SAM SEIDEN:
Back to the laws of supply and demand

Lessons from the trading floor translated into a simple supply-and-demand framework for this trader.

BY ACTIVE TRADER STAFF

Despite the dominance of computer back-testing and software programs that offer traders multitudes of market indicators, Sam Seiden eschews traditional technical analysis in favor of the simple laws of supply and demand.

First exposed to futures trading about 10 years ago while working on the floor of the Chicago Mercantile Exchange (CME), Seiden developed his theories of supply and demand from watching the market action in the currency pits. He traded for his own account while working as a phone clerk, and through spending several years on the floor, Seiden developed the methodology he still uses today.

Unlike many other off-floor traders, Seiden's approach has an almost simplistic focus on price.

"My trading has nothing to do with indicators, oscillators, news, earnings announcements, Federal Reserve speeches, or anything else that most people think affects price," Seiden says. "After all, any influences on price are reflected in price. Price alone reflects the market's true ongoing supply and demand relationship."

"Indicators are nothing more than derivatives of price and can only move after price does," he continues. "Any buy or sell invitation that lags price means your risk is increasing and your reward is decreasing."

Seiden left the floor in the late 90s to trade his own account. He also started a market advisory newsletter called *The Simple Swing Trader*. In early 2000, he became the director of technical research at Pristine Capital Holdings. He directed the firm's trading advisory services, developing trading methodologies and investment research for the firm's customers.

Currently, Seiden trades for himself, provides technical research to clients, and offers educational workshops via his firm, The Scientific Investor. He is the author of *Trade What Is Real, Not What You Feel*, which will be released by Trader's Press later this year.

AT: *What were some of the things you learned from the floor?*

SS: It allowed me to observe the actions of the buyers and sellers, and I figured out pretty quickly who was consistently profitable and who was not. When I focused on the actions of those groups, it became easy to notice behavioral patterns.

Traders who consistently lose make the same two mistakes. First, they buy after a period of buying or sell after a period of selling. Second, they buy at price levels where supply exceeds demand, or they sell where demand exceeds supply.

I began to figure out what those mistakes looked like on a chart. That's how I developed my current strategy.

There is such a big advantage to trading off the floor. Instead of being face to face with the people you're trading with, you're seeing a chart with price levels measuring supply and demand. Nine out of 10 floor traders run on emotion. They fall for the trap, which is why it's important to have a set of rules based on the laws of supply and demand.

AT: *Can you explain your concept of supply and demand?*

SS: It all comes down to simple math. If

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there are 100 buyers and 50 sellers at a specific price, you have an objective supply and demand imbalance. As soon as the 50 sellers sell, what has to happen to price? It must rise — there can be no other outcome. When you have buyers at a price and no sellers, there is competition to buy. Competition to buy leads to higher prices. It will continue to rise until it is met with a price level where supply and demand are in balance again.

I identify price levels in these markets where supply and demand are out of balance.

AT: *Explain how you determine where "true" support-demand and resistance-supply exist?*

SS: Most people think it looks like a cluster of trading activity above and below current price (i.e., trading-range type activity), but that's not enough. The conventional definition of support is a cluster of trading activity below the current price. But what nobody focuses on is what happens before and after the cluster of price activity, and that is where all the information is. The price action prior to the cluster is what determines if it is peak demand or nothing at all. So for support or demand, I look for a rally-base-rally pattern — that is, a rally in price would precede the cluster, or consolidation.

In the big picture, a rally preceded by a decline is just a decline to a support level. However, when a rally precedes that cluster of trading activity and price rallies from that cluster, you now have a peak demand area. I would only buy on the first price decline to that demand level because that's when the supply-demand imbalance is the greatest. With each successive decline to that price level, what's happening to demand? It's going down. I only want to buy that first pullback to the support-demand level.

AT: *Where is your target to get out?*

SS: The target to get out is the peak supply level above the market.

AT: *How do find you that on the chart?*

SS: It's just the opposite of support-demand. A cluster of trading activity above what you may think is resistance has to be preceded by a decline in price, not a rally in price. That is, a decline-base-decline formation.

AT: *Where do you place your stops?*

SS: Once I enter at a demand level, my stop is placed on the other side of the level. If I'm selling short at a supply level, the stop is just above the supply level.

AT: *Regarding your overall method, would it be accurate to say it reflects, first, watching for a breakout and, second, trading when price pulls back to the breakout level? It seems that this pattern occurs frequently.*

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SS: It does happen all the time. I choose to take the opportunities that offer the greatest reward relative to risk. The distance from the entry to the first target needs to offer a minimum three-to-one reward-to-risk ratio — in other words, it must be at least three times the size of my stop.

Basically, I find where peak supply or demand are — the rally-base-rally and the decline-base-decline patterns. The distance between those two has to offer a risk reward of three-to-one. If price revisits that objective demand level for the first time and the distance to the opposing supply level is at least three times the stop, I take the trade.

AT: *What is the typical time frame for your trades?*

SS: From one or two days, to two or three weeks.

AT: *What kind of charts do you use?*

SS: I use multiple time frames — 30-minute, 60-minute, daily, and weekly candlestick charts — to quantify the supply-demand relationship in a specific market.

AT: *What markets do you actively trade now?*

SS: The 30-year T-bond, 10-year note, E-Mini S&P 500, E-Mini Nasdaq, Japanese yen, euro, British pound and Swiss franc futures.

AT: *Do you tend to trade with or against the trend?*

SS: Conventional trend analysis invites you into a market well after price has moved away from the lowest-risk, highest-reward entry. When price declines to an objective demand level, the next move in price will be an uptrend. That's when I buy.

Typically, days later, after price has increased, is when the majority of trend traders will buy into the same market. They will typically pay those of us who bought when risk was low and reward was high. The only way you get paid in trading is when someone buys at a higher price after you buy or sells at a lower price after you sell.

AT: *It sounds like you try to get in at turning points, or when a trend is just beginning.*

SS: Yes, when you properly anticipate the "next" trend with objective supply and demand analysis, you end up being in the market before everyone else realizes there is a trend. Think about it — a large increase and higher highs and higher lows is what most people recognize as an uptrend. This uptrend invites them to buy, which actually pays the buyers who already bought because they properly anticipated the next trend. Conventional trend analysis ensures you will buy only after a period of buying and sell after a period of selling.

Every major technical pattern has you buying after a period of buying. For example, the cup-and-handle pattern has you buying after a period of buying, much like a head-and-shoulders top has you selling after a period of selling. Anyone that adheres to the laws of supply and demand will look at the cup-and-handle and say it is ridiculous to buy on a breakout after that pattern is formed.

The demand is at the bottom of the cup, which is why it formed. If you enter on the breakout of the handle, you are risking the distance from your entry to where true demand is, which is enormous.