MTPredictor Trading/Training Course

(Risk/Reward trading with Elliott wave)

Part 1

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Risk and disclaimer and disclosure

It should not be assumed that the methods, techniques or indicators presented in this course will be profitable, or that they will not result in losses. Past results are not necessarily indicative of future results. All examples in this book are for educational purposes only. This is not a solicitation or offer to buy or sell anything. There is risk of loss in trading and investing. All trade decisions are your own sole responsibility.

Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance track record, simulated results do not represent actual trading. Also, since the trade have not actually been executed, the results may have under or over compensated for the impact of certain market factors, such as the lack of liquidity. Simulated training programmes in general are also subject to the fact they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profitable losses similar to those shown in this trading course.

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Table Of Contents (Part 1)

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Chapter 1 - Introduction

Welcome to the MTPredictor Trading/training Course. Although this course is primarily designed for users of the MTPredictor software program to teach them how to get the most out of the software, it is also supplied as a stand-alone teaching aid on the topic of Risk/Reward trading with Elliott wave using MTPredictor. So, if you are using this course to learn more about MTPredictor, it will give you a very good insight into my unique *Isolation Approach*™ to trading Elliott wave and how the automatic routines in the software work.

This course is split into two main parts, Part 1 and Part 2 - Part 1 covers practical Elliott wave theory and the three standard MTPredictor trade set-ups; Part 2 covers advanced analysis using the MTPredictor software program.

Part 1 is essential reading and should be read before starting to use the MTPredictor software. Part 2 takes you to more advanced levels.

Although much of this course and, therefore, the MTPredictor program, is based on Elliott wave theory, please do not start with any preconceived opinions from other sources. I have a particular way of interpreting the Elliott wave theory, so I appreciate you taking a look at what I have to say in an unbiased manner. This is particularly important because Elliott wave theory has been taught in such a specific way for so many years that most believe there's only one Elliott approach to markets. As you'll see throughout this Course, I believe this is not true.

If you are new to Elliott wave theory, you will not fully appreciate the paragraph above. So, please read some of the standard Elliott wave textbooks to see how this analysis technique is taught conventionally. You will then be able to understand my own view and why it is necessary to amend the way the Elliott wave theory is typically taught.

Part 1 starts by tackling the practical application of Elliott wave theory, in particular where the theory breaks down in the real world. Importantly, I will offer a unique solution, which allows a very practical use of Elliott wave in today's markets. This unique approach is then detailed, showing how it is the basis of the three key, automatic trade set-ups within the MTPredictor software program. If you are new to the software, these three automatic trade set-ups will be the main automatic routines to use on a daily basis.

Please note, although these routines are provided in the software and are capable of automatically finding and analysing specific trade set-ups, they should not be viewed as a *black box* trading system. They are only designed to *highlight* potential trade set-ups. They should be viewed as a *systematic* approach to the markets and not a system to be followed blindly.

Chapter 8 in this section is probably the single most important chapter in the whole Course because it discusses what goes into and, more importantly, what comes out of your trading account - in other words, profits and losses. There are too many software programs and training courses that are unwilling to tackle the topic of trading losses, so a full understanding of this chapter is vital.

Part 2 takes the software to the next level, and shows you how to perform additional manual analysis to uncover more advanced trade set-ups. Although it is very detailed, the concepts and trade set-ups covered are simple and straightforward. More importantly, once you have learnt these advanced techniques you will fully appreciate how easy they are to apply using the modules and tools in the MTPredictor software.

Thanks, and good trading . . . .

Steve Griffiths

Chapter 2– Introduction to Elliott wave theory

In this first section, I would like to take a look at the Elliott wave theory as the standard Elliott wave books, courses, and software programs teach it today. I will then move on to show where (in my opinion) this theory falls down when applied to actual market activity. I'll then show one unique solution developed from practical experience as a private trader during the last 17 years.

Even if you are an advanced or expert Elliott wave analyst, please do read this section, as it will cover my own personal view on the Elliott wave theory, in particular why I feel that the Elliott wave theory does not work as well in practice as it does in textbooks. I'll show how I use the Elliott wave theory, which is very different to the standard way taught in most Elliott wave textbooks. As such, please do read this whole section, as it will allow you to fully understand how I approach market analysis myself.

This is especially important, as it is the basis upon which the MTPredictor software is built and the reason why the software works very differently from some of the other Elliott wave programs on the market today. It is vital that you have a complete and full understanding of this before you can fully appreciate the MTPredictor program and its automatic routines.

If you are one of those who have tried Elliott wave analysis, and have now given up on it because you have found that it has not worked for you, then please do read this section carefully as I hope you will be pleasantly surprised at the solution I've developed.

If you are new to Elliott wave analysis, then please understand that this is a unique take on the way Elliott wave analysis is normally taught. Please understand that I am not saying in this chapter that the Elliott wave theory does not work - only that I have found it difficult to apply consistently as it is taught conventionally. This is not just because I am not good at applying the theory, it is a story I have heard time and time again from hundreds of Elliott wave traders during my last 17 years in the markets.

If you are new to Elliott wave analysis, I do suggest that you read some of the standard Elliott wave analysis textbooks yourself. You will then be able to fully appreciate the differences and exactly why the MTPredictor approach to Elliott wave analysis is unique.

Although I do not intend to go into great depth on the Elliott wave theory, mainly because there are numerous books and training courses written already on the subject, I feel I do need to give a brief introduction to those of you who are unfamiliar with it. For those of you who are familiar with it, please read on as I would like to introduce my own view on the theory.

The Elliott wave theory was born from a set of articles written in the 1930s by R. N. Elliott, from his studies mainly on the Dow Jones Industrials index eg. the American Stock Market. He noticed that the market tended to move in certain patterns. He then surmised that these patterns could then be used to predict certain future price movements.

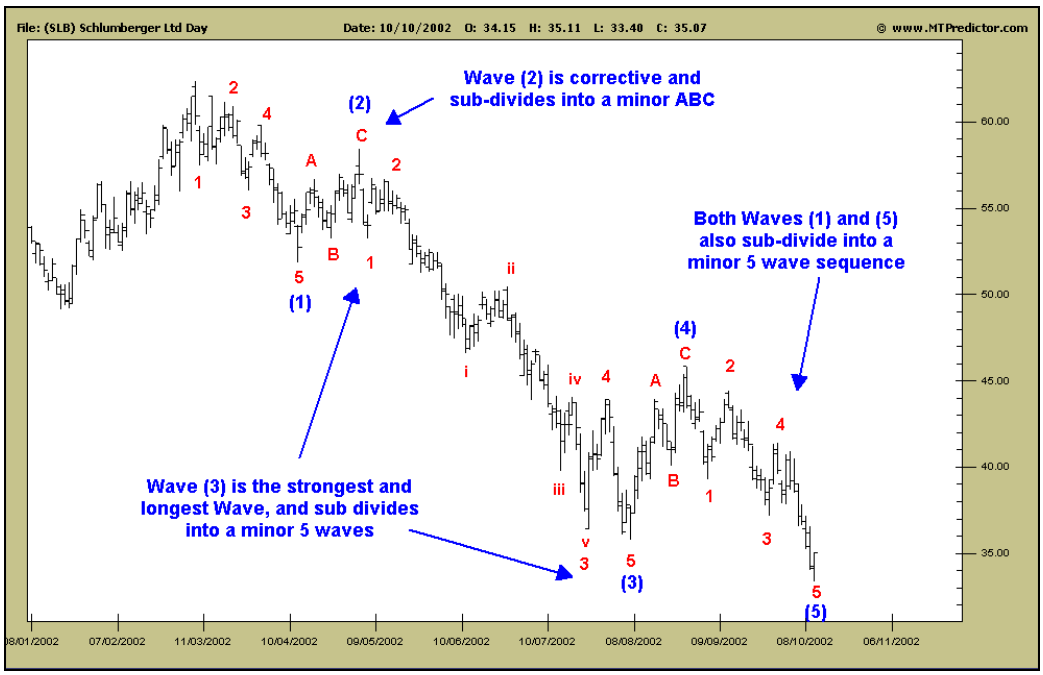
In essence, he noticed that most strong trends tended to unfold in 5 waves in the direction of the main trend, and which were connected by certain corrective patterns. He also noticed that when each pattern was complete, it then formed part of a larger-degree pattern. He also surmised that each pattern not only unfolded as part of a larger-degree pattern but also sub-divided into a minor pattern where the impulsive swings (the ones in the direction of the main trend) tended to unfold in 5 waves connected by corrective patterns (the simplest of which was the ABC).

He then surmised that *if* a market analyst pinpointed where in this pattern the market currently was, then he (or she) should be able to predict where the market would go from here. In essence, the Elliott wave theory allowed you to predict future market movements.

This is very different from many technical analysis techniques available today, where most of them are *lagging indicators* that show you when a market turn has unfolded in the past. Elliott wave theory is designed to be *predictive* in nature and as such should be considered a *leading indicator*, with the future movement of a market able to be anticipated, once the current position is established.

Continued on the next page . . . ..

If you look at the chart below, you can see how the decline on this US stock, SLB, unfolded in a perfect Elliott wave pattern, where each of the swings unfolded as either an *impulsive* 5 waves sequence, or a *corrective* ABC sequence. The larger-degree waves also sub-divided into a minor Elliott wave pattern, and the minor patterns made up a larger-degree Elliott wave pattern.



So, if you were able to determine accurately where in this current pattern you are, the Elliott wave theory should then be able to predict where the market should go in the future.

As you can see, knowing what a particular market is going to do in advance sounds great and should be the answer to every analyst's dream. However, as you may suspect, it is not as easy as this in reality, and the Elliott wave theory has received much bad press over the years - because so many of its *predictions* of where a market *should go* simply have not unfolded as anticipated.

This has sometimes given the Elliott wave theory a bad reputation, with many analysts not believing that it works, or that you can make money by trading it. This is where my own view on Elliott wave analysis comes in. Like many frustrated and fed up Elliott wave analysts, who have seen too many predictions fail, I also began to suspect the Elliott wave theory was no more than a very complicated way to show what *had* happened in the past, and was worthless for any predictive ability.

If you also fall into this category, please continue to read the next few chapters, as I hope to show you where I have found the wave theory has fallen down from my own experience, and also what parts of the wave theory I have found to be reliable.

Over the next few chapters, I will take a look at the Elliott wave theory as it's taught in the more *standard* Elliott wave sources and then move on to take a very detailed look at where (in my opinion) the Elliott wave theory falls down. In particular, I will look at what may be the greatest failing of the Elliott wave theory - it is so difficult to pinpoint exactly where you are in the current pattern, making any future prediction far less reliable than we would like.

Then, more importantly I will dissect the theory and take a look at what I have found to be a very reliable and simple pattern that, taken in isolation, provides a very good method for identifying a high probability, low-risk *trade set-up* that allows you to enter the market with a small initial risk, compared with the anticipated profit.

In essence, what I have done from my own research and experience over the last 17 years, is to take one part of the Elliott wave theory and, rather than use it for trying to predict the future, used it as a method for identifying a high probability, low-risk trade set-up - where the aim is simply to enter a trade with a small controlled risk. Over time, the result of these trades produces profits that are greater than the losses.

If you are an experienced trader already, then you will know that the single most important aspect of any successful long-term approach to the market is having a method that can consistently keep your losses small in relation to your profits.

Therefore, as you read the next few chapters, please bear in mind that this is a personal view of the Elliott wave theory, from my own experience as a private trader in the markets. Over the years, I have also heard a similar story from many traders who have also tried the Elliott wave theory, and have been less than impressed with the results.

Please understand, I am not saying that the Elliott wave theory does not work, or that some people cannot use it. There are a number of very good traders worldwide who use the Elliott wave theory very well indeed. But in my own experience I have found the Elliott wave theory to be less reliable than I liked, and also I have met many traders who have also had a similar bad experience with the theory, and found it difficult to apply on a consistent basis.

Even if you are an experienced Elliott wave analyst, and you like the Elliott wave theory, please bear with me, because I hope I can demonstrate that within the theory there is one simple pattern that is worth its weight in gold. But more importantly, that this simple pattern is far easier to identify and work with than trying to apply the whole of the Elliott wave theory all of the time with all of is complex patterns and alternate wave counts.

Chapter 3 – Basic Elliott wave theory

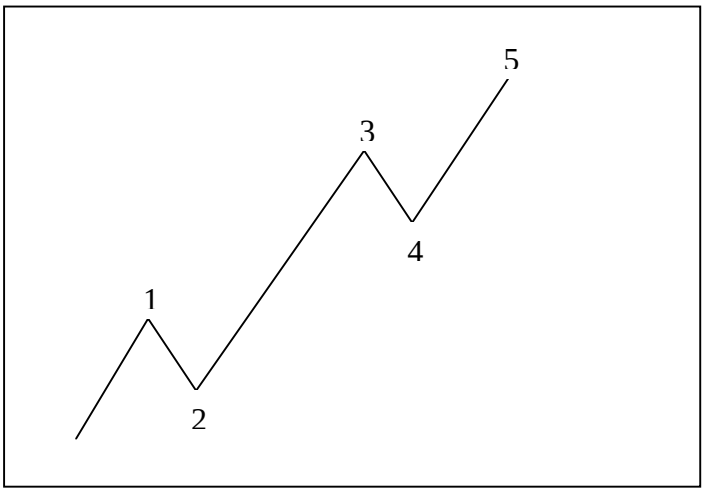
In this chapter I would like to look at the basic form of the Elliott wave patterns, and then look at some of the basic rules (or guidelines) that are currently used today by Elliott wave analysts. Although, at first sight, this chapter may seem very complicated, please read through the entire chapter, because it will lead on to why I suggest trading in the way I do later in the Book. It is vital to first understand Elliott wave theory in its conventional guise, to be able to see its shortfalls, to see how to use the parts that do work and why they work.

First I would like to give a General Overview of Elliott wave theory.

General Overview

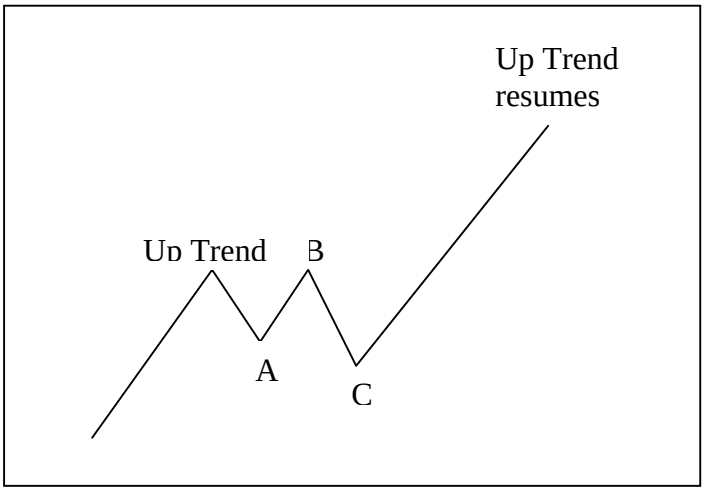
First there are two basic categories of waves: Impulsive (those that are *in the direction of* the main trend), and Corrective (those that are *against* the main trend).

An Impulsive Wave normally unfolds in 5 waves of lesser-degree, and normally unfolds in the direction of the main trend. Let's see what this looks like:



Here you can see the simple basic form of the Impulsive 5 wave swing, where you have 5 waves that unfold, in the direction of the main trend…in this example, up.

A Corrective wave is basically any form of wave that is not impulsive. The easiest to recognise and the most common is the simple ABC correction.

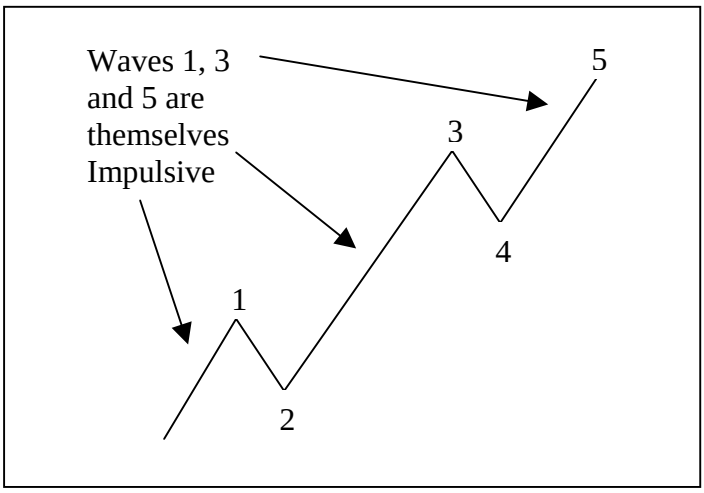


Here you can see the basic form of the simple ABC correction, where an up trend is followed by a correction that sub-divides into 3 swings, which are labelled A, B, and C. Then, once the correction is complete, the prior trend resumes.

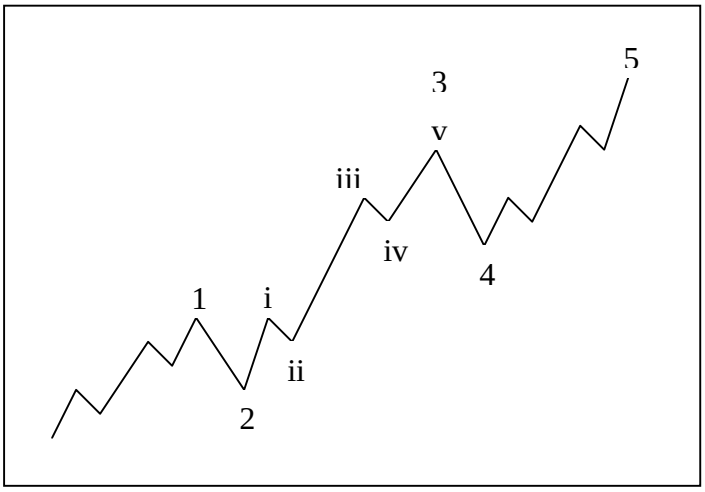
Now I would like to go into a little more detail on each category of Wave, starting with Impulsive waves.

Impulsive Waves – Basic form

The basic 5-wave pattern is made up of *lesser-degree* waves of which Waves 1, 3 and 5 are themselves impulsive 5-wave patterns.

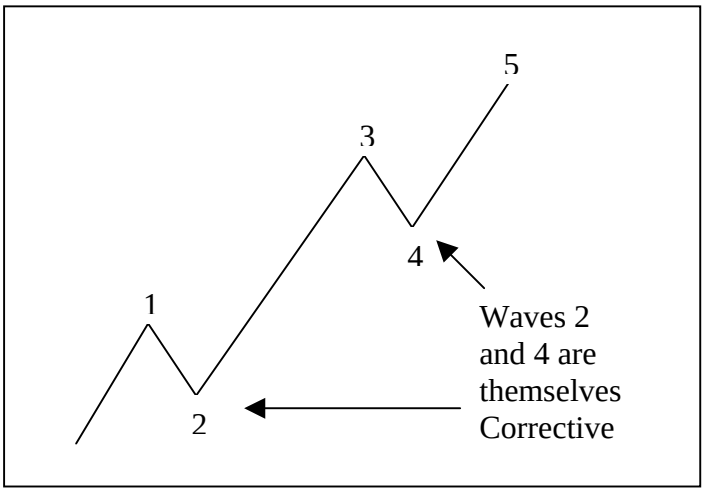


These impulsive waves (1, 3 and 5) should each sub-divide themselves into lesser-degree 5-wave patterns.



Here I have labelled the Wave 3 as unfolding as a minor 5 waves, labelled i, ii, iii, iv and v, but both the Waves 1 and 5 should also sub-divide into a lesser-degree 5 wave pattern.

Waves 2 and 4 (which *link together* Waves 1, 3 and 5) are Corrective.



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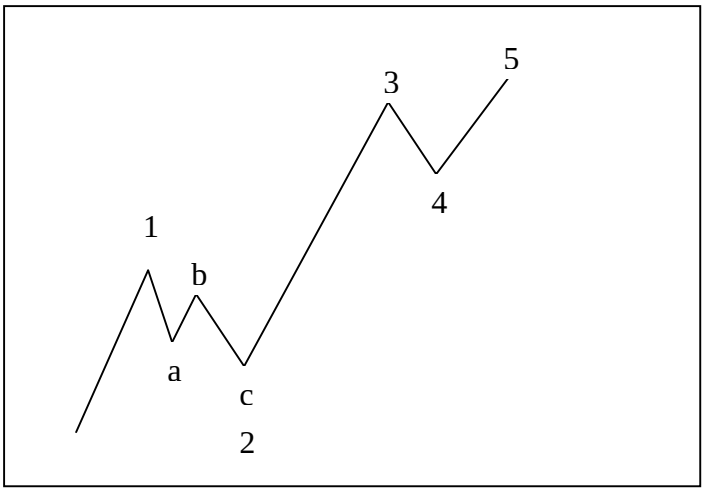
Waves 2 and 4 normally sub-divide into either a simple ABC or one of the more complex corrective Elliott wave patterns (more on this later).

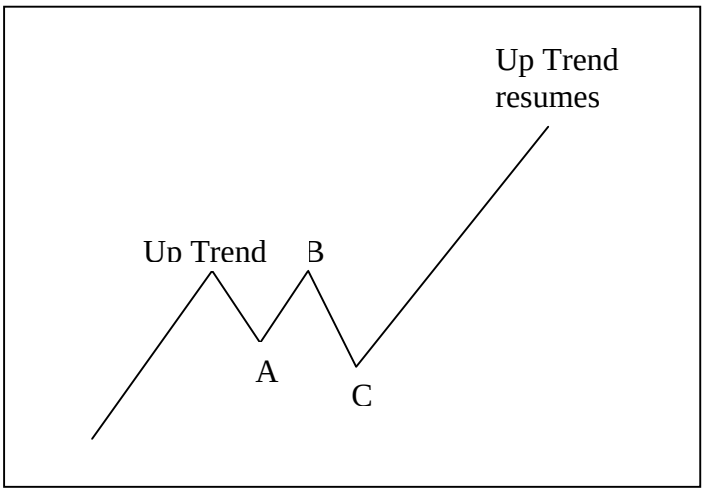


Here I have labelled the Wave 2 as unfolding as a minor 3 wave correction, labelled a, b and c, but wave 4 should also sub-divided into a minor corrective pattern.

Corrective Waves – Basic form

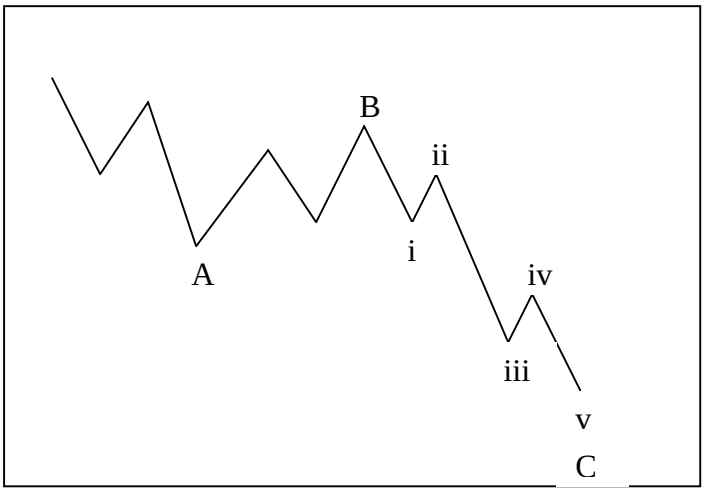
Although there is only one basic impulse wave (the 5 wave sequence) corrective patterns can unfold in many different forms. This (I believe) is one of the main reasons why Elliott wave analysis gets such a bad press, and why it is so difficult to apply consistently in practice, as many of these more *complex* corrections are what they sound - very complex, and are very often only visible after they are complete, which is useless for making an informed trading decision.

Elliott himself described in detail many of these complex corrections. However, because of their limited use, I believe it is best sticking to the easiest to recognize, most reliable and most common corrective pattern – the simple ABC correction.



As you saw earlier, the simple ABC correction is a 3-swing pattern where the Wave C exceeds the price extreme of the Wave A.

Ideally Wave A of the ABC should sub-divide into a *lesser-degree* 3 (ABC) or 5 (12345) wave pattern, and the Wave B should sub-divide into a lesser-degree 3 (ABC) wave pattern and the Wave C should sub-divide into a lesser-degree 5 (12345) wave pattern. This is the only place where a 5 wave pattern would be viewed as part of a correction and therefore not *in the direction of* the main trend.



Here you can see the minor 5-wave sub-division of the Wave C into a lesser-degree i, ii, iii, iv and v waves.

At first sight this may seen complicated, but I assure you things will get a lot simpler and easier in the following chapters. Part of what I wish to covey in this chapter is how complex and involved Elliott wave analysis can be in theory. Once we get on to the practical application in the next chapter, things will start to get even worse. But, again rest assured, this is only a means to an end, because I need you to see and fully understand the complexities of the Elliott wave theory to be able to fully understand the simplicity of the MTPredictor approach later in the course.

As you may have guessed already, you will be seeing a lot more of this simple ABC pattern as we progress further in the course!

Okay, now I have outlined the basic form of the two main categories of Elliott waves, I can start to look at the rules (or guidelines) on how they should unfold.

Impulsive Wave – rules for a 5 wave sequence

There are three main rules that most standard Elliott wave analysts adhere to today:

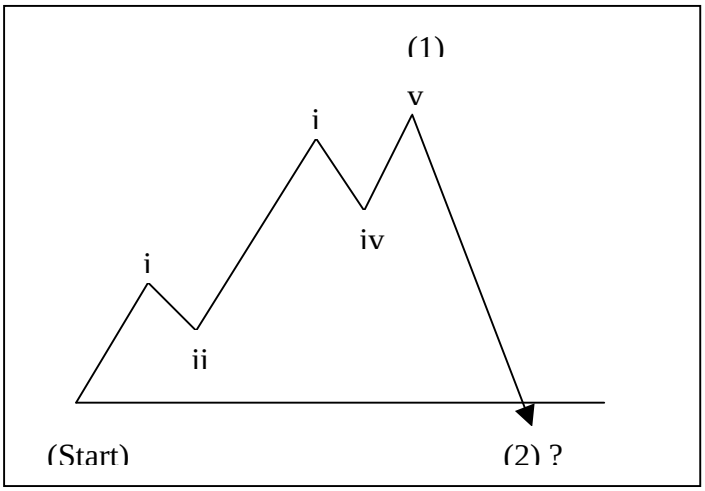
1. Wave 2 cannot retrace past the start of Wave 1
2. Wave 3 cannot be the shortest wave in a completed 5 wave sequence, and
3. Wave 4 cannot retrace into Wave 1

Although these are quoted as *rules*, Elliott himself (in his original writings) never referred to these as strict rules, he used phrases like *should* and *rarely* to describe them. As such, the label of *Elliott wave rules* was probably added in later years in an attempt to make the principle less ambiguous and more structured and exact. I will look at this in more detail in a later section.

For now I would like to look at each of these rules to demonstrate how to label a chart correctly.

Impulsive rule 1 – Wave 2 cannot retrace past the start of Wave 1

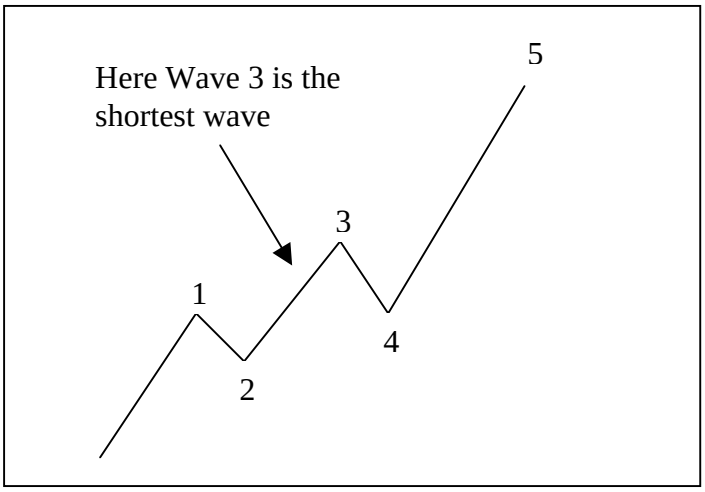
If Wave 2 retraces past the start of Wave 1, then it cannot be considered a Wave 2 and the current wave structure must be reconsidered.



This cannot be considered a valid wave count, because Wave (2) has traded below the start of Wave (1), so this wave count must be re-considered.

Impulsive rule 2 – Wave 3 cannot be the shortest wave

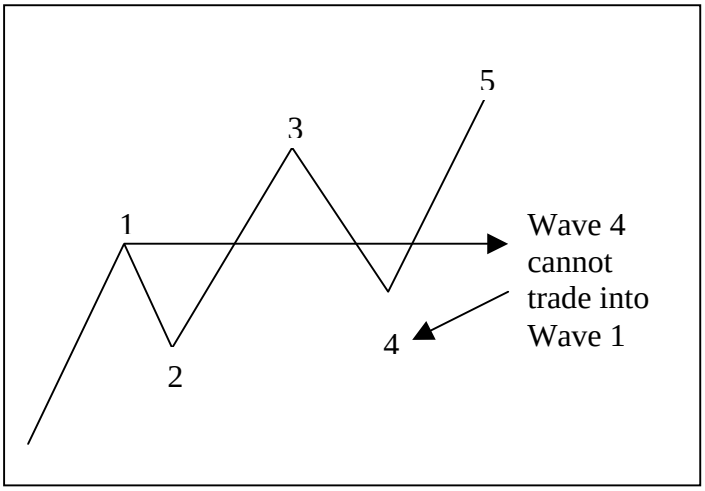
Wave 3 cannot be the shortest wave in a completed 5-wave structure.



Here Wave 3 is the shortest wave in this completed 5-wave sequence, which would be in breach of the second rule, so this wave count is incorrect and must be re-considered.

Impulsive rule 3 – Wave 4 cannot retrace into the area of Wave 1

If Wave 4 retraces into the area of Wave 1, then it cannot be considered a Wave 4, and the current wave structure must be reconsidered.



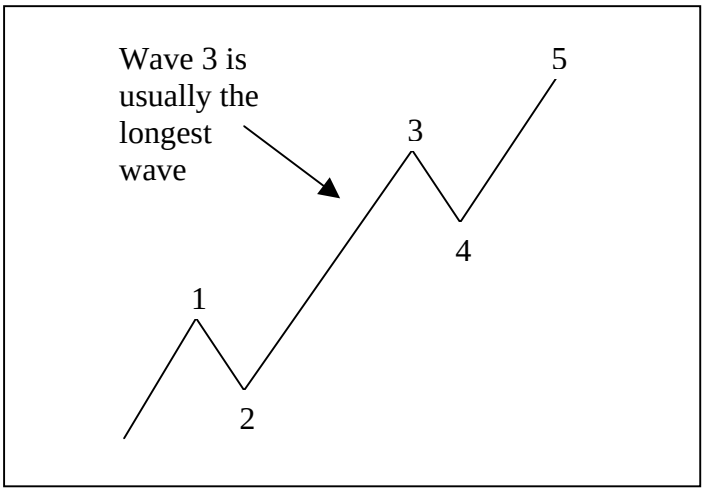
Here Wave 4 has retraced back below the high of Wave 1, which would be in breach of the third rule, so this wave count is incorrect and must be re-considered.

They are the three main Elliott wave rules that should be obeyed in all 5-wave sequences. Now I would like to look at some additional observations and general guidelines that can help in placing an Elliott wave count on a chart.

Corrections and corrective waves do not have a set of *rules* associated with them, so these general observations focus on the *ideal* 5 wave pattern.

General observation 1 – Wave 3 is usually the strongest Wave

Rule 2 started that Wave 3 cannot be the shortest wave in a complete 5 wave sequence. In practice, Wave 3 is usually the strongest and longest wave.



As wave 3 is usually the longest and strongest wave it normally carries the largest profit potential so (as you will see later) this is one of the best waves that you can trade.

Wave 3 very often is the *extended* wave, where this swing trades beyond what is considered normal in a completed 5-wave sequence. Again this makes this an ideal wave to trade, because of its large profit potential.

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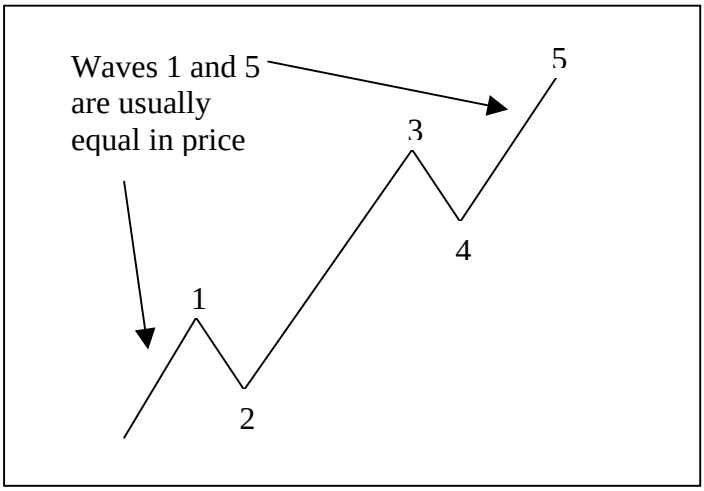
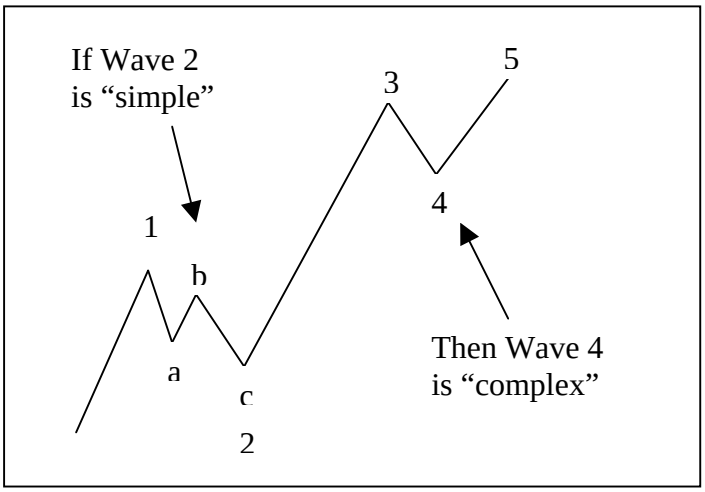
General observation 2 – Waves 1 and 5 are very often equal in price

If Wave 3 is the extended wave (i.e. it is the longest Wave) then very often Wave 1 and Wave 5 tend to be approximately equal in price.



As wave 5 is very often equal in price to Wave 1, once Wave 4 is complete, this allows an easy way to approximate where the Wave 5 will end.

General observation 3 – the rule of alternation

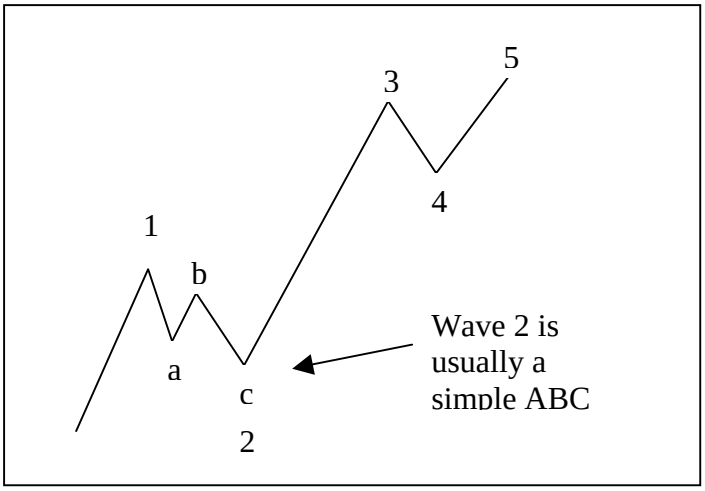


There is a general tendency for the pattern of the two corrective swings in a completed 5-wave sequence to alternate between a *simple* (very often an ABC) correction and one of the more complicated or “complex” Elliott corrections.

This is a very helpful observation, because if Wave 2 unfolds as a simple ABC correction then the probabilities will favour that Wave 4 will unfold as a more complex correction. And vice-versa, if Wave 2 is complex, then you should anticipate that wave 4 is likely to unfold as a simple ABC pattern.

General observation 4 – Wave 2 usually unfolds as a simple ABC correction

In most cases Wave 2 usually unfolds as a simple ABC correction. Or put another way, a simple ABC correction is found in a Wave 2 correction more often than in a Wave 4.

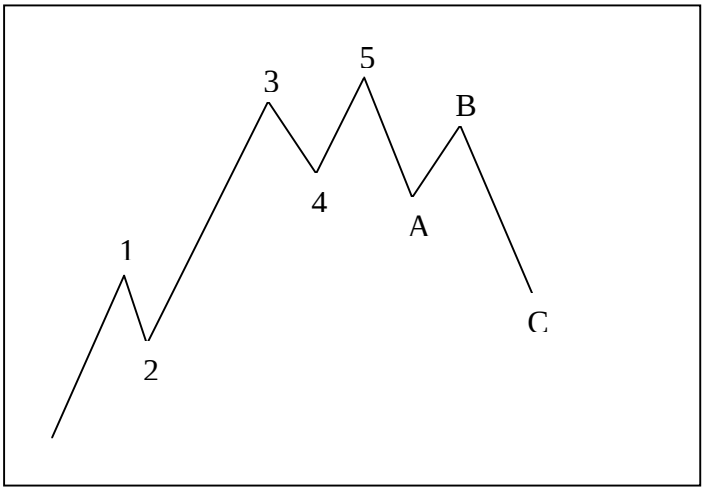


Again, this is a very useful piece of information, because once Wave 1 is complete, then the most likely pattern to unfold is a simple ABC correction.

And, because of the rule of alternation, this leads onto Wave 4 usually being the *complex* correction in a completed 5-wave sequence.

General observation 5 – Once a 5 wave sequence is complete, the whole sequence is corrected

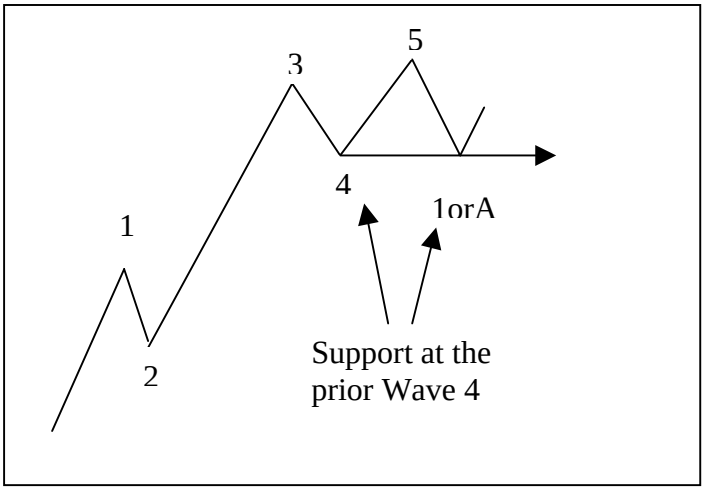
Once the Wave 5 of a completed 5-wave sequence is complete a correction will unfold that corrects the entire prior 5-wave sequence



What this means in practice is that once Wave 5 is complete a correction which is larger than any correction incurred during the prior 5-wave sequence should then unfold.

General observation 6 – The first leg of the move off a complete 5 wave sequence often finds support / resistance at the prior minor Wave 4

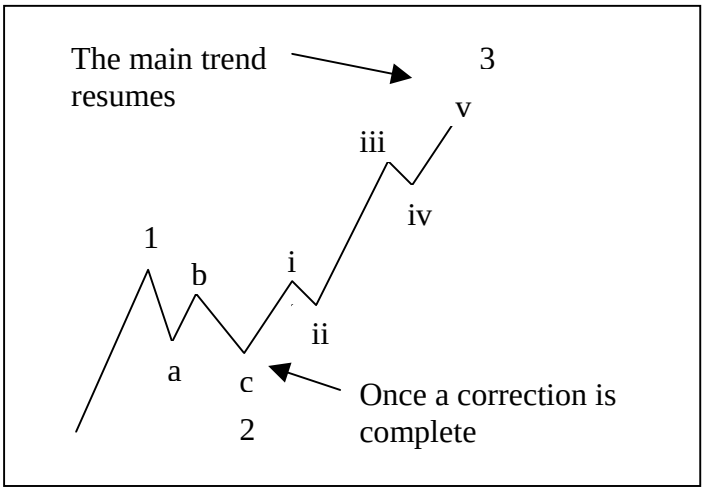
Again, this is a very useful observation as it gives you an approximate target for the first swing of the correction following the end of a completed 5-wave sequence. In Elliott wave terms this is the Wave 1 or A



Here you can see how the first swing off the Wave 5 high found support at the price level of the prior minor Wave 4.

General observation 7 – Once a correction is complete the main trend resumes

Once a correction is complete the main trend normally resumes.

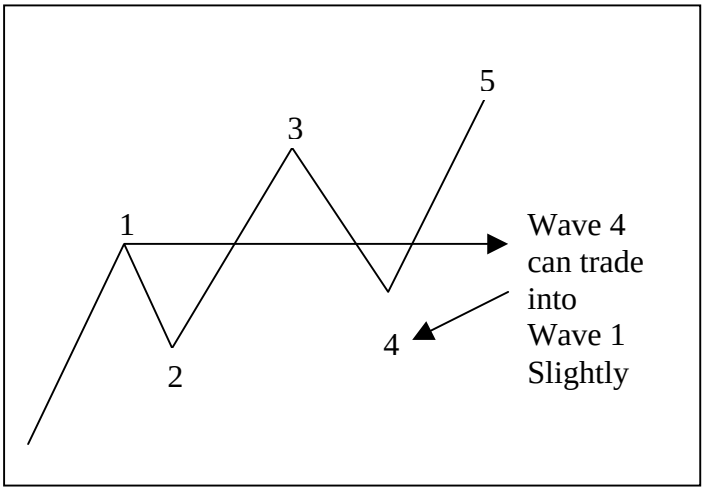


Again, this is a very important observation, because it allows you to anticipate that once a corrective sequence (ideally a simple ABC) is complete, it should be followed by a strong and impulsive move in the original trend direction.

I will be returning to this idea later in the Book.

General observation 8 – Wave 4 can retrace into the area of Wave 1 (slightly)

Rule number 3 states that Wave 4 cannot retrace into the area of Wave 1. However, in practice, particularly in the commodity markets, a small retracement into the area of Wave 1 often happens.



Here Wave 4 has retraced back *just* below the high of Wave 1, which normally would invalidate this as a potential 5-wave count. However, in practice you can allow Wave 4 to dip into the area of wave 1 slightly.

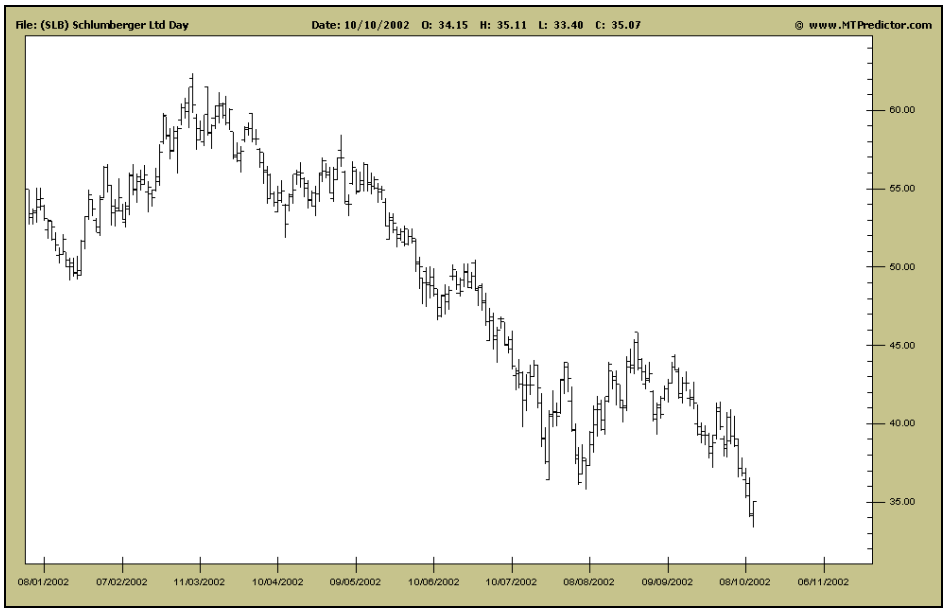
Actually, if the market in question immediately reverses and then moves out of the area of Wave 1, then this should be allowed as a valid 5 wave count. As you will see in a later chapter, although this minor breach of the Wave 1 extreme can be *allowed* it should not normally happen in a *perfect* 5-wave count.

As such, when this happens you should treat the wave count as *valid* but not perfect. More on this in Chapter 15 on advanced Elliott wave analysis.

Continued on the next page . . .

Okay, now I have finished a General Overview of Elliott wave, and the specific Elliott Rules and also some General Observations, you should be ready to apply these to some charts, so let's take a look at a few examples.

Firstly here is a chart of a US Stock, Schlumberger Ltd (SLB):

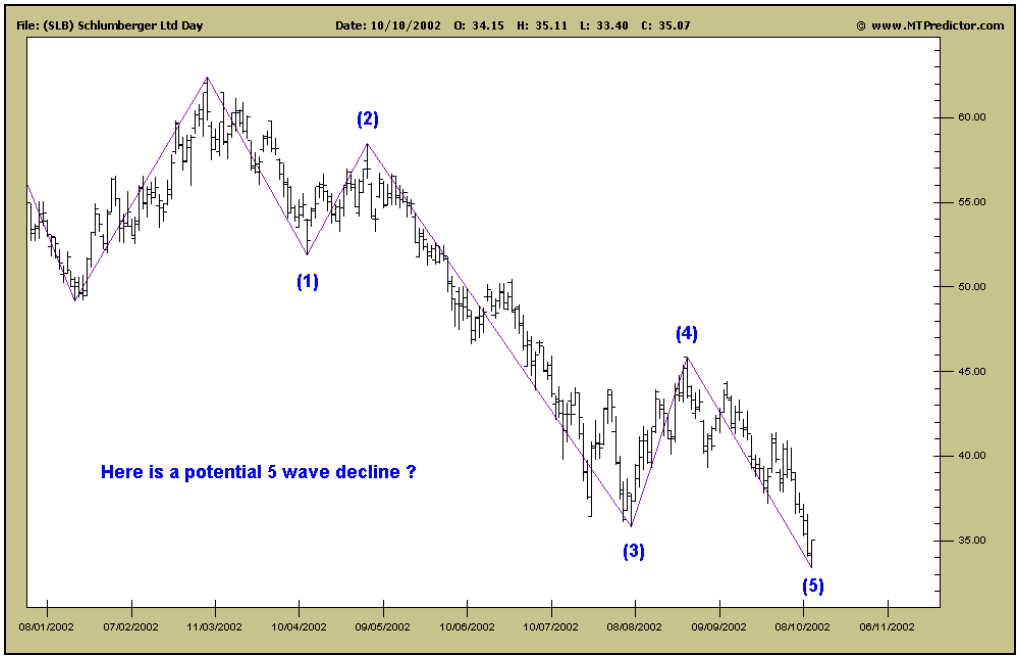


Can you see any Elliot wave patterns present on this chart ?

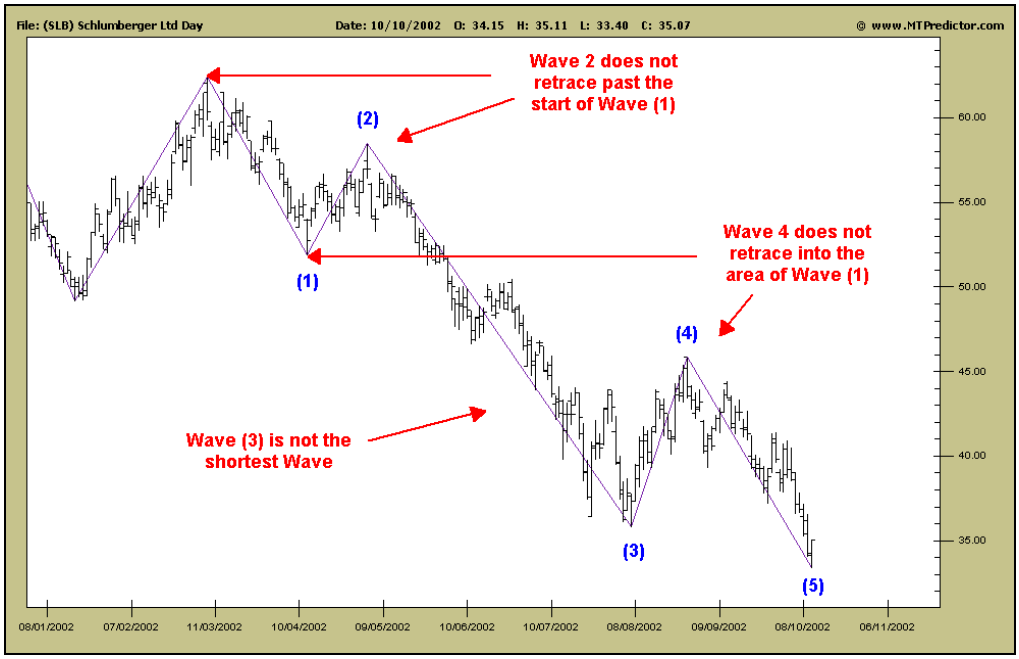
Please try to label this chart for yourself before turning the page to see the answer.

Continued on the next page . . .

Here is the answer - a potential 5-wave decline:

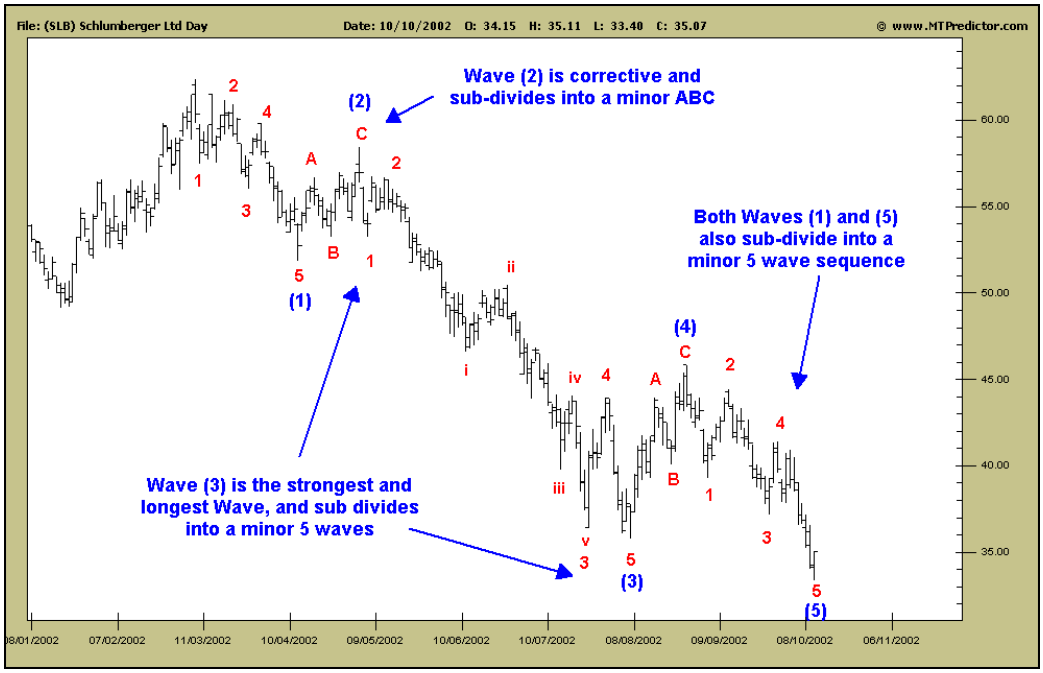


It obeys all of the specific Elliott wave rules:



As well as obeying the basic Elliott wave *rules*, this 5-wave decline also reflects many of the Elliott guidelines that were outlined earlier in this chapter. Please see the chart on the next page.

Here is a more detailed look at the Schlumberger chart:



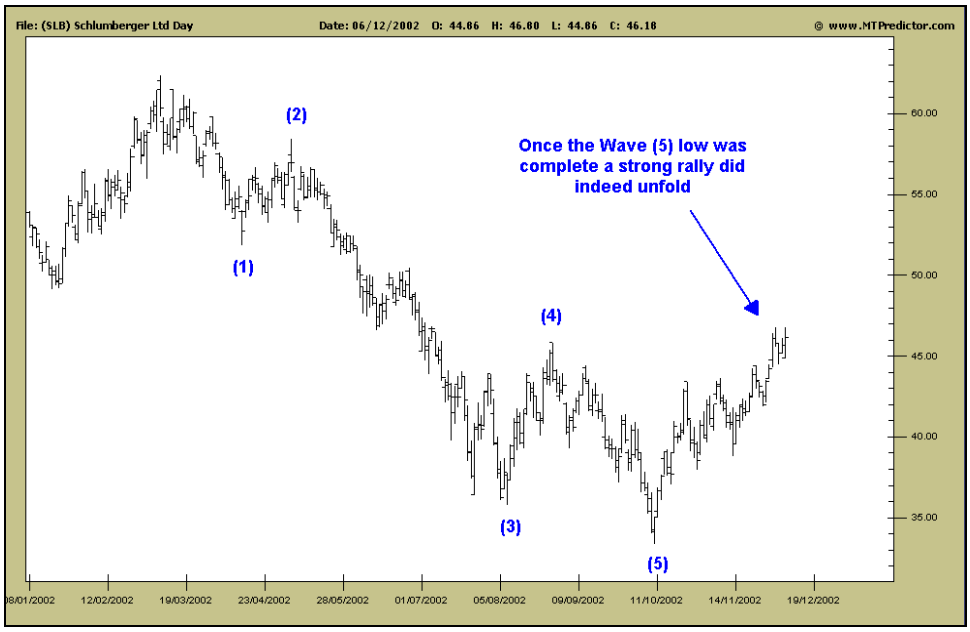
Here you can see many of the general Elliott guidelines, in particular:

- Wave (3) is the strongest and longest of all the Waves.
- Waves (1), (3) and (5), being the 3 impulsive waves, clearly sub-divide into a minor 5 wave sequence.
- Wave 3 of (3), being another impulsive wave, also sub-divides into a minor 5 waves, shown as i, ii, iii, iv, and v. This is what is meant when a Wave is said to be *extended*, another minor 5 wave sequence is clearly visible *within* the Wave 3 of (3)
- Wave (2) is corrective and sub-divides into a simple ABC correction.
- In this example Wave (4) also appears to sub-divide into a minor ABC, which disagrees with the rule of alternation and is viewed as being rare.

Once this Wave (5) low is complete, as outlined in guideline number 5, then a rally greater in magnitude than any of the corrective rallies during this decline should unfold.

Let's see what unfolded after this Wave (5) low was complete. Please see the chart on the next page.

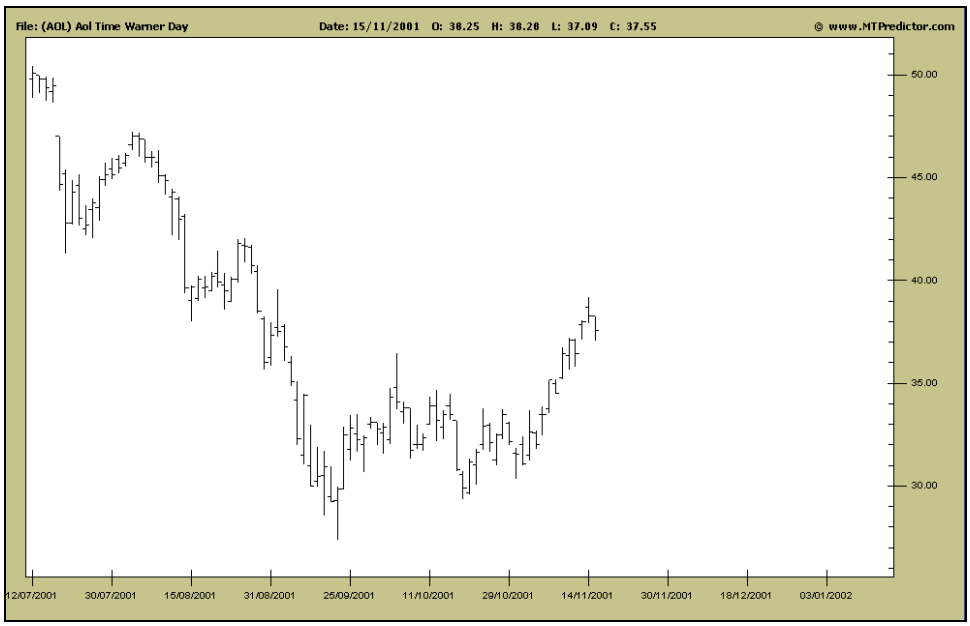
The result:



Exactly as anticipated, once the Wave (5) low was complete (on Oct 10 2002) then a rally stronger than any during the decline off the Feb 2002 high did indeed unfold.

As you can see, placing an Elliott wave count on a chart, and then anticipating where the market will move into the future is simply a matter of following the Elliott rules and guidelines.

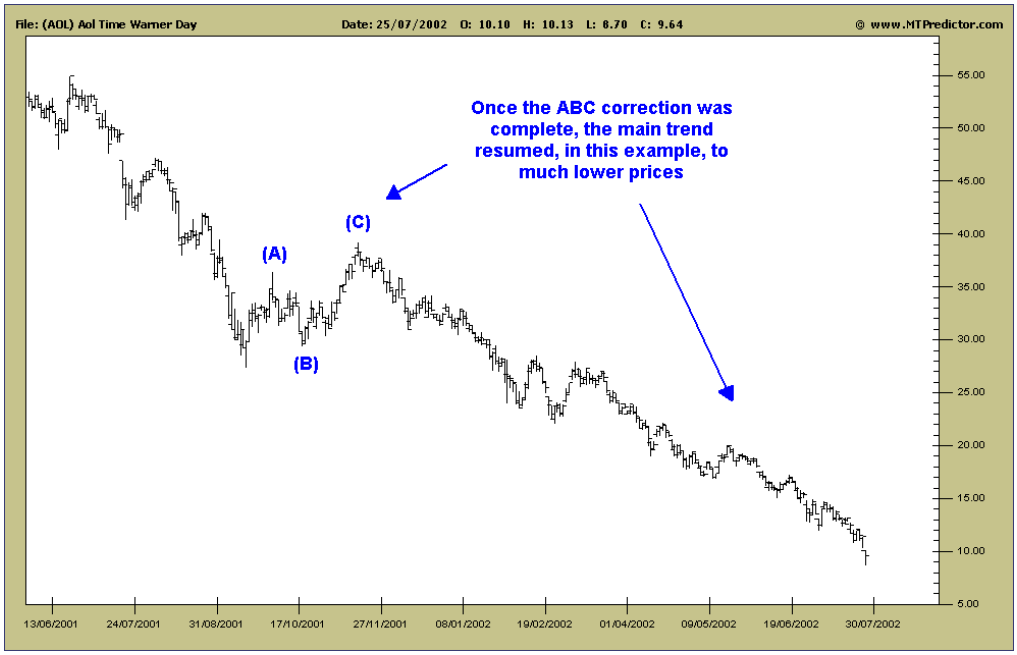
Let's look at another example:



Again, I invite you to try to place an Elliott wave count on this chart before turning the page.

Here is the answer:

And, as outlined in guideline number 7: Once a correction is complete, the prior main trend normally resumes:



Again, placing an Elliott wave count on a chart, and then anticipating where the market will move into the future is simply a matter of following the Elliott rules and guidelines.

The future appears to unfold exactly as anticipated by the Elliott wave theory!

These are just two examples but, at first sight, the Elliott wave theory appears to be perfect - all you have to do is place the appropriate wave count on the chart, by obeying a few simple rules and guidelines, and then you should be able to forecast where the market will go next. And as you have seen from these two examples, the profits should then just fall into your account.

Well, these were two carefully chosen examples, and this is where the problem normally occurs, in that most textbooks and Elliott wave courses use specially selected examples that are tailored to *demonstrate* the technique.

However, as we will see in the next chapter things are very different once you enter the real world.

Chapter 4 – Enter the real world

Please understand that the comments in this course are only a personal observation from my own experience, but it is one that appears to reflect many Elliott wave analysts I have met during my 17 years involved in the markets. The normal sequence of events goes something like this…

Firstly, the budding Elliott wave analyst hears about Elliott waves on some chat room or from another trader, and then goes and purchases an Elliott wave book or trading course. They then spend months carefully studying all of the rules and guidelines with the aim of becoming fluent in Elliott wave analysis.

They then try to apply the rules and guidelines they have learnt to real and live market examples, normally with limited success. You can always spot a new Elliott wave analyst because they always have the most current bar ending some sort of complicated wave structure, with labels of varying degree all over their chart. They then make a forecast that *must be correct* because everything is perfect and all the rules have been obeyed on their chart.

However, the market usually goes the other way, resulting in a trading loss. They usually try this on a number of charts over a few weeks or months, with most of the charts moving in exactly the opposite direction to anticipated. Sometimes the Elliott student will have one great success, and call the exact day of a market turn, which normally makes them deny or carefully forget more of the not-so-good recent calls on other markets. But usually, at some point, the student admits that most of their calls are not working out as anticipated.

Not to be disheartened, the budding Elliott student puts this minor setback down to lack of knowledge and then returns to a greater and more in-depth study of the subject, putting their recent failures behind them and continuing to study.

After months (sometimes years) of further study, the Elliott wave analyst emerges and returns to the market confident in his (or her) new found and now complete knowledge of the Elliott wave theory. He (or she) has spent many long hours carefully applying the rules and guidelines to as many charts and past examples as they can find, to make themselves confident to be able to recognise and apply the rules perfectly to real and live examples.

However, a very similar outcome normally unfolds, with most of the market calls made by the Elliott analysts not turning out as anticipated.

Chapter 4 – Enter the real world

To cut a long story short, at some point the Elliott wave student will come to the conclusion that Elliott wave analysis does not work and therefore cannot be used to profitably trade the markets.

Sometimes it can take years for Elliott wave analysts to come to this conclusion, but at some point they normally give up in a burst of fury claiming to anybody who will listen that Elliott wave theory is rubbish and useless.

So, depending on where you are along this time line, you will normally fall into one of three broad categories:

1. New to Elliott wave and still completely amazed at what it promises to do, or
2. Experienced but frustrated at your lack of success or consistency, or
3. Completely given up and angry and frustrated by the whole experience.

Although there are a few people who can (and do) use Elliott wave analysis in the markets successfully, they are few and far between. The vast majority of Elliott traders that I have met in the last 17 years fall into one of the 3 categories above. Can you relate to one of these categories?

To show you what I mean, and try to shed some light on the apparent lack of success by Elliott wave analysts the world over in what appears to be a very simple and easy to apply approach to the markets, I will take a look at a number of examples during the rest of this chapter. So if you are one of the frustrated Elliott wave analysts, then please read on, and take heart in the following examples.

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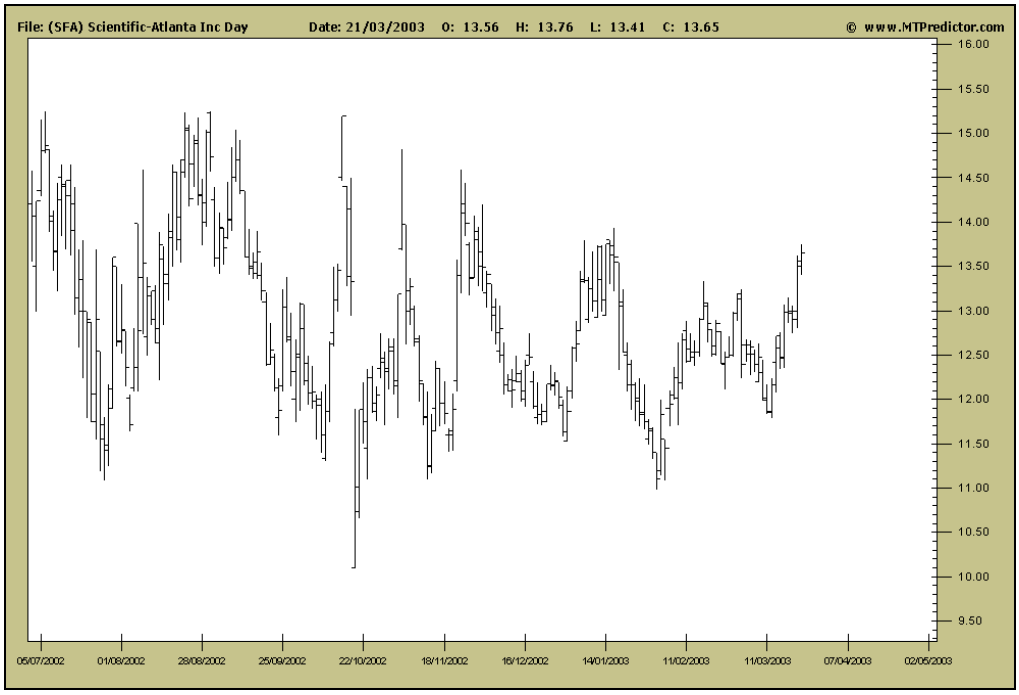
Here is the first example:



Here is a chart of Scientific-Atlanta Inc (SFA). Okay, how would you label this chart, what swings can you see and what Wave count would you use? Remember, all I did in the last chapter was apply the Elliott wave rules and guidelines and the rest was simple!

But I guess you are still looking at the chart above, desperately trying to make a reasonable count *fit* onto it.

This is the first and biggest mistake that I believe any Elliott wave analysts can make – assuming that just because they have a chart in front of them, a wave count can or indeed should be applied. This is false, as the worst mistake you can make is to *force* a wave count. If a wave count is not *obvious* then admit that there is no count present and move onto the next chart.

However, this is against human nature and against most of the Elliott wave textbooks available today, mainly because they teach that Elliott waves are always on a chart. As such you should always be able to *know* where in a wave count you are, so you should always be able to know where the next move is likely to unfold. However, this is the single largest misrepresentation of how Elliott wave analysis works in the real world.

This apparent ambiguity has led to the theory of alternate counts. This is where two (or more) alternate counts can exist at the same time, so the market (by its own action) will either confirm or invalidate these counts to show the true and current count.

However, as you can imagine, trying to deal with (and trade with) such uncertainty is a nightmare - for the trader, more often than not, the wave count you are using will turn out to be the wrong one, and although the theory was correct in hindsight, you have lost money.

The same can be said for many Elliott wave software programs on the market today in that they change their wave counts as new market data arrives. In theory this is great, because the program can *adjust* to unfolding events, but in practice I have heard too many horror stories where the trader was left with a loss, after the software has re-labelled the chart, to be correct, but again this was after the trader had lost money.

Please note, again this is a personal opinion from my own personal experience and other traders I have spoken with over the years.

I believe there is only one way to reasonably deal with a chart like the one on the prior page, and that is to forget it and move onto the next.

The idea that a valid wave count is not applicable on all charts all of the time is not new. However, it is not a practice that is common among the Elliott wave purists, who have developed a number of more complex and varied ways of counting wave structures to be able to cope with all eventualities. For those of you who have reached an advanced level of Elliott wave analysis, as well as alternate counts, you will have come across the *X* wave, which is a attempt to be able to link together complex corrections to take account of irregular wave structures.

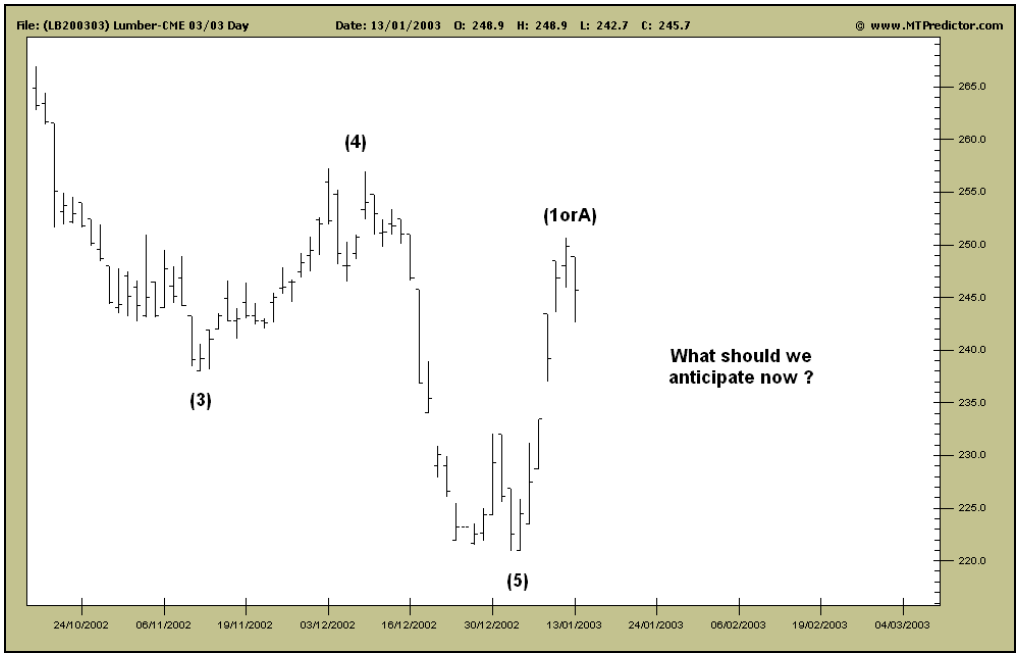
Again, I feel this creates more confusion than it dispels and should be re-named the *don't know* wave!

However, it is not just this particular wave formation that creates confusion, it is because there is a vast array of *complex* corrections that are categorised and defined and *could be* applied to a chart. Again, any corrective pattern that goes much beyond the simple ABC correction is too complex and as such should be avoided with the simple and easy to apply phrase "I don't know". But admitting that you *don't know* goes against human nature, so in a vain attempt to place an Elliott wave count on a chart, budding Elliott wave analysts often make more trouble for themselves by not admitting the count is beyond a simple and obvious one and moving onto the next chart.

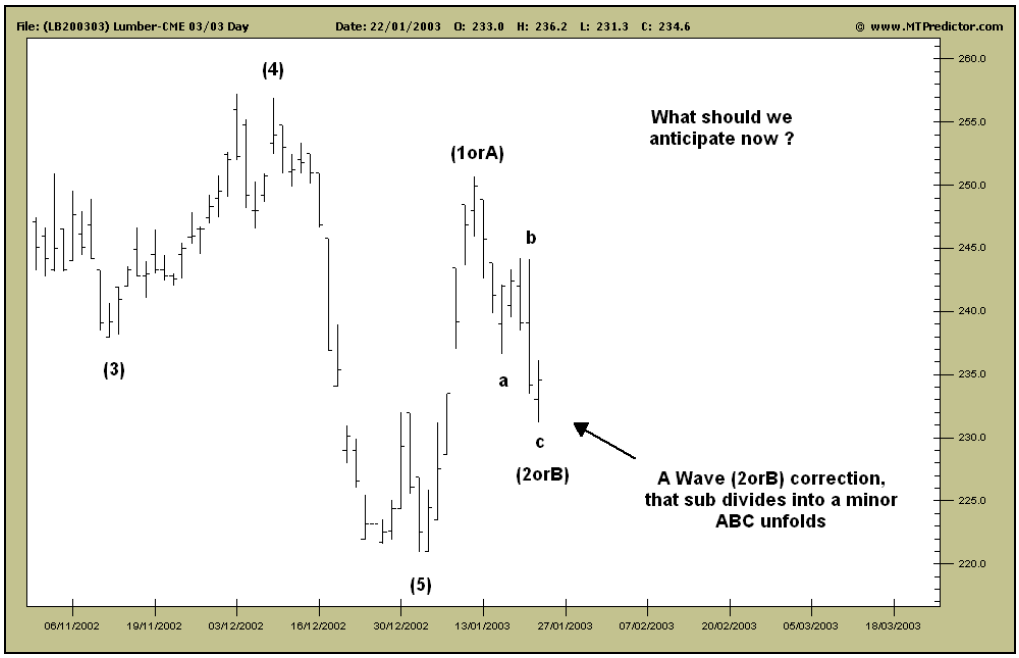
I could go on to show a huge number of ever more complex variations that just do not work out in practice, but I leave it as read that if you encounter a corrective wave structure that goes much beyond a simple ABC, then it is best avoided.

Okay, here is another example:

Here you can see a chart of Lumber (it does not matter what market this is, only that you have what appears to be an initial rally off a Wave (5) low). From the rules and guidelines covered in the last chapter, what should you anticipate will unfold from here?



Exactly…following a Wave 1orA high (or low) the market should make a corrective swing, and *ideally* this swing should unfold as *at least* a simple ABC (3 swing correction).

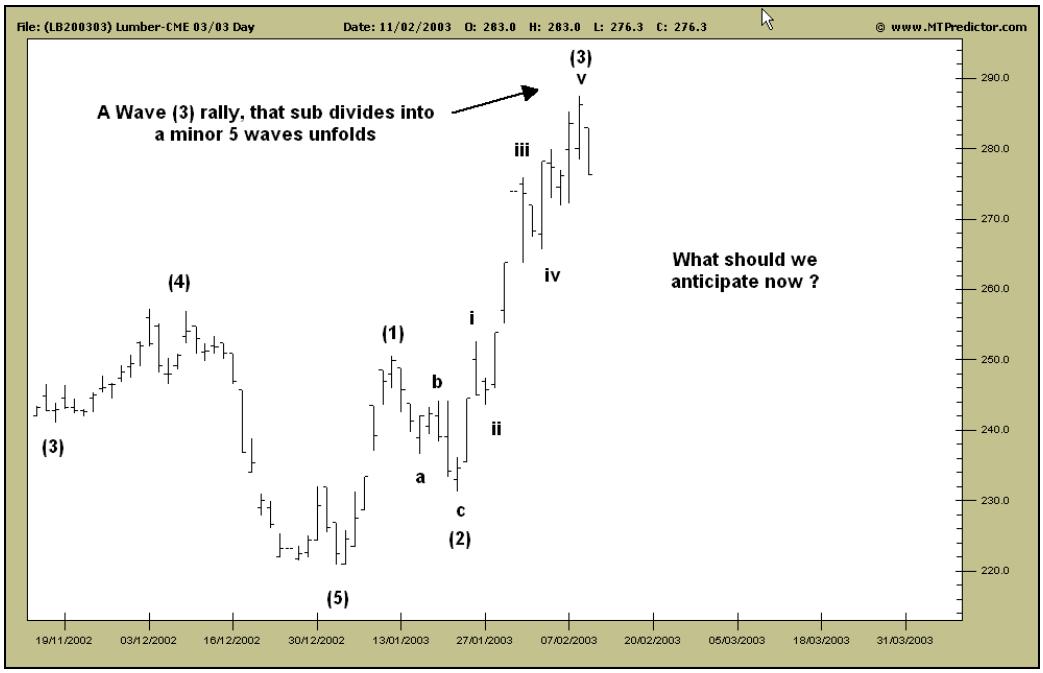


As you can see from the chart above, this is exactly what unfolded

So far so good, so what should you anticipate next?

As the initial correction from the initial rally off the Wave (5) low unfolded as a simple ABC correction then (from guideline No: 4) you should anticipate that this is *most likely* the end of a Wave (2) low.

After a Wave (2) low is complete, you should anticipate that a Wave (3) rally will unfold that will take the market in question (Lumber) to new highs, and this rally should be longer and stronger than Wave (1).



As you can see from the chart above, this is exactly what unfolded. The Wave (3) was perfect in that is was much longer than the Wave (1) rally and also sub-divided into a minor 5 waves (labelled i to v on the chart).

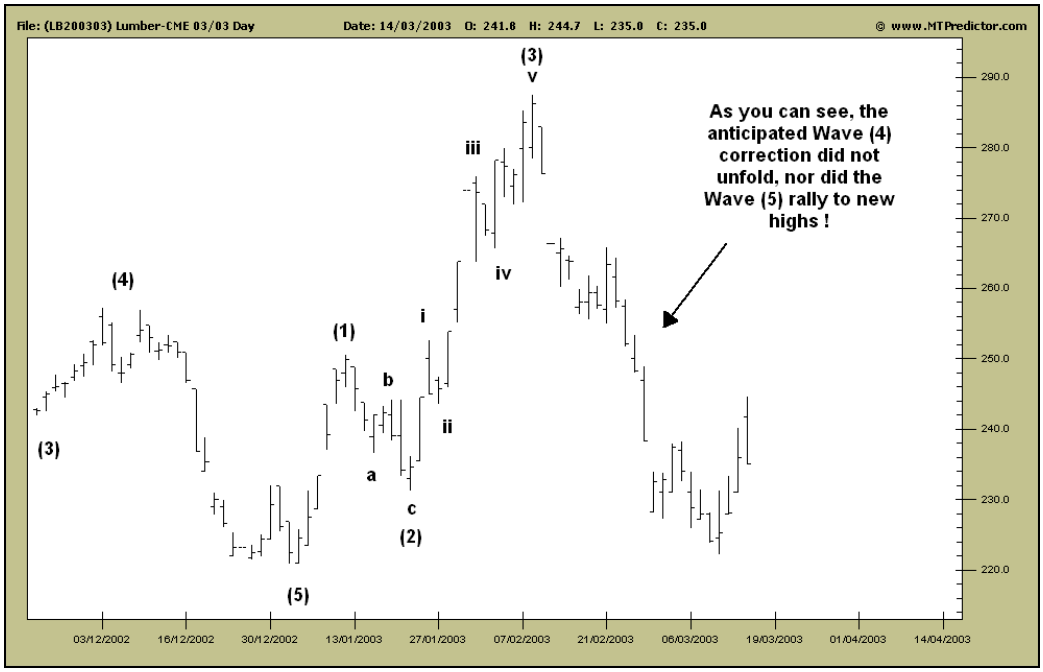
So far so good, and the Elliott wave theory has done a great job of anticipated what should unfold next.

Okay, now a Wave (3) high is complete, what should you anticipate will happen next?

Continued on the next page . . . . .

Ideally, following a Wave (3) high the market should make a Wave (4) correction, which should be followed by another rally to new highs – the Wave (5). This should then complete the entire sequence.

So far the Waves (1), (2) and (3) appear prefect so you should anticipate that this will continue, and a Wave (4) corrective decline should now unfold.



But, as you can see from the chart above, this did not happen. Instead Lumber declined sharply, with no sign of the Wave (4) correction, or the Wave (5) rally.

This situation happens far more than most Elliott wave analysts would like to admit. After a period of working perfectly, with textbook waves unfolding, the whole pattern blows up and just stops working. This is a nightmare if you are in a trade, because all your carefully laid plans have to be thrown out of the window.

If you are honest, I am sure that the experienced Elliott wave analysts among you have all seen this happen again and again, and it is one of the most frustrating parts of the practical application of the theory - one day you are in perfect control and know exactly what is happening, then suddenly, for no reason, you are left without a clue about the pattern, or are even expecting a pattern that does not unfold.

So why should the theory break down so suddenly?

This is a good question, and one that I do not have a good answer for except that it does, and it does more times that most Elliott wave professionals would like to admit.

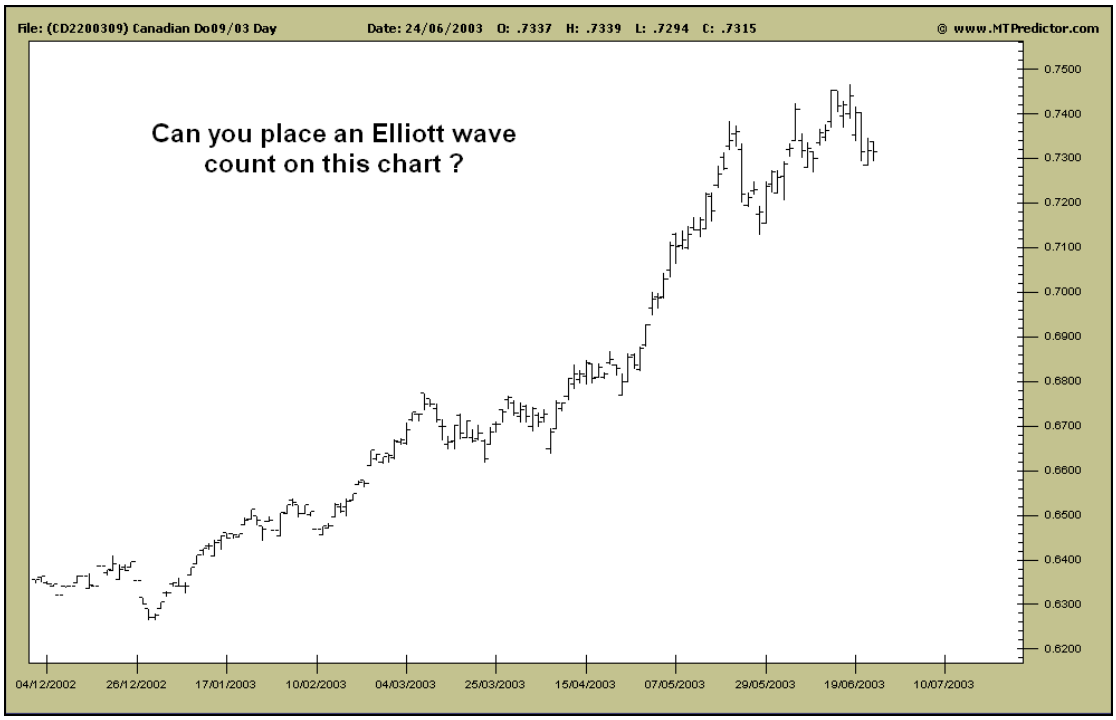
The only practical way round this is to accept that Elliott wave analysis only works about 50% of the time. In other words, an easy to recognise and obvious wave count only exists on ½ the charts you look at or will only work about ½ the time while you are looking at one market.

As we have seen in example 1, by taking this stance, if no easy to recognise and obvious Elliott wave pattern is present on the chart you are currently looking at, then move onto the next. This is an easy way to avoid being caught in a wave count that is just too complicated and, therefore, very unlikely to unfold as anticipated.

But, as we have seen in the second example, at some point during a perfect wave count the chart can slip into the *don't know* 50% and leave you in a very messy situation.

Before I go any further I would like to look at a few more examples, because I know that many of you at this point will disagree because you have read many Elliott wave books showing how easy the theory is and how it should work well on all charts and all time frames.

Please look at this chart:



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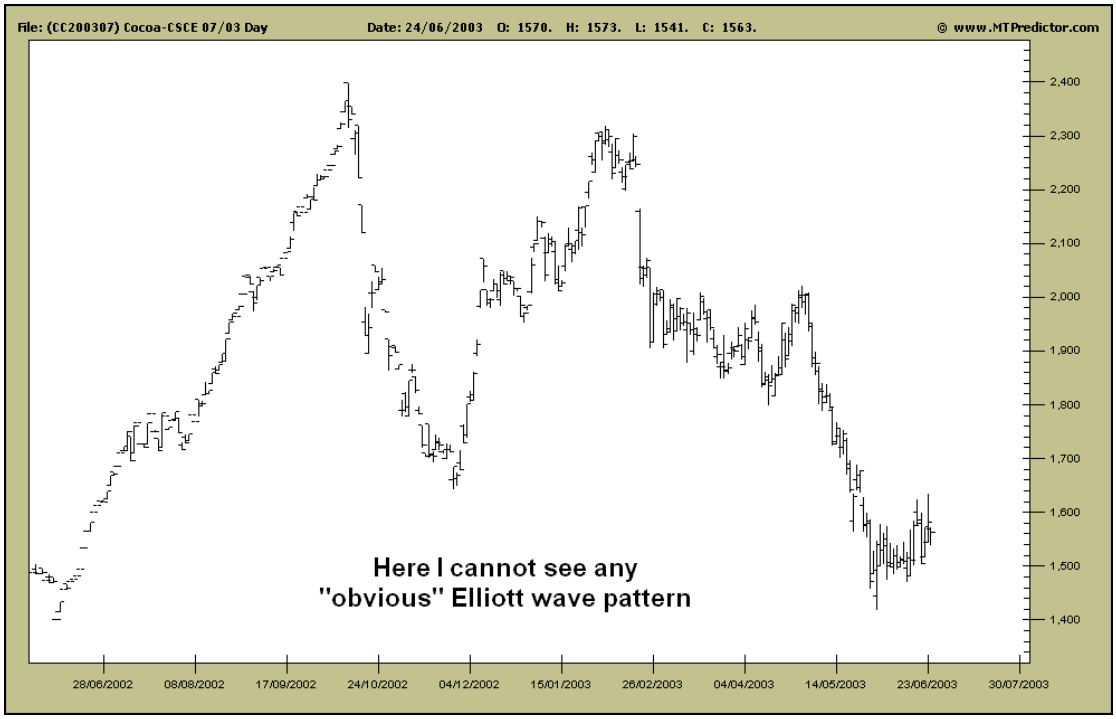
Or this chart:



What about this one ?

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These are only three examples, however I could have included many, many more.

All I ask you to do is look through as many markets as you can find and try to place an Elliott wave count on all of them. Then, honestly ask yourself how many of them were easy, where a wave count jumped off the screen at you, how many were more difficult, and then how many you simply did not know how to label.

These three examples were on different commodity markets, however the situation gets much worse once you enter the US stock market, where you can go chart after chart for hundreds of charts without finding any obvious Elliott wave structures.

Again, please do not take my word on this, I encourage you to perform your own research by looking at as many charts as you can on the markets you follow. However, all I ask is that you are honest with yourself when you look at the charts to see whether you can find any obvious Elliott wave counts. I hope that very quickly you will start to agree with me, in that it is very difficult to find an obvious and easy to spot Elliott wave sequence. In particular, it is extremely difficult to find a chart in which you can label *all* of the chart, obeying all of the Elliott wave rules and guidelines.

At this point, I hope I'm not depressing you too much, because all I want to do is to bring you back to earth, and demonstrate how Elliott wave analysis, as it is taught by the *standard* methods and sources, does not unfold as well as we would all like in practice.

Before you give up on Elliott wave analysis completely, please bear with me, as there is (I believe) a very good solution to this problem that I will move on to in the next chapter.

Chapter 5 – The solution

In the last chapter I looked at the practical application of Elliott wave theory, how it is taught by many of the standard books, courses and software programs, and came to the conclusion that *in practice* the theory did not work for long enough periods for it to be a reliable technical analysis method. Having reached this conclusion, where can you go from here ?

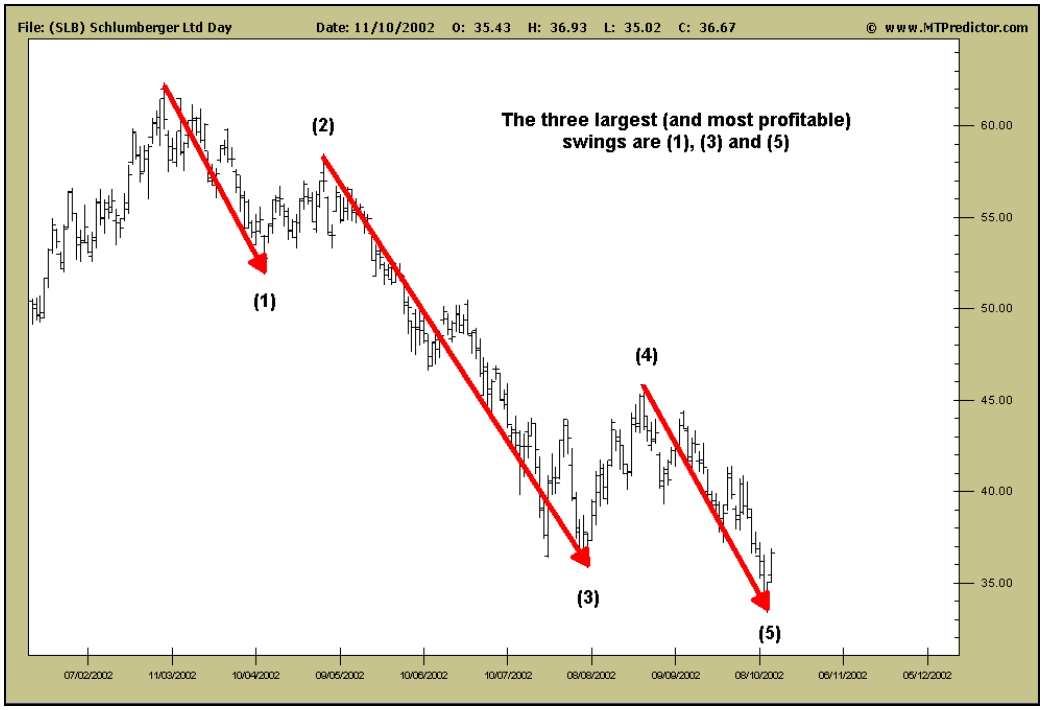
Rather than simply giving up and throwing the theory away I spent years looking at what (if any) parts of the theory produced reliable and, more importantly, consistent results, and the solution was remarkably simple.

But before I reveal my findings I want to review what is required for a long-term profitable approach to trading the markets.

As outlined in Chapter 2, the two main criteria are that you have a method that keeps the losses small, and that (on average) keeps the profits larger than the losses. So in an ideal world, assuming that Elliott wave theory is perfect and works all of the time, where could you find such trades ?

From chapter 3, you know that the largest waves are the Impulsive waves and, as such, carry the largest profit potential but the corrective waves are by nature corrective, so they have limited profit potential. So it makes sense that the largest profit potential should be found in a study of the Impulsive waves.

Okay, let's take a more detailed look at an ideal 5-wave count.

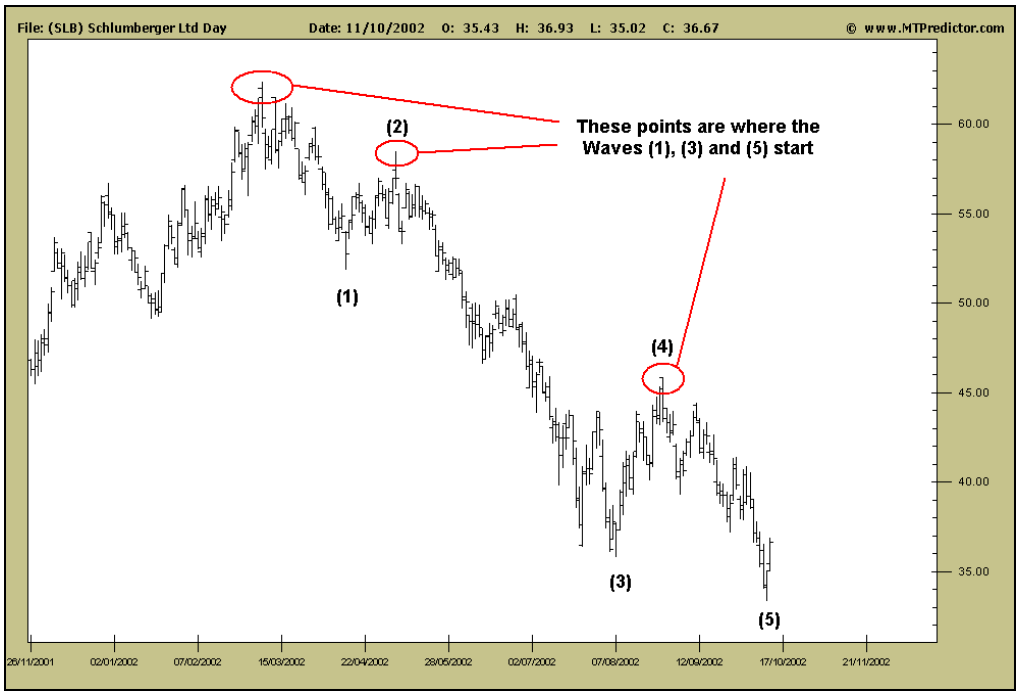


Here you can see that the largest (and most profitable) swings are Waves (1), (3) and (5), which is no surprise because, as outlined in chapter 3, these are the three swings that are in the direction of the main trend.

So it seems obvious that the best (and most profitable) trades would come from being able to participate in these strong and impulsive moves. This would fulfill one of our primary objectives of having a trading strategy that (on average) makes trades that are larger than the losses.

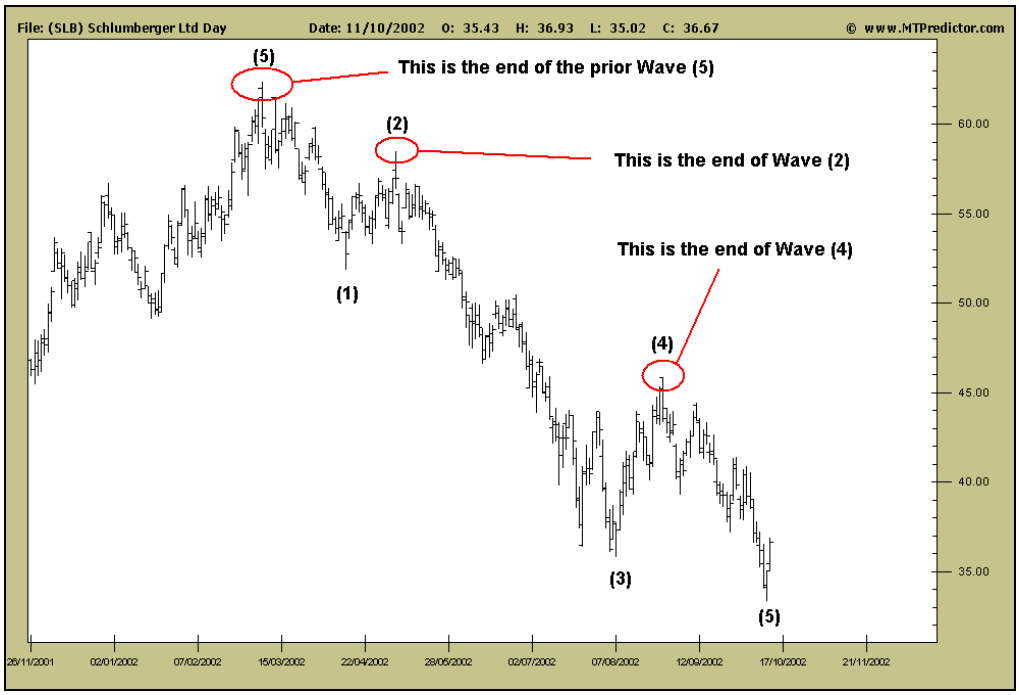
You also require that a strategy that enters trades with a small controlled risk i.e. the other side of the statement in the last paragraph, in that you try to keep the losses small in comparison with the profits. At first sight this may not make sense, because if the profits are large, then by definition (on average) the losses must be small. But, as you will see later, the only way to control this equation is to focus on the losses, or initial risk. More on this later, for now I just want you to focus on this ideal Elliott wave pattern and seeing how our primary objective fits into an ideal 5-wave pattern.

Okay, if you are to keep the initial risk on any new trade as small as possible it makes sense that you need to enter the trade as early in the new trend as possible. This also has the benefit of increasing the potential profit, but for now the main advantage is that it reduces to a minimum the initial risk required to enter the new trade.



As you can see from the chart above, there are three points where the new impulsive trend starts or, looking at it another way, where the prior Wave (5) ends and where the new Waves (2) and (4) end – please see the chart on the next page.

Here are the ends of the prior swings, which also signal the beginning of the 3 new impulsive trends:



As such, your aim must be to try to enter a new trade as the prior Wave (5), then current wave (2) and the current wave (4) end - this will then place you in a new trade as the Waves (1), (3) and (5) are just beginning. As I have already outlined, this is the best you can do because this both maximises the potential profit and also reduces the initial risk on the trade.

The question now arises, how do you achieve this ?

Leaving the end of the prior Wave (5) aside for now, I would like to concentrate on the two corrective waves in this sequence, which are Waves (2) and (4), and in particular the Wave (2) because this leads into the strongest and longest of all the Elliott waves, the Wave (3). Therefore, being able to reliably identify the end of the Wave (2) to then be able to trade the entire Wave (3) would be the most profitable Elliott trade possible. So this is where I focused my main attention. This idea is not new, W.D. Gann stated that the safest place to enter a new trade is at the end of the first correction in a new trend. In Elliott wave terminology, this is the end of the Wave (2). It therefore appears that I was starting to look in the right place.

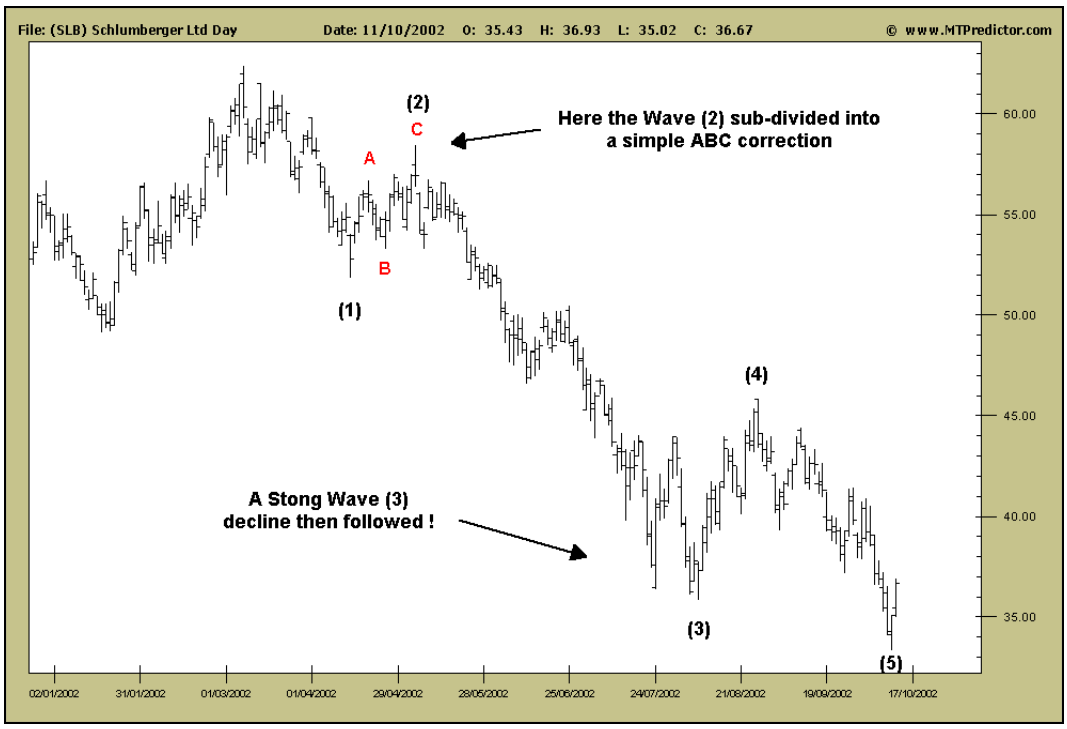
As outlined in chapter 3, the corrective Waves of an Elliott wave sequence can come in many forms, many of which are classified as *complex*. As their title suggests their complexity makes them hard to deal with. From a practical trading perspective, ideally, I was looking for a pattern that had a high reliability and could be identified easily, so looking at complex corrections appeared to being heading in the wrong direction. I then started to focus on the easiest and simplest correction in the Elliott theory.

As I outlined in chapter 3, the basic (and simplest) corrective Elliott pattern is the simple ABC correction. This is also the easiest to recognize and to work with. So I started to look at where these types of corrections unfolded.

And to my amazement, the most common pattern for the lesser-degree pattern within a Wave (2) correction was the simple ABC !

I cannot stress how important this is, because not only is the simple ABC correction the easiest recognise, but the end of the Wave C is the most reliable to identify as well. Combine this with the pattern occurring in the best place possible and the pieces were staring to fall into place, in that all a trader really needed to focus on was the identification of a simple ABC correction that unfolded as part of a Wave (2) correction.

Let's take another look at the current example:



As you can see, this is exactly what happened on this daily chart of Schlumberger Ltd. The Wave (2) sub-divided into a simple ABC correction. As such, being able to enter a trade as this ABC correction was ending would have placed you in the perfect position to take the maximum profit from the resulting Wave (3) decline, with the minimum initial risk.

I was starting to get excited now, as the pieces of what could be the ideal trade set-up started to come together. Although there is nothing new about this pattern, or indeed how it unfolds, up until now the significance and, more importantly, the simplicity of this potential trade set-up had been buried deep within the Elliott wave theory as a whole. So a number of Elliott traders had thrown this pattern out along with the whole wave theory because they had not realised that to be able to use this pattern they did not need to have to be an Elliott wave expert, or indeed become involved in the intricacies of the theory and, critically, they could avoid all the confusing and continually re-labelling patterns that tend to occur when the theory is applied in its entirety.

Let me explain what I mean.

What if all you were looking for was the occurrence of a simple ABC correction that unfolded as part of the *first correction* to the *initial move* off an *important high or low*?

There you have it, a simple ABC correction that unfolded as part of the corrective rally following the initial decline off an important high. No mention of Elliott wave or any in-depth analysis, just a very simple to recognise pattern.

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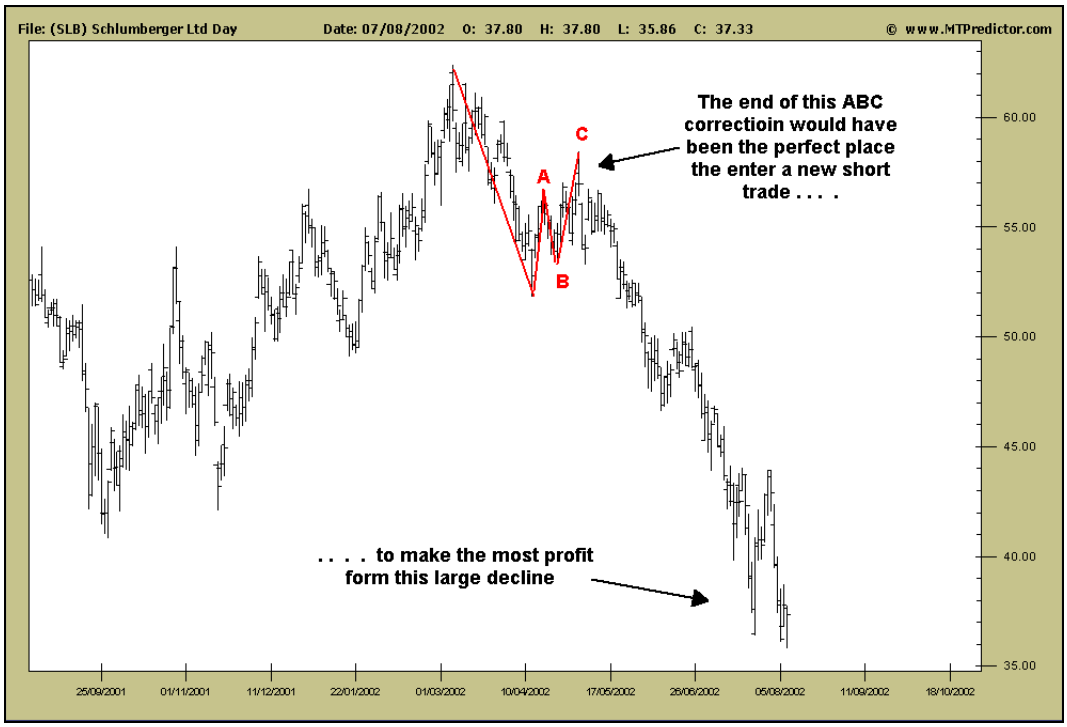


As you can see, being able to enter a new short trade just as the ABC correction was ending would have put you in the perfect place to make the most profit from the large decline that followed.

But I hope you can see how, although this pattern is part of the Elliott wave theory, its identification can be made *in isolation*, and you do not need to be an Elliott wave expert. There are a number of other advantages that we will come onto later in the book.

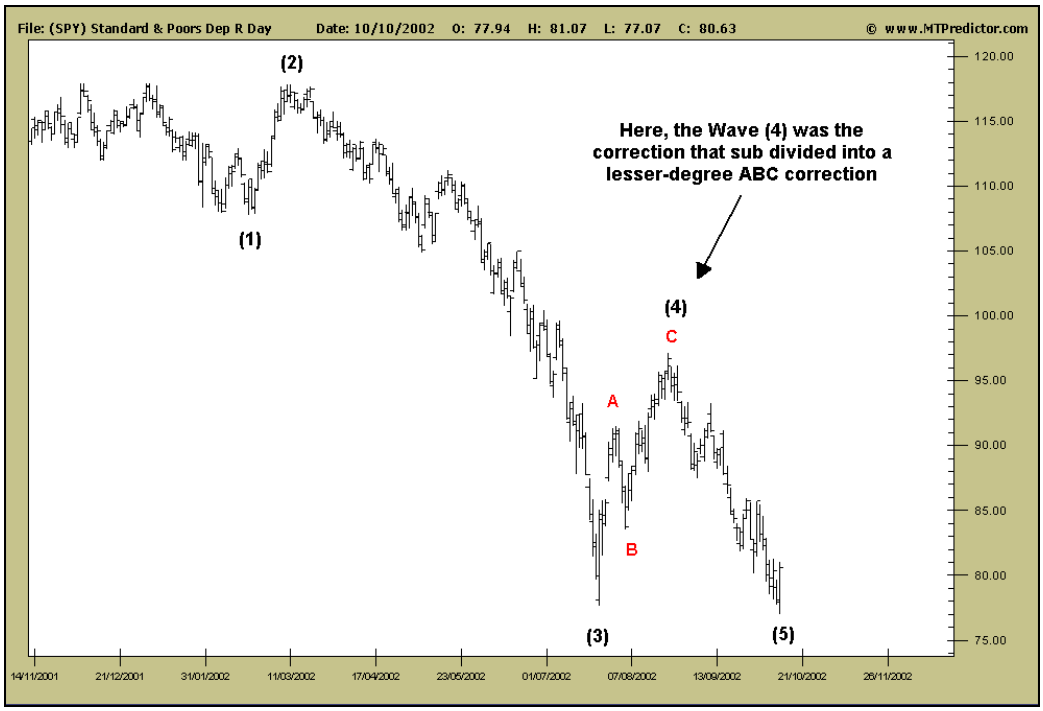
As a PS, if you look at the start of the data on this chart, can you see another ABC correction, this time for a potential long trade ?

Okay, now I have had a detailed look at how the minor pattern unfolds within a wave 2 correction, I would like to move on to the next corrective swing in the completed 5 wave sequence, which is the wave (4).

As you have already seen earlier in this section, the most common pattern within a wave 2 correction is the simple ABC correction and, as outlined in chapter 3, the rule of alternation would indicate that if a wave (2) correction unfolds as a simple ABC then you should anticipate that the wave (4) would unfold as one of the more complex of the Elliott wave patterns. As I have already detailed, the last thing you should get involved with is a complex correction. Because of the nature of a complex correction they are very hard to deal with and it is almost impossible to identify their end, as they are unfolding, so they are not ideal to work with when trying to identify an ideal trade set-up.

However, as I have also outlined in chapter 4, Elliott wave theory is not ideal and only tends to work about 50% of the time so how does that effect you when you are trying to look at the minor pattern within wave 2 and then wave 4? The answer is simple - as I have already suggested, the best way to treat Elliott wave analysis is to treat the swings and waves *in isolation*. This then means that you can look at the subdivision of wave 4 in exactly the same way as you did with wave 2), in other words look for the occurrence of a simple ABC correction.

Okay, let's have a look at a few examples:

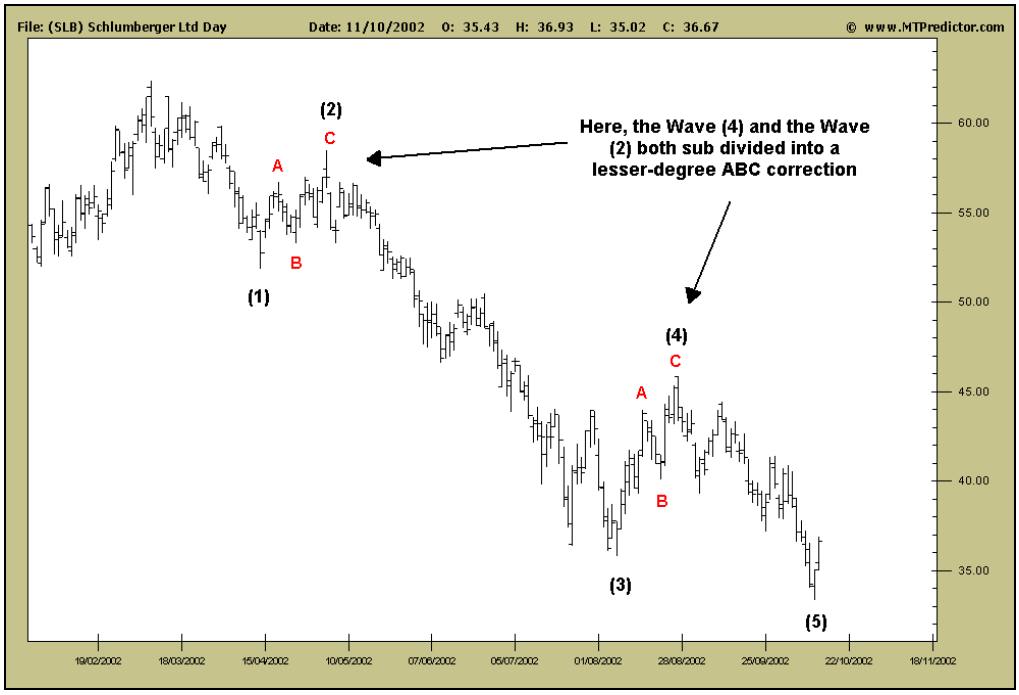


The chart above shows a classic Elliott wave sequence where the wave 2 correction alternated with the wave 4 correction and it was the wave 4 correction that sub-divided as a simple ABC. As such being able to identify the end of the wave C of the ABC correction would have resulted in a great short trade to take full advantage of the wave 5 decline.

I hope you can see that all you needed to do to identify this new short trade was to identify the end of the wave C of the ABC correction, there was no detailed Elliott wave analysis or, indeed, any need to categorise this correction into any larger degree pattern or large degree trend. In essence all you had to do was look for the end of an ABC correction, exactly the same procedure as was used in the last section, for the end of the wave 2 correction.

Unlike an Elliott wave 2 correction where the correction unfolds as part of the first correction against the first move off a major high or low (as outlined before), a wave 4 correction unfolds during the main trend - in other words after the end of a wave 3.

Let's look at another example.



This is the same example that was used earlier where you saw how the wave (2) correction unfolded as a simple ABC. The theory of alternation would now suggest that wave (4) cannot be a simple ABC because it has to alternate with the ABC which unfold as part of the wave (2). However, as you can clearly see on the chart above the wave (4) definitely unfolded as a simple ABC correction, so this seems to be in breach of the Elliott wave guidelines outlined in chapter 3. Does this matter?

If you are an armchair Elliott wave enthusiast whose main focus is on applying the theory correctly, then it would matter…however if you are a trader whose sole aim is to identify a high probability low-risk trade set-up then how you find the set-up is immaterial, whether it breaks a few of the Elliott wave guidelines or rules does not matter to you. The main thing you are after is a high probability low-risk trade set-up, it is as simple as that.

Coming back to the chart above, just as in the prior example, I hope you can see how the end of the wave C (of the ABC correction) did indeed identify both the end of the wave (4) and the start of the wave (5), so the ideal place to enter a new short trade.

I hope you are beginning to see where I am going with this? Although the Elliott wave theory is very good *in theory*, in practice all you need to be able to do is apply certain parts of it (in particular the ABC correction) consistently and reliably to be able to find high probability, low-risk trade set-ups.

Chapter 5 – The solution

So far I've been talking about a way to identify the end of the wave (2) and then a wave (4) correction in order to be able to trade the wave (3) and the wave (5), but that still leaves us with the wave 1.

As you have seen so far, both the wave (2) and the wave (4) are corrective patterns within the Elliott wave sequence, however the start of the wave (1) usually comes after the end of the prior trend. So to be able to identify the very start of wave (1), you have to able to identify the very end of the prior trend. In theory this sounds exactly the same as we've been doing so far with identifying the end of a wave (4) and a wave (2). But in practice there is a very big difference.

The main difference is in the word *trend* - a trend implies an impulsive move, which as you have seen in chapter 2 carries strength and momentum with it. Whereas waves (2) and wave (4) are corrective, implying they are weaker and less likely to overrun. This situation is very different with a strong impulsive trend, as they have a nasty habit of continuing on further than anticipated. What this means in practice is that it is normally very difficult to identify the end of a wave (5) or indeed the end of any impulsive swing.

As I have touched upon many times in the prior chapters, one of the main requirements for any trading strategy is that it can be applied reliably and consistently. The end of an ABC correction falls into this category, as it is one of the most reliable, consistent and easily recognisable Elliott wave patterns, however the end of an impulsive (5) wave swing does not fall into this category, as it has a nasty habit of overrunning. Therefore, in theory, while you should be able to identify the end of the prior impulsive trend, as such the start of a new wave (1), in practice this has a lower reliability than dealing with the end of a wave (2) and wave (4). So the question has to be asked, as a trader, would you prefer to deal with a simple and easy-to-use method that is reliable and consistent, or a method that has a low reliability, low probability and, more likely than not, would result in more losses than you are comfortable with?

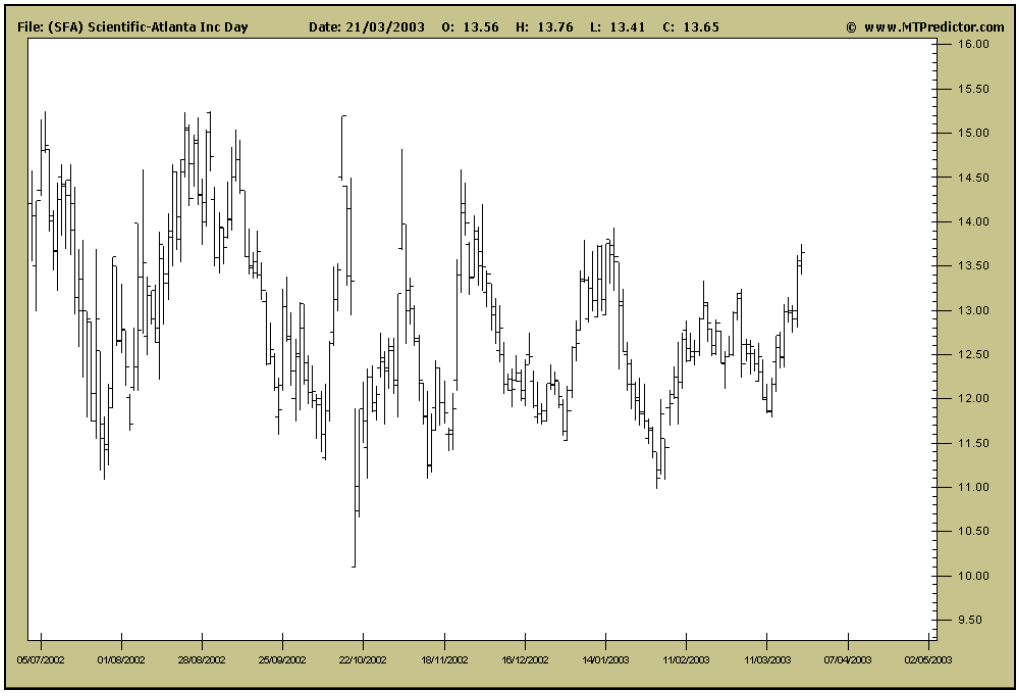
Personally, I prefer to deal with patterns that have the highest reliability and are the easiest to use, this means the simple ABC correction.

Chapter 5 – The solution

Up to now I have been dealing with perfect Elliott wave 5-wave sequences, in which I looked to trade the strongest impulsive moves, which were waves (1), (3), and (5). Out of these three waves, the ABC correction provided a simple and reliable method to identify and therefore trade in the wave (3) and wave (5). What if you are dealing with a pattern that cannot be categorised as a perfect 5-wave Elliott pattern? As you've seen in prior chapters, because only 50% of the time any given market is exhibiting a reliable Elliott wave pattern, this means that also 50% of the time the market is not exhibiting any pattern that can be categorised at all. Does that mean that you have to ignore half the markets, half of the time?

No, the answer is again simplicity in itself. As I have mentioned before, and will mention again, because I believe (personally) that the best way to deal with Elliott wave analysis is to treat the swings and waves *in isolation*, this means that you can look for a simple ABC correction by itself. If you think about it, all you are trying to do is use the unique characteristics of the ABC correction to identify a *trade set-up*, where the criteria of the trade set-up are to both keep the initial risk small and on average keep the profits larger than the losses.

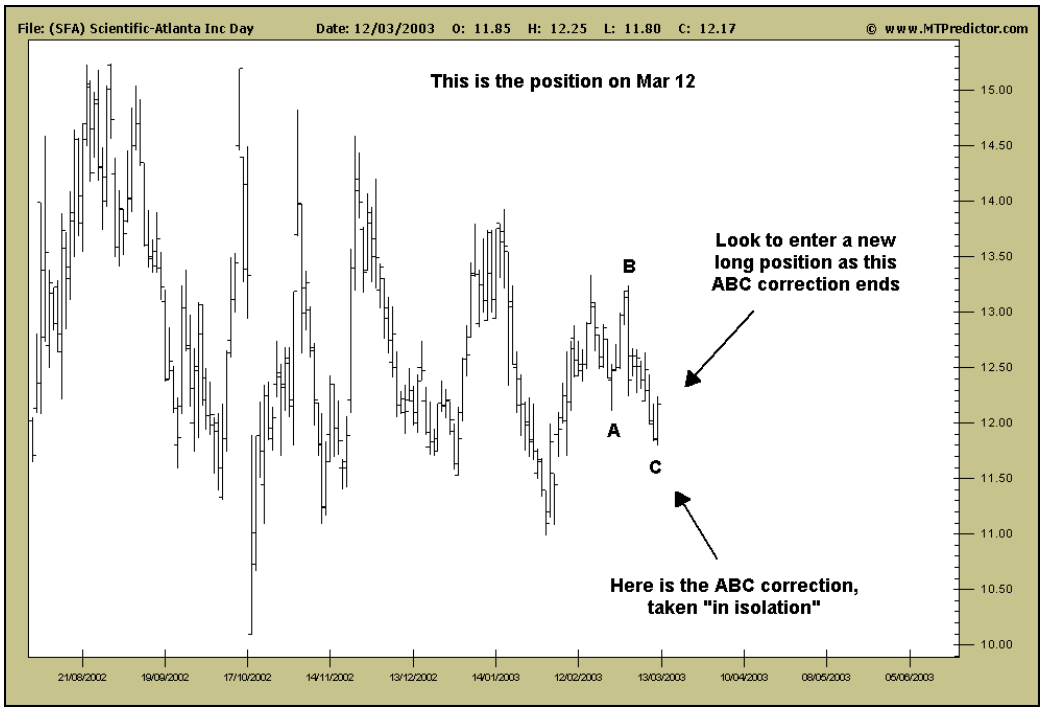
Let's have a look at an example:



This is one of the examples that I used in chapter 4 to demonstrate how often a market moved sideways in a very choppy and unpredictable pattern, in particular where it was almost impossible to try to label an Elliott wave count on the chart.

However, what if you did not try to place Elliott wave labels on the entire chart and only focused on small chunks of the chart, treating them *in isolation* ?

Let's roll time back in this example to March 12 and focus our attention on just the last section of the chart:



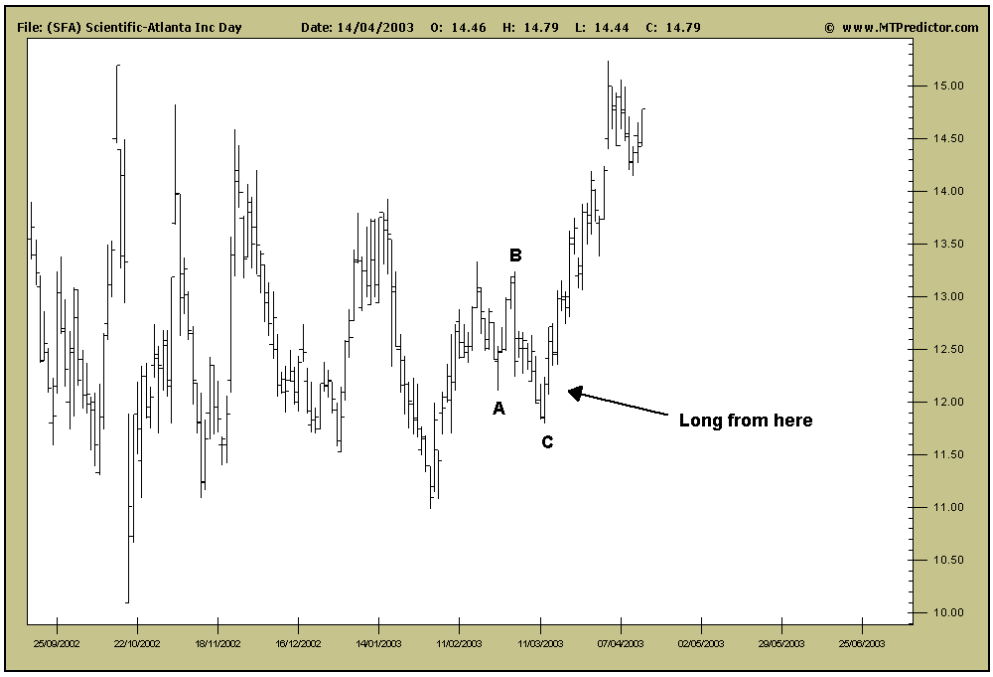
Here you can see how the initial rally off the low about a month ago was followed by a simple ABC correction. So let's treat this pattern *in isolation* and see if you can identify a trade set-up? As you saw in chapter 3, once a simple ABC correction is complete the prior trend normally resumes.

This is the situation you have on the chart above where, as of March 12, an ABC corrective decline appears to be ending. This means you should now consider a new long trade. But the most important point is that this potential buy set-up was identified in isolation, in other words it was not required to have any Elliott wave labels on any of the swings earlier in the chart. This is very important, because this approach to Elliott wave analysis is very different to what is taught by most classical Elliott wave analysts.

Let's now move time forward and see how this particular market unfolded from this wave C low.

Continued on the next page

Here is the chart a few weeks later:



As you can see, this stock rallied very nicely off the wave C low and resulted in a very profitable long trade.

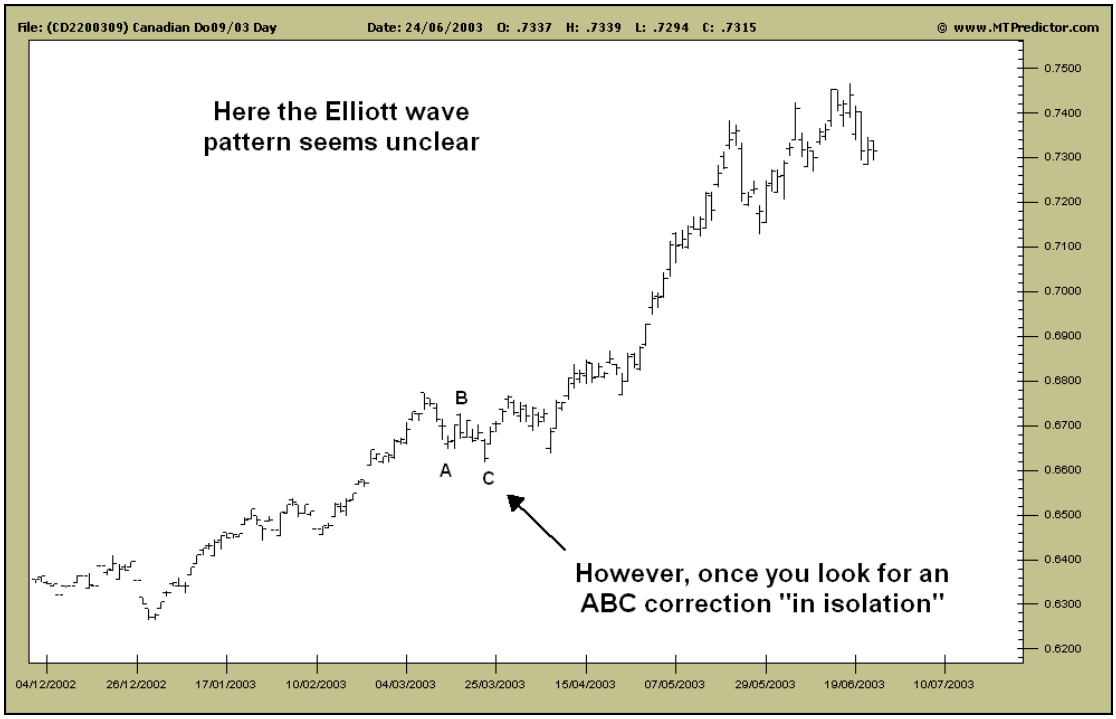
I hope you can all see the most important part of this example is how all that was needed was the identification of the end of the wave C of the ABC correction to be able to identify a potential trade set-up. There was no need for any complicated or in-depth Elliott wave analysis; in fact, you didn't even have to look at any pattern earlier in the chart prior to the set-up. This has a huge advantage over traditional Elliott wave analysis in that the trade set-up can be found *in isolation*.

Again, I would like to stress the difference between this approach and standard Elliott wave analysis because this is such an important point to understand fully.

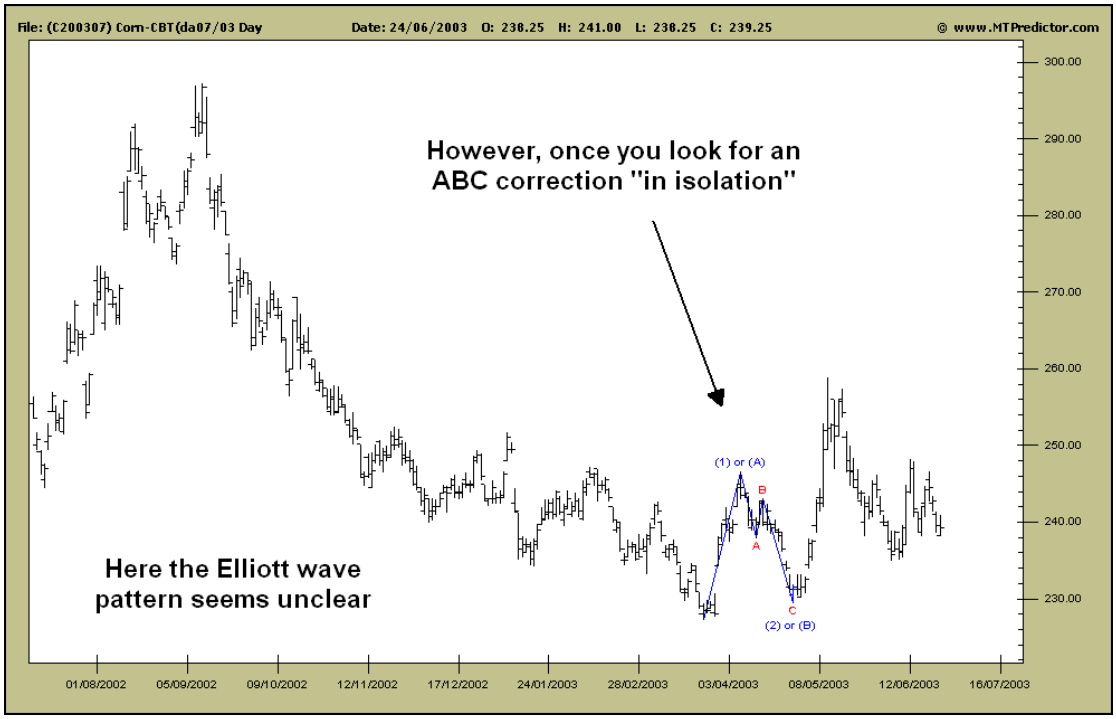
In standard Elliott wave analysis you are required to have Elliott wave labels (or at least an alternate wave count) on all of the swings, on the entire chart, all of the time. Then, once you know where you are in the Elliott wave pattern, you should be able to reliably predict where the market will go. As you have seen in chapter 4, in the real world this is virtually possible. This is trying to use Elliott wave to predict the future, which, again as you now know, is virtually impossible to do reliably, consistently, all of the time.

The approach I am looking at here is, rather than trying to predict the future, trying to identify a high probability, low risk *trade set-up*. Once your focus is on identifying trade set-ups and not trying to predict the future you are able to a look at the chart very differently. In other words, you are able to look at parts of the chart *in isolation* from what happened before or indeed may happen in the future. In essence, this releases you from the limitations of standard Elliott wave analysis.

Let's take a look at another example:



This was one of the charts I used in the last chapter where, as you can see, once you start to look *in isolation*, a simple ABC correction unfolds.



Again, a similar picture can be seen on the above chart.

I hope you're beginning to see how important the simple ABC correction is? During this chapter you have seen how the simple ABC correction not only identified two of the best (and most profitable) trades within an ideal 5 wave Elliott wave sequence, but also how it helped you identify a potential trade set-up even when the Elliott wave pattern was less than ideal.

Continued on the next page . . ..

Summary.

I started this chapter looking for a method that would allow you to participate in the strongest and longest moves in the completed five wave Elliott wave sequence - the wave (1), (3) and (5).

The primary concern was finding a method that would, firstly, maximise the profits and, secondly, keep the initial risk small on any new trade. The answer was the ABC correction. As you saw, this simple pattern could be used to both identify the end of a wave (2) and the end of a wave (4) to be able to participate in the wave (3) and wave (5) swings. Most importantly, the simple ABC correction was most likely to unfold as part of a wave (2), which meant that it positioned you exactly at the start of wave (3), which, as you have seen in chapter 3, is usually the strongest and longest of any wave in the completed 5-wave sequence. In essence the simple ABC correction could be used to identify the start of the most profitable trade in the book - combine that with being able to identify the start of a wave (5) (off the end of the prior Wave (4)) and you have what is starting to look like a winning trade set-up. The only wave where you were unable to find a reliable method to identify the start was a wave (1).

I then went on to show how the simple ABC correction could also be used to identify high probability low-risk set-ups even when the Elliott wave sequence was less than ideal.

At this point in my research I was getting very excited as this one simple pattern could be used in so many different locations and so many applications, all with the same aim of identifying an *ideal* trade set-up where the main criteria were that the set-up maximised profits and kept the initial risk small. To me, this seemed the ideal solution as this pattern was reliable and easy to identify, and, more importantly, was consistent to apply. To me this was more important than applying complicated or sophisticated technical analysis patterns.

The ABC correction had several more advantages, in particular when it is applied *in isolation*, in that the pattern and its end is relatively simple to identify, all of which leads to our primary goal of having a pattern that can identify a high probability and low risk trade set-up. To me, this is the single most important aspect to any successful trading plan.

In later chapters I will go on to look at the ABC correction in more detail and look at the maths behind the ABC correction that will enable you to predict *in advance* exactly where the ABC correction is likely to end.

The simple ABC correction forms the basis of the three main trade set-ups in the MTPredictor software program, more on this in later chapters.

Chapter 6 – Elliott wave summary

Over the last few chapters I have had a detailed look at the Elliott wave theory. In chapter 3 I looked at the rules and guidelines for labelling Elliott wave sequences on a chart. Chapter 4 took this one stage further and demonstrated how (from my own personal experience) I believe that Elliott wave patterns cannot be applied in practice as easily as they could be taught in theory. Chapter 5 then provided one unique solution, in which I took one of the Elliott wave corrective patterns, the simpl*e* ABC correction, and demonstrated how this could be used to identify trade set-ups *in isolation* rather than trying to predict the future with a complete Elliott wave count.

When the Elliott wave pattern was ideal, the simple ABC correction could be used to identify the end of a wave (2) as well as the end of wave (4), which allowed you to be able to trade two of the three impulsive swings in ideal Elliott 5-wave sequences (the Wave 3 and 5). This chapter also demonstrated how the simple ABC correction could be used to identify a trade set-up even when the Elliott wave pattern was less than ideal.

As I have already mentioned, the opinions of the author on Elliott waves and Elliott wave analysis are personal and derived from my own experience as a private trader. It is just that so many books and so many courses and so many software programs have tried to apply Elliott wave analysis to the markets with (what I believe to be) limited success. As I have mentioned, I do not believe this is the fault of the Elliott wave theory or indeed Elliott wave analysis in general. I just believe that the Elliott wave patterns simply do not exist on as many charts or as many markets enough of the time. This has led to me moving back to the simple ideas on the Elliott wave theory as suggested by R.N Elliott himself, in that markets *tend* to move in 5 waves in the direction of the main trend and *tend* to correct in 3 waves (ABCs) against the trend. I suspect that Elliott himself realised that the outcome of his analysis was only ever a matter of *probabilities* and, as such, did not work perfectly all of the time.

It is only human nature to require exact results from mathematical analysis of the markets. However the problem arises from the markets not being exact, as they tend to move with different rules governed by probabilities rather than exact mathematics. It is like being taught at school that 2 + 2 = 4 only 50% of the time. Most of us find this very hard to understand and deal with. However, if you wish to be a successful trader you must learn, understand and be totally comfortable with the theory of probabilities. At this point in time all you need to understand is that however good the Elliott wave theory is, it just cannot be applied consistently enough to the markets, enough of the time, to be able to produce the accurate forecasting results that we all expected of it.

However, as you have seen, I personally believe that the Elliott wave theory can only reliably be placed on any single chart about 50% of the time. This then allows you to focus on just the best wave counts that do have a high reliability, avoiding the less obvious patterns. Once you fully realise that the Elliott wave theory can drift in and out of phase like this, then the whole process of labelling a chart becomes a lot less stressful, in that if a wave count is not *obvious* then it should not be used. It is as simple as that !

This piece of advice will allow you to only focus on the best and most obvious wave counts. It is my opinion that trying to *fit* a wave count onto a chart that is not obvious is one of the greatest mistakes any Elliott wave analyst can make, mainly because it will give you an opinion of where the markets will go that very often does not unfold as anticipated. This can be disastrous for your trading !

Leading on from this, if you only use Elliott wave patterns to identify the end of the current wave *in isolation* (the unique MTPredictor *isolation approach*), then this also allows you to accept that the current Elliott wave count could at anytime drift out of phase. Again this has the main advantage of not keeping you in an Elliott wave pattern that suddenly becomes unclear and, as such, can give you misleading results.

I hope you can see by now that this is the place where the Elliott wave theory falls down, in that if you label a chart in a particular way, then you are anticipating a particular outcome from this pattern. However, if the pattern you base your original analysis on is not the correct pattern, then the market in question will normally be heading in the wrong direction, relative to your forecast. This is what happens too many times to standard Elliott wave analysts and is normally why the Elliott wave theory gets such a bad press. However, I hope you can see that if you change your view on how to approach the Elliott wave theory as suggested in this section, then this will avoid these major problems experienced by most Elliott wave analysts.

As such, these chapters have allowed you to release yourself from the shortcomings of the Elliott wave theory and trying to *forecast* where some market may go at some point in the future, in favour of using the Elliott wave theory to be able to identify a high probability, low risk trade set-up in isolation.

You either have to learn to deal with the situation as it really is, or give up on the Elliott wave theory, or look for a different method to trade the markets.

I hope that you don't make the decision of many Elliott wave analysts to give up on the theory, as I hope I have demonstrated that buried within the theory is one particular pattern that is worth its weight in gold. However, to be able to use this in your own trading you have to adjust the way you look at the markets or, indeed, the way you look at Elliott wave theory as it is applied by some of the more traditional Elliott wave theorists.

In particular, the main difference in my approach is that I believe the best way to use this particular pattern, or any Elliott wave analysis, is to look at the wave patterns *in isolation* (The unique MTPredictor *isolation approach*). Although many will say this removes the predictive ability of Elliott wave analysis, I hope I have demonstrated that this is less reliable than we would all like. So I have made a trade-off, against a low reliability predictive analysis technique (Elliott wave analysis) in favour of a high reliability way of identifying an individual trade set-up. I'll talk more about this in future chapters.

This *isolation approach* to Elliott wave analysis and trade identification is unique to MTPredictor.

As such, my best advice is to stick to using the simple ABC correction to identify a trade set-up. It is as simple as that. This is the basis of the three automatic set-ups in the MTPredictor software program: the simple ABC correction (TS3), and TS1 and TS2 trade set-ups.

However, I do realise that many of you would like to take Elliott wave analysis further, and I will cover some more advanced techniques in Part 2 of this course. But for now, I would like you all to focus on the simple ABC correction with the simple aim of using it to identify a trade set-up, but not just any trade set-up - a trade set-up that has a high probability and, more importantly, a low initial risk. In this way you can use this set-up to maximise your profits and, critically, keep the losses small. If you can do this you will have the ingredients for a success long-term approach to trading the markets.

This is what the standard MTPredictor trade set-ups are designed to do, more on this in the next chapter.

Chapter 7 – MTPredictor, and the three standard trade set-ups

As you have seen over the last few chapters, I believe that the best way to use the Elliott wave theory is to look at each individual pattern *in isolation*, (the unique MTPredictor *isolation approach*), and in particular, use the simple ABC correction as a way to identify a high probability, low risk trade set-up. The MTPredictor software program uses this simple pattern in the three specific set-ups that the software can automatically identify for you. These are:

1. **The TS1 trade set-up** – Minor abc correction within a Wave (2orB) swing.
2. **The TS2 trade set-up**. – Minor abc correction within a Wave (4) swing.
3. **The TS3 trade set-up** - The simple ABC correction by itself

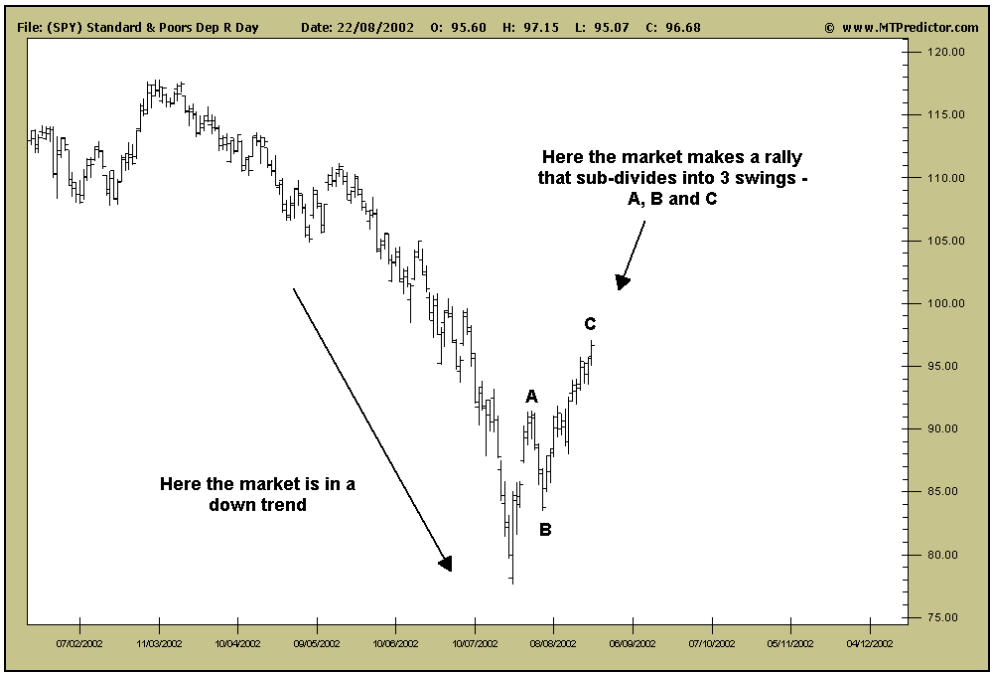
In this chapter I would like to introduce these three set-ups and look at them one by one in more detail, starting with the simple ABC correction or TS3 set-up.

What is a simple ABC trade set-up ?

A simple ABC is where the market makes a correction that subdivides into a lesser-degree ABC, where the minor Wave C exceeds the price extreme of the minor Wave A.

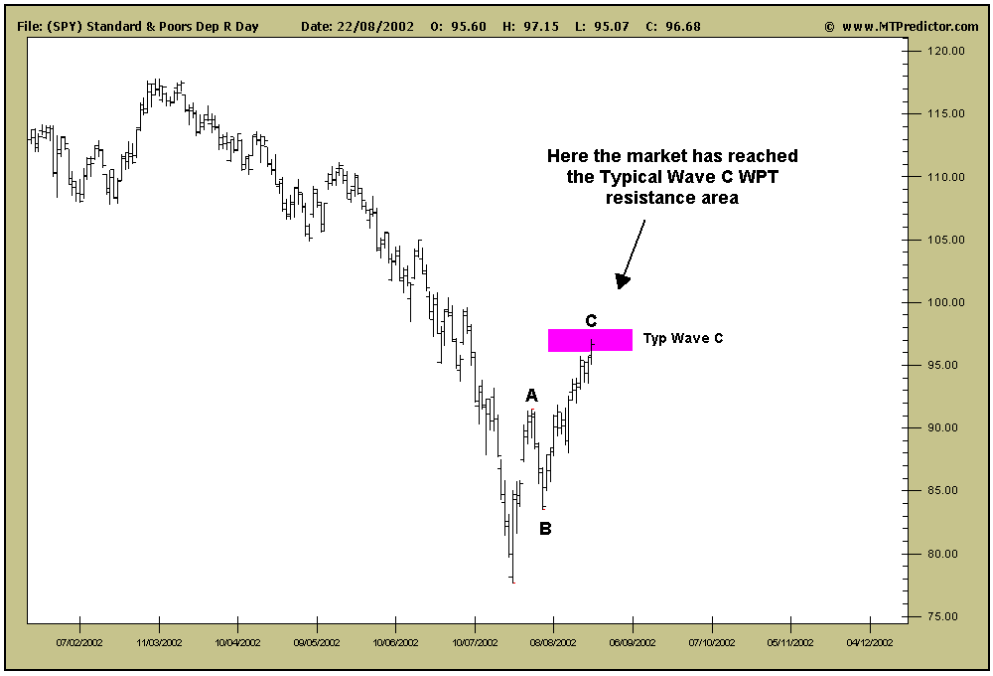
This a very important set-up because once the ABC correction is complete, the market normally continues in the original trend direction. As such, the end of the simple ABC correction is a great place to look to enter a new trade, to take advantage as the main trend resumes.

Let's take a look at an example to show you what I mean.



Here you can see in this example on the SPY, the US stock that tracks the S&P stock index, the market was in a clear downtrend going into the low in July. The market then made a rally, which unfolded as three separate swings, which I have labelled A, B and C on the chart on the previous page. As can be seen, this ABC rally is against the main trend, which was clearly down, therefore this rally would be viewed as corrective.

The first question I hear you asking is: Okay, the market is making a rally off the July low and this rally appears to be unfolding in three swings but how do we know how far this rally will go before it ends? The simple answer is that you don't for sure, however the MTPredictor software program has routines that can project the *most likely* areas where all of the Elliott waves will end. In this example, as you are looking for the end of the wave C (of an ABC correction) you will be using the typical wave C WPT.

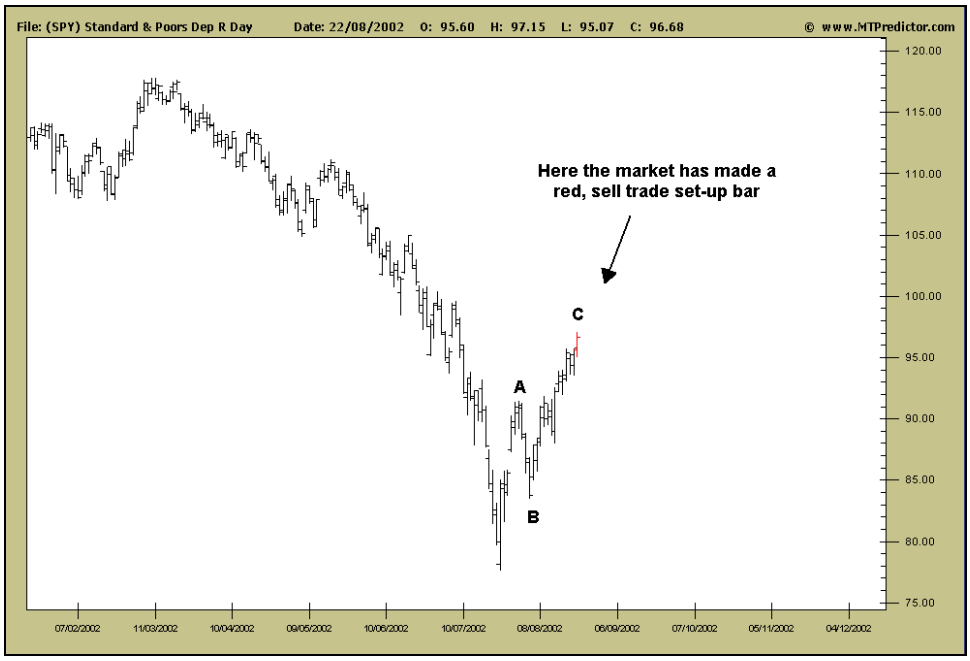


As you can see from the chart above, in this example the market has now reached the area of the typical wave C WPT. This is the *most likely* area where an ABC correction will end.

As we'll see in later chapters the software can calculate and display this level for you automatically.

Now the market is in an area where the ABC correction is most likely to end, the next question I hear you ask is: how do we know the current ABC rally is ending?

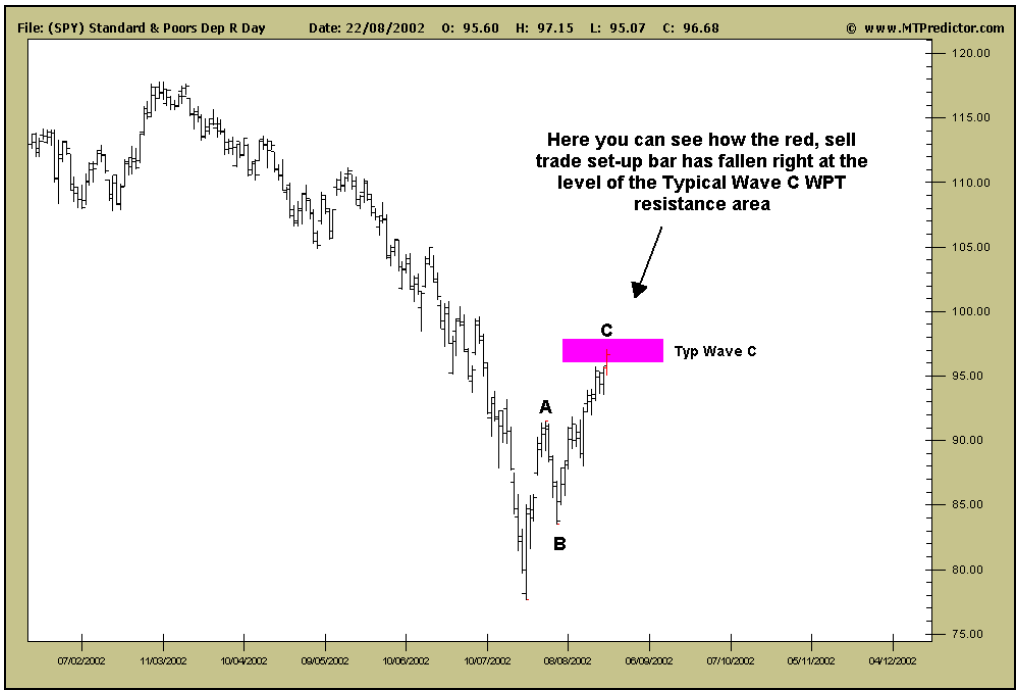
For this, the software can automatically colour the bars on the chart red for a sell and blue for a buy.



Here you can see that the last bar on the chart, which was August 22 2002, was painted red. This means that the MTPredictor software program has identified this as a potential sell Reversal Bar.

Let's take a moment and reflect on the current position as of August 22. Firstly, the market (the SPY) was making a three wave rally which is labelled as an ABC correction; secondly, the wave C (of this ABC correction) has now reached the most likely area (the typical wave C WPT) for the entire ABC correction to end; and lastly, the MTPredictor software program has coloured August 22 as a red sell trade set up bar.

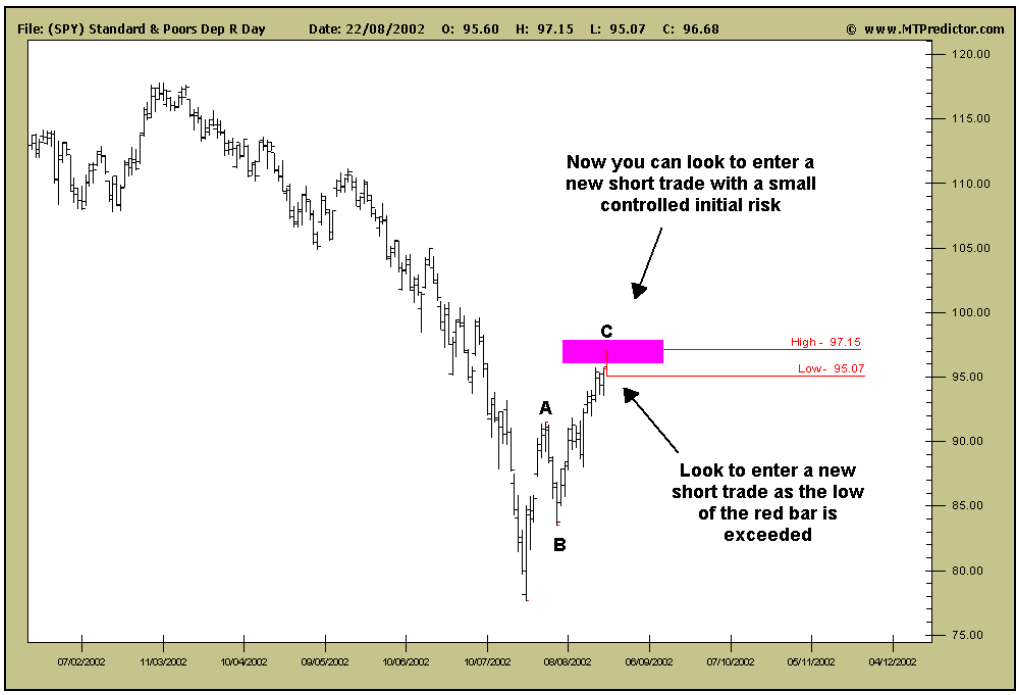
Let's see what this looks like on a chart.



As you can see, these three things (the ABC correction, typical wave C WPT, and sell trade set up bar) have all come together on August 22. This is like the three sides of a triangle all coming together to signal harmony entering the market and, as such, this is the area where a turn in this market *could* unfold.

So, this would be considered an *ideal* sell trade set-up.

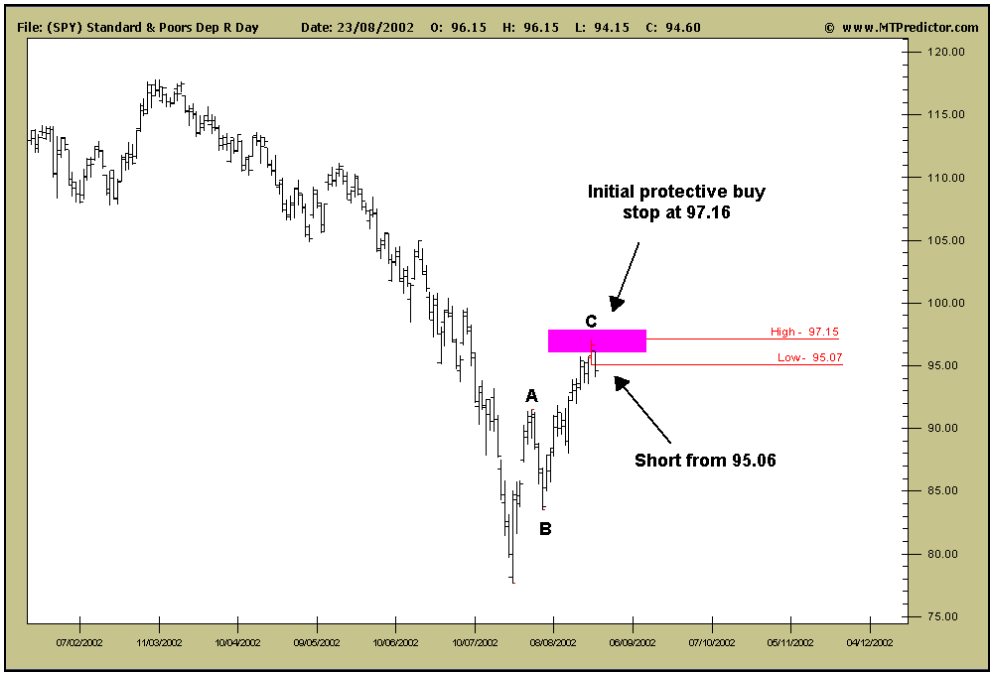
You can now consider entering a new short trade, *if*, the market in question (SPY) trades below the low of the red sell trade set up bar:



At first sight, this may seem quite involved, however the MTPredictor software program automatically identifies these trade set-ups for you and automatically displays all the information on the chart for you.

Although you can never know for sure whether any trade set-up will turn out as anticipated, the one thing you can control is the initial risk (or the amount to you are likely to lose) when a trade goes wrong. As I have mentioned in the previous chapter, the single most important aspect to any successful trading plan is to keep the initial risk (and therefore your losses) as small as possible.

In this example, the next day (August 23), the SPY declined below 95.07, which was the low of August 22, therefore taking you into a new short trade at a price of 95.06. Your initial protective buy stop would be placed just above the high of August 22 of 97.15 at 97.16. This means your initial risk on the trade would-be 96.06 - 97.16 or 2.1 points (ignoring slippage and commission).



I will be returning to initial risk, and its significance, in a later chapter. So all you need to realise and understand for now is that the initial risk to enter this new short trade is only 2.1 points (ignoring slippage and commission).

However, as I am sure you all realise, if you can enter trades at, or very near, a turn in the market then you can keep your initial risk extremely small.

However, what I would like to stress at this point is how three elements have all come together at the same time to signal a potential change in trend:

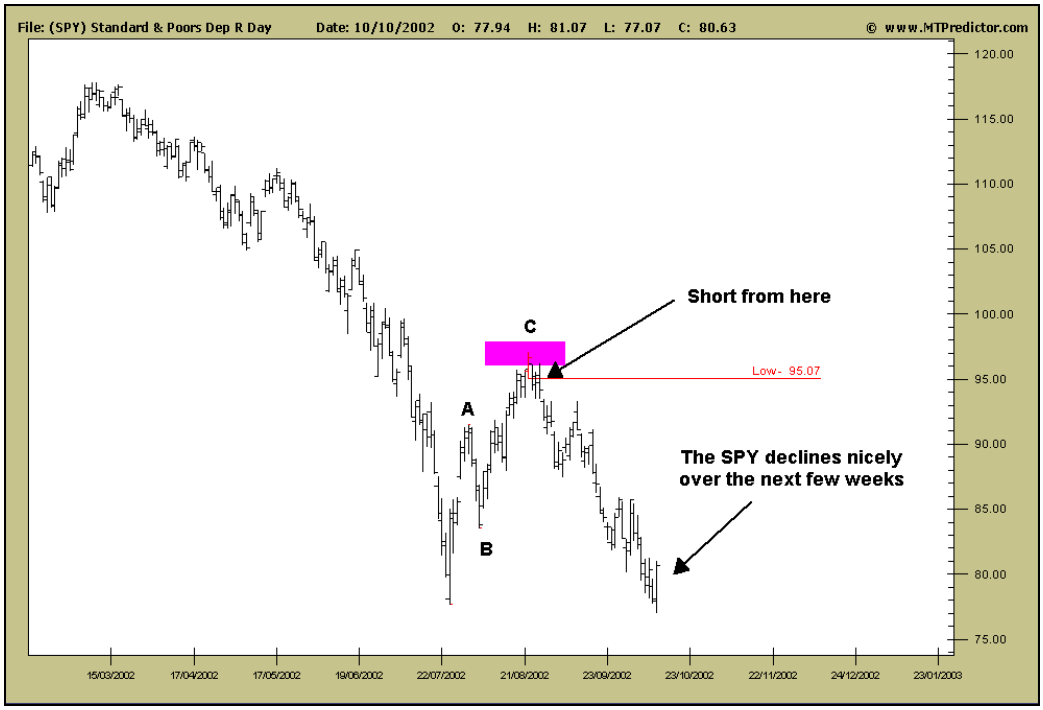
1. The market in question (the SPY) was at a level where a high was anticipated to unfold. This was the typical wave C WPT resistance area.

2. The market in question (the SPY) made a red sell Reversal Bar that unfolded right in the typical wave C WPT resistance area.

3. The market in question (the SPY) then declined below the low of the red sell Reversal Bar.

As you see, these three things meant that the SPY was not only at an area where a high was anticipated to unfold but it had also given an indication that a high was likely to unfold (by a red sell Reversal Bar appearing at the WPT), also the SPY (by its own actions) confirmed that the high was complete by declining below the low of the red sell trade set up bar.

Let's see how this turned out:

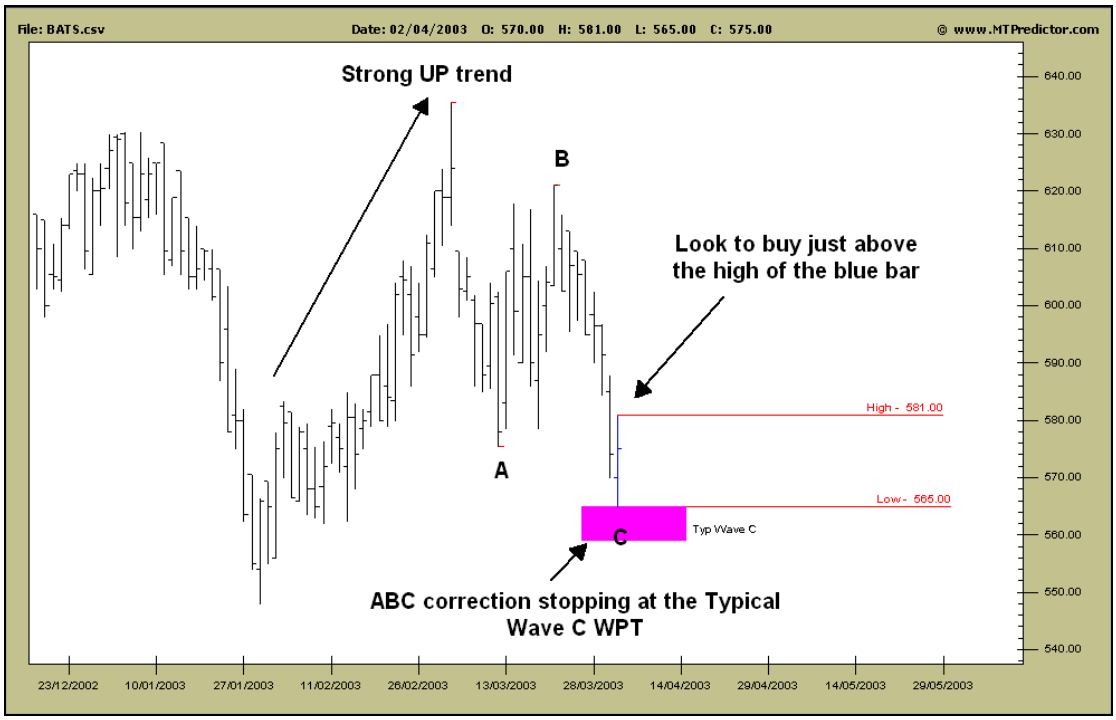


As you can see from the chart above, the SPY declined nicely from the sell set-up. In fact, the SPY continued down into the first potential profit target. I will cover how the software projects profit targets and how to manage your trades in later chapters.

August 22 (the day of the initial trade set-up) was the actual day of the Wave C high, however, the most important point to note is that the current profit of 16.96 points is far in excess of the 2.1 points that was required to take the trade.

Although this is was an example of a new short trade, exactly the same procedure is followed for a potential long trade, where the market makes a strong rally, which is followed by a correction that unfolds in 3 swings - a simple ABC correction.

Let's look at an example.

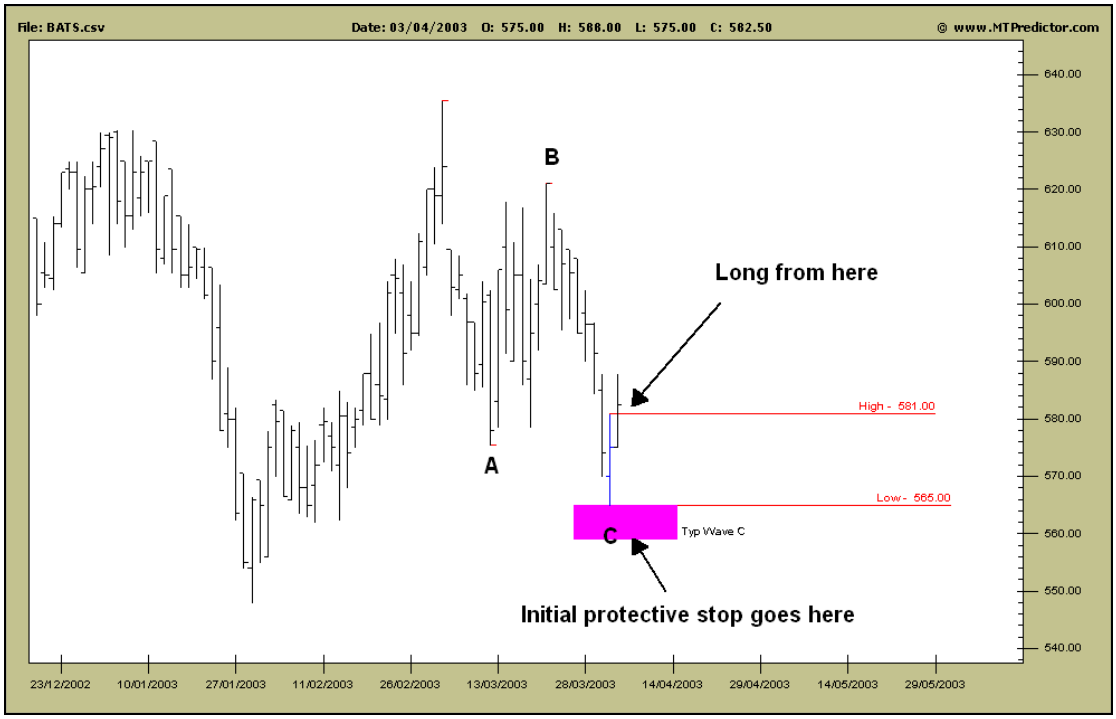


Here you can see an example on British American Tobacco Plc (BATS), which is a UK share on the FTSE 100. In this example there is a strong uptrend into a high in March 2003, followed by a correction that unfolds in 3 swings which I have labelled A, B and C. As in the prior example, the wave C is currently at the typical wave C WPT support zone (it is support in this example because the Wave C is a low), and the last bar on the chart, April 2, the MTPredictor software program has painted as a blue buy Reversal Bar.

This is exactly the same as the short trade in the prior example, where these three aspects - the ABC correction, typical wave C WPT, and coloured (blue for a buy in this example) Reversal Bar - have all come together on April 2, except it is for a potential buy set-up for a new long trade.

Continued on the next page . . . .

The very next day BATS rallied, triggering a new long trade:



As with the prior example, as soon as any new trade is entered a protective stop is placed in the market. Here, because it is protecting a new long position, this would be a sell stop just below the recent (Wave C) low of April 2. I will cover stop placement and adjustment in more detail in a later chapter.

However, for now, the point I wish to emphasise is that this new long position was entered with an initial risk of only 17 points (581.50 – 564.50). Please remember this number, as I will be returning to it again on the next page.

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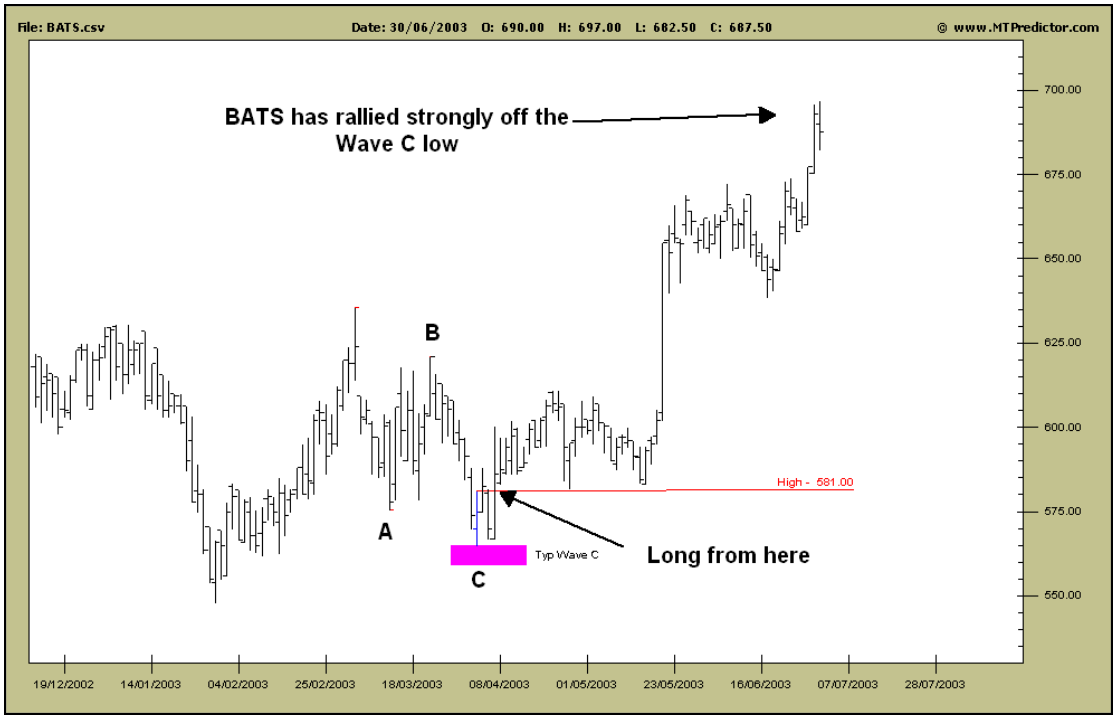
Let's see how it turned out.



As you can see from the chart above, British American Tobacco Plc (BATS) rallied very nicely of this wave C low. With the current price (at the time of writing) of 687.50, the current profit on this trade is 106 points (687.50 – 581.50).

Although April 2 (the day of the initial trade set-up) was the actual day of the wave C low, the most important point to note is that the current profit of 106 points is far in excess of the 17 points risk that was required to take the trade.

I hope you can see that the procedure I used was exactly the same as in the prior example except the wave C was a low and, as such, you were looking for a buying opportunity, as opposed to the wave C being a high and looking for a selling (or shorting) opportunity.

In both examples all three aspects, the ABC correction, typical wave C WPT and coloured reversal bar, all came together to signal the wave C swing was at an end and you should have been looking for a potential trade set-up.

Continued on the next page . . .

In each of these examples, the current profit has been far in excess of the initial risk required to take the trade. This is a very important point, because not all trades will result in profits. Loss can, and will happen.

I will be returning to this topic of initial risk to reward in greater detail later in the course, but at this stage I hope you can begin to see how keeping the profits large in comparison to the losses is vitally important to successful trading.

This is what these set-ups are designed to do.

However, for now, all I wish you to focus on and remember is that for a simple ABC correction you need all three aspects,

- The ABC correction,
- Typical wave C WPT, and
- Coloured Reversal Bar,

to combine to signal the wave C swing is at an end, so you should be looking for a potential trade set-up.

The MTPredictor software program will find and automatically identify these set-ups for you; all you have to do is confirm the set-up visually on the chart itself. It is as simple as that!

Next I would like to look at the TS1 trade set-up. This is where the abc pattern forms as part of the Wave (2orB) correction.

What is a TS1 trade set-up ?

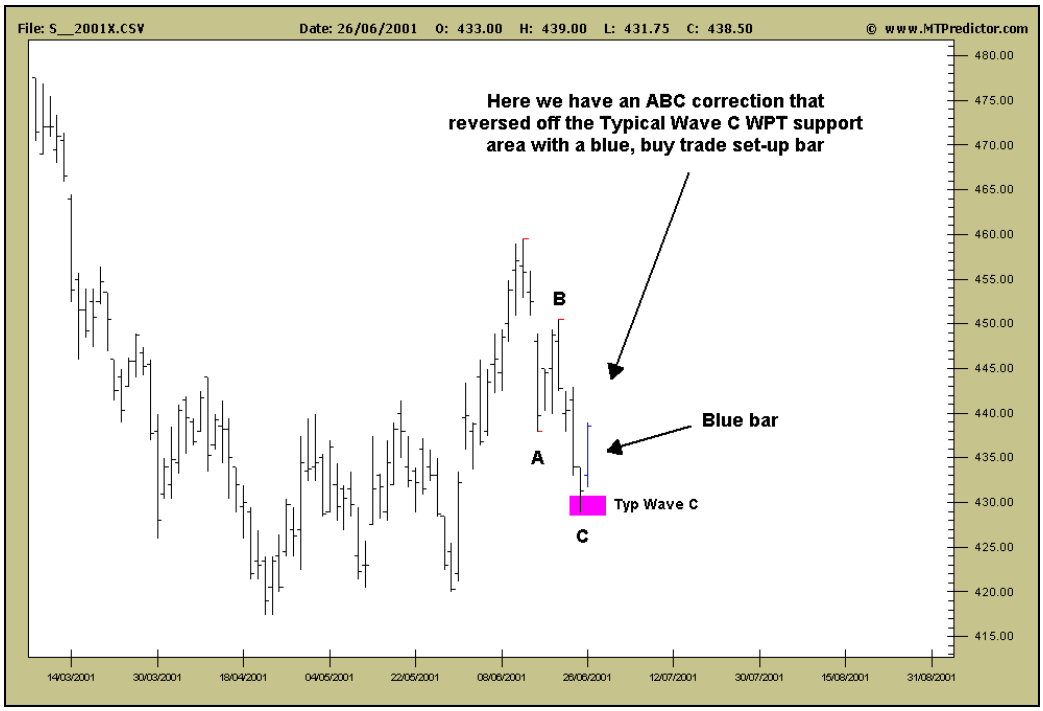
A TS1 trade set-up is where the abc correction forms as part of the *first correction* to the *first move* off an *important high or low*. In Elliott wave terms, this is off the end of a larger-degree Wave (2) or (B) correction.

Why is identifying this set-up so important ?

Because the next swing off a potential Wave (2) or (B) high or low has the *potential* to turn into a Wave (3) type swing. As Wave (3) is usually the strongest and longest of all the Elliott wave sequences, it carries the largest profit potential. Therefore, identifying the very end of a potential Wave (2) or (B) correction can be the best place to look to enter a new trade.

W.D. Gann stated *"the safest place to look for a new trade is at the end of the first correction to a new swing"*. This is what the TS1 trade set-up is designed to identify.

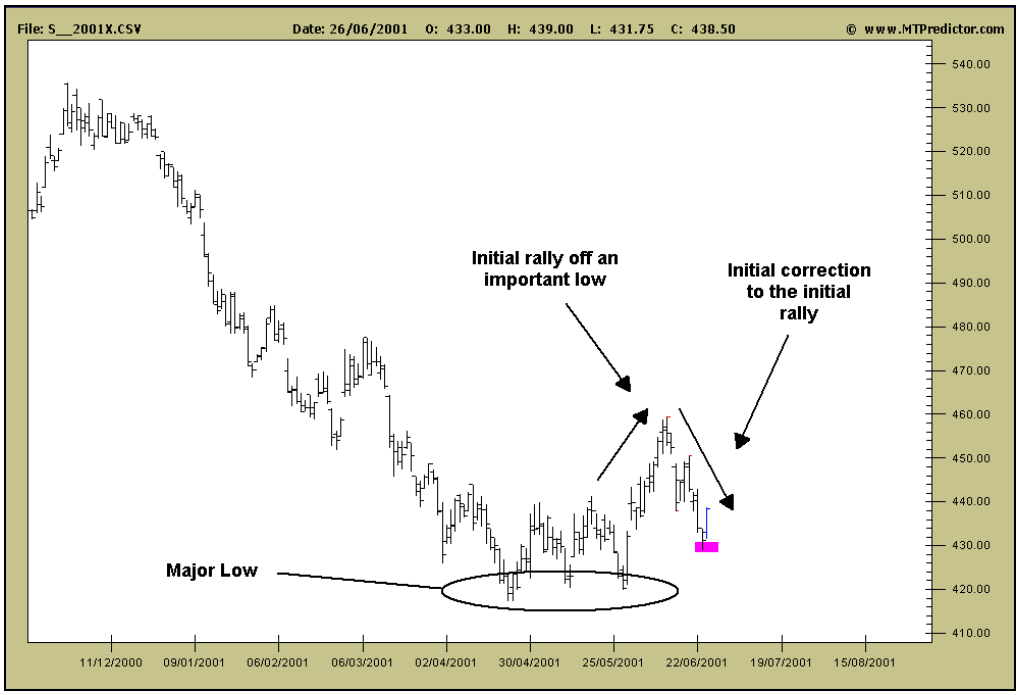
Let's take a look at an example.



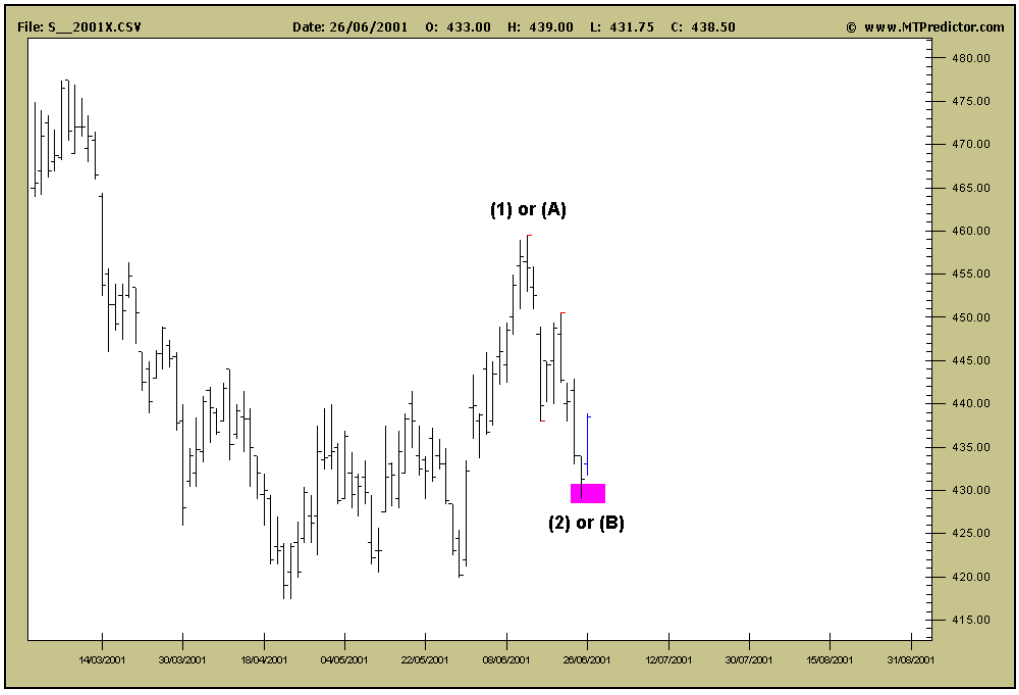
Here you can see exactly the same set-up as you looking at in the prior section, with a simple ABC correction, where the wave C stopped at the typical wave C WPT support zone with a blue buy trade set up bar.

However, there is one important difference between the simple ABC described in the prior section and this ABC. It is to do with where the ABC correction unfolds in relation to the *larger-degree* trend.

Let me show you what I mean:

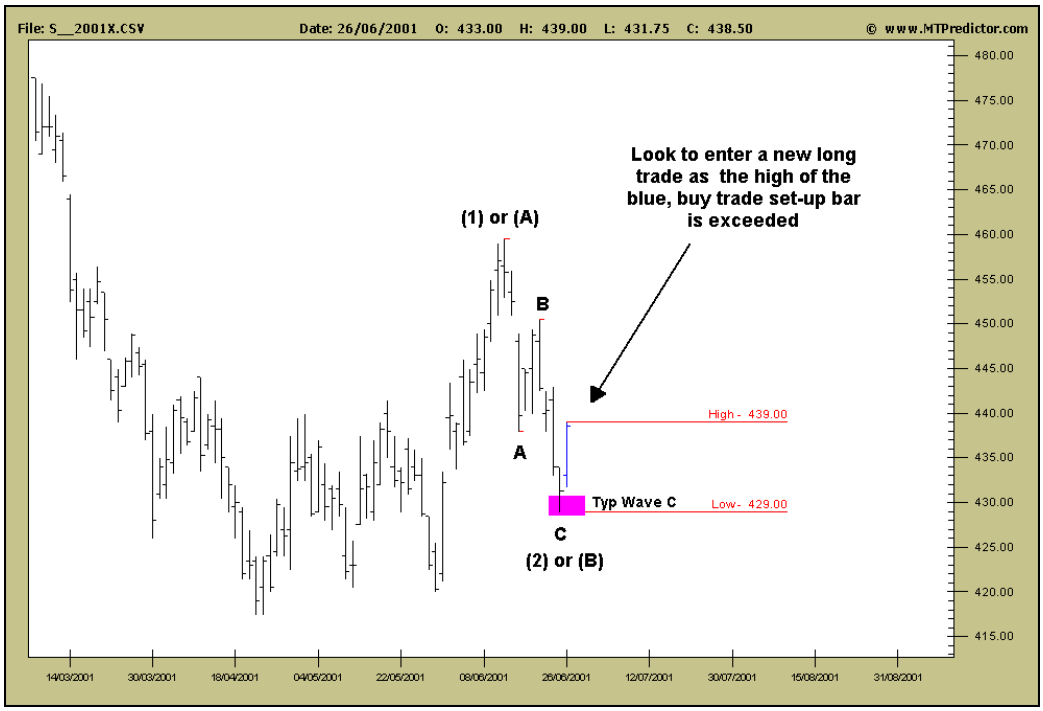


If you now zoom out on this chart to look at a slightly longer timeframe, you can see how this correction was in fact the *initial correction* following the *initial rally* off an *important low*. In Elliott wave terms this would be a large degree wave (2) or (B):



As far as the initial set-up is concerned there is very little difference between this ABC and the ABC in the prior section. The main difference comes with the trade management, and in particular how sometimes the move off a TS1 trade set-up can be very strong. The reason for this is if this correction turned out to be a wave (2) then you should anticipate a wave (3) swing to follow. As you have seen in chapter 3, a wave (3) is usually the strongest and longest in any of the Elliott wave sequences, as such it carries the largest profit potential. Therefore, being able to identify the end of a Wave (2) correction can be one of the best trades you can have!

The initial trade entry is exactly the same as before, where (in this example) a new long position is taken *if* the high of the blue buy trade set up bar is exceeded.



Then as before, if the trade is triggered the initial protective sell stop (in this example) is placed just below the last minor swing low.

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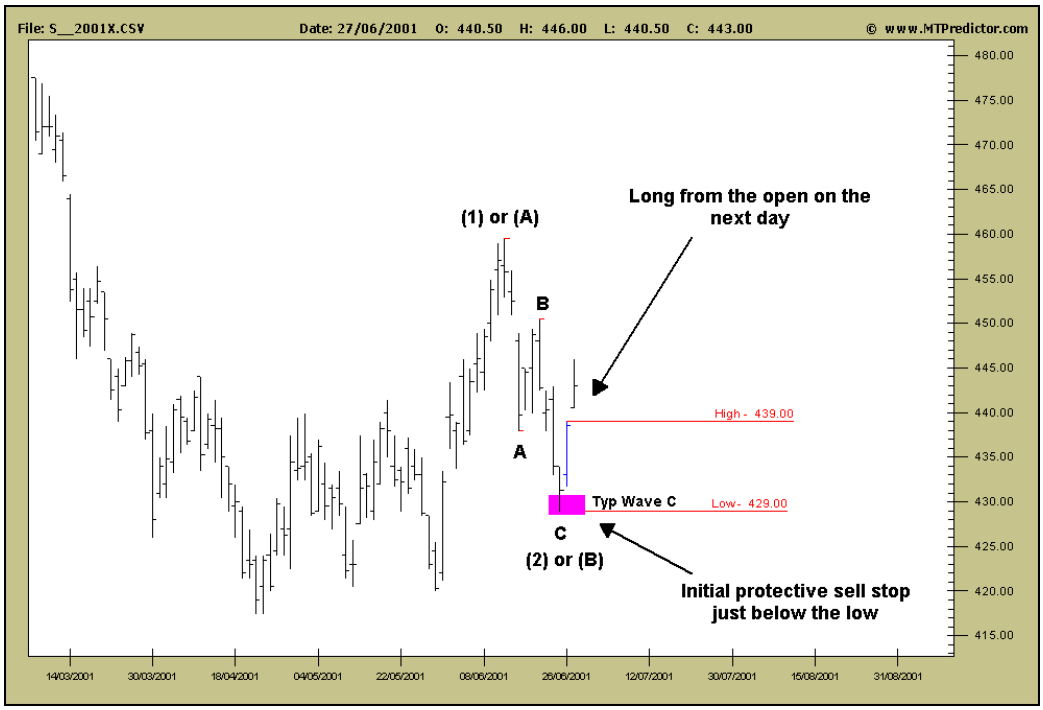


Here, this would have resulted in a new long position in (Nov) Soybeans at 440.50 (open the next day), with the initial protective sell stop at 428.75. This would have been an initial risk of $587.50 (440.50 - 428.75 x $50) per contract (ignoring slippage and commission).

I hope you see how similar this set-up is to the regular ABC, the only difference being that the ABC unfolds as the first correction against the first move off an important high or low.

Otherwise you have exactly the same position as before, in that all three aspects,

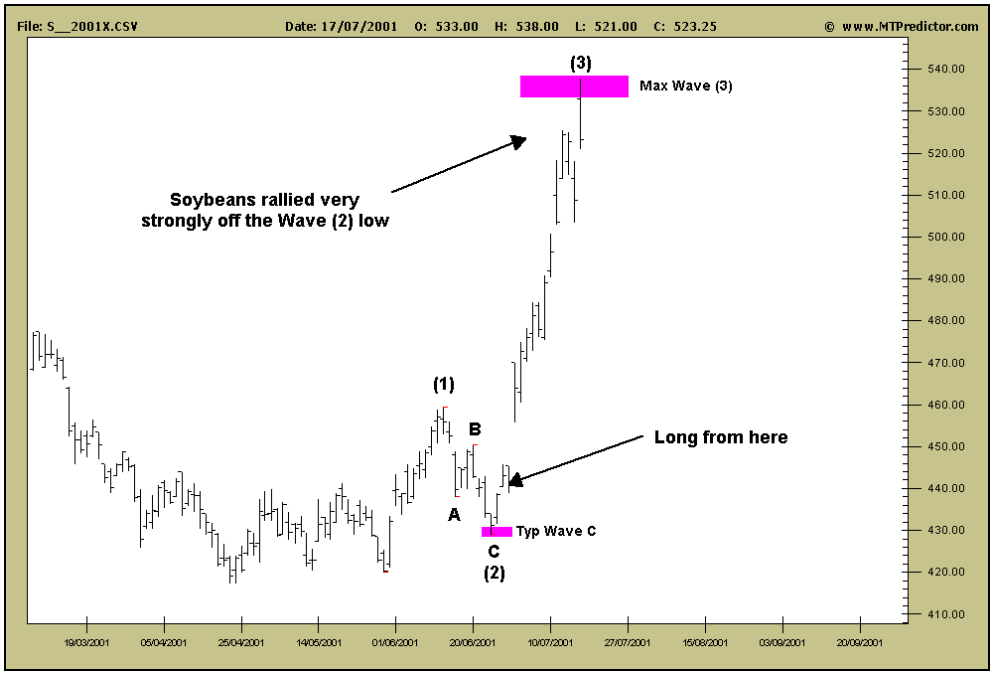
- The ABC correction,
- Typical wave C WPT and
- Coloured Reversal Bar,

came together to signal the wave C swing was at an end, so you should be looking for a potential trade set-up, just as before.

Again just as before, the MTPredictor software program automatically identifies and automatically displays these set-ups on the chart for you.

Continued on the next page . .

Let's see how this would have turned out:



As you see the market in question (Soybeans) rallied very strongly off this ABC correction and wave (2) low in a wave (3) type rally. In fact, the market went on to rally into the maximum wave (3) WPT resistance area. Again I'll be coming back to projected price targets and how to manage these trades in later chapters.

However, the important point here is that the profit at the maximum wave (3) WPT resistance area would have been $4,625 (533.0 - 440.50 x $50) per contract (ignoring slippage and commission). As you see, this is a lot larger than the initial risk required to take the trade of $587.50 (440.50 -428.75 x $50) per contract. This is what successful trading is all about, keeping the profits large in relation to the losses (or initial risks).

This is what these set-ups are designed to do. I will come back to this in a future chapter.

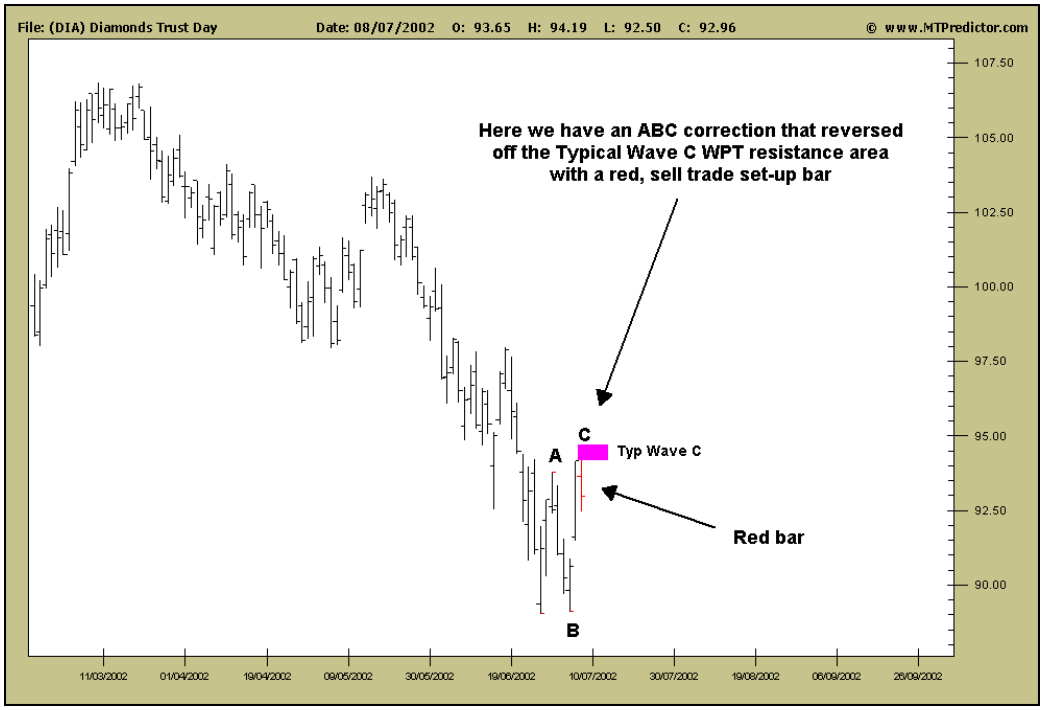
Next I would like to move on to the TS2 trade set-up. This is where the abc pattern forms as part of the Wave (4) correction.

What is a TS2 trade set-up ?

A TS2 trade set-up is where the ABC correction forms as part of a correction once the main trend is already well established. In Elliott wave terms, this is off the end of a Wave (4) correction.

This is also a very important set-up because once a Wave (4) correction is complete then the Wave (5) swing is the last impulsive move before the entire Elliott sequence is complete. As such, the move off a completed Wave (4) correction also represents a good tradable opportunity.

Let's take a look at an example.

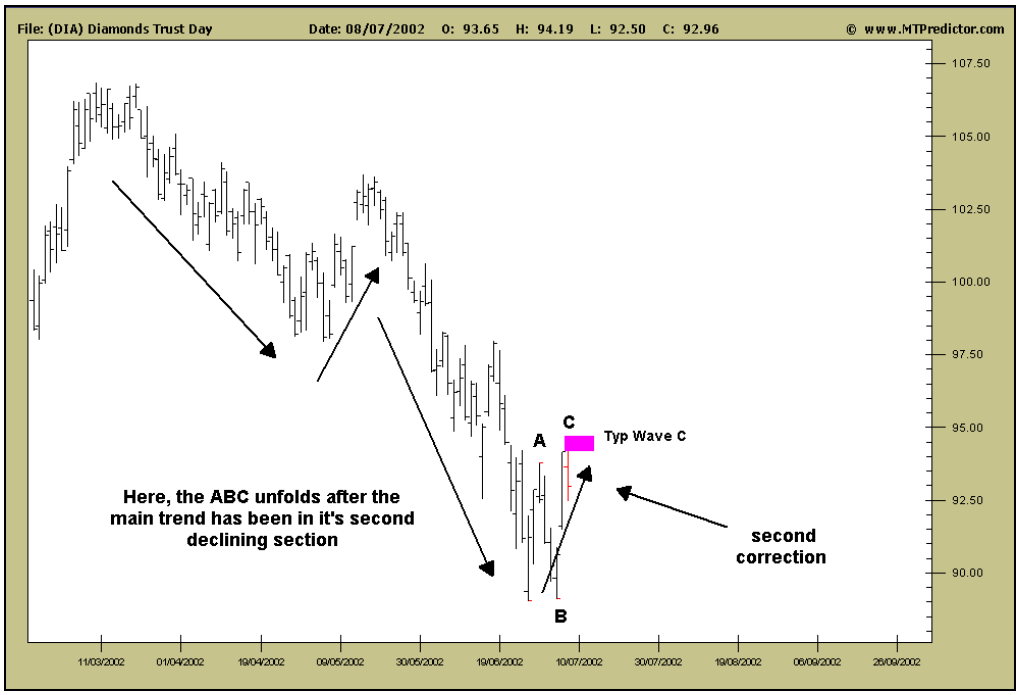


Here you can see exactly the same set-up as you were looking at in the prior sections, with a simple ABC correction, where the wave C stopped at the typical wave C WPT with a coloured Reversal Bar.

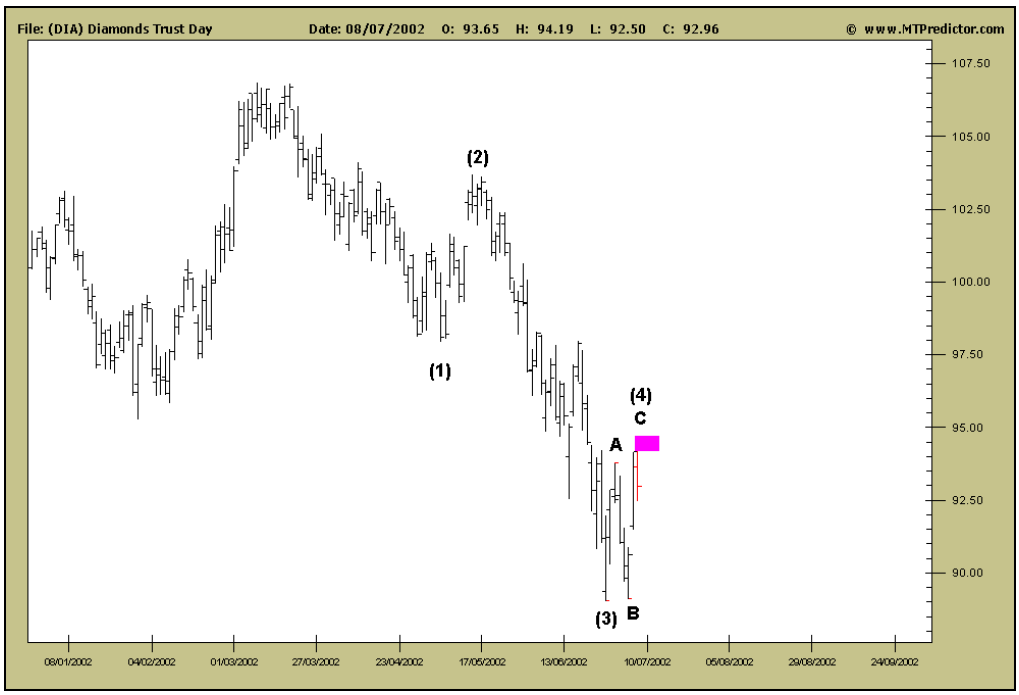
Continued on the next page . .

However, there is one important difference between the simple ABC described in the prior sections and this ABC. It is to do with where the ABC correction unfolds in relation to the *larger-degree* trend.

Let me show you what I mean:

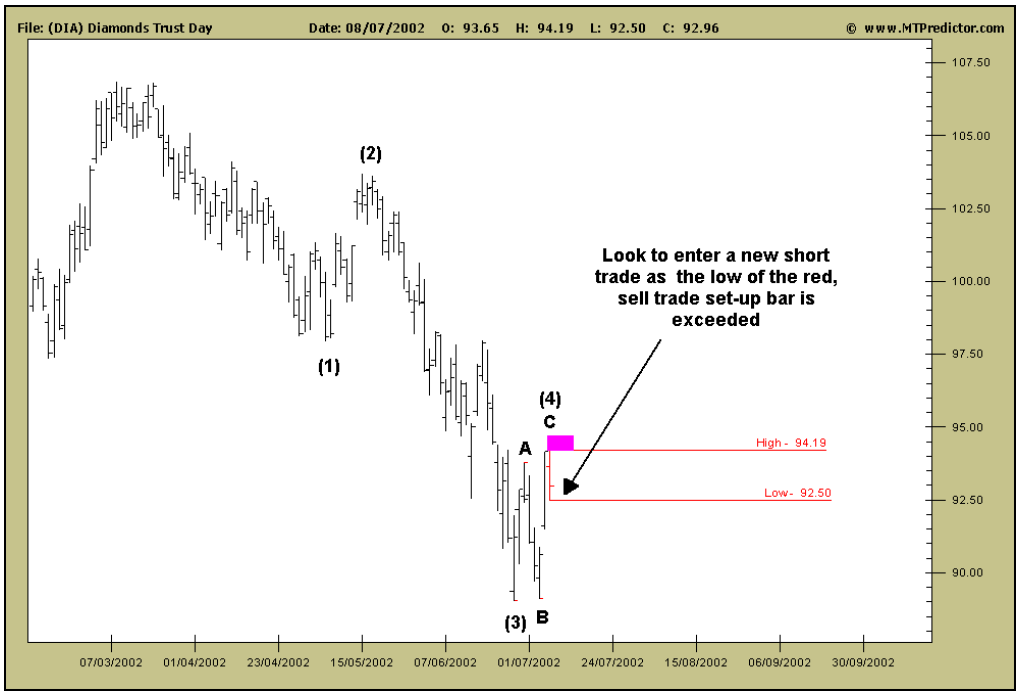


If you now zoom-out this chart to look at a slightly longer timeframe, you can see how this correction was in fact the *second correction* following the *second decline* well after the major high. In Elliott wave terms this would be a large degree wave (4):



As far as the initial set-up is concerned, there is very little difference between this ABC, and the ABC in the prior sections. The main difference comes with the trade management, as the next swing would be considered a Wave (5).

The initial trade entry is exactly the same as before, where (in this example) a new short position is taken *if* the low of the red, sell reversal bar is exceeded.



Then as before, if the trade is triggered the initial protective buy stop (in this example) is placed just above the last minor swing high.

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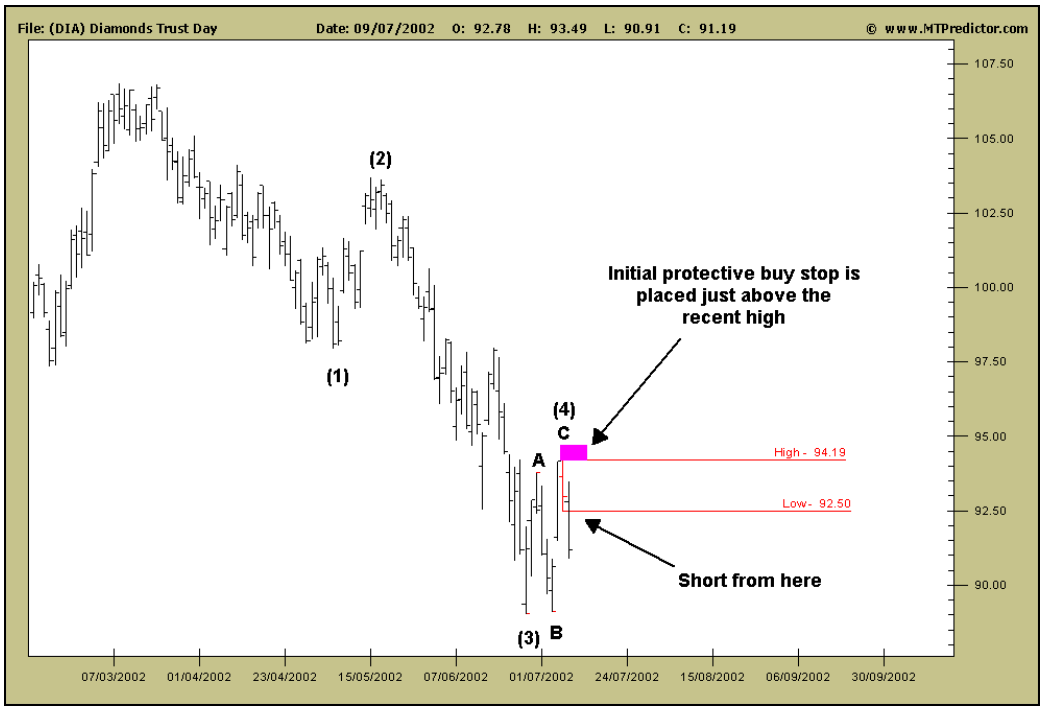


Here, this would have resulted in a new short position at 92.49 (as DIA declined below the low of the red sell Reversal Bar of 92.50), with the initial protective buy stop at 94.20. This would have been an initial risk of 1.71 points (94.20 – 92.49).

I hope you see how similar this set-up is to the regular ABC, the only difference being that the ABC unfolds as the second correction after a strong Wave (3) type swing. Otherwise you have exactly the same position as before, in that all three aspects,

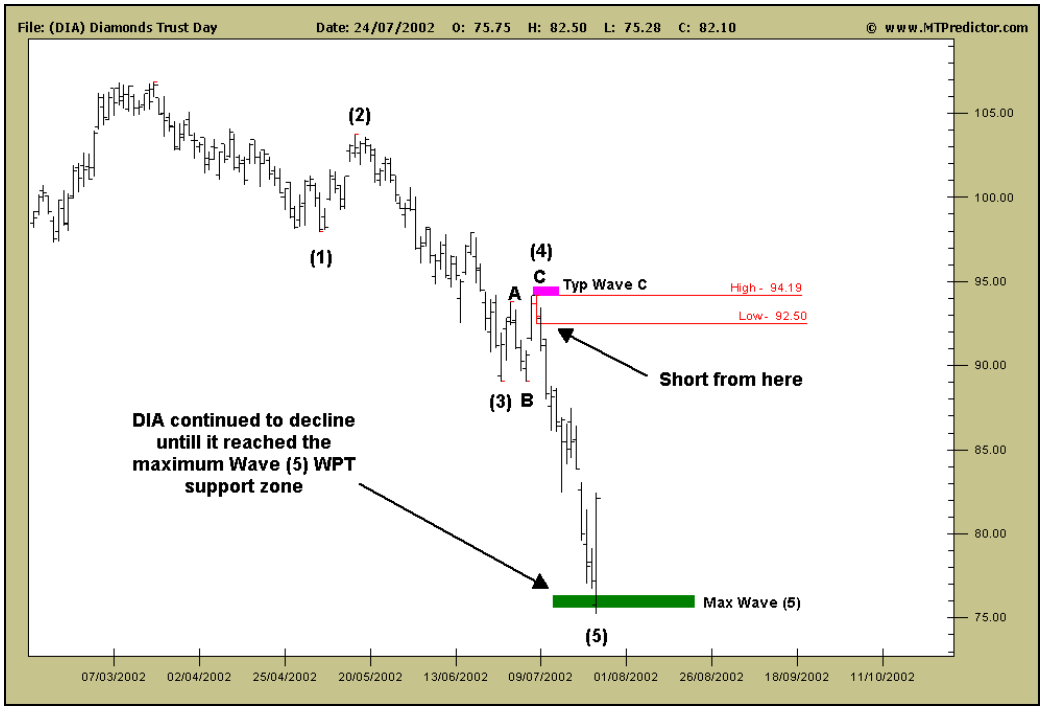
- The ABC correction,
- Typical wave C WPT and
- Coloured Reversal Bar,

came together to signal the wave C swing was at an end and, as such, you should be looking for a potential trade set-up, just as before.

Again just as before, the MTPredictor software program automatically identifies and automatically displays these set-ups on the chart for you.

Continued on the next page . .

Let's see how this would have turned out:



As you see, the market in question (DIA) declined very strongly off this ABC correction and wave (4) high in a wave (5) type decline. In fact, the market went on to decline into the maximum wave (5) WPT support area. Again I'll be coming back to projected price targets and how to manage these trades in later chapters.

However, the important point here is that the profit at the maximum wave (5) WPT resistance area would have been 16.04 points (92.49 - 76.45) (ignoring slippage and commission). As you see, this is a lot larger than the initial risk required to take the trade of 1.71 points (94.20 – 92.49).

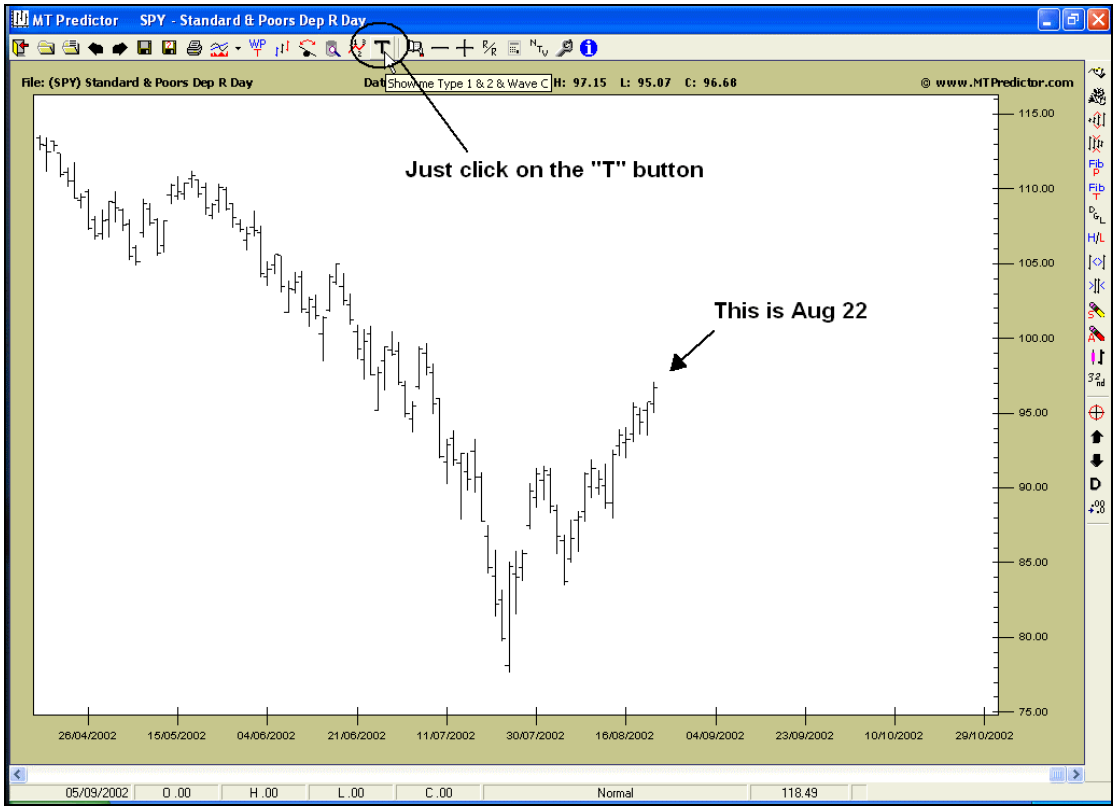
This is what successful trading is all about, keeping the profits large in relation to the losses (or initial risks). This is what these set-ups are designed to do. I will come back to this in a future chapter.

Continued on the next page . .

MTPredictor automatic routines

At fist sight, identifying these three specific trade set-ups can appear quite complicated especially when you have to worry about an Elliott wave pattern, a projected support or resistance area and coloured bars. However, this is where the MTPredictor software program excels, as it contains a special module that automatically identifies these trade set-ups for you.

Let's go back to the first example that started this chapter on the SPY on Aug 22 2002:



All you have to do now is click on the "T" (Trade set-ups) button and the software will scan the last portion of the chart to see whether any TS1, TS2 or Wave C trade set-ups are present as of the last bar on the chart, which, in this example, is on Aug 22 2002.

Continued on the next page . .. .

Here is the result:

As you can see from the chart, the software has automatically found an ABC correction, placed the Typical Wave C WPT on the chart and also coloured Aug 22 red for you.

Therefore, with just a simple mouse click a potential short trade is automatically identified for you !

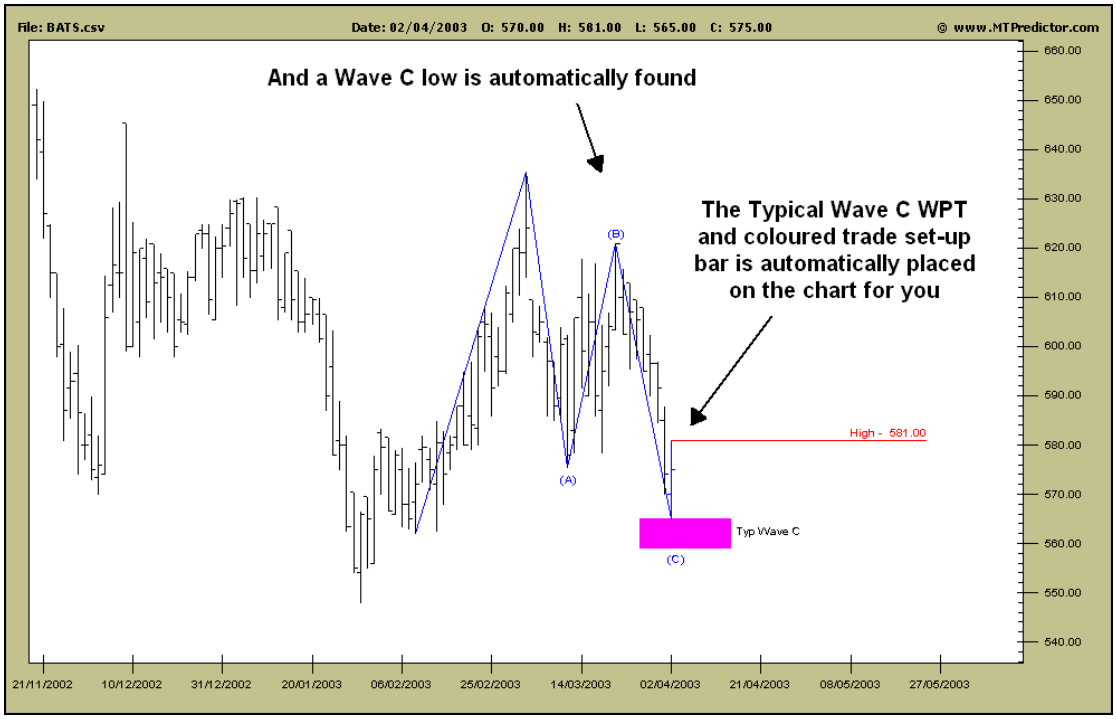
As with all the automatic routines in MTPredictor (more on this later) it will only identify a potential trade set-up, *if* there is one present on the chart, as of the last bar. Therefore, very often you will get the following message

which is good, because this will allow you to only focus on the best tradable opportunities and ignore other market action where the probabilities of a trade set-up are lower.

Let's look at the other examples from this section.

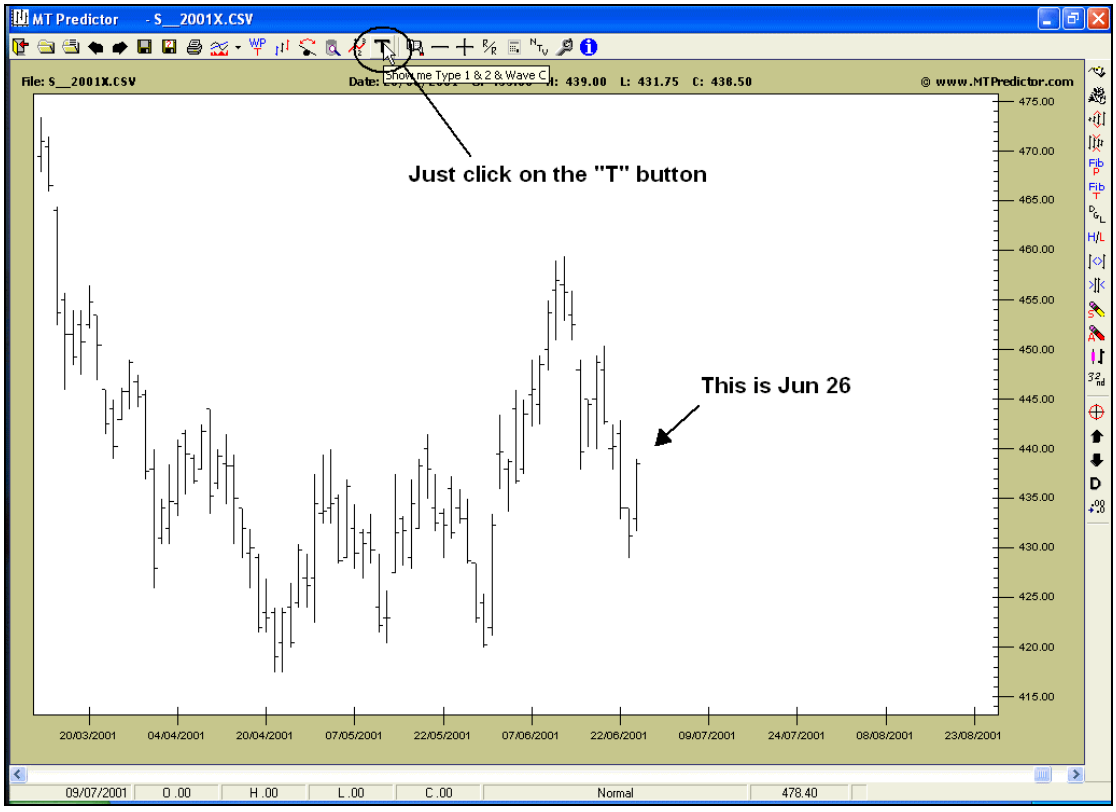
Here is the position on BATS on April 2 2003:

And the Wave C (TS3) low was automatically found.

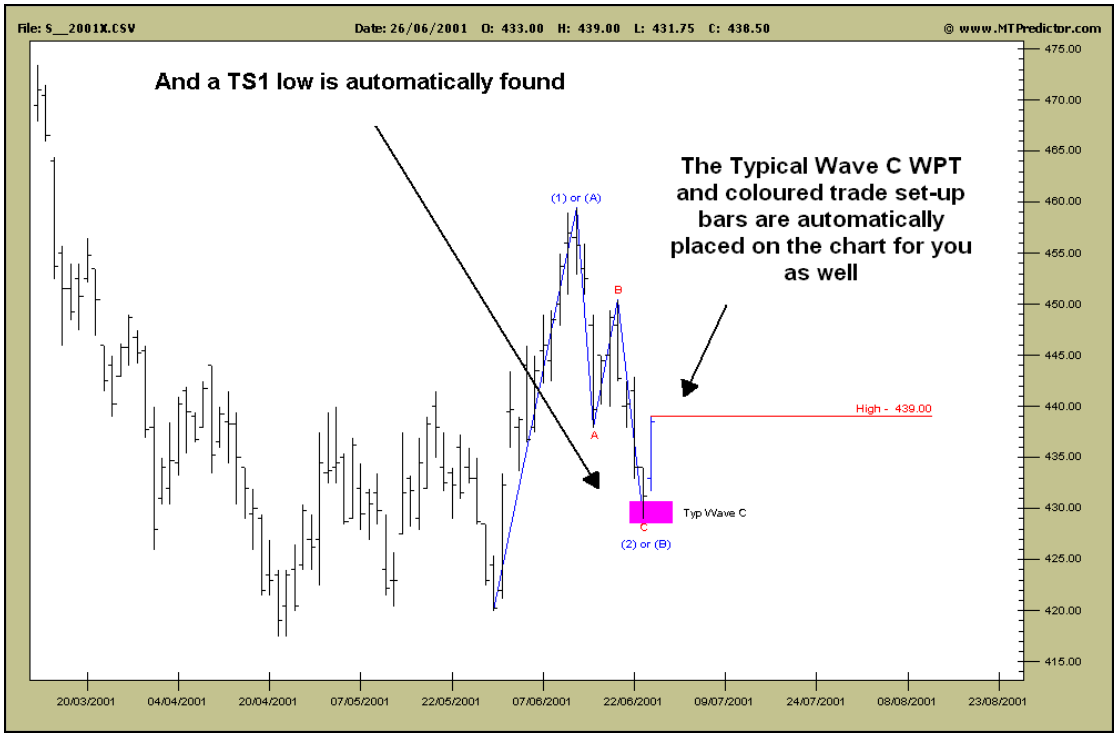


Including the Typical Wave C WPT and coloured Reversal Bar.

Here is the position on (Nov) Soybeans on Jun 26 2001:

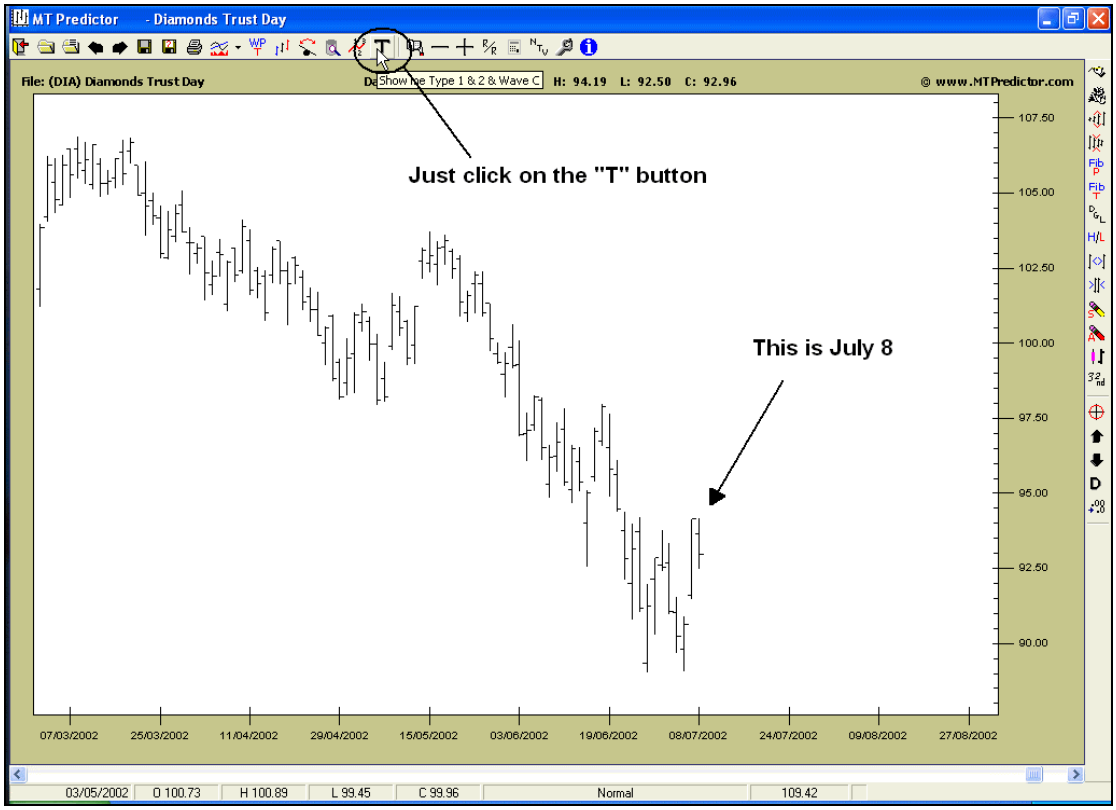


And the TS1 low was automatically found.

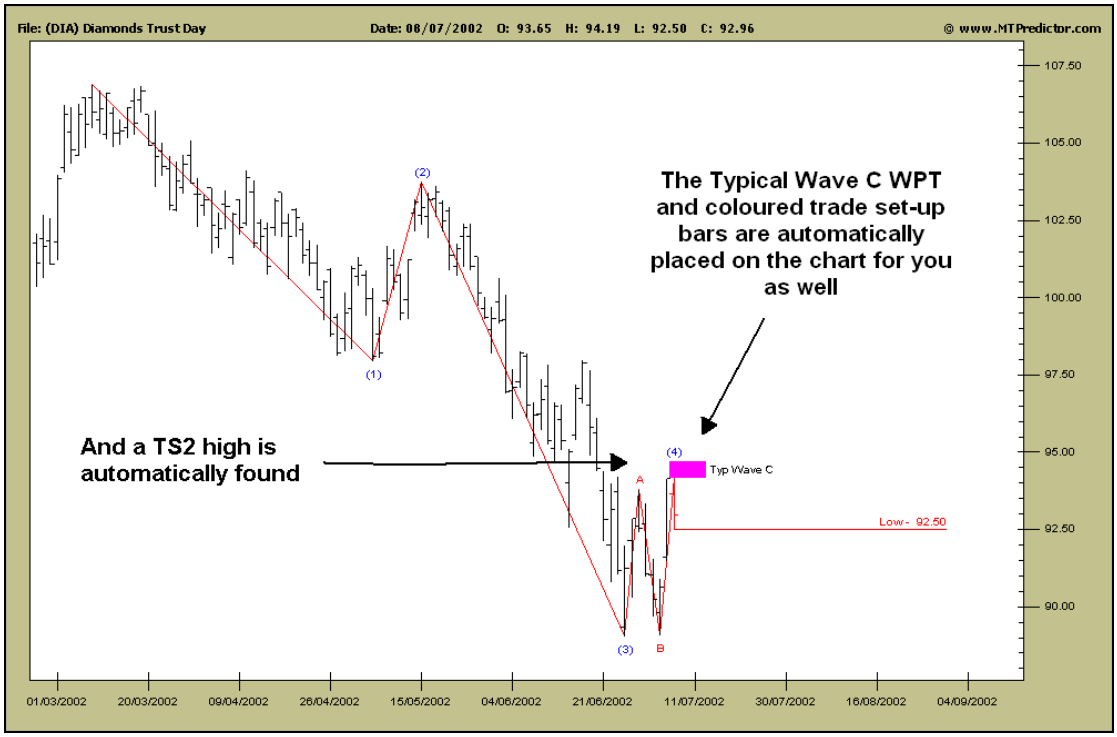


Including the Typical Wave C WPT and coloured Reversal Bar.

Here is the position on DIA on Jul 8 2002:



And the TS2 high was automatically found.



Including the Typical Wave C WPT and coloured Reversal Bar.

As you can see this makes identifying these three trade set-ups very easy indeed. In fact, the software will do this automatically for you.

Then comes the question of how can you find where one of these set-ups is currently unfolding? The answer to this question is the Trade Scanner, because this can scan through thousands of issues looking for those few that are currently unfolding as *ideal* set-ups. In this way you can spend your valuable time and energy just focusing on the few issues that have the highest probability of making a successful set-up.

I will cover the use of the Trade Scanner in more detail in a later chapter.

Over the next few pages, I would like to look at what is considered a valid trade set-up and, more importantly, what should be considered an invalid trade set-up.

For all these examples, I will use the automatic set-ups has generated by the software using the trade set-ups module.

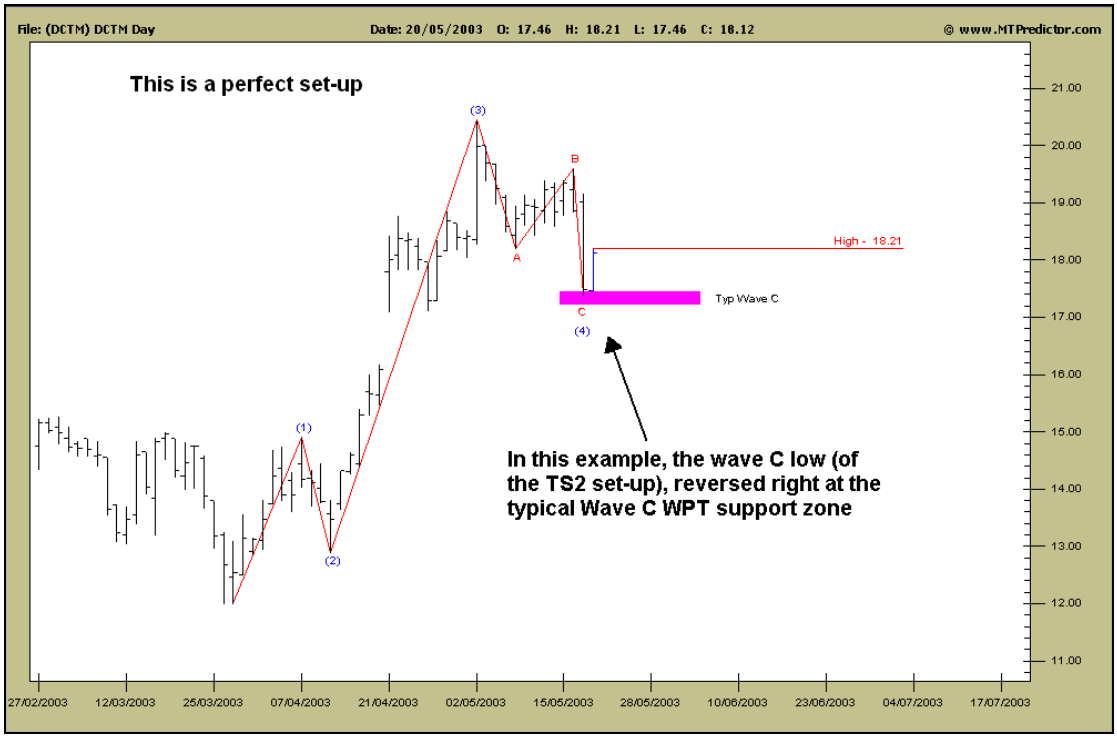
Continued on the next page . . .

What to look for in an "ideal" trade set-up

Again, the three basic trade set-ups are the simple ABC (TS3), TS1 and TS2.

An *ideal* trade set-up is where the ABC correction (of the Wave C, TS1 or TS2 trade set-up) reverses in the Typical WPT support/resistance area with a blue or red Reversal Bar. The trade entry is when the market in question exceeds the high or low of the blue or red Reversal Bar as described earlier.

Let's take a look at an example.



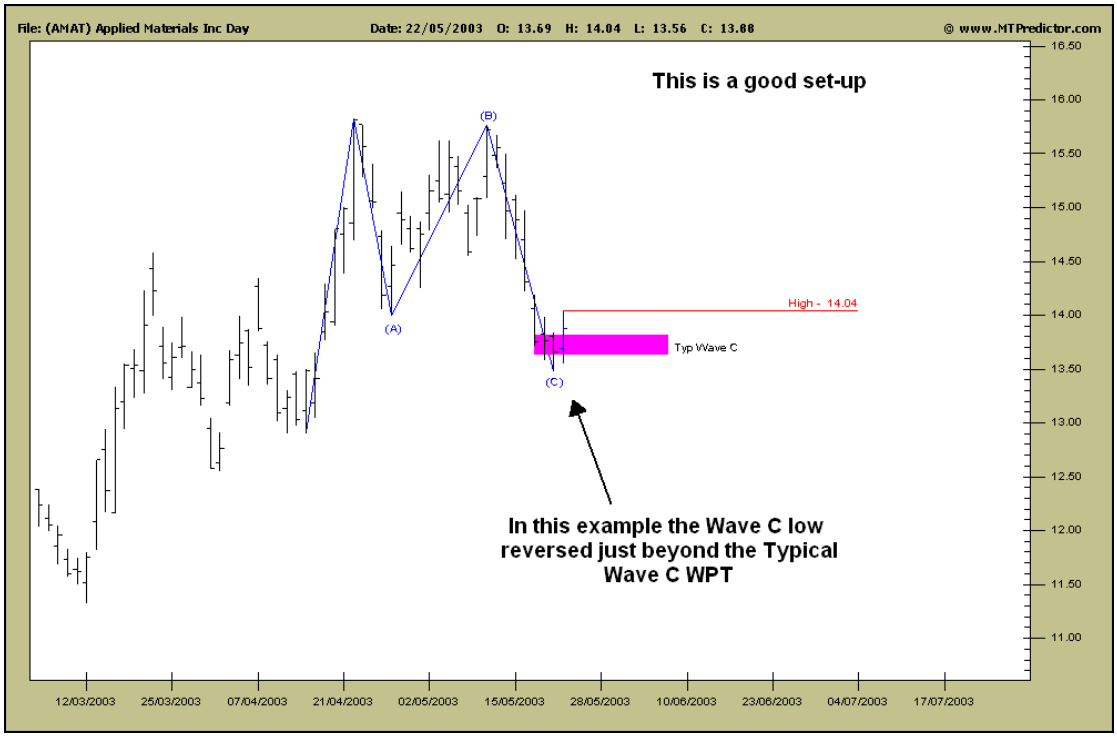
Here you can see how the Wave C low (of the TS2 buy trade set-up) reversed right at the area of the typical wave C WPT with a blue by Reversal Bar. This means that the market was reversing right at the *ideal* place where the wave C correction was *most likely* to end, and the blue buy Reversal Bar shows that the market in question was indeed finding support at this support area.

As such, this would be considered an *ideal* trade set-up.

Let's take a look at another potential set-up.

Continued on the next page . .. .

Here is another example:



Here you can see how the market in question has made a wave C low for a potential Wave C buy set-up, however the wave C low has *just* exceeded the typical wave C WPT by a whisker. If the market in question reverses at a level that is only *just* beyond (or *just* short of) a WPT support or resistance area, then it still can be considered a valid trade set-up.

The best guideline to use here is if the market makes a high a low that is just above or just below the current WPT by +/- ½ the width of the WPT, then it can still be considered a valid trade set-up.

As such, this would still be considered a good trade set-up.

Let's take a look at another potential set-up.

Continued on the next page . .. .

Here is another set-up:

This is actually on a short-term (15min) chart.

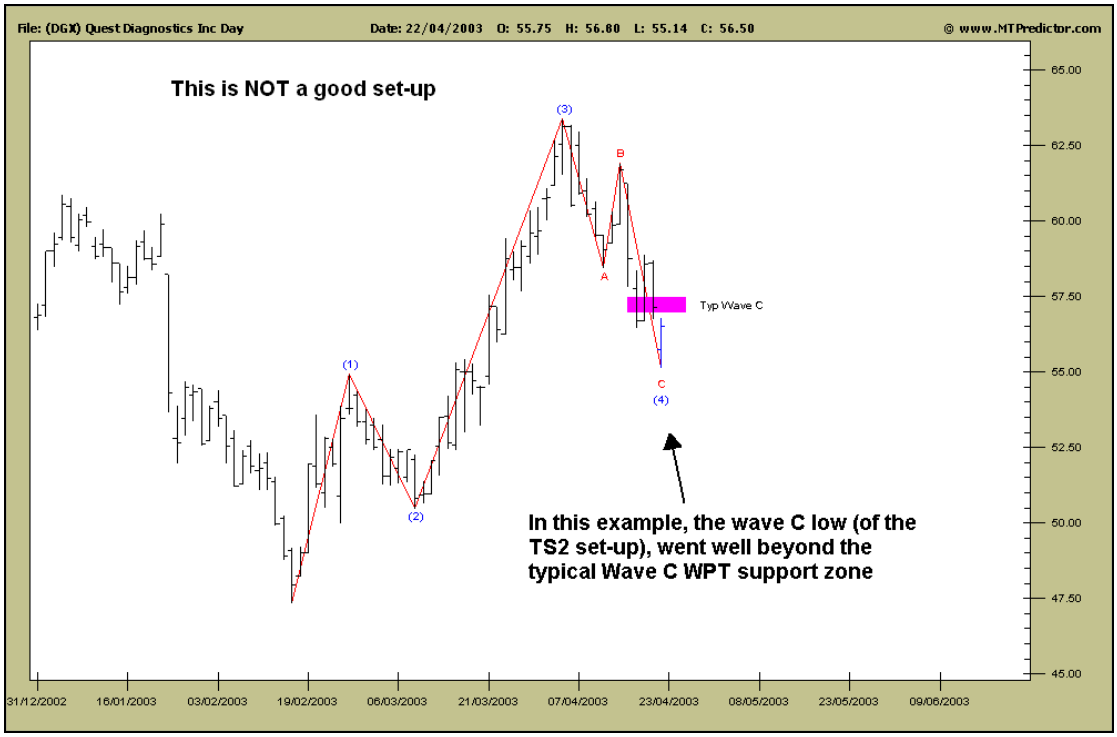
Here the low was below the Typical Wave C WPT, but it “snapped back” to above the WPT on the very next bar. This tends to happen more on intra-day and short-term charts rather than daily bars charts, therefore more leeway around the WPTs is allowed. But the requirement is that if the WPT is breached, the market should immediately reverse and close back into or past the WPT in the correct direction.

As such, this would still be considered a valid trade set-up, but not as ideal as when the reversal occurs exactly at WPT support / resistance.

However, as I have already said, this tends to happen more on intra-day and short-terms charts than on daily charts. I will cover intra-day charts in more detail in a later chapter.

Let’s take a look at another potential set-up.

Here is another example:



Here you can see how the trade set-up module has found a potential TS2 buy set-up, however, as you can see from the chart above the wave C low does NOT fall at any of the coloured WPT zones. In particular, in this example the blue buy Reversal Bar fell well below the typical wave C WPT support level.

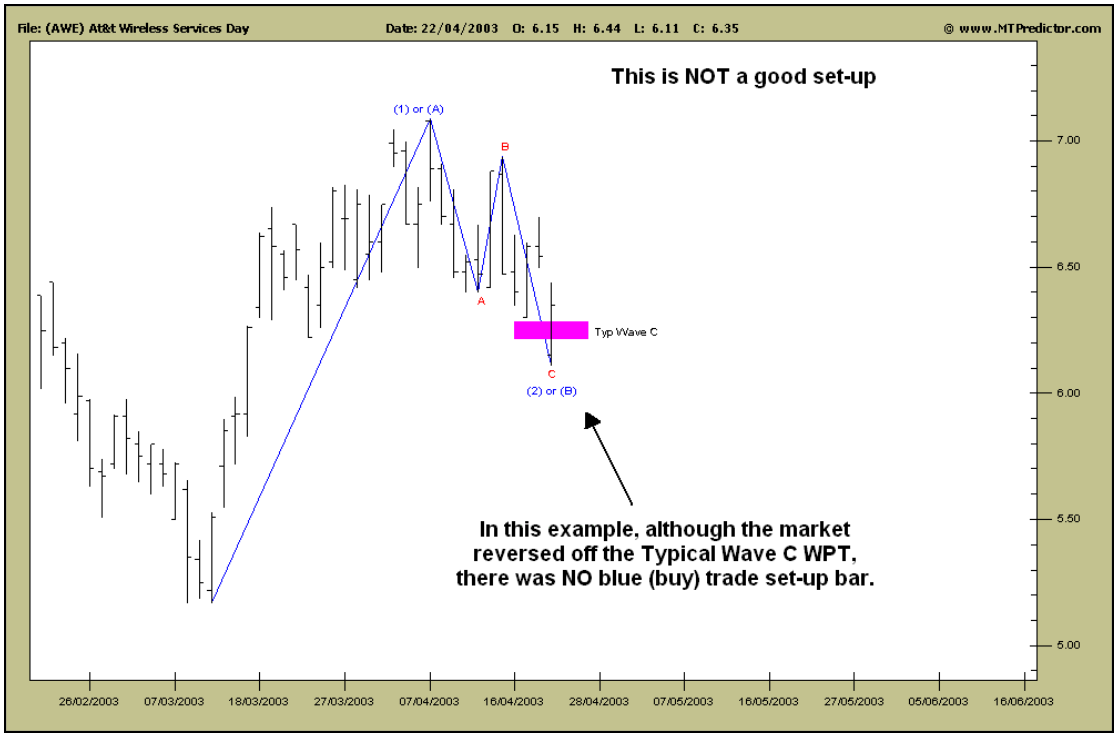
Therefore, this should NOT be considered a potential trade set-up.

Ideally the market in question has to reverse off a WPT support or resistance zone for a valid trade set-up, this is why you must always double-check the trade set-ups on the current chart.

The same is true for the Wave C (TS3) and TS1 trade set-ups. *Ideally* the minor wave C of the TS1, TS2 and TS3 (Wave C) trade set-ups should reverse at the typical wave C WPT support or resistance zone.

Let’s take a look at another potential set-up.

Here is another example:



Here you can see how the trade set-up module has found a potential TS1 Buy set-up, however there is no coloured Reversal Bar at the low, so it should not be considered a potential trade set-up.

This is NOT a potential trade set-up.

Ideally the market in question has to reverse off the typical wave C WPT support or resistance zone with the appropriate coloured Reversal Bar. In other words, there must be a blue Reversal Bar for a potential low, or a red Reversal Bar for a potential high.

The same is true for the Wave C (TS3) and TS2 trade set-ups, where *ideally* you need a blue buy Reversal Bar to confirm a low and therefore a potential buy set-up, and a red sell Reversal Bar to confirm a potential high and therefore a potential sell set-up.

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Here is another example:

Here the swings found by the software look *odd* and are not *in proportion* with each other. Ideally the swings should all look good and make sense as outlined in Section I. If they are not, then it is not a good set-up

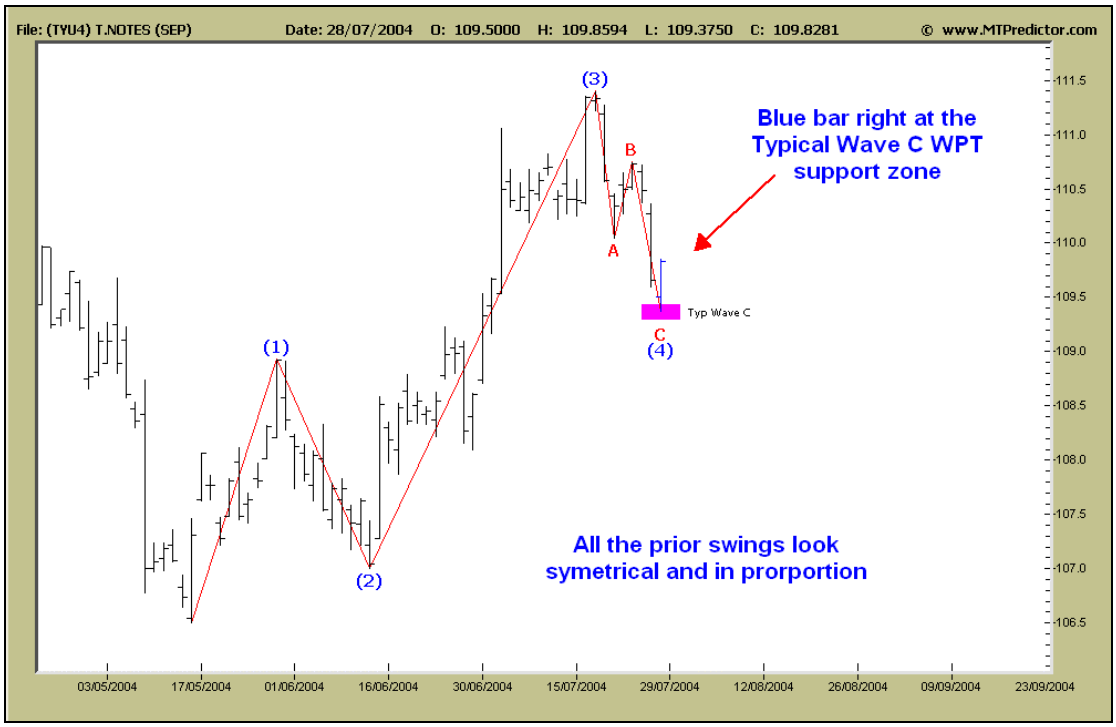
Therefore, this should NOT be considered a potential trade set-up.

Ideally the set-up should look perfect with all the swings looking good and in proportion which each other.

The same is true for all the automatic set-ups. If the set-up does not look good, then it should be avoided. This is important because a piece of software works on algorithms and maths, and sometimes a certain combination can arise that meets all the mathematical criteria for a potential set-up, but the swings are just not in the correct place for a good looking and ideal set-up. Therefore there is no substitute for a human brain taking a look to see what the chart actually looks like.

The software will do most of the work in narrowing down the list to a small number of charts to consider, but you do need to view each one to check that is does look OK.

To round up, here is a good example of what to look for as an *ideal and perfect* trade set-up:



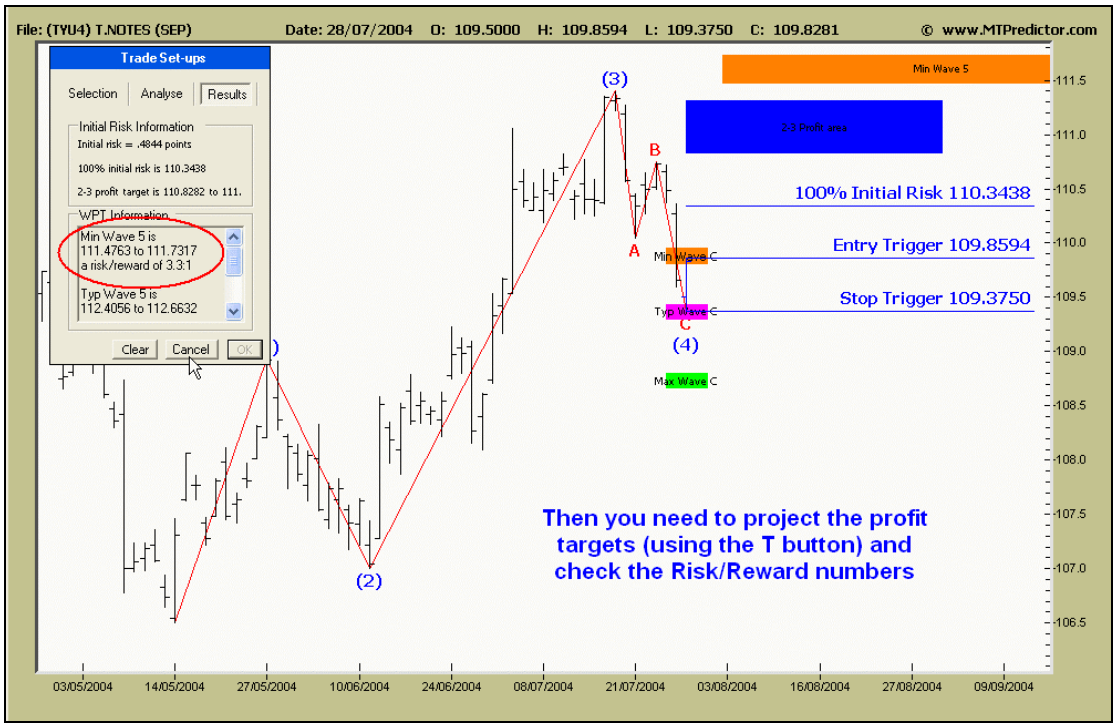
Here the Wave C (of the abc correction) for a TS2 buy set-up stopped right at the typical Wave C WPT, with the appropriately coloured reversal bar (blue in this example as it was a buy set-up). No only that, but the prior swing all look nice and symmetrical and in proportion with each other. In other words, it looks like a perfect textbook example.

As such, this would be considered an *ideal* trade set-up.

Many people criticise books and courses for only including ideal examples. However, I would say that these are the kind of trade set-ups you should only be taking. Therefore a good rule of thumb is that if the set-ups does not look good enough to put into a book, then don't consider it !

The software does as much as it can to narrow down the list of potential set-ups for you to consider, but it is up to you to look at the chart to check that it does indeed look good enough to then move onto the looking at the projected profit targets and Risk/Reward (more on this later). But again, I wish to stress that the best trades are the ones that are perfect, therefore it makes sense to restrict your trading to only these examples. If it looks odd or weird in anyway – then pass and look at another set-up.

The next job is to add the profit targets for the trade and check the Risk to Reward numbers at the first profit target:



The software performs this automatically for you, and I will cover this in greater detail in a later chapter. All you need to know for now is that because the potential profit at the first profit target is great than 2x the initial risk required to take the trade, this would be considered a good trade from the Risk/reward angle as well

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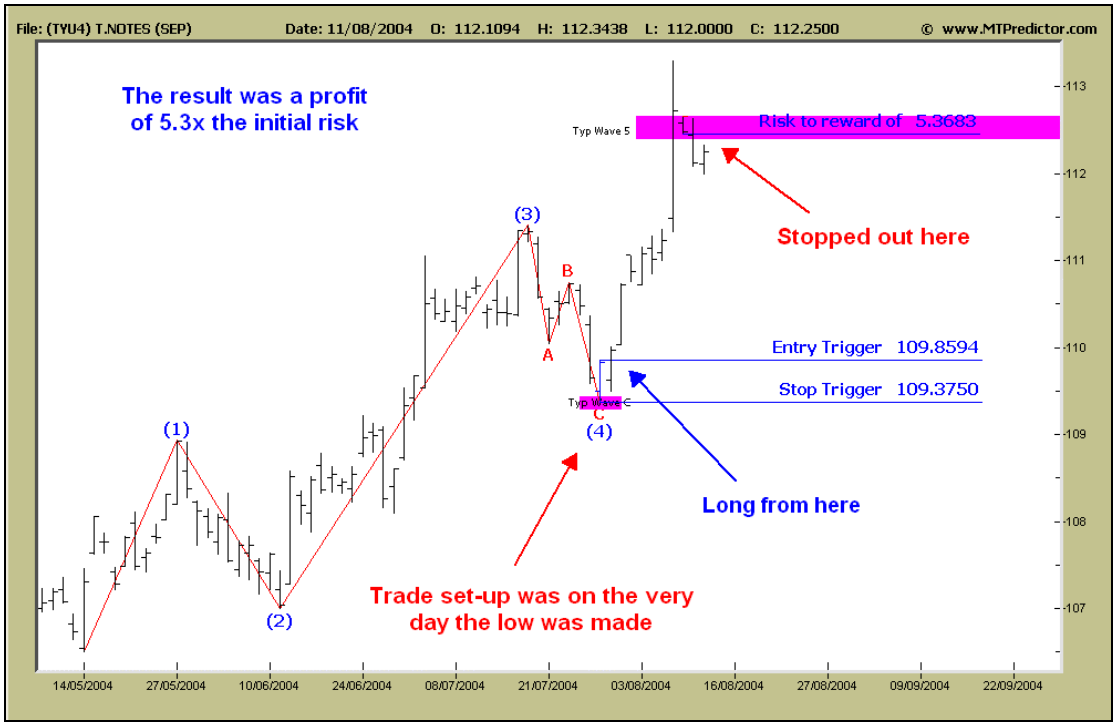
Here is the result:



As you can see, this market (T. Notes) rallied strongly over the next week and was stopped out for a profit of just over 5 times the initial risk required to take the trade (ignoring slippage and commission).

In fact the day of the trade set-up was the actual day of the low. So despite was some people say, it is possible to catch the exact point where a market makes a reversal.

Again, I will cover all these aspects in later chapters, so all you need to focus on here is how the initial set-up looked *ideal*. Where the Wave C (of the abc correction) stopped right at the typical Wave C WPT, with the appropriately coloured reversal bar (blue in this example as it was a buy set-up) and the swings looked nice and symmetrical and in proportion with each other. In other words, it was a *perfect textbook* example.

Continued on the next page . . .

Summary

This chapter has taken the simple ABC correction, which you found in earlier chapters was the single most reliable, and easiest to identify Elliott wave pattern and used it within the MTPredictor software program to form the basis of the three primary and automatic trade set-ups in the software. As you have seen, MTPredictor is designed to find and then automatically identify these three *ideal* trade set-ups for you.

I also covered what should be considered an *ideal* trade set-up and, more importantly, what should NOT be considered an ideal trade set-up. As you have seen, ideally the minor wave C correction (of the Wave C (TS3), TS1 and TS2 trade set-ups) should reverse off the typical wave C WPT with the appropriate coloured Reversal Bar and the whole set-up should look nice and symmetrical.

In particular I have focused on only ABC corrections that have unfolded, and then reversed, at the typical wave C WPT support or resistance areas. This is the area where most ABC corrections will make their reversals, however there are two other wave C WPTs that are important. These are the minimum and maximum wave C WPTs. I will go into more detail on these and when they should be used in later chapters. However, at the moment all I wish to focus on are the *ideal* trade set-ups in which you have an ABC correction, that reverses at the typical wave C WPT, with a red or blue reversal bar.

As you have also seen in these examples, I have started to introduce the topic of the initial risk, and how this relates to the profit from the trades. This is a vitally important topic, and as such I will devote the whole of the next chapter to exploring in more detail how this is probably the single most important aspect of any successful trading plan.

The MTPredictor software program does most of the work for you in identifying these three basic trade set-ups automatically. The Trade Scanner, in particular, makes it easy to scan thousands of issues to find the few that are currently positioning for an ideal trade set-up. This is similar to going fishing - you have an ideal set-up and you only wish to focus on those few issues where the ideal set-up is unfolding, you're not interested in what the rest of the markets are doing. In essence, you cast your fishing line out into the thousands of issues each day and then only focus your attention on the few that the Trade Scanner brings back to you.

It is your job to then view each chart individually to look at and check the set-up. But the point is that the Trade Scanner has done most of the hard work for you in reducing the list of candidates to look at down from 1,000’s to just a few.

Although these are the most reliable trade set-ups, MTPredictor does not stop there. I will go on to cover how you can perform additional manual analysis, above and beyond these three basic set-ups in future chapters. However, I hope you can all see how these automatic routines in the software make it easy to start to find ideal trade set-ups quickly without the need to perform lengthy or in-depth or complicated analysis. In fact, many MTPredictor customers prefer to stick to just the three basic set-ups, safe in the knowledge that they are the best and most reliable Elliott wave set-ups available.

Finding these *ideal* trade set-ups is only the first stage, the software can also *analyse* the initial trade set-up for you to show you potential profit targets, and also calculate what the initial risk to reward would be at these profit targets. Again, I will cover this in more detail in a later chapter, however all I wish you to remember is that finding the trade set-up is only the first stage.

This is very different to many other technical analysis approaches in the market, in that they are only interested in buy or sell signals. They do not focus on, or indeed realise that simply buying or selling is not the best approach to profitable trading. What you need to focus on is only taking those trades that are firstly coming off an *ideal* set-up, where the set-up has a high probability of making a profit far in excess of the initial risk.

Chapter 8 – Initial Risk to reward – the real Holy Grail

During the last chapter, I introduced the three basic trade set-ups within MTPredictor. These were the simple ABC (TS3), the TS1, and the TS2. They all share a similar pattern, the simple ABC, which is the single most reliable Elliott wave pattern that can be used for trade identification. However, this is only the first stage - not only do you require a reliable pattern that gives you a good trade set-up, but also, when the set-up goes wrong (which it will do), you need an approach that will keep the losses small in relation to the profits.

There are very few books, courses or trading educators that will focus on losses. This is mainly because, as human beings, we associate losses with failure. And the one thing we all hate to do is fail. However, taking a loss, and more importantly a small loss, is the single most important thing you could ever do when trading. The reason for this is that normally a small loss (if not taken early) will turn into a larger loss later. As I am sure you understand, keeping the losses small and infrequent will help significantly your bottom-line profits.

This is so important that I will rephrase this. It is not by making large profits that money is made over time; it is by keeping the losses small.

However, most books, training courses and educators focus on the positives, how much profit you can make from any trade. If you stop and think about this it is illogical. The main reason for this is that no one (despite what you may been told) can predict the future. This means that no one can know *for sure* how much profit any single trade is likely to make. Yes, we may have an idea, by using various techniques to project future profit targets, but before the market gets there, this is all they are - a projection. It is like a *best guess* of where a market may go in the future, but what you must understand at this stage is that this is all it is - a *best guess*.

Now compare this with the initial risk. When the set-up appears, you know at what level to enter the new trade, you also know at what level the trade will have gone wrong and, therefore, where you should place your protective stop. As such, you can control the initial risk (or loss) from the initial set-up. Obviously a market can gap beyond any stop orders, and I will cover that in more detailed in a future chapter. However, I just want to get you to focus on the difference between the initial risk, in which you can control the entry, and therefore the loss, (if it happens) and the future, with any potential profits that the trade may have, before it gets there.

To phrase this another way, what I am trying to get you to focus on is what you have direct control over (the initial risk) and not what you do not have control over (any future profit). This may be a slightly new idea for you, so could you please take a few minutes to think about this, and understand the implications.

Okay, now I hope you understand that the only thing you have direct control over at this stage is the initial risk. I can now look in more detail at how keeping this initial risk (and therefore any losses) small in comparison with the profits is so important to a successful long-term approach to trading markets.

Let's take a look at a couple of examples. First I would like to assume that you have (hypothetically) a $10,000 trading account, and you are trading either on your own, or by some other mechanical system. Now I would like to look at the results of the few trades you have taken. The first trade you made banked a profit of $500. So far so good, however the second trade was a loss of $2,000. Trades three and four also made losses of $1,500 and $2,500 respectively.

So here you are, only 4 trades into your new system, and you have already lost nearly 50% of your trading fund. This may seem unlikely, however I have heard many stories like this in the past where a significant chunk of trading capital has been lost to the market very quickly. A 50% loss may not seem totally devastating, but what you must realise is that to even get back to your original $10,000 starting capital you now have to make a near-100% return on your $5,500. This is the problem with letting your account decrease in value by any significant amount, as the percentage returns to get you even back to break-even become larger and larger, and therefore even more unobtainable.

It is, therefore, absolutely your number one priority to keep your trading capital intact. What this means is, keeping your losses small because, without trading capital you simply cannot trade.

I hope this make sense to you?

Okay, let's look at another trading system (or approach). With this approach the first trade also made $500, however the second trade only lost $250. Trade three was not taken (because the initial risk was too large), and trade four also lost $250.

As you see, the number of profits and losses was very similar to the first system, however because the losses were small (in relation to the profits), although the system made more losses than profits, you are actually break-even overall. What this means is, even after a bad string of trades, you still have your full $10,000 account intact.

I hope you can all see that this is a far better position to be in if you wish to continue trading.

So what are the main differences between approach one and approach two ? While initially the profits are the same, both at $500, it is the losses that are significantly different. With approach two the losses were limited to a maximum of $250. You even had to skip one trade because the initial risk was too large, but as you can see that avoided a large loss. The most important thing is that the losses (at $250) are small in comparison to the profits (at $500).

I hope you can begin to see how this will make a significant difference over time to your trading capital. If you can use a trading approach that keeps the losses small, and the profits large, then this will help your trading account grow. But more importantly, it will minimise the reduction in your trading capital when you hit a bad time, when a string of losing trades come through.

This may seem obvious, but you'd be horrified how many times a trading approach, or market tip sheet, or software program, gets people into trades where the initial risk (and therefore the inevitable losses) are far too large for their trading account. It is all too easy to focus on just the profits, and think 'if I make that $5,000 trade that will increase my $10,000 trading account by 50%'. What people don't look at, or sometimes even consider, is what would happen if, to get this $5,000 trade, they had to risk $5,000 or even $8,000. This is gambling mentality, where the only aim is to hit the one big winning trade.

Again I wish to stress that if you wish to become a profitable long-term trader then you need to focus on keeping the losses small, and not try to hit the one big winner.

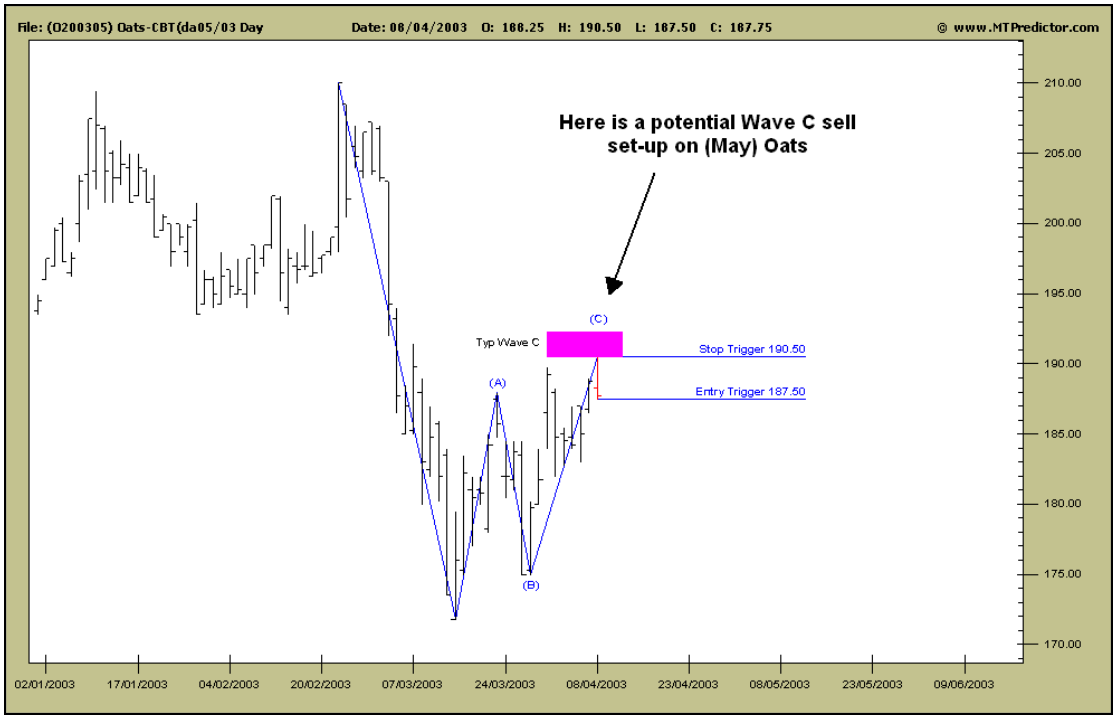
Okay, if you now understand that keeping the initial risk on any new trade (and therefore minimising the losses) is vitally important, how can you achieve this? The easiest way is to only ever enter a new trade if the initial risk is below a certain percentage of your trading account. For example, a good rule of thumb is to never risk more than 2% - 3% of your trading fund. Therefore, in this example of a person with $10,000 available, the initial risk should never be more than $200 - $300.

As you can see, this should instantly avoid any large losses in the region of $1,000 - $2,500 on your $10,000 account as you saw in example one.

However, this does have one drawback, in that it does restrict the number of trades that you are allowed to enter. I know a lot of traders find this very frustrating, particularly when the trade they decided not to enter (because the initial risk was too large) turned out to be a large winner. However, missing one large winning trade is far, far less important than keeping the large losses out of your trading account. Because, over time, there'll be far more large losses than large profits. A large profit is normally a gift, it does not happen all the time, whereas large losses have a nasty habit of creeping up on you far more often than you would like.

Okay let's have a look at a couple of examples on the next few pages.

Here is a recent set-up on (May) Oats:



As you can see, it is a perfect Wave C sell set-up in which all the three components of the ABC correction, typical wave C WPT resistance area and red sell Reversal Bar have come together to signal a potential short trade.

However, before you enter your order, you have to ask yourself a few questions: does this trade carry too much initial risk ?; what would happen if this turned out to be a losing trade ?; could my account withstand the losses ?

Let's take a closer look.

The initial trade entry would just be below the low of the red sell Reversal Bar of 187.50 at 187.25. If filled, the initial protective stop would be placed just above the high of 190.50 at 190.75. Oats have a tick value of $50 per full point. You can now calculate what the initial risk would be on this trade, even before you decide to enter it

Initial Risk = 187.25 - 190.75 x $50 = $175 per lot.

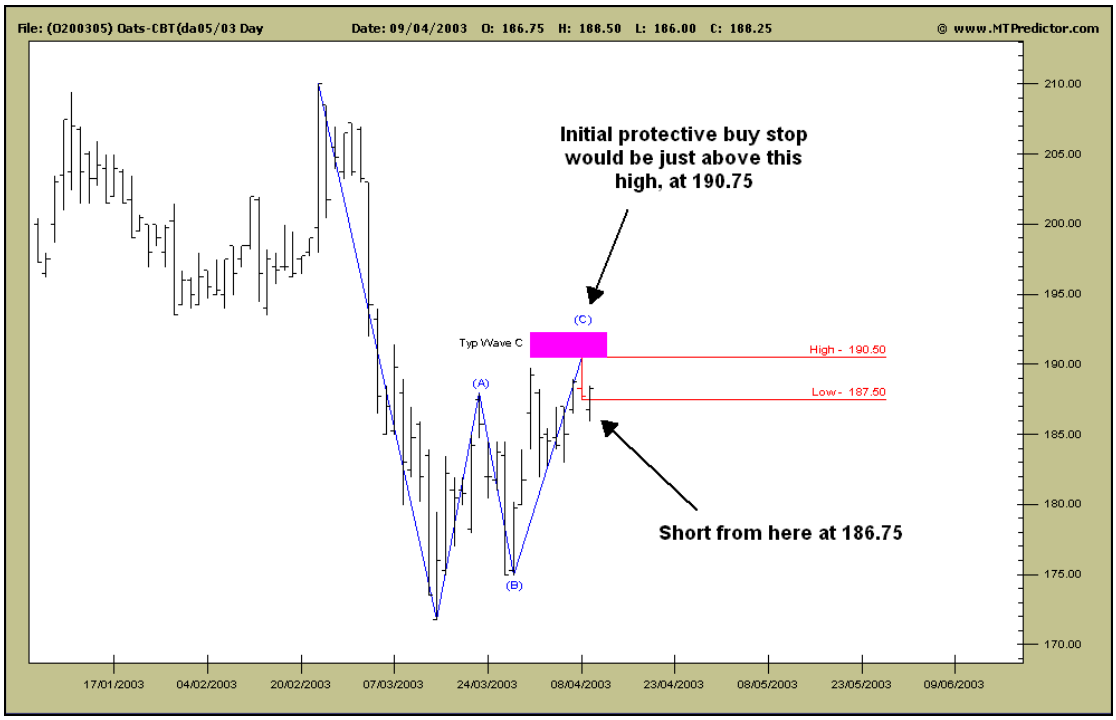
This value does not take into account commissions or slippage.

As discussed earlier, I suggest that the maximum initial risk you should take on your own trading account is 2% - 3% of your trading capital. Therefore for a fund of $10,000 this is a maximum of $300 (3%). This would mean that you could only trade one lot, as two lots would be an initial risk of $350 ($175 per lot), which is greater than your $300 maximum.

Okay, because the initial risk of just one lot would only be $175 plus commission, which will be less than your $300 maximum, you can therefore go ahead and place the order to trade one lot on this new position.

If you had a trading account of $20,000, 3% would be $600, so you could safely trade three lots of Oats from this set-up. This is because three lots at $175 per lot would be $525, which is less than the 3% maximum of $600.

Let's move forward one day:



As you can see, the very next day Oats gapped down slightly and would have filled your new short trade at 186.75. This would have increased the initial risk on this trade slightly from $175 per lot to $200 per lot. I will leave you to do the maths on this. However, this is still below your $300 maximum on your $10,000 trading account.

I will cover gap openings and increased initial risk in more detail in the advance sections later in this book, however, at the moment, all I wish you to focus on is how you can use the 2% - 3% of your trading account as a guideline to decide how many lots (or shares) you can trade on any new set-up or, indeed, whether to pass on the trade completely.

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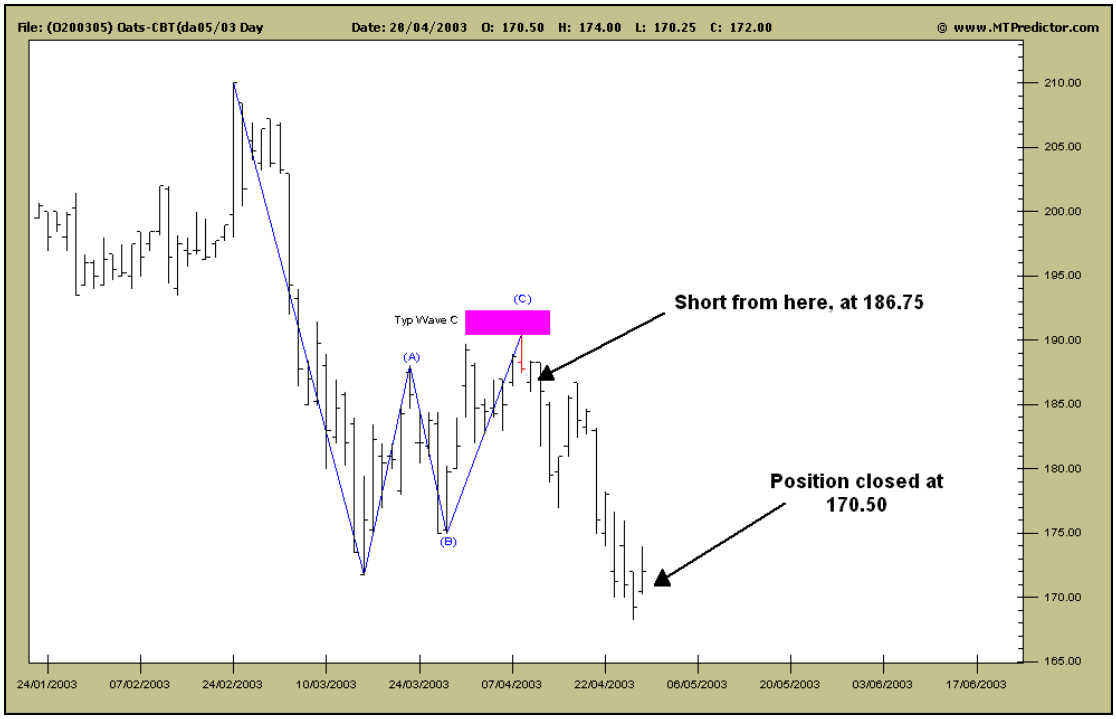
Let's see what happened a few weeks later:



As you can see, this turned out to be a very good trade with Oats declining nicely into the *first notice day* on April 28. As such, this short trade would have been closed on the open at 170.50 on April 28.

This would have resulted in a profit of $812.50 (186.75 - 170.50 x $50) per contract (ignoring commission and slippage). At first sight this may not seem a huge profit, but please bear in mind that all you had to risk was $200 in order to make approximately $800. This is a risk to reward of 4:1. I will come onto risk to reward ratios later, however I am sure you can see that if (on average) the profits are 4 times larger than the losses, this will help increase your trading capital significantly over time.

For a $20,000 count, because you would have traded three lots, the profit would have been just over $2,400. But again, the most important point is that the profit would have been 4 times the initial risk required to take the trade.

Lastly I would like to stress that this was not some *idealised* example, picked with the benefit of hindsight. This trade was found by the Trade Scanner, and identified by the automatic routines in the software, and then followed *at the time* in the MTPredictor Daily Report.

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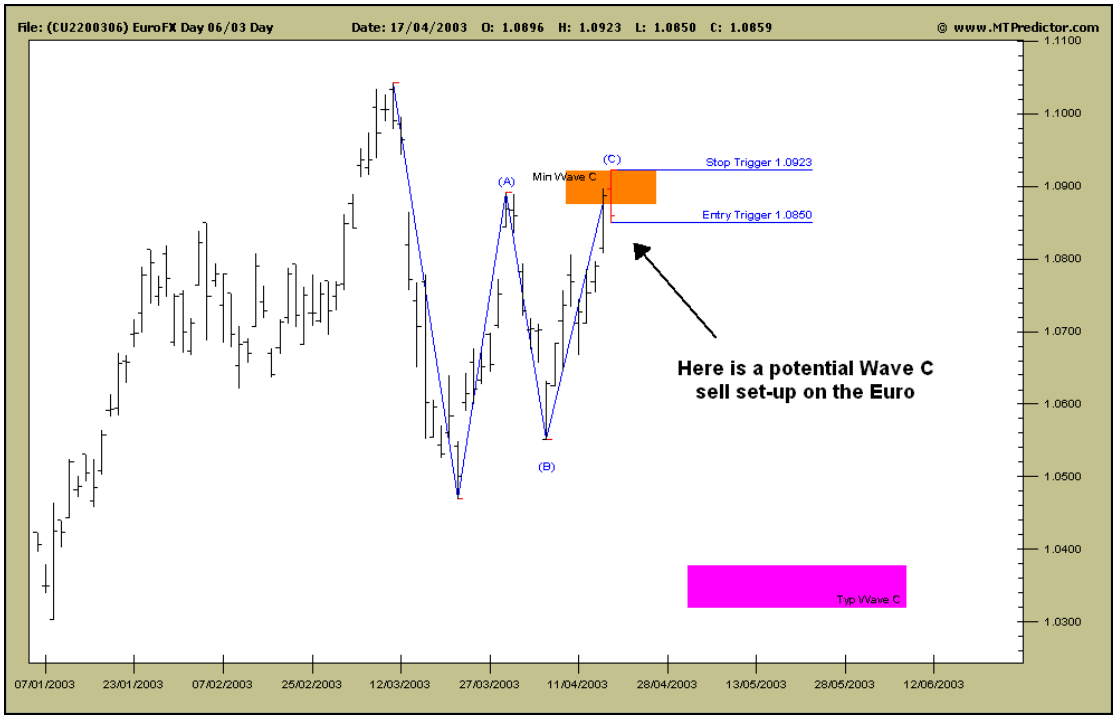
Here is another example again on a Wave C sell set-up, this time on the Euro.



As usual, all the ingredients are there for a good-looking trade set-up. However, you look at the first projected profit target (the typical Wave C WPT) and noticed that it does not fall until the 1.0320 - 1.0380 area. You get out your calculator and perform some quick maths and come up with a figure of a potential profit of $4,690 (1.0849 - 1.0380 x 100 x $1000), a nearly 50% return on your $10,000 just on this one trade. Your eyes start to see $ signs and you start to plan how you are going to spend your profit.

This is where the trouble starts, far too many traders just focus on the profit potential without stopping to even consider what may happen if the trade does not unfold as anticipated.

Let's see what happened a few days later.

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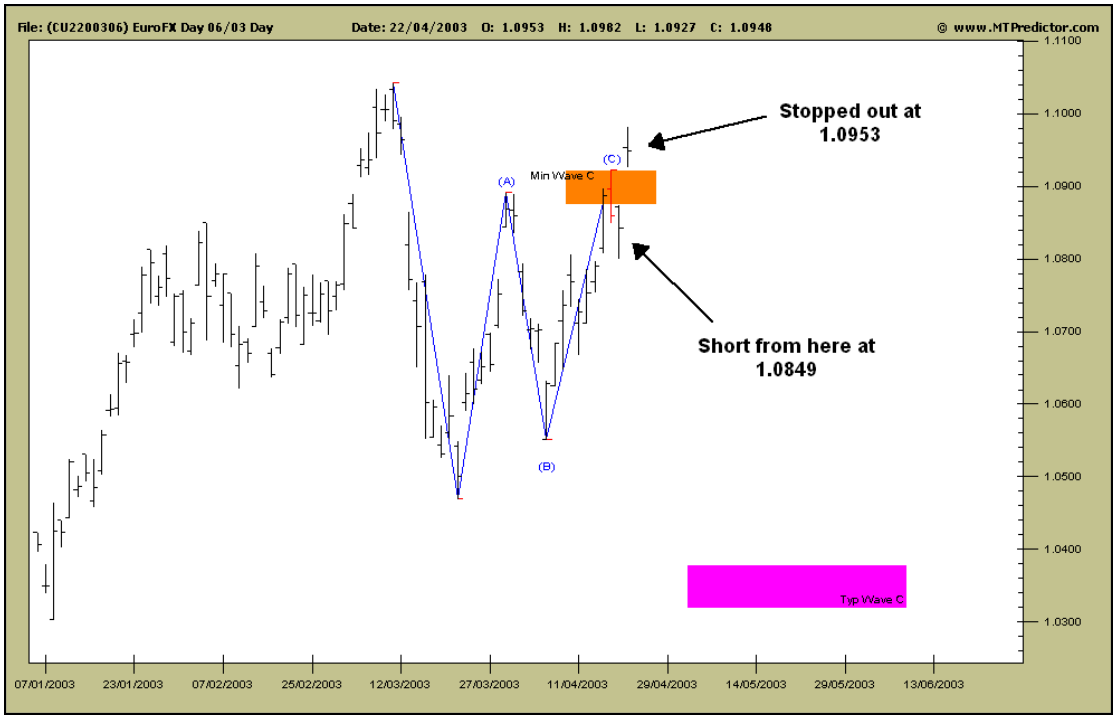
One day later the new short trade was entered just as anticipated:



However, one day later the Euro gapped up on the open and your short trade was stopped out for a loss at 1.0953. In dollar terms this equates to a loss of $1,040 (1.0953 - 1.0849 x 100 x $1000). Although not huge, a loss of $1,000 is just over 10% of your original $10,000 trading capital gone in one hit.

As you can imagine, it does not take many hits this large to soon decimate your trading account - as such they are best avoided.

Let's now stop and go back to original set-up and take a look at what the initial risk would have been. Here we can see that the original initial risk was $750 (1.0924 - 1.0849 x 100 x $1000). Although the gap up opened increased the eventual loss above the initial risk of $750, $750 is way above 3% of 10,000, which had already been calculated to be $300. So, you should not have even considered taking this trade.

However, very few traders stop and make this calculation. All they see is the profit potential and $ signs in their bank account. They never stop to consider the consequences if the trade went wrong. As you have seen here, this would have produced a much larger loss than was acceptable.

How many of you can relate to a situation such as this? Also, how many of you have had a large loss like this appearing in your trading account when all you thought could happen was a large profit?

Please note, I am not saying that this will always happen, however I hope you can see by these examples that if you can help avoid a big loss, it is far better to do so. And the best way to do this is to only take the trades that have an initial risk less than 2% - 3% of your trading account.

MTPredictor can perform this calculation for you.

The situation is slightly easier with stocks; this is because you can adjust the number of stocks to trade far easier than you can with futures that are traded in fixed contracts.

Okay, now you have decided to limit your trades to only those that meet your initial risk profile, is there anything else you can do to put the probabilities of success on your side? Some of you may have noticed already that I have mentioned earlier in this chapter that if your profits (on average) are much larger than your losses, then this will help your overall trading performance significantly. This is where you can use the *potential* profit targets and look at them in relation to the initial risk to get some idea of *how good* a new trade may be.

As I have already mentioned in the section on Elliott wave analysis, you can never know for sure how the future may unfold. As such, I suggested that it is far better to look at the market in isolation, and as a result the Elliott waves analysis should carry no forecasting ability. Having said that, because we are dealing with probabilities, this is a good basic stance to take, however there still exist profit targets within each wave structure that do have a certain amount of predictability. It is these we will use to try to gauge where a market *may* go into the future.

As long as you fully understand that this is only a *best guess* and only has a probability of success attached to it, this is good enough to help us avoid set-ups with the lowest probability of a good profit, and allows you to focus on only the best trades that carry the largest profit potential.

Let me show you a couple of examples.

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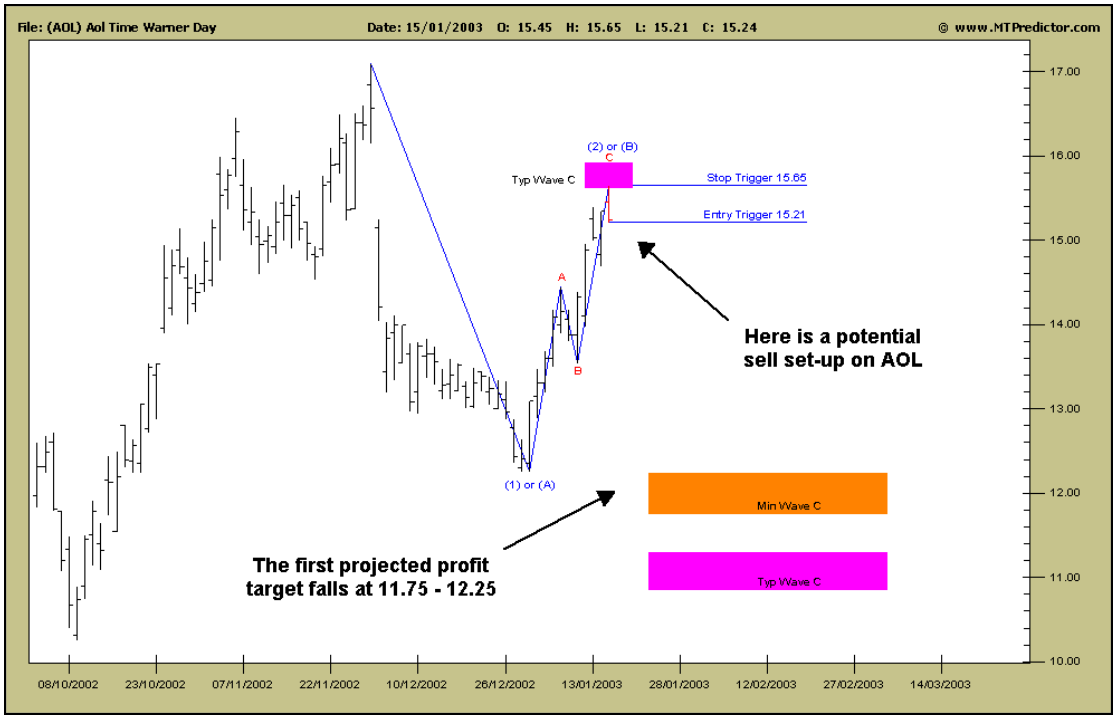
First, here is a potential sell set-up on AOL:



This is a TS1 sell set-up that meets all the standard criteria, where the ABC correction stopped right at the typical wave C WPT resistance area with a red sell Reversal Bar. As you have already seen, a new short trade would be entered as the low of the sell Reversal Bar at 15.21 is exceeded. Then as before, your initial protective buy stop would be placed just above the high of 15.65. This would mean an initial risk of 0.46 points (15.66 - 15.20).

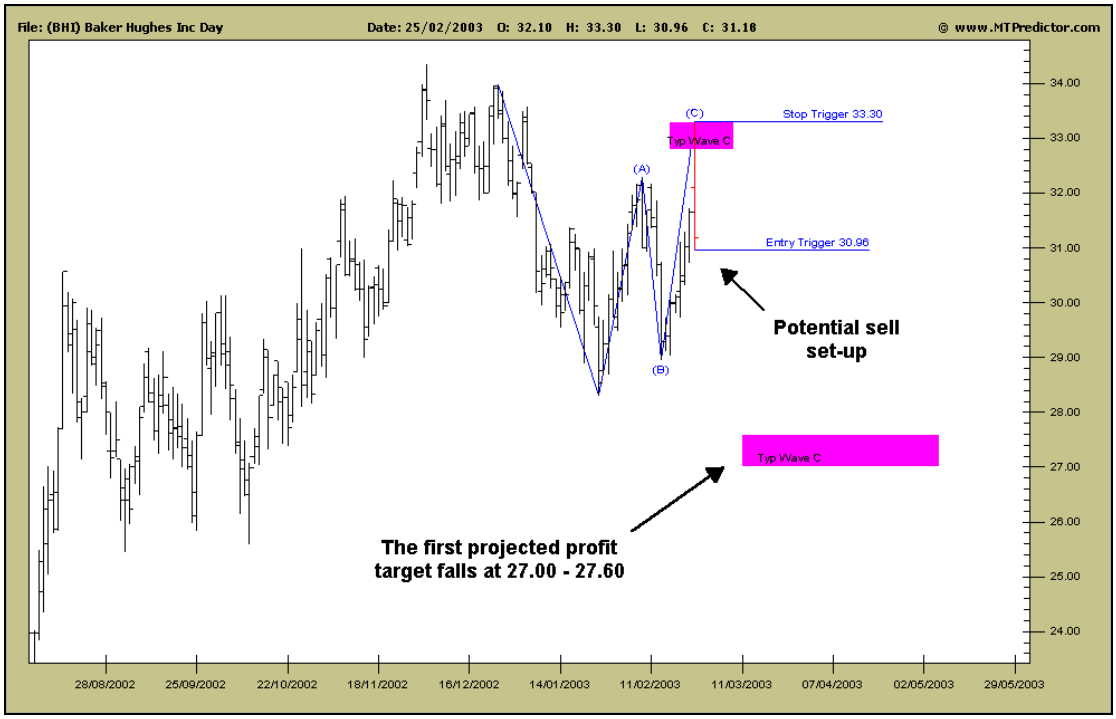
However, what I would like you all to focus on it is the first projected profit target which, as can be seen from the chart above, falls in the area of 11.75 to 12.25. As mentioned earlier this can be used to help calculate what the *potential* profit may be if the market declined into this area. Again I would like to stress, at this stage we cannot know for sure what the market will do but this level can be used as a *best guess* of where the market may go.

Okay, let's calculate what the profit would be *if* AOL declined into the first projected profit target at 12.25.

Profit = (15.20 – 12.25) = 2.95 points.

At first sight 2.95 points does not seem a large profit, however this must be considered in relation to the initial risk required to take the trade of only 0.46 points. Put another way, this potential profit is just over 6 times the initial risk required to take the trade (2.95/0.46). I hope you can all see that a profit of 6 times the potential loss is a very good trade to consider.

Let's now compare this with another sell set-up, this time on Baker Hughes Inc:



This time, this is a potential Wave C sell set-up. As before, a new trade would be entered if the low of the red sell Reversal Bar at 30.96 is exceeded. The initial protective buy stop would be just above the high of 33.30. This would mean that the initial risk on this trade would be 2.36 points (33.31 - 30.95).

As before, MTPredictor has placed the first potential profit target on the chart for you, at 27.00 - 27.60. We can now calculate what the potential profit would be "if" Baker Hughes declined into this target.

Profit = (30.95 – 27.60) = 3.35 points.

At first sight, this profit of 3.35 points appears to be larger than the 2.95 profit on the prior AOL trade. So is this a better trade to consider? For this you need to look at what the initial risk would have been to take this trade. I have already calculated this initial risk to be 2.36 points. So is a profit of 3.35 points a good profit if you are required to take 2.36 points risk to open the trade?

This would be an initial risk to reward ratio of 1.42 (3.35/2.36), in other words the profit is not even 1 ½ times the initial risk required to take the trade. Now compare this to the prior example on AOL, where the 2.36 points profit was over 6 times the initial risk required to take the trade of 0.46 points. So which trade do you think was the better trade?

Exactly, AOL was by far the better trade, because the potential profit was so much larger than the initial risk. If you stop and think about this, what this means is that for every profit you could make 6 consecutive losses. However, with the Baker Hughes trade 2 losses would have wiped out this single profit.

This may be a new concept for many of you, because very few traders or educators discuss losses, and even fewer discuss how losses relate to potential profits. But I hope you can see how vitally important this topic is, because if you have a strategy or approach to trading that allows you to make trades where the profits are consistently larger than the losses, then this will significantly add to your trading account over time.

So how can this information be used on a day-to-day basis?

Over time, if you consistently make trades that (on average) make profits that are in the region of 2-3 times the losses, then you will have a successful long-term trading approach.

As such, a general guideline would be to only consider any new trade if the potential profit (at the first profit target) is greater than 2 to 1. In this way it allows you to focus on only the best trades that have the highest profit potential, and therefore avoid trades where the profits (although they are profits) would be small in relation to the risk required to take the trade.

You can either calculate this yourself manually or let the automatic routines within the MTPredictor software perform this calculation for you.

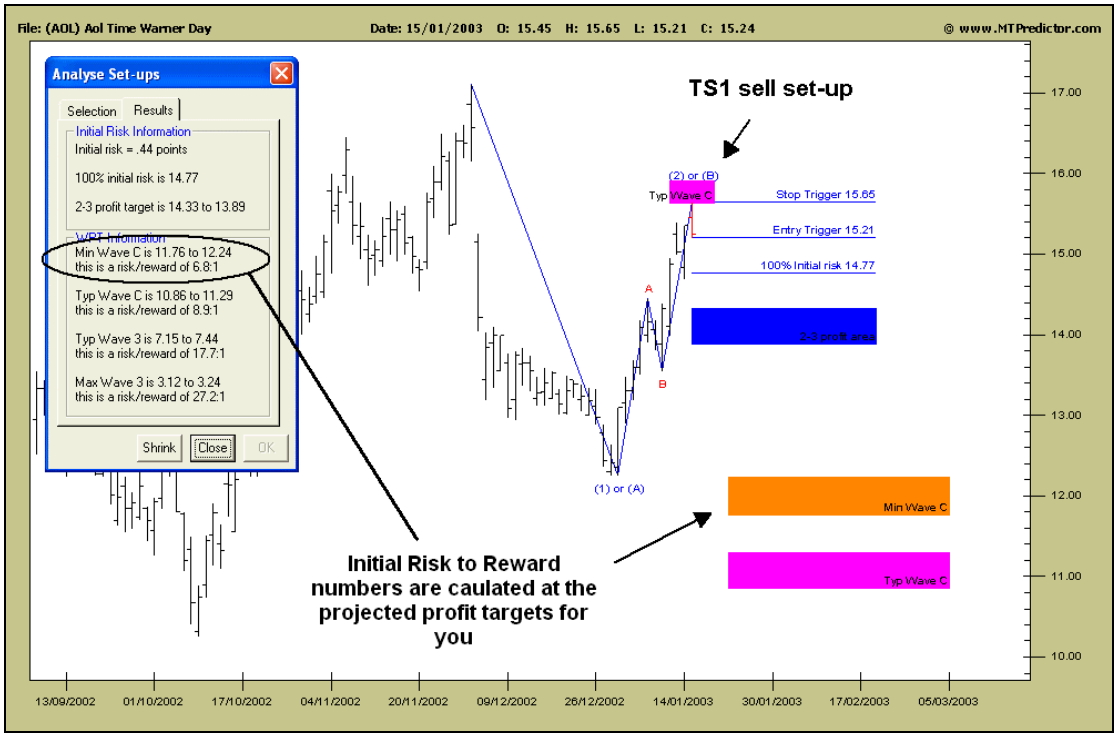
Continued on the next page . . .

As an example, let's return to the TS1 high in AOL on Jan 15 2003.

As you have already seen in the last chapter, the MTPredictor software is capable of automatically finding and then automatically identifying the three main trade set-ups (TS1, TS2 and TS3) on a chart for you. However, the automatic analysis does not stop there. The software also has the ability to automatically analyse the current set-up for you and to automatically calculate the exact initial Risk to Reward numbers at each of the projected profit targets for the trade in question.

I will be returning to projected profit targets in the next chapter, where I will look at how to manage these specific trade set-ups. All I would like you to focus on here, is how the software can automatically calculate the Initial Risk/Reward numbers at the first projected profit target. As I discussed on the prior page, if these fall above the 2:1 minimum, then this would be a good trade to consider.

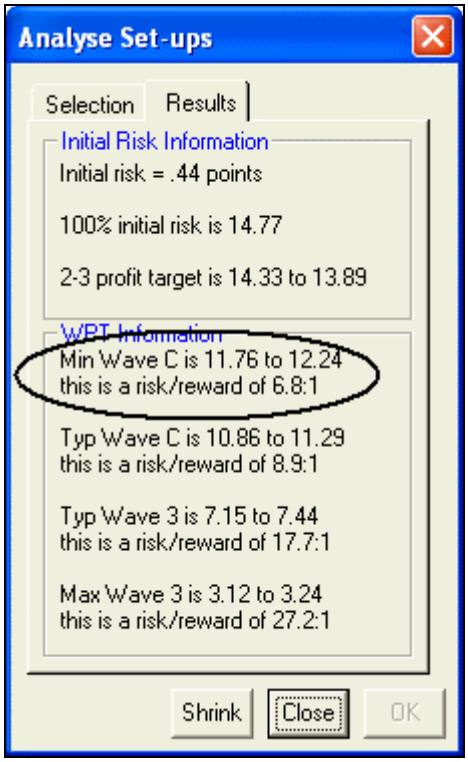
Therefore let's take a look at what the software says for this potential TS1 short trade in AOL:



As the text is a little small in the picture, I will enlarge the analysis window on the next page for you.

Continued on the next page . . .

Here is a blow-up of the analysis window:



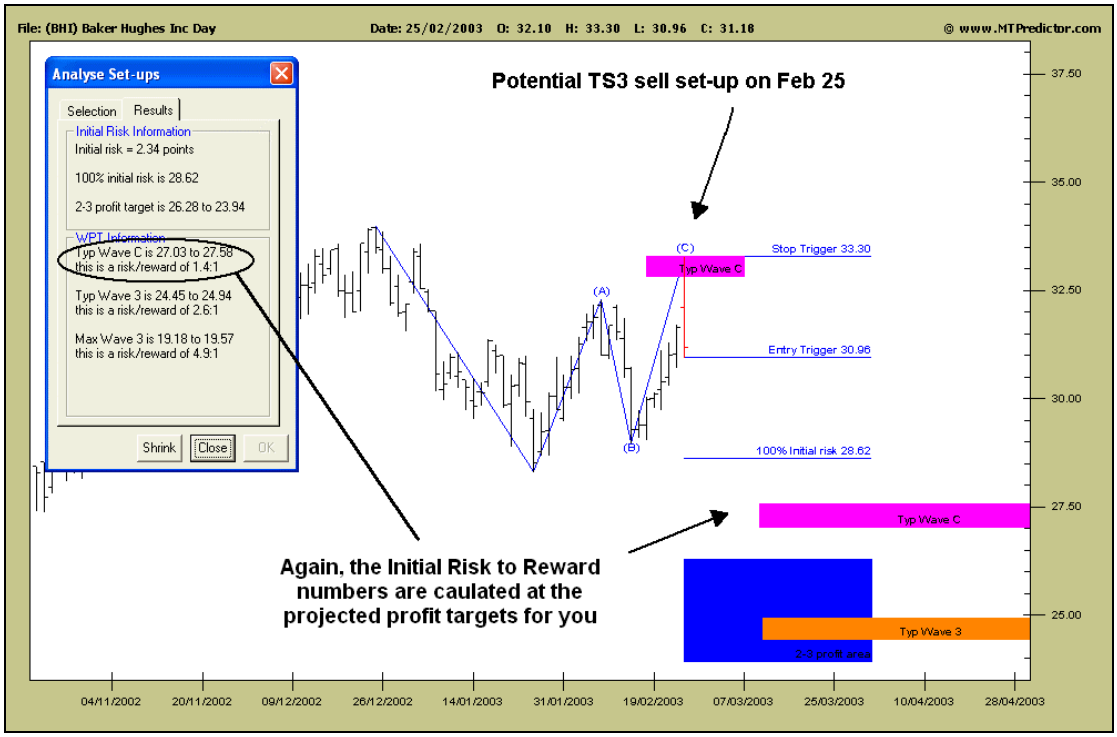
Here you can see that at the first projected profit target (the larger-degree minimum Wave C WPT) the potential profit would be approximately be 6.8 times the initial risk required to take the trade (ignoring slippage and commission).

Instantly you can see that this falls well above the 2:1 minimum, so this would be a good trade to consider.

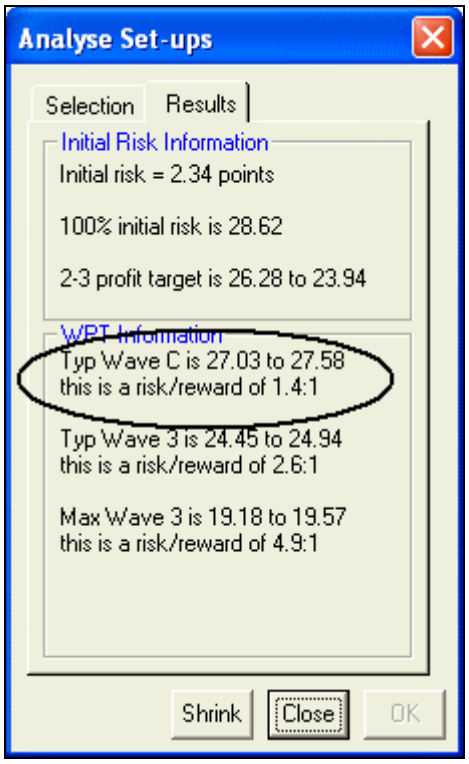
Now let's compare this with the same analysis for the potential short trade on Baker Hughes Inc on Feb 25.

Continued on the next page. . .

Here is the analysis for the potential Wave C (TS3) sell set-up on Feb 25 2003:



Again, here is a closer look at the analysis window.



You can instantly see the low initial Risk/Reward number of 1.4:1 at the first projected profit target.

You can see how this automatic analysis can very quickly and easily show which new trade set-ups carry the largest *profit potential* and, as such, are the best ones to consider.

Obviously, the outcome of any single trade is only ever a matter of probabilities and can never be known for sure, but what this module does is help put the probabilities of success on your side by enabling you to avoid trades that carry a lower than ideal profit potential in relation to the initial risk. Over time, this will help you make trades that, on average, make profits that are greater than the losses.

Continued on the next page . . .

Chapter 8 – Initial Risk to reward – the real Holy Grail

Summary

This chapter is the single most important chapter in the whole of this course…in fact, this may be the most important chapter you've ever read in any trading-related book. The reason for this is that it deals with what actually enters or leaves your trading account - in other words, trading profits and losses.

As seen in the last chapter, the simple ABC correction is the single most reliable trade set-up in any Elliott wave pattern. Then in this chapter, I took this one stage further by showing how vital it was to keep trading losses to a minimum. The best way to do this was to only take a trade set-up where the initial risk was small…as a guideline I suggested never risking any more than 2% - 3% of your trading fund on any single trade. In this way, the losses, when they happen, will only be small so will not eat away at your trading capital.

The second part of this chapter then built on this by suggesting only considering taking trades that have the highest probability of making the largest returns in relation to the initial risk. This way you could focus your energy and attention on only those trades that will most likely make the largest profits. In particular, you should not consider any new trade with less than a 2:1 initial risk to reward potential at the first profit target. As you have seen, the MTPredictor software can automatically perform this calculation for you.

Many other trading books, courses or tip sheets focus their attention on just analysing the market but, as you have seen so far, financial markets are an arena where the future is very uncertain most of the time. So what this chapter does is bring you back to earth to deal with the markets as they really are. The techniques described here are designed to preserve your capital as much as possible when the inevitable trading losses come through, and also to allow you to focus on only the best trade set-up where the likelihood of a profit greater than the potential loss is most likely. Crucially, I hope it has taught you how to look at profits not in pure dollars, but in relation to initial risk.

The reason this is critical is that to be a successful long-term trader over time you need to make profits that are (on average) larger than your losses. So, it is not just how large profits are that makes you a success, it is how small your losses are relative to these profits that is far more important.

Chapter 9 – Managing the standard trade set-ups

During the last few chapters I have looked at the three basic set-ups in MTPredictor, the simple ABC (TS3), TS1 and TS2, and how the MTPredictor software program can automatically scan for and automatically identify these set-ups for you. I also took a detailed look at initial risk in the last chapter, and demonstrated how keeping the initial risk (and therefore the losses) small was vital in any successful trading plan.

Okay, now you have identified (or MTPredictor has identified for you) a low risk initial set-up, and that set-up has been triggered, and you are now in a new trade, the next question is: "how do I manage this trade", or " how do I adjust my protective stop loss at the trade moves in my favour"? This is what I'll cover in this chapter. Again, the MTPredictor software program is designed to make this very easy and simple for you, and can perform these calculations automatically. However, so that you can understand exactly what to do, I would like to detail the basic stop loss guidelines for each of the TS3 (simple ABC), TS1 and TS2 trade set-ups in this chapter.

Please note, these are only the basic guidelines, there are more advanced strategies and alternate trade management methods I will go into later in the book. However, by simply following and utilising these basic guidelines, they will give you a good solid foundation upon which you can build your own (and personalised) trade management system.

The three basic trade set-ups are:

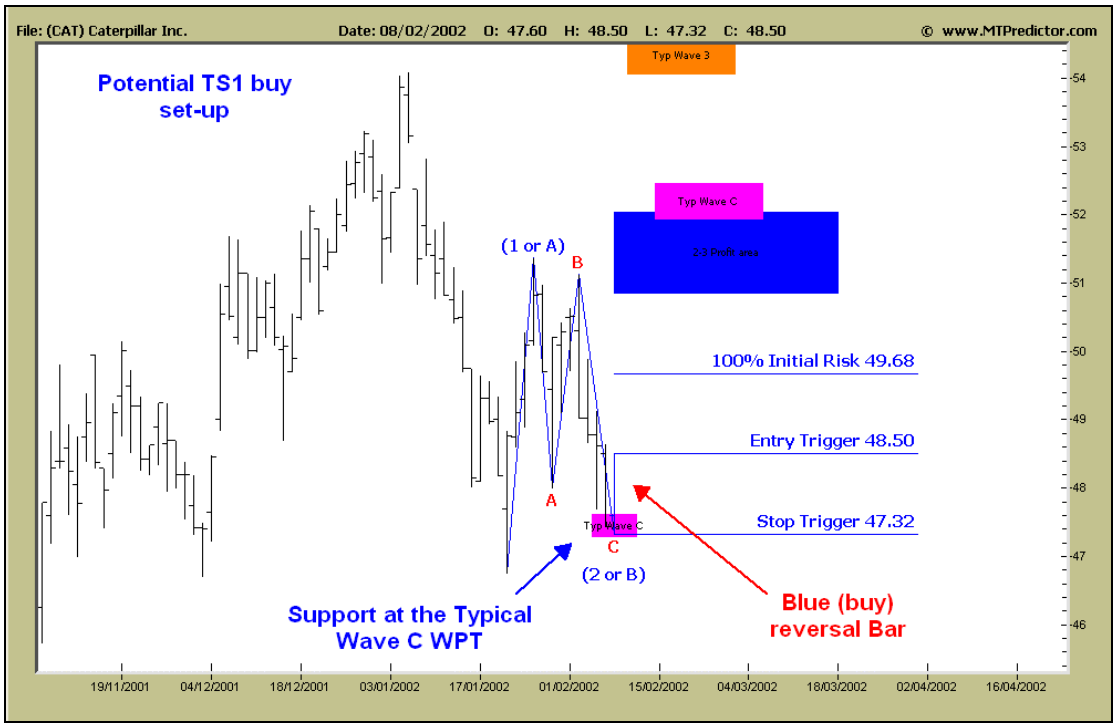
- The TS3 Trade set-up (simple ABC correction) and,
- The TS1 trade set-up (abc correction as part of a Wave (2orB) correction) and,
- The TS2 trade set-up (abc correction as part of a Wave (4) correction)

TS1 set-up

In this section, I will detail the basic guidelines suggested for advancing your projective stop loss as a TS1 trade moves in your favour. Please understand that having a protective stop in the market at all times is absolutely vital, because this protective stop will take you out of a trade quickly when it goes wrong, therefore keeping your losses small. As such, not having a protective stop on any open position is plain foolish, and is not recommended!

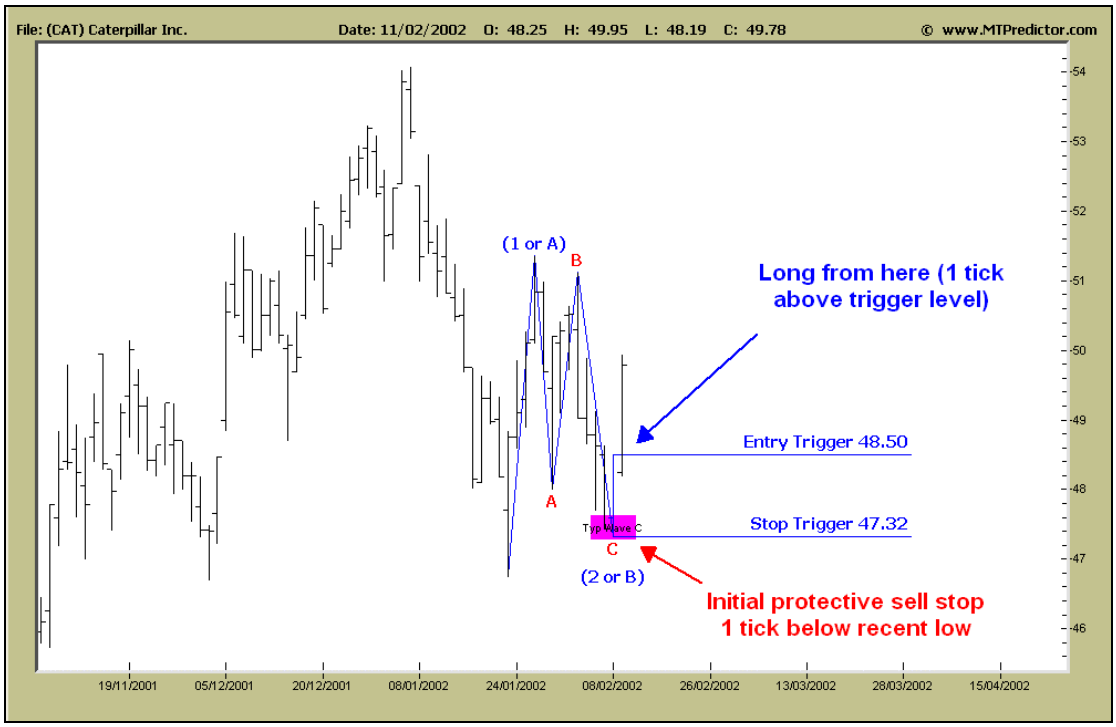
The basic idea is that you should advance your protective stop as the market in question reaches the next important *larger-degree* support or resistance area (these are the WPTs). Then if the market closes *beyond* one of these areas, you should anticipate that the current trend will continue into the next support or resistance area.

As an example, I would like to follow the progress of a US stock, Caterpillar Inc (CAT), from the initial buy trade set-up off a TS1 low on February 8 2002.



If you look at the chart above you can see the initial set-up, which was a perfect TS1 buy trade set-up. As outlined in a prior chapter this was automatically identified by the software. Please note the standard criteria, in which the Wave C fell right at the typical Wave C WPT (in Pink) and the rally off this support level unfolded as a blue buy Reversal Bar. This is a good example of a perfect TS1 set-up

Okay, lets move forward one day, to Feb 11:



As you can see, CAT rallied the next day, triggering a new long trade as the high of the blue buy Reversal Bar (on Feb 8) was exceeded.

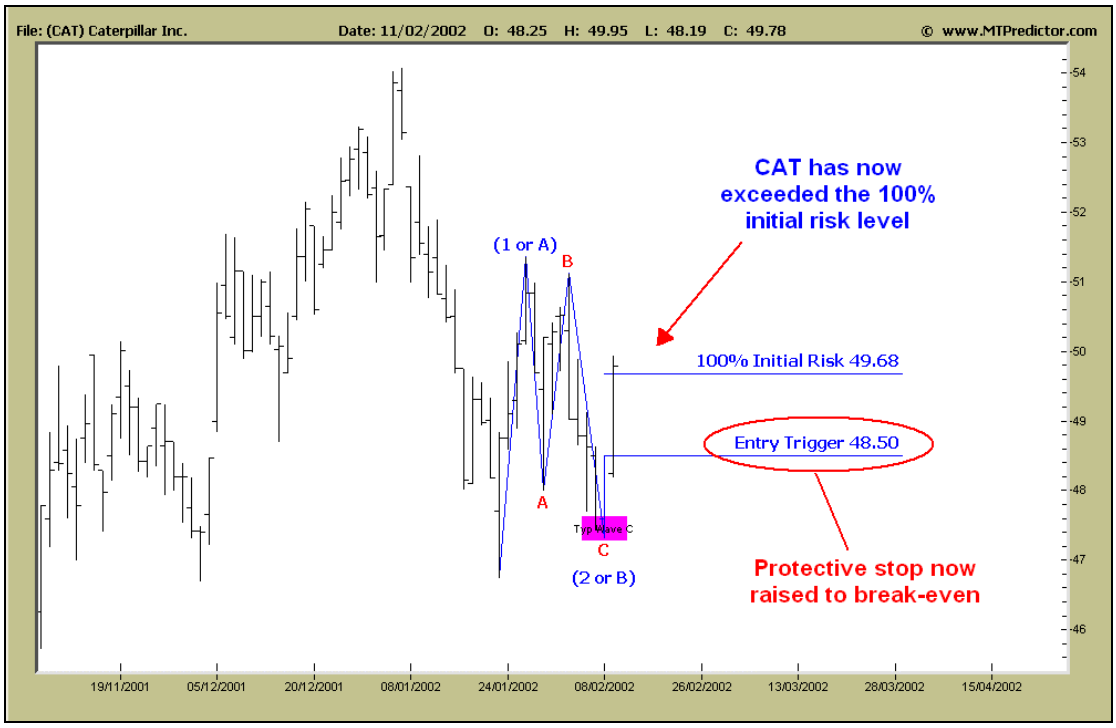
As outlined in a previous chapter, your initial protective sell stop should then be placed just below the last minor low. In this example, this would have been just below the low of Feb 8.

The stop then stays here until you are either stopped out for a small loss, or the market moves past the 100% initial risk point.

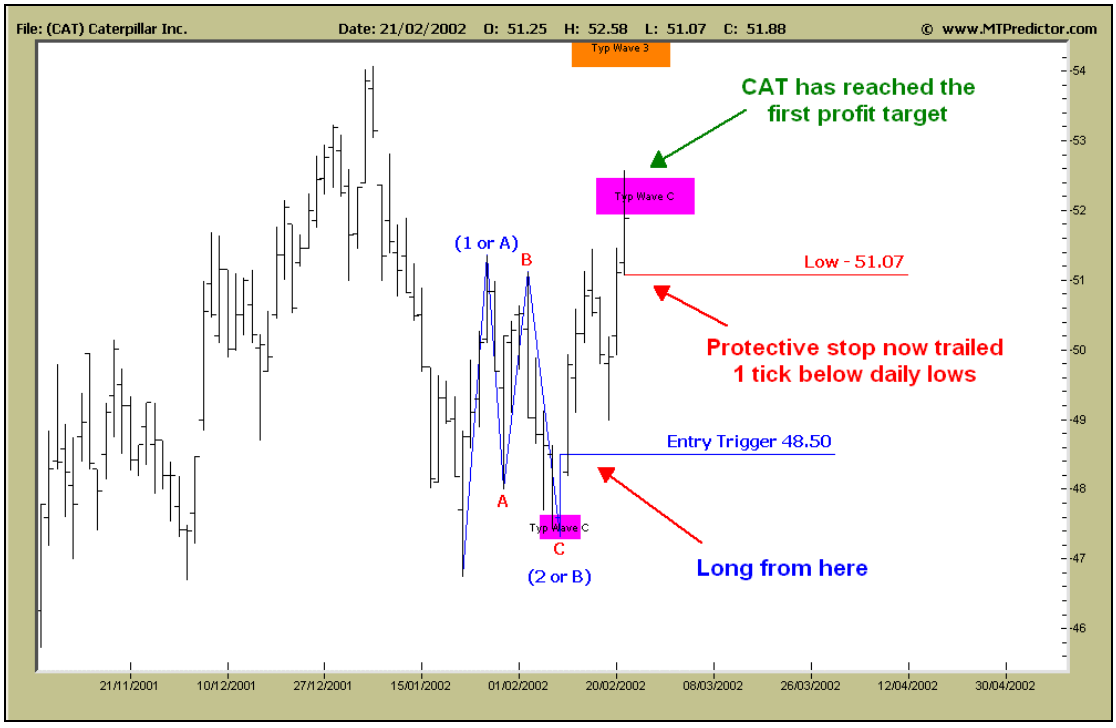
The 100% initial risk point is where your current profit would equal (be 100% of) the initial risk required to take the trade. In this example the initial risk would have been 1.18 points (48.50 – 47.32). As such, once CAT has rallied passed 49.68 (48.50 + 1.18) - the entry price plus the 100% initial risk value, then you should raise your protective stop to break-even.

As you can see from the chart on the next page, this happened on Feb 11.

Raising your protective stop to break-even as quickly as possible protects your trading capital. Keeping the losses as small as possible or, ideally, keeping them out of your account completely, protects your trading capital and builds the foundation for a solid long-term profitable approach to trading speculative markets, as outlined in the prior chapter.



The next stop loss adjustment does not happen until the market in question has reached the next support or resistance level. In this particular example, this is the *Typical* Wave C WPT, although it is normally the *Minimum* Wave C WPT:

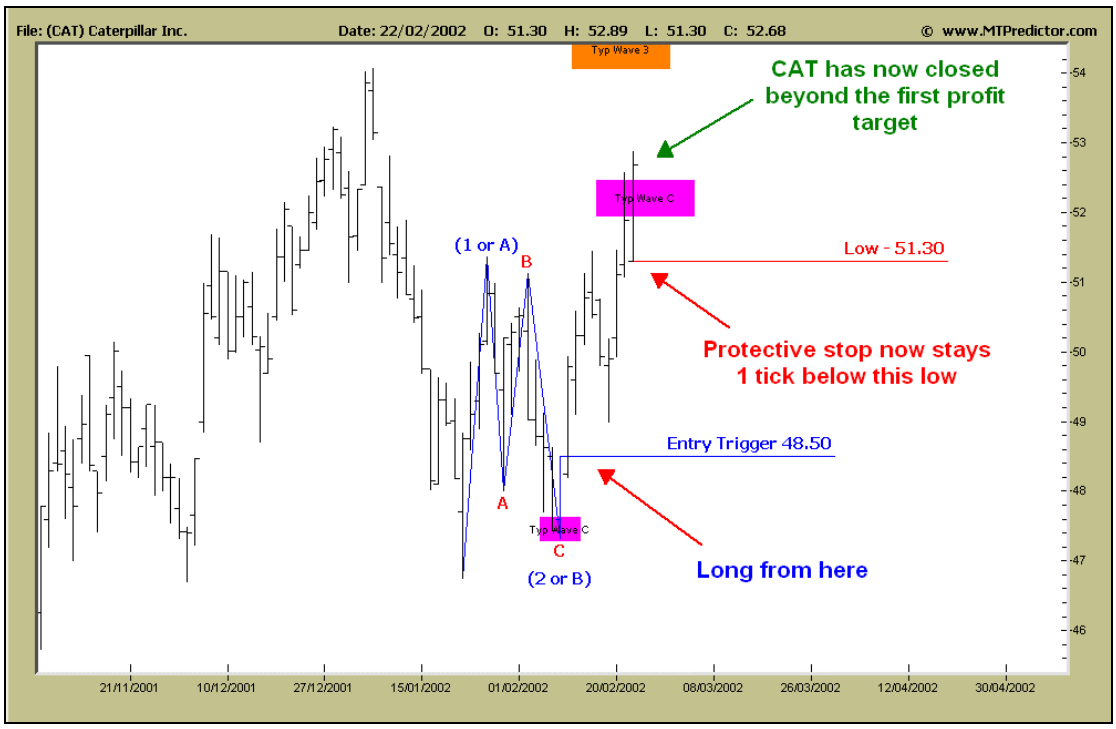


Once the market in question has reached this next resistance level, the protective stop should be trailed just below the daily lows (reverse for a short trade).

The idea behind this is that, at this stage, the current rally could still be either a Wave C or a Wave 3. As such, you have to be prepared to close the current profitable trade *if* the current rally off the original TS1 trade set-up turns out to be only a Wave C.

However, *if* the market closes beyond the typical Wave C WPT, then you should assume the current swing is more likely to be a Wave 3, so the market will continue into the next resistance area. In the case of a TS1 trade set-up, this is now the typical Wave 3 WPT. I will cover this in more detail in a later chapter.

Therefore, you will either be stopped out for a profit as the market declines off the current Wave C WPT, or *if* the market closes beyond the current Wave C WPT, you should leave the protective stop where it currently is, until the market reaches the next support or resistance area.



Now CAT has closed above the typical Wave C WPT, the stop remains just below the low of Feb 22 until you are either stopped out or CAT reaches the typical Wave 3 WPT.

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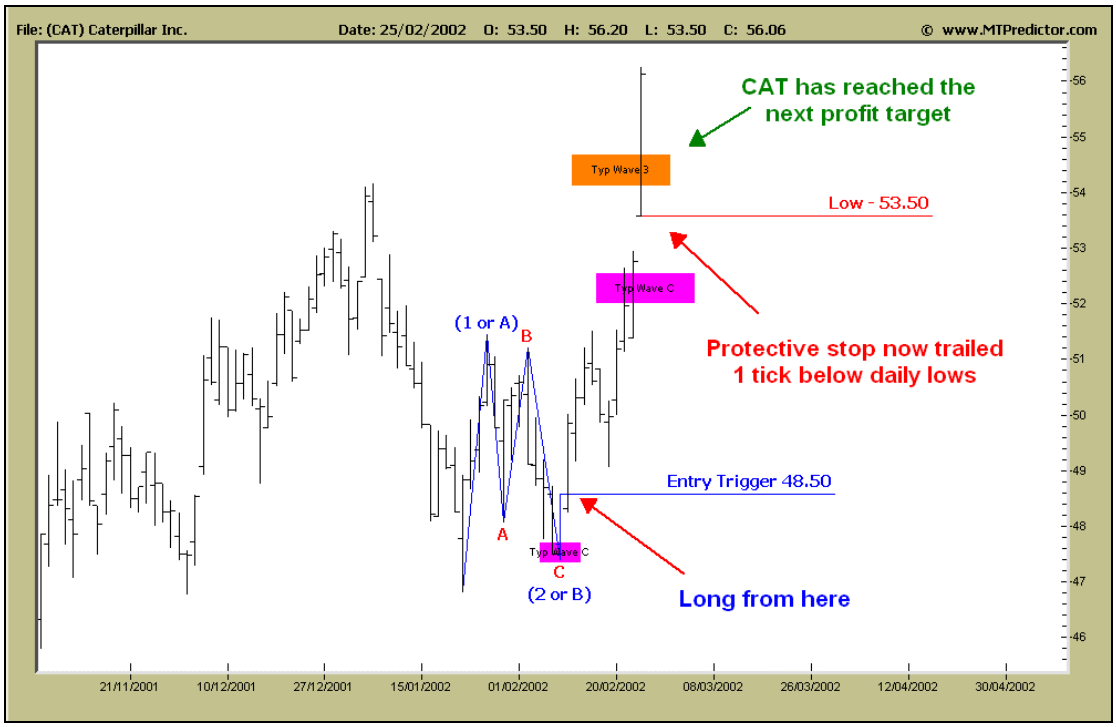
As before, once the market in question reaches the next resistance area, the protective sell stop is raised to just below the daily lows until you are either stopped out or the market closes above the current resistance area:



As you can see, in fact CAT reached, and then closed above the typical Wave 3 WPT all in one day – Feb 25. So, in this example, the protective stop would be raised to just below the Feb 25 low, and then would stay there until CAT reached the next resistance area.

You now employ exactly the same procedure: as the market in question has closed beyond the current support or resistance area, you assume it will continue into the next support or resistance area. In this case this would be the maximum Wave 3 WPT.

Now CAT has closed above the typical Wave 3 WPT, the stop remains just below the low of Feb 25 until you are stopped out or CAT reaches the maximum Wave 3 WPT.

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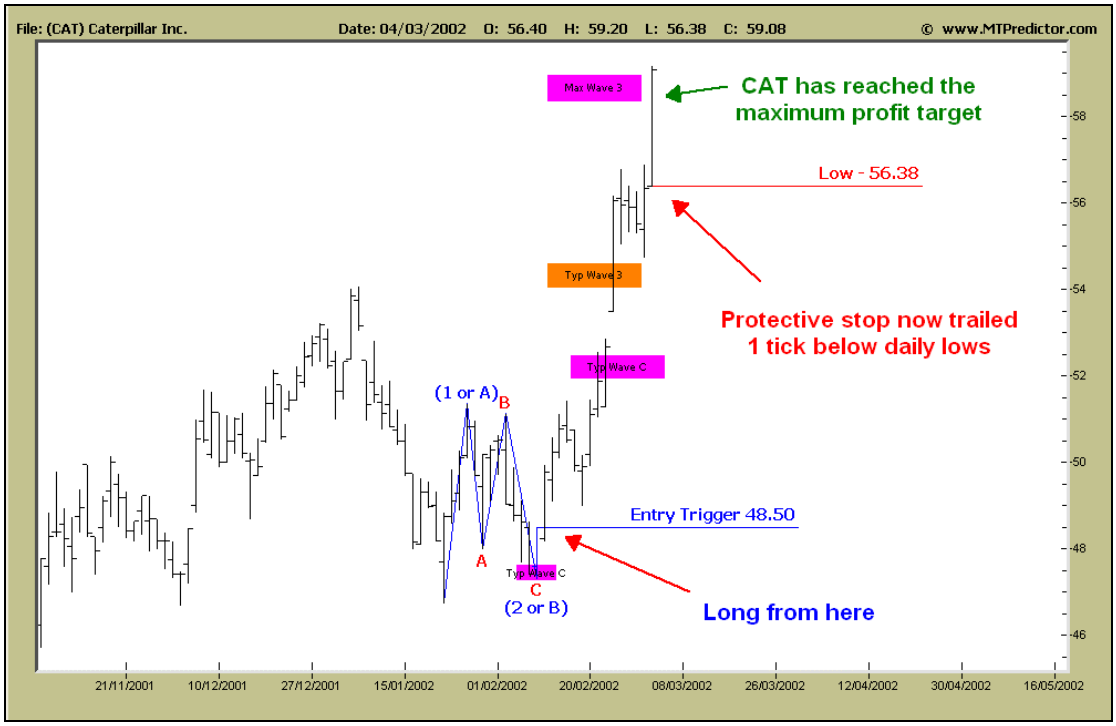
On March 4, CAT reached the next resistance area, the maximum Wave 3 WPT:

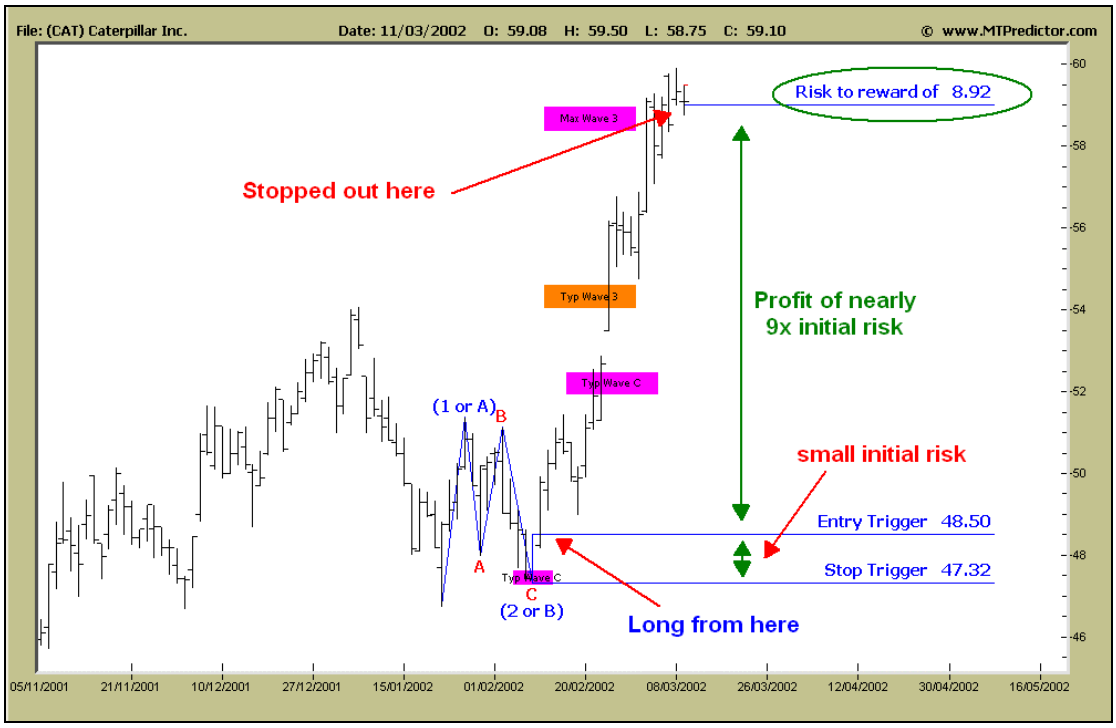


Now, because the market has reached what is normally considered the maximum area for the current swing to end, you should change your view slightly. You should no longer consider that a close beyond the current support or resistance area will continue into the next area, because the probabilities now suggest that, as the maximum anticipated support or resistance area has already been reached, a high or low is now very likely. Therefore, your aim now must be to bank as much of the current Profit as you can.

As such, you now simply trail the protective sell stop just below the daily lows (in the current example of a long trade) until you are stopped out.

If you turn to the chart on the next page, you will see how CAT eventually declined below the prior day's low a few days later, on March 11, stopping out the long trade for a good Profit. In fact this profit was nearly 9x the initial risk required to take the trade (ignoring slippage and commissions).

Please see the chart on the next page……



As you can see, the idea is that most markets will find support or resistance at the projected WPTs, so *if* a market closes beyond one WPT it will most likely continue on into the next WPT. You can then use this to advance your protective stop, as the market moves in your favour.

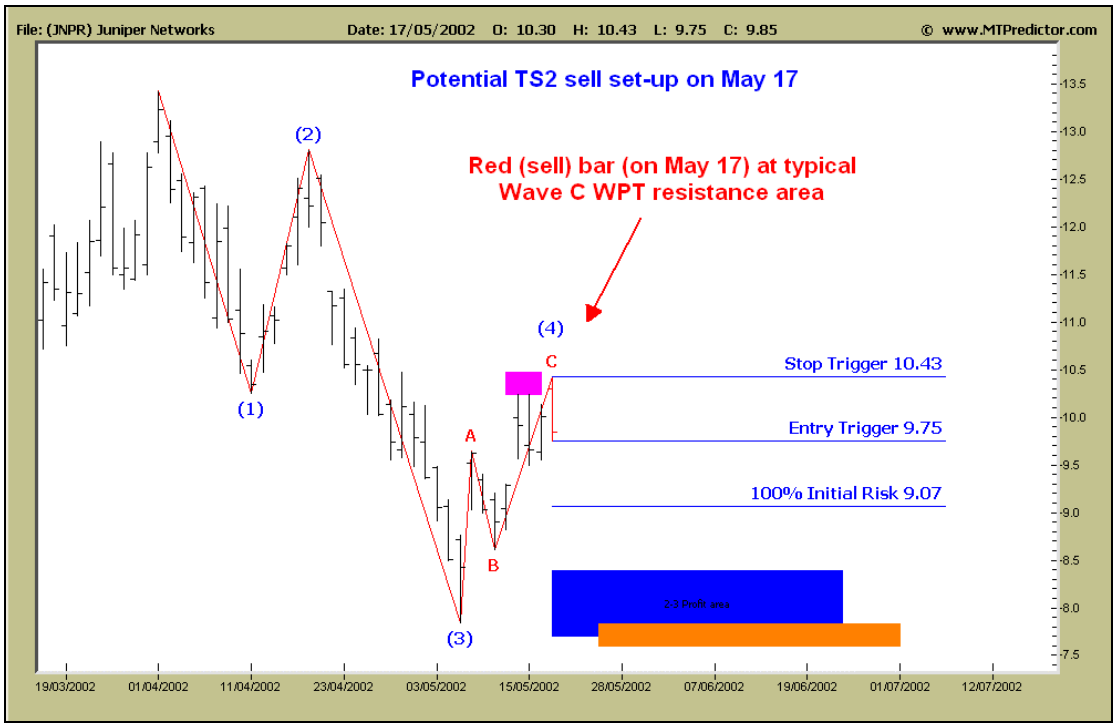
A similar approach is used for the TS2 and ABC (TS3) trade set-ups as well, please see the next sections.

The MTPredictor software program automatically projects these future profit targets for you, therefore making this trade management very easy indeed.

TS2 set-up

For the TS2 trade set-up, you should use a similar strategy as outlined in the prior section in that you should adjust your protective stop as the market in question reaches the next important *larger-degree* support or resistance area. Then, if the market closes beyond one of these areas, you should anticipate that the current trend will continue into the next support or resistance area. However, the main difference is that, because the TS2 trade set-up is of the end of a wave (4), this strategy will use the wave (5) WPTs.

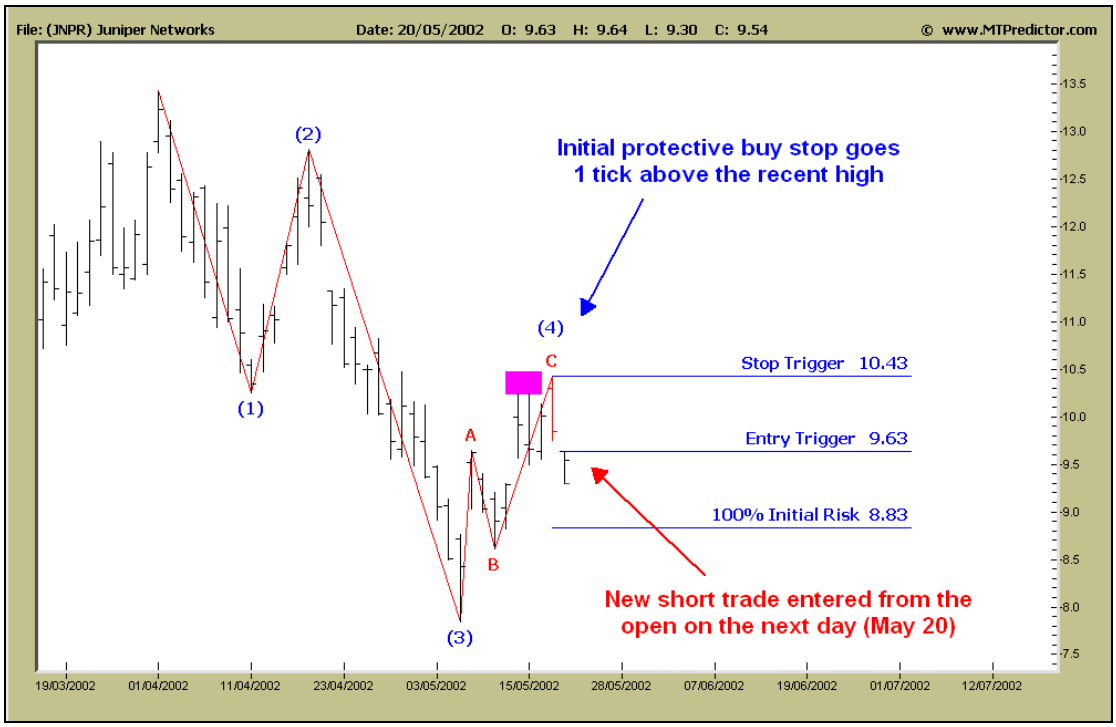
As in the prior section, I would like to follow the progress of a stock day by day as the trade moved in your favour. In this example it is a TS2 sell set-up on May 17 2202 on a US stock called Juniper (JNPR):



Here you have a perfect TS2 sell trade set-up as identified by the software, with the added confirmation of the minor Wave C falling at the typical Wave C WPT (in pink) and the decline off this resistance level unfolding as a red sell Reversal Bar.

Okay, lets move forward one day, to May 20:

Continued on the next page . .



As you can see, JNPR declined the next day, entering a new short trade as the low of the red sell Reversal Bar (on May 17) was exceeded. In fact, the trade would have been entered on the open of the next day, May 20.

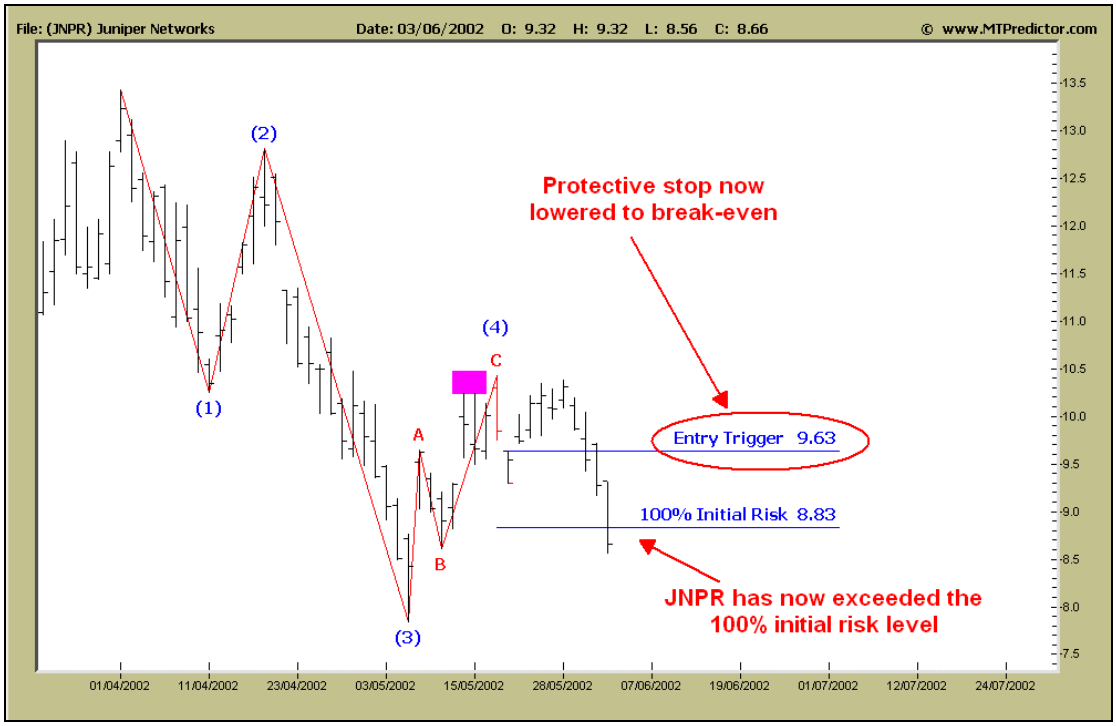
Your initial protective buy stop should then be placed just above the last minor high. In this example, it would have been just above the high of the May 17 high.

The stop then stays here until you are either stopped out for a small loss, or the market moves past the 100% initial risk point.

The 100% initial risk point is where your current profit would equal (be 100% of) the initial risk required to take the trade. In this example the initial risk would have been 8.83 (10.43 – 9.63). As such, once JNPR has declined past 8.83 (9.63 – 0.80) – the entry price minus the 100% initial risk value - then you should lower your protective buy stop to break-even.

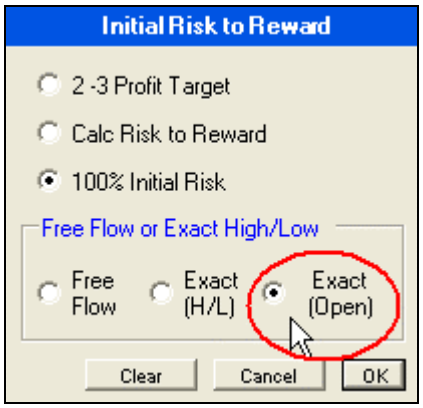
Continued on the next page .

This happened on Jun 3:



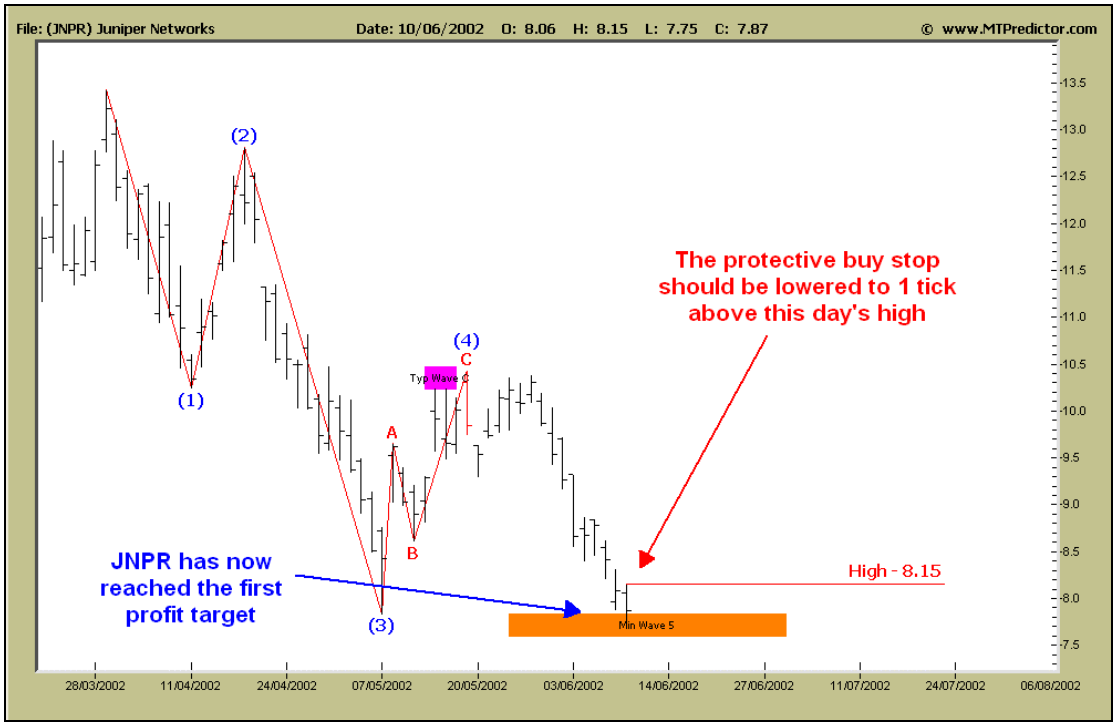
By moving your protective stop to break-even as quickly as possible, you protect your trading capital. Keeping the losses as small as possible, therefore protecting your trading capital, as outlined in the prior chapter, builds the foundation for a solid long-term successful approach to trading the speculative markets.

As you can see in this example, the initial risk was increased slightly by JNPR making a Gap open on the day of the trade entry, May 20. As such, you will need to adjust this 100% initial risk level from the one that is automatically calculated by the Trade set-up module. You can do this by manually using the Risk/Reward module and selecting the "Free Flow" option or in version 4.0 of the software you can select to take the "Exact (Open)" of the entry bar.



This will allow you to use the actual entry price in this calculation.

The next stop loss adjustment does not happen until the market in question has reached the next support or resistance level. In this example, this is the minimum Wave 5 WPT:



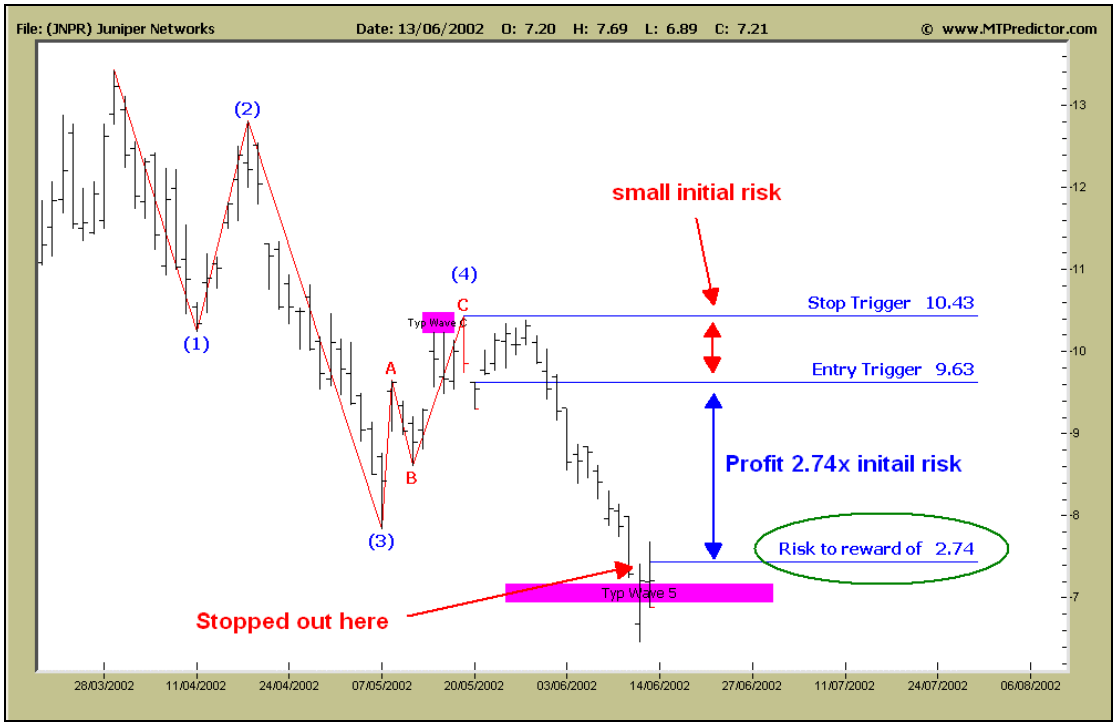
Once the market in question has reached this next support level, the protective stop should be trailed just above the daily highs (reverse for a long trade).

Continue to trail the protective stop just above the daily highs until either the trade is stopped out for a profit or the market closes beyond the current support level. In this example, this would be a close below the minimum Wave 5 WPT support zone.

Continued on the next page.

Now JNPR has closed below the minimum Wave 5 WPT, the stop remains just above the high of Jun 11 until you are either stopped out or JNPR reaches the next support zone, which is the typical Wave 5 WPT. This happened the next day, on Jun 12:

As before, once the market in question reaches the next support area, the protective sell stop is trailed just above the daily highs until you are either stopped out or the market closes below the current support area.



The next day, JNPR rallied above the prior day's high, therefore stopping out the current short trade for a good profit of approximately 2.75x the initial risk (ignoring slippage and commission).

JNPR stopped at the typical Wave 5 WPT, but what happens if this level is exceeded?

You should employ exactly the same procedure as outlined in the prior section: if the market in question closes beyond the typical Wave 5 WPT then the stop would stay just above the daily high (reverse for a long trade) until it reaches the maximum Wave 5 WPT.

If the market then reaches what is normally considered the maximum area for the current wave to end, you should change your view slightly. You should no longer consider that a close beyond the current support or resistance area will continue into the next area, because the probabilities now suggest that, as the maximum anticipated support or resistance area has already been reached, a high or low is now very likely. As such, your aim now must be to bank as much of the current Profit as possible. This is exactly the same strategy as outlined in the prior section.

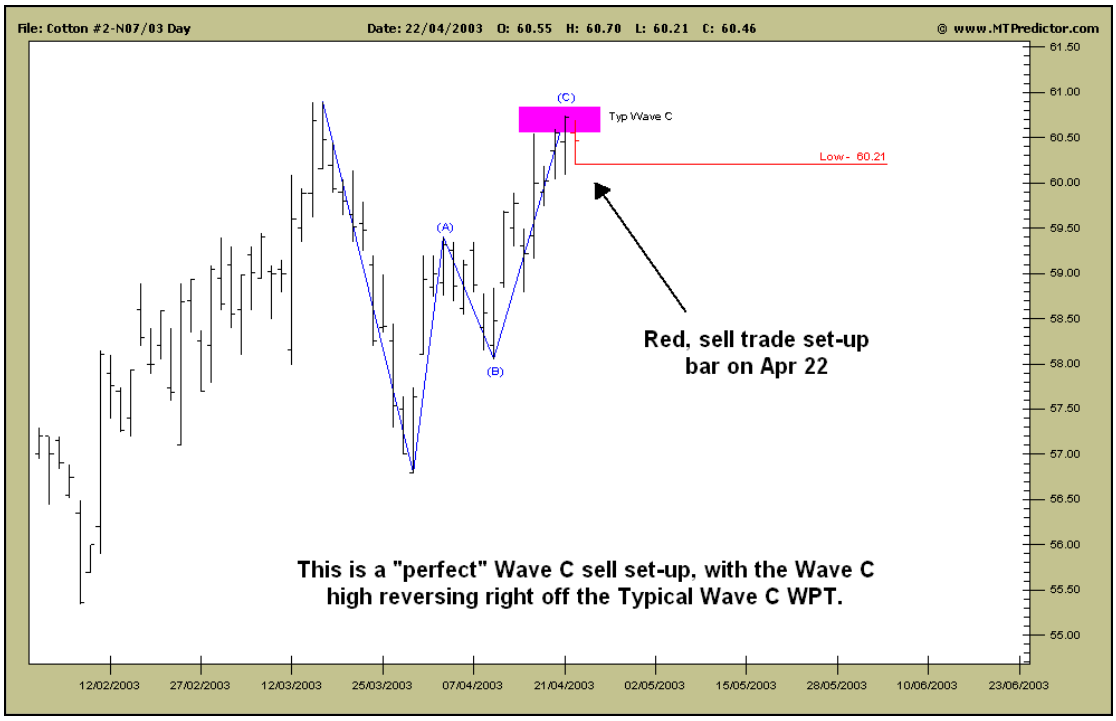
You can now simply trail the protective buy stop just above the daily highs until you are stopped out (again, reverse for a long trade).

As you can see, the idea is exactly the same as outlined in the prior section where you use the idea that most markets will find support or resistance at the projected WPTs, then *if* a market closes beyond one WPT it will most likely continue on into the next WPT. You can then use this to adjust your protective stop, as the market in question moves in your favour.

Wave C (TS3) set-up

For the Wave C (TS3) trade set-up, you should use a similar strategy as outlined in the prior two sections in that you should adjust your protective stop as the market in question reaches the next important support or resistance area. Then if the market closes beyond one of these areas, you should anticipate that the current trend will continue into the next support or resistance area. However, the main difference is that, because the wave C trade set-up is off the end of a wave C, you do not know for sure whether the next swing is going to unfold as a *larger-degree* Wave (C) or Wave (3), so you use all of the Wave C and then Wave 3 WPTs. In essence, this strategy is very similar to the strategy outlined for the TS1 set-up.

As in the prior sections, I would like to follow the progress of a market day by day as a trade moved in your favour, in this example it is a Wave C sell set-up on April 22 2003 on (Jul) Cotton:



If you look at the chart above, you can see the initial set-up, which was a perfect wave C sell trade set-up, in which the Wave C fell right at the typical Wave C WPT (in pink) with a red, sell Reversal Bar unfolding at the high. As with all examples in this section, the MTPredictor software automatically identified this set-up. This is a good example of a perfect wave C set-up.

Okay, lets move forward one day, to April 23:

Here is the situation on April 23:

As you can see, Cotton declined the next day, triggering a new short trade on the open of April 23, as the low of the red, sell Reversal Bar (on April 22) was exceeded.

As outlined in prior chapters your initial protective buy stop should then be placed just beyond the last minor swing extreme. In this example, this would have been just above the April 21 high of 60.75, at 60.80.

The stop then stays here until you are either stopped out for a small loss, or, the market moves past the 100% initial risk point.

The 100% initial risk point is where your current profit would equal (be 100% of) the initial risk required to take the trade. In this example the initial risk would have been $400 (60.00 – 60.80 x $500) per contract (ignoring slippage and commission). As such, once Cotton had declined and was in profit by $400 then you should move your protective stop to break-even. This level fell at 59.20 (60.00 – 60.80)

As you can see from the chart on the next page, this happened on the same day as the trade entry on April 23.

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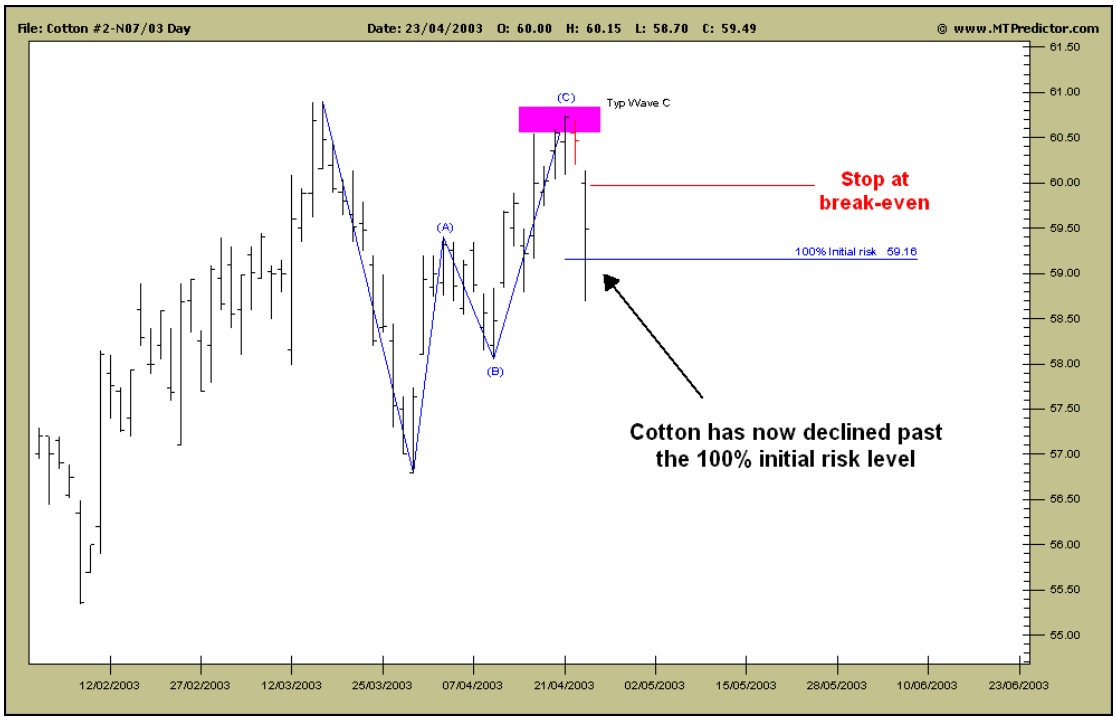
Cotton has now declined past the 100% initial risk level. You should now lower your protective buy stop to break-even.



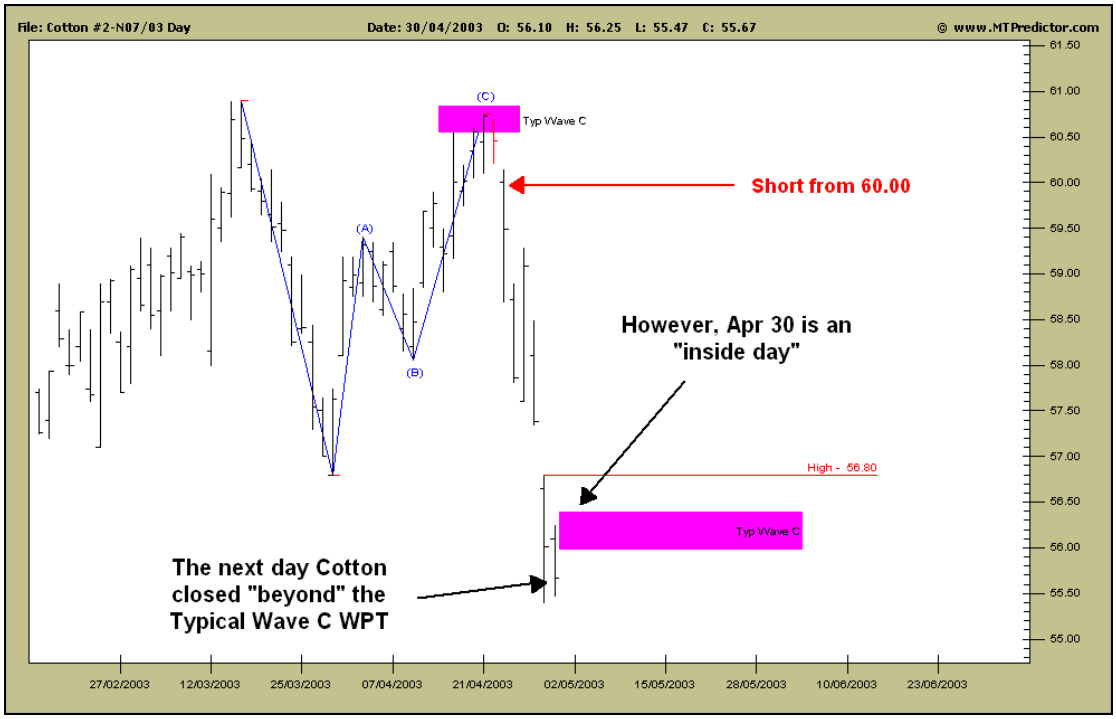
The next stop loss adjustment does not happen until the market in question has reached the first support zone. In this example, this is the typical Wave C WPT, but normally it is the minimum Wave C WPT:

Once the market in question has reached this support zone, the protective stop should be trailed just above the daily highs (reverse for a short trade).

The idea behind this is that, at this stage, the current decline could be either a *larger-degree* Wave (C) or a *larger-degree* Wave (3). As such, you need to be prepared to close the current profitable trade if the current decline off the original wave C trade set-up only turns out to be a *larger-degree* Wave C.

However, if the market closes beyond the typical Wave C WPT, then you should assume the current swing is *more likely* to be a larger-degree Wave (3), so the market will continue into the next support (or resistance) zone. In the case of a wave C trade set-up, this is now the *larger-degree* typical Wave (3) WPT.

Therefore, you will either be stopped out for a profit as the market rallies off the current Wave C WPT, or *if* the market closes beyond the current wave C WPT, you should leave the protective stop where it currently is, until the market reaches the next support zone.

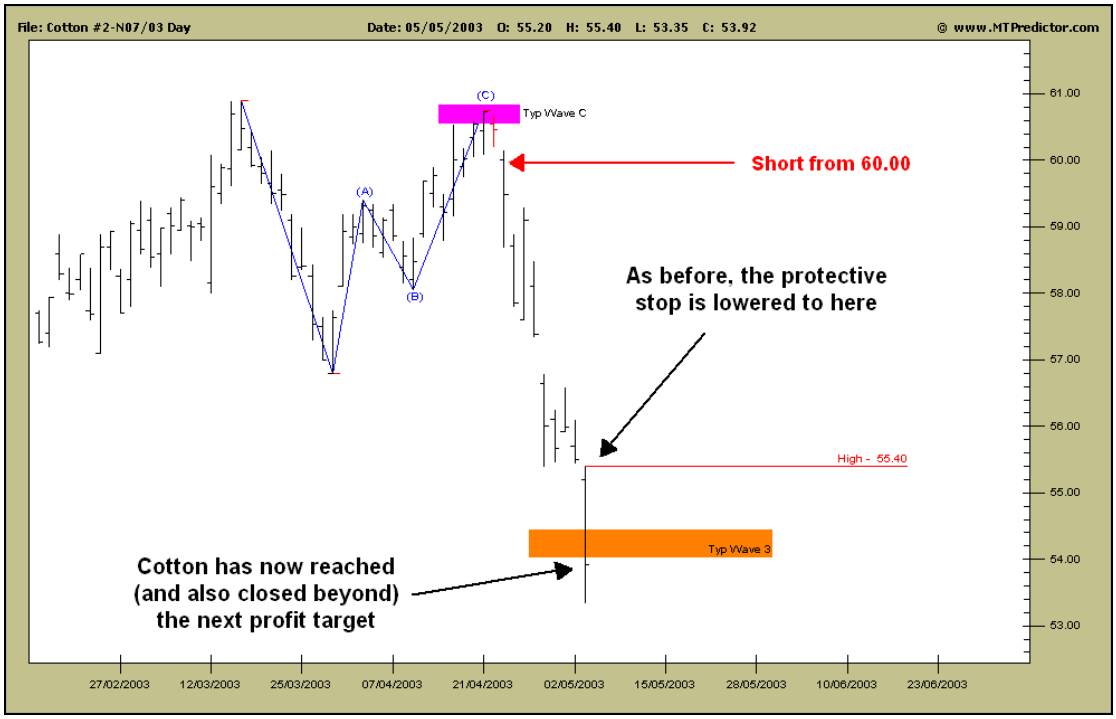


As you can see from the chart above, Cotton has closed beyond the typical Wave C WPT. As outlined in the prior sections, *ideally* the stop should be lowered to just above the high of this day and then it should remain there until you are either stopped out or Cotton reaches the next profit target, which is typical Wave 3 WPT.

However, Apr 30 is an inside day, so you need to adjust the basic guidelines to take account of the inside day. For more information on inside days please see chapter 18.

I have deliberately chosen this example to demonstrate how to take account of an inside day. The process is similar to the basic guidelines, except the stop stays just beyond the high (for a short trade) or the low (for a long trade) of the day prior to the inside day. In this example, this would be just above the high of April 29.

As before, the protective stop stays at this level until you are either stopped out, or Cotton reaches the next support zone.

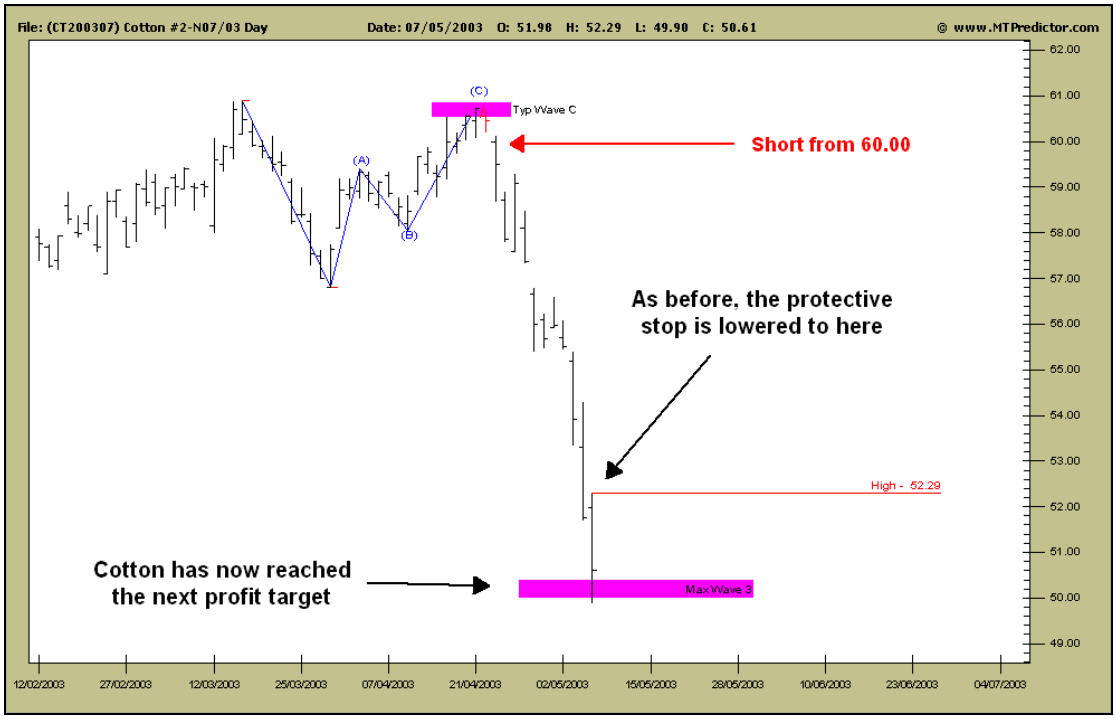


Cotton continued to decline and, in fact, reached and then closed beyond the next support zone (the typical Wave 3 WPT) all in one day – on May 5. So, in this example, the protective stop would be lowered to just above the May 5 high, and then would stay there until Cotton reaches the next support zone.

You should now employ exactly the same procedure, as the market has closed beyond the current support area: you should assume it will continue into the next support zone. In this case, this would be the maximum Wave 3 WPT.

Now Cotton has closed below the typical Wave 3 WPT, the stop remains just above the high of May 25 until you are either stopped out or Cotton reaches the maximum Wave 3 WPT.

On May 7, Cotton reached the next profit target, the maximum Wave 3 WPT:



Now, because the market has reached what is normally considered the maximum area for the current wave to end, you should change your view slightly. You should no longer consider that a close beyond the current support or resistance area will continue into the next area, because the probabilities now suggest that, as the maximum anticipated support or resistance area has already been reached, a high or low is now very likely. As such, your aim now must be to bank as much of the current Profit as possible.

So, you now simply trail the protective sell stop just below the daily lows until you are stopped out.

If you turn to the chart on the next page, you will see how Cotton rallied above the prior day's high the next day, on May 8, stopping out the short trade for a good Profit.

Please see the chart below:

As you can see, Cotton was then stopped out at 52.30 on May 8, as it rallied above the prior day's high for a very nice profit of $3,800 (60.00 – 52.30 x $500) per contract (ignoring slippage and commission).

This profit was approximately 9 times the initial risk required to take the trade.

As you can see, as in the earlier sections, the idea is that most markets will find support or resistance at the projected WPTs, then *if* a market closes beyond one WPT it will most likely continue on into the next WPT. You can then use this to advance your protective stop, as the market in question moves in your favour.

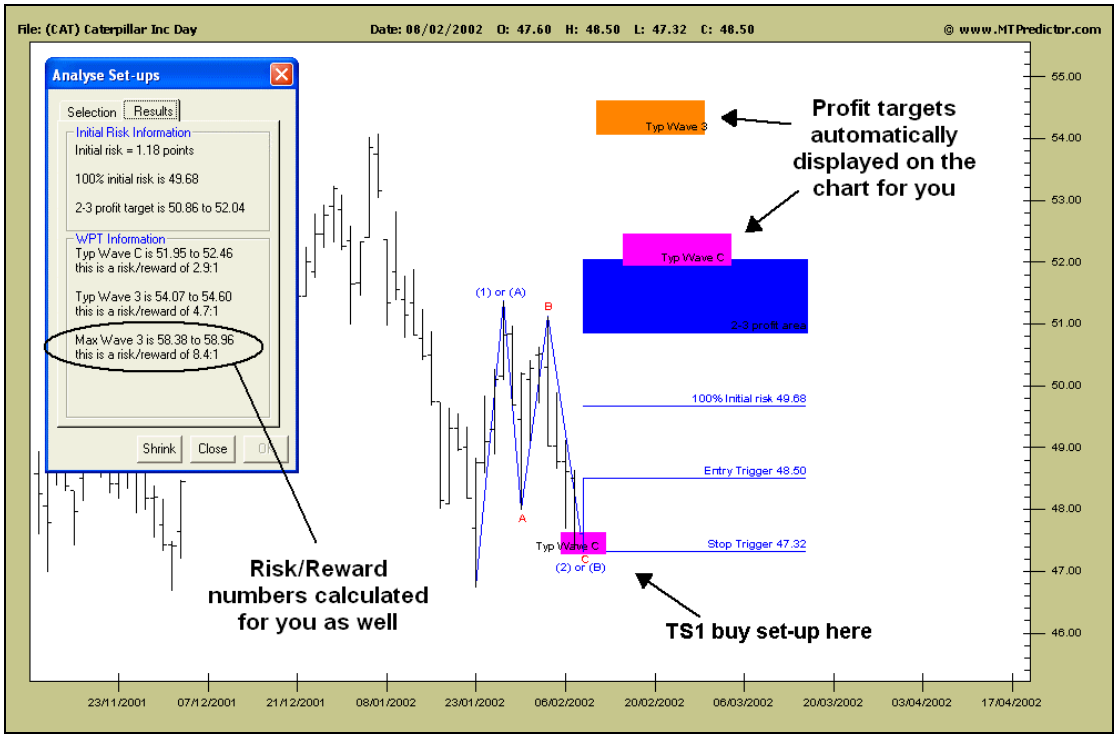
Continued on the next page.

MTPredictor automatic routines

Although it has taken just over 20 pages to go through in detail how to manage the standard Wave C, TS1 and TS2 trade set-ups, the MTPredictor software program can perform much of this work automatically for you. As such, you need not worry that you have to perform all these calculations manually.

Unlike many other software programs, which just provide technical analysis tools or techniques that you have to apply to the market yourself, MTPredictor is designed to help you as much as it can - by not only automatically identifying these trade set-ups, but also automatically projecting the future profit targets, in the form of the *larger-degree* WPT support or resistance zones for you.

Let me show you what I mean using the 3 examples from this chapter, starting with the TS1 set-up on Caterpillar Inc (CAT):

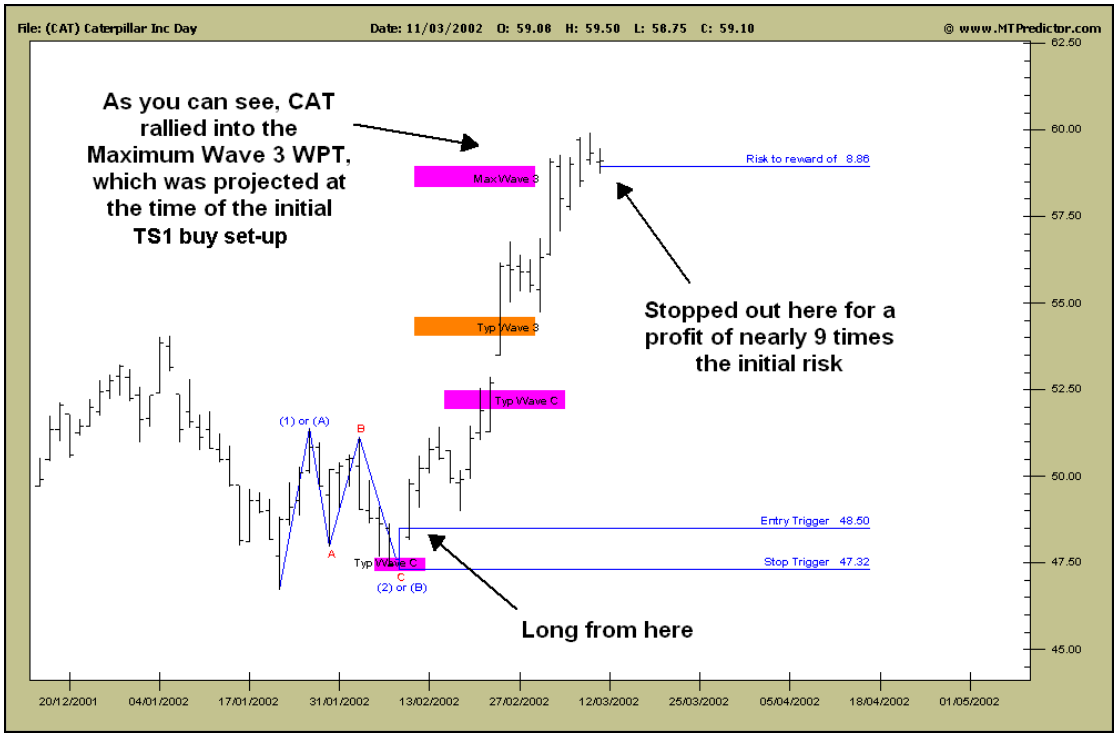


As you can see from the chart above, MTPredictor has calculated the potential profit targets automatically and displayed them on the chart for you, so you can see visually where they fall.

Furthermore, this routine also calculates the Risk/Rewards numbers for you, so you can instantly see that *if* CAT rallied into the maximum Wave 3 WPT, then this would mean a potential profit of approximately 8 times the initial risk (ignoring slippage and commission). In this way, you can be prepared in advance to only take the trades that carry the highest profit potential.

I hope you can all appreciate that having all this information available to you before you decide to enter a trade can help you *evaluate* the trade to see if it carries a high enough profit potential relative to the initial risk required to take the trade. As you all saw from the last chapter, if you can (on average, over time) make trades that have profits of 2-3 times the losses, then you will be on a sound footing for a successful long-term approach to trading the markets.

Let's move forward in time to see the end result:



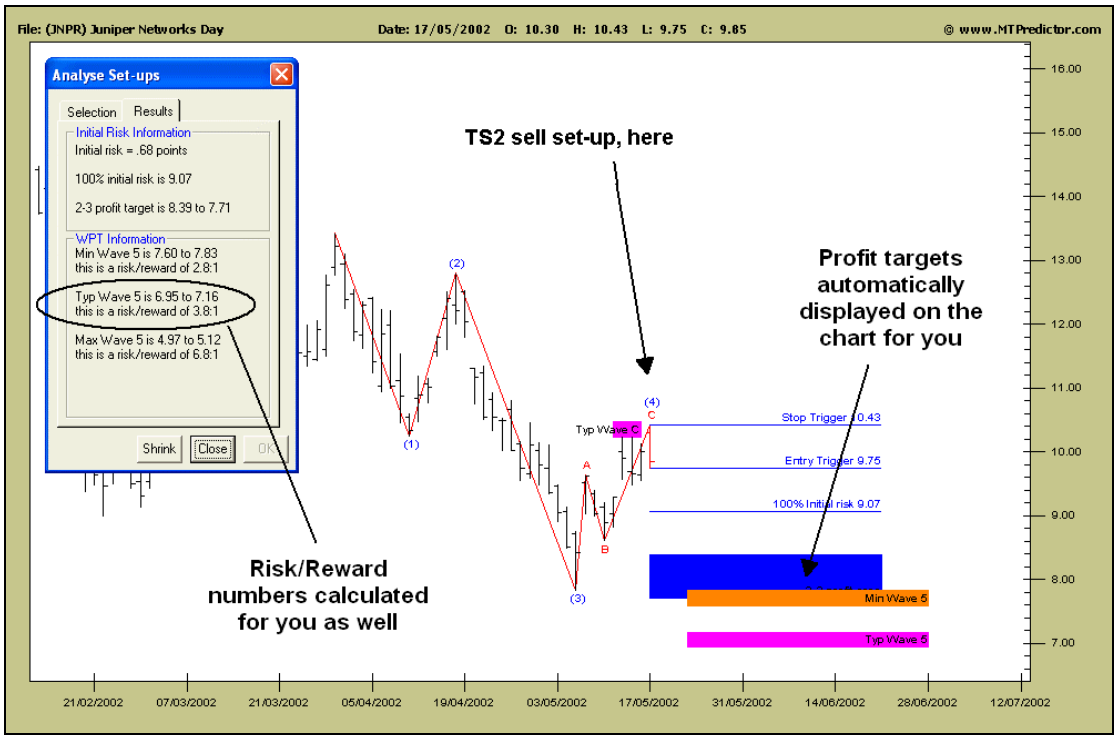
As you saw earlier in this chapter, CAT was eventually stopped out as it rallied past the maximum Wave 3 WPT profit target.

But you can see how these profit targets were automatically displayed on the chart for you at the time of the initial set-up. This made managing the trade very easy indeed.

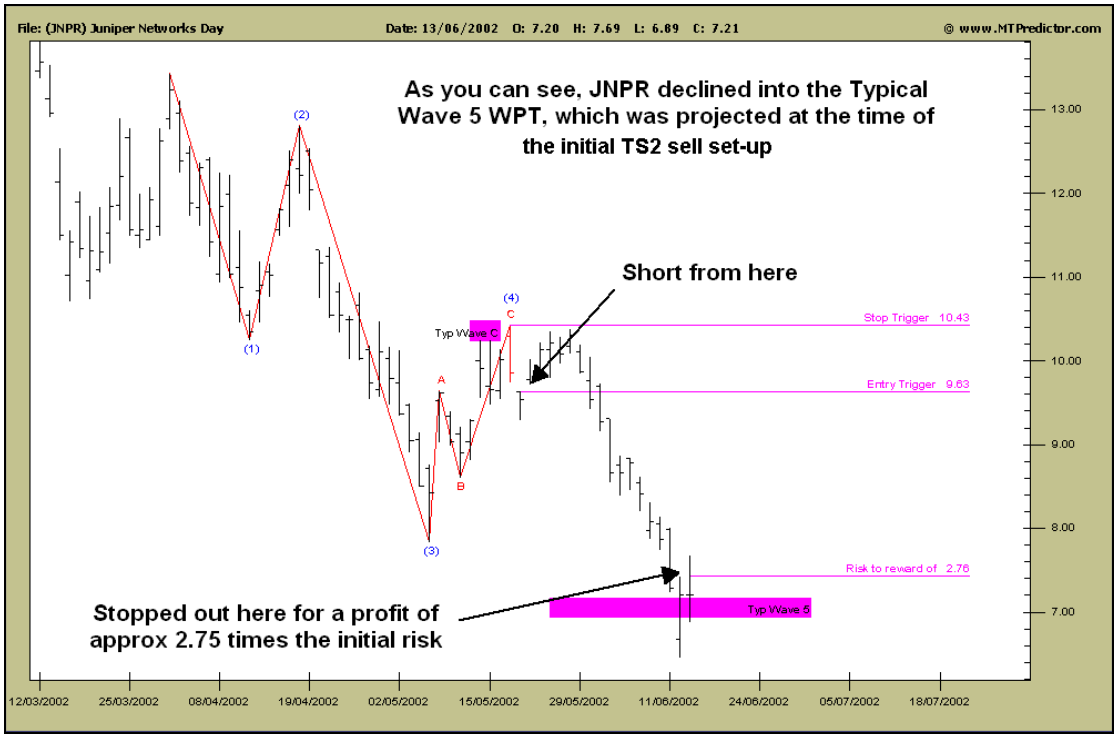
Let's take a look at the remaining examples from this chapter on Juniper (JNPR) and (Jul) Cotton.

Continued on the next page.

Here are the profit targets, projected at the time of the initial TS2 set-up:

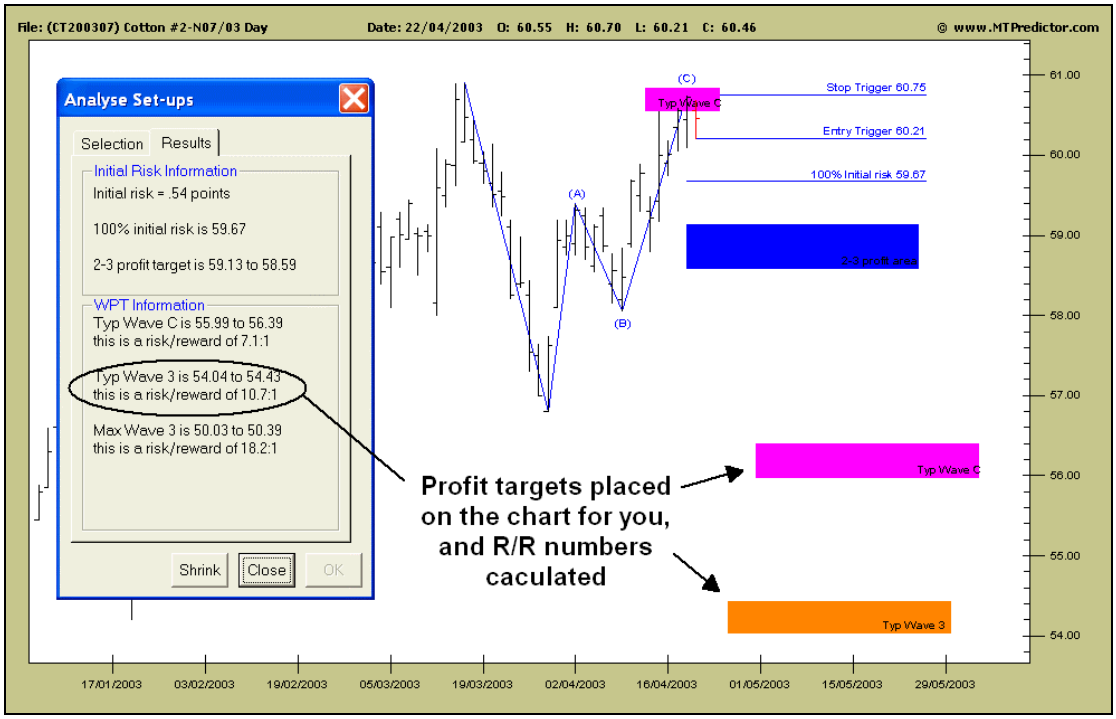


Let's move forward in time to see the result:

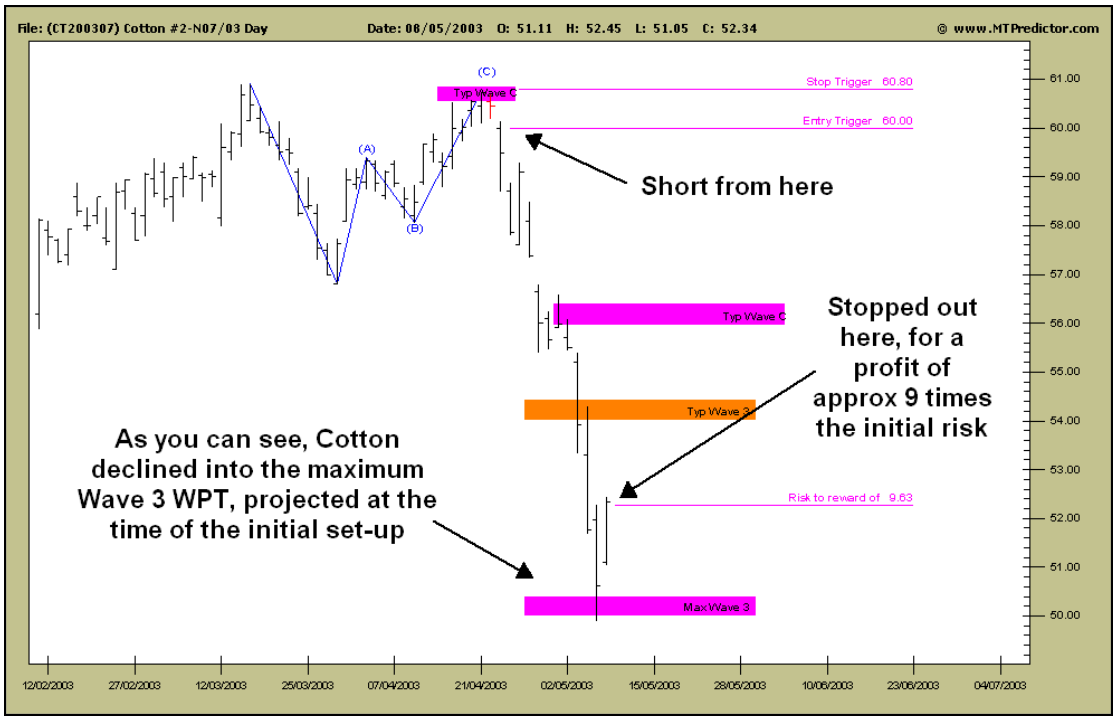


As you have already seen, JNPR declined nicely into the Typical Wave 5 WPT for a profit of approximately 2.75 times the initial risk (ignoring slippage and commission).

Here are the profit targets, projected at the time of the initial Wave C set-up:



Let's move forward in time to see the result:



As you have already seen, Cotton declined quickly into the Maximum Wave 3 WPT for a profit of approximately 9 times the initial risk (ignoring slippage and commission).

Summary

As you can see, the standard trade management strategy is very simple, using the idea that once a market exceeds one support or resistance area (as projected by the WPTs), then it is more likely to continue on into the next support or resistance area. As such, your protective stop should be kept close to the market as the trade enters the WPT support or resistance area, until it closes beyond that area. Then you keep the protective stop where it is until the next support or resistance area is reached. The process then starts again.

The idea behind this is that you do not know (for sure), in advance, how any individual trade will unfold. If you do have an idea where the market will go, for example you are anticipating a strong move, you can tweak these standard guidelines, as I'll outline in a section on advance trade management strategies later in this course.

One particular example of this is if, for another reason eg. fundamental analysis or seasonal trends, you are anticipating a particularly strong move, you can choose to adjust your protective stop as if the upcoming move is *more likely* to be a wave (3) type swing. I will go into more detail on alternate trade management strategies and the situations they are best suited to in later chapters. However, at this point I would like you to fully understand the standard trade management guidelines, and appreciate how (without any additional input) they give you the best overall trade management strategy. More importantly, they are easy to use and easy to follow, so they can be applied consistently on a trade-by-trade basis.

Also, I hope you can see how the automatic routines in MTPredictor can help you manage your trades more easily by projecting at the time of the initial set-up the potential profit targets, in the form of the larger-degree WPTs.

I will also answer additional questions in later chapters on topics such as gap openings, bad fills, fast moves and various other developments in real life trading. For now, this chapter deals with just the standard guidelines.

At this stage, I want you to be totally comfortable with the three standard trade set-ups and their management via the standard guidelines outlined in this chapter, and how they are used, before you move on to some of the more advanced modules and strategies in the MTPredictor software program as outlined in Part 2 of the Trading Course.

Chapter 10 – Summary

I hope you have enjoyed the journey through Part 1 of this Trading Course, and have now reached a level where you appreciate the simplicity and ease with which MTPredictor approaches analysis and trade identification.

As you know, my own view on the way Elliott wave analysis should be applied is unique, and very different from the way Elliott wave analysis is typically taught. Some pure Elliott wave analysts will disagree with me (that is okay!). But I hope you can see that by treating Elliott wave analysis *in isolation*, (the MTPredictor *isolation approach*) - with the primary aim of identifying *ideal trade set-ups* and not trying to forecast any future outcome - releases you from many of the constraints and problems that arise with this form of analysis.

I cannot stress this difference enough. Therefore, when you look at the way I approach the markets and MTPredictor is used to analyse and identify trade set-ups in the markets, please be fully aware of this difference.

In particular, I hope that I have been able to demonstrate, and also that you have found from your own research, that when you use Elliott wave analysis in the standard way, it tends to come unstuck more often than not. This is not to say that Elliott wave analysis does not work, just that from my own experience (and from many traders I have spoken to over the years) I believe there is an easier and simpler way to approach this analysis.

Again, taking one particular Elliott wave pattern (the simple ABC correction) and using this as the basis of the automatic trade set-ups in MTPredictor, makes trade identification and trade management simple and straightforward. There is so much information and so many techniques available today, that if you try to take it all in it will only lead to confusion. I have heard the phrases “information overload” and “paralysis of analysis” far too many times over the years. It is far easier to focus on one particular method and then take the fishing approach to trading. In other words, you take your line and cast into the markets and only reel in the best and biggest fish. Although it may take some time waiting for the big fish to bite, it is normally better in the long-run.

This analogy highlights the MTPredictor approach - it is far better to have the patience and discipline to wait for, and then only trade, the *ideal* and perfect trade set-ups. Although this will mean that you may not trade every day, I believe that over-trading is one of the worst mistakes any trader can make and should be avoided at all costs. Sticking to just the standard trade set-ups will help, because it will enable you to create the self-discipline and patience that is required for a successful long-term approach to the markets.

Chapter 10 – Summary

Throughout my years as a private trader, whenever I incurred a period of losing trades, I thought the answer was to become more educated and look for greater and more in-depth ways to understand the market. This personal journey took me through many different (an ever more complicated) ways to perform technical analysis. However, although I became an expert in many different forms of analysis, the bottom-line results did not reflect this new-found expertise. After many years of this, I suddenly stopped and looked back, and finally realised that the route to profitable trading does not come from unlocking the markets or finding that one perfect method - the so-called "Holy Grail" does not exist.

In a way, the real "Holy Grail" is to make trades consistently over time, in which the profits are larger than the losses. It is as simple as that. And in reality, the real Holy Grail is within yourself and your ability to apply your own simple method consistently and, more importantly, have the patience and discipline not to make silly and unnecessary trades.

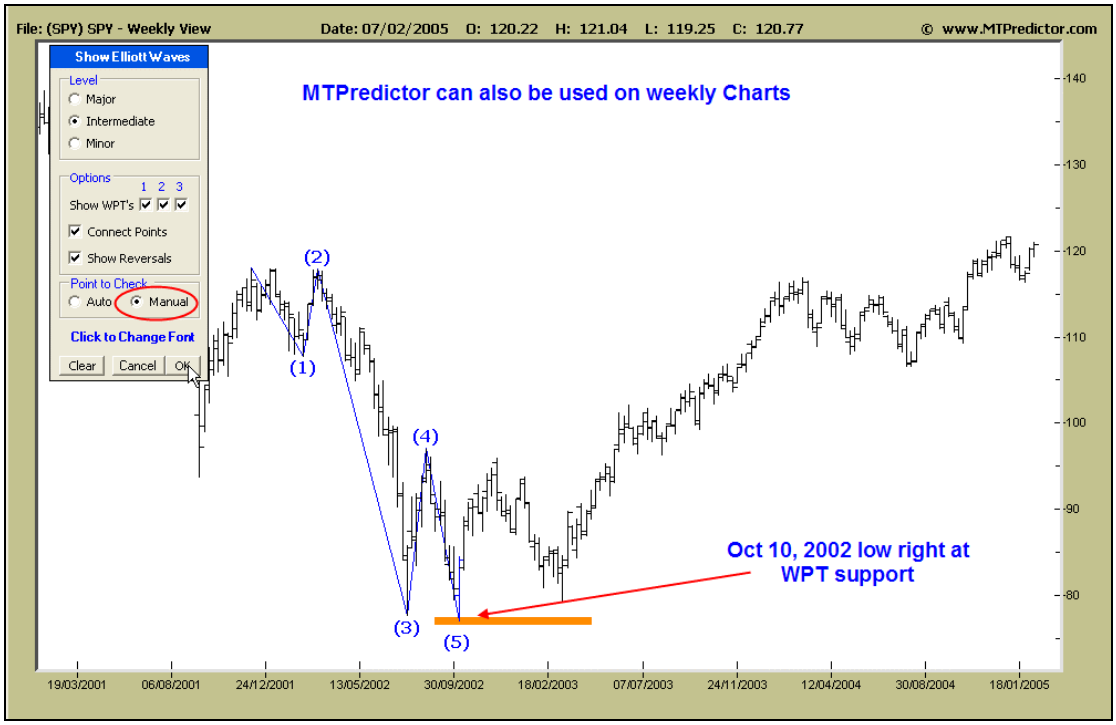
This is where the professional trader has a huge advantage over most new (and inexperienced) private traders. They fully understand that to make money over a period of a year does not mean making trades every day, or even every month. They fully understand that to make a profit at the end of a trading year needs the patience and discipline to wait for and only trade the best set-ups, which may mean only participating in and taking full advantage of one or two major moves during that year.

The statistics on the number of private traders that fail in the markets every year are alarming. One of the main reasons for this is over-trading, and the belief that there is one Holy Grail or perfect market technique that can predict with complete accuracy any future market movement. If you stop and think about this for a while, this is a pure gambling mentality and complete nonsense. If there were one Holy Grail, then some of the highly paid institutional traders would certainly have found it by now. If you look at most of the successful traders throughout history and those who have made the most money, one consistent theme links them all - the ability to keep their losses small in relation to their profits. Once you understand that this is the real Holy Grail and accept that you *will* make losses, but the trick is keeping the losses small (and stop looking for that one method which avoids all losing trades) then the sooner you will become a profitable long-term trader.

This is what the MTPredictor approach to the markets is designed to do - in particular, the three standard trade set-ups are designed not to predict or forecast any future market movement but to allow you to enter a new trade with a small controlled risk. And, more importantly, to keep the inevitable losses (and there *will* be losses) small in relation to the profits over time. This is the key to a profitable long-term approach to the markets - the real Holy Grail.

However, MTPredictor does not stop there, Part 2 of the Trading Course takes you to new and more advanced levels with the MTPredictor software.

For example utilising the **Show Elliott Wave** module to identify additional Elliott wave patterns, for example, the end of the Wave 5 swing



Here the automatic routines nailed the exact low of the Oct 10, 2002 low.

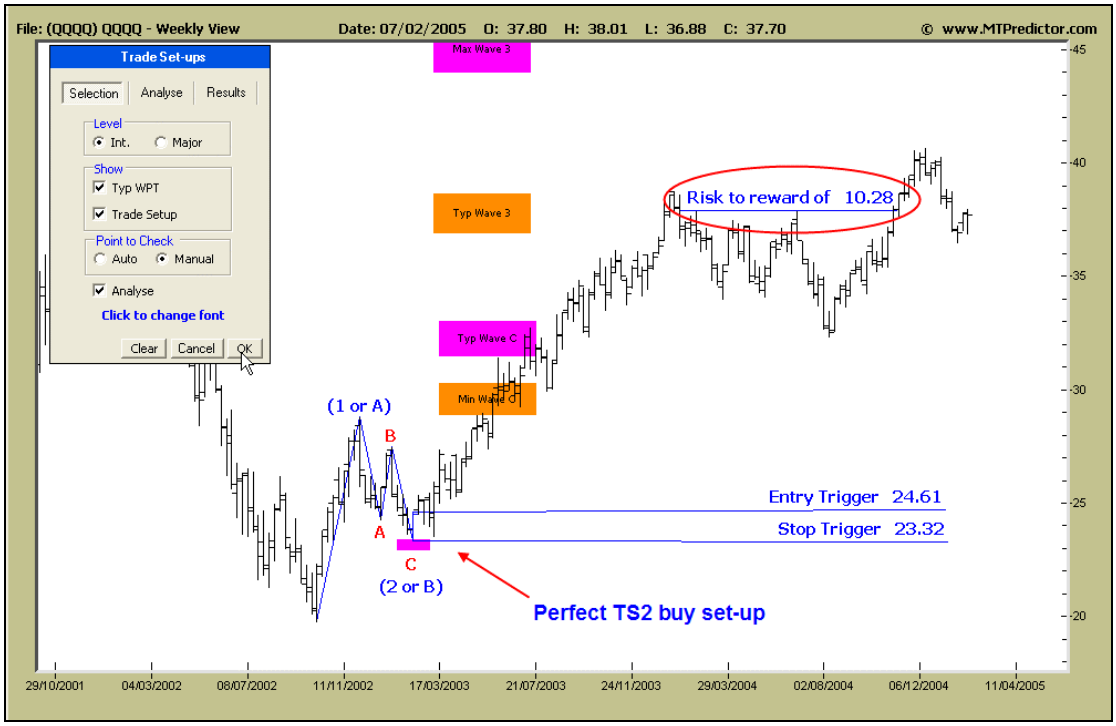
Part 2 of the Trading Course will teach you when to, and more importantly, when not to, trade off the end of a Wave 5.

As you can also see from the above Chart, Part 2 of the course looks at weekly charts and shows you how to incorporate these into your trading plan.

Please see the next page for another example on a weekly Chart.

Continued on the next page . . .

Here is a perfect TS1 buy set-up on a weekly chart of the QQQ:



As you can see, the automatic routines work in exactly the same way on weekly charts, as they do on Daily Charts.

Part 2 also takes you into the area of manual analysis. This is where you apply the same strict guidelines for trade identification, but you utilize the individual modules in the software to analyse a *manual* trade set-up. This is where you identify the ABC correction yourself by eye. Please see the chart on the next page.

Continued on the next page . . .

Here is a great example of a manual short trade on a 5min chart of the FTSE Index.

As you can see, this looks like an automatic TS3 sell set-up with a red (sell) reversal bar unfolding at WPT resistance; the only difference is that you identified the ABC correction manually. As you can see, this trade resulted in a profit of just over 8x the initial risk (ignoring slippage and commission)

Part 2 of the trading course teaches you how to do this, thereby allowing you to identify additional trades above and beyond the standard and automatic set-ups.

This brings me on nicely to intra-day trading. Part 1 focused on manly daily charts, but the same techniques (both automatic and manual) can be applied equally well to short term intra-day charts, please see the example on the next page.

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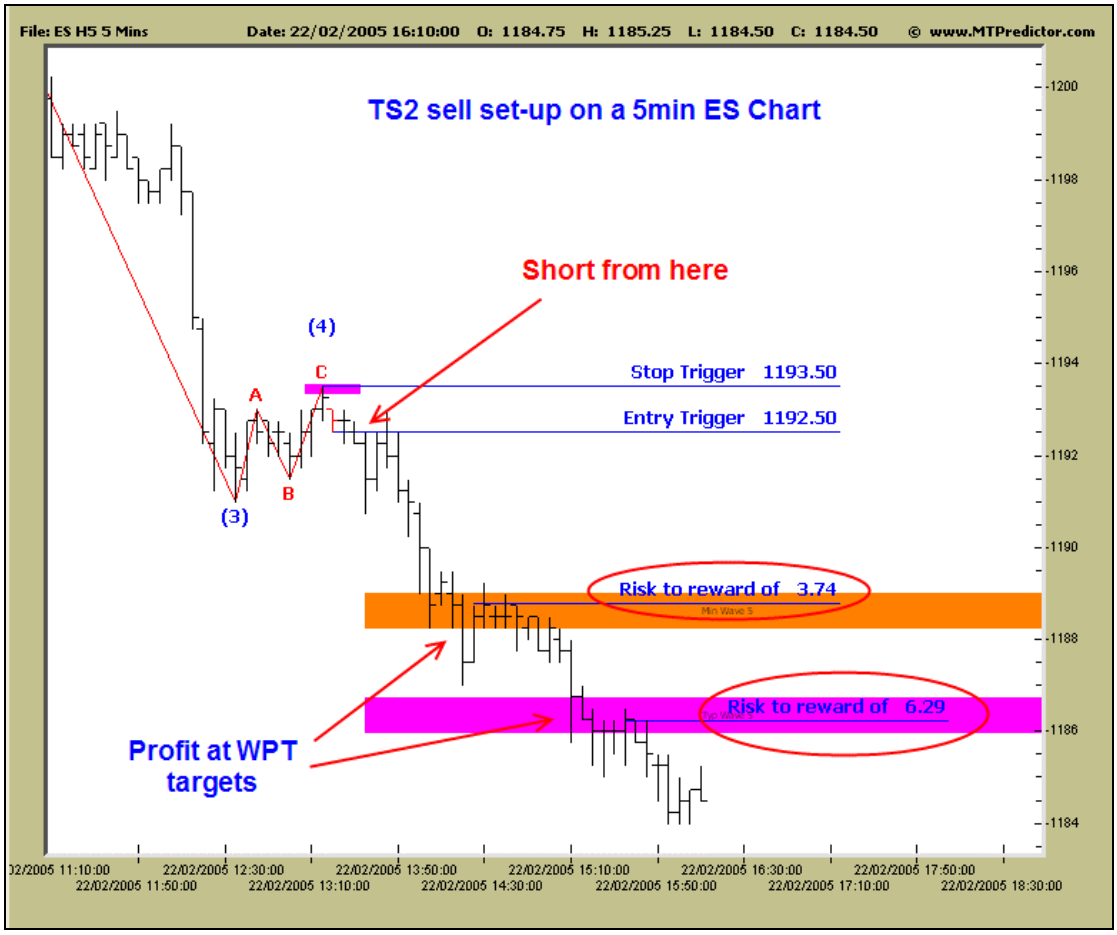
Here is an example of a short trade on a 5min ES Chart:

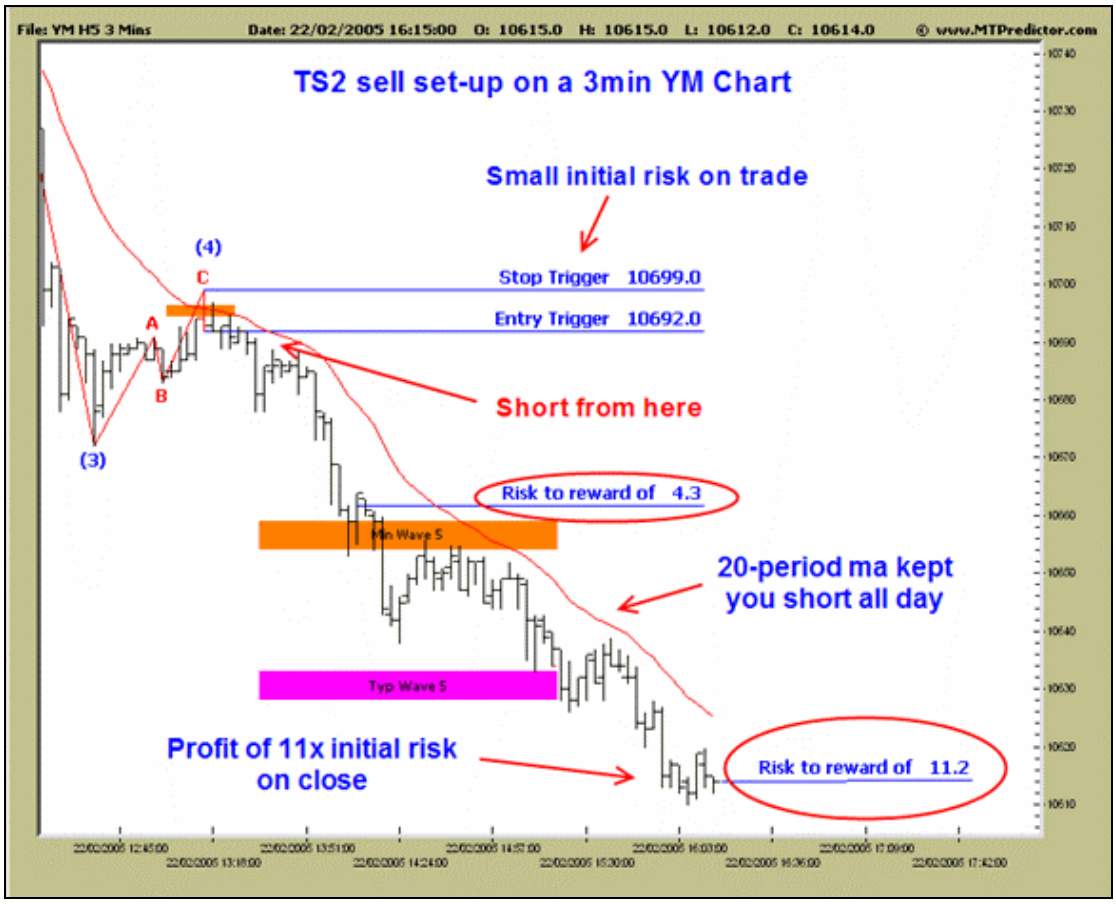


As you can see, this is a standard TS2 sell set-up managed according the standard trade management guidelines. Just that the trade was on a 5min chart rather than a Daily chart.

Part 2 of the Trading Course covers also covers many advanced techniques that not only allow you to identify additional trade set-ups but allow you to manage your trades to take account of the larger degree trend. One example of this is using the 20 period moving average when your short-term (e.g. 5min) trade is in the direction of the main (60min) trend. Please see the chart on the next page.

Continued on the next page . . .

Here is an example of an advanced trade management technique using the 20 period moving average:



As you can see, this kept you short for the balance of the day, resulting in a profit of approximately 11x the initial risk (ignoring slippage and commission.

As you can see, there is far more to MTPredictor than you have seen so far in Part 1 of the Trading Course. Part 1 is designed to build the foundation of a solid trading plan utilising the 3 standard trade set-ups. Once you become familiar with these, you can start to move up the techniques curve™ and make full use of all the routines and modules in the MTPredictor software program.

MTPredictor is not just a black box that spits out automatic trade set-ups, in the hands of an advanced trader MTPredictor becomes a very powerful trading software program that is capable of uncovering and then managing additional trade opportunities.

Chapter 10 – Summary

The contents of Part 2 are as follows:

As you can see, there is far more to MTPredictor than the standard 3 trade set-ups.

But for now, it is important that you fully understand and master the techniques covered in Part 1. These will allow you to use with proficiency the 3 standard trade set-ups as automatically found by the MTPredictor software program.

Thanks, and good trading

Steve Griffiths