HOW TO MAKE MONEY IN INTRADAY TRADING

"A master class by one of India's most famous traders"

Ashwani Gujral

Rachana A Vaidya

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About the Book

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A master class on making money in day trading by one of India's most famous traders

In his trademark blunt style, and laced with wry throwaway humour, Ashwani Gujral cuts through the clutter and awe surrounding day trading, sharply zeroing in on the skills, methods and abilities which spell success in this most challenging and rewarding of endeavours.

This book will equip you with the skills and temperament to make you market ready. It reveals Ashwani's time-tested and practical day trading strategies and systems which are easy to understand and implement:

- The 3Ms of trading success — method, money management and mindset
- The technical pillars — moving averages, pivots and exceptional candles
- Profitable trade entry, trade management and exit tactics
- How to trade the morning range, trends, gaps, and sideways markets
- How to add the catalyst of big news events to power your trades.
- How to avoid — and profit from — market traps
- How to harness the explosive power of multiple trading tools working in tandem
- Money management — position size and risk management
- How to master your mind in order to vanquish the market
- The daily discipline of a successful day trader.

Rachana Vaidya

Packed with 200+ real market examples and charts, this book shows you how to approach the market every single trading day like a winner, equipped with appropriate technical expertise and supreme self-confidence.

About the Authors

ASHWANI GUJRAL is one of India's most famous market analysts and trading experts. He is the Chief Market Strategist and Fund Manager of ashwanigujral.com and a regular market commentator including on CNBC TV18 business channel. He has written on trading and technical analysis for leading US specialist magazines and journals, including *The Active Trader, Stock Futures and Options, Futures, Trader's Source, and Technical Analysis of Stocks and Commodities.* Ashwani has been a full time trader of stocks and derivatives since 1995. His activities include running a technical analysis plus trading chatroom and newsletter.

Ashwani's brilliant academic background spans engineering and finance. He is BE (Electronics and Communications) from M.I.T. Manipal, 1993 and MBA (Finance) from Georgetown University, Washington DC, USA, 1995.

Ashwani Gujral's earlier two books, *How to Make Money Trading Derivatives and How to Make Money Trading with Charts* are established runaway bestsellers. This is his third book. You can catch up with his trading thoughts and ideas on his Twitter handle @GujralAshwani.

RACHANA A. VAIDYA is an independent full time trader on Dalal Street. A B.E. and MBA Finance she also has several financial market certifications. She worked in the corporate world for about a decade, including in Amul Industries, Kotak Mahindra Bank and Reliance Industries.

Rachana (www.dstreetwinners.com; twitter @Dstreetwinners) has worked on several technical research assignments with Ashwani Gujral.

Other Trading Books
by
Ashwani Gujral

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How to Make Money Trading Derivatives

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How to Make Money Trading with Charts

HOW TO MAKE MONEY IN INTRADAY TRADING

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Dedication

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This book is dedicated to the market whom I consider my foremost teacher. It not only gave me name, fame and a livelihood but also lessons which I then used in other areas of my life. Thank you for this enlightening journey.
– Ashwani Gujral

To my Dad who bestowed me with business sense and blessings; to my Mom for providing me with quality education; and with unlimited gratitude to Ashutosh, my raison d'être, for his unshakeable belief in me.
– Rachana A. Vaidya

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Preface

Are you struggling to find your feet in day trading?

Have you been struggling to find a future in futures?

Or, looking for an option in options?

Well, then your search ends here. The entire theory and methodology in this book is designed to create synergetic combinations of tools, especially for day trading and short term trading. Timing is crucial in such trading, even more so in the futures and options segment. The combination of tools and skills described in this book will give you timely and accurate signals, for a precise entry into a day trade, its subsequent management and trade exit.

Why So Many Traders Fail in the Markets

This is a question that has bothered me for the better part of the last twenty years. There are more sophisticated and better technical analysts than I am out there but many of them have not been able to translate those skills into trading profits. Now, after twenty years of trading every day, I think I am beginning to understand why. Trading by its very nature has a fundamental underlying uncertainty to it. Most people, on the other hand, are comforted by certainty. This is because our minds are inherently trained to seek certainty. So when we suddenly come face to face with uncertainty, we try to find certainty and hence fail. In trading, most people try to find certainty by looking for new and complex theories in the hope that they will then always know exactly what is going to happen next. Such people not only fail in doing that, but they never are able to take trading up to a size which changes their life because in their heart of hearts they know that their "new theories" do not have the success rate they would like the world to believe.

My trading turned around the day I accepted that markets are uncertain and used simple techniques and played big. I did this accepting that I did not have more than a 60 per cent probability of success in any trade. Accordingly, I am always vigilant to the fact that my trade may not work and that I may need to quickly cut or change my position. This has given me much greater accuracy and profitability than all the technical analysis pundits because first, my losses are always in control and, second, when I get into a profitable trade I am able to run it hard, applying trade management to it. According to me, the reason most people fail is that they are all running in the wrong direction in their need for certainty and to be right.

With time, I have also realised that somehow my eccentric, aggressive, uncompromising and unreasonable personality has helped me in the business of trading. I have found that conservative, compromising, fearful and "normal" people fail in successfully trading the markets. The less complicated approach may make you look human but it works.

The Mesmerising Power of Markets

Aasman bhi dikhlaya . . . Zameen par bhi le aaya . . . Hai gajab iski maya . . . Koi bhi bach na paya **— From the skies, down to the earth the markets take you in a jiffy. No one can escape this journey.**

Most people enter D-Street with an expectation of making easy money. When they subsequently realise that it is not a piece of cake, and that it requires hard work, perseverance and dedication many are no longer motivated enough to give it what it takes to achieve success and fortune. To be successful in this arena, you have to have your finger on the pulse of multiple factors, both local and global, every single morning.

Just consider how markets can change colours in no time at all. The figure that follows shows the intraday chart of Bank Nifty. As you will observe, the market first takes you to the seventh heaven, only to later pull you down into a deep abyss, all within a matter of hours.

The mesmerising power of markets can be seen in this chart of Bank Nifty on 18 April 2017. It's so solid at the beginning of the trading day, and equally pathetic by the end.

That's the stock market for you. It aptly defines the nature of markets and the awe that they create in one and all.

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We could have easily kept this book extremely serious, highly complicated — and barely comprehensible, one suited only for those with specialist education, the lucky, the super intelligent, the gifted few. The idea, however, was something different. With this book I want to instil confidence in those who want to succeed as day traders. I want to show how day trading or short term trading can be done as a business and how it can be your means of earning not just your daily bread but butter, cheese and jam as well. So we've covered not just technicals but every other element that goes into being a successful trader. Be it IT and systems, be it financial capital, be it emotional capital, be it the daily morning routine. Be it how to dress up, what to eat, how to behave, how to watch business TV, etc. I want to create entrepreneurs, and not just traders. I want you to learn to do your own thing, rather than look for a job here and there.

The Trader as an Entrepreneur

India has always been a country of business oriented people, with a penchant for risk taking and an appetite and inclination towards professions and businesses that connected the country with the outside world. It was the English, who ruled over India for nearly two centuries, who also created an education system that produced nothing more than clerks. Till date, India continues that tradition and has, for example, hundreds of colleges that produce hundreds of thousands of unemployable engineers!

This is not to say that formal education is not worthwhile; but education must also equip us with additional skills that prepare us for life. It will only be then that India can grow and make a mark.

I graduated as an engineer from Manipal Institute of Technology (MIT). My alma mater invited me on its diamond jubilee function. For anyone to be invited and honoured by the institution where he studied from, and be recognised and honoured for one's achievements by the seniors, is a milestone to be really very proud of. In my speech there I set out in some detail what makes an entrepreneur. I highlighted that in states like Gujarat, engineers earned ₹ 12,000 as starting salary. Can you imagine the return on investment (ROI) on all the money that your parents spent over decades to educate you from the best of the institutes, giving you quality tuitions and coaching classes, spending on your curricular activities plus entertainment and grooming? What is the rate of return on all of it? I added: "Getting a job is not a dream. Giving a job to ten people is a dream. Visualise repeatedly, with faith. Be in the zone."[*]

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Trading is a very unique business. You decide your own salary. You decide your promotion and demotion. You don't need to woo buyers. You don't need to go seeking sellers. You require no marketing gimmicks. You need not worry about issues relating to supply chain or inventory. Nobody sits over your head every April doing your appraisal. You can work from a mountain top or from a beach-facing room, so long as you have power supply and an Internet connection available. You never face labour related issues. You need nobody's permission to be by your family when they need you more than D-Street does.

This dialogue from the Bollywood movie *Dear Zindagi* is extremely apt: If you don't take the steering wheel in your own hands . . . someone else will sit in your life's driving seat.

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Before you jump onto the wagon, however, you have to prepare yourself mentally and financially for the challenges. Someone has rightly said, "Entrepreneurship is about living a few years of your life like most people won't, so that you can spend the rest of your life, like most people can't."

So take charge, take the plunge.

New Delhi
April 2018

ASHWANI GUJRAL

Throughout the book, we have addressed the trader as "he" instead of he / she. That's only for ease of reading. The fact is that irrespective of gender, anyone with the right knowledge, method and mind-set can become a good trader.

List of Abbreviations

ADR	American Depository Receipt.
AGM	Annual General Meeting.
Big B	Nickname of Indian film star, Amitabh Bachchan.
Bollywood	Nickname for Hindi Film Industry.
Business TV	Business Television.
CEO	Chief Executive Officer.
CPL	Central Pivot Line.
CPR	Central Pivot Range.
DMA	Daily Moving Average.
D-Street	Dalal Street, name of the street in Mumbai which houses the Bombay Stock Exchange. A metaphor for the Indian stock market.
EMA	Exponential Moving Average.
EPS	Earnings Per Share.
EQ	Emotional Quotient.
F&O	Futures and Options.
FMCGs	Fast Moving Consumer Goods.
IQ	Intelligence Quotient.
IT	Information Technology.
LB	Lower Boundary.
MA	Moving Average.
MACD	Moving Average Convergence Divergence.
MBA	Master of Business Administration.
MIT	Manipal Institute of Technology.
MTM	Mark to Market.
NBFCs	Non Banking Financial Companies.
NCR	National Capital Region.
NPA	Non-Performing Asset.
ONGC	Oil and Natural Gas Corporation.
PSU	Public Sector Undertaking.
RBI	Reserve Bank of India.
RERA	Real Estate Regulation Act.
ROI	Return on Investment.
SL	Stop Loss.
SMA	Simple Moving Average.
SRK	Shah Rukh Khan, a top Indian film star.
UB	Upper Boundary.

USD	US Dollar.

Introduction

Debut of a Novice Trader on D-Street

With a racing heart, perspiring palms and nervous nerves, he calls up his broker to buy a few stocks. After all, he thinks he knows the potential scope of price rise and the rocket power lying dormant in those stocks. He believes that the rocket shall get launched when his order is triggered. And there lies his opportunity to make a few quick bucks, read millions.

As dialogue from a Bollywood film goes: Dil mein umang hai, aankhon mein sapney hain, aur account mein paise apne hain, phir der kis baat ki — *The heart has hopes, the eyes dreams, and there is money in the bank, so what's holding you back?*

His trusted source gave him an "inside tip" the previous night. The loud, often arrogant, all-knowing and near-worshipped "market insider" he knows has been bombarding him with new trading ideas every few minutes. His WhatsApp account is buzzing all the time. All his spare moments and after dinner chats always revolve around expected market action in the next few days. There is so much information floating around him all the time; newer ideas, tips, the extremely popular "sure-shots," and what not.

Facing Facts

So, then, these traders should all be minting millions, enough to sustain their lives and fulfil their dreams and desires? Right? Hold on, it isn't that easy. The fact is it takes a lot more than tips and news to make your mark in one of the world's most difficult professions.

This book covers a very serious topic — serious because it involves your hard earned money. Markets can snatch away within minutes your earnings of many years.

The market is full of advisers, books, tools, plenty of software, and so many trading systems. Yet the success ratio is pathetically low. What do you think is lacking? Why is it so difficult to understand that profit is the difference between the buying price and the selling price, and that your selling price should be higher than your buying price in order to make gains? Is it so difficult to grasp that you will win only if you make the right moves, and also stay away from the market at times? Or, that you must enter low and exit high? After all, markets move — that is when they do, half the time they refuse to move much — in only two directions, either up or down. You can either buy or sell. What then makes it all so difficult, and why is it that very few traders achieve success?

These are the secrets that we are here to unravel.

This book is not intended to overwhelm you with fancy technical tools, difficult to pronounce techniques, or seemingly complicated screen shots in order to awe you. In fact, the endeavour throughout the book is to talk about extremely practical solutions and ideas about earning money from intraday trading in the stock markets, not only bread and butter money, but also wine and cheese money. It is about how to approach the market, every single morning. And, that, is the crux of the matter.

Our Trading Arsenal

We will reveal our time-tested day trading systems which are easy to understand and simple to implement. We will also deal with the kind of expectations, experiences and evolution that a D-Street newbie goes through in his or her journey, day after day and year after year.

As to technicals, we will talk about floor pivots and candlestick study, and we will combine these with simple yet meaningful moving averages. Importantly, we will learn how to add the catalyst of daily events and breaking news in our trading. We will learn how day traders can understand, interpret and gain from such events.

Stock market success is all about the 3Ms, method, money management and mind-set. In addition to the method, we will also devote significant space to the oft-neglected second and third Ms, namely money management and mind-set.

Every single day in the markets is different. Every new trade requires you to approach it in a specific way. We will cover the kinds of markets, the kinds of days, the kinds of approaches to be adopted, and the kinds of opportunities and traps that traders are typically presented with. The ways of trading indices and individual stocks are very different. We will study the differences in approach, with plenty of examples to highlight our methods.

Money is made through proper stock selection, timely entry and robust trade management, right from the entry and till you exit a trade. That includes managing the trade, your overall account size and, most importantly, managing your mind during the entire journey. It is not just techniques that we will study in this book; we will combine them with the art of reading minds through markets.

For market traders there are times to show raw guts, and there are times to be wise and lie low. We will discuss each of these aspects and as we proceed we will weave the warps and the wefts of intraday trading tactics into a robust money making mechanism.

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The first five chapters of the book cover the three technical pillars of our strategy, namely moving averages, candles, and floor pivots. These are the building blocks of trading. Any trader serious about making trading his business must clearly grasp these topics and master the related tools. You will also discover that we have a unique way of looking at traditional tools such as candles.

In Chapters 6 and 7 we will consider various entry and exit tactics, plus several strategies of active trade management. Chapter 8 is all about swinging sideways, namely about trading sideways markets. Chapter 9 shows how you can add spice and flavour to your trading with the help of catalysts.

Chapter 10 covers the critical element of market traps, which is especially important for futures and options (F&O) traders.

Chapter 11 uncovers the charisma of confluence, the synergistic power of all the tools and techniques working together.

In Chapter 12 we address the very important topic of money management. Successful money management is the one aspect that separates the winning traders from losers.

Chapter 13 is about an aspect that singularly makes a trader successful. It has nothing to do with technical know-how. It's about victory over your mind before victory over markets.

Finally, Chapter 14 offers you a complete run-down on a trader's daily preparation and trading plan.

Trading is like dancing on a revolving floor. The centre of gravity is constantly shifting and you need to maintain your equilibrium in the middle of it all. You have to be ever nimble, ever agile, ever alert.

Expectations and Evolution of an Intraday Trader

Success in intraday trading and short term trading requires a very dynamic, alert, disciplined and cool headed strategist who can digest victories, survive defeats — and bounce back quickly from both. There are many people in the world who have made their mark, as well as made millions, in this field. So there is no reason to believe that it's an unconquerable territory.

Yes, the territory is hostile and the punishments can be harsh because markets don't forgive mistakes. The rewards, however, are equally enticing, and these rewards go well beyond monetary benefits. This field is only for those who are highly disciplined and willing to go the extra mile.

Using a Bollywood metaphor, and recalling a dialogue from the Hindi film *Raees* — *siney mein aag aur dimaag mein thandak* — fire in the belly combined with a cool head is the right combination of qualities that makes for a successful day trader.

A novice on D-Street often assumes that there are endless opportunities waiting for him to make money, and that he simply needs to go forth and get his share. He assumes that once he knows the right stock to get into, he can just ride his way to super normal profits every morning. Well, he who knows not, and knows not that he knows not — no one can save him.

Novice traders typically ignore both the methodology that they should adopt and the discipline that they must adhere to as traders. They will also likely be surrounded by people who will make it seem all so easy. The resultant expectations that a novice therefore comes to the market with are usually illogical. He often struggles to put the pieces of the puzzle together. He will make money one day, only to lose it the very next, thus bringing himself back to where he started. He may add to his funds, and he will likely seek advice from various sources. He may then start trading more frequently, but even when he makes some profits, chances are that he may refuse to book his gains in expectations of even bigger gains. He will often find himself in deep shades of red and that's when he will finally exit. Once he is out of it, he may then find the same stock moving in his expected direction! He now has a reason to believe that if only he had shown some courage to hold on for longer, he would have made a killing. Next time he does exactly that, only to kill himself. Whoa!

Only then does he realise that there are miles to go before he can peacefully sleep. Thus begins a journey of self-discovery. If he finishes it successfully, he will have grown not just financially but in many other ways as well. This book will show you what goes into making your way through this jungle into a rewarding journey.

The Three Stages of a Trader's Journey

The journey of a trader has three stages:

- It starts with a "wow" stage where he is simply awestruck — and greedstruck — seeing the screen and the millions floating everywhere. He assumes it all to be a piece of cake.
- Then comes the "how" stage where reality sinks in. He now realises it's not as simple as he thought, and that a great deal of effort is required to succeed. If he survives it all, then he emerges as a winner.
- Then comes the third stage, again a "wow" stage when he can reap the fruit of his labour.

The path may appear long at times; at times, the journey may even look scary as well. But, then, we triumph without glory if we conquer without danger. So let the game begin. Don't just sit and stare. Do and dare.

So let's learn how to control the chaos, cut through the clutter and find our way through the seeming madness called the market. It is very easy to make things complicated. But it takes true expertise to make things simple. That is the purpose of this book. It teaches you how to keep your eyes and ears open, use your common sense, maintain a daily trading ritual that works. It will show you how to read the rhythm of the market, how to analyse the bigger picture, and then it will pin-point how and when to pull the trigger. That gives you simple to follow, all-encompassing and workable ways to making money in intraday trading.

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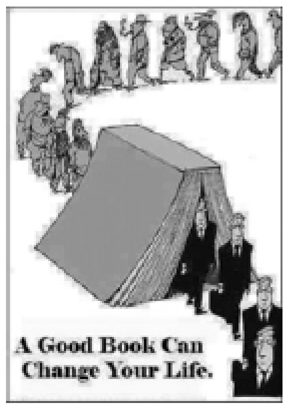

Chapter 1

Mastering Market Basics and Moving Averages

Introduction

I had my money, I had my friends,

I asked for advice from those friends,

I traded in stocks as advised by friends,

I first lost money,
and later my friends!

There are no free lunches in life. Equally, there are no easy gains in stock markets either. So while we all take help and advice from others, and there is nothing wrong with that, it is important to understand and master for yourself the game that you are playing. Markets are like car racing. Can you imagine yourself behind the steering in a fast racing car and WhatsApping your friends and asking them what to do next? You will be gone if you do so, sooner rather than later. It's the same in the markets. You need to help yourself, and equip yourself. As the popular adage goes, heaven too helps those who help themselves. Wisdom says, learn before you earn. So help yourself by making yourself market ready. You must understand the game and its rules before playing it.

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In this chapter we will learn about the different types of market movements and their broad phases. We will also consider the various types of market participants whose market behaviour results in those phases and moves. We will also get an insight into the *modus operandi* of economic and business cycles. Once through with these basics, we will introduce you to the first tool in our arsenal, moving averages.

Market Basics

The Two Kinds of Markets

Stock markets don't always move in expected or desired lines but, then, neither does your better-half! Well, let's be thankful to them all for giving us enough training in dealing with life's unexpected highs and lows. This experience equips us to handle both surprises and shocks. In short, living with volatility is a fact of everyday life. So, too, is the daily story of stock market traders. While it remains true that each market day is different from any other, but we can still broadly classify market movements into the following two commonly observed categories:

1. Trending markets, and
2. Ranging — or range bound — markets.

It's important to understand this broad classification. It will help you immensely in making your way through the thickets of the market jungle. Markets are not random, and there is a pattern to their moves. Let's see how.

Trending Markets

Trending markets are characterised by prices that keep moving in one direction for a significant length of time. When the price keeps moving higher, we call it an uptrend, while if the price keeps moving lower, it is called a downtrend.

In an uptrend, prices move in such a way that every price high is higher than the previous price high, and each price low is also higher than the previous low.

The reverse happens in a downtrend. The prices form both lower highs and lower lows in a downtrend.

Yes, there will be halts in between the successively higher or successively lower levels. Also, there are periods of retracements, namely temporary periods of price moving in the direction opposite to the trend. Retracements can be minor dips or deeper corrections, but the trend sustains so long as the retracements stay limited, and the price resumes its move further in the original direction as soon as the pullback finds support in the case of an uptrend — or resistance in the case of a downtrend. The self-explanatory diagrams in Figure 1.1, and the real market charts in Figure 1.2 and Figure 1.3 will help make this clear.

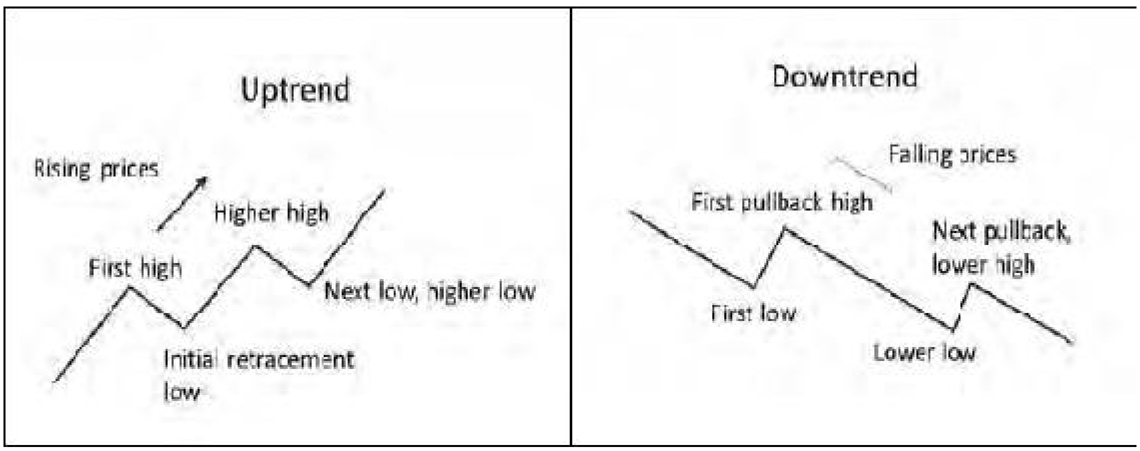

Figure 1.1: **Uptrend on the left characterised by the price making successively higher tops and higher bottoms, with retracements indicated. Downtrend shown on the right with prices making successively lower tops and lower bottoms, again with intervening pullbacks.**

Figure 1.2: **Clear case of an uptrend in the chart of Ultra Cement, each high is higher than the previous high; and each low is also higher than the previous low.**

Figure 1.3: **Mindtree in a clear downtrend; the price goes on forming lower highs and lower lows.**

All market participants love trending markets. Trending phases provide traders excellent money making opportunities. It is up to the trader to make the best use of a trend by staying with it so long as the trend stays with him.

For day traders, staying with the trend may mean holding onto the position for the better part of a day. This should be done only when the charts are showing the strongest signs of a trend day, and not otherwise. Of course, it goes without saying that if the situation starts going against him, the trader should not overstay his welcome. Always remember, adaptation is the key to survival.

On the other hand, if everything seems to be working in your favour then you should not be in any hurry to exit. Most traders underestimate how the really strong moves can overshoot all your targets and can surprise you with more gains than you can imagine. You do not want to later repent about premature exits, so take all precautions and have clear strategies for all situations formulated in your mind in advance. Stay logical, stay on edge, and stay sharp to all changes.

This reminds us of a story. Some of you might know about Victoria's Secret, the company that is into high-end lingerie wear for women.

A Stanford MBA named Roy Raymond wanted to buy his wife some lingerie but was embarrassed to shop for it at a departmental store. That's how he saw a gap in the market and came up with the idea of a high-end store that didn't make one feel awkward about shopping for innerwear. He borrowed funds from his in-laws and from a bank and opened a classy store, calling it Victoria's Secret, with funds of about USD 80,000. The store made sales of half-a-million USD in its first year. Raymond then started a catalogue, opened five more stores and began growing fast. Yes, there were business challenges but generally everything was falling in place and he was growing in a big way. But he didn't stay with it despite everything in his favour. He soon sold the business to Leslie Wexner for one million dollars. He lived happily ever after, right?

Wrong. Two years later, the worth of the company was USD 500 million. Oops! Roy Raymond must have felt likes jumping off the Golden Gate Bridge.

Ranging — or Range Bound — Markets

Ranging markets are those where stock prices, or indices, move in such a way that they form successive highs and lows at nearly the same level, unlike trending markets where successive highs and lows are either higher or lower, as described earlier. The price movement in a ranging market typically forms two horizontal boundaries some distance apart, and the price may rise and fall within the two boundaries and thus stay rangebound instead of making any directional moves. You will be able to see this with greater clarity after the formation of at least two equal highs, or two equal lows. There could be failed attempts to break out from the boundaries. When such breakouts fail to see a follow through move in the same direction, prices again fall back inside the range formed by the boundaries and move towards the other end. Such failed breakout attempts give trading opportunities for a trade towards the other end of the range.

This is a sort of consolidation of the market movement. It is the phase when the market is taking rest and building strength before taking another leap. Sometimes when the range is wide enough it is possible to take trades within the range. We know that once the price finds support at the lower end, it will make a move towards the upper end, and *vice versa.* So traders often like to enter long at the bottom of the range with a target near the top. Or, they go short at the top of the range with a target near its bottom. So we are essentially trading against the boundaries and this is commonly known as **fade trade.**

A ranging market requires very specific tactics and is not easy to trade, unless you are very good at accurately timing your moves. Also, there are times when the range is too narrow to be tradeable. It's best to wait on the side-lines at such times.

Let us have a look at Figure 1.4 and then a real market example in Figure 1.5.

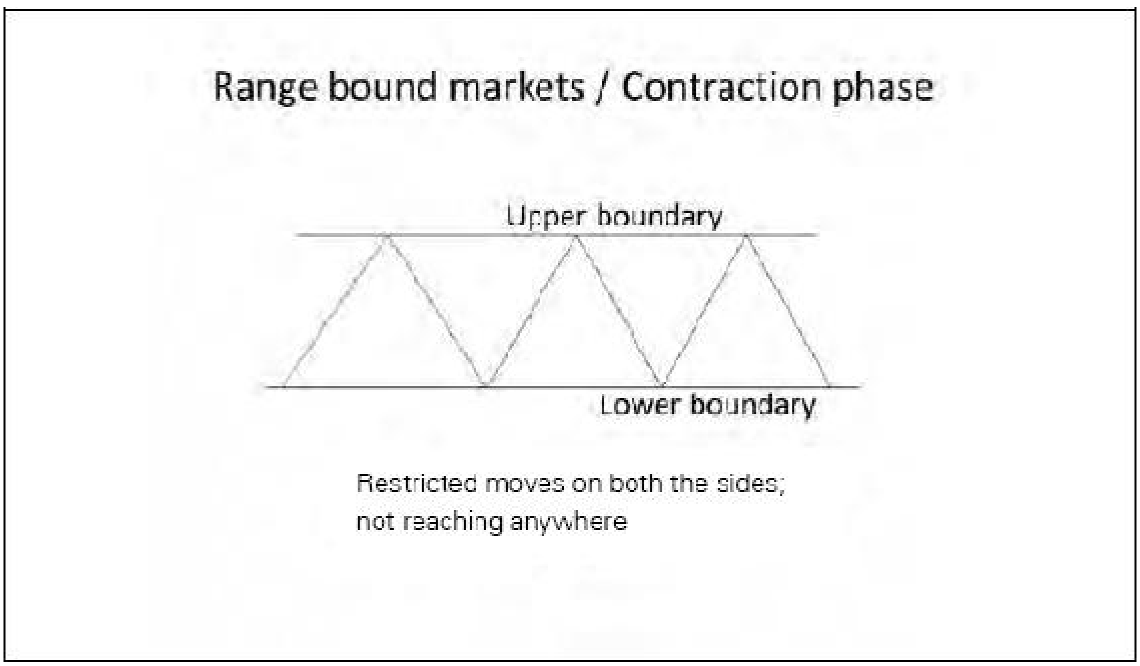

Figure 1.4: **This is how range bound markets look. Note that the successive price tops and bottoms are at about the same levels.**

Figure 1.5: **Asian Paints moving sideways, bounded in a range of nearly equal highs and lows.**

Market Participants and Their Behaviour

Markets are driven by the behaviour of their participants. It is the activity of buyers and sellers, or the lack of it, that decides the kind of charts that you see on your screen. The participants, whether buyers or sellers, can be broadly classified into two kinds. It is important to know them well because it is their behavioural pattern, their actions and their reactions that will tell you what you can expect from the market. Only if you can identify the kind of players who are participating in the market at the time can you hope to anticipate the outcome and trade accordingly.

Let's call the first type as reactive players, and the second type as active players.

The Reactive Players

Reactive market players are those participants who buy or sell a particular stock when they believe that the stock's prevailing market price is far above, or far below, its fair value. In other words, they will buy a stock if they believe that its current market price is lower than what the fair value should be. Correspondingly, they will be willing to sell if they see and believe that the current market price is way too stretched above the fair value. Thus, their efforts and actions will always drive the price towards its perceived fair value level. If the price of a given stock, as perceived by them, is too high, they will wait on the sidelines and buy if and only when it comes down lower. Similarly, sellers will sell a stock only when the price rises to their perceived selling level. They will thus react to what they see happening around.

Now if you look at this behaviour closely you will realise that investors have a pre-conceived valuation about a given stock in their mind. By their actions, they are trying to keep the stock around those pre-conceived valuation levels. This behaviour keeps the stock prices and, in turn, the overall market within a typical range. This range thus becomes a sort of equilibrium for the stock and the market. These are what we term as trading or ranged markets. The range is the area between the high and the low of the price, namely the boundaries within which the price is moving. So the previous day's range means the high and the low of the previous day.

Further, since reactive players usually have a shorter term horizon and target, they are unwilling to attribute any higher or lower valuation to the stock under study. Thus, they won't initiate any strong buying or selling activity that can lift the prices above this range or drag it below the range. This leads to range bound markets. Any price move that takes the stock to the lower end of the range will entice buyers to enter long and take the prices higher. Any move that takes prices higher and up to the upper end of the range, will entice sellers who will enter short and take the prices lower to the other end of the range. The moves are thus limited in size and will not break the boundaries of the range. The market or the stock will keep moving in between these boundary levels.

The Active Players

It takes a very strong and knowledgeable set of players to move the markets. These active players who believe that the price of a given stock can be, and should be, higher or lower than the equilibrium range created by the reactive players. When such buyers or sellers enter the market with a strong conviction about prices, they will be willing to buy above the upper boundary of the range, or sell below the lower boundary of the range. Only when this happens with considerable strength, conviction and volumes does the price break out or break down from the equilibrium zone, namely the range.

Active players are willing to buy at higher levels and sell at lower prices in the belief that prices will see further higher or lower levels in times ahead. By their actions, aggression and conviction about the future such market players are responsible for the price either breaking down or breaking out from a range. We shall call them active players. They don't react to the current price values; they are all out to form another value, higher or lower from the current one. They actively initiate actions that break the current normal. This, in turn, entices more players to enter the market, investors and traders who now realise that it is futile to wait any further for a correction back into the range, and that if they don't pull the trigger now then they may simply miss the bus. Such follow up participation prods the price, taking it further out of the equilibrium zone. That's when trends are formed. Thus the market moves from being a trading one, to being a trending one.

So, you see, it's necessary for the markets to lose equilibrium at times. After all, that's when trends are formed.

Right, so now we have two kinds of market participants, active and reactive *(see* Figure 1.6). And we also have two kinds of markets, trading or range bound, and trending. They form the two phases of the markets, expansion and contraction. Let's see how.

Figure 1.6: **Reactive players lack the conviction to pull prices out of a band. Active players do just that. And how!**

The Two Market Phases

Expansion Phase

The market or a stock is said to be in an expansion phase when its price is trending in one direction and the daily range is comparatively wide. Such moves are dictated by active participants who come in with strong conviction and are willing to take the price either to new higher levels or new lower levels. In other words, they are willing to buy at higher prices when they are expecting the price to go even higher. They are also willing to dump the stocks at lower prices since they anticipate even lower levels in the coming days. If the price highs and price lows are confined within a clear band, or between two parallel lines, then the price-band would be sloping either upwards or downwards depending on the direction of the trend. In such situations, there is a clear sense of direction and the moves are backed by strong momentum. It is the active participants who should be credited for these kinds of moves. Their aggressive buying or selling action takes the price far away from the mean value. It takes very specific techniques to trade these markets and you will have to get a grip over these techniques before you can trade profitably. You can get good moves in such markets by staying with the trend till it ends. You can take trades in the direction of the trend, either on price corrections or on time corrections.

Trending moves and expansion phases go hand in hand.

Contraction Phase

The market is said to be in a contraction phase when prices move in a tight range. This phase is driven by reactive participants who lack the conviction to take prices beyond a certain level, whether up or down. The price keeps moving around the mean value as perceived by these participants. There is a clear lack of conviction and market players are unwilling to pay higher than their perceived price for buying. Equally, they are also not ready to dump the stock at lower levels. The moves are thus limited in size until the range gets taken out or taken down. There will be supply pressure at the upper end and demand pressure at the lower end, but not enough to take the prices outside the band.

The markets keep alternating between the two phases of contraction and expansion. A contraction phase or a ranging market go hand in hand. A contraction is followed by an expansion, and then again by another contraction. This is very normal. It is the market's way of taking a breather post a trending move, and before making another trending move whether in the same or in the reverse direction.

Economy, Business Cycle and Sector Rotation

Stock markets move in anticipation of changes in economic activity and the likely impact of those changes on stock prices. The psychological attitude of investors to the expected economic and business developments is what drives the markets. That's why it is said that markets discount the future. Expectations of an expanding economy will lift the markets higher, while the fear of contraction in business activity and economy as a whole leads to a fall in stock prices. Markets and the economy are both always in a state of constant flux, rarely in equilibrium. An economy is made up of many sectors or businesses. As the economy moves from contraction to expansion, and back to contraction, so does the business cycle of various sectors that are parts of the broader economy. Thus, the business cycle comprises a series of events that constantly repeat themselves, forming alternate peaks and troughs as the economy contracts and expands.

This contraction and expansion in the economy is largely driven by interest rate cycles. As interest rates in the economy rise and fall, they have different impact on various businesses and sectors at each stage. The central bank, RBI in India, changes interest rates in order to control inflation. Thus, based on inflation levels the interest rates keep going up or down. Depending on the rates, the economic activity in the various sectors also keeps rising or falling. When interest rates are increased in order to control inflation, it leads to a lowering of economic activity along with lower inflation. On the other hand, a reduction in interest rates leads to a growth in business activities. During economic expansion, businesses often create too much production capacity in expectation of higher future sales. The excess capacity later remains unused, or idle, when sales become stagnant or start falling. There is then no question of business capacity expansion until the excess inventory is depleted. So, once such a situation occurs you will see long periods of low capital expenditure.

The ever changing levels of economic activity create ever changing cycles across various industry sectors. These various industry sectors operate in different cycles at the same time.

At the start of an economic cycle, interest rates in the economy are lowered in order to boost business activity and perk up rate sensitive sectors. Thus, you see an upturn first in sectors like housing, auto, etc. which are largely driven by interest rates. All consumer centric sectors also perform well at such times. The idle capacity of these plants and companies will start getting utilised as their sales improve.

Typically, businesses do not require any capacity expansion at this time and so there is no rise in capital expenditure. Initially, then, sectors such as capital goods, commodities, metals may not do too well. As the business cycle picks up further, these sectors will slowly expand and this will lead to a pick-up in capital goods and later also the commodity sectors. By that time the sectors which were earlier moving handsomely might be done and over with the best part of their move, and may well actually have peaked out. So, the responsibility to sustain the markets would now be shouldered by fresh sectors. Capacity expansion will lead to an increase in prices of commodities and thus a rise in inflation. To control inflation, the interest rates will be raised and that will lead to a fall in interest rate sensitive sectors. Thus, financial sectors and the consumer facing businesses and retail consumption sectors lead the upturn in the economic cycle, and capital goods and commodities, mines, metals, etc. are the laggards.

Also, higher the dislocation of the overall economy from the equilibrium levels to the lowest point, the stronger will be the swing back towards the equilibrium and to the positive side as well. The commodities that we are referring to here are industrial commodities, and not weather-driven agricultural commodities, such as food grain, etc. The typical business cycle thus keeps moving between peaks and troughs and usually the entire cycle lasts anywhere from 3 to 5 years between troughs. The central line shown in Figure 1.7 indicates the equilibrium. The phase above the equilibrium is the period of expansion and below it is the period of contraction. Periods of expansion usually last longer than do periods of contraction. That’s because it takes a longer time to build something than to tear it down. Technical analysis helps you determine which sector is turning, and when.

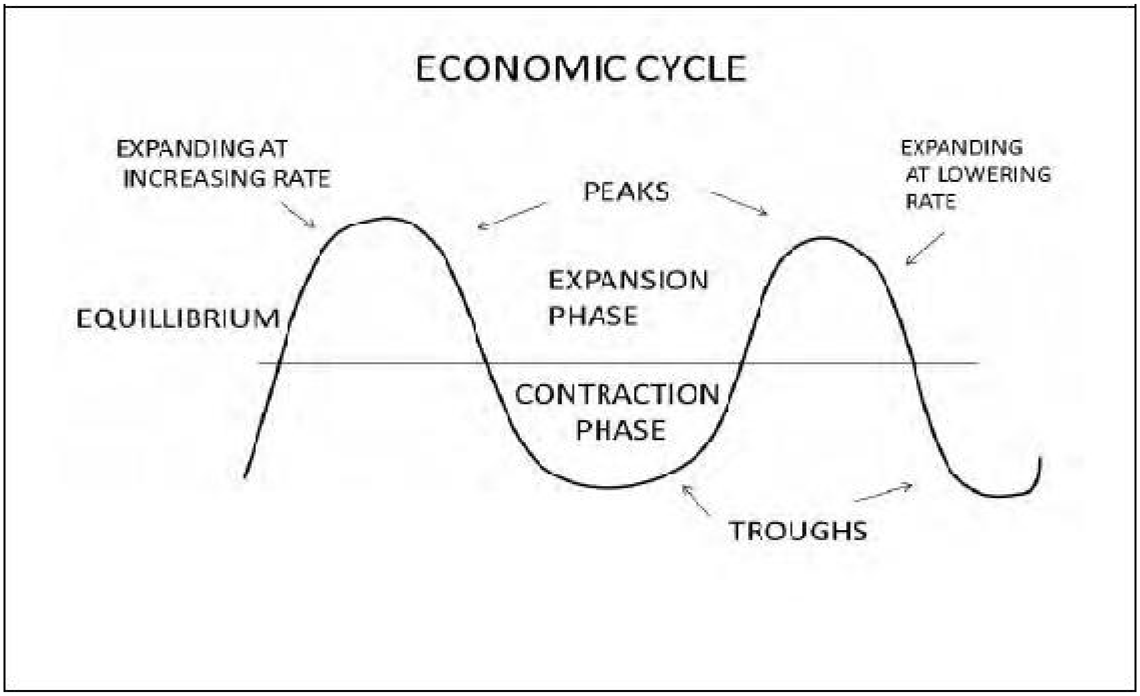

Figure 1.7: **The economic cycle with the expansion and contraction phases highlighted.**

It's also important to understand that when the economy initially turns upward, there is a lot of prudent focus on quality businesses because the wounds and bruises of the previous fall are still fresh in the memories of investors. As time passes, fresh gains and confidence overcome this caution. That's when you see even cats and dogs starting to fly.

~

This is the basic summary of how the economy moves, and how different sectors within the economy keep rotating. We have also seen the kinds of market movements that accompany each turn of the economy. It is crucial that short term traders, including day traders, to focus on these sectoral rotations and trade generally in the hot and happening sectors. If the strongest of sectors, like banks or technology, are falling fast, then traders must realise that it can get difficult for the overall markets to sustain higher levels in the absence of support from sectors that matter and carry high index weightage. Holding on to your stocks even when the situations change is not at all a great idea.

~

Moving Averages (MAs)

Now we know that markets do not move in straight lines, and that they are volatile. If you are expecting clear skies, then you are expecting too much. There's always going to be a lot of noise around in the markets. Thus, for example, it is important to beware that an uptrend will also have many down days, and a downtrend will have many up days. This is not just normal, it's healthy. Those who see and follow charts on a regular basis know this very well.

Money can be made when you learn to make sense of this chaos. That's exactly what a moving average line does. Once you understand how to read, interpret and use a moving average, it is a very simple tool. Most trading software have this tool in-built. Once you understand when and how to use it, there is no reason why you should get confused about the market's next move, or your own.

A moving average cuts out the noise, i.e. the market's random fluctuations, by giving you the average value of the price over a given duration. A moving average of 10 days will be calculated by determining the average value of closing prices of the stock or the index concerned for the previous 10 days. A 10-day moving average, or 10DMA, will be the average value of the closing prices from Day 1 to Day 10. On the following day, it will be calculated using closing price values from Day 2 to Day 11, and so on. That's the reason we call it a moving average. Since we are basically taking the successive previous ten days closing prices, we go on removing the first day of the series, and add the latest closing value as each day passes by. Similarly, for a 20-day moving average we take the average of the closing price values of the previous 20 days. There isn't any need to get into further details of calculations; you will be able to plot moving averages using your charting software. Once plotted, your aim should be to use and interpret them correctly — and make money.

Types of Moving Averages

There are various types of moving averages, such as a simple moving average (SMA), an exponential moving average (EMA), and a few more. It is useful to have a fair idea about those variations, and how they differ in their application.

Exponential moving averages are calculated by giving higher weightage to the more recent prices and thus the EMA line will hug the price line more tightly, unlike simple averages which give equal weightage to all data points.

We now know that moving average for "X" days is calculated by taking the closing prices of "X" number of days. This "X" is the time duration of the moving average, or MA, line. The moving average length (duration) being used by investors and traders varies from 3 periods to 200 periods. We will find out which particular moving averages ought to be used when we come to defining our day trading methods. But, first, we look at some more MA fundamentals.

Characteristics of Moving Averages

1. The simple moving average, or SMA, is less sensitive than the exponential moving average, or EMA. As a result, SMAs react a bit slower to changes in prices than do EMAs. Consequently, the EMA is often preferred by short term traders looking for quick moves. Simple moving averages react a little slower, but can still be used profitably for trading. The important thing is to be consistent with any one style that suits you, and you will succeed. Every moving average will work if you know how to use it.

2. Moving averages will stay closer, or farther, from the price depending also on their time period. A 10-period moving average stays closer to the price line as compared to a 20- or 50-period MA. This happens because the shorter period MA is based on fewer data points. A longer period moving average has more data points which may be placed farther from one another, and thus give you an MA line that strays farther from price points. Have a look at the chart in Figure 1.8.

Figure 1.8: **See how the shorter time period MA — the 10MA line — stays closer to the price as compared to the higher period moving averages, 20MA and 50MA.**

3. It is important to note that in the case of a sudden rise or fall in price, the price line immediately moves farther away from the MA lines, no matter which time frame MA is being used (*see* Figure 1.9). This is very common. Often at such times, the stock or the index under study may try to strongly snap back towards the MA line. This behaviour offers opportunities to alert traders.

4. When the price of a given stock is rising continuously, the moving average line, will start sloping upward. The upward slope of the moving average line shows that there is buying pressure and that the prices are expected to stay high and rise further (*see* Figure 1.10). The positive slope of the MA line is thus an indication of an uptrend. A trader should maintain a bullish bias for such stocks and try to enter them long at appropriate times. The price will stay above the MA line during the uptrend. We will explain this further as we define our entry tactics. Conversely, in a stock which is falling, the MA line will slope down and this confirms that the trend is down and prices may fall further. A trader should maintain a negative bias in such stocks and enter short at appropriate times. Prices will usually stay below the MA line during a downtrend.

Figure 1.9: **Drastic rise or fall will always take price action away from the MA lines. Sooner or later prices snap back towards the MA lines, offering trading opportunities to alert traders.**

5. When markets are trendless, the moving average lines may either stay flat, or move up and down rapidly as prices keep criss-crossing the MA line *(see* Figure 1.10). At these times, none of the directional biases or moves will sustain long enough for a successful trade. Since it is difficult to maintain a position in one direction for any reasonable time period, it is difficult to maintain a directional bias. Every now and then the direction of the price move may change and the price may keep crossing above and below the MA line and thus keep whipsawing you on both sides, up and down. As we proceed, we will learn how to handle such periods. This is a common phenomenon during range bound markets and, as mentioned earlier, you can either fade the boundaries, or stay away till a trend emerges.

Figure 1.10: **See the relationship between trends, price action and the MA line. Price stays below the MA line in a downtrend and above it during an uptrend. The MA line slopes up in an uptrend, and down during a downtrend.**

6 When the trend is up, any kind of a retracement in price will likely find buyers coming in around the MA line. Correspondingly, in a down trending stock, any efforts to pull the price back higher may meet with selling pressure, i.e. supply pressure, at the MA line. Thus an MA line will act as a support during an uptrend, arresting or halting the falls; and the same MA works as a resistance during a downtrend, capping the corrective moves or rises. All these points are illustrated in the chart in Figure 1.11.

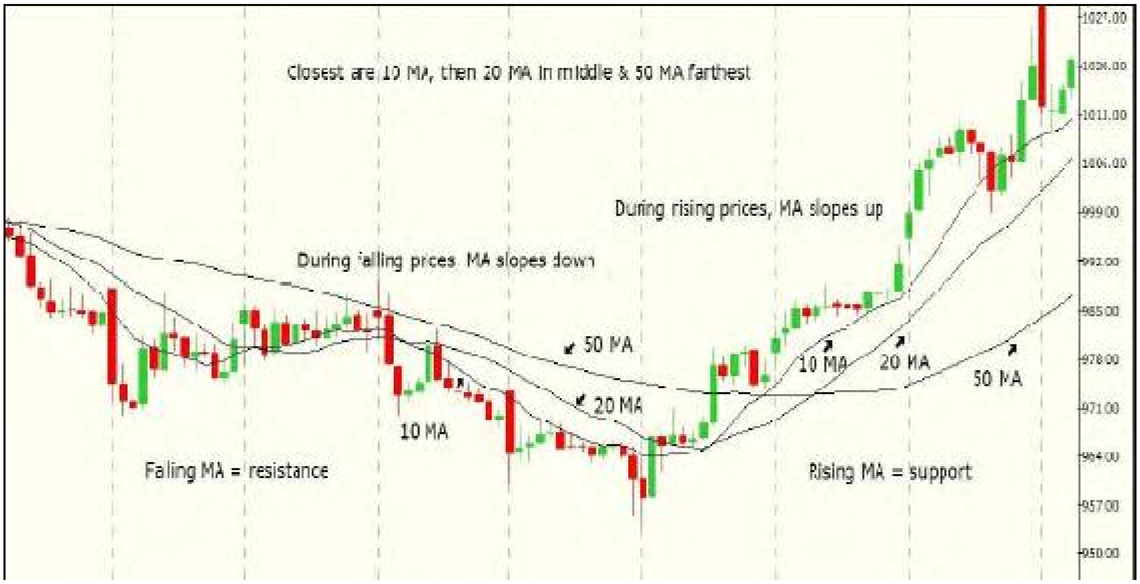

Figure 1.11: **Here we see all the characteristics together on one chart: 1. Prices stay above the MA line in uptrend and below the MA in downtrend. 2. The MA line slopes up in an uptrend and slopes down in a downtrend. 3. A smaller time frame MA line stays closer to prices. 4. The MA line acts as a support in an uptrend and as a resistance in a downtrend.**

7. Moving averages also reveal a change in trend. When price moves above the MA line from below, you can safely assume that there is a shift in the momentum, and in the bias of the participants from bearish to bullish. This gets confirmed if the price continues to journey up and as the MA line also then starts sloping upwards.

Conversely, when price falls below the MA line from above, it shows a shift in momentum and the participants' bias from bullish to bearish. This gets confirmed if the price journey continues downward, and if the MA line starts sloping down as well. The slope of the MA line is as important as the current trend.

8. Moving averages are considered trend following indicators as they are derived from past prices. They do not predict future direction; they react to past data. Which is why they are also said to be lagging indicators. Despite the lag factor, however, they do their main job well, which is to tamp down the market noise caused by volatile price fluctuations. MA lines are very powerful tools and can constitute a trading system on their own.

9. As we've learnt, different MA lines use different data points in their calculations. Accordingly, they will also show trends of different time periods. A 10MA will show the general price direction for ten time periods, while a 200MA will show the prevailing trend over 200 time periods. Longer moving averages take a longer time to change both their direction and slope and thus are less reactive to short term changes in prices *(see* Figure 1.12 and Figure 1.13). A 10MA line will turn quicker and behave more nimbly than would a 50MA line which will take longer to confirm a change in trend. This happens because the 50MA needs more data points for its calculations.

Figure 1.12: **This Nifty chart shows how the 200DMA line turns up from down after an almost 1,000 point rally in Nifty. The 20DMA responds immediately when Nifty turns. Nifty stays below the MA lines in a downtrend, and crosses above it when the trend reverses. These rules work on all time frames.**

Figure 1.13: **The longer time frame MA line doesn't turn in smaller moves but stays steady. Smaller time frame MA line is quick to react, even to smaller moves.**

10. Some of the moving averages that work well for intraday trading include 20MA, 50MA, 200MA. The 20MA line will stay closest to the price action, 50MA line a bit farther, while the farthest from the price will be the 200MA line. The best of upside trades occur when all the three moving averages are sloping up, are almost parallel to one another, and the price is above all of them. There will be corrections midway which can take the price down to the 20MA line, the 50MA line, and even the 200MA line depending on the extent of the correction. The reverse can happen in a down move, where prices are pulled upwards towards these MA lines during corrections. The best downside moves happen when all the moving average lines are sloping down, are almost parallel to one another, and prices are below the MA lines.

11. During periods of long consolidations, or in range bound markets, all the three moving average lines may start bunching together very close to one another and become almost flat. This is the contraction phase of the market we studied earlier, when the market is said to be ranging. If the market participants decide to let the trend resume, then the price will start moving higher, or lower, at some point depending on the direction of the new move. You can see in Figure 1.14 how the 20MA and 50MA lines begin to slope up, and down, accordingly. Once all MA lines start lining up parallel again, the trend is said to be well in place. The 200MA line will take a longer time before it starts turning, and thus stays relatively flat but the trending move can still be decently large and tradeable. And, yes, if the chart is a daily chart, the 20MA line would be coming from 20 days' candles. If it is an hourly chart, the MA line would be created by the last 20 hourly candles. You will see each of these combinations as we present the numerous examples and charts in the book, including the one Figure 1.14.

Figure 1.14: **During trends, all MA lines will slope in the direction of the trend. During flat markets, these lines may bunch up close to one another and stay flat.**

Milestones Covered

Right, so now we know about the two main market phases — the trading phase and the trending phase.

We have also seen the various trends — up, down, and sideways, i.e. the ranging trend.

We have identified the two kinds of players in the markets who cause these moves by their behavioural patterns and participation.

We reviewed what the economic cycle is and the resultant sectoral rotations it causes.

And, we have learnt the basics about the moving average tool.

Coming up next is our own unique and distinctive study of candlesticks. We'll stick to our promise of keeping things simple. So, it's going to be different from the typical candle analysis that you might have read at various places — and that's a promise.

~

During a Mirchi Music Awards telecast on Zee TV, we came across some beautiful lines recited and written by the poet Nusrat Badr which won him an award for the best non-film song. He had been writing for 14 to 15 years before being recognised for his work. We quote him, with minor modifications:

Aansu ko patthar ki bhi aankho se nikalte dekha hai hum ne. . . .	I have seen tears flowing from stones.
Phoolon ko sukhi hui shakhon par bhi khilte dekha hai hum ne. . . .	I have seen flowers growing on dried branches.
Mere vishwas ka udao na mazaak Khwabon ko haqikat mein badalte dekha hai hum ne.	Don't mock my faith, I've seen dreams turn into reality.

Moral: Success isn't impossible, but it may not happen overnight.

Chapter 2

~

Understanding Candles

Introduction

In this chapter we will see the basic anatomy of candlesticks and consider the important factors that one must heed while reading candles. We shall first cover three main candle types, and then study their important characteristics that one must pay close attention to for high accuracy candle reading.

This chapter covers the topic in a very unique way, unlike the traditional candle studies which often end up describing some fifty types of candle patterns. Let's, however, understand why we need to use this pictorial price presentation. Actually, the reasons are simple. First, a picture is worth a thousand words. Second, for making profits in the stock market one has to correctly time the trade entry and exit. Any position which is taken without correct timing will not give the desired results within the selected time frame. Candlesticks help in timing your trade entries and exits. Your success in markets depends on both, what trade you enter into, and when. Candles answer the second part, namely when.

The Anatomy of Candles

Just as a picture is worth a thousand words, a candle is worth many words, price quotes and interpretations.

A candle is a graphical representation of the prices traded during a certain period of time. For example, a 5-minute candle will show the price range that prevailed during that particular 5-minute period. The first traded price during this period forms the opening level of the candle, and the last traded price forms its closing level. Additionally, a candle will present the highest high point and the lowest low point made by the price during that period.

If the closing price is higher than the opening level, the candle's colour will be green (or white), while if it's lower the colour will be red (or black). A green candle thus depicts the bullish mood of market participants in that period. It shows that the bulls could successfully take the prices higher. A red candle, on the other hand, shows that the overall market mood was bearish and that the bears successfully forced the price lower. Thus, every candle depicts the battle fought between the bulls and bears during the period concerned.

A candle has two main parts:

- The **main body** of the candle, namely its green or red area as the case may be, is bound by the open and close price values.
- The other important part of the candle are its shadows, which are both above and below its body. These **shadows, or tails as they are also often called,** do indeed have a tale to tell. These are the lowest and highest price levels reached during the period concerned. It takes bull power to take the price from its lowest value to a closing value above this low. Higher the bull power, bigger is the pull-back from the low, and thus longer the lower tail or shadow. Correspondingly, it takes bear power to force down the price from the highs of the given period to a closing value which is lower than that high. Thus, a longer upper shadow means that the bears could force the prices that much lower from the highs before the candle closed.

If you grasp this concept clearly, then you will understand that **a small red candle with a longer lower shadow is more bullish than a small green candle with longer upper shadow — and *vice versa.***

Important Factors in Interpreting Candles

It is important that you thoroughly study Figure 2.1 and understand that it is not just the colour of a candle's body that decides the degree of bullishness or bearishness in a given candle. The size of the body matters as well, and so does the size of the candle's tails or shadows. As noted earlier, for example, a small green candle with a long upper tail is more bearish than a red candle with a long lower tail.

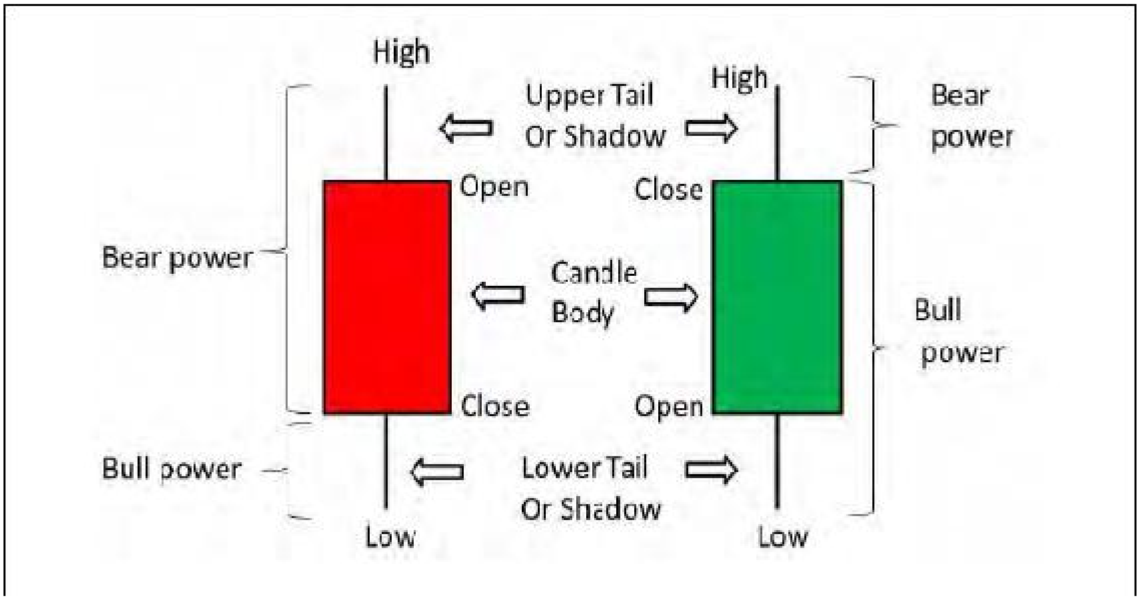

Figure 2.1: **The story of a candle, its various parts, and what they signify.**

The closing level is also very crucial and should be looked at in comparison to the highs and lows of the candle.

Try to keep in mind the following factors when you read candles:

1. **Candle colour:** Green is bullish and bulls are the winners; red is bearish and the bears are victorious.
2. **Size of candle body:** Bigger the body, bigger the victory of the winning side.
3. **Length of the candle shadow:** Longer the shadow, bigger the retracement from the extreme, and thus stronger the rejection of that extreme level.
4. **Candle closing level:** Never judge a candle before it closes. A candle's closing value is very important and any interpretation derived without taking this into consideration could be incorrect.

Markets are all about spotting opportunities and a clearer and deeper understanding of your subject increases your chances of success manifold. So, let's dig deeper still.

The market is flooded with books that talk about technical indicators; sometimes an entire book is devoted to just one indicator. Our aim here is different. We will not get into candle patterns that are commonly known, with names such as stars, harami, engulfs, hammer, hanging man, two crows, three mountains, four soldiers, and what not. The list is endless. Fifty or more of these names are common. Is it practically possible to identify all of these patterns in real time in a fast running market? We don't believe so.

So sticking to our promise of keeping things simple, we will capture the entire theory in a practical way and will focus only on 3 main candle formations. Yes, just 3 kinds of candle formations! What is important is that we learn how to quickly recognise the psychology underlying these candle formations in order to read the minds of the traders, and learn to take calculated risks. Thereafter, minor variations will not matter if you understand the underlying psychology behind the candle.

Understanding the market emotion is crucial because that is what creates a tailwind. In turn, the tailwind generates the boost to sustain momentum, and that's when you get big moves with a solid follow through. And, that's where the money lies.

3 Types of Candles — and What They Reveal about the Market's Mind

There are three main types of candles that we shall focus on:

1. Candles that are **under-sized, namely XXS-sized candles, or Lilliput candles.**
2. **Giant-sized candles,** or XXL-sized, or super-sized candles.

3. **Candles with extraordinarily long shadows or tails on either side;** we call them **rejection or reversal candles.**

Typically, most candles have regular bodies and tail sizes, exhibiting normal amount of bull or bear sentiment. These three types of candles are different from the others.

We will begin our study with under-sized candles, which are significantly smaller than typical candles. We will then move on to supersized candles, which are bigger than the regular ones. Finally, we will consider long-tail candles, which derive their significance from their tails rather than the body. We will see how to interpret all these three types, and how to use them to our benefit.

Under-sized / Lilliput / XXS-Sized Candles

When we say super-sized or under-sized candles, it is always in comparison to the average size of the previous many candles. There is no formula for defining it but visual interpretation should suffice for a trader.

A Lilliput candle is one where the price difference between the opening level and the closing level is much smaller than for the previous many candles. Depending on whether the candle is green or red, you can say who is winning. But no matter which side is winning the battle, the win size, or the move, is very small and there is no alarming action anywhere. This is not all bad. In fact, it's healthy. You cannot have a major move every single day or every single hour. There are various interpretations and uses of such candles.

Doji Candles — A Variation of Lilliput Candles

These are a minor variation, or subset, of the Lilliput candles. In the case of a Doji candle, the body is not just small, it's almost negligible in size. The opening and closing prices are almost the same, or extremely close to each other. The range may be mildly wide or narrow, but the real body looks almost like a single horizontal line instead of looking like a rectangle. If every candle is a battle between bulls and bears, then doji candles signify a match that ends in a draw. The candle body indicates neither a bull victory nor a bear victory because the price closes almost where it opened. If the tail is exceptionally long then the case is different, and we will cover this when we discuss rejection candles a little later.

Generally, small body and small tail candles indicate a phase of pause. They suggest indecisiveness amongst participants other than when there is a special or a different message coming from the extraordinary length of upper or lower tails. **So long as Lilliput candles have regular sized tails, they show a neutral bias among market participants.**

For better clarity, review Figure 2.2.

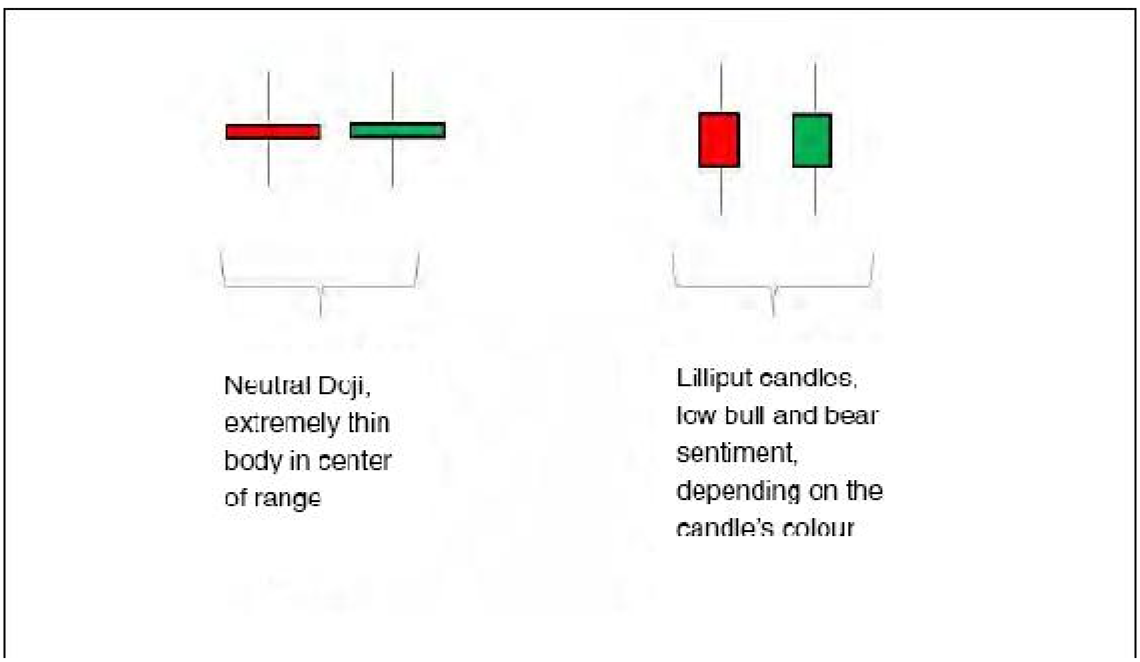

Figure 2.2: **Under-sized Lilliput candles and the Doji candles.**

Super-sized / Giant / XXL-Sized Candles

We have already learnt that every candle represents a battle between bulls and bears. It is the closing value of the candle that decides the winner.

When bulls successfully and decisively wrestle the bears down to the mat, they take the closing price much higher from the open compared to an average sized victory. That is when you get giant green candles or supersized green candles. On the other hand when bears maul the bulls in a big way, you get super-sized red candles. A super-sized candle shows a massive landslide victory for the winning side and, consequently, a strong market emotion driving it. Please note that it is the size of the candle's body that we are talking about here, and not the size of the shadows.

Average sized candles do not convey any special message other than quiet continuations, or minor retracements, of the current direction. But when you see super-sized candles, that's when you should immediately sit up and take notice. It could be a breakout. Or, it could be a reversal. It could be a new start, or it could be an end to the current trend, or even a consolidation. It would also mean that there is a high probability of seeing further levels in the direction of the big candle. It could be the time to act. One must not get frozen into inaction upon seeing such eruptions. This is the time to pull the trading trigger and shoot your enemy. Or get shot if the candle is positioned against you. So one must show agility and take quick action when giant candles appear. No second thoughts allowed here.

> **"When you gotta shoot; shoot, don't talk."**
>
> **— Tuco in the Good, the Bad, the Ugly***.!

At times a giant candle may cover, or envelop, several earlier candles within its own range, either partly or fully. The bigger the coverage, the stronger is the impact of the oncoming move. So this is a type of candle that we must always be on the look out for and act upon. How should we act upon it, and when? That we will discover as we proceed ahead.

The shadows of giant candles — the upper as well as the lower shadow — could either be normal or similar in size as those of most of the adjacent candles, or they could be exceptionally short, or even absent for that matter.

If the giant candle is a green one, and if the tails are negligible in size, it shows that the candle moved higher after opening, and that there was hardly any downward move after the opening. It also shows that the candle closed near its highest value for the given time period.

If, on the other hand, the giant candle is red in colour and its tails are negligible, it means that the prices started falling right from the time the candle began. There was no successful attempt to pull the price higher and the price closed at the period's lowest levels.

These factors will add to the candle's bullishness, or its bearishness, as the case may be. Such a candle shows the level of grip the participants have over the move. It could be a partial grip, or a total grip as mentioned above. The bigger the body and smaller the tail, the stronger is the control. Basically, giant candles show strong momentum, and such momentum does not die away easily. Because of the strong momentum depicted by a big candle with a negligible tail, you can expect further move in the same direction. What one must remember is that whenever a given candle closes at or near one of its extreme ends, it depicts price acceptance by the participants. This means that the market participants are willing to accept price on that side or that extreme end, and may even accept further moves in the same direction in the next candle.

You can see a pictorial presentation of the significance of giant candles in Figure 2.3, which shows regular sized tails, or small, negligible tails. But what if these shadows or tails are extra long? Well, that's a very important type of formation and deserves a separate title; we call them reversal candles or rejection candles.

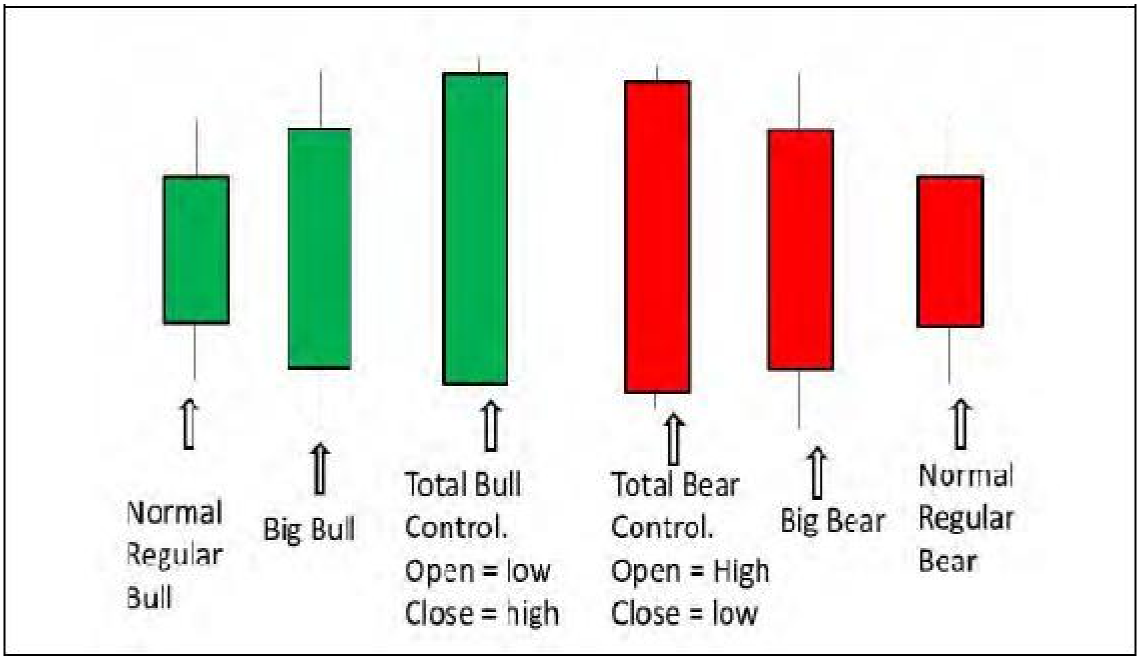

Figure 2.3: **What giant, super-sized or XXL candle mean.**

Reversal or Rejection Candles

Extra long-shadow candles can be aptly named as reversal or rejection candles. Such candles will have either a long top shadow or a long bottom shadow or, at times, even both. The body of the candle could be green or red, small or big, it doesn’t matter. Their distinguishing mark is their shadow. Now obviously green is bullish and red is bearish, but the key message of such candles is derived from what their tail is telling us. These candles depict strong directional bias and should never be seen as neutral, no matter the size and colour of the body. The tale lies in the tail.

A long bottom tail shows that the closing price level of the candle has been arrived at after a sizeable upward pullback from the lows that were made during the candle period. In other words, the extreme lower end of the price that was once touched could not be sustained. It saw buyers rushing in to grab the stock, whereupon the falling price found support and the fall got arrested. We expect higher levels ahead depending on the larger picture and a strong follow through. Those who sold at lower levels in anticipation of a further fall in prices are now trapped. A long bottom tail candle pattern, added to a green body colour, is super bullish. This interpretation, derived as it is from a rejection of lower price and a long bottom tail, remains valid even if the candle is red. The candle body will usually be located in the top or upper end of the candle range. Even a Doji, which is otherwise considered neutral, will be seen as a bullish candle provided the lower tail is long.

Conversely, a long top tail shows that the extreme top level touched during the candle formation was then immediately rejected by the market participants who obviously believed that the price was getting stretched too far up and must go lower. Supply pressure then came in, and the price drifted lower. Any bulls who might have tried buying at the top are now trapped. If such candles also see a follow-through on the downside, then RIP bulls!

Thus, a Lilliput candle with a long top shadow and with a red body adds to the bearishness, and the larger the red body, the more is the implied bearishness. The bearish interpretation stays valid even in the case of a green candle with a long top shadow. Even if it is a Doji, the candle with a long top tail is said to be very bearish, and is not seen as neutral.

What one must remember is that long tails represent price rejection. A top tail represents rejection of higher prices, while a bottom tail represents rejection of lower levels. These rejections increase the chances of the next candle moving in the other direction, as graphically brought out in Figure 2.4.

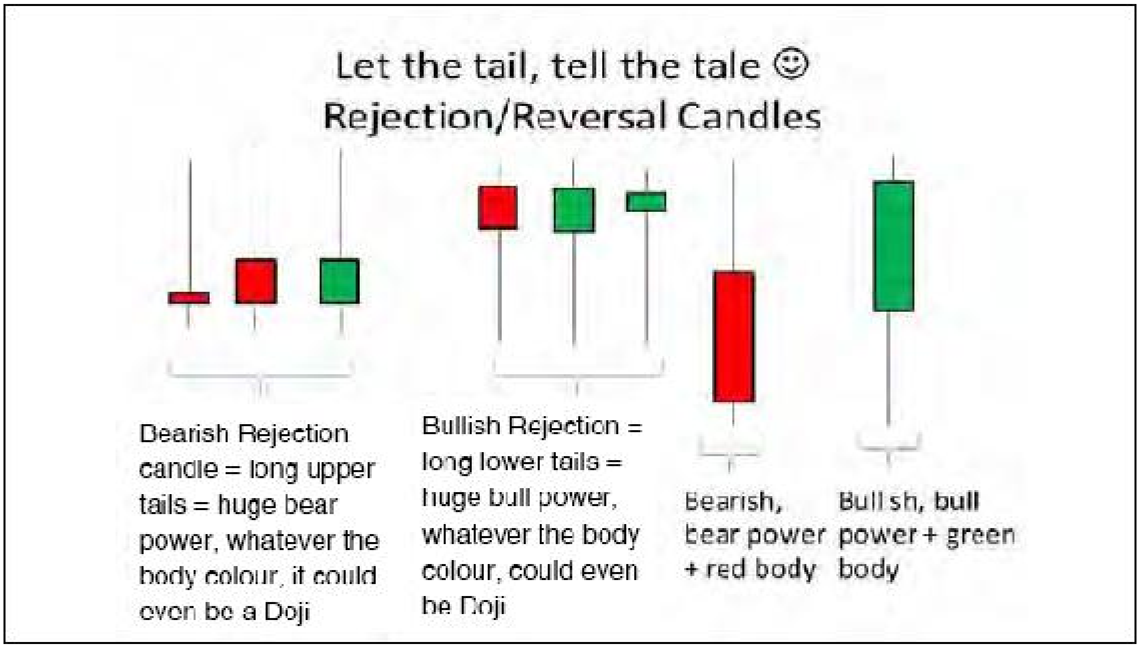

Figure 2.4: **Long tails.**

Apart from the above three types, other candles would fall under the category of a regular candle, suggesting normal bullishness or bearishness as the case and the colour may be. We have shown a normal candle in Figure 2.3. Do check it out.

Combined, the above insights should suffice to enable you to rank the bullishness or bearishness of any kind of candle or situation. And that is all that matters. This reduces the 50+ types of candles to just 3 main types, making this tool both much more comprehensible and much more effective.

Consider the candlestick chart in Figure 2.5 to review all that we have studied about candles, and how they look in real time markets.

Going ahead we will learn how to make use of all the information that a candle pattern offers us with the help of charts showing real market moves.

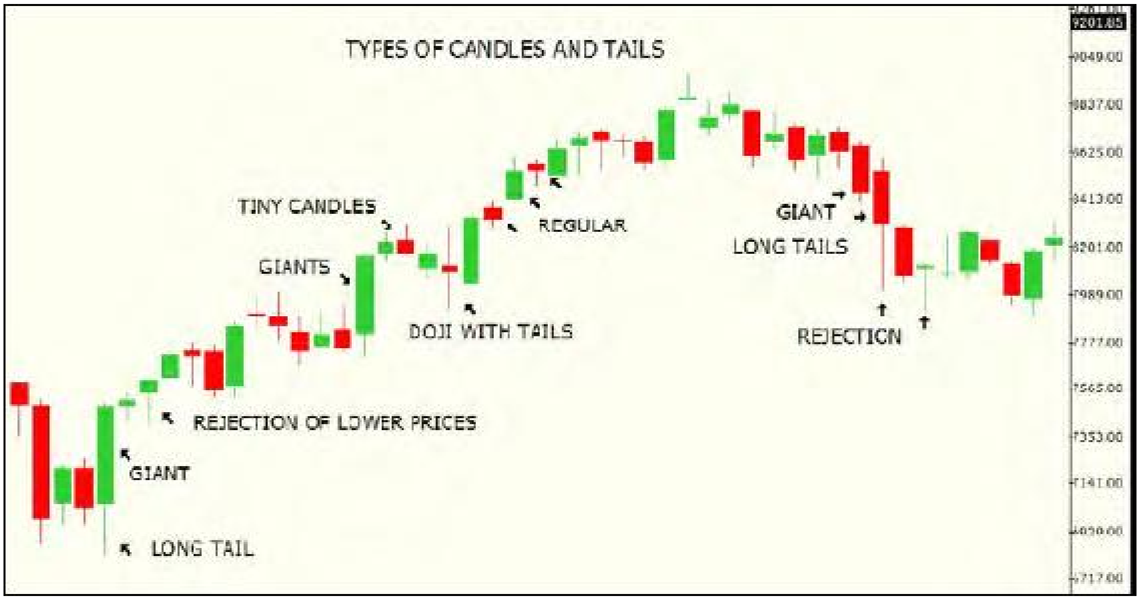

Figure 2.5: **Variations in candles — body sizes and tail appearances.**

Key Points for Accurate Candle Reading

Let the Candle Form Fully Before You Start Interpreting It

Before judging any candle, it is very important to allow it to fully form till the close. Your entire view or interpretation of the candle can reverse by the time a candle closes compared to your view when the candle begins to form. A candle that initially looks to be highly bullish, or even signal a breakout, can turn out to be a temporary top. A candle that seemed like a fresh breakdown may turn out to be the exact opposite if a long bottom tail gets formed.

It is the closing of the candle that will tell us what to expect next. Always keep this in mind and be patient.

Before Looking for a Trend Reversal Signal, Look for a Trend

Reversal candles need a very well defined and clearly visible prior trend to reverse from. It is important that you clearly understand what's happening around you before jumping to decisions. Also, always keep in mind that reversal patterns which appear at important price levels are the really important ones, and should be heeded strongly. The ones that appear at other places might not lead to the expected results or reversals.

Candles Work Better on Comparatively Longer Time Frame Charts

For example, a 5-minute candle chart will be more reliable than a 1- or 2-minute candle chart. And a daily or a 15-minute candle chart will be more reliable than a 5-minute candle chart. This is not to say that you cannot trade smaller time frames. The point is, longer the time that a candle takes in forming, larger is the number of participants involved in its formation. And, so, bigger is the amount of emotion involved in it. The same applies to chart study. Higher time frames bring in higher reliability. All time frames can be traded, and all of them work equally well if you know how to use them. What suits you will depend on your mental make-up.

You Don't Have to Take the Very First Trade that Comes in View

Just because the markets are open does not mean you have to take the very first trade that appears. You always have the choice not to do so. Make sensible use of that choice. Filters, filters and more filters should be used before making a financial commitment to a trading position or a trading call. As we move on, you will see how we test each scrip or chart, even before we allow its inclusion in our daily watch-list.

Always Wait for Pattern Confirmation

Most chart patterns require a confirmation before they work out fruitfully. Wait for that confirmation to come in the time frame you have chosen. There is no rush. There should not be. The share bazaar teaches us: "Never chase trades. *Ek jayegi, toh dusri aayegi* (If one opportunity goes away, another one will come along). So always enter a trade after a confirmation and not before that. If a particular candle pattern requires an additional candle to form before confirmation can be obtained, so be it.

Location Where the Pattern Forms is Very Important

The right location adds to the success probability of a pattern or a candle. We have already seen that corrections often find support at the moving average lines in an uptrend. During a downtrend, resistance comes in when a counter trend up move meets a moving average line lying overhead. It can be the 20MA, 50MA, or 200MA, or any other MA line. If these lines indeed provide support or resistance, then the original trend should resume from there. Accordingly, any kind of reversal patterns or candles that form at these levels should be watched closely and should be accorded higher importance in comparison to the same patterns occurring anywhere else. MA lines are areas of probable reversals, and a counter trend reversal occurring there is a strong indication that the trend may soon resume. So a fresh buying interest in an uptrend, and a strong supply pressure in a downtrend, can come in at these locations (*see* Figures 2.6 and 2.7).

Figure 2.6: **The counter trend moves find support at the 20MA (pink) line in this chart of Bata India. You can see giant trending candles appearing from there on. You can also see rejection candles that put an end to the corrections. Their locations make these candles more powerful and reliable.**

Figure 2.7: **Consolidations end at the MA line, — and giant candles take the price higher exactly from there in this chart of ABB. The 3MA lines in this chart are 20MA, 50MA, and 200MA.**

Always, therefore, check the location where a reversal pattern or candle is forming in order to gauge its relevance. Other important locations are the floor pivot levels, which we will consider in the next chapter, or the previous day's closing level, swing turning points and the prior highs and lows formed on the charts. It is amazing to see how the probability of success for a chart or a candle pattern increases when the pattern forms at any of these crucial levels. **So, always remember that in order of priority the location comes first, and then the pattern. If you fail to follow this order, your results could be random.**

Timing of the Pattern

If you are one of those who sits in front of the trading screen regularly, then you may immediately relate to this point. There are particular time periods of the day when the market, and its constituent major stocks, begin to make the day's decisive directional moves. These time zones are high probability periods when the market or the stock which was earlier just loitering around or doing nothing very much will start making meaningful moves.

Depending on the larger picture, the move could be in the direction of the trend or it could be a reversal. So any kind of a reversal or breakout pattern that either appears or starts getting confirmed at these times should be taken immediate note of and acted upon. In the Indian context, we can divide the current market operating hours into the following time zones:

9:00 a.m. to 9:15 a.m. — Market pre-open time zone. A trader who is serious about his work will always pay attention to all the local as well global setup that he wakes up with, and for any events, news, signals, cues before the markets open. In fact, he would be on his desk much before this time, going through his pre-market preparations and bringing himself in tune with the flow of events around.

9:15 a.m. to 10:30 a.m. — The first hour is crucially important and will give emphatic directional moves in many stocks. These moves may either be continuation of moves that had started the previous day, or may be the result of overnight news flow which the stock or the market will immediately try to price in. This is a period of hectic activity and will demand your complete attention and a very high degree of concentration. This is an action-packed time and the moves occurring within this time period require trading agility.

Try to recall what it takes for the players of the television show, KBC or *Kaun Banega Crorepati,* to make it to the hot seat: Fastest fingers first, remember? This first hour is similar, and it is only for the fastest and the best players. I remember one of my favourite quotes from school days: Patience during planning, and impatience (read nimbleness, agility) during execution can work miracles. The early morning markets require exactly that. If you are ready with your pre-market prep, then this could be the time to pull the trading trigger on many days.

10:30 a.m. to 1:30 p.m. — This could be a quieter period. That doesn't mean there won't be any important moves emerging at these times. There could well be but the level of aggression at display here is different. As the news flow keep coming every hour in the market, there will be newer moves as well. The amount of work and attention required will depend on your trading tactics and the number of stocks you follow. But you will often see a high number of stocks simply loitering around during this time.

1:30 p.m. to 3:30 p.m. — This will again be a high pressure time and will demand your undivided attention. Moves beginning during this period may decide the final direction for the day; the day's closing level and the day's trend.

Thus it is important to be alert as to which pattern or candle is appearing at what time of the day. Patterns appearing at more crucial times should be paid very close attention and should be acted upon quickly. You can have stronger conviction on the moves originating at these times. So always pay attention to a pattern's timing and choose only the patterns during high probability time periods for trading. Always remember one thing; money must flow in easily. We are not here to fight with the market, but to flow with it.

A Single Candle Doesn't a Story Make

The market never accomplishes anything with a single price swing or a single candle. If a stock has started moving in one particular direction, and if the move is genuine and not a false alarm, then it will continue for some more time, a few more swings, or a few more candles. The story doesn't end with a single candle whether on the up side or the down side. It is only when the market moves in one direction for a tradeable period of time that it makes sense to make a commitment. If the stock or index under study is making one green candle followed by a red one, which is again followed by a green candle and then another red one, the market may be lacking conviction — and this can make you miserable. If you keep seeing this phenomenon, it is a signal that you better stay out of that move. In other words, the longer moves are the ones which are more tradeable and every meaningful beginning in a longer move will give a good follow through.

Multiple Favourable Factors Lead to Moves that Sustain

More the factors in favour of your trade, the higher is the probability that the move will sustain longer. A meaningful move in the stock or the index will often sustain till it attains at least 3, or 5, or even 8 candles in the same direction. This is equally applicable to chart patterns.

For example, when the price moves above an MA line from below it, and finds support at the MA line on retracement for the first time, there is a strong possibility that it will do the same a few more times. Without these follow throughs, there cannot be meaningful breakthroughs (*see* Figure 2.8).

Figure 2.8: **The price moves from below the MA line to above it and finds support at the 20MA line for the first time. The move, however, doesn't end there, and you can see the price taking support at the MA line many more times.**

New Trends Give Higher Probability Trades

Entering a newly starting trend affords a higher probability of success than entering one that has been around for a while (*see* Figure 2.9). The reason is simple. Those who got in early will be tempted to book profits at higher levels, or at lower levels if it is downtrend. The better your timing of entry, the higher your chances of a successful trade. Therefore always remember that **the entry signals that appear after a fall, and from a nearby support, have higher probability of working out in the immediate term** — which is our time frame as day traders — compared to the same signal appearing after a huge surge of few days, and with a resistance nearby. In other words, the location, the prior move, the pattern timing and a strong follow through are all needed to be in your favour, and that's what good trades are made of.

Figure 2.9: **Bigger corrections can take place after the completion of big moves. Best entries are available at the start of a new trend on minor dips because these dips are not really deep, and may soon see trend resumption, as shown.**

Trading with a Trend Carries a Higher Probability of Success

Any move that appears on the trending side will have a higher probability of working out successfully, compared to a counter trend corrective move. Now, that doesn't mean that we should never trade against the trend but such counter trend moves should be restricted to specific trade setups which we will discuss ahead. In general, staying with the trend is the smarter thing to do.

Much of your fortune can be lost if you try to control the markets or fight the trend, i.e. if you hold onto your opinion — and hope and pray — even as the market is going against it. This behaviour shows that you are trading without a proper understanding of trade tactics. One must be aligned not just with the trading time frame trend, but also with the trend in a higher time frame. When the price action aligns in all time frames, the moves occur smoothly and sustain longer. Remember, money must flow in easily. Close attention should be paid not just to the higher time frame trend, but also to the supports and resistances in those time frames, because those supports and resistances are indeed strong.

Check the Volume

Volume definitely plays a role and if it is above average as the move appears in the direction in which you are planning to enter a trade, that works in your favour and increases the chances of your success. Any price breakout move that begins with a huge volume breakout will have higher odds of success, and higher chances of seeing a follow through.

50% Counter Trend Limit for Ongoing Trends

A trend remains trustworthy till the time the retracements or the counter trend moves stay within a certain limit. Beyond that limit, the quality of the trend turns doubtful. There are various theories that propagate various threshold limits. As a part of our trading tactics, we will maintain this limit at 50%.

What this means is that if a given trend has to sustain, then the counter trend moves should not erase more than 50% of the trending move. So long as the market or the scrip concerned takes two steps forward and only one step back, you can keep faith with it. Any retracement beyond this threshold limit should make you doubt the very existence and continuation of the trend. If the move is being observed on the chart, say from a swing low to a swing high, then the retracement must stay within 50% of that rise.

Correspondingly, in a downtrend any retracement move on the upside should also stay within this 50% limit. If a giant green candle has appeared in the direction of the trend, then the next few candles might be counter trend and corrective candles, but these should not erase more than 50%, i.e. half, of the prior giant candle. If it does, the validity of that big green candle becomes questionable. A minor retracement, on the other hand, is normal, expected and should be healthy. It also gives you another opportunity to enter in the direction of the trend — and at a better price.

The point is that the retracement should not get so large that it leads to loss of control for the winning side. This is very important. As they say in life, all human relationships that maintain themselves within boundaries of respect stand a better chance of continuing longer. Similarly, every retracement of a trend should stay within a threshold for the trend to continue to look good for more. Have a look at Figure 2.10, and then check out the same rule in a real example from the market in Figures 2.11 and 2.12.

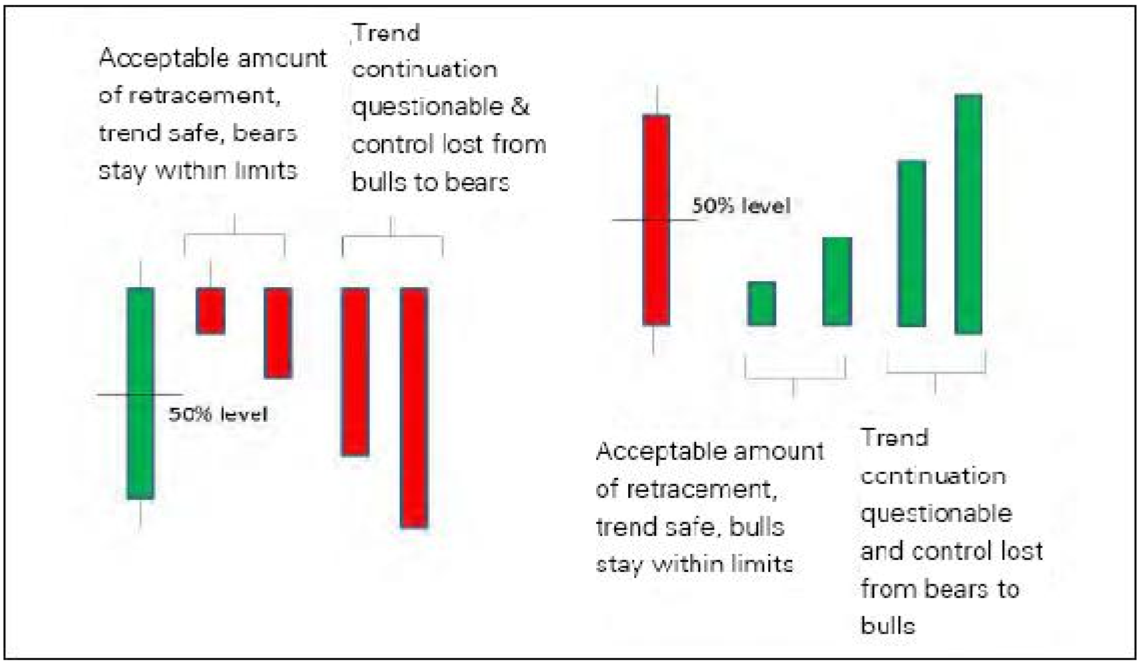

Figure 2.10: **Acceptable and unacceptable levels of retracement.**

Figure 2.11: **Look how the counter trend corrective moves in Adani Enterprises remain limited in size. The corrections do not erase more than 50% of the uptrending move which started with the giant green candle. Soon after the corrective moves, a green candle reappears and the trend resumes and sustains nicely.**

Figure 2.12: **Jain Irrigation resumes its up move after a 50% correction.**

All of these factors are important. The higher the number of positive factors on your side, the better is the chance you stand to win big time. In Chapter 3, we will look at the implementation of our candle study. We will learn how, when, and where to use each of these candle types. Before that, let's revise all 12 important candle characteristics that we have studied in this chapter.

Summary of important Points for Accurate Candle Reading

1. Never judge a candle before it closes.
2. A clear prior trend is important for a meaningful reversal.
3. Higher the time frame, higher the accuracy and reliability.
4. Use sufficient filters before a trade commitment; choose only the best trading opportunities.
5. Look for confirmation of a candle signal before making a trade commitment.
6. Location of the candle is extremely important and must be looked at carefully.
7. Pattern timing is crucial; choose high probability timings for better success.
8. Nothing is accomplished in a single candle — it usually takes 3, 5 or 8 candles.
9. Newer trends are more profitable to trade than the more matured ones.
10. Trades with the trend are superior to trading counter trend moves.
11. Volume support makes a big difference, it must be checked.
12. Never forget the 50% retracement rule; the retracement must stay within the 50% limit for the trend to continue for longer.

Milestones Covered

1. The two (2) colours the body of a candle can have — green (white) and red (black), and their interpretation.
2. Five (5) important variations the candle body can have, namely, Giant, Lilliput (Tiny), Rejection, Regular, Doji.
3. Four (4) major variations in the tail lengths of candles — long, very short, regular, absent.

~

Chapter 3

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Trading With Candles

Writers at Work

Ashwani Gujral: Achha ek baat suno. English bilkul simple rakha karo. Shashi Tharoorwali nahi chahiye **— Mind you, keep the language simple, not like Shashi Tharoor's.**

Rachana: **That's a good one . . .** ***Tharoorwali*** **. . . No worries, will definitely take care.**

Ashwani Gujral: **Now you can go and enjoy your Sunday.**

Rachana: **Sir, I am at my desk reading many interesting things, and will be working till 5 p.m.**

Ashwani Gujral: **Yes that's exactly what I meant by enjoy your Sunday. That's the right way to spend a weekend.**

Rachana: **Oh, . . . Sure Sir, thank you.**

~

In this chapter we will consider the various ways of trading the three main types of candles we studied in Chapter 2. We will find out:

1. Where to look for each of the three types of candles.
2. In what kind of markets should one pay more attention to them, and under what context do they become extremely crucial.
3. When to trade them.
4. How to trade them.

How to Trade Lilliput (XXS-Sized) Candles

Lilliput Candles Often Lead to Volcanic Eruptions

We have learnt that markets move through phases of contraction and expansion. It is here that the secret of money making lies. Every phase of expansion is followed by a phase of contraction, and every contraction will, sooner or later, erupt into an explosion. Very often contraction phases are full of Lilliput candles, and new expansion phases often erupt from these small candles. If there are many Lilliput candles around, then there will hardly be any trending move and the stock or the market will move sideways, rather than go up or down and you'll see more traders at the coffee machines and water coolers than on their trading desks. At such times, there is said to be a lack of institutional buying or selling, or any major action by any big players. This could, however, well be the calm before the storm.

We must keenly observe these range bound markets and we can even trade them provided the range is wide enough. At other times, we will wait for such a phase to dissolve and look for the next phase of expansion to take over. Erupting after a contraction, an expansion phase can give us a big directional move.

A contraction requires you to maintain tight stop losses based on the width of the range. That, in turn, allows you to enter the eruption trade with relatively small risk. Should the eruption see a decent follow through, then not just your first target but even the second and third targets can be met. **This is how we use Lilliput candles — for entering big trades, when a range gets broken.**

For a long trade, we will enter right on the breakout, — and immediately on the breakdown for a short trade. The entry must be made as soon as the range is broken.

In the chart in Figure 3.1, you can see that the stock was previously in a very narrow range. So when the breakout finally happens, the stock is coming out of a range of more than a day. This releases the stock's coiledup energy with great force, and there are higher chances of seeing a decent follow through during the rest of the day. This is especially true in this case as the narrow range of the previous 2 or 3 days was not showing any erratic or wild swings.

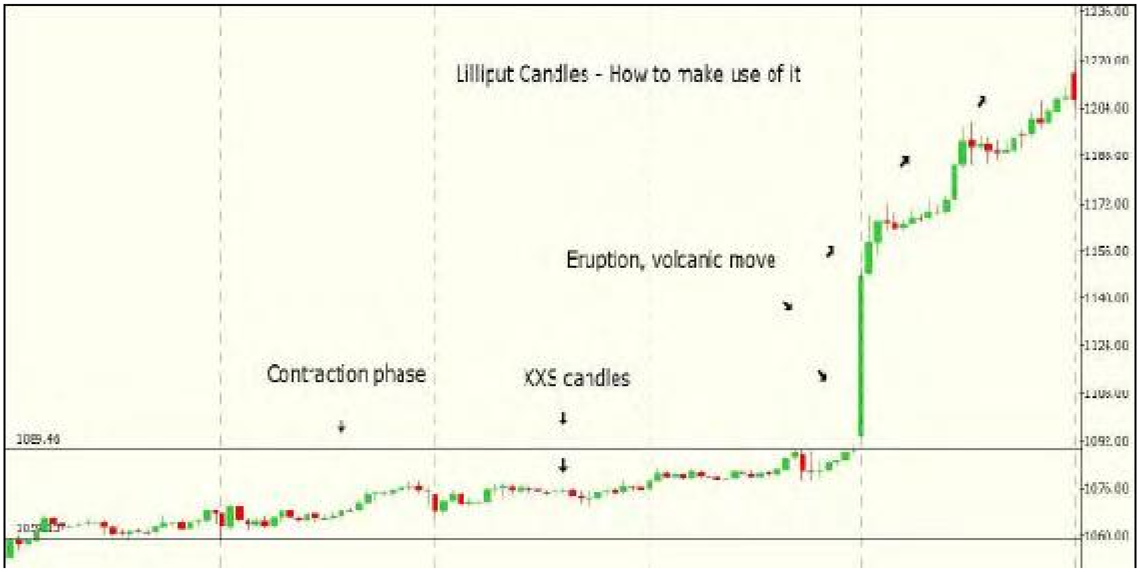

Figure 3.1: **Have a look at this chart and see how the tiny Lilliput candles lead to a near-vertical eruption. You will find such trades when the contraction phase featuring Lilliput candles ends leading to an eruption on either side.**

Lilliput Candles Also Help Us Trade Trend Continuations

Lilliput candles may also appear in trending markets or in an expansion phase, as can be seen in Figure 3.2. The appearance of these small candles in a newly started trend, or in a strong ongoing trend, has a special significance when they are surrounded by comparatively larger neighbours.

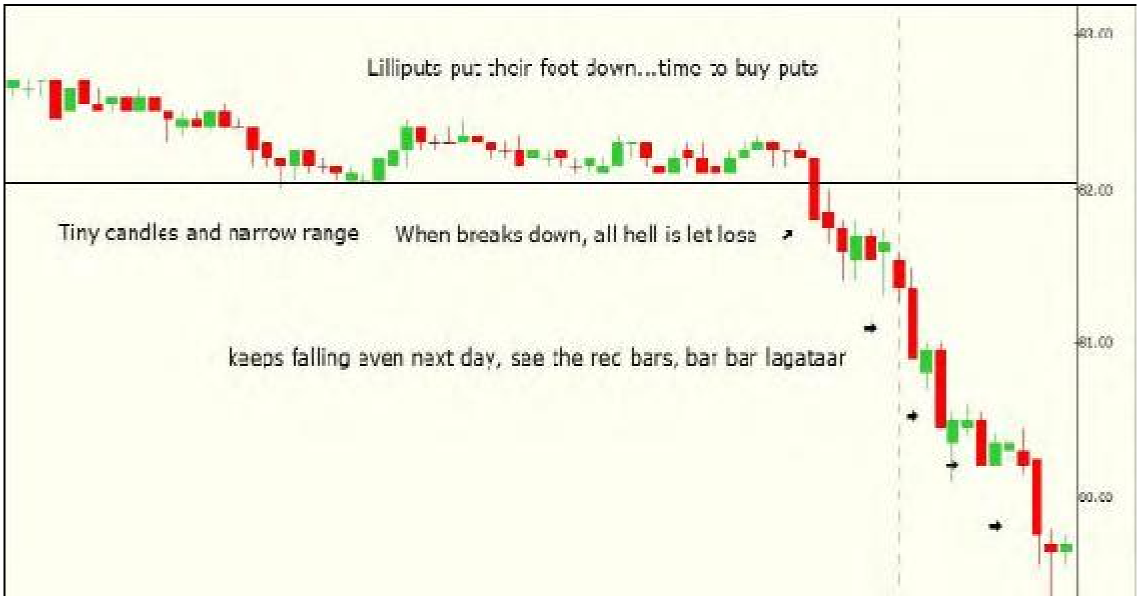

Figure 3.2: **This IDBI chart shows how we can use Lilliput candles by waiting for the end of a contraction phase — and then trade the expansion that follows. One can enter short on the breakdown.**

Let us assume that you are looking for an entry into a strong uptrend. Midway, you see a tiny red candle. This candle shows that there was a minor dip in price but the buyers immediately came back in to absorb the selling. This prompted the price to start rising again. This is an opportunity. The opportunity is even stronger if the red candle is formed at or around the top end of the previous green candle. That would show that only a minor part of the price got erased and that support came in quickly thereafter. In such a case we can safely assume that the market or the scrip is simply gathering itself for the next leap forward. This gets confirmed if the next candle, or the one thereafter, takes out the high of the small red candle. That is when we enter the trend.

We take such entries when the trend has a very strong momentum and we are not expecting a major dip, or even a time correction. In an uptrend, entry can be made once the high of the red counter trend candle is taken out. Conversely, in a downtrend you enter when the low of the counter trend green candle is taken down. Have a look at the charts in Figure 3.3 and Figure 3.4, respectively, for a better clarity of the concept.

Figure 3.3: **Trading a trend using Lilliput candles. The tiny red candles appearing midway offer a fresh opportunity to board the upmoving train, especially because this candle appears at the higher end of its neighbour on the left.**

Figure 3.4: **A tiny green candle appearing midway in a downtrend offers a fresh opportunity to board the trend, especially when the tiny green candle appears at the lower of the preceding red candle.**

This is how we can use Lilliput candles to enter an ongoing trend.

Lilliput Candles Can Also Signal an End to the Current Leg of a Move

There is one important caveat to note here. If the uptrend has reached a near term top — or bottom in the case of a downtrend — and you see the appearance of tiny candles there, then there may not be any trend resumption. In such a case we will see a reversal of the trend instead of any further move in the original direction. If the minor pullbacks, as shown by these small candles, do not lead to just a temporary halt, they will lead to a reversal sooner than later. Such an occurrence is more likely when these candles appear at some crucial level of resistance in an uptrend, or support during downtrends.

Let's say the trend was up and you have already seen a sizeable up move. You then see tiny candles appearing at some kind of a resistance level. In such a case we assume that the small body may be showing a loss of momentum. If the momentum doesn't pick up in the same direction again sooner or later, it may well do so in the opposite direction. And if the trend is indeed going to reverse, then you would see the appearance of bigger candles of the opposite colour, which would signify reversal.

The tiny candles give similar interpretations even when they appear at the end of a counter trend corrective move. At such times they may signal an end to the correction, and a probable trend resumption. Have a look at both cases as shown in the charts in Figures 3.5 and 3.6, respectively.

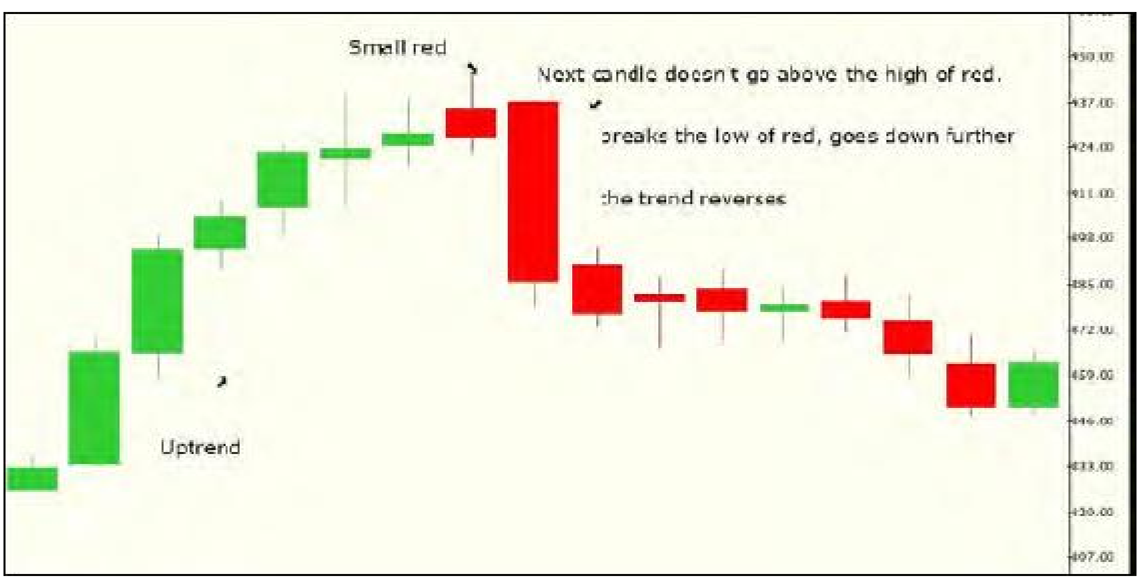

Figure 3.5: **Have a look at how the narrow candles can lead to a reversal of the current trend when they do not lead to a resumption of the trend. This is more probable after an extended move in one direction, and from levels of hindrance, whether support or resistance.**

Figure 3.6: **You can see how Lilliput red candles keep counter trend corrective moves within limits, and lead to trend resumption sooner rather than later. A trend resumption move often originates from support levels, and has bigger sized candles.**

Thus, the mighty Lilliput candles are important everywhere:

1. In a new trend starting by way of a breakout / breakdown of range.
2. In boarding an ongoing trend.
3. In signalling an end to a trending move when it reaches an obstacle, or gets over-extended and loses momentum.
4. In signalling an end to a corrective move when the correction reaches levels of support or resistance.

What Giant (XXL) Candles Reveal — and How to Trade Them

Depending on the location of their appearance, giant candles have altogether different interpretations from Lilliput candles. A giant candle has a large body connoting that the difference between its opening and closing prices is huge. That in itself directly implies a major shift in the sentiment of market participants during the candle formation period. As described earlier, it takes a strong rush of active buyers, who bring along strong conviction and bullishness, to create a huge green candle. To create a big red candle, it takes an equally strong rush of sellers willing to dump the stock at any price.

Giant candles offer three main cues to traders. Let us consider each of the three.

Giant Candles that Begin a New Move

In case an XXL-sized or giant bullish candle is seen after a major fall or a correction, we can assume that a near term bottom has been formed and the trend has reversed. This assumption takes on greater significance when the candle is formed at an important level of support. It becomes even more important if the same happens after some degree of base building process, or some sort of a sideways move. We can then safely say that the support is being perceived by the participants as a near term bottom. Thus, when such a candle appears after a down move and post a sideways consolidation or a base building process, or near some important support, it strengthens our conviction all the more. Such a giant candle will lead to a breakout from that narrow range or base in most cases.

At other times, giant candles can even lead to a V-shaped reversal and thus signify a sharp turn which could be either the start of a new trend or a strong counter trend move. Such a candle shows that the momentum is huge and is not going to die down soon. Active players have the capacity to take prices further. Of course, it's important to remember that markets do not achieve anything meaningful in just one candle. There is a high probability of a follow through as more and more participants who see the prices rising will want their own share of the rise. Say, it's a sudden upturn from down. Seeing this the bears who had shorted the scrip at a lower level will definitely get jittery and rush for cover, and thus add to the bullish mood merely out of fear. Giant candles can start a new trend in this manner and it makes sense to enter the trade on the trending side. Let us understand this on a few charts.

The first is an example where a huge red candle begins a new downtrend after a good up move *(see* Figure 3.7). We believe in this giant red candle strongly because it appears at a level of resistance and also after an extended up move. We can expect more downfall ahead and look for a good entry using either this candle itself or the next one. If the down move starts with a range breakdown, we enter at the breakdown level. Such a giant candle, of a colour contrary to the ongoing trend, often signals an end to the ongoing trend and the beginning of a new one with a bang.

Figure 3.7: **The earlier trend was down, and then came a green giant candle. That signalled the beginning of a new uptrend, especially as it happened around a support and after an extended down move.**

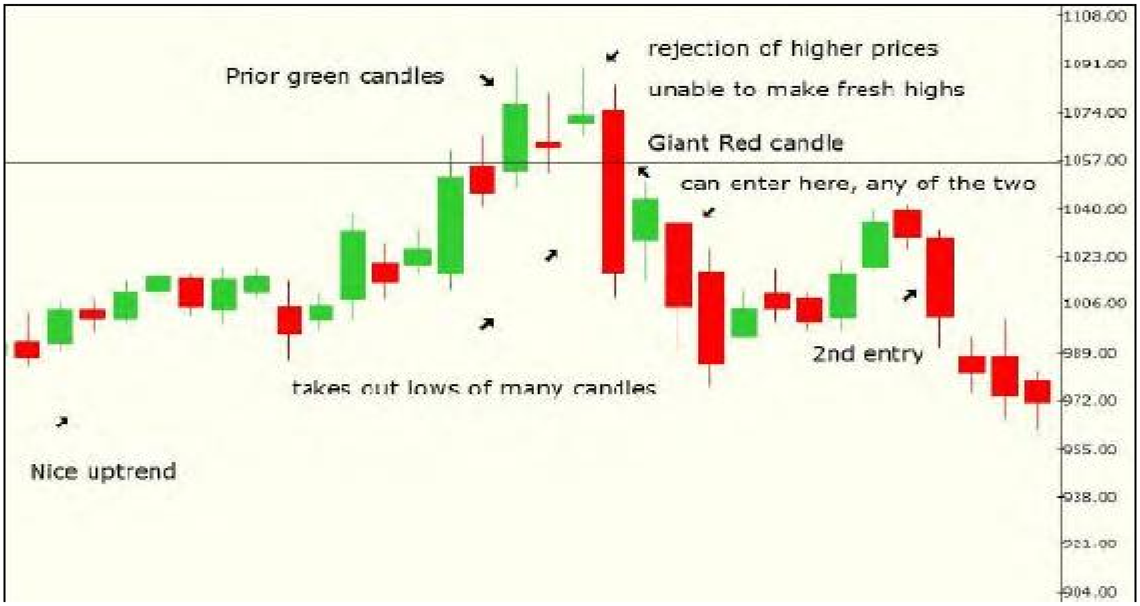

Figure 3.8: **The earlier trend was up but nearing a resistance as shown by the appearance of rejection candles. The big red candle — note that it's of the opposite colour to that of the current trend — leads to a V-shaped reversal.**

Trend Compatible Giant Candle Often Ends an Ongoing Trend

A giant candle of the same colour as the trend can also appear after a sizeable trending move. Being of the same colour, it is in the direction of the current trend. When this happens it could be a sign that the current trend would soon be nearing an end and the price may start reversing as soon as a strong resistance, if it is an uptrend, or a strong support, if it is downtrend appears close by. This doesn't mean that you immediately get into a reverse trade. It simply means you stay alert for any additional signs that confirm this possibility. For example, in Figure 3.8 you can see the formation of a base that finally breaks on the opposite side to the current trend, which may even lead to a sharp reversal. In such situations, these XXL-sized giant candles are the springboard for a final leap by the trend, much like a tired athlete putting in a final burst of energy near the finishing line. The move might begin with a gap on the given day. If the trend does indeed reverse after that, then it can be said to have worked as an exhaustion gap. There wouldn't be much of a follow through to the up move the day after the giant candle. In fact, at times you may also get to see some significant amount of topping, or bottoming, here. The examples of Figure 3.9 and Figure 3.10 will help you understand this better.

Figure 3.9: **After an extended uptrend, the big green candle appearing close to a resistance ends the trend soon after its appearance. You can enter a short trade on the break down.**

Figure 3.10: **The giant red candle after a big fall signifies the final sell-off. Small green candles and a reversal red candle lead slowly to a new trend. Go long on breakout early morning.**

Giant Candle Can Lead to Sharp Corrections Midway in a Trend

Very often you will see giant candles of the opposite colour to the ongoing trend appearing midway in the trend. Let us say you see a big red candle in the middle of a strong uptrend. These can lead to sharp and sudden corrections midway (*see* Figure 3.11) in a trend. You can enter a trade when the correction ends and the trend resumes from some important level of support. At times the trend resumes slowly, with multiple small candles of the same colour as the trend. At other times, the trend may resume equally sharply with another big candle of the trending colour (green in the case of Figure 3.12) which leads to a 180-degree turn from the correction.

Figure 3.11: **This chart of Ashok Leyland shows a sharp midway correction by a comparatively large red candle. But the high of that candle is taken out the very next day, and so the ongoing trend continues.**

Figure 3.12: **This chart of Asian Paints shows a sharp upsurge in the middle of a downtrend at the appearance of a giant green candle, followed immediately by the resumption of the ongoing downtrend in the next candle.**

For example, suppose a comparatively large bearish red candle appears in an uptrend, but the immediate next candle is again bullish (green) and crosses above the high of red candle. This would lead to a sharp price upturn. The important thing to watch out for is that the bearish giant red candle must not have erased more than 50% of the previous up move. If it has, the trend becomes weak and doubtful.

Thus, the XXL-sized candles or giant candles are important in three ways:

1. In starting a new trend with a bang.
2. In putting an end to the ongoing trend by way of a final blow-off, or bottom, as the case may be.
3. In giving sharp corrective moves during an ongoing trend, which may then resume equally sharply as soon as the brief correction ends.

Let us now move on to rejection candles and see how to use these in our daily trading.

How to Trade Rejection Candles

Rejection Candle Can End an Ongoing Trend

As we learnt earlier, candles with extremely long tails are rejection candles. The long tail formed in the candle shows that during the formation period the price reached a far higher, or lower, level, but that level could not be sustained and was immediately rejected by market participants who believed it to be too over-stretched. That should generally lead to a reversal of the current trend. Thus, these rejection candles are also called reversal candles and often signal an end to the move in the ongoing direction. If a rejection candle succeeds in doing so, and gets a followthrough in the opposite direction, then it begins a new trend.

Let us assume that the current trend is up and has already made a sizeable move. You now see a rejection candle with a long upper tail appearing. That is a sign to get cautious. You may not straightaway exit the long trade that you might be in. Neither should you go short quite yet. But if you see another red candle taking down the low of the rejection candle, that's the time to exit your longs and, probably, even go short. The latter option will be determined by the larger picture.

Rejection Candle Can End a Corrective Counter Trend

If you see a long bottom tail candle at a support during a corrective down move in an ongoing uptrend, you can expect the uptrend to resume soon. This rejection candle is about to bring an end to the corrective move, as support comes in and buyers rush in at lower levels. If the next candle is green, and if it takes out the high of the previous rejection candle, then it is time to enter long again.

Conversely, if you see a rejection candle with long top tail at a resistance during a corrective up move in an ongoing downtrend, you can expect the down move to resume soon.

All such moves will work out more accurately when seen in conjunction with some other tools and parameters which we will come to as we march forward. The general principle is that we will take trades only post a confirmation. Thus:

- In the case of a bottom rejection, we enter long only after we get a confirmation of an upside reversal.
- In a top rejection, we enter short only after the down move seems well in place.

A close look at the charts in Figure 3.13, Figure 3.14, Figure 3.15 and Figure 3.16 will help you understand these points better.

Figure 3.13: **A rejection candle after a major correction — and the subsequent reversal from down to up.**

Figure 3.14: **After an upsurge, there appears a rejection candle with a long top tail — note the subsequent reversal from up to down.**

Figure 3.15: **In this chart of LIC Housing Finance, the rejection candle comes at the end of the correction, and leads to trend resumption.**

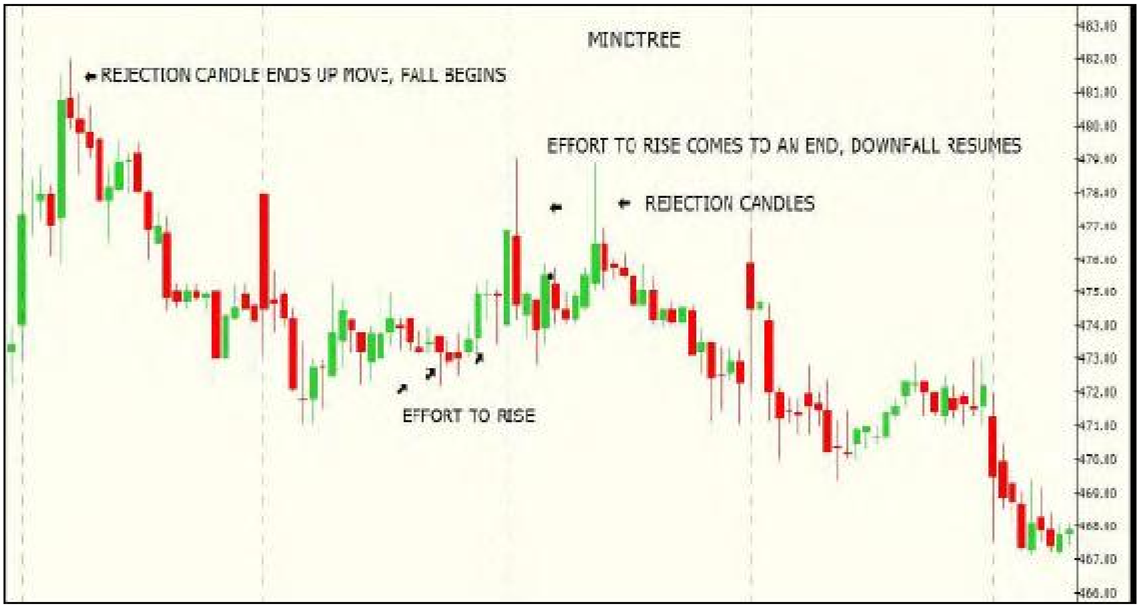

Figure 3.16: **The rejection candle in this chart of Mindtree leads to a reversal. The midway counter trend up move also ends with the appearance of repeated rejection candles — and the fall continues.**

Thus:

1. Rejection candles lead to fresh moves that begin when the prior trend ends once the stock refuses to go further in the same direction.
2. Rejection candles lead to trend resumption as well when the given stock refuses to correct any further after some retracement, when there appears demand / supply from crucial levels, and you see a follow-through on the trending side.

Milestones Covered

Let us recapitulate all that we've learnt about candles so far:

- We began with the anatomy of candles.
- We then considered the three main types of candles of our interest, namely giant or XXL candles, Lilliput or XXS candles, and rejection

candles.

- In addition, we also studied the Doji candle.
- We classified all other candles together as regular candles.
- We learnt how a Lilliput candle can give volcanic moves and how it can also appear during minor pull-backs, during consolidations, and even when the current trend nears its end.
- We saw how giant candles can appear at the start of a new trend or at the end of a trend, and sometimes during sudden but short-lived counter trend moves.
- We have learnt how to interpret rejection candles and how to use these candles to increase our probability of success by considering their location, timing, volume, retracement, time frames, etc.

We'll now move on to Chapter 4 which reveals our next building block, namely floor pivots.

So take a deep breath. Fetch yourself a cup of coffee, come back and stay tuned for more on market technicals.

Chapter 4

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Trading Pivots — Part I

Floor Pivots

Introduction

Pivots are a crucial element in our overall intraday trading strategy. We have already seen two important elements, namely candles and moving averages. The pivot is the third one. In order to appreciate the trading cues that pivots provide, we should first be clear about some often seen yet rarely understood price patterns.

The market is constantly searching for the fair values of various instruments in every changing situation. We will look at the different kinds of market opening styles and their interpretations, and how a trader can use these with profit in his daily trading. We will consider what morning range is and how to use it. We will then consider the basics of floor pivots; how the pivot levels are derived, and their basic characteristics. We will examine how a trader should approach the high speed D-Street market every morning using pivot levels as his milestones and guideline.

The Fair Valuation Concept

Markets facilitate trades between buyers and sellers. That is the essential reason why markets exist. The price of any given security in the market will always keep moving higher, or lower, in search of sellers and buyers, respectively. If the initial price of a security is perceived to be too high by the players, then it will go fall lower till it finds buyers. This is because when the price is perceived as being too high, it attracts sellers who push the price back lower. Then, as fresh buyers enter the market, their demand takes the price higher. The price keeps rising higher so long as it keeps finding buyers who are willing to purchase at higher and higher prices — till the last buyer buys and gets in.

Correspondingly, the price would keep falling lower so long as there are sellers willing to sell their offerings at lower and yet lower prices, till the last seller sells out. When the price has fallen enough such sellers lose interest, the price will again start rising. When it reaches a level where it gets difficult to find buyers, it will again start falling.

During this entire process of trying to find the right price, namely the price that keeps both the buyers and sellers happy and satisfied, the market will keep shifting between the two phases of balance or consolidation, and imbalance or trend. We have learnt this earlier, too, right, in Chapter 1. When the price of a given stock is trading at a value that is perceived as "fair" or "accurate" by both parties, that level will sustain for some time. A higher price than the perceived fair value will attract sellers who will sell and bring the price back to the value zone. Correspondingly, a fall from the perceived fair value will bring in buyers whose buying will pull the price higher and back towards the value area perceived by the market. Thus, the actions of buyers and sellers serve to keep the price in a narrow band around this value. This phase is called the balanced phase, or a phase of consolidation.

During the phase of consolidation, you will see opportunities of trading back and forth at the two ends of the value zone. The demand and supply are in balance at such times. When one of these two, either the demand or the supply, significantly exceeds the other we then see the price break out either on the upper side of the range or on its lower side. This happens when one of the sides begins to believe that the current price does not reflect the correct value, and that the fair level is somewhere outside the current range. The price won't then consolidate around the current fair value but will move strongly in one direction till the participants find a new fair value for themselves. This phase of imbalance is called the trending phase.

During a trending phase, the price moves sharply in one direction. The emotions of buyers and sellers are not in balance and the stronger party is able to overrule the weaker side. During such phases of imbalance, or trend, you will get opportunities to buy pull-backs during uptrends, and opportunities to sell the rallies in downtrends. The move in one direction will go on either till the opposing players muster enough strength to stop it, and / or take the fight and the price to the opposite direction. This cycle of moving from acceptance of fair value (balance) to rejection of current fair value (imbalance), and then again acceptance (another balance or fair pricing) is a constant process. We know these two phases as ranged market phase and trending phase, and here we have seen the reason behind the constant rotation of markets between these phases (*see* Figure 4.1).

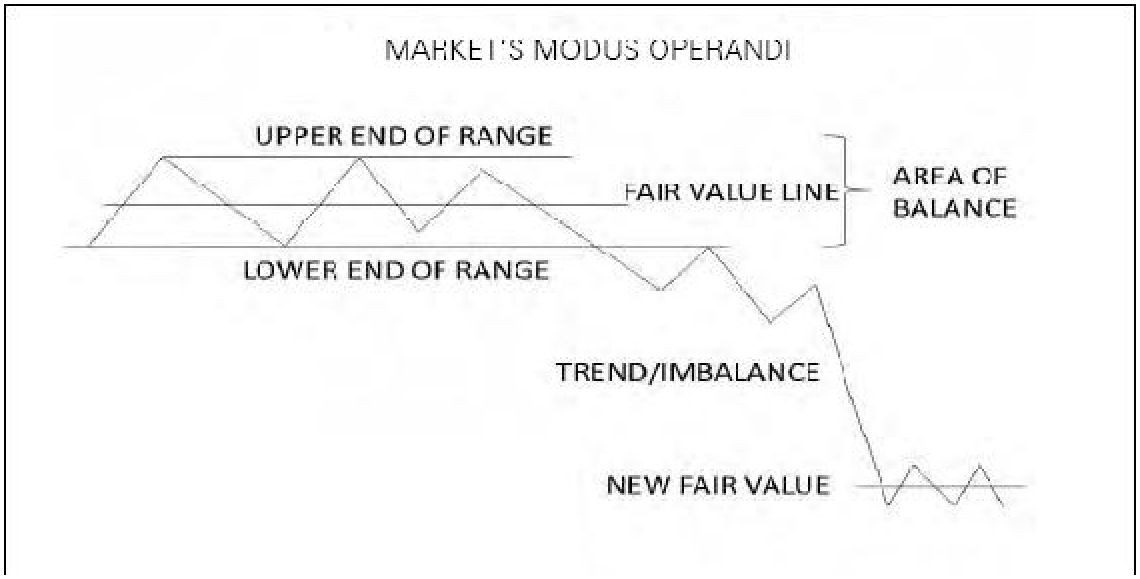

Figure 4.1: **This is how the market or a stock move between trend and ranged phases as participants seek to discover fair value.**

How to Trade the Market's Opening Ceremony

Every morning when the market's opening bell rings it throws up signals to those who can read them about the kind of day it might turn out to be and the price action to be expected through the day. Which is why it's important to correctly read and interpret the message of the market's opening bell.

There could be many variations in the opening style of the market but, broadly speaking, you will see two kinds of opening trades:

- The first kind is when the opening price ticks fall within the previous day's range, namely within the area between the previous day's high and low.
- The second kind is when the opening price ticks fall outside the previous day's range, namely when the price either breaks out above the previous day's range or breaks down below it.

Trading the Opening that's Within the Previous Day's Range

When you see the opening ticks falling within the previous day's range, you can safely assume that reactive participants are at play. Typically, they will trade the markets in such a way that the price will keep moving to and fro between the upper and the lower boundaries of the range. If the opening ticks have taken the price to either boundary of the range, then chances are that the rest of the day may get spent in taking it to the other end. You can thus expect the day to pan out within a band, and you can trade accordingly. You can buy at the lower boundary with upper boundary as the target, or you can sell at the top with the bottom level as the target. You can continue doing this till the time either of the boundaries gets broken. This can happen at any time during market hours on the same day, or in the coming days.

Trading the Opening that Breaks the Previous Day's Range

When you see the market opening outside the previous day's range, you should know that it is time to be on your toes. That's because you can expect that the active market participants are gearing up for some aggressive action. Observe for a while and check what the market does after the first few ticks. You should see how the price is moving in relation to the pivots.

The price may either move further from the opening levels in the direction of opening, or it may retrace back. Or, it may hover around the opening for a while before making up its mind about further action.

If the price opens above the range and builds on further from there, then there are good chances that we may see much higher levels during the day as characterised by active participants and their behaviour. These are the days when you may probably see rocketing moves in the market or the scrip under study. This kind of opening definitely signals an overnight change in the sentiment of market participants. That does not mean that we will necessarily jump the gun at the very first tick. There will be several possibilities to examine and several parameters to use and gauge and understand what exactly is happening; only then would we decide our course of action *(see* Figures 4.2 and 4.3).

Figure 4.2: **This L&T chart shows how the opening can signal a strong move. A slow effort to start moving higher from the bottom end of the range was seen the previous day, and prices had even closed higher. Then came an opening gap up the next morning, followed by the strong up move.**

Figure 4.3: **Strong opening leads to a strong trending day in Shriram Transport Finance as shown in this chart. The breakout moves with strong candles / momentum — often the signal of a profitable trade ahead.**

The Concept of Morning Range and How to Trade it

Another parameter that can provide clues about the kind of day ahead is the morning range. Morning range is defined as the range between the high and the low levels of the first hour after the market opens.

The high and low of this range are very important and should be watched carefully. These levels show the degree of balance between the buyers and sellers during the initial market moves.

- If the morning range is very wide, it may imply that the rest of the day could probably see the price go back and forth between the two boundaries of the morning range. Wide ranges are not broken easily. The responsive participants may remain active within this wide range for the rest of the day, and thus you may see limited moves back and forth within the range.
- In case the morning range is very narrow, we can expect the price to break through it in the next few hours and thus lead to an extension of this range. Narrow ranges have higher chances of being taken out on

either side. It is in narrow morning ranges that active players are expected to come into the picture and take the price further *(see* Figures 4.4 and 4.5).

Figure 4.4: **This 5-minute chart of Lupin shows a wide range in the morning, namely ₹ 1,462 to ₹ 71,485, but hardly any significant move thereafter.**

Figure 4.5: **This 15-minute chart of Siemens shows a narrow range in the early part of the day. Once the high of the range is taken out, you get a solid trend.**

There will be days when the day's price movement will depend on the morning range in a big way. Correct interpretation of the morning range, along with other factors, can give you an accurate assessment about what to expect during the day.

The Basics of Pivots

Let us now move on and see how pivots can help us decide our course of action every trading day.

On the graph of an actively traded instrument, **a pivot is a particular level of price at which the instrument is said to be at an equilibrium between the buyers and sellers:**

- A pivot is a neutral zone where the bullish and bearish sentiments of the players are in balance.
- It is also a key junction where the buyers and sellers may battle it out to decide who shall take the price action further from thereon.
- A pivot is also a level from where you can expect a directional move in the price.

Pivot levels aid us in determining where the current level of bullishness or bearishness for the day is. Trading activity above the point of equilibrium, or balance, is expected to be bullish for the day, while activity below the point of balance is expected to be bearish. These levels are said to have a sort of pull for the prices because the majority of participants are expected to react at these levels. And because market players react at these levels, so the levels turn out to be all the more important, much like a self-fulfilling prophecy, and can be used as points of decision making.

You may well be thinking it would be great if one knew the levels from where the price might reverse, where exactly the current trend is ending or a new trend is beginning, and where exactly this point of decision making is positioned. Well, the good news is that there are ways and means of knowing the probable pivot levels with reasonable accuracy. Having these levels plotted on charts can work exactly the way milestones and signboards work on highways. They help you navigate through your trade and also guide you on the road to your price target.

There are multiple kinds of pivots in technical analysis. Broadly, though, these can be classified into two kinds:

- Pivots which are formed purely by price action and swing lows or highs of prior days; and
- Pivots which are found by using some calculations of those price values.

The latter kind is typically used for gauging the direction in the coming days. There are again further classifications of pivots using various formulae. But for our trading system, we will restrict ourselves to floor pivots.

Floor Pivots

Floor pivots are calculated using the previous day's closing price and its highs and lows. There is a set of 7 pivot values that can be placed on charts. Their values are available in most trading software. The central one is called the central pivot point or, simply, pivot point. That happens to be our neutral zone. The three pivot levels falling above the central pivot point are called resistances and the three pivots below the central pivot point are called supports.

When calculated based on the previous day's closing price, and high and low values, these are all called daily pivots, as that's what they are. Daily pivot values will thus change every day.

If pivot values are calculated based on the previous week's closing, and high and low values, they would be weekly pivots. Monthly and yearly pivots can similarly also be calculated.

Table 4.1 shows how the 7 pivot levels — the central pivot or pivot point, along with 3 resistances and 3 supports — are arranged on the charts.

Table 4.1

7 Pivot Levels Showing Resistance and Supports

■	R3 = 3rd Resistance
■	R2 = 2nd Resistance

■	R1 = 1st Resistance
■	PP = Central Pivot Point
■	S1 = 1st Support
■	S2 = 2nd Support
■	S3 = 3rd Support

Derivation of Pivot Values

As noted above, we use the previous day's high, low and close values to calculate pivot levels. These levels become our milestones for the next day, no matter howsoever turbulent the day is.

The previous day's high and low show its most bullish and bearish levels. The closing value reflects the final outcome, or the directional bias, for the forthcoming day as perceived by the participants. Similarly, if we use the closing, the high and the low of the previous week, or the previous month, we get the weekly and monthly pivots for the upcoming week and month, respectively.

Let's now take a look at the formulae (*see* Table 4.2) which give us all the seven levels for the next day. You can use either of the closing price or the settlement price. Both should work well. You can observe that the central pivot is nothing but the average of the previous day's high, low and close values.

Table 4.2

Formulae for Calculating the Pivot Levels

■	Central Pivot Point (PP) = (High + Low + Close) ÷ 3
■	R1 = (2 * Pivot) – Low
■	R2 = Pivot + (High – Low)
■	R3 = R1 + (High – Low)
■	S1 = (2 * Pivot) – High
■	S2 = Pivot – (High – Low)
■	S3 = S1 – (High – Low)

Interpretation of Pivots

Pivots should be studied in two parts. One part is the intraday pivot levels which we mentioned above, and which should be placed onto your intraday charts every morning. You should watch these closely during market hours. The calculation part can be done either by your software or even by using an Excel sheet. The interpretation is what matters here.

The day's trading activity is expected to hover around, and also gravitate towards, the central pivot point. Any movement in price action above this point will initially approach the first resistance (R1), while any move below this point will first approach the first support (S1). The area above the pivot is basically a bullish price action area, while the area below it is considered as a bearish area. The price behaviour is to be critically observed as it moves to either of these areas.

Any rejection of the higher levels above the pivot, or lower levels below the pivot, will result in the price again drifting back towards the central pivot point. A price move that takes out these levels successfully is taken as the market's acceptance of the new value of the instrument and thus increases the chance of the price moving further in that direction.

Remember reactive and active participants? Any piercing of the levels above the central pivot point shows increased participation of active buyers. It shows strong interest from these players and thus a possibility of higher levels ahead.

Conversely, any penetration of levels below the central pivot would indicate that the active participants perceive a lower fair value and, thus, there are chances of the price drifting even lower in the coming hours, or days, as the case may be.

On the other hand, any rejection of higher or lower levels from any of the resistances or supports may bring in reactive players and their actions will nudge the price back towards the equilibrium, namely the central pivot point.

Thus we can get a directional bias for the day when we look at the price behaviour in relation to the daily pivot levels on the charts. Further, the kind of participants the price moves indicate will give an idea of the extent of move that we can expect. Similarly, when we look at price action along with the weekly pivots, we can get a directional bias for the upcoming few days or weeks.

You may recall we noted earlier that as the price moves away from the pivots and range, it draws interest of more and more participants who will want to get onto the moving train. Once a larger crowd gets drawn in, higher will be the possibility of the next pivot — whether it be resistance or support — being taken out.

Let's understand this with the help of a few examples of intraday charts with the daily pivots plotted on them (*see* Figures 4.6, 4.7 and 4.8). **Please note that the charts in all the chapters of this book have many concepts and price action explained within the charts. It is therefore important that you carefully read the details inset inside the charts as these highlight the theory and concepts as applied in live markets.**

Figure 4.6: **Daily pivots on the intraday chart of Pidilite Industries illustrating a bullish day. The price opens above a pivot, a sign of a bullish day ahead. Note how the pivots look on the charts.**

Figure 4.7: **In this chart, Adani Enterprises opens around the pivot, sustains there, and builds on further from there during the day, taking out each level of resistance, indicating that there's more rise to come.**

Figure 4.8: **This chart of NMDC reveals a fine trading day. The stock hovers around the central pivot and then builds on further as the day progresses. The chart illustrates how on a bullish day the price action will stay above the central pivot and move higher, piercing each level of resistance above.**

When the market opens above the previous day's range, it is possible that the price may open even above the central pivot, or even above the first level of resistance (R1). Correspondingly, when the market opens below the prior range, it may open even below the central pivot, or even below the first level of support (S1). This is a possibility though it may not always bear out. But if the price level is breaking away from the range as well as from the pivot, then the significance of the break immediately multiplies. Accordingly, we can expect more dramatic action and a more magnified move ahead, as illustrated in Figure 4.9.

Figure 4.9: **Maruti opens above the pivot and soon thereafter it crosses above the previous day's high and range as well. The stock takes out each level of overhead resistance with such ease; all clear signs of a bullish day, right from the day's start.**

If the price breaks the range of several days instead of just one, then the break's significance multiplies even further. Such a move shows that the bottled up energy of multiple days is getting freed, and that can lead to an extremely powerful march ahead.

In all the four charts from Figures 4.6 to 4.9, the market opens above or around the central pivot. Later, when it moves higher, and the size of the move becomes more and more significant, that's when you know that there are active participants at play. You can then expect a large move day.

The chart in Figure 4.10 shows a bearish start to the day for Hindalco. You can see the price opening and staying below the central pivot right from the beginning of the day. That signals weakness for the given day. Sure enough, the price soon starts falling further.

Figure 4. 10: **Daily pivots on intraday chart of Hindalco illustrating the price action on a bearish day. The opening price itself indicates bearish sentiment for the day. Once the range of the previous day breaks down, the active participants come to play and drive the stock lower with gusto. The stock had opened around ₹ 185 and had touched sub ₹ 180 levels by mid-day.**

The chart of L&T in Figure 4.11 shows another day of bearish price action.

Figure 4.11: **L&T's intraday chart showing daily pivots. Any rejection of upper side pivots (resistances) will lead to price falling, or coming into equilibrium, or moving towards the central neutral pivot.**

Role Reversals of Pivots

Once crossed, the daily pivot levels have a tendency of reversing roles. Thus, a broken support will then work as a resistance during retracements on the upside. Conversely, any resistance which is taken out will turn into support during pull-backs.

In effect, pivot levels are nothing but supports and resistances, which is why once broken they also reverse their roles. When a support is broken on the way down, it reverses itself into a resistance, and thus any subsequent upward move can get capped by it. This increases the possibility that the retracements may remain limited *(see* Figures 4.12, 4.13 and 4.14).

Figure 4.12: **This chart of Dilip Buildcon shows how roles get reversed when pivots get taken out. Both R1 and R2 turn into supports during subsequent retracements.**

Figure 4.13: **Havells opens below the centred pivot, tries to rise towards the central pivot, but fails. It breaks supports S1 and S2. Rejection of the central pivot leads to lower levels, and broken supports turn resistances.**

Figure 4.14: **This chart of SAIL shows how the roles of the pivots reverse, once they are taken out. There is also a catalyst for this move. Now you might be wondering about what this catalyst is. Just go on reading the chapters ahead, and you'll discover more and more trading tactics and insights that we are here to share.**

Analysing Market Opening Using Pivots

Once the market opens, say above the pivot point or above the first resistance R1 depending on the overall market tone and the stock story — we will cover this in greater detail further on in the book — the trader can look for the first probable pull-back towards the central pivot. If the price heads that way from above and finds support there, or even at R1, there is then a good chance of an uptrend day and you can expect closing levels of R2, R3, or even higher.

Correspondingly, if the stock opens either below the pivot, or below S1, and again also depending on the stock story and the overall market trend, you can wait for a pull-back from below either to the pivot point or to S1. Each of these levels should act as a resistance now and one can sell from there with an expectation to see S2, S3, or even lower levels.

In case the price doesn't pull back towards the support, the resistance or the central pivot point, and instead proceeds directly further up or down from where it started, and in the direction in which it started, then you can consider the price action to be even stronger.

Sometimes the price may not correct but instead may move sideways for a while before proceeding further. That's an equally good sign that there's more steam left in the same direction. In the case of an uptrend, it means that all the selling is getting absorbed by fresh buying. In a downtrend this shows that any new buying activity is failing to lift the price higher due to additional selling pressure flowing in.

Sometimes the retracements may find support, or resistance as the case may be, at the high / low of the previous day's range instead of at R1 or at the central pivot. The previous day's closing can act either as a strong support or a strong resistance depending on the direction of the trend. The highs and lows of the previous day / week, or even swing highs or lows, can also form an important support / resistance to watch. Often, trend resumptions occur from these levels. All of these are variations to be observed while you try to read the market opening and try to confirm the directional bias for the day. You should commit yourself to a trade only after the view, derived from your pre-market analysis gets confirmed during market hours. The validity of each of these levels will be largely dependent on the extent of move that occurred before prices approached these levels. When markets are already over-stretched, and the move is already over-extended, these levels will provide a stronger halt.

Let us take a look at the day's price action in Jet Airways through its intraday chart in Figure 4.15 which also shows the day's pivots. The price opens in positive territory above the central pivot, retraces initially but soon finds support at the previous day's closing level, which happens to appear even before the pivot, and builds on the gains from thereon. Any move above the pivot signifies bullishness.

Figure 4.15: **Jet Airways takes off early enough in the day for a solid day trade. (Do read the detailed insights and observations contained inside the chart). The opening price is above the central pivot, which signifies bullish sentiment. The breakout above the previous day's range again signifies strength of the positive sentiment and the force of the active participants. The limited retracement that follows finds support even before the pivot, right at the previous close to be precise, showing the participants' determination to break free from the previous range. This leads on to a rocketing move during the day.**

Chart 4.16 is another example of the price finding support at the previous close above the central pivot.

Figure 4.16: **In this chart of Future Consumer, trade can be taken on retracement. Note how the price found support at the previous close which was above the pivot.**

We have been using pivots for many years and have often been amazed at how well they work. As you unravel the magic of pivots, you will perfect the various ways of using them in different kinds of markets. This is one weapon that should definitely be a part of your trading arsenal. Pivots are based on simple calculations. They are also simple to understand, and easy to use. In short, as we often say colloquially, pivots are: *kifayati, tikau and bharose-mand* (economical, sturdy and dependable).

Now let's dig deeper into pivots and see what more these magical levels can do for us.

~

Chapter 5

Trading Pivots — Part II

The Central Pivot Range

The Central Pivot Range

We learnt in Chapter 4 that the daily pivot levels — namely the central line plus the three resistances and three supports — should be placed onto your intraday charts every morning. These levels are calculated from the previous day's values. These are the levels that you must focus on during market hours.

Extending our understanding of pivots, we'll now consider an expanded version of the central pivot line. For that, **we add two more levels around this central pivot line and we call them the upper boundary line and the lower boundary line, respectively. The two boundaries and the middle line together form the central pivot range (CPR).** Thus, we now have 3 central pivot lines forming the central pivot range (CPR), the 3 resistances above CPR, and 3 supports below CPR (*see* Table 5.1).

Table 5.1

Constituents of the Central Pivot Range (CPR)

Central Pivot Line (CPL) = (High + Low + Close) ÷ 3
Lower Boundary (LB) = (High + Low) ÷ *2*
Upper Boundary (UB) = (Central Pivot Line – LB) + Central Pivot Line

The CPR is very crucial in your pre-market analysis and preparation, as well as during live market hours. When preparing for the day ahead, you should focus on the CPR of the upcoming day, in conjunction with the CPR of several previous days. This will give you the context whether the pivots are progressively higher or lower, and whether the pivot width is narrowing or widening over a number of days.

In short, such a review helps you to assess the left side on the chart, before trading the chart's right side. It is very crucial for traders to learn to do this.

There can be days when the value of the CPR's lower boundary may turn out to be greater than that of the upper boundary. So long as your computer software is doing all the calculations and plotting the boundaries for you, there is nothing to worry. If you are doing it yourself, just remember that in such a case the higher value should be plotted as the top boundary line and the lower value as the bottom boundary line. There is no need for us to get into further details of the mathematics involved. Now, let's have a look at how the pivot levels will appear with the added CPR *(see* Figure 5.1).

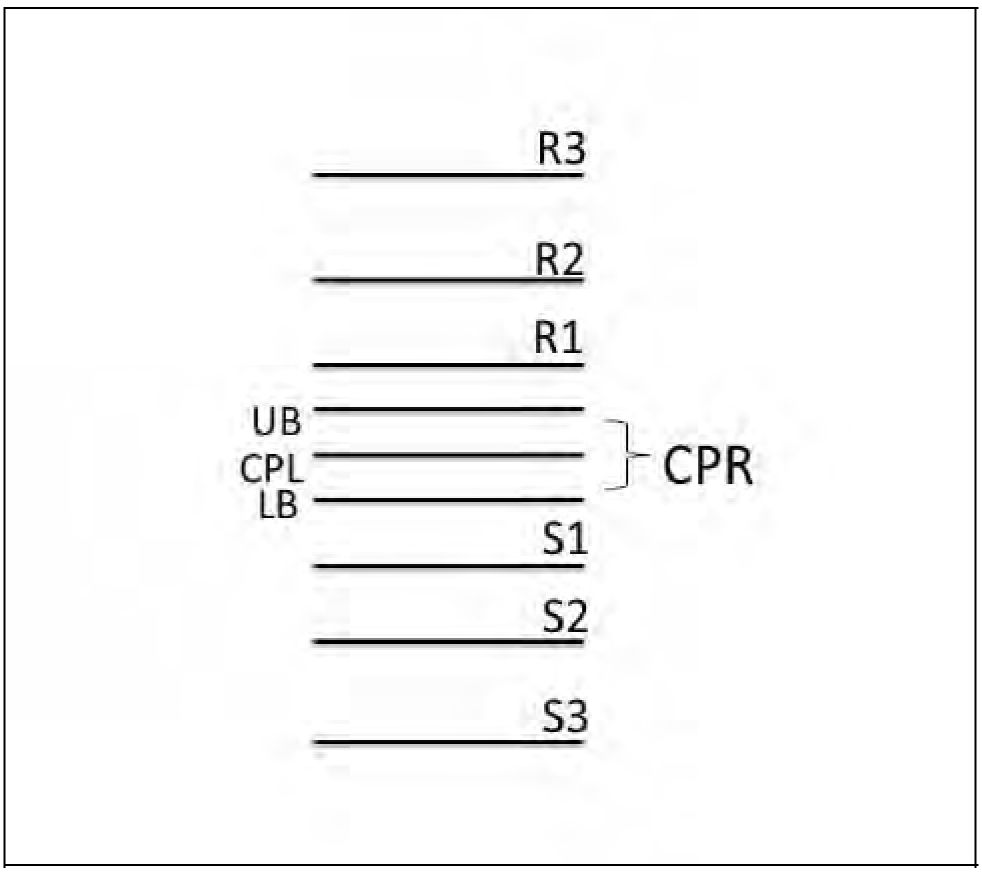

Figure 5. 1: **This is how the placement of all the pivot lines together will look.**

Let's try to understand the significance of CPR. Well, there are very useful signals that can be derived by studying pivots in this way, especially when we place these levels for multiple days on the charts. There are a few software that enable this. We suggest using Amibroker platform as it allows you to customise your study. The next few charts are made in Amibroker using the above formulae for pivot calculations.

Let's look at the chart in Figure 5.2 which has the CPR and the first two levels of resistance and support of multiple days plotted on it. The blue dotted lines show the CPR, the red lines are R1 and S1, and the purple lines are R2 and S2. You must get yourself well-versed with such charts. It can make a big difference in your pre-market preparation and can give you an undeniable trading edge.

When you view the levels of multiple previous days together, as in Figure 5.2, you can get a very distinct view about what has been happening in the recent past, and what could be expected ahead even before the market opens. This view, combined with the intraday chart showing the floor pivots for the given day, will make many things clear.

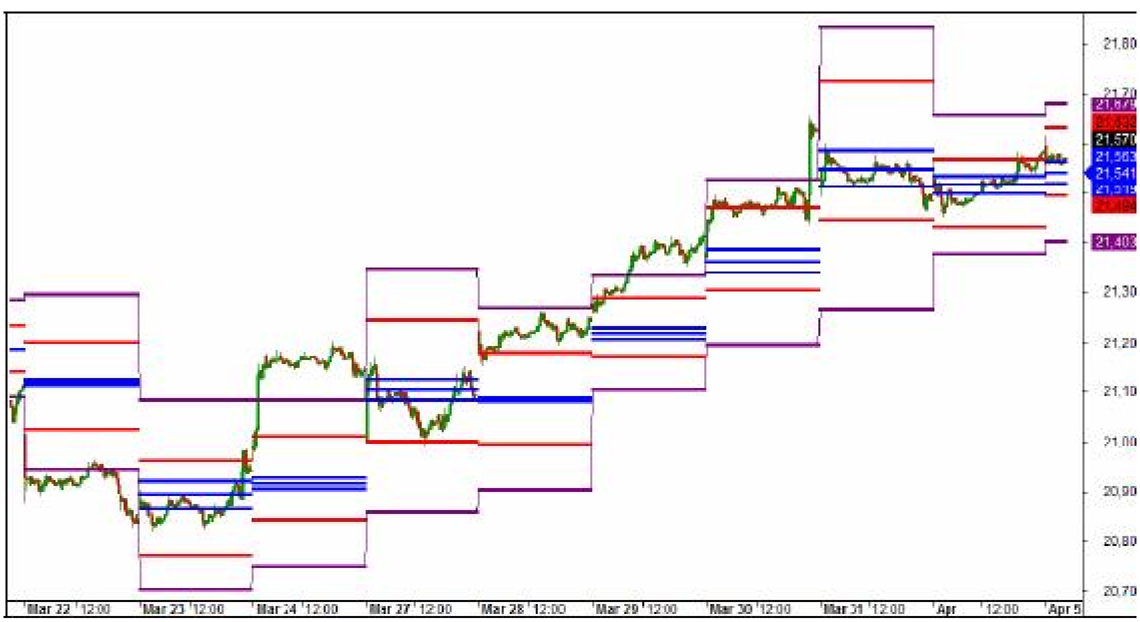

Figure 5.2: **The 3 blue lines in the centre indicate the CPR. The red lines show R1 and S1 and the purple lines are R2 and S2.**

Relationship between CPRs of Various Days

Each day’s CPR has a specific relationship with the next day’s CPR. Depending on the placement of the CPR over multiple days, as well as the CPR width, we can derive a lot of useful information about the upcoming day. Let us take each point, one by one.

CPR Width

We know that the CPR levels are calculated from the previous day’s high, low and close values. If the previous day was a narrow range day, then the levels will be closer together and thus its CPR will be tighter in comparison to the CPR for wide range days. Wide range days, naturally, will lead to wider pivots in the upcoming days, and thus a wider CPR as well. Now, as you can perhaps guess what we are interested in is abnormal behaviour.

Anything other than normal, whether it be the candle size or the pivot width, always has some hidden message in it. If you can read those hidden messages, then you have got yourself an edge in the market. Unusually narrow CPR over multiple days, for example, indicates a coiling-up of the market and tells us that we should prepare for a major breakout, or breakdown, in the near future. Such moves often start with a gap in the morning, and if the move is accompanied by a favourable larger picture then you are in for a big day. Sometimes pure price action doesn't show such tight consolidation in a very clear way. It is especially at such times that the CPR provides that extra clarity and pin-points emerging opportunities.

As CPR can be calculated even before the market opening, that indeed is an advantage. It helps you in multiple ways:

- You can decide your position sizing for such days, as well as estimate targets.
- You can allow yourself more leeway in terms of stop losses as well, based, of course, on your trading style.
- On days when you see an abnormally wide pivot range in comparison to earlier days, you know that it was a big move day. That being the case, you can reasonably expect range trading for the upcoming day. You can

trade accordingly with appropriate stop losses, targets and methods that will suit trading a ranged market.

- When you are expecting a big trending day, you can be alert and stay prepared to encash any major moves that you foresee.

Have a look at the CPRs of multiple days plotted on the chart in Figure 5.3. Here, again, the 3 blue lines show the CPR over multiple days. The purple lines above and below the candles show the R2 and S2 levels of each of the multiple days. The red lines show the levels of R1 and S1 on each of the multiple days.

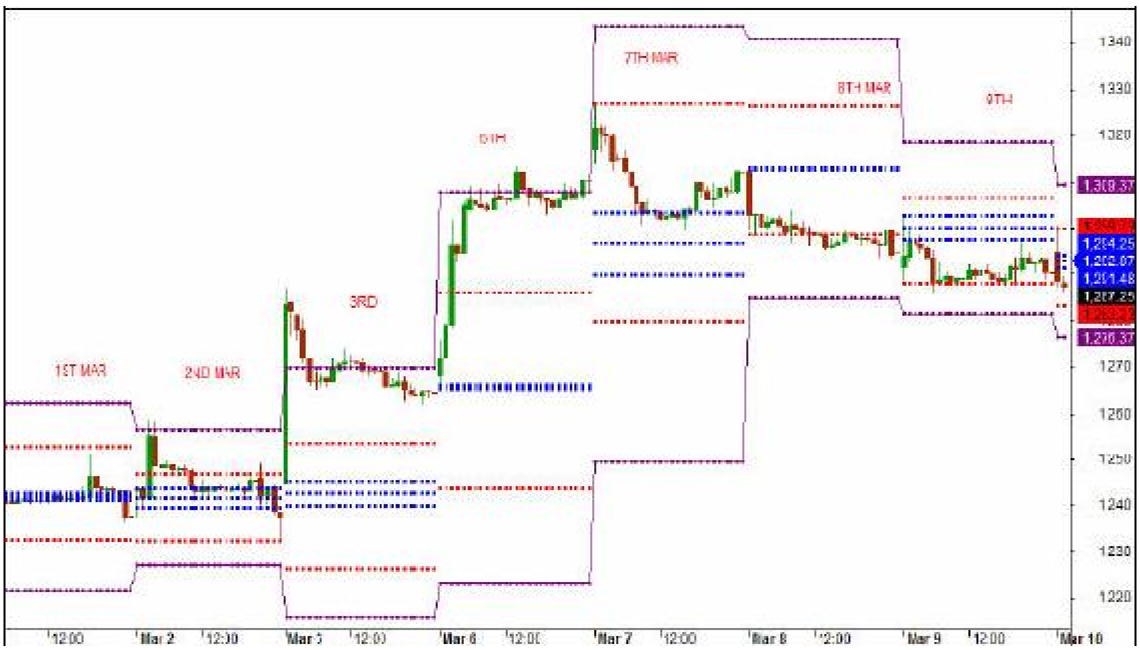

Figure 5.3: **Observe how the narrow CPR on the first two days of March leads to a breakout on the morning of 3 March. The next day's pivot range is also narrow and the move continues. A wide CPR on 7 March leads to a trading range day where the price keeps gravitating towards the CPR.**

Figures 5.4 to 5.6 show further examples of the impact of CPR width on upcoming price moves.

Figure 5.4: **Narrow range days. Look how a narrow pivot range over three days leads to a breakdown even below S2 (purple line).**

Figure 5.5: **You can see in this example of Century Textiles how narrow pivots lead to trending days, and wider ones with wider CPR lead to sideways moves. Notice also how the price keeps gyrating towards the central pivot on ranging days.**

Figure 5.6: **Consider this Reliance chart. On Day 2, the CPR and other pivots are wide, and the price gyrates towards the pivot. On Day 1, the narrow pivots led to a breakout from all levels. In fact, on this day Reliance even took the Nifty higher. It single-handedly contributed 100% to the market's rise that day.**

One must keep in mind that big moves often begin with an opening gap. The move can then either build further from the gap, or give a minor retracement and then move on from a support / resistance. So, you should be comfortable trading both these types of situations. Let's consider the price movement of SAIL in Figure 5.7 and Asian Paints in Figure 5.8.

Figure 5.7: **The narrow CPR of the previous days, combined with a gap up opening, leads to a strong trending day for SAIL. The price loiters around the opening, and then moves further up.**

Figure 5.8: **This chart of Asian Paints shows a narrow CPR followed by a gap down opening below the pivot. The price made an effort to rise after an initial gap down but failed at S1 level; the stock then moved lower.**

Sometimes a corrective move during an uptrend can go below the central pivot line. But so long as it sustains above the lower end of the CPR, the uptrend is considered strong enough and you can expect the price to move higher, as exhibited in the charts in Figure 5.9 and Figure 5.10.

During a downtrend, corrective moves that pierce the central pivot line but maintain or respect the upper end of the CPR indicate that the downtrend has more steam left. This point is highlighted in Figure 5.9 and Figure 5.10.

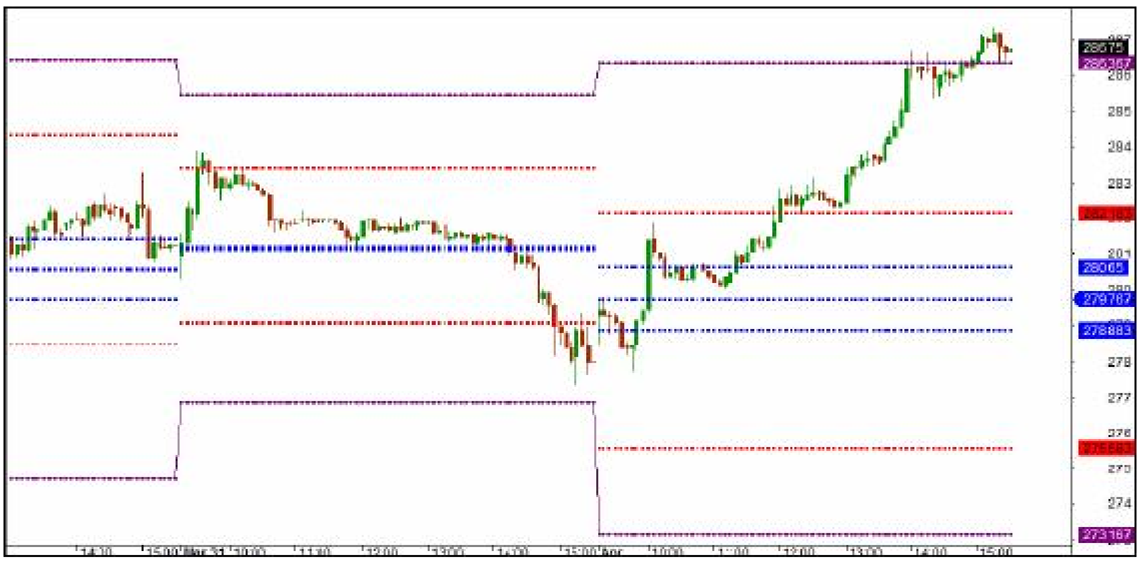

Figure 5.9: **This chart shows that barring a minor breakdown the corrective down move in ICICI Bank stopped at the lower end of the CPR. These lower prices were immediately rejected as can be see by the rejection candle, and the stock then rose in a big way. The subsequent correction sustains well above the central pivot line.**

Figure 5.10: **In this chart of Hindalco, the mid-day correction stays around the lower end of the CPR. Any further fall below it sees rejection. The uptrend continues nicely after that.**

On the days when the pivot width, namely the distance between the three lines of CPR, doesn't give any clear signal, what we have learnt about the morning range, or the opening range that we have learnt about in Chapter 4, can do the trick for us.

Trend Analysis with CPR

Another use of the central pivot range over multiple days is in analysing trends. Here is how:

- So long as a given index or scrip is in a clear uptrend, the price will not close below the CPR and / or below S1.
- An uptrend will always have a rising CPR.
- In an uptrend, the CPR acts as a support.
- A closing above the day's CPR tells you that you can have a bullish bias for the next day.

Thus, if the market has been falling for the last few days and then one day it closes above the CPR, you can at least expect a sideways market, or even a reversal from down to up in the coming days.

Correspondingly, in a downtrend:

- In a clear downtrend, the price won't close above the CPR and / or above R1.
- A downtrend will always have a falling pivot range.
- In a downtrend, CPR acts as a resistance.

Price closing below the CPR indicates that the next day could be bearish. Thus, if the price starts closing below the CPR after rising for many days, you can expect either a sideways market or an outright reversal the next day. You can wait to see whether the market is confirming your view or not by the action it exhibits the next morning.

In this manner when you observe the CPR over multiple days on a chart, you can form a better understanding of the current trend. Let us now see how the price sustains above the CPR over multiple days when the trend is clearly up — and below the CPR in a downtrend — with the help of examples in Figures 5.11 to 5.14.

The charts in Figures 5.10 to 5.14 which we have used in exploring CPR were created using Amibroker software, and thus may look a little different than most other charts in the book since those are created using another software. Doing the right kind of analysis takes effort and may require multiple kinds of setups, tools, techniques and equipment. While we have tried to keep it as simple as possible, you cannot play test cricket with a plastic bat, can you? So having the required software, tools and skills is vitally important.

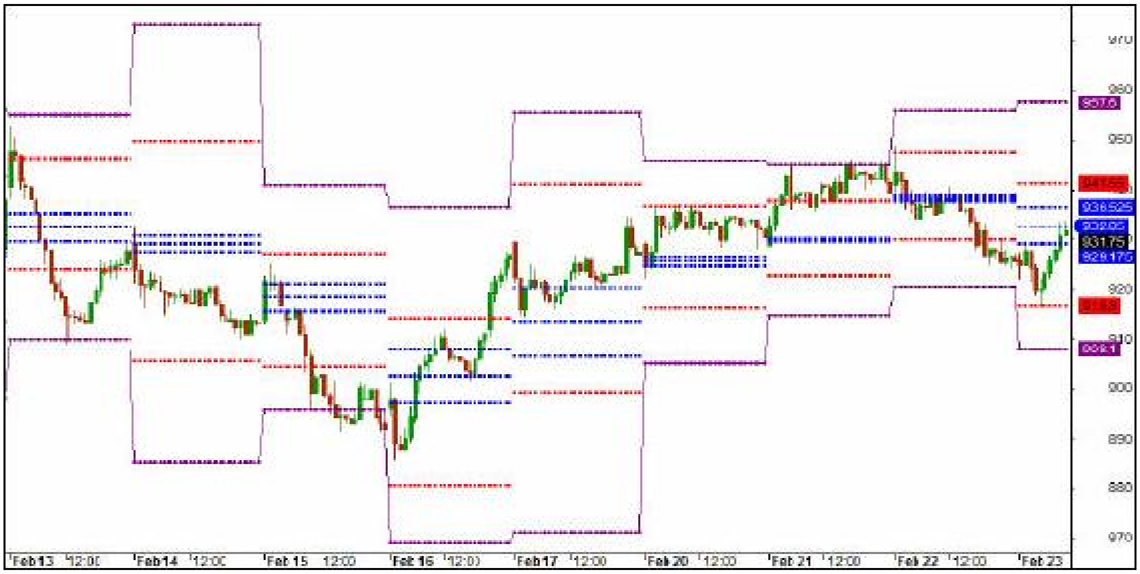

Figure 5.11: **Have a look at this chart of Century Textile. In a clear downtrend, the price stays below the CPR. When it tries to rise, the CPR acts as a resistance. Also note the price never goes above R1 in any case. The day when the CPR starts providing support and reverses roles, the trend reverses too. In the subsequent uptrend, the price stays and closes above the CPR.**

Figure 5.12: **This is the chart of Tata Motors between 17 March and 23 March 2017. Note how the CPR acts as resistance in the downtrend. The day the CPR is pierced, the trend also reverses.**

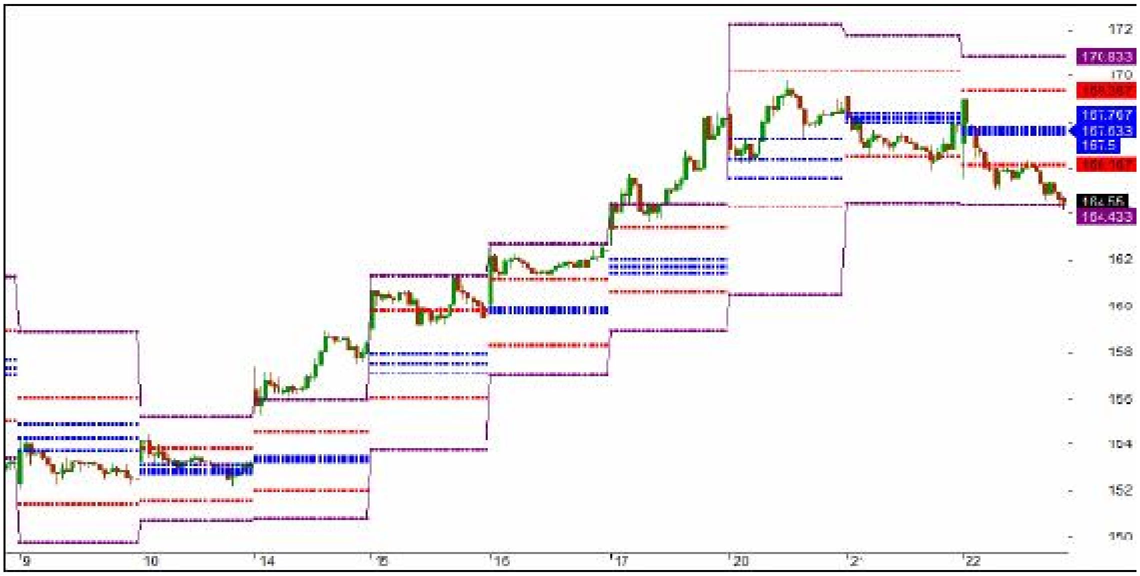

Figure 5.13: **In this chart you can see how the price closing above the CPR is the noim in an uptrend. The price stays above the CPR for multiple days in a row, and the trend remains in play. When the CPR is broken, the trend reverses, and the price begins to close below it.**

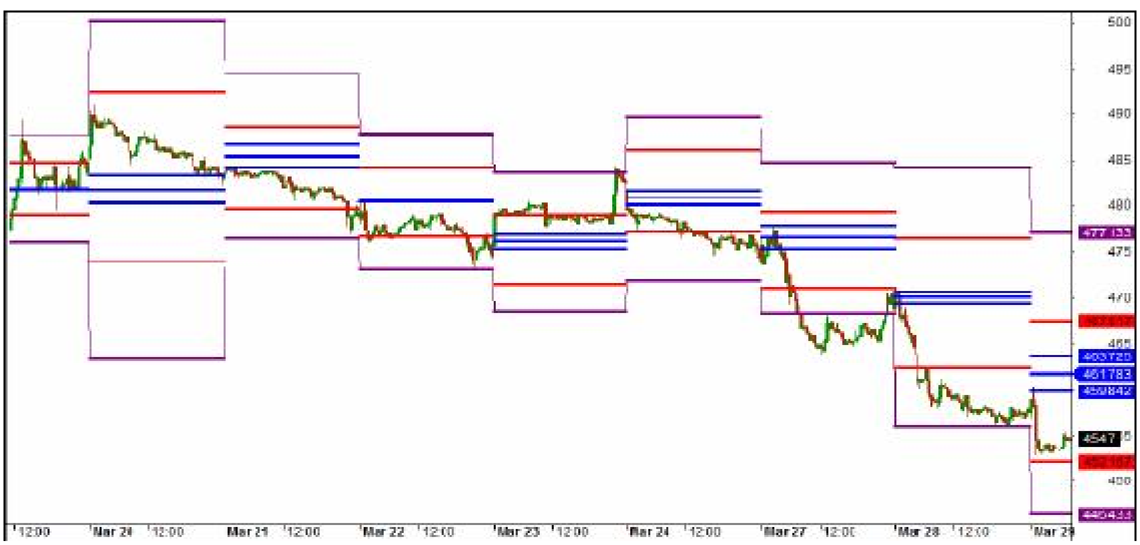

Figure 5.14: **The price remains below R1 during the downtrend for several days in this Tech Mahindra chart. There is one day in between where you can see a sharp effort at recovery. The next three days thereafter continue to be down days and the price stays below R1 (see the top red line). And below the CPR, the price shows a strong downtrend.**

Assessing the Day Ahead

We have now learnt about pivots, including pivot width. We have also learnt about trending markets and trading markets, and the differences between the two. We know what and how much to expect in each of the scenarios. We have studied the importance of the various types of market openings. What we will now do is create a unified table of all these parameters combined together which will help us assess the kind of day that we are likely to see ahead of us. This would give us an edge, keep us alert to the kind of opportunity that lies ahead, and give us an appropriate signal whenever there is a chance of a big day coming. Traders can use this table every morning and thus bring to their trading day an actionable market view derived from it. This will save you from taking random trades or decisions based on emotion.

Table 5.2 is specifically created keeping Nifty Bank in view. At the time of writing, the value of Nifty Bank was around 20,000 in the cash segment. You can create and maintain a similar table for any other indices or stocks of your choice.

Table 5.2
Mapping the Trading Day Ahead

Trend	*Opening*	*Pivot width*	*Action to be taken*
Strong	Greater than 130 points	Narrow	Buy on dip/sell on rise
Strong	Greater than 130 points	Wide	Buy on dip/sell on rise
Strong	Around 30 to 40 points	Wide	Buy on dip/sell on rise
Strong	Near the pivot	Wide	No trade zone
Sideways	Near the pivot	Narrow	No trade zone
Sideways	Above previous high/low	Narrow	No trade zone
Sideways	Above previous high/low	Wide	Act against previous day's action/move

In earlier chapters we saw many charts showing clear trending days. Now let's consider the chart of Nifty in Figure 5.15 which shows a notrade day for 7 April 2017. By then, the markets had already turned sideways after multiple trend days in a row. On 7 April, the opening was not great, pivots were also quite close and the CPR narrow, making it a no-trade day for the index. Were Nifty to break down below S1 and / or the previous low, we might have considered an intraday short because the price action remained below the pivot all the time. We will learn more about this in Chapter 8 which deals with when and how to swing sideways. For now, Nifty's chart in Figure 5.15 is a no-trade day; contrast thus with L&T's chart in Figure 5.16 which signals a big day ahead.

Figure 5.15: **No trade day as Nifty stays within the previous day's range.**

Figure 5.16: **This chart of L&T of 3 April 2017 shows multiple factors that signalled a big day ahead. There's a range breakout after several days of narrow range. Such moves have the probability of sustaining for many coming days.**

The next chart in Figure 5.17 again shows the same move in the same scrip as the chart in Figure 5.16, namely L&T, on the same day. In this chart from Amibroker, you can see that the pivot range, or CPR, on 3 April was above the CPR of previous many days. This happens when a stock begins to move in a strong and clear uptrend. As we've learnt earlier, so long as the stock remains above the CPR, or even above S1, the trend remains up and the CPR will keep rising higher each day. This particular trend had begun just on the previous day when the price moved above the high of many weeks. The pivots also started to rise simultaneously. When the market opens the next day, the new CPR will again be higher than the CPR shown here for 3 April in Figure 5.17.

Figure 5.17: **Amibroker chart of L&T — the price builds a clear uptrend as the day's CPR was above the CPR levels of many previous days.**

Importance of the Context

While doing your analysis, you should keep an eye on the context. You will be able to see the context when you take into consideration all the market action over the previous many days. It is vital that you equip yourself with both the required skills as well as tools if you are really serious about trading. You should be fully aware of all the important turning points on your chart, be these floor pivots, or even swing pivots, or the crucial levels of support and resistance. Once you have done your pre-market analysis using CPR, you can better anticipate the upcoming day's action and check if your bias is being confirmed or rejected on your intraday chart by considering the daily pivots. You should then trade the day accordingly.

There is one thing that should be especially taken note of. Despite a correction if the stock sustains S1, the uptrend should be considered intact. This point remains valid provided it happens only once or twice. If the price starts criss-crossing the pivots every now and then, you are probably in a sideways market and the scrip under consideration is no more trending.

Contrary behaviour and boundary crossing can be tolerated to some extent, but there must be limits, as in life, so too in the markets.

Advantages of Pivots

Once you start using pivots you will understand how much of a chaoscutting tool they are. Even on the most volatile of days, pivots can throw light on what to expect next from a particular price level on a particular chart. The greater the liquidity in a particular instrument, the better will be the effectiveness of these pivots. Which is why including pivots in your trading system gives you a fair idea about what to expect the next day even before the market opens. Also, since these levels are based on pure price action, they give indications much earlier compared to signals coming from some of the lagging indicators. These points are well illustrated by real market examples in Figures 5.18, 5.19 and 5.20.

Figure 5.18: **You can see how pivot signals are generated much earlier compared to those from lagging indicators on this 5-minute chart of Adani Power. Remember, a few minutes can mean a lot to a day trader. Sometimes the trade may even end within a few minutes, and you could be done for the day!**

Figure 5.19: **Look how prompt the pivots are in spotting entries on this Dish TV chart. Pivots signal entry at 10:54 A.M. while the MACD signal comes in only at around 12 noon.**

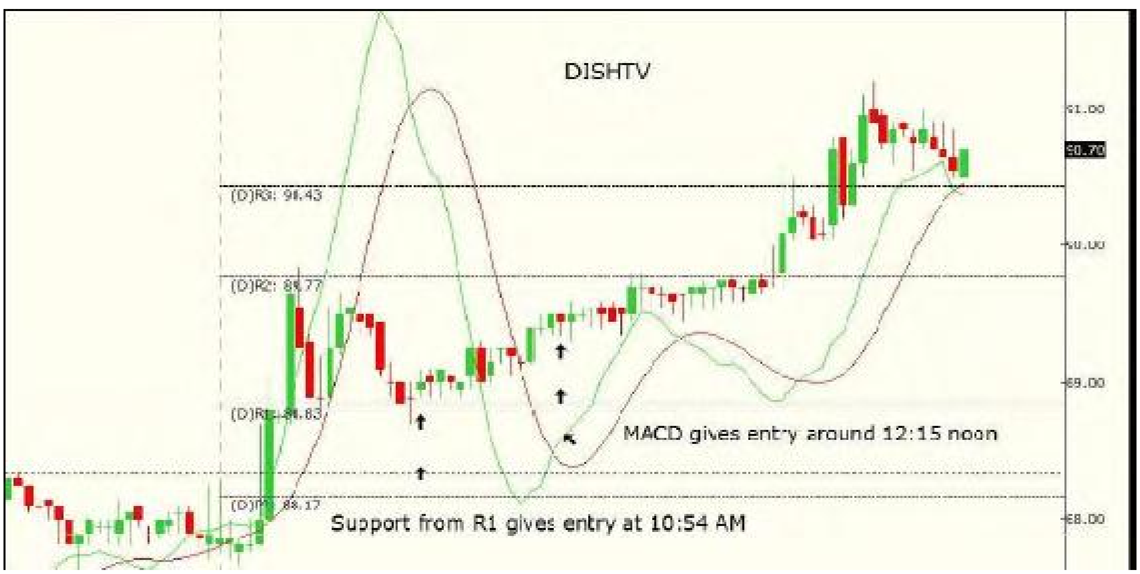

Figure 5.20: **This Hindalco chart bears out the same point. Look how the inability to take out R1 could have warned you in a timely manner, signalling that the price would likely drift towards the equilibrium.**

Multi Time Frame Analysis with Pivots

Another important thing to remember is that in case you see a particular daily pivot, say S1, lying close to a weekly support pivot, then that particular level becomes all the more important as a support level on the price chart. Accordingly, if such a level is taken down it may signify a much bigger price correction in the coming days. In other words, the confluence of levels on various time frames reinforces the relevance of the levels, signifying larger moves in both cases — namely, whether they are successfully retested or whether they are broken. This helps us in multi time frame analysis and understanding of price behaviour for the stock under study over a longer horizon.

So it makes sense checking the weekly pivot levels as well once in a week. Also, weekly pivots work as wonderfully on intraday charts as do the daily pivots. Let's see an example of how a weekly pivot would look and work as plotted on daily charts. In the example of SRF's daily chart in Figure 5.21, the stock had seen a decent rise prior to its quarterly results but the results failed to keep pace with expectations. As you can see in the chart, the stock opens below the weekly pivot level of ₹ 1,724 post the results and falls from levels of ₹ 1,710 to ₹ 1,550 on the very same day. That's the impact of higher time frame pivots being broken.

Figure 5.21: **SRF daily chart with weekly pivots plotted. The price opened below the pivot leading to a big downtrend day.**

The example of L&T in Figure 5.22, again illustrates the importance of weekly pivots, in this case showing how the price rises from above them.

Figure 5.22: **L&T stays above the weekly pivot and then makes multi-month highs. This is the daily chart showing weekly pivots.**

A Practical Caveat

Markets are full of noise and do not operate in perfect text book manner in real life. Traders should be flexible and able to weave according to the twists and turns of the highly volatile real time environs. Accordingly, do not expect the price to open exactly at a pivot point on a bullish day. It may well open a few points above or below it and still give us a good bullish or bearish day, respectively, with multiple entry opportunities. Remember our comparison of trading with dancing on a revolving floor? Yes, that's how agile and nimble you have to be as a trader. These levels operate more like zones and not exact points, and as traders we have to learn to love volatility. Or, at least learn to live with it.

We have already seen that during an uptrend the price action would remain above S1 on each given day, and for multiple days together. Correspondingly, during a downtrend, the price action remains below R1 on each day for many days together. The same theory applies to the intraday charts that you will be trading with. So, the right way to interpret pivots is to give the stocks some leeway to play out the intraday retracements and the opening ticks. We will, therefore not write-off a stock that opens below the daily pivot or below the CPR, provided the price stays above the first support, S1. We will give it some benefit of doubt and consider it for a buy when it tries to move higher. Remember, it is only an intraday dip and not a close below these crucial levels. So we can afford to be a little accommodating here. This should be done keeping in view the other multiple factors affecting the stock behaviour for the day. As we progress with each chapter, we will learn further nuances in the case of all of these factors.

Once the price moves up from S1, or from anywhere between the central pivot and S1, we can look for higher levels towards R1 and R2, or even higher. Correspondingly, in a down trending market if the stock opens above either the pivot or above the CPR, or even between the CPR and R1, you can get a better sell entry depending on the larger picture. As we Indians often say about various matters in life, *Thoda sa idhar udhar adjust karo, bhai* (Brother, life is not a perfect fit; we need to adjust a bit here and there). In sum:

- An uptrending stock can remain in our buy list for the day even if it opens a little lower than the daily pivot, so long as the price sustains above S1, finds support around it, and shows signs of moving higher.
- Correspondingly, a stock in a downtrend that opens higher on a given day continues to remain in the sell list provided it doesn't go above R1, and resumes its fall. You can see an example of this in Figure 5.23.

Figure 5.23: **In a downtrend, PNB continues in our sell list as it does not go above R1 despite opening higher.**

Milestones Covered

In the two chapters on pivots, namely Chapter 4 and Chapter 5, we have learnt about:

- Morning range;
- Types of market opening styles; and
- Details of floor pivots, including the central pivot range (CPR), the central pivot line, the six levels of support and resistance, pivot width, role reversal by pivots, multi time frame analysis, and trend analysis with pivots.

It is the simultaneous use of past information and price behaviour, plus the current day's market sentiment, that helps us more accurately estimate a particular move during the day. A successful trader has to keep both these perspectives in mind when entering a trade. That is how you keep the context in view.

Your pre-market preparation will provide you with the broader picture when you study the development and placement of pivots over multiple days of the recent past. It is the study of the CPR over multiple prior days, combined with the early morning opening tick in the market, the morning range of the current day, the opening style, as well as the daily pivots on your intraday charts that will have a huge impact on the day's directional bias. Depending on that, you will know whether you should expect a major move or trade with a smaller target.

It is nobody's claim, however, that pivots are some unfailing holy grail. It would be naïve to think that the market moves can be captured or manipulated using any single technique. All that we are saying is that pivots definitely help a day trader in narrowing down his focus while trying to gauge the direction for the day. As you will discover in the following chapters there are many more things that we will combine with pivots. The lovely pieces of music or songs that we often hear in music albums or movies are hardly ever created using a single instrument. It is always an orchestra of multiple musical instruments that get together to create heart pumping or foot thumping rhythms. In the same way, it's the confluence or the synergy of many aspects which work magic in the markets. And that's the magic we shall unravel by the end of the book.

So, on to other factors that we can add to our daily arsenal.

~

"Looking at any single factor in isolation is short sightedness; an entire orchestra needs to be put together to create a symphony."

— Ashwani Gujral

Chapter 6

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Trading Trending Markets — Part I

Trade Entry Tactics and Stop Losses

Introduction

A man in a hot air balloon realised that he was lost. Looking down, he saw a man below. "Excuse me, but can you help me? I promised a friend an hour ago that I would meet him soon, but I don't know where I am," he said.

The man below replied, "You are in a hot air balloon hovering approximately 30 feet above the ground. You are between 40 and 41 degrees North latitude and between 56 and 57 degrees West longitude."

To which the balloonist replied: "You must be a broker."

To which the man on the ground said: "Yes I am, but how did you know?"

The balloonist: "Everything you told me is technically correct but I have no idea what to make of your information and, the fact is, I'm still lost. Frankly, you've not been much help so far."

The man below responded: "You must be a trader."

To which the balloonist replied: "Yes, I am, but how did you know?"

To which the man on the ground said: "You don't know where you are or where you are going. You have risen to your current position due to a large quantity of hot air. You made a promise which you have no idea how to keep and you expect me to solve your problem. The fact is, you are in exactly the same position that you were in before we met but, now, somehow it's my fault."

~

Yes, indeed, many traders are exactly like the one depicted in the story above.

Without having your own tools, knowledge and analysis, no amount of borrowed "sure-shots" can suffice. You cannot take the steering wheel of a racing-car and keep WhatsApping others to ask what is to be done next. That's not how consistent money is made. Come to think of it, every trader does make money. The difference is that some do it for themselves, while others do so for their brokers. Well, we don't want to behave like the balloonist trader. So let's chart our own path by learning some more skills. After all, it is your money and you want to grow it. So, be the pilot, not just a passenger in your financial journey.

In this chapter we will learn about entering trades in trending markets:

- We will start with the various time frames to be used during analysis as well as in live markets.
- We will check out how the entire trade setup should be laid out.
- We will describe four tactics for entering a trade in trending markets.
- Plus, we will look at three methods of trailing the stop loss once the trade is in decent profits. We will also understand the circumstances under which trailing stop loss techniques should be used.

How to Select Stocks to Trade Using Different Time Frame Charts

We have come to the arena to win! A warrior never enters the battlefield without enough preparation.

A disciplined day trader is expected to do his homework regularly and in detail. His pre-market chart analysis should cover the study of technicals on various time frames. Though his time horizon for actual trading may span from 9:15 a.m. to 3:30 p.m., he must be fully aware of what is happening in higher time frames as well. Yes, that will take some time and effort every day but if you refuse to pay in terms of effort and time, you will end up paying in money terms. If you think that reading or learning from successful professionals is costly, by all means try ignorance.

Your analysis should begin with a study of the daily charts. The daily charts will give you the idea about the current bias of market participants. It will tell you whether the sentiment in the stock you're looking at is bullish or bearish. As you start studying daily charts regularly, you will realise that certain ripe trade setups that appear on daily charts can give big moves in the morning, or within the next few days. Keeping such stocks on your watch-list can alert you to the upcoming opportunity.

What's more, moves that originate from higher time frame charts can even go on for multiple days. Even if you do not intend to carry positions home as a day trader, you can take daily entries and exits at appropriate times. A newly started trend having strong momentum behind it will make your life easier as it sustains for a few days. If there is no immediate obstacle in the path, it can provide you with multiple opportunities of entry and exit. If you are lucky, you may also get an intraday move worth many days of smaller moves. For example, the daily chart of Indiabulls Housing Finance in Figure 6.1 clearly brings out the possibility of a solid trade owing to a ripe setup. The stock opened at ₹ 865 with a gap, and continued higher during the day till ₹ 930.

Figure 6.1: **High probability trade: this daily chart of Indiabulls Housing Finance shows a solid trade setup and a possible good move as the price and 20MA line were rising above the 200MA line, and it was also breaking out above a multiday range. Big moves can be found when you focus on all time frames simultaneously.**

Figure 6.2: **Dredging Corporation rises more than 50% in 3 days — from ₹ 478 to above ₹ 650 — on a multi-year breakout. Its daily chart shows price levels from 2014 to 2017.**

Figure 6.3: **This intraday chart of Indiabulls Housing Finance stock lives up to the expectations built on the basis of pre-market preparation. The preceding narrow range over multiple days, and the price above relevant MAs raised expectations of a coming big move. Every contraction is followed by an expansion; the stock's charts of higher time frames suggested an upward breakout from the range.**

Do also look at the examples of Dredging Corporation in Figure 6.2 and Indiabulls Housing Finance in Figure 6.3.

It is also useful to review the weekly and monthly charts once a week and once a month, respectively. New patterns as well as changes in the patterns on these charts are not going to appear or disappear very frequently. When they do, however, they can foretell the comparatively bigger move that can be expected in a stock.

Always remember, higher the number of factors in your favour, the easier and smoother will be your ride, and the quicker you shall rise.

Intraday Chart for Further Confirmation

Once you have short-listed your best stocks for the upcoming day's trade on the basis of daily charts, you can dig deeper by having a look at their hourly and / or 15-minute charts. No matter how accurate your reading of trend or sentiment from the daily chart is, unless the intraday move is aligned in the same direction you will not become profitable *(see* intraday chart of Indiabulls Housing Finance in Figure 6.3). As a day trader, your stop losses are comparatively tighter and it is important that you come into profits soon. **The best of moves appear when a given trend aligns in multiple time frames. The idea is to be on the right side of the trend, and preferably at the earliest possible entry.**

Trade Setup

We will be using all the three tools for our trade setups, namely:

1. Pivot levels;
2. Moving averages; and
3. Candlestick patterns.

We have already learnt how to read, interpret and use all these three tools. In real time trading during market hours, we will look at all three of them together, and try to derive trading signals that emerge from their combined impact.

Also, as discussed earlier we will be using the 20MA, the 50MA and the 200MA lines in our trading. The 20MA will be used as the main MA line.

We will look for buy entries whenever the price rises above the 20MA line, or is moving towards it from lower levels. If the price has crossed above the moving average from below it, we will observe if the MA line is providing support during subsequent pullbacks or not. Only then will we accept that a clear trend is emerging.

In a downtrend, the price typically stays below the 20MA line, and this MA line acts as resistance. If the price has fallen below the 20MA line from above, we will wait and observe if the MA line is capping any subsequent rise. If so, we will look for short entries. Short entries are also possible when a given stock moves towards the MA line from a level which is way above it.

The best of trending moves will have all the three moving averages lined either up, or down, as the case may be, in favour of the move. At such times, because the trend is clear and strong, the pivots too will work very well. Strong uptrends will find support at the 20MA line during retracements. In case of stronger pull-backs or corrections, support can emerge around 50MA or 200MA lines. In a strong downtrend, the 20MA line will stop the rise. In case of stronger pull-back rallies, 50MA or 200MA line will halt the rise.

The best uptrends will have the 200MA line below the 20MA line. The best of the downtrends will have the 200MA line lying above the 20MA line. An overhead 200MA line can act as a resistance whenever the price tries to rise higher from below it. Correspondingly, a 200MA line lying below the price can act as a strong support in cases of price falls or breakdowns. An intraday trader should keep an eye on the 200MA line in the 5-minute chart, as well as in the 15-minute and 60-minute charts. The MA lines and pivots can work very well as important locations from where we can expect trends to resume post a correction, or as points for the price to reverse from.

Together, moving averages and pivots will give you a clear idea about the kind of market you are in. The daily floor pivot levels placed on your intraday charts will clearly tell you the levels at which you can expect to see buyers and sellers. The additional significant levels, such as the previous day’s close, the range boundaries in a ranging market, and the previous swing highs and swing lows will throw up enough clues so that you can quickly interpret the data during intraday markets. It is equally crucial to keep an eye on the weekly and monthly highs and lows because those are also important levels from the location point of view.

When the right moment arrives, candlesticks will provide the final signal for pulling the trigger. We have already learnt that candle signals which appear at the right time, and at high-probability locations or levels have a higher chance of working out successfully. When momentum in the market is strong, and is building further, giant candles will appear more often; while tiny candles will form the majority in ranging markets. We will keep all these points in mind when choosing our trades each day. Once we find that most factors are in our favour, we will go all out and make a killing.

To repeat, we will commit ourselves only when we see a majority of factors aligned in our favour, and when the path ahead looks clear. Once we make a commitment, we are at the mercy of the market and there is nothing we can then do to change its course. So keep a cool mind, process all available information, analyse your charts, and plan your trades before making a commitment or taking the plunge.

Four Entry Tactics for a Trending Market

Having well defined entry tactics will help you refrain from jumping into random trades. Entering into the right trade at the most precise time can alter the outcome of your trade in a dramatic way, and it can have a huge bearing on your trading profits.

We will now consider four kinds of entry tactics in a trending market.

1. Entry on Trend Resumption After a Correction Upto a Support or Resistance

In a clear uptrend, if you see a stock retracing from higher levels you can consider entering a long trade once the correction is over and as soon as the trend resumes.

The retracement, or the counter trend move, will force the price lower. You will therefore see a few bearish candles appearing as the price retraces down in search of support. We have already learnt that market often achieves what it wants to in 3, 5 or 8 candles. While this should not be treated as a hard and fast rule but it is a commonly observed phenomenon and can work as a useful guideline. Once you see the price reaching an important level of support, you can expect the retracement to end and the original trend to resume. This support could be either the floor pivot levels, or any of the moving averages sloping in the direction of the trend. It could also be the previous day's close, which often acts as a support when the price retraces intraday. If any of these levels do indeed provide support, you would see the appearance of bullish candles at those levels. Once that happens, you wait for a confirmation which comes if another candle of the same colour appears. You can then enter long, above the high of the last bearish candle. You may see the trend resuming steadily.

The initial stop loss in a long trade should always be placed below the entry candle, or below the nearest swing low if it is close by, with some buffer.

In the case of a downtrend, you should look for a retracement that takes the price higher until it meets with a resistance at one of the pivots, or at an overhead moving average acting as a resistance. The retracement candles in a downtrend will be bullish candles. Sometimes it can take a candle or two more before the trend picks up, the previous low gets taken down and the downtrend resumes. Let that happen. You should enter short once you see the appearance of a bearish candle, i.e. once the low of the last green candle is taken down. You will then see the downtrend resume steadily. You will learn to deal with these variations as you go on implementing the tactics.

In the case of a short entry, place the initial stop loss above the high of the entry candle, or above the nearest swing high if it is very close by, with some added buffer. The examples in Figures 6.4, 6.5, and 6.6 bring out these points clearly.

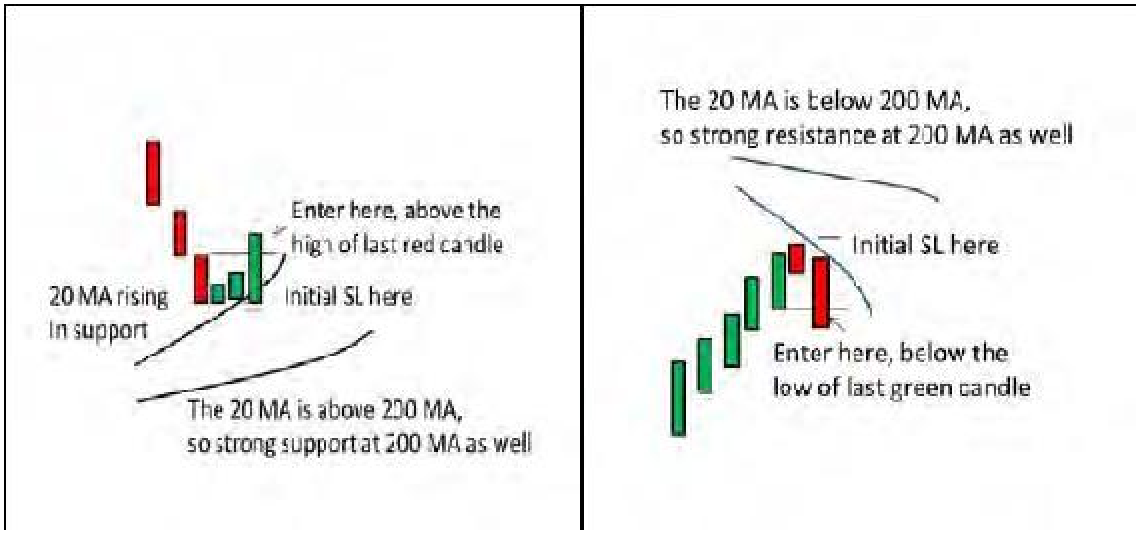


Figure 6.4: **Entry and stop loss locations after correction in an up- and downtrend, respectively.**

Figure 6.5: **This chart of Godrej Properties clearly brings out how and where to enter after a retracement in an uptrend. The stock opens above the pivot, which is a bullish sign. After an initial, limited retracement, it resumes its upward move, and makes higher highs from the MA location.**

Figure 6.6: **With the entire IT sector under pressure, HCL Tech opens below the pivot. After an initial retracement, it resumes its fall from the pivot point as location. The short trade entry is clearly indicated on the chart.**

2. Entry After a Minor Pullback Midway in a Strong Trend

A second possibility is that the trending price may not see any sizeable correction and that at the appearance of the very first bearish candle in an uptrend, buyers quickly come in and the selling, or the supply, gets immediately absorbed. The very next candle is then again green and it smoothly takes out the high of the previous bearish candle — and the trend continues higher. While this kind of price move will not give you the luxury to enter lower, it should definitely bolster your confidence about the strength of the trend. The momentum is said to be strong enough to restrain the stock from making any deep corrective move. Minor or negligible retracements can be ignored, and the trend is assumed to continue. The same thing can happen in a downtrend as well. A single green candle is immediately met with selling pressure and the trend continues down.

The entry and stop rules in such a case are:

- In a downtrend, enter short when the low of the counter trend bullish candle is broken.

- In an uptrend, enter long above the high of the bearish candle.
- Placement of the initial stop will remain the same, namely below the low of the entry bar in an uptrend, and above the high of a bearish bar in a downtrend.

If the counter trend move is sharp and sudden, then the pullback candle could be a little bigger. The trend resumption can still happen within one candle but the stop in such cases will be wider. Again, the entry is suggested once the high of the red counter trend candle is taken out in an uptrend, with a stop below the low of the entry candle, or below the recent low. The converse is true for a downtrend. Have a look at the examples in Figures 6.7, 6.8 and 6.9 which illustrate these points. As always, please do also carefully read the details written inside the chart boxes which highlight some key points.

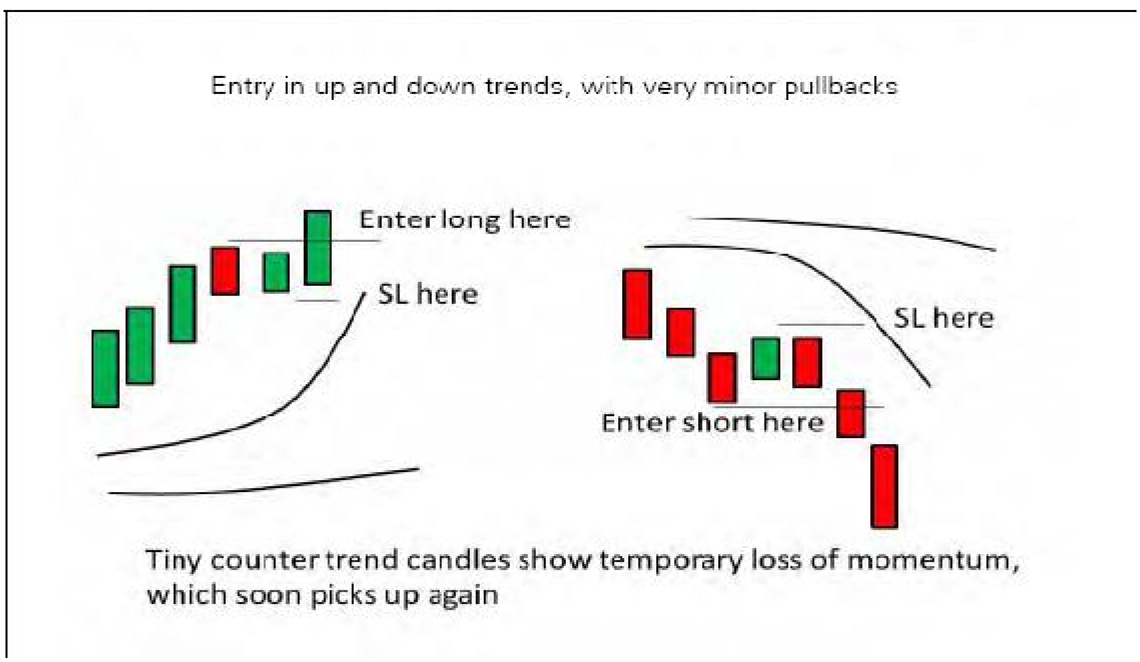


Figure 6.7: **Entry points in up- and downtrends after very minor pullbacks. The positions of stop losses are also shown.**

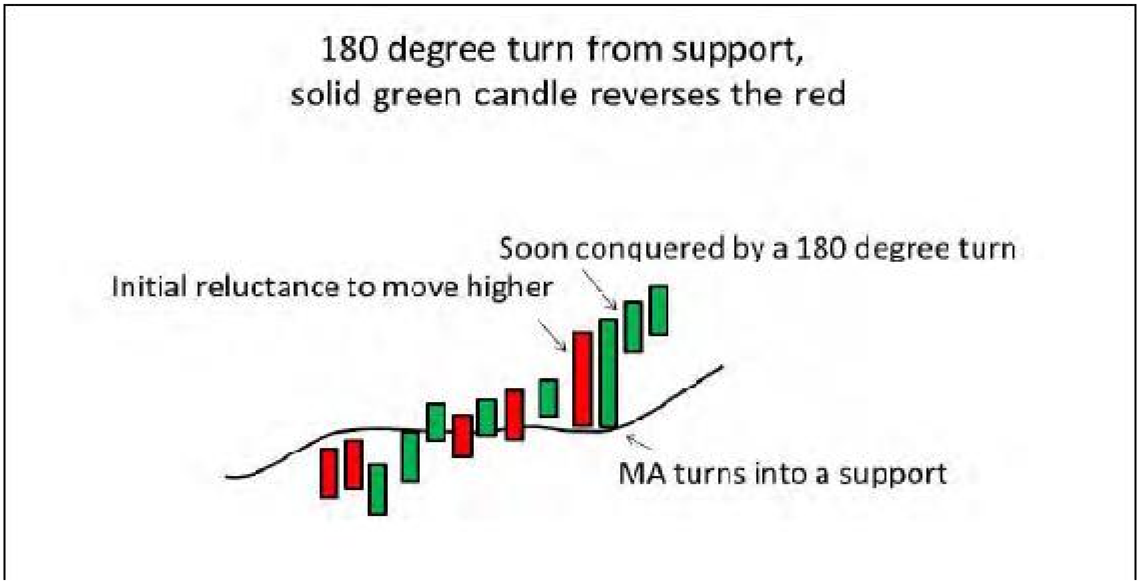


Figure 6.8: **A single red candle briefly interrupts the uptrend but the trend is swiftly set right by the very next solid green candle. Please note how the MA line is acting as support to the uptrend.**

Figure 6.9: **The price of Sobha Developers rises higher the entire day, giving only minor pull-backs for entry. Strong uptrend.**

3. Entry upon Trend Resumption after a Sideways Move

Another possibility is that you get to see a sideways move in the price action. This is often referred to as time correction. The stock is said to be consolidating, or taking rest, before it makes another big leap in the direction of the trend. Formation of multiple Lilliput candles is a typical characteristic of a sideways move. There is no fresh or forceful buying that can lead to higher prices even if the trend is up. Neither is there any major sell-off. You will not see lower prices here, but only flat moves for some time. The range is narrow and the candles are tiny in size. The volume may also be negligible. The price action which was earlier at a distance from the MA line, will now drift sideways and will move towards the MA line. At such times, there is a high probability of another trending move to begin. It could be either an up move or a down move, depending on the direction of the earlier trend and the broader context. As we move on, we will consider the question of context in detail.

Let's now look at the examples in Figure 6.10, Figure 6.11 and also Figure 6.12.

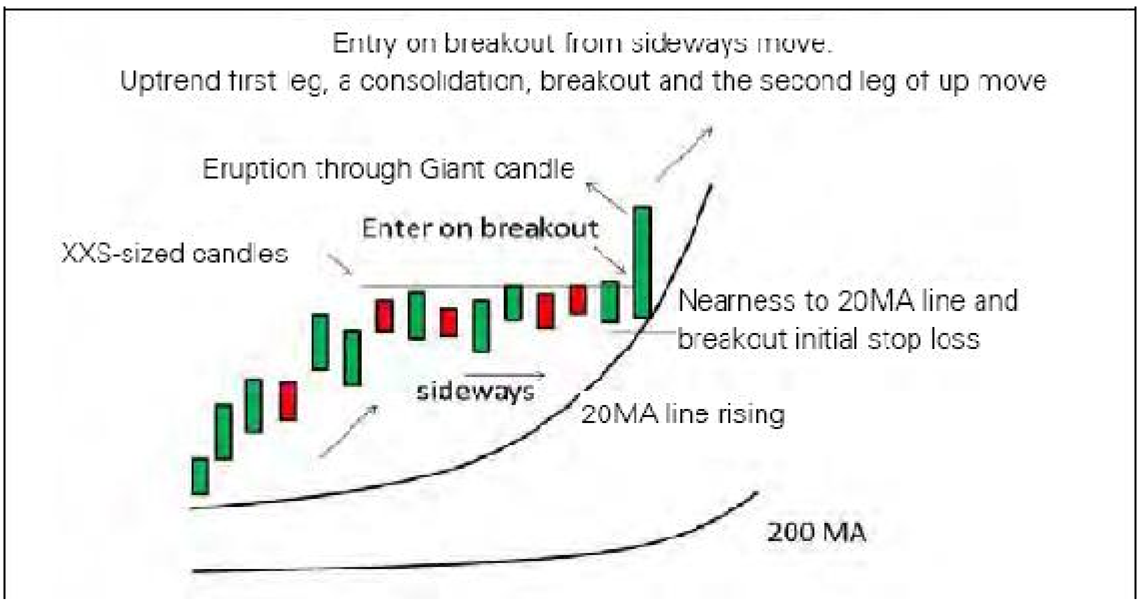


Figure 6.10: **Entry after a giant green candle signifying breakout from a sideways range. Note the position of the stop and the supporting MA lines.**

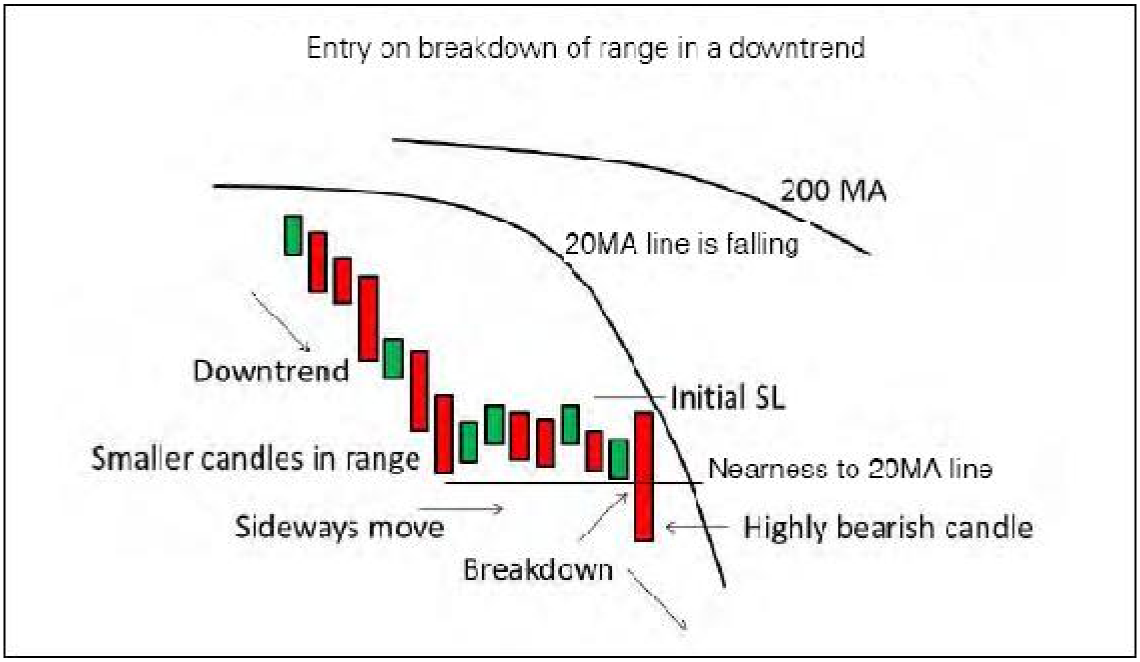


Figure 6.11: **Entry upon the breakdown of a range in a downtrend, signalled by a big bearish candle. Note the position of the stop loss and the downward sloping MA lines in the chart.**

Figure 6.12: **Coal India has a weak day. Breakdowns of midway consolidations in a downtrend provide entry on the short side.**

4. Entry on Trend Resumption Upon the Appearance of a Rejection Candle at a Crucial Location after a Retracement

Another opportunity to enter a trending move occurs when you see a rejection candle during a retracement.

Consider the case of a retracement in an uptrending market or stock. Let's say this retracement ends at a level of support with a rejection candle. This is a sign that market participants are not willing to let the price fall any further. This candle pattern typically gives a high probability trade, especially when it appears at a crucial support. If it also happens at important market hours, that's still better. In such situations you can enter long at the next candle or after the next few candles when the price takes out the high of the rejection candle. The initial stop loss will be below the recent low, or below the entry candle.

Correspondingly, in a falling stock or market a rejection candle having a long top tail during a retracement is a sign that the counter trend rally is about to end. If the pattern appears at a level of resistance and / or at an important market hour, the better and stronger is the cue. Once the low of this rejection candle is broken, entry should be taken on the short side. The initial stop loss can be placed above the high of the rejection candle, or above the recent high. Sometimes if the tail is too long, you can use the 50% rule explained earlier, and place your stop loss accordingly. So long as 50% of that reversal or rejection candle is not given back, we assume that the trend may go on. Have a look at the examples in Figures 6.13 and 6.14.

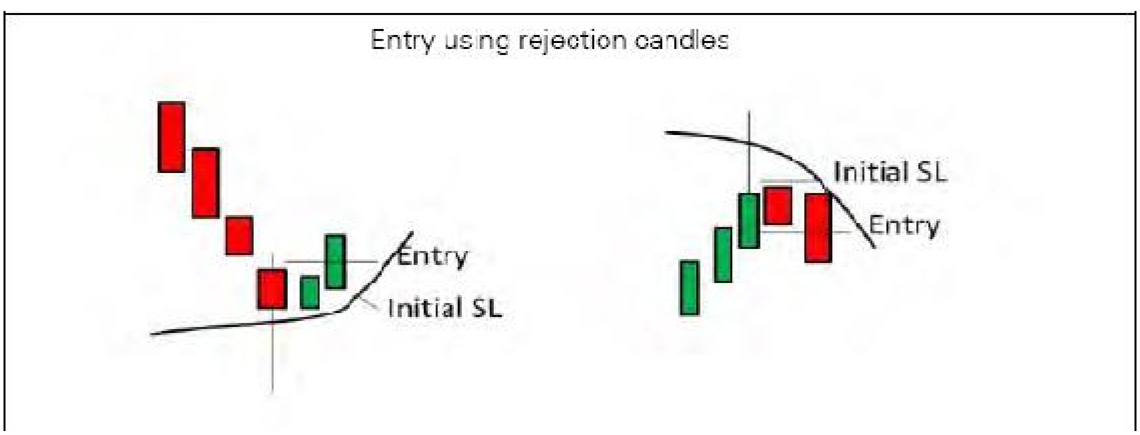


Figure 6.13: **Entries using rejection candles in both uptrend and downtrend, with initial stop loss positions.**

Figure 6.14: **IT is under pressure resulting in weak day for all IT stocks, including Tech Mahindra shown in this chart. Note the rejection candle sell signal in direction of the downtrend and entry point, as marked on the chart.**

So, there are four entry tactics available at the support levels in an uptrend, and at resistances in a downtrend. As described above, all four are capable of leading to trend resumptions in their own ways (*see* Table 6.1). More often than not, it is from these candle patterns and locations that the trend will resume.

Table 6.1
4 Entry Tactics in a Trending Market

■	Entry on trend resumption after a correction up to a support / resistance.
■	Entry after minor pullback midway in a strong trend.
■	Entry on trend resumption after a sideways move.
■	Entry on trend resumption upon the appearance of a rejection candle at an important location after a retracement.

It is also important to keep the trading hour in mind as you observe these price patterns.

Sideways moves are very common during mid-day markets.

While a new trending move can also start in the middle of the trading day, the chance of a final move erupting from narrow ranges made during mid-day is higher as the market approaches the last trading hours of the day. The location factor, namely proximity to the MA line, pivots, swing high /

low, etc. act as fuel to ignite the firing move. The best breakouts with the highest probability of strong follow-throughs will start from around such important locations. There is also a chance of seeing larger candles here if the move begins with a bang. We have learnt earlier that the biggest market moves generally erupt from tiny candles. When they do, you often get to see giant-sized candles in the eruption stage. Initial stops in the case of both up- and downtrends should be maintained below / above the recent low / high of the range and / or below / above the entry candle. Remember to always add some buffer to the stop loss placement.

~

Let us now consider a few more real market examples to understand how these tactics are implemented for entering real-time trades. We will mark multiple factors from hereon, and it is therefore important to study all the details given within the charts of Figures 6.15, 6.16, 6.17 and 6.18.

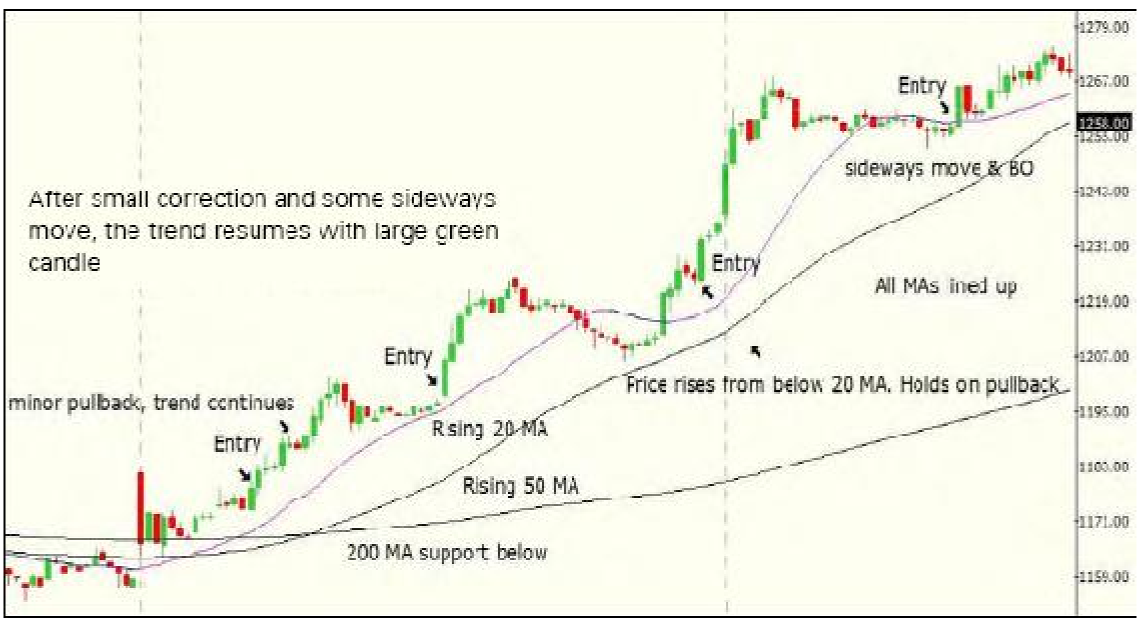


Figure 6.15: **Have a look at how a strong uptrend sustains above the moving averages and provides multiple trade entries during retracements.**

Figure 6.16: **Observe how the previous highs are soon taken out when retracements occur with tiny candles, and the uptrend resumes and newer highs are made.**

Figure 6.17: **The stock falls below the pivot. The 20MA line is below the 50MA line which is below 200MA line. The price is also soon seen below S1 and S2. Entries shown on the chart after failed pullbacks and after range breakdown.**

Figure 6.18: **Rejection candle leads to a strong down move in the chart above**

The Initial Stop Loss

We've now seen how to take entries into a trend using either a correction, a minor pull-back, or a sideways consolidation. For all such entries, the best initial stop loss level would be either below the low of the entry candle in an uptrend, or above the high of the entry candle in a downtrend. In an uptrend, if the recent swing low or the range-bottom low is close by, one can extend the stop loss to accommodate that level. In a downtrend, if the recent high is nearby the stop loss can be placed in such a way that it stays above both the entry candle high and the recent high as well. As day traders we neither want to see any major drawdowns, nor do we want to stay in trades that go on loitering around aimlessly for very long. A tight initial stop loss helps achieve these considerations. You may, however, choose to add a bit of a buffer to your stop value derived from the charts to accommodate random market noise.

The Trailing Stop Loss

Stay with the stock till the time the stock stays with you. Dump it when it dumps you.

When a trade moves in our favour, we definitely want to ride the entire move as far as possible. Not that we will ever overstay our welcome but when the market is in a giving mood, we do not want to keep jumping wagons either. In other words, we stay with the stock so long the stock stays with us. It can be for the entire day or, at times, even for the next day depending on your trading mind-set.

Now, how do we achieve this? We do so by trailing our stop loss. Thus, we raise our stop loss levels in tandem with the stock moving higher in an uptrend. If we are in a downtrend, we keep lowering the stop loss in synch with the falling stock prices. This tactic will ensure that you do not give back more than a minimal amount of your earned profits in case of a sudden move against you. It also ensures that you stay with the stock and reap the maximum returns so long as the stock moves in your favour.

Of course, staying with a move longer also saves commission costs incurred on frequent entries and exits. The real idea, however, is to make big bucks when the market is moving favourably.

When to Trail a Stop Loss

If you focus on the top line, namely managing your quality trades, instead of being enamoured of taking on too many trades, namely overtrading and wagon jumping, the bottom line of profits will be taken care of automatically.

Before getting into the mechanics of how to trail a stop loss, let's be clear about when to do so.

Trailing the stop loss is meant strictly for trending markets, namely for the expansion phase only. If the range is narrow, if markets are contracting, and if the momentum is very low, then it is better to be satisfied with the targets achieved through a fixed initial stop loss. So it is imperative to keep the larger context in mind, and know what is happening around you, before deciding on the action plan.

Without understanding the context you may end up using exactly the right techniques at the exact wrong places. Always check out the environs before you check-in.

Three Methods of Trailing a Stop Loss

1. The 8MA Line Trailing Stop Loss Technique

We've learnt that stock prices remain above the 20MA line in an uptrend and below it during a downtrend. We have also learnt that shorter time frame moving averages will wrap around the price more tightly than do longer time moving averages.

It has been observed that when a trend is strong and the moves are clear, the candles will remain not just above the 20MA line but also above the 8MA line. This 8MA line will stay closer to the price action and will keep rising as the price moves higher. When price action stays above the 8MA line, the momentum is said to be really strong since every pullback will immediately be absorbed by fresh buyers coming in. Accordingly, all minor dips will be bought into in such cases and the up move will remain intact without any major correction.

When you find such a move you are in for very decent profits, especially if the larger picture and the context are also in your favour. The trend is said to be at its best so long as the price sustains above this 8MA line. The same holds true about the trend's strength so long as the price stays below the 8MA line in a downtrend. Accordingly, **we suggest the use of the 8MA line for trailing your stop.** In other words, you continue to hold your position so long as the candles keep closing above the 8MA line in an uptrend and below the 8MA line in a downtrend. This MA line does a fantastic job of keeping you in the trade. So long as the market is in an expansion phase, the 8MA line will let you ride the trend, not just intraday but sometimes even for two days or even longer.

Conversely, when the downtrend is strong the rallies will get immediately sold into and the price action will remain below the 8MA line. You can continue holding your short trades till the price crosses above this line and kicks you out. This way you stand to gain the maximum without giving away much from your earned profits. If the move goes on for several days, you may also get the advantage of opening gaps in your favour. The examples in Figures 6.19 to 6.21 will help you understand this concept through real market trades.

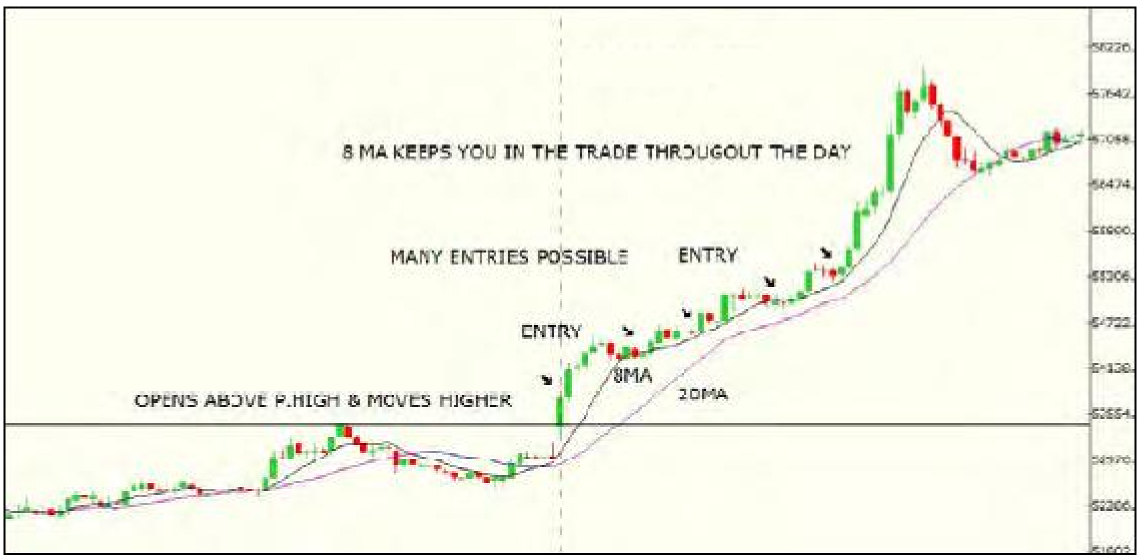


Figure 6.19: **This chart of MRF Tyres of 15 March 2017 shows a clearly uptrending day with multiple entry opportunities. Using 8MA line as stop loss would have kept you in the move the whole day.**

Figure 6.20: **Hitting the road to growth with JK Tyres — total bull control here in the second leg of the up move, using 8MA line as the stop loss.**

Figure 6.21: **Infosys in a downtrend. As you will note, the 8MA line does a fantastic job as a trailing stop loss tool.**

The example in Figure 6.22 exhibits the mighty power of the 8MA line in acting as a trailing stop loss over several days. While our focus in this book is on day trading but it is important to appreciate how solid the system is, so that you have conviction about the technique that you are learning and are going to use every single day.

Figure 6.22: **See how well the 8MA line trailing stop loss technique works in this daily chart of Yes Bank.**

2. Using the Mighty 20MA Line as Trailing Stop Loss

For those who are willing to take bigger risks for bigger returns, we also suggest the use of the 20MA line as trailing stop loss. The technique remains the same as in the case of the 8MA line. The difference is that the trader using the 20MA line may stay with the trend, and therefore in the trade, for a longer duration. He should also be willing to give back a little more when the trend ends. There isn't anything wrong or right with either of the two MA options. What suits you will depend on your mental makeup. Later in the book, we will discuss more about the mental make-up for a trader.

For the present, let's consider a few examples of how a 20MA line trailing stop loss will work and look on charts illustrated in the examples in Figures 6.23, 6.24 and 6.25.

Figure 6.23: **As this chart shows, the 20MA line keeps you in the move for two days in a row as the price of Ceat Tyres trends upward.**

Figure 6.24: **Asian Paints is reeling under severe pressure in this daily chart. Note the effectiveness of the 20MA line as a trailing stop loss in a higher time frame.**

Figure 6.25: **This is a classic example of an entire cycle of price movement. Tata Steel suffered a sizeable fall in the previous week, which was followed by a sideways pause for a few days, then came a breakout early morning with a follow-through move. The price moves above the 200MA line from below.**

3. Two Steps Forward, One Step Back Trailing Stop Loss

Now we come to the third technique of trailing the stop loss. In this case, we allow the price to move two candles forward in our favour from the entry level. We then start trailing the stop loss, once we see two green candles in an uptrend — or two red candles in a down trend — including the entry candle.

With every new candle that begins to form from the start of the third candle onward, we move the stop loss to below the low of the previous candle. This way we permit only one step back of retracement. We keep shifting the stop loss with every new candle, until the stop loss takes us out of the trade.

In a fast moving, momentum-driven final leg of an up or a down move, you often see big green and red candles, respectively, which move the prices like there is no looking back. The price seems to jump ahead in big leaps and quickly crosses many pivots — resistances or supports as the case may be. We try making a few quick bucks by chasing the momentum

as early as possible. We also intend to exit once our target is met, or as soon as we see the stock halting or retracing.

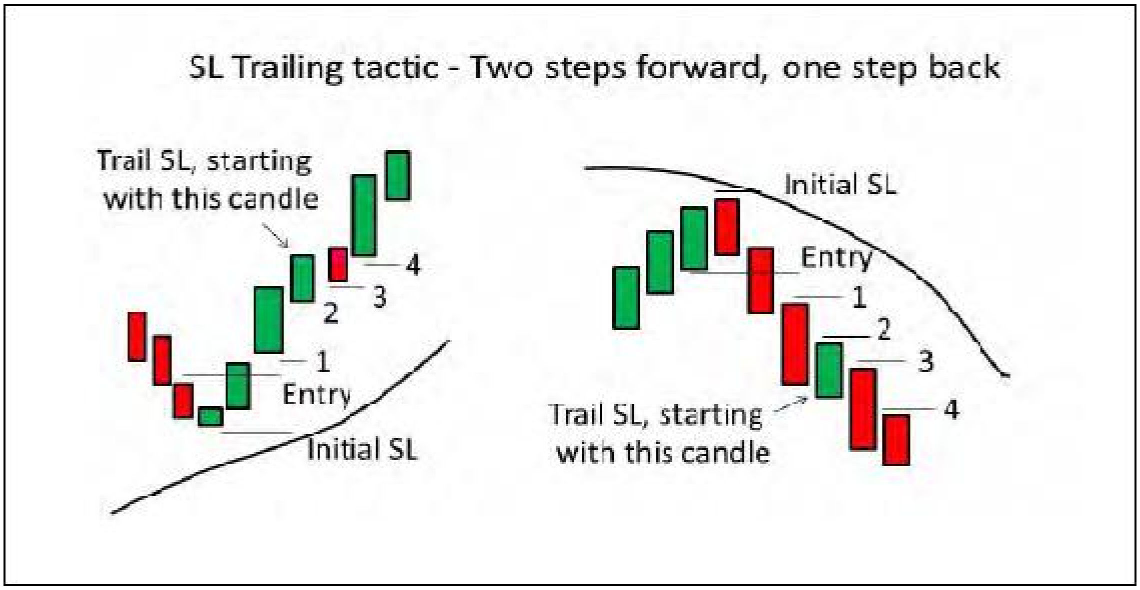


Figure 6.26: **Two steps forward, one back stop loss trailing method. Points 1, 2, 3 and 4 are levels where the trailing SL will be placed. You begin doing so as soon as the third candle from your entry begins.**

Such moves begins very rapidly and may even finish in a similar way within the same day. This technique of trailing stop loss will not only keep you in the move so long as it sustains, but will also ensure that you do not overstay your welcome because at all times your stop loss is just one candle away from the current candle under formation. Figure 6.26 illustrates this concept, and two real life examples in Figure 6.27 and Figure 6.28 highlight its working in the market.

Clearly, this technique permits only very limited buffer and is therefore best used while chasing momentum in the last phase of a trend.

Figure 6.27: **This mega up move in Reliance Capital on 16 March 2017 proved impossible to cap! The stock opened higher in the morning. It was also in the news due to a mega analyst meet scheduled for that evening. The stock rose almost 10% that day. The move was slow and steady enough to provide multiple entry opportunities. The price consolidated in the afternoon hours (remember our market timing theory). The last leg of the day's move began in the last trading hour with a breakout from the intraday range, accompanied by strong bullish candles. You could have kept raising the stop loss continuously from the third bar onwards.**

Figure 6.28: **Maruti creates magic. The final surge of the third day could be traded trailing the stop loss with every single candle.**

So we have now seen four methods for entering a trade in a trending market, and three methods to trail the stop loss during favourable trades. Don’t go anywhere, we will see more trading tactics in the next chapter.

~

Chapter 7

Trend Trading Tactics — Part II

Managing Ongoing Trades, Counter Trend Trading and Trading Gaps

Introduction

Were this not a book but a live session, we would have wanted to know how many of you have been active in the trading jungle, and for how long?

Have you been making money?

Do you do your own analysis?

Have you found yourself a trading system that has worked for you consistently, over a reasonable period of time?

Is there a pattern to your repeated successes or failures?

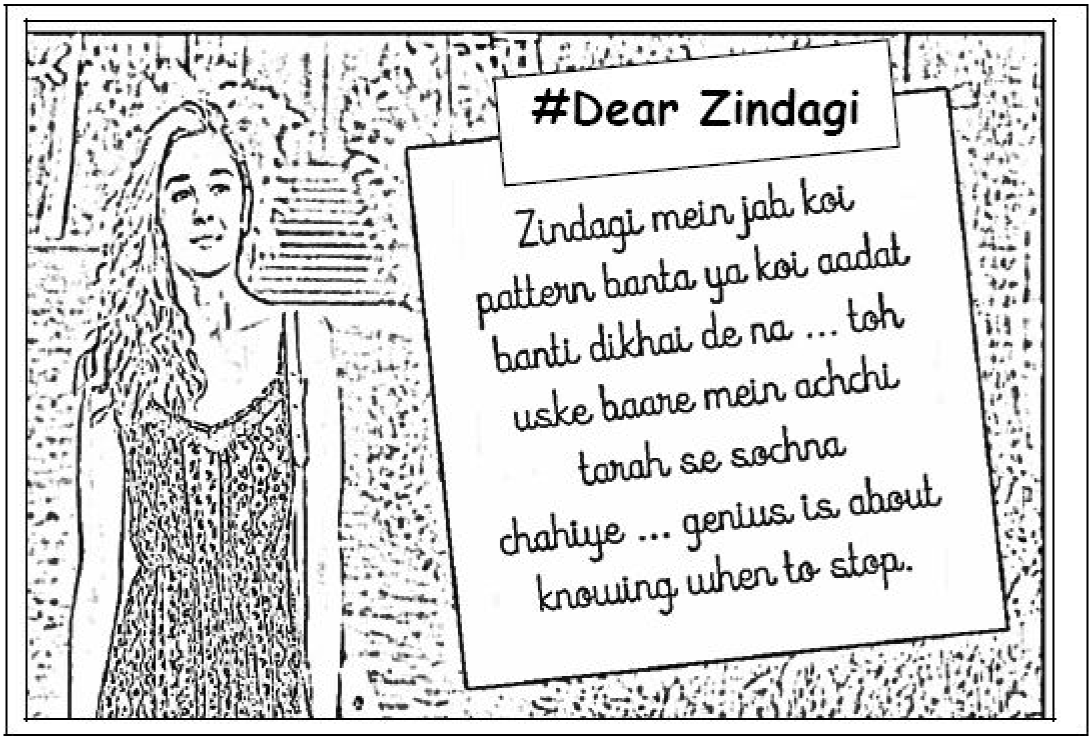
In short, do you have a time-tested method in your trading armoury?

If, yes, enjoy the ride. If not, then one must sit up and think. One must analyse what has been going wrong. One must change one's trading method, if required. One must modify the trading tactics if and as required. There is no point going on and on repeating the same mistakes, and then expecting different results. If there has been a pattern to your losing trades and yet you keep on doing what you have always done, then you will keep on getting the same results that you have got thus far.

You must stop, analyse and realise, or keep getting penalized.

~

In this chapter we will learn about the various methods of managing an ongoing trade right till a profitable exit. If a trade hasn't worked, the stop loss will take care of it and throw you out. If it works well, we need to manage it actively in various ways.



"When you observe a harmful pattern or a habit forming in your life... you must reflect on it. Genius is knowing when to stop." — An apt dialogue from the Bollywood film, Dear Zindagi.

We will also learn about counter trend trading. And, then, we will see how to handle the various types of gaps.

Trade Management

A sound trade entry is only a small part of the entire process of making money. Trade management is an extremely crucial function and plays a big role in defining a trader’s bottom line. The entire game is about managing your stay during the trading move by way of timely entry and timely exit.

We do not want to leave too much money on the table for the next trader by exiting a profitable position before time. We aren't here for charity. Nor do we want to lose the profits we've earned by overstaying our welcome. So timing is a crucial element. As traders, we must be as fast as a cheetah, as sharp as a hawk, and alert to every changing scene in the playfield.

Setting Trade Targets

In ranging markets, targets can be the upper and the lower boundaries of the range. You will have to be patient to let the boundaries form clearly. For this, you will need two highs and two lows at approximately similar levels. The target could also be some important moving average line, or any other levels that form some kind of hindrance to the continuation of moves.

When a clear trend resumes after a retracement or correction, the targets can be kept at any of the three levels, namely 50%, 100%, or above 100% of the total prior retracement. Which of the three works out in reality will depend on the trend's strength. In strong markets, each of these can get surpassed easily. So watch each of them carefully and combine those levels with your trailing stop loss technique. This will tell you exactly what is happening around you, and you can then make the best of the situation. Have a look at Figure 7.1 and Figure 7.2.

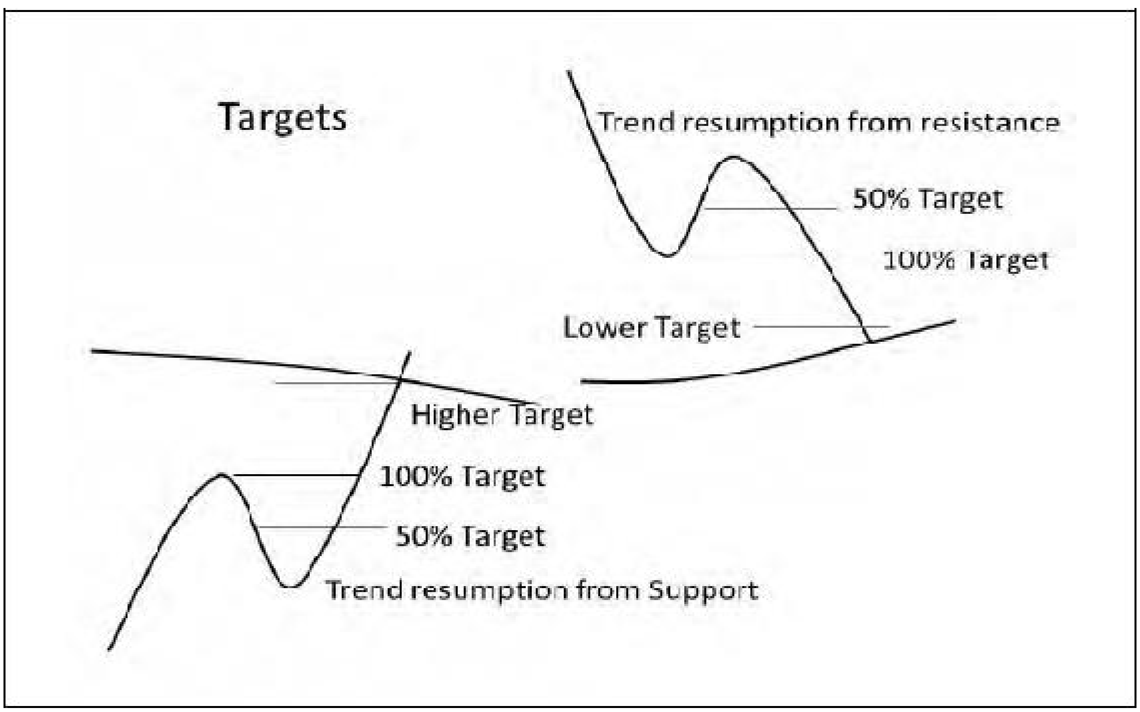


Figure 7.1 **Trend resumption from support and from resistance and the three target levels in each case, namely 50%, 100% and more than 100% of the preceding retracement.**

Figure 7.2: **This chart highlights the kind of expectations one can keep in a sideways trading markets. As shown, the three targets to be kept are at 50% of the previous fall, at 100%, and above the previous fall, say 150% or up to some important overhead resistance level.**

Trade Exits in Different Types of Markets

One possibility is that the trade doesn't work. In that case, your exit will be automatic by way of the stop loss.

In case the trade works, you can exit either by keeping a pre-determined target as described above, or you can exit when the trailing stop loss kicks you out.

When the market is in an expansion phase, good profits are made by holding on to the right trades for a longer period of time. That could mean the entire day, or even for more than a day. By keeping a pre-determined target and exiting at that target, we do not want to cap our gains in a generous market. That is where you can use the trailing stop loss tactics, which we have discussed above. These will ensure that you neither exit too early, nor too late.

On the other hand, when markets are range bound there is no point in having unlimited and open targets. Exiting at pre-determined targets is a better choice at such times.

Candle Signals that Tell You It's Pack-up Time

If you are not amongst those who like exiting at a pre-determined target, you should be looking for signs which tell you that your time in the trade is up. What are those signs?

1. A rejection candle appearing at a crucial support or resistance, followed by a confirmation of that rejection.
2. A giant bar taking the final leap in an ongoing move, as discussed earlier in the chapter on candles. When price reaches some overhead resistance in an uptrend, or a support below it in a downtrend, the current leg of the ongoing move could stop. So this could be an exit level. Stay alert to such developments.
3. When you see more than 50% of the previous move getting erased, that could be the end of the current move. You can hope for the trend to resume till this level, but not after that. Exit should be considered at such points.

Also, never forget that these signals are more relevant when they appear at important locations. Appearance of any of these at critical locations demands special attention as highlighted through examples in Figures 7.3 and 7.4.

Figure 7.3: **The chart of Dredging Corp shows that the trend resumed once the pullback or upside retracement ends within 50% of the previous fall.**

Figure 7.4: **This is the chart of Canfin Homes for 23 May 2017. Up move of the day faces resistance at the previous day's high. Price has also risen strongly by then, so there is nothing wrong in booking out the earned profits here.**

The chart shown in Figure 7.5 shows all important factors coming together. Look at it closely, and also read the details inset within the chart, and you will understand and hear the entire orchestra playing together.

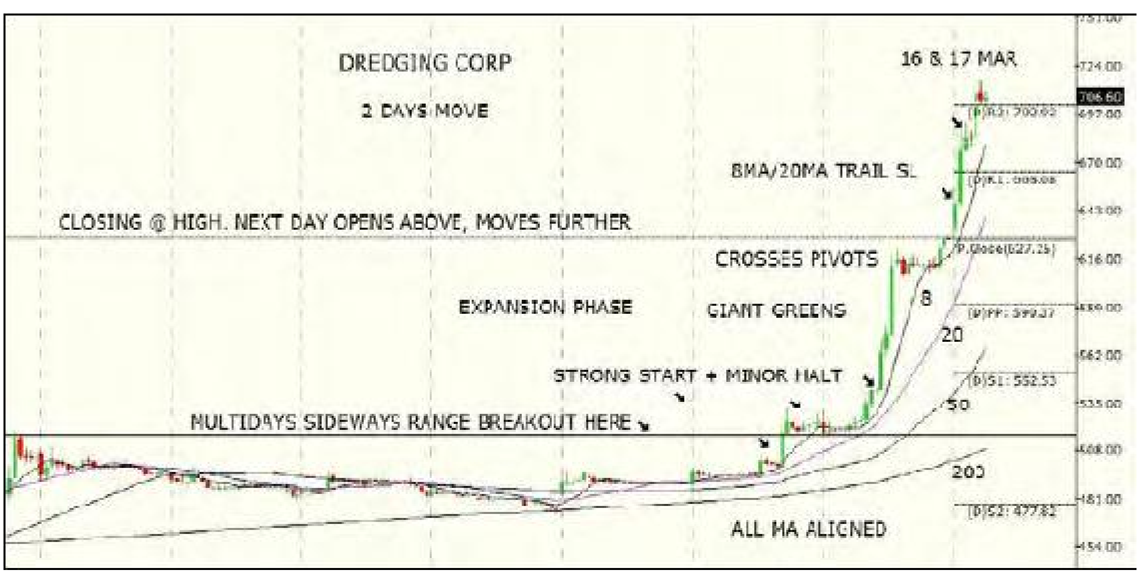


Figure 7.5: **This chart captures all that we have learnt so far: daily pivots, moving averages (8 / 20 / 50 / 200MA lines) and their alignment, strong candles on the trend side, and tiny candles on pullbacks. The chart also shows the contraction phase spanning multiple days, breakout from that range and from the previous high. The price closes at the high of the breakout on Day 1, opens even higher the next morning, and continues to rise further. Also shown are the trailing stop losses and the midway consolidations or halts. It shows a multiday move. What more could a trader want?**

Counter Trend Trading

Things that are denied often hold a lot of temptation and excitement. The same applies in the markets as well. We are generally told to stay with the trend. While that is generally the right thing to do, there are times when opportunities exist to take a quick trade against the trend as well. That brings us to our next topic — when to permit ourselves the liberty to go counter to the trend?

We have learnt earlier that, at times, an ongoing trend gets a sudden boost or momentum, often leading to the formation of multiple consecutive giant candles or larger than normal candles. At such times, the price moves ahead without any pullback or pause, and often strays far away from the zone of equilibrium. Such a move can happen within no time.

The sheer enthusiasm, or panic, of market participants will lead to extreme moves in the market and the price could reach levels that look over-stretched. Crowds are often over emotional and also behave irrationally. The tendency to copy or follow others is not limited to monkeys and parrots! Knowingly or unknowingly, we humans often exhibit the same tendencies.

Now, when the rapidly moving price hits some level of crucial resistance on the upside, or some support on the downside, there can arise the chance of a profitable counter trend relief rally, or pullback. This is especially true in the case of over-stretched moves, or sharp rises and falls. While the trend is intact at such times but there is a chance that the overextended price may try to snap back towards the equilibrium zone or moving average levels.

This pattern works out especially nicely when the price is also hitting a resistance or support from a higher time frame as well , and not just on the trading time frame. It becomes stronger still when the 3, 5, 8 candle rule is met. It gets even stronger if this entire phenomenon occurs at some important market timing, as discussed earlier. The probability increases when you see some reversal sign appearing at the resistance, support, moving average line, especially when it gets confirmed by the next candle.

Say, we are looking at a downtrend and you have a 20MA line and / or 200MA line placed above the price. Let's further say that the price has fallen much below the MA line. There would then be a tendency for the price to move back towards these averages. Those levels can be your target for such trades. Let's now understand the concept with some examples as to how and when to permit yourself the liberty to rebel against the trend *(see* Figures 7.6, 7.7 and 7.8).

Figure 7.6: **This is an example of a counter trend trade during an uptrend. Towards the middle of this Jet Airways chart, the price zooms away for three candles leaving both 20MA and 200MA lines far below. The "gravitational" pull of the two MA lines being imminent, it's a fine counter trend trade setup which you can get into.**

Figure 7.7: **In this chart, the Bank Nifty trend is down but when the price plummets far below the 20MA line with seven successive bear candles, a 150-point intraday counter trend move beckons the day trader as the price gets pulled back to the 20MA line, and even above it.**

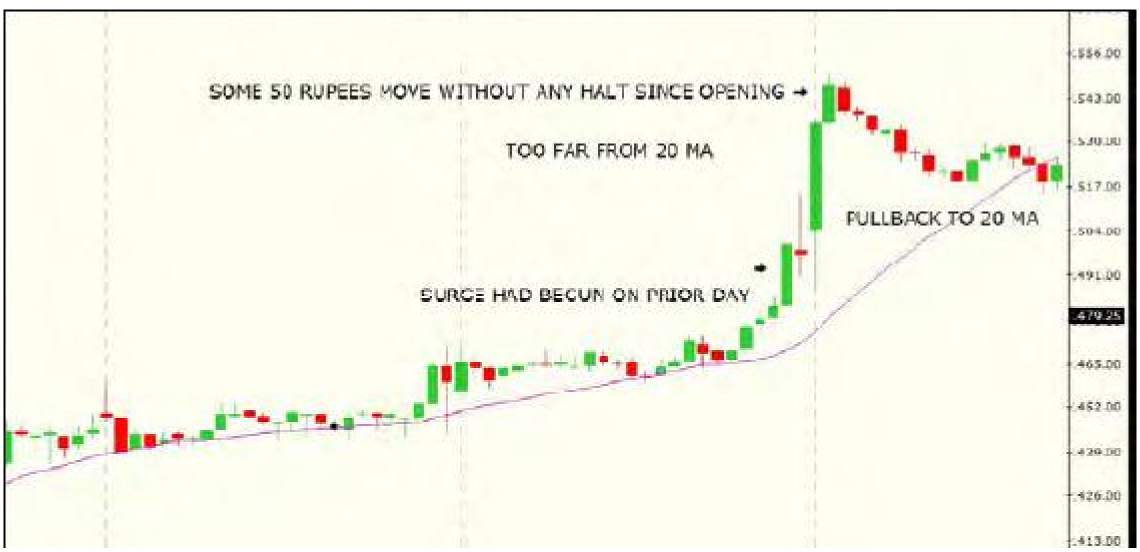


Figure 7.8: **The price of Torrent Pharma rises too rapidly and gets too far above the 20MA line. It then retraces towards the 20MA line. That's another counter trend trade for a day trader.**

Trading Gaps

Despite gaps being one of the most lucrative trade setups, most times traders fail to at successfully trade opening gaps. Why is that? Let us address this issue.

Opening gaps are a sign of momentum built up overnight, a sign of strong emotion among market participants in the direction of the gap. A gap has the capacity to change the direction of an existing trend and start a fresh trend in the opposite direction. It can also occur in the direction of the current trend and yet end that ongoing trend of multiple days. **If handled well, gaps can give you big money. Equally, they can wipe you out in a big way if repeatedly mishandled.** An opening gap could be genuine, in which case the price can build on further from its opening levels. Alternately, it could also be a fake one, in which case it can trap you.

In short, love it, like it, trade it or hate it — but you cannot ignore a gap. So it is better to understand how to handle it. Let's get going! We will not be tackling gaps in the traditional way they are usually explained elsewhere — for example, breakaway gaps, exhaustion gaps, runaway gaps, etc. We have our own way of reading and using gaps. We are concerned not with naming ceremonies but with the context coming at us from the left side of the chart, i.e. from the recent past, and the impact that it may have on the chart's right side.

Gap in the Direction of the Trend — and the Trend Continues . . .

There are two ways of entering a trade after a gap in the direction of the trend.

The first way is to wait for a retracement back towards some support or resistance as the case may be, depending on the trending side and the gap.

Say the trend is up and the gap is on the up side as well, in which case you wait for a pullback towards some significant level, whether it be pivot levels, moving averages, the previous day's close, or the previous day's high. You enter when the up move resumes from such a support, using one of the entry tactics explained earlier.

Conversely, if the trend is down and if the gap is down as well, you wait for a pullback up towards a significant resistance. And you enter from there as the downtrend resumes, using any one of the entry tactics already discussed earlier *(see* Figures 7.9, 7.10 and 7.11).

Figure 7.9: **In an uptrend, Jet Airways opens with a gap, followed by a minor initial retracement in the second candle that stays within the range of the opening candle. Soon, the move takes out the high of the second red candle, and the stock then moves up further.**

Figure 7.10: **Jain Irrigation opens with a minor morning gap above the previous close, then follows a retracement till a support, followed by the resumption of the up move.**

Figure 7.11: **Reliance Capital opens below the previous close with a gap, we see a minor direction retracement, and the trend then resumes its downward direction.**

Now, let's see the second way to trade gaps.

There will be times when there is no retracement after the opening gap. Instead, the price keeps going higher, or lower as the case may be, without any pullbacks. At such times you can wait for the first few minutes, say 5 minutes or 15 minutes, depending on your level of aggressiveness as a trader and your mental make-up, and observe what the market is doing. If the trend is up, and if the scrip takes out the high of the first 5- or 15-minute range, and if the momentum seems to be sustaining, then you can enter using the breakout entry tactic explained earlier. This is illustrated by the examples in Figures 7.12 and 7.13.

Figure 7.12: **Bank of India opens with an upside gap, and straightaway builds further on it. Arrows inset in the chart show the three possible trade entry points.**

Figure 7.13: **ONGC opens with a gap on the downside and the price continues to head lower. The trade entry point is indicated with an arrow inset in the chart.**

You should also keep an eye on the level of the hurdle — a support in case the trend is down and a resistance in case the trend is up. If it is too close, and too strong, then the trade will have lower chances of being successful to any sizeable extent. If the path is clear, the move will be smoother.

Gap Against the Current Trend — Yet the Trend Continues . . .

If the gap is against the trend — for example, if the trend is up and the opening is gap down — that can give you a long entry at a lower price. If the trend is down and the opening gap is on the upside, it can give you a short entry at a better, i.e. higher price. Such trades will have a greater probability of working out if the opening gap takes the price action towards some important level of support in the case of a downside gap in an uptrend, or some level of resistance in the case of an upside gap in a downtrend. Ideally, you should wait for the initial euphoria or panic to settle down and see if the trend is indeed resuming. Sometimes the price may go just a little bit higher, or lower, before the ongoing trend resumes.

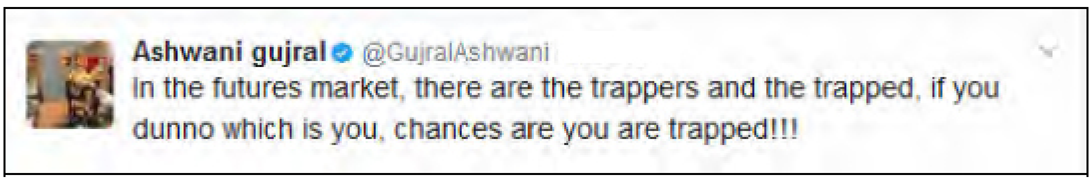
That's because most times the market is absorbing the overnight news flows before resuming its own journey after the first few minutes. If you enter assuming that the trend has changed because of the gap, you may get trapped. Let some level of support or resistance first come in before you enter. Allow some time and space for the trend resumption if it's going to happen, and only then take your call. There's no hurry. You will be better placed to decode what is happening once the initial few minutes pass. Always remember that desperation in D-Street will only lead to disaster. Please review Figures 7.14 and 7.15 with these points in mind.

Figure 7.14: **Birla Nuvo has corrected sharply downward in the previous few days and it then opened with a minor upside gap which only gives a stronger move on the downside later on. This happened when the lower end of a 2-day range was broken.**

Figure 7.15: **Reliance gaps down at the open but the uptrend doesn't come to an end with that. Soon, the up move restarts with a big bull candle making a fresh 9-year high on RBI policy date, 6 April 2017. Many entries were possible, as shown by arrows on the chart. A day trader's delight for sure.**

Gap in the Direction of the Trend Which Puts an End to the Ongoing Trend

There will be times when the trend is taking the price in a particular direction *via* multiple candles. The move might, in fact, be looking overstretched due to a series of successive significantly large candles of the trending colour next to each other in a row, 3, 5, 8 candles or more. The next morning the market opens with a gap in the direction of the trend. At times, the driver behind such jumps could be some positive macro or micro news. Now, if this gap appears after an already over-stretched up move and takes the market towards some resistance level — or support if it is a downtrend — then there could be an immediate pullback from there. The over-extended price might have been looking for a reason to correct. There could be profit booking that takes the price back towards the moving averages.



In such a case, you can profit from a counter trend trade. There could be many people who may have got trapped on the other side at the opening; don't forget to say thank you to them. After all, they are the ones who will help you reach your target. The day begins with a move in one direction, say up, but the scrip soon changes its mind and goes the other way. There will be players who will hold onto their opinions, as well as losses. They will get trapped when the move extends in the other direction. Trapped longs will then take the price down at a rapid rate; conversely, the trapped shorts will take the price higher. Those smart traders who are holding this book right now and reading it are the ones who will make a killing; see the examples depicted in Figures 7.16, 7.17 and 7.18.

Figure 7.16: **Hindustan Petroleum had been falling for some days. The final gap, which you can see in the middle of this chart, puts an end to that downfall and gives a great 2-day up move on 22 March 2017. Two good entries are marked in the chart. If you fail to understand the technicals in detail, you can get trapped on the short side here. But if you do, and even if this reversal doesn't sustain for multiple days, we would have made our profits on the given day. That's it.**

Figure 7.17: **After a major rise, a gap up in the price of Bajaj Finance fails to make newer highs. The stock was also at the upper end of the range which had been developing over the previous few days. That resistance leads to a strong fall, and gives a move towards the other end of range.**

Figure 7.18: **Towards the middle of this chart, the price of Amara Raja Batteries opens around ₹ 914 with a gap up. Many days of rise end with a final gap up that, however, fails to sustain. Those who bought at the open are trapped.**

Trend Reversal after a Gap in the Direction Opposite to the Current Trend

Let's say the trend has been down for the past two or three days in a row and most market players expect the trend to continue heading down in the short term. But, you guessed it, the market has its own mind. The next morning it opens with a gap in the opposite direction. But, no, that doesn't give you a better short sell entry. The price continues going in the new direction, namely upward, and this price action results in a reversal of the immediate term trend. You can then enter a long trade after waiting for some time. If it looks like a reversal, you can use any of our entry tactics and take the trade accordingly. The only two ways of knowing what is happening are, one, by keeping the context and the trend in mind and, two, by showing some patience and closely following the charts.

This setup will work better when the short term trend is over-done in any one direction and is ripe for a reversal. Let's say the higher time frame trend is up and there was a sharp correction in the stock leading to a short term down move for multiple days. That correction ends with an upside gap, which also sees further build up post the gap on the higher side. This reversal is now taking the stock in the same direction as the higher time frame trend, which is up. So, while it is a reversal on the smaller time frame, but it is a trend resumption on the higher time frame.

Such a price move can be aggressive and highly dynamic. It will require a great deal of agility and concentration to enter at an appropriate level. You have to be relatively quick in making your decision and taking action as a newly started trend reversal can pack in high levels of energy, especially in the first few hours of market opening. Those who don't grasp this will be left holding their earlier positions. By preparing yourself well, you get an edge over others; as examples, see Figures 7.19 to 7.22.

Figure 7.19: **Bhushan Steel reverses its over-extended downtrend of the past few days when a very minor opening gap appears in the opposite direction and the price then builds further on it. This is highlighted in the stock's intraday chart shown here. The very next candle is a giant candle as well, which takes out multiple small red candles on its left side. This price went on much higher and the stock had doubled by the last week of May 2017 from these levels of March 2017.**

Figure 7.20: **Daily chart of Bhushan Steel — see how the price doubles between March and May 2017.**

Figure 7.21: **In PNB, the downtrend ends with a sudden gap up opening the next morning. This story too continued for a much longer time.**

Figure 7.22: **This chart of Indiabulls Housing Finance shows more than one type of gap, and how the trend both continues after a gap, as well as how it reverses after another.**

The last point we wish to emphasise here is that if you know your job well, and if you have done your pre-market preparations properly, you will be able to find the right entry in the right stock. And the right entry in the right stock will work, no matter which time frame you choose on intraday. Money can be made with a 3-minute chart, as well as with a 15-minute chart. There is no right or wrong chart. What varies is the kind of expectations that you must keep with different time frames, and the kind of effort each one entails. A strong and clear trend can give a good trade on the shortest of time spans. You have to know what suits you best, and take your calls accordingly. The example in Figure 7.23 illustrates these points.

Figure 7.23: **Ujjiivan has been in a short term downtrend for a few days. The stock then opens lower, rises till the previous close, and gives an excellent short entry. The point being emphasised is that any time frame will work if you use it correctly. This is a 3-minute chart which gives a solid intraday trade with 20MA and multiple entries.**

Moral: Profitable entry is possible only once you learn to read gaps like a book.

Pyramiding — Position Building with Multiple Contracts

Those who trade multiple contracts may choose to enter long, or short, from plunges and spikes. Or, they can do so after deeper corrections. Once the trade starts working in your favour, and once you are in profits, you can then add to your positions. Later, you can keep exiting the various positions as each of your target levels are achieved.

Milestones Covered

We have covered a considerable number of techniques and strategies by now. Let us briefly recapitulate these before moving on to the next chapter.

We began the trend trading chapters (Chapters 6 and 7) by considering the time frames we should use for pre-market preparation. We also considered the time frames for actual day trading during market hours. We described why we begin with daily charts during preparation, and then drill down deeper into intraday charts for trade entry during market hours. We went over the need to also review the weekly and monthly charts once a week and once a month, respectively. Our arsenal has three main pillars till now. **We use floor pivots and swing pivots for determining location. We also use moving averages for trend analysis and location. We use candle study for trade management and timing.**

We have seen the kinds of trade setup that must be in place before we make any commitment.

We have learnt four styles of trade entry; entry on correction, entry on minor pullback, entry on consolidation, and entry on rejection. We learnt how to place the initial stop loss in such a way that we are not unnecessarily thrown out of a profitable trade. We also saw how to do so without taking undue risk.

We've learnt two different methods for exiting trades in two different kinds of markets, namely trading markets and trending markets. We focussed on three methods of trailing stop losses, including the two steps forward and one back method, as well as the 8MA line and 20MA line trailing techniques.

Then we moved on to the challenging topic of how and when to go counter trend. Finally, we saw how to handle gaps, both which occur in the direction of the trend, and those that occur against it. We saw how gaps can lead to better entries when the trend stays sustained. We also saw how gaps can end the current trend and lead to a reversal, i.e. a new trend.

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Right, that's quite a lot to chew on. Let's take a short break to get rejuvenated so that we come back recharged when we go swinging.

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Chapter 8

Trading Ranged Markets

Ways of Swinging Sideways

Introduction

It has history. It has mystery. And to unravel it all, you will have to build with it, a real strong chemistry. That's the market for you. Once you start reading the market like a book, you would be able to create market magic for yourself on a consistent basis. This chemistry includes not just an understanding of what impact any fresh development might have on the price of a stock, but also knowing how much of that impact is already priced into the stock. It also includes having a grip on understanding the markets, not just when the price is moving clearly up or down but also when the trend is not clear.

Most books on markets focus on clearly trending moves and charts. There's nothing wrong with that; after all, one must select the best setups for trades. Additionally, however, since markets spend a huge amount of time moving sideways, one must also focus on getting a solid grip over sideways markets. Sideways markets are never easy to trade. The setup for a sideways market will look different from that in a clearly trending market. The required skills for making money from such a market are also different. If one does not understand these differences, all the earnings made during trending times might be easily lost or significantly eroded during ranging times. It is, therefore, extremely important to know how to trade ranged, or ranging, markets. We have covered a few aspects of this earlier. In this chapter, we will sharpen our focus through learning additional skills and cover more scenarios and setups that recur frequently in sideways markets. **Understanding these trading styles is especially crucial for those who like to restrict their trading to indices, like Nifty or Bank Nifty because indices stay in ranges more often than not, and far more often than do**

individual stocks. So, if you are among those traders who like to stay with only one or two trading instruments, it is essential for you to master how to trade any and every kind of pattern that may appear and reappear in those limited number of instruments.

We will also see some examples that will teach us how to try and understand if a particular news event is already factored in the current price of a stock or index. If it is, then the event will not have any further impact on price. Or, sometimes, it may even have the opposite effect, i.e. a stock may rise on bad news, or fall on good news. We will try and understand when and why this happens, and how to anticipate this so that we can trade it to our advantage.

And, yes, one more thing. We often hear experts say, "Buy the dip, go long on correction," or "Sell the rally, go short from higher levels," etc. But not very often do you get to learn when to actually short a rally or buy a dip, and when not to do so. As a result, such advice may not always work in real time markets. So, when does it fail? And why does it fail? What should be done to avoid such failures? Without getting into these nuances, our know-how remains incomplete; and half knowledge is extremely dangerous, not just in trading but in any aspect of life.

Two Ways to Trade the Markets

Depending on the market phase, you have to trade differently. Learning to recognise the phase the market is in is thus a prerequisite to trading each phase successfully. A trending market must be looked at differently, as compared to a tightly ranging market. You have to learn to weave each factor into your plan, especially if you trade a limited number of instruments. That's what we call a 360-degree view of the entire situation. That's the way to go:

1. You stick to one pattern and trade any and every instrument depicting that particular pattern. For this, you must have an eye on newer securities every now and then, as different ones keep falling in and out of flavour.

2. You stick only to a limited number of instruments, say Nifty and Bank Nifty, and trade as many patterns in those instruments as possible. For this, you must know and understand the personality of each instrument in detail, and how they behave in different kinds of markets.

So you either stick to a given instrument or stock and trade all its variations and moves, whether in ranging market or in trending times. Or, stick to trading only clearly trending stocks, and keep looking for such stocks regularly.

Important Parameters for Trading Sideways Markets

In ranging markets, levels such as the previous day's high / low, morning range, previous close, previous week's high / low, etc. are all very important. Moving averages and the central pivot are less important in such markets as they are likely to repeatedly get crossed over on both sides.

Price moves in sideways markets are limited in size and restricted within the boundaries of the range. It takes extremely accurate timing to trade narrow ranges. So you must always heed all the significant levels that have a higher probability of being respected.

It is also important to maintain a very strict stop loss in sideways markets — absolutely nothing wider than one bar or the nearest swing high / low should ever be allowed. Any method of stop loss other than this will widen the loss per trade and reduce your chances of closing the trade in profit. There could also be a higher proportion of trades that might not work. Very often you might even have to cut off your trades that fail to work as expected. So if you limit your loss to just one bar, and if you can make 6, 8, 10, or 12 bars in trades that do work, only then does it make sense to trade such markets.

Extremely well timed entries, from precisely accurate levels and locations, along with tight money management is what makes for

successful trading in sideways markets.

Characteristics of Sideways Markets

In a trending market we expect either higher highs and higher closings or lower lows and lower closings in the direction of the trend on most days. In other words, we basically expect additional progress in the trend's direction.

In ranging markets, on the other hand, what we often see is negligible net movement at the end of the day. If markets open at higher levels, they often spend the better part of the day in moving to the other end of the trading band. Or they may open with an upside gap but later move down lower. On the other hand, if the market opens gap down it will try to rise higher in the remaining part of the day till it touches some important level on the other side and faces resistance there.

When the trend is clear, buying on dips and selling on rallies will work well. But the same strategy will not work well in a ranging market. In such markets, you cannot go and buy any or every dip. You cannot sell any and every rally either. Trying to enter dips or rallies in the middle of the range will do more harm than good. Such trades may not be very fruitful, especially if the range is narrow. It becomes crucial that you wait till the price reaches either of the extremes of the range. That increases the odds in your favour and you may get a sizeable move. Thus if the market opens gap up and then starts falling, it might be a good idea to go short instead of trying to buy that dip. Correspondingly, if the market opens gap down and then rises, it might not be wise to try and short the rally. It might be a better idea to go long for the target of the upper end of the range. So you see, in a sideways market the entire outlook — the action as well as the expected outcome — is different as compared to that in trending market. Unless a trader understands this, he might end up using a good strategy but in the wrong phase. Once you have assessed the market's phase correctly, you know what to do. Also, with tight risk management your stop loss would be just below the entry bar and your entry will be from the extreme end of the range. You will enter when you see the price starting to move towards the other end. Thus, even if you are wrong, you will realise it early. If you mindlessly buy every dip and sell every rally, you will reduce your chances of being profitable.

Even in a trending market, for that matter, if a stock has broken down, say, 5% to 7% on a given day, and if it opens another 4% gap down the next morning, then you do not short at the open. Correspondingly, in a trending market which is gapping up you may wait for a pullback to lower levels and then enter long from a support. One size doesn't fit all, as we keep emphasising. You must understand what you are being handed before handling it. Also, if one is graduating from investing into trading, it will take time to change one's mind-set. You cannot keep holding onto opinions while the move is running against you. Until you clearly understand these nuances you will not know which strategy to use, when, and where. Even the best strategy will fail if applied or used incorrectly. If such a thing happens with you, then you must try and dig deeper into the reasons for the failure of a given trade. Correct yourself if you think you applied a strategy incorrectly. Exit, and then think coolly. Then use the correct method, and see the magic work out for you.

In other words, dump the wrong trade and not the right strategy. Stick to the right strategy and not to the losses arising out of incorrect implementation. Often some traders do the exact opposite. They stick to losses from a wrong trade, and dump their time-tested strategies. And then curse whoever they can.

Appropriate knowledge is your best insurance against losses. The problem lies in not knowing what you are doing.

Let's now move ahead and consider all these points on real market charts. We will study many examples from live markets because there is no better way to learn trading than by studying examples. Earlier in the book we used examples of individual stocks that were trending nicely. In this chapter, for the benefit of index traders we will use examples of index trades from the two indices, Nifty and Bank Nifty.

As shown in Figure 8.1, Bank Nifty had had two strong days back to back. Day 3 was expected to be sideways since taking a pause, or trying to catch up with averages, after a good run is only natural. On Day 3, the index again opened strongly and tried to go on higher, but faced resistance at R1. Now, think back to our pivot theory which says if the price fails to take out R1 it might see a pullback towards the central pivot point, which in this case lay approximately a good 150 points away. A day trader could have gone short from R1 for a target of the pivot point. From levels of around R1, the index also looked stretched quite far from the 200MA line. Also, in the previous two days it had risen almost 1,000 points already. It was well worth a short trade. Of course, only and strictly after watching the price behaviour on charts.

Figure 8.1: **Bank Nifty 5-minute chart showing a 100-point short trade.**

Later as the price loiters around the pivot point, the market seemed to have lost momentum. Had you been watching this chart armed with the knowledge gained earlier in the book, you too would have sensed the loss of momentum and the slowdown during the day. One could still have taken a long trade as the index started moving higher but with a lower expectation about the target compared to the morning short trade. It could have given you some 30 to 50 points, unlike the first trade with over 100 points of intraday move. The price finally meets up with the 200MA line before moving higher.

The next chart in Figure 8.2, spans the same three days as in Figure 8.1 but using is the Amibroker software showing the CPR and other details of the CPR as described earlier. It will help you understand the context and the trade in an even better way. Have a look.

Figure 8.2: **As the chart shows, the sideways move of Bank Nifty in the later part of the day stays within the CPR, which happens to be about 60 points wide. The better trade for the day was the short trade in the morning, while the trades later in the day in extreme narrow range were difficult and less profitable.**

The day following the day charted in Figure 8.2 (marked day 2 in Figure 8.3) was again a sideways day for Bank Nifty — but with a difference. Let us see what was different, and check out how it was best traded *(see* Figure 8.3).

Figure 8.3: **5-minute chart shows how the index opens higher on Day 1 and then moves lower. On Day 2, it opens lower and moves higher.**

Long trades were easier in the example of Figure 8.3 because these would have basically been on the trending side. Till the time the index remains sideways, however, even these up moves would be much shorter and thus a little difficult to trade, especially if the move does not begin from a crucial location. In the chart in Figure 8.3, Bank Nifty begins lower on Day 2. That throws up an opportunity for the first trade of the day, which is on the long side. As noted earlier, when the index opens higher in a sideways market, it could well then spend the rest of the day moving lower. When it opens lower, on the other hand, it then often makes an attempt to move higher during the rest of the day. The horizontal 20MA and 200MA lines show that it is a consolidation day, and that tells us a lot about what to expect and how to trade. In such cases, your first entry for the day might occur within the first 30 minutes of market opening. In case the swing lows and swing highs of the two days also match, it serves to confirm that the market is sideways. When the index makes a second attempt to rise from levels near to the previous close, one could have attempted another long trade for the day which also happens to be in the direction of the main trend. Each of these locations could be used for precise entry and exits.

Now, have a look at the next chart in Figure 8.4, which is a 5-minute chart for Day 3.

Figure 8.4: **Bank Nifty Day 3 — again a sideways day.**

The opening on Day 3 was within the previous day's range and almost in the middle of it. There was, therefore, no point trying to take the early trade, whether up or down. In a sideways market it is all the more important that we always initiate a trade only from a perfect entry location, which could be either of the ends of the range, or the previous high, low, close, etc. But in the latter part of the day, as Bank Nifty makes a higher low at 23,187 and starts moving even higher from there, that's a trade we should concentrate on.

On Day 2, the lows were made around 23,147. Now it's the third day of consolidation and we may expect higher levels ahead. Or, at the very least, we say that there are chances of a breakout in the second half of the day. This trade is again starting from a congestion zone where there was a lot of activity in the past days at the level of around 23,180. Just before the start of this up move, the 20MA and 200MA lines are both close to the price level. Contraction, or merging of levels, can invite an expansion from there. That's an added advantage. This move gives a trade of 100+ points. And that's the only move in this index for the day. It begins exactly from the central pivot point, so there is a big location advantage, and the obvious target is R1. The chart in Figure 8.5 shows a zoomed view of this move on Day 3.

Figure 8.5: **Up, close and personal with Bank Nifty on Day 3. A zoomed view of the chart in Figure 8.4.**

The chart in Figure 8.5 also shows how the move progressed for the rest of Day 3. Please note the last-minute breakout effort above 23,295 / 23,300 levels. Target R1 was achieved. Each formation of a higher low showed increased chances of a breakout ahead. In this way, we have managed a decent intraday trade in Bank Nifty that we kept following for three days in a row, and all the three days were sideways ranging days. Yet we took home some money:

- On Day 1, we took a short trade by 9:30 a.m., followed by a long trade later in the day around 10:30 a.m.
- On Day 2, we took a long trade early morning by 9:30 a.m.
- On Day 3, we took a long trade after 11:30 a.m.

This is an example of how to trade sideways markets. On Day 1 we got two trades, and on each of the next two days we got just one trade apiece, though we could have done even two on the Day 3. Incidentally, these were the last three days of May 2017.

When a setup appears ripe, don't hesitate. When the setup is under formation, show no desperation. Got it?

Now let us see what the main market index Nifty was doing all this while, and how a Nifty trader would have done during the same period. Let's start with the 5-minute chart of Nifty on Day 1, which is displayed in Figure 8.6.

Figure 8.6: **Nifty on Day 1.**

As you would notice, the index had made a big move on the previous two days. Accordingly, a huge amount of action was not expected on this day. Compared to the limited expectation, however, we saw quite a decent move. The previous day the market had closed at its high point, and the next morning it proceeded further from there. It would have been safer had there been a bit of a consolidation, or a minor dip, before any further rise. Well, markets don't move to favour us. They do what they do, and we must learn to live with it. Nifty faced resistance at R1. If a long entry were taken at the start of the day, or if the trade was being carried forward from the previous day, this was a sign to exit. A wiser course would have been to take the short trade from R1 towards the obvious lower target of the central pivot point. That also happened to be quite a decent 60- to 70-point move for an intraday trader.

When this dip from R1 saw immediate buying, that was a call to then go long for the day. It made sense also because it came after an initial dip and also from a very crucial intraday level. Timing-wise, it was post the early morning rapid fire moves. Often we have seen that the initial few ticks are all over the place which leaves the index players in confusion. Once that phase is done and over with, the move that emerges is much more comprehensible and the directional signals also are much more reliable.

Next the Nifty temporarily broke the morning low as well as the previous close, but recovered soon enough. This would have left a few people trapped on the short side whose subsequent short covering would help the long players. This long trade gave a sizeable move of 60 to 80 points for the day, which was definitely more than expected. Even if you did not take the initial short trade, this second opportunity became available and that too in the direction of the trend. This would have also given you enough time after the opening so that all the initial euphoria and panic associated with the early ticks would have settled down, both within you as well in the markets.

On Day 2 and Day 3, Nifty offered only minor opportunities. The market got more and more compressed. The range went on getting narrower and narrower. Nevertheless, a day trader exclusively into index trading could still make smaller trades. Does this make sense? Yes, it does. Let's see how.

Say, a trader gets some 20 to 30 points on Nifty on such sideways days. He then makes some ₹ 1,500 to ₹ 2,250 per lot. On some days a trader may get even more than one such trade. Now, one lot of Nifty futures would have cost less than ₹ 58,000[*]. The cost of transaction and taxes per lot would be, say, ₹ 100 to ₹ 150. This leaves the intraday trader with returns of 3.5 percent within a few hours. And that's with just one trade. Even with your cost going a little higher, the day's returns may still be more than 2%. Not bad at all. The important thing is to be more and more accurate in timing the trade. If you can manage a trade with a stop loss of 10 points and a target of 30, that's good enough. Similarly, with a 30 to 40 point stop loss on Bank Nifty, if you get 70 to 80 points on the target side, you are making returns of some 3% to 3.5% in a matter of few minutes, or hours; again, not bad. These trades, however, require very tight risk management. While the quantum of these moves may not sound very dramatic, you will also get a few bigger days in a month. Make use of those when they come along. That's how it is for those who wish to stick to Nifty and Bank Nifty. For those willing to take newer ideas, there's always something or the other that might be clearly trending, and that may give bigger moves in the process. Stocks like Escorts, Hindustan Lever, Ashok Leyland, for instance, gave huge moves in the last few days of May 2017. So, markets always have got enough to offer to one and all. You get your share depending on what you like and what suits you.

Let's now consider Nifty's charts for Day 2 (Figure 8.7) and Day 3 (Figure 8.8), respectively.

The chart in Figure 8.7 shows that on Day 2 there were two opportunities to trade on the long side from previous swing lows to highs. This level had seen much action and was a significant level. The move was from 9,586/90 to about 9,625/30.

Figure 8.7: **Nifty chart for Day 2 with the previous day also shown for reference.**

The chart in Figure 8.8 shows the trade for Day 3, as the index makes a higher low. One could have entered around 9,614, with stop loss at 9,600 and the support of multiple moving average lines available, especially the 200MA line.

Figure 8.8: **Nifty on Day 3, with the day trade shown.**

Let's now include Day 4, namely 1 June 2017.

As you can see in Figure 8.9, on Day 3 Nifty had closed near the upper end of the range, at 9,629 to be precise, after a futile effort to break out. It had turned back from a high of 9,640. It opened around the same level on the morning of Day 4. The very first candle was a red one suggesting an initial downward pull. There was then no question of buying in the middle of the range; rather, one would sell from the top end of the range, or at around the level of 9,640 which was the previous high. That was also the R1 level for the day. This level had been touched twice earlier but not crossed. This was again a sign of initial weakness and a consequent pull towards the previous low could be expected. The price initially moved towards the pivot (9,625) as shown in the chart. Another attempt to rise failed from there, and there was also a confluence of 20MA and 50MA lines around this pivot level. This was a clear invitation for a short trade towards the lower end, since the breakout of Day 3 did not find any follow-through for itself. That short trade ends exactly at the previous low. With an entry around 9,630 to 9,640, and a stop loss around 9,640-50, your target would be either the round figure of 9,600, or 9,590, which was also the previous low. And that's precisely how it turned out.

Figure 8.9: **Nifty chart from Day 2 to Day 4 with different trading opportunities highlighted.**

The index found support and started moving higher, providing a long entry at around 9,605 with stop loss at 9,590. This was after 3 or 4 candles of rest. The obvious target had now to be the top end of the range and that's exactly what you got. Nifty moved to 9,635-38, before shying away again. These two trades combined would have given you some 60-plus points, and you could have churned and turned around your capital twice in the day. You would have made some 7% returns intraday. Even if you made 4% or 5%, and not 7%, it's not bad at all for a few hours of work! The support of pivots and MA lines adds to your conviction but, basically, a sideways market can be traded even solely on the basis of swing highs and lows, and previous highs and lows. These would suffice.

As you can see, the entire movement of Day 4 remained within the range of Day 3. That's how sideways markets behave. A temporary break of these boundaries will immediately reverse on the other sides.

What a Trader Must Pay Attention To

In a sideways market, what a trader must pay attention to are the high and low of the previous session. One can easily trade a sideways market with the help of these two values alone.

In trending markets, on the other hand, depending on the trend side you may see higher and higher, or lower and lower, pivots and MA lines every day. The pivots in a sideways market, on the other hand, will neither be rising nor falling.

Let's now look at the next two charts of Bank Nifty (Figure 8.10) and Nifty (Figure 8.11) respectively, using Amibroker which show the entire context and make clear how one must trade a sideways market.

The chart in Figure 8.10 highlights how during a sideways market the CPR stays horizontal and adjacent to the CPR of nearby days. The price does not cross above R1 or below S1 on any of the days, remaining within the band of R1 and S1, and this coincides with the previous day's high and previous day's low on many of the days. So rather than expecting R2 after R1 and R3 after R2, we play the high and low of the previous day. That's it. Let's live up to our promise of keeping things simple. We have also covered these characteristics earlier during the pivot chapters, remember?

You can see the phenomenon very clearly here as we discuss each move on the charts, from level to level. And, it works amazingly well.

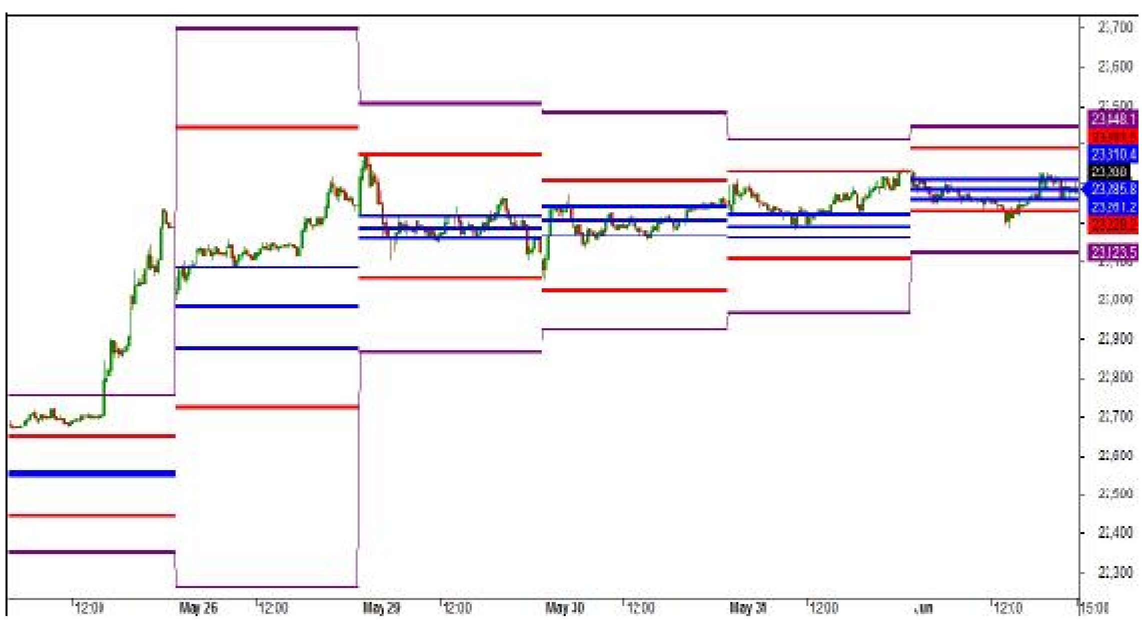

Figure 8.10: **This is the Bank Nifty chart from 26 May to 1 June 2017. Initially there were some trending days, and then came the 4 ranging days we have been discussing.**

The same thing can be seen in the chart of Nifty in Figure 8.11, for the same time period.

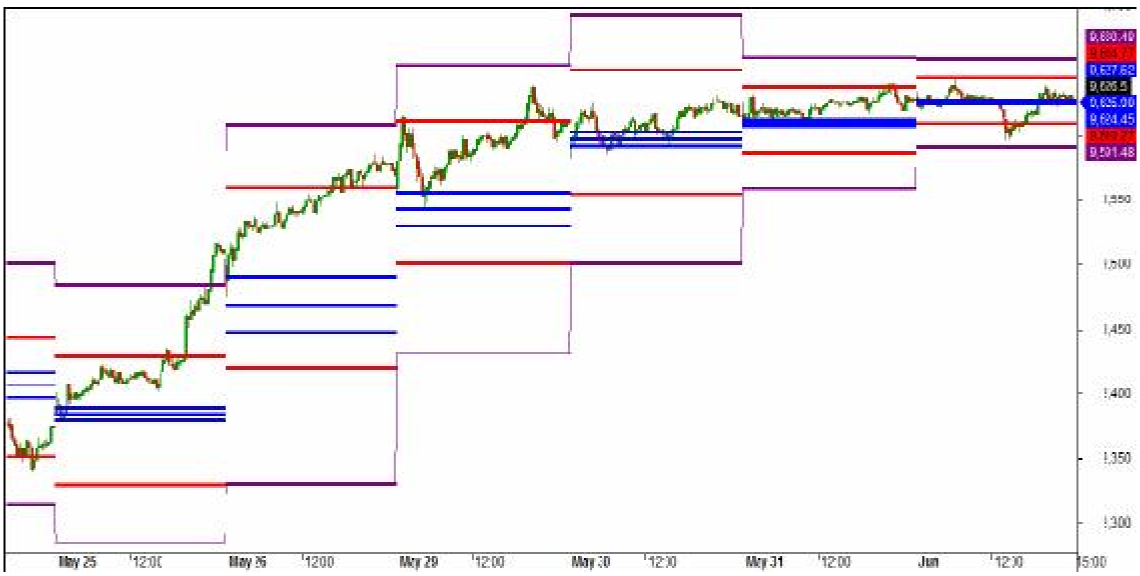

Figure 8.11: **Nifty chart for 6 days from 26 May to 1 June 2017. The initial 2 were trending days, and then came the 4 ranging days in the new week.**

The red lines are R1 and S1 as noted earlier, and the blue lines are the CPR.

The trader must treat the range between R1 and the previous high as a zone, and the range between S1 and the previous low as another zone. This will help you understand the moves of the sideways market. Only when you recognize the highs and lows correctly, will you know how to trade them.

There will be times when the indices may make attempts to break out. Many of these attempts may fail before you get a real breakout with strong follow through. At times, the price may fall back into the range. At other times, the range bracket may simply shift a little higher or lower depending on the direction of the breakout. The price may again start hovering within the newly formed range, instead of continuing the move further in the breakout direction. Such things will happen, and you must learn to live with them. Nevertheless, you may still be able to find some trades using smaller targets and tight risk managements. There will also be days when the market will contract to such an extent that taking a trade would not be feasible. Don't trade on those days. It is not necessary to trade every single day. In fact, it is extremely important to recognise when not to trade.

During breakouts you may find really good opportunities within the initial fifteen minutes itself. During a ranging situation, it may be completely different.

The other times when good opportunities could emerge might be around 1:30 p.m. and 2:30 p.m. News based moves can, of course, come anytime. So keep all this in mind and trade small when only small trades are available in sideways market. Trade big on clearly trending days. Stay on the sidelines when the environment is not apt for a trade, whether because the range is too narrow or the moves too erratic. If you don't mess with the market every single day, and trade wisely during tradeable days, you should be able to stay in the green at the end of the month even with limited instruments. Those who are willing to trade a variety of instruments may choose to trade only when the instrument is clearly trending.

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Let’s now consider the chart of Bank Nifty in Figure 8.12. This chart depicts Day 5, where the range shifts higher, the index breaks out but doesn't get a solid follow through.

Figure 8.12: **Bank Nifty chart shows two trades for Day 5, a day when the range shifts higher as the index breaks out but without a solid follow through.**

The index trades between the new highs created during early ticks from the level of the breakout. Later, it does give a trade worth some 60 to 80 points twice during the day. Even if you took one opportunity out of the two, you would still have made some money for the day. The market had gapped up at the open due to overnight global cues. But that wasn't enough to give a follow through on the upside and the market started falling immediately after the first tick itself. The ideal recipe for a genuine breakout would require a narrow range for many past days, added to some macro news that can impact the economy. When this leads to a gap up or gap down at the opening, and if the turn takes place in a sharp way — a big bullish bar taking out big red bar, for example, or *vice versa* — then there are higher chances of seeing a follow through. In this case, some of the ingredients were missing. While the index made an attempt to rise after the first strong red bar, but it was stopped by R1. That was a clear sign to take a short trade from R1 (23,360) to a pivot or previous close (23,290- 23,270), with a 20-point stop loss at around 23,380 / 90. The sudden and sharp move takes the price to the target pretty soon. But it still holds above the pivot and stays above the previous close, as well as above the 200MA line and forms a higher high in the process. In doing this, it remains in the positive territory. You get a second trade with an entry around 23,310- 23,315 worth another 70 to 80 points. Stop loss would again be around 23,280 which is 30 to 35 points lower. Have a look at the entire explanation through the chart shown in Figure 8.12. Despite the early attempt to break out, the index stays sideways.

With the end of Day 5, we have come to the weekend. Let's see what the market offers us ahead. Till then, let's take a break from markets and enjoy the outdoors. The universe has been supportive as we write on sideways markets; the markets remained sideways.

An Important Point in All the Above Charts

One important point to note is that on Day 1 and Day 4, there were sharp intraday plunges. Such plunges, or spikes, are very good for traders. These sudden and sharp moves typically take the price to the extreme ends of the range, leading to a higher probability move towards the other end. This will happen once the relevant support or resistance is met. This may have a higher probability of working out well when the support or resistance is met at some important market hour.

The point being made is that the market should first get spent out in one direction, in terms of both time and distance. This also creates traps for people who may enter the move at its tail end. When the index reverses, those who are trapped will help you achieve your target in the opposite direction pretty fast, like it happened in the above charts. When the market starts getting strongly biased in one direction, it attracts players to enter in that direction. This directional bias may not be there early morning when the index might be choppy, but may get created by noon. So both time and distance, or the length of the move, are important. In the absence of either, things may not work out.

Important Points to Remember about Trading Ranged Markets

- Sideways markets often have a tendency to reverse every third day. This isn't a hard and fast rule, but this pattern is frequently observed in sideways markets. If there is going to be a big move on a given day, the signs of it may sometimes be visible from the opening itself.

- Unless the opening gap is significant, don't expect active players — remember, the two types of market participants we discussed in Chapter 7 — to get really active. And unless they do, the range may sustain and the price may fall back into it again. That’s why we say that it takes bigger gaps to give follow throughs.

- In trending markets, the pivot point will either work as a support in an uptrend or work as a resistance in a downtrend. In a sideways market, the pivot will keep getting pierced and penetrated, much like an MA line does. With flat markets, you might have to sell the opening gap up, which often turns out to be a fake-out rather than a breakout. With trending markets, you may wait for a decline or consolidation and buy the gap-ups.

- Even the size of the gap is important. Too small a gap may die down without any follow through, while too big a gap might have already taken away the best part of the intraday move. Wider pivots will attract the price towards the central pivot, in which case a bigger amount of intraday gyration may be available and tradeable on either side, unlike with narrow pivots. Remember, different types of pivot widths will give different kinds of pullbacks.

- On days when the pivot width is neither very narrow nor very wide, and is thus not providing you any clear signal, you may get signals from the morning range.

- All these are permutations and combinations. Coming to trade every morning with a thesis or strategy is important; equally important is to allow the market to approve or reject that thesis. Nothing works all the time. So it is important to know when to expect each hypothesis to work. You can keep alert levels in indices and stocks for yourself, and allow the market to lead you, rather than trying to lead it. If it behaves differently from your expectation, you wait and see what’s happening before jumping in. You cannot come with two biases.

All the above mentioned details will add up to clarify your trades in sideways markets.

The essential idea is that the system a trader chooses to follow should be so clearly defined that it covers as many angles and contingencies as possible. It should throw up entries and exits — you should not be having to chase them; rather, these must be clearly calling out to you. So it is the totality of the broader picture, plus the context and the mood of the market for the day that together must prod a trader into decisions, and not his whim or fancy. This ability comes from an in-depth study of your system.

Correspondingly, in a trending market you must have clarity about your navigation using different criterea. Are you going to trail the stop loss? Are you going to exit at a pre-determined target? How are you pre-deciding that target? When and how do you expect an end to the intraday move, and thus tighten your stop loss? As we have learnt, a narrowing range, price rejections, higher time frame hurdles, etc. are good signs for this.

The closing of a candle at highs or lows is a sign of price acceptance in that direction, while a long top or bottom is a sign of rejection. We know how to recognise a tiring out market and loss of momentum, right? Our effort is to strike a balance between untimely or early exits in a giving market, and overstaying our welcome in a sideways market. The map should be well defined, and should be marked clearly with all milestones in your mind.

Conclusion

Trading only a limited number of securities, meaning staying only with one or two stocks or indices, when trading sideways markets is as good a method of trading as any other. If you can master it, you will succeed. More is not always merrier. Even if you are tracking more than two stocks or indices, and prefer variety, you must still keep a limit on the total number of stocks that you actually try to track or trade at a time. Tracking too many stocks is no guarantee that you will do better. Some of the best traders work with only limited stocks at any point in time. As the time and the flavour of the season change, their watch-list gets updated. The selection can be based on liquidity and volatility. We want stocks with good movements and not lazy, lethargic and poor movers. Before we conclude, let's have a look at the chart in Figure 8.13 for another example of a sideways market trade.

Figure 8.13: **Nifty on 7 June 2017. The range had shifted higher compared to the last days of May, but it still remained sideways. On the day in question, we had RBI policy news and also the news about discounts expected by clients from IT companies in the second half of the day. The trades are indicated on the chart.**

An ideal F&O trade would consist of Price action plus Location plus Timing plus Trap plus Catalyst. We have seen the first three factors, and we will cover the other two as we move ahead. Keep reading. Keep learning. Keep earning.

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Chapter 9

Trading Big News Events

The Catalyst by Your Side

Do you remember the impact on Sun TV's stock the day when the late Tamil Nadu Chief Minister J. Jayalalithaa left this world?

Do you recall the big moves in stocks like PVR, the multiplex company, upon the release of the all-time Indian blockbuster movie, *Baahubali?*

Do you recall the disastrous moves in Idea and Bharti Airtel telecom stocks on 1 September 2016 when Reliance announced the launch of its telecom service Jio? Or, the drop in the ADAG group in May 2017 when there was a major fall in bond prices and there was a doubt about the company's ability to repay the 2020 bonds?

The moral: If you are not on the right side of the affected stocks on such days, then you will definitely be left behind. That is exactly what this chapter is all about. As traders, our job is to mint money, no matter who is born, who expires, who merges with whom, who de-merges from whom, who will repay their debts, who profits, and who is in deep red.

Let's see how to use it all to our benefit as traders.

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We have already discussed a lot about trade setups, trading tactics, etc. We will now add one catalyst which can power your trades. Remember what we said earlier; the higher the number of factors on your side, the bigger your edge and higher the odds of success? If there are factors beyond the charts that go in our favour, they can add to our edge.

One such factor is some news or event whether about a stock or the market in general. Such news or event can work as powerful catalysts for your trading moves. In effect, a favourable news event can create a significant tailwind. It can act as a force multiplier behind your trading move. When there is a news or an event backing a chart setup, there would be a larger number of players who will be tracking it. When the cumulative emotion of many market players initiates a move, it will have stronger momentum behind it. The move may then sustain for more points — and thus more profits. The news could be a stock specific catalyst, a sector catalyst, or a macro catalyst impacting the market as a whole. Also, we need not concern ourselves whether the presumed future positive or negative outcome may be borne out. We just assess the current emotional impact of the news or the event, make a profitable trade, and move on.

One must always remember that markets run on emotions and money flows. News and events impact both. For example, a news tailwind might ensure that you see enough follow through to any opening gaps. When the wind is behind you, your move forward will become smoother and easier. So it is definitely a good thing to have a news event on your side. It makes sense to focus on the big news of the day or the week and the stocks that are going to get impacted by it. Such moves may begin right from market opening and give you entry within the first few minutes itself. Even during market hours, as fresh news keeps flowing in, you will see big moves in the impacted stocks. The Reliance Jio AGM on 1 September 2016, for example, and the news of Indian Army's surgical strike on Pakistan-based terror camps in 2016, and many other such events get reported through the day. You can keep a tab of these through the Internet, live TV, social media, or any kind of mobile applications.

It takes a great deal of skill, agility and conviction to trade stocks based on breaking news, but it can be very rewarding. Very often at such times you may get a candle which is equivalent to two or three days of a normal move. It can all happen within one day.

You will have to build a solid level of conviction and use a strict risk management method to make the most of such rapidly unfolding moves.

How to Trade Stocks That Are in the News

Events create emotions. And a trader's job is to encash these emotions — after he is done controlling his own.

One of the ways of selecting stocks to trade is a combination of technical know-how and news events taken together. You zero-in on the best stocks for the day where you see the highest probability of both being in your favour.

The concerned news could be a macro event that impacts the larger picture, the overall market or the major indices. These are the events that will have a major bearing on the entire economy. It could also concern micro events that impact specific sectors and stocks.

We will consider several examples to see how daily news events impact stock prices through the day. Sometimes company specific news can even result in a spill-over effect on multiple stocks belonging to the same industry or sector. At other times, the news driven trend may even continue for several days. Traders who are willing to hold onto their positions overnight will find this very useful. All of it, however, will begin with a good day trade. You can then choose to ride the wave for as long as it stays in your favour.

In the examples that follow, we will also examine how to manage such trades with the help of our day trading system and trade setup.

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We saw a major move in Idea on the day when the news of Idea and Vodafone merger broke. This stock gave a big intraday move with multiple opportunities for entry based on our locational strategy and entry signals using candles. The pivots were surpassed by a huge margin within the first few minutes. But the story had much more steam left in it. The 20MA line support provided some entry signals, and every minor pullback was immediately absorbed. There was a strong larger context as well to this move. The stock had bottomed out on a higher time frame. Those who were short in this stock would have immediately felt the fear and the resultant pressure as the stock kept rising. F&O players often have a sense of urgency when a position goes against them. Their short covering action thus provided further boost to the up move. This is exactly how you combine technicals with emergent news and the larger picture or the overall context. When a trade is taken keeping the entire overall context in mind, the chance of its success multiplies. That's when you get a roaring move. In this case, the Idea stock opened with a gap and then had a decent follow through. It immediately took out the highs of the previous few days and went on to rise 28% intraday! You can see this move in the chart in Figure 9.1.

Figure 9.1: **What an Idea: the 28% intraday up move in Idea on the day news broke of its merger with Vodafone.**

On 17 February 2017, Reliance Capital announced that it had found a buyer for its stake in Paytm. The company was planning to focus on its core businesses by selling off its non-core stuff. It was also planning to soon list its home finance division. There was also an expectation that some hot-shot top appointee would join the company. All these factors combined to give a big intraday move in Reliance Capital, all driven by this news event. By the month of May, the stock reached around ₹ 700 without any midway corrections. That's the power of news-driven stock selection.

The move is captured in the intraday chart of Reliance Capital in Figure 9.2.

Figure 9.2: **The move in Reliance Capital that could not be capped once the news of its divestment from Paytm broke.**

The stock of Reliance Industries broke out on the higher time frame chart on 22 February 2017. This was after eight years of consolidation. On that day it crossed its previous day's high, its weekly and monthly highs, and also closed above its 8-year range. The move was triggered by the news of the imminent start of the commercial operations of its telecom venture, Jio. If you kept the entire context and the larger picture in mind, you would not have hesitated in trading the strong momentum evident on this day. Further, the move was not expected to end in a day. Market veterans as well as the media were expecting a still higher level in the coming days. The much awaited breakout was finally here! Have a look at it in the chart in Figure 9.3.

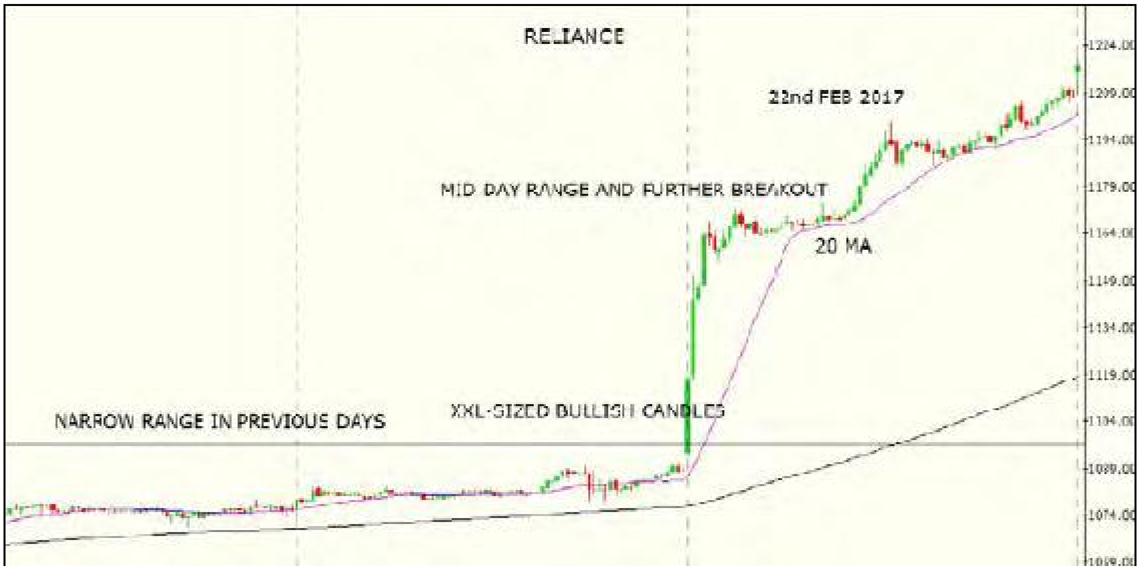
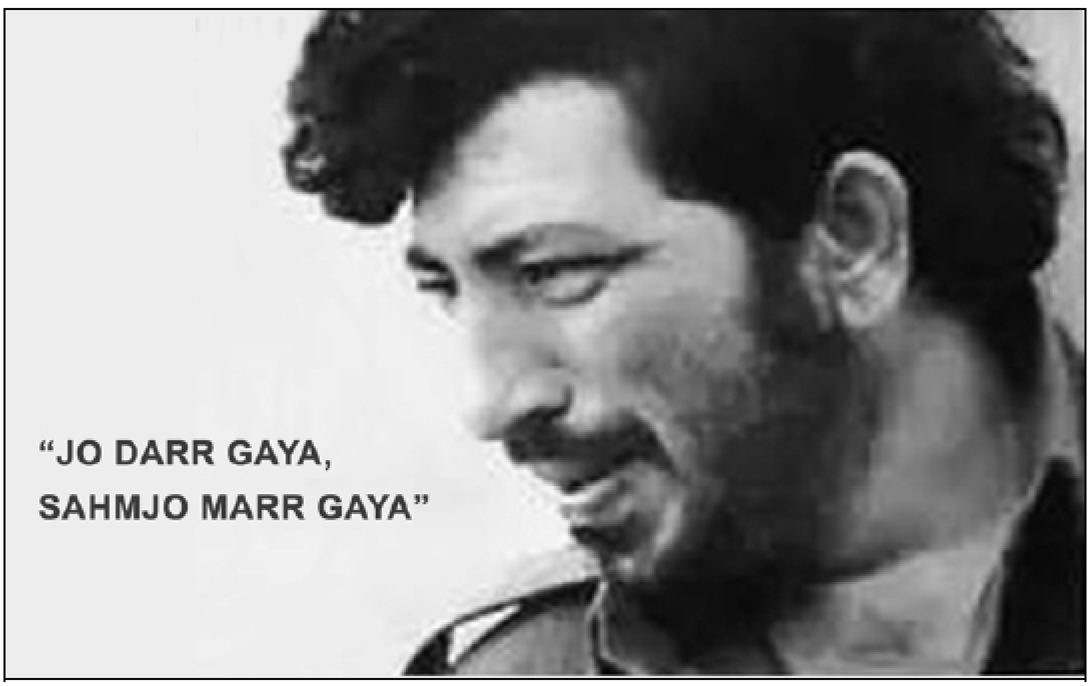


Figure 9.3: **Once the news broke of the imminent start of Jio's commercial operation, this move in Reliance Industries could be relied upon for a few more days as well. The price rose 10% intraday. And added another 10% within a week; taking it from levels of ₹ 1,100 to ₹ 1,300.**

Figure 9.4: **Another leg of the Reliance Industries up move after news of its upgrade and revised price targets. When you have such a story on your hand, there's nothing wrong in trading the same story till all the juice is squeezed out.**

Within a few days, research firms were upgrading the stock and revising their price targets. The stock continued its journey into the stratosphere on the morning of 27 February 2017 as well. It was again a very clear intraday trade. Whatever minor consolidation occurred on the previous day came to an end and the rally gathered further steam with the stock making newer highs, exactly as everyone was expecting it to do. This is brought out clearly in the chart of Reliance for 27 February 2017 in Figure 9.4.

A day trader is expected to remain vigilant about market developments through the day and take advantage of them. But he must definitely check his charts before committing to any trade. Such moves will require agility. Your hand should not tremble, and you must exhibit utmost level of focus and tight risk management. It's worth recalling a dialogue here from the Bollywood classic *Sholay:*



Jo darr gaya, sahmjo marr gaya — "He who hesitates, perishes," taunts the supervillain Gabbar in the Bollywood classic, Sholay.

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Let's now consider another story. On 8 March 2017 there was a sudden newsbreak during the day about a cut in aviation fuel tax from 25% to 1%. All aviation stocks rose in a rapid move intraday.

Have a look at the Jet Airways move on its intraday chart in Figure 9.5.

Figure 9.5: **Jet Airways takes off immediately on news of aviation fuel tax cut. The trend had already been up for some days, though it had also recently seen some correction.**

Another day, another story. The stock of Maruti was at an all-time high at the end of January 2017 and it had been performing really well ever since the market picked up pace after the demonetisation effects had settled somewhat (*see* Figure 9.6). On 1 February, the news of the automaker's monthly sales numbers was strong enough to put the fear of demonetization completely to rest. The market had had few expectations of a good performance from any of the auto companies due to the huge cash crunch that the entire country had recently faced. In fact, the stock made historic highs on this day and offered many entries for a day trade. Moreover, the overall sentiment was also solid during the second half on this day once the Finance Minister completed reading out his Budget speech. Yes, it was the Budget day, too. The best moves are seen when most factors are in your favour. That's the advantage of keeping the larger context in view. The stock created history.

Figure 9.6: **What a move!!! Maruti makes magical moves and newer highs, creates history on sales numbers plus budget bonanza, putting to rest the fear of demonetisation. Tightly coiled moves of the previous days gave a solid breakout. Look also at the power of the mighty 20MA line.**

On 3 March 2017, there was the news of a dip in the production of sugarcane and the likely resultant deficit in sugar inventory. Indian Sugar Manufactures Association (ISMA) reported a dip of 18% in sugar production. This, combined with the ever burgeoning demand for sugar, proved to be good news for sugar stocks which saw a big surge, as is illustrated by the chart of Dhampur Sugar in Figure 9.7. The stock had been in a narrow range during the previous days and, as expected, this news led to a breakout.

Figure 9.7: **Sweet returns for sugar stock players. Sugarcane production dips, sugar deficit rises, and so does the stock of Dhampur Sugar. This move sustained on the next day as well.**

When the technicals and a news event align, you may see turbo-charged moves, whether up or down, due to the tailwind in your favour.

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Spice Jet announced poor quarterly results on the evening of 14 February 2017. The stock broke down from its range of many weeks right from early morning trade on 15 February. This, combined with a rise in the fuel cost, signalled pressure on the operating margin. Have a look at Spice Jet's chart in Figure 9.8 which illustrates the move.

Figure 9.8: **Spice Jet crumbles under the pressure of poor results news plus higher fuel costs. In fact, this drastic move created a near term bottom.**

The Economic Times carried a big headline early morning on 7 February 2017 about Tata Motors. It mentioned the negative impact of the proposed border tax levy by USA on some companies. The report said the development could impact the EPS of Tata Motors by as much as 50%, since US accounted for some 20% of its Jaguar car sales. Adding fuel to the fire were the low growth numbers of Jaguar in China, Europe and the UK. The stock price crumbled right from start of the day as depicted in the chart in Figure 9.9. You can see how our trading system could have given you a great intraday trade, provided you were aware of the news and had accordingly put the stock in your watch list for the day. The price started falling from ₹ 524 that day, and declined to ₹ 435 over the next few days, without any pullback on the upside. The move goes on and on. Again, it's the power of solid stock selection.

Figure 9.9: **Tata Motors faces downward heat arising from news of a proposed US border tax.**

Auro Pharma put out its results on 10 February 2017 even as the entire pharma sector was reeling under pressure that particular morning, leading to further weakness in all industry stocks. Twice the stock tried to go above the levels of ₹ 713, but failed both times and remained stuck in a sideways range. The stock and the sector both had been under pressure for a long time. When you keep this entire context in mind, and then see the way the stock behaved at the opening, your call for the day would be obvious; actually, even for many days to come as the chart in Figure 9.10 reveals.

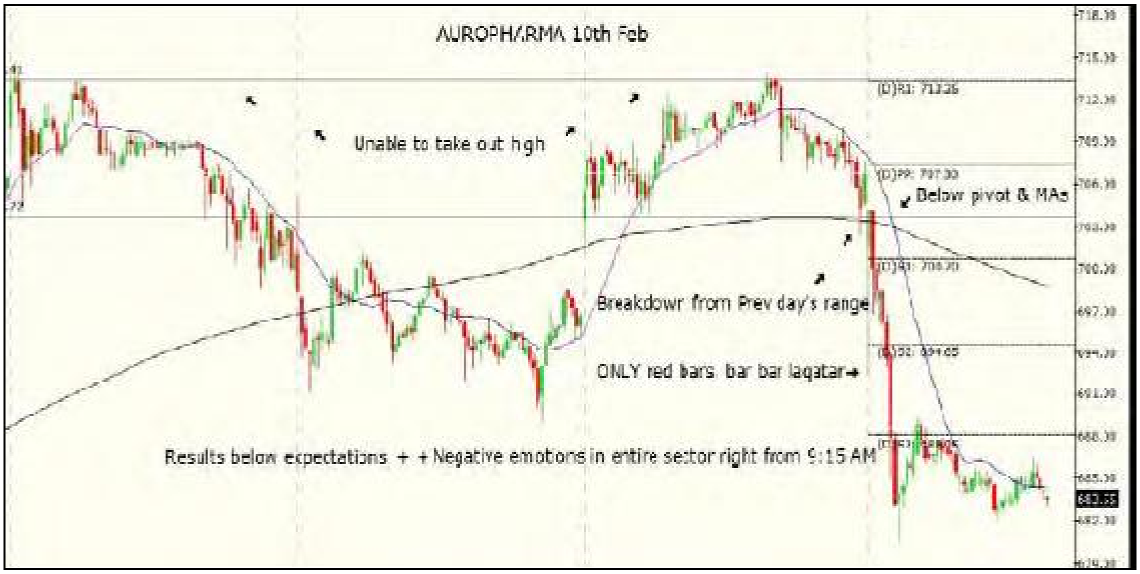

Figure 9.10: **Auro Pharma's intraday chart shows that the stock is not just down, but out as well. This wasn't the end, though.**

While reviewing this chapter three months later, it was noticed that the Auro Pharma stock had closed the day at ₹ 526. The high of around ₹ 705 shown in the chart in Figure 9.10 for 10 February 2017 had not been taken out on closing basis ever since. In other words, if you were on the wrong side and didn't maintain a strict stop loss, three months later you would still have been paying daily mark-to-market margin (MTM). This again demonstrates the strength of our stock selection strategy. The stories we selected in February and March 2017 went on paying off till May 2017. The chart in Figure 9.10 is the intraday chart of 10 February 2017. The one in Figure 9.11 is the daily chart of the same stock till 24 May. Have a careful look at both.

Figure 9.11: **Auro Pharma daily chart till 24 May.**

Let's now consider a story from the banking sector. Kotak Mahindra Bank held a press conference on 29 March 2017 and speculation was rife that there could be a possible acquisition announcement in order to reduce the promoter's stake in the company. Due to its link with the Mahindra group, M&M Financial was believed to be a probable candidate. Accordingly, M&M Financial rose very strongly during the day prior to the conference. Though the stock closed the day lower, but it gave a strong intraday up move before that. A day trader could have found his stock of the day here. That's not the end of the story. In fact, the entire group of NBFCs did well due to this news and related sentiment. While the news later turned out to be mere speculation, we are more interested in the resultant trade opportunity rather than trying to guess the future. So we won't waste time arguing whether this was going to be good or bad for the company's future. Take a look at the chart in Figure 9.12.

Figure 9.12: **M&M Financial was in news due to its rumoured takeover by Kotak Mahindra Bank. While the stock closed lower, but an intraday trader would have made his profits by then.**

Let's now cross borders, as we have seen enough of domestic events. When US President Trump got vociferous about H-1B visa norms in early 2017, Indian IT professionals and Indian IT companies operating in USA began feeling the heat. This led to major price moves in the sector as Indians residing in the mighty US felt unsafe and insecure in times to come.

The pensive old Bollywood number comes to mind here: *Chal udd ja re panchi, ki ab yeh desh hua begana* — Fly away, bird, this land has turned inhospitable and alien!

Take a look at the Tech Mahindra daily chart in Figure 9.13. You will notice the size of the intraday move it made. One such trade in a month can change the entire look of a trader's monthly P&L statement.

Figure 9.13: **Tech stocks get trumped. Tech Mahindra stock moves from ₹ 486 to ₹ 425 within a day. It's a range bound market, and this was a breakdown from the lower end of the range.**

It wasn't just Tech Mahindra, though. All the Indian IT stocks were under pressure and you could have picked any of the multiple movers at that time. Or, you could have even traded the index. See the IT index chart in Figure 9.14.

Figure 9.14: **IT Index in the dumps, courtesy President Trump.**

On 13 February 2017, Bank of Baroda announced poor quarterly numbers. The stock fell sharply intraday, right from a morning gap down. Now if you see the entire context you will easily understand why. By applying weekly pivots, you will see that the move during the day was entirely below the weekly pivot. Also, the stock had already moved significantly higher before the results. Consequently, it was already too far from its 20MA line on daily charts.

You may be trading the right side of the charts but you should still have a look at the left side because that's how you get to grasp the entire context. Have a look at the charts of Bank of Baroda, both daily chart (Figure 9.15) and intraday chart (Figure 9.16). The stock kept falling on subsequent days as well, till it found support at the 200MA line on the daily charts.

Figure 9.15: **Daily chart of Bank of Baroda providing the larger picture, and showing the larger move as well, along with weekly pivots.**

Figure 9.16: **Here's the resultant impact on Bank of Baroda brought out by this intraday chart. It had earlier been flying for many days.**

Remember that song in Raj Kapoor's autobiographical film, Mera Naam Joker — *Aye bhai, zara dekh ke chalo . . . aagey hi nahi pichey bhi . . . daayein hi nahi baayein bhi* — Hey brother, mind your step; look not just upward but down as well, not just left, look right, too.

Talking of news events and their impact on price charts, how can we ignore the chart of Bank Nifty on one of the year's biggest days, the Budget Day on 1 February 2017. As the budget speech was being read out, the stock market waited patiently doing nothing very much, checking for unexpected surprises or shocks. The market was already under pressure post demonetisation, and was looking forward to some relief. It was keenly watching if the government woud resort to a politically popular budget or take the bolder steps required for the economy's growth. When all seemed to have gone well, the market made up its mind. As soon as the speech was over, the market started moving higher as the lack of any bad news was deemed good news, good enough to trigger a rally! There was a sizeable breakout from the previous day's lows in the indices and related stocks post the finance minster's budget speech. This is illustrated by the Bank Nifty chart for the budget day 2017 in Figure 9.17.

Figure 9.17: **Massive move!!! Budget bonanza for Bank Nifty on 1 February 2017 due to favourable Budget news.**

Knowing the entire context also tells you when to follow the wellknown trading adage — buy the rumour, sell the facts. Let us once again take the example of Idea. Since the news of its possible merger with Vodafone, the stock had already risen much higher. On the day when the merger was actually announced, the stock was done and over with the rise and, in fact, it fell big time from the day's opening highs. Once it broke the levels of ₹ 106, it was below the low of the entire previous month. A minor pullback effort was sold into as well. We had even suggested a short trade in this stock on live television while the move was unfolding real time in the market. The move did not end with that day's action but went on and on. By May 2017, the stock reached levels of ₹ 74. Have a look, first at the build-up before the merger on higher time frame in Figure 9.18, and the intraday chart of the merger day, 20 March 2017, in Figure 9.19.

Figure 9.18: **This daily chart of idea gives the full month's view, and thus the full context.**

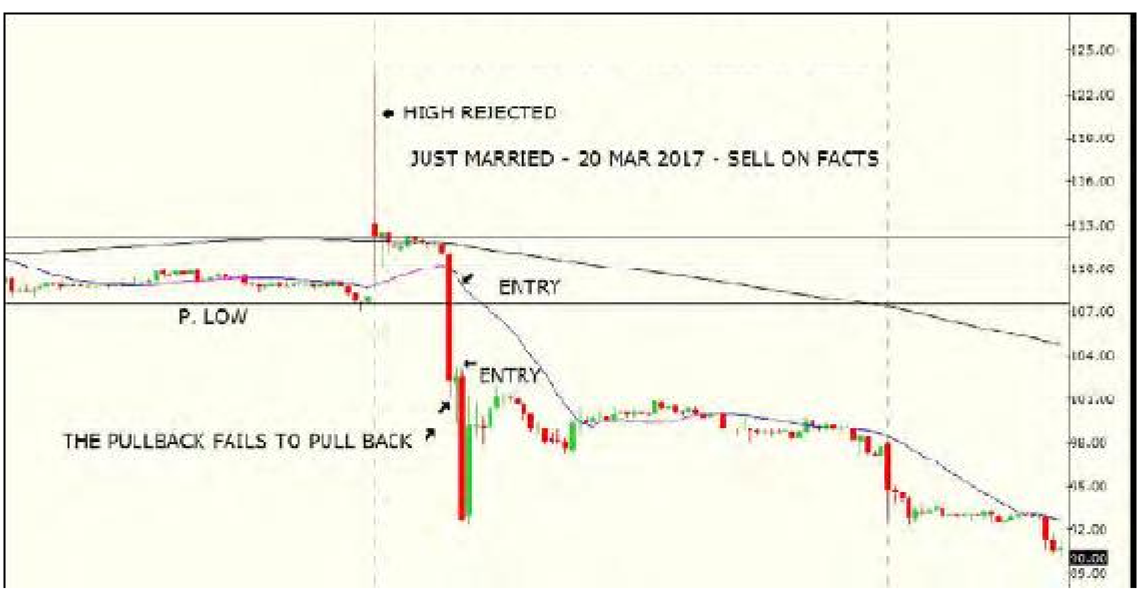

Figure 9.19: **Buy on rumour, sell on fact is borne out in this intraday chart of Idea. This is a detailed view for a short trade.**

Early in 2017, tyres stocks had been moving higher over many days on hopes of the government levying anti-dumping duties on imported tyres. As the time approached for the actual event, the stocks that had already run ahead started correcting significantly intraday on 28 March. Also, the market now began to believe that tyre makers did not actually have a strong case for anti-dumping duty as the price difference between the tyres being sold by Chinese manufacturers and Indian players was not big enough. As technical traders, this price reaction was bound to happen. It is like Newton's Law, after all. Even if duty had been levied, stocks that were over-stretched would have corrected anyway (*see* Figure 9.20). But the news would definitely tell us when, and that can change the game. We can make the most of it by trading the stock on the given day. There was constant discussion on the media about this.

Figure 9.20: **Newton's Law — what goes up, comes down; news plus the chart is what tells us when and by how much. What more do we want? MRF intraday chart is shown here. The price fails to rise above R1 and then again fails to rise above the pivot, a clear sign of fall ahead for the day.**

News Based Trading in Context

We do not suggest taking a trade based only on news. What we are saying is that the greater the number of factors in your favour, higher the chances of your success. The technicals of the market should, of course, always be verified before taking a plunge. There will be times when the news will not make the expected impact on the stock price. That is why you must see what is happening at the market opening and only then take your call, and do so always with a strict stop loss.

People who believe in trading stocks that are "hot and happening" should also keep a watch on the day's action during market hours. Each day there will be sectors that will be active. There would also be smaller groups of stocks belonging to a particular industry group which could be finding favour with the market. Very often all stocks belonging to the sector of the day give trades in the same direction. Market scanning will always tell you about the industries or groups in action.

On a given day there may be high interest among market players in, say, leather stocks, or in tea stocks, in airlines industry, or in tyre stocks, in textile stocks, or in sugar stocks. If you keep a close watch on the day's action, you will not miss out such moves. All it requires is presence of mind and quickness in action. If you have done your pre-market preparation in a proper way, you would also be aware of the higher time frame chart patterns of these categories. If everything is falling in place simultaneously, you can expect a magnified move in that stock. Check out the examples in Figures 9.21, 9.22 and 9.23. Each is from the "hot sector" of the particular day.

Figure 9.21: **All NBFCs were strong on this day. The intraday chart of Bharat Finance is shown here. The daily time frame chart of the stock also showed important breakout as on 17 February 2017.**

Figure 9.22: **This intraday chart of DHFL shows the price move from ₹ 300 to ₹ 325 within a few hours; a big move indeed. This was on 17 February 2017. There was sectoral support for NBFCs, all of whom were moving higher together. By May 2017, DHFL touched ₹ 450, without any interim fall.**

Figure 9.23: **In March 2017, PNB rose along with all PSU banks after the Finance Minister spoke in his Budget 2017 speech of some imminent solution to the NPA issue between the banks and RBI. This sector also demonstrated general sectoral strength; PNB touched ₹ 185 by May, nearly doubling from its end-March level without any midway correction below these levels.**

Spill-Over Impact of News on Related Stocks

Very often news relating to a particular company also impacts other stocks belonging to the same industry group.

For example, because one stock from a sector fared well from demonetisation, it would be reasonable assume that other stocks belonging to the same sector may also have been spared from its adverse impact. Thus, when there were good results from Titan post demonetisation, there was a big surge in PC Jeweller as well, as you can see from the charts of these two companies in Figures 9.24 and 9.25, respectively.

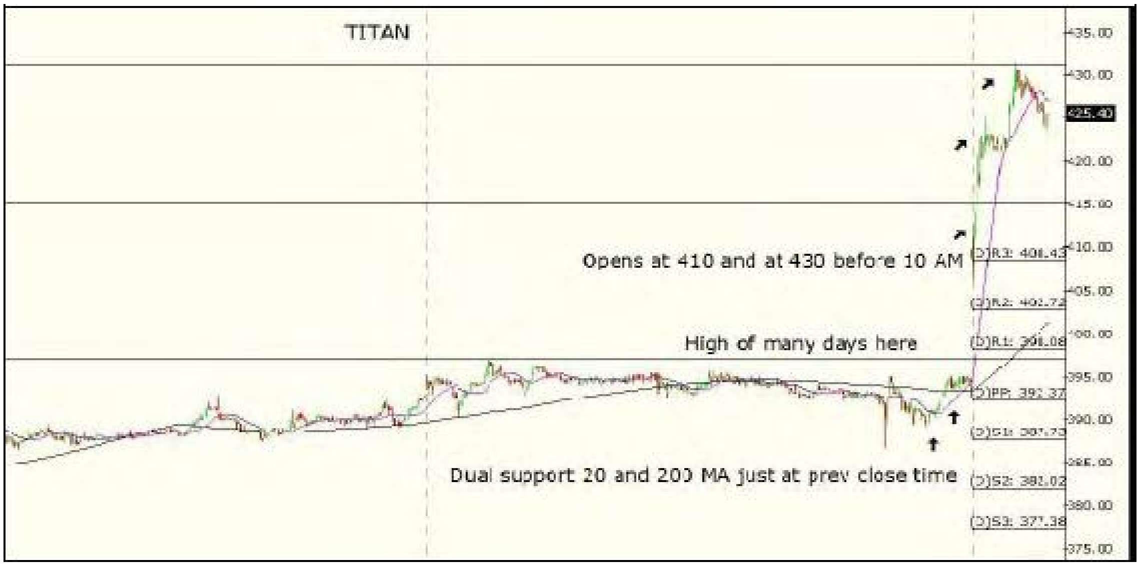

Figure 9.24: **Its time to shrug off the demonetisation blues, says Titan.**

Figure 9.25: **See the rub-off effect: the price of PC Jeweller rises in anticipation of lower than expected adverse impact of demonetisation on jewellery companies, after seeing good results from Titan.**

When Sun TV heaved a sigh of relief in its legal battle, Raj TV rose up 10% for no reason of its own. That's how this rub-off effect works.

When the market got news of Idea's merger with Vodafone, we also saw a big move in Bharti Airtel. Let's have a look at spill-over impact of news on related stocks through some real examples.

Bharti saw a big surge on the day the news broke of Idea's merger with Vodafone as depicted by the chart in Figure 9.26 which shows how on that single day the stock moved above the high of the entire month.

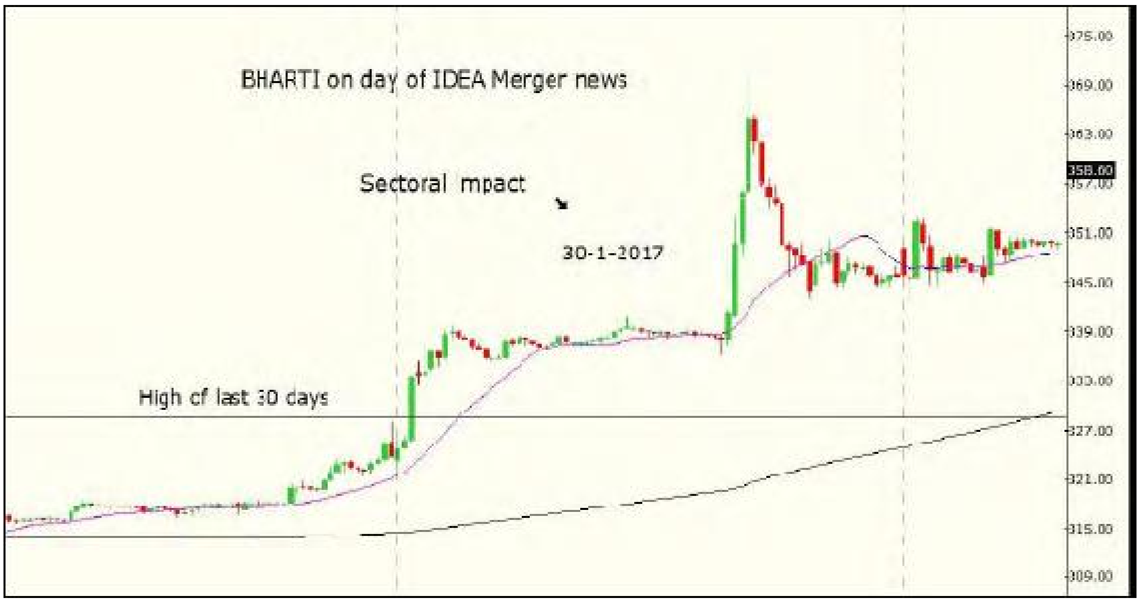

Figure 9.26: **Bharti Airtel tags along with Idea on the big announcement of the latter's impending merger. That's the sectoral impact of news on related companies.**

Figure 9.27: **Sectoral rub-off impact: Infosys surges ahead on buyback news in Tech Mahindra.**

Similarly, when there was news of a buyback in Tech Mahindra, even Infosys saw a big move intraday. The stock opened with a big gap early morning, and it moved higher after a bit of sideways movement. In the process, it broke above its previous high and range and stayed above all the MA lines, as illustrated in Figure 9.27.

Keeping the larger context in view also includes paying closer attention when a ripe trade setup appears on higher time frame charts. It can give stronger moves that can go on for more than a day. Have a look at India Cements in Figure 9.28.

Figure 9.28: **This daily chart shows a perfect trade setup in India Cements**

How to Read the Market's Reaction to a News Event

We have seen many instances and charts where good news leads to an up move and bad news lead to a down move. Many times, however, markets also do the opposite. Does this mean that the market is not good at reading or discounting events? That is not the case; in fact, markets are always right. Price is the king. Only, we need to learn to interpret it better before passing judgement. It is not without reason that these things happen. The reason may be in the context. If the good or bad news is already built into the price, then it may not move in the expected direction. Instead, you may see a strong reversal in the other direction; namely, a strong up move after a bad news break, or a strong down move after good news.

Let us consider two examples and see how and why this happens.

Auro Pharma was hit by bad news in the form of muted results in May 2017 as its products faced pricing pressure in the US and EU markets. Also, the pharma sector had already been beaten down since long. Post the results, the stock rose 10% intraday. That reaction from the market was a clear sign of a negative event already having been priced in. The force of the upward turn was visible from early morning. We had mentioned on television during that day's pre-market analysis that we expected the stock to close in the green, even if it opened gap down. For an alert trader, this stock should already have been on the radar. The move gave many entry opportunities during the day as depicted in the chart in Figure 9.29.

Figure 9.29: **Aurobindo Pharma chart shows entry around R1 when it turns into a support during a pullback. Another few entries around R2 are visible as well.**

The next example is that of Jet Airways (*see* Figure 9.30). The company announced pathetic quarterly results with its profit nosediving on the back of low airfares and high fuel costs. But all of it was already priced in and the stock behaved in a similar way as the earlier example. It did gap down at the open, only to reverse sharply and close higher for the day as shown in Figure 9.30. It is not that you will realise this happening only at the end of the day. The price behaviour will alert you before the opportunity is lost, provided you know both the context and your stock. As you can see, the price action on the chart says it all.

Figure 9.30: **Jet Airways intraday chart shows that the first trade was available when the price moved above the first candle, with stop loss below the candle — and a target of ₹ 463-₹ 471. The next trade signal appeared when there was a pull-back towards the central pivot point. It held the pivot, and moved further, even rising above the 20MA and 200MA lines.**

Trade entries in Jet Airways were available during the day. The initial sharp move was a snap back towards the overhead 200MA line which coincided with R1, after the price grew over-stretched on the downside. After that, the price started respecting the pivot and the 20MA line. That was another sign for a long trade. The snap back could be estimated even from the higher time frame chart, which is shown in Figure 9.31.

Figure 9.31: **Triggered by the result, the daily chart of Jet Airways showing the snap back effort from monthly S2 level towards S1, all within a day.**

Even a week later, both these stocks — Auro Pharma and Jet Airways — were ruling higher from the levels discussed in these charts.

If you have bought a rumour, you sell the fact. If you had sold the rumour, you buy the fact.

How to Get the Best Out of Business TV

In school and college we are taught about differentiating between facts, opinions and views. That is one lesson which a trader must use every single day. It should get deeply ingrained in you; it will help your trades immensely. If you are an aspiring trader, you will be watching business news on television on a regular basis. There are also Internet websites and various mobile applications along with social media that keep bombarding us with essential as well as useless information. It is crucial that you know how to separate the wheat from the chaff. Otherwise, you shall simply confuse yourself — and even damage your trading account.

There will be a large number of television experts and media analysts doing their own research and presenting large amounts of information on a daily basis. Your job is to separate facts from opinions and views. You may want to go by someone's opinion whom you strongly believe in, but even that doesn't mean you ignore the charts. Charts are the distilled view of the entire market. There's nothing wrong in listening to opinions as opinions, but you must also know how to analyse an opinion. An independent trader would also prefer using facts from the media as triggers for his or her own analysis and, finally, go by the charts. Of course, one must always check the larger time context while analysing all such triggers.

Milestones Covered

In this chapter we have discussed intraday trading using events and news as catalysts. The best trades occur when the news and the technicals join hands. Nothing in this universe works in isolation, and the same applies to charts as well. Also, no matter how good a trade setup looks on a particular chart for a long trade, if there is overnight bad news about it, the trade may not work out well. It makes sense staying alert to all kinds of market events.

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Next we will address one of the major issues faced by traders — traps. Short term traders often get trapped on the wrong side of the market. With leverage, the traps get more painful. The next chapter teaches you how not to get trapped. Not just that, but how to also actually encash situations in which others are trapped!

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Chapter 10

How to Profit from Traps

He was an honest police officer. He was loyal, dedicated and hard-working. Everyone trusted him and he enjoyed great credibility. He always acted from a level of professional expertise and experience and had a well balanced mind. He could successfully read the minds of criminals and knew exactly how to tackle and control them.

In one particular case, however, he reacted emotionally. When he discovered that his own family had been wiped out by an outlaw, he reacted impulsively and without any strategy. He went after the killer but took neither any weapons nor his team along. He failed to read both the situation and the enemy's strength. He failed to control his own emotions. What happened? He got trapped and lost the battle to the sharp, agile and opportunistic enemy. He got chopped and lost his arms, an irreversible loss caused by an action that was made without preparation.

An emotionally wrought Thakur is caught unprepared in the Bollywood classic, *Sholay*

In fact, it was a reaction based on sentiment rather than strategy. He got himself trapped so quickly and easily, one would say he voluntarily went ahead and offered himself.

This is the story of Thakur in the bollywood blockbuster, Sholay. *The enemy was the highly popular super-star villain, Gabbar.*

Thakur should have realised that capturing the unarmed Gabbar, isolated and without his gang and weapons, was one thing. Going after Gabbar in the latter's territory without a police force or weapons, quite another. As the challenges differ, the strategies should also be modified. Acting out of emotion against such a powerful outlaw was an unforgivable crime. He paid the price.

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The situation in the markets keeps changing from hour to hour, and even minute to minute. If you fail to read and interpret the situation and fail to strategize and act accordingly, the all-powerful market will chop you out with ease.

A smart trader should not just keep himself safe, but must also find opportunities to profit. He should encash from the emotional frailty of others while keeping his own emotions under control. The day he fails to do so, he gets trapped. Let us now consider the various situations arising in the market which trap traders. We will understand how such setups look, and learn how to trade them.

What is a Trap?

Basically, a trap is a false signal that suggests that the market is moving in one direction when it is actually going to head in the other.

A chart pattern that suggests that the current uptrend has ended will inevitably invite participants to come in with shorts. If this signal is false, they will soon get trapped as the market continues to rise. Conversely, long players will get trapped when there appears a false signal suggesting reversal from down to up. Those who enter assuming that they have cracked a deal at cheaper valuations will be left scratching their heads as the market continues to fall further. Then, again, there are times when market players expect the trend to continue, but the trend actually reverses. That is also a trap situation. At other times, when players are expecting a reversal, the trend stays put.

All such market traps come with big rewards for those who can read them correctly, and with bigger punishments for those who don't. These can be very powerful moves and can give instantaneous rewards to F&O players. If you find yourself trapped, and if you go on averaging or praying, then you are inviting disaster. Markets can be like wild beasts, they can charge much beyond our imagination. Trying to control a market is a waste of time, money and energy.

The market can lay its traps in various forms; we will consider each type, and see how to use them to our benefits.

Trap Trading Technique 1: Ranging Markets

When the market has been moving sideways for a few days, it puts in place a clear high and low of the range. The best trade one can take at such times is to play against the boundaries when the price hits any one of the boundary levels. Traders can go short at the top — and go long from the lower boundary of the range.

There are times when the market, or the stock concerned, makes an abortive effort to break through one of the boundaries. If the market fails to see any follow-through after the breakout, it leads to a breakout failure. Say, the market tried to break out above the upper boundary and several players entered long in anticipation of higher levels. Their stop losses would be either inside or around the boundary. If the price fails to move higher and instead loiters around or corrects, their stop losses may get triggered. These players are then trapped by the failed upside breakout. It was a false signal and they fell prey to it. When the upside breakout fails, and as the trapped long players dump their holdings, the price may see a free fall and soon reach the other side of the range.

Conversely, had the market broken down past the lower boundary, some players might immediately short the market at the breakdown levels. If the market then immediately sees buyers come in and pull the price back up higher, those short players would get trapped. When the trapped shorts then run for cover, the price rises sharply. Thus, failed range breakouts and breakdowns lead to sharp surges and sudden plunges which create huge fear and emotions.

When you see such trade setups, you can make a good trade provided you know how to play it. The reason is very simple. As an F&O player, you would always want your scrip to fire in your direction as soon as you enter. Your time horizon is extremely short term, which is why there is a definite sense of urgency amongst F&O players. Fear is a stronger emotion than greed and scared bears create bigger upsurges in shorter periods. So, don't underestimate the power that traps come with. Similarly, scared bulls create sharper knock down moves in short time spans. That is how the derivatives markets work. It takes trapped shorts to take markets sharply higher, and it takes trapped longs to bring the markets sharply lower.

Stock markets are ruthless and merciless and one person's loss is another's gain. **So when you see a failed breakout in one direction in a range bound market, you can take a trade in the other direction. This is our Trap Trading Technique 1.**

Let us look at some examples of markets with clearly defined boundaries with failed breakouts immediately leading to big moves on the other side. Let's first consider the charts of the two major indices Nifty as well as Bank Nifty given in Figure 10.1 and Figure 10.2, respectively.

Figure 10.1: **Nifty's chart on the expiry day for March 2017 series shows that it stayed in a tight range throughout the day. After breaking the lower boundary, it jumped rapidly to the other end. Rejected lower levels followed by strong bullish candles at the strong location of the 200MA line all combine to make things clear. The same thing happens again at the top end, and Nifty falls rapidly to the lower end. It rises again, and this time it breaks above the earlier highs.**

Figure 10.2: **Bank Nifty chart clearly shows the impact of traps. Bank Nifty breaks below the low of the entire day, after having stayed in a tight range through the day. The mood of the participants soon saw a swing and it immediately turns super bullish. Again, we have a**

combination here of multiple factors, including rejection candles, followed by a giant green candle. This combination is present at the strong location of 200MA, and it appears at an important time in the second half of market hours.

Let us consider one more example of Bank Nifty which is shown in Figure 10.3; again, it is a ranging market.

Figure 10.3: **Another example of classic traps in range bound markets. Look at how a temporary piercing of boundaries with no follow through leads Bank Nifty to the other end of the range. Also note a break above R1 and morning high which doesn't sustain.**

The next chart of Nifty in Figure 10.4 shows a failed breakout leading to a breakdown. That did not, however, mean a downtrend. Therefore, those who shorted Nifty and refused to change their opinions in line with the changing chart got trapped on the other side of the market later in the day when the index respected the lower boundary and went higher in the second half. Shorts should have booked out when the lower boundary got respected.

Figure 10.4: **On 13 February 2017, Nifty tries to rise right at the open but even the early morning momentum fails to take it above the earlier range, spelling doom for the longs.**

All these traps and the resultant trades are a part of Trap Trading Technique 1. **Index traders must study these charts very closely because indices remain within ranges very often.**

Trade plays such as these keep occurring so long as the index or the scrip stays range bound. Basically, breakthrough rejection at one end leads to a rapid move to the other end of the range due to the fear factor.

This type of a trap, where markets try to go higher or lower but fail to decisively cross the range boundaries is particularly common in Nifty and Bank Nifty. Consequently, an understanding of this trap is very important for you if you are an index trader. Indices have a high tendency of getting into, and staying within, a range every now and then. They may often threaten to break out but end up staying within the range for far longer than we may think. Also, there can be several failed attempts before an actual breakout occurs.

You can trade profitably using this technique. All the other trading techniques that we will discuss in this chapter should also be useful to those who prefer to trade only a limited number of stocks, say two or three, throughout the year.

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Fear creates panicked reactions among those who are trapped. It provides an opportunity to cheer for savvy traders, for those who know how to play the game. The chart in Figure 10.5 illustrates the same trap in the case of the Tata Motors stock.

Figure 10.5: **Excellent intraday trading opportunities on both sides in a range bound Tata Motors. The day begins with a long entry from the bottom of the range, where a gap down gives a good entry. There is a clear rejection of this up move in the second half of the day — and that gives another trade, this time on the short side as shown. Many might have got trapped assuming it to be a genuine breakout above the upper end of the range. A flat MA line confirms the sideways move. The stock moves to the lower end again before 3:30 P.M.**

Trap Trading Technique 2: Correction Ends and the Trend Resumes

The scorching summer days of 7 April and 10 April 2017 saw the Nifty fall rapidly from around 9,280 to 9,180. At that time, many might have thought that it was hot enough to start using shorts (pun intended)! But the market wasn't having any of it and changed its mind. It went higher, again trapping those who could not see the trap — and those who did not read this book!

The *uttar* (answer) that the Modi government gave to the entire desh (country) by its landslide victory in Uttar Pradesh elections in mid-March 2017 had started the run that was not going to stop so easily. So the thing to do was to stay with the trend till it stayed with you. Midway corrections like the one mentioned above shouldn't be taken as a change of trend, and one must stay alert to any signs of trend resumption and be thankful for a lower level entry. Those who failed to read this on the charts were the ones who got trapped.

Well, all the traps may not necessarily arise from a sideways range. In April 2017, for example, the market had been surging higher and it was clearly a trending period as can be see in Figure 10.6. After a minor correction in the previous two days, Nifty opened gap down early morning on 7 April, and went even lower as well. It then found support at an important location and resumed its move. When you look left, and trade right, you will really trade right. Always also focus on the context or the larger picture.

Figure 10.6: **Nifty opens lower but soon changes its mind after a temporary piercing of the previous day's low, marking the end of the correction for the day, and the resumption of the uptrend. As intraday traders, we are interested in today's action. If you understood what was happening, you would go long and earn from those who got trapped. If not, you get hunted by**

those who do. Please note how viciously the price breaks above the overhead 200MA line at the third attempt.

Markets opened gap down but that turned out to be a buying opportunity — look at the sharp surge after that.

The lower low put an abrupt end to the ongoing correction in an uptrending Nifty, ending the counter trend move and the uptrend resumes. We also knew that Bank Nifty had stayed stronger even while Nifty corrected, so there was again support from there. Such an analysis increases your conviction. This situation, wherein the counter trend move ends in a trap and the earlier trend then resumes, leads to our Trap Trading Technique 2. If you fail to see the resumption of the trend, you will keep entering on the wrong side, and keep getting trapped in the process. This trade is described in Figure 10.6 and Figure 10.7.

Figure 10.7: **The same move as in Figure 10.6, shown here with reference to the previous days. Nifty's level of 9,200 had strong support, the level where the counter trend ended and the main uptrend resumed, trapping the shorts.**

Such moves happen in individual stocks as well and provide excellent intraday trading opportunities to the alert trader. The next few examples focus on individual stocks *(see* Figures 10.8, 10.9 and 10.10).

Figure 10.8: **Bharat Forge forms lower lows in the early part of the day, which puts an end to the ongoing correction from the previous day in an otherwise uptrending stock. The uptrend resumes later and gives a sharp surge.**

You get trapped if you fail to understand the changing landscape, and if you refuse to accept or acknowledge the prior trend's resumption.

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An example of MRF Tyres is next in line (*see* Figure 10.9). One strong day of counter trend move, another lower opening, and the buyers eagerly return. We often wait for lower prices to enter a strong uptrend. We often wait for corrections as well but when one finally appears, we often shy away from buying. Can you relate to this from your own experience? Think about it; what's the point of waiting for a correction then? You must learn to understand the market better, be thankful of those lower levels, and learn to make a quick buck as the trend resumes.

Figure: 10.9: **MRF Tyres forms a lower low which doesn't sustain, and the uptrend soon resumes.**

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A similar move was seen in Apollo Tyres (*see* Figure 10.10) on 28 and 29 March 2017. This was caused by the previous day's shorts which provided the fuel required to get a sharp surge when the shorts found no follow through. And that's precisely what we are interested in. Just a day of correction and the trend is on again. We are interested not just in staying away from traps but also in making money from people who get trapped, right?

Figure 10.10: **Apollo Tyres regains the uptrend after a sharp correction with an equally smart resumption the very next morning. The gap down opening soon finds support. It takes flexibility and agility to stay away from getting trapped in these moves.**

The presence of shorts can be noted either from rejection candles, or even from large green candles that take out large red candles. The appearance of such candles should ring a bell. And when you combine these with the location, timing and the context, then you get to catch the right moves. A large candle that fails to see a follow through and instead sees an opposite coloured large candle could well be a trap.

Here are the right ways to save yourself from traps and actually profit from them:

- Keeping an eye on the larger picture, or the bigger context.
- Staying humble, flexible and nimble.
- And accepting the market as the master.

Many times the corrective moves that go on for more than a day or two can mislead you into believing that the trend has changed. But as the price approaches support levels on higher time frames, such moves have a strong chance of resumption. If you have done your pre-market preparation well, you should be able to immediately notice it in real time as it happens. If not, then you may remain biased on the wrong side, especially under the pressure of running markets. That is why prior preparation is absolute necessary.

The next few examples focus on individual stocks along with their larger time frame picture. You can see how, almost magically, the price moves in all the examples. Do study these charts and examples closely.

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Looking at the context will help you understand why you saw a sharp surge in Jet Airways *(see* Figure 10.11).

Figure 10.11: **After a correction on the previous day, the Jet Airways stock soon finds support as lower prices get rejected, and there you go . . . zip, zap, zoom!!**

Now let's again have a look at the Jet Airways chart in Figure 10.12.

Figure 10.12: **The daily chart of Jet Airways tells you that you must go long and exit shorts, if any, as the price bounces back up from the previous close.**

Now let's have a look at the charts of Sun TV in Figures 10.13 and 10.14.

Figure 10.13: **A sharp surge in Sun TV intraday, rejection of the lower level after a three-day fall and the trend resumes. Those who got in last and refused to accept what the market tried to say, got trapped.**

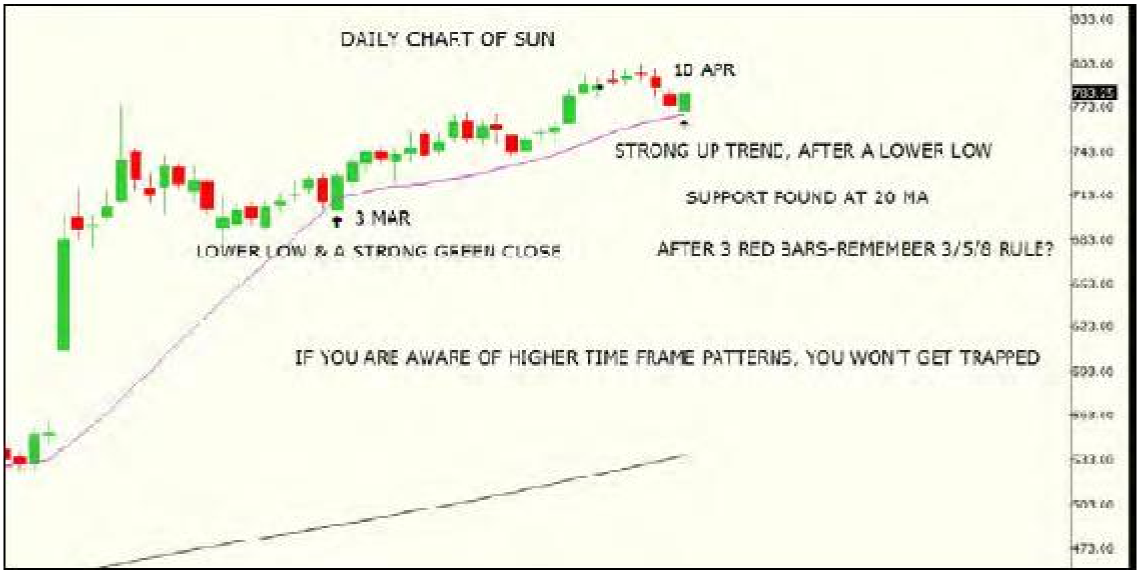

Figure 10.14: **A glance at the higher time frame daily chart of Sun TV would have told you to be ready if you intended to trade the scrip long. The setup looked solid.**

In addition to the rejection candle and the strong trending bar, there is another method of recognising a trap being laid. When you see a strong counter trend bar, start following it closely. If the trend is say, up, watch out for the appearance of a red candle. If the candle after the red candle makes a lower low but fails to close at the lower end and instead closes green, that should ring an alarm bell. This forms the setup. It may not have a large body or a long tail, but that is fine. This second candle is the setup candle. Now, if the third candle also makes a move in the direction of the trend which is up, then it is time to enter in that direction. See the example of Ceat Tyres chart in Figure 10.15.

Figure 10.15: **This daily chart of Ceat Tyres shows the technique just explained. The ongoing uptrend is halted and reversed by the big red Candle 1. Candle 2 then goes lower but closes higher, and is a green candle. Candle 3 is again a green candle and closes still higher. This marks the resumption of the original uptrend. You enter at Candle 3. If you are aware of these behavioural patterns of the market, you can encash them even as others get trapped.**

The chart in Figure 10.16 shows how the correction in Dish TV stops at the limit of 50%, and the original trend then resumes. If you have done your homework, you can earn from this kind of a move. If not, you get trapped. Have a look at the wonderful intraday opportunity arising for the alert trader. Also review the higher time frame chart of Dish TV in Figure 10.17, which tells you what is going on as Dish TV dishes out good intraday returns.

Figure 10.16: **Dish TV dishes out a superb intraday move.**

Figure 10.17: **The higher time frame daily chart of Dish TV shows how support comes in at around 50% correction level of the previous upsurge. Remember our 50% rule? The trend then sustains itself. These are the various ways in which a trend resumes, the correction ends, and there appear traps for those who don't read good books!**

Next, let's consider the example of Escorts. A strong uptrend faces a midway correction for 3 to 4 days, which ends exactly at a strong support level from where the trend fires up again. Have a look at both the intraday chart in Fig-ure 10.18 and the setup on the higher time frame daily chart in Figure 10.19.

Figure 10.18: **This is the intraday chart of Escorts. Look how the previous lows are sustained and the stock fires up in top gear after a rejection of the lower levels.**

Figure 10.19: **Escorts on daily chart. The counter trend ends at the 20MA line and the strong uptrend resumes. Perfect setup.**

Trap Trading Technique 3: Trend Ends, Correction Begins

If you enter a trade far away from the MA lines, and hold on stubbornly even when the price reverses then you contribute to wealth building — not yours, but of others.

Many times trends that run too hard and too fast may end as a trap, and that usually occurs during the last leg of a move. The participants who enter late and stay in stubborn may end up holding the baby. Thus, if you entered last and if you refuse to bend, then you are the one who is trapped. Stay cautious, or pay the price.

Have a look at the chart in Figure 10.20. The fall in Delta Corp began from around ₹ 200 in April, and by the end of May it touched levels of ₹ 140, that's a full 25% erosion.

Figure 10.20: **Delta Corp's daily chart shows the price extending far above the MA line to about ₹ 220. Those who bought at those higher levels were trapped when the price turned lower from there. Prices fell all the way to about ₹ 140- 150 by the end of May.**

The chart in Figure 10.21 is Delta Corp's intraday chart, which shows one of the ways in which an ongoing trend gets temporarily countered. If the trader fails to see this halt, he gets trapped. This halt can come about in various other ways as well:

- It can happen with the market opening with an upside gap that eventually works as a final blow out. The trend then immediately reverses and the scrip closes lower that very day.
- Or, it can also come about by way of giant candles that lead to the final leg of the move during the day, post which the trend begins to correct. This may lead to the formation of a top tail.

The event is the same; its unfolding may reveal itself in various ways. A trader should be able to recognise it as it unfolds so that he can save himself from any trap. And even profit from it!

Figure 10.21: **On 5 April 2017, Delta Corp got hammered down after an unsuccessful struggle to rise in the first half of the day. The price fell from ₹ 218 to ₹ 202 within the day. If you were among those trapped by the price move in Figure 10.20, you proved to be a generous donor for others!**

What is important is the location and the context. When you combine all the factors, that's when you catch the right moves and avoid the wrong ones. Let's consider the chart of Nifty Bank in Figure 10.22. This up move had been going on for many weeks. A smart trader having a finger on the market's pulse will definitely get the feel as and when the move ends. He can recognise the final surge and can exit before the price reverses.

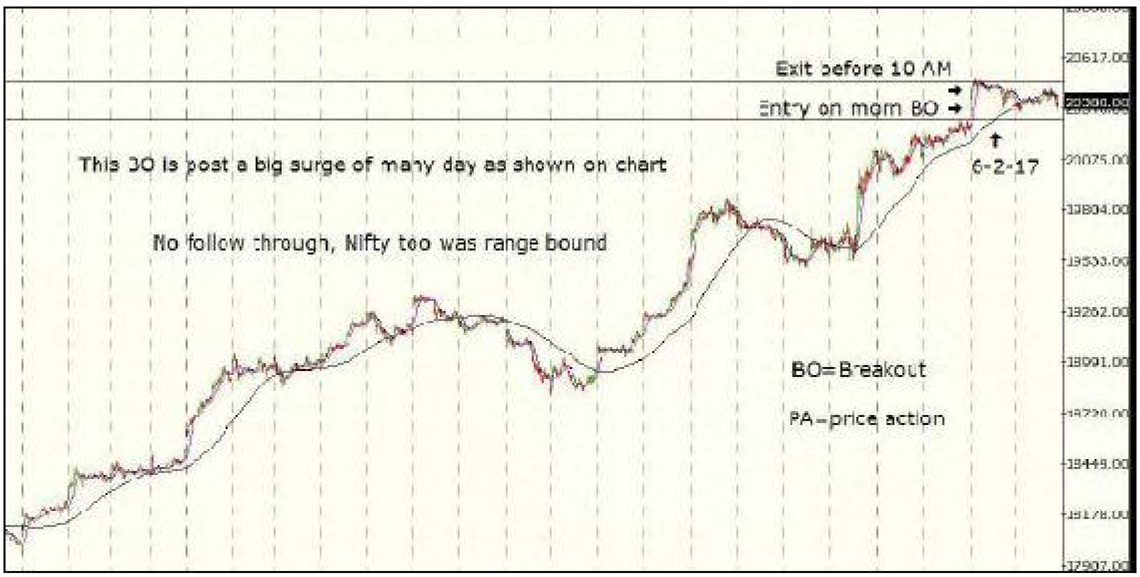

Figure 10.22: **After a major move over several previous days, an additional gap up is normally a bonus. Post that, if the scrip starts loitering around, as is the case in this chart of Nifty Bank, it makes sense to book out. You can re-enter later, if warranted.**

Of course, trap trading won't always work. Nothing ever does. There will be times when the markets will keep trapping players on both sides. There's nothing to be done at such times except stepping aside fast. Or, you look for trade opportunities elsewhere.

The chart of GAIL in Figure 10.23 shows traps on both sides. It is futile to try to make money in such a situation. You will keep getting chopped either way.

Figure 10.23: **GAIL made a futile attempt to breakdown earlier in the day. It then makes equally futile attempts to rise. But equal number of red bars with long top tails would scare any player — and trap many.**

Is it Wise to Buy after a Significant Decline?

Often when a stock falls sharply, traders feel shy of buying it even after strong signals and signs of trend resumption. Should one ignore and forget these trades? Or, are there significant opportunities in such situations? Thus, should one buy or not after big falls? This is an issue traders face almost daily.

Here is our take:

1. Yes you can buy after a significant decline, and there are methods of doing so profitably. Once you know those methods, you can get better entries with bigger corrections. Those could then become entries with lower risk and higher reward.
2. Nothing works all the time, so don't forget to maintain stops just like with any other strategy.

3. What we are trying to do while buying after deep cuts is being on the same side as the big institutions. The big boys will not buy at highs, they will always buy from deep support levels.
4. These supports could be moving average lines of longer durations, like 50MA or 200MA. Locations and entry events are very crucial and without a strong locational support, you must not buy just because there has been a correction.
5. You must also ensure that you are not entering alone. This can be done when you buy only with a huge turnaround candle. Remember, the giant candles of XXL size? Those are ones you must look for. This is crucial since such candles signify a major sentiment reversal. We are not interested in marginal bars because they don't exhibit strong reversals. Only the big ones do that. This big candle could be enveloping multiple previous candles on its left side on the chart.
6. Your stop loss should be below such a candle and your target should be multiple candles above it.
7. With this method the losses will remain limited to one candle but when you succeed, the winning trade will give you multiple candles. And that's what ultimately makes you a winner. If your system, or any system for that matter, fails twice or thrice, you have to dump it. Nothing works every time and if you keep looking for "perfect" systems, you are destined for a lifelong search! This game is such that you must always be prepared for some losing bets.
8. These strategies can give not just a day trade but a trade that may work for even longer.
9. You can choose to exit when the move reaches a resistance overhead.
10. We are not in any way suggesting you buy while a stock is falling. It is about buying when it turns. That's different.
11. This setup has high chances of getting the shorts trapped. That's what we want, right? The trapped shorts can work as a fuel to fire the futures in your direction with full fervour.

Now, an interesting related question. Do institutions prefer buying from supports or is their strategy more inclined towards buying breakouts? The answer might startle you: Institutions don't look at chart patterns, they create chart patterns.

But we definitely need to look at charts. Let’s consider the charts of Bajaj Finance in Figure 10.24 and Figure 10.25 which illustrate how to buy after deep falls in the manner that we just explained above.

Figure 10.24: **This intraday chart of Bajaj Finance shows where to buy after the giant bullish bar subsequent to a multi-day fall. In the next ten days, the price crosses above ₹ 1,360 levels from about ₹ 1,200 levels.**

The daily chart of Bajaj Finance in Figure 10.25 shows the context on a higher time frame. It shows buying coming in after a significant fall.

Figure 10.25: **The daily chart of Bajaj Finance showing buying after a deep correction pushing the price significantly higher.**

Milestones Covered

In this chapter, we have seen how to trade three types of traps:

- The first type of trap occurs when there are false breakouts and breakdowns in range bound markets.
- The second type of trap occurs when counter trend moves end, and the original trend resumes.
- The third type of trap springs when a trend ends, and the correction begins.

Well, patterns like what we described in the chart of GAIL (Figure 10.23), with traps on both sides, will also occur. Not all trap trading will work. Nevertheless, it helps to understand traps and learn trap trading. Traps are there lurking in the market all the time. Institutions and bigger players are perfectly capable of pushing prices in a way that can trap retail players. They often push orders in one direction, only to immediately reverse the game. They can create and counter huge candles.

Institutions and big players can easily manipulate novice traders and their stop losses and trigger their orders — and then take the markets on the other side. These big bulls and bears are always ready to trap the small players who show a lack of will to learn and exude ego. Learning these patterns can equip you to play in the direction of the institutions, instead of playing head-on against them, allowing them to trap and mutilate you.

Sometimes moves from one end to the other end of a range happen with a huge amount of thrust and big candles. At such times it often appears that we are going to break all boundaries and rush outside the range and keep going further. Actually, nothing of the sort happens and the boundaries remain sustained. Herd mentality can trick you into assuming that a new trend has begun. But after grasping this chapter, you should be able to maintain calm and assess if a breakout is real. This mistake happens more often when the range is reasonably wide. And by the time the scrip reaches the extreme, it may already be exhausted, thus giving no further move.

Markets spend longer time in trading ranges than in trending phases. Markets often push too hard in both directions during range-bound days, and this can easily lead to an illusion of a breakout. Which is why traps appear very often. Only a good grasp of the nature and types of traps can save you from getting trapped. If you are into index trading, or if you prefer trading only a limited number of stocks, then it is imperative that you know how to trade more and more types of situations that will keep appearing in those limited number of charts.

You will often hear the market truism, "Buy low, sell high." But should one always do so? No, not at all. A green candle in a strong downtrend could be an attempt to shake out weaker hands. Buying in such cases without a proper understanding is a perfect recipe for disaster. Many traders who fall prey to such a trap, may go on averaging — thereafter all they can do is to go on praying. Sounds familiar?

Writers at Work

Rachana Vaidya: Sir, Sometimes it takes so long for a breakout to occur, and then the breakout fails. All the patience shown over days goes in vain.

Ashwani Gujral: True. Sometimes even I am left wondering at the market's capricious nature, but then who are we to judge the market. Anything can happen here. So, learn to live with the reality that everything can't be known in advance. Hunting a lion involves tracking its pugmarks.

Chapter 11

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The Trading Power of Confluence

To Indians, and Hindus in particular, the Sangam at Allahabad is a particularly holy and special place. Here the rivers Ganga, Yamuna and Saraswati merge into one. This confluence of north India's rivers is a place of special pilgrimage for Hindus. Similarly, wherever the various tributaries join the holy river Ganga as it flows down the Himalayas, the respective confluences are considered auspicious spots. Much in the same way, any confluence of mutually reinforcing or mutually supportive factors can provide a power boost to stock market moves.

What is a Stock Market Confluence?

In this chapter, we will look at how the various factors combine either in favour of, or against, a particular move — and how that creates a huge impact on the stock's price movement. With the magnified impact of multiple factors, and a confluence of key levels significant, a short term trader's journey becomes much easier and smoother. At such a confluence, the stock may fire up or down more smoothly — and the run may also be much longer.

A confluence of factors is said to occur when more than one tool, or more than one time frame chart, show nearly the same price levels as being key areas of support or resistance. When nearly the same price levels are seen as key areas, the strength of those levels gets hugely magnified. If those levels hold, any resultant move starting from there may really be a big one. Should those levels be broken, on the other hand, the results could be equally shattering. In case the levels are emerging from varying time frames, as well as from various tools, that's still better because then it's an even stronger confluence. So there can be a confluence of multiple tools, of multiple time frames, between news events and candle patterns, or between locations and events, etc.

Say, the moving averages and pivots show resistance at a similar level. Or, say, intraday pivots and weekly or monthly pivots show support at similar levels. In either case, you can expect more action or participation from around those levels. If you are lucky, you may also get the backing of a news event that acts as a catalyst and adds to the significance of those levels; that, then, is icing on the cake. You may often get to see rocketing moves from such levels, and at such times. In trading parlance, that's the time to go full throttle and make the most of the opportunities on offer.

Undoubtedly, there is charisma to confluence, and added energy in the synergy of factors.

Parameters to be Considered while Studying Confluence

It is important to understand that a confluence does not mean that two levels thrown up by two different tools, or two different time frames, have to exactly coincide. If that happens, so be it. It should suffice even if the two levels are close enough within a tight zone. Remember, supports and resistances are zones, and not exact levels.

Another important point is that the various tools throwing up the same levels should be measuring different parameters. In other words, one must look at tools that use different formulae to calculate these levels. If all of them use similar formulae and/or data points, then their throwing up the same numbers is without much significance.

Equally, a favourable confluence of multiple factors does not imply that you jump into the deep waters without waiting for the appropriate entry trigger, namely an appropriate candle pattern, or without your life jacket, i.e. without stop losses. No matter how strong a signal is, we must continue to follow the rules of the trade. We must also always adhere to our rules of money management and position sizing. Going full throttle doesn't mean trying to swallow more than what you can digest, or what your account size permits you to trade. Yes, there could be minor leeway here and there but there is no question of breaking the boundaries of permissible volumes to trade. We will learn more on money management and position size in Chapter 12.

We will be looking at multiple parameters that combine to create a confluence. Of course, not all of these may necessarily combine in every single chart but when most of these parameters combine in our favour, we can look forward to a Muhammad Ali punch!

Your success will also depend on your ability to filter out the noise. When one looks at so many factors on multiple charts, it's easy to get baffled by the contradictory bullish and bearish signs thrown up by various time frames. The more time you spend studying how all these factors combine simultaneously, the better you become in using them with each passing day.

If you are totally new to pivots, it may be useful to first focus on intraday pivots, and only then start using pivots on multiple time frames, along with other multiple factors. Good things take time. And short cuts can cut you short as Prime Minister Narendra Modi said in one of his speeches. Give it time, before expecting it to give you profits.

Another important point is that a trader must focus on entry signals that appear at highly significant locations. **Always remember that the location comes first, and only then comes the entry signal by way of candle patterns.** If you do not follow this priority, then your trading results are likely to be random.

Our confluence study will consist of the following parameters:

- Floor pivots and moving averages.

- Swing pivots and range highs / lows, etc.
- We will also use daily, weekly and monthly floor pivots.
- We will use 8, 20, 50 and 200 moving average lines.
- In addition, we will use multiple time frame charts, including daily charts, 5-minute, 15-minute, and 60-minute charts.
- The confluence of fundamental news events and technical chart patterns and levels. Sometimes the news might not relate to the specific scrip of your interest but may concern an entire sector that is buzzing with activity. The spill-over effect of some news in one scrip may well fuel a rally in some other scrips belonging to the same sector. This can tell us where to look for a strong move. And that's what matters.
- We will also keep an eye on the initial balance or the morning range that we have earlier discussed. The highs and the lows of these ranges are crucial levels as well.
- As we've learnt, the previous day's close is also an important level to watch.
- We will keep in mind the overall trend as well. We know that moves starting in the direction of the trend have higher odds of success.
- We must, of course, keep the context in mind before taking a plunge. The expected move must be studied in the context of the price action that has been built up over the last few days, or even weeks.
- While looking at the context, you can also look at the multi-day pivot relationships discussed earlier.

Let us now consider several real-life examples, and see how each of them worked out. Let us unravel the power of the power zones created by confluences.

The Era of RERA

The Real Estate Regulation Act (RERA) is an effort to ban the bandit-like behaviour of builders, and to protect home buyers from their bullying.

On 3 May 2017, back from a long market weekend, we were all geared up and charged up to welcome the new era of RERA, that kicked in from 1 May. The new legislation RERA brought along a ray of hope for all home seekers, and a warning signal for defaulting builders. While it would take some time before we get to see the impact of any change, RERA's impact was already visible on D-street since many weeks. The real estate sector was buzzing with great expectations and so were the charts of real estate stocks. Each day brought multiple trading opportunities to choose from. When this sectoral strength, and the catalyst of the RERA news event combined on the charts, we expectedly got a strong intraday move. Of course, its goes without saying that we will trade only the volume that's permitted by our account size and we pull the trigger only when the entry signal appears in our time frame of trading.

Let's consider the two charts of Sobha in Figures 11.1 and 11.2. One of them is the daily chart showing the weekly floor pivot levels and the MA lines. The other is the intraday chart with daily floor pivot levels and other tools like MA lines.

The chart in Figure 11.1 shows that the stock is in a clear uptrend. At the end of April 2017, it completed five days of correction and resumed its uptrend from exactly a rising 20MA line. By itself, this is a very solid trade setup parameter. RERA became effective from 1 May. That added to the overall bullishness in the real estate sector. The trade setup was already ripe for a big up move and the price duly started moving higher on 2 May, as indicated on the chart by the first of the two big green candles. The move took the stock above the weekly pivot and it closed near the weekly R1 of ₹ 395 on Day 1. So this level of around ₹ 395 now also becomes the closing price for the day.

Figure 11.1: **This is the daily chart of Sobha showing 20MA and 200 MA lines, along with weekly pivot levels. The last two big green candles towards the right end of the chart show the first two trading days of May 2017 when the uptrend resumed after 5 days of correction that took place at the end of April.**

Let us now look at what happened the next day through the intraday chart for 3 May in Figure 11.2. The chart shown here is a 15-minute intraday chart with 20MA, 50MA, 200MA lines and intraday floor pivots displayed. For the sake of reference and better understanding, it also shows the previous day's move.

Figure 11.2: **Intraday 15-minute chart of Sobha for 3 May 2017. The price rises from higher time frame support, and closes at the high of the previous day. The second leg of the move takes place after consolidation the next morning.**

The stock consolidates for a good part of the day, a healthy sign after the previous day's strong move. But the price doesn't yield and the move remains sideways, showing that all the selling is getting absorbed. On this day, too, the entire real estate sector was abuzz. The previous day the price had closed in the upper end of the day's range. On the day in question, i.e. 3 May, the price action stayed above the day's pivot. Both these factors point to strength. As the price moves sideways, it also catches up with the 20MA line, and even the 50MA line. Also, this happens exactly around the previous closing level of ₹ 395, which is also the weekly pivot level as noted above. The trade setup again looks perfect for another leg of up move. Sure enough, the stock fires up 6% in the second half. As it moves above ₹ 403, which was the level around where it had consolidated the previous day, it picks up more pace. As it rises above the weekly R1, the next target on the daily chart and weekly pivots would be around ₹ 420 (as shown in the chart), and that's exactly where the stock ended the second day of its up move.

Isn't it magical? If this doesn't mesmerise you, then perhaps trading itself doesn't excite you.

Let's now review the power drivers in this trade. The confluence here is of a news event, plus the context of the previous few weeks, plus sectoral strength, the higher time frame MA support, the higher time frame pivot support, the previous day's close at the top end of the range, and the intraday pivot on Day 2. The more positives there are to a move, the merrier it is for us. At such times you can go full volume and make the most of a benevolent market. Basically, when you get a synergy of more and more factors capable of creating a high impact, that's the time you can expect to see amplified moves.

The best way to trade is by being ready every morning with a background check on the markets as well as your favourite stocks. Study them, and arrive at your own views. Always come in to trade with a thesis, and then see whether the market approves or rejects your thesis. Be willing to take the market's word as final, over and above your own opinion.

The Pharma Sector and the Mighty USA

The next is an example of the pharma company Lupin will help us understand the impact of a confluence of factors with a downward bias and a falling price. Have a look at the daily chart of Lupin in Figure 11.3 which contains monthly pivots and 20MA and 200MA lines. Seeing this larger time frame chart will establish our perspective, and we will be in a better situation to know what to expect.

Figure 11.3: **Daily chart of Lupin shows the stock in a well-defined downtrend. The overhead resistance of a flat 200MA line hovers right above the price, blocking any effort of the price to rise above it. Can you see that long top tail in the middle of the chart?**

The entire pharma sector had been slack and had long been reeling under the US FDA and President Trump's pressure. Added to that was the strength of the rupee, troubling for companies having large foreign exposure. The last candle on the right side of the chart is for 24 April 2017, and that's the one we are analysing. The earlier price action shows that despite making two attempts the stock had not been able to cross above the monthly pivot level of about ₹ 1,460. The stock is also below the 20MA line and that's definitely bearish. The price level of ₹ 1,400 was earlier touched in November and December 2016 when the stock found support there. So that multi-month low is now very crucial and any break below it would signal further trouble. That level also happens to be the S2 level with monthly pivots. If broken, it hints towards S3 as the next support which is around ₹ 1,366, a good 40 points lower. We can expect more weakness if that too gets taken down.

Now let us see what happens on Lupin's 15-minute intraday chart on 24 April (*see* Figure 11.4). The stock was also in focus for news about the company's Goa plant while the sector was in focus due to the use of generic drug names and other regulatory issues along with a debate over the expected quarterly results as well. Thus the entire sector was weak on that given day and that works to our advantage.

Figure 11.4: **Intraday 15-minute chart of Lupin. You will note that the level of ₹ 1,395 also happens to be the weekly S1, below which, as we know, the trend should be considered weak. As you can see that level was taken down right at the start of the day. A minor effort to pull back after the first big red candle seems to be going in vain. The first candle itself was a strong candle, and one would definitely expect more red ahead. In fact, the stock pretty soon gives up S2 as well. It soon reaches the monthly pivot of around ₹ 1,360 discussed earlier and closed the day around there. The move clearly shows how a multi-day low getting broken early gives a bearish sign for the remaining day. It may even signal weakness for many more days to come.**

If you try to decompose this chart further, say into 5-minute time frame, you can get many more locations for entry. The move from ₹ 1,380 to ₹ 1,360 was a clear fall, and it offered a good trade even if you entered later in the day. The stock achieved the target which was S3 on monthly as well as weekly pivots. This was a confluence of sectoral weakness plus pivots over various time frames and the MA line along with a breakdown from a range that was built over multiple months. Clearly, thus, the move was an amplified one. Such moves don't generally die down soon. Nothing is accomplished in one candle as we have learnt earlier, remember? By May end, this stock was at levels around ₹ 1,100, as Lupin's daily chart in Figure 11.5 shows.

Figure 11.5: **The daily chart of Lupin from November 2016; the last candle on the extreme right is of 26 May 2017.**

The Indian pharma sector absolutely refused to rise all through the Nifty up move in 2017, and that continued even on the above mentioned date, 26 May 2017, when Sensex hit 31,000 and Nifty touched 9,600. Even amidst all this euphoria, Lupin was down by 2%. Strong trends don't reverse that easily, that's the point to keep in mind.

Trading on D-Street During the Earnings Season

The next example is from another sector in boom. Through 2017, as the expectations of green shoots in the economy kept making news every day, the infra and related stocks, such as cement, remained hot favourites. Whether the economy was actually seeing green shoots and starting to grow is not our concern here. The point is that if a trending stock also gets the support of good quarterly numbers, then that acts as a catalyst, the icing on the cake.

Let us now consider the example of a premier cement maker ACC and check out how strongly it cemented its relationships with the bulls in an earnings season. The results were good and the stock also received upgrades from rating houses. It also had the advantage of a low volume base, and the numbers fuelled the vision of an infra-rich India in the coming times. Have a look at ACC's intraday chart in Figure 11.6. It has plotted on it the 20MA and 200MA lines and daily pivots as well.

Figure 11.6: **Intraday chart of ACC for 24 April 2017. R1 is around ₹ 1,510, R2 around ₹ 1,525 and R3 around ₹ 1,540. The stock opens strongly with a gap up and closes at the higher end of its range. The first candle itself is an XXL giant sized bullish candle. The next candle, though a red one, doesn't break below 50% of the previous green one. That assures us that the bulls are here to stay, and won't give up. The very next candle was again strong. One could have entered as the initial high gets taken out. That means there's more to go in this move. One could have entered later in the day as well, as shown in the chart.**

The larger time frame context would have revealed another very important factor. As the stock opened with a gap up and moved higher, it also crossed above the high of the last 60 days or so. Also, it had just crossed above the 200MA line on the higher time frame (daily) chart. That was a solid signal for a sharp surge in price some time in the near future, as soon as it finds a reason to do so. The company results worked as the much needed booster and propelled the stock like a rocket, the price rising higher by some 8% to 10% intraday.

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If you really want to make big money, you have to do more than what other traders do. The effort is entirely worthwhile when you see commensurate results, no matter even if you are a small trader. Remember Baahubali's words in the eponymous blockbuster:

Says Baahubali (the strong-armed) "Agar soch pakki hai, toh ek chota sa tinkaa bhi talvaar ban sakta hai — If your resolve is steely, even a reed will work as a sword."

~

Now let's have a look at the daily chart of ACC in Figure 11.7 to review the points that we just discussed above. This coinciding of all pivots and tools, isn't it amazing again? What more could a trader ask for? By mid-May, the price touched ₹ 1,750.

Figure 11.7: **Confluence of factors on the daily chart of ACC with weekly pivots plotted. R1 is at ₹ 1,510, R2 at about ₹ 1,530 and R3 at approximately ₹ 1,540. All these three levels are matching, or overlapping, with the intraday R1, R2 and R3. As each resistance is taken out, it confirms the trend's strength. Above ₹ 1,540, the stock was flying in the open sky. You can see that the stock also moved above the 200MA line.**

The April 2017 march of the bulls continued in May 2017 as well. Among other stocks, traders were going ga-ga over Godrej at that time.

There was news of the company having successfully sold some one thousand homes in its new projects in NCR, Pune and Mumbai. The real estate sector was already buzzing due to the RERA theme. The company is amongst the more reputed players within the real estate sector. The entire sector was higher on this particular day, namely 3 May 2017. Have a lookat the intraday and daily charts in Figure 11.8 and Figure 11.9, respectively. The stock rises intraday from about ₹ 513 to ₹ 586. The good thing was that the morning gap proved digestible. It didn't eat away the better part of the day's move. There were multiple entry points available, and had one entered early in the day and kept trailing the stop loss using one of our trailing techniques — remember 8MA trailing stop loss, for example? — then one could have stayed with the move throughout the day. And when the price starts moving against us, we exit. Simple as that., as you can see in Figure 11.8.

Figure 11.8: **A 5-minute chart of Godrej Properties, with daily pivots and 3 MA lines plotted for 3 May 2017. The stock opens strongly and a minor pullback gets immediately absorbed by the buyers. The very next candle is a giant bullish candle — everyone is going ga-ga over Godrej. Once above R1, the trend is getting stronger and the next level to watch out would be R2 and, then, R3. There isn't even a mild correction anywhere and the stock stays above the tightest moving average line of 8MA. It would have kept you in the trade for most of the move.**

Remember, a rising stock above a rising 8MA line above a rising 20MA line means a fattening bottom line for the trader. Let us also consider the higher time frame chart, and see how the confluence of context, the pivots, the trend and the MA all helped us.

Figure 11.9: **Going ga-ga over the daily chart of Godrej Property with encouraging weekly pivots and 20MA line.**

You can observe in the chart in Figure 11.9 that the stock was rising, and so was the 20MA line, thus showing a good trend. The move had only just started from near the 20MA line support so there could defintely be more to go. The stock started moving higher from a weekly pivot point and closed around the R2 level line. Naturally, what you would next expect was a move to the level of R3 at around ₹ 521, and anything above it would always be welcome. The next morning this level of R3 was duly taken out by the very first candle, and you had the whole day to fly high . .

The stock rose above ₹ 580 and then closed lower, but that shouldn't affect you. The daily chart had hinted towards a move from ₹ 505 to ₹ 520, and above.

~

We have seen examples from cement, real estate and pharma sectors, but how can we forget the ever-present theme of PSU banks. Throughout 2017, there was this constant talk about how the government and RBI would come up with some solution to the ever-burgeoning NPA issue of these banks. This problem had been troubling the Indian economy for a very long time and had led to major stock price declines in many banks over the earlier few years. The banking sector being a crucial engine for the economy's growth, it was seen as vital that the banks improve their financial health if the economy was indeed to see the green shoots and growth pick up.

As the expectation of an NPA solution built up, there was a surge in investor interest in this sector, especially towards the banks that were into corporate lending.

Such macro-level news, when combined with the charts, can create excellent opportunities. These opportunities may not just be intraday but last even for many months to come. Depending on your interest, you can choose to either trade or actively invest in them. Many of these stocks had been largely ignored by investors for a long time and had been trading at a fraction of their previous highs. Having fallen out of flavour, nobody was paying any attention to them even at lower valuations. When underownership of such major levels gets corrected, the trend reverses and the moves in the new direction can get amplified beyond anyone's imagination. Such themes can go on giving newer stock ideas every week to short term traders. You must ride such moves, so long as they exist.

As extreme short term traders, we will use all the regular tools from our arsenal. We will combine as many of them as possible. If there is any micro news pertaining to any specific scrip on a given day, we will try and utilise that too in our favour. We will also see if the trend of the day is in our favour, along with the sector strength on the given day. When everything seems well-aligned, that's when we fire on all cylinders. Essentially, what we are doing is a combination of fundamental and technical trading. We are taking macro events as themes and we are riding the momentum they create, whenever they do so. We then confirm it on the charts and fine-tune the trades for best possible entry timings.

~

The next two charts are for 4 May 2017. The first one is of ICICI Bank that declared better than expected results the previous evening.

The NPA number in ICICI results was lower than feared. NPAs had been the major problem areas for banking scrips. The stock was underowned, and had been under-performing the Nifty Bank index for a long time. The ADRs were higher by some 4% to 5% the previous night despite weak overseas markets. When such long time under-performance corrects, the moves are usually large — 10% intraday in this case. We don't recommend one should have entered it at the open. There was a huge gap up. A safer entry was once our thesis was approved by market behaviour early in the day. The important context here is that the stock had not risen at all prior to the results. Thus, it was a fresh start post the result. In fact, the stock was going into the event with accumulated shorts. Those shorts had now no choice but to run for cover.

Another supporting factor was the announcement of bonus shares which came as a positive surprise to many investors. Free!, Free!! Free!!! Indian just love that, right? Who doesn't?

In the case of ICICI Bank there were also multiple brokerage houses announcing an upgrade for the stock, and these came with revised, higher price targets. Now whether these targets later get achieved or not, and when they do, is not our look out. As short term traders, we are opportunists interested in the booster that such factors add to the momentum. So, more the factors in our favour, the merrier the ride.

Figure 11.10: **5-minute chart of ICICI Bank.**

Since ICICI Bank price had given the major move in the morning half itself, a day trader could go hunting for another move during the second half *(see* Figure 11.10). That's where our next chart of Canara Bank comes into the picture; it's a chart of another PSU bank stock. And what a wonderful chart it is, with so many well aligned factors! Have a look at Figure 11.11.

Figure 11.11: **This 5-minute chart of Canara Bank shows sideways consolidation for the entire day, and a breakout only in the highly crucial last hour. The move had begun simultaneously in all PSU banks during the last hour on this day. No alert trader could have missed that. Market timing factor also plays a role here.**

Let us now consider the chart of the private sector bank, Federal Bank for 28 April 2017 *(see* Figure 11.12). The bank had announced excellent numbers, as a result of which it was definitely in the news — and also on every alert trader's radar.

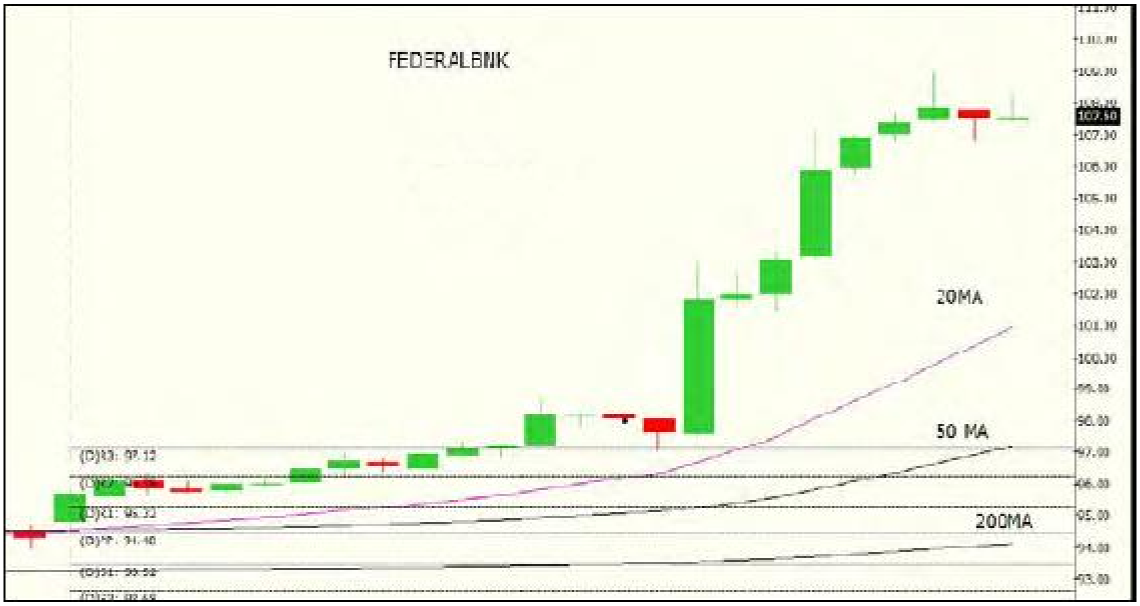

Figure 11.12: **Federal Bank's intraday chart with intraday pivots and 20MA, 50MA and 200MA lines.**

The chart in Figure 11.12 shows R1, R2, R3 at around one rupee intervals between ₹ 95 and ₹ 97. A move above the level of ₹ 95 would indicate a very strong day for the stock as per intraday pivots. The stock had opened strong and was adding to its strength with each new candle. Immediately after the first candle it rose above the resistance R1, and in doing so it also reached above the high of the previous many days.

You can see this clearly when you see the 60-minute chart in Figure 11.13, which presents the larger context and the monthly pivots. It was a breakout move above the sideways range of many days. And it was fuelled by a news event. To add to the strength of our case, the move was slow enough and steady enough to provide multiple entry opportunities through the day. The price action remained well above the 20MA line, even on the small time frame of 5 minutes. The previous day had been a narrow range day and the morning move had begun from the support of both the 20MA and 50MA lines overlapping each other. These factors by themselves are very strong. Let us see what additional factor the larger context can offer us (*see* Figure 11.13).

Figure 11.13: **60-minute Federal Bank chart with monthly pivots. The chart clearly shows that the rise above ₹ 95 was a breakout from many days of narrow range. The monthly R1 was also at the level of ₹ 95, so that the intraday R1 and the monthly R1 were same, and that coincides with the high of the last many days' range. So crossing above that level was highly significant. In this case, it happened right at the first candle. The immediate next target was ₹ 98 which got surpassed easily. In fact, the move had just begun. The price had started moving higher from the support levels of daily and weekly charts. On this day the entire banking sector was rising strongly, so there was sectoral strength as well. Once the level of ₹ 97 was taken out, the immediate next level was ₹ 103 on monthly pivots.**

These examples vividly exhibit the high energy of synergistic confluence, and this synergy amplifies a move.

Stocks of the Same Sector Moving Together

Another kind of confluence gets created when stocks belonging to the same sector or industry rise or fall together. Even if some stocks do not have any event related action, just the rub-off effect from other stocks of the same sector may suffice to create big moves. There's nothing wrong in trading these rub-off stocks if you want to, or if you have missed the main bus.

The move in Dena Bank *(see* Figure 11.14), consequent to the move of the above-mentioned Federal Bank is another example of the rub-off effect on sectoral friends. It was the spill-over emotion of Federal Bank results that was driving the Dena Bank stock. Be that as it may, as far as we are concerned, we focus not on the cause but on the effect.

Figure 11.14: **60-minute chart of Dena Bank with weekly pivots. Focus on the last day on the right side of the chart and see how easily the weekly resistances get surpassed within a day, courtesy the move in Federal Bank and sectoral strength impact. The move above ₹ 41.3 was a multi-day range breakout. The price level of approximately ₹ 42, was the resistance R2, R3 on daily, weekly and monthly pivots.**

There is another kind of confluence which gives a trade in the reverse direction. By reverse, we don't mean necessarily counter trend here. What is meant is that the stock may seemingly be showing signs of going higher but then there comes along some confluence of resistances which provides a good shorting opportunity. Or, when a stock seems to be going lower but meets some confluence of supports that reverses the direction and gives us a long trade. This could even be in the direction of the main trend. If so, it becomes an even stronger trade. Such a confluence can also occur in range bound markets. This can be called as a confluence of aligning indicators, and which can be a trap setup during a corrective move.

The day may begin with the opening range getting created in a way that keeps the price within a narrow band. The price then halts at one of the extreme ends of this opening range. If this level also happens to be a resistance, or support, on higher time frames, then it may prove more difficult and may not get crossed. The stock then temporarily makes an effort to break out of the opening range, but without much success. It may immediately and forcefully retrace within the range. Or, it may also move strongly towards the other end of the range.

This creates a trap for traders who could not decipher the move. They are then left with no option but to cover their positions to avoid immediate losses. If the morning range also overlaps with the range of the previous day, or the previous few days, or with any significant levels, then the trade setup gets stronger. So, it is a case of a trap with a confluence *(see* Figure 11.15)!

Figure 11.15: **The chart of Nifty Bank shows a confluence of levels — early range is the same as the prior low, and a temporary break from this turns out to be a trap setup.**

It is important to note that such trades will have a higher probability of working out successfully on days when there is quick action and high volumes in the market. On dull days, the price may find it difficult to reach the other end of the range. It may, instead, loiter around, keeping you itching for action and scratching your head. Another way of adding more confirmation for such trades is by being on the side of the main trend. When we take trades in the direction of the trend rather than those on the opposite side, we are increasing the odds in our favour. In most of our examples, the trade is indeed in the direction of the main trend. You will add still more confirmation for such trades when the false breakouts are slow and short-lived, and when the bounce back in the main direction is sharp and quick. That shows the eagerness of the market players to sustain the trending direction. If this is found lacking, it is a sign of caution.

It is a commonly known fact that breakouts fail more often than not. Rather than cursing the market at such times, why not look at capitalising on them? When moves in one direction fail, the market is telling you something. Why not sit up and listen to the market's message instead of cursing it? If you don't obsess yourself in looking for a justification for your failure, then you will successfully find the opportunity that the market's move brings along. Every failure is an opportunity, either to step aside and be patient till the time is right for a fresh trade, or to take a reverse trade as and when it seems right.

If a trader gets depressed with failure, then he or she will never be able to recognise the next opportunity for success. We all fail, but that doesn't stop us from moving on with the next trade immediately. It's all in a day's work.

So, keep faith. Even an SRK can give a bad film like *Happy New Year.* Even a Karan Johar can act in a failure like *Bombay Velvet.* Even Sachin Tendulkar can get out for a duck. Even Big B can go into debt and then rise higher, more successful and more determined than ever. When life or the market punishes you for something, take note and try to hear its message. There may be a hidden lesson. It might be trying to teach you something. Learn from it. Earn from it.

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The next three chapters are extremely crucial. No serious trader should close the book without reading these. One of them ensures your stay in the game for longer, and thus increases the chance of your success. The next two increase your chances of success, not just in trading but in every single facet of life.

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It is rightly said of the stock markets that people who come armed only with money gain only experience. Those who come with experience, make all the money.

Chapter 12

Money Management

Introduction

When he blew up a 100K at the blackjack table in a casino, a customer yelled: "How can you lose a 100K at a 10K table!"

Another customer replies: "Patience my friend . . . ."

~

Money is what you need to stay alive, to fight another battle, another day, for another trade.

This chapter is all about money and money management for traders. If not handled well, losses and risk can grow exponentially in no time at all. Ignorance or indiscipline in managing capital can bring down not just you and I, but even the Enrons, Worldcoms and Satyams of the world. So, let's see what constitutes fiscal discipline for a trader.

Well, there is both good news and bad. The bad news is that neither the system that we share here, nor any other system in the whole wide world can promise you risk-free trades or guaranteed returns — or a 100% trade success rate. The good news is that you don't need these either.

Your success as a trader doesn't come from being right every single time. One of the key factors in trading the success is money management. It is only through a solid money management system that a trader can build wealth over a period of time. Please note, I am saying a period of time; there is no overnight magic anyway.

What is Money Management

Well timed entries and exits are a trader's way to defend his capital. This game is first about capital preservation, followed by capital growth. — Ashwani Gujral

Trading is not gambling and neither should it be treated as such. It is a business and every business has to have plans for funds management and cash flow. There has to be a rationale behind every decision pertaining to funds. Such fiscal discipline is of utmost importance and it must be adhered to every single day, in every single trade.

Someone has rightly said: To err is human, but if the eraser wears out before the pencil, you might be overdoing it. Someone has also said: To forgive is divine. But D-Street doesn't take this seriously. It never forgives.

Every trader who is serious about building wealth in the market has to adhere to the principles of money management. This adherence ensures your long term survival in the game. Failed trades are part of a trader's daily life; every trader will have his share of these. Nobody can be right all the time. When you are clear about your money management plans, and when you strictly follow those plans, you survive and thrive in this game.

Money management will ensure that you never bet beyond your risk capacity. Risk is inevitable. But the amount of risk can be controlled by controlling the size of the bet on each trade. That's exactly what money management does. It tells you how much to bet on any given trade. That bet size is called position size.

Money management is, thus, clearly not just about stop loss. While we will learn more about stop losses in this chapter, but let us be clear that stop loss defines the risk in a given trade setup. It tells you about the loss or risk in terms of points. You multiply it with your position size, and you get the total risk in terms of the amount. Money management, on the other hand, gives you the position size. It answers, how much of the stock you should buy or sell. Nevertheless, in order to clearly understand the concept of position size in a given trade, we will start with some lessons on stop loss.

Stop Loss Revisited

It doesn't matter what college professors teach about efficient markets theory. The fact remains that human behaviour is driven more by emotion than by logic. People will often behave irrationally. If markets were rational then I would have been a waiter and not a rich man, said Warren Buffett. Even those who believe and swear by the honesty and capabilities of top managements based on corporate balance sheets do not understand many things. After spending an entire life together, we often fail to know even our own family members well. We expect one thing from past patterns but we often see unexpected changes as newer life developments take place in our lives. There is always an element of the unknown

Every balance sheet can be camouflaged. That's not to say that every balance sheet is camouflaged. All that is being said is that since there are always unknown risks around, the greater the number of factors we check, higher the chances of getting things right. That's all. So let's accept the risk and learn to use charts as well as money management. Stick to price action. Stick to stop losses, not to opinions and beliefs. As Gujaratis often say: *Bhav ej bhagwan* (price is God).

Technicals don't lie. People may.

Stop loss is essentially the difference between your entry price level and the level at which you will exit your trade if it goes against you. It is defined in terms of points, and is derived from technical analysis. Say, you enter Scrip A at the price level of ₹ 243. You look at the charts and decide to exit if it falls below ₹ 240, then your stop loss is 3 points, or ₹ 3. When you multiply it with the quantity of stock that you are trading, you get the total risk or total potential loss per trade in terms of rupees.

We strictly urge that the amount of total risk per trade must never exceed 2% of your total trading capital.

Thus, suppose your total trading capital is ₹ 5 lakh, namely 500K. The maximum permissible risk, or loss per trade, must then never exceed 2% of this amount, namely ₹ 10,000. Only in very exceptional cases, when the market is clearly trending and so is your stock, and when the volumes are high and the trend is young, and when the local and the global setup are all in your favour should you allow a minor variation and permit yourself to raise this limit up to 3%. This must not happen every now and then, only exceptionally. This variation in total amount is allowed due to increased volumes that one may want to trade in clearly trending markets, and not due to a wider stop loss in terms of points. You will understand this more clearly as we proceed.

On the other hand, when the markets are sideways, and when the volumes are thin as well, you can even restrict your position size to 1% loss of capital per trade. For more than 90% of your trades, you must stick to the 2% permissible risk / loss per trade on total trading capital. For all trades, irrespective of the lot size, two per cent means two per cent, whatever the lot size. Period.

Deriving the Stop Loss

Stop losses are like condoms. If you refuse to use them, you may be left holding the baby, forever.

- There are traders who decide stop losses on the basis of their willingness to lose money either in terms of percentage or amount. They use the amount that they are willing to risk for every trade they take to derive the stop loss.
- There are traders who will accept X per cent of trading capital as acceptable loss for every trade they take. This per cent may have nothing to do with technical analysis, chart patterns, or tools.
- Traders also often like to stick to fixed rupee stop loss for every trade and they exit the trade if the loss mounts to that level.

All such methods of determining a stop loss are random. The market doesn't care what your risk appetite is. It does what it is best at doing. It is neither your friend, nor your enemy. It is neither aiming at forgiving your mistakes, nor determined to give you any favours. It is just doing its stuff. If there is any problem, it is with you. It is within you and/or your system.

The stop losses must come from the market technicals and not from your mood of the moment. Yes, as day traders we can keep time stop losses. That is, you may choose to exit a trade if it is taking too long to work out. That's also because a good trade will work from the word go. If it stalls for too long, you might be missing out on better alternate opportunities.

For day traders it is very important to time their trades well. Entering too early means wasting time as well as losing other opportunities, while entering late means bigger risk. So you must try to get not just the trade direction right, but also the timing. As F&O traders, you are betting not just on the direction but also on the volatility and timing. So the stop loss levels must be derived on the basis of some logic:

- This logic can be the low / high of the entry candle and the nearby swing low / high, as we have kept in our buy/sell trade setups in the examples in this book.
- It can also be the pattern low for those who trade chart patterns, such as head and shoulders, etc.
- It can be some volatility based stop loss, such as below or above the MA lines like we did in the trailing stop loss technique.

The point is that the stop loss must be arrived at from logical levels and not from your whims, fancies, dreams, desires, fears, greed, or any other emotion. You cannot say that you will keep the stop loss at, say, 5%, just because you feel comfort in that. The market doesn't care about your comfort, nor about what you think. You must control risk by following trading logic. That's how you better the chances of seeing your stop loss levels sustain. If the levels still do not sustain, you must get out. At such times, the market is trying to tell you something — and you ignore its message at your own peril.

Stay with the trend and stick with the stop losses; leave the past, and live the future.

All Scrips are Different, So Must the Stops Be

The value of stop loss in terms of points will vary with each stock. Some stocks have lower volatility and smaller candle formations. Accordingly, these will have smaller stop losses. Other stocks with higher volatility and bigger candles may have wider stop losses in terms of points. The position size in each of these will vary accordingly. Lower the volatility, the smaller will be the stop loss in points, and higher the position size that you may be able to afford with the same amount of total risk. It is also possible that some F&O contracts may simply not fit your account size. You have a choice to reject those. Exercise the right. Make a choice. Every stock is different. And each stock should be looked at differently. Each comes with its own level of volumes, liquidity, volatility, risk and returns. Not everything may be right for you, or suitable for your account size. Have a look at Table 12.1 for clarity. If you fail to follow these principles, then you may be causing yourself not just monetary damage but something even bigger. Understanding this table is crucial. The cost of ignoring it can be very high.

Table 12.1

Different Scrips, Different Stop Losses

Scrip	*CMP (₹)*	*Stop loss in points*	*Total Capital (₹)*	*Permitted risk / trade @2% max (₹)*	*Permissible Position size*	*Contract Size in F&O*	*No. of contracts allowed*	*Contract value being controlled*
A	102	2	4,50,000	9,000	4,500	5,000	0	0
B	1,500	12	4,50,000	9,000	750	600	1	9,00,000

When Stop Losses Get Triggered

Write it down in bold letters on all your walls — there is no shame in triggered stop losses. There shouldn't be any stigma attached to it. It is very normal and it is a part and parcel of a trader's life.

You can do the following things when it happens to you:

1. Analyse the trade and see if you get thrown out merely by random market noise. If yes, then again two things.

2. First, a good-quality stop loss must be wide enough to contain the noise, yet narrow enough to keep you afloat as per money management rules. So check out and, if needed, work on your technical know-how going ahead. Placing stop losses exactly where expected is a sure way to get hunted. There has to be some minor amount of buffer which will depend on the kind of scrip that you are dealing with, its volatility at the time of trade, and the chart setup.

3. Second, if the stop loss was triggered as a result of a sudden turn in the market, then see if the turn was short-lived and whether the trend looks intact. See if the move is resuming in the original direction with a decent amount of vigour and volumes. If yes, re-enter the trade. Such traps could give great trades.

4. If the trend resumption seems to be lacking participation or conviction, then it is a good idea to just step aside and wait it out.

5. If it is a strong reversal with good volumes, then you can enter in the reverse direction. That can be done provided you have quick enough reflexes and don't get frozen into inaction by a loss.

In either of the cases, keep haste and desperation under control. Bus, train, and trade opportunity, *ek jayegi . . . toh dusri aayegi . . . yaad hai na* (if one goes, others will come along).

Modifying the Stop Loss Midway

Very often traders get into the habit of modifying the stop losses in an ongoing trade. For one, they widen the stop loss when they see the price nearing their pre-determined stop loss level. They do this with the intention of accommodating wider gyrations before the trend and the scrip may resume the move in their favour. This is a huge sign of nonprofessional behaviour. **Once a stop loss, always a stop loss. There is no question of midway modifications. Other than for trailing the stop loss in a winning trade, there is no question of fiddling with these levels.**

The safest thing to do is to always keep the stop loss order entered into the system, and not merely made a mental note of. You are not monitoring the screen for modification of risk. In fact, there shouldn't be any decision left to be taken once you enter a trade. The entire path must be chalked out before taking the entry. There is no point going on hoping if the trade goes against you.

Stop looking for some miraculous Viagra that might lift your collapsing stocks higher. Obey your stop losses.

It is your emotion, false hope, your refusal to face facts and, probably, your ego that are at play when you resort to such suicidal behavioural patterns. The price may very well move in your favour after triggering your stop loss. So what if it does? Nothing justifies modifying the stop loss midway.

If the trade again moves in your favour, nobody stops you from reentering. But if the stock has not respected your levels at the given moment, you must dump it. You must promise to yourself that you will not hesitate when the time appears ripe for a re-entry. If that doesn't happen in the same stock, then you can always look for another stock.

Once you are mentally free from a losing trade, you can focus on newer opportunities. Your clarity will definitely be better once you are out of a trade gone bad. The smaller the loss, the easier and quicker is the recovery.

Staying with a loss is no way to recover from it. Time is not the medicine for everything. Accepting facts is the way forward.

Total Risk or Drawdown Value

Now we know that the maximum amount of risk allowed per trade involves two variables; one is the stop loss in points, and the other is the position size for a given trade. This total risk amount is also called the drawdown value. It means that the total capital available for your next trade is lower by that much value. Say, you started with 100K, or rupees one lakh, and you lost 20K in two trades. Your drawdown amount is then 20K, and your available capital for next trade is 80K.

To summarise:

1. Total Risk / Drawdown = Risk in points × No. of shares (volume or position size).
2. Drawdown per Trade or Total Risk per Trade <=2% of Total trading capital.

Position Size

We now come to position sizing, which is the main crux of this chapter. We strongly recommend that the upper limit of the total permissible risk per trade must be kept fixed at 2%. Now we know that this is called the drawdown amount. The stop loss in terms of points is a variable, and should ideally come from the technicals and charts. Thus, this is not something which is in our hands. **The only variable that we can control is the position size. And that's money management.** We divide the permissible drawdown per trade by the stop loss in points. And we get the permissible position size.

Position size = Total permitted risk in amount ÷ Stop loss in points.

Say, for example, you have ₹ 2 lakh in your trading account. Taking a risk of not more than 2% of the entire trading capital means a total permissible loss per trade of ₹ 4K. If you see a trade setup on charts with stop loss of, say, ₹ 6, i.e. 6 points, you can afford to take the trade for up to 666 shares (4,000 ÷ 6 = 666). Rounding it off, let's say you can buy up to 650 shares.

With a stop loss of 6 points and a position size of 650, your loss per trade stays within the permissible limit of ₹ 4K. So if the lot size in F&O segment is, say, 600, you can afford to buy one only lot, and no more.

This method ensures that you never lose more than 2% of your total trading capital on any single trade. This is most important because it keeps you in the game for longer.

Imagine if you go on losing 10% of your capital on each trade, you would be broke if ten consecutive stop losses were to get triggered. And, no, this is not very unusual. It can happen. No matter how good or bad you are. And if it does, it will wipe you out. As John Keynes said: "Markets can remain irrational for a time period that is longer than the period for which you can maintain solvency."

Drawdowns Can Really Draw You Down

You must have heard your share of interesting, read shocking, stories from the 2008 stock market disaster, like those of Amtek Auto or Unitech. Here's another disastrous story from then. A small stock called Shiv-Vani Oil & Gas Exploration, one of India's largest oilfield services providers, was quite a favourite among many market players at that time. The share price was around ₹ 700 at the highs of January 2008. By January 2009, the price was down to about ₹ 100, and it was at ₹ 6, yes, just ₹ 6 in early 2016 when lenders took over the company. The company boasted of customers such as ONGC and Oil India and investors like Franklin Templeton till 2010 who had faith in its capabilities. So what? What goes down need not come up when you want it to. Got the point? And this is also applicable to blue chips, which too can erode very badly when markets crash.

The major problem with drawdowns is that recovery from losses requires much higher rates of return or percentage returns. Let us understand how.

The Math Behind the Drawdown Losses

If you incur a major loss in any single trade, your available trading capital goes down. Until you recover the loss, you cannot come into overall profits. The bigger the drawdown, the larger will have to be your profit from the next trade, or from the next few trades, to get you back even to neutral. In percentage terms, to recover from a 50% loss you will have to gain 100% returns just to bring you to neutral level. Here is how.

Suppose your stock goes down by 50%, say, it falls from ₹ 100 to ₹ 50. Now assume that it recovers again by the same percentage, namely by 50%. That is a rise of ₹ 25 — 50% of ₹ 50 is ₹ 25. So now the new value of your stock is ₹ 75. You are still down by 25% as you bought it at ₹ 100. Thus, it will take 100% profit returns simply to bring your capital back to its original level.

A stock that goes down by 50%, and again goes up by 50%, is still down by 25%.

Your first mistake was that of having taken a wrong trade. That can be forgiven. The bigger mistake is that of holding onto it for so long that the loss grows so big. That's unforgiveable. Often traders stay with a trade only because they feel that they have already invested time and energy into it. They need to remember that a mistake is cheapest at the start; it only gets bigger the longer you stay with it. Never stay with a mistake just because you invested a lot of time in making one.

Take a look at Table 12.2. It shows the returns that you will need to generate after various levels of drawdowns, simply to reach back to your original capital level or to breakeven. This vividly highlights why you must control your total amount of loss per single trade.

Table 12.2
Recovering from Drawdowns

Drawdown of total trading capital (%)	*Returns / recovery required to breakeven (%)*
5	5.3
10	11.1
15	17.6
20	25.0
25	33.0
30	42.9
50	100.0
60	150.0
70	300.0
80	900.0

That's why we say that drawdowns can draw you down . . . very down. If you operate this way, you will never make money.

The moral of the story is that controlling the damage and limiting losses is far better than running after recoveries. Getting into a bad trade can hurt, but holding on to it can hurt even more.

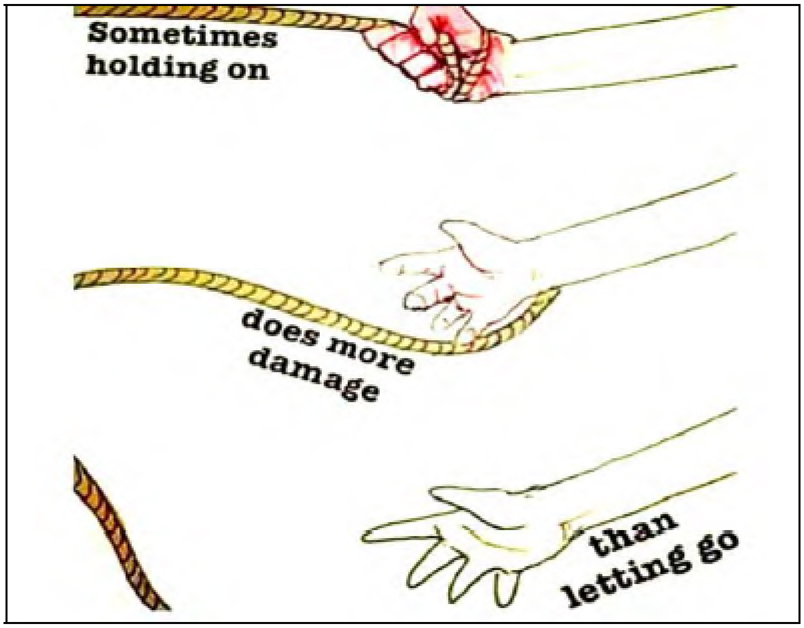

Figure 12.1: **Let it go . . . release it . . . and relieve yourself! Making mistakes is pardonable. Staying with a mistake is definitely not.**

Everybody makes mistakes; winners are those who correct their mistakes, and not those who stick with them and allow them to grow bigger.

The Mental Damage of Drawdowns

A drawdown is not limited to damaging your trading capital. It goes much beyond that. Drawdowns cause huge emotional damage that can last longer than the financial impact. Drawdowns can rob a trader of his confidence. If they happen repeatedly and are not controlled, they can wear off his self-esteem. The impact can last for many trades. A drawdown can create desperation, and that can lead to hasty decisions. It can also send a trader into a shell and he may shy away from newer trade ideas. That can lead to a lack of opportunities coming his way. He may be surrounded by others who may be putting on even false impressions of being super successful. That can add to his desperation. We will be dealing with this issue of handling emotions in Chapter 13.

What we are essentially doing with our money management system is that we are factoring in a series of consecutive losses and yet ensuring that we do not get thrown out of business. Survival is the key — *Jaan hai toh Jahan hai* as a Hindi saying goes — so long you are alive, you can conquer the world! So long as you are not forced to quit, there remains the chance of bouncing back. To keep going, you need both financial strength as well as mental strength. So you have to protect both. All said and done financial damages leave bruises at multiple places, including on your mind. This becomes all the more important in leveraged products. Whether you earn or not, you will have to pay the mark to market (MTM) margin. This creates immense pressure if mishandled.

Factoring in Slippage Losses

Not all your orders will be limit orders. Depending on your trading style, at times there will be market orders as well. In the case of market orders, there could be a sizeable difference between the price at which you expected to get your order filled and the actual price at which it does get filled, particularly in a volatile market with high volumes. There could also be runaway gaps during fast moving markets. All of these can result in entries at prices higher than anticipated, and selling at lower levels. With regular trading, multiple trades a day, and with significant account size slippage, losses could add up to sizeable amounts. A trader must factor in these costs of doing business. Also to be factored in is the cost of taxes and commissions. Commission costs can also vary in a wide range, and you will be paying these not just on profits but also on losing trades. Which is why you must negotiate a good deal from your broker. Anybody paying brokerages higher than the minimum is an idiot. These costs may be a very small part of the trader's middle-line as a whole but controlling them will definitely add to the bottom line.

Profit Expectations — What is Enough?

As you sow, so shall you reap. There are no rules defining an average or an above average performance. A trader defines his own average. A good trader will make consistent money, while a lethargic, undisciplined dreamer will help other good traders build their wealth by his daily market donations.

What makes a winner is the allocation of capital and its risk management. We have seen that there has to be some acceptable ratio between the amount that you risk and the reward that you look forward to. The higher this ratio, the better it is for the trader. The upper side can be anything; there is no limit to it. History has shown people achieving 5- and 6-digit returns over time. It is only risk that needs to have boundaries. The returns must be better and bigger than the risk being undertaken in every trade.

Risk Management Mistakes Traders Often Make

Traders often resort to practices such as averaging and hedging in order to manage risk. None of these can save you. Instead, you will get yourself deeper into the soup. There are also people who like to double their position size after losses. They do this in the hope of recovering multiple losses with one gain. They believe that just because they have been through a series of losses, their probability of victory in the next trade is higher. That's total ignorance about the laws of probability.

According to the theory of probability, each individual trade has an equal probability of being a loser or a winner trade. The chances of profit or loss will always be 50%. So just because you have failed, say, 5 times, it doesn't mean that you have any higher probability that the sixth trade will be a winner. Please do not harbour any such superstitions. I have seen people adopting weird ways and means to guess whether a stock is a buy or a sell call — and then they blame the markets. Any increase in position size on the basis of such assumptions is an invitation to self-sabotage and fiscal suicide.

Recovering money from a losing position is ten times more difficult than making money from a winning position. Strong trends don't give up easily, and staying in their way is not the correct thing to do.

Buying options also doesn't mean risk management by any stretch of imagination. Leverage is a double edged sword. Whatever generates a high return will generate higher risk as well. If you put your entire trading capital into options and do not properly manage the risk, you can go broke there as well. With futures, the ratio of risk and reward is linear. So when you hedge your losses, you are hedging your profits, too. Never forget that. On top of it all, you are adding to the costs, taxes and commissions. Capital must be preserved, yes, but it must also grow. Else, there is no point investing your time, money, attention and energy. The best thing is to understand and accept that losses are not worth managing, just have the acceptable loss levels pre-determined, cut your trades there, and move on.

The best way to control risk is by knowing what you are doing. If you know your job well, both stress and risk will be easier to control.

Your Exit Strategy Is Also a Part of Money Management

Money once earned must not be returned to the market beyond a certain pre-determined level. That doesn't mean you refuse to stay with the stock that is willing to stay with you. But as the trend matures, as the profit grows, as major resistances approach, you must grow increasingly vigilant and have a definite exit strategy in place beforehand. It could be an MA line, a particular pivot, your pre-defined target level, or 50% retracement, whatever it is that suits you best. The point is, you must have an exit plan and stick with it. Those who trade multiple positions or contracts can even use partial profit booking.

Don't Always Wait for Stop Losses to Get Triggered

You can learn a lesson without paying a price. In normal circumstances, we keep some buffer space in placing stops and we don't exit whether out of fear or some other reason. But, say, you are long in a stock and you see a sudden negative news-break regarding the company — something which is very common in stock markets, or there is a sudden macro news-break, like the one on the day of surgical strikes on Pakistan in September 2016, then you don't need to wait for the stop loss to get triggered. In such cases, you can exit with a lower loss value. There could also be a possibility that you realise that your trade is technically incorrect. Ideally, this must not happen and you are expected to do your trade planning very diligently beforehand. But if it does, then you don't just keep hoping and praying. You accept the mistake and exit at the earliest without waiting for the stop loss to trigger.

You are permitted to make mistakes; but not mighty ones. Always tell yourself: "Thou shalt remain solvent."

When Can You Increase Your Position Size

A position size increase should only be considered after you double your trading capital. Say, the lot sizes permit you to buy one lot for every ₹ 350,000. Then you can buy a second lot only when you have ₹ 7 lakh or more in your trading kitty. The overall leverage must be maintained. If you are trading with a leverage of, say, 50%, that percentage has to be sustained. Often traders increase their position sizes without any such considerations, based purely on the strength of their conviction on a call. While nobody can stop you from doing so, the law of probability that we explained earlier will remain in play. The chances of success for a given trade do not increase or diminish based on your perception of the move. Also, just because a few trades worked out well is no reason to start increasing your position size. Each decision has to be governed by trading logic and math. Emotions have no place and must be kept strictly under control. You will make money only when you understand the emotions of others while keeping your own totally under control.

Hit Ratio and Risk-Reward Ratio

The ratio between the risk that you accept and the reward that you expect should always be 1:2, or higher. This means that for every one rupee of risk, you must target at least two rupees of profit. Moreover, this expectation must be based on analysis, and not wishful thinking. The success ratio can be as low as 50%, or even lower, and you can still emerge a winner provided you keep your losses under control and keep riding your big winners.

With a hit ratio of just 50%, you still end up winning at the end of the month because of two factors:

1. You never allowed your losses to exceed the upper permissible limit.
2. You showed patience during the winning trades and achieved your targets.

Even if this ratio comes down to 40%, you are still in the green. Study the various outcomes in Table 12.3.

Table 12.3

100 Trades at Different Hit Ratio and Risk-Reward Ratio

Parameters / Variables	*Case I*	*Case II*	*Case III*	*Case IV*
Total Trades	100	100	100	100
Hit Ratio	30%	50%	50%	40%
Risk-Reward Ratio	1:2	1:1	1:2	1:2
No. of losing trades	70	50	50	60
No. of winning trades	30	50	50	40
Total loss in losing trades	70	50	50	60
Total gains in winning trades	60	50	100	80
Net gains	-10	0	50	20

Ride Your Winners

Yes, I know it feels great to book profits. But never do so prematurely. You may have often heard that nobody goes broke booking profits. That isn't necessarily so. If you keep booking out smaller amounts of profits and refuse to ride profitable trades for longer even in a giving market, then one big loss can wipe out multiple smaller profits combined. Staying long enough in profitable trades is as important as cutting off quickly from losing trades. Money over the longer term will be made only by a limited number of trades. The Pareto Principle of 80:20 is almost always in play. As per this principle, 80% of your profits will come from 20% of your trades. Also, most of your profits will come from the trades that will return you amounts equivalent to 3 to 5 times the risk. Strong trends don't break easily and can go on, not just for an entire day but even for multiple days for those interested in holding their positions longer. We have seen many such charts in the previous chapters. When you happen to be with one such trade, your aim must be to ride the wave as long as possible. Remember, maintaining an existing position is also trading.

So because strong moves don't end easily, we exit these only once they start going in the opposite direction to our position. The reason to continue holding should be that a trade is moving favourably. What most traders do is exactly the opposite. They stick with a trade when they should be dumping it. They dump one when they should be sticking with it.

Balancing the Hit Ratio and Risk-Reward Ratio

If you think that the hit ratio is meaningless and you can simply focus on risk and reward, then you might be making a mistake. There are various combinations of the two that make a winner as we just saw in Table 12.3. The trade outcome is the result of both the ratios, not just any one. Doing some further analysis, we derive the combinations given in Table 12.4. It is important to understand these combinations as this would help you analyse your monthly trading journey better.

The key point is that with a higher ratio between reward and risk, you will be able to sustain profits despite a lower hit ratio or success ratio. So don't get carried by the desire to be right all the time. There's more to success than that. After all, there is a limit to which you can control the success ratio. That other factor is the amount of profit you make in trades that work in your favour.

Have a look at Table 12.4. This is a hypothetical example wherein a trader again takes a hundred trades. We go on lowering the hit ratio from 60% to 20%, while we go on raising the reward to risk ratio from 1 to 5. We make different combinations such that the net gains stay constant. In other words, the loss on the losing trade is constant. Gain on the winning trade is derived as per the risk and reward ratio. Observe how with an increasing reward to risk ratio, the trader can maintain his net gain despite a lower hit ratio.

Table 12.4

Different Combinations of Hit Ratio and Risk Ratio

Variables	*Case 1*	*Case 2*	*Case 3*	*Case 4*	*Case 5*
Reward to Risk	1	2	3	4	5
Hit Ratio	60	40	30	24	20
Gain	60	80	90	96	100
Loss	40	60	70	76	80
Net Gain	20	20	20	20	20

You would note that as the reward goes on improving for every rupee of risk, you could stay afloat with lower and lower success ratio. Focus on both for a winning combination. Thus, for example, a 40% hit ratio and a 2:1 reward to risk ratio is a very well-known combination.

After taking all the required precautions if you are still in the red on any given day then just remind yourself of a very famous incident. One day in 1976, Ronald Wayne, the lesser known co-founder of Apple Inc., sold his entire 10% stake in Apple for USD 800. A few decades later, in March 2016, the same stock was worth some USD 62 billion. You are not the only one!

Diversification as Risk Management

The first thing to recognise is that no amount of diversification can protect you against bad planning or poor implementation of technicals and / or ignoring money management rules. So, by itself, diversification doesn't spare you from the hard work. Diversification cannot protect you against ignorance, lethargy or hibernation.

Secondly, while diversifying one must choose negatively co-related stories. If you are diversifying among three stocks, all of which are expected to rise or fall together, then it hardly serves any purpose. The selected scrips or sectors should ideally be expected to move differently. While these things are more relevant for medium term position holders, short term traders may choose to diversify depending on their trading style and account size. They can choose more than one sectors that are current flavours of the market. As we write this in the first half of 2017, real estate, PSU banks, capital goods and even FMCGs were moving well; 2016 had been more about metals and NBFCs moving in a major way.

At times, traders may also choose multiple stocks within the same sector for intraday trading. While you may know that today is the day for PSU banks, you don't know which one is going to surge the most. These are not negatively co-related but, still, if one of the banks rises less, the other may compensate by being the top mover for the day.

How much diversification is needed? Neither too much, nor too little is the ideal recipe. Diversification is all about not putting all the eggs in one basket. While it sounds simple, it's not so simple to implement.

Having said that, it must be added that diversification doesn't mean you have ten open positions at one time. Over-doing diversification can cause more damage than good. You may give away gains from one trade due to a loss incurred in the other. One must know one's limits, keep practical considerations in mind, and stay within boundaries. Remember, each open position demands time and attention.

One must also remember that in the case of a sudden carnage or sharp fall, no amount of diversification can help. **Diversification doesn't mean you ignore stop losses.** The basic reason behind diversifying is that the chart patterns may not necessarily work as expected. We have seen multiple ways to control losses, and diversification is only one. It protects you with the law of averages. A short term trader will also have to keep in view the cost of over-doing diversification since trading costs can multiply into big amounts merely due to a high number of smaller value transactions, plus the daily volume per trade. The penalties could include slippages, transaction costs, etc. Thus, much like leverage, diversification is also a double edged sword. It reduces the losses in one position due to a sudden adverse move, but it can also reduce the profits in another position which is working in your favour. **All said and done, position size is the basic tool of risk control for a trader.** It's easy to understand that 500 shares of something is always riskier than 100 shares of the same thing.

How Often Should You Measure Your Performance?

A day trader is in the business of capital defence. Unless he keeps regular track of his capital, he will not know how well or how poorly he is doing his job. He is expected to be highly objective in his approach. His aim should be to go home for the day in the green. He doesn't get stressed in case something doesn't work out. He faces the consequences calmly. He keeps a close tab on his account statements. He never runs away from issues. He faces them upfront and fixes the issues wherever he can. Stress is the outcome of an inability to understand a situation and the resultant feeling that one lacks the resources or the ability to meet the situation or take remedial action. If you really know what you are doing, half the stress will vanish immediately. An objective evaluation of the situation at hand, the guts to face it upfront, and the ability to take timely corrective actions are the qualities of a solid day trader.

Failing is actually vitally important for big success. It changes you forever, and for the better, provided you learn and retain the right attitude. Provided you learn the right lessons, failure is your best teacher.

Are You Overtrading?

One of the major issues that often afflicts many traders is the need to be always doing something. While day trading will keep providing trading opportunities every few minutes, not all of them may necessarily come under your purview at the right moment. Not all may be of equal quality.

Not all may have the support of volumes, news event, corroborating higher time frame technicals, sectoral support or macro support. Just because a trap is laid out, you don't have to get trapped. Use filters as per your trading plans, and take only the best trades. **There are no border lines that define overtrading. But if you are taking too many trades without making any money, that's overtrading.**

Making money in trading is sometimes a lot of hard work. Sitting and doing nothing for long duration also takes a lot, after all!

Trading merely to recover the loss from a previous trade is not technical trading. Trading for the sake of revenge doesn't qualify as technicals either. Take the compulsion out, and take charge of yourself. Not doing anything is sometimes the best trade. It is not about the number of trades that you take.

Let us pay heed to Shivaji, founder of the Maratha Empire and a master of guerrilla warfare who said: He who fights and runs away, lives to fight another day. There has to be a good balance between patience during arrow sideways markets and quick reflexes when trading action is called for required. What is important is that your hands must not shake or hesitate when the time comes for pulling the trigger. That moment is not going to last forever. Especially in day trading, the window of opportunity stays open for a very limited time.

Attack with full force at the right moment; do your thing, and get out — again at the right moment. If the scene on the field starts looking different, you cannot keep waiting till the end of the day. You must follow your predetermined rules and get out before you get thrown out.

Heard that song from the Bollywood blockbuster, *Dangal? Bhedh ki hahakar ke badle sher ki ek dahad hai pyare*,— Ignore the continuous bleating of goats, hark the roar of the lion in the contest.

Never overstay your welcome in a trade. Once you master what is presented in this book, there's no reason to be scared of the markets. And there is absolutely no need of listening to multiple views, and keep getting confused. Everyone may have a different view as technicals are highly subjective.

Till You Book Profits, Everything is Notional

We often tend to forget is that you make — or lose — money only on the second leg of your order, i.e. when you exit. Until then, everything exists only on paper. In other words, exit is as important as entry. And focusing only on entries will not take you anywhere. Risk management addresses this issue:

- Focussing on exits in losing trades keeps losses in control and keeps you alive and kicking for another day.
- Exiting from money making trades at the right time will ensure that you do not give away what you have earned. Moral of the story: Keep booking profits at regular intervals.

There is a lot of work that markets require of a trader. The rewards are equally interesting. If you are willing to shed some perspiration, then you can definitely fulfil your aspirations. *Maangti hai laagat mein, tujhse har boond pasina, par munafa badle mein, yeh jaan le behad deti hai, bande ki mehnat ko kismet ka saadar parnaam hai pyare . . . Dangal dangal* (The contest demands of you every drop of your sweat. But understand, it gives back much. Luck favours and blesses a hard worker).

D-Streets is no less than a daily *dangal* (contest) — you either hunt, or you get hunted.

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Chapter 13

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Mastering Your Mind

Winning Techniques Beyond the Technicals

In first part of this book, we learnt how to identify the probable direction of the market.

We then covered market timing or trading tactics.

Then came the third important part, namely money management.

We now turn to the fourth part which will empower you to implement the other three parts. That's mind management.

Intraday trading in general, and the F&O segment in particular, hardly leave any room for error. If a trader ignores any of these four foundational aspects of trading, then he may easily screw himself up. It is very easy to keep losing money despite being right on the market's direction. Technical tools like the RSIs and ATRs of the world — even though very important by themselves — do not suffice to separate the wheat from the chaff, the winners from the losers. If that were not so, there would be many more market-made millionaires around.

Every person wants to protect his or her money and wants to grow it as well. Nobody enters D-street with the intention of charitable donation. In routine life, most people behave rationally. The same rational people, however, often behave irrationally in D-street. So, what goes wrong? Why is the value of money different when it goes inside the pocket, from when it comes out of it? Why does the loss of the same amount cause more pain than the happiness generated by the gain? Why don't people manage their money well? Why do they repeatedly resort to self-sabotage? Why do they put in their hard-earned money to buy losers? Why do they dump the winners to average out losers?

The answer to these questions is the topic of this chapter. And the answer is a lack of mastery over one's mind. **The simple truth is: You need to**

master your mind before you can master the markets or money. Until you grasp this point and train your mind, you may find it difficult to stay afloat or consistently implement any other dimension discussed in this book. This one chapter carries the weight of five. Ignore it at your own peril.

~

Markets are no less than the Italian car, Maserati.

Markets too can accelerate from 0 to 100 km/h in less than 5 seconds of the opening bell. Such breathtaking, blood-thumping and heart-stopping behaviour — which is quite normal to the market — can unnerve and terrify the bravest of the brave hearts. With stock markets as your bread earner, at any given point in time you are just one trade away from becoming a millionaire, and — hold your breath — exactly equidistant from losing your shirt. Unfortunately, not everyone is born to look like the Bollywood superstar Salman Khan when shirtless. Nor can everyone make millions out of doing so, as does Salman.

The evolution of a D-street trader includes lessons that actually go beyond trading. Successful trading is a journey that, crucially, requires mental training. That's what we intend to cover in this chapter.

What are the psychological blocks that keep people away from success in D-Street? We will address them all, one by one.

Stop Fantasizing, Accept Facts

Looking for sure-shot trades and safety are a sign of the amateur. Accepting risk is the sign of a professional trader.

You must accept that trading entails risk. Trading is a very unique profession. Across the globe, and in all other professions, people work and earn money. In trading, the goal is to make money work for you and earn for you. Trading is much more than the technicals that underpin it. Trading can be aptly compared to adventure sports. Whether it is para gliding, para sailing, white-water rafting, motor biking, rock climbing, all of them require extreme mental toughness and intense training. And despite all the caution, there is always an element of risk. Trading, too, comes with risk, no matter which technique you choose to use. Standing in D-Street and looking for safety is like standing in a war-zone and seeking serenity.

This game is for those who are willing to accept risks. The only way to have zero risk is by staying away from the markets.

Just as there are no free lunches in life, so too there are no risk-free trades in the markets. The sooner you accept this, the quicker you grow. At every single price level in a given stock, there are people who believe that it’s a bargain deal and is worth buying. Equally, there are many others who believe that the scrip is too costly at current levels and would fall sooner rather than later. Each set considers itself smarter than the other one. Both believe they can steal money from the other’s pocket. Only one of the two will succeed — at the cost of the other. This process goes on and on, and the loss of one is the gain of the other. That’s the way the markets are made. Somebody parties while the other pays the bill. You never know which side you will belong to with 100% guarantee.

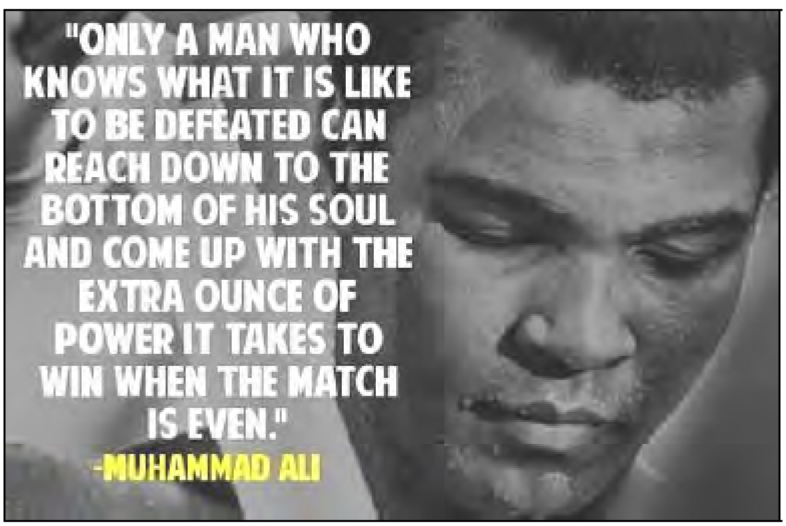
So focus on how to win more often and win bigger amounts. Learn how to cut your losses to smaller amounts, and learn to lose less often. That is the way to survive and grow in this line. Accept losses. Accept markets and the risk. And accept your own mistakes. Stop searching for the perfect and error free setup or technique. Stop fantasizing. Fantasies aren’t real.

Markets are not casinos, and trading is not gambling. It takes hard work and discipline to merely survive here. The territory is ruthless and hostile. It takes money, blood, sweat and tears before you can start winning consistently.

When people say that trading is like gambling, marriage comes to mind. Only time will tell whether the decision was right or wrong. Don’t we still get married? In fact, our families are usually more than eager to help us take that gamble! If you can take risks in life, you can take them in markets too, provided you take calculated risks and you stick to risk management and stop losses.

Mental Hygiene

A good trader is not one who claims to be always right with his calls, or someone who can accurately predict the tops or bottoms at every turn. A good trader is the one who makes consistent money, period. And that has very little to do with predicting the market. Failure is good. In fact, failing is crucial to your growth. Failure teaches what success doesn't, provided your attitude is correct. And provided your mind is open enough to squeeze out lessons from each failure.



A good trader will stay focussed on his work during work hours. Have you ever seen a doctor discussing how to cut open a patient and from where to operate on, say, WhatsApp during an on-going surgery?

Trading is a loner's job; it's not about consensus. Money is made when you have a strategy that you have seen working successfully a number of times. You must also be open to change, to adapt and to learn from those who know the game better than you. Borrowed know-how alone, however, cannot make any business successful. The business owner has to know his business inside out. Similarly, you have to know your scrips better than you know your better half! The market is booby trapped for self-sabotage and provides immense opportunity for that.

Hey, trader — crush your ego before the ego crushes you.

Focus on What Matters

Please park your emotions outside before entering D-Street.

Focus instead on what matters, and the rest of life will take care of itself automatically. The performance of an emotionally ruffled person is never consistent. Focus on stability and self-control. When anything disturbs you, just ask yourself whether this contributes to your journey towards your goal? If yes, address it. If not, ignore it and move ahead. This is one of the most difficult things to do, and the weak or the ruffled ones stand no chance.

Ditch that Itch for Constant Action

Desperation only leads to disaster in D-street. You must understand that just because the markets have opened, you don't need to jump in or immediately pull the trigger. If a trap is laid out, you have no obligation to get trapped. Holding an existing trade throughout the day, or for even longer, is also trading. Sitting tight when right, and squeezing out more from a "giving" market is the right thing to do. Waiting for the right entry is also trading. Equally, staying away when required is also a part of trading strategy.

Focus on Self, and Not on the Opponent

The biopic of India's former cricket captain M. S. Dhoni brought out a striking incident. During Dhoni's days of struggle, when he was growing up, he once lost a game.

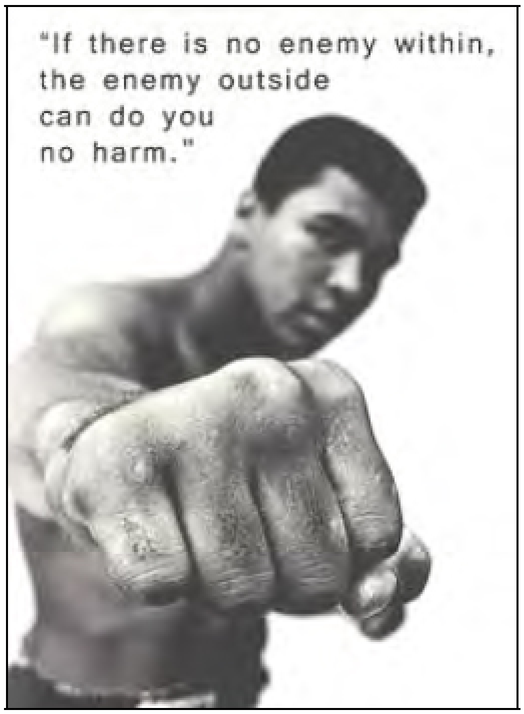
Afterwards, Dhoni's team was discussing the reasons behind its failure in the evening meeting. What Dhoni pointed out to everyone was very perceptive. The evening prior to the match, Dhoni and his team had come across Yuvraj Singh at the nets and they were all awed by his batting and personality. They were already viewing him as a force to reckon with. And, what was Yuvi doing? Well, he wasn't even looking at Dhoni or his gang. He was busy practising. Dhoni told his team during the post-loss analysis: *"Match toh hum kal sham hi haar gaye the* (We lost the match the previous evening itself when we were all awe-struck by Yuvraj)." The lesson that Dhoni learnt was spot on.

The body language of a winner is different, since he thinks about winning and not about defeating the opponent. The lesson is loud and clear: Focus not on the opponent. Focus on mastering your own self. Do not ever get awe-struck by the market, other traders, or their moves. When you reach a stage where you actually do not worry about anything else but your own game, you've reached an awesome level of freedom.

Seek Within

You are both the problem as well as the solution.

A good trader will never blame the charts or the markets media analysts or the media for a losing trade. Owning your failures is the first condition for moving towards success. When you say that someone else is responsible for your failure, you are making him the hero. You are saying that he was capable enough to harm you and you were weak in allowing that to happen. The market doesn't owe you anything; neither does life. So, work on yourself.



Unlearn Before You Learn

And there are more things to unlearn than you think.

As kids we are often told to go on trying until we succeed. That's a dangerous lesson unless you know where to apply it and where not. If a trade is not meant for you, it will not work for you. Use your stop loss and get out of it. Don't go on trying.

Your energy is better spent on building the good rather than in endlessly trying to control the bad. Get out of things that are bad for you fast, and get going on the good ones.

Time is Not the Solution to Every Problem

No matter how much time you give it, a piece of coal will not get transformed into a diamond by itself. So it is with stocks and trades as well. **It is not just about the holding period, it is equally about what you are holding onto.** It is the quality of the trade that matters. If someone had shorted Maruti at around ₹ 1,400 in the year 2013, he would not have come into profits even by April 2017. The market is full of hundreds of such stories.

Another Lesson to Unlearn

As children, we also often hear that day dreaming is bad and a waste of time. But dreaming about a good and a successful career is the first step towards building one. When you back the dream up with action, then it is no more bragging or dreaming. Dream it. Believe it. Build it. Achieve it.

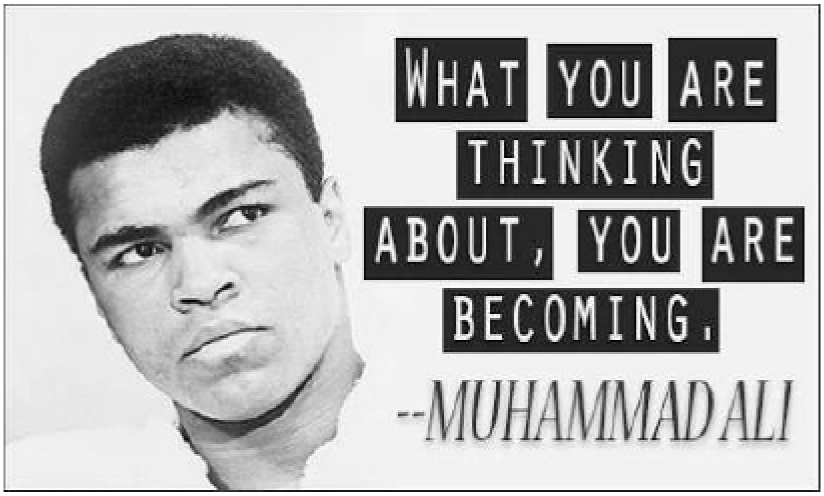
Have dreams, there's nothing wrong with that — but also have plans to realise those dreams.

The Seductive Market Can Disrupt Your *Tapasyaa* (Focus)

Beware of the seductive power of the market. Sometimes the disruptions can come in the form of temptations. Beware of the temptations of the lure of big money. Don't get led into chasing a trade idea, or the temptation of taking a super large position that's unsuitable for your account size, simply because of someone's recommendation or your own greed. These could well be the traps we defined earlier. So, go slow and steady. Stay focussed and don't fall for such lures of the market.

What You Seek Will Seek You

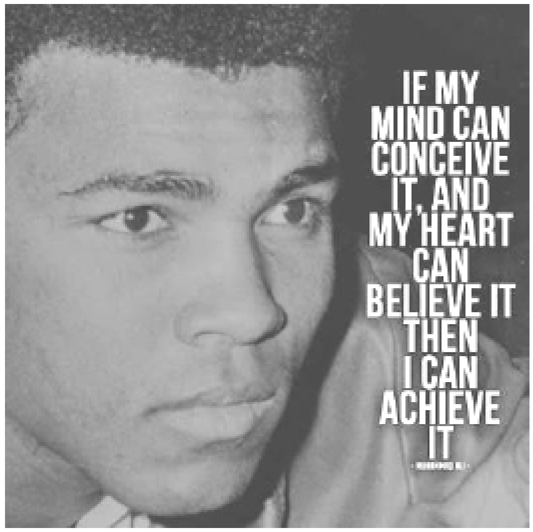
Anything that exists in the real world is first conceived by the mind. What you keep thinking, you keep creating. What you even verbalise, will materialise. So, beware of what you speak.



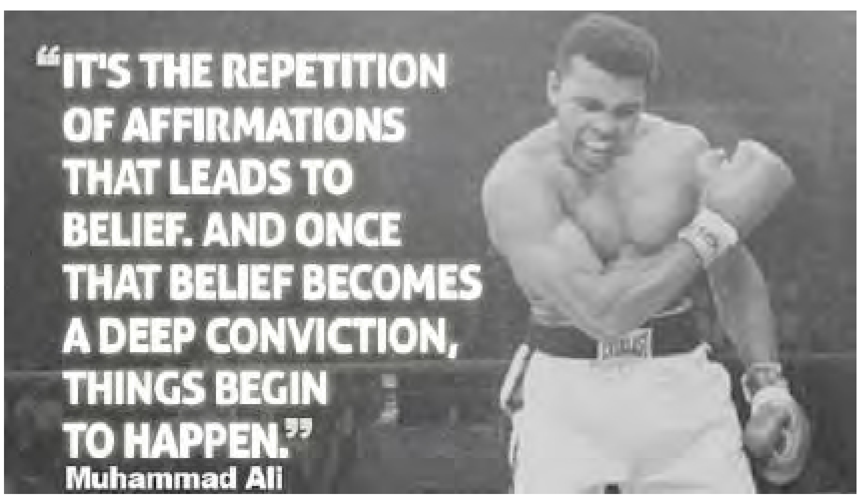
It is right there in your mind that the journey begins. Believe before becoming. This brings us to visualisation.

Visualisation Technique

The universe has got a long queue of pending requests for approval. So you are in the queue, please wait, — or make sure your intentions are so strong that you leave the creation with no option but to sit up and take cognisance of your desires. As we noted earlier in the book, nothing less than obsession will suffice. Visualisation is the act of imagining what you want from the universe, believing and feeling how you would be if you actually got it right now, and keeping faith that you will definitely get it one day. Whatever you think, whatever you believe in is what materialises.



If you grow up thinking and believing that money-making is a painful journey and success doesn’t happen unless you struggle and drain yourself out, that will become your reality. Such belief systems invite hurdles. On the other hand, if you believe that money and success will flow easily, then they do materialise comparatively smoothly. If your mind is always working in a particular direction, that constant focus aligns you to your goal. So believe in yourself, believe that you will make it even before you do. Tell this to yourself, and do so repeatedly.



Take Time Off

Once in a while, it's very helpful to disconnect from all the noise around. Taking time off can instill much needed stability and calmness and can reenergise you as you reboot.

Keep a distance from the digital distractions and detoxify yourself, for the discipline that's demanded by D-Street!

Calm-a-Sutra is the Key

Remember, every interaction is an exchange of energy. When you interact, you either gain energy from the other party — provided he is charged enough and is positive for you. Or, you lose energy — if the other party is either hostile or parasitic. Avoid unnecessary debates and stay away from minor battles here and there. Peace is more productive. Every single factor matters. Especially when the endeavour is ambitious and the road is filled with twists and turns, full of bulls and bears, highs and lows, greens and reds.

Stay away from energy suckers as well as time suckers. Isolate yourself, and concentrate. Limit your interactions, and prevent energy dissipation.

Developing the Killer Instinct

Any kind of business venture requires a penchant for risk. Setting up your own venture is as much about dash as it is about cash. It will take initial capital. It will also take working capital. And it will also require a gestation period.

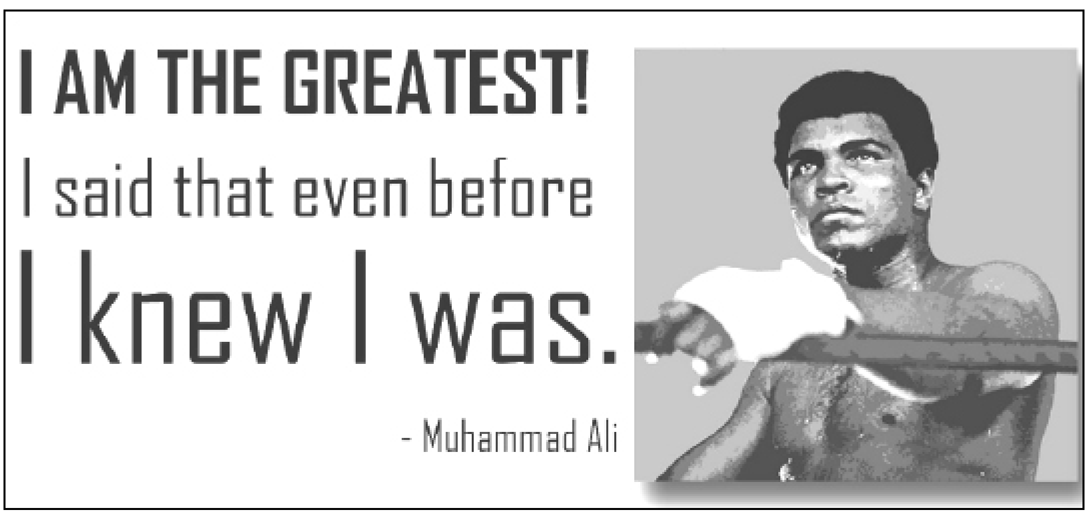
As I once said on the television is: "My strategy is that; if the snake bites you; you bite the snake back."That is what may be called the killer attitude. — Ashwani Gujral

Victory over Mind before Victory over Markets

Visualisation is just one technique that can build strong and positive mental strength. There are other techniques as well. It could be rigorous physical training. It could be chanting. It could be yoga. It could be pranayam and Sudarshan Kriya technique. It could be meditation. You may choose what suits you the best. Be strong, and stay unruffled. That's the point here.

Instead of saying, "I hope I don't lose," if you say "I am going to play to win," it makes a world of a difference. I had once said in a Delhi investor camp: "When the setup is right, I know that I am going to kill the market." That's the thing. You must play and win one thousand times during practice before you even enter the trading ring. Mental imagery has a profound effect on performance. It builds conviction. And that works magically. Victory over your mind is the key to victory in the market.

Remember that Bollywood song from yesteryears: *Humko mann ki shakti dena . . . mann vijay karein . . . dusron pe jai se pehle . . . khud pe jai karein* — Give us the strength to win over our own mind; before we can vanquish others, we must vanquish our own distractions and infirmities.



Conclusion

To all those people who might think that this was a chapter without any trading techniques, consider this: Do you think it is rational logic that drives the stock market?

Think again . . . .

When dealing with people, it's important to remember that we are not dealing with creatures of mere logic. We are dealing with creatures of emotion, full of fear, greed, pride and prejudice, and motivated by dreams and desires. Stock markets too are predominantly influenced by emotion. There are bouts of emotions during calculations of risk as well as during decision taking. When stakes are particularly high, emotions reign supreme.

There are two aspects to trading stock markets; one is the rational part, and the other is the "irrational" part. The second part is, in fact, what often drives the markets. The "why" part cannot make money. The part that looks at why the company did this, and why did it do that can only help you build a good research report.

It is not the cause, but the effect, that makes money. It is not the reason behind the move, but the reaction to the move or the event — it is the emotion on charts — that makes the money. Yes, we do keep a track of events because they help us know where to focus.

Trading success is more about the EQ than about the IQ. Stocks can go up on bad news and can fall on good news. Good traders do not get frustrated by these things as they understand how the markets operate.

Even the most experienced of traders with reputation for cool and rapid decision making abilities are said to have palpitations during volatile events, and at times their emotions — regret, pride, greed, fear, excitement, panic, anxiety, patience — can and do impact their decisions. Without the required focus on the psychological side of trading, winning consistently is difficult. And that is why focus on mind management is vital to your trading success.

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Chapter 14

The Discipline of a Day Trader

Anybody who has played professional sport would be familiar with the kind of qualities that make a sportsman successful. Playing professional sport is a tough job. It takes a lot of effort, endurance and energy to keep bouncing back after each setback. Every other person likes to play. But not everyone becomes a Sachin Tendulkar, a Saina Nehwal, a Mohammad Ali or a Geeta Phogat. Talent is a very small part of it. It is “practice up to perfection” that makes champions. Here are some qualities that show how similar stock trading is to being a professional sport:

- Each ball bowled in cricket is an opportunity to hit a six. Equally, it comes with the risk of getting out. Similarly, every trade comes with the risk of triggering the stop loss.
- Each ball in cricket must be assessed on its own merit depending on the placement of fielders, pitch conditions, direction, etc. Similarly, every trade must be assessed based on your pre-defined norms, context, entry, and exit and risk management.
- Unless you truly believe that you are really good at your job, you will find it difficult to sustain yourself during tremors, or be able to bounce back from setbacks. Whether in professional sport or in trading, high self-esteem is a must.
- You either kill, or you get killed. There is no third way. Whether in professional sport or in trading.
- You may have to read signs which may not be obvious. You have to understand the context and measure the validity of the opponent’s moves. There could be guerrilla tactics against you, whether in sport or in trading.
- If you fail to adequately analyse or prepare, then you should prepare to be penalised. Period. This applies equally in the boxing ring and in the trading ring.

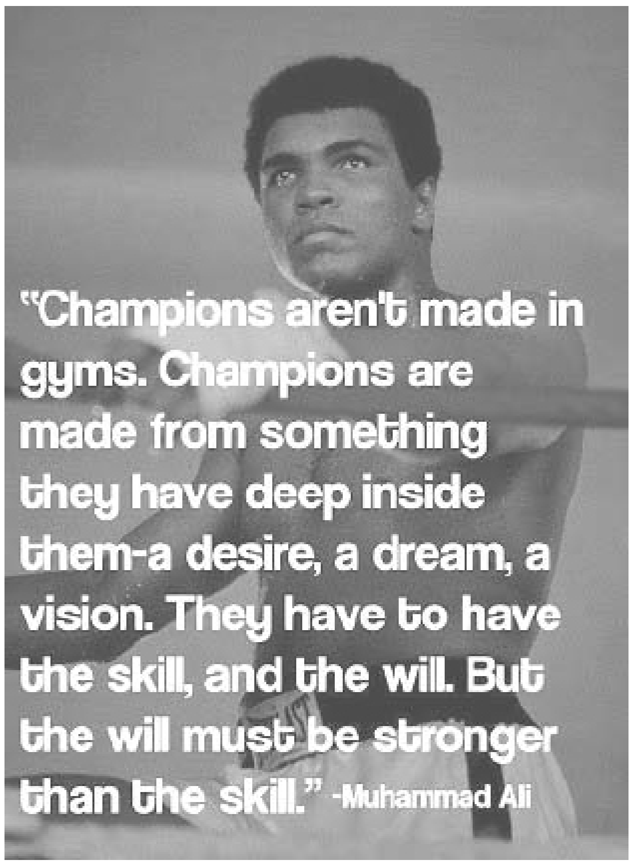
- One major mistake and you can lose a winning game, be it in sport or in trading.
- Both professional sport and professional trading require agility, nimbleness, sharpness, quick reflexes.
- You must have the ability to keep track of multiple factors, and also be able to shift gears swiftly with shifting situations. This is important both in sport and trading.
- Practice, patience, and perseverance differentiate winners and losers. Whether in sport or in trading.
- It is important to avoid late nights and partying, both before your match and before your trading day.
- Mounting losses build pressure both in sport and in trading.
- There is no overnight success whether in sport or in trading. It has to be built over time.
- Without an inner drive, you will definitely fall short of the required effort, whether in sport or in trading.
- Nothing can be achieved without concentration and commitment, whether it be cricket or trading.

There have been many movies on achievers in boxing or in cricket or even in the business world. All of them highlight commitment, concentration, and a single minded focus. Whether it is about M. S. Dhoni, Mohammad Ali, or Geeta Phogat. Even the bollywood movie *Chak De India* or the movie on Mary Kom for that matter, all of them bring out the extreme levels of dedication that go into making a world champion in professional sport.

Many of you might have seen the movie on Mark Zuckerberg, the founder and CEO of Facebook. We all use Facebook but only a few of us know how it was built. Mark's commitment was unbelievable, and unshakeable was his focus towards his passion. It is never without reason that a person goes on to become the youngest billionaire in the world.

Short Term F&O Trading is Only for Full-timers

It's a fact that talent is never sufficient. Neither is hard work. Absolutely nothing less than pure obsession will suffice. Putting in your hard earned cash without putting in the other required due diligence every single morning is asking for losses. Any lack of deep desire will definitely affect your decisions during desperate times. So either fall in love with the markets, or don't be there.



Day trading, and even swing trading in the F&O segment must be given full time, energy and attention. Equity trading can be done part-time but, again, that doesn't mean buying something and then dozing off into hibernation. Due diligence before action, and analysis and timely review post the action are both not just important but necessary for everyone. F&O trading is a specialised function.

Those who think that F&O is a joke will be made a joke of by the markets. I haven't heard of a part-time cricketer with top ranking or a part-time neuro surgeon. — Ashwani Gujral

The Daily Preparation of a Trader

If you are a full time trader, you must do your pre-market planning every single day. There is no question of entering the trading ring without preparation. A good trader will always have his view about the market and his scrips before the market opening. He will also be open to the rejection of his thesis based on subsequent market action. He will accept the market's word as final and overriding his own view. He understands that the market may accept or reject the thesis that he brings along every morning. Nevertheless, he will always have his thesis ready.

You must have your eye on overnight developments, local as well as global. You should be at your desk much before market opening. Disconnecting from the cacophony around at the end of day is important, as is reconnecting with the latest developments at the start of the next day.

In fact, the early morning routine that you follow will contribute to your energy levels during the trading session and the resultant outcome or trading performance. Everything, including how healthy your breakfast is, or how well you dress up for your work, all of it matters. It impacts your mood, your energy levels, your confidence levels, your focus, your logical thinking, your emotional stability and your organised approach. A shabbily dressed trader who has been watching movies till late at night, or one who has not even had his breakfast early morning, or has been attending ten other matters both in the real and the virtual world before market opening and during market hours, will not be focussed. He will not perform the way he should in a fast running market.

Remember one thing; you will not attract something just because you want it. You will attract not what you want, but only what you are. So, to be a winner, dress up like one. If you think you are a king — then you are one!

Be the *Mughal-E-Azam* (the Grand Moghul) in whatever you do; be the master at your craft, and nobody shall be able to beat you.

Yes, there are successful billionaires such as Richard Branson who operate from a hammock instead of a traditional office desk but day trading, or even short term trading in F&O segment, is a different profession, a very special one. It requires you to be highly attentive at all times and to always be on your toes. I remember one of my trader friends once had an open F&O position one morning. He got up for a break and sat on a hammock nearby within his home-office. Suddenly he saw a sea of red colour reflected on the mirror-finished wall near him. He jumped out of the hammock . . . but he had already lost money in six digits by then. He had broken his back while taking a break. We tease him about this incident till today. The price of carelessness or inattentiveness is far too high in this game. Welcome to trading!

Pre-market planning includes knowing the current phase of the market. It also includes your view about what kind of a day you are expecting to see ahead. It includes being aware of overnight developments across the globe as any major event can make or break the markets in the morning, such as the cratering of Wall Street on 2 February 2018 which knocked the stuffing out of global markets the next week. It includes your prepared daily trade plan which a day trader must bring to his trading desk every morning. It is suicidal to get into the trading ring without a plan. The plan must mention the current phase of the scrips of your interest, and all the important levels in those scrips that you will focus on during the trading day ahead.

Daily Trade Plan

Let us now look at a sample daily trade plan — *see* Table 14.1. There isn't any hard and fast rule about the format. You can modify it the way you feel comfortable. What is important is that you trade with a plan, and not randomly.

Table 14.1

Sample Daily Trade Plan

DATE

Sr. No.	*Index / Scrip*	*Current Phase*	*Broad Trend*	*Overall Strategy for Upcoming Day*	*Current Market Price*	*Imp. Levels Pivots / Highs / Lows / Entry / Stop Loss / Tgt, etc.*
1.	Nifty	Sideways & Nearing Breakout	Up	Buy on Breakout		
2.	Bank Nifty	Trending	Up	Buy on Pullback		
3.	Maruti	Correcting	Up	Let It Reach Support		
4.	ICICI Bank	Sideways & Near the Bottom of Range	Up	Time Ripe for Long Entry		
5.	Ceat	Major Correction on	Up But Over-Stretched	Can Look for a Short from Resistance		

Always remember: Plan your trades . . . and trade your plans.

Post Market Analysis

A good trader is equally rigorous about post-market analysis as he is about the thrill of live market execution. He knows that ignoring this activity can cost him money. Equally, the psychological and the mental damage that losses, mistakes and repeated failure cause are even more painful and destructive to a trader's future. A good trader will always analyse what went right and stay humble. He will always analyse what went wrong and stay grounded.

Use Technical Analysis for What It Is

Technical analysis is not meant to generate error free trades. It is only meant to provide you higher probability trade setups. Neither the tool nor the analyst is wrong if it doesn't lead to a hit ratio of 100%. That is simply not possible; nor is it needed for you to be a profitable trader. It is the right combination of research accuracy or success ratio, and risk management in execution, namely the risk and reward ratio, plus the position sizing and your ability to ride winners and cut losers with equal ease that keep you healthy in this business. If you don't know how to handle these issues, the problem lies in you and not with technical analysis. The sooner you accept this, the quicker you will rise. Period.

So, use techincal analysis for what it is rather than blaming it for what it is not.

Capital is Necessary but That Alone is Not Sufficient

Being under-capitalised is of no help in trading. For you may have to learn to lose professionally before you reach a stage where you win like a professional. On the other hand, no amount of money can ensure trading success. Capital alone doesn't guarantee that you will succeed. Markets are perfectly capable of washing away 7-digit, or an even higher level account, within a day or even minutes if and when mishandled. The only way to reduce risk is by knowing what you are doing. And by knowing what to do when you go wrong. Unmanageable risk comes from trading without appropriate knowledge.

Developing a "Gut Feel" for the Markets

Traders must develop a sense, or a feel factor, about the markets. This feel comes from observation, experience and constant effort at skill upgradation. It comes when you start keeping more and more factors in your view. It happens when you understand sectoral strengths and the impact of high weightage stocks on Nifty moves, along with the main trend of the market. It helps in having conviction about the trade that you would like to take. It happens when you start understanding the correlation between various sectors, scrips, news and events, the broad market indicators such as advance decline ratio, etc. It comes when you learn to keep the larger context in view, when you learn to understand the rhythm of the markets. It takes years of market experience before your eyes can start spotting money making opportunities. Just as it does for doctors, engineers, architects, singers, dancers, painters, astrologers, sportsmen, entrepreneurs, getting a feel for the market takes time. But it happens. And this intuition, or gut feel, is an educated guess and is different from emotional biases that make you live in hope and wish. When you combine this with technicals, that's when your technicals work better and the chances of going wrong get reduced. You start filtering better.

Complex human activities do not lend themselves to complete automation. Which is why the pursuit of wealth cannot be totally automated. Gut feeling plays a role but short cuts can cut you short. There is no substitute for human judgement. So learn to build that.

Goals Must be Stepped

Every "overnight success" takes years of efforts. So instead of focussing on becoming an overnight millionaire, focus first on survival. Then try to consistently make smaller amounts of money. Then aim bigger. Go step by step.

Hardware, Software, Costs, Commissions and Record Keeping

Only cheap things come cheap. Premium things come at a premium.

One of the best investments that you will ever make is in your business. Don't stinge on the required hardware and software. Learn to differentiate between an expense and an investment. The costs will stop pinching when you get results. The market is flooded with software options. Check them out and get what suits you best. Keep in mind, however, that what matters more is what you do with the software. So invest in that as well. Only if you know your job well will the right software get used in the right way. Also, it definitely helps having multiple screens for those who trade a variety of stocks and use multiple softwares or scanners, etc.

It is not the machine, but the man behind the machine, plus his method along with his mind-set, that makes money in the markets.

Another thing — no business is run without documentation. Always document your work; your planning, your analysis, your results. Not doing that is a sign of treating your work casually.

Toolkit of a Successful Trader

1. *A method of trading that you would like to stick to.*
2. *Technical know-how about markets and their working.*
3. *Sufficient back-testing of your trading strategies.*
4. *Constant skill upgradation and training with changing times.*
5. *Pre-market planning or home-work.*
6. *Post market review and analysis.*
7. *Dedication.*
8. *Unshakeable commitment.*
9. *Regular reading habit and staying updated with events around you.*
10. *Sufficient computer skills and comfort with making best use of IT.*
11. *Comfort in working with numbers and large amounts of data.*
12. *Patience in waiting for right trading setup, namely the right opportunity.*
13. *Decision making ability when the right time comes.*
14. *Guts to pull the trigger, nimbleness and agility.*
15. *Grit or mental strength to overcome obstacles and to withstand the pressure in an ongoing trade.*
16. *Resilience to rebound quickly after a fall.*

17. *Laser sharp focus.*
18. *A sharp and alert mind to spot opportunities in this jungle of more than 5,000 scrips moving every moment.*
19. *An understanding of the economy's macros as well as micros sectors, and their co-relation, no matter whether you are into technicals or fundamentals.*
20. *Execution abilities and trade management, namely grip over ongoing multiple trades, from entry till exit.*
21. *A positive attitude.*
22. *The right relaxation that rejuvenates you and gives you a high, without a hangover.*
23. *High self-esteem; remember, you become what you think yourself to be.*
24. *Zero mental baggage.*
25. *A burning desire to win; you can even call it obsession.*
26. *Good karma — yes, it matters and it makes a world of difference.*
27. *Ultimate level of discipline — and this includes not just in the work hours, but even in your life as a whole.*
28. *Ability to see your own mistakes and accepting them with humility.*
29. *Spirituality — it strongly impacts intuition.*
30. *Mindfulness — the ability to be in the present moment.*
31. *Ability to bend yourself at sudden and sharp turns; flexibility to instantly shift gears.*
32. *The spirit to take things in your stride and moving on.*

Don't Try to Drink the Entire Ocean

Nobody can drink the entire ocean, or be everywhere at all times. Find your trading niche and stick to it. If a certain pattern or market mood doesn't give you comfort, avoid it. You have a right to say no, and even a right to be wrong. Be selective. There is no compulsion and there is no reason to deal with mediocrity. Choose only the best trades and forget the rest. Remember, we want the money to flow easily.

Experience and expertise do not come bottled, canned or blister packed. You have to work your way through pressure, perspiration, persistence, practice and patience before arriving at perfection.

Overcome the Need to be Always Right

Changing tracks is fine. There is no crime in it and there is no stigma attached to it either. This is the only way to stay flexibile, keep moving in and out of positions, cut your trades when they go wrong, and make yourself mentally free for the next opportunity. Once you get out of the drama and the disaster of an incorrect position, the picture gets much clearer.

Conquer Your Ignorance

Ignorance is the biggest risk you face in the markets. You need to conquer it through right knowledge. Cultivate a habit of reading.When Warren Buffett was asked about the key to success, he pointed out at a stack of books and said: "Read 500 pages like this every day." Well, he spent nearly 80% of his time reading and is convinced that it worked magic for him.

The two best teachers are: books and Mr. Market itself. What is important is that you should stay teachable.

With the right kind of learning you can greatly improve your trading results. So keep trying the techniques till you find your niche, and then stick to it. Remember that something that did not happen till yesterday can happen tomorrow. There's nothing impossible if you believe in yourself — and if you want it strongly enough.

Throughout the book we have given you so many techniques and tools to handle the twists and turns like a pro. We have covered the 3 Ms for success in the market:

- Method,
- Money, and
- Mindset.

Now ahead, make use of these techniques. With these you are equipped to become a *Kaabil* (capable) trader, a *Races* (wealthy) trader and a D-Street winner.

Conclusion

Below we encapsulate some of the important points that you must remember before you begin to trade each morning:

- Don’t look back for anything, except to review the lessons learnt. Anything other than that serves zero purpose.
- Market prices and valuations will rarely in catch up. That’s the way they are designed to operate. Markets are meant to discount the future.
- We are interested in an event only up to the point where it tells us about the expected flow of funds. That is what reveals the underlying emotions and emotions drive markets. Otherwise even the best companies can under-perform for years together. We are not married to them, and we must never do that.
- We don’t take every trade. We stay with quality setups. We stay selective. You must choose your battles wisely. If a trade fails, don’t worry, don’t glare, go and find another bull or bear.
- We go full throttle when the time is right. We vanish from the trading ring in seconds, when time is right for that.
- Trading affects your psychology, and your psychology affects our trading. Protect yourself from emotional damages.
- The only way to overcome fear is to face it up front.

Publisher's Afterword

500% ROI! — The Proof of the Pudding Is in the Eating

It's natural for readers to wonder if the methods contained in a book actually deliver results in real life. Well, here is proof.

The table below summarises Ashwani Gujral's Bank Nifty trading results for FY 2017-18:

Client name: Ashwani Gujral Investment and Portfolio Management Pvt Ltd
Absolute P&L Statement for ALL-FO from 01/04/2017 to 31/03/2018

FUTURES

Trade details	*Buy qty*	*Buy avg ₹*	*Buy value ₹*	*Sell qty*	*Sell avg ₹*	*Sell value ₹*	*Realized Profit (₹)*
BANKNIFTY17MAYFUT	74000	22763.06	1684466558	74000	22755.79	1683928224	-538334
BANKNIFTY17JUNFUT	196960	23432.98	4615360716	196960	23448.76	4618467358	3106642
BANKNIFTY17JULFUT	207040	23937.54	4956028438	207040	23959.02	4960475506	4447068
BANKNIFTY17AUGFUT	299200	24491.53	7327866698	299200	24505.64	7332086736	4220038
BANKNIFTY17SEPFUT	239000	24627.71	5886021790	239000	24639.17	5888761648	2739858
BANKNIFTY17OCTFUT	25880	24555.95	635507880	25880	24553.63	635447886	-59994
BANKNIFTY17NOVFUT	176560	25557.69	4512465034	176560	25571.36	4514878456	2413422
BANKNIFTY17DECFUT	166240	25300.25	4205913740	166240	25326.20	4210228272	4314532
BANKNIFTY18JANFUT	312480	25928.93	8102271548	312480	25929.71	8102514334	242786
BANKNIFTY18FEBFUT	119040	26102.64	3107258858	119040	26103.56	3107367420	108562
BANKNIFTY18MARFUT	410680	24645.53	10121427870	410680	24655.05	10125336522	3908652
						Total	24903232

I must admit the results spun my mind when I saw them. They will spin yours, too:

1. Gross trading profit of ₹ 2.50 crore with a trading capital of ₹ 50 lakh.
2. This translates into a mind-bending ROI of 500%, yes, 500%.

So, one thing is clear. The methods Ashwani describes in his books certainly work for him. There is no reason why they shouldn't work for you.

But, do remember, these are results achieved by a master trader after years of learning the craft and disciplined trading. Obviously, it would be quite unrealistic for lesser knowledgeable, lesser experienced and lesser focused traders to achieve similar results straightaway. But it is something of a shining goal to aim for. As they say, if one man can do it, another man can, too, and maybe even better — and bigger.

Good luck and profitable trading.

Kapil Malhotra
Publisher, Vision Books

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[*] https://www.youtube.com/watch?v=ll-5GPy0xEk&t=2s This is tlie link to the Youtube Video of Ashwani Gujral at MIT, Manipal.

[*] As at the time of writing in May 2017.