Jim Wyckoff on the markets
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62 Rules Used by Profitable Futures Traders

By
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Profitable futures traders discipline themselves to follow rules. The 62 rules below have been used by the masters--including W.D. Gann, Jesse Livermore, Richard Wyckoff and Charles Dow, who in the late 1800s began discussing the Dow theory of trend analysis.

In developing for yourself a set of futures-trading rules, key considerations include trading tactics, timing techniques, money management, the allocation of funds to trade and the development of a conservative or aggressive trading approach. The rules below address all of these key considerations and represent the combined wisdom of dozens of successful traders, including those I have personally interviewed--and also my own research over the past 25 years.

1. CUT LOSSES SHORT; LET PROFITS RUN

This is the "golden rule" of trading.

Bernard Baruch, a famous investor said, "If an investor is right three or four times out of ten, he should do well if he has the sense to cut his losses quickly." One of the oldest rules in trading markets is to cut losses short and let your profits run. Protect your capital by knowing what you're willing to lose on any given trade. However, the smaller the loss you are willing to accept, the more likely you are to get "whip-sawed" in choppy short-term market action. But it is better to get whip-sawed than to get "wiped out."

2. BUY INTO PRICE STRENGTH; SELL INTO PRICE WEAKNESS

Buying into market strength (or selling into market weakness) can be difficult concept for many traders to grasp. Yet, adhering to this one trading rule can be your key to more successful trading.

One of my favorite trading "set-ups" is to buy a market after it has broken out on the upside of a technical resistance or "congestion" area. This occurs when a market has traded in a "sideways" pattern and then pushes above the top of the recent trading range. This is a powerful signal that the market has some significant upside potential. The trading rule of "buying into strength" or "selling into weakness" is followed by many of the most successful traders. This tenet runs counter to bottom-picking markets—or trying to buy at perceived bargain-basement prices, which is usually not a wise or profitable trading decision. Yet, so many traders fall into this trap.

3. RISK ONLY WHAT YOU CAN AFFORD TO LOSE

Make sure the money you expose to the futures market is not "grocery and rent" money.

Trading with money you can't afford to lose puts too much pressure on your decision-making process. It is a dangerous game to look at the futures market to solve financial problems. Near the end of every major bull market, unqualified traders get the idea that buying into the market can make money. Such "exuberance" frequently leads novices to trading losses. The successful traders have a very disciplined approach to trading, which includes investing money in the market that they can afford to be without. Make no mistake: Commodity futures markets are risky.

4. DON'T OVER-TRADE

Make a few bigger trading decisions every month, instead of betting on several "hunch trades" every day.

If you do have the appetite to be a day- trader in the futures market, limit how much you will lose in that endeavor. Don't feel bad if you can't make it as a day-trader. Commit yourself to trading in an environment where there is excellent trade-execution capability. Some of the most successful traders I've interviewed say they are unsuccessful trading the market on an intra-day basis. A good day-trader must have access to a very good trading platform, excellent execution and low commissions to have a reasonable chance at success.

5. CREATE A TRADING PLAN OF ACTION

Test your plan--then, stick to it.

Your trading plan of action should clearly state your objectives. For example, are you willing to take high risks, or is it your objective to be a more conservative trader. Before you take a trading position, decide on the amount of loss you are willing to accept. When you reach that point, get out. Use protective buy and sell stops and don't pull them at the last minute, thinking the market will suddenly move your way. Your trading plan should include what methods you will use to enter the market and to take profits. Decide how frequently you will trade and what, if any, of your capital will be used in day trading.

6. DO SOME CONTRARY THINKING

Do the opposite of what is the "general public's" opinion of a market.

There is an old market adage that if the Wall Street Journal publishes a bullish (or bearish) story on a market, the top (or bottom) is then close at hand. Once the "general public" has caught wind of a major bull or bear move in a market, it's very likely that the majority of that bull or bear move has already occurred, and a trend change may be close at hand. Contrary-opinion-type trading generally does go against the prevailing price trend, but it is nonetheless a valid trading methodology that has served many successful traders, including me, very well. Don't use this trading method in every market situation; pick and choose carefully the markets that look ripe for some contrary trading.

7. ON ENTERING A TRADING POSITION, MAKE THE MARKET FIRST COME TO YOU

Making the market first move in the direction you want to trade it is a very good "filter."

Make the market verify to you that your research is correct by making it first move a bit in your desired direction of your trade. If the market never moves a bit in your direction, then you will not have made a losing trade. This is a very good way of filtering out trades that should not have been made. This rule assures that you are buying on daily strength or selling on daily weakness.

8. AVOID BOTTOM-PICKING AND TOP-PICKING, UNLESS…

You can occasionally break this rule, if you place close protective stop orders.

If a market has moved lower for weeks or even months and looks like a buying opportunity to you, it's a temptation to step in and be a "bottom-picker". If you buy thinking the market is forming a bottom, you are buying weakness. To keep from being crushed by the continued downward market momentum, wait for the market to indicate to you via some technical formation or indicator that the bottom has been made, or is close at hand. If you do decide to be a bottom-picker, know how much money you are willing to lose before you enter the position. Place a tighter protective sell stop so you can get out if you are wrong. The same applies to a market that appears to be in a topping process. A conservative way of trading the market if you feel it's close to a major top or bottom is to buy call or put options. Options on futures allow you not to be so absolutely correct on the timing of the occurrence of a top or bottom in a market.

9. TAKE UNEXPECTED QUICK PROFITS

At least lighten up on a position that yields surprisingly quick profits

Veteran traders know that quick trading profits are also susceptible to quick profit erosion. That's why if you take a trading position that moves far beyond your initial profit objective in a very short period of time, you may want to take profits. Greed tends to cause inexperienced traders to want to add to a position if it becomes profitable quickly. If you have the discipline to do just the opposite, you are probably moving in the opposite direction of the masses

10. ONLY ADD TO WINNERS, NOT LOSERS

Double-down is double trouble unless you have very deep pockets.

Some traders think it is a good idea to add to a losing position by "averaging down" the price. This means that you are already locked into a loser, and you are doubling your potential trouble. Wise traders add only to winning positions, and only if that was part of their initial trading plan of action. If you have a loser, it is much smarter to cut your losses than to add to them.

11. DON'T OVER-TRADE

Know when to step back and let the market do your work.

Over-trading is an expensive process because you tend to confuse yourself and create lots of commission expense. One exception to this rule is the experienced day-trader who knows what he is doing and consistently makes a profit by taking positions, cutting his losses short, and moving quickly. This is a specialty, and if you haven't been trained for it, it's too risky.

12. KNOW YOURSELF

Know your ability and propensity for risk. Trade within those limits.

Your ability to take risks is based on your financial status. If you have $100,000 net worth, obviously you're on the edge if you try to trade several futures contracts at a time, or attempt to trade the more volatile markets such as the energies. The propensity for risk is based on your internal make up. If cheap "out-of-the-money futures options purchases make you nervous, you probably should not trade futures. If you have the ability to assume risks then you are more likely to be successful as a futures trader. And, if you have the energy and ability to make all the quick decisions in a day's time and can reverse yourself quickly, you might have the make-up to be trained as a day-trader. Day-trading exposes you to a different set of risks than position trading.

13. LEARN TO ACCEPT LOSSES

Don't cry over spilled milk. Forget yesterday's losers. Every day is a new beginning, a fresh start.

Don't blame "the market" for your losses. Take responsibility. Learn to accept losses as part of the investment process.

It is a good idea to have a rule in your trading strategy which says you will take only small losses, then get out--by using protective stops. By accepting these losses you preserve your capital to trade another day. This kind of "financial triage" keeps your money pointed in the direction of winners.

14. DON'T PUT ALL OF YOUR EGGS IN ONE BASKET

Don't look for that "home run" trade.

Placing heavy bets on that one futures trade that will be a big winner and "hoping" to cash in on huge profits is a recipe for disaster in futures trading. Successful traders will tell you that "base hits" (small to medium winners) on a regular basis should be the goal of a futures trader.

15. TAKE A TRADING BREAK ONCE IN A WHILE

The more you trade, the more you may need breaks to clear your mind.

Everyone gets tired from trading too frequently, from constantly watching the markets every day. It is a good idea to take a complete break from trading for a period of time. Your family will likely appreciate this, too! Remember that successful futures traders strike a balance between work, trading and family. An unhappy futures trader could mean an unhappy family life.

16. SEEK WISE COUNSEL

Get a second opinion; have a second set of eyes on the markets.

Good information is available from many sources. But in a fast-moving market, unless you are a position trader who only makes a few trades a year, you should be watching the market every day for new developments, new ideas, new opinions, and new breakouts of technical positions that create very unique buying or selling opportunities. So, it is important to have access to a good analytical service delivered to your computer. Your broker can also act as wise counsel.

17. STAY LIQUID

Avoid big positions in low-volume futures markets.

In other words, don't become so over-leveraged that you could be getting margin calls from your broker at any time. Also, don't "load up" big trading positions in illiquid futures markets like lumber or pork bellies, which do not have high volume and open interest, or that see the market locked at maximum trading limits due to lack of liquidity.

18. BUY THE RUMOR, SELL THE FACT

By the time an idea or news event hits the major media, chances are the market has already discounted the information.

It is a good idea to listen to analysts and observers who are ahead of the market. Many people who walk the floors of the futures exchanges or who are on Wall Street have access to information that may only become apparent in the next day or two. Once information that is rumored becomes a fact it is usually too late to profit from the idea. However, it is not a good idea to make an investment on rumor alone or on someone’s insight of what might be happening. Such information or "tips" should be traded in the context of knowing where the general market is, from a technical analysis perspective, and how the chart patterns look for the market in question.

19. KEEP AN EYE ON GOLD

Gold price measures the world's fear factor. The higher the price, the higher the fear.

Gold in an inflation hedge and a "flight-to-quality" market in times of major geopolitical uncertainty. Higher geopolitical uncertainty will see gold prices rallying. Check out the reasons why gold is making its move.

20. KEEP POSITIVE COMPANY

Positive people impact your attitude and attitude affects your confidence.

To keep a positive mental attitude you need to believe in your ability to make good trading decisions. If you are around negative people (or are in negative chat rooms) that continually make excuses, blame the government, their broker or their newsletter service and have an attitude of hopelessness, it can affect your own trading ability and confidence. Avoid these kinds of people and chat rooms and instead seek advice from those who are more positive.

21. DON'T BE A PIG

Bulls make a little, bears make a little, and pigs get slaughtered.

Pigs in the marketplace are those who get too aggressive and double their trading positions at the top or bottom of the market. They allow their emotions to run wild. When they should be taking some profits off the table they add in hopes of "getting rich quick." It is a much better strategy to be a cautious and conservative trader who is always looking for ways to make some profit, yet be able to exit the market with a small loss if it is a losing trade. The consistent use of technical chart patterns such as trend lines and support and resistance levels can be a big help. But the warning is to watch out for greed, because it will eat up your trading account.

22. GO WITH YOUR GUT…SOMETIMES

Not all the time.

Occasionally you can take a chance based on your own internal "gut" feeling. You will develop a “sense of the marketplace” after you’ve been a trader for a few years. However, if you simply use your instincts as a trader day in and day out, you will not be as successful as the trader who uses the rules in this list consistently and in a disciplined manner.

23. ON TRADING SEVERAL CONTRACTS: BUY BIG, ADD SMALL

Build a trading pyramid by laying the base and then make incrementally smaller additions as the market moves in your favor.

If your trading account allows you to trade several futures contracts on a trade, your trading pyramid should look like a solid base representing your original trading position. This simply means that if you were going long a market priced at a 100, you might buy 40% of your intended position. If the market goes to 110 you might add 30%. If it goes to 120 you might add another 20%. Then finally add the last 10% when the market goes to 140. Then, you hang on and use a protective trailing stop or a trendline to help give you the clue to help lighten up and begin taking your profits and moving the money off the table.

24. STAY HUMBLE

A cocky attitude is a prerequisite for making bad trades.

Sometimes early, quick success in the futures market gives rise to a trading attitude of arrogance. Such a thought process can lead to over-confidence and develop into careless trading patterns. Until you have two or three years of successful trading, you really have no reason to get puffed up. In the long run, the market can be very humbling. An ancient book of wisdom says, “Pride cometh before the fall.”

25. USE TRAILING PROTECTIVE STOPS TO LOCK IN PROFITS

But use straight protective stops to get out of losers.

A trailing protective buy or sell stop is one that is moved (tightened) when the market moves in your desired direction. Let's say you decided on a five-dollar trailing protective sell stop on a long position in a market that is priced at $100. Your stop-loss would be set at $95, initially. If the market moved to $110 you would move the stop to $105 by placing a sell-stop order at that point. If the market moved down to $105 you would be stopped out with a winning trade. That is how you protect trading profits. In using protective stops to get out of losing positions, it is best to decide on a fixed amount of money you're willing to lose, then refuse to move the stop any lower. Better yet would be to find a technical support or resistance level near where your "money bss" target would be. Place a protective sell stop (on a long position) just below technical support or your protective buy stop (on a short position) just above technical resistance.

26. MEASURE YOUR RISK-REWARD RATIO

Only trade when the expected reward exceeds your risk by two times.

If you're limiting your risk to $500 on a futures trade, you should make a trade that has the potential to return at least $1,000. That's a 2-to-1 risk-reward ratio. Some veteran traders suggest the risk-reward ratio should be at least 3-to-1.

27. HIRE AN EXPERT, BUT ALSO TAKE RESPONSIBILITY

Get that important second opinion, but be responsible for your own actions.

Confident futures brokers, trading advisors that publish newsletters, and brokerage house analysts can all be considered expert resources--especially when you have a "day job" and can't spend full-time monitoring markets. However, take personal responsibility for your own trading. That means when your "expert" gives you a good idea, you check with some of the rules in this list to use if you agree. Another type of expertise is trading execution. Getting good trade execution is particularly important if you trade often--and vital if you are a day-trader.

28. WATCH THE CONTINUOUS COMMODITY INDEX (CCI) OR THE REUTERS/JEFFRIES CRB INDEX

These two indexes gauge raw commodity price inflation.

There are a few commodity markets that can influence other raw commodities markets, in general. For example, energy futures markets that are trending strongly can influence markets like gold and soybeans. Keeping a close watch on the CCI and CRB indexes will also provide you with an excellent gauge of the general trend of raw commodities prices. For example, commodity futures bulls want to see a general uptrend in the CRB and CCI indexes. When considering trading the long side of a commodity futures market during a solid downtrend in the CRB and CCI indexes would raise a warning flag. Financial market traders also watch the CRB and CCI indexes, as inflation is the arch enemy of T-Bond and T-Note bulls.

29. WATCH THE VOLUME AND OPEN INTEREST SIGNALS

Significant volume and open interest changes are a warning of an impending trend change.

A huge increase in daily trading volume and open interest can be a strong technical signal. If the increase in volume and open interest takes place at the time a market is breaking a trendline and tending to move higher, chances are the market will move much higher. If a market pushes to a new high on very light volume, it is a signal there is not much conviction behind the up-move and that buying interest may be waning at higher prices. Declining open interest at higher price levels is also a bearish clue. This could mean a top in the market is close at hand. A strong move lower on heavy volume is a bearish signal, and could mean that more price weakness lies ahead. Conversely, if a market moves to a new low on very light volume, it could mean that a turnaround is imminent. It is difficult to take a trading signal from a volume and open interest alone. Such information should always be accompanied by good chart analysis as well as an awareness of the fundamentals on that market.

30. LEVERAGE IS A DOUBLE-EDGED SWORD

High leverage is high risk. When you are wrong, margin buying magnifies your error.

If you put $100,000 in a futures brokerage account, your broker will allow you to buy upwards of $1 million in commodities futures contracts. Such margin buying puts you at risk. If the market you are trading goes against you, you may get a “margin call.” A rule of thumb used by successful traders over the years is: “Never meet a margin call." Exit your trading position instead.

31. WATCH THE COMMITMENTS OF TRADERS DATA, RELEASED WEEKLY

Read the CFTC commitments data to see what the "big boys" are up to.

In your trading position, it can give you a great sense of comfort to know you are on the same side as major commercial or fund traders. Examining the weekly Commodity Futures Trading Commission Commitments of Traders report will give you solid clues on what the "big boys"--the commercials and large fund traders are doing in each market. The report is free on the CFTC's web site, and there are also services such as the Bullish Review, which do further analysis on the Commitments of Traders data. The COT data should not be relied upon too heavily in your trading decisions, but it's a good trading tool in your trading tool box.

32. BUY AND SELL WITHIN DEFINED TRADING RANGES--SWING TRADING

Markets tend to operate in a sideways trading range for a period of time.

Swing traders like to buy when a market is in the lower portion of a recent trading range and sell in the upper portion of the range. The trading ranges needs to be well-defined within solid technical support and resistance levels on the chart. When a market "breaks out" of the trading range, the swing trader moves aside and the trend trader may move in to enter a position.

33. NEVER LET A WINNER BECOME A LOSER

Use stop-loss orders to protect your gains.

Once you have a profit in a futures market, you never want to allow your trading techniques to get so sloppy that you allow it to turn into a loss. If a market you purchase moves 10% higher, it is always a good idea to move your protective stop to your break-even point. Then, you have “free trade.” If it continues to go higher you have a winner; if turns around and it breaks lower, the worst that happens is that you break even--minus broker commissions, of course.

34. DON'T RUN WITH THE MASSES

When all the news is bullish on a market and analysts are following each other like sheep with buy recommendations – quietly head for the exit with your profits.

Emotions drive markets to extremes, and at the end of those extremes powerful forces of fear cause lots of people to run for the exit door at the same time. Beat them to the punch. Sell "too early" and move on to another trade. Remember that markets (and traders) are the most very bullish at the very highest high that is scored on the chart. Markets are the most very bearish at the very lowest low scored on the chart. This is where "contrary opinion" trading can pay off.

35. BE PATIENT IN MAKING TRADING DECISIONS

Major price moves need time to run.

Don't take profits during the early stages of a strong trending price move. Quick power moves can't always be trusted, however. That's why a trailing protective stop can protect you--yet allow the market to keep running your way, if it so desires.

36. BEWARE OF THE ANALYST OPINION

Most fundamental market analysts are usually "behind the curve."

They usually buy late and sell late, following the herd of other fundamental market analysts. Be sure to balance analyst opinion with good observation from price action itself. By balancing technical analysis with fundamental analysis and in the light of several other opinions, you increase your level of confidence on making a trade or getting out of one.

37. DON'T BE PENNY-WISE AND POUND-FOOLISH ON MARKET ENTRY

When you decide to enter the market, avoid the temptation to put a limit order in to get it just a bit cheaper.

This nickel-and-dime mindset will cost quarters and dollars in the long run. If you have spotted a buying formation on your futures market chart and other research tells you to buy, just do it with a "market order." Place the order and get on with the next piece of analysis.

38. TECHNICAL ANALYSIS IS A POWERFUL TRADING TOOL.

Price action itself produces accurate information about the market place, which can be decoded with visual chart analysis.

Price data gives you a completely objective view of the market. The study of charts to forecast price is called "technical analysis." The pure technical analyst believes that all factors which can impact a market are reflected or discounted into a price. The technician studies fundamentals, political factors, supply and demand, and psychology--all in the action of price itself. Charts, say the technicians, reflect the total bullishness and bearishness of a market at any point in time. Why does price action throw off trading clues? Because the daily bar created by the trading range of that security on any day represents condensed buy/sell patterns from the largest auction markets in the world. That little bar says, based on all the information available to all market participants, this is the price range people with real money were willing to pay. An experienced chart analyst considers the tracks made by price action to be worth more than any personal opinion, no matter how well credentialed the person might be. The goal of the chartist is to identify trends in their early stages with an eye toward making profitable trades.

The chart rules below are some of the chart analysis tenets that have helped thousands of traders develop the discipline to become successful in futures trading. There are literally dozens of technical trading rules that you can use to help you decide when to enter or exit a trade. Pick from a large body of technical trading advice those rules which best fit your trading personality. Then, stick with them.

One of the best books you can buy, regarding learning more about technical analysis, is "Technical Analysis of the Futures Markets" by John J. Murphy. It's available on amazon.com.

Here are some of the most important rules of technical analysis:

39. TREND LINES ARE POWERFUL TECHNICAL TOOLS

A market track or price chart is nothing more than lines on a graph that show the range between the day's high and low, with a vertical mark indicating the close.

A series of tracks tend to form price patterns. Looking for breaks of long-term trend lines, breakouts of channel lines, formations like double-bottoms, double-tops, "head-and-shoulders" are all important market clues. When they are examined with accompanying data such as fundamentals of earnings and volume, chart analysis can go a long toward helping you sort out stocks that really have potential from those that will probably give you only mediocre performance.

40. THE TREND IS YOUR FRIEND.

Before you enter any trade, know if the market is in an uptrend, downtrend or sideways pattern.

Buy in an uptrending market. Sell in a downtrending market. Charles Dow defined an uptrend as a price move in which each successive high and each successive low is higher than the one before. A downtrend is defined by successive lower lows and lower highs. Buying when the market is in an uptrend puts the risk-reward odds in your favor. Buying a market in the early stages of an uptrend greatly increases your chances for trading success. Spotting price trends increases your chances for trading success. This is what chart analysis is all about.

41. SPOT PRICE TRENDS EARLY AND RIDE THEM.

Dow identified three stages of an uptrend: accumulation, rapid advance and distribution.

Bigger profits in markets come from jumping in during the early stage of a price trend. When prices do break out of a "trading range" it may be a clue to a change in the trend. Buying at the early stage of an uptrend does carry more risk than waiting for the trend to clearly identify itself, but that ride is longer and more profitable when you are right. The same applies to selling in a downtrend.

42. ROUNDING BOTTOMS WAKE UP BULLS.

When you see a pattern of prices that forms a gently rounding pattern that looks like a saucer get ready for a major move.

Rounding bottom formations on charts frequently portend a change in trend, including possible major upmoves. As a rule, the longer it takes to form the bottom the stronger the move higher.

43. SELL THE BIG M; BUY THE BIG W

When charts show double bottoms or tops, there is usually a profit opportunity at hand.

The classic double-top and double-bottom chart formations have been used profitably by successful traders for more than 100 years. Reason: They are the most obvious, easiest-to-read formations on a price chart. When a new high is made on increasing volume, followed by a dip on decreasing volume, you have an early clue when the next rally fails to break the previous high, the “M” is in formation. A selling opportunity then occurs. When the market makes a high, then backs off for several weeks or months and begins to challenge its old high, you should watch that market closely to see whether it breaks through the old high or stops and forms a double top. Some markets form double tops and find such resistance at that level that they don’t make new highs again for several months or years. If a market makes a third run at the high and fails (a triple top), you get a very important sell indicator. Sellers love a completion of a triple top.

44. TRIANGLES AND WEDGES ARE GOOD ‘BREAKOUT’ FORECASTERS.

Triangles can either be ascending--forecasting an upward price "breakout" or descending--forecasting that prices may break lower. Symmetrical triangles are usually continuation patterns.

Ascending triangles are formed by a series of higher lows on a daily bar chart, along with some overhead resistance that has capped recent gains. Descending triangles are formed by a series of lower highs on a bar chart, along with a solid technical support level under the market. A "breakout" from these patterns occurs when prices either push above the resistance level (on an ascending triangle) or below the support level (on a descending triangle). Symmetrical triangles have sides that are equal in length and angle, and are usually continuation patterns. If you see a symmetrical triangle forming on the chart, odds favor prices breaking out in the direction of the most recent trend. If a symmetrical triangle forms in the wake of choppy and trendless price action, then odds favor more choppy and trendless price action occurring in the near term.

45. HEAD & SHOULDERS REVERSAL PATTERNS YIELD PROFIT SIGNALS.

One of the most important visual clues on a chart is the head-and-shoulders reversal formation.

A head-and-shoulders top looks like rally highs, with the middle one being higher than the other two, to form the head. The drawing of an imaginary neck-line across the bottom of the head, chartists find a good place to time their trades. Ideally, the head-and-shoulders formation is accompanied by heavy volume as the market price reaches each of the highs. Although the final confirmation that a head-and-shoulders top is formed does not come until the neck-line is broken, some chartists look for slightly lower volume on the third rally as a clue that the market is "running out of gas." In that event, they would begin to exit long positions at the top of the right shoulder, rather than waiting for the neckline break. The head-and-shoulders top provides an excellent clue to use as an exit strategy, if you are long a market. And, a head-and-shoulders bottom reversal throws off a profitable buying signal. The head-and-shoulders bottom is formed by three significant lows, with the middle one being the lowest low. The head-and-shoulders top formation is one of the most common and most reliable of all reversal patterns, according to authors Edwards and McGee in their classic book *"Technical Analysis of Stock Trends."*

46. JUMP ON THE BREAK-AWAY PRICE GAP

When a market opens higher than the previous day's high, or lower than the previous day's low, and sustains that level throughout the day, a "gap" has formed on a daily price chart, which is a strong buy or sell signal.

Gaps on daily price charts are not common, and when they do occur, pay heed to them. There's an old market adage that says all price gaps on charts will be filled. That may be the case, but the problem is that is could take months or years to fill the gaps! Price gaps on weekly or monthly charts are an even rarer occurrence and are even more powerful bullish (upside gap) or bearish (downside gap) signals.

47. DOWNSIDE GAP IN A MATURE UPTREND REVEALS TIRED BULLS.

Downside price gaps late in an uptrend mean the bulls have thrown in the towel.

When a market has made a sustained move up, and then gaps lower on heavy volume, it usually means the move has reached its climax. Move to the sidelines if you are long. If you are a more aggressive trader, such a signal could be a good clue to short the market.

48. ISLAND REVERSALS TRIGGER TREND CHANGES.

These big price moves on the charts are telling signs of a market top or bottom.

When a market makes a big gap-move higher on the daily bar chart and pushes prices to a fresh for-the-move high, it is certainly bullish. However, when a move like this is followed soon after by a big gap-lower trade, an island-top reversal has formed on the daily chart. This is bearish and a strong warning sign that a top is in place. Conversely, when a stock that gaps to a fresh for-the-move low and then soon after gaps right back higher, an island bottom reversal pattern has formed. This is bullish and a strong signal that a bottom is in place in the stock. These island reversal patterns do not occur often, but are powerful signals when they do occur.

49. PRICES REVERSE OR 'RETRACE' PERCENTAGES OF THEIR TRENDING MOVES.

Use these "Fibonacci" percentage retracements to help you take profits or set protective stops.

Frequently, when prices make a major trending move, the move is followed a "correction" or "retracement" of 38.2%, 50% or 62.8%, before a pause or even the completion of the retracement move. These Fibonacci retracement numbers are very important to monitor. Many savvy traders also place their protective sell stops just above or below these key percentage retracements.

50. KEY REVERSALS ARE A BIG CLUE.

Making sure there is "follow-through" will help to avoid false signals.

A key reversal down occurs on a price chart when a new high is scored for the trending upmove--followed by prices backing off during that same session and scoring a daily low that is lower than the previous session's low. This, by itself is called an "outside day" down on the daily bar chart. If there is significant follow-through selling the next session, then a key reversal would be confirmed, which is bearish. The same can situation can occur in a downtrend. If a fresh low is scored, followed by prices rebounding strongly that same session to reach a high that is higher than the previous session, this is an "outside day" up on the daily chart. If there is follow-through buying the next session, then a key reversal up will have occurred. These chart formations usually indicate some type of buying or selling climax.

51. SET A TRENDLINE TRAP.

These basic lines are one of the most powerful technical tools.

Whether you use a trend line or a moving average, you let the market tell you when to get in or when to get out when your trap is triggered. If you are thinking of buying a market that has been trading lower, draw a line across the descending highs and wait for the price action to close above your trend line before buying, pick your favorite moving average and do the same. Traditionally, the 40-day moving average is one of the strongest indicators for the grain and livestock.

52. BUY OR SELL THE SECOND CLOSE AFTER THE TREND BREAKS.

Avoid getting whipsawed by false breakouts by exhibiting some patience.

Once a price pattern is broken, if the signal is bullish it is a good idea to wait for the second higher close after the market crosses over the trend line. If you are long a market whose price has broken below a trend line, you may be less patient and be more inclined to take the sell signal the first time the market trades below the trend line. However, any activity close to the trend line can be very tricky, and one-day trend-line breaks can frequently become false signals. That is why it is a good idea to wait for the second close or even the second consecutive close in the direction of the breakout.

53. BE ALERT WHEN MOVING AVERAGE LINES CROSS.

Moving average crossovers are good buy and sell signals.

If you got long when a market crossed above its 40-day moving average, you may want to exit the position if the 9-day moving average penetrates the 18-day on the downside. Many traders use moving average line crossovers as important buy or sell signals. Some traders use moving average crossovers as complete trading systems.

54. CHANNEL BREAKOUTS ARE PROFIT CLUES.

The longer the channel, the better the clue.

When prices move within a relatively well-defined channel or form a rectangle pattern on a price chart, technical analysts wait for a breakout either on the upside or the downside to determine when to place their orders. Other analysts recognizing this channel will try to buy the market when its in the lower one-third of channel's trading range and sell it when it is in the upper one third of the trading range. This is also called "swing trading." The second strategy is a bit more risky, because if a breakout occurs, the trader is caught on the wrong side of the market. However, using the channel as a guide, stop orders can be placed just outside the trend lines to either take you out of the market or build a position.

55. WIN PENNANTS WITHOUT PLAYING BASEBALL.

Pennants and flags are a visual picture of a consolidation area, which when broken can be a trading signal.

A flag on a chart looks like a tilted rectangle with price action being contained within a compact parallelogram. A pennant is a similar formation and is no more than a pointed flag. The pennant may look like a wedge, but is shorter and more compact. Prices tend to move out of flags and pennants in the opposite direction of their slant. Sometimes the distance between a flag and its breakout of the previous formation can be used as a measuring stick to forecast of the length of the next price breakout.

56. SELL TRENDLINE BREAKS.

When an uptrend line is broken, odds increase that at least a downside correction will occur.

It was pointed out earlier that trend lines are one of the more powerful trading tools in the trader's "toolbox." If a stock has been trending higher for quite some time, it's likely that a trend line up can be drawn off of the lows on the chart. When prices break soundly below an uptrend line, it's a good opportunity to book some profits and sell. Chances are that the market has either topped out or at least is about to experience a decent downside correction.

57. BUY BREAKOUTS OF A FLAT BASE.

The longer the "basing" pattern, the more powerful the upside breakout.

Once a market forms a tight trading range at lower price levels for six to eight weeks, or longer, its next move up can lead to a good trading opportunity. This price action is called "basing." The longer the consolidation period before the break, the stronger the buy signal. Once the market has moved away from the trading range, the high of the old trading range can then be used as a place for your stop-loss orders to protect your profits.

58. BUY CONGESTION BREAKOUTS.

There is an old adage. "If you can buy right, you've solved half of your selling problem."

If you buy or sell within the first 15% of a price move after the market leaves a congestion area, you enhance your success odds immensely. The best way to recognize a congestion area is to study price charts. Congestion areas can be sideways price channels, or a period of time when price action is mostly "sideways" and in a narrower trading range.

59. WATCH OUT FOR FALSE BREAKOUTS FROM PATTERNS.

Wait for a breakout from a pattern to be "confirmed."

Conservative traders will many times wait for "confirmation" of any price breakout from a chart formation or congestion area. Reason: False breakouts can and do occur, which can stymie a trader. For example, if a market price breaks out of an ascending triangle pattern, prudent traders will wait one more trading session before initiating a long-side trade, to make sure prices see "follow-through" movement in the same direction. If that follow-through movement does not occur and prices reverse course, that is considered a false breakout.

60. USE SUPPORT AND RESISTANCE LEVELS FOR STOP PLACEMENT

Placing sell stops just under support, or buy stops just above resistance, decreases your odds of getting "stopped out."

Professional traders like to place their protective sell stops just under a technical "support" level for when buying--or just above a technical resistance level when selling, or shorting, a market. This lessens the odds that the stop will be hit, because the support or resistance level could stop and reverse any trend. It's important, however, to keep your protective stop within your money-management parameters. If you have decided to go with a plan that puts your sell stops around 15% below the entry point into the market, then you should look for support that comes in around 15% below the market. If there is no technical support at that area, then still stick with your plan.

61. BROADENING FORMATION ON THE CHART IS BEARISH.

Higher volatility forms this rare chart pattern, and it portends topping action.

If a market exhibits wider trading ranges at higher price levels--amid directionless, choppy price action, then a broadening formation can occur. These patterns are rare, and usually occur at market tops. With a broadening formation, trend lines can be drawn off the highs and lows, such that a reverse triangle pattern occurs--with the apex of the triangle at the opposite end compared to the other triangle patterns technical analysts employ. When a market's trading range begins to widen at higher price levels, and the uptrend appears to have stalled, this is a warning of an impending market top. If you are long a market when this type of higher volatility occurs, it's best to take your profits and get out of the market.

62. OSCILLATORS INDICATE OVERBOUGHT OR OVERSOLD STOCKS

The RSI is one of the most popular computer-generated indicators.

The Relative Strength Index (RSI) is a price momentum indicator that oscillates as prices fluctuate within any given trend--whether that trend is up, down or sideways. If an uptrend or downtrend on the chart is sustained for a period of time, an oscillator such as the RSI or Slow Stochastics will move into an "overbought" or "oversold" reading. This is another early warning sign that a change in trend, or at least a "correction" to the trend, may be imminent.

IMPORTANT NOTE: I am not a futures broker and do not manage any trading accounts other than my own personal account. It is my goal to point out to you potential trading opportunities. However, it is up to you to: (1) decide when and if you want to initiate any traders and (2) determine the size of any trades you may initiate. Any trades I discuss are hypothetical in nature.

Here is what the Commodity Futures Trading Commission (CFTC) has said about futures trading (and I agree 100%):
1. Trading commodity futures and options is not for everyone. IT IS A VOLATILE, COMPLEX AND RISKY BUSINESS. Before you invest any money in futures or options contracts, you should consider your financial experience, goals and financial resources, and know how much you can afford to lose above and beyond your initial payment to a broker. You should understand commodity futures and options contracts and your obligations in entering into those contracts. You should understand your exposure to risk and other aspects of trading by thoroughly reviewing the risk disclosure documents your broker is required to give you.

Jim Wyckoff