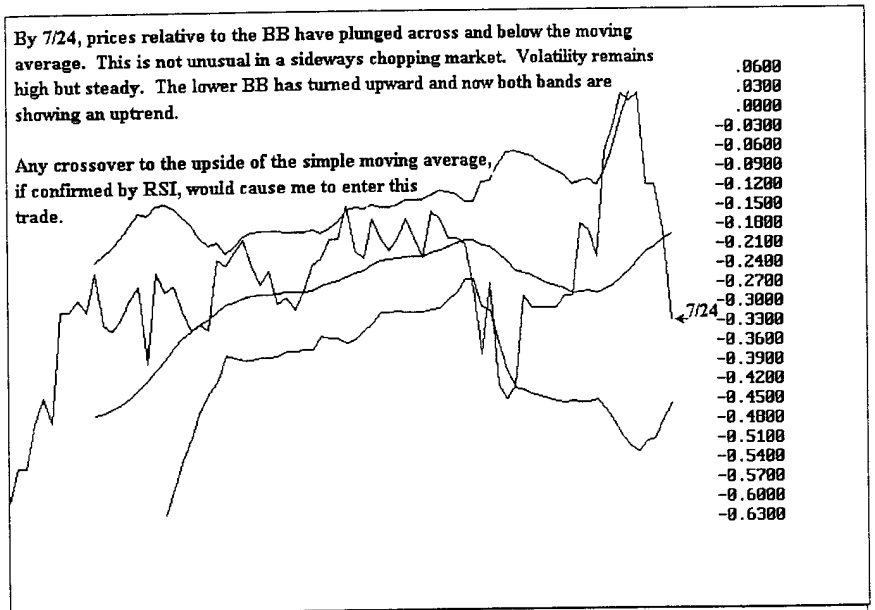
The 14 bar RSI baraely confirms the momentum of the price move as set against the BB's. The indicator has not reached the "overbought" level. However, the fact that price has penetrated the upper BB line may be indicative of a trend that will continue. At this point, it is better to wait. This is quite often where the amateur trader is separated from the professional What appears to be a major move in price is not really that much of a move.

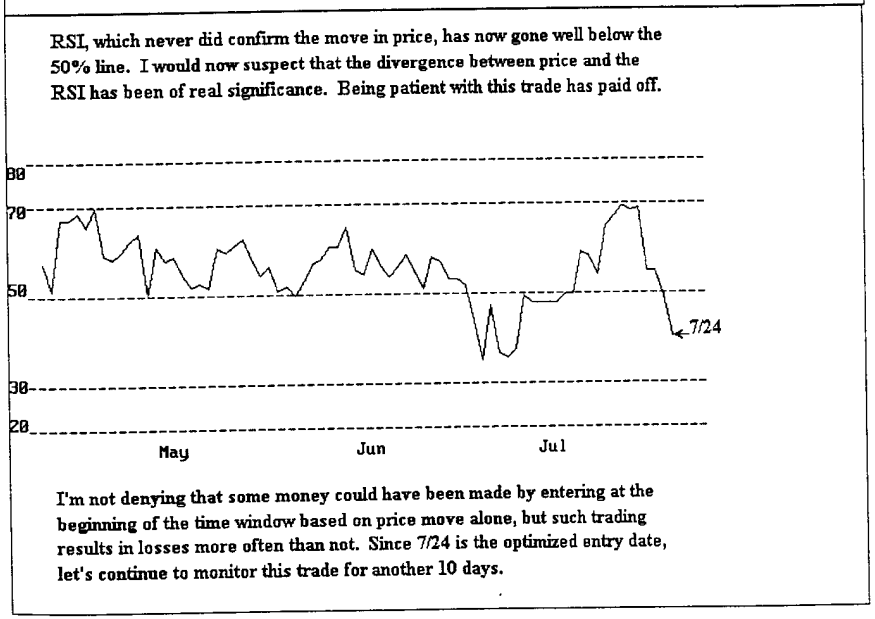


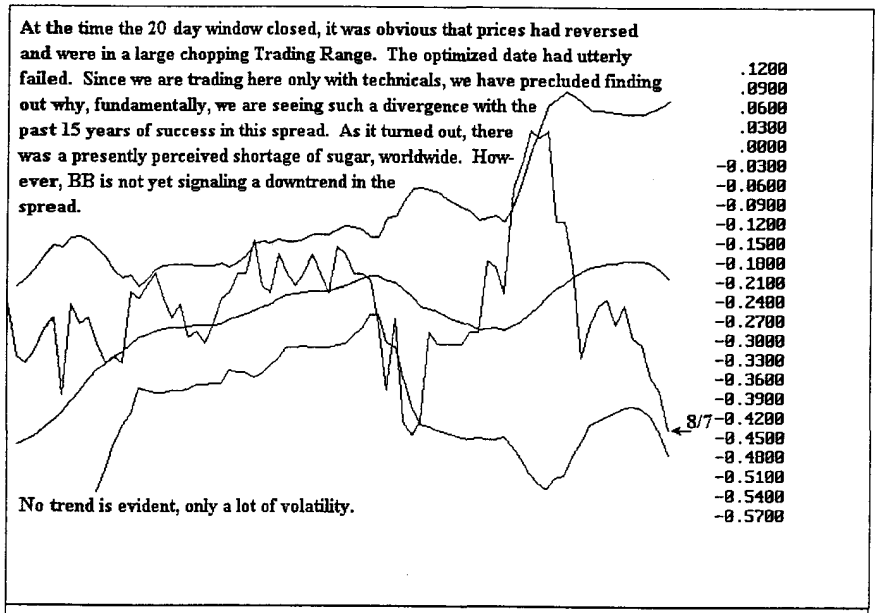
The scale on which the chart is shown can be deceptive as to the magnitude of a move. This market has been moving sideways. The price scale will tend to magnify the size of the move. We still do ot have a clear indication of direction. Entry at this point carries more risk than I am willing to take.

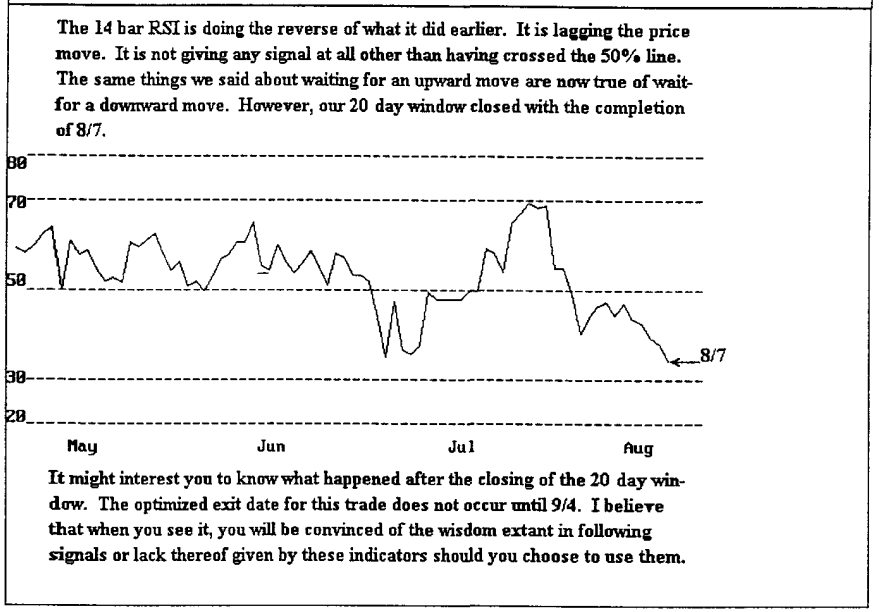

SBK/SBV
By 7/18, prices have moved even higher. They have been outside the upper BB for several days. A pull-back here and then another advance would cause me to enter the spread. As yet we have no confirmation from the lower band that we are indeed trending. All we really have is a sudden and definite increase in volatility. BB in and of itself is not sufficient for generating entry signals. We still have to filter through RSI.
7/18
If the market begins to trend, this line will turn up.
.0300
.0000
-0.0300
-0.0600
-0.0900
-0.1200
-0.1500
-0.1800
-0.2100
-0.2400
-0.2700
-0.3000
-0.3300
-0.3600
-0.3900
-0.4200
-0.4500
-0.4800
-0.5100
-0.5400
-0.5700
-0.6000
-0.6300
-0.6600
Apr
May
Jun
Jul

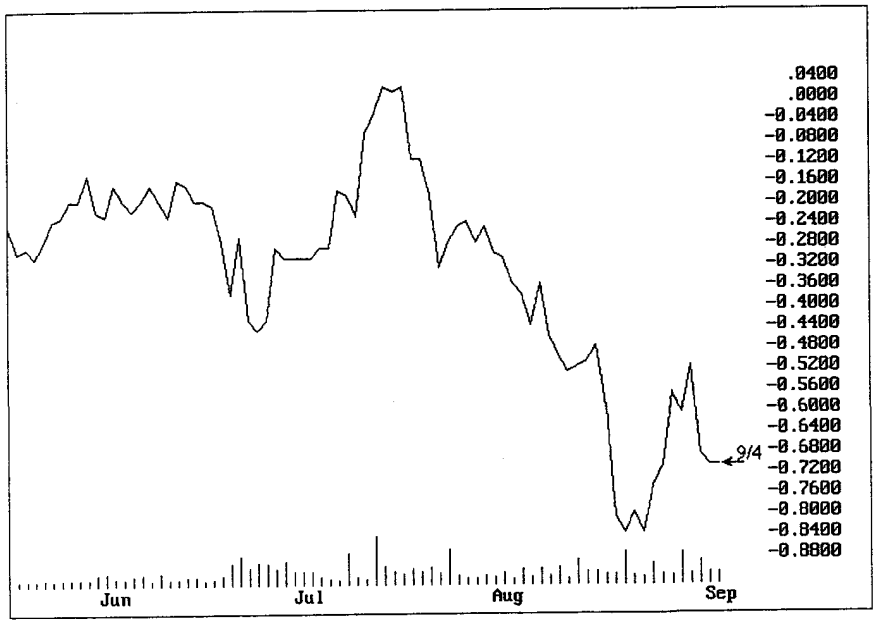

Not only do we have a failure of the lower BB to turn in and upward, we also have no confirmation from the 14 bar RSI that there has been a real change in momentum. In fact, while prices are making a new high, RSI is somewhat divergent in that it is failing to make a new high. This could mean that temporarily, at least this move is running out of steam.
80
70
50
30
20
7/18
RSI is failing to confirm.
Apr
May
Jun
Jul
It remains to be seen if we have a real move here or not. We are still a few days shy of the optimized entry date.


By 7/24, prices relative to the BB have plunged across and below the moving average. This is not unusual in a sideways chopping market. Volatility remains high but steady. The lower BB has turned upward and now both bands are showing an uptrend.
Any crossover to the upside of the simple moving average, if confirmed by RSI, would cause me to enter this trade.
7/24
.0600
.0300
.0000
-0.0300
-0.0600
-0.0900
-0.1200
-0.1500
-0.1800
-0.2100
-0.2400
-0.2700
-0.3000
-0.3300
-0.3600
-0.3900
-0.4200
-0.4500
-0.4800
-0.5100
-0.5400
-0.5700
-0.6000
-0.6300


RSI, which never did confirm the move in price, has now gone well below the 50% line. I would now suspect that the divergence between price and the RSI has been of real significance. Being patient with this trade has paid off.
80
70
50
30
20
7/24
May
Jun
Jul
I'm not denying that some money could have been made by entering at the beginning of the time window based on price move alone, but such trading results in losses more often than not. Since 7/24 is the optimized entry date, let's continue to monitor this trade for another 10 days.





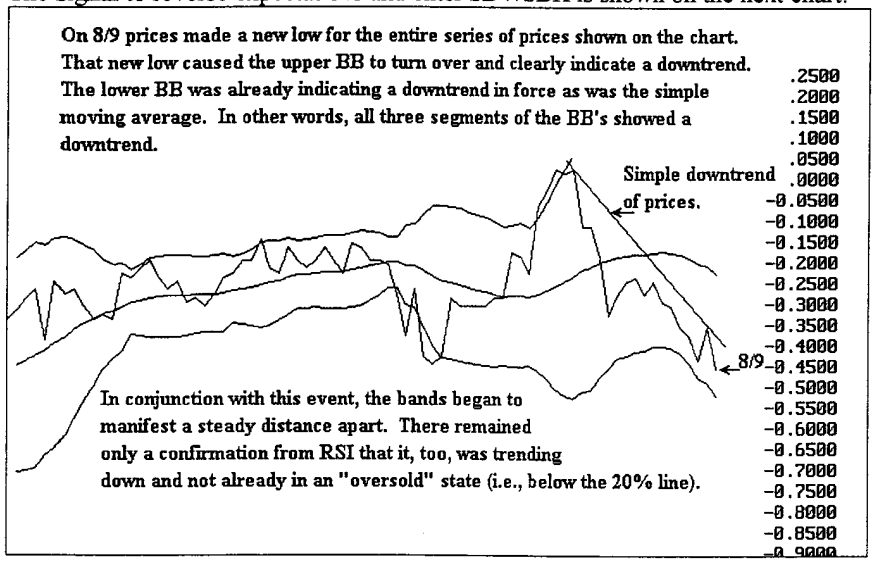


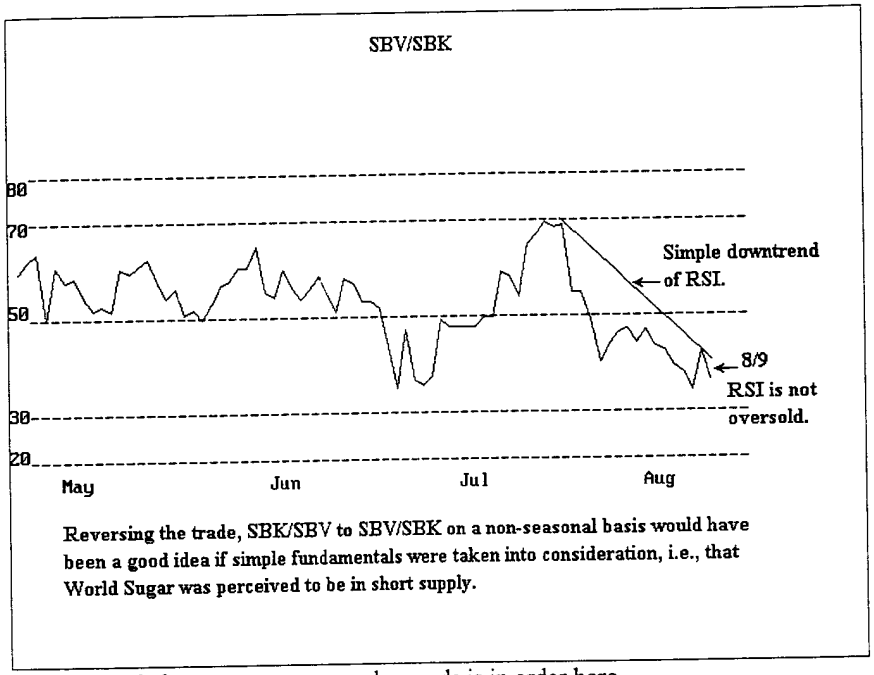
The chart above shows the final outcome of SBK/SBV at the time of the optimized entry date. Shortly after the 20 day window, there was a truly clear, non-seasonal entry signal. I would be remiss if I didn't show you this event. It will serve to make an additional point of which I feel you should be aware: Whereas a price chart always reflects all the knowledge that is in the market, it cannot possibly show knowledge that is soon to be included in the market. Nothing I know of can foretell the future.

The fact that the spread failed to act in accordance with its historical profile within the 20 day window served as a strong warning that all was not fundamentally as it should be. Although this in itself was not predictive of future price action, it still offered a situation in which great caution should have been taken with regards to the fundamentals that were underlying the sugar contracts.

There is an inherent weakness in blindly following a mechanical system. We saw that weakness in the previous Cattle trade and now again in this Sugar trade.

The signal to reverse expectations and enter SBV/SBK is shown on the next chart.





A final word about counter-seasonal spreads is in order here.

Whenever you are confronted with counter-seasonal trades, it is a good idea to extend the expectation of such counter-seasonality to all trades within the same or even related markets. It is not unusual for counter-seasonality to continue for some time. You can make some wonderful trades from markets that are moving against their normal seasonal pattern. When you see them, jump on them. You will have little if any competition from other traders. Typically, when a seasonal spread goes the opposite way than expected, there will be a substantial move, one from which you can profit greatly.

PART II

OUTRIGHT SEASONALS

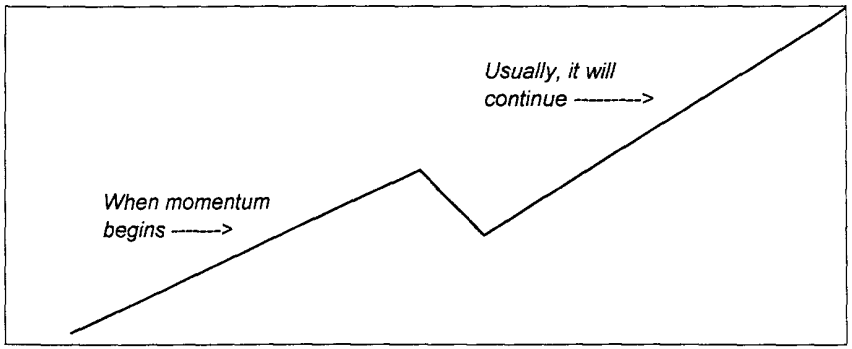
Chapter 16

Introducing Seasonals

I've been showing you concepts and techniques using line charts. I know that most of you are not as familiar with line charts as you are with bar charts.

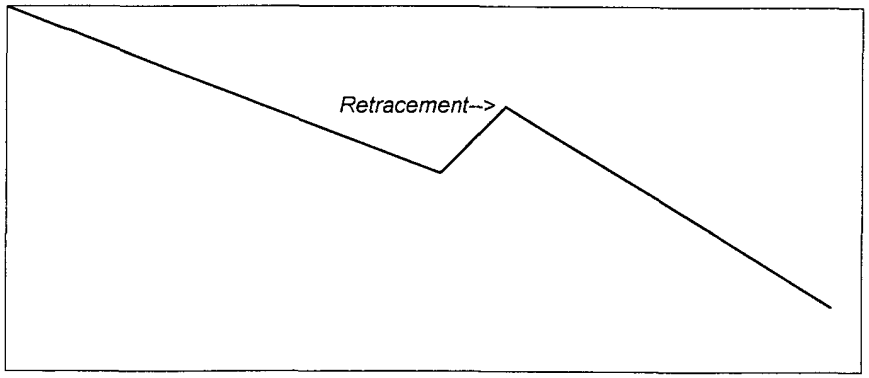
Please be aware that the techniques I've shown you regarding Bollinger Bands and RSI are as equally applicable to bar charts as to line charts. Now, in Part II, I am going to show you techniques using bar charts that are equally applicable to the use of line charts. I've chosen to show these techniques using bar charts because of most readers' greater familiarity with them.

In Trading by the Book I presented a concept that I am going to repeat here. It is one of the overriding principles of all trading. The concept looks like this:



What must be realized is, that when **fundamental** conditions exist that impart momentum to a market, most of the time that momentum will continue. This is a rather simplistic explanation and certainly there is more to it than what I've just shown. The "more" is found in the center of the chart, typically called a retracement or correction.

The retracement or correction is much shorter in time and much smaller in magnitude than the rest of the move. The causes of the retracement are several and can occur in a variety of ways depending upon the participants. The reasons, and how the participants fit into the picture, are taught at my seminars, but I won't leave you without a clue. One of the major causes of every retracement is that of profit taking.



In periods when markets are retracing, the magnitude and extent of the retracement is largely dependent upon who the participants are and their reasons for taking profits where and when they do.

I'll give you another clue, one that anyone who aspires to trade must always take into consideration The markets are driven by fear and greed, and of the two, fear is the more pervasive.

Before I introduce the various techniques and tools that I use for trading seasonals, I need to explain just what I mean by a seasonal trade.

Chapter 17

What is a "Seasonal?"

For purposes of this course, a seasonal is an outright futures trade whose main reason for entry is that it falls within an optimized window in time. In other words, the primary filter for a seasonal futures trade is a time-tested entry window.

Why Trade Seasonals?

Over a period of many years, seasonal entry signals for trades have proven to be among the most consistently effective and reliable of all entry signals. This does not mean that one can blindly enter a seasonal trade without the use of other entry filters, but when trading seasonal trades in futures, the primary rationale for the trade is the fact that it is taking place during a time period that has repeatedly proven to be a "best" time for successful entry. The chances for a winning trade are greatly multiplied.

My Own Experience

Decades ago, when I was being taught the art of trading, I was instructed to memorize certain seasonal trades. I was taught that at certain times of the year various commodities had a tendency to rise, and at other times of the year those same commodities had a tendency to fall.

In fact, much of my early trading success centered around the reliability of seasonal trades. At that time I did not have the benefit of a commercial computerized service to assist me in selecting such trades. I was taught most of them. Those in which I was not directly instructed I learned as a result of studying charts and information available from the exchanges. I also learned some of them from the work and research of brokerage firms and other traders. The entire process spanned many years of trading.

As with seasonal spreads, outright seasonal futures trades must be filtered by means other than a simple time window. In my opinion, filtering seasonal futures is more difficult than filtering seasonal spreads.

Let's take a look at the advantages and disadvantages of seasonal futures.

Advantages of Seasonal Futures

The main advantage to trading seasonal futures is the enhanced opportunity for success. Another benefit is the lack of competition in these trades. In their anxiety to get rich quickly, most traders ignore seasonality in trading futures. Although much has been written about seasonal trading, few traders have the patience to wait for seasonal windows to open a better opportunity.

Seasonal trading has the advantage of commercial power. The strong hands in the market are totally aware of seasonality. In fact, in many cases their actions are the primary factor behind a seasonal trade.

Prior to a harvest, commercial interests have a compelling reason to attempt to push down the prices of a commodity in order to be able to buy for less.

As a general rule, commercial interests are more powerful than are producers. Producers tend to be smaller and weaker than the commercials who buy their output. What individual or corporate farmer can compete financially with a company the size of some of the major food processors in the US, Canada, or Europe? Under normal circumstances, their actions, especially in commercially dominated markets such as cocoa and coffee, tend to depress prices for a period of time. That period of time, in part, gives rise to the seasonality in a particular commodity market.

When the commercial interests decide to buy, that, too, gives rise in part to seasonality in the markets.

Governments, with their various agricultural policies, can affect seasonality in various commodity markets. Governments tend to try to dissipate seasonality. By encouraging massive storage programs, governments try to even out the supply of commodities. Government subsidies and protective tariffs also tend to modify the seasonality normally extant in commodities. *Perhaps the first government intervention of this sort is recorded in Bible. The patriarch Joseph stored grains for seven years having been apprised of a coming famine that would last equally as long.*

Cartels, such as OPEC and the Cocoa and Coffee Cartels, are an attempt by producers to control the prices of commodity markets and offset the effects of commercial domination. Very often these cartels are also formed to offset the effects of government policies.

The greatest overriding factor involved in seasonality is that of weather. Weather conditions can overwhelm even the largest commercial interests, producer cartels, or governments.

Generally speaking, I like the idea that when I am shorting a market, the major interests, the strong hands in the market, are busily depressing prices. Conversely, I feel a lot better about buying a market when these same interests are eager to buy a particular commodity.

Just as there are times when the strong hands are busy depressing prices, there are periods in which the strong hands traditionally drive prices up. Once they have completed their purchases of a commodity at the lowest prices possible, having driven out the weak hands in a market, it is in their best interests to drive prices up. They love to do this at times when demand is the greatest. There are seasonal tendencies in demand as well as in supply.

Seasonal trading has the advantage of professionalism. The wise traders in the market are the ones aware of seasonal tendencies. Their actions tend to aid my cause in trading.

Funds, large pools, and institutional traders rush in and out of markets, greedily eager to grab off some quick profits. Their trading tends to be mechanical, based upon some mathematical model or computerized trading system. Much noise in the

markets is created by the charging in and out of a myriad of daytraders. Such trading is often unwise, as is evidenced by the horrendous mortality rate among such traders. The institutional traders, the large pools of money, etc., pay little attention to seasonality, lacking both patience and wisdom.

It is exactly the opposite among the commercial interests, the cartels, and the large traders. They have the wisdom of many years. They are totally aware of seasonal tendencies and they often have the power to move markets. They can do it despite the noise created by those who foolishly jump in and out of markets in a frenzied, greed-driven manner of trading. Even in those markets that appear quite erratic due to constant in-and-out trading, the undercurrent of the wise traders can be followed. They are the ones who create and maintain the trends in the markets, they are the ones who know where a particular market is going, and they are the ones, the strong hands, who can take it there.

The seasonal trader has the advantage of being in step with the wise and powerful traders. It is difficult to think of a stronger entry filter.

Disadvantages of Seasonal Futures

The disadvantage of seasonal futures trading are many, but with proper management they can be overcome. It is not my purpose to scare anyone away from the trading of futures, but happy is the trader who knows and understands what one is up against when dealing in futures. In Part III of this course, I will be discussing some of the problems encountered. At that time, I will address only those disadvantages that are peculiar to seasonal futures.

The main disadvantage to trading seasonal futures is that of being mislead or misinformed about the need for additional filters. Seasonal futures trades do not stand on their own strength. They must be filtered beyond the fact of seasonality. Such filters can be fundamental in nature, technical in nature, or both, but they must be put in place in order to increase the expectation of success.

I'm happy to say that providers of information on seasonal futures warn against blindly taking seasonal entries.
If a commodity is trading in a seasonal window that calls for a trader to sell, and that commodity is in short supply, then it would be the height of foolishness to attempt a short position in such a market. Understanding the condition of a market

before entry entails some work. It involves some research. It means you will have to exert some effort to find out at least a small amount of fundamental information about the vehicle that underlies the futures contract you are about to enter. Some traders would consider having to perform this kind of work to be a disadvantage.

To properly trade seasonal futures involves the expense of discovering which trades are seasonal. My opinion is that these are best discovered through the use of a commercial service or advisory. A trader earns money by trading so that he can pay for research. The major research into seasonal trades is best left to specialists who have the facilities for ongoing exploration of such trades.

Over time, seasonal windows can shift, appear, and disappear. Shifts, appearances, and disappearances can be attributed to local or global shifts in supply and demand, changes in weather, and changes in economic and political policies of regions and nations. To some traders, the expense of discovering and keeping current on seasonality in futures is viewed as a disadvantage.

Sources of Seasonal Futures Information

The various exchanges publish information about seasonality in the outright futures. Generally this material can be obtained at nominal cost and in many instances is free.

There are also some excellent commercial sources for seasonal futures trades. Such trades are discovered by computer analysis, and the sources are listed in Appendix C of this course.

Chapter 18

Seasonal Futures Market Selection

Although seasonal futures traders have many disadvantages from which seasonal spread traders find themselves considerably protected, there is still reason to enter outright seasonal futures trades. The effect of seasonality is so considerable that, in my opinion, it ought to be one of the primary considerations for any position trade in outright futures.

Market selection in seasonal futures is somewhat more complicated than it is in seasonal spread selection. This is because seasonal futures trading lacks many of the advantages of seasonal spread trading.

Stop running, which is not a factor with seasonal spreads, is a serious factor with seasonal futures. To a large extent seasonal spread trading avoids volatility in the market place. Not so with seasonal futures. Seasonal futures trades are fully exposed to volatility.

Seasonal spreads have the advantage of being largely unresponsive to the direction of the trend in outright futures. This is not true of seasonal futures trades. Seasonal futures trades will suffer greatly when the underlying market trends against the trader's position.

While seasonal spreads are mostly immune to explosions and collapses in the underlying futures, seasonal futures positions are much more vulnerable to explosive events and can be devastated by explosions and collapses.

Liquidity looms much more important with seasonal futures trading than with seasonal spread trading, as does treachery in markets that are controlled by a few traders, which I call "Old Boy" markets.

Whereas I would consider a seasonal spread trade in Orange Juice to be viable, I would refuse to take an outright trade in such a treacherous market no matter what the potential profits might seem to be. While I might enter a trade in the TED Spread, I would never take an outright position in T-Bills because they are much too thin and illiquid. With the exception of highly unusual circumstances, I will not trade outright seasonal futures in Feeder Cattle, Coffee, Copper, Heating Oil, or Unleaded Gas. I refuse to trade Cotton even when it is not thin because of the treachery that takes place among the "good old boys" in the Cotton Pit. Such markets as Feeder Cattle, Lumber, Value Line, Canadian Dollars, Pork Bellies, and often Coffee are much too thin to trade and should be left to those having a commercial interest. Trades in Cocoa may at times be acceptable.

I know that some of my readers will say, "Why did you leave out Platinum futures, or what's wrong with trading Heating Oil contracts?

My answer is that I can only indicate to you those markets in which I would personally consider seasonal trades. You may not agree with my choices. You may have a favorite market not mentioned in my list. You may have a commercial or hedger's interest in a market not discussed here. Certainly, you should choose to trade in those markets in which you are the most comfortable. It is generally preferable to select markets in which you have knowledge and a genuine interest.

In any case, there are plenty of markets in which to trade outright seasonal futures:

Currencies:

D-Mark, J-Yen, S-Franc, and occasionally B-Pound. B-Pound can be thin at times.

Energy:

Crude Oil, and hopefully, Natural Gas.

Grain:

Corn, Chicago Wheat, Soybeans, Kansas City Wheat, Soybean Oil.

Financial:

US Treasury Bonds, Ten Year Treasury Notes, Eurodollars.

Meat:

Live Cattle and Live Hogs (be careful with the Hogs).

Metal:

Gold, Silver.

Chapter 19

Seasonal Futures Trade Selection

Seasonal futures trades require a filtering process, as do trades in seasonal spreads. The filtering process is a bit more difficult for seasonal futures than for seasonal spreads.

Outright Seasonal Futures: The Filtering Process

Here is my filtering process:

I check to see if there is any fundamental reason for the seasonal futures to behave abnormally. I want to know if there is any news or market situation that would affect the seasonal tendencies of the trade I'm about to enter; drought, flood, shortages, oversupply, governmental decisions, political situations, etc,. In short, I want to know about anything that might affect the market and my proposed trade.

I enter a proven seasonal futures trade during a time window covering ten trading days prior through ten trading days subsequent to the usual entry date for the trade, a total time window of twenty trading days in all.

I enter the trade based upon a signal from a simple chart pattern. If such a signal does not appear, I refrain from entering the trade regardless of the probability of success. If I miss a good trade because of a failure of the chart pattern to appear, I consider that ***this*** was not my trade. The chart patterns are detailed in Appendix A.

As discussed previously, with the advent of computerized selection of seasonal futures trades and with that information so readily available, I no longer go through the process of trying to memorize them. My time as a trader is far too valuable for me to pore over ancient trading history looking for seasonal futures trades. For a small sum, I can obtain more opportunities than I would find by manually researching these types of trades.

It is also necessary to check the fundamentals when trading seasonally with outright futures. Rather than ask you to re-read Chapter 5, I'm going to include a modified version of its content in the next chapter.

Chapter 20

Outright Seasonal Futures: Checking the Fundamentals

The first step of my filtering process is to check everything I can about the general fundamentals of the underlying futures contracts relative to the time of year I propose making my entry.

For me this means looking at the most basic of fundamentals that are readily available. I've written elsewhere that as an individual trader I cannot hope to compete with the large commercial interests in gathering fundamentals. That statement remains true today.

The large commercials can afford to have agents worldwide who can go out in the fields and examine crops, research intended plantings and actual plantings, pore over government and private reports of crop conditions, weather, soil conditions, insect infestations, etc.

However, there is certain fundamental information available to the individual trader and, in fact, with the news reports available via a data feed, there is more information than I can possibly handle or want to know.

Seasonal Futures: Checking the Weather

It doesn't take a great deal of effort to turn on the news and find out the weather, not only in one's own country, but worldwide.

If there is flooding or drought in the Midwest that will affect the grains, it doesn't take much effort to find out about it. If there is a freeze in Brazil that could affect coffee or soybeans, it doesn't take a lot of research to be informed about that either. I can quite easily find out if the silver miners in Mexico are threatening a strike.

If there is trouble in South Africa that might affect the mining of gold or platinum, it will be part of the news. If OPEC is planning a meeting, energy prices are likely to be affected, and it's not difficult to find out. The news will carry tales of unrest in the Ivory Coast that might affect the supply of cocoa beans, etc.

The point I am making is as old as the hills, "LOOK BEFORE YOU LEAP." This point is in keeping with my old adage, "Trade what you see, not what you think." Any oddity in the weather is going to cause me to take a hard look at a proposed seasonal futures trade in a commodity that is eaten by someone or some thing. I am going to see if the underlying markets appear at all normal individually and relative to each other. Depending upon what I find, I may even consider entering a seasonal futures trade opposite to the way in which it was intended to be traded. I'm also going to look for the next item.

Seasonal Futures: Checking for Backwardation

One of the easiest things to spot is the reversal of the natural order of prices. This reversal is known as "backwardation" and can be seen in any newspaper that features a section carrying futures prices. For all futures contracts except interest rate contracts, the normal carrying charges (insurance, storage, interest) cause prices in the later (back) months to be higher than prices in the nearer (front) months. However, when some change in the fundamentals occurs to cause excessive demand in the front months, the prices in the front months may rise higher than those of some of the back months, causing backwardation. Backwardation is caused when someone is willing to pay a premium today to get something that they fear may be much more costly later on.

If I see backwardation in anything but interest rate futures (where it is normal for contract prices in the front months to be higher), I am immediately alerted to the fact that a normal seasonal futures trade may not be profitable. In fact, such a condition may cause me to consider going opposite to the seasonal tendency.

Backwardation in the interest rate contracts is the opposite of that in the commodities, the back months become higher in price than the front months. Backwardation there will cause me to be alerted to potential problems.

Suppose I had a seasonal trade calling for shorting January Soybeans futures. I would want to see a normal progression in prices from lower front months to higher back months because this would be the normal progression for Soybeans.

Let's now look to see if there is any backwardation in my supposed Soybean futures trade.

SOYBEAN FUTURES PRICES

January	679 1/2
March	**688 1/4**
May	**692 1/2**
July	**693**

The progression from low to high prices is normal for Soybean prices. If there is also a normal condition in open interest, I would be inclined to take this trade. The only remaining factors would then be an entry based upon an appropriate chart signal within the seasonal window.

Seasonal Futures: Checking the Position of Commercials and Large Traders

There are two sources I can look at to see the position of the major players in the markets:

1. The exchange issued "Position of Large Traders Report."

2. The open interest of Put and Call options on futures.

The normal position of commercial and large traders is to be short the various commodity markets and long the interest bearing financial futures. What I am concerned with is if the "big guys" decide to get long commodity futures (short financial futures).

This situation may or may not occur in conjunction with backwardation. Getting long commodity futures means the big guys are buying futures or selling Put options. Getting long interest rates means getting short financial futures. To do this, the big guys are selling financial futures and selling Call options.

If a major shift in open interest does occur, I will reconsider any proposed seasonal futures trades and, again, may even consider a reverse futures entry.

The Position of Large Traders Report

This report is issued once a month by the exchanges. It is not a timely report and is issued two weeks after the data are known. It becomes increasingly less reliable as time passes and the next report is due. I find that for purposes of seasonal futures trading, this report is not quite adequate. The Position of Large Traders Report is available by calling the exchanges, and is generally available from data services that carry news reports.

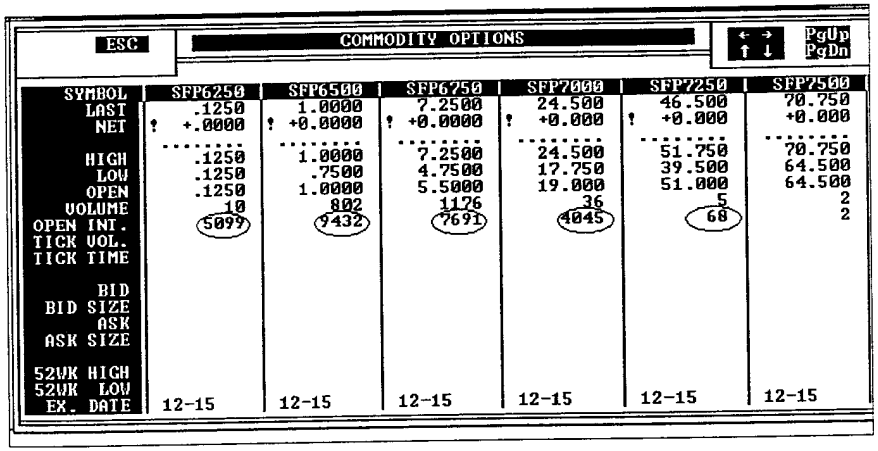
Put and Call Open Interest

A current view of the position of commercial and large trader interests can be ascertained by looking at the Put and Call open interest in options for the individual contract that is going to be included in the seasonal futures trade.

The reason for checking this factor is that the large traders and commercials are the parties who write and sell most of the available options in any market.

Put and Call open interest by month is not generally available in newspapers. As far as I know, it must be obtained commercially from data services that carry the daily reported figures. Availability probably includes every live and end-of-day data service because the exchanges release open interest by contract along with volume and prices on a daily basis. (By the way, futures and options volume and open interest figures are always reported a day late.)

I'm going to show you what I see and what I look for on my computer screen.



SYMBOL	SFP6250	SFP6500	SFP6750	SFP7000	SFP7250	SFP7500
LAST	.1250	1.0000	7.2500	24.500	46.500	70.750
NET	! +.0000	! +0.0000	! +0.0000	! +0.000	! +0.000	+0.000
HIGH	.1250	1.0000	7.2500	24.500	51.750	70.750
LOW	.1250	.7500	4.7500	17.750	39.500	64.500
OPEN	.1250	1.0000	5.5000	19.000	51.000	64.500
VOLUME	10	802	1176	36	5	2
OPEN INT.	5099	9432	7691	4045	68	2
TICK VOL.						
TICK TIME						
BID						
BID SIZE						
ASK						
ASK SIZE						
52WK HIGH						
52WK LOW						
EX. DATE	12-15	12-15	12-15	12-15	12-15	12-15

I'm interested in the numbers I've circled. Those represent the amount of open interest for, in this case, Soybean Puts at the strike prices shown at the top of the column.

ESC | COMMODITY OPTIONS | ← → ↑ ↓ PgUp PgDn

SYMBOL	SFP6250	SFP6500	SFP6750	SFP7000	SFP7250	SFP7500
LAST	.1250	1.0000	7.2500	24.500	46.500	70.750
NET	! +.0000	! +0.0000	! +0.0000	! +0.000	! +0.000	+0.000
HIGH	.1250	1.0000	7.2500	24.500	51.750	70.750
LOW	.1250	.7500	4.7500	17.750	39.500	64.500
OPEN	.1250	1.0000	5.5000	19.000	51.000	64.500
VOLUME	10	802	1176	36	5	2
OPEN INT.	5099	9432	7691	4045	68	2
TICK VOL.						
TICK TIME						
BID						
BID SIZE						
ASK						
ASK SIZE						
52WK HIGH						
52WK LOW						
EX. DATE	12-15	12-15	12-15	12-15	12-15	12-15

Supposing I had the same seasonal trade discussed under the topic of backwardation. The trade was to get short the January contract for Soybean futures on a seasonal basis. Since I found that the normal progression for prices was in effect, and assuming there is no news that would prevent me from taking this trade, I would then begin examining the options open interest for Soybeans. First I would look at the open interest of the near and at-the-money strike prices in the January Soybeans. Since the commercials are usually short Soybeans, the normal position for them to be in the options would be to be short Calls, or short futures. For the market to be normal, there should be significantly more Call open interest than Put open interest. If this were not the case, I would be alerted that there may be something abnormal going on, perhaps something I have not picked up from the news. It may mean that I have to dig further into the fundamentals of the Soybean market.

With Soybean futures at 679, and prices generally rising, Put open interest for the first three strikes below the market (625, 650, and 675) totals 22,222 contracts.

Now let's look at the open interest for the three strikes above the market on the January Soybean Calls.

The Call open interest for those three strikes (700, 725, and 750) totals 23,367 showing that the commercial interests in Soybeans are **not** overwhelmingly short. If they were, I would have expected them to write many more Calls. Call open interest exceeds Put open interest by only a small amount. This may indicate that the commercials are neutral or are themselves long this market.

ESC | COMMODITY OPTIONS | ← → ↑ ↓ PgUp PgDn

SYMBOL	SFC6250	SFC6500	SFC6750	SFC7000	SFC7250	SFC7500
LAST	54.500	30.500	12.000	4.0000	1.3750	.5000
NET	! +0.000	! +0.000	! +0.000	! +0.0000	! +0.0000	! +.0000
HIGH	62.500	38.500	17.500	6.3750	2.2500	.8750
LOW	54.500	30.000	12.000	3.7500	1.3750	.5000
OPEN	62.500	36.500	16.000	6.2500	1.8750	.7500
VOLUME	2	149	867	1119	824	107
OPEN INT.	1924	6241	7279	12050	5536	5781
TICK VOL.						
TICK TIME						
BID						
BID SIZE						
ASK						
ASK SIZE						
52WK HIGH						
52WK LOW						
EX. DATE	12-15	12-15	12-15	12-15	12-15	12-15

This is **not** the normal condition I would expect for Soybean futures.

I would now be alert to the possibility of an inverted seasonal trade. I would feel unable to proceed with the trade based upon the factor of options open interest even if everything else were correct.

As it turned out in actual practice, Soybeans continued to rise higher for some time due to an unusual demand for them. Had you not looked at any fundamentals, the lack of an excess of Calls over Puts in this market was sufficient reason for you to seek additional information on the fundamentals of Soybeans.

Chapter 21

Seasonal Futures: Time Window

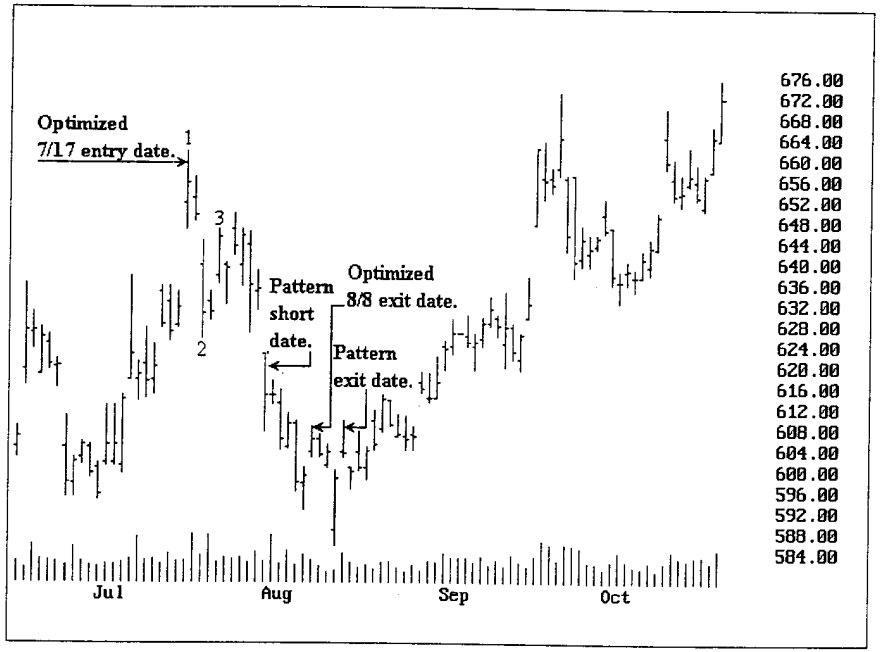
Seasonal futures trades work best from a window in time. Computer generated seasonals offer an optimized entry date and an optimized exit date. I have found, and the providers of such dates state, that you shouldn't enter a trade based solely upon optimized dates.

That is why I use a time window of twenty trading days based around an optimized entry date. Of course, sometimes I miss good trades that fall in line before or after my preferred window. I assume these trades were not meant for me and look elsewhere for opportunities.

Sometimes the optimized seasonal dates produce better results than my seasonal window, but most times, my seasonal window produces the better results. That's why I continue to use them.

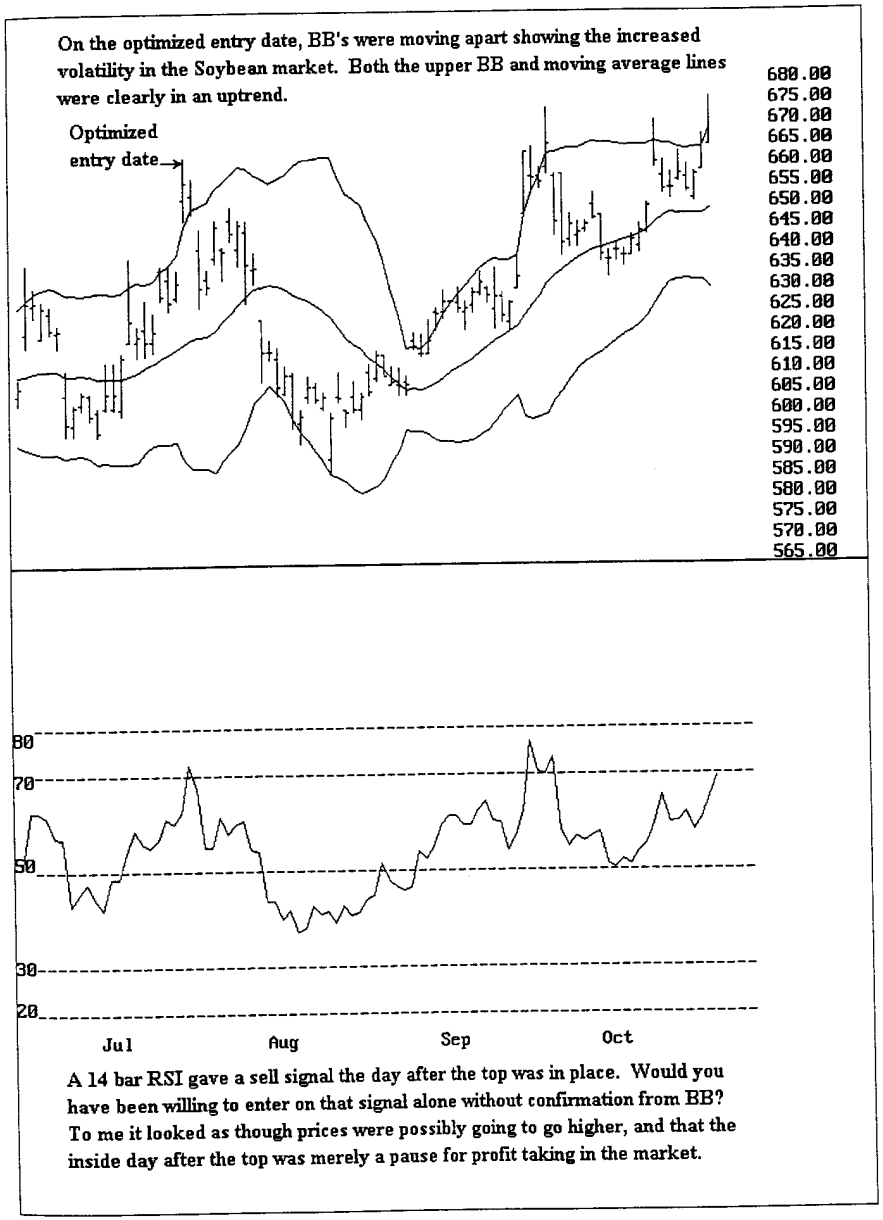
The results using my entry window are similar to those for seasonal spread trades. The following comparison charts will show you that sometimes the optimized dates are better and sometimes my own window is better.

A trade to get short November Soybeans on 7/17 and exit on 8/8 was previously unknown to me. As you can see by the dates, this seasonal tendency does not last all that long. Yet Moore's research reports this trade as having worked in 13 out of 15 years for an 86% accuracy rating.



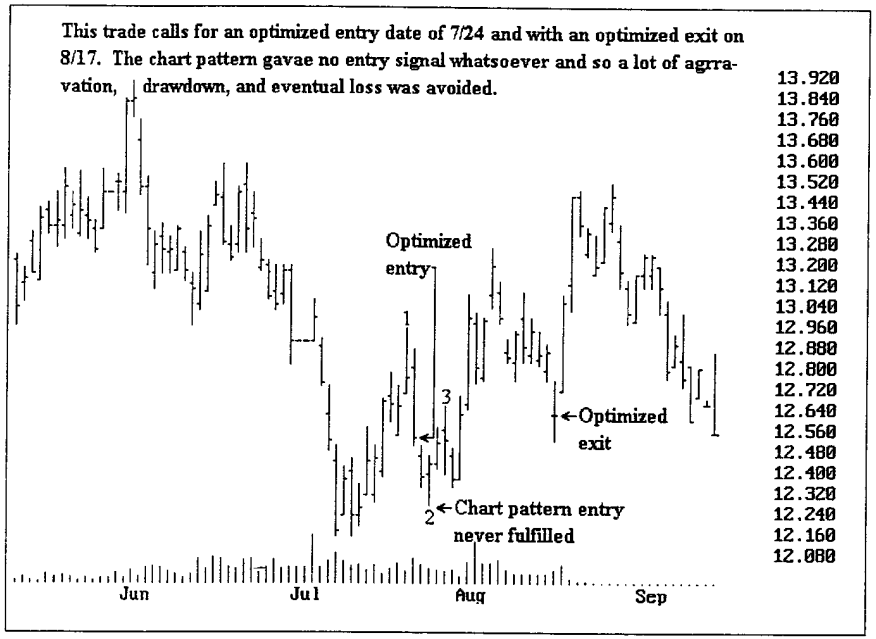
It would have been difficult to come up with a better entry date than the optimized entry date for this trade. Following the chart pattern would have resulted in less of a gain and not quite as good an exit. The only way the optimized exit date could have been better would have been if it came 3 days later than it did (8/11). The entry date to go short was the top of the market at that time.

As long as I get my piece out of the middle, I'm happy. But there is no question on this trade that had you taken the optimized entry date you would have made more money. However, that entry date does not take into account any filters that might have been used. Depending upon which filters were used, the trade might not have been as good as was the pattern trade, and the trade might not have been entered at all. For instance, look at the following chart:



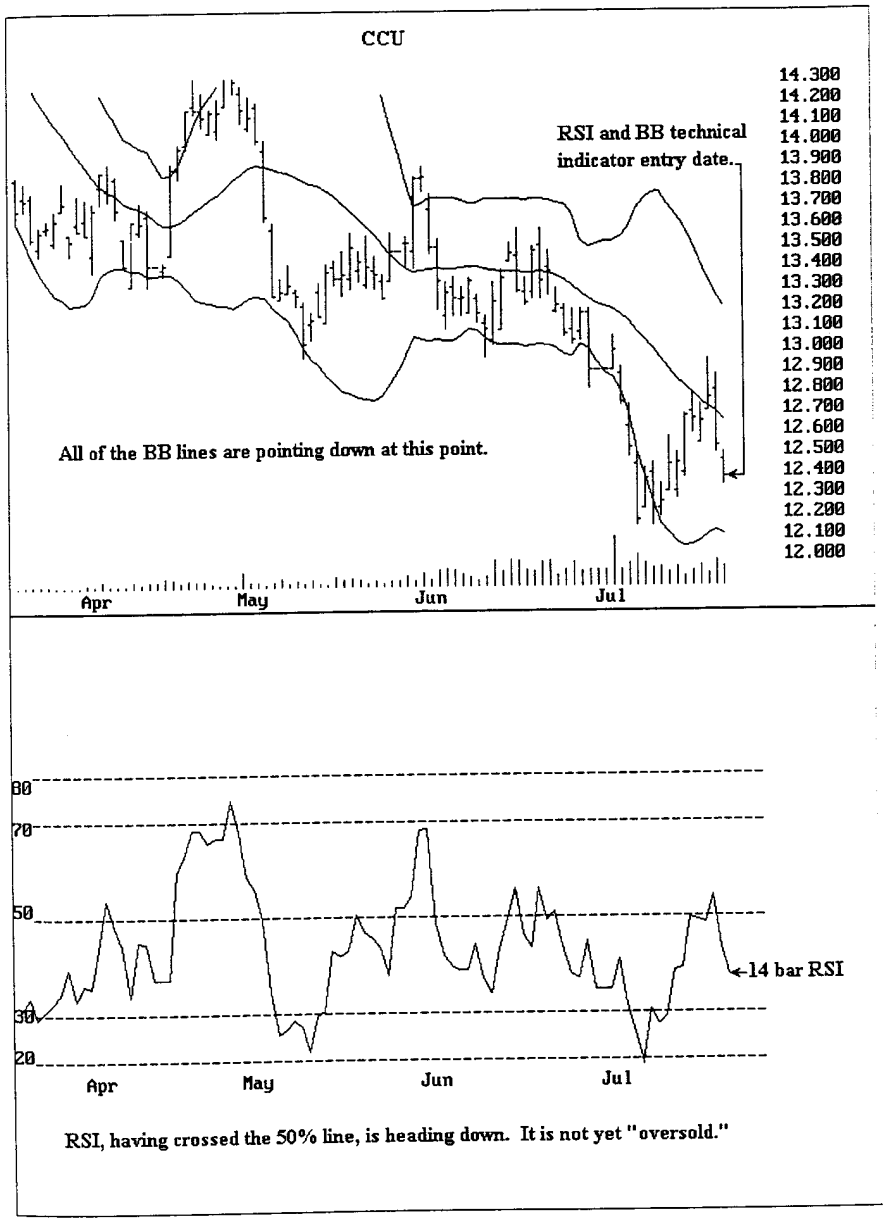
So you see it's all a matter of perception. No one gets all the trades. No one always can pick tops or bottoms. There is no perfect way to trade.

Here's another seasonal futures trade. Again, it is short term, and one I would not have known about without its being computer generated. The trade has worked 13 out of 15 years, i.e., 86% accurate based upon the optimized entry and exit dates. The trade calls for shorting September Cocoa.



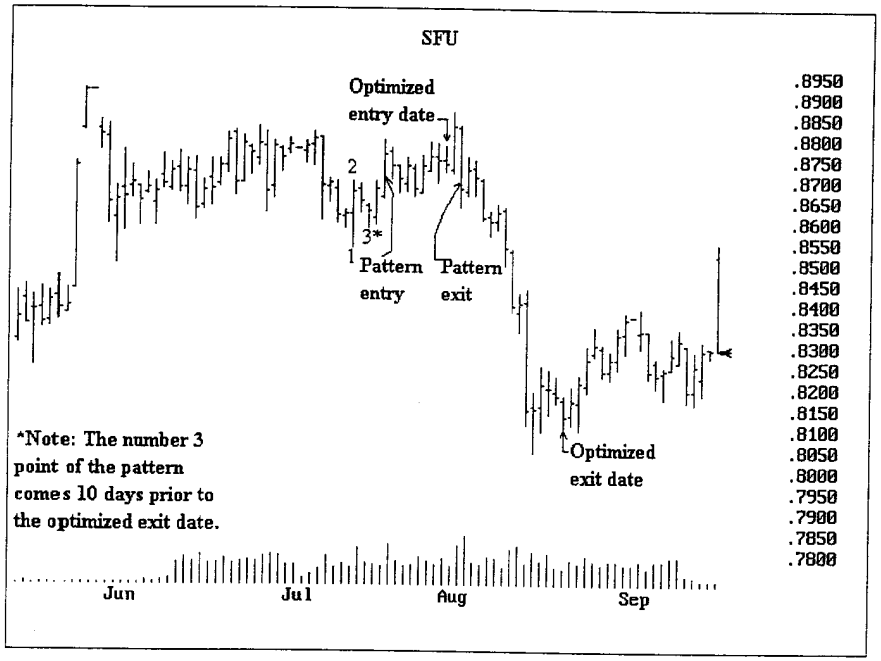
This trade never fulfilled any chart pattern and so no trade was made. However, in this case no trade was better than a trade taken from the combination of Bollinger Bands and RSI.

Unfortunately, these technical indicators, BB and RSI, gave an even worse signal than did the optimized entry date. You can see what happened on the next page.



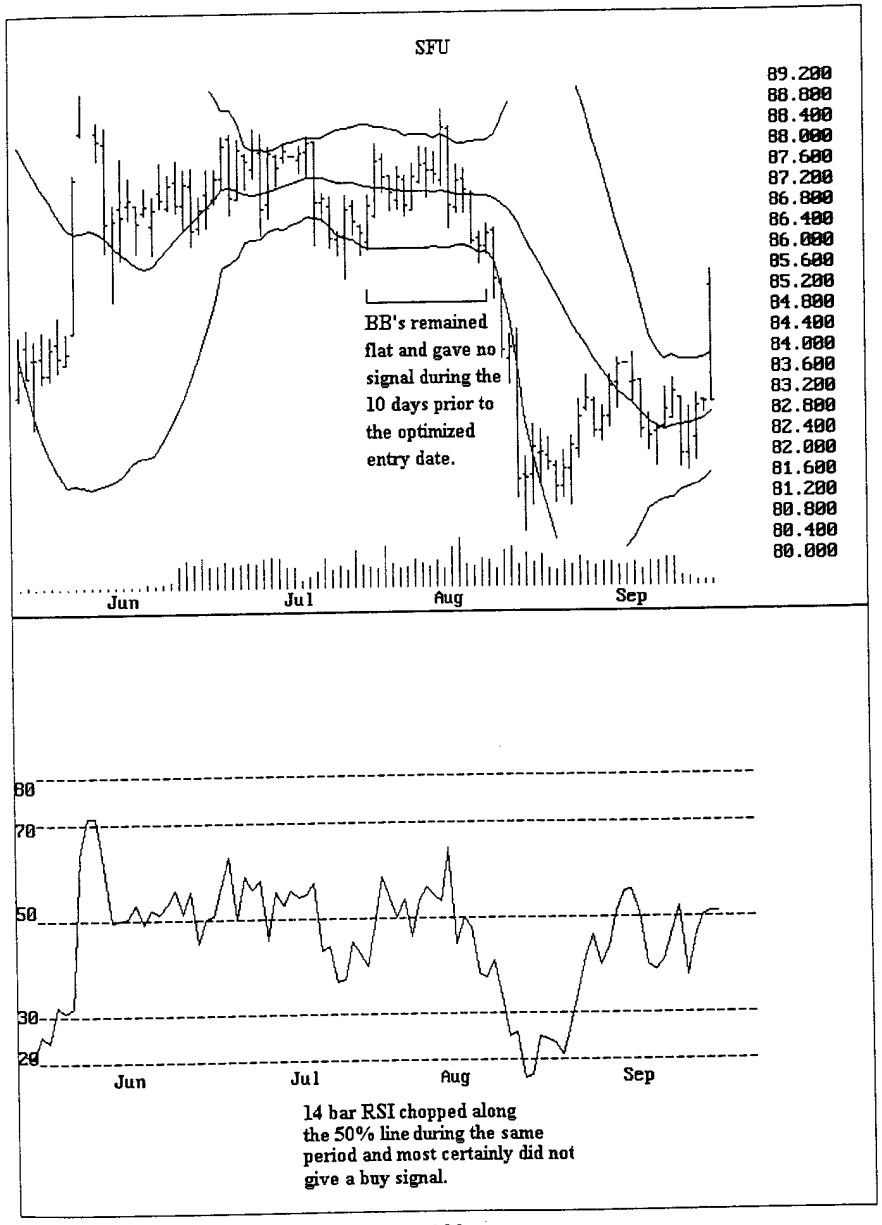
The third trade I'm going to show in this chapter involves another trade I would not have known about without the benefit of computer optimized seasonality.

This trade calls for buying the September Swiss Franc on July 31, and selling it on August 22. This trade has 80% accuracy and has worked 12 out of 15 years.



Can you see that the pattern entry, if made at the exact prices shown by the arrows, would have resulted in a breakeven or small loss? The optimized entry date would have gotten you into this trade the day before the high of the Trading Range was made, and the optimized exit date resulted in a disastrous trade.

In this case, the best trade signal of all was given by the Bollinger Bands and the 14 Bar RSI. Because neither one of them gave any kind of a signal at all, you would not have entered the trade. I have shown how the market looked during the entire 20 day window up until contract expiration.



In this chapter I've tried to show you that there are no perfect methods for filtering. The best overall for my own trading has been chart pattern entries.

In the next chapter I'm going to show you how to use chart patterns coupled with Bollinger Bands.

Chapter 22

Trading Seasonal Futures with Chart Patterns and Bollinger Bands

As we begin this chapter, I want to remind you that the techniques I show here are equally applicable to the trading of seasonal spread charts. I have had much success using chart patterns in conjunction with Bollinger Bands. The bands are used to enhance what I see in the chart patterns and not the other way around. In other words, the chart patterns are able to stand on their own, but the bands are used to provide information I am unable to see in the chart patterns themselves. The Bollinger Bands are not able to be used in and of themselves for entry and exit signals. There must be a filter, non-correlated to the greatest degree possible.

Why Use Bollinger Bands with Chart Patterns?

Bollinger Bands are an excellent measure of volatility. They are closely related to the volatility measurements used in options trading models, where volatility is considered to be of utmost importance.

In truth, an options model is only as accurate as its ability to accurately compute true historical volatility. Bollinger bands come as close as anything I've ever seen to accurately giving a pictorial view of historical volatility.

Bollinger bands offer a way to see a statistical measurement that would otherwise be quite difficult to ascertain in any other manner. That measurement is the location of two standard deviations.

Why is this important?

Two standard deviations give an excellent profile of where approximately 96% of the price action will be contained. Pure statistics dictate that if you measure two standard deviations from a 20 bar moving average of the close, you will see containment of 96% of those closes. This represents knowledge of major significance to a trader.

If a chart pattern yielding 65% accuracy in being correct for entry signals is coupled with an indicator containing 96% of the price action at the close, then an entry technique based upon the chart pattern and the Bollinger Bands should yield a method that is 62.4% (96% x 65%) accurate in calling tradable entry signals. If a chart pattern is accurate 80% of the time, then coupling those chart pattern signals with an indication from the Bollinger Bands should offer a method that is 76.8% (96% x 80%) accurate in providing a good entry signal.

Of course, entry signals represent only a small part of trading. It is what you do once you are in the trade that counts. It is trade, risk, money, business, and personal management that should make up the bulk of a trader's activity. Exiting properly is far more important than anything one can do at entry. Entry can be done with the flip of a coin or by throwing a dart at a dart board. If the trade is properly managed thereafter, the chances for a win are far greater than if a high probability entry signal is coupled with a poorly managed, poorly exited trade. Unfortunately, most traders spend the majority of their time looking for the perfect entry signal, and thoroughly neglect all other matters of management on the mistaken idea that if they can make the perfect entry, everything else will work itself out and they cannot fail to win.

Bollinger Bands are also useful as an overbought/oversold indicator. In my opinion, they are every bit as accurate as any other indicator purporting to measure overbought/oversold. Overbought/oversold indicators give an accurate picture of this so-called condition only when a market is moving sideways. Once a market begins to trend, they are virtually worthless as far as being accurate for the overbought/oversold condition. As a market trends, these indicators simply wobble along in the overbought or oversold area, continuously giving false readings until such time as the market begins to move sideways once again.

Bollinger Bands also give excellent overbought/oversold signals when a market is moving sideways in a Trading Range. As prices approach the upper or lower bands,

they will often bounce off of those bands and head back across the channel toward the opposite band.

When a market begins to trend, eventually the bands will begin to trend, offering a far better indication of what is taking place than is available from overbought/oversold oscillators. As we go through the various charts in this section, you will see the validity of what I'm writing here. When you see prices hugging a Bollinger Band, and the Band is trending, you *know* you are in a trend.

However, Bollinger Bands do not offer a very accurate picture of momentum. They are far too sensitive for that. When a market has been moving sideways for awhile, almost any sizable move will send prices scurrying from one band to the other. This situation was seen in the chapter on combining Bollinger Bands with RSI. Quite often, prices seemingly rushed from one side of the channel to the other, while RSI failed to confirm what appeared to be great momentum. The reason for the inaccuracy of Bollinger Bands to properly record momentum is that in a sideways market, any sizable one day price move is going to show a major deviation from a moving average of price moves.

This brings me to a final advantage of using Bollinger Bands. They are extremely sensitive to sizable one-day price moves. This means the bands will respond relatively quickly to the beginning of a trend, or to the ending of a trend. When properly assessed in conjunction with chart patterns, a trader can obtain an excellent visualization of what is happening in a market.

Over the years, the more I have used Bollinger Bands, the more I have come to rely on them for a broader and more in-depth picture of the markets I observe. I use them on daily, weekly, and monthly charts. In recent years I have used them on long-term charts to pick up major moves in Gold, Eurodollars, and British Pound. However, none of those were seasonal trades.

Since this is a course on seasonal trading, the situations and charts I will be showing pertain strictly to seasonal trades. Seasonality has been a major filter for me since I began trading almost four decades ago. However, be aware that even if you are not using seasonality as a filter, these techniques are still valid. They can be used on intraday charts as well as weekly and monthly charts.
Seasonality is not really a factor on intraday charts, and it has limited use on weekly and monthly charts. When trading those, I generally have to forego the benefits of seasonality.

Understand, also, that the series of trades that are illustrated in this chapter are not meant to impress you with the "magic" of trading with this method. I have not included here a bunch of spectacular trades with which to impress you. In my trading career, the vast majority of trades have been mundane. I try to make my living from the day to day trading that occurs in the day to day markets.

I know professional traders who have never made the really "big" score. They don't have time for that. They take their piece of what they can get, realizing that even the smallest win is a victory because it means they didn't lose.

Each trade included in this chapter is designed to teach a lesson. Each is designed to bring home to you the things I look for. Each has one or more points to make. All of these trades exhibit the exercise of discipline. I hope, also, that you will see that consistency is the key to successful trading. I recently received a letter from one of my students which I will print here for you, because it gives me a great thrill every time I hear from a student who is finally making it in this tough business.

"Dear Joe, I have just finished reading Trading Is a Business for the umpteenth time and it seemed appropriate to write and thank you for the insights contained therein.

"I have been trading consistently since May and have never had a losing month in that time. They have not all been brilliant successes, mind you!

"It has taken a while, but it finally dawned on me that the patterns are less important that the context in which they occur. In the right conditions the techniques have a greater probability of success. As a result I am able to take entries in a strongly trending market (S&P) with no more than six ticks at risk. Some of my friends think that I am crazy, but I do not care because it works.

"Also, I have performed exhaustive back testing of different exit techniques with the hope that one would prove to be better than the rest. You know what I discovered? They produced different results on a trade by trade basis, but overall the results were so similar as to make little difference. Then the light came on. The key is be consistent!"

Dear readers of this book, please take the preceding comments to heart. And now onward and upward.

Why Not to Use Bollinger Bands With Chart Patterns

If you are the type of trader who requires lots of action, the combination of chart patterns and Bollinger Bands may provide too much of a filter for you. You may have to wait longer than you would like to see situations in which the seasonal

window, the chart pattern, and the Bollinger Bands are all signaling an entry. Invariably, such entry signals will rarely be at the very inception of a move. However, such signals will pick up major moves in the markets. Very often, getting your piece of a major move may turn out to be worth more than getting a large piece of a lesser move.

It is up to you as an individual trader to work out those levels in which you find yourself most comfortable. We are not all the same. There are traders who need and thrive on the action down on the trading floor. At the other extreme, there are traders who quite happily and contentedly trade from monthly charts. I have a European student who was quite pleased being continuously long via the S&P 500 monthly chart for a period extending over 5 years the last time I spoke with him.

Some traders have a tendency towards great caution in their trading and others are ready to throw caution to the winds if they feel they are "on a roll."

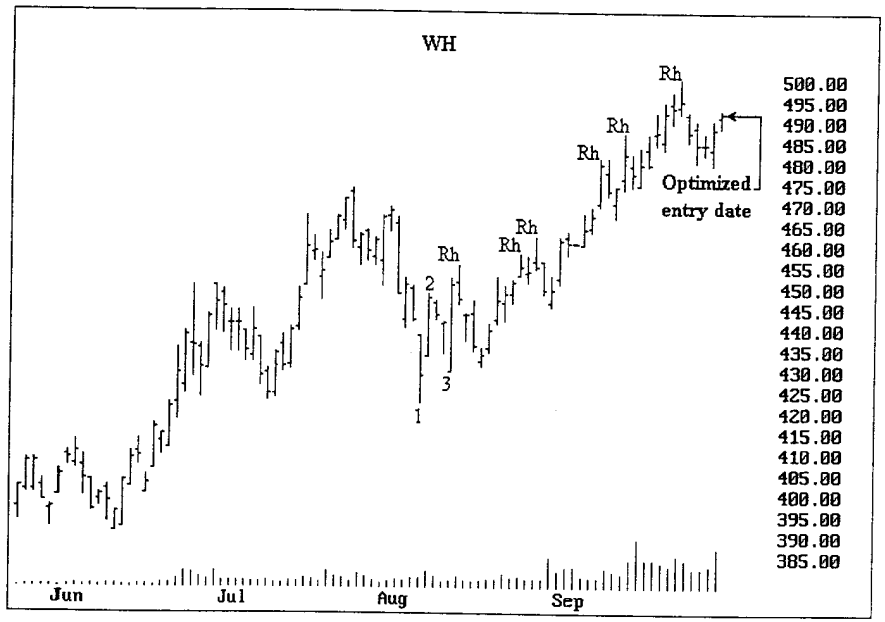
The entry method under discussion in this chapter requires that an entry formation confirmed by the Bollinger Bands takes place within the time frame of a seasonal window. Such occurrences will not be frequent. If you do not have the patient endurance to wait for these, then you will need to use one of the other methods presented in this course.

I present this method here because there are mature traders who appreciate the greater potential of this type of trading filter and who are willing to wait for the greater certainty of the move.

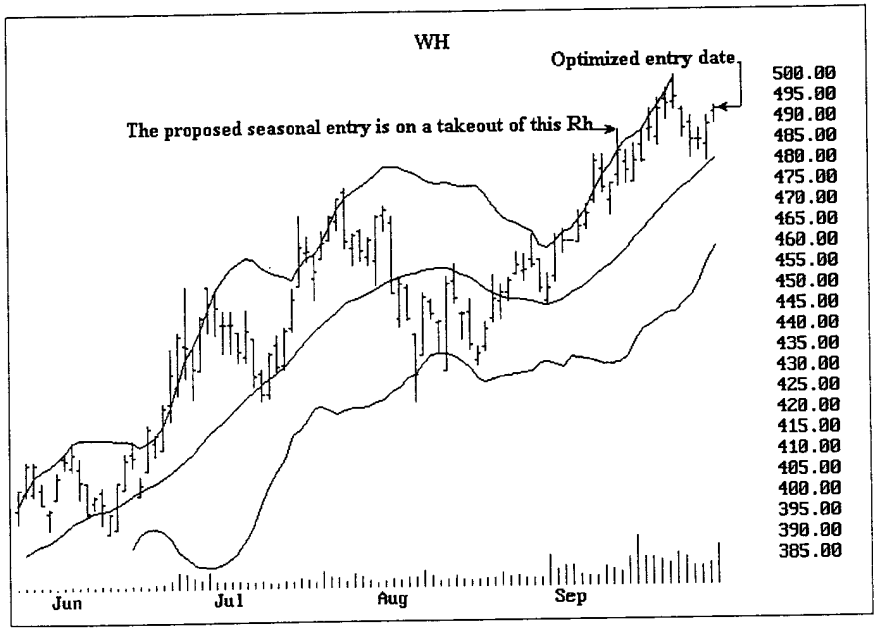
Bollinger Bands: A Wheat Trade

The following trade surprised me when I read about it in Moore's research report. I am used to selling December Wheat on a seasonal basis in late summer or early fall of the year. However, Moore's report calls for purchasing March Wheat in late

September. I was previously unaware of this trade. However, it has worked in 13 of 15 years for an 86% accuracy based upon the optimized entry and exit dates.



Beginning with the intermediate low, I count a 1-2-3 formation. Thereafter, every retracement that does not create a newer low than the previous retracement's low results in a Ross Hook (Rh). At the time, ten days prior to the optimized entry date, I would normally enter on a breakout of the high of the most recent Rh. That means I would be attempting entry on a breakout of the Rh just prior to the last one shown as the highest high on the chart. That signal is in and of itself a good signal. Now let's see if we can gain any depth of information from a look at the Bollinger Bands.



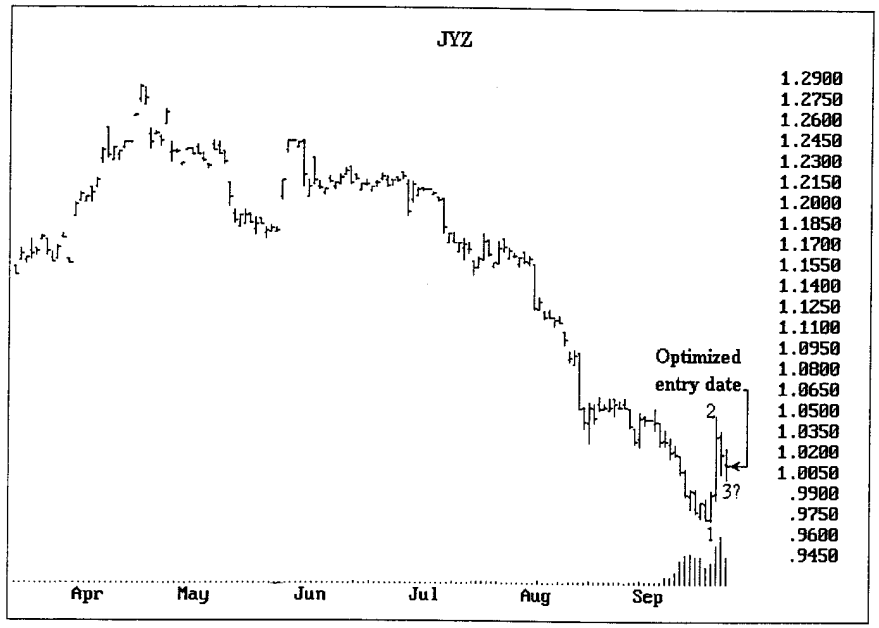
The Bollinger Bands are indicating an uptrend in progress at the time of the proposed chart pattern entry. Notice that all three lines are in an uptrend. Prices are hugging the upper band line and remaining constantly in the upper channel. Volatility is also confirming the uptrend. When the Bollinger Bands are both trending in the same direction and stay at relatively the same distance, it is indicative of moderate volatility, exactly what should be found in a strongly trending market.

The Bollinger Bands are in every way confirming an entry at the breakout of the Rh.

Had a choice been made to enter this trade based upon the optimized entry date, the Bollinger Bands were still confirming the uptrend, although in and of themselves they are not giving a buy signal.

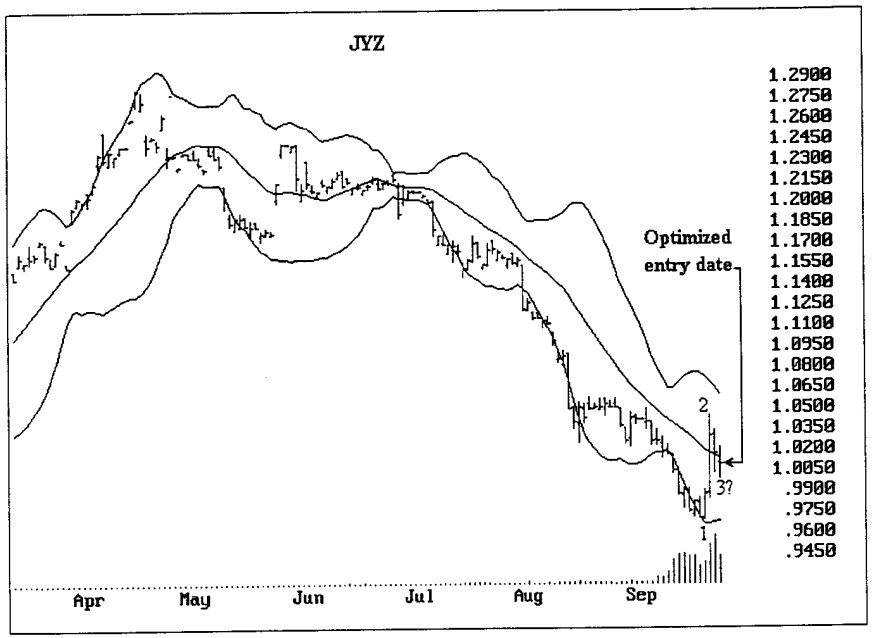
Bollinger Bands: A Yen Trade

The next trade using chart patterns and Bollinger Bands involves buying the Japanese Yen. This trade has an 80% chance of success if held from the optimized entry date until the optimized exit date. Those dates call for entry in the last week of September and exit in the third week of November. The trade has worked 12 of 15 years.



At the time of the proposed entry date, a chart pattern is just beginning to form. It is not yet clear whether or not a #3 point has been made. As much as ten days prior to the optimized entry date, there was no buy signal of any kind as the market was clearly in a downtrend.

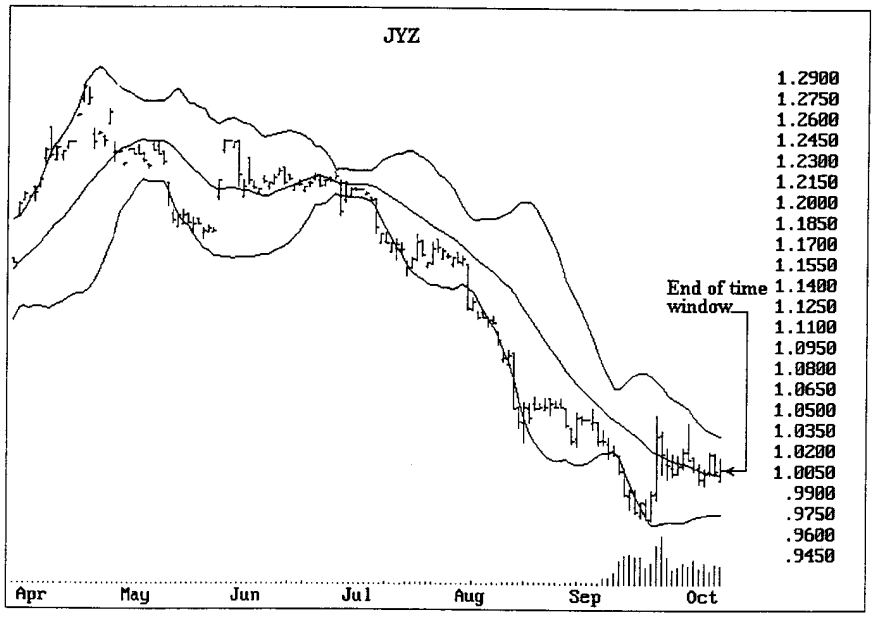
Now let's look at what the Bollinger Bands are telling us.



Notice that the lower Bollinger Band has turned in. The two bands are coming together in a pincer-like movement. This signifies decreasing volatility and is a hint that the market may begin to move sideways for awhile. The bands had been fairly constant in their distance apart, but recently they became somewhat volatile and are now narrowing. The combination of these two factors having this kind of action is typical of at least a temporary market bottom. As you look back at the chart, you can see that virtually every sideways step in this market has been associated with bands displaying similar characteristics.

The chart pattern is also revealing here. The extra long bars at the recent bottom are indicative of a change in momentum. This, too, occurs at market bottoms. I would not trade a breakout of the #2 point unless I had much confirmation from the Bollinger Bands that an uptrend was soon to be in progress.

Now let's look to see if at any time during the 20 day entry window a buy signal occurred for this seasonal trade.

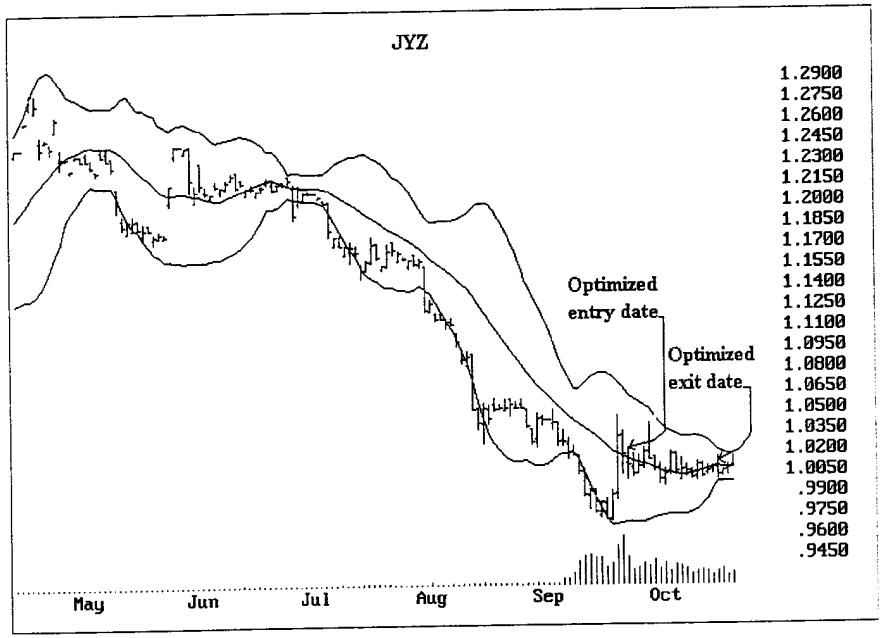


At no time during the 20 day window did a signal arise from either the chart pattern or from anything visible from the Bollinger Bands.

The bands have narrowed and at least the lower band has definitely gone flat. The moving average is flat as well.

No trade has been possible based upon the technique for filtering used here.

Let me show you one more chart that takes us beyond the exit date as set out for this trade. It will help you to see the action of the Bollinger Bands as they move into an extended Trading Range.



Looking at the chart between the time of the optimized entry date and the optimized exit date, we can see an ever decreasing amount of volatility. By the time shown at the end of the chart, we have never had an entry chart pattern, and the Bollinger Bands are about as narrow as they can get.

When the Bollinger Bands become extremely narrow, volatility is very low and this situation portends a soon-coming expansion of volatility. The breakout from this extended congestion could go either way. There is no way to predict the direction based upon what we see here.

The seasonality of this trade failed to materialize. An entry on the optimized entry date would have produced a small loss by the time of the optimized exit date. The filters for this trade have worked well to keep us out of the market.

Bollinger Bands: A Soybean Trade

The next trade I'm going to show you reveals what can happen when a trader flies in the face of not only his indicators, but the fundamentals as well. It is a seasonal trade in Soybeans in a year when demand for all grains was much greater than supply. This condition was easily ascertained from even the most cursory scanning of agricultural news. The trade calls for selling November Soybeans during the second week in September and buying them back in the first week of October. Commercial interests are usually hammering down Soybean prices during this time period just ahead of the bulk of the US harvest. As mentioned previously, even the strongest interests cannot overcome the forces of supply and demand, weather, or any other real fundamental reason for a market to behave the way it does when such fundamentals truly exist.

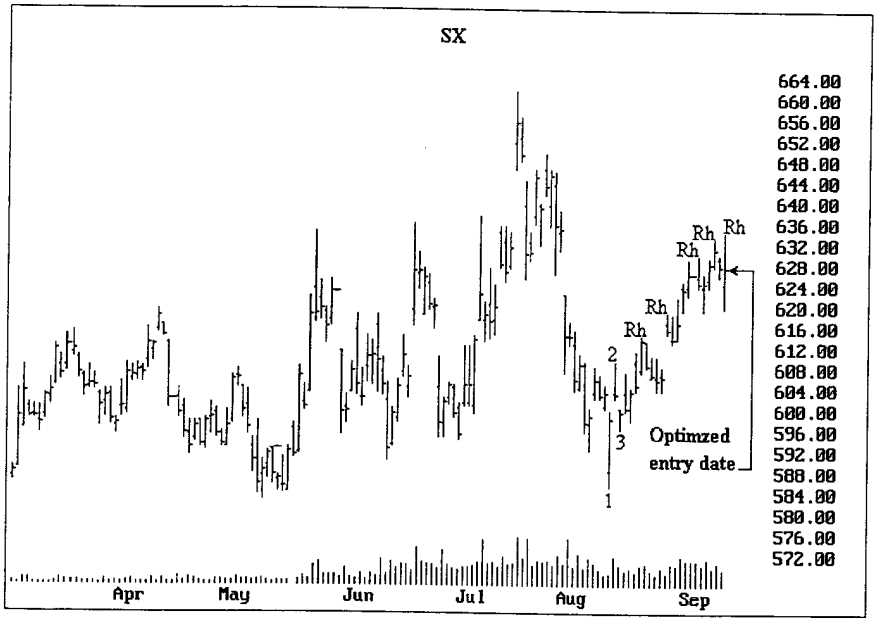
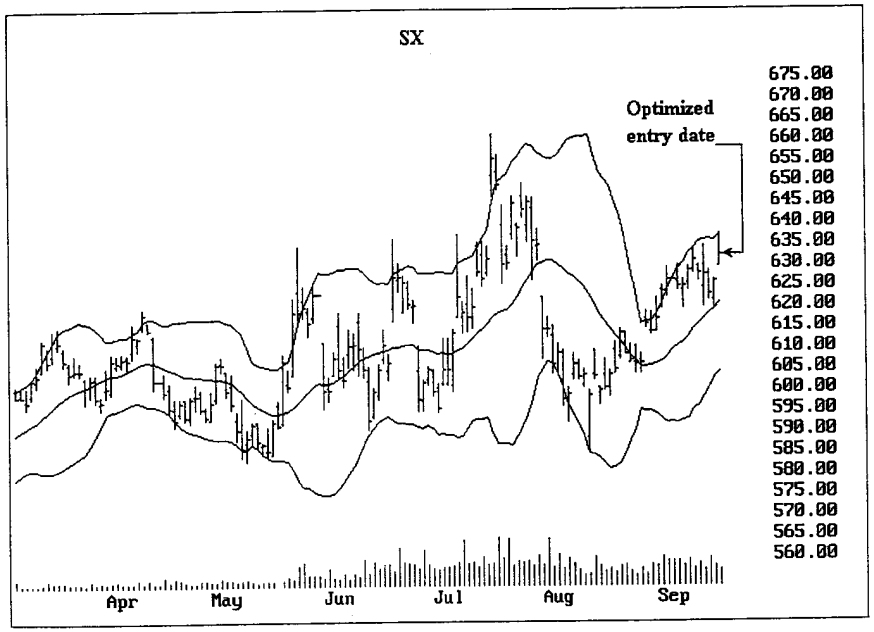


Chart patterns for this trade indicate a steady uptrend beginning with a 1-2-3 formation followed by a series of Ross Hooks. Certainly not a situation that lends itself to selling. Even as early as 10 days before the optimized entry date, there is no chart pattern indication to go short.

The Bollinger Bands confirm our conclusions.

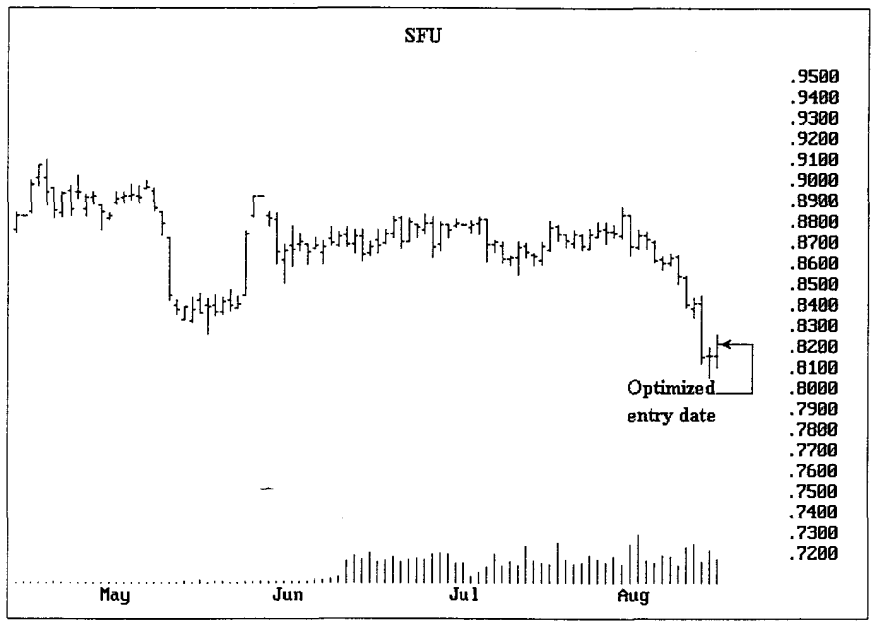


At all times during the initial 10 days of the window, including the optimized entry date, all aspects of the Bollinger Bands are indicative of a trend in progress. At the expense of being repetitive, both bands are trending, as is the moving average. The upper and lower bands are remaining at approximately the same distance apart, indicative of moderate volatility and a trend. Prices remain in the upper channel.

The market is trending. Add to this the fact that grains in related markets such as wheat and corn were in short supply. These factors when taken together give a strong indication that seasonality is not in effect.

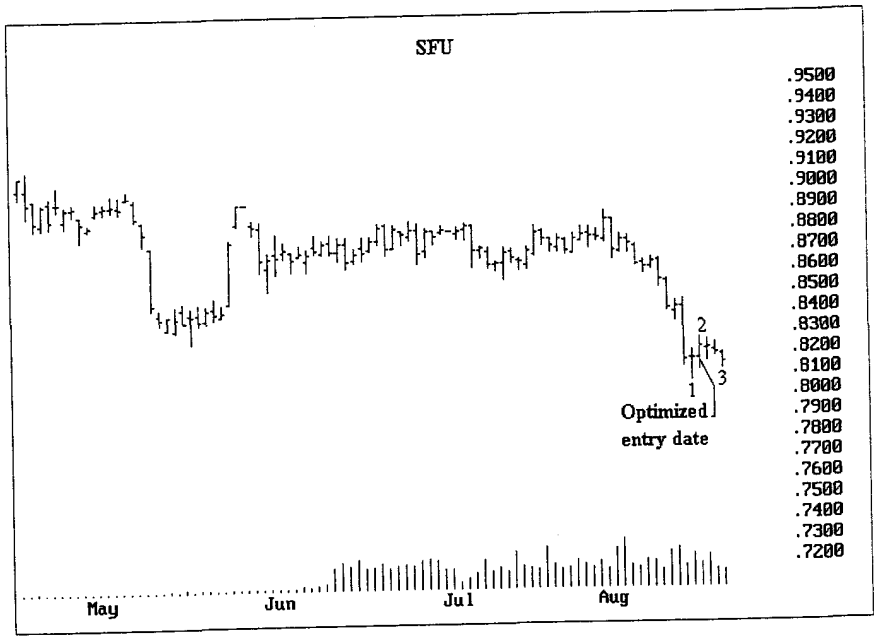
Bollinger Bands: A Swiss Franc Trade

This next trade in the Swiss Franc is entered in mid August with an optimized entry date of 8/17. The trade calls for getting long December Swiss Francs almost one month prior to expiration. With that much time left, getting long December Swiss Francs would put you into a mighty thin market. I would prefer to enter long into the September contract and roll over into the December contract at such time the trade warrants continuation and the Volume and Open Interest in December exceed that of September. In currency trades I am particularly interested in liquidity, and December does not offer that liquidity until much closer to first notice day. First notice day for the currencies takes place in mid September.

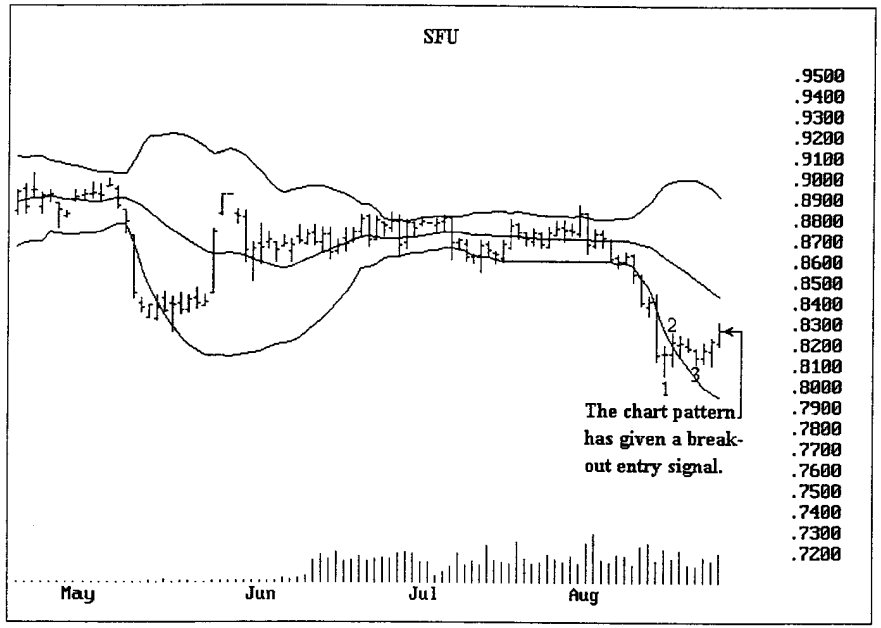


From ten days prior to the optimized entry date, until that actual date, there were no entry signals based upon chart patterns. As you will soon see, the optimized entry date turned out to be just about the perfect time to have entered this trade. Before we can make any judgments, we need to see the entire trade, including whatever patterns might develop in conjunction with the Bollinger Bands.

It is rare to get the benefit of an entire move. If we can manage to get "our piece" of the move I will be content. Let's see what happened.

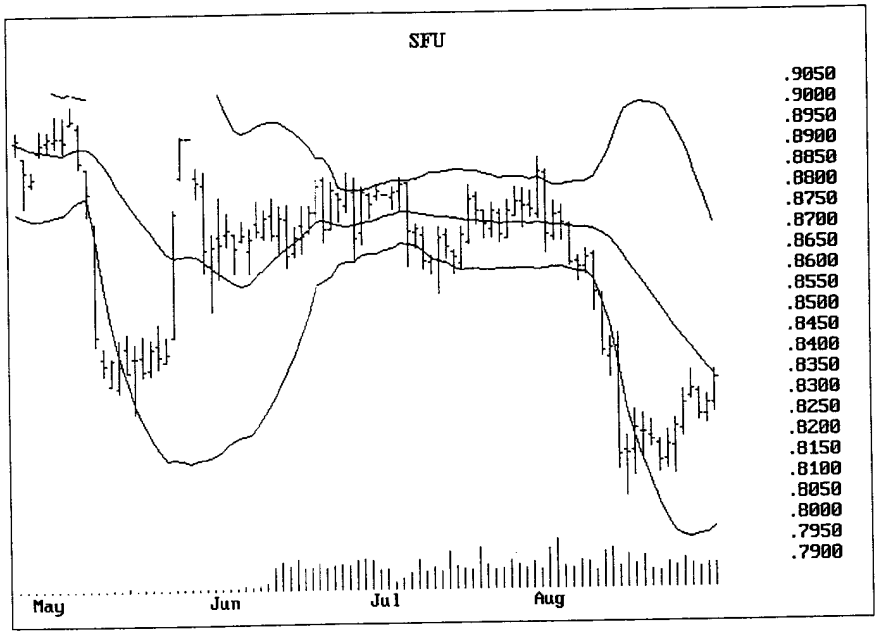


Shortly after the optimized entry date a 1-2-3 low takes place on the chart pattern. If we so choose, we can enter this seasonal trade on a breakout of the #2 point. But because we are also filtering these trades with Bollinger Bands, we will have to wait until some sort of confirmation comes from them.



We have an entry signal from the chart pattern, but at this time all of the parameters of the Bollinger Bands are still indicating a short position is in order. Discipline for this method dictates that we stay out of the market. If we are going to use a method, we need to be consistent in staying with our strategy and carrying out our tactics.

Not always, but often, patience has its reward.



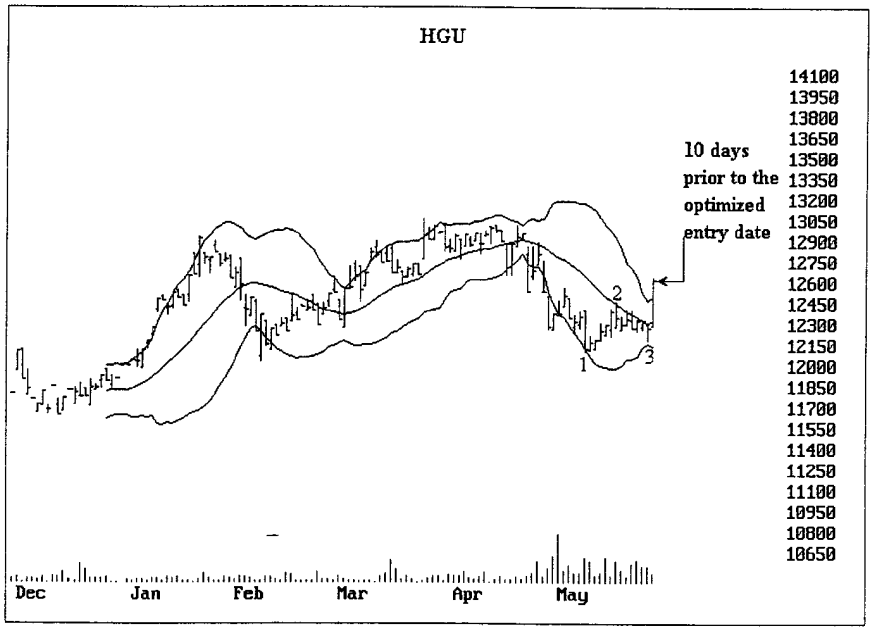
During the 20 day window allotted for entering this trade, Bollinger Bands never gave a confirming signal. We never managed to get our piece of the move. Does that bother you? Does that disappoint you? Do you think you must now run out and change parameters so that you do get an entry signal?

Has much been missed by not getting into this trade? In my opinion, no! An optimized entry would have delivered 118 points up to the last bar shown on the chart where my own 20 day window is closed. A few days later (not shown) witnessed the disappearance of all that paper profit, and a panicky exit could have ended up with an actual loss.

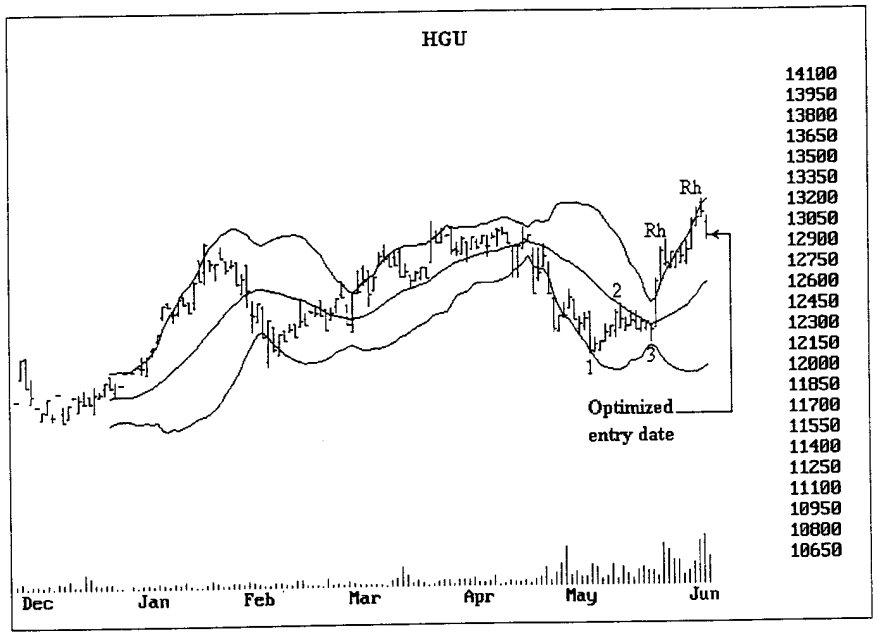
Now, let's look at one more outright seasonal futures trade. I will show you one in Copper. Although I personally do not trade outright futures in Copper, others do, and there is particular lesson I want you to see.

Bollinger Bands: A Copper Trade

At the beginning of this chapter I said that only from time to time would a trade come in which an entry pattern, confirmed by the Bollinger Bands, takes place within a seasonal window. Now let's look at this trade in September Copper so you can see for yourself that such things do happen. The trade called for entry at the end of the first week in June. The optimized entry date for the year shown was 6/6, with an optimized exit date of 7/25.

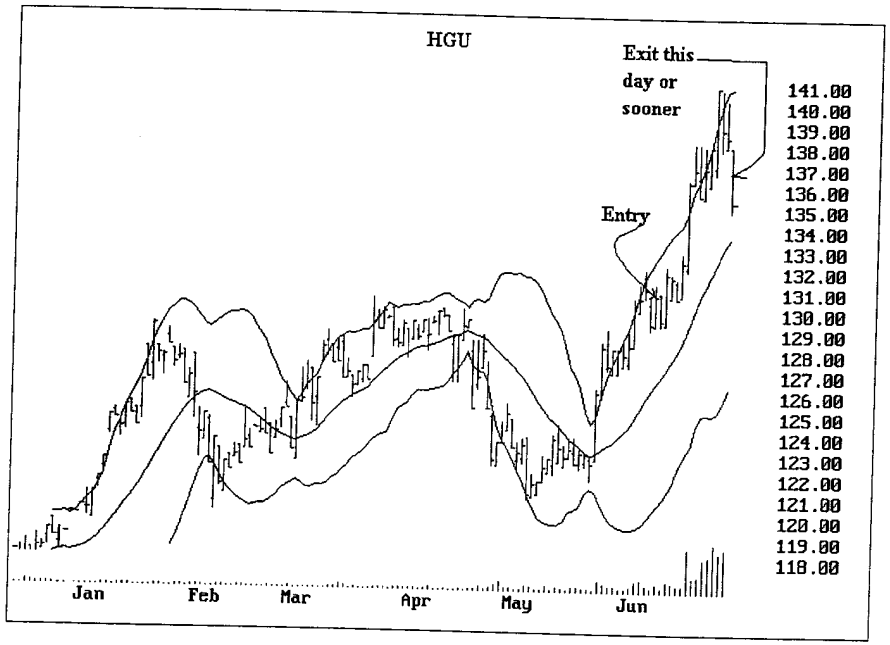


Immediately prior to the opening of the 20 day window, prices formed a 1-2-3 low and on the very day the window opened, prices thrust upward taking out the high of the #2 point of the 1-2-3 pattern. At that particular time the Bollinger Bands had just reached a narrow flattening out indicating low volatility. We might say that all components of the bands were just about flat.



A second Ross Hook is formed on the very day of the optimized entry date. By this time, the Bollinger Bands are giving a strong entry signal. All three components have turned up. Prices remain in the upper channel and have been hugging the bands. The 20 bar moving average is indicating an uptrend, and the lower band has also turned the corner and is pointing up. If I traded Copper, I would enter this trade by attempting to get back into the longer term trend at the earliest practical moment that affords me the momentum of the market to help my cause. Any break-out of the high of a correcting bar signals an entry into the trade. For example, a breakout of the high of the correcting (retracing) bar, the last one shown on the chart, should cause entry, because for prices to take out the high of that bar would be an indication that momentum is now back in the direction of the trend.

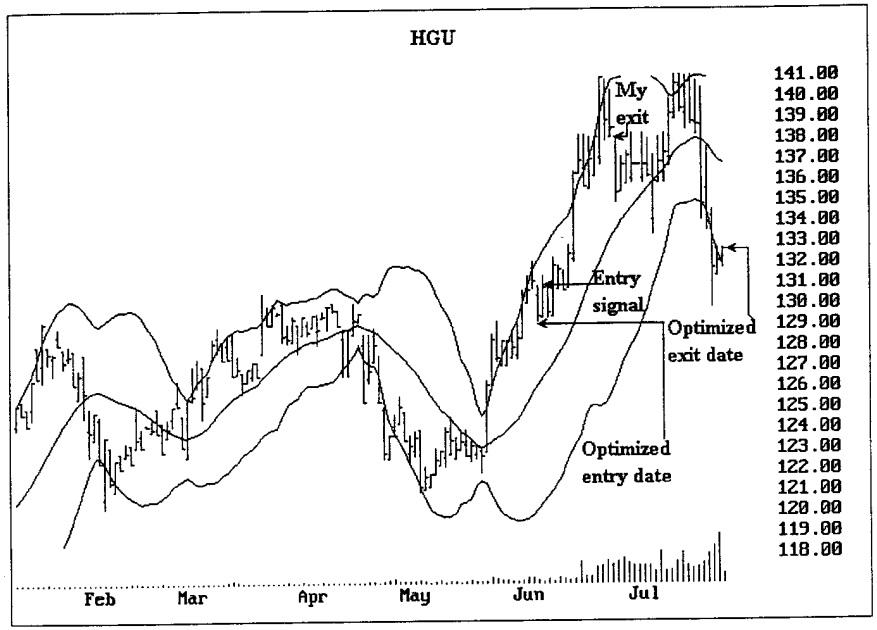
Let's see what happened to the remainder of this move. Did it work, or did it fall apart? Can a trader get a piece of the action? Will what is obtained have been worth the wait?



It turns out that it was possible to get a nice chunk of the move made in copper. Everyone has his own way of getting out of a trade. That is why I labeled the chart "exit this day or sooner." In my opinion, exit should have been made on that very day having given back less than most people. The reason I say that is because as soon as prices began making lower tops, in the way I trade I would have begun tightening my exit point by moving it closer to the price action. Of course, this gets me stopped out more often than it does someone who is willing to keep his exit stop further back. But tightening the stop when I see a decent profit for a trade has worked for me and suits my comfort level.

Notice there was no signal from the Bollinger Bands themselves.

One more question comes to mind. What would have been the result had a trader stayed with the trade until the optimized exit date? Would he have done better? Worse? Won more money? Lost money?



Even using only the optimized dates, this trade gave you a piece of the market. I've shown where I think I would have gotten out. I think that because each day that the market failed to move higher, I would have tightened my stop. You may have some other way that is more suitable to your own style of trading. If so, and if it works for you, then stay with it. Consistency is very important to your trading.

PART III
REALITY TRADING

Chapter 23

Thinking and Trading Go Together

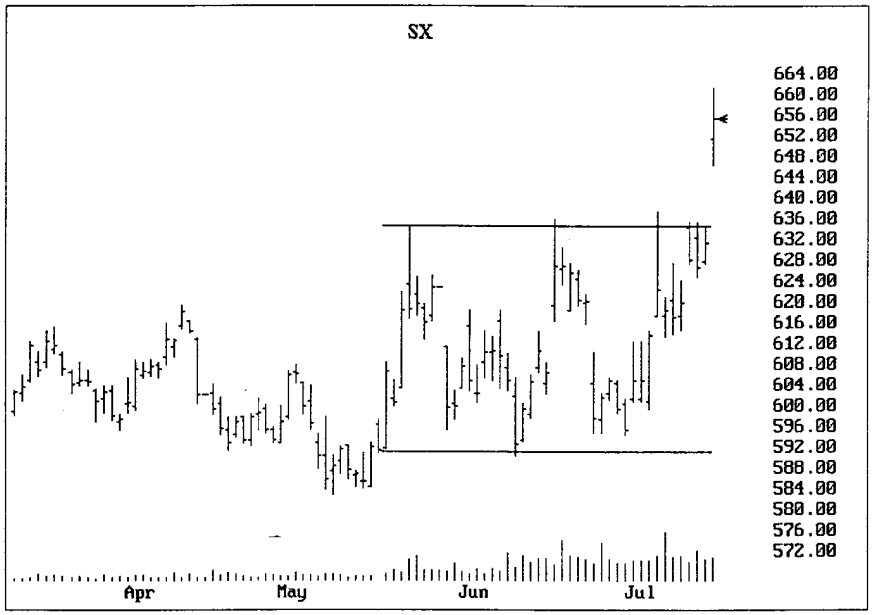
So far in this course we have looked at a lot of definitions, rules, and techniques. My intention has been to give you a realistic look at seasonal trading. In this section we need to look at the concept of "how to trade the trade."

Entry technique is all well and good, but it is only a small part of trading. A much more important aspect of trading is that of having a strategy and then deploying the tactics that will fulfill the intent of that strategy. In other words, now that you're in the trade, ***what do you do next?*** Of course, the use of seasonality is part of our strategy and the main concept behind what we've been looking at, but what are the tactics we can use to keep losses small and maximize wins? What can be discerned from careful inspection of a chart as the trade progresses? What problems might we run into during the course of a seasonal trade, etc?

To bring these things to light, I am going to look at some additional seasonal trades and at least one of the trades we looked at previously. We will in effect revisit them to see how we might have improved on them. We will use outright seasonal trades because we want the use of standard bar charts. Bar charts and outright seasonals reveal the kinds of problems we are likely to encounter, whereas line-type spread charts are not subject to such problems as stop running and the perception of many other traders. We will use any or all of the tools previously discussed, only this time we will be less mechanical and more interpretive. We're going to start looking at these charts the way a trader really should view them. We want to glean all the information we can as the trade runs its course. We may bend a few rules or even

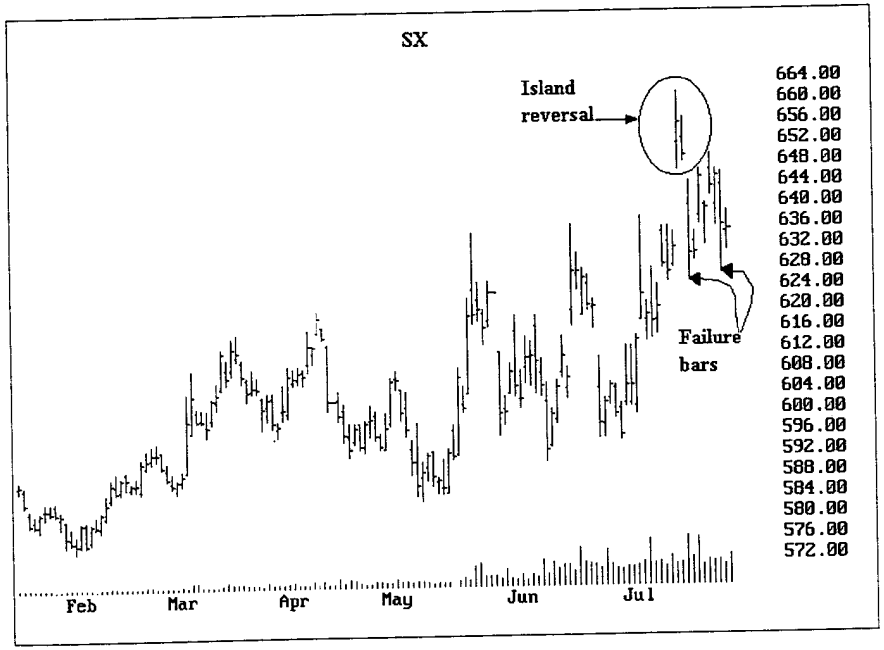
throw a few out, because real trading is that way. That's why I have called this section of the course REALITY TRADING.

Do you remember the trade from Chapter 21 in which we had a seasonal signal to get short November Soybeans on 7/17? Let's look at that market again, only this time we'll back up in time to show more of what immediately preceded the optimized entry date.



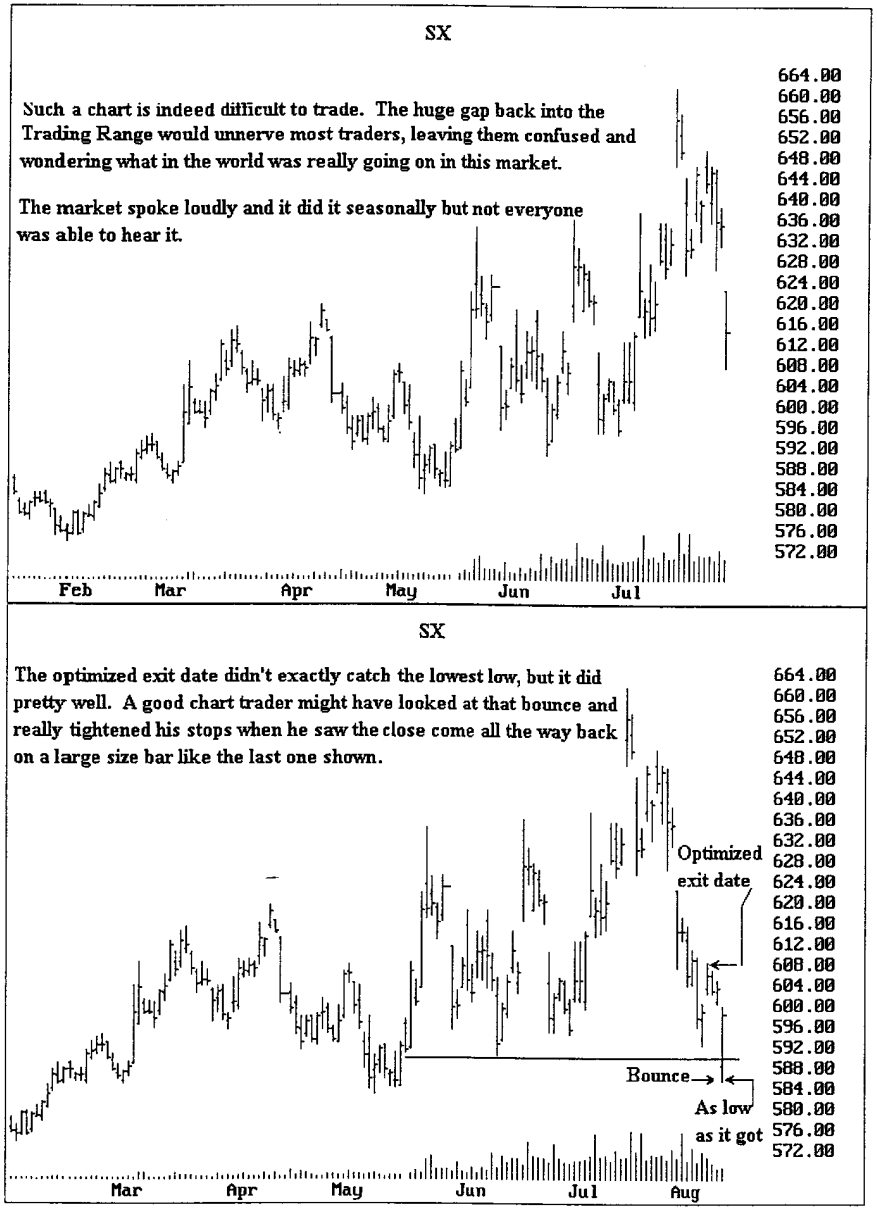
From this picture we see that Soybean prices had been moving sideways in a major Trading Range just before the explosive breakout day. That breakout came in conjunction with a weather scare. It could be seen in all the grains, but the one grain most affected by the news was the Soybeans, because the scare came at a time that is crucial to the growing cycle of Soybeans.

However, a few days later, when the scare failed to materialize, Soybeans started inching back towards the former Trading Range. In fact, the gap up was quickly closed leaving an island reversal at the top of the chart. This represented a massive pattern failure, leaving the chart as you see it below.



Although there was no way to have improved on the optimized entry date because it called the exact day of the top, the chart, without benefit of anything else, was saying, "think about getting short."

The reality is, that even with the knowledge of the failure, the trade would have been difficult to enter. Why? Because unless you had entered short during the few days of congestion following the failure, you would have been looking at a chart like the one at the top of the next page.



Contrarian Trading

From time to time, it becomes clear that a particular market is not going to behave seasonally. What makes it clear? Unexpected backwardation, unusual weather, a known shortage, a strong trend in the direction opposite to which you would expect the market to be moving, a trending market at a time when you would normally expect prices to be in congestion, or congestion when you would normally expect a market to be trending. Obviously, this type of information precludes your being ignorant of the basic fundamentals of the market in which you are attempting to trade seasonally. At times, when it becomes clear to you that the market is behaving abnormally, it may be practical to consider trading the opposite way because the changes in fundamentals preclude any hope of using a seasonal filter.

In my experience there have been a number of years in which, for one reason or another, individual markets, entire complexes, and even the majority of market groups, failed to behave seasonally.

Such behavior invariably can be explained by changes in the underlying fundamentals governing supply and demand. When it becomes clear that such is the case, the seasonal trader can choose to sit on the sidelines or trade on the knowledge that trading with a seasonal filter just isn't going to work.

I believe that in such situations, the reasons for trading counter-seasonally are very strong. So strong, in fact, that the probabilities for success are as great or greater than they would be for taking a seasonal trade, and most certainly greater than for just entering a market based on one's opinion or a signal from some technical indicator.

I mentioned earlier that there have been years in which the underlying fundamentals precluded any reasonable expectation of seasonality. In fact, an attempt to trade using a seasonal filter would be the height of foolishness.

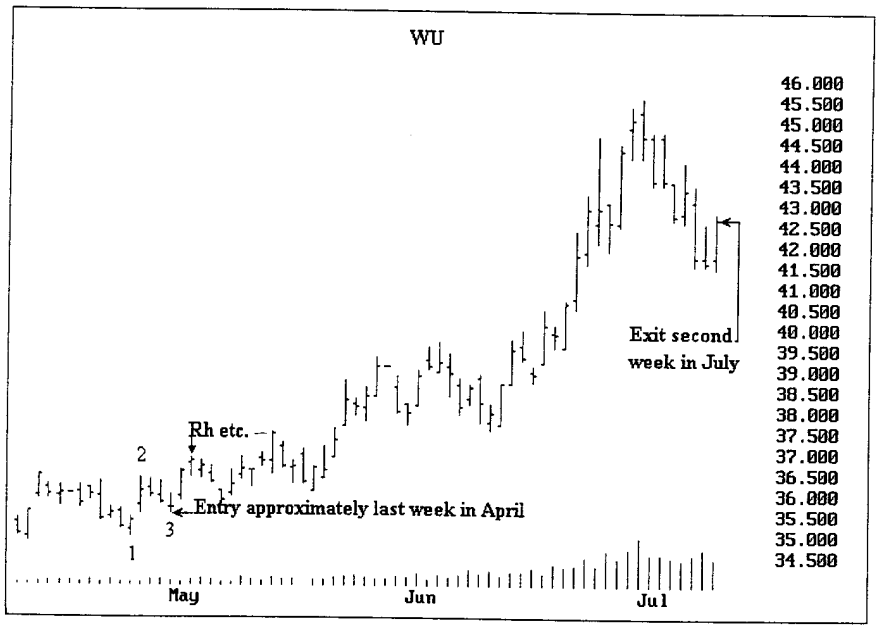
We've looked at a few counter-seasonal spreads earlier in the course. Now let's look at a very powerful counter-seasonal move in the grains.

The move to which I refer took place in the wheat market. At the beginning of the year, worldwide wheat reserves were lower than they had been in many years. The

previous year's wheat harvest had been lean, and the demand for wheat was quite strong, in part because of a similar shortage in the reserves of all grains. It was hoped that the wheat harvest would be plentiful, but for the second consecutive year, the worldwide wheat harvest was poor in both quality and quantity.

In such a year, would anyone expect wheat to behave seasonally? Of course not! Wheat gave a wonderful opportunity to be a seasonal contrarian.

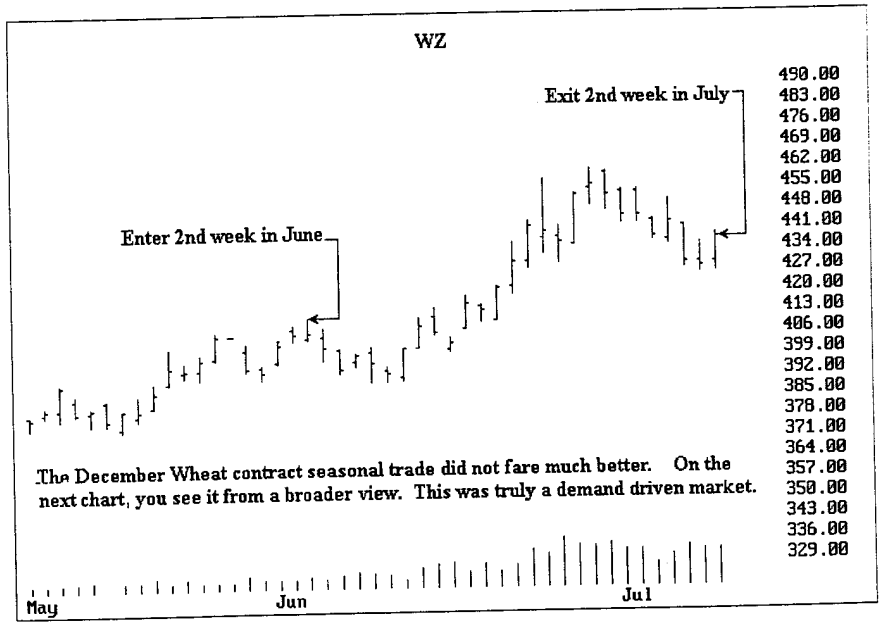
Let's look at a series of seasonal Wheat trades that call for ***selling*** Wheat futures to see what happened to those trades. We'll look at seasonal ***short*** trades that were called for ***after*** it became known that the Wheat harvest was going to be poor for a second consecutive year. Along with the poor condition of the crop came the knowledge that wheat reserves were lower than they had been in 40 years. This knowledge became available in early March of the year.

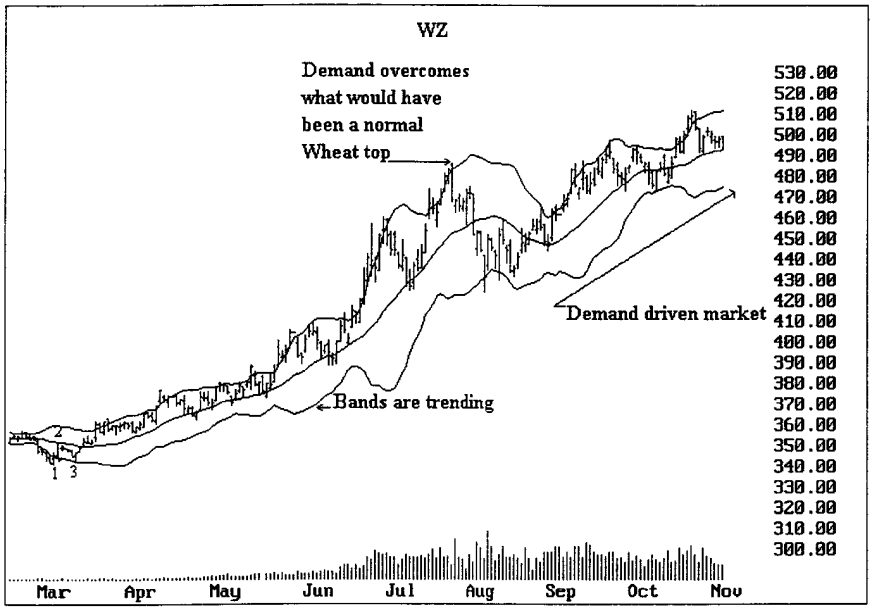


The first trade calls for selling September Wheat during the last week of April. Coincident with this trade were the following seasonally optimized trades:

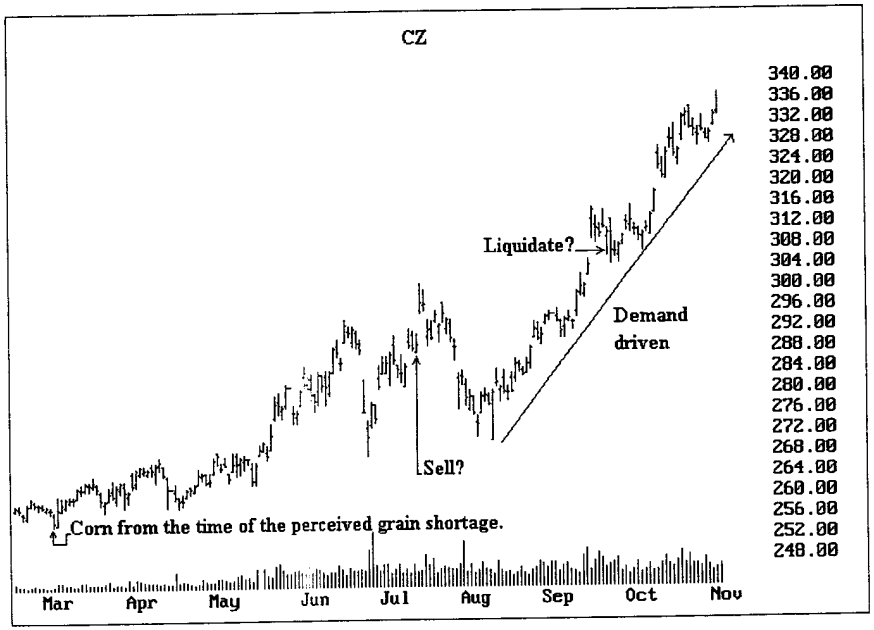
Sell September Wheat 2nd week in May, exit last week in May.
Sell September Wheat 2nd week in May, exit last week in June.
Sell September Wheat 2nd week in May, exit second week in July.
Sell September Wheat 3rd week in May, exit second week in July.

As you can see, all such trades failed miserably, yet the primary trade wins 87% of the time and no trade of this type has done worse than win 80% of the time in 15 years.





I mentioned earlier that sometimes the fundamentals underlying an entire complex can cause a situation in which it is wiser to trade as a contrarian. The signal can be very strong indeed. Look at the Corn chart for the same year.



Would a thinking trader take such a seasonal trade? I don't think so! There are times when every trader needs to use common sense. That is why it is important to a seasonal trader to have some knowledge of the most basic fundamentals of the markets in which he trades. Having such knowledge pays off handsomely. By his realization of the demand driving the grain markets, a trader could have made a great deal of money trading them. This is what reality trading is all about.

A similar situation was found in the Soybean market during the same period.

If you find that seasonals are not working well, or not working at all in a particular market, then you must find out if they have a reasonable chance of working out in related markets. This kind of thinking must be used in the grains, the Crude Oil complex, the currencies, the interest rate contracts, and the stock indices. It would be the height of folly to do otherwise. If any one member of a complex is not behaving normally, then look to see if the same thing is happening to the other members.

If you notice that the Chicago Oat contract is not behaving seasonally, you need to look with great caution at Corn, Wheat, Soybeans, Soybean Oil and Soybean Meal. Conversely, if you see that seasonally grain contracts are making tons of money, you can be pretty sure that grains are the very markets you should trade.

If you see Crude Oil behaving seasonally, then you can be fairly sure that seasonal trades in Heating Oil and Unleaded Gas will also behave seasonally. Of course, other considerations may enter the picture that will serve to break the link between Crude Oil and the rest of the complex. A very severe winter can drive Heating Oil futures to new highs despite the fact that, seasonally, Crude Oil is behaving as one might expect.

Chapter 24

Beware of Stop Running

One of the major differences between trading seasonal spreads and trading seasonal futures is that of stop running. The spreads, especially those that are put on one leg at a time, do not have that problem. A chief advantage of spreads is that no one but yourself need know that you are holding a particular position. However, this advantage is not available to the seasonal futures trader. He is totally exposed to the vagaries of stop running.

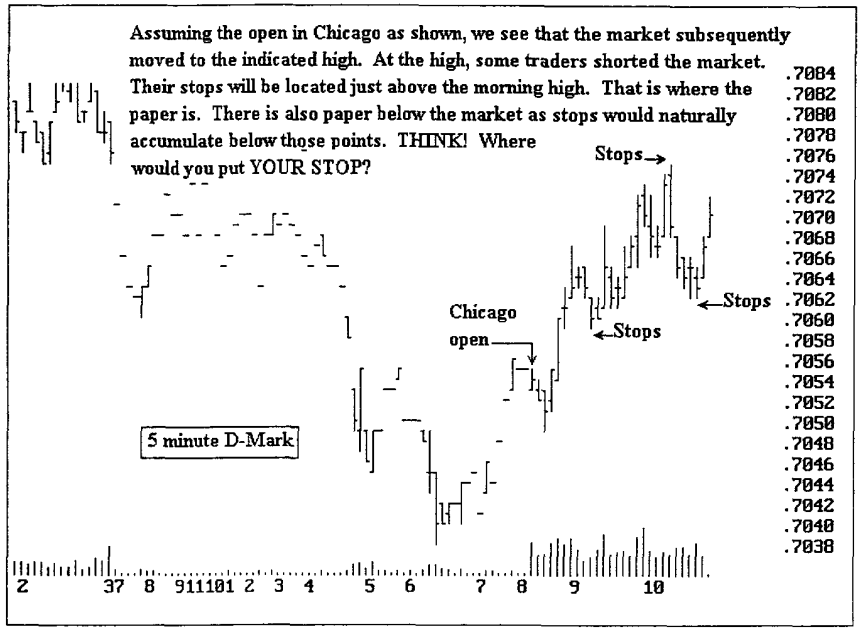
What Constitutes Stop Running?

Stop running, or "stop fishing" as it is sometimes known, generally, but not necessarily, involves action by the locals on the floor. The "strong hands," in order to drive out the "weak hands" in the market, are also know to run stops. Such action is commonly known as a "squeeze."

The majority of locals are scalpers trading for only a few ticks. It is important for you to realize that when order flow into the pit dries up, markets do not trend nor do they exhibit very much movement. Trends do not originate among the locals on the floor. Typical action by the floor traders is that of trying to scalp out a few ticks from very short term price moves. The floor traders call this action "picking each other's pockets."

Real moves in the market invariably come from orders originating off the floor. This order flow from non-locals is generally referred to as "paper."

It is paper that moves the market. Until paper comes into the market, it will not move much. Paper is what creates the bunching of orders that enables the locals to move a market from one point to another. I can best show you this with a couple of pictures.

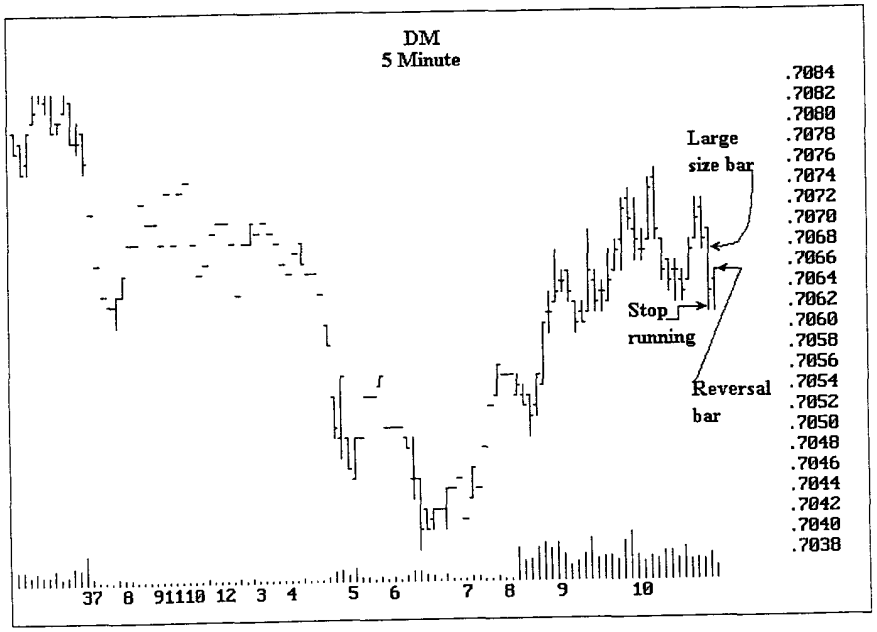


If you were a local on the floor looking for only a few ticks to scalp for profit, where would you look first?

You know there is paper (order tickets) just below you. That means if you sell, there are sell stops below you to guarantee that when you buy back you can unload your short position profitably. It remains only for you to determine your sell point. This will probably be decided by the action you witness around you on the floor. To me it looks as though there would be more sell stops in the market than there would be buy stops. This is because most of the early action has been to the upside. The buyers, since the open, have outnumbered the sellers, and therefore are protecting their long positions with sell stops.

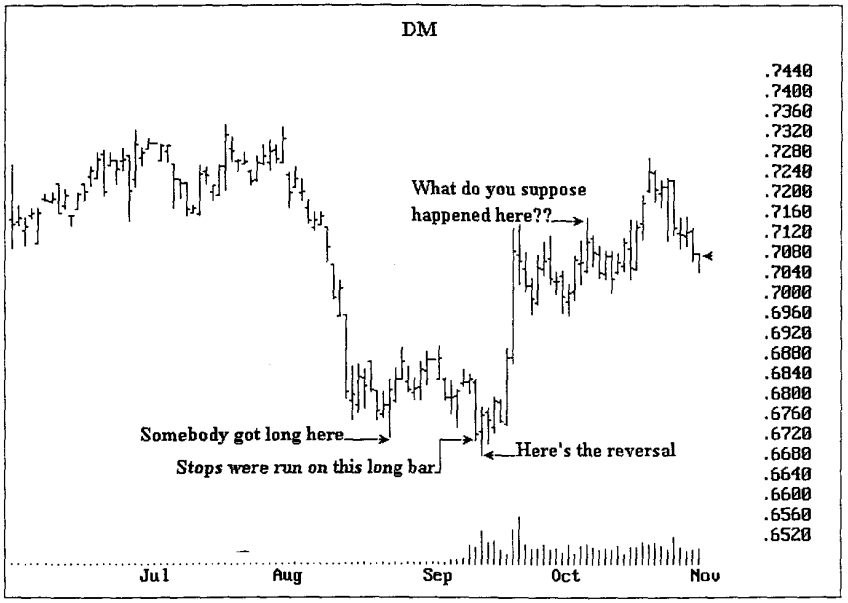
Conversely, there are some buy stops above you, placed there by those who shorted the morning high. By the way, those fly-speck looking price bars are from trading on the very thin Globex Exchange during the Asian and European sessions.

If you are able to watch the price action intra-day you will see that if stop fishing is taking place, you will generally see an extra long bar that takes out the stops, and then either reverses direction immediately or reverses direction on the very next bar. It looks like this:



Interestingly, you will see the same price pattern on daily charts. As a seasonal trader you are most interested in daily charts. So let's look at the same thing happening there.

Stop running on the daily chart usually involves a larger number of contracts because there is more time for paper to accumulate. That is why in Trading by the Minute I said that the taking out of yesterday's high or low was a major event for a daytrader. It is even more important when the highest high or lowest low of the last three days is taken out. In any case, the price action looks the same.



You've seen it, what are you going to do about it?

Where will you place your stop if you see a market breakout during a seasonal window where you have an entry signal? Perhaps a better question would be *when* should you place your stop in the market in light of the problem of stop running?

The Importance of Second Time Through

Stop running takes place simply because that is where the paper is. When a preponderance of orders are available at a certain price, it is just a matter of time until the market fills those orders. Let's face it, that's why markets exist. The markets are there to fill orders. The more orders that can be filled in a market at popular prices, the more that market is considered to be efficient. When orders are filled you have price discovery, and that is what futures is all about, isn't it?

In light of the knowledge that bunched orders are going to be filled, how can you defend yourself against this kind of action?

The answer to that question is to do the opposite of what we did with spreads where, in defending ourselves, we dropped one side. It is something I've already introduced earlier in the course — we hedge. Remember, the markets were created for hedgers.

When we are positioned in a trade and we suspect that a bit of stop fishing is going to take place, or that we may be facing a seasonal anomaly, we place a hedge stop in the market. A hedge stop gets us stopped *into* a spread rather than stopped *out* of a market. We then wait hedged until the stops have been run. Once they have been run, and we are sure the market is going our way, we can lift our hedge and hold a position in the market. If the first time through is a real move, and we are convinced that it is, then we act as a contrarian and reverse our position. We do this by liquidating the original position and staying with the position we put on as a hedge.

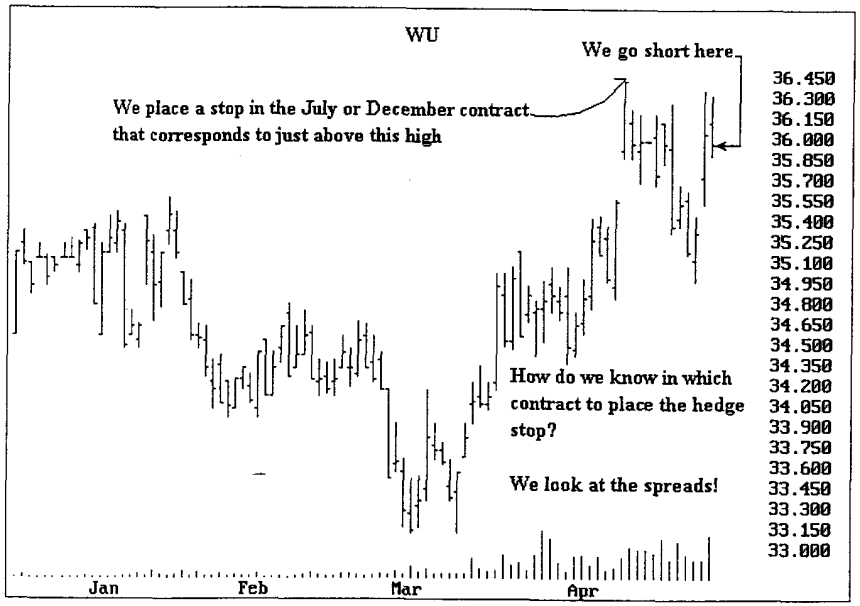
If what I've just stated leaves you puzzled then re-read it until you understand it. This concept may be one of the most important things you will ever learn about trading. We are talking here about the "thinking" person's way to trade.

If you think you do understand, then continue on because next I'm going to go through a chart example of what I'm talking about.

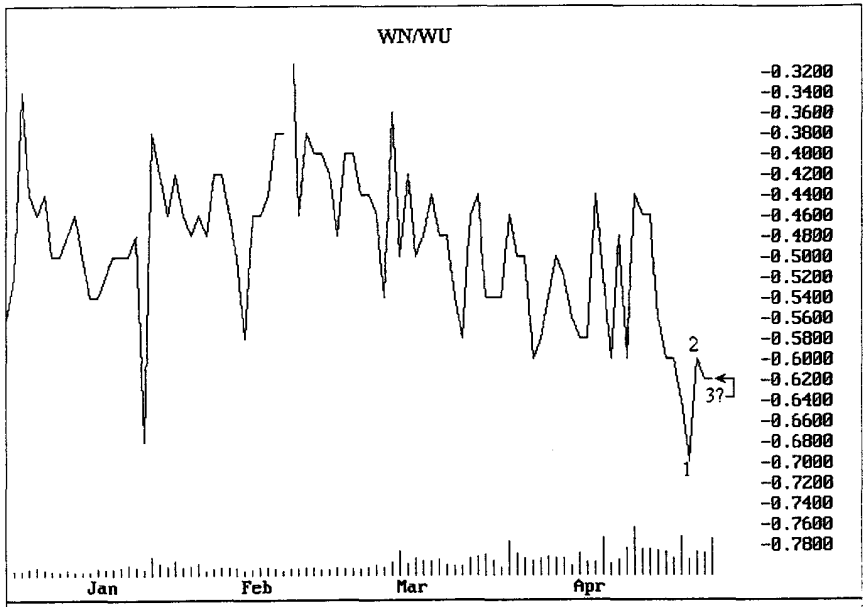
Revisiting a Wheat Trade

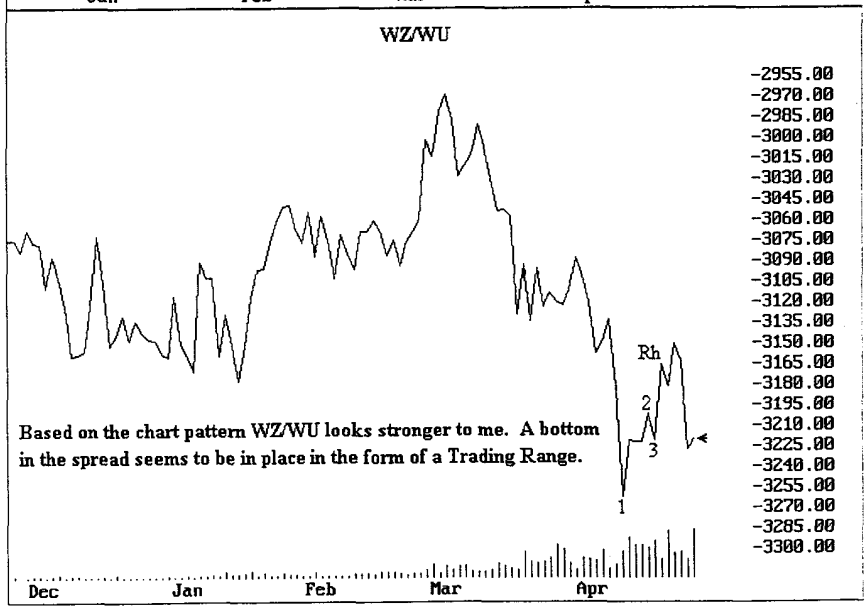
Do you recall one of the seasonal Wheat futures trades of the previous chapter? It called for getting short September Wheat approximately the last week of April with a proposed exit in the second week of July.

Let's look at it close up. Let's simply take the optimized entry date and optimized exit date for this trade. We'll use no confirming chart pattern, no technical indicator, no filter of any kind. Why? Because I want to show you how to turn a lemon into lemonade.



We want to use another month in the market for a possible hedge in case we are wrong about this trade. To do so, we will look to see which spread, if any, is the most favorable to us. We will look at WN/WU and WZ/WU.

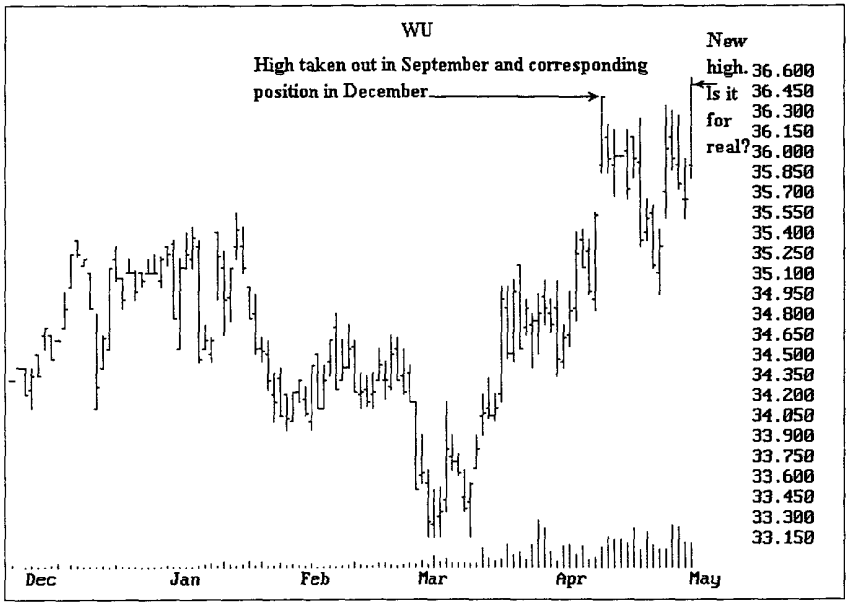




Since we decided to use December Wheat as our possible hedge, we will look at the December Wheat contract to place our hedge stop.

You can see the similarity of the December Wheat chart with that of the September Wheat chart. The higher price of December Wheat was because of the greater interest and carrying charges attributable to December being further from delivery than September. We also can see that there was no backwardation in effect at this time.

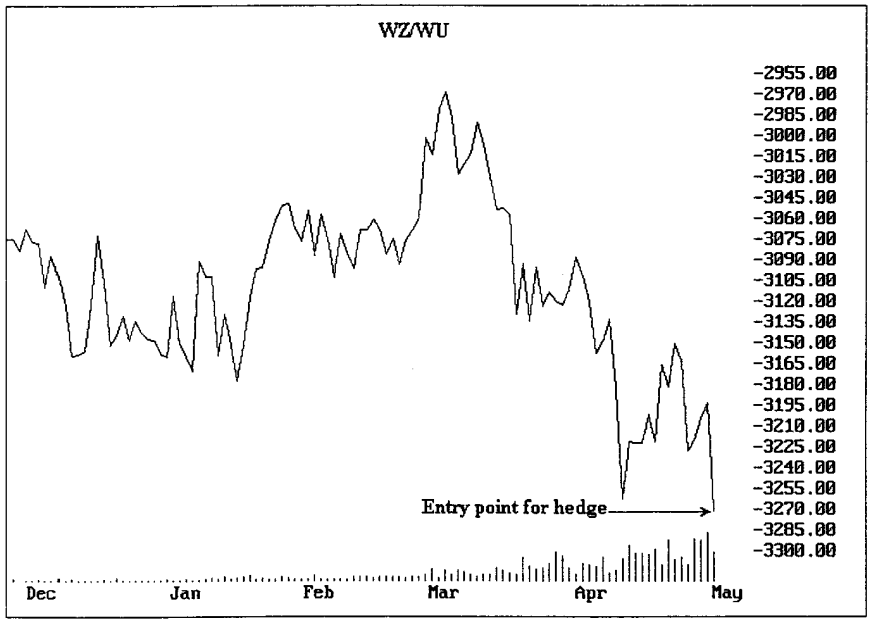
The outright short in WU made money for a couple of days, but then prices reversed and took out the high in the September contract.



The high (not shown) in the December contract was also taken out, and so on the first day of May the trade was stopped into a hedged position WZ/WU.

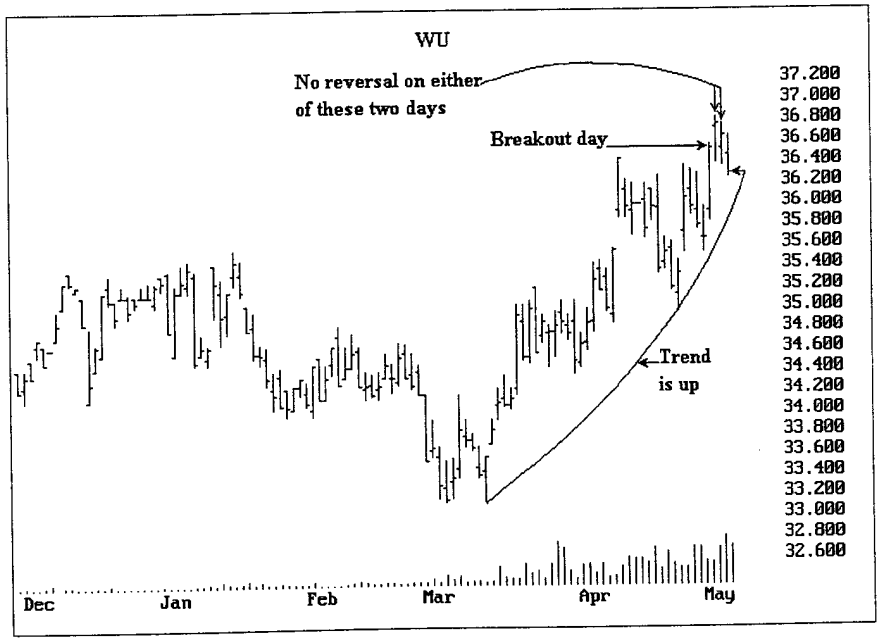
Was this a continuation of the trend that is now becoming apparent, or was this simply stop running?

We'll take a look at the market as prices progressed. Right now, I want to show you what the spread looked like at the time we were stopped into our hedge.



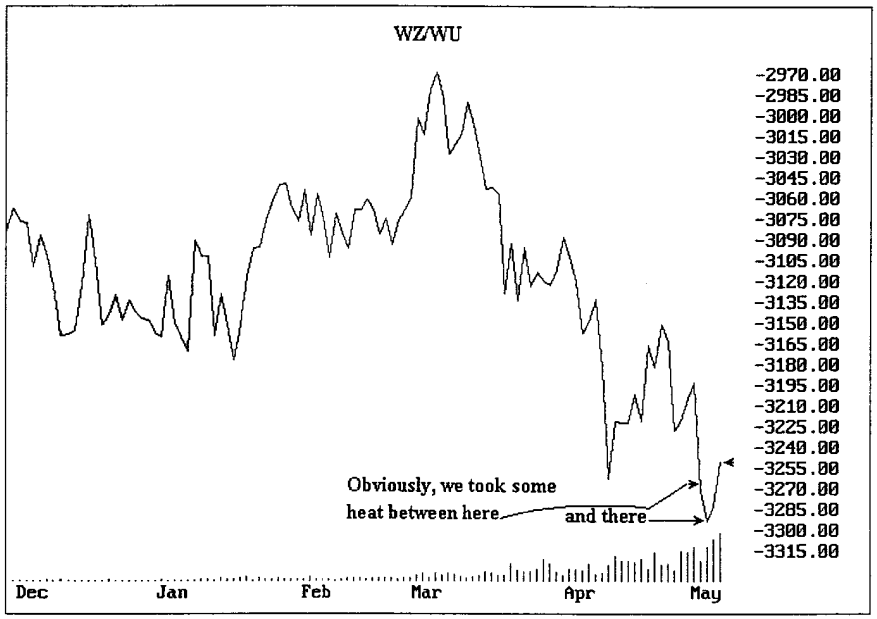
The entry point for the spread indicates that if remained hedged, we may have lost on the hedge. As prices broke out in both contracts, September Wheat gained on December Wheat. At this point, it remains to be seen whether or not we would wish to remain hedged, drop the hedge in favor of long December Wheat, or in favor of short September Wheat.

Next comes an important part of our analysis. We have reversal of trend on the breakout day, the following day, or even the day after that. This would lead us to believe that there was more to this breakout than merely stop running. When prices finally do reverse, we suspect that a correction is taking place and that prices will go higher. A correction is different from stop running. A correction points to an eventual continuation of the trend. You can see that a trend has formed. This market was going up. Admittedly, it is choppy, but overall the move is up.



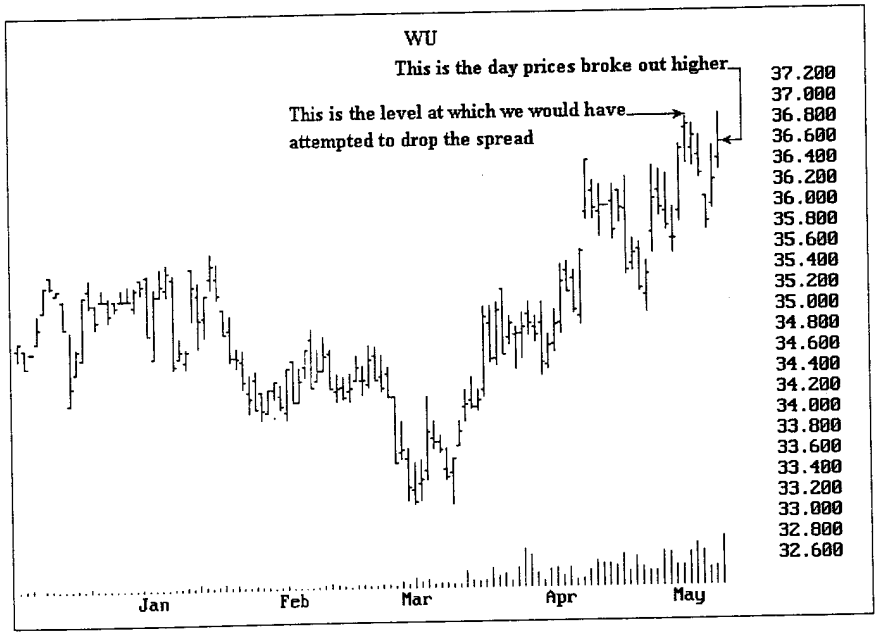
Now let's look at the position of our hedge on this same day.

By remaining hedged from the time prices broke out and stopped us into the spread, the most the trade was down was 30 ticks, or $375.00



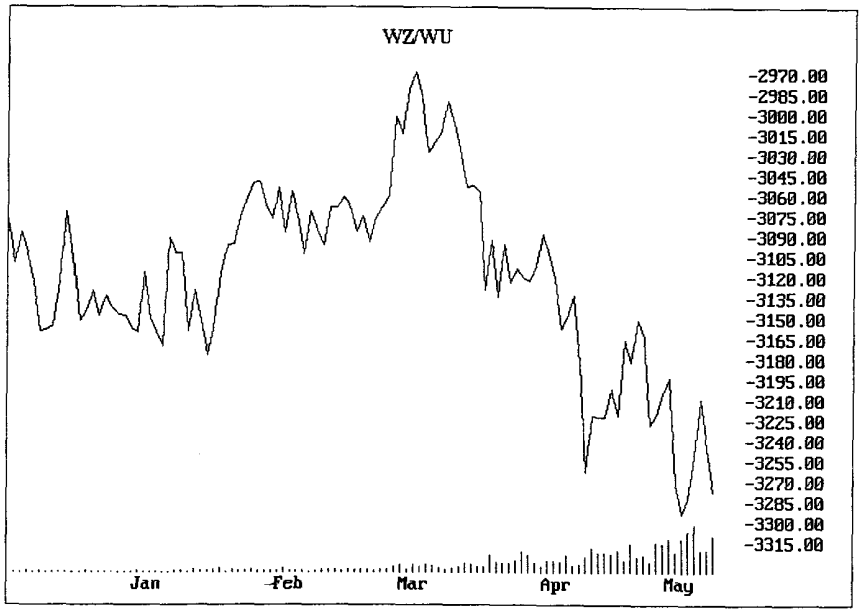
Believing that this is a correction and not just stop running, our decision is to drop the hedge in favor of a long December position the next time September prices move outside the local (most recent) high. We note the price where a breakout of the local high took place in the September contract. We then place a buy order in the market at that price level.

Here's how the market looked the day the hedge was dropped. The price at which the short September Wheat was liquidated was determined in advance.



Since we were still within the time window for this market to trade short September, we would plan to hedge our now long December position by shorting September on any day in which prices close at the level of stop we are willing to risk. In other words, if we are willing to risk $400 on this trade, we will hedge the position as close to that amount as possible. If we are willing to risk $500, we will hedge the position as close to that amount as we possibly can. We'll remain hedged until the market gives a clear cut signal as to which way it is actually going to go.

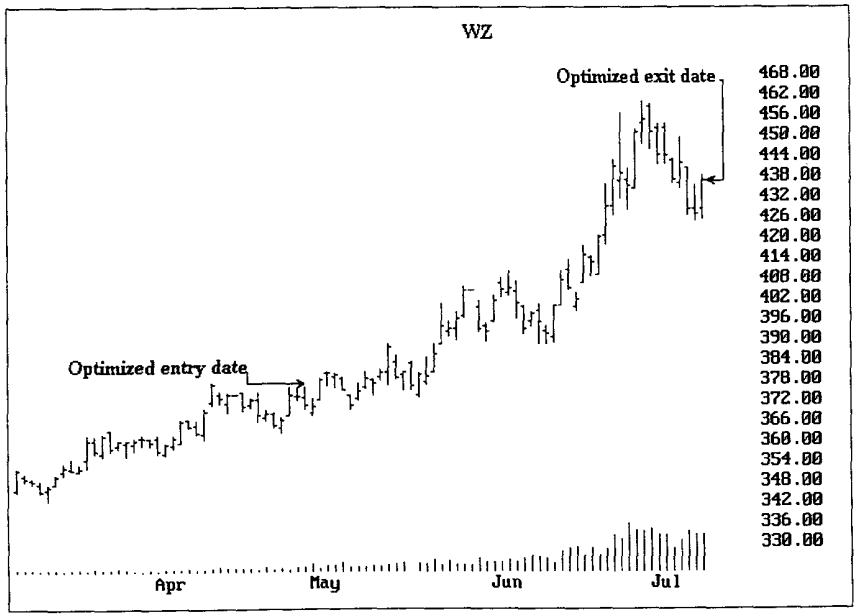
Here's the way the spread looked at the time it was dropped in favor of a long December position. The hedge had lost about 6 ticks, or $75.



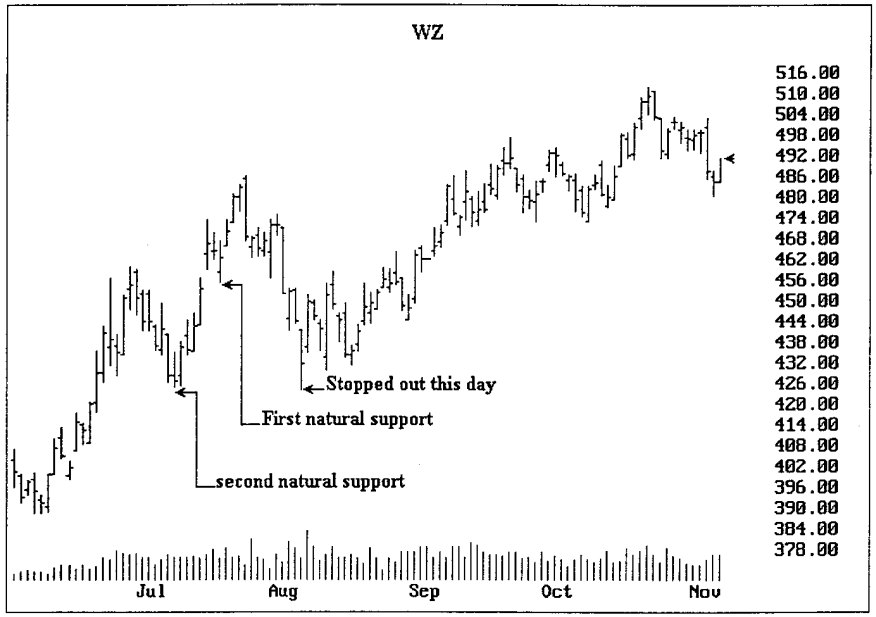
The trade was long December Wheat. For the sake of this example, let's assume we are willing to risk $400. At that amount of risk we never again would have to hedge this trade. The most it went against us was $375.

From the close at the optimized entry date until the close on the optimized exit date, there were 63.25 points available, or $3,162.50. Obviously we would not have gotten all of the available money.

We did not filter this trade, which could have made it better or worse. We also did not trail a stop, which would no doubt have made possible the extraction of more of the available profit. We also did not allow the trade to run as far as it might ultimately have gone. Once it became clear that this was a bonafide move with strong underlying fundamentals, I would have a tendency to trail my stop two natural support areas behind. In other words, each time prices break to a new high, I move my stop so that it rests just below the low of the second to last retracement. In that event, I would not have been stopped out at any time during the course of the trend shown.



Let's take a final look at this December Wheat contract at a time just a few days before it expired. The trade has an interesting end.



You see the first and second natural support area. You also see the day the stops at the second natural support area were taken out. Look closely at that day. Notice that it is an extra long daily bar. Now notice what happened the following day. You guessed it, prices reversed. The strong hands in the market, not the locals, ran the stops. There must have been a considerable amount of paper accumulated beneath that second natural support area. Notice that once those stops were run, Wheat prices never again went that low.

There are times when there is no way to stop the strong hands from doing this. The only thing that could have been done would have been to use a hedge stop rather than a protective stop. The hedge stop would have kept you in the market until you were sure as to which way it was ultimately going to go. A knowledge of the fundamentals would have encouraged you to use a hedge stop in this particular situation.

Next, I am going to describe a few events that can mess up the best of trades. We need to be aware of these events and we need to know what to do when they happen. The solution is the same for all events, and it is one that we've already discussed a number of times throughout this course.

Reports

Various entities put out various reports at various times. Some of these reports have a great impact on the futures markets and can cause them to go somewhat berserk for a period varying from a few minutes to several days, on up to a few weeks.

The Crop Report can cause the grains to react violently. The Cattle on Feed Report can cause wild gyrations in the Live Cattle futures, and the Pig Report can cause similar gyrations in the Live Hog futures.

I have seen the American Petroleum Institute (API) Report cause the Crude Oil Complex to go wild. A meeting by the OPEC cartel can causes a comparable wild reaction in this complex.

Government economic reports, speeches by government officials and dignitaries, and proposed actions and speeches by central banks and their spokesmen can cause huge fluctuations in the currency, interest rate, and stock index futures.

Picture yourself safely ensconced in a winning seasonal trade when one of these reports come out. Can you imagine losing all your winnings because of the reaction to a report? It happens many times! How do you protect yourself, what do you do?

Options Expiration

Another event that can cause frantic short term futures trading to take place is the day that options are due to expire. Why? Because the large firms that write most of the options are not willingly going to let them expire in-the-money! When options writers are overwhelmingly short a particular strike price, and futures prices are challenging their position at or close to options expiration day, these large firms can muster an army of traders to buy or sell futures in an attempt to drive futures prices away from the threatened strike so the options will expire worthless. Similarly, when at or near options expiration day it becomes apparent to these large firms that they cannot defend a particular strike price, they may attempt to move the market away from the threatened strike just long enough for them to enter the futures ahead

of the endangered strike, and then reverse their futures position. From their now winning futures position, they can explode prices through the formerly threatened strike in an effort to drive prices high enough or low enough to cause options premiums at further-out strikes to become exceedingly high. At that point they will sell additional options at very high prices to go along with their winning futures trades.

Let me give you an example of each situation.

Suppose that on expiration day, T-Bond futures prices are approaching an even numbered strike above the market. Suppose also that there is a very large open interest in the Calls at that strike. The large traders and large firms who have written those Calls do not want them to expire in-the-money. They will sell futures in an attempt to drive prices down so that the options will expire out of the money.

Suppose that two days prior to options expiration day Soybean futures prices are collapsing and moving strongly toward a very large number of Puts written by commercial interests. Suppose also that those interests realize that they cannot stop the collapsing prices in Soybean futures. These large firms can attempt to get short futures ahead of the threatened strike. If prices have already reached the threatened strike, they may enter the market long by buying large amounts of futures contracts. They may attempt to drive prices upward and away from the threatened strike just long enough for them to short futures ahead of the short Puts. If they are able to accomplish this, they are now in a winning position. There is no way for them to lose on the short Puts and they no longer care if those Puts finish in the money. To amplify their winnings, they may sell considerably more futures contracts than they bought in their effort to drive the market away from the threatened Puts. This extra selling will cause more distant Put strikes to rise exceedingly in premium. The added selling causes great volatility in the market and options premiums rise markedly in response to increased volatility. The large firms may then choose to take advantage of those extra high premiums by writing more Puts at inflated prices, far below the current market.

Is it wrong for the large firms to do this? Wouldn't you do the same if you had the capability?
When they act in this manner, the large firms are simply being astute in business. Maybe that's how they got to be large firms in the first place. They have a strategy and those are the tactics they are using to carry out their strategy.

There you are in your winning seasonal futures trade. You are an ant and they are the elephants. What happens to the ants when the elephants stampede? Your winning position can be turned into a loser in a short time. What do you do? What can you do? Think for a moment! We have already covered it earlier in the course. Here's a hint. The futures markets serve a purpose that enables people to _____?

Holidays

Hedge! Volatility

Vic, a large trader in the Japanese Yen, had a plan. The markets would be closed Friday for a holiday. Vic knew that on Thursday, ahead of the holiday, the market would be very thin. In fact, many traders would not even show up, because they wanted to get a head start on the holiday. On Wednesday, minutes before the close, Vic began to sell Yen futures. He sold a number of contracts and a bank stepped in and bought them. He then sold a larger number of contracts, and another buyer faded his order. He sold even more contracts on his next offer. The Bank of Japan bought those. His next offer was larger yet. At that point, Yen futures broke. The market collapsed and Yen futures went crashing down. The Bank of Japan took a terrible hit. During the close, Vic covered his shorts and went home flat. It was a great day for Vic. The next day, the day before the holiday, the market was even lower. During the night, currency traders worldwide picked up on Vic's momentum and bashed the Yen, driving it further down. On Thursday, knowing the futures market would be thin, Vic showed up and began buying huge amounts of Yen. Yen futures rose in response to his buying. Vic bought fast and furiously at different times throughout the trading hours. By the time the market was to close, the Yen was considerably higher than where it had closed the previous day. Vic unloaded his long futures and went home happily flat.

The preceding incident is based on a true story. I've changed the details just enough so that you will not know who it was and in which market it happened.

What if you had a winning seasonal long Yen futures position when Vic decided to short futures just before the Wednesday close? You would have seen all or most of your profits disappear. You may even have sustained a considerable loss. What could you have done? How would you protect yourself?

Hedging With Spreads

The solution to all of the described situations is to learn to spread ahead of these events. When you know that a report is due out that will affect your trade, hedge by spreading. When you know that you are within a few days of options expiration, and futures prices are threatening an options strike price having a relatively large open interest, hedge by spreading. When you know you are within a few days of a holiday in which the markets will be closed, hedge by spreading.

The professional traders "even-up" their positions before such events. Shouldn't you? The financial futures can become very quiet two to three days ahead of a major report. Why? Because the professional traders, those who do the majority of trading, will get themselves relatively flat waiting for the report to come out.

Professional traders know better than to be in a market a day or two ahead of a holiday. If they retain a position, they spread it so they cannot be hurt.

Knowledgeable professionals are acutely aware of options expiration dates. If they continue to hold a position, they protect it by offsetting in some manner. Shouldn't you do the same?

The most money is made in the markets by those who are able to maintain a position for many days, weeks, or months. My very best student carried a long position in the S&P 500 for at least six years. During those years he made a fortune. At the time of this writing and to the best of my knowledge he is still long, going into his seventh year. His stop is such that there is no way he can lose. But prior to that time, he regularly hedged in the NYFE stock index futures.

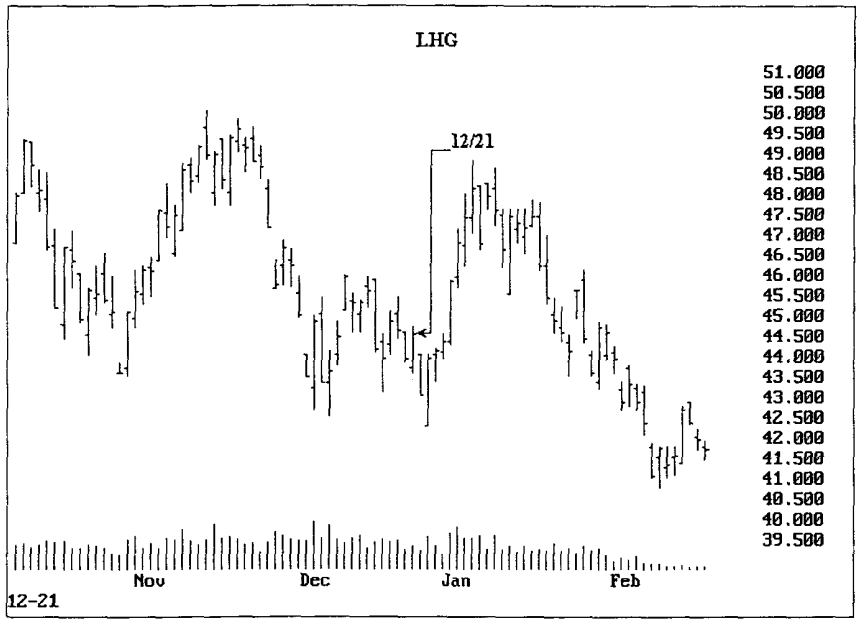
My very first student made over one million dollars in T-Bond futures. He held 100 contracts for over five months. He never allowed himself to be stopped out. Until he could maintain a stop at a considerable distance from the current price action, he regularly hedged in the T-Note futures. He hedged ahead of reports, holidays, and options expiration days.
He dropped his hedges only when he was convinced that T-Bonds were moving higher. At times he made money incrementally simply by being short the NOB.

Earlier in this course I showed you a 500 point day in the Japanese Yen. I also showed you that had you been spread, the amount of heat you would have taken was considerably less than the devastation you would have suffered in the outright futures.

Now I want to show you three Live Hog charts I simply chose at random. They all show February Live Hogs because that's what you would have been trading in December. Live Hogs are a thin market at any time. The last day of trading before Christmas the market is extremely thin. I have watched this market since the day it began trading. I don't like to trade it other than with options positions. These charts will serve to show you how a thin market can be run, first one way and then the other. They will also serve to demonstrate to you what can happen just before a holiday.

The three charts are typical of Live Hog price movements just prior to Christmas. You might find it interesting to check many charts in various markets over a period of many years to see what happens to prices the last trading day before Christmas. Get set for a shock if you do. Then you might try looking at all markets the day of a major report, and from now on, observe what happens on options expiration day when strikes having major open interest are threatened. Obviously I cannot include hundreds of such charts in this course. However, I guarantee that you will have a major eye-opening experience if you undertake to do as I've suggested.

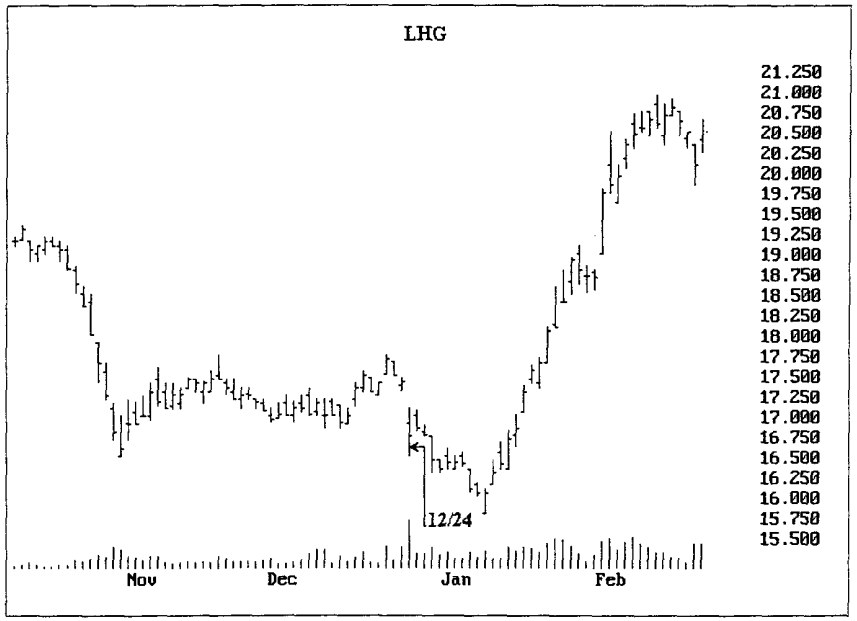
The Hog charts follow.



This particular year, the last trading day before Christmas was December 21. The market gapped down on the open and traded down briefly before heading higher. The locals ran the market from one extreme to the other creating an outside day.

This is typical of the kind of price action you will see in many markets on the trading day before a holiday.

This year the locals on the floor really had themselves a party. They opened the market with a tremendous 100 point gap (limit is 150 points). They filled all the buy stops above the preceding double high right at the open. Then they shorted the market for most of the day badly burning all the longs. As you can see, they didn't do too badly for themselves on the first trading day after Christmas, or the two days following. The last down day in their series was??? You might have guessed it – December 31, the next thin day prior to a trading holiday.



In the year above, the locals must have been tired of running stops on the long side. This time they nailed all the sell stops at the open. However, they must have been feeling the Christmas spirit of generosity and giving, because it could have been a lot worse. After filling all the sell stops, they could have then taken the market up doing just the reverse of what we saw on the previous page.

Chapter 25

Carrying Charge Spreads

There is a type of spread that is seasonal in a somewhat different manner from all other seasonal spreads. The carrying charge spread is in season whenever a certain situation occurs. I don't believe there is any service in particular that can give you accuracy statistics for carrying charge spreads. Few traders know about them, but there is a seasonal situation in which it pays to investigate them.

Sure Thing Spreading

The carrying charge spread is as close to a sure thing as one can get when conditions for trading it are right. They are especially worthwhile investigating: 1.) in a prolonged bear market. 2.) when it is likely that interest rates will fall. Therefore, I especially look for them in conjunction with the fact that seasonality indicates an outright seasonal short position for a particular market. To trade this kind of spread you will have to do a bit of leg work. You will have to ascertain the prime rate of interest, and the amount being charged for storage and insurance for each market in which you wish to take a position.

What Are Carrying Charges?

Storable commodities, grain complex, cotton, frozen concentrated orange juice, metals, energy complex, cocoa, and coffee are examples of commodities that sustain carrying charges.

Carrying charges are made up of interest, storage, handling, and insurance, with interest charges being by far the greatest part of the cost of carry. Some currencies, interest rate futures, and stock indices have carrying charges, but these markets are not storable commodities. At the time a futures contract expires and delivery is to take place, the full costs of carrying the commodity will be incurred and have to be paid in cash.

What Is a Carrying Charge Spread?

A carrying charge spread involves the differential between two futures contracts of the same commodity, but calling for delivery in different months. For instance, the spread differential between October and December Soybean Oil is, at least in part, made up of the difference in carrying charges. In a normal market, the distant month would be at a higher price than the nearby month. Carrying charge spreads are usually undertaken in a *normally* priced market, but can become more profitable in a market that subsequently goes into backwardation. *Normally* the progression of prices for storable commodities is that distant months tend to carry higher prices than nearby months. This progression of prices is called the *contango*. Backwardation, you may recall, is when the normal progression of prices becomes inverted.

If the price for the distant month is equal to or greater than the price for the near month plus the carrying charge for the period between, the spread is considered to be a "full-carry" spread. In actual practice, carrying charge spreads seldom exceed 80% of full carry because the commercial traders are able to borrow at less than the prime rate of interest.

How Do You Trade a Carrying Charge Spread?

I mentioned earlier that these spreads work best in prolonged bear markets. Therefore, I look for seasonal short positions in markets that are already moving down at the time. If an outright seasonal futures trade calls for selling a commodity, and that commodity is already in a downtrend, a carrying charge spread will be an almost "sure thing" trade. In such a situation, I buy the nearby month and sell the distant month. If I am able to sell the distant month at or near full carry to the nearby month, the chances for failure are extremely slim. The risk is about as low as it is possible to get when trading futures.

I have the filter of seasonality working in my favor, and unless some unusual or unexpected event occurs that would suddenly cause the situation to change, the carrying charge spread is going to work. The profits from such a trade are good and the

risk is very low. If the trade is working, I will hold onto it until first notice day in the nearby month but no more than a day or two thereafter. I don't want to run the risk of being delivered upon. If the trade does nothing at all, I will drop it and eat the commissions and fees for having entered the trade.

As the spread gets closer to full carry, it attracts more traders, mostly commercials who are acutely aware of these spreads and buy the nearby contract while selling the distant contract. The buying causes upward pressure on the nearby contract, and downward pressure on the distant contract. The spread will then narrow or move away from full carry. Since I am long the nearby contract and short the distant contract, with the nearby contract gaining on the distant contract, I am making money.

Carrying Charge Spread Advantages

The carrying charge spread has all the advantage of spreading. In particular, nobody has any idea what it is that you are doing, not even the traders at a spread desk. No one is going to run your stops. You can enter such spreads in virtually every market that incurs carrying charges, even markets like cotton and orange juice. They are especially good in the metals, because with metals interest rate make up close to 99% of the costs of carry. If taken in conjunction with a seasonal short in a downtrend, you will encounter spreads that go as close to full carry as they can possibly go, and may, in extremely rare cases, go beyond full carry because of bearish sentiment. Ideally, we want to see the development of backwardation because usually when that happens, the near month will begin gaining on the distant!

Carrying Charge Spread Risks

As mentioned earlier, the carrying charge spread is typically done when you expect interest rates to fall. The risk in a carrying charge spread is that there may be a sudden upward surge in interest rates or that nothing at all will happen to interest rates. Such situations seldom occur in bear markets, but be aware that when trading, anything can and does happen. If conditions suddenly change, liquidate the trade. Keep your losses small.

Computing Carrying Charges

A bit of research is involved in computing carrying charges. I always call my broker or the exchange to find out the current costs of storage and insurance. For interest rates, I figure 1% over prime. Of course, the commercial interests are able to obtain lower interest rates than 1% over prime, and that is why you seldom see more than

80% of full carry by the time you have to liquidate the spread. The commercial interests are often able to borrow at fed funds rate, which is usually lower than the prime rate.

Interest is computed on the entire amount of the contract. For example, if Soybean Oil is trading at .2500, the contract is worth $15,000 (60,000 pounds x .2500), and the prime rate is 9%, then you would determine the interest to be 10% (1 point over prime) of $15,000 or $1,500, or $125 per month. If your broker tells you that the cost of storage and insurance is 10 points per contract per month, then storage and insurance for a Soybean Oil contract is going to be $60 (10 points x $6) per month.

Let's assume you had an outright seasonal trade in Soybean Oil that called for you to short the May contract. You look and you see that May Bean Oil is already in a downtrending market, and is priced at .2500. You notice that the July contract is also in a downtrend. You find out that on the day of entry, interest rates, storage, and insurance are as stated above, and that interest is going to cost $1,500. $1,500 divided by 12 months means that interest is $125 per month. You determine that the rest of the overhead will be at $60 a month for the May contract.

At the time of entry, there is no backwardation in the market. You look at the July contract and you see that it is trading at .2535. The July contract is going to run two months longer than the May contract.

You compute the following:
May Soybean Oil:

60,000 Lbs. x .2500 = $15,000 = value of May contract
10% x $15,000 = $1,500 / 12 = $125 = monthly interest on one BO contract.
10 points x $6 point for Bean Oil = $60 = monthly overhead for one BO contract.
2 months x $60 = $120 = total overhead for two months for one BO contract.
2 months x $125 = $250 = total interest for two months for one BO contract.
$15,000 + $250 + 120 = $15,370 the theoretical price of full carry if May were to be carried an extra two months.

$15,370 / 60,000 Lbs. = .2562, the theoretical price per pound for July Bean Oil.
July Soybean Oil is at .2535, therefore the spread would be at 56.45% of full carry. The July contract's value at the time of entry is $15,210. Full carry is equal to .0062. The actual difference is .0035. Therefore, May vs. July is 56.45% of full carry (.0035 / .0062 = .5645 of full carry).

When to Use the Carrying Charge Spread

Carrying Charge Spreads are a way to incrementally pick the pocket of the market. You will have little competition when you trade them. They may be especially good for traders who have difficulty in shorting a market in a downtrend. The carrying charge spread is used to profit from a change in carrying charges. Storage and insurance costs are small in the costs of carry. This is particularly true in the calculation of carrying costs for the gold and silver, where storage and insurance comprise about 1% of the costs of carry. Any change in carrying costs can, for all practical purposes, be attributed to a change in borrowing costs. A carrying charge spread is a way of managing a change in interest rates. Gold and silver are ideal commodities to trade as a spread because of their direct relationship to interest rates. Our example will be a spread using silver.

Assuming an existing downtrend, and a seasonal short is called for, to trade this spread effectively you must make a judgment on the direction of interest rates.

Suppose the prime lending rate is at 10%. If you thought interest rates were going to decline, you could attempt to profit from this decline by using a carrying charge spread. For instance, you could short a distant month because it would not cost as much to finance the metal in the future as it does in the present. You would go long a nearby contract, expecting the spread to narrow as rates declined.

Let's say that the prime rate fell to 8%. The following table shows the result.

Example of Carrying Charge Spread In Silver

Date	Action	Futures Price per Ounce	Profit/(Loss) per Ounce	Total Profit/(Loss)
June	Buy one 5,000 ounce December Silver contract	$5.75		
	Sell one 5,000 ounce February Silver contract	$5.92		
January	Sell one 5,000 ounce December Silver contract	$4.85	($0.90)	
	Buy one 5,000 ounce February Silver contract	$4.97	$0.95)	
Result		$0.05	$0.05	$250 per spread

Seasonally or not, when you see a bear market, take a look at entering a Carrying Charge Spread. If nothing else, you will learn a good deal more about how markets work than you ever previously knew.

Chapter 26

Converting Daytrades to Spreads

Question: Why would anyone want to convert a daytrade into a spread?
Answer: Because at times it is good sensible business to do so!

Question: Isn't it true that daytraders ***have*** to be out of the market by the close?
Answer: No!

Question: What possible benefit can you gain by spreading off on a day trade? Answer: You can hedge a position until you are more certain which way the market will go! You can drop the hedge intraday or you can keep your position hedged up overnight.

Question: Why not just get out of a trade you are not sure of and reenter later? Answer: You probably won't enter later or you might not be able to enter later!

The reality of trading is that rules are made to be broken. Will it hurt your feeling of security to convert a daytrade into a spread, perhaps one you even hold overnight? There is no law against holding a daytrade overnight. There is no law against converting it to a spread and holding the spread until you are more certain of market direction. It's a lot better than moving your stop further back to "give the market more room??!!"

Allow me to relate to you one of the most inane statements I've ever heard made by a professional trader. He said, "Joe, I'm entirely into daytrading now. I just could not stand leaving all that money lying on the table."

It is my opinion, after having traded almost every way imaginable way for close to four decades, including over twelve years of daytrading like a mad fool, that it is the daytrader who leaves the most money on the table.

I am not knocking daytrading. It has its place among the trading tools that are available to be mastered by any trader who is inclined to do so.

I'm not even against daytrading all day long, if that suits your emotional and psychological makeup. However, when a daytrader is holding a winning position at the end of the day, why should he let go of that position? Is it because the rules in his mind say he has to? Is it because he doesn't want to make additional money that may be available by staying with the trade? Is it because he feels sorry for his broker, the NFA, and the exchanges, and wants make an offering to them of additional commissions and fees?

Perhaps the daytrader is afraid to hold his position overnight? Yes! That may be it!! He is driven by fear. Yet, every hedger knows that spreading off the risk can greatly reduce the impact of any calamity which might take place in a market overnight. The locals in the trading pits understand how to spread off, and their positions are usually a lot shorter in duration than that of a daytrader.

I've already shown how a hedged trade in the Yen could have easily withstood a 500 point move. I can think of dozens of examples in which limit moves occurred in markets where I, as a daytrader, had hedged my position and safely rode out the wild gyrations of a market gone seemingly insane.

I have entered tight markets with both long and short positions, through different accounts at different brokerages. In other words, I've entered the market absolutely flat waiting for the inevitable break to one side or the other.

"But," you say, "Why not simply get long when the market breaks to the upside, or get short when the market breaks to the downside?"

The answer is that the move may be such that you cannot get in! The move may be such that it startles you and your fear or caution will not let you in. However,

except in the case of a limit move, you can drop the wrong side of the trade and keep the winning side.

If you are long D-Marks at the CME, and at the end of the day you are in a winning position, you can create a perfect hedge by shorting two D-Mark contracts at the Mid-Am. If during the night the D-Mark moves 200 points in a direction that would have been against you, you will not be hurt because you are flat. You are equally long and short. When you are finally convinced that the D-Mark is going to continue to move, which is entirely possible because of the momentum behind the move, all you have to do is drop the losing side of the trade and keep the winning side.

If you are short Soybeans and have a winning trade at the end of trading, why not spread off on another month? You can buy a back month contract and have an almost perfect hedge. Who knows, with a little luck and planning you may even make money on the spread?

You say, "But if I hold Soybeans overnight I will be held to full margin and I can't afford that. My account is not big enough." I say, "For an overnight spread in Soybeans, your account may very well be big enough!" At a time when Soybean margin was $1,350 per contract, spread margin was $500.

Even the S&P 500 can be spread for holding overnight. Granted, S&P 500 back months are very thinly traded. But you can usually find enough traders to lock in a spread. At least you can try. The volume may be 500 contracts, or it may be 1500 contracts. At a time when S&P 500 margins were $9,000 per contract, S&P spread margins were only $490!! That's right, only $490. Surely anyone daytrading the S&P 500 can come up with that much margin.

What exactly are the advantages of hedging a daytrade?

For the price of a commission, you can buy more time.

The advantage is tactical in that you may not have been able to enter a particular trade, but by being already in the market you can decide when and which side to drop.
The advantage is psychological if you find it easier to drop a position rather than enter a position. (There are many traders who fit this description.)

The advantage can be financial if the spread begins to outperform the outright futures position. Of course, this will never happen in cases of a perfect hedge.

It seems strange to me that futures traders have not seen this way of trading as a viable tactic. Yet it is commonly done among options traders. It is not a big problem for an options trader to buy both an at-the-money Put and Call, and when the market breaks to drop one or the other and thus be either long or short the market via an option. The identical situation can be achieved by a futures trader having two accounts. I have even heard of a futures trader having two accounts with the same broker. He did it so he could be both long and short at the same time. His broker was aware of the way he traded, and periodically shifted money from one account to the other to keep them in balance.

Chapter 27

Wrap-Up

I am going to end this course with a review of certain thoughts and concepts that I have and hold with regards to trading. Since I've been a private individual trader all of my trading career, my views are necessarily derived from that perspective.

Comfort

I feel it is extremely important for a trader to find his level of comfort in trading. That entails discovering the following:

Account size: You must find the account size with which you are at ease. Coincident with that, you must find out how much of it you are comfortable in trading. What I mean is that one trader may be comfortable trading 80% of a $100,000 account, whereas another trader, in order to trade a similar amount of money, may need to trade 16% of a $500,000 account. Use a cushion with which you feel comfortable.

I cannot tell you how many dozens of times I have been contacted by letter and by telephone by aspiring traders calling me to ask how big an account they need to have to "make a living" as a trader. Think about the absurdity of that question. How much money is a "living?" Is a "living" the same for you as it is for me?

Contrary to what you may read or have read in magazine ads and fliers that are beyond my control to edit, I live a very simple life, one in which I am constantly trying to get rid of material possessions. I am at that stage of life where I no longer want a lot of "things."

Markets: You must discover those markets in which you enjoy trading regardless of what others may say about them. If you are getting good fills and making steady profits in one or more markets, stay with them. Learn all you can about them, and trade there, even if that involves trading in only a single market.

Time-frame: Determine a time-frame in which you are at ease in trading. Select one that gives you adequate time to think, one that is suited to your temperament. Decide whether or not you want to be a daytrader or a longer term trader. If you want to trade seasonally, you will probably choose the daily charts. But if trading the daily charts drives you to distraction, then perhaps you are better off trading a five minute chart. Only you can make this determination. It is a totally individual decision. Not all of us can stand to be enslaved to a five minute S&P chart all day long. Not all of us can stand to wait an entire month to see one more bar on our chart.

Charts: Select the kind or kinds of charts you will look at. Do you prefer candlestick charts? Fine, use them. They give you a strong visualization of a very important concept in the market, the relationship between the open and the close. Do you prefer line charts? Wonderful, your perception of a market will be somewhat different from that of most of the other traders. Here's a suggestion, try using a line chart that connects open to open rather than close to close for the session you are going to trade. The open is far more important than the close. The open reflects many more hours of price discovery world wide than does the close, which reflects only a few hours' price action.
Try looking at Point and Figure charts. I have a friend who is a successful trader using Point and Figure charts. It wasn't until he switched to them that he became successful.

Indicators: If you are going to use one or more indicators in your trading, then you must know everything about that indicator that is possible to know. If possible, learn how it is constructed. What aspect of the market does it measure? Learn its patterns of behavior. How does it act when a market is trending? How does it act at the beginning of a trend? How does it behave at the end of a trend? What does it look like when a market congests and moves sideways? Remember, too, that an indicator will always lag the price action. Indicators, without exception, are totally dependent on what has already happened. I used to think that there were such things as "leading" indicators. But logic alone should tell you that such a thing is impossible. The greatest weakness in using indicators is that you become married to them. This takes away your flexibility and skews your ability to think. However, if you trade best when using indicators, then use them. Use those with which you are comfortable.

Brokerage: Finding the right broker for your chosen style of trading is of the utmost importance. It is one of the toughest jobs a trader faces. As a rule, brokers are an odd lot. You may have to search long and hard to find a broker with whom you are compatible, who gives you good service and good fills, who stays in the industry (the turnover is very high), who is generally honest, who understands the way you trade, and who will give you reasonable commissions and margin requirements.

Predicting

I have probably written this a thousand times in other places: "It is not within the realm of man to be able to tell the future. Telling the future is reserved for God." You will no doubt read about people, methods, and systems that can predict tops and bottoms. My advice is, don't believe a word of it! If anyone really knew how to tell the future, why would they tell you how to do it? Anyone who can predict highs and lows would be filthy rich. Anyone who could truly tell tops and bottoms, or where, when, and how much a market will turn, would surely own the whole world and would probably set himself up as God. As the famous saying goes, "in a land where everyone else is blind, the one-eyed man is king."

The results of trying to predict the future are these:

You cannot predict with sufficient consistency to actually trade by your predictions.

When you do predict, you will become married to your own view, and will lose the flexibility needed to change when you are incorrect about your prediction.

Mechanical Systems

While I agree that it is possible to trade with a mechanical system and win, to do so takes an iron discipline — one much more difficult than the discipline needed to trade as a thinking person. You have to be willing to bite the bullet and follow the system come hell or high water. This is not a way that has been comfortable for me in my own trading. In addition, there is a total loss of flexibility when trading a mechanical system. When trading a mechanical system, one becomes a slave of that system. When markets change, and they do so with increasing frequency, you are a prisoner of your mechanical system. You are unable to change. You are in a marriage gone sour and have no way out because you have never really learned how to trade. What you have learned is how to follow a system, and how to have a rigid discipline. While that may be commendable, it is not really trading.

Stops

Learning where other people have placed their stops is one of the most important lessons you can learn. When you are trading, it is absolutely essential to determine where the paper is. The market is always going to go to wherever the orders are. You can determine where the paper is by calling your floor persons, or have your broker call them. You can also determine where it is by noticing where natural support and resistance are located. Sooner or later, prices will move to where the orders are and the floor or the strong hands in the market will run the stops. They are not out to get you. They are trying to make money, and if there are a lot of sell stops below them, they are going to sell knowing that when they cover their shorts by buying, whoever has that paper is going to sell to them.

Conversely, if there are sufficient buy orders above the current price action, someone is going to buy at the current price level, knowing that when prices rise to a level where the buy orders are located, they will be able to liquidate their long position by selling to those buyers.

Fundamentals

Whereas I do not trade from fundamentals in the sense that most fundamental traders do, I have found that it is essential to be aware of the type of fundamental knowledge that can be found in the news and other easily accessible places. You must be aware of report dates, options open interest, breaking news, weather, governmental policies, etc. Basic fundamentals such as these are of particular importance to seasonal traders. You must try to ascertain the probability of the success for a seasonal trade. You simply cannot spit into the wind. If there is a reason why a seasonal trade will probably not work, then by all means create a plan to fade that situation. Such trades usually work better and longer than the seasonal trades would have worked. Such trades are relatively few and far between, but when they occur, jump on them and trade them with the utmost confidence that huge profits will be available.

Be Aware of Order Flow

The market goes nowhere until orders come in from off the floor. The floor traders are mostly scalpers and it takes orders from the retail trade, the commercials, the large traders, the funds, managed money, or institutional traders to cause real movement in a market. Until this outside money comes in, prices will go nowhere in particular and a market will remain congested in a tight trading range. Order flow can be monitored via volume, but remember that volume is always reported too late to do the off-the-floor trader any good. One way to find out what is going on and the amount of volume in the market, as well as whether or not large trade participants are in the market, is to have adequate connections to the floor. You can find out who is trading and the degree of volume simply by asking someone at an arb or trade desk what is going on.

Know How to Give Orders

You must make it your business to know and understand every kind of order that can be given and what it does. You can then plan entire strategies with that knowledge, because ordering is part and parcel with the kinds of tactics you use in

implementing your strategies. For that purpose, I have prepared a course on tape cassettes. Trading Order Power Strategies teaches you how to order and how to use ordering to increase your profits and minimize your losses. See the Appendix C for further details. I am constantly amazed at how little attention is paid to this vital aspect of trading. You must know everything you can about order placement, tactics, and strategies.

Stay Flexible

One of the most important things I've learned over my long association with the markets is that markets can and do change. In recent years, markets have changed more rapidly than ever before. To be able to profit in such markets, you must be able to adapt, to change with the markets. To do that you must remain flexible and willing to change. That is why mechanical systems are a greater hindrance than you might imagine. I have seen mechanical systems that worked well for many years, but eventually they failed. You think to yourself, "what do I care if markets change, all I want is for this system to work long enough for me to make my money, then I can run!" I have no doubt that such has and will happen to some traders. Many of the great luminaries of trading had that exact thing happen to them. They made a ton of money during a short period of time, and now they spend their time writing about it and basking in former glory. However, that is not the way to make a career of trading. All too many of those who hit it big during a short period of time end up giving back all of what they made and more. I've seen it happen dozens of times. Trading for the short run, knowing that what you are doing is going to fail when the markets change, is a form of gambling. A career trader knows the markets will change and that he has to change with them. It's the only way I have ever seen to have and maintain a career as a trader.

Learn to Take What the Market Gives You

A professional trader learns to take consistent profits out of the market on a regular basis.

I know many professional traders who have never, during long careers, hit a really big winner. They never caught the grains during a drought, they were not short the S&P when it crashed, and they were not long any of the currencies when they made 500 point days. They learned to take their profits out of the middle or wherever they could get them. They learned to be satisfied with whatever the market handed them. They were already out of the market with their money when the big move came. This is the life of a professional trader. Be consistent, be disciplined, and

avoid being greedy. Quit trying to win the lottery in the futures markets. If you take a lot of chances and are a gambler, you are in one of the worst places you could possibly be. In a gambling casino or at a race track, you do not start out in a hole. You do not have to pay commissions and fees. When you use the futures markets to gamble, you start out as a loser every time. You are always in the hole by the amount of your overhead. And, believe me, it is considerable. You have the costs of data, brokerage, exchange fees, hardware, software, maintaining an office, etc.

Be a trader, not a gambler, and take your profits regularly.

I wish you the very best in your trading.

Joe Ross

Appendix A

Chart Patterns for Outright Seasonal Futures

Charts Made Easy

Note: The material in this appendix is not new. Much of it is taken from my course on TRADING OPTURES AND FUTIONS. I present it here primarily for the benefit of those who are not familiar with my other writings.

What does a spread trader need to know about the futures markets to successfully employ them in his trading? The answer is, surprisingly little. Since this book is not a primer on futures trading, I assume that the reader has at least a basic understanding of what a futures contract is, and the mechanics involved in the trading of futures.

In my previous works, **TRADING BY THE BOOK**, **TRADING BY THE MINUTE**, **TRADING THE ROSS HOOK**, and **TRADING IS A BUSINESS**, I have presented various chart formations, and methods and techniques for trading those formations. The formations discussed in those books have stood the test of time. This appendix briefly describes those formations. Seasonal futures are merely another method or technique for trading those same price formations.

This should not come as a surprise. Virtually anything you can do with a non-seasonal futures contract can be accomplished by the buying and selling of seasonally filtered contracts. My success as a trader is a testament to the infallibility of the time tested price formations I will be showing you.

Recognition of these basic chart formations has enabled me to profitably trade the futures markets for many years. The truth is the truth, it does not change.

Those readers thoroughly familiar with these chart formations may wish to skip this appendix and move on to the next. However, you may find a review useful to your trading. Any other price formations used for trading seasonal futures was shown in the context pertinent to the particular seasonal strategy.

Patterns for Success

I'm now going to show you some very potent patterns for trading in any time frame. These price patterns are my major entry signals. They are not the only signals I've shown in this manual. Others were shown in context in previous chapters. Those in this appendix are ideal for grasping the basic tenets of chart reading.

Major Entry Signals

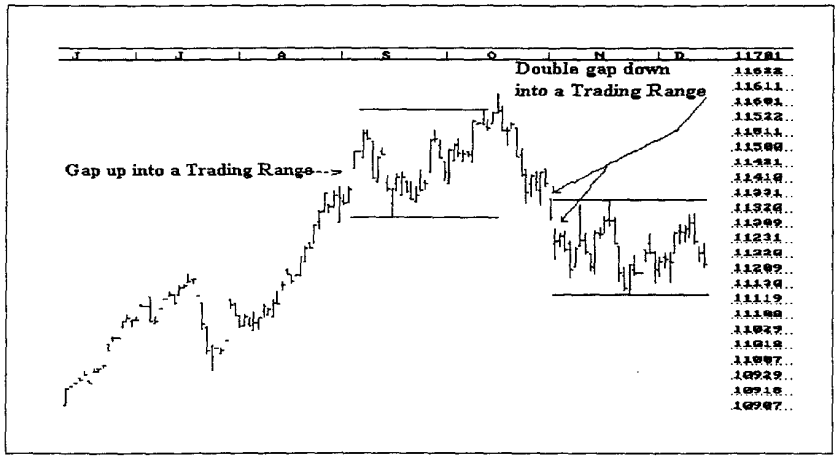
My major entry signals are as follows, and I give them my highest priority. They are **all derived from the DAILY BAR CHART**:

- The breakout of a Trading Range.
- The breakout of a 1-2-3 high or low.
- The breakout of a Ross Hook.
- The breakout of a Ledge.

Let's take these in the order listed above.

THE BREAKOUT OF A TRADING RANGE

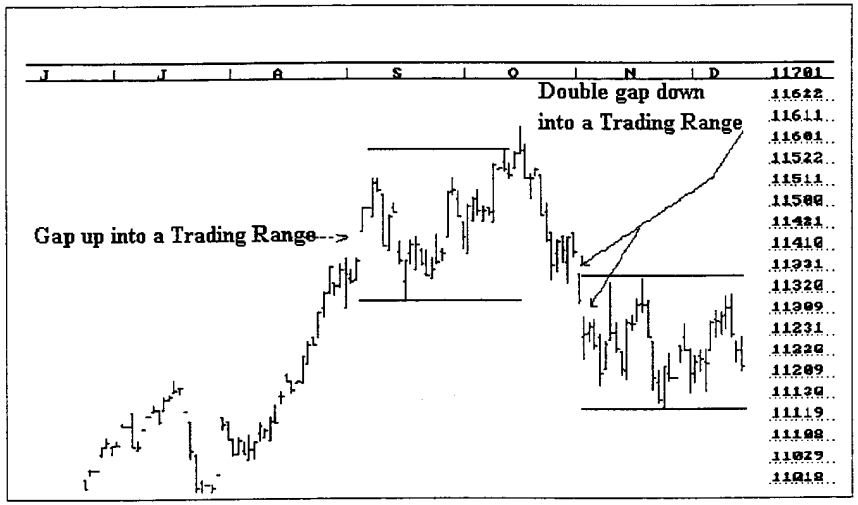
Most of the time, a Trading Range will be preceded on the daily chart by either a gap or a day which is relatively large in size from high to low. The next figure illustrates this point. *(Readers of my other books, please note that I may or may not draw an expanded envelope around a* Trading Range *when trading seasonally. Whether or not I do is subjective, based upon what I am seeing on the chart.)*



My first step after noting a gap, a series of gaps, or a large size trading day, is to begin to watch for a Trading Range to evolve. Here is how it will usually happen:

- There will be a gap or large one day move up into or down into what will eventually be seen as a Trading Range.
- There will be a leg (this is a leg /, or this \) counter to the thrust of the gap or large day move.
- Then there will be a second leg back in the direction of the gap or large single day move. At that point, the market's most recent action looks like this /\ or this \/ from a bird's eye view.

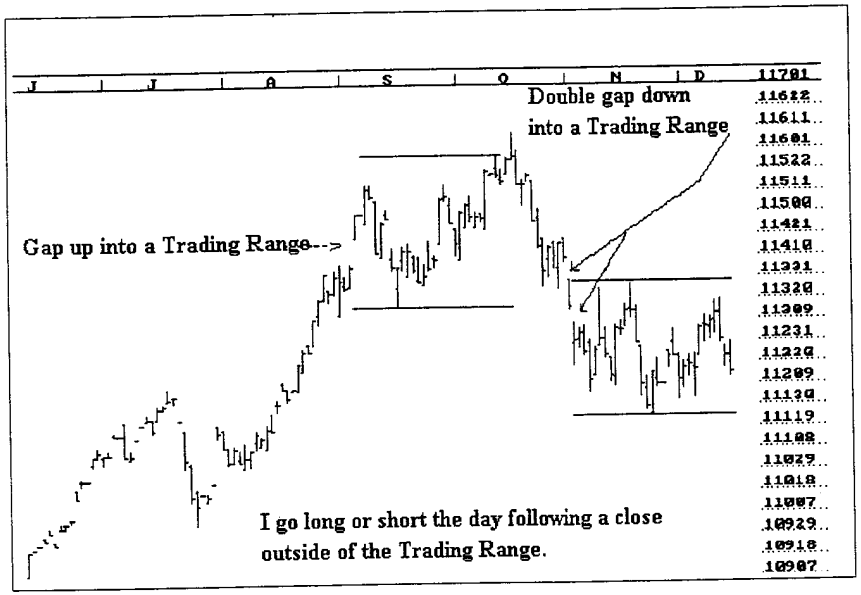
It is then that I draw a horizontal line across the highest high and a parallel horizontal line across the lowest low. It will usually take about 10 days or so for all of this to happen. The formations /\ or \/ constitute "market swings."



- In the next few days, a third leg will form, giving us /\/, or \/\. This is the beginning of what may turn out to be a Trading Range. Again I draw horizontal lines across the highest high and lowest low, unless the old ones are still intact. I have now established a rudimentary envelope that is delineated by drawing a simple horizontal line across the top of the Trading Range and a parallel line across the bottom of the Trading Range.

- My next step is to count the number of bars on the daily chart. Sometime between 21 and 29 days, a fourth leg will usually be completed. The Trading Range now looks like /\/\, or \/\/. If there had been a new high or low, or both, during that last leg, I would have redrawn the envelope. Usually this is not necessary.

I can now set a mental alert or a computer alert, or both, to tell me when I am approaching the proximity of these numbers which represent the outer limits of the envelope. Any non-gap breakout of these numbers will constitute an entry point for me to trade. This will be the least frequently occurring entry technique in my arsenal, but it will be one of the best. The thrust out of an envelope will yield many a worthwhile trade. The next figure will serve to demonstrate this point.

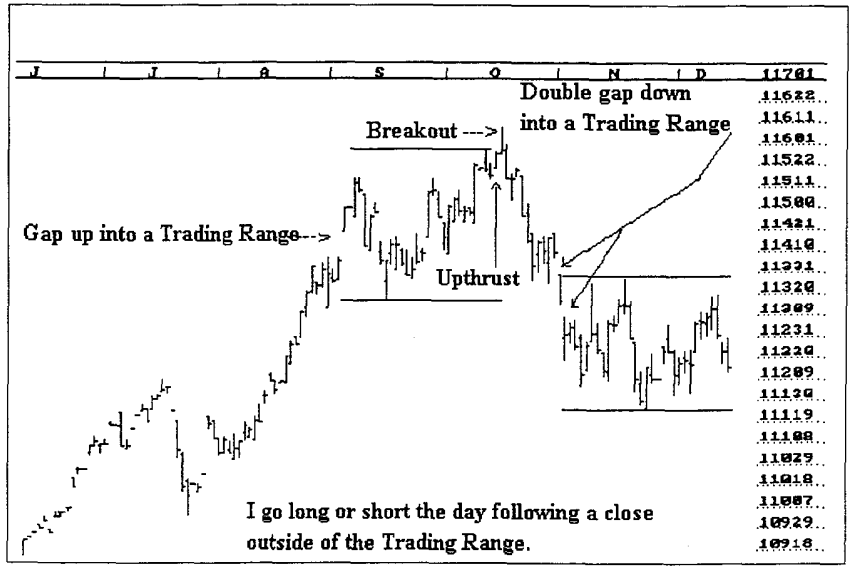


My entry point is a trade-through by prices of the breakout point. The breakout point is the highest high or the lowest low of the Trading Range. I will enter a trade at or (for those familiar with the Trader's Trick) before the breakout. I will not enter if prices gap past my entry point. The Trader's Trick is discussed in detail in **TRADING THE ROSS HOOK**, and **TRADING IS A BUSINESS.**

When I take the first breakout of a Trading Range, I anticipate a short term trade, two, perhaps three price bars in the direction of the breakout. The time frame has no bearing on my expectations. Obviously, a two or three bar move on the daily chart is going to cover a lot more price movement than would a two or three bar move on an intraday chart.

In any event, I anticipate a short-term move of a few bars, followed by a correction of some kind. The more conservative approach is to wait for the correction to take place, and then attempt entry into the market.

In the figure below, you can see that the first breakout failed. After such a failure, a reentry of the range is probable and a breakout on the *opposite* side is possible.

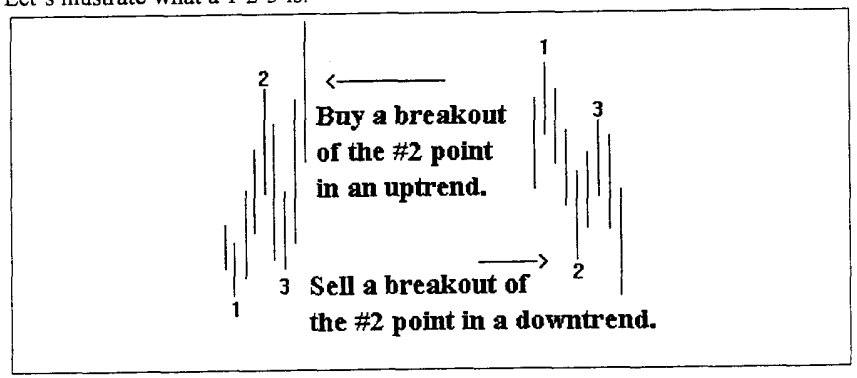


On a daily chart, such a move would be nicely profitable. On a five minute chart, such a move would not have been nearly as profitable, and probably would have had the trader scrambling for his life.

Should the breakout momentum continue, resulting in an extension of the long upward trend that preceded the initial Trading Range, the probabilities are that such a resumption of the major upward trend would see the realization of a nice profit on any bar chart, in any time frame. For more detail on how I use the envelopes described, consult my previous course, **TRADING BY THE BOOK**.

THE BREAKOUT OF A 1-2-3 HIGH OR LOW

Let's illustrate what a 1-2-3 is:



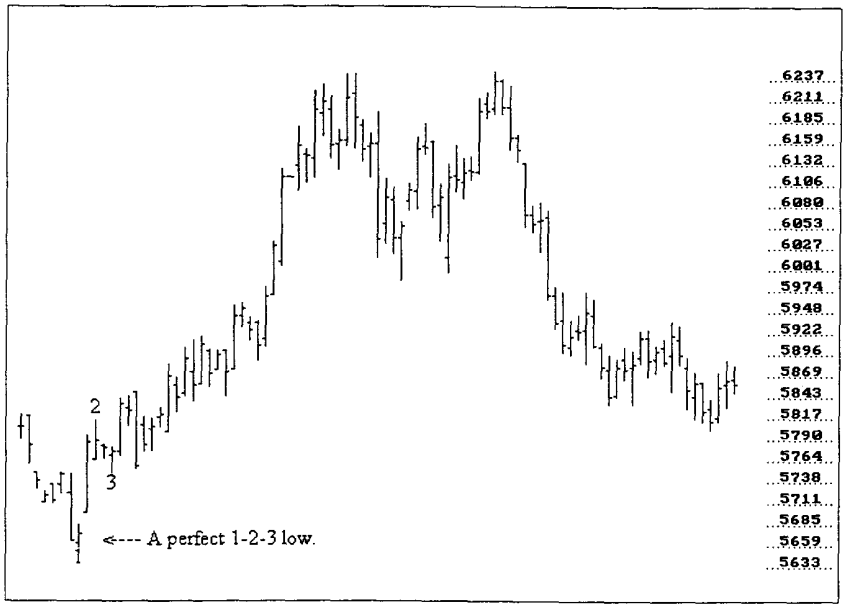
Note: The #3 point does not come down as low as the #1 point in a uptrend, or as high as the #1 point in a down trend.

I set a mental or computer alert, or both, to warn me of an impending breakout of these key points. I will not enter a trade if prices gap beyond my entry point. I will enter it only if the market trades through my entry point.

1-2-3 highs and lows come only at market turning points at the end of a trend. I look for 1-2-3 lows when a market seems to be making a bottom, or has reached a 50% or greater retracement of a preceding leg up. I look for 1-2-3 highs when a market appears to be making a top, or has reached a 50% or greater retracement of a preceding leg down.

Entry will always be at or prior to the actual breakout of the #2 point.

The next figure illustrates this entry technique in action.

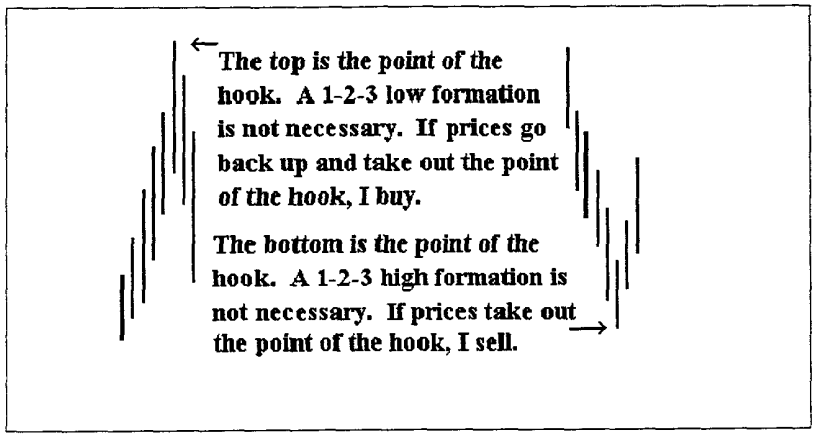


The 1-2-3 low is characterized by the fact that the #3 point does not come back (retrace) as low as the #1 point. A 1-2-3 high is characterized by the fact that the #3 point does not come back (retrace) as high as the #1 point.

Detailed discussion of how I use the 1-2-3 to trade futures can be found in **TRADING BY THE BOOK** and either **TRADING BY THE MINUTE** or **TRADING THE ROSS HOOK**. The essential concept is to buy or sell as the price action "takes out" (trades through) the #2 point. There are other refinements to this concept which are discussed in the aforementioned volumes.

THE BREAKOUT OF A HOOK

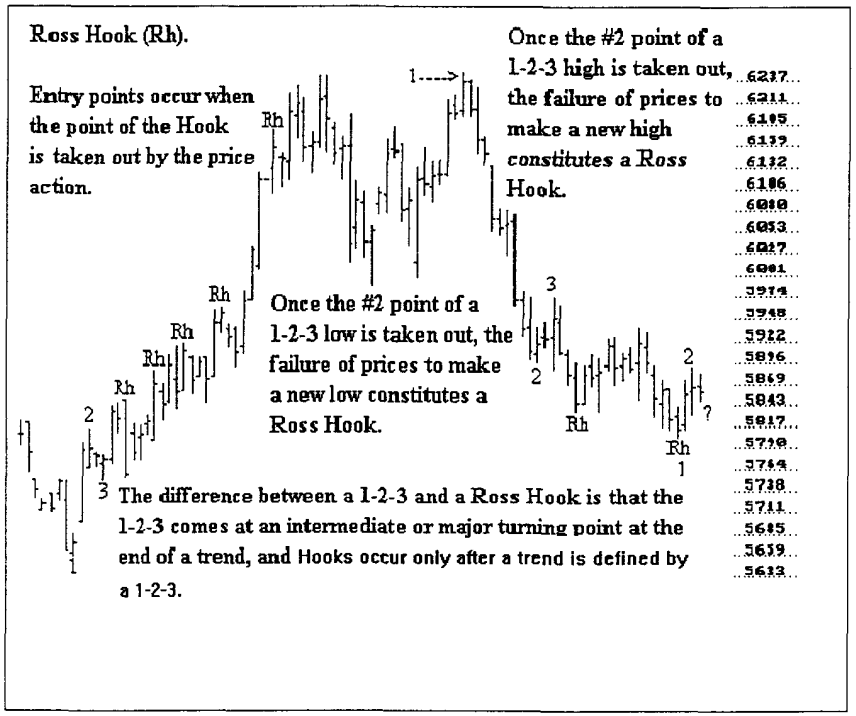
A Ross Hook looks like this:



In a sense, a hook is a part of a 1-2-3, but it doesn't have to have a definitive high or low. It may pop out of a congestion area, or otherwise be indistinguishable as to any exact formation. Ross Hooks occur only in trending markets, whereas 1-2-3 lows occur at market bottoms, and 1-2-3 highs occur at market tops.

A Ross Hook does not need more than one correction bar on the chart. In a down market, as soon as you have a higher low, you have a hook. In an up market, as soon as you have a lower high, you have a hook. The correction can be an inside bar, just make sure the market is truly trending. A more conservative view would be that to create a hook in a down market you have to have both a higher low and a higher high, and in an up market, you have to have both a lower high and a lower low to create a hook. The choice must be your own according to experience. My own preference is that any correction bar, including an inside bar, forms a hook.

The next figure shows what I mean by Ross Hooks.



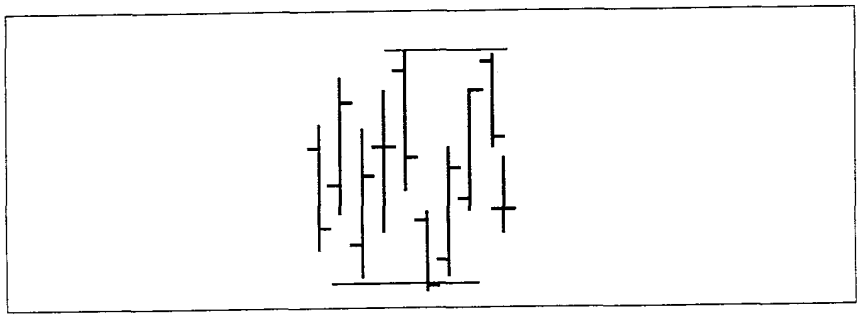
A Ross Hook can occur only **after** a valid 1-2-3, or , in the absence of a 1-2-3, after the breakout of a Trading Range or Ledge. The #2 point is created by a correction but is **not** a Ross Hook. All subsequent points created by corrections are Ross Hooks. The above Ross Hooks "Rh" were tradable because they had non-gap breakouts. There are other Hooks shown, but, because of gap openings, they were not tradable.

I've shown 1-2-3 lows and highs to demonstrate the difference between 1-2-3's and Ross Hooks. An automatic alert should be placed the minute a market makes a hook on the daily chart. I place the alert at a point prior to the taking out of the hook.

The Ross Hook appears in all of my earlier books, and is discussed in great detail in **TRADING THE ROSS HOOK**.

THE BREAKOUT OF A LEDGE

This is what a Ledge might look like:



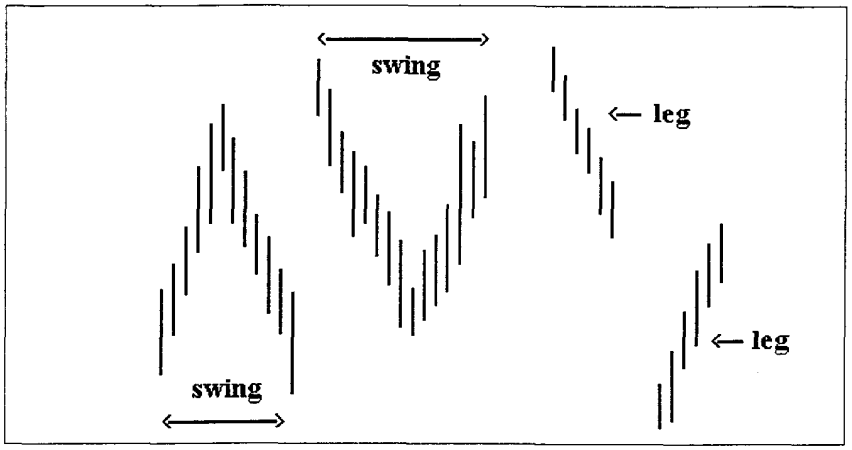
This is how I determine what constitutes a Ledge:

I look for a correction or congestion that is at least three bars in length, but no more than ten bars in length.

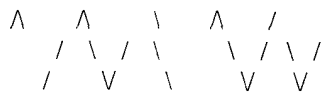
The Ledge is characterized by a "squaring off" of highs and/or lows, the flatter the better. Perfect squares are best.

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 alert on one side of the Ledge, there is an opposite alert entered at the other side of the Ledge.

I can go back only as far as the first leg of the previous market swing to find a matching high or low.



The following sets of four legs constitute 2 swings:



When defining the Ledge, I can go back no further than the first of the four legs.

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 not a straddle as the word is used in options trading.

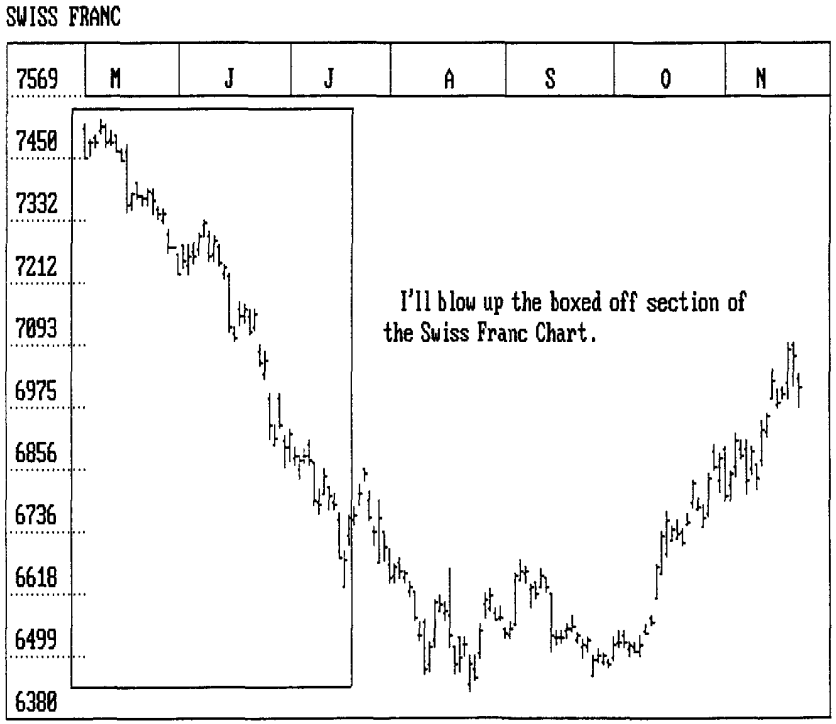
The technique I use becomes possible because the market decides to move sideways for a number of bars on the chart, thereby making it possible for me to straddle the prices with my buy and sell orders at natural support and resistance points.

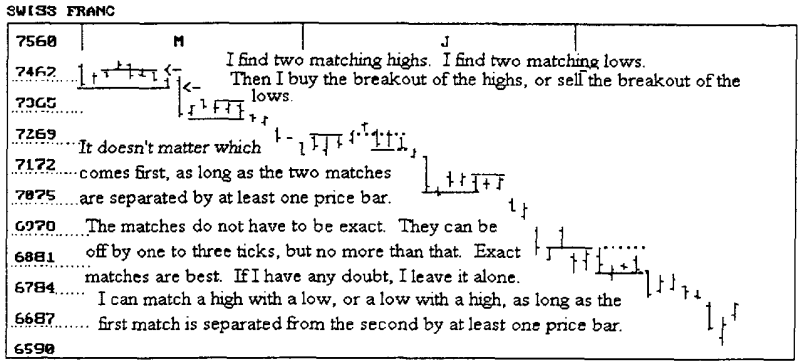
I mark these off as soon as I can draw a line with a ruler across two highs or two lows, just so long as they match in price. I will enter a trade only if prices break out of the Ledge by trading through the high or the low (or both). I will not enter a trade if prices gap past my entry points.

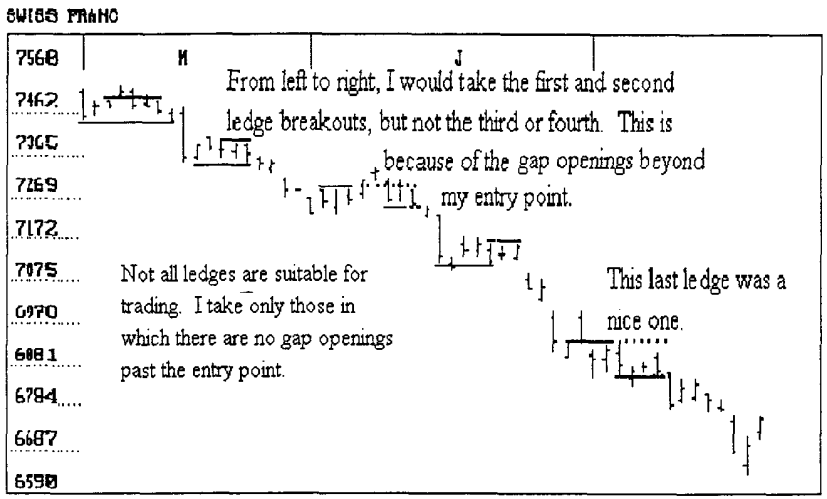
Once there are more than ten bars on the chart, I stop trying to trade the ledges. I wait for the market to start trending again, or for a full blown Trading Range to complete itself.

Why does this entry technique work so well? Because 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.

In order to show more clearly what I'm doing with this technique, I have shown a Swiss Franc chart in the next figure.







In the figure above, I trade only an actual breakout of the Ledge. The breakout point is where I have drawn the line connecting two matching highs or two matching lows. This may **not** be the absolute high or low of the entire congestion on a chart of daily prices.

Ledge trades should be taken only in strongly trending markets. You will be killed if you attempt them in Trading Ranges. What is a strongly trending market? One that is moving at a 45° or greater angle.

For more detail on how I trade ledges in the futures markets, see my book **TRADING IS A BUSINESS.**

SUMMARY OF MAJOR ENTRY SIGNALS

- **The breakout of a Trading Range.**
- **The breakout of a 1-2-3 high or low.**
- **The breakout of a Ross Hook.**
- **The breakout of a Ledge.**

Note: some of these may occur concurrent with one another.

That's it! Four simple patterns are all you need to trade seasonals properly.

Congestion

Since this may be the reader's first contact with my writings, I must, for the sake of building a foundation, explain what various chart patterns are like, what congestion consists of, why congestion occurs, and how it looks. I will also be showing how to identify a trend. Being able to identify either congestion or a trend for the most part used to be sufficient. If a market was trending, then it was not in congestion. If a market was in congestion, it was not trending. If you were not sure, then you stood aside until you were sure.

What Is Congestion?

If we have rules for defining congestions and trends, why do we need to examine the fundamental causes? Because as much as we would like to set rules about market action, the markets do not always accommodate our rules. We've seen how congestion appears, but what is it? Why does it occur? When does it occur?

Congestion is characterized by an area where prices move sideways. Prices move in a "Trading Range." There is a price zone of relative support, and a price zone of relative resistance. Support and resistance are usually readily seen at a price area that is tested or challenged more than once.

Congestion is typified by alternating bars of lower-open, higher-close and higher-open, lower-close, as well as Doji bars. Technically, a Doji bar is a price bar having an equal open and close.

Congestion may be an area of neutrality of opinion.

Congestion may be an area of equilibrium. Supply and demand are approximately equal, or in balance.

Congestion may be an area of accumulation or distribution.

Why Congestion Occurs

A number of reasons for congestion are described in the next few paragraphs. There are other reasons as well.

Equilibrium: A balance between supply and demand may cause a market to move sideways in a Trading Range. This happens because at the lower price zone of the Trading Range, prices are perceived by some traders as being inexpensive, and buying takes place. At the upper price zone of the Trading Range prices are high enough that some traders are willing to take profits. To whom do they sell? To those traders who buy the market thinking that prices will go up even further. They are looking for a breakout. Why does their buying not cause the market to break out and go higher?

Because in addition to the selling by those who take profits, there is selling by those traders who feel the market has gone too high, they trade "resistance." Their selling defeats the buying by the breakout traders, and the market moves back down to the lower price zone. At the lower price zone, the sellers who sold high buy back their short positions in order to take profits.

From whom do they buy? From those traders who feel the market is now underpriced. Why doesn't the market continue down? Because in addition to the bargain shoppers, there will be traders who are buying "support." If more traders buy than sell, the market will begin to rise, thus prolonging the length of the Trading Range. One aspect of equilibrium then is profit taking, which in itself is a reason that markets congest.

Profit taking: When a market has been trending for awhile, a point will be reached where accumulated profits in the trade are too tempting to be left in the market. Profit taking will result in a pause in the trend, at which point an active exchange between buyers and sellers will take place. Profit takers will be met by those eager to join the trend on a retracement.

Accumulation and **distribution:** These phases of a market's price action usually cause it to enter congested Trading Ranges. Those eager to accumulate a given tradable will buy when the price drops below their target, but stop buying when the price rises above what they perceive to be the "value area." The price will then have to drop to encourage new buyers. Those who want to distribute will sell, but only when the price is sufficiently high.

Doubt: A market will tend to move sideways when traders are not sure concerning various fundamentals that affect a particular market. Uncertainty regarding whether there will be sufficient or excess rain or any early freeze may affect foodstuff markets. A threatened strike by gold miners in Africa or silver miners in Mexico may create doubt and cause those markets to move sideways. The threat of central bank intervention may cause currencies to move sideways. Divergence of opinion concerning a report to be issued can cause congestion in a market.

Confusion: When government policies affecting a market are not clear, the market may move in a Trading Range. Conflicting government reports on the economy can cause markets to go into congestion.

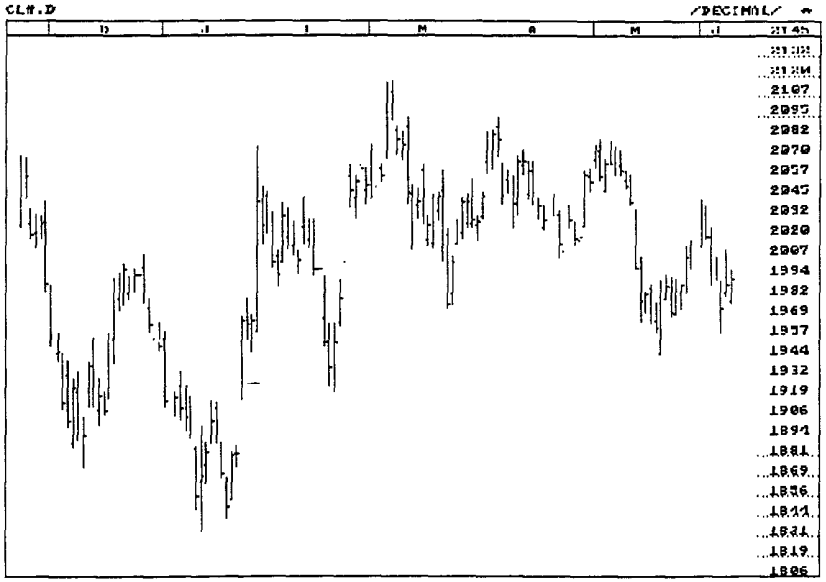
Conflicting private or government weather reports, conflicting statements by governmental and quasi-governmental officials can cause a market to congest.

In general, anything that creates confusion or doubt may cause a market to stop trending and congest before resuming an existing trend or changing direction and forming a new trend.

Remember, if a formation is not congestion, then it must be a trend, and vice-versa. Let's begin by learning to visualize congestion.

Visualizing Congestion

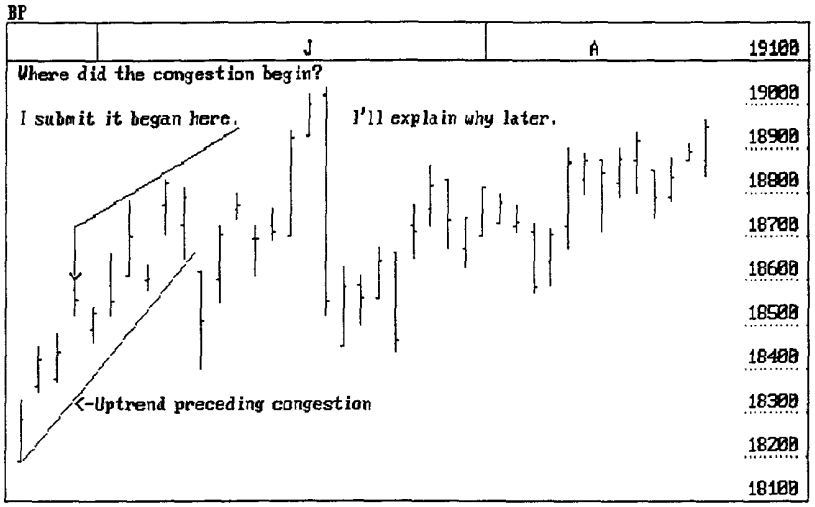
What does congestion look like? How does it appear to the eye? I'm going to show you a series of charts, all of which, at least in some part, depict congestion.



The chart above shows nearly seven months' worth of daily price bars. The entire chart is one big congestion, and contains numerous smaller congestion areas.

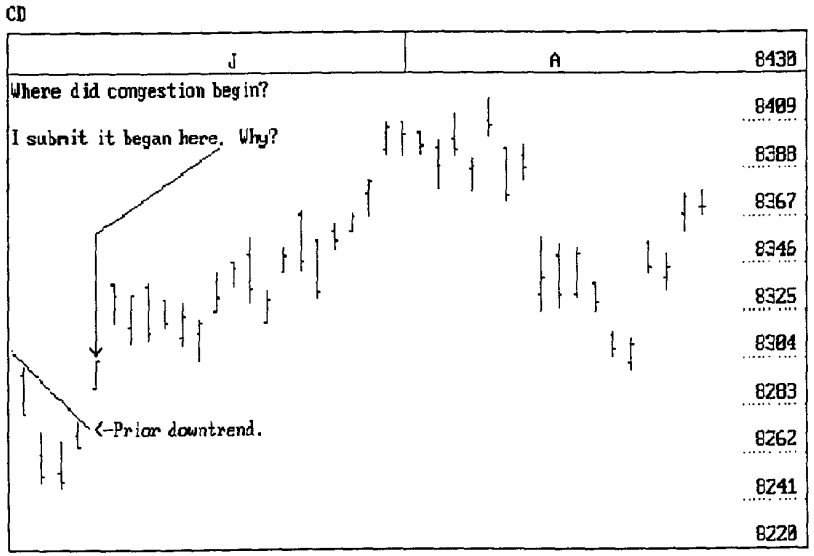
Only at the far left of the chart do we see two brief periods when the market trended for a few days.

Now we will take a closer look at some other charts and derive the definitions of trend and congestion.



Above is a typical congestion or Trading Range. Begin looking carefully to see if you can spot where and why congestion began. How could you tell visually? Take a few minutes to think about this chart. It will help you to understand what follows.

Take note, if you will, that the congestion began while the market was still trending. Only by looking back can it be seen that congestion began at the point I marked on the chart.



Ask yourself, "Why does congestion begin there? Why not somewhere else?" How can one tell it began there? What are the characteristics of congestion? Was there any place on the chart where congestion ended? Why? See if you can anticipate how we will define congestion.

Defining Congestion

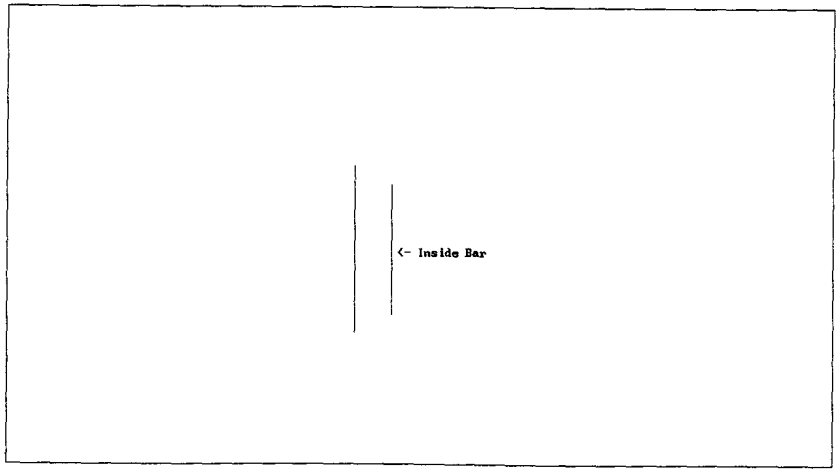
One of the concepts I learned in the earliest years of my trading was how to know when I was in congestion. I was taught each of the concepts I will present, the most recent by my trader friend, Neal Arthur Muckler. I'll begin with that one.

Any time prices **close** on four consecutive bars, within the confines of the range of a **single price bar** and subsequent to that bar, you have congestion. This is regardless of where the highs and lows may be located. The **single price bar** may be termed a **measuring bar.**

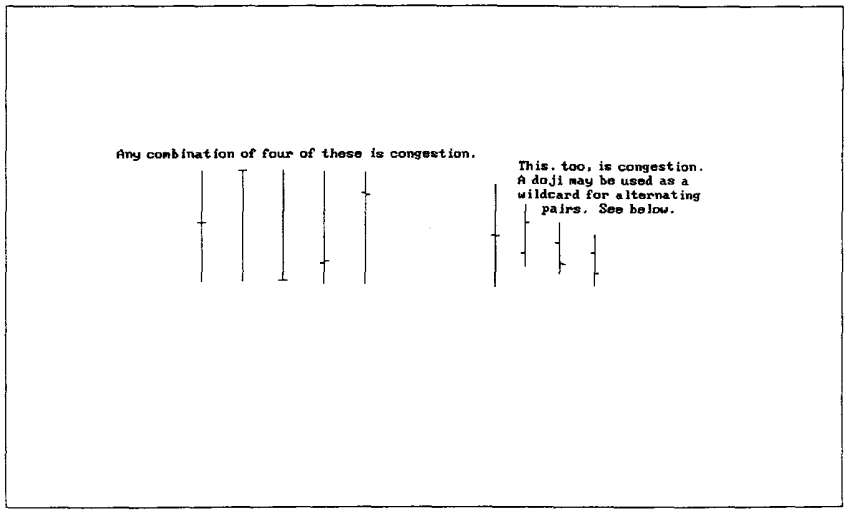
You will have to closely and carefully study congested areas. Congestion can be very subtle in appearance. Often the difference between congestion or trend is the positioning of a single open or close.

Now it's time to review another way to know when we are in congestion.

Any time we are not making higher highs and higher lows, or lower highs and lower lows, and we can see four alternating bars, at times coupled with inside bars, at times coupled with Dojis, we have congestion. Alternating bars are ones where prices open lower and close higher on one bar, and open higher and close lower on the next. Inside bars look like this:



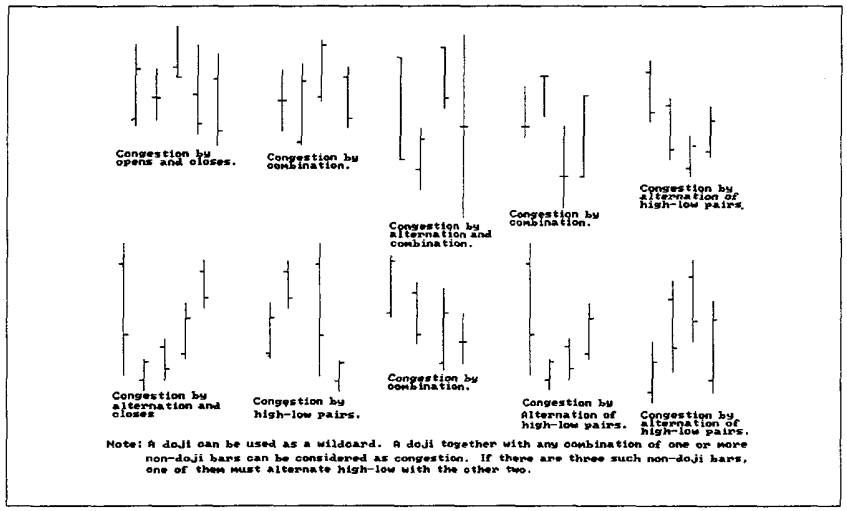
Dojis are bars where the open and close are at the same price or very near to the same price, yielding a bar that looks like this:



A combination of alternate closing high-low, low-high pairs is congestion.

"Pointy" places made when the market is in congestion are **not** Ross Hooks.

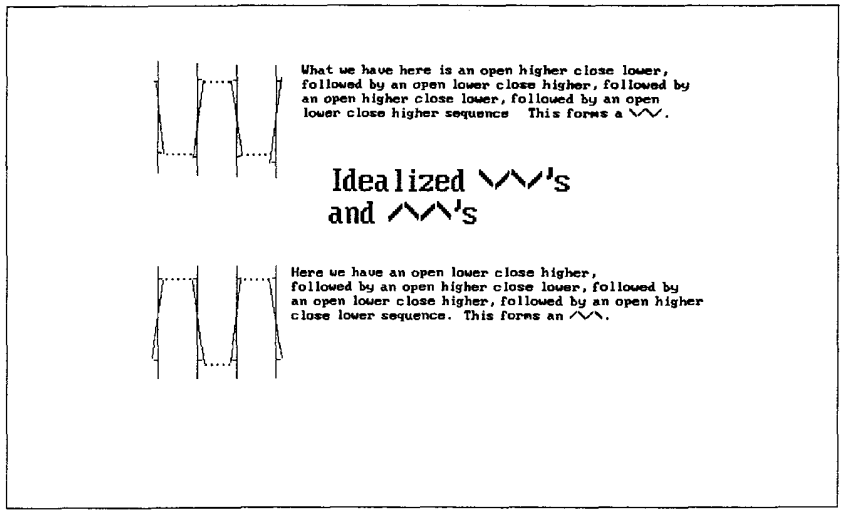
The first bar of the congestion may very well be the last bar of what had been a trend. A congestion may look similar to any of the following, as long as it consists of four or more bars:



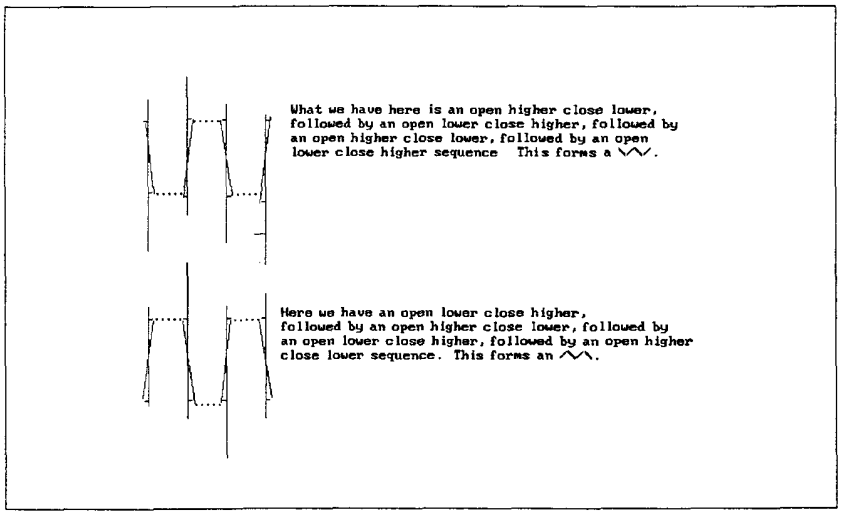
Frequently congestion will start or end with a doji. Frequently congestion will begin or end with a long bar move, or a gap.

Another way to identify congestion is when you see /\ or \/ on the chart.

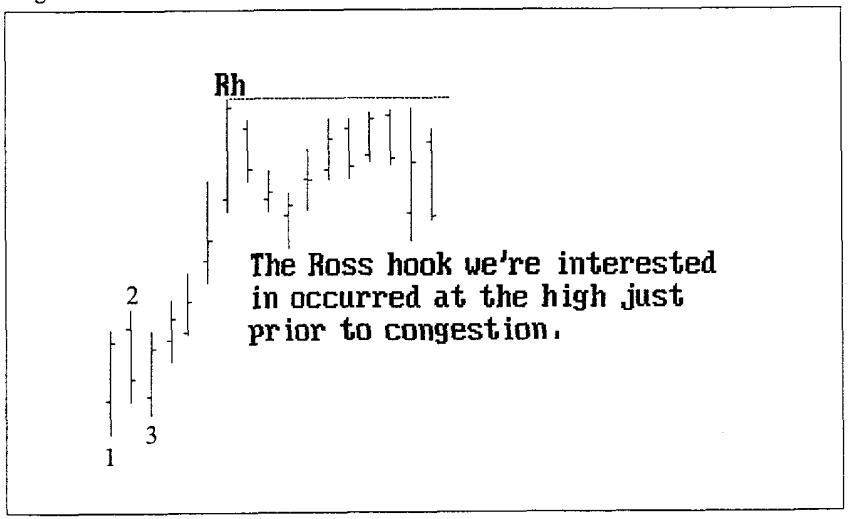
The smallest possible number of bars that can make up this formation is four. Let's see how this can be done.



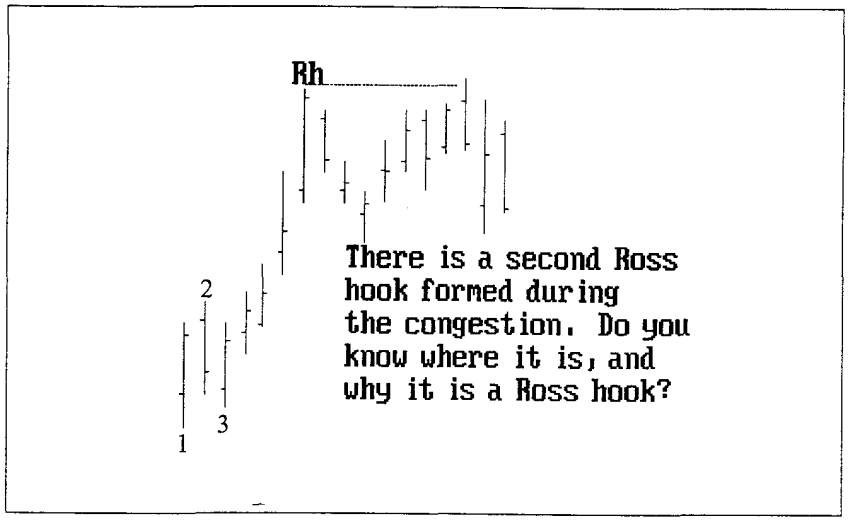
In reality, we may get something that looks more like the following:



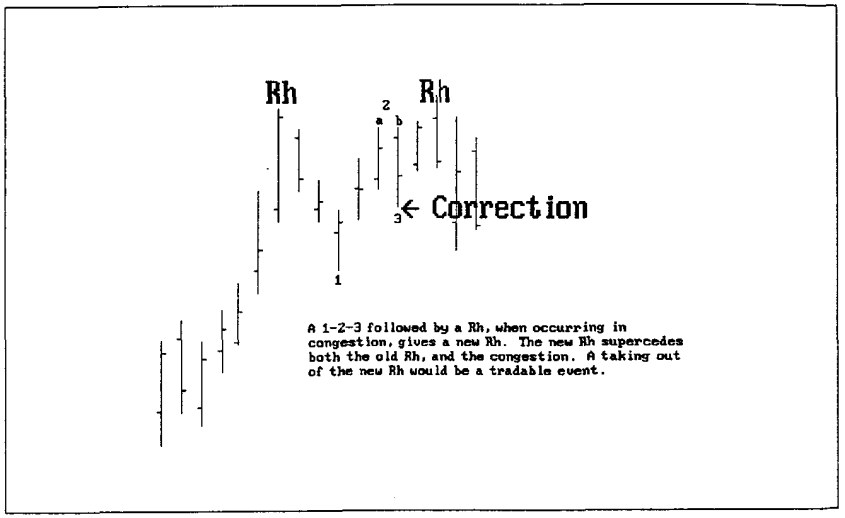
If we were to get a formation that looked like the following, the Ross Hook would be as marked. If that Hook is taken out, we would want to be long. Notice that the bar that created the Ross Hook was the last bar of the trend and the first bar of the congestion.



Now, let's see if you're really getting this.



The Ross Hook is as marked below.



Note: **A 1-2-3 followed by a breakout of the #2 point, that subsequently results in a Ross Hook, supersedes any congestion, or previous Ross Hook.**

The price bar labeled "b" made a new local low. The take out by prices of the local double resistance, "a" and "b", is a significant event. "a" and "b", together, constitute the number two point of a 1-2-3 low occurring in congestion.

The new Ross Hook represents an even more significant breakout point. Combined with the old Rh, there is significant resistance, and within a few ticks, the two constitute a double top. If prices take them both out, you would normally expect a relatively longer term, strong move up.

I use the term "relatively" here, because the intensity and the duration of the move would be relative to the time frame in which the price bars were made. Obviously such a move on a one minute chart would hardly compare with an equivalent move on a daily chart.

While we are looking at the chart, there is something else of importance to notice. Prices retreated from the resistance point, thereby creating the second Ross Hook.

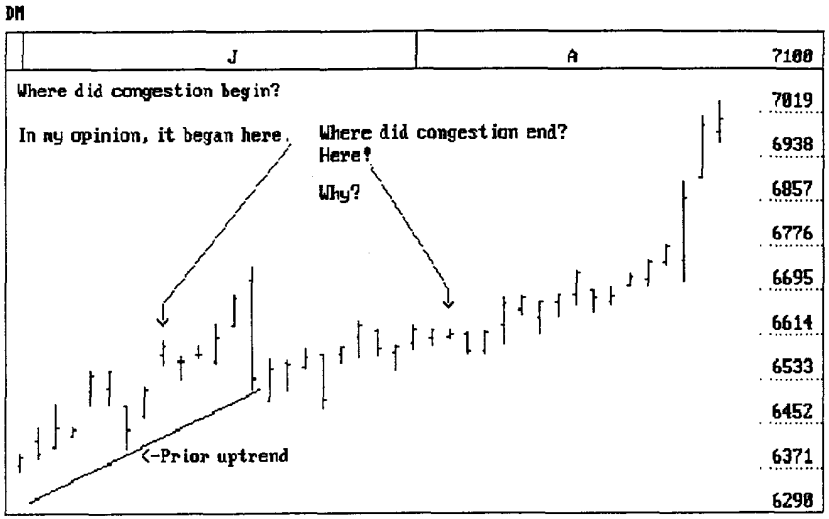
This represented a failure to break out. This failure is why Reverse Ross hooks are important.

Now, let's give you a brief review of the various congestions. All of the three following conditions that define congestion must occur without consistently making higher highs or lower lows.

Congestion by Opens/Closes: Four consecutive closes or opens within the range of a measuring bar.

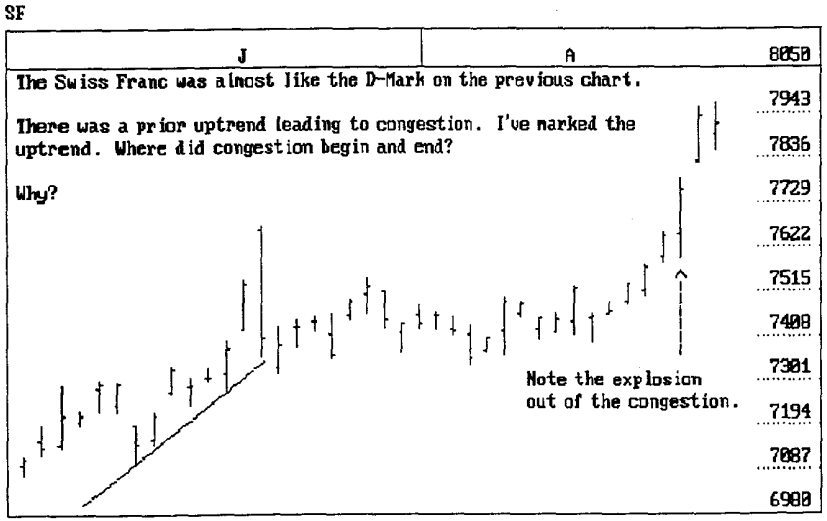
Congestion by Combination: A series of four consecutive dojis, or at least one doji and any three alternating bars. The doji is a wild card and can be used to alternate with any other bar. If there are three non-doji bars, one of them must alternate high-to-low with the other two non-doji bars.

Congestion by Alternation: A series of four consecutive alternating open high - close low, open low - close high bars in any sequence. This definition includes Congestion by High/Low pairs.



Congestions are supposed to have a beginning. At times they can continue quite a long while before they have an end. It is just as important to be able to identify the end of congestion as it is to identify the beginning. When congestion ends, a new trend may be born. Sometimes the market just quickly moves to a new congestion area. That is what we are seeing more of now – periods of extended congestion alternating with sudden explosions and collapses of price.

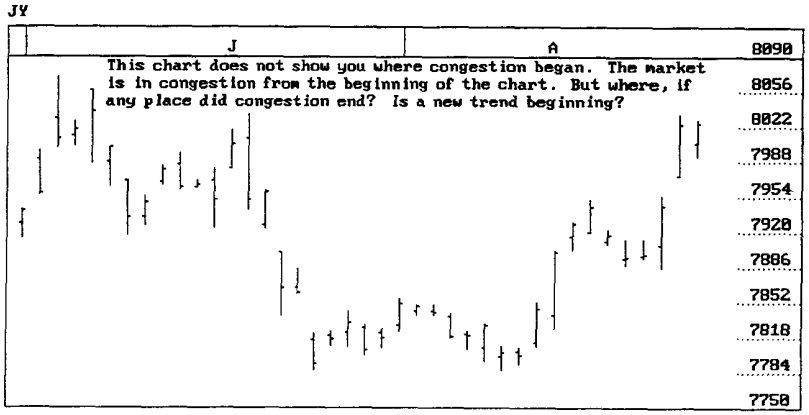
If you have studied in detail the previous charts in this section, perhaps you are beginning to *see* how I define congestion. For purposes of trading as shown in this course, I define congestion as the ***absence of trend***.



Including the first bar, if you said it began with the ninth bar from the left you were correct. Including the last bar, if you said congestion ended with the eleventh bar from the right, you were right again. In a moment you will see why.

So much for the suspense. The next few charts will reveal what I *see* that helps me define both trends and congestion areas. Remember, for this exercise it can be one or the other, but not both.

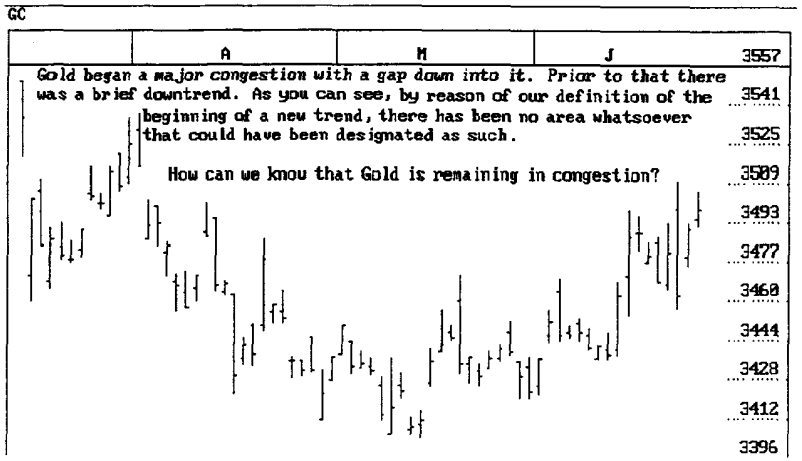
Defining A Trend



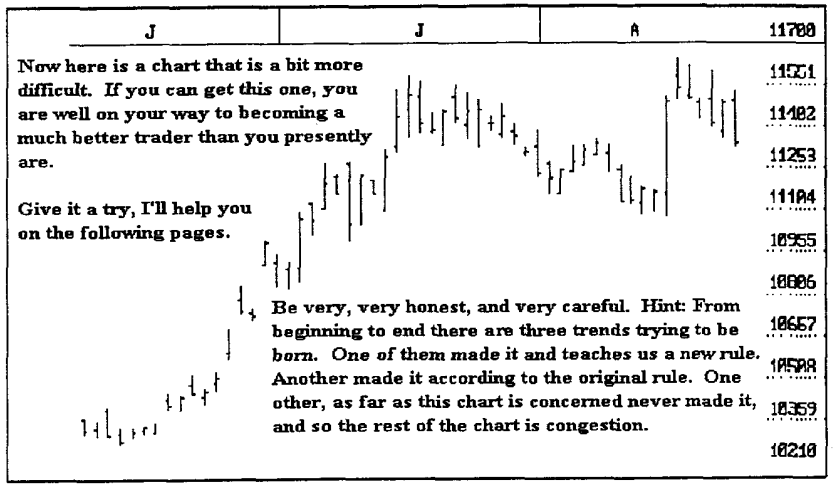
I am going to show you a new way to define a trend. This is not in conflict with my other writings, rather it is in addition to them.

Including the last bar, congestion ended with the seventh bar from the right. *Why*? A new trend is beginning. *Why*? **The seventh bar from the right is the fourth successive bar that has closed higher than it opened.** A trend is being born. Following a turning point (five bars prior to the seventh bar), four successive bars that close higher than they open indicate a trend being born. But what of the bars following that seventh bar from the right?

We have three correcting bars followed by a breakout bar. The breakout bar **defines** the trend. It took out the high of the fourth bar that closed higher than it had opened. A new trend has been born within the old congestion. There is no guarantee as to the probable duration of this new trend. Nevertheless, for purposes of this book a new trend has started, it has been **defined**. It remains to be seen whether this new trend will break out of the old congestion. Later we'll see what all this means and how we can trade it.



Look at the relationship between the opens and the closes on the Gold chart. They are mostly alternating, with occasional bars (Dojis) where the open and the close are the same. There is not a single series of four or more bars ***after*** a ***turning point***, where there is a steady progression of closes higher than opens to signify the birth of an uptrend, nor a single progression of opens higher than closes signifying a downtrend being born. The first rule of an **emerging** trend is that there must be at least a series of four closes higher than opens, or a series of four closes lower than opens, following a turning point (some call them pivot points) in order for a trend to be considered as emerging. What constitutes a ***turning point***? Looking back you see that the market has changed direction. It may be a correction in process, but the market is no longer going in the same direction. I don't know how to predict turning points, but I can see them when I look at what has happened. When I say ***after*** a turning point, I mean the pivot bar cannot be counted in the progression. A ***turning point*** would have been a Ross Hook in the prior trend, or is near the extreme of a Trading Range, or could also be either a #1 or #3 point.



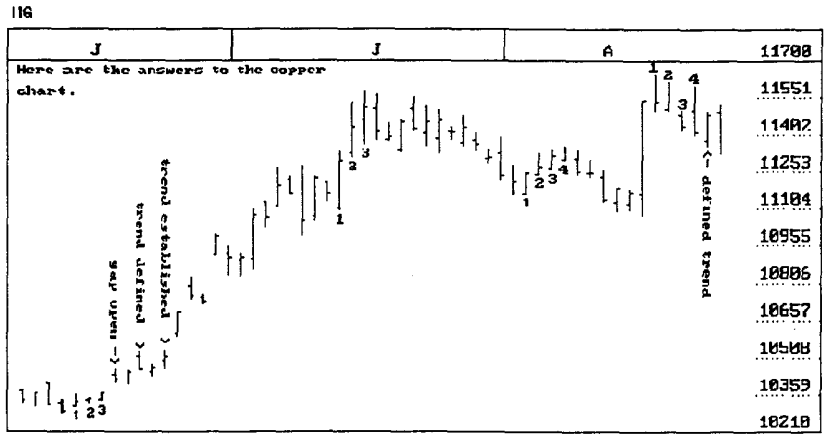
Let's look at this chart and learn a new rule. The rule is, that if subsequent to a turning point, there are three successive open-lower, close-higher bars followed immediately by a gap up opening beyond the Trading Range of the previous bar, or three successive open-higher, close-lower bars followed immediately by a gap down opening beyond the Trading Range of the previous bar, a trend is attempting to emerge. Once again, this **must** occur ***after*** the turning point.

We now have two rules that show the birth or emergence of a trend out of congestion. Let's repeat them:

1. Subsequent to a turning point, four successive open-lower, close-higher bars, or four successive open-higher, close-lower bars, mean a trend is attempting to emerge.

2. Subsequent to a turning point, three successive open-lower, close-higher bars followed immediately by a gap up opening beyond the high of the previous bar, or three successive open-higher, close-lower bars followed immediately by a gap down opening beyond the low of the previous bar, mean a trend is emerging or being born.

Under either rule the emerging trend is not yet **defined**. We cannot say the trend is defined unless and until the highest high of the emerging trend is taken out in an up-move, or the lowest low of the emerging trend is taken out in a down-move. When the appropriate breakout has taken place, we have a **defined** trend. I've also labeled the successor to the defined trend. We will call it an **established** trend. An **established trend** takes place when there is a correction subsequent to a **defined** trend. When the **extreme** of the **defined** trend is taken out, we then have an **established** trend.

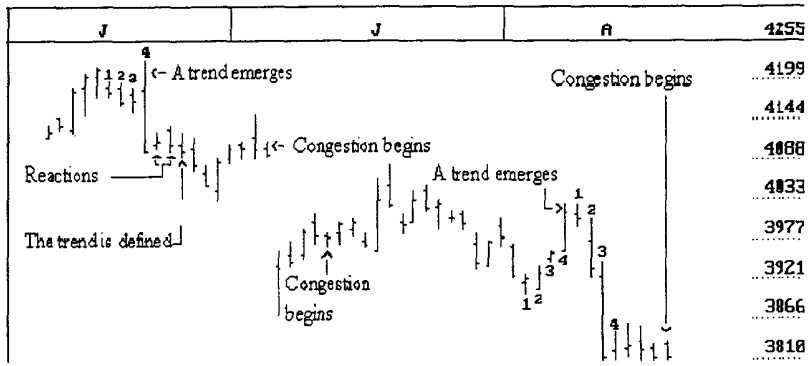


In a rising market:

- Subsequent to a turning point, four successive closes higher than the opens = *emerging* trend.
- Subsequent to a turning point, three successive closes higher than the opens, followed by a gap up open beyond the high of the previous bar = *emerging* trend.
- The breakout of the high of an emerging trend = *defined* trend.
- The breakout of the high of a defined trend = *established* trend.

In a falling market:

- Subsequent to a turning point, four successive closes lower than the opens = *emerging* trend.
- Subsequent to a turning point, three successive closes lower than the opens, followed by a gap down open beyond the low of the previous bar = *emerging* trend.
- The breakout of the low of an emerging trend = *defined* trend.
- The breakout of the low of a defined trend = *established* trend.



Now let's learn some other rules:

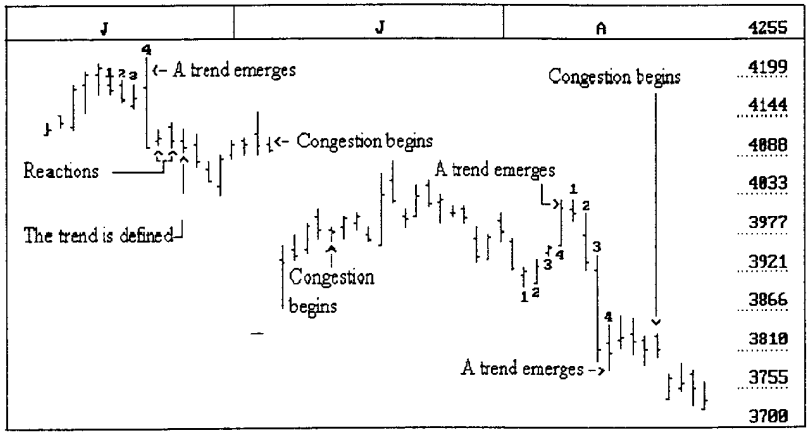
3. A correction can last no more than three bars. Four bars marks either congestion or the birth of a trend in the opposite direction. A correction in an uptrend is any failure by prices to make a new high. A correction in a downtrend is any failure by prices to make a new low.

4. Once a trend is defined, it requires at least four non-trending bars to break the trend, i.e., four or more bars in which the trend fails to continue, either by virtue of congestion or correction.

5. An uptrend is **defined** when the highest high of an emerging trend is taken out or violated. A downtrend is **defined** when the lowest low of an emerging trend is taken out or violated.

6. An uptrend is **established** when, after a reaction or even a sideways hesitation (Ledge), the high of the defined uptrend is taken out or violated and the trend continues. A downtrend is **established** when, after a reaction or even a sideways hesitation (Ledge), the low of the defined downtrend is taken out or violated and the trend continues.

Combining Rules 5 and 6, a trend is first **defined**, and later **established**. A **defined** trend puts us on alert. An **established** trend is a tradable event. If we know how to identify an emerging trend, then by default we know how to identify congestion. Anything that is not a trend must, by definition, be congestion. However, congestion can also be defined on its own terms, for fundamental reasons, as described earlier.



Appendix B

Decision Tables

In several places throughout the text, I mentioned the fact that you can get professionally researched data on seasonality. I asked Moore's Research Center for permission to reproduce their seasonal tables so that you could see first hand the format of what I am able to see when I look for seasonality in a trade. The following pages contain examples of the Moore's Research Decision Tables. All tables show a fifteen year history. The top section of the tables is explained below. The bottom section of the tables is explained at the end of this Appendix.

1. The Contract Year

2. The Optimized approximate Entry Date

3. The theoretical Entry Price for that Entry Date

4. The Optimized approximate Exit Date

5. The theoretical Exit Price for that Exit Date

6. The theoretical Profit Amount had you entered on the Optimized Entry Date and exited on the Optimized Exit Date.

7. The Best Equity Date, which represents the date for each year on which the trade had the greatest amount of unrealized paper profits.

8. The Best Equity Amount, which represents the greatest theoretical amount of profit that could possibly have been made.

9. The Worst Equity Date, which represents the date on which the greatest amount of drawdown took place between the optimized entry and exit dates.

10. The Worst Equity Amount. Based on the optimized entry and exit dates this is the amount of the greatest theoretical drawdown that could have taken place.

A Decision Table Showing a history of the September D-Mark/B-Pound spread

Moore Research Center, Inc.

Buy Sep 95 Deutsche Mark(IMM) / Sell Sep 95 British Pound (IMM)

Enter on approximately 05/26 - Exit on approximately 06/20

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	05/26/94	-18438	06/20/94	-17875		562.50	06/20/94	562.50	06/08/94	-1025.00
1993	05/26/93	-20237	06/18/93	-19275		962.50	06/04/93	2600.00		
1992	05/26/92	-35875	06/19/92	-36225		-350.00	09/03/92	800.00	06/18/92	-387.50
1991	05/28/91	-34463	06/20/91	-31725		2737.50	06/18/91	3387.50		
1990	05/29/90	-29238	06/20/90	-31425		-2187.50	06/04/90	375.00	06/20/90	-2187.50
1989	05/26/89	-34725	06/20/89	-31725		3000.00	06/14/89	3287.50		
1988	05/26/88	-42238	06/20/88	-39350		2887.50	06/06/88	3887.50	05/27/88	-75.00
1987	05/26/87	-31575	06/19/87	-31325		250.00	05/27/87	643.75	06/12/87	-1706.25
1986	05/27/86	-37838	06/20/86	-37025		812.50	06/04/86	1031.25	06/11/86	-181.25
1985	05/28/85	-36856	06/20/85	-38169		-1312.50	06/05/85	131.25	06/18/85	-2356.25
1984	05/29/84	-40769	06/20/84	-40169		600.00	06/20/84	600.00	06/01/84	-37.20
1983	05/26/83	-49381	06/20/83	-46075		3306.25	06/15/83	3718.75	05/31/83	-656.25
1982	05/26/82	-58331	06/18/82	-57800		531.25	06/17/82	793.75	06/07/82	-1281.25
1981	05/26/81	-77025	06/19/81	-71938		5087.50	06/05/81	8031.25	05/27/81	-212.50
1980	05/27/80	-74425	06/20/80	-72425		2000.00	06/03/80	4281.25		
Percentage Correct		80						Protective Stop		(1637)
Average Profit on Winning Trades		1894.79		1894.79				Winners		12
Average Loss on Trades		-1283.33		-1283.33				Losers		3
Average Net Profit Per Trade		1259.17		1259.17				Total Trades		15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the June/December Eurodollar spread

Moore Research Center, Inc.

Buy Jun 95 Eurodollar(IMM) / Sell Dec 95 Eurodollar(IMM)

Enter on approximately 03/04 - Exit on approximately 04/28

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE	PROFIT	PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	03/04/94	0.82	04/28/94	1.17	0.35	875.00	04/18/94	1075.00	03/11/94	-100.00
1993	03/04/93	0.50	04/28/93	0.52	0.02	50.00	03/15/93	650.00	04/22/93	-150.00
1992	03/04/92	1.03	04/28/92	1.06	0.03	75.00	03/20/92	775.00	04/09/92	-500.00
1991	03/04/91	0.61	04/26/91	0.75	0.14	350.00	04/22/91	625.00	03/05/91	-50.00
1990	03/05/90	0.29	04/27/90	0.49	0.20	500.00	04/27/90	500.00	03/20/90	-175.00
1989	03/06/89	-0.18	04/28/89	-0.06	0.12	300.00	03/31/89	1075.00	03/10/89	-75.00
1988	03/04/88	0.50	04/28/88	0.62	0.12	300.00	04/28/88	300.00		
1987	03/04/87	0.11	04/28/87	0.58	0.47	1175.00	04/24/87	1400.00	03/27/87	-325.00
1986	03/04/86	0.17	04/28/86	0.12	-0.05	-125.00	03/07/86	250.00	04/10/86	-375.00
1985	03/04/85	0.89	04/26/85	1.23	0.34	850.00	04/26/85	850.00	03/06/85	-100.00
1984	03/05/84	0.66	04/27/84	1.01	0.35	875.00	04/24/84	975.00	03/08/84	-25.00
1983	03/04/83	0.48	04/28/83	0.50	0.02	50.00	04/18/83	300.00	03/25/83	-400.00

Percentage Correct	92			Protective Stop	(571)
Average Profit on Winning Trades	0.20	490.91		Winners	11
Average Loss on Trades	-0.05	-125.00		Losers	1
Average Net Profit Per Trade	0.18	439.58		Total Trades	12

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the May Feeders/August Fat Cattle

Moore Research Center, Inc.

Buy May 95 Feeder Cattle (CME)/Sell Aug 95 Live Cattle(CME)

Enter on approximately 04/30 - Exit on approximately 05/14

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	05/02/94	11295	05/13/94	11040		-255.00			05/10/94	-498.00
1993	04/30/93	13477	05/14/93	13775		298.00	05/14/93	298.00		
1992	04/30/92	10910	05/14/92	11722		812.00	05/14/92	812.00	05/04/92	-385.00
1991	04/30/91	14420	05/14/91	15205		785.00	05/08/91	957.00		
1990	04/30/90	12665	05/14/90	13387		722.00	05/11/90	777.00	05/01/90	-158.00
1989	05/01/89	11010	05/12/89	11397		387.00	05/12/89	387.00	05/03/89	-85.00
1988	05/02/88	12290	05/13/88	12705		415.00	05/13/88	415.00		
1987	04/30/87	9380	05/14/87	10300		920.00	05/14/87	920.00	05/05/87	-220.00
1986	04/30/86	5957	05/14/86	6760		803.00	05/13/86	1045.00		
1985	04/30/85	6627	05/14/85	9642		315.00	05/10/85	648.00		
1984	04/30/84	6367	05/14/84	6392		25.00	05/14/84	25.00	05/09/84	-915.00
1983	05/02/83	7355	05/13/83	7742		387.00	05/13/83	387.00		
1982	04/30/82	7410	05/14/82	7427		17.00	05/06/82	240.00	05/12/82	-213.00
1981	04/30/81	6375	05/14/81	6890		515.00	05/14/81	515.00	05/05/81	-635.00
1980	04/30/80	7602	05/14/80	8892		1290.00	05/12/80	1728.00		

Percentage Correct	93			Protective Stop	(644)
Average Profit on Winning Trades	549.36	549.36		Winners	14
Average Loss on Trades	-255.00	-255.00		Losers	1
Average Net Profit Per Trade	495.73	495.73		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the December Gold/Silver spread

Moore Research Center, Inc.

Buy Dec 95 Gold(CMX)/Sell Dec 95 Silver(CMX)

Enter on approximately 06/11 - Exit on approximately 06/28

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	06/13/94	11645	06/28/94	12355		710.00	06/27/94	795.00	06/15/94	-350.00
1993	06/11/93	15725	06/28/93	15320		-405.00	06/18/93	30.00	06/25/93	-415.00
1992	06/11/92	13705	06/26/92	14515		810.00	06/26/92	810.00		
1991	06/11/91	14840	06/28/91	14945		105.00	06/26/91	195.00	06/13/91	-140.00
1990	06/11/90	10745	06/28/90	11270		525.00	06/25/90	685.00	06/12/90	-90.00
1989	06/12/89	10140	06/28/89	11210		1070.00	06/23/89	1070.00	06/16/89	-85.00
1988	06/13/88	9915	06/28/88	10025		110.00	06/24/88	425.00	06/20/88	-635.00
1987	06/11/87	6620	06/26/87	10110		3490.00	06/22/87	3745.00		
1986	06/11/86	8080	06/27/86	9750		1670.00	06/27/86	1670.00		
1985	06/11/85	555	06/28/85	985		430.00	06/28/85	430.00	06/18/85	-255.00
1984	06/11/84	-6260	06/28/84	-4995		1265.00	06/27/84	1530.00	06/12/84	-205.00
1983	06/13/83	-18800	06/28/83	-16215		2585.00	06/28/83	2585.00	06/23/83	-1120.00
1982	06/11/82	2870	06/28/82	4330		1460.00	06/21/82	2450.00		
1981	06/11/81	-5750	06/26/81	-2845		2905.00	06/26/81	2905.00	06/12/81	-800.00
1980	06/11/80	-20450	06/27/80	-17930		2520.00	06/23/80	3730.00	06/13/80	-850.00

Percentage Correct	93			Protective Stop	(1668)
Average Profit on Winning Trades	1403.93	1403.93		Winners	14
Average Loss on Trades	-405.00	-405.00		Losers	1
Average Net Profit Per Trade	1283.33	1283.33		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the September J-Yen/B-Pound spread

Moore Research Center, Inc.

Buy Sep 95 Japanese Yen(IMM) / Sell Sep 95 British Pound (IMM)

Enter on approximately 05/21 - Exit on approximately 06/25

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	05/23/94	26763	06/24/94	28250		1487.50	06/21/94	2600.00	06/06/94	-1287.50
1993	05/21/93	17575	06/25/93	26063		8487.50	06/25/93	8487.50		
1992	05/21/92	-15763	06/25/92	-17100		-1337.50	06/02/92	1862.50	06/24/92	-1475.00
1991	05/21/91	-16138	06/25/91	-10888		5250.00	06/20/91	5262.50	05/28/91	-1087.50
1990	05/21/90	-21700	06/25/90	-25962		-4262.50	05/25/90	2000.00	06/25/90	-4262.50
1989	05/22/89	-8100	06/23/89	-5975		2125.00	06/23/89	2125.00	06/15/89	-1187.50
1988	05/23/88	-15200	06/24/88	-10700		4500.00	06/24/88	4500.00		
1987	05/21/87	-14888	06/25/87	-14519		368.75	05/27/87	2518.75	06/12/87	-381.25
1986	05/21/86	-19138	06/25/86	-18688		450.00	06/20/86	1250.00	06/02/86	-400.00
1985	05/21/85	-28413	06/25/85	-29137		-725.00	05/24/85	1356.25	06/18/85	-1637.50
1984	05/21/84	-33188	06/25/84	-31631		1556.25	06/25/84	1556.25		
1983	05/23/83	-44150	06/24/83	-43650		500.00	06/22/83	1481.25	06/09/83	-3212.50
1982	05/21/82	-59150	06/25/82	-58700		450.00	06/25/82	450.00	06/07/82	-1775.00
1981	05/21/81	-74094	06/25/81	-66450		7643.75	06/05/81	8950.00	05/27/81	-181.25
1980	05/21/80	-87669	06/25/80	-86581		1087.50	06/03/80	3087.50	05/28/80	-1556.25

Percentage Correct	80			Protective Stop	(2390)
Average Profit on Winning Trades	2825.52	2825.52		Winners	12
Average Loss on Trades	-2108.33	-2108.33		Losers	3
Average Net Profit Per Trade	1838.75	1838.75		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT *ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED* FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the April/August Live Cattle spread

Moore Research Center, Inc.

Buy Apr 95 Live Cattle(CME)/Sell Aug 95 Live Cattle(CME)

Enter on approximately 03/17 - Exit on approximately 04/07 - Caution: This Trade Enters Deliverable Period

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE	PROFIT	PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	03/17/94	3.60	04/07/94	5.00	1.40	560.00	04/07/94	560.00	03/21/94	-60.00
1993	03/17/93	9.00	04/07/93	9.13	0.13	52.00	03/24/93	360.00	04/02/93	-240.00
1992	03/17/92	8.40	04/07/92	10.00	1.60	640.00	04/07/92	640.00	03/20/92	-208.00
1991	03/18/91	6.85	04/05/91	7.25	0.40	160.00	04/03/91	220.00	03/20/91	-300.00
1990	03/19/90	5.53	04/06/90	6.75	1.22	488.00	04/06/90	488.00	03/27/90	-392.00
1989	03/17/89	6.40	04/07/89	9.23	2.83	1132.00	04/07/89	1132.00		
1988	03/17/88	6.05	04/07/88	7.17	1.12	448.00	04/05/88	732.00	03/22/88	-88.00
1987	03/17/87	6.45	04/07/87	8.98	2.53	1012.00	04/07/87	1012.00		
1986	03/17/86	0.50	04/07/86	0.88	0.38	152.00	03/25/86	260.00	03/18/89	-148.00
1985	03/18/85	-2.95	04/04/85	-1.55	1.40	560.00	04/01/85	900.00	03/20/85	-128.00
1984	03/19/84	5.75	04/06/84	6.58	0.83	332.00	04/05/84	432.00	03/21/84	-440.00
1983	03/17/83	1.62	04/07/83	6.27	4.65	1860.00	04/07/83	1860.00		
1982	03/17/82	4.63	04/07/82	7.72	3.09	1236.00	04/07/82	1236.00	03/22/82	-80.00
1981	03/17/81	-4.48	04/07/81	-6.43	-1.95	-780.00	03/23/81	112.00	04/07/81	-780.00
1980	03/17/80	-1.38	04/07/80	-1.05	0.33	132.00	03/31/80	132.00	03/25/80	-288.00

Percentage Correct	93			Protective Stop	(692)
Average Profit on Winning Trades	1.56	626.00		Winners	14
Average Loss on Trades	-1.95	-780.00		Losers	1
Average Net Profit Per Trade	1.33	532.27		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the October Fat Cattle/May Feeders spread

Moore Research Center, Inc.

Buy Oct 95 Live Cattle(CME)/Sell May 95 Feeder Cattle(CME)

Enter on approximately 03/10 - Exit on approximately 04/28

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	03/10/94	-11055	04/28/94	-10490		565.00	04/28/94	565.00	04/05/94	-197.00
1993	03/10/93	-13102	04/28/93	-13017		85.00	04/12/93	530.00	03/23/93	-108.00
1992	03/10/92	-10830	04/28/92	-10687		143.00	03/23/92	375.00	04/09/92	-577.00
1991	03/11/91	-13305	04/26/91	-13697		-392.00	03/13/91	268.00	04/05/91	-512.00
1990	03/12/90	-11525	04/27/90	-11427		98.00	04/04/90	515.00	04/16/90	-267.00
1989	03/10/89	-11655	04/28/89	-10580		1075.00	04/27/89	1333.00	03/27/89	-852.00
1988	03/10/88	-12955	04/28/88	-12365		590.00	04/15/88	1195.00	03/15/88	-270.00
1987	03/10/87	-9490	04/28/87	-9217		273.00	03/13/87	300.00	03/25/87	-635.00
1986	03/10/86	-8625	04/28/86	-5817		2808.00	03/28/86	2808.00	03/12/89	-12.00
1985	03/11/85	-9692	04/26/85	-7392		2300.00	04/25/85	2370.00		
1984	03/12/84	-8630	04/27/84	-7270		1360.00	04/27/84	1360.00		
1983	03/10/83	-9680	04/28/83	-8680		1000.00	04/22/83	1618.00	03/16/83	-67.00
1982	03/10/82	-8370	04/28/82	-8097		273.00	04/19/82	638.00	04/06/82	-410.00
1981	03/10/81	-9220	04/28/81	-8007		1213.00	03/20/81	1698.00	03/12/81	-62.00
1980	03/10/80	-12632	04/28/80	-8845		3787.00	04/28/80	3787.00	03/11/80	-240.00

Percentage Correct	93			Protective Stop	(1315)
Average Profit on Winning Trades	1112.14	1112.14		Winners	14
Average Loss on Trades	-392.00	-392.00		Losers	1
Average Net Profit Per Trade	1011.87	1011.87		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the October/February Live Cattle spread

Moore Research Center, Inc.

Buy Oct 95 Live Cattle(CME)/Sell Feb 96 Live Cattle(CME)

Enter on approximately 06/22 - Exit on approximately 08/07

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE	PROFIT	PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	06/22/94	-2.42	08/05/94	3.05	5.47	2188.00	08/05/94	2188.00	06/24/94	-4.00
1993	06/22/93	-0.38	08/06/93	0.10	0.48	192.00	08/06/93	192.00	07/23/93	-760.00
1992	06/22/92	1.77	08/07/92	2.98	1.21	484.00	08/07/92	484.00	06/25/92	-248.00
1991	06/24/91	-0.98	08/07/91	-1.88	-0.90	-360.00	07/08/91	680.00	08/01/91	-396.00
1990	06/22/90	0.22	08/07/90	1.55	1.33	532.00	07/25/90	620.00	07/02/90	-56.00
1989	06/22/89	0.35	08/07/89	2.40	2.05	820.00	07/26/89	1100.00		
1988	06/22/88	-6.45	08/05/88	-2.52	3.93	1572.00	08/05/88	1572.00	06/23/88	-172.00
1987	06/22/87	-2.50	08/07/87	-1.07	1.43	572.00	08/07/87	572.00	07/23/87	-320.00
1986	06/23/86	-0.02	08/07/86	2.93	2.95	1180.00	08/07/86	1180.00	07/14/86	-24.00
1985	06/24/85	-2.48	08/07/85	-2.43	0.05	20.00	07/25/85	32.00	07/23/85	-476.00
1984	06/22/84	-2.22	08/07/84	-1.33	0.89	356.00	07/09/84	496.00	07/24/84	-64.00
1983	06/22/83	-1.58	08/05/83	-1.35	0.23	92.00	06/23/83	312.00	07/21/83	-208.00
1982	06/22/82	-0.67	08/06/82	1.48	2.15	860.00	08/06/82	860.00	07/28/82	-180.00
1981	06/22/81	-1.45	08/07/81	-1.07	0.38	152.00	08/03/81	388.00	07/06/81	-220.00
1980	06/23/80	-2.00	08/07/80	-0.87	1.13	452.00	07/29/80	712.00	07/21/80	-100.00

Percentage Correct	93		Protective Stop	(790)
Average Profit on Winning Trades	1.96	676.57	Winners	14
Average Loss on Trades	-0.90	-360.00	Losers	1
Average Net Profit Per Trade	1.52	607.47	Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH *TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION.* RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the May Soybean/Wheat spread

Moore Research Center, Inc.

Buy 5M May 95 Soybeans(CBOT)/Sell 5M May 95 Wheat(CBOT)

Enter on approximately 02/12 - Exit on approximately 04/23

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE	PROFIT	PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	02/14/94	325.00	04/22/94	344	19.00	950.00	03/23/94	1762.50	04/07/94	-737.50
1993	02/12/93	231.50	04/23/93	240.25	8.75	437.50	03/10/93	1237.50	04/16/93	-237.50
1992	02/12/92	159.50	04/23/92	200.75	41.25	2062.50	04/15/92	2750.00	02/14/92	-325.00
1991	02/12/91	321.00	04/23/91	312	-9.00	-450.00	03/08/91	250.00	03/25/91	-1787.50
1990	02/12/90	209.00	04/23/90	235.5	26.50	1325.00	03/09/90	1875.00	02/26/90	-37.50
1989	02/13/89	309.00	04/21/89	345.5	36.50	1825.00	03/22/89	2837.50	04/03/89	-375.00
1988	02/12/88	302.75	04/22/88	348.5	45.75	2287.50	04/04/88	3287.50	02/16/88	-450.00
1987	02/12/87	222.50	04/23/87	237.5	15.00	750.00	04/23/87	750.00	03/02/87	-1162.50
1986	02/12/86	242.00	04/23/86	243.25	1.25	62.50	02/19/86	525.00	04/04/89	-1475.00
1985	02/12/85	241.25	04/23/85	247.5	6.25	312.50	03/19/85	1050.00	04/15/85	-500.00
1984	02/13/84	384.75	04/23/84	418.25	33.50	1675.00	03/20/84	3650.00	02/14/84	-25.00
1983	02/14/83	254.50	04/22/83	296.25	41.75	2087.50	04/22/83	2087.50	02/16/83	-112.50
1982	02/12/82	263.50	04/23/82	286.25	22.75	1137.50	04/08/82	1525.00	03/03/82	-587.50
1981	02/12/81	305.50	04/23/81	344.25	38.75	1937.50	04/09/81	2987.50	03/02/81	-712.50
1980	02/12/80	222.75	04/23/80	203	-19.75	-987.50	02/13/80	412.50	04/09/80	-2437.50

Percentage Correct	87		Protective Stop	(1336)
Average Profit on Winning Trades	25.92	1296.15	Winners	13
Average Loss on Trades	-14.38	-718.75	Losers	2
Average Net Profit Per Trade	20.55	1027.50	Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the August Soymeal/Soybean Oil spread

Moore Research Center, Inc.

Buy Aug 95 Soybean Meal(CBOT)/Sell Aug 95 Soybean Oil(CBOT)

Enter on approximately 06/08 - Exit on approximately 06/15

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	06/08/94	2812	06/15/94	3946		1134.00	06/15/94	1134.00		
1993	06/08/93	6172	06/15/93	6314		142.00	06/15/93	142.00		
1992	06/08/92	5350	06/15/92	5558		208.00	06/15/92	208.00	06/10/92	-138.00
1991	06/10/91	5312	06/14/91	5716		404.00	06/14/91	404.00	06/11/91	-56.00
1990	06/08/90	2708	06/15/90	3172		464.00	06/13/90	484.00		
1989	06/08/89	7210	06/15/89	7870		660.00	06/15/89	660.00		
1988	06/08/88	11844	06/15/88	12918		1074.00	06/10/88	1094.00		
1987	06/08/87	6886	06/15/87	8738		1852.00	06/15/87	1852.00		
1986	06/09/86	4488	06/13/86	4792		304.00	06/13/86	304.00		
1985	06/10/85	-5364	06/14/85	-5052		312.00	06/14/85	312.00	06/11/85	-344.00
1984	06/08/84	-1392	06/15/84	-328		1064.00	06/15/84	1064.00	06/13/84	-36.00
1983	06/08/83	6050	06/15/83	5874		-176.00			06/13/83	-178.00
1982	06/08/82	6570	06/15/82	6768		198.00	06/11/82	302.00		
1981	06/08/81	7360	06/15/81	7386		26.00	06/10/81	150.00		
1980	06/09/80	4246	06/13/80	4288		42.00	06/11/80	70.00	06/12/80	-2.00

Percentage Correct	93			Protective Stop	(668)
Average Profit on Winning Trades	563.14	563.14		Winners	14
Average Loss on Trades	-176.00	-176.00		Losers	1
Average Net Profit Per Trade	513.87	513.87		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. SIMULATED RESULTS DO NOT *NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH* TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

A Decision Table Showing a history of the July Soybean Oil/Soymeal spread

Moore Research Center, Inc.

Buy Jul 95 Soybean Oil(CBOT)/Sell Jul 95 Soybean Meal(CBOT)

Enter on approximately 06/17 - Exit on approximately 06/29

CONT YEAR	ENTRY DATE	ENTRY PRICE	EXIT DATE	EXIT PRICE		PROFIT AMOUNT	BEST EQUITY DATE	BEST EQUITY AMOUNT	WORST EQUITY DATE	WORST EQUITY AMOUNT
1994	06/17/94	-3722	06/29/94	-3406		316.00	06/21/94	776.00		
1993	06/17/93	-6314	06/29/93	-6264		50.00	06/18/93	178.00	06/23/93	-168.00
1992	06/17/92	-5700	06/29/92	-5804		-104.00	06/19/92	124.00	06/26/92	-138.00
1991	06/17/91	-5566	06/28/91	-4942		624.00	06/28/91	624.00	06/19/91	-276.00
1990	06/18/90	-2862	06/29/90	-3140		-278.00	06/19/90	198.00	06/27/90	-446.00
1989	06/19/89	-9892	06/29/89	-9138		754.00	06/22/89	830.00		
1988	06/17/88	-13504	06/29/88	-9850		3654.00	06/29/88	3654.00	06/21/88	-800.00
1987	06/17/87	-8532	06/29/87	-7344		1188.00	06/22/87	1286.00		
1986	06/17/86	-4866	06/27/86	-4788		78.00	06/25/86	204.00	06/18/86	-42.00
1985	06/17/85	6262	06/28/85	6134		-128.00			06/20/85	-824.00
1984	06/18/84	1472	06/29/84	2502		1030.00	06/26/84	1198.00	06/20/84	-122.00
1983	06/17/83	-6024	06/29/83	-5782		242.00	06/29/83	242.00	06/24/83	-130.00
1982	06/17/82	-6860	06/29/82	-6826		34.00	06/28/82	120.00	06/21/82	-196.00
1981	06/17/81	-7222	06/29/81	-6586		636.00	06/25/81	878.00		
1980	06/17/80	-4044	06/27/80	-3860		184.00	06/23/80	188.00	06/19/80	-86.00

Percentage Correct	80			Protective Stop	(718)
Average Profit on Winning Trades	732.50	732.50		Winners	12
Average Loss on Trades	-170.00	-170.00		Losers	3
Average Net Profit Per Trade	552.00	552.00		Total Trades	15

HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT ACTUALLY BEEN EXECUTED THE RESULTS MAY HAVE UNDER- OR OVER-COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. *SIMULATED RESULTS DO NOT* NECESSARILY IMPLY FUTURE PROFITS. THE RISK OF LOSS IN TRADING COMMODITY CONTRACTS CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. RESULTS NOT ADJUSTED FOR COMMISSIONS AND SLIPPAGE.

You will note that beneath each Decision Table there is section showing statistical information that helps you to get a better overall picture of the history shown above, year by year.

You see the following:

1. The Percentage of years in which the spread worked in accordance with the Optimized Entry and Exit dates.

2. The Average Profit on those trades which were Winning Trades.

3. The Average Loss on those trades that did not work within the optimized dates.

4. The Average Net Profit Per Trade, i.e., the average net profit from all trades both winners and losers.

5. A suggested Protective Stop. The stop is an optimized amount based on the fifteen year history shown in the Decision Table.

6. The Total Number of Winners in fifteen years.

7. The Total number of Losers in fifteen years.

8. The Total number of trades in fifteen years.

Appendix C

Resources

Seasonal and Spread Services

Commodity Futures Spreads, A Biweekly Futures Spread Letter, by Bob McGovern. If you enjoy monitoring or even trading the spreads offered by a multi-year, old-timey veteran commodity trader, then Bob McGovern is your man. You can learn a ton from his biweekly letter. Bob uses good old-fashioned logic and reasoning in selecting his spread trades. He is a wealth of information on the economy, politics, and markets. [Bob McGovern, 30882 Colonial Place, Laguna Niguel, CA 92677. Phone: 714-363-6667 Fax: 714-363-6672 E-Mail: rbmassoc@aol.com]

Moore Research Center Report, A Monthly Seasonal and Spread Report, compiled by the staff at Moore Research Center, Inc. A thorough and comprehensive report listing upcoming computer generated seasonal and seasonal spread trades, along with a recap of trades still current and ongoing. Trades have up to 15 year reliability. This report features commentaries by members of the staff as well as illuminating articles by some of the top names in futures trading. The report contains charts, optimized entry and exit dates, and strategies. This report is the Cadillac of seasonal trading information. [Moore Research Center, 321 West 13th Ave., Eugene, OR 97401. Phone: 503-484-7256 or 800-927-7259 Fax: 503-484-2202 e-mail: swm@mrci.com MRCI World Wide Webb Home Page: http://www.mrci.com]

The Supertrader's Almanac by Frank A. Taucher. A yearly Almanac and reference manual listing computer generated seasonal and seasonal spread trades and

computer generated exotic seasonal and seasonal spread trades. Trades have seven year reliability. The Almanac contains a plethora of philosophy, techniques, and astrological data pertaining to the futures markets. [Market Movements, Inc. 5212 East 69th Place, Tulsa, OK 74136. Phone: 918 493-2897]

The Seasonal Trader Report – Futures Price and Seasonal Factor Data Book, A quarterly report listing trades having a seven to ten year reliability. [Seasonal Trader Report 889 Ridge Lake Blvd., Suite 350, Memphis, TN 38120. Phone: 901-766-4510 or 800-526-4612]

Seasonal and Spread Books

Techni-Seasonal Commodity Trading, by Everet H. Beckner, Windsor Books, P.O. Box 280, Brightwaters, NY, 11718.

The Handbook of Commodity Spreads, by Wayne Esserman, P.O. Box 201, Delphi, IN 46923.

Materials - Products and Services from Ross Trading Inc.

Trading by the Book
Position trading primarily from daily charts and focus on 4 major entry techniques: Trading Ranges, 1-2-3's, Ross Hooks, Ledges.
Basic use of oscillators and moving averages

Trading by the Minute
Intraday trading in various time frames.
Major, Minor and Intermediate entry signals.
Trading organization and issues.

Trading is a Business
The trading business, organization and management.
Trading psychology and temperment. Trading entrys, exits and warnings.
Tricks, techniques and analysis.

Trading the Ross Hook
Ross Hooks - the basics, variations and tricks.
Trade filters, rules, and studies - Volatility Stop, Stochastics, Envelopes, Bollinger Bands, MA Bands and other filters.

Trading Order Power Strategies
Four, one-hour audio cassettes and manual.
Rules, entry orders and exit orders. Orders for options and spreads.
Important considerations and strategy development.

Trading Optures and Futions
Combining options and futures into a powerful, trading strategy.
Using Optures and Futions to offset weaknesses of trading only options or only futures. Create a "income pump" and increase profits.

Traders Notebook
The monthly educational teaching letter - covering:
Futures, Economy, Other Investments and Implications on you.
Chart Reading, Technicals, Questions/Answers, Considerations.

Introduction to Futures Seminar
One day seminar - the basics and the foundation.
Markets, exchanges, basic chart reading, how money is made.
Papertrading. Resources and your educational path to trading success.

Introduction to Options Seminar
One day seminar - the basics and the foundation.
Nomenclature and terms explained. Basic option strategies.
Resources and your educational path to trading success.

911 -Get Help Seminar
Two day seminar - focus on the mechanics and execution.
Markets, environments, pits and a fundamentals review.
Chart reading.

Defensive Trading Seminar
Two day seminar - focus on hedging, spreads, seasonal trades and seasonal spreads. Primary defensive techniques to manage the trade.
Strategic trading and the evolution of the trade.

Trade the Truth Seminar
Three day seminar - Bar-Anatomy. Interrelated Determinants in Trading.
The trading business, organization and management.
Extensive chart reading and practical tricks and techniques.

Trading Optures and Futions Seminar

Three day seminar - market analysis and anatomy.
Basic and Advanced Optures - Basic and Advanced Futions.
Chart reading and the applications of Optures and Futions strategies.

Referral and Customer Services

We keep an extensive database of resources and references
which we are happy to share including: Hardware, Software,
Brokerage, Research materials, Reference Materials,
Books by other Authors and Systems Analysis.
From our own research and contributions by others.