

futures.io webinar – May 3, 2016

Distinguishing Strong Legs within Trading Ranges and Trends

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Main Points

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▪ Gaps	5
▪ Leg in trend or in TR	10
▪ 2 nd leg trap	24
▪ Market cycle	37
▪ Scaling In	45

Entering with Stop Order

Beginner should only enter with stop orders
Want trend to sweep him into trade by
market going his way, even if only single tick

Put initial protective stop
1 tick below signal bar



Stop Order Bulls

To buy on stop, place **buy stop order**
1 tick above high of prior bar
(which is **signal bar**)

When market trades 1 tick above the signal bar,
buy stop order becomes a market order
In big volume market, usually no slippage (get filled at stop order)

Enter with Limit Orders

Tails above bars mean sellers above

Limit Order Bears sell with limit orders above prior highs, betting bull BO will fail

Every tail is failed breakout and reversal
If lots of bars with tails,
better to bet on failed breakouts

Tails below bars mean buyers below

If most bars have tails and overlap prior bar too much, then most breakouts will fail
Bad for stop entries
Good for limit order entries

Limit Order Bulls buy with limit orders below prior lows, betting bear BO will fail

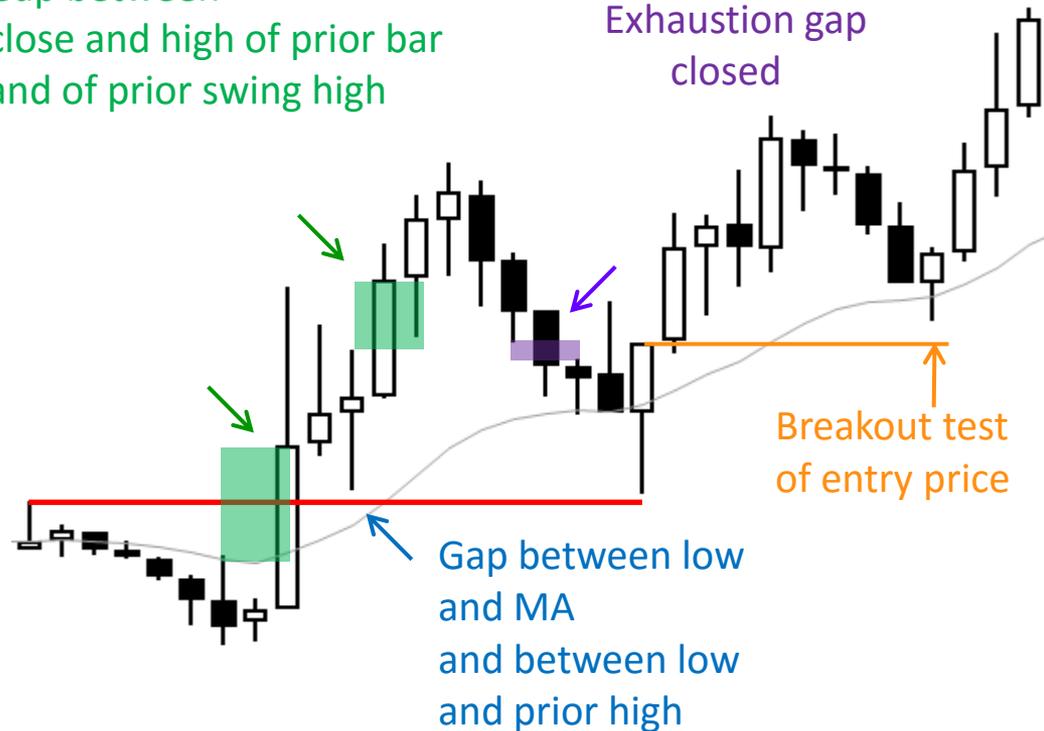
What Is a Gap?

Any space between any support and resistance

- H, L, O, C of any bar
- Moving averages
- Trend lines
- Can be very minor

Gap between close and high of prior bar and of prior swing high

Exhaustion gap closed

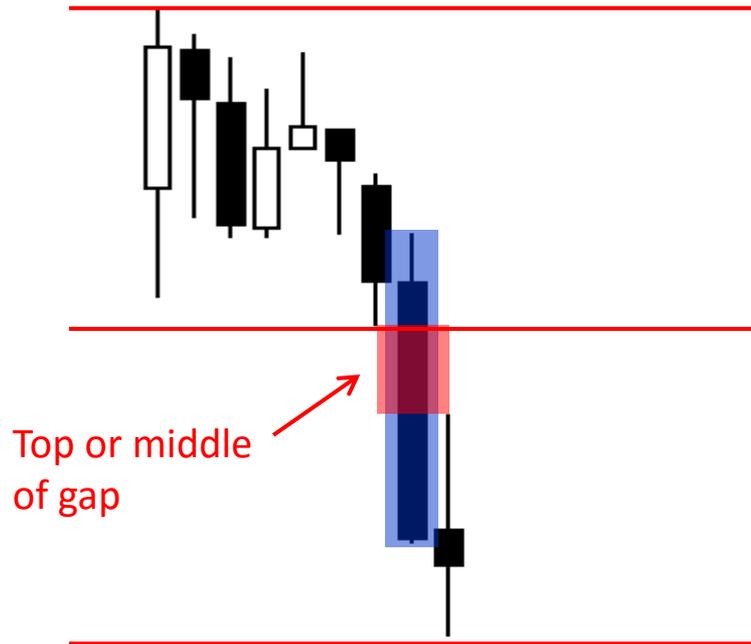


Gap between low and MA and between low and prior high

Breakout test of entry price

Bear Measuring Gap

- **Bear trend bar** after bear has gone on for 5 – 30 bars
- **Low of bar before is above high of bar after**
- Often leads to **measured move**
- Becomes **Measuring Gap**

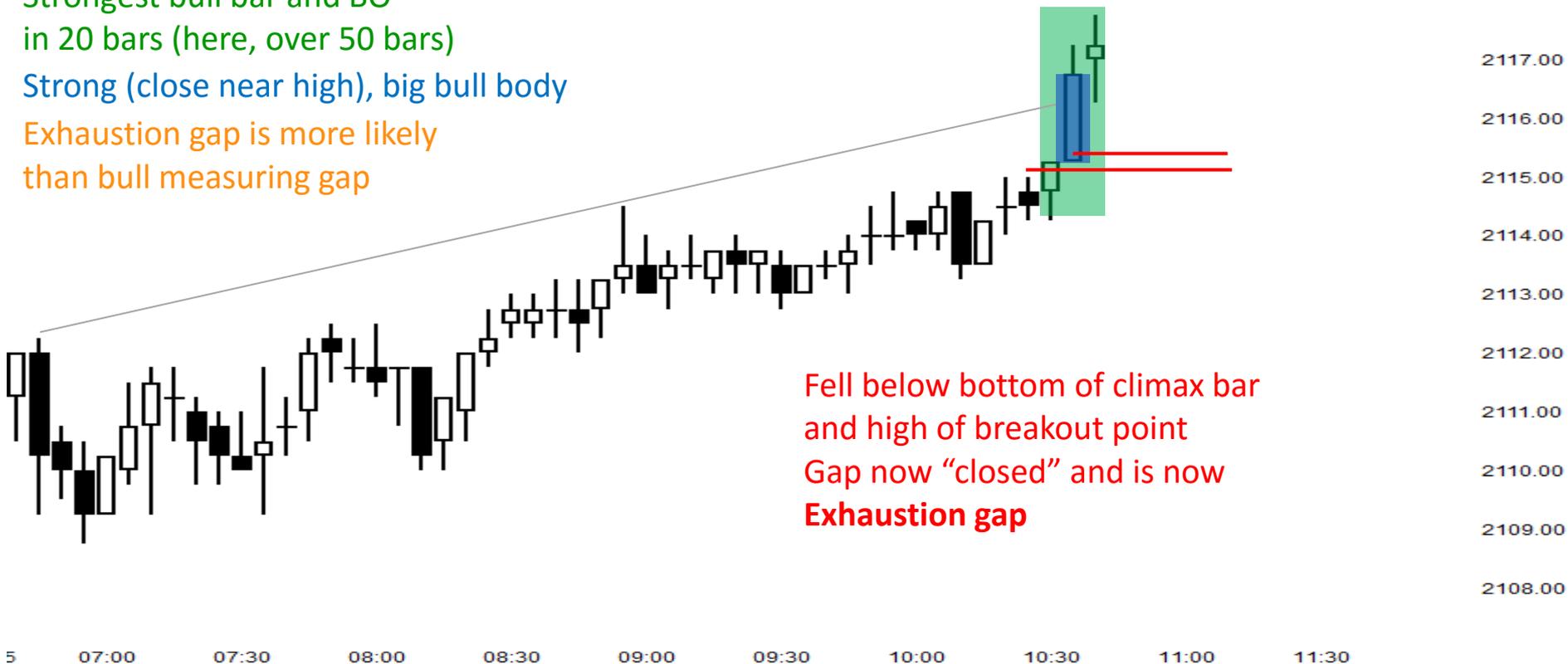


Bull Exhaustion Gap

Strongest bull bar and BO
in 20 bars (here, over 50 bars)

Strong (close near high), big bull body

Exhaustion gap is more likely
than bull measuring gap



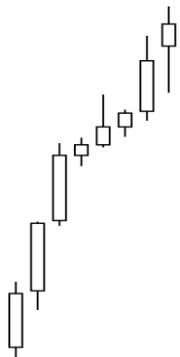
Every Bull Chart Made of 1 or More of These 4 Patterns

Each pattern might be 1 – 2 bars,
or 20 or more bars

Some charts contain only 1 pattern

Bull breakout

No PBs
Bears cannot
make money



Tight bull channel

PBs last 1 - 3 bars
Gaps and almost
gaps (minimal
overlap)



Bears rarely can
make money

Broad bull channel

PBs last 3 - 10 bars
No gaps (lots of overlap)



Bears usually can
make money

Trading range

Bull and bears about
equally strong



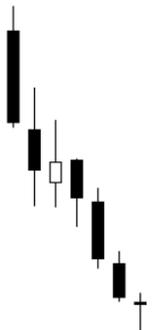
Easy for bulls and bears
to make money

Every **Bear** Chart Made of 1 or More of These 4 Patterns

Each pattern might be 1 – 2 bars,
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Some charts contain only 1 pattern

Bear breakout
No PBs



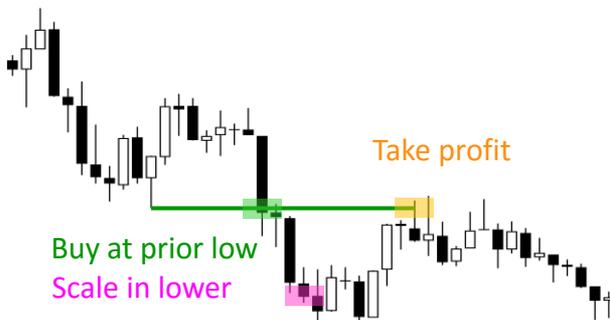
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Broad bear channel
PBs last 3 - 10 bars
No gaps (lots of overlap)



Bulls usually can
make money

Trading range
Bull and bears about
equally strong



Easy for bulls and bears
to make money

Bull Leg in Bull Trend Instead of in Trading Range

Small Pullback Bull Trend

One of the strongest types of trend

Looks weak, like leg in what will become TR

Many small bodies, tails, bear bodies, overlapping bars

Fools traders into thinking will form TR soon

If bull leg looks weak,
but forms one or more gaps,
and PBs are not deep,
do not sell new highs for scalps

Gaps make Small PB Bull Trend more likely

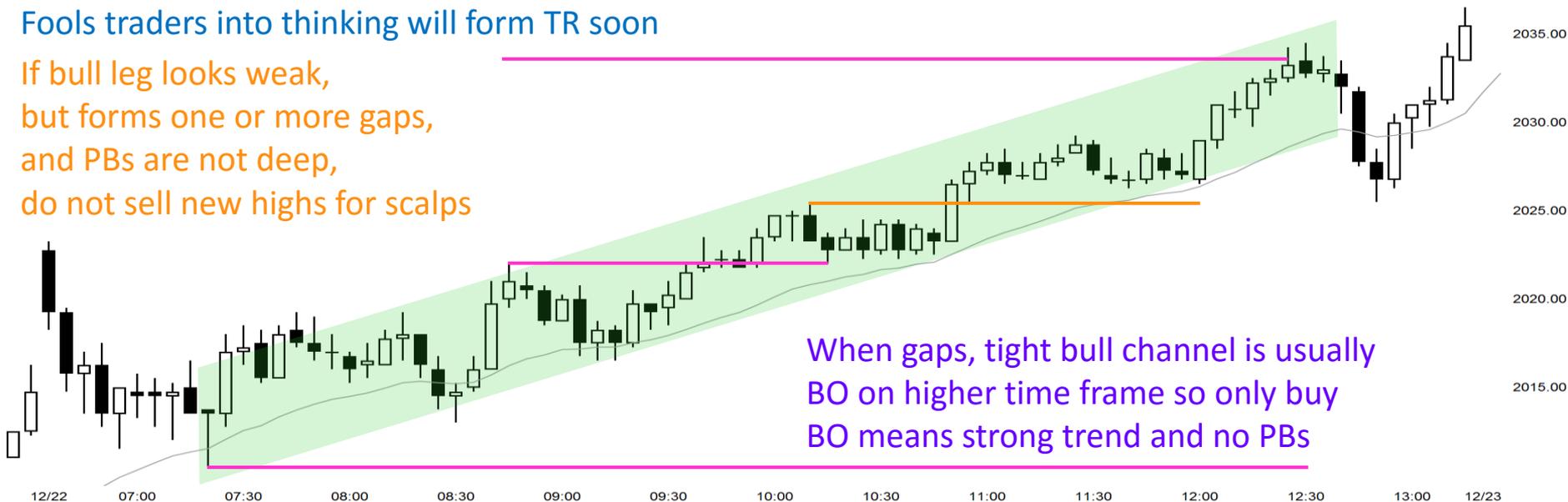
Possible measured move up

Limit order bears get trapped

When gaps, tight bull channel is usually

BO on higher time frame so only buy

BO means strong trend and no PBs



Bear Leg in Bear Trend Instead of in Trading Range

Small Pullback Bear Trends look weak
Overlapping bars and prominent tails
Many small bars with small bodies and bull bodies

Weak bars make traders think
tight channel will evolve into TR soon,
but very strong type of bear trend

If bear leg looks weak,
but PBs are shallow and only 2 – 3 bars,
and there are one or more gaps,
do not buy new lows



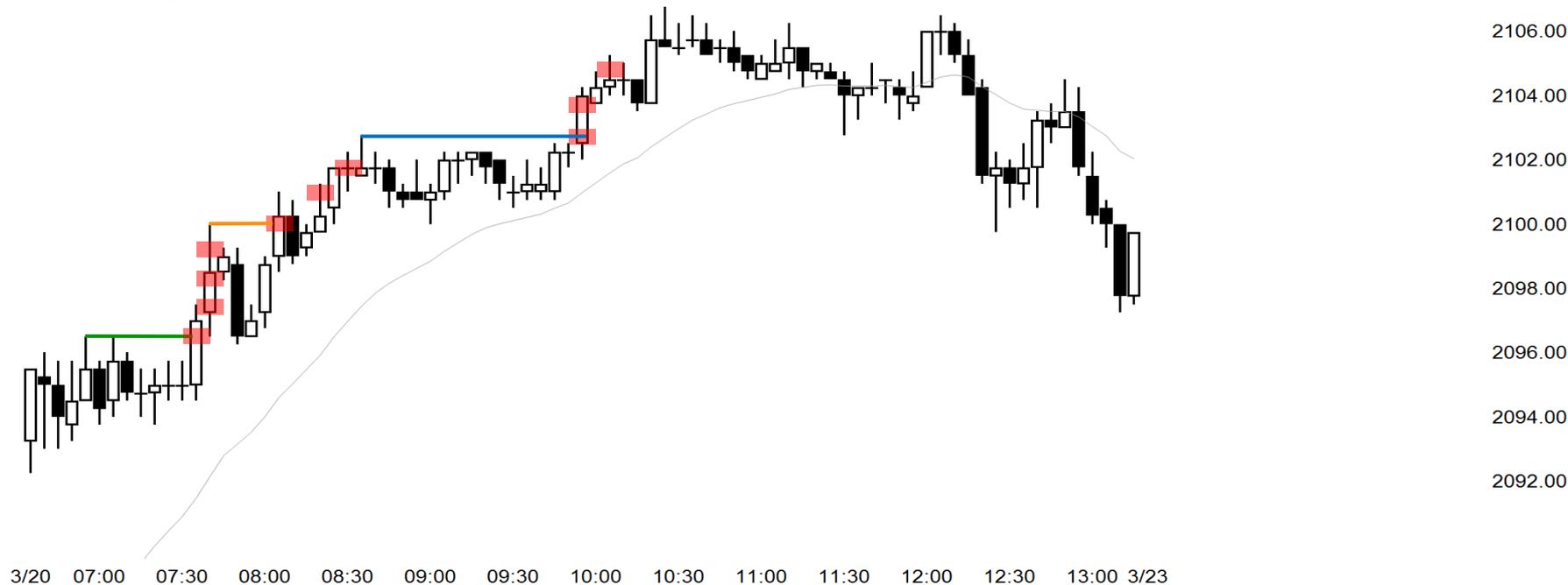
Gaps often lead to measured move
They trap limit order bulls who then have to sell

Gaps usually mean BO on higher time frame
BO is strong bear so only sell

Do Not Sell When Hard to Make Money Selling

If **Limit Order, Scale In Bears**
rarely make money, bull trend is strong
Only look to buy

Whenever it is hard to make money,
it is usually better to only do opposite



Trade like a Breakout (Almost!)

Look for a reason to buy
Since it is BO on higher time frame,
can buy exactly same

One difference from BO is better to
not buy above prior high,
but still reasonable



Determine where protective stop goes

Figure out position size, based on risk

Buy, right now, this minute!

Trust your stop

Trend, so 60% Probability of Profit

You know it is trend
Therefore believe 60% chance of more trend
Yet, it never feels 60% certain
60% is as good as trading gets so TRADE!!



Always Try to Buy Near Bottom of Channel

Beginners often afraid to buy as market is falling

Math is good in bull channel if rely on stop



Many Ways to Buy

Can buy breakout above swing high, but many bulls take partial profits there, unlike in strong bull breakouts where bulls buy there

Channel has frequent pullbacks so many opportunities to buy below the high



- Buy PB to support, like MA or prior high
- Buy PB to support, like BO point or 50% PB
- Buy breakout of bull flag, especially if bull signal bar
- Buy below bar, especially if weak sell setup (like bull body)
- Bet bears will fail and have to buy back shorts
- Scale in 1 – 2 pts lower

Trend or Just Leg in TR?

Bull channel lacked big consecutive bull bars
Stalling near yesterday's high

TR for 4 hours

2115.00

2110.00

2105.00

2100.00

2095.00

2090.00



Pullbacks every few bars

Many bear bars

Deep PBs (relative to last small leg up)

Many overlapping bars (tight TRs)

Reversal up with 8 bars in bull micro channel

Breakout, so expect higher prices and possible measured move up

Trend or Just Leg in TR?



Probably Bear Leg in TR

Yesterday had a lot of TR price action



Trend or Just Leg in TR?

No strong BO with follow-through above yesterday's high

Bull leg in TR more likely than bull trend

2115.00
2114.00
2113.00
2112.00
2111.00
2110.00
2109.00
2108.00
2107.00
2106.00



Limit Order Bears making money

No consecutive big bull bars
Instead, small bull bodies
PBs every few bars
Many big reversals

12:00 12:30 13:00 4/24 07:00 07:30 08:00 08:30 09:00 09:30 10:00 10:30 11:00 11:30 12:00 12:30 13:00

Bear Trend or Bear Leg in TR?



Why Important to Know If Trend Becoming TR?



Most Swings Have 2 Legs or Wedges

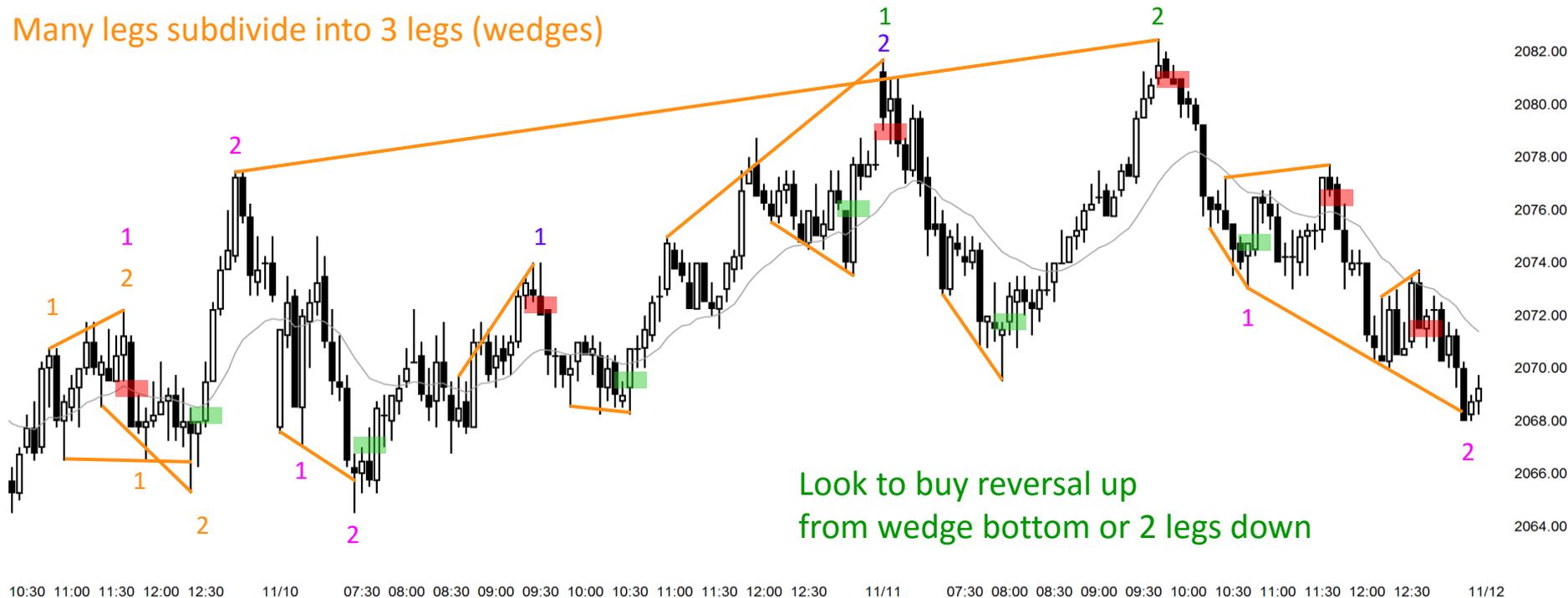
Most swings up and down have 2 legs

Many legs subdivide into 2 legs

Many legs subdivide into 3 legs (wedges)

Look to sell reversal down
from wedge top or 2 legs up

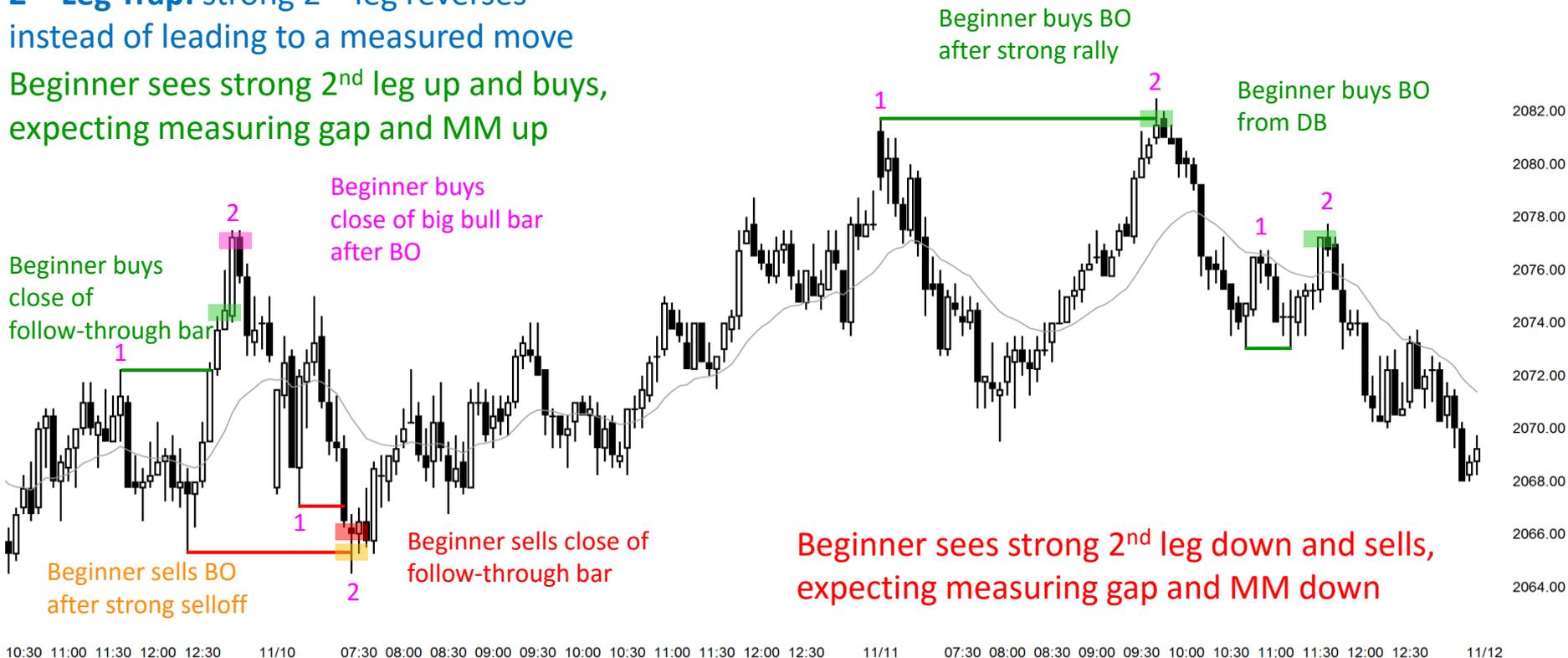
Look to buy reversal up
from wedge bottom or 2 legs down



Strong 2nd Leg Is Trap: Hopeful Beginner Betting on Trend

2nd Leg Trap: strong 2nd leg reverses instead of leading to a measured move

Beginner sees strong 2nd leg up and buys, expecting measuring gap and MM up



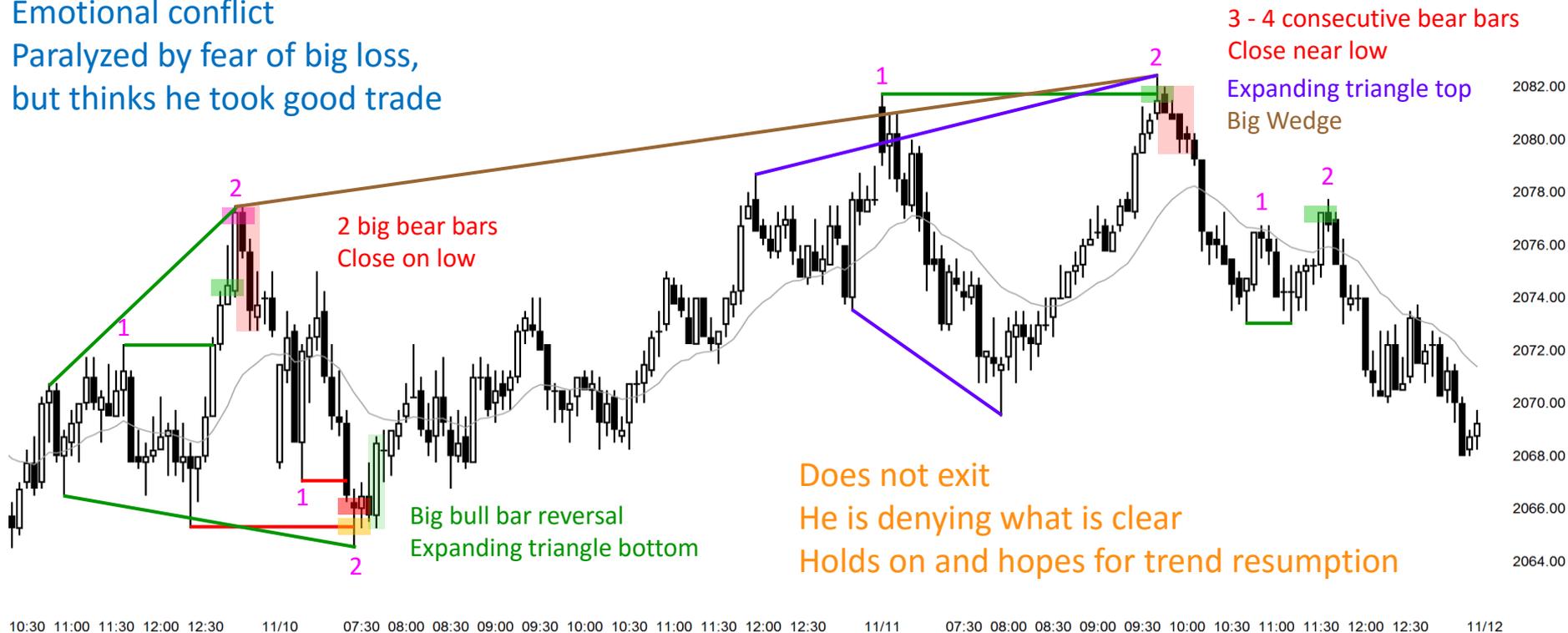
Beginner: Trapped When Buying High, Selling Low

Beginner shocked by immediate reversal
Emotional conflict
Paralyzed by fear of big loss,
but thinks he took good trade



Beginner: Trapped When Buying High, Selling Low

Beginner shocked by immediate reversal
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Expert: Fades BO, Betting on Trapped Traders

Expert sees strong 2nd leg up in TR
(or channel) and sells,
expecting exhaustion gap and reversal down

Sell close of big bar
Probable buy climax

2

Sell below bear sell signal bar

Sell close of big bear entry bar

Sell above weak buy signal bar

1

1

Buy close of big reversal bar

Buy reversal up (here, micro DB)

Buy below prior low in TR

2

Sell above prior high in TR

Sell below bear sell signal bar

Sell close of 3rd or 4th bear bar

Sell close of
big bear entry bar

1

2

Expert sees strong 2nd leg down in TR
(or channel) and buys,
expecting exhaustion gap and reversal up

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2082.00
2080.00
2078.00
2076.00
2074.00
2072.00
2070.00
2068.00
2066.00
2064.00

Trend Bars: Expect Bad Follow-Through

If a bull BO needs 1 more bar to become clearly Always In Long, bears will sell the close, betting on 80% rule and betting against the next bar being a bull bar



If a bear BO needs 1 more bar to become Always In Short, bulls will buy the close, betting on 80% rule and betting against the next bar being a bear bar

TR: Very Forgiving to Limit Order Traders

TR is forgiving to traders
who can use wide stops and scale in
Good management is necessary

Even if buy the high,
usually can avoid loss if manage well

Exit breakeven on 1st buy and scalp on 2nd buy

Sell more at 50% PB
or on reversal down

Buy more at 50% PB
or on reversal up

Exit breakeven at midpoint of 2 entries

Even if sell the low, TR usually will allow trader to avoid loss



2nd Leg Trap Is Strong, but Fails



Strong breakout above wedge top
50% chance of measured move up
50% chance of failed BO and reversal down

Good follow-through from BO above prior high
Probably buyers below and then 2nd leg up,
but maybe just one more bar up
1st reversal down probably will be bought
Bears should wait for 2nd sell signal

Strong breakout above channel
75% chance of failed BO within 5 bars

Possible exhaustive buy climax
and start of trading range
1st leg up was wedge, 2nd was bull BO

2nd Leg Trap Is Strong, but Fails



Strong breakout above wedge top
50% chance of measured move up
50% chance of failed BO and reversal down

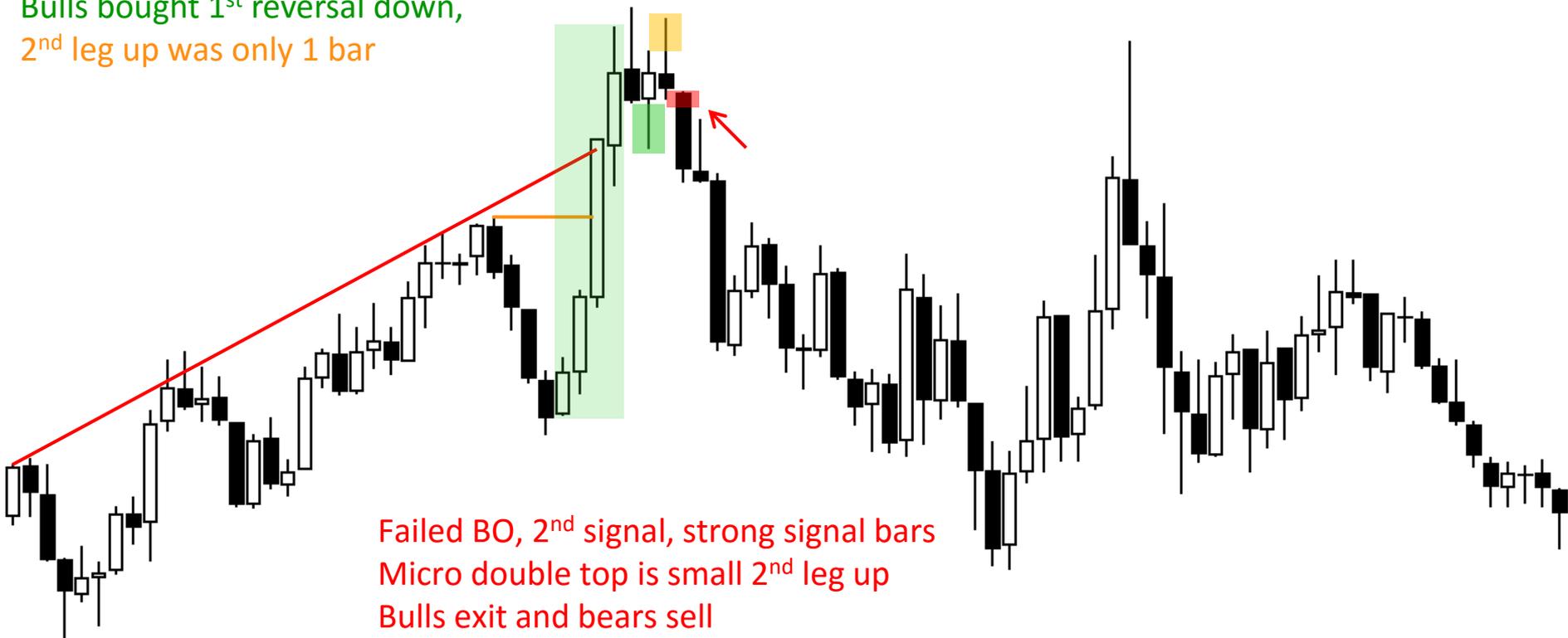
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Strong breakout above channel
75% chance of failed BO within 5 bars

Possible exhaustive buy climax
and start of trading range
1st leg up was wedge, 2nd was bull BO

2nd Leg Trap Is Strong, but Fails

Bulls bought 1st reversal down,
2nd leg up was only 1 bar



Failed BO, 2nd signal, strong signal bars
Micro double top is small 2nd leg up
Bulls exit and bears sell

2nd Leg Trap Is Strong, but Fails

Big Up, Big Down so Big Confusion
Disappointed bulls
Probable now TR
Be ready for 2nd leg traps

Strong bear breakout
Possibly sellers above and
then 2nd leg down
Since TR likely, possible 2nd leg trap



2nd Leg Trap Is Strong, but Fails

Strong 2nd leg up, but still in a trading range
so probable 2nd leg trap



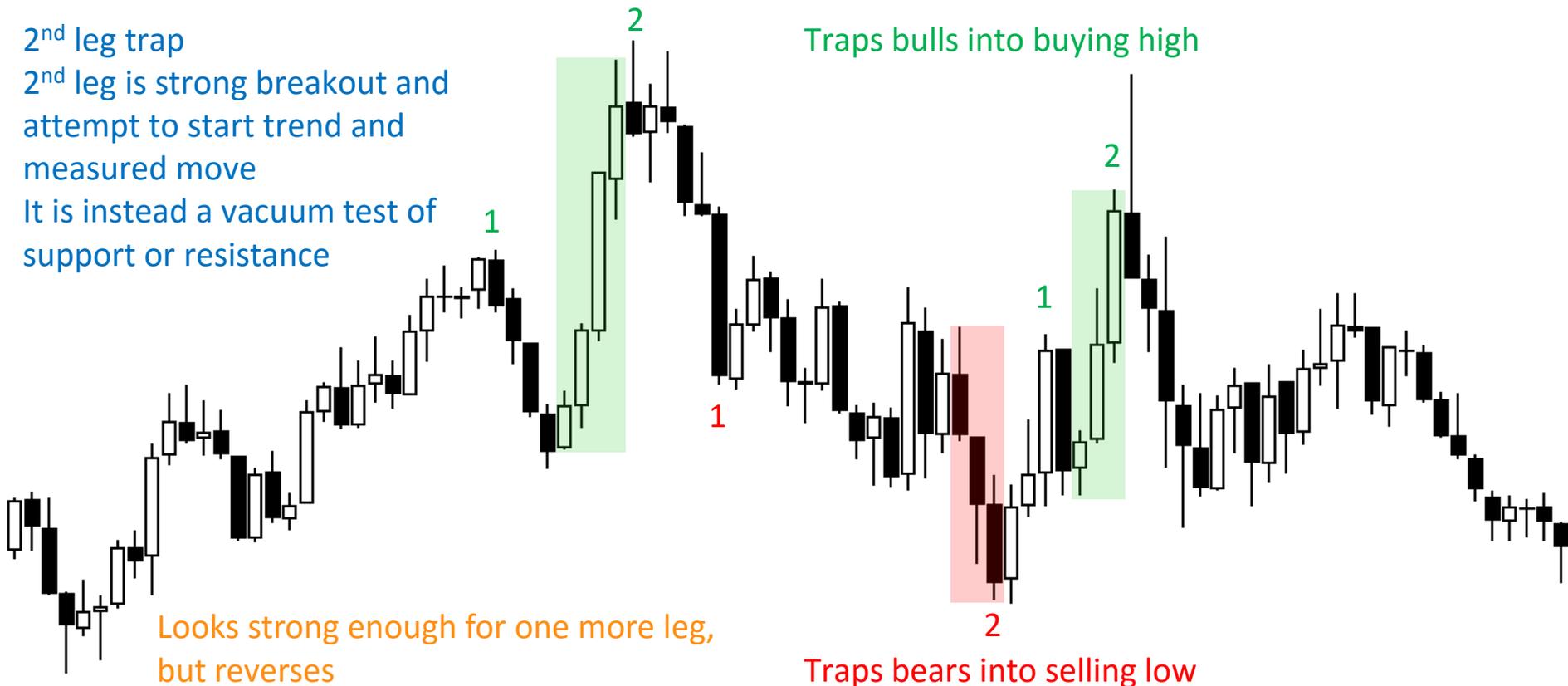
More likely 2nd leg trap and failed breakout
Less likely another leg up after pullback

2nd Leg Trap Is Strong, but Fails

2nd leg trap

2nd leg is strong breakout and attempt to start trend and measured move

It is instead a vacuum test of support or resistance



Trading Range Breakout

Eventually there will be successful BO

Usually better chance of profit if wait to see strong BO
far beyond TR

Big breakout bar

Big Follow-through on next bar or two

Consecutive big trend bars

No tails

Close far above highs of past 50 bars

Good context



Market Cycle: 10% of Bars Are in Strong BO

From the Market Cycle, traders know that
10% of bars are in strong breakouts up or down
Strong enough bull BO on the open for
70% chance of measured move (MM) up
based on the size of the BO

Take profit around MM target

Very positive Trader's Equation

High probability of MM based on **Initial Risk**

Only need reward of 1x **Actual** risk



Buy close of consecutive big bull bar

Closed on its high and above neck line of double bottom

Could wait to buy close of follow-through bull bar

Market Cycle: 90% of Bars Are in Channel or TR

During the 10% of bars that are in a strong BO, usually difficult to make money trading in the opposite direction

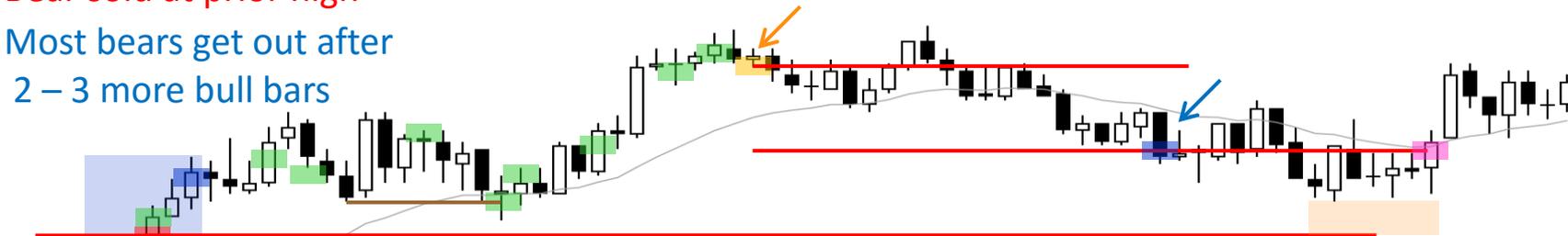
Bear sold at prior high

Most bears get out after 2 – 3 more bull bars



Difficult to hold short for 40 bars during bull trend
Missed many buying opportunities to make money

If bear decided to stay short and try to manage to get a profit, he might sell more below 1st bear reversal bar



Might change goal and just try to avoid loss
Exit at average entry price
Never fell to 1st entry price
Running out of time
Exit at average entry price on reversal up to get out breakeven on entire trade

Bad Management: Causes Most Losses

90% of the bars are in channel or TR

40 – 60% chance direction will continue or reverse

Probability for bulls and bears is between 40 – 60% during 90% of the bars on every chart



Bad management is the major cause of losses
Must manage position size, risk, and reward
If fail at any step, you will lose money

From Trader's Equation, trader knows that even with only 40% probability, it is winning strategy to exit with reward at least 2 times Actual Risk

This means that during 90% of the bars, both bulls and bears can make money by managing trades correctly

The reason for most losses is **bad management**
When manage well, 90% of time can get out breakeven (without a loss)

Timing an Entry Can Be Difficult

Skilled trader often uses wide stop or scales in
When not confident, most should
wait for 2nd signal or strong reversal

When selling near top, never sure if final top
Confident top not too far and bull BO will fail



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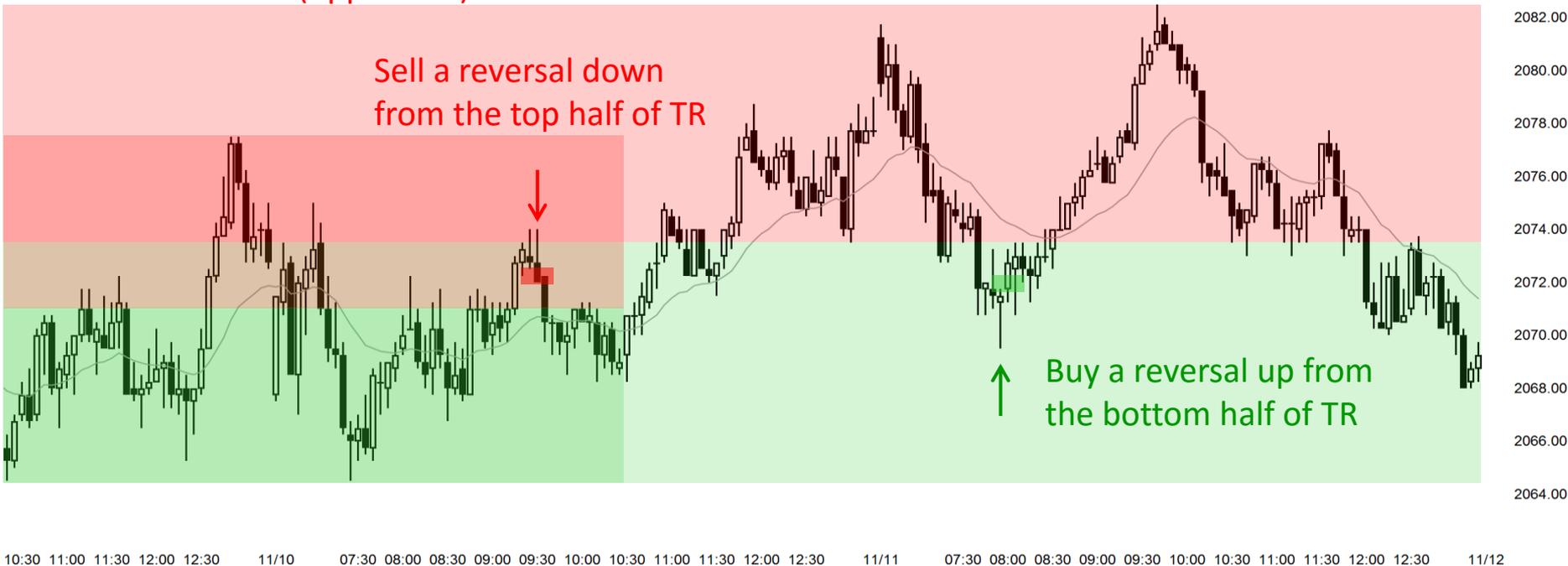
Entering with Stop Orders

Beginners should only enter with stop orders

Buy in the Buy Zone (lower half)

Sell in the Sell Zone (upper half)

Market going your direction
so higher probability of profit



Entering with Stop Orders

When a leg up is strong,
wait for a 2nd entry sell signal,
like a micro double top, or for strong bear BO

Sell 4th consecutive bear close



When a leg down is strong,
wait for a 2nd entry buy signal,
like a micro double bottom, or strong bull BO

Entering with Limit Orders: Use Reasonable Stop

Bulls will buy below a prior low
when in the bottom half of the range

When buying with limit order in TR, use reasonable stop
Stop sometimes has to be far



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Scale In: To Increase Chance of Profit

Some bulls will buy more lower

Increases chance of profit

Reduces size and chance of loss

Increases risk so trade small enough

so that risk is acceptable

Minimum scalp is 1 point

Scale in 1 – 2 points lower



Take Profits: Trading Range So Many Will Scalp

Ok to scalp out at 1 – 2x Actual Risk,
as long as bigger than minimum scalp
(1 point in Emini)

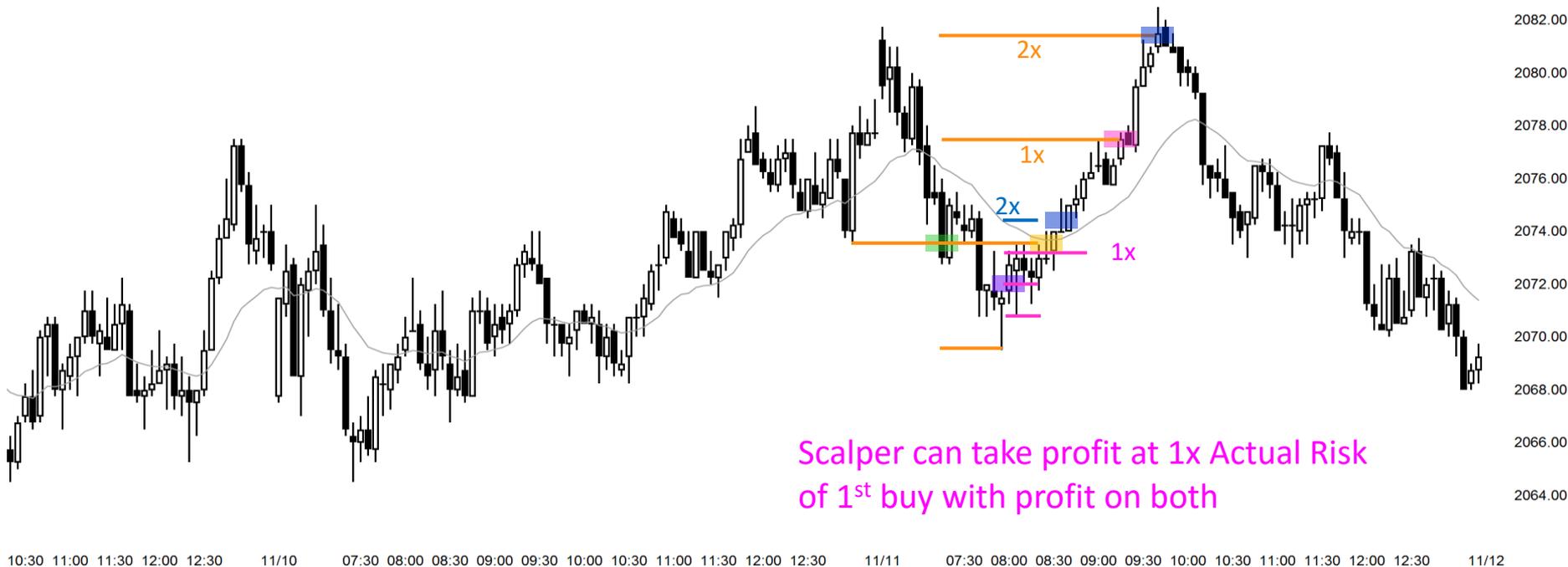
That is minimum needed for
profitable Trader's Equation
Minimum is rarely best choice

Scalper can take profit at 2x Actual Risk
Profit on both buy entries



Take Profits: Many Logical Choices

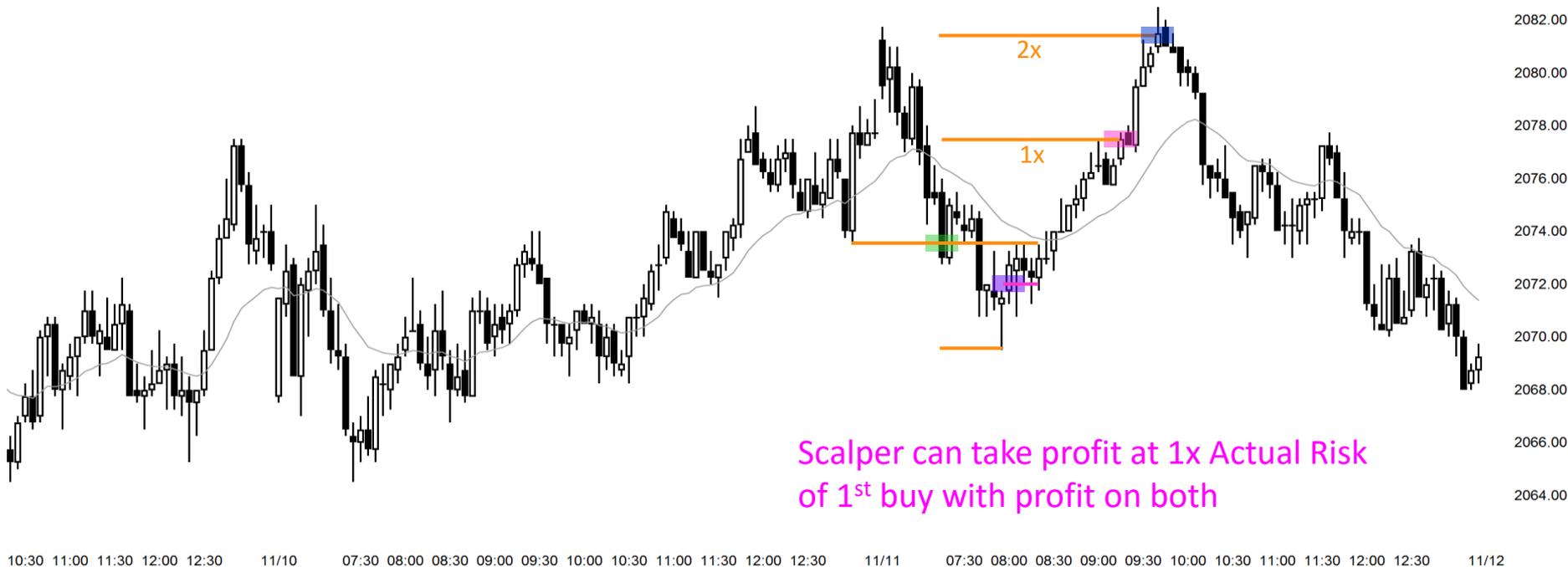
Scalper can take profit at 2x Actual Risk of 1st buy with profit on both



Scalper can take profit at 1x Actual Risk of 1st buy with profit on both

Take Profits: Big Swings up and down So Many Will Swing

Scalper can take profit at 2x Actual Risk of 1st buy with profit on both



Scalper can take profit at 1x Actual Risk of 1st buy with profit on both

Tight Trading Range

TR is horizontal channel

Like all channels, can be broad or tight

When broad, can enter with stop, market, or limit orders and can scalp or swing

When tight, little profit potential

Can only scalp and only enter with limit orders

Never scalp with stop orders since most are losers

Some use swing stops and scale in

Most should wait



A Tight TR is a **Limit Order Market**

This range is too tight to make enough money to compensate for effort and risk

Wait for broader range or breakout

Tight Trading Range

To scalp in **Tight Trading Range**, need:

Most bars more than size of scalp (4 ticks)

Height of TR at least either 3 times size of average bar, or

3 times bigger than smallest scalp (1 point)



Tight Trading Range

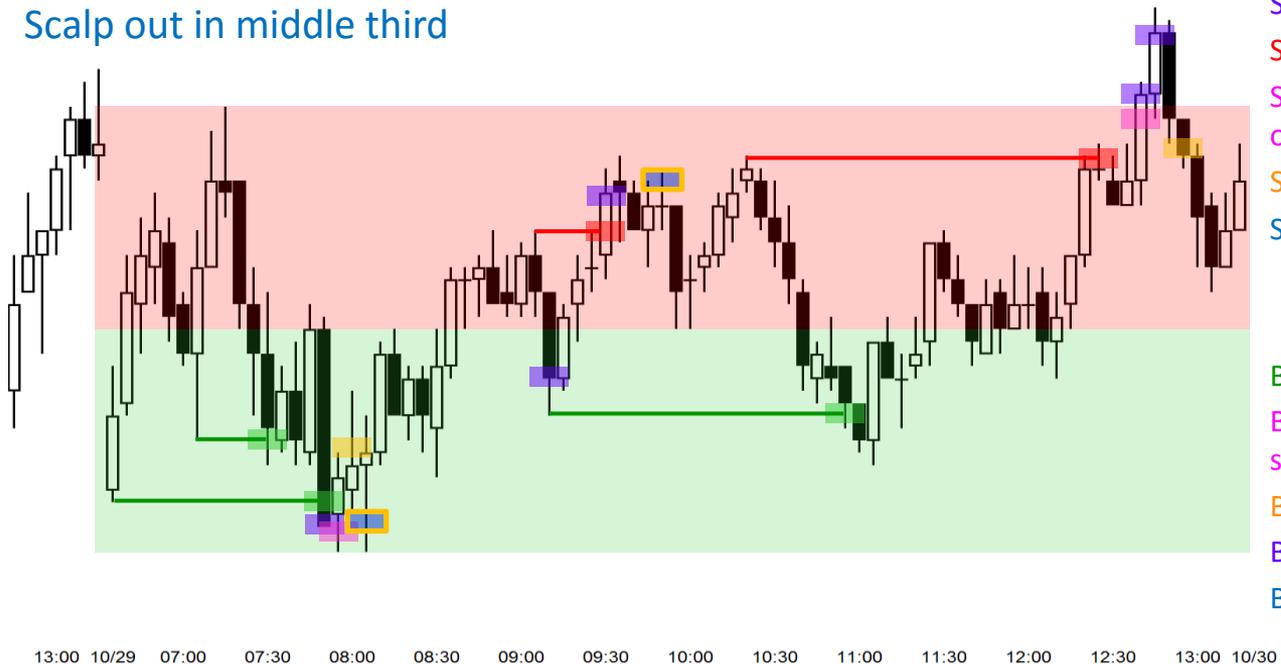
Trade like any other Limit Order Market

Buy bear strength in the bottom half

Sell bull strength in the top half

Scalp out in middle third

Many scale in, scalp, and use wide stops



Sell strong bull close

Sell at prior high

Sell 1 point above prior high
or scale in 1 point higher

Sell reversal down

Sell above weak bull flags

Buy at prior low

Buy 1 point below prior low or
scale in 1 point lower

Buy reversal up

Buy strong bear close

Buy below weak bear flags

2078.00

2076.00

2074.00

2072.00

2070.00

2068.00

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