



TRADING SMART

92 Tools, Methods and Helpful Hints to
Help You Succeed at Futures Trading

— by Jim Wyckoff

This publication is protected by International Copyright © 2003. All rights reserved. Reproduction in any form, electronic or mechanical, in whole or in part, is strictly prohibited without written permission from Jim Wyckoff.

Hello, my name is Jim Wyckoff. I am the proprietor of the analytical, educational and trading advisory service, "*Jim Wyckoff on the Markets*." I am also the chief technical analyst for FutureSource.com and for the OsterDowJones newswire. I was also the head equities analyst at CapitalistEdge.com. For nearly 20 years I have been immersed in markets and trading. Indeed, markets, trading and educating traders are my passion.

In this information-packed book, I will share with you—in plain English—the trading philosophies and methodologies that have allowed me to survive and succeed in a fascinating but very challenging field of endeavor: **Trading futures**. I will also touch upon other important topics about which traders need to know in order to survive and succeed in futures trading.

I think you will enjoy the format of this book: short chapters that are easily comprehended. Too many times in this industry, books on trading have been so technical and complicated that traders find themselves swimming in a sea of market statistics, computer code or mathematical formulas. You will find none of that in this book. What you will find are important lessons and anecdotes that will move you up the ladder of trading success. You will also discover valuable trading tools that you can incorporate into your own trading plan of action.

Following are two of my most important trading tenets:

- Like success at any other job, successful futures trading requires hard work. There are no short-cuts. This is not a “get-rich-quick” business.
- Simple trading strategies work the best. I have read the classic technical analysis books and talked face to face with the best trading professionals in the world. Most agree that, as my friend Stewart Taylor says, “Simple is Simply Better” when it comes to employing successful trading strategies. All the neural networks and powerful computers in the world won’t compare to a good, basic and well-researched trading plan. Don’t confuse simple strategies with easy trading. Simple trading methodologies still require a lot of preparation and work.

Jim Wyckoff’s Background

I am into my third decade of involvement with the stock, financial and commodity futures markets. I was a financial journalist with FWN (now called OsterDowJones) for many years, including stints as a reporter on the rough-and-tumble commodity futures trading floors in

Chicago, New York and abroad. I covered every futures market traded in the U.S. — and some that traded overseas — at one time or another.

I was born and raised in Iowa, where I now reside. I have a wonderful wife and two great children. I work very hard on the job, but also play hard after work, as I love adventures. From driving a Jeep across the highest mountain pass in the continental U.S., to extreme winter camping in the Boundary Waters, to hiking in the jungles of South America, I'm always up for a new challenge.

I know you will enjoy my book.

Jim Wyckoff (jim@jimwyckoff.com)

Tele: 1-319-277-8643

Website: www.jimwyckoff.com

Table of Contents

1. Before You Make a Trade: 10 Critical Questions	8
2. Volume and Open Interest: How to Use it to Trade More Effectively	11
3. How to Handle a Losing Streak (Everyone has Them)	13
4. Contrary Opinion: Making it Work for You	15
5. What Are The "Big Boys" Up To? How use the Commitment of Traders Report in your Trading	17
6. Support and Resistance – All-Important Levels on the Charts You MUST Identify!	19
7. Understanding Those Big, Bad Commodity Funds	21
8. “Collapse in Volatility” Portends a Bigger Price Move	23
9. Using the “ADM” Method to Deal with Losing Trades	25
10. “Pyramiding” – When and When Not to Do it	27
11. “Follow-Through” – its Significance for Your Market Position	28
12. “Cash Basis” -- How it Works	30
13. An Introduction to an Exciting Market — FOREX	32
14. “ OK, Maybe I Should Just Do the Opposite”	34
15. Making the Momentum Indicator Work for You	36
16. Using Joe Granville’s “On Balance Volume” (OBV) to Your Trading Advantage	38
17. Eight Short-term Technical Tools that can Make You Money	39
18. Technical Traders – Don’t Ignore the Fundamentals – PLEASE!	42
19. Selling Options: The Real Story	44
20. Why, When, and How to Buy Options on Futures	46
21. A Realistic Look at Futures Trading	48
22. When To Quit Your Day Job	50
23. Employing Protective Stops to Manage Your Trades	53
24. The “Andrews Pitchfork” Trend Lines Indicator: A Cool Secondary Tool	55
25. A Short Primer on Welles Wilder’s “True Range” and “Average True Range”	58
26. The K-Wave: A Cycle Worth Examining	60

27. Don't Hold Your Breath Too Long While Under Water	62
28. Entry and Exit Strategies for Maximum Profitability	64
29. Jim Wyckoff: One of my Favorite "Trading Setups"	66
30. Fear and Greed: Two Strong Emotions to Manage in a Grain Weather Market	68
31. Those Fascinating Fibonacci Numbers and the Golden Ratio	70
32. Identifying Overbought and Oversold Markets using The Keltner Channel	72
33. Identifying Market "Noise"	74
34. Futures Trading: The Ultimate "Head Game"	76
35. 11 Fascinating Market Correlations You'll Want to Use	78
36. 13 Different Market Orders and When to Use Each	80
37. The Single Most Important Aspect of Futures Trading	83
38. "Why Economists don't Make Good Traders" and a Few Nuggets	85
39. The Basic Principles of "Swing Trading"	87
40. "System Trading:" What Is It? Should you Buy and Use a Trading System?	89
41. Understanding and Using Donald Lambert's "Commodity Channel Index"	91
42. The MACD Indicator: A Great Secondary Tool	93
43. 4 Key Questions to Gauge Your Trading Success	95
44. Never Stop Learning! Education's Role in Your Long-Term Trading Success	97
45. The Top 10 Mistakes Traders Make	99
46. Fear Factor: The Impact of Trading With "Scared Money"	101
47. Nuggets You can use from a Trading Seminar	103
48. Don't Fight the Tape!	105
49. Using Larry Williams' Percent Range Indicator in Your Trading	107
50. Formulating Your Own Plan of Action	109
51. Quotes, Nuggets and Useful Tidbits from A Trading Seminar	111
52. The Elliott Wave Theory Demystified	114
53. How I use Bollinger Bands in My Trading	117
54. Another Secondary Tool: The DMI	119
55. EMAs: Where They Belong in Your Trading Toolbox	121
56. Howe's Limit Rule: Making it Work for You	123
57. Simple Moving Averages: A Helpful, but Secondary Tool	126
58. The Importance of Basic Trading Tools – Like the Venerable Trend Line	128

59. The Importance of Psychology in Trading	130
60. A Look at Seasonality in 10 Markets	133
61. How to Choose a Futures Broker that Fits Your Style	136
62. Spread Trading: More Complicated, Yes. But Less Risk, and Less Expense	138
63. Market Fundamentals: Use them to Avoid that "Naked Feeling"	140
64. Triple Moving Averages Explained	143
65. The Importance of "Knowing What You Don't Know"	145
66. Using Two Popular Oscillators: Slow Stochastics and Relative Strength	147
67. This Trading "Checklist" Will Help You Execute with Confidence	150
68. Studying and Preparation: Don't Sell it Short!	152
69. Technical Traders: You Should Still Examine Fundamentals	154
70. Veteran Traders Share Their Secrets and Strategies	156
71. Trading Lingo: Definitions for the Less-Experienced Trader	158
72. Better to Be Profitable Than Right!	161
73. Keep Market "Noise" in Perspective — Set Bigger Price Benchmarks	163
74. Abell, Koppel Discuss Their Profitable Short-term Trading Strategies	165
75. RSI Indicator: The "Cornerstone" of Andrew Cardwell's Trading Model	167
76. Jesse Livermore, World's Greatest Trader	169
77. Another 20th Century Great: Richard Wyckoff and His Methods	172
78. Trader Linda Bradford Raschke Gets "Back To Basics"	174
79. Tom Bierovic: Thoughts on Trading, and a Successful Trading Method	177
80. "Vibrating Prices" and the Trading Philosophies of W.D. Gann	179
81. Stan Erlich and Mark Cook on "Trading to Win"	182
82. John Murphy's Key to Success: Simplicity!	186
83. Hank Pruden on "Behavioral Finance" and Technical Analysis	187
84. Futures Trader Joe DiNapoli: Faring Well in a Tough Business	189
85. Chase Manhattan Technical Analyst Tirone: "You Need Game Plan"	192
86. Kaufman: Multiple Trading Methods and Market "Noise"	194
87. How Richard Lees Combines Physics Into His Technical Analysis	196
88. Trader Linda Raschke: Tips On Day-Trading the S&P 500	198
89. Mark Cook: "How to Lose Money Profitably"	201
90. Trader Mark Cook Reveals His Rules For Day-trading	203

91. Stan Ehrlich: Using Simple Cycle Analysis for Profit **205**
92. 10 Key Questions on Measuring your Trading Progress and Success **207**

Before You Make a Trade: 10 Critical Questions

A "Trading Checklist" of prioritized criteria not only will help you decide when to execute a trade, but will also help you identify potential winning trades.

What kind of stuff should a trader put on a Trading Checklist? That depends on the individual trader. Each trader should have his or her own set of criteria, or rules, that helps determine a market to trade and the direction to trade it--including when to get in and out.

Below are my Top 10 rules on my trading checklist.

1. Are shorter-term and longer-term charts in agreement on price trend?

I've told readers for years that this is my No. 1 trading rule. If the weekly, monthly and daily (and sometimes intra-day) bar charts are not in agreement on price trend, I'll likely pass on a trade. I'm usually a trend trader, and the "trend must be my friend" before I make a trade.

2. Is this potential trade within my financial risk tolerance?

To be a successful trader, I not only have to have winning trades, but I must survive the more numerous losing trades I am likely to encounter. If I see a potentially profitable trading "set-up," but the market is too volatile, I'll likely pass on the trade because of the potential for a big drawdown or even a margin call from my broker. An example is the energy markets a couple years ago. They were highly volatile. Certainly, there were some big moves (and trading opportunities for some) in the energies--both up and down. However, when a 75-cent, or more, daily move in crude oil is a "routine" trading session, that market is too volatile for my risk tolerance--at least when trading straight futures.

3. What is the potential risk-reward ratio of the trade?

My risk-reward ratio in a futures trade should be at least three to one on maximum profit potential. In other words, if my risk of loss is \$1,000, my maximum profit potential should be at least \$3,000. Anything less is not worth making the trade. Now, any eventual profit that is made may not always attain that three-to-one risk-reward ratio, but the point here is there should be the "potential" for a profit three times greater than your capital at risk in the trade.

4. Has there been a price "breakout" from a trading range?

One of my favorite trading "set-ups" is when prices have been in a trading range--between key support and resistance levels--for an extended period of time (the longer, the better). This type

of trading range is also called a congestion zone, or a basing area when at historically lower price levels. If the price breaks out of a range (above the key resistance or below the key support), I like to enter the market--long on an upside breakout or short on a downside breakout. A safer method would be to make sure there is follow-through strength or weakness the next trading session--in order to avoid a false breakout. The trade-off there is that I could be missing out on some of the price move by waiting an extra trading session.

5. Is there a potentially good entry point if the trade looks good?

Entry points in trades most times should be based on some type of support or resistance levels in a market. If I see a potential set-up for a long-side trade, I will wait for the market to push up through a resistance level and begin a fledgling uptrend. Then, if I do go long, I'll set my sell stop just below a support level that's not too far below the market. And if the trend does not develop and the market turns back south, I'm stopped out for a loss that's not too painful. Another way to enter a market that is trending (preferably just beginning to trend) is to wait for a minor pullback in an uptrend or an upside correction in a downtrend. Markets don't go straight up or straight down, and there are minor corrections in a trend that offer good entry points. The key is to try to determine if it is indeed just a correction and not the end of the trend.

6. Is there a support or resistance level nearby, at which I can set a protective stop when I enter the trade?

This is my exit strategy, and is one of the most important factors in trading futures. On when to get out of a market, I have a simple, yet very effective method: Upon entering a trade, if I place a sell stop below the market if I'm long (buy stop if I'm short), I know right away approximately how much money I could lose in any given trade. I will never trade straight futures without employing stops. Neither should you. Thus, I will never be in a trade and have a losing position and not know where my exit point is going to be.

7. Do "fundamental" market factors raise any warning flags?

Those who have read my features know I base the majority of my trading decisions on technical indicators and chart analysis--and also on market psychology. However, I do not ignore fundamentals that could impact the markets I'm trading. Neither should you. There are U.S. government economic reports that sometimes have a significant impact on markets. Associations also release reports that impact futures markets. Even private analysts' estimates can move markets. I make it a priority to know, in advance, the release of any scheduled reports or forecasts that have the potential to move the market for which I'm thinking about trading. I don't like surprises when I am in the middle of a trade.

8. What do computer-generated indicators show? (*RSI, DMI, Stochastics, etc.*)

Some traders use the Directional Movement Indicator (DMI) as a complete trading system. Also, some traders use the Relative Strength Index (RSI), Slow Stochastics or other computer-generated technical indicators solely for determining entry and exit points. I do neither and here's why: I consider these computer-generated technical indicators to be secondary, yet still important, trading tools. I will use these "secondary tools" to help me confirm or reject ideas that are based on my "primary tools"--which are basic chart patterns, support and resistance levels, trend lines, and fundamental analysis.

9. Do volume and open interest provide any clues?

Most veteran futures traders agree that volume and open interest are also "secondary" technical indicators that help confirm other technical signals on the charts. In other words, traders won't base their trading decisions solely on volume or open interest figures, but will instead use them in conjunction with other technical signals, or to help confirm signals. As a general rule, volume should increase as a trend develops. In an uptrend, volume should be heavier on up-days and lighter on down-days within the trend. In a downtrend, volume should be heavier on down-days and lighter on up-days. Changes in open interest also can be used to help confirm other technical signals. Open interest can help the trader gauge how much new money is flowing into a market, or if money is flowing out of a market. This is helpful when looking at a trending market. Another general trading rule is that if volume and open interest are increasing, then the trend will probably continue in its present direction--either up or down. And if volume and open interest are declining, this can be interpreted as a warning signal that the current trend may be about to end.

10. What is the prevailing general opinion of the market? (*Possible contrary thinking.*)

When I was working on the trading floors of the major futures exchanges, traders would many times "fade" (or trade against) the featured articles on commodities in the major newspapers, such as the Wall Street Journal. They figured that if the general financial press had picked up on a market (such as a drought driving grain prices higher), then that uptrend must be about over. Contrary opinion in the trading business is defined as going (trading) against the popular or most widely held opinions in the marketplace. This notion of "going against the grain" of popular market opinion is difficult to undertake, especially when there is a steady drumbeat of fundamental information that seems to corroborate the popular opinion. If you've read books on trading markets, most will tell you to have a trading plan and stick with it throughout the trade. A main reason for this trading tenet is to keep you from being swayed or influenced by the opinions of others while you are in the middle of a trade. Popular opinion is many times not the right opinion when it comes to market direction.

Volume and Open Interest: How to Use it to Trade More Effectively

Futures volume and open interest are significant factors to monitor when trading futures, for several reasons. First, let's define the two terms.

Open interest is the total number of futures or options on futures contracts that have not yet been offset or fulfilled by delivery. It is an indicator of the depth or liquidity of a futures market, which influences the ability to buy or sell at or near a given price.

Open interest can be a tricky concept, especially for beginners. In a nutshell, here's how open interest is calculated: If a new buyer (a long) and new seller (a short) enter a trade, open interest increases by one. However, if a trader already holding a long position sells to a new trader wanting to initiate a long position, open interest remains the same. And if a trader holding a long position sells to a trader wanting to get rid of his existing short position, open interest decreases by one.

Volume is the number of transactions in a futures or options on futures contract made during a specified period of time. It is usually recorded for one trading session.

You will want to exercise extra caution when attempting to trade a market with very low volume and open interest--or in other words, an illiquid market. Good and timely fills (order execution) may be hard to obtain. Also, markets with lots of liquidity are less likely to be manipulated by traders.

Most veteran futures traders agree that volume and open interest are "secondary" technical indicators that help confirm other technical signals on the charts. In other words, traders won't base their trading decisions solely on volume or open interest figures, but will instead use them in conjunction with other technical signals, or to help confirm signals.

For example, if there is a big upside price "breakout" in a futures market (or a stock, for that matter) that is accompanied by heavy volume, then that only makes the upside move a stronger trading signal. Also, a big upside move or a move to a new high that is accompanied by light volume makes the move suspect. Big price moves (up or down) accompanied by heavy volume are powerful trading signals. If prices score a new high or new low on lighter volume, then that is an indication a top or bottom may be near or in place. Also, if volume increases on price moves against the existing trend, then that trend may be nearing an end. This is called divergence.

As a general rule, volume should increase as a trend develops. In an uptrend, volume should be heavier on up-days and lighter on down-days within the trend. In a downtrend, volume should be heavier on down-days and lighter on up-days.

Changes in open interest also can be used to help confirm other technical signals. Open interest can help the trader gauge how much new money is flowing into a market, or if money is flowing out of a market. This is helpful when looking at a trending market.

Another general trading rule is that if volume and open interest are increasing, then the trend will probably continue in its present direction--either up or down. And if volume and open interest are declining, this can be interpreted as a signal that the current trend may be about to end.

Here's a difference in open interest, as opposed to volume: Open interest has seasonal tendencies--higher at some times of the year and lower at some times of the year, in many markets. The seasonal average of the open interest is important in analyzing open interest figures. If prices are rising in an uptrend and total open interest is increasing more than its seasonal average (5-year average), new money is considered to be flowing into the market, indicating aggressive new buying, and that is bullish.

However, if prices are rising and open interest is falling by more than its seasonal average, the rally is being caused by the holders of losing short positions liquidating (short covering) and money is leaving the market. This is usually bearish, as the rally will likely fizzle.

The same holds true in a downtrend. Open interest increasing more than its seasonal average on the downmove means new aggressive sellers entering the market, and this is bearish. But if open interest is declining more than the seasonal average on the downmove, then it's likely holders of long positions are liquidating their losing trades (long liquidation), and that the downtrend may be near an end.

Here are two more rules for open interest:

Very high open interest at market tops can cause a steep and quick price downturn.

Open interest that is building up during a consolidation, or "basing" period, can strengthen the price breakout, when it happens.

Many seasoned traders like to examine the Commodity Futures Trading Commission's (CFTC) "Commitments of Traders" (COT) reports, for changes in open interest and to see what the big speculators and commercial traders are doing. More information on the COT reports is available free at the CFTC's website at www.cftc.gov.

How to Handle a Losing Streak (everyone has them)

A trader emailed me a while back, asking for some advice on a good money manager for him. He said he was a "lousy trader" and tired of losing money.

I doubt there is one non-rookie trader reading this story who has not experienced at least a small run of poor performance in trading futures. I've said before that most successful veteran traders have more losing trades than winning trades in any given year. The key is maximizing profits on the winning trades and minimizing losses on the losers.

I will also argue that at one point or another in most traders' experiences, they, too, have felt like "lousy traders." I certainly have. (Those who say they have never had a run of poor trading performance or felt "lousy" about a trade or trades are likely either lying or completely out of touch with futures trading reality.)

So what's a trader to do when losses start to pile up and winners become scarce. Here are a few tips that I've picked up over the years from some of the very best traders in the business:

- **Don't overtrade.** If you are trading several markets and not having any success, cut back to trading one or two markets. You can follow fewer trades more closely and document your success or failures more easily. Plus, your trading account won't be drawn down so quickly.
- **Keep a detailed trading diary.** If you keep a good trading diary, you can go back and see if there is a common thread among your losers--and your winners, and possibly make the proper adjustments.
- **If you are not trading that many markets and still racking up losers, take a break from trading for a while.** Gather your thoughts. You may want to "paper trade" for a while to get your confidence back. Then, if you are still losing on paper, you will want to look for other trading methods.
- **If you are losing money trading, DO NOT (I REPEAT) DO NOT try to make a big home-run-type trade that will get you back to even or the plus side in a hurry.** In fact, do just the opposite. Make smaller trades that risk less capital, until your performance starts to turn around and you can resume your normal asset allowances for trades. Successful traders survive the rough waters by hunkering down and being conservative.
- **Exhibit patience and discipline.** I've preached about this before. Are you following a trading plan that you devised before you put on the trade? If not, you should be. You are

not shooting from the hip (no exit strategy in place) once a trade gets initiated, are you? If so, that could be part of your problem. On the patience issue, are you impatient? I've talked to successful position traders who may only trade a few times a year, because they wait for what they feel is that "perfect set-up" to occur. If you are a position trader (as opposed to a day trader), you don't have to be "in the market" all the time. Wait for the good trades to develop and don't chase markets.

- **Be confident.** Have faith in your trading methods. And if you don't have faith in your methodology, why don't you? If your methods are really not successful, find something else. Read some of the many books out there by the successful traders, and how they have traded successfully. But be cautious of the person who wants to sell you some so-called successful trading method for big bucks. (See the next item on hard work.)
- **Work harder.** Don't expect to produce winning trades if you are not working very hard at trading. Do you know well the fundamentals of the markets you are trading? Even if you know technicals well, you should have at least a good understanding of a market's fundamentals. Here's an example: Let's say the charts and technical indicators look bullish for corn and it's the day before a major USDA report. Smart traders likely won't initiate a trading position in corn the day before a big government report is out.

In case you're wondering what I told the reader who emailed me and told me was a "lousy" trader, here's what I said: Don't give up just yet. The fact that he admitted he needed some help (before he lost all of his trading assets) is a positive first step. I then told him I would write this feature because there were likely many traders who feel the same way, at times, that he feels, and that there are steps to take on the road to recovery and eventual successful trading.

Contrary Opinion – How to Make it Work for You

I have told readers that one of the best methods to trade a market is to jump on board when prices "break out" of a congestion or "basing" area on the charts and begin a new trend. I have also stressed to readers that one of the most risky and least successful trading methods is trying to pick tops and bottoms in markets. Now, I'm going to muddy the waters just a bit and discuss contrary opinion.

Contrary opinion in the trading business is defined as going (trading) against the popular or most widely held opinions in the marketplace. This notion of "going against the grain" of popular market opinion is difficult to undertake, especially when there is a steady drumbeat of fundamental information that seems to corroborate the popular opinion.

To help you understand why contrarian thinking is used successfully by some traders, consider these questions: When is a market most bullish? When is a market most bearish? The answers are: A market is most bullish when the highest daily high on the chart is scored--it's downhill for prices from there. A market is most bearish when the lowest low is reached on the chart, and then the market turns up.

It's no wonder many novice traders lose their assets quickly in the futures trading arena. Traders are most bullish at market tops and most bearish at market bottoms!

Since nobody has discovered the Holy Grail of trading markets, the best traders can do is seek out clues, through chart and technical analysis, fundamental analysis, and possibly do some contrary thinking.

If you've read books on trading markets, most will tell you to have a trading plan and stick with it throughout the trade. A main reason for this trading tenet is to keep you from being swayed or influenced by the opinions of others while you are in the middle of a trade. Popular opinion is many times not the right opinion when it comes to market direction.

I'll give you an actual example of how contrarian thinking and trading can be successful. The year was 1988, the last big drought year in the Midwest that saw corn and soybean prices skyrocket. It was a Friday in July that saw corn and bean prices trade sharply higher, based on ideas the hot and dry weather would continue in the Corn Belt. Then, after the close, the National Weather Service issued its 6-10 day forecast that, sure enough, called for more hot and dry weather for the Corn Belt. Bulls confidently headed home for the weekend. Even "local" traders on the Chicago Board of Trade floor went home long--something most never do, especially over a weekend.

Well, come Monday morning, the updated weather forecasts had changed a bit, but more importantly, trader psychology had changed immensely. The drought and resulting poor yields had all been factored into the market with prior price gains, culminating with Friday's big push higher. Corn and bean markets traded limit down on Monday and recorded very sharp losses for around three days in a row.

I know of one trader who used contrary opinion thinking and bought put options on corn that Friday that prices were pushing higher. He made a good deal of money that next week.

But isn't that top-picking? Yes, technically it is. But this trader used a low-risk trade by purchasing options and employed contrary opinion to score a winning trade. Contrarian trading is not for everyone, but some traders are successful in employing it.

For further reading on using contrary opinion in trading, there is a book called "Contrary Opinion" by R. Earl Hadady. He is the founder of Market Vane's "Bullish Consensus." This is a weekly report that provides traders' degree of bullishness or bearishness in the major markets. Traders use this report to help them gauge when a market is overbought or oversold.

What Are The 'Big Boys' Up To? How use the Commitment of Traders Report in your Trading

I have discussed in past articles how volume and open interest can be used to help identify and confirm market situations and trading opportunities. I'll take open interest one step further in this column by examining the Commitments of Traders (C.O.T.) report, issued by the Commodity Futures Trading Commission (CFTC).

The C.O.T. report is released weekly--every Friday afternoon. There is also a C.O.T. report that includes options on futures issued at the same time. The report that includes options is not as closely followed as the report that covers only futures. Reason: The combined futures and options report has less history.

The C.O.T. reports provide a breakdown of each Tuesday's open interest for markets in which 20 or more traders or hedgers hold positions equal to, or above, reporting levels established by the CFTC.

The C.O.T. report breaks down by open interest large trader positions into "Commercial" and "Non-Commercial" categories. Commercial traders are required to register with the CFTC by showing a related cash business for which futures are used as a hedge. The Non-Commercial category is comprised of large speculators--namely the commodity funds. The balance of open interest is qualified under the "Non-reportable" classification that includes both small commercial hedgers and small speculators.

What is most important for the individual trader (you) to examine in the reports is the actual positions of the categories of traders--specifically the net position changes from the prior report. To derive the net trader position for each category, subtract the short contracts from the long contracts. A positive result indicates a net-long position (more longs than shorts). A negative result indicates a net-short position (more shorts than longs).

Now, if I've got many of you lost at this point, DON'T WORRY. I've got some suggestions later on that allow you to look at some examples of reports on other websites. What I'm trying to do at this point is familiarize you with the general basis of the report, related terminology and how traders use the C.O.T. report. This stuff will sink in--it just takes a little while.

My friend, Steve Briese, is one of the world's foremost experts on C.O.T. data. He publishes the "Bullish Review," which comes out right after each C.O.T. report. It is from conversations with Steve through the years and reading some of his material that I have learned about the C.O.T. report and its value to traders.

The most important aspect of the C.O.T. report for most traders is the change in net positions of the commercial hedgers. Why? Because studies show that commercials hold a superior record to other trading groups in forecasting significant market moves. The large commercials are generally believed to have the best fundamental supply and demand information on their markets, and thus position their trades accordingly. Along with the advantage of having the best fundamental supply and demand information on their markets, large commercials also trade large size, which in itself moves markets in their favor.

It's important here to note that whether a particular trader group is net long or net short is not important to analyzing the C.O.T. report. For example, commercials in silver are the producers and they have never been net long, because they hedge their sales. In gold, however, the commercial mix is more heavily weighted toward fabricators who buy long contracts as a hedge against future inventory needs. So, again you need to look at the net change in positions from the previous report or several of the recent reports.

Individual traders that consider positioning themselves on the same side of the market as large commercials, when the large commercials become one-sided in their market view, is the best way to utilize the C.O.T. report.

Some traders do like to take the opposite sides of the trades on which the small trader (non-reportable positions) in the C.O.T. reports are shown taking. This is because most small speculative traders of futures markets are usually under-capitalized and/or on the wrong side of the market.

Also, some traders will also follow the coat-tails of the large speculators, thinking the large specs must be good traders or they would not be in the large trader category.

Briese says that contrary to what some believe, divergences from seasonal open interest averages in C.O.T. report data are not reliable trading indicators. This is even true with agricultural markets, where one would suspect that hedging is a seasonal consideration.

For more information on the C.O.T. reports, check out the Internet websites www.bullishreview.com or www.cftc.gov.

Support and Resistance – All-Important Levels on the Charts You MUST Identify!

In this educational feature, I'm going to tackle an issue about which several readers have inquired: How to determine support and resistance areas on the charts.

My favorite method (and I believe this the most accurate method) of determining support and resistance levels is to look at a bar chart and its past price history and then see at what price levels the highs, lows and closes seem to be touching the most. This method of determining support and resistance levels works on any bar chart timeframe--hourly, daily, weekly or monthly. Many times a bunch of highs or lows will be concentrated in a small price area, but not at one specific price. If that's the case, I will determine that area to be a support or resistance "zone." The one thing I will point out with determining support and resistance zones is that you don't want your zone to be so wide that it's virtually useless from a trading standpoint.



Major price tops and bottoms in markets are also major resistance and support levels. Unfilled price gaps on charts also qualify as very good support and resistance levels. Trendline support and resistance is also very useful to the trader. Projecting these trendlines to determine future support and resistance areas is extremely effective.

It's important to note that when a key support level or zone is penetrated on the downside, that level or zone will likely become key resistance. Likewise, a key resistance level or zone that is penetrated on the upside will then likely become a key support level or zone.

Another way to discover support or resistance areas is by looking at "retracements" of a significant price move--price moves that are counter to an existing price trend. These moves are also called "corrections." For example, let's say a market is in a solid uptrend. That uptrend began at the 100 price level and prices rallied to 200. But then prices backed off to 150, only to then turn around and continue to rally higher. This would be considered a 50% retracement of the move from 100 to 200. The 150 level proved to be solid support. In other words, the 50% retracement level proved to be a solid support level because prices dropped by 50% and then moved back higher. The same holds true for downtrends and "corrections" to the upside.

There are a few retracement percentages that work well at determining support and resistance levels. They are as follows: 33%, 50% and 67%. There are also two other numbers called Fibonacci numbers. (Fibonacci was a mathematician.) Those numbers are 38% and 62%. So, these five numbers are the best at determining retracement support and resistance levels. Most of the better trading software packages have these five percentages calculated in a tool, so that all you have to do, for example, is click your mouse at the beginning of the price trend and then at a high, and the percentage retracements are laid out right on a price chart.

Still another way that support and resistance levels can be identified is through geometric angles from a certain key price point. W.D. Gann, a legendary stock and commodity trader who died in 1955, is the most noted proponent of this method. He also used the same five numbers mentioned above to calculate his angles. Again, the better trading software will provide "Gann fans" to plot the angles on the charts.

Finally, support and resistance levels for markets can be determined by "psychological" price levels. These are usually round numbers that are very significant in a market. For example, in crude oil, a psychological price level would be \$20 per barrel, or \$25, or \$30. In soybeans, a price of \$5.00 or \$6.00 or \$4.00 would be a psychological level. In cotton, 50 cents would qualify. Silver would be \$5.00.

There are other methods traders use to determine support and resistance levels, but those mentioned above are the most popular.

Understanding those Big, Bad Commodity Funds

How many times do you read the news wires and hear about the commodity funds (or just the "funds") doing this or doing that in the market? And it seems like these big bullies are always on the opposite side of the market than the smaller speculator. To the less-experienced traders the "funds" may seem like the CIA or the Mafia: a powerful and secretive force that has a reach far and wide. In this feature, I'll try to present a clearer picture of the funds, and maybe dispel some myths regarding them.

Just what are the "funds?" They can come in several forms, but usually it's a large pool of investor money (funds) that is managed by a single entity, such as a Commodity Pool Operator (CPO) or Commodity Trading Advisor (CTA). The CPO or CTA then trades futures contracts with the goal of gaining the best annual return on that money possible--better than any other funds or "managed accounts."

Most wealthy investors do not put a big portion of their investment portfolio into futures trading. But some may put 10% or less of their portfolios into managed futures trading accounts. Still, given that it's usually the wealthier investors (and not the smaller investors) that put a small percentage of their portfolio in the futures market, even that small percentage coming from many wealthy investors into commodity pools can add up to a lot of speculative cash pouring into the futures markets. Thus, the "funds" can and do have the weight to move markets.

Generally speaking, the commodity fund operators are trend-following traders who use a shorter-term timeframe to trade futures. Many tend to use moving averages as a major trading tool, or some type of mechanical trading system. Either way, these traders rely on technical analysis for the vast majority of their trading decisions. The funds like to see a market start to "lean" one way, and then pile on positions in favor of the way the market is leaning. This is why markets tend to become overbought and oversold, on a technical basis. The fund buying or selling causes markets to over-react, or become over-extended.

Probably the one commodity group where the funds have the most notoriety is the grains complex. The grains provide an excellent medium for the funds because of the liquidity (high volume and open interest). Given that the funds usually take big trading positions, it would be more difficult for them to dabble in futures markets where the liquidity is thin, such as lumber or platinum. Also, the higher-liquidity markets allow the funds to get into and out of positions more discreetly.

Even with the big pools of cash that the commodity funds possess, they can't stand up to the "big brother" of futures markets: the commercials (the hedgers). The major food processors such as Cargill or Pillsbury have the huge clout and very deep pockets to keep the funds honest and keep

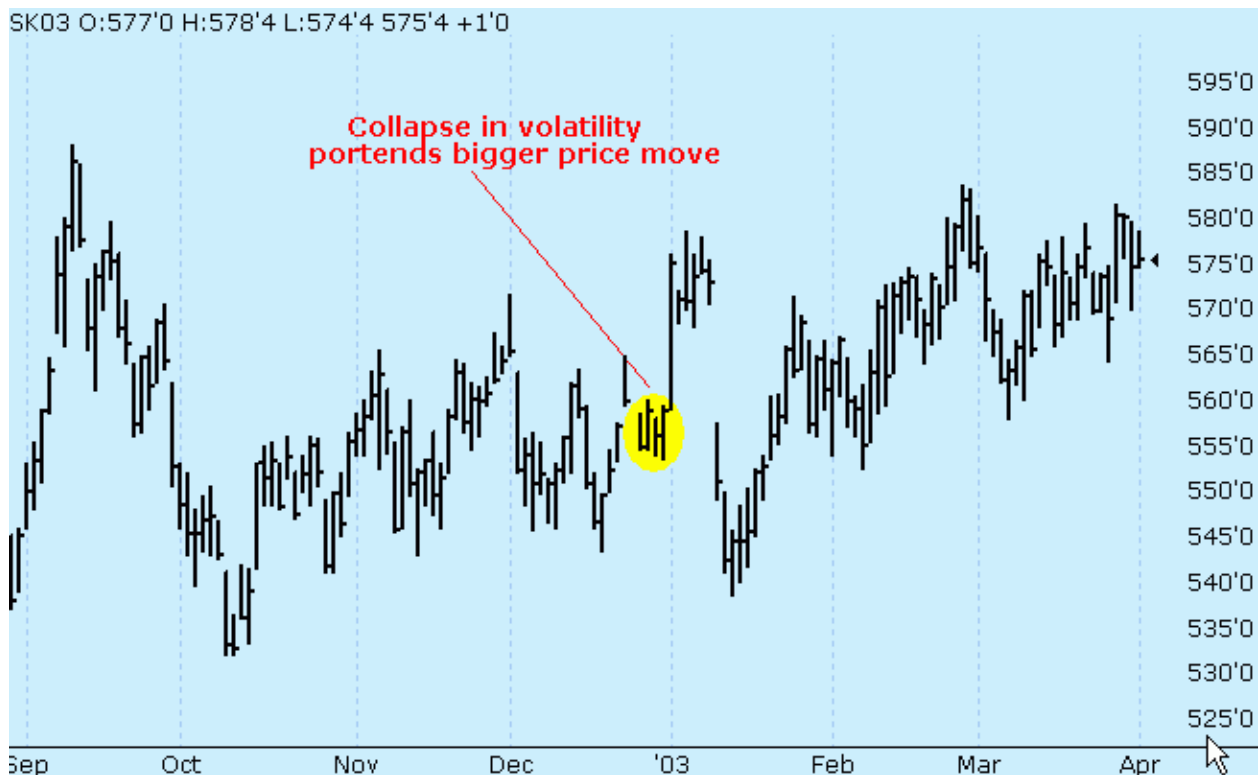
futures markets fairly priced at most times. But still, the funds have enough power to more than jiggle markets once in a while. Here's an analogy: The funds are like a fly and the commercials like a horse: A biting fly can still make a horse wince.

“Collapse in Volatility” Portends a Bigger Price Move

Market behavior can be predictable to a certain degree. However, nobody can predict exactly what a specific market will do at a precise time. The true professionals in our business will tell you that market analysis is not a business of predictions, but one of probabilities. I saw a TV commercial recently that "hit the nail on the head."

On the topic of brokerage firm research, a wise old gentleman said, "If you want a fortune-teller, go to the circus."

Market analysis professionals do know that price history repeats itself, and from price history one can extrapolate predictable patterns of price behavior. One such pattern is what I call a "collapse in volatility." My friend Glen Ring, who is a respected trader, researcher and trading educator, introduced me to this phenomenon.



A collapse in market price volatility occurs when trading ranges narrow substantially. This price pattern is evidenced by price chart bars (the bars can be daily, weekly, monthly, hourly or minutes) that suddenly get smaller. The smaller price bars should number at least three in a row, and do not necessarily need to get progressively smaller with each bar.

Importantly, this "collapse in volatility" usually sets off a significantly bigger price move--either up or down.

As the smaller price bars accrue on the chart, there is no set number of bars that will set off the bigger price move. It could be three bars, or it could be 10 bars or more before the bigger price action is set off.

When I point out a collapse in volatility in a market, traders will ask me, "In which direction will be the big price move?" I don't know. I just know that a bigger price move is likely forthcoming. However, there are occasions when there is a collapse in volatility and at the same time other technical indicators are signaling a price move in one direction. It's on these occasions that one can determine that odds favor a bigger price move in a certain direction.

It's also important not to confuse a collapse in volatility with a trading range or a "congestion area." A trading range or a congestion area on the price charts is defined as prices moving in a sideways pattern, usually bound by some stiff support and resistance levels. Trading ranges or congestion areas are longer in duration than a collapse in volatility, and are also marked by trading bars that are not so narrow. Remember, a collapse in volatility needs to show significantly narrower trading bars for at least three bars in a row. And if some slightly bigger price bars do form after several smaller price bars in a row, then a bigger price move is not likely to occur.

Using the "ADM" Method to Deal with Losing Trades

A main tenet of success in futures trading is the ability to accept losing trades as part of the overall trading process. This is not an easy undertaking--especially since many futures traders tend to be of a more competitive nature in the first place. Traders certainly don't have to enjoy losing trades, but they must accept the fact and move on. Those who can't accept the fact that losing trades are a part of futures trading usually don't stay in the business very long.



My wife is a school teacher, and one of her favorite acronyms--ADM--can be applied to losing futures trades. "Accept" it. "Deal" with it. "Move" on. (This is a part of the important psychological aspect of trading, and deserves much more discussion than I can provide in this feature.)

I had lunch with one of my trading mentors a while back. We discussed losing trades. I asked my mentor how many losing trades in a row he has had to endure during his long and successful trading career. His reply was 13 in a row. I asked him how he coped with that. He said that while it was certainly not easy, he knew that losing trades are a part of the business and that he was in the business "for the long haul," and that his trading methodology was sound. He added, "Ninety-percent of futures trading profits are made on 10% of the trades, which means most of the other trades are either small losers or break-even-type trades." This is an important fact for all traders to keep in mind.

My lunch meeting with my mentor was good for me because, even though we made no "break-through" discoveries on the path to increased futures trading success, we did reaffirm our own philosophies on trading and markets. My passion for trading and market analysis is fed immensely every time I talk with people in my profession, or attend the quality trading seminars.

For many of you, the futures trading arena can be more fulfilling (and more fun) if you have someone, or some support group, with which to share your thoughts and strategies. If you are passionate about futures trading and markets, finding someone who shares that passion is a great trading tool within itself!

“Pyramiding” – When and When Not to Do it

A frequent question I get from less-experienced traders is: "Should I add futures contracts to my existing market position?" That's a broad question and there is no single right answer. So, let's break down the question into some scenarios.

First, if your trading plan calls for the "scaling in" to a trading position, then adding to an existing position would be prudent. For example, let's say a trader plans on entering a long soybean trade with three contracts. His first "leg" into the trade may be at \$4.40, and the second "leg" at \$4.60 and his third "leg" of the trade would be at the \$4.80 level. Thus, if the market action plays out the way the trader expected in his initial trading plan, he would be adding to his existing position twice. Again, this trader is adhering to his initial trading plan.

Let's look at another scenario: A trader enters a long soybean futures trade at \$4.40, and he has an upside objective of \$4.80. That is his initial trading plan. However, when prices hit \$4.80, the general feeling among the "soybean marketplace" is that prices will track still higher--possibly much higher. The trader decides that instead of either placing a very tight trailing sell stop or exiting the trade (as was his original plan), he will add a couple more contracts to his already-profitable position--even though he did not have this idea in his original plan of trading action. This is not a prudent way to trade. Reason: The trader got caught up in the emotion of a bullish run in the soybean market. He got greedy. Emotions can destroy a trader. This is why trading plans should be strictly followed. Don't let the heightened emotions of being "in the market" influence your trading decisions.

The one emotion that can quickly take a person out of the fascinating business of trading futures is greed. In the last trading scenario, the trader who wanted to add to an already-profitable position was exhibiting greed. It was not enough for him that he could pull a \$2,000 profit out of a single-contract trade (as expected in his original trading plan). He wanted more. It's this kind of rationale that many times leads to trading ruin.

Most veteran traders agree that adding contracts to a losing position is a recipe for disaster. Trying to "average down" a losing trade should NEVER, NEVER be attempted.

One more factor to consider when adding contracts to an existing position--even to a profitable one--is that a move against you is now multiplied by the amount of contracts you just added. While this is likely readily apparent to most traders, what is sometimes missed is the rapidity at which profits can evaporate when more contracts are added to an existing profitable trading position and the market then moves only modestly against you. You may lose all of your original profit--and then some--including getting a margin call.

Finally, many prudent traders of multiple contracts in one position will actually trade fewer contracts as their profits accrue. For example, let's say the soybean trader who had three "lots" (contracts) in the example above continues to accrue profits as prices rise above \$5.00. He may then start to "scale out" of his winning trade by selling one lot at \$5.10, and then one at \$5.20, and then maybe he'll let the final lot "ride" with a tight trailing protective sell stop.

“Follow-Through” – its Significance for Your Market Position

Patience is a virtue in most endeavors in life, and it's certainly a valuable asset in futures and stock trading. You will many times hear me use the important term, "follow-through," when I discuss significant market moves such as price breakouts or trend changes.

"Follow-through" trading activity is really just a confirmation of the previous trading session's bigger price move. If one day's (or one price bar's) move is really that technically significant, then prices should be able to show some follow-through in the same direction the next trading session (or next trading bar on the chart).



Many times that all-important follow-through price action does not occur. What many times does occur is the market retraces much of the previous trading session's bigger gains or losses, and when all is said and done at the end of the day, prices are not that far from where they were two sessions (or two price bars) ago.

I am not a perfect trader and I, too, am continually learning (or trying to learn!) from past trading missteps. I want to provide you with a specific example of when I did not wait for a market to

show me that important follow-through strength on what I thought to be an upside breakout--but instead was a false breakout.

I had the corn market on my "Radar Screen" for several weeks a while back. I was waiting for the market to break above and negate a longer-term downtrend line. On a Wednesday, corn did show a strong up-move and prices pushed just slightly above a longer-term downtrend line--but did not come close to negating it. Well, I had to be out of the office for the next two days (Thursday and Friday), and would not have any access to my broker or price data. So I called my broker that Wednesday afternoon and put in a buy-stop order for corn at a price level far enough above the downtrend line so that if the buy stop was hit, I thought it would be a strong enough price move to negate the downtrend line and signify an upside breakout on the daily bar chart.

So I took off out of town that night, with a little gremlin in the back of my brain that was saying, "You are still not waiting for follow-through price strength the next trading day to confirm the upside breakout in corn!" Sure enough, corn futures opened up on Thursday morning and moved high enough to touch my stop and get me into the market on the long side--only to have that price level be the high for the month. Prices then reversed lower and I was stopped out of the corn market about a week later.

Of course, hindsight is always 20/20. However, this particular trade reconfirmed to me the importance of having the patience to wait for a market to show follow-through price action to confirm a potential trading "set-up." In waiting for follow-through strength or weakness, a trader does run the risk of missing out on some of a price move. But more times than not, it is prudent to make a market confirm a bigger price move with follow-through activity the next session--or the next price bar for intra-day charts.

By the way, a market sometimes can exhibit a small-trading-range "rest day" after a bigger price move, and then confirm that bigger move the next trading session. But usually, if follow-through strength or weakness is going to occur, it's the very next trading session after the bigger move.

Cash Basis: How it Works

I received an email message from a reader the other day, asking me to explain the “cash” markets, as they relate to the futures markets. The cash market is also called the “prompt” market, the “physical” market or the “spot” market.

All futures markets are based upon some type of underlying cash or physical market. A futures market must be tied to some type of physical market, in order to keep the futures market price fairly valued and actively traded. For example, in the corn futures there is the “cash” corn that farmers harvest and deliver to their local elevators. In the crude oil futures, there is the physical crude oil that is refined into various industrial forms, such as gasoline. In gold, there is the world “spot” market and London cash fixings. The same situation applies to other raw commodities futures. All have some type of an underlying cash market.

U.S. Treasury Bond futures also have a cash market, which is the actual debt sold at auction by the U.S. Treasury Department, via bonds, notes and bills. Stock index futures also have a cash market, which are the actual individual stocks that are bought and sold on stock exchanges.

Many cash market products are actually deliverable at designated locations to offset an existing position in the futures market. Grain futures are one example of a deliverable commodity against existing futures market positions. There are some futures markets that are cash-settled only, such as feeder cattle futures and the stock indexes.

Cash Market “Basis”

Cash basis is defined as the cash price of the commodity minus the futures price of the commodity. Basis can be positive or negative depending on the factors that determine basis. These factors include local supply and demand for the raw commodity, supply and demand for transportation, variations in the commodity’s quality and the futures contract specifications, and the availability of substitutes for the commodity. Generally, transportation expenses makes up the largest portion of cash basis.

Changes in cash basis are not as volatile as changes in cash market or futures prices. Changes in basis tend to follow seasonal patterns. At harvest, grain supplies are generally more plentiful, resulting in a higher demand for transportation services and an increased cost to move grain (weaker basis). Post-harvest improvement in basis often occurs because of increased availability of transportation services at a better price, and improvements in local supply and demand conditions.

Country grain elevators base the price they will pay farmers for their grain on the price of grain futures at the Chicago Board of Trade. For example, a grain elevator in central Nebraska will likely have a wider basis than will a grain elevator located on the Mississippi River in Dubuque, Iowa. Reason: Shipping costs to get grain from the elevator in central Nebraska to the Gulf of

Mexico are more than the shipping costs of the elevator located in Dubuque, Iowa, shipping to the Gulf of Mexico.

For example, the cash soybean price quote from a grain elevator in Nebraska might be “28 cents under the May futures contract.” Whereas the cash soybean quote from a Dubuque elevator might be “8 cents under the May futures contract.” And at the Gulf of Mexico, cash soybeans could be quoted at “30 cents over the May contract.” See how the basis “narrows” as the cash grain gets closer to its final shipping destination. The cash basis at the Gulf of Mexico includes the transportation costs of getting the grain to that major shipping destination.

Changes in cash basis levels are closely watched by futures traders. Commercials go to great lengths to keep history and study various cash basis levels for the markets in which they are involved. It is a laborious process. Changes in cash basis levels signal changes in demand coming from the end-users and changes in supply coming from the producers of the raw commodity.

An Introduction to an Exciting Market — FOREX

The largest traded "market" in the world is not the U.S., Japanese or European stock markets. It's the foreign exchange market. It's also called FOREX for short, or called the cash currency or spot currency market. Speculators can and do trade this huge market, in which over 1 trillion dollars (and other currencies) can change hands every day.

The purpose of this feature is to introduce you to the FOREX market. I will just scratch the surface here, and I suggest you read some books on FOREX trading if you want to learn more about the world's largest traded market.

Here's an example to help you better understand the FOREX market. If you have ever traveled to another country and needed to exchange your own currency for another country's currency, then you know why foreign exchange is a necessity. (Americans are spoiled when they travel to other countries because many retail merchants will accept U.S. dollars for payment.)

The "exchange rate" for your currency is usually posted at the institution at which you exchange your currency for another currency--for example, a bank branch at an airport. Exchange rates fluctuate on a daily basis. Factors that impact an individual country's currency exchange rate are the health of its economy, political events, natural disasters and events around the world that could impact that particular country's economic or political well-being.

FOREX trading is done in "currency pairs." In other words, when you trade spot currencies you are trading in pairs. It has to be that way. Think about it: When you go to the airport to change out American dollars for Euros (the new European Union single currency), you are actually making a transaction in the "Euro-Dollar" currency pair. The first currency listed in every pair is known as the "base currency." The exchange rate refers to the amount of the second currency that can be exchanged for one unit of the base currency.

Here are some major currency pairs that are traded by hedgers and speculators worldwide: Euro-Dollar, Dollar-Swiss Franc, Dollar-Canada Dollar, Dollar-Japanese Yen, Dollar-Australian Dollar and British Pound-Dollar. Notice that the U.S. dollar is the "base" currency for most major currency pairs.

There are currency futures and options that trade at the Chicago Mercantile Exchange. You can trade the British pound, Swiss Franc, Australian Dollar, Canadian Dollar, as well as others. But again, even though the CME currencies are not labeled as "pairs," that is in fact what the futures are based upon. For example, Japanese yen futures prices are based upon the Dollar-Yen currency pair.

One big advantage to trading in the FOREX market is that it is a very liquid market (remember, it's the largest traded market in the world). The FOREX market trades from about 6:00 p.m. Central U.S. time on Sunday night, straight through until about 2:00 p.m. Central U.S. time on Friday afternoon.

There are some nuances in FOREX trading that futures traders do not encounter. One is the fact that since FOREX trading occurs continuously for 24 hours per day, five days per week, there is a daily settlement period designated. FOREX traders must theoretically "settle up" or square their positions at the end of every day. There is usually a small fee charged for this daily settlement process.

The margin for trading the FOREX market is usually around 1%, meaning that a \$10,000 account can trade about \$1 million worth of currencies. Most FOREX brokers do require at least a \$10,000 margin deposit to open a FOREX trading account.

U.S. traders wanting to explore more about trading the world foreign exchange market should be aware that in the Commodity Futures Modernization Act of 2000 (CFMA), the Commodity Exchange Act was amended to make clear that it is unlawful to offer FOREX products to retail customers unless the entity offering the service is a regulated financial entity as spelled out in the CFMA. For more details regarding FOREX trading and the U.S. laws regulating it, check out the following Commodity Futures Trading Commission (CFTC) website address:
www.cftc.gov/opa/enf98/opaforexa15.htm

“OK, Maybe I Should Just Do the Opposite”

Anybody who makes the pitch that trading futures is easy and a sure-fire ticket to "Easy Street" is either way out of touch with reality, or a scam artist out to take your money. Success can be achieved in this fascinating business--but it is not easy, folks. It's not easy for the less-experienced traders, and it's also not easy for the professionals.

I was thinking the other night about what I was going to write for my latest educational feature. I was thinking about how many people through the years have jokingly (and some seriously) said to me: "Maybe I should just take the exact opposite trading position that I had planned." Think about it. At first blush, that seems not to be such a silly idea. If indeed the vast majority of traders have more losing trades than winning trades, then it seems that if they just did the opposite they would have more winning trades than losing trades, right? **Wrong.** Here is why:

The reason futures trading is difficult is because of the high degree of leverage involved in trading futures. You can be right in your determination of market trend, but if the market does an unexpected "hiccup" during the trend--as it many times does--then you could be stopped out of your position for a loss. These "hiccups" can be unnerving and frustrating to traders, but in reality they are only very small blips in the overall scheme of the market's price structure. Let me explain by providing you with this example: Most traders would agree that a 25-cent daily trading range in soybeans is fairly large. However, that's less than a 5% fluctuation in the overall price of the commodity. It's the high leverage the futures trader accepts that makes this type of move seem so large. Remember, for less than \$1,000 in margin money, a soybean trader is actually responsible for a soybean futures contract that is worth over \$20,000.

Some may ask: "Then why use stops? Why not let those 'hiccups' play out and the market will eventually trend in the direction you anticipated." If only trading futures was that easy. If traders opt not to use protective stops, they are inviting big drawdowns on their trading accounts, amid the "hope" that prices will eventually turn in their favor. That is not a good situation for most traders. Cutting losses short is a much better alternative.

However, I do know a few traders that have made very long-term trades with no protective stops. These traders know that their drawdowns can be steeper, but they plan on "waiting the markets out" for their anticipated moves. These traders have well-defined trading plans and they cannot be faulted, even though most traders don't employ such trading plans.

I also want to share with you another phenomenon that I quite often see in analyzing and trading futures markets: When nearly everyone agrees on the likely direction of a particular market trend--even the experts: watch out. The U.S. Treasury bond futures market a while back was a classic example. Last winter, every one of the trading advisory newsletters that I followed

indicated a near-term bearish stance on bonds. (The nice thing about being a newsletter writer in this business is that many of us exchange our newsletters on a complimentary basis.) Guess what happened? The T-Bond market trended higher (and is, still). The markets are always right, and even the best traders and analysts in the business are tripped up more often than they like to admit.

Making the Momentum Indicator Work for You



When analyzing markets I often use the term "momentum" when referring to the amount of strength the bulls or bears have at a given point in time. This market "momentum" is a key indicator regarding the strength of a trend, or whether a trend is about to end or begin.

When I worked as a market reporter on the trading floors of the Chicago Board of Trade and the Chicago Mercantile Exchange, I (as well the floor traders) had a very keen sense of which camp (bulls or bears) had momentum on their side. This was especially true in the grain pits at the Board of Trade. One obtained this keen awareness by being right on the trading floor, talking with all the market-makers who helped determine prices.

By examining charts, cycles, seasonality and other technical indicators--and near-term fundamentals--one can also get a good reading on whether the bulls or the bears have the edge in any given market. However, I must admit that when trying to gauge market momentum there is no substitute for working right on the trading floor and talking face-to-face with the market-makers. But very few get that opportunity, so other tools have to be employed. One such technical tool is the Momentum indicator.



The Momentum indicator is a popular technical study. It is easy to calculate and can be applied in various ways. Momentum can be calculated by dividing the day's closing price by the closing price "X" amount of days ago and then multiplying the quotient by 100.

The Momentum study is an oscillator-type that is used to interpret overbought/oversold markets. It assists in determining the pace at which price is rising or falling. This indicates whether a current trend is gaining or losing momentum, whether or not a market is overbought or oversold, and whether the trend is slowing down.

Momentum is calculated by computing the continuous difference between prices at fixed intervals. That difference is either a positive or negative value, which is plotted around a zero line. When momentum is above the zero line and rising, prices are increasing at an increasing rate. If momentum is above the zero line but is declining, prices are still increasing but at a decreasing rate.

The opposite is true when momentum falls below the zero line. If momentum is falling and is below the zero line, prices are decreasing at an increasing rate. With momentum below the zero line and rising, prices are still declining but at a decreasing rate.

The normal trading rule is: Buy when the momentum line crosses from below the zero line to above. Sell when the momentum line crosses from above the zero line to below. Another possibility is to establish bands at each extreme of the momentum line. Initiate or change positions when the indicator enters either of those zones. You could modify that rule to enter a position only when the indicator reaches the overbought or oversold zone and then exits that zone.

You specify the length of the momentum indicator. You must determine a value suitable to your trading needs and methods. Some technicians argue the length of the momentum indicator should equal the normal price cycle. The best method is to experiment with different lengths until you find the length that works best for that particular commodity you are trading.

Like most other "secondary" trading tools in my trading toolbox, I do not use the Momentum indicator, solely, to generate buy and sell signals, or to gauge the overall technical situation in a market. I use the Momentum indicator to help confirm or refute general ideas I have developed by using my "primary" trading tools, such as trend lines, chart patterns and fundamental analysis.

Using Joe Granville's "On Balance Volume" (OBV) to Your Trading Advantage

Still another "secondary" trading tool in my "Trading Toolbox" is the On Balance Volume indicator (OBV), developed by Joe Granville, the respected stock market trader and analyst.

OBV is calculated as the continuous consecutive sum of volumes, whereby the entire volume of a day is added to the volume of the previous trading session's OBV, if today's closing price is above that of the previous session. Should the closing price be below that of the previous session, the day's volume is subtracted. Unchanged closing prices have no effect on the OBV--the volume is neither added nor subtracted.

The OBV study indicates whether money is flowing into or out of a market. Based on Granville's principle, changing trends in the price of the underlying market are anticipated by trend changes in the OBV indicator. The theory is that one can see the flow of "smart money" into a market by an increase in the OBV. As soon as the public moves into the market, both the market and the OBV will surge ahead.

The OBV indicator shows an upward trend whenever a new high or low exceeds the previous one. In the opposite case, a lower high or low indicates a downtrend. The changing in the OBV from an upward to a downward trend is called a breakout.

Importantly, in the OBV analysis, it is assumed that OBV breakouts precede the market breakouts, but that there is very little time for a trader to react. This study is not a timing tool. Rather, it monitors market sentiment, and it can alert you to a changing market situation. This alert may be used as a signal to taking a long position on upside breakouts, and selling short when the OBV makes a downside breakout. Traders usually hold the position until the trend changes.

Once a trend has been established, it remains until it is broken. This happens when a downward trend changes to an upward trend and vice versa, or when a trend changes to a choppy, sideways movement for more than three days. If a market changes from an uptrend to a sideways trend, and remains non-trending for two days only and then reverses to an uptrend again, the market is considered being in an uptrend as before.

It should be noted that the OBV indicator does not work on intra-day charts.

Granville has a book, "The New Commodity Trading Systems and Methods" that has more details on this and other indicators.

Eight Short-term Technical Tools that can Make You Money

There are several valuable technical trading tools that I use on a shorter-term and even an intra-day basis. While I am not a "day trader" and am more of an intermediate-term "position trader," I do have many readers that are day traders or trade shorter timeframes. Thus, I like to provide analysis and clues that do help out those traders who use shorter trading timeframes. And even for the longer-term position traders, shorter-term trading tools can help refine their all-important entry and exit strategies. Below are some of my favorite shorter-term chart signals that I employ.

(You'll note that my favorite shorter-term trading signals are not computer-generated, in keeping with my philosophy that while computers certainly aid traders in many ways, they can never replace the extreme value of the human eyes examining a price chart.)

Collapse in volatility:

A collapse in market price volatility occurs when trading ranges (price bars) narrow substantially. This price pattern is evidenced by price chart bars (the bars can be daily, hourly or in minutes) that suddenly get smaller. The smaller price bars should number at least three in a row, and do not necessarily need to get progressively smaller with each bar. This "collapse in volatility" usually sets off a significantly bigger price move--either up or down. As the smaller price bars accrue on the chart, there is no set number of bars that will set off the bigger price move. It could be three bars, or it could be 10 bars or more before the bigger price action is set off.

Outside days (or bars):

Outside days (or bars) occur when the last price bar is bigger (a bigger trading range) than the previous bar on the chart. If the close (or last trade of the bar's timeframe) is higher than the previous bar's last trade, then that is considered a bullish "outside day" (or bar) up. A bearish "outside day" (or bar) down occurs when the close (or last trade of the bar's timeframe) is lower than the previous bar's close, or last trade.

Inside days:

These occur when the last price bar is "inside" the previous bar--meaning the trading range is smaller and inside the previous bar's trading range. In other words, the last bar's high is lower and the low is higher than the previous bar's trading range. Inside days (or bars) signal that the market is taking a break after a busy period. Inside days can also be an indicator that a collapse in volatility may be setting up and that yet another bigger price move could be on the horizon. After a big price bar and busy trading day, one can expect the next session could be an "inside" rest day.

Key reversals:

These are more important chart signals that occur less frequently than most others I discuss in this feature. Key reversals are one important signal of a potential market top or bottom. A key reversal occurs when a new for-the-move high or low occurs, and then during that same day (or trading bar), the price sharply reverses direction to form an "outside day" up or down. Some analysts will call this, alone, a key reversal. But in my trading rules, a key reversal must be confirmed by follow-through strength or weakness the next trading session (or trading bar). Follow-through greatly helps eliminate false signals and makes a market "prove itself" after a bigger move.

Exhaustion tails:

These occur when either buying or selling apparently is exhausted after prices make a fresh-for-the-move high or low that creates a bigger price bar on the chart. Then prices reverse course to close at the other extreme of the bar's earlier move. Thus, you get the bigger bar that creates a "tail." These tails are then important guideposts because they then become an important resistance or support level on the chart.



Closing Price:

Most traders agree that the most important price of the trading session is not the open, the high or the low--but it is the closing price, or settlement. After an entire session of buyers and sellers doing business, this is the level at which they have agreed (voluntarily or involuntarily) on price. I place more emphasis on a closing price below an important support level or above an important

resistance level, or above or below a trend line or chart pattern--as opposed prices just probing above or below those levels during the session only to then pull back.

Daily or weekly high or low closes:

If a market closes near the session high or at the weekly high close, that's a sign of market strength and suggests there will be at least some follow-through strength the next trading session (or price bar). On a close near the daily low or a weekly low close, this suggests market weakness and that follow-through selling could occur the next trading session or price bar.

Gaps:

These chart formations occur when price bars push well above or below the previous bar to form a gap on the chart. (The last bar's low is higher than the previous bar's high for a gap-higher move. The last bar's high is lower than the previous bar's low to form a gap-lower trade.) Gaps can be created on a minute, hourly, daily, weekly or monthly chart. Price gaps indicate a strong market move and many times the gaps will then serve as important support or resistance levels on the chart.

Technical Traders – Don't Ignore the Fundamentals – PLEASE!

Those who have read my features know I base the majority of my trading decisions on technical indicators and chart analysis--and also on market psychology. However, I do not ignore certain fundamentals that could impact the markets I'm trading. Neither should you.

In this feature I'd like to share with you the types of fundamentals in various markets about which technically oriented traders should be aware. While this article will be most beneficial to beginning and intermediate traders, the experienced traders may enjoy it as a "refresher."

I have been very fortunate in my career in the futures industry. When I was a reporter and editor for FWN, I was forced to learn about the fundamentals impacting all the markets I covered. (At one time or another, I covered every futures market traded in the U.S., and also many overseas futures markets.) I had to talk to traders and analysts every day, regarding the fundamentals that impacted the particular market on which I was reporting .

Realizing very few get that kind of unique opportunity to learn about market fundamentals, what can beginning to intermediate traders do to "get up to speed" regarding the fundamentals of the markets they wish to trade?

Here are some useful nuggets to consider regarding market fundamentals:

- You should know in what increments your market trades, the contract size, if it's physically deliverable, cash settled or both, and when first-notice day and last trading day occur. This information is all free and available on the websites of the exchanges on which the markets trade. For example, if you trade U.S. T-bonds, you should know that prices trade in 32nds of a point, based on a yield of 6%. You don't have to become an expert on yields, deliveries or notices, but you should be aware of the concepts. Reading about what the exchanges have to say about their markets is a great way to start out learning fundamentals.
- The Internet is indeed a wonderful tool to help you learn about futures market fundamentals--for free. Use your favorite search engine and do a search on your market of interest. However, make sure you use "futures" in the search words, as this will narrow the focus of the search engine.
- Here's a caveat on market fundamentals: The professional traders anticipate them and many times factor the fundamentals into price even before they occur. In fact, this happens quite often in futures markets. For example, it stands to reason that heating oil

demand will increase in late fall and winter, and that heating oil futures prices should rise in that timeframe, as opposed to summertime prices. A novice trader may think it's a no-brainer to go long the December heating oil contract in September. However, keep in mind all the professional traders and commercial traders know this, and they have likely already factored this seasonal fundamental into the price of the December contract.

- There are U.S. government economic reports that sometimes have a significant impact on markets. Associations also release reports that impact futures markets. Even private analysts' estimates can move markets. Try to learn about the reports or estimates that have the potential to impact the market you wish to trade. You should make it a priority to know, in advance, the release of any scheduled report or forecast that has the potential to move your market. For example, if you are thinking about establishing a position in the T-Bond market and the U.S. employment report is due out the next day, you may want to wait until the report is released before entering your position. The employment report can whipsaw the bond market in the minutes after it's released, which could stop you out of your position.

- If you like to trade financial futures markets, newspapers like the Wall Street Journal and Investors Business Daily have sections that follow bonds, stock indexes and currencies, etc. Reading about how fundamental events impact these markets allows you to get up to speed on fundamentals.

- If you trade commodities like cotton, coffee or cocoa, it's a little more difficult to find fundamental news sources for free. You may want to subscribe to a news service like Bridge, where specialized reporters scour the world for news that impacts those markets. The U.S. Department of Agriculture has a website with reports on many commodities that trade in futures markets, including not only the major U.S. row crops, but also markets like coffee and orange juice.

Finally, traders should consider the knowledge of market fundamentals as just one more tool in their trading toolbox. The more tools in a trader's toolbox, the higher the odds he or she will be a successful trader.

Selling Options: The Real Story

There are old sayings in the futures industry that go something like this: “Eighty percent of all options on futures expire worthless.” And, “The only way to make money trading options on futures is to sell them--not buy them.” Neither one of these statements is accurate. This educational feature will focus on the advantages and disadvantages of selling (also called “writing”) options on futures.

But before I discuss writing options on futures, let me first elaborate on the first “old saying” that 80% of options on futures expire worthless. While I have heard the saying many times through the years, I have never seen credible statistics on the percentage of futures options “that expire worthless.” Maybe it’s because such a statistic cannot be compiled. Consider this: If a trader hedges his straight futures positions with options purchases, and those options do perform their function of limiting risk for a period of time, then those options have performed their intended function--even though they may expire “worthless.” Also, most speculative options buyers who make profits on trades do sell their options before they ever expire. Thus, I expect it would be very difficult, if not impossible, to have any accurate statistics on the number of futures options that are bought and sold that did not successfully fulfill their intended purpose.

A major appealing factor for speculative traders to sell (or write) options, as opposed to purchasing options, is that the odds are more favorable for producing a winning trade. Reason: If a trader is writing options, generally the market can move “against” the trader by a certain amount before the trader sees his option’s strike price hit and he starts to lose money. Also, the option writer has “time decay” working in his favor—meaning that the day the option is sold, its time premium starts to decay as the option moves toward expiration.

Now you might be thinking this options-writing stuff all sounds pretty easy, huh? Well, hold on just a minute! Remember that there are trade-offs in every aspect of trading futures. Here’s the “rub” with selling options:

--First, the premium traders collect for writing options is generally not nearly as much as the profits a trader would collect on a straight futures trade or a winning options purchase trade. For example, if a trader sells a call option on corn futures for 10 cents, that is his profit. But then he has to wait (or “squirm” might be a better way to put it) until the option expires to secure his profit. For many traders, pocketing just 10 cents profit on one corn contract is not much, so they may sell several contracts to make a bigger overall profit. Read on...

--Second, when writing options (just like in straight futures trading) you cannot absolutely limit your risk of loss. Margin money is required by the broker.

-- Finally, there is one more “old saying” regarding writing options on futures. It goes something like this: “A trader will make money and make money and make money writing options...until

that one time when an option sale will go against the seller. And that one options sale will then take back all the profits that were made on the previous winning options sales—and then some.”

I do want to be clear on one point. There are very good and successful traders who do employ options-writing strategies. I have another “old saying” that I use frequently when discussing a trader’s methodology. “If it ain’t broke, don’t fix it.” If there are options writers reading this educational feature and you are having and have had consistent success—more power to you! The main point I want to make in this feature is that there is generally more risk and generally less reward involved in writing options than in purchasing options on futures. The one big advantage of buying options on futures is that the price you pay for the option is the most you will ever lose on that trade. Also, there is no margin required. That’s very good money management.

Why, When, and How to Buy Options on Futures

In this educational feature I will discuss trading options on futures--specifically buying puts and calls. You can also sell options, but your financial risk is not limited like it is when you buy an option. I won't get into selling options in this feature.

I know that many beginning (and even veteran) traders think options trading is too complicated, and they don't have a clue about the vega, theta, delta and gamma pricing formulas--or the strangles, straddles, butterflies and other such options trading methods. Well, don't worry. I'm not going to get into those strategies in this column.

Entire books have been written on options and options-trading strategies, but I will only focus on a few basic, low-risk and limited-risk trading strategies for beginning traders (and veterans, too). I'll also briefly talk about using options to "hedge" winning trading positions in volatile markets. I do suggest that if you are interested in trading options, you should read a book or two on options trading. Again, you don't have to be a rocket scientist to employ simple options-trading strategies.

First, I am going to assume readers know the definition of an option on a futures contract, and also the difference between a put option and a call option and "in the money" and "out of the money." (If you don't know the meaning of these terms, that's okay. Just go to one of the big futures exchange websites, and you can find a glossary of trading terms, digest the options terms and then read this article.)

A while back there was a big runup in the price of crude oil. It certainly was tempting for many traders to want to short that market at those sharply higher price levels. However, remember that to successfully trade futures you not only have to be right on market direction, you also have to be correct on the timing of the market move. Furthermore, you can be right on market direction and very close to being right on timing the trade, but still lose your trading assets because of market volatility. In crude oil, for example, a trader could have established a short position two days before the top in the market was in, and still be stopped out and lose his trading assets because of the high volatility.

Purchasing options allows you to limit your financial risk and let's you ride out volatile market swings without the worry of increased margin calls.

Buying a put or a call that is "out-of-the-money" is a relatively inexpensive way to wade into futures trading. The money the trader lays out to his broker for the option purchase is all the trader has to worry about losing. No margin money. No margin calls. He can sleep well at night. And he is still trading futures, learning the business, honing his trading skills.

Here's another trading tactic to think about regarding purchasing options in volatile markets. Just because you have a protective buy stop or sell stop in place when trading straight futures contracts, that does not guarantee you will get out of the market (filled) close to your stop. For example, weather markets in the grains and soybean complex futures can produce limit price moves--sometimes for two or more sessions in a row. If you have a straight trading position on in soybeans and the market moves against you by the limit, or multiple limits, your protective stop is virtually worthless. But if you had hedged your straight futures position with a cheap out-of-the-money option purchase, you have limited risk in a volatile market.

Let's say you are long soybeans at \$5.00 in a highly volatile market. You initiated that trade on the long side, but then decided to purchase a \$4.50 put option that limits your trading risk to 50 cents a bushel (\$2,500 per contract), plus the price of the put option purchase. The trade-off here is that you are gaining peace of mind and losing some profit potential. But for many traders, that's well worth it. You can stay in the game to trade again another day, and won't get wiped out by a limit price move.

There are trade-offs in purchasing and trading options on futures, as opposed to trading straight futures. If you purchase "out-of-the-money" options, the market has to move in your favor for a period of time before your option becomes "in-the-money." During periods of high market volatility, the prices of options can and usually do increase substantially.

One more thing: Anyone considering trading options on futures needs to check the open interest level on the particular "strike price" they are contemplating trading. Just like in straight futures trading, the more liquid (higher open interest) strike prices and options markets are usually more desirable to trade.

A Realistic Look at Futures Trading

A futures trader's mission is to be profitable by taking the preponderance of technical and/or fundamental evidence he or she has on a market, and then making a well-founded trading decision based on a trading plan of action. That is the best a trader can do. If the market does not respond in the way the trader thought it would, he or she will hopefully have a tight protective stop in place and losses will be minimal. Then, the trader moves on to the next preponderance of evidence on a market, and the process starts over.

I take pride in the fact that I portray futures trading in what I feel is a "realist" fashion. Nowhere on my website or in any of my feature stories on news wires do you see claims made by me that futures trading is an easy way to make money, or that my trading methods are "guaranteed" to make you profits. People in the futures industry that make those claims, use fancy wording or "smoke and mirrors" to skirt the real facts are less than genuine, I believe.

Those of us who have been in the business for many years know there is no "Holy Grail" for futures trading success. We know how brutal the markets can be to even the most savvy and deep-pocketed traders. The principals at the big hedge fund called Long-Term Capital Management certainly know what I'm talking about. (That's the big speculative trading firm--which supposedly had trading geniuses at the helm--that went bust a couple years ago after the markets they were trading made a devastating turn against them. Some well-known investors got burned.)

Yet, there are individuals, me included, who are fascinated by the markets and trading, and find great satisfaction when we are able to "take some money off the table." We know there are dangers to futures trading, but sound and strict money-management principles can greatly reduce the dangers of losing all of one's trading assets.

One of the realities of futures trading is that there are trade-offs to just about every trading method or trading philosophy. (When we think about it, there are advantages and disadvantages to just about everything we do in life, so why should futures trading be any different.)

Here are the trade-offs for just a few futures trading methods. These trade-offs may be obvious to some, but I believe it's prudent for all traders to have a very clear picture and a keen understanding of what they are up against when they initiate a trade and take on "the market," which can quickly turn into a two-headed monster if it is not respected and understood.

--Purchasing options on futures: This is a great way for individuals, especially beginners, to participate in futures market trading and limit their risk to the price paid for the option. Traders sleep well at night, knowing that if the market makes a violent turn against them, they won't get a margin call from their broker. The trade-off: For the traders that purchase options, the timing of the trade has to be even more precise than straight futures trading, as options expire well before the underlying futures contract and "time decay" continually erodes the option premium. Also, in

volatile markets, options premiums increase significantly. Finally, if an option that is purchased is not "in the money," any favorable moves in the underlying futures contract price will likely not be matched on a one-to-one price basis by gains in the option's value.

--Selling options on futures: There's an old market adage that says the vast majority of the profits made in options trading are made by the sellers and not the buyers. I don't disagree with this. The trade-off: There's another old adage that says options sellers will make good profits--until that one time a market turns unexpectedly and violently against them, and wipes out all the profits they had previously made writing (selling) options.

--Trading volatile markets: There are indeed big profits that can be made trading volatile markets. The past couple years the energy futures markets have been one example. The trade-off: Volatile markets can turn against a trader "on a dime." Big profits can turn into big losses in very little time. I call a highly volatile market a "gunslinger's" market.

--Using tight protective stops: I use protective stops with nearly every trade. It's a good way to go into a trade with a plan of action, should the market turn against you. For traders who don't have real-time price data or who can't monitor price action all session long, stops are an excellent risk-management tool. However, protective stops are not perfect. They are not effective in "fast" market trading in the pits that sees a price vacuum. Stops are virtually useless when a market makes a limit move. Floor traders will sometimes "gun" for resting stops, trigger them, and then the market seems to reverse course.

--"System" trading: I don't use a mechanical system for trading, but many traders do and are successful at it. By "system trading," I mean traders that solely use computer-generated buy and sell signals, based on some parameters that are fed into a computer trading program. Some of these trading systems are advertised as being 90% profitable. The trade-off: What many system trading advertisers don't tell people is that with most computer-generated trading systems, a trader is in the market--either long or short--virtually all of the time. Draw-downs on the trading account can be, and many times are, very large. Also, some of the claims of high profit percentages are based on a trading system that is hypothetically back-tested over several years.

When To Quit Your Day Job

I have had many readers through the years--most of whom were less-experienced traders--tell me that at some point in the future they planned to quit their day jobs and trade futures full-time. While their optimism was certainly positive from the standpoint of eagerness to learn about a truly fascinating business, it is also probably unrealistic that they will ever make a good living as a full-time futures trader. At the end of this feature I have a few questions that may help determine if you are ready to attempt to join the elusive rank of "full-time" trader. But first, I want to present you with some straight facts.

I have been in this business nearly 20 years. I have read stacks of trading books and have voraciously studied markets and market behavior. I have worked right on the trading floors of all the major futures exchanges. As a journalist, I have conducted countless interviews with the very best traders and analysts in the world. But I still cannot specifically predict what a given market will do in the future.

Now, at this point a few of you may be thinking, "This is not very encouraging news. Maybe I should listen to some of those other guys that say I can have immediate trading success by learning their 'secrets' or adopting their 'proven' system or strategies?" While I hope this is not the case with you, I am very proud of the fact that I have made my reputation in this industry by refusing to be marketed and promoted (hyped) as something I am not, nor can ever be.

It's very important to realize the fact that neither I nor anyone else--not even the most powerful computer trading systems--can predict what the markets will do in the future. Markets will never be tamed. I've said many times that my profession is not a business of market predictions, but one of exploring market probabilities, based upon fundamental and technical analysis--and human behavior. By exploring and understanding market probabilities, and human nature, one can achieve trading success.

Many traders are lured by fast-talkers or fancy wording into thinking that someone or some firm has a sure-fire trading "secret" or system that beats the markets on a consistent basis--and racks up big trading profits in the process. But the truth is, most of these claims are half-truths at best and downright lies at worst--and come from people who are out to take your money. I tell my readers right up front that I have no "trading secrets" and that achieving futures trading success is not easy and takes hard work. And even hard work does not guarantee futures trading success. Unfortunately for many traders, it takes the pain of losing substantial amounts of money early on before they finally realize what I stress to my readers right away.

Okay, enough preaching from me.

What are some clues that you could be one of the fortunate few that actually could succeed at being a full-time trader? I'll get some questions for you shortly, but first I want to address an

issue about which you may be pondering right now. That is: Jim, why don't you only trade futures full-time if you are so knowledgeable?

I have never attempted to be a full-time futures trader. By "full-time" I mean focusing only on trading futures and using the realized profits for my living expenses. In my case, that would mean no analytical service, no custom consulting, no educational writing--all of which I'm doing now. Since I have never tried to make a living only by trading futures, I cannot tell you whether I would be successful or not. The reason I have never attempted to trade futures full-time is because I truly enjoy the communications aspect of being a market analyst and a trading educator and mentor. I hope that those of you who have talked with me or emailed me would agree that I do really enjoy discussing markets with other traders. I do know that if I were to attempt to be a "full-time" futures trader, the task would not be easy, even though I do have much experience and knowledge.

Now, on to a few questions to ask yourself if you think you might be ready to trade futures full-time:

1. Are you a successful part-time trader? You'll need to be successful at trading futures on a part-time basis before you think about moving into the full-time trader ranks. Don't be fooled into thinking that trading futures on a full-time basis will allow you to spend more time to cure your part-time trading ailments. In other words, don't say to yourself: "If only I could spend more time trading markets, I could have more success than I've had just trading 'one-lots' here and there."
2. Do you have enough money available to live on when (yes when, not if) you hit a streak of losing trades? A losing streak will inevitably occur--and probably sooner rather than later. And I don't mean a losing streak of two weeks, but more like a stretch of poor performance of up to six months, or longer.
3. Do you have the psychological stamina to be a full-time futures trader? Quite frankly, most people do not. Can your psyche (not to mention your pocket book) handle six months of mostly losing trades?
4. Will your immediate family members support you--even during a prolonged rough stretch of trading? Believe it or not, this is a very, very important question. For example, if your spouse does not support your decision to trade full-time, then you are likely doomed to failure. The pressure of having to produce winning trades and knowing that your spouse is skeptical of your efforts is almost insurmountable.
5. And on your part, will you be able to uphold your family or other important responsibilities even during a rough trading stretch? Or, will you brood and kick the dog when he happens to cross your path?

I think you'll agree with me that those are tough questions to answer.

One more thing: I do have many readers that are "full-time traders" but who do fall into a different category than what I described above. These are people who do have enough money to trade futures on a full-time basis--even if their trading profits alone will not support their lifestyles. These are individuals who already have significant amounts of money derived from means other than trading futures. Also, I have many readers who are now full-time traders, and that have retired from another profession and want to spend the "autumn of their lives" not in a rocking chair, but in a field that is challenging to them. Again, they, too, have other means of income besides just futures trading profits.

Employing Protective Stops to Manage Your Trades

There is no absolutely perfect money-management tool in futures trading, although purchasing options on futures does limit your risk of loss to the amount paid for the option. Purchasing options does have its disadvantages, however, and I won't go into that in this feature. What I will focus upon in this educational feature is the placement of protective stops (a sell stop if you are going long and a buy stop if you are going short) in futures trading. Protective stops are not a perfect money-management tool, but they are very effective in helping to solve one of the most important elements of futures trading: When to exit a position.

Before I discuss the advantages of using protective stops, I want to discuss a disadvantage about which many long-time traders are fully aware: Floor traders in the pits "gunning" for stops. This is a real phenomenon whereby "local" floor traders (those who trade for their own account) think they know where most of the resting buy or sell stops are located, and then attempt to push prices into those stops, set them off, and then let the corresponding price move run its course, only to then take profits on that move and the market price then returns to near levels seen before traders went gunning for the stops. This action by floor traders is not illegal or even unethical--it's just a part of futures trading. These floor traders have to pay a lot of money (or their sponsor pays their fees) to trade in the trading pits on the exchange floor. They do have some advantages over off-floor traders and, importantly, they also provide the needed market liquidity that all traders and hedgers appreciate.

Floor traders gunning for stops is more an art than science, as market conditions have to be just right for their efforts to pay off. For "local" floor traders to push a market in their desired direction, outside fundamental factors need to be about in equilibrium and not having an influence on market prices. For example, any floor traders gunning for sell stops just under the current market price won't get the job done if there were a bullish fundamental development that would push prices higher. Remember, no one group of traders--not even floor traders--can influence market prices very much or for very long.

Also, sometimes floor traders think they know where stops are located, and when they push a market and try to force a bigger price move, they do not find the stops and then they are forced to cover their trades at a loss.

A longtime friend of mine and former Chicago Board of Trade grain floor trader, John Kleist--now a highly respected grain and livestock market analyst--told me the following about locals gunning for stops: "Back in the 1970s and most of the 1980s were really the 'last hurrah' for locals wanting to gun stops. And it basically was in the 1990s when better (and more transparent) communication allowed important news to filter 'down' to the pits, rather than 'up' from the trading floor. Locals gunning for stops now is usually more effective in illiquid trading pits, such

as the hogs or bellies--and less effective in soybeans and wheat, and very difficult in the corn pit. Gunning for stops has been replaced by locals coat-tailing the commodity funds and exaggerating price moves. Maybe that's the same effect but done a different way. Stops have to be relatively nearby current prices--i.e. support/resistance areas commonly used as 'public' stop areas, if the locals are to be effective. And, of course, if near major moving averages in the case of the funds."

Okay, on to the advantages of futures traders employing protective buy and sell stops. As I said above, the major advantage of using protective stops is that--before you initiate the trade--you have a pretty good idea of where you will be getting out of the trade if it's a loser. If your trade becomes a winner and profits begin to accrue, you may want to employ "trailing stops," whereby you adjust your protective stop to help you lock in a profit should the market turn against your position.

On specifically where to place your protective stop upon entering a trading position, one of the most popular and effective methods is to find a support or resistance area that is within your loss parameter for that particular trade. Here's an example: A trader decides to go long corn futures and he does not want to lose more than \$250 per contract if the trade turns out to be a loser. He should try to find a technical support level that's around 5 cents below the present market price, and then place his sell stop just below that support level.

I generally use the above formula when I place my protective stops. However, I know that the local floor traders also know where it would be most logical for most traders to place their protective stops. So, I will "tweak" my stop placement a bit to reflect this. For example, if I decide to go long corn and there is a solid support level that is within my loss-tolerance parameter, I will set my protective sell stop maybe a couple cents below that support level. My thinking would be that most other traders would set their protective stops about a penny below that solid support, and if floor traders were going to gun for stops, then they may not be able to hit mine if it's a couple cents below the solid support level. The disadvantage to this theory is that your stop may be hit anyway, if there were a bunch of stop triggered above my own stop and pushed prices lower. Also, my losing trade would be about \$100 or \$150 steeper per contract than if I had not tweaked my stop.

Only rarely will I call my broker and change the position of a protective stop in a trade in which I'm "under water"--meaning it's a losing trade at the time. That would defeat the purpose of making your decision on how much of a loss you'll absorb BEFORE you make the trade and are in the heat of battle during a trade. Conversely, on winning trades that I have going, I may call my broker every day and tighten a protective stop, if the market is moving rapidly.

The “Andrews Pitchfork” Trend Lines Indicator: A Cool Secondary Tool

The Andrews Pitchfork is yet another one of my "secondary" trading tools. My "primary" trading tools include basic trend lines and chart patterns, trader psychology and fundamental analysis. I use the secondary trading tools to help confirm what my primary trading tools may be telling me.



The Andrews Pitchfork is a trend-line study developed by Dr. Alan Andrews a few decades ago. It is also called the Median Line Study. It consists of three parallel trend lines drawn on a chart. The lines resemble a farmer's pitchfork. The upper and lower lines of the pitchfork provide a channel of support and resistance levels. Basically, you wait for a significant "correction" from an overall price trend, and then measure that correction and draw and project trend lines from it.

Remember that trend lines can be applied to all markets in all time frames. An uptrend finds prices bouncing up off the supporting uptrend line. A downtrend finds prices bouncing down off its resisting downtrend line. In an uptrend, the trend line provides a potential buying point at each

potential bounce. If the market is still trending higher (meaning the uptrend line has not been negated), then there is no signal given as to when to sell. But by drawing parallel lines to the trend line (as in the Andrews Pitchfork study), a channel can be created which contains short-term rallies and declines within the general trend. The bottom trend line can be used to buy into the rally and the top trend line can be used to take short-term profits. After selling, the trader would then wait for the market to hit the bottom trend line to buy again. This is very similar to the "swing trading" method about which I have written.

With the Andrews Pitchfork technical study, a trader will pick an extreme low or high on a chart to define a "pivot point" and then draw a trend line, called the median line. Then the trader bisects a line drawn through the next corrective phase on the chart that occurs after the pivot point. Lines parallel to the median line are drawn through the high and low points of the corrective phase, hence the look of a pitchfork

Pitchforks can also help identify trading channels before simple parallel trend lines can be drawn. By using an already established market move (correction) as the width of the channel, the median and parallel lines can be constructed, giving the trader early targets for short-term trading within the new trend. These market retracements generally occur at Fibonacci levels, so a pitchfork can almost be considered to be Fibonacci lines on an angle.

The double channels of the Andrew's Pitchfork serve to identify a longer-term trend at the same time as the shorter-term trend. As long as counter-trend moves are smaller than the overall channel width, the primary trend will remain intact. Trading from one end of the channel to the other may present short-term trading opportunities. But breakouts from the overall channel may indicate true trend changes. The latter should be combined with simple trend line analysis for a more reliable signal.

Dr. Andrews' rules state that the market will do one of two things as it approaches the Median Line: 1. Prices will reverse at the Median Line. 2. Prices will trade through the Median Line and head for the upper or lower parallel lines and then reverse. He suggested that prices make it to the median line about 80% of the time while the price trend is in place. This means that while the basic long-term price trend remains intact, Andrews believed that the smaller trends in price would gravitate toward the median line while the larger price trend remained in tact. Importantly, when that does not occur, it may be evidence that a reversal in the larger price trend may be under way.

When prices fail to make it to the median line from either side, it is often an expression of the relative bullish or bearish psychology of buyers and sellers, and may predict the next major direction of prices. If prices fail to reach the median line while above the median line, it is a bullish signal. If prices fail to reach the median line from below that line, then that is a bearish signal.

Drawing the parallel lines can often be more subjective because most of the time markets do not trade up and down in neat channels. There often is "market noise" and overlapping short- and

long-term cycles that make trading appear irregular. To better measure a trading channel, the Andrews Pitchfork can help by building it around real, objective market activity that is a counter-trend move (retracement or correction).

Just like with horizontal support and resistance levels, markets trade within one range and then move to another, similar range and back again. The Andrews Pitchfork measures a larger trading channel. It is common for a market to trade in the lower end of channel and then jump to the upper end and then move back to the lower end. During all of this activity, the general trend is still intact. When prices move outside of the larger channel, the overall market trend may have changed.

A Short Primer on Welles Wilder's "True Range" and "Average True Range"

Respected trader and educator J. Welles Wilder developed "Average True Range" (ATR) as a tool for a more precise and realistic calculation of market's price activity and volatility.

The ATR is useful when calculating the directional movement of a market. Wilder defined the "True Range" of a market to be the greatest of the following periods:

- The distance from the session's high to its low.
- The distance from the previous session's close to the next session's high.
- The distance from the previous session's close to the next session's low.

A good example of a situation where True Range would be significantly larger than the normal daily trading range would be when price gaps occur on bar charts.

"True Range" measures market volatility and is an integral part of indicators such as ADX (Average Directional Movement) technical indicator, or several others, to identify the directional movement of a market. The ATR is the basic unit of measurement for Wilder's Volatility System.

Average True Range is a moving average of the True Range values over a period of time. The periods are the number of bars in a bar chart. If the chart displays daily data, then the period denotes days; in weekly charts, the period will stand for weeks, and so on. Wilder used a period of 7 for a default setting. Other common periods used are 14 and 20.

The Average True Range indicator identifies periods of high and low volatility in a market. High volatility describes a market with ongoing price fluctuation; low volatility is used to define a market with smaller price range activity.

When a market becomes increasingly volatile the ATR tends to peak, rising in value. During periods of little volatility the ATR bottoms out, decreasing in value. A market will usually keep the direction of the initial price move, though this is certainly not a rule. Analysts, therefore, tend to use Average True Range to measure market volatility and other technical indicators to help identify market direction.

Wilder has found that high ATR values often occur at market bottoms following a panic sell-off. Low Average True Range values are often found during extended sideways periods, such as those found at tops and after consolidation periods.

Measuring market volatility can help in identifying buy and sell signals and, additionally, risk potential. Markets with high price fluctuation offer more short-term risk/reward potential, because prices rise and fall in a shorter timeframe.

Wilder has a book, "New Concepts in Technical Trading Systems," where more information on True Range and the ATR indicator can be found.

The K-Wave: A Longer-Term Cycle Worth Examining

The long-term Kondratieff cycle (also called the "K-Wave") is based on the study of nineteenth century price behavior that included wages, interest rates, raw material prices, foreign trade, bank deposits, wars, technological discoveries, public opinion, politics, weather and other available data. In this educational feature, I will touch upon the basics of this long-term economic cycle, including its possible implications for commodity prices and the economy in the coming months or the next few years.

Nikolai Kondratieff (1892-1938) was a Russian economist who believed the interaction of current events produces a repetitive pattern over a long period of time. He believed public reaction is directly influential to the ebb and flow of economic prosperity, and therefore vital to the economy. He viewed public response as waves of change, with its measurement and its effect on the future forming the basis of his theory.

Kondratieff proposed that economic trends tend to repeat themselves approximately every 54 years. This alternating of a "long wave" from prosperity to depression, complemented by many "shorter cycles," creates a dynamic trend to the economy that becomes predictable.

His work became known in the early 1930s, when he accurately predicted not only the Great Depression, but also the 1920s stock market boom that preceded it.

Like Ralph Nelson Elliott of "Elliott Wave Theory" fame, Kondratieff was convinced that his studies of economic, social and cultural life proved that a long-term order of economic behavior existed and could be used for the purpose of anticipating future economic developments.

Kondratieff detailed the number of years the economy expanded and contracted during each part of the half-century-long cycle, in which industries suffer the most during the downwave, and how technology plays a role in leading the way out of the contraction into the next upwave.

According to most who have thoroughly studied this long-term economic cycle, the most recent revolution of the Kondratieff Wave began after the global economy pulled out of a deflationary depression in the 1930s. Prices began to accelerate upward after World War II, and reached the commodity price blow-off stage in 1980. Since that time, and then after the recession of 1990-1991, the global economy has been experiencing a "secondary plateau." During this period, consumers and investors became aware that inflation is not accelerating and disinflation becomes visible.

Paper assets such as stocks and bonds have done well the past few years, since neither inflation nor deflation hurt the marketplace. But during the secondary plateau, the first signs of economic problems become evident.

Isolated economies fall into deflationary contraction, and signs such as declining gold prices begin to take hold. During the 1990s, it was the Japanese economy that slid first into deflationary contraction. The recent stock market decline is another signal that the period of economic growth along the secondary plateau is ending.

In the very informative book, "Elliott Wave Principle," by Frost and Prechter, the authors note: "Kondratieff noted that 'trough' wars--wars near the bottom of the cycle, usually occur at a time when the economy stands to benefit from the price stimulation generated by a war economy, resulting in economic recovery and an advance in prices."

Indeed, many analyses of the Kondratieff cycle suggest that the cycle will "trough" around the present timeframe. The present U.S. war against the terrorists, or an upcoming war between the U.S. and Iraq, could be construed as a "trough" war.

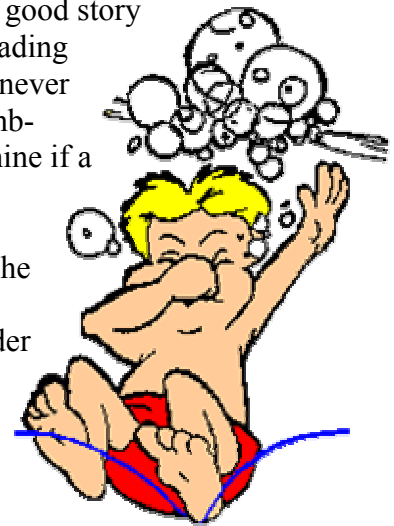
By studying this longer-term economic cycle, I can also see it has merit, just as do many other shorter-term cycles. However, I won't immediately rush out and go long all the basic commodities. Remember, timing is key to futures trading. Longer-term cycles, while valuable in gaining a "bigger-picture" perspective of the marketplace, have wide enough parameters that they do not make for good short-term timing methods for trading.

What the Kondratieff wave does is combine with and corroborate other studies and other cycles that also suggest the period of low inflation and recently weak raw commodities prices will not last forever, and in fact the commodities and inflation landscape may be on the cusp of a major change. In the past few months we have indeed seen some raw commodities prices start to trend strongly higher after longer-term price lows were established.

Don't Hold Your Breath Too Long While Under Water

The headline of this educational feature pertains not to swimming but to trading. Most professional traders do not hold onto their losing positions for very long. Once a trading position goes "under water" most professional traders will immediately begin looking for an exit strategy--if they do not already have one in place (and most do) via protective stops.

I had lunch with my trading mentor the other day and he shared a very good story with me. It went something like this: There once was a trader whose trading decisions were based upon using a "plumb-bob." (For those who have never worked on a construction site or in the land-surveying business, a plumb-bob is a turnip-shaped weight that is attached to a string to help determine if a structure is straight.) When this trader dangled the plumb-bob and it swung back and forth from north to south, he would buy. If the trader dangled the plumb-bob and it swung back and forth from east to west, he would sell. The trader had success using this methodology--with one simple rule applied: At the end of the first day, if his position was "under water," he exited his trade first thing the next trading day.



The moral of the story is: Traders can (and do) have all kinds of trading strategies, but prudent money management is paramount. In other words, **cut losses short!**

Over the years I have received emails and telephone calls from traders who were way "under water" and had not prudently liquidated their losing trading positions. These traders were "hoping" the markets would turn around and losses would be reversed. Any time a trader has losses which are so big that "hope" comes into play, it's usually a situation where prudent money management has not been employed.

It's also important to mention that traders who know they have waited way too long to exit a losing position should not think already-big losses can't get even bigger--much bigger. I've heard many traders say, "Well, I've lost so much already that now I might as well wait for the market to turn around because it can't go much farther against me." That's a recipe for disaster and potential financial ruin. This is where the saying, "**Never meet a margin call**" comes into play. If a trader gets a margin call from his or her broker, it's best just to close out the losing position and look for trading opportunities in other markets.

I've often mentioned the old trading adage: "**A market will do anything and everything possible to frustrate the largest amount of traders.**" Guess who are the traders that get most frustrated? It's the ones who are hanging on to losing trading positions, waiting and hoping for

the market to turn around so they can get their money back. "I just want to get back to even" is a desperate quote that comes from some traders who are under water. That "hope" is usually never realized.

One of the most interesting aspects of trading futures is that there are a few basic and effective rules that have been used by successful traders for years. However, adhering to these rules on a continual basis can be most difficult for many traders--including the experienced veterans. Why is this? It is because some of the most effective rules in futures trading go against the grain of human nature. Indeed, the "psychology of trading" plays such an important role in trading success.

Entry and Exit Strategies for Maximum Profitability

I have received several email messages from readers asking about how to best determine entry and exit strategies when trading markets. Here are just a few of their quotes:

"Though my success rate has been high, I am only breaking even financially, due to getting out too early in profit and letting my losses run too far."

"Many articles are written showing when and where to enter trades--but how many articles are written about 'running' positions? Where to exit surely has to be the biggest key to trading success!"

"I would appreciate some advice or tips on how to and when to enter a market and when to exit."

Of course, if a trader knew exactly when to get into a market and when to get out, wouldn't trading be easy! But even the most successful traders in the world can't do that. The best they can strive for is to catch a bigger part of any move (trend) in the market, and then get out with a decent profit before the market turns against them.

I've written past articles on trading with the trend and not against it, on the perils of trying to pick tops and bottoms, on support and resistance, and on letting profits run and cutting losses short, as well as trading the "breakouts." I won't repeat all those trading tenets here, but if you've missed some of my articles, they are on my website at www.jimwyckoff.com.

In this feature, I'll get more specific on entries and exits, and what to do if you are in a trade and are accumulating profits or absorbing losses.

First of all, if you are in a trade, you should already have a general plan of action in place, including potential entry and exit points, before you entered the trade. Certainly, you can alter your plan of action in the heat of battle, but you should not enter any trade without having a well-thought-out trading plan. Also in your trading plan you can have a few scenarios that could occur and what you would do if they did occur.

Entry and exits points in trades most times should be based on some type of support or resistance levels in a market. For example, in the coffee market at present, many traders think prices are close to a bottom. But I won't go long in a coffee contract just because I think it's close to a bottom. I need to see some strength in the market. I will wait for the contract to push up through a resistance level and begin a fledgling uptrend. Then, if I do go long, I'll set my sell stop just

below a support level that's not too far below the market. And if the trend does not develop and the market turns back south, I'm stopped out for a loss that's not too painful.

Another way to enter a market that is trending (preferably just beginning to trend) is to wait for a minor pullback in an uptrend or an upside correction in a downtrend. Markets don't go straight up or straight down, and there are minor corrections within a trend that offer good entry points. The key is to try to determine if it is indeed just a correction and not the end of the trend. In an earlier "Trading 101" article I mentioned using Fibonacci and other percentage numbers to identify potential "retracement" levels.

On when to get out of a market when you're losing money, I have a simple, yet very effective answer: Upon entering the trade, if you place a sell stop below the market if you're long (buy stop if you're short), you know right away approximately how much money you will lose in any given trade. You should never trade without employing stops. Thus, you should never be in a trade and have a losing position and not know where your exit point is going to be. I prefer setting tighter stops because I'm a conservative trader and want to survive financially to trade another day. Yes, I'll get stopped out sometimes and then right away the market will turn in the direction I had planned. However, by setting tighter stops, I will not be in a position whereby I lose substantial money because I'm fighting the market, "hoping" it will soon turn in my favor.

What about when you've got a winner going and good profits already in place? This is the time to employ "trailing stops." For example, if you're long a market and it reaches your initial upside objective, but now you really think there may be more upside and you don't want to exit your trade. You put in a sell stop at a certain level below the market that allows you to stay in the winning trade. But if the market turns south you are stopped out and still have a decent profit.

I can't tell traders exactly at what percentage below the market (above the market if they are short) they should set stops or trailing stops, because all markets are different at different times, and traders have different views on how much money they can stand to lose. However, a general rule of thumb is to place stops and trailing stops just below a support level that's not too far below the market. (If you're short, place the buy stops not too far above the market.)

Jim Wyckoff: One of my Favorite Trading "Set-Ups"

A fellow emailed me recently, asking: "Without giving away any precious secrets, could you tell me a way to improve my entries and exits (on trades)? It seems nobody wants to share their system."

Well, first of all, I don't have any trading "secrets." What I do have is many years of market experience, including studying the markets and technical analysis--and listening carefully to the best and brightest traders share their philosophies on successful trading. (You should be suspicious if anyone tries to tell (or sell) you any trading "secrets.")

On better entering and exiting trades, first of all you need a trading plan--before you enter the trade--and you need to stick to it. Your trading plan can have different scenarios and options once you're into the trade, but the key here is don't "fly by the seat of your pants" when you're into a trade. You don't want to let emotions dictate your strategies while you're actively trading a market.

Know how much money you can stand to lose and then place a protective buy or sell stop accordingly, and then don't change your mind when you're in the middle of the trade.

If you've got a winner going, you should also have a plan in place regarding when to take your profits. Again, your trading plan can allow for some flexibility once you are in the trade.

More specifically, I like to "buy into strength" and "sell into weakness." This trading method abides by the old trading adage, "The trend is your friend." Conversely, traders who try to "fight the tape" and be a bottom-picker or top-picker usually wind up getting their fingers burned.

One of my favorite trading "set-ups" is when prices have been in a trading range or congestion area on the chart--between key support and resistance levels--for an extended period of time (the longer, the better). Then if the price "breaks out" of the range (above the key resistance or below the key support), I like to enter the market--long on an upside breakout or short on a downside breakout. A safer method would be to make sure there is follow-through strength or weakness the next trading session--in order to avoid a false breakout. The trade-off there is that you could be missing out on some of the price move by waiting an extra trading session.

If you are long the market, set your sell stop just below a technical support level that's within your tolerance for a drawdown. If you're short, set your buy stop just above a technical resistance level that's within your tolerance for a drawdown. Don't set your stops right at support or resistance levels, because there's a decent chance that those levels will check and possibly reverse the price move--and you'll miss getting stopped out.

If you've got a winner and decide to let your profits run (per your initial trading plan), use trailing stops that utilize technical support and resistance levels.

Fear and Greed: Two Strong Emotions to Manage in a Grain Weather Market

There is nothing like a rip-roaring "weather market" in the grain futures to seriously challenge the two most important emotions a trader can experience: *fear* and *greed*. In the heat of a weather scare in grains, prices become extremely volatile and trader emotions run very high, as the latest weather forecasts can and do turn markets "on a dime."

Some would argue that "fear" and "greed" are terms that have been over-used and over-emphasized in our industry. Yes, they have been bandied about a lot, but for good reason. In general terms, too much fear in trading will not allow a trader to even pull the trigger to enter a trade. Or, even if a trade is entered, fear will prompt a trader to set a stop that's too tight, or to exit a trade before a strong-trending move gets well under way. Importantly, fear can cause a trader to lose sleep at night, which by itself can cause a myriad of problems.

Generally, greed will cause a trader to become intoxicated with thoughts of hitting the "grand slam" of trading, instead of being content with a base hit or even a double. Home runs and grand slams occur only rarely in trading futures. However, weather markets do allow for numerous base hits and a few doubles--and even a triple here and there.

Trading a full-blown weather market in the grains--and surviving to trade again another day--is a great experience for all traders. While there is some degree of a weather market scare in the grain futures nearly every year, the "full-blown" and highly volatile weather markets that are usually marked by severely dry weather conditions in the U.S. Corn Belt come around only once in a few years. While the year 2002 does not compare with the last major weather market of 1988 (at least not as of this writing), it does rank well above the "run-of-the-mill" weather markets that occur about every year in the grains.

Here are a few valuable lessons that a trader can learn by trading the grains during a weather market--lessons that can be applied to trading other markets during more volatile trading conditions.

- My experience in trading weather markets is that there is tremendous pressure on all traders to "follow the herd." Deviating from the consensus market opinion is not easy. However, it's the traders that can step in and sell into rallies or buy into dips that seem to have more success in trading weather markets. In other words, doing some contrary thinking and trading can pay dividends in weather markets.

(I'll give you an actual example of how contrarian thinking and trading can be successful in the grains. The year was 1988, the last big drought year in the Midwest that saw corn and soybean prices skyrocket. It was a Friday in July that saw corn and bean prices trade sharply higher, based on ideas the hot and dry weather would continue in the Corn Belt.

Then, after the close, the National Weather Service issued its 6-10 day forecast that, sure enough, called for more hot and dry weather for the Corn Belt. Bulls confidently headed home for the weekend. Even "local" traders on the Chicago Board of Trade floor went home long--something most never do, especially over a weekend.

Well, come Monday morning, the updated weather forecasts had changed a bit, but more importantly, trader psychology had changed immensely. The drought and resulting poor yields had all been factored into the market with prior price gains, culminating with Friday's big push higher. Corn and bean markets traded limit down on Monday and recorded very sharp losses for around three days in a row.

I know of one trader who used contrary opinion thinking and bought put options on corn that Friday that prices were pushing higher. He made a good deal of money that next week.)

- For bulls, it's important to remember that markets are the most bullish at the very top--it's downhill from there. Recognizing the clues that suggest a top is in place in the grains, during a weather market, is especially difficult, as technical indicators can become less reliable. Thus, being content to catch a bigger part of a price trend should be the goal of the trader. Don't be disappointed if you did not capture all of a price move in grains in a weather market. Becoming greedy and trying to do just that will usually get a trader into serious trouble.
- Pyramiding trades or "averaging down" losing trades is a no-no. (Unless, adding futures positions was in your initial trading plan of action.) One cannot believe the extreme temptation there is to add to winning positions when a profitable trade is occurring in a weather market in grains. Being long soybeans and hearing a bullish weather forecast heading into the weekend certainly invites adding a couple more long contracts on Friday. But that is pure greed kicking in. Greed in trading is not good.

Those Fascinating Fibonacci Numbers and the Golden Ratio

Support and resistance levels on bar charts are a major component in the study of technical analysis. Many traders, including myself, use support and resistance levels to identify entry and exit points when trading markets. When determining support and resistance levels on charts, one should not overlook the key Fibonacci percentage "retracement" levels. I will detail specific Fibonacci percentages in this feature, but first I think it's important to examine how those numbers were derived, and by whom.

Leonardo Fibonacci da Pisa was a famous 13th century mathematician. He helped introduce European countries to the decimal system, including the positioning of zero as the first digit in the number scale. Fibonacci also discovered a number sequence called "the Fibonacci sequence." That sequence is as follows: 1,1,2,3,5,8,13,21,34 and so on to infinity. Adding the two previous numbers in the sequence comes up with the next number.

Importantly, after the first several numbers in the Fibonacci sequence, the ratio of any number to the next higher number is approximately .618, and the next lower number is 1.618. These two figures (.618 and 1.618) are known as the Golden Ratio or Golden Mean. Its proportions are pleasing to the human eyes and ears. It appears throughout biology, art, music and architecture. Here are just a few examples of shapes that are based on the Golden Ratio: playing cards, sunflowers, snail shells, the galaxies of outer space, hurricanes and even DNA molecules.

William Hoffer, in the Smithsonian Magazine, wrote in 1975: "The continual occurrence of Fibonacci numbers and the Golden Spiral in nature explain precisely why the proportion of .618034 to 1 is so pleasing in art. Man can see the image of life in art that is based on the Golden Mean."

I could provide more details about the Fibonacci sequence and the Golden Ratio and Golden Spiral, but space and time here will not permit. However, I do suggest you read the book "Elliott Wave Principle" by Frost and Prechter, published by John Wiley & Sons. Indeed, much of the basis of the Elliott Wave Principle is based upon Fibonacci numbers and the Golden Ratio.

Two Fibonacci technical percentage retracement levels that are most important in market analysis are 38.2% and 62.8%. Most market technicians will track a "retracement" of a price uptrend from its beginning to its most recent peak. Other important retracement percentages include 75%, 50% and 33%. For example, if a price trend starts at zero, peaks at 100, and then declines to 50, it would be a 50% retracement. The same levels can be applied to a market that is in a downtrend and then experiences an upside "correction."

The element I find most fascinating about Fibonacci numbers, the Golden Ratio and the Elliott Wave principle, as they are applied to technical analysis of markets--and the reason I am sharing this information with you--is that these principles are a reflection of human nature and human behavior.

The longer I am in this business and the more I study the behavior of markets, the more I realize human behavior patterns and market price movement patterns are deeply intertwined.

Identifying Overbought and Oversold Markets using The Keltner Channel

The Keltner Channel was developed by Chester Keltner back in the early 1960s. He is a well-known commodity trader, especially grains.

It is a volatility-based indicator that makes use of the "envelope theory." Moving average bands (or channels), like the Keltner Channel, fall into the general category of envelopes. These envelopes consist of three lines: a middle line and two outer lines. Envelope theory states that the market price will generally fall between the boundaries of the envelope (or channel). If prices move outside the envelope, it is a trading signal or trading opportunity. Some have used the Keltner Channel as a trading system.

The Keltner Channel can be used to help identify overbought and oversold conditions in a market. When a market's price is close to the upper band, the market is considered overbought. Conversely, when a market's price is close to the bottom band, the market is considered oversold. However, this study can be used to help determine the strength of a price trend. Some traders use a market price move and price close that is above the upper band of the Keltner channel as a buy signal, and use a push below and price close below the lower band as a sell signal.

An advantage of Keltner Channel compared to other channel indicators is that market lag is not as pronounced because Keltner Channels are extremely sensitive to fluctuations in volatility.

The Keltner channel is not as well known as other channel methods, such as Bollinger Bands or the Commodity Channel Index (CCI).

To calculate the center-line moving average of the Keltner Channel, you take a moving average--usually 10 periods. You then multiply that moving average price by a number, such as 1.5, to plot the upper and lower bands.

Well-known and respected trader and educator Linda Bradford Raschke has relied upon Keltner channels in her trading methods. When I was a reporter for FWN several years ago, I did a feature story on her.

She says Keltner Channels can serve as buy and sell stops by which to enter or exit a position. Keltner's original system was traded on a stop-and-reverse basis, which was mildly profitable, said Raschke.

By varying the bands on the most recent average daily price range, the channels will naturally be a greater distance from the market when the price swings are wide than when they are narrow. However, they will stay at a much more constant width than other envelope methods.

"You can see how you would have participated in the majority of a trend if you used Keltner's rules. Unfortunately, you would have experienced many whipsaws, too. This is because the system's intentions are to keep you in the market all the time," Raschke said.

"I put Keltner channels set at 2.5 times the 20-day moving average daily range, centered around the 20-period moving average. This is wide enough so that it contains 95% of the price action. In flat-trading markets, as indicated by flat moving averages, it serves as a realistic objective to exit positions. However, I find its greatest value is in functioning as a filter to signal runaway market conditions, much as a rising ADX would do." (The ADX, or directional movement index, helps determine market trend.)

"Keltner channels will identify runaway markets caused by a large standard deviation move or momentum thrust. Thus, they can alert one much earlier to unusual volatility conditions than the ADX, which has a longer lag. On the other hand, (Keltner channels) will not capture the slow, creeping-trend market that an ADX will indicate," said Raschke.

Her rule for defining trending markets: "If the bar (on the bar chart) has a close outside the Keltner channel, or trades 50% of its range outside the band, with a close in the upper half of its trading range, the market should not be traded in a counter-trend manner."

Identifying Market "Noise"

For many years I was a futures market reporter with the FWN wire service (now called OsterDowJones). I spent time working right on the futures trading floors in Chicago and New York. Most of the time my daily reporting "beat" involved interviewing traders and analysts and then writing three daily market reports. For months at a time I would cover the same markets, day in and day out. It was a fantastic learning experience and an opportunity that very few get.

One thing I eventually discovered from covering the same markets day after day, month after month, was that the vast majority of the time the vast majority of the markets' overall fundamental and technical situations did not change on a day-to-day basis. Yet, as a market reporter I was conditioned to write about why the market went up one day and why the market went down the next day, and so on. Even though a market may have been in a very narrow trading range for days or weeks, I had to ask the traders and analysts every day to come up with some fresh fundamental and/or technical reasons why that market moved only a fraction.

Reporting on the New York "soft" futures markets (coffee, cocoa, sugar, cotton and orange juice) is especially difficult for a reporter. He or she needs to dig up and write about some fresh-sounding news every day. The soft markets many times just do not have much fresh fundamental news on a daily basis--or sometimes even on a weekly basis, for that matter. Conversely, it was easier covering the financial and currency markets because there was usually at least one government economic report that came out every day that would make those markets wiggle a bit. Or, some government official (like Greenspan) would make comments to which those markets took notice.

As time went on and I came to better understand markets and market behavior, and as I studied specific trading strategies, I realized that the day-to-day market "noise" is not of much use to most traders. Here's a specific example of market noise: Recently the live cattle futures market was up a bit on a Monday due to talk that the cash cattle trade later in the week would be at higher money. On Tuesday the futures market dropped a bit because of ideas the cash cattle market trade later in the week may not be at firmer money, but steady at best. Nobody was trying to manipulate the live cattle market that week. It was just a case of differing opinions getting center stage when the market closed on different sides of unchanged.

For a trader who tries to follow the near-term fundamentals in a market too closely, hearing that kind of conflicting news can be a nuisance at least, or a factor that prevents successful trading results at most. It's not easy for less-experienced traders to ignore the differing daily drumbeat of fundamental news that is reportedly impacting a market.

The lesson here is that prudent traders should not become overly sensitive or reactive to most of the day-to-day fundamental news events that are reported to be moving the market on any given day. What is important for the trader is that he or she recognizes and understands the overall

trend of the market, and that daily market "noise" is usually an insignificant part of the overall process of trading and of market behavior, itself.

Futures Trading: The Ultimate Head Game

This educational feature will not address any one topic, but instead focus on a few important “odds and ends” that traders will find helpful on their road to more successful trading.

Trading is Indeed a “Head Game”

I have written extensively about the all important psychological aspect of trading futures. My conversations with traders continually reinforce the truism that trading is much more about personal discipline and controlling emotions than it is about discovering some great trading method. The one truth about futures trading that “psyches out” many traders is that losing trades are a part of the overall process of trading. If a trader cannot accept the fact that during most years he or she will likely have a higher percentage of losing trades than winning trades, then odds for his or her ultimate trading success are very low. Most professional traders will “cut their losses short” on the more numerous losing trades, and “let their profits ride” on the fewer winning trades—and that’s why they are profitable traders. Remember, it’s more important to be profitable in futures trading than to be “right.” Being “right” is an ego thing that will cause traders to pull protective stops, try to “average down” losing positions, and do other things that are not conducive to successful trading.

Protective Buy and Sell Stops Are a Must for Most Traders

The advantage of using protective buy and sell stops when initiating a trading position is that you have an exit strategy in place when you make the trade. It is much more difficult to try and figure out where you are going to exit a trade when you are right “in the heat of battle” in the middle of a trade. Most veteran trading professionals agree that “any fool” can enter into a trading position, but it’s the astute and successful traders that know when to exit a trade. Having an exit strategy, via protective buy or sell stops, in your initial trading plan will take you a long way toward the goal of trading success.

The “Moving Average Envelope” Trading Method

The Moving Average Envelope trading method displays two lines on a chart that are an equal percentage distance from a simple moving average. The moving average line is not visible on the chart. The envelope represents bands that are plotted in a certain, identical relationship above and below a selected moving average. There can be various interpretations and trading rules when using moving average envelopes. Basically, envelopes capture a significant part of price movements. Trading signals are released if prices approach or move away from the envelope.

While several different trading rules are available, the simplest approach uses the price band as an entry and exit point. When the price penetrates the upper price band, you initiate a long position or buy. If you have an existing short position, you close out shorts and go

long. Conversely, when prices penetrate the lower price band, you close out long positions and go short.

Perry J. Kaufman is a respected futures trader and educator who has developed more specific trading methods using the moving average envelope theory. He authored a book called, "Commodity Trading Systems & Methods," published by John Wiley & Sons, Inc in 1978.

The Bullish Divergence and Bearish Divergence Indicators

Bullish Divergence and Bearish Divergence are technical studies which are available on many computer trading programs.

Bullish Divergence marks occurrences of lows in the market price not accompanied by lows in the value of a certain indicator. If the criterion of bullish divergence is met, a value of +1 will be assigned; otherwise, a value of 0 will be assigned. In order to use this function, the MACD, Momentum, RSI or Rate of Change indicators need to be plotted on a chart.

When the market displays falling prices while the values of the indicator are rising, the technical position is said to be improving, since the prices will be declining at a slower rate. Market bottoms can sometimes be forecast when the falling prices are not followed by declining indicators, and the trader can in this case take a desired position to make profits from identifying the bottom in the prices. A useful reminder is that the longer the divergence holds, the likelier it is that the market price will sharply follow the trend of the underlying indicator.

The Bearish Divergence function marks occurrences of highs in the prices not accompanied by highs in an indicator. If the criterion of Bearish Divergence is met, a value of +1 will be assigned; otherwise, a value of 0 will be assigned.

The same technical indicators are applied as with bullish divergence.

When rising prices are supported by weaker indicator values, the signal indicates a warning sign of underlying weakness in the price trend. Though the price may be rising and the natural interpretation implies a perfectly healthy trend, an underlying deteriorating indicator sends out a warning flag to the bulls. Again, the longer the divergence holds, the likelier it is that the price will sharply follow the trend of the underlying indicator.

Bullish Divergence and Bearish Divergence do not have specific formulas, since they are only tools used by traders to define the technical health of a particular market.

As with other computer-generated technical studies, the Divergence and Envelope studies are only "secondary" trading tools in my trading tool box. My more important "primary" trading tools include basic chart patterns, trend lines and fundamental analysis.

11 Fascinating Market Correlations You'll Want to Use

Experienced futures traders know there are many correlations among futures markets—some of which are valuable guides in helping to determine specific market trends, and some of which are fickle. This educational feature will examine some basic correlations among futures markets, and will likely be most beneficial to the less-experienced traders. However, it just might be a good refresher for the experienced traders who may have forgotten a few of the market correlations.

It is important to emphasize that market correlations are never 100% predictable, and that some market correlations can and do make 180-degree turns over a period of time.

(Note to the long-time veteran traders reading this story: If I've missed some market correlations you have observed, please drop me an email at jim@jimwyckoff.com with your observations, and I'll add to this list.)

U.S. Dollar-Gold: The gold market and the dollar usually trade in an inverse relationship. This has been the case for many years. During times of U.S. economic prosperity and lower inflation, the dollar will usually benefit as money flows into U.S. paper assets (stocks and bonds), while physical assets (gold) are usually less attractive. Conversely, during times of weaker U.S. economic growth, higher inflation or heightened world economic or political uncertainty, traders and investors will tend to flock out of “paper” assets and into “hard” assets such as gold. Inflation is a bullish phenomenon for gold.

U.S. Dollar-U.S. Treasury Bonds: Usually, a stronger dollar means a stronger bond market because of good demand for U.S. dollars (from overseas investors) to buy U.S. T-Bonds. T-Bonds are also seen as a “flight-to-quality” asset during times of economic or political instability. In the past, the U.S. dollar has also benefited from “flight-to-quality” asset moves. However, since the major terrorist attacks on the U.S. and the resulting damage to the U.S. economy, the safe-haven status of the “greenback” has been much less pronounced.

Crude Oil-U.S. Treasury Bonds: If crude oil prices rally strongly, that is a negative for U.S. T-Bond prices, due to notions that inflationary pressures could reignite and become problematic for the economy. Inflation is the arch enemy of the bond market. Rising crude oil prices are also bullish for the gold market.

CRB-U.S. Treasury Bonds: The CRB Index is a basket of commodities melded into one composite price. A rising CRB index means generally rising commodities prices, and increasing inflation. Thus, a rising CRB Index is negative for U.S. Treasury Bond prices.

U.S. Stock Indexes-U.S. Treasury Bonds: Since the bull market in U.S. stocks ended just over two years ago, stock index futures prices and U.S. Treasury bond futures prices have traded in an

inverse relationship. When stock prices are up, bond prices are usually down. However, during the long bull market run that preceded the current bear market, stock and bond prices traded in tandem. In fact, years ago, before all the electronic overnight futures trading had begun, the best way to get a good read on how the stock indexes would open was by early trading in the T-bond market. (T-Bond trading opens 70 minutes before the stock indexes).

Silver-Soybeans: This corollary may be more fiction than fact, at least nowadays. But during the “go-go” days of soaring precious metals and soybean prices, it was said that if soybean futures would lock limit-up, bean traders would buy silver futures.

Cattle-Hogs: The point to mention here is that if strong price gains or losses occur in one meat futures complex, there is likely to be somewhat of a spillover effect in the other meat complex. For example, sharp losses in the cattle or feeder cattle futures will likely weigh on the hogs and pork bellies.

Currency Futures-U.S. Dollar Index: Most major IMM currency futures contracts are “crossed” against the U.S. dollar. Thus, when the majority of the currencies are trading higher, it’s very likely that the U.S. Dollar Index will be trading lower. It’s a good idea for currency traders to keep a watchful eye on the U.S. Dollar Index, as it’s the best barometer for the overall health of the U.S. dollar versus major foreign currencies.

U.S. Stock Indexes-Lumber: Lumber is a very important commodity for the U.S. economy. It is literally a building block for the nation. If the stock market is sharply higher, lumber futures prices will be supported. A big sell off in the stock market will likely find selling pressure on lumber futures.

N.Y. Cocoa-British Pound: London cocoa futures trading is as important (or even more important) than New York cocoa futures trading, on a worldwide basis. London cocoa futures trading is conducted in the British pound currency. Thus, big fluctuations in the pound sterling will impact the price of U.S. cocoa futures, due to the cross-currency fluctuations of the British pound versus the U.S. dollar. Keep in mind there is constantly arbitrage taking place between the New York and London cocoa markets, and thus the currency cross-rates between the pound and the dollar are very important.

Grains-U.S. Dollar Index: A weaker U.S. dollar will be an underlying positive for the U.S. grain futures markets because it makes U.S. grain exports more competitive (cheaper prices) on the world market. Larger-degree trends in the U.S. dollar will have a larger-degree impact on the grains.

13 Different Market Orders and When to Use Each

A customer signed up for my service the other day and was asking me about stops and different types of market orders. They were good questions and they reiterated to me the fact that I have subscribers that range from seasoned trading professionals to those testing the futures trading waters for the first time.

One thing I always like to point out to the less-experienced traders: There are no "dumb" questions and there is no shame in being inexperienced. Every single futures trader that ever walked the face of the earth has been inexperienced at one point.

This feature on types of market orders, including stops, may be a "refresher" feature for the more experienced traders, and will likely be a more valuable feature for the traders newer to this fascinating field.

Market Order

The market order is the most frequently used futures trading order. It usually assures you of getting a position (a fill). The market order is executed at the best possible price obtainable at the time the order reaches the futures trading pit.

Limit Order

The limit order is an order to buy or sell at a designated price. Limit orders to buy are placed below the market; limit orders to sell are placed above the market. Since the market may never get high enough or low enough to trigger a limit order, a trader may miss getting filled if he or she uses a limit order. Even though you may see the market touch your limit price several times, this does not guarantee a fill at that price.

"Or Better" Orders

"Or better" is a commonly misunderstood order type. You should only use "or better" if the market is "or better" at the time of entry to distinguish the order from a stop. "Or better" on an order does not make the pit broker work harder to get a better fill. It is always the broker's job to provide you with the best possible fill. If an order is truly "or better," then this designation assures the broker that you have not left "stop" off the order. In many instances, unmarked "or better" orders are returned for clarification, potentially costing the trader valuable time and possibly a fill. Orders that are not "or better" when entered only serve to better use the pit broker's time upon receipt as he checks to see whether or not the order deserves a fill. Sometimes, using the "or better" designation before the opening is helpful in assuring the broker that your order is meant to be filled.

Market if Touched (MIT) Orders

MIT's are the opposite of stop orders. Buy MIT's are placed below the market and Sell MITs are placed above the market. An MIT order is usually used to enter the market or initiate a trade. An MIT order is similar to a limit order in that a specific price is placed on the order. However, an MIT order becomes a market order once the limit price is touched. A fill may be at, above, or below the originally specified MIT price. An MIT order will not be executed if the market fails to touch the MIT specified price.

Stop Orders

Stop orders can be used for three purposes: One, to minimize a loss on a long or short position. Two, to protect a profit on an existing long or short position. Three, to initiate a new long or short position. A buy stop order is placed above the market and a sell stop order is placed below the market. Once the stop price is touched, the order is treated like a market order and will be filled at the best possible price.

Importantly, while stops and MIT's are usually elected only when the specific price is touched, they can be elected when the opening of a market is such that the price is through the stop or MIT limit. In this case, you can routinely expect the fill to be much worse than the original stop or better on the MIT. This applies to stop orders and MIT orders placed before the opening of pit trading.

Stop-Limit Orders

A stop-limit order lists two prices and is an attempt to gain more control over the price at which your stop is filled. The first part of the order is written like the stop order. The second part of the order specifies a limit price. This indicates that once your stop is triggered, you do not wish to be filled beyond the limit price. Care should be taken when considering stop-limit orders--especially when trying to exit a position, because of the possibility of not being filled even though the stop portion of the order is elected. There is no stop-limit order without a second price. If your order cannot be filled by the floor broker immediately at the stop price, it becomes a straight limit order at the stop price.

Stop-Close Only Orders

The stop price on a stop-close only will only be triggered if the market touches or exceeds the stop during the period of time the exchange has designated as the close of trading (usually the last few seconds or minutes).

Market on Opening Order

This is an order that you wish to be executed during the opening range of trading at the best possible price obtainable within the opening range. Not all exchanges recognize this type of order. One exchange that does is the Chicago Board of Trade.

Market on Close (MOC) Order

This is an order that will be filled during the period designated by the exchange as the close at whatever price is available. A floor broker may reserve the right to refuse an MOC order up to 15 minutes before the close, depending upon market conditions.

Fill or Kill Order

The fill or kill order is used by customers wishing an immediate fill, but at a specified price. The floor broker will bid or offer the order three times and return to you with either a fill or an unable, but it will not continue to work throughout the trading session.

One Cancels the Other (OCO) Order

This is a combination of two orders written on one order ticket. This instructs the floor brokers that once one side of the order is filled, the remaining side of the order should be cancelled. By placing both instructions on one order, rather than two separate tickets, you eliminate the possibility of a double fill. This order is not acceptable on all exchanges.

Spread Orders

The customer wishes to take a simultaneous long and short position in an attempt to profit via the price differential or "spread" between two prices. A spread can be established between different months of the same commodity, between related commodities, or between the same or related commodities traded on two different exchanges. A spread order can be entered at the market or you can designate that you wish to be filled when the price difference between the commodities reaches a certain point (or premium).

Good Till Cancelled Orders

These orders are also known as open orders and will remain valid until cancelled.

The Single MOST IMPORTANT Aspect of Futures Trading

Okay, traders: Do you know what is the most important aspect of successful futures trading? Is it identifying the trading opportunity? Is it proper entry into the market? Is it the trading "tools" you are using? Is it an exit strategy that is the most important aspect of trading? The answer is: None of the above (although an exit strategy is close).

The most important factor in successful futures trading is money management. One still has to be savvy at chart forecasting and-or fundamental analysis, but it's the money-management factor that will make or break a futures trader. The huge leverage involved with trading futures absolutely requires pinpoint money managing.

Over the years, I have listened to the best traders in the business talk about what makes them succeed in this challenging arena, and nearly every one emphasizes the importance of sound money management. A few years ago I attended a TAG (Technical Analysis Group) trader's conference in Las Vegas. One of the featured speakers stressed that becoming a successful futures trader should be more an act of survival in the early going than scoring winning trades.

Surviving in the futures market absolutely requires practicing sound money management. Even a rookie trader who starts out with a hot hand will eventually find that at least some trades are not going to go his way. And if he has not employed good money- management principles on those losing trades, he will likely have squandered his trading profits and his entire trading account.

Conversely, the novice trader who uses good, conservative money management techniques will be able to withstand some losses and be able to trade another day. The ability to take a loss and trade another day is the key to survival--and ultimate success-- in the futures trading arena.

Here's an important point to consider, regarding money management and successful futures trading: Most successful futures traders will tell you that during the span of a year they have more losing trades than winning trades. Then why are they successful? It is because of good money management. Successful traders set tight stops to get out of losing positions quickly; and they let the winners ride out the trend. On the balance sheet, a few bigger winning trades will more than offset the more numerous smaller losers. Good money management allows for that to happen.

"Good money management" is a relative principle. A good money- management practice for one trader might not be a good money- management practice for another. Here's a real-life example: I had a fellow email me a while back, saying he was up \$3,000 in a sugar trade, and that his total trading account was \$4,000. Although I don't provide specific trading advice to individuals, I told the trader that if I had only a \$4,000 trading account and had racked up 3 grand in profits on

one trade, I would seriously think about ringing the cash register on that trade and building up my account so that I could withstand those drawdowns and losers that will eventually occur.

On the other hand, if a trader with a \$30,000 account had a \$3,000 winning sugar trade, he may want to let the winner ride a little longer, as pocketing the profit would not nearly double his trading account, as it would the smaller-capitalized trader.

In other words, don't be a greedy trader. There's an old trading adage that says there is room for bulls and bears in the marketplace, but pigs get slaughtered.

Let me emphasize here there is nothing wrong with starting out with, or keeping, a smaller-capitalized futures trading account. But I strongly suggest that those smaller accounts use the very strictest of money management.

There are dozens of good futures and stock trading books available, and most spend at least an entire chapter on money management.

Here are just a few very general money-management guidelines:

- For smaller-capitalized traders, don't commit more than one-third of your trading capital to one trade. For medium- and larger-capitalized traders, you should not commit more than 10% of your capital to one trade. The guideline here is, the larger your trading account, the smaller your commitment should be to one trade. In fact, some trading veterans suggest larger trading accounts should not commit more than 3-5% of their capital to one trade. Smaller-capitalized traders, by necessity, have to commit a larger percentage of their capital to one trade. However, these small-cap traders may want to trade options (buying them, not selling them), as risk is limited to the price paid for the option. Or, smaller-capitalized traders may want to trade on the Mid-American Exchange, a division of the Chicago Board of Trade that has smaller futures contract sizes.
- Use tight protective stops in all your trades. Cut your losses short and let the winners ride the trend.
- Never, never, never add to a losing position.
- Your risk-reward ratio in a futures trade should be at least three to one. In other words, if your risk of loss is \$1,000, your profit potential should be at least \$3,000.

I can't stress enough that survival in the futures trading arena (especially for beginners) should be your top priority.

"Why Economists Don't Make Good Traders" and other Nuggets

My ideas for educational feature topics usually come from readers' suggestions or from tidbits I have gleaned from many years of studying and trading futures markets and stocks. I also get educational topic ideas from discussing markets with my peers in the newsletter and trading advisory services industry. For this educational feature, I don't have any one topic that I will focus upon, but instead will give you a few more trading "nuggets."

Why Economists Don't Make Good Traders

Are you a little surprised at the headline of this nugget? When I first started in this fascinating business I was a reporter right out of college, working on the floor of the Chicago Mercantile Exchange. Just before my very first trip onto the trading floor, I suspected I'd find that floor traders were a bunch of academics (or economists) in pinstripe suits, conducting business quietly with their noses stuck into a notebook full of trading statistics and charts. **Wrong!** Instead, I found that floor traders were more like construction workers than academics, in that they were "regular" guys or gals, many of which did not conduct business quietly, and who read the sports page first--and even told a salty joke here and there.

Actually, I found that a bit refreshing because my background is rooted in a blue-collar-type work ethic. (I was also a construction worker before and during my college days.) Anyway, my point is that successful floor traders (and other traders) are good at what they do not because of their extensive studies of economics or business principles or related text books. Stock and futures traders are successful because of their trading experience and their realization that markets are a reflection of human nature--which tends to repeat itself.

Let me provide an analogy with the famous "Old Faithful" geyser at Yellowstone Park. An academic (economist) may study what makes the geyser work and all the physical elements involved in producing the big shot of water and steam. However, all the trader really cares about is one important thing: When the geyser will produce its next big plume of steam. Most economists tend to be "behind the curve" when it comes to pegging economic conditions and market moves. Traders are forced to be right out there on the cutting edge of market trends and trend changes. (And yes, that "edge" can be very sharp!)

Baseball and Trading Futures: Both are a Big Boy's Game

Trading futures is not a game for the faint of heart. I read a story on the ODJ newswire the other day that succinctly put the specter of losing trades into perspective. The greatest baseball hitters in the world do not even bat .400. In other words, the best baseball sluggers are successful about 3 out of 10 times they step up to the plate. The same is true with futures trading. The very best

traders in the world lose on well more than half of all the trades they make. The key is limiting losses on the more numerous losing trades and maximizing profits on the fewer winning traders. Some individuals' egos cannot accept the fact that more losing trades than winning trades are a part of trading futures.

Barry Bonds, Hank Aaron, Willie Mays and Mark McGwire all suffered hitting slumps--and more than just one. I'm sure they didn't like those slumps, but they persevered and eventually broke out of them. Futures and stock traders will also almost certainly experience periods of poorer trading performance. And, of course, there are the many men whose dream was to make it to "The Show" in the Major Leagues, but did not have the skills required. Those men who did not make it to "The Bigs" were not "losers." They were the ones who at least gave their dreams their best shot. And then they went on to pursue other things and found their successful niche in life. I believe the same is true in the very challenging fields of trading futures and stocks.

Some People Never Learn

I am going to describe to you a CNBC TV interview that I saw aired a while back, and then I want you to figure out what's wrong with the analyst's approach.

The interview was with a stock analyst/advisor. He was asked by the CNBC reporter to provide his stock picks that he saw as good bets to perform well in the next year or two. The analyst went on to describe several stocks. He went into detail about how one stock had been beaten down too far the past few months, and that another stock was a bargain at its current low price level and was sure to rise from the depths. Still another stock had been "underperforming" but was likely going to kick into higher gear once some kinks were worked out and the economy picks back up. He described a couple more stocks that were also "due for rebounds."

What's wrong with this investment approach? **The stock analyst is a bottom-picker!** So-called bargain hunters for beaten-down or cheap stocks only have slightly better odds for success than bottom-fishers in futures markets. When a stock or futures market price is low, there is a reason why it is so low: The collective marketplace has determined the price to be a fair price at that given moment.

One of the best stock-trading books I've ever read is, "How to Make Money in Stocks," by William J. O'Neil, the founder of the Investors Business Daily newspaper. O'Neil's trading principles are very much like those of many successful futures traders.

The Basic Principles of “Swing Trading”

"The Trend is Your Friend" is a tried and true market adage that is indeed one of the most valuable futures trading tenets. However, history shows that most markets tend to move in a non-trending, or "sideways" fashion more of the time than they are in a trending mode. There are several methods by which to trade non-trending markets. One popular method is called "swing trading."

The basic principle for swing trading is finding a market that is trapped in a sideways trading range (also called a congestion area), or in an up-trending or down-trending channel on the chart. On the chart, the trader must be able to distinguish some clear support and resistance levels that are boundaries of the congestion area or channel. When a market price approaches the support or resistance area boundary, the trader will establish a position: long if prices are moving lower and close to the support boundary, and short if prices are moving higher and toward the resistance boundary.

Swing trading techniques can be used in any chart time frame--daily, weekly, monthly and intra-day charts. However, the most popular timeframe for swing trading is the daily bar chart.

It's important to note that the strength of the support and resistance at the boundaries is usually determined by the number of times the market has pivoted at the boundaries. The more times a market has reached a support or resistance boundary, and then reversed course, the more powerful is that boundary. Thus, a trader wants to find a well-established channel or trading range for which to attempt to swing trade. An exception to this is a market that has been in a trading range, but is bound by one or two powerful spike moves, which also indicate a strong support or resistance boundary. In other words, some congestion areas that may offer a good swing-trade opportunity do not require several pivot points. Instead, those one or two spike levels would be determined to be a potentially good pivot area for a market.

The swing trader should still use tight protective stops. A good area to place a protective stop is just outside of a support or resistance boundary that makes up the trading channel or congestion area. For example, if a market in a trading channel is nearing the upper boundary of that channel, the swing trader would establish a short position and would want to place his protective buy stop just above the resistance level that serves as the upper boundary of the trading channel.

Interestingly, if the market keeps moving higher and breaks out above the channel, or congestion area, (stopping the swing trader out of the market) then that would likely be considered an upside "breakout," which is a favorite trading set-up among many veteran position traders. This set-up would suggest establishing a long position if there was good follow-through buying strength the following session after the upside breakout from the congestion area or channel. The trader establishing the long position would place his protective sell stop just below the former upper boundary of the trading channel or congestion area that was just penetrated on the upside.

"System Trading:" What Is It? Should you Buy and Use a Trading System?

There is an endeavor of futures trading that is popular among many traders, but also about which many other traders are unfamiliar. It's called "system trading." In this educational feature I will define system trading and detail the advantages and disadvantages of the methodology.

What is System Trading?

System trading (also known as mechanical trading systems) is the deployment of a well-defined and very strict set of criteria for trading a futures market or individual stock--including entry and exit points. The trading criteria for a particular trading system can include all kinds of technical indicators, chart patterns, volume, open interest, and even fundamental factors. There are all kinds of trading systems available for sale, and even more trading systems that have been developed by individual traders, for their own use.

The key tenet of a trading system is that strict signals are given for entry and exit points, based on the parameters of the system. Most trading systems are computer-program based, due to the complex nature of most of the trading parameters. Indeed, trading systems can be highly complex and have dozens of parameters plugged into the system. Or, a trading system can be as simple as a moving- average "crossover" method that provides buy and sell signals with each moving average crossover.

Advantages of System Trading

A major advantage of system trading is that it takes the human emotion factor out of a trade. By strictly adhering to criteria built into a trading system, a trader cannot be swayed by such emotions as fear or greed "in the heat of battle" during the trade. Many veteran trading professionals argue that the major downfall of futures traders is their own emotions and lack of trading discipline. A trading system attempts to control both emotions and trading discipline.

Trading systems can be "back-tested" by running the trading system program through many years of previous price data for one or many markets. A trader may discover that his particular trading system works best in T-bonds or best in grains. When doing back-testing, a trader can refine the trading system's parameters to get what he or she feels is the very best trading system, based on past price history, and for various markets. This is what trading system advertisers and marketers call "hypothetical" trading results.

For some traders who are also computer programming "wonks" anyway, much of the enjoyment of a trading system is derived from designing it, actually building it and testing it--before it is ever actually put through the paces of real-time trading.

Disadvantages of System Trading

There are at least a few significant disadvantages of the "system trading" methodology. A major drawback is the potential for severe drawdowns in one's trading account. Since many trading systems have a trader in the market--either long or short--all the time, then unexpected big price moves can be devastating to a system trader who does not have a bigger trading account.

Another disadvantage is the propensity for marketers to "hype" a trading system as generating immense profits, based on "hypothetical" results. For example, a trading system may be advertised as generating 300% profits over the past five years, based on hypothetical back-testing. What the marketers and advertising don't tell you is that the drawdowns on a trading account may have been so severe that the vast majority of traders would have been wiped out before the market ever turned around.

While mechanical trading systems attempt to eliminate the potentially negative human emotion factor, they also eliminate the very important "trader intuition" and experience tools that can be extremely valuable. While computer trading programs are very powerful and take into account many, many variables (as many as the developer wants to add), there is no substitute for the power of the human brain and its flexibility.

For comparison, my "toolbox" approach to trading means that I may use any and all trading tools available to me in any given trading situation. I'll use different trading tools for different trading circumstances. To program a trading system to have such flexibility would be extremely difficult, if not impossible.

Finally, I do get many inquiries regarding the use of trading systems by individual traders. There is no single right answer regarding the viability of trading systems for individual traders. "Different strokes for different folks," as the saying goes. However, my universal response to those seeking out a trading system and who ask for my opinion on the matter is this: Don't spend hundreds or thousands of dollars purchasing a trading system and think you are on your way to Easy Street. Instead, at least first spend less than \$200.00 on some classic books on futures or stock trading tools and strategies. Learn and fully understand some of the basic trading tools and trading methods before diving into any trading system.

Understanding and Using Donald Lambert's "Commodity Channel Index"

The Commodity Channel Index (CCI) was developed by Donald Lambert and is an indicator that follows market trends. The CCI was designed to detect beginning and ending market trends.

This indicator measures the distance between the market price and its moving average and thus allows a measurement for the trend strength and/or intensity. Values of +100 to -100 indicate a market with no trends. According to Lambert, 70%-80% of all price fluctuations fall within +100 and -100, as measured by the index.



Buy and sell signals only occur when the +100 line (buy) and the -100 (sell) are crossed. The way this indicator works is almost the opposite of how you would use an oscillator (overbought/oversold) such as the Relative Strength Index (RSI) or Slow Stochastics.

The CCI is calculated as the difference between the mean price of a market and the average of the means over a chosen period. This difference is then compared with the average difference over the time period.

The trading rules for the Commodity Channel Index are as follows: Establish a long position when the CCI exceeds +100. Liquidate when the index drops below +100. For a short position, you use the -100 value as your reference point. Any value less than -100, let's say -125, suggests a short position, while a rise to -85 tells you to liquidate your short position.

The time period for the study is defined as the number of bars in a chart. If the chart displays daily data, then the period denotes days. In weekly charts, the period will stand for weeks, and so on. Common settings are 20 and 14. The default number is 14.

As always, the computer-generated Commodity Channel Index is one of my "secondary" trading tools and carries less weight than my "primary" trading tools, such as trend lines, chart patterns and fundamental analysis.

The MACD Indicator: A Great Secondary Tool

The Moving Average Convergence Divergence (MACD) indicator has the past few years become one of the more popular computer-generated technical indicators.

The MACD, developed by Gerald Appel, is both a trend follower and a market momentum indicator (an oscillator). The MACD is the difference between a fast exponential moving average and a slow exponential moving average. An exponential moving average is a weighted moving average that usually assigns a greater weight to more recent price action.

The name "Moving Average Convergence Divergence" originated from the fact that the fast exponential moving average is continually converging toward or diverging away from the slow exponential moving average. A third, dotted exponential moving average of the MACD (the "trigger" or the signal line) is then plotted on top of the MACD.



Parameters:

Mov1: The time period for the first exponential moving average. The default value is usually 12, referring to 12 bars of whatever timeframe plotted on the chart. (This is the fast moving average.)

Mov2: The time period for the subtracted exponential moving average. The default value is usually 26, referring to 26 bars. (This is the slow moving average.)

Trigger: The period of 9 bars for the signal line representing an additional exponential moving average.

(Note: For a graphic example of the MACD indicator, send me an email at jim@jimwyckoff.com and I will email you back with the picture example.)

The MACD study can be interpreted like any other trend-following analysis: One line crossing another indicates either a buy or sell signal. When the MACD crosses above the signal line, an uptrend may be starting, suggesting a buy. Conversely, the crossing below the signal line may indicate a downtrend and a sell signal. The crossover signals are more reliable when applied to weekly charts, though this indicator may be applied to daily charts for short-term trading.

The MACD can signal overbought and oversold trends, if analyzed as an oscillator that fluctuates above and below a zero line. The market is oversold (buy signal) when both lines are below zero, and it is overbought (sell signal) when the two lines are above the zero line.

The MACD can also help identify divergences between the indicator and price activity, which may signal trend reversals or trend losing momentum. A bearish divergence occurs when the MACD is making new lows while prices fail to reach new lows. This can be an early signal of a downtrend losing momentum. A bullish divergence occurs when the MACD is making new highs while prices fail to reach new highs. Both of these signals are most serious when they occur at relatively overbought/oversold levels. Weekly charts are more reliable than daily for divergence analysis with the MACD indicator.

For more details on the MACD, Appel has a book in print, entitled: "The Moving Average Convergence-Divergence Trading Method."

As with most other computer-generated technical indicators, the MACD is a "secondary" indicator in my trading toolbox. It is not as important as my "primary" technical indicators, such as trend lines, chart gaps, chart patterns and fundamental analysis. I use the MACD to help me confirm signals that my primary indicators may be sending.

4 Key Questions to Gauge Your Trading Success

The attitude of the individual trader (part of the important aspect of trading psychology) plays a huge role in success (or failure) in futures trading. For a trader to become successful, he or she must enjoy the "process" of futures trading.

I have a few questions below that will help determine whether you are a good candidate to become a successful trader--if you don't feel you already fit into that category.

Before I get to the questions, it's important to touch upon the term "trading success." What is trading success? Many would reply that trading success is defined as being profitable at trading--making more money at futures trading than one loses. I cannot disagree with that definition, but there is more to trading success than just the amount of profits accrued from trading. To better explain, here are examples of two hypothetical traders:

1. Trader Bob just started trading this year and has racked up \$50,000 in futures trading profits. But he's not happy with that figure. He wants more. Bob wants to "bring the markets to their knees"--and quickly. Bob does not at all enjoy studying charts or reading and learning about fundamental factors that impact markets. His trading decisions are based mostly upon "tips" from friends or his broker. Soon, Trader Bob says he will begin establishing larger trading positions to accrue even bigger and faster profits.

2. Trader Mary has read many books and attended trading seminars--and "paper traded" before she began putting "real money" on the trading table. She, too, has been trading for around one year, and has accrued about \$2,000 in profits. She enjoys studying charts, reading about market fundamentals and continues to read books on how successful traders became successful. Trader Mary enjoys the interaction she has with other traders with whom she has become acquainted. She does not get overly excited about winning trades or overly discouraged about losing trades. Trader Mary knows she's "in it for the longer haul" and figures that if she works hard, uses sound money management and "loses her ego," then hopefully good things will come from trading futures.

One can argue that both Trader Bob and Trader Mary have been successful futures traders. But which trader would you say has been most successful? Which trader would you say will continue to be successful? Most would agree that Trader Mary is achieving the greater degree of success in futures trading--even though she does not have nearly as much trading profits as Trader Bob. No doubt, Trader Bob has seen a very good run of trading profits. However, he appears to be a "flash in the pan" and is very likely doomed to "flame out."

One more analogy before I get to the questions that may help determine if you are, or will be, a successful trader. (I think my friend and respected fellow trader and educator Joe DiNapoli

would agree with this analogy, as Joe restores classic cars, too.) Trading futures is like rebuilding and restoring a classic automobile. There are several tasks (many of them tedious) on the road to completing the restoration. Those restorers who do not enjoy the tasks of restoring likely will not continue to restore, and will not have a good finished product. Those restorers who take their time and enjoy the entire process of restoring an automobile will have a very fine finished product. The same is true with trading.

Now, here are a few questions to help determine if you are, or will be, a successful futures trader:

1. Do you enjoy the entire process of trading futures--from studying charts, reading about and learning fundamentals, listening to and learning from mentors, and even figuring out what mistakes you have made in previous trades, and how you will improve from those previous mistakes? (Remember, a trader never stops learning and should never stop seeking knowledge about markets and trading.)
2. If you are a beginning trader with less than a couple years experience, are you willing to use the very sound money management principles required for survival in futures trading--even if it means meager profits (or meager losses) the first year or two?
3. Do you have the "patience" to wait for good trading opportunities to develop, and then have the "discipline" to follow your trading plan once you make the trade?
4. Are you the type of person who CAN stand to lose, and can you accept that trading losses are your own fault? (This is a very important question, because the typical futures trader has a more competitive personality. Remember that even the most successful traders have losing trades--and sometimes several in a row.)

If you have answered "yes," to these questions, then your road to trading success will be less rocky. If you answered "no" to any of the above questions, then you face a more difficult task on the road to trading success, and you need to figure out what changes you should make to make the "process of trading" more rewarding.

Never Stop Learning! Education's Role in Your Long-Term Trading Success

My first experience in the futures industry was as a young (and naïve) reporter working right on the trading floor of the Chicago Mercantile Exchange. It was a unique and very rewarding way to start my career in the fascinating field of markets and trading. I was able to talk face-to-face with floor traders and analysts, and as a reporter got to ask many questions in my quest for knowledge.

After my first few weeks of working on the trading floor of the "Merc," I went home one night and made this bold statement to my wife: "All I need to do is spend a few months studying markets and technical analysis--and then I will begin successfully trading for a living and soon we'll be rich!" (Now you see why I was a "naïve" young reporter!)

It was not too long after that bold statement that I began to realize trading and analyzing markets is a lot like playing the game of golf. The beginners don't have any idea how bad they really are! And then, once a few basic skills are understood, the beginners suddenly realize how difficult the task is and how much work lies ahead on the road to success.

That "bold statement" I made was nearly 20 years ago. And, after 20 years of being involved in markets, trading and analysis on a full-time basis--including reading stacks of educational books at night--my hunger for market and trading knowledge is still insatiable. Every day, I am still learning valuable lessons regarding markets and trading.

Futures traders should never abandon their quest for more knowledge about markets and trading. Below are some tips on "continuing education" in futures trading.

DO: Read books on trading and markets. Books are a great (and inexpensive) way to continue to learn about this challenging field. There are many good futures trading books readily available. Check out the www.amazon.com website and type in the search words "futures trading" and there will be many good books retrieved.

DON'T: Go out and spend hundreds of dollars (or more) on some mechanical trading "system" that just employs one set of trading parameters. Or, if you do plan on taking the system approach, at least read books and study other materials first--to get as much of a broad background on markets and trading as possible. Remember: More money spent does not necessarily equal more good knowledge acquired.

DO: Search the Internet for websites that offer free research and educational material on trading and markets. It's surprising and refreshing to see how much free educational material on markets

and trading is available on the Internet. The major futures exchanges have major sections of their websites devoted to educational material that is of high quality.

DON'T: Head down a narrower alley of market analysis or a specific trading method without first examining a wide variety of trading methods or market analysis. For example, Elliott Wave theory is a respected field of study. But for beginners to focus only on Elliott Wave without having studied other methods of market analysis and trading limits their scope.

DO: Seek out a mentor who can answer your questions and also give you advice other than just what market to trade. Also, seek a fellow trader with similar experience as you. Sharing ideas and discussing markets with a fellow trader is an enormous benefit.

DON'T: Shell out big bucks for someone who claims they will be your mentor and make you a big winner in futures trading in only a few short weeks or months. The old adage, "If it sounds too good to be true, it probably is" should be heeded in this challenging business.

The Top 10 Mistakes Traders Make

Achieving success in futures trading requires avoiding numerous pitfalls as much, or more, than it does seeking out and executing winning trades. In fact, most professional traders will tell you that it's not any specific trading methodologies that make traders successful, but instead it's the overall rules to which those traders strictly adhere that keep them "in the game" long enough to achieve success.

Following are 10 of the more prevalent mistakes I believe traders make in futures trading. This list is in no particular order of importance.

1. Failure to have a trading plan in place before a trade is executed. A trader with no specific plan of action in place upon entry into a futures trade does not know, among other things, when or where he or she will exit the trade, or about how much money may be made or lost. Traders with no pre-determined trading plan are flying by the seat of their pants, and that's usually a recipe for a "crash and burn."

2. Inadequate trading assets or improper money management. It does not take a fortune to trade futures markets with success. Traders with less than \$5,000 in their trading accounts can and do trade futures successfully. And, traders with \$50,000 or more in their trading accounts can and do lose it all in a heartbeat. Part of trading success boils down to proper money management and not gunning for those highly risky "home-run" type trades that involve too much trading capital at one time.

3. Expectations that are too high, too soon. Beginning futures traders that expect to quit their "day job" and make a good living trading futures in their first few years of trading are usually disappointed. You don't become a successful doctor or lawyer or business owner in the first couple years of the practice. It takes hard work and perseverance to achieve success in any field of endeavor--and trading futures is no different. Futures trading is not the easy, "get-rich-quick" scheme that a few unsavory characters make it out to be.

4. Failure to use protective stops. Using protective buy stops or sell stops upon entering a trade provide a trader with a good idea of about how much money he or she is risking on that particular trade, should it turn out to be a loser. Protective stops are a good money-management tool, but are not perfect. There are no perfect money-management tools in futures trading.

5. Lack of "patience" and "discipline." While these two virtues are over-worked and very often mentioned when determining what unsuccessful traders lack, not many will argue with their merits. Indeed. Don't trade just for the sake of trading or just because you haven't traded for a while. Let those very good trading "set-ups" come to you, and then act upon them in a prudent way. The market will do what the market wants to do--and nobody can force the market's hand.

6. Trading against the trend--or trying to pick tops and bottoms in markets. It's human nature to want to buy low and sell high (or sell high and buy low for short-side traders). Unfortunately, that's not at all a proven means of making profits in futures trading. Top pickers and bottom-pickers usually are trading against the trend, which is a major mistake.

7. Letting losing positions ride too long. Most successful traders will not sit on a losing position very long at all. They'll set a tight protective stop, and if it's hit they'll take their losses (usually minimal) and then move on to the next potential trading set up. Traders who sit on a losing trade, "hoping" that the market will soon turn around in their favor, are usually doomed.

8. "Over-trading." Trading too many markets at one time is a mistake--especially if you are racking up losses. If trading losses are piling up, it's time to cut back on trading, even though there is the temptation to make more trades to recover the recently lost trading assets. It takes keen focus and concentration to be a successful futures trader. Having "too many irons in the fire" at one time is a mistake.

9. Failure to accept complete responsibility for your own actions. When you have a losing trade or are in a losing streak, don't blame your broker or someone else. You are the one who is responsible for your own success or failure in trading. You make the trading decisions. If you feel you are not in firm control of your own trading, then why do you feel that way? You should make immediate changes that put you in firm control of your own trading destiny.

10. Not getting a bigger-picture perspective on a market. One can look at a daily bar chart and get a shorter-term perspective on a market trend. But a look at the longer-term weekly or monthly chart for that same market can reveal a completely different perspective. It is prudent to examine longer-term charts, for that bigger-picture perspective, when contemplating a trade.

Fear Factor: The Impact of Trading With "Scared Money"

I am not a big casino gambler, but I have been at the venues in Las Vegas and Atlantic City, as well as in other casinos worldwide. I have observed a myriad of gamblers at the poker, black jack, roulette and craps tables. An interesting characteristic among gamblers is exhibited to me time and time again. It is this: The gamblers who appear to have money they can afford to lose usually are the ones who can win. The gamblers who appear to be using their rent or grocery money (or what I call "scared money"), and really should not be gambling, are usually the ones who lose.

You may ask, "How can you tell who is gambling with scared money and who is not?" Facial expressions, reactions to losing bets and to winning bets, and other "body language" are dead giveaways to me.

The "scared-money" phenomenon I see in casino gambling can be applied to futures trading. Those traders who are using grocery and rent money in their brokerage account and "must win" on their next trade, or else they will be forced out, have a huge emotional burden to carry. That burden certainly affects their trading psychology and ultimately their trading success.

The most common reason for scared-money trading in the futures markets is undercapitalization or being over-leveraged. A person with a \$20,000 trading account should not be trading full-size S&P 500 futures contracts. A couple of moderate daily price moves against an S&P trader with an account this size could find him getting a margin call from his broker.

So, what factors determine whether a trader is trading with "scared money?" Is there a certain income or savings level a person must attain to not trade with scared money? Does one have to be wealthy to trade futures successfully? The answer is: There is no single right answer. It depends on the individual trader.

I hearken back to the all-important "psychology of trading" with an example. A person with a modest income and a prudent money-management plan can trade futures and do so without using scared money. He or she can trade options (buying them, not selling them), or trade smaller-sized contracts offered at the Chicago Board of Trade, or even trade regular-size contracts such as soybean oil, where the "tick size" is relatively small in dollar amount. In fact, I submit that a good percentage of speculative futures traders worldwide fall into the above category.

Conversely, a so-called wealthy person with a higher income and/or savings can still trade scared money. If the better-capitalized trader holds his purse-strings too tight and cannot accept the fact that even the best professional futures traders in the world can and do have losing trades, then he, too, is trading "scared money." I think we all know of at least one wealthy Scrooge who totes his money sack on his back and doesn't even tip the waitresses or bartenders. Certainly, individuals like that are not good candidates for successful futures traders.

"Nuggets You Can Use" from a Trading Seminar

When I was a journalist with FWN I attended many trading seminars and interviewed dozens of professional traders over a span of about 15 years. I was hungry (starving!) to gobble up any and all knowledge and perspective proffered by the seasoned traders and trading educators. Trading seminars are a great way for traders to gain knowledge that will hopefully move them up the ladder of trading satisfaction and success.

It's not just coincidental that of all the trading seminars I have attended and of all the books on trading that I have read, there are a few common themes espoused by many trading professionals. Below are some valuable trading and educational "nuggets" I gleaned from speakers at the "International Trading & Markets Conference" that I attended in San Francisco in 1996. The event was sponsored by "Futures" magazine.

- ◆ About the closest thing to the Holy Grail of trading is the market adage: "Trade with the trend. If it's up, buy the dips. If it's down sell the rallies."
- ◆ The primary aspect to a healthy (and successful) trader is one simple, universal trait: hard work.
- ◆ Perseverance never stops for a true trader. The reason it cannot is because the market has a personality with radical mood swings.
- ◆ Stick to your trading program. It's the "George Foreman" approach: "You might lose a few rounds, but it's the decision that you want. Take the emotions out of it and you will sleep better at night.
- ◆ Why traders really fail: 1. Lack of "accurate" knowledge. 2. Stress. 3. Can't "pull the trigger" and make a trade.
- ◆ In options trading (buying not selling): Position yourself to enter the markets when volatility is low and exit when it is high. Don't enter markets that have already jumped to a higher volatility level.
- ◆ Don't feel compelled to trade if you don't see the trade as a winning situation for you. The only time you should get into a trade is when you feel the odds are very much in your favor, your potential losses are calculated in advance and you are comfortable with your decision.

- ◆ Know when important reports or dates occur (like an employment report or contract expiration date) for your particular futures market you plan to trade.
- ◆ More decisions and more complicated equal less profits and less effective.
- ◆ More emotion equals less profits.
- ◆ What most traders do does not work.
- ◆ Most traders are wrong most of the time--even the successful ones.
- ◆ The vast majority of traders lack discipline.
- ◆ Undercapitalized traders trade "scared" money.
- ◆ Do your homework before you do anything!
- ◆ It's been said that a good trader can make money with a mediocre trading system, but that an average trader cannot make money even with a good trading system.
- ◆ Good traders will always find positions in the markets from which to extract profits, either by experienced judgment or by unconscious intuition that computers just don't see.
- ◆ You must focus your mind and thoughts on your goals and develop a method to achieve those goals. Unless you are willing to lock onto your goals with dogged determination, the odds of achieving those goals will remain slim.
- ◆ The use of a combination of technical tools will produce low-risk entry points and provide the potential to produce substantial profits. The use of one technical tool without confirmation of other technical tools will often produce inferior results.

One final thought: Traders who do run into a tough stretch where a few or more losses in a row are absorbed (especially the less-experienced traders) would especially benefit from attending a trading seminar. Not only would these traders absorb some fresh knowledge and perspective from successful trading professionals, but they would also very likely meet seminar attendees who are experiencing, or have experienced, the same feelings during a tough stretch of trading. Sharing your trading experiences--even your bad ones--with other traders is a healthy thing to do.

Don't "Fight the Tape!"

I was busy one morning a while back when I got an email from a trader. He said he was bullish on a market that had been in a long-term downtrend for quite some time. He wanted to do some "bottom-fishing." All morning long, it seemed, trader emails had been popping up on my computer screen--and many were advocating playing the long side of markets these traders perceived as being at a price low enough to be a "bargain buy."



That's when I decided to stop what I was doing that morning and write about the perils of "fighting the tape" (trend) in markets. Think about it: Do traders really want to fight the market? Remember, only the markets are ALWAYS right--no one else.

Traders many times think like consumer shoppers think: "I need to buy at bargain-basement prices to get the very best deal." Unfortunately, when trading futures markets (or stocks), thinking like a consumer shopper is unwise and unprofitable. I think one of the major mistakes most traders make is trying to "bargain hunt" and go long a market (or a stock) that he or she perceives as being "low-priced."

The same is true for trying to sell (go short) a market at perceived high prices. Crude oil is a good example. A couple years ago, the trading landscape was littered with the carcasses of traders trying to pick a top in crude oil. These top-pickers were brutalized by the market--which is always right.

Don't fight the tape.

If the general market trend is one way, you usually do not want to trade against it. In my "Top 10" trading rules list, rule No.1 is: Are the daily, weekly and monthly charts all in agreement on trend? If I'm thinking about position-trading a market and the aforementioned charts are not in agreement on trend, I'll likely pass on the trade. I usually won't initiate a position trade that is against the overall trends shown on the charts.

Some traders may prudently ask, "What about "contrary opinion" trading and the Commitments of Traders (COT) reports showing commercials buying in downtrends? Well, I cannot argue that contrary thinking and trading is valid and is employed successfully by some traders. I have used contrary thinking and trading, myself. But I think that type of trading method is an exception and not the rule, regarding becoming a successful trader. It's a bit like a winning football team with a very good running attack. Their running game makes them a winning team, but they occasionally sprinkle in a pass here and there to keep the defense honest. Also, commercial traders (the big boys in the business) most times seem to be on the right side of the market. However, we as individual traders do not have the resources (research staff, worldwide connections, very deep pockets, etc.) that the commercials enjoy.

Also, when good market trends get under way, even though trend traders usually don't "catch the bottom" (or the tops), there is likely plenty of distance for the market to run to allow profits to accrue.

Using Larry Williams' Percent Range Indicator in Your Trading

The Percent Range (%R) technical indicator was developed by well-known futures author and trader Larry Williams. This system attempts to measure overbought and oversold market conditions. The %R always falls between a value of 100 and 0. There are two horizontal lines in the study that represent the 20% and 80% overbought and oversold levels.



In his original work, Williams' method focused on 10 trading days to determine a market's trading range. Once the 10-day trading range was determined, he calculated where the current day's closing price fell within that range.

The %R study is similar to the Stochastic indicator, except that the Stochastic has internal smoothing and that the %R is plotted on an upside-down scale, with 0 at the top and 100 at the bottom. The %R oscillates between 0 and 100%. A value of 0% shows that the closing price is the same as the period high. Conversely, a value of 100% shows that the closing price is identical to the period low.

The Williams %R indicator is designed to show the difference between the period high and today's closing price with the trading range of the specified period. The indicator therefore shows the relative situation of the closing price within the observation period.

Williams %R values are reversed from other studies, especially if you use the Relative Strength Index (RSI) as a trading tool. The %R works best in trending markets. Likewise, it is not uncommon for divergence to occur between the %R and the market. It is just another hint of the market's condition.

On specifying the length of the interval for the Williams %R study, some technicians prefer to use a value that corresponds to one-half of the normal cycle length. If you specify a small value for the length of the trading range, the study is quite volatile. Conversely, a large value smoothes the %R, and it generates fewer trading signals. Some computer trading programs use a default period of 14 bars.

Importantly, if an overbought/oversold indicator, such as Stochastics or Williams %R, shows an overbought level, the best action is to wait for the futures contract's price to turn down before selling.

Selling just because the contract seems to be overbought (or buying just because it is oversold) may take a trader out of the particular market long before the price falls (or rises), because overbought/oversold indicators can remain in an overbought/oversold condition for a long time--even though the contract's prices continue to rise or fall. Therefore, one may want to use another technical indicator in conjunction with the %R, such as the Moving Average Convergence Divergence (MACD).

The trading rules are simple. You sell when %R reaches 20% or lower (the market is overbought) and buy when it reaches 80% or higher (the market is oversold). However, as with all overbought/oversold indicators, it is wise to wait for the indicator price to change direction before initiating any trade.

Larry Williams defines the following trading rules for his %R: Buy when %R reaches 100%, and five trading days have passed since 100% was last reached, and after which the %R again falls below 85/95%. Sell when %R reaches 0%, and five trading days have passed since 0% was last reached, and after which the Williams %R again rises to about 15/5%.

Like most other "secondary" tools in my Trading Toolbox, I use the Williams %R indicator in conjunction with other technical indicators--and not as a "primary" trading tool or as a stand-alone trading system.

More information on the Williams %R indicator can be obtained from Williams' book: "How I Made \$1,000,000 Last Year by Trading Commodities." It's published by Windsor Books, New York.

Formulating Your Own Plan of Action

I enjoy receiving email messages from my readers worldwide, and I do try to answer each and every one of them. A frequent question I get from readers goes something like this: "Here is my own trading system (or trading plan) and what do you think of it?" The reader then explains in detail the trading system parameters or the trading plan. My answer to this question is usually this: "If your trading system or plan works for you, then stick with it and don't make major changes to it. The old American saying, "There's more than one way to skin a rabbit" certainly rings true in successful futures or stock trading methods.

Importantly, just because one trading method or plan works well for a particular trader, it does not mean the same plan will work well for another trader. Trading plans should be customized to fit the particular person.

There are certain basic trading tenets that all trading plans should address, such as proper money management. But again, what is proper money management for one trader may not be for another.

Below are a few general questions that may help you define or refine your own trading plan, or that may help reaffirm that your trading plan is the right one for you.

1. Are you a trend trader? Most successful traders are trend followers, in some form or another. But there are a few successful traders who do "buck the trend" and are not trend-followers. If you are a trend-following trader, then your trading plan should include employing some technical tools that focus on the trend of the market--such as moving averages or oscillators like the Relative Strength Index (RSI) or Slow Stochastics. If you do not consider yourself a trend-following trader, then you probably should not use trading tools whose main focus is price trend.

2. What is your trading "timeframe?" If you are mostly a "day trader," then your trading plan needs to include trading tools that attempt to define shorter-term trends or recognize shorter-term market turns. A day trader is likely to be less interested in a 40-day moving average than he or she is a 15-minute moving average. A longer-term "position trader" is likely to focus on longer-term trend lines or fundamental factors such as economic reports or weather patterns. There are successful day traders and successful position traders, but the point here is that some different trading tools should be employed for each type of trader.

3. Are you an aggressive or conservative trader? There is no right or wrong answer here. There are successful aggressive traders and successful conservative traders--but they very likely have significantly different trading plans or methods. The aggressive trader should realize that he or she will likely experience some bigger trading losses at some point, in an attempt to take bigger profits off the table. The aggressive trader's trading plan should take into account that

trading-account drawdowns are likely to be larger during any losing streak. While the conservative trader's trading plan will likely not place as much emphasis on big drawdowns, neither should that more conservative trading plan expect to see bigger trading profits accrue in shorter periods of time.

4. What is your benchmark for trading success? This question does not have a single right answer, either. However, your trading plan needs to take into account what you deem to be successful trading. Are you satisfied to be a part-time trader who is not "in the market" with trades at all times. Or, are you determined to be a full-time trader who does have a position or positions on most of the time. There is no doubt that there is much more pressure on the person who tries to be a full-time trader. Any trading plan for the full-time trader needs to be that much more concise, including contingency plans for losing streaks and bigger trading-account drawdowns.

Quotes, Nuggets and Useful Tidbits from A Trading Seminar

In past articles I have mentioned the value of attending quality futures trading seminars. I highly recommend them. In 1999, I attended the 21st annual Technical Analysis Group (TAG) seminar in Las Vegas. Unfortunately, the TAG seminars have since been discontinued.

At the TAG seminars they gave you a big fat book that contained all the presentations from all the speakers at the seminar. Recently, I pulled out my book from that conference and thumbed through it. Following are some valuable "nuggets" from various speakers' presentations at the 1999 TAG conference. Many of these "nuggets" have a common theme, upon which I will comment at the end of this article.

Psychology is the most important component of successful trading. Regardless of whether a trader uses discretionary methods or a mechanical trading system, the proper mindset differentiates successful traders from others.



Six Keys to Success in Trading Futures

1. Correct Mindset
2. Commitment
3. Proper Capitalization
4. Position Sizing
5. Money Management
6. Be Responsible for Your Own Trading



Gordon Gecko was wrong. Greed is not good. (Gecko was the character in the movie "Wall Street.") Greed, fear, anger and all emotions can be a trader's downfall.



Success in trading is its own reward. The money is merely a by-product of that success--not the goal.



Discipline is the one quality that all traders must possess. This is the ability to master your mind, your body and your emotions.

Know yourself. Your risk tolerance, your experience and your capitalization will play the biggest parts in determining what you will trade, and how. Lose your ego. Letting your ego influence your decision-making is the easiest way to end your career as a trader.



Five Common Trading Mistakes

1. Trading without a plan or with a poor plan
2. Losing your discipline. Not enough patience.
3. Trading without stops. Canceling stops.
4. Hanging onto a losing position. Turning a winner into a loser.
5. Too much risk. Not enough capital.



A great trader who has made tens of millions of dollars from the stock and commodities markets said the one individual universal reason for failure in trading is the inability to take a loss. The true path to riches lies not with the wins but managing the losses in a prudent and confrontational manner.



The true path to success always must journey through failure. The true winner in futures trading is the one who perseveres. The race is a marathon, not a sprint.



Why do traders and investors fail?

1. Limited trading capital.
2. No experience
3. No psychological preparation.



You are responsible. Win or lose, you are responsible for the outcome. Don't blame the market or your broker. Losses are an opportunity to focus on the problem. Don't get caught up in personal denial.



There is no Holy Grail. There is no get-rich-quick scheme. There is no free lunch. No one else can do this for you. If something sounds too good to be true, it probably is.



When it comes to trading, there is no "hoping," no "wishing," and no "praying." There is just the cold, hard reality of the market.



Looking at timeframes when trading a market, start out with the longest first. This would be the monthly charts, then the weekly charts, then the daily charts, and then even the hourly or minute charts. You begin with the bigger picture and work your way down to smaller timeframes.



W.D. Gann's Four Essential Trading Qualities:

1. Patience
2. Knowledge
3. Guts
4. Health and Rest



There you have them.

Of all the seminars I have attended, and all the books I have read, and all the successful traders I have personally interviewed, there is a common and very important theme that comes to the surface: Trading success comes less from the specific types of trading methods you employ or the types of markets you trade, or what trading timeframes you use. Trading success comes more from knowing yourself, knowing how to control your emotions, and forgetting about your ego.



The Elliott Wave Theory Demystified

I've had many readers ask me whether purchasing a trading system for several hundred or even a few thousand dollars is worth the investment. When I say "trading system," I mean some type of mechanical trading system that usually requires one to be "in the market" (either long or short) all or much of the time--or, some specific trading method a trader has devised and deems profitable. My answer to these readers is: While some trading systems or specific methods may (or may not) be useful or profitable, why not spend that kind of money, or less, and attend a quality trading seminar or workshop.

Attending a trading seminar or trading workshop allows you to hear some of the best traders and trading educators in the world share their knowledge. Furthermore, the smaller trading workshops allow you to not only learn from the trading instructor, but also likely learn something from your peers who are also attending the workshop.

I've attended many trading seminars and workshops over the years. My favorite seminars were the Technical Analysis Group (TAG) seminars. I've heard these TAG seminars are no longer conducted--or at least were not conducted this year. These were annual seminars held each fall at some major city in the U.S. The cost of the TAG seminars was around \$700 per person. From 15 to 20 of the most respected traders and trading educators in the world gave lectures at the conference. And, attendees got a big fat notebook filled with all the featured speakers' presentations, in case an attendee could not make it to all of them.

One should never stop striving to learn more about markets and trading. The more knowledge a trader can attain, the better his or her chances for trading success. Last year, my good friend Glen Ring asked me to attend one of his intensive three-day trading workshops. Glen is a trading and trader education master. His website is www.glenring.com. Glen has taught me much about markets, trading and the psychology of trading. I want to share with you some of the topics the workshop touched upon--without giving away any of the specific trading methods Glen discussed at his workshop.

Here are a couple "nuggets" we discussed at the workshop that I think will be beneficial to you:

--There are several components involved with successful trading. They include spotting the trading opportunity, proper entry and exit strategies and money management. Glen says (and I concur) that the most important of the components I mentioned above are money management and exit strategies. "Anybody can get into the market, but it's the real pros who know when to get out," says Ring. He, too, advocates using fairly tight protective stops when trading futures. He pointed out statistics in our industry that underscore why "survival" in futures trading is so important during a trader's first few months or first couple years of trading. Glen said studies in the futures industry show the average length of time a person stays in the business of trading futures is nine months to one year. What this very likely means is that the vast majority of

beginning futures traders start out in this business not using effective money management or protective stops--and end up losing most or all of their trading capital in a few short months. I can't stress enough the survival mentality that all traders--especially those with less experience--need to employ.

---At the workshop we also discussed how Elliott Wave Theory can be a valuable trading tool. However, it is complicated and many traders do not master the theory well enough to ever use it effectively. I'll briefly discuss Elliott Wave Theory, but if you want to learn more I'd suggest reading books dedicated to this theory.

R.N. Elliott discovered the wave theory in the 1930s. Elliott waves describe the basic movement of stock or futures market prices. The principle states that in general there will be five waves in a given direction followed by usually what is termed an A-B-C correction, or three waves in the opposite direction.

In Wave One, the market makes its initial move upward. This is usually caused by a relatively small number of traders that all of a sudden feel the previous price of the market was cheap and therefore worth buying, causing the price to go up. This is where bottom-pickers come into the market.

In Wave Two, the market is considered overvalued. At this point enough people who were in the original wave consider the market overvalued and take profits. This causes the market to go down. However, in general the market will not make it to its previous lows before it is considered cheap again and buyers will re-enter the market.

Wave Three is usually the longest and strongest wave. More traders have found out about the market; more traders want to be long the market and they buy it for a higher and higher price. This wave usually exceeds the tops created at the end of Wave One.

In Wave Four, traders again take profits because the market is again considered expensive. This wave tends to be weak because there are usually more traders that are still bullish the market, and after some profit taking comes Wave Five.

Wave Five is the point most traders get long the market, and the market is now mostly driven by emotion. Traders will come up with lots of reasons to buy the market and won't listen to reasons not to buy it. At this point, contrarian thinkers will probably notice the market has very little negative news and start shorting the market. At this point the market becomes the most overpriced.

At this point in time, the market will move into one of two patterns, either an A-B-C correction or starting over with Wave One. An A-B-C correction is when the market will go down/up/down in preparing for another five-wave cycle.

I am not an Elliott Wave expert, but I do believe there is merit to the tenets of the theory. Importantly, the tenets of the wave show us how much human psychology plays a part in the way traders trade and the way markets move.

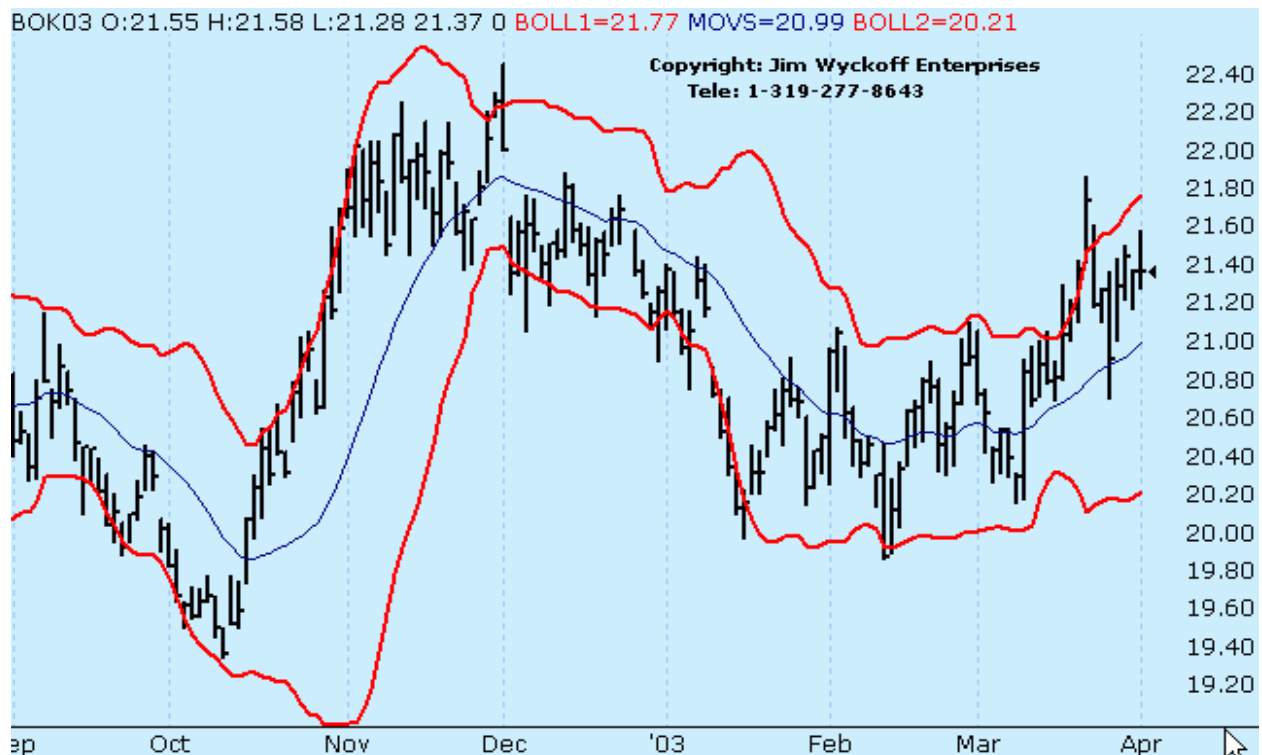
How I use Bollinger Bands in My Trading

The Bollinger Bands (B-Bands) technical study was created by John Bollinger, the president of Bollinger Capital Management Inc., based in Manhattan Beach, California. Bollinger is well respected in the futures and equities industries.

Traders generally use B-Bands to determine overbought and oversold zones, to confirm divergences between prices and other technical indicators, and to project price targets. The wider the B-bands on a chart, the greater the market volatility; the narrower the bands, the less market volatility.

B-Bands are lines plotted on a chart at an interval around a moving average. They consist of a moving average and two standard deviations charted as one line above and one line below the moving average. The line above is two standard deviations added to the moving average. The line below is two standard deviations subtracted from the moving average.

Some traders use B-Bands in conjunction with another indicator, such as the Relative Strength Index (RSI). If the market price touches the upper B-band and the RSI does not confirm the upward move (i.e. there is divergence between the indicators), a sell signal is generated. If the indicator confirms the upward move, no sell signal is generated, and in fact, a buy signal may be indicated.



If the price touches the lower B-band and the RSI does not confirm the downward move, a buy signal is generated. If the indicator confirms the downward move, no buy signal is generated, and in fact, a sell signal may be indicated.

Another strategy uses the Bollinger Bands without another indicator. In this approach, a chart top occurring above the upper band followed by a top below the upper band generates a sell signal. Likewise, a chart bottom occurring below the lower band followed by a bottom above the lower band generates a buy signal.

B-Bands also help determine overbought and oversold markets. When prices move closer to the upper band, the market is becoming overbought, and as the prices move closer to the lower band, the market is becoming oversold.

Importantly, the market's price momentum should also be taken into account. When a market enters an overbought or oversold area, it may become even more so before it reverses. You should always look for evidence of price weakening or strengthening before anticipating a market reversal.

Bollinger Bands can be applied to any type of chart, although this indicator works best with daily and weekly charts. When applied to a weekly chart, the Bands carry more significance for long-term market changes. John Bollinger says periods of less than 10 days do not work well for B-Bands. He says that the optimal period is 20 or 21 days.

Like most computer-generated technical indicators, I use B-Bands as mostly an indicator of overbought and oversold conditions, or for divergence--but not as a specific generator of buy and sell signals for my trading opportunities. It's just one more "secondary" trading tool, as opposed to my "primary" trading tools that include chart patterns and trend lines and fundamental analysis.

Another Secondary Trading Tool: The DMI

A technical indicator I use to determine the strength of a market trend is the Directional Movement Indicator (DMI), also called the Directional Movement System.

I'll explain the basics of the DMI first, and then, importantly, I want to share with you how I use the DMI, as well as other computer-generated signals such as the Relative Strength Index (RSI) and Slow Stochastics in my trading decisions.

The DMI is a trend-following system developed by Welles Wilder. The Average Directional Movement index, or ADX, is part of the DMI and determines the market trend. When used with the up and down Directional Indicator (DI) values -- Plus DI and Minus DI -- the Directional Movement Indicator is considered a trading system.



The rules for using the Directional Movement Indicator are: You establish a long position whenever the Plus DI crosses above the Minus DI. You reverse that position--liquidate the long position and establish a short position--when the Minus DI crosses below the Plus DI. There are some other rules to help prevent getting whipsawed by choppy markets, but I won't touch on them here.

For some traders, the most significant use of the ADX line is the "turning-point" concept. First, the ADX line must be above both DI lines. When the ADX turns lower, the market often reverses the current trend. The ADX serves as a warning for a market about to change direction. The main exception to this rule is a strong bull market during a blow-off stage. The ADX turns lower only to turn higher a few days later.

I use the DMI mainly to determine the strength of a market trend -- either up or down. I look at the ADX line of the DMI. If the ADX line is trading above 30, then the market is in a strong trend. If the ADX line is below 30, it means the trend is not a strong one. Importantly, if the market is in a solid trend and scoring new highs (or lows), and the ADX line shows divergence and turns down, then that is one warning signal that the market trend is losing power and a market top or bottom may be close at hand.

Even if the ADX line is well above the 30 level and starts to turn down at the same time the market is trading near new highs or lows, that is also a signal the trend is losing some power. However, as long as the ADX line is above 30, you should still consider a strong trend to be in effect.

As mentioned above, some traders use the DMI as a complete trading system. Also, some traders use the RSI, Slow Stochastics, or other computer-generated technical indicators for determining entry and exit points. I don't, and here's why: I consider these computer-generated technical indicators to be secondary, yet still important, trading tools. I will use these "secondary tools" to help me confirm or reject ideas that are based on my "primary tools" — which are basic chart patterns, support and resistance levels, trendlines and fundamental analysis.

A few years ago I did a feature story on futures trader Linda Bradford Raschke. She is one of the best-known traders in the world. She, too, advocated the use of basic technical tools that have been around longer than computers. Renowned technical analyst John J. Murphy also says the best trading tools are the basic ones. In fact, I've been attending trading conferences for many years and the vast majority of traders speaking at the conferences consider these same basic charting techniques as their primary trading tools. You should, too.

EMAs: Where They Belong in Your Trading Toolbox

The exponential moving average (EMA) is a less popular but more sophisticated version of the simple moving averages. You need a computer trading program such as FutureSource to employ an EMA indicator. With the EMA, more importance is put on the recent price action, but all the price data in the futures contract is used. I'll define the EMA below and then I'll discuss how I use and rank this trading tool in my "Trading Toolbox."

An EMA is another type of moving average. In a simple moving average, the price data have an equal weight in the computation of the average. Also, in a simple moving average, the oldest price data are removed from the moving average as a new price is added to the computation. The EMA assigns a weight to the price data as the average is calculated. Thus, the oldest price data in the EMA are never removed, but they have only a minimal impact on the moving average. The EMA calculation is achieved by subtracting yesterday's exponential moving average from today's price. Adding this result to yesterday's exponential moving average results in today's moving average.

The main use of the EMA indicator is its smoothing out function. In this way, the moving average removes short-term fluctuations and leaves to view the prevailing trend. This can be important because simple moving averages tend not to work well in choppy trading conditions.

Many trading programs display the EMA as a crossover trading system. For a crossover system, you may insert three different exponential moving averages. Generally, the lengths for these moving averages are short, intermediate, and long term. A commonly used system is 4, 9, and 18 intervals. An interval may be in ticks, minutes, days, weeks, or months; it is a function of the chart type. The closing price is used by most systems when calculating the exponential moving average. On many systems, however, you may specify a different price to use in the calculation (open, high, low, close, midpoint, or average price) by changing the computation of the EMA.

If the EMA crossover trading system is used, a buy signal occurs when the short- and intermediate-term averages cross from below to above the longer-term average. Conversely, a sell signal is issued when the short- and intermediate-term averages cross from above to below the longer-term average. Another trading approach is to use the "current price" method. If the current price is above the exponential moving averages, you buy. Liquidate that position when the current price crosses below your selected moving average. For a short position, sell when the current price is below the EMA. Liquidate that position when the current price rises above the EMA.

I use the EMA as one more "secondary" trading tool, along with most other computer-generated technical indicators that fall into that category. I use the EMA less often than simple moving averages. I use "secondary" trading tools to help confirm my ideas that are derived from my

"primary" trading tools, which include trend lines, chart patterns, market psychology and fundamental analysis.

Howe's Limit Rule: Making it Work for You

One of the most important tenets of successful futures trading is survival. In order to enjoy those winning trades that will make you successful, you must survive the losing trades that all traders encounter. Even the most successful futures traders usually have more losing trades than winning trades in any given year. The key is the successful traders' losing trades result in much smaller losses than their winning trades' profit gains.

Surviving the more numerous losing trades in order to catch the fewer big-winner trades requires the use of prudent buy and sell stop placement. However, there are some home-run-type trades (which we all dream about) that may require even more protection for you than stops. If you are in the middle of a potential "home-run" trade and are accruing very nice profits, you may not want to exit the trade because of even more profit potential by staying in the trade. However, you also have a substantial profit in place and don't want to lose it if the market becomes highly volatile--which is many times the case in big "home-run-type" market moves. It is situations like this where the purchase of options on futures can "lock in" trading profits for you--yet allow you to remain in a trade that could result in even more profits.

I'll provide a "hedging with options" example, but first I want to discuss the market conditions that can lead to the use of options to hedge futures trading profits.

I've said the placement of buy and sell stops in your trading plan is very important. However, when market movements become extreme, stops can be far less effective. The gap between bid and ask prices can get so large that a stop level gets bypassed by a large degree. When a market locks limit up or limit down, stops are virtually ineffective.

Indeed, limit price moves in futures markets can be the best and the worst of times for a futures trader. At this time I'd like to share an interesting futures market theory with you.

My good friend, Steve Moore, of Moore Research Center (www.mrci.com) in Eugene, Oregon, pointed out to me many years ago "Howe's Limit Rule," and I want to share it with you.

Robert Howe, a market and technical analyst, suggests that a futures price at the limit of a tradable daily range, once reached, becomes an objective which the market will again test and ultimately exceed, at least briefly, and usually sooner rather than later. Why? A primary function of any market is to explore and discover value. A market artificially interrupted in its pursuit of current value is unsatisfied and leaves critical questions, such as how far and how urgently the market would continue searching for fair "value."

Unlike objectives derived from chart formations and mathematical formulas, which approximate a target range, Howe's Limit Rule identifies precise price targets which can be valuable to both short-term and position traders.

For instance, if a market trades at a "limit up" price: 1. Short-term traders may more confidently buy into any pullback (whether intraday or during subsequent trading days). 2. Traders already long may be encouraged to maintain their positions. 3. Prospective short-sellers may be discouraged from taking immediate action.

Understanding the principles of Howe's Limit Rule, each of the above would expect a decline, if any, to be minor unless and until that limit price is exceeded by at least one tick.

However, if after a prolonged trend a limit price is exceeded only briefly and tentatively, a failure that ultimately constitutes a reversal may be imminent (as the market exhibits exhaustion). As a corollary, an unexpected limit move in the direction opposite the prevailing trend can be an early warning of a trend reversal (as everyone changes their minds at the same time).

Finally, an abrupt limit move from out of accumulative or distributive congestion can signal the beginning of a powerful new trend (as everyone tries to go through the same door at the same time).

On the rare occasion when a lead futures contract leaves a traded limit price "hanging" (not exceeded prior to its expiration), that limit price is carried over as a future objective for subsequent lead contracts. As such, it can become a target for intermediate- or long-term trend exhaustion. In other words, the prevailing trend may be maintained and/or a new trend suppressed until that "hanging" limit is exceeded, often creating a double top or double bottom. The lead contract is most cash-connected, and those prices later become significant support/resistance points on weekly/monthly charts. Limits left hanging in deferred contracts are specific to them only and become irrelevant at expiration.

Okay, let's get back to an example of hedging some decent futures profits with options. Let's say a trader established a long position at 7.00 cents in one contract of N.Y. sugar futures, just after prices broke out above a resistance area. The trader then sees a nice uptrend that takes prices up to 8.50 cents, but then the market pauses. The trader already has a profit of \$1,680 (150 points), but thinks the bull run may not be over. He purchases a put option on sugar futures with a strike price of 8.50 cents, for a cost of 45 points, or \$504. He has just locked in a profit of \$1,176, and he is still in the market and long sugar. If the trader then stayed in the market for a rally that took prices to a high of 10.81 cents, and exited his long position at, say, 10.50 cents, that's another 200 points of gain, or \$2,240 more in profit. Thus, the trader pockets a total profit of \$3416.

Another point I want to make is that when markets move toward price extremes, you have a double-edge sword. The profit potential is likely the highest during these big price moves, but the high volatility means the market can very quickly turn against you--and your protective stop may not be effective. If you have purchased an option to hedge your profits, you have also limited your potential losses if the market makes a sudden and violent turn against you.

Here are some important caveats about hedging your futures profits with options: Make sure the market you are trading has a "liquid" options market. Some markets, such as lumber or the U.S. dollar index, have adequate enough open interest to trade straight futures, but their futures options are "thin" and not a good candidate for hedging profits. Also, you want to make sure you have a substantial profit accrued before hedging your winning position. You probably don't want to take a bigger bite out of your trading profits by purchasing an option than you have profit left after purchasing that option.

Simple Moving Averages: A Helpful, but Secondary Tool

I take a “toolbox” approach to analyzing and trading markets. The more technical and analytical tools I have in my trading toolbox at my disposal, the better my chances for success in trading. One of my favorite "secondary" trading tools is moving averages. First, let me give you an explanation of moving averages, and then I'll tell you how I use them.

Moving averages are one of the most commonly used technical tools. In a simple moving average, the mathematical median of the underlying price is calculated over an observation period. Prices (usually closing prices) over this period are added and then divided by the total number of time periods. Every day of the observation period is given the same weighting in simple moving averages. Some moving averages give greater weight to more recent prices in the observation period. These are called exponential or weighted moving averages. In this educational feature, I'll only discuss simple moving averages.

The length of time (the number of bars) calculated in a moving average is very important. Moving averages with shorter time periods normally fluctuate and are likely to give more trading signals. Slower moving averages use longer time periods and display a smoother moving average. The slower averages, however, may be too slow to enable you to establish a long or short position effectively.



Moving averages follow the trend while smoothing the price movement. The simple moving average is most commonly combined with other simple moving averages to indicate buy and sell signals. Some traders use three moving averages. Their lengths typically consist of short, intermediate, and long-term moving averages. A commonly used system in futures trading is 4-, 9-, and 18-period moving averages. Keep in mind a time interval may be ticks, minutes, days, weeks, or even months. Typically, moving averages are used in the shorter time periods, and not on the longer-term weekly and monthly bar charts.

The normal moving average “crossover” buy/sell signals are as follows: A buy signal is produced when the shorter-term average crosses from below to above the longer-term average. Conversely, a sell signal is issued when the shorter-term average crosses from above to below the longer-term average.

Another trading approach is to use closing prices with the moving averages. When the closing price is above the moving average, maintain a long position. If the closing price falls below the moving average, liquidate any long position and establish a short position.

Here is the important caveat about using moving averages when trading futures markets: They do not work well in choppy or non-trending markets. You can develop a severe case of whiplash using moving averages in choppy, sideways markets. Conversely, in trending markets, moving averages can work very well.

In futures markets, my favorite moving averages are the 9- and 18-day. I have also used the 4-, 9- and 18-day moving averages on occasion.

When looking at a daily bar chart, you can plot different moving averages (provided you have the proper charting software) and immediately see if they have worked well at providing buy and sell signals during the past few months of price history on the chart.

I said I like the 9-day and 18-day moving averages for futures markets. For individual stocks, I have used (and other successful veterans have told me they use) the 100-day moving average to determine if a stock is bullish or bearish. If the stock is above the 100-day moving average, it is bullish. If the stock is below the 100-day moving average, it is bearish. I also use the 100-day moving average to gauge the health of stock index futures markets.

One more bit of sage advice: A veteran market watcher told me the “commodity funds” (the big trading funds that many times seem to dominate futures market trading) follow the 40-day moving average very closely--especially in the grain futures. Thus, if you see a market that is getting ready to cross above or below the 40-day moving average, it just may be that the funds could become more active.

I said earlier that simple moving averages are a "secondary" tool in my trading toolbox. My primary (most important) tools are basic chart patterns, trend lines and fundamental analysis.

The Importance of Basic Trading Tools -- Like the Venerable Trend Line



In some of the educational stories I have written, I discussed my "primary" trading tools and my "secondary" trading tools. I also mentioned that the more tools one has in his or her "Trading Toolbox," the better the odds for trading success. In this educational feature, I want to focus on one of the most basic--yet most powerful--trading tools: the trend line.

As a refresher, I'll reiterate that my "primary" trading tools are basic chart patterns, such as triangles, double-tops and bottoms, head-and-shoulders formations, flags, pennants, etc.--and of course, trend lines. I also consider fundamental analysis a primary trading tool. My "secondary" trading tools are the computer-generated technical indicators, such as moving averages, Slow Stochastics, MACD, RSI, DMI, etc. Volume and open interest are also categorized as my secondary indicators.

I believe that futures and stock traders can still be successful without the aid of computers. Two of the most famous and successful traders never touched a computer--Jesse Livermore and Richard Wyckoff. When I first got into this fascinating business, I had no computer to give me an RSI or DMI or moving averages. I had a weekly chart service that was mailed (U.S. Postal Service, not email!). On the markets I was following, I plotted the daily high, low and close on

the daily bar chart and drew trend lines with a ruler and pencil. For the longer-term monthly and weekly continuation charts for nearby futures, the chart service would send out updates about once a quarter.

I'm sure there are still some traders who use a chart service and trade successfully. Certainly, the evolution of computer trading and charting software the past 15 years has made technical analysis much easier. But the point I make here is that while computers have made the chore of technical analysis and charting easier, they have not made trading success any easier.

In the early 1990s the "neural networks" were the buzzwords in futures trading. Magazine articles espoused the wonders of using "artificial intelligence" to virtually do your all of your trading for you. That fad seems to have come and gone--thank goodness! Now, the "back-to-basics" approach to trading has regained popularity. (To many of us, this approach never lost popularity!)

Before discussing trend lines, I want to share with you one anecdote, regarding all those computer-generated, whiz-bang and bells-and-whistles technical trading indicators. Many of them remind me of the Sears Robo-Grip pliers I got for Christmas a couple years ago. These pliers were touted as a break-through wonder tool that does it all. However, in reality, when you've got a tough nut or bolt to loosen, you head for the toolbox and your trusty old box-end wrench or vise-grips. In trading, my box-end wrenches and vise-grips are the basic chart patterns that you can plot (by hand if you have to) on a chart.

Now on to the venerable trend line. Here is what respected technical analyst John J. Murphy says about trend lines in his excellent book, *Technical Analysis of the Futures Markets*: "The importance of trading in the direction of the major trend cannot be overstated. The danger in placing too much importance on oscillators, by themselves, is the temptation to use divergence as an excuse to initiate trades contrary to the general trend. This action generally proves a costly and painful exercise. The oscillator, as useful as it is, is just one tool among many others and must always be used as an aid, not a substitute, for basic trend analysis."

On drawing trend lines on the charts, the methodologies vary--and there are really no hard and fast rules. Like much of technical analysis, drawing trend lines is more art than science. When drawing an uptrend line, you draw a straight line up to the right along successive "reaction" lows. A downtrend line is drawn to the right along successive rally peaks. It's important to note that the more times the rally peaks or reaction lows touch the trend line, the more powerful the trend line becomes. The rule I use for the negating of trend lines is that prices must penetrate the trend line resistance or support level--and then see follow-through strength or weakness the next trading session. However, if prices make a big push above or below the trend line, then that trend line is negated without needing follow-through confirmation.

John Murphy's book, which I mentioned above, has much more detail on trendline analysis as well as other basic chart patterns.

The Importance of Psychology in Trading

In past articles, I have told my readers about the quality trading seminars I have attended through the years and how beneficial they are to anyone seeking knowledge and wisdom on the road to becoming a successful trader. The other night I was browsing through the workbook from a Technical Analysis Group (TAG) conference I attended in 1996. These TAG workbooks are packed with valuable information presented by all the speakers (usually 20 or more) at each conference. As I was thumbing through this particular workbook, there was a common theme espoused by the majority of presenters at the conference: In order to succeed at trading, it's not only important to strive to learn more about markets and trading tools, but it's also very important for a trader to know himself or herself. This is part of the all-important--but sometimes overlooked--aspect of "trading psychology."

I will admit that when I first got into this fascinating business, I was skeptical of the whole "trader psychology" thing. My main concern at that time was learning as much about markets and technical analysis as I could--and my trading mentality or psychology would take care of itself. However, the more I learned about the markets and about trading, the more I realized human nature and psychology play huge roles in both.

The following are some valuable "nuggets" regarding trading psychology that I pulled out of the TAG workbook. It's my hope that one or more of these "nuggets" will help you better understand your own trading psychology and the importance of psychology in trading markets.

- Remember that becoming a profitable trader is a journey, not just a destination. The perfect trader does not yet exist. Try to become a better trader each day and enjoy the progress you make. Concentrate on learning the craft of technical analysis and on improving your trading skills, rather than focusing solely on the amount of profit or losses in your trading.
- Congratulate yourself and feel good about a trade when you have done what you were supposed to do, according to your trading plan--regardless of the profit or loss on the trade.
- Don't get overly excited about the winning trades or too depressed about the losing trades. Try to maintain an even keel and a professional outlook regarding your trading.
- Do not expect certainty in a trade. You are looking for a preponderance of evidence, not proof beyond the shadow of a doubt.
- The pain of standing aside and missing a good trade that your method told you to take is much worse than the pain of losing on a trade that you entered and exited properly and according to your trading plan.

- Your own life experiences shape how you think about trading. If your first experience with trading was a negative one, the odds are high that you will not trade in that particular market again for a long time--and maybe never. The psychological impact of loss and defeat can be much greater and last much longer than the effects of physical pain. If you were not defeated psychologically by a negative trading experience, then the loss does not have such a negative and lasting impact.

- Education plays an important role in shaping the way traders think about trading. A formal business education can give you an edge in understanding the economy and the market in general--but it is no guarantee of success in trading. Most of the information you learned in a formal college setting will not give you the specific knowledge necessary to be a successful trader. To succeed in trading, you must learn to perceive opportunity where most others see none--and you must seek out the information which gives you the knowledge necessary for success.

- Your ego and winning can make you broke. Winning can create powerful emotions that distort reality. The more you win, the better you feel, and your ego takes over. The joy of winning is what gamblers seek. A gambler will lose as many times as necessary just for the thrill of winning once.

- Always remember this: You are the sole person responsible for winning or losing in trading. Don't blame the market or your broker. Losses are an opportunity to focus on whatever problem occurred during the trade. Don't get caught up in personal denial.

- A successful trader quantifies, analyzes and truly understands and accepts risk. Emotional and psychological acceptance of risk is what determines your mental state in each trade. Individual risk tolerance and preferred trading timeframe make each trader unique. Select a trading methodology that reflects your preferred timeframe and risk tolerance.

- The market is not physical. It's an amalgamation of the mindset of all trading participants. The daily tug-of-war between the bulls and the bears reveals what they are thinking on a daily basis. Make sure to look at the market's close in relation to the session high and low.

- Never buy just because the price is low, or sell just because the price is high. Never average a losing trade. Don't become impatient with the market. Always have a good reason for initiating every trade. Remember, the markets are always right.

- Traders need to listen to the market. To listen effectively to the market, traders need to know and pay attention to their trading methods, but also pay just as much attention to themselves as they pay to their charts and the market. The trader's challenge is this: Learn who you actually are, and then consistently and consciously develop the qualities that allow you to trade well.

- As traders, the more we can detach ourselves from the emotions of hope, greed and fear, the better our chances for trading success. Why are there hundreds of good technical analysts but few good traders? Because they need to spend more time on their personal psychology than their analytical methodology.

- "If I had eight hours to chop down a tree, I'd spend six hours sharpening my axe."--Abraham Lincoln. I like this maxim, because it is similar to trading: Research and learning are very important. Preparation for trading takes much longer than executing and watching the trade.

- The market has far more patience than the majority of traders. There is an old saying that the market will do whatever it takes to drive the largest amount of traders crazy. Trends can persist as long as there are traders fighting them. Don't fight the tape.

A Look at Seasonality in 10 Different Markets

Two of my favorite trading subjects are cycles and seasonality. In this feature, I'll discuss seasonality in agricultural markets.

I want to start out by emphasizing that seasonality or cycles, by themselves, do not make good trading systems. However, they are great "tools" to add to your "Trading Toolbox."

Seasonality in agricultural markets is a function of supply and demand factors that occur at about the same time every year. For agricultural markets, supply stimuli can be caused by harvest, planting, weather patterns and transportation logistics. Demand stimuli can result from feed demand, seasonal consumption and export patterns.

Livestock futures, too, have seasonal tendencies. Hog and cattle seasonals tend to be caused by production, marketing, and in the case of hogs, farrowing.

Grains tend to follow the general rule of lower nearby futures prices at harvest more than other agricultural commodities.

Here is a quick summary of seasonals in several markets. (If you are interested in a more complete study of seasonality, there are entire books written on the subject.)

Corn: This market's seasonality can be divided into three time periods: late spring to mid-summer; mid-summer to harvest; and post-harvest. The most pronounced seasonal trend in corn is the decline of prices from mid-summer into the harvest period. Prices are often near their highest level in July because of factors associated with the old crop and uncertainty over new crop production. Even in years when a price decline begins before mid-July, it can continue after mid-July if the crop outlook is favorable. Harvest adds large supplies to the marketing system, which normally pressures prices to their lowest levels of the crop year. Prices usually rise following harvest. However, the "February Break" is a well-known phenomenon whereby corn prices usually show some degree of decline during the month of February.

Soybeans: The July-August period is usually a bearish time for soybeans. Closing prices during the last week in July are usually lower than those of the previous week in July. Closing prices at the end of August are also usually lower than those at the end of July. Also, soybean prices in late January are usually higher than those in late December. Soybeans many times also succumb to the "February Break" seasonality phenomenon. Soybean meal and oil have the same seasonal tendencies as soybeans.

Wheat: The seasonality of wheat prices works best when a trader is on the long side from the period of harvest lows to October\November. On the short side, from winter into summer harvest tends to work well. Wheat has two prominent seasonals: One is a strong tendency to decline during late winter and spring as the harvest approaches. The other is to rise from harvest lows into the fall or early winter. Wheat prices begin a seasonally weak period by January or February, in most years.

Live Cattle and Feeder Cattle: Seasonality in feeder cattle prices depends on the seasonality in live cattle prices, along with annual fluctuations in feeder cattle supplies. In general, feeder cattle prices are strong from late winter through spring, drop during the summer, and stabilize at lower levels in the fall, before turning up in December. Live cattle prices normally trend higher from January through May. Prices for live cattle reach their seasonal peak in May and then usually begin a downtrend that extends through the end of the year. Demand for feeder cattle also begins to peak in May, and prices fall into July.

Live Hogs: Seasonal marketing pressure increases during March and persists at increased levels during all or part of April. The reason for this is that August and September farrowings are usually larger relative to other farrowing months. Slaughter levels decline seasonally from March-April into July or August. Thus, prices could generally be expected to rise from March to May and decline from May into August.

Cocoa: The yearly seasonal low tends to occur in January with the Bahia (Brazil) main crop, rather than in May or June with the Temporao (Brazil) crop, because of consumer demand. Consumer demand tends to rise into late fall and early winter, which boosts prices during that timeframe. As demand peaks and then begins to decline, cocoa prices fall into January. It's important to note that seasonal tendencies in cocoa are not very strong.

Coffee: The frost season in Brazil occurs during the May through early-August period. In anticipation of this frost, prices tend to rise from January into June. This seasonal tendency is not real strong, however, because coffee can come from other producing countries, such as Mexico. Still, the potential for a Brazilian frost should be monitored. The other seasonal influence is during the winter, when U.S. coffee consumption tends to rise.

Cotton: Cotton is a market where the "trade" has very heavy participation and seasonals tend to be a function of heavy deliveries issued against the expiring futures contracts--December, March, May, July, and to a lesser degree, October. In November, the market tends to recover from harvest lows, and then in January the market tends to back off to lower levels.

Orange Juice: Seasonal price movement of FCOJ (Frozen Concentrated Orange Juice) does not usually reflect the December-February freeze period in the southern U.S. Seasonal tendencies are caused by harvest, production (also called "pack") and demand ("movement"). The most significant seasonal move in O.J. is that prices generally fall from November to January. Freezes cannot be completely ignored, however.

Sugar: Prices tend to peak in November because of a combination of supply and demand. Production at this time is not complete, as the European crop is not yet on the market. Demand in the Northern Hemisphere, however, is usually at its peak in the fall.

I would classify seasonal tendencies as "secondary" technical indicators in my "Trading Toolbox." I do follow seasonals, but they are not my "primary" trading tools. I have seen much hype in the marketplace regarding seasonals. I remember one summer hearing a radio advertisement from a futures brokerage that went something like this: "Colder weather is just around the corner and heating oil demand will increase. Thus, you should buy heating oil futures now, and profit from the increase in demand." If only futures trading were that easy! Every professional trader and commercial firm knows that heating oil demand rises in the winter--and even in the summer months they have already factored that rise in demand into the prices of the farther-out (deferred) futures contracts. The same is true for other markets' seasonal price patterns. The professional traders and commercials all know about seasonals in the markets, and position themselves accordingly. It is always good that we speculators have as much information on markets as possible. Seasonal price patterns are just one more bit of information to factor into our trading decisions.

How to Choose a Futures Broker that fits Your Style

I get many questions from individual traders regarding selecting a futures broker or brokerage firm, whether to choose a discount brokerage or a full-service brokerage, and what functions should brokers perform for individual traders. As you might expect, there is no single, best answer to these questions because there are many different types of traders and brokers. In this educational feature, I will discuss brokers, selecting a new broker and brokerage firm, and the roles brokers can play for different types of traders.

Like any profession, there are differing degrees of quality in futures brokers and brokerage firms. It goes without saying that it should be your goal to choose a futures brokerage firm that is reputable. Your personal broker should be honest and have your best interests in mind—and not be a “churn and burn” pitch man who racks up big commission fees by cajoling you into trading all kinds of markets. I’m not exaggerating when I say that the ultimate success or failure of some traders lies in the hands of their brokers.

For traders who are searching for a new broker and brokerage firm, here are some tips:

- Check out any brokerage firm or individual broker by contacting the National Futures Association. The NFA’s website, www.nfa.futures.org, has a system called “BASIC,” in which you can perform a search on brokerage firms or individual brokers to find out if they have had any infractions levied against them by the NFA. The Commodity Futures Trading Commission (www.cftc.gov) also has an informative website that is a help to anyone sizing up a new broker or brokerage firm.
- For the less-experienced trader, dealing with an overly aggressive broker can be an intimidating experience—especially since many newer traders are still likely learning the terminology and may be confused by sometimes-hard-to-understand trading concepts.
- Always remember this: You, the individual trader, should always be in control of your trading account and your trading decisions—even if you are inexperienced. If your broker gives you recommendations, you can certainly act upon them. But again, you should be the one in control of your money and your trading decisions. If you feel uncomfortable with your broker being too pushy or not allowing you to have control of your own trading account, you should find a new broker. I don’t want to confuse anyone at this point, but Commodity Trading Advisors (CTAs) do in fact have discretionary trading authority for individuals who have willingly deposited funds with the CTA, and expect the CTA to make all the trading decisions. However, Introducing Brokers (IBs) do not have that discretionary authority. I suspect the majority of the brokers you deal with will be IBs.

- There have been many books written by professional traders that advise individual traders who have done their homework and have decided to enter a trade, based on their own trading plan and study, not to be influenced by anyone else—including their broker. I, too, concur with this philosophy. I have a fine broker. He executes trades for me and tries his hardest to get good fills for me. He will answer any question I pose to him, including first-notice day dates and last trading day dates, margin requirements, etc. However, he has never questioned why I would make a trade, or offered his own opinion on any trade to me. This is the type of relationship with my broker that I require, and it works well for both of us.

- I want to point out that many individual brokers do their own research and provide their information to their customers, including trading opportunities. This type of research can be and many times is as high in quality as any available, and there is absolutely nothing wrong with this scenario. In fact, many traders prefer this type of business relationship with their brokers.

- On whether to do business with a discount brokerage or a full-service brokerage, that depends on what the individual trader wants. If the individual trader wants more customer service that includes the firm's own research and trading recommendations, then a full-service brokerage is probably the best choice. Full-service brokerages do charge more for commissions.

- For a trader who relies on his own study, combined with another outside source of information such as an independent analytical service, then a discount brokerage may be the best choice. Discount brokers do charge less in commissions than full-service brokerages.

- For reputable full-service futures brokerages and discount futures brokerages, there is no difference in the “slippage,” or quality of fills you receive from the trading floors.

I have never been a futures broker, but I came very close to accepting an IB position with a brokerage firm many years ago—including studying all the reference material needed to pass the “Series 3” test. The reason I mention this is because I think futures brokers sometimes receive a “bad rap” from individual traders and even the media. Sometimes traders find it hard to blame themselves for unsuccessful trades, and the broker is an easy scapegoat. Certainly, there are a few “bad eggs” in the bunch, just like in every industry. However, the vast majority of futures brokers are honest and hard-working individuals who do have your best interests in mind when it comes to trading.

Spread Trading: More Complicated, Yes. But Less Risk, and Less Expense

Spread trading in futures markets does not get a lot of attention among speculative traders. However, many traders do employ this method of trading because it can be less risky and less expensive than trading straight futures contracts. It is beyond the scope of this article to provide all the specifics of how to spread trade. However, this feature will introduce you to the concept and define some of the terms used in spread trading. I have a book called “Commodity Spreads” by Courtney Smith that I have used for reference. It is published by John Wiley & Sons in New York.

First, let’s define spread trading: It is the simultaneous purchase of one futures contract and the sale of a different contract. The futures contracts can be different delivery months in the same commodity; or they can be two different commodities spread against each other. Or, they can be the same commodity traded on two different futures exchanges. The spread trader becomes simultaneously long one futures contract and short one futures contract. A spread is composed of two “legs.” One leg is the long contract position and the other leg is the short contract position.

A spread that is between different contract months in the same commodity is called an inter-delivery spread. A spread between two different commodities is called an inter-commodity spread.

Traders try to profit from spreads by the price difference between the two contracts. The spread trader is more concerned with the relative price between the two contracts, as opposed to the absolute price of the commodity.

Large commercial firms are often large spreaders and analyze and utilize commodity spreads in many different ways. Large speculative firms (the funds) also employ spread trading. The smaller speculators—the individual traders—are the least frequent users of spread trading. This is because of the complexity that tracking and analyzing some spreads can entail. However, there are simpler spread-trading techniques that individual traders can employ.

It has been said that most spread traders rely heavily on fundamental analysis when employing their spread trades, while most speculative traders of straight futures rely more heavily on technical analysis.

As I said in the first paragraph, spread trading usually involves less risk than trading straight futures. Because storable commodities have “carrying charges,” spreads rarely go beyond a certain level that is known to veteran spread traders. This means a trader can initiate a spread and know to a fairly certain degree how much risk is involved. There are some spreads that do

involve higher volatility, such as inter-commodity spreads. Also, due to lower risk involved, margins required by brokers are less than margins required when trading straight futures.

Inter-delivery spreads are categorized as a “bull spread” or a “bear spread.” A bull spread is when a trader is long the nearby contract and short the deferred contract within the same commodity. The trader who puts on a bull spread is looking for the nearby contract to be stronger (price will rise faster) than the deferred contract. Conversely, if the price is falling, the bull spreader is looking for the price of the nearby contract to decline to a lesser degree than the deferred contract. And, there is always the possibility that the nearby futures price will rise and the deferred contract price will fall. The bear spread is the reverse of the bull spread. The trader is short the nearby futures contract and long the deferred contract in the same commodity. The bear spreader is looking for the deferred contract to be the stronger mover up in price than the nearby, or the nearby contract to decline in price faster than the deferred. Bull and bear spreads can be used as a substitute for outright positions in a market. The advantage is less volatility and lower margin costs. The disadvantage is that spread trading does not usually accrue the amount of profit that is possible on a per-contract basis as does straight futures trading, when the market does move in your favor.

A special type of inter-commodity spread is the spread between a commodity and its products. A very common spread is the “crush spread” between soybeans and its products, soybean meal and soybean oil. This spread is considered to be a complex spread. Very few soybeans are used just as soybeans. Nearly all soybeans are crushed into two products, meal and oil. A soybean crusher makes his profit from the difference between the cost of buying the beans and the price of selling the products. This is called the “crush margin.”

Commodity spreads can be a valuable tool to the trader of outright futures who does not spread trade. For example, if the nearby futures contracts for corn are gaining in price relative to the deferred contracts, this generally indicates more demand or less supply, or both. It’s a strong signal that fundamentals are bullish and prices may well move still higher. However, if the nearby corn futures do not gain on the deferreds during an upmove, then the trader may surmise that the recent price advance has been technical in nature and not backed by bullish fundamentals, and that a sell off may be close at hand.

By looking at the spreads, a trader can also see which contract is trending the strongest, and decide to trade that contract as opposed to others that may not be trending as strongly.

Again, this feature just scratches the surface of spread trading in the futures markets. If you are interested in trading spreads, then I suggest reading a book or two on the subject.

That’s it for now. Next time we’ll examine another important issue on your road to becoming a more successful trader.

Market Fundamentals: Use them to Avoid that "Naked Feeling"

I get a lot of questions from less-experienced traders regarding how to best learn about and study "fundamentals" in markets. There is no quick and easy way to study market fundamentals, and I don't know of any books that focus only on fundamentals that impact all the futures markets. The reason books on fundamental analysis of futures markets are so rare is because the subject matter is so enormous.

Here is just a smattering of macro fundamental factors that impact commodity and financial futures prices: weather, world politics, consumer tastes and consumer demand, physical supplies of a commodity, inflation, interest rates, currency values, and natural disasters.

I have been fortunate in my career in the futures industry. When I was a reporter and editor for FWN, I was forced to learn about the fundamentals impacting all the markets I covered--which included all the U.S. markets and some traded overseas. I had to talk to traders and analysts every day for about a dozen years, regarding the fundamentals that impacted the particular market on which I was reporting. Indeed, very few get that kind of unique opportunity to learn about market fundamentals.

An important point to keep in mind is that fundamentals are constantly changing in markets. So, for example, what you read in the Wall Street Journal or a magazine, regarding market fundamentals, can be outdated by next week--or sooner.

Many traders feel almost "naked" when they attempt to trade a market for which they know little about the fundamentals that impact it. Yet, I've said before that learning and keeping up with the fundamentals in a market (or several markets) would be a full-time job (or more). Given that the majority of speculative futures traders have full-time "day" jobs, and trading is either a hobby or "second" job, what's a trader to do?

First of all, the study of technical analysis addresses part of the dilemma of keeping up with all the fundamental factors impacting futures market prices. Remember that futures market price activity and price history, including volume, is a composite reflection of every news event and/or other fundamental factor known to all traders. Price activity also factors in ideas and speculation about the future prospects, and future news, for the market.

Still, to avoid that "naked" feeling when entering a trade, below are some useful suggestions regarding studying and learning about basic market fundamentals:

- You should know in what increments your market trades (ticks), the contract size, if it's physically deliverable, cash-settled or both, and when first-notice day and last trading day occur.

This information is all free and available on the websites of the exchanges on which the markets trade. For example, if you trade U.S. T-bonds, you should know that prices trade in 32nds of a point, based on a yield of 6%. You don't have to become an expert on yields, deliveries or notices, but you should be aware of the concepts. Reading about what the exchanges have to say about their markets is a great way to start out learning fundamentals.

- The Internet is a wonderful tool to help you learn about futures market fundamentals--for free. Use your favorite search engine and do a search on your market of interest. However, make sure you use "futures" in the search words, as this will narrow the focus of the search engine.

- Here's a caveat on market fundamentals: The professional traders anticipate them and many times factor the fundamentals into price even before they occur. In fact, this happens quite often in futures markets. For example, it stands to reason that heating oil demand will increase in late fall and winter, and that heating oil futures prices should rise in that timeframe, as opposed to summertime prices. A novice trader may think it's a no-brainer to go long the December heating oil contract in September. However, keep in mind all the professional traders and commercial traders know this, and they have likely already factored this seasonal fundamental into the price of the December heating oil contract.

- There are U.S. government economic reports that sometimes have a significant impact on markets. Associations also release reports that impact futures markets. Even private analysts' estimates can move markets. Try to learn about the reports or estimates that have the potential to impact the market you wish to trade. You should make it a priority to know, in advance, the release of any scheduled report or forecast that has the potential to move your market. For example, if you are thinking about establishing a position in the T-Bond market and the U.S. employment report is due out the next day, you may want to wait until that report is released before entering your position. The employment report can whipsaw the bond market in the minutes after it's released, which could stop you out of your position.

- If you like to trade financial futures markets, newspapers like the Wall Street Journal and Investors Business Daily have sections that follow bonds, stock indexes and currencies, etc. Reading about how fundamental events impact these markets allows you to get up to speed on fundamentals.

- If you trade commodities like cotton, coffee or cocoa, it's a little more difficult to find fundamental news sources for free. You may want to subscribe to a news service like OsterDowJones, where specialized reporters scour the world for news that impacts those markets. The U.S. Department of Agriculture has a website (www.usda.gov) with reports on many commodities that trade in futures markets, including not only the major U.S. row crops, but also markets like coffee and orange juice.

Finally, traders should consider the knowledge of market fundamentals as just one more tool in their trading toolbox. The more tools in a trader's toolbox, the higher the odds he or she will be a successful trader.

"Triple Moving Averages" Explained

Those who have followed my work for some time know that I take a "toolbox" approach to analyzing and trading markets. The more technical and analytical tools I have in my trading toolbox at my disposal, the better my chances for success in trading. One of my favorite "secondary" trading tools is moving averages.

In a past educational feature, I explained how I use my two favorite moving averages: the 9- and 18-period moving averages. In this feature, I will discuss using three moving averages in analyzing and trading a market. It's called the "triple-moving average" method.

The moving average is one of the most commonly used technical tools. In a simple moving average, the mathematical median of the underlying price is calculated over an observation period. Prices (usually closing prices) over this period are added and then divided by the total number of time periods. Every day of the observation period is given the same weighting in simple moving averages. Some moving averages give greater weight to more recent prices in the observation period. These are called exponential or weighted moving averages.



The length of time (the number of bars) calculated in a moving average is very important. Moving averages with shorter time periods normally fluctuate and are likely to give more trading

signals. Slower moving averages use longer time periods and display a smoother moving average. The slower averages, however, may be too slow to enable you to establish a long or short position effectively. Moving averages follow the trend while smoothing the price movement. The simple moving average is most commonly combined with other simple moving averages to indicate buy and sell signals.

In the triple-moving-average method, "period" lengths typically consist of short, intermediate, and long-term moving averages. A commonly used system in futures trading is 4-, 9-, and 18-period moving averages. Keep in mind a time "period" may be minutes, days, weeks, or even months. Typically, moving averages are used in the shorter time periods, and not on the longer-term weekly and monthly bar charts.

The trading signals generated by a triple moving average may be interpreted as follows: The shorter-term moving average above the longer-term average indicates a bullish market. When the shorter-term moving average crosses below the longer-term moving average, the market is viewed as bearish and a sell signal is generated. If the shorter-term moving average remains below the longer-term moving average, the market is still considered bearish. When the shorter-term average crosses above the longer-term average, a possible reversal to a bearish market is signaled.

The relation of the three moving averages can help to better and more quickly define the strength of the trend and provide shorter-term trading clues. For example, if the 4-period moving average crosses above the 9-period average, but the 9-period is still below the 18-period, that signals a trend change may be on the horizon, but it's best to wait for the 9-period to cross above the 18-period for a better reading of the trend change.

The trader who uses shorter timeframes to trade markets is better suited to using the triple-moving-average method--because trading signals are given faster. But keep in mind the shorter the moving average, the greater the potential for false signals.

Here is an important caveat about using moving averages when trading futures markets: They do not work well in choppy or non-trending markets. One can develop a severe case of whiplash using moving averages in choppy, sideways markets. Conversely, in trending markets, moving averages can work very well.

When looking at a daily bar chart, one can plot different moving averages (provided you have the proper charting software) and immediately see if they have worked well at providing buy and sell signals during the past few months of price history on the chart.

As an aside, veteran ag market watchers say the "commodity funds" (the big trading funds that many times seem to dominate futures market trading) follow the 40-day moving average very closely when they trade the grains. Thus, if you see a grain market that is getting ready to cross above or below the 40-day moving average, it just may be that the funds could become more active.

The Importance of Knowing What You Don't Know

The headline of this educational feature may be a bit confusing, but I will explain what I mean shortly. First, I want to reiterate that trading futures, stock and FOREX markets is not an easy undertaking. It disgusts me that there are a few unsavory people in our industry that portray trading as an easy, get-rich-quick scheme, or as some endeavor for which there are “secrets” to be learned from those who hold “trading secrets.”

Folks, the plain truth is that there are no trading secrets and no easy paths to quick success in trading markets. Beware of anyone who tries to tell (or sell) you such.

One of the biggest obstacles to success in trading markets is a lack of knowledge and understanding of the process of trading. The “process of trading” includes understanding financial leverage, market behavior and trader psychology. Understanding the process of trading can be achieved with perseverance and a willingness to continue to learn.

It's not coincidental that trading markets is similar to most other human endeavors: Hard work and experience are required to achieve notable success. A person who enjoys classic automobiles would not attempt to tear down and successfully rebuild an engine without having some previous experience, or without having learned about the workings of an automobile engine—including knowing about the tools involved in the operation.

I have written numerous times that learning about different trading tools, different markets and different trading strategies provides a solid foundation on the road to trading success.

Ironically, I believe a major advantage of being an experienced trader is knowing what you don't know about markets and trading. Yes, you heard that right: **Knowing what you don't know.**

What do I mean by this? I mean that there are certain elements of futures trading about which I do not “know,” and never will.

I don't “know” what markets are going to do in the future. Some may ask, “How can you be in this business and not know what markets are going to do? How can you be a successful trader and not know where market prices are going?” My answer is that market analysis and trading (at least the way I see it) is not a business of bold predictions, but one of exploring market probabilities based upon market knowledge, price history, human behavior and trading experience. The fact that I “know that I don't know” exactly what a market will do gives me a trading edge. Why? Because I will exercise more caution and think about and plan for what could happen if a trade turns against me. I know that some trades will indeed turn against me and that I need to have the capital to trade another day, so I won't “put all my eggs in one basket.”

I prudently place protective buy and sell stops on trades because I do not “know” what the markets will do. I would rather absorb a small trading loss and be termed “wrong” about that trade, as opposed to risking trading with no protective stops and seeing a small loser turn into a big loser--all in the “hope” the market will turn around so I can be proven “right.”

(Do you see what I mean when I discuss human behavior? Most of us don’t like to be “wrong,” and will make decisions so that we are not wrong. In trading, sometimes the decisions traders make to avoid being “wrong” are not prudent decisions for those wanting to be successful traders in the long run.)

One sure fire clue I get that a trader does not have much trading and market experience (and needs more!) is when the trader tells me he or she “knows” a market is going to do something. What can be even worse is when a trader thinks he or she “knows” what the market is going to do, and then makes a trade that turns out to be a winner. That type of psychological reinforcement of a flawed trading characteristic only sets up the trader for a bigger disappointment at some point in the future—likely sooner rather than later.

Traders absolutely must respect the markets. Only the markets are 100% right. Traders who think they “know” exactly what a market will do are not showing the markets respect.

Using Two Popular Oscillators: Slow Stochastics and Relative Strength

Two of the more popular computer-generated technical indicators are the Slow Stochastics and Relative Strength Index (RSI) oscillators. (An oscillator, defined in market terms, is a technical study that attempts to measure market price momentum—such as a market being overbought or oversold.)

I'll define and briefly discuss these two oscillators, and then I'll tell you how I use them in my market analysis and trading decisions.

Slow Stochastics:

George Lane has been called the father of the stochastic indicator. I met this gentleman a few years ago. He and his wife still attend and participate in trading seminars around the U.S. Lane's basic premise is as follows: During periods of price decreases, daily closes tend to accumulate near the extreme lows of the day. Periods of price increases tend to show closes accumulating near the extreme highs of the day. The stochastic study is an oscillator designed to indicate oversold and overbought market conditions.

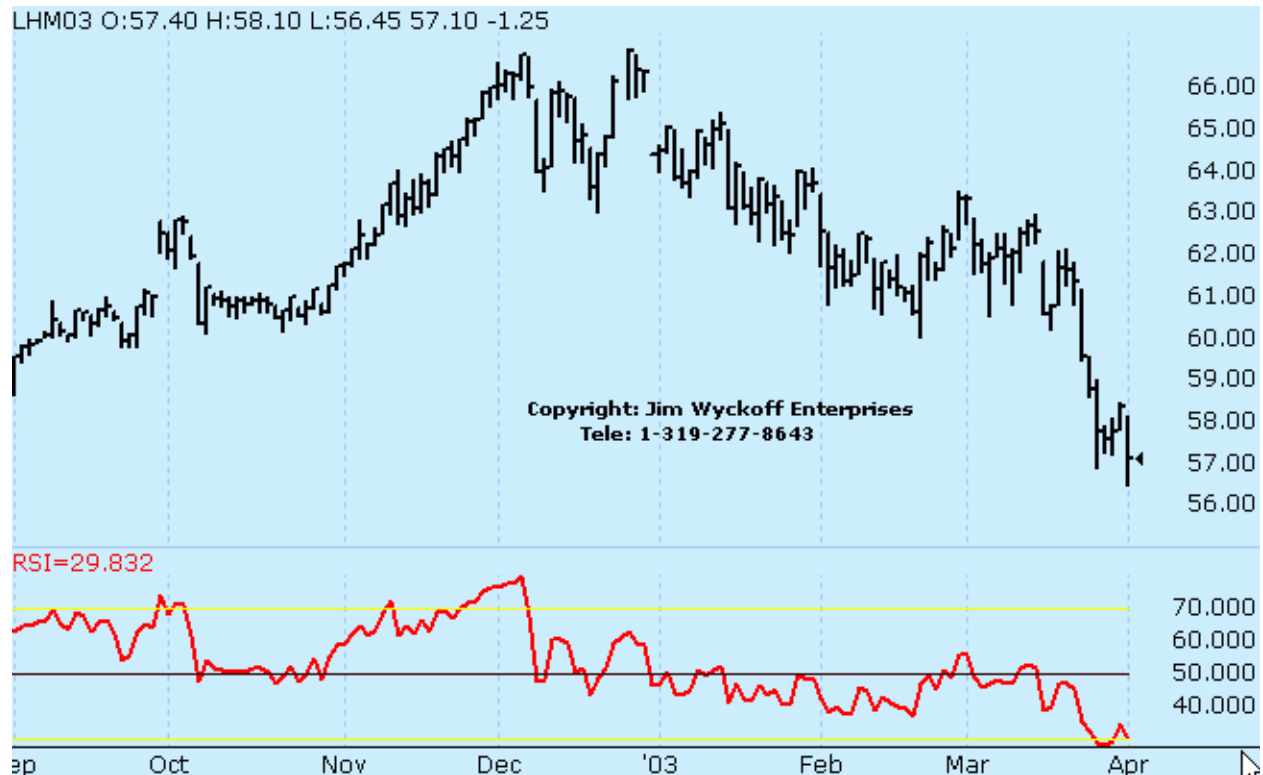
Some technical analysts, including me, prefer the slow stochastic rather than the normal stochastic. The slow stochastic is simply the normal stochastic smoothed via a moving average technique. The slow stochastic, like the normal stochastic study, generates two lines. They are %K and %D. The stochastic has overbought and oversold zones. Lane suggests using 80 as the overbought zone and 20 as the oversold zone. Some technicians prefer 75 and 25. I like to use the 80-20 figures.

Lane also contends the most important signal is divergence between %D and the commodity. He explains divergence as the process where the stochastic %D line makes a series of lower highs while the commodity makes a series of higher highs. This signals an overbought market. An oversold market exhibits a series of lower lows while the %D makes a series of higher lows.

When one of the above patterns appears, you should anticipate a market signal. You initiate a market position when the %K crosses the %D from the right-hand side. A right-hand crossover is when the %D has bottomed or topped and is moving higher or lower and the %K crosses the %D line. According to Lane, the most reliable trades occur with divergence and when the %D is between 10 and 15 for a buy signal and between 85 and 90 for a sell signal.

Relative Strength Index:

The Relative Strength Index (RSI) is a J. Welles Wilder, Jr. trading tool. The main purpose of the study is to measure the market's strength or weakness. A high RSI, above 70, suggests an overbought or weakening bull market. Conversely, a low RSI, below 30, implies an oversold market or dying bear market. While you can use the RSI as an overbought and oversold indicator, it works best when a failure swing occurs between the RSI and market prices. For example, the market makes new highs after a bull market setback, but the RSI fails to exceed its previous highs.



Another use of the RSI is divergence. Market prices continue to move higher/lower while the RSI fails to move higher/lower during the same time period. Divergence may occur in a few trading intervals, but true divergence usually requires a lengthy time frame, perhaps as much as 20 to 60 trading intervals.

Selling when the RSI is above 70 or buying when the RSI is below 30 can be an expensive trading system. A move to those levels is a signal that market conditions are ripe for a market top or bottom. But it does not, in itself, indicate a top or a bottom. A failure swing or divergence accompanies the best trading signals.

The RSI exhibits chart formations as well. Common bar chart formations readily appear on the RSI study. They are trendlines, head and shoulders, and double tops and bottoms. In addition, the study can highlight support and resistance zones.

How I employ Slow Stochastics and the RSI:

First of all, these two oscillators--especially the RSI--tend to be over-used by many traders. As you just read above, some traders use these oscillators to generate buy and sell signals in markets—and even as an overall trading system. However, I treat the RSI and Slow Stochastics as just a couple more trading tools in my trading toolbox. I use them in certain situations, but only as “secondary” tools. I tend to use most computer-generated technical indicators as secondary tools when I am analyzing a market or considering a trade. My “primary” trading tools include chart patterns, fundamental analysis and trend lines.

Oscillators tend not to work well in markets that are in a strong trend. They can show a market at either an overbought or oversold reading, while the market continues to trend strongly. Another example of oscillators not working well is when a market trades into the upper boundary of a congestion area on the chart and then breaks out on the upside of the congestion area. At that point, it’s likely that an oscillator such as the RSI or Slow Stochastics would show the market as being overbought and possibly generate a sell signal—when in fact, the market is just beginning to show its real upside power.

I do look at oscillators when a market has been in a decent trend for a period of time, but not an overly strong trend. I can pretty much tell by looking at a bar chart if a market is “extended” (overbought or oversold), but will employ the RSI or Slow Stochastics to confirm my thinking. I also like to look at the oscillators when a market has been in a longer-term downtrend. If the readings are extreme—say a reading of 10 or below on Slow Stochastics or RSI—that is a good signal the market is well oversold and could be due for at least an upside correction. However, I still would not use an oscillator, under this circumstance, to enter a long-side trade in straight futures, as that would be trying to bottom-pick.

These two oscillators are not perfect and are certainly not the “Holy Grail” that some traders continually seek. However, the RSI and Slow Stochastics are useful tools to employ under certain market conditions.

This Trading "Checklist" Will Help You Execute with Confidence

A lot of email has come in from readers asking me how to improve upon "pulling the trigger" to enter a trade. How many traders out there have ever pondered a potential trade for so long that once they actually got ready to execute it, they then got cold feet due to concern they had missed the move?

Some traders are reluctant to put on a position because they are torn between what they perceive as conflicting market factors. Here's a typical quote from such a trader: "The moving averages are positive, the market is trending higher, but the RSI shows the market as being way overbought. What should I do?"

A "Trading Checklist" of prioritized criteria not only will help you decide when to execute a trade, but will also help you identify potential winning trades. You'd be surprised how a visual checklist can resolve uncertainty in your mind.

What kind of stuff should a trader put on a Trading Checklist? That depends on the individual trader. Each trader should have his or her own set of criteria that helps determine a market to trade and the direction to trade it--including when to get in.

(As an aside, I like to compare my trading criteria to a bunch of tools in a toolbox. The more tools I have at my disposal, the better. Also, there are different tools for different tasks. However, there are some basic tools that I think are more important than the others and that are a must for the toolbox.

In trading terms, the more you know about chart patterns, technical indicators, fundamental factors, etc., the more tools you will have in your "trading toolbox" and at your disposal when trading the markets.)

Back to the checklist: You'll want to put your most important trading tools on the checklist, and in order of importance.

At the top of my Trading Checklist is: "Are daily, weekly and monthly bar charts in agreement on trend?" A very important position-trading tenet for me is that shorter-term and longer-term charts should agree on the trend of the market. If the daily and weekly charts are bullish, but the monthly is bearish, there's a good chance I'll pass on the trading opportunity.

So if my very first (and most important) objective on my Trading Checklist is not met, then I really don't need to go any farther down the list. I'll look for another trading opportunity.

However, if the last item (least important) on your Trading Checklist does not meet your objective, but the big majority of the other objectives on your list are met, then you may make the trade anyway. It's entirely possible that all of your trading tools on the list may not give you the proper signal to trade the market, but it's still a good trading opportunity.

Every trader should have at least a few trading "tools" that help determine a trading opportunity. Listing those tools on paper, in order of importance, and then examining that list when deciding each trade should make easier the sometimes difficult task of "pulling the trigger."

Study and Preparation: Don't Sell it Short!

A good percentage of my readers are futures traders who consider themselves beginners and have traded for less than one year. Most of these readers are very hungry for information they can digest in order to move them "up the ramp" to an experienced (and hopefully successful) futures trader.

Most of my readers have "day jobs" or other commitments that don't allow them to be full-time traders. Thus, the time they do spend studying futures markets and trading needs to be "quality time."

I have been fortunate in my career, because I get to spend all day long studying and being involved with markets and trading strategies. And I love it! But part of my responsibility to my valued readers is to help you focus on the "quality" information you need to study--because the vast majority of you do not have all day long to be involved with the markets.

A quick anecdote: In the 1980s, I began my career in the futures industry by working on the floor of the Chicago Mercantile Exchange. Right away, I fell in love with the markets. After a few days on the job, I went home one night and told my wife: "I'm going to learn all I can about the markets, and then trade them--and we'll be rich!"

Well, first of all I was pretty young at the time and was a bit optimistic (naïve??). Secondly, I soon found out that trying to become a successful futures trader is a lot like playing golf: When you first start out, you say, "Hey, this game is not so bad, and I'm doing okay." But then after you have played the game for a while, you realize how challenging golf really is and how "green" you really were when you started playing.

So, what can beginning futures traders do to "ramp up" as quickly as possible, on the road to becoming a successful trader? Below are a few "nuggets" that I believe will help the beginners get up to speed as soon as possible--and also just maybe get some veteran traders who are struggling back on the right track.

► First of all, there is no substitute for trading and market experience. You can paper trade for months (which I do recommend for the real rookies), but when you've got real money on the line, it's different. Stuff just "sinks in" to your brain and is not forgotten when you're making or losing real money. But the good thing about experience is that it's something everyone can accrue. Just by reading this story, you are gaining some market-related experience, which is part of the experience you need to become a successful trader.

► Become familiar with the markets you plan to trade. Not only study the markets and their supply and demand fundamentals, but also study how the market is traded--on what exchange, the contract size, trading hours, expiration of the contract month, delivery notices, if applicable,

etc. All of this information can be found free on the Internet. Just go to a bigger futures exchange website, like the CBT, CME or CEC, and there is all kinds of information on the markets that trade on that particular exchange. There is also other valuable information on the markets at those sites. Again, it's all free.

► Read some good books by successful futures traders. Not only do you need to know the markets, you also need to know how the successful traders trade them. Much of a trader's success comes from his or her "trading psychology." The best place to learn about trading psychology is from books, such as Jack Schwager's "Market Wizard" books. The better books also discuss money management in futures trading, which is also very important.

► Study a variety of trading methods--not just one trading system. I get a lot of email from beginning traders asking about a certain trading system that costs XXX amount of dollars. My advice is to them is to take the money they would spend on a single trading system and go to a quality seminar and listen to several of the best traders in the world explain why they are successful.

► When studying, don't dive into one subject or one market and just focus solely on it. Spend your study time touching on several topics. My experience is that I absorb more of the subject matter (and it's less boring) when I read some of it, and then come back to it later. Also, if you get into complicated subject matter, sometimes it's better absorbed when it's digested in smaller pieces.

Technical Traders: You Should Still Examine Fundamentals

I base the majority of my trading decisions on technical indicators and chart analysis--and also on market psychology. However, I do not ignore important fundamentals that could impact the markets I'm trading. Neither should you.

In this feature I'd like to share with you the types of fundamentals in various markets about which technically oriented traders should be aware. While this article will be most beneficial to beginning and intermediate traders, the experienced traders may enjoy it as a "refresher."

I've told readers that I have been very fortunate in my career in the futures industry. When I was a reporter and editor for FWN, I was forced to learn about the fundamentals impacting all the markets I covered. (At one time or another, I covered every futures market traded in the U.S., and also many overseas futures markets.) I had to talk to traders and analysts every day, regarding the fundamentals that impacted the particular market on which I was reporting.

Realizing very few get that kind of unique opportunity to learn about market fundamentals, what can beginning to intermediate traders do to "get up to speed" regarding the fundamentals of the markets they wish to trade?

Here are some useful nuggets to consider regarding market fundamentals:

- You should know in what increments your market trades, the contract size, if it's physically deliverable or cash-settled, and when first-notice day and last trading day occur. This information is all free and available on the websites of the exchanges on which the markets trade. For example, if you trade U.S. T-bond futures, you should know that prices trade in 32nds of a point, based on a yield of 6%. You don't have to become an expert on yields, deliveries or notices, but you should be aware of the concepts. Reading about what the exchanges have to say about their markets is a great way to start out learning fundamentals.
- The Internet is a wonderful tool to help you learn about futures market fundamentals--for free. Use your favorite search engine and do a search on your market of interest. However, make sure you use "futures" in the search words, as this will narrow the focus of the search engine.
- Here's a caveat on market fundamentals: The professional traders anticipate them and many times factor the fundamentals into price even before they occur. In fact, this happens quite often in futures markets. For example, it stands to reason that heating oil demand will increase in late fall and winter, and that heating oil futures prices should rise in that timeframe, as opposed to summertime prices. A novice trader may think it's a no-brainer to go long the December heating

oil contract in September. However, keep in mind all the professional traders and commercial traders know this, and they have likely already factored this seasonal fundamental into the price of the December contract.

- There are U.S. government economic reports that sometimes have a significant impact on markets. Associations also release reports that impact futures markets. Even private analysts' estimates can move markets. Try to learn about the reports or estimates that have the potential to impact the market you wish to trade. You should make it a priority to know, in advance, the release of any scheduled report or forecast that has the potential to move your market. For example, if you are thinking about establishing a position in the T-Bond market and the U.S. employment report is due out the next day, you may want to wait until the report is released before entering your position. The employment report can whipsaw the bond market in the minutes after it's released, which could stop you out of your position.

- If you like to trade financial futures markets, newspapers like the Wall Street Journal and Investors Business Daily have sections that follow bonds, stock indexes and currencies, etc. Reading about how fundamental events impact these markets allows you to get up to speed on fundamentals.

- If you trade commodities like cotton, coffee or cocoa, it's a little more difficult to find fundamental news sources for free.

You may want to subscribe to a news service like OsterDowJones, where specialized reporters scour the world for news that impacts those markets. The U.S. Department of Agriculture has a website (www.usda.gov) with reports on many commodities that trade in futures markets, including not only the major U.S. row crops, but also markets like coffee and orange juice.

Finally, traders should consider the knowledge of market fundamentals as just one more tool in their trading toolbox. The more tools in a trader's toolbox, the higher the odds he or she will be a successful trader.

Veteran Traders Share Their Secrets and Strategies

An elite group of traders and technical analysts gathered in Las Vegas last weekend to educate and enlighten several hundred attendees of the 21st annual TAG (Technical Analysis Group) conference. For two and one-half days, these respected market watchers shared their trading secrets and strategies.

Following are some trading and technical tidbits this writer picked up from this year's TAG 21 conference, which was put together by Tim Slater, a respected technician in his own right, and was sponsored by INO.com.

- * One of the themes coming out of this year's conference was the increased volatility in the stock market, and how traders with a futures-related trading background have used their experience with volatility to obtain better entry and exit points in stock trading. Most agreed that whether one trades stocks, or financial futures, or commodity futures, there are key trading techniques and tenets that apply to all three.
- * All the speakers heard by this writer pointed out that successful traders must have a specific trading plan before they execute a trade--and show keen discipline in following through on the plan. This includes entry points and potential exit strategies--including setting stops. Always set a stop when trading.
- * Keep a diary when trading. This helps identify any trading mistakes, or trading successes, in future decision-making on trades.
- * Have a money-management plan. This is a must. Know what your financial risk tolerance is and trade accordingly.
- * Don't add to a losing position.
- * If you are in a trading slump, take a break for a few days or weeks, in order to reflect upon your trading methodology.
- * Do not overtrade. This is a common mistake among many traders.
- * Take advantage of market trends. "The trend is your friend" saying rings true. Use extra caution when trading against the prevailing trend of the market. Don't try to pick tops or bottoms.
- * Let your profits run and cut your losses quickly.

* The fundamentals in any given market are always most bullish at market tops and most bearish at market bottoms.

This is where the "buy the rumor, sell the fact" anecdote sometimes comes into play.

* There is no Holy Grail in trading. There is no "free lunch." Trading successfully is hard work.

* Most speakers said their methodologies should be used as one "tool" amid a variety of tools in your own trading "toolbox."

Trading Lingo: Definitions for the Less-Experienced Trader

Trading futures and stocks involves the use of some of the more arcane terms found in any field of endeavor. Those less-experienced traders who are trying to break into an already-difficult business are many times even more frustrated by “phraseology” they do not understand and which seems to make no sense at all. I wish you could have seen the look on my wife’s face when she overheard a telephone conversation in which I told a customer we were seeing a “dead-cat bounce” in a market!

When I broke into this fascinating business about 20 years ago, I worked right on the trading floors of the Chicago Mercantile Exchange and the Chicago Board of Trade. As a “cub reporter” I, too, heard trading terms that I did not understand. And I was even a bit afraid to ask those veteran floor traders what some terms meant—for fear of being embarrassed. But after a short time, I realized the only way I was going to learn was to ask. I always tell my readers there are no “dumb” questions. Every single trader that has ever executed a trade had to start out as a rookie who also did not know the “lingo” of the trade. (Some veterans do have a hard time remembering that they, too, were once inexperienced traders.)

Below are some of the more widely used trading terms and their explanations. If you have any questions about other terms I do not address in this feature, just drop me an email at jim@jimwyckoff.com and I’ll do my best to answer your question.

“Dead-Cat Bounce.” The general theme of this trading adage, which many feel has now become “politically incorrect,” is that many times a market will experience a modest rally (a bounce) from depressed price levels. But most of this price rise is due to short covering (see definition below) or weak long positions getting back into a market that very likely has little or no upside power on the horizon.

“The trend is your friend.” This simple sentence is a very powerful one and is important for most traders. If you trade with the market’s trend, your odds for success are higher than if you trade against the trend. Most successful traders employ some type of trend-following trading strategy.

“Buy the rumor, sell the fact.” This is a frequently occurring phenomenon whereby a market will make a corresponding price move in anticipation of an expected result of a fundamental event. And then when the event does actually occur and the result was as expected by traders, the market price will move in the opposite direction. For example, if grain traders expect a bullish USDA report, the market will rally in the days before the report’s release—but then actually sell off once the actual bullish USDA figures are released. Traders were “buying the rumor and selling the fact.”

“Bulls make money and bears make money, but pigs get slaughtered.” In other words, don’t be a greedy trader. Don’t try to take too much profit out of a market too fast. The two biggest and potentially most damaging human emotions in trading are “fear” and “greed.”

“Cut your losses short.” This trading maxim is even more important than, “The trend is your friend.” Traders must limit their losses on their more numerous losing trades by using strict money-management and by employing buy and sell stops.

“Markets ‘discount’ events.” This phrase is similar to the “buy the rumor, sell the fact” phrase. Markets will many times “factor in” or discount events before they occur. For example, the last major U.S. Corn Belt drought was in 1988. The growing seasons for soybeans and corn end in late-summer to early fall. However, corn and soybean futures prices topped out in June of 1988. Traders had factored in the damage to the crops well before most of the damage had actually occurred.

“Never meet a margin call.” In other words, traders should never let a trade become so much “under water” that a margin call from the broker is initiated. “Cut your losses short.”

“Short-covering.” This is a phenomenon whereby traders who have established short positions decide to exit the market—either to take profits or because their trading positions have moved too far “under water.” Many times, short covering will occur after a market has been in a sustained downtrend without much upside movement recently.

“Long liquidation.” This occurs when traders decide to “ring the cash register” and take profits from long positions—or in which weaker longs exit the market when it appears to be showing weakness. Long liquidation usually occurs when a market has been in a sustained uptrend and many bulls decide to bail out—knowing the market is vulnerable to a downside correction.

Consolidation: Also known as “sideways trading.” Many times a market that has undergone a sustained trend will “pause” to catch its breath or move into a consolidation phase. This means price action on the charts turns more sideways and choppy.

A price “breakout.” This occurs when prices move solidly above or below a “congestion area” (or a sideways trading area) on the bar chart. Many trend traders like to trade price breakouts.

“Basing” action. This is extended sideways trading at recent historic lower price levels. Prices are forming a “base” at lower levels, from which to eventually see an upside “breakout.” Keep in mind that markets can also see a downside price breakout at what was perceived to be a basing area at lower levels.

A market “correction.” When a market has seen a sustained price trend, it will make a shorter move in the opposite direction. This is called a correction, as odds favor the eventual resumption of the trending move.

“Locals.” These individuals trade right out of the futures trading pits at the exchanges. They trade for their own accounts and are a needed function of pit trading because they provide the important market liquidity for better trade execution (fills).

Better to Be Profitable Than Right

The ultimate goal of a futures trader should be to have overall trading success by being profitable. There is no single-best path one can take on the destination to trading success and profitability. However, there are a few general trading tenets to which all successful traders have subscribed. One such trading tenet is “losing your ego” when trading futures.

Mark Cook, a well-respected trader and trading educator from rural Ohio, for many years has stressed that traders need to lose their egos before getting into trading futures markets. He is also an advocate of survival in futures trading. One must survive in this challenging arena before one can succeed. I enjoyed listening to Mark at a trading seminar a few years ago. He even used to wear bib-overalls (with no shirt) at some of his trading seminars—just to drive home the point that trading futures is not easy and that ultimate success takes a lot of hard work.

My good friend and respected trader and educator Glen Ring also espouses the notion, and may have even coined the phrase, “it’s better to be profitable than right in futures trading.” Those who know or have talked to Glen know he, too, is a no-nonsense, no-hype trader who takes a yeoman’s approach to the business. When asked what direction a specific market “will” go in the future, Glen is never afraid to say, “I don’t know,” before he adds that, “successful trading is not a business of predictions but one of probabilities based on past price history.”

It’s been reported that people who get into the endeavor of futures trading tend to be of higher-than-average intelligence and have more aggressive personalities—called “Type A” personalities. Having higher-than-average intelligence certainly can be advantageous in any field of endeavor. However, in futures trading, possessing the “Type A” personality can be a disadvantage. Reason: More aggressive and competitive people do not like to lose and do not like to be wrong. It’s a time-proven fact that trading futures is about absorbing numerous losing trades. But that does not mean “Type A” personalities cannot succeed in futures trading. Those with the competitive and aggressive tendencies just need to realize they possess those traits and then manage them properly when trading futures. (My wife says that I’m a “Type A” personality, but I say I’m not. I just know I’m right and she’s wrong—just kidding!)

Most have heard the simple trading adage, “Cut your losses short and let your winners run.” What this also implies is that during any given year the vast majority of futures traders will see more losing trades than winning trades. Yet, some can still realize profits by getting out of the more numerous losing trades quickly at small losses (by setting tight protective stops), and allow the fewer winners to run and accrue bigger profits.

Just think for a minute about the futures trader who does not want to lose his or her ego. This is the trader who likes to be right and cannot stand to be wrong. In fact, this type of trader will probably go to great lengths just to be proven right. What does this mean when executing trades? It probably means that the trader who hates to be wrong won’t be willing to get out of a losing

position at a small loss. Instead, this type of trader may pull a protective stop when in the heat of a trade, or may not use protective stops at all—in the hope that he or she will be proven correct. This type of trader is likely to see a small loser turn into a big loser, and might even get a margin call from his or her broker. And if this type of trader repeats this scenario and keeps absorbing big trading losses, he or she will eventually be forced to exit the endeavor of futures trading. This is also the type of person who would likely blame the markets or the broker for his or her lack of trading success.

Be a humble futures trader. If you are not a humble futures trader now, the markets will eventually make you one—and very likely sooner rather than later. I guarantee it. There are few guarantees in futures trading but this is one that I can make.

Keep Market "Noise" in Perspective — Set Bigger Price Benchmarks

One of the more difficult aspects of futures trading is to be right in the middle of a trade and see the market begin to gradually move against your position. Almost as difficult for a trader is to watch the market he or she is trading languish in a choppy, sideways pattern for days or weeks--or even longer.

Indeed, the trading buzzwords "patience" and "discipline" again come to mind when markets are pausing or are in shorter-term choppy and non-trending conditions. This condition of the markets is also called "market noise." The majority of the time, most markets are in non-trending or choppy modes. Thus, if a trader does not have a good plan to deal with this type of market condition odds are very low that any trading success will ever be achieved.

Most trading professionals recommend that position traders ignore the day-to-day market noise, and instead focus on the bigger-picture perspective of the market. This can be accomplished in several ways. Examining longer-term price charts (weekly and monthly) is a good way to obtain that important bigger-picture perspective of a market and its trend.

Here's another simple, yet effective way to help you filter out day-to-day price "noise" in a market you are trading: Set major support and resistance benchmarks on the shorter-term chart (usually a daily chart for position traders). These major price benchmarks can be weekly or monthly highs and lows, or spike highs and lows, or major psychological price levels (such as \$6.00 in soybeans, or \$2.50 in corn, or \$300.00 in gold, or \$25.00 in crude oil).

It's a better idea to set these price benchmarks before you execute a trade and are in the heat of battle. Once you have established and duly noted these important shorter-term price benchmarks, then if prices do move above or below one of your benchmarks, that is a solid clue the price move is NOT just market "noise" and a bigger price trend is likely developing.

Many times if prices do move above or below major shorter-term price benchmarks, that is also considered a price "breakout" from a congestion area on the chart. This also suggests a stronger price move is possible in the direction of the price breakout.

Some traders may prudently ask, "Should I set my protective buy or sell stops near these major shorter-term price benchmarks?" That depends on the individual trader and how much capital he or she wants to risk on any given trade. For me, the major price benchmarks that I set for guideposts on any market are usually too far away from the price at which I'm filled (my market entry). In other words, I like to set protective stops at tighter levels than where my major price benchmarks are located.

Any time a trader can implement a strategy to better define or determine a market's trend, or that will help the trader keep a better perspective on the market during the heat of trading that market, odds will be higher for trading success.

Abell, Koppel Discuss Their Profitable Short-term Trading Methods

No short-term trading system is perfect. However, having and using a system is critical for short-term trading success, say Howard Abell and Bob Koppel.

“A successful short-term trading system must be profitable, consistent, and personal--conforming to the unique psychological and methodological needs of the individual,” they said.

Abell is chief operating officer for Innersgame Division and author of “The Day Trader’s Advantage” and “The Insider’s Edge.” Koppel has authored “The Intuitive Trader” and is president of Innersgame Division, which is a professional and institutional brokerage and trader execution services division of Rand Financial--a Chicago-based futures commission merchant with clearing representation worldwide.

Innersgame Division is also associated with the Moore Research Center, based in Eugene, Ore. Steve Moore is the proprietor. Together, they have created the Innersgame Partners/Moore Research, Inc. (IPMR) Trading Approach.

The trading method has the following tenets:

Patience Is Your Edge

The edge of the floor trader is buying the bid and selling the offer. This is an unreasonable expectation for off-the-floor day- and swing-traders. However, there are other ways to maintain an edge. Patience and preparation serve to create an edge that helps build and conserve equity. Knowing what you expect the market to do and waiting patiently for the market to come to you--in other words, to meet your expectations--gives you that edge.

Good Daytraders and Swing Trades Result from High Percentage of “Set-ups”

Each day must be viewed in a larger context, which might be one day to two weeks of market action. Understanding how markets “set up” to make predictable moves and anticipating these moves through the set-up is a valuable key to success.

Anticipating Market Opportunities

In most instances, waiting for the market to demonstrate what appears to be a trading opportunity will result in entering too late for maximum profits.

Predetermined Buy and Sell Areas Must Be Executed

For those traders who have difficulty “pulling the trigger,” putting resting orders in the market will get you into or out of the trade.

Trade One Set-Up Per Market Day

Overtrading comes from indecision and anxiety. By setting your sights on one good set-up in a market, you avoid trading your emotions.

Ignore the Noise, Follow the Signal

Much of what a market does during the day can be considered noise--that is, market action without meaning. Hanging on every tick can be a wearisome and misleading chore. You must eliminate your reactions to the noise and follow the essential signals.

Take “Fast-Market” or Climax Condition Profits

In day- or swing-trading it is a good idea to exit a profitable trade if the market climaxes on heavy tick volume or “fast-market” conditions. It is a high probability that the high or low of the day is being made at this time. If the market hits your resting entry orders under these conditions, expect immediate profits or be alert for another wave in the same direction.

Abandon Dull or Non-Performing Markets

If you find yourself in a market that is very dull--look elsewhere. Time is scarce and watching a dull market drains energy.

Koppel and Abell made their presentation to traders attending the Technical Analysis Group (TAG XVIII) meeting in New Orleans late last week. The meeting was sponsored by Dow Jones Telerate.

RSI Indicator: The Cornerstone of Andrew Cardwell's Trading Model

The ideal technical indicator, according to Andrew Cardwell, Jr., is one that offers capability to identify and monitor the current trend, highlight overbought and oversold extremes, and give early warnings of a trend change.

“The Relative Strength Index (RSI) is such an indicator, offering the best of all worlds,” said Cardwell, president of Cardwell Financial Group, Inc., based in Woodstock, Ga. The RSI “is the cornerstone of my trading model,” he said.

Cardwell is a featured speaker at this weekend's 20th annual Telerate Seminars Technical Analysis Group (TAG 20) conference here.

“In the lectures and workshops I have given, I have shown how the RSI can be used as either a completely independent trading model or an addition to and enhancement of a trader's current technical approach. I use it as a completely independent model to identify trend, support and resistance, overbought/oversold levels, divergence, trend change, reversal and price targeting.”

Cardwell said most traders who use the RSI focus their attention on trying to identify bullish and bearish divergences. He said basic price and momentum divergence can and does help to identify extreme overbought or oversold conditions in market momentum.

“However, most traders fall prey to the concept of divergence and see it as the end or reversal of the prevailing trend of the market. All would be right in the world if markets were to reverse from simple divergence. But there are times when sentiment and momentum are so strong that the market continues to make new highs (or lows), which will keep the RSI at overbought (or oversold) levels for extended periods of time.

“Momentum and price corrections, when they do materialize, are usually sharp and swift. After these brief respites the market is then ready to resume its normal upward (downward) trend. With each successive new high (low) and divergence formed, anxious traders are ready to call for a top (bottom) and reversal of trend. However, in strongly trending markets, multiple divergences can and do develop, which only lead to corrections of the overbought (oversold) condition of the market.

“If a trader attempted to take positions based solely on divergences, he or she would need deep pockets and eventually exhaust his or her trading capital,” said Cardwell.

While Cardwell takes note of divergence, he said that only shows the market is overextended and needs to correct the overbought or oversold condition. Even though the RSI is considered a momentum oscillator, he said it has more values as a trend-following indicator.

“One of the guidelines I have established for myself is to identify a range for uptrends as well as downtrends. As the market trends higher or lower I will adjust the normal range of RSI (70-30) to account for the shift in market momentum and bullish or bearish sentiment on the part of the traders. The fact that this adjustment needs to be made in the range of RSI is one of the first indications that the market is undergoing a trend change.”

The ability of a trader to recognize a trend change quickly, reverse a position and trade in the direction of that next trend is the skill that traders must develop to be successful, said Cardwell. “By having a position in tune with the trend, the trader will have the opportunity to participate in the bigger market moves, which generate larger profits.”

Cardwell has what he calls “Three Keys to Success: have a trading program, patience and discipline.”

Jesse Livermore: World's Greatest Trader

In the early part of the 20th century, Jesse Livermore was the most successful (and most feared) stock trader on Wall Street. He called the stock market crash of 1907 and once made \$3 million in a single day. In 1929, Livermore went short several stocks and made \$100 million. He was blamed for the stock market crash that year, and solidified his nickname, "The Boy Plunger." Livermore was also a successful commodities trader.

I think the most valuable knowledge one can gain regarding trading and markets comes from studying market history, and studying the methods of successful traders of the past. Jesse Livermore and Richard Wyckoff are two of the most famous and successful traders of the first half of the 20th century. Many of the most successful traders of today have patterned their trading styles after those of the great traders of the past.

Here are some valuable nuggets I have gleaned from the book, "How to Trade Stocks," by Jesse Livermore, with added material from Richard Smitten. It's published by Traders Press and is available at Amazon.com. Most of the nuggets below are direct quotes from Livermore, himself.

- "All through time, people have basically acted and reacted the same way in the market as a result of: greed, fear, ignorance, and hope. That is why the numerical (technical) formations and patterns recur on a constant basis."
- "The game of speculation is the most uniformly fascinating game in the world. But it is not a game for the stupid, the mentally lazy, the person of inferior emotional balance, or the get-rich-quick adventurer. They will die poor."
- Don't take action with a trade until the market, itself, confirms your opinion. Being a little late in a trade is insurance that your opinion is correct. In other words, don't be an impatient trader.
- Livermore's money made in speculation came from "commitments in a stock or commodity showing a profit right from the start." Don't hang on to a losing position for very long.
- "It is foolhardy to make a second trade, if your first trade shows you a loss. Never average losses. Let this thought be written indelibly upon your mind."
- "Remember this: When you are doing nothing, those speculators who feel they must trade day in and day out, are laying the foundation for your next venture. You will reap benefits from their mistakes."

- "When a margin call reaches you, close your account. Never meet a margin call. You are on the wrong side of a market. Why send good money after bad? Keep that good money for another day."
- Livermore coined what he called "Pivotal Points" in a market or a stock. Basically, they were: (1) Price levels at which the stock or market reversed course previously--in other words, previous major tops or bottoms; and (2) psychological price levels such as 50 or 100, 200, etc. He would buy a stock or commodity that saw a price breakout above the Pivotal Point, and sell a stock or commodity that saw a price breakout below a Pivotal Point.
- "Successful traders always follow the line of least resistance. Follow the trend. The trend is your friend."
- A prudent speculator never argues with the tape. Markets are never wrong--opinions often are.
- Few people succeed in the market because they have no patience. They have a strong desire to get rich quickly.
- "I absolutely believe that price movement patterns are being repeated. They are recurring patterns that appear over and over, with slight variations. This is because markets are driven by humans--and human nature never changes."
- When you make a trade, "you should have a clear target where to sell if the market moves against you. And you must obey your rules! Never sustain a loss of more than 10% of your capital. Losses are twice as expensive to make up. I always established a stop before making a trade."
- "I am fully aware that of the millions of people who speculate in the markets, few people spend full time involved in the art of speculation. Yet, as far as I'm concerned it is a full-time job--perhaps even more than a job. Perhaps it is a vocation, where many are called but few are singled out for success."
- "The big money is made by the sittin' and the waitin'--not the thinking. Wait until all the factors are in your favor before making the trade."

An important point I want to make is that Jesse Livermore's trading success came not because of any "inside" information or some huge store of knowledge he had about each and every stock or commodities market he traded. Livermore's trading success was derived from his understanding of human behavior. He realized early on that markets and stocks can and do change--but people and their behaviors do not. Therein lay his formula for trading success. That formula for trading success has not changed since Livermore's hey day in the stock and commodities markets almost a century ago.

A final note: Jesse Livermore may have been called the greatest stock market trader of the 20th century, but I question that notion. Certainly, no one can disagree that his profits were immense and his trading prowess was unmatched. But his life was not in balance. He was a "workaholic" who paid too little attention to his family. Livermore put a gun to his head and pulled the trigger in 1940. He "crashed and burned." You must have balance in your life to achieve *lasting success* at any endeavor. Trading markets is no exception.

Another 20th Century Great: Richard Wyckoff and His Methods

I received favorable feedback on my feature article on Jesse Livermore. So I'm doing a feature on another famous trader of the early 20th century: Richard D. Wyckoff. (Many readers ask if I am related to Richard Wyckoff. No, I am not. However, I always tell folks it's not a bad last name to have in my business.)

I derived much of my information on Richard Wyckoff from two good books: The first is "How I Trade and Invest in Stocks & Bonds," by Wyckoff. This book was first published in 1924 by "The Magazine of Wall Street." The second book is "Charting the Stock Market: The Wyckoff Method," first published in 1986 by Jack Hutson, the publisher of the magazine "Technical Analysis of Stocks & Commodities." Both books are available at www.amazon.com, I believe.

Richard Wyckoff, like Jesse Livermore, was a Wall Street stock trader in the early 1900s. Wyckoff's first job in 1888 was as a 15-year-old stock runner on Wall Street. By the age of 25, he had his own brokerage office. He also published his own market magazine and advisory newsletter.

Wyckoff's basic trading methodology was to chart price, volume and their relationships over time. He would then search for "turning points" in the stocks or markets. He also grouped stocks into sectors and then charted the sectors. He called these "wave charts." Wyckoff believed that stock price action consists of waves of buying (or selling) that last just as long as they can attract buyers (or sellers). When that following is exhausted, the wave stops and a counter-wave begins. His theory is not unlike the Elliott Wave theory. Importantly, Wyckoff's method in determining critical turning points was based not on mathematical formulas, but on investor psychology.

Below are some valuable "nuggets" I gleaned from the two books above. Many of these nuggets are direct quotes from Wyckoff, himself.

- "Anyone who buys or sells a stock, a bond or a commodity for profit is speculating if he employs intelligent foresight. If he does not, he is gambling."
- Wyckoff's goals were to select only stocks that move soonest, fastest and farthest in bull or bear markets. He limited losses and let profits run.
- "Stock market technique is not an exact science. Stock (and commodities) prices are made by the minds of men (and women)." Mechanical trading methods or mathematical formulas cannot compete with good human market judgment.
- Whenever you find hope or fear warping judgment, close out your position.

- Being in the market at all times is not the key to profits. Being in the market when there is a clear, unconfused technical signal, and the trader's judgment is not swayed by emotion, was Wyckoff's method for trading success.
- "I have yet to find a man, in or out of Wall Street, who is able to make money in (markets) continuously or uninterruptedly. Like anyone else, I have good and bad periods."
- "Success in trading means excess of profits over losses. If anyone tells you they can almost be invariably successful, put him down as trying to impose on your credulity."
- "While I have made it a practice to limit my risk in most cases, I can trace most of my principal losses to my failure to place stop orders when the trades were made."
- "Whenever a (market) situation is not entirely clear to me, I find I can clarify it by putting down on paper all the facts, classifying them as favorable and unfavorable. In thus writing it down on paper, I not only have time to reason out each point as I go along, but when I get it all down it can be looked over and analyzed to much better advantage."
- "People are successful in business because, while they make mistakes at first, they study these mistakes and avoid them in the future. Then by gradually acquiring a knowledge of the basic principles of success, they develop into good business men. But how many apply this rule to investing and trading? Very few do any studying at all. Very few take the subject seriously. They drift into the market, very often get 'nipped' as the saying is, avoid it for a while, return from time to time with similar results, then gradually drift away from it, without ever having given themselves a chance to develop into what might be good traders or intelligent investors. This is all wrong. People go seriously into the study of medicine, the law, dentistry, or they take up with strong purpose the business of manufacturing or merchandising. But very few ever go deeply into this vital subject (of trading and investing) which should seriously be undertaken by all."

Trader Linda Bradford Raschke Gets "Back To Basics"

Some of the best methods of technical analysis were formulated many years ago--well ahead of the computer age, according to Linda Bradford Raschke, the well-known market trader and lecturer.

"There is little 'new' technical analysis; it's all been touched on in some way or another" over the years, she said. Raschke was speaking at the Technical Analysis Group (TAG XVIII) workshop held in New Orleans and sponsored by Dow Jones Telerate.

Successful futures traders need to "get back to basics," said Raschke. She said traders that rely solely on computer-aided "trading systems" are overlooking a key element of the markets: "tape-reading," or the study of the price action.

"System" or "mechanical" trading methods use computer-generated signals that usually have a trader "in" the market much of the time.

"Do your homework the night before, and study price action," Raschke urged all types of traders.

Raschke relies on Keltner channels in her trading. Chester Keltner was a famous grain market trader with over 30 years of commodity trading experience. He was one of the first to pioneer systems work using trend-following rules.

One of the systems Keltner presented was the 10-day moving average rule. A 10-day moving average of the daily trading range was added and subtracted to a simple 10-period moving average--essentially forming bands.

These bands served as buy and sell stops by which to enter or exit a position. Keltner's original system was traded on a stop-and-reverse basis, which was mildly profitable, said Raschke.

By varying the bands on the most recent average daily price range, the channels will naturally be a greater distance from the market when the price swings are wide than when they are narrow. However, they will stay at a much more constant width than Bollinger bands, she said.

"You can see how you would have participated in the majority of a trend if you used Keltner's rules. Unfortunately, you would have experienced many whipsaws, too. This is because the system's intentions are to keep you in the market all the time," Raschke said.

"I put Keltner channels set at 2.5 times the 20-day moving average daily range, centered around the 20-period moving average. This is wide enough so that it contains 95% of the price action.

In flat-trading markets, as indicated by flat moving averages, it serves as a realistic objective to exit positions. However, I find its greatest value is in functioning as a filter to signal runaway market conditions, much as a rising ADX would do." (The ADX, or directional movement index, helps determine market trend.)

"Keltner channels will identify runaway markets caused by a large standard deviation move or momentum thrust. Thus, they can alert one much earlier to unusual volatility conditions than the ADX, which has a longer lag. On the other hand, (Keltner channels) will not capture the slow, creeping-trend market that an ADX will indicate."

Raschke's rule for defining trending markets: "If the bar (on the bar chart) has a close outside the Keltner channels, or trades 50% of its range outside the band, with a close in the upper half of its trading range, the market should not be traded in a counter-trend manner. Stay with the trend and trail a two-bar trailing stop."

Another trading technique Raschke relies upon is the Richard Wyckoff method of analyzing accumulation and distribution patterns.

On Wyckoff's trading methods, Raschke recommended traders read his book, "The Art of Day Trading," which is available at many publishing firms focused on business and investing.

One key component of Wyckoff's trading techniques involves a "critical" day. This usually involves a triangle formation on any bar chart—whereby price ranges and volatility are decreasing, to the point where a breakout in either direction is likely. Once the breakout occurs and a trend is under way, traders can get into the market and follow the trend.

In her presentation to around 150 futures and equities traders from around the world, Raschke also gave the following recommendations for all traders:

Always put current price action into perspective with historical price action. Raschke likes pivot points, as they determine whether prices are moving closer to, or farther away from, the pivot points.

When volatility expands, "impulse moves will be followed by more impulse moves. You don't have to hit the first move" to be successful in a trade.

The first hour of market trading usually is the most critical, when determining significant highs or lows in a market.

In "runaway" markets, one side (longs or shorts) is usually trapped. "Don't try to pick tops or bottoms."

Oscillators don't work well in strong-trending or runaway markets. They work best in choppy markets.

When a market looks at its very best, or very worst, a major change in trend is likely.

Raschke recommends that smaller-scale traders trade shorter timeframes than larger-scale traders.

On where and when to take profits and place stops in a market, she says, "How much do you want to win or lose? There is never a magic place to take profits or place stops." However, look at "swing moves" and key support and resistance levels closely. "Find your own comfort level."

The most successful traders "like to play the game" of trading markets. If you like the game, then you'll play a safe game and enjoy trading.

On trading psychology, Raschke says follow 3 rules:

- 1) Believe in "your" trading methodology.
- 2) Have a good attitude toward trading.
- 3) Concentrate. "Be 100% in the game."

There is no such thing as "mental stops." Always have your desired stops in place.

Raschke began her trading career in 1981 as a floor trader at the Pacific Coast Stock Exchange. In 1984, she became a member of the Philadelphia Stock Exchange, where she expanded to trading futures markets. She has been featured in "The New Market Wizards," by Jack Schwager, and also co-authored, with Larry Connors, the book, "Street Smarts."

Tom Bierovic: Thoughts on Trading, and a Successful Trading Method

Tom Bierovic got a taste of technical analysis early. At the age of 13, he had a part-time job updating daily and weekly bar charts for his father, who was a member of the Mid-American Commodity Exchange.

Bierovic has been trading for his own account since 1971. Through the years he has presented seminars on technical analysis and trading in 35 countries, and contributed the chapter on oscillators in Jack Schwager's 1995 book: "Schwager on Futures: Technical Analysis."

He was a featured speaker as part of the 20th annual Telerate Seminars Technical Analysis Group (TAG 20) conference in Las Vegas. He shared with me some of his general ideas on trading, as well as one specific trading method.

"The most important requirements for a trader's success are that he trades in a way that is consistent with his own personality and belief system," said Bierovic. " 'To thine own self be true,' as Shakespeare said." Bierovic said he has always needed "simplicity, structure and a clear vision of the path ahead" in order to trade successfully. "My trading method has to reflect those values."

"I need to know why I'm getting into a trade, where I'll get out if the market moves against me, and how I'll exit with a profit if the market trends in my favor. I have to be careful not to over-complicate my trading method, not to make up new rules as I go along, and not to lose sight of my goals."

Regarding entering a market, the risk and profit objective in a trade, Bierovic said one of his best indicators is called Momentum Retracement.

"In Momentum Retracement, I first determine the trend. I use exponential moving averages (EMA) of highs and lows with a faster EMA of closes. I confirm that trend indicator with the signal line of a sensitive MACD (Moving Average Convergence/Divergence). Second, I check to see if the trend has good momentum and consistent directional movement. I use an RSI (Relative Strength Index) to evaluate the momentum and the DMI spread to evaluate the market's current 'trendiness.'" (The DMI spread is the difference between the + Directional Index and the – Directional Index of Welles Wilder's Directional Movement Index.)

If Bierovic determines the market is in a good uptrend, he next looks for retracement. "At least three of these four conditions must be met: prices decline into a moving-average channel, the MACD line crosses below the signal line, the RSI declines below its midpoint, and the countertrend decline is at least a 38.2% but not more than a 61.8% retracement of the previous trend wave."

After he identifies a retracement: "In an uptrend with RSI declining at yesterday's close, I buy at a one-third retracement of the countertrend decline. In other words, one-third of the way back up. If RSI was rising at yesterday's close, I buy at one-third of the way back up or at a return to yesterday's high--whichever is lower."

Once in the market and long, Bierovic then sets a protective stop at the low of the countertrend decline "or at one 10-day average true range below my entry point--whichever is lower."

If the trade is going his way, "I trail a stop at the highest high since entry minus one tick more than the size of the previous corrective wave."

To review, Bierovic looks for an impulse wave and a corrective wave. He buys if the market starts back up, and he sets a "reasonable" protective stop. Then, he trails a stop the highest high since entry minus one tick more than the number of ticks in the corrective wave.

Bierovic does not always continue to trail a stop until the market stops him out. "There's a time to trail a loose stop and a time to trail a tight stop. On the day that the market reaches my profit target, I raise the trailing stop to the intraday low."

On his profit target, Bierovic relies on a "measured-move objective. It's a little complicated to explain, but here goes: After my entry into a long position, I look back on the chart and find the most recent pivot point low (a low with higher lows to its left and right on the chart) that would make the recent countertrend decline a 38.2% to a 68.1% retracement of the uptrend. Then I subtract that pivot-point low from the high of the uptrend and add the difference to the low of the countertrend decline. That's the measure-move objective."

"Vibrating Prices" and the Trading Philosophies of W.D. Gann

William Delbert (W.D.) Gann is regarded as one of the pioneers of technical analysis and market behavior. He wrote several books on stock and commodity trading and developed the well-known "Gann angles" and "Gann Fans."

Gann was born on a farm near Lufkin, Texas, in 1878. His rise to trading fame is a remarkable story. He was the oldest of many children on the farm, and did not even finish grade school. Back then, it was not uncommon for the oldest boy to quit school at a relatively young age and stay at home to help out on the farm.

However, W.D. did not want to be a farmer. He wanted to be a businessman. For a short period of time he worked for a brokerage in Texas while attending business school at night. He then set out for New York City in 1903.

In 1919, at the age of 41, Gann quit his job with a stock brokerage and set out on his own. He began publishing a daily market newsletter called the "Supply and Demand Letter." The newsletter covered both stocks and commodities and provided traders with his annual market forecasts.

In 1924, Gann's first book, "Truth of the Stock Tape," was published. A pioneering work on chart reading, it is still regarded as one of the best books ever written on the subject.

Gann's market forecasts during the Roaring Twenties were reportedly 85% accurate. The stock market in the 1920s was skyrocketing, but Gann didn't think the bull run would last. In his forecast for 1929, Gann predicted the stock market would hit new highs until early April, then experience a sharp break, and then resume with new highs until early September. Then it would top and afterward would come the biggest stock market crash in history.

After around 20 years in New York City, Gann moved to Miami, Florida for reasons of both health and personal preference. His "How to make Profits in Commodities" book came out shortly thereafter.

Following are the general tenets of Gann's trading philosophies and methods. I won't go into great detail on his specific methods in this feature. If you want to learn more about Gann's specific trading methods, I suggest you read his books, or books written about Gann, some of which are available at www.amazon.com.

Gann designed several unique techniques for studying price charts. His main theory uses three parameters to project changes in price trend and market direction. They are: Pattern, Price and

Time. These parameters can exert their influence individually, with one or the other being more determinate under different conditions. But they are best applied in a balanced manner. The basic idea is that specific geometric price patterns and angles have special properties that can be used to predict future prices.

He believed the markets are geometric in design and in function, and they follow geometric laws when they're charted. All of Gann's techniques require that equal time and price intervals be used on the charts. Thus, a rise of one price unit over one period of time (1 x 1) will always equal a 45-degree angle. Gann believed that the ideal balance between time and price exists when prices rise or fall at a 45-degree angle relative to the time axis. This is called a 1 x 1 angle.

Gann angles are drawn between a significant bottom and top (or vice versa) at various angles. Deemed the most important by Gann, the 1 x 1 trend line signifies a bull market if prices are above the trend line, or a bear market if below the trend line. Gann felt a 1 x 1 trend line provides major support during an uptrend, and when the trend line is broken it signifies a major reversal in the trend. Gann identified nine significant angles, with the 1 x 1 being the most important.

Gann said each of his predetermined angles provide support and resistance depending on the trend. For example, during an uptrend the 1 x 1 angle tends to provide major support. A major reversal is signaled when prices fall below the 1 x 1 angled trend line. Prices should then be expected to fall to the next trend line (the 2 x 1 angle). As one angle is penetrated, expect prices to move and consolidate at the next Gann angle.

Prices have a way of repeating themselves--or "vibrating," as Gann put it. One can think of vibration in terms of periodic oscillation, the theory of waves, or cycles, as in cycle theory.

Gann said in his own words, "Through the law of vibration, every stock and commodity in the market place moves in its own distinctive sphere of activities, as to intensity, volume and direction. All the essential qualities of its evolution are characterized in its own rate of vibration. Stocks and commodities, like atoms, are really centers of energy, and therefore, they are controlled mathematically. They create their own field of action and power--power to attract and repel, which explains why certain stocks and commodities at times lead the market and turn dead at other times. Thus, to speculate scientifically it is absolutely necessary to follow Natural Law. Vibration is fundamental; nothing is except from its law. It is universal, therefore, applicable to every class of phenomena on the globe. Thus, I affirm, every class of phenomena whether in nature or in the markets, must be subject to the universal laws of causation, harmony and vibration."

There is no question that Gann's trading track record in the 1920s was truly remarkable. And, his trading methodology certainly has merit. However, I think the most important tenets of Gann's success were stated in a paper published by Gann's grandson, edited excerpts of which are below:

"Delbert Gann of Lufkin, Texas, started with nothing. He and his family had no money, no education, and no prospects. But less than 40-years after overhearing businessmen talk on railroad cars in Texas, W.D. Gann was known around the world.

"Hard work pays. W.D. Gann rose early, worked late, and approached his business with great energy. Virtually all his education was self-administered. This teacher, writer, and prescient forecaster had a third-grade formal education. But he never stopped reading.

"Unconventional thinking may have its merits. W.D. was intellectually curious to an extraordinary degree. He was unafraid of unorthodox ideas, whether in finance or in other areas of life. He wasn't always right--none of us are--but he dared to pursue a better idea.

"And finally, the only lesson for traders I will venture to offer is W.D. Gann never stopped studying the market. Even after his forecasts happened, even after he achieved international acclaim. Although he believed in cycles, he also knew that markets are always changing and that decisions must be made based on today's conditions, not yesterday's."

W.D. Gann's personal characteristics, as related by his grandson, are strikingly similar to two other famous traders of Gann's same era: Jesse Livermore and Richard Wyckoff.

Stan Erlich and Mark Cook on “Trading to Win”

I've made an effort through the years to try to attend the quality seminars featuring the very best futures traders in the world. This type of trading and markets education allows a class-room type of learning environment, where one can ask questions, meet your peers and even speak directly with the trading expert after the lecture. Of all the seminars and lectures I've attended through the years, there has not been one time that I left feeling like my head was not filled to the brim with useful information.

As a journalist, I also conducted dozens of interviews with top traders. Following are three short stories that I wrote after attending a Technical Analysis Group (TAG) seminar in Las Vegas a few years back.

VETERAN TRADERS SHARE THEIR STRATEGIES

Following are some trading and technical tidbits this writer picked up from the TAG 21 conference, which was put together by Tim Slater, a respected technician in his own right.

- One of the themes coming out of this year's conference was the increased volatility in the stock market, and how traders with a futures-related trading background have used their experience with volatility to obtain better entry and exit points in stock trading. Most agreed that whether one trades stocks, or financial futures, or commodity futures, there are key trading techniques and tenets that apply to all three.
- All the speakers heard by this writer pointed out that successful traders must have a specific trading plan before they execute a trade--and show keen discipline in following through on the plan. This includes entry points and potential exit strategies--including setting stops. Always set a stop when trading.
- Keep a diary when trading. This helps identify any trading mistakes, or trading successes, in future decision-making on trades.
- Have a money-management plan. This is a must. Know what your financial risk tolerance is and trade accordingly.
- Don't add to a losing position.
- If you are in a trading slump, take a break for a few days or weeks, in order to reflect upon your trading methodology.

- Do not overtrade. This is a common mistake among many traders.
- Take advantage of market trends. "The trend is your friend" saying rings true. Use extra caution when trading against the prevailing trend of the market. Don't try to pick tops or bottoms.
- Let your profits run and cut your losses quickly.
- The fundamentals in any given market are always most bullish at market tops and most bearish at market bottoms. This is where the "buy the rumor, sell the fact" anecdote sometimes comes into play.
- There is no Holy Grail in trading. There is no "free lunch." Trading successfully is hard work.
- Most speakers said their methodologies should be used as one "tool" amid a variety of tools in your own trading "toolbox."

In the next part, more specific ideas attributed to individual veteran traders will be examined.

STAN EHRLICH ON "SIMPLE CYCLICAL ANALYSIS"

Stan Ehrlich's highly informative lecture at the TAG 21 conference was entitled "Simple Cyclical Analysis."

Ehrlich began his career as a runner on the floor of the Chicago Mercantile Exchange in 1971. He presently owns Ehrlich Commodity Futures, based in Novato, Calif.

Following are some highlights of Ehrlich's presentation:

- The use of cycles can help a trader anticipate when a market turn may be likely to develop. The monitoring of technical studies, especially at those potential cyclic turning time periods, should help warn the trader that a turn is imminent, or in the process of occurring.
- Market tops and bottoms often occur when the average trader may be caught up in the emotional fundamental developments of the moment. That's why it's so hard to pick tops and bottoms, because fundamentals are most bullish at tops and most bearish at market bottoms. This is why "contrary opinion" trading works well.
- Cycle analysis helps the trader better anticipate market tops and bottoms.
- When the general public catches wind of a strong-trending market and starts to trade it, that is many times when the top is achieved in the market.

- When analyzing a market, look at the longer-term charts and cycles for a bigger market perspective. Then work into shorter-term charts and cycles.
- Ehrlich showed the group his Ehrlich Cycle Finder. This is a neat little gadget that, when put over a chart, allows even a beginner to locate a cycle on a chart.
- Options traders find cyclical analysis especially useful when trying to identify market tops or bottoms.
- Ehrlich's favorite one-day turning signal is the key reversal pattern. A bullish key reversal is defined as a day when the low is lower than the previous day's low, and the high is higher than the previous day's high-and the close is higher than the previous close. A bearish key reversal would be when the market closes below the previous close. He said he generally believes that if the high and low exceed the previous day's high and low by very small amounts, then the signal will be less powerful. High volume increases the validity of the signal, while low volume makes the signal suspect.

MARK COOK ON HOW TO SURVIVE AT FUTURES TRADING

The title of Mark Cook's lecture at the recent TAG 21 conference in Las Vegas may seem a little odd at first: "How to Lose Money Profitably." However, successful traders know it's the amount of profit realized in trading that's important--not just the percentage of winning trades.

Cook is from East Sparta, Ohio, and operates M.D. Cook, Inc. from his family farmhouse. He manages his own proprietary account and offers a trading advisory service, "Mark D. Cook's Trader Advisory," which focuses on S&P 500 futures, T-bonds and OEX options.

This professional trader's lively presentation focused on knowing your own risk tolerance in trading and preserving capital.

"A great trader who has made tens of millions of dollars from the stock and commodities markets told me the one individual universal reason for failure is the inability to take a loss. This has become my motto, as the true path to riches lies not with the wins, but managing the losses in a prudent, confrontational manner," says Cook.

He shared with the audience his first few years of unsuccessful trading, including losing large sums of money. Then, he came back from the brink. Sheer determination and hard work are factors Cook cites that turned him into a successful professional trader.

He developed the Cook Cumulative Tick indicator, and overbought-oversold indicator which draws on correlations between the S&P 500, T-bonds and S&P 100 index (OEX) options.

Cook won the 1992 U.S. Investment Championship with a 564% return.

The trading veteran advises traders to keep a trading diary and have a daily ritual when trading. Have a trading "battle plan" before entering the trade. He said traders should have complete faith in the indicators they use to trade.

Trading losses will occur with every trader. The key is to manage those losses and not let ego get in the way of sound decision-making.

"The true path to success always must journey through failure. All--and I mean all--the million dollar traders I know had severe losses. And only when they coped with the losses did they achieve true success," Cook said. "The road is long--perhaps five to 10 years. The emotions will sometimes be an obstacle that just plain wins that battle.

"The true winner is the one who perseveres. The race is a marathon and not a sprint. Recognition that all humans fall short of perfect is the first step to the trek to knowing yourself and knowing your limitations.

"However, you must also keep foremost in mind that our God-given talents are very rarely realized to the true extent of the gift.

"Trade and prosper--it is an attainable American dream," Cook said.

John Murphy's Key to Success: Simplicity

"My work has gotten better due to simplifying my approach," John J. Murphy, the veteran technical analyst, author and CNBC resident technical analyst, told a group of equities and futures traders attending the Technical Analysis Group (TAG) XVIII trading conference sponsored by Dow Jones Telerate in New Orleans.

Murphy said he relies heavily on five or six "useful" technical indicators, including relative strength indicators, trendlines, moving averages, Bollinger bands, classic chart patterns such as triangles and double tops, and Fibonacci retracement levels.

"You must trade a combination of technical signals, not just one" indicator, said Murphy. He said that many times he'll set up a "good" column and a "bad" column regarding technical studies. If the "good" column has the overwhelming evidence supporting a selected trade, Murphy will enter the trade. But if the evidence supporting a trade is not strong enough, he'll bypass the trade.

Murphy correctly called the topping of the U.S. semiconductor stock index (SOX) during mid-summer (of the year this story was written). His reasoning was plain and simple: the SOX uptrend line was broken, followed by a double-top formation. "The first sign of a top is breaking of an uptrend line," he said.

On moving averages for individual stocks, Murphy likes to use the 50-, 100-, and 200-day moving averages. If the 200-day moving average on an individual stock is broken on the downside, "big trouble" is in store for that stock. Also for stock sectors, he said if a 50-day moving average breaks down, "that sector is in trouble."

Charting a stock market sector divided by the S&P 500 is a favorite method the veteran technician uses to determine if a given sector is underperforming the broad market. (Examples: SOX index divided by S&P 500 index, or NASDAQ index divided by the S&P 500 index.)

Another good technical indicator is the Moving Average Convergence Divergence (MACD), said Murphy. The MACD uses exponential moving averages, as opposed to the simple moving averages used with an oscillator. Gerald Appel is credited with developing the study.

Longer-term technical signals are more powerful than shorter-term signals, said Murphy. "Longer-term charts give you the value of perspective," he said.

Many traders consider Murphy's book, "Technical Analysis of the Futures Markets" to be the bible of technical analysis. Murphy heads his own consulting firm, based in Oradell, N.J.

Hank Pruden on "Behavioral Finance" and Technical Analysis

Hank Pruden's theory of "Behavioral Finance" proposes that human flaws are consistent, measurable and predictable, and being aware of and utilizing this phenomenon can benefit a trader.

"For the better part of 30 years, the discipline of finance has been under the thrall of the random walk\cum efficient market hypothesis. Yet enough anomalies piled up in recent years to crack the dominance of the random walk. As a consequence, the popular press has been reporting the market behavior," said Pruden. One of these new methods discussed is "behavioral finance."

Pruden is a professor in the School of Business at Golden Gate University in San Francisco. He was a featured speaker at the 20th annual Telerate Seminars Technical Analysis Group Conference (TAG 20).

Behavioral finance is "the use of psychology, sociology and other behavioral theories to explain and predict financial markets. Behavioral finance describes the behavior of investors and money managers and their interaction in companies and securities markets. It recognizes the roles of varying attitudes toward risk-framing of information, cognitive errors, lack of self-control, regret in financial decision-making and the influence of mass or herd psychology," said Pruden.

Predictable human behavior can and does impact markets, said Pruden. One example is the "crowd psychology" or "bandwagon" theory. For example, if a market is coming up from a basing area on the charts, "smart money" is responsible for the majority of the initial buying. "As people jump on board, we see the bandwagon effect, and that bandwagon pushes prices up. Volume tends to surge at its peak, certainly on the buy side, during the mark-up phase in the middle. Later on, toward the end of the trend, smart money is not doing the buying; somebody else is. The smart money is doing the selling. The market tops by curving over, or sometimes with a spike top. So, we can see express that in price and we can see under it in volume," said Pruden.

Regarding the type of trading approach to the bandwagon effect, Pruden said, "We align our indicators to show a distribution pattern or a breaking of trendlines, and we should see a post-volume peak. Volume will typically peak before a big change in sentiment."

Pruden said he puts time, price and sentiment together to come up with a composite to look at all those parameters at once. This composite would help in any trading decision, he said.

In the four major elements of technical analysis—price, volume, time and sentiment—recognizing and factoring in human behavior is certainly a major portion of the sentiment element, said Pruden.

At Golden Gate University, Pruden developed and teaches accredited courses in technical market analysis.

Futures Trader Joe DiNapoli: Faring Well in a Tough Business

Achieving success as a futures market trader can be a daunting proposition, most traders will agree. Given that premise, why would a successful, longtime futures trader like Joe DiNapoli reveal his trading secrets to the public?

“Commodity traders tend to be risk-takers--self-made people. I enjoy them immensely. The public doesn’t realize some of the advantages you receive by teaching your successful methodologies,” said DiNapoli, president of Coast Investment Software, Inc., in Sarasota, Fla. He is in New Orleans speaking at the “Tag XVIII” traders conference, sponsored by Dow Jones Telerate. His topic is Fibonacci ratios and displaced moving averages.

“Obviously, there’s the money that one can make from selling a (trading) system or teaching. But the contacts you make--literally around the world--couldn’t be bought at any price. If you have something worthwhile to say, exposure also gives you access to other professional traders, and that access cannot only be intellectually stimulating, but it can be financially beneficial. You can fine-tune your trading methods by brainstorming with others,” he said.

DiNapoli has given trading seminars all over the world--in major centers in Asia, Europe and the Middle East. In 1996 alone, he’s spoken in over 20 different countries.

A book due out in January, entitled “Trading Systems: Secrets of the Masters,” by Joe Krutsinger (published by Irwin Professional Publishing), has an extended interview with DiNapoli.

In 1967, DiNapoli finished engineering college and began seriously trading. “Back in those days, I was dealing with low-capitalized, small over-the-counter stocks, where you’d lose 15% to 25% just in the bid\ask spread.” He started trading commodities around 1980.

“My educational background is electrical engineering. Of course, I really didn’t like engineering, but that background has been an unbelievable help to me as a trader. Good engineers think in structured patterns. That’s the way I think--disciplined and structured.

“At this point, I trade my own account. I don’t manage money and I don’t want to. I teach and have a software company” DiNapoli has been a registered CTA since the mid-1980s.

“The trading techniques I use are substantially different than those used by other people. I mix leading and lagging indicators and interact with prices based on that approach. I use certain lagging indicators like Displaced Moving Averages and the MACD/Stochastics combination, to determine the trend.

Displaced Moving Averages allow a trader to shift or center the moving average on a price chart. A trader specifies the length for one or more moving averages, then selects the number of intervals to displace the moving average.

Moving Average Convergence/Divergence (MACD) uses exponential moving averages, as compared to the simple moving averages used in an oscillator study.

“Once I’m in a trend, I use Fibonacci analysis as a leading indicator--to position myself within that trend. The last step is to take ‘Logical Profit Objectives.’ Those profit objectives are calculated by certain Fibonacci techniques.”

DiNapoli has spent a lot of time developing his present trading system. “I use Displaced Moving Averages, for example, in very specific and unique ways. I think I’ve really done my homework on that one--about three years worth of research in the early 1980s. During the mid-1980s, I spent another three years or so determining the most effective method to utilize Fibonacci techniques.

“I think I’ve done a good job separating the best from the good, or average. Sometimes it’s not a matter of developing a brand new indicator. It’s a matter of utilizing an existing indicator in a more effective manner. For example, instead of using standard moving averages, I use Displaced Moving Averages.

“In fact, back in the mid-1980s, when I started speaking about this, there weren’t any computer programs out there available, except our own, that would displace a moving average. Prior to that, some people used the opens, instead of the close, to determine the moving average, so that they would know what the moving average value was before the end of the day.

“When you displace a moving average, say, five days, you know what the moving average is going to be up to five days out. There was no longer any reason to use the open. Unfortunately, many of the graphics software programs that displace moving averages don’t show them past the last day’s price action. It’s an example of programmers creating trading software, rather than traders.”

DiNapoli’s best and current trading system is an approach he has used continuously for years. He buys dips in an uptrend and sells rallies in a downtrend.

“The lagging indicators allow me to determine trend. The leading indicators, primarily Fibonacci analysis, allow me to safely place myself within that trend. I use ‘Logical Profit Objectives’ continually and I have oscillators that are used as filters, to keep me from entering in the direction of a trend which is too dangerous to bother with.

“I also have about eight trading patterns or conditions which act to give me the direction of a market. If they are in conflict with the trend analysis, I always go with what the patterns are telling me.”

On timeframes he uses when trading, DiNapoli said, “The approach I take to the market is exactly the same--whether I use monthly charts or 5-minute charts. In 1980, I was trading primarily daily charts, and in about 1983 I went down to the 5-minute world.

“I could learn more and develop my approach more quickly in the 5-minute world than on dailies--particularly relative to Fibonacci analysis. So, in the development phase of it, I gained more experience in less time, by trading 5-minute charts.

“I went through this development process by actually trading--not theorizing. I think most good systems should be applicable across timeframes. If they are not, it’s a red flag.”

Stepping back from the markets on a regular basis is paramount, said the veteran trader.

“I will tell you one thing I try to do every single day that affects my performance as a trader: I think, at least for a few hours a week, every commodity trader should do something that he or she really enjoys. Something that does not involve the markets or the computer.

“I like working with my hands. I restore classic cars, things like that. You need to be able to settle the mind and avoid all that frenetic activity. The graveyard of past traders is littered with those who couldn’t get the needle out of their arms. Markets can destroy you emotionally, physically and financially. You must keep perspective.”

Chase Manhattan Technical Analyst Tirone: "You Need Game Plan"

All successful traders have one common, yet very important ingredient in their trading methodologies: a game plan.

“When it comes to planning, many traders can be compared to the German army during World War II--in that the invasion of Britain was planned but never executed, while the Battle of Britain was executed, but never planned,” said John C. Tirone, senior technical analyst for Chase Manhattan Bank in New York, and a trader for 30 years. “Many traders and investors go through their sometimes very short investing lives planning trades they never execute and executing trades they never plan.”

Tirone was speaking at the Technical Analysis Group (TAG XVIII) meeting in New Orleans, held last week and sponsored by Dow Jones Telerate.

“Experience has proven that success follows the wise trader/investor who identifies an effective strategy, and has the discipline necessary to carry it out,” said Tirone. He said there are two key elements that distinguish the successful trader from the unfortunate majority: strategy and discipline.

Tirone said many traders take positions “based on impulse, hunch, or what they read from a newsletter--instead of reason--and then wait to get lucky. They have not learned or probably even thought about the fact that even the very best traders consider themselves fortunate to be right on most trades, or even to make significant profits during most years.”

“If the trader will take the time to plan his trades properly, he can possibly have the odds on his side in the long run, which is something few gamblers could ever attempt to achieve. Over the long term, those traders/investors that are still operating in the markets--and who have followed a carefully thought out and well-defined plan in a disciplined manner--expect to have favorable results,” said Tirone.

The basic elements of a trading plan should provide the reason for logically entering and exiting a position, whether it proves profitable or not. “Once a position is entered, the price can only take three paths: rise, fall or remain unchanged . . .”

“The heart of a game plan must indicate, unequivocally, how the trader is to exit from a trade he has entered.” Likewise, this critical area consists of three parts: 1) accepting losses if a position shows adversity; 2) a plan for accepting profits; and 3) a plan for exiting a trade if the price, over time, is negligible or does not meet expectations.

Exiting from a trade that shows a loss is best done with a stop that is implemented at the time the trade is executed, said Tirone.

Trading plans may be mental or written, but written plans are best, said Tirone, as they are more likely to be followed by the trader.

In a written trading plan, traders should include: markets traded, long or short positions, risk exposure per trade, total portfolio loss (not win) if wrong, and commissions paid. Also, considering each trade on its own merits may result in having a number of positions all long or short, and the risk exposure thus being heavily skewed in one direction (even if it may be the correct direction).

Traders should plot the amount of capital exposed per trade and its relation to total capital. "This is one way to force the trader to think of the dollar value of such a trade before it is entered," said Tirone.

Other factors to log in a written trading plan include:

- * Reasons for entry into the position. This is "critical because you have to know why you are in this particular market at this time, said Tirone."

- * Note the actual price of entry into the market, and how it compares with your planned entry price. "The differences between planned entries and actual entries are sometimes great and could affect trading results."

- * Note the stop-loss price level and the liquidation plan once the market is entered, as well as the minimum profit objective and does it correspond with the risk involved in the trade.

- * The trader should check his record of closed profits and losses, to ensure that results generally parallel the plan's expectations regarding profit or loss.

"The final section of the plan is the 'trade evaluation,' which is commentary and control of the trader's discipline. It is like a diary the trader should keep for a very long time, to compile his trading statistics.

"In essence this is what all successful traders do, and the results of the plan should be in accordance with his objective and risks parameters.

"The trader should have a plan form that is complete for every trade, and a strong enough discipline so that there is seldom a significant variation within his control between the actual and possible events," said Tirone.

Kaufman: Multiple Trading Methods and Market "Noise"

Many traders attempt to find the single-most "robust" trading strategy possible by looking for one set of rules which works for all markets. Such systems don't take into account the fact that markets can change quickly and dramatically due to a news event, according to Perry Kaufman.

"There are times when a market is volatile, or moves unusually, and you need to take different strategies to trading," said Kaufman, a market strategist, author and director of research for the consulting firm Kaufman, Diamond & Yeong, based in Wells River, Vt. He was speaking at the Technical Analysis Group (TAG XVIII) traders conference, held here late last week and sponsored by Dow Jones Telerate.

"Price shocks"--a government economic report or other major news event--can quickly turn a quiet, sideways market into a volatile and highly discretionary one, he said. A trading system that works in a sideways market will likely not work well in a volatile one.

Kaufman focused on what he terms "market noise," which is the unpredictable movement of a market. He said more active markets have more market noise, and are therefore harder to trade.

The formula for measuring "market noise" is as follows, according to Kaufman: Change in price divided by the sum of each price movement over a period of time.

More market noise means it takes longer for a trader to identify a trend in a market, said Kaufman. He said the S&P 500 futures are very "noisy," and therefore need a longer time for a trend to develop. Conversely, Eurodollars have less noise, so traders can jump on a price trend in a shorter period of time.

Very long timeframes make market noise less significant, said Kaufman. For short-term trading, noise is more important than the trend, he said.

"Short-term (price movement) is mostly noise and long-term is mostly trend," said Kaufman.

"If a market has high noise, you should not trade with a trend-following system," he said.

Kaufman ranked the world's markets by their "noise" factor--keeping in mind his proposition that less noisy markets are easier to trade.

Brazil has the least market noise because it's an emerging marketplace, said Kaufman. There's less participation in emerging markets. Thus, "you can trade trend-following systems and faster

moving averages” in those markets, he said. Indonesia, Turkey, Malaysia and South Africa are among the other less noisy world markets, he said.

The U.S. markets are the noisiest, most active markets, and hardest to trade, said Kaufman. France, Japan, Germany and U.K. markets are close behind.

How Richard Lees Incorporates Physics Into His Technical Analysis

Stock market and options trader Richard Lees has combined physics, pattern recognition and technical analysis to form several new “pH-Indicators” to guide him in trading.

Lees is a money manager and president of Richard Lees Capital Management in the Studio City area of Los Angeles. He is a featured speaker at the Telerate Seminars 20th annual Technical Analysis Group (TAG 20) conference here this weekend.

“I began to trade the markets in 1982 when, after my father died, managing family money arose literally from a life-and-death situation as my responsibility in the family. So the enterprise has, from day one, left me with little patience for hypothetical market methods,” said Lees.

He has studied technicals, fundamentals and systems trading that combined them both. “Eventually, I felt my own way to what worked in real time and with real money,” he said.

After some valuable additional encouragement from one of the “wizards” in Jack Schwager’s book, “Market Wizards,” Lees developed an entirely new set of indicators.

“The indicator set, which is what I’m introducing for the first time in public at TAG 20 in Las Vegas, is called The pH-Indicators. And they are elastic, or what I like to call liquid oscillators. They do not reach, what conventional oscillators call ‘overbought’ and ‘oversold,’ but rather establish trend points which give signals, although in all timeframes. I use them on everything from intermediate signals on the stock market to day trading.”

Lees said three proprietary indicators are literally enough for him to reviewuate the stock market.

“One is pH-F, my fundamental indicator, and keys off the S&P earnings yield rather than its price-earnings ratio. This has kept me on the right side of the bull market of the 1990s.

“Second is pH-L, my Liquidity Indicator, which sits at the heart on my work. It is a simple, but I think elegant, way I’ve found to connect what the Federal Reserve is doing in the real economy with how the stock market is valuing that real economy.

“Last is pH-I, my Market Internals indicator, which gives me everything technical I need to know about market action in one indicator. It’s kind of an updated version of TRIN, and it was formed at least in part because of my simultaneous admiration for and disappointment in TRIN. I would emphasize that I consider Richard Arms one of the true brilliant men in technical analysis, and I’ve long admired his work. It’s just that I found what I consider a more immediate and fast-

changing indicator which I believe is more suited to the electronic markets of today and tomorrow.”

Lees said he then combines what these indicators are telling him about the market to produce an Overall Market-pH number, which is also the percentage he will be invested at any given time in the market. (i.e., if the Overall Market-pH is 9.3, he wants to be 93% in the market with his stock picks.)

Then he uses a 21-point Screen he developed for picking stocks, which essentially identifies “a key data signature that I’ve found over the years selects value just before it’s about to become growth.”

“I’m effectively always in the market then, but at different levels of commitment. I believe in stock picking, not mutual fund investing, as I believe money managers should be paid for picking stocks, not other money managers.”

Trader Linda Raschke: Tips On Day-Trading the S&P 500

The S&P 500 futures market is a trading arena unto itself, which can accommodate many different trading styles, according to Linda Bradford Raschke, a well known trader, lecturer and president of LBR Group, Inc.

“Not only does this market display a different daily profile than the other futures markets, but it has a much longer “length of line” (intraday swings), which offers more trading opportunities, she said. “Additionally, there is a wealth of information provided by many internal indicators on the equities market that some professionals like to monitor.”

Below, the longtime trader provides some tips on trying to be a successful S&P 500 day trader. “However, let me also say that the majority of the professional S&P day traders I know tend to specialize in just one pattern or trade just one style. This is definitely a market where overtrading can be a temptation.”

“Swing Trading” Concepts

The principles of “swing-trading” involve applying basic technical analysis to the secondary fluctuations which occur in a market, said Raschke. “We can apply these principles to all timeframes and all markets, but they work particularly well with the S&Ps, so a brief summary is first in order.”

Swing trading is following the price action and learning to anticipate the market’s most probable course of action. “We learn to determine the immediate trend by observing whether upswings are greater or lesser than downswings. In a simplified model, we look to enter on retracements in the direction of the trend. An early sign of a trend reversal is a ‘test’ of a most recent extreme price level which usually forms a higher low (or lower high).”

A trend reversal is confirmed when the upswing leg exceeds the length of the downswing (or vice versa). If a trader enters a position on a “test” looking for a trend reversal, but does not get this confirmation, he should exit the trade or pull his stop up close to his entry price, said Raschke.

There are also periods of market rest, consolidation or low-volatility range contractions. These patterns provide an opportunity for traders who like to trade “volatility breakouts”--a methodology in which one waits for the market to tip its hand with a powerful thrust and then jumps on board in the direction of the movement. “This too, can be a form of swing trading, as we are playing only for the market’s next immediate move and not making any longer-term valuation judgments.”

“When a trader practices the principles of swing trading, he learns to develop a conceptual roadmap in his head. In the S&P market, it is particularly important to learn to think in terms of concepts because there can be so much distracting intraday noise.”

Some more examples of concepts, in S&P 500 trading, are: mid-morning trends tend to carry into 11 a.m. Central Time, plus or minus 15 minutes. The best average intraday trends tend to last 45 to 90 minutes before having a countertrend reaction. The earlier a trend starts, the earlier it “peters out.” There is often an opportunity to play off a reversal of the move into 9 a.m. Central Time, plus or minus 15 minutes. The markets tend to be more emotional at the beginning of the day, when a good move counter to the initial opening swing can occur.

“If you learn to think in terms of concepts, you can master the markets instead of becoming a slave to the charts,” said Raschke.

Time-of-Day Tips

On average, there are only two to three “great” S&P 500 intraday “legs” or swings, said Raschke. “Most professionals catch only three or four really great trades a week, if that. Most trades will often be very small wins and losses. So don’t be too harsh on yourself if you feel that you are missing the majority of the movement. Overtrading suckers one into seeing only the trees and missing the forest.”

Traders tend to be creatures of habit, and thus it is easy to compile market tendency charts. There are several key patterns which have held constant over time, she said. “One common pattern might be the market rallies or sells off into noontime. At this point, a large percentage of the floor traders and brokers in New York go to lunch and a countertrend correction begins. When the late stragglers get back from lunch, the morning direction tries to reassert itself again.

“If the afternoon rally or sell-off starts too soon, it won’t be able to sustain itself through the end of the day. It will die out around the bond close. However, if there is an afternoon ‘shakeout’, usually between 1-1:30 p.m. Central Time, then the market can finish in a trend mode into the close.”

Raschke said not to fade a move into the last hour of the day, “for there is no time to exit gracefully if wrong. The odds suggest a better entry price the next day on the probable morning follow-through. Moves on Friday tend to end at 2 p.m., not 3 p.m. Central Time, as too many traders prefer to flatten out or even up before the weekend.

“On many days there occurs what I call the 2 o’clock jiggle. Right around the time the bonds close, there is a great 10-15 minute scalp trade. I believe it occurs as an emotional reaction to how the bonds go out. The trade usually lasts for no more than 10 to 20 minutes, but is fun to anticipate.”

Sometimes a good selling opportunity occurs around 1 p.m. Central, she said. “In fact, it is amazing how many good turning points occur on hourly readings, for example, 9:00, 11:00, 12:00. It think this is because people are more conscious of time at these moments, creating a slightly sobering effect.”

Mark Cook on "How to Lose Money Profitably"

The title of Mark Cook's lecture at the recent TAG 21 conference in Las Vegas may seem a little odd at first. However, successful traders know it's the amount of profit realized in trading that's important--not just the percentage of winning trades.

Cook was a featured speaker at the Technical Analysis Group (TAG) 21 conference, sponsored by INO.com and held the weekend of Nov. 19-21 in Las Vegas. The annual conference is put together by Tim Slater and consistently features some of the world's best traders--be it in stocks, options or futures.

Cook is from East Sparta, Ohio, and operates M.D. Cook, Inc. from his family farmhouse. He manages his own proprietary account and offers a trading advisory service, "Mark D. Cook's Trader Advisory," which focuses on S&P 500 futures, T-bonds and OEX options. (Phone: 330-484-0331; email: cookfax2@aol.com)

This professional trader's lively presentation focused on knowing your own risk tolerance in trading and preserving capital.

"A great trader who has made tens of millions of dollars from the stock and commodities markets told me the one individual universal reason for failure is the inability to take a loss. This has become my motto, as the true path to riches lies not with the wins, but managing the losses in a prudent, confrontational manner," says Cook.

He shared with the audience his first few years of unsuccessful trading, including losing large sums of money.

Then, he came back from the brink. Sheer determination and hard work are factors Cook cites that turned him into a successful professional trader.

He developed the Cook Cumulative Tick indicator, and overbought-oversold indicator, which draws on correlations between the S&P 500, T-bonds and S&P 100 index (OEX) options.

Cook won the 1992 U.S. Investment Championship with a 564% return.

The trading veteran advises traders to keep a trading diary and have a daily ritual when trading. Have a trading "battle plan" before entering the trade. He said traders should have complete faith in the indicators they use to trade.

Trading losses will occur with every trader. The key is to manage those losses and not let ego get in the way of sound decision-making.

"The true path to success always must journey through failure. All--and I mean all--the million dollar traders I know had severe losses. And only when they coped with the losses did they achieve true success," Cook said. "The road is long--perhaps five to 10 years. The emotions will sometimes be an obstacle that just plain wins that battle.

"The true winner is the one who perseveres. The race is a marathon and not a sprint. Recognition that all humans fall short of perfect is the first step to the trek to knowing yourself and knowing your limitations.

"However, you must also keep foremost in mind that our God-given talents are very rarely realized to the true extent of the gift.

"Trade and prosper--it is an attainable American dream," Cook said.

Trader Mark Cook Reveals His Rules For Day-trading

A day trader is a cross between an extrovert and an introvert, with both characteristics in balance, according to Mark Cook, a veteran trader from East Sparta, Ohio.

“The introvert aspect is depicted by the disciplined workaholic with a reclusive concentration. The extrovert aspect is depicted by an aggressive, competitive, self-motivated individual striving to be the best in a selective profession,” said Cook.

Cook won the 1992 U.S. Investment Championship with a 563% return on his money. He is a featured speaker at the Telerate Seminars Technical Analysis Group (TAG 20) conference held here this weekend.

Each trading day, “I am a creature of habit, going through a daily ritual before the markets open. I outline in detail all three possible scenarios for that day: up, down or sideways. I assign a probability to that scenario and make a written strategy plan, which has been incorporated into a trading fax service that is devoted to teaching people how to trade. Thus, a disciplined trading plan is imposed on me.”

Every day trader must be “flexible, alert and feisty,” said Cook. The flexibility must be used to shift from being long to being short “literally within seconds.” The alertness is used for observing price movements that are an aberration from the norm, he said. “Feistiness is the savvy aggressiveness to fight back with a vengeance to regain money you lost. I don’t know how many times I’ve seen people lose money in the morning and quit. My most profitable days are when I lose money in the morning and stay in because I want to get it back.”

For 12 years, Cook has kept a daily diary of trading patterns he has observed. He said the diary is “priceless” because price patterns occur much more frequently than most realize. Regarding keeping a diary, Cook uses the adage: “If you don’t know history, you’re doomed to repeat it.”

The following are Cook’s seven major rules for day trading:

1. **DO NOT TRADE THE LAST HOUR OF THE DAY IN THE S&P 500 FUTURES MARKET.** The probabilities of a successful trade diminish in this timeframe due to the impulsive and reckless buying and selling by institutions just because they didn’t get their trading done earlier, said Cook.
2. **IF YOU DON’T LIKE THE TRADE YOU’RE HOLDING, GET OUT.**
3. **AFTER TWO HOURS OF TRADING, ASK YOURSELF: “DO I FEEL GOOD ABOUT MY TRADING TODAY?”** Once two hours have passed, Cook says a day trader should have

made at least two, or perhaps more, trades, “but enough to evaluate what you have done.” If the trader feels good about the day’s trading, continue. If not, stop trading that day.

4. **ALL CYLINDERS OF THE ENGINE MUST BE RUNNING EFFICIENTLY.** “Day-trading is a job, and your paycheck is determined by your ability. You can only maximize your ability if you have all the information you need to make trading decisions. “If a piece of equipment that one uses for trading is not working, stop trading.
5. **HAVE COMPLETE FAITH IN YOUR INDICATORS.** “This is a must for success,” said Cook. “Many times your indicators give you a buy or sell signal, and you don’t follow it because you don’t have the confidence the signal is right this time. Successful day traders believe in their indicators, but also are aware that nothing is 100% foolproof.”
6. **TO ANYONE WHO ASPIRES TO BECOME A DAY TRADER, OBSERVE THOSE WHO ARE SUCCESSFUL.** “Any information you can procure on the trading philosophies, mechanics and techniques is well worth your while.”
7. **DAY-TRADING IS A LONG-TERM COMMITMENT.** “I fervently believe it takes several years to become a true professional,” said Cook.

Stan Ehrlich: Using Simple Cycle Analysis for Profit

Stan Ehrlich's highly informative lecture at the TAG 21 conference, held in Las Vegas, was entitled "Simple Cyclical Analysis."

Ehrlich began his career as a runner on the floor of the Chicago Mercantile Exchange in 1971. He presently owns Ehrlich Commodity Futures, based in Novato, Calif. (Ph. 800-323-7898) (email: stanecf@earthlink.net).

Following are some highlights of Ehrlich's presentation:

- * The use of cycles can help a trader anticipate when a market turn may be likely to develop. The monitoring of technical studies, especially at those potential cyclic turning time periods, should help warn the trader that a turn is imminent, or in the process of occurring.
- * Market tops and bottoms often occur when the average trader may be caught up in the emotional fundamental developments of the moment. That's why it's so hard to pick tops and bottoms, because fundamentals are most bullish at tops and most bearish at market bottoms. This is why "contrary opinion" trading works well.
- * Cycle analysis helps the trader better anticipate market tops and bottoms.
- * When the general public catches wind of a strong-trending market and starts to trade it, that is many times when the top is achieved in the market.
- * When analyzing a market, look at the longer-term charts and cycles for a bigger market perspective. Then work into shorter-term charts and cycles.
- * Ehrlich showed the group his Ehrlich Cycle Finder. This is a neat little gadget that, when put over a chart, allows even a beginner to locate a cycle on a chart.
- * Options traders find cyclical analysis especially useful when trying to identify market tops or bottoms.
- * Ehrlich's favorite one-day turning signal is the key reversal pattern. A bullish key reversal is defined as a day when the low is lower than the previous day's low, and the high is higher than the previous day's high-and the close is higher than the previous close. A bearish key reversal would be when the market closes below the previous close. He said he generally believes that if the high and low exceed the previous day's high and low by very small amounts, then the signal

will be less powerful. High volume increases the validity of the signal, while low volume makes the signal suspect.

10 Key Questions on Measuring Your Trading Progress and Success

At some point in nearly everyone's trading timelines, they wonder how their trading successes (or failures) compare with those of other traders. Wondering just how well you stack up to other traders in the industry is a natural curiosity and a human psychological tendency. However, actually knowing the success or failure rates of others doesn't do a lot to move you farther down the road of where you want to be regarding trading success.

Most traders also wonder about the success rates of the "professional" traders—the ones who make their living solely by the profits they generate from trading. I will provide you with an answer to this question at the end of this feature.

Below are 10 questions regarding measuring your own trading progress and success. These questions should help you determine where you stand in this challenging field of endeavor.

1. What is trading "success?" This is a most basic question. Most would agree that ultimate trading success is defined as being profitable at trading—making more money than you lose. There are other secondary factors that also define success in trading, such as finding a "balance" between trading and other life activities. But it's being profitable at trading that is the benchmark of defining success.

2. What is trading "progress?" Beginning traders should not expect to have immediate and ultimate success trading futures, stocks or FOREX markets. What they can expect in the early going is to make steady progress through gaining knowledge and experience. Even veteran successful traders continue to make trading progress. Achieving and maintaining trading success requires continual progress—namely continuing to seek out trading and market knowledge. Traders who truly enjoy the "progress" and process of trading do have a significant trading edge over those who do not enjoy learning and gaining experience.

3. At what point in my trading timeline should I expect trading "success?" Trading success (winning trades) can come right away—even for the beginning traders. What is less likely for the inexperienced traders is sustained trading success. Beginners can even run into a "hot streak" that skews the overall reality of trading. Immediate (and likely fleeting) success for a beginning futures trader can do longer-term psychological harm—if he or she does not fully recognize and understand the hard work and perseverance required on the road to trading success. Many times I get questions from less-experienced traders that go something like this: "I've been trading two years and I've only been able to about break even." My reply to them is, "Hey, you should not be too discouraged with those results. Many traders don't have that kind of success in the early going."

4. How long will it take to go from being a less-experienced trader to an experienced and hopefully successful trader? Determining a precise timeline at which trading success will arrive will vary greatly among traders. Some beginning traders will spend nearly full time coming up to speed. Others may spend an hour or two a week on the subject. There is no right answer on how much time to spend studying trading and markets. I have many readers who are taking up trading in retirement. I have a few that have taken up trading over the age of 80 years. One is never too young or too old to learn about markets and trading. A general rule would be for a beginning trader not to expect sustained trading success within a few months. More likely is a timeframe of a few years to achieve sustained trading success. Now you see why money management is so important in futures trading. You have to survive before you can succeed!

5. When should I “throw in the towel” and admit that trading is not for me? There is no one right answer to this question. If trading is making you miserable and creating other bad habits (kicking the dog), then it’s time to quit—or at least take an extended break. If you do not have the financial resources to trade futures, then you should not participate. Futures trading should be conducted only with money a trader can stand to lose, without impacting other more important obligations, such as grocery and rent money. It is important to point out that the beginning futures traders who “flame out” first are usually the ones who did not have the financial resources to trade futures in the first place.

7. How many trading losers should I absorb before I change my trading plan of action? This is a real tough one to answer. Again, there is no single right answer. However, if you believe you have a well-founded and thoroughly researched trading plan of action, don’t abandon it just because you are on a losing streak. All traders have winning and losing streaks. That’s a part of trading. Traders enjoy the winning streaks and do not enjoy the losing streaks. But during the losing streaks they forge ahead, knowing that their plan of action is still solid. Trading plans can certainly be tweaked, such as trading fewer contracts or trading less frequently during a losing streak. For most traders, a complete overhaul of one’s trading plan is probably a last resort that merits much consideration.

8. How can I keep myself motivated on the winding road to trading success? Traders who enjoy the entire process of trading don’t really need a lot of motivational help because they are already fascinated by what they are reading and learning. But during a losing streak or some other “dry spell” in trading—when morale can slip—it is prudent to read some trading books that are based less on specific methodologies and more on trading psychology. Attending trading seminars is a great way for a trader to become reinvigorated. (And it’s also a great value to those already invigorated!) You not only will gain fresh trading and market knowledge, but you also will get to see and speak with the seminar lecturers as well as traders who are in the same position as you.

9. How much should I listen to other traders when trying to evaluate my own trading progress or my own trading plan? It is good to have a trading partner or “buddies” with whom to share your ideas and to discuss markets and trading. The learning curve improves when a trader has another trader or traders with similar experience with whom to share ideas. It is also

beneficial to have an experienced mentor to help guide you through the “rough waters” that all traders experience at times. But at some point, most traders do want to be more or less autonomous in their decision-making. As many traders gain more experience, knowledge and confidence, they will use outside influences as “second opinions” to reinforce or provide another angle to their own sound opinions. Many traders also have full-time “day jobs” and need outside sources to help save them time and to keep track of what’s going on in all the markets.

10. What is the average success rate of the “professional” trader? I have not seen any “official” studies of the percentage of winning trades of the average professional trader. However, it is generally agreed upon by many in our industry that the better professional traders have a winning percentage of around 4 out of every 10 trades—or a 40% winning percentage. Breaking this down even further, it is estimated that half of the winning trades are only small winners and not much better than break-even. Thus, it can be loosely extrapolated that most of the professional futures traders make most of their money on one or two trades out of every 10. This only underscores the importance of sound money management in futures trading—namely cutting losses short and letting winners run.

THE END