# Al Brooks MD

Sacramento, CA

Book:

*Reading Price Charts Bar By Bar:*
*The Technical Analysis of Price Action for the Serious Trader*
*(Wiley, 2009)*

Available on Amazon (I make very little from it so only buy it if you think you would enjoy it):
http://www.amazon.com/Reading-Price-Charts-Bar-Technical/dp/0470443952/ref=sr_1_1?ie=UTF8&s=books&qid=1240802725&sr=1-1

# Al Brooks MD

Sacramento, CA

Three New Books: (530,000 words)

*Trading Price Action Trends*

*Trading Price Action Trading Ranges*

*Trading Price Action Reversals*

*(Wiley, November, 2011)*

# Websites:

- Free articles:

  [Brookspriceaction.com](Brookspriceaction.com)

- Free detailed analysis of 5 min Emini for past several months:

  http://www.brookspriceaction.com/viewforum.php?f=1

- Free videos of daily Emini analysis:

  http://www.youtube.com/user/brookspriceaction

- Real-time daily webinar ($99/month)

  http://www.brookspriceaction.com/portal.php?page=9

# What is Price Action?

- The broadest definition: any representation of price movement during the course of trading for any financial instrument, on any type of chart, and in any timeframe.
- Since price is changing with every tick (trade) during the day, each price change becomes an example of price action.
- You cannot dismiss anything because very often something that initially appears minor leads to a great trade.

# My setup

- Laptop, single 5 min candle chart, 20 bar ema
- No indicators!
- Blinds closed, don't take calls, don't watch TV
- Ignore the news and pundits
- I don't want any distractions or opinions
- I am very focused
- My job: take money from your account and put it into mine (that is simply the game we are playing!)

# Why does PA trading work if everyone knows it?

- Simple…Trading is very difficult to do well! The margin for error is tiny and every little mistake works against you being profitable.

- Even the best analysis is right only about 60-70% of the time.

- You are competing against the best traders in the world in a zero sum game, and they want your money.

- There is a huge difference between knowing how to play golf and playing it well enough to make a living.

# Edges are Fleeting and Small

- This is a zero sum game and you are trying to take money from very smart people.
- All trading is subjective and hard.
- Holy Grails do not exist. If you had one, those smart people would stop giving you their money and in fact would start doing what you are doing.
- There wouldn’t be anyone left to take the other side of the trade and it would stop working.

# Successful traders base every trade on math

- They  ask, "Will I **probably** make money on this trade?"

- They might determine the probability by using computer testing or by relying on years of personal experience.
- Everyone at least subconsciously, uses the **Trader's Equation**.

  Only take a trade if:

  the chance of success times the reward (how far your profit target is)

  is **"significantly"** greater than

  the chance of failure times the risk (how far your stop is)

  ("significantly", to cover commissions, slippage, mistakes, unknowns)

# Trader’s Equation

- Example: An Emini setup looks good enough to make
- 2 points, using a 2 point stop. For you to believe that, you have to be at least 60% certain, so the probability of success is 60% and the chance of failure is 40%. Commissions = $5, or 0.1 pt.

- Chance of success x reward = 60% x 2 pts = 1.2 pts
- Chance of failure x risk = 40% x 2 pts = 0.8 pts

- Since 1.2 pts is more than 0.1 (“significantly”) greater than 0.8, the trade has a positive Trader’s Equation, and you have a mathematical advantage (an “edge”) when taking the trade.

# Institutions control the market

- The large moves on the 5 minute chart and all of the swings on daily charts are due to traditional institutions placing trades based on fundamentals.
- The small swings on the 5 minute chart are due to program trading and most of it is based on statistics and not fundamentals.
- 60 Minutes reported that a High Frequency Trading firm was placing 40 million trades a day on a basket of 4,000 stocks with a goal of making a penny per trade.

# The day is controlled by program trading.

- The algorithms are based on every imaginable concept.
- Even in quiet trading ranges, the volume is huge and countless firms are continuing to buy and countless others are continuing to sell.
- The bullish programs are fighting to create an upside breakout and the bearish programs are fighting to create a downside breakout.
- Eventually one side wins and the other side covers.

# MARKET INERTIA

- Always bet that the market will continue to do what it has been doing
- When the market is **trending**, 80% of attempts to reverse will fail  (so trade in the direction of the trend)
- When the market is in a **trading range**, 80% of attempts to breakout into a trend will fail (so trade in the opposite direction of the incipient trend)

# Starting Out

- Starting out, be very selective and take only the best 1 – 3 trades per day. Never risk more than your reward.
- After becoming consistently profitable, work on increasing position size rather than the number of trades.
- Trade small enough to be in "I don't care" mode
- If you can average just 1 point/day:
  - 10 contracts per trades = $100,000/year
  - 25 contracts = $250,000
  - 100 contracts = $1 million

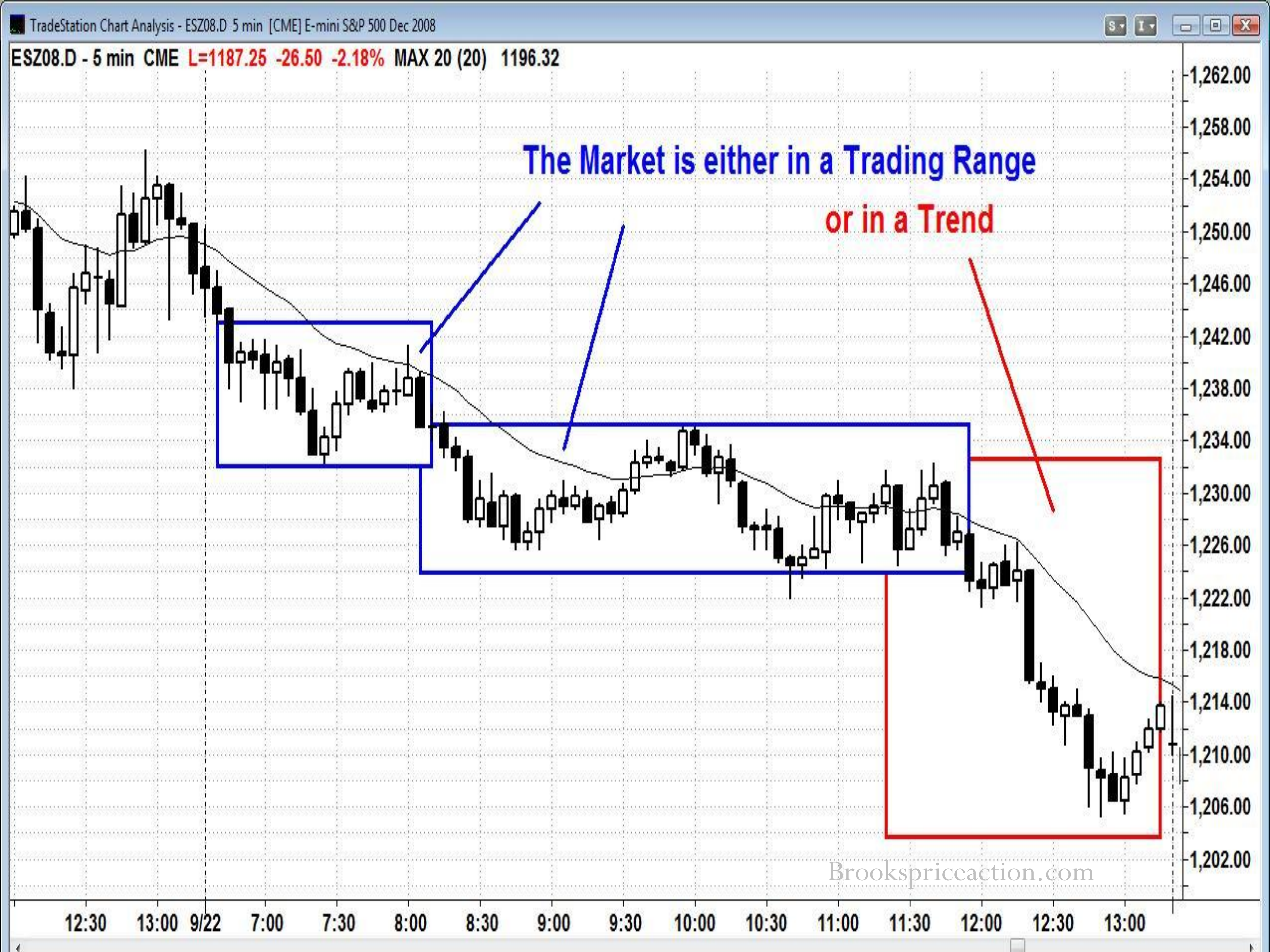
# Can anyone really make money at this?

- Yes, but it is difficult. Some supposedly make a fortune:
- Do a search for Paul Rotter
- Supposedly places up to a hundred trades a day for 3 ticks and made $60M a year for many years

http://www.trading-naked.com/paul_rotter.htm

and

http://www.traderdaily.com/?p=4399



TradeStation Chart Analysis - ESZ08.D 5 min [CME] E-mini S&P 500 Dec 2008
ESZ08.D - 5 min CME L=1187.25 -26.50 -2.18% MAX 20 (20) 1196.32
The Market is either in a Trading Range
or in a Trend
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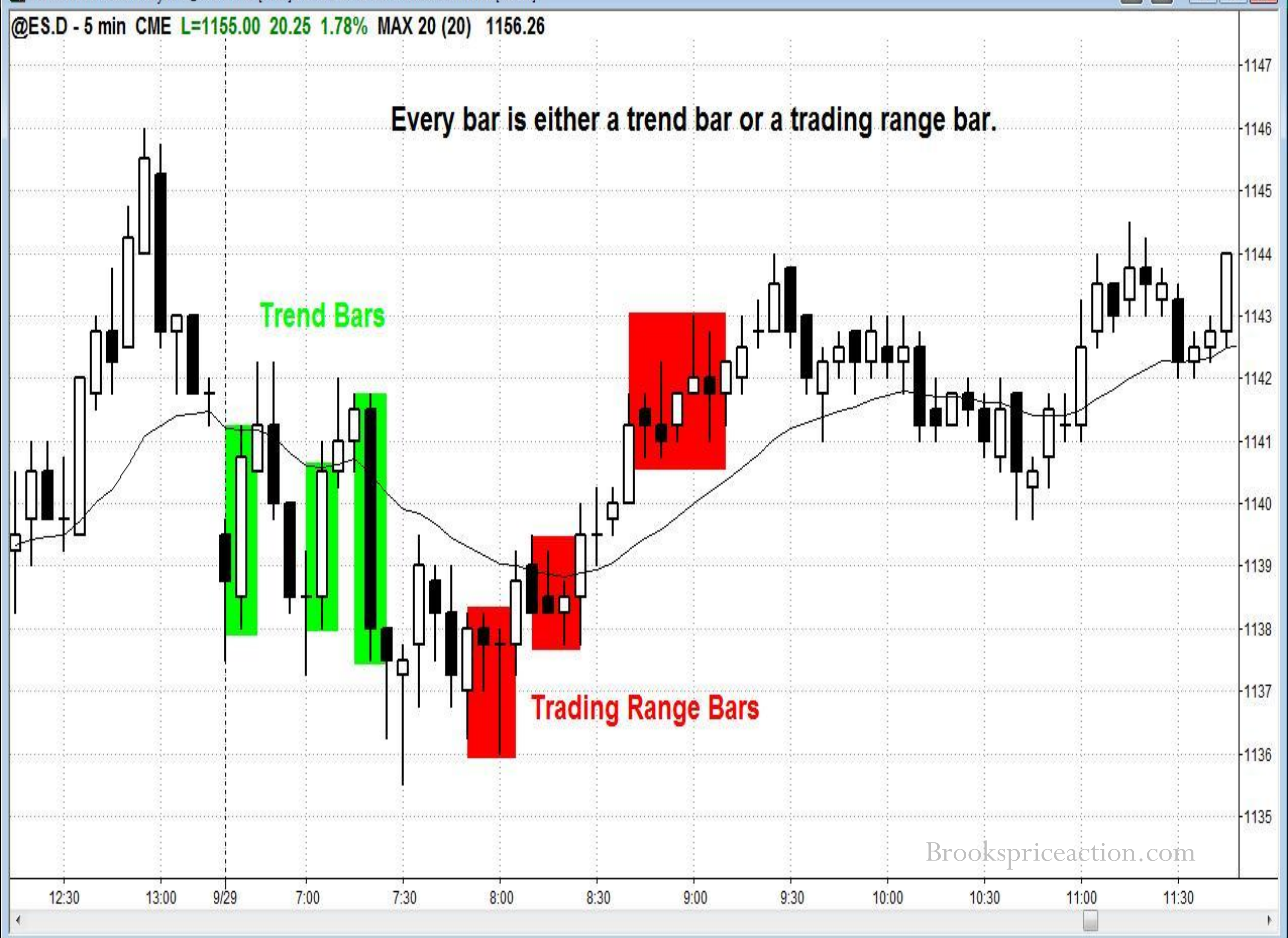
Brookspriceaction.com



@ES.D - 5 min CME L=1155.00 20.25 1.78% MAX 20 (20) 1156.26
Every bar is either a trend bar or a trading range bar.
Trend Bars
Trading Range Bars
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Brookspriceaction.com


TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1155.00 20.25 1.78% MAX 20 (20) 1156.26
Every trend bar and every series of trend bars
is always a:
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Breakout
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# Spikes (Breakouts) are common

- They form every few bars all day long
- In **trends**, they are followed by pullbacks or pauses and then more trending.

  Only 20% of climaxes in trends lead to trend reversals.
- In **trading ranges**, they are climaxes that lead to reversals.

  Only 20% of breakout attempts lead to trends.

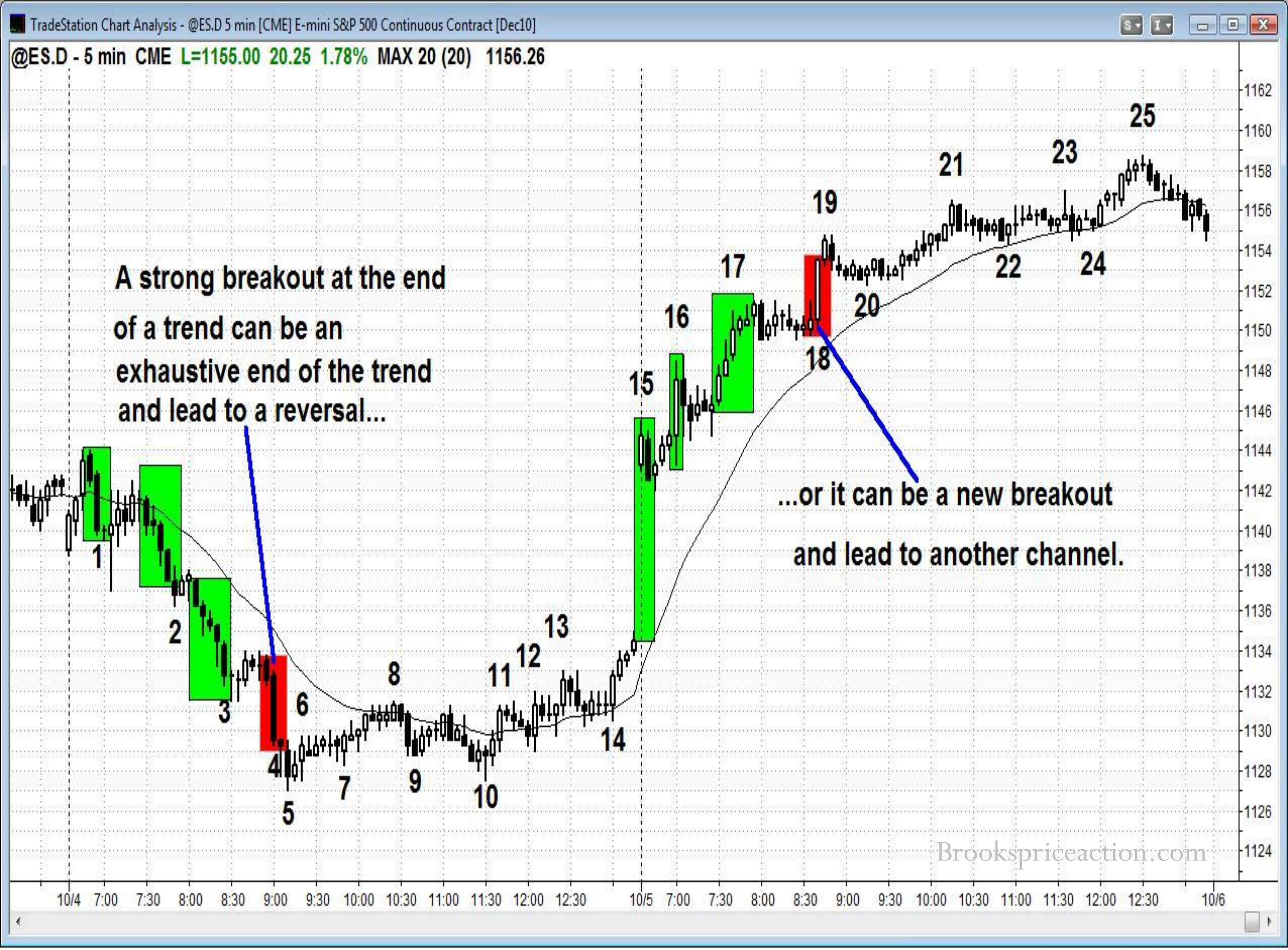
# …and so are Failed Breakouts!

- There are traders buying above the high of every bar, and other smart traders selling, believing the opposite of you.

- There are traders selling below the low of every bar, and other smart traders buying, believing the opposite of you.

- Traders must constantly look for edges, which are mathematical advantages.

- If a trader believes that the buyers will win above or below a bar, he should buy.
- If he believes that the sellers will win, he should sell.
- If he is uncertain, he should wait.



TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1155.00 20.25 1.78% MAX 20 (20) 1156.26
A strong breakout at the end of a trend can be an exhaustive end of the trend and lead to a reversal...
...or it can be a new breakout and lead to another channel.
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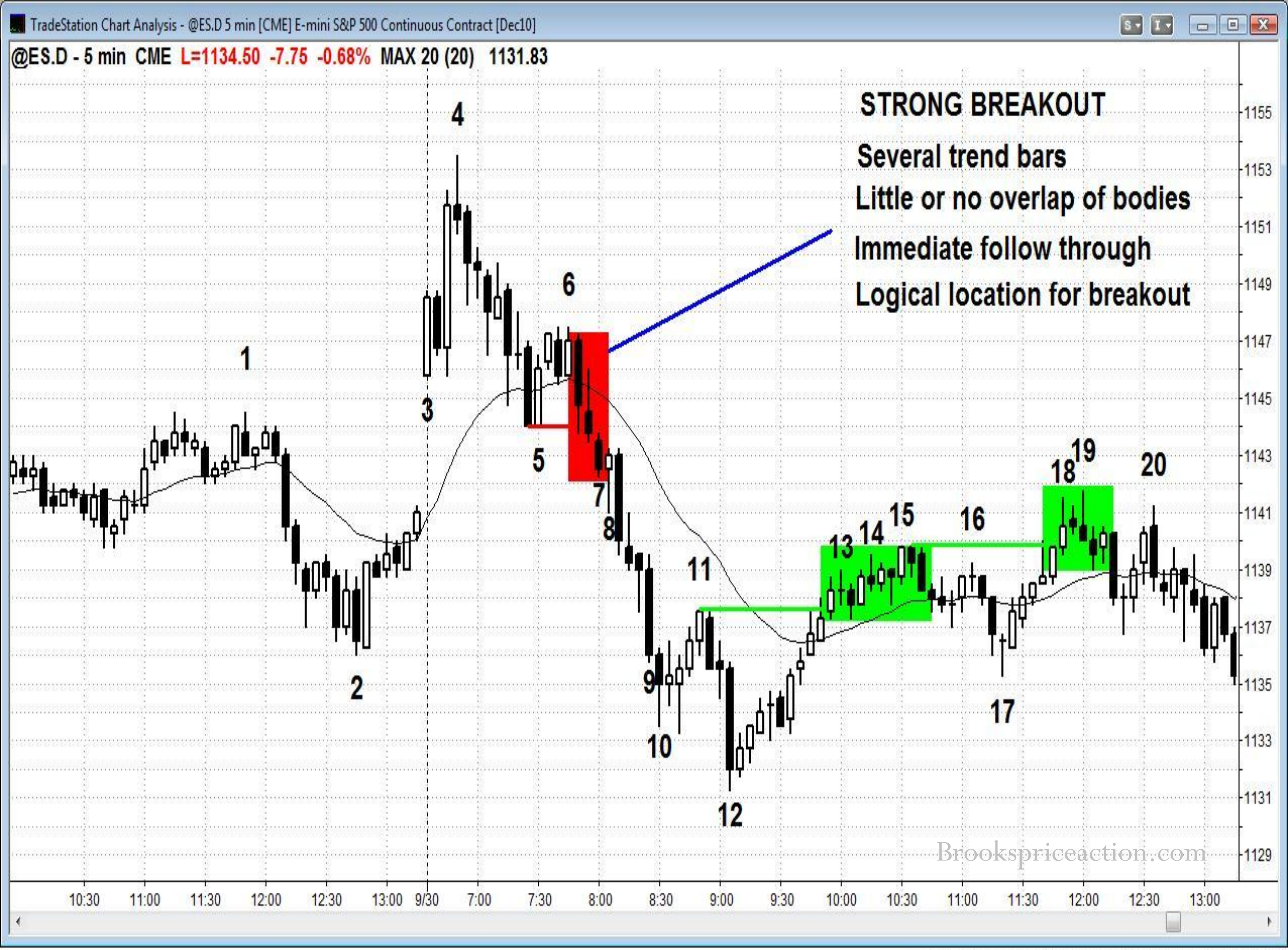
Brookspriceaction.com



TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1134.50 -7.75 -0.68% MAX 20 (20) 1131.83
STRONG BREAKOUT
Several trend bars
Little or no overlap of bodies
Immediate follow through
Logical location for breakout
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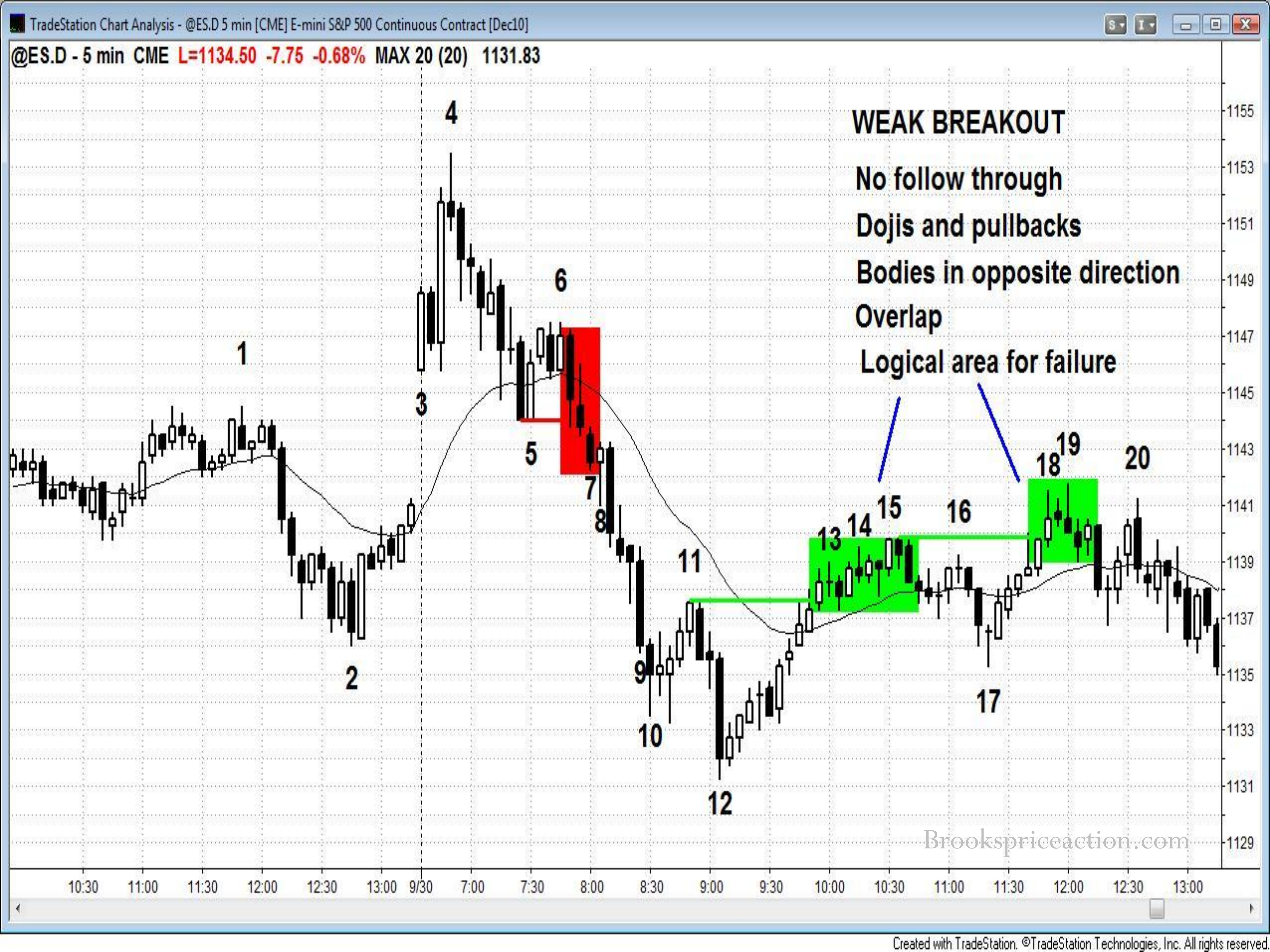
Brookspriceaction.com


TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1134.50 -7.75 -0.68% MAX 20 (20) 1131.83
WEAK BREAKOUT
No follow through
Dojis and pullbacks
Bodies in opposite direction
Overlap
Logical area for failure
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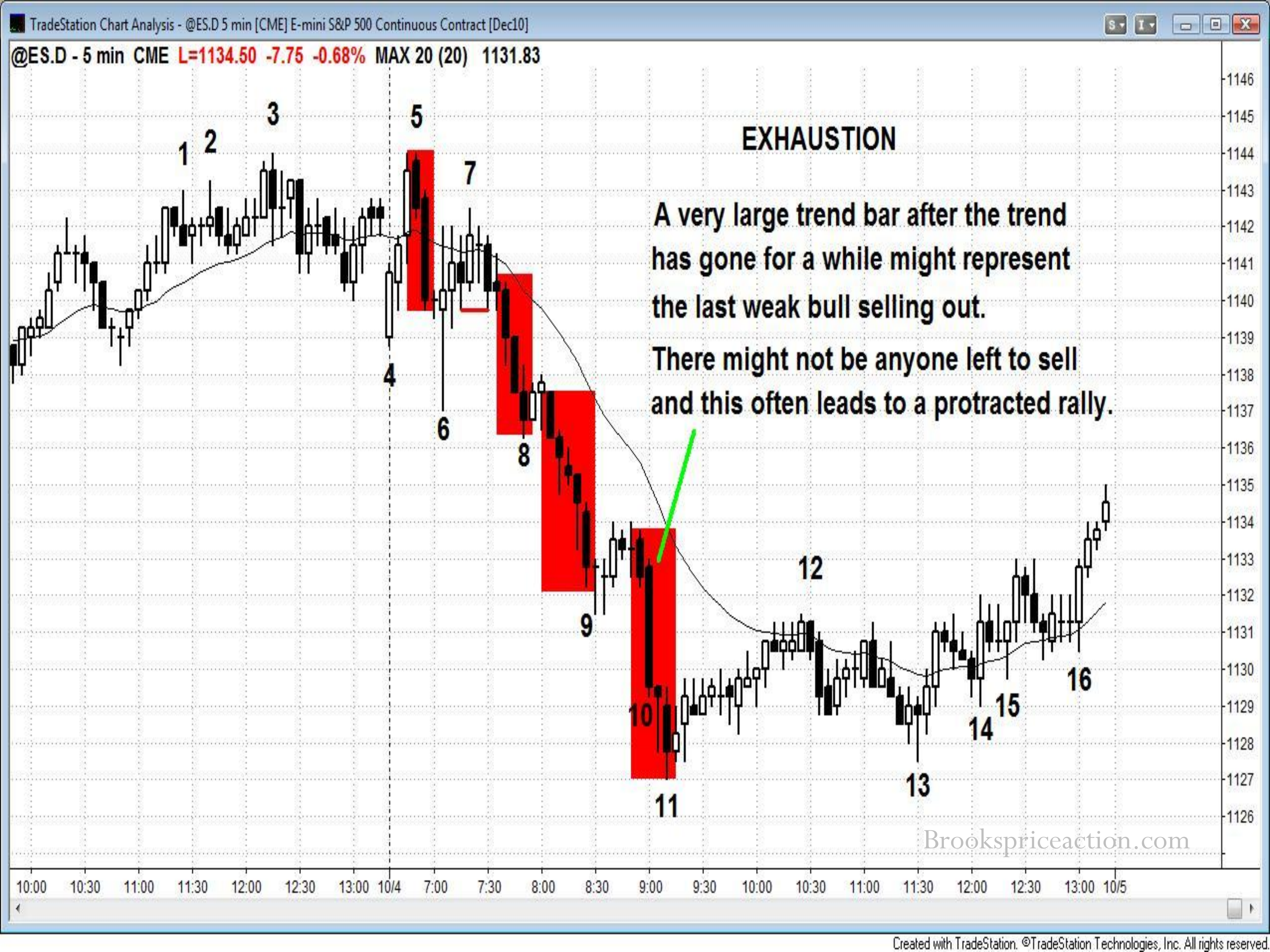

TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1134.50 -7.75 -0.68% MAX 20 (20) 1131.83
EXHAUSTION
A very large trend bar after the trend has gone for a while might represent the last weak bull selling out.
There might not be anyone left to sell and this often leads to a protracted rally.
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TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1160.50 4.00 0.35% MAX 20 (20) 1161.46
Consecutive spikes can represent a climactic exhaustion.
Weak bulls finally buy.
Weak bears finally give up.
Once no weak bulls left,
strong bulls will only buy if pullback.
Once no more weak bears,
strong bears see value and short relentlessly.
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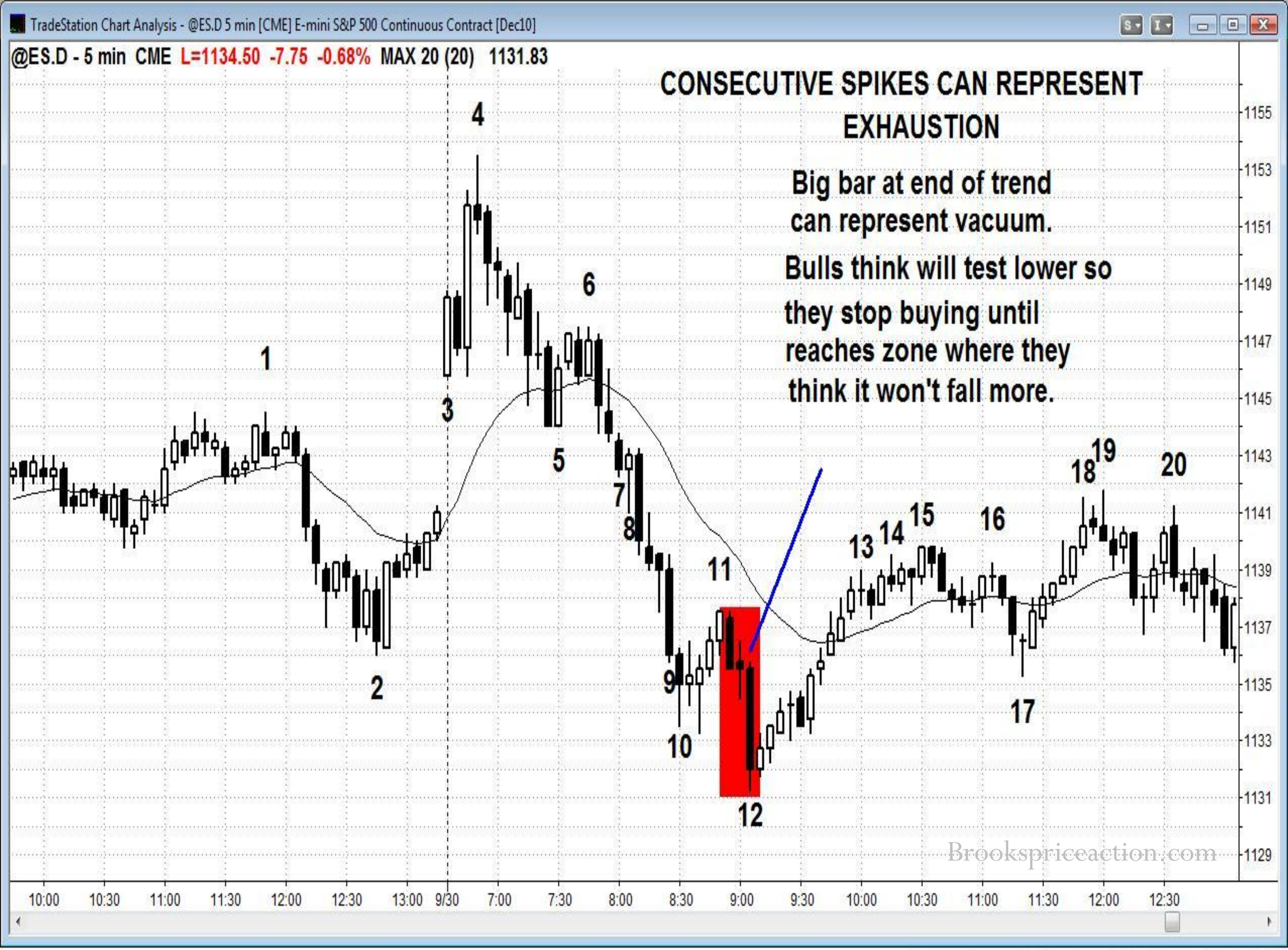
TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1134.50 -7.75 -0.68% MAX 20 (20) 1131.83
CONSECUTIVE SPIKES CAN REPRESENT EXHAUSTION
Big bar at end of trend can represent vacuum.
Bulls think will test lower so they stop buying until reaches zone where they think it won't fall more.
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Brookspriceaction.com

# Trading ranges and the vacuum effect

- **Strong bull spikes near top**:

  The bears think the market will go a little higher so they wait for it to get there and then short heavily and relentlessly. The bulls expect the same and wait to take profits there.

- **Strong bear spike near bottom**:

  The bulls think the market will go a little lower so they wait for it to get there and then buy heavily and relentlessly. The bears wait to take profits there.

# Vacuum effect

For example, near the top of a trading range:

- Once bearish institutions believe that the market will test a little higher to the top of the range, they stop selling. The bulls expect the test as well and wait to sell out of longs.
- Both believe the market will go a point or two higher so it does not make sense for them to sell until market gets there.
- This creates a buy imbalance and market races up.
- Bears appear out of nowhere once in their sell zone. Bulls take profits there.

TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1160.50 4.00 0.35% MAX 20 (20) 1140.04
Trading Ranges always look like they are about to break out, but...
Don't Buy Near Top, and
Don't Sell Near Bottom.
BAD TRADES!!
Smart Traders are Doing the Opposite!!
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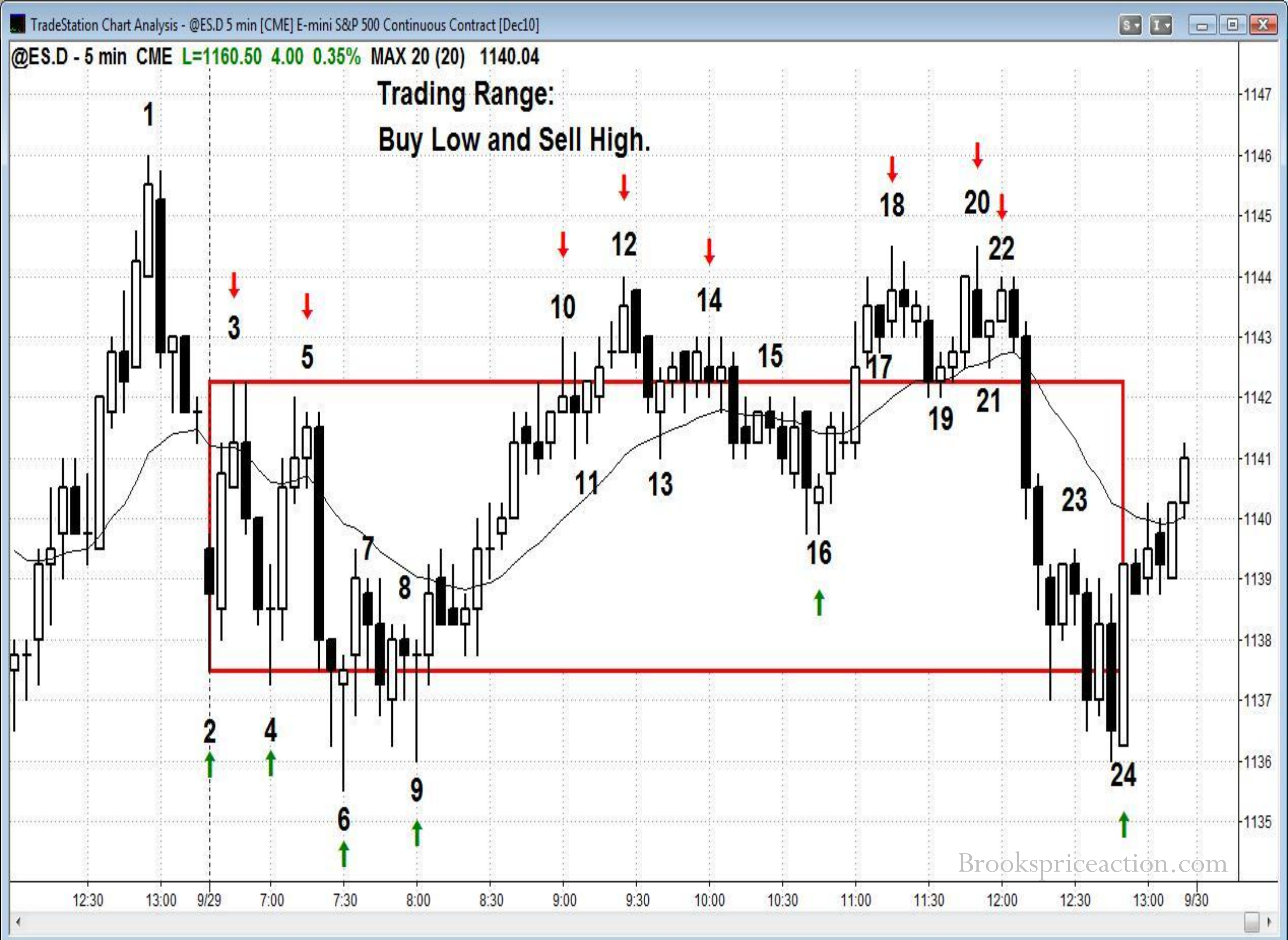
TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Dec10]
@ES.D - 5 min CME L=1160.50 4.00 0.35% MAX 20 (20) 1140.04
Trading Range:
Buy Low and Sell High.
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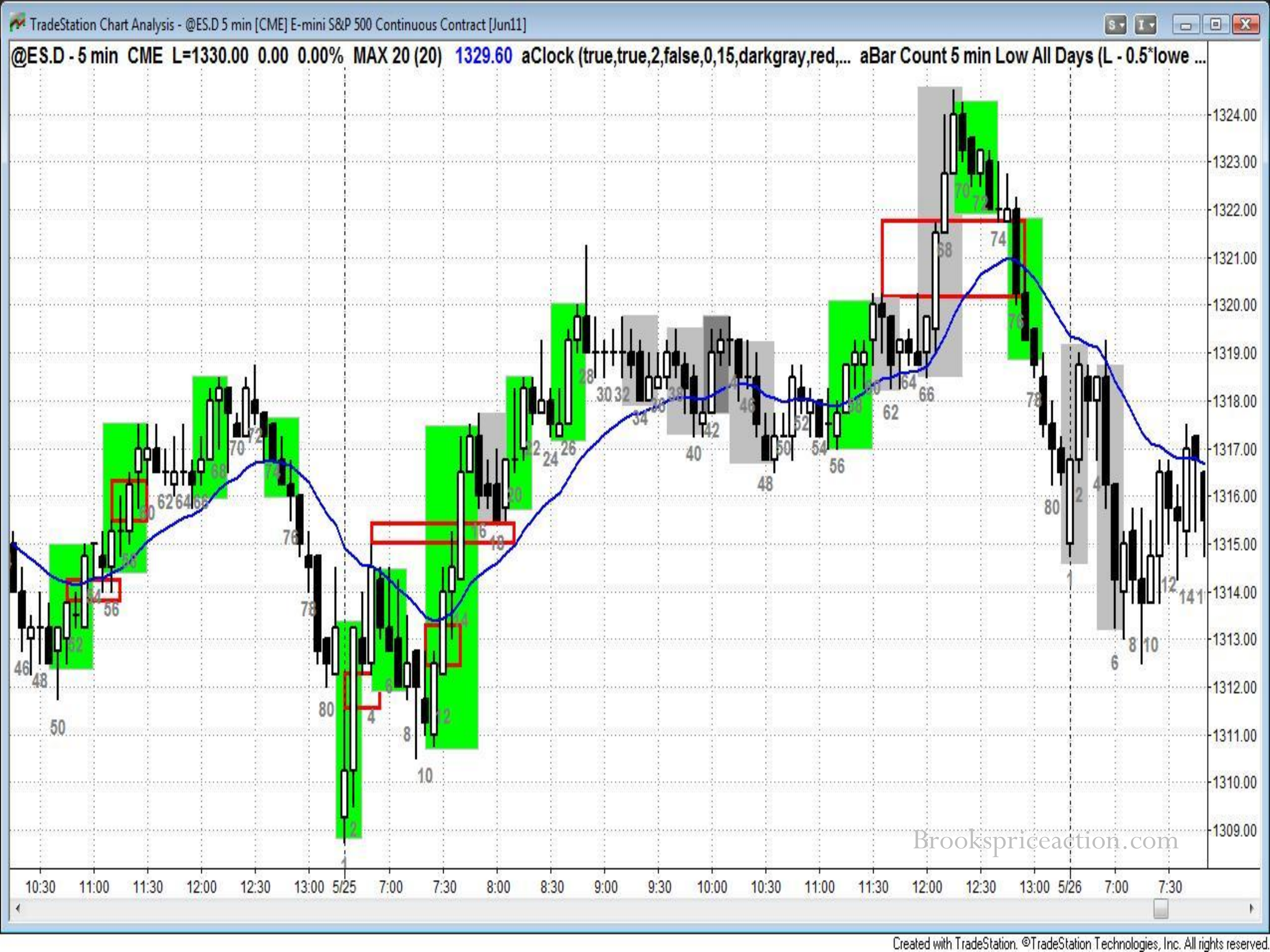
Brookspriceaction.com

# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The breakout bar has a large bull trend body and small tails or no tails. The larger the bar, the more likely the breakout will succeed.



TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Jun11]
@ES.D - 5 min CME L=1330.00 0.00 0.00% MAX 20 (20) 1329.60 aClock (true,true,2,false,0,15,darkgray,red,... aBar Count 5 min Low All Days (L - 0.5*lowe ...
Brookspriceaction.com
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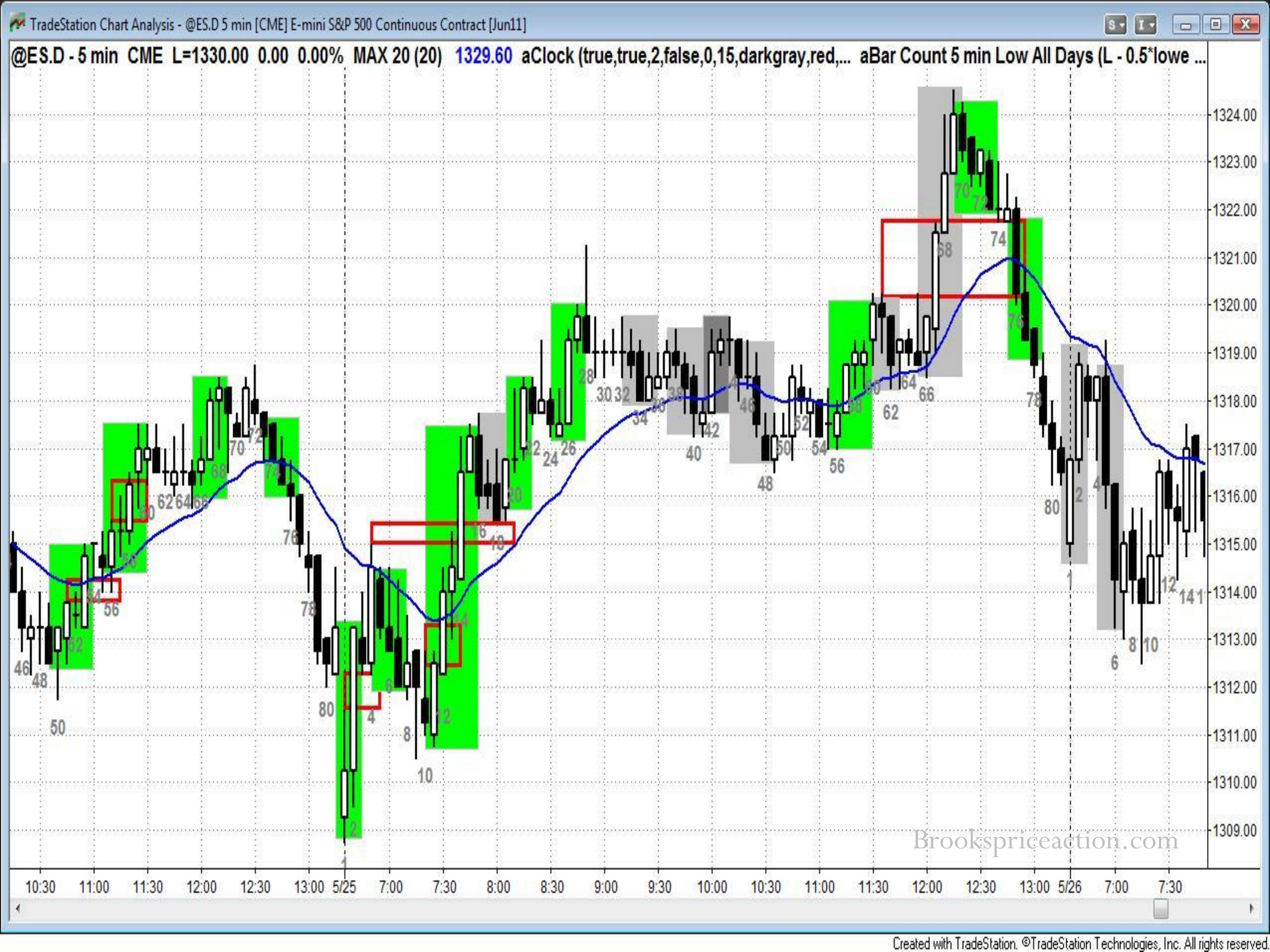
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The spike goes very far, lasts several bars, and breaks several resistance levels like the moving average, prior swing highs, and trend lines, and each by many ticks.


TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Jun11]
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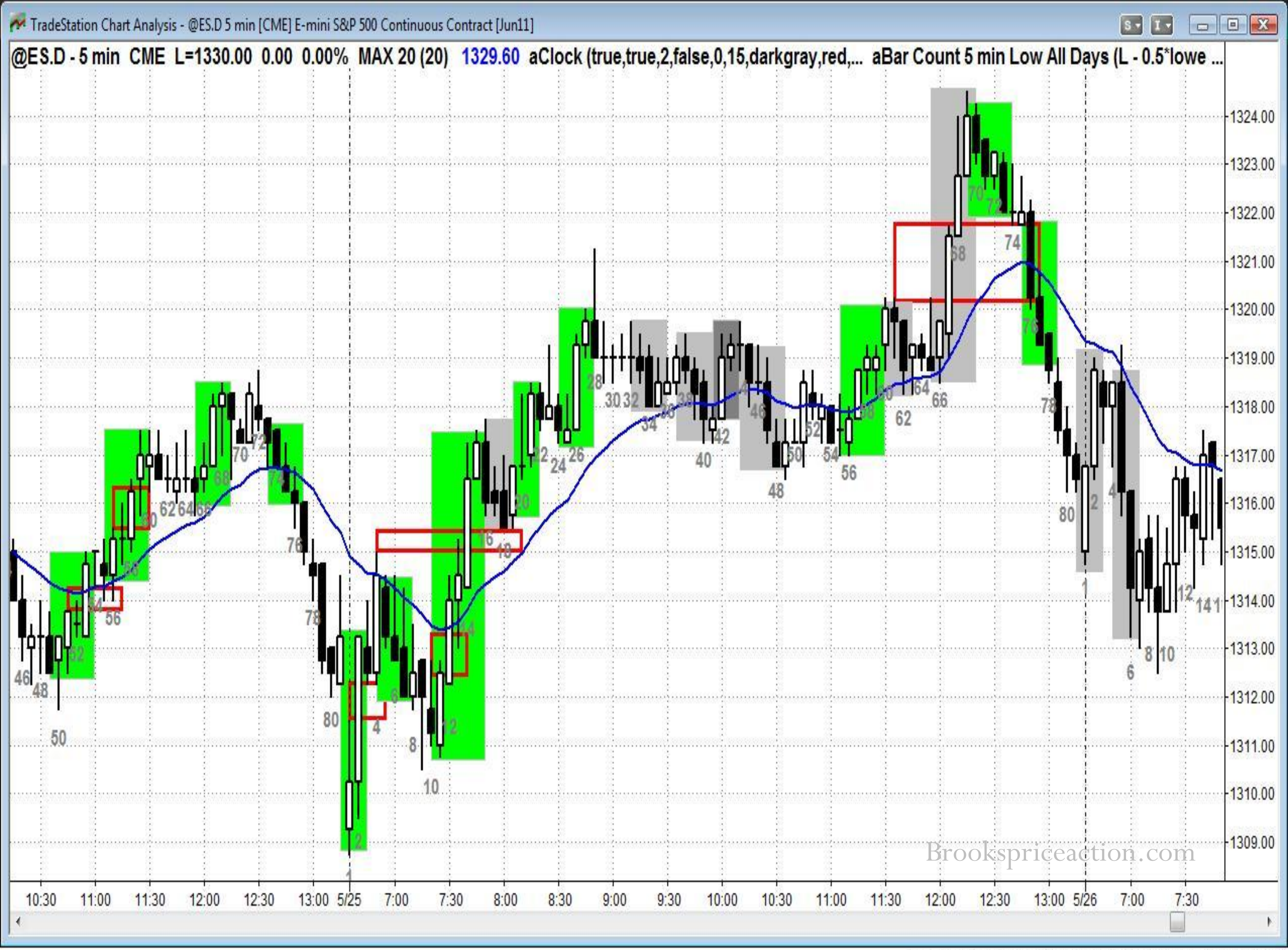
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- As the first bar of the breakout bar is forming, it spends most of its time near its high and the pullbacks are small (less than a quarter of the height of the growing bar).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Brookspriceaction.com
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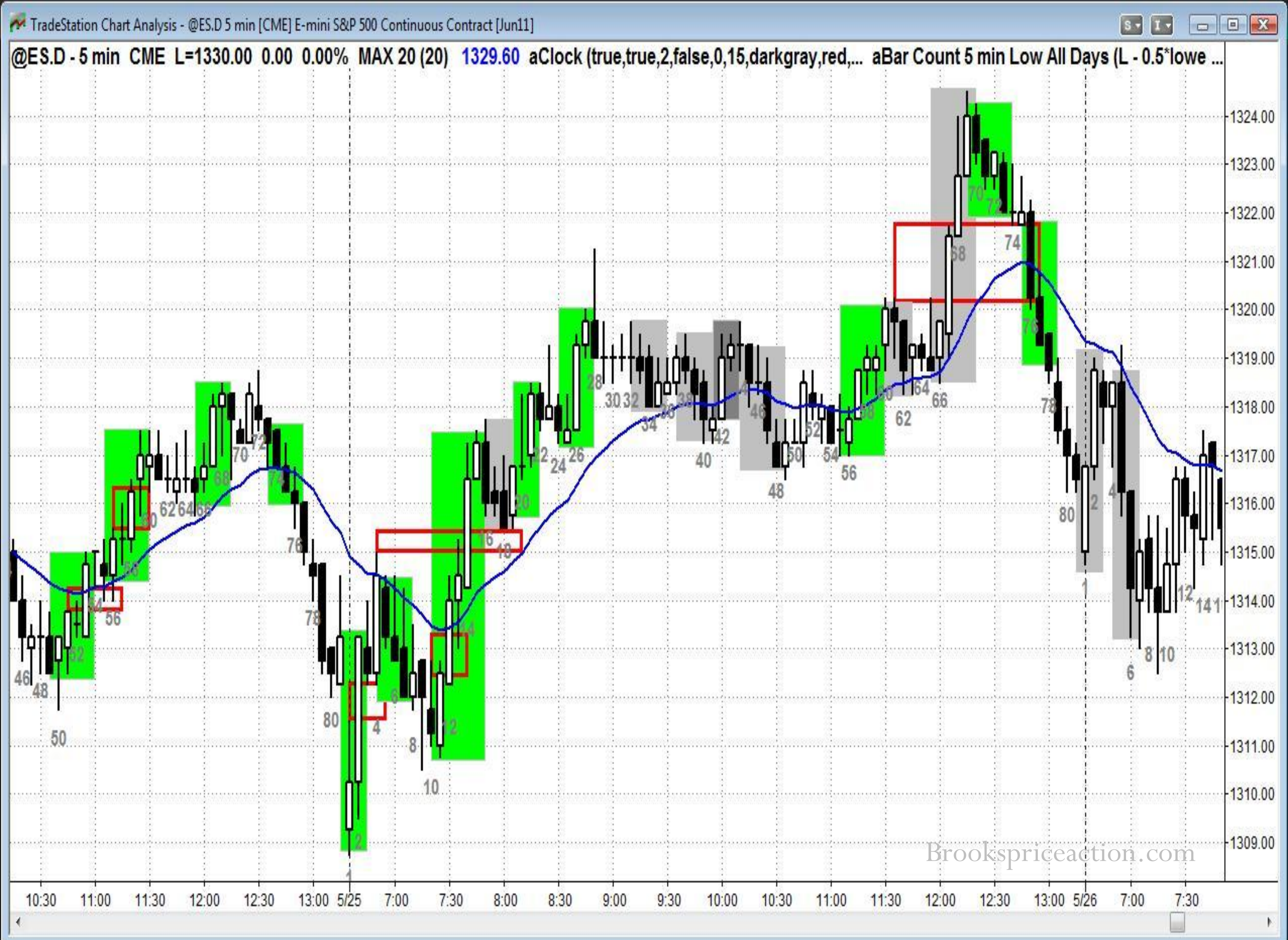
1324.00 1323.00 1322.00 1321.00 1320.00 1319.00 1318.00 1317.00 1316.00 1315.00 1314.00 1313.00 1312.00 1311.00 1310.00 1309.00

# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- There is a sense of urgency. You feel like you have to buy but you want a pullback, yet it never comes.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@ES.D - 5 min CME L=1330.00 0.00 0.00% MAX 20 (20) 1329.60 aClock (true,true,2,false,0,15,darkgray,red,... aBar Count 5 min Low All Days (L - 0.5*lowe ...
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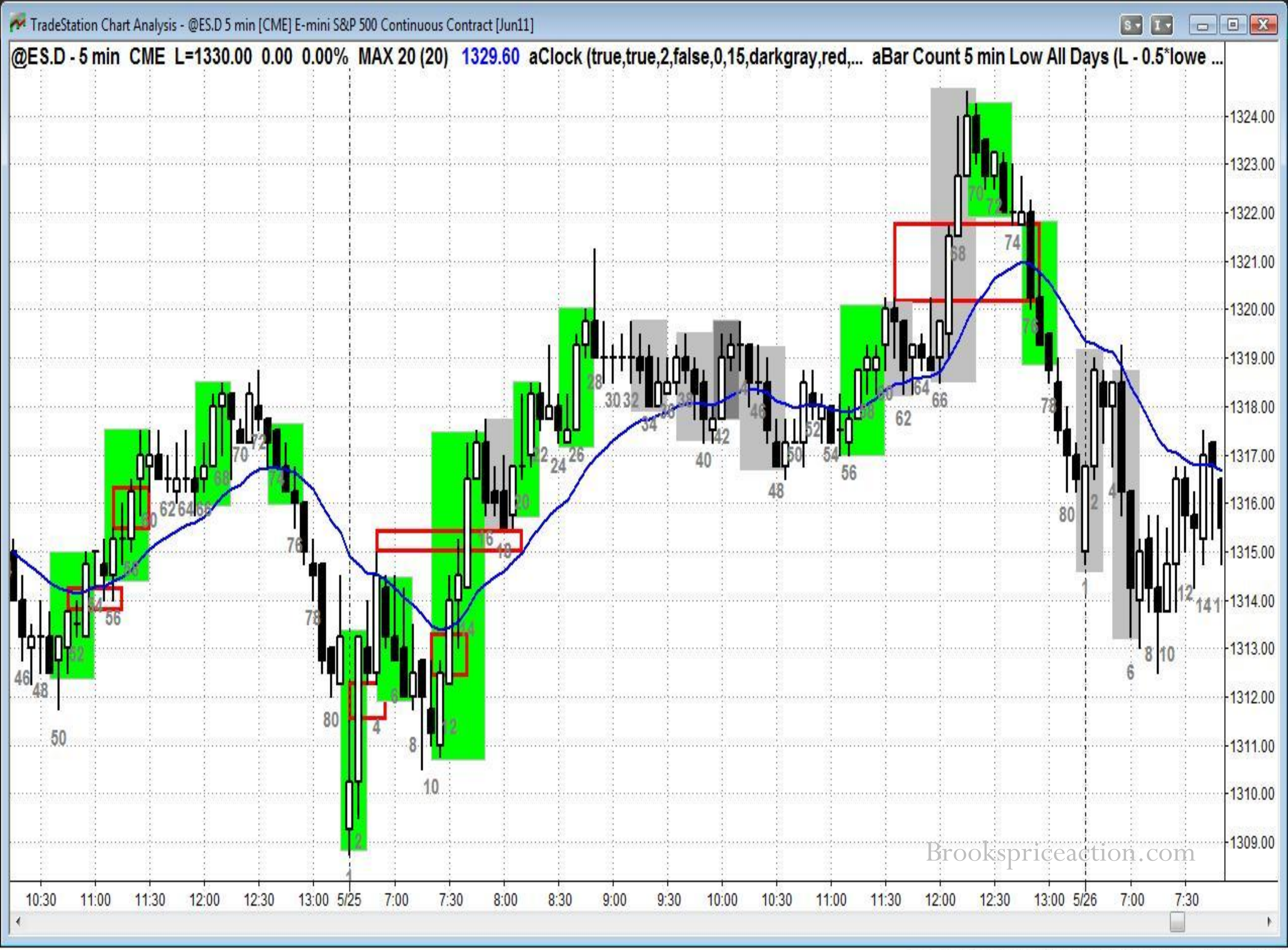
Brookspriceaction.com

# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The next two or three bars also have bull bodies that are at least the average size of the recent bull and bear bodies. Even if the bodies are relatively small and the tails are prominent, if the follow-through bar (the bar after the initial breakout bar) is large, the odds of the trend continuing are greater.



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@ES.D - 5 min CME L=1330.00 0.00 0.00% MAX 20 (20) 1329.60 aClock (true,true,2,false,0,15,darkgray,red,... aBar Count 5 min Low All Days (L - 0.5*lowe ...
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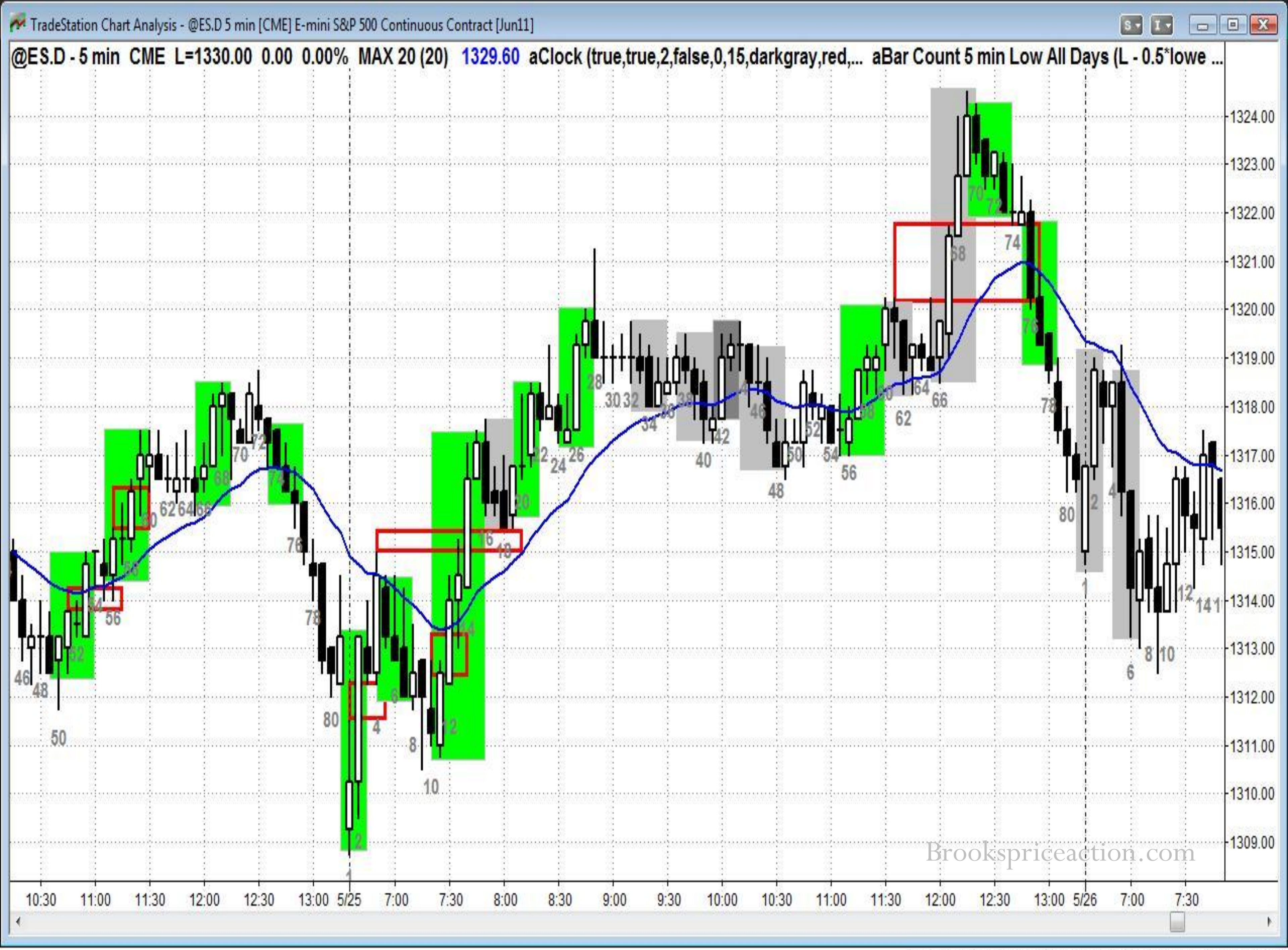
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The spike grows to five to ten bars without pulling back for more than a bar or so.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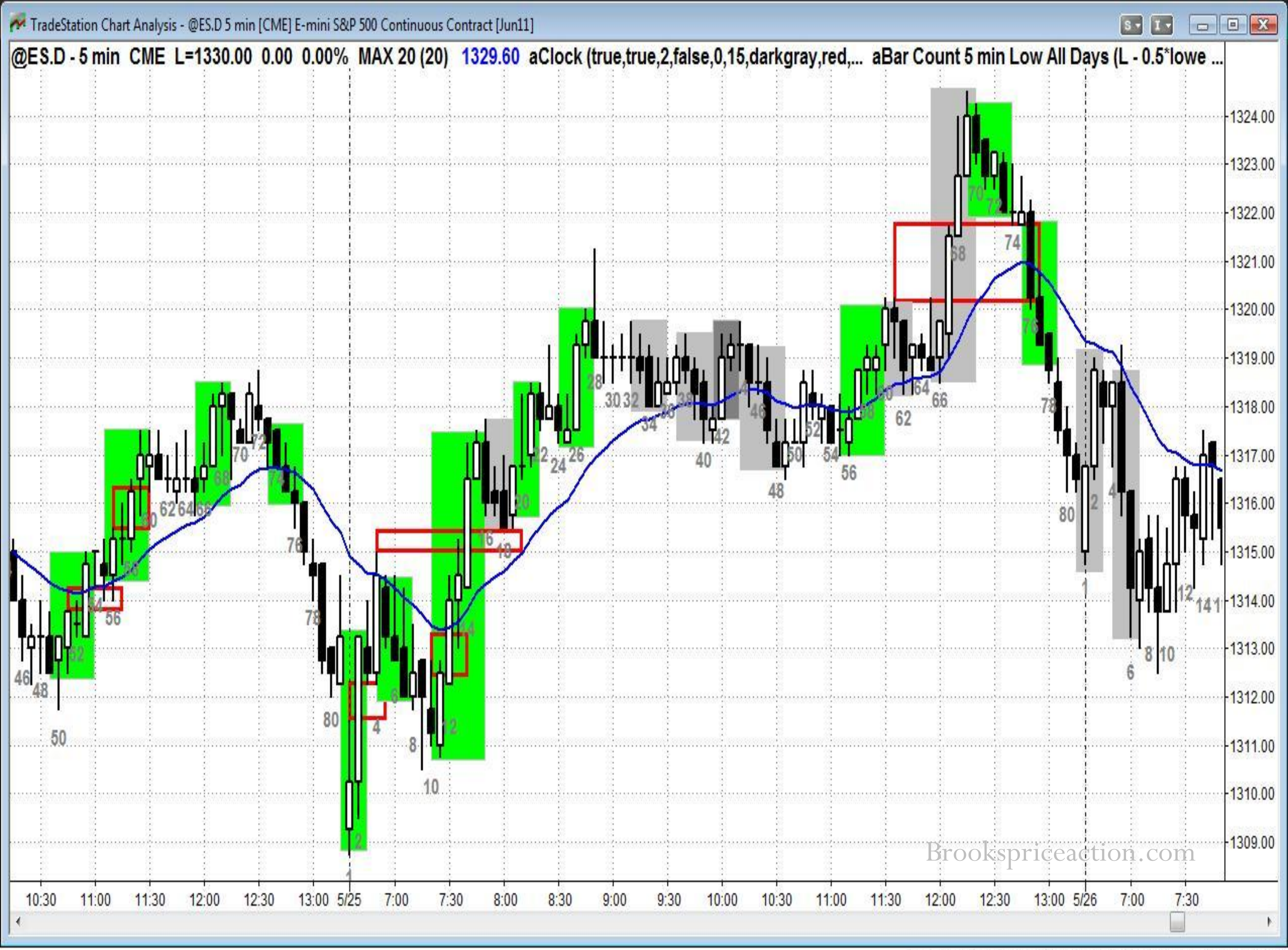
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- As a bull breakout goes above a prior significant swing high, the move above the high goes far enough for a scalper to make a profit if he entered on a stop at one tick above that swing high.



TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Jun11]
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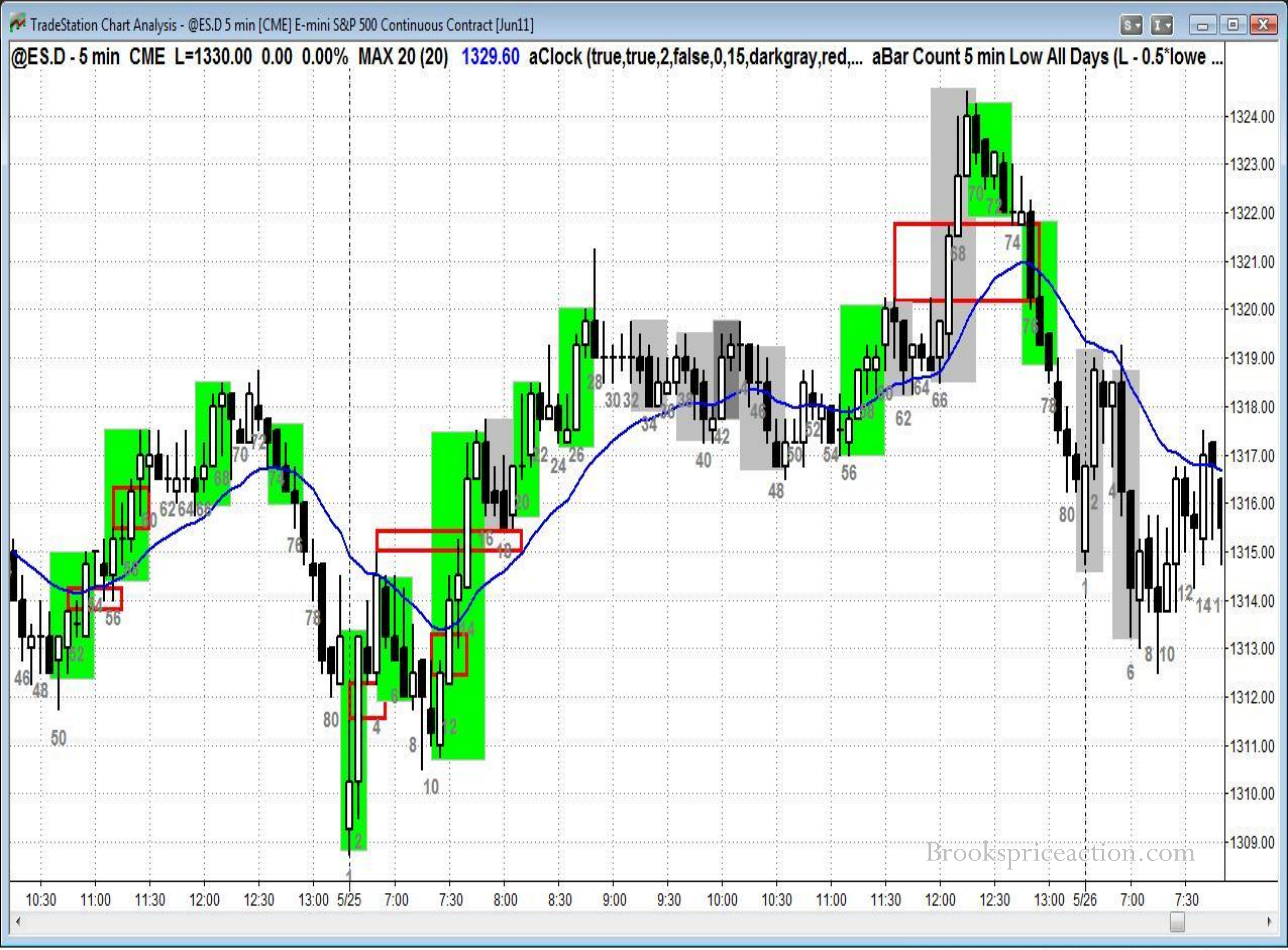
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- One or more bars in the spike has a low that is at or just one tick below the close of the prior bar.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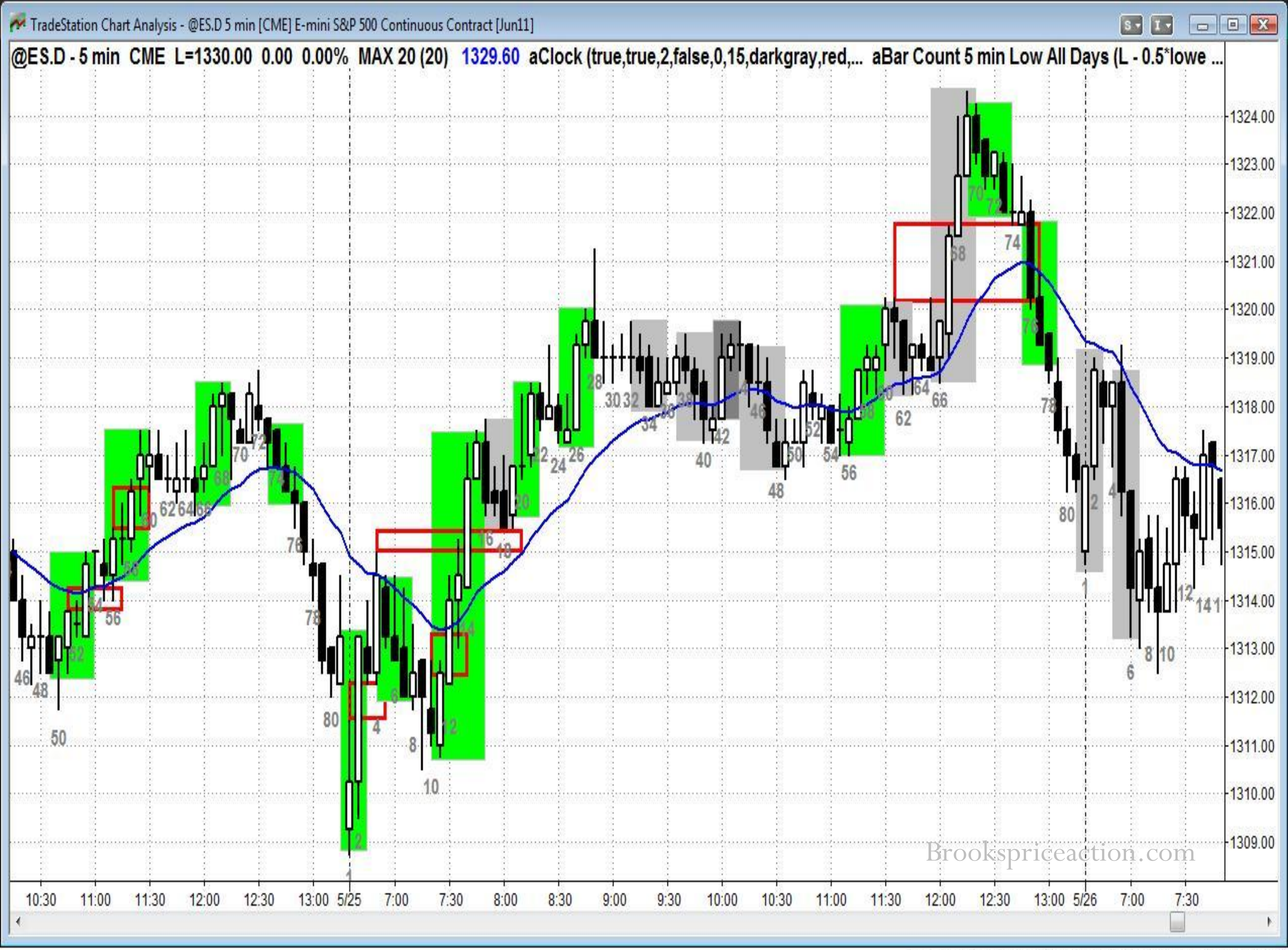
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- One or more bars in the spike has an open that is above the close of the prior bar.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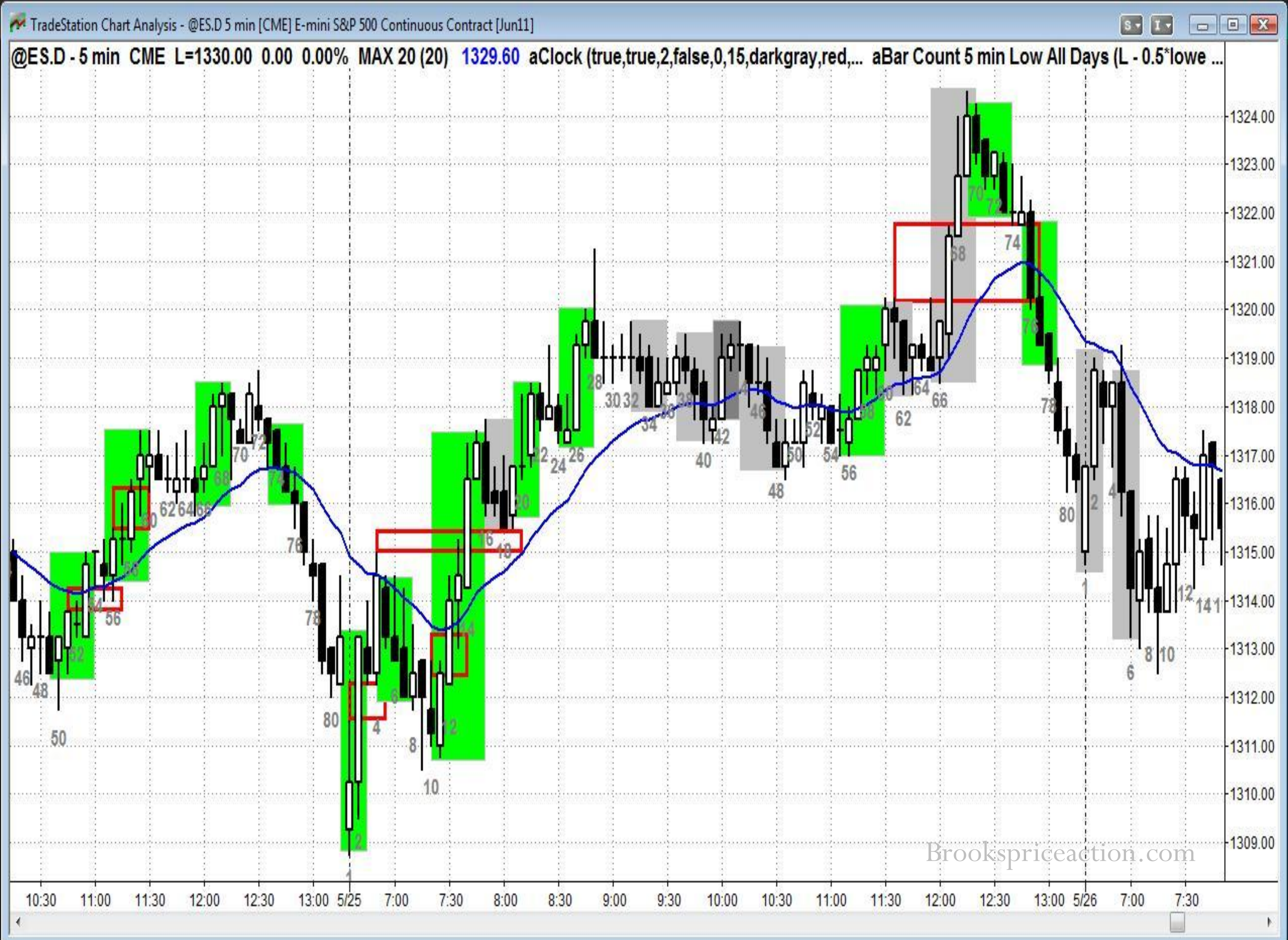
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- One or more bars in the spike has a close on its high or just one tick below its high.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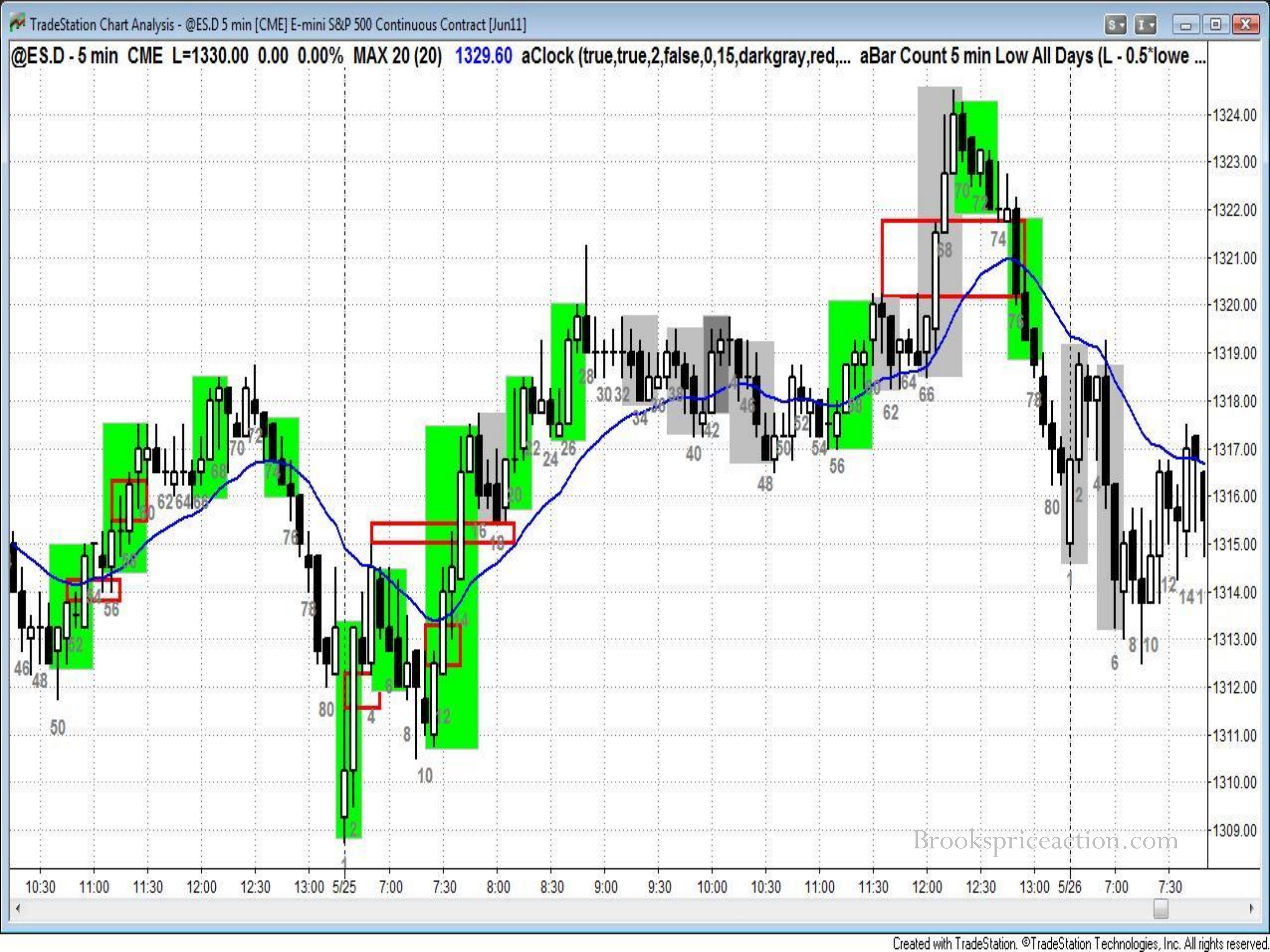
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The low of the bar after a bull trend bar is at or above the high of the bar before the bull trend bar, creating a micro gap, which is a sign of strength. These gaps sometimes become measuring gaps. Although it is not significant to trading, they probably represent the space between a smaller time frame Elliott wave 1 high and a wave 4 pullback, which can touch but not overlap.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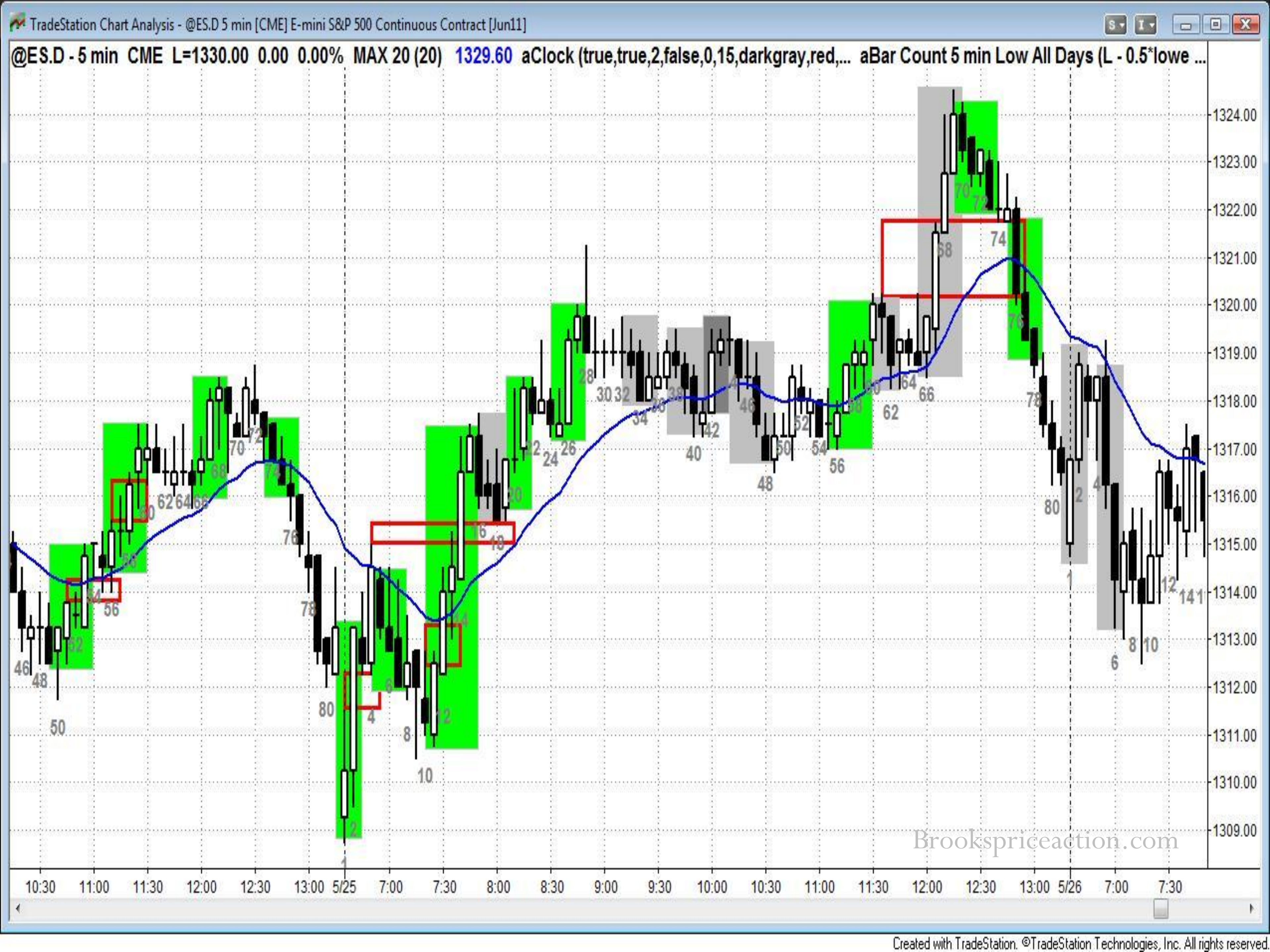
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The overall context makes a breakout likely, like the resumption of a trend after a pullback, or a higher low or lower low test of the bear low after a strong break above the bear trend line.
- The market has had several strong bull trend days recently.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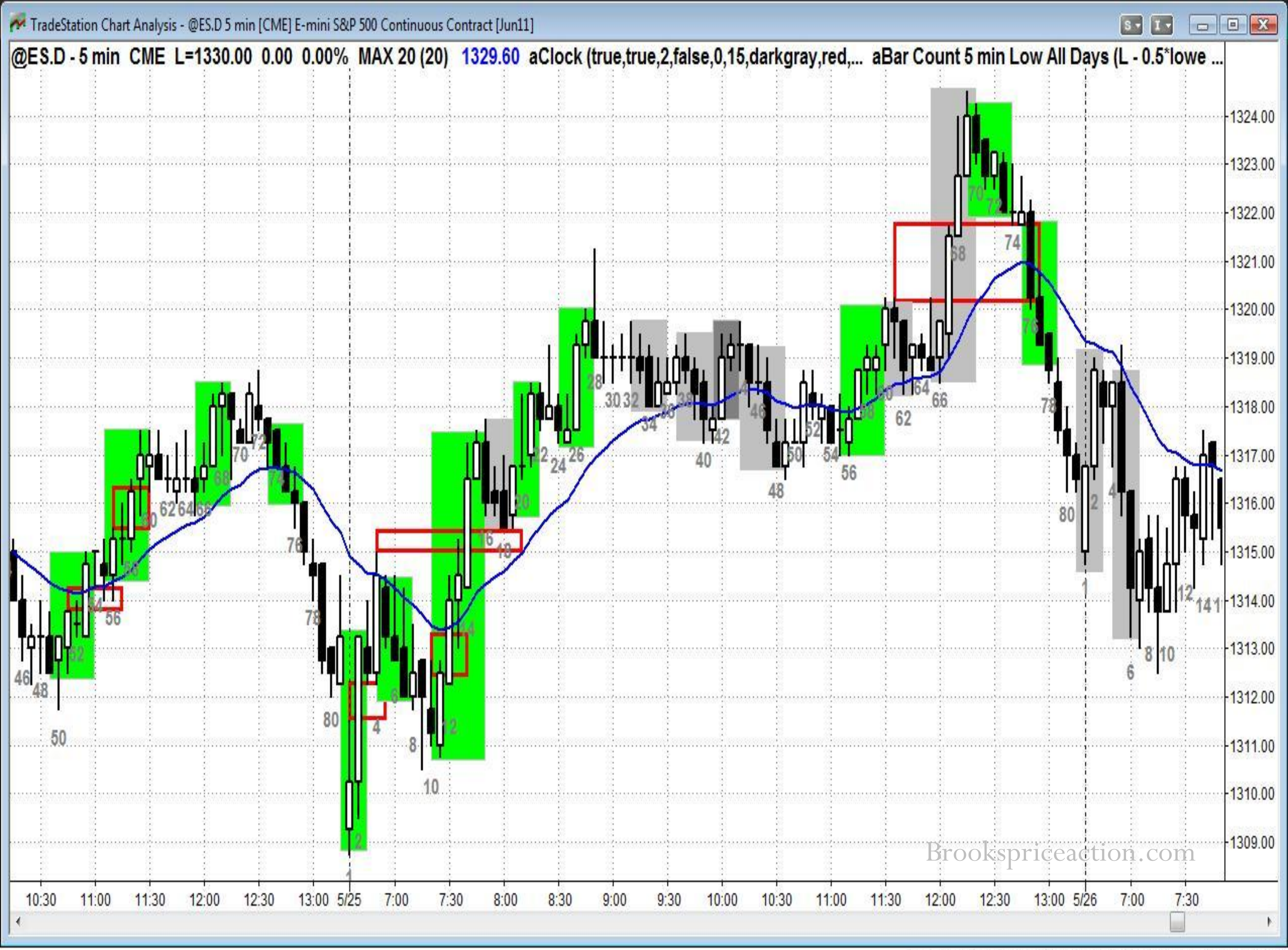
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- There was growing buying pressure in the trading range, represented by many large bull trend bars and the bull trend bars were clearly more prominent than the bear trend bars in the range.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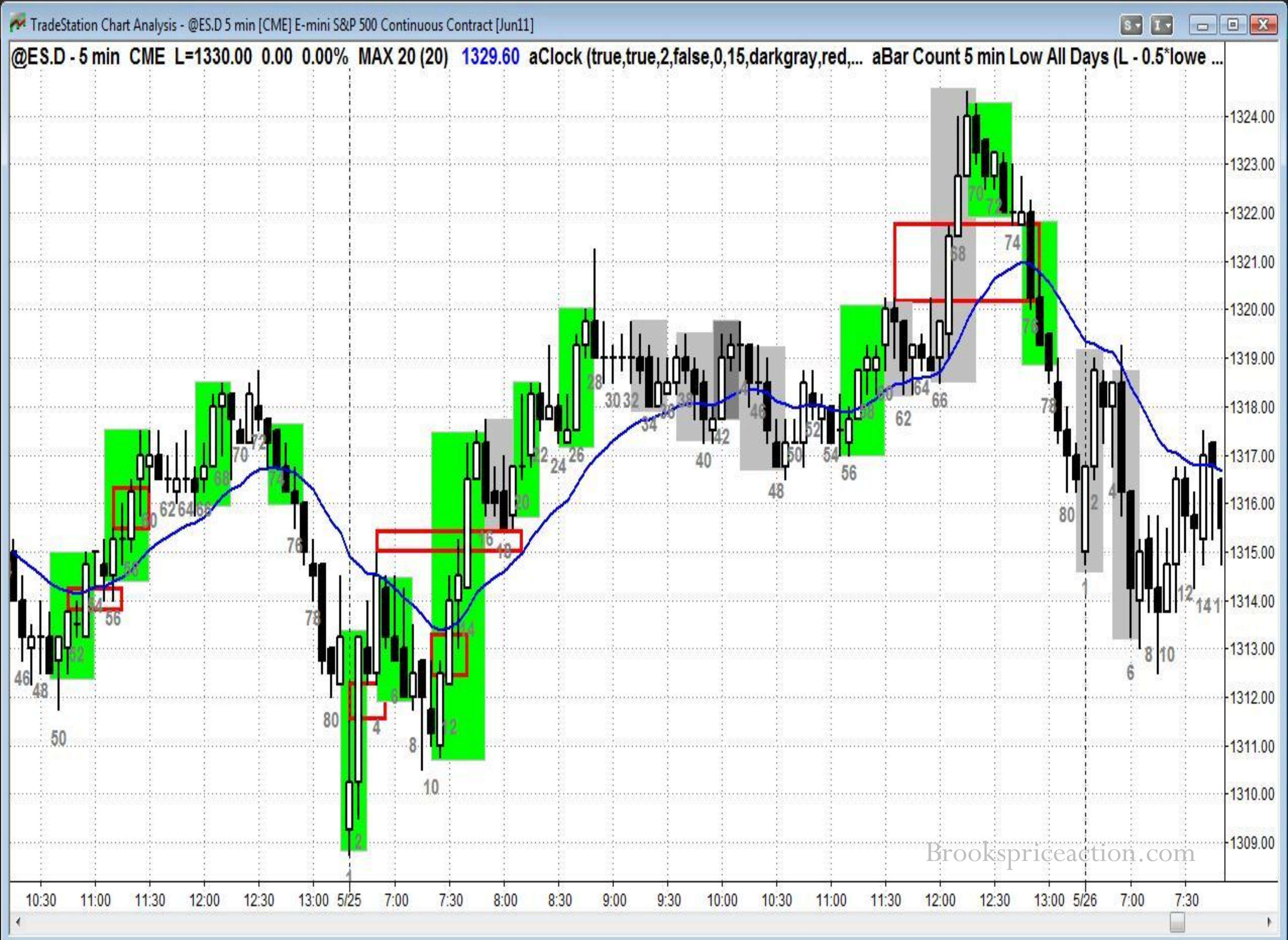
## The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The first pullback occurs only after three or more bars of breaking out.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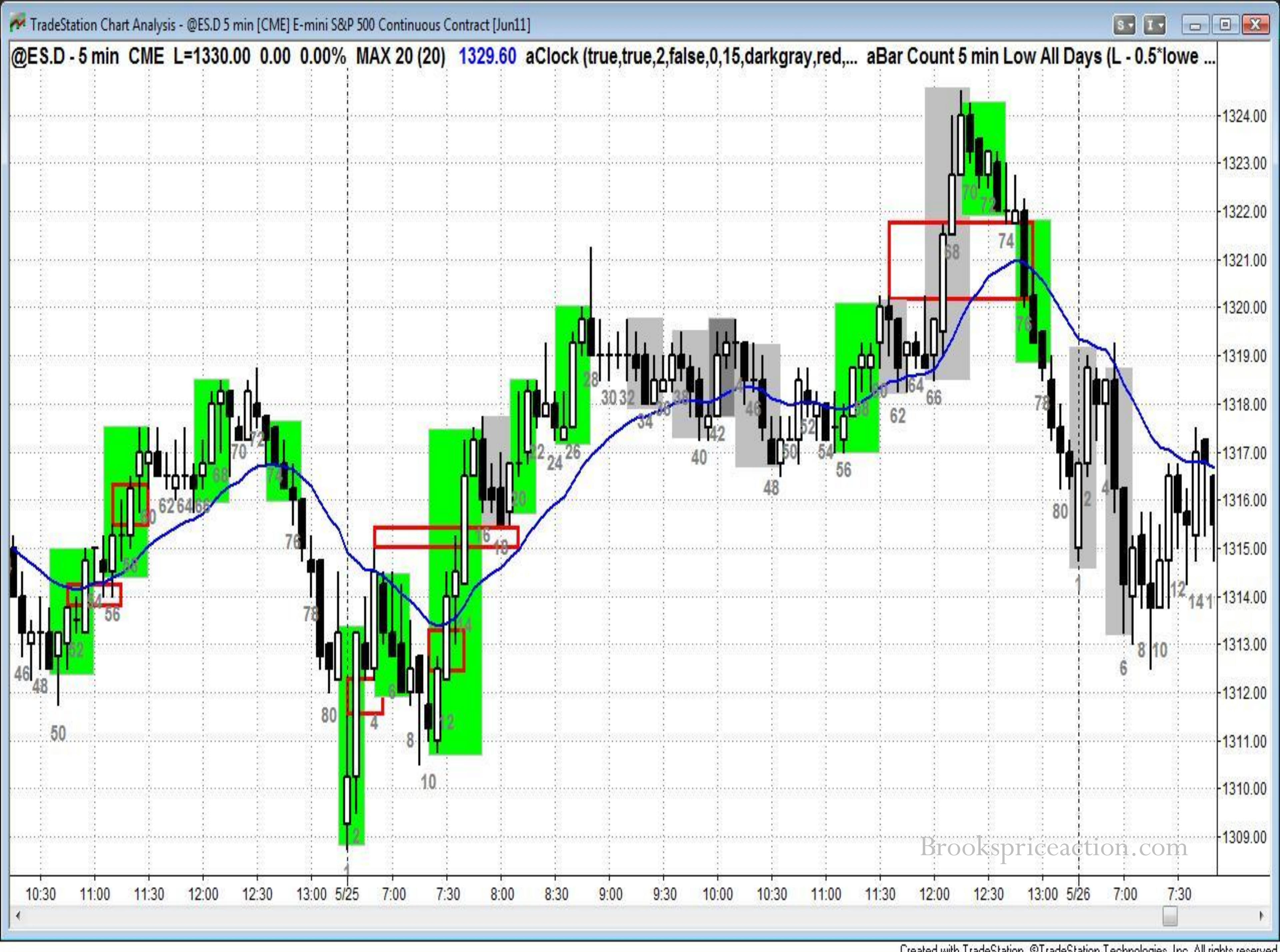
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The first pullback lasts only one or two bars and it follows a bar that is not a strong bear reversal bar.



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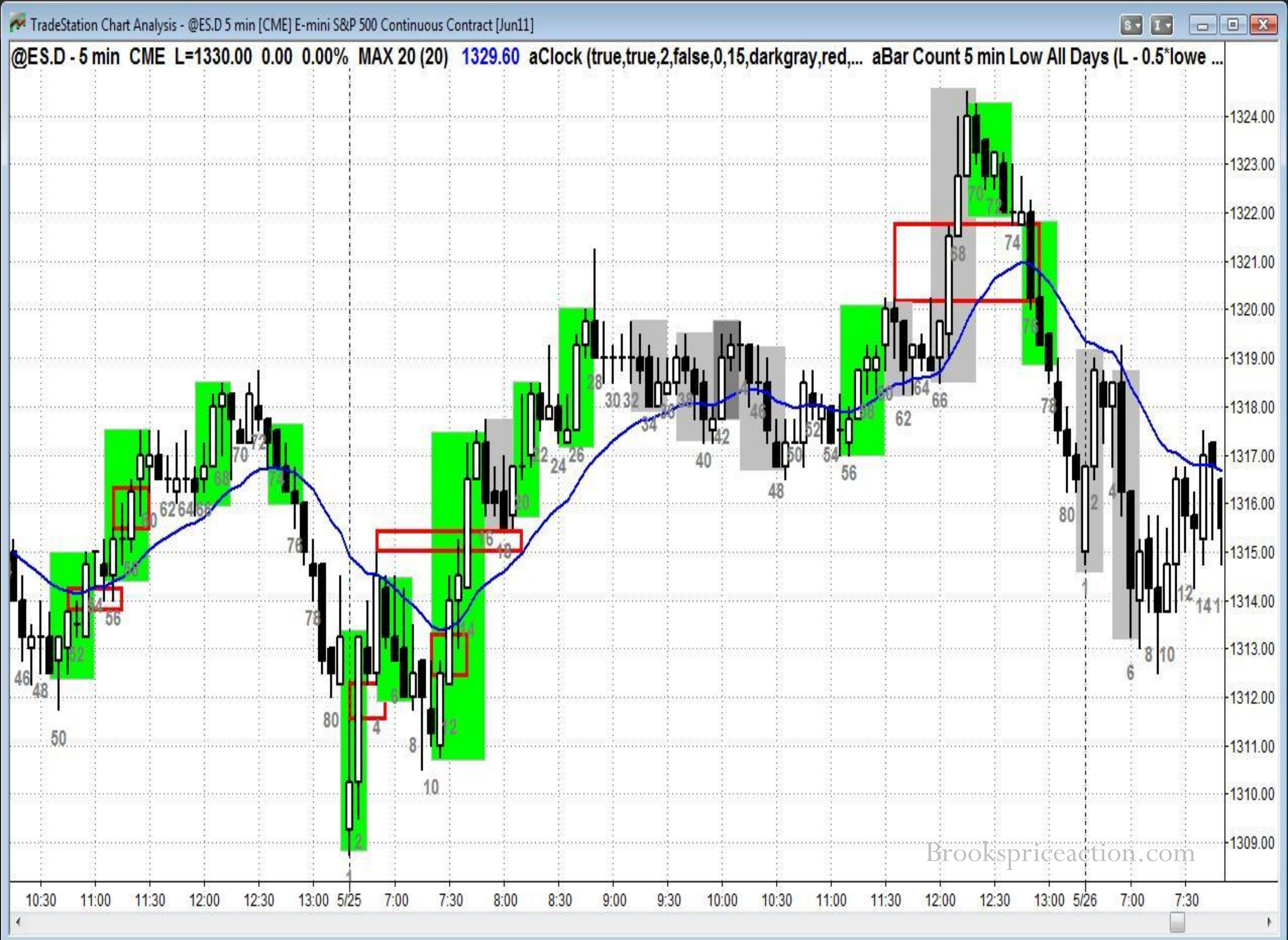
# The more of the following characteristics that a bull breakout has, the more likely the breakout will be strong:

- The first pullback does not reach the breakout point and does not hit a breakeven stop (the entry price).


TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Jun11]
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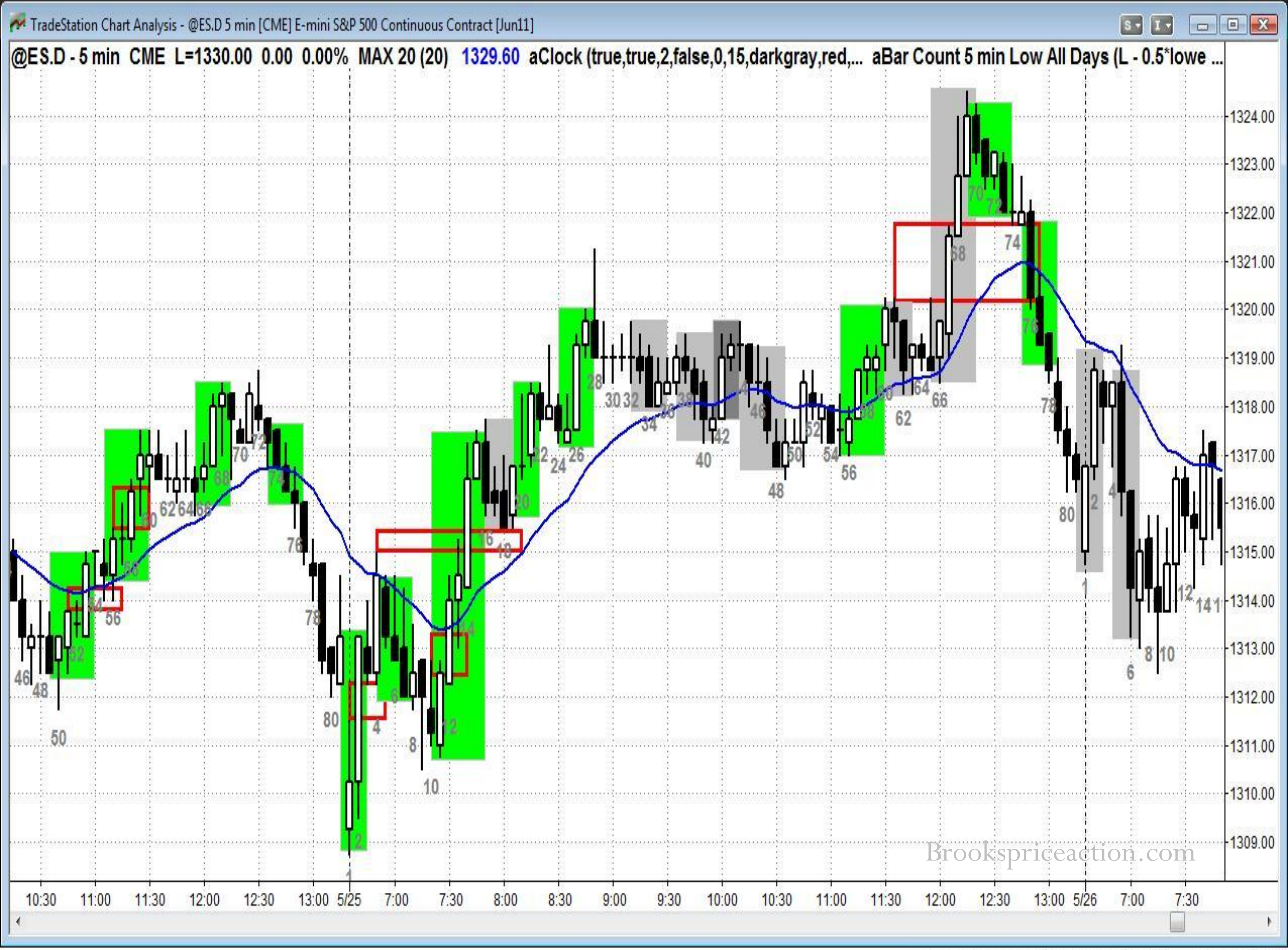
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The breakout bar has a small or average size bull trend body and a large tail on top.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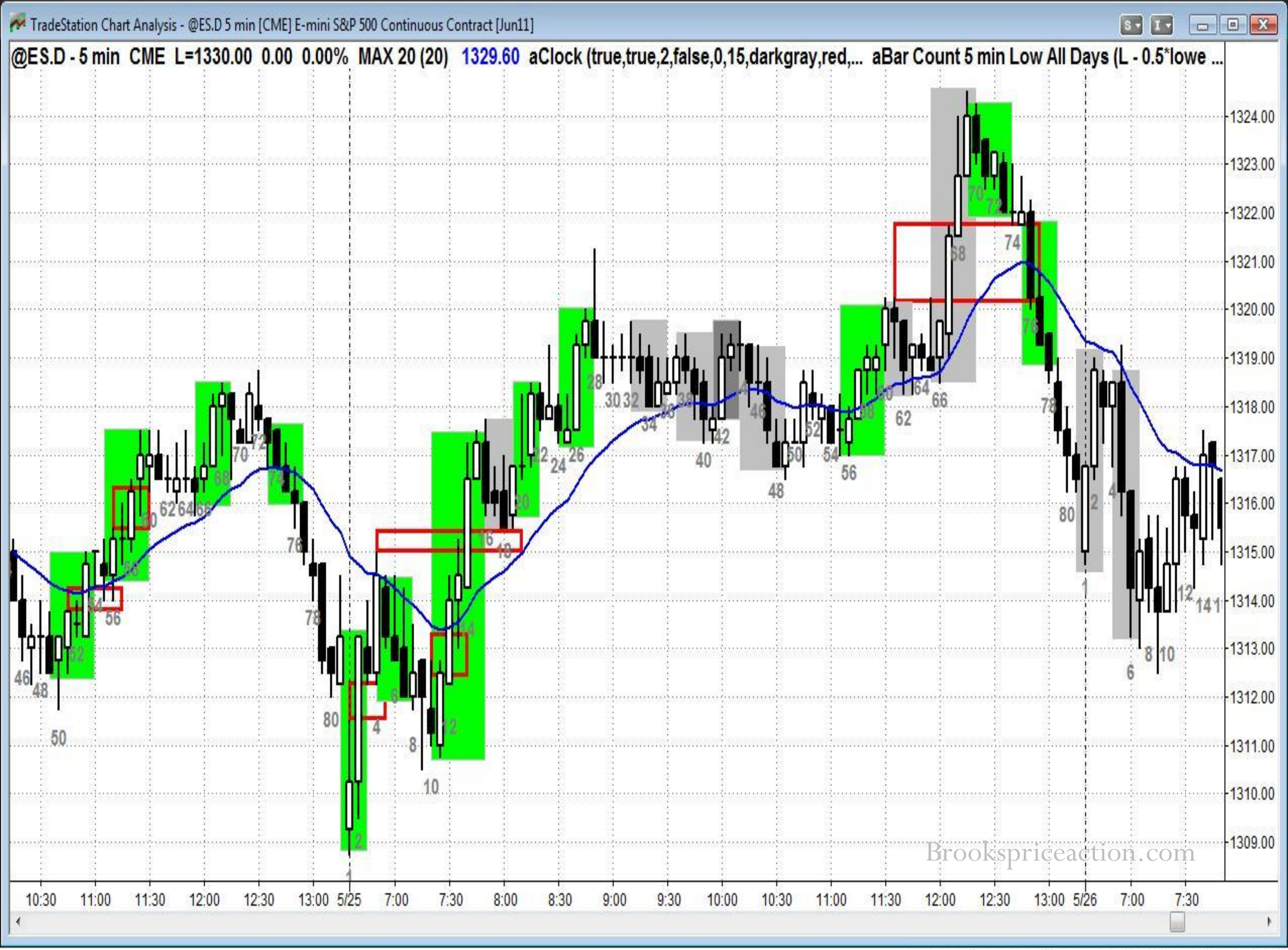
## The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The next bar has a bear body and is either a bear reversal bar or a bear inside bar, and that bar closes on or near its low and the body is about the size of the average bodies of the bars before the breakout (not just a one tick tall bear body).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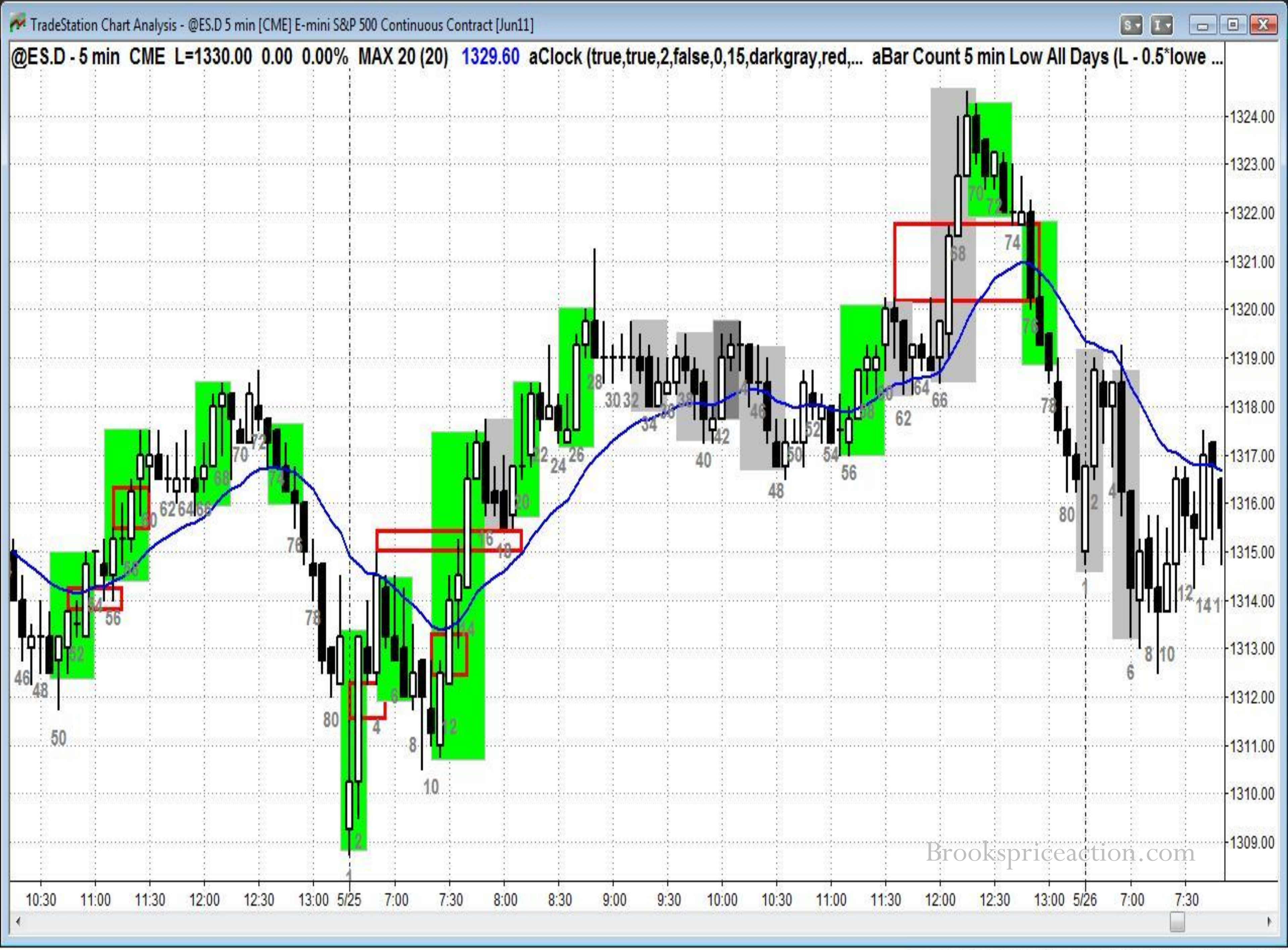
Brookspriceaction.com

# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The overall context makes a breakout unlikely, like a rally to test the high of a trading range day, but the rally has bear bars, many overlapping bars, bars with prominent tails, and a couple of pullbacks along the way.
- The market has been in a trading range for several days.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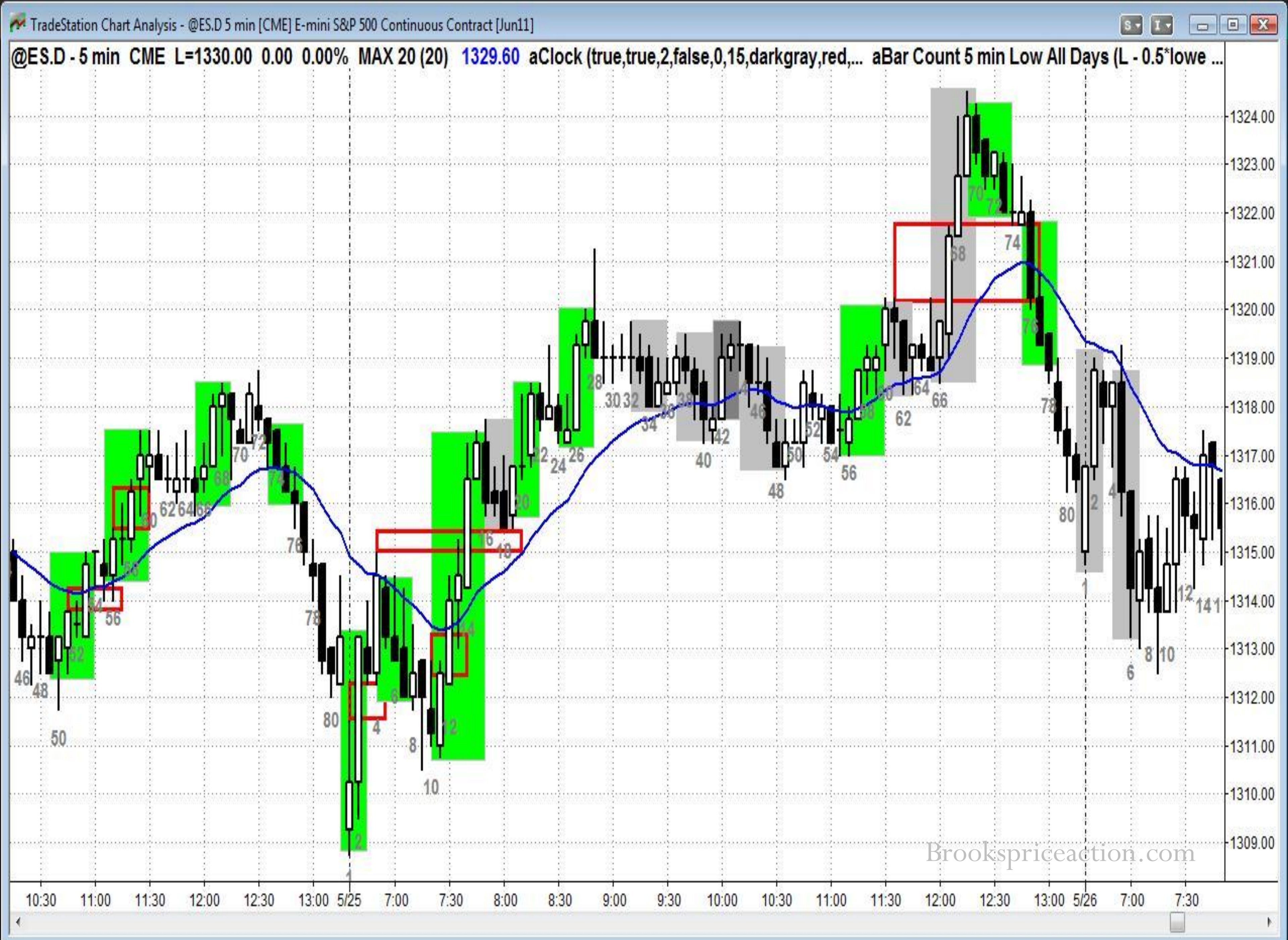
## The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The bar after the breakout bar is a strong bear reversal bar or a bear inside bar.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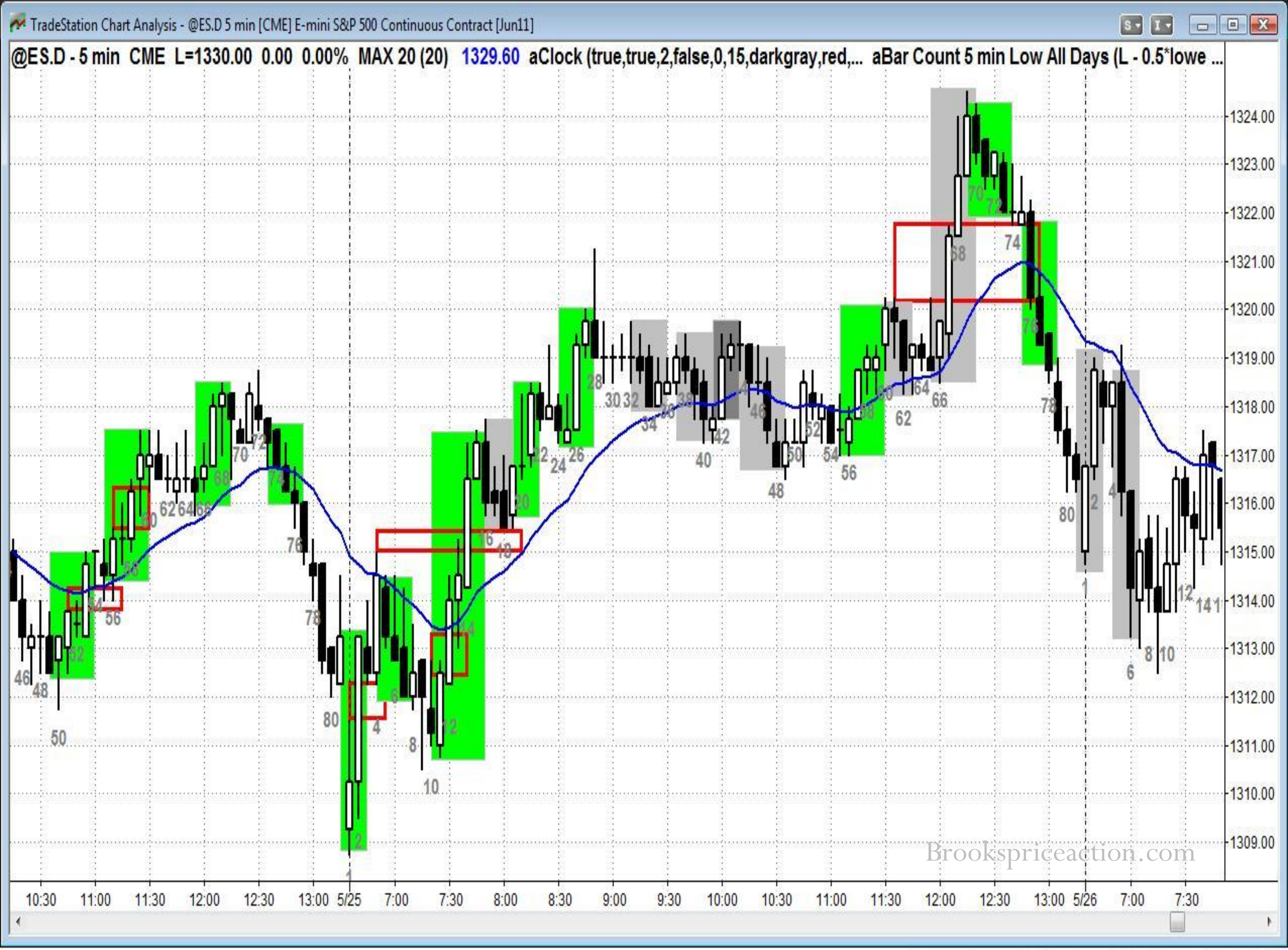
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The bar after a bull trend bar has a low that is below the high of the bar before the bull trend bar.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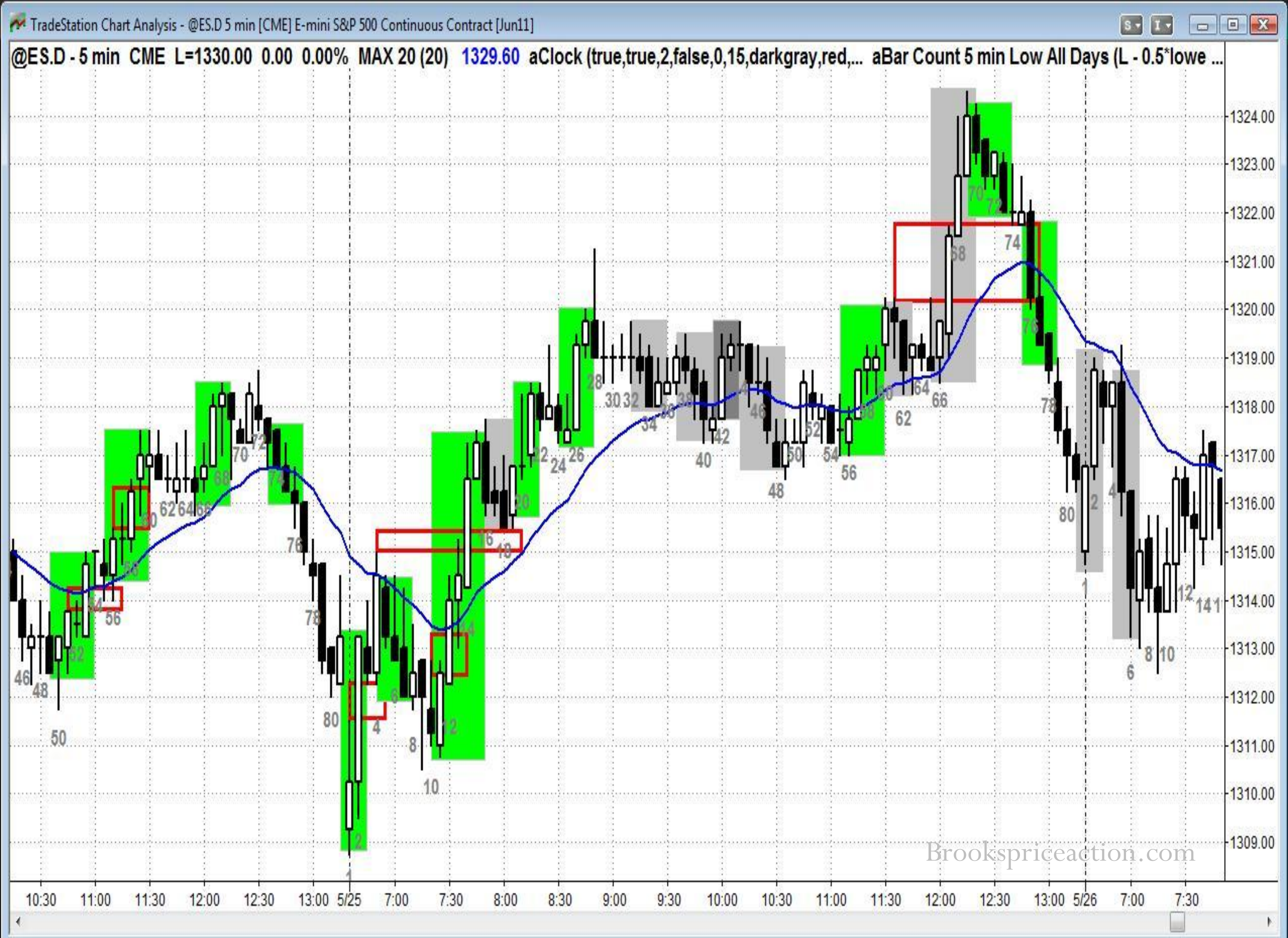
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The first pullback occurs two bars after the reversal.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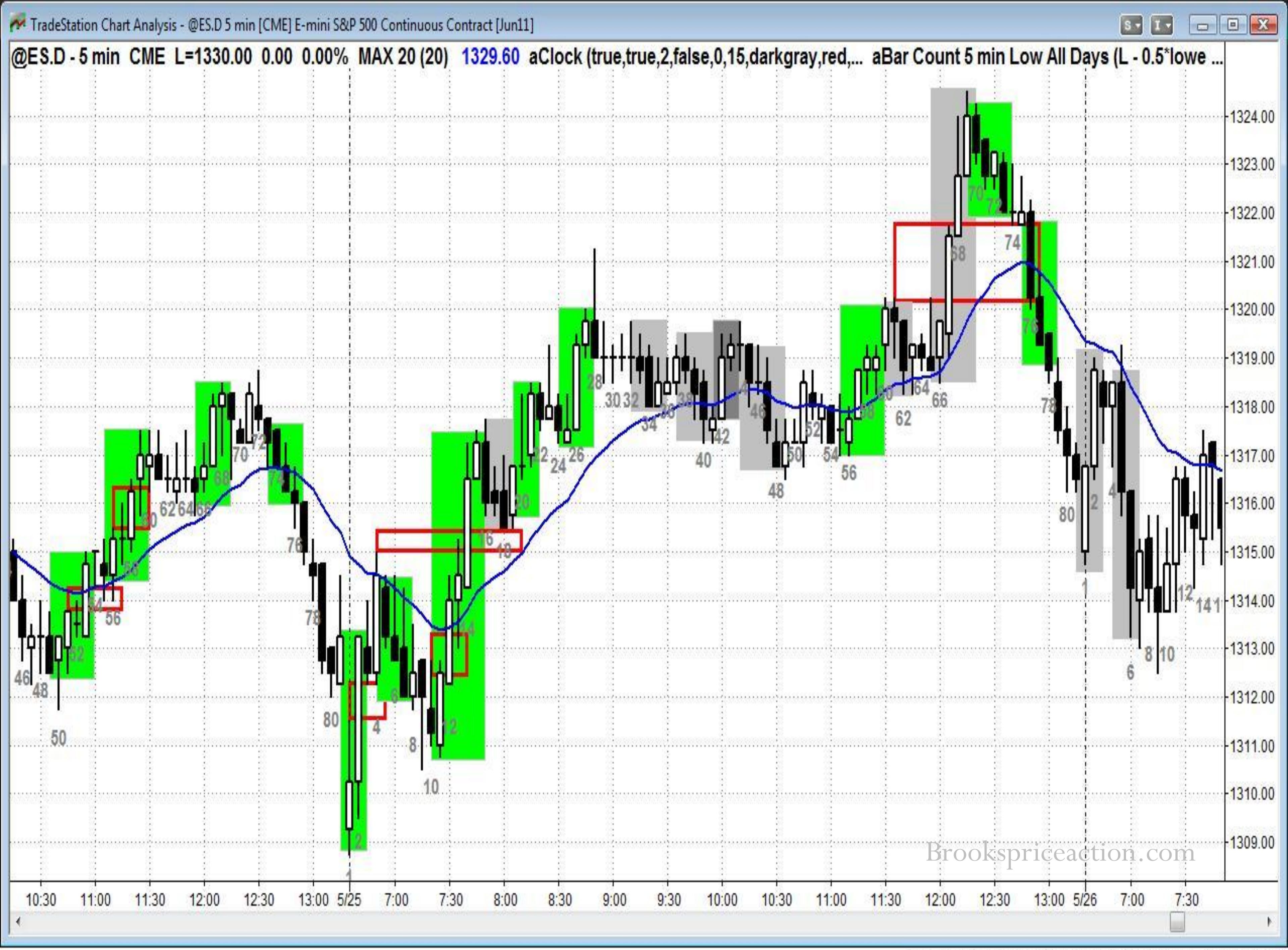
The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The pullback extends for several bars.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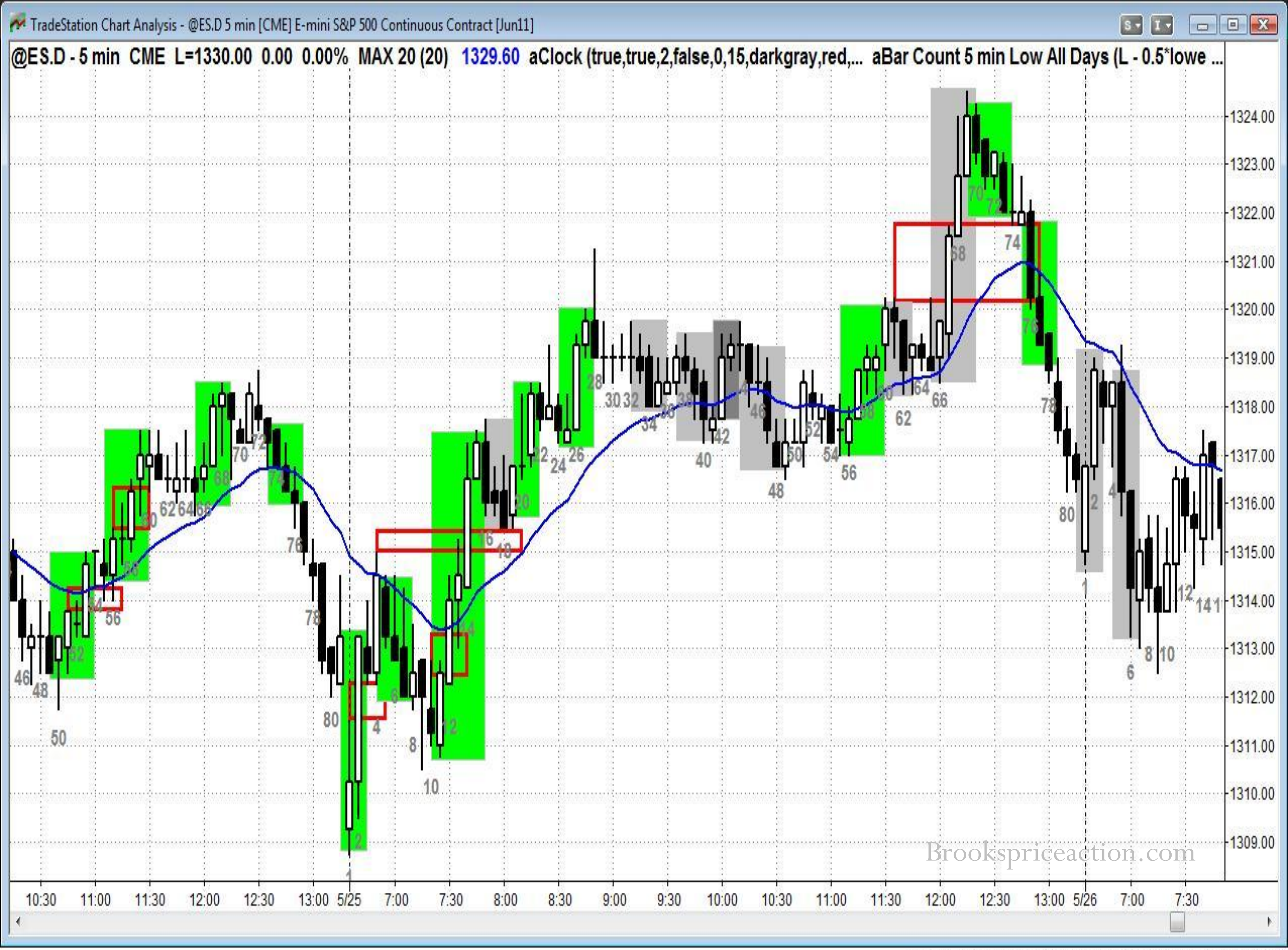
## The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The trend resumption after the pullback stalls and the market forms a lower high with a bear signal bar.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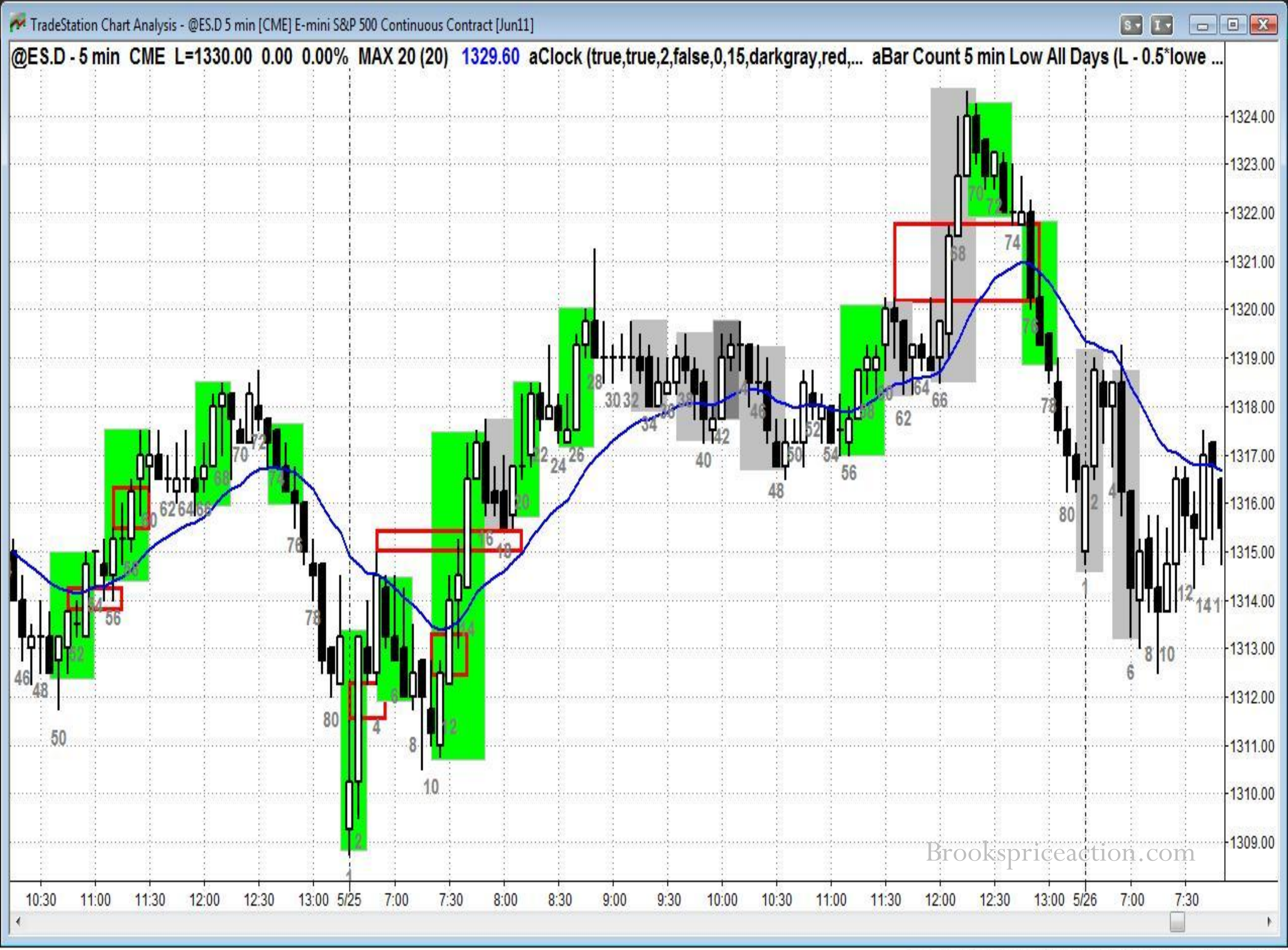
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The spike breaks above a resistance level like a swing high, a bear trend line, or a bull trend channel line by only a tick or so and then reverses down.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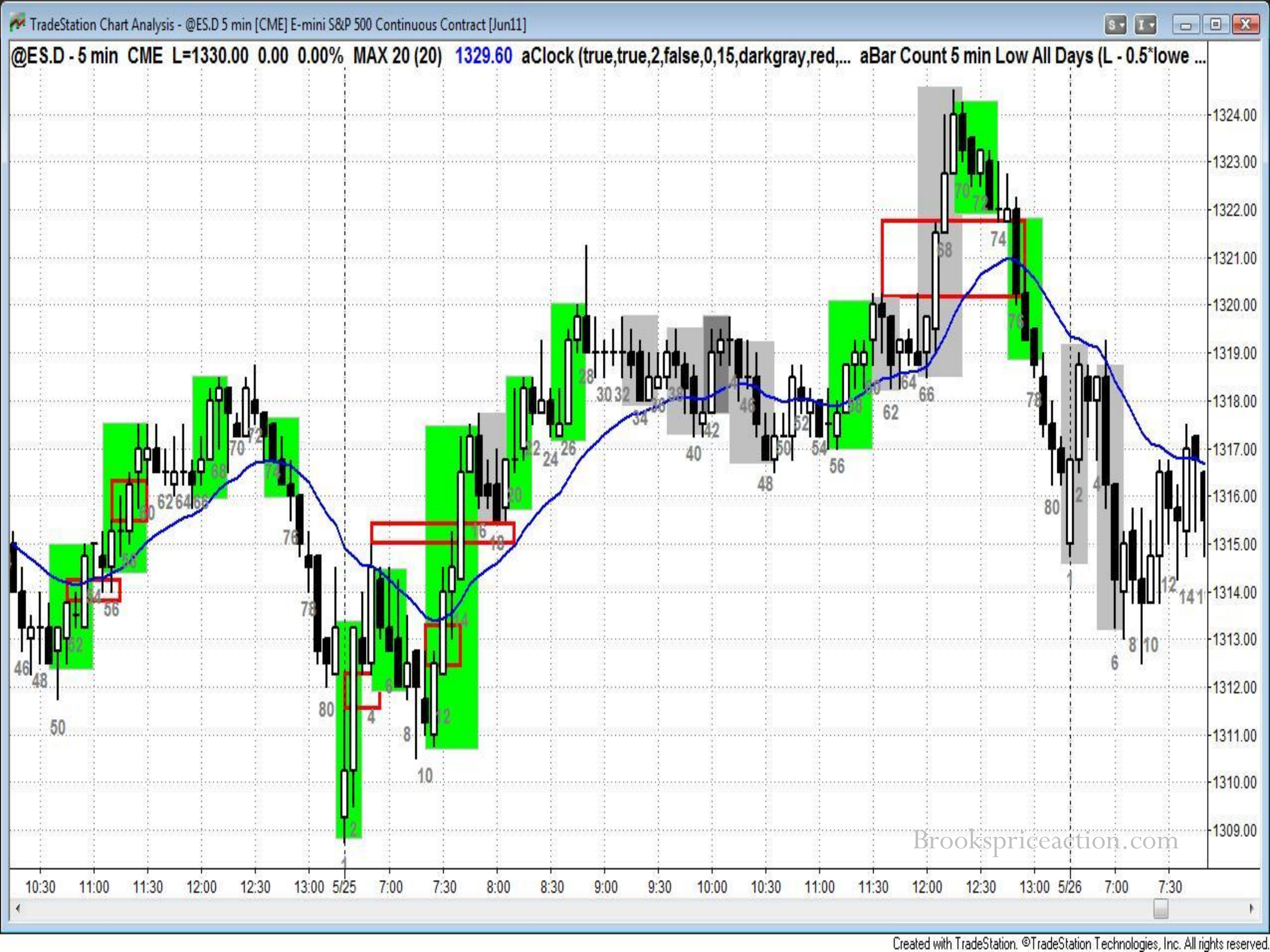
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The spike barely breaks above a single resistance level but pulls back before breaking above other levels that are just a little higher.


TradeStation Chart Analysis - @ES.D 5 min [CME] E-mini S&P 500 Continuous Contract [Jun11]
@ES.D - 5 min CME L=1330.00 0.00 0.00% MAX 20 (20) 1329.60 aClock (true,true,2,false,0,15,darkgray,red,... aBar Count 5 min Low All Days (L - 0.5*lowe ...
Brookspriceaction.com
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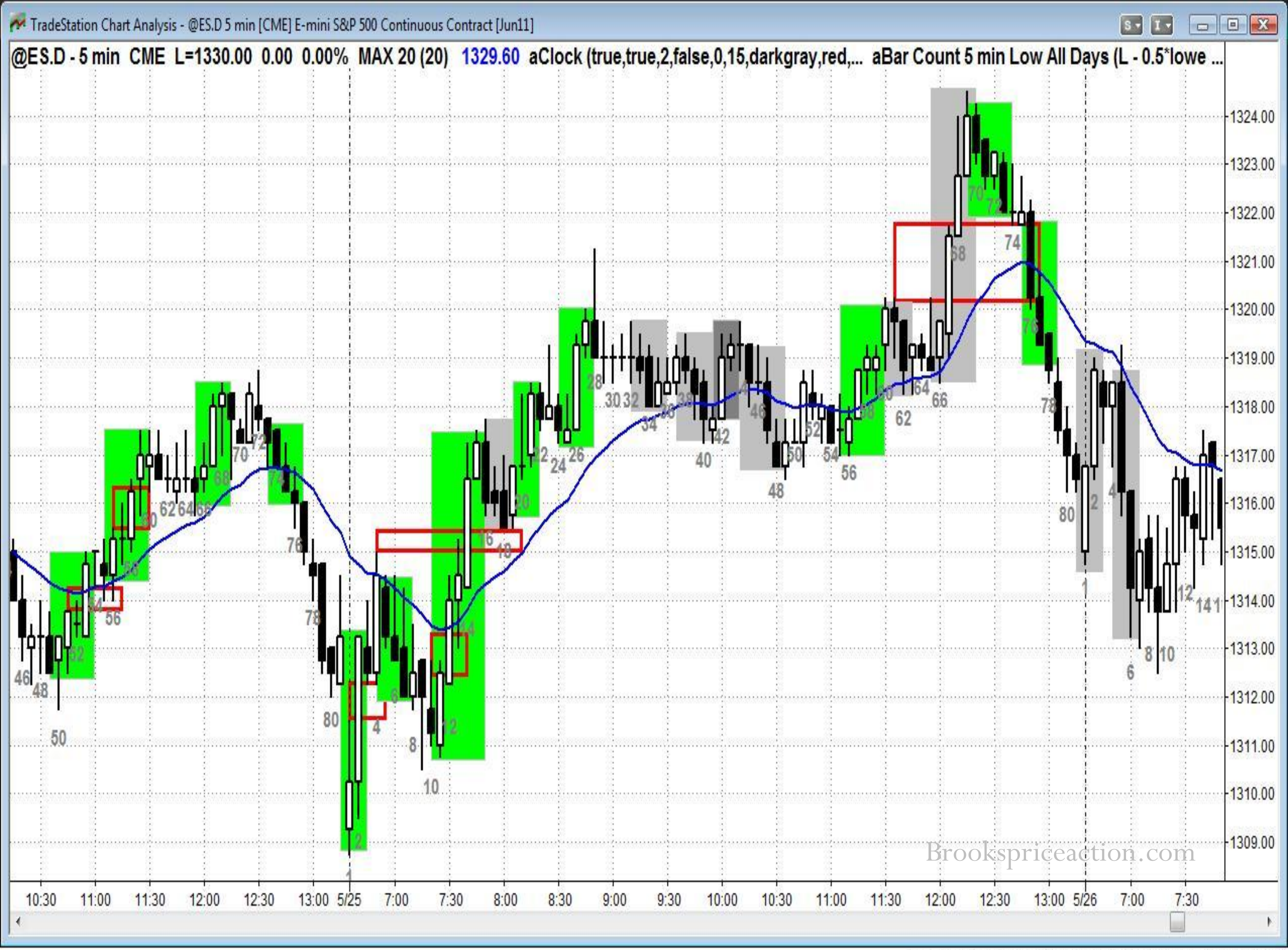
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- A trader who bought on a stop above a prior swing high would not be able to make a scalper's profit before there was a pullback.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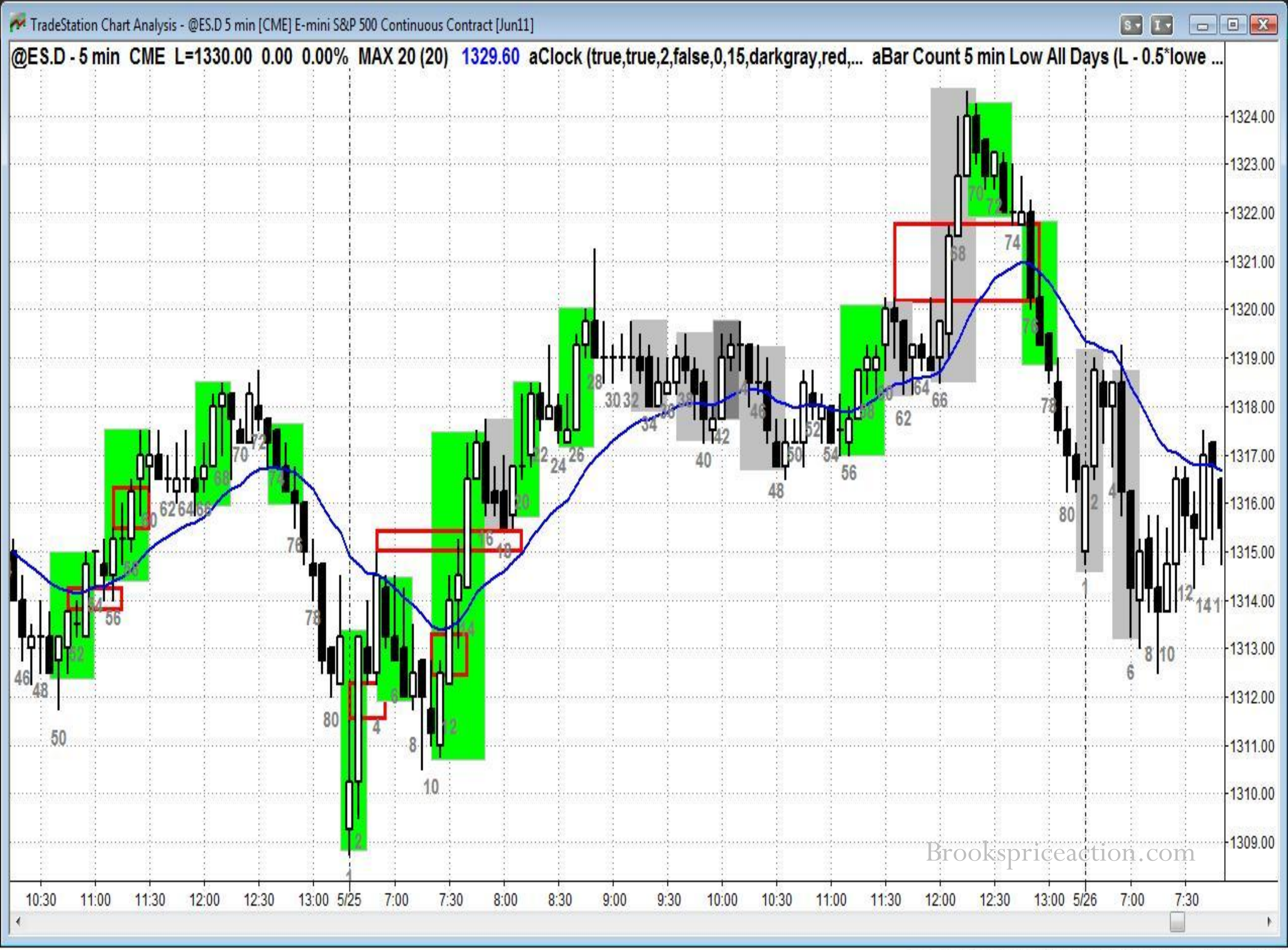
Brookspriceaction.com

# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- As the breakout bar is forming, it pulls back more than two thirds of the height of the bar.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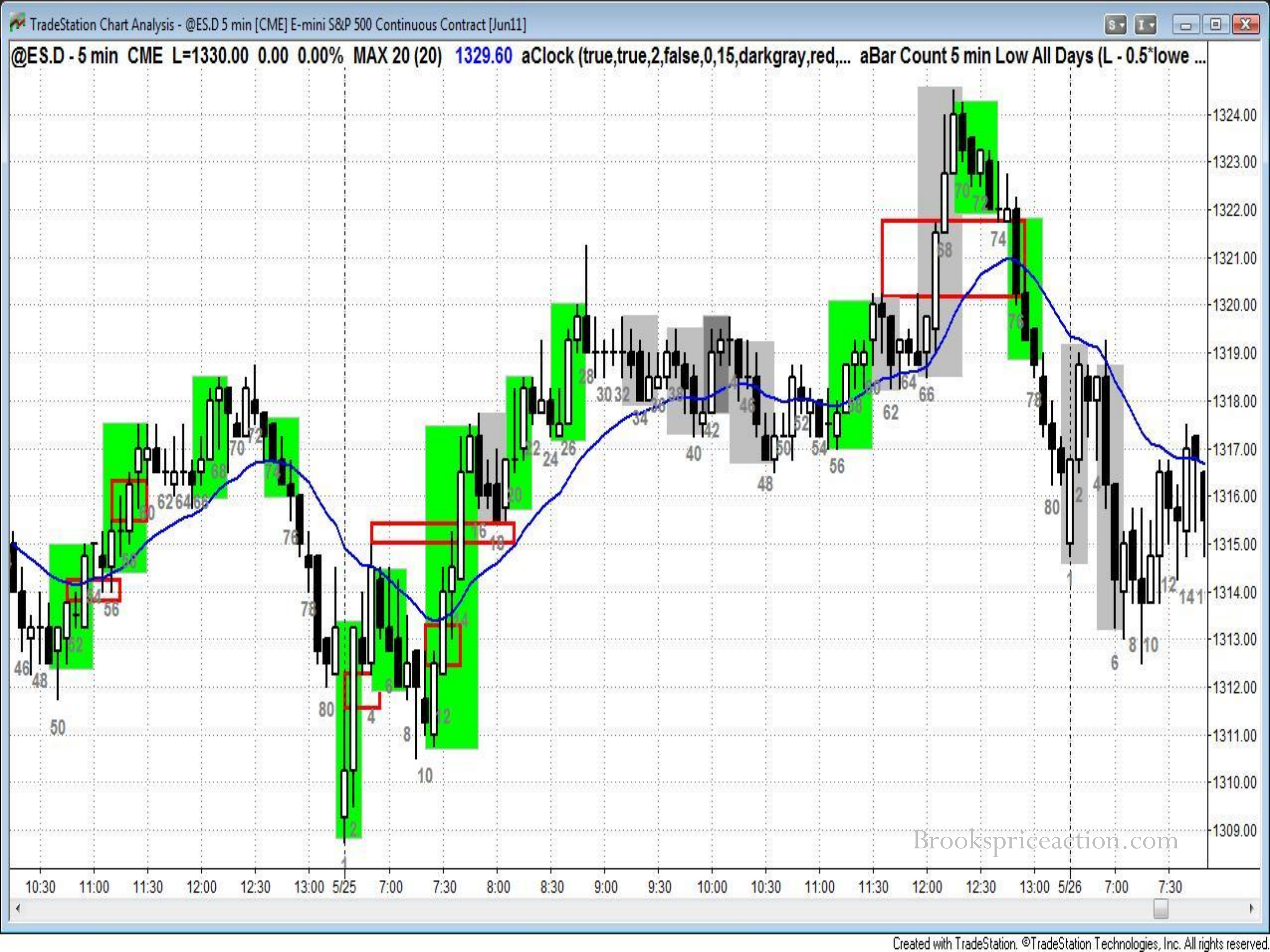
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- As the breakout bar is forming, it pulls back for at least a third of its height two or more times.



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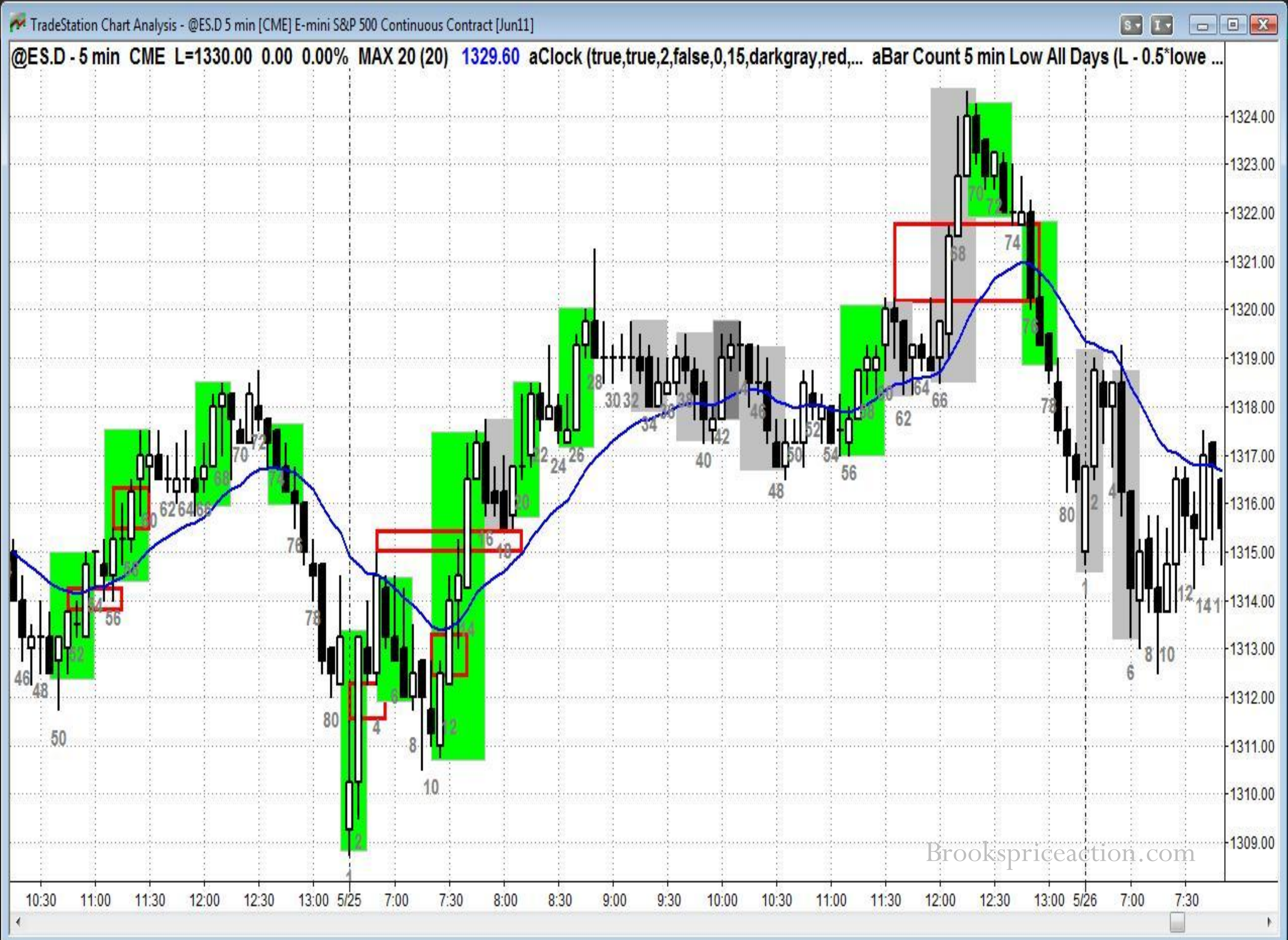
## The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The pullback falls below the breakout point. There are no gaps between the low of any bar and the high of the bar two bars earlier.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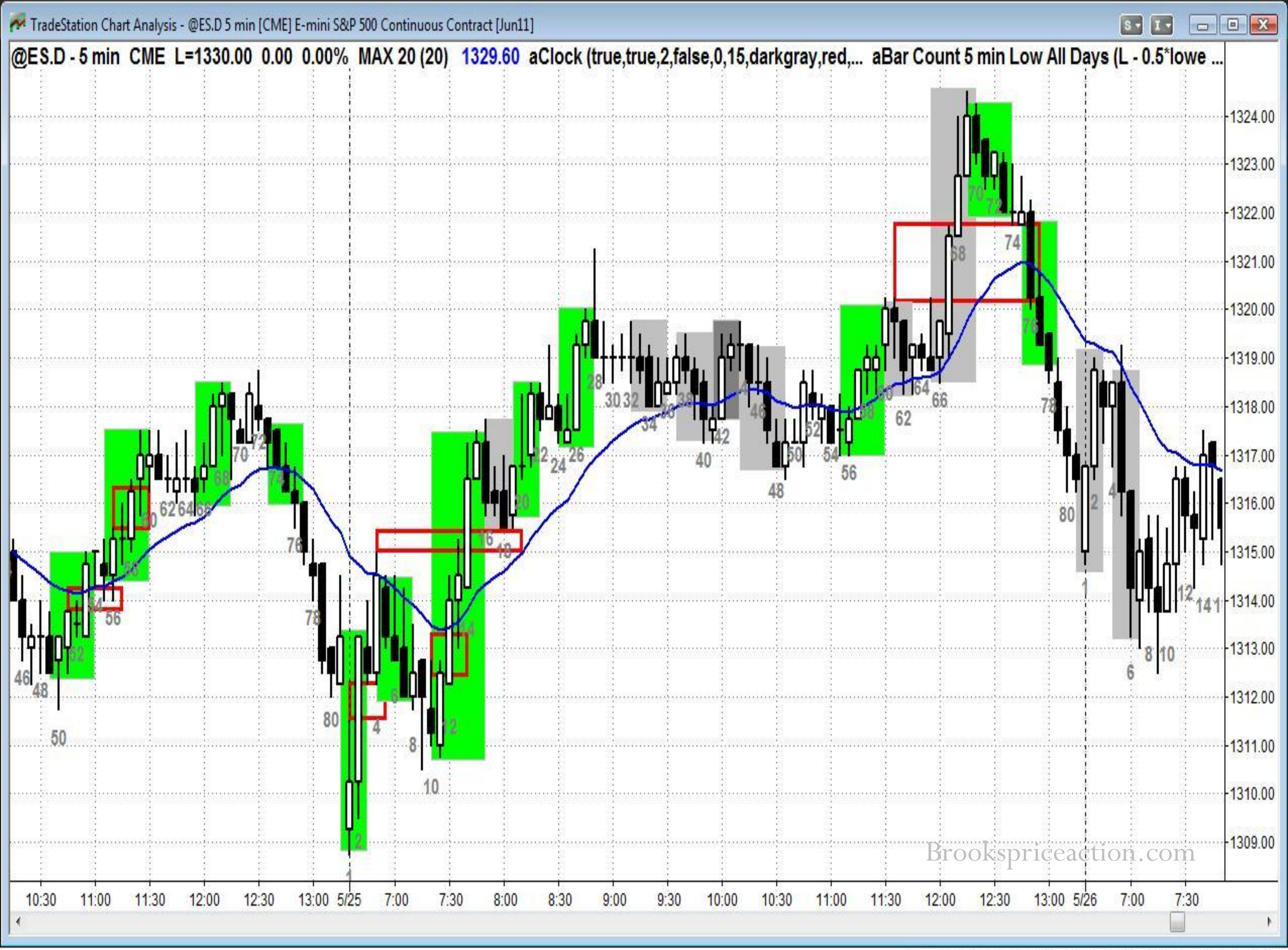
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The pullback falls below the low of the first bar of the spike.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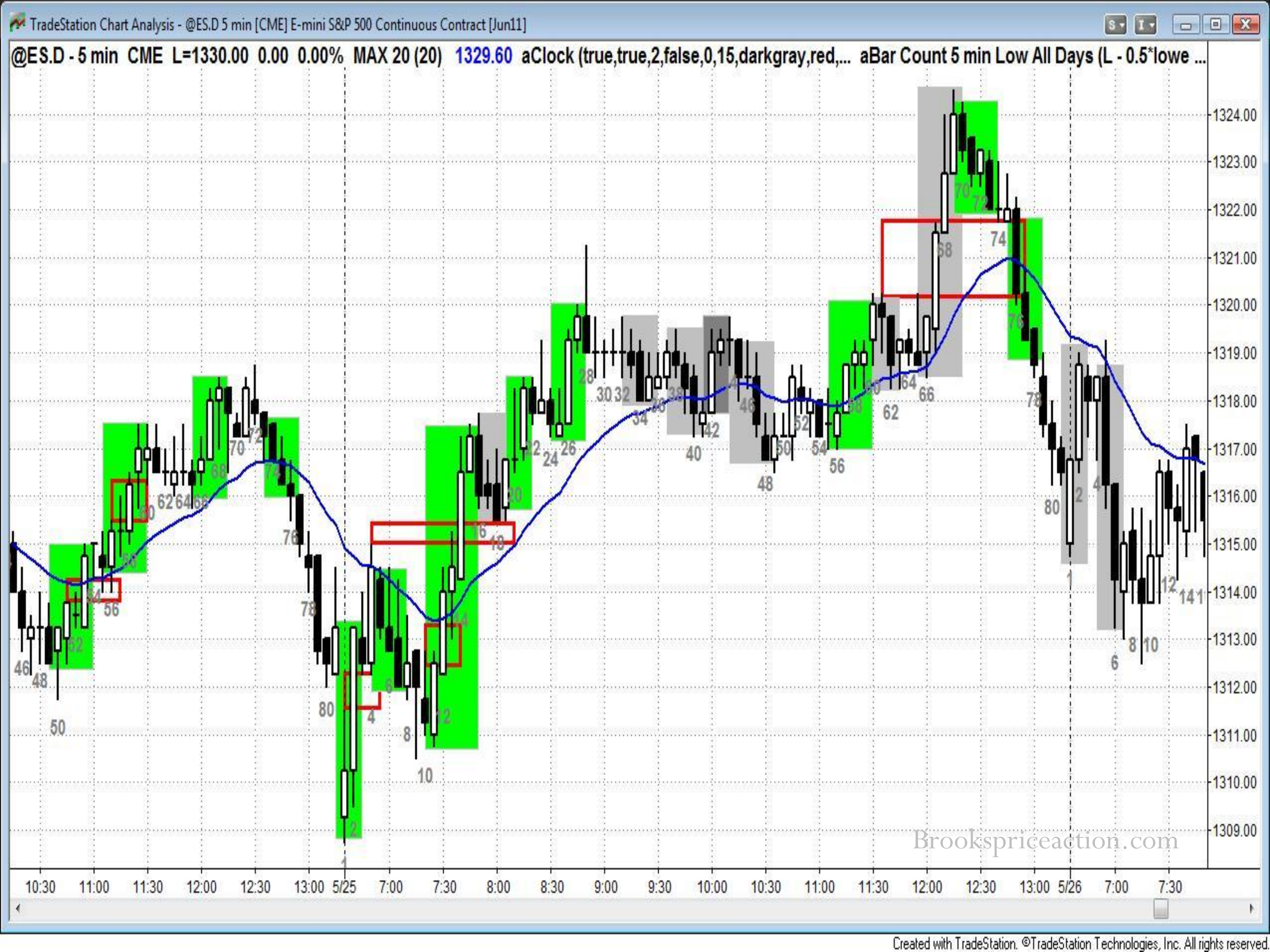
The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- The pullback hits the breakeven stop.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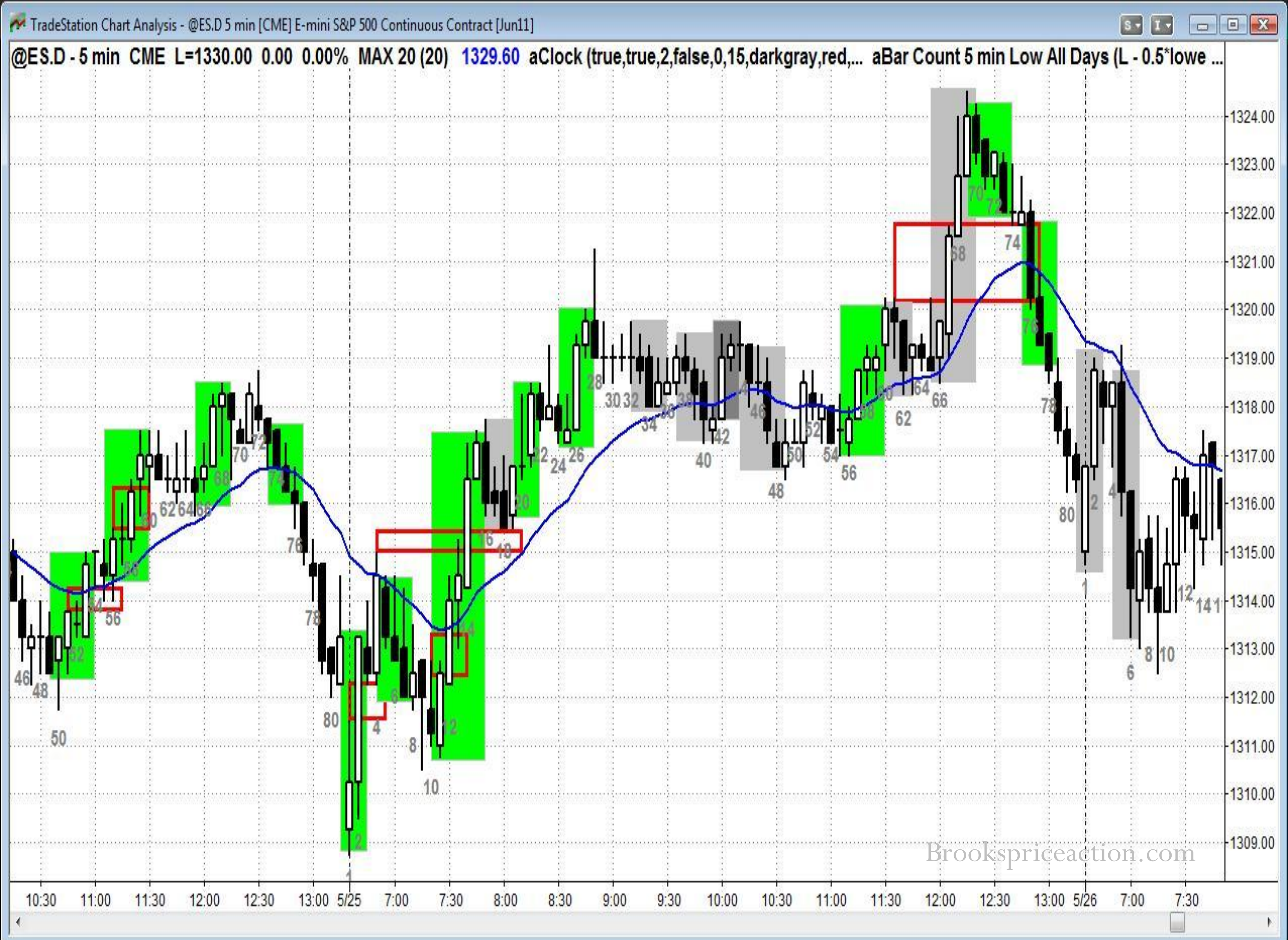
# The more of the following characteristics that a bull breakout has, the more likely it will fail and lead to either a trading range or a reversal:

- There is a sense of confusion. You feel like you are not certain that the breakout will succeed or fail.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# Additional Information on Price Action

- Where to find lots of other free examples of 5 min Emini charts that are analyzed bar by bar?

http://www.brookspriceaction.com/viewforum.php?f=1