KEY POINT: This pattern is very often an explosive intraday reversal at key levels that we will incorporate into the strategies after you have a good understanding of all six of the 1,2,3 patterns.

In all of these 1,2,3 buy patterns, you want to see positive or confirming divergences in the basic indicators like stochastics, RSI, etc. You also want to see market dynamics, such as NYSE TICK and premium (S&P futures minus S&P cash index) moving in your favor as you decide to take the trade.

On the daily and weekly charts, don't take a 1,2,3 lower bottom or a 1,2,3 higher top unless you have a POSITIVE divergence on the buy pattern and a NEGATIVE divergence on the 1,2,3 higher top sell pattern.

The following three charts will give you a quick summary of the three 1,2,3 buy patterns with a bit more information on the chart, including the open and close, which will illustrate some points of buying pressure. (We will be using both candle and bar charts during the seminar presentation, but in reality, they tell you exactly the same information, but it's just what you are used to working with.)

Entry Strategies For Pattern #1 -- 1,2,3 Higher Bottom

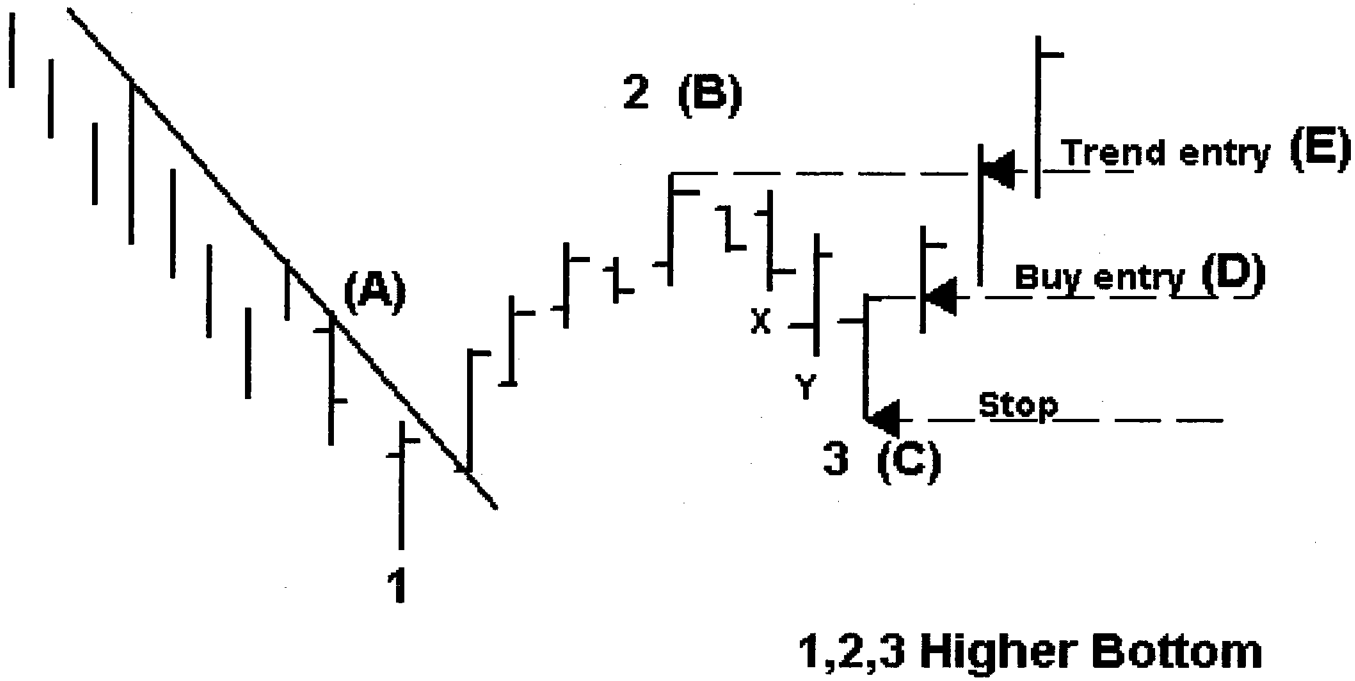


Figure 11

Entry Strategies For Pattern #1 -- 1,2,3 Higher Bottom

1. Swing Point 1 is formed as the logical trendline is broken at (A) on a change-in-direction bar that has a higher low and a higher high. The Swing Point 1 low bar showed a possible change in trend with the open and close in the top of the range after making a lower low in the current trend. This was the initial sign of buying pressure.

Entry Strategies For Pattern #1 -- 1,2,3 Higher Bottom

2. The bar breaking the trendline at (A) is a solid thrust bar with almost its entire range above the low bar, indicating more buying pressure. It is at this point you want to see an increase in volume and positive divergence (confirmation in NYSE TICKS, Slow Stochastics or RSI). This will have more detail in the Market Dynamics portion of the module.

Entry Strategies For Pattern #1 -- 1,2,3 Higher Bottom

3. There is a six-bar run (including the low bar) where Swing Point 2 forms (B). The index trades and closes below the low of Swing Point 2's high (X)! We now have confirmed Swing Points 1 and 2.
4. You should now be looking for at least a 38% retracement to the Swing Point 1 low and at least a three-bar reaction from the Swing Point 2 (B) high. It is best when the retracement to (C) is on lighter volume than the volume on the trendline break that Swing Point 2 was formed at (B).

Entry Strategies For Pattern #1 -- 1,2,3 Higher Bottom

5. Swing Point 3 (C) is formed after the retracement from Swing Point 2. There is a buying-pressure bar (Y) with a close above the midpoint and it is the third reaction bar from the Swing Point 2 high. We get entry above the high of the Swing Point 3 bar (D).
6. Initial stop is placed below the signal bar low (C) which is the Swing Point 3 low. If it is too tight, then you can use the low at Swing Point 1 if it is not too far away.
7. Trend entry (E) for conservative traders not trading the 1,2,3 patterns is above the high of the Swing Point 2 (B), and for you should only be a second entry on fewer shares.

Entry Strategies For Pattern #2 -- 1,2,3 Double Bottom

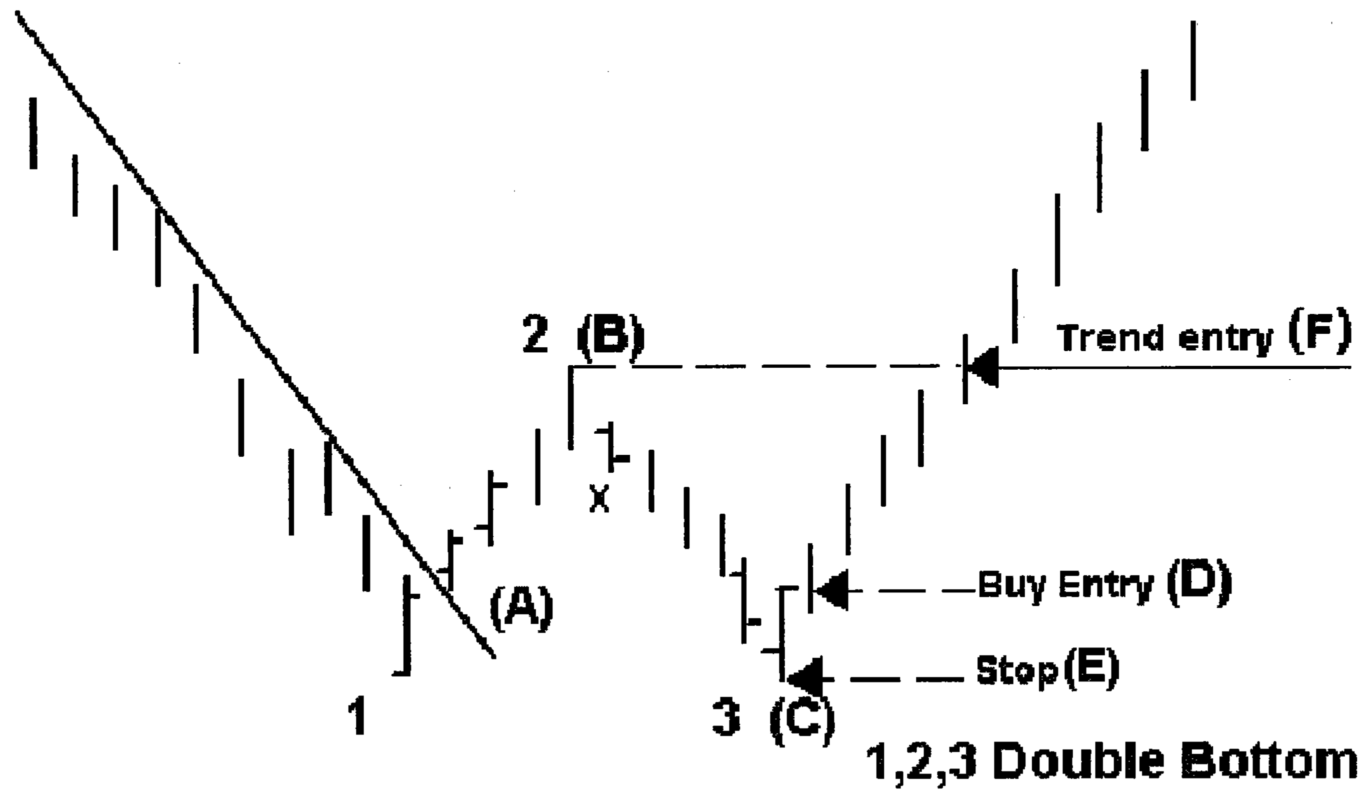


Figure 12

Entry Strategies For Pattern #2 -- 1,2,3 Double Bottom

1. Swing Point 2 is confirmed on a close under the swing point 2 low by the next bar (X).
2. Double Bottom sets up at Swing Point 3 (C) and entry is above the signal bar high (D).
3. Initial stop is placed below the Swing Point 3 (E) low. If it is too tight, then use a money stop below that Swing Point 3 low.
4. Your entry point is at (D) above the Swing Point 3 high.
5. Trend entry (E) should not be too far from your primary entry and not taken as a second entry unless the market dynamics are very positive.

Entry Strategies For Pattern #3 -- 1,2,3 Lower Bottom (Shake and Bake)

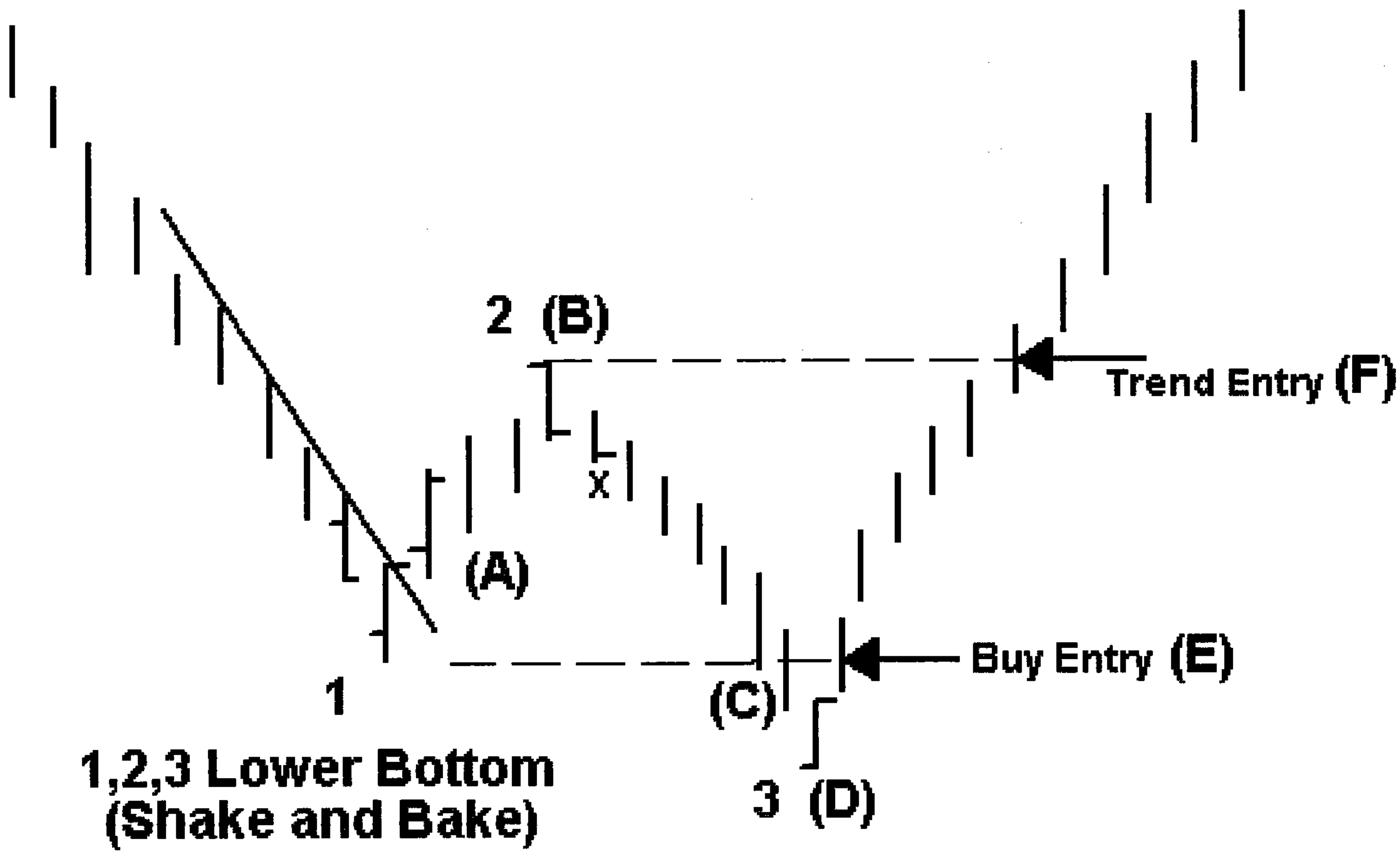


Figure 13

Entry Strategies For Pattern #3 -- 1,2,3 Lower Bottom (Shake and Bake)

1. Swing Point 1 formed on logical trendline break at (A).
2. Swing Point 2 confirmed on close below (X) the signal bar's low (B).
3. The Swing Point 1 low is taken out at (C) and trades down another bar, which becomes Swing Point 3 (D).
4. The entry is on a reversal of the Swing Point 1 low (E). Trend entry (F) should not be taken if too far above Swing Point 3 low.
5. Initial stop is below swing point 3, but if too far, use a money stop or a stop below the swing point 1 low, but give it a little room.

Entry Strategies For Pattern #3 -- 1,2,3 Lower Bottom (Shake and Bake)

6. I must remind you that 1,2,3 Lower Bottoms, in addition to 1,2,3 Double Bottoms, seem like the last thing you want to do at the time, but that is exactly why they are so successful if you understand the pattern and are able to recognize the quickly improving dynamics and the key inflection point levels.

Entry Strategies For Pattern #3 -- 1,2,3 Lower Bottom (Shake and Bake)

7. 1,2,3 Higher Bottoms and 1,2,3 Lower Tops are the most frequent 1,2,3 patterns and starting out with them will probably give you some initial confidence.
8. Because 1,2,3 patterns are clearly defined, they can be paper traded, and I suggest non-professionals do just that starting out.

1,2,3 Sell Patterns

The exact same guidelines apply to the 1,2,3 sell patterns as they do for the 1,2,3 buy patterns, except of course, for direction and the plus tick rule if you're shorting stocks (not including QQQ, SPY, DIA, SMH, etc., all of which can be sold short on minus ticks).

Entry Strategies For Sell Patterns #4, #5 and #6

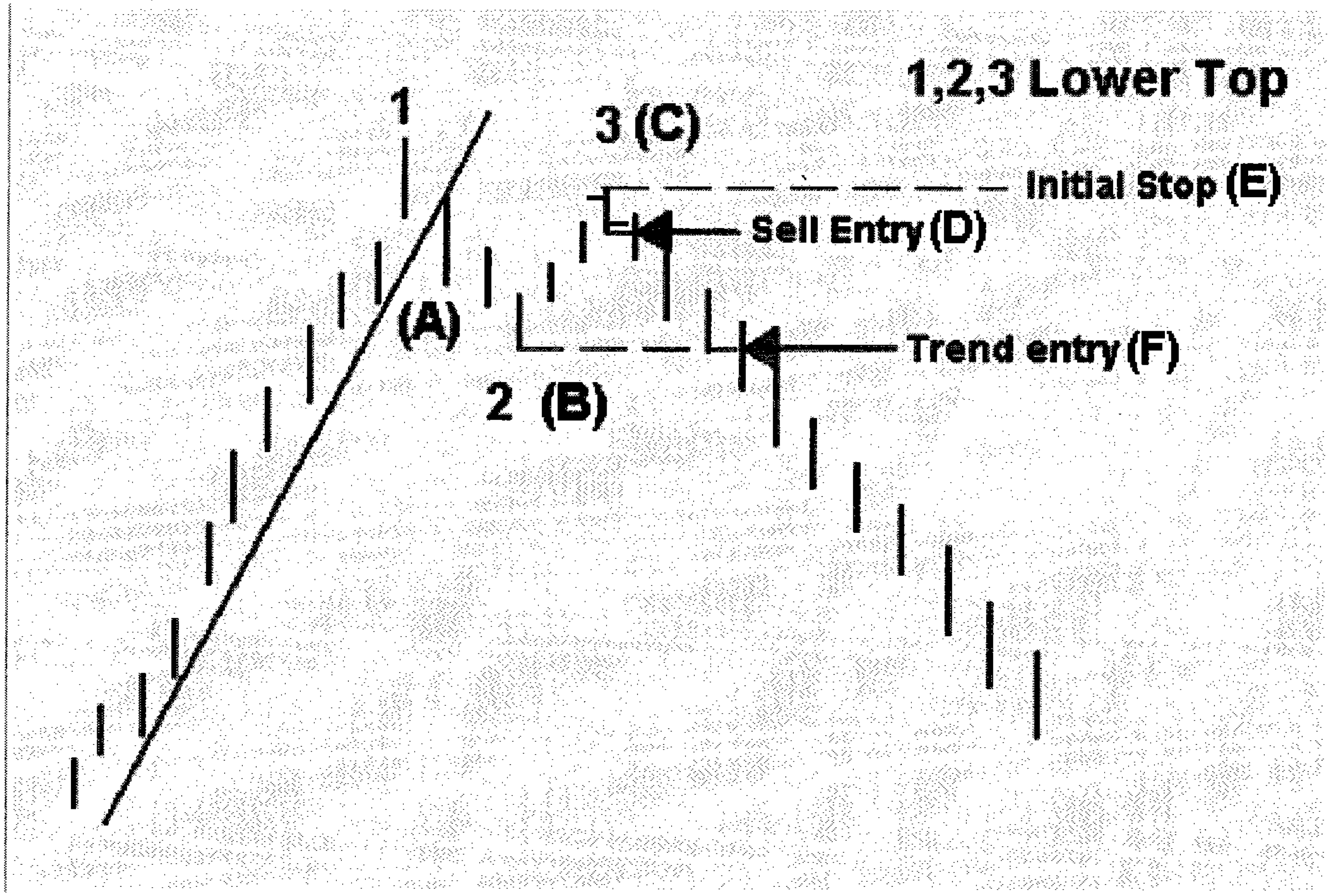


Figure 14

Entry Strategies For Sell Patterns #4, #5 and #6

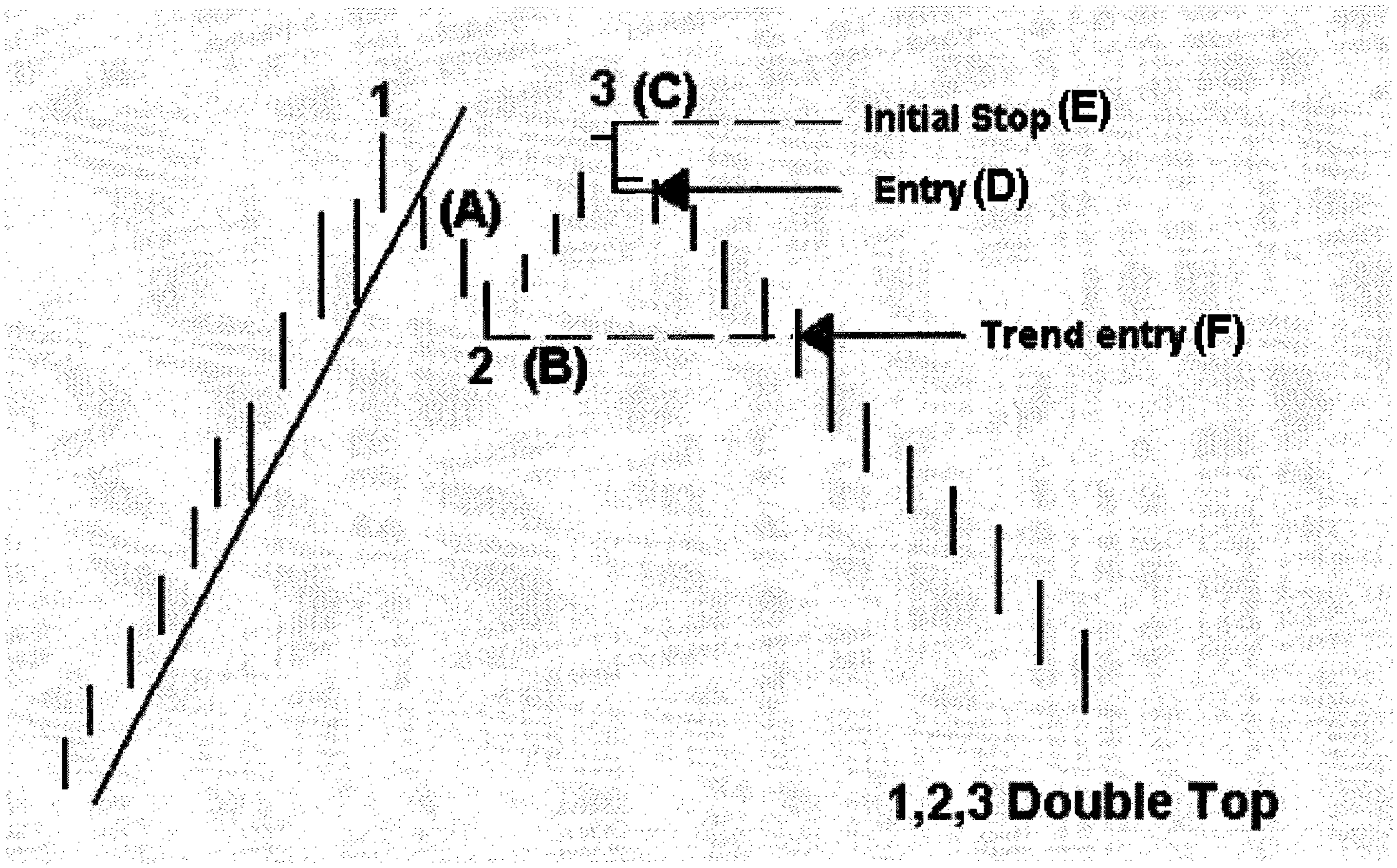


Figure 15

Entry Strategies For Sell Patterns #4, #5 and #6

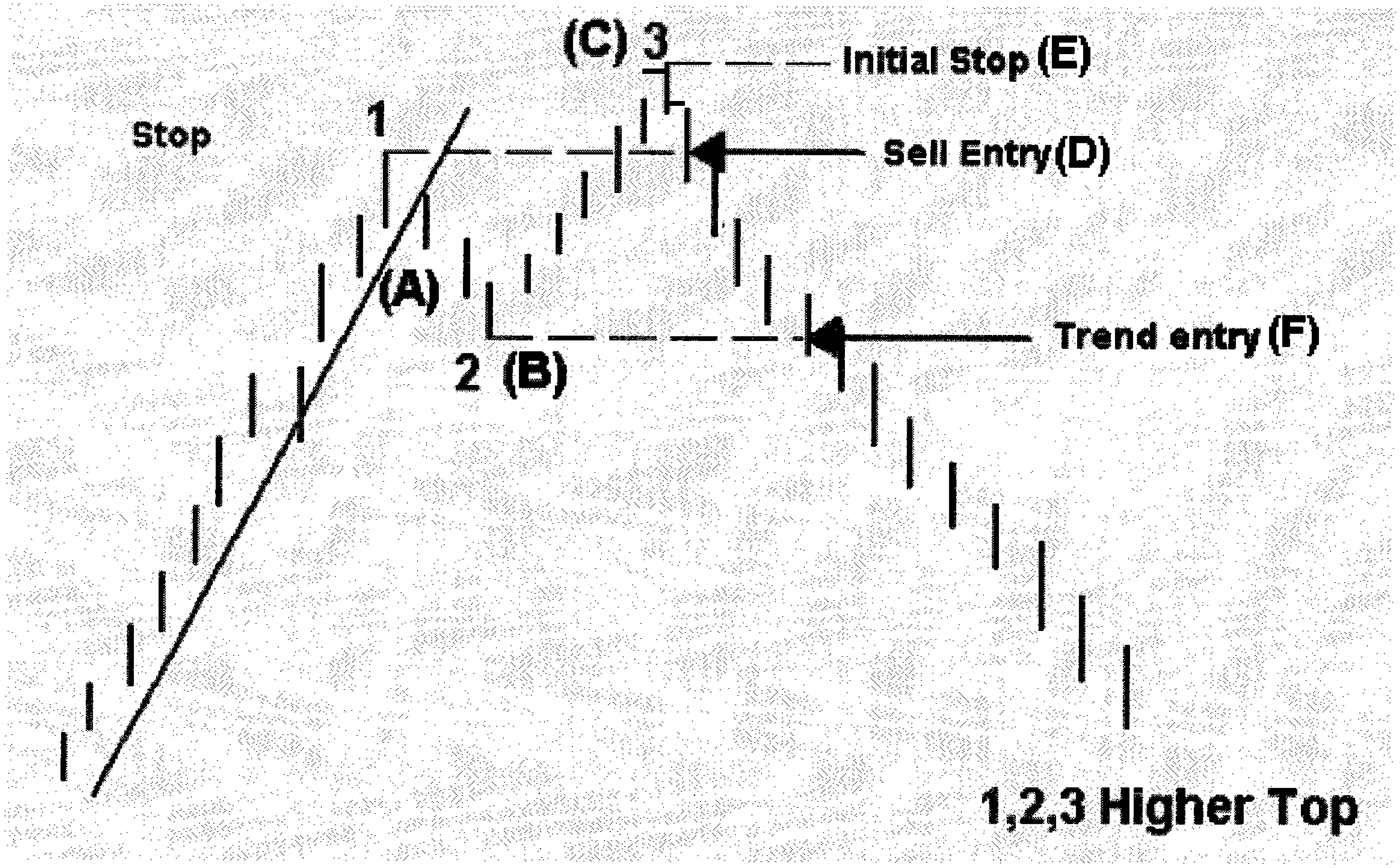


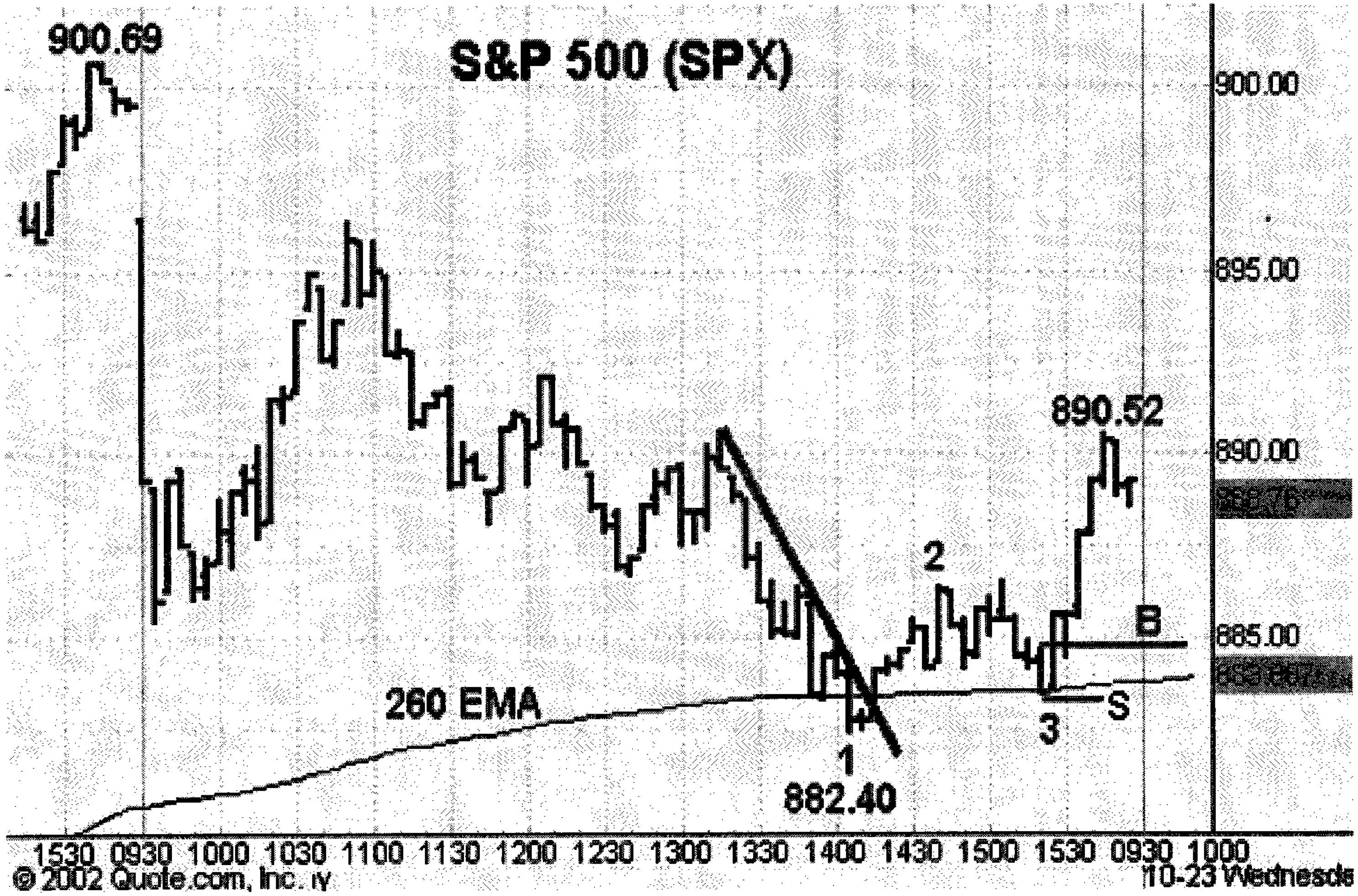
Figure 16

Key Point: Shorting stocks at the correct entry point is very difficult when daytrading, so you would need to look into using “bullets” at your Direct Access broker so that you can sell short on a minus tick. Not all brokers offer this service.

1,2,3 Buy Examples

At this point you have seen some graphic chart examples of the six 1,2,3 patterns and have been given the guidelines needed to trade the 1,2,3s.

We will now progress to some actual chart examples which should further clarify what the trades look like in real situations.

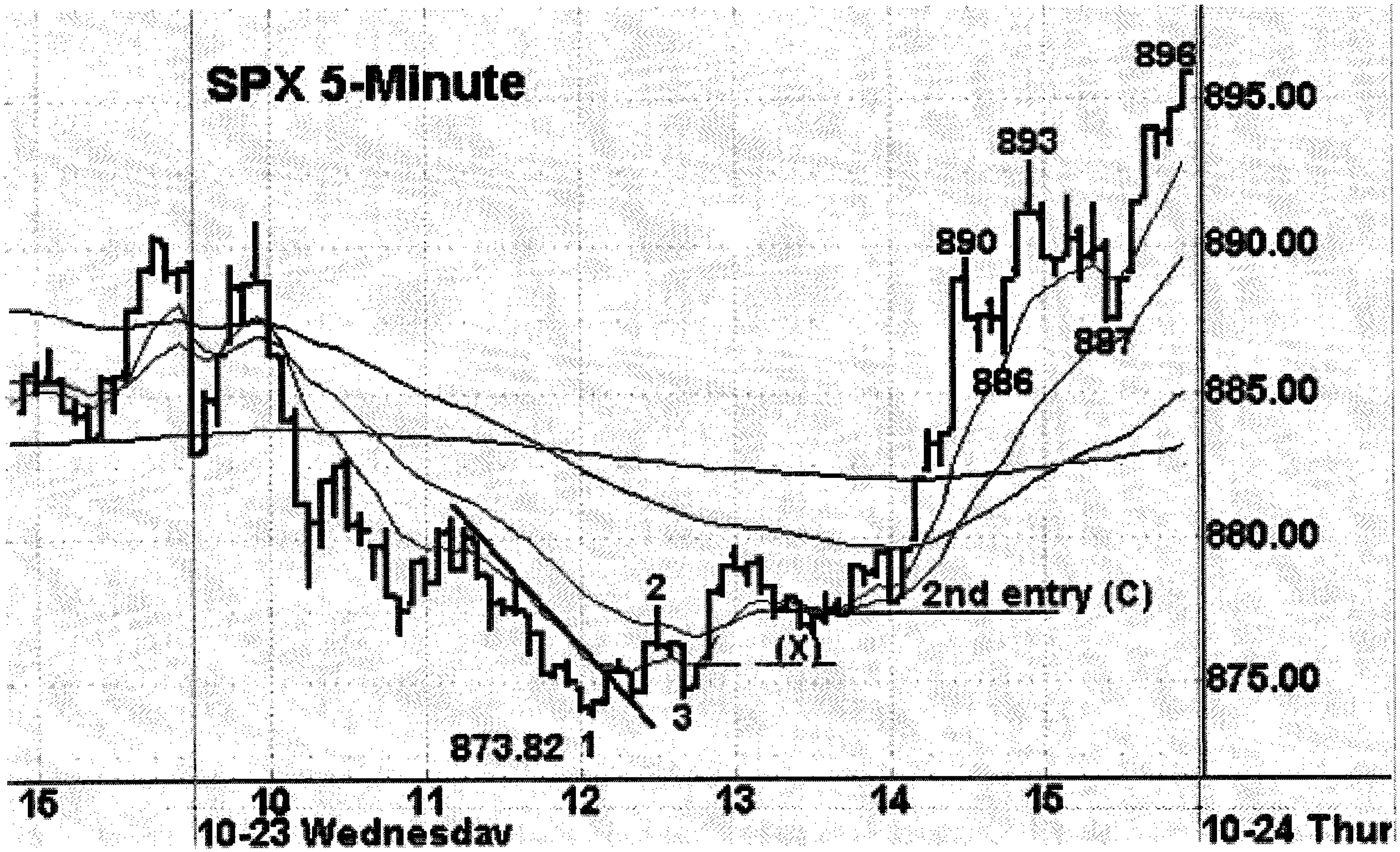


S&P 500 (SPX)
900.69
900.00
895.00
890.52
890.00
2
B
885.00
260 EMA
S
3
1
882.40
1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930 1000
© 2002 Quote.com, Inc.
10-23 Wednesda

Figure 17

Figure 17 Trade Detail

1. **The SPX hits a low at 882.40 then breaks its near-term trendline, forming Swing Point 1.**
2. **It then rallies and makes a new leg higher to Swing Point 2.**
3. **After forming swing point 2, the SPX only retraces two bars and would not be a valid swing point.**
4. **The signal bar for swing point 3 is a narrow-range bar that touches the 260 EMA and meets retracement guidelines.**
5. **A buy entry is triggered above the signal and occurs on the wide-range bar (B). The index rallies to 890.52.**
6. **Initial stop below swing point 3 (S).**



SPX 5-Minute
896
895.00
893
890
890.00
886
887
885.00
880.00
2nd entry (C)
2
(X)
875.00
3
873.82 1
15
10
11
12
13
14
15
10-23 Wednesday
10-24 Thur

Figure 18

Figure 18 Trade Detail

1. **The SPX hits a low at 873.82 then breaks its near-term trendline, connecting two swing points, forming Swing Point 1.**
2. **It then rallies and makes a new leg higher to Swing Point 2. After forming swing point 2, the SPX only retraces two bars and would not be a valid swing point.**
3. **After a three bar reaction down, Swing Point 3 is formed (includes inside bar) and meets retracement guidelines. A buy entry is triggered above the signal and occurs on the wide-range bar (B). The index rallies to 890.52.**
4. **A buy entry is triggered above the high of the inside bar. (X) on the chart. The index rallies to a high of 896 by the end of the day for big gain after entry just above 877.50.**
5. **A second entry for adding to the position (C) occurs after the trend entry breakout, which was above Swing Point 2.**

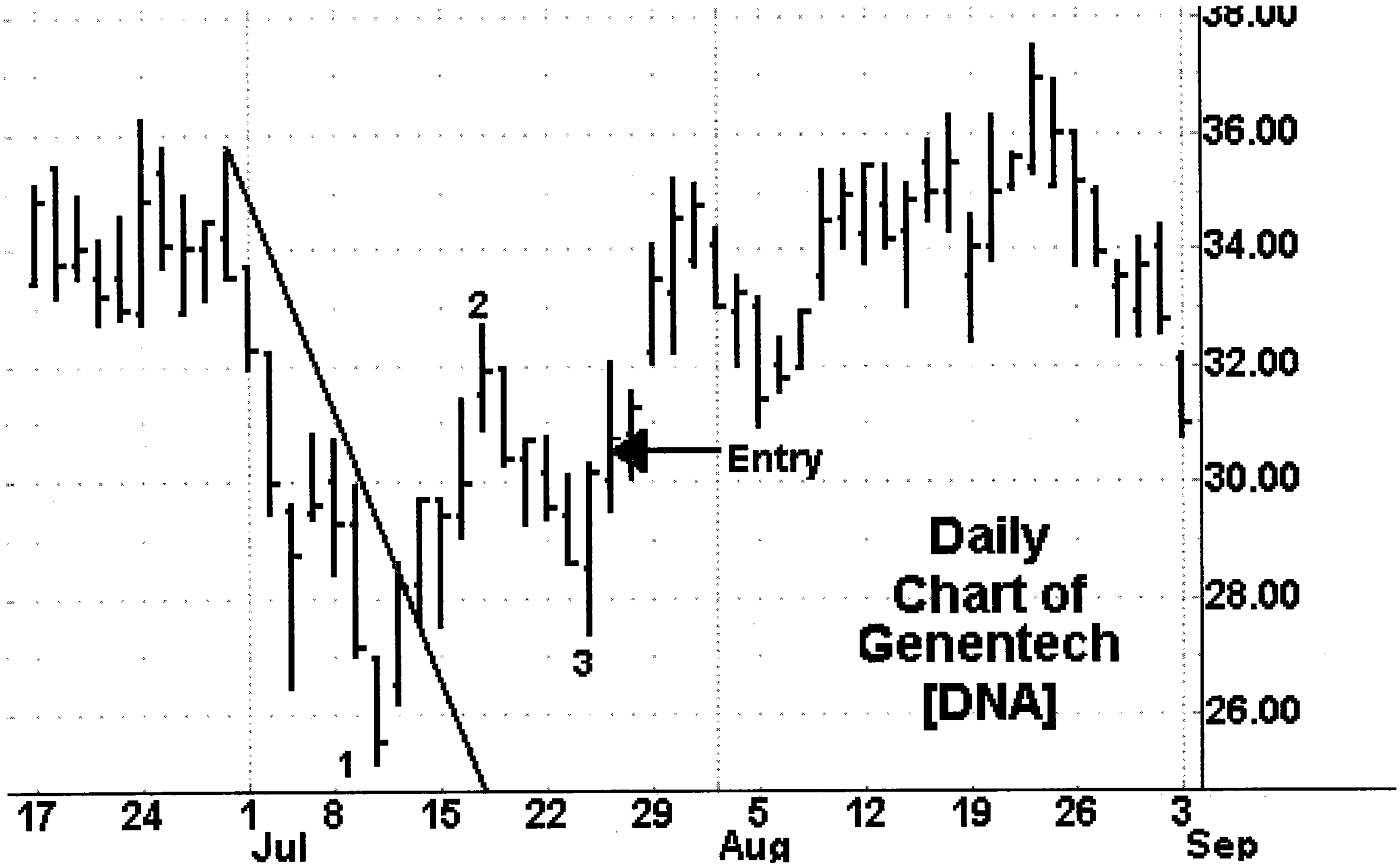

38.00
36.00
34.00
32.00
30.00
28.00
26.00
2
1
3
Entry
Daily
Chart of
Genentech
[DNA]
17
24
1
Jul
8
15
22
29
5
Aug
12
19
26
3
Sep

Figure 19

Figure 19 Trade Detail

1. **The trendline is broken when Swing Point 1 forms after hitting a new low and rallies to Swing Point 2.**
2. **After Swing Point 2 forms, it retraces to form Swing Point 3 meeting retracement guidelines.**
3. **Entry is above the high of the Swing Point 3 bar and only kept overnight in position if there was a profit at the close.**
4. **Your initial stop would have been based on an intraday level, not below the daily chart swing point 3, which was a wide-range bar of just under 10%. If you keep a trade like this in position overnight because you think it's a swing trade, then you would have a trailing stop based on your percentage risk tolerance.**

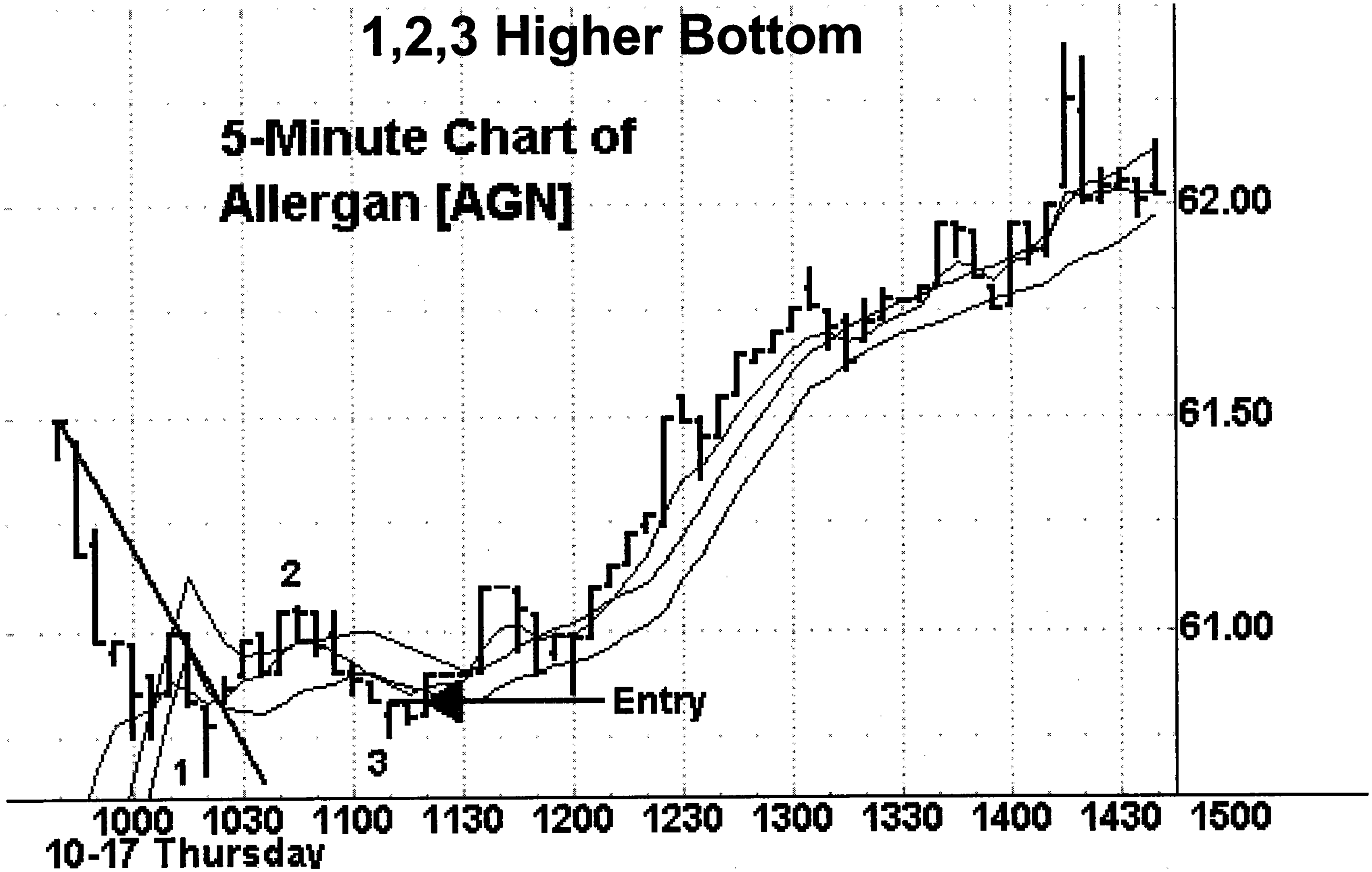


Figure 20

***EMAs shown on the chart are the 8-period EMA of the high, 8-period EMA of the low, and 5-period EMA of the close.**

Figure 20 Trade Detail

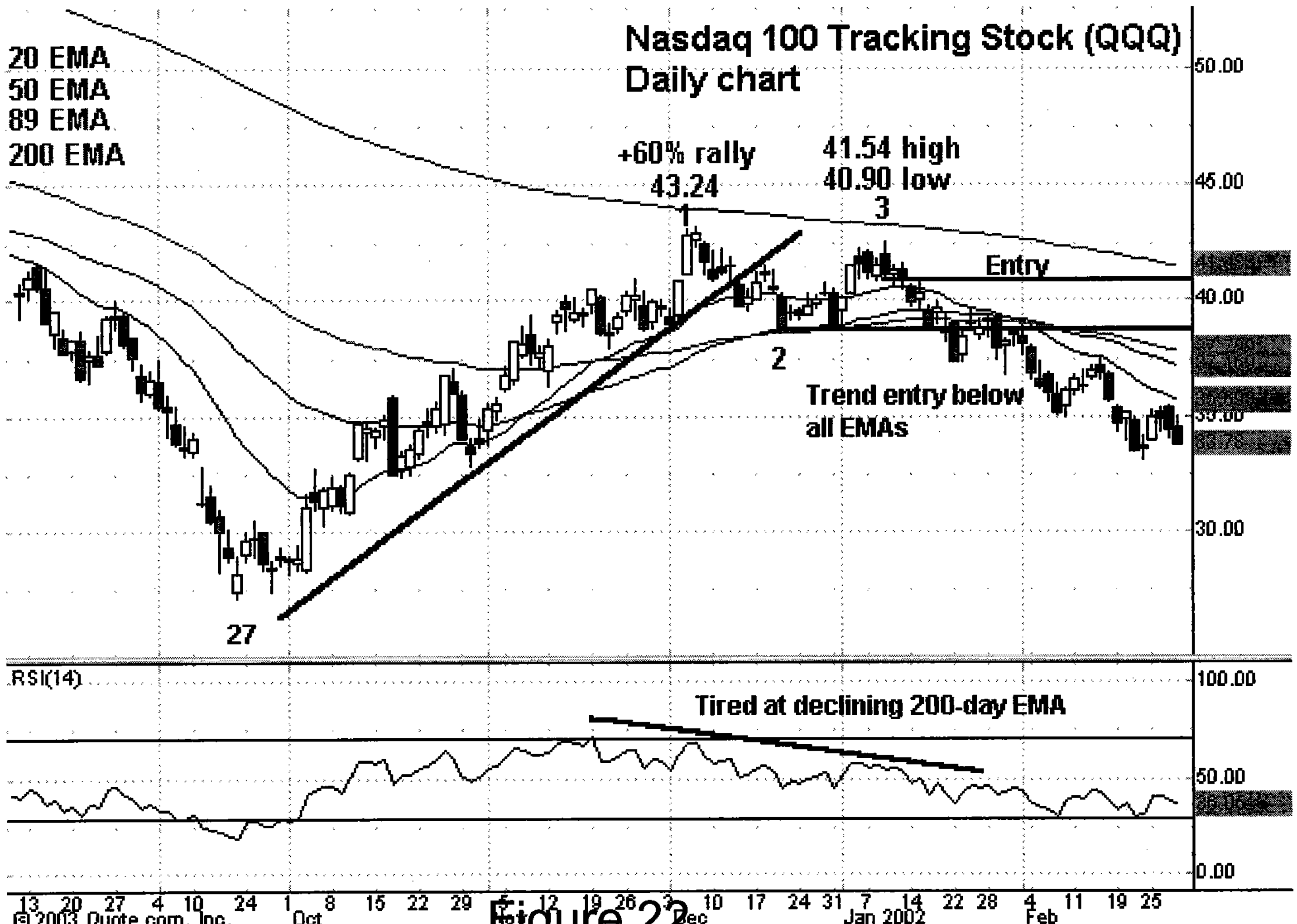
1. **The trendline is broken when Swing Point 1 forms at an intraday low and rallies to Swing Point 2.**
2. **After Swing Point 2 forms, it retraces to form Swing Point 3, meeting the retracement guidelines.**
3. **Entry is above the high of the Swing Point 3 bar.**
4. **Place your initial stop at the low of the Swing Point 3 bar.**
5. **AGN remained in a strong trend all day as price and 5-period EMA traded above the 8-period EMAs.**

1,2,3 Lower Bottom

Figure 21

Figure 21 Trade Detail

1. **The trendline is broken when Swing Point 1 forms and rallies to Swing Point.**
2. **After Swing Point 2 forms, it retraces to form Swing Point 3 below the swing point 1 low with a POSITIVE divergence in both the 14,3,3 slow stochastic and RSI.**
3. **Entry is above the low of the Swing Point 1 bar, since Swing Point 3 formed a "shake and bake" just under the Swing Point 1 low.**
4. **Place your initial stop below the low of the Swing Point 3 bar and don't keep position overnight for possible swing trade unless you have a profit into the close.**



Nasdaq 100 Tracking Stock (QQQ)
Daily chart
20 EMA
50 EMA
89 EMA
200 EMA
+60% rally
43.24
41.54 high
40.90 low
1
2
3
27
Entry
Trend entry below all EMAs
RSI(14)
Tired at declining 200-day EMA
50.00
45.00
40.00
30.00
100.00
0.00
© 2003 Quote.com, Inc.
Oct
Dec
Jan 2002
Feb

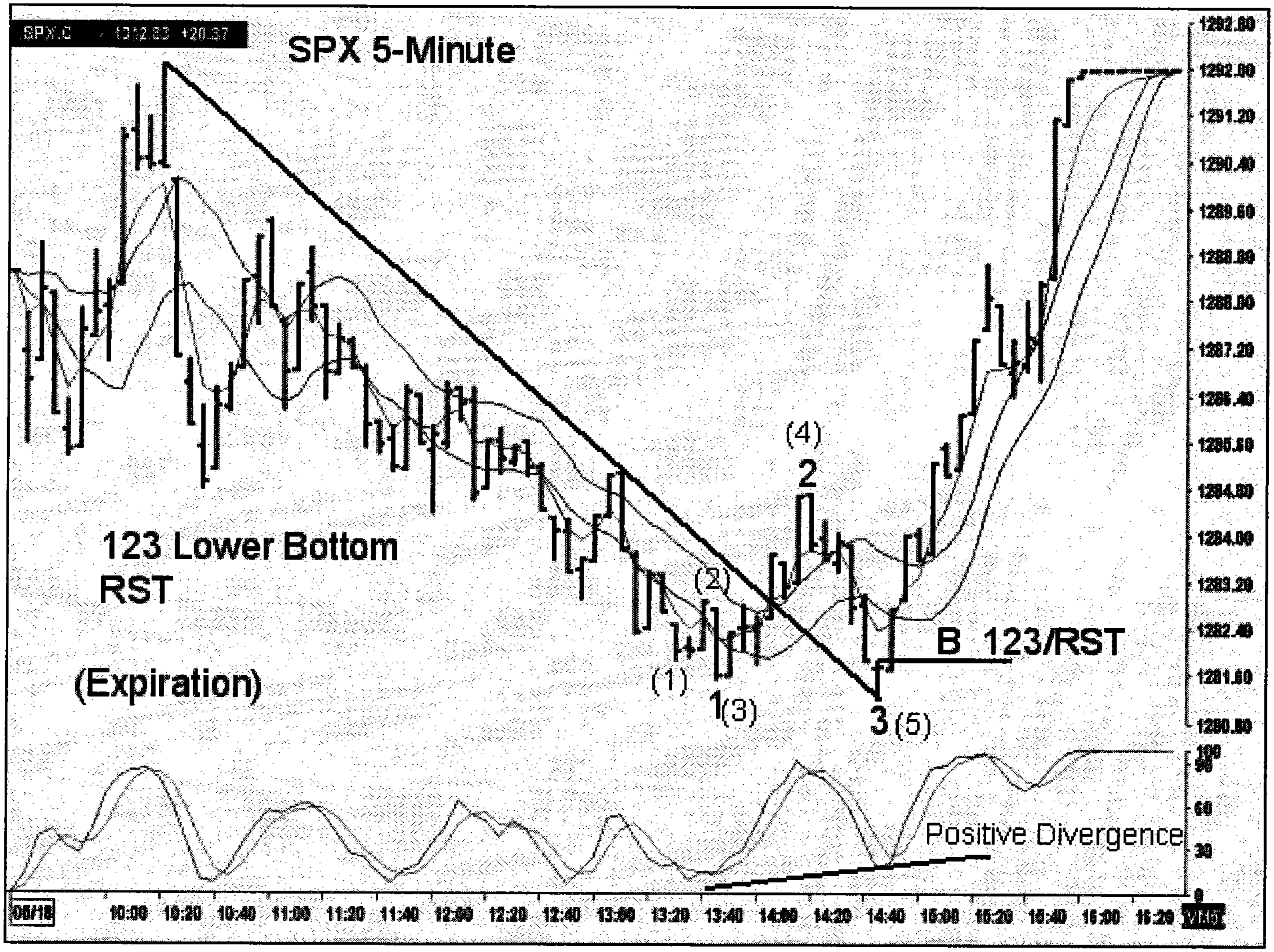
Figure 22

Figure 22 Trade Detail

1. QQQ rallied +60% from Sept. 2001 low of 27 to a 43.24 high and right to a declining 200-day EMA. The 27 level was at the extreme 3.0 STDV band.
2. 43.24 was right at the .618 RT zone to the last major swing point high of 51.96, which was 42.42.
3. Trendline is broken and the QQQ retraces to the 38.68 low right at the 50 and 89-day EMAs, forming swing point 2. The bounce up to form the 1,2,3 double top at 42.60 was 10%.
4. Entry is below 40.90 with a stop just above 42.60, or a bit higher above the 200-day EMA. This is an excellent position trade that had confluence of the declining 200-day EMA, retracement to the .618 zone of a major swing point top at 51.96 (not show on chart), in addition to being extended to the three-month +3.0 STDV band after a 60% rally.

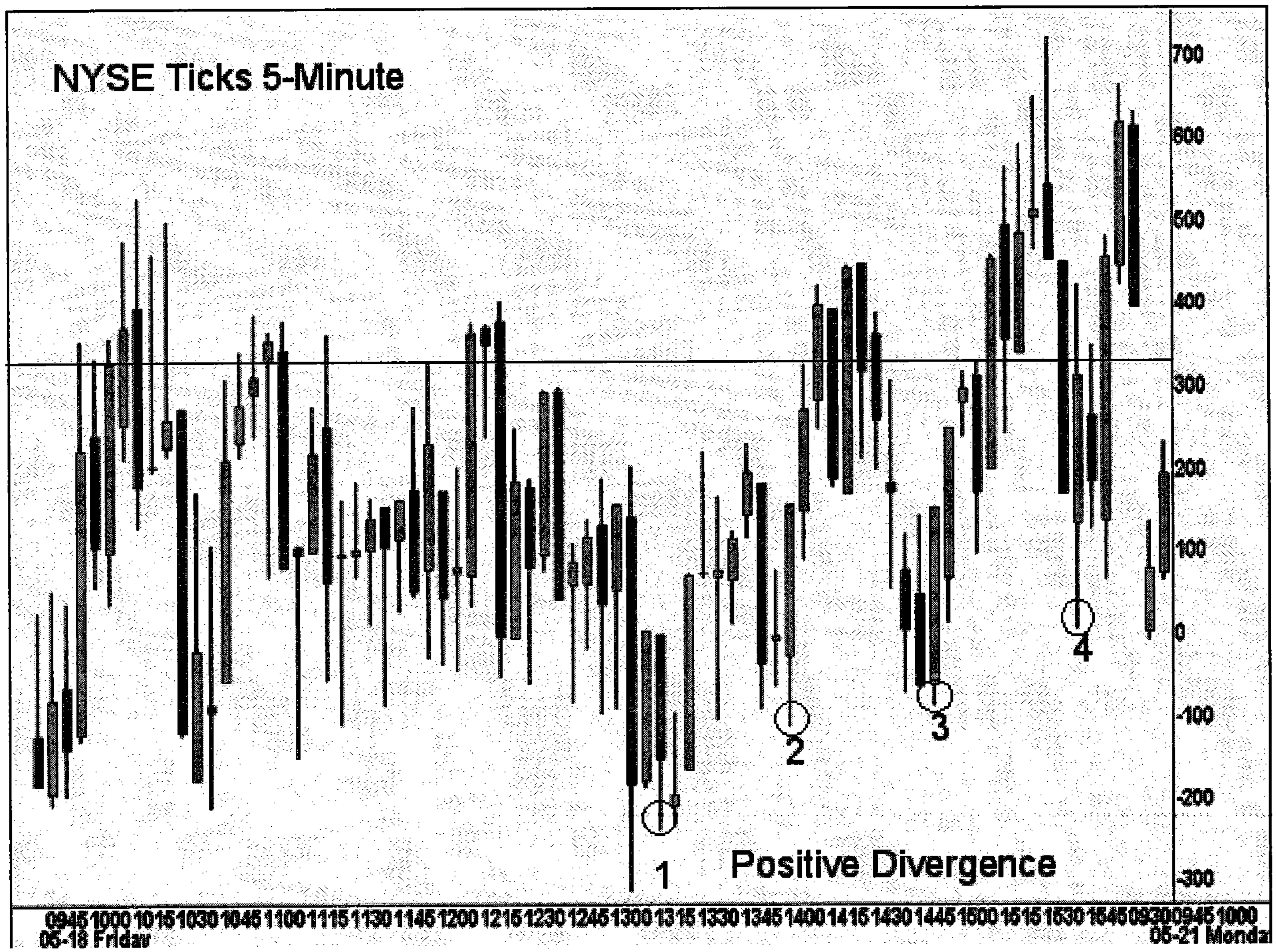
1,2,3s
Real World Examples

1,2,3s

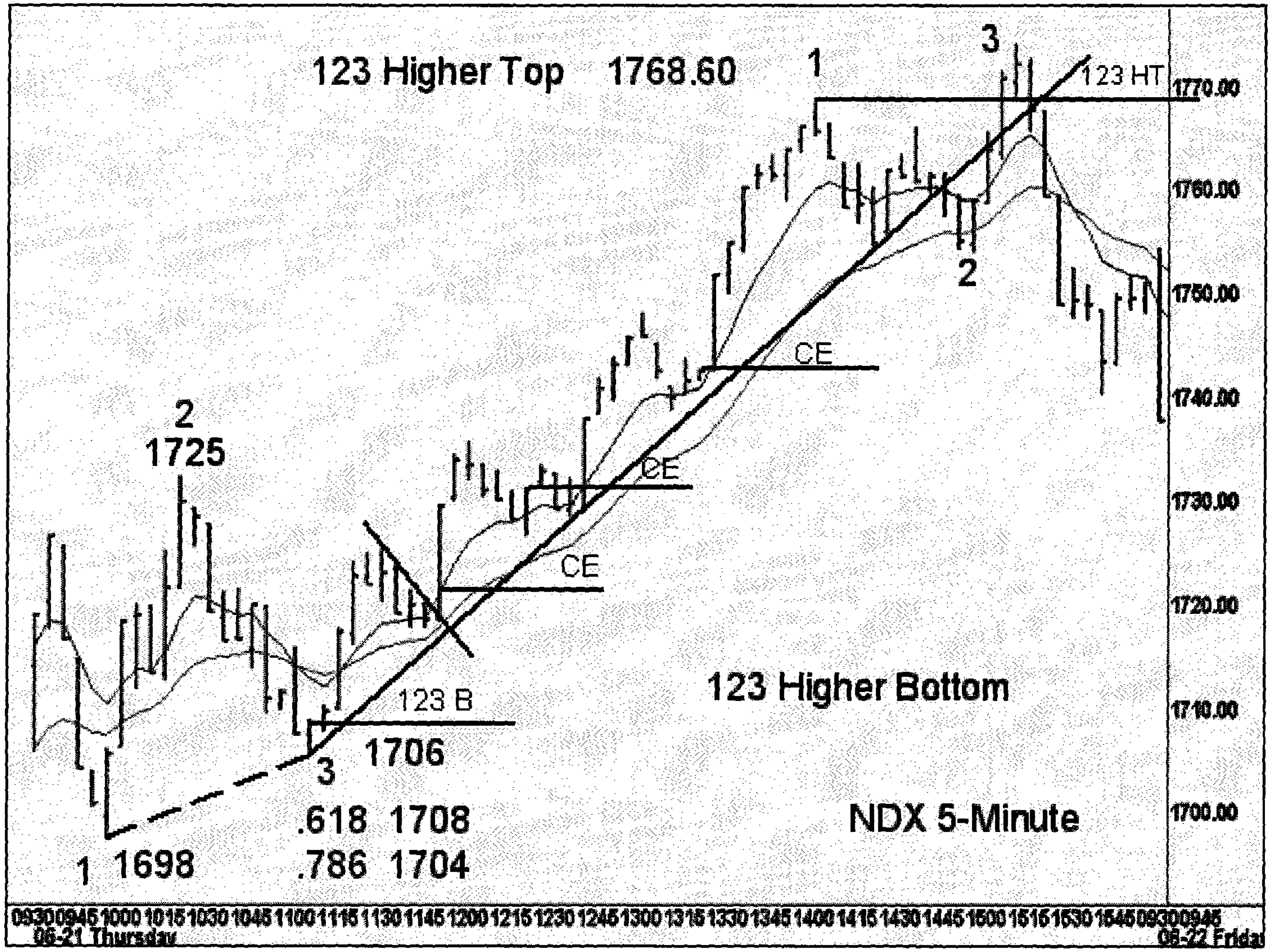


SPX 5-Minute
123 Lower Bottom
RST
(Expiration)
(1)
(2)
1(3)
(4)
2
3(5)
B 123/RST
Positive Divergence

1,2,3s

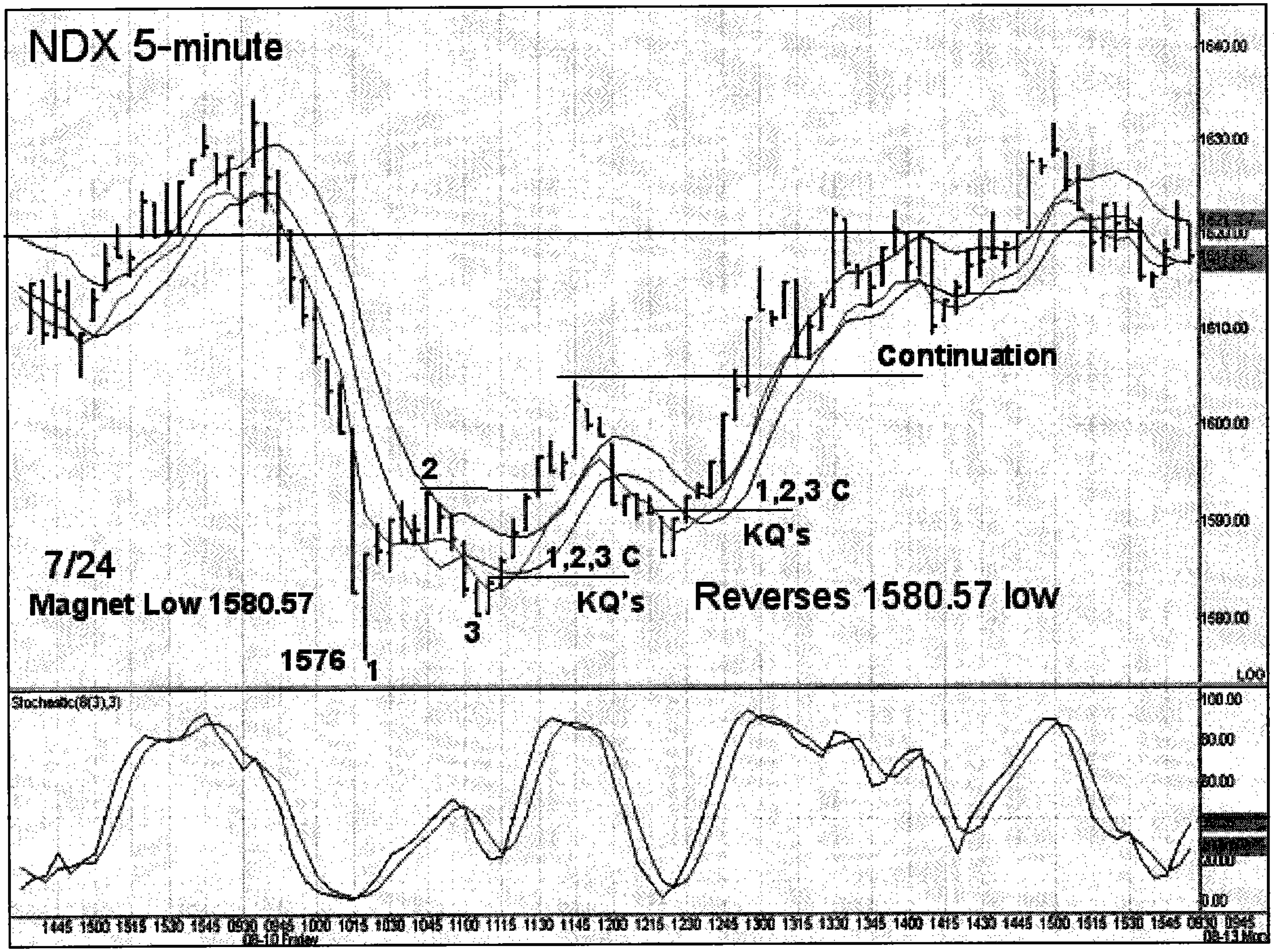

NYSE Ticks 5-Minute
Positive Divergence
1
2
3
4
700
600
500
400
300
200
100
0
-100
-200
-300
0945 1000 1015 1030 1045 1100 1115 1130 1145 1200 1215 1230 1245 1300 1315 1330 1345 1400 1415 1430 1445 1500 1515 1530 1545 0930 0945 1000
05-18 Friday
05-21 Monday

1,2,3s



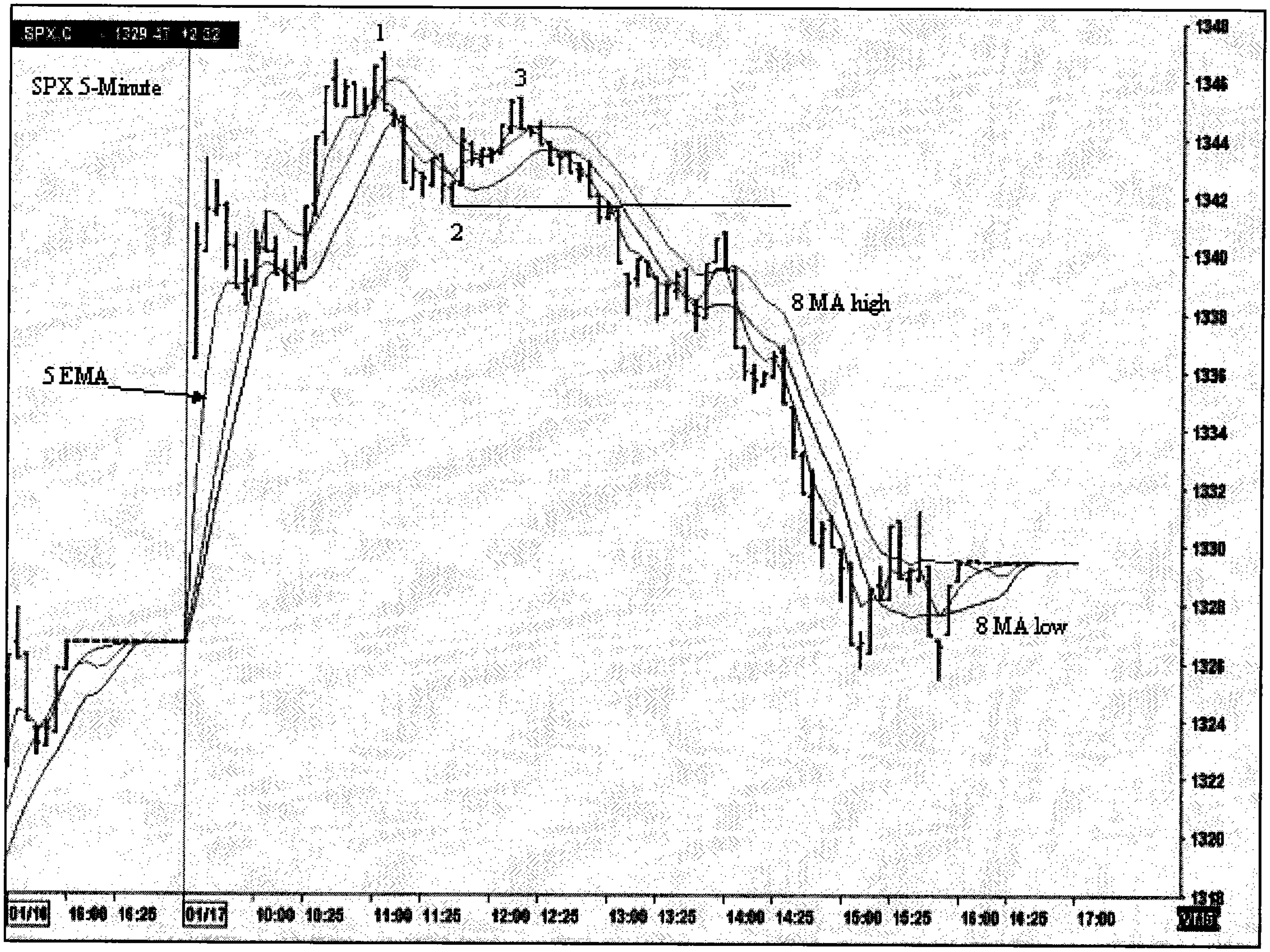
123 Higher Top 1768.60
1
3
123 HT
2
1725
CE
CE
CE
123 B
1706
3
.618 1708
.786 1704
1 1698
123 Higher Bottom
NDX 5-Minute
2
1770.00
1760.00
1750.00
1740.00
1730.00
1720.00
1710.00
1700.00

1,2,3s

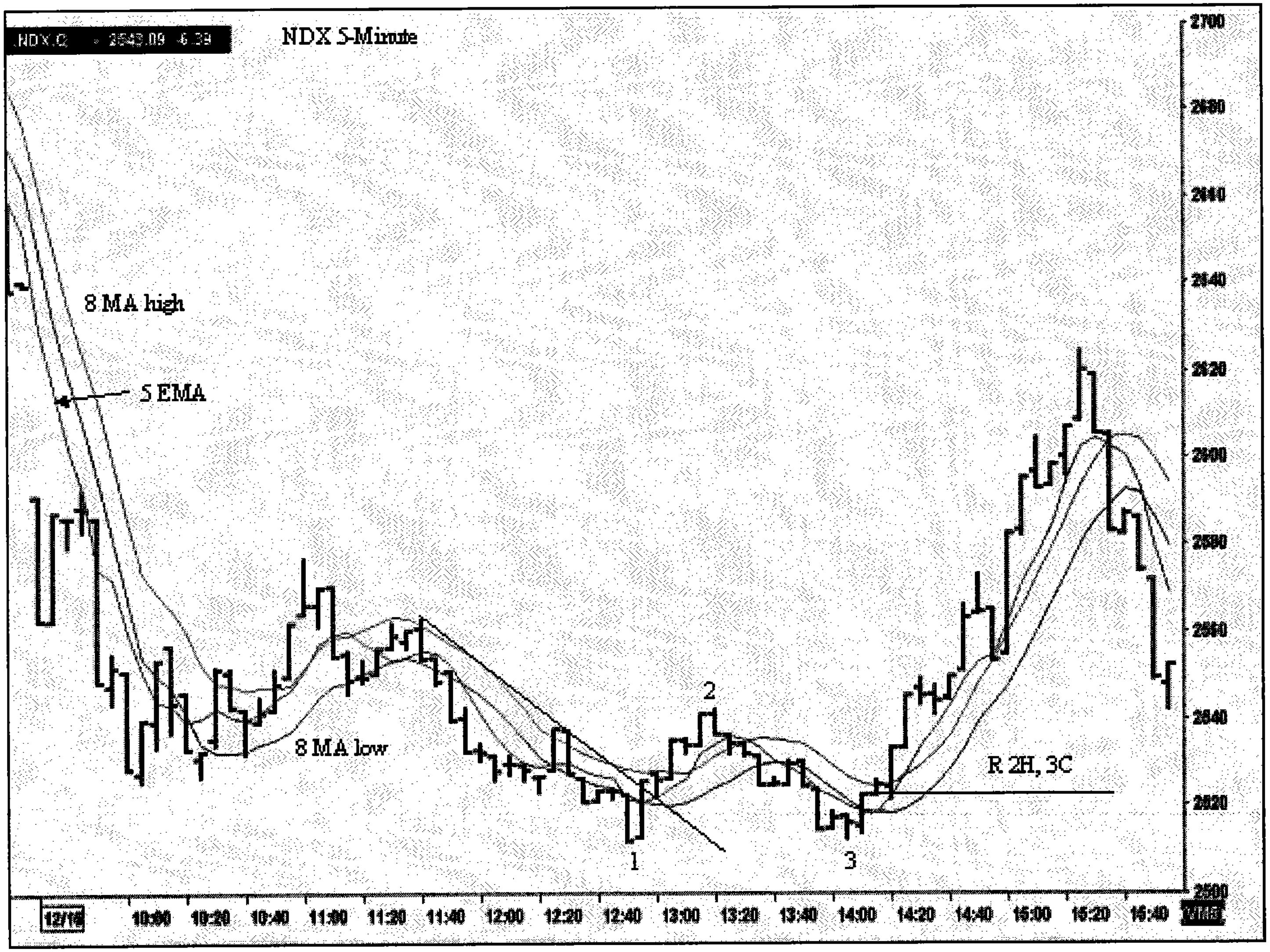


NDX 5-minute
Continuation
2
1,2,3 C
KQ's
1,2,3 C
KQ's
7/24
Magnet Low 1580.57
Reverses 1580.57 low
3
1576
1

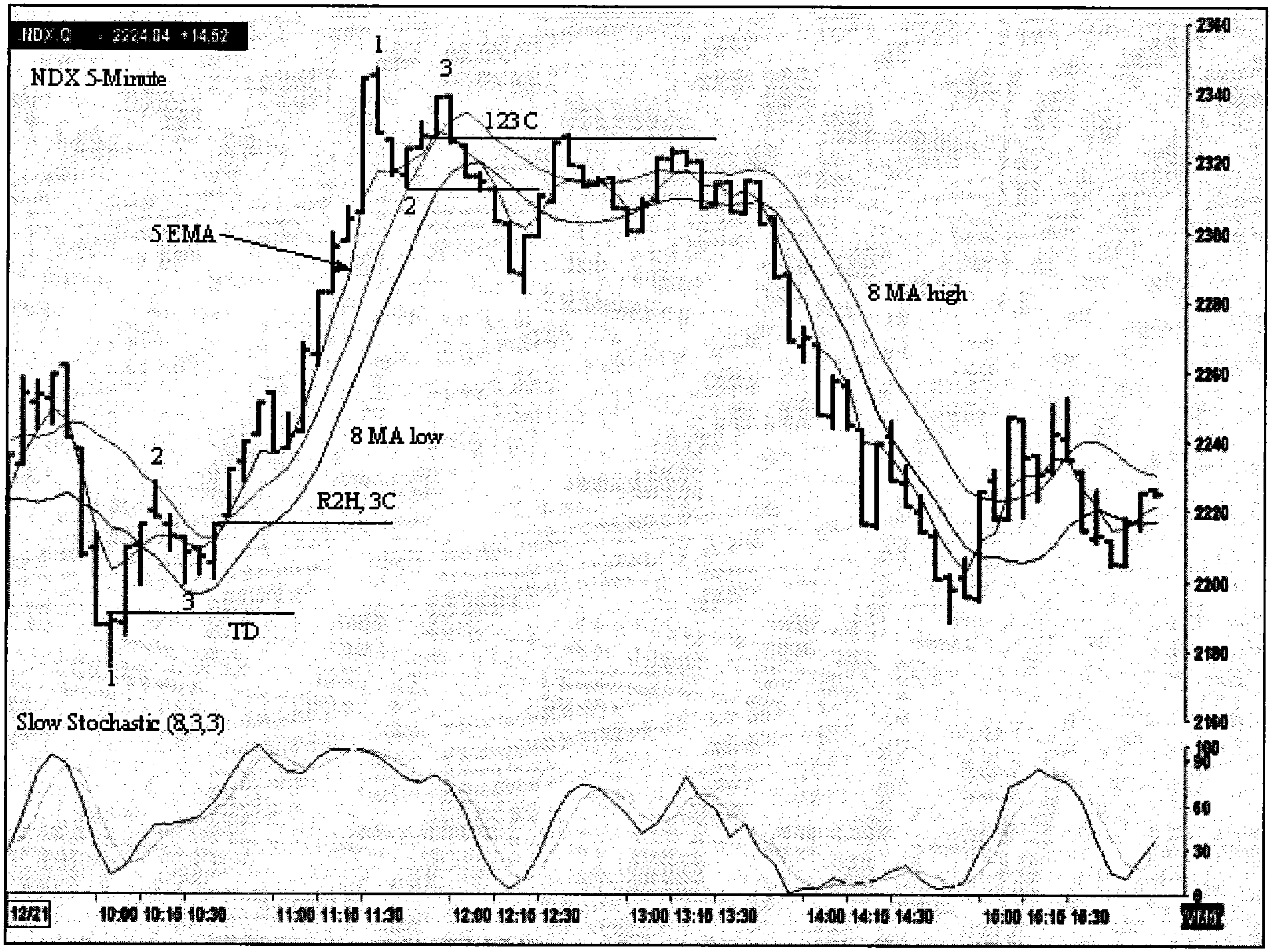
1,2,3s



1,2,3s

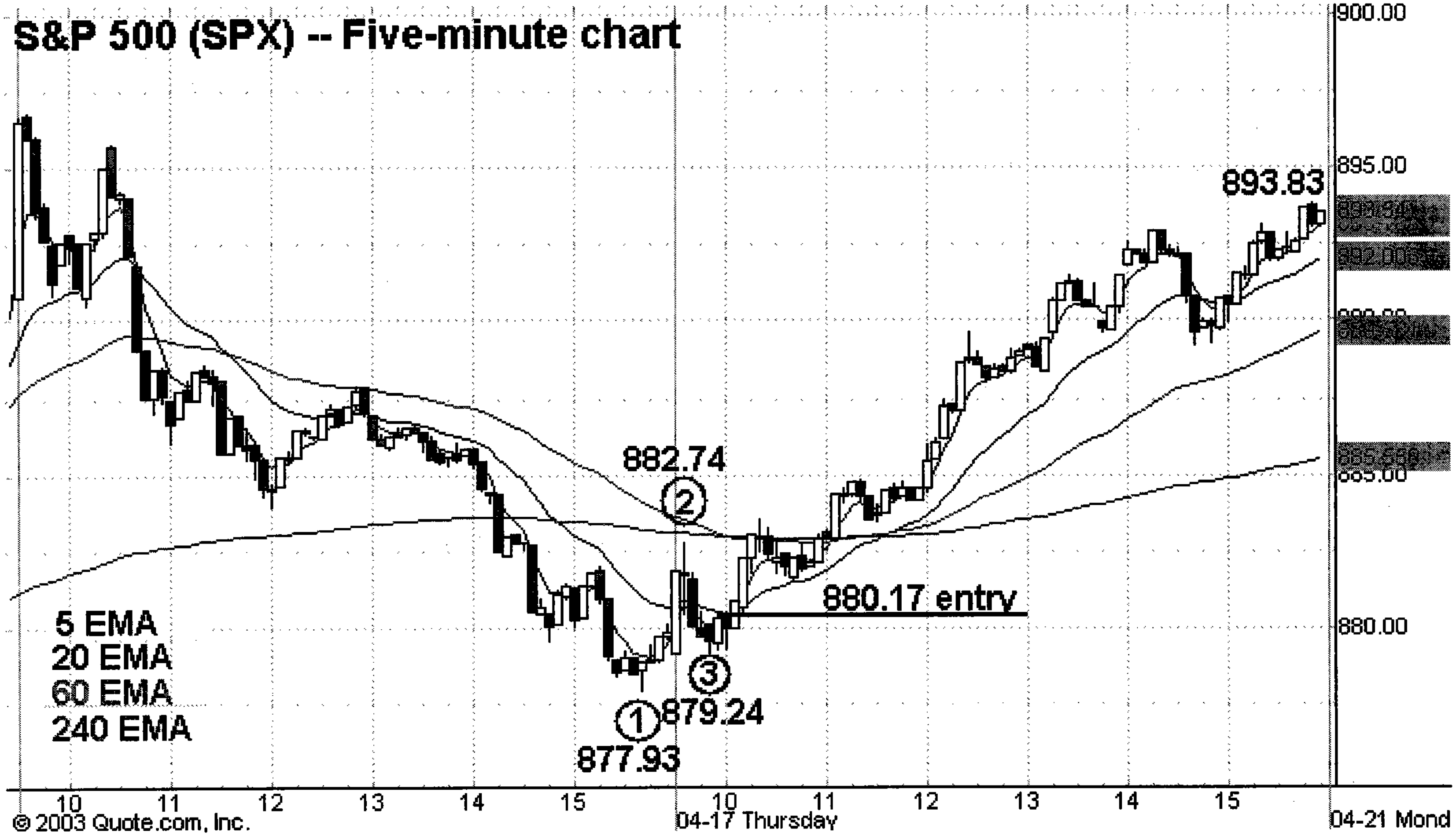


1,2,3s



.NDX.Q 2224.84 +14.52
NDX 5-Minute
1
3
123 C
2
5 EMA
8 MA high
8 MA low
2
R2H, 3C
3
TD
1
Slow Stochastic (8,3,3)

1,2,3s



S&P 500 (SPX) -- Five-minute chart
900.00
895.00
893.83
882.74
2
880.17 entry
880.00
5 EMA
20 EMA
60 EMA
240 EMA
3
879.24
1
877.93
10
11
12
13
14
15
04-17 Thursday
10
11
12
13
14
15
04-21 Mond
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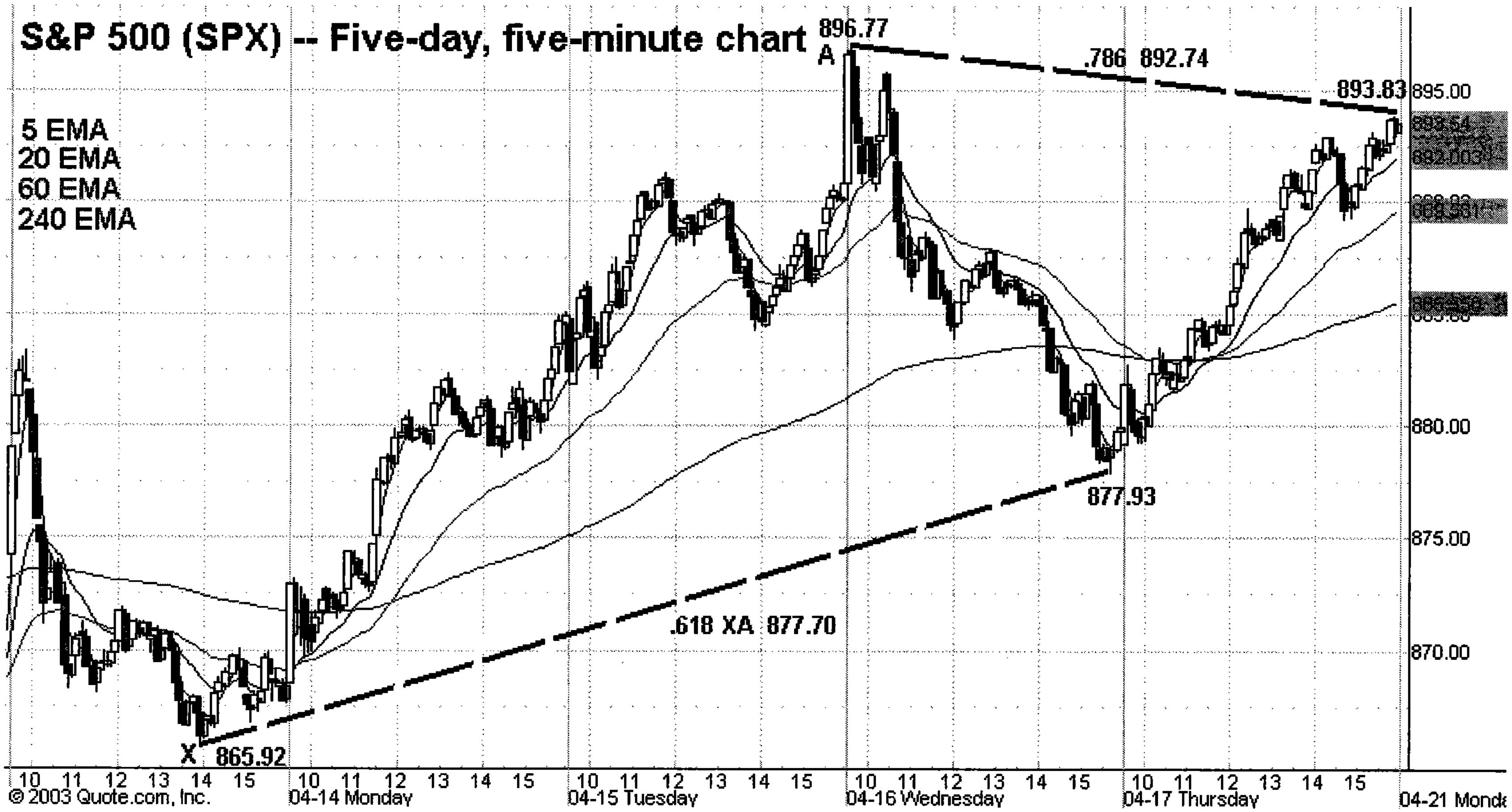
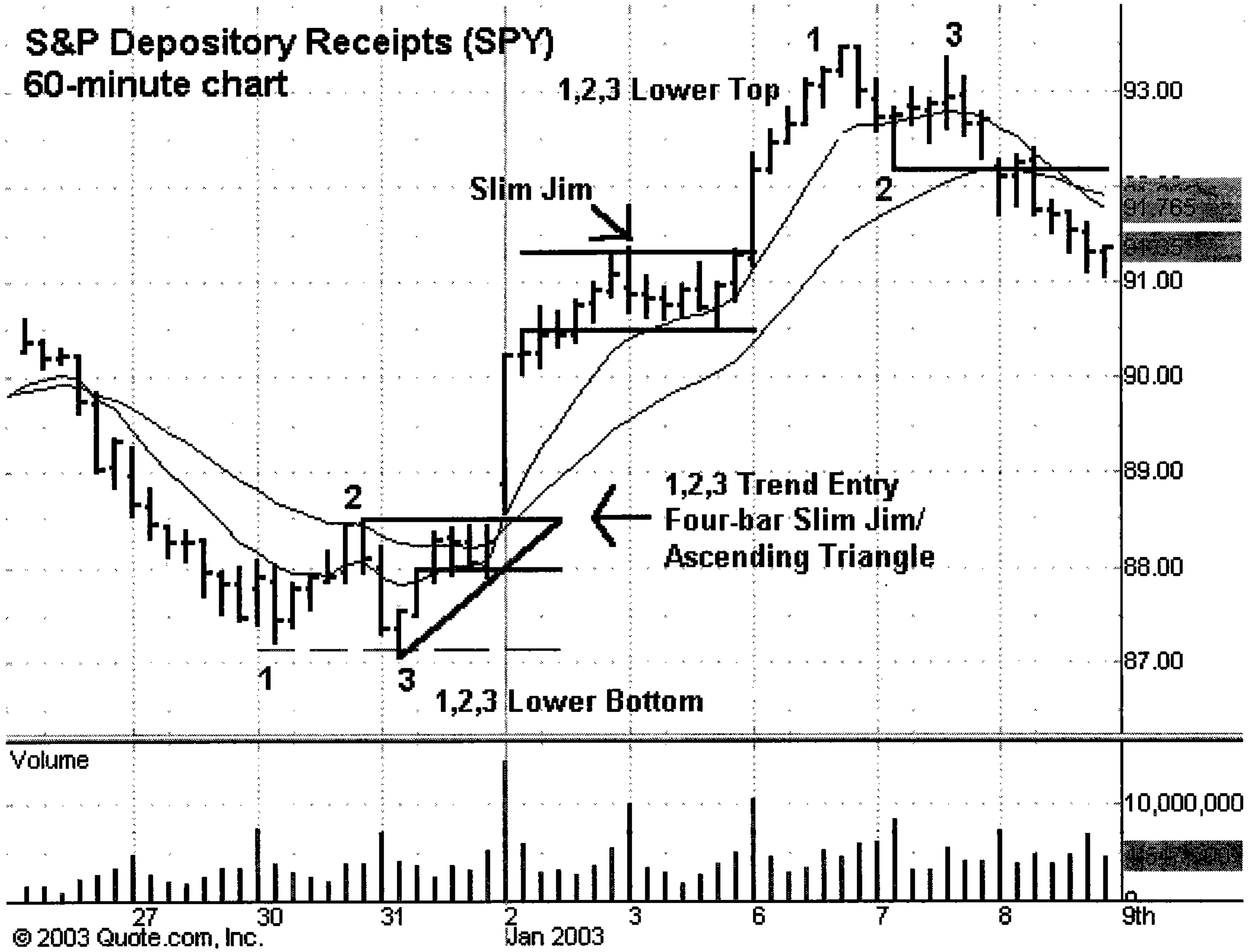
1,2,3s



S&P 500 (SPX) -- Five-day, five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
896.77
A
.786 892.74
893.83
877.93
.618 XA 877.70
X 865.92
895.00
880.00
875.00
870.00
© 2003 Quote.com, Inc.
04-14 Monday
04-15 Tuesday
04-16 Wednesday
04-17 Thursday
04-21 Monda

1,2,3s



S&P Depository Receipts (SPY)
60-minute chart
1,2,3 Lower Top
Slim Jim
1,2,3 Trend Entry
Four-bar Slim Jim/
Ascending Triangle
1,2,3 Lower Bottom
1
2
3
1
2
3
93.00
91.00
90.00
89.00
88.00
87.00
Volume
10,000,000
27
30
31
2
3
6
7
8
9th
Jan 2003
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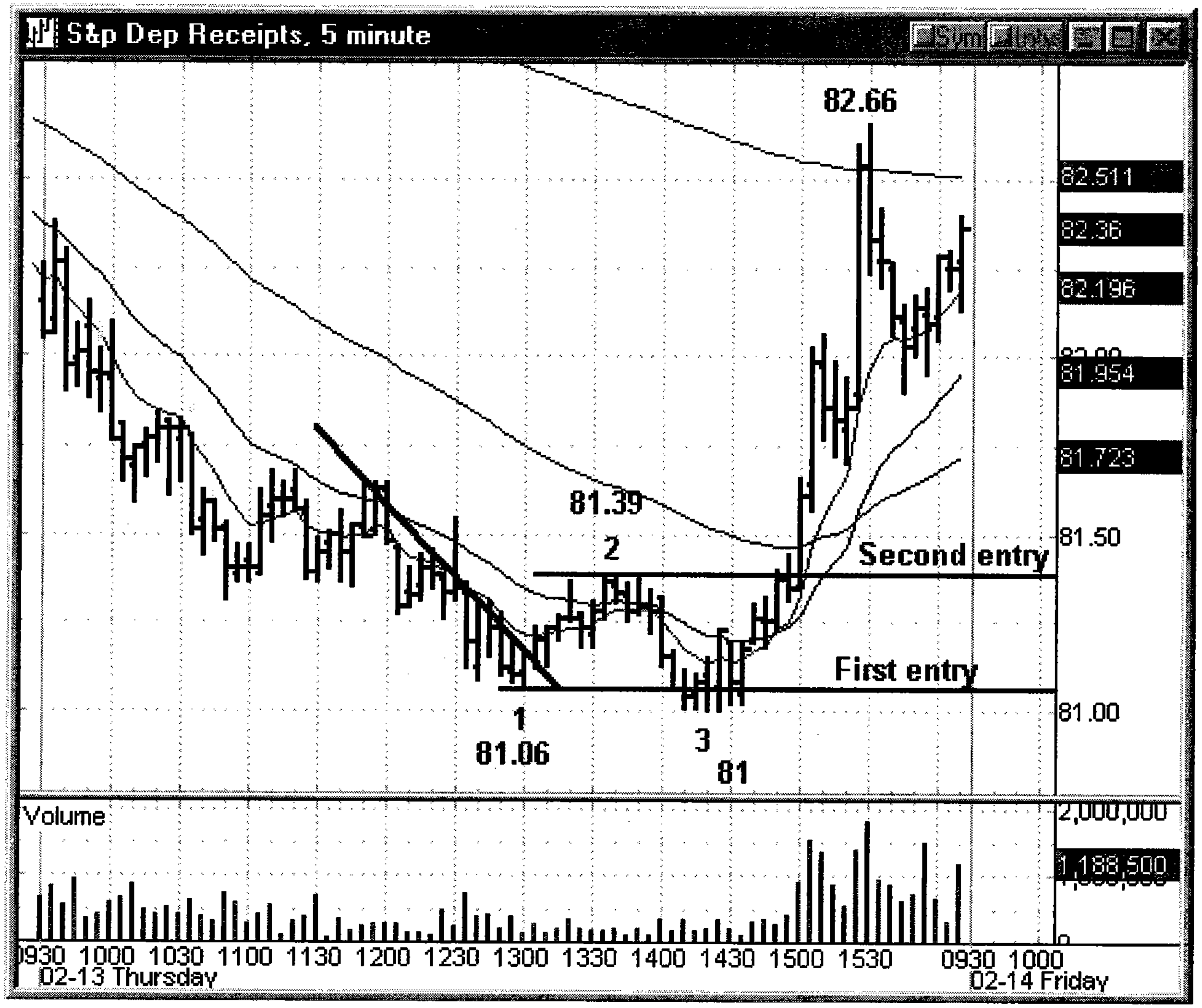
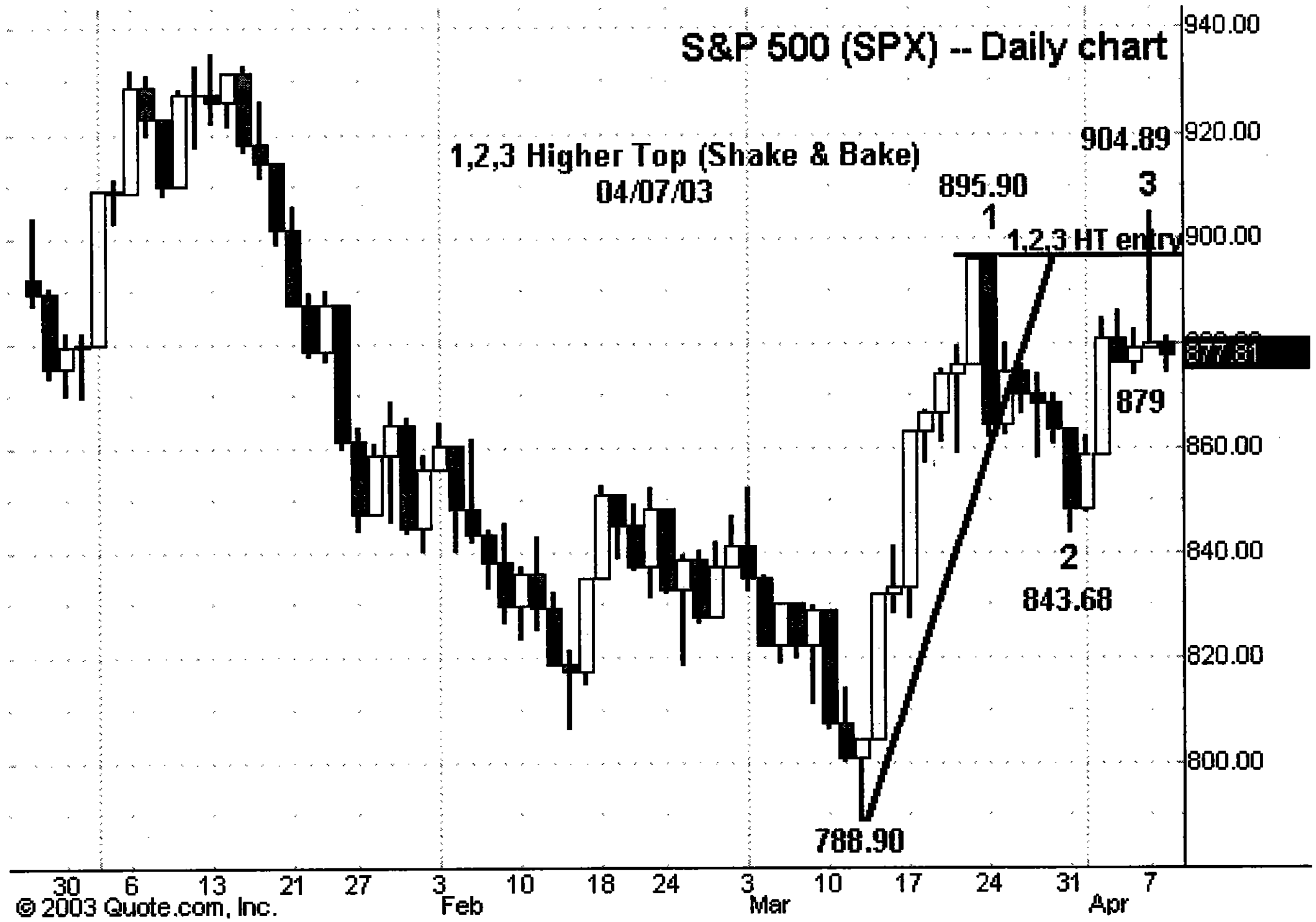
1,2,3s



S&p Dep Receipts, 5 minute
82.66
82.511
82.36
82.196
81.954
81.723
81.39
2
Second entry
81.50
First entry
81.00
1
81.06
3
81
Volume
2,000,000
1,188,500
0
0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930 1000
02-13 Thursday
02-14 Friday

1,2,3s


S&P 500 (SPX) -- Daily chart
1,2,3 Higher Top (Shake & Bake)
04/07/03
895.90
1
904.89
3
1,2,3 HT entry
879
2
843.68
788.90
940.00
920.00
900.00
877.81
860.00
840.00
820.00
800.00
30 6 13 21 27 3 10 18 24 3 10 17 24 31 7
Feb
Mar
Apr
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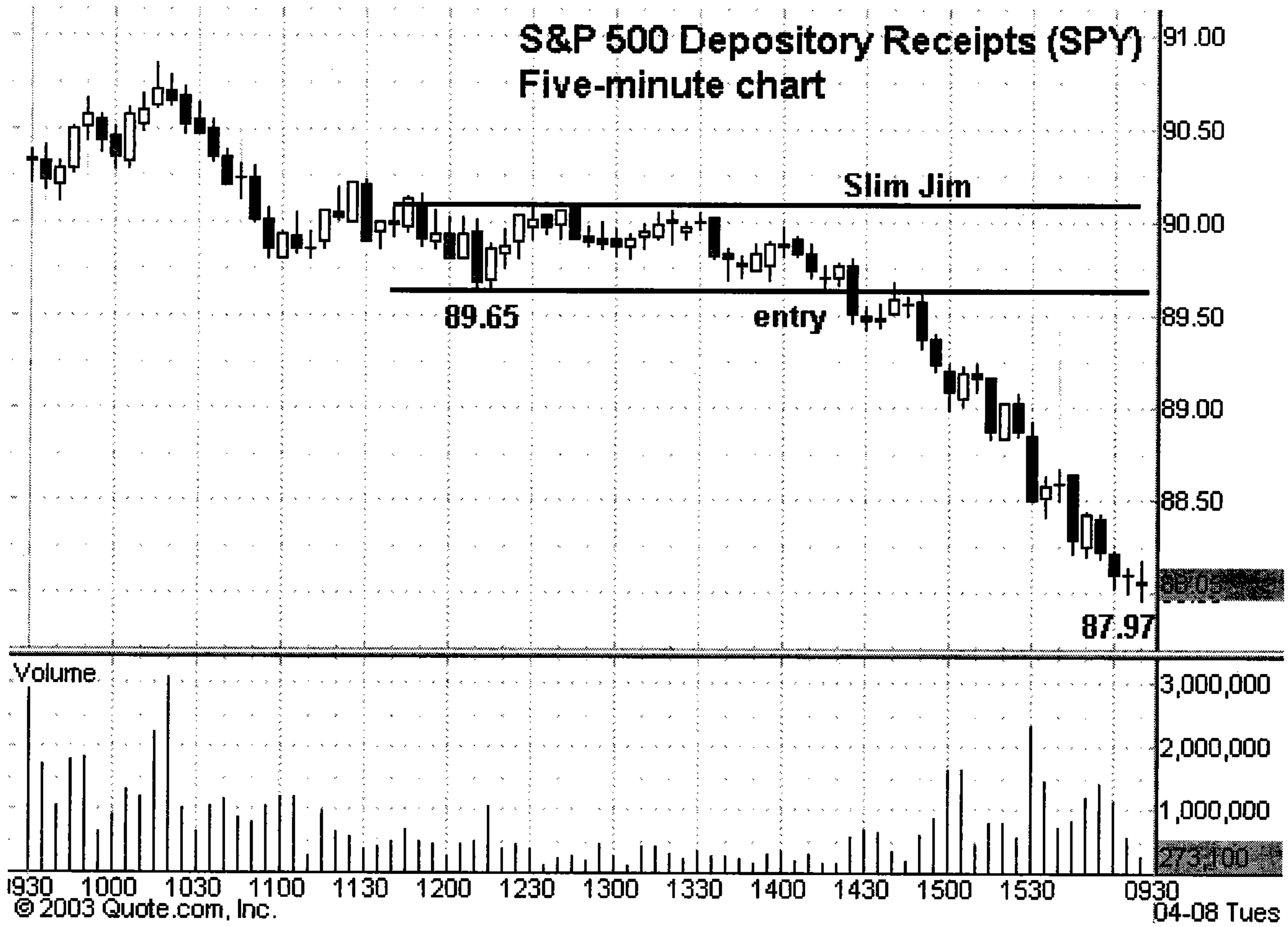
1,2,3s



S&P 500 Depository Receipts (SPY)
Five-minute chart
Slim Jim
89.65
entry
87.97
91.00
90.50
90.00
89.50
89.00
88.50
Volume
3,000,000
2,000,000
1,000,000
273,100
0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930
04-08 Tues
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You should now have an excellent understanding of how to identify and trade the six primary 1,2,3 patterns. With the information up this point, you will be very successful trading this strategy. However, to gain the maximum edge, you must be able to apply the various "tools" that will give you a positive mathematical expectation by pinpointing significant market turning points with much greater precision and probability.

It is better to incorporate these tools after you learn all of the various seminar strategies that they apply to. You will discover that they are pertinent to almost every other strategy that you use to trade the markets.

Next I want to give you a short form 1,2,3 strategy that will give you early entry for a change in direction from a significant level that has compelling market dynamics at the time of entry. For lack of a better term, I call it 1,2,3 closes.

1,2,3 Closes

- This reversal strategy reduces the normal 1,2,3 Lower Top or Higher Bottom entries down to the lowest common denominator of using closes rather than the trendline and swing points guidelines you use for these 1,2,3 patterns.
- It will enable you to enter a trade at the earliest indication of a change in direction after a significant bottom or top if you feel the dynamics are compelling at the time of entry.

1,2,3 Closes -TRADE CRITERIA

Buys (Sells Reversed)

1. Must be at least a seven-bar low.
2. It must have an up close. (This up close can also be on the same bar as the significant lows.
3. Next, it must have a down close.
4. You enter long above the high of the down close bar provided it has formed a swing point low when it changes direction.

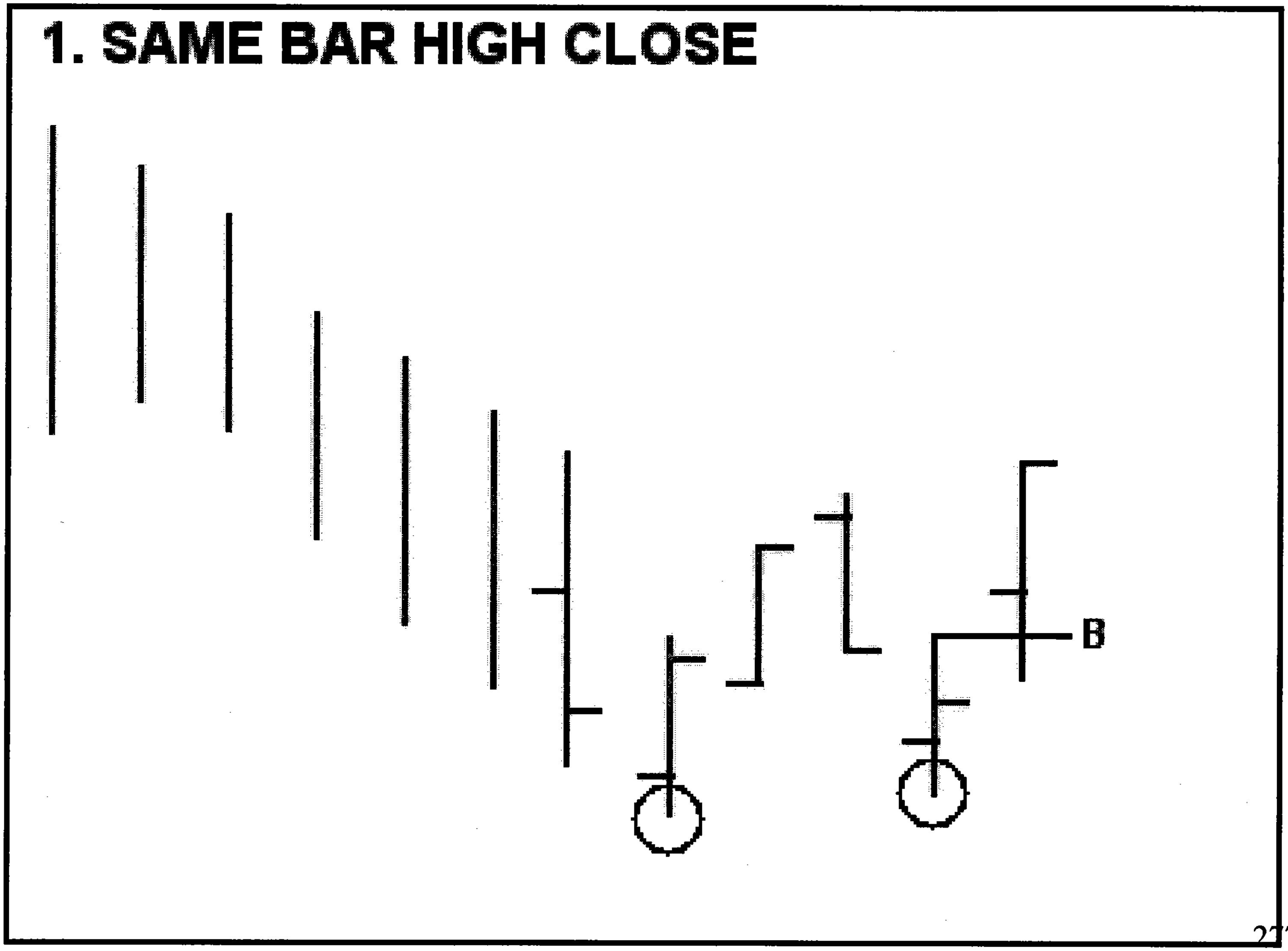
1,2,3 Closes -TRADE CRITERIA

5. The exception to forming a swing point low when you enter above the high of the down close bar is as follows:
   a) If the seven-bar low also has the up close and the close is above the midpoint of that bar, then you enter above the high of that bar if the down close bar is an inside bar.
   b) There can be consecutive up closes, but the setup count begins when you get the first down close. If you get a second down close and its high is lower than the high of the first down close bar, you just lower your entry to one tick above the high of the second down close bar.

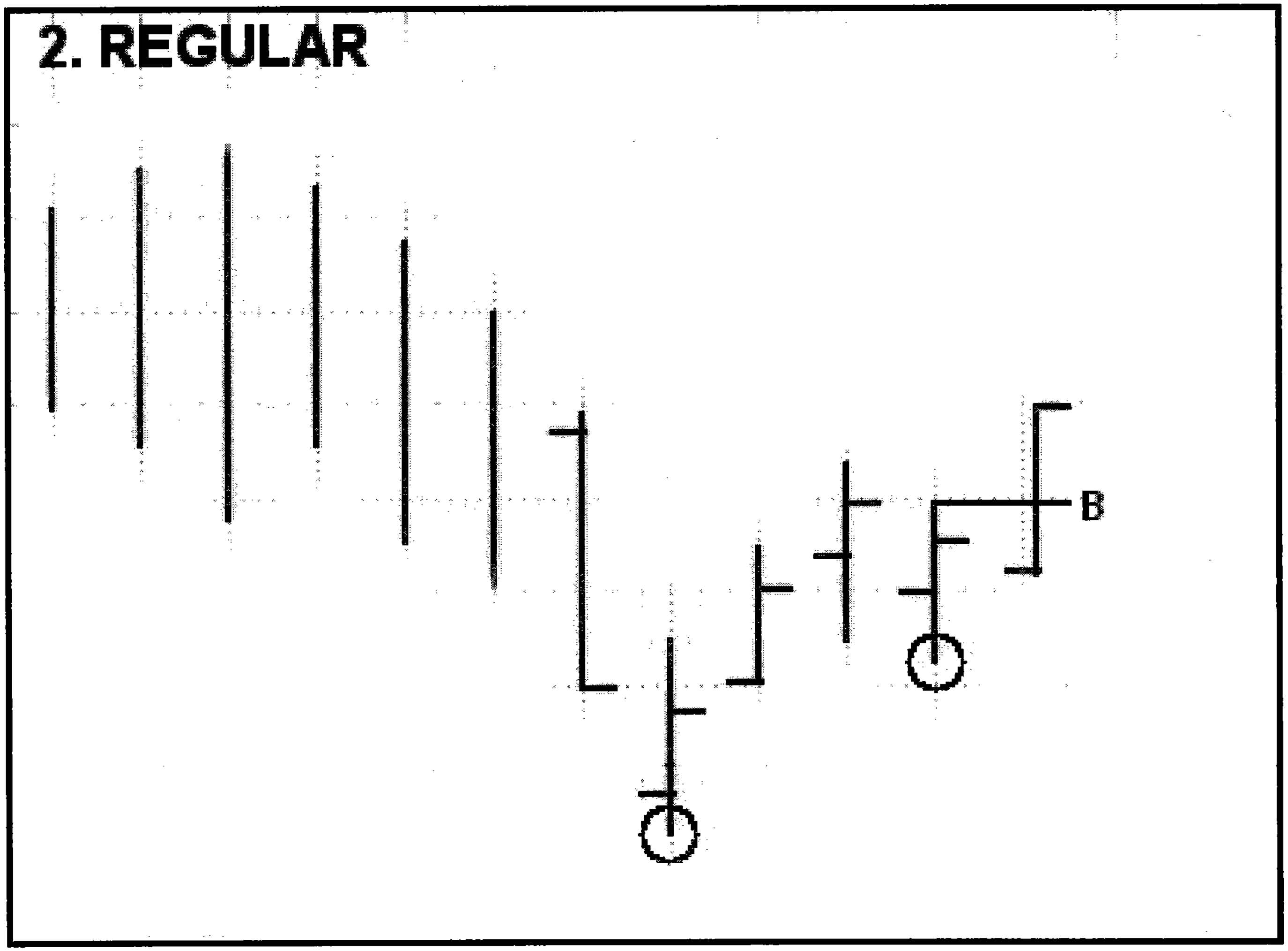
1,2,3 Closes -TRADE CRITERIA

6. If there is a new lower low before you get entry, then the count starts over again.
7. Ninety-five percent of the time you get entry no later than the eighth bar, and on a few occasions one or two bars past. Anything past that and it becomes an invalid trade.

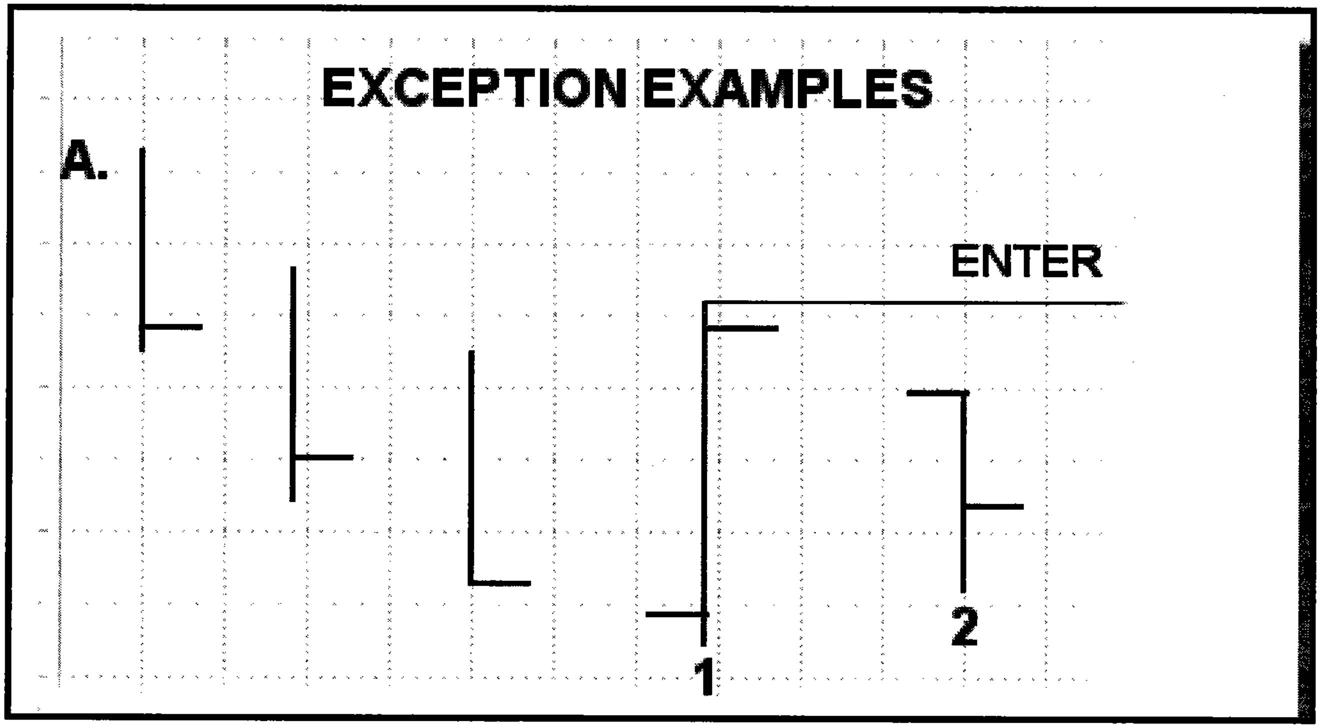
1,2,3 Closes



1,2,3 Closes



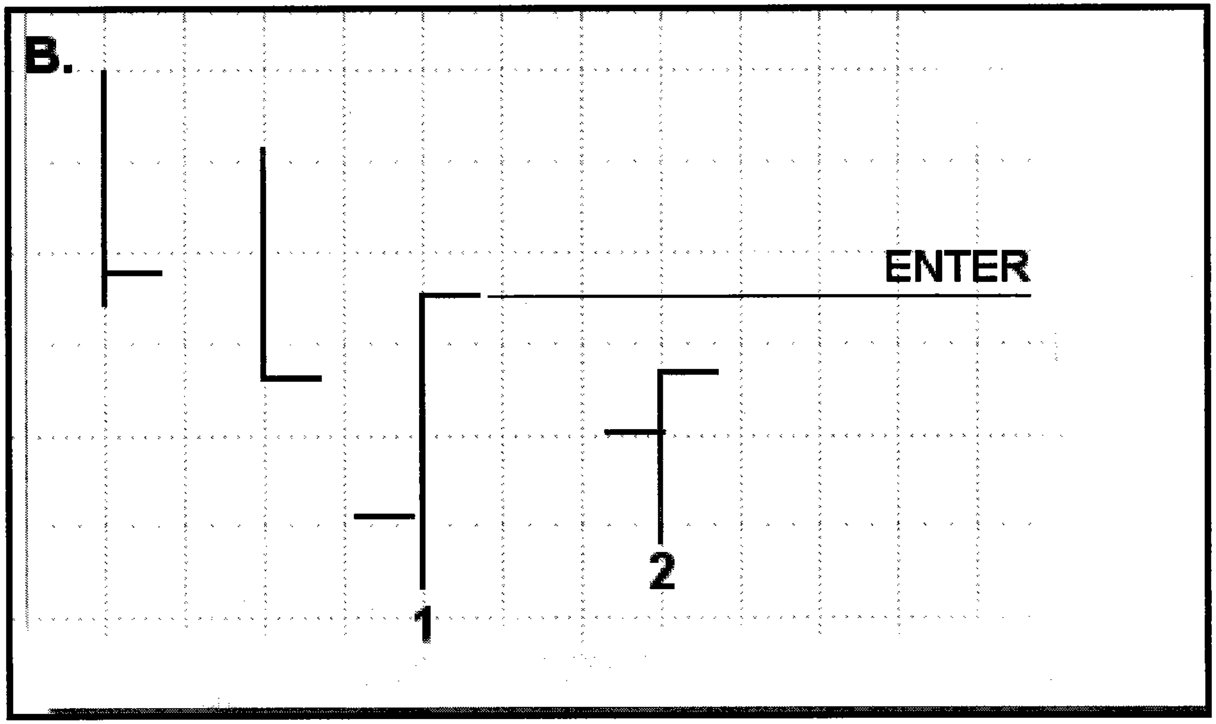
1,2,3 Closes



1. Seven-period low and an up close in the top of the daily range for an outside day reversal bar.

2. Down close on an inside bar which sets up long entry above the high of Day 1.

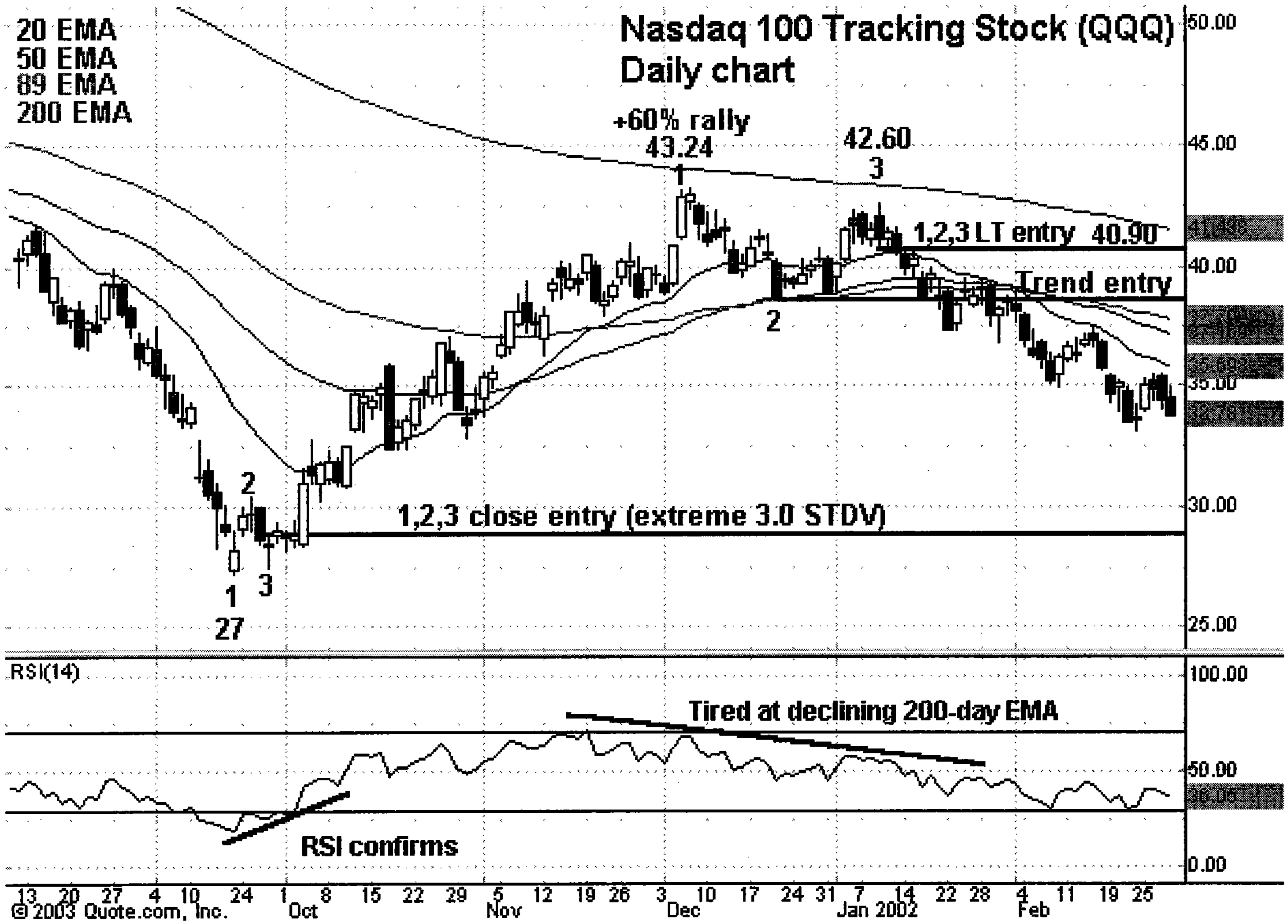
1,2,3 Closes



1. Seven-period low with up close.
2. Down close on inside bar. Take entry above high of Day 1.

1,2,3 Closes
Real World Examples

1,2,3 Closes



20 EMA
50 EMA
89 EMA
200 EMA
Nasdaq 100 Tracking Stock (QQQ)
Daily chart
+60% rally
43.24
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42.60
3
1,2,3 LT entry 40.90
Trend entry
2
2
1,2,3 close entry (extreme 3.0 STDV)
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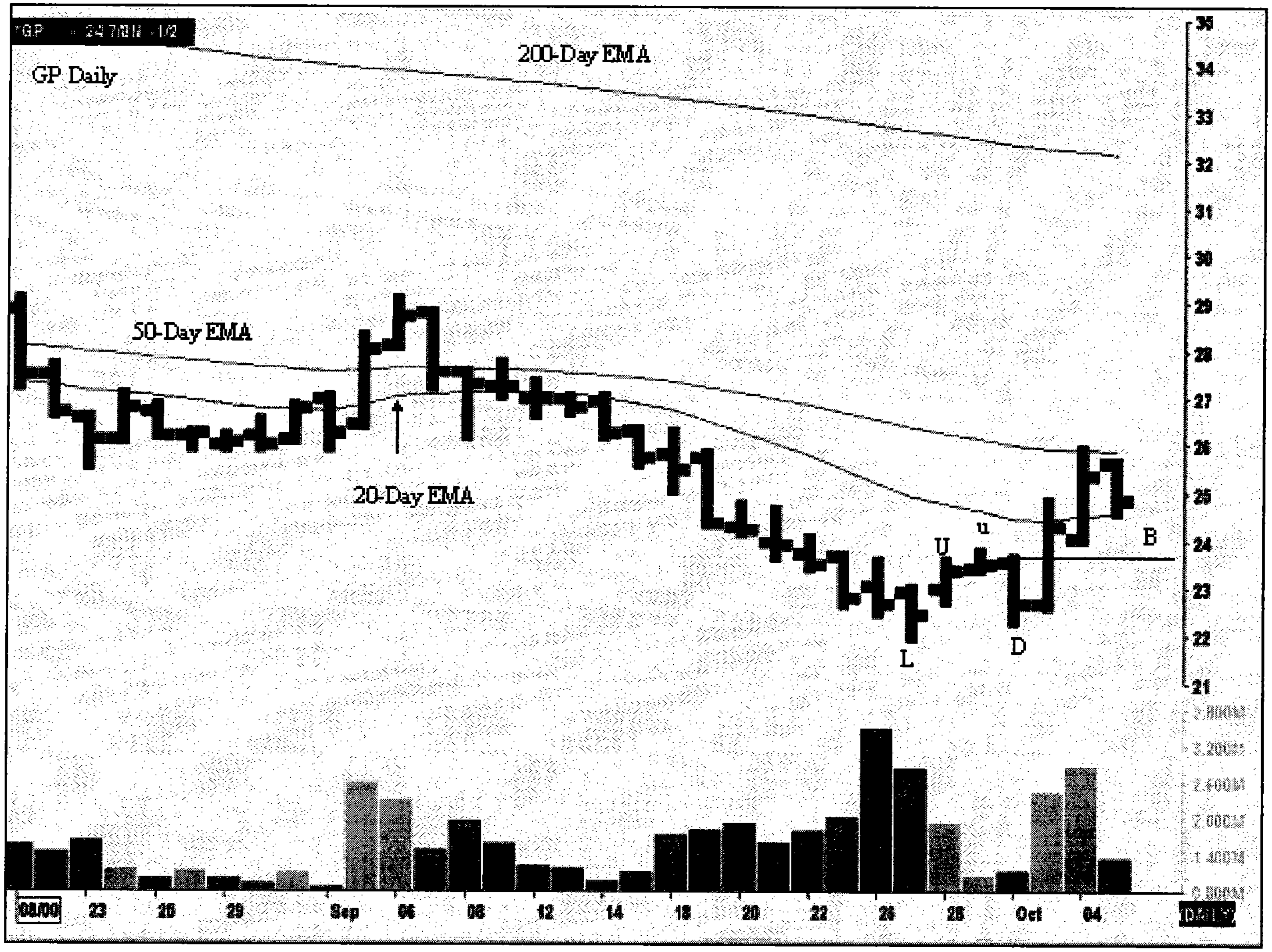
3
27
50.00
45.00
40.00
35.00
30.00
25.00
RSI(14)
Tired at declining 200-day EMA
RSI confirms
100.00
50.00
0.00
13 20 27 4 10 24 1 8 15 22 29 5 12 19 26 3 10 17 24 31 7 14 22 28 4 11 19 25
© 2003 Quote.com, Inc.
Oct
Nov
Dec
Jan 2002
Feb

1,2,3 Closes



GP Daily
200-Day EMA
50-Day EMA
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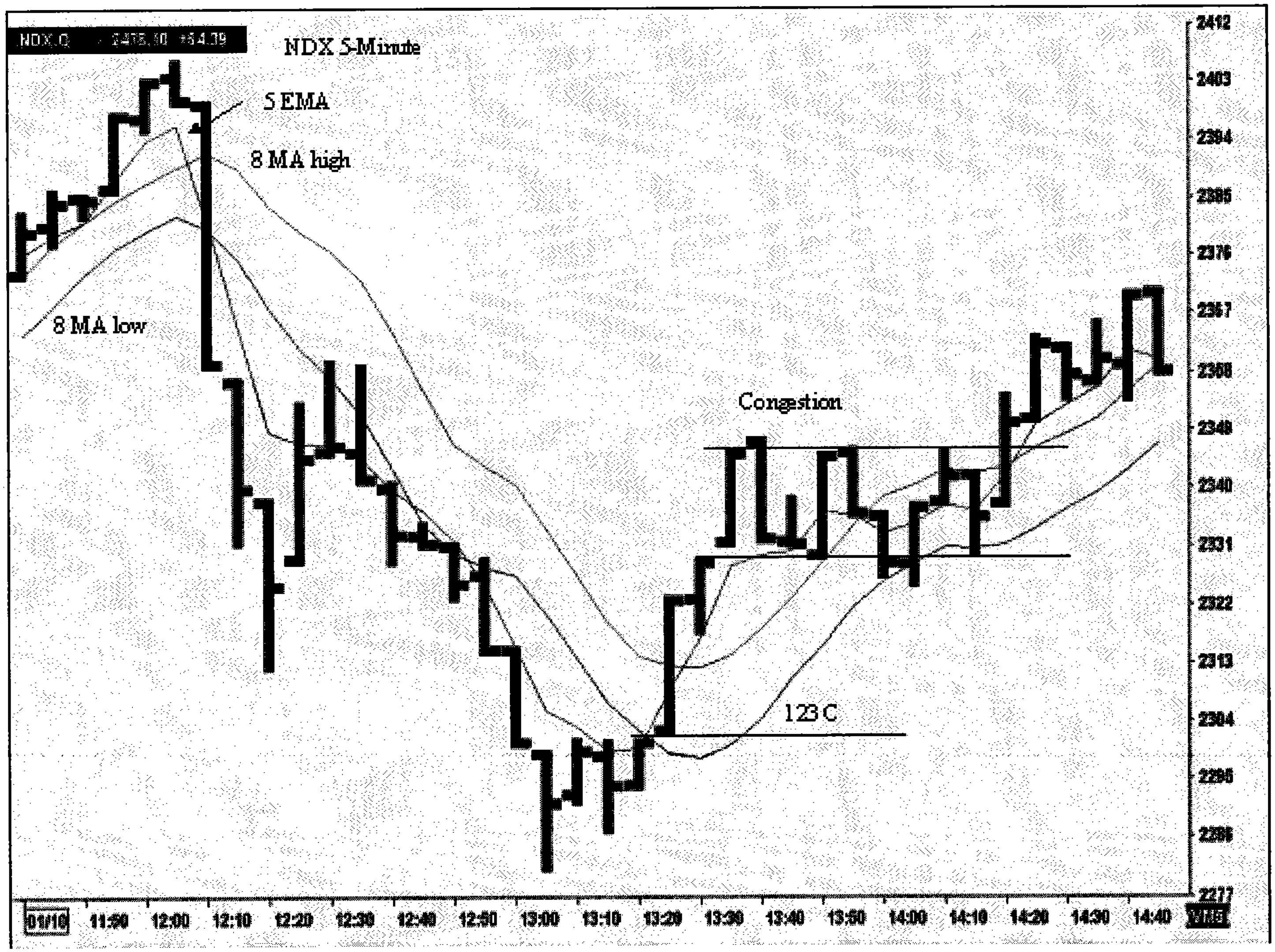
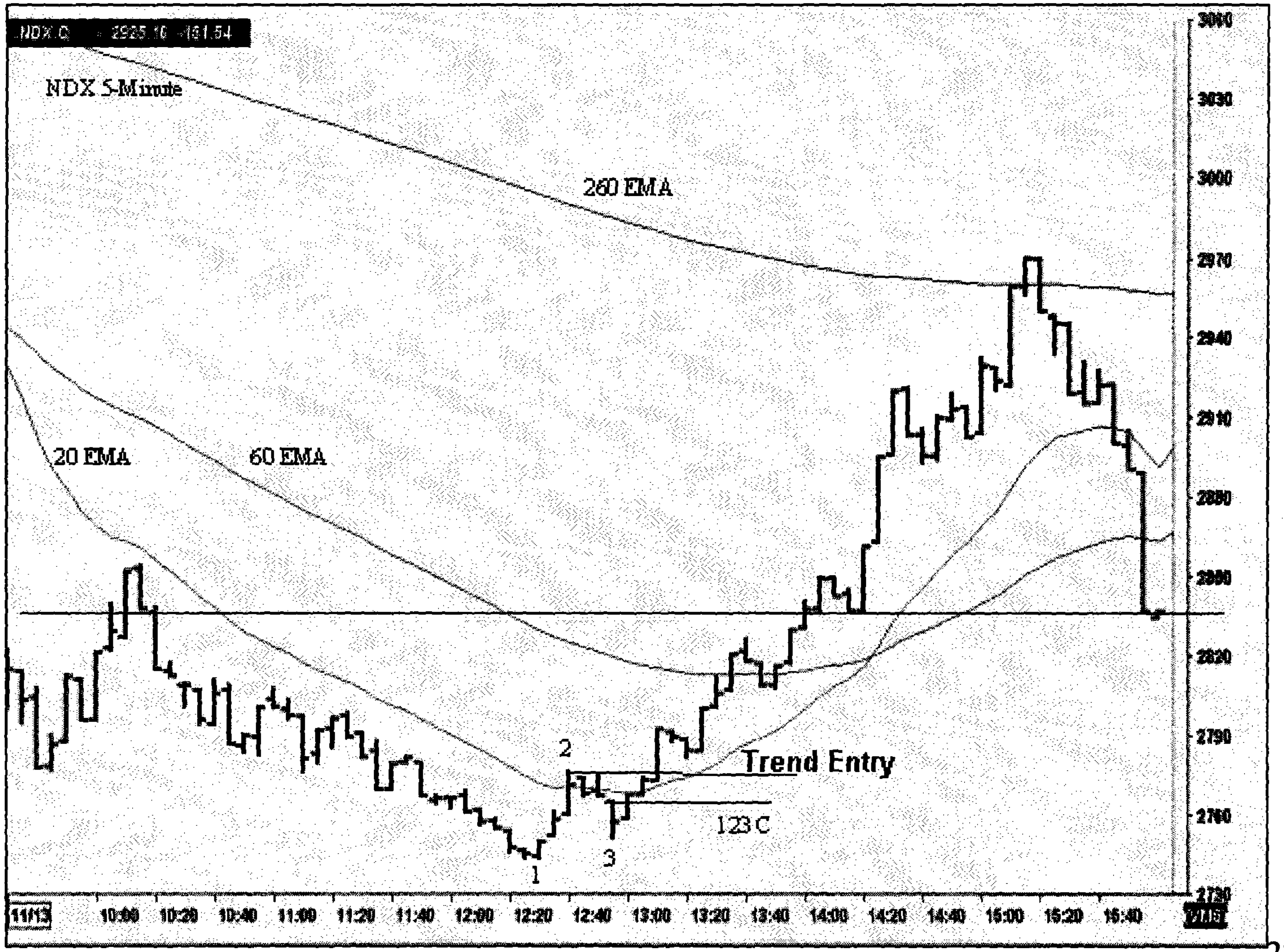
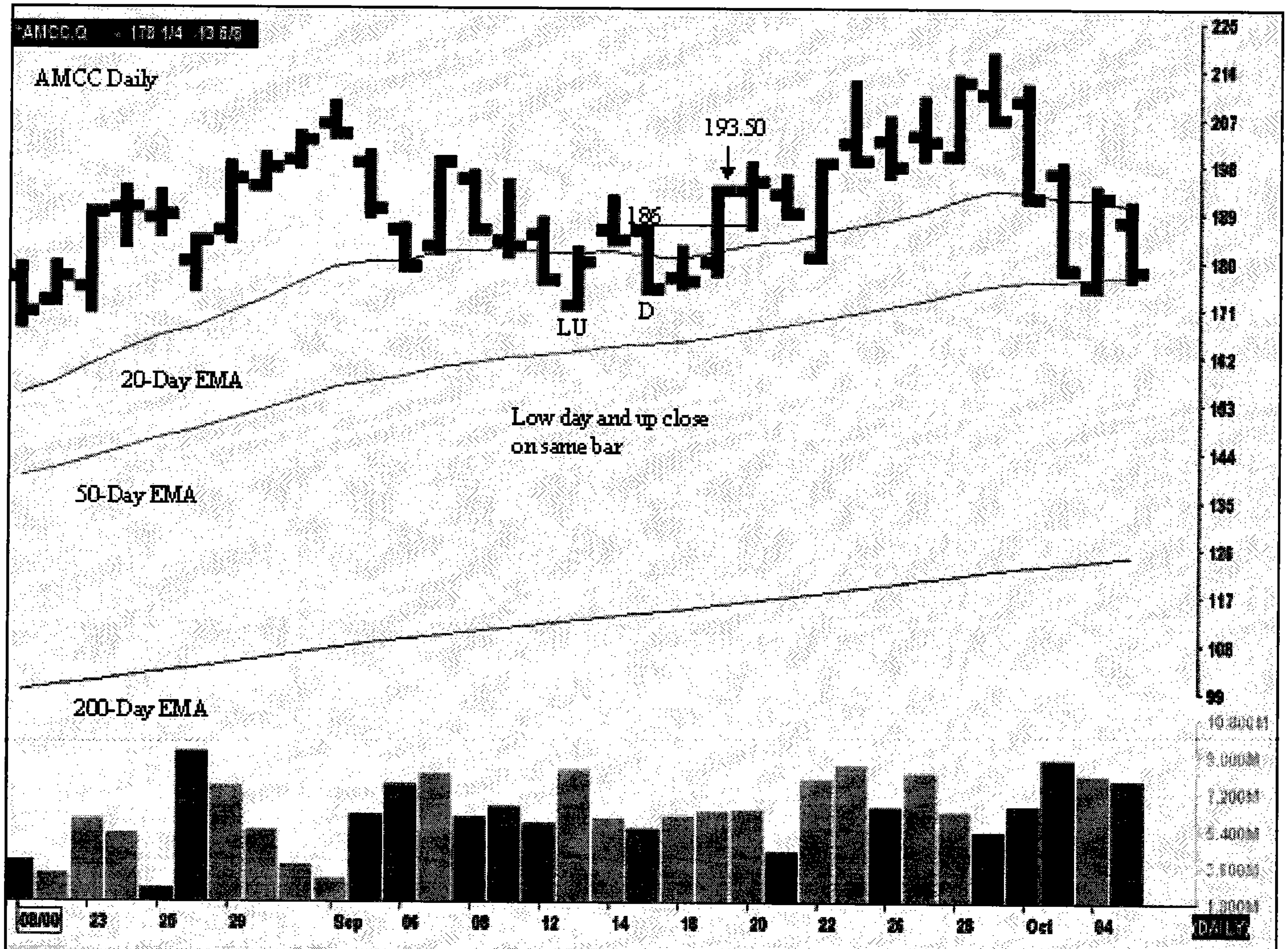
1,2,3 Closes



1,2,3 Closes



1,2,3 Closes


AMCC Daily
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on same bar
50-Day EMA
200-Day EMA
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DAILY

X. First Hour Strategies

Introduction To First-Hour Trading Strategies

This section is all about how to trade first-hour strategies that will put you on the same side as the market makers, specialists and also the Generals.

The strategies you will learn are geared to the way professionals interact with the opening period order flow from both retail and institutional. They are strategies that capture the dynamics of how the Generals react on and after the open when they decide how aggressive they will be on their buy/sell orders that day.

The first hour of trading is a time when prices can get taken out of line, which sets up some of the best trades of the day.

Professionals make a significant percentage of their trading profits during the first hour of trading, and so can you.

The primary strategies that I use and will be outlined in this section are

- Opening Reversals
- Trap Doors
- Gap Pullbacks
- Volatility Band Openings
- Flip Tops

LET'S GET STARTED!

Opening Reversals (ORs)

The OR is a highly effective daytrading strategy based on a reversal of the opening price and/or the early high/low of the first five-minute bar, which is the specific time period used with this strategy.

This strategy is designed to take advantage of emotional opening reactions to pre-market futures activity, news and economic reports.

ORs work best with trending stocks that set up as high-probability trades on the daily charts based on the previous day's trading.

Opening Reversals (ORs)

Select the OR setups that demonstrate the best relative strength vs. the early market direction if you are trading big cap stocks.

Big-cap institutional stocks make the best ORs because of the liquidity, and they are the stocks that market makers and specialists commit the most capital to.

The big-cap stocks are involved in program trading, and this can be a significant edge that can make you right for the wrong reasons. Higher Probability.

The opening is near the high or low of the day a significant percentage of the time, so taking ORs can be an excellent risk/reward trade.

Rules for Buys (Sells Reversed)

1. After the opening, the stock sells off no more than 30% of its average daily range, which is best when it is at least 1.5 points, which leaves you with ample profit potential.
2. Entry into an OR is best within the first 30 minutes of trading.
3. Enter the trade one tick above the opening price, or first five-minute bar high if it is close to the opening price.
4. Keep a tight money stop just below the open (not more than .30) because this kind of trade can reverse very quickly in the direction of the open if the sellers return, especially after 9:45 a.m.

Rules for Buys (Sells Reversed)

5. Entry into the trade should be confirmed by improving market dynamics. The two best early indications will be a positive or negative divergence in NYSE TICKS, in addition to the premium expansion or contraction between the S&P futures and SPX cash index. For stocks, you look for any volume clues or whether the stock is trading to the bid or ask side prior to the opening reversal breakout.

Rules for Buys (Sells Reversed)

6. ORs must have a minimum of two five-minute bars before entry on the third bar because anything less than that is mostly chop, and you can get whipsawed very easily. The exception is when there is a significant gap up/down into a key Resistance or Support level. Your best trades will generally be when there are at least three five-minute bars trading before entry.

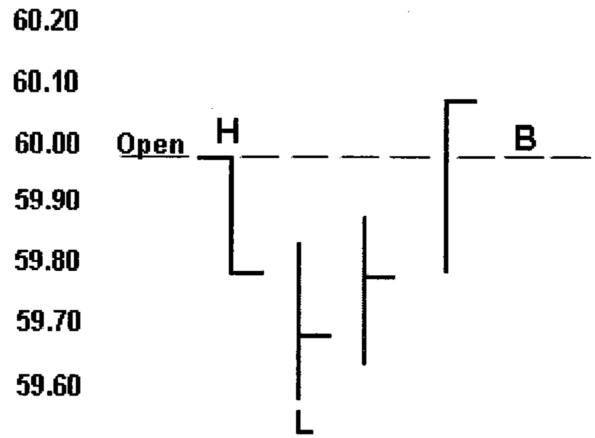
Key Points:

1. The ORs you want to trade are after a general early decline or advance due to pressure from the pre-market futures, not on a stock with specific company news.
2. If you trade the S&P futures, use the SPY as your opening proxy/indicator. If you get an OR in the SPY, you can then trade the E-mini futures. The OR strategy is for the 9:30 NYSE opening and after. You don't look for opening reversals in the futures before 9:30 a.m.

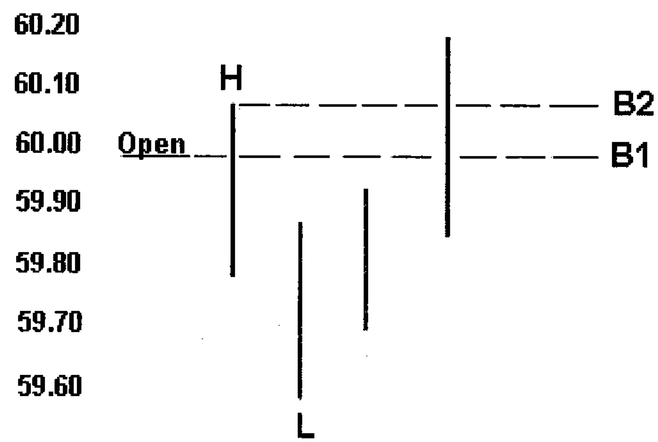
Key Points:

3. Opening Reversal that also trade above the previous day's close are in what I call a Net Plus situation and Net Minus if the OR trades below the previous close. The earliest indication of trend on an intraday basis is when price is above/below the open and also the previous close.

Example: A stock trading at 60 with an average daily range of 2 points.

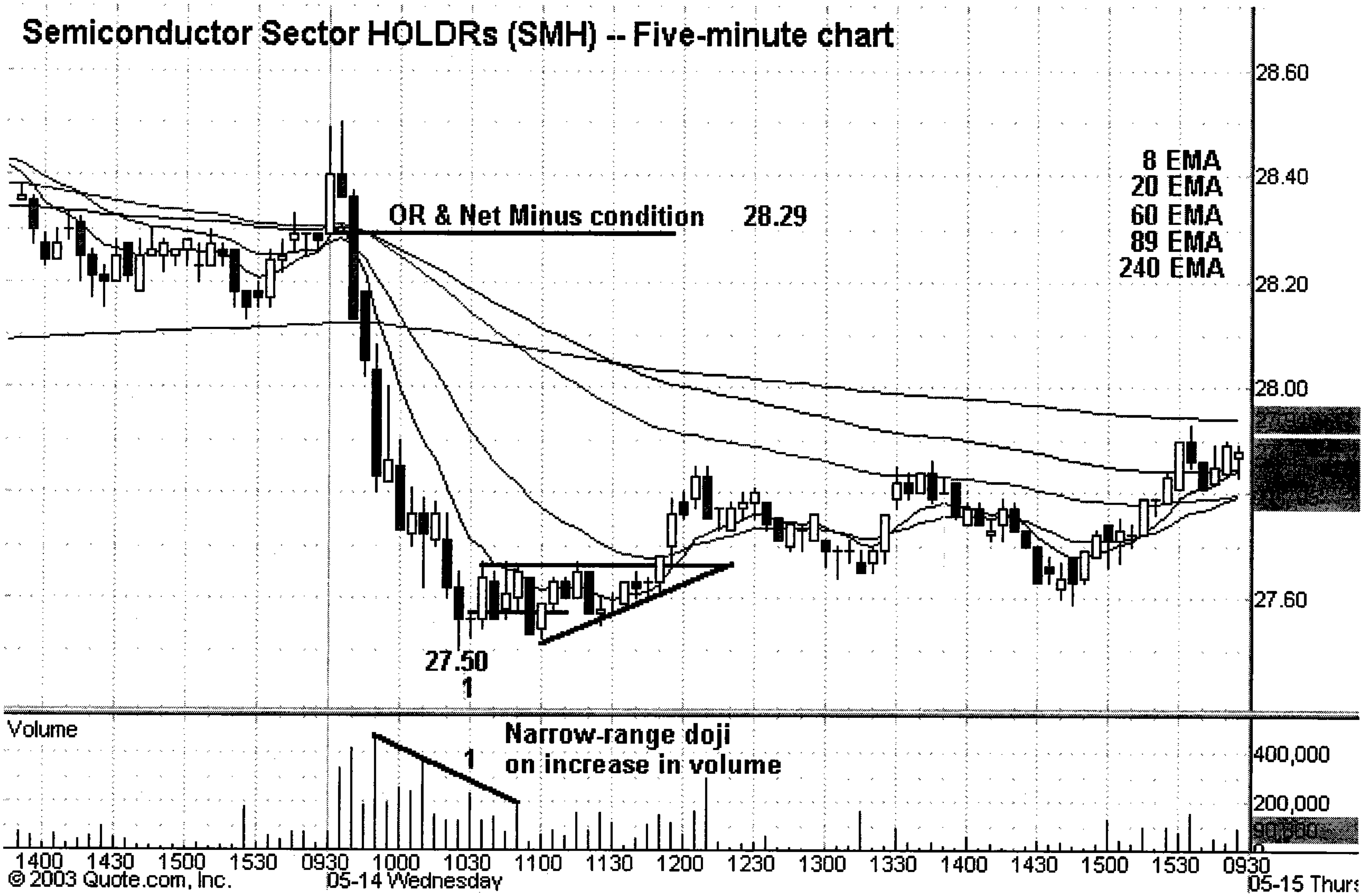


30% of daily range

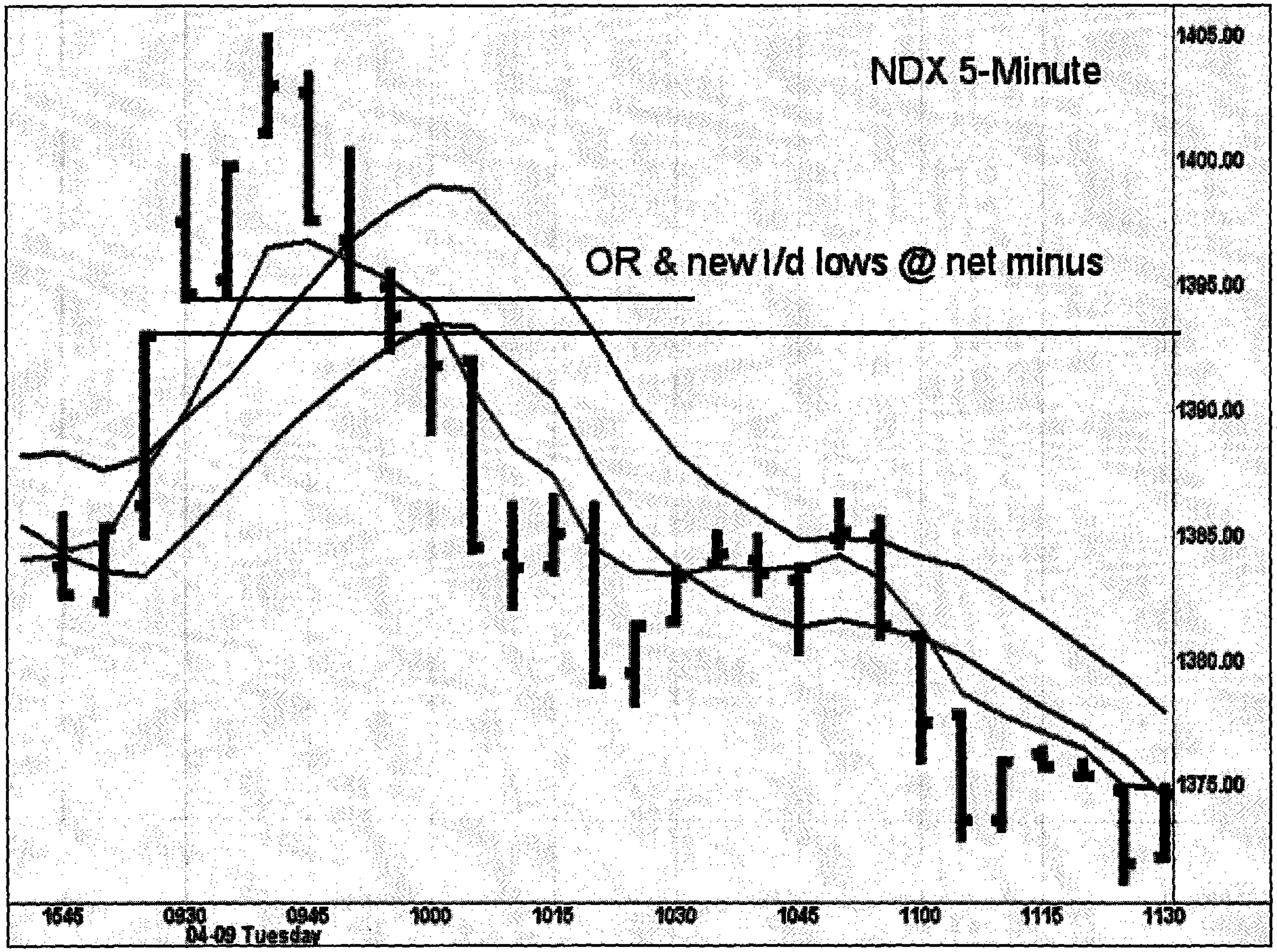


Opening Reversals
Real World Examples

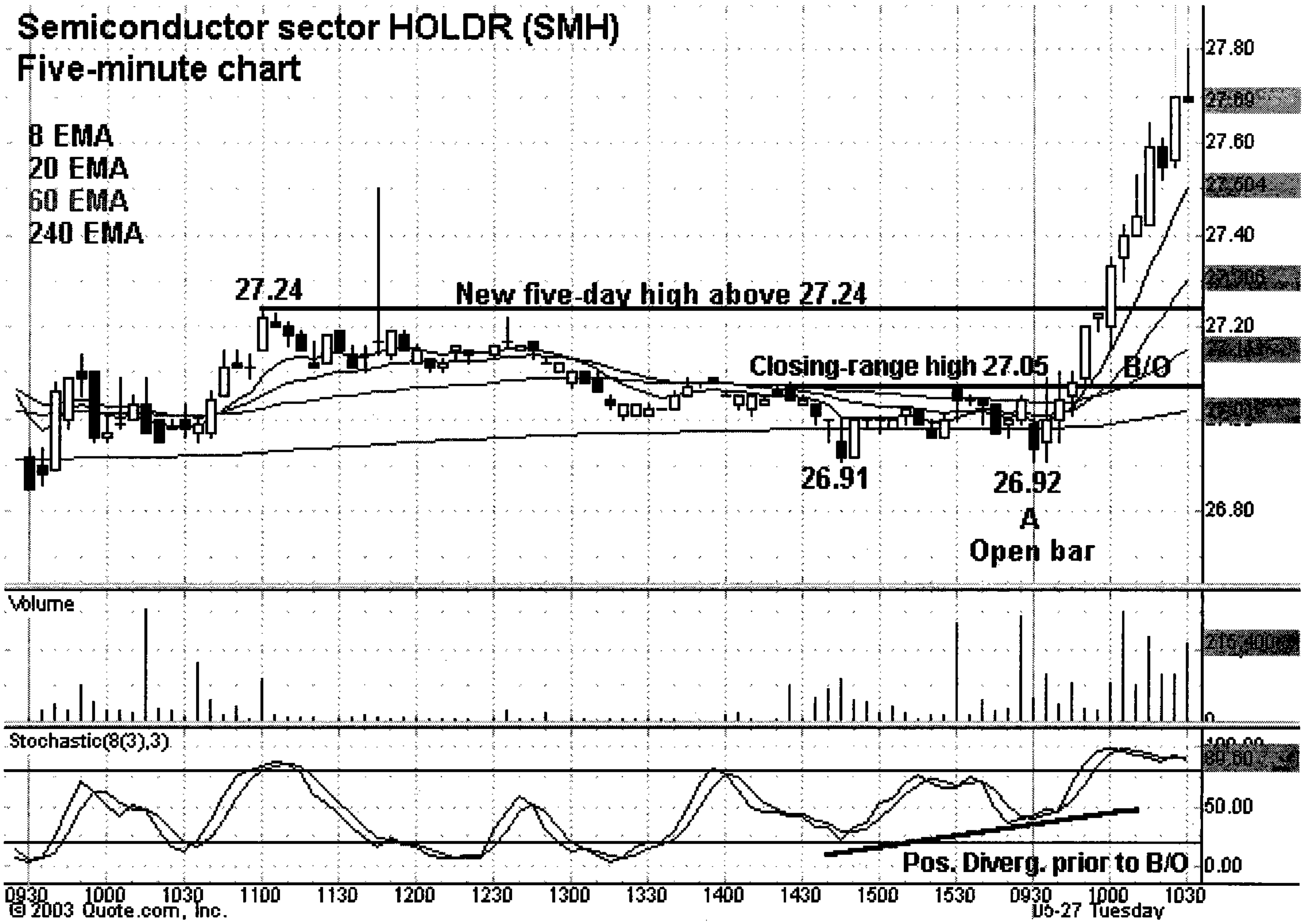
Opening Reversals



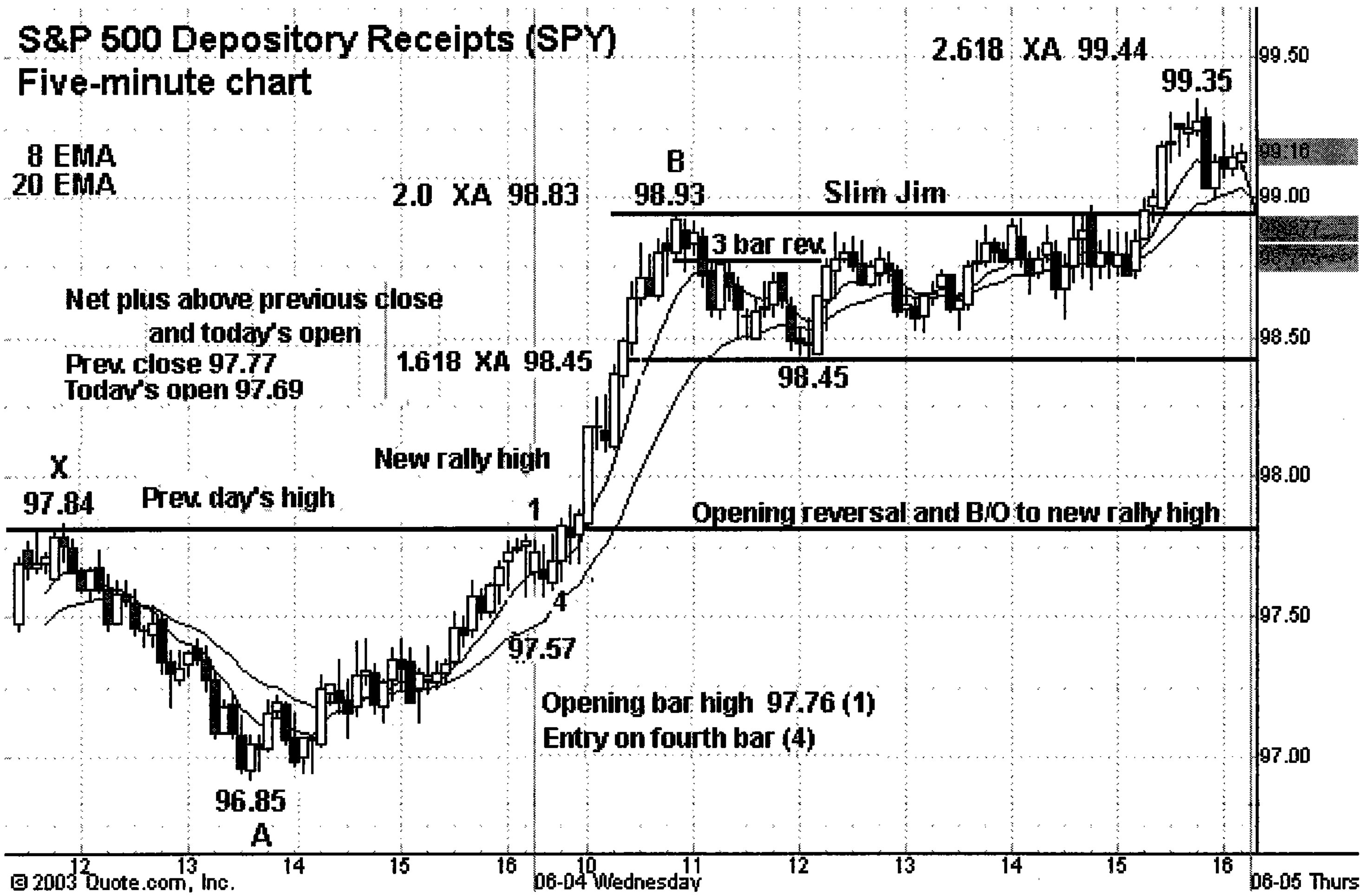
Opening Reversals



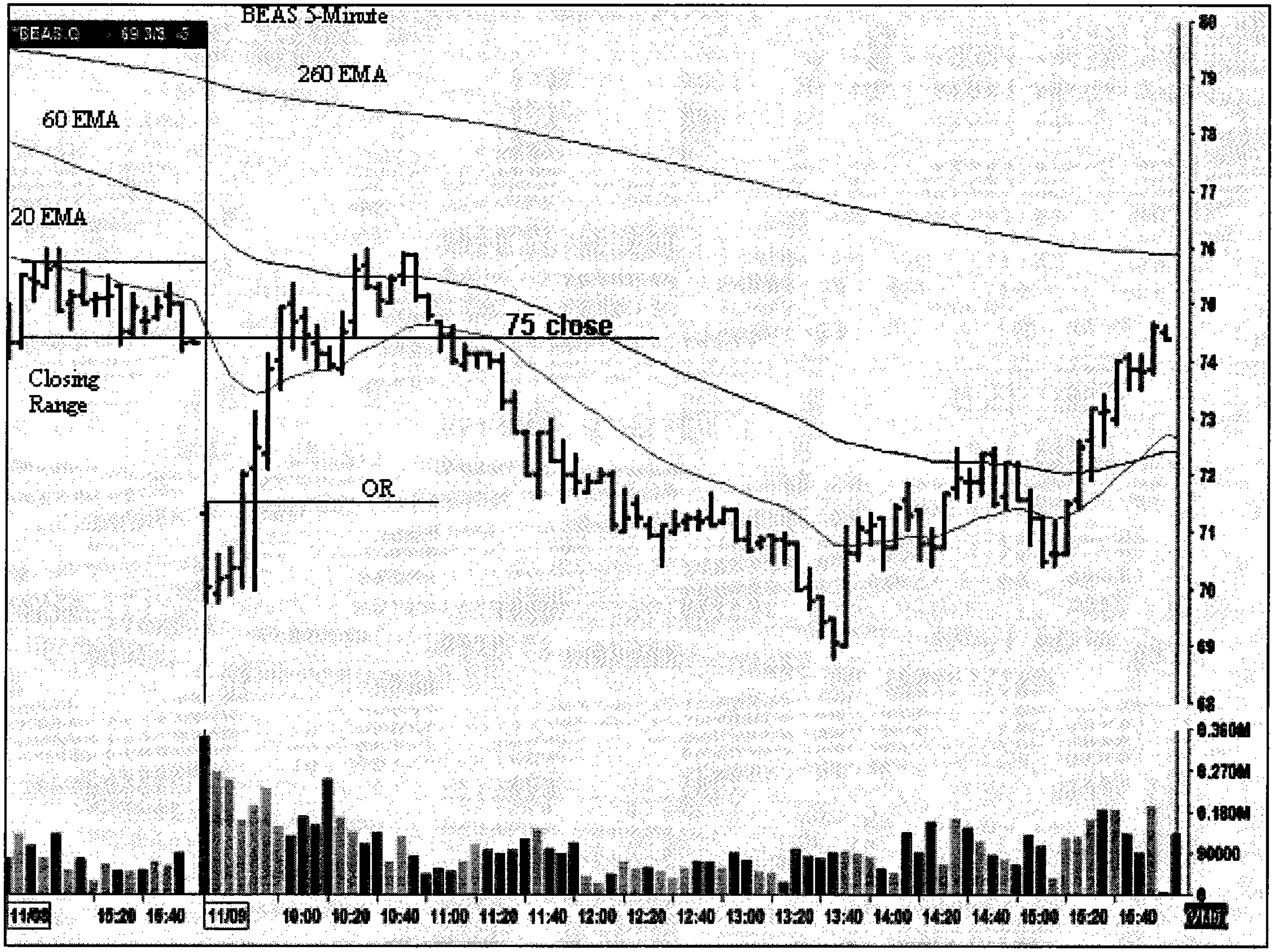
Opening Reversals



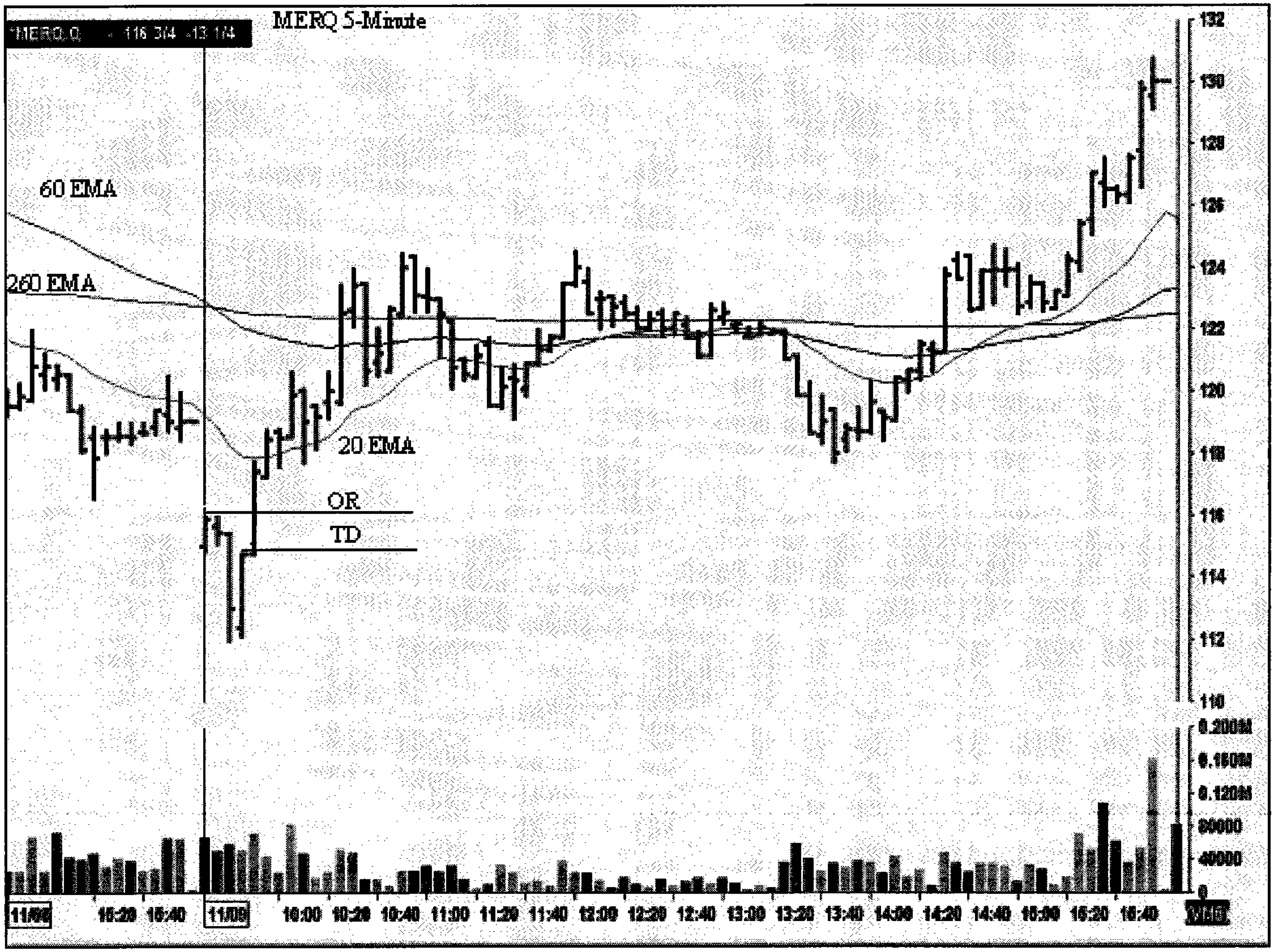
Opening Reversals



Opening Reversals



Opening Reversals



Trap Doors

- The Trap Door is a powerful daytrading reversal strategy that exploits emotional buying/selling on and after the opening.
- It puts you on the same side as the professionals (dealers) who are primarily the Market Makers (OTC) and NYSE Specialists. They make a significant percentage of their trading profits during the first hour of trading because they are able to influence the opening prices according to the pre-9:30 a.m. ET order flow, which is mostly the retail orders reacting to economic reports, brokerage firm research updates, and geopolitical and monetary news.

Trap Doors

- The pre-market trading in the futures lacks liquidity and can be influenced by the "accelerators" who are the hedge funds, program traders, and other major players with sufficient capital that have an agenda.

Trap Doors

- OTC market makers will often influence the 9:30 opening prices by trading in Instinet in order to open prices at more of a discount or premium. When the pre-market order flow is largely biased to, for example, the sell side, and the S&P futures are trading down, say, 8 points, the market makers will want these stock prices opened at the biggest discount to the previous day's close as possible. It is called "taking it down to a level where the buyers are or up to where the sellers are."

(This bullet is continued on the next slide)

Trap Doors

This is what gives the maximum edge to the professionals as they capitalize on the contra move resulting from the discount selling or premium buying. NYSE specialists can't influence price in Instinet prior to the 9:30 opening, but when the futures are strong either way, they have great flexibility to maximize the discount/premium that they open the stock at as a result of the imbalance of sell or buy orders because they must act as principal (for their own account) on this imbalance.

(This bullet is continued from the previous page)

Trap Doors

- Retail order flow on the opening is very emotional, and usually the biggest percentage is market orders, so this plays into the professionals' hands. The Generals don't commit a major portion of their orders on these emotional openings unless there is OVERT news.
- The professionals' and daytraders' biggest ally in the Trap Door strategy is the media hype of the various news items. This sets off a chain of emotion and enables the accelerators to influence the pre-9:30 S&P futures trading, creates more retail order flow, and allows the market makers and specialists to open prices at bigger discounts or premiums.

Trap Doors

- Trap Doors work best with index proxies, futures and big cap liquid, volatility stocks, as this is where the professionals commit significant capital and make most of their trading profits.
- Program trading, which is now between 30% and 40% of NYSE volume, is primarily in the S&P 500 stocks and to a much lesser extent the NDX 100. This is a major reason why you should focus on these stocks trading Trap Doors.

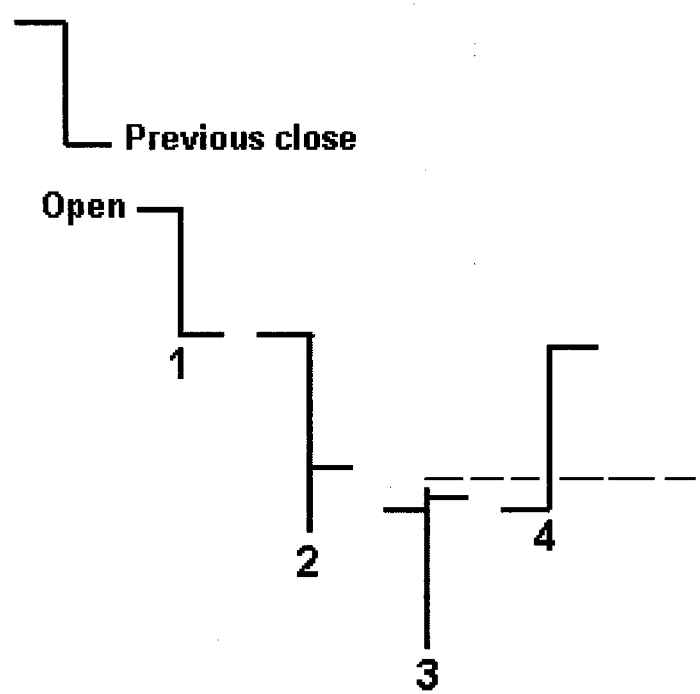
Trap Doors

- It is my observation that there is a contra move after significant discount/premium openings about 90% of the time and that approximately 60% of the time, the market/stock will resume the direction of the open during the first hour. This is your edge.
- Trap Door is a reversal strategy, so you need some evidence of a change in direction before entry is taken. I have included examples of the most common reversal bar patterns you will encounter. Before you review the trading rules, familiarize yourself with the following patterns.

Trap Door Patterns - Buy Pattern A

1. Opening bar below the previous close.
2. First lower high and low following the opening bar.
3. Signal bar, which is also the second bar with a lower high and low. It qualifies as the signal bar because it opened and traded below the 2 bar, yet closed in the top of its range. This sets up entry above the high. Indications of buying pressure. Look for a volume increase.

A.

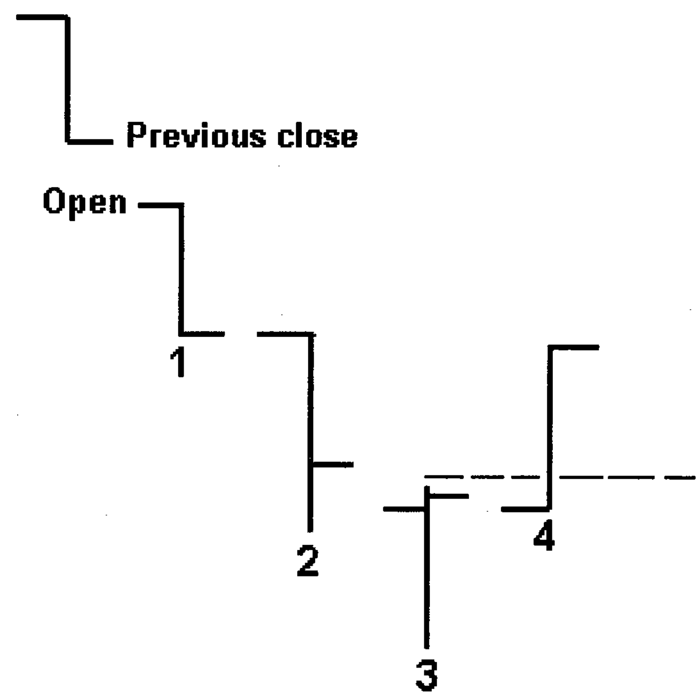


Trap Door Patterns - Buy Pattern A

4. Entry bar: Which should be a trade-through entry, not a gap above the high of the signal bar (3). If it's only a couple of ticks above, you can take the trade if the dynamics are compelling.

Initial stop is below the signal bar low, or if it's a wide-range bar, then you might place it below the midpoint of the bar's range. If that is beyond your normal trade risk, then use a money stop.

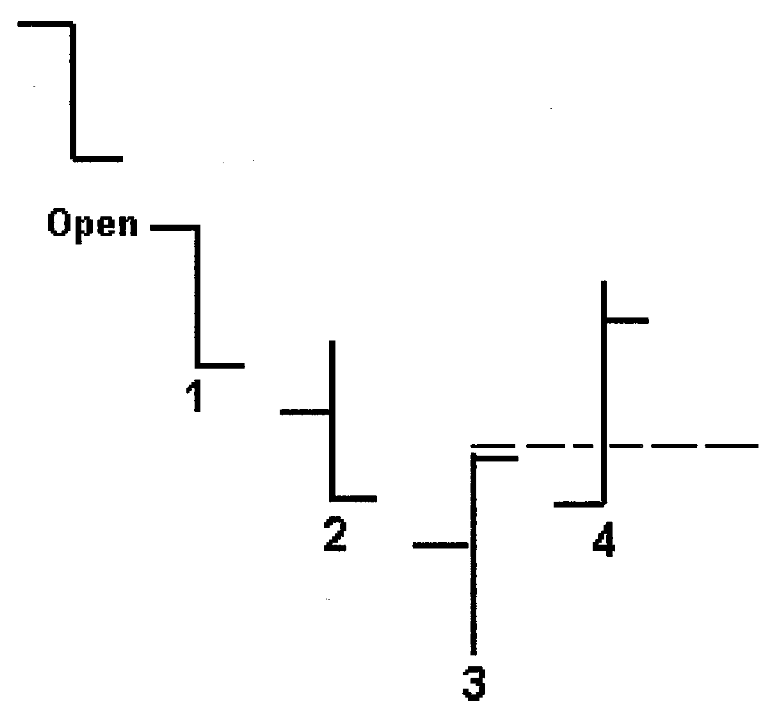
A.



Trap Door Patterns - Buy Pattern B

B.

1. Opening bar.
2. Lower high and low.
3. Signal bar, which opened below the 2 bar's low, yet reversed and closed in the top of the range above the open and above the previous close. This is a sign of buying pressure and should be in conjunction with a volume increase.
4. <u>Entry bar</u>.

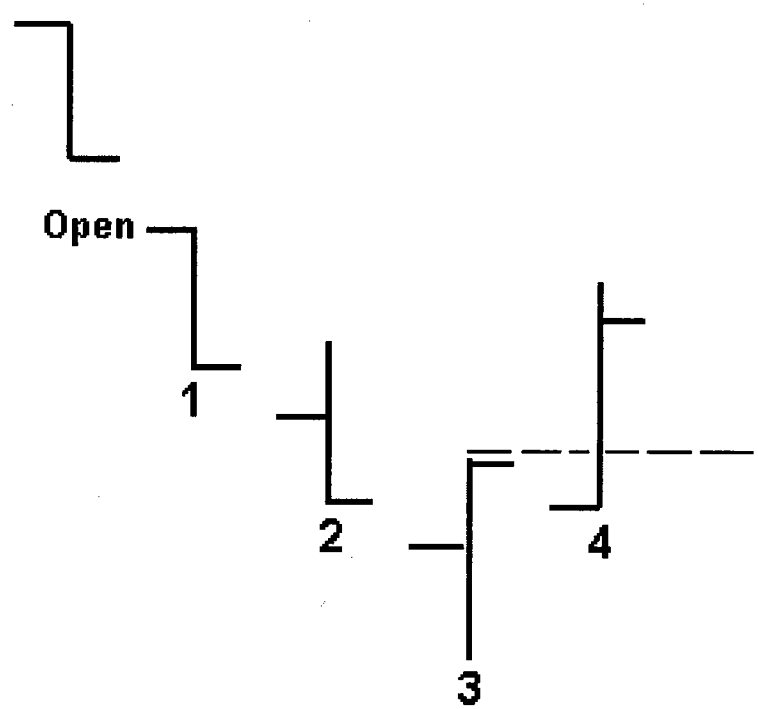


Trap Door Patterns - Buy Pattern B

Initial stop is the same as in (A).

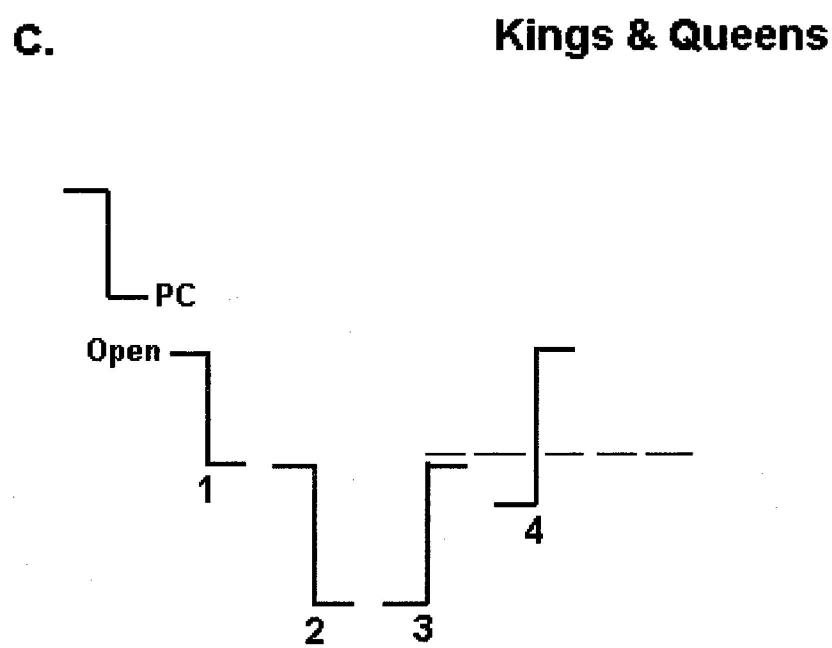
Key Point: In any reversal buy pattern, you look for declining volume on the sell-off, then an increase in volume on the change in direction (reverse for sells). Sometimes in Trap Doors, the volume increases on the entry bar, but most often you see the increase on the signal bar.

B.



Trap Door Patterns - Kings & Queens

1. Opening bar.
2. First lower high and low with the open near the top of the range and close at the bottom of the range.
3. Opens in the bottom of the range and closes in the top of the range, indicating buying pressure.
4. Entry bar.

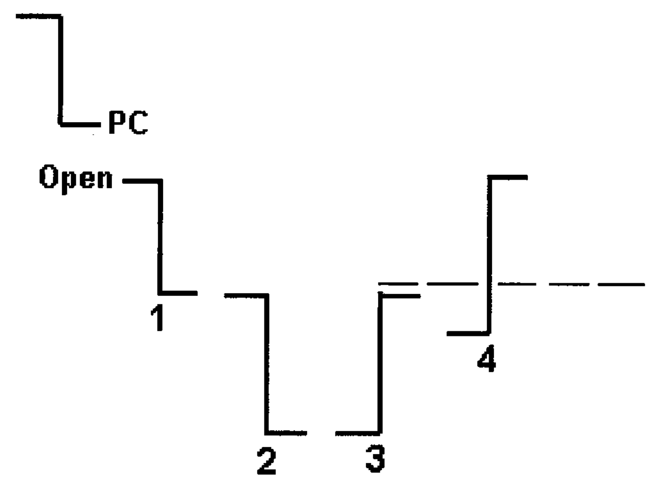


Trap Door Patterns - Kings & Queens

<u>Initial stop</u> is placed below the low of bar 3 or other options outlined in example (A).

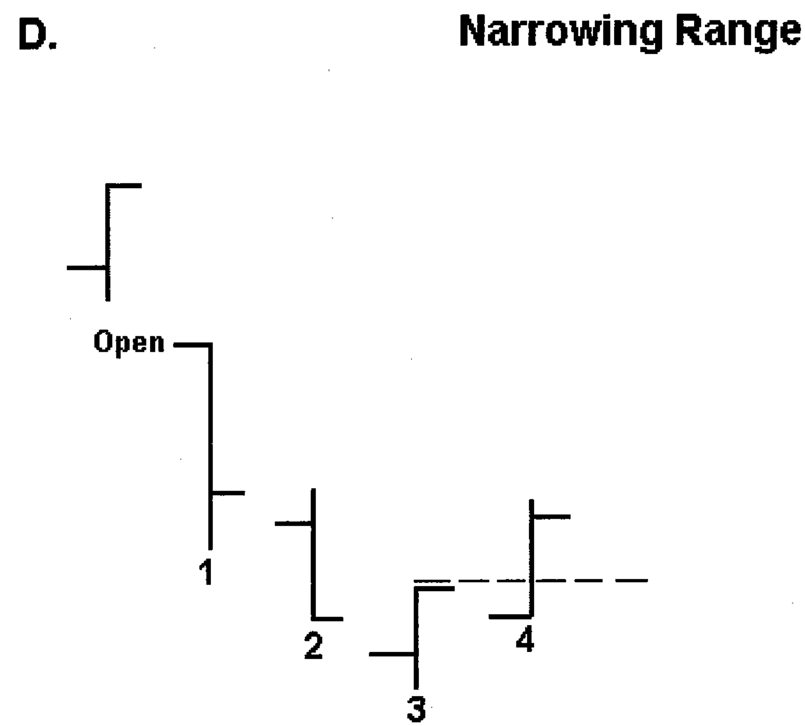
It is called Kings & Queens when you have two bars of almost equal range with one opening in the top of the range and the next bar opening in the bottom of the range, but reversing to close in the top of the range, indicating buying pressure. You don't see it as often as (A) and (B), but it is an excellent pattern.

C. **Kings & Queens**



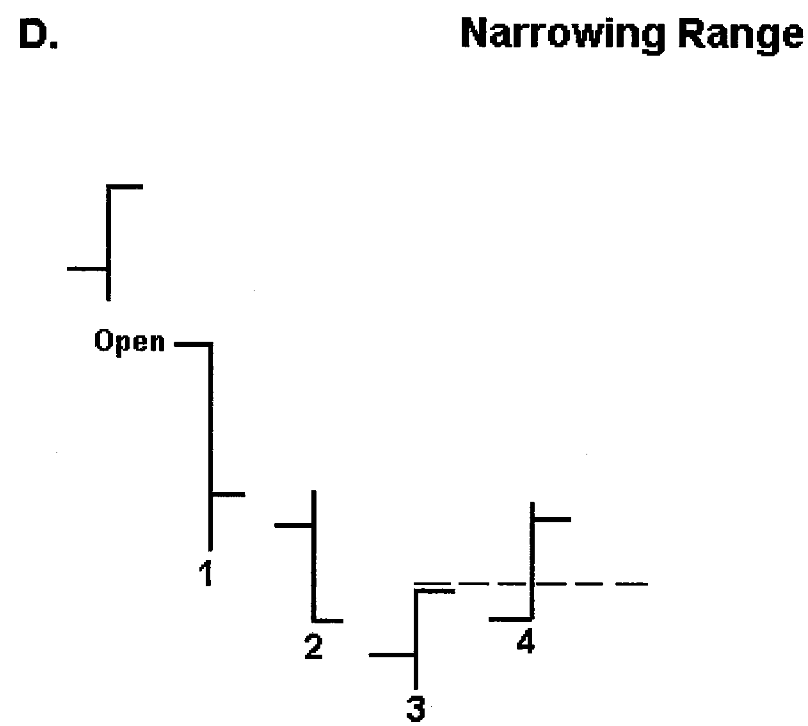
Trap Door Patterns - Narrowing Range

This is a powerful pattern where each bar has a smaller range than the preceding bar, and usually the signal bar has increasing volume and closes above the midpoint or at the top of its range. If it is a very narrow bar, the close is not important and you take entry on the next bar if it is above the signal bar's high.



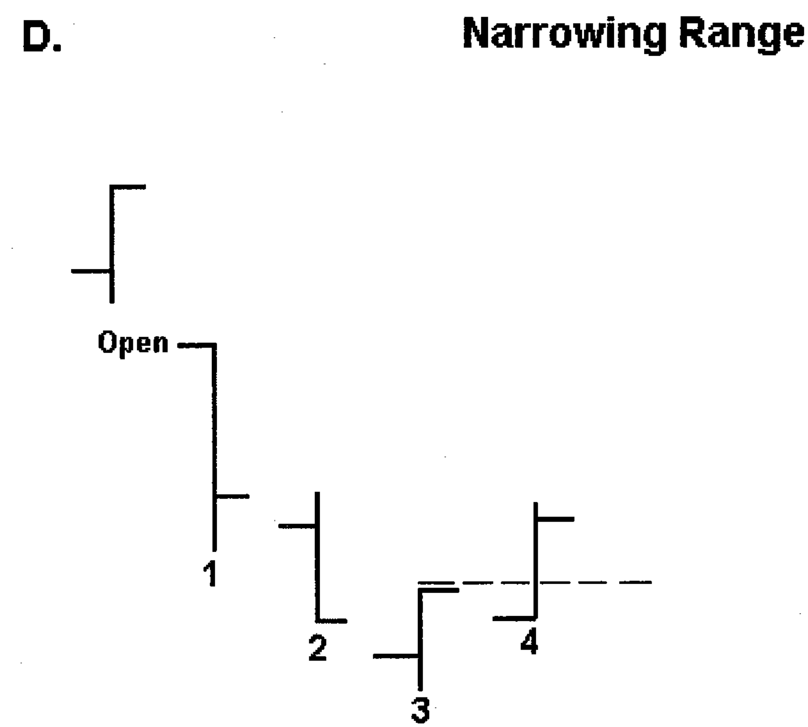
Trap Door Patterns - Narrowing Range

1. Opening bar (wide range).
2. First lower high and low with a range less than bar 1.
3. Narrow-range bar less than bars 1 and 2. It opens below the 2 bar low and closes at the top of its range, above the open and above the previous close.
4. <u>Entry bar</u>.



Trap Door Patterns - Narrowing Range

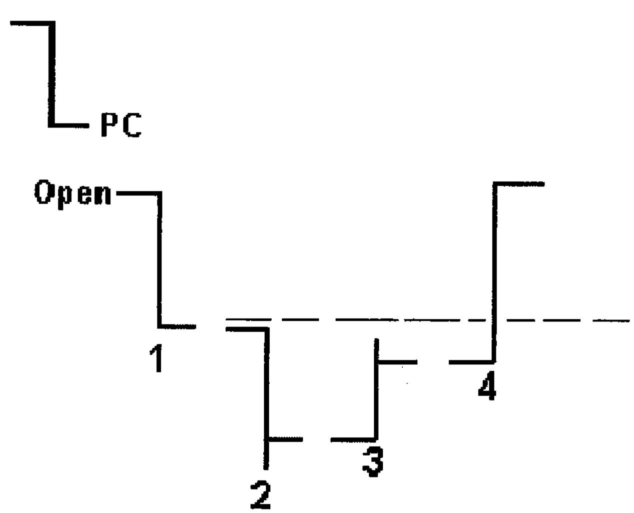
<u>Initial stop</u>: Same options as (A).



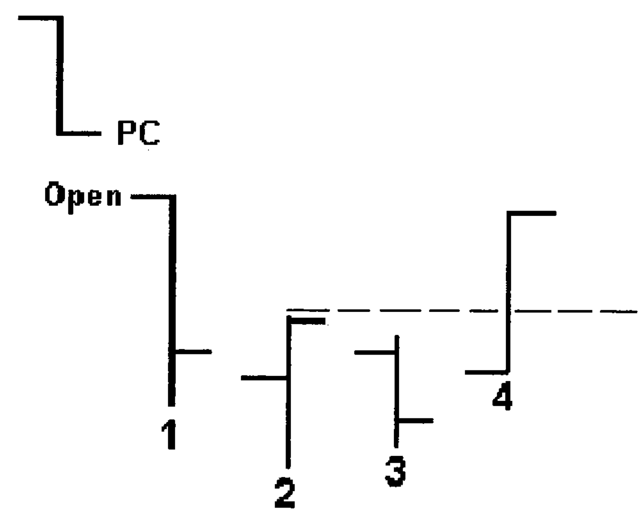
Trap Door Patterns

Graphics E and F are both inside bar patterns, but one is much stronger than the other.

E.



F.

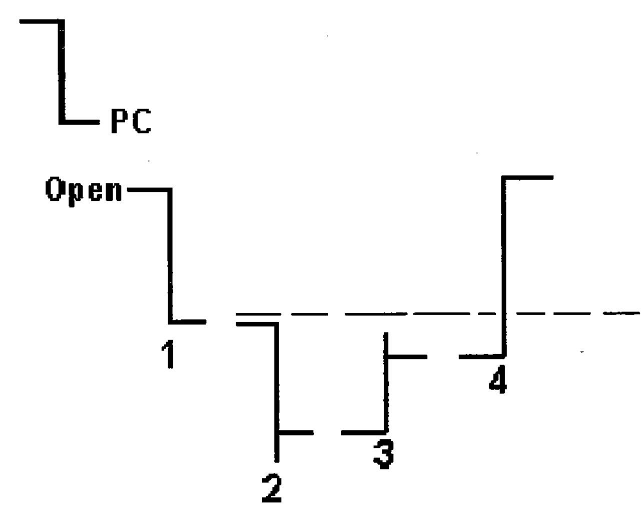


Trap Door Pattern – Chart E.

E.

1. Opening bar.
2. First lower high and low with the close in the bottom of the range.
3. Inside bar with the close above the midpoint.
4. <u>Entry bar</u> with entry above the high of bar 2. If bar 3 (inside bar) closes in the top of the range on a definite increase in volume and the market dynamics are strong, then you might take entry above the high of the inside bar.

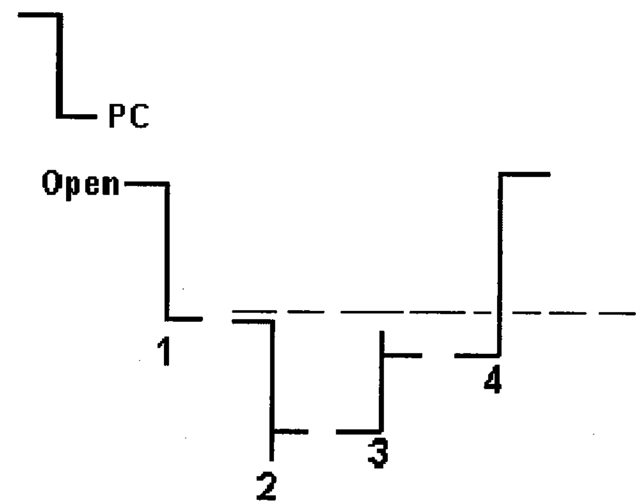
E.



Trap Door Pattern – Chart E.

Key Point: Because bar 2 is the low bar and closed in the bottom of its range, then the inside bar (3) might be just a pause bar before a break below the 2 bar's low and further downtrend. This is not my favorite inside bar pattern, as pattern F is much stronger because the low bar is also a signal bar that indicates buying pressure with the top of the range close.

E.

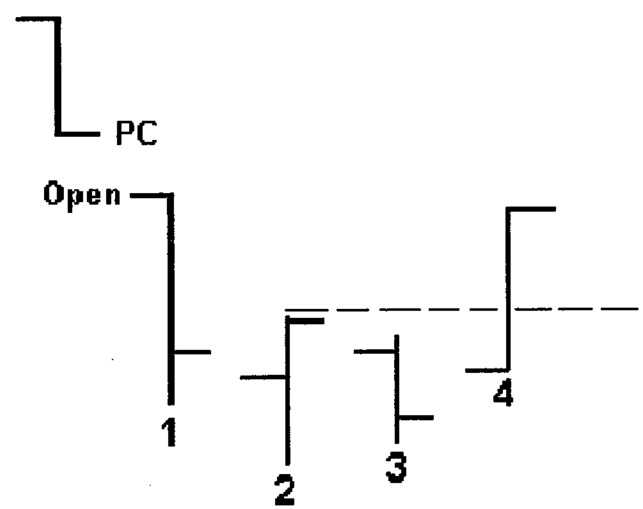


Trap Door Pattern – Chart F.

This inside bar pattern is stronger because of bar 2's close in the top of the range and most likely is an inside bar pause. Entry is above the high of bar 2 and has a better trading potential than chart E.

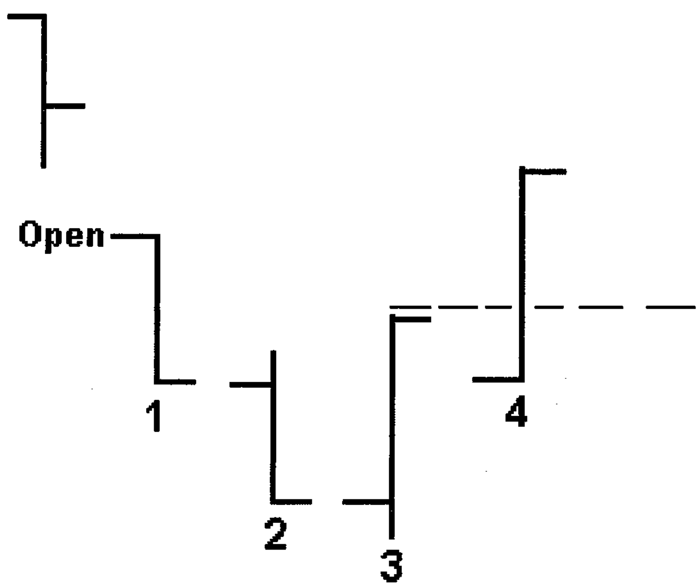
Initial stops for both E and F are placed below the low of the low bar or else use the other options as outlined in pattern (A). You will choose the options if the low bar is a wide-range bar.

F.

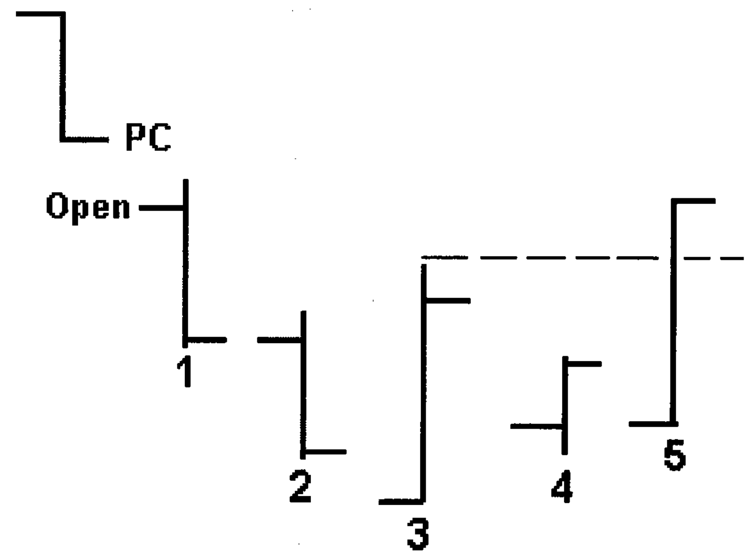


Trap Door Patterns - Outside-Bar Pattern

G.



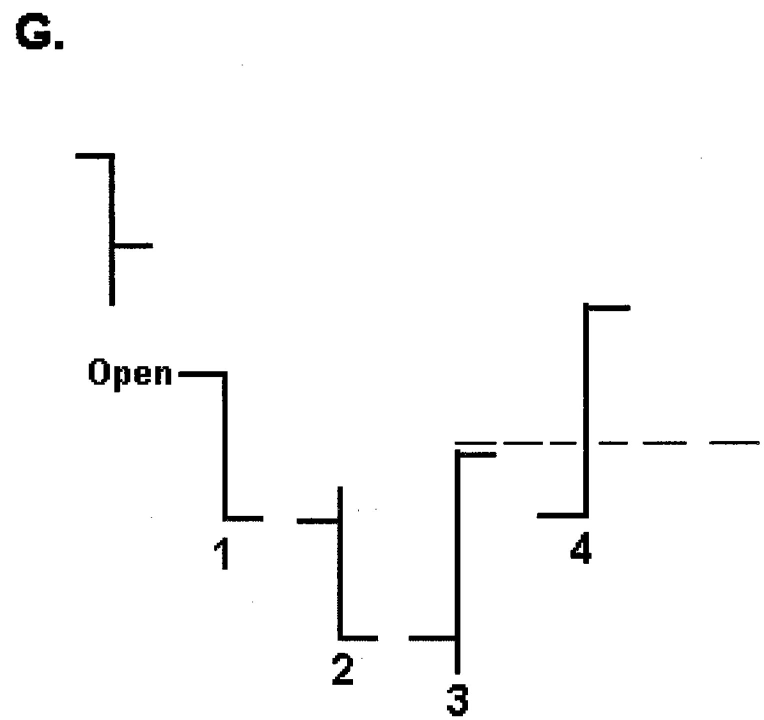
H.



Trap Door Patterns – Chart G.

G.

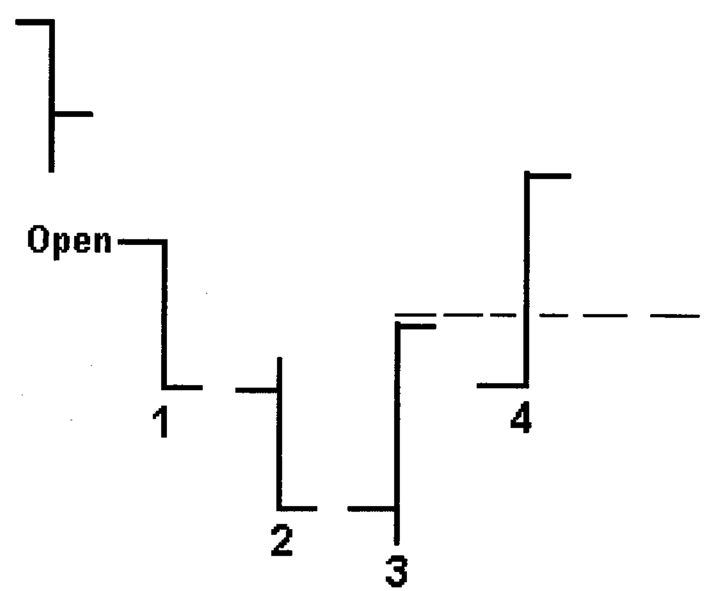
1. Opening bar.
2. First bar lower high and low.
3. Outside bar with the close in the top of the range and above the previous bar's high after opening and trading below that bar's low.
4. <u>Entry bar</u>.



Trap Door Patterns – Chart G.

<u>Initial stop</u>: Place your initial stop below the low of bar 3, but most of the time, because it is a wide-range bar, you will place the stop below the midpoint of the outside bar (3) or use a money stop.

G.

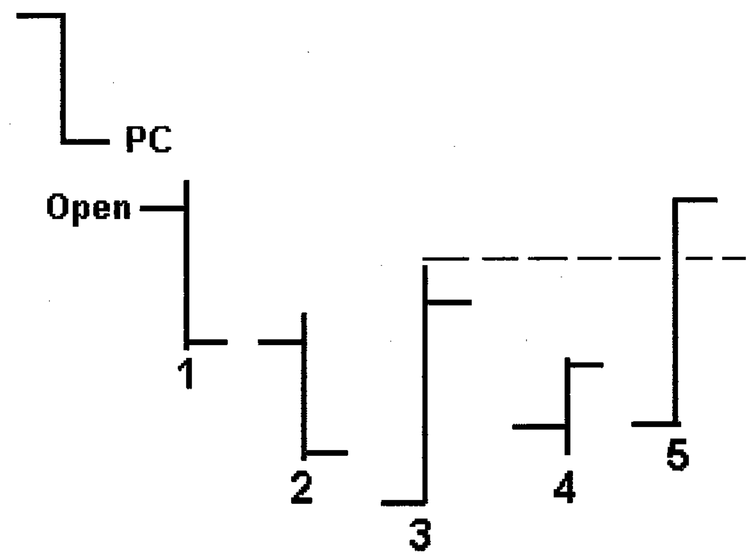


Trap Door Patterns – Chart H.

H.

This is essentially the same, except you have another inside bar (4) following the outside bar (3). Entry on this pattern can be above the high of the inside bar (4) if the dynamics remain strong. Stop placement is handled the same way as (G).

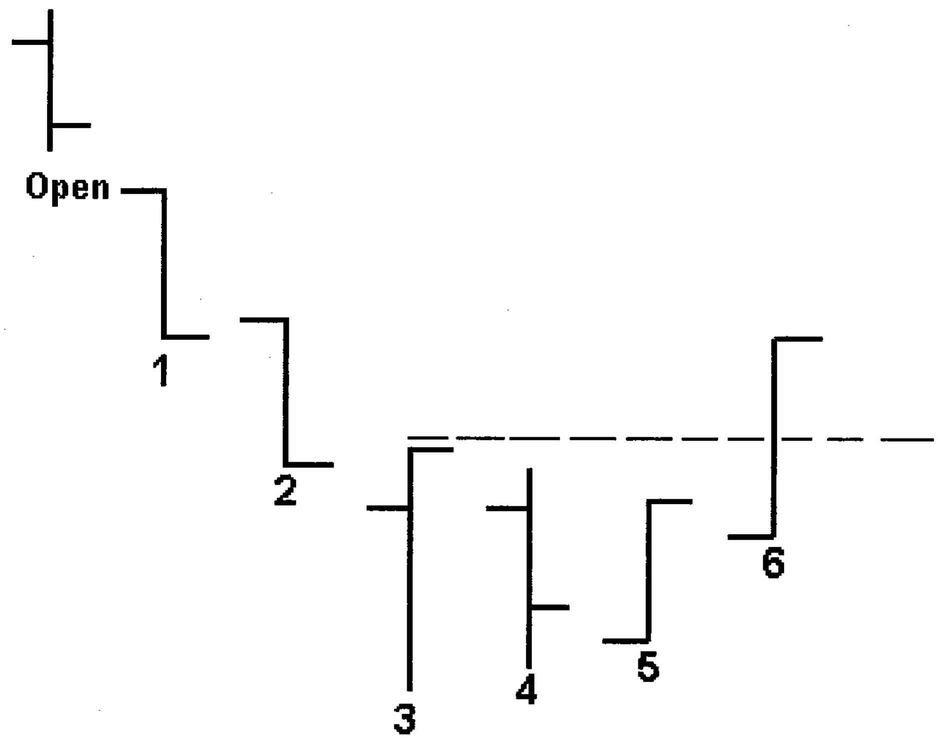
H.



Trap Door Patterns - Dynamite Triangle

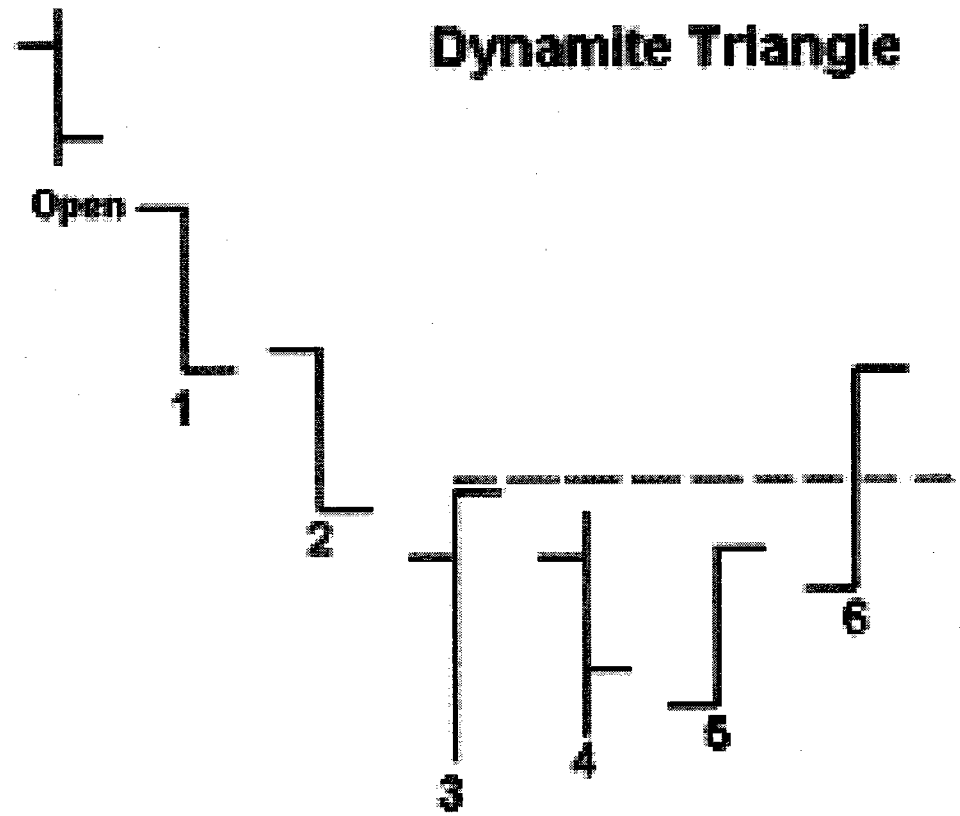
I.

Dynamite Triangle



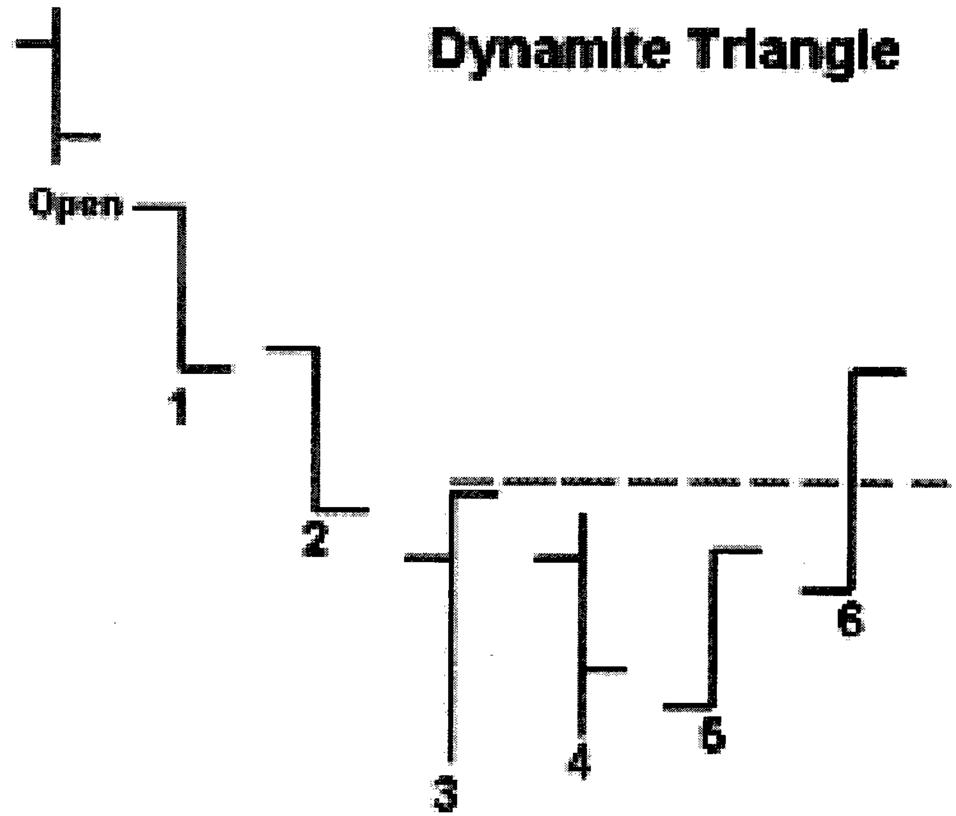
Trap Door Patterns - Dynamite Triangle

This is an explosive six-bar pattern that can explode, especially in a stock that has a good daily chart setup.



Trap Door Patterns - Dynamite Triangle

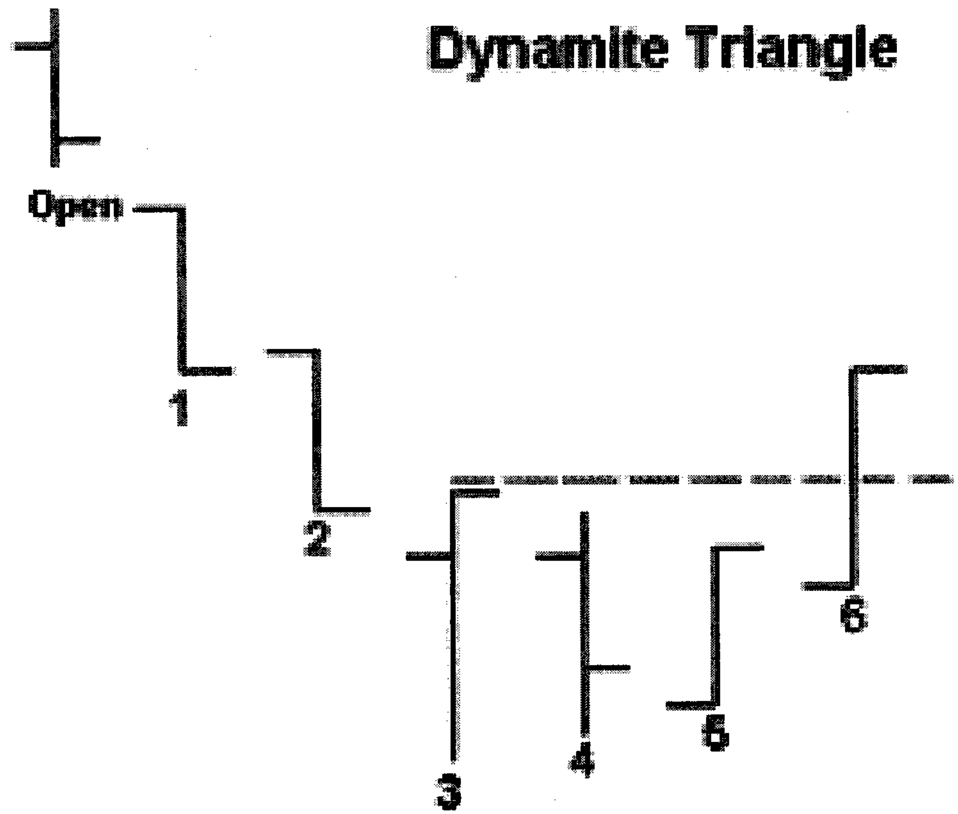
1. Opening bar.
2. First lower high and low.
3. Wide-range bar that opens below the previous bar's low (2), then reverses to close in the top of the range and above the previous close (not mandatory). This is your first signal bar.
4. Inside bar which delays possible entry above the signal bar's high.



Trap Door Patterns - Dynamite Triangle

5. A second inside bar which forms the Dynamite Triangle and a close in the top of the range. At this point you have a choice of entry above the high of the second inside bar or above the signal bar high (3). If the dynamics are strong, you can take entry above the inside bar (5).

6. Entry bar.



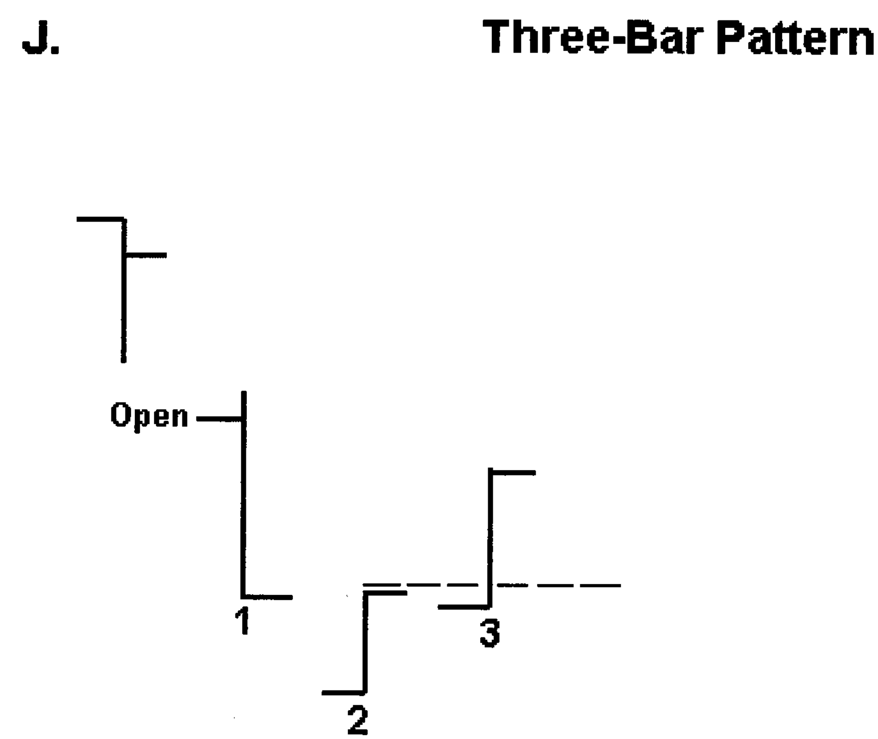
Initial stop is below the bar 5 low if not too tight, or else below the signal bar low (3).

Trap Door Patterns - Three-Bar Pattern

J. Three-bar pattern

This is an example where there is a wide-range bar down on the opening, followed by a very narrow-range bar with a close in the top of the range.

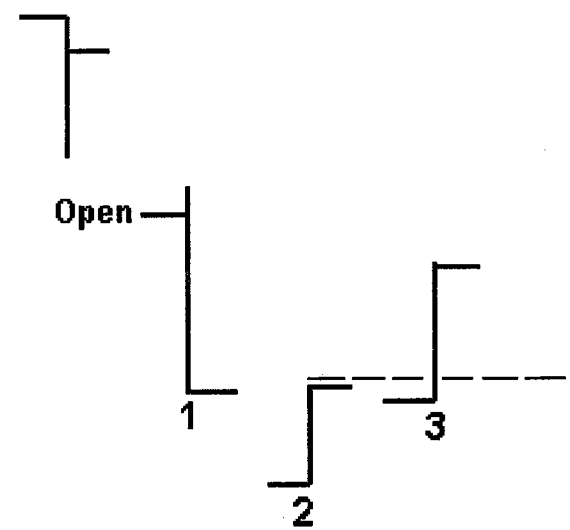
<u>Key Point</u>: Narrow-range bars with a significant increase in volume usually precede a change in direction/trend.



Trap Door Patterns - Three-Bar Pattern

1. Wide-range bar on opening.
2. Narrow-range bar on increased volume with a close in the top of the range.
3. <u>Entry bar</u>.

J. Three-Bar Pattern

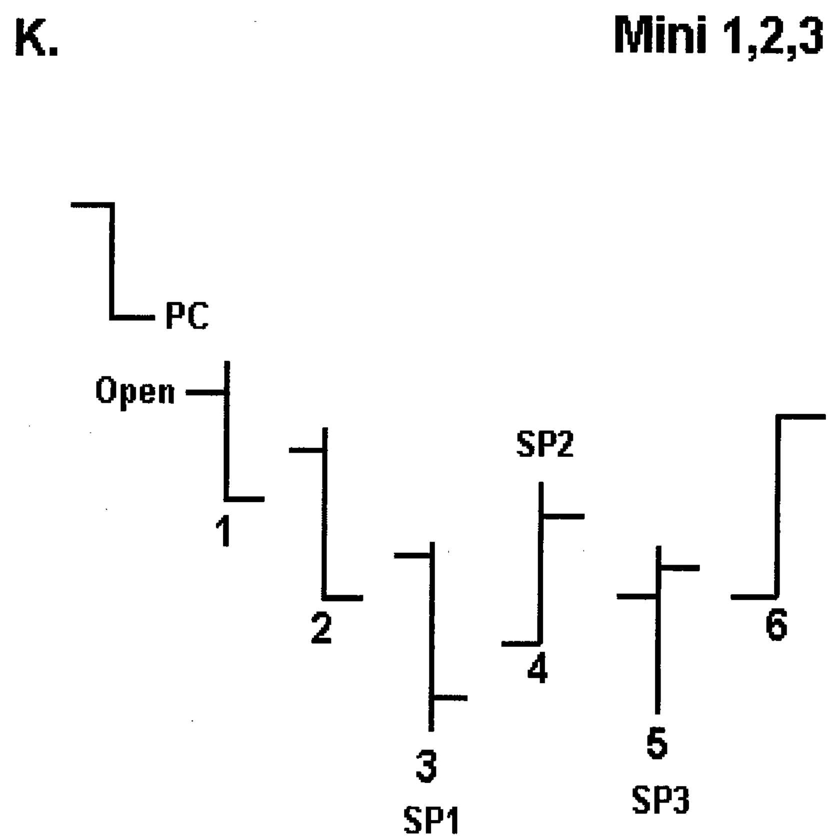


<u>Initial stop</u> is placed below the bar 2 low, unless it is to tight because of the narrow range, so you would give it some room with a money stop.

Trap Door Patterns - Mini 1,2,3

K. Mini 1,2,3

1. Opening bar.
2. First lower high and low.
3. Second lower high and low with a close in the bottom of the range, which is not a signal bar (must close above the midpoint, unless it is like example (J).



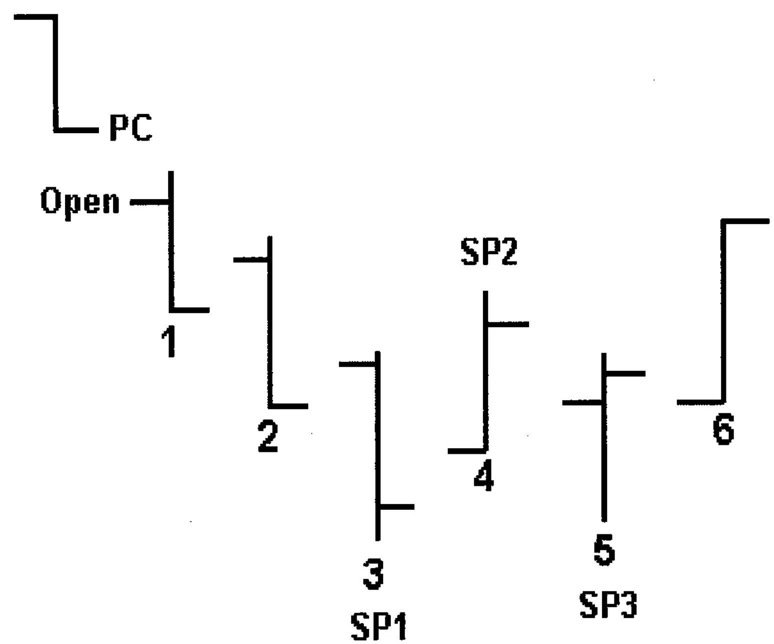
Trap Door Patterns - Mini 1,2,3

4. Higher high and low with the close above the bar 3 high. This is a change in direction bar, but we didn't take it because the previous bar closed in the bottom of the range. The bar 4 close establishes bar 3 as swing point 1. (A swing point has a higher low on each side of it. Reverse for sells.)

5. Opens and closes in the top 10% of its range on a retracement to the bar 3 low. This still indicates buying pressure.

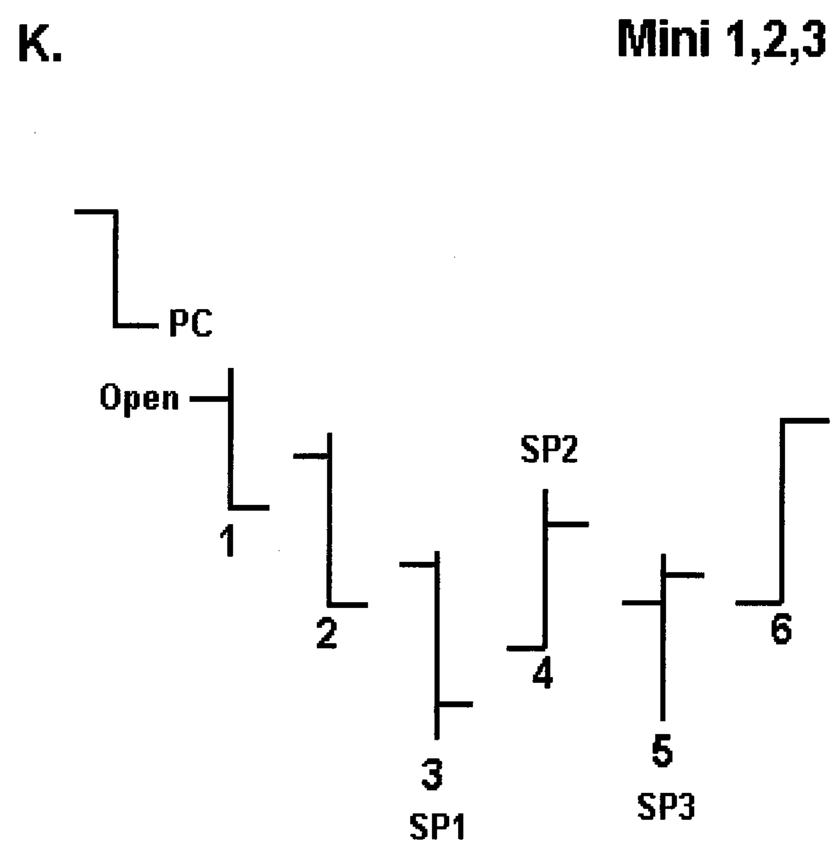
K.

Mini 1,2,3



Trap Door Patterns - Mini 1,2,3

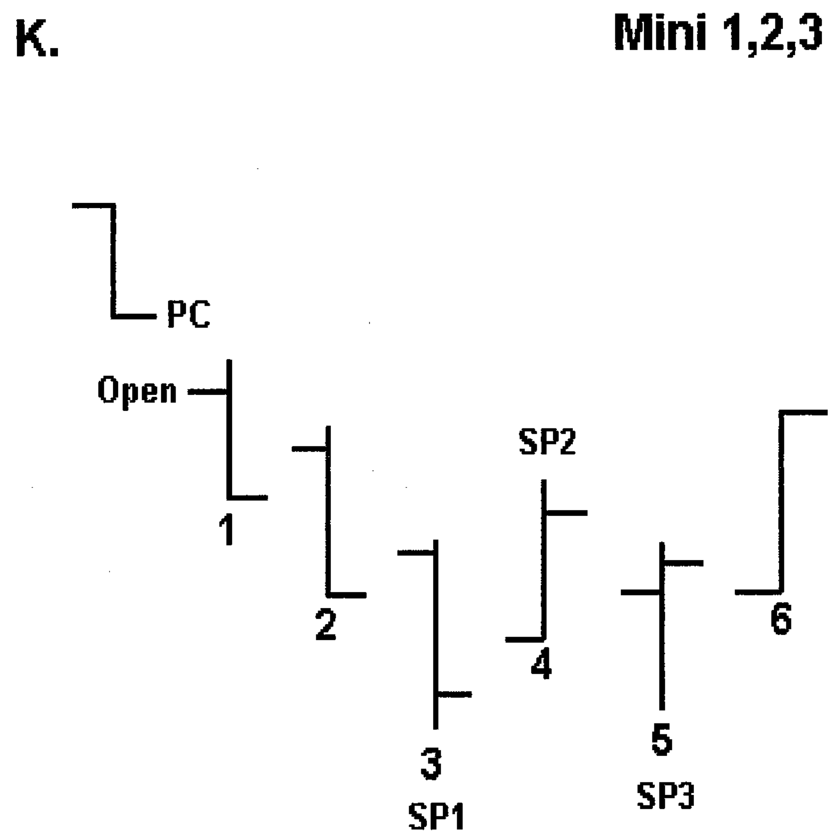
<u>Key Point</u>: Bar 5 establishes Bar 4 as swing point 2 because of the lower high and low. As you can see, swing point 2 has a lower high on each side of it. You set your entry just above the high of bar 5, which is now your signal bar because of the close in the top of the range and a higher low than bar 3.



Trap Door Patterns - Mini 1,2,3

<u>Entry bar</u> is above the signal bar high. This establishes bar 5 as swing point 3 and a confirmed higher low, which indicates buying pressure.

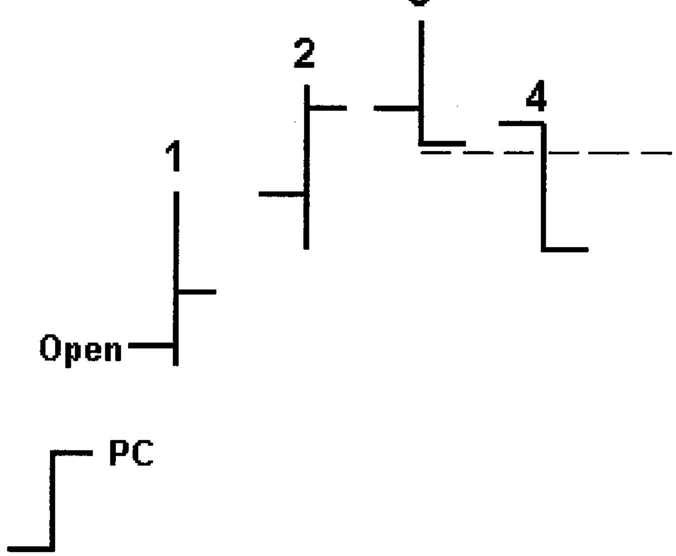
<u>Initial stop</u> is placed below the low of bar 5 (swing point 3).



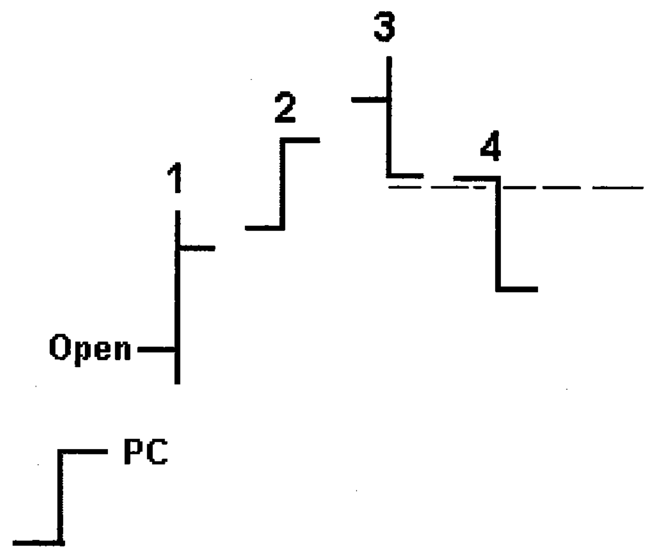
Trap Door Patterns - Sell Patterns

The Trap Door Sell patterns are simply the reverse image of their buy counterparts. In all of the cases, the buy rules are reversed, the same as the patterns themselves. The entry point in the diagrams is the blue dotted line.

A.

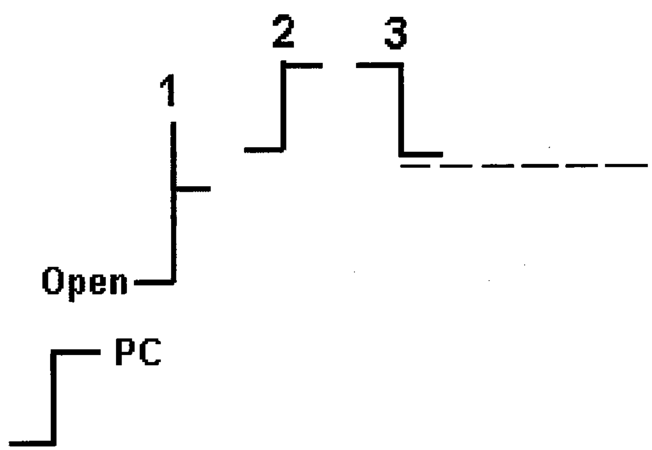


B.

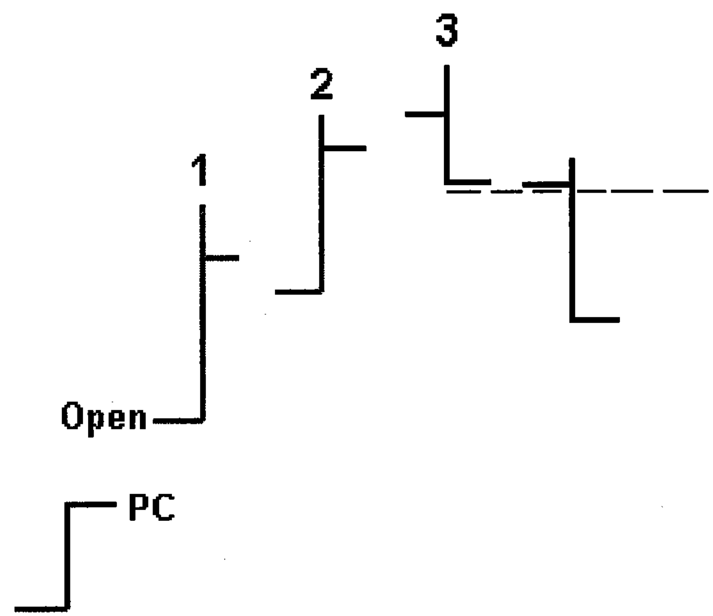


Trap Door Patterns - Sell Patterns

C.

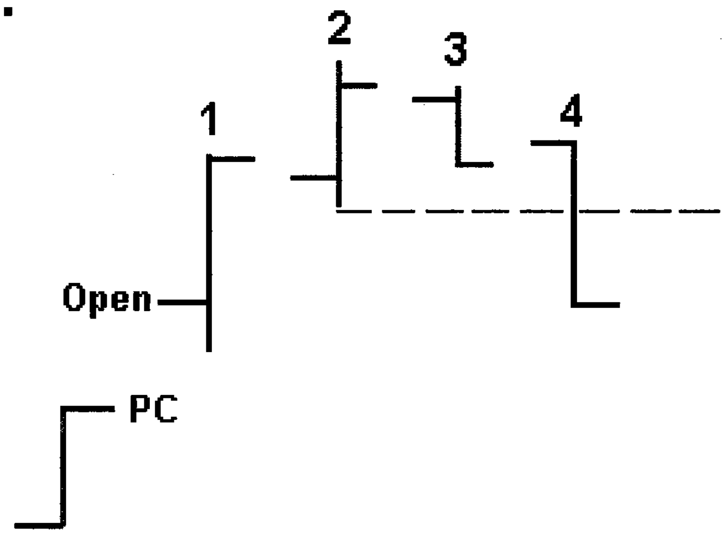


D.

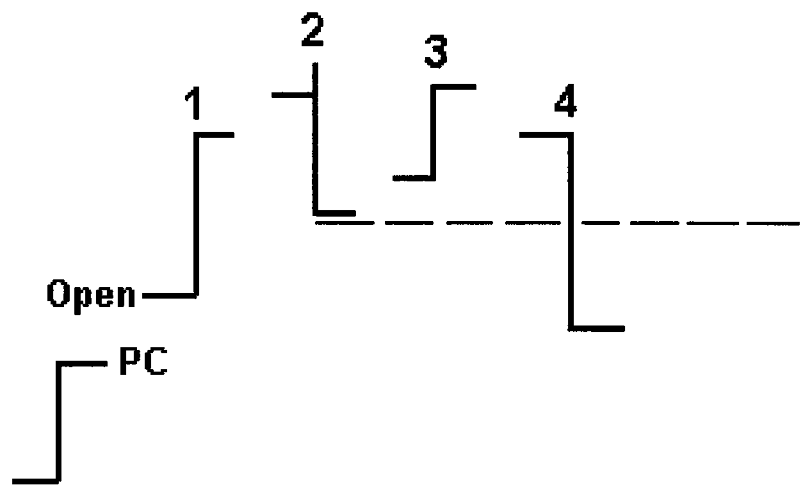


Trap Door Patterns - Sell Patterns

E.

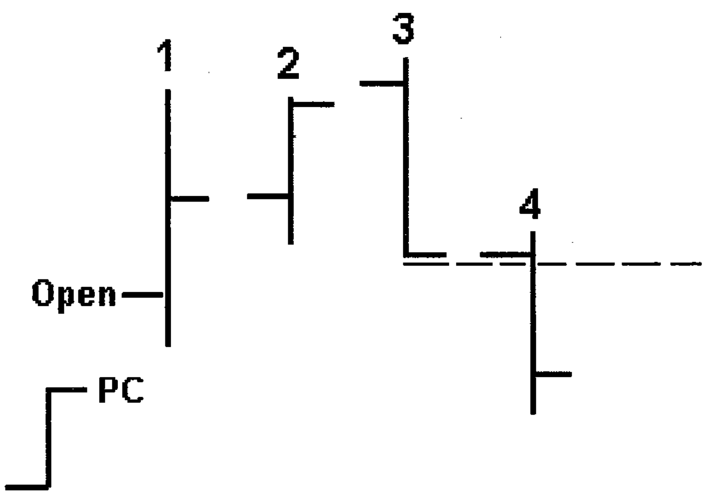


F.

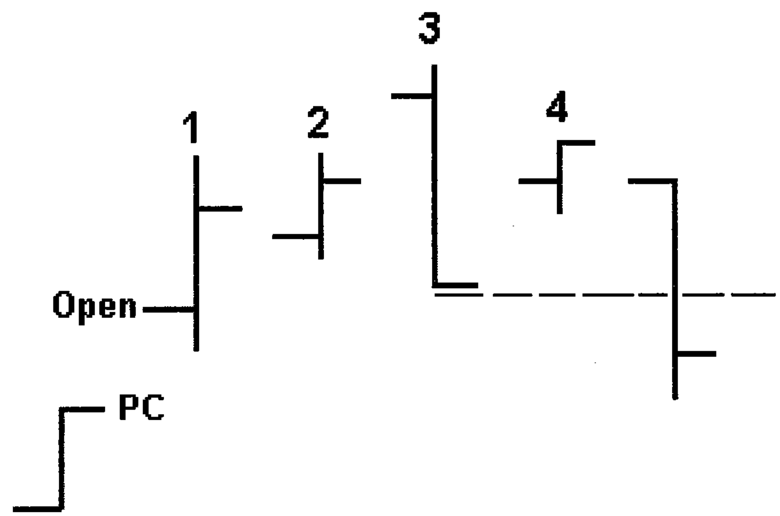


Trap Door Patterns - Sell Patterns

G.

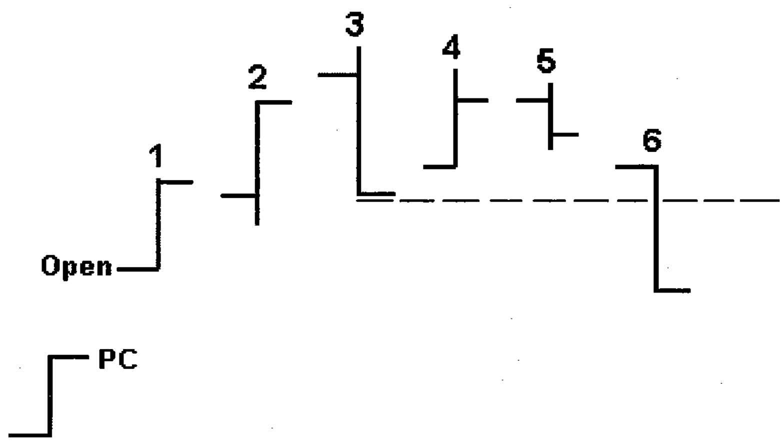


H.

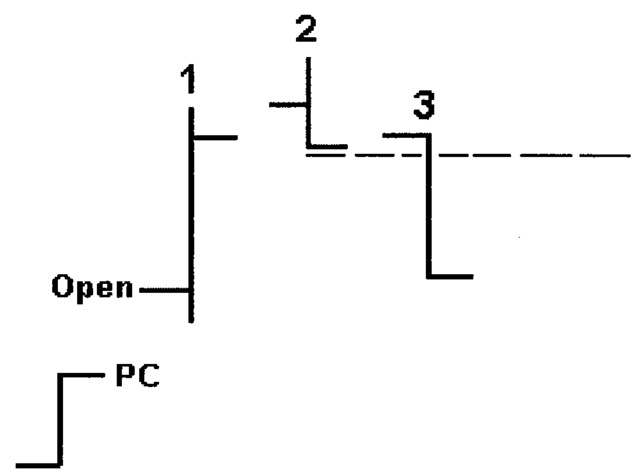


Trap Door Patterns - Sell Patterns

I.

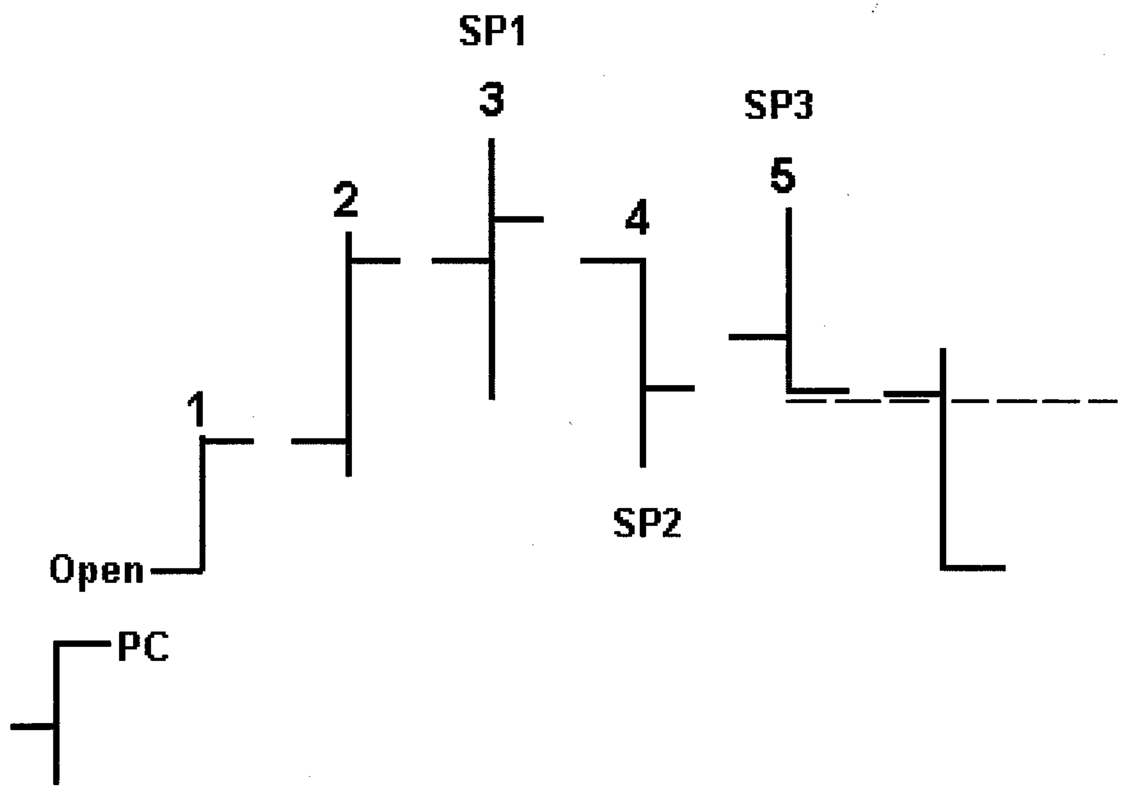


J.



Trap Door Patterns - Sell Patterns

K.



Trap Door Patterns - Sell Patterns

The chart examples all show a gap opening, but it is also a valid Trap Door pattern if it opens in line, then proceeds to trade straight down/up on the next few bars, setting up the pattern.

Trap Door Rules (sells reversed)

1. The intraday chart used for the strategy is a five-minute bar chart (or candle) with the open, high, low and close.
2. Ninety-five percent of the Trap Door entries will be from a three- to six-bar pattern.
3. Most Trap Doors will have at least two bars, excluding the opening bar that will have a lower high and lower low than the preceding bar. On exception would be if the third bar is an inside bar. Another, which doesn't happen often, is if there is an extreme wide-range opening bar that carries down to a key inflection point or volatility band level for that day.

Trap Door Rules (sells reversed)

4. The signal bar should close above the mid-point and is best if it closes in the top 25% of the range. An exception would be the inside bar pattern example and another would be the narrowing range pattern.
5. Entry is above the high of the signal bar, and you should see some market dynamics improving as you prepare to take entry.
6. The initial stop is placed below the signal bar low. If it is a wide-range bar, you can place the stop below the mid-point of the signal bar, or else use a money stop.

Trap Door Rules (sells reversed)

7. Because the trade will reverse in the direction of the open better than 50% of the time, you should look to take profits on one-half of your position after the initial contra move and move to breakeven on the balance of your position ASAP.
8. You will know if the trade is good in the first few bars after entry, because if the dynamics don't continue to improve, the Generals will return with stock to sell as they only do part of their orders on the opening bars and wait to see if they can scale up the balance at higher prices (reverse for buys).

Trap Door Rules (sells reversed)

9. You look for Trap Doors when the overall market has an over-reaction during the opening period, NOT when it is just a stock-specific situation.
10. When you are trading the big cap stocks, the best Trap Doors will most often be in those stocks that have the best daily chart setups from the previous day's trading. The buyers/sellers will return to take advantage of the lower/higher prices caused by the emotional reaction to some media-hyped news.

Trap Door Rules (sells reversed)

11. If you trade the futures, the Trap Door setup starts at 9:30 a.m. ET, and I suggest trading off the SPY opening bar because the SPX opening bar is skewed because the S&P 500 stocks don't all open at the same time.

Key Point: Once you have an understanding of the basic market dynamics explained in the next section, you will be well prepared to successfully trade the Trap Door Strategy. However, to make the most powerful strategy it can be, you must be ready to apply the "tools" that can quantify the trade so that it is a high-probability trade with a POSITIVE MATHEMATICAL expectation.

Market Dynamics for Trap Doors

The Trap Door is a reversal strategy or contra move to the discount/premium opening trading period. The move is fast, but there are certain dynamics you can watch to confirm that there is a potential change in direction.

1. NYSE Tick (TICK) -- The first thing I look for when trading the index proxies or futures is a divergence. In the case of a discount opening for the S&P 500 Index where the index makes a lower low, but the "Ticks" fails to make a lower low, indicates a positive divergence or non-confirmation of the S&P 500 Index lower low. When the Ticks stop declining, the market is often ready to reverse for the contra move. This divergence also leads the big cap stocks.

Market Dynamics for Trap Doors

2. S&P 500 Premium between futures and cash index -- I use the TICK in conjunction with the premium level. Futures will often lead a move in the cash index, and when the market declines rapidly, the premium contracts (reverse for advance). If you see the premium start to expand because the S&P 500 made a lower low, but the premium made a higher low in conjunction with a positive divergence in TICK, you have every reason to take the trade. Note: Most vendors have a premium indicator, but if not, you can just eyeball the difference between the S&P futures and S&P 500 cash index on your market monitor.

Market Dynamics for Trap Doors

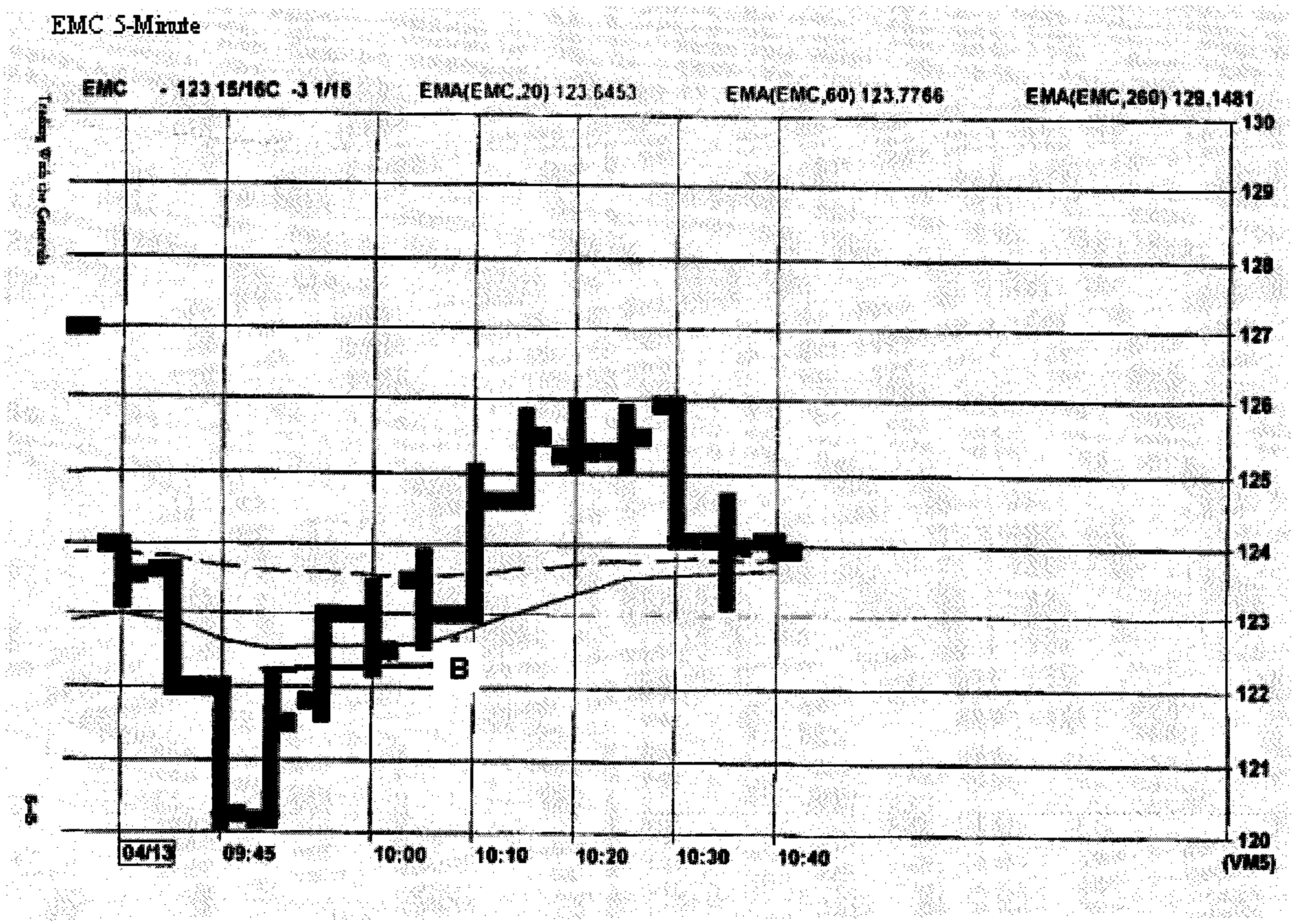
3. TRIN -- This is a key indicator for traders, but in the 9:30 - 10:00 a.m. period, it is erratic because stocks don't all open together, so data is skewed. This comes into play after the Trap Door period as a change in direction for TRIN often precedes a market turn. It might become a factor as you are deciding to exit your trade.

Market Dynamics for Trap Doors

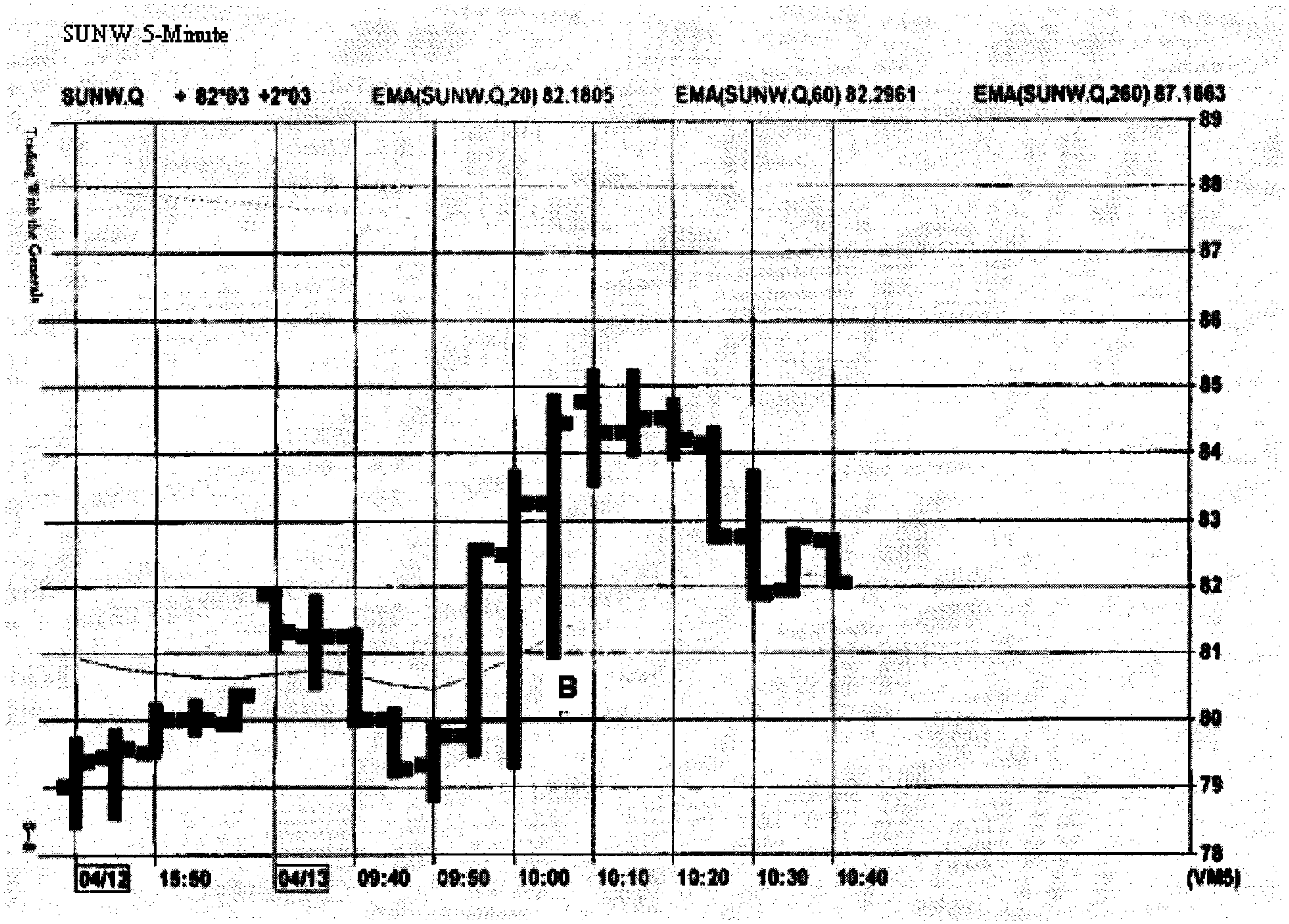
4. Up Volume/Down Volume -- If the index proxies have signal bars, you might see a quick shift in the ratio for both the NYSE and for individual stocks.
5. Relative Performance -- When trading Trap Doors with big cap stocks, you look to see if the stock and group are acting better than the major indices. You can observe this in price and also volume, especially on what appears to be the signal bar.

Trap Doors
Real World Examples

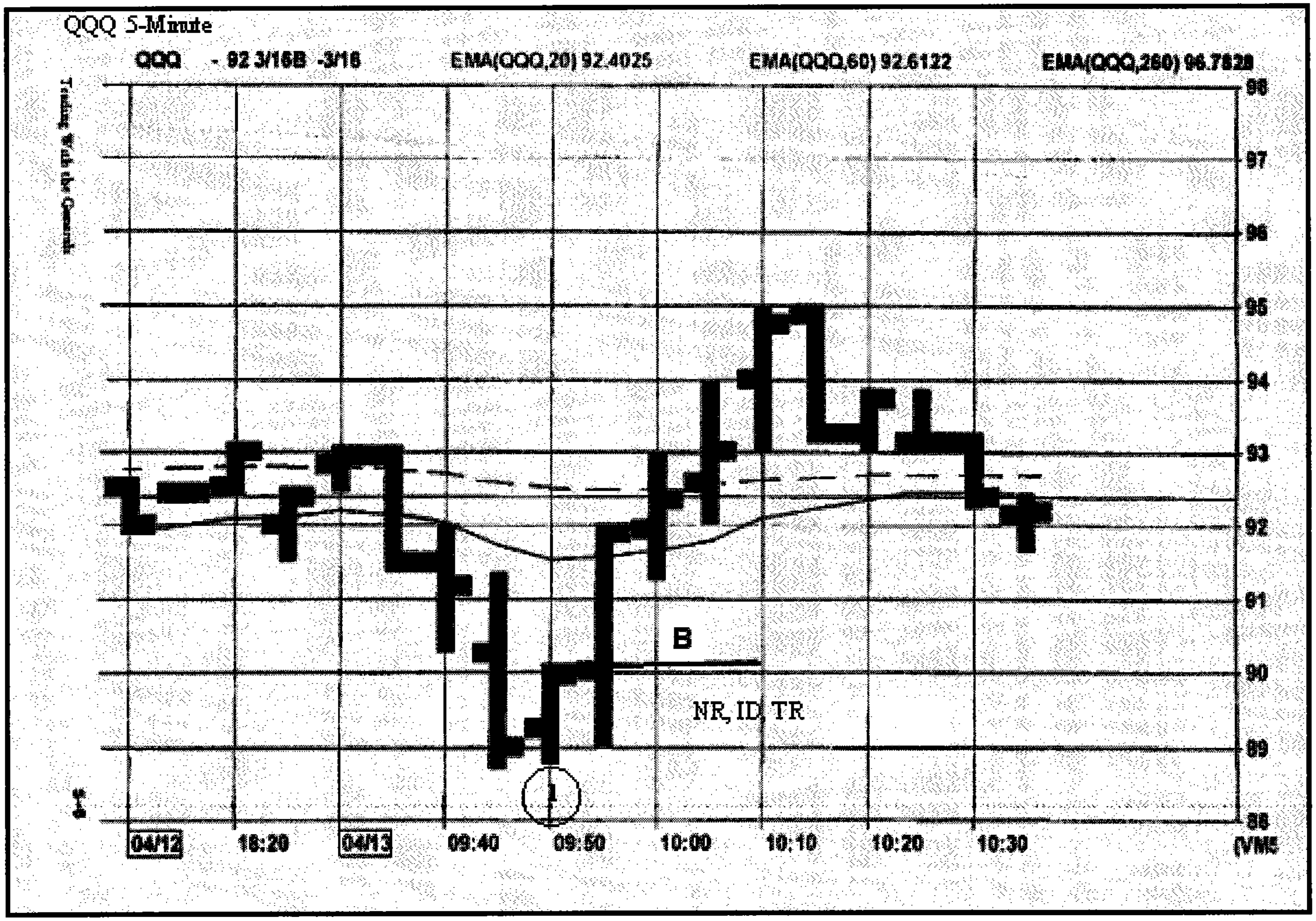
Trap Doors


EMC 5-Minute
EMC - 123 15/16C -3 1/16
EMA(EMC,20) 123.6453
EMA(EMC,60) 123.7766
EMA(EMC,260) 129.1481
130
129
128
127
126
125
124
123
122
121
120
(VM5)
B
04/13
09:45
10:00
10:10
10:20
10:30
10:40

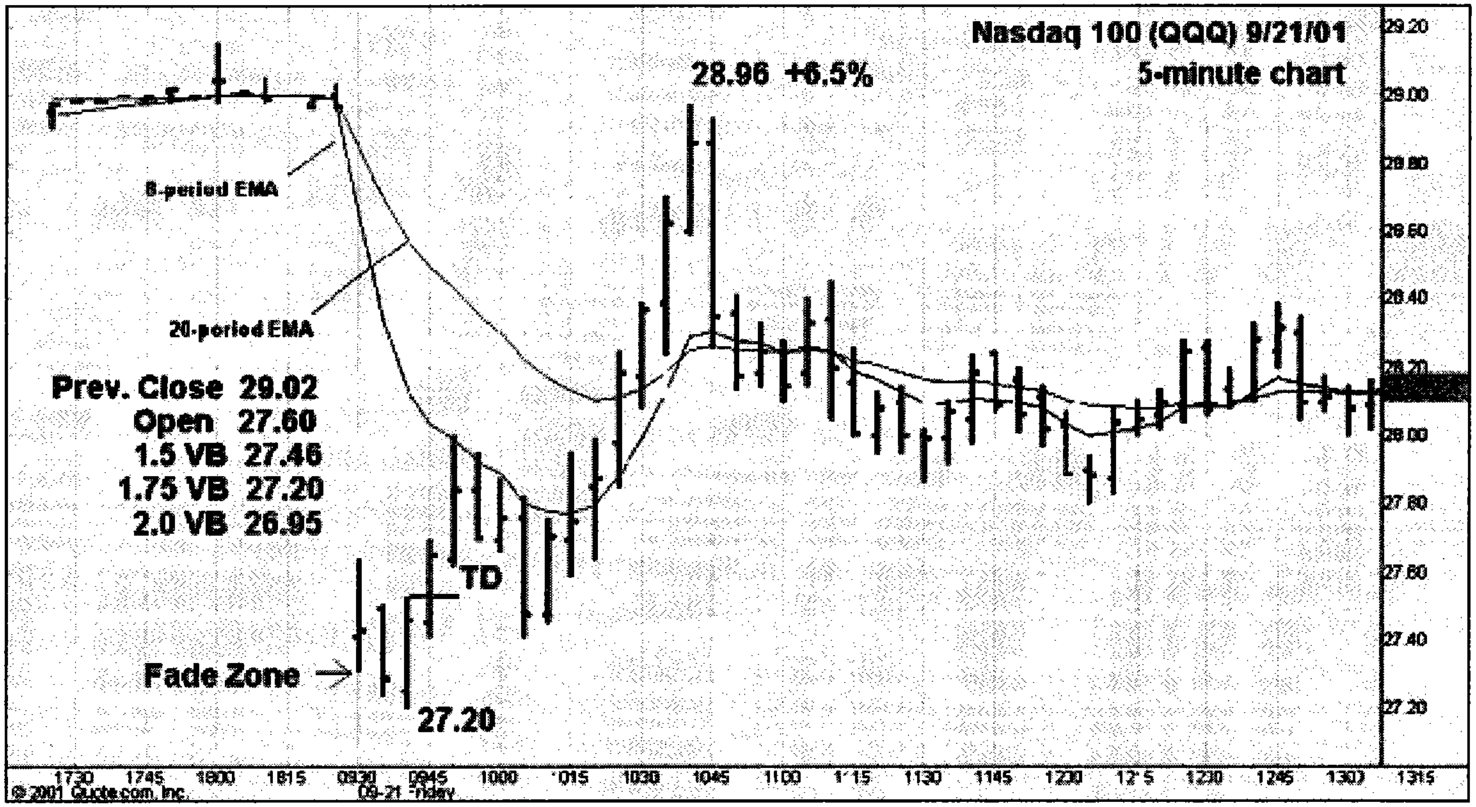
Trap Doors


SUNW 5-Minute
SUNW.Q + 82*03 +2*03
EMA(SUNW.Q,20) 82.1805
EMA(SUNW.Q,60) 82.2961
EMA(SUNW.Q,260) 87.1663
89
88
87
86
85
84
83
82
81
80
79
78
B
04/12
15:50
04/13
09:40
09:50
10:00
10:10
10:20
10:30
10:40
(VM5)

Trap Doors

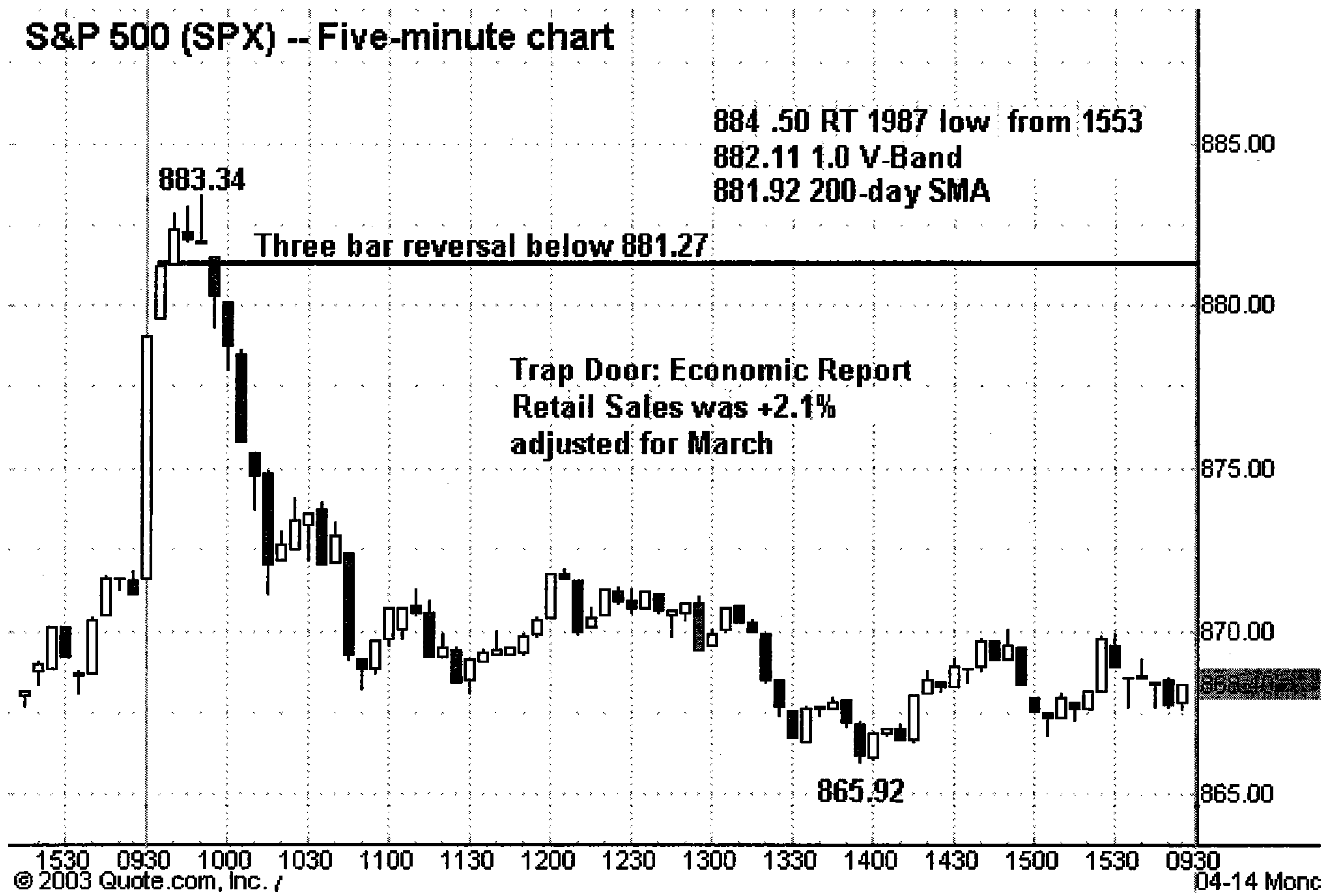

QQQ 5-Minute
QQQ - 92 3/16B -3/16
EMA(QQQ,20) 92.4025
EMA(QQQ,60) 92.6122
EMA(QQQ,260) 96.7828
B
NR, ID, TR
1
04/12
16:20
04/13
09:40
09:50
10:00
10:10
10:20
10:30
98
97
96
95
94
93
92
91
90
89
88

Trap Doors

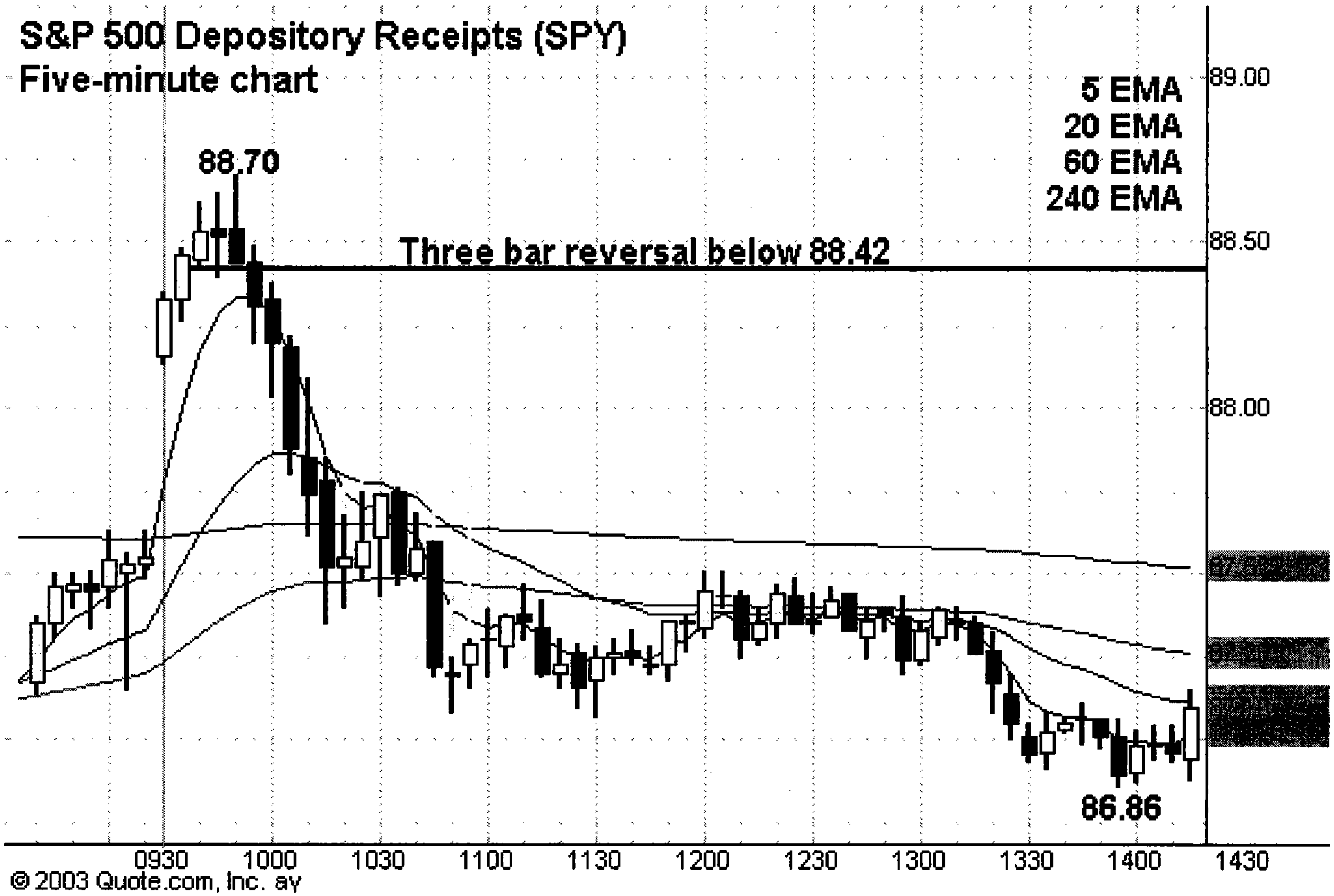


Nasdaq 100 (QQQ) 9/21/01
5-minute chart
28.96 +6.5%
8-period EMA
20-period EMA
Prev. Close 29.02
Open 27.60
1.5 VB 27.46
1.75 VB 27.20
2.0 VB 26.95
TD
Fade Zone
27.20

Trap Doors


S&P 500 (SPX) -- Five-minute chart
884 .50 RT 1987 low from 1553
882.11 1.0 V-Band
881.92 200-day SMA
883.34
Three bar reversal below 881.27
Trap Door: Economic Report
Retail Sales was +2.1%
adjusted for March
865.92
885.00
880.00
875.00
870.00
865.00
1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930
© 2003 Quote.com, Inc.
04-14 Monc

Trap Doors



S&P 500 Depository Receipts (SPY)
Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
88.70
Three bar reversal below 88.42
86.86
89.00
88.50
88.00
0930
1000
1030
1100
1130
1200
1230
1300
1330
1400
1430
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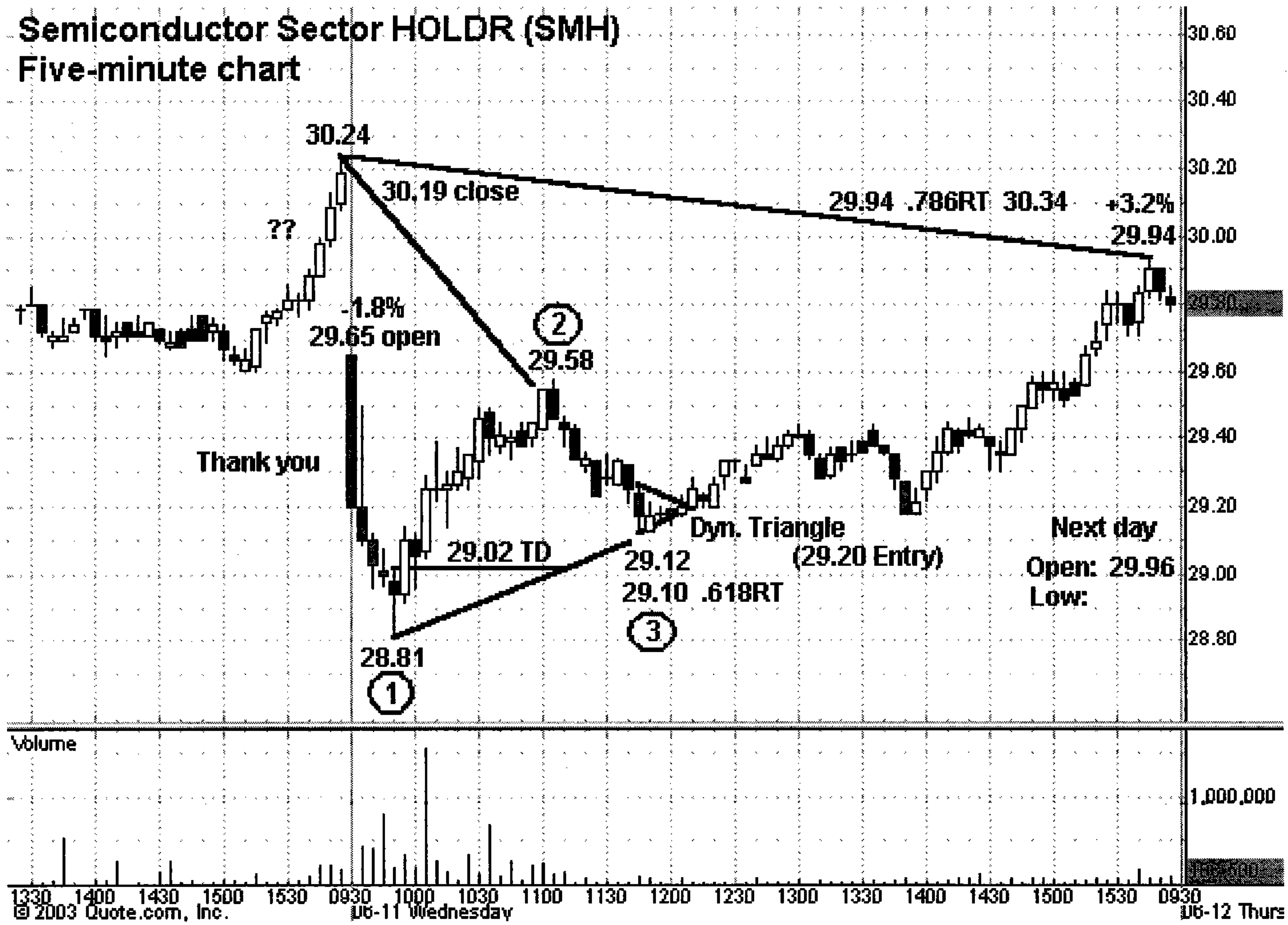
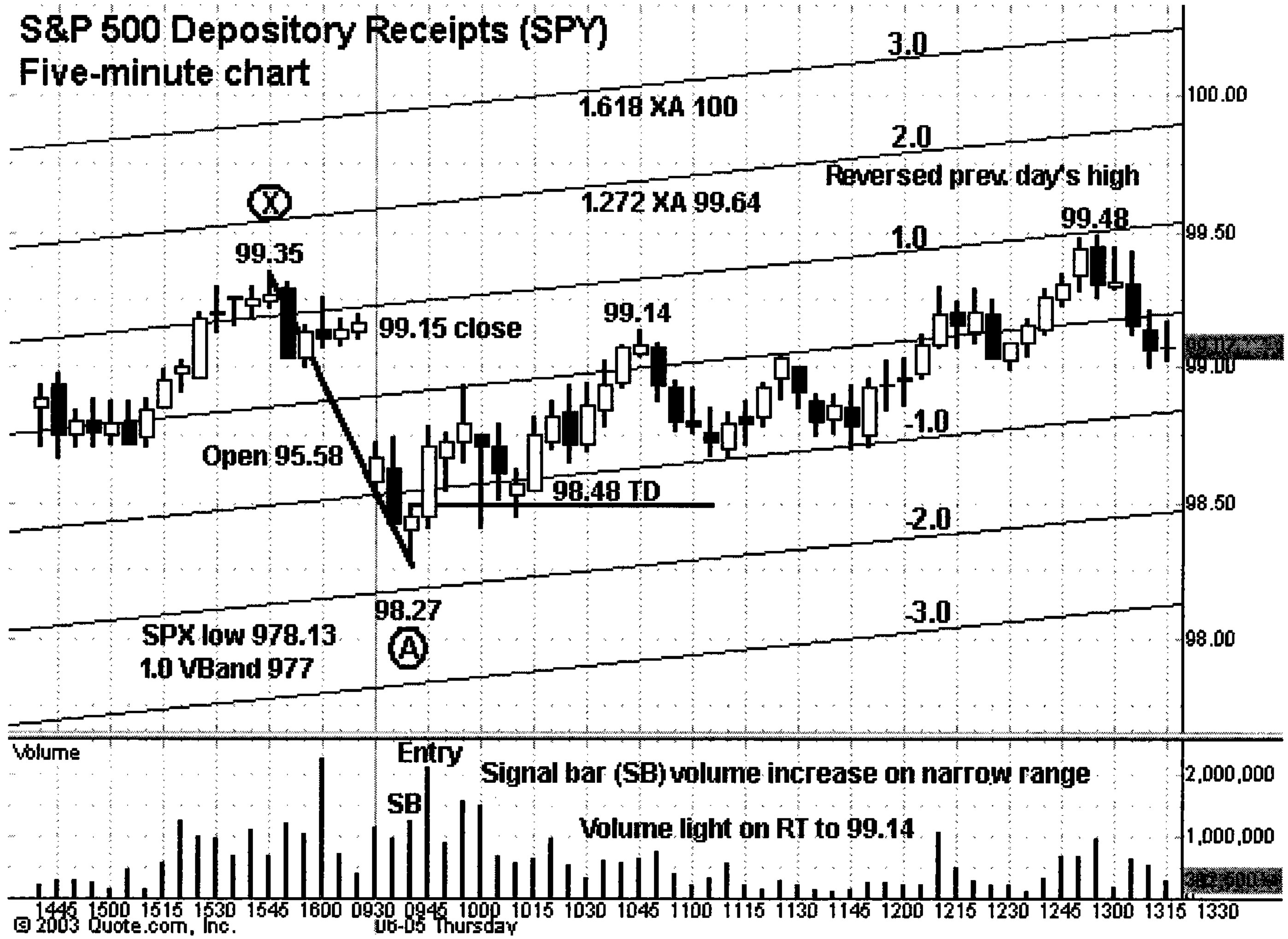
Trap Doors



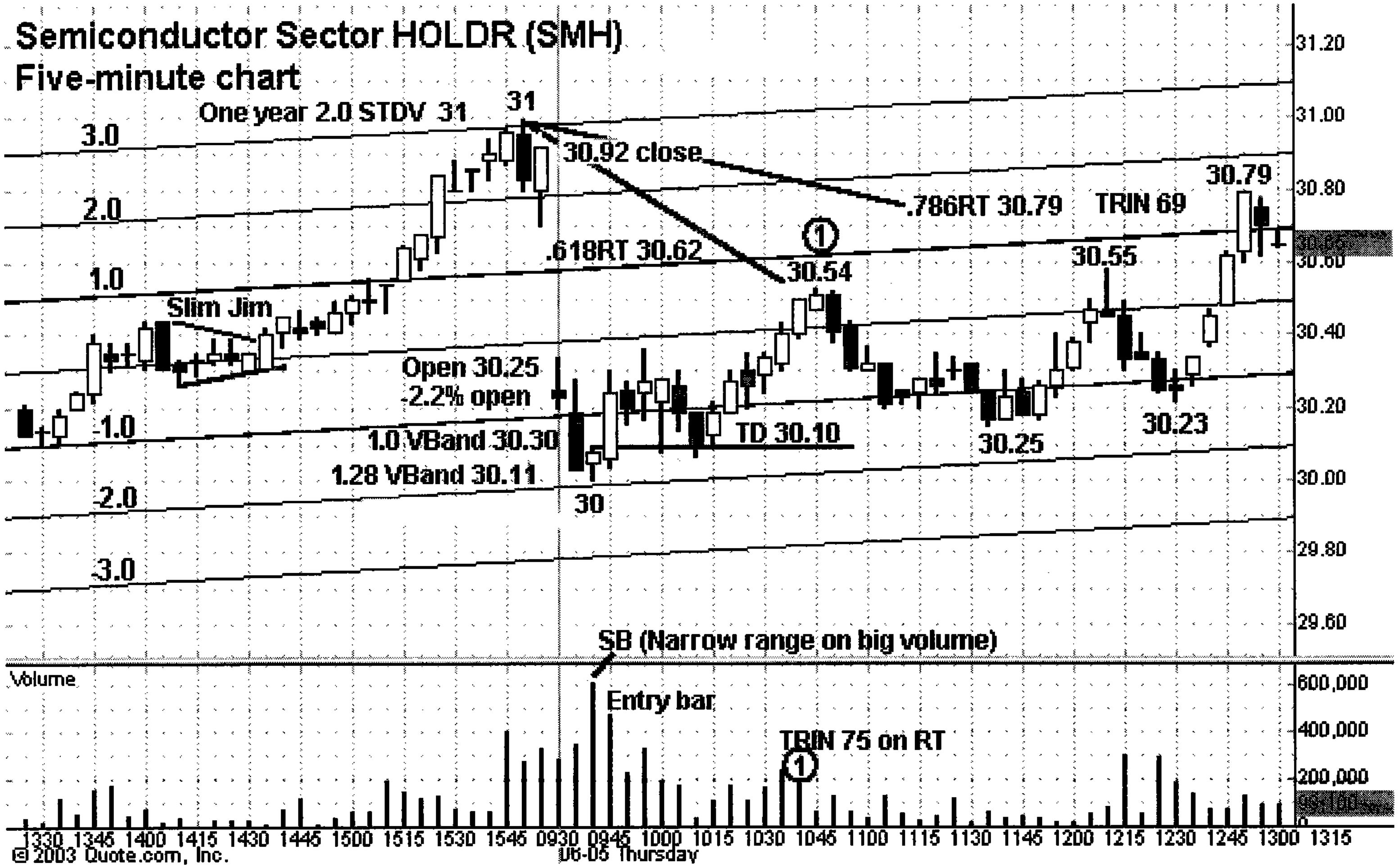
Semiconductor Sector HOLDR (SMH)
Five-minute chart
30.24
30.19 close
??
-1.8%
29.65 open
Thank you
29.02 TD
28.81
1
2
29.58
29.12
29.10 .618RT
3
Dyn. Triangle
(29.20 Entry)
29.94 .786RT 30.34
+3.2%
29.94
Next day
Open: 29.96
Low:
30.60
30.40
30.20
30.00
29.60
29.40
29.20
29.00
28.80
Volume
1,000,000
1330 1400 1430 1500 1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930
© 2003 Quote.com, Inc.
06-11 Wednesday
06-12 Thurs

Trap Doors



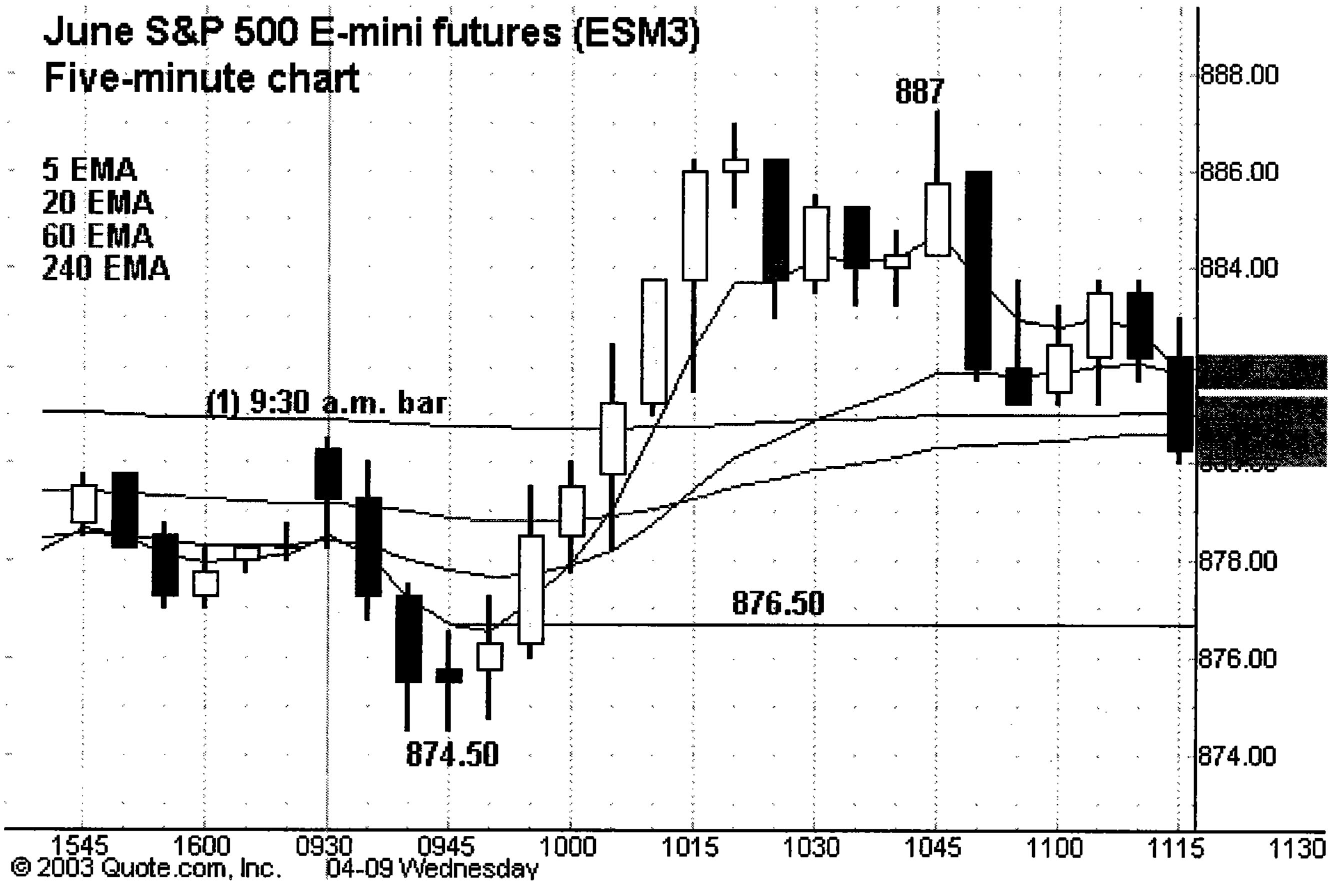
S&P 500 Depository Receipts (SPY)
Five-minute chart
3.0
1.618 XA 100
2.0
Reversed prev. day's high
1.272 XA 99.64
X
99.48
99.35
1.0
99.15 close
99.14
-1.0
Open 95.58
98.48 TD
-2.0
98.27
-3.0
SPX low 978.13
1.0 VBand 977
A
100.00
99.50
99.00
98.50
98.00
Volume
Entry
Signal bar (SB) volume increase on narrow range
SB
Volume light on RT to 99.14
2,000,000
1,000,000
1445 1500 1515 1530 1545 1600 0930 0945 1000 1015 1030 1045 1100 1115 1130 1145 1200 1215 1230 1245 1300 1315 1330
© 2003 Quote.com, Inc.
06-05 Thursday

Trap Doors



Semiconductor Sector HOLDR (SMH)
Five-minute chart
One year 2.0 STDV 31
31
30.92 close
.786RT 30.79
TRIN 69
30.79
.618RT 30.62
1
30.54
30.55
Slim Jim
Open 30.25
-2.2% open
1.0 VBand 30.30
TD 30.10
1.28 VBand 30.11
30.25
30.23
30
3.0
2.0
1.0
-1.0
-2.0
-3.0
SB (Narrow range on big volume)
Entry bar
TRIN 75 on RT
Volume
31.20
31.00
30.80
30.60
30.40
30.20
30.00
29.80
29.60
600,000
400,000
200,000
1330 1345 1400 1415 1430 1445 1500 1515 1530 1545 0930 0945 1000 1015 1030 1045 1100 1115 1130 1145 1200 1215 1230 1245 1300 1315
© 2003 Quote.com, Inc.
06-05 Thursday

Trap Doors



June S&P 500 E-mini futures (ESM3)
Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
887
(1) 9:30 a.m. bar
876.50
874.50
888.00
886.00
884.00
878.00
876.00
874.00
1545
1600
0930
0945
1000
1015
1030
1045
1100
1115
1130
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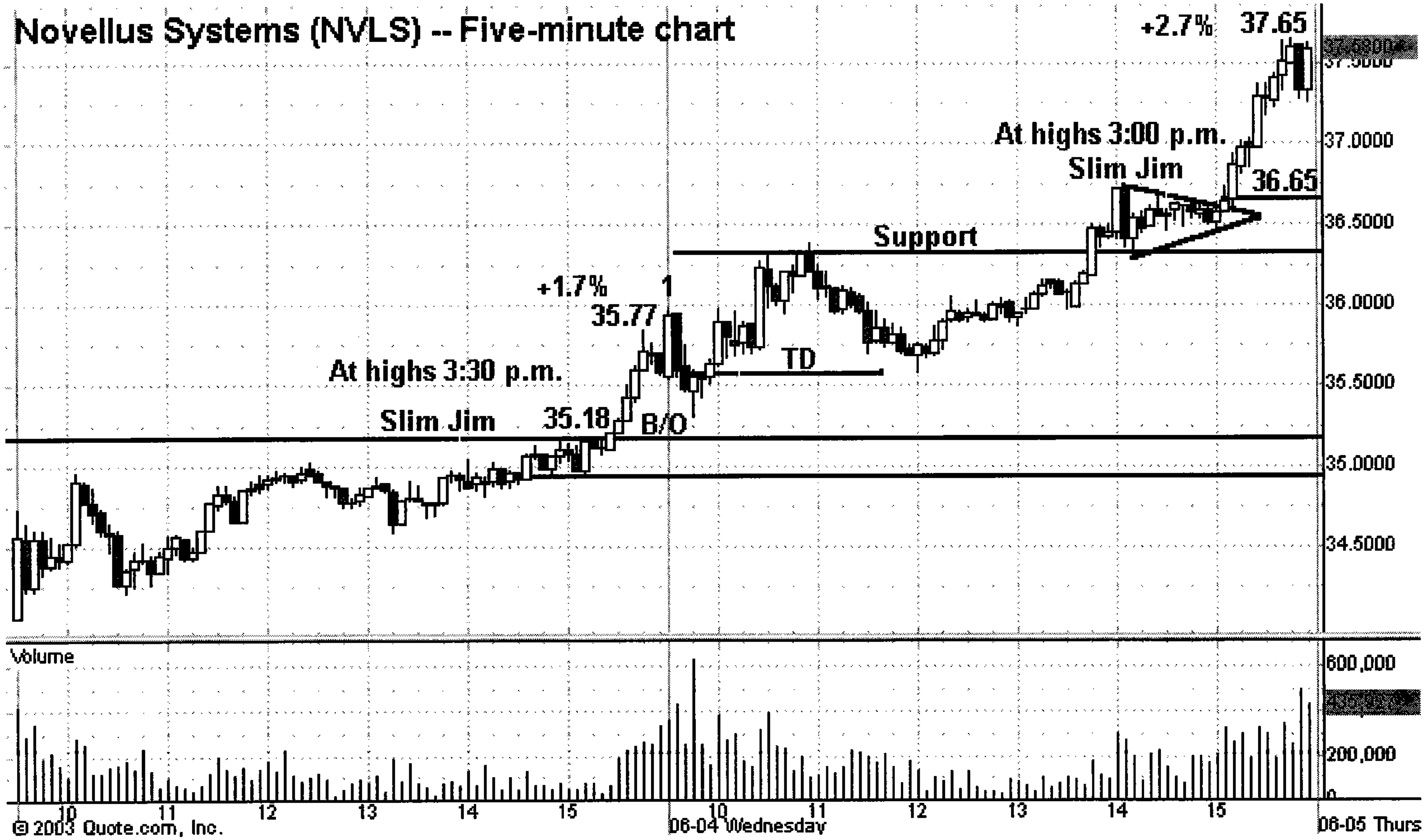
04-09 Wednesday

Trap Doors



Novellus Systems (NVLS) -- Five-minute chart
+2.7%
37.65
At highs 3:00 p.m.
Slim Jim
36.65
Support
+1.7%
35.77
TD
At highs 3:30 p.m.
Slim Jim
35.18
B/O
37.0000
36.5000
36.0000
35.5000
35.0000
34.5000
Volume
600,000
200,000
© 2003 Quote.com, Inc.
06-04 Wednesday
06-05 Thurs

Gap Pullbacks

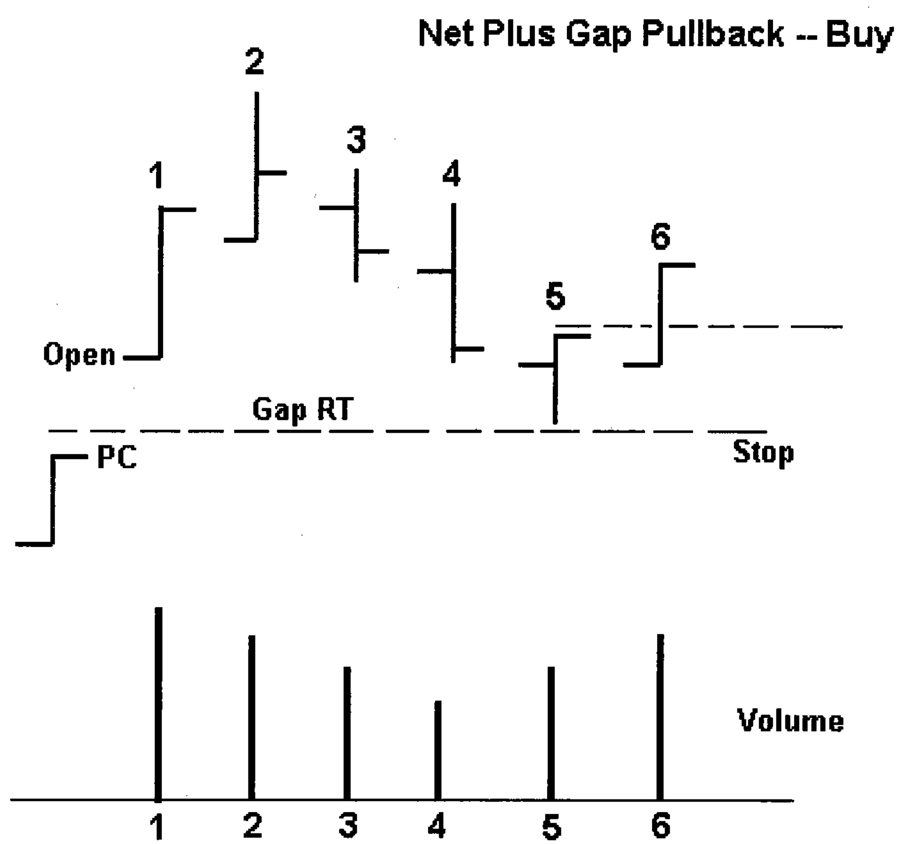
- Sixty percent of the time a stock will resume the direction of the open. This strategy allows you to capture that move.
- The Gap Pullback trade starts with a gap opening, and the best ones have heavier than normal volume, which means more than usual institutional (Generals) participation.
- The pullback to fill the gap is on declining volume and I like to see at least a 50% retracement to the previous day's high. That is a guideline, not an absolute because dynamics might be extremely strong and the Generals jump back on the train sooner.
- The Gap Pullback trade will follow a Trap Door trade.

Gap Pullbacks

The following two graphics are examples of the Net Plus and Net Minus Gap Pullback trades.

Net Plus Gap Pullback -- Buy

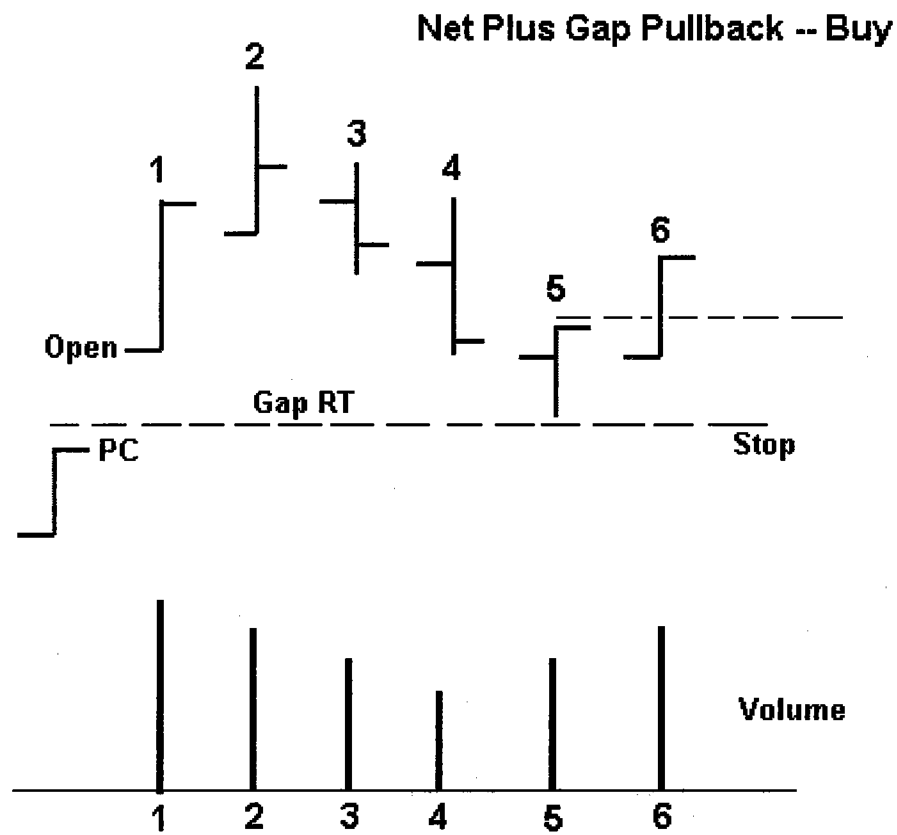
1. Gap opening bar on good volume.
2. Advance with higher high and low.
3. Pullback bar on less volume than bars 1 and 2.
4. Another pullback bar on even lighter volume.



Net Plus Gap Pullback -- Buy

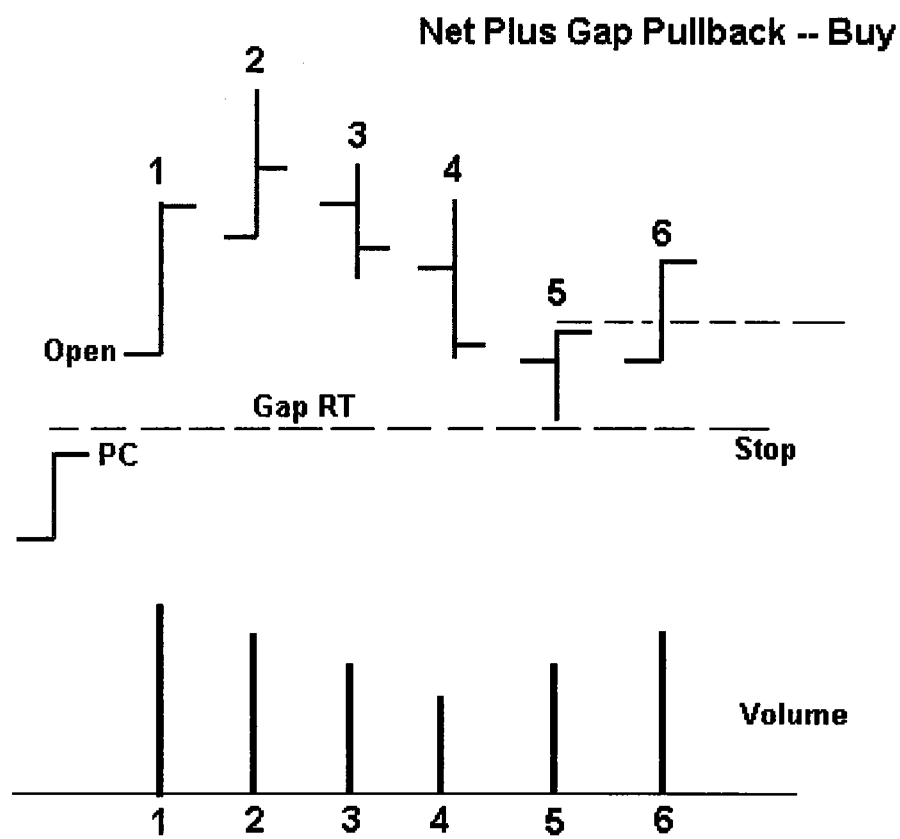
5. Signal bar that partially closes the gap and remains above the previous day's close and high. The signal bar close is above the open and in the top 25% of its range on a pick up in volume.

6. <u>Entry bar</u> with trade-through entry above the high of the signal bar (5), which also puts you in a <u>Net Plus</u> trend.



Net Plus Gap Pullback -- Buy

7. <u>Initial stop</u> is below the low of the signal bar, unless it's a wide-range bar where you would put the stop below the midpoint of that bar, or else a money stop.



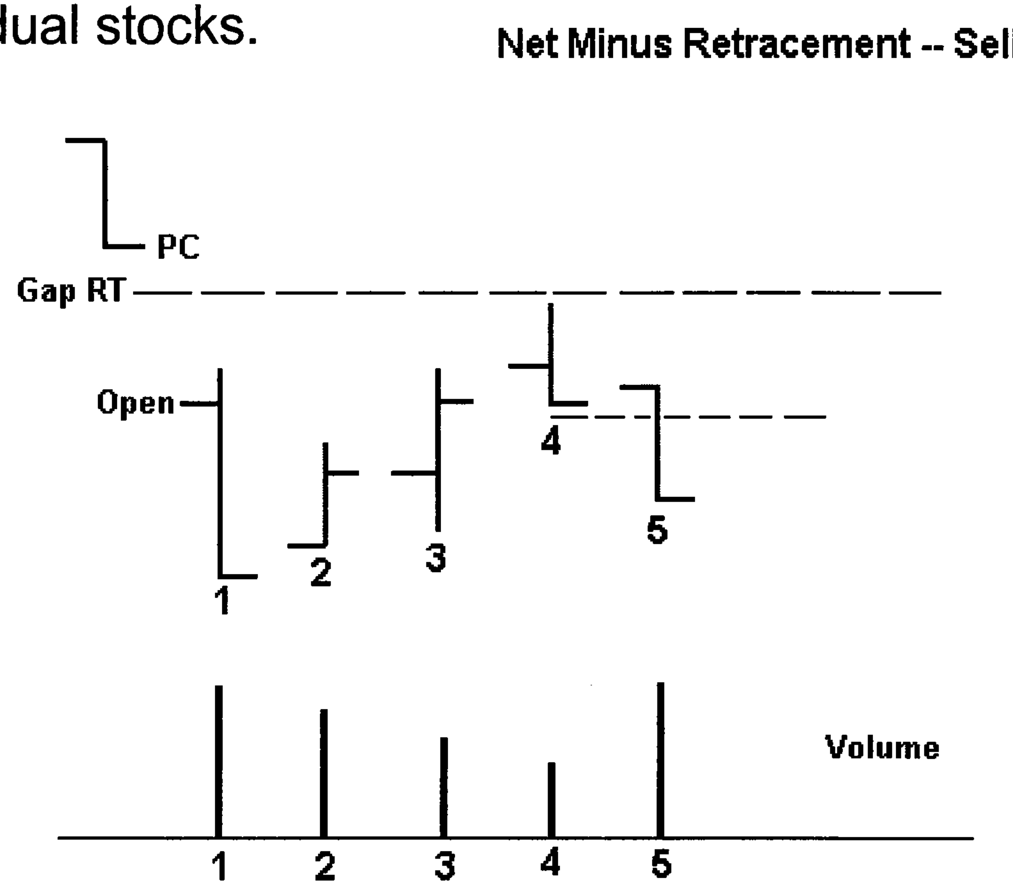
Gap Pullbacks

Key Point: When a stock opens on strength because there are multiple buyers, the Generals will back off to see how it trades because they don't like to chase price without getting enough volume. They are conscious of the volume-weighted average price (VWAP), and after buying stock on the first early up move, will often instruct their broker to either walk away or scale down lightly at lower prices. What happens is that after the pullback on light volume, they see that the market dynamics are still strong and they are not getting enough volume on the pullback, so they tell their broker to get more aggressive on the order. This in turn creates the herd mentality and they all start to buy the stock at once [signal bar (5)]. This kind of trade will very often result in a strong trend day.

Net Minus Gap Retracement -- Sell

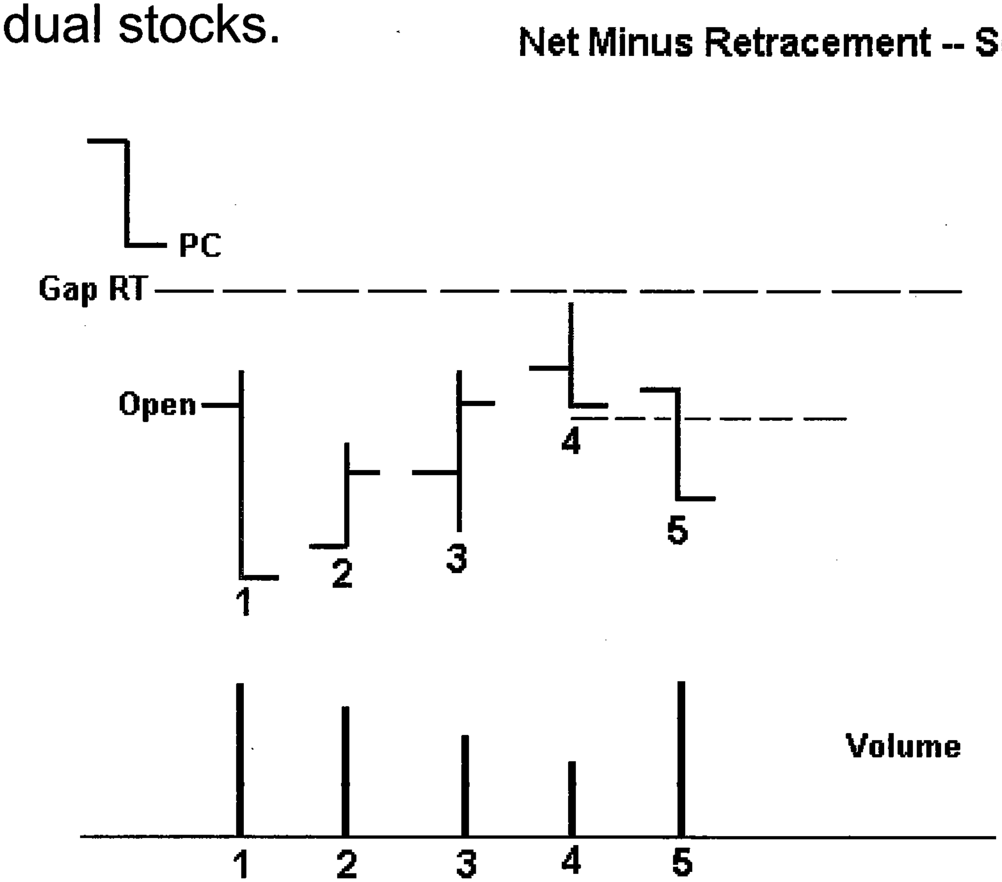
This is the same as the buy trade, except reversed. It will be easier on the short side if you are trading futures, index proxies, HOLDRs or using married puts on individual stocks.

1. Gap opening bar on good volume.
2. Advance with higher low.
3. Pullback bar on less volume than bars 1 and 2.



Net Minus Gap Retracement -- Sell

This is the same as the buy trade, except reversed. It will be easier on the short side if you are trading futures, index proxies, HOLDRs or using married puts on individual stocks.



4. Another pullback bar on even lighter volume. This is the signal bar that partially closes the gap and remains below the previous day's close and low. The signal bar close is below the bar's open and in the bottom 25% of its range on a pick up in volume.

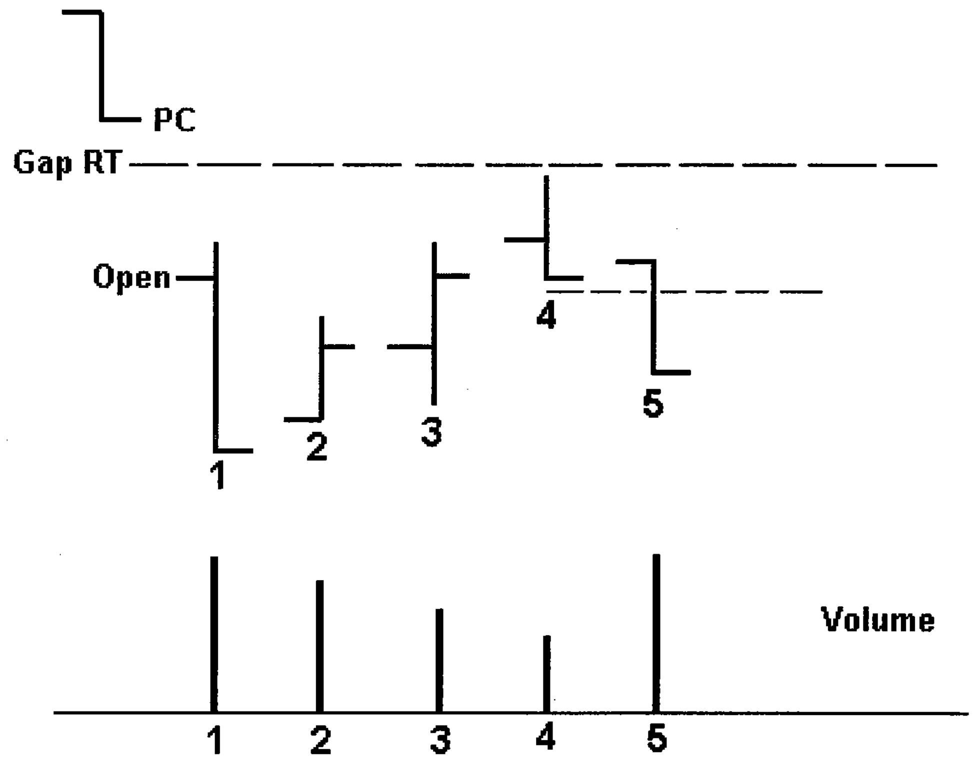
Net Minus Gap Retracement -- Sell

This is the same as the buy trade, except reversed. It will be easier on the short side if you are trading futures, index proxies, HOLDRs or using married puts on individual stocks.

5. Entry bar with trade-through entry below the low of the signal bar (5), which also puts you in a Net Minus trend.

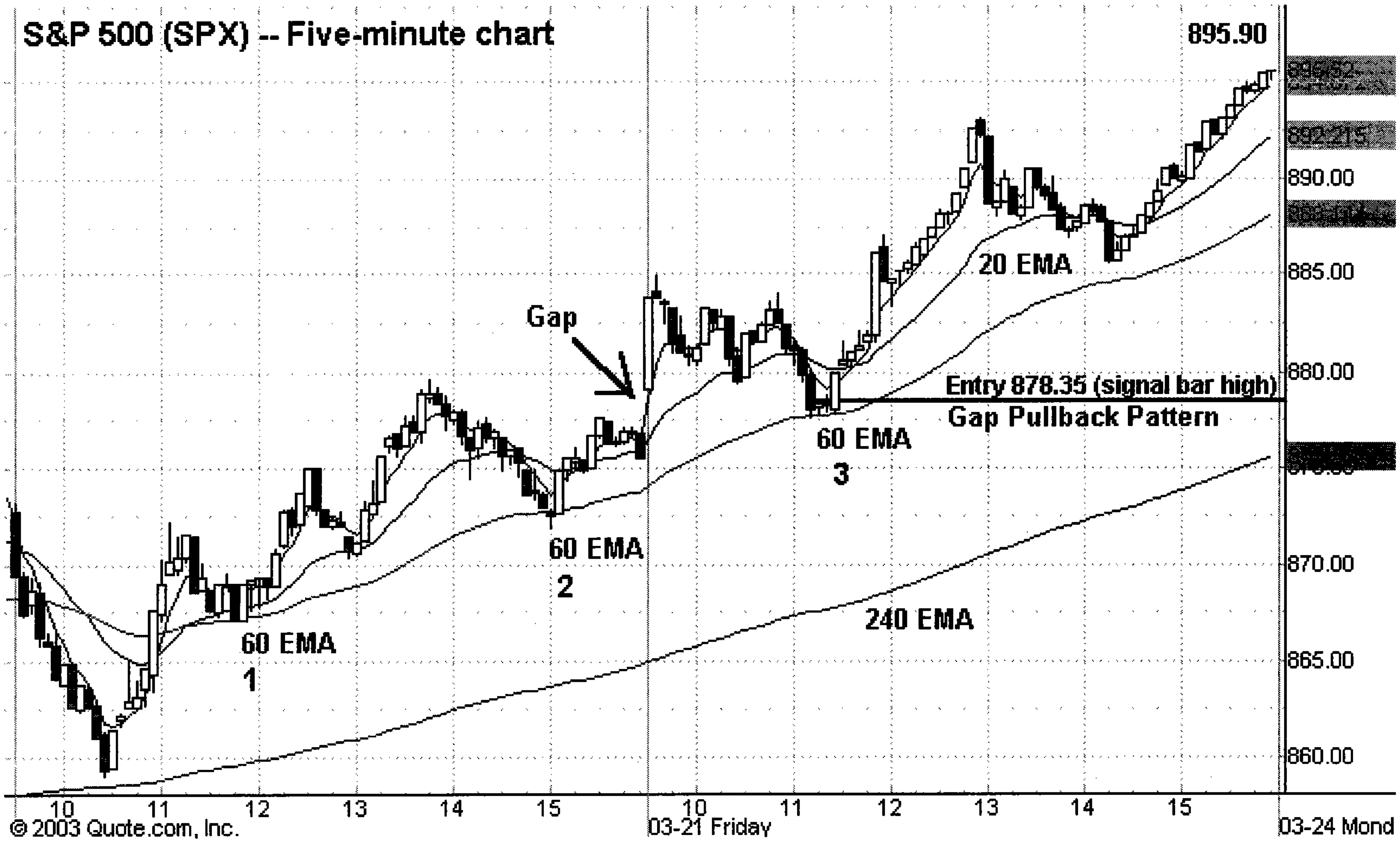
6. Initial stop is above the high of the signal bar, unless it's a wide-range bar where you would put the stop above the midpoint of that bar, or else use a money stop.

Net Minus Retracement -- Sell

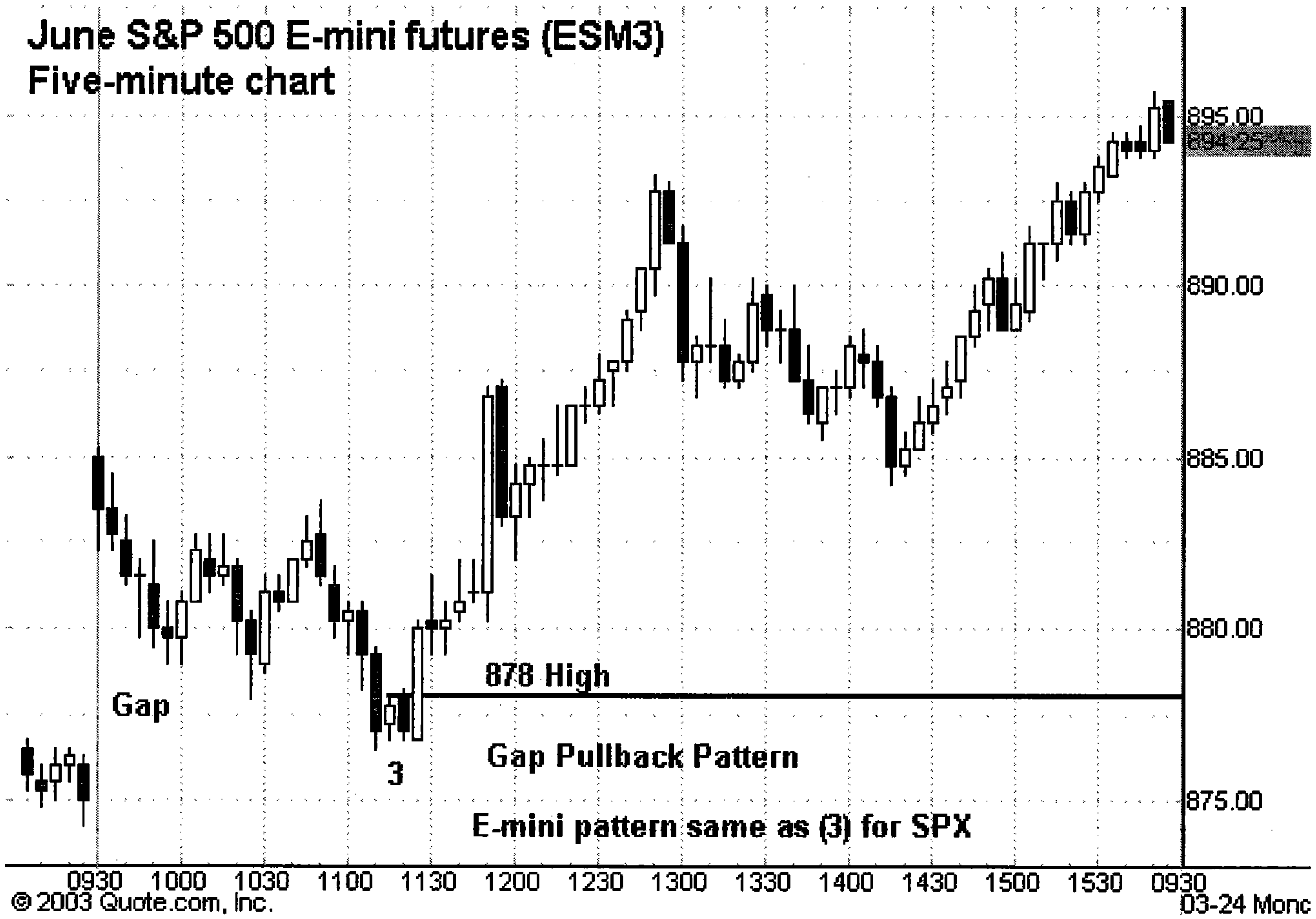


Gap Pullbacks
Real World Examples

Gap Pullbacks



Gap Pullbacks



Flip Tops

- This is a very effective daytrading strategy that can catch the first trend of the day after the opening noise with no real direction. Most FTPs occur between 9:30 a.m. – 10:00 a.m. ET, but you do get a few that form to 10:30 a.m.
- The opening range trade in the futures, especially the S&P 500, is being watched by every trader in the business, so it's not the pattern that makes this trade, it is your feel for the dynamics at the time of entry, and more importantly, before the breakout. Your selection process is the key to a positive win/loss ratio when trading the opening range.

Flip Tops

- FTPs are easier to trade when you are using the big cap stocks because you don't have as much competition and the stock dynamics are easier to read as you can compare it to other stocks in the group and relative to the major indices. The volume is easier to read and you can observe whether the volume is better on the bid or the ask prior to a breakout, which might make you select that trade.

Flip Tops

- By using big cap stocks, in addition to trading the futures or index proxies, your trade opportunities multiply as you scroll your intraday charts for FTP setups.
- Higher priced, liquid, volatile stocks with good daily range (I prefer stocks with minimum 1.5 point range) work best.
- The most powerful Flip Top in the futures or stocks are those that form at key inflection points, such as the previous day's closing range, daily volatility bands, previous day's high and low, or significant moving average, in addition to any Fib retracement or extension level.

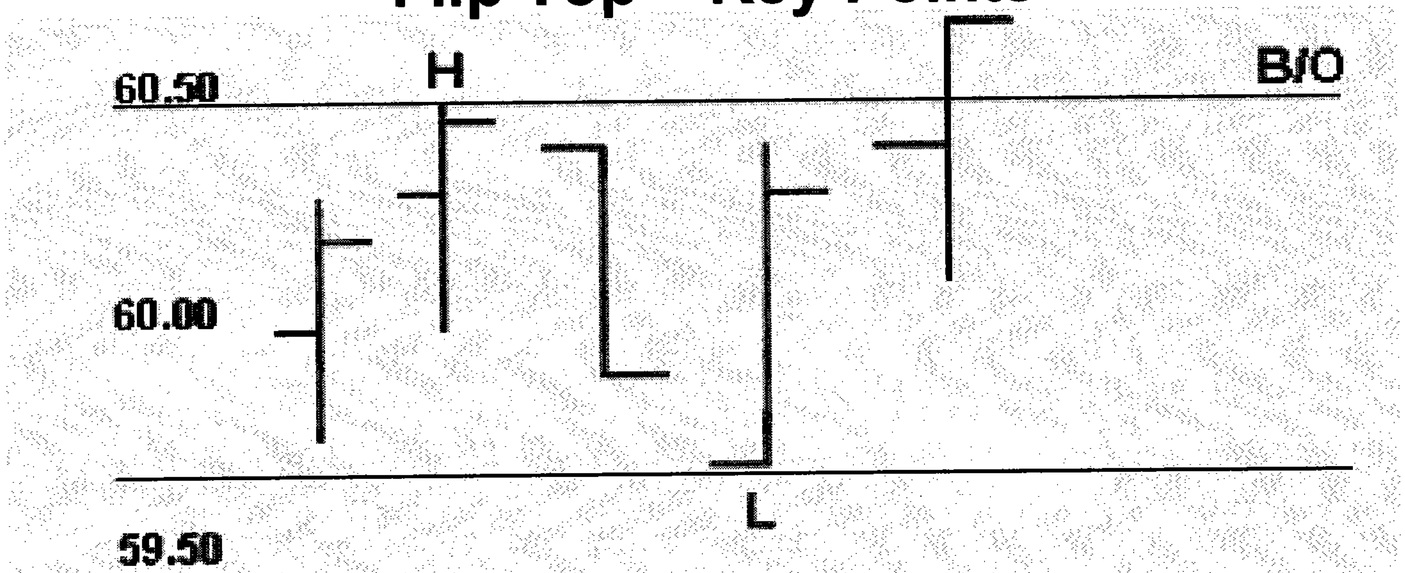
Flip Tops

- Some of the most explosive FTPs come from vehicles that have been trending and then give you a good daily chart setup, which indicates buying or selling pressure in the direction of the trend. If they open quietly, form an FTP, and then breakout in the direction of the trend, your probability of a good trade is much higher.
- When trading futures, the Flip Top setup does not start until the 9:30 a.m. opening.

Flip Tops

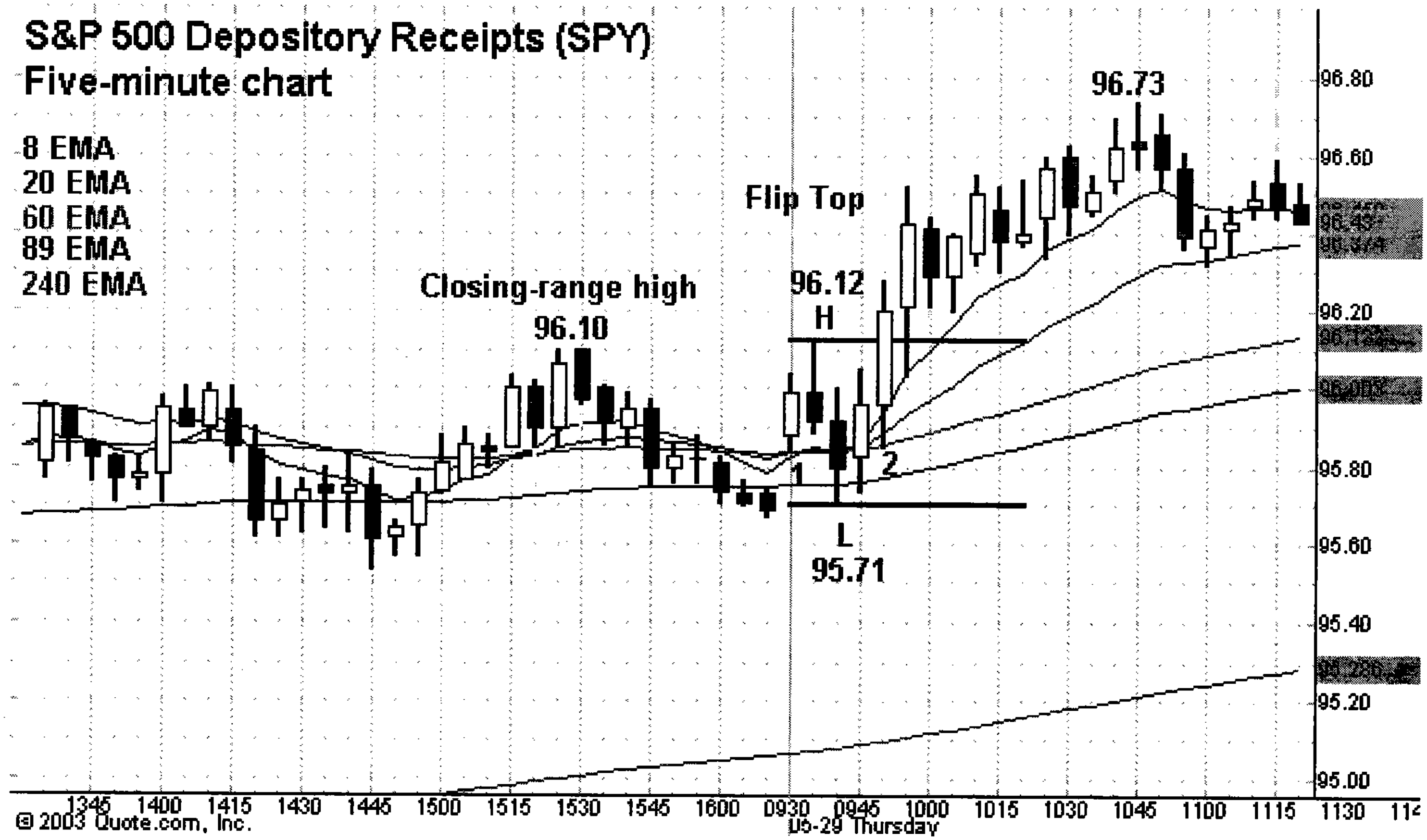
- FTPs must have at least four five-minute bars and the range should not be more than 30% of the recent average daily range. This will allow ample profit opportunity. Only make an exception if the dynamics are very strong.

Flip Top – Key Points



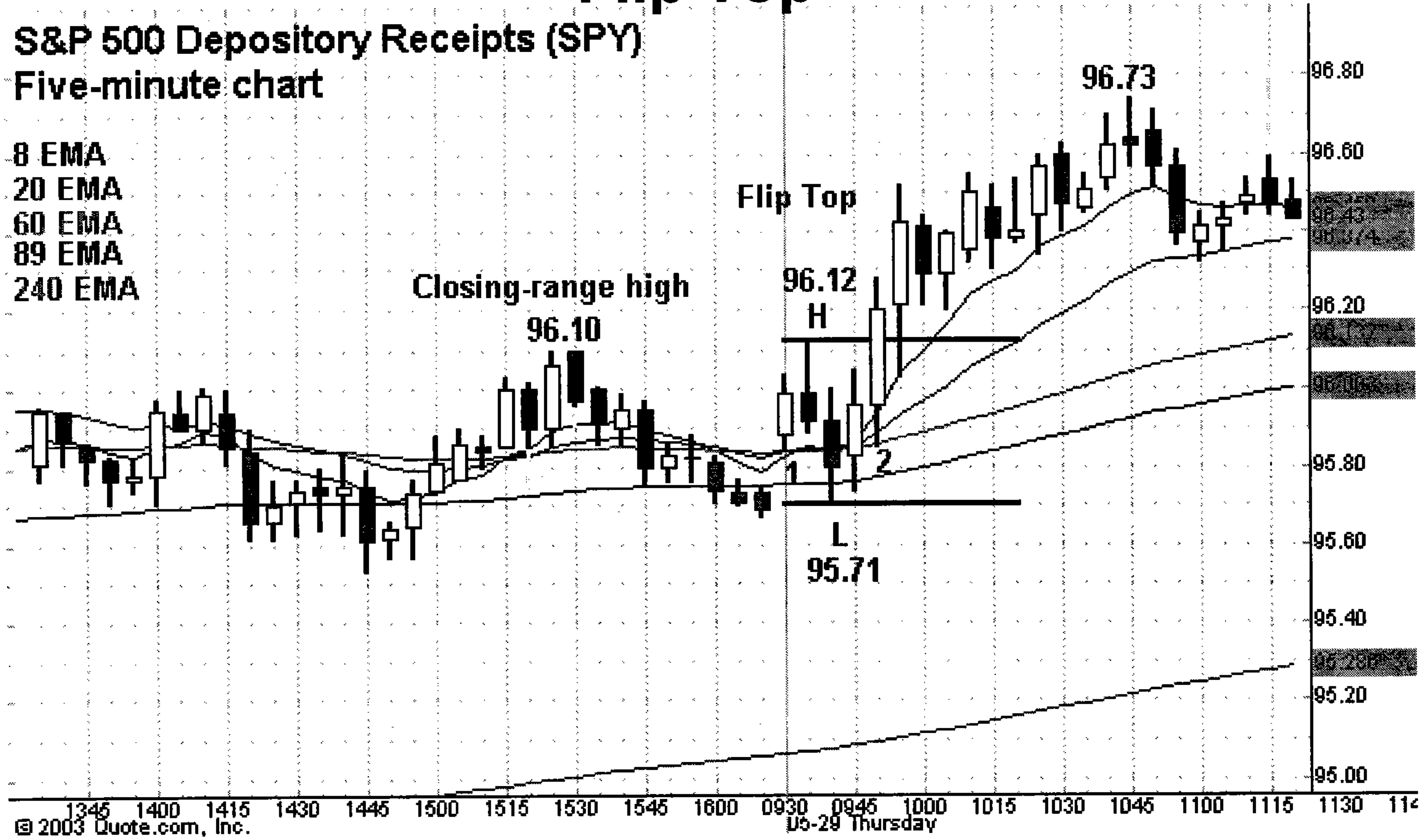
- The FTP pattern must have a minimum of four five-minute bars.
- The opening is not included, as the high or low of the range, or else it would simply be the low of the range.
- I find that the pattern works better when the high and low of the range are not on the first bar. The exception is when all of the range is within the range of the opening bar. This would make it a combination of an FTP and an OR.
- This is an example where the high and low are not on the opening bar.

Flip Top



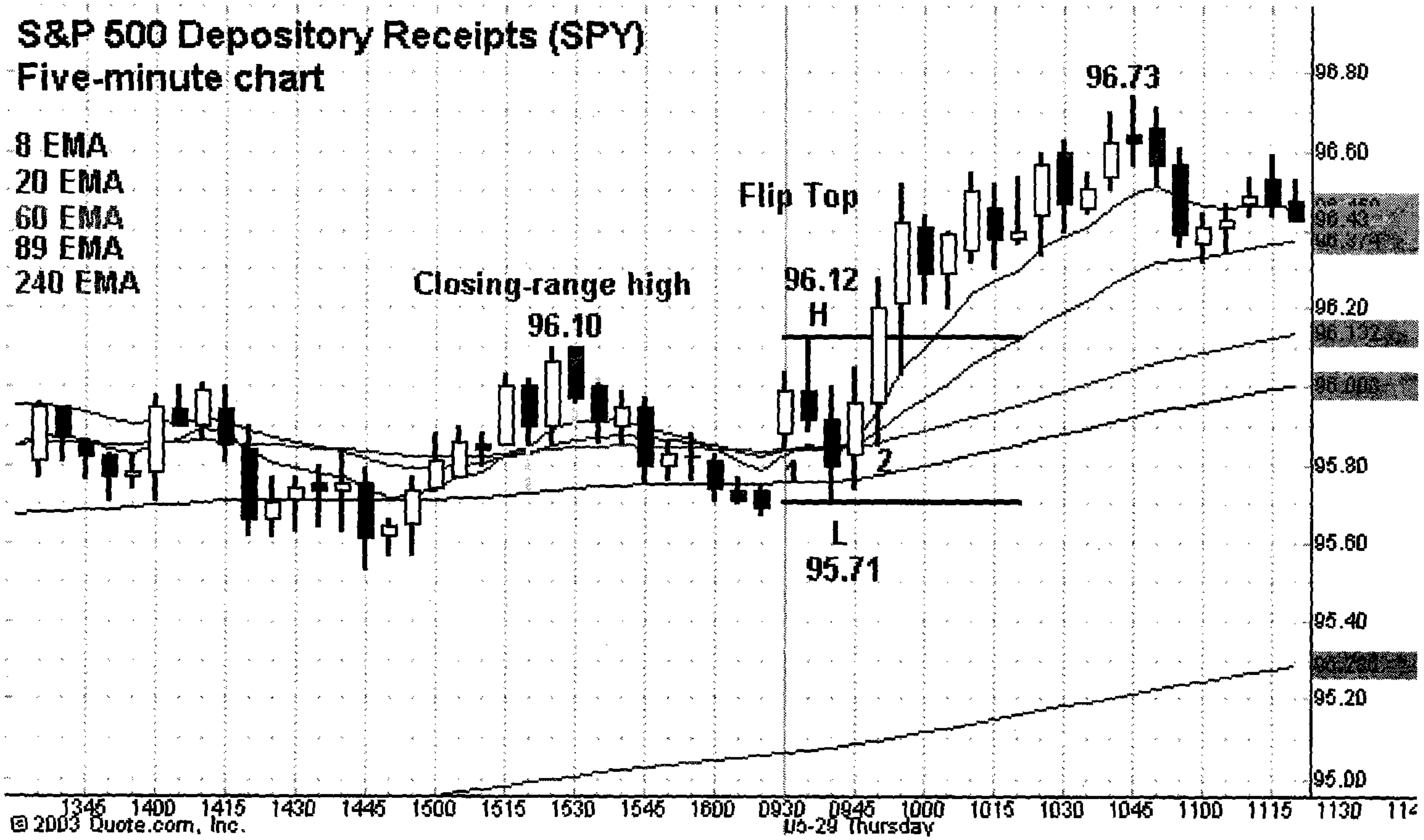
•After the opening bar (1), the SPY traded above the previous day's closing range high of 96.10 and made a Flip Top high.

Flip Top



- Price reversed on the third bar, which was the 95.71 low.
- The fourth bar traded within the 96.12 – 95.71 range.

Flip Top



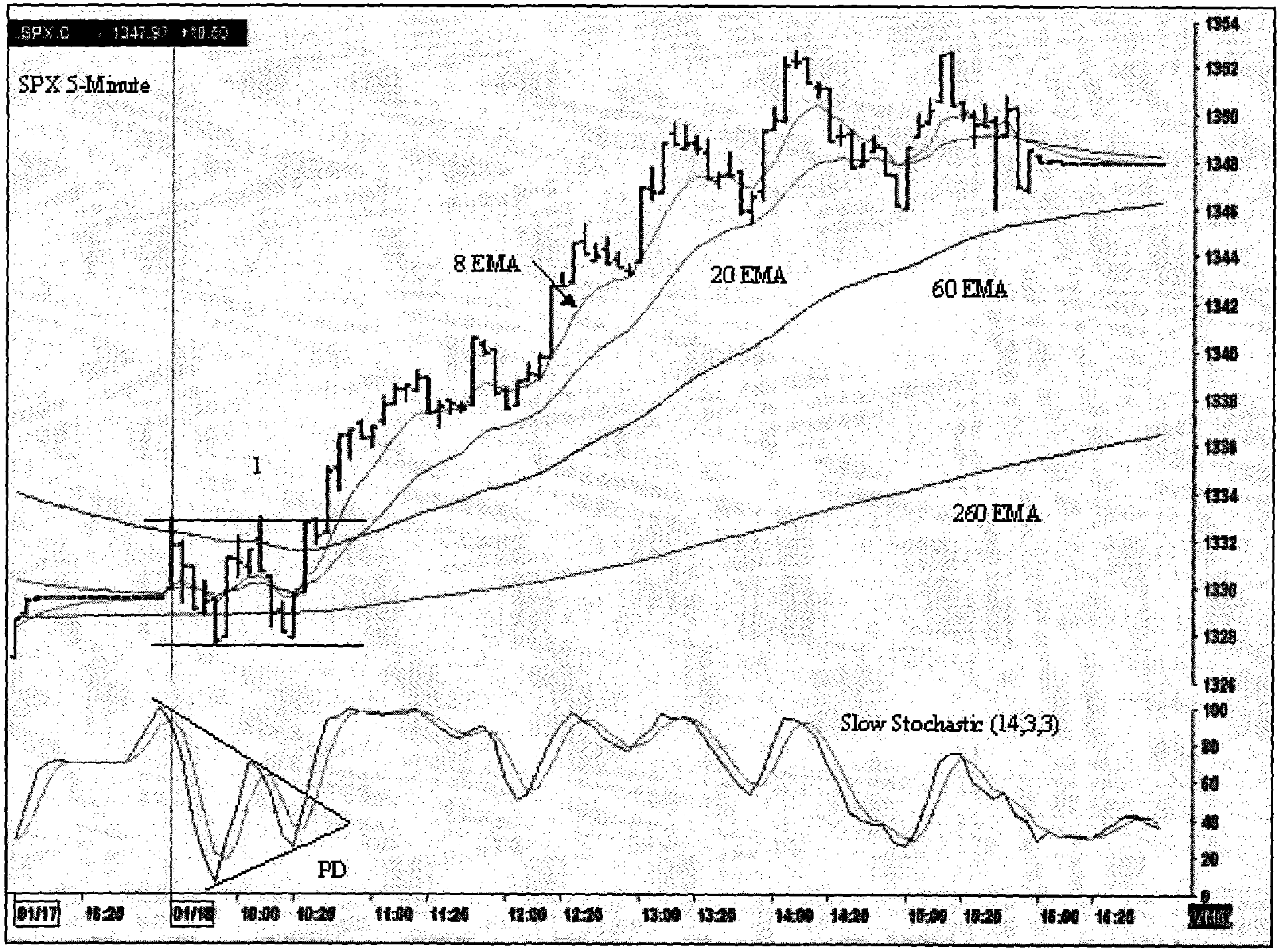
•Entry for this Flip Top was on the fifth bar (2) and the trade carried to 96.73 before reversing.

Flip Top

1. The better trade will be when the high or low of the setup is not the opening bar.
2. The breakout was above all of the 8, 20, 60, 89, and 240 EMAs and above the previous day's closing range 96.10 high.
3. The SPY had been in a strong uptrend since the March 12 79.38 low and had made a new closing high the previous day.
4. The Flip Top low held the 89 EMA.
5. TRIN was below .65 on entry bar and most of the major sectors were green prior to entry.

The next two charts are examples of a one-hour opening range for the SPX on a five-minute chart, and an SLR Flip Top where the opening bar was the high of the range and the next six bars were all within the opening bar's range.

Flip Top



SPX 5-Minute
8 EMA
20 EMA
60 EMA
260 EMA
1
PD
Slow Stochastic (14,3,3)

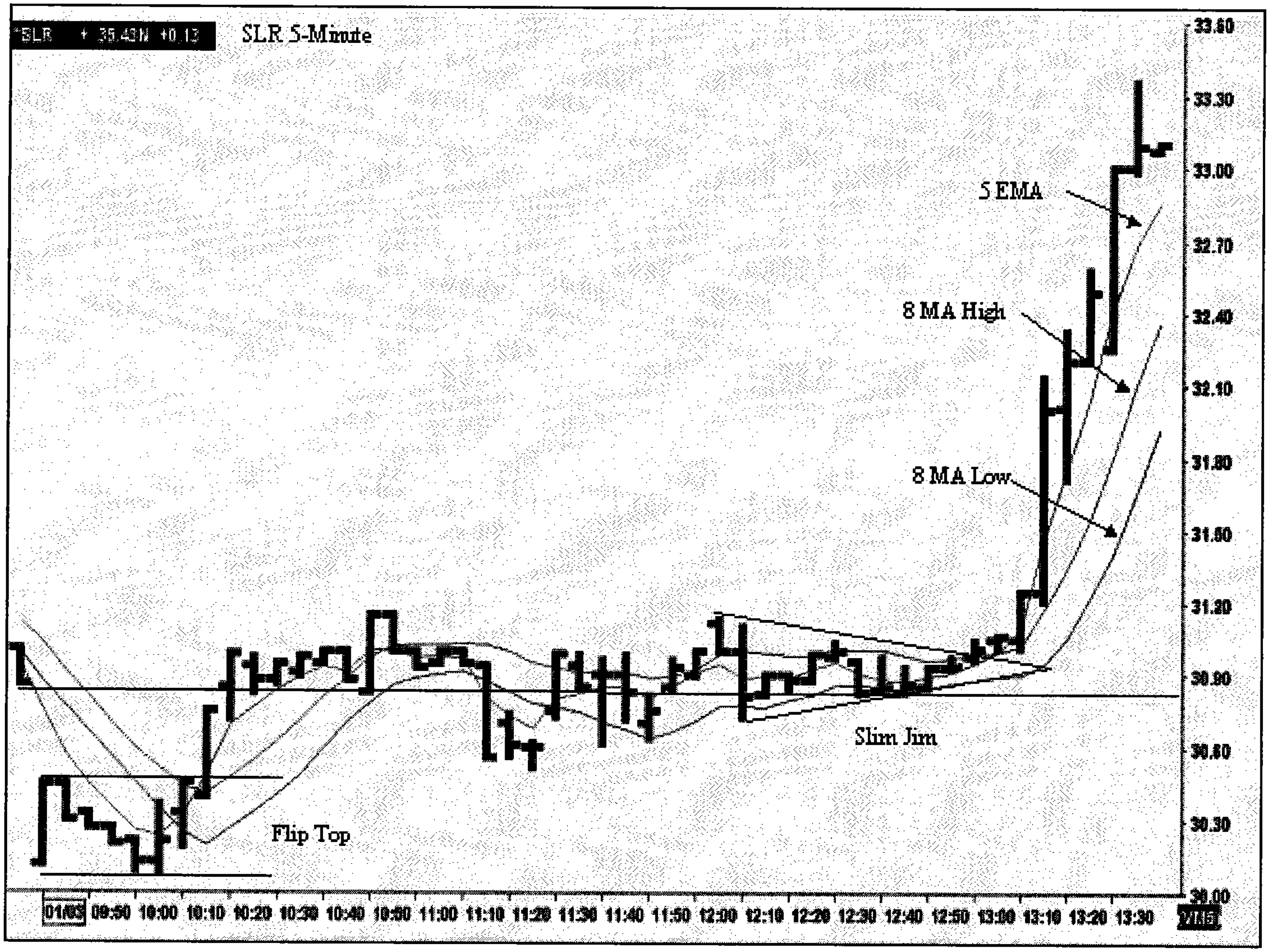
Flip Top

1. SPX opens up to 1333, then forms a Flip Top over the first 60-minutes between 1333 and 1328.
2. It makes an attempt to break out above the opening bar, 1333, but fails (1) and trades down to 1328 again, but you had a positive divergence on the slow stochastic (14,3,3).
3. The third attempt to 1333 had both bars closing in the top of the range (2), followed by an opposite bar (3).

Flip Top

4. Entry and breakout (4) was the fourth attempt, which can lead to explosive moves (third and fourth attempts are high-probability when at key inflection points).
5. This FTP breakout was above the 8, 20, 60 and 240 EMAs, and when that happens, you want to be long.
6. The breakout was confirmed the stochastic breakout.

Flip Top



SLR 5-Minute
5 EMA
8 MA High
8 MA Low
Slim Jim
Flip Top
33.60
33.30
33.00
32.70
32.40
32.10
31.80
31.50
31.20
30.90
30.60
30.30
30.00
09:50 10:00 10:10 10:20 10:30 10:40 10:50 11:00 11:10 11:20 11:30 11:40 11:50 12:00 12:10 12:20 12:30 12:40 12:50 13:00 13:10 13:20 13:30

Flip Top

1. SLR opens down 2.6% to 30.05 on very light volume.
2. The opening bar high was 30.50, which was a nice +1.5% bounce right off the opening of 30.05, which was just beyond the 1.0 volatility band.
3. The first bar high of 30.50 was the high of the Flip Top, with the next six bars all within that bar's range.

Flip Top

4. The breakout from the pattern (1) was right at the key reversal period of the morning, which is 10:00 to 10:15 a.m. ET.
5. Prior to the breakout, the 5-period EMA started to rise, and there was a positive divergence in the 8,3,3 slow stochastic (not shown on chart).
6. The pattern was at a key inflection point on the five-minute chart, which was above the 8-period EMA of the high and 8-period EMA of the low and also the 5-period EMA of the last, which was rising and crossed both 8-period moving averages.

Key Points: (Reverse for sells)

- Reversals of the previous day's low/high can prove to be a very rewarding trade.
- Taking out that low or high is an exercise that futures traders engage in when there is an opportunity, which is usually when there is no significant institutional order flow active either way during the Flip Top setup.
- If the previous day's close was above the mid-point to the top of the range that day, they know that stops are placed right below the low. If they can shake the tree and run the stops taking out that previous day's low, they will attract short sellers.

Key Points: (Reverse for sells)

- If that happens, buying the reversal of the previous day's low on the way back up can be a rewarding trade. The buyers that had established the buying pressure the previous day might have returned, and the first entry shorts are trapped and have to cover. You look for any hint of improving dynamics, such as NYSE TICKS or premium (S&P 500 futures – S&P 500 cash index) expanding as you decide to take the trade.

Key Points: (Reverse for sells)

- Should the market reverse due to new selling pressure and take the previous day's low again, you should be ready to take a Double Up And Reverse Trade (selling two contracts, the one you were long and other one to make you net short one contract).
- This would end up being a second entry short of the previous day's low, which might be the first good trend of the day.

Key Points: (Reverse for sells)

- Many traders, especially new ones, won't be comfortable with a Double Up Reverse strategy, but it can be a very high risk/reward because your stops are so close to the previous day's low, regardless of which way you play the trade.

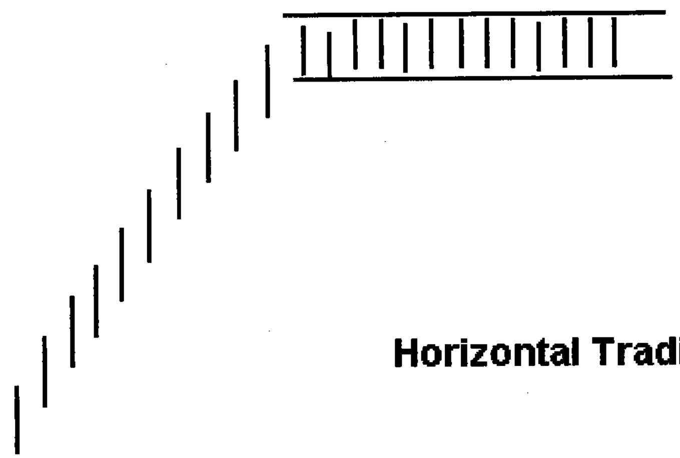
XI. Slim Jims

Slim Jims

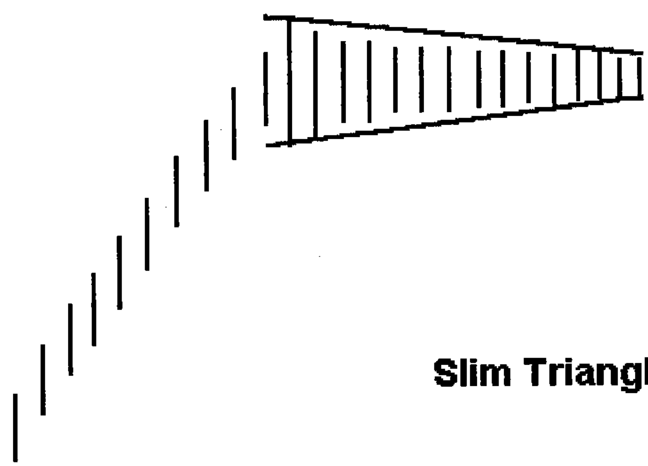
•This is a simple pattern that is easily identified, occurs daily and is very often explosive, as it is found near the high/low of the day or previous day(s).

•The pattern is simply a narrow-range horizontal consolidation at or near the current day's high or low. It can also be a narrow range slim triangle or wedge.

Slim Jims

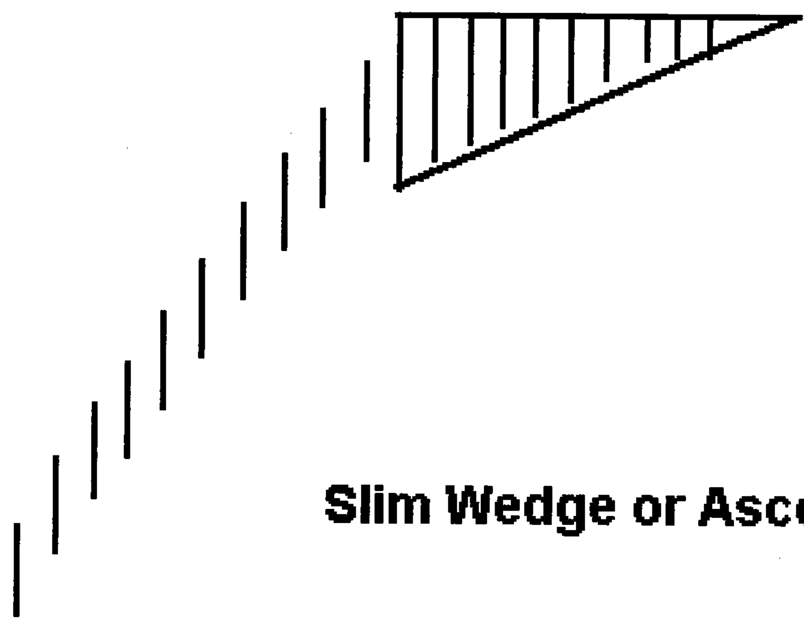


Horizontal Trading Range



Slim Triangle

Slim Jims



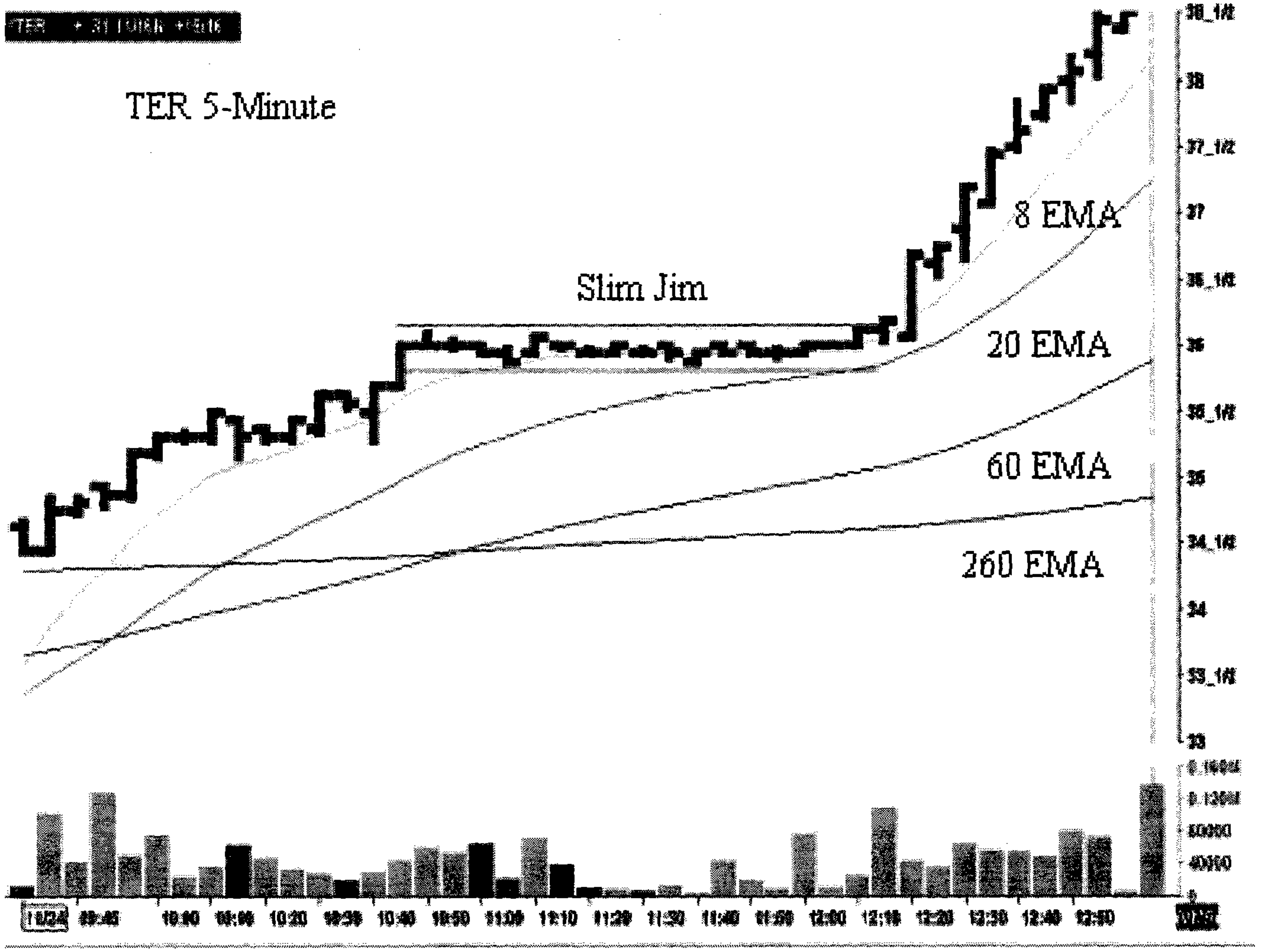
Slim Wedge or Ascending Triangle

Slim Jims

•There must be a minimum of seven bars in the consolidation (on a five-minute chart).

•The longer and tighter the pattern, the more explosive the move, as the narrow-range volatility gets resolved in the direction of the trend or a reversal from a key inflection point described in the section on tools. Experience has demonstrated that the strongest moves originate from 12-bar or more patterns, the more explosive the move.

Slim Jims



Slim Jims

•If you could only trade on pattern, or are a relatively new trader, the Slim Jim would be an excellent choice.

•It is a very high-probability trade from both risk, because your stops are tight, and also reward, because of a better than 75% chance for a profitable trade in the direction of trend.

•There is never a day that you can't find a Slim Jim either long or short.

•Slim Jims are even more explosive when there is a confluence with a higher time frame inflection point, such as moving averages, Fibonacci retracements, and support/resistance.

Slim Jims – Key Points

1. The first Slim Jim breakout to new intraday highs is usually best because it provides the best reward-to-risk ratio with the highest probability of success, i.e., If a stock has an average daily range of 2.5 points, and your Slim Jim entry is after the stocks has only traded .75 of a point, then your trade has more potential to run, provided the momentum continues in the direction of your trade.

2. The best Slim Jims are from the big cap stocks in the S&P 500 and NDX 100 indices because that is where the Generals are involved the most and where the specialists and market makers commit the most capital, which provides liquidity.

Slim Jims – Key Points

3. Program Trading is a major catalyst for profitable Slim Jims and this occurs in the S&P 500 stocks and, to a lesser extent, the NDX 100.

4. Front Running by hedge funds in the afternoon as the Generals that couldn't complete their order of buying S&P 500 futures at fair value have to buy the actual stocks and be completed by the 4:00 p.m. ET NYSE close. This is a primary reason for those late explosions usually after 2:30 p.m.

Slim Jims – Key Points

5. Look for confirmation of strength or weakness from the other stocks in the group and also the major indices.
6. Identify any buying/selling pressure prior to Slim Jim breakout.
7. When trading the E-mini futures, use the SPX cash index as your Slim Jim pattern (or SPY) because it eliminates much of the noise as the futures traders try to influence prices.
8. The second entry is usually the best in all but the strongest of markets.

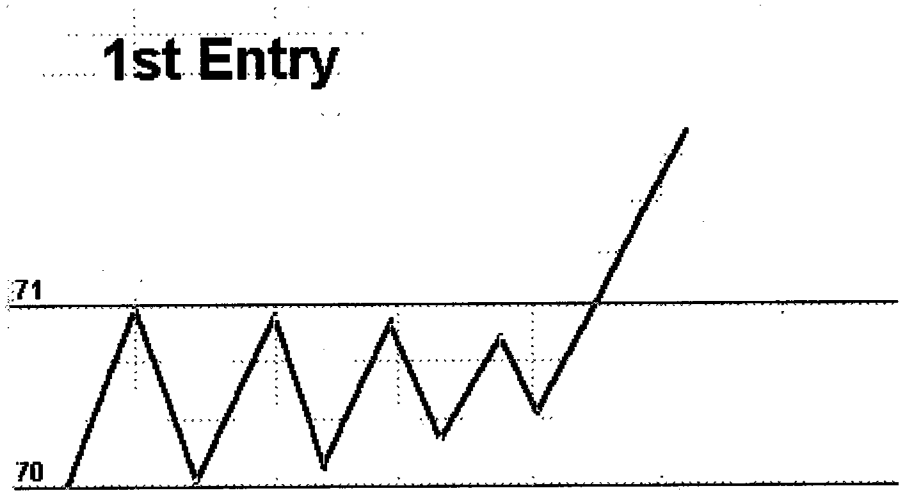
Slim Jims – Key Points

9. Stocks that had good setups on the daily chart and indicated buying or selling pressure that day will most often give you the best Slim Jims the next day as the Generals return to the market.
10. The risk/reward declines greatly when you get to the high end of the intraday trading tree, so beware of those third and fourth Slim Jims you might get on a very strongly trending day.
11. If the dynamics are compelling and you decide to anticipate the breakout, just take half of your normal position because the odds are not in your favor doing that in the long run over many trades during the year.

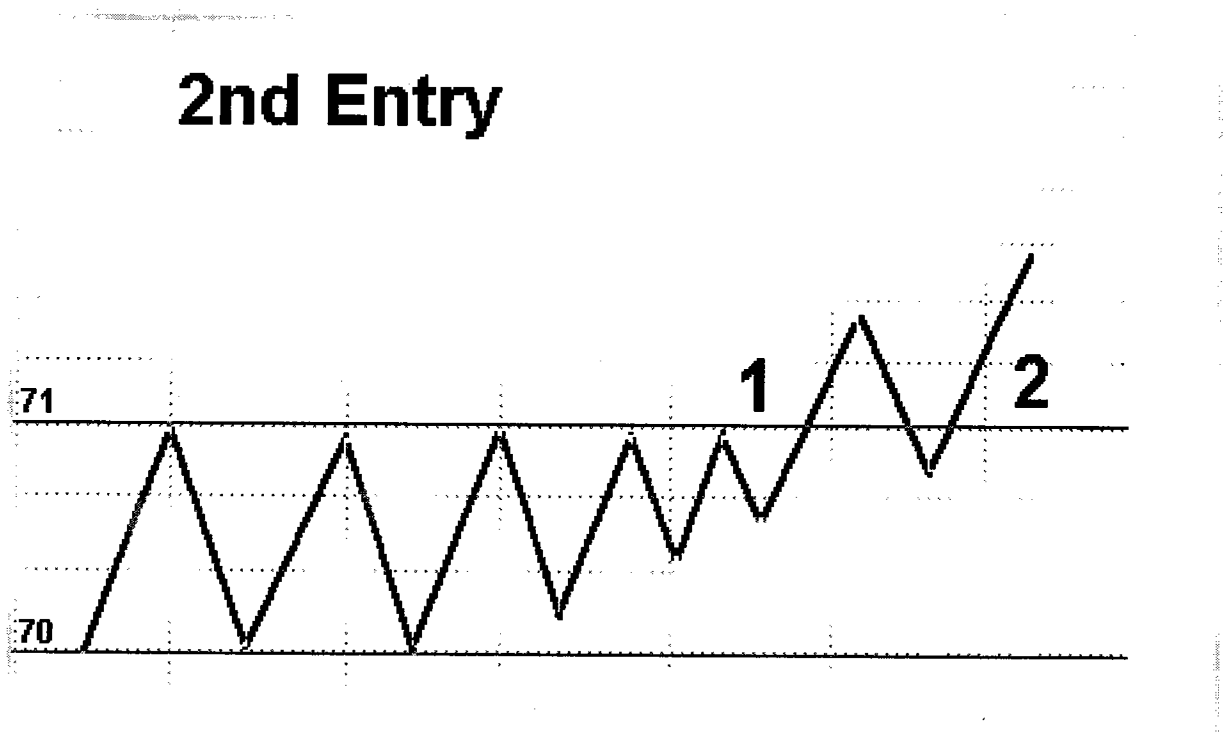
Slim Jims – Key Points

12. Slim Jim patterns on higher time frames over a longer period of time can be extremely explosive. I favor the 60-minute time period because I am prepared in advance after scrolling for any setups that are in play going into the day's trading. I know my levels in advance.

Slim Jims – First Entry

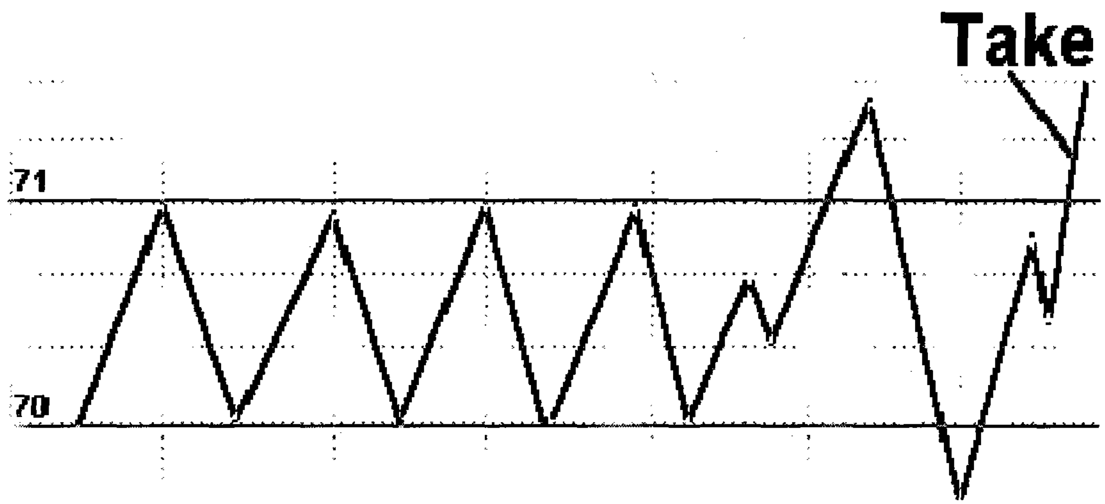


Slim Jims – 2nd Entry

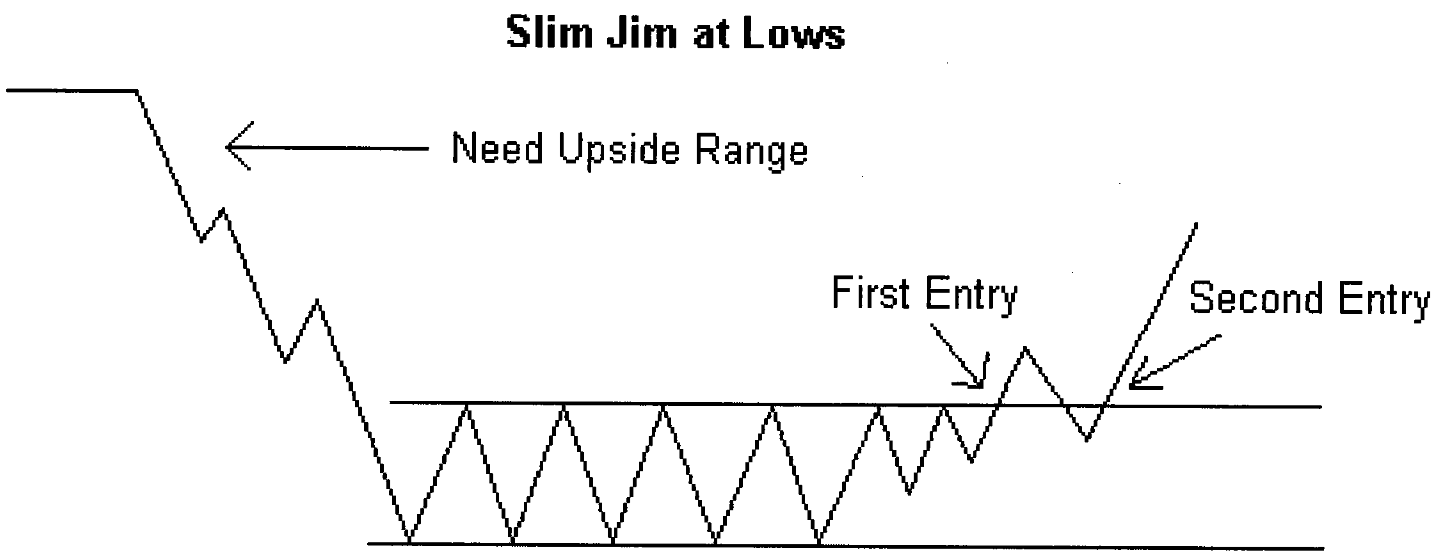


Slim Jims – FAILURE AND REVERSE

FAILURE AND REVERSE

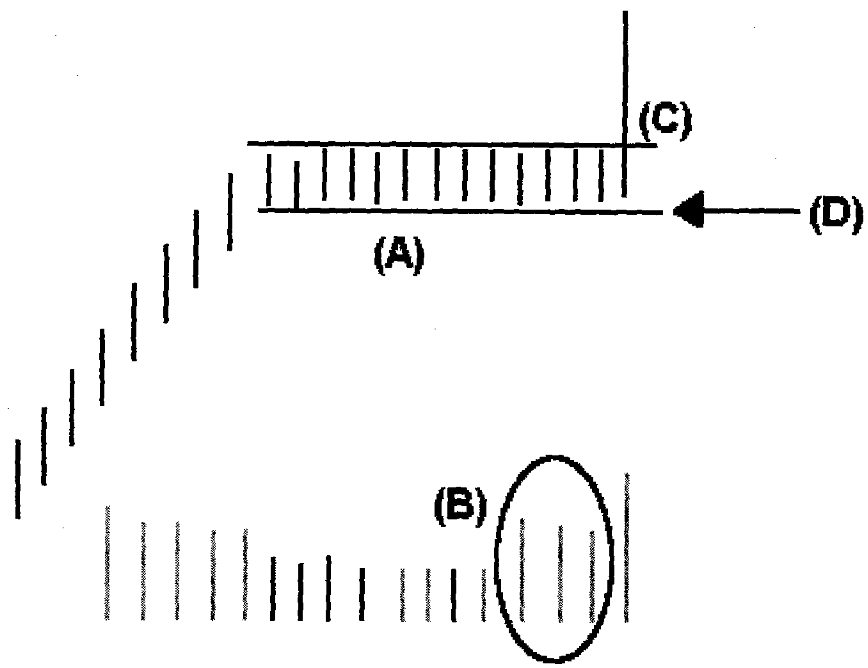


Slim Jims at Lows



Entry Rules For Slim Jims – Long Entry

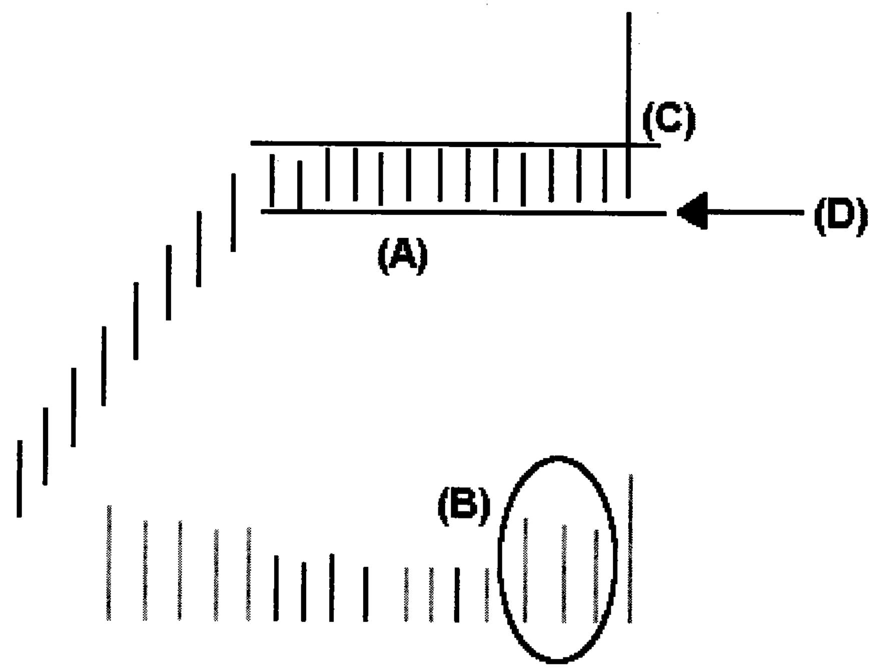
1. Look for a minimum seven-bar consolidation on the five-minute intraday chart at or just below the high of the day (A).



<u>KEY POINT</u>: It is important that you are aware of the current average daily range and how much of the range the initial advance has covered.

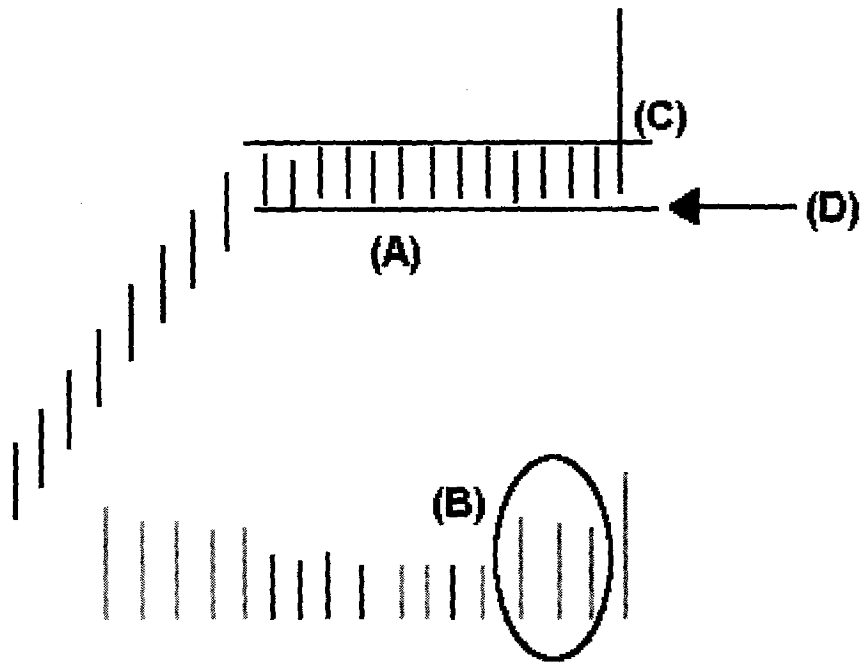
Entry Rules For Slim Jims – Long Entry

2. Volume is best when it has increased on the initial advance to the Slim Jim consolidation indicating buying pressure by the Generals. As it consolidates, the volume usually decreases until just before the breakout (B).



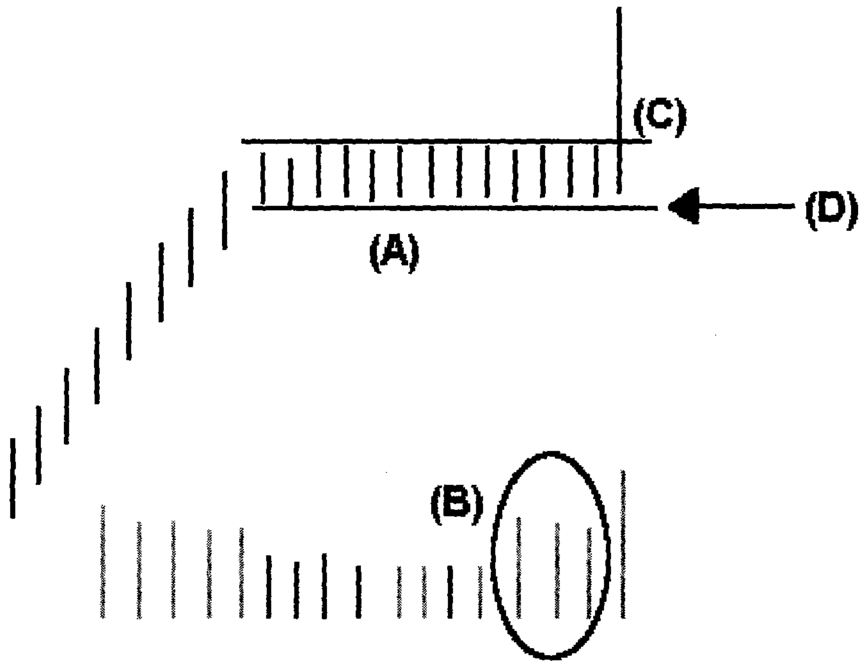
Entry Rules For Slim Jims – Long Entry

3. Market dynamics must be positive, with the futures moving up and your quote screen showing most of the stocks positive for the day (particularly the group) if you are taking a long-side entry.



Entry Rules For Slim Jims – Long Entry

4. Enter long when the stock breaks out of the consolidation (C).
5. Place your stop just under the low of the pattern (D).



KEY POINTS ON STOP PLACEMENT:

- Placing the initial protective stop is easy with the Slim Jim. The maximum distance you will place your stop is just below the bottom of the pattern for longs and just above the high of the range for short setups.
- Your risk should be no more than 1/2 point or 20-25% of the current daily range, whichever is less on intraday trades.
- You can also stop yourself out just under/over the breakout points and take an even smaller loss. The reason for this method is that you can always take a second entry trade in the same direction after it has traded back into the pattern's range and broken out of the pattern a second time.
- On position trades from the daily charts, you can also use the second method mentioned above, but never use more than a three to five percent stop, depending on the stock's price and volatility.

Action Prior To The Slim Jim Breakout

You can often anticipate a strong breakout by observing the price and volume action while price is still within the consolidation.

If the stock advances up to the consolidation on strong volume, then declines as the stock consolidates in a narrow range, you are now on alert for the pre-breakout price and volume action to exhibit certain characteristics. What you should be looking for is:

Action Prior To The Slim Jim Breakout

1. Price starts to trade on the ASK side on increasing volume and size.
2. Usually there will be closes in the top of the range on the bars of the five-minute chart over the last couple of bars prior to the breakout.
3. The last few bars before the breakout might have higher lows and narrow-range bars as the coiled pattern gets set to explode.

Action Prior To The Slim Jim Breakout

KEY POINTS:

- When you see this kind of action, it is the Generals starting to show their hand because they may see too many competing buyers and an intraday market trend that continues to be strong, so they decide to get more aggressive with their orders.

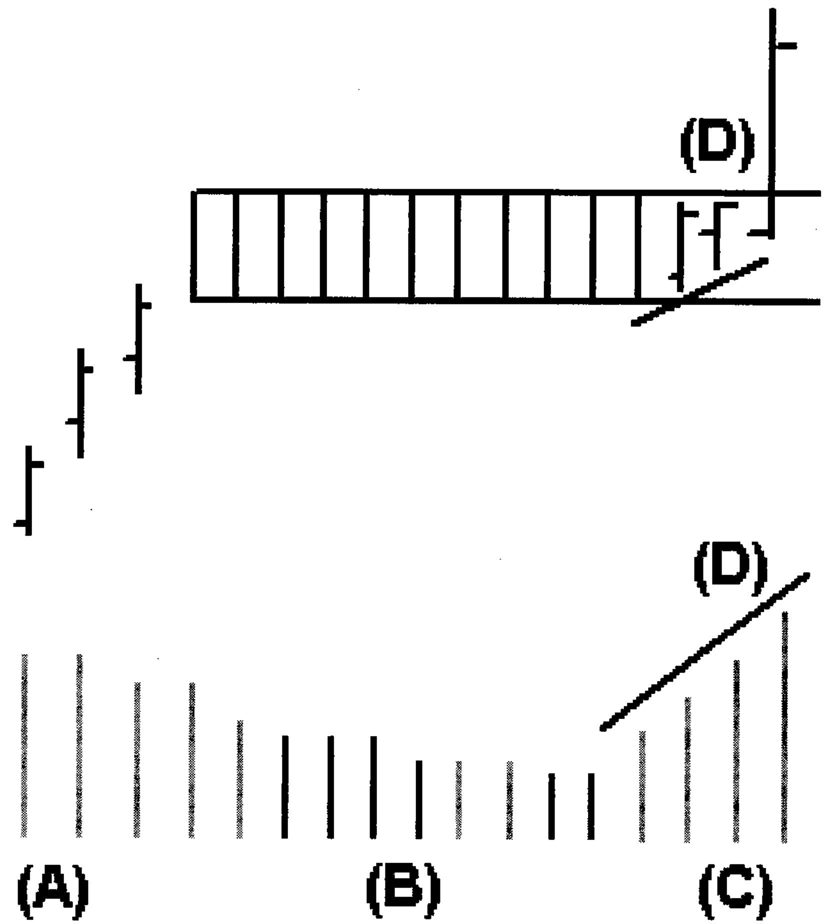
Action Prior To The Slim Jim Breakout

KEY POINTS:

- It is not a "rule" that one must see this exact action. Rule is not a term I particularly like to use when discussing this pattern, since it is a dynamic, rather than static, pattern that must be viewed in context with the current market conditions. The Slim Jim pattern can still explode without any of that pre-breakout action because of a news event. The "moonshot" takes place when it all hits at the same time.

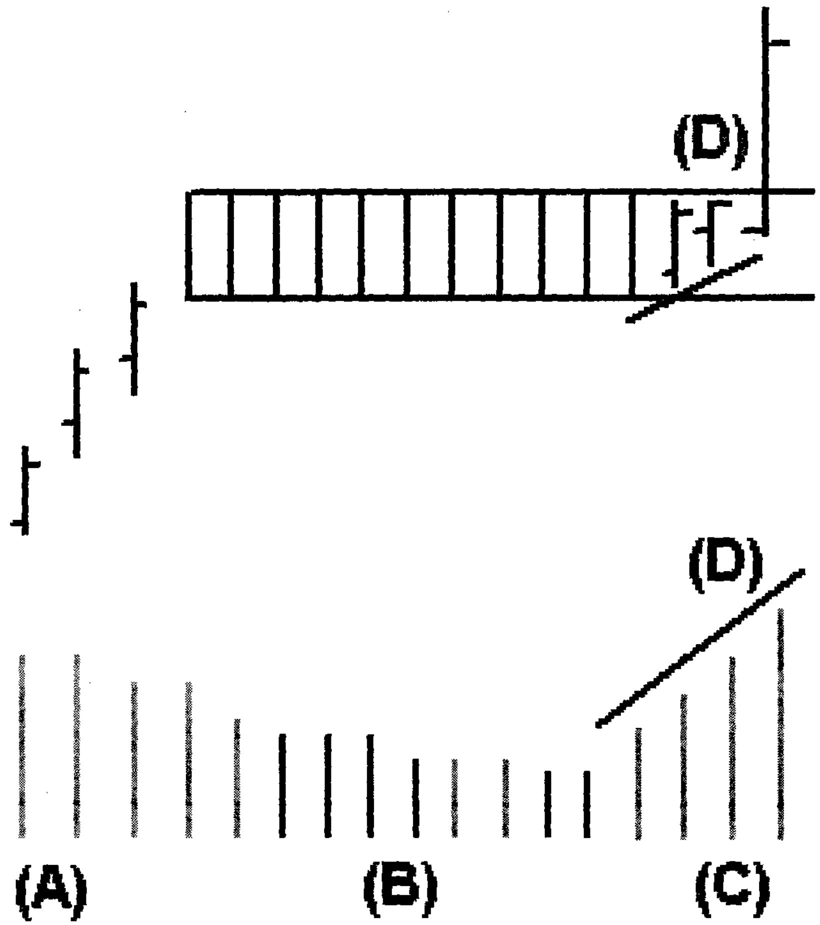
Action Prior To The Slim Jim Breakout

This chart is a graphic example of this price action prior to the first entry Slim Jim breakout.



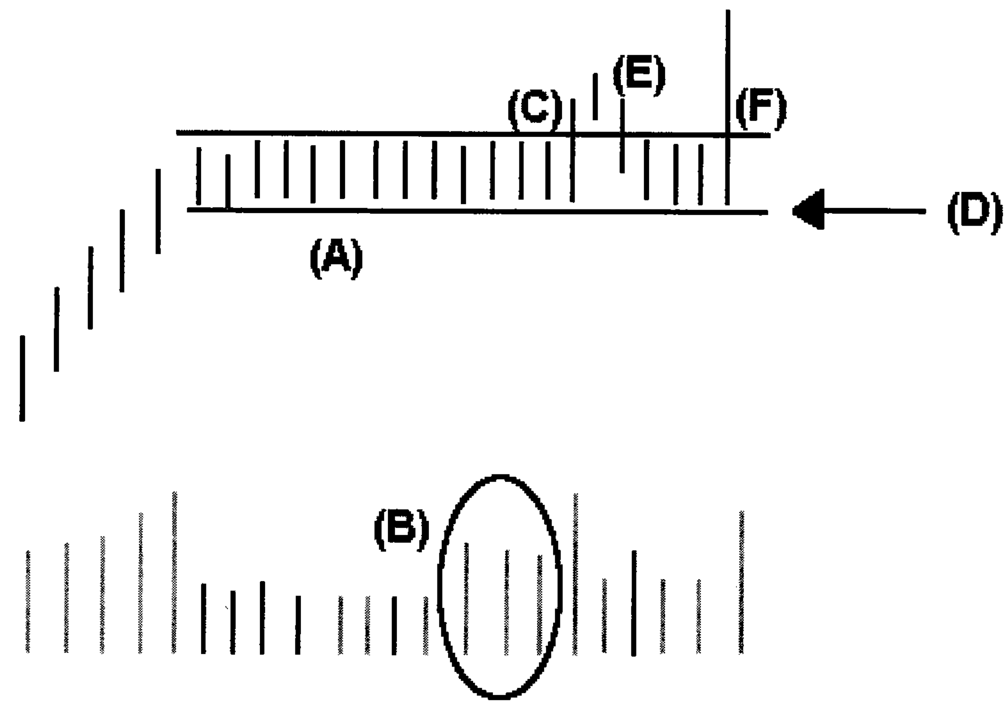
Action Prior To The Slim Jim Breakout

1. Rising volume on the initial advance to the consolidation in a tight range (A).
2. Volume goes quiet as the stock consolidates in the Slim Jim. This is the quiet area before price and volatility explode (B).
3. Volume increases and you see two higher lows with closes in the top of the range (C).
4. Breakout on a wide-range-bar thrust with very strong volume (D).



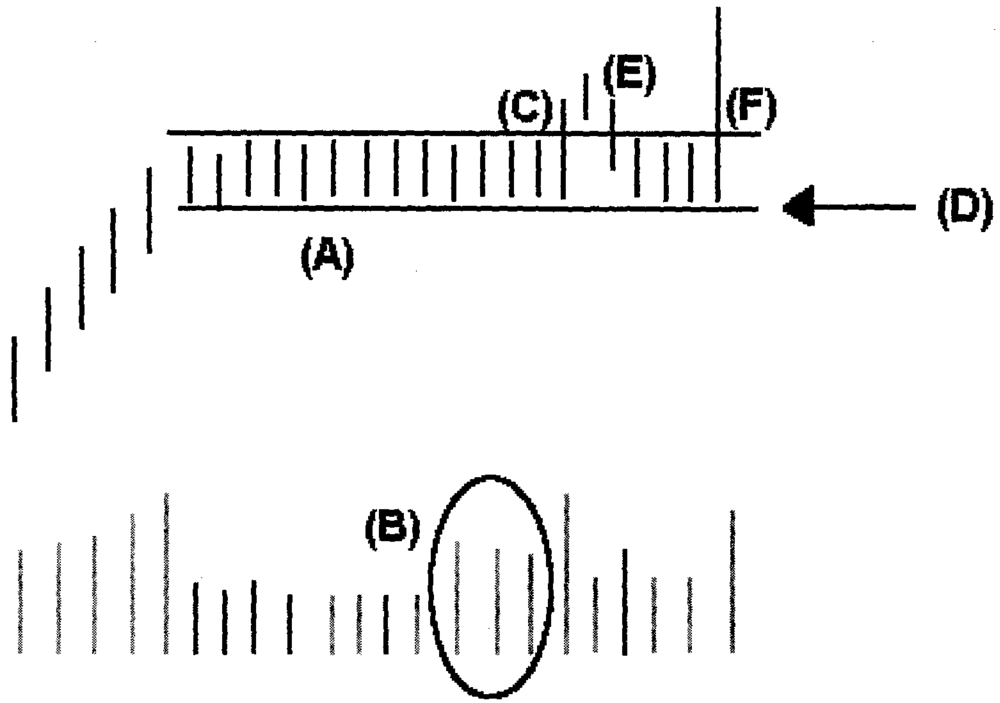
Second Entry Slim Jims - Long

1. Look for a minimum seven-bar consolidation on the five-minute intraday chart at or just below the high of the day (A).
2. Volume must be increasing on trades, meaning larger lots of the stock start to trade (B).
3. Market dynamics must be positive, with the futures moving up and your quote screen showing most of the stocks positive for the day if you are taking a long-side entry.



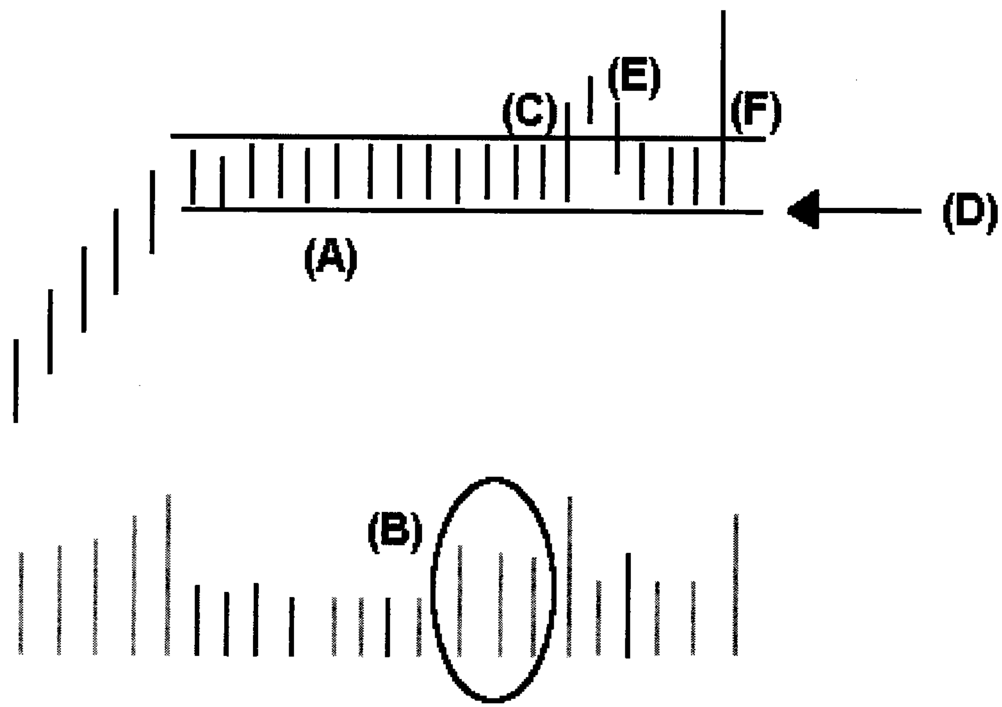
Second Entry Slim Jims - Long

4. Enter when the stock breaks out of the consolidation (C).
5. Place your stop just under the low of the pattern (D), or just under the upper boundary of the Slim Jim as described in **<u>KEY POINTS FOR STOP PLACEMENT</u>**.
6. The stock moves back into the pattern's range (E). If it does not hit your stop just below the bottom of the range, hold tight.



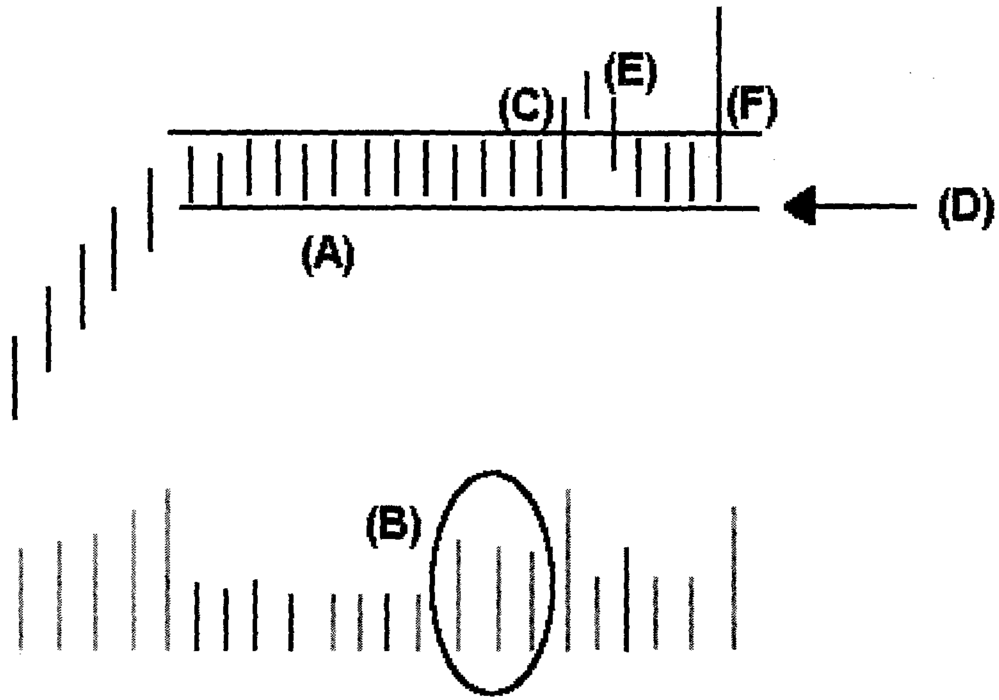
Second Entry Slim Jims - Long

7. If you used the alternate method and got stopped out, you are now alert for a second entry. This is a good entry to wait for in highly volatile stocks. This is especially true in the OTC stocks, where it is often better to not take the first breakout and wait for the second entry. Aggressive traders can also add to the position here if the market dynamics remain favorable. I would recommend that new traders start trading the Slim Jim pattern with second entries only until you get familiar with the dynamics of the pattern.



Second Entry Slim Jims - Long

8. The second entry stop can be placed below the bottom of the pattern or else below the upper boundary after the second entry.



Entry Rules For Slim Jims -- Short Entry

The Slim Jim short entry has the complication of needing the up tick for a valid short trade on stocks, but is not a problem when trading futures, index proxies like SPYs, DIAs and QQQs, in addition to HOLDRs, such as the SMHs.

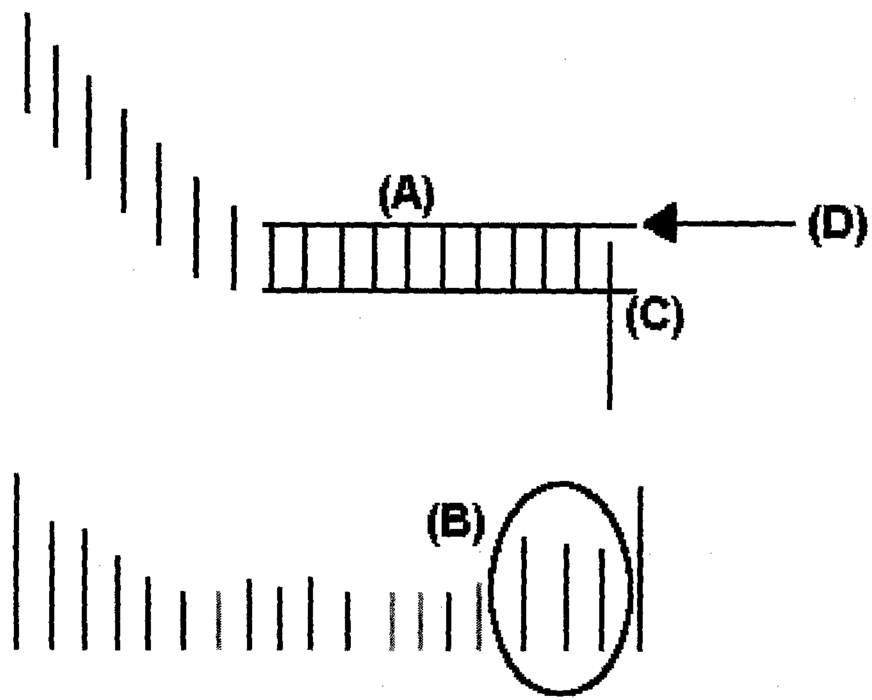
Some of the more experienced traders might be using "married puts" which enable you to short stocks on a down tick. If you need more information on this, you should contact your direct-access broker.

Because the Slim Jim is a breakout pattern, it is obvious that having to adhere to the up tick rule will prevent you from getting executed on Slim Jims that make strong breakouts to the downside because there will be few up ticks.

Entry Rules For Slim Jims - Short Entry

1. Look for a minimum seven-bar consolidation on the five-minute intraday chart at or just above the low of the day (A).
2. Volume should be increasing on trades, meaning larger lots of the stock start to trade (B).
3. Market dynamics must be negative, with the futures moving down and your quote screen showing most of the stocks negative for the day if you are taking a short entry.

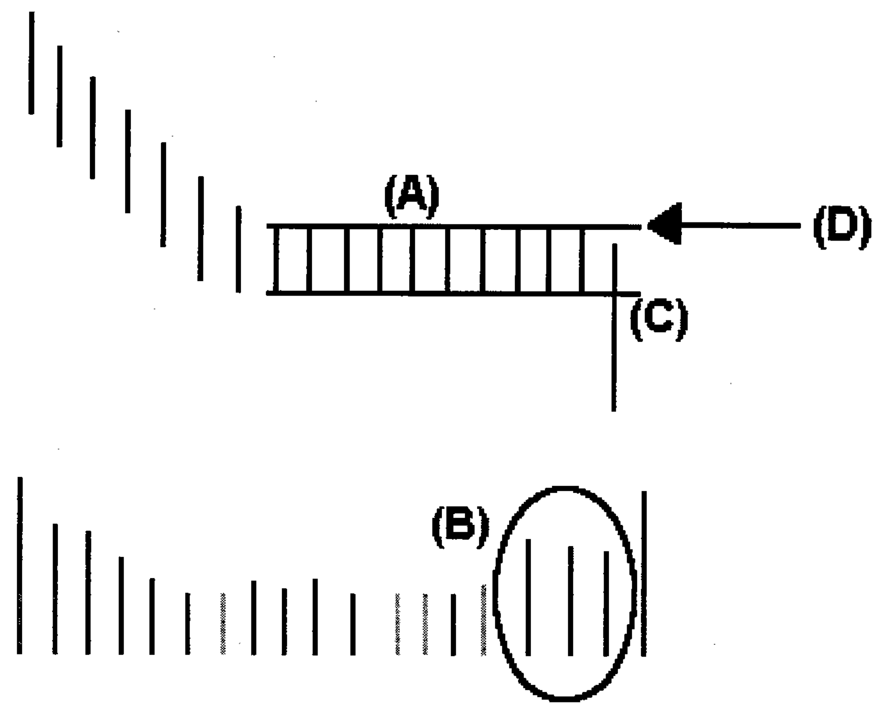
For a short entry, the rules are similar, but reversed.



Entry Rules For Slim Jims - Short Entry

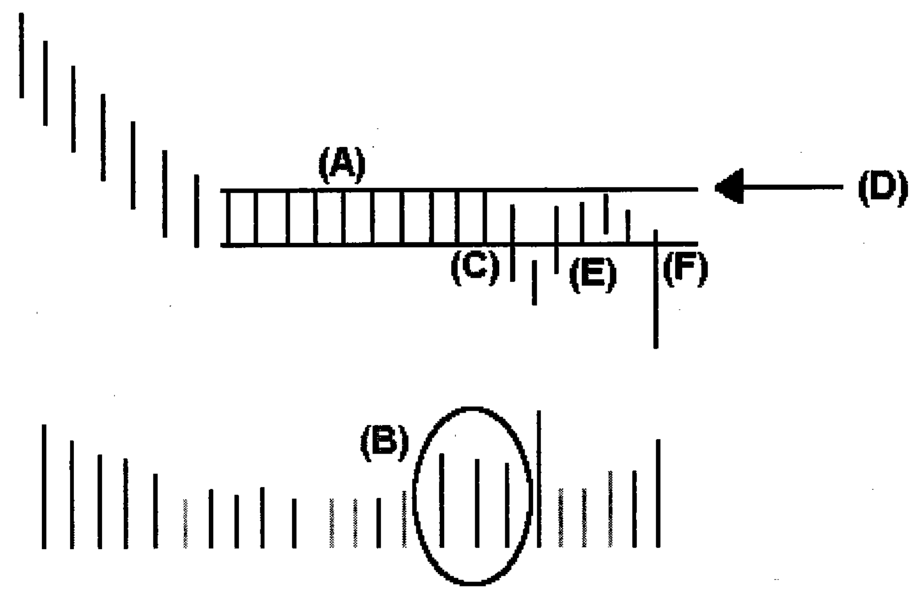
4. Enter when the stock breaks down from the consolidation (C).

5. Place your stop just above the high of the pattern (D), or else you can use the alternate method with your stop a little bit above the breakout point, but be sure to give it a little wiggle room.



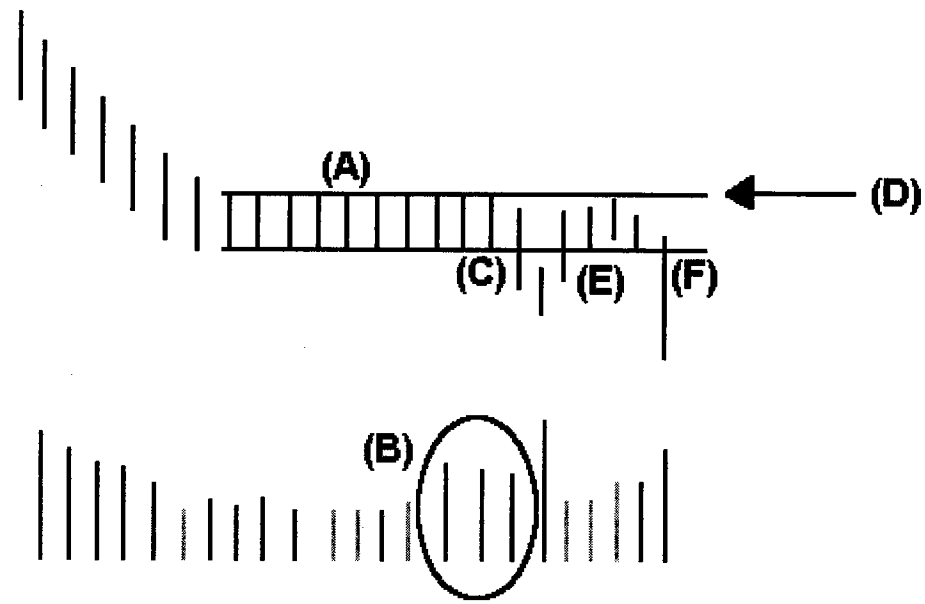
Second Entry Slim Jims - Short

1. Look for a minimum seven-to ten-bar consolidation on the five-minute intraday chart at or just below the high of the day (A).
2. Volume should be increasing on trades, meaning larger lots of the stock start to trade (B).



Second Entry Slim Jims - Short

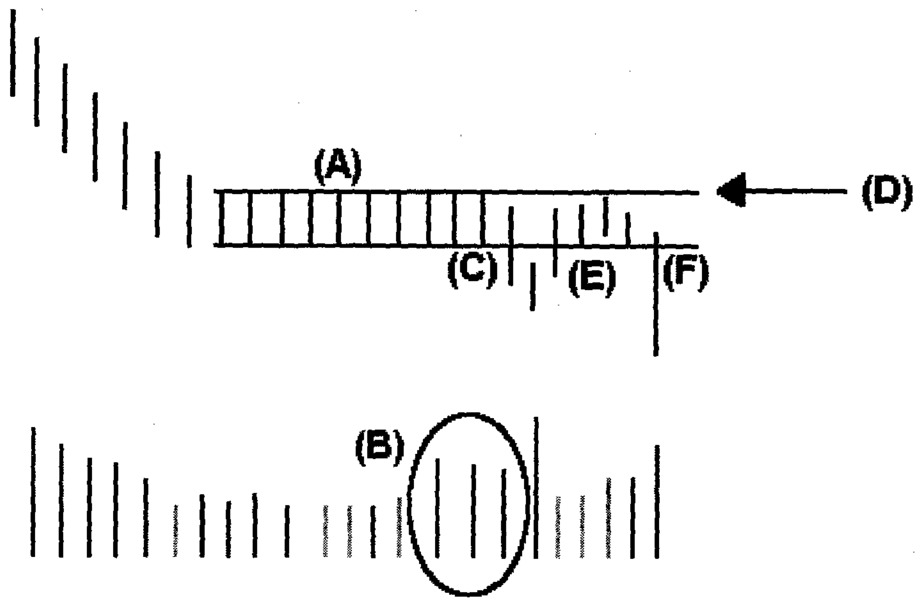
3. Market dynamics must be negative, with the futures moving down and your quote screen showing most of the stocks negative for the day if you are taking a short-side entry.
4. Enter when the stock breaks out of the consolidation (C).



Second Entry Slim Jims - Short

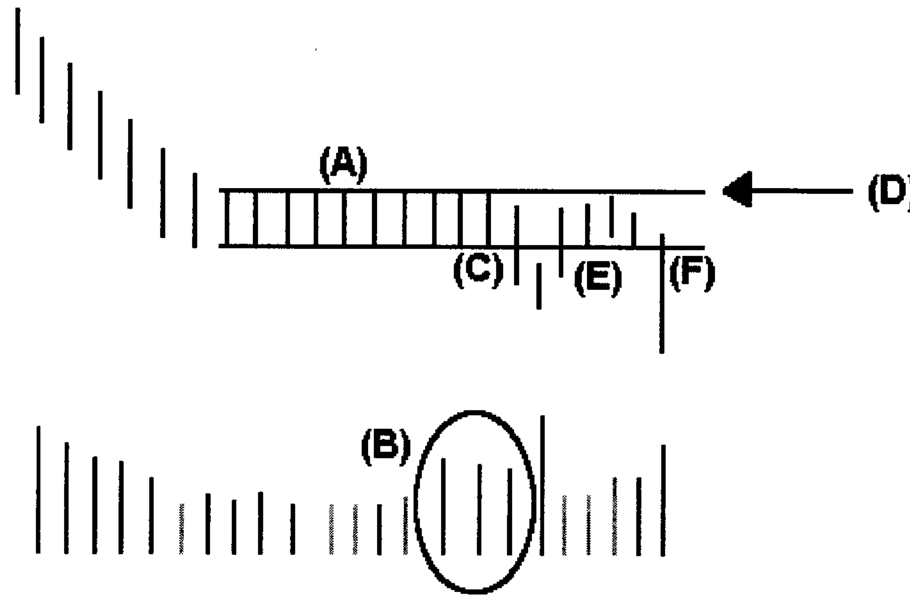
5. Place your stop just under the low of the pattern (D), unless you are using the alternate method discussed in the previous example.

6. The stock moves back into the pattern's range (E). If it does not hit your stop just above the top of the range, hold tight. If you got stopped out for a small loss using the alternate method, then you are on alert for a second entry trade.

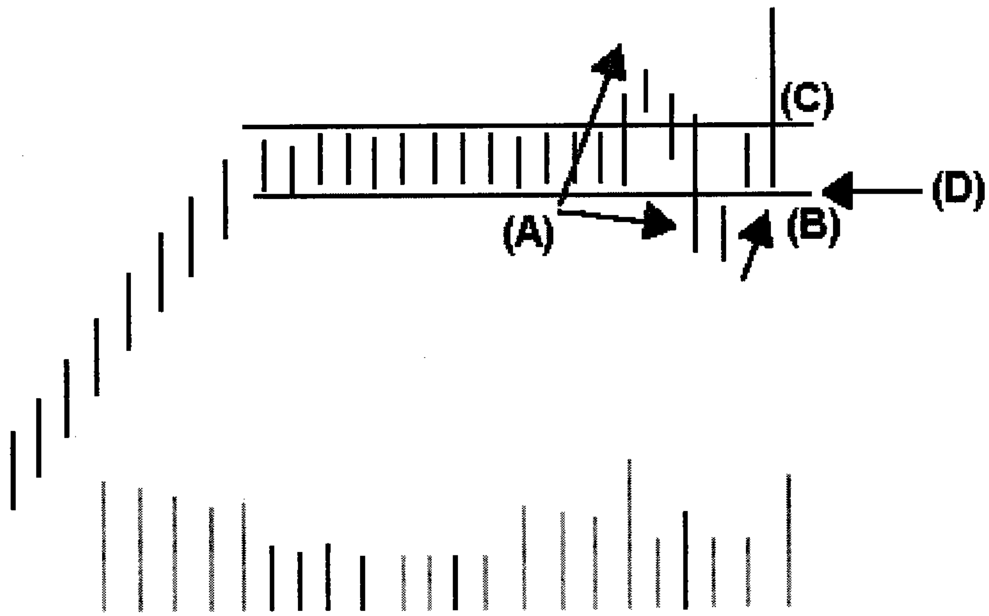


Second Entry Slim Jims - Short

7. When the stock moves out of the bottom of the range again (F), "second entry" occurs. This is a good entry to wait for in highly volatile stocks. In a very volatile stock, like many Nasdaq issues, it is better to pass on the first breakout and wait for the second entry. Aggressive traders can also add to the position here if the market environment is favorable.



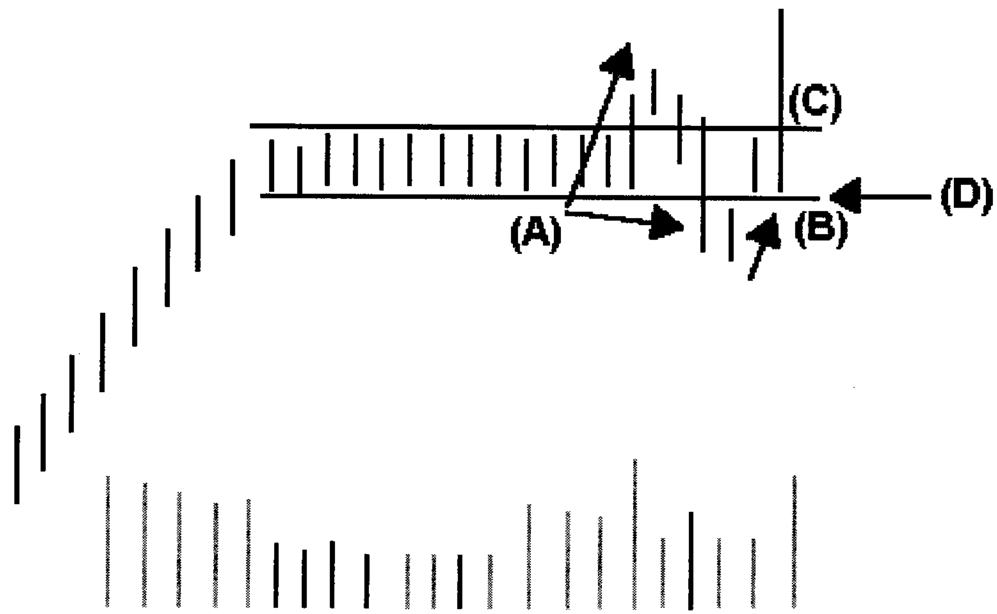
Failure and Go - Shaking Out The Scared Money



The failure and go is often the best Slim Jim to trade because it gives the appearance of a breakout that fails, then reverses back in the direction of the original trade.

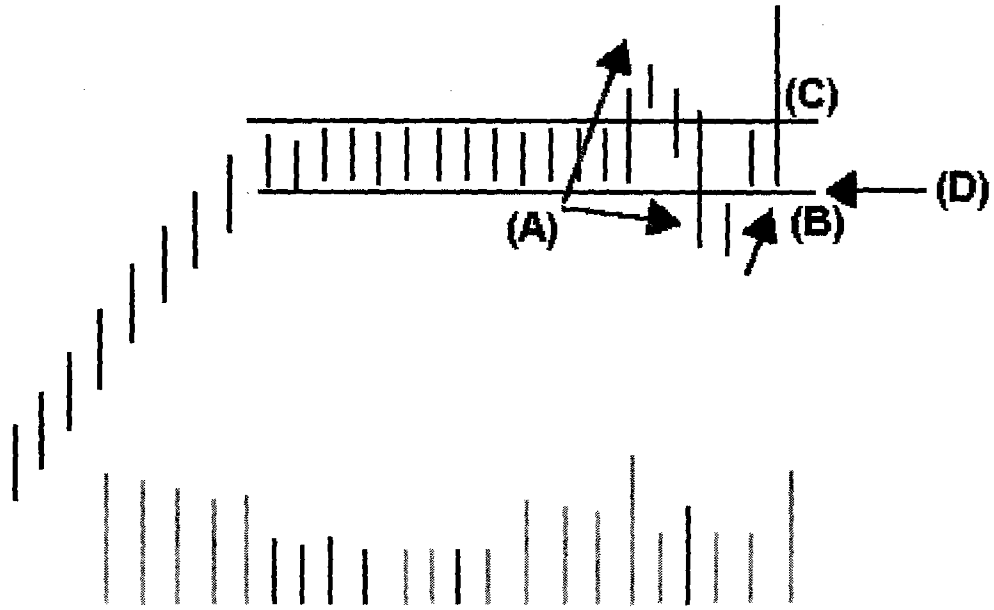
The rules will be the same for the other types of Slim Jim entries, with the following exceptions:

Failure and Go - Shaking Out The Scared Money



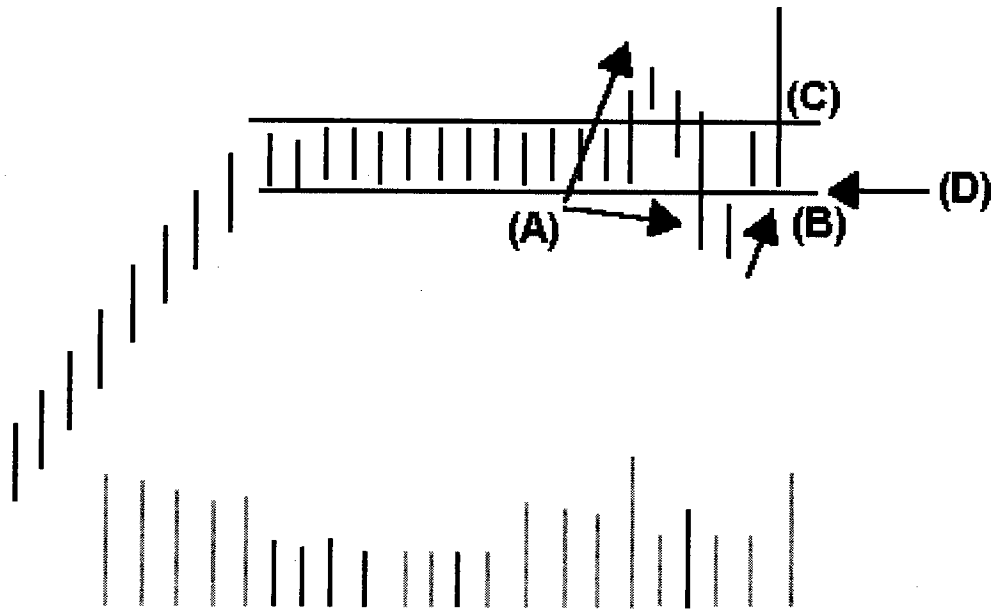
1. The stock must break out of the top of the pattern for a buy entry, then reverse and go back through the bottom of the pattern (A). You would have been stopped out of your original entry on both the regular and alternate methods.

Failure and Go - Shaking Out The Scared Money



KEY POINT: This shakeout happens quite frequently on days with high volatility. It could be the market makers or specialists trying to influence the stock, or it could be program trading or maybe just a wrong reaction to a quick news flash.

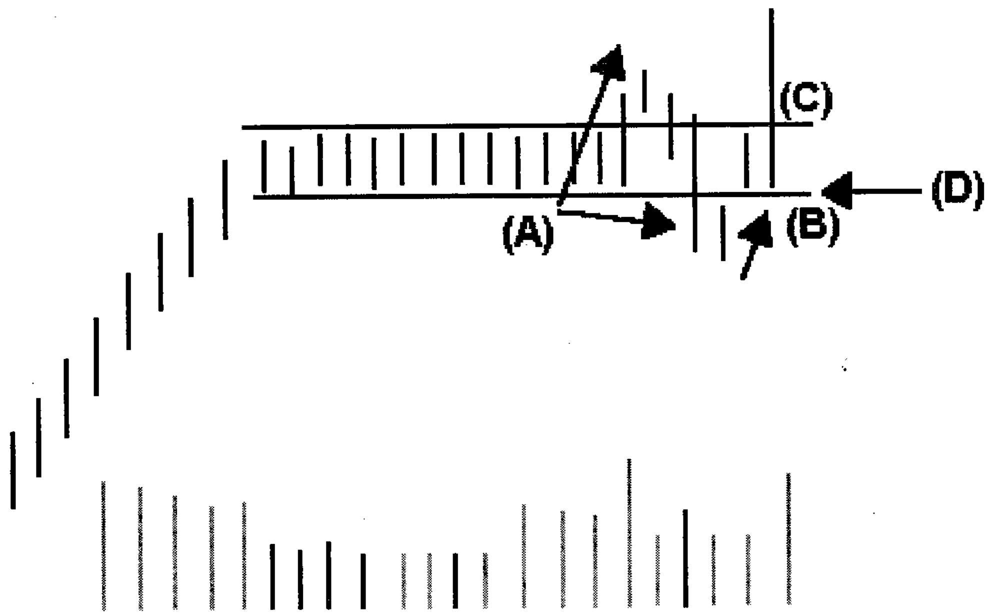
Failure and Go - Shaking Out The Scared Money



2. When the stock reverses back up again (B), take entry when it moves out of the top of the pattern (C).

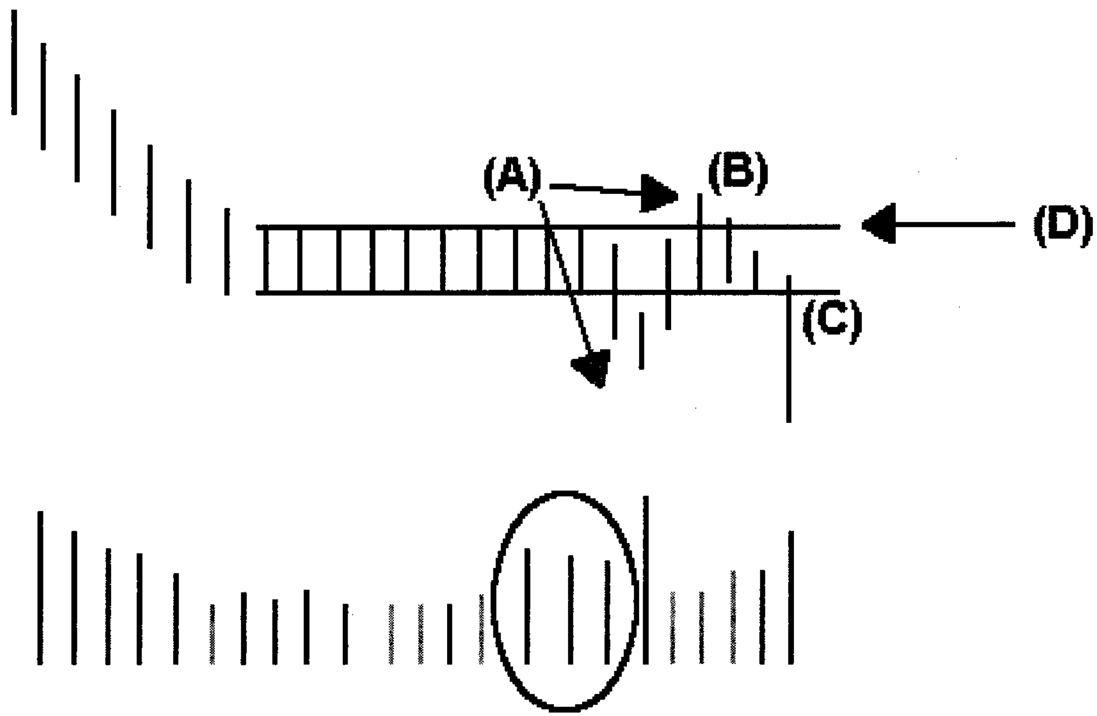
3. The initial protective stop is still placed just below the bottom of the pattern at (D), or else use the alternate method which is often only risking .25 - .30 of a point. This is more apt to give you the confidence to take the "failure and go" entry.

Failure and Go - Shaking Out The Scared Money



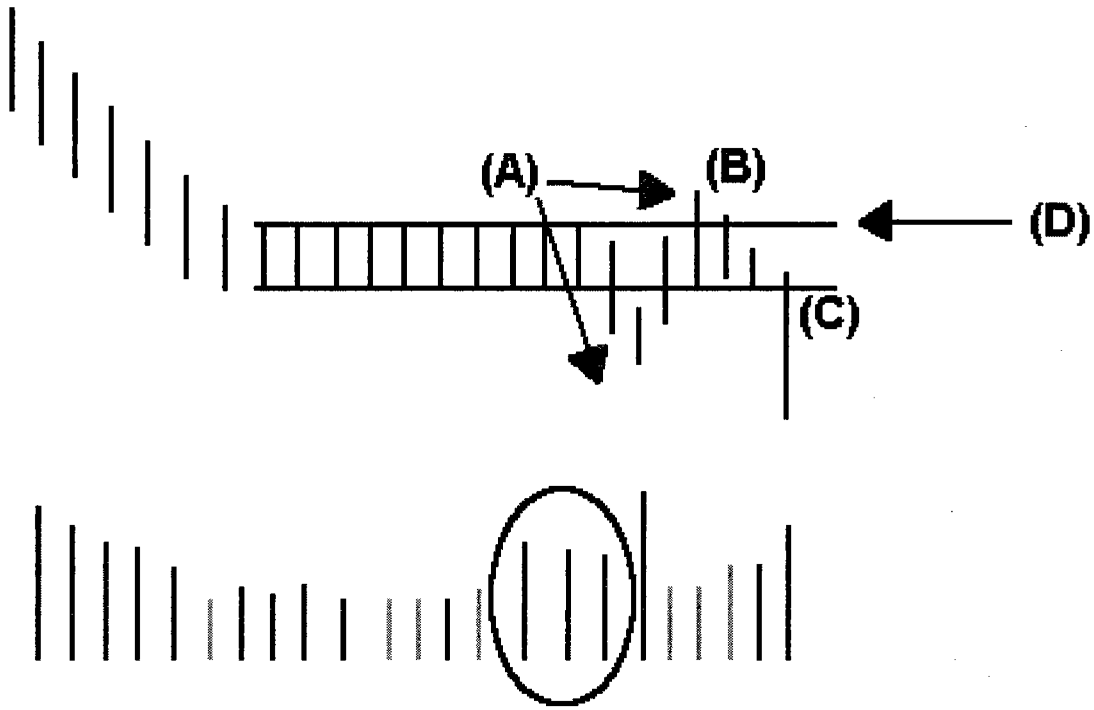
4. Many traders are scared to enter after this volatile action, but the trade will often move very quickly in your favor. This head fake puts the scared money on the sidelines and will often clear the way for the stock to explode further.

Failure and Go - Short Entry



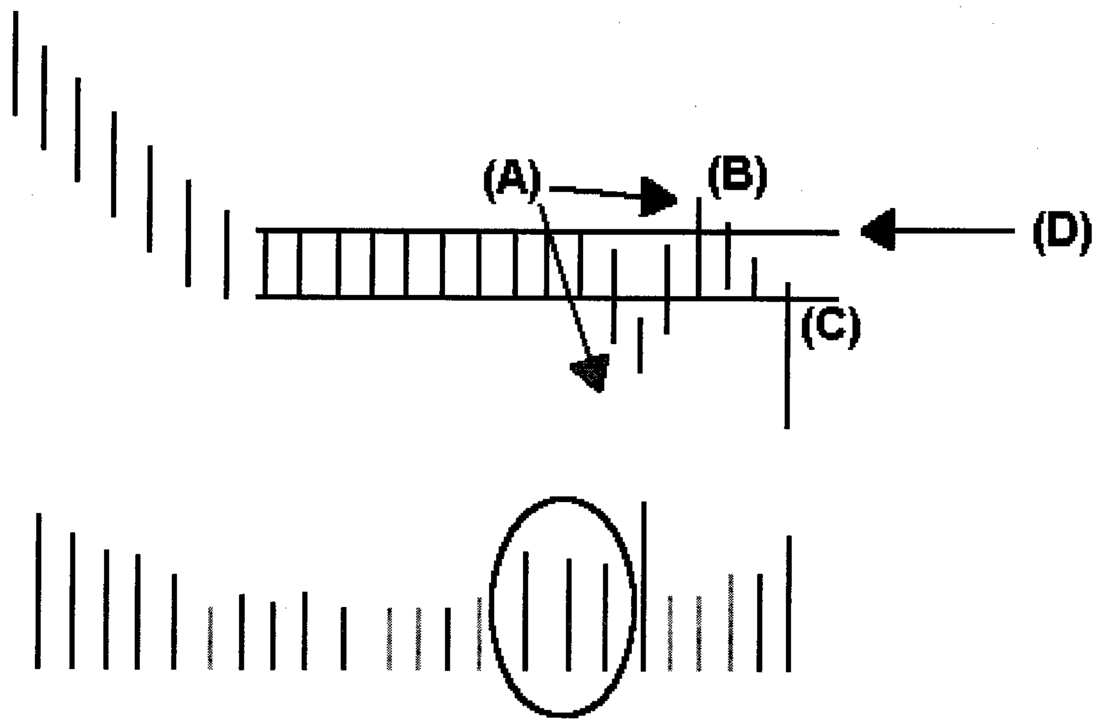
As with the long failure and go, the rules will be the same for the other types of Slim Jim entries, with the following exceptions.

Failure and Go - Short Entry



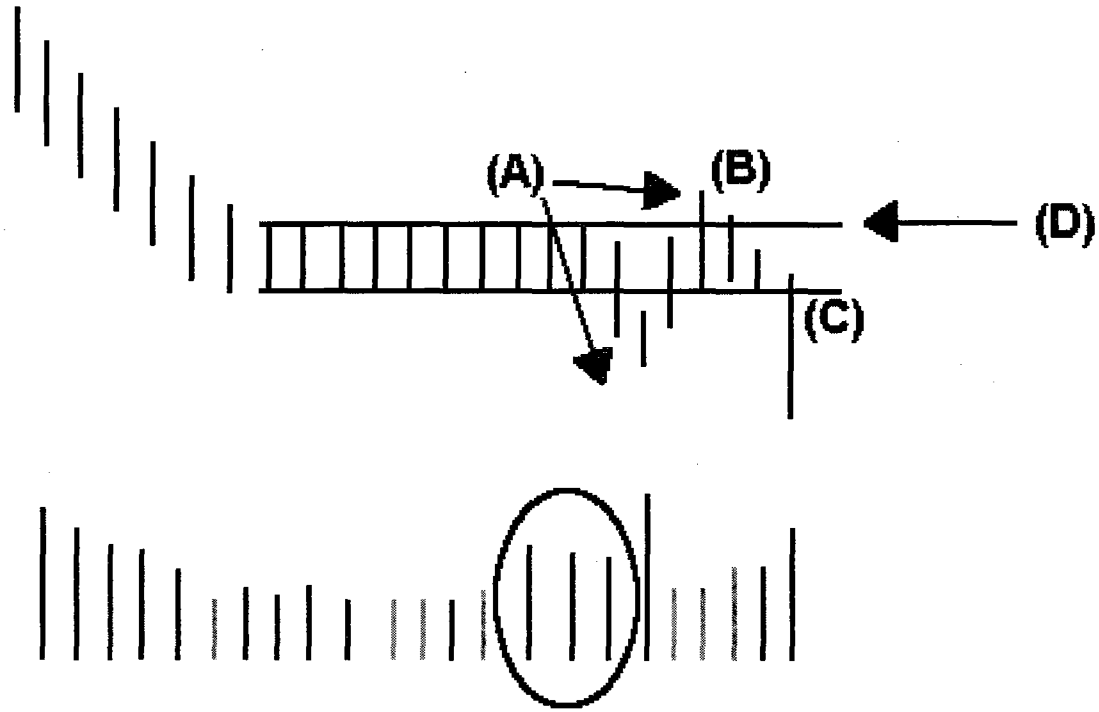
1. The stock must break down out of the bottom of the pattern, then reverse and go back through the top of the pattern (A).
2. When the stock reverses back down again (B), take entry when it moves out of the bottom of the pattern (C).

Failure and Go - Short Entry



3. The stop procedure is the long failure and go, only reversed. You can use either the regular stop at (D), or use the alternate method and put the stop just above the bottom of the range after you get your entry at (C).

Failure and Go - Short Entry



Again, many traders are afraid to enter after this volatile action, thinking "it is too choppy," or after getting stopped out fear another losing trade. You should approach it as just another trade of the many you will take over the course of the year.

When To Buy A Slim Jim At The Intraday Lows

The Slim Jim patterns we have covered so far are continuation breakouts in the direction of the intraday trend. We will now explain how to trade the intraday contra-trend Slim Jim.

Very often, if the market has sold off more than usual, Slim Jims will develop at the low of the day that can be played to the upside, as well as any further continuation to the downside.

One key point to keep in mind when taking a long side entry in a Slim Jim at or near the intraday low, in addition to improving market conditions, is that there must be enough profit potential to risk when taking the breakout.

When To Buy A Slim Jim At The Intraday Lows

For example, if a stock has a 2 point current average daily range and is down 2 points on the day due to general market conditions and company-specific news, and then forms a Slim Jim, it becomes a prime candidate, especially if it hasn't had a real contra move up during the decline.

These plays normally work best when at least half of the average daily range remains from your entry point to the intraday high.

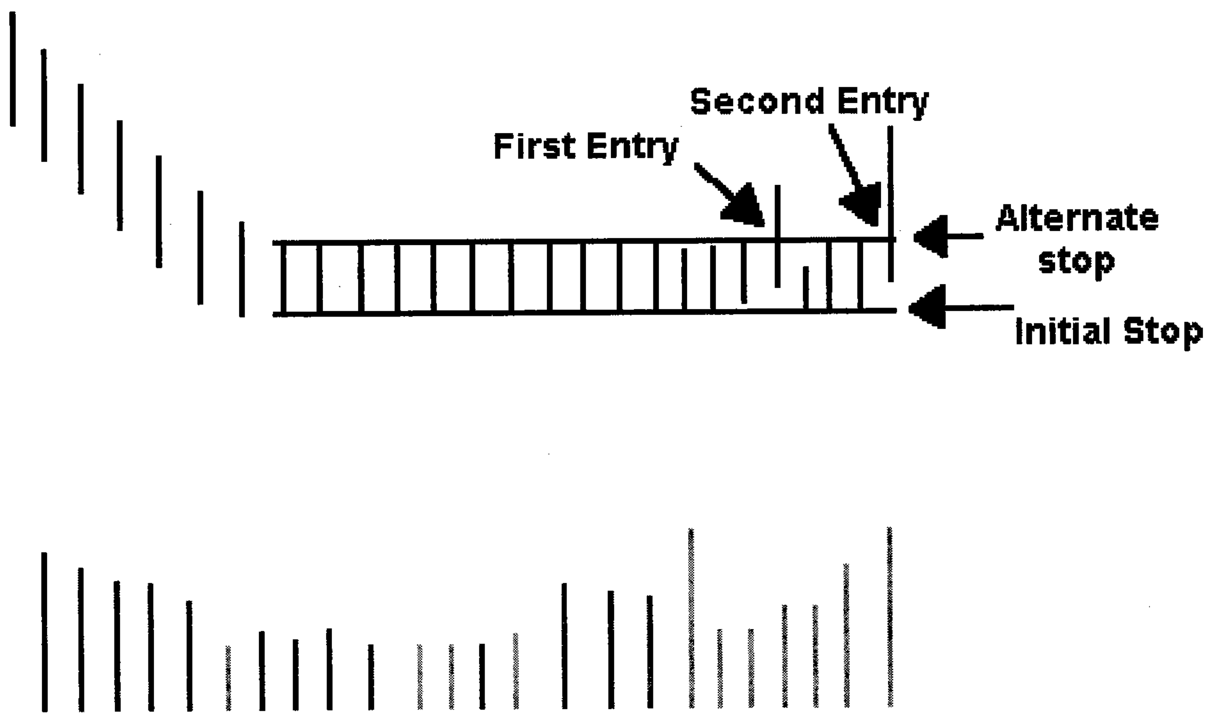
When To Buy A Slim Jim At The Intraday Lows

The entry from a Slim Jim at a low to the long side is best utilized as a second entry trade, or else only take a half position on the first entry. It will take you a few trades to get the hang of this contra trend Slim Jim, but they can provide you with an excellent reward-to-risk ratio if you adhere to your stops.

If you do decide to take the first breakout, I suggest you use the alternate stop method because your risk will be no more than .25 to .30 at most.

Remember, it is very important that you see the market dynamics improving to take this trade, particularly the NYSE TICKS.

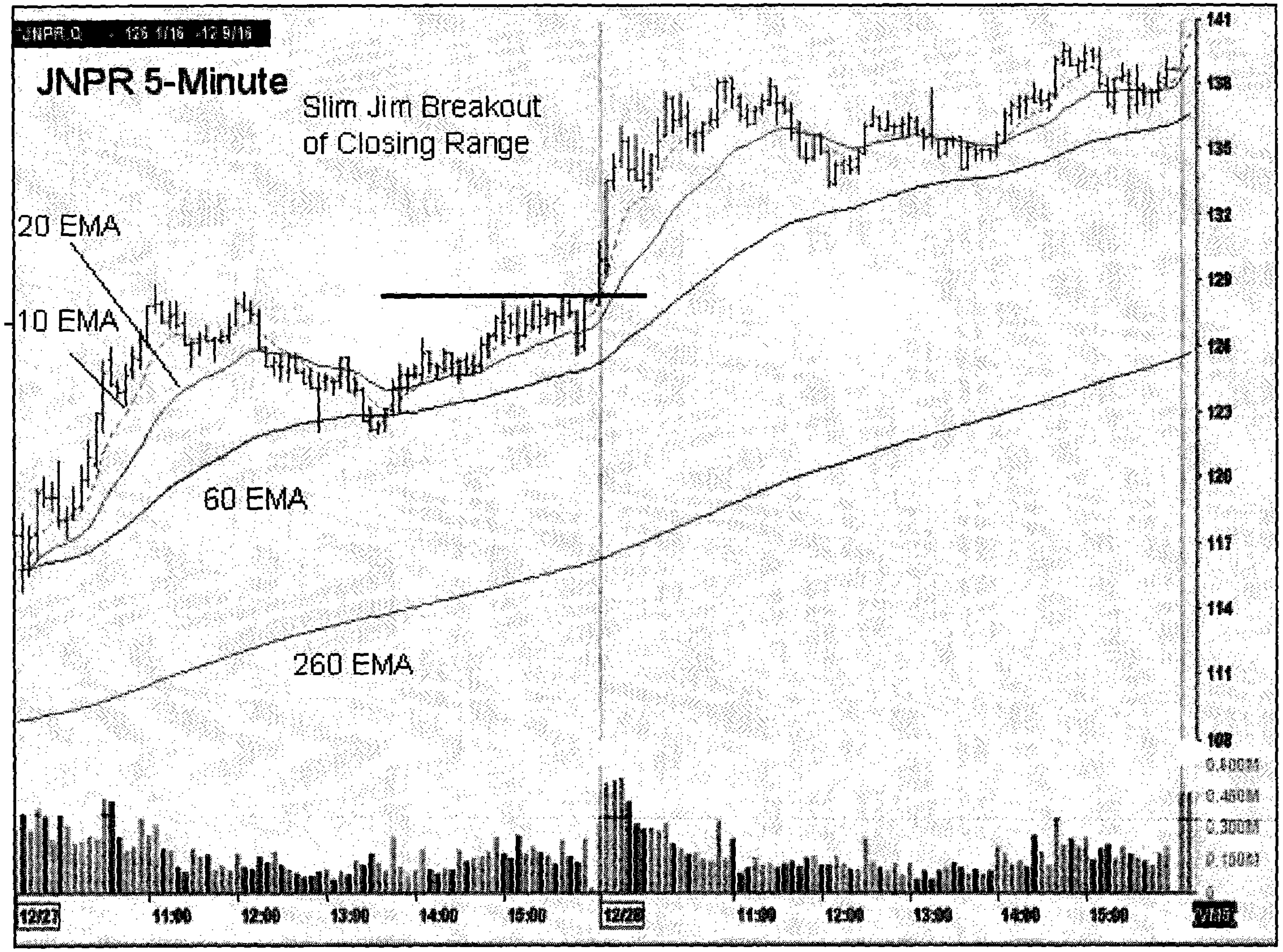
Slim Jims At The Intraday Highs



The rules are reversed for Slim Jim sells at intraday highs and that are extended in range. Remember to keep in mind that shorts are much harder to get off in individual stocks due to the up tick rule.

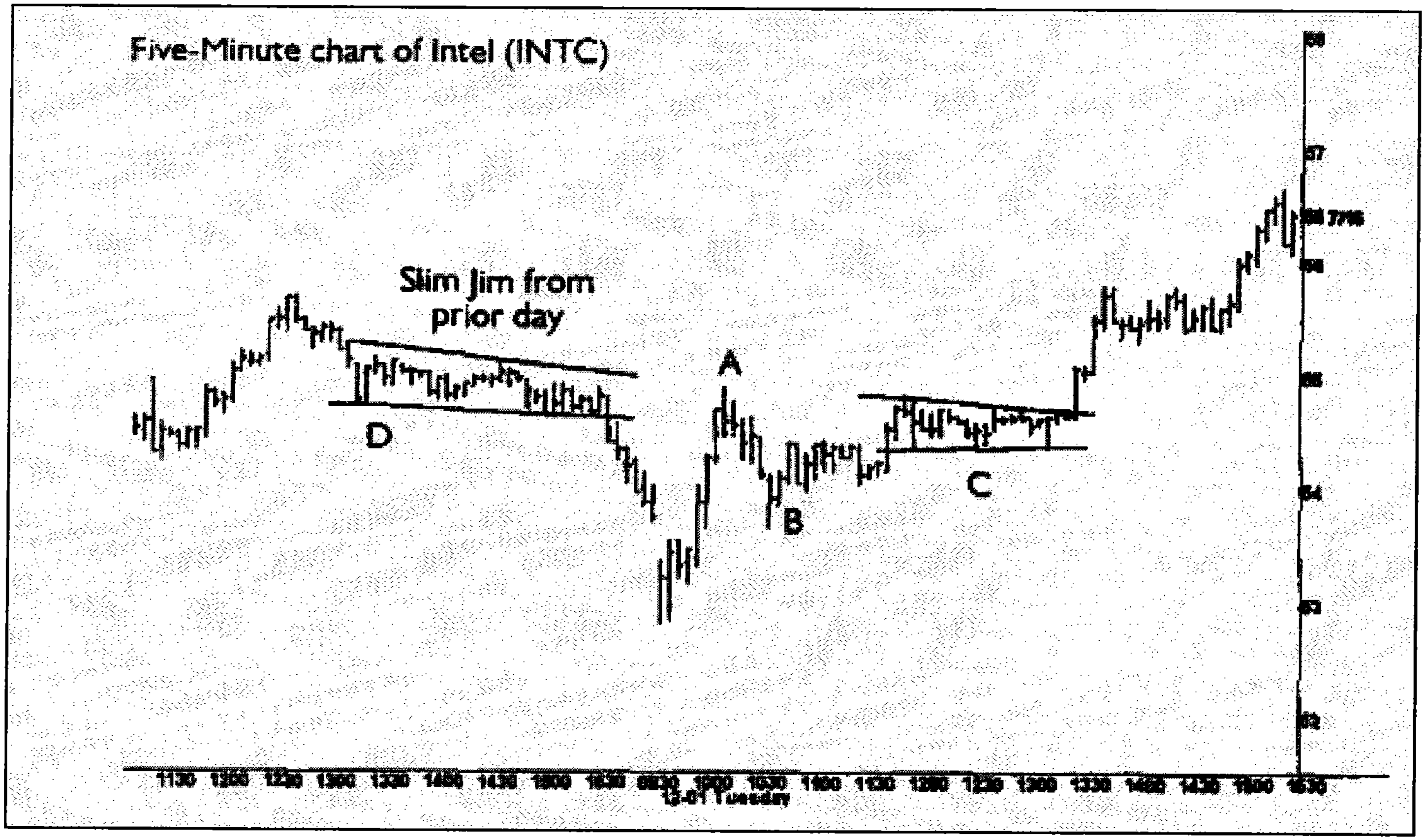
Slim Jims
Real World Examples

Slim Jims

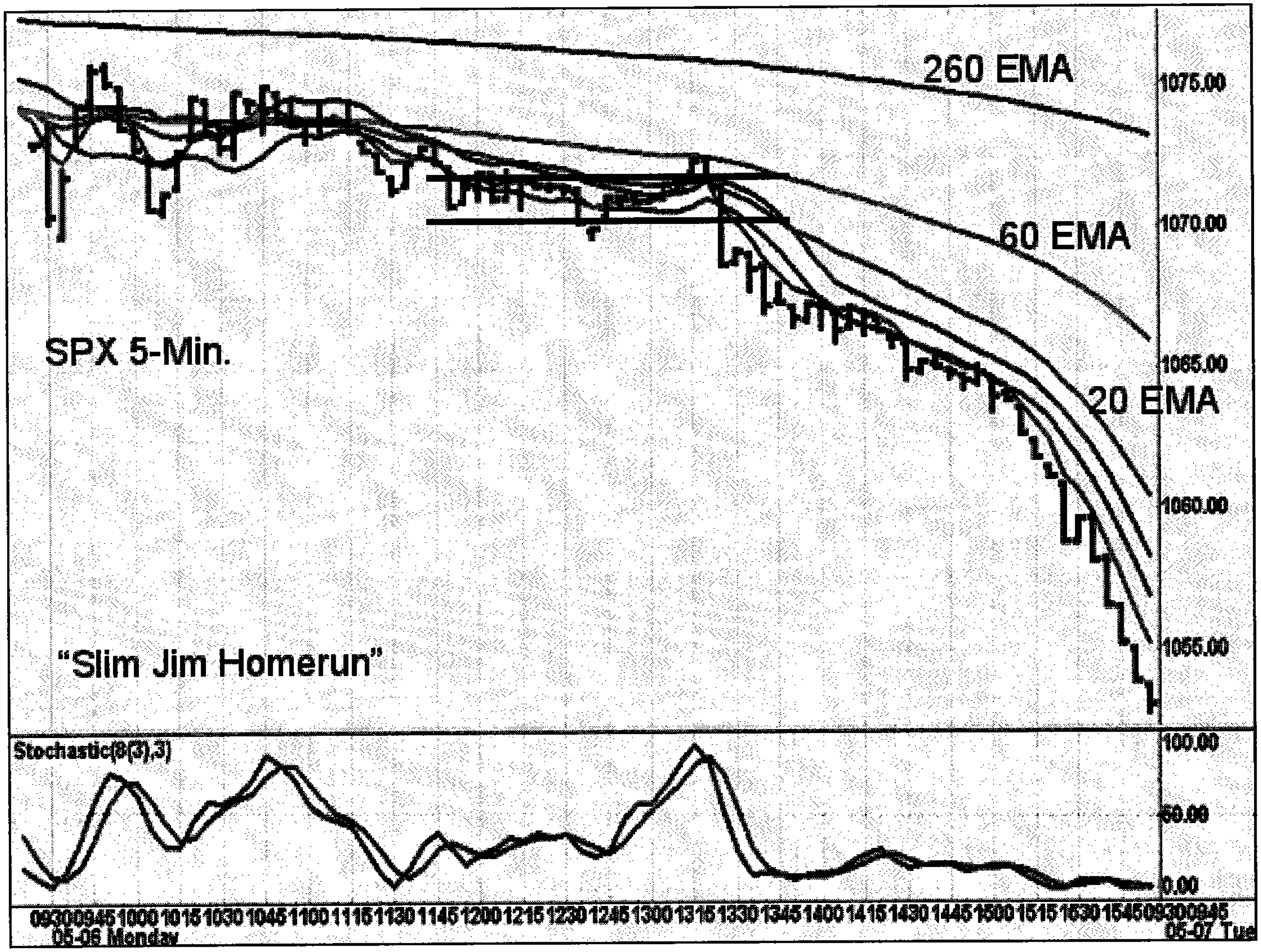


JNPR 5-Minute
Slim Jim Breakout
of Closing Range
20 EMA
10 EMA
60 EMA
260 EMA

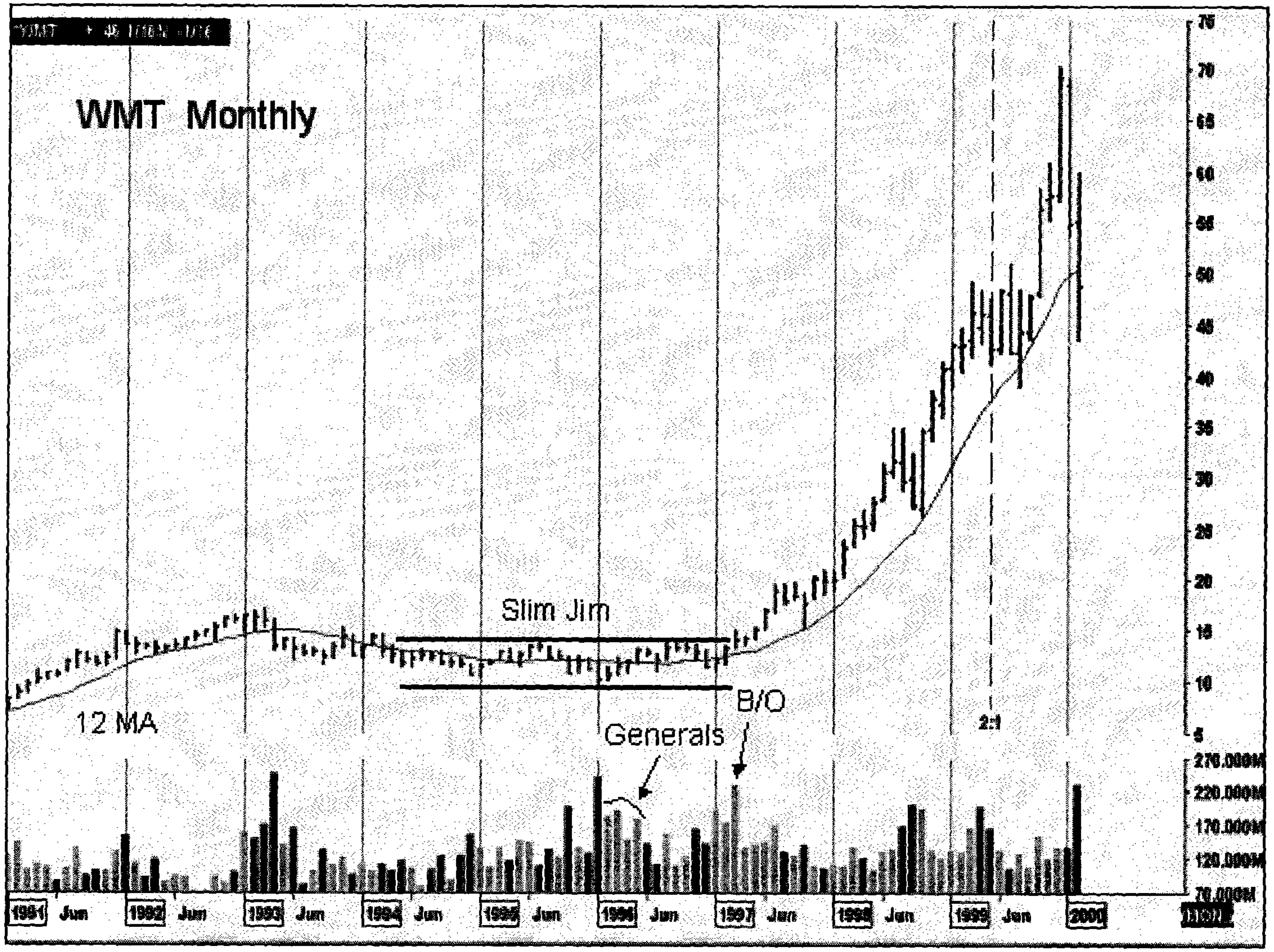
Slim Jims



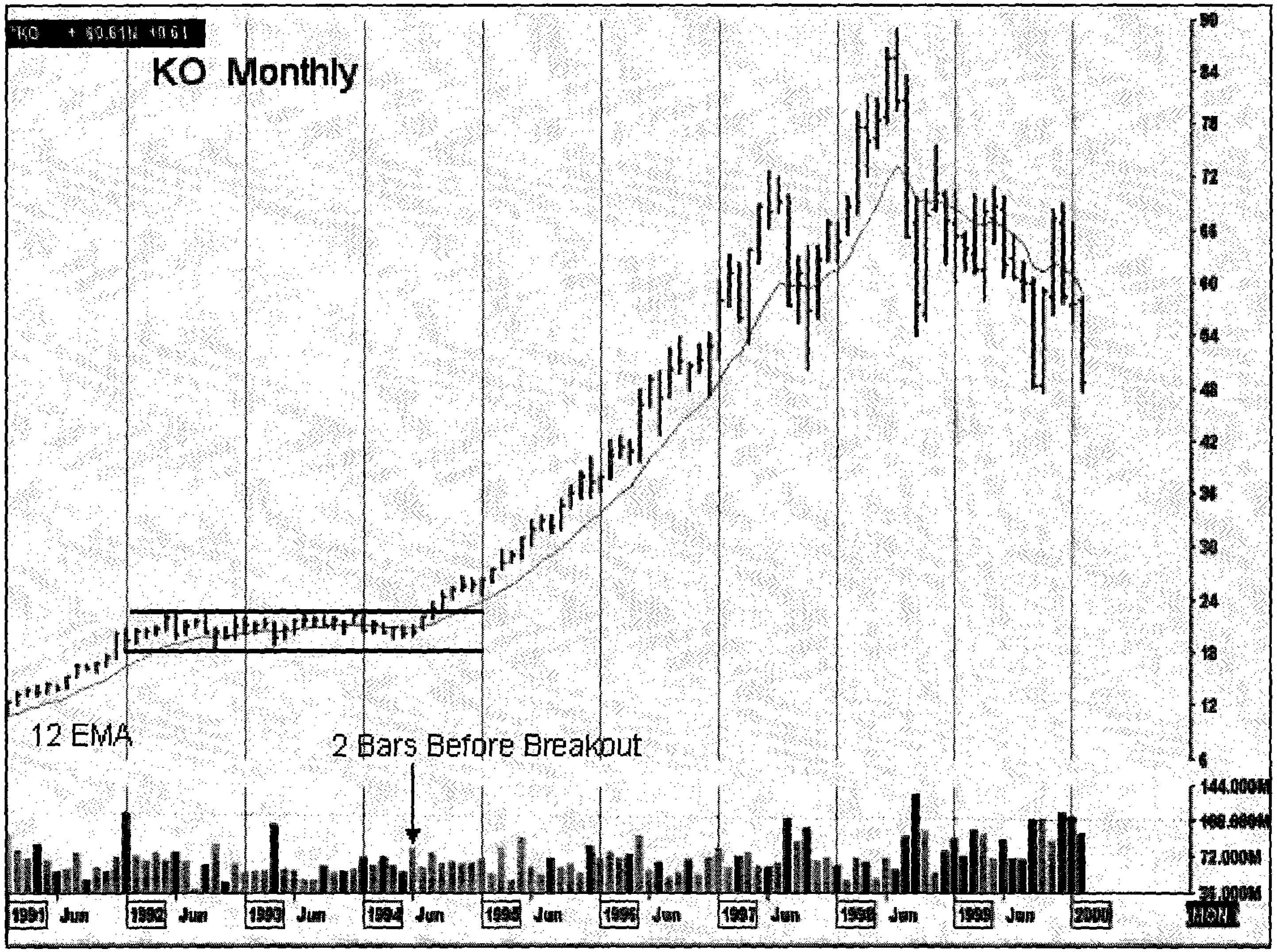
Slim Jims


260 EMA
60 EMA
20 EMA
SPX 5-Min.
"Slim Jim Homerun"
1075.00
1070.00
1065.00
1060.00
1055.00
Stochastic(8(3),3)
100.00
50.00
0.00
05-06 Monday
05-07 Tue

Slim Jims



Slim Jims


KO Monthly
12 EMA
2 Bars Before Breakout
1991
Jun
1992
Jun
1993
Jun
1994
Jun
1995
Jun
1996
Jun
1997
Jun
1998
Jun
1999
Jun
2000

XII. First Consolidation Breakouts

First Consolidation Breakouts To New Intraday Highs

- The first consolidation breakout to new intraday highs can be an explosive move as the primary trend asserts itself.
- When the Generals want to buy stocks, but know they have competition from other major institutions and are not getting their desired share of the volume, they will often reach in price, provided they can get volume. This happens when there are several different institutions trying to buy stock and one of them decides to reach in price, which is the catalyst for the other buyers to follow the leader. The move out of the pattern can be explosive, especially when the hedge funds are front-running the orders and then buy programs kick in.

First Consolidation Breakouts To New Intraday Highs

- The best moves will always be in conjunction with positive market and stock dynamics prior to and with the breakout.
- If the TRIN is below. 80 and most of the major sectors are green, along with positive NYSE TICK action, you can sometimes anticipate the breakout and take early entry with a tight stop. Only do this if you are a trader that has a good market sense. If you are a mechanical or system trader, wait for the breakout.
- If the first move out of the pattern is a head-fake, which happens mostly with OTC stocks, take the second entry trade, provided the market and stock dynamics remain positive.

First Consolidation Breakouts To New Intraday Highs

- There can certainly be more consolidation breakouts after the first one, provided the trend remains strong, but be aware that the Trading Tree gets weaker the higher up price is from the initial breakout. That is why consolidation around the 200-day MA, for example, that base for a period of time, then break out are some of the best position trades that an investor can take because the risk increases after the stock is well into the momentum or advancing stage. Whether it's a daytrade or a position trade from a daily chart pattern, you want to get in at the base of the tree.
- The most common patterns you will encounter are ascending symmetrical and dynamite triangles, in addition to Slim Jims.

First Consolidation Breakouts To New Intraday Highs

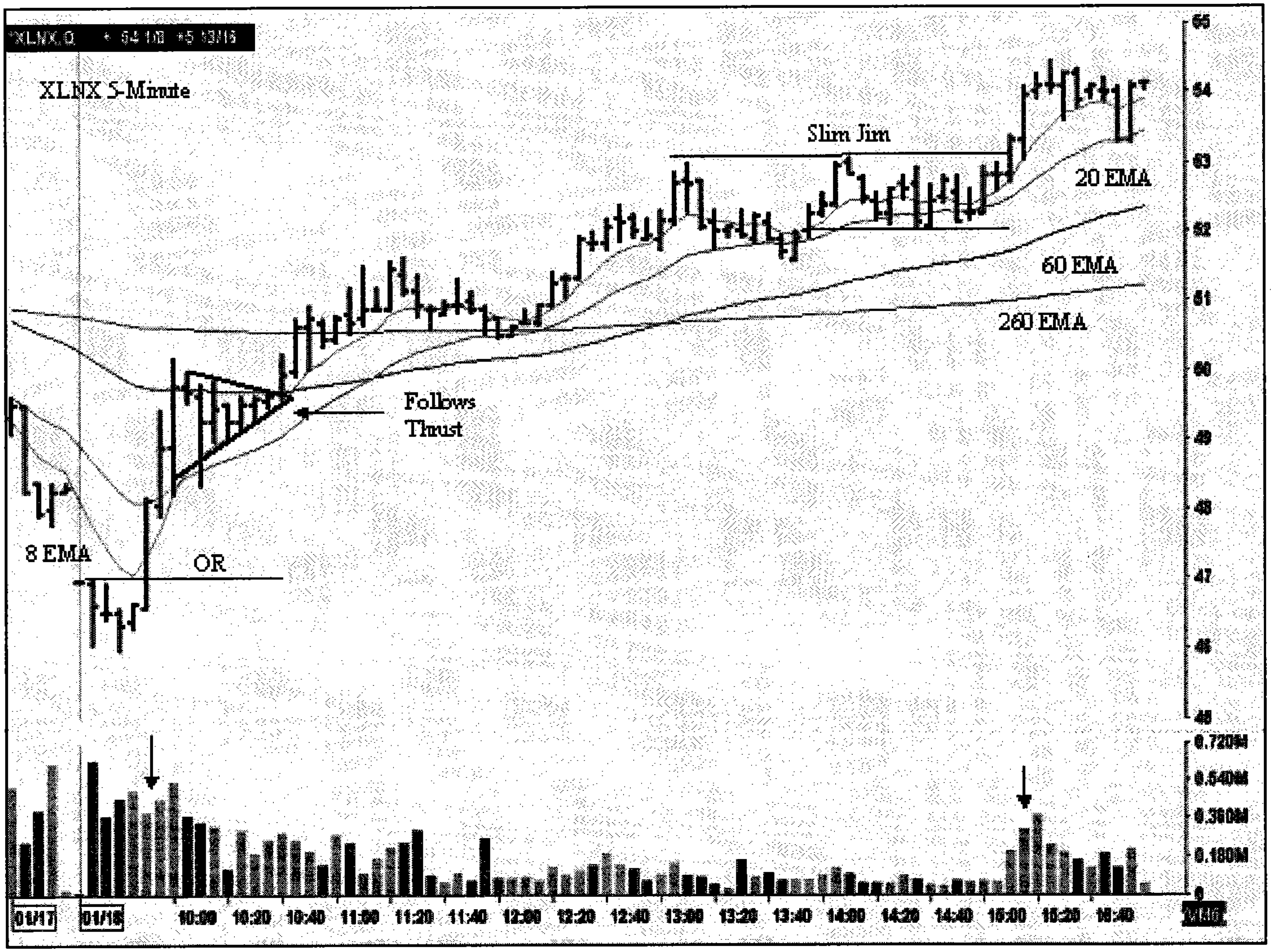
- The futures and index proxies pattern up very well, but when you are trading individual stocks, stick with the big cap stocks that are higher priced, have good liquidity and volatility. Big cap stocks pattern much better than the erratic mid-cap and smaller-cap stocks that can be easily pushed around on much less volume.
- By trading big cap stocks, you will also benefit from program trading, primarily in the S&P 500 stocks, in addition to the fact that the professionals commit most of their capital to the big cap stocks because that's where they make most of their trading profits.

First Consolidation Breakouts To New Intraday Highs

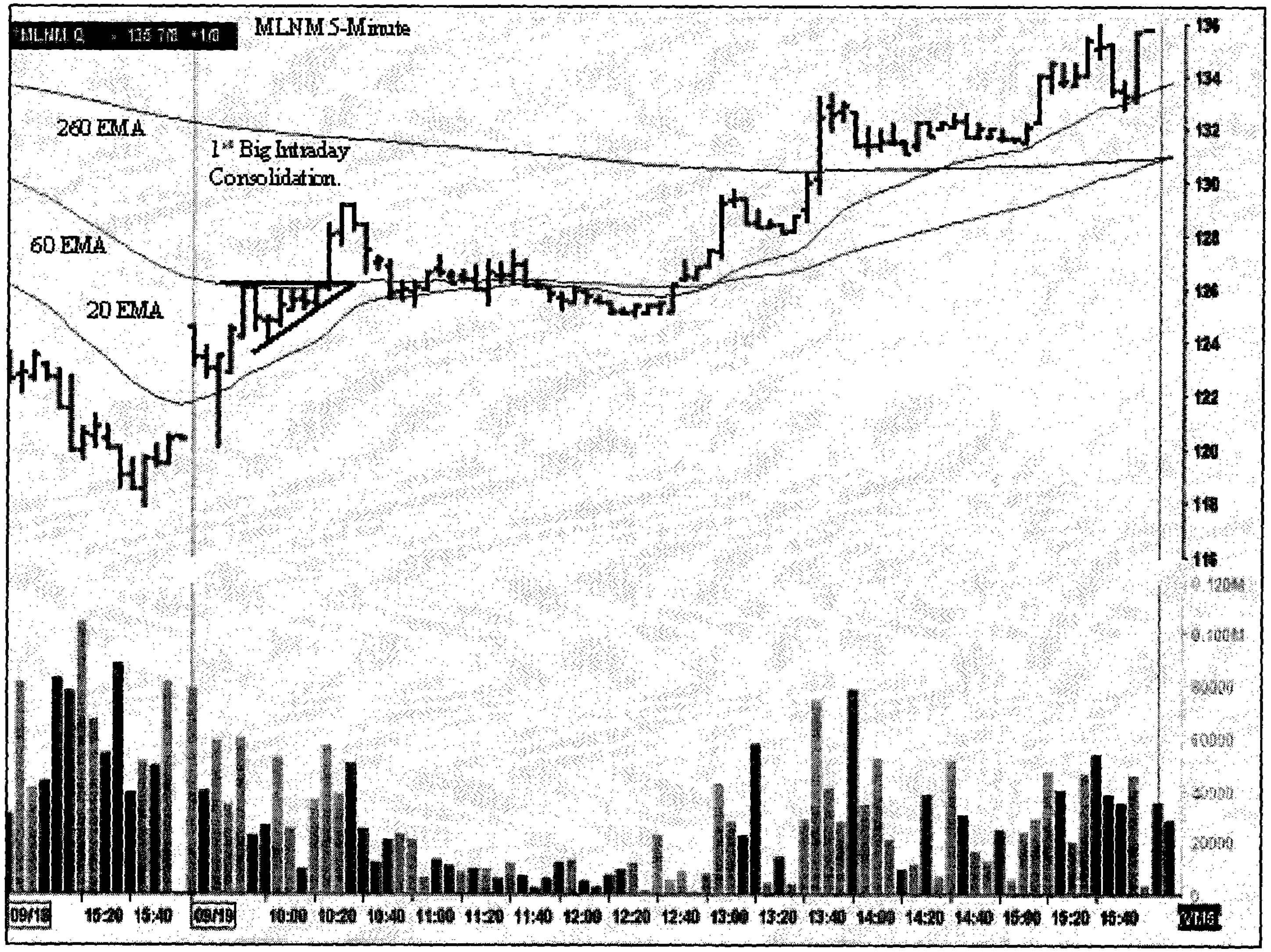
- When scrolling your charts for this pattern, you want to see other stocks in the group that show strength, which results in a higher probability trade most of the time.
- These parameters are for buy trades and are just reversed for sells. However, if you are trading individual stocks, you won't get executed at the correct entry point most of the time because of the plus tick rule, and you should look into the use of "bullets" at your direct access broker, as they will enable you to sell short on a minus tick, provided you are flat at the end of the day.

First Consolidation Breakouts
To Intraday Highs
Real World Examples

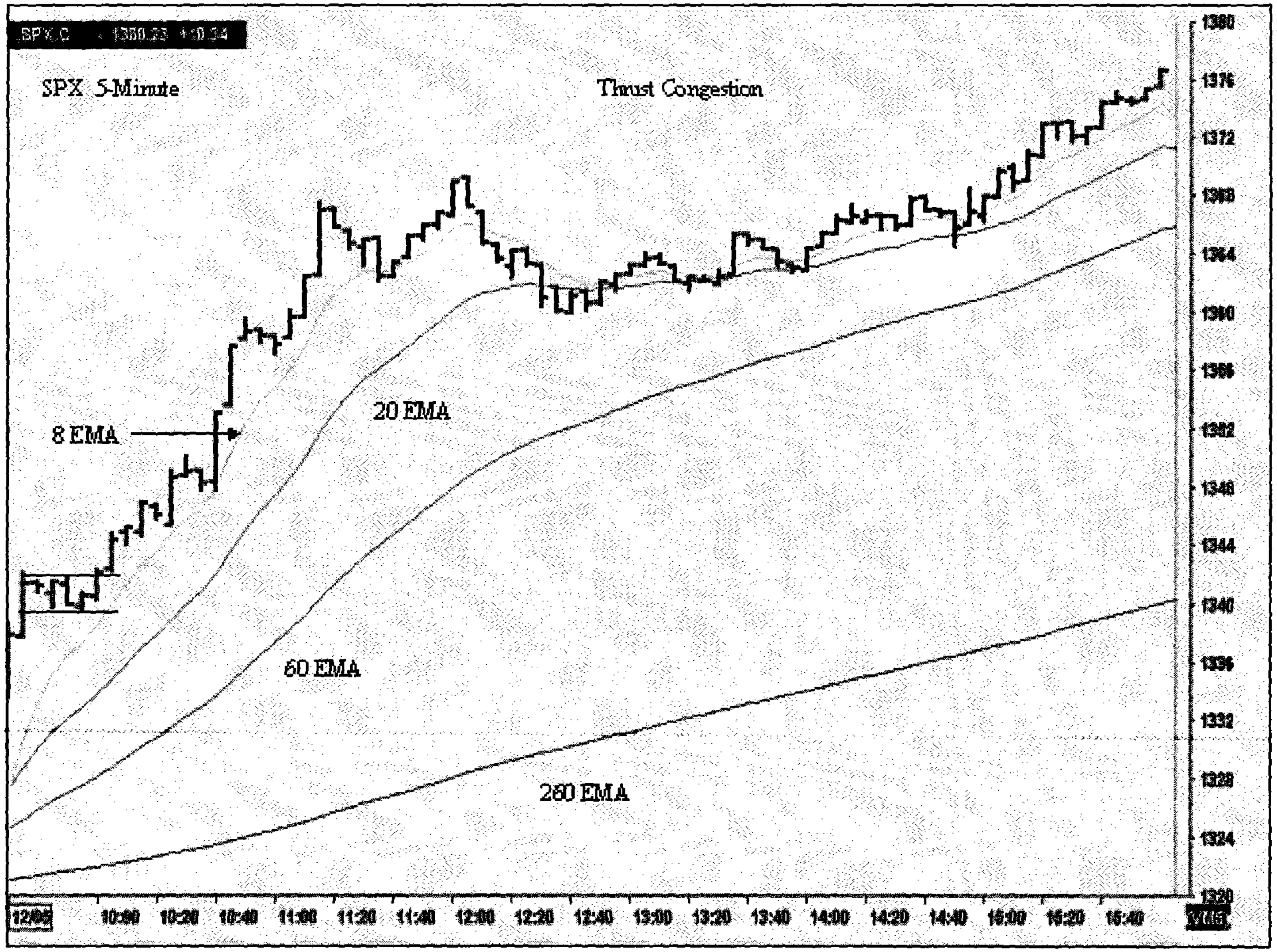
First Consolidation Breakouts To New Intraday Highs



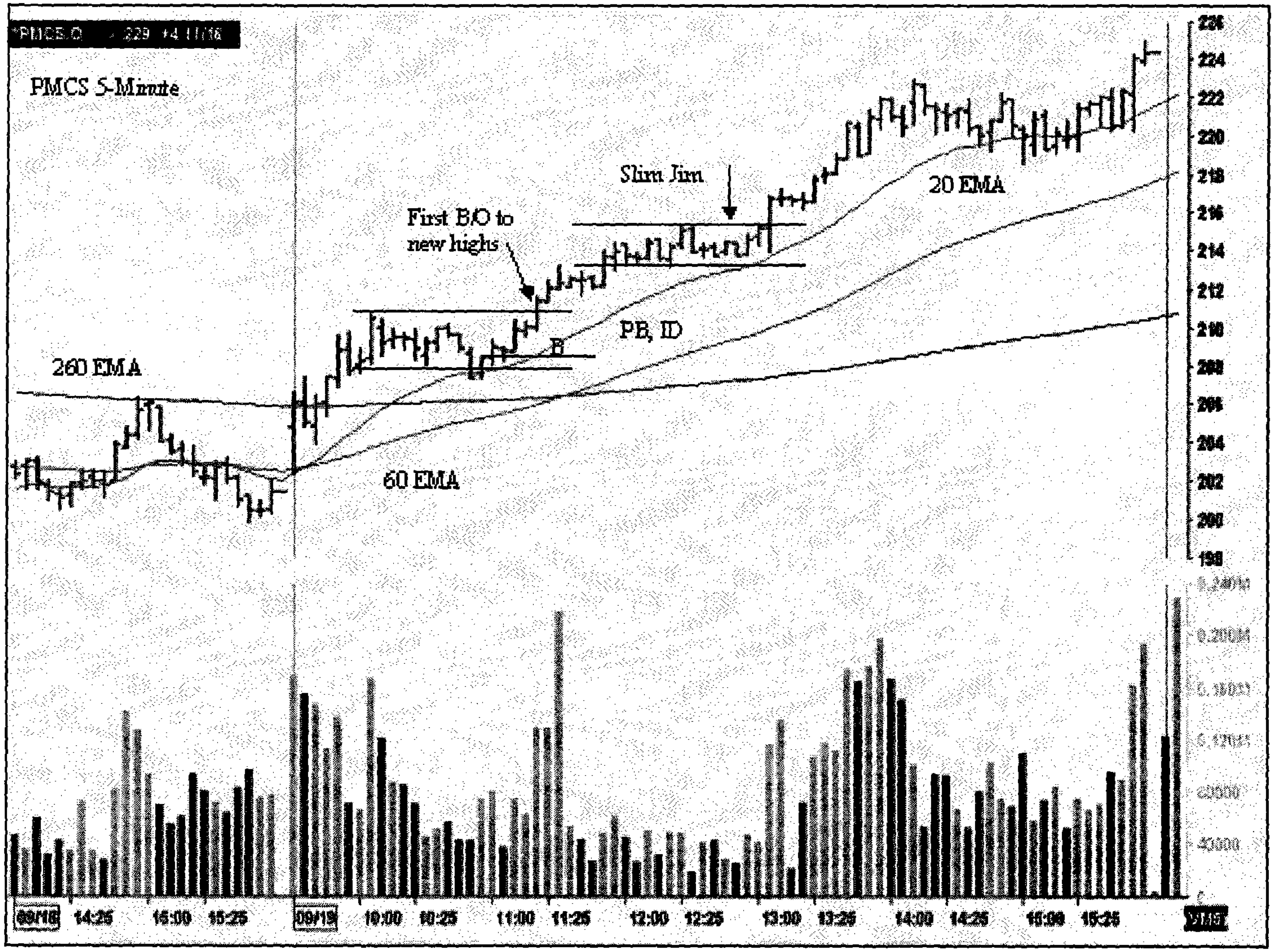
First Consolidation Breakouts To New Intraday Highs



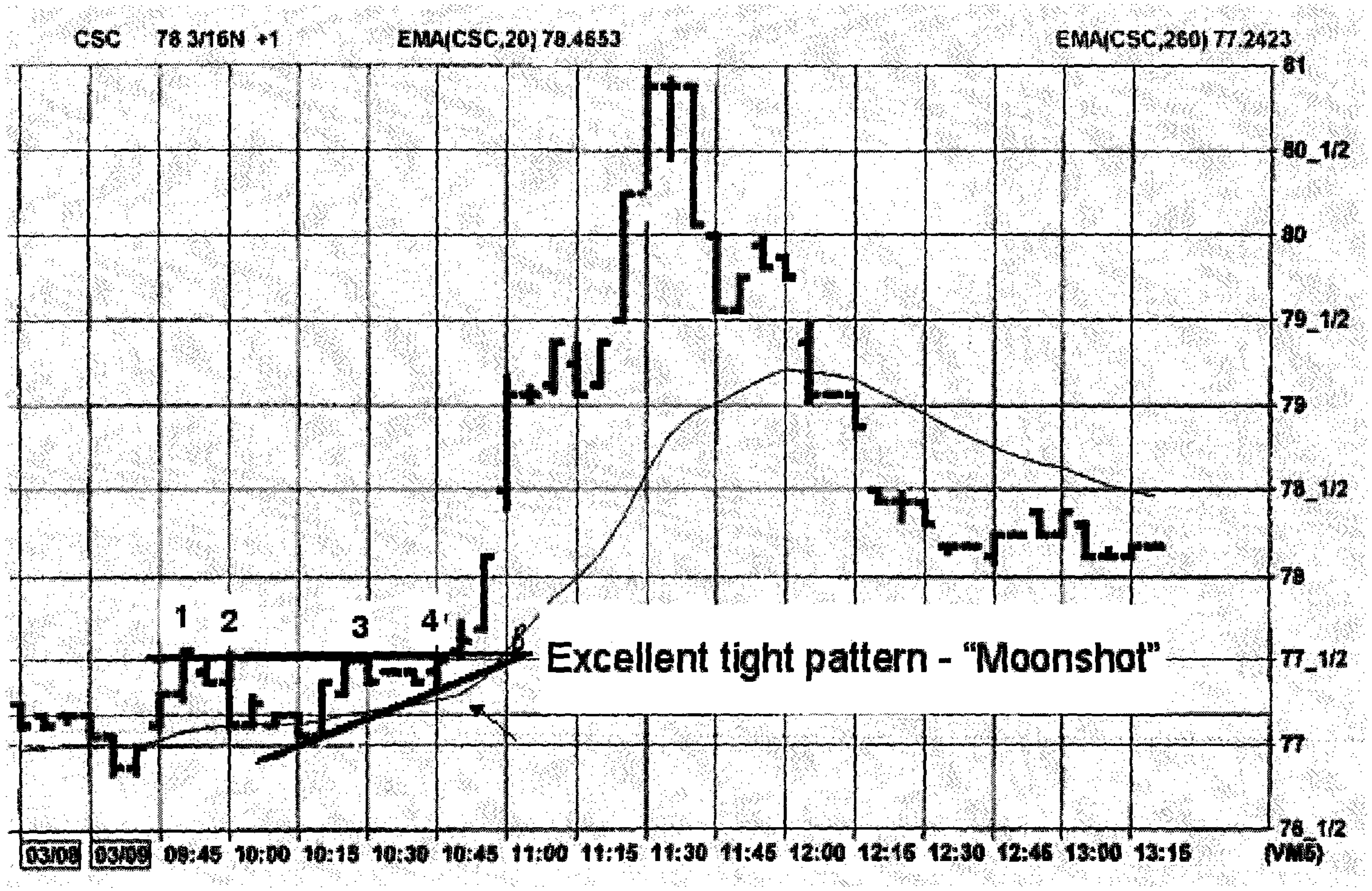
First Consolidation Breakouts To New Intraday Highs



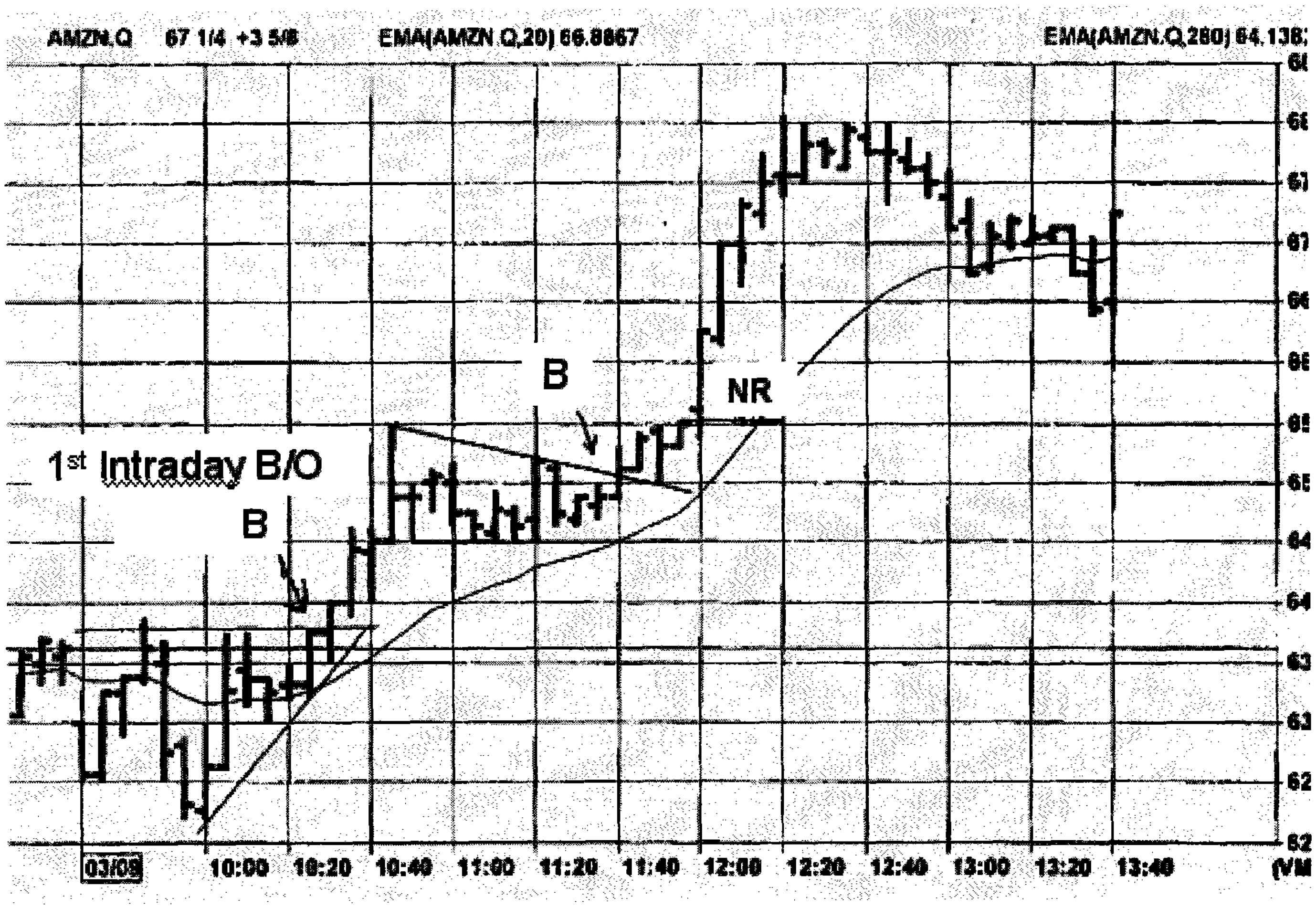
First Consolidation Breakouts To New Intraday Highs



First Consolidation Breakouts To New Intraday Highs



First Consolidation Breakouts To New Intraday Highs



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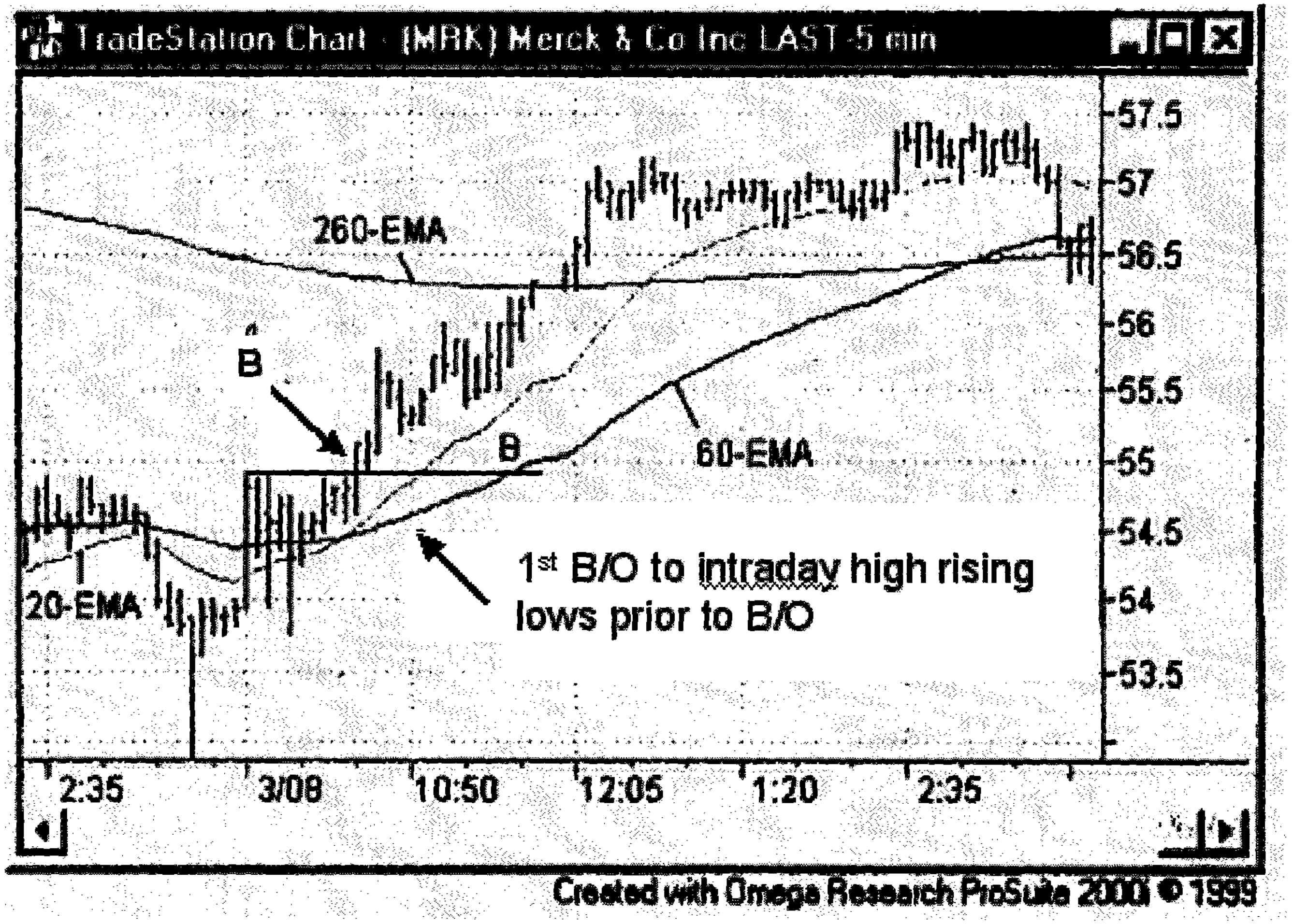
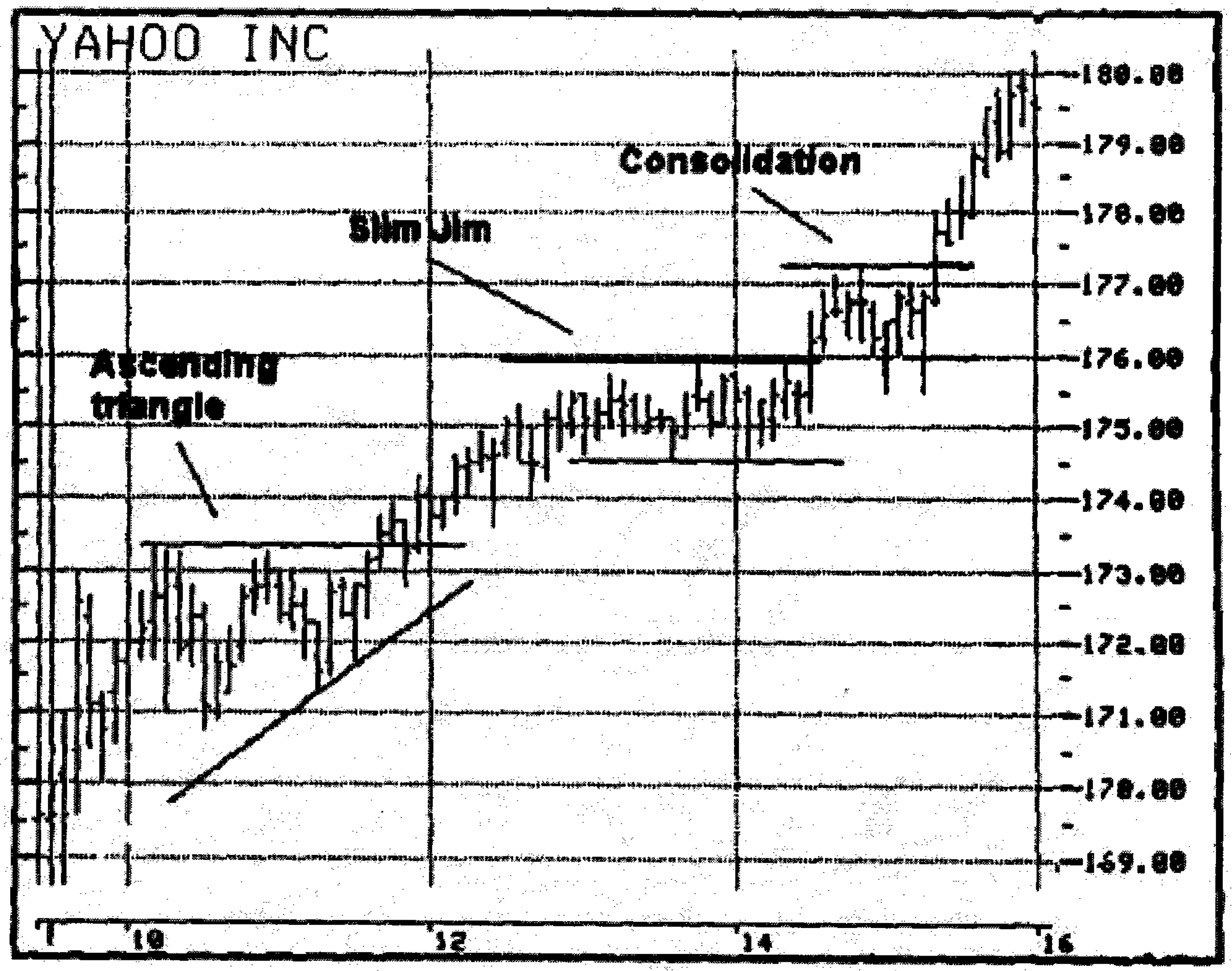


First Consolidation Breakouts To New Intraday Highs



XIII. RSTs

RSTs

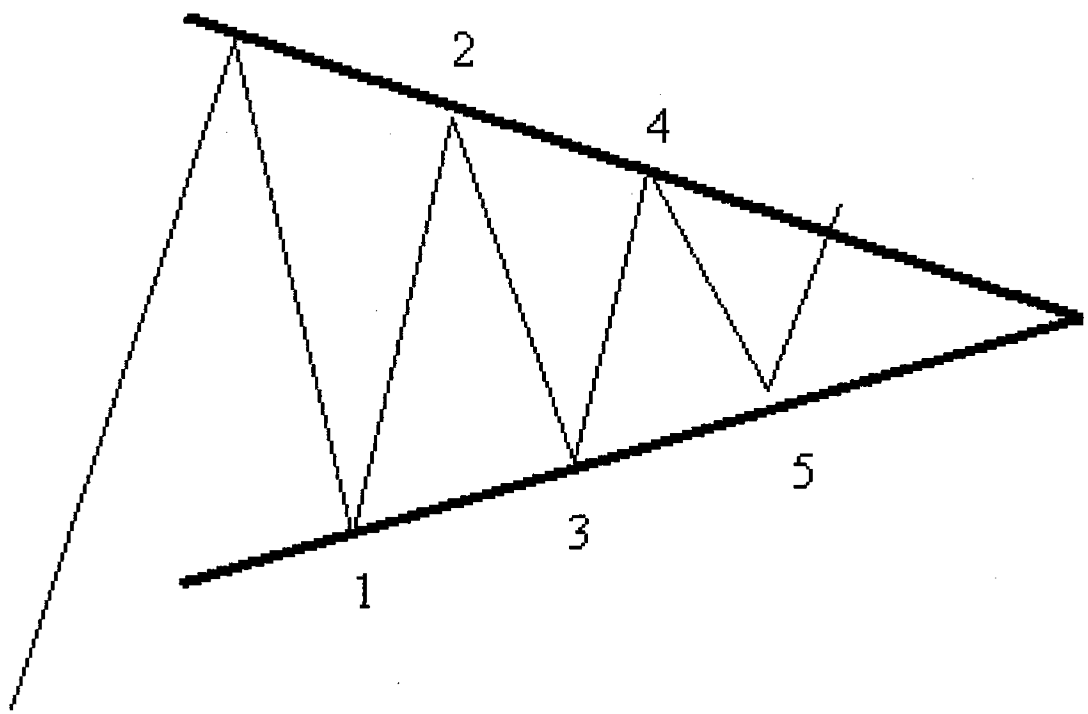
The RST is a very powerful reversal pattern that capitalizes on expanding volatility. It is named RST because when it forms, it most often resembles a Reverse Symmetrical Triangle. It is a pattern that you can trade in any time frame or any market with any vehicle.

This pattern (RST) takes advantage of expanding volatility, which by the pattern definition is ascending highs and descending lows, much the same as broadening formations. This is in contrast to the Symmetrical Triangle which has contracting volatility with lower highs (descending) and higher lows (ascending).

RSTs

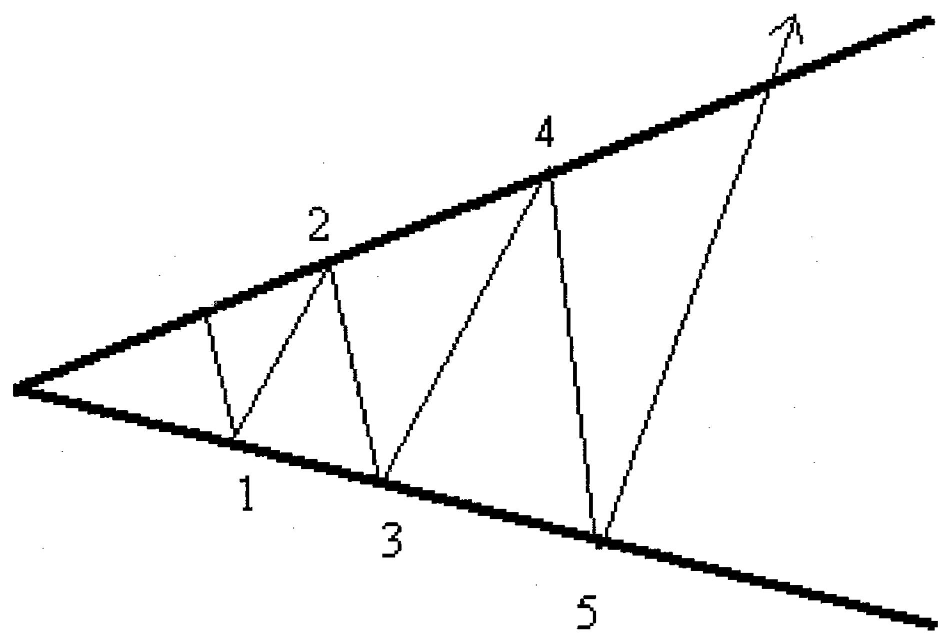
The RST, or broadening formation, are classical patterns that have existed since the markets started recording charts, but how you trade them after this seminar is what will give you a major edge. Very few traders will actually trade an expanding volatility pattern because when the best RSTs set up, it feels like you shouldn't be taking the position at that time. This is especially true when you trade the RST on an intraday basis.

RSTs



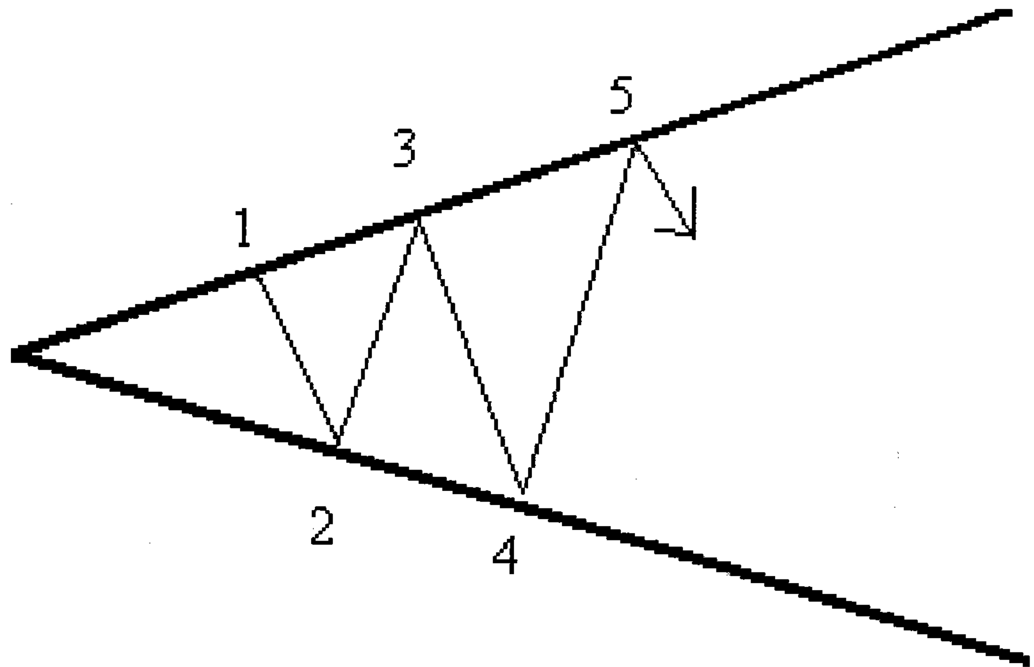
Symmetrical Triangle

RSTs



RST Buy Pattern

RSTs



RST Sell Pattern

RSTs – Swing Points

- In order to identify the pattern, you must first recognize the swing points, which outline the pattern.

Swing Points Defined:

A. Swing Point High: This is a high with a lower high on each side.

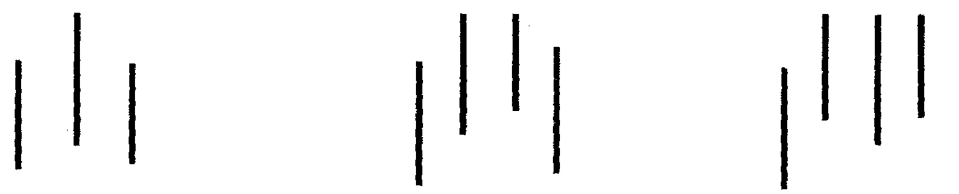
B. Swing Point Low: This is a low with a higher low on each side.

- Swing Point Highs/Lows are most often one bar, but sometimes are either two- or three-bar swing points.
- When identifying swing points, make sure to close any gaps on either side of the low/high.

RSTs – Swing Points

Swing Point Highs

1 Bar 2 Bar 3 Bar

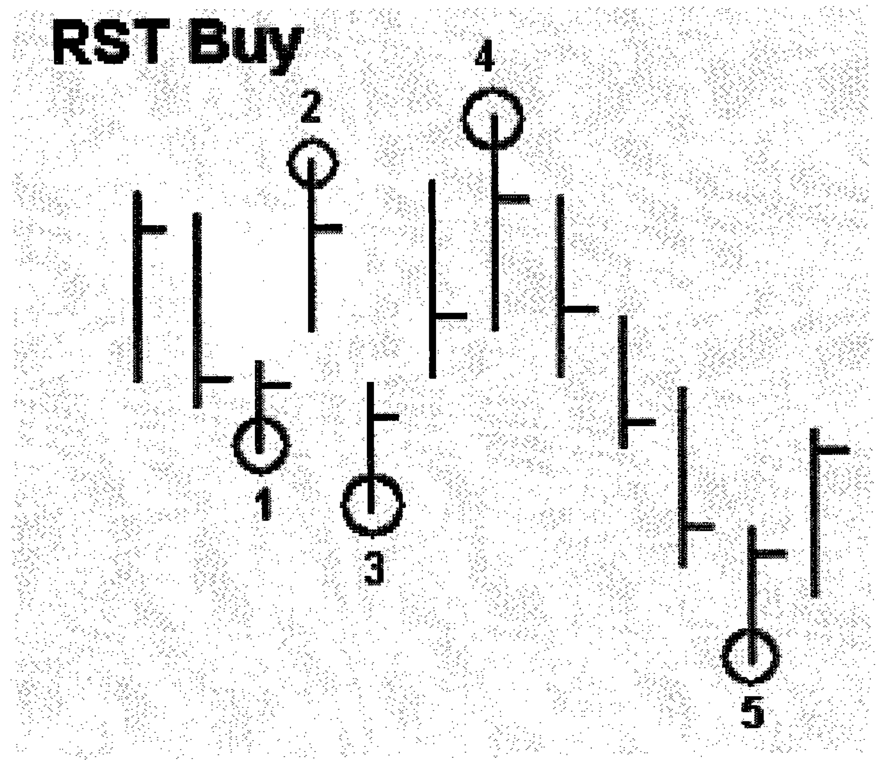


Swing Point Lows

1 Bar 2 Bar 3 Bar

RSTs – Identify the Pattern

- Start on the right hand side of your chart at the most recent high (sells) or low (buys) to locate the possible 5 point.
- After identifying the 5 point, count the swing points to the left until you can find the remaining swing points (4, 3, 2, 1).
- The minimum number of bars needed to form the pattern is seven.
- There must be ascending highs and descending lows for a valid pattern.



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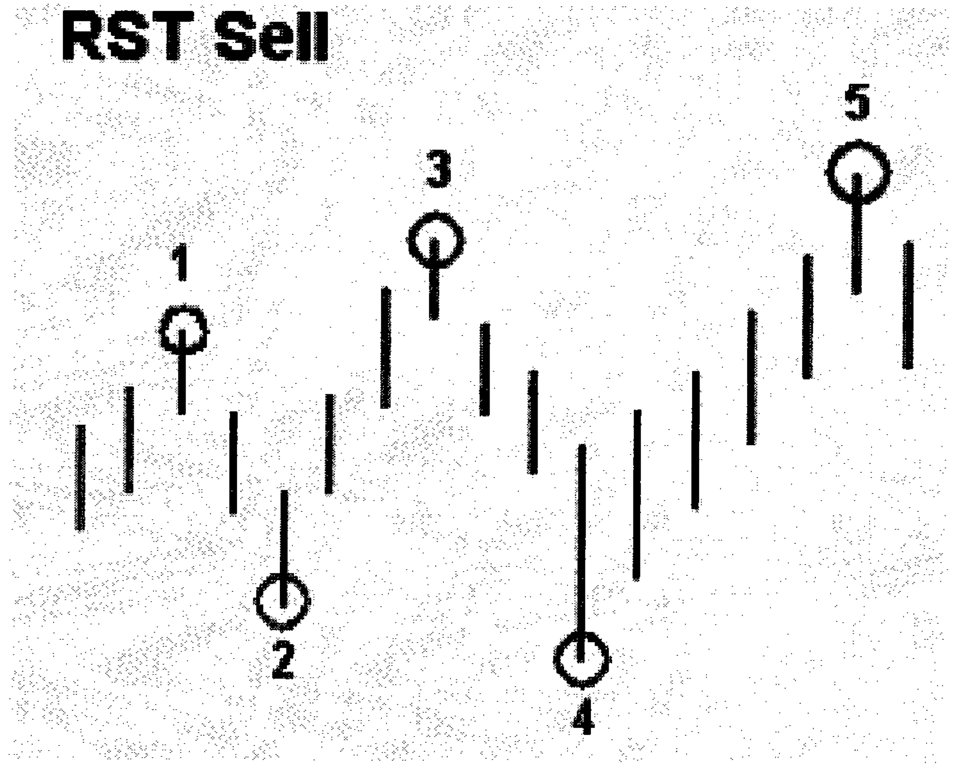
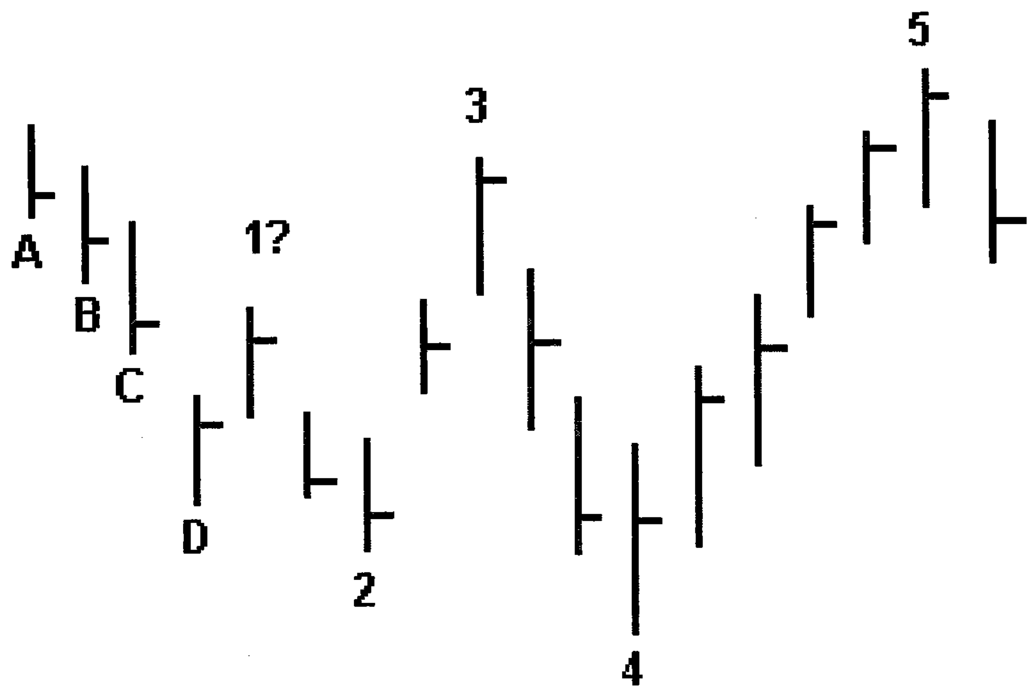


RSTs – Gap Example

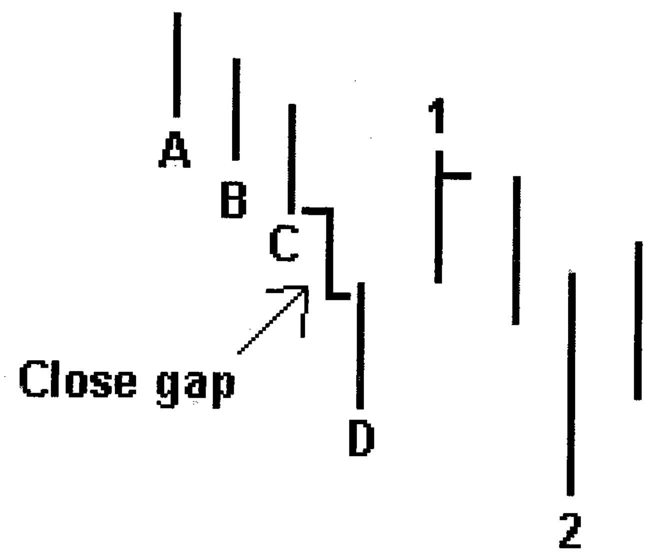
Gap Example



RSTs – Close Gap Example

Close Gap Between C & D

Not valid point if gap is closed.



RSTs

Unlike the 1,2,3 patterns (except 1,2,3 lower bottoms and higher tops) that have an initial trendline break indicating a change in direction and then an entry in that direction, the RST entry is as close to a bottom/top that you can get in a reversal strategy. The 1,2,3 lower bottoms and higher tops patterns are similar, and in fact, are often 1,2,3s in addition to RSTs, which are great risk/reward trades with a very high probability.

RSTs

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RSTs

You will excel because the RSTs that you take will have a confluence of the following “tools” that make the pattern explosive.

1. Fibonacci retracements
2. Fibonacci extensions
3. Fibonacci pivot dates by ratio and by sequence
4. Volatility bands
5. Standard deviation using various time frames
6. Moving averages in play
7. Natural square, cardinal and corner numbers
8. Pivots (monthly, weekly, daily)
9. Support and Resistance

The “tools” are explained in a separate section which will be an excellent reference for you and will be the backbone of your trade preparation going forward.

RSTs

<u>Key Point</u>: You should use the daily charts when searching for position RSTs. They will be found after substantial declines or advances or else around the longer-term moving averages, such as the 150- and 200-day moving averages. RSTs that set up below a rising 150- or 200-day moving average are very high-probability trades.

RSTs – Entry Guidelines

After some practice, you will get substantially better at identifying the pattern, and you will get started at this seminar. The entry rules are few and simple.

1. Entry for position trades is on the close above the high of the low day for buys and below the low of the high day for sells.

   Early entry for aggressive position traders would be to take an intraday setup, and if it fulfills the requirement at the close, then you would avoid getting in at the top of a wide-range bar, or bottom for a sell. Your intraday early entry would be above the high of the low day, or below the low of the high day.

2. Initial stops for position trades should be placed below or above the 5 point low or high unless it is beyond your percentage loss rule on any one trade. You would then just use a money stop.

RSTs – Entry Guidelines

3. If you are stopped out on your first entry and you get a second entry at lower levels after another swing point forms, it is all right to take it, provided the dynamics are the same, but never take more than two entries.
4. After substantial declines or advances over a longer period of time and then an RST sets up, it is best when there is a positive divergence in an indicators like a14,3,3 slow stochastic or RST (Wilder for buys), or a negative divergence for RST sell setups, such as there was at the top of the last bull market.
5. After a long steady decline or advance, you want to see one of the longer-term MAs start to flatten out or turn under for RST position buys or roll over for RST sells.

RSTs – Entry Guidelines

6. If it is a rapid decline over several months, then the RST might set up 20% or more below the longer-term MA (reverse for sells), and you will still take a trade if the RST pattern is symmetrical and one or more of the "tools" are in play. The Generals are the major players and volume is always a key element for you to observe, i.e., increasing volume and no real price decline as an RST buy pattern is setting up and rising prices on declining volume as the RST sell pattern is forming. You should also look at volume in conjunction with divergences.

7. The shorter the time that an RST sets up on apposition basis, the less divergence you will see in an indicator, but if the "tools" are in play, you can take the trade.

RSTs – Entry Guidelines

8. Expanding volatility patterns like the RST set up after emotional or substantial moves, which is the "good news – bad news" syndrome. Don't start looking for them in neutral zones where there has been no advance or decline prior to the RST setup. Just as a symmetrical triangle has contracted volatility waiting to expand and revert back to the mean, an RST has extended volatility ready to reverse direction along with price.

Key Point: If you have sufficient risk capital and are trading undervalued stocks, it is better to have several positions of smaller size rather than just one. You can have long and short RSTs on at the same time and keep rolling the portfolio as new RSTs set up.

Intraday RST Entry

I prefer to use options when taking RST position trades in individual stocks, but this is not something you should unless you are option educated and experienced. For intraday RSTs, I use the actual future or stock.

1. On an intraday basis, RSTs are found primarily at the high or low of the day to that point and in conjunction with one or more of the "tools" previously mentioned.
2. Entry is simply above the high of the swing point 5 low or below the low of the swing point 5 high bar.
3. Initial stops are below the 5 point for the RST buys or above after you take an RST sell trade.
4. The risk/reward for RSTs is excellent regardless of time period, but be ready to move your stop to breakeven after you cover your initial risk, especially on intraday trades.

Intraday RST Entry

5. The first profit objective I look for is some Fibonacci retracement to the previous swing point high after I have moved my stop to breakeven. I like to take early profit on 40% - 50% of a position and let the balance ride with a trailing stop that gives it some room. Once your risk is covered priced exceeds the amount of risk, keep a tight trailing stop ready to unload that first part of your trade because you might get lucky and get a moonshot of a reversal.
6. Regardless of how you manage the trade, it is the market that determines your action. If the dynamics change, you can exit your trade before your stop is taken out and then be ready to take an RST second entry if it sets up.
7. RSTs will often coincide with 1,2,3 higher tops and lower bottoms, which is a powerful combination when in confluence with one or more of the "tools."

Intraday RST Entry – Key Points

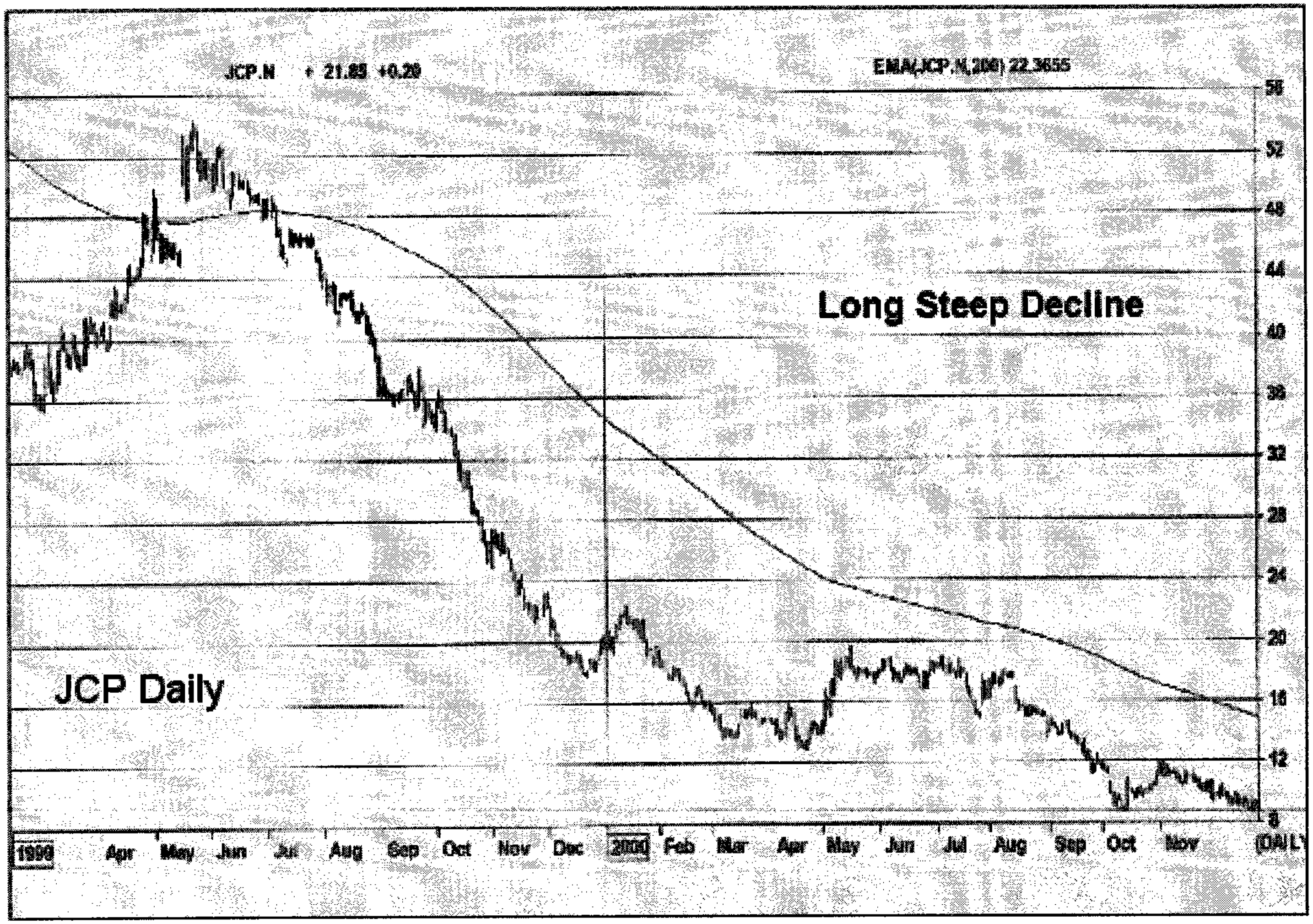
Key Point: RSTs on an intraday basis will occur most often in the futures and index proxies, in addition to big cap stocks that have a good correlation to the index or HOLDR that they are related to.

Key Point: Most all of the intraday RSTs will occur after a significant move in either direction and going contra to the move will seem like the wrong thing to do at the time. There will almost always be a daily volatility band or a Fibonacci retracement and/or extension in play, in addition to the other "tools" that will also come into play at different times.

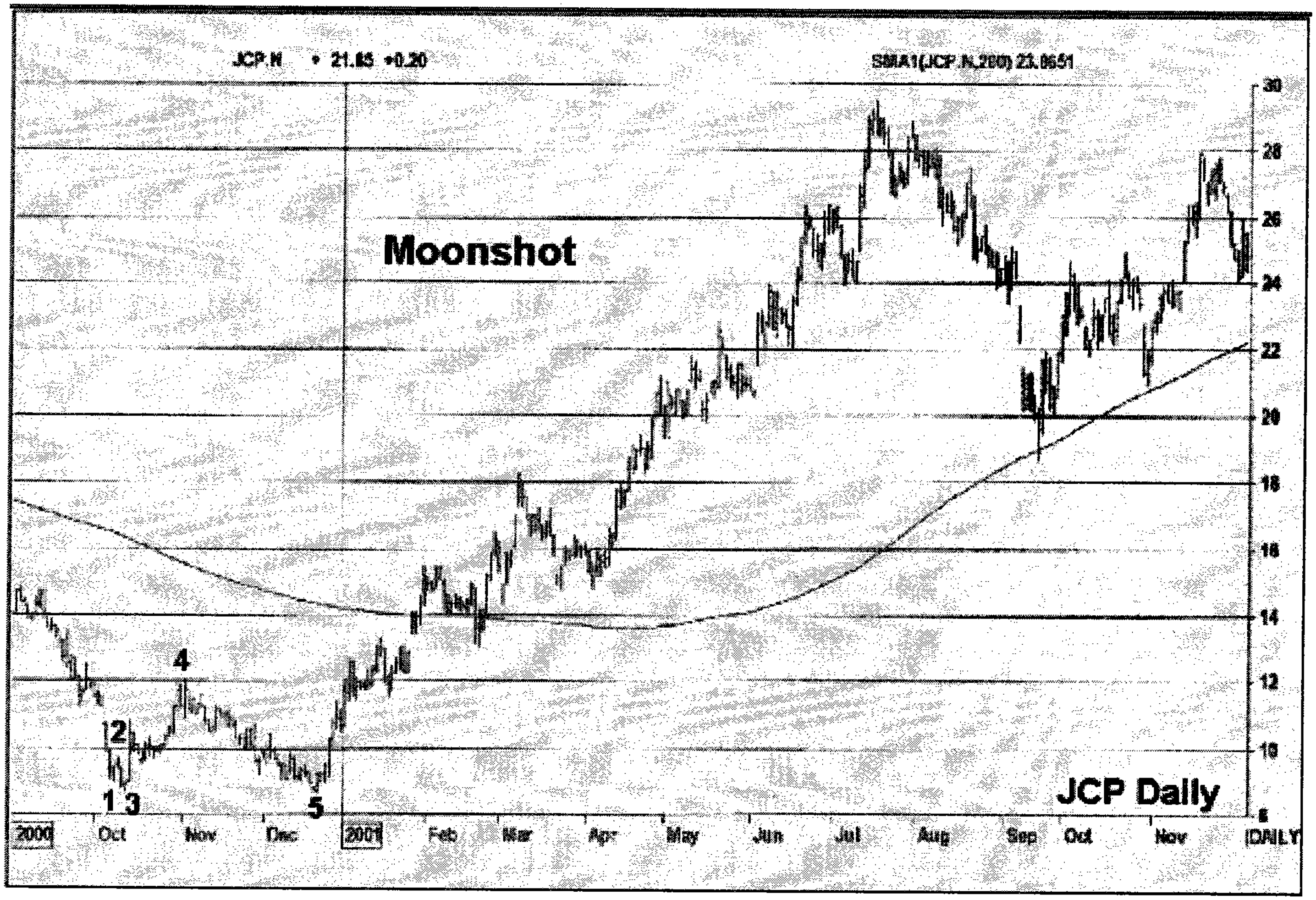
Key Point: When identifying intraday RSTs, make sure you include previous trading days' action. RSTs can and often do set up over several days or more, and not necessarily on the same day.

RST
Real World Examples

RSTs

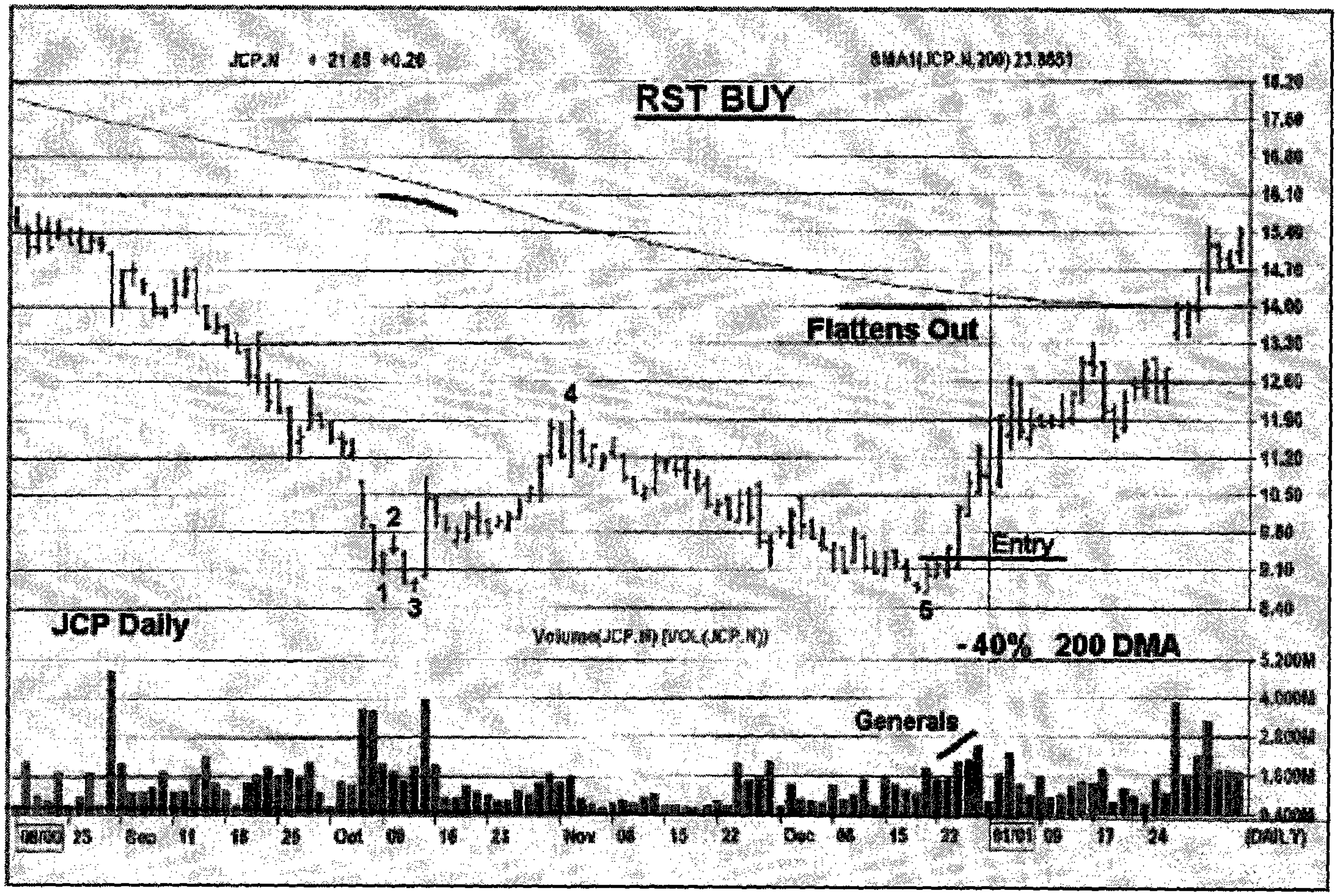

JCP.N
EMA(JCP.N,200) 22.3655
Long Steep Decline
JCP Daily
56
52
48
44
40
36
32
28
24
20
16
12
8
1999
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2000
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov

RSTs

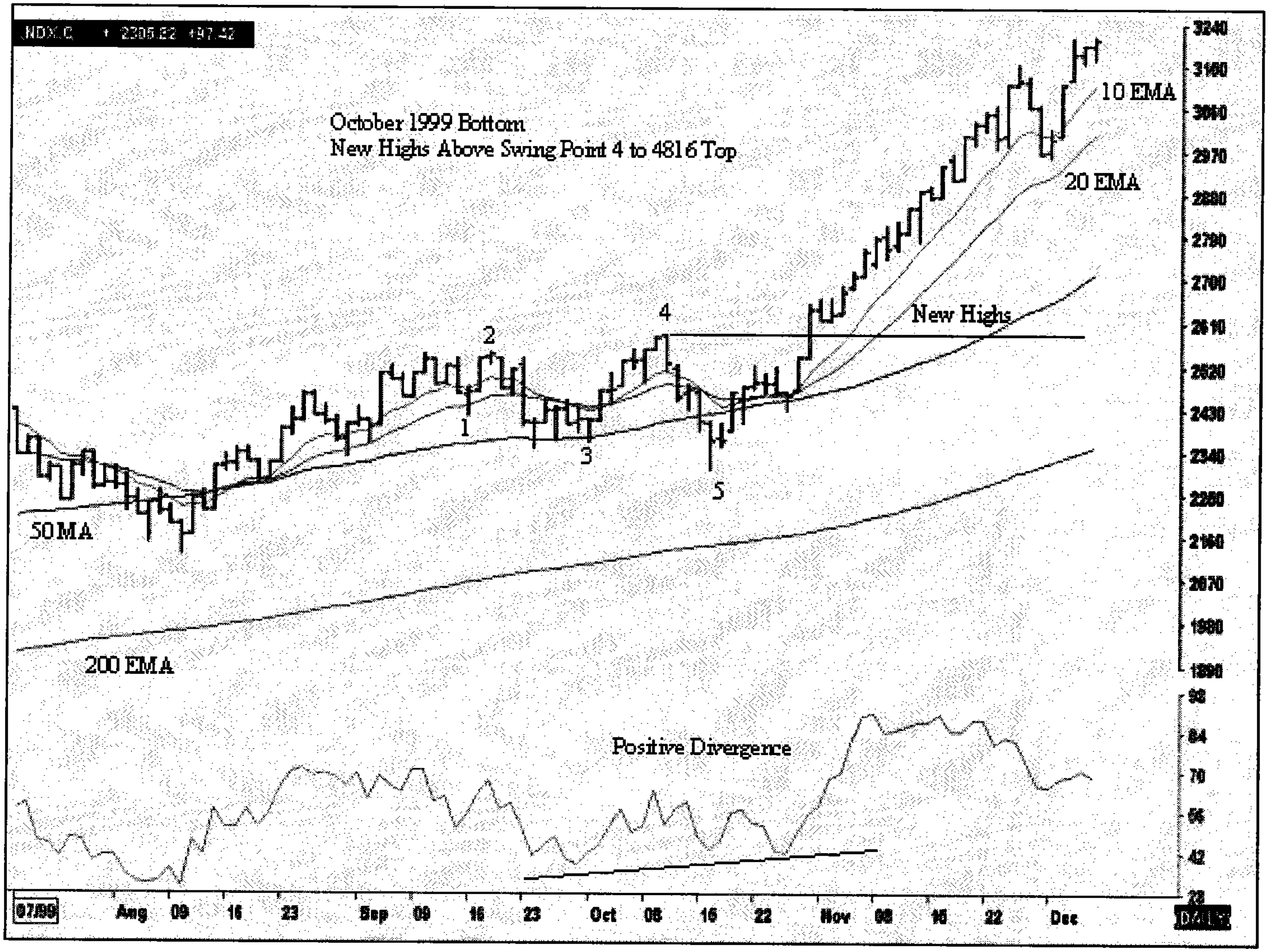


JCP.N
SMA1(JCP.N,200) 23.8651
Moonshot
JCP Daily
1
2
3
4
5
2000
Oct
Nov
Dec
2001
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
DAILY
30
28
26
24
22
20
18
16
14
12
10
8

RSTs

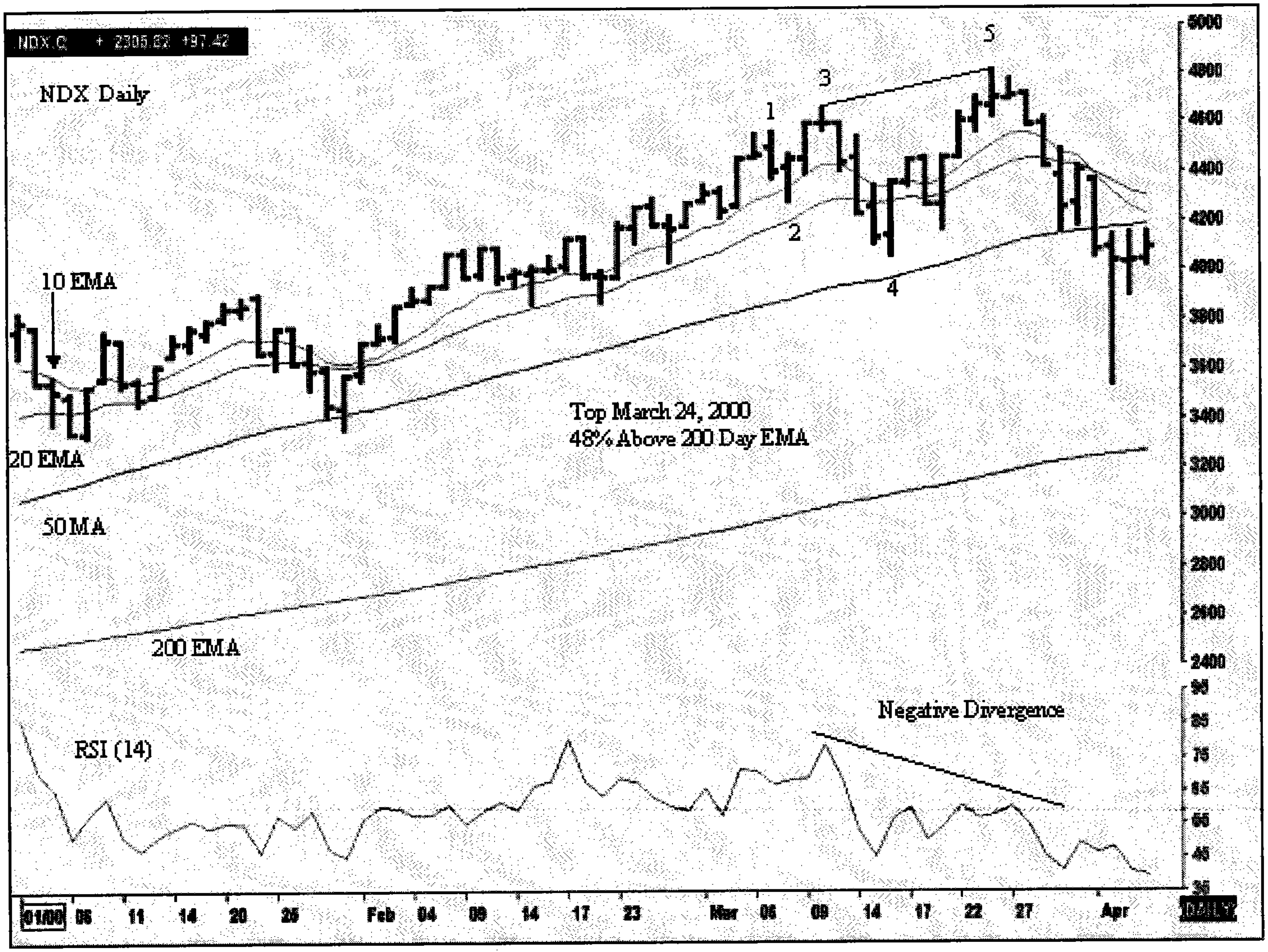

RST BUY
Flattens Out
Entry
JCP Daily
-40% 200 DMA
Generals
1
2
3
4
5

RSTs

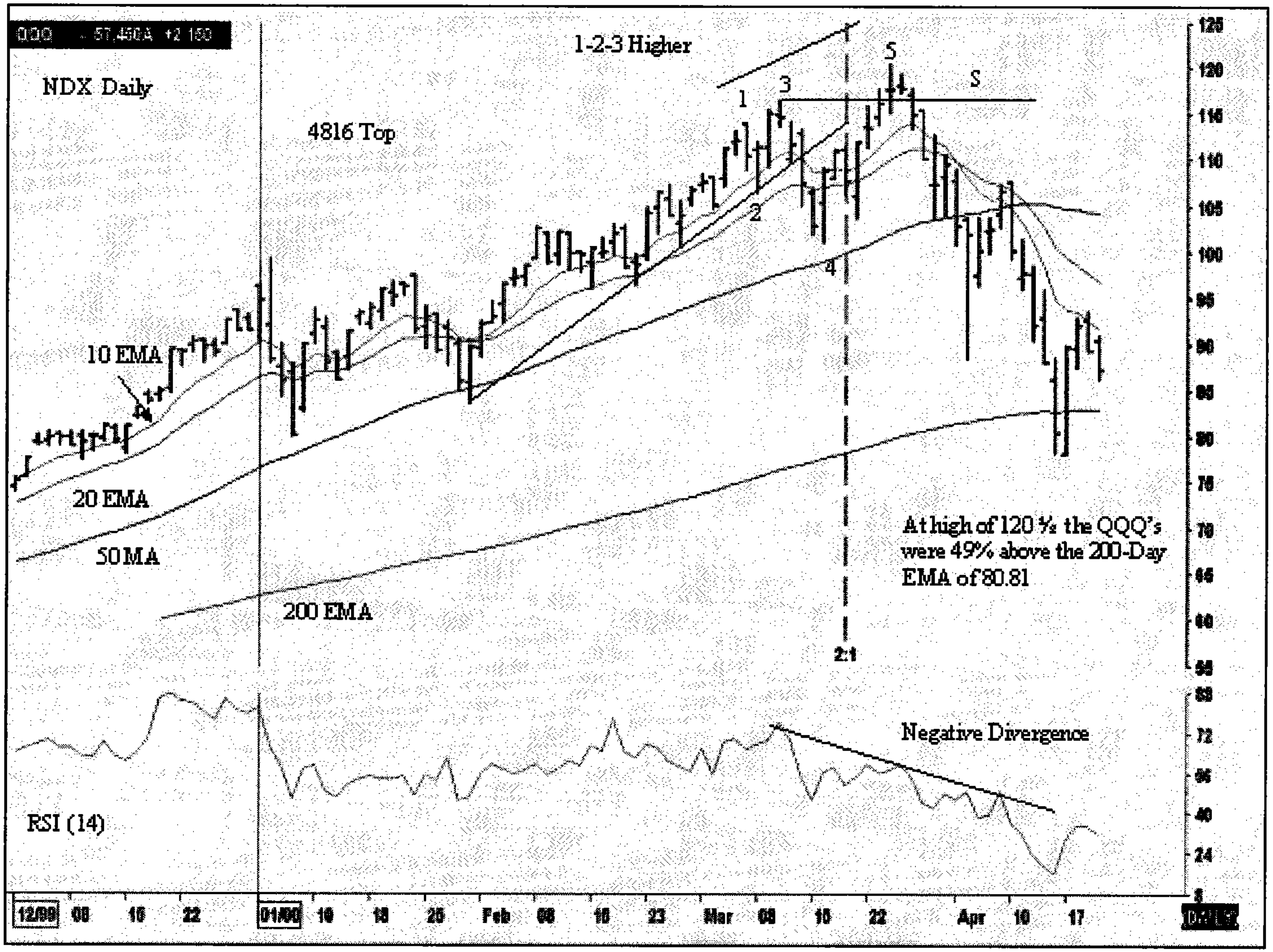


October 1999 Bottom
New Highs Above Swing Point 4 to 4816 Top
10 EMA
20 EMA
New Highs
50 MA
200 EMA
Positive Divergence
1
2
3
4
5

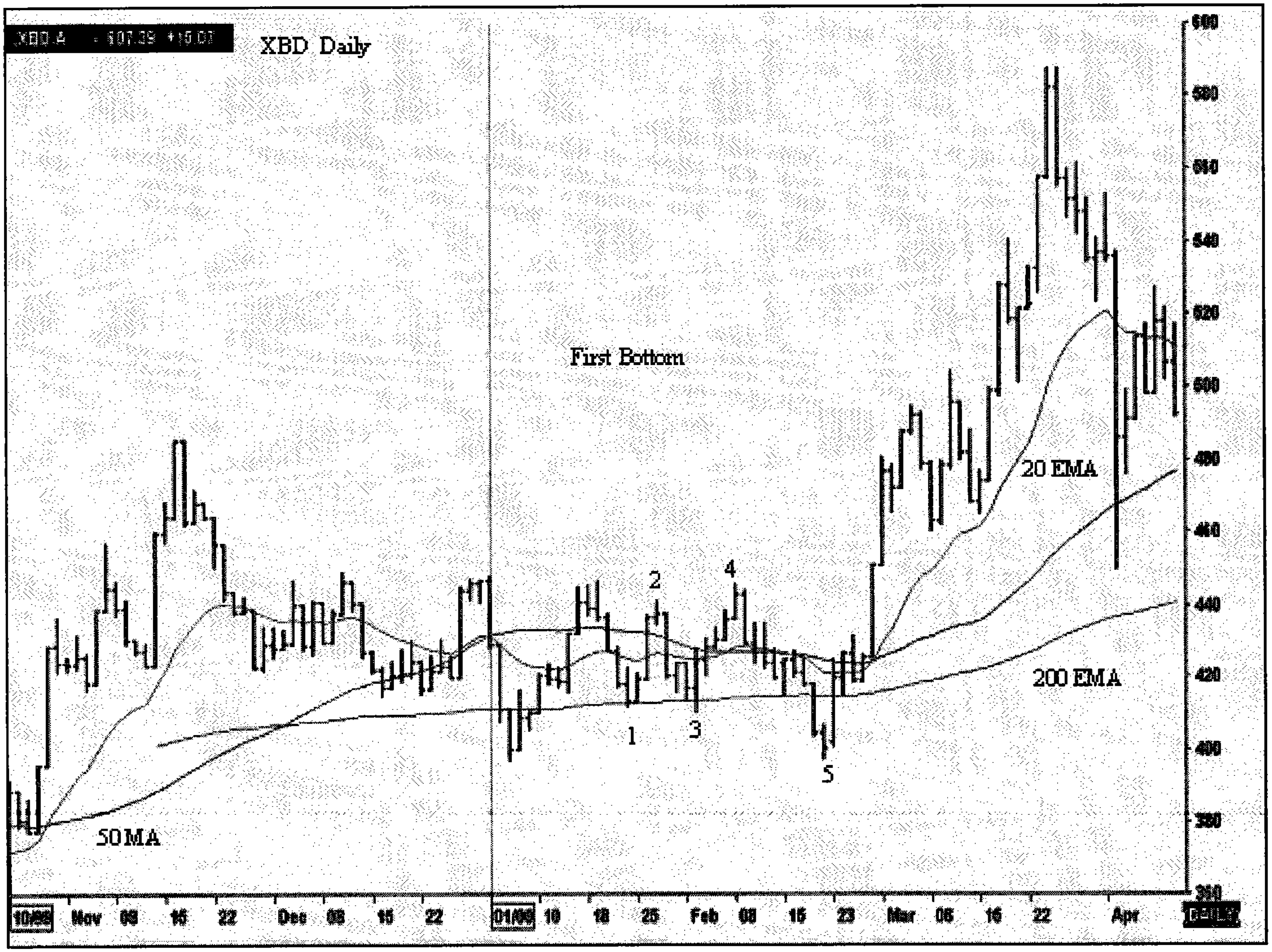
RSTs


NDX Daily
10 EMA
20 EMA
50 MA
200 EMA
Top March 24, 2000
48% Above 200 Day EMA
1
2
3
4
5
Negative Divergence
RSI (14)
5000
4800
4600
4400
4200
4000
3800
3600
3400
3200
3000
2800
2600
2400
Feb
Mar
Apr

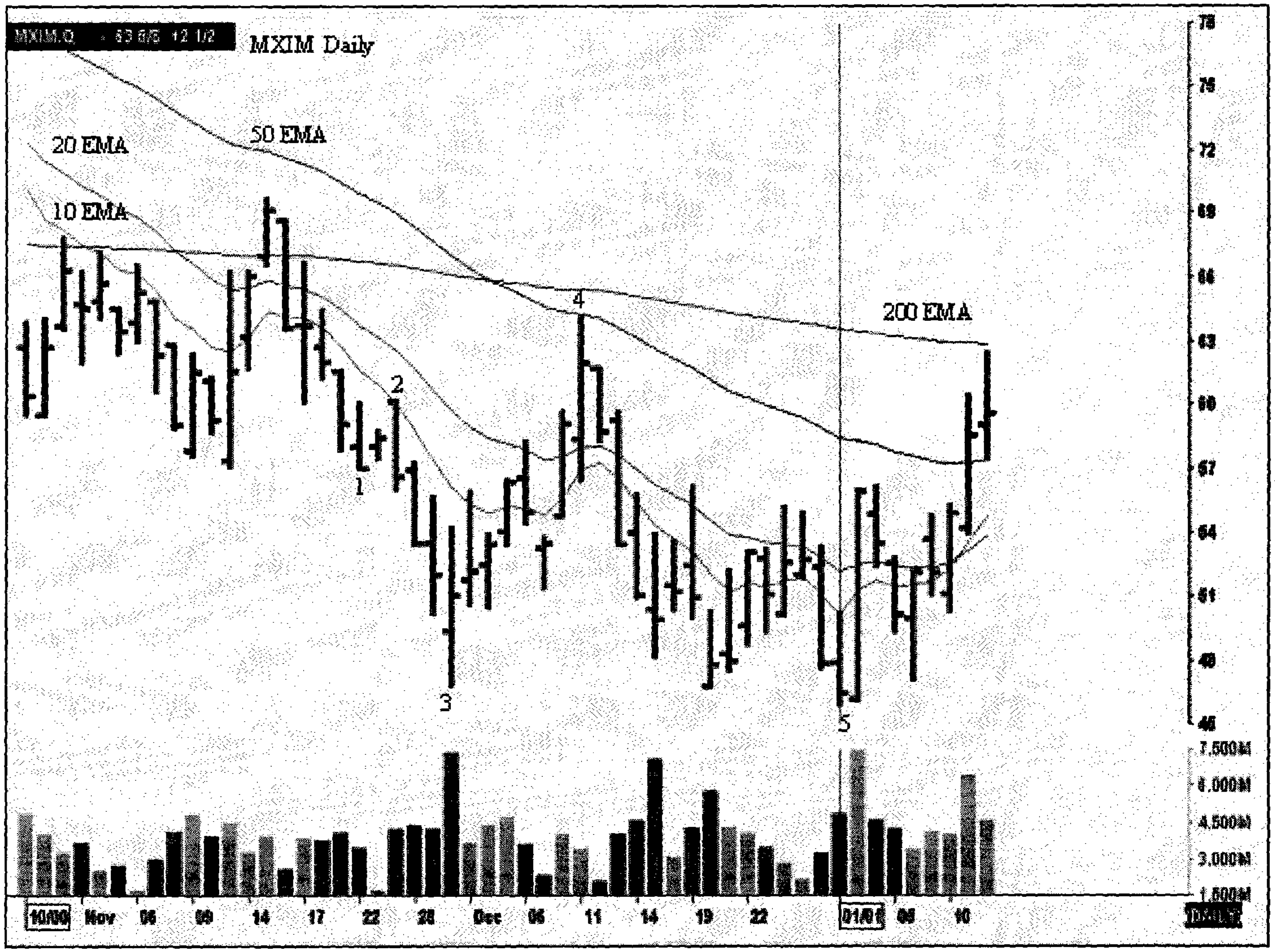
RSTs


1-2-3 Higher
NDX Daily
4816 Top
1
3
2
4
5
5
10 EMA
20 EMA
50 MA
200 EMA
2:1
At high of 120 ½ the QQQ's were 49% above the 200-Day EMA of 80.81
Negative Divergence
RSI (14)
12/99
08
16
22
01/00
10
18
25
Feb
08
16
23
Mar
08
16
22
Apr
10
17

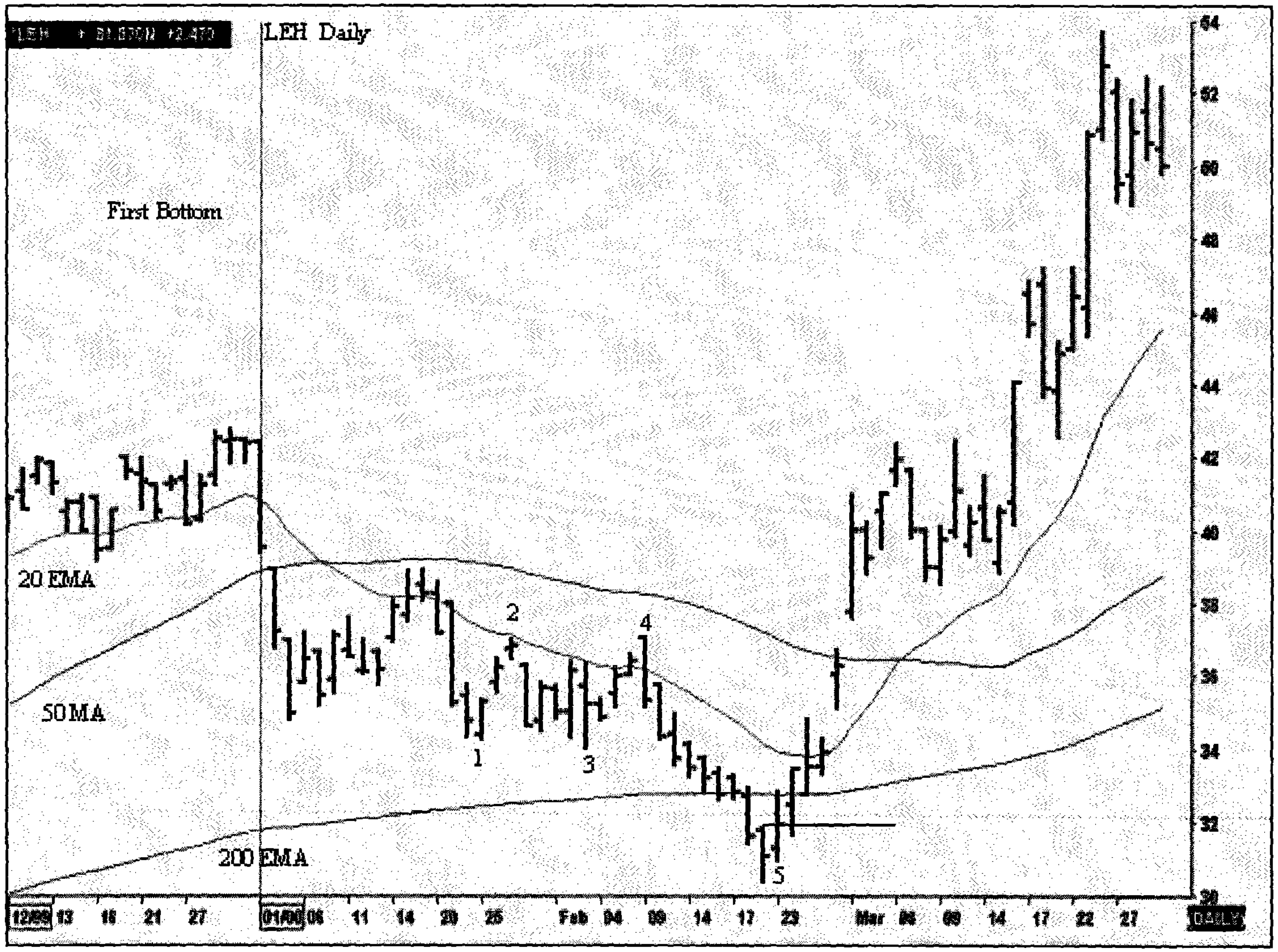
RSTs



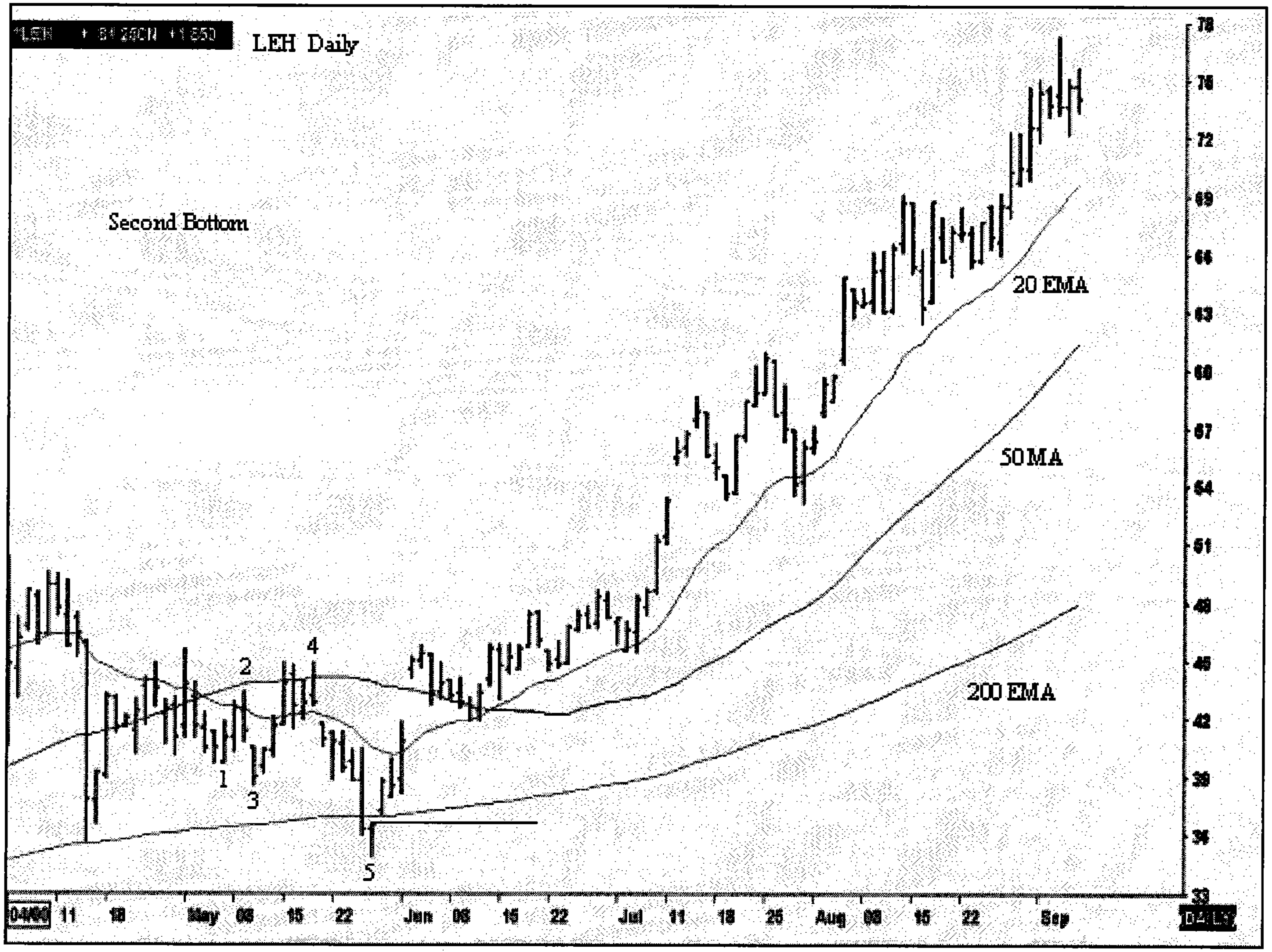
RSTs



RSTs

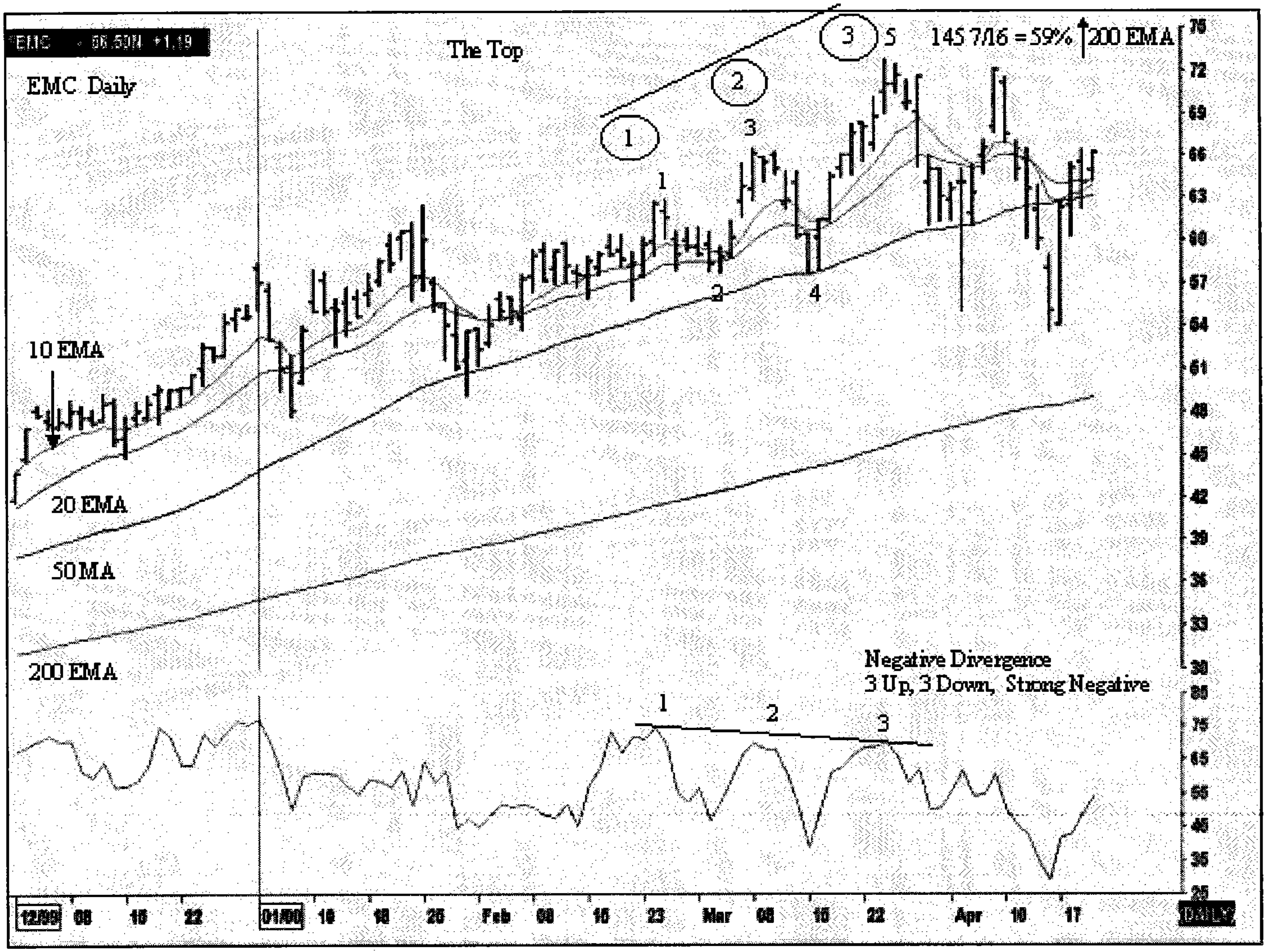


RSTs

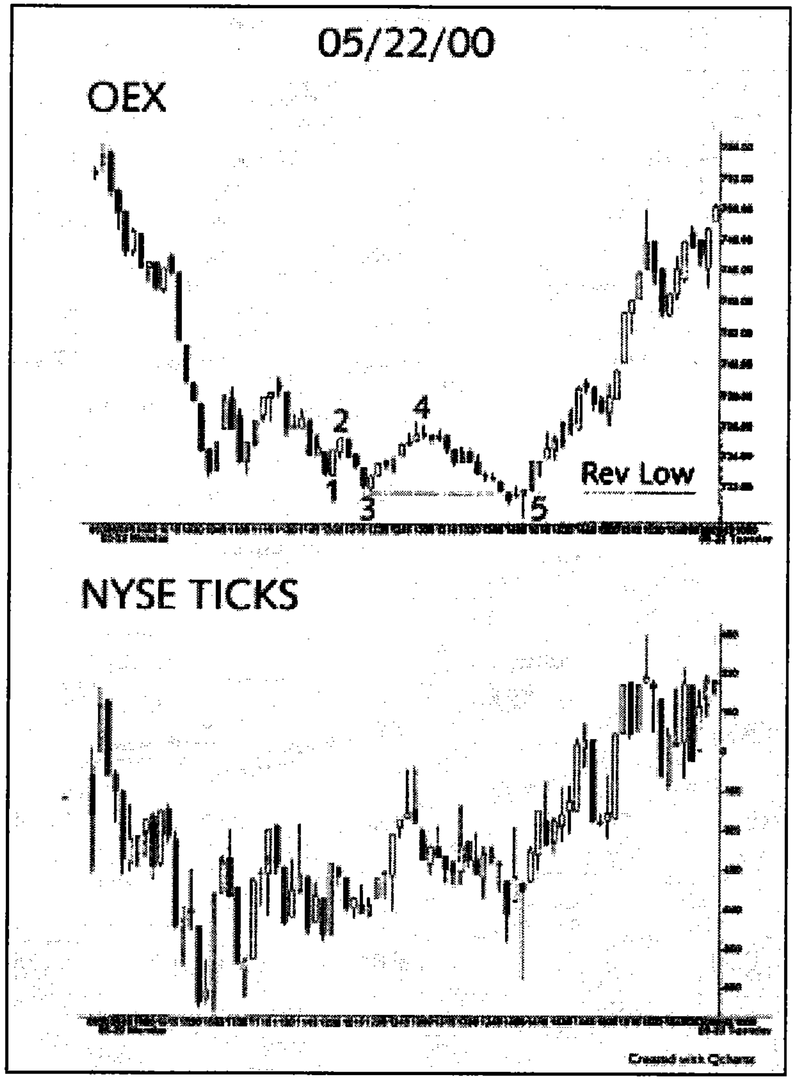


LEH Daily
Second Bottom
1
2
3
4
5
20 EMA
50 MA
200 EMA
78
75
72
69
66
63
60
57
54
51
48
45
42
39
36
33
11
18
May
08
15
22
Jun
08
15
22
Jul
11
18
25
Aug
08
15
22
Sep

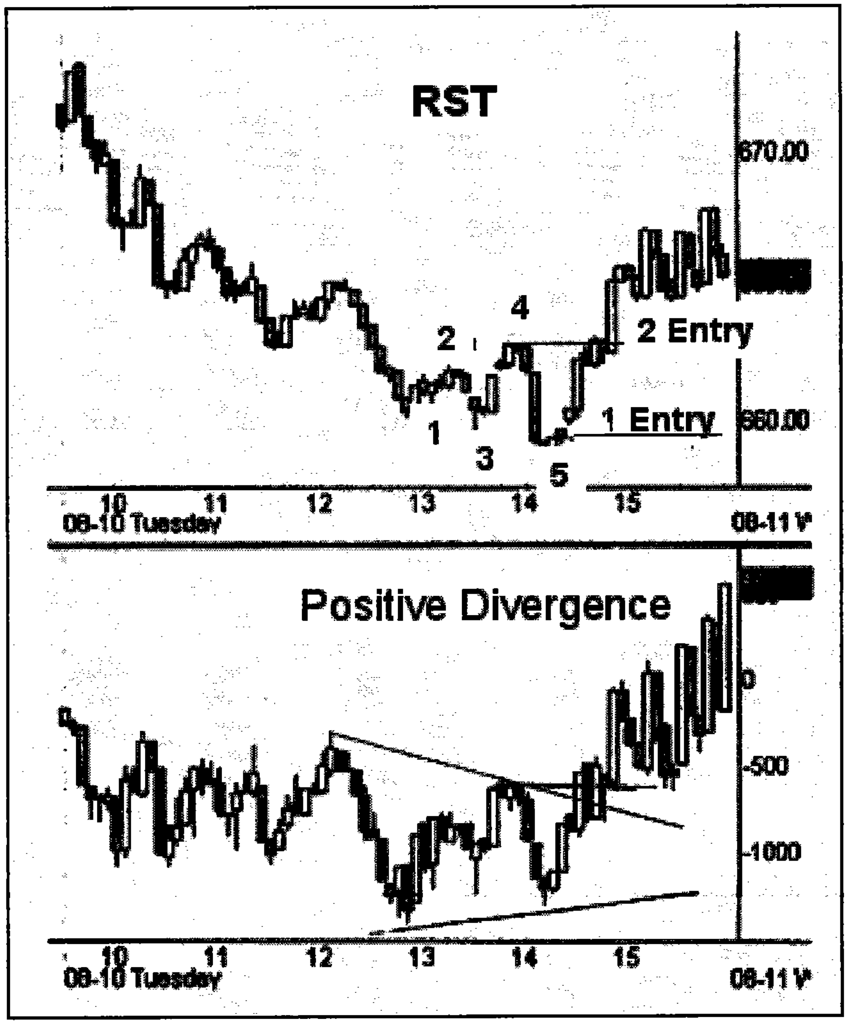
RSTs


EMC Daily
The Top
1
2
3
1
3
5
145 7/16 = 59% 200 EMA
2
4
10 EMA
20 EMA
50 MA
200 EMA
Negative Divergence
3 Up, 3 Down, Strong Negative
1
2
3
Feb
Mar
Apr

RSTs

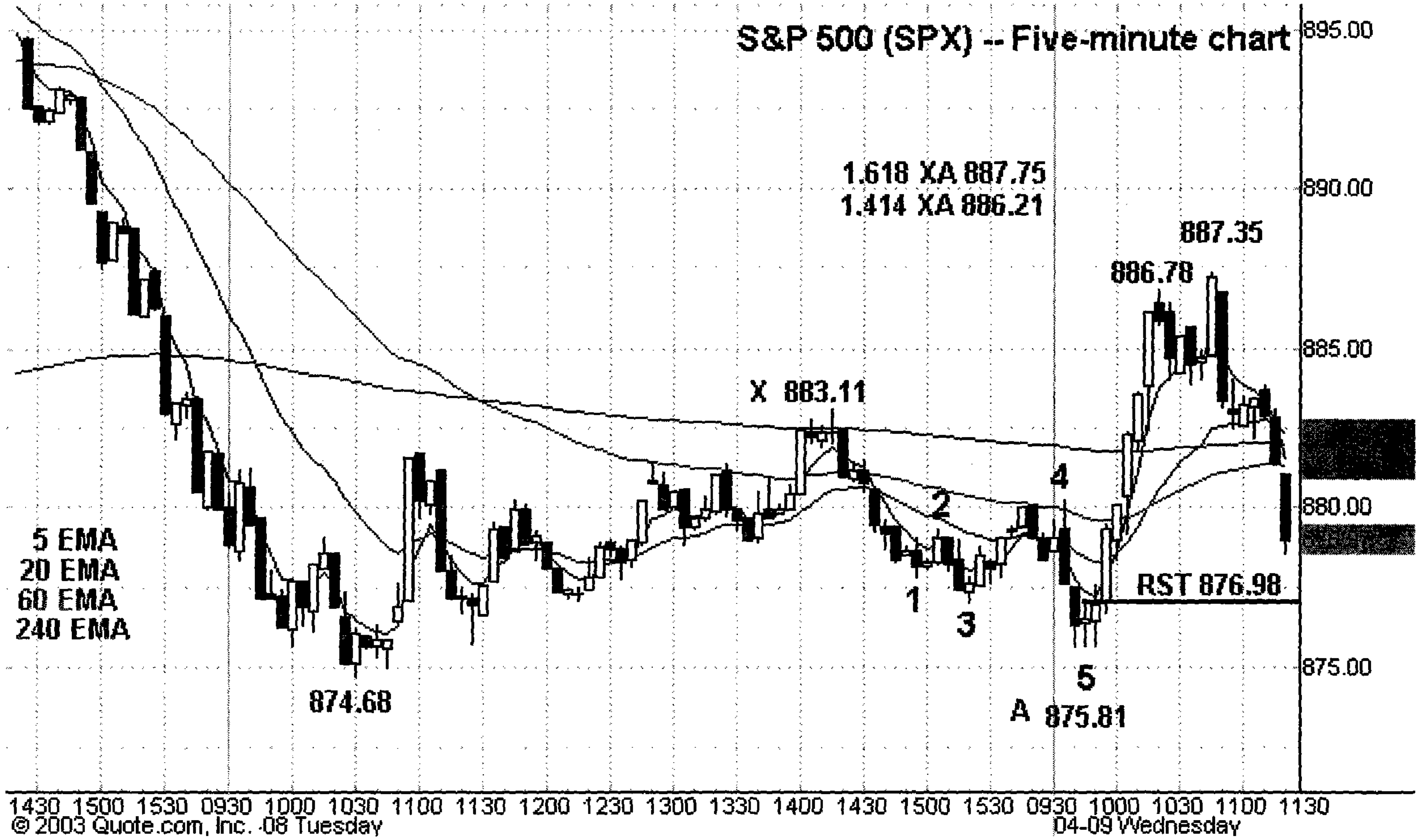


RSTs



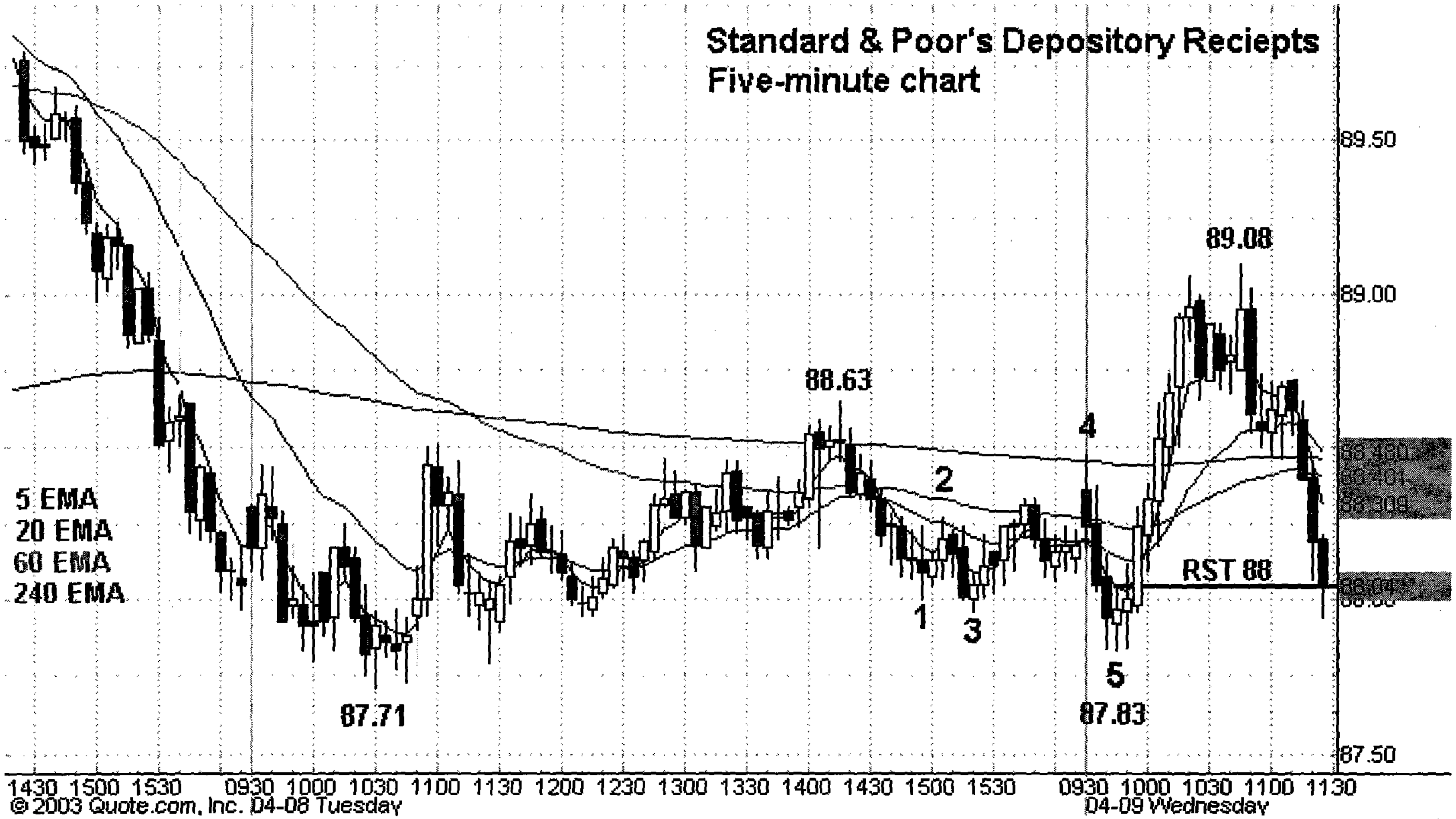
RST
670.00
4
2
2 Entry
1 Entry
660.00
1
3
5
10
11
12
13
14
15
08-10 Tuesday
08-11 W
Positive Divergence
0
-500
-1000
10
11
12
13
14
15
08-10 Tuesday
08-11 W

RSTs



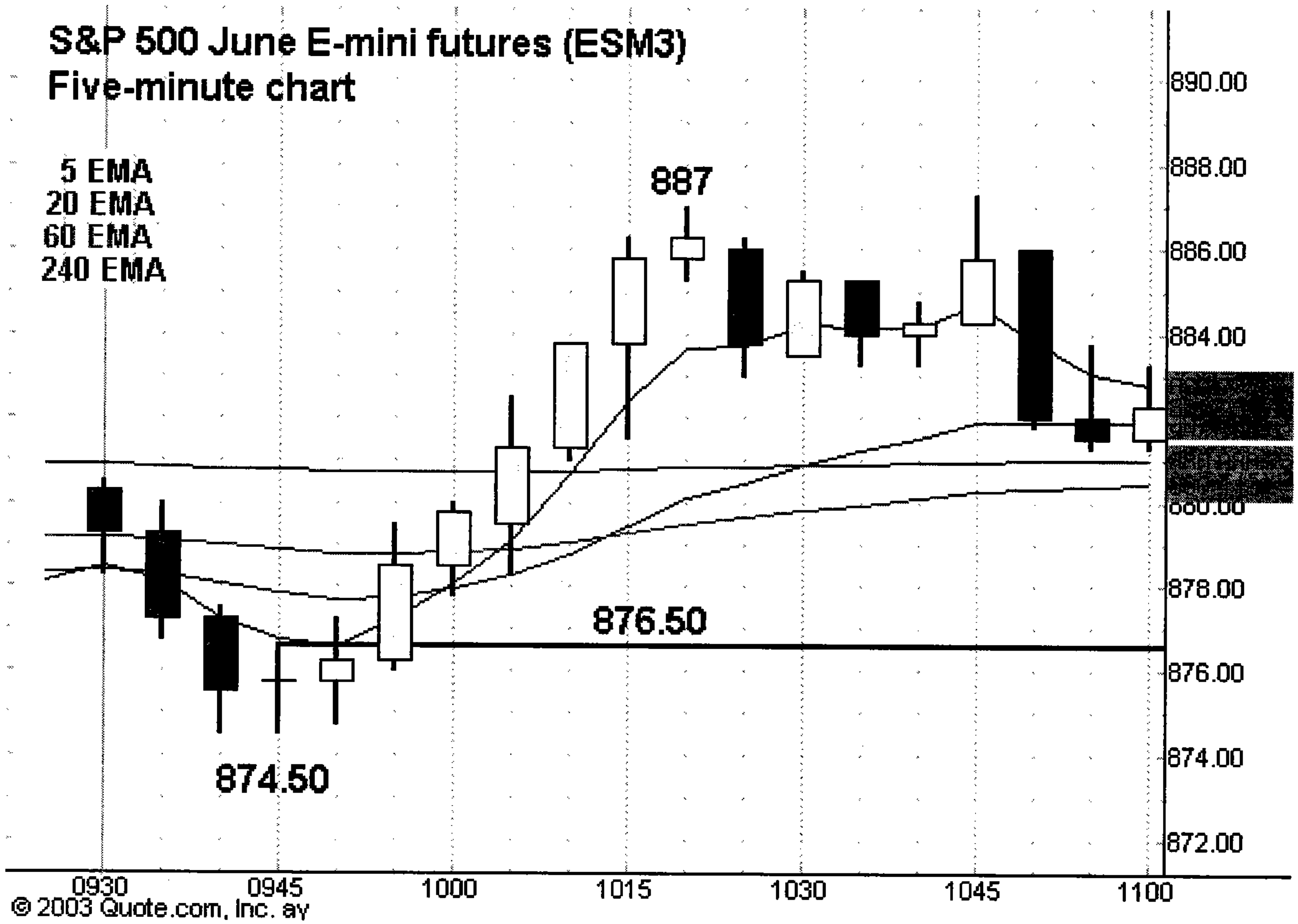
S&P 500 (SPX) -- Five-minute chart
1.618 XA 887.75
1.414 XA 886.21
887.35
886.78
X 883.11
4
2
1
3
5
A 875.81
874.68
RST 876.98
5 EMA
20 EMA
60 EMA
240 EMA
895.00
890.00
885.00
880.00
875.00
1430 1500 1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930 1000 1030 1100 1130
© 2003 Quote.com, Inc. 08 Tuesday
04-09 Wednesday

RSTs



Standard & Poor's Depository Reciepts
Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
87.71
88.63
1
2
3
4
5
87.83
89.08
RST 88
89.50
89.00
87.50
1430 1500 1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930 1000 1030 1100 1130
© 2003 Quote.com, Inc. 04-08 Tuesday
04-09 Wednesday

RSTs



S&P 500 June E-mini futures (ESM3)
Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
887
876.50
874.50
890.00
888.00
886.00
884.00
878.00
876.00
874.00
872.00
0930
0945
1000
1015
1030
1045
1100
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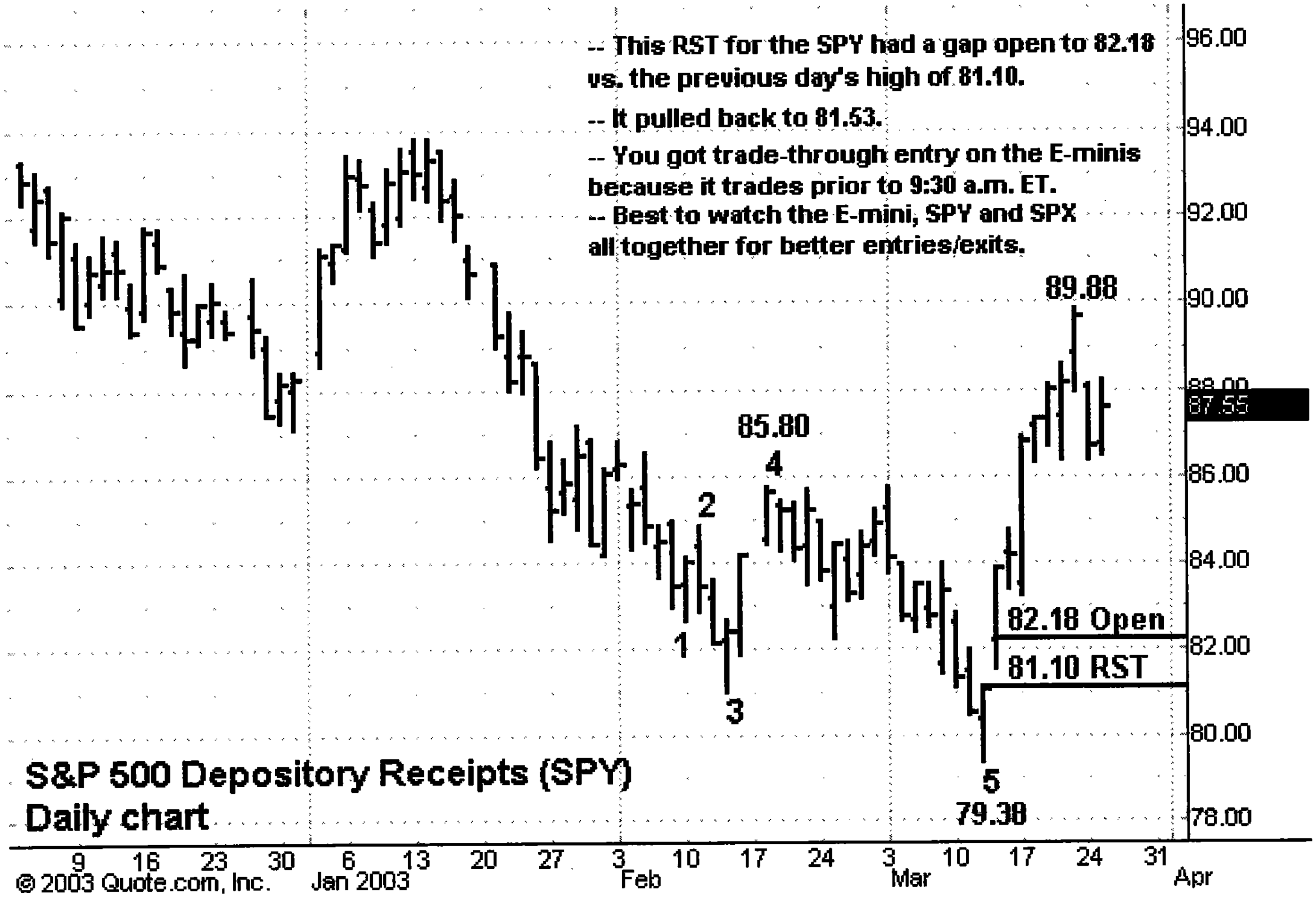
RSTs



-- This RST for the SPY had a gap open to 82.18 vs. the previous day's high of 81.10.
-- It pulled back to 81.53.
-- You got trade-through entry on the E-minis because it trades prior to 9:30 a.m. ET.
-- Best to watch the E-mini, SPY and SPX all together for better entries/exits.
89.88
85.80
4
2
1
3
5
79.38
82.18 Open
81.10 RST
S&P 500 Depository Receipts (SPY)
Daily chart
96.00
94.00
92.00
90.00
88.00
87.55
86.00
84.00
82.00
80.00
78.00
9
16
23
30
6
13
20
27
3
10
17
24
3
10
17
24
31
Jan 2003
Feb
Mar
Apr
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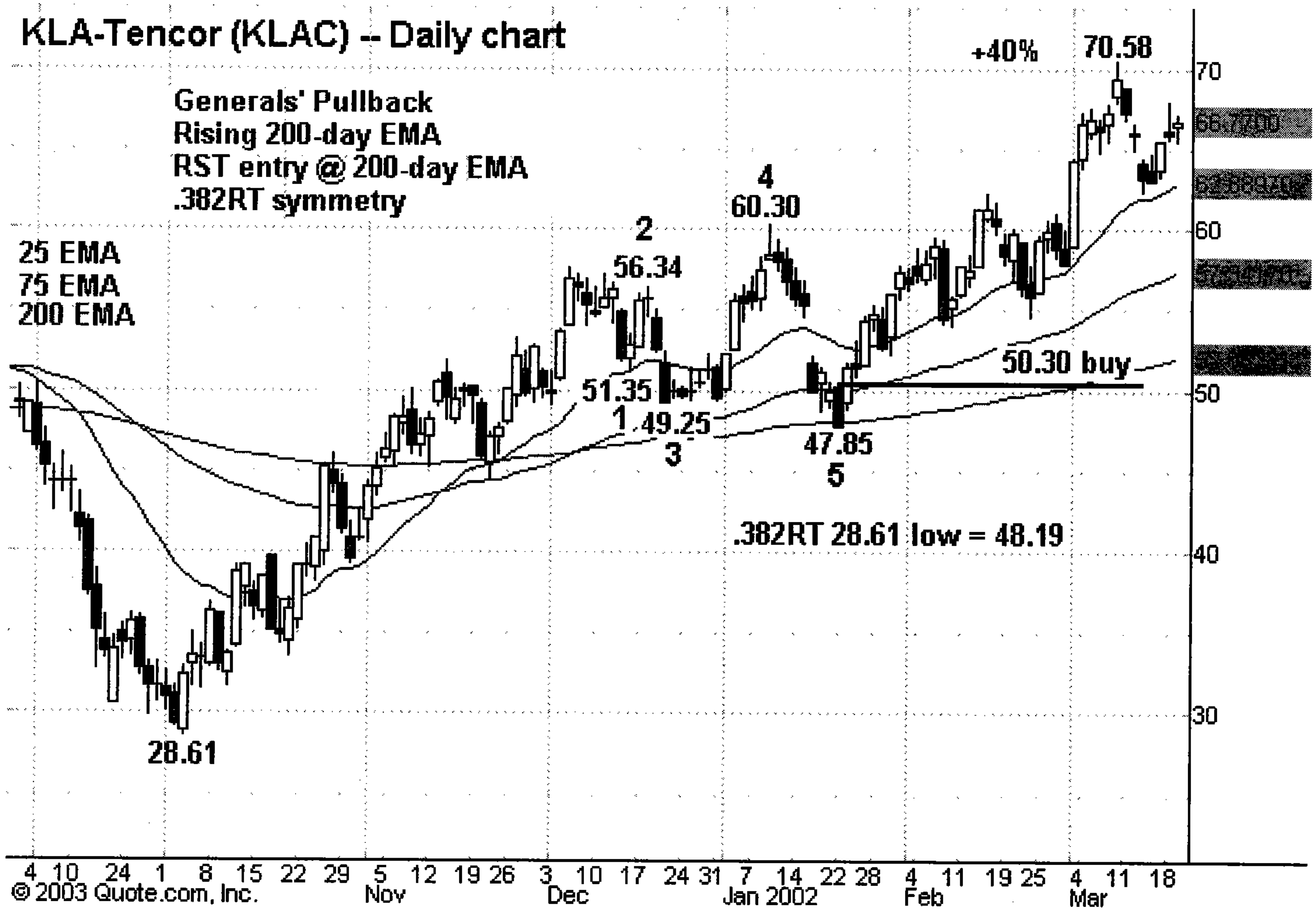
RSTs



KLA-Tencor (KLAC) -- Daily chart
Generals' Pullback
Rising 200-day EMA
RST entry @ 200-day EMA
.382RT symmetry
25 EMA
75 EMA
200 EMA
28.61
2
56.34
51.35
1 49.25
3
4
60.30
47.85
5
.382RT 28.61 low = 48.19
50.30 buy
+40%
70.58
70
60
50
40
30
4 10 24 1 8 15 22 29 5 12 19 26 3 10 17 24 31 7 14 22 28 4 11 19 25 4 11 18
Nov
Dec
Jan 2002
Feb
Mar
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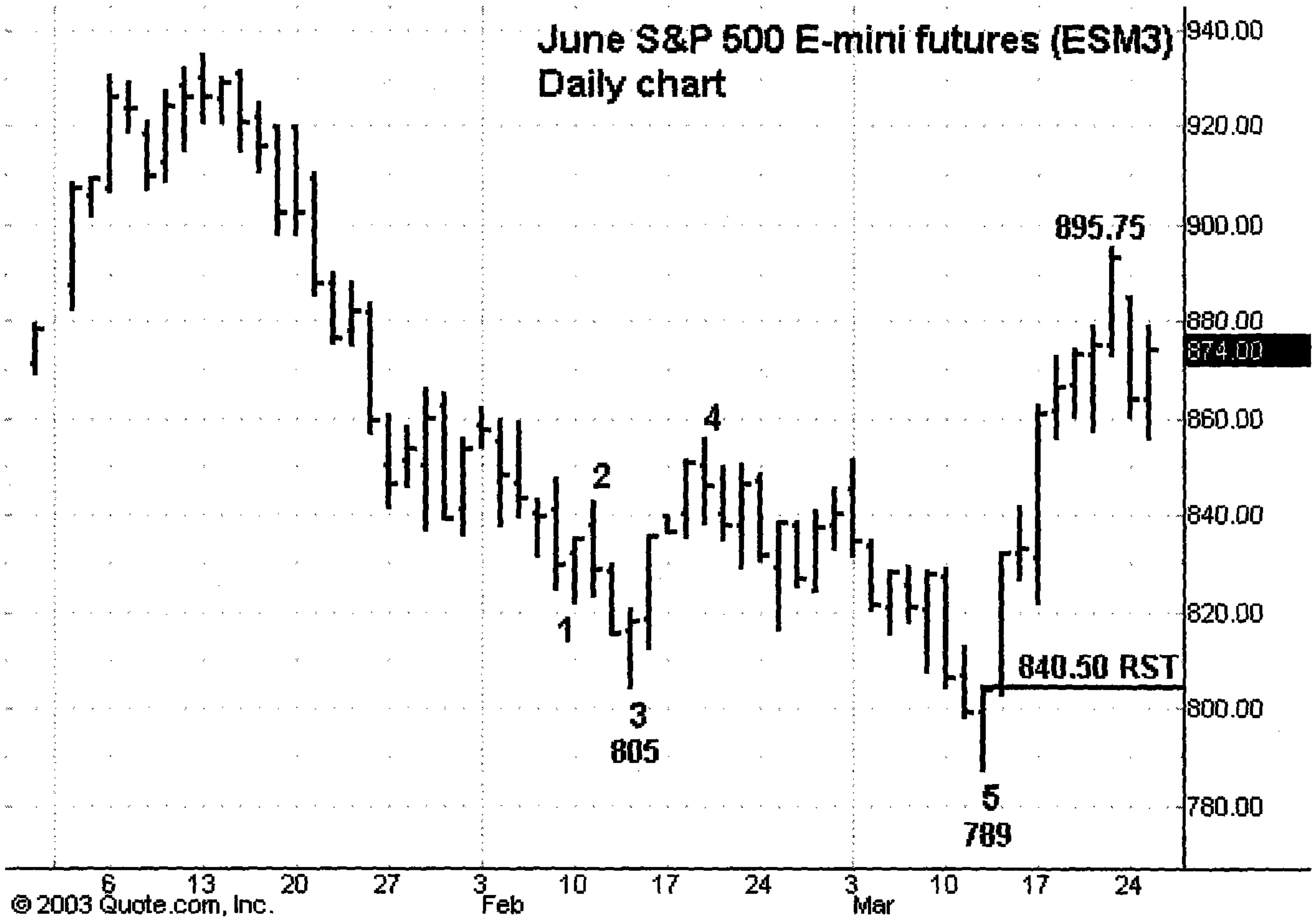
RSTs



June S&P 500 E-mini futures (ESM3)
Daily chart
895.75
840.50 RST
1
2
3
805
4
5
789
940.00
920.00
900.00
880.00
874.00
860.00
840.00
820.00
800.00
780.00
6
13
20
27
3
Feb
10
17
24
3
Mar
10
17
24
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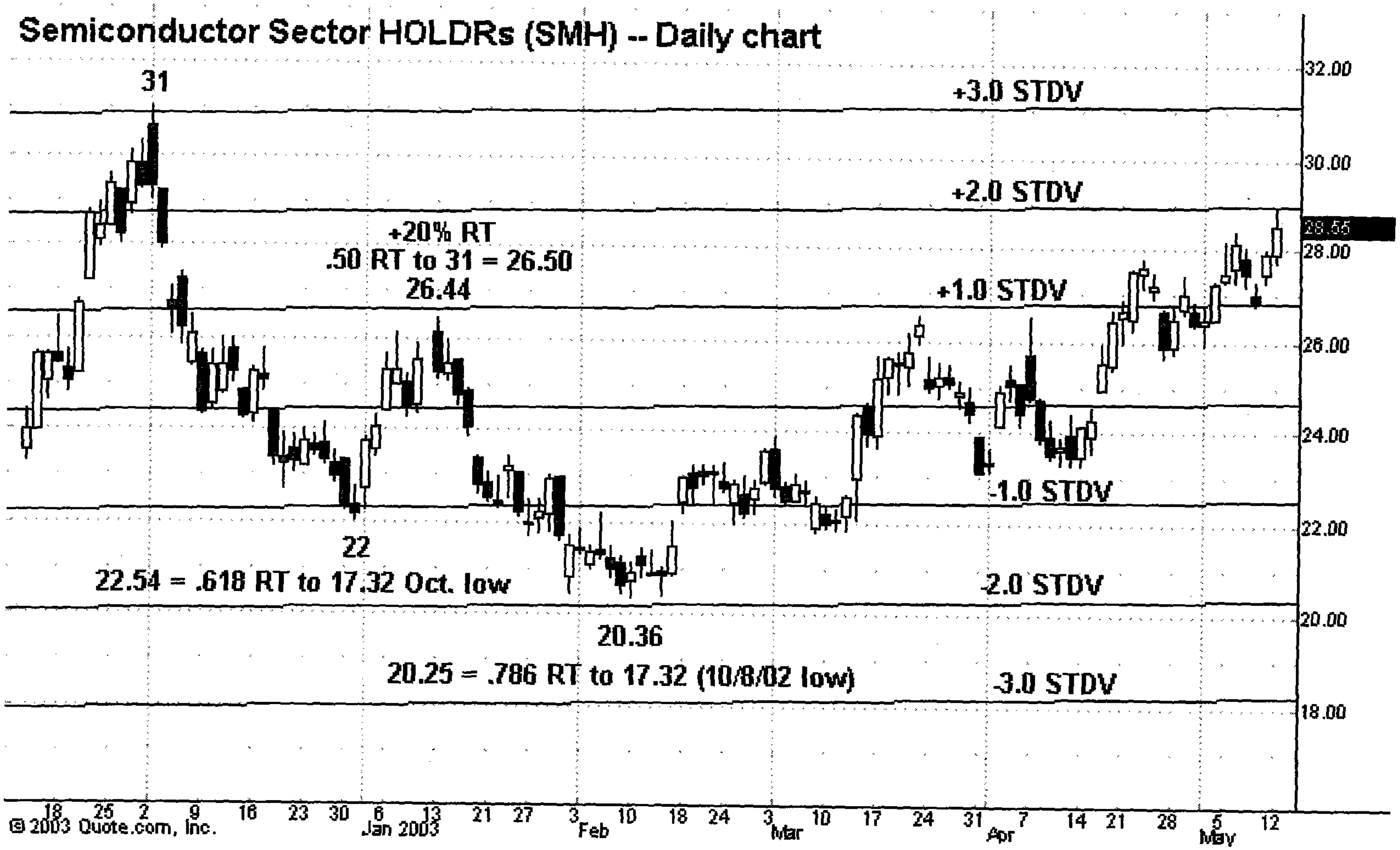
RSTs


Semiconductor Sector HOLDRs (SMH) -- Weekly chart
X
50.19
.382 RT XA = 29.88
B
31
17.32
A
20.36
.786 RT AB = 20.25
55.00
50.00
45.00
40.00
35.00
30.00
28.55
25.00
20.00
15.00
2002
© 2003 Quote.com, Inc.
Apr
Jul
Oct
2003
Jan
Apr

RSTs


Semiconductor Sector HOLDRs (SMH) -- Daily chart
31
+3.0 STDV
+2.0 STDV
+20% RT
.50 RT to 31 = 26.50
26.44
+1.0 STDV
-1.0 STDV
22
22.54 = .618 RT to 17.32 Oct. low
-2.0 STDV
20.36
20.25 = .786 RT to 17.32 (10/8/02 low)
-3.0 STDV
32.00
30.00
28.55
28.00
26.00
24.00
22.00
20.00
18.00
18 25 2 9 16 23 30 6 13 21 27 3 10 18 24 3 10 17 24 31 7 14 21 28 5 12
Jan 2003
Feb
Mar
Apr
May
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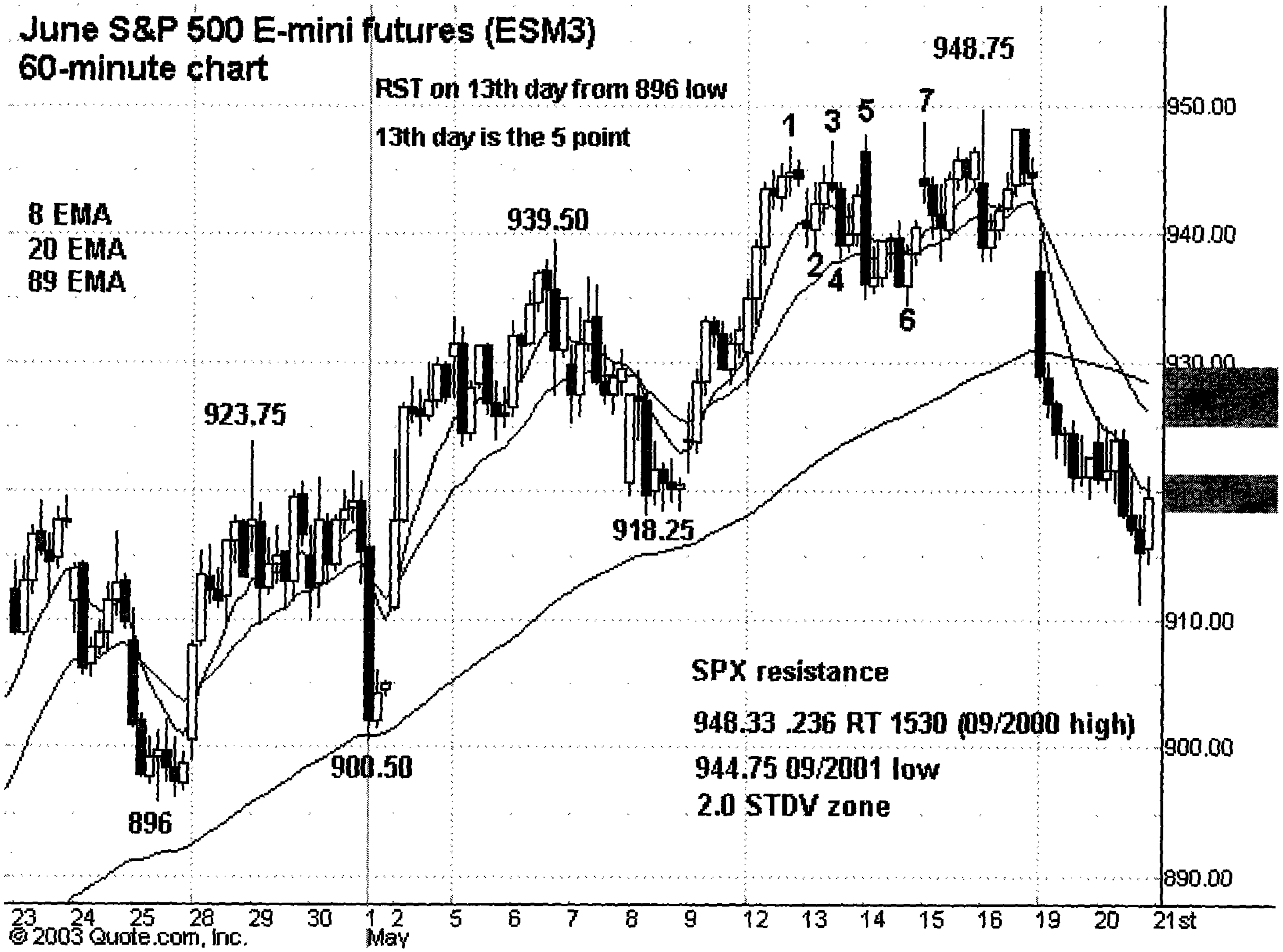
RSTs



June S&P 500 E-mini futures (ESM3)
60-minute chart
RST on 13th day from 896 low
13th day is the 5 point
8 EMA
20 EMA
89 EMA
948.75
939.50
923.75
918.25
900.50
896
1 3 5 7
2 4 6
SPX resistance
948.33 .236 RT 1530 (09/2000 high)
944.75 09/2001 low
2.0 STDV zone
950.00
940.00
930.00
910.00
900.00
890.00
23 24 25 28 29 30 1 2 5 6 7 8 9 12 13 14 15 16 19 20 21st
May
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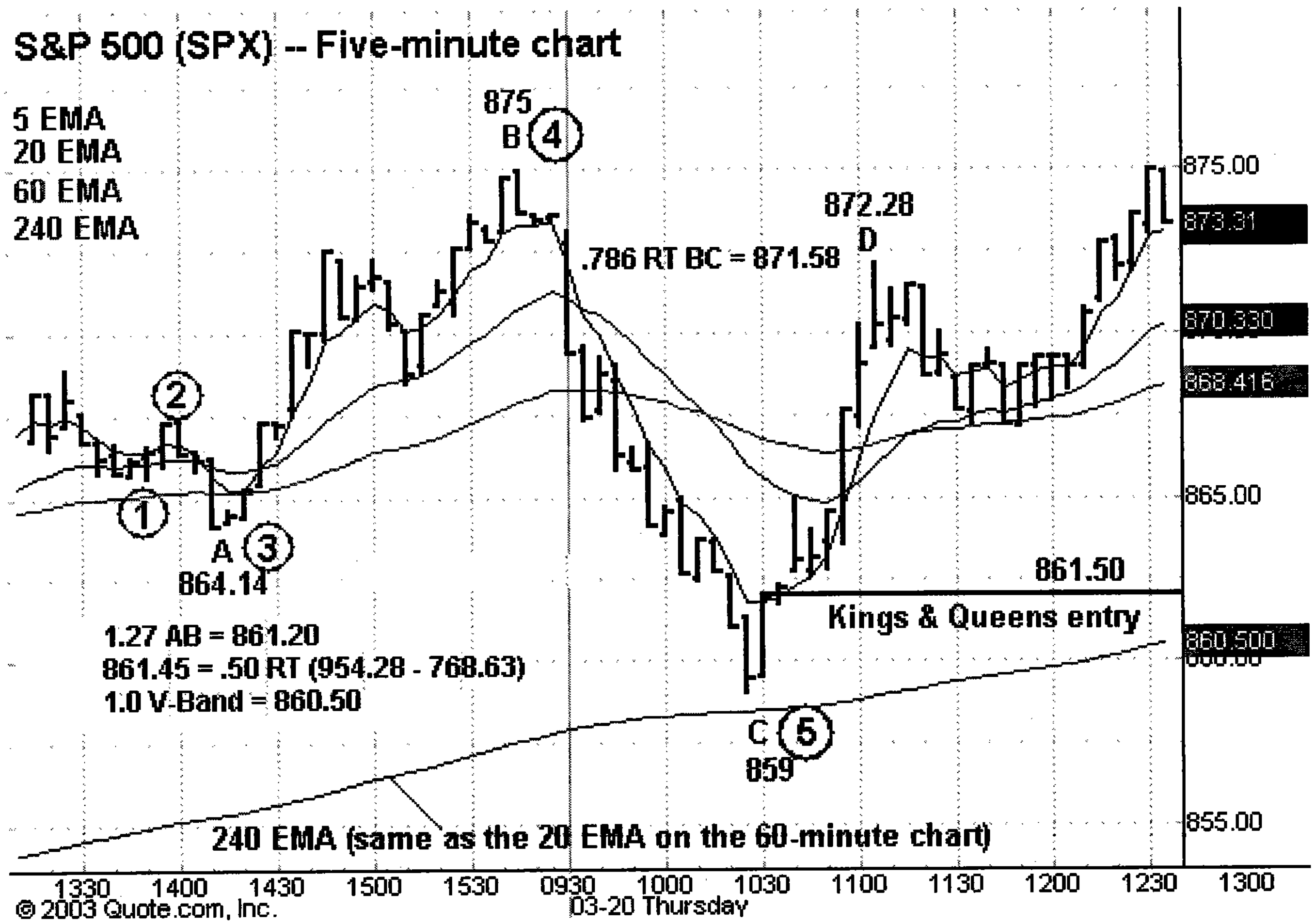
RSTs


S&P 500 (SPX) -- Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
875
B 4
.786 RT BC = 871.58
872.28
D
2
1
A 3
864.14
1.27 AB = 861.20
861.45 = .50 RT (954.28 - 768.63)
1.0 V-Band = 860.50
861.50
Kings & Queens entry
C 5
859
240 EMA (same as the 20 EMA on the 60-minute chart)
875.00
873.31
870.330
868.416
865.00
860.500
855.00
1330
1400
1430
1500
1530
0930
1000
1030
1100
1130
1200
1230
1300
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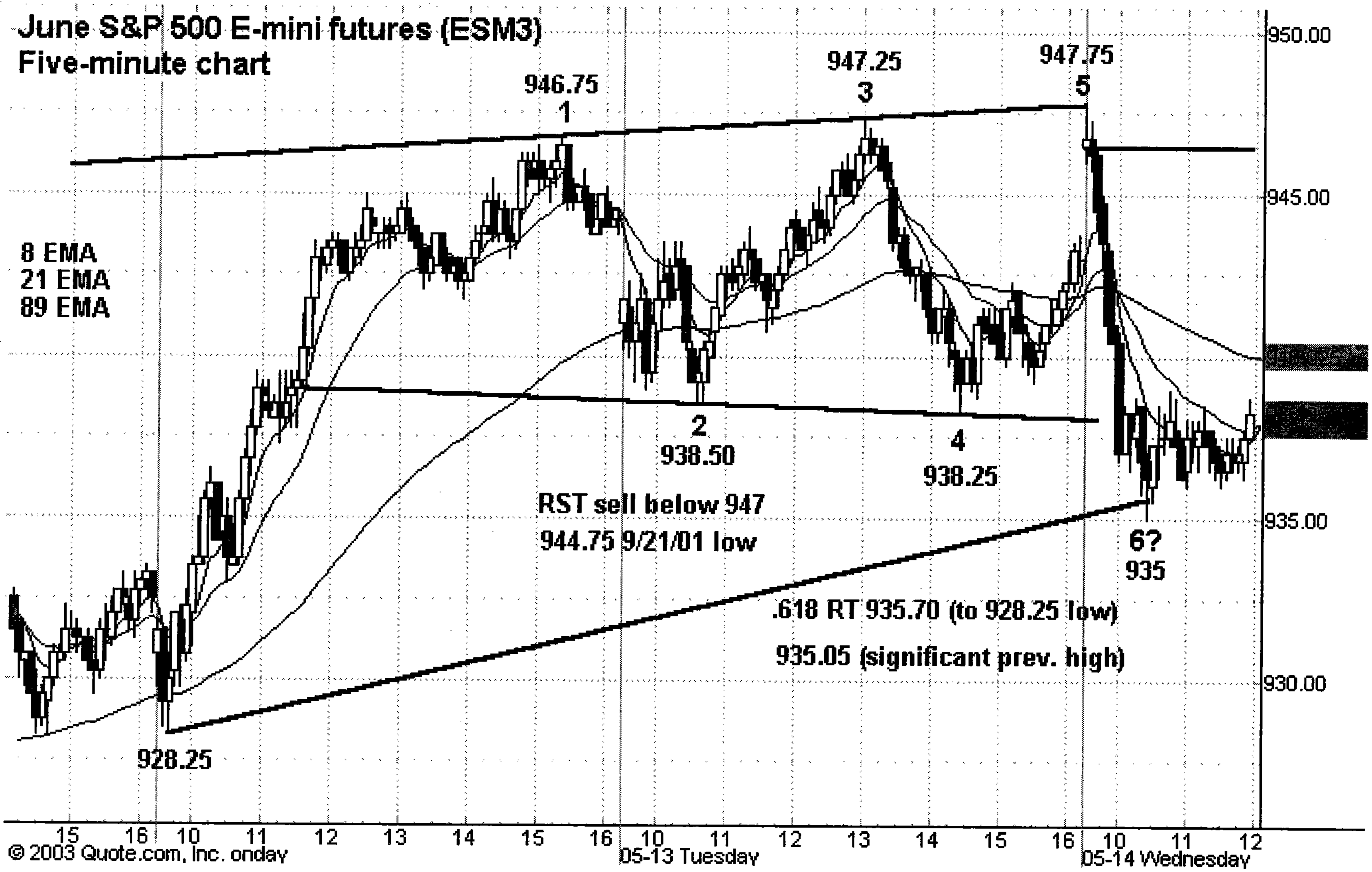
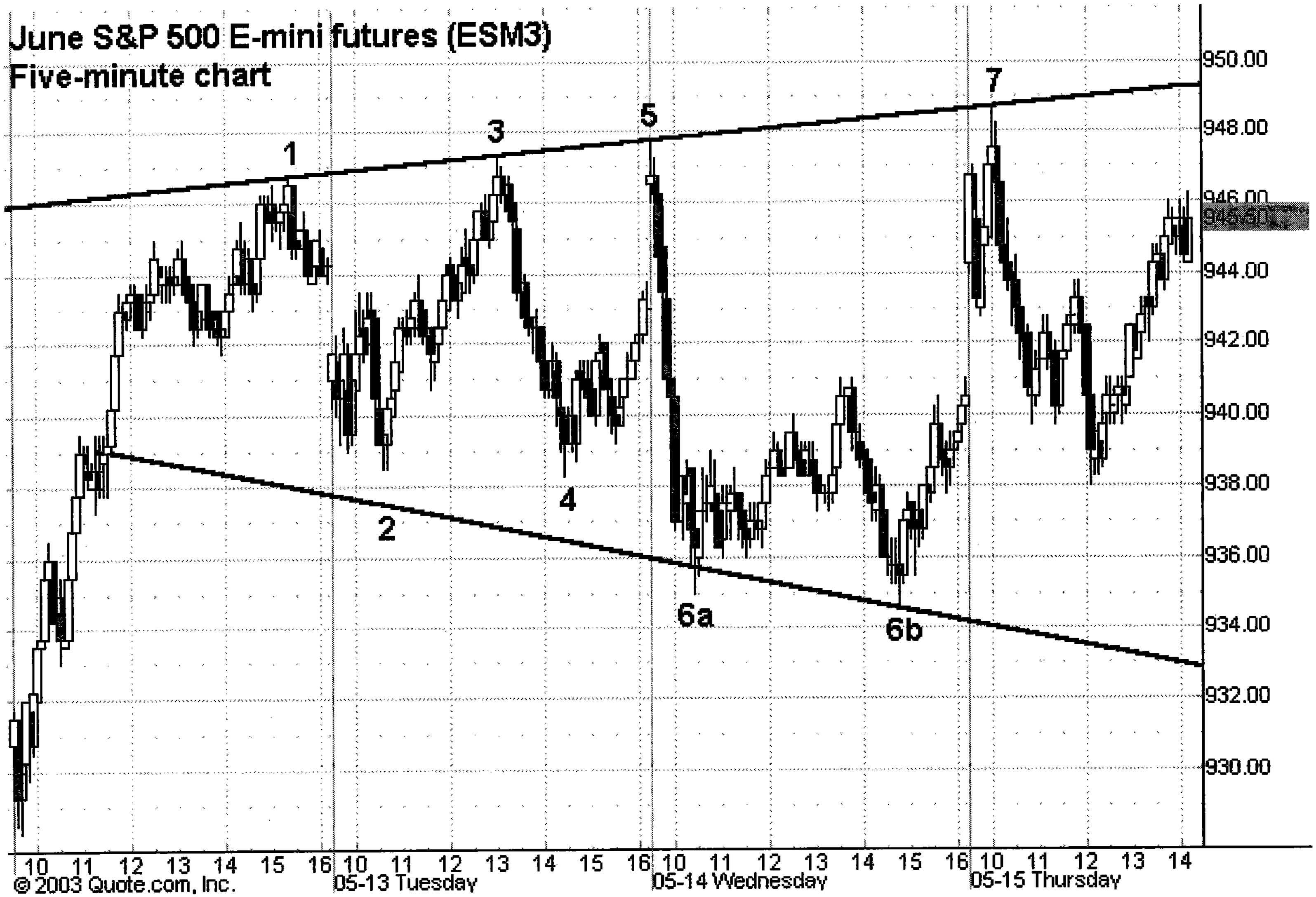
03-20 Thursday

RSTs


June S&P 500 E-mini futures (ESM3)
Five-minute chart
8 EMA
21 EMA
89 EMA
946.75
1
947.25
3
947.75
5
2
938.50
4
938.25
RST sell below 947
944.75 9/21/01 low
6?
935
.618 RT 935.70 (to 928.25 low)
935.05 (significant prev. high)
928.25
950.00
945.00
935.00
930.00
15
16
10
11
12
13
14
15
16
10
11
12
13
14
15
16
10
11
12
© 2003 Quote.com, Inc. onday
05-13 Tuesday
05-14 Wednesday

RSTs


June S&P 500 E-mini futures (ESM3)
Five-minute chart
1
2
3
4
5
6a
6b
7
950.00
948.00
946.00
945.50
944.00
942.00
940.00
938.00
936.00
934.00
932.00
930.00
10 11 12 13 14 15 16 10 11 12 13 14 15 16 10 11 12 13 14 15 16 10 11 12 13 14
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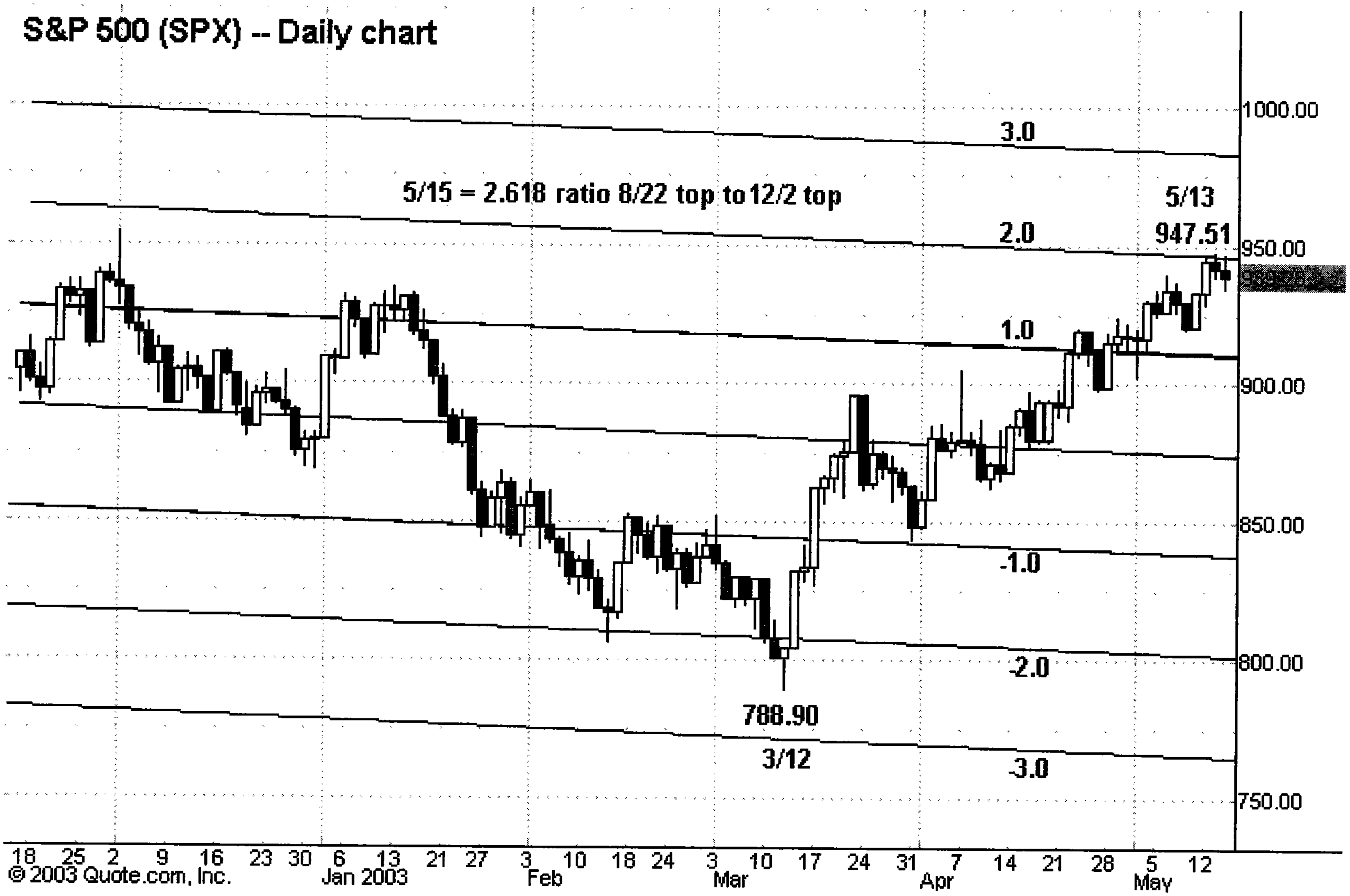
05-13 Tuesday
05-14 Wednesday
05-15 Thursday

RSTs



S&P 500 (SPX) -- Daily chart
5/15 = 2.618 ratio 8/22 top to 12/2 top
3.0
2.0
1.0
-1.0
-2.0
-3.0
5/13
947.51
788.90
3/12
1000.00
950.00
900.00
850.00
800.00
750.00
18 25 2 9 16 23 30 6 13 21 27 3 10 18 24 3 10 17 24 31 7 14 21 28 5 12
Jan 2003
Feb
Mar
Apr
May
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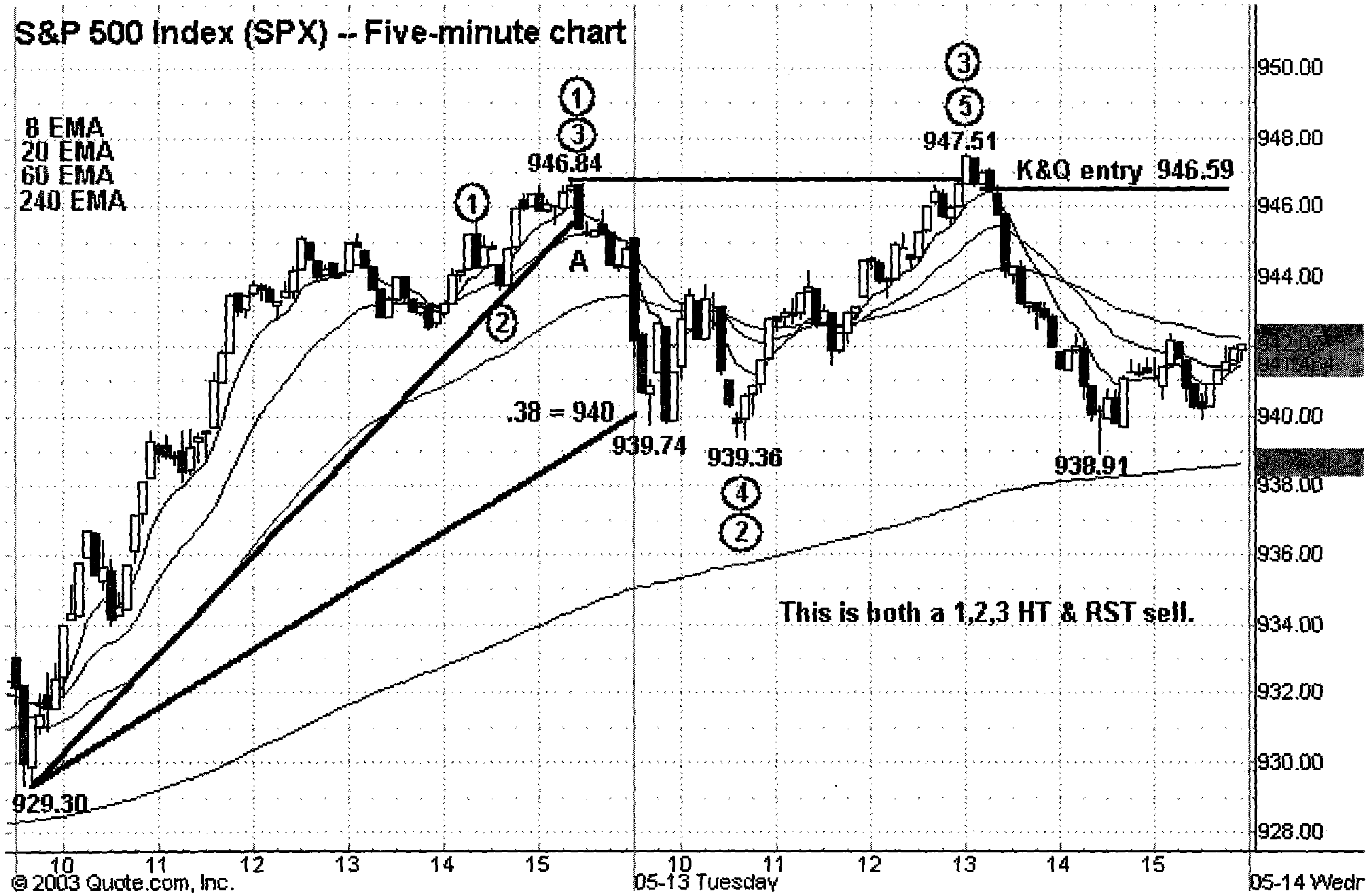
RSTs



S&P 500 Index (SPX) -- Five-minute chart
8 EMA
20 EMA
60 EMA
240 EMA
946.84
947.51
K&Q entry 946.59
A
.38 = 940
939.74
939.36
938.91
929.30
This is both a 1,2,3 HT & RST sell.
950.00
948.00
946.00
944.00
940.00
938.00
936.00
934.00
932.00
930.00
928.00
10
11
12
13
14
15
05-13 Tuesday
05-14 Wedr
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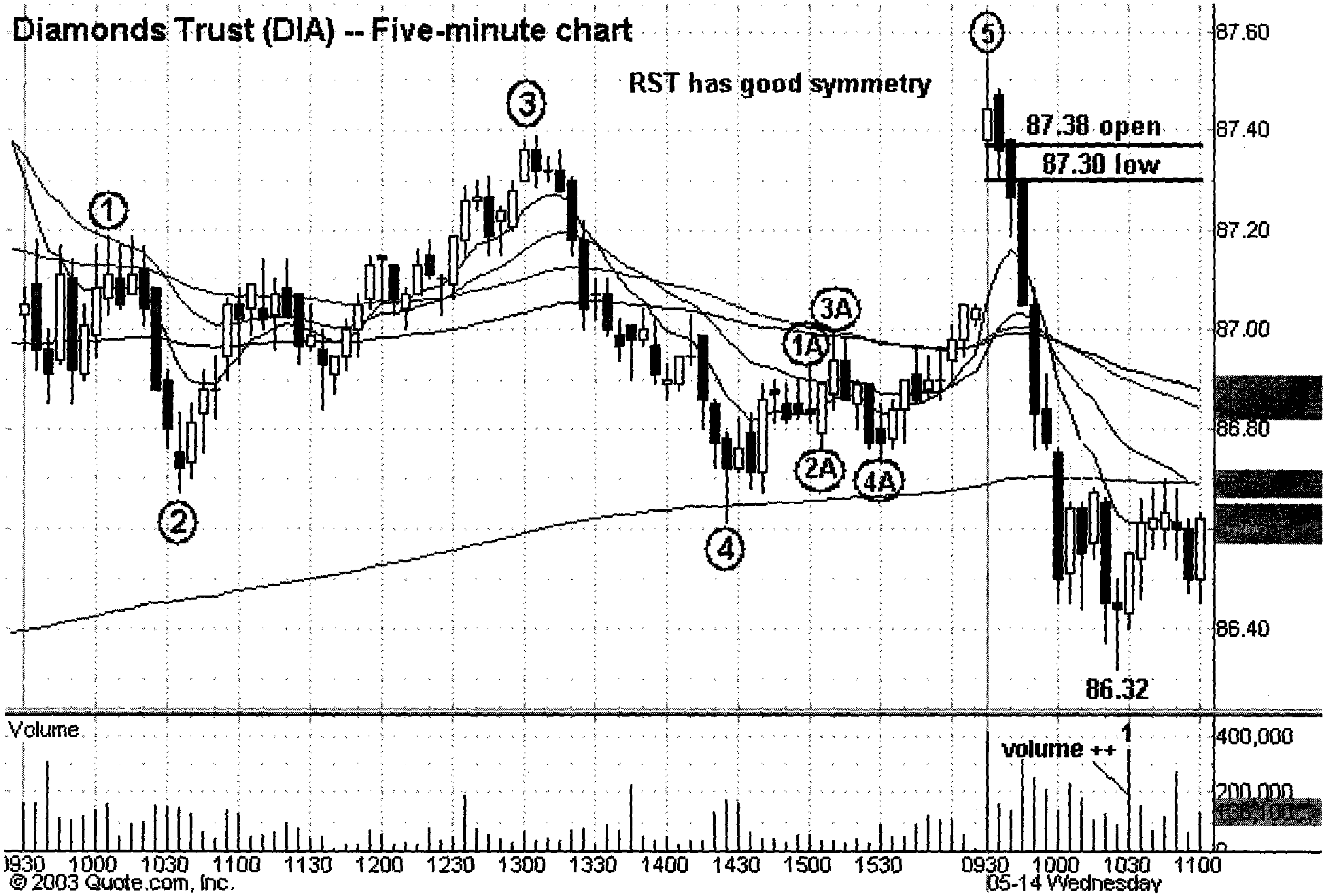
RSTs



Diamonds Trust (DIA) -- Five-minute chart
RST has good symmetry
1
2
3
4
5
1A
2A
3A
4A
87.38 open
87.30 low
86.32
87.60
87.40
87.20
87.00
86.80
86.40
Volume
volume ++
1
400,000
200,000
0930
1000
1030
1100
1130
1200
1230
1300
1330
1400
1430
1500
1530
0930
1000
1030
1100
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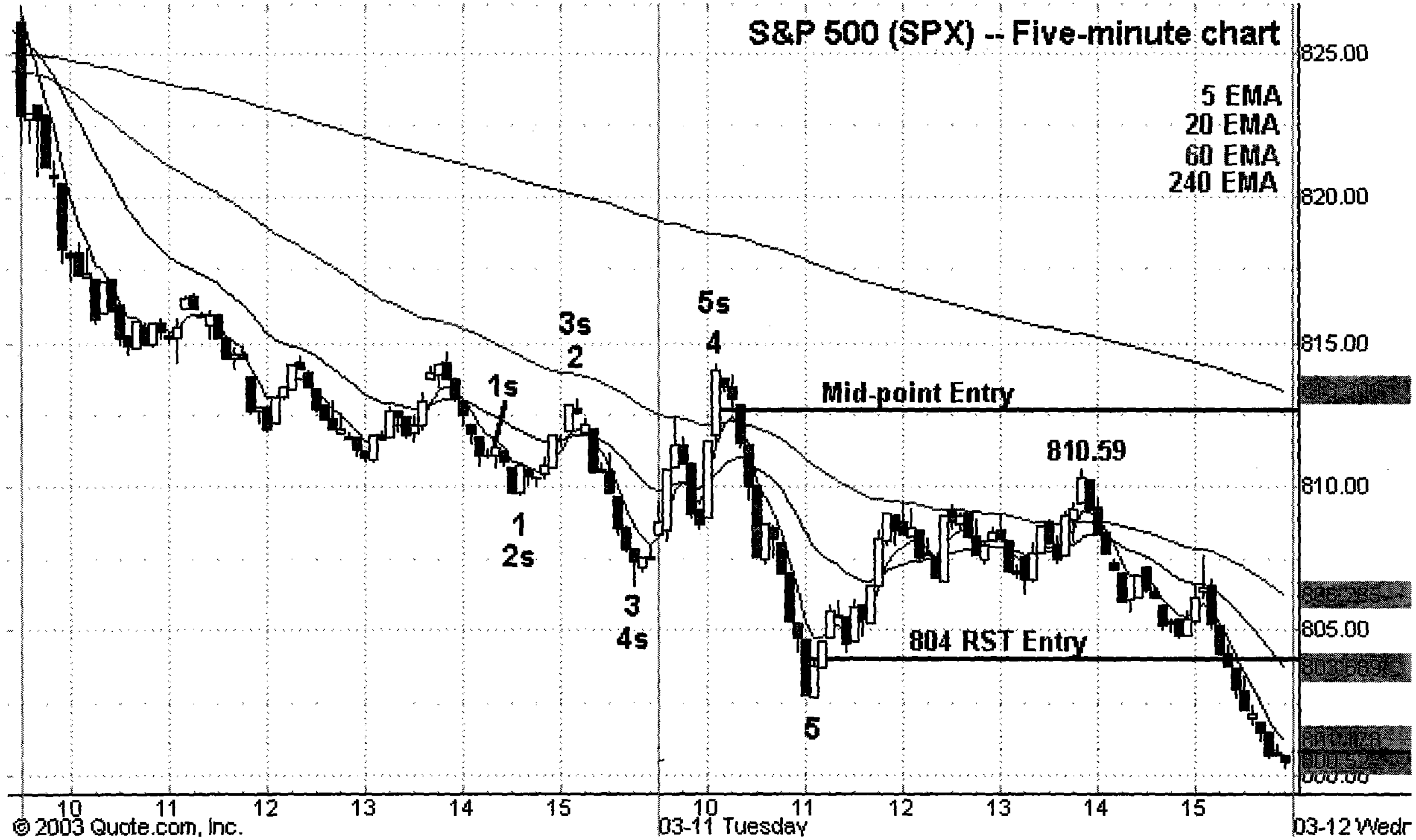
05-14 Wednesday

RSTs



S&P 500 (SPX) -- Five-minute chart
5 EMA
20 EMA
60 EMA
240 EMA
825.00
820.00
815.00
810.00
805.00
5s
4
3s
2
1s
1
2s
3
4s
5
Mid-point Entry
810.59
804 RST Entry
10
11
12
13
14
15
10
11
12
13
14
15
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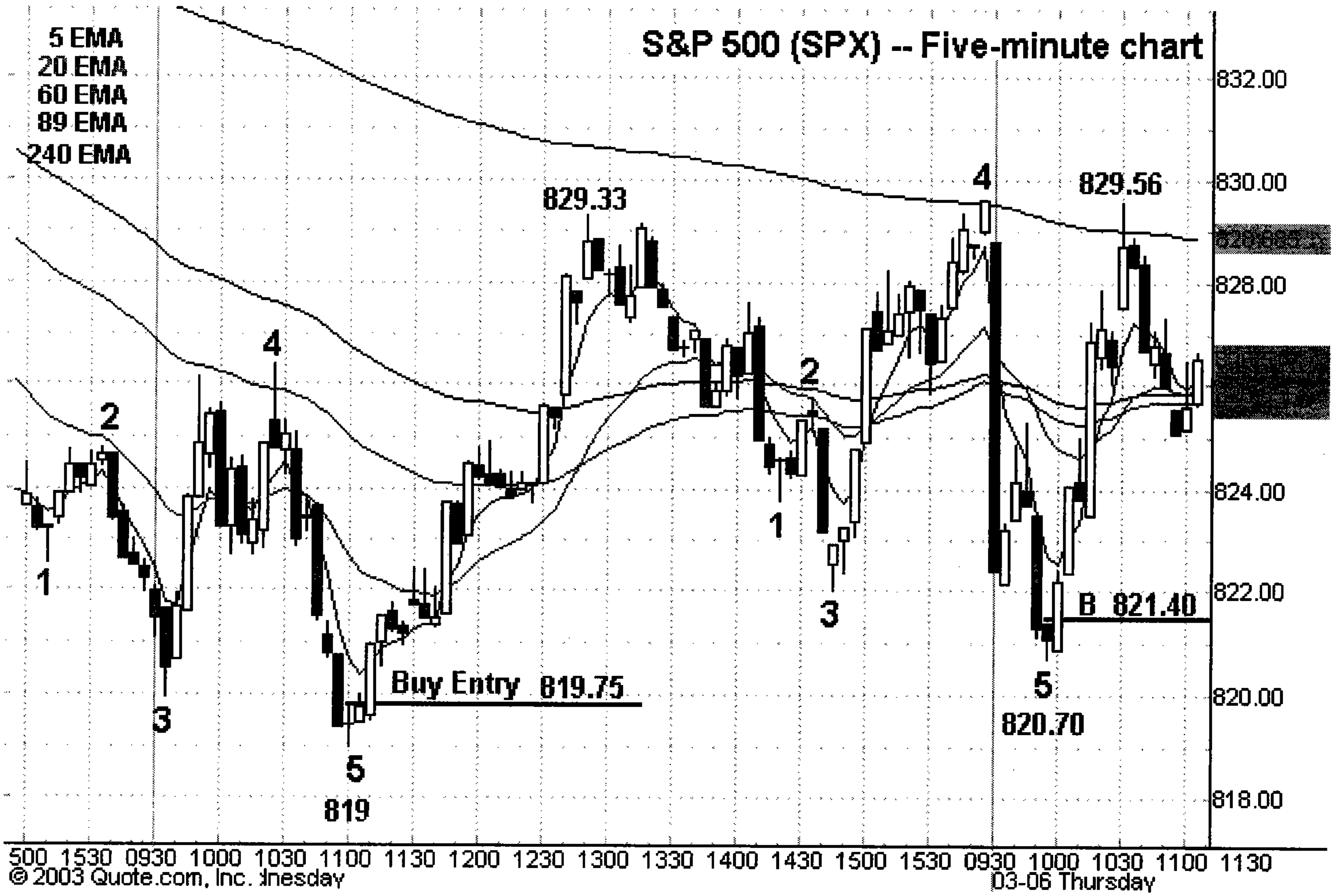
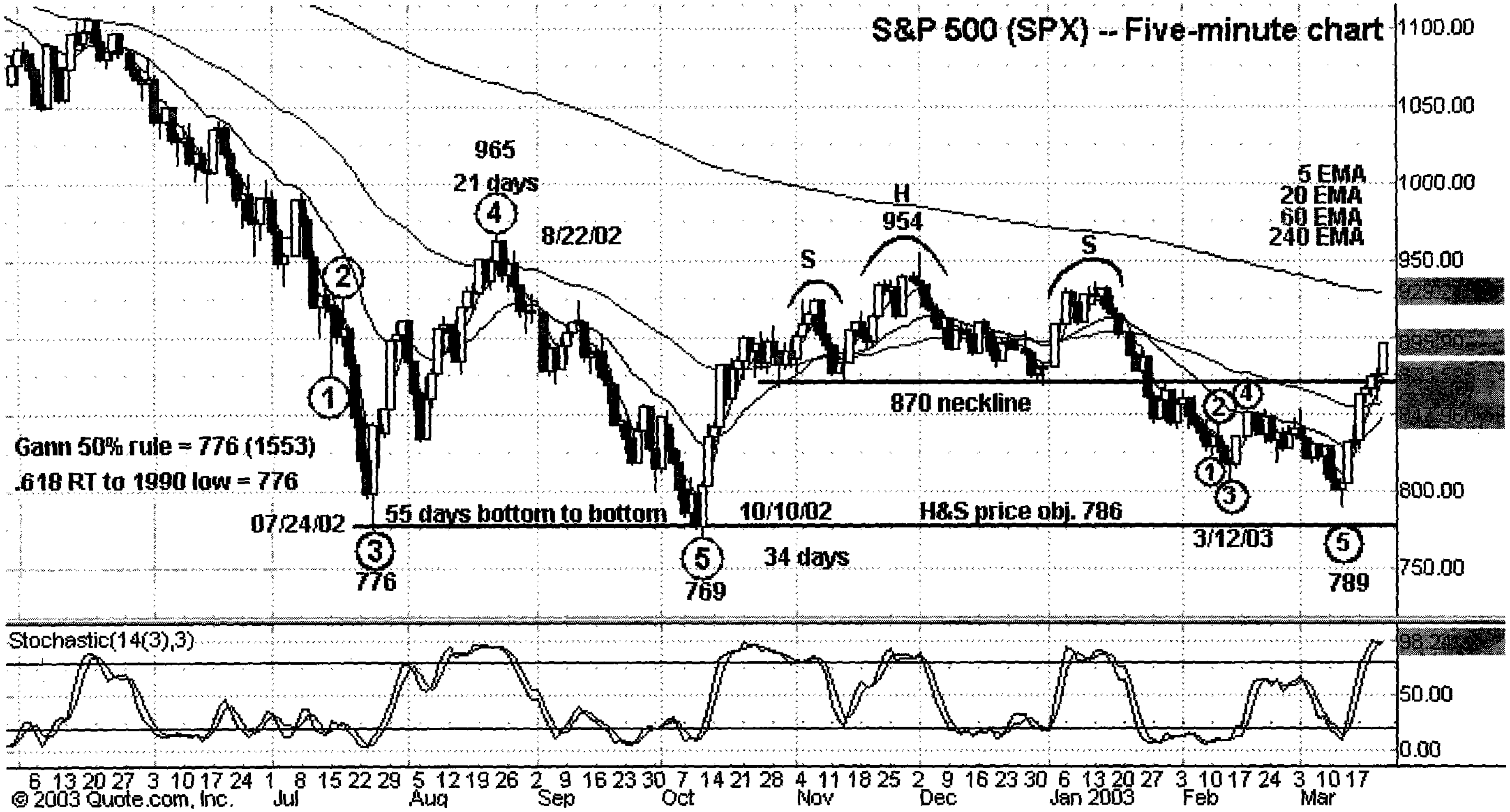
03-11 Tuesday
03-12 Wedr

RSTs



5 EMA
20 EMA
60 EMA
89 EMA
240 EMA
S&P 500 (SPX) -- Five-minute chart
832.00
830.00
828.00
824.00
822.00
820.00
818.00
829.33
829.56
1
2
3
4
5
819
Buy Entry 819.75
1
2
3
4
5
820.70
B 821.40
500 1530 0930 1000 1030 1100 1130 1200 1230 1300 1330 1400 1430 1500 1530 0930 1000 1030 1100 1130
© 2003 Quote.com, Inc. dnesday
03-06 Thursday

RSTs


S&P 500 (SPX) -- Five-minute chart
965
21 days
8/22/02
5 EMA
20 EMA
60 EMA
240 EMA
S
H
954
S
870 neckline
Gann 50% rule = 776 (1553)
.618 RT to 1990 low = 776
07/24/02
55 days bottom to bottom
10/10/02
H&S price obj. 786
3/12/03
776
769
34 days
789
Stochastic(14(3),3)
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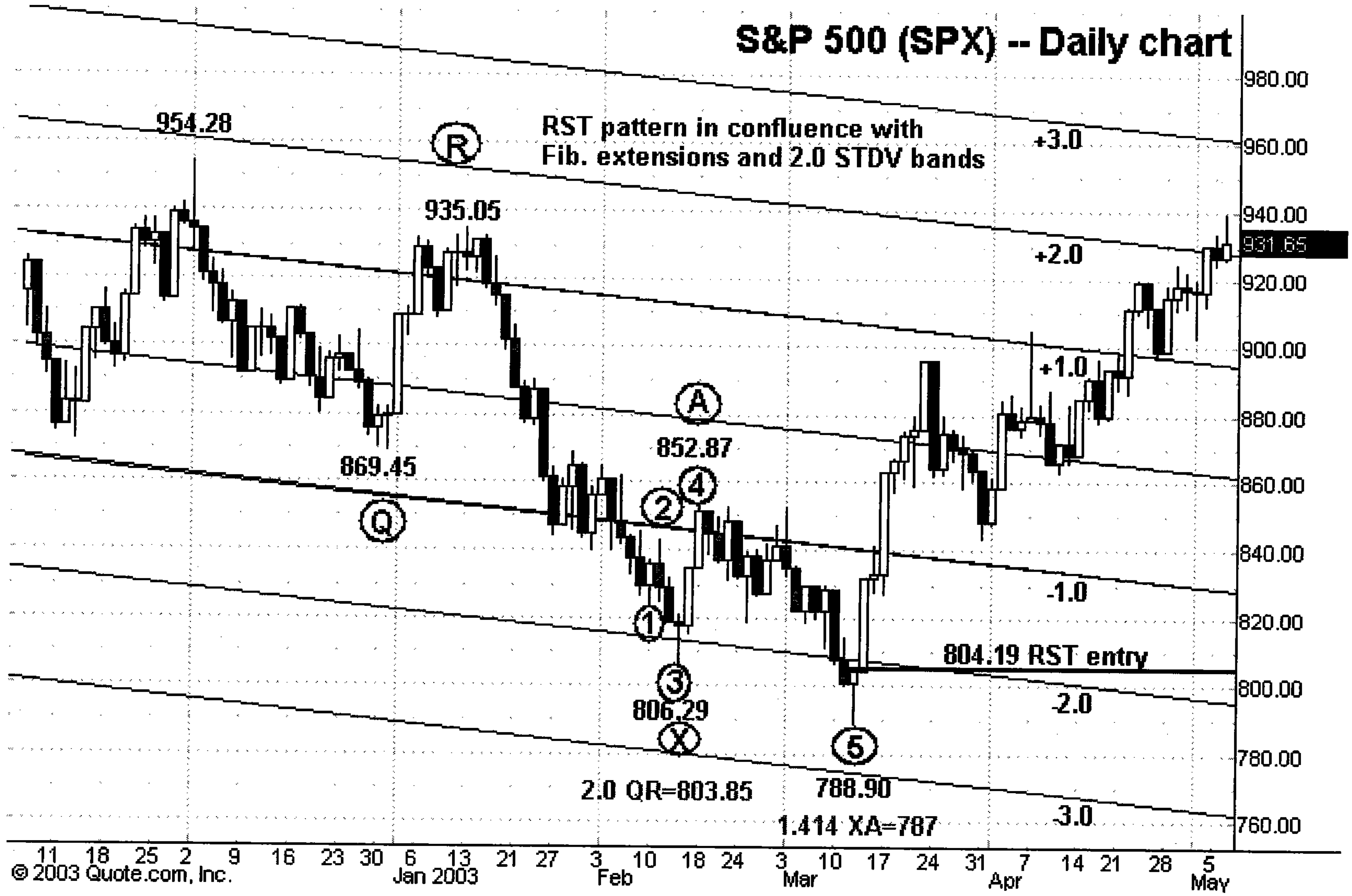
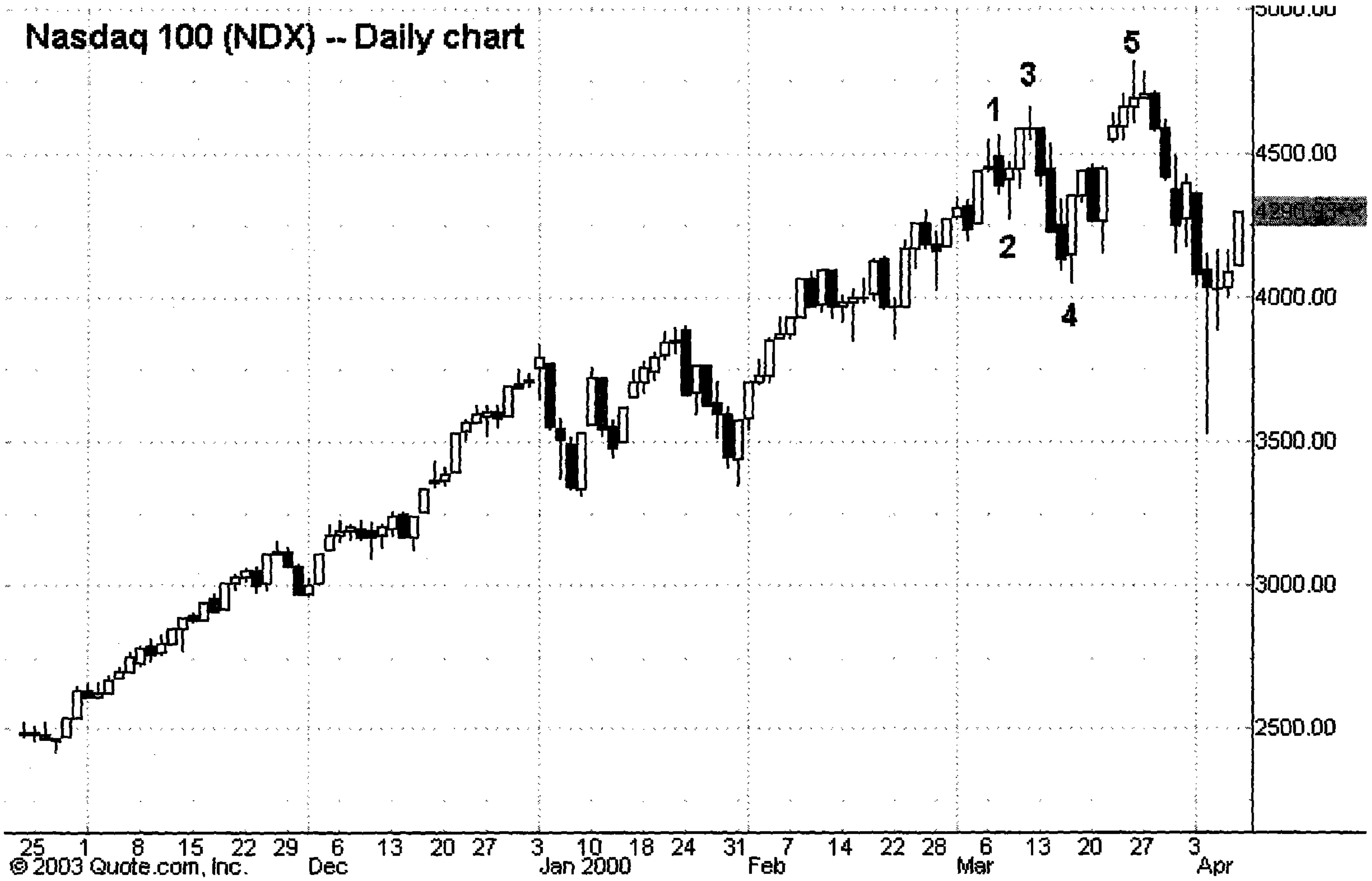
Jul
Aug
Sep
Oct
Nov
Dec
Jan 2003
Feb
Mar
1100.00
1050.00
1000.00
950.00
800.00
750.00
50.00
0.00

RSTs

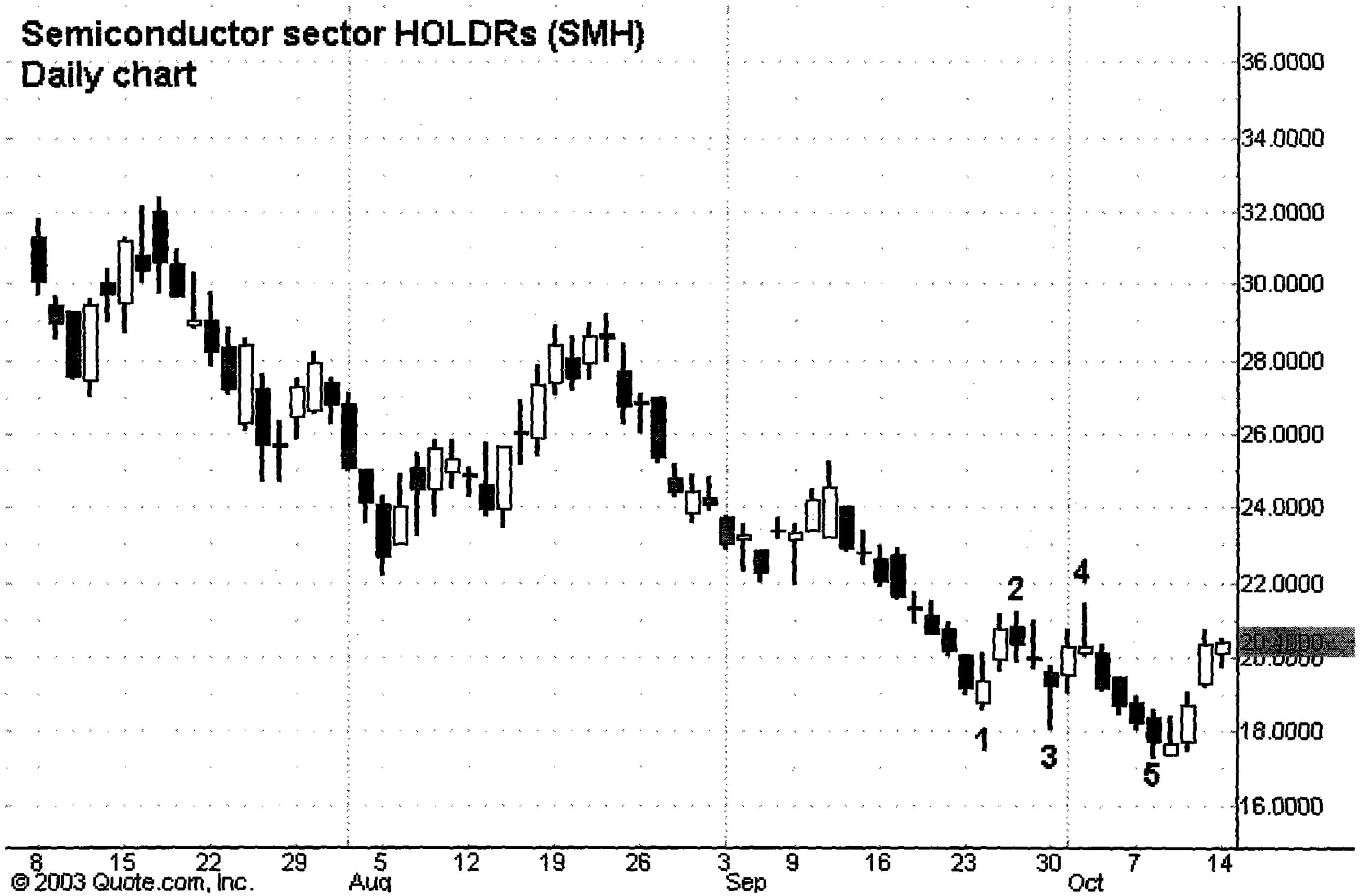

S&P 500 (SPX) -- Daily chart
RST pattern in confluence with
Fib. extensions and 2.0 STDV bands
954.28
R
935.05
869.45
Q
A
852.87
2
4
1
3
806.29
X
5
788.90
2.0 QR=803.85
1.414 XA=787
804.19 RST entry
+3.0
+2.0
+1.0
-1.0
-2.0
-3.0
980.00
960.00
940.00
931.65
920.00
900.00
880.00
860.00
840.00
820.00
800.00
780.00
760.00
11 18 25 2 9 16 23 30 6 13 21 27 3 10 18 24 3 10 17 24 31 7 14 21 28 5
Jan 2003
Feb
Mar
Apr
May
© 2003 Quote.com, Inc.

RST Work Study

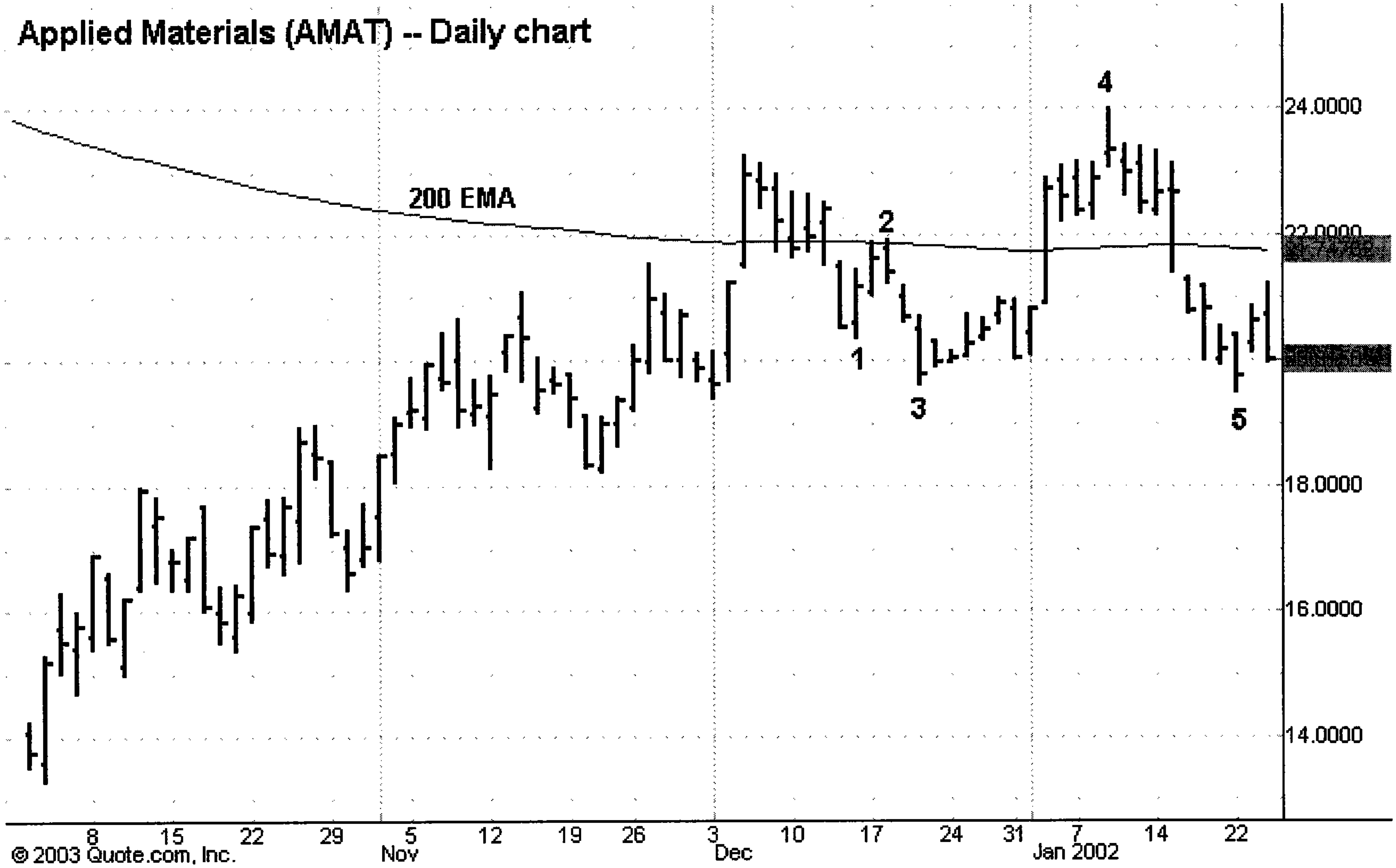
RST Work Study



RST Work Study



RST Work Study



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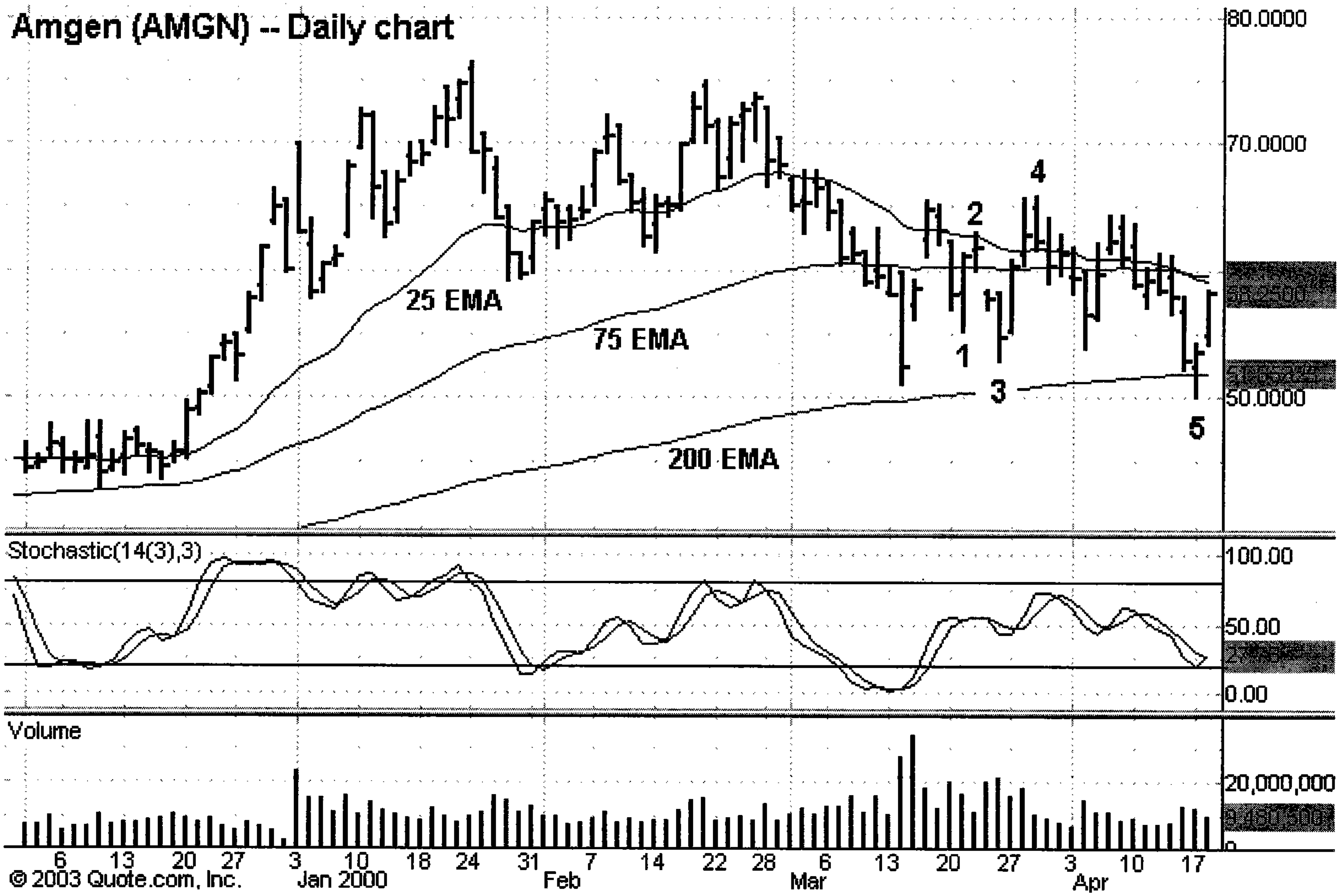

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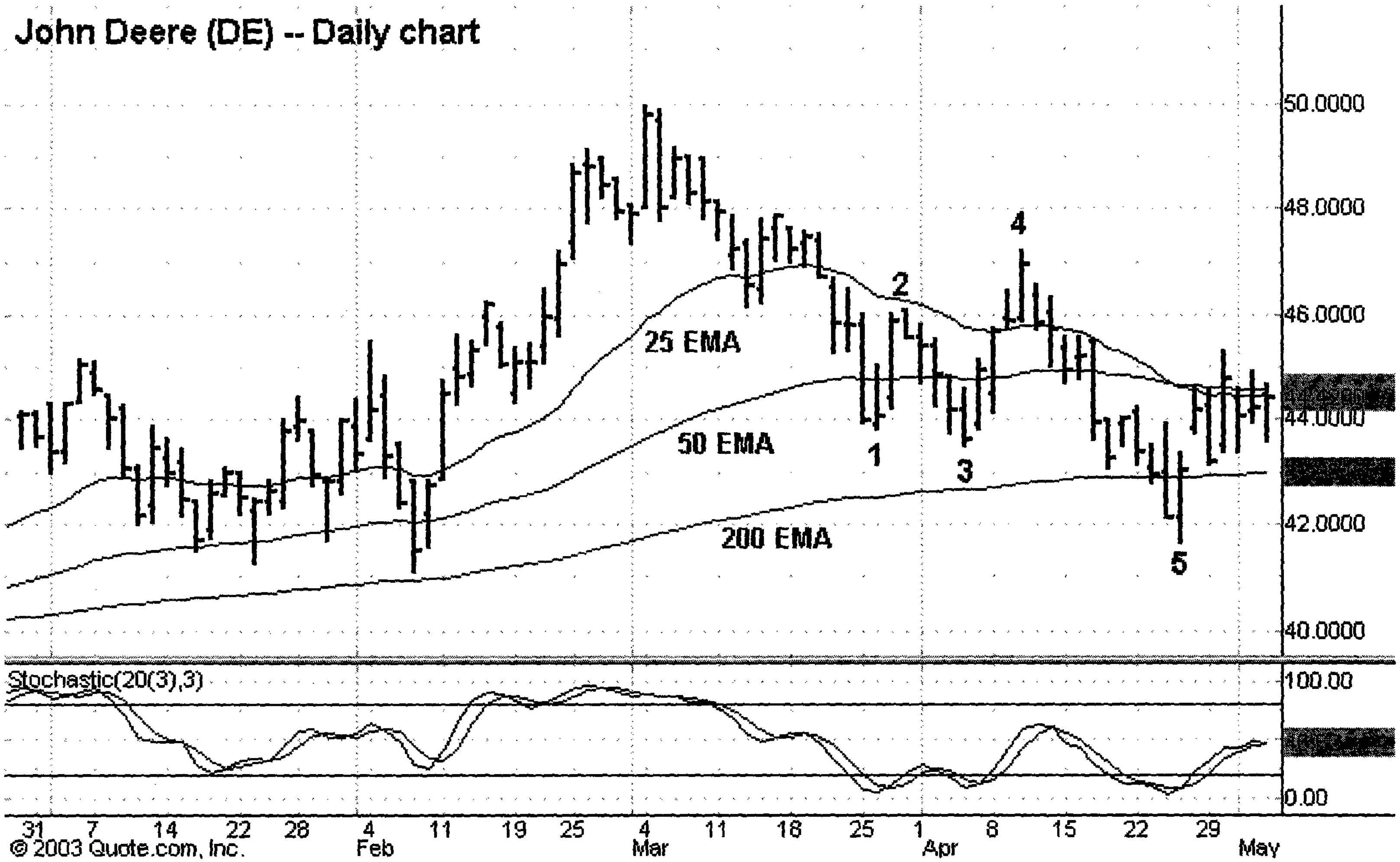
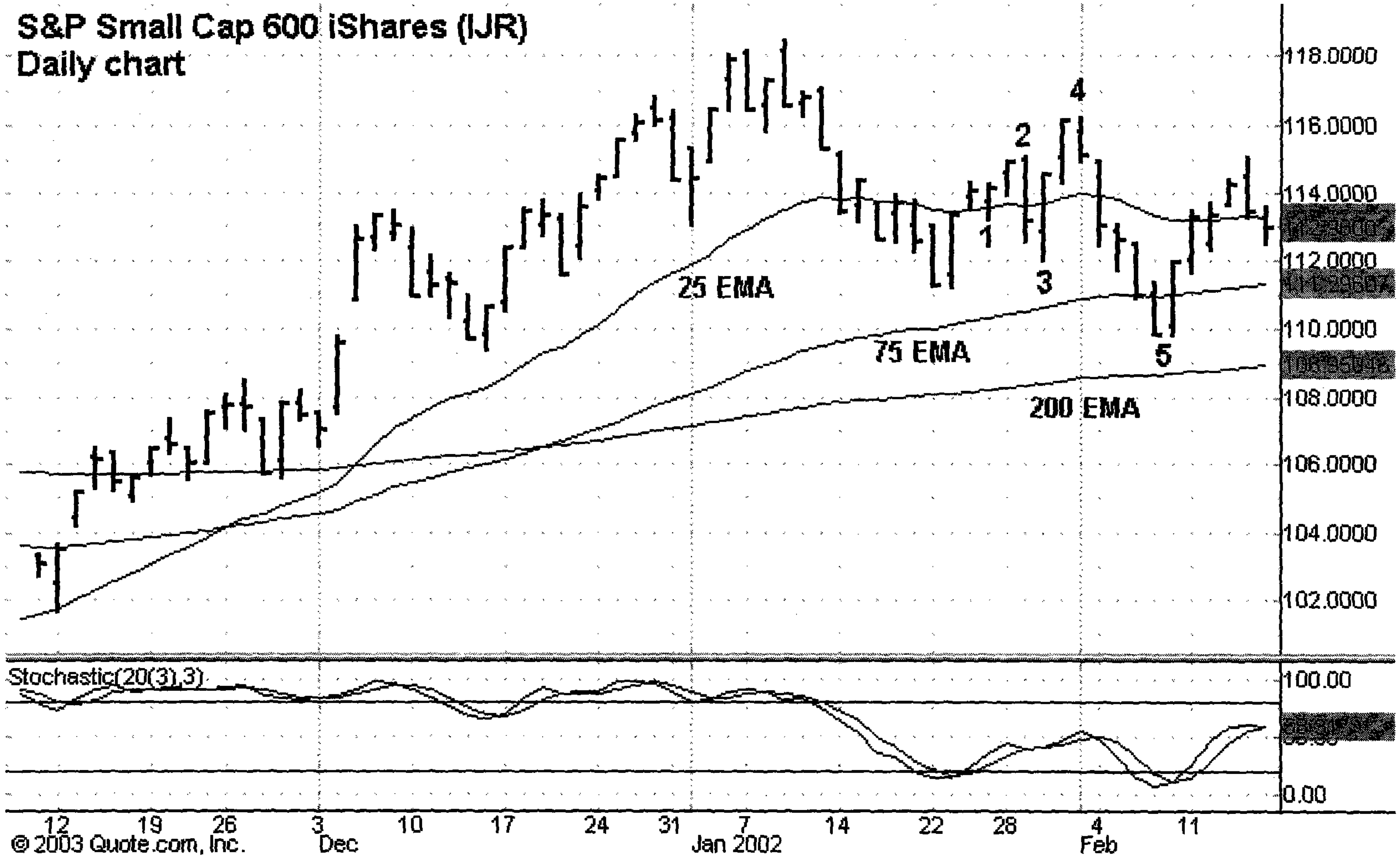


RST Work Study



XIV. Chart Review

Chart Review

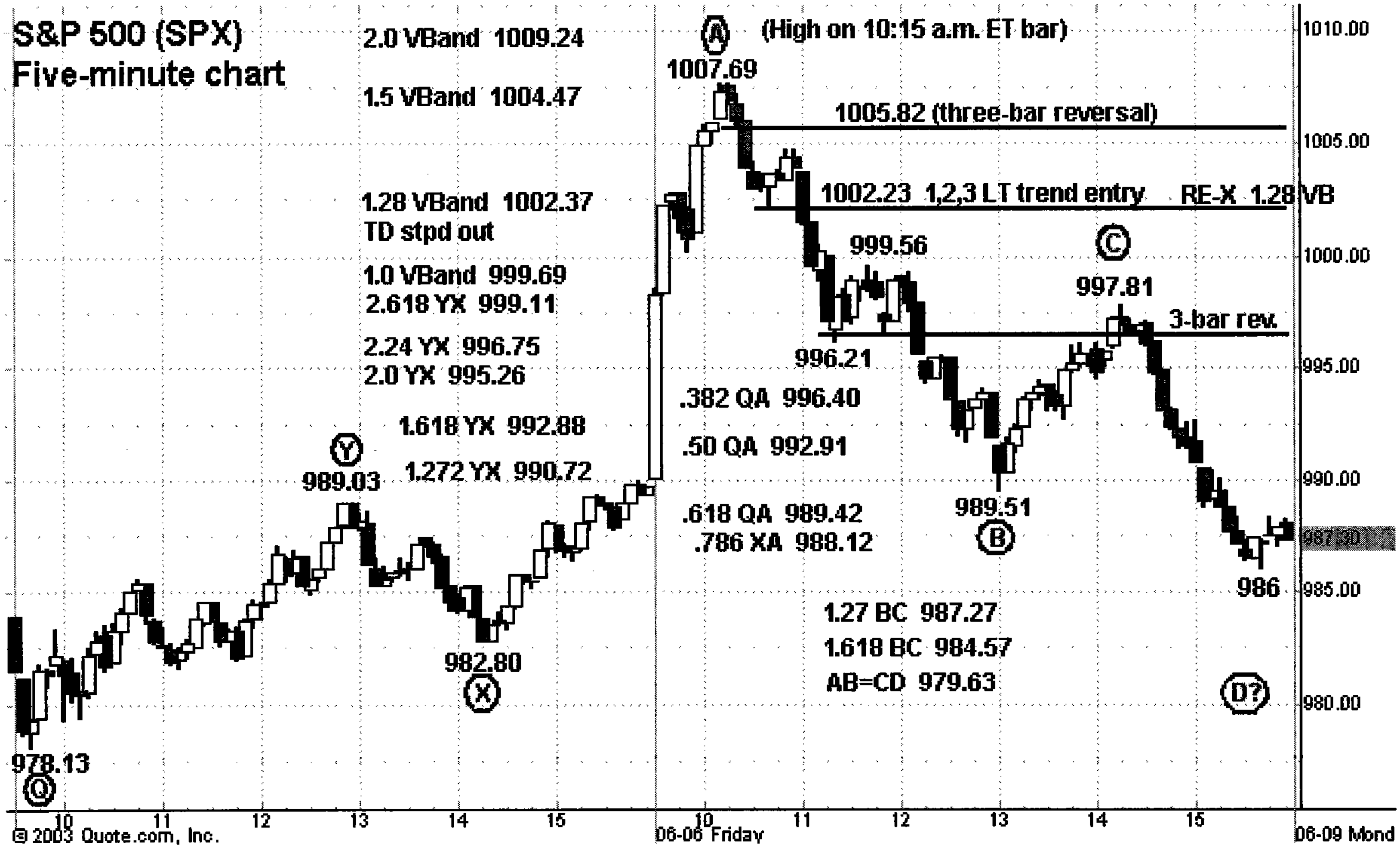


Chart Review

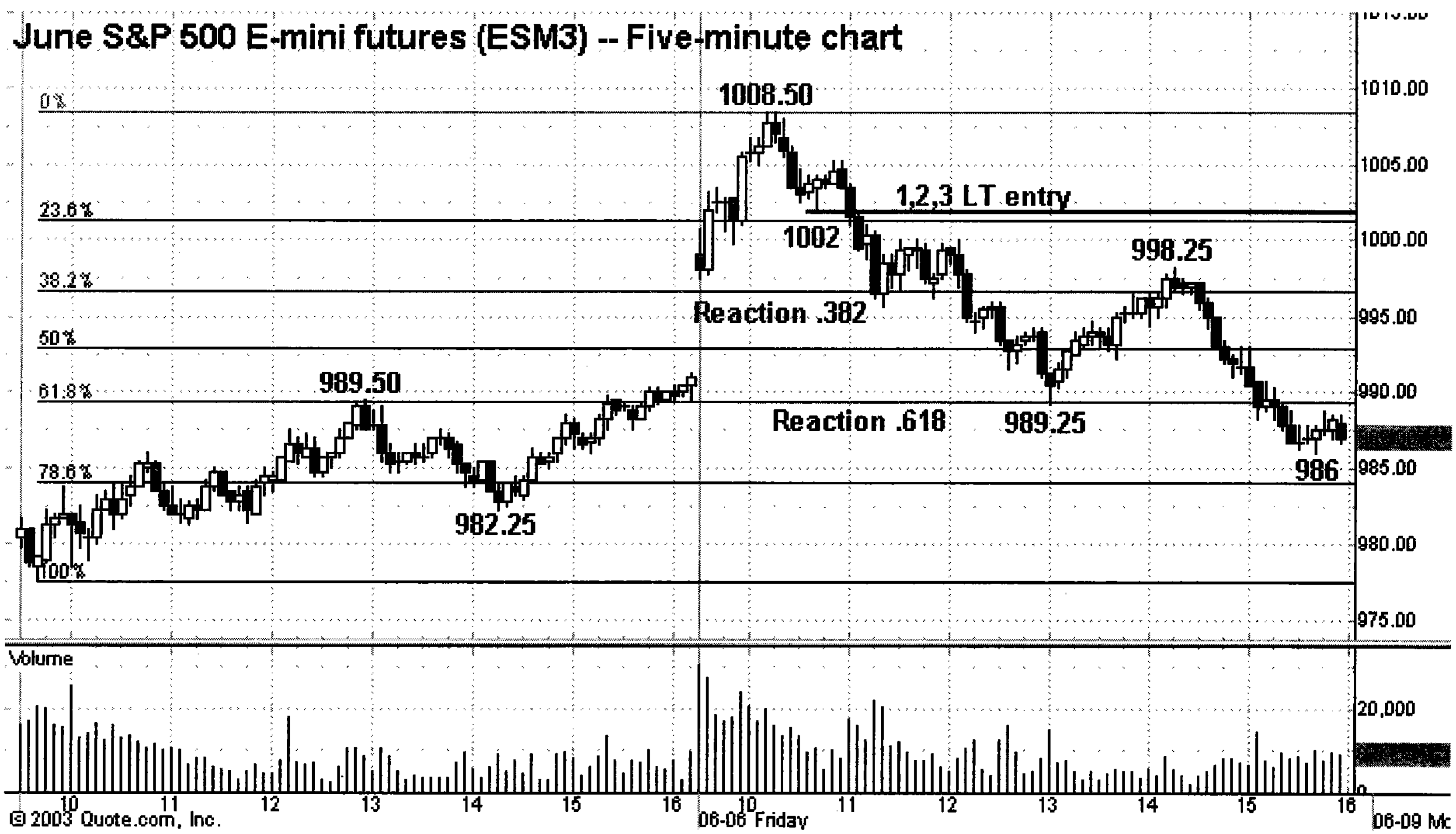


Chart Review

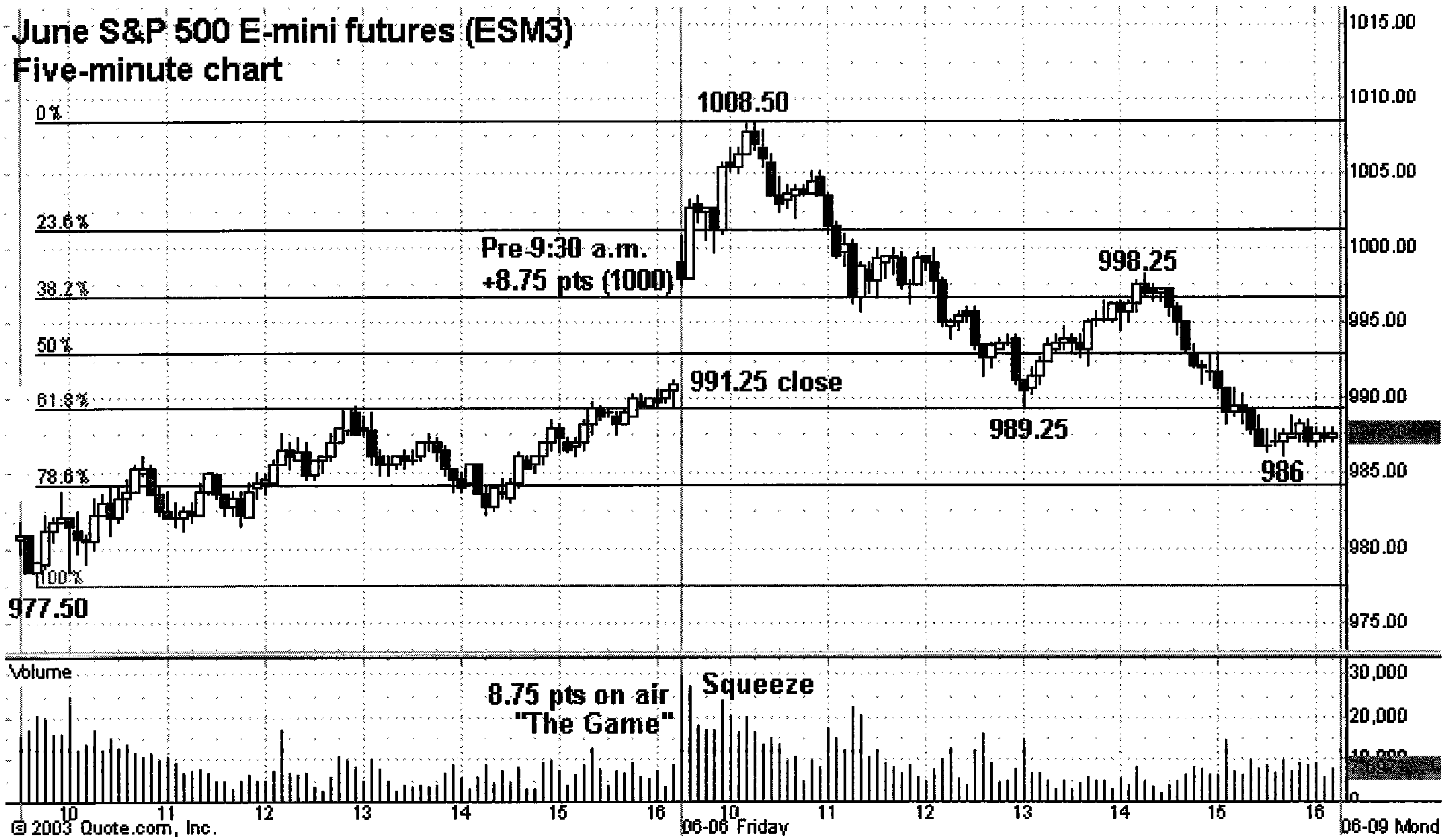


Chart Review

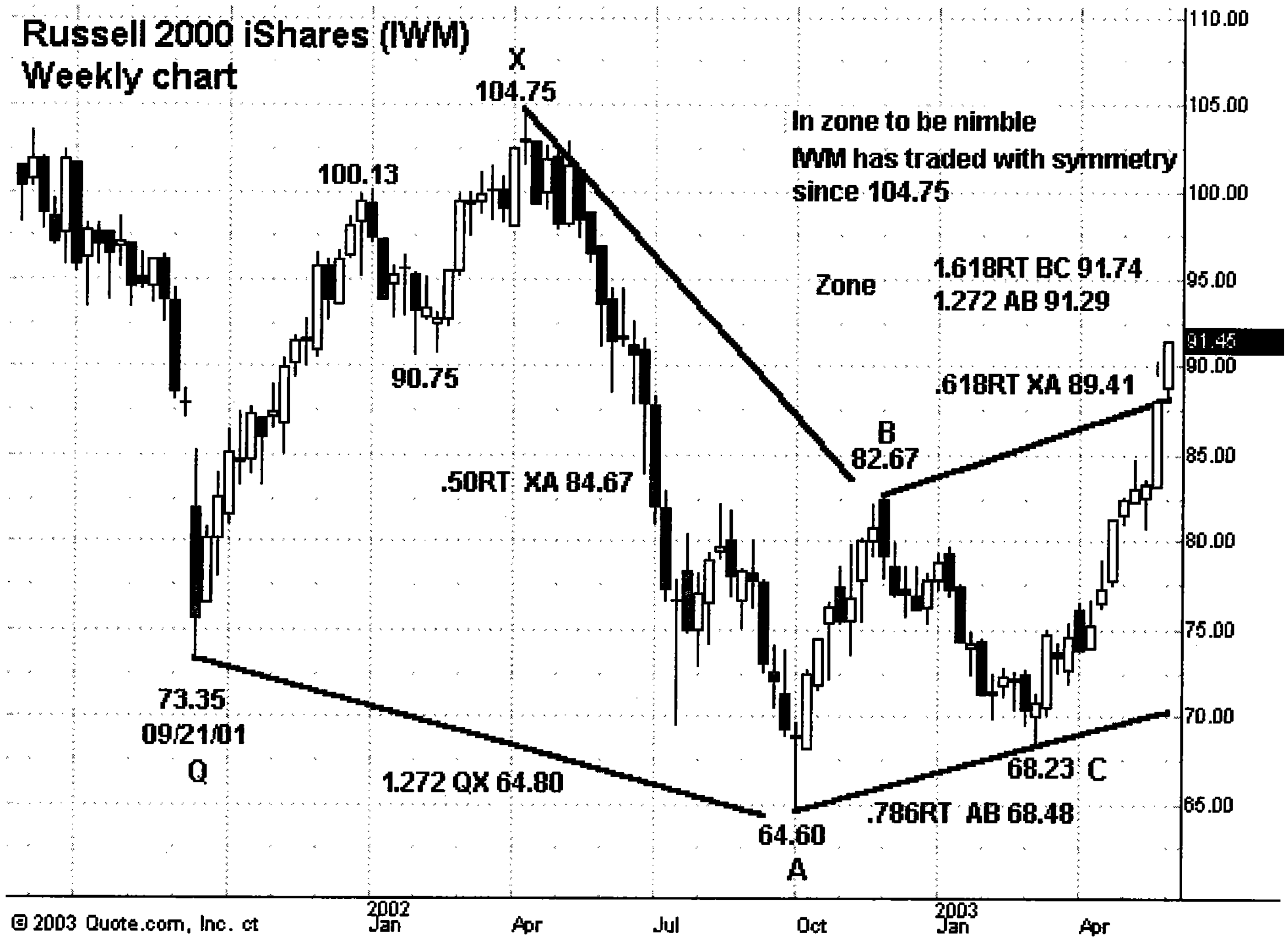


Chart Review

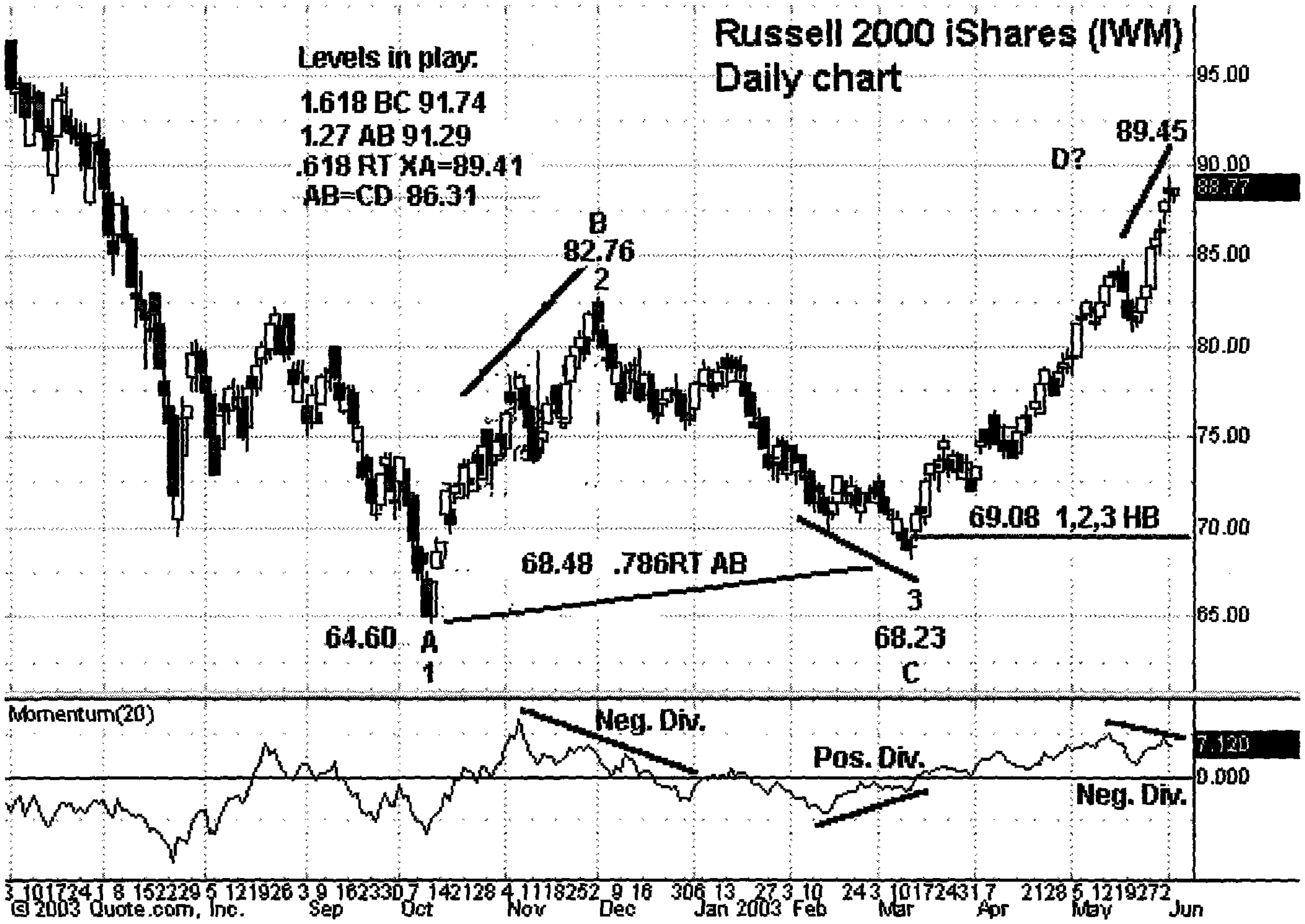


Chart Review

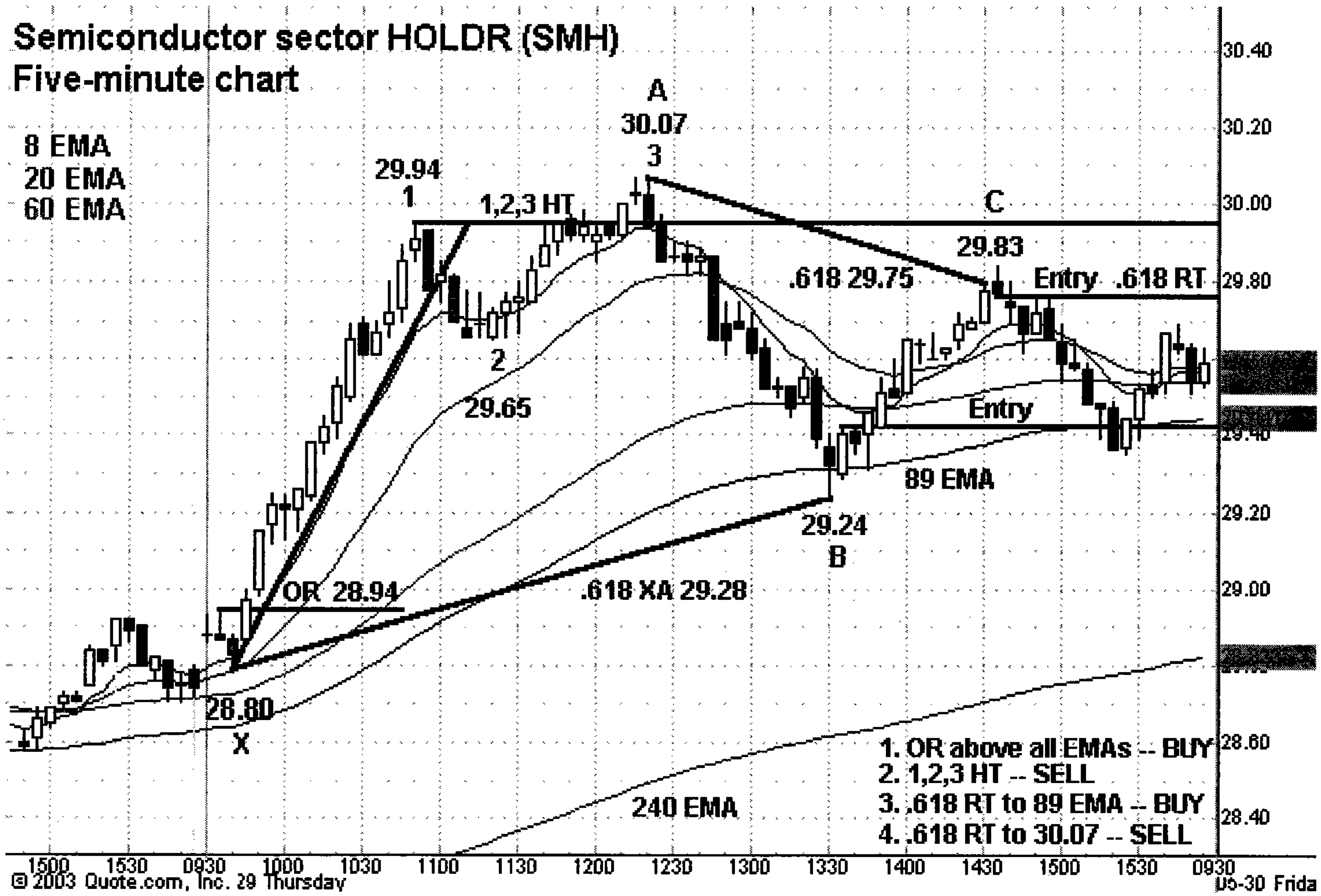


Chart Review

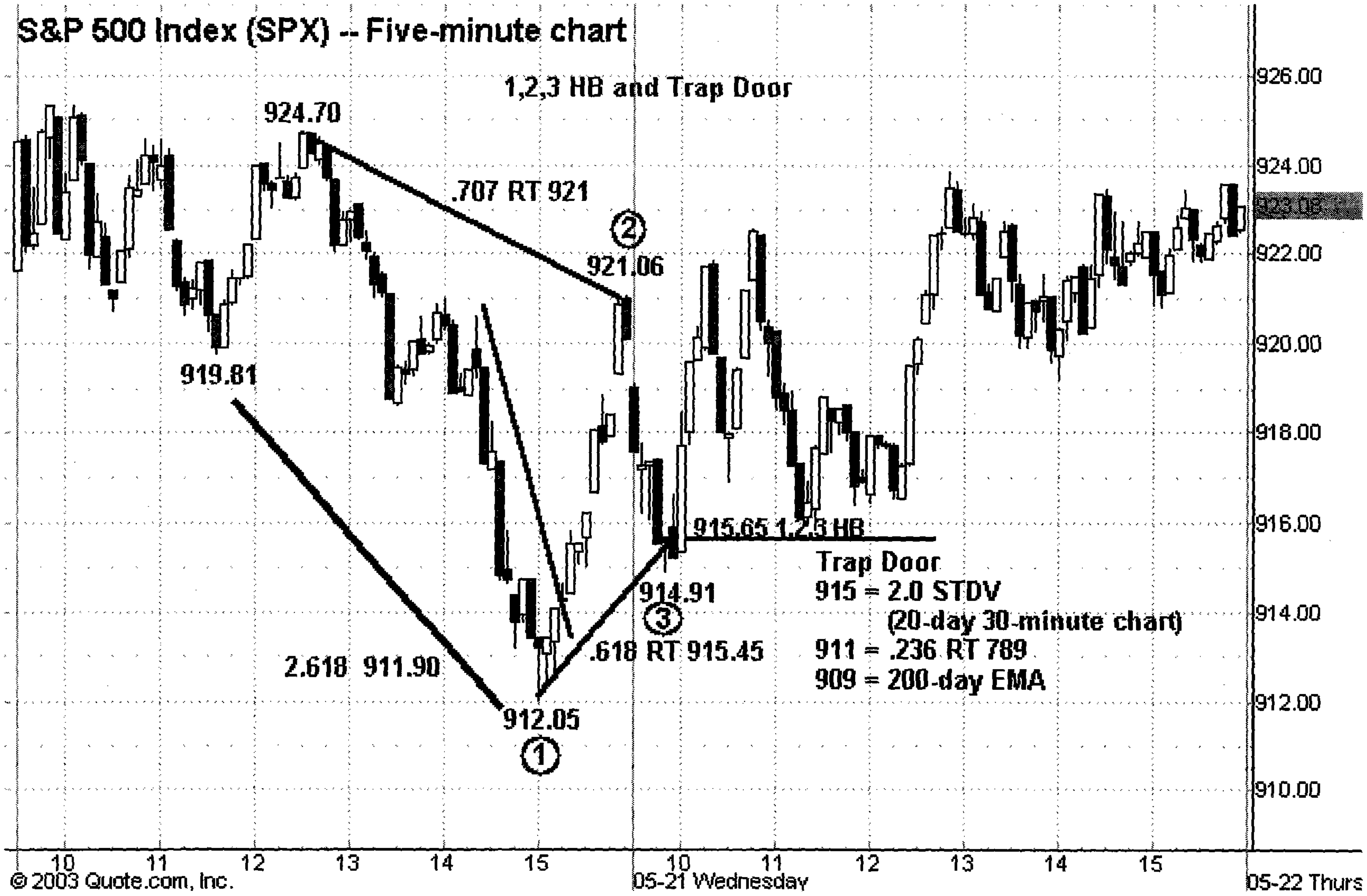


Chart Review

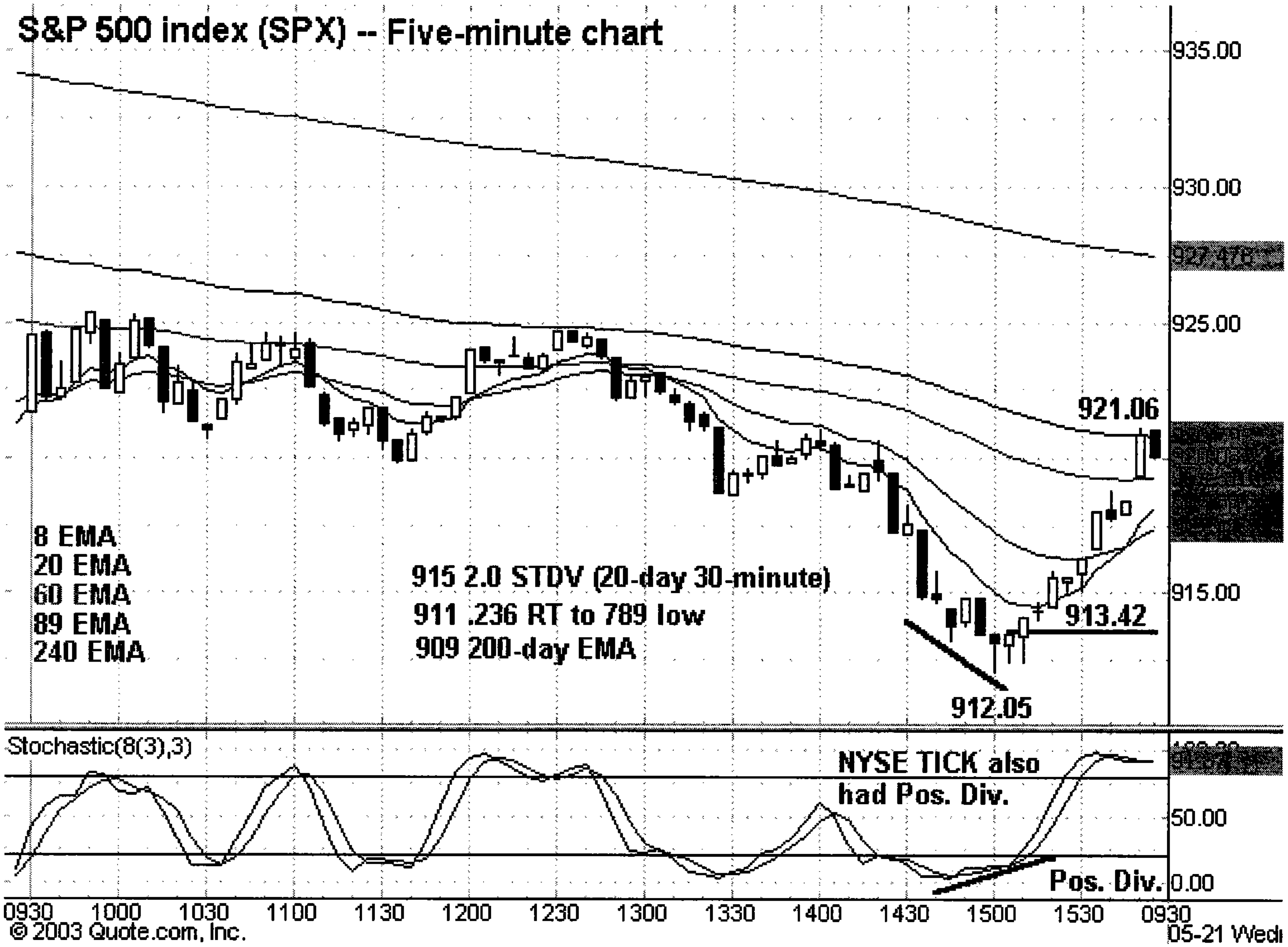


Chart Review

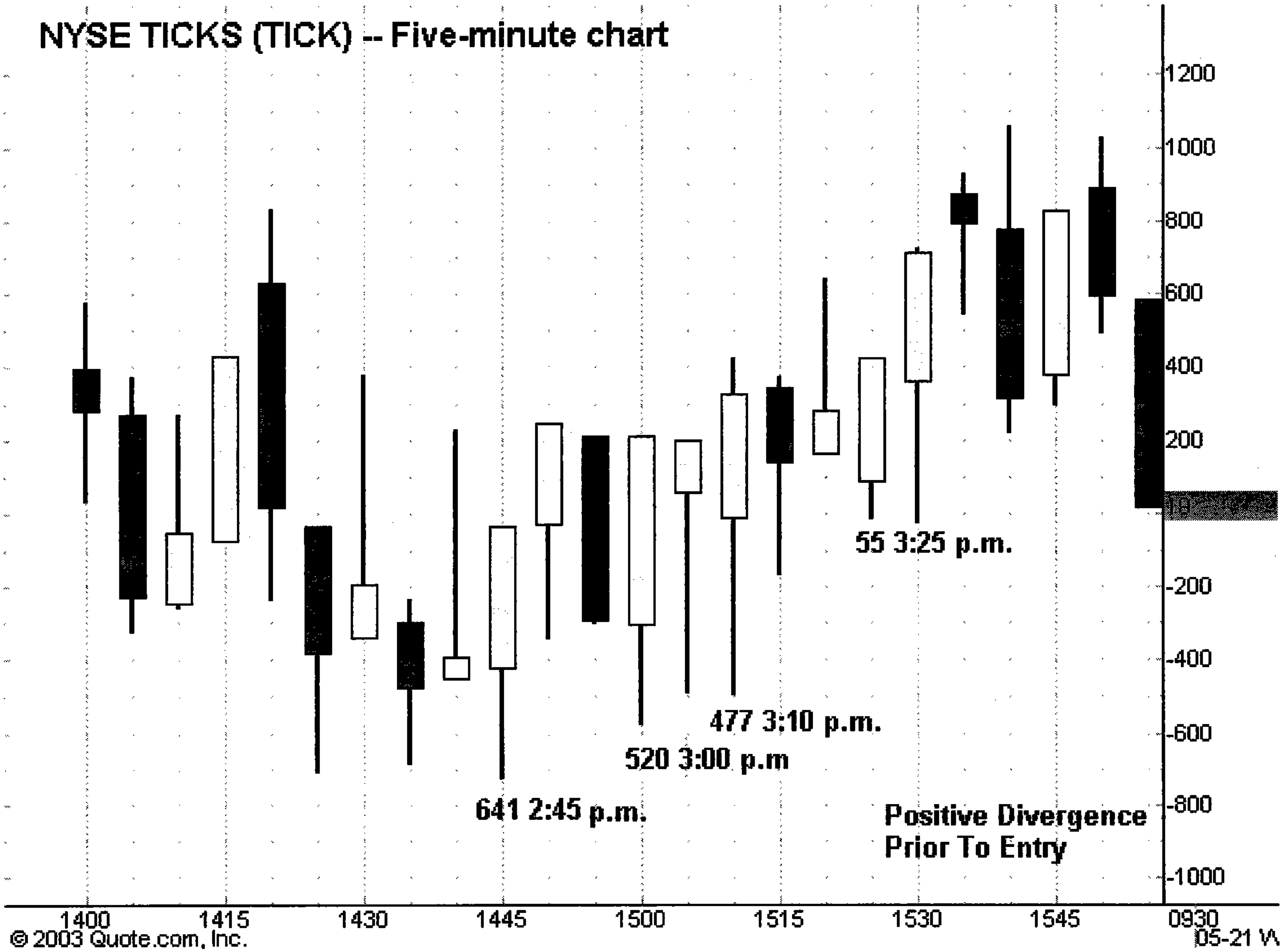


Chart Review

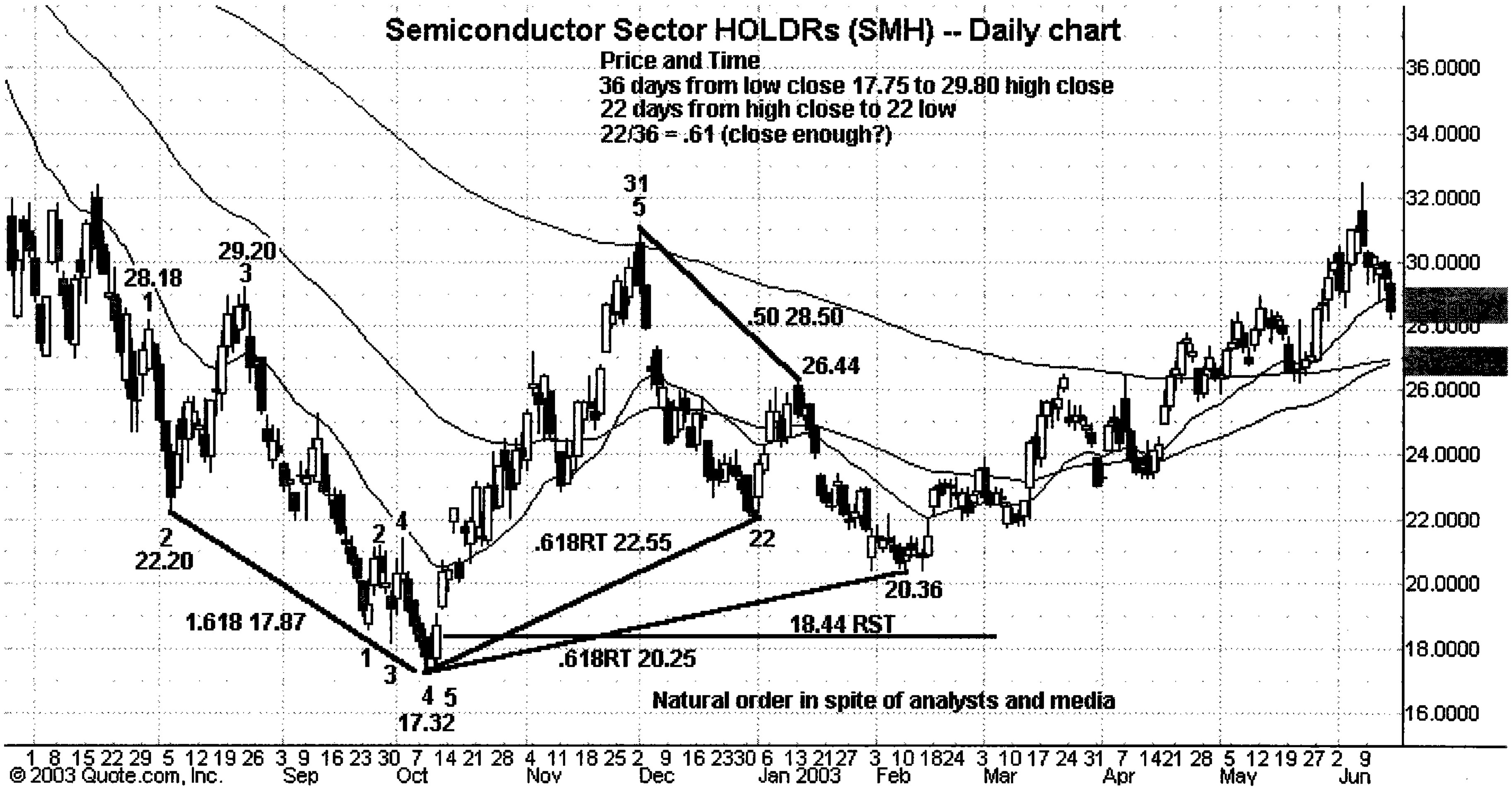


Chart Review

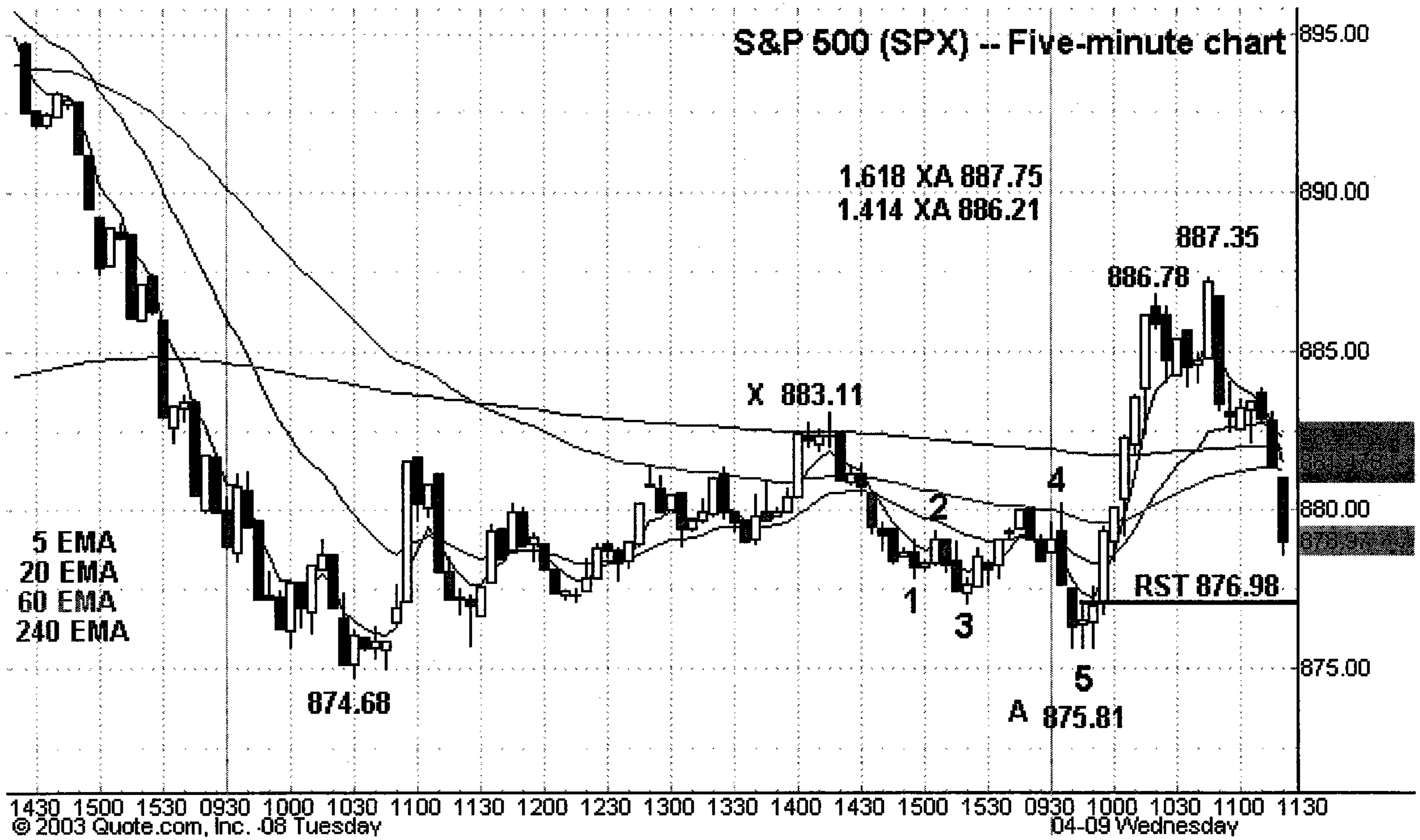
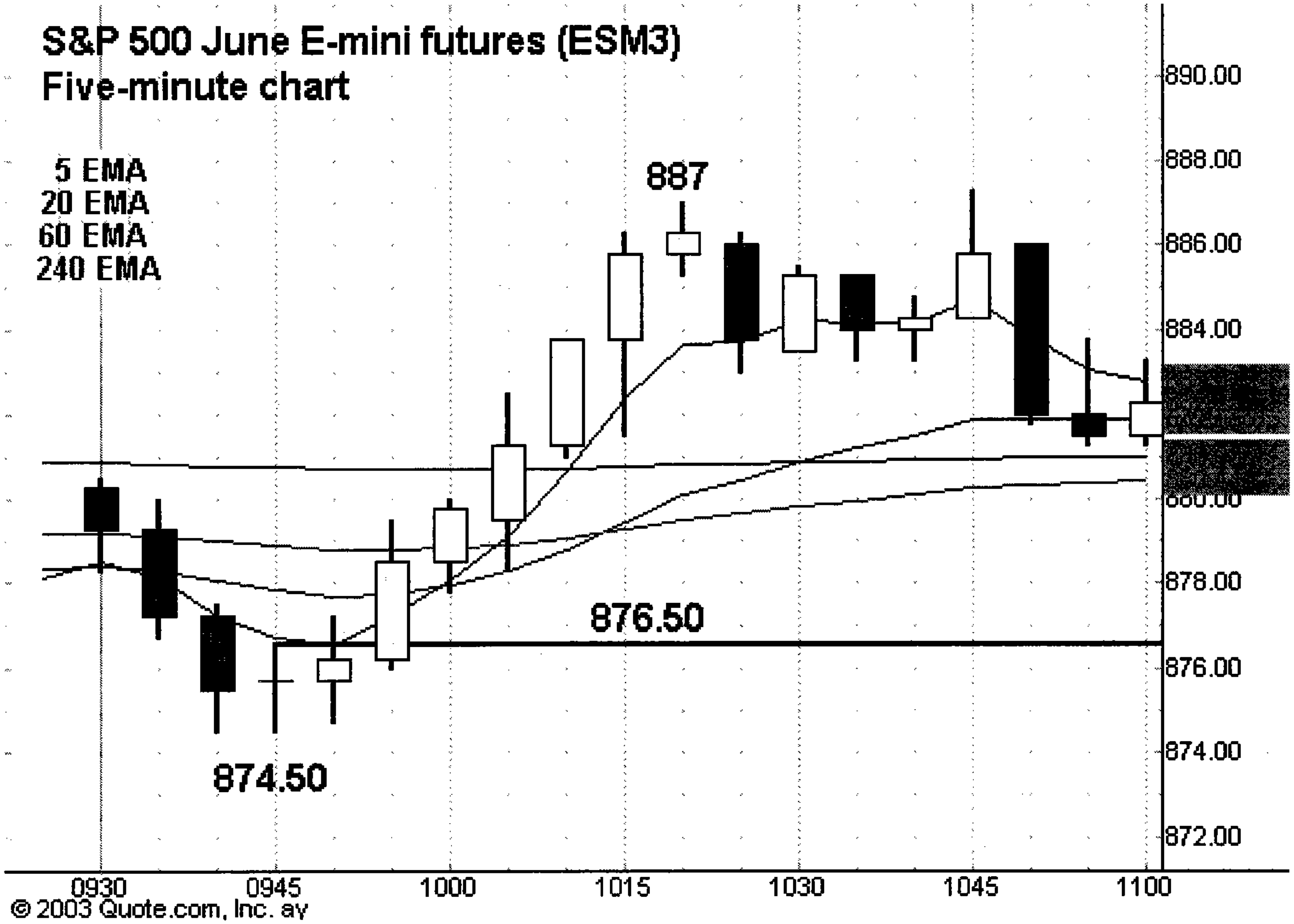


Chart Review



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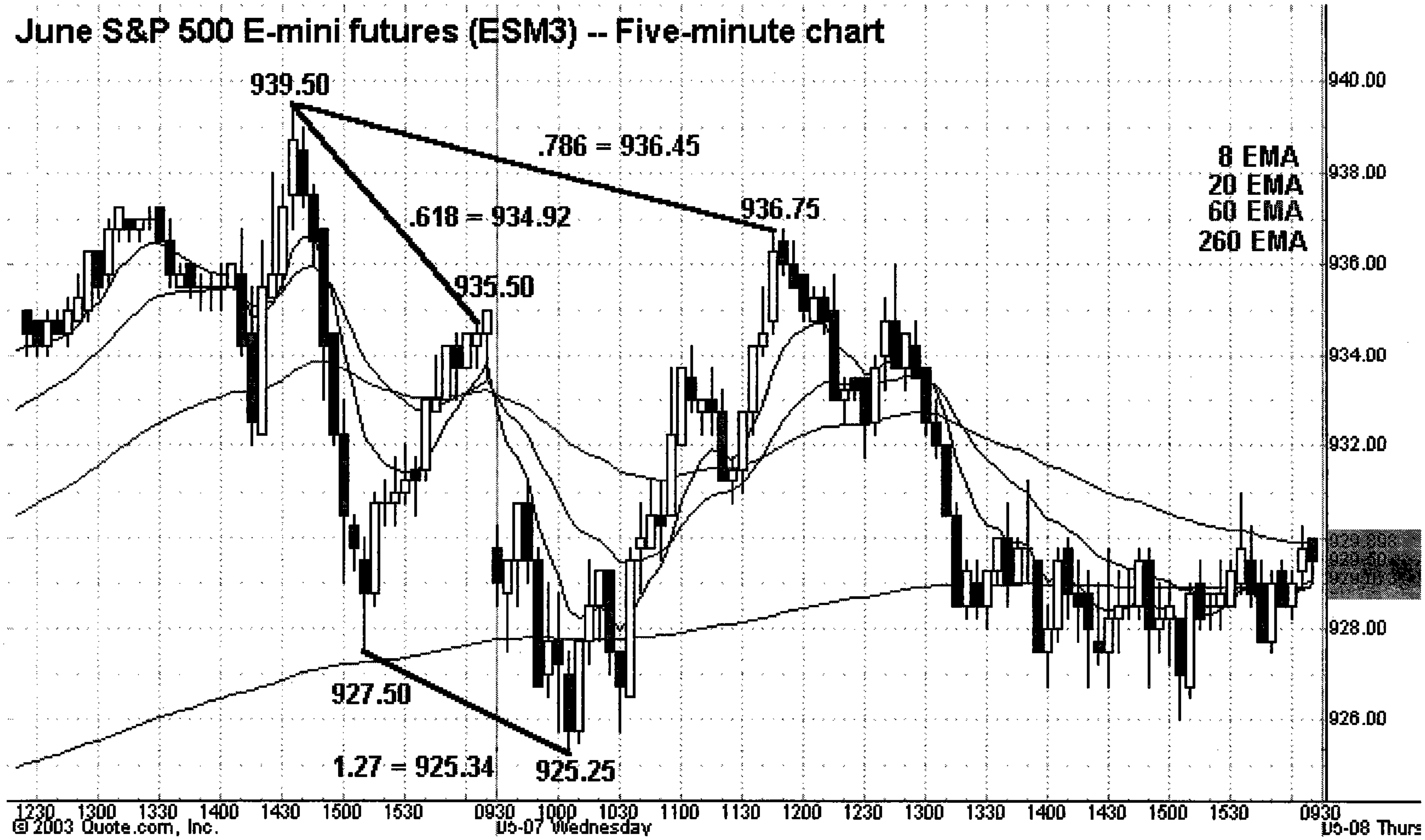

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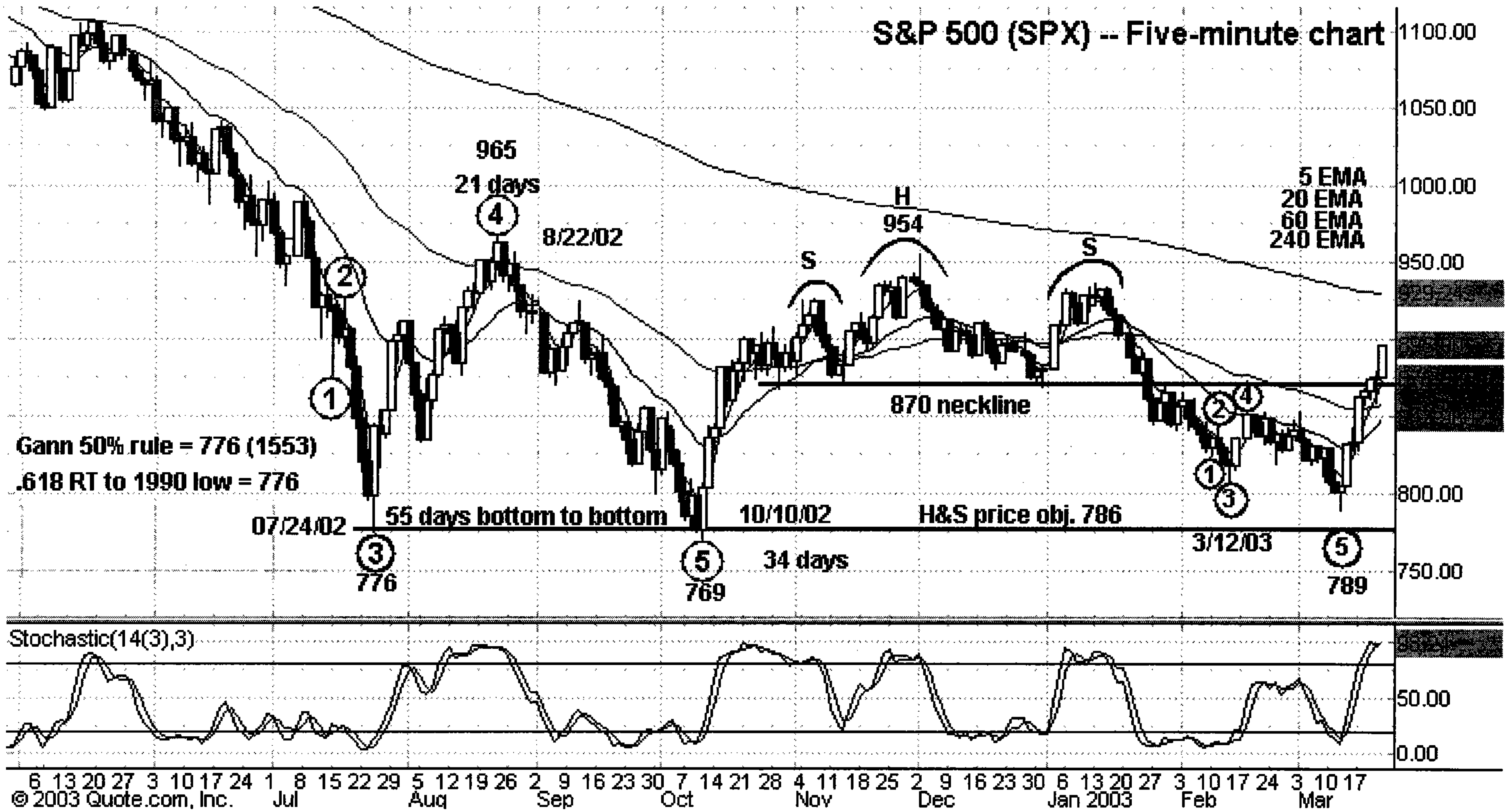

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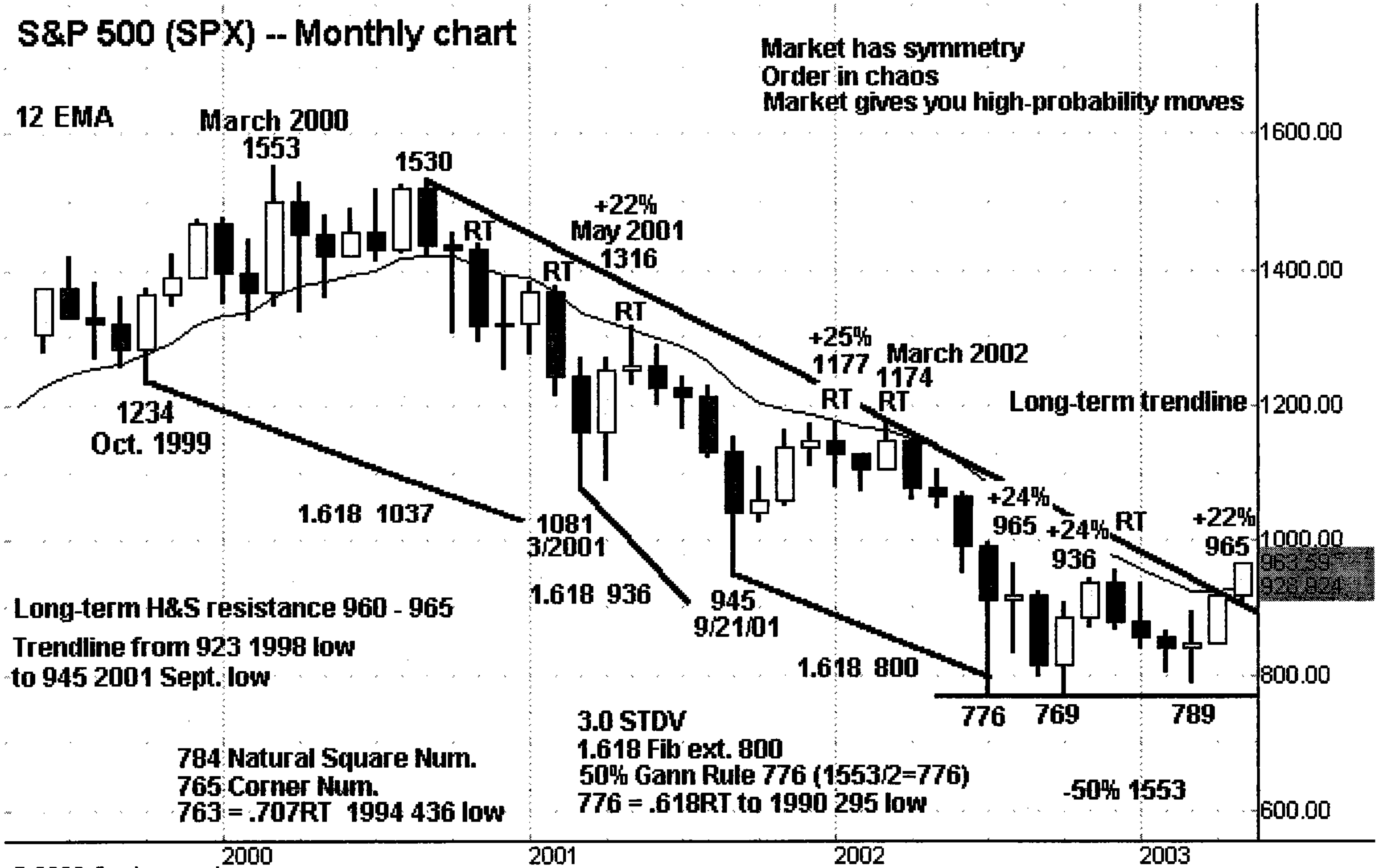

XV. Risk Control and Money Management

RISK CONTROL – MONEY MANAGEMENT

The Traders Equation

Maximum % of Profitable Trades x Maximum Profit Per Trade minus Small Losses x Multiple Trades = Successful Trader

1. The most important thing you must manage as a trader is the size and frequency of your losses.
2. Control of your emotions to be able to pull the trigger or hit the ejection button. There can't be any emotional involvement. Stick to your trading plan because they are just numbers, not personal possessions.
3. Manage winning trades to maximize the profit on each trade.
4. Take profits on one-third to one-half of your position and move stop to cost. It's better to leave the table with cash in your pocket.

RISK CONTROL – MONEY MANAGEMENT

5. Adjust size to volatility (wider stops, smaller size).
6. Never take more than a small percentage loss on your total trading capital on any specific trade. Set a maximum amount of loss for the day.
7. Allocate a specific dollar amount to each trading position (i.e., $100,000 equity split to form $25,000 positions).
8. Only trade the good setups. Don't force it if you don't clearly see the pattern or sequence.
9. Take time off and don't try to trade every day.
10. Review your trades at the end of each day.

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