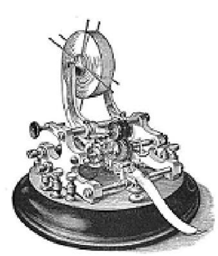
How are we to know in advance why and to what extent someone else is prompted to buy or sell? We cannot know; it is impossible for us to foretell what actuates all of those whose orders are poured into the vast intake of the Stock Exchange machinery during the day's session.

But if we study the action of prices; the responses; the speed of the ticker, indicating urgency or the contrary; the intensity of the buying or selling, as indicated by the volumes; and the intervals when the volume is heavy or light -- all these in relation to each other -- then we gain insight or the design and the purposes of those who are dominant in the market situation for the time being.

All the varying phases of market technique may thus be studied and interpreted from the buying and selling waves as they appear on the tape. From these we form a conclusion as to the balance of the probabilities. On this we base our commitments.

–Richard Wyckoff



 **The Mind Game 1**

 **Developing A Plan 18**

 **The Straight Line Approach (SLA)
and Auction Market Theory (AMT) 33**

Bonuses (separate *.doc downloads):

The Journey

Demand&Supply

I wrote "The Mind Game" almost twenty years ago. The whys and wherefores are not particularly important, but it's something that even I come back to periodically for a "tune-up", a re-orienting, a re-centering. While this may illustrate a certain simple-mindedness on my part, there is to me a certain accidental depth here, arising most likely from what I've appropriated from others.

I've made some slight revisions and updated a few things to drag it into 2015 and to enable me to "package" it with the SLA/AMT and Developing A Plan. They do work together, after all, and offering them together not only makes the material more approachable but might also provide some synergy for not only the beginning trader* but the trader who's lost his way.

> *In the 90s I referred to "investors" and "traders". But after the Internet Bubble, the Housing Bubble, the "Financial Crisis" of 2008, and the current Fed Bubble, I'm not so sure there are any investors left, at least of the buy-and-hold variety. Therefore, most of the references to "investors" have been changed to "traders". You are of course welcome to change them back in your own mind and no one will know.

It would not only be impossible to provide a seamless integration among "The Mind Game", "Developing A Plan", and "The SLA/AMT" but an attempt to do so would severely reduce the flexibility inherent in each of these three components. The SLA, after all, is not the only game in town. At best, as stated more than once, it is a primer, a starting point, a launching pad, a foundation, one response to the plaintive "where do I start?" that one hears almost daily.

I hope that others get at least some of what I got out of putting it together. Too much money is being lost needlessly.

--DbPhoenix, 2015

Until the lens of experience focuses information, it does almost no good. No matter how much the marketing machines of the Information Age would have us think otherwise, information by itself isn't power: knowledge is. And turning information into knowledge requires more time, experience, and effort than an afternoon spent staring at a screen full of facts.

Information is passive. To make it knowledge, you need to assimilate it. Put it in context. Understand it. Knowledge streamlines and focuses our relationship with information. Knowledge helps us avoid information we don't want or need and leaves us with the stuff we can use.

In an age in which endless amounts of bits and bytes are always available, it's a daunting task to spot the worthwhile stuff. It's easy for the Net to overwhelm us or lull us into the misconception that simply having access to something is as good as knowing it.

–Michael Penwarden

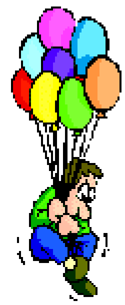
the Mind Game

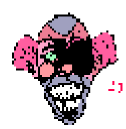
A few short months ago(JAN00) I was sitting pretty. I had no credit card debt. I only had a car payment and rent. I owned: 200 sh INTC, 100 sh DELL, 200 sh DIS, 100 SH HDI, 100 sh EGRP, 100 sh CCRD. I was about to get engaged. The ring I picked out cost $7500. I had not saved for it and I did not want to wait so I bought it on 90 days same as cash. I had just completed one short term margin trade and made just over $1000. I thought to myself, "if I do this six more times, I'll have the ring paid for". Well thanks to some volatility in LU and WCOM I easily made the rest of the money I needed to pay for the ring. But I did it with about 45 days before I had to mail the check to pay off the ring. I kept on trading. In three months I made $15K. Free money. Until Mar/Apr when VRTY, XCAR, and PMTC all tanked. I was margined on all three. Not only did I lose everything but I never paid off the credit debt. Now I'm struggling to save money and pay down the debt.

I had been leery of investing in stocks after listening to countless stories from my grandparents about the "Great Depression"; however, I felt I was missing the boat on the greatest stock run-up in history. My friends were telling me about all of the money that was just being handed to them in the stock market. After months of screwing up my courage and trying to convince my wife, I gathered up a fair amount of funds (for me) and took the plunge. Boy, I was on my way. I too would be able to regale all who would listen of great tales of the money I was making "In the Market".The first day, the stocks I had purchased were up 5 percent.The next day another 3 percent. Wow, this was easy. What had I been thinking all of this time? The date of my first purchase? March 8,2000. Needless to say, my fortune did NOT continue to increase on a daily basis. In fact, quite the opposite was happening. Over the next couple of months my portfolio fell by 29.7 percent. Being completely unprepared for such a turn of events, I did nothing. I had no plan. I had no knowledge of how to even approach a plan. I did, however, have a computer(which is partly how I got into this mess in the FIRST place)...

The stock market is a carnival -- and a tattered and disreputable one at that -- filled with conmen, hucksters, liars, and cheats whose primary goal in life is to take every last cent away from the ignorant, the fearful, the greedy, the arrogant. Occasionally one finds a good witch, and rarely a benevolent wizard, but anyone who thinks that the person on the other side of the trade has his best interests at heart is likely to find himself in a dark and unwelcoming place with time running out.

Most participants quickly realize that they are out-classed, that they are travelling in unknown and hostile territory, that if they don't find some way of protecting themselves real quick, they are going to be in real trouble. Many of these investing neophytes turn to mutual funds, believing that there is safety in banding together. And mutual fund managers know a hell of a lot more than the investor about investments and investing, don't they?





Surely.

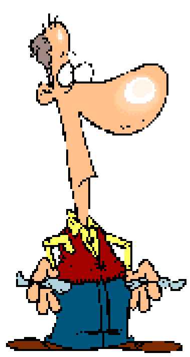
Others who have come before and who are weary of being pushed and pulled and whipsawed by the markets, including mutual fund managers, turn to newsletters, CNBC, various business magazines and newspapers, gurus like Buffet or Lynch, websites paid and unpaid, brokers, certified financial planners. They try all sorts of strategies in the same way that so many people try one diet after another, never tiring of disappointment, always hoping that the next one will be the one that really works. They try mechanical investing, value investing, DRIP investing, dollar-cost-averaging, growth investing, aggressive growth investing, specialization, diversification, the Motley Fool, daytrading, position trading, long-term buy-and-hold, momentum investing, options, HGS investing, CANSLIM. They "buy what they know". They buy what's "hot". They buy what's "undervalued". They buy GARP (Growth At a Reasonable Price). They buy earnings. Or sales. Or the promise of sales. Or they buy "vision".

And sometimes one or another of these strategies actually works. At least for a while. Perhaps for quite a while. But ultimately it disappoints. The market environment changes. Or investor sentiment changes. Something. Often elusive. Sometimes undetectable. And the quest continues for the "best" strategy. The ultimate strategy. The strategy that will see them through thick and thin, through good times and bad, that will pay off no matter what. The HolyGraille.

The trading game, however, is not won in the strategy one selects. The trading game is won in the mind.

> *Twice within the last four months I've been up around 15% or more. Both times I've been up, I've later given almost all of it away. Recently, I did give it all away, in less than 10 days. Why? Because for some reason when I become profitable I stop obeying my stop losses and start to sputter with my trading. I self-destruct. I can let a couple of trades wipe out my profits. It's bad enough to have to try make a profit in this market. However, when you lose because of breaking key rules -- that's another issue. I figure if I had kept all of my losses to the amount I'd set, I would be up about 25%-30% for this year. Instead, I'm starting over again...*

The big news is that the strategy one elects to follow is largely irrelevant. This is not to say that some strategies are not inherently superior to others, depending on timeframe and desired return. But unless one has the discipline to follow the strategy, no matter what the strategy is it will not provide the results that one expects. In other words, buy-and-hold is not necessarily superior to daytrading; growth investing is not necessaily superior to value; any strategy can be screwed up by an undisciplined investor.



Depending on just how new one is to the game, it may come as a surprise that the individual trader's worst enemy is not his broker or the market maker or Abby Joseph Cohen or HFTs or the Grinch that stole Christmas; the individual trader's own worst enemy is himself. His unexamined fears, hopes, greed, arrogance, self-doubt, lack of confidence, ignorance, stubbornness, anger, paranoia, laziness, and occasional stupidity will sabotage him every time and make his brokerage statement look like something that's been dragged by a fast horse over ten miles of bad road.

A single "article" like this, however, is no substitute for long-term therapy. It can explain what discipline is and the need for it, and it can also explain how various emotional and cognitive problems of one sort or another can interfere with an effort to achieve that discipline. But an individual's efforts to overcome those obstacles which are impeding his success in the financial markets can take years to reach even tentative success. The recognition of the need to embark upon this particular journey is only a first step.

Discipline is not just a matter of doing the same stupid and unproductive thing over and over again. It must also be objectively rational. It is acting in accordance with a specific set of rules, but those rules must make sense within the context of whatever it is one is trying to accomplish, whether that goal be to lose weight, quit smoking, or get rich. In other words, the acquisition of discipline in and of itself isn't going to get you very far if the goals you acquired all this discipline to reach are the wrong goals for you. In fact, if you select the wrong goals, you may wind up -- after having achieved them through a great deal of disciplined, objective, and rational effort -- asking yourself "Now what?" (this is a common problem amongst those who define success as becoming "famous"). Just as likely, you may find that you're unable to reach those goals at all -- no matter how disciplined you are -- because something inside you knows that those goals aren't the right ones and will sabotage you at every opportunity.

Let's take dieting as an example. Virtually any dieter would tell you that his goal in dieting is "to lose weight". And it is because this "goal" is largely unexamined that dieters almost invariably fail in their attempts, except perhaps in the very short term. It should be obvious that if one wants to do more than lose a few pounds in a few weeks that he's going to have to do more than chow down on bananas and ice cream, or Salisbury steak and cottage cheese, or granola and tofu. If one wants to take the weight off and keep it off, he's going to have to examine what he eats and why he eats it. He's going to have to think about whether his "comfort foods" are a gateway to regression or whether they are a response to the body's request for salt, or Vitamin C, or a particular amino acid. He's going to have to find his triggers, and determine why they prompt him to eat and when, and why some are so much stronger than others. And he's going to have to learn just what it is about being fat that is so rewarding, even though those rewards may seem neurotic in the extreme.

Similarly, most new traders, when asked, would tell you that their goal is to "make money". But if they never go beyond that, they are almost guaranteed to ***lose*** money, and though they may get lucky in the short term, lose money is exactly what they do, often with astonishing rapidity.

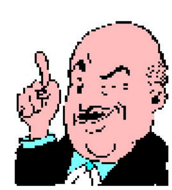
Everybody's goal is to make money. Unless one is a masochist. Why else fool around with it all? But to make a success of all this for a period of time long enough to actually *make* that money, one must go a little deeper than that. What is he going to do with it? Is it for retirement? If so, how far away is that? Is it for a kid's college education fund? Is it for a new house? Is it to feed a gambling addiction? Is it to prove one's manhood? Is it to impress the neighbors? Is it to make enough money on the sly so that one can leave her idiot husband and adopt a new identity in a different state? Is it to fill up the endless meaningless days with something more involving than *Riven*? Making money in and of itself can of course be a goal without qualification, but few people truly understand the single-minded determination -- even obsession -- required to achieve this goal. They often burn out, but not before creating a lot of suffering for those around them.

The strategy one employs, the trading instruments one looks at, the risks one takes, the amount of time one devotes to this are all directly related to the goals he has (though the amount of time he has to begin with will have a great deal to do with how much is devoted to the strategy, and if there isn't enough, the goals may have to be re-examined). Putting no more thought into it other than "make as much money as fast as possible" is usually the first step on that slippery slope to a negative balance. Only after deciding "this is where I want to be and this is when I plan to get there" can one even begin to plan *how* he intends to get there. Internet stocks, for example, are [were] clearly inappropriate for a sixty-year-old widow living on a fixed income. If one is playing them, and he loses a third of his portfolio value, can he make it back? Is he good enough? Will he have enough time?

> As the playing field is leveled for investors and trading professionals alike, technocrats are rapidly losing their competitive edge. Soon everyone will have the same technological edge in the financial world. Inner space is now the new frontier. As a result, the keys to financial success are rapidly shifting from the left-brain to the right-brain - from 80 percent technology and rational solutions, to 80 percent mind games, intuition, mental discipline and the techniques of mass psychological "warfare." --Paul Farrell

Once one has determined his goals, the next most logical step would seem to be a choice of strategy that will enable him to reach those goals, preferably as soon as possible. But just as going to the store and getting the roller and the paint is not all you need to do in order to paint the house (first you have to repair it, sand it, caulk it, prime it...), choosing one's strategy is not necessarily his next task. How is he going to go about choosing that strategy? Will he choose the one which claims to provide the greatest return in the least amount of time? What if it ties his stomach in knots? What if it seems not to deliver as quickly as it promised? Perhaps something slower and steadier would be more appropriate. But what if it's timeline is intolerable? What if the trader just can't summon the patience to wait for the promised benefits of the safer and steadier course?

Many new traders will take the adopt-a-guru approach. They'll have heard about or read about Warren Buffet or Peter Lynch. Or they'll have heard about daytrading and its supposed rewards. They'll read one or all of Buffet's or Lynch's books. Or they'll read one of the "interviews with traders"-type books churned out by Schwager or Abell or Koppel or Tharp, among others, believing that if they can emulate these gurus and adopt their behaviors and behavior patterns, then they will be well on their way to reaching those goals they so carefully articulated.



The most obvious and inescapable problem with this approach is that one puts himself in the position of becoming someone else. Perhaps this is done on purpose because he believes that he does not have what it takes to be a success in the markets, but that he can achieve that elusive success if he can think and behave like a demonstrated achiever. And this approach can in fact work out quite well for some if they coincidentally just happen to be on the same wavelength as the guru in question, just as there is often a ring of recognition between two soon-to-be lovers when they find they've met their soulmates.

But the fanclub approach to trading will eventually begin to chafe many newbies because they've made the error of trying to adapt themselves to what may essentially be an incompatible strategy, rather than try to determine exactly what kind of trader they are, then find a strategy that's appropriate to that type of trader.

By "type of trader" I don't mean short-term or long-term or agressive. How one characterizes himself as an trader is a direct result of and is inextricably connected to the kind of person he is. A person who can't tolerate risk in real-life sure won't be able to tolerate it well as a way of approaching the markets. A person who is rightfully proud of his intelligence and skill and the quality of his judgement isn't likely to find happiness with a mechanical strategy that prevents him from using any of that. A person who is fearful, lacks self-confidence, is subject to self-doubt, fits of anger, feelings of envy or even greed will find the going much rougher than the individual who's gone through some serious self-examination and is ready to meet the market on its terms. Are you thoughful or impulsive? Conservative or wild? Are you patient or do you have a short fuse? When confronted with an obstacle, do you immediately become frustrated or do you begin to evaluate various ways of getting around, over, or through the obstacle? Are you methodical or do you act according to your "gut feeling"? Are you focused? Easily distracted? Do you walk fast or slow? Do you put your socks in the laundry hamper or do you leave them where they lie?

These are only a few of the questions that you'll eventually wind up asking yourself, but they must be addressed sooner or later as everything else flows from the answers. The less one knows about himself, the more disconnected he will become from himself and his surroundings and the poorer his results will be. You may have yet to deal with this step, perhaps because it's the most difficult or perhaps because it never even occurred to you that it might be necessary. But it's both difficult *and* necessary and you won't succeed as a trader until you come to terms with it. Therapy is an option, of course, and a surprising number of people do go through it in order to become better traders. But not everyone is going to go that far just to obtain an edge. For these, I find Douglas' *Trading In The Zone* and the second half of Sperandeo's *Methods of a Wall Street Master* to be of invaluable help, but until the FedEx man arrives, the following from David Barney may give you a start:

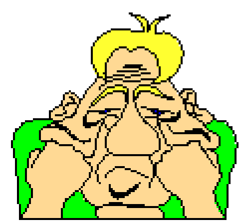
> The first type of trader, and the one that is potentially the most destructive to both himself and to his

account, is **the Gambler**. The Gambler believes that he or she is just one step away from finding the next Microsoft. He spends all his time doing extensive company research hoping to hit a homerun. He reviews thousands of company stock reports and earnings estimates and spends countless hours in chat rooms looking for that diamond in the rough. When the Gambler convinces himself that he has discovered the goose that will lay the golden egg, he risks most if not all of his capital, only to find out he has purchased an infertile pigeon. The reason the Gambler fails is simple: the odds are clearly against him, yet he ignores this fact and plunges in. There are tens of thousands of publicly-traded companies. What are the odds of picking the right one? The Gambler would be better off buying lottery tickets.

The second type of trader is **the Nerd**. He believes that if he can just develop a computerized trading method, he will gain riches beyond his wildest dreams. He purchases expensive computerized software and does extensive back-testing of different trading strategies. He uses this back-testing like the Gambler uses the earnings reports, as a way to convince himself that he is now in possession of the same goose. Once the Nerd begins trading using his newly-found computerized model, he may begin to experience limited success. This serves to fuel his belief that he will soon be rich and causes him to take greater risks. History, however, is strewn with broken-down trading systems and poor Nerds. The Nerd fails because he refuses to believe he is wrong or modify his trading system and, like the Gambler, he puts too much at risk.

The third type of trader is aptly called **the Sheep**. The Sheep, by nature, is both lazy and unintelligent. The Sheep believes that by reading financial newspapers, subscribing to newsletters, and relying on other traders' opinions, he can get rich by following the herd. This problem has been magnified by the [online] flock, those traders that check the chat rooms and message boards 40 times a day looking to make a fast buck without doing their own due diligence. The Sheep fails because he or she believes that others are smarter than they are. They put their faith in others because they do not believe in themselves.

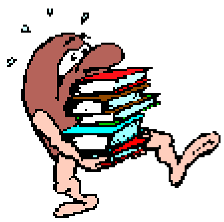
Self-doubt or lack of confidence may be your greatest obstacle and your greatest enemy at this point. You may begin to feel that this is all far more complex than you ever imagined. And you may be right. And you may be ready to say the hell with it and put your money back in the shoebox. Understand, however, that everyone is overwhelmed at the beginning, just as anyone who decides to build a house and act as his own contractor is soon overwhelmed. Whether you rise to meet the challenge or shrug off the whole subject and go back to your joystick and *The Tower of Doom* will say a lot about whether you will be -- or would have been -- successful at managing your own portfolio.



Unless you're the type of person who takes his car to the mechanic, opens his wallet, and says "Here", you're going to want to obtain at least a smattering of knowledge about whatever it is you intend to become involved in, in this case, financial markets and the instruments in which they deal. The SLA/AMT is dedicated to making the complex simple, or at least trying to. It begins by explaining how markets work and what charts are. It then delves into all sorts of issues, most of which are clearly market-related, but some of which are related only to keeping the trader sane. But no single work can tell you everything you need to know about markets and trading, and the less you know about either, the more severe your disadvantage will be.

Your next task, therefore, can be summed up in three words: learn your business. Learn what markets are and how they operate. Learn what a stock/futures contract/option is and what it represents. Learn at least something about who all these people are and how they're trying to screw you out of your life's savings. Learn something about charts, about the difference between stocks and bonds, about market cycles and the influences of inflation and interest rates.

How?



Reading. Observing. Studying. Maintaining a journal of what you're observed and what you think about it. Joining an investment club. Subscribing to *Investor's Business Daily* and the *Wall Street Journal*. Reading *Business Week* and *Barron's*. Reading what seems stupid and disagreeable (you won't learn much if you limit yourself to that which bolsters what you already think you believe). Reading books on the markets and on investing and on money management. Reading trade publications on electronics if you're interested in electronics. Reading trades on retail if you're interested in retail. Reading trades on . . . you get the idea.

One book which is particularly helpful in that one explores not only the markets but his own relationship to the markets is *The Nature of Risk: Stock Market Survival and the Meaning of Life* by Justin Mamis: interesting, engaging, extremely well-written and thought-provoking. This plus the remaining books in his trilogy – *How to Buy* and *When to Sell* – are very nearly a course in trading.

Another is *The General Semantics of Wall Street* by John Magee. If you read nothing else this summer . . .

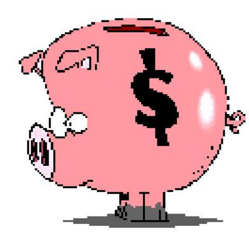
And to help you avoid shooting yourself in the foot is *Why Smart People Make Big Money Mistakes* by Gary Belsky and Thomas Gilovich.

And for those for whom even the above-listed books begin at a level which is *way* beyond where the trader believes himself to be, *The Wall Street Journal Guide to Understanding Money & Investing* by Kenneth M. Morris et al. Perhaps the most difficult task one faces in selecting a beginning book on the markets -- other than finding one that he can understand -- is finding one that doesn't have an agenda, one that doesn't tell you, for example, that you shouldn't buy penny stocks (you shouldn't, of course, but that's not the point; it's your money and you can throw it away on anything you damn well please). Or that you should ignore charts. Or that you're mentally defective if you don't diversify (or that you're mentally defective if you do). This particular guide is as non-partisan as any I've found.

The Day of Reckoning, however, cannot be postponed indefinitely, no more so than your appointment with the dentist for that root canal. After taking these necessary detours and making these necessary preparations, we must face the issue of discipline once again, this time in earnest, vorpal blade in hand.

You may know by now whether you really are capable of creating your own custom strategy or whether you ought to look for an off-the-rack strategy (but which can be tailored to fit) such as the SLA/AMT, at least to begin with. Or whether you ought to stick with mutual funds while you explore alternatives which might (or might not) be more compatible with your way of negotiating your way through the world.

Regardless of the strategy selected or created, however, the need for engaging the market with as little fear, anger, and arrogance as humanly possible will be unavoidable if you are to avoid expensive mistakes. Unless and until you can be objective, rational, and emotionally disciplined in every market interaction, you are in danger of making that error which will generate a loss. You will win not because of how smart you are or how knowledgeable you are, but because of how well you can *execute* that knowledge. The process of selecting a strategy combined with one's ability to execute *any* strategy work together along with what he knows of himself to create a profit-generating trading machine.



Only a relatively small percentage of traders -- amateur or professional -- have what it takes to execute in an objective, rational, and disciplined way. If you think you are a member of this group, or are wondering if you might be, try a simple experiment:

First, sit in a comfortable armchair, feet on the floor, arms on the armrests, head erect and balanced on your neck so that you don't have to consciously maintain its balance. Close your eyes.

Next, focus on your breathing. Concentrate on it. Count your breaths, an inhalation and exhalation counting as one. Count them up to four, then begin again with one.

The catch is that you must think of nothing else other than your breathing. Not for an instant. Not the temperature. Not the barking dog outside. Not that errand you have to run. Not the itch on your forearm. If your attention wanders even for a split second, you must begin again with one and try to work your way up again to four.

A surprising number of people never get past one. Or even past the top of the first inhalation (that pause between the inhalation and the exhalation is a killer). Much less two or three. Few people who aren't practiced in meditation can make it to four. Unless they fudge.

But this is the level of control that is required when engaging the market.

Now this, monks, is the noble truth of pain: birth is painful; old age is painful; sickness is painful; death is painful; sorrow, lamentation, dejection, and despair are painful. Contact with unpleasant things is painful; not getting what one wishes is painful. In short the five groups of grasping are painful. Now this, monks, is the noble truth of the cause of pain: the craving, which leads to rebirth, combined with pleasure and lust, finding pleasure here and there, namely the craving for passion, the craving for existence, and the craving for non-existence. Now this, monks, is the noble truth of the cessation of pain: the cessation without a remainder of craving, the abandonment, forsaking, release, and non-attachment. Now this, monks, is the noble truth of the way that leads to the cessation of pain: this is the noble eightfold way, namely, correct understanding, correct intention, correct speech, correct action, correct livelihood, correct attention, correct concentration, and correct meditation. --The Four Noble Truths of Buddha

Life, in other words, is difficult. Life has *always* been difficult and always *will* be difficult. It is only when we expect it to be easy that we are disappointed. We want from it and we demand of it, and when we don't get what we want or demand, we are disappointed. We expect and we anticipate and we plan, and we are disappointed. We do not acknowledge the reality. We do not accept the truth: life is difficult; get over it. Rather than whine and moan about how difficult it all is, we should focus on ways of overcoming those difficulties. Only by overcoming those difficulties can we find pleasure and joy, whether that joy resides in closing on that dream house or on completing a successful trade.

Goals are necessary as a prompt. They motivate us to act, to decide. It doesn't matter if the goal is to find something to eat because we are hungry or to fund our retirement because we're terrified of living in a box, at the mercy of the state. Goals provide our reason for living, for making it through the day, even if the goal is *only* to make it through the day.

But reaching our goals, if they are at all worthy of our attention and of our effort, will not be easy. Reaching them will take concerted effort, focus, determination, will. By understanding and accepting the difficulty of reaching our goals, that difficulty ceases to be an issue. It is simply accepted as the way things are, and no longer presents a distraction, much less a roadblock to our ultimate realization of those goals.

In order to select or to create a strategy, one must have data. Reading and study is one means of collecting data. Observation is another. Tracking the behavior of markets and the performance of particular trading instruments over time to determine the characteristics of those which succeed, and maintaining a journal of our thoughts and facts and hypotheses along with the thoughts of those whose opinions we respect, is yet another means of collecting data. Using that data to fine-tune our goals enables us to create a preliminary strategy for engaging the market, a strategy which will be subject to continuous -- or at least periodic -- revision. One's natural tendency in creating this strategy, however, will be to build in a level of difficulty and complexity to match that of the target of the strategy, i.e., the financial markets, and this must be avoided at all costs.

Knowing and truly accepting the difficulty of the task before us, and striving for simplicity at every step, at every turn, represents a giant step toward incorporating the emotional discipline necessary to reach our goals. We know that the will to execute is largely dependent on the simplicity or complexity of the strategy, and that the simpler it is, the more likely we are actually to do it. We focus on achieving "correct understanding, correct intention, correct action" (see Buddha, above) in order to determine just exactly what it is we ought to be doing. We focus on "correct attention, correct concentration, and correct meditation" in order to enable us to go about doing it.

If the meditation explained earlier seems just too weird for you, put yourself in the place of the tightrope walker (if you have no imagination and no tightrope, upend a 2x4 and step up onto its edge). In order to reach the goal of making it to the end of the rope, one must focus on the intermediating goals of not losing his balance at every step. The intensity of the focus necessary to reach *those* goals is -- as you can imagine -- extraordinary. To a large extent, survival lies in simplicity: the feel of the rope underneath the foot, the movement of the air, the interplay of the muscles. To increase the complexity of the task by allowing in the noise of the crowd, the sweat pouring down one's body, the potentially overwhelming fear, is to invite disaster. Only by focusing intently and exclusively on each step in its turn can the performer hope to reach his ultimate goal.

Similarly, the investor can reach his endgoals only by focusing on each of the intervening goals in an emotionally disciplined way. To do this, he must write down in excruciating detail every step of his trading plan. He must write down whatever might conceivably go wrong, along with all the possible contingency plans he can derive for dealing with those events.

He must write down all his possible options in the event that everything goes right. He must write down potential courses of action for dealing with the unexpected, which, by definition, will be unexpected (in other words, if for example something unexpectedly unpleasant happens, will he exit immediately in order to evaluate the situation more objectively, no matter whether he is in a profit or loss position?). This will provide him with a plan, a routine, and a reference point. By means of the journal, it will evolve over time into a thoroughly unique instrument which will fit him like a glove and which will enable him to reach those goals which he worked so hard to develop. This is referred to as "planning the trade".

After this, one must actually "trade the plan", focusing on each step in its turn, ignoring the commentary, the message board flames and entreaties and boosterism, the unimportances and trivialities, the hunches, the guesses, the hopes, the SMOTEs (should, might, ought to, expect). And it is here that the fear, the anger, and the arrogance will loom large and act to sabotage his efforts at every opportunity. Oddly enough, the more carefully he has planned, the more likely he will be to have a problem with arrogance since he *must* be right by virtue of having planned so carefully (arrogance is a particular problem for fundamentalists since they know the company so well; unfortunately, they are generally incapable of separating the performance of the company from the performance of its stock). Fortunately, as recompense, careful planning enables one to de-fang fear, and the more careful the planning, the less able fear will be to bite the trader in the butt.

In this business, you never stop learning.

Let me put it another way. If you stop learning, you're on your way to going out of business. Wall Street is a tough teacher but also a good teacher. If you have any weakness -- arrogance, laziness, stinginess, cowardice, procrastination -- the market will zero in on that weakness and make you pay dearly.

--Richard Russell

Anger will not be so easily calmed by careful planning. To the contrary, it is most likely that anger and arrogance will feed each other to the point where they are capable of paralyzing the trader. "Correct speech", however (remember Buddha?), can help to melt this anger like a Popsicle in July. We use words and gestures to describe ourselves and the world around us. We naturally choose those words and gestures which we believe will most accurately reflect our thoughts. But words have the power not only to describe but to influence. If we choose a different set of words to describe, those words can have the effect of changing our thoughts (consider the differences between aggressive and bitchy, faggot and gay, homeless and bum, sensitive and wimpy, conservative and tight-assed, free-spirited and slut). This is called "re-languageing".

The advent of the Internet has enabled the individual trader to come closer and closer to competing on a level playing field with the "pros". And when all the relevant information and all the tools are equally available to everyone, the winners in the game will be those who understand that the game will be won in the mind. As Koppel and Abell put it, "Overcoming your personal psychological barriers and conditioning yourself to produce feelings of self-trust, high self-esteem, unshakable conviction, and confidence will naturally lead to good judgment and winning trades based on a proven methodology". Re-languageing is a large part of that conditioning.

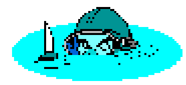
It is now clear that the words we use to address our children can have a lifelong effect on how they view themselves. But the words we use to address *ourselves* can have the same effect. For example, if after a trade goes bad one says to himself "How could I have been so stupid?", he is likely to become angry with himself, or with his strategy, and that anger may generate feelings of worthlessness or stupidity or cowardice or hopelessness. Or the anger may trip his arrogance, and he'll begin to rant against the market or the market-maker or the daytraders or the worldwide conspiracy to cheat him out of his money yada yada, none of which will be very productive. On the other hand, if he acknowledges the bad trade and asks himself why it went wrong and what he has to do or learn in order to prevent a re-occurrence in the future, that entire cascade of unproductive and potentially damaging negativity is short-circuited before the first thought even begins to form. Re-languageing doesn't change the event, but it changes how we view the event. Thus it changes how the event affects us, how we react to it, and how we feel about the way in which we reacted. The perception becomes the reality.

According to Sperandeo, "practicing emotional discipline not only enhances your ability to act, but also reduces the level and frequency of emotional conflict -- it becomes a source of consistency in thought, actions, and feelings". Practicing emotional discipline, however, need not imply a rigid and mindless adherence to a series of inflexible rules. We can choose what we think about, but we can also choose *how* we think about it, our perception of that reality, through the words we choose to describe it. And the words we choose to describe ourselves and what's happening around us will be chosen for reasons that are far beyond the question of whether one should or should not buy a particular stock at a particular time at a particular price. For example, did your mother ever tell you to take that money out of your mouth because it was "dirty"? Did your father ever call you "stupid"? How have you handled failure and success in other areas of your life? What do you think failure and success *are*?

Chuck Norris, of all people, says that "once you have mastered your art and brought yourself up to a peak of perfection, the chances are that each time you lose it’s a result of the same problem: your mind". Within the context of emotional discipline and re-languageing, the concept of "changing your mind" takes on an entirely new and different aspect.

Most of us believe that money-making is a game that is played with forces outside ourselves, forces such as the economy, the stock market, interest rates, the Fed, government policies, employment statistics and the like. But as you move along a spiritual path and begin to get a taste of the power of your invisible self, you discover that money-making is merely a game that you play with yourself. --Wayne Dyer

Getting Your Feet Wet



So you've read a couple of the books, you've read the SLA/AMT, you've read "Developing A Plan", you've toured the internet and window-shopped at least a few strategies. You've thought about just how much time you want to devote to all this, how much time you *have* to devote to all this, you've given some thought to your feelings about money, your feelings about success, your feelings about failure, your feelings in general and how likely they are to sabotage you. You've even thought about the kinds of stocks or whatever you'd like to trade and perhaps even selected a few. You may even have bought a spiral notebook and jotted down a few rules for yourself that you hope will keep you from losing the farm.

But before you pick up that phone or logon to that website to place your first order, before you step off that cliff into the shark-infested waters, before you step into the quicksand, before you poke that stick into that African bee hive, you would be wise to back off a bit and plan this invasion just as carefully as you planned your strategy (preferably more so). If you do it right, you'll learn something about the trading instrument you've selected, you'll learn something about markets, and you'll learn something about yourself. And you'll do it at far less cost than you might otherwise if you were to just leap in, guns blazing.

Your mission -- should you decide to accept it -- is to take *a set amount of capital* (i.e., you may not add to it during the mission), buy *one stock* with it, and *double* that capital within *six months*.

It doesn't matter if you start with $1000 or $5000 or $100,000.

It doesn't matter if you double your capital with just that one stock or whether you buy and sell several. But you can't buy another stock until you've sold the one you already have. You can hold only one at any given time.

You can buy and sell (and short) your stock as many times as you like. Being stopped out is the same as selling. Either buy it back or move on. Your choice.

The double must be net, not gross. You must account for commissions, taxes, margin costs, any transaction costs whatsoever.

You must do it for real, not paper-trade it. The value of this is directly proportional to the commitment you make.

You must maintain a journal of your transactions, your strategies for buying and selling the stocks, what goes wrong with your strategies and why you think so, what goes right with your strategies, the details of whatever struggles you may be having along with the sources of your pride and your pleasure. This journal must be private, for your eyes only. Otherwise you'll feel a need, unconscious though it may be, to impress somebody and to save face if you screw up.

The single greatest problem of every trader no matter how experienced or skilled is the maintenance of focus. Without focus, you can't have discipline. Without discipline, your performance will be far less than it would otherwise be. Concentrating on one stock, its group, and the general market to the exclusion of everything else will tell you whether or not you're capable of acquiring -- much less maintaining -- a level of focus that will enable you to succeed. Being required to double your capital in six months or less will prevent you from sticking it in something like GE and going on a cruise.

The purpose of this exercise, then, is to teach you something about focus and discipline and filtering out noise, about what it means to concentrate on one thing and get to know it, its support and resistance levels and what the volume at each level reveals.

But its purpose is also to teach you something about yourself and your ability to develop the intellectual and emotional skills required by this endeavor. Even if you're a "long-term" trader, you still must learn to pay attention to what's happening and learn if you're likely to waffle around when it's necessary to get out or go all wimpy when it's time to buy. If paying this kind of attention is beyond what one is willing to commit to, he needs to know that ASAP and look at things like market or sector instruments (ETFs, etc.) instead, forgetting about individual stock selection (or futures or options) altogether.

Most everything you need to know is in the SLA/AMT and in the books I've suggested. What isn't can be found via a simple online search. You can use this exercise as an opportunity to test the validity of what others recommend doing or to test the validity of what they recommend *not* doing. Or you can buy books on trading or shorting and go that way. It's all up to you. Once the six months is up, you'll have learned more about yourself as a trader -- and perhaps as a human being -- than most traders learn in their trading lifetimes.

My analysis of the markets and stocks I keep track of is frequently excellent, sometimes even brilliant. Furthermore, my trading scenarios are a work of art. But as my stop discipline is so very strong, I end up taking lots of break-even or small losses. In fact, I violate my stops by exiting before stops are hit, and before my positions have the time to manifest the profitable behavior I so presciently anticipated. I expend so much effort calculating where the stops should be, and then emotionally sabotage my own trades...

There are only two mistakes one can make along the road to truth:

not going all the way,

and not starting.

–Buddha

Developing A Plan

The Trading Journal

In order to succeed at trading, you must have an **edge**. Your edge begins with the knowledge you gain through your research and testing that a particular market behavior offers a level of predictability that provides a consistently profitable outcome over time. Without it, one is just "playing" the market in order to have something to talk about on message boards. To get it, you have to know exactly what you're looking for and what to do with it once you've found it. This process is what the journal is all about.

The journal goes through several stages depending on where you are. Once you've decided where you want to concentrate your efforts (at this level, the journal may resemble a diary), then you begin the process of developing a system (or method, strategy, procedure, whatever you want to call it). Here the journal takes on a different character. Once you've developed a tentative/preliminary system, you begin testing/trading it, and the journal adopts a still different character.

The first step is to decide what kind of trader you want to be.

- What do you want to accomplish with your trading? Is it recreational? Supplementary income? A part-time job? Do you want to make a living at it? Even the greenest of the green knows whether or not he wants to make a living at it, trade only part time, trade for recreation, trade for the action, trade to have something to talk about with other traders (for whatever reason), trade only long enough to earn money to do or buy X.

- Do you have any idea what sort of trading is most comfortable? Long or intermediate-term trading? Short-term trading? Day-trading? Trend-trading? Scalping? (Note here that a short-term trader, for example, does not become a long-term trader just because his stop was hit and he didn't sell; a long-term trader doesn't become a short-term trader because he chickened out and sold too soon. Each of these approaches is selected deliberately and for thoroughly-considered reasons.) How patient are you? How adventurous? Are you a leader or a follower (most people think they're leaders)?

The second step is to decide what you're going to trade and when you're going to trade it.

- Have you found an instrument -- futures, stocks, ETFs, bonds, options -- that provides you with the range and volatility you require but also the safety that enables you to relax and trade in an objective and rational manner?

- Have you yet found a time (5m, hourly, weekly) or tick (1t, 200t) or volume (1K, 100K) interval that gives you enough trading opportunities but also gives you enough time to think about what you're doing? If you want to limit your trading to the "morning", are you physically and psychologically prepared to trade all day? If not, can you shrug off whatever opportunities you may miss by limiting the amount of time you spend trading?

The third step is to develop your system.

A system consists of (a) a set of rules that you use to **select profitable positions** and (b) a set of rules that you use to **manage the trade** once you're in it (again, whether you call it a system, a method, a strategy, a plan, a scheme, an approach, a procedure, or a modus operandi is not as important as sitting down and doing it).

- Developing a system begins with deciding just what it is you're looking for. Therefore, begin by **studying price movement**[1] in real time (or at the end of the day through "replay", if your charting program offers it). By "study", I mean to observe it with intent, not just read about it or listen to somebody talk about it. You have to understand what you're looking **at** before you know what to look **for**. Note the conditions under which price rises, falls, drifts. Make every effort to avoid imposing your biases onto what you observe. You may see trading as a war, a competition, a game, or a puzzle. You may think you're out to kill somebody, outwit somebody, or are out only to detect the flow and slip into it, riding the waves as if you were sailing. None of this should be allowed to affect what you observe.

  Pretend that you are watching a team sport in which you know nothing about the rules and couldn't care less about the players, much less about who wins. But you do want to understand what's going on, out of curiosity if nothing else. Your chief thought is not when you should jump onto the field and begin playing. Your chief thought centers around the following questions, primarily What the Hell Are These People Doing? So you observe.

  What are they doing?

  Where are they doing it?

  Why are they doing it? Why are they doing it *where* they're doing it and *when* they're doing it?

  How are they doing it?

  What do they want to accomplish? What were they doing before?

  If one observes the game long enough, he begins to discern the rules and will enter a phase where he pretty much understands what's going on but still has no interest in which team wins.

  And if the teams are buyers and sellers . . .

- Develop a set of preliminary hypotheses which exploit the profit opportunities presented by these movements, e.g. price began trending "here". Price broke out "there". Price reversed "there". What can I do to take advantage of that? What do I have to look for?

- Decide what strategy will best take advantage of what you think you've found. Are you looking to catch a **reversal** in the hopes that it will become a trend? Or are you looking to trade series of reversals within the day's or week's range? Or do you prefer to wait for a **breakout** and trade what may become a trend? Or would you rather wait for a **retracement** in what may be shaping up to be a trend? Limit yourself to only one strategy at the beginning.

- Carefully define the setup (the set of circumstances which you define which triggers an entry) which implements this strategy, preferably using old charts (attempting to define the setup by studying realtime charts is inefficient since you don't yet know what it is that you're looking for). This is called **"backtesting"**[2]. All else flows from this. Unless you know what you're looking for, you cannot test it, much less screen for it. If you have not tested it, you have no idea of the probability of its success. With no idea of the probability of success, any trades made are essentially guesses.

Therefore, focus on the setup. One setup. Determine its characteristics, find the markers of buying and selling interest, buying and selling pressure, buying and selling exhaustion. Define it so specifically and so thoroughly that you can recognize it without any doubt whatsoever in real time. Decide provisionally where best to enter, what the target ought to be, where the stop should be placed, and so on. Only after the setup is defined and tested (and it can't, ipso facto, be tested until it's been defined) can one even begin to think about trading it with real money, much less trading multiple setups. Attempting to shortcut this process merely expands the amount of time it will take to develop the necessary skills. Nothing is gained by painting the house before scraping it, cleaning it, and priming it since you'll have to do it all over again sooner rather than later.

You are free to create your own based on whatever jingles your bells. You may, for example, focus on divergence. Or higher swing lows and lower swing highs. Or candlesticks of one sort or another. Or trendline breaks. Or base breakouts. Doesn't really matter. What matters is that you keep four concepts in mind: demand/supply, support/resistance, price/volume, and trending/ranging. In this way, you can create your own setups which hundreds of thousands of other traders won't be watching along with you. You must understand, however, that what determines the success of the trade is the trader, not the setup. If you're looking for something that "works", you may as well save yourself a lot of time and stop right here. What will “work” – or won’t, as the case may be – will be you.

- Forward-test what you have so far, again using old charts, preferably replaying them (if replay is not available to you, then scroll through them, bar by bar). In other words, "pre-test" the setup. Make whatever modifications are necessary to the setup, i.e., re-examine and re-define your strategy. Address risk management, trade management, money management in further detail. Determine the ratio of winning trades to losing trades (you will, of course, have to define "winner" and "loser", which is where risk management and trade management come in). Determine the ratio of profit to loss. Determine the maximum loss. Determine the maximum number of consecutive losers.

  Note that beginners often use "win/loss" to combine two separate considerations into one, and failing to keep them separate can create problems. One is win:lose. The other is profit:loss. Between the two, the "lose" and the "loss" have two distinct meanings. Win:lose refers to the ratio of winning trades to losing trades. Profit:loss means, expectedly, the ratio of profit to loss.

You'll read that the % of winners can be less than the % of losers as long as the winners are sufficiently profitable, one's management is superior, etc. And, yes, theoretically, one can "win" less than 50% of the time if his profits sufficiently outweigh his losses. But if your real-time real-money test begins with a string of the losses anticipated by your backtest, you'll be out of the game almost before it begins. In fact, one can be left high and dry even if his % of wins outnumber his % of losses, as mentioned above, if there is insufficient control of the amount of loss OR if the losses occur in sufficiently high numbers at the beginning of the trial.Then there are commissions and assorted trading costs to take into account, which is why traders who actually trade find that, without size (the quantity of what you're trading), all the postulations about percentage don't mean much in practice.

- Paper-trade this plan, in a simulated environment, as a semi-final test, until you are satisfied that it performs at least as well as it did during the previous testing phase. This may take several months or more depending on how many trials you perform. If your plan is not consistently profitable, go back however many steps are necessary to arrive at a potential solution.

- Trade the plan using real money in real time, spending only what is absolutely necessary on "tools" and trading the minimum number of shares, contracts, etc., allowable. If your plan is not consistently profitable, go back however many steps are necessary to arrive at a potential solution. Recalculate your win rate and profit:loss ratio on a continuing basis.

- If your plan is consistently profitable in practice, increase your size to what is a comfortable level, maintaining a continuous loop of re-appraisal and re-evaluation. When things come unglued, back up as far as necessary to regain your footing.

Novices rarely do any of this. They borrow something from somebody or somewhere and perhaps modify it somewhat, but they rarely go through the defining and testing process themselves. Some just try whatever seems like a good idea and hope for the best.

If one has absolutely no idea where to begin, there is nothing wrong with using a canned strategy IF it is used only as a point of departure. In other words, the canned strategy, regardless of what it is or what claims are made for it, still has to be tested, which often entails taking what is unexpectedly vague to begin with and defining it to a level of specificity that enables the testing to take place (it should come as no surprise that those who do go through the process succeed and those who don't, struggle, often to the point of being driven out of the market). Examples of canned strategies and setups that are reasonably well-defined include the Darvas Box, the Ross Hook, the Opening Range Breakout, O'Neil's Cup With Handle, Dunnigan's One-Way Formula. Some of these are more vague than others and will require considerable work on definition before they can be tested. But they serve as points of departure.

Wyckoff's "hinge" is another setup, though not one which would be classified as "canned", requiring as it does some sensitivity to trader behavior. The hinge is a type of "springboard", in which price action firms, like Jello, another Wyckoff concept (the springboard, not the Jello), the idea being that something is getting ready to happen as a result of what bulls and bears have been doing to "discover" price. (The pattern people call it a symmetrical triangle; the difference is that the hinge is the result of a particular dynamic between bulls and bears and can be expected to result in something; the triangle is technically nothing more than a pattern, and can result in nothing at all but drift, particularly if it's not symmetrical.)

This particular "setup" occurs when bulls and bears are struggling over price, and it can be seen everywhere from a tick chart to a monthly chart. There is first a wide discrepancy between what one side thinks is a fair price and what the other side thinks is a fair price. Since they disagree, the range narrows (so that they can complete trades), the bars get shorter, trading activity becomes subdued, and eventually you close in on a point which is more or less a midpoint between the two extremes. From this, price will then move -- often explosively -- in one direction or the other IF the hinge is being formed in an important spot, such as a point just after the initiation of what promises to be an important trend.

> *The market always tells you what to do. It tells you: Get in. Get out. Move your stop. Close out. Stay neutral. Wait for a better chance. All these things the market is continually impressing upon you, and you must get into the frame of mind where you are in reality taking your orders from the action of the market itself — from the tape.*
>
> ***Your judgment will become poorer from the very time when you decide that you know more about the market than the market is telling you.*** *From that moment your results will be unsatisfactory, for in this trading business the tape is the boss. You must learn to obey its orders, doing exactly what it tells you. When you can accomplish this, you are on the high road to success in your stock trading.*
>
> *–Richard Wyckoff*

Then there is the SLA/AMT. As pointed out in the Afterword to that section, the SLA/AMT is a primer. Training wheels for the beginner. Rehab for the damaged trader. The beginner will learn discipline, patience, how to plan, how to prepare. The damaged trader will, one hopes, find his way back to a disciplined and professional approach, assuming he was ever disciplined and professional in the first place. Though the SLA is not "turnkey", it's close enough to that to enable the trader to at least get started without having to start from nothing with nothing.

Recommended Books:

The General Semantics of Wall Street
by John Magee (see my review on Amazon)

The Nature of Risk/How to Buy/When to Sell
by Justin Mamis (see my reviews, also on Amazon)

And if you're greener than green . . .

The Wall Street Journal Complete Money and Investing Guidebook by Dave Kansas

or

Standard and Poor's Guide to Money and Investing by Morris and Morris

[1]Trading by price -- and "volume" (or trading activity) -- requires a perceptual and conceptual readjustment that many people just can't make, and many of those who can make it don't want to. But making that adjustment is somewhat like parting a veil – or taking the red pill -- in that doing so enables one to look at the market in a very different way, one might say on a different level.

One must first accept the continuous nature of the market, the continuity of price, of transactions, of the trading activity that results in those transactions. The market exists independently of you and of whatever you're using to impose a conceptual structure. It exists independently of your charts and your indicators and your bars. It couldn't care less if you use candles or bars or plot this or that line or select a 5m bar interval or 8 or 23 or weekly or monthly or even use charts at all. And while you may attach great importance to where and how a particular bar -- or candle -- closes, there is in fact no "close" during the market day, not until everybody turns out the lights and goes home.
Therefore, trading by price and volume, or at least doing it well, requires getting past all that and perceiving price movement and the balance between buying pressure and selling pressure independently of the medium used to manifest or illustrate or reveal the activity.

For example, the volume bar is a record of transactions, nothing more. The volume bar does not "mean" anything. It does not predict. It is not an indicator. Arriving at this particular destination seems to require travelling a tortuous route since so few are able to do it. But it's a large part of the perceptual and conceptual readjustment that I referred to earlier, i.e., one must see differently and one must create a different sense of what he sees, he must perceive differently and create a different structure based on those perceptions. As long as one believes, for example, that "big" volume must or at least should accompany "breakouts" and clings to this belief as ardently as he clings to his rosary beads or rabbit's foot or whatever, he will be unable to make this perceptual and conceptual shift.

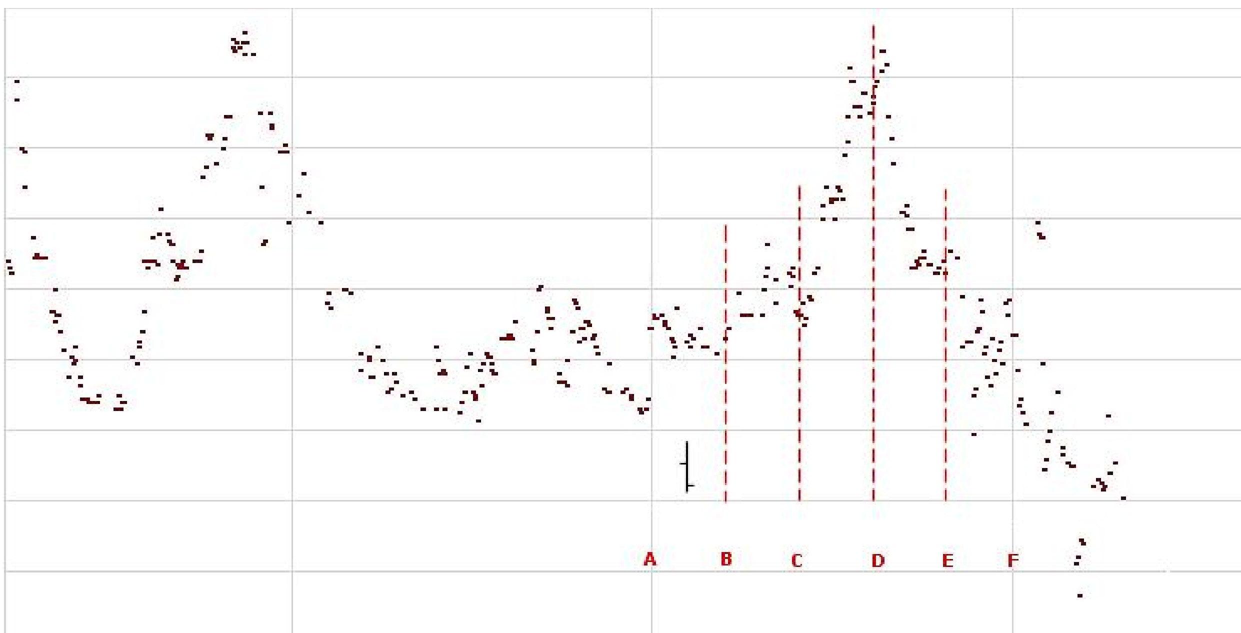
If you can work your imagination and use it to travel in time, you will have a far easier time of this than most. Imagine, for example, a brokerage office at the turn of the 20th century. All you have to go by is transaction results -- prices paid (and maybe # of shares) -- on a tape. No charts. No price bars. No volume bars. You are then in a position wherein you must decide whether to buy or sell based on price action and your judgment of whether buying or selling pressures are dominant. You have to judge this balance by what's happening with price, e.g., how long it stays at a particular level, how often price pokes higher, how long it stays there, the frequency of these pokes, their pace, at what point they take hold and signal a climb, the extent of the pokes, whether or not they fail and when and where, etc., all of which are the result of the balance between buying and selling pressures and the continuous changes in dominance and degree of dominance.

Time	Price	Volume
17:06:22	4711.0	1
17:06:20	4711.0	20
17:06:17	4712.0	3
17:06:16	4711.5	10
17:06:16	4712.0	5
17:06:16	4712.5	24
17:06:15	4713.0	5
17:06:13	4713.5	42
17:06:12	4713.5	4
17:06:10	4712.0	9
17:06:10	4712.0	1
17:06:08	4713.5	2
17:06:07	4713.0	1
17:06:05	4713.0	5
17:05:59	4713.0	1
17:05:58	4713.0	3
17:05:57	4713.0	18
17:05:56	4712.5	1
17:05:56	4712.5	2
17:05:54	4713.0	1
17:05:54	4712.5	1
17:05:53	4712.5	1
17:05:51	4712.5	1
17:05:49	4712.5	1
17:05:48	4713.0	1
17:05:48	4712.5	1
17:05:47	4712.5	1
17:05:46	4712.5	7
17:05:46	4712.0	36
17:05:45	4711.5	2
17:05:44	4712.0	1
17:05:42	4711.5	7
17:05:41	4711.0	31
17:05:41	4711.0	3
17:05:40	4711.0	3
17:05:39	4711.5	3
17:05:38	4711.5	1
17:05:37	4711.0	1

One way of doing this using modern toys and tricks is to watch a Time and Sales window and nothing else after having turned off the bid and ask. But this wouldn't do you any good unless you spent several hours at it and no one is going to do that. Another would be to plot a single bar for the day and watch it go up and down, but nobody's going to do that, either. Perhaps the least onerous exercise would be to follow a tick chart, set at one tick. Then follow it in real time. Watch how price rises and falls due to imbalances between buying pressure and selling pressure. Watch how and where these waves of buying pressure and selling pressure find support and resistance to their movements. And when I say "watch", I mean just that. Don't worry about what you're going to do about whatever it is you're looking at. Don't worry about where you'd enter or where you'd exit or how much money you'd make or whether you'd have been right or wrong to do whatever. Just watch. Like fish in an aquarium. If that seems only slightly less exciting than watching concrete harden, or it's just not possible for you to watch this movement in real time, then collect the data and replay it later at five or ten times normal speed. You can do an entire day in little more than half an hour (though you won't get any sense of real-time pace). Granted this means a lot of screen time, even in replay, and only a handful of people are going to do it. But those few people are going to part that veil and understand the machinery at a very different level than most traders.

Once the continuous nature of these movements is understood, and this may take no more than an hour, the idea of wondering -- much less worrying -- about what a particular volume bar "means" is clearly ludicrous, as is the "meaning" of a particular price bar or "candle" (including where it "opens" and "closes" and what its high is and so forth), and eventually the trader may come to the realization that all those people who've been insisting that these bars have some cosmic meaning have been trying to sell him something, i.e., DVDs and courses and software and seminars (box lunch included) and so forth that explain what these meanings allegedly are.

For example, here is a tick chart:



Note that the third pane has been subdivided into 1m blocks, i.e, A to B spans 1m of time. Now look at all those ticks – transactions – that are printed during that 1m span. If one were to consolidate all those ticks into a bar, he'd end up with the bar shown below the ticks in the first interval: the "opening" tick, the high and low ticks, and the "closing" tick. What is more informative? The character of the array of the ticks? Or the bar? And what about the array of trades/ticks in the second interval, B-C? And the third? Is it worth knowing that price retraced a little after printing the highest tick? Is it worth knowing that the ticks in the D-E interval printed with little to no buying pressure and finished only a couple of ticks off the "low"?

If the continuous nature of these movements is not understood, then the trader spends and wastes a great deal of time over "okay so this bar is higher than that bar but lower than this other bar, and price is going up (or down or nowhere), so . . .".

[2] *So, when your recommend backtesting, do you actually mean applying your system manually on historic charts or do you use some coding to test your ideas?*

No coding, no algorithms, no computerized backtesting at all. It's all done manually.

The manual way will be tough, since one needs to create a large sample, right?

Depends on how long it takes for you to get it. If you have a lot of experience with coding and indicators, it will likely take you far longer to get it than it would someone who's starting fresh for you are more likely to view price as something independent of the efforts made by buyers and sellers to arrive at that price.

Take support, for example. A lot of traders view support as a mathematically determined level or point that one reaches by calculating Fib or Pivots or plotting MAs or whatever. But support is none of that. Support is that level or zone where buyers decide for whatever reason that they are going to stop the decline of price and turn it around. This entails a different way of looking at price and price movement. Price is the product of an activity. To trade by price, one must understand the nature of that activity and not define price solely as prints on a page or tape.

You may, therefore, be able to distinguish between trend and trading range by looking at only a handful of charts. Or it may take dozens. Or more. Or you may never be able to do it (and don't feel bad; there are plenty of vendor/pundits who can't tell up from down and consequently make one losing countertrend trade after another).

A thorough backtest, of course, ought to cover at least a year (though with replay it needn’t take a year; you can cover a year in a few months, or even a few weeks). The comfort level that a trader attains by having backtested all market conditions is impossible to reach any other way. August does not trade like November does not trade like March does not trade like June. A couple of weeks, needless to say, just doesn't cut it. Those who try to get away with the minimum end up changing their trading plans to accommodate every curve ball that the market throws their way. In a few months, they have a real mess on their hands, so many rules that they wind up unable to act at all.

A thoroughly-backtested trading plan will cover the vast majority of contingencies. The market can and will come up with completely unexpected behaviors, but the trader who has backtested a year's worth of contingencies will recognize the unexpected for what it is and either stand aside or try to make the best of it. He will not alter his trading plan to accommodate something that may never reoccur.

There is also the forwardtest, which too many beginners skip, thinking that real-time trading is pretty much the same thing and will accomplish the same objective. It isn't and it doesn't. Those who skip it will experience far more failures in real-time trading and end up having to rewrite their plans again and again, which they will likely do rather than go through the backtesting again, which is what they ought to do instead.

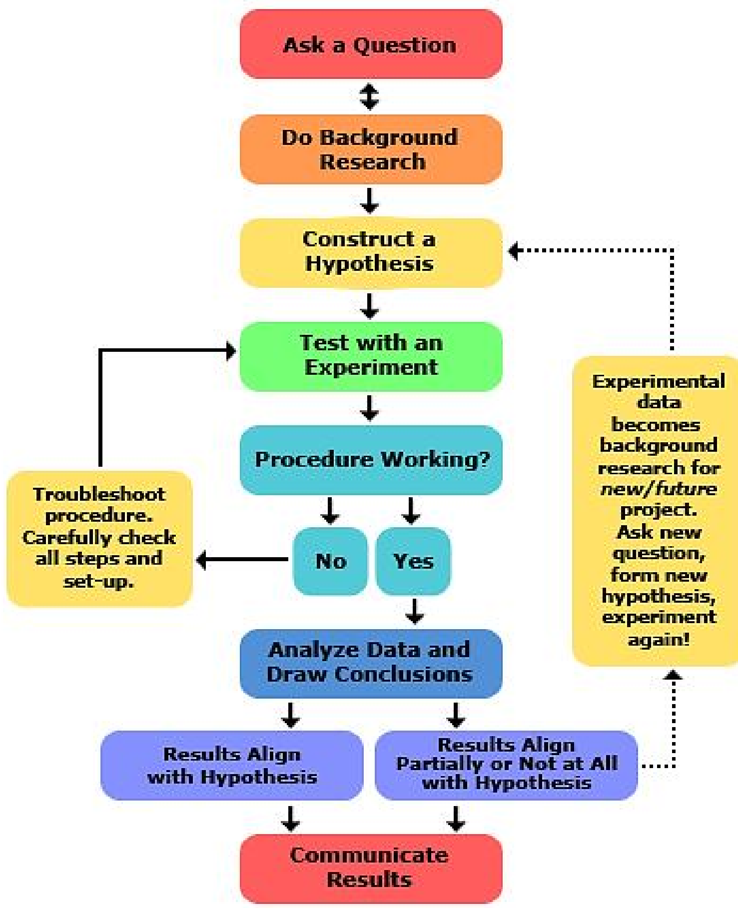
How do you distinguish between backtesting and walk-forward testing, when both are on historic charts?

When you backtest, you're surveying or scanning from some point backward, right to left. You see the result and you want to figure out how that result was obtained. For example, if you find a trend day, where and how did the trend start? How was the activity different before and at the turning point from what it was during the preceding downturn/upturn or trading range? Once you've found what you think are the key elements that determined or at least affected the turnaround, you choose charts at random, and you either replay them in simulated real time or you cover them up and disclose the price points only one at a time, reading from left to right. Look for those elements which are part of your hypothesis. When you find them, see if they offer the desired result. If they do, keep going until you find another of your patterns. If they don't, determine where you went wrong in your hypothesis and try again. Once you have this, you'll be able to determine support and resistance and trend and trading ranges in real time. You will then be at a point where you can look at how to take advantage of this knowledge with minimum risk and make some money.

The most common error traders make when learning this approach is to try to determine where they should enter and where they should exit in order to make the most money with the least risk rather than determine what's going on with the traders involved in the trading activity that's occurring in front of them. Since they don't understand what's happening in front of them, i.e., they don't know what they're looking **at**, they don't know what to look **for**. So they guess. But whether the guess works out or not is irrelevant to their ultimate success -- or failure -- because there is no structure to their trading, no thoroughly-tested underpinning (e.g., they think price is in an uptrend, so they go long). However, they figure that as long as they keep making these guesses in more or less the same way, they are being "disciplined" and will eventually meet their objectives. Of course, it's always possible. Monkeys at typewriters. But it will take years, and they will more likely go broke before the light ever dawns. How much more efficient , and profitable, to do the testing in the first place.

If you can anticipate where price is most likely to break trend and move sideways or reverse and what it will do thereafter, you will be far more likely to profit from that anticipation than if you have no idea why traders are doing what they're doing and view all of this as a random sequence of events. For instance, one of the more important things you'll learn as a result of testing is that entering trades inside a trading range is riskier and less profitable than entering trades at the limits of that trading range. But this is something that you have to prove to yourself through testing, which is both risk-free and at-your-own-pace. If you decide instead to skip the testing and treat it as some sort of principle, you won't internalize it, and you'll violate it repeatedly, involving yourself in losing trades again and again.

If you are in a hurry, the best I can do is to urge you to hurry as slowly as possible. Open up some old charts and see how much sense they make to you without guidance. If you're used to using bars and candles as indicators, convert the display to a line chart. Once you're able to understand the continuous flow of and interaction between trading activity and price movement, your chances of success will be much greater.



The Trading Log

As part of your journal, a trading log should be more than just bought here, sold there, made this, lost that. It should contribute to the record of your journey (“journey” -- ”journal”). If done correctly, a log will reveal **patterns**. Patterns of what you're doing right and what you're doing wrong and when and how often and under what circumstances. Patterns of the behaviors of those who are trading your stock (bond, fund, option, whatever). Patterns of the market you're trading, of its cycles, of its stages, of what works at some stages and in some cycles and not in others. It will reveal much regarding your trading. It will also reveal much regarding your “self”.

Addressing the questions asked in **The Trading Journal** and defining and testing the setup are only the preliminaries. Eventually, one starts trading, if only on paper, and that is where the log and journal can make the difference between success and failure.

A log is not just a record. It is also a plan. Before the first trade is ever made, even if only on paper, prepare for the day. Note any events that you should be aware of (reports, press releases, meetings, speeches, testimony, nuclear explosions, approaching meteors, etc). Write down reminders of any elements of the trading plan that you're having trouble with and what you intend to do about them, e.g., “don’t take any trades anywhere but at support or resistance” or “be wary of wide-range bars” (this may be necessary as early as the afternoon of the first day).

Above all, record your justification for each and every trade. Record your thoughts before, during, and after the trade, written in real time (your perception of what looks to you like a potential setup will change substantially after the “setup” resolves itself, and when you ask, later, “what the hell was I thinking?”, your record of your thoughts -- your "self-talk" -- will tell you, so that the next time, in real time, you’ll have a deeper and more rational perspective). This is more than just the reason for the trade (“It looked like it was going to go up”). It is more than the rationalization (“It was time for it to go up”). It is more than the mystic prompt ("I felt it was going to go up"). It’s the justification for it, the explanation that one would provide to one’s boss or client if he were trading for someone else. If everyone wrote down the reasons behind and justifications for every trade, their learning curves would be accelerated dramatically. And if writing all this down proves to be too much of a distraction from the screen, pick up a digital voice recorder from eBay for a few bucks.

At the end of the day, review your decisions, if necessary by "replaying" the day, a feature available in several charting programs. Did you make good trading decisions, i.e., did you follow your rules or not? If you followed your rules but made one or more losing trades anyway, do any of your rules need to be re-examined? If you didn’t follow one or more rules, which do you most often fail to follow? What’s the problem? What did you say to yourself at the time? What do you need to work on the following day? Always, what could you have done differently to improve the outcome? Can it be tested to find out if it's only an occasional anomaly or worth incorporating into the system?

And then you write down your detailed plan for the next day . . .

When Trading Journals Don't Work

(edited)

Brett Steenbarger
18 Aug, 2005

The journal lacks specifics. Many times the journal becomes an outlet for the trader, a way of venting. While there is nothing wrong with venting per se, it is hard to see how simply venting in a journal can improve performance. A common entry might state, "I overtraded a slow market and broke all my rules. I know I have to take what the market gives me. Tomorrow I need to trade with more discipline". All these things may be true, but the entry lacks specifics regarding *why* the trader overtraded; *how* the overtrading will be avoided in tomorrow's trade; and *what steps* will be taken to return to the discipline. A journal entry that lacks specifics is a statement of good intentions; not a plan. If your journal entry does not include concrete steps that you can follow to address a problem situation, it is unlikely that it will serve as an action guide.

The journal emphasizes problems, not solutions. Traders love to keep journals when they're losing and then fall off the journaling bandwagon when they're making money. I would argue that, when you're making money, that's the *best* time to keep a journal. Your goal should be to replicate successful trading patterns, not simply analyze problematic ones. The ideal journals isolate what traders do when they're trading their best, so that these solution patterns can be isolated and mentally rehearsed as part of a learning process.

The journal talks too much about the trader and not enough about the markets. Journals are a learning tool, and your ultimate goal is to learn how to trade. By focusing exclusively on your state of mind, what you did or didn't do in the trade, etc., you lose the opportunity to identify and learn patterns that appear in the market. It's extremely helpful to review a market day and examine what you could have noticed to alert you to a market move. By retrospectively identifying such trading patterns, you train your mind to look for them the next time they appear.

The journal is reactive, not proactive. This is part of the venting phenomenon: traders will make journal entries after the market day, but rarely use the journal to actively prepare for the coming day's trade. An ideal journal captures what you'll be looking for in the coming day in the markets (anticipated setups) and what you'll be working on in your own trading. Learning from past performance is important, but if the learning is not reflected in future plans, it will not be reflected in actual trading outcomes.

The journal lacks metrics. I have found that traders can best assess their strengths and weaknesses by keeping detailed records of their trades and by evaluating themselves across a series of performance measures. I cannot tell you how many traders I've encountered who don't have the faintest notion of their average profit per trade; their average win size and loss size; their average holding period per trade; etc. It's not that the traders don't care about performance; it's that they have not drilled down to the trade-by-trade level to see what they’re actually doing in the markets. Many times, traders *think* they’re trading one way, only to find out when they look at the data that they’re not trading that way at all. It’s hard to see how a trader can identify if they’re having problems trading in the morning vs. afternoon; if they’re more often right on the long side than short; or if they are trading large size differently than smaller size if the statistics are not there to be analyzed.

So what’s a trader to do? The first step is to decide whether or not you really *want* to know what you’re doing and how well you’re doing it; whether you want to put in the time and effort to identify the patterns in each trading day—the market’s and your own. To paraphrase U.S. college basketball coach Bobby Knight, many traders want to trade and many want to win, but not many are willing to put in the work it takes to be a winner. This is the effort required of a winner, and each trader needs to know if he or she has the fire in their belly to sustain such work.

Ultimately, the effort to win is sustained by a desire to know. Excellent traders are always keeping score: they want to know what they’ve done right or wrong, and what’s making and losing them money. They are always working on themselves and their trading. I’ve met far too many “breakeven” traders who, upon inspection, have been losing money consistently. It’s not that they’re lying; they simply don’t want to know the truth. Thus, they avoid it. It is simply too painful to look at the money and opportunities lost. Keeping a journal *should* be painful at times, but it should also bring out the best in you. Without it, you’re likely to be a business without a plan.

A Final Note

Trading plans invariably become egocentric. A few traders get past that and move on to a different level, but most of those who begin the process of developing a trading plan do not (most traders, of course, don't begin at all). Because the process is egocentric, the chief concerns are where do I enter, where do I exit, what should my target be, what should my stop be, how much risk can I tolerate, and so on. The character of the market itself is a secondary issue at best. What is paramount is how the market can serve the ego rather than the other way around.

The market couldn't care less about the trader's entries and exits and stops. The market couldn't care less about what the trader wants. The market couldn't care less about the trader's personality. The market functions in a certain way. It has a certain structure. If a trader is to be truly successful, i.e., more than just "getting by", he must understand these functions and this structure, neither of which have anything whatsoever to do with him.

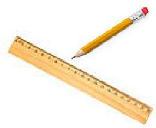
One begins, of course, again, by observing the market, characterizing it, then formulating hypotheses that tentatively explain its movements. One then tests those hypotheses in order to determine whether or not they are true, i.e., predictable and reliable. Only after all this do the matters of how to take advantage of what one has determined come into the picture, i.e., entrances, exits, stops, etc. It is at this point that the process becomes almost entirely egocentric, e.g., how much risk can I tolerate, and the market itself becomes largely ignored except insofar as it serves the trader's needs and wants. But the market couldn't care less about the trader's needs and wants. And this results in a perpetual frustration among those who focus on themselves rather than on the behavior of price (which is the aggregate of the behaviors of everyone who is participating in the market). If, for example, the trader is focused not only on breakeven but on getting to breakeven as quickly as possible, he is focusing not on the market but on himself. One of the more obvious consequences of this, particularly if the trader is "stopped out", is that the trader dwells or even obsesses over his "failed trade" and completely ignores what the market has told him by having come back to or exceeded his entry point, thus preventing him from evaluating the situation and preparing for the next trade, especially if it happens to be in the opposite direction.

I suggest, therefore, that those who are serious about developing trading plans focus on the market and on price behavior rather than on themselves, unless they want to spend years trying to reconcile two forces which are in many ways mutually incompatible. If one enters correctly, for example, issues of stops and breakeven and size and "targets" become irrelevant. If one doesn't enter correctly, then of course he has to exit. But his doing so has nothing to do with his hopes and needs and wants and desires. Rather it has to do with the fact that he read the market incorrectly. One should, in fact, once he has entered a trade, forget about the fact that he entered the trade at all and instead focus on the market. Only in this way will he become "available" to profit from what the market has to offer.

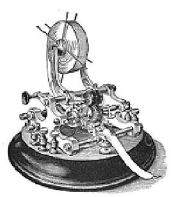
Nearly all traders except for beginners are in a quandary: they are eager to trade yet are afraid to trade (beginners have not yet learned fear). Thus they seek to exploit the market while simultaneously insulating themselves from any negative consequences of attempting to do so. That's what the bulk of the millions of trading forum posts and blogs and books and articles et al infinitum are all about. Only an infinitesimally small number of them are focused on why price moves as it does. Which is why there are so many millions (billions?) of posts (and books and blogs and so forth).

The principles of successful stock speculation are based on the supposition that people will continue in the future to make the mistakes that they have made in the past.

–T F Woodlock



Straight Line Approach, The 33



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Straight Line Approach, The

Keep Your Hands And Feet Inside The Stochastic Until Your Oscillator Comes To A Complete Stop

Charts are among the most mysterious aspects of the financial markets that the beginning trader will face. For many people, charts look like a child's experimentations with a Spirograph. But charts are really nothing more than stories, using symbols rather than words, like algebra uses symbols instead of numerals (yes, I know that words and numerals are technically symbols, but you know what I mean). They are a bit like the storyboards used in producing movies and cartoons, except we use dots and lines rather than drawings or photographs. Understanding the stories these charts are trying to tell can make you money. Or, at the very least, save you what could become a great deal of money.

Many technicians and technical analysts sabotage their own case by making the subject of charts and charting so elaborately complex as to be ludicrous. More than a few beginners have visions of wizened old crones with palsied hands, stroking – in a vaguely obscene way – ancient leather pouches filled with dessicated chicken bones which they scatter onto pitted and scarred tables while muttering invocations to Chaikin, Bostian, Donchian.

These technicians then explain the results of their analyses much as Lewis Carroll might, by pointing out how brillig the pattern is, and how the slithy toves are gimbleing in the wabe, while over here (they point), the borogroves are mimsy, which indicates a possible outgrabe by the mome raths, unless of course the Bandersnatch whiffles, in which case . . .

It's just not that hard.

A chart is a visual representation of transactions. The results of these transactions are depicted by either a line which will look like a map of the Pacific Coast Highway, or by a bar which represents the opening price (the little notch on the left side of the bar), the low for the day (the bottom of the bar), the high for the day (the top of the bar) and the closing price (the little notch on the right of the bar). At the bottom of the graph you'll usually also find volume bars which will tell you how many transactions were completed that day.

But beyond all this, a chart is a visual representation of buying and selling behavior on the part of investors, not just a tally, and this behavior creates patterns, like ranges, or "boxes". Thus if you approach this from the viewpoint of psychology and sociology rather than cut-and-dried mathematical models, you'll have a leg up. These patterns do not exist in nature. They are created by the buying and selling dynamic.

Law of Supply and Demand, the

Much nonsense has been circulated about trading over the past seventy years or so, the bulk of it since the internet made possible discount brokers, affordable charting software, real-time streaming data, chat rooms, trading rooms, trading websites, blogs, and so forth, all of which offered fertile ground to a literally endless assortment of books, DVDs, courses, seminars, "alert" services, mentors, counselors, trading software, indicators and so on, all designed to separate the beginner or struggling trader or otherwise low-hanging fruit from his money.

There is, however, only one essential, one lynchpin, one fundament when it comes to understanding the auction market: supply and demand and the Law thereof. Everything else – support, resistance, trend, price movement, volume – stems from the balances and imbalances between supply and demand, selling pressure and buying pressure, sellers and buyers, yet struggling traders are generally incapable of accurately assessing the state of these imbalances, i.e., determining who's in charge at any given moment or interval (some are capable but can't implement what they know, but that's another subject).

Trading price hinges on the ability to assess the state of these imbalances not only in the abstract but in every moment of the trading session. If one does not thoroughly understand just what it is that he's looking at, he will be lost. When trading price, the trader knows at all times who's in charge, who's dominant, who's holding the good cards. If he doesn't know this, he's just guessing, and that's not the route to consistent profits, no matter what you read on message boards.

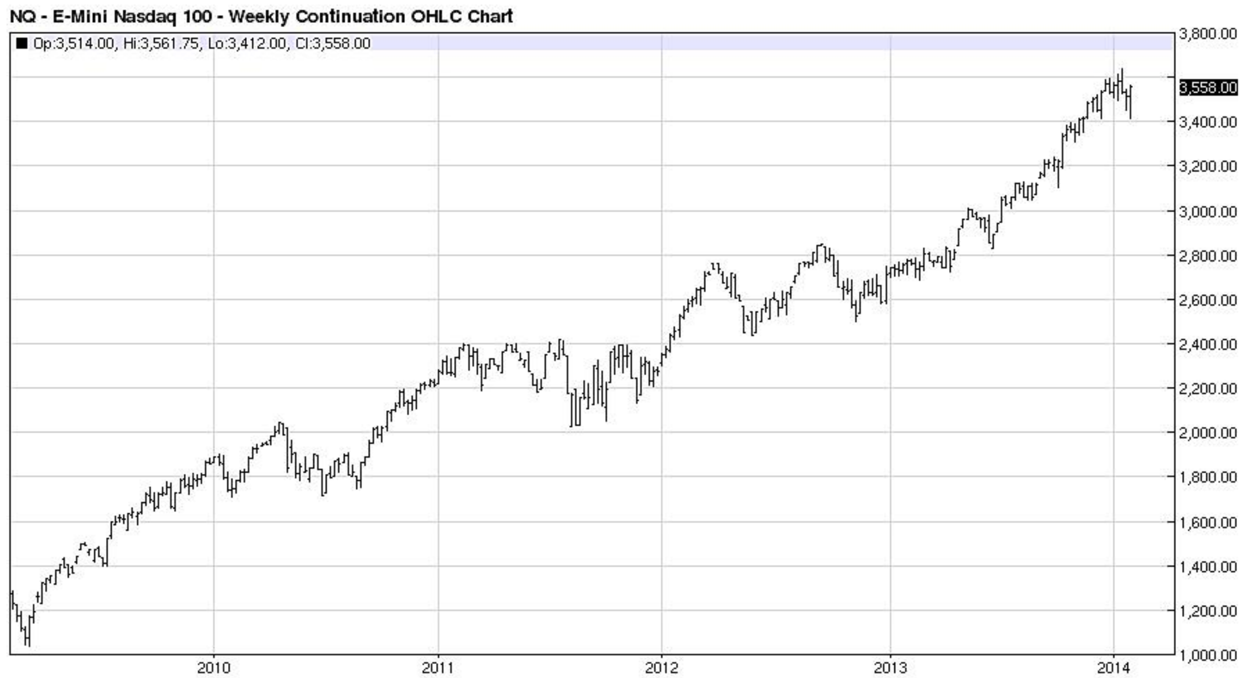
Why bother? Because once you learn how to trade price, your edge* will never fail. You will understand trend and how to play it under all circumstances, including its endings and reversals. You will also learn how to distinguish between trending and ranging, the latter including "chop" which is a collection of micro-trends which generate tons of commissions and very little if any profit.

**the knowledge you gain through your research and testing that a particular market behavior offers a level of predictability that provides a consistently profitable outcome over time (from Douglas)*

The Importance of Context

Trading price begins with determining the context, i.e., what is the market doing outside the intraday world, daily, weekly, monthly, even yearly? By studying the illustration of activity that is a chart, one can (1) assess whether buyers (demand) or sellers (supply) are in charge (price is going up or down) at any given interval, (2) determine how active they are (**volume**), how quickly price reaches its destination (**pace**), how far each buying or selling wave goes (**extent**), how long each of these lasts (**duration**), where and how and for how long traders come to rest (**equilibrium**). Daytraders often consider this to be a waste of time since the trading that begins at the opening bell so often seems to have little to nothing to do with what price was doing overnight or where it was going. But this sort of analysis will at least provide one with a sense of the "tone" of the day, even if that amounts to no more than his first trade. After that, one must follow price, wherever it leads, though price has a tendency to halt at points and levels that were important at previous intervals and even take off in the opposite direction. If one has not even scanned these points and levels, price is likely to take off without him. leaving him wondering what just happened. He may even find himself taking the wrong side of the trade, an all-too-common occurrence.

Determining the Context This has been a particularly interesting week (ending 020714), one of the reasons why I decided to put this together now, as I am able to show you just about everything you need to know to trade price profitably, without relying too much on hindsight. Any sort of review at all is of course by definition "hindsight", and this hindsight begins a little over five years ago:



The purpose of the Straight Line Approach (SLA) is to enable both the beginning and the damaged trader to focus on what is most likely to affect his ability to enter and manage profitable trades. Both will find this simple. That's the point of it. But those who are just starting will likely find it far easier (there's a difference between simple and easy) than those who have been struggling for years, largely because of all the nonsense the latter have been carrying in their heads. All that must be got rid of, and not everyone can do it. Many cling to their MACDs and RSIs as if they were rosaries. The SLA, however, ***demands*** that the trader focus, pay attention, keep his mind on business and ignore all the extranea like indicators and Fibonacci and Pivot Points and envelopes and bands and clouds and candles and what CNBC said and whatever the hell else and perform the simple task of drawing straight lines to track the course of demand and supply and the balance between them. If he can do this simple thing, his profits will be consistent and his losses will be minimal. Why? Because the SLA forces him to be in synch with the market, and if he can keep his ego out of it and stop trying to outsmart it, he will be in and stay in the right side of the market.

> *I've said it before, and I'm going to say it again, because it cannot be overemphasized: the most important change in my trading career occurred when I learned to* ***divorce my ego from the trade****. Trading is a psychological game. Most people think that they're playing against the market, but the market doesn't care. You're really playing against yourself. You have to stop trying to will things to happen in order to prove that you're right. Listen only to what the market is telling*

you now. Forget what you thought it was telling you five minutes ago. The sole objective of trading is not to prove you're right, but to hear the cash register ring.

–Marty Schwartz

The Trendline

You can talk all you want about what a stock should *be doing or* why *it isn't doing what it* should *be doing. You can talk about inflation, interest rates, earnings, and investor expectations. Ultimately, however, it comes down to the picture. Is the stock going up or down? Knowing the reasons behind a stock's movement is interesting, but not critical. If your stock goes up on a given day, they won't take the money away from you if you don't know why it went up. And if you can explain why it went down, they won't give you back your lost money. All that really matters is a picture, a simple line on a chart. The trick to visual investing is learning to tell the difference between what is going up and what is going down.*

–John Murphy

To bring order out of what may appear to be chaos, the first straight line one must learn to draw is a trendline, specifically, in this case, for now, a trendline that tracks demand. A <u>demand line</u>. These lines can be drawn just about anywhere, and many traders do just that. But if they are to do their job, <u>track the trend</u>, they have to be drawn a particular way.

Looking at a chart on which no trendlines of any sort have been drawn is sort of like the burglary movies where the guy is trying to steal the big diamond that's sitting on a pedestal in the middle of the room. He knows that there is an alarm which is triggered by the interruption of one or more of a series of laser beams which criss-cross the room. Unfortunately, he doesn't know where those laser beams are because they're invisible to the naked eye. So what does he do? He blows smoke into the room so that the beams become visible. Knowing where they are enables him to miss them and avoid setting off the alarm. Similarly, there are a variety of trendlines on your chart, even though you may not be able to see them. Blowing smoke on your chart will be of no help, however, so you'll have to be satisfied with a less-dramatic straightedge and pencil.

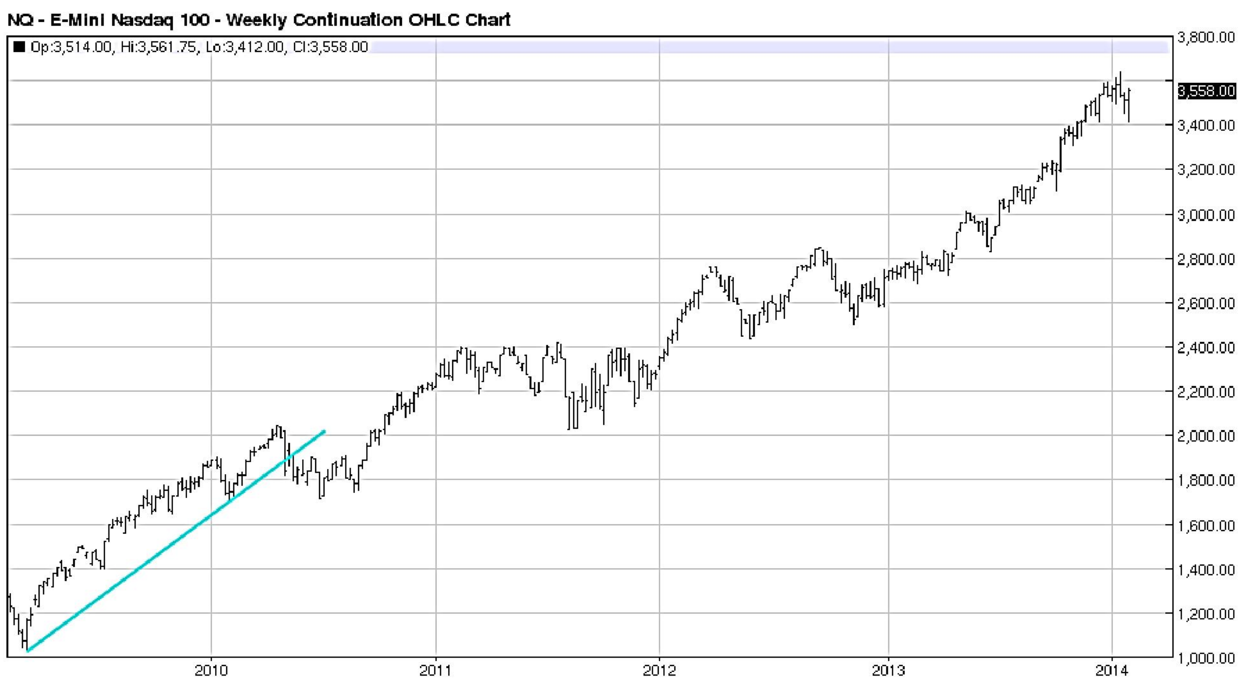
A chart is a visual representation of stock transactions, or the buying and selling behavior of traders. The price points which represent those transactions can be plotted as a line (like on a heart monitor) or as a series of vertical bars (which show the high, low, closing, and usually the opening prices). The purpose of trendlines is to help the trader find order in all these price points and tell him whether price is going up or down (he could also ask a five-year-old to look at the chart and tell him whether price is going up or down as small children have an uncanny ability to do this, but five-year-olds aren't always available).

Even though the upcoming chart is presented *in toto* and the lines are drawn in hindsight, you will probably be able to ignore everything but the left edge and work your way forward. If you can't, just cover most of it with a sheet of paper. Why do this? Because tomorrow you're going to start plotting trendlines on your own charts in preparation for your own upcoming session, and as they "ripen" over the coming days and weeks and months, you'll need to know how to make the necessary adjustments that will enable them to continue doing their job, which is, again, to <u>track the trend</u>. If you had been tracking this trend four years ago, for example, your first trendline would have looked like this <u>at the time</u> (note that this is a daily chart while our master is weekly, thus the slight shift in the line):

<u>The Weekly Chart</u> So, the first line is drawn under the first two swing lows. That's your trend/demand line *at the time* (see above):

And that's it. As long as price remains in this trend, its moves will more or less conform to the trendline you've drawn, not because it's aware of your trendline but because this is one of the characteristics of price movement. You're following price; price is not following you. Price doesn't even know you. When traders decide they want to do something else, your lines will warn you of their plans and you can make the necessary adjustments, i.e, when the line is broken, you "fan" the line down to the next swing low once price has indicated that it's finished falling by making a higher high.

And ditto here:



And ditto here:

This process will continue until the advance has cooled down enough and reduced its angle enough to segue into a sustainable advance (severe angles are unsustainable because sellers run out of buyers too fast; if the angle isn't softened, price collapses into a "\/" or "/\" reversal;a gently-sloping price gives more buyers a chance to take positions; the more holders at a given price or zone of prices, the more "support under the market"). This particular "softening" took almost three years:

Once things have settled down, you can copy your trendline and plot the copy against the highest swing high between the two swing lows used for the lower limit of your trendline, in parallel. This is your supply line and provides you in most cases with a trend "channel".

Then plot another copy down the middle of this channel. This is your "mean" and it will be important to you. But that can wait for now.

Traders then, having rested for over a year, began to depart from the lower limit of the trend channel. Or at least they appeared to do so. And here is where the difference between a demand line and a trendline may be made a bit clearer. Here you have what appears to be a departure from the trendline but you really won't know until price exits through the upper limit and fails to make the return trip to the lower limit. So, you leave the trend channel in place and draw a tentative demand line underneath what is/was at the time the upslope of price.

Still with me?

When price then works its way through the mean and you've got two new swing lows, you can draw a new demand line. If price falls through this and seeks the lower limit of the long-term trendline again, fine. That's unknowable. In the meantime, you can keep track of demand so that you're not surprised by something unforeseen.

When price then works its way through the upper limit of the trend channel, it's time to draw a parallel supply line, though this could also have been done against any of the demand lines on the way to this point, one little trend channel after another.

We see now that the angle of ascent has not only become more severe but that the NQ has exited, temporarily, the upper limit of the trend channel. What this means in terms of whatever entry one needs to make at the opening bell will be addressed later. For now it's enough to know the context of all that's going on in the daily charts. And that you need update the weekly maybe once a month or even less. It's not something you have to do every day

__The Daily Chart__ Now we look at the daily chart leading up to the day for which we're preparing. This is the tail end of the weekly chart posted above:

The upper limit of the trend channel was tested many times over three months, so there's no way to time the big plunge. Assuming we'd never seen this before, we know now that it did plunge and that it rode the mean for a week. After that, it dropped to and tested the lower limit of the trend channel.

Now what?

This is the chart we're looking at while we prepare for the next trading session. We may have studied it the night before, which is likely, or we may have waited until the morning thereof. In either case, we can see what happened in more detail with regard to the interplay between buyers and sellers as price worked its way down toward the lower limit of the trend channel. We can also see how the bounce unfolded.

The Continuity of Price

And now we have to take a timeout to talk about price, and bars, and candles, and the meaning of it all.

In order to trade price effectively, one must first accept the continuous nature of the market, the continuity of price, the continuity of transactions, the continuity of the trading activity that results in those transactions. The market exists independently of you and of whatever you're using to impose a conceptual structure. It exists independently of your charts and your indicators and your bars. It couldn't care less if you use candles or bars or plot this or that line or select a 5m bar interval or 8 or 23 or weekly or monthly or even use charts at all. And while you may attach great importance to where and how a particular bar – or candle – closes, there is in fact no "close" during the market day, not until everybody turns out the lights and goes home, which doesn't happen until the end of the week with the NQ, ES, *et al*.

Therefore, **trading by price**, or at least doing it well, **requires getting past all that and perceiving price movement and the balance between buying pressure and selling pressure independently of the medium used to illlustrate or reveal the activity**.

Once the continuous nature of these movements is understood, the idea of wondering – much less worrying – about what a particular bar – or candle – "means" is clearly ludicrous (including where it "opens" and "closes" and what it's high is and so forth), and eventually the trader may come to the realization that all those people who've been insisting that these bars have some cosmic meaning have been trying to sell him something, i.e., DVDs and courses and software and seminars (box lunch included) and so forth that explain what these meanings allegedly are.

If the continuous nature of these movements is not understood, then the trader spends and wastes a great deal of time over "okay so this bar is higher than that bar but lower than this other bar, and price is going up (or down or nowhere), so . . .".

Price is a movie, not a slideshow

On Your Mark, Get Set . . .

And now back to the morning of the 6th. We already know that price bounced off the lower limit of the trend channel, either because we saw the above chart or because we were there. Either way, we want to know **how** price hit and bounced off that limit. We can see that there was a hell of a plunge on Monday, but before the market opens the next day, we can find the midpoint of that plunge, which turns out to be around 3470. When price reverses there, we can begin thinking that maybe we have a little trend channel shaping up here, and when we get that climactic drop the next day which not only tests the Monday low but snaps back above the long-term trend channel (the dashed lines), our tentative trend channel is confirmed and we can draw it in, along with a mean.

(A Word About This Trend Channel. Some of you will note that this trend channel is completely illegal. The lower limit does not begin with the swing low, at 3480, between the first two swing highs. Instead it's drawn below a much later swing low, on the 3rd. But the clever will realize that there are or had been other trend channels preceding this one, such as the one immediately preceding, with the first swing high at 3545. But to get into that would mean at least three more charts and the accompanying explanations and they really aren't relevant at this point and I'm sure everyone would like to get on with it. So . . .)

We can also see, 3½ hrs before the NY open (these charts are MtnTime; sorry), that price has worked its way up and through the upper limit of this little channel, and while ordinarily this would call for a reversal and a short, price just bounced off the lower limit of a

four-year trend channel. Though one has to be prepared for anything, the circumstances surrounding this bounce shift the probabilities to a move further upward, perhaps to the mean of that four-year channel (see Auction Market Theory, later, p. 30). If we check in a couple of hours later, we find this:

Buyers clearly have a tiger in their tank, and while it's always possible that they will have a major fail, the probabilities, for all the reasons previously stated, favor the upside, and if one turns out to be wrong in his analysis, the demand/supply lines he draws will keep him on the right side of whatever direction price takes.

As it turns out, price did in fact make it all the way to that midpoint plus a little more, reaching 3560 before shutting down for the weekend.

So much for context and for zooming in out of the monthly to the weekly to the daily to the hourly to the moment of truth, when one has to look for an entry into this. Now it becomes a matter of <u>knowing what to look for</u> and <u>waiting until one sees it</u>. Which is where the lines come in. Unfortunately, I can't go much further with this because I don't know how it will turn out. I suspect that price will go all the way to the previous high, but whether it will reach the top of the trend channel or not is another matter because the high was outside the channel to begin with. Are there enough buyers to propel price not only to the last swing high but to a higher high and the upper limit of the long-term trend channel? Stay tuned.

. . . Go!

Now it's time to get down to the actual business of trading.

The SLA is as simple as I can make it:

1. Track the balances between supply and demand with straight lines. Don't hug price like Spandex. Otherwise your line is guaranteed to be broken for what may be nothing more than a stumble. If price is ranging (moving sideways), so much the better.

2. When price breaks a line and takes off in the opposite direction, or when it breaks out of a range, wait for a retracement.

3. Enter on that retracement, a few ticks above the trough of a \/ retracement or a few ticks below the crest of a /\ retracement, and stay in until your line is broken. And by "broken" I don't mean that price pokes the line. As long as buyers are in charge, stay long. If sellers are in charge, stay short.

4.When the line is broken, exit and wait for a retracement in the opposite direction.

5. Continue until you enter chop (two consecutive trades that don't go anywhere and are accompanied by a higher low and a lower high, i.e., not trending: see Appendix A, the Hinge, though there's no hurry).

6. Wait patiently. Quit when you get tired and start to lose focus.

And that, at its most basic, after 14 pages of build-up, is it. Yes, judgement is often called for, and if one has been batted around by the market and has the bruises to show for it, he will be far more likely to exit at those breaks, and if he wants to grab five points and pat himself on the back, who's to say he shouldn't, whereas the beginner who may be a touch more fearless may find himself a bit more in tune with price than with fear and will be willing to give price a little more room to pull back a little before continuing on its original course. If there is a pullback and continuation, he may have to "fan" his line a bit to cozy up to the line that's on the chart rather than the one that's in his head. But, yeah, that's pretty much it.

I've annotated hindsight charts which don't accomplish much because one glance tells you how it all came out and how hard is that? Yes, one can learn what to look for that way, but it's not the same thing. So I have also done series of charts in real time to show what to look for and what to do when one doesn't know what's going to happen next. Unfortunately, the winrate is so high (around 67-80%) and the profit:loss ratio is so high (never mind) that nobody buys it. The thing is, though, that if one knows the plan and one knows the rules, he can recreate the trading sequences himself. And people have. And they've come extremely close to the same entries and exits that I took. It's not like there's a whole lot of wiggle room.

So what follows is a series of charts that are by now hindsight. But they will at least illustrate the lines and the retracements and the entries (the exits are always taken at a break of the line unless otherwise noted; you can't, after all, take the opposite side until you've exited whatever side you're in). You can figure out the profit:loss ratio yourself.

I chose hourly for this series because I encourage traders to use an interval they can follow in real time. It doesn't do much good to use a 1m bar interval if one is working or in class. An hourly isn't exactly a tick chart, but as long as one has reached an understanding of the continuity of price movement, it serves as an example. And one can cover more territory, time-wise. The process and the rules are identical regardless of bar interval.

The first step is to determine the current trend of the market (Wyckoff)

The hourlies following are from December/January, so we'll use the same long-term chart we used earlier and cut closer to the chase:

It looks like the sky's the limit, but if one completes the trend channel for that last 3-month segment, he can detect weakness by the departure from the long-term supply line (next).

The second step is to determine one's place in the current trend

Here we see from the departure from the upper limit of the long-term channel that this rocket may be running out of fuel. Yes, it may rally and even hit the upper limit again. If so, price will have broken that tentative supply line on what may or may not be a new trend channel and we go long. But we don't have to concern ourselves with that now. All we have to do is draw lines and track the demand/supply imbalances.

The third step is to determine the proper timing of one's entry into whatever it is he's trading.

Next we zoom in to the very last of December, before the weekend. This chart represents in an hourly interval the last 12 days of the daily chart above:

Yes, the bigger picture implies weakness. But we don't have to make judgements. The demand lines are broken, which tells us that in this timeframe, 11 days, price is in fact weak, and we ought to be looking for a short. We get one in that first retracement, but I'm not showing it here because I wanted this series to begin the new year, on Jan 1. So I fudged. Shoot me. One can see, though, that a short would have been exited on the 30th, due to a break in that fanned supply line, for a small gain. The job then is to wait for a retracement thereafter, regardless of whatever bias we might have or have had toward weakness. That retracement takes place overnight, and a long is entered.

The fourth step is to manage the trade by monitoring the balance between buying pressure and selling pressure, exiting when the balance is no longer in your favor

This is a zoom-in of the chart on the previous page with two extra days added. The same long is still there, but it's easier to see its particular context. Doubts about taking this long are easily understood since we're looking at the task of breaching that last swing high before our entry. But the requirements for a long are met, so we take it. When the trading session opens in NY, we head hellbent for leather to that last swing high and fail to breach it. And we could exit there if we were to have drawn an extremely tight demand line. But we also have the option of finding the halfway point of that rally, which is where the dashed blue line has been drawn. If price can hold there, that rebound suggests strength. But when it then fails a second time to make a higher high, we are entirely justified in exiting the long. The market is not just telling us what to do; it's screaming at us. Even so, we can hold for a break of the demand line just like we're supposed to and exit for 5 or 6 points. Not a fortune. BUT NOT A LOSS. We then short the first retracement and ride that down. When the supply line is broken, we can exit, or we can see just how much strength the buyers have. As it turns out, not much. They can't even rally half of the downdraft (the dashed blue line again), so we stay in and see if we can make a lower low. We can, so we fan our supply line out to include that next swing high.

Price then breaks our new supply line and again we have to make a choice: exit the break and take the money or wait to see how strong the rally might be, not unlike "Let's Make A

Deal" ("Do you want to take the car or Door #2?"). Here, though, we have three choices: exit at the break of the supply line, exit at a breach of the last swing high, or exit at a breach of the halfway point. For our purposes here, we'll assume that the trader relaxed and stayed in, keeping in mind that even if he had exited, there's always the option of getting back in.

On that next attempt, price just barely breaches the halfway point and immediately retreats. Nonetheless, one could have exited and then re-entered off that failure, which itself is a retracement. When price makes a lower low, the supply line can be fanned again, and when price retraces, the swing high holds below the halfway point of the immediately-preceding downdraft.

After the market opens on the 6th, price spends the day forming a hinge, or coil:

The coil – or hinge – represents – or can – an energy compression. The difference between what sellers are seeking as value and what buyers are seeking as value gets narrower and narrower. If this doesn't go on too long, this compression will result in a substantial and sometimes explosive move out of this coil ("coil" implies a readying to spring; don't forget Appendix A).

As you can see, buyers have been able to push price up to the upper limit of the coil. Sellers can be expected to push it down toward the lower limit (this is all part of the exploration process to "feel each other out" and negotiate what each considers to be the "best price").

If price has not broken out to one side or the other by the time the coil is nearly complete, it is more likely to do little more than dribble out the end and move sideways until somebody gives somebody a hot foot and price takes off again into parts unknown. This listlessness occurs because traders have given up their efforts to make something happen, for whatever reason, and are focusing instead on their Danish. Why they've given up is less important than the fact of it, and that can be determined by the price movement. Or lack of it. This goes on here for six hours before buyers move to test that supply line.

And they not only test it, they break it, so we go long on the first retracement thereafter. The fact that price can rally to and through and hold above the halfway point is encouraging.

Self-explanatory, I hope.

These lines may need some explanation. Once price goes as far as it can, rolls over, and breaks the demand line, a short is taken at the first retracement. Price then rallies, breaking the new supply line as well as the last swing high – which happens to be at the same level as the top of that brief trading range where the arrow line is begun – and the halfway point, not drawn, but which is on the same level as those arrows. So there's really no wiggle room here. You have to exit. The first retracement thereafter provides the long, or, if you prefer, re-entry.

This one is a trick chart. But before we get to that, I want to point out the "retracement" that is noted by the arrow. Some traders have all sorts of bar intervals plotted on their screens, but unless you're watching a tick chart, you can see what price is doing, if you're actually watching the screen, by following the righthand tick on each bar. Here, after price reached what would become the high of the bar, it retraced, as you can see. So if you happen to be there at the right time, it's perfectly okay to consider that a "retracement" for a long entry. It is, after all. All one has to do is look at a smaller bar interval to see it. Point is, you don't have to take up extra real estate in your display to accommodate another chart.

As for the trick. Everything is cool here, done just like it's supposed to be done, but there is also a caution. If you'll look at the two swing highs and the two swing lows, you may see what looks like a very-short-term trend channel. That puts that last short just above the mean of it, which suggests a move upward. However, if one is following the rules, one has to take this. As Douglas says, "anything can happen" but "you don't have to know what's going to happen next in order to make money". If you happen to notice that undrawn trend channel, you can be prepared for an event other than a drop.

Here's the same chart without all the extraneous lines but with the trend channel drawn in along with the short just taken. Notice that price does rally, just as can be expected – though not guaranteed – by holding above that mean. But if one is alert and sees that channel, he can enter the reversal which one can expect during a test of the limit of a trend channel. Unfortunately, if he isn't alert, he'll lose about 6 pts on that short and won't find an opportunity to participate in what was one hell of a dramatic fall.

The recoil is easier to play because of the SLA setup: first retracement after a break of the supply line. The blue dot here is where I exited, not because the demand line was broken but because it rose all the way back to that upper-limit trendline. And it did it fast. And it was late in the day. So I took it. Shoot me.

Price obviously continues to rise and eventually breaks an undrawn demand line (surely one can see that price is rising), providing a short op at the first retracement. This doesn't result in much, maybe even a small loss. After that is a retracement which provides an op for a long, undrawn. That's stopped out quickly (for an hourly chart), and the short off the first retracement after the break of the demand line, also undrawn, is also stopped out pretty quickly. This tells you you're in chop, and you need to back off until you get out of it. By this time, you can draw the upper and lower limits of the trading range you may not have noticed.

The next opportunity, though, does better. An interesting facet of coils/hinges is that they nearly always provide a clean entry if one pays attention to the midpoint or apex of them. They very often make fake moves out one side before returning to the hinge – usually the apex – and then making their real move out the other side (some would think that this is some sort of conspiracy, running stops and so forth, but all it means is an effort to find buyers or sellers out one side and, failing to find them, fishing for them out the other side). If they don't make a move in the opposite direction, an entry off the retracement to that apex is perfectly okay. If price takes off in the opposite direction, the entrystop generally isn't triggered, so the risk is minimal to non-existent. If this in fact occurs, one can then enter a retracement off the move out the opposite side. This is a lot easier in real time than it sounds in the explanation, but if one doesn't want to futz with any of this, he can just wait until everybody decides just what it is they want to do and then enter the first retracement thereafter.

This short works out pretty well, providing 8pts by the time the supply line is broken, and the long entry is very clean. In fact, one could have drawn a tighter supply line and gone long at 3585 after the double bottom at 3578. Trader's choice.

All this should be self-explanatory except for that NT, which means "not triggered", i.e., the short that would ordinarily have been taken there wasn't triggered, so no entry, no loss. Instead, price reaches the last swing high and retraces a bit before continuing upward. The same scenario could have unfolded here, i.e., a failure to continue the move upward would have resulted in an untriggered entrystop and, again, no loss.

And, finally, the last:

The long is stopped out after the demand line is broken at 3620, and the short is taken off the first retracement thereafter.

This was one hell of a three-week arc, but you just never know. That's what's challenging but also fun about real-time trading: to paraphrase Douglas, you never really know what's going to happen. But you can determine the probabilities.

In Conclusion

The straight line approach enables the trader to act confidently and decisively when price flashes a big red sign in his face that it's going to travel in a particular direction. If the trade turns out not to be worth much, this same approach gets him out of a potentially losing trade rather than let him hang. He may even wind up with a point or two. More importantly, HE WILL NOT SUFFER A LOSS, at least nothing of the magnitude that he's used to or that he fears. A few ticks. A couple of points. Bupkus.

The three-legged stool here, as I've said, is constructed of a thorough understanding of supply and demand, trend, and support and resistance. A surprisingly large number of people are absolutely convinced that they possess this understanding when in fact they haven't the least idea what support and resistance and trend and so forth are all about. But even if one has no idea what these three fundaments are, much less how to apply them, he can still turn a profit if he knows how to draw a straight line. Unfortunately, quite a few people can't do that either. These people ought to find some other way to trade. Or quit. Otherwise they will find themselves trading congestion, day after day, and getting chopped up in the process with no understanding of what wrong and blame the method ("another method that's all baloney, another scam, more snake oil").

Traders trade not the market but their perceptions of it. Drawing a straight line can help prevent the trader from wandering into that particular field of weeds. But, like the werewolf tied to the chair, eventually, if he wants to sabotage himself badly enough, he will find a way to do so. This may be beyond even the power of a straight line to cure.

A final note: those who are fearful will scatter like cockroaches at the flip of the lightswitch when price makes the slightest move against them. Even a tick. But the money is made by staying in the trade for as long as it generates a profit. Therefore, the trader should look for every excuse to stay in a trade, not to get out of it. This doesn't mean sitting there like a post when the trade is clearly going against you. But neither does it mean setting "targets" and exiting as soon as they're reached, nor freaking out for no other reason than price has tripped over its own feet and fallen to just the other side of a line (see Appendix F).

This approach is by no means mechanical. It requires instead that the trader be continuously sensitive to the changing imbalances between supply and demand – or selling pressure and buying pressure – and act accordingly. Therefore, any break or countermove should not be cause for panic but for reassessment. Those who follow this approach will find it difficult to lose if they just pay attention and refuse to allow their egos and biases to prevent them from doing what's required.

Wyckoff and Auction Market Theory

The Box

Traders who have a lot to buy or a lot to unload will avoid trying to catch the tops and bottoms and focus on "the middle", since "the middle" is by definition where most of the trading is going on. However, since "the middle" is by definition largely non-directional, there is also a lot of whipsawing there, and that generates a lot of losing trades. One can sometimes avoid this by widening the stops, but, since the market always teaches us to do what will lose the most money, this will turn out to be an unproductive tactic.

The safest and generally most profitable trades are found at the extremes. Therefore, you wait for the extremes. Wyckoff used a combination of events to tell him when a wave was reaching its natural crest or trough: the selling/buying climaxes, the tests, higher lows/lower highs, and so on, all confirmed by what the volume (trading activity) was doing and by the effect this activity had on price. As a result of this work and of his exploration of trading ranges, he developed the concepts of support and resistance along with their practical application. **Auction Market Theory** (AMT) takes these investigations into support and resistance further, an "organic" definition of support and resistance like Wyckoff's, that is, determined by traders' behavior, not by a calculation originating from one's head or from a website somewhere. Determine whether you are trending or "balancing" (ranging, consolidating, seeking equilibrium, etc.), determine the limits of the range (support and resistance), and you're in business.

The notion of support and resistance has been and is the missing piece for many market practitioners, the ignorance of it being the chief reason why the "2b", "1-2-3", "Ross Hook" and other "borrowed-from-Wyckoff" ideas so often fail. One can try to hit what appear at the time to be the important swings again and again and be stopped out again and again, like Dunnigan, hoping all the while that once one hits the true turning point, all the effort will turn out to have been worthwhile and the P&L will change from red to black. But by waiting for the extremes, one avoids most or all of those losing trades, and, even more important, avoids trading counter-trend. The "Darvas Box", which illustrates Wyckoff's notions of range, at least provides a graphic means of locating those extremes. What I've found most useful about them is that they are encapsulated by time, i.e., the price and volume ranges have a beginning and an end. This enables me to see at a glance where the important S&R are, or at least are likely to be. Without them, one ends up with line after line after line until the S/R plots become a parody of themselves.

All of this can be very confusing to someone who's learned to view the market in a different way, perhaps less so to someone who's just starting since he has so much less to unlearn. But backing up to the basic tenets of AMT, as well as to the concepts developed by – and in some cases originated by – Wyckoff, one can perhaps find a solid footing and proceed from there.

To begin with, in the market, price is often not the same as "value". In fact, one could say that since the process of "price discovery" is a search for value, they match only by coincidence, and then perhaps for only an instant. Blink and you missed it. Add to this the fact that for all intents and purposes there is no such thing as "value" but rather the perception of value. After all, what is the "value" of, say, Microsoft or GE or that little stock your stylist told you about? This state of affairs may seem like a recipe for chaos, but it is in fact the basis for making a market, that is, reconciling the differences – sometimes extraordinarily wide differences – in perceptions of value.

As Wyckoff put it, if a stock (or whatever) is thought to be below “value” and a trader or group of traders see a large potential for profit ahead, he/they will buy all they can at or near the current level, preferably on “reactions” (or pullbacks or retracements), so they don’t overpay. If the stock is above what they perceive to be value, they'll sell it (or short it), supporting the price on those pullbacks and unloading the stock on rallies until they are out (or as much out as they can be before the thing begins its downward slide). “This”, he writes, “is why these supporting levels and the levels of resistance (a phrase originated by me [Wyckoff] many years ago), are so important for you to watch.” When price then begins to lose momentum and move in a generally sideways direction, you’ve found “value” (if value hasn’t been found, then price won’t stop advancing or declining until it has). Value, then, becomes that area where most of the trades have been or are taking place, where most traders agree on price. Price shifts from a state of trending to a state of balancing (or consolidation or ranging), the only two states available to it.

The trading opportunities come (a) when price is away from value and (b) when price decides to shed its skin and move on to some other value level (that is, there’s a change in demand). This is also where it gets tricky, partly because demand is ever-changing, partly because you’ve got multiple levels of support and resistance to deal with and partly because we trade in so many different intervals, from monthly to one-tick. If we all used daily charts exclusively, it would all be much simpler, though not necessarily easier. But that’s not the case, so we must remember always that a trend in one interval – say hourly – may be a consolidation in another, such as daily. The hourly may be balancing, but there are trends galore in the 5m chart. Or the 5s chart. Or the tick chart. Regardless of how one chooses to display these intervals – line, bar, dot, candle, histogram, etc – there are multiple trends and consolidations going on simultaneously in all possible intervals, even if they’re in the same timeframe, even if that timeframe is only one day (to describe this ebb and flow, Wyckoff used an ocean analogy: currents, waves, eddies, flows, tides). If the trader becomes confused by all this to the extent that he is well into the weeds, he should keep in mind that all charts, at bottom, are tick charts, i.e., price moves in ticks, not bars or candles or whatever. What most traders choose to do is view summaries of ticks, whether in 1m bars or 5m or 7m or 26m or 48m ad infinitum. None of this changes the fact that price moves in ticks, and charts are displays of one sort or another of ticks. What is of more practical importance to the trader is an awareness that as price moves up and down, he will be trading with different "classes" of traders. When price makes a new daily high, for example, those traders who trade daily bars will be aware of it and will act according to their own lights, whereas they may pay no attention whatsoever to what price is doing in the 15m bar realm. This is why breaks through the previous day's or week's high or low can be so forceful: not only are different groups entering the fray, but there are more of them. The trick is to hitch your wagon to one of their stars.

To sum up where we are so far, and keeping in mind that there is no universally-agreed-upon auction market theory, the following elements are, to me, basic, and are consistent with what I've learned from Wyckoff et al:

1) An auction market's structure is continuously evolving, being revalued;
   future price levels are not predictable.

2) An auction market is in one of two conditions: balancing or trending.

3) Traders seek value; value is price over time; price is arrived at by

negotiation between buyers and sellers.

4) Change in demand drives change in price.

5) One can expect to find support where the most substantial buying has occurred in the past and resistance* where the most substantial selling has occurred. This does not mean that anyone who bought at a particular price at some point in the past still holds what he bought. In fact, no one who is viewing this past activity may have been part of it at all. But anyone who looks at it in whatever form will see the obvious level of interest overall as well as those price levels where interest was most intense. Whether or not this intense interest will reoccur is unknowable, but the preconditions for unusual activity are there.

I'm sure everyone has noticed that swing highs and lows and the previous days' highs and lows and other /\ and \/ formations can serve as turning points and appear to act as resistance. However, this type of resistance stems from an inability to find a trade and is accompanied by low volume. Price then reverts to an area where the trader finds it easier to close that trade. "Resistance" in this sense, then, refers to resistance to a continuation of the move, whether up or down.*

***Volume may look "big" at the highs and lows, but the price points are vertical, not horizontal (as they would be in a consolidation), so the volume – or trading activity – at each price point is less than it would be if the same price were hit repeatedly, as it would be in a consolidation.*

So how does one trade all this?

First, find a range, preferably one with an easily determinable upper and lower limit.

Second, determine where price is within that range.

Third, locate the extremes. If you have a range that is wide enough for you to trade (that is, there are enough points from top to bottom to make a trade worthwhile) and price is at the bottom of that range, there is a good possibility for a long. If price is at the top of the range, there is a good possibility for a short.

At this point, you have three options: a **reversal**, a **breakout**, or a **retracement**. If, for example, price bounces off or launches itself off the bottom of the range (support), trade the reversal and go long. If instead it falls through support, short the breakout (or breakdown, if you prefer). If you don't catch the breakout, or you prefer to wait in order to determine whether or not the breakout was "real", prepare yourself to short whatever retracement there may be to what had been support and may now be resistance.

A more boring alternative is that price is nowhere near the top or bottom of any range that you can find but rather drifting up and down, aimlessly. No change is occurring; therefore, there is no trade, or at least no compelling trade. Finding the midpoint of the range – where the largest number of trades are occurring – may be useful since price sometimes ricochets off the midpoint, or launches itself off the midpoint if it has settled there. Such actions represent change since price may be looking for a different value level. It may come to a screeching halt and reverse when it gets to one side or the other of the range and return to the midpoint, or it may launch itself through in breakout form and extend itself into the next range, if there is one, or create a new range above or below the previous range (in determining which, zoom out in order to determine whether or not price is in a wider range that is outside your view, i.e., back away from the tree a bit and take a look at the forest). Or it may reverse off one side, break through the other, and begin trending. When all is said and done, however, the most profitable alternative, boring or not, may well be to do nothing, i.e., just stand aside attentively until one extreme or the other is approached and a more attractive trading opportunity presents itself. If one is patient, the market will eventually show its hand and tell the trader what to do.

The Trend Channel

Applying AMT to trend channels is tricky. Yes, trend channels are ranges. If they weren't, they wouldn't be channels. However, they aren't the result of just taking a lateral trading range or "box" and tilting it. For one thing, the volume dynamic is different. The greatest amount of volume in a lateral trading range is in the middle. That's how the "middle" is defined. If the greatest amount of volume were someplace else, so would be the middle. One could argue, in fact, that the characteristic box is defined not by its limits but (a) by its middle and (b) by how far price travels from one side of it to the other. In any case, as price moves back and forth from one extreme of the range to the other, the transactions in the middle pile up because that's where price spends the most time. If one then has a lot to buy or to unload, he looks toward the middle, as explained in the first part of this piece, since that's where the bulk of trading is taking place (and if anyone has noticed a potential Chicken Or The Egg Conundrum at this point, no, I don't want to get into it here; in practice, it doesn't matter anyway).

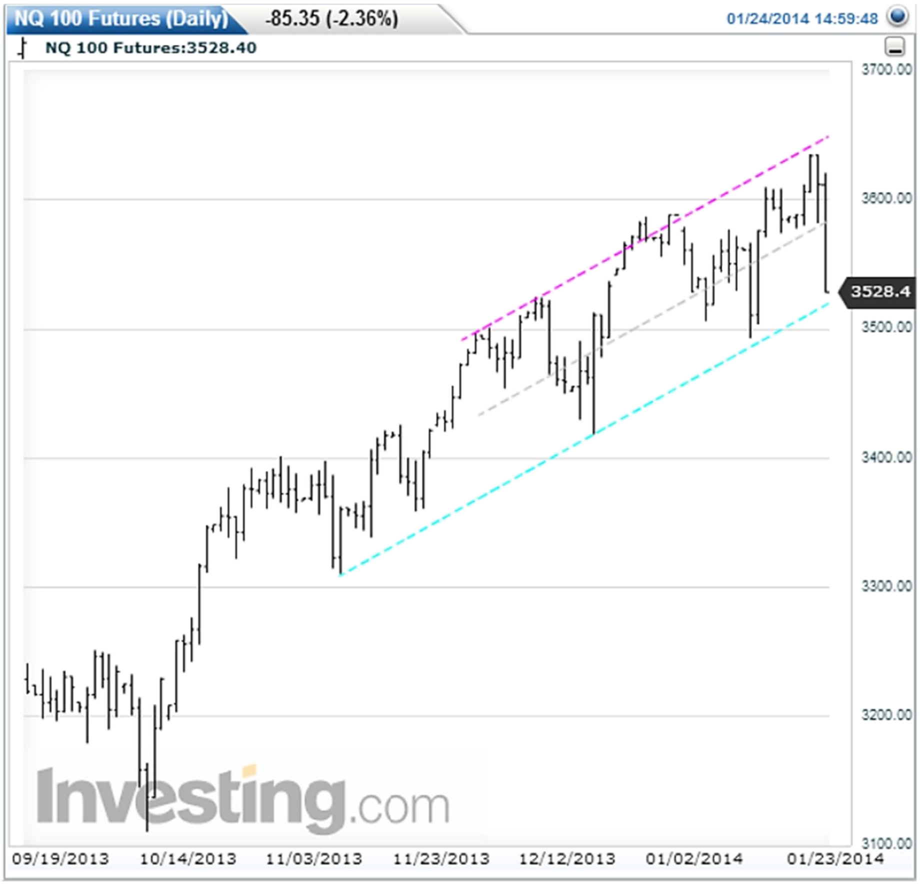
If one thinks instead of the middle of the trading range as the mean, many of the difficulties one might have in wrapping his mind around the whole idea of applying AMT to trading ranges may evaporate, or at least lift, since trend channels also have means. Even the sloppy ones. And price tends to revert to the mean, along with the traders it's saddled with. This is called "mean reversion", and there are sound behavioral reasons for it which I have no intention of getting into here since this is not a monograph. Suffice it to say that even in – or particularly in – a rising market, at least some people will say to themselves that they've made an awful lot of money in whatever and maybe it's time to act like a grown-up and sell some of it while others, for whatever reasons, think prices are just too damn high and stop buying. Prices will then fall, at least to the mean, or "home". Sometimes they'll go past that, particularly if the advance has been a bit too "exuberant". If the downdraft gets out of hand, price may travel all the way to the other extreme of the channel at which point traders will think Hey!, this is a pretty attractive price here; let's buy some of this. And price rises. It does not usually, however, rise all the way to the opposite extreme that it just left in one fell swoop. More often it stops off at the mean, gets out of the car, uses the restroom, has a Coke, walks the dog. The same dynamic applies to a falling market, which is why it eventually stops falling.

The attentive reader may have noticed by now that one's ability to make use of this information depends largely – or entirely – on his ability to draw a trend channel. Many cannot do this. However, if one can at least tell whether price is going up or down and enclose this movement in something resembling a PVC conduit, then he is at least on the right track. If he continues to have difficulty and he has or has access to a child under the age of 10, let him do it. He should have no difficulty in doing so, particularly if he has some experience with Chutes And Ladders. If the trader then draws a line down the middle of this channel, a line that is equidistant from the two sides, he will have his mean and can then begin making prognostications about price movements and Amaze His Friends (depending on how easily his friends are amazed).

On the next pages are examples of some recent trend channels, or at least recent as of 01/24/14. They may be helpful. Or not. But at least they're free.

When initiating your trend line, begin with the first two swing lows, here the first point, then "1". As the trend runs its course, "fan" your line down to include new swing lows ("2") if and when price makes higher swing highs. Otherwise, your line will begin to cut through the price course and become useless (if price does not make higher highs and your line does cut through price's course, then you have a signal of a potential change in that course; a more complete discussion is provided on p. 6). The next fanning takes place when swing low "3" is made.

Note that if your trendline isn't within a country mile of the price course, then you're doing it wrong. The whole point of a trendline is to track the trend. If it isn't doing that, it serves no purpose.



Once you have your lower line, draw a parallel line beginning with the first swing high between the first and second swing lows used by your trendline. Draw a mean equidistant between these two lines.

And, finally, an example of how price can react to a mean.

It might be instructive at this point to look at how we got to this day from the beginning of the trend five years ago.

As explained earlier, one begins with the swing lows and plots his trendlines and, if it all works out that way, his trend channel with the information that he has available to him at the time. Once he's plotted these lines, he will most likely find that price escapes them either to the upside or downside from time to time. This in itself is not cause for concern.

However, when price penetrates one trendline or the other, in this case the upper trendline, and doesn't come anywhere near returning to the lower, one must be alert to the possibility that traders are seeking new value and a new value area, again as explained earlier.

Note here, for example, how price lifts off the lower trendline in August '11 (B) and never looks back. And though it doesn't actually leave the channel until June '13 (D), it never even drops below the mean during this period.

One need not wait for these breakthroughs, however, in order to track the course of price and be alert to changes that may affect either current or future trades and investments. Here, for example, we can begin at "B" to anticipate the future course of price by adding an upper trendline and a mean to the lower trendline which we plotted in the chart above (the letters in these charts all correspond to the same price/time points throughout):

(And a note here about the seeming ill-fit of this trend channel. Those who aren't familiar with the function and purpose of trendlines and trend channels will alter them – either by changing their angles or raising or lowering them – in order to force them to more closely conform to price, in the manner of the Prince trying to fit the glass slipper onto the wicked stepsister's foot.

But that's not what trendlines/channels are for. By drawing them in this manner, unusual price activity alerts the trader – if he's paying attention – to possible important changes in the course of price. Here, price becomes "overbought" in March, which means that buyers are paying a price that is too high – too far away from the mean – even to them. They therefore lighten up, and price falls. That price does so again just six months later is a testament to the short-term memory of traders, though the break above the trendline is less severe this time. After that, it behaves, at least until "E", which comes as no surprise since traders have twice driven price outside the channel. This time however, there hasn't been a return visit to the lower trendline for months. Not even the mean. All of this signals a potential search for new value and a change in the course of price.)

Here we skip ahead to save time and plot a complete trend channel off "D":

The very end of this chart, just after "E", may be found in daily form 4p back. For trading purposes at that time, it was decided to "zoom in" to the activity taking place between the mean and the upper trendline since there was nothing taking place below. The mean in the chart above therefore became the lower trendline for the trend channel and a new mean was drawn for the new channel (if this is confusing, keep in mind that there are both weekly and daily charts here covering much the same territory; print them out and put them side by side).

Where price will go from here is anybody's guess. It may continue to fall to the lower trendline illustrated above, or it may bounce here and make a return trip to the upper limit. The trader who is prepared for both will profit.

When Worlds Collide

Occasionally one will come across a situation in which the world of the box and the world of the channel merge, and while trading these can seem like rubbing one's stomach and patting one's head at the same, monitoring both will provide more trading opportunities – sometimes dramatic opportunities – than choosing one over the other.

Here, for example, one can see that price has been in an uptrend. It's been in no rush and appears to be in the midst of a trend change. Whether it is or not, it is making lengthy sideways movements to the extent that trading ranges are formed, with clearly delineated upper and lower limits. Keeping both the diagonal and the lateral in one's sights may require more attention, but the rewards are numerous (not all opportunities are annotated):

Crib Notes

1. Determine the current **trend** of the market (Wyckoff), weekly then daily.
2. Determine your place in the current trend.
3. Determine the proper timing of your entry into whatever you're trading.
   a. Find a **range**, preferably one with an easily determinable upper and lower limit.
   b. Determine where price is within that range.
   c. Locate the extremes (support and resistance).
   d. Short **reversals** off the upper limit; buy reversals off the lower limit.
   e. When breaks out of the range, either trade the **breakout** or wait for and trade the **retracement**.
   f. Track the balances between supply and demand.
   g. When the trend or "stride" is broken, exit and wait for a retracement in the opposite direction.
   h. Continue until you enter **chop** (two consecutive buy/sell or sell/buy trades that don't go anywhere and are accompanied by a higher low and a lower high, i.e., not trending).
   i. When price exits the chop (which may become a range), resume trading the trend.

GLOSSARY

Breakout: BO. A breakout is not just a matter of a price exceeding a previous price level. Price must break *out of* something, most often a trading range. There are three strategies: breakouts, reversals, and retracements.

Climax: A major buying or selling panic that occurs at the end of a steep increase or decline in prices

Demand: Buying power, buying pressure.

Demand Line: DL. That line which passes through two successive swing lows.

Last Swing High/Low: LSH/LSL. A swing high or low represents a point at which traders are no longer able to find trades. Whether that point represents important support or resistance will be seen the next time traders push price in that direction. But everyone knows this point, even if they aren't following a chart. It exists independently of the trader and his lines and charts and indicators and displays. It is the point beyond which price could not go. Hence its importance, both to those who want to see price move higher (or lower) and those who don't.

Price movement (price action, price behavior): PA. The continuous tick-by-tick (transaction-by-transaction) movement of price as shown on the tape (or on a corresponding chart).

Resistance: An area where selling pressure overwhelms buying pressure. More specifically, resistance is the zone or level at which those who have enough money to make a difference attempt to retard, halt, and reverse a rise by selling.

Retracement: RET. The first pullback after a break through support or resistance or a V reversal and the second opportunity (the first being the break or reversal itself) to enter the trade. If price does not resume its course, the "retracement" becomes a failed breakout or a retracement after a reversal that never was.

Reversal: REV. A bounce off of or rejection of the upper or lower limit of a trading range. Also the result of a buying or selling climax.

Scratch: To exit a trade if the market does something that proves your initial decision to enter the trade was wrong.

Supply: Selling power, selling pressure.

Supply Line: SL. That line which passes through two successive swing highs.

Support: An area where buying pressure overwhelms selling pressure. More specifically, support is the zone or level at which those who have enough money to make a difference are willing to show their support by retarding, halting, and reversing the decline by buying.

Tape: A thin strip of paper on which is printed a series of stock symbols, each print representing a transaction in that stock and consisting of the price at which the transaction took place and the volume of shares changing hands. Modern day equivalents are the "time-and-sales window" and the one-tick chart.

Tape Reading: The art of determining the immediate course or trend of prices from the action of the market as it appears on the tape.

Trading Range: TR. A period of balance between buyers and sellers. Prices move within a range where the bottom represents demand and the top represents supply.

Trend: The line of least resistance (LOLR).

Trendlines: TL. Straight lines drawn through the tops or bottoms of the price path established during an upward climb or downward pitch. They "serve to define the stride of the price movement, thereby frequently directing our attention either to possibilities of an approaching change of trend or to an actual reversal." (Wyckoff*)

Volume: Number of units changing hands in each transaction.

*Richard Wyckoff (1873-1934) was a pioneer of technical analysis. While Dow contributed the theory that price moves in a series of trends and reactions, and Schabacker classified those movements into chart patterns, developed gap theory, and stressed the role of trader behavior in the development of patterns and support/resistance, Wyckoff contributed the study of the relationship between volume and price movement to detect imbalances between supply and demand, which in turn provided clues to direction and potential turning points. By also studying the dynamics of consolidations or horizontal movements, he was able to offer a complete market cycle of accumulation, mark-up, distribution, and mark-down, which was in large part the result of shifts in ownership between retail traders and professional money.

Wyckoff sought to develop a comprehensive trading system which (a) focused on those markets and stocks that were "on the springboard" for significant moves, (b) initiated entries at those points which offered the highest probability of success, and (c) exited the positions at the most advantageous time, all with the least possible degree of risk[1]. His favorite metaphor for the markets and market action was water: waves, currents, eddies, rapids, ebb and flow. He did not view the market as a battlefield nor traders as combatants. He counseled the trader to analyze the waves, determine the current, "go with the flow", much like a sailor. He thus encouraged the trader to find his entry using smaller "waves", then, as the current picked him up, ride the current through the larger waves to the natural culmination of the move, even to the extent of pressing one's advantage, or "pyramiding", as opposed to cutting profits short, or "scalping".

<u>Continuity of Price</u>: Wyckoff began as a tape reader. By the time he incorporated daily charts into his trading, the continuity of price movement via the tape, tick by tick, had

become so ingrained that he could see price no other way. Even though he might be looking at a series of daily bars on an end-of-day chart, he saw price as continuous. Thus the bar itself was irrelevant to him, and he was just as comfortable using line charts as bar charts. The line chart, in fact, more closely conforms to this continuity.

"Setups": There are no "setups" in Wyckoff, at least insofar as we commonly use the term. He did not say that if price does this, you buy and if price does that, you short. Rather he stressed that the trader must be sensitive to imbalances in buying pressure and selling pressure, particular at levels where these imbalances might most likely result in profit opportunities, e.g., reversals. Therefore, the "trading signal" is not, for example, a "double bottom" or a "higher low" or a "climax bottom"; the trading signal is provided by the imbalances between buying pressure and selling pressure, and if one does not view price as a continuous movement and is not sensitive to these continuous shifts in balance/imbalance, he will not understand what it is that he's supposed to do (see Appendix D).

[1]Risk is minimized by (1) focusing on liquid markets, (2) monitoring the imbalances between buying pressure and selling pressure at those levels of "support" or "resistance" where price is most likely to reverse its trend, (3) entering on reversals (or, if necessary, retracements) rather than breakouts, and (4) getting out when the market tells you to.

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Appendix A: The Hinge

A **hinge** is a trading range that's tired of screwing around. While price in a trading range will bounce up and down in search of **equilibrium** with no particular timetable in mind, price in a hinge conducts that search more seriously, giving itself a deadline, i.e., that point – the apex – where the diagonal lines meet. Hinges are created by **successive lower highs and higher lows** and represent a **tightening and compression**. If interest is sufficient, this compression will eventually lead to a worthwhile move (if it isn't, price may simply dribble off into nothing worth bothering with). As Schabacker wrote, these hinges or coils should be **"filled with price"**, that is, there is no aimless drift but a struggle between those who want to move price ahead and those who don't. Therefore, price should bounce in an ever-tightening range which culminates in a release of **pent-up energy** and a tradeable move. This tightening and compression leading, typically, to this release is why many people call this a "coil". A particularly attractive feature of the hinge is that it's so easy to recognize in real time: as soon as you note a higher low and a lower high (or vice-versa), be on the lookout. A hinge may be on the horizon.

Genuine hinges – those which form as the result of successive negotiations between buyers and sellers to find equilibrium – share common characteristics and can therefore be traded in much the same way. If shorting what appears in real time to be a downside breakout through the demand line, keep a tight stop. If it doesn't go, you're out at breakeven. If price returns to the midpoint, one can place a sellstop below this activity so that one can be stopped in on a second attempt at a decline. If none of that goes, one can sell a break of the supply line, again with a tight stop. If he is again stopped out but the return to the midpoint turns out to be a test, he can place a buystop above this test and be stopped in on a second attempt at an advance.

For example:

The dynamics of this endgame are not difficult to understand. The hinge, after all, is created because of differences of opinion. That this testing should continue once one side or the other pushes price out of the hinge should not come as a surprise. But clearly one has to be quick on one's feet to avoid getting trampled.

Many beginning traders – and many not-so-beginning traders – have trouble trading this because they think that the market, or the "big" money, or the "smart" money, is out to get them, to trick them. It never occurs to them that neither the market nor the big/smart money could care less about them. Therefore they are forever looking out for the trick, the trap, the gotcha, and are thus guarding themselves against a threat that doesn't exist, making all the wrong decisions at the wrong times.

It's really just a matter of looking for trades, which is after all the business of trading. If traders can find trades out of the bottom of a trading range, great. If there are none, traders will search for trades out of the top of the range. This doesn't mean that anybody "tricked" anybody into selling the breakdown. It means only that there was no business there. This is also why first exits from hinges are so often in the opposite direction from the ultimate move. Knowing this gives the trader the confidence to reverse his position. And, yes, sometimes there are no trades out of the opposite side, either. Then everybody returns to their corners and futzes around inside the range for a while, and the "price action" trader is standing aside, waiting for everybody to decide what they want to do. Quite often what they want to do is go to lunch.

There are, of course, many hinges without drama. They more closely resemble rest stops than combat zones. In these cases, everyone decides after discussion and negotiation that they want to go up:

Then there are those which require very little discussion and even less negotiation. Long before the hinge completes itself, most decide they want to go down. Buyers may give it the old college try after exiting the hinge, but they have too much trouble pushing their way back inside the hinge and beat a reluctant retreat. After all, it's Friday afternoon and everyone wants to go home:

Price moves because traders are trading, and bots notwithstanding, traders are people, and people behave in expected ways. The hinge is a sign of this, which is why looking at it as nothing more than a pattern won't help the trader much in terms of making a trading decision. The hinge exists because traders are looking for – and in the process, determining – a new value level. If they weren't, the hinge would never form.
The hinge therefore is a kind of reset, and whatever came before is not necessarily pertinent to what happens after due to the task that traders are performing. In short, all bets are off. And if price doesn't exit the hinge by the time it's about two-thirds complete but rather remains inside all the way to the apex, this indicates that traders have come to an agreement on what is fair value, so price simply drifts along at or about that level rather than bolt upward or down. Sometimes for hours, or, in a larger bar interval, for months.

Playing a pattern usually entails following a relatively rigid set of rules: flags, pennants, head-and-shoulders, wedges, 2Bs, 123s, N4s, N7s, hooks, springs, and on and on. Playing the behavior involves understanding what it is that traders are doing that prompts the "pattern" to form in the first place, where they're doing it, what buyers and sellers are trying to accomplish. If one understands this, he is more likely to trade it profitably than be yanked around by other traders into a state of immobilized frustration.

Therefore,one must abandon whatever biases he may have or have had and let the market tell him what to do. If he doesn't understand what the market is telling him, then he should back off and just listen until the sense of it becomes clear. If one is the corporate sort, he might think of the hinge as a closed meeting. Once the meeting is over, the rank-and-file finds out what conclusions were reached in the meeting by what the participants then do. The participants exit and go about their business according to those conclusions, and in this case, those conclusions were to head downward. Whether these decisions make sense to the trader or upset his plans in any way is entirely beside the point.

Appendix B: The Dog That Didn't Bark

A Sherlock Holmes short story, "Silver Blaze", has to do with the disappearance of a race horse and the murder of its trainer. Holmes suspects that Scotland Yard Inspector Gregory has the wrong man because of what he terms a "curious incident":

Gregory: "Is there any other point to which you would wish to draw my attention?"

Holmes: "To the curious incident of the dog in the night-time."

Gregory: "The dog did nothing in the night-time."

Holmes: "That was the curious incident."

The fact that the dog did nothing, didn't bark, suggests to Holmes that the dog knew the perpetrator, that he was not a stranger but rather a friend of the family or even a member of the family itself.

The dog did not do what one would expect it to do under normal circumstances. When price doesn't do what one expects it to do under normal circumstances, one should at least begin to suspect that "something is afoot". Yes, it's silly. But it provides the trader with a mental hook on which to hang his thoughts and examine them.

When price first drops out of that narrow range (1), one expects it to continue its move downward. But it doesn't. When it drops out of the range a second time (2), it still doesn't, even though it makes a lower low. If price does not do what's expected, it will more likely do the opposite. If price won't fall, either buyers are supporting it or sellers aren't very motivated to sell. Either way, pressing for a short entry will not likely be productive. Price isn't doing what's expected. The dog isn't barking.

All goes well until price tries to make a higher high at (3). The trend is up, there is a series of higher highs and higher lows, but then price doesn't do what it's expected to do, i.e., make a higher high. The dog doesn't bark. So price reverses and begins a downtrend, lower highs, lower lows until price reaches (4). Price doesn't do the expected thing. It doesn't make a lower low. The dog doesn't bark. Price reverses and begins a new uptrend.

Reversals v. Retracements

This particular way of looking at price behavior also aids in resolving that common bugaboo regarding retracements and reversals: when and how does one become the other?

Here we have a demand line. According to the rules, when it's broken the trader looks for the first retracement in what he expects to be a reversal and enters a short. This short is triggered, but price doesn't confirm it by making a lower low, i.e., dropping below the swing low. The trader is left hanging. Price isn't doing what's expected. The rules have been followed so far, but the dog ain't barking. Instead, price takes off in the opposite direction, suggesting a reversal of the "downmove" that was supposed to be and a continuation of the preceding upmove. If one is REAL fast, he might be able to get out of his short and go long.*

But wait. Price once again gets sly and doesn't do what's expected, i.e., make a higher high. So even though the long may be triggered, there's no confirmation. The dog doesn't bark. The eventual result? A lower high and a higher low, and the stage is set for a hinge. Betcha didn't see that coming, unless you were aware of that curiously silent dog.

**Reversals can be simple and not-so-simple. The reversals above illustrate price movement that goes in one direction and is expected, under the conditions noted, to reverse and go in the opposite direction. But when those conditions aren't met, it then reverses the "reversal" and becomes a continuation.*

On the other hand are the "\/" or "/\" reversals which take place at the ends of parabolic moves, up or down. These do not often give one the opporunity to enter the opposite side via a retracement because there isn't one, or else it's so far into the opposite movement that it's almost guaranteed to recoil to such an extent that the trader is thrown out. Entering this sort of reversal is a much more testicular trade, requiring as it does the willingness to step right out there on the basis on one's own judgement and press that Transmit button. AMT can help with this *decision – a demand or supply line is largely irrelevant – in that price that's creating a parabola at or near the limit of a trading range or trend channel is more likely to provide a successful reversal trade than one that's being created in thin air.*

Needless to say, one should spend a considerable amount of time observing parabolic moves before trying to trade them.

Appendix C: The Law of Supply and Demand

(underlinings from the original)

The Law of Supply and Demand operates in all markets in every part of the world. When demand exceeds supply, prices rise, and when supply is greater than demand, prices decline. This is true not only of stocks; it is constantly being demonstrated in markets for wheat, corn, cotton, sugar and every other commodity that is bought and sold; also, it is reflected in other markets such as real estate, labor, etc.

. . . the stock market, by its own action, continually indicates the probable direction of its immediate and future trend, and anyone able to determine this with accuracy should attain success in trading and investing. . . . The trend [is] simply the line of least resistance. When a stock [meets] opposition in its rise, it must either be strong enough to overcome this resistance (selling) or it must inevitably turn downward, and when, in its downward course, sufficient buying [is] encountered to halt the decline, it [will] turn upward. The critical moments in all these various phases of the market [are] these minor and major turning points, or else the points where the price [breaks].

. . .

Whenever you study the tape or a chart, consider what you see there as an <u>expression of the forces</u> that lift and depress prices. Study your charts not with an eye to <u>comparing the shapes</u> of the formations, but from the viewpoint of the <u>behavior</u> of the stock; the <u>motives</u> of those who are dominant in it; and the successes and failures of the buyers and sellers as they struggle for mastery on every move. The struggle is continuous. The tape shows all this in detail. The charts enable you to pick the market apart and study whatever portion or phase of it you choose.

. . .

The tape is like a moving picture film. Every minute of the day it is demonstrating whether supply or demand is the greater. Prices are constantly showing strength or weakness: strength when buyers predominate and weakness when the offerings overpower the buyers. All the various phases from dullness to activity; from strength to weakness; from depression to boom, and from the top of the market down to the bottom – all these are faithfully recorded on the tape. All these movements, small or great, demonstrate the workings of the Law of Supply and Demand. By transferring to the charts portions of what appears on the tape, for study and forecasting purposes, one is more readily enabled to make deductions with accuracy.

. . . <u>prepare your mind for [this] by discarding most of the factors that you have heretofore employed</u> in forming your judgment and making your decisions, such as: tips, rumors, news items, newspaper and magazine articles, analyses, reports, dividend rates, politics and fundamental statistics; and especially the half-baked trading theories which are expounded in boardrooms and popular books on the stock market.

It is not necessary for you to consider any of these factors because the <u>effect of all of them</u> is boiled down for you on the tape. Thus the tape does for you what you are unable to do for yourself; it concentrates all these elements (that <u>other people</u> use as a basis for their stock market actions) into the <u>combined effect</u> of their buying and selling.

. . .

You need <u>never</u> read anything on the financial page of your newspaper except the table of stock prices and volumes.

You need pay no attention to the news, earnings, dividend rates or statements of corporations.

You need never study the financial or the business situation.

You need not understand railroad or industrial statistics, the money market, the crop situation, the bank statements, foreign trade or the political situation.

You can absolutely ignore all the thousands of tips, rumors, reports and especially the so-called inside information that flood Wall Street.

You can discard all of these completely and finally.

UNLESS YOU DO THIS YOU WILL BE UNABLE TO GET THE BEST RESULTS FROM YOUR MARKET OPERATIONS.

–Richard Wycoff, 1931

Appendix D: A Wyckoff Practicum

DETERMINING THE TREND OF THE MARKET BY THE DAILY VERTICAL CHART

of the New York Times Average of 50 Stocks

Section 7M, the Richard D. Wyckoff *Method of Trading and Investing in Stocks: A Course of Instruction in Stock Market Science and Technique* (1931)

(abridged)

The most important thing to know about the market is the trend. Since we aim usually to operate in harmony with this trend, a study of our Daily Trend Chart (daily vertical chart of a composite stock average) should be the starting point of all our deductions.

The accompanying chart [at the end of this practicum] includes the total volume of transactions of all stocks dealt in daily, as indicated by the vertical lines at the bottom of the sheet. These volumes must be considered in conjunction with a study of the price movement. The element of time, as previously explained, is represented by the daily additions to the chart from left to right. The closing figure of each day is indicated by a horizontal line across each of the vertical lines which represent the range from high to low.

A good way to impress upon your mind the principles involved in reading the chart is to cover all but the extreme left side of the chart, exposing only the first few days' plotting. As you read the instructions which follow, gradually slide the paper toward the right, revealing the price movement and volume one day at a time. This will have the same effect as reading the market just as if it were being recorded on the chart today and as if you didn't know what was coming next.

The story told by this chart is as follows: We use the period from December 8th to December l7th as our starting point, and without regard to the market history previously recorded. This interval of nine days marked a sharp acceleration of the previous major decline, culminating in a widening spread of the daily price range and a very marked expansion in the daily volume of trading as the market reached its low point – thus reflecting the panicky selling which takes place under such conditions (see Footnote following).

The volume on the 8th was around 2,000,000. This increases to 5,000,000 on the day of the low point. Tape observers would have noted the fact that a large part of this volume occurred as the market recorded the extreme low and on the rally from the lows. This confirms the fact that the climax of the downward movement (*) has actually been passed, and gives us the starting point for our next forecast.

**The phenomenon of the Selling Climax is caused by the panicky unloading of stocks (supply) by the public and other weak holders which is matched against buying (demand) of (1) experienced operators; (2) the large interests and sponsors of various stocks who now either see an excellent opportunity to replace at low prices the stocks they sold higher up, or wish to prevent further demoralization by giving the market support temporarily; and (3) short covering by the bears who sense a turn.*

Stocks thus become either temporarily or more lastingly lodged in strong hands. An abnormal increase in volume is one of the characteristic symptoms of a selling climax, since supply and demand must both expand sharply under these conditions, but the supply is now of poor, and the demand of good, quality; and since the force of supply now will have been exhausted, a technical rally ensues.

If buying on the break (i.e., during the Selling Climax) was principally for the purpose of supporting prices temporarily and checking a panic, or relieving a panicky situation, this support stock will be thrown back on the market at the first favorable opportunity, usually on the technical rebound which customarily follows a selling climax. This, and other selling on the rebound, may increase supply sufficiently to drive prices through the lows of the climax day and bring about a new decline, that is, a resumption of liquidation.

On the other hand, should a secondary reaction occur after the technical rally above referred to, and prices hold around or above the climax lows while volume at the same time shrinks appreciably, we have an indication that liquidation was completed and support is again coming into the market. Therefore, the market's behavior on these secondary reactions is usually indicative of the next important move.

In this connection, it should be noted that the same principles which apply to the large swings also apply to the smaller moves and to the day-to-day buying and selling waves. Thus, a careful examination of your Trend Charts, Group Charts, and charts of individual stocks over a period of time, will reveal numerous examples of the above phenomena, These will appear on a small as well as a large scale, however, you must allow for variations. That is, do not expect one selling climax to look exactly like another. The same basic characteristics may be observed; but the time and magnitude of price movement and volume, and the extent and sequence of price movements almost invariably will differ.

For example, the abnormal volume may last either one or several days; or the abnormal volume may precede the recording of the extreme low point one or more days. In other words, a selling climax may be completed in one day or be spread over a few days, and volume may reach unusual proportions on the day the low point is made or some days ahead of the final low.

We must now assume, in view of the above, that the trend is tentatively upward; but this is subject to confirmation by the appearance of higher support on the next reaction; that is, if on the next down swing, prices should break through the turning point of 135½ recorded on December 17th, it would be evident that liquidation was not completed and that support which turned the market upward on the l6th has been withdrawn (see previous Footnote). On the other hand, if, as happened to be the case, the buying support comes in around or at a higher level than 135½, we may conclude that demand is beginning to overcome supply (see previous Footnote), and that the next logical development for final confirmation of an important reversal will be the market's ability to rise above the top of the last rally, which was around 150, Dec. 18th.

On January 3rd these averages rise above 152, which gives final confirmation of an upward swing which might develop into a rise of substantial proportions.

In taking a position in the market, which, of course would be a long position, we have had, up to now, three opportunities:

(1) On December 17th when the market gave indications of having completed a selling climax, and at the same time, as shown by the entry on our vertical chart for that day, was able to rally vigorously on increasing volume. This was the first time it had shown ability to rally aggressively and the first time increasing volume had been shown on an advance for some time past. On the basis of these tentatively bullish indications we are justified in establishing long positions if we can get in near enough to the lows so that when we place stop orders on our commitments two or three points under our purchase prices, our stops will be about 1 to 1½ or 2 points under the danger level, that is the lows of the climax day.

(2) Our next buying opportunity is on December 29th when the market completes three days of lower support but the closing prices on each of these days are between 140 and 141, showing that the selling pressure is losing its force, since the net result of these three days' pulling and hauling is to leave the average almost unchanged following a considerable reaction. At the same time, lower volume on the reaction from December 18th's high, compared with the volume of the mid-December decline, confirms the inference that selling pressure is losing its force; buying power is overcoming it, as it now appears that the market has completed a typical secondary reaction (see previous Footnote) which has the effect of broadening the zone of support around the 136-140 level to sustain a

proportionately more substantial advance than the first recovery, we either buy on this reaction if we missed our first opportunity, or add to our holdings; with stops on these new positions, as before, under the danger point, that is, the lows of December 17th. The average is now "on the springboard".

(3) On Jan 3rd the average goes into new high ground, overcoming the previous tops of December 18th, l9th, 20th and January 2nd. Volume tends to increase on the rally days, December 30th to January 3rd, an indication that is characteristic of a bullish trend. However, this is the least favorable of our three buying opportunities so far, since we would now be purchasing on an upwave, thereby materially increasing our risk, whereas previous commitments were established on downwaves, close to the danger point.

Having decided that the trend of the market is upward we must thereafter continue to trade on the long side until there are indications of a change in trend, or until the trend is in doubt. We must always be on our guard against any changes; and when the trend is in doubt we must take a neutral position, that is, be out of the market.

For the next several days, until January 9th, the market makes further progress on the bull side, recording 156½ on that day; but observe that the closing figures on the 6th, 7th, 8th, 9th and 10th are all within a range of about one point. That means the market made no upward progress as a net result of four days' activities following the 6th. The daily volume shows a tendency to taper off, which may mean a lessening of demand at the top of the swing to January 8th. This conclusion is partly confirmed by the shortening of the upward thrusts from the 3rd to the 7th, indicating that it was hard work advancing the market from l5O to 155. Buyers now seem reluctant to follow prices upward. On the day when the high of 156½ is recorded, the volume increases abruptly compared with the volume of the preceding sessions at the same time that the price runs up to a new high only to close near the day's low (*) and actually below that of the previous session. All of the foregoing is evidence of the approach of a corrective reaction, but we still hold our long position because, as yet, we have had no indications of important distribution.

* *The action of the 9th is an illustration of a typical buying climax, which is the reverse of a selling climax. On this day, a poor quality of demand is being promptly overwhelmed by the superior force of supply of good quality. In order words, the bulls, realizing that they are encountering resistance to the advance, break the stalemate of the 6th to 8th by bidding prices up to attract those buyers who were too timid to come in before the advance to 155, but who now fear that the market may get away from them because it is "making a new high." Thus, there is a concerted rush of public demand which gives the larger and shrewder operators their opportunity to dump part of their lines on a broad and active buying wave, made to order for the purpose.*

Such a reaction begins on the 12th and the low point of it occurs on the 16th. Volume on the reaction diminishes appreciably compared with volume on the rise from the December 29th low, a bullish indication, showing that the selling pressure is light. On the 16th, the closing is nearly at the high point of the day – a bullish indication which is the reverse of the bearish indication on the 9th. This is our first sign that the reaction is nearly over. (*) So here we have a new buying opportunity in expectation that the advance will be resumed. (**) Further confirmation of this comes in higher support on the 17th and in an almost complete drying-up in volume on a dip to the same low level on the 19th. The closing prices on the l5th, 16th, l?th and 19th show support within a narrow zone, mostly around 147-8. We must, therefore, look for the advancing tendency to be resumed.

* *Note that there is also an indication of a minor selling climax in the somewhat marked increase of volume on the 15th.*

*** To insure proper limitation of risk on purchases made at this level, our stops should be placed a point or so under the supporting points (lows) of the 16th. The stops on these new, and any previous, long commitments, should be raised to within a point or so of the January 16th to 19th supporting level after the rally of January 20th.*

Then follow four days, in each of which we see higher tops, higher bottoms and higher closing levels, accompanied by gradually increasing volumes – bullish behavior. This brings the market up within a fraction of the high figure of January 9th where, on the 23rd, a volume surge after four days almost perpendicular advance warns us of a buying climax. But here, in any case, we may expect hesitation or reaction, due to the influence of the previous top – January 9th.

Now observe that for the next thirteen sessions following the 23rd the market fluctuates within the range of 156-51, a very narrow range for the average. This is because it is called upon to absorb offerings representing stock purchased by over-anxious bulls who got hooked around the high level of January 9th, and perhaps other quantities bought on the way down in 1930 during the period not shown on this chart – purchases made by people who are now eager to get out even.

Such absorption is evidently completed by February 9th when after closing almost at the top on the previous Saturday, an advance into new high ground, 160 5/8, is recorded. (*) Note how the speed of the advance tends to increase, the average gaining 9 points in two sessions – 9th and 10th. (This is the mark-up forecast by item 3 in the footnote below.) See also how the volume increases to 4,000,000 shares and over on these two days, compared with a previous volume of 1,000,000 or 2,000,000 a day for thirteen days past. The exceptionally large volume of the 10th and 11th, plus the failure to record any material further gain on the high volume of the 11th, as usual, is an indication of some distribution and a setback. On the 11th the average makes a high of only one point above that of the 10th and closes at only a small fractional gain, on large volume – a large supply overcoming demand.

**The probability that this lateral movement, or trading range, between 156-151 is an area of absorption rather than one of distribution may be determined: (1)from the fact that volume remains low on the reaction to January 29th and tapers off promptly on the reaction to February 2nd; (2)from the tendency of the price movement to narrow into a comparatively small range instead of reacting as much as halfway back to the January 19th low, which implies that stocks are not being pressed on the market; and (3)from the fact that after the recession to February 2nd, volume tends to build up consistently at the same time that there is a lifting of the supporting points from February 5th to 7th –- behavior typical of the completion of a period of accumulation or absorption prior to a mark-up.*

After the mark-up of February 9th, we raise the stops on our long commitments to a figure within a point or so of the lows of the Jan. 23-Feb. 7 trading zone, inasmuch as the Feb. 9th rise enables us clearly to define the 151 level as a new and critical line of support.

Now, as we watch the supporting points for the next five sessions (13th to 19th), we find that they are all around the 160-162 mark. Meanwhile, volume decreases promptly on the dip to 160. This says there is another advance coming; the market is not ready to turn downward yet. On the 17th there is an attempt to run the average up to a new high, which fails. The closing is almost on the bottom and volume increases noticeably over that of the three previous sessions. It looks at first as if this might be a buying climax (Footnote, Pg. 3), preceding the end of the rise, so we bring the stops on our long trades up within one point of the February l4th low as a precautionary measure. We have now had a substantial advance, followed by six days lack of progress and comparatively high volume, which means that the market has reached a critical position.

But the average is immediately supported the next day and on the 19th the closing is nearly at the top. It thus shows ability to rally away from a possible danger zone and willingness to try to negotiate the resistance around the tops of the range at 166. The lower volume under these conditions may mean that the supply of stocks has become scarce; so we sit tight. Next day, the 20th, the average advances again into new high ground, absorbing the overhanging offerings on a volume increasing from around 2,500,000 to nearly 4,000,000 shares; on the 21st to a new high and a higher closing, with the volume up to 5,000,000 shares, thus far making progress in proportion with the expansion of volume. (*) On the 24th (holidays intervening) it registers a further gain of 2 7/8 points in price and a little over a point and a half in the closing figure, on a volume of 5,300,000 shares. We now become very suspicious of this advance on such large volume and particularly the failure (apparent on the next day) to hold a quick upthrust to a new high on such heavy turnover (which is characteristic of distribution), suspecting that this volume surge may be climactic. (**) Accordingly, we move our stop orders up within a point or two of the lows of the 24th. (***) Next day, February 25th, we observe a lower top and bottom and a lower closing, as well as a loss of the two previous days' gain, which indicates that

**The actual volume of Feb. 21st was 2,435,000 but in comparison with the volume of recent five-hour, and recent previous Saturday sessions it is clearly evident that this two-hour turnover is relatively large and consistent with the increase of Friday, Feb. 20th. Hence, in order more fairly to reflect the relative magnitude of this particular Saturday's volume -- in comparison with the full five-hour sessions -- we double the actual total and find that we have the equivalent of a 5,000,000 share day.*

***With volume running at the rate of 5,000,000 shares per day for three consecutive sessions, we conclude that the market's advance is attracting an expanding public following. This increased public participation creates an active demand (of poor quality) which facilitates unloading (supply of good quality) by large interests at prices advantageous to themselves.*

****Meanwhile, following the mark-up of February 21st, our stops were brought up under the February l4th low point.*

supply is overcoming demand and confirms the previous indication of a probable reaction. If our stops have not been caught, we now promptly close out all our long stocks; and select from our list of individual issues the best five or ten that are in the weakest technical positions, and sell them short with stops 1 to 3 points above the danger level, i.e., the high points of the advance.

After such a prolonged rise, we may expect a more substantial reaction than any we have had since the December-February bull move started; and perhaps an important decline because there have been evidences of distribution extending as far back as February 10th. On the 26th, the high, low and closing are almost identical with those of the previous day. The market, therefore, is making no further progress upside on heavy volume, but the demand is still enough to hold it within the previous range – 168-173. On the 27th, however, we note a clearly lower top, bottom and closing, and some – but not a very large – shrinkage in volume to about 3,700,000 shares. The significant feature of this day's action is that it marks a pronounced change in the market's behavior. It is the first time since early December that volume has remained so high on a reaction. Heretofore, volume has been shrinking promptly on setbacks.

The fact that prices cannot continue to advance into new high ground, combined with the comparatively high volume, leads us to conclude that the big fellows are unloading. And the relatively large volume on the reaction of the 27th indicates that they are filling up all the buyers on the way down from the highs with what they were able to sell in the range between 168-173.

We must bear in mind that prices have now advanced from 135½ to 173, 37½ points. This is a big rise in the averages, because such a rise indicates that many individual stocks used in making up the averages have advanced nearly double that amount. Also, the angle of the advance, as shown by placing a ruler along the line of bottoms from February 5th to the 18th is such that it is unlikely that this pace of acceleration of rise can be maintained. This is emphasized by an even sharper angle from the 18th to the 24th, when the supporting points were raised considerably away from the previously established diagonal support line. This sudden whooping up of prices, after such an advance, suggests the application of hypodermics which, combined with a high and expanding volume, increases the market's vulnerability to heavy realizing sales and likewise increases the danger of a general withdrawal of experienced operators who refuse to continue to buy at these levels. It is such conditions as these (created, as they are, by large interests who are managing the market) that are detected by floor traders and large outside professionals and recognized as indications of a turning point. The latter now add to the supply by getting out of their long stocks and taking short positions, thereby not only helping to assure a turning point but also placing themselves in a position to profit by that downward swing. (*)

Note: *We should also suspect, when we see such "whooping up" tactics, that informed interests are in a hurry to wind up their campaign of distribution because they see some bad news or adverse conditions in the offing, events not yet apparent to the public, which draws its conclusions from the emphasis placed on all current "good news" and the befuddling atmosphere of bullish excitement in board-rooms.*

In your own experience, you must have observed that "bad news" very frequently comes out say a week or ten days after a decline following just such a violent bidding-up of prices. Financial writers then "explain" the break as being due to the bad news. But the logic of the situation is that large interests have already sold out their long stocks in anticipation of impending bad news, thus creating the supply which starts the market downward before the general public is aware that any bearish developments are imminent. Insiders may, in addition, take short positions in advance of the unfavorable news so they may have added buying power with which to support the market when a frightened public begins to sell in response to, and simultaneously with, the release of the "news."

We must act in harmony with these shrewd operators and put out more shorts, (with stop orders placed as before, above the Feb. 24th resistance point) as the action of the 27th gives us a new selling point. On March 2nd, after a little rally, the average declines 6 points from the high of that day and closes nearly at the bottom. If we have ignored all the previous warnings of a gradual weakening of the technical position, we cannot ignore this decisive breaking of the very backbone of the advance. This day's behavior shows definitely the heavy withdrawal of bids underneath the market and the volume (3,300,000) remains high – very high in comparison with the volume on all previous reactions since December 8th – indicating that very substantial lines of stock are still being pressed for sale by large interests. Having accepted some or all of the bearish indications of the foregoing six sessions, we conclude that the upward trend has terminated (at least for the time being), after running the greater part of December, January and February and that a change to a downtrend has begun. That is to say, we are entering a substantial intermediate reaction which may develop into a decline of major proportions.(*) It looks now as if we were correct in our assumption that some distribution was accomplished as early as February 10th, but the main move upward was continued in order to facilitate unloading of stocks which had not topped out at that time.

**Under the conditions now existing, we should liquidate investment as well as long trading positions, for even though it may develop that the major trend will turn upward again later on, by standing aside with our investment funds liquid while the market is working out an important intermediate downward swing, we avoid the danger of carrying some or all of our investment stocks through a bear cycle. Thus, we insure ourselves against serious depreciation of capital and the ever present possibility that Dome of the stocks which we originally held might fail to recover on the next or succeeding advances.*

We shall have ample warming when the market is again stabilizing and preparing for a new bull movement. With buying power intact, investment positions can then be reestablished. And most probably we shall *find that certain of the stocks we previously held will not be as desirable or as responsive to the next upward cycle as others which will become new leaders.*

By such scientific handling of investment commitments, we may gain more through capital appreciation than we might lose in dividends in consequence of having stayed out of our stocks for as much as a year or more.

At this juncture we should be alert for opportunities to sell short more of such stocks as are shown by their individual charts and Group charts to be in a weak position. These should be sold short only on bulges, and the fact that the averages have declined from the top about ten points (although they may decline further) is indication of a part way rally which normally is likely to fall slightly short of recovering about half the recent decline.

The initial reaction of the downward swing ends on March 4th at around 159, a point at which the market was previously supported on February l4th. Here we have a reverse of the situation which existed on January 23rd. The sharp acceleration of the downward movement on March 2nd, 3rd and 4th creates an oversold position at the same time that the average touches a former support level, a condition that usually is conducive at least to an attempt at a rally due to the buying of traders and others who may believe that stocks are again cheap, and covering (buying in) of shorts on the part of bears who wish to cinch profits and stand aside, waiting to see how the market will meet a test of the former supporting level.

Our expectations of hesitation and a possible rally from this point are fulfilled as demand from the above sources brings a fairly vigorous run-up on comparatively light volume on the 5th. A further rally to a higher top and a higher bottom next day tends to confirm our anticipation of a possible turning point for more recovery; but the sudden increase of volume on the 6th may indicate the climaxing of the rebound, so we wait for clearer indications. Another higher low (marking the fourth day of no material progress on the down side) and a closing near the high on the 7th says that the volume of the previous session was climactic on the down, rather than on the up side. This demonstration of a change from technical weakness to technical strength brings in sufficient new demand to start the part way recovery we have been waiting for. However, we do not expect this recovery to carry much above 165 because large interests would not be willing to help the market far enough into the February distribution area to let the public out even.

Stated another way, our reasoning is that a part way recovery would now be a normal development; but the big fellows would be anxious to run the market back to the February tops only in the event they saw an opportunity of pushing prices far enough above those former highs to realize a profit on the offerings they would have to take from the buyers who are "hung-up" with stocks at these levels. Even should they see such an opportunity, it is more likely that they would prefer first to tire out, or shake out, this overhanging supply. However, we reason further, that in view of the extent of the distribution as indicated by the heavy volume and breadth of the February campaign, the greater probability is that they will manage just enough recovery to discourage amateur shorts from selling and to keep the February buyers locked in while they, at the same time, distribute more stock on rallies to a lower top.

Meanwhile, we observe that the average, from February 24th to March 4th, recorded a total decline of 14 points from the high of 173. A normal recovery of less than half of this would be five or six points in the averages; or to 164 or 165 (approximately). On March 10th, the average actually recovers 7 points from the low, which is just halfway. Volume on this rally is not measuring up to the standard of the February rise; behavior which (1)marks the rebound as purely technical, and (2)indicates the exhaustion of buying power as a result of filling up all the buyers on the previous distributive movement, thus (3)confirming the probable accuracy of our other deductions.

Around the top of this rally, therefore, we take our additional short positions, selling at prices as close as we can to the danger points on the individual stock charts, so that our risk is limited to a minimum in every case. Further symptoms of progressive weakening of the market's position appear in the dip to March l3th. The volume (*) again remains comparatively high instead of shrinking appreciably as it did during the corrective reactions of December, January and the forepart of February; and on the l3th we find the average down to 158, which is a point lower than the previous supporting point of March 4th. This substantiates the correctness of our general bearish position and suggests further selling on subsequent rallies if we have not sold our full line.

**In judging volume behavior, allowance must be made for the fact that declining markets normally are accompanied by lower volume than advancing markets except, perhaps, at times when active liquidation is taking place. The reason for this is that bull movements attract a much greater public following than bear movements.*

In the following several sessions there is an irregular recovery to 166 with no material or consistent expansion of volume except for a sudden increase on the l9th. But this has the earmarks of a climaxing indication, confirmed by hesitation – or lack of further upward progress – on the next two days. We now also note that the average is faltering about a point below the top of the rally of the 10th, at a level where our previous deductions led us to anticipate just such a probability, we watch carefully for further developments, realizing that the average has reached a critical position. Should new demand fail to come in here, we may anticipate a decline in proportion with the extent of the primary distribution of February, to which there has now been added secondary distribution on this March rally. (Stops on our short positions may now be brought down within 1 or 2 points above the highs of March 10th to 25th.)

There is more lateral movement over the next three sessions, featured by a weak rally on the 24th and 25th (note the relatively small volume), making a total of six sessions during which the average has hesitated just under the lows of the February 20th-28th trading range. The market's inability to overcome the high of March 10th, and its failure even to equal that level is now clearly defined, affording final confirmation of the comparative safety of our short positions; likewise a clear warning of the advisability of liquidation by investors who may not have sold out heretofore, since we now have all of the elements to corroborate the prospect of a substantial decline.

On March 26th, the average starts downward, plunging toward the recent line of 158-160 supports on steadily expanding volume over the next two sessions, which tells us, in advance, that these former lows will not hold. (*) From here on the down trend is unmistakable continuing almost without interruption. A brief rally on the 3lst

**The volume surge of March 28th (4,200,000 shares if we consider this Saturday's volume as doubled) should not be mistaken for a selling climax. The distinguishing difference between this day's relatively large volume increase and previous volume surges is that the latter appeared after an extended or well-developed downward swing, whereas the comparatively high volume of March 28th accompanied the penetration of the March 4th to 27th trading range, 158-166; and therefore indicated a large increase in supply, stimulated by the breaking down of the line of supports around 158-160.*

To clarify this, we may set forth the following principle: A sudden or abnormal increase in volume, appearing after a given price movement has been in progress, usually indicates the end or the approaching end of that particular movement, up or down.

However, if unusual volume appears when the price is breaking through a well defined trading range, or zone of congestion, in that event the abnormal volume more probably indicates a continuation of the price movement in the direction of the break through. Thus, if the price works up to the top of a trading range and breaks out on large *volume, the inference is that somebody is willing to absorb all of the offerings overhanging around the previous tops in the expectation of pushing the price to a higher level; and vice versa in the case of a break out on the down side of a trading area. Whether he or they will succeed in extending the movement and accomplishing the purpose intended will depend upon the existing condition of the market.*

Therefore, you must not attempt to apply the above principle in a mechanical way, nor as a fixed, or hard and fast rule; but consider it only in conjunction with other contemporary technical manifestations.

and a small two-day rebound from the old January 28th-February 2nd supporting level around 152, on April 4th and 6th, emphasizes the weakness. (Note the immediate shrinkage of volume on these rallies.)

Next follow several days of holding within a narrow range from April 7th to 14th inclusive, as the average approaches the January 15th to 19th supporting points, with no evidence of any selling climax nor convincing rallying power. But as the average levels off and then drifts to a dead center on the 11th, we may reduce the stops on our short positions to a point or so above the level of a halfway recovery from the April 7th low, merely to guard against an unexpected change of trend. But instead of rallying vigorously away from this dead center, after six days' apparent support, the market tells us there is still no buying power by its inability to enlist higher support or materially expanding volume when it tries to follow up the advantage of the April 13th bulge.

On the 15th, a breaking down into new low ground confirms the above indications and affords an opportunity for increasing our short line by pyramiding with more short sales of the same or other stocks which promise to exhibit the greatest weakness. These sales can be protected by stop orders one or two points above the highs of the previous day; and the stops on our other shorts may now also be brought down to the same levels. The persistent increase in volume from April 11th to April 18th accompanied by declining prices is characteristic of a liquidating market, and so long as volume continues at about this level, or higher, there is little danger on the short side, with systematic stop 1oss protection, as above indicated.

There are occasional sharp rallies, evidently made by short covering, such as on April 30th and May 1st. This kind of buying kept the volume up to around the 3 million share level but as will be seen by the performance of May 1st, such advances are quickly lost because when the numerous shorts have covered, no buying power remains to take the place of this demand and the market underneath proves to be hollow. (*)

**The volume surge of April 23rd implies a possible selling climax which suggests that in view of the extent of the decline to date and the fact that the average has now come down into the important December support area, we might expect a corrective rally to appear here.*

A normal rally would be about halfway back to the April 14th high point which, in this instance, would also be up to the small rally top of April 20th, or to about 146. Because of the previous bearish behavior of the averages and the likelihood that we are in a liquidating market, we do not regard this one day's slender evidence (that is, the high volume of the 23rd) nor the possibility of a corrective rebound as threatening to our short positions. However, if we wish, we may reduce our stops to a level one or two points above the part-way rally mark while we watch to see what the market will do next.

When it fails to rally as might be expected but instead sinks back almost immediately to close at the low points with no shrinkage of volume on the 25th, we recognize that it is vulnerable to fresh selling pressure.

The sharp rally of April 30th puts us on guard again, however, for now we observe that the downward thrusts have been shortening since the 28th -- that is, between the 27th and 30th, the bottoms show a tendency to round off or flatten out -- i.e., the rate of decline is diminishing. From the standpoint of the major trend, the breaking of the December lows, plus our other indications, are still bearish. But the slackening of downward progress, on comparatively heavy volume, also warms us to be on the lookout for a possible minor turning point, in other words, a belated technical recovery which may later prove to be the beginning of a more important change depending upon how the market behaves during and after the indicated recovery.

Observe how the rally beginning May 2nd and running to the 4th and 5th is accomplished on markedly decreased volume, showing that whatever demand exists in the expectation of a recovery from the firmer December supporting level, is not willing to follow prices up. Such support is more likely to be due to short covering than the re-entry of substantial buyers. The rally which begins May 7th lasts only three days until the 9th and that day's close is around the low, which shows that the bulls have exhausted their buying power. (*) From the 11th, the downward march of prices is resumed and the volume again increases on the down side, showing a breaking out of fresh liquidation. (Note the complete failure of any tendency toward hesitation or rally as the average touches the critical April lows. Compare this action with December 26th to 30th, and see Footnote Page 1.)

**Additional indications of the weak character of this recovery are given by the following: (1) the volume surge of May 8th which is confirmed as a minor buying climax by the prompt loss of that day's gain over the next two sessions, as (2) the average runs into resistance just under the temporary supports of April 17th to 21st -- resistance created by the offerings of buyers who mistakenly judged those lows to be a bottom and who are now anxious to get out even.*

On the up-wave to May 9th, therefore, we have another selling opportunity in anticipation of a resumption of the major decline on the secondary reaction to the April lows.

A low point is recorded around 113 on June 2nd, with the closing practically at the low. The only warning the average itself gave us of an upturn from this point was the small downward progress made on June 2nd in comparison with the previous day; the closing price on June 1st was 114 ½ and on the 2nd, 113 3/8, notwithstanding heavy dealing -- 3.300,000 shares. This showed resistance -- possible buying by substantial interests. Moreover, the market has now been declining steadily since the high point of February 24th when the average reached 173. The price of 113 is therefore 60 points down, which means that prices have shrunk about one-third from the high.

From our figure charts of the averages and the position of our group charts and of leading stocks on individual charts, and the action of our Wave Chart, we may learn that a danger point to shorts is approaching. But for the purpose of this explanation of the vertical daily Trend Chart, we will assume that this is our only guide. So when the market suddenly reverses its form on June 3rd, recovers 9 points (from the low point) in the average and closes nearly at the top, with the volume of trading equal with that of the two previous days of heavy liquidation, we must, somewhere during the session of June 3rd, cover our shorts if we are still short. In any event, this should be done at the next day's opening. (*)

**Additional reasons for taking such action are that the pace of the decline on May 29th and June 1st became so sharply accelerated as to create an oversold condition which is dangerous to shorts; and the speed with which the market recovers the latter day's loss (on June 3rd) suggests that this last phase of the downward movement is probably in the nature of a shake-out.*

The averages have shown no preparation for a change in trend. This sudden change is like a hypodermic or a heart stimulant, administered to a patient who is dying. He suddenly revives. Of course, we all know that this change reflected the favorable sentiment due to President Hoover's plan of postponing reparation payments. But these things do not always show on the charts at the time they occur and we cannot consider them. We are learning to read the market without the aid of the newspapers. Having operated on the short side for the past three months, we have substantial profits, even though we cover at the high prices of June 3rd or around the opening of the 4th. We await developments in order to ascertain whether this bullish factor is sufficient to turn the tide; that is, turn the bear market into a bull market. With sufficient experience as a foundation for our judgement, we know that such violent changes in trend occurring within a few hours are not a lasting basis for bull operations.

The closing at the top, June 3rd, in itself indicates a further rally. On the 4th, there is a gain of nearly 5 points (over the previous day's high), making about 14 from the low point. The volume is still high, over 3,000,000. That is, we have good progress on high volume. But on the 5th, the gain in the average is only 3 points, and the volume decreases a little, showing that the buying power is less; buyers are reluctant to follow prices upward after such a steep rise. The closing price is below that of the previous day, which indicates that the day's net pressure, or supply of stocks, was greater than the demand. This looks as if the rally is over for the moment. On the 6th, there is a further loss of nearly 8 points, bringing the average down halfway from the top – a normal reaction on reduced volume. On the 8th, after a further small recession, the average runs up and closes at the top, showing that the market met support at the 120 line. It recovers to 126, which is about two-thirds of the reaction. Although the volume is comparatively light, the speed of the rebound and the behavior just described says the balance is in favor of the bull side.

From the 8th to the 15th, a zone is established roughly between 130 and 120. On the basis of what this chart indicates, we are neutral, waiting to see whether, when the market works out of the zone, it will be on the up or down side. As the rallying days proceed, we observe a falling off in the volume which is not a bullish sign; also that on the 11th and 12th, the net gain (in the closing price) for the day on the up side is a point or less. The average seems to be meeting resistance again where the June 5th rally was checked. On the 13th, the range of the average narrows until it is less than 2 points, with a fractional net loss for the day. This is also a bearish sign -- the narrowing into dullness at the top of a 17 point rally, on a volume of only 540,000 shares (or about 1,000,000 if we double this Saturday turnover).

This bearish symptom is confirmed on the 15th by a little wider spread (from high to low), meaning more activity (greater willingness to follow prices down), a closing near the low and an increase in volume, showing slight increase in pressure. The bearish signs are then borne out by the following four sessions, ending on the 19th, with the volume remaining stationary around 1,000,000. However, volume does not increase on the downside; instead it tends to taper off as compared with volume on the rally from June 8th to 12th indicating light pressure; nor does the price break out of the 120 range; in fact it meets support on the 19th at around 122, which is about two points higher than the support on the previous low of the 8th. (*)

**Here we have a variation of the sequence of selling climax, technical rally and secondary reaction referred to in the Footnote, Pg. 3. Considering the action in broad perspective, observe that volume diminishes appreciably on the secondary reaction to June 19th, even more decisively than in the case of the secondary reaction to December 29th and in marked contrast with the increasing volume on the secondary reaction to May 14th which failed to hold. Also, the market on June 19th meets support well above the climax lows of June 1st and 2nd. Likewise compare the greater speed, spread and sustaining power of the June 3rd to 6th rebound with that of April 30th and May 1st.*

All now depends upon what the market does in the next day or two. If we have another downward session on increased volume, particularly if the average price goes below that 120 line of previous support (June 8th), we must conclude that chances favor a lower market (compare with behavior of May 14th and 15th); but if support continues around 122 on such small volume (compare with action of Jan. 15th to 21st), there may be a trading opportunity on the long side with a close stop.

Next day, June 20th, removes all doubts as to the immediate tendency of the average, for the market opens up a point and a half above the previous night's close and on a greatly increased volume (**) makes a rapid advance nearly to 131, putting the average into new high ground above the previous trading zone. The heavy volume emphasizes the importance of this. (See Footnote Pg. 9.) The gain in the average over the previous day's high is more than 7 points and the close is near the top. If we have been watching the tape during the day, or refer to our Wave Chart at the end of the day, we observe this sudden change and we either buy during the session of June 20th with a close stop or we wait until the price breaks through its former highs and buy around the closing price of that day or the opening of the following session, June 22nd, as the market's behavior to here tells us we may expect a quick mark-up. We are not justified in reestablishing investment positions, however, for as explained in Paragraph 1, Page 11, we do not have the basis for a lasting advance.

***The volume is obviously large for the two-hour session and hence should be doubled.*

June 22nd there is a higher opening and a gain of 7 points in the average, most of which is held for the day. The volume runs up to 4,600,000 shares – the price is gaining in proportion with the rise in volume. A reaction on the 23rd shows that most of the gain of the previous day was lost, but the bullish indication therein is a shrinkage in volume to 2,600,000 shares – nearly one-half the activity of the day before. That is our warning to sit tight.

The 24th recovers the loss; the average advances 8 points for the day and 3½ points above the June 22nd high, or to 141, and the volume is the highest thus far, over 5,000,000 shares. We begin to grow wary of the bull side because that volume in comparison with the trading of previous weeks indicates selling by large interests. (That is, a probable buying climax.) We move our stops up within a point or so of the June 23rd low and await developments.

The 25th makes a further gain of 2 points in the average, then the price slumps about 6 points, closing a point from the low, on volume of 4,300,000 shares – large supply overcoming an excited public demand coming in, as usual, on the top of the rise. This is distinctly bearish.(*) We therefore close out our long trading positions and examine our individual charts for stocks which are in a weak technical position so that we can get short on the next bulge.

**Note the shortening of the upthrusts, that is, the tendency of the high points to arch over, from the 24th to the 27th.*

June 26th shows a range of about 5 points – a little narrower. Although the closing is near the top, the volume has fallen off to about 3,100,000 shares and the upthrusts are shortening. In the net, these indications are bearish. The outlines of a new trading zone have been tentatively established between 137 and 143.

On the 27th, the average bulges over a point, narrows its range to 3½ points and closes with a net gain of about 1½ points on a volume of about 3,800,000 (Saturday's volume doubled). This looks like bidding up to a new high in order to catch shorts, and selling on the way down. We therefore put out some shorts, protecting our commitments with stops 1 3/8 to 2 or 3 points above the high of June 27th.

On the 29th, the opening is lower and the price recedes from 144¾ (the previous day) to 140, closing near the low. We now observe that the average has spent four days moving sidewise, making no further progress after a steep rise from the June 2nd low and, following the 5 million share session of June 24th, there has been a steady decrease in volume. In view of our previous deductions, we interpret this to mean that there is a lessening of demand on the top of the rise. We also note that any further lateral movement or reaction would definitely break the upward stride established on the last phase of the advance from June 19th. Hence, we are ready to sell more stocks short if we can get them off on bulges.

On the 30th, the average declines nearly 3 points to 137 on volume (2,000,000) about the same as the previous day. The market is still in the 137-143 zone but has now definitely dropped out of the sharp upward angle in which it rose from June 19th to the 27th, showing exhaustion of buying power. Low volume on the two-day dip to the bottom of the range 137-143, however, suggests we may anticipate an effort to rally back toward the high at 144¾. The way the market behaves on the expected rally will probably help to confirm, or it may contradict, our position; so we await developments.

July 1st, there is a wider spread in the price, nearly 2 points higher closing, but volume shrinks to 1,700,000: bearish. On the 2nd, the market narrows to a 3 point range for the average and the closing is 1½ points lower on reduced volume – increased dullness, lower close, and less volume indicate less power on the bull side. On the 3rd, there is another attempt to rally and the average reaches the old 143 supply line at the upper edge of the trading zone, closing about 3 points higher but volume is not measuring up to the standard of previous (late June) rally days. Nothing to be afraid of. (We sell more stocks short on this rally which is the bulge we have been waiting for, placing stops, as before, above the danger point, that is, the high of June 27th.)

July 6th, a 2 point range for the average, closing nearly 2 points down on 1,000,000 shares. We read this as an indication that the rally of July 1st to 3rd could not be sustained and that the tendency toward narrow swings, heaviness and dullness is the result of the market's having become saturated with offerings. All bearish. (*)

**The average is now on the hinge and on the "springboard" for an important slump.*

July 7th, a rally at the opening, then a 7½ point break in the average on decisively increasing volume (3,000,000). The market is now out of its former trading zone on the down side and the volume indicates that liquidation is being resumed. Thus the rally from 113 (June 2) to 145 (June 27) has run its course after lifting the average into the lower edges of the old December, 1930 - January, 1931 support area, and we must assume that the next test of the market will be around the levels at which support was rendered (122) on June 19th. If the large interests who bought on June 2nd and 3rd, and who undoubtedly distributed their holdings during the high markets of the last week in June are willing to take them back near or above the previous low levels, it will be an indication of their confidence in the future and a sign that the bear market is over. If there is no such sign, we conclude that the bear market has been resumed and that the June recovery was only an interruption of the main trend. We are on the short side and shall occupy that position until we see some reason for changing it, either to neutral or the bull side.

A 2 point further loss on July 8th, a small rally on a 1,500,000 share volume during the 9th and 10th (as the average hesitates halfway back to the June 19th low), then a dropping off until, on the 15th, the average nearly touches 126 – a 19 point decline from the top. On this day, prices spread over 4 points from high to low and close slightly above the middle of the 4 point range, on a 2,600,000 volume – a minor selling climax. There is no follow through on the down side next day; instead, a quick rally and a high closing. Thus we have two indications which might lead to a rally. But that will be a normal occurrence after a decline of 19 points. It should, in fact, amount to 7 or 8 points from the low if it is to be a real rally. Halfway would be about 9½ points. Such a rally occurs from the 17th to the

21st and amounts to 9 points, thus affording another good selling level if we are not satisfied with the size of our short line. (*)

**So that you may understand better how to handle your investment funds and may recognize the hazards in carrying stocks up and down through intermediate bull and bear trends -- a procedure that causes so many investors heart-breaking losses -- the following general observations are introduced at this point:*
The relatively small volume on which the market is now declining tends to lull the public into a spirit of indifference toward the market. But, contrary to popular impression, the low volume accompanying the steady downward drift is of bearish and not bullish import.

This small volume is explained by the fact that the majority of people are "constitutionally" bullish. They can always be induced to buy stocks <u>after</u> the market has been advancing for some time, or when everybody else seems to be buying. But, as pointed out elsewhere (Footnote, Page 8), they fear to sell short and hence will not participate in a bear market as experienced operators do. Consequently, the volume of daily trading tends to grow smaller during the progressive states of a bear market.

To put it another way, the public which came into the market and bought freely around the tops of the February, 1931 rise and the June recovery, is not loaded up with stocks at the highs. Its buying power, accordingly, is exhausted. These people will not liquidate -- until compelled by necessity -- because on the one hand they fear the market <u>might</u> go up again and on the other they are <u>wishing</u> and <u>hoping</u> that it will. Instead of recognizing the danger and philosophically adapting themselves to the logic of the situation by cleaning house and accepting some losses so that they may have buying power to repurchase profitably and advantageously when the time comes to be bullish again, they merely hang on and thereby magnify their errors. And those whose funds are not so tied up are too frightened to buy and much too timid to sell short.

Consequently, volume shrinks and the market becomes a professional affair, except when outcroppings of new weakness force the tied-up long holders to liquidate from time to time.

Thus we have both an explanation of a little understood market phenomenon and an example of the risks involved in: (1) failing to liquidate promptly on the early warnings of danger to bull positions (which appeared in this case in February); (2) refusing at least to protect long commitments with judiciously placed stop orders; and (3) the folly of yielding to a natural impulse to jump into the market when prices are away up and everybody else is excitedly buying.

Now the rally is over, for, on the 22nd, prices drop off again after approaching the lower edge of the recent 143-137 supply zone a second time (the first was on July 10th) and proceed toward the former low of 126, where we watch to see if any real support appears. It does not. The average goes to about 122½, recovers slightly, makes a new low August 10th around 120, rallies nearly 10 points after dipping briefly to the June 8th support point, narrows and dies out at the top (August 15th); swings back again to around 120 (August 24), recovers weakly and on small volume (under 1,000,000) from this critical supporting level until August 28th and 29th, when it begins a new downward march at a very sharp angle. The volume rises to around 2,000,000 and stays fairly constant at that figure after a break through 120, showing that the liquidation is again active and heavy. We have no reason to change our short position, but plenty of reason to pyramid every little while. (*)

**Stops on our short positions, meanwhile, have been moved downward as follows: To a level even with our original selling prices after the minor selling climax of July 15th; to a little above the high of July 21st after the decline to July 24th and 25th; to a point or so above the Aug. 15th resistance point after the drop to August 24th and 25th.*

Beginning on September 18th, the volume increases to 3,000,000 shares and on the 19th to nearly 5,000,000. This great increase in volume from less than 1,000,000 shares in late August to the equivalent of 5,000,000 shares on September 19th (Saturday's volume doubled) is our warning to move stops down close to the temporary rally tops of September 15th to 17th and be on the lookout for a sharp rally or turning point. Reason for this: Prices have receded from 145 to 98 without serious interruption. The abrupt extension of the decline, plus the unusually high volume of the 19th suggests that the market has reached an oversold condition. A sharp rebound should not surprise us at any time now and it probably is not far away for there has been no rally of any size since August 29th – about three weeks. Seldom does the market run continuously in one direction for so long without a reversal of some sort.

September 21st, the average loses 4 points more, making a low of 94, but recovers 5 points by closing time and this makes it close above the previous day. The volume is 4,400,000 -- again unusually high and almost equal to the day before. This action, combined with the 8 point spread in prices for the day and the slightly higher closing leads us to cover our shorts with a view to putting them out again on a further rally; or, we may prefer to sit tight and depend on our recently reduced stops to keep our trades alive if the expected rally should fail to develop material proportions.

On the 22nd, the volume drops off to about 2,000,000 shares; the close is slightly lower and the range has narrowed. The net result of these three sessions is to leave the market practically unchanged at the third day's close. Downward progress seems to have been checked and the small volume on the dip back from the high of the 21st, on Sept. 22nd, implies a lifting of selling pressure. After such a great decline within three weeks, this is an indication of more rally. This comes on the 23rd, and gives us an opportunity to sell short again while the market is still strong or when we see the rally is failing. Such an indication is given by the way it rallies on the 23rd. On this day, the average recovers to nearly 107, closing at 105½, but the volume falls off to under 3,000,000 shares and we therefore suspect that it is merely due to shorts who all tried to cover at once. Such a rally is too effervescent. It is not likely to last because it removes buying power which formerly existed, and leaves the market without support between the high point of the rally and the previous low.

The market acts just that way; on the 24th it loses 8½ points from the previous day's close and ends 3 points above the extreme low of the 21st. The constant volume, compared with the previous day, plus the rapidity with which the average yields nearly all of the previous three days' gain, confirms the fleeting character of the rallying power and the lack of important (good quality) demand.

We conclude that the market's inability to enlist worthwhile support and its tendency still to seek the lows will probably induce a fresh outpouring of liquidation should it break the line of support at 95. The situation is still critical on the 26th and 28th when a brief one-day rally (on light volume) and a dip back to 95 bring about a slab-sided, or downward slanting formation, judged by the tops of the 23rd to 28th, which suggests the pressure is downward. Volume decreases to under 1,500,000 on the 26th and 28th, but in view of the market's recent bearish action this looks more like a swing to a dead center preceding new weakness, than diminishing force of supply. Furthermore, the low closing of the 28th leaves the average hanging on the edge of the 95 supporting line. If it cannot rally promptly from here, there will be more decline ahead. Accordingly, should prices break through the low point of September 21st at 94 on increasing volume, we shall again sell more stocks short. We realize that after a big decline we may be taking chances in trying to get what may prove the end of a bear market, but we do not know when the real turn will come so we keep on playing the short side until the market itself tells us we are wrong or that the trend is changing.

New lows are the rule until October 5th when the average touches 79, closing within a point of the low and the volume is more than 3,000,000 shares. On the evidence of this chart alone, we find nothing that causes us to cover on this day, although the decline is again becoming sharply accelerated which warns us to become wary (refer to Footnote, Page 19, commenting on similar behavior May 27th to June 1st).

The low closing suggests lower prices the following session but the market fails to confirm this expectation, thereby giving us additional warning of a change. Instead of sagging, it opens slightly higher on the 6th, then advances steadily all day with only a 1½ point reaction at the close. The recovery in the average is about 11 points on that day, the most aggressive rebound since the long decline from 145 started. Also, there is a heavy increase in volume -- 4,300,000 shares; emphasizing the change. If we were not watching the tape that day (which would have told us to cover), or we had no Wave Chart to show us what the tape revealed, and our other charts (if any) gave us no indication of a reversal, we must cover our shorts after we have had a chance to examine the results of the day's activities.

We realize that the average has now declined from about 312 in September, 1929, to 79 in October, 1931. We cannot expect this bear market to go on indefinitely. We do not immediately jump to the conclusion that a violent recovery is occurring; that a bull market is under way. We wait and study the action of the averages and our other records.

Over the next three sessions, there is a strong rebound from 79 to 99 – 20 points. The rise to October 9th breaks the downward angle of the decline from the August 29th high point as will be seen by placing a ruler across this and the high of September 23rd. On the 10th, the market narrows; volume falls off to 800,000 shares. From what we have learned by our preceding study of this chart, we recognize the indication as a sign of a reaction which comes in the next two days when the average recedes to 88, a point over a normal halfway reaction. Observing on the 14th that the market dips back to the supporting points of Oct. 7th and 8th on comparatively light volume, we decide that if it is able to hold at this level or above the lows of Oct. 1st and 2nd, it will be completing a secondary reaction which would confirm the action of October 5th as a shake-out. Thus the market seems to be forming the outlines of a supporting zone with the low points of September 30th to October 14th (85-88) as its probable base.

Accordingly, we watch for an opportunity to establish long trading commitments with the idea that we may be able to make a play for a further recovery, provided we can secure the proper limitation of risk with stops placed close to the Oct. 5th and 6th, or under the Sept. 30th - Oct. 14th danger points. We do not take an investment position, however, because we should like to see a period of dullness in preparation for a real bull market which, normally, after such a decline, should begin somewhere about this level. To say positively that it <u>will</u> begin would be a pure guess. The market will tell us when it is time to take a long <u>investment</u> position.

On the 15th, after rallying to the previous day's high, the average reacts, but a decrease in volume, higher close and higher low tend to confirm this performance as completion of the secondary reaction from the October 9th rally top, thereby giving the cue to venture trading purchases. Accordingly, we now buy the few stocks we have selected for the purpose of catching the indicated further recovery.

Diminishing volume on the rally of the 17th and 19th, followed by climaxing indications on the next two days as the average reaches the previous resistance point, all tell us to anticipate another setback. We wait to see whether it promises to be brief or whether it may involve another test of the 85-88 support level. In the next three sessions, the market swings to a dead center, coming to an apex on the 24th. Four days' lateral movement, between the 21st and 24th, meanwhile breaks the rather steep angle of the advance from Oct. 5th. Apparently, buying power has been exhausted by the recovery to 100 or buyers are not yet ready nor willing to follow prices upward. Also, there is no increase in volume on the rally efforts of the 23rd and 24th. These indications are all bearish so we either raise our stops close to the lows of Oct. 23rd and 24th, or we get out of our long trades immediately and watch.

If our previous conclusions that a base of support might be forming around the 85-88 level are correct, the market's behavior on the reaction which now seems imminent may give an important confirmation of these deductions or it will contradict them and perhaps indicate a resumption of the bear market. Or, it may do neither. That is, the indications may not prove to be clear, in which case we shall have to maintain a neutral position and expect a professional or trading market; in other words, a series of relatively small swings up and down in a narrow range, say between the recent lows and the recent tops, 79-100, until the market works into a position for its next important intermediate move.

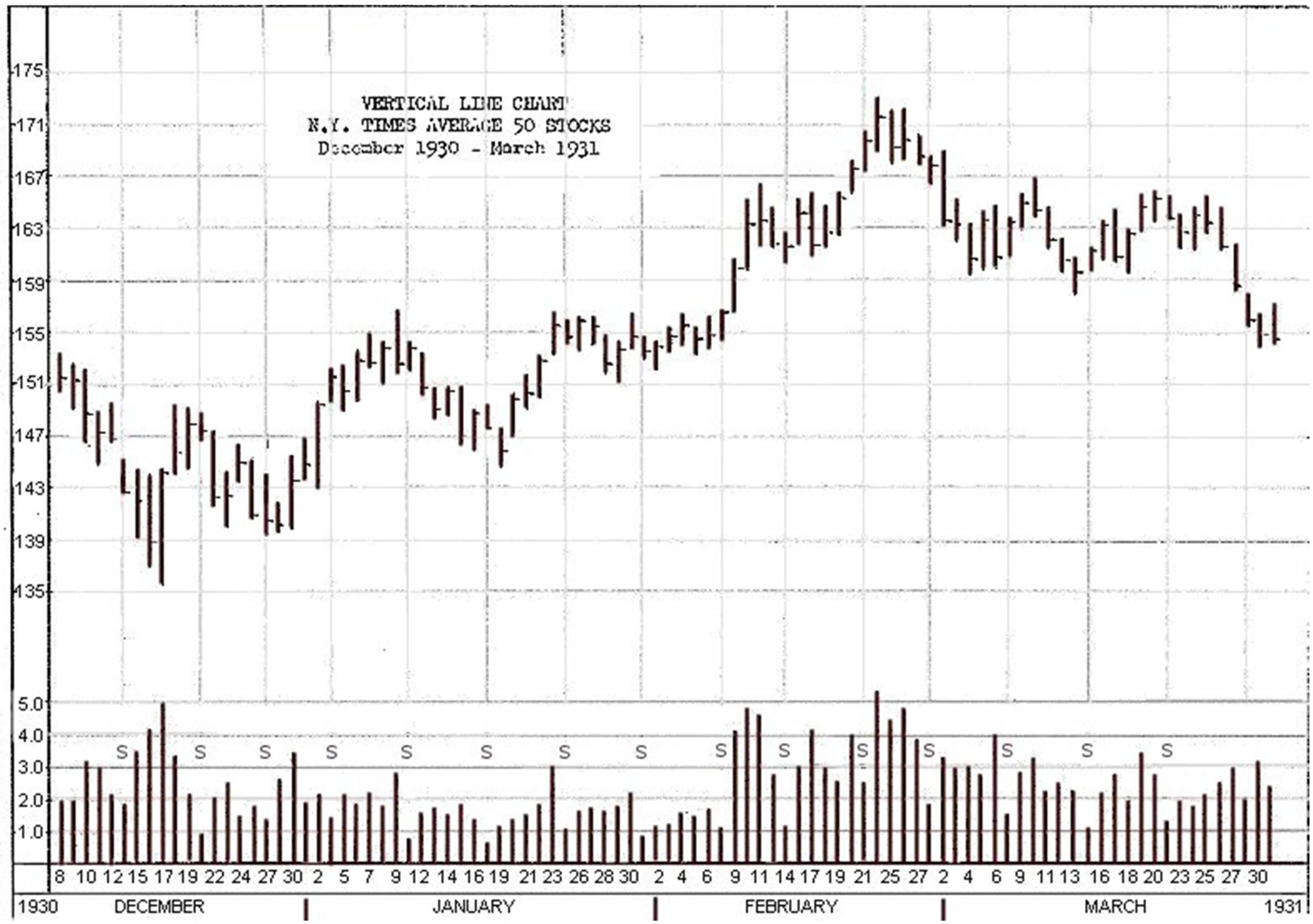
When, on Oct. 28th, the volume gives a minor climaxing indication after the average has settled down to the former supporting line (around 88) with no increase in volume on the way down, Oct. 26th and 27th, we conclude that there is no further liquidation to worry about and that support is again coming in at this level. This is confirmed by decreasing volume and no net change in the closing price, following a small further recession next day, which shows there is no follow-through on the down side.

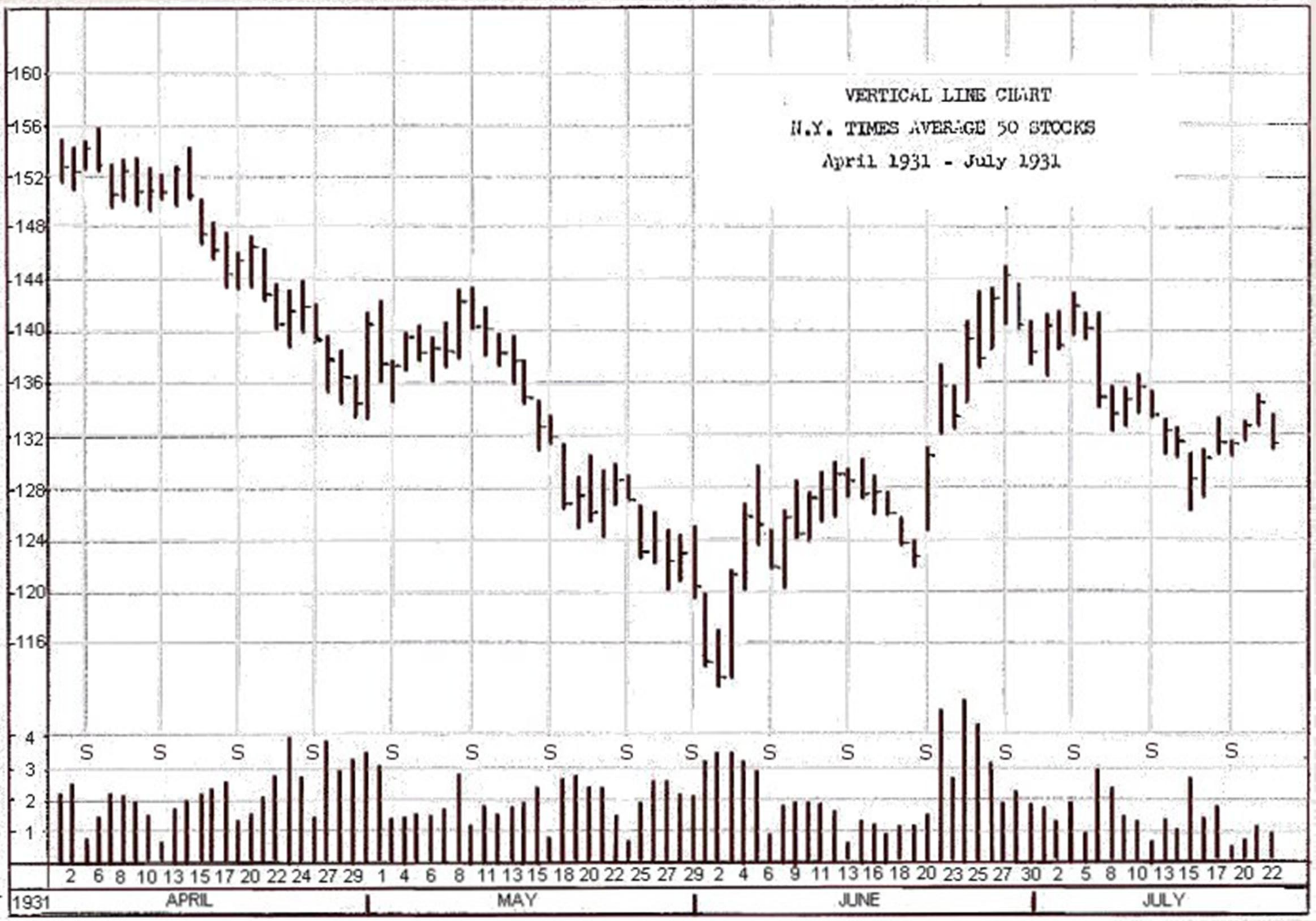
The zone of support has now broadened to provide a foundation for a more substantial recovery (though our other records still do not encourage us to take investment positions) so on the 30th we buy again for trading purposes, this time placing stops a point or so under the Oct. 14th and 29th lows. The average then records a series of rising supports and higher daily tops on moderate volume, until Nov. 9th when the appearance of climactic volume on a small further upthrust to the vicinity of the Sept. 23rd rally top tells us to get out of our long trades and go short; supply is overcoming demand as the average reaches the long bear market supply line running through the successive highs of July, August and September.

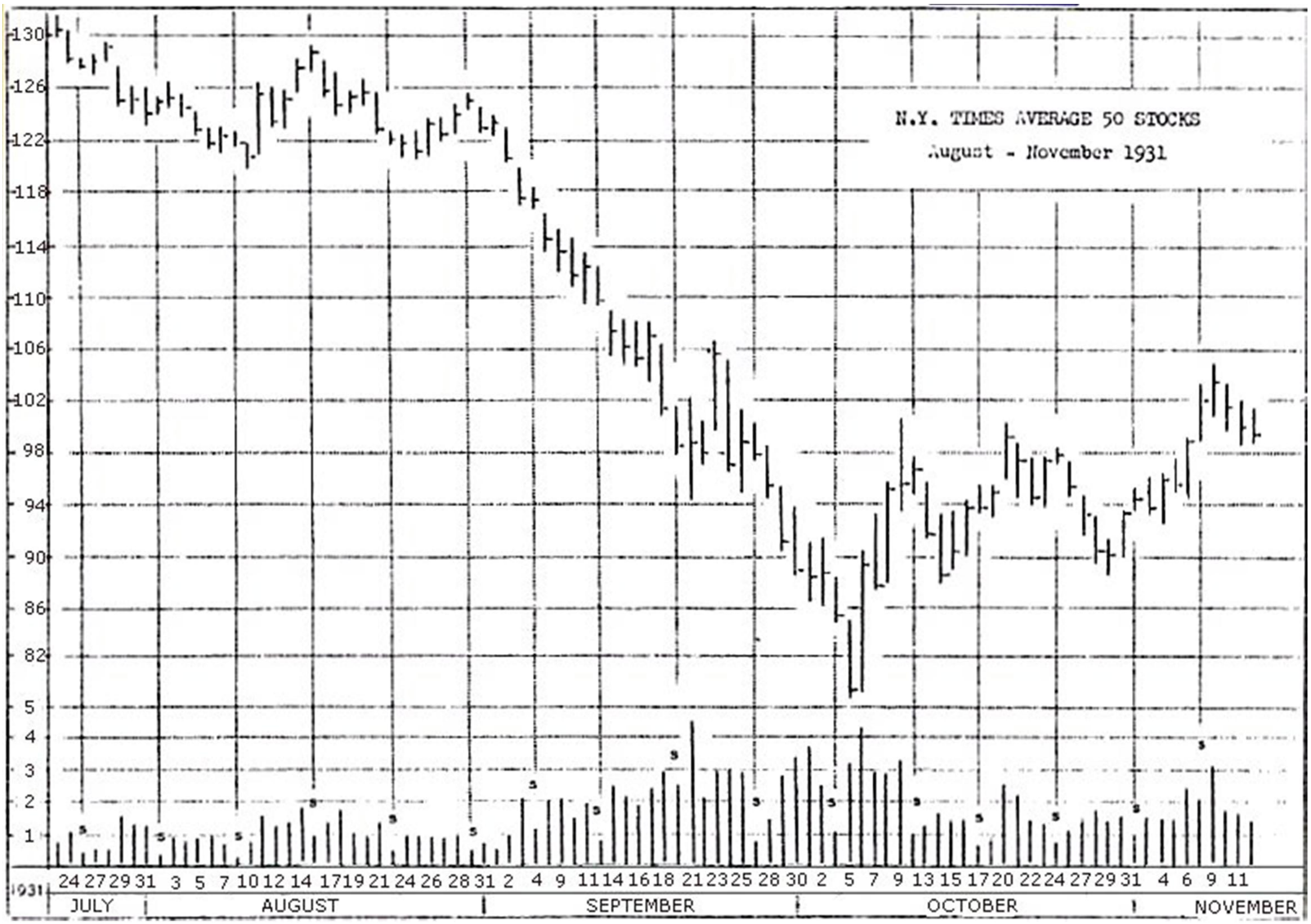
At the point where our chart ends, it appears at first glance that we are getting a reaction on slightly diminishing volume which, if the market has not exhausted the force of the demand stored up around the September-October lows, should encourage another rally effort. No such effort materializes, however. On the contrary, the average gives an indication of renewed weakness by dropping sharply to 95 on November 13th and eventually sinks through the October low with no semblance of rallying power and nothing more than a period of nine days' hesitation in a five point range from the end of November to the 8th of December (none of this is shown on the chart).

Again we have an illustration of the vital importance of employing stop orders to protect investment as well as trading positions at all times. For instance, assume we had mistaken the tentative formation of a base of support in October, 1931, as preparation for a real bull market, and had made investment purchases around the logical buying points of Oct. 28th and 29th. Suppose also that we had let our stops on these commitments remain undisturbed where we originally placed them, just under the 85-88 level. The worst that could happen to us now would be the automatic closing out of our positions at small losses about the middle of November. Thus we would have our capital still intact and liquid, ready to take advantage of the final turning point. But if we had no stops we might have carried these stocks down for seven more months of deflation and loss.

And so we conclude our interpretation of a period of very instructive market movements with one further observation: You may now see why study of the stock market cannot be reduced to rule of thumb procedure; why it is foolish to seek mechanical short cuts and to draw fantastic diagrams on charts.

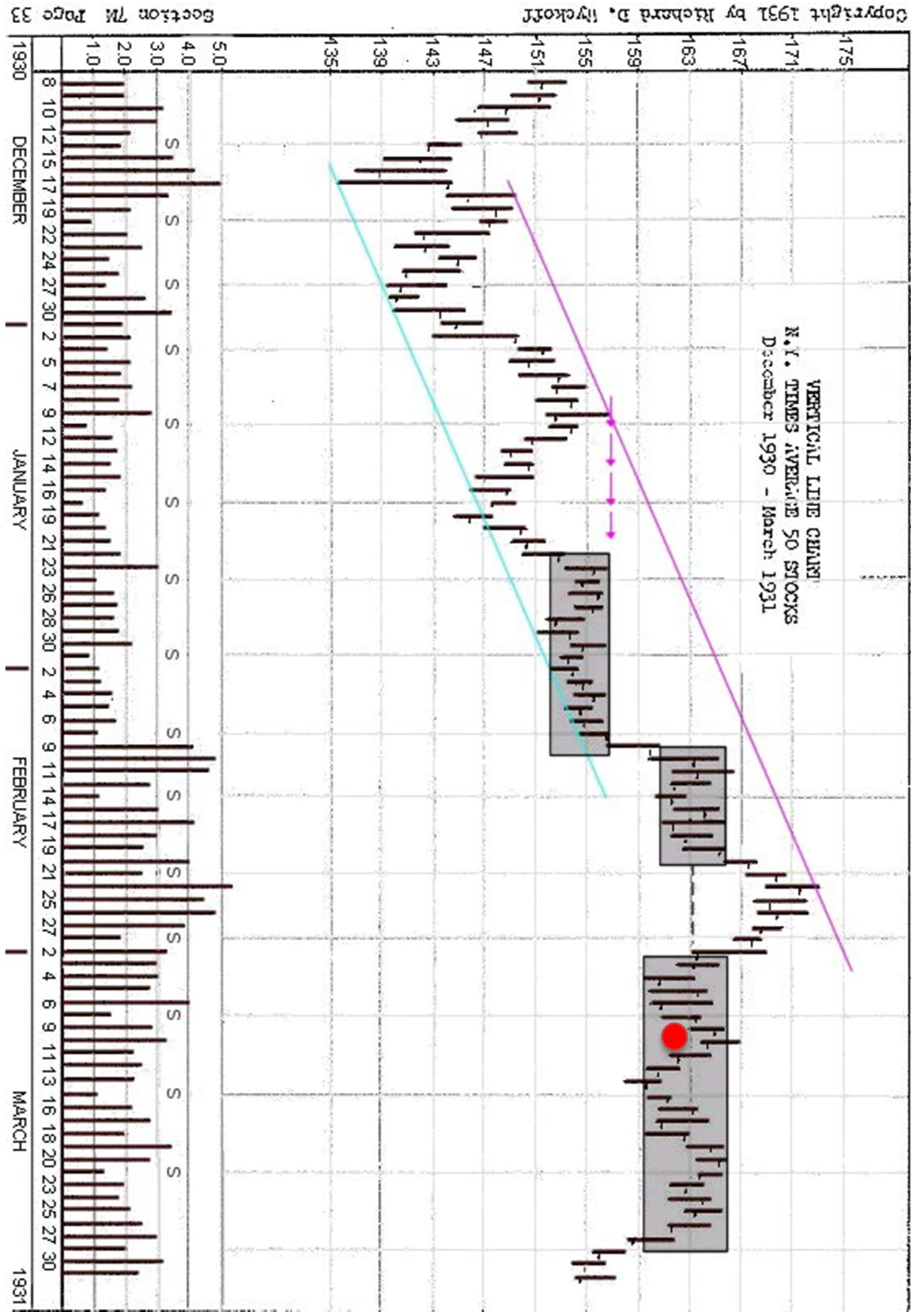

VERTICAL LINE CHART
N.Y. TIMES AVERAGE 50 STOCKS
December 1930 - March 1931
175
171
167
163
159
155
151
147
143
139
135
5.0
4.0
3.0
2.0
1.0
S
8 10 12 15 17 19 22 24 27 30 2 5 7 9 12 14 16 19 21 23 26 28 30 2 4 6 9 11 14 17 19 21 25 27 2 4 6 9 11 13 16 18 20 23 25 27 30
1930
DECEMBER
JANUARY
FEBRUARY
MARCH
1931


VERTICAL LINE CHART
N.Y. TIMES AVERAGE 50 STOCKS
April 1931 - July 1931
160
156
152
148
144
140
136
132
128
124
120
116
4
3
2
1
S
2 6 8 10 13 15 17 20 22 24 27 29 1 4 6 8 11 13 15 18 20 22 25 27 29 2 4 6 9 11 13 16 18 20 23 25 27 30 2 5 8 10 13 15 17 20 22
1931
APRIL
MAY
JUNE
JULY



N.Y. TIMES AVERAGE 50 STOCKS
August - November 1931
130
126
122
118
114
110
106
102
98
94
90
86
82
5
4
3
2
1
1931
24 27 29 31 3 5 7 10 12 14 17 19 21 24 26 28 31 2 4 9 11 14 16 18 21 23 25 28 30 2 5 7 9 13 15 17 20 22 24 27 29 31 4 6 9 11
JULY
AUGUST
SEPTEMBER
OCTOBER
NOVEMBER

The Origins of the SLA



Appendix E: Characterizing a Market

To "characterize" a market means to determine the characteristics or behaviors of the traders engaged in that market. Since a price is the result of a transaction between a buyer and seller, it is more productive to attempt to understand the unique buying and selling behaviors of these participants than to engage in gurubabble about "price behavior" (yes, I know, I'm guilty of this myself due to the shorthand made possible by what appear to be little cheats but which are more mnenomics, much like a chef will instruct the student to "prepare a mirepoix"* rather than go through detailed instructions every time he gives the order). After 100 pages, I know that you know that I know that price behaves as it does because of what traders do. And now you know that I know that you know that I know.

**a finely-diced mix of carrots, onions, and celery, used as the seasoning base for a meat dish or sauce.*

While nearly all hobbyists resort to mathematical TinkerToys like indicators and formulas and others look for "fanciful shapes", professionals focus on traders and their behavior. When, for example, they see a "double top", they don't think "Ah, a double top" but rather "Hmm, sellers ran out of buyers". **The first and probably most important step is therefore to think in terms of trader behavior** for it is that, not TinkerToys, that moves price.

> *In 1936, British economist John Maynard Keynes gave the best description of the stock market I've ever heard. He said stock market investors are like judges in a beauty contest. But the idea of this beauty contest is not to pick the prettiest girl, but rather to pick the girl that all other judges will think is the prettiest.*
>
> *This simple metaphor is profound because it reveals the truth: For all of our study of the economy and companies, it is subjective perception – not objective reality – that sets stock prices.*
>
> *And it's perplexing because, as Keynes pointed out, all of the judges are fully aware of the true nature of the contest and act accordingly. Each judge knows that he's a player in an fabulously complex game of psych and double-psych, an infinite regress of figuring out what the other guy is thinking you're thinking he's thinking you're thinking he's thinking, and so on and so on . . .*
>
> *–Don Luskin*

The second step is to begin the characterization process, part of which is cut-and-dried and part of which requires a certain sensitivity to behavioral dynamics, particularly the dynamics of fear (fear of making the wrong decision, fear of losing money, fear of missing out, fear of holding too long, fear of not holding long enough, fear of being tricked, fear of being trapped, fear of being blind-sided, etc, etc, etc). But regardless of which aspect may appear to be more important at any given time or interval, **it is absolutely essential that meticulous records be kept**. Without that, you may as well save yourself the time and effort. Trading for a living is not for you.

If you're prepared to create and maintain these records, **the next step is to observe your market during whatever timeframe is of interest**. If beginning with a day, how does your market behave **overnight**? Is it flat and listless? Or does it provide clues as to where buyers and sellers may be found? If there is a pre-market report coming up, do traders anticipate the results or do they lie in wait? Are certain levels tested repeatedly? Broken? Reset? Are prices trending upward or downward? What are the extents and durations of the waves? Does the pace change at any point? In what way? What effect does the change have on price movement? Are any nearby previous levels of supply or demand probed and tested? How? What is the result?

At the open, does price spike or plunge, providing no opportunity for entry other than a market order? Is there an opportunity to enter before the "open"? How high or low do these moves go? How long do they last? What are the qualitative and quantitative differences between the first 10 minutes and the second 10 minutes? The third 10 minutes? How "emotional" is all of this? When does trading settle down? What is the breadth of the opening range? If there is an economic report due out at 1000, how does price behave in anticipation of it? Do traders appear to wait for it? Is there a line beyond which they will not go? How does it behave after the report is released? How does it react to earnings reports? How does it react to unanticipated news events?

How long is trading active? An hour? Ninety minutes? Two hours? At what point does activity begin to trail off? At what time does it begin to pick up again? 1300? 1400? 1430? How does it behave at the "close"? How does it behave as it drifts into the evening and the overnight? Does foreign trading become active? Or does the market go to sleep?

Looking back on the day, does the market trend with any sort of pattern or is it seemingly chaotic? If it trends, is it mean-reverting? Does it spend more time trending or ranging? If and when it trends, how deep are the retracements? Do the bars overlap a great deal or are the trending moves "clean"? Are the ranges wide enough to permit a retracement tactic or must one trade reversals at the limits? Are the limits easily definable? Are the trend channels stable enough and long-lasting enough to be tradeable? Do they provide easily definable limits or must one make his decisions according to how far price travels from the mean? At what levels do sellers run out of buyers? At what levels are buyers able to force sellers to meet their price? At what levels are most contracts traded (incorporating a T&S display or plotting Volume At Price will help here). How does price react to those limit levels suggested by AMT?

What are the cost-benefit implications of all these trending/ranging movements for scaling in or scaling out? What are the relative risks attending to one or the other? How can one orchestrate scaling-in or scaling-out tactics to obtain the best cost-benefit ratio while minimizing risk?[1]

IF you can maintain meticulous records and **IF** you are diligent in reviewing these records every day, **THEN** you can **BEGIN** to cobble together a set of strategies and tactics that you hypothesize will exploit the behaviors that you found during your observations. Much of these have been done for you through the SLA and AMT. However, the SLA and AMT do not relieve you of the responsibility for pouring over your day's records every evening and preparing a plan of action for the following day. If you do not do this every day, you may as well not trade at all on those days when you just didn't feel like doing the work. You'll not only be throwing away your money but you'll be setting yourself back. **Never forget that professionals are doing all this work**. If you're not, and you can't properly characterize your market and anticipate the most probable moves (see AMT again), then you're not prepared. If on the other hand you are able and willing to maintain these records and review your trades after each and every trading session, there is every possibility – given how few people go through this procedure – that you will find something that nobody else sees and take advantage of it while everybody else is standing around wondering what just happened.

With regard to prediction vs expectation vs anticipation, hobbyists who don't understand trader behavior, much less how to characterize their markets, call these debates "semantics". They see no difference between prediction and anticipation. Those who have gone through the characterization process, however, understand the difference quite well. They understand that AMT, for example, provides the expectation that price will reverse at the upper limit of a trend channel and one can anticipate, based on his work, that price will do so. Can he predict that price will reach a specific price at that upper limit? No. Can he observe the behavior of other traders to see what they do as price approaches that level and act accordingly even though price begins to stall just ahead of it or overshoots it a bit? Of course. Can he then postulate the level to which price will fall based on the principles of AMT? Yes. And when price reaches that level, will onlookers be amazed, convinced that he is a wizard, a genius, a seer? Depends on how easily the onlookers are amazed.

But none of this has anything to do with precognitive abilities or tea leaves or crystal balls. It's simply a matter of doing the prep. Those who don't do it will understandably be impressed, just as those in the audience who know nothing about magic tricks will be amazed and delighted when Presto pulls a rabbit out of his hat.

> *The average man does not like uncertainties. He is not trained to cope with them. He will try to "sweep them under the rug." He will use any device that will make it possible for him to feel "more sure," for he is not willing to accept a "maybe" or an "I don't know" as an answer.*
>
> *And so he will resort to averages, to market indicators, to complicated charts of intersecting lines designed to prove that "it" is either a Bull Market or a Bear Market. He will accept almost any kind of nonsense if it is stated with enough assurance. He will buy horoscopes to determine the trend of the market by the position of the planets. If all else fails, he will look for some authority who will relieve him of using his own intelligence, by making the either/or decisions for him. But he must have a straight, simple answer; otherwise it means nothing to him.*
>
> *Do you see how this way of looking at things is out of line with the facts? Do you see how it leads, inevitably, to frustration, anxiety, and demoralization? It is asking too much of reality. It is setting up a make-believe world, and then crying if the world isn't exactly like the make-believe.*
>
> *We know, for instance, that trees "in general" are round. But you have seen tree trunks distorted by a cramped location, or by the trunks of adjacent trees, that are not round at all. It is useful to know that "tree trunks are round," only so long as we understand that this is an abstraction, and the reality in any particular case has to be looked at, and if it is not round, that is that; the territory is the final answer, not our "map."*
>
> *–John Magee*

Mapping that territory is what characterization is all about. The more distant the trader is from it, the more likely he is to make errors, to miscalculate, to remain out of touch. But when he begins to slow down, to observe, to wonder, to postulate, to test and verify, he begins to understand all the many-varied features of the territory, not someone's map of it. At this level, he is prepared to whup some posterior.

[1]One possible scenario for scaling out 5 contracts, or multiples of 5 contracts:

Many thanks to Steve46. If he hadn't got me thinking about characterization several years ago, I probably wouldn't have given it as much deliberate thought.

The following is just one example of what can be discovered during the characterization process.

Notice the similarities and difference in how the NQ and ES moved on Friday, April 4, 2014. They both fell, as one might expect, even though the ES represents the S&P 500, with its five hundred stocks, while the NQ represents the NDX with its one hundred. But look at **how** they fell.

By 1130 (the arrowed bars), the NQ had fallen 78pts. The ES had fallen 12pts (30 equivalent NQ points)

By the end of the session, the NQ had fallen 133pts. The ES had fallen 36 (90 equivalent NQ points).

All else being equal, which would you have preferred to have traded that day?

Now how did AMT fit into all this? How could a knowledge of it have helped the trader prepare for this dramatic one-day plunge?

(next page)

The left chart represents part of the prep done the day before. It shows the upper limit of the trend channel, the mean of the channel, and the lower limit of the channel.

As you can see, after the market opened, price came within 2pts of the upper limit of the trend channel, then plunged all the way down to the lower limit and beyond, overshooting the lower limit by 15pts.

In addition, the five most heavily-weighted stocks in the NDX – AAPL, MSFT, GOOGL, AMZN, and INTC – were charted and annotated. AAPL, GOOGL, and AMZN were and had been already weak. MSFT and INTC were vulnerable to reversal under the right conditions. AMT provided the right conditions.

This is only one day, of course, but it serves as an example of the kind of thing one looks for during the characterization process. One also looks at the swings, the overlaps, when and where and how much price retraces once an entry has been triggered, which symbol requires the fewest trades to capture price movement going up or down and so on.

Is this a case of cherry-picking? Of choosing an exceptional or even unique example in order to "prove" the auction market theory? Arguably. AMT is after all only a theory, not a law like the Law of Supply and Demand. However, by going through the characterization process, especially with AMT in mind, one can determine the probabilities himself for likely moves, their locations, and their extents, then anticipate and exploit those moves. If he figures the probabilities correctly, he will be in a better position to profit than his peers who have done none of this.

> *Chance favors the informed mind.*
>
> *—Louis Pasteur*

Here's another example (next page) from two weeks earlier:

As you can see, this plunge took two days instead of one and wasn't quite so dramatic. But, again, AMT provided the upper and lower limits for the (same) trend channel. In this case, price had already reversed off the upper limit on Friday, so the only question was whether it would bounce off the mean and rally back to that upper limit or drop through the mean and fall to the lower limit. Two choices (other than the possibility that it would just sit there buffing its nails all day long).

If you can draw a straight line . . .

Appendix F: On Fear

Traders will find it next to impossible to work their way through the typical book on trading without being exposed to the subject of "controlling one's emotions". Indeed, the conventional wisdom demands that controlling one's emotions is absolutely essential to trading success. And, technically, that's true. If one has them. But, contrary to conventional wisdom, emotions are not an unavoidable component to trading (granted, those who insist that emotions are unavoidable consider the selection of a shirt or of sunny-side up vs over easy to be emotional decisions, but this is about neurotic behavior: addictive, compulsive, illogical, irrational, obsessive, self-defeating, self-damaging behavior; revenge trading is neurotic behavior; cutting profits short and letting losses run is neurotic behavior).

By "emotions", the Wise are referring to The Big Three: Fear, Hope, and Greed. And withstanding all of these, much less controlling them, can seem insurmountably difficult. Hope, however, is only the fear that all will not turn out as expected or anticipated, and greed is the fear that one will either "miss" all that a particular opportunity may provide or that he will miss the opportunity altogether. Fear is the nexus.

But fear of what? Left to its own devices, fear can be invasive and seem all-encompassing. But if we examine it closely, we can see that "fear", with regard to trading, can be reduced to two elements: fear of being wrong (ego damage) and fear of losing money (destitution). Focusing on fear in this manner makes it manageable, even dispensable. Why? Because if one has **a thoroughly-tested and consistently-profitable trading plan**, there's nothing to be afraid of. If one follows it.

The novice is to be envied. He has nothing to unlearn and has no preconceptions. If he is curious, able to concentrate, is reasonably intelligent, and is able to work without investing his ego in either the process or the result, fear has no opportunity to intrude. And if he is working with the aforementioned plan, trading emotionlessly becomes a matter of course, like changing one's spark plugs.

The "experienced" trader (struggling, perhaps failing), on the other hand, not only knows a great deal that isn't so and thus has to be unlearned, he is also a bundle of neuroses, obsessively questioning his perceptions, his decisions, his actions (or, just as likely, his inactions). And running through his head almost without pause are the voices: so and so says, or I read somewhere that, or I took this seminar once that, or this book said, or but the ADX says. He has spent embarrassing amounts of time (and often money) in a search for instructions as to where EXACTLY to draw the line, EXACTLY where to enter, EXACTLY where to exit. This search is in large part what makes Pivots and Fib and Gann and MAs and so forth so seductive. One doesn't have to think about just where it is that price (traders) really react. All the trader has to do is draw the calculated lines. This search for exactitude also motivates the search for the EXACT stop and exact TYPE of stop that the trader should use, along with the EXACT trigger and the EXACT target. But if it were all that simple, one could package it into a kit and sell it (4x Made Easy and Weekend Seminar – lunch included). Learning how to trade properly from the beginning, with the aforementioned trading plan, would have enabled the struggling trader to avoid all this turmoil and become consistently profitable, if not at the outset, then close to it. But there's no going back, this side of amnesia, so wanting to is simply wishful thinking.

All is not lost, however. Though the struggling trader can't go back and start over, he can reprogram himself, rewire himself. This may take more discipine than he's capable of, but it's either that or continued losses and eventual bankruptcy.

The reprogramming begins with becoming intimate with fear, nuzzling up to it, licking its ear. Unless and until one addresses fear directly, eyeball to eyeball, he will find it impossible to bring about its evaporation.

<u>First</u>, realize that the fear of being wrong and the fear of losing money can be consolidated and simplified further by becoming acquainted with their father: the fear of the unknown. By this I'm not referring to the fact that the outcome of any particular trade is unknowable; I'm referring to the fact that the struggling trader rarely understands just what it is that he's looking at.

<u>Second</u>, one must know just what it is that he's looking *<u>for</u>*. If he doesn't know what he's looking for, ipso facto he won't recognize it when he sees it. If he doesn't recognize it when he sees it, he of course will not what to do with it. And if he doesn't know what to do with it, it's a cinch that whatever he does will very likely be the wrong thing (fear of being wrong). And not only will he be doing the wrong thing, he'll be doing it at the wrong time. And doing the wrong thing, especially if he's doing it at the wrong time as well, he will very likely lose money (fear of losing money).

<u>Third</u>, the task then becomes to transform the fear of the unknown into a confident ease with the known. And one accomplishes that by developing a (you guessed it) thoroughly-tested, consistently-profitable trading plan. In order to realize a consistently-profitable trading plan, one must thoroughly test the elements that go into it. In order to thoroughly test those elements, one must define them precisely (e.g., what is a "range"? what is a "breakout"?). And once one knows exactly what he's looking for, he will know it when he sees it. And when he sees it, he'll know exactly what to do with it. Fear becomes irrelevant. The trader may in fact be so focused on his plan that he isn't even aware of fear's departure.

The trader who develops his own plan is in an arguably superior position due to his creating it step by step, block by block, from raw data. The fact that he is developing it himself and the process that he goes through in order to do so guarantee that he will have confidence in it. Whether or not he has the discipline to follow his own plan is another matter, but at least he will have no reason to distrust it.

The SLA/AMT, however, is pre-packaged, ready-to-go, turnkey. All one has to do is follow the rules. But damaged traders are the least likely to follow the rules of a plan they didn't put together. Given that they are unlikely to develop their own plan from scratch, though (if they were, they would have done it already), the SLA/AMT or something similar may be their best shot. And it doesn't cost anything. Nor does one have to have a fancy, bells-and-whistles charting program to trade it.

So how do you go about learning to trust a plan you didn't create, at least enough to trade it and profit from it? Begin by learning the language. Just as you have to know what a full house and a straight flush are if you want to play poker, you have to know what a range is and how to recognize it, first on static charts, eventually in real time. You have to know what a trend and a trend channel are and how to recognize them. You have to know what a reversal looks like and a breakout and a retracement and you have to know how to trade all of them. You have to know what a swing point looks like. You have to know what a double top and a double bottom and a lower high and a higher low look like. You have to be able – and don't laugh – to distinguish between up and down.

And you have to be able to draw a straight line.

All of this is explained herein, but you can't and won't become a master at it by skimming it once and jumping right back into the pit. You must **practice**, preferably in replay. You must develop the ability to **concentrate**, if only for fifteen minutes (if you're daytrading). Then a half hour. Then an hour. You must develop **focus**, turning off the TV, shunning message boards until after your session, ignoring the news. Concentration without focus is pointless as you must have something on which to focus in order to concentrate on it. In other words, concentrating on something that is more or less meaningless to you isn't going to get you very far.

Fear cannot be dissolved unless and until one achieves **competence**. If one believes he is competent to solve a problem, fear becomes much less a factor, and the more competent one becomes, the less influence fear has, if any. How is this competence achieved? Same as how one gets to Carnegie Hall: practice, practice, practice. And by "practice" I don't mean watching somebody else practice or reading the results of somebody else's practice; I mean engaging the market oneself, walking right up to it and shaking its hand, sitting in front of a live chart, either via replay – in which case you can do it anytime, at your own convenience – or real-time or delayed quotes, and focusing on a series of tasks, e.g., is price rising or falling? Is it trending? Ranging? Concentrating on what price is doing and how it's doing it (quickly or slowly or forcefully or hesitantly) and where it's doing it (if in a range, where in the range). Trading what you understand – or think you understand – about these movements, win or lose. Then, after your session is over, completing a task which hardly anyone begins, much less completes: **the chart review** (if observing) and **trade review** (if you tried any).

Trade reviews usually end up being a couldawouldashoulda pity fest. And while they may provide a milky comfort of sorts, they do not come close to providing a plan of action, much less one that will improve one's performance and results. In order to formulate such a plan, you must get past the I'm Such An Idiot hurdle and begin to look at the errors you made and why you made them *and what you plan to do to avoid making them again during the next session*. Look also at what you should have done instead and what specific steps you plan to take to do it right at the next opportunity. If, for example, you're still hesitant about where to draw a line or you have not yet decided upon a satisfactory definition of a "break", then you are ill-equipped to put fear in its place, much less kick it to the curb.

"Just follow the rules" is not enough if one has not internalized the rules and cannot apply them without hesitation and without thought. Trading with "discipline" if one is trading a plan he doesn't trust is not productive. Fortunately, there are a few tweaks* that are required of the trader in order to make implementation a success. I say "fortunately" because the trader is more likely to trust an approach that he had at least some say in as opposed to something that he's handed that he's expected to follow without question. And if he doesn't trust it, he's not to going to follow it without hesitation.

Hesitation is the stick in the spokes, the bomb in the hold. Hesitation is a sure sign that you're not ready, and if and when it makes an appearance, you should stop instantly, lean back, and breathe. You have no control whatsoever over price movement, *but you have complete control over how you respond to it*. How you respond to it, however, must be based on the decisions you've made, not on how you "feel". These decisions begin with **preparation** (see the Afterword), pulling up the weekly and daily and hourly charts so that you have a clear idea of where you are. Determining whether or not you were and/or are in a range before the opening bell. Where you are in that range, if any. What its limits are. Where you plan to go long and short out of it. All of these decisions can and must be made before the session even begins.

And when the bell rings? It is not possible to know exactly what the market will do once the opening bell rings much less what it will do once one has entered a trade. But there is a world of difference between the trader who tenses up and holds his breath while the trade unfolds -- hopefully away from his entry point -- and the trader who understands that anything can happen and anticipates the market's moves, is fully confident that he knows how to deal with those moves, and that he will act appropriately when required to act. If the focus is on these elements, there is no space for fear. It becomes an indulgence.

The trading game is not won in the strategy one selects.
The trading game is won in the mind.

The Scratch

The scratch is probably the best idea to come down the pike since digital charts. It functions much like a microchip implant, flicking you into auto mode when you're about to do or have just done something stupid. Not only when events go against you but when they even LOOK like they're going to go against you, you can scratch and defuse the whole situation, leaving you clean and unsullied with time to breathe and calm down and think and elbow fear in the gut before he has a chance to mess with you.

The most obvious and frequent use of the scratch is the precipitous exit from a trade. I say "precipitous" because the exit will almost certainly be too soon. However, when the heart stops and the brain freezes, "too soon" is not on the table. What is absolutely paramount is getting out and getting out fast.

A common scratch occurs immediately after an entry. The trade doesn't go the way you expected it to go, but instead of falling back into the warm and welcoming arms of hope or giving in to that gut-wrenching feeling when you see yourself living in a box under the bridge, just get out. Instantly. Without even thinking about it. Just get out. Scratch it. What have you got to lose? A tick? A point? Just get out. And if the trade ends up going in the direction you had expected it to, so what? You can deal with that if and when the opportunity presents itself. In the meantime, you're out. You're clean. You're calm. You're fearless. Your vision is beginning to clear. *And you had the discipline to do what needed to be done.*

Another common scratch occurs the first time price moves against you. This may happen in seconds, immediately after the entry, as discussed above. But it may not happen for what seems like minutes, though it can be much less, particularly if you've managed to grab onto a rocket. At some point, this rocket will begin to run out of fuel and sputter and retrace a bit. How much room are you willing to give it? How much CAN you give it before your bowels begin to loosen? Regardless of whether or not you objectively should exit this trade, it should be scratched as soon as you begin to fear the outcome. Immediately. Without thinking about it. Whatever happens after can be addressed after.

One cannot go on like this, of course. While scratching ensures minimal losses, if any, it also ensures that your profits will be far less than they would be if only you had let them run.

But maximizing profits is not the point of scratching. Its purpose is to reprogram you into understanding at a behavioral level that you are in complete charge of whatever happens to you. That you decide when and how to enter and when and how to exit. Once you've reached this state, fear is an afterthought, if one thinks about it at all.

You'll find all sorts of opportunities to scratch, the number depending on how much reprogramming you need, i.e., how screwed up you are. But one common opportunity which to me is essential to the trader's growth but which few people even think about has to do with **concentration** and **focus**. Trading requires that you **pay attention**, but it must be attention of the right kind. You've planned, you've prepared, you've reviewed the decisions which have been and have yet to be made, you're psyched, you're ready to go. An opportunity presents itself, you take advantage of it, and then everything goes to hell. Instead of concentrating and focusing on price and what it's doing and where and how, *you're thinking about your trade* and whether or not it's in profit and if so how much and how much danger it's in and should you give it room or scratch and what about that loss you took and can this trade bring you back to breakeven or maybe a little profit besides or maybe more than just a little and there you are back where you started, fear sitting on your chest. Though it's difficult to pull off, scratching when one's mind begins to wander is an excellent, straightforward, and efficient way of not only smacking yourself for wandering off onto the wrong thoughtcourse but of bringing you back to the straight and narrow. It's so effective, in fact, that even the mere thought of scratching may be enough to bring you back into focusing on what you ought to be focusing on – price behavior – rather than on your trade and its status. And if you've been giving it the old college try and doing everything right but fatigue begins to set in and you're losing focus not because you're thinking of the wrong things but because you're just so damn tired, then stop. Exit and stop. The market will be here tomorrow (unless it's Friday). So will you be if you don't kill yourself with overwork.

Remember: <u>the best plan is of no use if one is afraid to follow it</u>. Scratch when you have to, for as long as you have to. Nobody is going to know if you don't tell them. And when you get to the point where you can trade emotionlessly, you'll be better able to detect fear in others by the way they're moving and reacting to price and to use that knowledge to your advantage. All's fair.

*1. What constitutes a "break" of a line? A tick? Two ticks? A point? Two? Five? Ten?

2. How far are you willing to let price travel against you before deciding that you need to exit? A point or two or three below a demand line break (in an uptrend)? Half the distance of the most recent upwave? All the way to the last swing low? All the way back to where you entered in the first place? When you conduct your review, did you exit out of fear? Or did you have a good reason? A ***really*** good reason.

3. Where are you going to enter a breakout? A tick above the upper limit of the range? Two? A point? Two? Are you going to use a hard stop? How much? Will it be fixed or trailing? When will you move it to breakeven? Why there and not someplace else?

4. Where are you going to enter a retracement? A tick from the deepest part of the trough? Two? A point? Two? How have you defined "trough"? Have you defined it at all?

5. If a higher low prints before the supply line is broken, are you going to go ahead and take it? Or wait for the line break and retracement? What if there isn't a retracement? What if the higher low was enough? Are you going to feel like a dummy for not having entered on the higher low? (Ditto a double bottom.)

Appendix G: Trading the SLA/AMT Intraday

Once one has worked with the SLA/AMT for a few months, or even a few weeks, he may find that he is able to pick up on behavioral nuances easier and faster than he thought. Why this is, I don't know. But some clearly go with this faster than others. If and when he is able to do this, he may find that the AMT half provides a better fit, and the SLA will become secondary. Or he may find that AMT is a continuing mystery and rely instead on the SLA to keep him out of the weeds and on the straight-and-narrow. But choosing over the other is an error. The SLA and AMT are cojoined, and if one emphasizes one at the expense of the other, he'll be missing out on a considerable number of profitable trades.

I've used hourly bars in this pdf because they are far easier to trade than anything less and easier even than daily bars, though if the trader prefers daily bars, fine, then go with that. Many traders, however, simply cannot hold overnight, much less for days or weeks. They are incapable of doing so without making serious psychological adjustments. They will apply – or try to – this approach to intraday trades, or at least to trading opportunities that occur during one's waking hours (the NQ trades 24/5). But the SLA is a trend-following approach, and the trader who wants to "daytrade" will generally find far fewer trends intraday than he will trading interday. Many days in fact are entirely range-bound and never trend at all. And the trader who doesn't particularly like trading reversals is going to find himself between a rock and a hard place since reversals are the only options in ranges (though one might find all sorts of seemingly-profitable retracements in hindsight, there is simply no time for retracements in ranges; by the time the retracement occurs, one is usually almost to the other side of the range). Which, again, is why I've chosen to illustrate the pdf with hourly bars: the trends last far longer.

As I've said more than once, there are two states available to price: trending and ranging. Trends are born of ranges. Price reverses from one side of the range to the other until it eventually and inevitably breaks out of it and begins trending. The trader who wants to make the most of his session, then, will learn both since, as I said above, they are cojoined. There will be times when price launches itself into a trend right out of the gate, but more often it will range for at least a little while – sometimes a great while -- before price exits the range and takes off to greener pastures. So those who focus on the SLA without incorporating AMT into their trading aren't going to have a whole lot to do.

The prep begins as all prep does, whether trading the SLA, AMT, or both, intraday or not: the weekly chart. Here I'm posting the weekly from the week of January 6th (2015). It shows that, while we had been in a down-sloping trend channel in the daily, the previous three weeks had failed to make a lower low. This led me to postulate that we might be creating a range, which is what accounts for that tentative demand line at what looked to be a good spot (I mean three weeks is three weeks; seemed to me that something was up, no pun intended).

In the meantime (meanwhile, back at the ranch), the dailies had been working their way higher. The first is from the day before. The second is of the morning of (pre-trading for the 13th). If this makes no sense, just go with the pictures. They're self-explanatory.

And then the hourly, to see what traders were up to during the night:

And then we focus on the territory for the upcoming session. A few minutes before the NY session begins, a range has formed between 54 and 59. But there's also a half-assed range from earlier in the night between 46 and 52 that may be important later (doesn't really matter what bar interval is used for this; 30m is too big, 1m is too small):

And here's where the range-avoidance trader is faced with a lot of do-nothing time. Those who want to trade the SLA intraday are faced with a range from 54 to 59. Unless and until price breaks up past 59 or breaks down below 54, there is no trade unless one focuses on the AMT approach. If one insists on trading the SLA anyway, the losses can most likely be minimized, but the profits aren't going to amount to much, if only because by the time there's been a retracement after bouncing off the top or bottom, price is very nearly to the other side. Therefore, whatever profits might be made will be minimized as well.
And there are all those commissions.

In this case, the day that followed the "hard right edge" above was typical with regard to SLA results: a breakeven trade, a 3-point loss, a four-point gain, followed by a 2-point loss on a short and a 2-point loss on a long, which shuts down the SLA enterprise (two losses in a row, one short and one long, signalling chop). But then it was a range. Taking the AMT route meant considerably more and greater profits, including two 14-point moves by 1330.

Let's revisit the 60m bar interval, the one used for the pdf. In this particular example, AMT is helpful in locating a range. Once price breaks out of it, the SLA takes over, sort of like a tag team:


NQ 100 Futures (Hour...
-1.60 (-0.04%)
02/16/2015 13:00:04
NQ 100 Futures:4375.40
What is illustrated by
the 5m chart above
Price breaks out of an overnight range
at 0800 on the 11th, then tests the mean
of that range at 1300
Investing.com
02/10/2015 06:00
02/11/2015 06:00
02/12/2015 01:00
02/12/2015 20:00
02/13/2015 16:00


NQ 100 Futures (Hour...
-1.60 (-0.04%)
02/16/2015 13:00:04
NQ 100 Futures:4375.40
80pts, so far
Investing.com
02/10/2015 06:00
02/11/2015 06:00
02/12/2015 01:00
02/12/2015 20:00
02/13/2015 16:00

But even though trading a larger bar interval is simpler and clearly superior, doing so is not necessarily easy. If one can't sleep at night worrying about his trade, then statistical arguments about whether or not larger bar intervals such as the daily or hourly make more money than small ones are philosophical, and who cares? The trader has to play the hand he's dealt.

No matter what the bar interval or the timeframe, the trading session must be **approached**. This is what examining context is all about. To do otherwise is no different from watching a play beginning with Act 3. Are the dailies and hourlies "hindsight"? By the time the session begins, of course they are. But that's what preparation is, studying what has happened up to the point where the trading session begins, just as an actor prepares the backstory of his character before he walks onstage (or at least the better ones do). Without it, the trader has no context within which to make choices, which means that the odds of his making the wrong ones are pretty much 50/50.

One of the first questions to ask is whether price is trending or ranging. Both states are eminently tradeable as long as one is prepared. But knowing in advance which state price is in reduces the choices from two to one.

Here is a recent example.

Whether trading intraday or interday, one begins with the weekly, daily, and hourly charts. Why the weekly? Well, for one thing, it needs to be done only once a week, and sometimes not even that often. But it takes only seconds to just look at it, so there's no reason not to make it a part of the prep. If nothing else, you'll know if you're anywhere near the extremes of the weekly trend channel.

Ditto the daily, though here the sentiment for the upcoming session is a bit more pressing. In this case, price had not only failed to make a higher daily high, but had failed to reach the last one. This is of course echoed in the hourly. The failure at this level with these bar intervals matters, in large part because everybody sees it, i.e., every professional, even those who focus on weekly charts. And knowing what they're looking at is obviously useful.

If you were trading interday, then, you would have been in as price reversed off the upper limit of the daily/hourly range. When you entered would have to do partly with your risk tolerance but also – to be practical about it – where you live. Unless like an ant you never sleep.


NQ 100 Futures:4457.70
4560.00
4540.00
4520.00
4500.00
4480.00
4460.00
4440.00
4420.00
4400.00
4380.00
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4320.00
4300.00
4280.00
4260.00
4240.00
4220.00
4200.00
Investing.com
02/08/2015
03/05/2015
03/29/2015
04/20/2015
05/11/2015
06/07/2015


NQ 100 Futures:4455.20
4560.00
4550.00
4540.00
4530.00
4520.00
4510.00
4500.00
4490.00
4480.00
4470.00
4460.00
4450.00
Investing.com
05/26/2015 00:00
05/27/2015 06:00
05/28/2015 05:00
05/31/2015 18:00

If you're trading intraday,the daily and hourly are "gone", but they still influence subsequent movements, particularly when an important failure such as this one is in the picture. Continue then to at least the 15m, 5m, and even the 1m. Here a more immediate range presents itself, complete with two hinges that converge on close to the same apex:

Whichever one you choose is up to you. Same range, same upper limit, same rejections. All you have to do is prepare and then act when appropriate.

You also have to be up and ready to go, in this case, by 0800. But that's the price of being an intraday trader. On the other hand, look at the potential rewards of entering off an extreme rather than be tossed around by chop.

But again, as I pointed out at the beginning of this appendix, unless you're presented with a nice range at or before the open, or the market decides to plunge to an important hourly or daily (or weekly) level just before the open, or Germany decides to invade Poland again, you may be spending most of your intraday session either clipping your toenails or giving your money away. The longer your bar interval, the fewer opportunities there are, but the better they tend to be. Plus, with a longer bar interval, there are opportunities to pyramid your position and make the most of a trending move. These are rare intraday.

In any event, plan, prepare, *approach*. And don't be afraid to take a position before the NY open. As long as it meets the necessary criteria and doesn't suddenly present itself at 0925, it's just as good if not better than an equivalent opportunity that presents itself at 1000 or 1100 or whenever.

I take the making of these charcoal layouts very seriously. Too many novices wait until they are on the canvas before trying to solve many of their problems.

–Norman Rockwell

Afterword

The SLA/AMT is a primer. Training wheels for the beginner. Rehab for the damaged trader. The beginner will learn discipline, patience, all the good stuff below. The damaged trader will, one hopes, find his way back to a disciplined and professional approach, assuming he was ever disciplined and professional in the first place. If he wasn't, then it may provide him with a reset and reboot. The damaged trader will find it vastly more difficult to start over. But it can be done.

If one wants to be a winning trader (and who doesn't), there are certain characteristics that one must either have or acquire. Fortunately, the SLA/AMT addresses all of them (for a more detailed examination, see Appendix F).

1. **Losses**. One must accept the fact that he is going to incur losses, no matter what bar interval he chooses. The task is not to avoid loss but rather contain it. The SLA/AMT is designed not to prevent loss but to keep losses minimal.

2. **Preparation**. Doing nothing before the beginning of the session in anticipation of exciting, new experiences pretty much guarantees that those experiences are not going to be pleasant. No, one cannot know for sure what is going to happen, but he can know where he is with regard to whatever extremes are in his neighborhood, probably ranges. If he hasn't reviewed at least the weekly, daily, and hourly charts before his session, he has no one to blame but himself for what happens. If he *has* reviewed these charts, he will have a clearer notion of where and how far price may go, which may help him stay in a trade rather than jump out simply because price has gone against him a tick or two.

3. **Planning**. The SLA/AMT is its own plan. But if it isn't followed, if it's "tweaked", it can't be expected to function properly. Yes, there are minor decisions that must be made on the fly if one is truly reading price and not just being led on a leash, but as one gains familiarity with price behavior, these decisions become matter of course, like slowing down at a Yield sign. Larger changes, however, will most likely require at least minimal testing. Changing something just because "it seems like a good idea" is not likely to yield the desired result. As for ignoring the rules altogether, well . .

4. **Discipline**. Without discipline, whatever you do will result in failure. The SLA/AMT, however, forces you to be disciplined. If you keep fighting it, like hitting the snooze button over and over again, it will fold its arms and lean against the wall, waiting for you to pull yourself together. If you are a beginner, but especially if you're damaged, it is essential that you follow the rules. Yes, you will have to decide what, for example, constitutes a "break" of a line: a tick, two ticks, a point or two. But not five. Not ten. Not half your account (an hourly interval, of course, requires a bit more leeway than a point or two). And you must do this every single occurrence. Otherwise the SLA/AMT is no better than that trading plan you got in your mailbox from Profits 'R Us.

5. **Patience**. The best trades are found at the extremes, either of range limits or channel limits. If you're nowhere near one or the other, you have nothing to do but watch (and don't try to be clever and draw teeny-tiny ranges and teeny-tiny channels in teeny-tiny bar intervals to rationalize and justify your lack of patience).

- Learn to use inaction as a defense against your tendencies toward impulsive action, e.g., "revenge trading", or fear of "missing it", or "making up" for that loss.
- Don't get irritated or angered or feel like a martyr when waiting.
- Regard patience as a central pillar of your strategy. Don't assign it a secondary or lesser role.
- Don't be impatient about patience. One part of your brain is telling you to be patient while another is saying, "What's taking so long?" These must work it out and learn to live together.
- Begin by being patient, but don't forget to *stay* patient. The important thing is not whether you are controlled and disciplined at the start of your session, but also at the middle, the end, and all points throughout. (from *Zen and the Art of Poker*)

> *One of the best rules anybody can learn about investing is to do nothing, absolutely nothing, unless there is something to do. Most people always have to be playing; they always have to be doing something. They can't just sit there and wait for something new to develop. I wait until there is money lying in the corner, and all I have to do is go over there and pick it up. I do nothing in the meantime. Even people who lose money in the market say, 'I just lost my money, now I have to do something to make it back.' No, you don't. You should sit there until you find something.*
>
> *–Jim Rogers*

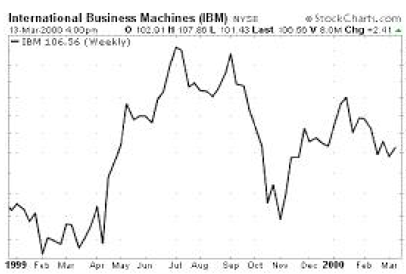
6. **Record-keeping**. It is essential to collect and maintain records of your end-of-session reviews (you are of course doing end-of-session chart/trade reviews). If you do not keep track of what you did right and what you did not-right and the results of each, you won't be looking at early retirement any time soon. Avoid, however, the I'm A Useless Sack drama. Focus instead on what you saw correctly, what you missed that you should not have missed, what you missed that the greatest trader on the planet would have missed, which trades were made according to plan and which weren't (along with why, so that you can avoid the same behavior in future). Review Appendices E and F.

Wall Street is a tough teacher but also a good teacher. If you have any weakness – arrogance, laziness, stinginess, cowardice, procrastination – the market will zero in on that weakness and make you pay dearly.

–Richard Russell

Most of us believe that money-making is a game that is played with forces outside ourselves, forces such as the economy, the stock market, interest rates, the Fed, government policies, employment statistics and the like. But as you move along a spiritual path and begin to get a taste of the power of your invisible self, you discover that money-making is merely a game that you play with yourself.

–Wayne Dyer



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Figuratively speaking, the small trader should imagine himself as a hitch-hiker in the market. For the ordinary hitch-hiker, someone else supplies the car, chauffeur, oil and gas. When he thinks the car is about to go in his direction, he jumps aboard and rides as far as he thinks the car will go. When he notices the machine has been stopped by a red light, or is about to turn a corner and go in some other direction, or that the car is running out of gas, or the brakes failing to work properly, he steps off and figures he has secured about as long a ride as he may expect. All he has supplied in this transaction is a modest commission and whatever brains were necessary to observe and recognize the opportunity when to get on and off.

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The action of the whole market tells you when the selling is better than the buying and vice versa. You do not care why insiders are buying or selling, but you should care a lot about the action of their stock on the tape, for that is what tells you the truth.

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In a certain sense, reading charts is like reading music, in which you endeavor to interpret correctly the composer's ideas and the expression of his art. Just so a chart of the averages, or of a single stock, reflects the ideas, hopes, ambitions and purposes of the mass mind operating in the market, or of a manipulator handling a single stock.

The study of charts is not as some people claim, the mere identification of certain labeled patterns made by the actions of stocks. That sort of thing borders on the mechanical and does little to aid in the development of one's judgment. But when a student undertakes to read from his charts the purposes and objective of those who are responsible for a stock's action in the market, he is beginning to see, in a true light, the meaning of scientific stock speculation.

–Richard Wyckoff