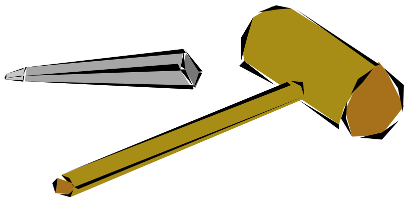
LXXVI
76 Rules of Millionaire Traders



by Merrill J. Oster, Chairman

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Successful traders discipline themselves to follow a set of rules. Some of the rules in this list have been used by the masters – including Charles Dow who in 1884 began discussing the Dow theory of price trend analysis. Others have been used by the commodity trading masters like Rich Dennis in the late 1990's. These rules transcend stocks and commodities and they cover the three major areas of concern to a trader; price forecasting, trading tactics and money management. They cover both fundamental and technical considerations. These rules represent the best wisdom of dozens of millionaire traders gleaned from interviews with the pros themselves or through research into the history of "trading legends."

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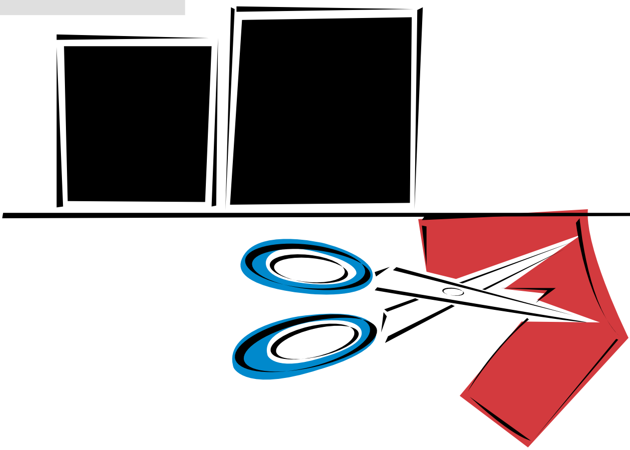
1 Cut Losses Short; Let Profits Run

Since this is the “golden rule,” dump an 8-12% loser.



Bernard Baruch, a famous investor said, “If an investor is right three or four times out of ten, he should do well if he has the sense to cut his losses quickly.” One of the oldest rules in stock trading is to cut losses short and let profits run. Protect your capital by knowing how much you’re willing to lose on any given stock. The smaller the loss you are willing to accept, the more likely you are to get "whip-sawed" in short-term market declines. But, it is better to get “whip-sawed” than to get “wiped out.” It is too late to set your investment parameters after you have already lost 15% or 20% of your stock’s value. At that point emotion takes over, and fear drives your investment decision-making process. Fear and greed are the two big enemies of the stock or futures traders.

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Buy High, Sell Higher

Buying into market strength is counter-intuitive to the "buy low, sell high" market.

One favored trading strategy is to buy a stock or commodity after it has broken out on the upside of a resistance or "congestion" area. This occurs when a stock or futures price has traded in a "sideways" pattern and then pushes above the top of the recent trading range. This is a powerful signal that the investment has some significant upside potential. The trading rule of "buying into strength" is followed by many of the most successful traders. This tenet runs counter to "bottom-picking" philosophy – or trying to buy at bargain-basement prices.

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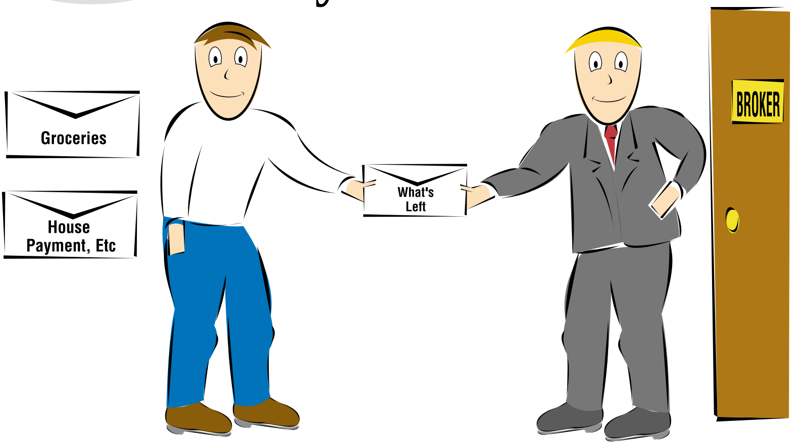
Risk Only What You Can Afford To Lose

Make sure the only money you expose to the market is discressionary funds.



Trading with money you can't afford to loose puts too much pressure on your decision-making process. It is a dangerous game to look at markets to solve financial problems. Near the end of every major bull market in stocks and futures unqualified investors get the idea that buying anything can make money. Such "exuberance" frequently leads novices to invest in trades that are merely speculation, and can cause them financial setbacks they are not prepared to accept. The highly successful investors have a very disciplined approach to trading, which includes only investing money in the stock market that they can afford to be without. Stock and commodity markets are risky. In any given year it is easy to find stocks that have lost 75%-90% of their value. And, in the case of highly volatile commodity markets, you can lose more than your original investment.

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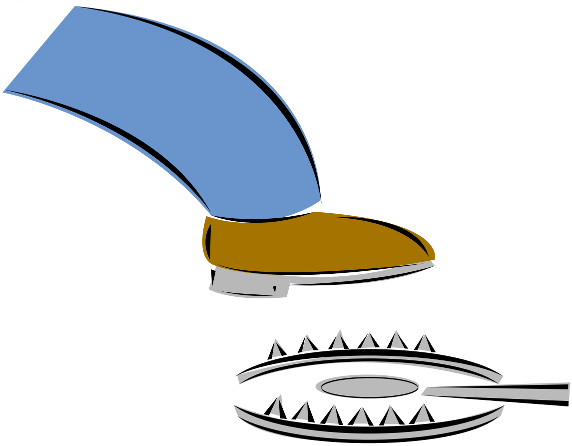
Avoid The Trading Trap

Day trading is entertainment. Position traders build wealth.



Many traders have day-traded and invested for years, with millions to show for long term investment decisions and only a few thousand dollars of losses to show for day-trading stocks and commodities. Create a trading bias for making a few big decisions every month, instead of betting on a dozen “hunches” every day. If you have the appetite to be a daytrader, limit how much you will lose in any given year. Don’t feel bad if you can’t make it as a day-trader. Some of the most successful stock market investors we’ve interviewed say they are totally unsuccessful trading the market on an intra-day basis. A good day-trader must have access to excellent execution and low commissions to have a reasonable chance at success.

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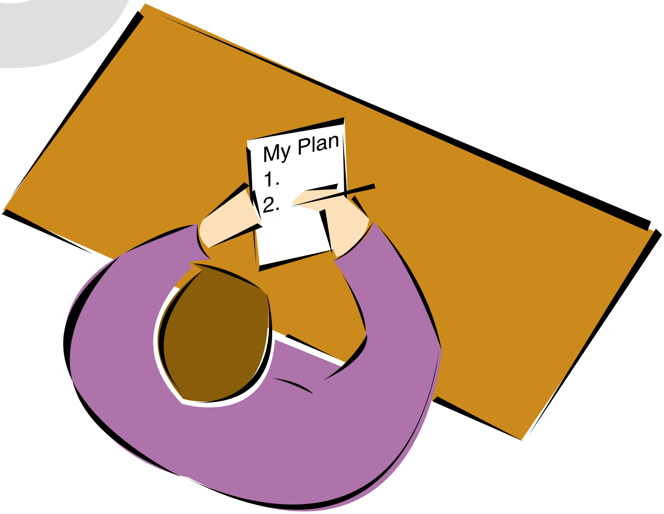
Create A Trading Plan

Test your plan. Then, stick to it.



Your trading plan should clearly state your objectives. For example, are you willing to take high risks, or is it your objective to be a more conservative investor? The plan should state the percentage of your total financial portfolio to be invested in various types of assets and the amount of loss you will take on any one trade. When you reach that point, get out. Your plan should include what methods you will use to enter and exit the market. Decide what percentage of your portfolio you hope to hold for the long run – one to five years. Decide what part of your portfolio you plan to position trade that you might hold for one month to a year. Decide how frequently you will trade and what, if any, of your capital will be used in day trading.

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Let The Market Come To You

Enter with buy stops $1 over the market.

Let the market time your entry into a position by putting a buy stop $1 or $2 over its current trading price if you are buying stocks or 1% to 2% above the market if you are buying or selling a commodity. That lets the market, itself, verify to you that your research is correct, that there are more buyers than sellers, and that there are others who are investing at the time. Frequently, the market may move $3 or $4 lower and you will have an opportunity to move the trailing stop down and buy it for even less money. This rule, if followed regularly, assures that you are buying on daily strength. If your research indicates you should buy, take a look at the day's range and place your order one dollar higher. If you happen to be wrong and the market goes down, you can continue to move your buy stop to a spot just above that day's close, and continue to do so until you are finally "stopped in" to a position.

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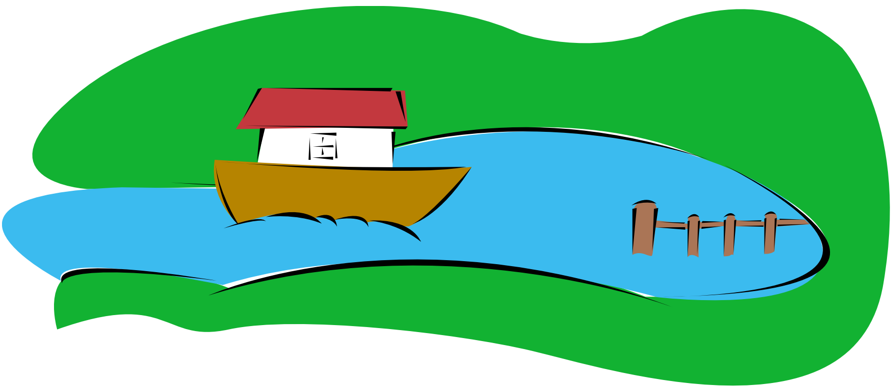
Safe Harbor Your Profits

Don’t expose all of your profits to the market. Buy real estate or some liquid asset with part of your profit.



If you started with a $100,000 portfolio that is now worth $200,000, you may want to consider putting some of the profits in a form that can’t be taken back by the market. Moving some of your profits into bonds or real estate is a good way to diversify. And, diversification is one way to avoid net worth meltdown in the event of a major market crash.

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Take Unexpected Quick Profits

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

Long-term investors know that quick profits are usually very susceptible to quick erosion. That's why if you take a position that moves far beyond your investment objective in a few weeks or even in a few months, you may want to move your quick gains into another financial asset. Greed tends to cause us to add to our position if it becomes profitable quickly. If you have the discipline to do just the opposite, you are probably moving in the opposite direction of the masses.

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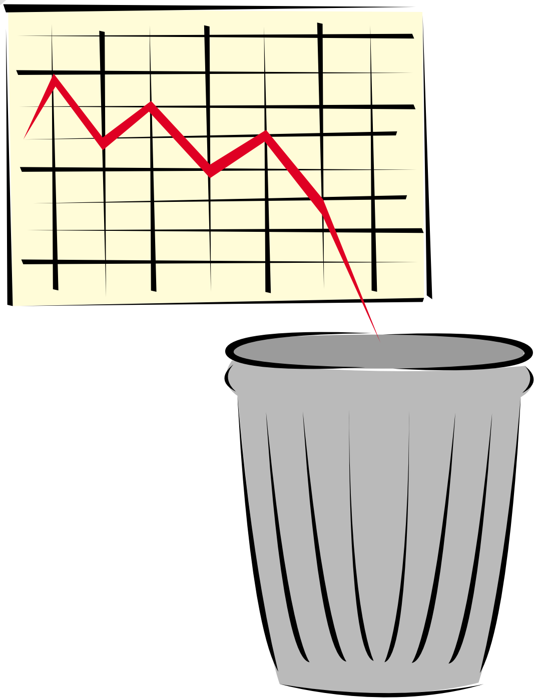
9 Add To Winners, Not Losers

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



Some people think it is a good idea to add to a losing position by “averaging down” the price. This means that you are already locked into a loser, and you are doubling your potential trouble. Wise investors add only to winning positions. If you have a loser, it is much smarter to cut your losses. Losers should be dumped.

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Don't Over-Trade

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

Over-trading is an expensive process because you tend to confuse yourself and create huge commission expenses. Millions are made by traders, but billions are made by those who invest and hold. One exception to this rule is the experienced trader who knows what he is doing and consistently makes a profit by taking positions, cutting his losses short, and moving as quickly as a rabbit. Short term trading for small profits, sometimes called scalping, is a specialty, and if you haven't been trained for it, it's too risky.

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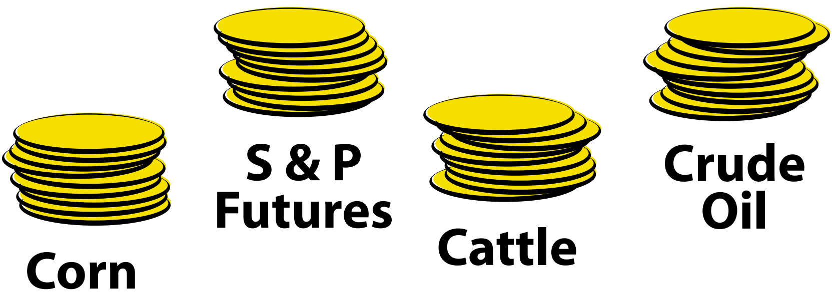
Take A Few Big Risks

Put 5% of your risk capital on wild possibilities. But don’t "bet the farm" on those long shots.



In a portfolio of 10 to 20 positions, most of them should be stocks or commodity positions that you have purchased because of a combination of careful fundamental and technical signals being triggered. If you want to take a “long shot” in a market you know little about, protect yourself with a stop loss order.

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Know Yourself

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

Your ability to take risks is based on your financial status. If you have $100,000 net worth, obviously you're on the edge if you trade more than 20% of your total net worth in single stocks or commodities trade. The propensity for risk is based on your internal make up. If holding only $20,000 worth of a stock makes you nervous, you probably should be in mutual funds. If you have the ability to assume risks you are more likely to be successful as an investor – someone who takes positions and is able to hold them for a long period of time. And, if you have the energy and ability to make all the quick decisions in a day's time and can reverse yourself quickly, you might have the make-up to be trained as a day-trader. But day-trading exposes you to a different set of risks than position trading.

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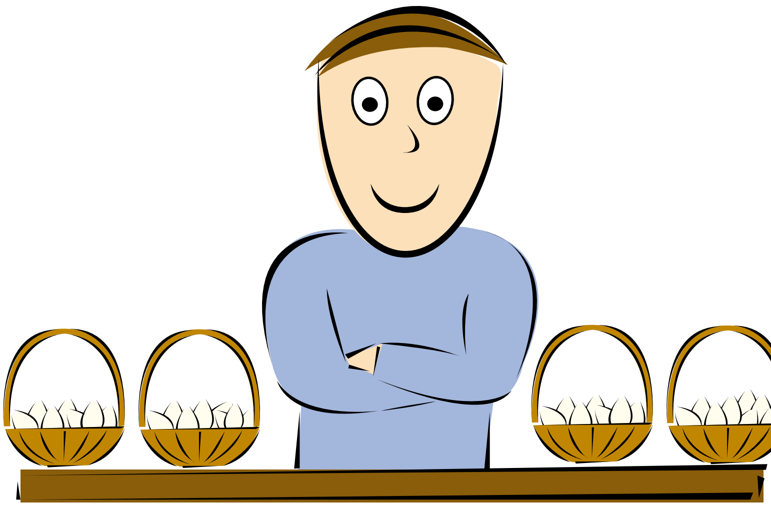
Don't Put All Your Eggs In One Basket

Own 25 stocks over 5 sectors. Spread your risk. Spread your commodity risk over several unrelated markets.



Don’t use 25 stocks as a hard and fast rule. The number is just an example. If you have $100,000 to invest, it’s a good idea to spread your risk over 10 stocks or four commodity positions protected with “stop loss” orders. By spreading your risk over several sectors and several stocks, you reduce the chance of a general market downturn taking a huge percentage of your equity away from you.

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Take A Trading Break

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

Everyone gets tired from trading too frequently, from constantly watching the market every day. It is a good idea to take a complete break from trading for a period of time. Tighten up your stop losses, and take a vacation. Let your broker do the worrying for a while. Or, just liquidate and start over later.

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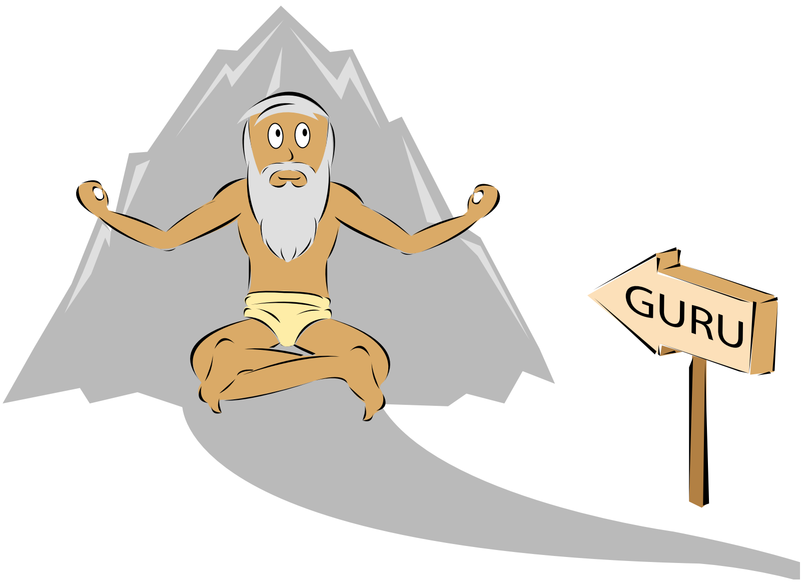
Seek Wise Counsel

Then get a second opinion.



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

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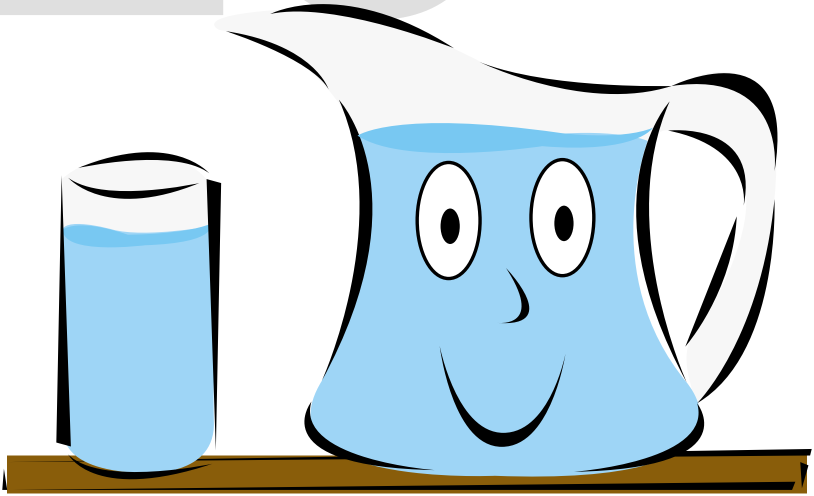
Stay Liquid

Avoid big positions in low-volume markets.



It is easy to check how many shares of a stock traded in yesterday's trade. If it only traded 1,000 shares, and you are thinking about buying 1,000 shares, you have a pretty good clue that your position would become a market factor if you tried to sell it in one day. Such a limitation can put you at a real disadvantage. If, for example, your technical chart signals tell you to sell, you may want to sell everything immediately. If you happen to be in a low-volume stock or commodity, the penalty for selling immediately could be another 10%-15% lower price. So, your position needs to be judged against the average daily volume. For most investors, it is just not worth trading where there isn't good liquidity. That means a daily trading volume of 100 to 200 times your position.

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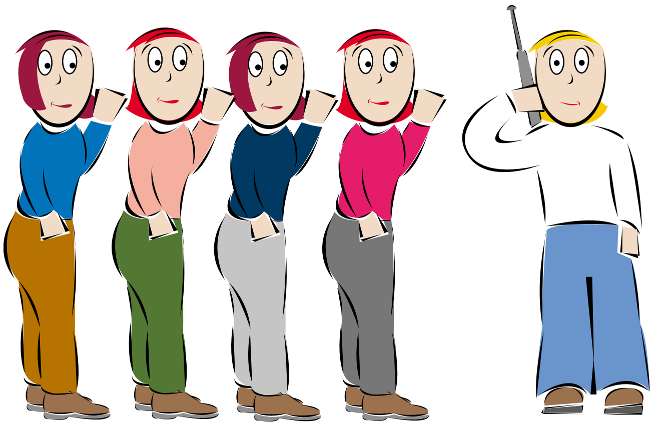
Buy The Rumor, Sell The Fact

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



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

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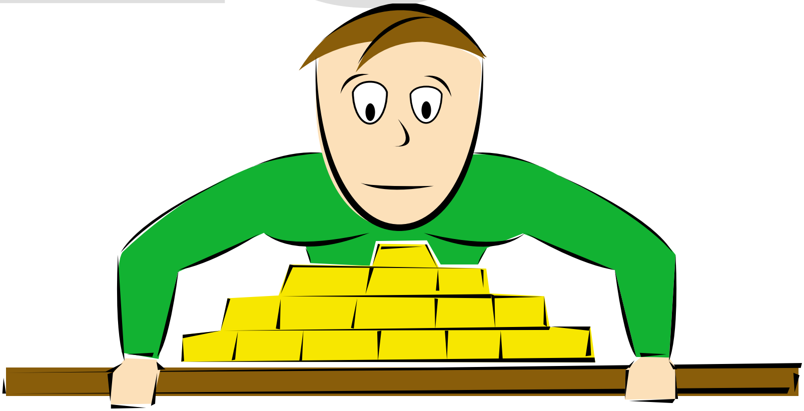
Keep An Eye On Gold

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



Using gold as an inflation rate indicator has since fallen into disfavor among many people. But it is a good idea to take an occasional look at the price of gold. Check out the reasons why gold is making its move. For example, in September of 1999 when gold ran from $250 to $300, there really wasn't any new fear. That move was based entirely on Western European central banks deciding not to make any additional gold sales. That message sent by the central banks caused the price of gold to go higher; it had nothing to do with inflation. If, on the other hand, gold would have moved $50 higher and there was no fundamental information, that could have been indicating a "flight to quality" and could have been a signal to lighten up on your equity positions. "I know of no single variable that is as reliable as gold in predicting inflation," says John Ryding, senior economist at Bear Stearns. Gold can either be a bullish or bearish factor for an individual stock, depending on the circumstances.

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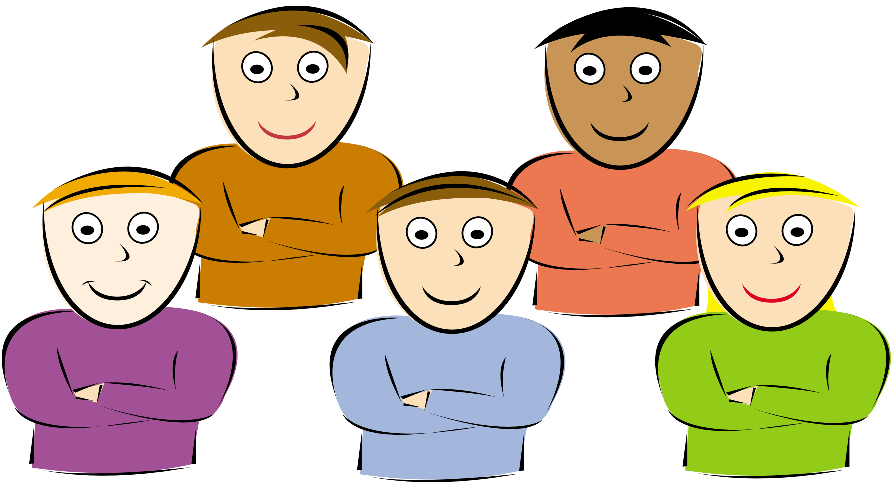
Keep Positive Company

Positive people impact your attitude and attitude affects your confidence.



To keep a positive mental attitude you need to believe in your ability to make good decisions when you are investing in the stock market. If you are around negative people who continually make excuses, blame the government, and have an attitude of hopelessness, it can affect your own trading ability and confidence. Avoid these kinds of people and instead seek advice from those who are more positive.

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Don't Be A Pig

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

Pigs in the marketplace are those who get aggressive and double their positions at the top of the market. They allow their emotions to run. When they should be taking some profits off the table they add to their positions in hopes of "getting rich quick." It is a much better strategy to be a cautious investor who is always looking for ways to make some profit and put it into a safe harbor. The consistent use of chart patterns such as trendlines that aid you in these decisions can be of big help. But the warning is to watch out for greed, because it will eat up your equity.

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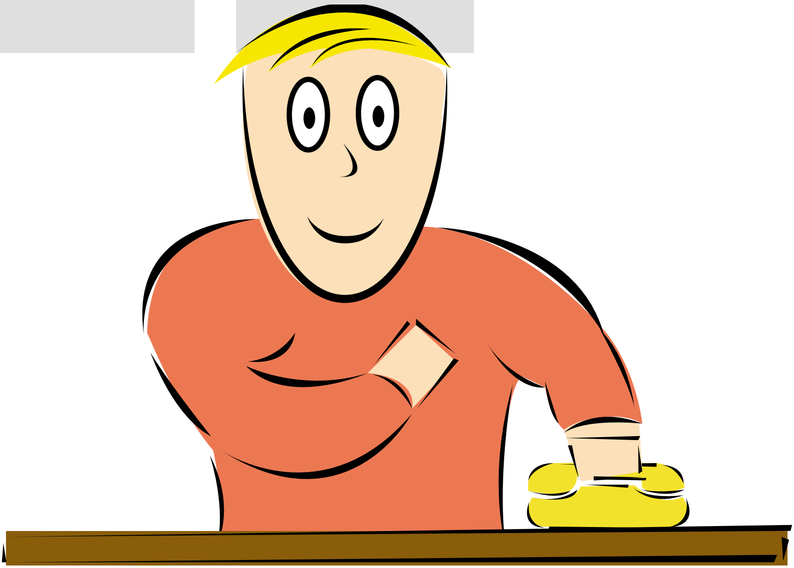
Go With Your Gut

Sometimes. Not all the time.



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

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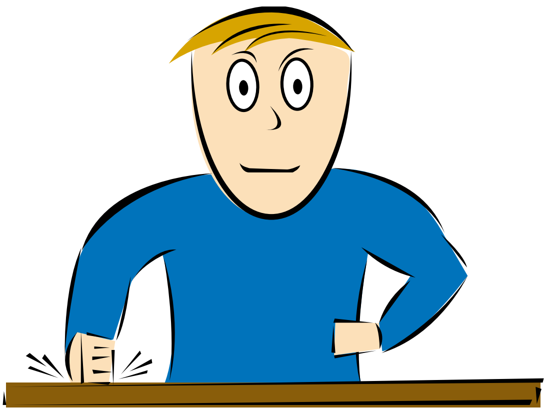
Buy What You Believe In

If you find a piece of software you like, check out the company behind it. Watch what your own family and friends are buying.



One of the best ways to get a clue to impending higher earnings is to check what is happening in the consumer market to see who is buying what. If there are consistently long lines in the parking lot waiting to get in to Costco or Home Depot, and the shopping carts are full as people leave, it is worth checking out the earning history of the company and perhaps your parking lot clue could lead to a wise investment. Also, keep an eye on what teenagers like and are wearing. They represent a new huge consumer market that can help direct a portion of your portfolio.

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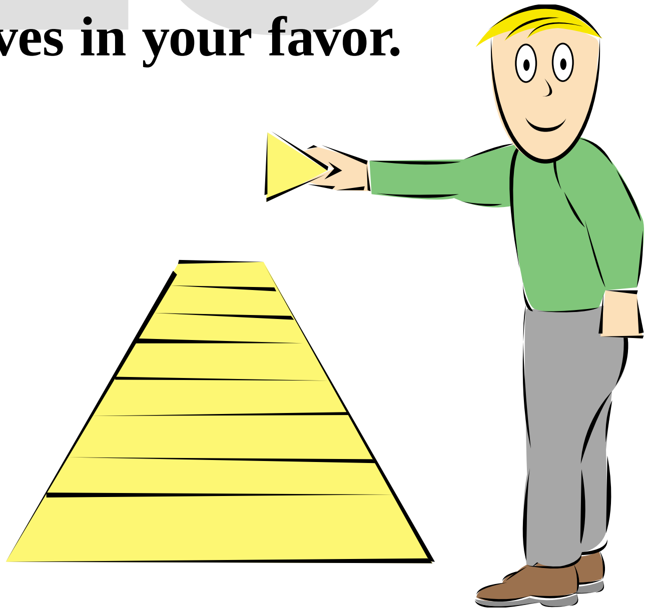
Buy Big, Add Small

Build a trading pyramid by laying the base investment, then making incrementally smaller additions as the market moves in your favor.



Your trading pyramid should look like a solid base representing your original investment with a little bit of investment left at the very top. This simply means that if you were buying a stock priced at $100, you might buy 40% of your intended position, if the stock goes to $110 you might add 30%, if it goes to $120 you might add another 20%, then finally add the last 10% when the stock goes to $140. Then, you hang on and use a trailing stop or a trendline to help give you the clue to help lighten up and begin taking your profits and moving the money into another winner that has similar potential.

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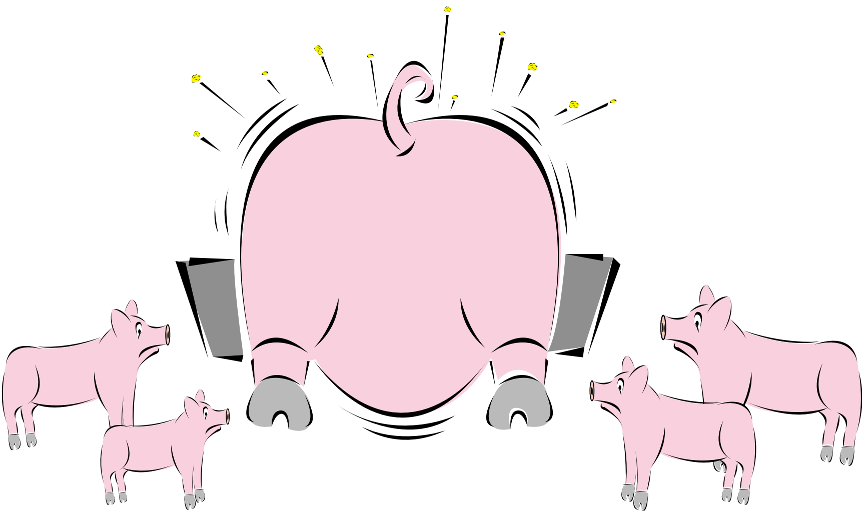
Let the "Fittest" Trades Survive

Sell the weakest positions in your portfolio, even if they are winners.



One millionaire fund manager we interviewed, Foster Friess of Brandywine Funds, uses a “pigs at the feeder” theory of investing. The strongest pigs tend to push the weaker animals from the feed. So, this farm-boy-turned-stock-expert feeds strong stocks more cash and dumps weak ones. “Starve the weak stocks of cash and give it to the strong ones.” Add to winners’ positions as the stock price moves higher, says Friess. That idea works just fine if you don’t “double up at the top,” in which case a small move down in price erodes accumulated equity very rapidly.

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Stay Humble

A cocky attitude is a prerequisite for making bad investments.

Sometimes early, quick success as a trader gives rise to a trading attitude of arrogance. Such a thought process can lead to over-confidence and develop into careless trading patterns. Until you have two or three years of successful trading, which means outperforming the NASDAQ or the S&P general market indicator, you really have no reason to get puffed up. In the long run, the market can be very humbling. An ancient book of wisdom says, "Pride cometh before a fall."

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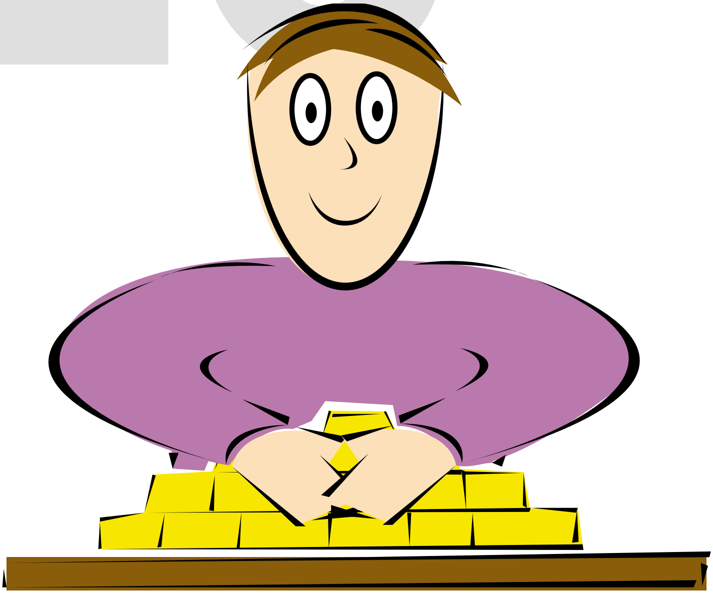
Few Favorites

Try to avoid a short-term mindset on more than 20% of your portfolio.



Some of the largest gains in stock market history have been held by investors for five years or more. In the long run, more money has been made “sitting” than by “strategizing and trading.” This rule applies to commodities, but on a much shorter time frame – hold good commodity positions for several months.

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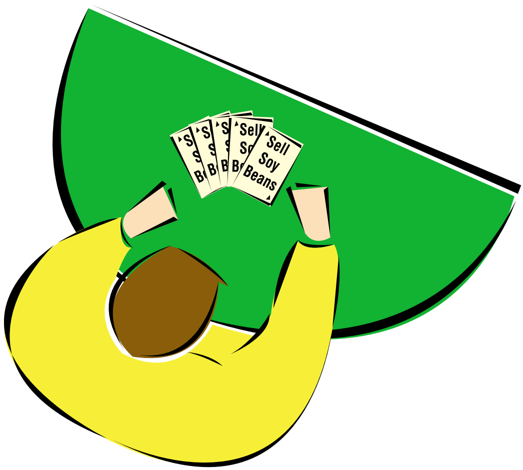
Know When To Hold And When To Fold

When you don’t get what you expect, move on to another investment.



If the trade you have made hasn’t made any kind of a move or has moved slightly against you in the first month of ownership, replace it with another transaction in your portfolio, and put the original trade on your “watch” list. Time is money in any business, so impatience with a stock or commodity position going nowhere is as important as having patience with your big winners.

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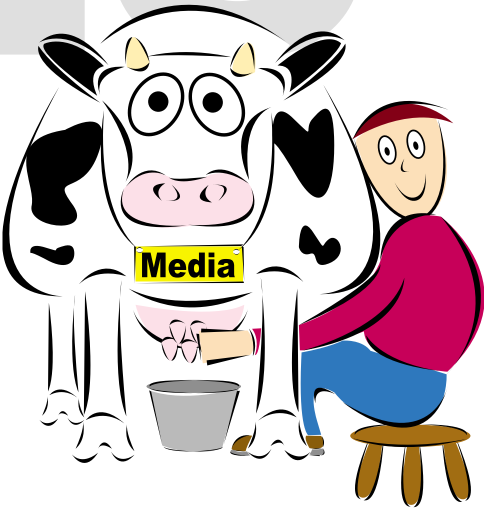
Milk The Media

Get good ideas from smart people. Some of the smartest people spill their best research in public.



If you have time to invest in media watching start with the Wall Street Journal, Barrons and Investors Business Daily. If you have time to watch television, keep an eye on CNBC. In commodities, read the daily news stories from global sources like OsterDowJones Commodity News. It is consistent with human nature for an expert to want to look good in the eyes of the public. Therefore, when he is speaking before a large audience or is being interviewed by a business journalist, the analyst is likely to reveal the results of his best research. Experts being interviewed on television are likely to give you their very best stock picks. Sometimes this public information can be very valuable, but it should be accompanied by a good analysis of price charts and fundamentals on your own before you blindly make a trade.

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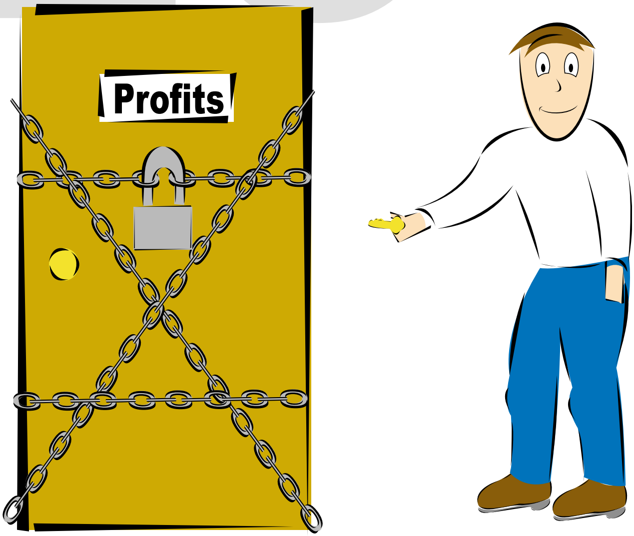
Use Trailing Stops To Lock In Profits

But use fixed stops to get out of losers.



A trailing stop is one that is moved each time the market goes higher. Let's say you decided on a five dollar trailing stop on a stock that is priced at $100. Your stop-loss would be set at $95, initially. If the stock moved to $110 you would move the stop to $105 by placing a sell order at that point. If the stock moved down to $105 you would be stopped out with a winning position. That is how you protect profits. However, in using stops to get out of losing positions, it is best to decide on a fixed amount of money you're willing to lose, then refuse to move the stop any lower. The same principle applies to commodity markets which are usually more volatile than individual stocks.

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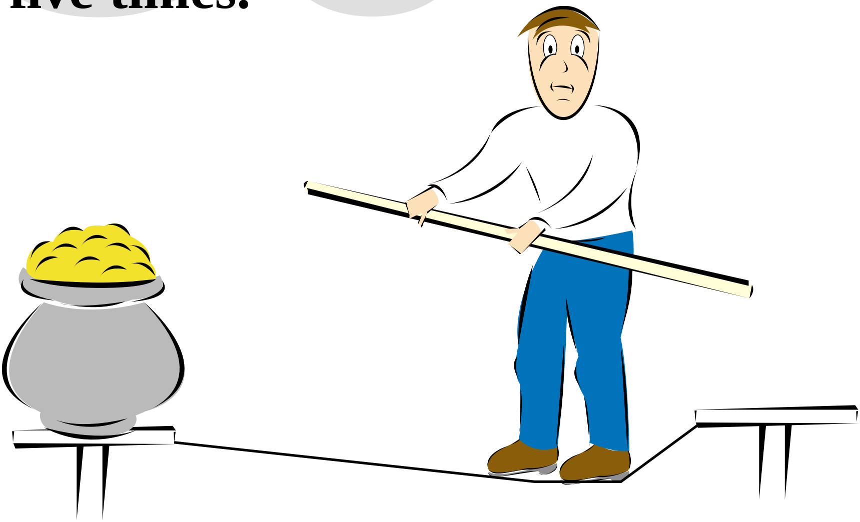
Measure Your Risk/Reward Ratio

Only invest when the expected reward exceeds your risk by five times.



If you're limiting your risk to 10% on any trade, you should pick one that has the potential to move 40% or 50% higher. Trades that have the potential to move 40% or 50% higher are usually those that are "breaking out" of one of the classic charting patterns.

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Hire An Expert

Compare your investment results with "hired management."

Millionaires use private bankers and mutual funds for part of their portfolio. Confident brokers, advisors who publish newsletters and brokerage house analysts can all be considered expert resources. However, take personal responsibility for your trading. That means when your "expert" gives you a good idea, you check with some of the rules in this list to use if you agree. Another type of expertise is trading execution. Getting good trades execution is particularly important if you trade often – and vital if you are a day-trader.

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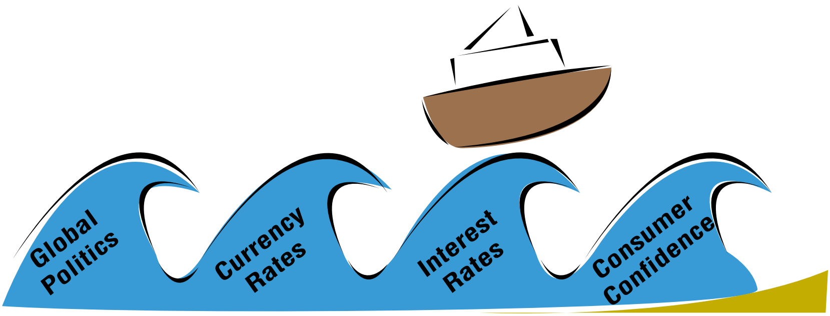
Trade The World's "Power Waves"

A few huge trends drive corporate growth and commodity supply/demand.



There are always a certain number of "megatrends" that power stock and commodity markets in one direction or another. These trends are monitored by strategists who take a longer view than analysts who look primarily month-to-month or quarter-to-quarter. One such strategist is Harry Dent, author of *The Booming 2000*. He believes the power waves that will push stock prices for the next several years are population driven, due to the fact that a large number of baby boomers will be entering their retirement years. This means their purchases for retirement real estate will be abnormally high relative to long-term trends. Another current wave is the move toward E-commerce. Companies that can capitalize on these waves are likely to grow at a rate two or three times faster than the general market. Interest rates, global problems, currency moves, inflation ratio, and consumer confidence are other "power waves" that can influence all markets. Tap into FuturesMegaTrends.com for an update from the OsterDowJones staff on major shifts in these global trends.

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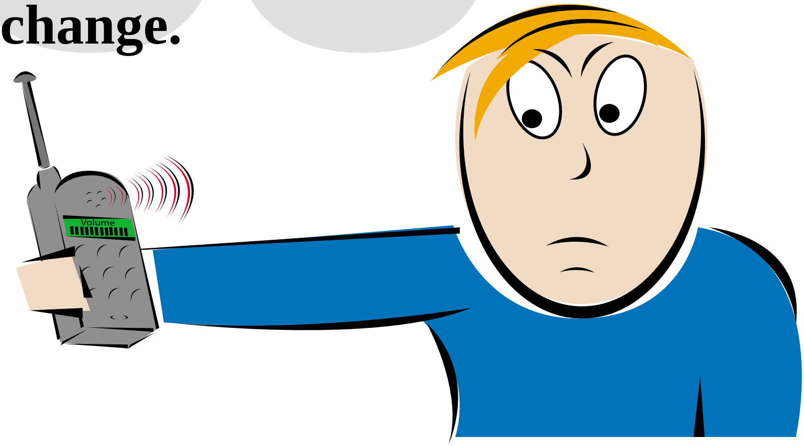
Trade The Volume Signs

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



A huge increase in volume, such as a stock or commodity contract trading at twice the normal volume on any given day compared with its previous month's average, can be a strong technical signal. If the increase in volume takes place at the time a market is breaking a trendline and tending to move higher, chances are it will move much higher. If a stock pushes to a new high on very light volume, it is a signal there is not much conviction behind the up-move and that buying interest may be waning at higher prices. This could mean a top in the market is close at hand. A strong move lower on heavy volume is a bearish signal, and could mean that more price weakness lies ahead. Conversely, if a stock moves to a new low on very light volume, it could mean that a turnaround is imminent. It is difficult to take a trading signal from a volume alone. Such information should always be accompanied by good chart analysis as well as an awareness of the fundamentals on that stock.

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Never Meet A Margin Call

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

If you put $100,000 in a brokerage account, your broker will allow you to buy $200,000 worth of stock. In a commodity account you can own $1,000 worth of commodity for a deposit of only $50 to $100. Such margin buying puts you at a very high risk. If your investment goes down you may get a "margin call." If you do buy stocks or commodities on margin, a rule of thumb used by successful investors over the years is: "Never meet a margin call. Sell out instead."

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Sell A 20% Rally

After a price breaks out of a congestion area, it usually rallies 20%.

$5.00

$4.80 Sell X

Buy 5 XXXXX $4.00

That's a good time to take some money "off the table." If you consistently take profit at 20% and cut losses at 8%-12%, you go home a winner if only half your stocks are good picks. However, you don't want to take all of your money away from a trade just because it rallies 20%. To be highly successful as a trader, some of your trades must show gains of 100% or more over a period of years. This rule is best used by the person who is an active trader. The active trader will sell a 20% rally in hopes that the stock will break and he will be able to buy it back for less and rebuild his position in that stock.

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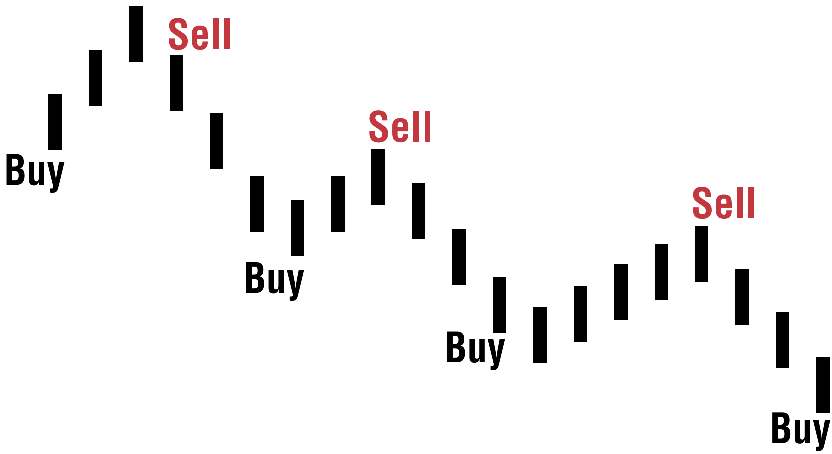
Buy And Sell Trading Ranges

Some stocks tend to operate in a trading range for a period of time.



Buy when a stock is in the lower one-third of the range. Sell in the upper one third. When the stock breaks out of the trading range, move aside unless you have some other price clue working.

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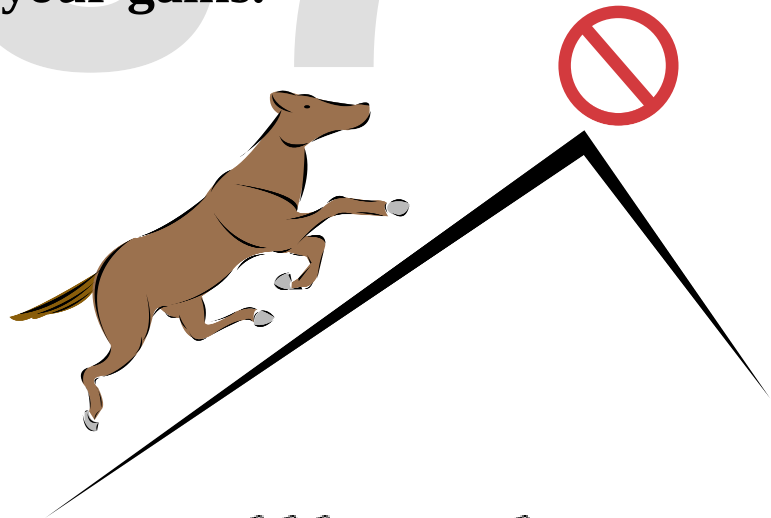
Never Let Winners Turn To Losers

Use stop-loss orders to protect your gains.



If a stock has gained 20% or a commodity trade has earned a 20% return on invested equity, either sell some or move your stop-loss up to the point that you will make a small profit even if the market reverses. Once you have a profit in a stock, you never want to allow your trading techniques to get so sloppy that you allow it to turn into a loss. If a stock you purchase moves 10% higher, it is always a good idea to move your stop-loss order to your break-even point. Then, you have “free trade.” If it continues to go higher you have a winner; if turns around and it breaks lower, the worst that happens is that you break even.

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Walk When Masses Run

When all the news is bullish and analysts are following each other like sheep with buy recommendations – quietly head for the exit with some of your money.

Emotions drive markets to extremes, and at the end of those extremes powerful forces of fear cause lots of people to run for the exit door at the same time. Beat them to the punch. Sell “too early” and move on to another trade. You never go broke by taking profits too early.

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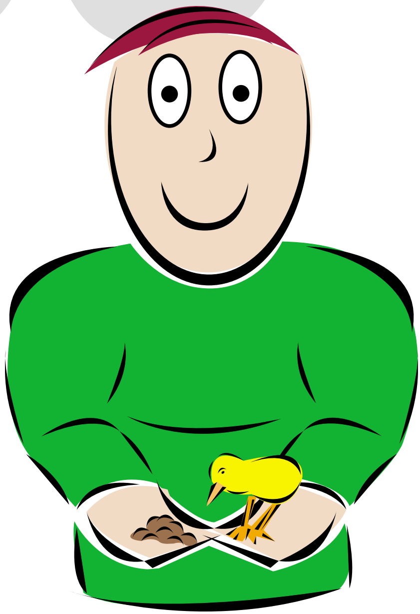
Be Patient

Major price moves need time to run.



Don’t take profits during the first 8-10 weeks of a move. Sometimes the stocks or commodities which double or triple in value make a quick 20% move in the first few weeks of a breakout. Quick power moves can’t always be trusted, however. That’s why a trailing stop 10%-12% behind the recent high can protect you. This is also why it’s a good idea to take some money off of the table once a trade gets a 20% return since you’ve owned it.

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Beware Of The Analyst Opinion

Analysts usually under-perform the S&P average with their investment picks.

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

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Don't Be Penny-wise And Pound Foolish

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

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

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Keep A Trade-Watch List

Keep track of 20 trade candidates by setting up a mock portfolio.

By watching your mock investments for a few weeks, some of the trades will outrun the rest. If one has gained 10%-15%, check out the chart formations. If it fits in your plan, make this leading candidate your next buy. This type of activity is sometimes called “paper trading” and gives you a chance to test out ideas without using real money.

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Use These Technical Analysis Trading Signals

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

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

The chart rules below are some of the chart analysis tenets that have helped thousands of traders and investors develop the discipline to grow small savings into large fortunes. There are literally dozens of technical trading rules that you can use to help you decide when to dump a stock. Pick from a large body of technical trading advice those rules which best fit your trading personality.
Then, stick with them.

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

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Trade Major Trend Breakouts

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

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

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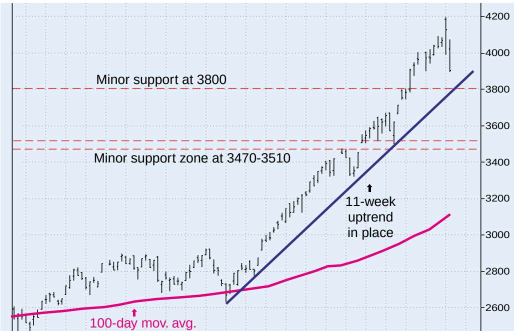
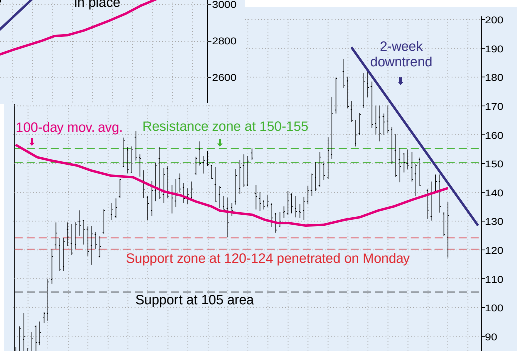
The Trend Is Your Friend

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





Buy in an uptrending market, using a 100-day or 200-day moving average as your guide. Charles Dow defined an uptrend as a price move in which each successive high and each successive low is higher than the one before. Buying when the major market indices are in an uptrend puts the risk-reward odds in your favor. Buying a stock or commodity in the early stages of an uptrend greatly increases your chances for investment success. Spotting trends also increases your chances for investment success. This is what technical price chart analysis is all about.

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Spot Trends Early And Ride Them

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

Big profits in stocks come from jumping in during the early stage of a trend, just after all the "bad veins" about the stock have been absorbed by the market. When prices break out of a "trading range" it may be a clue to a change in the trend. Buying at the early stage carries more risk than waiting for the trend to clearly identify itself, but that ride is longer and more profitable when you are right. Once a trade has received lots of favorable press and the public is fully on board, the speculative buyers create wider trading ranges, which can warn you of a "distribution top" which means it's time to find another trade.

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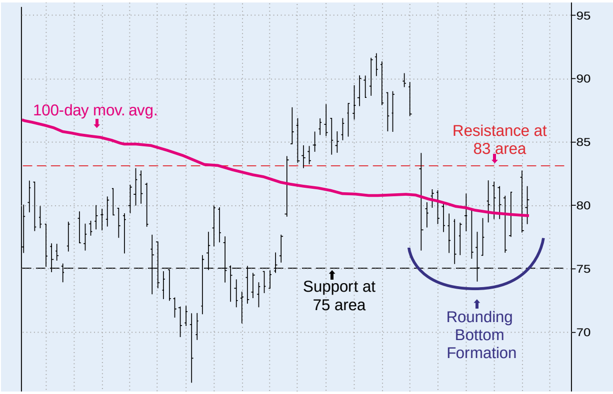
Saucer Bottoms Wake Up Bulls

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



Saucer bottoms and their invested cousins at the top of a market frequently present major moves. As a rule, the longer it takes to form the top or bottom the stronger the move. Sometimes the saucer will be interrupted with a price burst at the middle of the saucer. Usually, volume diminishes as the saucer is forming, then gradually increases as the new direction begins to take shape.

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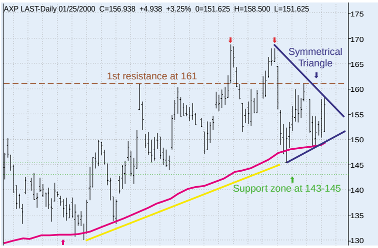
Sell The Big “M”

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



The classic double-top and double-bottom formations have been used profitably by successful investors for more than 100 years. The reason: they are the most obvious, easiest-to-read formations on a price chart. When a new high is made on increasing volume, followed by a dip on decreasing value, you have an early clue when the next rally fails to break the previous high; the “M” is in formation. Sell the second lower close below the previous low. When the market breaks below the first correction, your first sell signal is in place. If the succeeding rally fails, you can add to your short position. The reverse is true at the bottom of a move. When the market makes a high, then backs off for several weeks or months and begins to challenge its old high, you should watch that stock closely to see whether it breaks through the old high or stops and forms a double top. Some stocks form double tops and find such resistance at that level that they don’t make new highs again for several months or years. Wise investors take their money off the table on stocks as they approach a high the second time, simply to wait and see if it has the momentum to continue to go higher. Such action by nervous investors, in itself, can create a double top. If a market makes a third run at the high and fails, you get a very important sell indicator. Sellers love a completion of a triple top.

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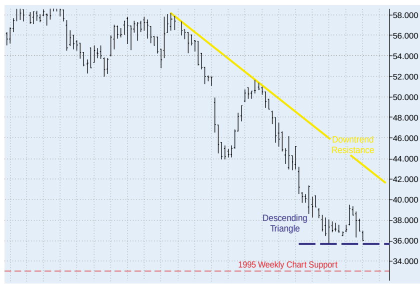
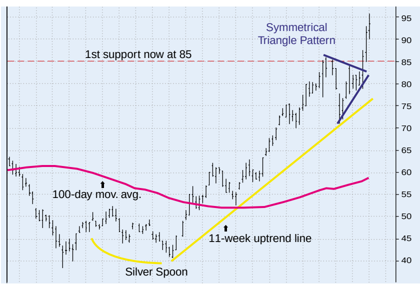
Triangles Are Good "Breakout" Forecasters

Right angle triangles can either be ascending – forecasting an upward price movement or descending – forecasting that prices may break lower. Symmetrical triangles are usually continuation patterns.



The key difference between the right angle triangle and the normal symmetrical triangle is that one side of the triangle is formed by a right angle. If the long side of the triangle points



higher, buy the upside breakout. If the long side points lower, sell the breakout from the bottom side of the triangle pattern. Symmetrical triangles (triangles with sides that are equal in length and angle) are usually continuation patterns. If you see a symmetrical triangle forming on the chart, odds favor prices breaking out in the direction of the most recent trend. If a symmetrical triangle forms in the wake of choppy and trendless price action, then odds favor more choppy and trendless price action occurring in the near term.

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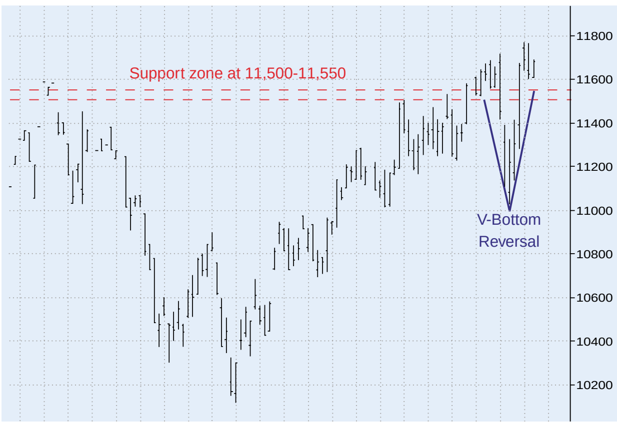
V-Bottoms Power Strong Rallies

A sharp bottom usually projects a big turnaround in price.



You may have to watch a position for a week or two to get a clue on whether a “V” bottom is forming. Trendline analysis helps spot these big opportunities early.

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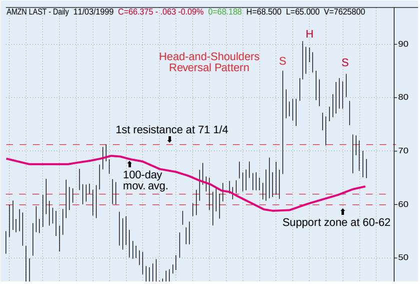
Head & Shoulders Patterns Forecast Major Turns

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

It looks like rally highs, with the middle one being higher than the other two. The drawing of an imaginary neck-line across the bottom of the head, chartists find a good place to time their trades. Ideally, the head-and-shoulders formation is accompanied by heavy volume as the stock price reaches each of the highs. Although the final confirmation that a head-and-shoulders top is formed does not come until the neck-line is broken, some



chartists look for slightly lower volume on the third rally as a clue that the stock is "running out of gas." In that event, they would begin to exit long positions at the top of the right shoulder, rather than waiting for the neckline break. The head-and-shoulders top provides an excellent clue to use as an exit strategy. And, a head-and-shoulders bottom throws off a profitable buying signal. The head-and-shoulders top formation is one of the most common and most reliable of all reversal patterns, according to authors Edwards and McGee in their classic book "Technical Analysis of Stock Trends."

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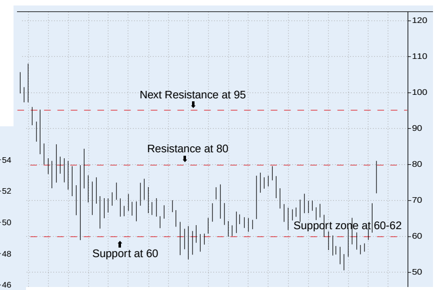
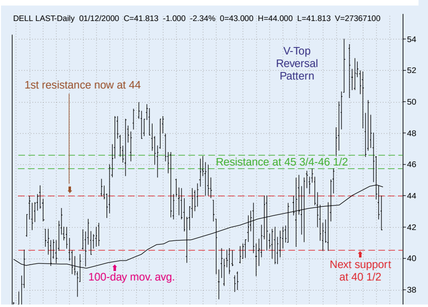
Jump On The Break-Away Gap

When a stock opens higher than the previous day's high and sustains that level throughout the day, the "gap" formed on a price chart is a strong buy signal.





Canadian researcher Robert S. Cable found 127 stocks that gapped higher during his study. One month later they were up a cumulative 15.3%, two months later 26.3% and three months later, during the 1995 study, stocks which gapped higher were up 36.8%. What's the gap mean? Simply that strong demand hit the stock's limited supply and drove the price higher. Cable found that the 127 stocks which gapped higher had 55 million shares outstanding on the average. So, with fewer stocks outstanding, stocks are more vulnerable to a gap. Such an event is a marker you shouldn't miss if it happens early in the stock's price move.

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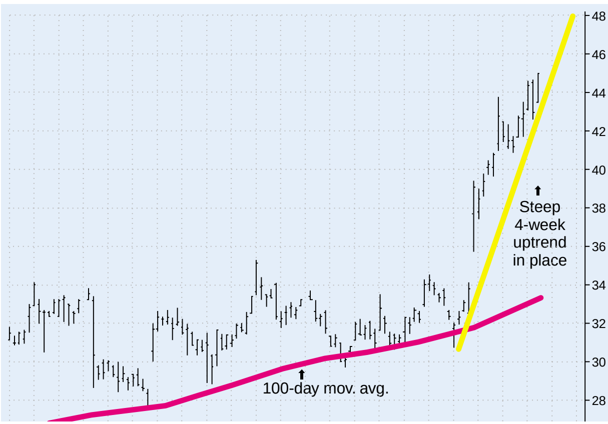
Exhaustion Gaps Say “It's Over”

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



When a price has made a sustained move up, and then gaps lower on heavy volume, it usually means the move has reached its climax. Don’t overstay your position after you get this warning. Move to the sidelines if you have owned the stock. If you have nerve, such a signal would be a good clue to short the stock.

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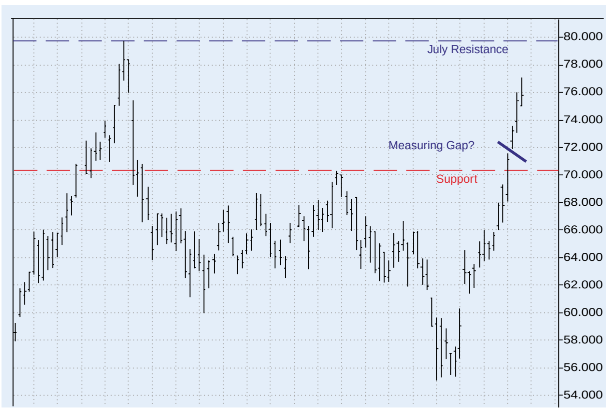
Measuring Gaps Predict Prices

A run-away or measuring gap usually occurs about the half-way point of a major move.



If a stock or commodity price has broken out on the upside of a congestion area and trended higher for several days or several months, before gapping higher, chances are good that this “measuring gap” could indicate that what you have seen to date is the first half of the rally.

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Island Reversals Scream, “Trend Change!”

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

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

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Prices "Retrace" 33% And 66% Of Their Moves

Use these percentage retracements to take profits or set protective stops.

Frequently, when prices make a major trending move, the move is followed by a "correction" or "retracement" of one-third (33%) or two-thirds (66%) before a pause or even the completion of the retracement move. One way to use this tendency is to take some profits after a one-third retracement of a major move or two-thirds retracement of a major move. Many savvy traders also place their protective sell stops just below these percentage retracements.

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Key Reversals Trigger Turnarounds

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

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

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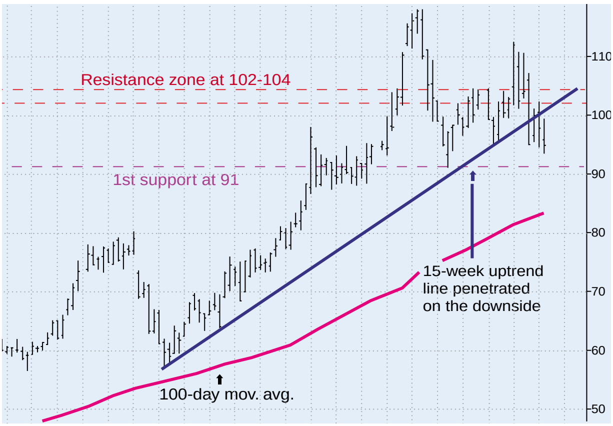
Set A Trendline Trap

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



Whether you use a straight line or a moving average let the market tell you when to get in or when to get out when your trap is triggered. If you like a stock or commodity position that has been trading lower, draw a line across the descending highs and wait for the price action to close above your trendline before buying the stock, or pick your favorite moving average. Traditionally, the 200-day moving average is one of the strongest indicators for the overall markets. However, the more astute traders prefer the 100-day moving average. When the stocks move up above the 100-day moving average, they look more favorably on the stock. Likewise, a move below the powerful 100-day moving average would indicate a change in trend.

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Buy The Second Close After Trend Break

Avoid getting whipsawed by false breakouts by exhibiting some patience.

Once a price pattern is broken, if the signal is bullish it is a good idea to wait for the second higher close after the stock crosses over the trendline. If you own a stock whose price has broken below a trendline, you may be less patient and be more inclined to take the sell signal the first time the stock trades below the trendline. However, any activity close to the trendline can be very tricky, and one-day trendline breaks can frequently become false signals. That is why it is a good idea to wait for the second close or even the second consecutive close in the direction of the breakout. In other words, if you were trading a stock that crossed the trendline at 35, a very conservative play would be to wait until a stock closed higher two days in a row before you would decide that the market trend had clearly established itself.

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Be Alert When Moving Average Lines Cross

Moving average crossovers are good buy and sell signals.

If you got long when a stock commodity crossed its 100-day moving average, you may want to exit or short the position when the 50-day moving average penetrates the 100-day on the downside. Many traders use moving average crossovers as important profit clues. Rather than waiting for the longer 100-day moving average to be broken, a 50-day moving average could forecast that the 100-day moving average will be broken soon and will allow you to exit the position profitably. In some highly volatile commodity markets, 10- and 20-day crosses are helpful price trend signals.

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Channel Breakouts Are Profit Opportunities

The longer the channel, the better the clue.

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

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Win Pennants Without Playing Baseball

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

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

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63 Eat From A "Silver Spoon"

The "Silver Spoon" is a technical formation which throws off good buy signals. "The Silver Spoon" formation is the result of a solid price correction followed by a period of price consolidation at a gradually higher level week to week. If this happens on the day when volume increases 50% from what it has been normally, you have a strong buy signal. William J. O'Neil of Investor Business Daily built a fortune on this one, calling the formation a "cup with handle." Either way you picture it, this is a powerful visual clue.

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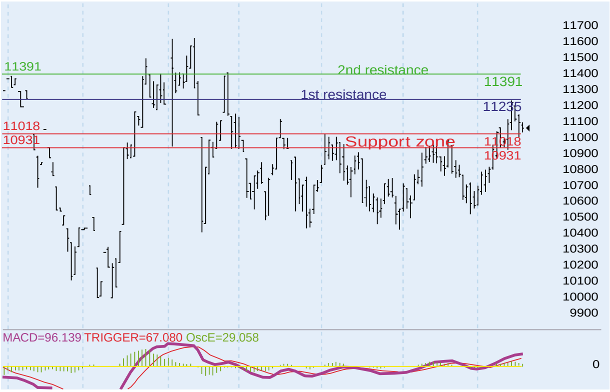
Buy Breakouts Of A Flat Base

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

Once a stock or commodity forms a tight trading range for six to eight weeks or longer, its next move up can lead to a good investment. It is an even better trade if the base was formed after making a "Silver Spoon" pattern and rallying. The longer the consolidation period before the break, the stronger the buy signal. Once the market has moved away from the trading range, the high of the old trading range can then be used as a place for your stop-loss orders to protect your profits.

Buy Congestion Breakouts

There is an old adage. “If you can buy right, you’ve solved half of your selling problem.”



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

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Watch Out For False Breakouts From Patterns

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

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

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Use Support And Resistance Levels For Stop Placement

Placing stops just under support decreases your odds of getting "stopped out."

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

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Broadening Information On The Chart Is Bearish

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

If a stock or commodity exhibits wider trading ranges at higher price levels – amid directionless, choppy price action, then a broadening formation can occur. These patterns are rare, and usually occur at market tops. With a broadening formation, trendlines can be drawn off the highs and lows, such that a reverse triangle pattern occurs – with the apex of the triangle at the opposite end compared to the other triangle patterns technical analysts employ.

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Increased Volatility Warns Of A Change In Trend

Higher volatility at lofty price levels is a big warning siren to the bulls.

When a trading range begins to widen at higher price levels, and the uptrend appears to have stalled, this is a warning of an impending market top. If you are long a stock when this type of higher volatility occurs, it's best to take your profits and get out of the market.

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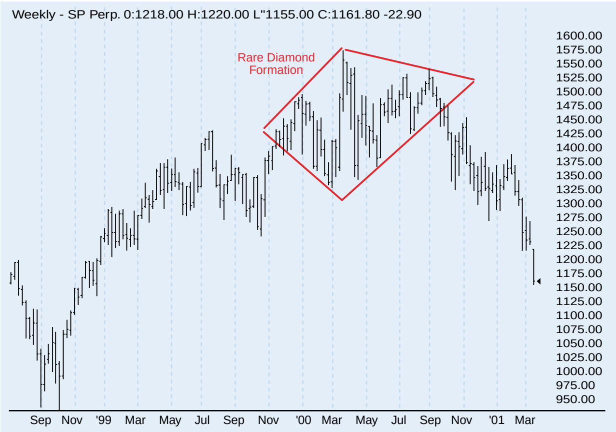
Diamond Patterns Not A Bull's Best Friend

These rare formations usually portend a market downturn.



Diamond patterns are not common and occur when price volatility and trading ranges increase at higher price levels. The diamond formation is a signal the bulls are getting exhausted and that a downturn is imminent. There is no better chart to use as an example than the S&P 500 nearby futures, basis the weekly continuation chart.

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Divergence An Early Warning Signal For Trend Change

Traders using computer-generated technical indicators need to watch for divergence.

Traders using sophisticated computer trading programs such as FutureSource's ProNET should be aware that while computer-generated technical indicators such as the Relative Strength Index (RSI), Slow Stochastics and Directional Movement Index (DMI) all have unique characteristics, they all can show “divergence.” Divergence occurs when a technical indicator, while it still may be in a bullish mode, starts to weaken just a bit, while prices have not (yet) shown that same weakness. The same holds true when technical indicators are reading bearish, but then start to turn back toward a bullish mode – before prices start to show any signs of rebounding.

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Oscillators Scream "Buy" Or "Sell"

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

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

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"Fibonacci" Numbers Find Support And Resistance Levels

There are a few retracement percentages that work well at determining support and resistance levels.

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

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Ride The Elliot Wave

However, the Elliot Wave Theory is complicated and many traders do not master the theory well enough to ever use it effectively.

R. N. Elliott discovered the wave theory in the 1930s. Elliott waves describe the basic movement of stock prices. The principle states that in general there will be five waves in a given direction followed by what is usually termed an A-B-C correction, or five waves in the opposite direction. In Wave One, the market makes its initial move upward. This is usually caused by a relatively small number of traders that all of a sudden feel the previous price of the market was cheap and therefore worth buying, causing the price to go up. This is where bottom-pickers come into the market. In Wave Two, the market is considered overvalued. At this point enough people who were in the original wave consider the market overvalued and take profits. This causes the market to go down. However, in general the market will not make it to its previous lows before it is considered cheap again and buyers will re-enter the market. Wave Three is usually the longest and strongest wave. More traders have found out about the market; more traders want to be long the market and they buy it for a higher and higher price. This wave usually exceeds the tops created at the end of Wave One. In Wave Four, traders again take profits because the market is again considered expensive. This wave tends to be weak because there are usually more traders that are still bullish the market, and after some profit taking comes Wave Five. Wave Five is the point most traders get long the market, and the market is now mostly driven by emotion. Traders will come up with lots of reasons to buy the market and won't listen to reasons not to buy it. At this point, contrarian thinkers will probably notice the market has very little negative news and start shorting the market. At this point the market becomes the most overpriced. At this point in time, the market will move into one of two patterns, either an A-B-C correction or starting over with Wave One. An A-B-C correction is when the market will go down/up/down in preparing for another five-wave cycle.

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Note Trade Breaks Through Round Numbers

Psychological support and resistance levels should not be ignored.

Support and resistance levels for stocks can also be determined by "psychological" price levels that are round numbers. For example, a psychological price level would be $25, or $50 or $100. On grains, each $0.50 or $1.00 per bushel increment becomes a potential turning point.

Invest Gains In Good Causes

The hope of our grandchildren rests in our investment in causes which create positive cultural change.

Many millionaire investors find good, charitable causes in which to invest their profit by carefully selecting faith-based ministries and other good philanthropic causes. The gains you make from the stock market can help reshape our nation. The spiritual and moral decay which has influenced society in the past 50 years can be significantly influenced by the giving of successful investors. Pick a cause you believe in, learn to articulate how this idea you believe in can change society, then follow through with a significant investment of your own time and money.