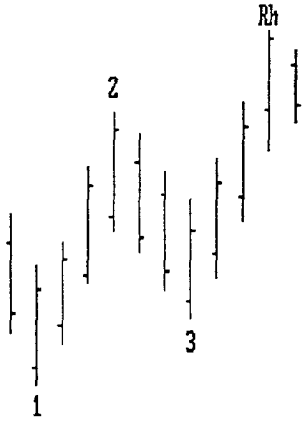

TRADING THE ROSS HOOK

by JOE ROSS

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Chapter 1

The Path

If you follow the simple path I map out in this book, you will have in your possession a way to accumulate wealth trading in the futures markets. You will have to work hard. However, your labors will not be where most would expect.

When I followed this same path, I did not spend countless hours backtesting systems. I did not spend weeks and months pretending to trade. Instead, I spent much time, and still do, in perfecting my attitude and my approach to trading. I spent great amounts of time in learning the discipline and self-control needed to trade realistically and profitably.

As I've repeatedly stated in my other writings, trading is a business, and it must be treated and managed as a business.

By reversing the way that most traders approach their trading, I have managed to reverse the outcome. For most, their approach has been disastrous.

How can my experiences help you?

Instead of trading with great risk, uncertainty, complexity, and confusion in your trading, it is possible for you to begin to enter trades with a high probability for success. Mathematical, scientific, cyclical, and computerized approaches to the market are totally unnecessary, as are those based on theory. If a high degree of proficiency in mathematics and science were necessary to profitable trading, there would be no way I could have accomplished a winning strategy in the markets. The bottom line is that I am greatly deficient in all but one of these areas, the computer, and my trading approach and style were developed long before I was ever able to use a computer in my trading.

Winning trades can be yours, and you can consistently pile them up if you will rigorously follow the simple, uncomplicated path I'm going to reveal to you.

What I show will be conceptually easy. Yet it may be difficult for you to do. I'm not going to promise that you'll have the discipline to implement the techniques in this book, but if you do have it or can develop it, it's hard for me to see how you can fail to be a successful trader.

The best part is that trading can be as easy as lifting a finger and turning off the switch of risk and uncertainty, and flicking on the switch of simplicity and inevitable wins. The choice is yours.

You can choose to go from one complicated mathematical concept to another — continuing to lose as you try to force the markets to fit into your preconceived notion of what they should or should not do, or you can learn to simply read a market and let it tell you what it is going to do, and then go along for a profitable journey.

Does This Sound Hard to Believe?

I assure you that what I will show in this book is totally genuine, real and true. I have done it, and still am doing it. Others I've taught are doing it, right now, perhaps as you are reading this. It works!

The technique of the Ross hook, and the approach to trade selection that I describe in this book, are based on sound, time-tested, fundamental rules for successful trading in the futures markets. If you long for a way to *simplify* your trading life so that you can concentrate on the important jobs of taking control of your trading and yourself, if you want an exciting fresh start, then pay close attention to the concepts I will be revealing in this book.

If you desire to be honest with yourself, realizing that you cannot control the markets, and that when trading, the only thing you can control is yourself, then the methods I show you will work for you.

If you want your trading to start compounding successes in a systematic, ever-growing fashion, but you recoil from risking tons of money on the uncertainty and volatility of all futures markets, then perhaps you've finally found the book you've been looking for.

If you never want to painfully look at yourself in the mirror — or confront your spouse and admit with reluctant shame, "Darling, I lost again today," then the ins-and-outs of trading the Ross hook may be the answer for which you've searched.

And if you hunger for the kind of money and leverage you can find in the futures markets, yet you still want to be relatively *safe and secure* in how your margin account grows, then this approach will change your life as a trader. My approach has already helped many of my students to become more successful. What I will be showing you is a better, safer, more relaxed way to trade and yet still make money in the futures markets.

This book, then, is the story of my discovery of the Ross hook and how almost anyone can achieve wonderful results trading in the futures markets by using it properly. This book will tell you how you can apply the marvelous concept of the Ross hook to your trading, beginning today. Along with the technique of the Ross hook, I will be showing you numerous ways to filter your trading so that your trade selection will be vastly improved. Trading the Ross hook, together with fastidious trade selection, should bring a definite improvement in your success as a trader.

This is not a book for the raw beginner. It assumes you have at least a basic knowledge of how to place orders, read a bar chart, and have a basic understanding of what the futures markets are, and how and why people trade in them. It assumes you have at least paper traded futures, and you've seen or suffered the inevitable losses that have been the nemesis of so many traders.

The Bottom Line in Trading

The bottom line in trading is **love and hate.**

I've gone out on a limb with that statement. I've gone against the conventional wisdom. **Although profit and loss are the financial bottom line for trading, profit and loss are not what trading is about!** Profit and loss are important, but they are only secondary. They are a measure of your ability as a trader, but they are not ***the*** **bottom line.**

I found out years ago that it's ***love*** and ***hate*** that drive the futures markets and control your trading destiny. This will take some explanation, so bear with me. I assure you, the rewards will make it *well* worth your while.

Why Do You Trade?

Ask yourself, "Why do I trade?"

The reason you trade is because you ***enjoy*** the results a winning trade can achieve. Wise trading can *make you rich*, multiplying your wealth many times greater than if you simply keep your money in the bank, CD's, equities, or most other vehicles for accumulating and building wealth. Let's face it, inflation and taxes constantly gnaw at and erode your wealth. The leverage available in trading the futures markets gives your trading one of the highest profit potentials of any money making vehicle available. The results of winning can be spectacular, and you love the idea and excitement of trading as well as the outcome. You thrive on the anticipation of the "big" win.

You also like the notion that your money can work for you like a tireless machine, piling up riches day after day for as long as you trade, making you richer and your life easier.

And while friends and relatives may lose their jobs, and professional and business prospects may diminish considerably, your trading prowess will always be there for you, an ever-loyal skill that can add immeasurable security and comfort to your life.

You relish the thought that one day the yearly income you earn from your trading can even surpass the income you earn from your work which may have become tedious humdrum, and when that happens, you will never have to work another day in your life except at the thing you love the most — trading. And your trading ability will enable you to keep on enjoying your efforts as a trader, making the big money so *you* can have the good, easy life.

Or, you may delight in the thought of enhancing your retirement income, leisurely trading and bringing in additional funds in the relaxed and enjoyable pastime you perceive trading to be.

You love the *excitement* of seeing a trade you've chosen zoom by scores of points, rolling up perhaps a year's worth of income on a single position. Few experiences in life can surpass the thrill of watching your net worth soar higher so fast — and with so little effort.

And while money certainly isn't everything, you cherish the freedom that wealth affords — the ability to treat yourself and your family to the better things of life: a fine home, a prestigious car, travel, and entertainment. You take pleasure in the thought of being able to give to those in need, and to feel surrounded by financial security, knowing you can always afford the finest medical care for you and those you love, and you look forward to a retirement marked by complete financial independence so you can enjoy your restful years free of financial anxiety.

Such rich rewards make smart trading *extremely* important to your future, don't they?

But following close behind your love for trading are the things you **dislike**. You detest the risk of loss and the awful *emotions* that losses trigger. You detest the anger and self-blame you feel for making a wrong trading decision. *"How can I be so stupid?"* is a trader's most painful complaint. *"When will I ever learn to do it right?"* These are questions with no answers, yet will taunt you over and over again, never allowing you to forget that your hard-earned money is lost.

You may be uncomfortable with the reality of the dozens of trading choices all shouting out to be taken, all holding out the promise that ***this** is the one to take*. Faced with so many possibilities, you feel overwhelmed and certain you're not going to pick the right one(s). Worse than that, you may try to take them all.

You don't like not having anyone you can really *trust* for objective counsel. With brokers, you always wonder, *"Are they urging me to buy or sell for **my** benefit, or so they can make a commission today?"* With advisers, you always wonder, *"Is this going to be a winning trade, or is this one a loser?"* You wonder if you can take the heat of the adviser's stop loss, or conversely you wonder why the stop is so close to the price action, and you would like to give the trade more room.

You hate the wild, unpredictable volatility of all markets. You sometimes find yourself wasting so much mental energy wondering, *"Where should I place the stop?" "Should I be increasing my position?" "Should I move my stop now, or give this trade a little more room, or should I be getting out NOW!?"* Those decisions are not easily made. They make you uncomfortable. They challenge and test you, and put your trading fortitude on the line.

You sense from the depth of your soul that whatever you decide, the market will almost certainly do *exactly the opposite*, as if it takes a personal and perverse pleasure in trying to make you feel like a fool. And all this goes against the grain of an achiever like yourself. In almost every other area of life you can feel in *charge* and *successful*. But when it comes to trading, you wonder *"Will I ever get it right? Can anyone?"*

All these feelings add to your anxiety, often paralyzing your ability to reach decisions, and making trading an exasperating mix of feelings you love and feelings you hate. *Is there any way out?*

What if you could experience MOSTLY what you LOVE and avoid what you HATE? What if you could feel comfortable with your trading? What if you could feel reasonably sure that the trades you are entering are the right ones? What if you knew where to place your stop on every trade? What if you could pick a high percentage of winners?

What if you could actually achieve the dream of letting your winners run while keeping your losses small?

Early in my career as a trader, I realized the great *emotional* stakes at risk for most traders. I decided to see if I could design a personal approach to trading that would consistently give me only the experiences I *covet* while shielding me against the experiences I *loathe.*

Could it be done? How could I do it?

Actually it was simple, once I experienced a tremendously important insight.

Between the two emotions that continuously grappled for my trading soul (*my love of gain versus my hatred for loss*), **it was the hatred of loss to which I had to pay the greatest attention.**

To understand why, all you have to do is realize a rule I've come to call...

The True Wealth Principle

This principle simply states that if you can consistently avoid losses, you will not only feel much better, more comfortable and in control of your trading, but you will also *automatically and inevitably grow richer.* How can it be any other way?

You see, trading money is rarely static. The money you trade with proper selection works ceaselessly while in that trade, minute after minute, even overnight in some contracts, to multiply itself and make you wealthier.

In fact, the only way you can *stop* money from multiplying itself and relentlessly making you richer while in a trade, is to LOSE that money.

Losing, invariably, is what most traders manage to do. That is when the entire magnificent and automatic process of building wealth breaks down — and it's why the majority of traders never really succeed at trading.

So this great principle of wealth teaches that the most important secret of building a trading account is to *avoid losses.* If you do, your money will automatically and inevitably multiply. It cannot do anything else.

So what? You've always known that, right? But sometimes the simplest truths are the most profound. And this truth does have profound implications for how you should trade, as you'll soon see.

My approach has enabled me to trade with very low risk, often much lower than you can imagine. As you'll see in the remaining pages of this book, it's an approach that raises avoidance of loss to the highest pinnacle of decision making. It's an approach whose chief characteristic is avoidance of overtrading and an almost fanatical avoidance of loss of capital. Perhaps most surprising of all, this approach, which has kept me very safe in the markets, has also been unusually profitable year in and year out.

Trading the Ross hook using the filtering processes I will show you, accompanied by the money management techniques I use, all in conjunction with the right mental attitude, has let me experience mostly the things I **LOVE**, and very little of the things I **HATE.** It is a safety-first style of trading that allows me to sleep comfortably.

You might be wondering, *"How can this be possible? How can any style of trading give me what I love about trading and eliminate what I hate about it?"* I'll be sharing with you how I employ the true principle of wealth to do just what I've said. Here are some of the things you will be doing if you learn to properly trade the Ross hook:

1. You will learn to protect your capital.
2. You will greatly simplify your trading life.
3. You will not keep all your money in your margin account.
4. You will never again have to worry about what a market is going to do.

5. You will enter trades when they have the highest probability of being correct. You will be eclectic in your trading, learning to take the best of the best, and profit by so doing.

6. You will learn to read the market in such a way as to be able to profit from the emotional drives of other traders.

7. You will trade like the wise owner of a profitable business — one who knows how to make a profit, and take it when it is available.

8. You will be able to utilize the Ross hook for daytrading, position trading, or both. The time frame you choose will be up to you.

Let's Set the Stage

At various points in this book I refer to the floor, operators, market movers, and insiders. By this I mean traders apart from the public. Insiders include floor traders, large traders, commercials, and market makers (operators). I always refer to the public as "outsiders." For the most part, that's you and me, and some of the professionals and commercials who trade off the floor.

Management

To those of you familiar with my trade, risk, and money management techniques, this section will be familiar.

This may sound strange to some, but it is my management techniques that have made successful most of the methods I have used over the years.

I am an individual who thrives on variety. I become bored with trading one method for very long periods of time. The longest I have traded a particular method was for three years. That was at the outset of my trading career. By the time the three years were completed, I was ready to go out of my mind with boredom.

Yet, during those three years, the discipline I developed by sticking to a single methodology was firmly cemented in place. Although occasionally I have strayed from that discipline, I have never lost it. I have always been able to go back to it. My roots are firmly grounded in it, and it has anchored my trading career to this very day.

I have successfully traded many methods and, although the methods vary considerably one from the other, my management techniques have hardly changed at all since I first began trading.

I was taught to trade at least two contracts and preferably three. The reason for this was to use one contract to cover costs, and then allow the other to ride to a reasonable profit level, if the market would grant that.

I was taught never to try to take from the market, only to accept what it so graciously gave me.

This differs considerably from the mind-set of most traders who are driven by greed to seek to squeeze every last penny from each and every trade.

From the very beginning, I have traded no less than three contracts. The three contract concept is as follows: One contract is cashed as soon as possible to at least cover costs. Sometimes this produces a small profit. Two contracts are then pulled up to breakeven as soon as practical.

When the market yields a few more ticks, the second contract is cashed, thereby locking in some sort of profit for the trading effort. The third contract is held back at breakeven for as long as possible to allow the trade the most room.

As profits are earned, a stop is trailed according to any one of a number of acceptable methods. The stop is never allowed to do any worse than breakeven.

This management technique derives from a different attitude towards the markets than is commonly taught and practiced by the majority.

I have heard and read that a trader should learn to "love small losses."

Such an attitude is pure nonsense. My philosophy of trading is to learn to hate losses and reluctantly settle for break-even.

It yields a totally different result from learning to love losses.

The trader who learns to love small losses expects to get them, and so he does.

Conversely, the trader who learns to love to win, and at worst to break even, begins to manage his trades, risk, and money in such a manner as to **not lose**.

There are two sides to the human brain. One side responds to positive suggestion, the other to suggestions phrased in the negative.

A part of every trader's plan should be to program himself to win. "I will win" programs the positive side of the brain with the mind-set needed to win.

"I will not lose" establishes the opposite side of the brain with the mind-set needed to not lose.

The human mind is a goal seeking mechanism. Once programmed correctly, it will strive day and night, awake or asleep, in an attempt to bring about fulfillment of the goals with which it has been programmed.

In my book **Trading Is a Business**, I show how to deal with every aspect of your life that might affect your trading. The book deals with the "**Life Index**" and its use in gaining control over yourself so that you can trade properly.

As a trader, you can control only one thing — yourself. You cannot control the market. As pointed out by Mark Douglas in his book **The Disciplined Trader**, one of the reasons most people fail in the market is because they try to control it.

Most people who trade are of above average intelligence. They are used to solving problems by controlling their environment. Often, they are used to being part of the solution.

Unfortunately, when trading the markets in front of a screen or from a set of printed charts, you cannot control the environment. This calls for an entirely different approach to problem solving from that which most people employ throughout their entire lifetimes.

I strongly recommend reading Mr. Douglas' book along with **Trading Is a Business**. Between the two, you should have all the ammunition you need to begin to change the way you think and the way you behave when trading in the markets.

Capitalization

I receive phone calls from far too many would-be traders who are tremendously undercapitalized.

I know the urge to "get rich quick" is a powerful drive of human nature. But I must say, if you cannot place an order for at least two contracts, you have no business trading in the market in which you are placing your trades.

If you haven't sufficient margin to trade two contracts in some market, then you surely need to obtain that margin **before** attempting to trade.

The one contract trader, unless he accidentally runs into immediate success and good fortune, cannot in reality hope to be a winner.

The one contract trader has all his eggs in one basket. His one trading decision must not only see him through cost covering, but must also deliver a profit.

People call to ask me if they can succeed by trading one contract. My answer is "yes," if you get very lucky. It has been done, but the winners are few and far between. The odds are tremendously against a one contract trader. For most, it amounts to nothing more than gambling.

Perhaps the odds are a bit better than the lottery, but I'm not sure of that.

Lot Size

Once a trader can go beyond a three lot, he should trade in multiples of five. That would be a five lot, a ten lot, a fifteen lot, etc.

Care should be taken to not enter trades with an "odd lot" such as four, six, seven,...twenty-three. It is too difficult to get decent fills with odd lots.

Even more care should be taken on final exit from a trade. If I have traded a ten lot and need three contracts to cover costs, I will cash five contracts at the cost covering level. That accomplishes two things:

1. Simultaneous with covering costs, I take a profit out of the market.

2. I am left with a five lot for my final exit. At each step I will, on average, be able to obtain better fills.

Prices

Consideration should be given to prices when entering a market. It is essential to give the correct price. Contracts such as the British Pound, Heating Oil, Unleaded Gasoline, Pork Bellies, Live Cattle, and Live Hogs trade in amounts that can trade with last digits ending in numbers that rise or fall other than in increments of 1 or 5 with each tick.

Although many brokers will accept orders with wrong digital endings, and although they may also be accepted by the floor, such orders cannot actually be filled at the price given, and so slippage occurs, destroying your anticipation and expectation from a trade.

Orders

I use three types of orders for my trades. As a rule, I enter trades only at a price. That means using limit orders. This is extremely important when trading large size orders, but should be important to any trader. I feel it is important to learn to trade market entries with price orders the majority of the time. I cover costs mostly with MIT orders, and I exit sometimes with a market order, but mostly with a resting stop order which becomes a market order if prices trade at or through my price.

I will include more of these matters as they come up in context and at the correct places throughout the book. However, you cannot really begin to read this book without a basic understanding of how I manage my affairs as a trader.

If I were a beginning trader, or a trader attempting to build an account in order to be able to trade more contracts, here is how I would manage my money:

I would enter each trade with three contracts. Assuming the trade went my way within a short time, as soon as I could cover immediate costs (commissions and fees), I would cash two of those contracts. One contract would take care of immediate costs, and the other would give me a return equal to my costs, thereby giving me a 100% return based on immediate costs.

As soon as possible, I would pull my third contract to breakeven. This could be immediately or after a short time. There is no way to know in advance just how soon. Each trade is different and must be adjusted to the market action.

At breakeven (the original price of entry), I would expect to be stopped out 7-8 out of 10 attempts. The other 2 or 3 tries would result in medium to very large wins.

What if the trade does not go my way immediately, or after a short time? Then I would get out. Something is wrong! If my entry does not result in immediate, or almost immediate success, I would exit.

Immediate costs are cheap compared with the losses most traders suffer because they lack the discipline to quickly extract themselves from a trade.

The problem with most traders is that they view each trade as though it were the 'be all' to 'end all'. This is simply a wrong view. Trades must be viewed as a series of events, the majority of which will earn money for you if you have the discipline to follow a plan of action.

Once a method or system has been proven to work most of the time, then the rest becomes simply a matter of discipline and proper trade, risk, and money management.

Philosophy

I like variety in my trading. The thought of sitting and daytrading the S&P on a three minute chart is anathema to me. I would burn out in short order doing that. I like to trade a variety of markets and a variety of time-frames.

I would agree with many professional traders on the need for specialization — for them. For me, it's boring.

Many have strong feelings regarding daytrading. They want to trade a single market, in a single time-frame. For me it's difficult to do. My thought is that trading that way is like going to a buffet dinner and choosing to eat only the roast.

I want the bread, the vegetables, a salad, dessert, and a drink along with my roast.

There is strong agreement among professionals that you should trade only extremely liquid markets and only those with good volatility, especially when daytrading.

I agree with that wholeheartedly.

In the estimation of many, the only markets that have sufficient liquidity and volatility for daytrading are the currencies, Bonds, S&P, and Soybeans.

I disagree with that. Corn has excellent liquidity, possibly more than the Beans. Traded on a sixty minute chart, Corn can be daytraded successfully, and much more easily than the Beans. There is an advantage to trading Corn that is not available in the currencies. You can more easily turn a day trade into a position trade. In addition, studies have shown that Corn trends more than the Beans.

Sugar can be a wonderful trending market on thirty and sixty minute charts. It has great liquidity.

With the exception of trades designed specifically to scalp, I believe the only way to trade off the floor is to position trade. By position trade, I mean any trade designed to keep one in the market as long as possible relative to the time frame traded.

Whereas a scalp trade is designed with a short term targeted price zone, a position trade has no such targeted price zone. Instead it is a trade designed to stay with a trend in the market for as long as possible, even to the point of transcending the current shorter term trend in favor of matriculating to an overall longer term trend.

When I daytrade a five minute S&P chart, I position trade it most of the time. The same is true for the currencies. I position trade them intraday. By that, I mean I take a position based upon the intraday trend, and hold until near the close.

In fact, any market that will 'form up' on a one minute chart can be safely position traded intraday.

In all markets except the S&P, if I can turn a daytrade into an overnight, longer term position trade, I will do so.

I have heard many daytraders say that the reason they daytrade is because in trading the daily charts they leave too much money on the table.

I say "Nonsense" to that kind of thinking. I've tried it both ways, and can honestly tell you that it is the pure daytrader who is leaving most of the money on the table.

I have seen daytraders lose scads of money in markets that were trending beautifully. The daily-chart position traders were picking up a fortune, and the daytraders were fighting their way into the market every single day and losing on the intraday action.

There are a great many bugaboos and false beliefs that have been propagated through the years.

For instance, who says that a weekly chart needs to consist of five trading days? Why not make three day charts and obtain different signals from everyone else?

Why do daytraders think they have to use five, fifteen, thirty, or sixty minute charts? Why not use a seven minute chart and trade from a completely different set of signals?

I have used, and still do use, twelve minute charts. I do it because I want to see the chart form somewhat differently from the way others see it.

I have traded, and still do trade bonds from a 120 minute chart. I do it because I do not want to go along with the pack. At heart, I'm a contrarian.

I strongly believe in trading where I feel most comfortable. I am not afraid to take a trade in cocoa, or orange juice, if a good opportunity arises. I simply lengthen the time frame, so that the liquidity is there to go along with the volatility.

Orange juice may be a thin market on a daily basis, but how about trading it from the weekly chart? There is sufficient liquidity in an entire week to trade orange juice. Volatility due to a thin market, especially during the cold months, is not a problem.

I refuse to be rigid in my trading. But I am as rigid as I can be about self-discipline and self-control. I will put up with no nonsense from myself in those areas.

I think that many who try and fail do so because they think that by being rigid in their trading, they are being disciplined traders. But that is the wrong place to be rigid.

If you are going to be rigid about anything in your trading, it must concern your work habits and mental outlook. Be rigid in determining to not lose. Be rigid in setting your heart to win. Be rigid in keeping good records and statistics about your trading that will enable you to be a better planner and executor of your trades.

I am comfortable with variety, so I trade a variety of markets and time frames. I prefer to be eclectic. I want to smell all the flowers, not just one. I want to sample every market, not just one.

I've learned to trade where I'm comfortable. I've learned to take only the best of the best trades. I place stops where I'm comfortable. I insist on being a happy trader. If trading ever became like work, I would find something else to do.

Conclusion

My final thought in this introductory chapter is that there is something for everyone at the table. Daytraders can daytrade exclusively if that's what they desire. Daily-chart position traders can trade the daily charts to their heart's content.

Others can do as I do, and combine both, and in varying ways. We won't all do it the same. We will trade in different markets, and with varying degrees of success. It's always been that way, and will continue to be that way.

The notion that if I reveal my secrets, everyone will begin doing what I do which would spoil the method for everyone, is the height of naivete. You will never trade exactly as I do, nor will I trade exactly as you do. To even make the attempt would be foolish. We are wonderfully and individually different. I cannot be you, and you cannot be me.

The best thing you can do with this book is to integrate the things you care for into your own style of trading. You must be yourself in the markets. You trade within your own frame of reference and your own comfort level. Trading must make sense to you or you will not have the confidence — the courage of conviction that you need to be a winner.

This book contains a **history** of the Ross hook, yet I am ready to stand by each and every nuance in trading it as being a valid way to trade. One method is not necessarily any better than the next. It is only as good as it meets with your needs.

Some will ask, "Which one do you recommend now?", or "Which one is the one you do?" The answer to that is that I would be willing to do them all as the mood suits me.

Remember? I told you I like variety. But when I do select a method, I stick with it for awhile, sometimes as much as a year.

In the chapter entitled "Vanilla Hooks," you will see my personal preference for trading the Ross hook. That does not mean that the other methods shown are bad. They all work, and all are derived from real life experiences of myself and my students.

In my entire trading career I have avoided the use of oscillators and technical indicators of every kind as a means of **direct** decision making. I simply have not needed them. I show them in my books only because I know that others relate to them, and so they yield a common ground for communication.

I am totally aware of the use of technical studies and indicators. I do use them **indirectly**. I have studied and am very much cognizant of how others use them. Other professionals have done the same thing. I will use such studies against those who use them. If I detect that an indicator or study has become popular and that a large number of traders are using that particular study or indicator, then I will adjust my trading accordingly in order to take advantage of those traders and use it against them. There is great danger in trading along with the crowd, so let the trader beware!

I try to not close off my options to change, because markets change. The Ross hook is for use in trending markets. There have been years when markets didn't trend. Then I had to set aside the Ross hook, and use other methods. It is not the Holy Grail of trading by any means.

This should be of interest to the pure daytrader. If you are going to exclusively trade the S&P, for instance, there are plenty of days when the market doesn't trend. Then you must either use other methods, or wait until the S&P does trend intraday.

I have students who tell me that they have waited patiently for as much as two weeks in the S&P, using a five minute chart to trade hooks in combination with the filters they are using. They are making a lot of money doing this.

This has been a rather long first chapter. I felt it necessary to give you some sort of foundation upon which I could build. Now it's time for me to begin the history I promised.

The first step is for me to tell you how I came across what has become known as the Ross hook.

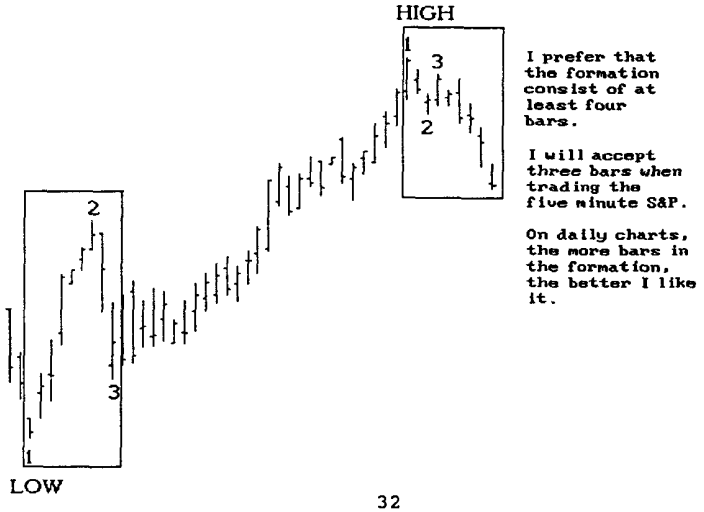
Chapter 2

How It Started

The year was 1959. My education and apprenticeship in the academics of business and markets was over. My real education in trading and business was about to begin. Apart from the rigorous discipline I had encountered from a stint in the Navy, and from time spent with my great-uncle, I had only a few tools with which to make my living as a trader: I knew how to identify a trend, I knew what constituted a 1-2-3 high or low, I knew how to identify congestion, I knew the five functions of a manager, and I knew how to give orders to brokers in a forceful and intimidating way. I knew something of the fundamentals that drove the various markets, but I also knew that I couldn't afford to accumulate the information needed to trade based upon fundamentals. That remains true to this very day. I'll illustrate the basic tools available for my work.

1-2-3 Highs and Lows

I suppose I can never cease showing this most basic and essential of formations in the market. In my view, the 1-2-3 high or low is the buttress of almost every great move ever made in a market. Why? Because virtually every trend, great or not so great, can start from it.



The 1-2-3 high or low formation not only initiates trends, but establishes them as well. They occur at major and intermediate highs and lows in a market. Of course, what constitutes a major or intermediate high or low is somewhat interpretive — one of those things that is in the eye of the beholder. I'm sorry about that, but whoever said that trading was a science? There is nothing more foolish than to attempt to apply scientific principles to the art of trading.

I've stated before, and will state again here, that there is nothing scientific about the actions and interactions of markets. Market action is not mathematical, geometrical, cyclical, statistical, or theoretical. The markets move based upon the perceptions of those who trade them. Therefore, markets are emotional, at times bordering on hysteria. For the most part, money is made in markets by those who most correctly read and act upon the perceptions of the masses who trade the markets.

Notice that I said, "for the most part."

Often market moves are initiated by those who have an interest in, and the ability to engineer, such moves. Many moves, particularly short term intraday moves, are totally contrived.

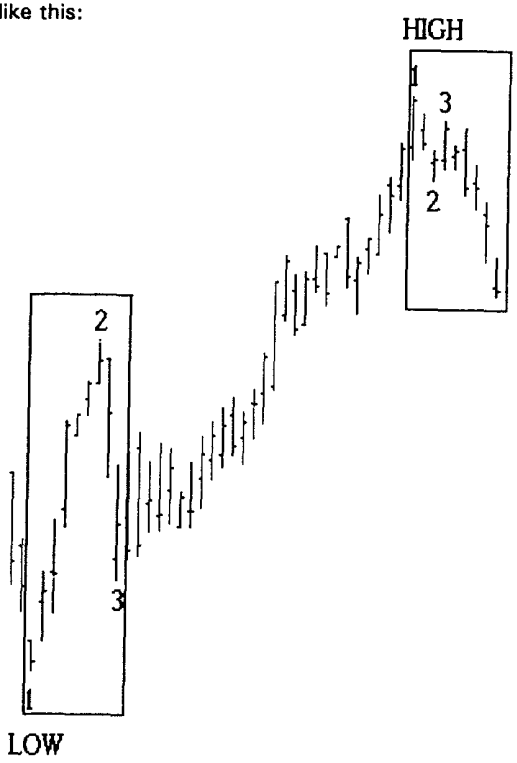
Nevertheless, it is the perception by traders of market action, and their expectations for a profit, that trigger the buy/sell orders that almost continually cause markets to tick up and down.

The emotions and human behavior driving the markets can be seen in the price action as revealed on a simple bar chart showing the open, high, low, and close of any given time period. This is true whether time be measured in seconds, minutes, hours, days, weeks, months, or years.

The more adept one is at reading the finer points of a price chart, the closer to the reality of what is actually happening in the markets one can become. The ability to read the finer points of a price chart increases the probability of incurring a successful transaction when trading.

In a moment I'll show what a 1-2-3 means, and how it can evolve into an established trend. The 1-2-3 is a gateway to the practical use of momentum. Momentum is created by the emotional drives of human nature as they affect the various markets. Remember, we are dealing here with human emotion as expressed by human perception of market direction. There is nothing exact about it.

1-2-3's look like this:



I prefer that the formation consist of at least four bars.

I will accept three bars when trading the five minute S&P.

On daily charts, the more bars in the formation, the better I like it.

The usual objective with 1-2-3 highs and lows is to enter a market on a breakout of the number 2 point. That is an overly simplified view of 1-2-3's and how they are traded, but it will suffice for now. The main thing is to recognize what they are. When trading in conjunction with hooks, we do not trade the breakout of the number 2 point.

Here is what I was taught about the anatomy of 1-2-3's.

1-2-3 Lows

A 1-2-3 low is characterized by a market reaching a major or intermediate low. The low is evidenced by prices then making an up leg away from the low. The low is the number 1 point marked on the chart. This up leg is immediately followed by a correction as the market moves briefly back towards the low. The move back towards the low leaves behind a high which can be labeled as the number 2 point. If the correction is such that it reaches or exceeds the former low, the 1-2-3 low is nullified in favor of a downside move or a congestion area.

If the correction fails to reach the low and then begins to move upward, it leaves behind a somewhat higher low which can be labeled as the number 3 point.

The Meaning of a 1-2-3 Low

Since 1-2-3 lows can come at the end of a downtrend, or also after a period of consolidation, it is reasonable to ask what is taking place in the market to cause this formation to occur.

When a 1-2-3 low occurs at the end of a downtrend, the number 1 point is brought about by the following events:

First, there simply are no more willing sellers in the market. Prices have been pushed as low as they can go. At that point, supply shifts from too much to too little, and prices begin to move up. When those who were short, thereby pushing prices down, realize that prices have started to move up, they buy back their short positions in order to extract profits. Their buying in order to liquidate their short positions causes the market to move up. Would-be longs who have been sitting on the sidelines waiting for these short bears to finish having their fun, then begin to buy, adding to the upward price movement. Prices are then driven upward from point 1 to point 2.

Soon those early longs, especially those with a short term view, begin to take profits by selling out at least a part of their long position. This tends to drive prices downward again away from the number 2 point towards the number three point. This downward move or correction is aided by those bears who think the market is going to go down forever. They perceive the upward move as a bear market rally, and move to establish or re-establish their short positions in hopes of a continuation of the downward trend.

If they are correct, prices will go down and take out the number 1 point, thereby nullifying any new uptrend. If they are wrong, and prices will not be pushed lower, new buying will come into the market and drive prices back away from the number 3 point and towards the number 2 point. If prices then take out the number 2 point, a new trend may be in the process of being established. How long it will last or how far it will go remains to be seen.

It is of the utmost importance that you understand the scenario I've just described. It has everything to do with the stop placement and the money management plan I've already mentioned and I will be showing later on.

It is entirely possible that the breakout will go nowhere as the bulls and bears battle the market into a consolidation phase. This consolidation may represent accumulation prior to a later move upward, or it may represent distribution resulting in a later continuation of the downtrend. Only time will tell.

If a consolidation phase does occur, the 1-2-3 may form from **within** the price structure of the resulting trading range. Be aware that the 1-2-3 can form from the high of the range and result in a breakout to the downside from a 1-2-3 high. Conversely, if the 1-2-3 forms from the bottom of the range, it can result in a breakout to the upside from a 1-2-3 low.

Prices will break out to the upside if the consolidation was indeed an accumulation phase. Once the supply of the commodity is gobbled up at the low prices, there will be a shortage of supply and prices will rise according to the amount of demand in relation to the shrinking supply.

A 1-2-3 low breakout to the upside usually signals that the battle is over and the bulls have won.

The Meaning of a 1-2-3 High

A 1-2-3 high breakout to the downside usually signals that the battle is over and the bears have won. Many downtrends in markets are preceded by the formation of a 1-2-3 high. 1-2-3 highs tend to be larger from top to bottom in most markets. This is because markets generally fall faster than they rise. Such is not the case in the currencies. Currency markets rise and fall relative to one another. When one is rising another correspondingly falls. A steep decline in one currency will be reflected in a correspondingly steep rise in another.

1-2-3 Highs

A 1-2-3 high is caused by the exact opposite phenomena of the 1-2-3 low. When there are no more buyers in the market, and prices refuse to rise to any greater heights, prices begin to stabilize or even to drop. The bulls, sensing that for the time being the upward move is over, begin to liquidate their long positions and take profits.

The bulls liquidate their long positions by selling what they have bought. This tends to drive prices down even more, and a number 1 point is formed. This downward action attracts the bears who are looking for an opportunity to enter the market from the short side. Their entry pushes prices down even further. Prices move away from the number 1 high and toward what will become the number 2 point. Soon the early bears begin to liquidate at least a portion of their position by buying back their shorts.

This drives prices back towards the number 1 point, leaving behind a low that can be marked as the number 2 point. Eager bulls, and those anticipating even higher prices, jump on the bandwagon and buy, expecting new highs. They view the downward move as a bull market reaction. This drives prices even higher. If prices come all the way back and take out the number 1 point, the 1-2-3 high is nullified and the uptrend is still intact. The bulls have won.

If prices fail to take out the number 1 point because they are simply too high, prices will begin to move downward again, leaving behind a number 3 point. Longs will have to cover their positions by selling. This action, coupled with the bears jumping on the wagon to go short, may cause prices to take out the number 2 point. The taking out of the number two point to the downside establishes the downtrend.

Whether or not prices will continue to slide cannot be known. Prices may go into a consolidation phase. If this happens, we have come full circle, as I've already explained the possible breakouts from the trading range surrounding the consolidation.

If you want to know how I trade the breakouts of distributive and accumulative congestions or "Trading Ranges," please refer to Part I of my first work, **Trading by the Book**. That topic is beyond the scope of this book.

In the days when I first started trading, taking the breakout of 1-2-3 formations was a pretty good way to trade. Even today a high percentage of them work out for the good. This is an especially good trading signal for day traders, as the momentum needed to carry through the number 2 point on the daily chart generally gives enough thrust to cover costs and yield a profit.

I have only one rule as pertains to 1-2-3 formations: they should be well defined, and easily seen as a 1-2-3. On the daily charts, I insist that it consist of at least four bars. The more bars, the better, so that the formation really stands out as being a 1-2-3.

On intraday charts there must be at least 3 bars, but you will have to experiment on your own. Three seems to work on a five minute chart.

However, this is not a book about 1-2-3 formations. It is about the Ross hook. It is via the 1-2-3 that I came upon the Ross hook. It is the number 2 point that led me to pursue further my search for viable trading situations.

I Discover the Hook

My discovery of the Ross hook is somewhat akin to Columbus' discovery of America. What has become known as "America" was here all the time. It wasn't discovered by Columbus.

And so it was with Ross hooks. They were there all along. They've been there since the first bar chartist drew a bar chart. I, being the opportunist that I am, gave them a name. It is through publicizing them in my writings and seminars that they have become known as Ross hooks. We have come to call those who trade them "hookers."

My discovery of them came as with most discoveries — I was looking for something.

Columbus was looking for a shorter passage to India. I was looking for a way to enter trending markets.

By virtue of my training and discipline, I had learned to recognize and trade the number 2 point of the 1-2-3 formation.

But as I looked over and studied my charts, I noticed there were plenty of other "pointy" places on the chart. Amazingly, I was able to find nothing that indicated that anyone was trading these "pointy" places. It was as if everyone were trading right past them and somehow no one was seeing them. It was as though they were invisible.

What a find! What a rare treasure! Here were acres of diamonds, and everyone else was stumbling past them, kicking them to the side as they would any ordinary stone.

I can't say for sure that no one else had ever utilized these "pointy" places. In fact, I think there must have been plenty of others who used them. There are a good number of secret traders one never hears of. I know, because I was one. But I couldn't find anyone who had ever written about these pointy places. My brokers certainly didn't know about them. I felt like the man who has found a pearl of great price. It is only since I began imparting my trading knowledge to others that I've been willing to share what I know about these "pointy" places on the chart, which I have named the Ross hook.

An Evolution

This book is the story of the evolution of the Ross hook. In it I will show step by step how I began to use it, how and why it works, and why I think it will continue to work in the markets. Perhaps, more importantly, I believe that it will work no matter how many people trade it. If enough people do trade it, it may become self-fulfilling.

My use of the Ross hook, and its development, came over a period of years of trading it in the markets. Its use, for me, has encompassed the implementation of everything I love about trading.

It has evolved as I learned to read market action as depicted by a bar chart of prices showing the open, high, low, and close.

My use of the Ross hook has been, and still is, a continuing growth process. I am happy now to have shared it with others. It gives me great delight and pleasure to be witness to the wonderful innovations my students have come up with surrounding the Ross hook.

I thrill to the way they are learning to use it, taking it further than I ever could have trading it selfishly and by myself.

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Suffice it to say, many of them have become and are becoming rich by trading these "pointy" places in the markets.

Since I do not normally trade with technical indicators other than to fade those who do, every one of the concepts and tricks I will be showing in this book are included by permission of my students, with the exception of "plain vanilla" trading of the hook. My students, too, have learned that it's better to share.

It's a strange thing about learning to give. What you give comes back to you many times over, and in ways you would never expect. It's as though there were an invisible law at work.

One of the greatest benefits is that giving up selfishness in the markets makes one a less selfish trader. Selfishness in trading, "wanting it all," has been the downfall of many.

Chapter 3

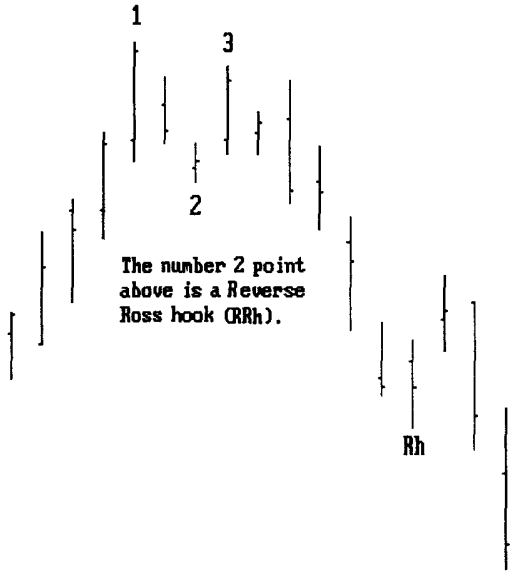
Identifying the Ross Hook

Sometimes Ross hooks are 1-2-3's that occur subsequent to the initial 1-2-3 formations that occur at lows and highs. Indeed, many of them are formed at the intermediate and minor lows and highs that occur in trending markets. But to call them all 1-2-3's would be to present an erroneous picture. Not all Ross hooks are identifiable as 1-2-3's.

1-2-3's are the direct result of certain market forces at work. I described them earlier. Ross hooks are the result of a different market phenomenon. Then, too, there are Reverse Ross hooks which are a bit more difficult to see, identify, and trade. The number two point shown next is a reverse Ross hook

Before this book is finished, you will know how to identify and trade Ross hooks, reverse Ross hooks, double bottom Ross hooks, and double top Ross hooks. But before I go any further, I need to show you what these hooks look like, and also show you how they relate to, and often derive from, the basic and fundamental 1-2-3 formation. Later, I will show you how I utilize some of the trading tools mentioned in Chapter 2. Just so you'll remember what they were, I'll repeat them here: I knew how to identify a trend, I knew what constituted a 1-2-3 high or low, I knew how to identify congestion, I knew the five functions of a manager, and I knew how to give orders to brokers in a forceful and intimidating way.

The following chart shows a 1-2-3, and then the subsequent Ross hook.

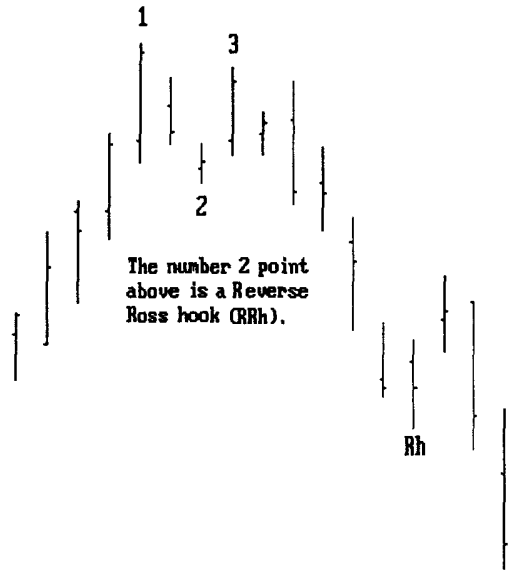


First, you see that the market topped out at the number 1 point. That's when prices were higher than what any additional buyers were willing to pay. At this point, there is too much supply and not enough demand.

Longs taking profits drive the price down to the number 2 point. They are aided and abetted by bears seeking to establish a short position.

Shorts take profits by buying. Renewed buying comes into the market by virtue of bullish traders who treat the pull-back as a bull market correction. This creates the number three point on the chart.

There are not enough traders willing to buy at the high prices, so the attempt to continue the upward trend fails. The market takes out the number two point, and a new downtrend is established.



After prices move down for awhile, a correction takes place. This correction is caused by shorts taking profits. To cover their positions, they buy, thereby causing the market to rally. At this point, other buying may come into the market by those who think the down move is about over. They may feel that prices are at support. Buying may also come in to the market by technical traders and retracement traders who think *"this is the time to buy."*

The rally leaves behind a minor or intermediate low which I have called the point of the Ross hook. The shaft of the hook is the down trend. The hook itself, the remainder of the formation, consists of the rally also known as a correction or reaction. It is this correction, the move opposite to the trend, that leaves behind a "pointy" place on the chart. The correction can be from one to three bars in length. At times it can occur in a much more subtle way by having the correction **and** low occur in the same bar. Other nuances can occur and will be shown as we progress. For now, the important thing is to understand what a hook is and how it looks. It is the breakout of the hook that can earn us a great deal of money.

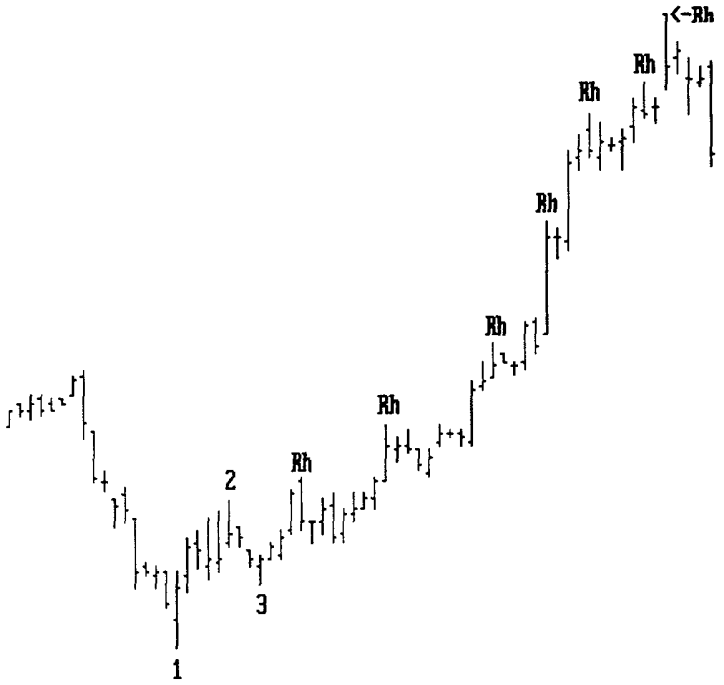
The preceding chart began with a 1-2-3 high, a breakout of the number 2 point, and the establishment of a trend which led to a hook and ultimately to a continuation of the downtrend.

Next, let's look at a series that begins with a 1-2-3 low.

In the following graph we see an end to selling, which was the low at point 1. As prices started to rise intraday, shorts began to cover in order to take profits. Their buying, aided and abetted by the entry of longs who think this is the bottom, causes prices to rise to the number 2 point. Some longs, looking for a quick profit, begin to sell. They are joined by traders who feel that what they are seeing is a bear market rally. Prices head back down to the number 3 point.

However, there is simply not enough supply at these low prices to warrant continued selling. Prices refuse to go as low as, or even to take out the number 1 point. Instead, demand takes over the market and bargain hunters, who are afraid that prices will move even higher, begin to buy. The demand is strong enough to overcome the number 2 point and thereby establish a new upward trend.

As prices rise, selling comes into the market as some longs liquidate all or part of their position. This selling, joined by those who feel it's time to get short, drives prices back down in what is viewed as a pull-back, a retracement, or a correction, take your pick. Prices move down in reaction to this selling.



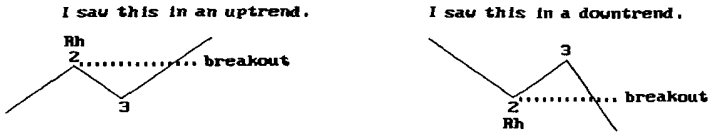
But demand is still greater than supply, and prices are not yet too high to keep buyers away. The market moves up, taking out the point I've labeled as Rh. This process is repeated several more times, until eventually we see what may prove to be a market top.

The Ross hooks made subsequent to the initial breakout of the 1-2-3 low are a frequently occurring event. Yet they are often not easily categorized as 1-2-3's. Sometimes the distance between what might be labeled as a number 1 point and what might be

labeled as a number 2 point is considerable.

My early discipline dictated that if I couldn't label a 1-2-3, I couldn't trade these "pointy" places on the chart. I was missing a lot of good trades.

Then I noticed that the only thing missing was that there was not necessarily a number 1 point. The number 2 and number 3 points were always there.



It didn't matter where the number 1 point might be. The important thing was that the formation occurred in a trending market. Within reason, the stronger the trend the better, but not always so. There were also times when caution overruled all other considerations. More of that in another chapter.

The next step was for me to thoroughly test the idea of trading these hooks and to simultaneously work out a managerial scheme that would enable me to cash in on their potential.

What I liked best about the concept of trading the hooks was that they represented truth in the market. A breakout represents a truth in the market. Once prices have broken through the point of the hook, they have broken out. Even if the breakout should prove to be a false breakout, the immutable fact is that prices have broken out — generally with sufficient force to afford the opportunity to at least cover costs and allow the remaining time in the trade to be "free."

My next question may seem overly simplistic, but I had to ask myself...

"What Causes a Ross Hook?"

Obviously these "pointy places" were different from the number two points of 1-2-3 formations. It became equally obvious that they had nothing to do with supply and demand.

If that were the case, there were only two things that could be causing them. One was obvious — the hooks were caused by profit taking. Whenever the market had moved sufficiently to satisfy a majority, profit taking caused the market to begin to move counter-trend.

The other reason was not so obvious, at least not to me, and not at that time. Today, it has become all too obvious and is a splendid way to pick the pockets of naive, less experienced traders.

At the point in my trading career where I discovered the hooks, I was almost totally unaware of the phenomenon I've come to call "the technical indicator trader."

I had been taught classical technical analysis which involved learning how people traded heads and shoulders, megaphones, pennants, flags, speed lines, etc.

Also, I had been taught how to fade these traders in the markets.

I had been taught a great deal about floor trader action in the markets, and how to neutralize what they do.

I could generally spot an engineered move by large operators on the floor. Then I could either participate or not according to my choosing.

What I was ignorant of was the use of moving average crossovers, and technical indicators such as stochastics, RSI, and others that were coming to be used in the markets.

Apart from an offset moving average, the only technical indicator I had been taught was known to me as Percent C. Percent C was a very old indicator and was used to find overbought and oversold areas in the market. Percent C stands for percent of Cycle. It has since been presented as something "new" in the form of the so-called fast stochastic, which really isn't a stochastic at all, and its flip side, Percent R, which is nothing more than the fast stochastic turned upside down.

If you look up the word stochastic in a dictionary, you will readily see that the term stochastic is a misnomer.

The **New World Dictionary of the American Language** says, "**sto-chas-tic** (sto kas'tik)**adj.** [<Gr.*stochastikos*, proceeding by guesswork, lit., skillful in aiming <*stochazesthai*,to aim at < *stochos*, a target: for IE. base hastikos, *proceeding by guesswork, lit., skillful in aiming* <stochazesthai,*to aim at* < stochos, *a target: for IE. base see STING] 1. of, pertaining to, or arising from chance; involving probability; random 2.* **Math.** *designating a process having an infinite progression of jointly distributed random variables.*

I will not argue with anyone against the fact that ***markets*** are an infinite progression of jointly distributed random variables. But the study which has wrongly been named stochastics is not the market, but rather a mathematical attempt to measure momentum, divergence, and an idiotic concept called "overbought" and "oversold", on a fixed scale. It is always relative — where is the closing price today relative to where closing prices were previously? This is precisely why the so-called Stochastics falls apart in a trending market, where it can stay "overbought" or "oversold" for many time periods beyond where the market was supposedly in the "overbought" or "oversold" condition.

Later, I will show you how to trade Ross hooks with the original so-called Stochastics as revealed to me by my friend Rick Redmont, but with some nuances of which even he is unaware.

Although I generally take a stance against attempting to trade with cycles, there is enough substance to them that they may prove useful in calculating Percent C should you choose to use it in conjunction with Ross hooks. My friend Dr. Ed Dalton has convinced me of this. However, you'll have to attempt it on your own, as I have no real experience with it.

To conclude the thought I started earlier, about the causes of Ross hooks: it was trading by technicians using technical indicators that in part caused the market corrections that resulted in Ross hooks.

More than that, as you will see later, it was the **incorrect** use of these oscillators and indicators that in part caused the corrections that yielded Ross hooks.

Technical traders, thinking the market was in an overbought or oversold condition, were entering the market the wrong way, and adding to the momentum of the correction by profit takers.

In later years, with the advent (or should I say the re-invention) of Fibonacci trading, the corrections often became more pronounced, as these traders would blindly buy or sell at their predetermined "magic" Fibonacci ratios, where the market was supposed to stop going one way and begin going another.

Add to this the more recent, illogical notion that markets are supposed to turn on moon dates, and you will know exactly how to fade these moves and stick a huge chunk of money in your pocket.

Ross Hook Definition

WHENEVER A MARKET TREND IS INTERRUPTED BY A CORRECTION, NO MATTER HOW SLIGHT, IT WILL LEAVE BEHIND A ROSS HOOK. IN A DOWN MARKET, A FAILURE BY PRICE TO MAKE A NEW LOW CONSTITUTES A ROSS HOOK. IN AN UP MARKET, FAILURE BY PRICE TO MAKE A NEW HIGH CONSTITUTES A ROSS HOOK.

IN A DOWN MARKET, IF PRICES MAKE AN EQUAL LOW, REVEALING A DOUBLE SUPPORT POINT ON THE CHART, THE MARKET HAS MADE A ROSS HOOK. IN AN UP MARKET, IF PRICES MAKE AN EQUAL HIGH, REVEALING A DOUBLE RESISTANCE POINT ON THE CHART, THE MARKET HAS MADE A ROSS HOOK.

This means that a double (two consecutive equal lows) low followed by a higher low or a double (two consecutive equal highs) high, followed by a lower high, also constitute a Ross hook.

There are other ways to define trends that lead up to the identification of Ross hooks that were covered in my book **Trading by the Minute.** In essence what I showed there was that Ross hooks always occur in trending markets. I showed several ways to define a trend. Once a trend was defined, the very next correction that occurred resulted in a Ross hook.

What will be shown here is in no way in conflict with what I showed in **Trading by the Minute.** By definition, Ross hooks always occur in trending markets. In this book I show that a trend can be defined by a 1-2-3 formation. This is precisely the same formation that was labeled the **True Trend** in **Trading by the Minute.** Regardless of how you define the trend, a Ross hook always occurs once a trend has been defined, and indeed establishes that trend. This concept was shown in **Trading by the Book** in a section that dealt with a technique for entering an established trend. Each subsequent Ross hook serves only as additional confirmation of the trend, until such time as the trend is exhausted.

It becomes crucial, then, to know when you are in a trending market.

I must show you a most elemental way to identify a trend.

Chapter 4

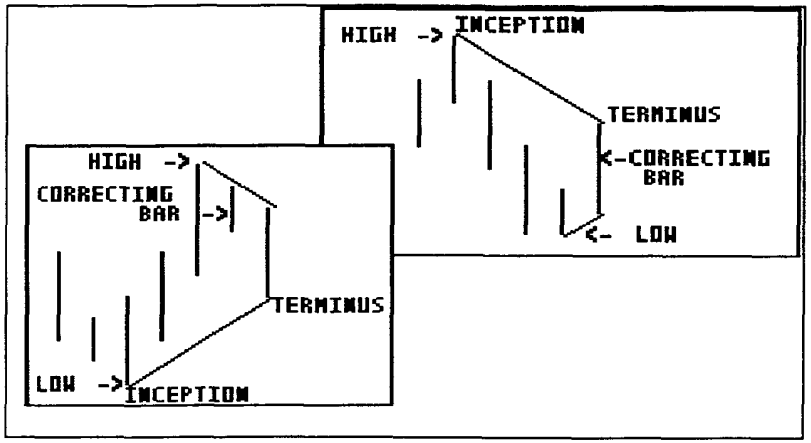
Identifying the Trend

I mentioned earlier that one of the tools available to me in my early trading was one that clearly identifies the trend. The tools allowed me to lock onto a definite set of rules. Either the market was trending or it was not, according to my set of rules. Now I want to show you what those rules were. They are still correct after these many years. They were utilized before I ever began trading, and they worked as well then as they do now. Is there some sort of magic about these rules? Definitely not. Their value lies in the fact that they afforded me a concrete definition of what constituted a trend. As long as I followed the rule, I could safely assume the market was trending.

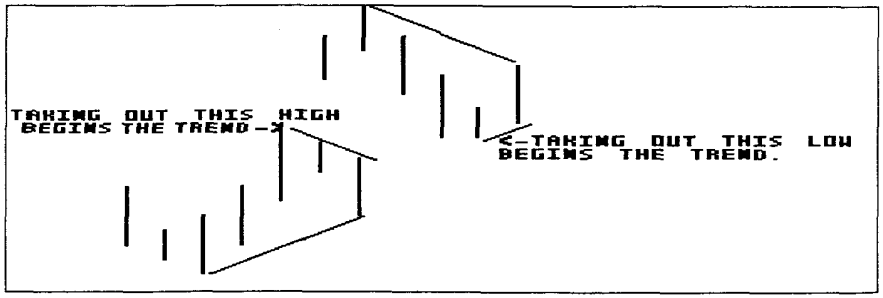
Did the rule work one-hundred percent of the time? No! I have not yet found a perfect way of trading. The rule worked most of the time, and that was sufficient for me.

The Rule

A market had to move in a single direction, for instance **up,** from a low to a high, or **down,** from a high to a low. Once the market was in motion, it then had to react, or correct sufficient to give me a connecting point for a trend line. This connecting line would have its inception at the original high or low, and its terminus would be the reaction high or low. This concept is best shown by illustration.



When prices would take out the extreme of the low bar in the direction of the trend line as shown below, I would then assume a trend had begun. As stated, this was not a perfect method for identifying a trend, but it is the one I use when I want to trade Ross hooks exclusively.



Over the years, this has proved to be an adequate and excellent way to determine a trend.

Before you race out to start trading this way, please realize there is more to this concept than what I've just shown. Money management and some filters need to be applied. For now, I simply want you to begin grasping the concept and the terminology that it is my habit to use.

Once the trend had begun via the rule, I could then begin looking for and trading Ross hooks.

The hooks came only **after** the trend was in effect.

An Important Concept

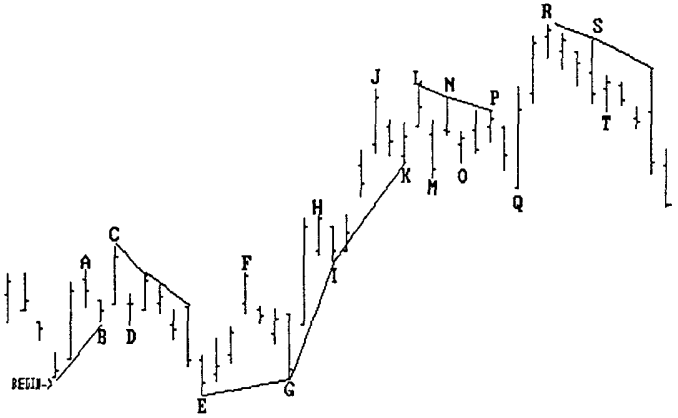
ROSS HOOKS OCCUR ONLY IN TRENDING MARKETS. There are plenty of "pointy" places on a bar chart, but not all of them are Ross hooks. It is essential to your trading them that you understand this.

Those hooks which occur in trending markets will remain as valid hooks. Often, they may be taken out more than once.

Now, let's look at the difference between a Ross hook and any other "pointy" places in a market. Remember, they can occur only **after** the trend has begun.

I have purposely chosen a chart with some very difficult areas to define. Each letter labeling a particular price bar was placed there because at the time that bar was made, it was a pointy place on the chart.

The lines drawn connect either a high or a low to a correction. The pointy places were either local highs or local lows at the time they were made.



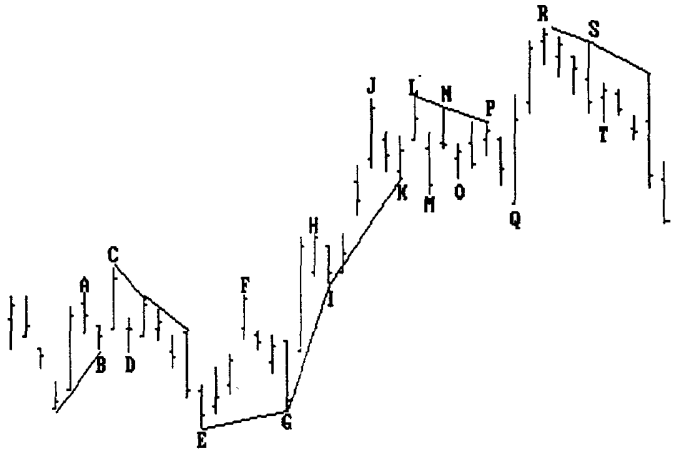
We begin two bars prior to point "A," which was a pointy place on the chart. It was not a Ross hook. Why? Because until point "A" would have been taken out by prices, there would be no trend.

Point "B" would have constituted a Reverse Ross hook had the uptrend begun at the time it was made. Since there is also no downtrend in effect, point "B" cannot be considered a regular Ross hook. In other words, had there been an uptrend in effect, "B" would have been a reverse hook. Had there been a downtrend in effect, "B" would have been a regular Ross hook. As is, "B" was neither.

Point "C" was a Ross hook. Why? Because it was made after the trend had begun by virtue of the move up, the correction bar, and the taking out of point "A". If point "C" would be taken out by price in an uptrend, we would want to be a buyer, preferably using the Trader's Trick entry (to be explained in a later chapter) to get in early.

Point "D" was not a Reverse Ross hook. Why? Because it was made while the market was in congestion. The congestion was in effect when bars "A"-"D" gave three closes and an open all within the trading range of the bar preceding bar "A". Point "D" is especially important, because it, together with point "B," constitute a double support point. If Point "D" is taken out, it would be a significant event worthy of notice.

Point "E" was a Ross hook. Why? It was made in a downtrend. If it would ever be taken out, we would want to be a seller.



Point "F" was not a Ross hook. Why? Because until prices would have taken it out, there was no uptrend in effect. Point "F" was like point "A".

Point "G" was not a Ross hook. Why? Because it did not occur in a trend. If point "G" were to be taken out, a trend would be in effect. Until then, it was simply the flip-side of points "A" and "F". Point "G" was the equivalent of point "B".

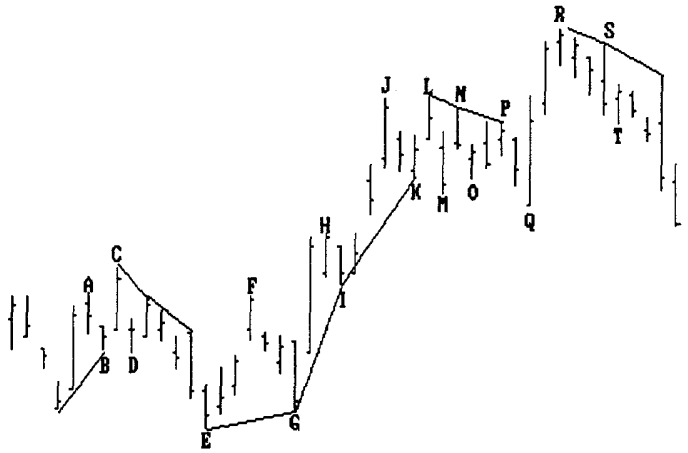
However, point "G" was important because it gave a connecting point from point "E."

Point "H" was a Ross hook. Why? It occurred in a defined trend. Once point "F" was taken out, the trend was, by definition, in effect.

Please note that as prices moved toward point H, the hook at point C was taken out. We would have wanted to be in the market at or before the breakout. How to get in earlier than the breakout will be discussed in a later chapter.

Point "I" was a Reverse Ross hook. Why? Because it was made in a trending market, in this case an uptrend. The trend was put in effect when the bar preceding bar "H" took out the high at point "F". If point "I" were to be taken out, we would want to go short. It also gave us a connecting point from point "G."

Point "J" was a Ross hook. Why? It was made in a defined uptrend. The trend was put into effect at the taking out of point "F".



Point "K" was a Reverse Ross hook. Why? It was made in a defined trend, in this case an uptrend. It also gave us a connecting point from point "I."

Point "L" started out as a potential Ross hook. Why? Because it was made in an uptrend. Point "L", together with point "J", constitute an important double resistance point. If they are ever taken out in an uptrend, we would want to be long. Double resistance hooks and double support hooks are treated the same as single pointed hooks. Taking them out is a tradable event. However, subsequently point "L's" status as a Ross hook is nullified when it becomes part of a four bar congestion beginning with the bar after "J." **If a bar that would ordinarily make a hook is also the fourth bar qualifying for congestion, the congestion takes precedence and you do not have a hook. In this case "L" is nullified. "J" remains as the Ross hook.**

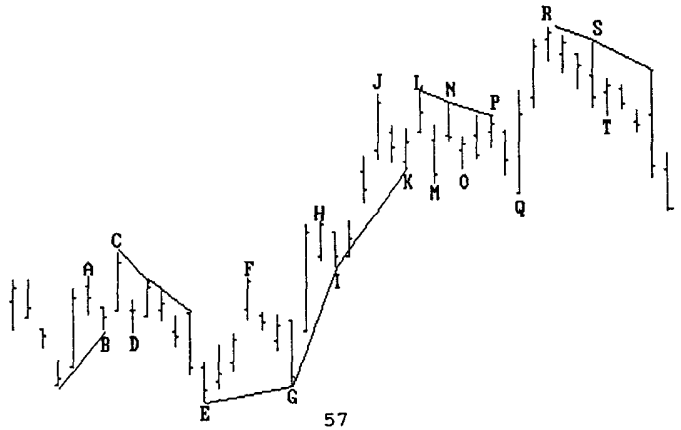
Point "M" was not a Ross hook. Why? Because it was not made in a trend.

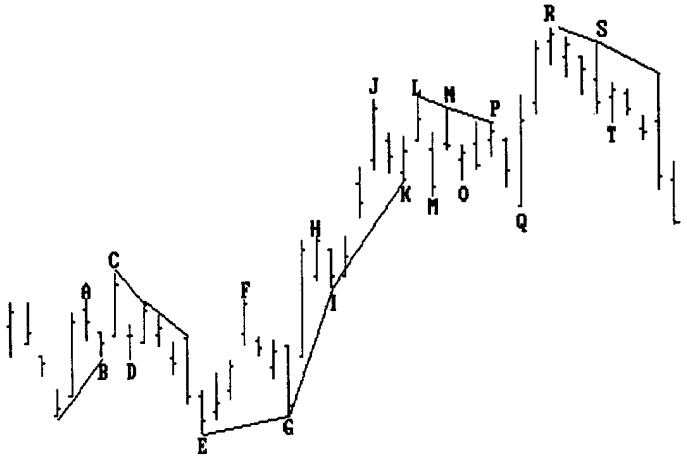
Point "N" was not a Ross hook. Why? Because it was the sixth bar of a congestion area. However, point "N" was important because it gave a connecting point from point "L."

Point "O" was not a Ross hook. Why? Because it was the seventh bar of a congestion area.

Point "P" was not a Ross hook. Why? Because it was the ninth bar of a congestion area. However, point "P" was important because it gave a connecting point from point "N".

Point "Q" was a Ross hook. Why? Because it was made in a defined downtrend. The taking out of point "O" established the trend.





Point "R" was not a Ross hook. Why? Because it was not made in a defined uptrend. Point "R" is like point "A".

Point "S" made a higher high, taking out the high of the previous day. That gave a connecting point from point "R".

Point "T" is a Ross hook. Why? Because it was made in a defined downtrend.

Before I go any further, I must explain how I was taught to identify congestion.

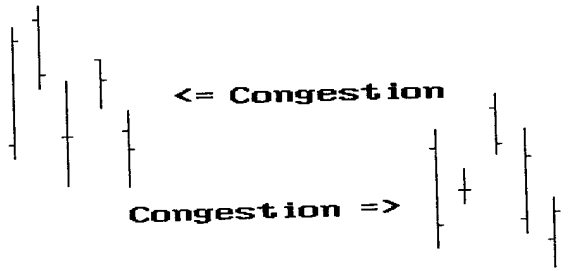
Chapter 5

Identifying Congestion

One of the concepts I learned in the earliest years of my trading was how to know when I was in congestion. I was taught each of the concepts I will present, the most recent by my trader friend, Neal Arthur Muckler. I'll begin with that one.

Any time prices **close** on four bars, within the confines of the range of a **single price bar** and subsequent to that bar, you have congestion. This is regardless of where the highs and lows may be located. The **single price bar** may be termed a **measuring bar.**

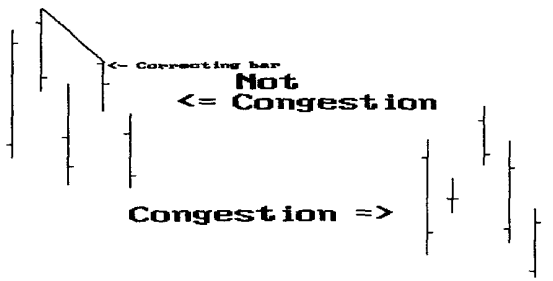
You will have to closely and carefully study the charts that follow. Congestion can be very subtle in appearance. Often the difference between congestion or trend is the positioning of a single open or close.



I have added to this method a concept of my own. Any time prices **open, close, or both** on four consecutive bars, both **subsequent to** and **within the range of any preceding single measuring bar**, you have congestion, **provided that the bar having only the open inside the applicable range occurs before a correction is made.**

An inside open and close on the same bar count as one towards the four necessary to define congestion.

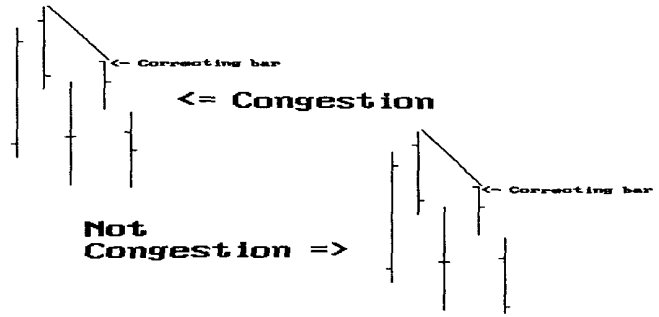
Let's take a look at this concept.



In the first instance above, we do not have congestion because the close of the bar following the correcting bar did not occur within the range of the measuring bar.

In the second instance above, we **do** have a congestion. A correction has **not** occurred, and we cannot initiate a trend line until it does. Keep in mind that the four bars defining congestion must be consecutive. There can be no intervening bars.

Just to be sure that you get the hang of it, let's try it again showing almost identical formations so you can see the difference.



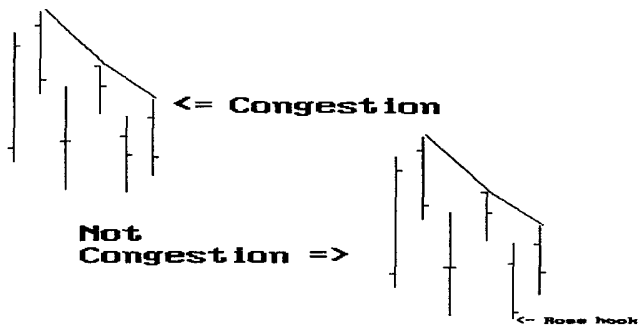
The only difference between these two formations is the position of the close on the last price bar.

Because we have had a correction, all bars must have the close within the confines of the range of the very first bar in order for us to define this situation as congestion.

By drawing an additional bar on the chart we can see the difference that would be made in the decision making process.

In the first instance, the additional bar produces no Ross hook. Why? Because the higher low of the last bar took place in what we have defined as congestion.

In the second instance, the additional bar does produce a Ross hook.

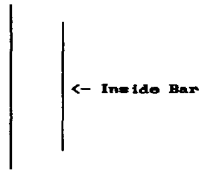


Why? Because in the second instance, the higher low of the last bar was made in what we have defined as a trending market.

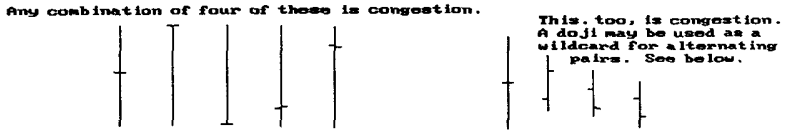
Now, to further show you this concept, look at the combination of points "K" through "M" on the chart from the previous chapter, reproduced below. Even though "M" closed below the range of "J," the fact that "L" made a new high and then closed, dropping back into the trading range of "J", tells us that prices are still in congestion. In addition, we now have congestion by virtue of alternating bars, which will be discussed next.

Now it's time to look at another way to know when we are in congestion.

Any time we are not making higher highs and higher lows or lower highs and lower lows, and we can see four alternating bars, at times coupled with inside bars, at times coupled with dojis, we have congestion. Alternating bars are ones where prices open lower and close higher on one bar, and open higher and close lower on the next. Inside bars look like this:



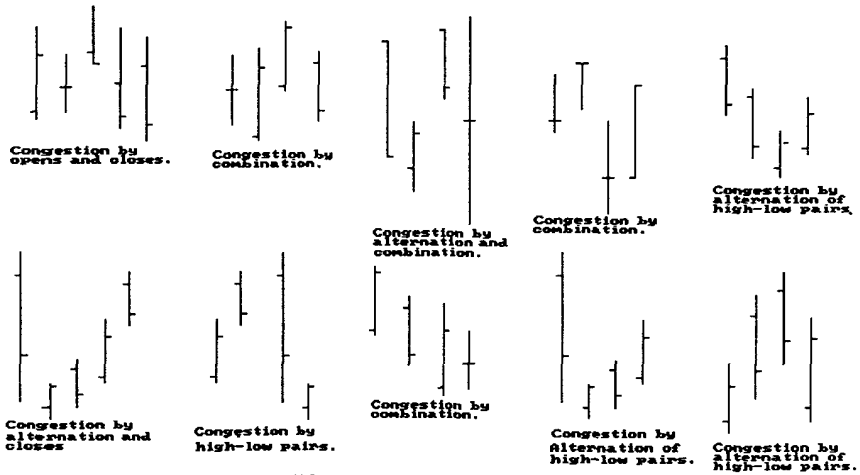
Dojis are bars where the open and close are at the same price or very near to the same price, yielding a bar that looks like this:



A combination of alternate closing high-low, low-high pairs is congestion.

"Pointy" places made when the market is in congestion are not Ross hooks.

The first bar of the congestion may very well be the last bar of what had been a trend. A congestion may look similar to any of the following, as long as it consists of four or more bars:

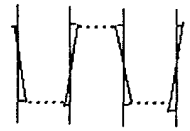


Note: A doji can be used as a wildcard. A doji together with any combination of one or more non-doji bars can be considered as congestion. If there are three such non-doji bars, one of them must alternate high-low with the other two.

Frequently congestion will start or end with a doji. Frequently congestion will begin or end with a long bar move, or a gap.

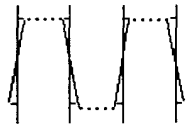
Another way to identify congestion is when you see /\/\ or \/\/ on the chart.

The smallest possible number of bars that can make up this formation is four. Let's see how this can be done.



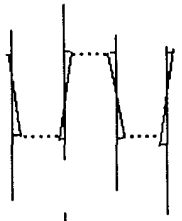
What we have here is an open higher close lower, followed by an open lower close higher, followed by an open higher close lower, followed by an open lower close higher sequence This forms a ⩛.

Idealized ⩛⩛'s and ⩚⩚'s

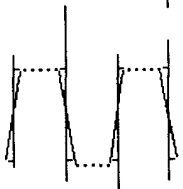


Here we have an open lower close higher, followed by an open higher close lower, followed by an open lower close higher, followed by an open higher close lower sequence. This forms an ⩚.

In reality, we may get something that looks more like the following:

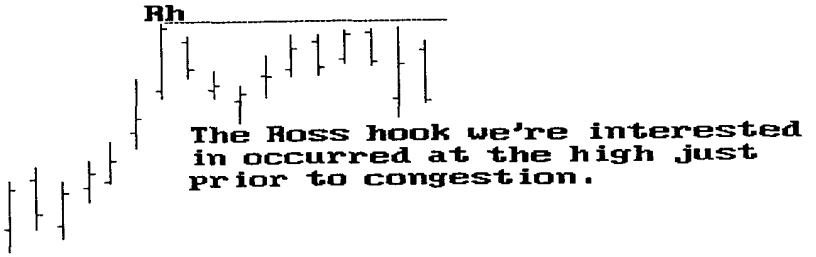


What we have here is an open higher close lower, followed by an open lower close higher, followed by an open higher close lower, followed by an open lower close higher sequence This forms a ⩛.

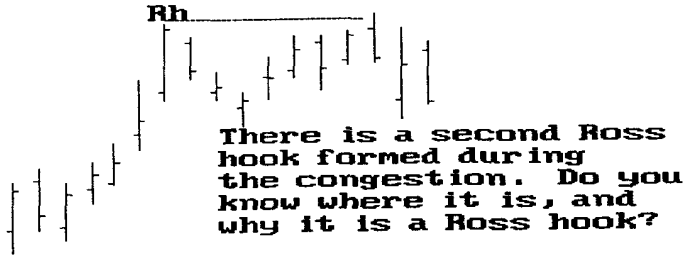


Here we have an open lower close higher, followed by an open higher close lower, followed by an open lower close higher, followed by an open higher close lower sequence. This forms an ⩚.

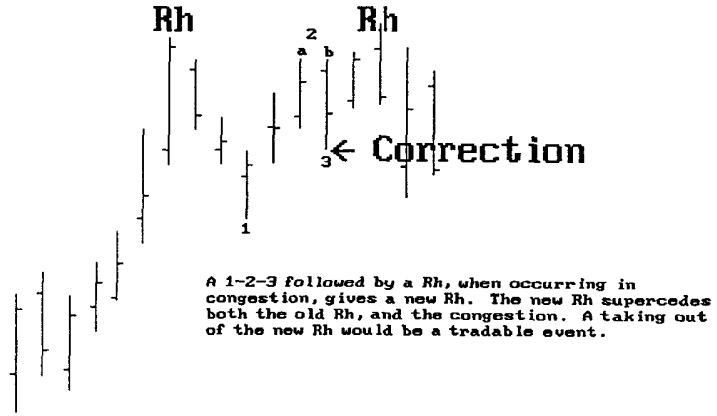
If we were to get a formation that looked like the following, the Ross hook would be as marked. If that hook is taken out, we would want to be long. Notice that the bar that created the Ross hook was the last bar of the trend and the first bar of the congestion.



Now, let's see if you're really getting this.



The Ross hook is as marked below.

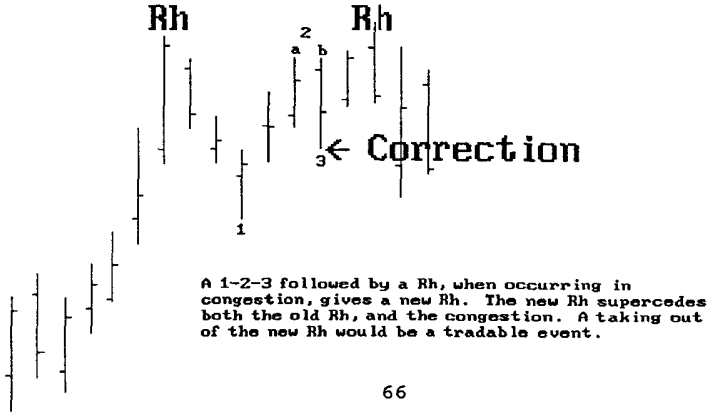


A 1-2-3 followed by a Rh, when occurring in congestion, gives a new Rh. The new Rh supercedes both the old Rh, and the congestion. A taking out of the new Rh would be a tradable event.

Note: **A 1-2-3 followed by a breakout of the #2 point, that subsequently results in a Ross hook, supersedes any congestion, or *previous Ross hook.***

The price bar labeled "b" made a new local low. The take out by prices of the local double resistance, "a" and "b", is a significant event. "a" and "b", together, constitute the number two point of a 1-2-3 low occurring in congestion.

The new Ross hook represents an even more significant breakout point. Combined with the old Rh, there is significant resistance, and within a few ticks, the two constitute a double top. If prices take them both out, you would normally expect a relatively longer term, strong move up.



A 1-2-3 followed by a Rh, when occurring in congestion, gives a new Rh. The new Rh supercedes both the old Rh, and the congestion. A taking out of the new Rh would be a tradable event.

I use the term "relatively" here, because the intensity and the duration of the move would be relative to the time frame in which the price bars were made. Obviously such a move on a one minute chart would hardly compare with an equivalent move on a daily chart.

While we are looking at the above chart, there is something else of importance to notice. Prices retreated from the resistance point, thereby creating the second Ross hook. This represented a failure to break out. This failure is why Reverse Ross hooks are *important and will lead into the next chapter.*

Before leaving this chapter, let's give you a brief review of the various congestions. All of the three following conditions that define congestion must occur without consistently making higher highs or lower lows.

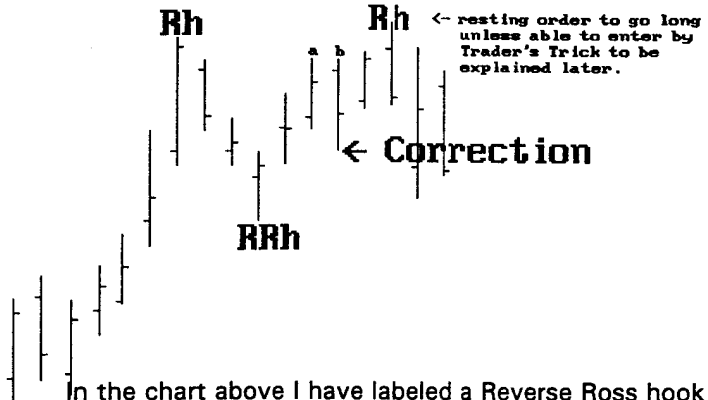
Congestion by Opens/Closes: Four consecutive closes or opens within the range of a measuring bar. If opens are used, there can be no correcting bars *before* or *coincident* with the bar in which the open is used.

Congestion by Combination: A series of four consecutive dojis, or at least one doji and any three alternating bars. The doji is a wild card and can be used to alternate with any other bar. If there are three non-doji bars, one of them must alternate high-to-low with the other two non-doji bars.

Congestion by Alternation: A series of four consecutive alternating open high - close low, open low - close high bars in any sequence. This definition includes Congestion by High/Low pairs.

Chapter 6

Trend Reversals



In the chart above I have labeled a Reverse Ross hook (RRh), on the third bar after the Rh bar. The subsequent bar to the RRh bar was the fourth bar with all closes within the range of the Rh bar. You may wonder, "If the bar that makes the hook is also the bar that qualifies for congestion to have been entered, what takes precedence, the RRh or the congestion?"

The answer to that question is forthcoming in great detail when we discuss filtering the Ross hook.

RRh's are important in spotting trend reversals. **Some** RRh's occur in the correction that follows a market top.

An RRh is created via the following scenario.

Demand is sufficient to take prices to new highs.

Then, profit takers sell into the strength of the rally to the top, pushing prices back down to what is to become the point of the RRh prior to the rise to the next but not necessarily higher high.

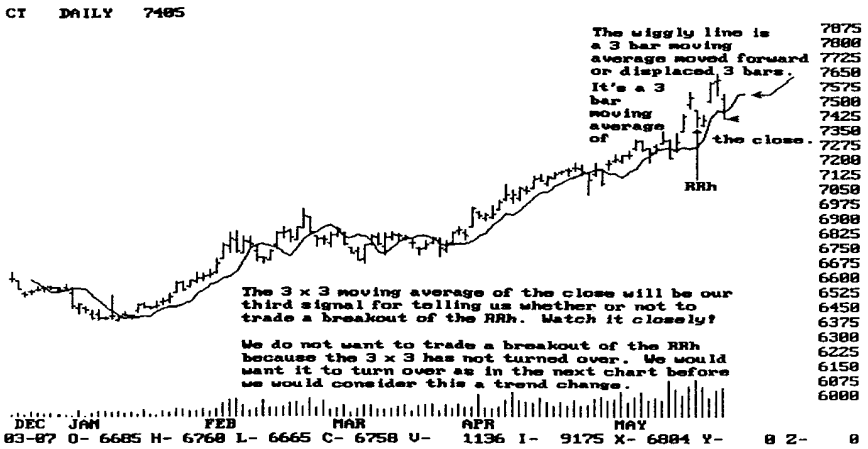
Then, the remaining bulls step in again to push prices up. Usually volume is thin compared with the previous up legs.

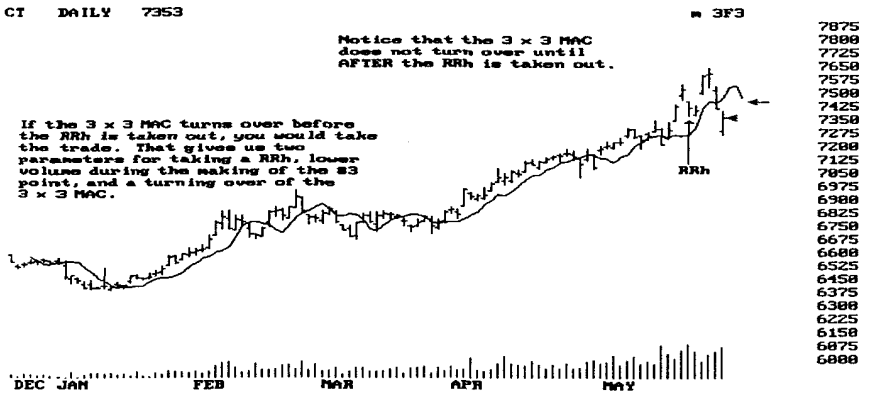
Finally, one last sell-off follows on very heavy volume, pushing price down through the RRh.

It is when you see a market approach a previously made Rh on lower than previous volume, and then fail to take it out, that you have one signal that prices may be ready to reverse. Such an event is a first clue as to what the market may be saying.

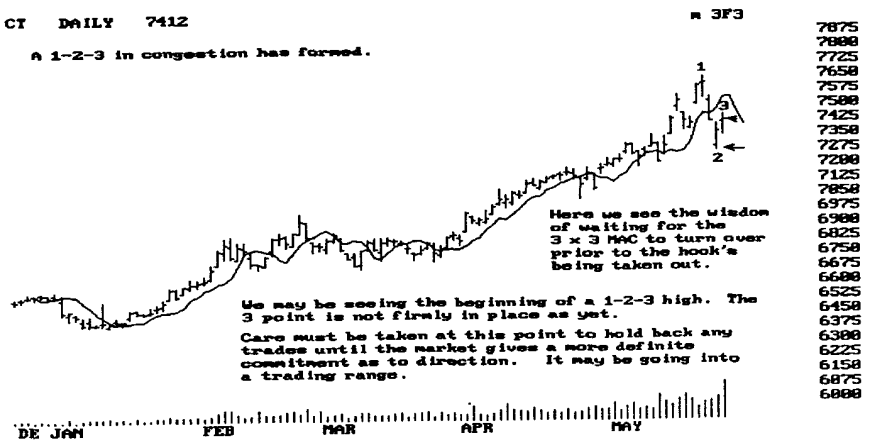
Then, when prices drop down and take out the bar labeled RRh, you have a second signal to indicate a trend reversal is in the making. At this point, you do not blindly take a breakout of that RRh. There must be a filtering process. The filtering process will give us the third signal that a trend reversal is taking place.

Let's look a step at a time at a chart that shows what I mean.

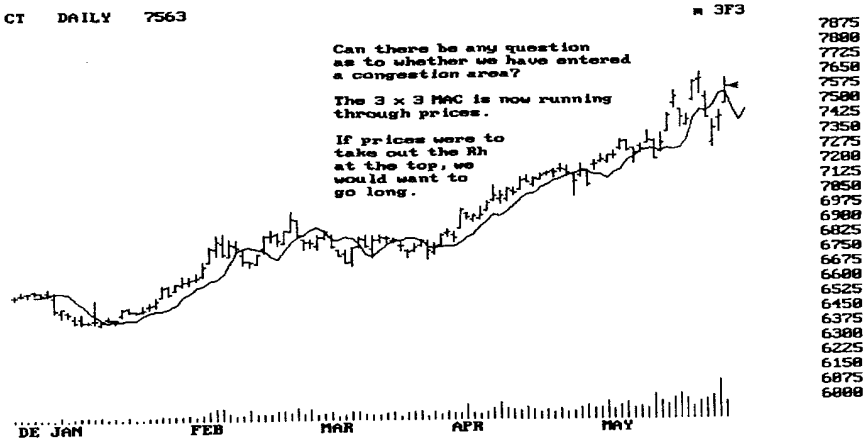


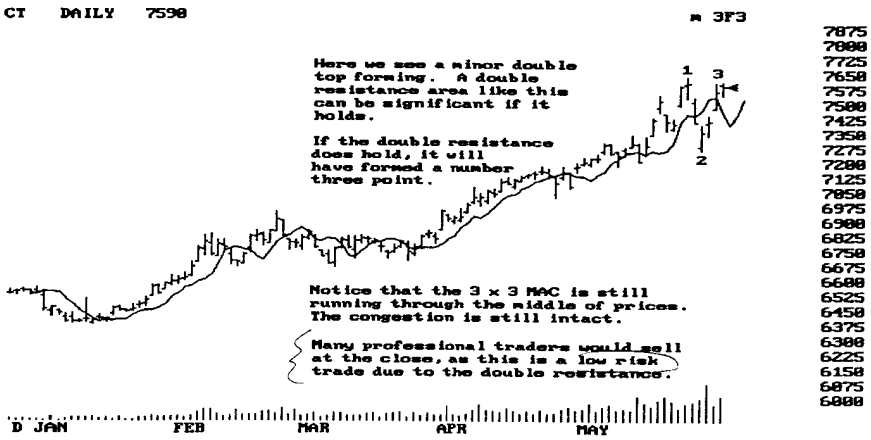


It can be argued that looking ahead, we can see that taking out the RRh would cause the 3 x 3 MAC to turn over. This is true, and is a more refined, advanced way to trade, one that has made me considerable money. However, if a turnover by the 3 x 3 MAC is anticipated, we must be prepared to daytrade any breakout of the RRh, as the trade may be only short lived. If we try to trade the anticipation as a position trader using a daily chart, we must be prepared to take a short term scalp by having a short term objective stop. Breakouts of RRh's are often false. We keep that firmly in mind when we trade them. RRh's are not nearly as high percentage trades as are Rh's preceded by 1-2-3's.

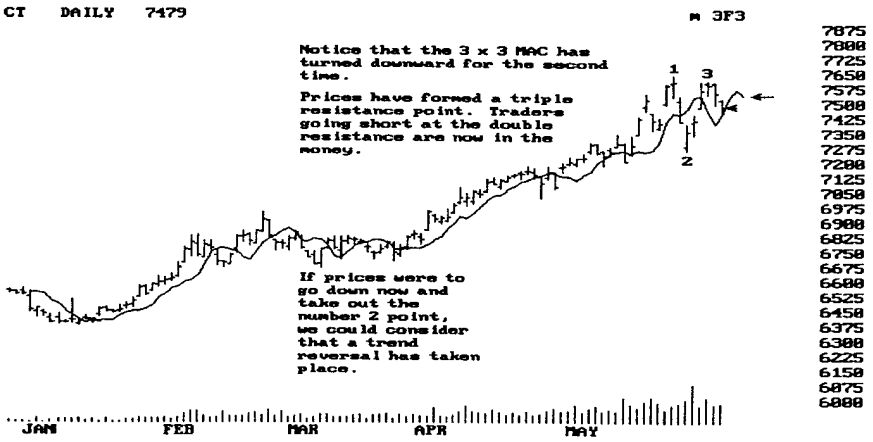


In fact, by our definition of congestion, we are now seeing congestion on the chart. Beginning with bar 1, we have had a doji, an open-higher close-lower, an open-lower close-higher, and an almost doji. These, one after the other.





A double resistance point gives a relatively low risk entry point, if you want to trade within the congestion.



At the place where the number two point would be taken out, we could then start looking for Ross hooks.

If you are a reader of any of my previous books, you may be wondering why I am not writing about going short on or before the breakout of the 1-2-3 high that has been forming.

It is not my intention to go into that information here. It is a subject that has been treated in each of three other books I have written, **Trading by the Book, Trading by the Minute,** and **Trading Is a Business.**

Incidental information such as the concept of getting short at the double resistance minor top is presented as "nice to know." However, such information is not the subject of this book. I have and will continue to reveal such information in my teaching letter, **Traders Notebook**, and in an additional book I intend to write, called **Trading in Congestion.**

It is the combination of three things that determine that a trend reversal has indeed taken place. Let's review them here, noting that numbers 2 and 3 may be reversed in order of occurrence.

1. A failure to take out a Ross hook on lower volume at the end of a trend, signifying weakness in the market.

2. A correction strong enough to take out an RRh.

3. The 3 x 3 MAC turning down ahead of the takeout of an RRh, or a number 2 point. Later on, in the chapter on plain vanilla trading, I'll shown you how you can know, without any indicators, whether or not to take an RRh trade.

I've shown the beginning of a trend reversal at a market top. If you want to see what such a reversal looks like at a market bottom, simply turn the page upside down and hold it up to a mirror.

When there is a test of an extreme followed by a failure, be aware that you may be looking at a trend reversal. However, be cautious. Before the trend reversal goes into full force, there may be a trading range or congestion area.

Such a trading range can be indicative of accumulation or distribution. You cannot be sure which. Be sure to wait for definite commitment by the market before beginning to look for Ross hooks.

Such commitment can be seen in the form of a 1-2-3 breakout, followed by the forming of a Ross hook.

Yes, you will miss a part of the move, but you will, if you follow what I have shown, trade most of the time in an established trend. Since most of the money to be made in the markets for off the floor traders occurs in trends, this represents a conservative and effective way to trade.

We've now seen something of trend reversals and Reverse Ross hooks.

We've seen that the RRh in itself is one signal that helps us to suspect a trend reversal may be imminent.

We've also seen that a filtering process is necessary in combination with the RRh for determining the plausibility of entering a trade.

The RRh as a signal must be filtered. In the case shown previously, we used the 3 x 3 MAC as our filter for the RRh.

When I began trading, I did not have the luxury of a computer. I had to do everything by hand. I kept a book on the 3 x 3 MAC so I would always know where it was. I marked my chart by hand each day. Eventually, I came to be able to see when to take an RRh or not, based upon what the market was doing.

The computer relieved me of what to me was a grievous chore. Yet there are many today who still mark their charts by hand. They enjoy it, and I salute them. There is a certain feel you get when you do charts by hand. It really helps you "feel" the market. That's the only part of manually updating charts that I miss. I've never found a substitute.

I have watched Neal Arthur (Muckler), who has a computer and live data, sit down each day and bracket his charts by hand. What great patience and love of trading he shows by doing that. He doesn't know it, but watching him do that brought a tear to my eye. Whatever happened to the things that worked in the markets? People have lost them. It is knowledge carried forward by only a few.

The old timers used to sit and watch the clacker board. The few left who do this can still trade the socks off most everyone else.

Traders used to keep a "book." They knew when a market was trending or in congestion. They knew where support and resistance were. They knew how to correctly use the study that has become known as stochastics. The book gave them the feel of the market. When they went home at night, they updated their charts. They knew the markets and how to read them. They understood the markets they traded. Their knowledge made them rich.

They were not trying to "get rich quick" as are so many of today's traders. They plied their trade as astute craftsmen of the markets. They knew they would not get it all on one trade and they didn't try. They took steady profits from the market without having to go through all the emotional knee-jerking that are the hallmark of today's trading. They didn't need psychologists to teach them how to modify their behavior. They traded from knowledge of what they saw.

What I've shown you to this point has been the way I traded the hooks from the time I first discovered them. I traded them that way consistently for a long time.

In the chapters ahead we will be looking at various ways to filter Ross hooks, and nuances, concepts, and intricacies that will help you. These will add immeasurably to your success in trading, especially if you are addicted to the modern day crutches called technical indicators.

Chapter 7

Conceptual Processes

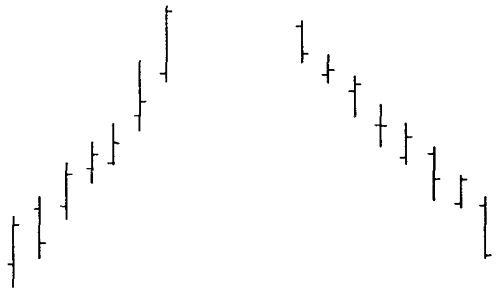
Anticipating Hooks

In Chapter 6 I said, "It can be argued that looking ahead, we can see that taking out the RRh would cause the 3 x 3 MAC to turn over."

The key point was that a signal can be based upon "looking ahead". I call such a concept "anticipatory trading."

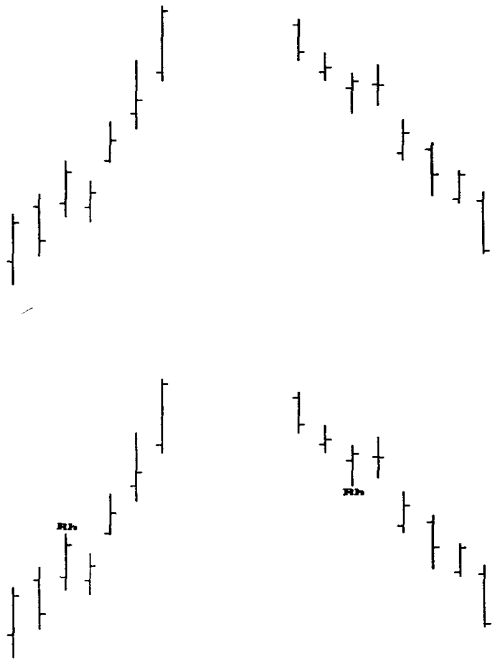
Here's how it works. When we see a market in an established trend, we can anticipate that every bar in the direction of the trend has the potential of becoming a Ross hook.

Let me show you a picture of what I mean.



In the above illustration we see pictured two trends, one up and the other down. Let's assume that somewhere earlier they had become established trends.

What if I were to change a single bar in each of the two trends?



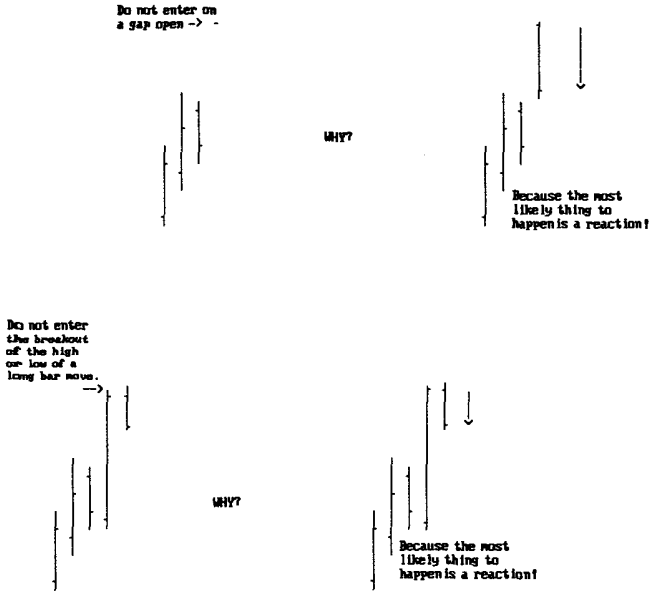
I would then have a Ross hook in each trend. For now, let's say I would want a resting entry stop above the point of the hook in the uptrend and below the point of the hook in the downtrend. Later, we will see ways to enter the market ahead of the actual breakout of the point of the hook.

The idea that the extreme of any price bar may become the point of a hook gives rise to the following trading signal: In an established uptrend, buy a breakout of the high of any price bar. In an established downtrend, sell a breakout of the low of any price bar.

Why? Because that is what you would do were that bar to become the point of a hook. The anticipation is that you can jump in front of the market and it will take you along for the ride.

However, there must be some filters used with this concept.

1. Never enter on a gap opening past the trading range of the previous bar, and never enter on the breakout of a long bar move made by the previous bar.



2. This type of trading should normally be limited to day traders, because a hasty retreat may become necessary. Daily chart position traders can take such trades provided they are able to give explicit instructions to their broker with an assuredness that such instructions will be carried out. This means the ability to give a set of contingency orders.

3. If there have been three successive bars in the same direction, do not attempt to jump in front of the market; a correction is usually imminent and a better entry will be obtainable.

Anticipating Correction

Even a cursory study of charts reveals that most moves in the direction of a trend last only three to five price bars, with the average being four bars in the direction of the trend before a correction of some type takes place.

Because most moves in the direction of the trend average four bars, we want to be conservative. We do not attempt to jump in front of a market after three consecutive price bars in the direction of the trend.

After three to five consecutive price bars in the direction of the trend, a correction will normally take place, giving an opportunity to either take a position in the trend or add to an existing position.

Anticipating Correction Length

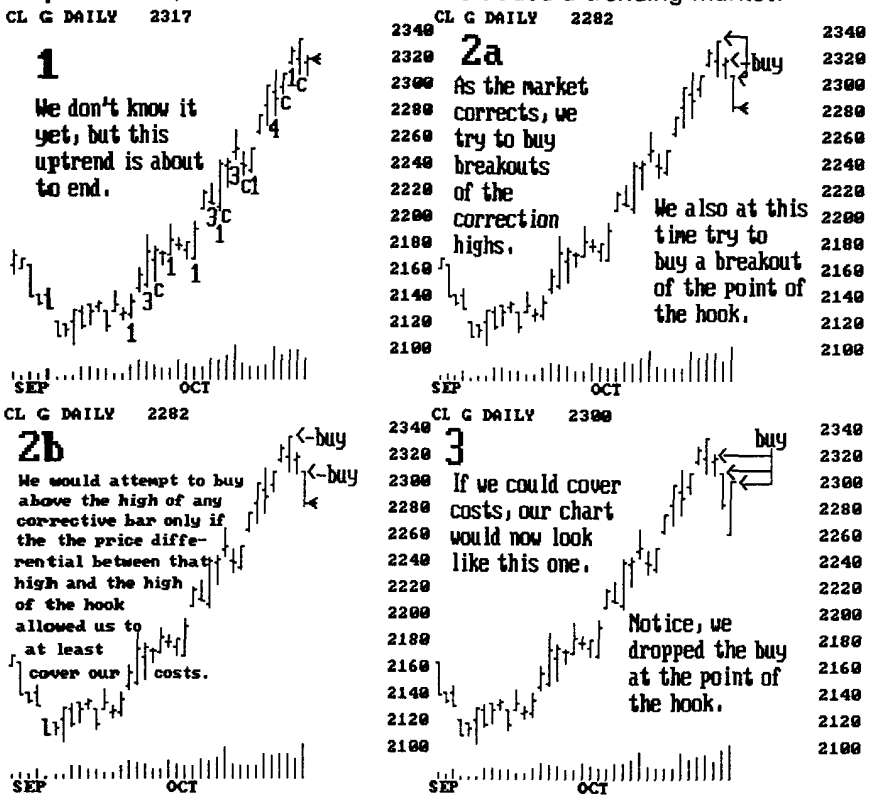
Most corrections last from one to three price bars opposite to the trend. It is here that we have a safe entry opportunity with relatively low risk.

Anticipating Trend Resumption

In most cases, a trend will resume after one to three price bars of correction. Anticipation of the trend resumption is an important factor in trading Ross hooks.

Trading Anticipation

Now, let's put our anticipations together, and taking it one step at a time, see how we would have traded a trending market.



I know I've cluttered up these charts, but there are a number of lessons that must be learned here, and I did not want to use one chart to a page just to make the book larger.

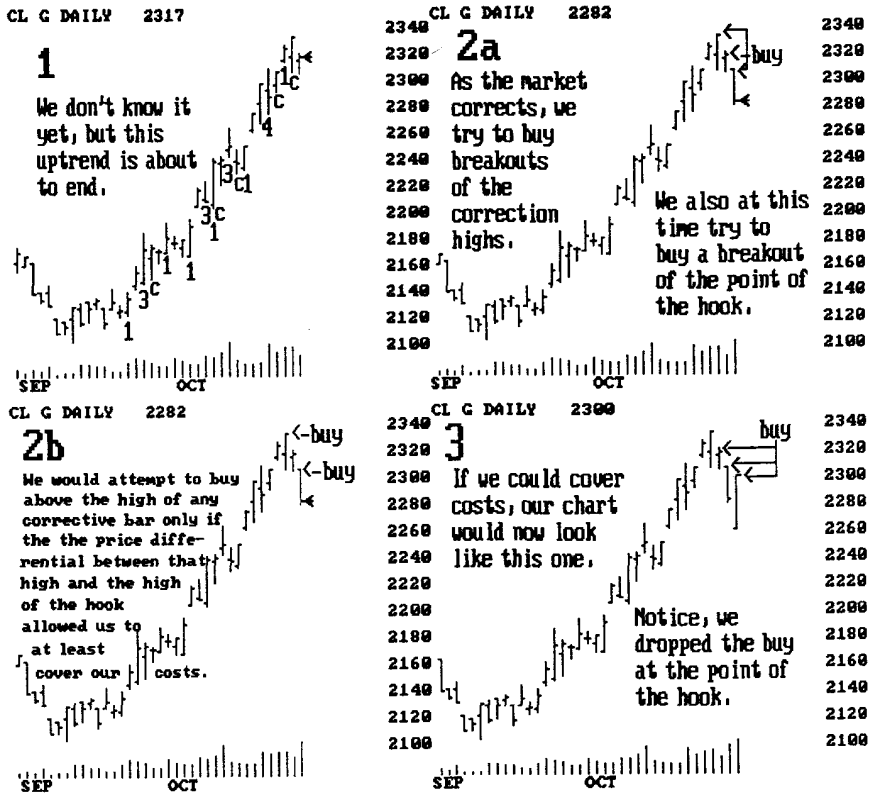
In chart 1, I've marked a cadence count. See if you can follow along moving from bottom to top.

1 - prices take out the high of the doji bar.

3 - prices have made 3 higher highs.

c - prices fail to make a new high.

1 - prices make a new high, but notice there is no follow through at the next price bar. This is a warning of either a trend reversal to follow, or that we are entering a congestion area.



Prices do little for two days.

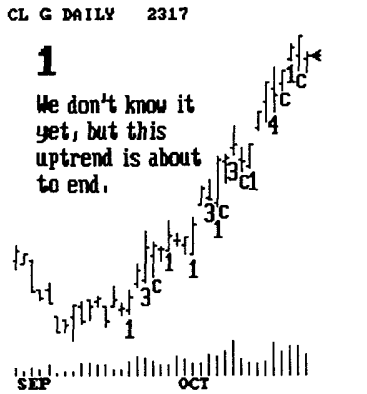
1 - prices make a high, moving out of the congestion area.

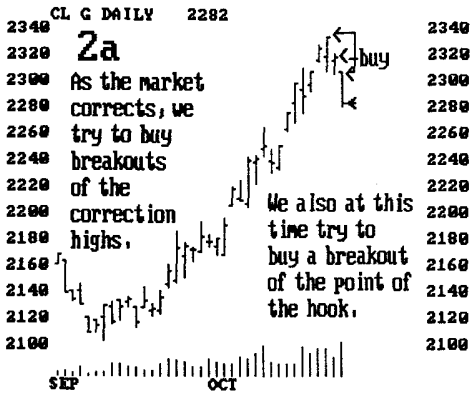
3 - prices have made three higher highs.

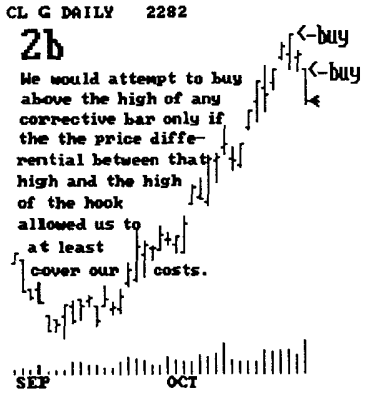
c - a correction occurs. Prices gap lower at the open and trade down before moving up to give a new high. This bar is both a correction and a 1 count.

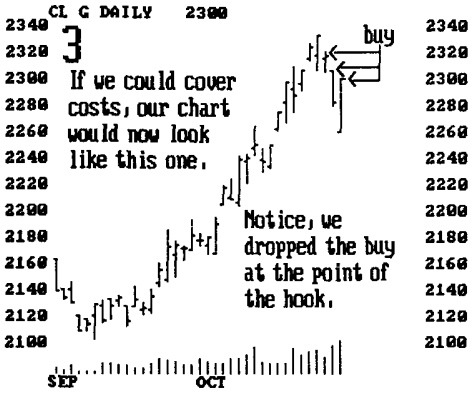
3 - prices have made three higher highs.

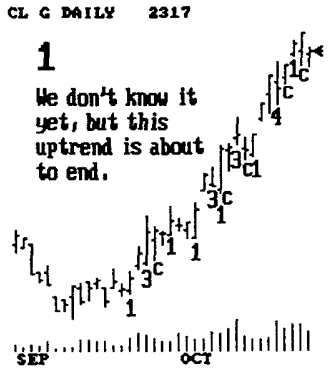
c - a correction occurs. On a gap lower opening doji bar, we fail to make a new high.

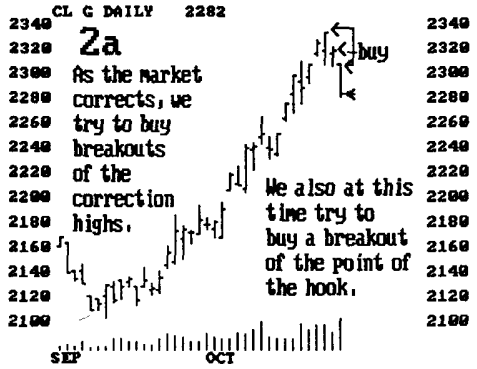


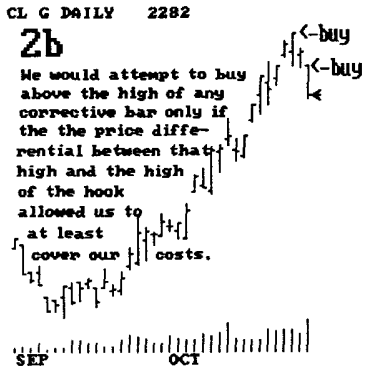


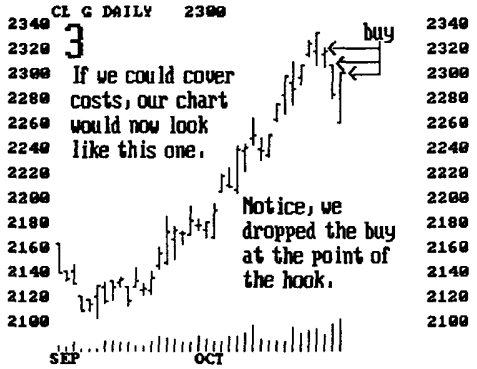












1 - prices make a high taking out the high of the doji bar.

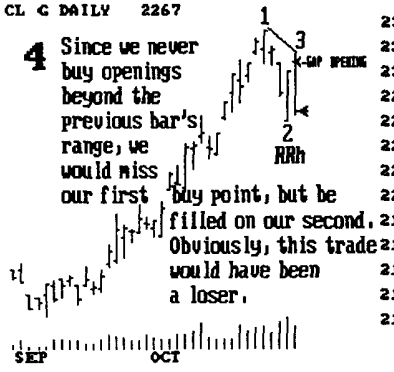
4 - prices have made four higher highs.

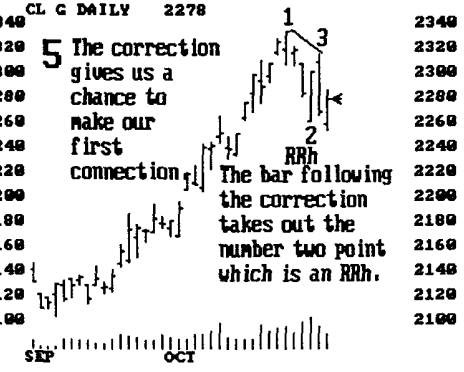
c - prices fail to make a new high on an inside bar.

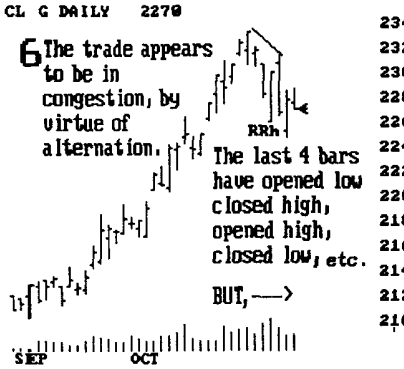
1 - prices make a high gapping up at the open.

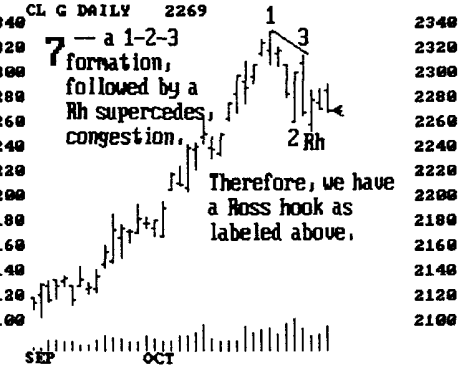
c - a correction occurs, after only a one count. This is important. We must suspect either a trend reversal is ahead, or a congestion area is coming.

Charts 2a,b, and 3 need no further explanation.



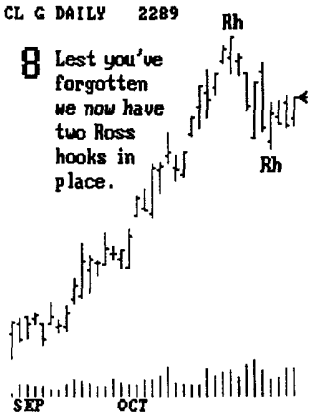


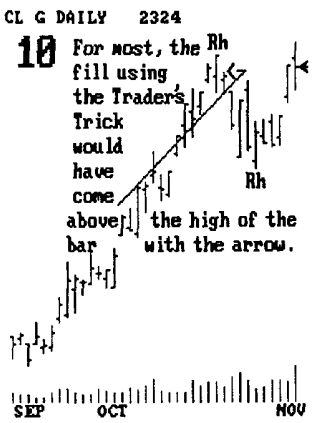


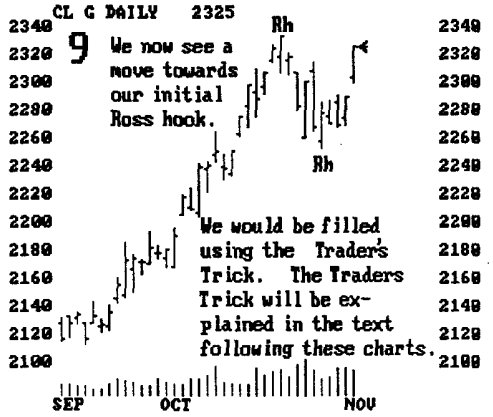


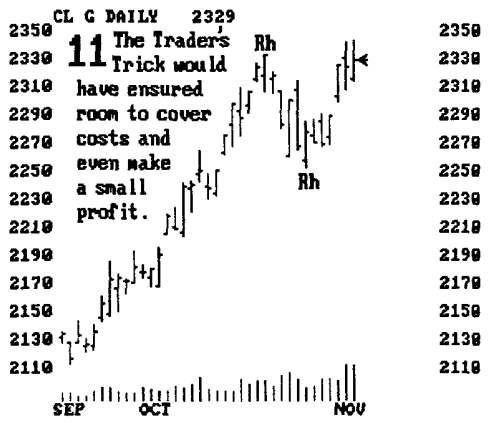
The loss taken on chart four would probably have been less for a daytrader than for a position trader. A daytrader could have gotten out more quickly when there was a failure to at least cover costs. Depending on intraday price action, a day trader might have been able to reverse and go short, thereby making a profit.

If you are a daily chart position trader, don't feel badly about this. Pure day traders leave a lot more money on the table than most of them would care to admit, with the exception of the S&P 500, and possibly the Bonds. Daily chart position traders make far more than day traders in virtually all other markets. I'll discuss this further when I deal with the subject of market selection. For now, let's continue our step-by-step analysis of this market.









For those of you who already know about the Trader's Trick, this will be a good review. For everyone else, I must take time out from our excursion to do a bit of explaining. We will resume our excursion right after this next chapter.

Chapter 8

The Trader's Trick

The purpose of the Trader's Trick entry (TTE) is to get you into a trade prior to the entry by other traders.

Let's be realistic. Trading is a business in which the more knowledgeable have the advantage over the less knowledgeable. It's a shame that most traders end up spending countless hours and dollars searching for and acquiring the wrong kind of knowledge. Unfortunately, there is a ton of misinformation out there and it is heavily promoted.

What we are trying to avoid here is the damage that can be done by a false breakout.

Typically, there will be many entry stops just beyond the point of a Ross hook. This is also true of the number two point of a 1-2-3 formation.

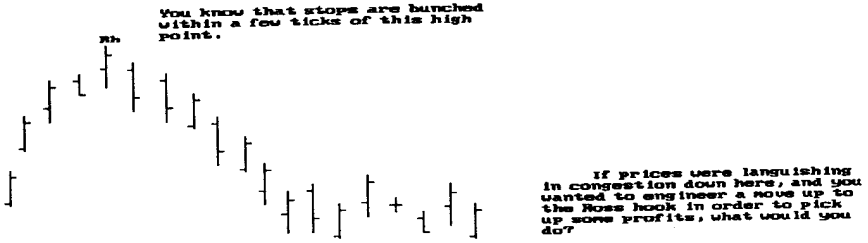
The insiders are very much aware of the bunching of stops at those points, and if they can make it happen, they will move prices to where they see the entry stops bunched together, and then a little past that point in order to gather as many of those stops as possible.

Unless the pressure from the outsiders is sufficient to carry the market to a new level, the breakout will prove to be false.

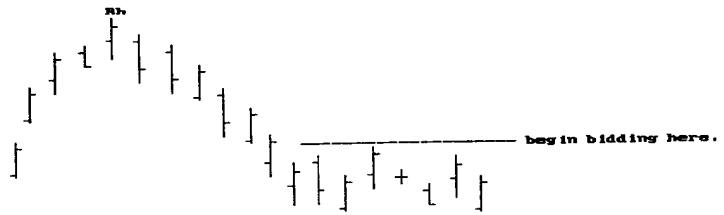
The Trader's Trick is designed to beat the insiders at their own game, or at the very least to create a level playing field on which you can trade. When trading hooks, we want to get in ahead of the actual breakout of the point of the hook. If the breakout is not false, the result will be significant profits. If the breakout is false, we will have at least covered our costs and pulled to breakeven.

Insiders will often engineer moves aimed at precisely those points where they realize stops are bunched. It is exactly that kind of engineering that makes the Trader's Trick possible.

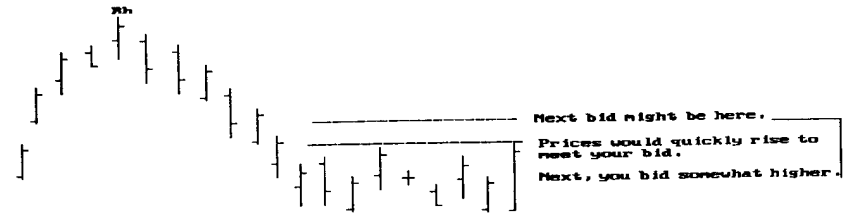
The best way to explain the engineering by the insiders is to give you an example. Ask yourself the following question: If you were a large operator down on the floor, and you wanted to make the market move sufficiently for you to take a fat profit out of the market and know that you could liquidate easily at a higher level than where the market now is because of the stops bunched there, how would you engineer such a move?



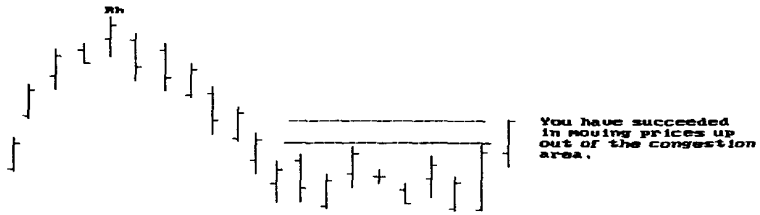
You would begin bidding slightly above the market.



By bidding a large number of contracts above the market, prices would quickly move up to your price level.



Once again by bidding a large number of contracts at a higher level, prices would move up to that next level.



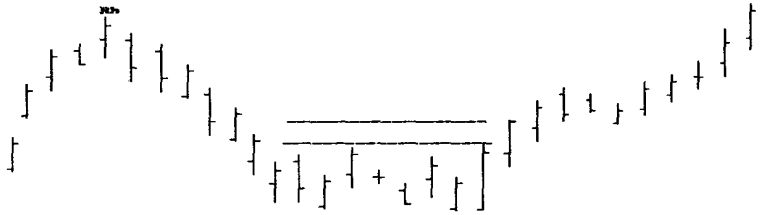
The sudden movement up by price, to meet your large-order overpriced-bid, will cause others to take notice. The others are daytraders trading from a screen, and lesser floor traders.

Their buy orders will help you in moving the market upward towards where the stops are bunched. It doesn't matter whether this is a daily chart or a five minute chart, the principle is the same.

In order to maintain the momentum, you may have to place a few more buy orders above the market, but you don't mind. You know there are plenty of buy stops above the high point. These buy stops will help you fill your sell orders when it's time for you to make a hasty exit.

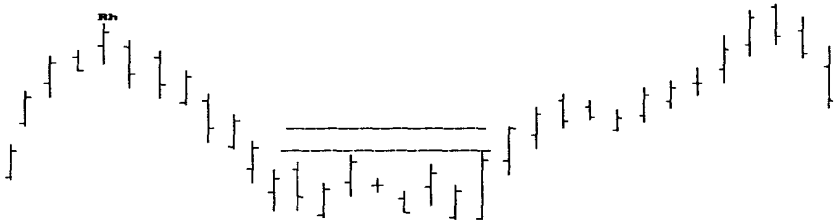
Who has placed the buy stops above the market? The outsiders, of course. They are made up of two groups. One group are those who went short sometime after the high was made, and feel that "way up there" is a safe place for their stop. The other group are those outsiders who feel that if the market takes out that high, they want to be long.

Because of the action of your above-the-market bidding, accompanied by the action of other floor traders and daytraders, the market begins to make a strong move up. The move up attracts the attention of others, and the market begins to move up even more because of new buying coming into the market.



This kind of move has nothing whatsoever to do with supply and demand. It is purely contrived and engineered.

Once the market nears the high, practically everyone wants in on this miraculous move in the market. Unless there is strong buying by the outsiders, the market will fail at or shortly after reaching the high. This is known as a buying climax.



What will cause this failure? Selling. By whom? By you and all the others who are anxious to take profits. At the very least, the market will make some sort of intraday hesitation shortly after the high is reached.

If there is enough buying to overcome all the selling, the market will continue up. If not, the insiders will have a wonderful time selling the market short, especially those who know this was an engineered move.

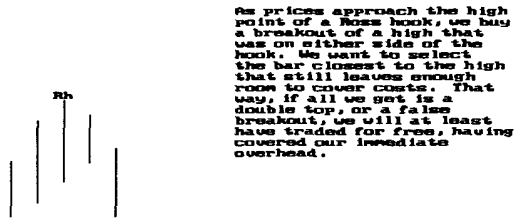
What will happen is that not only will selling be done for purposes of liquidation, but also for purposes of reversing position and going short. This means the selling at the buying climax may be close to double the amount it would normally be if there were only profit taking.

The buying from the outsiders will have to overcome that additional selling.

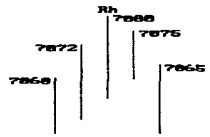
Because of that fact, the charts will attest to a false breakout. Of course, the reverse scenario is true of a downside engineered move resulting in a false breakout.

It is very important to realize what may be happening when a market approaches a Ross hook after having been in a congestion area for awhile. The prior pages have illustrated this concept.

With the preceding information in mind, let's see how to accomplish the Trader's Trick.



There were two bars on either side of the bar that made the high. As prices approach the area of the hook, we buy a breakout of the high of whichever bar leaves us enough room to cover costs and is closest to the point of the hook.

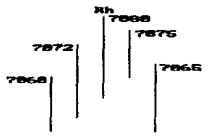


Let's assume the high was at 7080, and you had costs of $25 per contract including exchange fees. Let's also assume we are talking about the Swiss Franc, and that we are going to enter an order for a three lot.

Our immediate costs are going to be $75. If we are to sacrifice one of our contracts to cover costs, we would need six ticks in the Swiss to cover them (6 x $12.50/tick = $75). Obviously we cannot take a breakout of the high of the bar whose high is 7075. Our entry would have to be 7076. If prices rose only to the previous high, we would earn only four points — not enough to cover costs.

Our choice then would have to be the bar whose high was 7072. There, we would seek entry at 7073. If prices made a double top, we could realize costs with a single tick to spare.

What if, in that same illustration, we were talking about Live Cattle. Then, the picture changes. Live Cattle is only $10 per tick. In order to cover costs for Live Cattle, we would need 8 ticks.



If we sought entry at 7073, that would leave us wanting for one tick. We would therefore seek entry at 7067, or two ticks above the bar whose high was 7065.

Why 7067? Why not 7066? Because Live Cattle trades do not have prices ending with the number 6.

Let's put some general rules around the Trader's Trick concept and we'll be ready to resume trading hooks where we left off in Chapter 7.

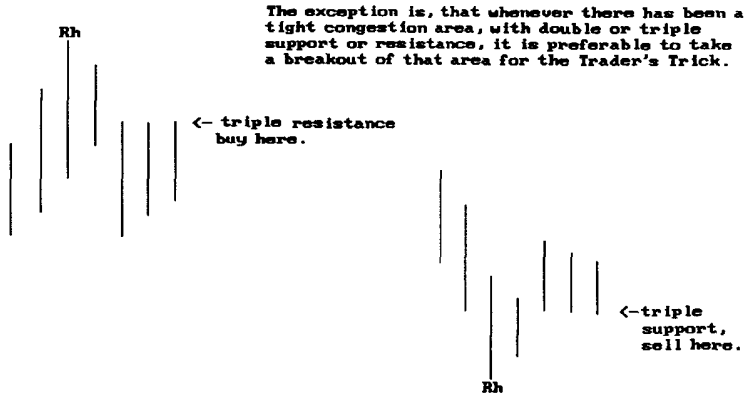
Risk management is based upon the expectation that prices will go up to at least test the point of the hook.

If unable to monitor the intraday action, we must enter our order as follows: With the point of the hook at 7080, and if this trade is three contracts of the Swiss Franc, we enter an order to buy at 7073, which is a breakout of the high nearest the point of the hook that still yields sufficient room to cover costs.

We instruct our broker to liquidate two contracts at 7079 MIT to cover costs of $25 per contract, and if filled, to set a stop at 7073, which is our breakeven point.

If our anticipated scenario works out, we will cover our costs and pick up a small profit. Barring any horrible slippage, the worst we can do after setting our stop to breakeven is to be stopped out with some sort of profit for our efforts.

We usually limit the Trader's Trick to no more than three bars on either side of the bar that made the point of the hook. However, there is an important exception to this rule. The next chart shows the use of double or triple support and resistance areas for implementing the Trader's Trick.



Now for some finer points.

Covering costs means covering cost for an entire contract set. If you are trading two contracts, you would use one of them to cover costs for both contracts. If you are using a three contract set, you would use one of them to cover the costs of all three contracts. If you are trading a five contract set, you would generally use two of the contracts to cover the costs of all five. Should you elect to cover costs with three of the contracts, you can pick up a profit over and above costs. The next step is to use two contract sets, for a total of ten contracts (five contracts in each set). On a ten contract set, you can typically cover costs with three to five contracts. This will usually result in receiving a profit beyond costs.

In covering with one contract of a two contract set, you must pull the second contract to breakeven almost immediately, even if this results in being stopped out at breakeven. This may happen as often as eight out of ten attempts. If you can afford only two contracts, you will have to be patient and build your account so that more contracts can be placed. On daily charts, this can be several months. What you are looking for are the trades that break out and never look back. You will make your money only on the two out of ten trades that have that kind of breakout.

If you are covering with one contract out of three, you can pull one contract to breakeven immediately after covering costs. The remaining contract should be held back and allowed to lag behind for profit taking. However, if the second breakeven contract is stopped out, you must consider exiting immediately with the third contract.

Here, too, you want to greatly limit losses. On three contract set trading, I prefer to cash two of the contracts at the point where one of them would cover costs. I then immediately move my remaining stop to breakeven. If I am stopped out there, I have covered costs and made a profit. If two out of ten trades break and run, I will have a very nice profit to show for my efforts.

When trading a five contract set, a similar approach can be followed. Cover costs with two contracts. This may result in a small profit depending on market volatility.

I prefer to cover costs with three contracts and thereby guarantee a profit. I then immediately move my stops to breakeven.

For instance, if Gold has moved six ticks ($60) in my favor beyond my entry fill, I will liquidate three contracts to cover costs of $100 ($20/contract for five contracts). That will leave me with $80 profit [$60 x 3 contracts - $100].

I then have two alternatives from which to choose. Usually I will bring the stops on both of the remaining two contracts to breakeven. If I see prices moving against me, I will try to exit before my breakeven stop is hit. If I salvage only $100 from the trade, I am making 100% over costs.

Less frequently, I will risk the profit I have made on the first three contracts ($80 in the example above) and place the stop on the fifth or last remaining contract $80 below breakeven.

Any time a business can consistently make that kind of profit, that business is going to prosper. Add to that profit the huge amount of money made on the two out of ten trades that never look back, and you can readily see that enormous profit is available from trading futures.

The management method I use shows you why it is so important to be properly capitalized. Size in trading helps enormously.

The method also shows you why, if you are undercapitalized (most traders are), you must be patient and gradually build your account using the two contract method.

Whenever possible, I use Stop Limit for my entry order. Even the CBOT will take Stop Limit orders (broker not held) as long as prices are below our entry when going long, and above our entry when going short.

You never want to place an order ahead of the open without a limit order of some kind. If you cannot obtain a limit order, then you must instruct your broker to wait until the market opens before entering your order, and to cancel the order if the market gaps past your price.

If you are not able to tend to your own orders intraday, it may be well worth your while to negotiate with a broker who will execute your trading plan for you. There are brokers who will do this, and you may be surprised to find that there are some who will perform such service for under $30. You should have no problem finding brokers who will watch your trades for you in a commission range of $30-$35.

You never want to be filled on a gap opening beyond your entry price.

Can you grasp the logic of what I'm trying to show you here?

We have no way of knowing whether a move toward a breakout is real or not. If it is engineered, the market will move forward to the point of taking out the stops and perhaps a few ticks more. Then the market will reverse, with no follow through in the direction of the breakout. As long as we have left enough room between our entry point and the point of the Rh to at least cover costs, we will do no worse than breakeven. Usually, we will also have a profit to show for the trade, however small.

If we take an amount equal to immediate costs, then we will have doubled our money relative to our immediate costs. It will happen this way at least 75% of the time.

If the move proves to be real (not engineered), then the market will give us a huge reward relative to our costs. Remember, immediate costs are our only real investment in the trade if it goes our way.

How often are breakouts for real? This has varied over the years and within particular years. It has a lot to do with a phenomenon I have come to call the Trading Cycle.

Trading Cycle

If you can picture a pendulum swinging from side to side, then you can picture the Trading Cycle.

When the pendulum is all the way to one side, most traders are trading retracements. When this is happening in the markets, many more breakouts will be real than not. Why? Because the markets will quickly adjust to the way most people are trading. The floor will be fading the retracement traders.

When about half the traders are trading retracements and the other half breakouts, the pendulum will be at dead center.

When the majority of traders are trading breakouts, the pendulum will have swung to the opposite side, and the floor will be fading breakout traders. There will be more false breakouts than when the pendulum is at the opposite extreme.

If your management is appropriate, as it will be using the Trader's Trick, you will not get caught with the majority who enter the trade exclusively at the breakout point, thereby bunching their stops for an easy target for the vultures on the floor.

When a move is genuine, based upon the underlying fundamentals, large amounts of money will be made by those who have correctly managed the trade.

What about the stop? Where do you place the protective stop? And where do you place objective stops?

As much as I'd like to go into that here, it will be the subject of a later chapter. At that point I will really expound on stop placement and treat the entire subject of stops. It will be a very long chapter.

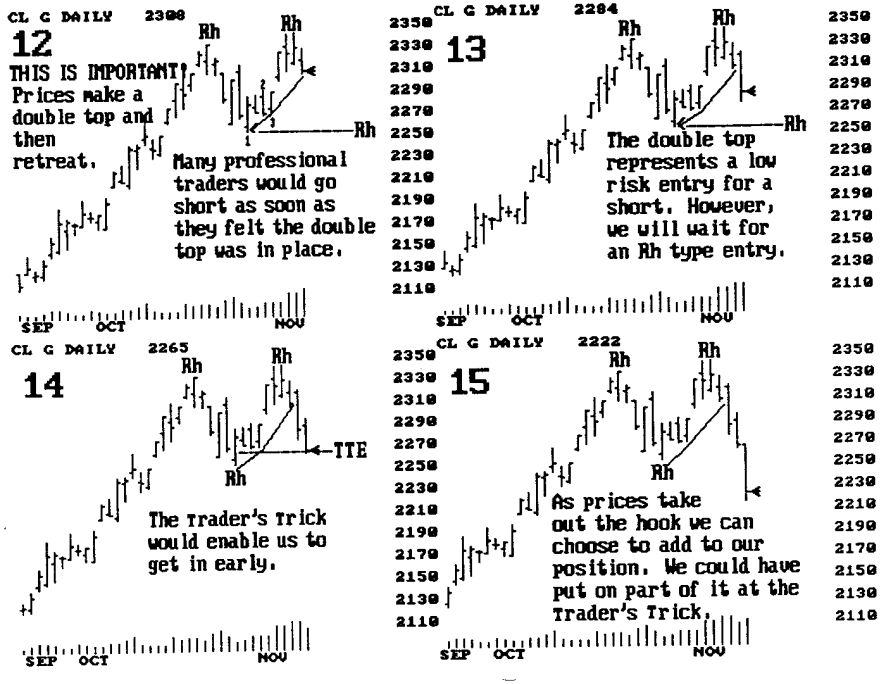
Right now, I want you to fully understand that by taking entry into a market at the correct point, we can neutralize the action by the floor and the large commercials. We can be right and earn something for our efforts should the breakout prove to be false.

Some breakouts must always be correct. The fundamentals insure that. When they happen we will be happy, rich traders.

With proper money management, we can earn something for our efforts *even if* the breakout proves to be false.

Chapter 9

Continuing Our Analysis



Some comments about the above graphs might clear up a few questions.

Notice on Chart 12 that we were able to connect the point of the Ross hook to a correction (the congestion area) and then to the correction low created by the price bar that pulled away from the double top. That left us with a 1-2-3 low and a hook. A breakout of the double top (Rh) would set us up for a new Ross hook once prices took out the double resistance area and then corrected.

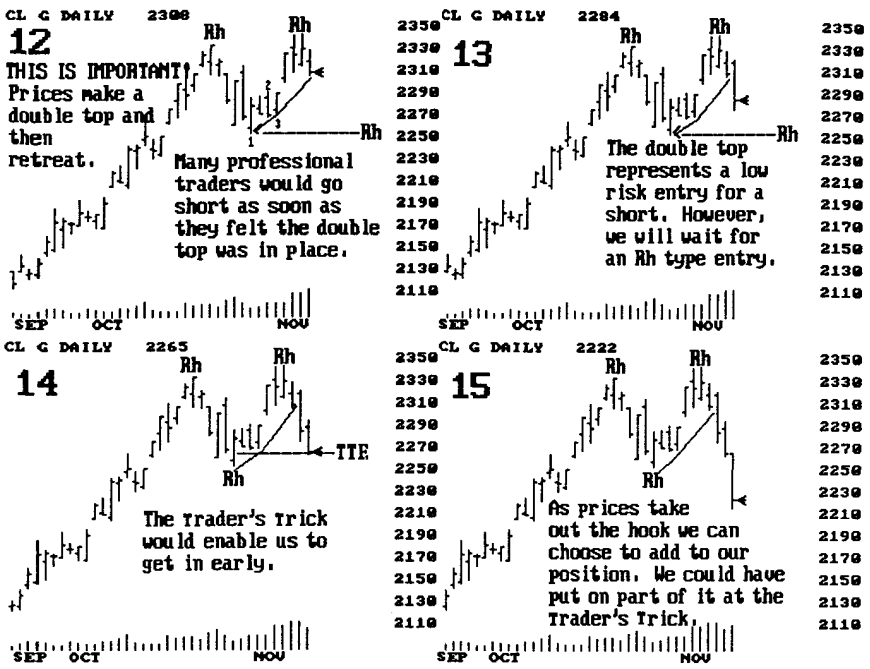


Chart 13. A more advanced trader might wish to go short as prices moved away from the double top. This is a low risk trade, because a stop can temporarily be placed above the high. Notice I said temporarily. The double top could be a terrible place to have a stop, should the insiders engineer a move up to run the stops they know are there.

Chart 14. The more conservative trade is to use the Trader's Trick Entry, figuring that prices will at least test the low as prices move down. The Trader's Trick Entry in this case was just below the small congestion area. All or part of the position can be put on at the Trader's Trick Entry point. It's simply a matter of choice. If you want to know what my choice is, it is to place the entire position on at the TTE (Trader's Trick Entry). For those who have read **Trading by the Minute**, the small congestion area is a matching congestion to the two bar congestion on the left side of the hook. The breakout of that small congestion is significant.

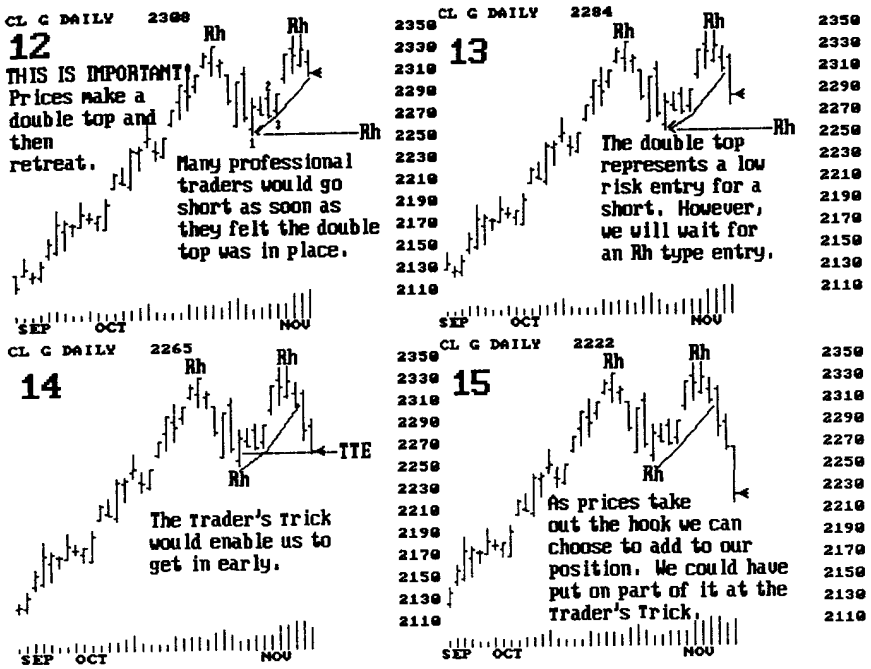


Chart 15. If we hadn't put on the entire position at the TTE, then the hook is an excellent place to join the crowd who will be selling there. The market has excellent momentum going into the hook.

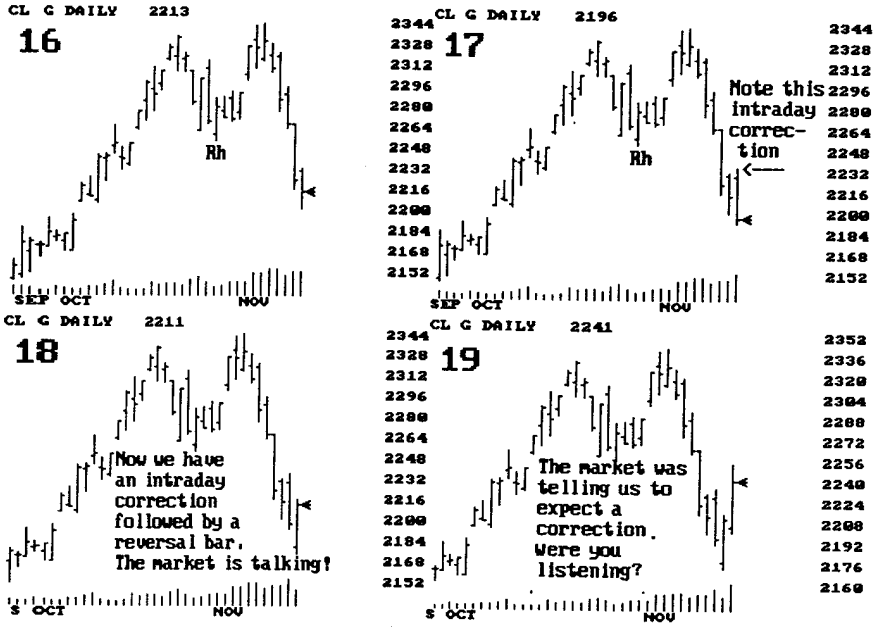
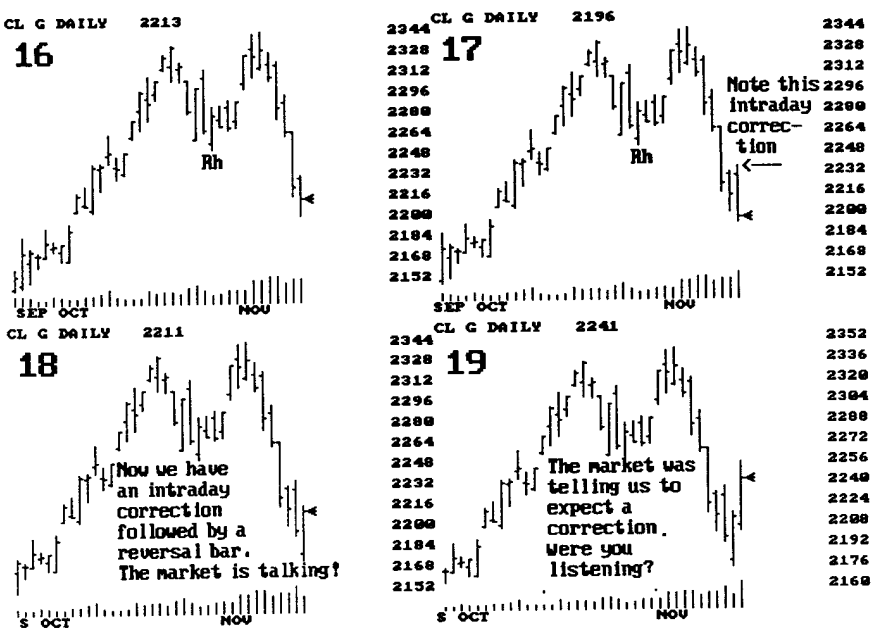


Chart 16. We see that prices are plunging. However, we should not be jumping in front of the market each bar, because by the time prices took out the Ross hook, the market had already been moving down for three consecutive bars.

Chart 17. An important event takes place, an intraday correction. This makes it OK to jump in front of the market. The fact that the market opened, traded above the previous bar's high, and then took out the previous day's low, signifies at least one more good day to be short. Jump in front of the hook created by the intraday correction. In fact, if watching intraday, use the TTE as prices take out the previous day's low.

Chart 18. Note the gap open beyond the previous bar's low. Then notice the price action for the remainder of the day. Professional traders will go long on a gap open like that, some of them as soon as possible after the open, and others when prices trade through the open to the upside.



When you see a gap open like that in a strongly trending market, take profits. If you've got your guts under control, take profits and reverse. Most of the time you will be glad you did. In fact, many professionals, if they think the market is beginning to congest, will double up on a gap opening, and trade twice as many contracts **against** the trend as they would **with** the trend.

Chart 19. When a market that is correcting opens in the upper part of the previous bar's range, and then trades above the previous bar's high, chances are you haven't seen an end to the correction.

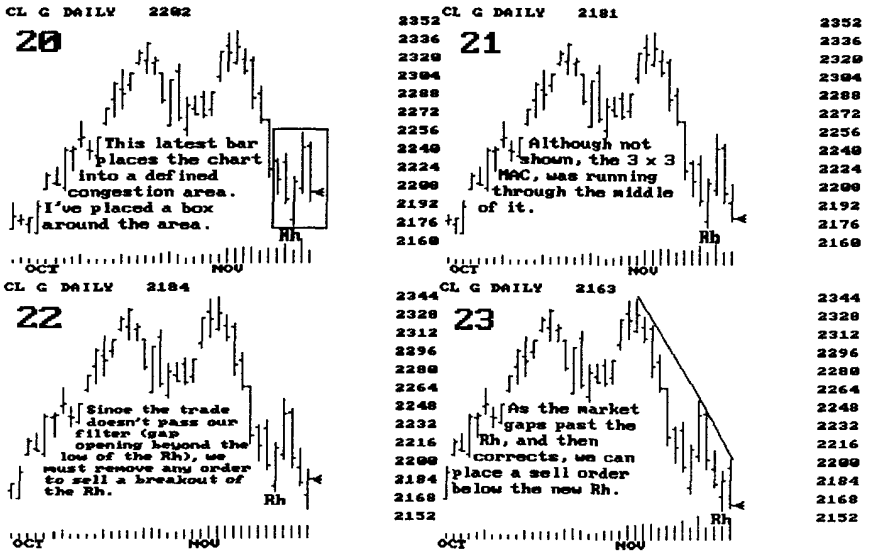


Chart 20. We have congestion by alternation,

Chart 21. A 3 x 3 MAC would be passing through the congestion area. You will recall that the 3 x 3 is a filter for RRh's, it is also a filter here for the same reasons — we are in a defined congestion.

Chart 22. The gap opening below the previous bar's range has brought in a double load of orders from the floor. Prices move up on a reversal day. Remember, when the floor feels a market is congesting or correcting, they will double their orders on openings that gap beyond the previous day's trading range. This doubling can serve as a filter for our trades, we can expect the floor to try to fill the gap. Day traders can use this to trade with the floor.

Chart 23. Another gap, this time above the high of the previous day, has brought in another double load of orders, this time to short the market. This is a correction day and so we can connect some segment lines.

Chart 24. There are many problems with getting filled on a gap opening below our sell stop. Therefore if at all possible, we do not enter orders until we see where the open occurs. Brokers can be instructed in that manner. In the chart above, prices opened on our sell stop.

Chart 25. We protect profits by moving our stop 1 tick above the high of a bar that closes so close to the high.

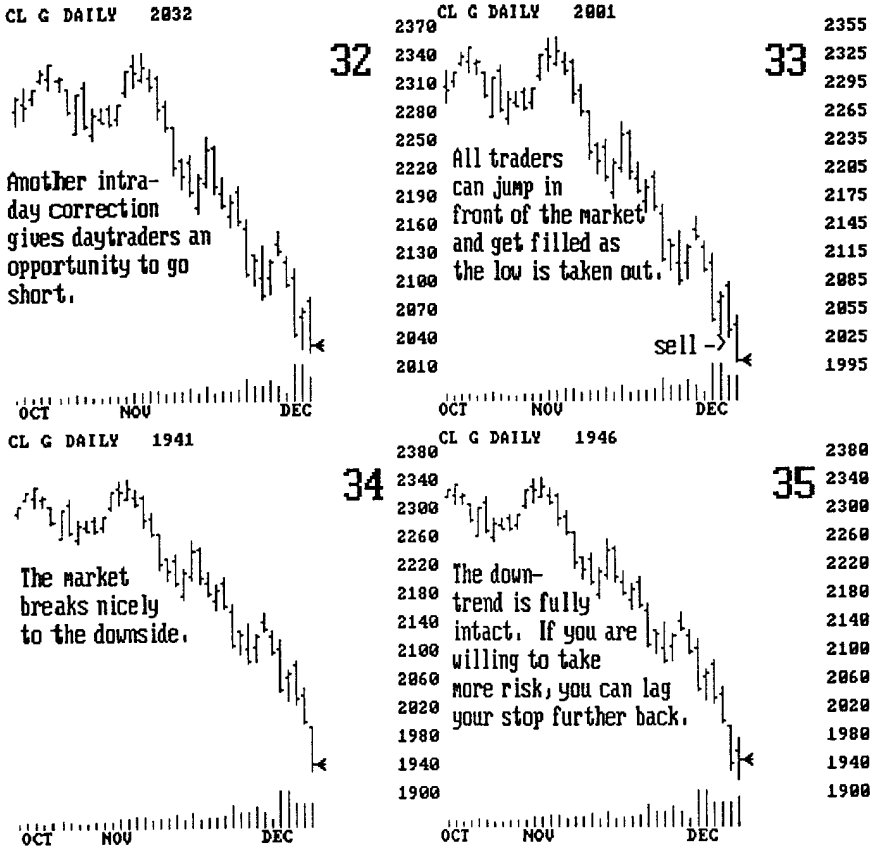
Chart 26. Day traders may have been able to scalp a few ticks of profit here by selling under the low of the previous day.

Charts 28 and 29. We want to put on our entire position. But we have only two opportunities. It's best to put on 2/3 of the position at the higher of the two entry points and only 1/3 at the hook, if we are given the choice. Once prices start back down, we try for 2/3 immediately. If we still cannot get our position on, then we will have to place the entire position on at the hook. Chart 29 differs from Chart 22 in that the 3 x 3 MAC was still in containment of the trend. By containment, I mean the 3 x 3 MAC was above the highs of the price bars.

Remember, even here we can use the Trader's Trick for an entry.

Charts 30 and 31. As we take profits out of the market, we come to a point where we have accumulated sufficient profits that if we wish to risk those profits, we can begin to keep the stop further away from the price action.

If we don't want to take additional risk, then it's best to trail a 50% stop as the market moves down, and pull stops even tighter on reversal bars, or any indication that something is amiss.



The charts above should be self-explanatory.

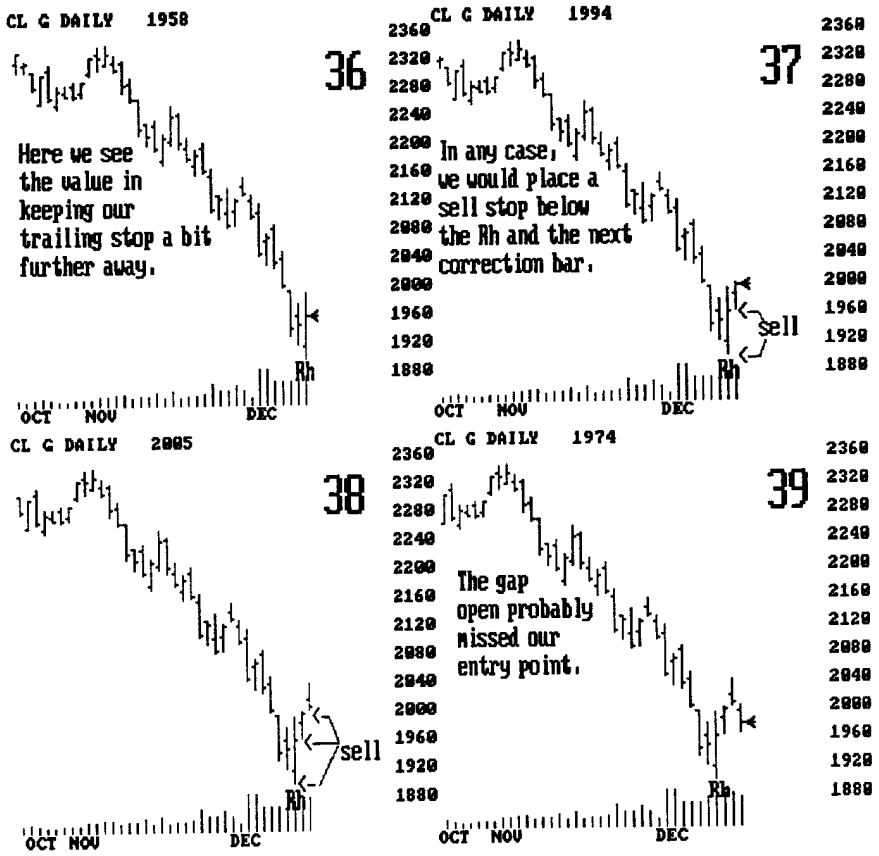
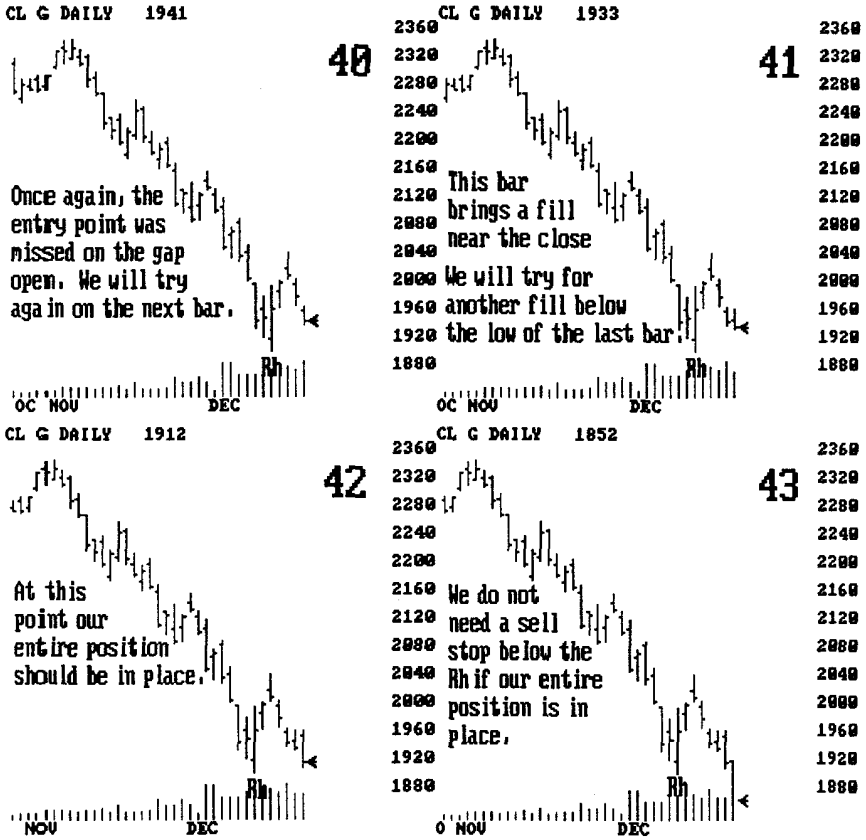
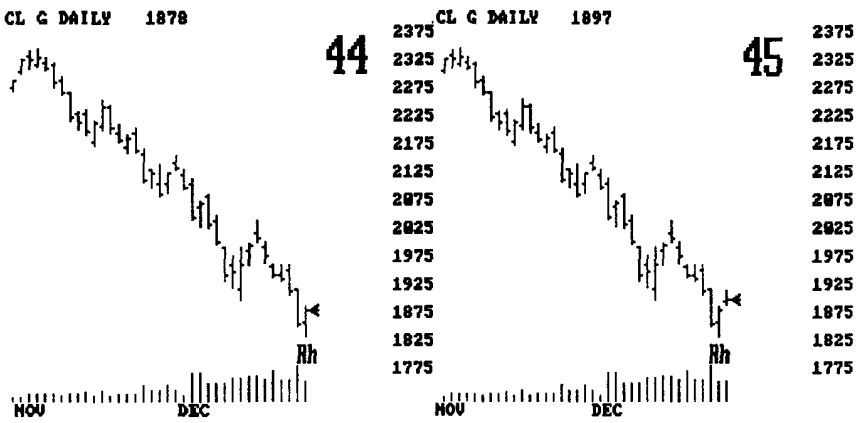


Chart 39. The gap open, since it missed our entry order, would cause us to try to fill 2/3 of our position on a breakout of the low of the gap bar.



Charts 40-43. An adequate trailing stop would have kept us in the market throughout the four days shown on this set of charts. We would have been able to build our position by adding on.



These are the last two charts in this series. It remains to be seen how long the downtrend will continue.

Chart 44. Here we see a reversal day. By now you should know that it usually means some sort of correction is due.

Chart 45. Sure enough the market corrects. We would start trying to sell a breakout of the correction low. We would also place a sell stop below the Rh for part of our position.

Remember, it is up to you to decide how much of your position you want to place at any given level. It is a matter of comfort and style. Where do you feel best about placing your entry stops?

Now I want to give you an additional concept which can best be shown by some illustrations. It involves the very situation that caused me to begin seeing the hooks in the first place. It embraces the concept that you can't always identify the number 1 point of a 1-2-3, and yet you don't want to miss the "pointy" place in the market.

You can count these next charts as part of what I have termed conceptual processes in Chapter 7.

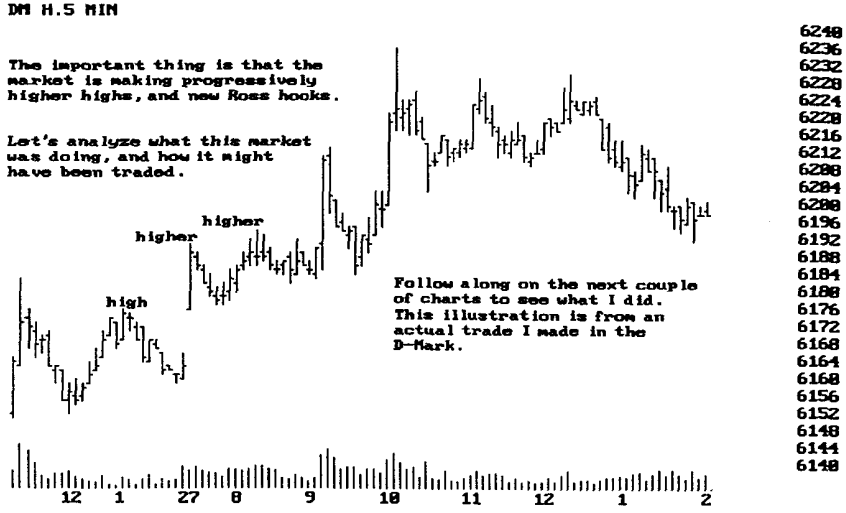
Hooks and 1-2-3's

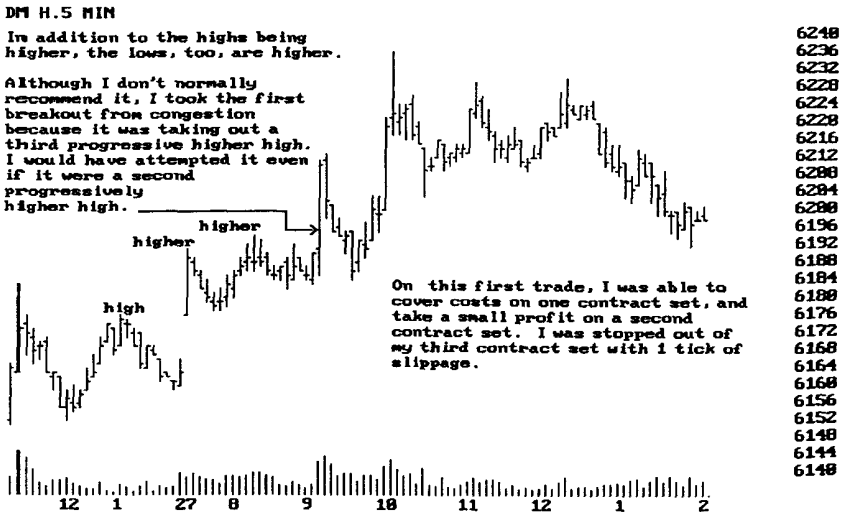
Take a look at the following chart.

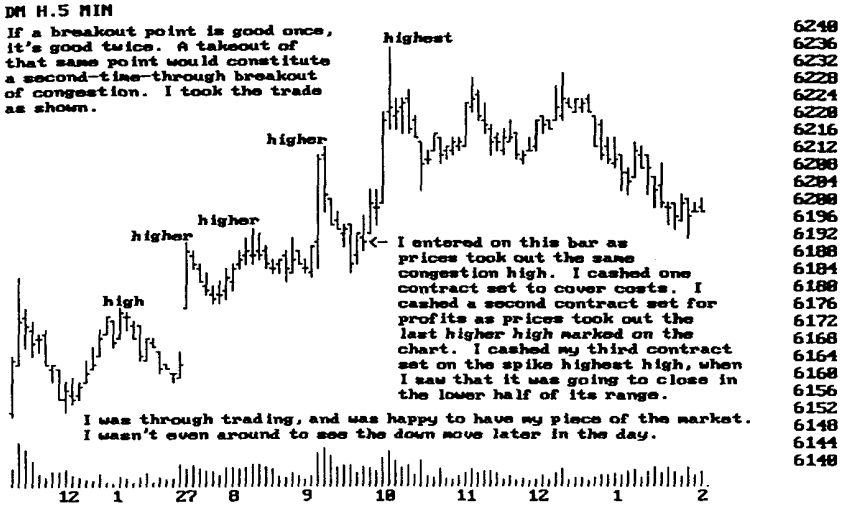
How do we identify the difference between a 1-2-3 formation and a Ross hook, in relation to the gap opening?

At times it is difficult to see the number 1 point of a 1-2-3. Is it important to see and be able to identify the number 1 point? The answer is no. What is important is, that even when we are not sure where to place the number 1 point, if we can identify progressive hooks, we know we are in a trend and should be willing to "mechanically" take a breakout of that hook, *or sooner, if possible!*

Do we also need to take into account the fact that this commodity trades overseas during the night while the markets are closed in the United States? The answers are that it doesn't matter which way we mark the chart, nor does it matter that the commodity traded overseas during the night.







For better or worse, this is the way I trade and this is the way I think. I've pretty well automated my reactions to what I see in the market. For instance, the cashing of a second contract set for profits as prices took out the last higher high marked on the chart, shown above. This was an intermediate profit objective for me based upon my previous entry. I almost always enter an intermediate profit objective order as a resting MIT order at the number of ticks I wish to take out of the market. In the case above, it happened to coincide with the higher high. If I see any sign of reversal as I watch prices progress, I will immediately go to the market with all remaining contracts. I can always attempt reentry later.

I know that getting in early when possible is the best way to enter breakouts. I also know they work most of the time.

Another thing I know is that I have extremely fast reaction times, and can therefore dare to take first time breakouts. But unless both you and your broker are very fast and have excellent execution on the floor, you must wait for the second time through. It means you will miss some trades, but better safe than sorry.

It's time now to give some serious thought to stop placement. The next topic will be quite lengthy. If you feel that you would like to read it completely through, this might be a good place to stop for a break. Get something to eat, take a nap, or do some exercise.

When you come back get ready for some in-depth material about stops.

Chapter 10

Stops

Where Do You Place the Stop?

Stop placement appears to be a topic that is on every trader's mind. Where **do** you place the stop?

In this chapter, we will consider four situations for using stops:

1. Mechanical Stops: As dictated by mechanized trading systems.

2. Protective Stops: To protect against loss, or to protect profits.

3. Objective Stops: To cover costs.

4. Entry Stops: To initiate a trade.

5. Exit Stops: To terminate a trade.

General Considerations

At various times you will hear or read material from someone who tells you where to place a protective stop.

Of course, if you are following an adviser and taking that adviser's trades, you must utilize the adviser's stop placement. Why? Because when you follow an adviser, you are trading a mechanical system. The adviser is your system. You cannot possibly expect to achieve success until and unless you do exactly as the adviser dictates. In addition, you also need to do a lot of praying. Pray that the adviser will have a good year in the markets.

The same consideration is true if you follow a mechanical system. If you expect to get the results you paid for when you purchased the system, you must place your stops as the system dictates. At times, the draw down against your margin will be virtually intolerable. That's the price you have to pay for trading a mechanical system.

There are few traders who can maintain the discipline needed to exactly follow a mechanical system, whether it be computer generated or derived from an advisory of some sort.

I will have a few more words to say about trading mechanical systems a bit further ahead.

Should you place a stop at a certain number of points distant from current price action? Should you place a stop at a certain percentage distant from current price action? Or, should you place a stop a fixed money amount distant from current price action? Any or all of these may be an incorrect way to place stops.

I am thoroughly convinced that no one on earth can tell **you** where to put **your** stop.

The truth is, only you can decide. Unless you are trading a mechanical system or following an adviser, the responsibility is yours. If you are calling your own trades, there is no way you can pass that responsibility to anyone else.

Since proper stop placement is such an important responsibility, let's take a few minutes to reflect on some of the items that must be taken into consideration when placing stops. We will return to these individually later on and view them in the context of whether we are using the stop to protect against loss, protect profits, or seek an objective.

Specific Considerations

1. **The size of the margin account.** Certainly, the size of your margin account will affect where you are able to place stops. It will even affect the selection of markets in which you are able to trade.

2. **Margin requirements.** The margin requirements set out by the exchanges, and any additional requirements set by your broker, will affect which markets you can trade, as well as where you place your stop.

3. **Your individual psychological and emotional tolerance for pain, that is, your individual comfort level,** greatly affects stop placement. Provided you can afford to trade in the market you have chosen, this is probably the most important factor in setting stops. You might have a $100,000 account, but if taking a $200 hit will devastate you psychologically, then you cannot set your stop that far away.

4. **Your economic tolerance for loss.** Your willingness to lose a certain amount of money and being able to afford it even though it makes no sense. If you are stopped out with a loss often enough, you will reach the point where you will no longer have money to lose. Therefore, you must have a rational approach to stop placement.

5. **The number of existing open positions already held.** If you are already positioned in other trades, you may not be able to set your stop properly in any new trades. In that case you may be forced to miss a good opportunity, or to set stops too close.

6. **Market volatility**. This is a market generated criteria for setting stops. The market may be too volatile, causing you to need to set a stop beyond your affordability or comfort level. Conversely, using a market-generated criteria, volatility may be not sufficient to even warrant entering a market let alone placing an effective stop. The stop would be too close to the price action and virtually certain to be hit.

7. **The rate of trading.** Whether you are in a fast or slow market affects stop placement. If a market is moving quite fast, you may have to set a stop further away than is affordable or comfortable.

8. **Tick size.** Usually, when a market is fast, or highly volatile, the tick size will also increase. That means your usual and normal stop will not suffice. An example would be if you limited your losses to $250 on a five minute S&P chart, and suddenly the ticks moved away from the normal five to ten points per tick to twenty-five points per tick. In other words, the market becomes fast. It would only take two of these super sized ticks moving against you to take you out of the market.

9. **Participants on the floor.** When a large commercial, or large trader steps onto the floor, the market may begin to do strange things. These operators often have the resources to move the market. They may move it up quickly so they can go short from a higher price. They may sell it down quickly so they can go long from a lower price. Whatever their reasons, knowing who is down on the floor can affect where you place your stop, or even whether you should enter a trade.

10. **Liquidity.** Whether a market is thin or liquid affects successful stop placement. Thin markets tend to be much more volatile than liquid markets. The operators in thin markets can "run" the markets more easily than operators in liquid markets. This volatility can greatly affect where you have to place a stop. In addition, operators can more easily run stops in thin markets.

11. **Turnaround time.**

a. Your reaction time, in part, dictates stop placement. How long does it take you to see and react to a situation? If you are slow, plan on using larger stops.

b. Your brokers reaction time, in part, also dictates stop placement. If your broker is slow in getting your orders to the floor, you will need to use larger stops. You might consider placing stops ahead of time if slowness is a problem.

c. Your relationship with your broker. If you and your broker like to chat and exchange pleasantries, you will need to set your stops further away. Time is money. Markets can move quickly. The longer the time you spend in taking care of business, the more you will have to risk in stop placement.

12. **The time frame of the chart in which you are taking trading signals affects stop placement.** Obviously, you can use smaller stops in lesser time frames than you can on the greater time frames. If you are trading from weekly charts, you can be a lot more casual and leisurely about setting your stops. You will also have to be able to afford larger stops, because markets move a greater overall distance on a weekly basis than they do on a five minute basis.

13. **Your overall objectives and strategy for the trade.** For instance, if you expect to make a long term trade, you would place your stop a lot further back than if you were anticipating a short term trade.

In view of the preceding points, how can a trader expect someone else to tell him where to place a protective stop? You, and only you, are in a position to know all of these things. And while someone else may know some of these things, only you can know your comfort level.

Also, in view of the considerations I've presented, isn't it a bit ludicrous to set loss protection stops at a fixed number of points, a set money amount, a previously determined percentage away from the price action, or based upon the dictates of a mechanical trading system?

None of these methods has anything to do with the reality of price action in the market, or the trader's economic, mental, or emotional condition, or any of the other conditions mentioned.

Stop placement is truly the arena in which you separate the men from the boys.

Mechanical Systems

No discussion that concerns separating the men from the boys would be complete without mentioning mechanical trading systems. *Therefore, before going on with my discussion of stop placement for* loss protection, let's digress a bit in order to peer into the concept of mechanical systems. It seems as if many feel this is the solution to stop placement.

I realize some will have read the following material in other of my writings. I feel the concept I will present here is very important, so if you have read it previously, please read it again.

It is said that imitation is the highest form of compliment. Some of the people who have come to my seminars have paid me that highest form of compliment — they want to learn to think as I do. While I feel unworthy of such high praise, there is no doubt more to this concept than I ever imagined. I'm sure, to a certain degree, trading is in the mind and thought processes of the trader. At a recent seminar I shared a thought with those attending. It's a thought I don't mind repeating and sharing with others. It has to do with computers and mechanical systems. More importantly, it has to do with discipline.

Over the years I have seen numerous intellectual individuals who have tried to automate trading. They have tried to turn trading into mechanized systems. I have never personally met anyone who succeeded at this, but I feel that my statement needs to be qualified.

I have known professional traders trading managed money who were able to use models in their trading. Notice the plurality of the word models.

These traders ran several models. They had models for trading in congestion, and they had models for trading in a trend. These models ran simultaneously in the markets desired for trading. The model producing the best result in a trending market is traded in a trending market. The model producing the best result in congestion is traded in congestion. All other models are constantly fine tuned so that they can be adjusted to current market conditions.

By continuously fine tuning, optimizing, and adjusting, there is always a model from which to choose. One model is always outperforming the others.

This type of automated trading is very expensive and time consuming. It is far beyond the reach in both time and money of the average futures trader. The amazing thing is that it rarely does better than a good individual trader who knows a market and trades well in that market.

I know one trader who has been trading professionally for more years than I. He is a very large trader, one of the "big hitters." For many years he has paid a programmer holding a Ph.D. in physics and math, to program every method and system imaginable. This programmer is currently paid in excess of $150,000 a year.

In addition to systems conceived in-house, many purchased systems have also been employed. The conclusion of the matter has been that no mechanical system attempted has been able to outperform the professional trader himself. No stone has been left unturned — no expense spared in trying to find an easier or better way than what can be done by the human factor. The money spent has been in vain, other than to prove, at least to my friend, that it cannot be done.

An expert in artificial intelligence has been called in, in an attempt to computer emulate the trading of my friend. There are simply too many details, nuances, and variations. What can be seen by the human eye and interpreted by the human brain is beyond the ability of any programmer to translate into a computer program.

On the surface of it, it would seem that the Ross hook is a highly programmable phenomena. Yet, those who have tried have all had to admit failure. The hook can be computer emulated to a point, but not completely.

The Need for Automation

Is there a need for automation? Yes, there is. But in an area you might not immediately consider. **What you must do to become a successful trader is to *automate* yourself.**

Yes, learn to automate **your** behavior in the market. Discipline **yourself** to act and react in certain ways to various market conditions.

When you see a trending market pause to correct, leaving behind a hook, and when your filters all indicate a market entry, then condition yourself to take that opportunity.

Do not waiver. Do not hem and haw. Your actions must be automatic, but based upon an intelligent deployment of the knowledge within your possession.

In this regard, trading is like the martial arts. You must be so well trained and conditioned that you act automatically and appropriately to market stimuli.

If the trade is not going your way, exit immediately. No wavering. No wondering. You go out. You do it now!

If a developing opportunity gives you any pause for thought, refuse that trade. It must be your trade. It must happen your way, when you are ready for it. There can be no "but's", no "maybe's." If it does not have your name on it, leave it alone.

If you have placed a limit order in the market and it is not filled, and the market goes on to make what would have been a wonderful trade for you, there can be no regrets. You cannot afford to stop and mourn over trades missed. You must be looking to the next trade, to the next opportunity. Above all, you must not change what you are doing simply to accommodate the missed trade. That kind of thinking can be disastrous. Drill yourself to stay with what you know works for you.

You cannot automate the market anymore than you can control the market. Just as your actions and reactions are the only thing in the market which you can control, so it is with automation. You can only automate yourself.

Stop and think about it. To successfully trade a mechanical system, you must develop the discipline to follow it religiously. That means blindly following the dictates of an electronic machine.

If you're going to blindly follow a system, why not blindly follow your own reason, based upon the best computer that has ever been available — the human brain?

Unlike what many would have you believe, trading a mechanical system does not remove the emotional strain of trading. It does not get rid of the suffering so many experience. The emotional strain remains. It is only relocated to another area. You are forced to agonize under the terrible drawdowns associated with mechanical systems. You have to trade not knowing exactly why you are doing what you are doing. You have made a mechanism your god. You must bow to its dictates. If you are trading a system that uses daily charts, there are still the same sleepless nights when you get in trouble. If you are daytrading, there is still the same gut wrenching agony of seeing the trade go against you.

You still have to grit your teeth and hang on. You dare not get out, even in the face of disaster. The moment you take any initiative and act apart from the system, you have broken the system.

Is there any virtue in sitting still while your mechanical system destroys you financially? I doubt it. The very same discipline that you must exercise to withstand the withering heat of mechanical trading could be harnessed to work for you if you are determined to make it so.

We all have a computer. It's our own brain. No mechanical monstrosity has ever come close to the marvel you carry around in your own head.

Your job is to learn to act upon what your human computer is telling you. Isn't it easier to develop that kind of discipline than to force yourself to become the slave of a machine?

Is there any better computer than the one housed between your ears? No!

It is not one bit harder to follow the dictates of human reason than it is to follow a mechanical trading system. Both require a discipline and faith that is tantamount to religion.

Seldom, if ever, can an electronic computer relate the myriad of variables needed to make a trading decision any better or faster than your brain. The computer simply cannot see all the relationships in any manner approaching the adeptness with which you can see it with your own eyes.

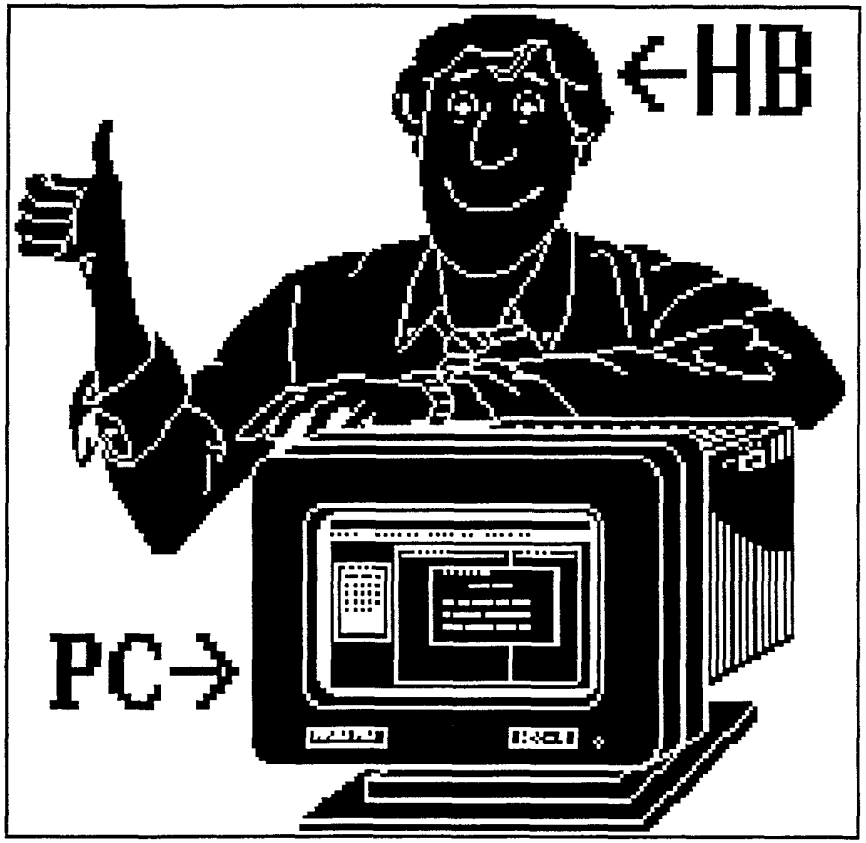
Most traders confuse their inability to control their emotions, their human behavior, with their ability to know what is going on in the markets.

You know what to do. You simply do not act appropriately to what you see.

The computer is not going to see any better than you do. Therefore, if you can determine to follow a mechanical system, you can equally determine to follow a system based upon your own human logic and reason. After all, a mechanical system is not going to be any better than your own or someone else's logic and reason transferred into the computer via a programming language.

Learn how to trade. Learn to read what a market is showing you, and then discipline yourself to follow the dictates of the best system you can have for you, the one based upon your own observations and knowledge.

I look at it this way:
Here are two computers:



Each gives buy and sell signals. One is a personal computer programmed to follow certain linear relationships in the market. The other is the human brain, trained and educated to see complex relationships in the market. PC can view the market only serially. It cannot multiplex ideas. No matter how carefully it is programmed, it cannot possibly reason or take into account the myriad combinations that occur in the market.

HB can view the market in a multiplexed fashion. It sees numerous relationships within moments. It is able to comprehend the big picture in context, relative to everything else that is going on in the market. While it may not register every combination of events, it is able to take into account multiple combinations that do occur in the market. It can spot formations even though they do not exactly conform to a specific definition of what those formations are supposed to be.

For instance, HB can spot an intermediate high or low in the market, and judge it to be that in relation to all other highs and lows in the market. It can see /\/\ and \/\/ formations in every imaginable way they can occur, along with heads and shoulders, pennants, flags, megaphones, etc. In fact, it is the ability of HB to make judgments that sets it so far above PC that the gulf between them is immeasurable.

As mentioned previously, both these computers give buy and sell signals.

Is it any more difficult to develop a discipline surrounding the signals from HB than it is to develop a discipline surrounding the signals from PC? I think not! It takes no more discipline, determination, and mind set to state, "I will follow the signals from HB," than it does to state, "I will follow the signals from PC." In fact, it is harder to blindly follow the signals from PC — it takes more discipline.

Is there any virtue in attaining to the greater discipline required to follow PC? No! But because it may appear that way, many choose it, thinking that somehow the market is going to reward them for doing so.

It is the decision to blindly follow signals that makes a system mechanical. The act of blindly following invokes the faith and discipline involved in successful trading. Once you have a method or system that gives more dollars won than dollars lost, all that is necessary is to develop the mind set, diligence, and determination to follow that method or system.

Notice, I said a method or system that gives more dollars won than dollars lost. It does not have to give more winning trades than losing trades. It's the end result that counts. The plus dollars have to exceed the minus dollars.

Once you have a vehicle that gives that kind of result, it does not matter which computer gives you the signals. However, because of the ability to make judgments, personally I'll take the signals from HB any time over those from PC.

As previously stated, stop placement is where you separate the knowledgeable mature trader from the amateur trader who still does not know how, when, or where to place stops in the market. Stop placement is where you separate the "men" from the "boys".

Placing a Loss Protection Stop

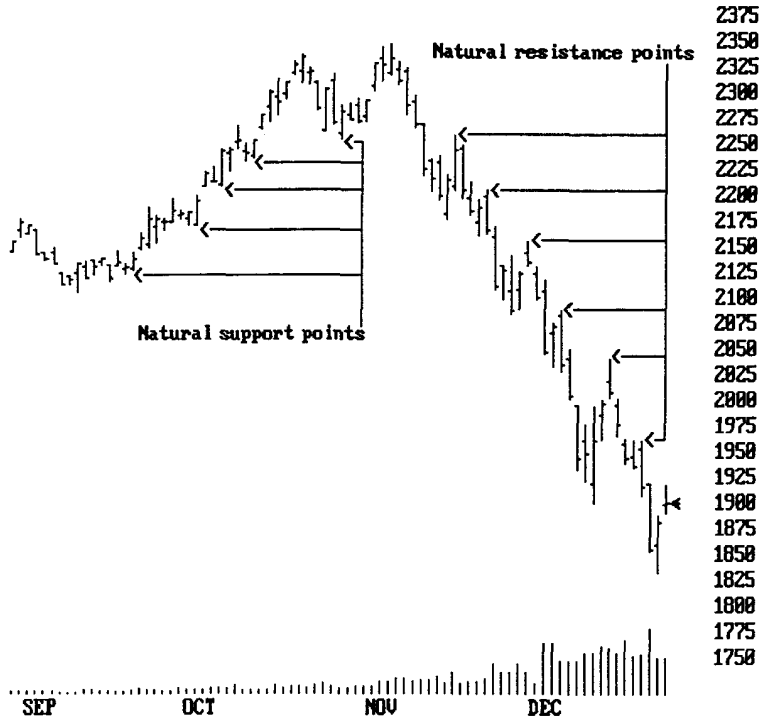
Of the many stop-loss placement techniques I have seen, only two have proven continuously successful over the years. Only two have made any sense at all. One method uses natural support and resistance for placing stops. The other uses market volatility to dictate stop placement. In both cases, we allow the market to tell us where to put the stop. We then filter that knowledge through our financial, mental, and emotional condition.

If the market is telling us where to place a stop and that stop is too far away for comfort, then we do not take the trade. Or, if placing the stop where the market indicates would create too great a financial risk, we refrain from taking the trade.

Using Natural Support and Resistance

I'll now show you what I mean by "natural" support and resistance. Let's look at a nicely trending market in Crude Oil.

CL G DAILY



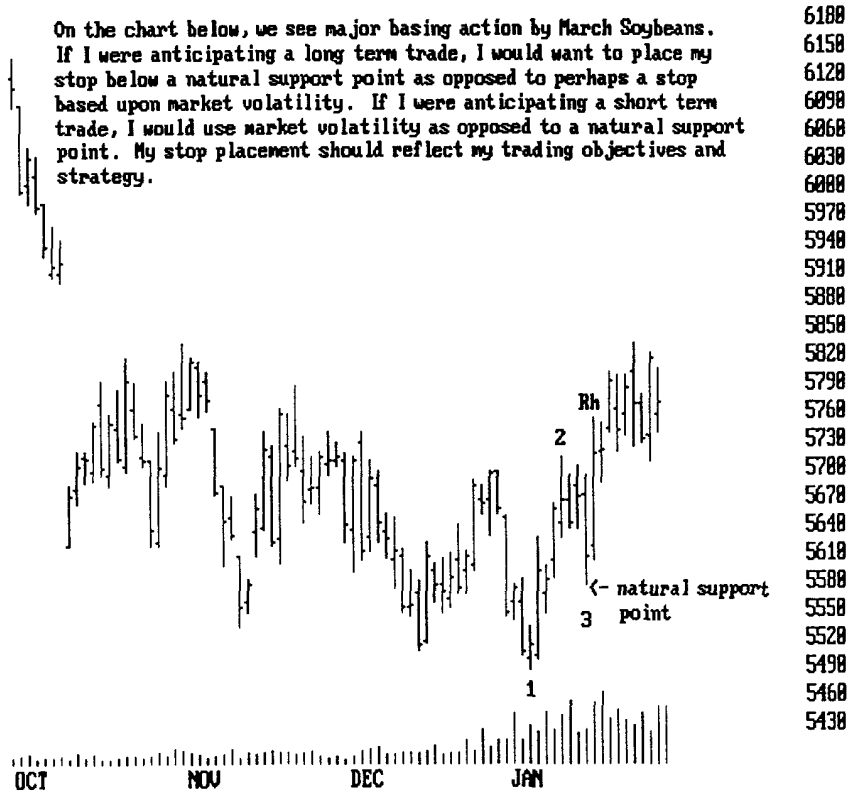
Natural support and resistance points are those places in a trend where prices either move sideways for a brief period or where prices make some sort of correction by moving counter-trend for a few bars.

These stops usually work because price action in the market has previously held at those levels. If recent price was too high or too low at that level, then price will probably be considered too high or too low at that level in the near future. These stops take advantage of the natural support and resistance in the market.

If prices at a natural point of resistance or support do not hold, then the probabilities are that we have been wrong in our estimation of market action, and we are better off being stopped out of the trade.

I have a tendency to use natural support and resistance points when planning a longer term trade for the time frame in which I'm trading. The next chart will illustrate this concept. The main thing is to set the stop in light of my objectives and strategy.

S H DAILY



Advantages and Disadvantages of Natural Stops

The single greatest disadvantage to using natural stops is at one and the same time its greatest advantage: Prices may be too far removed from the current price action.

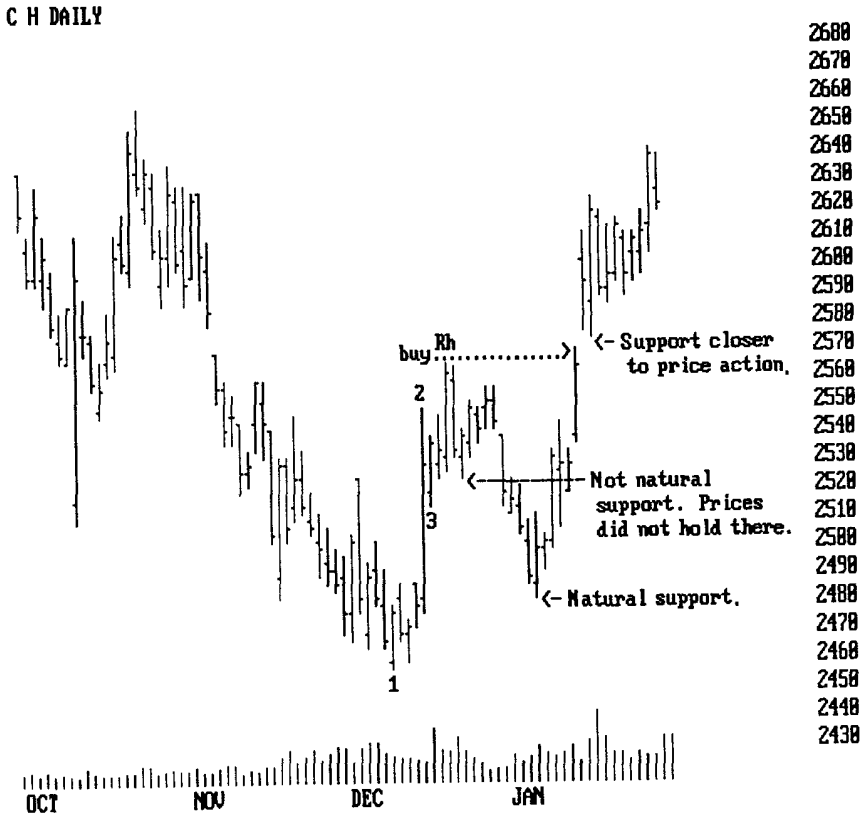
Natural stops are easy to see on a chart once prices move away from them, and in a trending market prove to be remarkably safe. They tend to keep you in a trade for a long time.

A big disadvantage to using natural stops is that at times, when you wait until they are hit, you may see a rather nice gain turn into a loss.

Natural stops are of little or no use in non-trending markets.

The next chart gives you an idea of what I mean when I say a natural support point may be too far removed from the current price action.

Anticipating a bull move in Corn, technically supported by the strong basing action on the chart, I would want to use a natural support point. However, if I took the most natural support point, I would have a stop substantially away from current prices. I've shown the alternative stop placement point I would have used.



Volatility Stops

In my experience, other than natural support and resistance points, the market has only one other factor to aid in stop placement. That factor is volatility.

To understand how to use volatility you first need to understand the concept of volatility.

The difference between a bar's high and low price is that bar's trading range. You can use the high and low of a week to get a weekly range, or you can go intraday to look at hourly, 15 minute, or the trading range of any time period. You simply subtract the low from the high for that period. When you look at any bar chart, the length of each bar, from high to low, represents that bar's (or period's) range.

Once you have the range for one period, you can do the same calculation for any number of sequential periods, and then take an average. If you want to look at the range over a five bar period, you subtract the low from the high of each bar, and after five bars you add up all five individual bars' ranges, then divide by five to get the five bar average range. However, there's a complication.

Let's say that you have a gap up opening, and the low for the current bar ends up being higher than the previous bar's close. If we assume the range to be high minus low, then what happens to the gap, the distance that the market moved between the previous bar's close and the current low?

The true range must include the distance from the previous bar's close to the current bar's high. Conversely, when there is a down gap, and the current bar's high is lower than the previous bar's close, the true range is equal to the difference between the previous bar's close and the current bar's low.

There is yet another complicated consideration. What do you do about markets that trade elsewhere, or are affected by trading elsewhere, and the result is often a large gap opening due to the price action that has taken place overnight?

You must decide for yourself whether or not to take that kind of gap into consideration in your calculation of volatility. The answer may be that you count gaps in some markets and not in others.

Once you learn how to calculate a bar's true range with or without gap considerations, you can take an average over any selected number of days to come up with the true average range.

The true average range is a direct measurement of the market's volatility. When daily ranges expand, we are seeing increased volatility come into the market. When ranges decrease, so does volatility.

If a market is very volatile, a stop based upon that same volatility will give a good indication of where to place the stop.

There are a number of ways to compute a volatility stop. In each case, we must first come up with a volatility figure.

In my own trading, I use average volatility for the last five price bars, provided they are reasonably the same in size relative to one another. If there is an abnormally large, or an abnormally small price bar, I will compute average volatility for the last ten bars. As much as possible, I want to eliminate any aberrations in the market place.

I use ten or more days in markets that have a lot of gaps.

To compute average volatility for any number of days — N, I take the sum of the differences between the high and the low for N days, and divide by N. I then have the average volatility for the last N days.

I'll give an example using the bonds. If you can figure average volatility for the bonds, you can do it for anything. When I compute anything that has to do with the bonds, I first convert them to decimal.

To accomplish that I multiply by 32 and then add the 32nd's:

Day	High	Low	Conversion	Difference
1	103-20	103-08	3316 - 3304	12
2	103-16	103-02	3312 - 3298	14
3	103-14	102-19	3310 - 3283	27
4	102-27	101-29	3291 - 3261	30
5	101-29	100-28	3261 - 3228	33

Total 116 / 5 = 23.2 AV

I then subtract the average volatility point from my entry price, to obtain a logical price at which to place my initial protective stop.

If I were to go long the bonds at 103-14, I would subtract 23/32 from my entry price and place the stop at 102-23.

In order to be consistent and also to show you how I convert back from decimal to 32nds, note the following steps.

103-14 = 3310 - 23 = 3287.

To convert back, you divide 3287 by 32. This gives a whole number and usually a fraction expressed as a decimal, NNN.xxx

You then subtract the whole number away. This will be the mantissa (whole number) to use for your order.

You then multiply the fraction by 32. This gives the remaining thirty-seconds if any for the remainder of your order.

3287/32 = 102.71875 - 102 = .71875.
.71875 x 32 = 23
Result = 102-23.

It's important to notice that there is a flaw in this method of computing volatility. There's something missing. Can you guess what it might be?

Gaps are missing from this calculation. In the currencies, on the daily chart especially, this leaves a lot of the market missing from the calculation.

The truth is that on a gap day, prices have moved from where we see the close today to where we see the open the following day.

There are two sides to the argument. One says that regardless of the gaps, prices are only volatile to the extent that we see the market move each day during the hours we trade. The other side says that to compute true volatility, you must include the **net** amount of the gap. In an up market that would be the distance from today's close to tomorrow's open. In a down market it would be the distance from today's close to tomorrow's open. On intraday charts it doesn't really matter.

You should try to calculate volatility both ways and see which method suits you best. For my own purposes, I have left out the gaps. But you need to be aware that they are there, and they may be more important in some markets than in others. That is the reason I compute a ten bar, or more, volatility on daily charts that contain many gaps.

I have set my stops both according to natural support and resistance points, and computing volatility as shown, over most of my trading career. It wasn't until I came across the Volatility Stop study contained within Howard Arrington's very fine Ensign program, that I began to consider another way to set stops.

The Volatility Stop Study

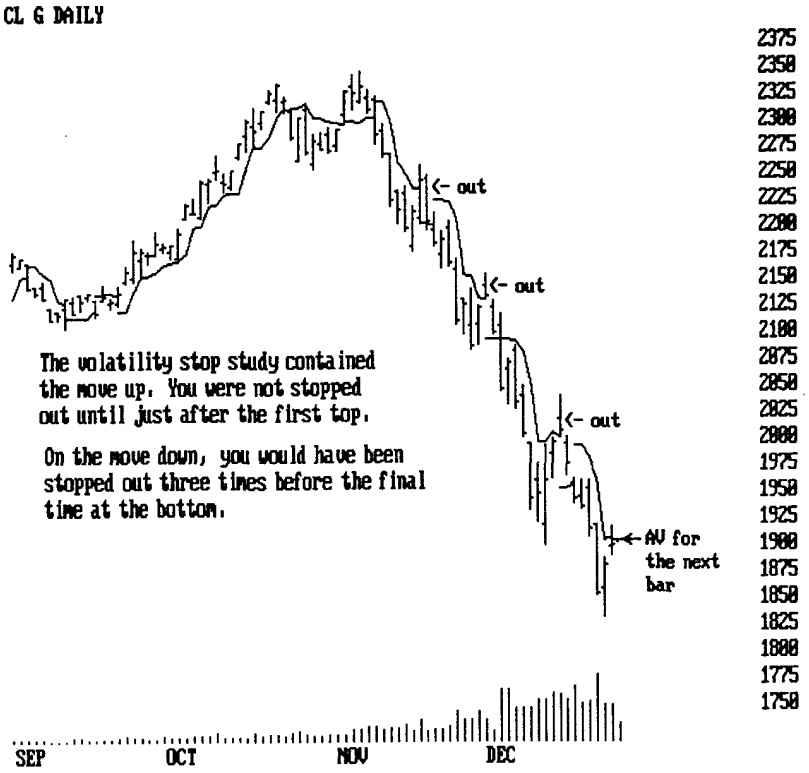
One of the more interesting ways to set stops using volatility is to utilize the study called the Volatility Stop.

I have adjusted this study to my own liking by occasionally removing the multiplier that is normally a part of the study. However, the multiplier can be used effectively in a more volatile market to curve fit the study to the greater volatility occurring in that market.

To use the Volatility Stop study, simply compute average volatility and then add the figure to the lowest close in the last N days, and subtract it from the highest close in the last N days.

This will yield two prices, one for upper volatility and one for lower volatility. Typically, one of the figures will be a price that is within the range of prices you see on your chart for the last N days. The other figure will be either above or below the range of prices you see on your chart. You want to use the price that is furthest away from the range of prices for your stop.

Rather than try to explain further, I'll show you a picture of the Volatility Stop study. If you have such a study available, simply set the multiplier to 1 to put it out of commission, or experiment with the multiplier until you get a plot that contains the move.



Volatility for the above study was set at 5,1. The 1 takes away any multiplier.

An interesting thing about the Volatility Stop study is that it is computed and plotted at the completion of each bar such that you know where the stop is for the next bar. It is displayed forward. On the preceding chart you see it sticking out by the arrow.

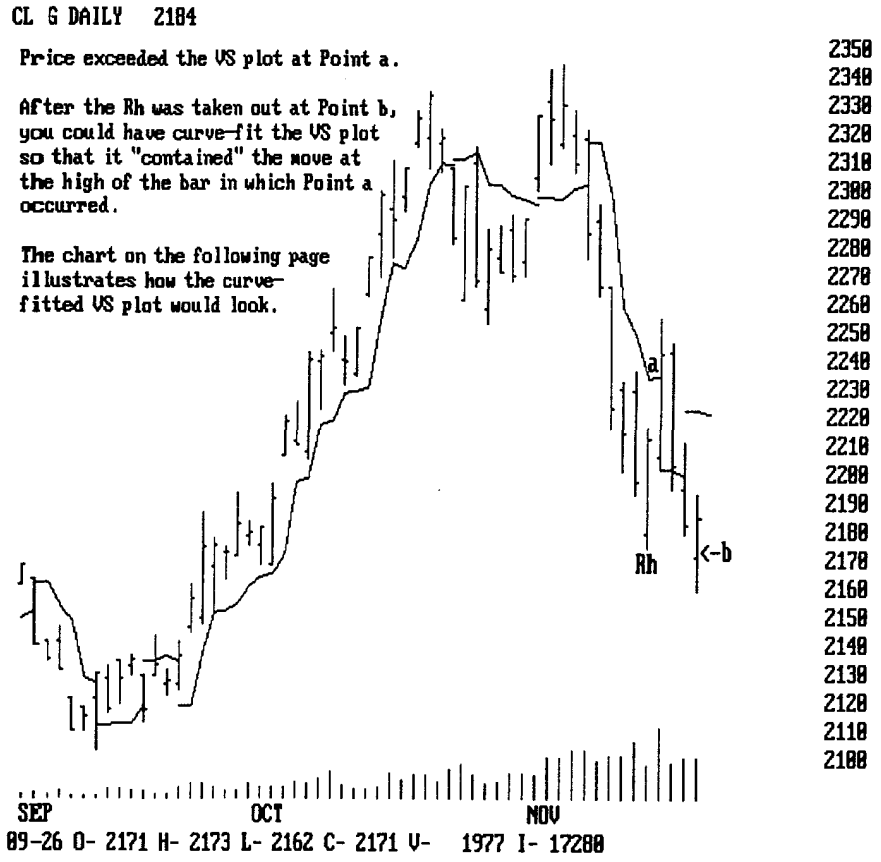
When Average Volatility (AV) is running through the price range, it is a sign to avoid entry into the market, unless of course you want to trade in the congestion.

Here is an interesting way to use the Volatility Stop (VS) study.

Since a setting of 5,1 contained the upmove, you would leave that setting in place for the down move.

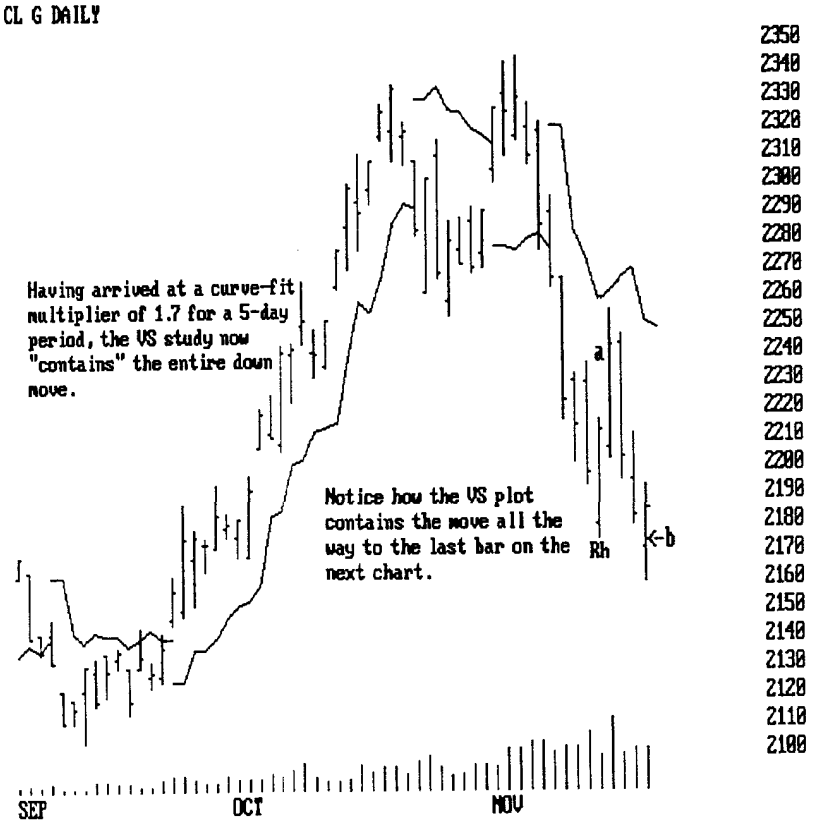
However, once the down move failed to be contained by the study, you could try setting the multiplier to a number greater than 1.

Here's how you would do it.



Is there anything wrong with curve fitting in this manner? I think not.

After all, we want to cooperate with the market. If the volatility is such that a 5,1 VS study is not able to contain price action, then set up a study that will contain it. The market is always right, the only one wrong is you! You must adjust to what the market is doing, not what you want to force it to do.



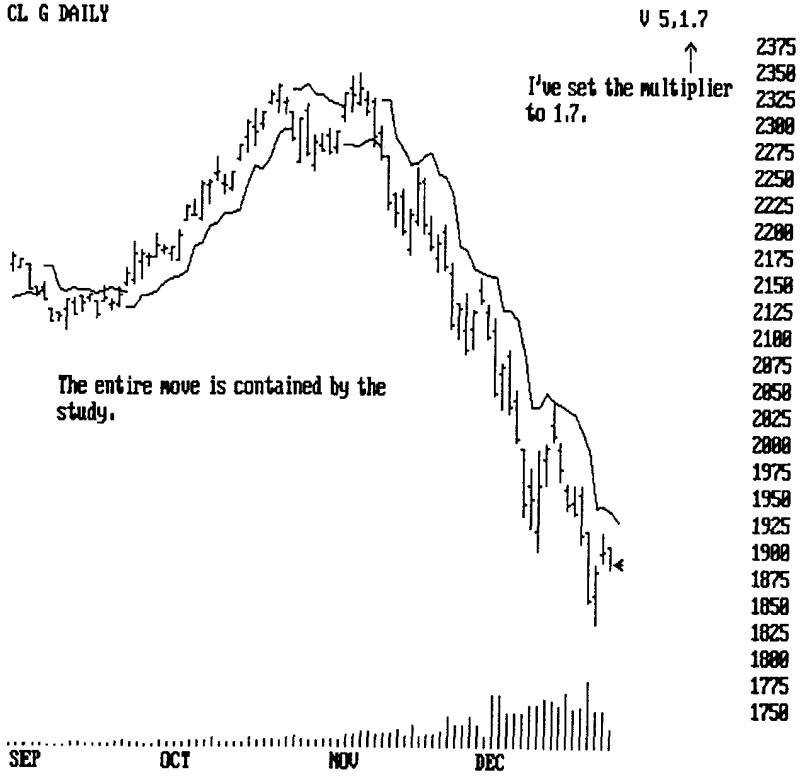
I like to see a little room between the high and the VS study.

Remember that if the stop is too far away, you don't have to trade. No one is twisting your arm to make you take the trade.

I prefer to fit the study to the market when I have made some profits.

Then it's my decision whether or not I want to risk those profits.

A good rule of thumb is that if the VS study would cause you to lose more than you've made, then it might be better to chip away at the market until you do have enough to risk the amount dictated by the study.



Isn't this a much more intelligent way to set stops than to just use some fixed number of points, dollars, or percentages that have no real meaning?

Once you see that the market is in an established trend, simply ride that trend. The concept here is to wait for commitment by the market. Once you have it, hang on for the ride.

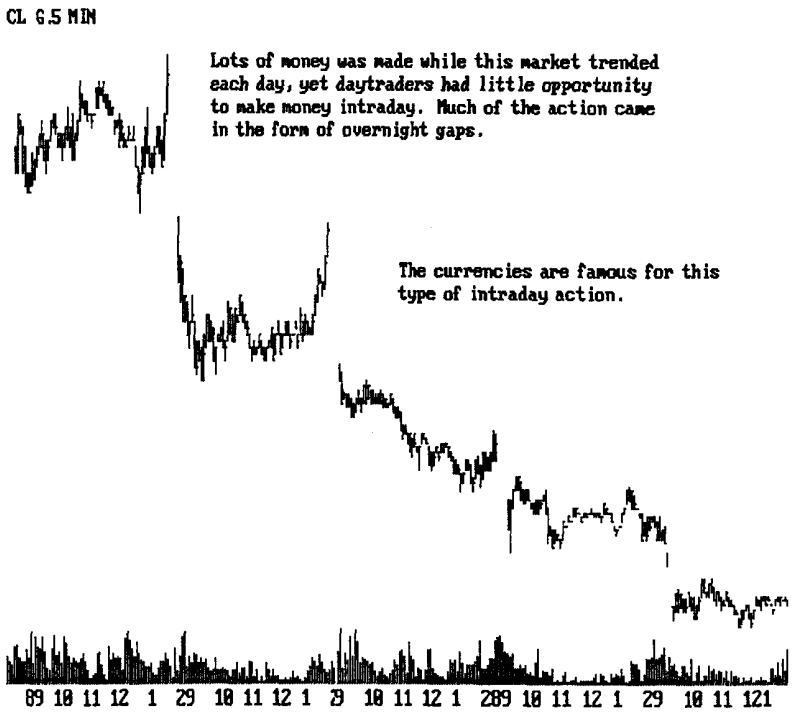
This type of trading is a lot better than jumping in and out all of the time. We are letting the market tell us how far away to place the stop.

In the introduction to this book I mentioned that day traders leave more money on the table than do daily position traders. I said that while a market may be wonderfully trending, the day traders have to battle their way into the market each and every day, often losing while the daily traders are making piles of money staying with the trend.

Since this is a chapter on stops, let's realize that one way to get stopped out of a market is to be purely a day trader. When you make the decision to daytrade exclusively, you have made the decision to stop yourself out of the market.

To my way of thinking, this is tantamount to closing a toy store in the month of December.

I have repeatedly shown you a Crude Oil chart in this book. While scads of money were being made by the daily position traders, there were plenty of days that looked like the chart below on an intraday basis.



Here's a D-Mark intraday chart. It, too, shows that most of the movement came as a result of gaps. This happened during a strongly uptrending market on the daily chart.

The point I'm trying to make here is that a lot of traders end up stopping themselves out of a market when there is no need to do that.

I believe in a balanced approach to trading. Every time you enter a trade, you are going into business. When you get stopped out, you are out of business. It's bad enough that we are put out of business more often than we care to be. Taking yourself out of a market that is making you money seems to me to be the height of foolishness.

This is the type of rigidity that has nothing to do with good trading. When you say to yourself, "I'm a daytrader, therefore I must be out by the close," you are being rigid in a way that may be harmful to your success. If you don't get the big wins, how can you ever make up for the small losses?

Probably the oldest saying in the business is to let your winners run. If you stop yourself out of the market you are ignoring this most basic of principles.

Of course, there may be an overriding reason to be strictly a day trader. If you simply cannot stand the pressure of holding a trade overnight, then by all means you should restrict all trading so that you are out by the close. Comfort in trading is more important than money. If you have a problem with staying overnight, you will just have to leave that money there for me to pick up.

The only market I will purely daytrade is the S&P. I am not willing to put up so much money ($22,000 as I write this) per contract for the privilege of staying overnight. Sufficient money can be made by simply daytrading the S&P.

I'm not much for holding the Bonds overnight, but for a different reason. The Bonds simply don't trend sufficiently to warrant overnight positions most of the time.

Chapter 11

Placing Objective Stops

Good planning dictates that you should have some sort of objective for at least a part of your position. I use a three step approach to placing objective stops.

Cost Covering Stop

1. **Cost covering objective stop.**

For me, it is important that I cover costs. This single, simple idea has been one of the most important concepts of my success in the markets.

I never allow myself the luxury of counting profits until I have covered my costs. As long as I take care of that one detail, the profits seem to take care of themselves.

By covering costs, I mean taking care only of the immediate costs of the trade — commissions and fees.

I do this in conjunction with market volatility. Volatility must be equal to at least twice my immediate costs or I will not trade.

That means unless I have a chance to cover costs with no more than half my position, I will not trade. An exception to this rule would be if I were trading three contracts. Then I would want to be able to cover with one or two contracts.

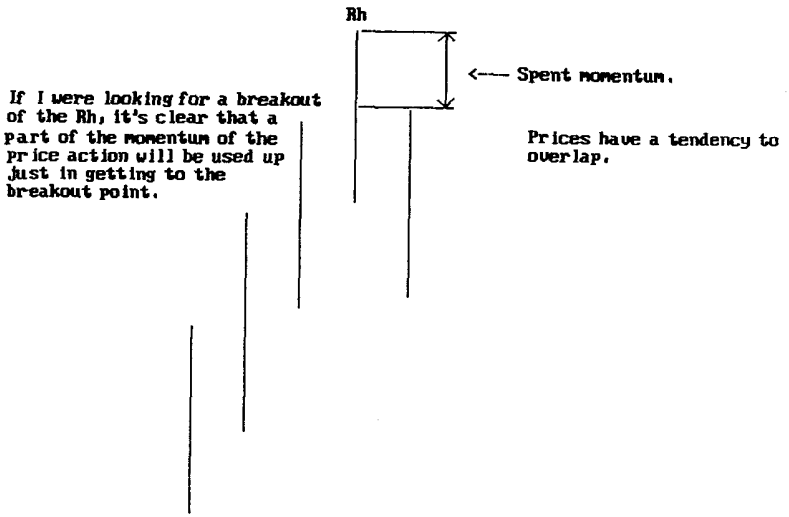
Let's assume I want to get long a day trade in the S&P using a five minute chart, and that my costs are $25 per contract, and that I am going to do a three lot.

I would need $75 to cover costs. Since a single tick in the S&P is worth $25, I would need six ticks of average volatility in order to meet my rule of the volatility being twice my immediate costs.

Why twice my costs rather than some other multiple? Or why any multiple at all?

The reason for a multiple of two is the propensity for prices to overlap.

Take a look at what follows:



By using twice the volatility as the least amount of volatility with which I'm willing to enter a trade, I increase my chances of reaching my objective of covering my costs.

These stops, where possible, are placed as "market if touched" (MIT) orders.

Small Profit Stop

2. Small profit objective stop.

Once I have covered costs, I try to take some sort of profit. Depending upon observable market action, I may take that profit at the same price at which I cover costs. Whenever possible, I attempt to take the profit at a better price than costs, but that is not always possible. How do I tell?

If a market has been moving strongly prior to my entry into a trade, especially if it has been trending well in a time frame that is longer than the one in which I'm trading, I will have resting MIT orders for only that number of contracts that enable me to cover costs. My first profit stop will be set at an amount which is dictated by average market volatility. For example, if I need six ticks to cover my costs, and average market volatility is thirteen ticks, then I will have a resting, cost covering MIT, at six ticks and a resting, **small profit MIT**, six or seven ticks beyond my cost covering MIT stop.

The point of all this is to avoid a situation where I have no profit to show for my having taken the risk of market entry.

Full Profit Stop

3. Full profit objective stop. My third objective is to capture as much of the move as the market will allow. This is done with a trailing stop. In other words, my objective is to be stopped out. There are two considerations here.

A. Until I am satisfied in my own mind that the market is now trending, or is going to trend strongly, I will trail a 50% stop. When I am convinced I am in a strong trend, then I can do a number of things which will be covered in the next section under trailing stops.

B. When I am satisfied that I've made a nice profit, and feel there is no way I can be terribly hurt, I will lift my 50% trailing stop in favor of giving the market all the room I am comfortable in allowing.

Trailing Stops

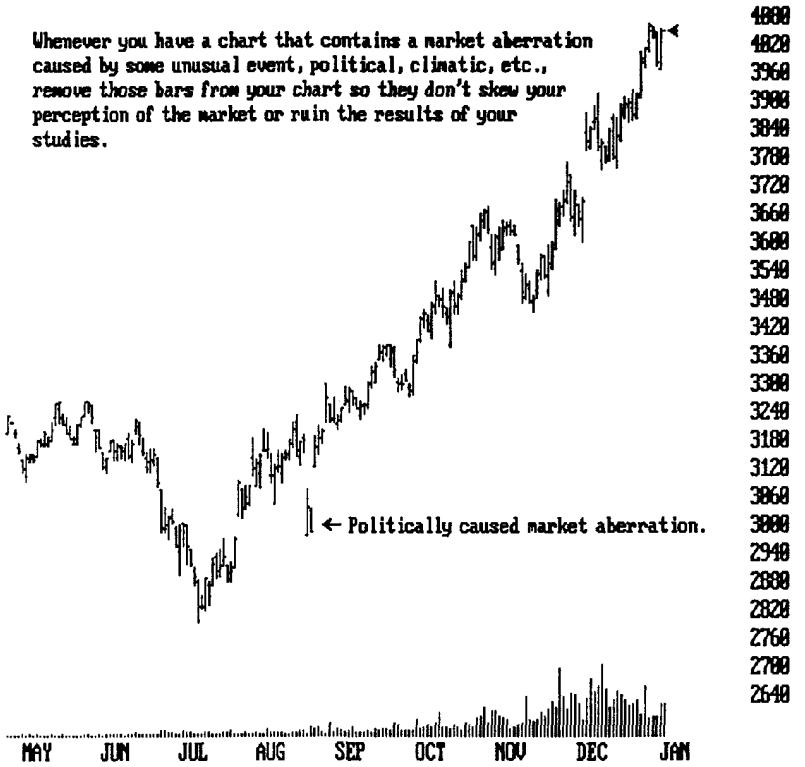
As stated previously, I trail a 50% stop until I feel as though I can take a chance on allowing the market a lot of room.

There are at least three ways I can do this, and I use them as the mood strikes me. A fourth way exists, but I reveal this only at my seminars. However, these three ways are all excellent and I still use them according to my perception of the market action.

1. Natural Support and Resistance. I've already mentioned this but in a different context. Natural support and resistance points are superb stop placement points in steeply trending markets. The use of them is a judgment call — you have to look at the market anatomy and see if they have been working in this market, both in past trends and in the current trend. If they have been working well, use them. This is the simplest, least complicated way of trailing a stop. It requires that you know the market in which you are trading. You come to "know" it by studying its history.

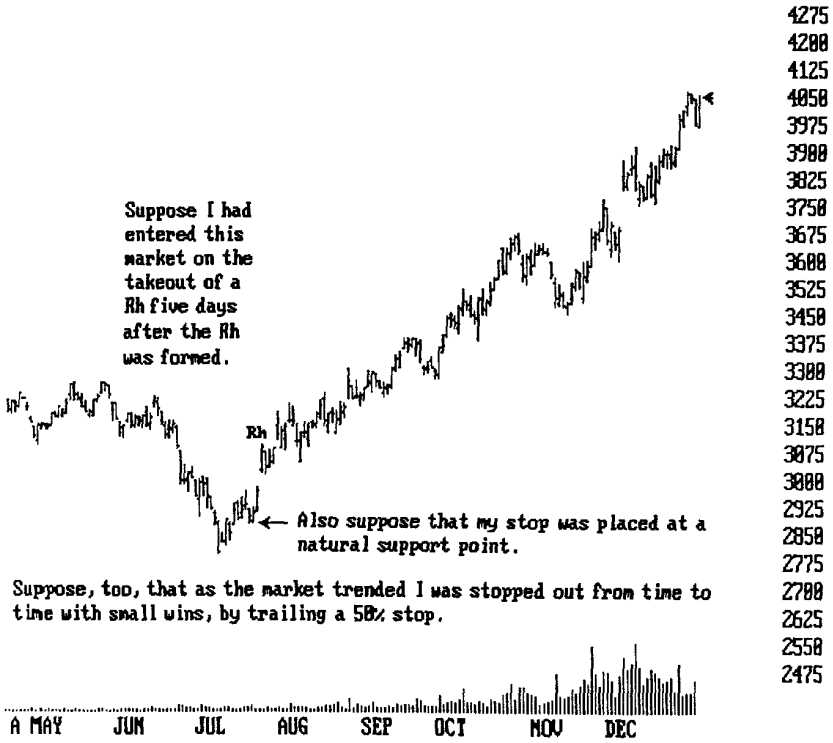
2. The Volatility Stop study, which is available in some trading programs, and which can easily be computed by hand. The Volatility Stop study and how to compute it is covered elsewhere in this book.

3. Curve fitting a moving average to a trend. This is done in the same manner as I showed for curve fitting the Volatility Stop Study. Study the charts that follow. There are some important lessons to be learned.



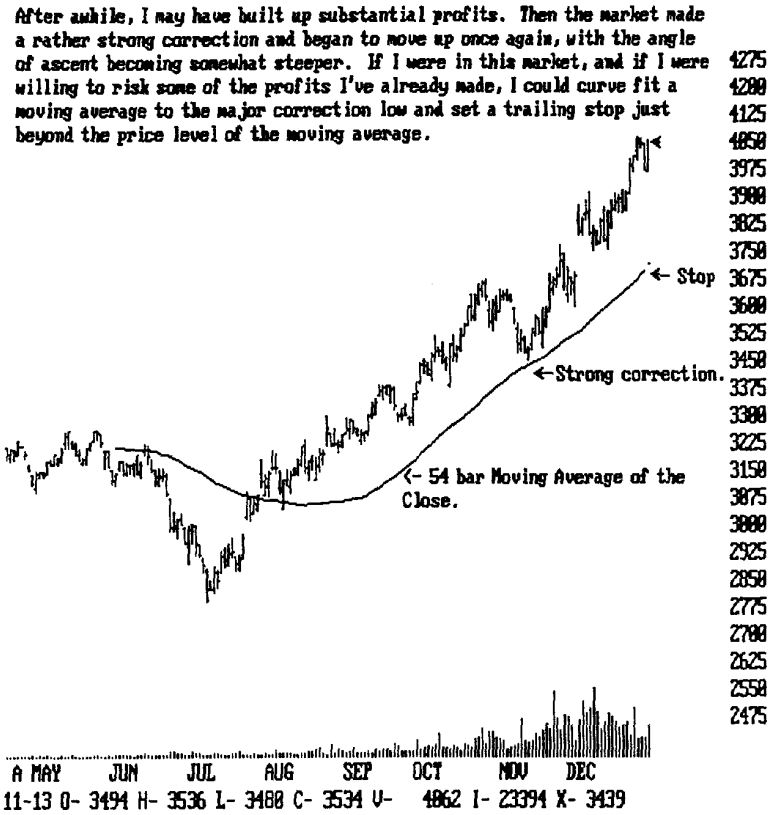
Simply remove the offending bars from your chart. They do not reflect the true, overall action in the market, but they will give false readings to any technical studies you may have on your chart.

In the charts that follow, you will see I do what I say.



In the above fictitious situation, the market is trending steadily but not steeply. Although I might have used an initial stop set at a natural support point, the market action, and the shallow angle of the trend, would dictate that a 50% trailing stop be used.

In other words, this market is not exactly running away. It is plodding along.



Although I used a 54 bar moving average of the close, there are a number of other MAC's that would have given similar results. In addition, I could have used a moving average of the lows, since this is an uptrend. If it had been a downtrend I could have used a moving average of the highs.

There's no magic in these moving averages. I use them only to show containment of a trend.

Perhaps, you could have used a volatility stop with a large multiplier to show this containment. Offset Moving Averages could have been used. You might even have drawn an old fashioned trend line!

Other Considerations

Profit Objectives Using Points

If I am able to cover costs with one-third of my position, I will often take profits based on making a certain number of points. For instance, if I have made five points to cover costs on an intraday trade, I may take some profits by liquidating a part of my position when I see another five points. This, too, may be placed as an MIT order.

There are certain trades that are designed as short term scalps. I will very often have a profit objective based upon points for these trades.

Some markets lend themselves to the concept of setting point objectives. In the S&P, you can get fifty points on most breakout trades involving intraday hooks on a five minute chart. At fifty points in the S&P, I will take some profits, and then pull my protective stop to breakeven. If the market continues to move, I will make even more, but I almost always am able to take the fifty points.

Point objectives may be adjusted upward for time frames greater than five minutes, but keep in mind the volatility of the market and time frame you are dealing with. You wouldn't expect an objective of fifty points on a daily Bean Oil chart. It may take Bean Oil two or more days to move that far.

Using Fibonacci Expansion Objectives

The use of this type of objective has been pretty much hammered to death in recent years. It has been written up repeatedly. How to use these are described in Part I of my book entitled **Trading by the Book**.

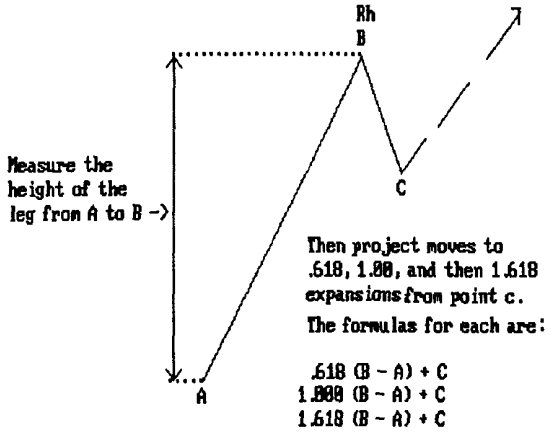
I use Fibonacci objectives to project the expansion from a trading range. They can also be used in trending markets. Objective stops can be set at these objective points because they tend to be self-fulfilling when enough people use them in a market.

That in itself is a reason to know where they are. When enough people are using them, you will know where to expect reactions in certain markets.

For instance, Fibonacci traders abound in the U.S. Treasury Bond and S&P 500 markets. This is especially true intraday. You can pretty much tell where these traders will be looking for profits. If you see a market moving to Fibonacci expansion ratios, you can use these ratios to your own advantage. You will be able to forecast market moves with fairly good accuracy. Not only can you take profits there, but you can make good counter-trend, short-term scalps at those expansion levels.

Here's how to do it.

When you see a market making a leg up, a correction, and then a resumption of the trend by taking out the Rh, you can expect profit taking at one of three places.



I do not use money objectives. I have trained myself to think of my trades in terms of points. When I do that, the money takes care of itself. I firmly believe that you do not count your money until the trade is over.

I do not use percentage objectives. I think it's rather foolish to attempt to dictate to a market that it must move a certain percentage. However, if Fibonacci ratios can be deemed to be percentages, I will take advantage of those ratios by scalping into them in markets where I have determined that many other traders are using them.

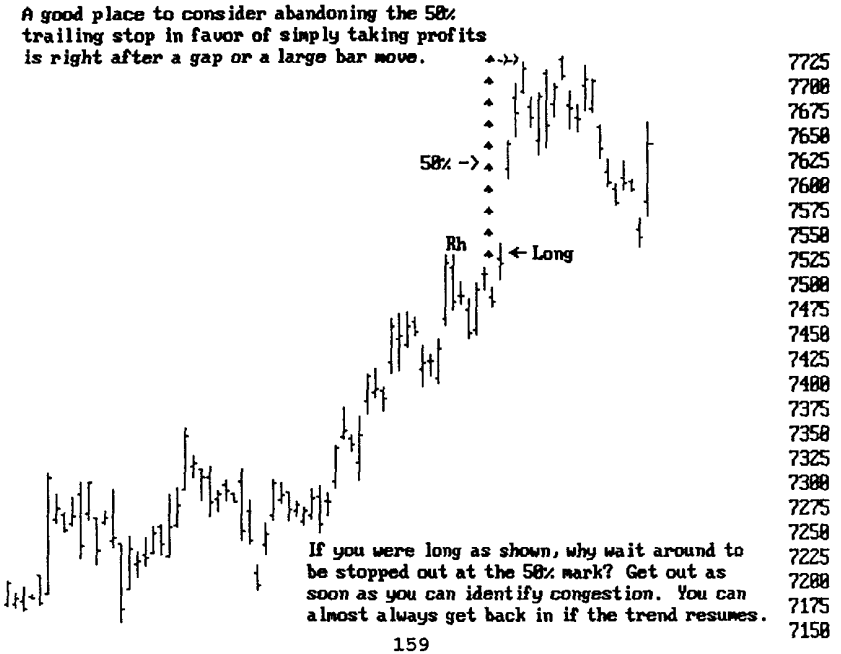
Placing a Profit Protecting Stop

Taking profits from a market while they are there to be had is a very important part of my money management when trading the Ross hook.

Any of the trailing stop methods can be used. The idea is to make sure you get out with a profit. By using a profit protecting stop, you will not fall into the trap of seeing the profit in a trade disappear and turn into a loss. By trailing a 50% stop in the early stages of a trade, you will make a decent profit on most of your trades.

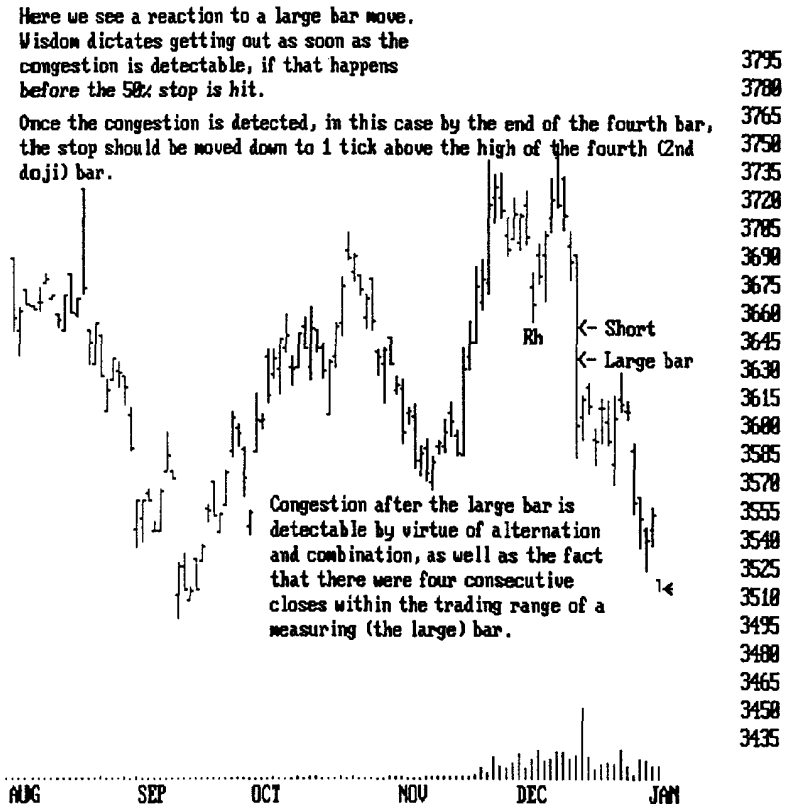
There is a time to lift the 50% trailing stop. One instance is when you decide to let the market run, and place a stop far back using one of the trailing stop methods I've described. The other is when you decide to get out before your 50% stop is hit because of the price action you are seeing in the market.

This decision is normally made at a short to intermediate term phase of the trade.



In other words, in the early or intermediate stages of a trade be aware of the market going into congestion. At the end of the congestion, or even at some point during the congestion, prices may move to your 50% stop, and you will have given up more than necessary.

Don't feel "honor bound", or in any way compelled to stay with a trailing stop if it doesn't seem to make sense. Take profits!



Another important realization to consider when setting a 50% trailing stop is the concept that markets retrace to the ±50% level fairly often. This is often a self-fulfilling prophecy because so many people believe in it. Be very aware of where the move started. The retracement will often be from the **inception** of the move to the point where the correction starts, not from where you **entered the market** to the point where the correction starts.

If your 50% trailing stop is in the pathway of a 50% correction, it is virtually sure to be hit. Therefore, try to wait until the market has made a correction from the current leg before you begin to trail a 50% stop.

Chapter 12

Filtering the Ross Hook

There are a number of way to filter trades. Many of them have to do with the very same parameters that are taken into consideration when setting stops.

As a quick review, let's look at some of them.

1. The use of Stop Limit orders automatically eliminates some trade entries because you are never filled.

2. Too much or too little volatility can keep you out of a trade. Too much volatility means you have to place your stop further away than is comfortable. Too little volatility arises when prices are moving so little, as to give little or no promise of movement sufficient to cover costs and make a profit.

3. Placement of stops at natural support and resistance points may keep you out of a trade. They may be too close or too far.

4. Technical studies such as the Volatility Stop may keep you from trading. They may call for your stop to be set too far away for comfort, or too close to be practical. If you are using the Volatility Stop study, too little volatility occurs when the study fails to yield a number that is not outside the range of current prices.

5. The 3 x 3 MAC can keep you from entering a trade. It may not confirm the breakout.

6. Your choice of market(s) and time-frame in which to trade. Recalling that Ross hooks are intended to be traded in trending markets, the fact that a market is not trending in the time-frame in which you choose to trade will filter you out of the market. Therefore, it's vital for you to be able to identify congestion. Congestion, then, is also a filter.

All of these parameters have been covered previously. They are ways to filter trades. With proper implementation, you will enter only the trades you want at a price you want. They are trades that occur in a trending market with an affordable stop protection level. They are trades having a reasonable expectation of covering costs *and* making a profit.

There is a lot to keep in mind when trading. It involves work and thought. You must always be asking yourself if everything is right about a trade, and then take only the best trades. To me, the filtering I've just talked about is fundamental to good trading. It means you simply cannot take every trade that comes along. It means you cannot trade too many markets simultaneously. Trading more than four to six markets at once is almost too much to bear. It is over trading. Doing the work necessary for conservative filtering of trades is in itself a filter. You must select the best of the best trades.

That means sitting down each day and poring over weekly and daily charts to get market perspective. You must do that even if you are a daytrader. Getting the overall picture will filter out many intraday trades, simply because perspective shows you that elsewhere there are more likely candidates for a winning trade.

I suggest making yourself a checklist that asks the kinds of questions I've raised. Then strain each contemplated trade through the filter of your checklist. Ask yourself:

"Is the market trending?"

"Can I identify congestion?"

"If I were to place my stop 'here' how would I feel if my stop were hit?" "Could I stand either or both the pain or dollar loss?"

"If prices move with the same volatility with which they've been moving, can I cover costs?" "Besides covering costs, is there sufficient momentum that I can also expect to make a profit?"

"Is this market giving better signals in another time frame?" "Is it perhaps more liquid in another time frame?"

"Where is the closest natural support or resistance?" "Is it too close or too far for comfort?"

Confirmation Filters

I want to make something perfectly clear! Although I have traded and won with every one of the technical indicator techniques that will be shown in this and the next few chapters, I prefer to trade with only what I see on the bar chart. I do not normally use technical studies or indicators. In the chapter on plain vanilla trading you will see how I filter trades simply by reading what the bars are telling me.

Much of the work done on the studies has come from my students who are willing to share their knowledge and experimentation. There are no techniques contained in this book that have not been proven to be consistently successful. However, be forewarned that in trading, one person's success with a particular technical indicator study is often another person's failure using the identical indicator. The distinction is in the deployment, discipline, management, and other ingredients that comprise the difference between the winning trader and the losing trader.

There **are** technical studies that can serve as confirmation filters.

"Does the 3 x 3 MAC show containment?"

The 3 x 3 MAC is often important in deciding about trade entry. The angle at which the 3 x 3 MAC changes direction, and then begins to show containment, gives an excellent idea of the momentum behind the trade. Assuming containment of prices, when the angle formed by the 3 x 3 MAC's change of direction is between 45 and 65 degrees, this is indicative of a strong trend in the making.

But there are better confirmation filters than the 3 x 3 MAC. One of these is the Commodity Channel Index (CCI).

When you write a book, you always want to include something that few have ever seen. Something that makes the book unique. I'm going to do that right now. I'm going to show you how you can use the CCI study in a way that few have seen before. I'll take it a step at a time. I want to be sure you follow what I'm going to do. First, a bit of history.

It is my understanding that when the CCI was originally introduced and developed by Donald Lambert, it was intended to reflect cycles in the market.

The CCI measures the mean deviation of today's Typical Price relative to N day's average Typical Price. Typical Price is computed as the high plus the low plus the close, divided by three. This gives a close-weighted Typical Price.

The number of bars to use (N) was selected according to the futures cycle or half-cycle.

It was my friend Sandy Stith who introduced me to the CCI study. He has experimented with it for years. Others who tried it have abandoned it as worthless.

Being the contrarian that I am, I wanted to make it work where others could not.

First, I realized that there was a potential error in the way CCI is computed. In arriving at Typical Price, gaps were ignored. In most cases this didn't matter, but in some cases it made the difference in whether or not I would take a trade.

Second, I realized that there was another possible error in the way CCI is constructed. CCI was supposed to show overbought and oversold within the futures' cycle. It had three lines: +100, 0, and -100. However it was theoretically, if not practically, infinitely expandable. At what value would it be oversold or overbought?

There was one great advantage to the scale. It was increasingly difficult for CCI to make ever greater extremes in its readings. It took more and more momentum to push the CCI plot further out on its scale.

I read about how you were supposed to buy when CCI crossed the +100 line from below and how you were supposed to sell when CCI crossed the -100 line from above.

Sandy Stith's work was of great help to me. He suggested a 30-bar CCI. I tested it all the way to 50 bars and agreed that 30 bars was best.

I then enlisted the help of my friend George Damusis who programmed the Market Detective software package. He constructed the CCI so that it would reflect the true range of prices to include the gaps.

Then I asked him to do something special. I asked him to program the CCI study so that it could be projected ahead to show where it might be tomorrow.

He did that for me in two different ways: 1. I could ask the program what the price would be if the CCI were to have a certain value reading on its scale. 2. I could ask the program what the value of the CCI would be if the Typical Price tomorrow were X.

If you don't have software that will allow you to project tomorrow's price bar, then I recommend either Market Detective or Investograph Plus Special Edition/RT. They are the only programs I know that will do this projection. They are available only through Ross Trading.

If you don't want to buy either of these programs, I'll show you another way that you can use the CCI study. If you have software that will let you insert tomorrow's Typical Price, then you can do it with the software you already have. If you do insert tomorrow's Typical Price, be sure to erase the bar once you have what you need.

To insert tomorrow's price, you need to be able to create a hypothetical price bar for tomorrow, and place it in your data base. Once you have placed the hypothetical bar in the data base, then simply run the CCI study with the hypothetical bar in place, and see what the reading will be.

The hypothetical bar need only have one price for all fields. The open, high, low, and close can all be a Typical Price, but you can also insert a high and a low if you want to do the extra work.

How do you know what tomorrow's Typical Price might be?

I'll show you two ways to do it. Then, I'll show you how to use CCI with the Ross hook.

Figuring tomorrow's Typical Price in congestion has been done essentially this way since the inception of floor trading. Each day the floor traders come into the pit with these figures in hand. They tend to sell at or near the typical high and buy at or near the typical low. If either the high or the low are violated by more than a few ticks, you will see the floor traders bail out and run for their lives. This shows up on a chart as an extra long intraday bar.

Figuring Tomorrow's Typical Price In Congestion

(Open + High + Low + 2(Close)) / 5 = X

2X-High = Tomorrow's Projected Low
2X-Low = Tomorrow's Projected High

Example: (6023 + 6054 + 6000 + 2(6040)) / 5 = 6031

2(6031) - 6054 = 6008 = Tomorrow's Projected Low
2(6031) - 6000 = 6062 = Tomorrow's Projected High

Tomorrow's Typical Price = (Tomorrow's Projected Low + Tomorrow's Projected High) / 2

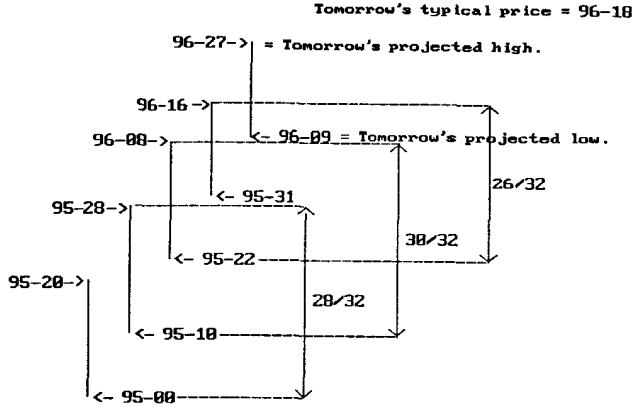
(6008 + 6062) / 2 = 6035

Figuring Tomorrow's Typical Price In a Trend

Tomorrow's Typical Price In an Uptrend.

To compute tomorrow's Typical Price in an uptrend, we need to find the average rate of ascent. It's important to use 3 bars for this computation.

What we want to know is on average how much are prices moving in the direction of the uptrend. To find out, we measure from low to high.



Here are the steps to follow:

1. We measure from one day's low to the next day's high, to see how far prices move over a two day period. We do this for three overlapping two day periods. In the example shown we had 28, 30, and 26/32nd's for each of the three periods.

We then add those together and divide by three.

28 + 30 + 26 = 84. 84 / 3 = 28/32 on average.

Adding 28/32 to the last known low, we obtain a number of 96-27 for tomorrow's projected high. 95-31 + 28 = 96-27.

Next we need to determine tomorrow's projected low.

2. We measure the average volatility for the last three days. Average volatility equals the sum of the differences between high and low, divided by three.

We have 96-16 - 95-31, 96-08 - 95-22, and 95-28 - 95-10.

The three differences are 17, 18, and 18.

Summing these and dividing by 3 = 53/3 = 17.6666 = 18 (rounded).

Subtracting 18/32 from the projected high, we obtain a number of 96-09 for tomorrows projected low. 96-27 - 18 = 96-09.

The final step is to add the projected low and the projected high and divide by two to come up with a Typical Price. In this case, (96-09 + 96-27) / 2 = 96-18.

It's important to realize that this is not an exact science, but you might be surprised how often we can come within a tick or two of being right.

You can also compute the Typical Price differently by measuring from high to high to get the projected high.

To obtain the projected low, you would then do as we've just done and subtract average volatility for three days from the projected high.

A third idea is to also measure from close to close to come up with a projected close. Then you could add the projected high + the projected low + the projected close and then divide by three to come up with a close weighted Typical Price.

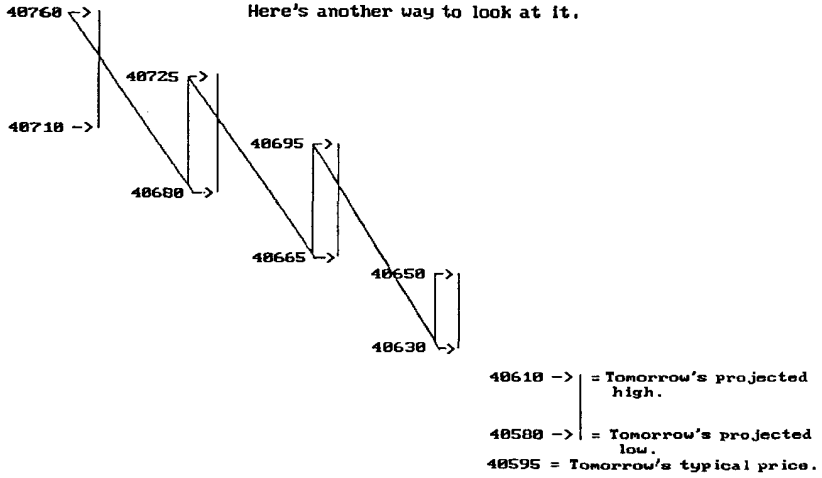
I guess the ultimate would be to project an open and throw that in there as well. Then you could substitute the four prices into the formula I gave for finding Typical Price in a congestion.

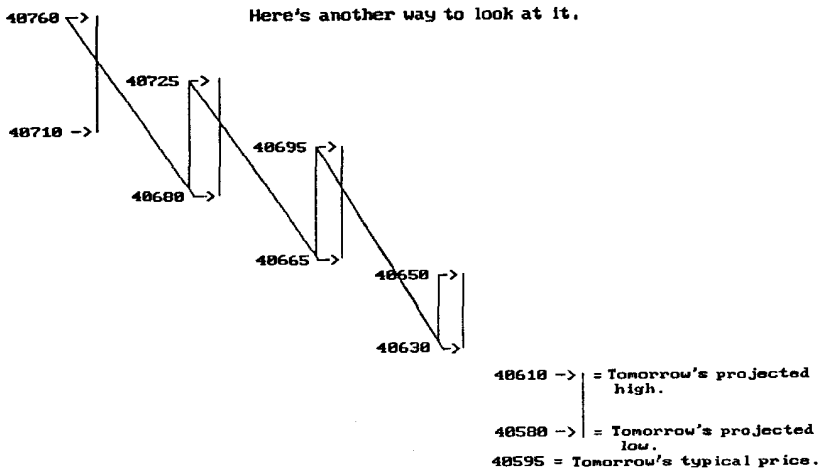
The choice is yours. With today's software in many instances being programmable by you, you can figure all the different ways and then take your choice.

Tomorrow's Typical Price In a Downtrend

To compute tomorrow's Typical Price in a downtrend, we need to find the average rate of descent. It's important to use 3 bars for this computation.

What we want to know is on average how much are prices moving in the direction of the downtrend. To find out, we measure from high to low.





Here are the steps to follow:

1. We measure from one day's high to the next day's low, to see how far prices move over a two day period. We do this for three overlapping two day periods. In the example shown we had:

80, 60, and 65 for each of the three periods.

We then add those together and divide by three.

80 + 60 + 65 = 205 / 3 = 68.3333 = 70 (rounded up) on average.

Subtracting 70 from the last known high, we obtain a number of 40580 for tomorrow's projected low. 40650 - 70 = 40580.

Next we need to determine tomorrow's projected high.

2. We measure the average volatility for the last three days. Average volatility equals the sum of the differences between high and low, divided by three.

We have 40725 - 40680, 40695 - 40665, and 40650 - 40630.

The three differences are, 45, 30, and 20.

Summing these and dividing by 3 = 95 / 3 = 31.6666 = 30 (rounded).

Adding 30 to the projected low, we obtain a number of 40610 for tomorrow's projected high. 40580 + 30 = 40610.

The final step is to add the projected low and the projected high and divide by two to come up with a Typical Price. In this case, (40580 + 40610) / 2 = 40595 = tomorrow's Typical Price.

One last thing. For those of you who might want to know the formula for the CCI it's as follows:

Four steps to calculate CCI

1. Compute today's "typical" price, using high, low, and close:

$$X_1 = 1/3(H + L + C)$$

2. Compute a moving average of the N most recent typical prices:

$$\bar{\bar{X}} = \frac{1}{N} \sum_{i=1}^{N} X_i$$

3. Compute the mean deviation of the N most recent typical prices:

$$MD = \frac{1}{N} \sum_{i=1}^{N} \left| X_i - \bar{\bar{X}} \right|$$

4. Compute the Commodity Channel Index:

$$CCI = \frac{(X_1 - \bar{\bar{X}})}{1.5 * MD}$$

Where:

N = number of days in the data base

X_1 = today's typical price

X_2 = yesterday's typical price

X_3 = day before yesterday's typical price...

X_N = oldest typical price in the data base

$\sum_{i=1}^{N}$ stands for the sum of the items following the symbol starting with 1 and ending with N, e.g.

$$\sum_{i=1}^{N} X_i = X_1 + X_2 + X_3 \cdots + X_N$$

$|\ |$ signifies "absolute value"; difference should be added as if all were positive numbers.

If you think I have any idea of what all that mathematical notation means, you have another think coming, but it sure is impressive. I had to take that to a mathematician to have it translated. To the best of my knowledge, CCI shows you the relationship (expressed as the mean deviation) of today's Typical Price to a moving average of Typical Prices.

Now it's time to show you how to make money with this concept. The charts are going to look somewhat different as I switch to the Market Detective software.

Rules

1. Here are the rules we will use to filter the Ross hooks through the CCI: The CCI must either have passed through two of the visible horizontal (VH) lines (+100, 0, -100) prior to taking the hook, or it must be projectable that it will pass through two of the visible lines. Any two visible lines will do: +100, 0, -100. Once CCI has moved beyond the ±100 line, we will take all Ross hooks that occur, as modified by Rules 3-6.

2. Taking Ross hooks implies that we will, wherever possible, enter ahead of the hook by placing orders at correction extremes. We will also use the Trader's Trick for entries.

3. If taking out the point of a hook will not result in a tradable reading for CCI, we will not take a breakout of the hook. Tradable readings are as follows:

> CCI having moved from 0 to ±100
> CCI having moved from ±100 to ±150
> CCI having moved from ±150 to ±175, or any increment of ±25 thereafter, such as from ±175 to ± 200, or ±200 to ±225, on to infinity. Beyond ±100, all lines are invisible.

4. With CCI at ±150 or beyond, if CCI recrosses one invisible line, it need only cross that same line again to be tradable.

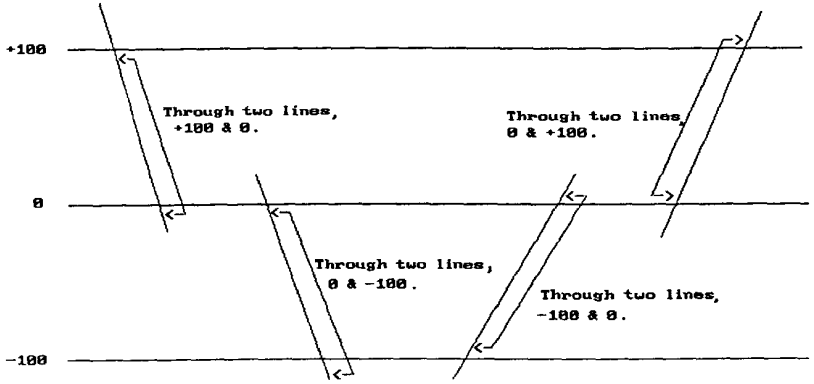
5. With CCI not having achieved a reading of ±150, if CCI recrosses one visible line, it must cross two lines (one visible and one invisible) to be tradable.

6. If CCI recrosses any two visible lines, we will consider ourselves back to the beginning, waiting for CCI to cross two visible lines.

Following are some illustrations to help clarify the above rules.

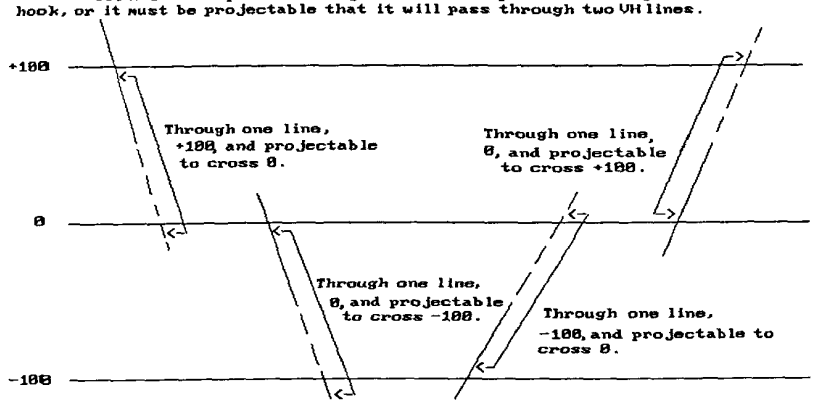
Rule 1

CCI must have passed through two VH lines prior to taking the hook, or it must be projectable that it will pass through two VH lines.



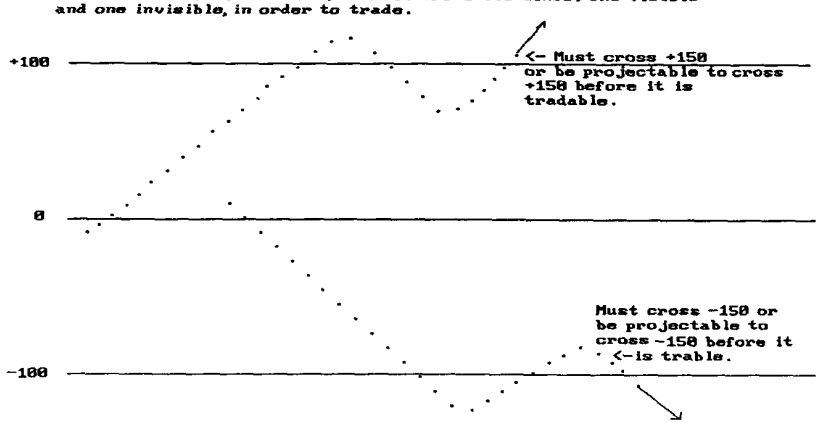
Rule 1

CCI must have passed through two VH lines prior to taking the hook, or it must be projectable that it will pass through two VH lines.



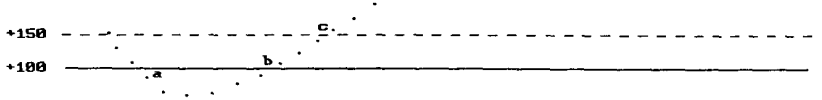
Rule 5

If CCI recrosses one VH line, it must cross two lines, one visible and one invisible, in order to trade.

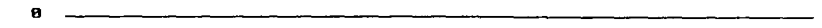


Rule 6

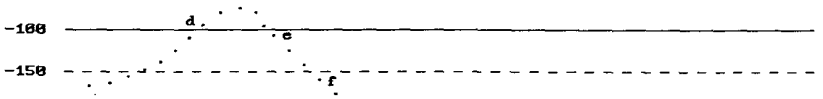
If CCI recrosses +100 (a), it must cross both +100 (b) and +150 (c).

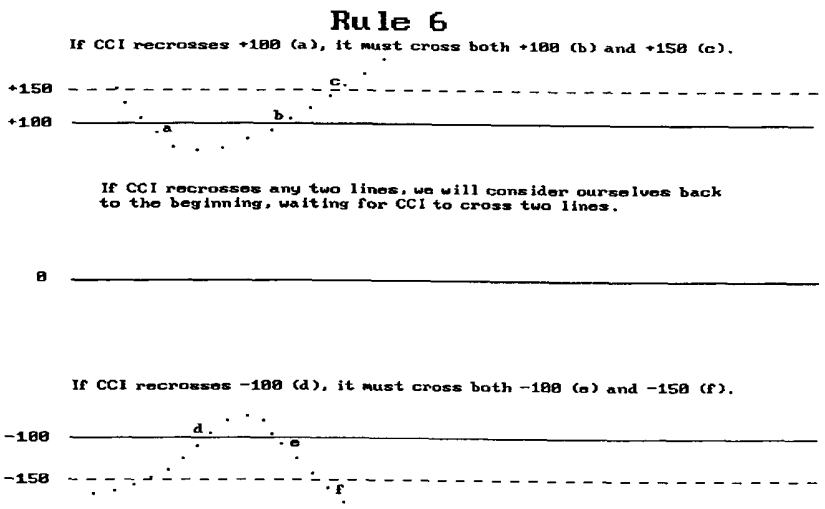


If CCI recrosses any two lines, we will consider ourselves back to the beginning, waiting for CCI to cross two lines.



If CCI recrosses -100 (d), it must cross both -100 (e) and -150 (f).



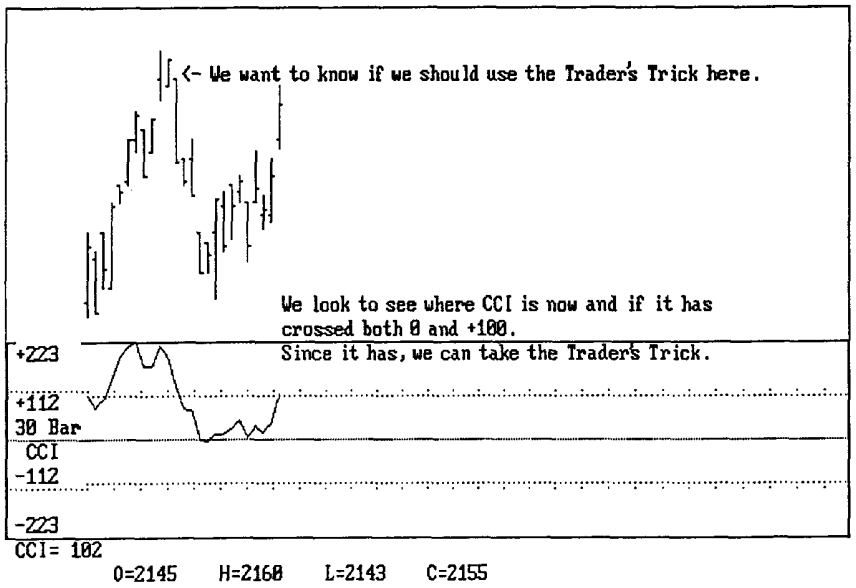


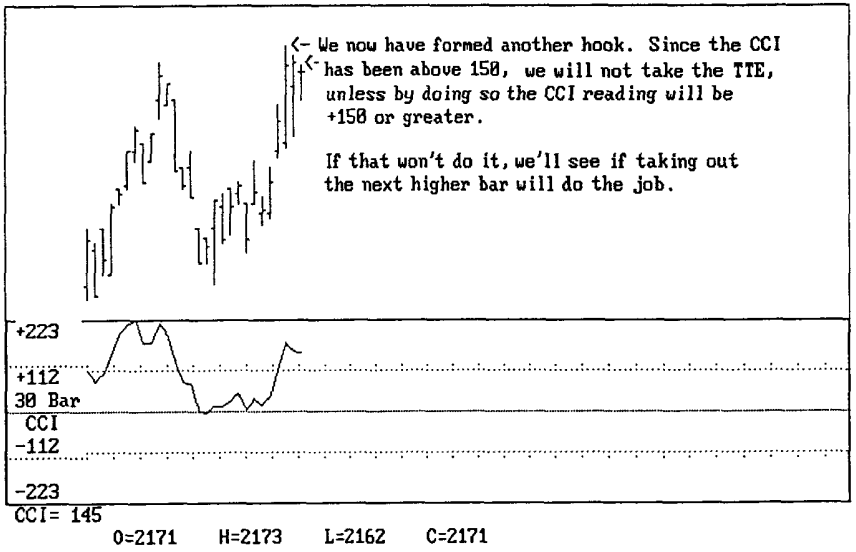
WARNING:

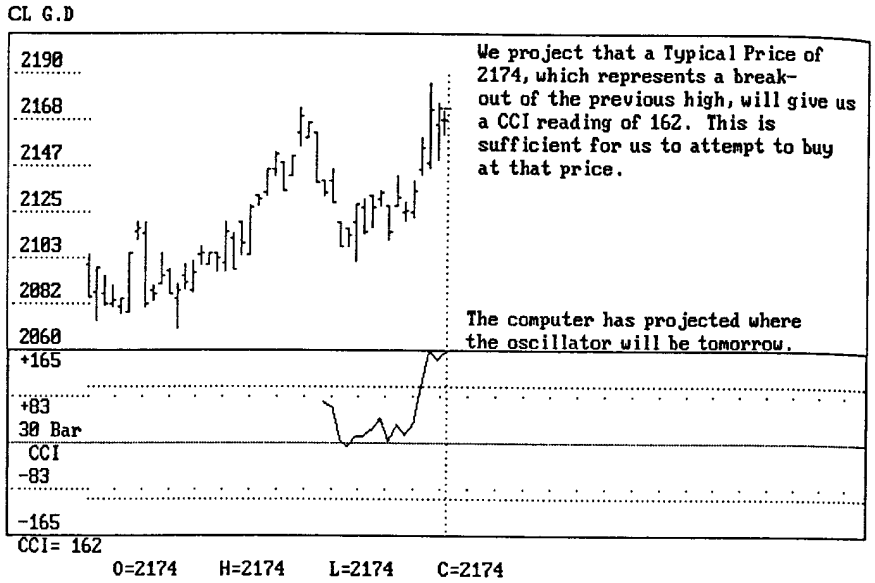
The charts shown for CCI were created with the Market Detective program.

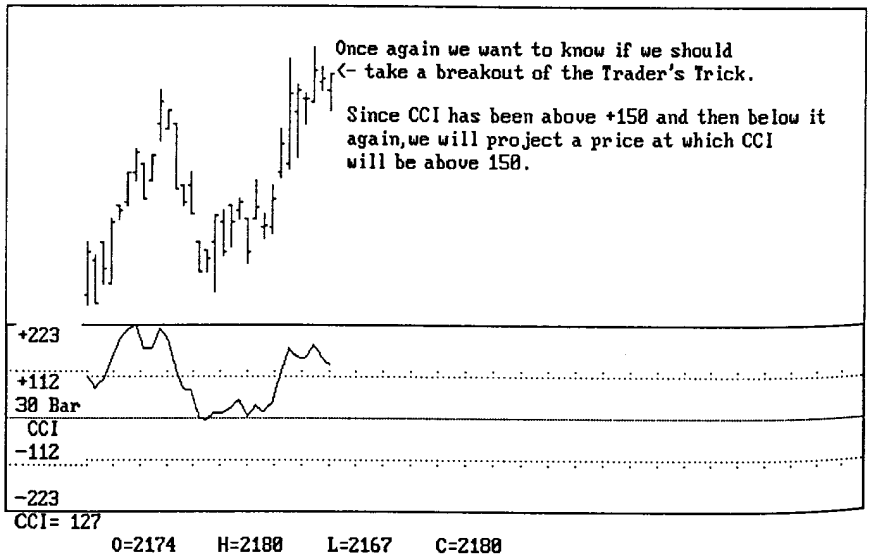
When CCI has been tested on other programs, the signals have differed dramatically. However, the signals given by other programs proved to be valid within the context of those programs.

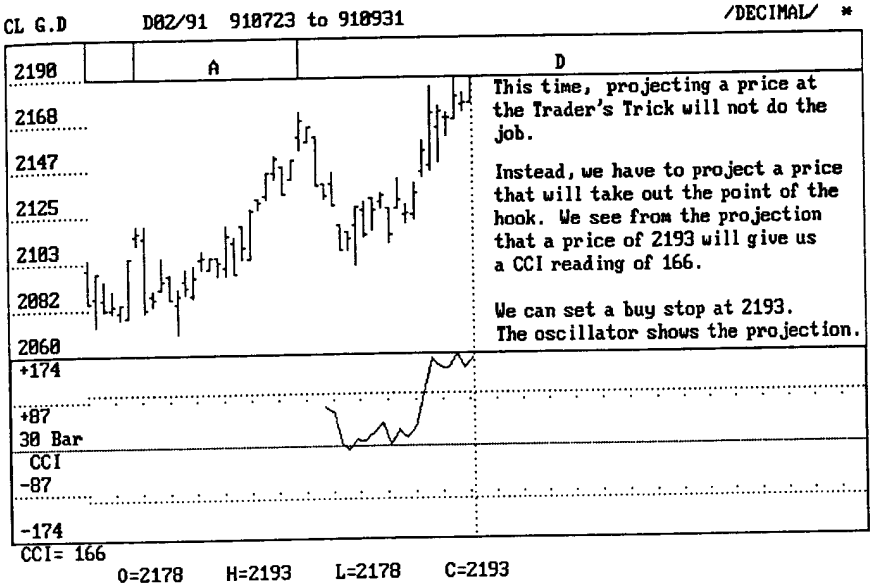
You should be familiar with our old friend Crude Oil.

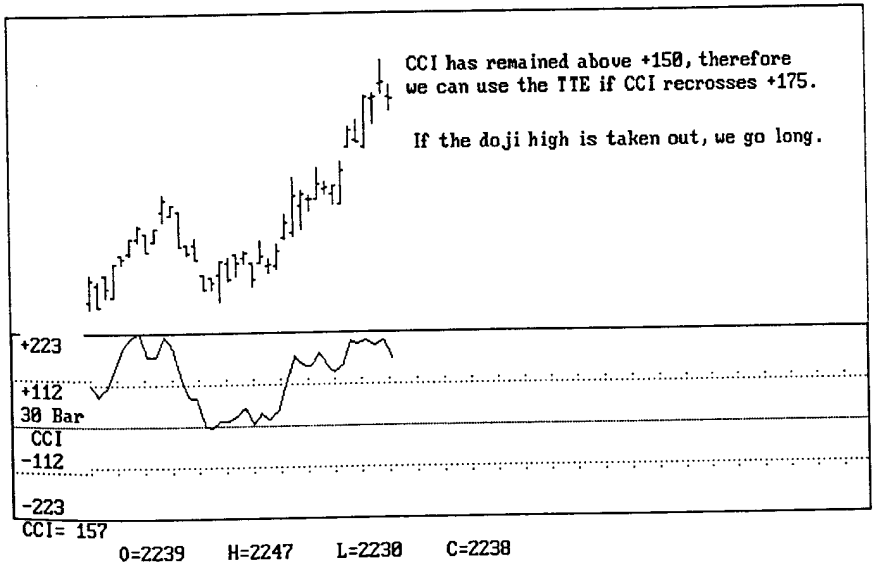


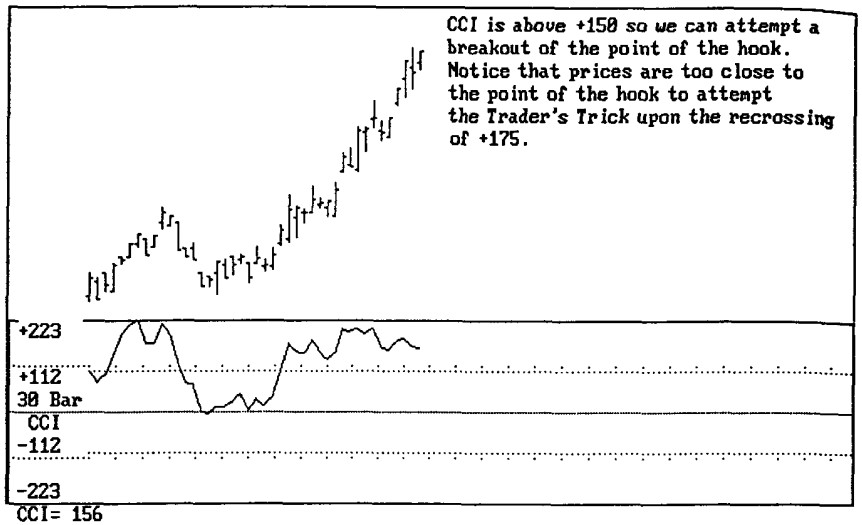


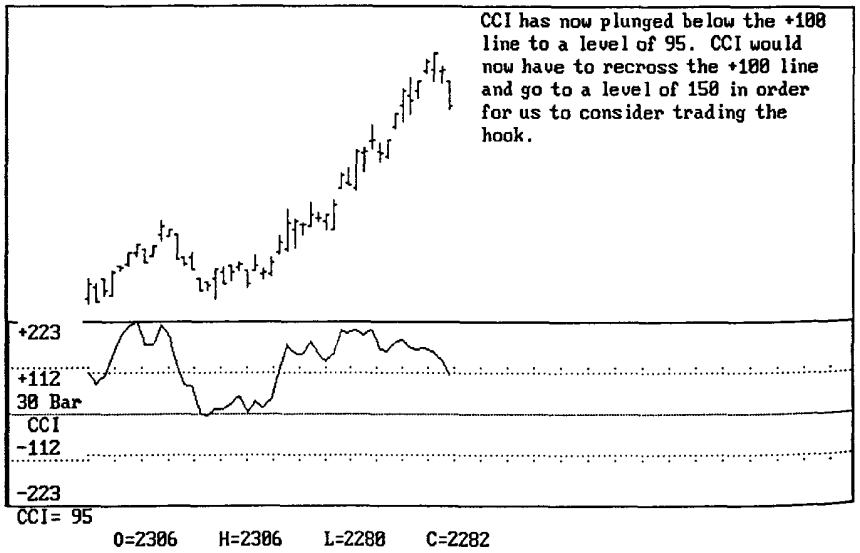

CL G.D
2190
2168
2147
2125
2103
2082
2060
We project that a Typical Price of 2174, which represents a break-out of the previous high, will give us a CCI reading of 162. This is sufficient for us to attempt to buy at that price.
The computer has projected where the oscillator will be tomorrow.
+165
+83
30 Bar
CCI
-83
-165
CCI= 162
O=2174 H=2174 L=2174 C=2174


Once again we want to know if we should
<- take a breakout of the Trader's Trick.
Since CCI has been above +150 and then below it again,we will project a price at which CCI will be above 150.
+223
+112
30 Bar
CCI
-112
-223
CCI= 127
O=2174 H=2180 L=2167 C=2180

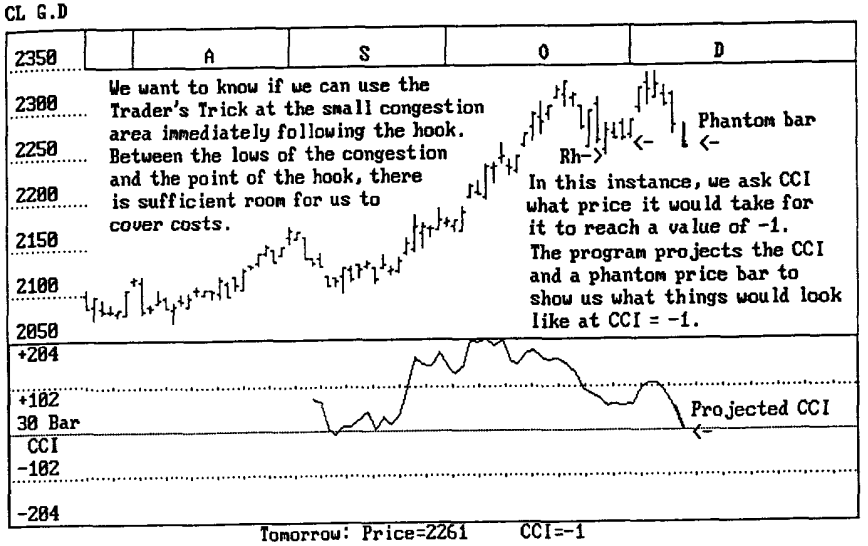

CL G.D D02/91 910723 to 910931 /DECIMAL/ *
2190
2168
2147
2125
2103
2082
2060
A
D
This time, projecting a price at the Trader's Trick will not do the job.
Instead, we have to project a price that will take out the point of the hook. We see from the projection that a price of 2193 will give us a CCI reading of 166.
We can set a buy stop at 2193. The oscillator shows the projection.
+174
+87
30 Bar
CCI
-87
-174
CCI= 166
O=2178 H=2193 L=2178 C=2193

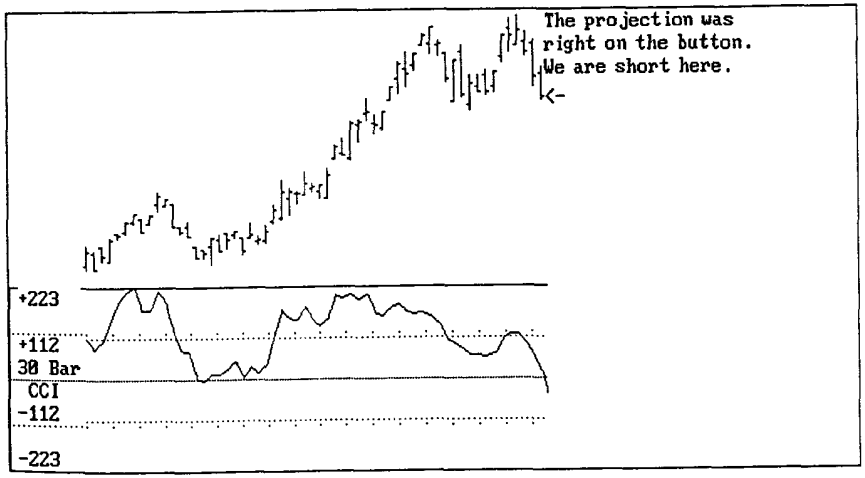

CCI has remained above +150, therefore we can use the TTE if CCI recrosses +175.
If the doji high is taken out, we go long.
+223
+112
30 Bar
CCI
-112
-223
CCI= 157
O=2239 H=2247 L=2230 C=2238

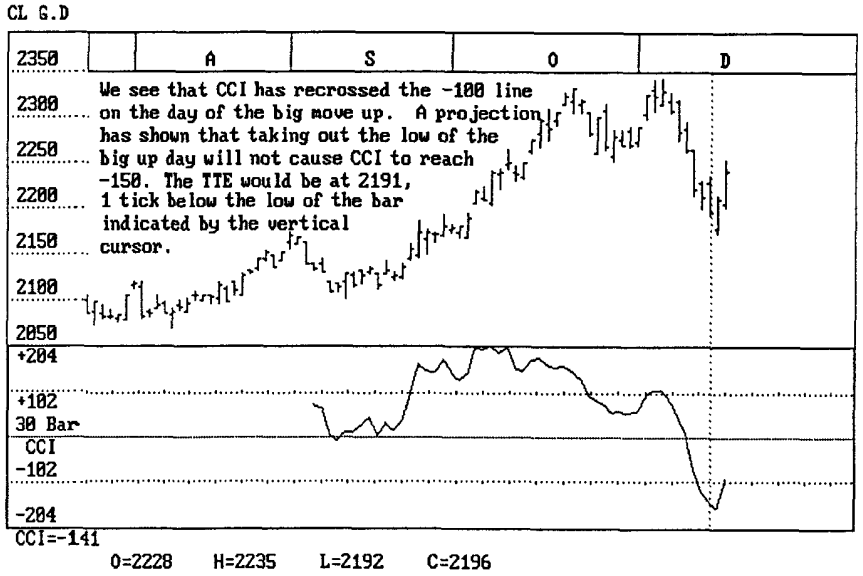

CCI is above +150 so we can attempt a breakout of the point of the hook. Notice that prices are too close to the point of the hook to attempt the Trader's Trick upon the recrossing of +175.
+223
+112
30 Bar
CCI
-112
-223
CCI= 156
O=2296 H=2306 L=2291 C=2306

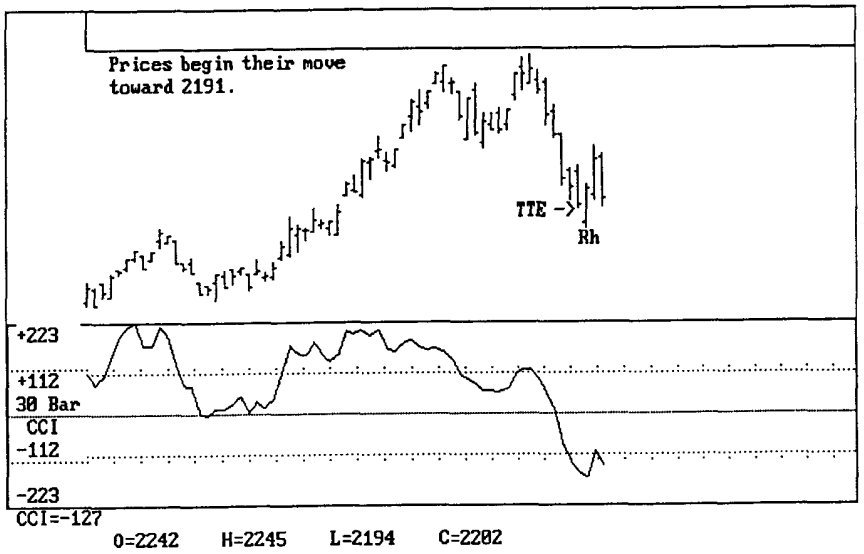

CCI has now plunged below the +100 line to a level of 95. CCI would now have to recross the +100 line and go to a level of 150 in order for us to consider trading the hook.
+223
+112
30 Bar
CCI
-112
-223
CCI= 95
O=2306 H=2306 L=2280 C=2282

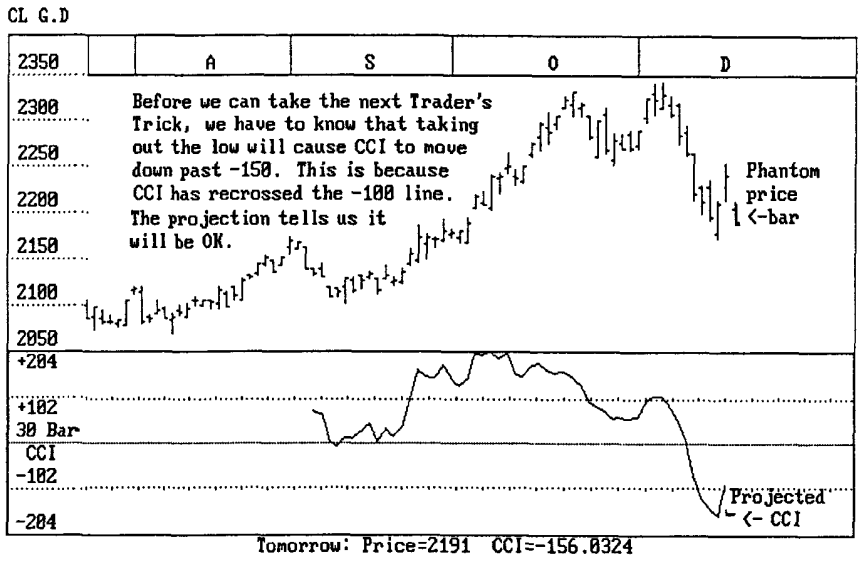
CL G.D

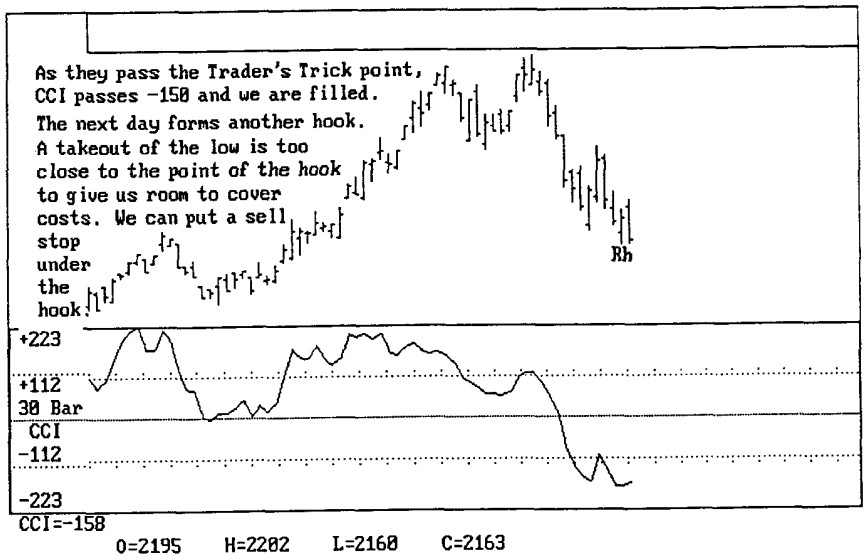

2350
A
S
O
D
2300
2250
2200
2150
2100
2050
We want to know if we can use the Trader's Trick at the small congestion area immediately following the hook. Between the lows of the congestion and the point of the hook, there is sufficient room for us to cover costs.
Rh->
Phantom bar
<-
In this instance, we ask CCI what price it would take for it to reach a value of -1. The program projects the CCI and a phantom price bar to show us what things would look like at CCI = -1.
+204
+102
30 Bar
CCI
-102
-204
Projected CCI
<-
Tomorrow: Price=2261 CCI=-1

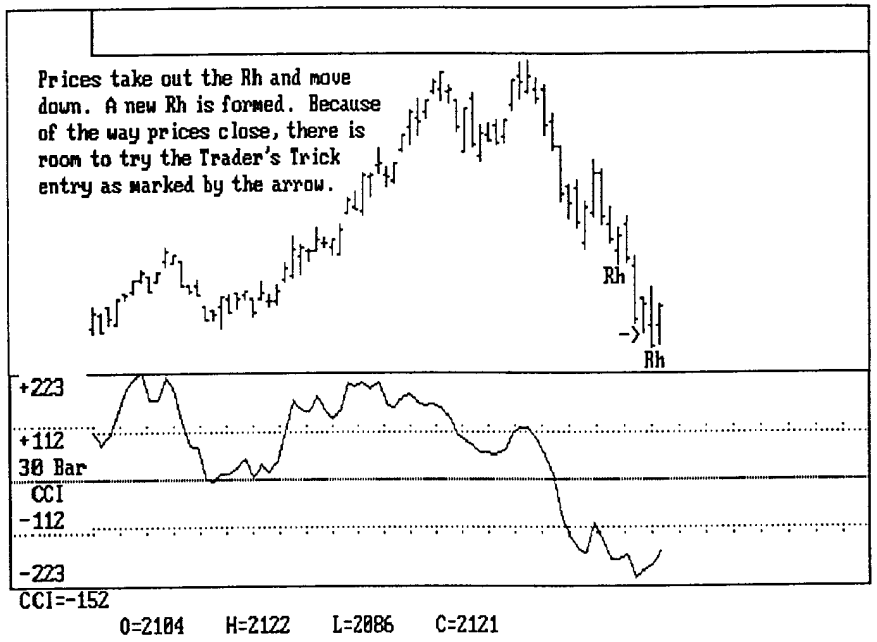

The projection was right on the button. We are short here.
<-
+223
+112
30 Bar
CCI
-112
-223

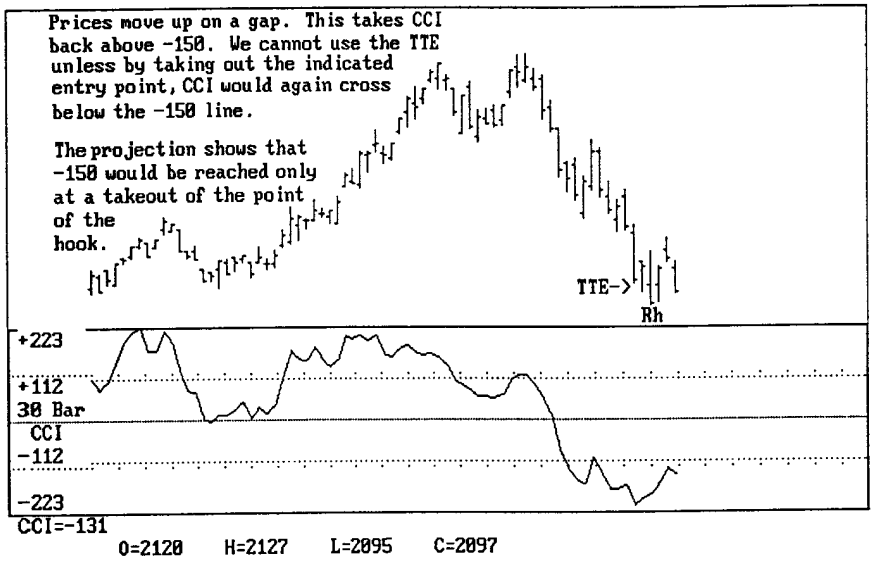


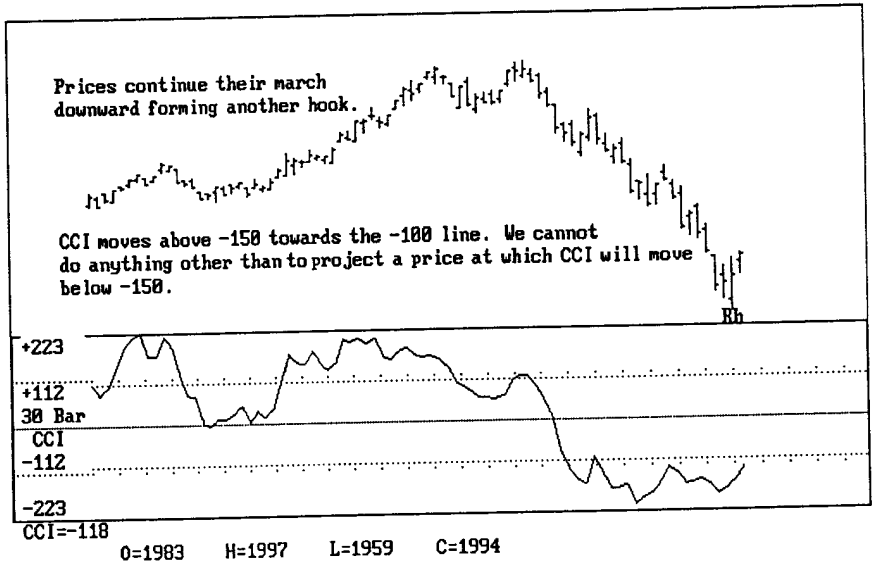


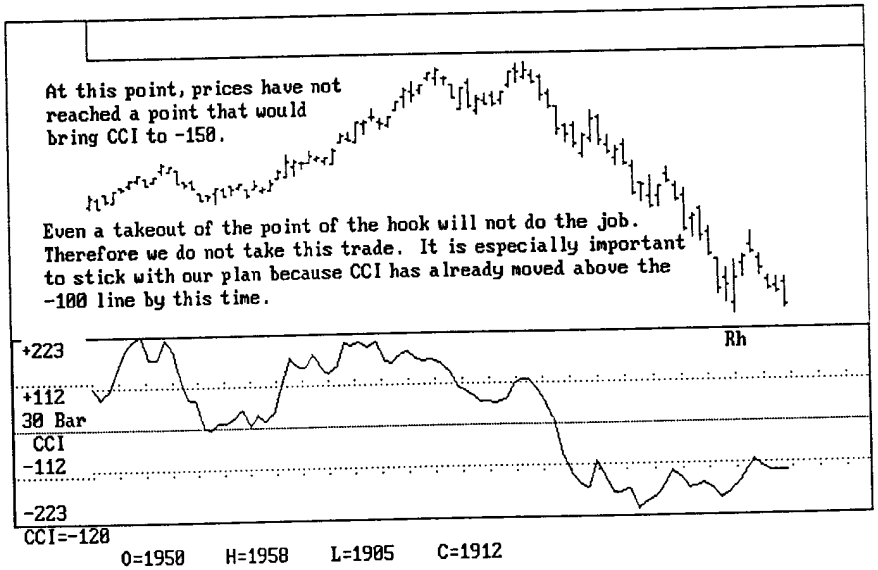


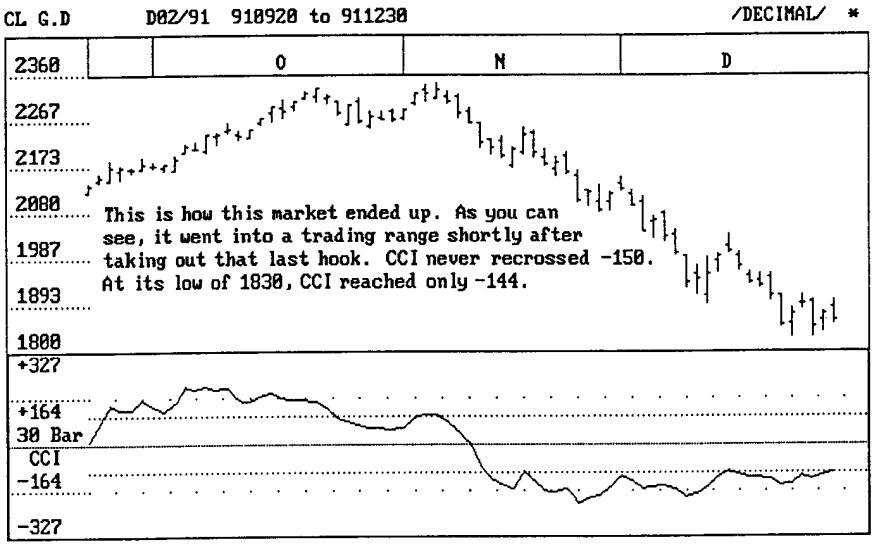



Prices take out the Rh and move down. A new Rh is formed. Because of the way prices close, there is room to try the Trader's Trick entry as marked by the arrow.
Rh
->
Rh
+223
+112
30 Bar
CCI
-112
-223
CCI=-152
O=2104 H=2122 L=2086 C=2121


Prices move up on a gap. This takes CCI back above -150. We cannot use the TTE unless by taking out the indicated entry point, CCI would again cross below the -150 line.
The projection shows that -150 would be reached only at a takeout of the point of the hook.
TTE->
Rh
+223
+112
30 Bar
CCI
-112
-223
CCI=-131
O=2120 H=2127 L=2095 C=2097


Prices continue their march downward forming another hook.
CCI moves above -150 towards the -100 line. We cannot do anything other than to project a price at which CCI will move below -150.
Rh
+223
+112
30 Bar
CCI
-112
-223
CCI=-118
O=1983 H=1997 L=1959 C=1994


At this point, prices have not reached a point that would bring CCI to -150.
Even a takeout of the point of the hook will not do the job. Therefore we do not take this trade. It is especially important to stick with our plan because CCI has already moved above the -100 line by this time.
Rh
+223
+112
30 Bar
CCI
-112
-223
CCI=-120
O=1950 H=1958 L=1905 C=1912



Chapter 13

Stochastics Filtering

Stochastics has probably become the most corrupted of all technical analysis studies.

Not only is the study named incorrectly, but its original form and usage have all but been forgotten. It is sometimes referred to as "stocastics," and elswhere as "stochastics."

However, a contemporary of mine, Mr. Richard Redmont, has been kind enough to fill me in on the truth. That means Rick might even be older than I am. It means he's been trading a long, long, time. When you see how it is really done, I think you will be pleasantly surprised. I include it in this book because it works so well as a filter for the Ross hooks via the Trader's Trick Entry.

First, let's make sure you know the original formula and how to compute it.

The Process

Dt	Hi	Lo	Hi-5	Lo-5	Cl	R-5	U-5	D-5	K	R-3	U-3	D-3	D	D-T	D-S
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16

Column 1 = Today's DATE
Column 2 = Today's HIGH
Column 3 = Today's LOW
Column 6 = Today's CLOSE

Take the highest figure in Column 2 for five days including today, and place it in Column 4.

Take the lowest figure in Column 3 for five days including today, and place it in Column 5.

Take the difference between Columns 4 and 5 and put it in Column 7.

Take the difference between Columns 4 and 6 and put it in Column 8.

Take the difference between Columns 7 and 8 and put it in Column 9.

Total the last three days of Column 7, including today, and put it in Column 11.

Total the last three days of Column 8, including today, and put it in Column 12.

Total the last three days of Column 9, including today, and put it in Column 13.

Divide the total in Column 7 into the total in Column 9, and put it in Column 10.

Divide the total in Column 11 into the total in Column 13, and put it in Column 14.

Total the last three days of Column 14, including today, and put it in Column 15.

Divide Column 15 by 3 and put the answer in Column 16.

Column 14 is D. Column 16 is D smoothed over a three day period.

If you have software that performs the arithmetic for you, then make sure you set it at 5,1,3, or 5,3,1. How you set it will depend on your software. When I use Market Detective I set it at 5,1,3. When I use Ensign software, I set it at 5,3,1. Apparently different programs use the numbers differently. If you see only one plot instead of two, then switch the parameters. You need a "K" plot and a "D" plot.

To the best of my knowledge, Columns 15 and 16 were not computed in the original formula.

In his book Technical Analysis of the Futures Markets, by John J. Murphy, he states, "The *Stochastic Process* was invented by George Lane (president of Investment Educators, Inc., Des Plaines, IL, 60018) many years ago..."

My own research has shown this is not true. In his own book, Using Stochastics, Cycles, & RSI to the Moment of Decision, by George C. Lane, Mr. Lane calls his version "Lane's Stochastics," implying that there is another "Stochastics" that precedes "Lane's Stochastics."

From what I've been able to ascertain, George Lane did not invent the version of the study shown above. This type of study has been around a lot longer than George Lane. Nor did he invent the "Stochastics Process." By definition of what stochastics is, no one could have invented the process. Progressions of random variables have existed throughout time.

The truth is that there are few living traders who know how the so-called "stocastics process" originated. Prior to George Lane's association with Investment Educators, C. Ralph Dystant owned Investment Educators and was teaching %D. Rick Redmont was taught my Mr. Dystant in 1966. Over the years Mr. Dystant improved the documentation with new ideas which you will see in this book. Mr. Dystant began teaching the slowed version around 1972-73. He claimed it was only for "slow thinkers." %D came to be named "Stocastics" by Mr. Tim Slater, presently the head of Computrac. Tim felt that Stocastics sounded better than %D. The early documentation calculation page reads "Stocastic Process."

C. Ralph Dystant died of a massive heart attack in 1978.

Lane's "Stochastics" would require a setting of 5,3,3 on a computer, rather than 5,1,3. Compare the following method of computation by Lane with the original previously shown.

Without a computer, here's how I calculate Lane's Stochastics.

$$100x \frac{\text{close - 5 day low}}{\text{5 day high - 5 day low}} = \%K$$

(sum 3 %K) / 3 = %D

(sum 3%D / 3) = Slow %D

Enter today's high in column 1.
Enter today's low in column 2.
Enter highest high of last 5 days in column 3.
Enter lowest low of last 5 days in column 4.
Enter today's close in column 5.
Subtract 5 day low from today's close and enter it in column 6.
Subtract 5 day low from 5 day high, and enter it in column 7.
Divide the number in column 6 by the number in column 7 and multiply by 100. This is %K.
Enter %K in column 8.
Sum last 3 day's %K. Divide sum by 3. This is %D.
Place %D in column 9.
Sum last 3 day's %D. Divide sum by 3. This is Slow %D.
Place Slow %D in column 10.

1	2	3	4	5	6	7	8	9	10
H	L	H5	L5	C	C-L5	H5-L5	%K	%D	%D-S

Now if you don't mind, I will no longer call the original study "Stochastics." It annoys me to call something by a name that it is not. From now on, let's call it "Study."

Now let's get on with the use of the original Study.

The method is based upon an observation: As price increases, daily closes tend to accumulate closer to the highs of the daily range. The opposite is also true: As price decreases, daily closes tend to accumulate closer to the lows of the daily range. This observation is derived from intraday monitoring of closes, but works in any time frame.

There are two valid signals available when working with the Study and the Ross hook.

1. Buy and sell signals are based entirely on a crossing of the "D" plot by the "K" plot.

2. Divergence indicates that a hook should not be taken because the trend may be ready to end.

For example, when prices have made a new high, then react, and subsequently move to a higher high, while corresponding peaks of "D" make a high and then a lower high, *a bearish divergence has taken place*. The ascending trend may be almost over.

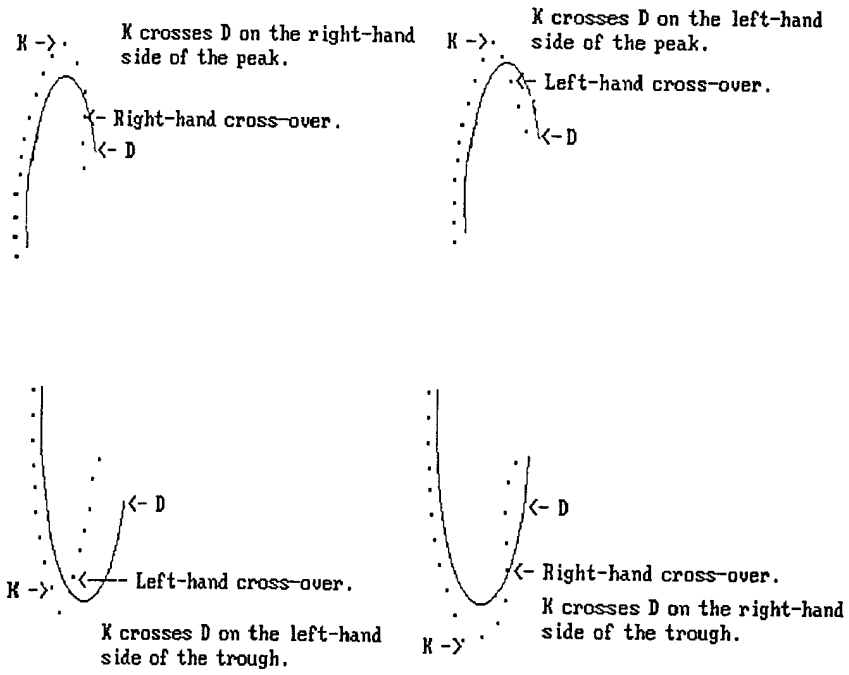
If prices have made a new low, then react, and subsequently move to a lower low, while corresponding troughs of "D" make a low and then a higher low, *a bullish divergence has taken place*. The descending trend may be almost over.

Here is a very important refinement: The original signal was to act upon the divergence when the "K" plot line crossed on the right hand side of the peak of the "D" plot line at a top, or on the right hand side of the trough of the "D" line at a bottom.

This concept still works and is especially true when a market is in congestion. But when we are dealing with Ross hooks, we are only interested in how the Study is to be understood in a trending market.

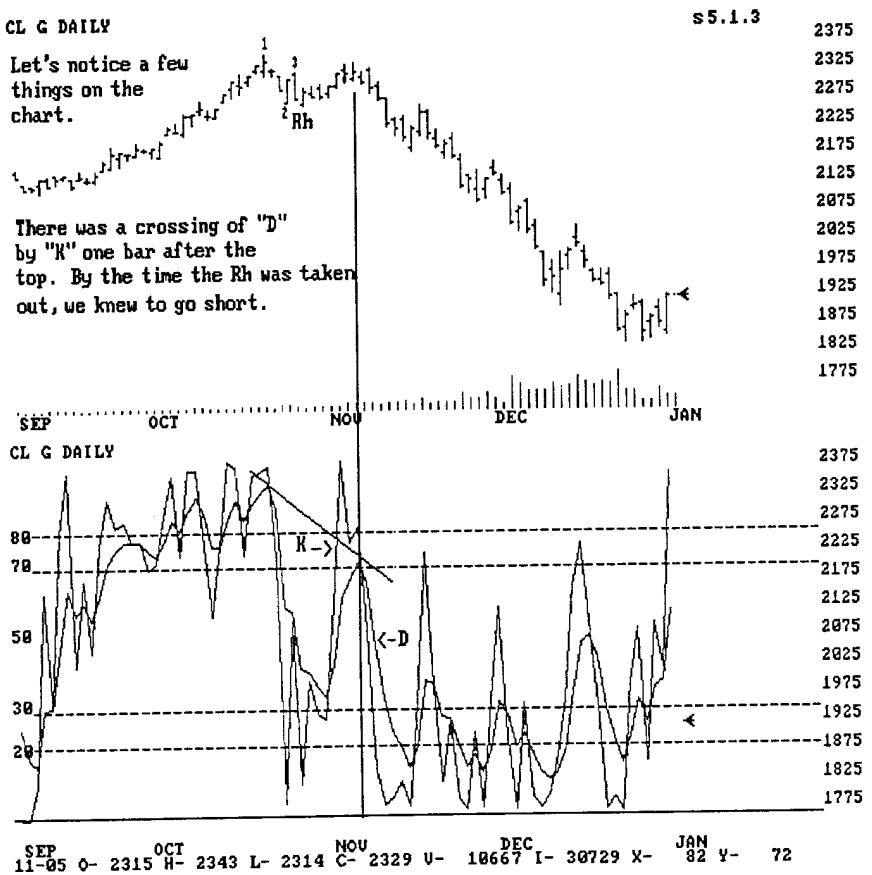
When trading Ross hooks, all we care about is the fact that the "K" plot line has crossed the "D" plot line. It makes no difference in filtering the hook entry as to which side the crossover takes place. We do care at which level the crossover takes place. We don't want a crossover above 75 for an up move or below 25 for a down move, but we most certainly don't care about any such foolishness as "overbought", or "oversold."

Let's look at the crossover concept so you'll know what I mean by crossover. This is nice to know information, not something to use.

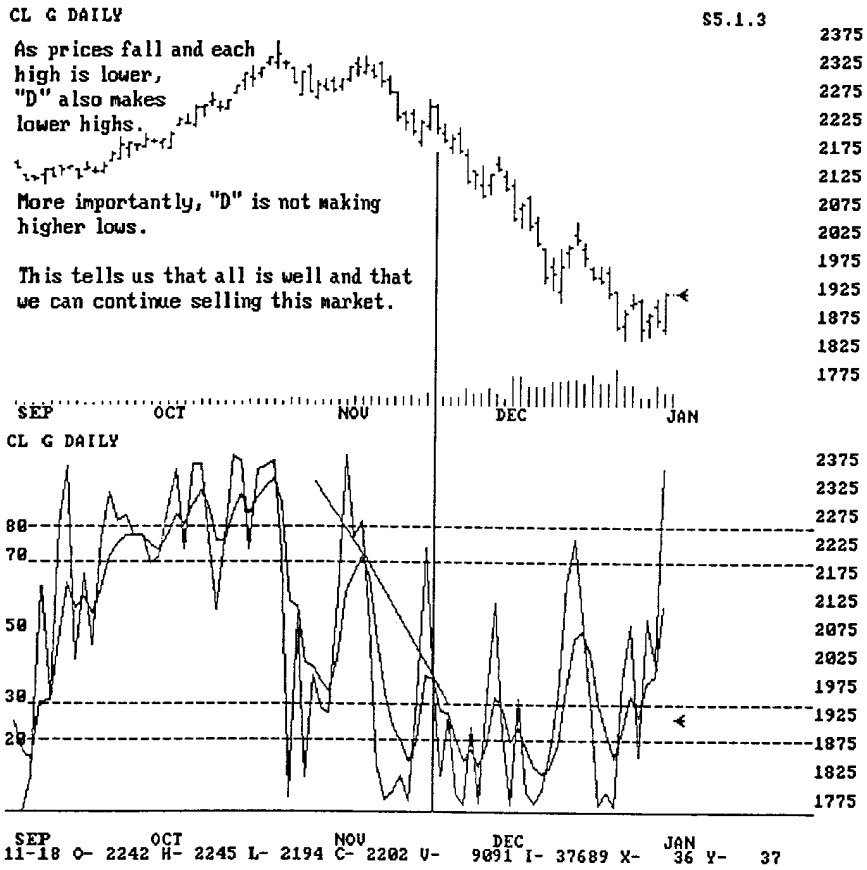


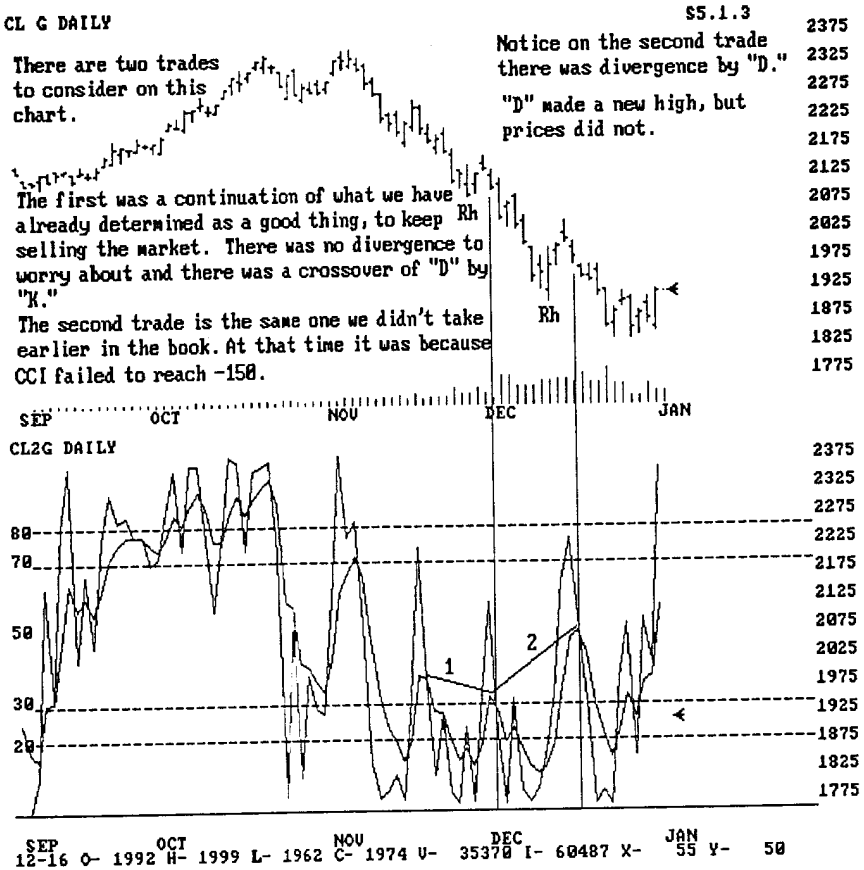
Now let's look at how this would have affected some of our Ross hook trades in Crude Oil.

The more wiggly line is the "K" plot and the less wiggly line is the "D" plot. At times the crossover may be dead center.



The fact of the relative divergence by the "D" plot from prices, coupled with a crossing of "D" by "K", gave a strong indication that it would be okay to take a breakout of the Ross hook.

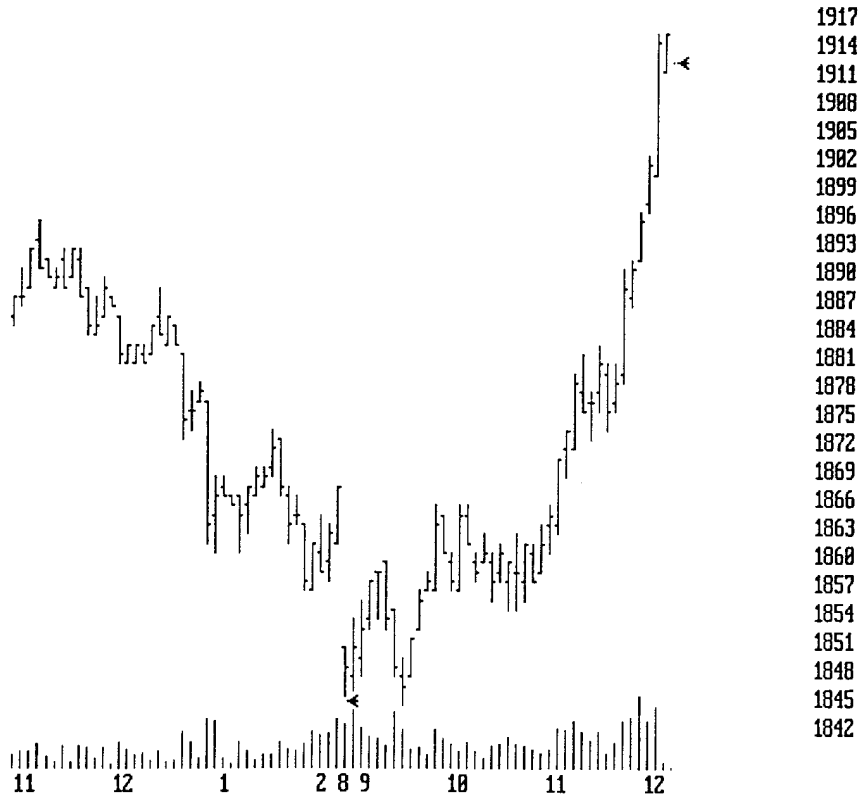




I've shown an unusual thing in the chart above. Normally you would look only at the lows of the "D" plot for divergence. But when I trade the hooks, I look for divergence from either the highs or the lows of the "D" plot. That divergence in conjunction with the fact that CCI failed to reach -150 would be enough to keep me from taking that last Rh.

As you can see from the more recent charts above, the market has gone into congestion and is beginning to look as if accumulation is taking place.

By the way, for you daytraders who think the only game in town is the S&P, take a look at how that very last daily bar looked intraday.

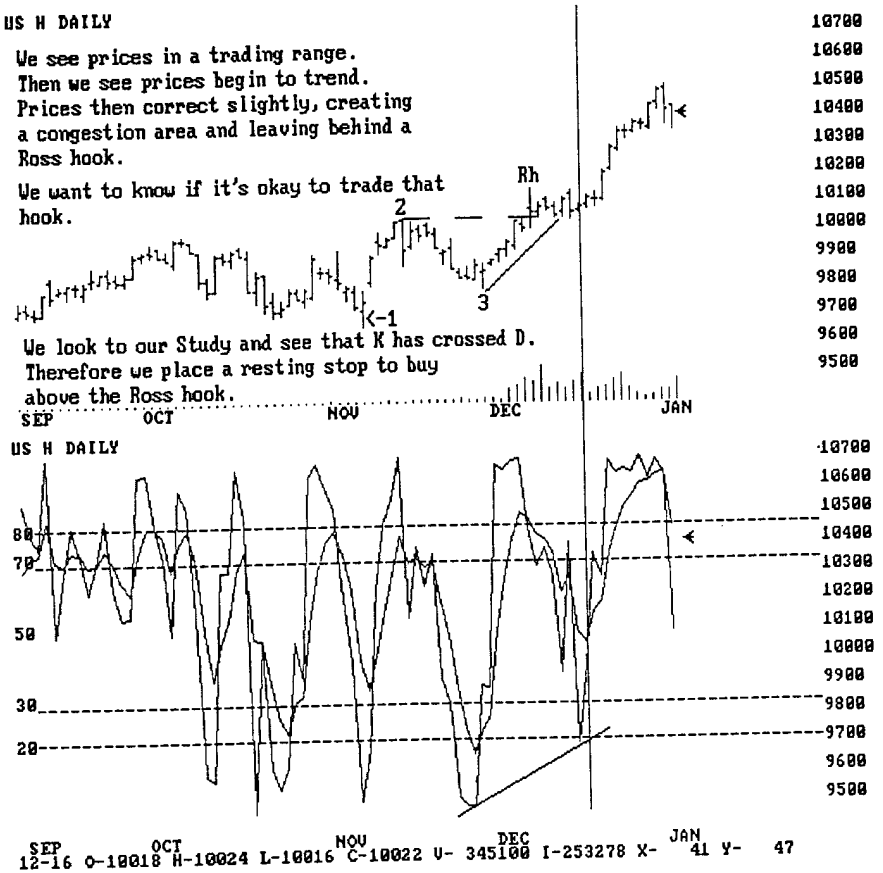


We need to look at a few more charts so you can see some markets other than Crude Oil.

Please look carefully at the following daily Bond chart. There is a very important concept I want you to see.

You will recall that Ross hooks are to be traded when markets are trending. That concept would have resulted in a single entry into the Bond market shown on the chart.

Notice that the market makes a very subtle 1-2-3 formation just prior to a minor trend. Subsequently our Study starts to have rising bottoms. This is the tip off of what is to come.



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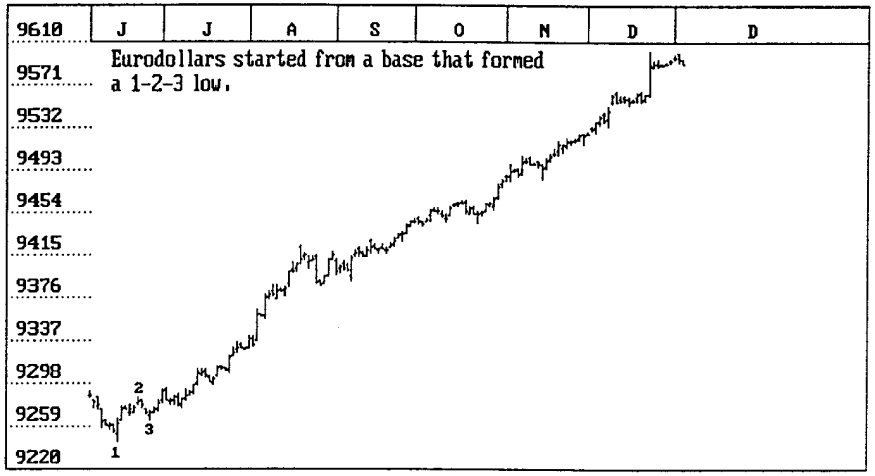
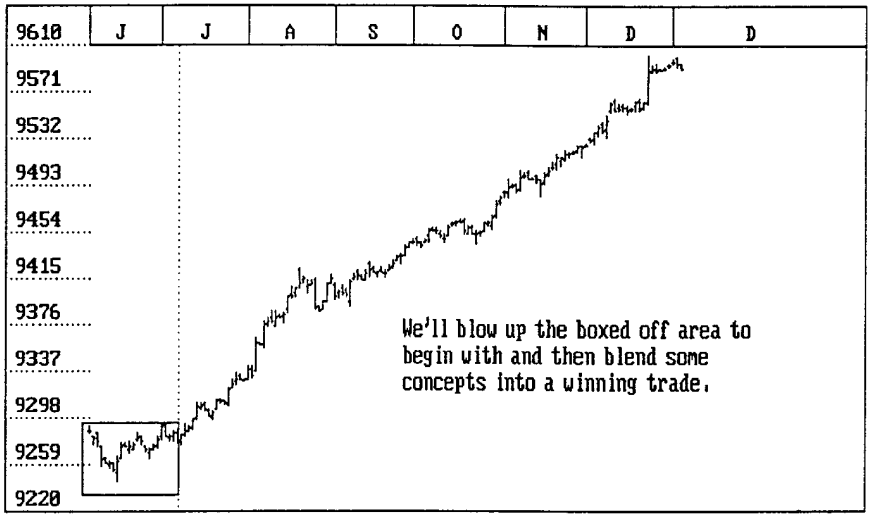
With our next series of charts, let's start putting together some of what I've been teaching you.

We'll take a Eurodollar chart from the inception of a trend to as far as we have data for it.

ED H.D

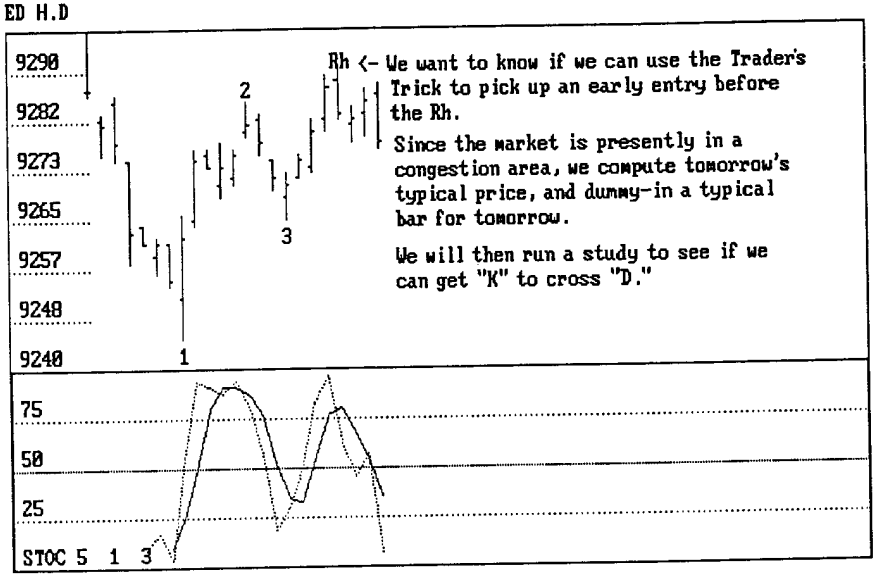


ED H.D



O=9286 H=9288 L=9277 C=9278

ED H.D



The last bar on the chart is as follows: O=9286, H=9288, L=9277, C=9278. Our formula is (O + H + L + 2(C)) / 5 = Tomorrow's Typical Price.

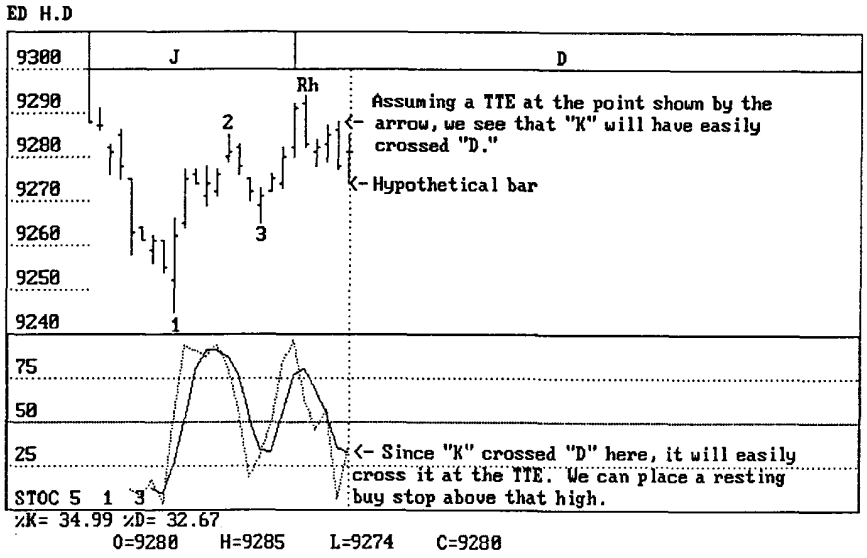
We have: $\frac{9286 + 9288 + 9277 + 2(9278)}{5} = 9281$

Tomorrow's projected high = 2(9281) - Today's low of 9277 = 9285

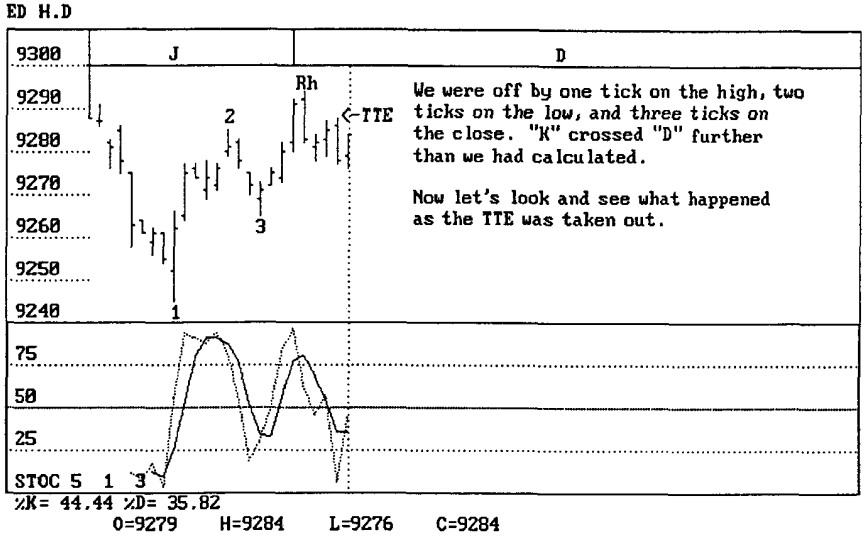
Tomorrow's projected low = 2(9281) - Today's high of 9288 = 9274

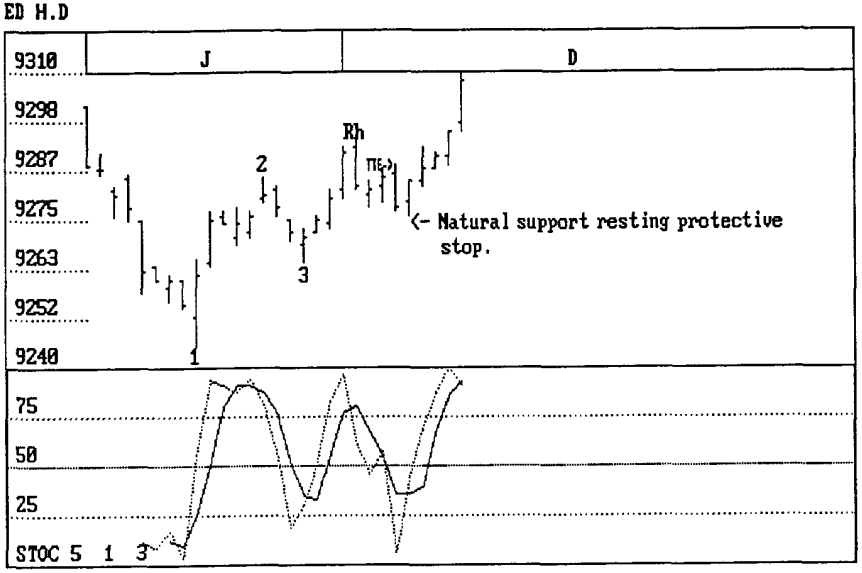
We can insert 9280 for both tomorrow's open and close.

We then run our study to obtain the following chart:



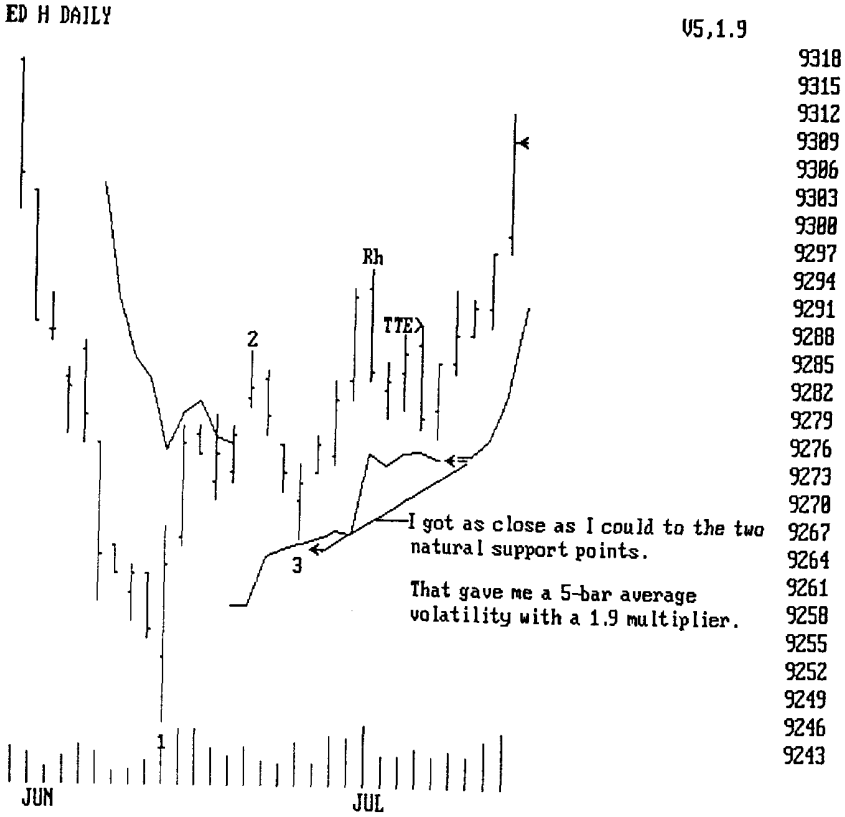
Our assumed prices are shown at the bottom of the chart. How did that compare with what actually happened on the following day?



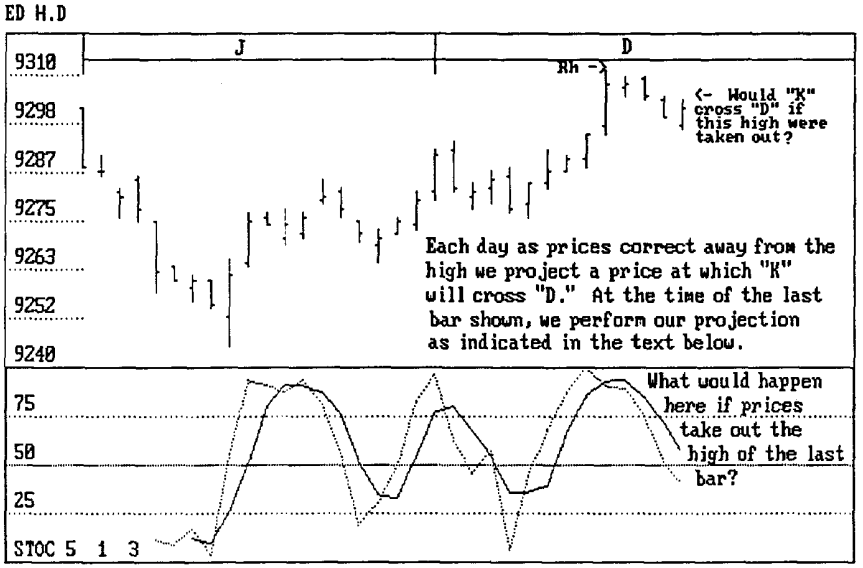


Here's the picture of how it would have all worked out for that particular trade.

The next picture shows how I could have curve fit a Volatility Stop study to the new trend in the market.



Now, let's get on with another leg of that magnificent uptrend in Eurodollars.

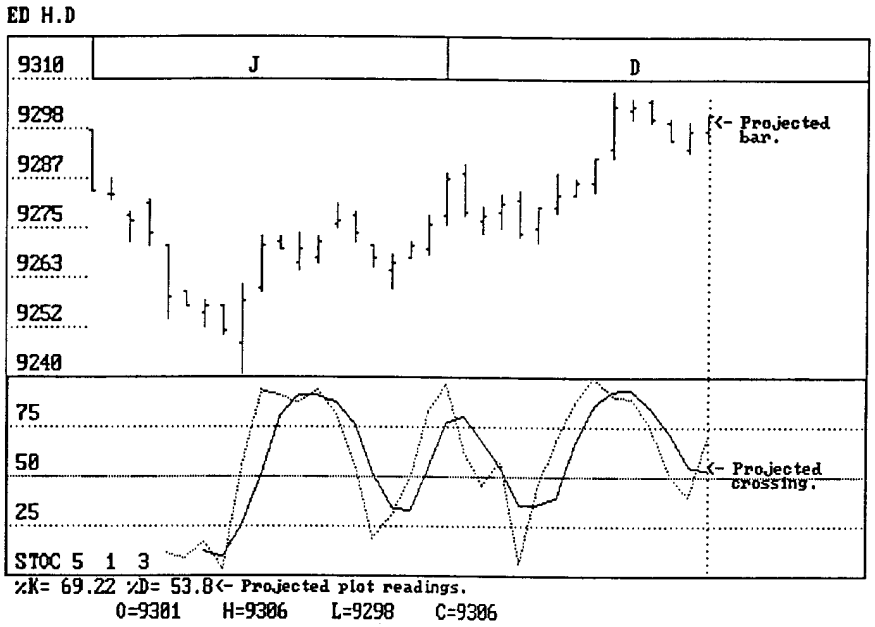


By definition, we are in a congestion during this correction. We have had four closes (and opens) all within the range of the bar that made the point of the hook. As each bar forms, we can insert a price, or ask our program if "K" will cross "D" if the current high is taken out. If there is enough room to cover costs at that price, and "K" will cross "D", we place a resting buy order (I use Stop Limit) at the price that constitutes a taking out of the current high.

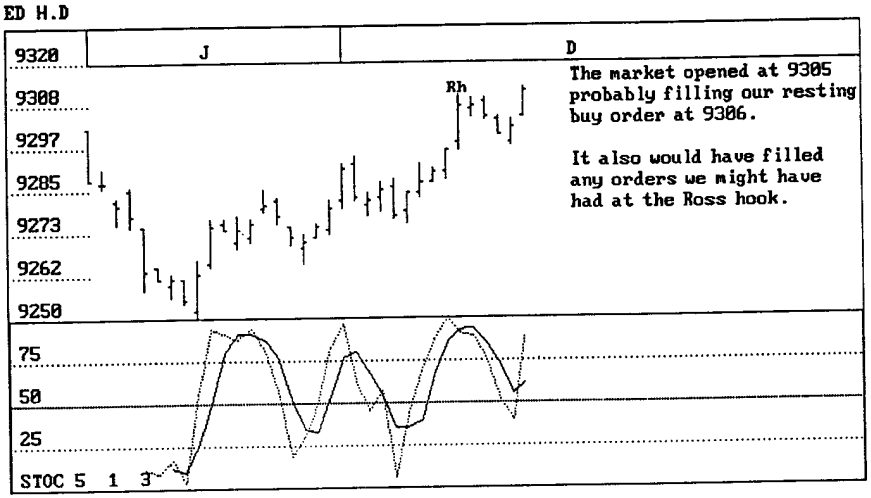
The current bar has a price range of O=9298, H=9304, L=9297, and C=9302. Using our formula for Typical Price (O+H+L+(2C))/5, we arrive at 9301. The Typical Price will always be our open and our close.

2(9301)-9304=9298=Tomorrow's projected low.
2(9301)-9297=9305=Tomorrow's projected high.

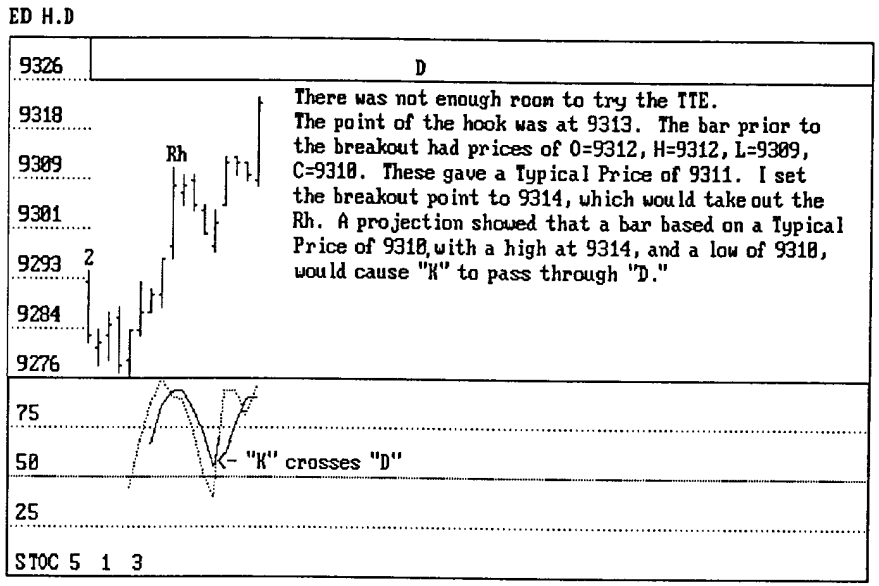
We can insert a bar with those prices to get an idea of how tomorrow might look. In order to make sure I cleared the latest two bars, I set the breakout point at 9306 instead of 9305. As you can see on the next page, "K" projects a crossing of "D" with ease



Now, let's look at what really happened.

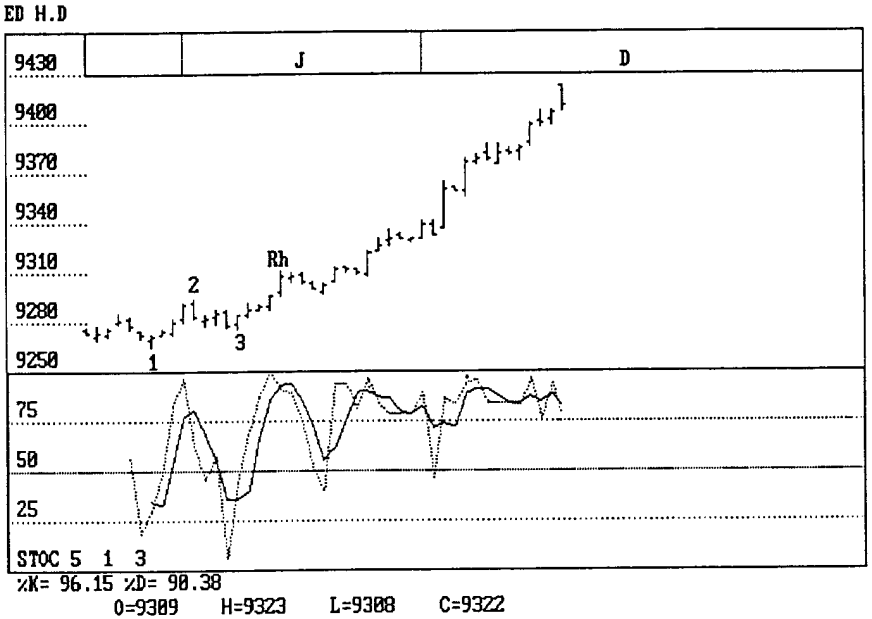


By now, you should be getting the idea of how this works. I'll print out some more of the chart with the Study on it so you can see how the projections would have worked out.



Eurodollars broke out and continued to march on. Stops could have been successfully trailed at natural support points, or with a curve fitted volatility stop. A curve fitted moving average of the lows would also have worked.

The next segments up were almost all able to be projected for a "K", "D" crossover. You can spot them on the next chart. After that I'll show you something interesting that took place.

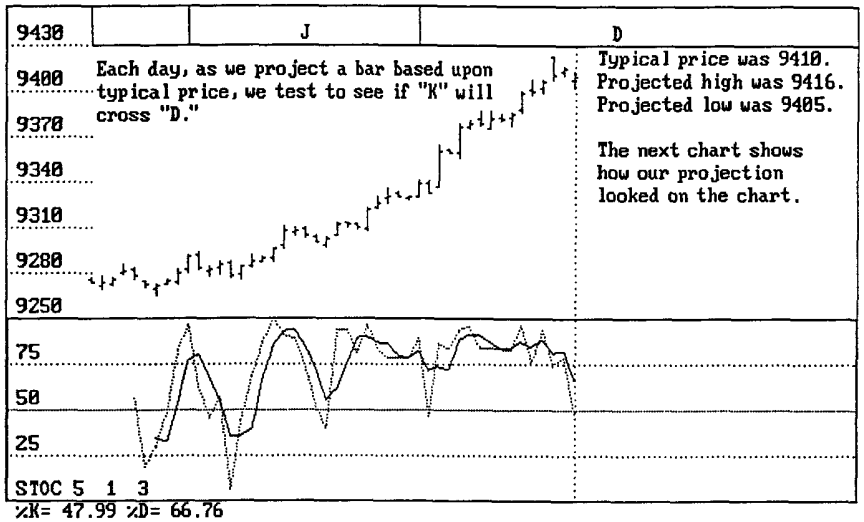


Up until the high on the chart above, prices had been moving up steadily.

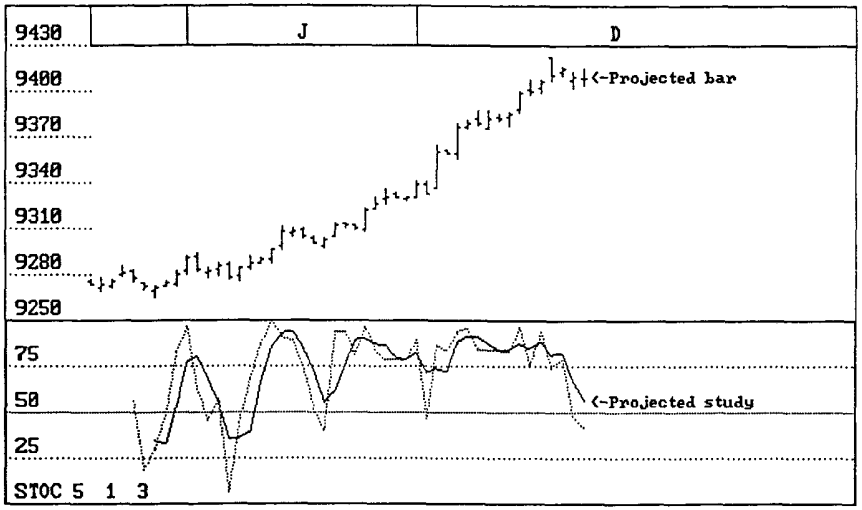
Then came a more severe correction. This correction was warned of when the "D" line began to diverge from prices. During that correction, there was one critical juncture at which it was possible to be stopped into the market at a wrong time.

I've shown that series on the three charts that follow.

ED H.D

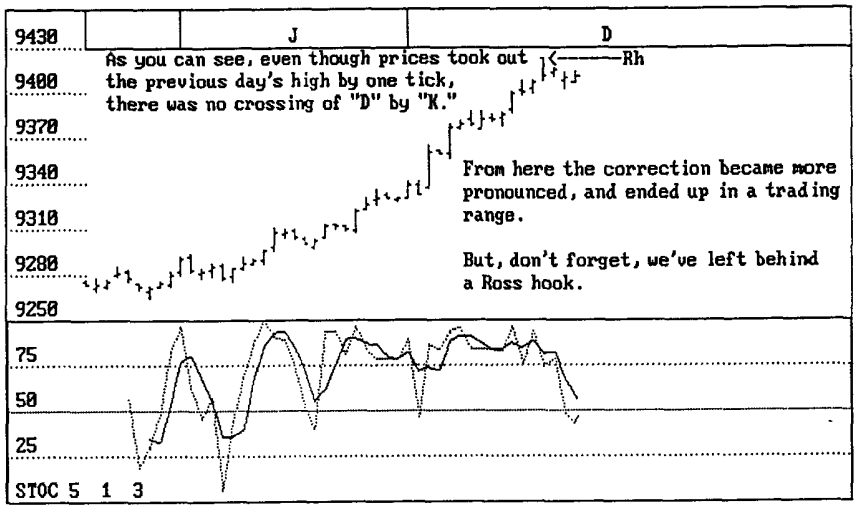


ED H.D

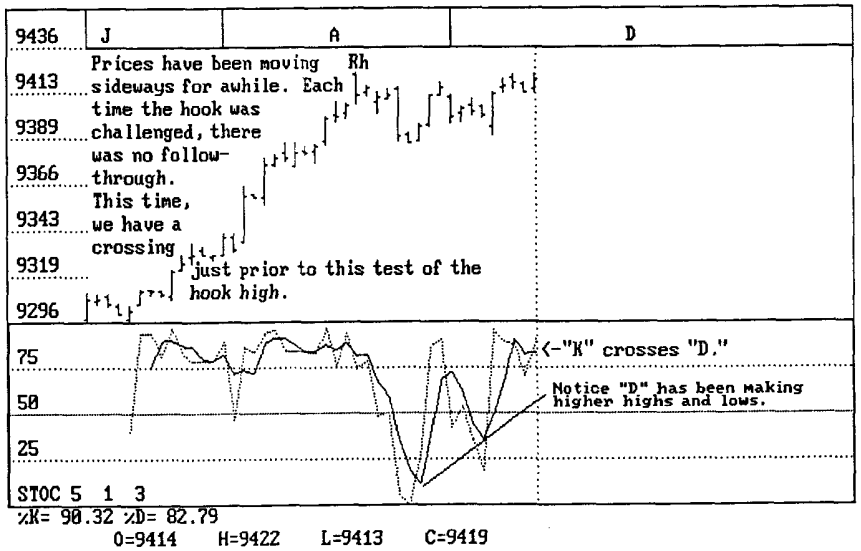


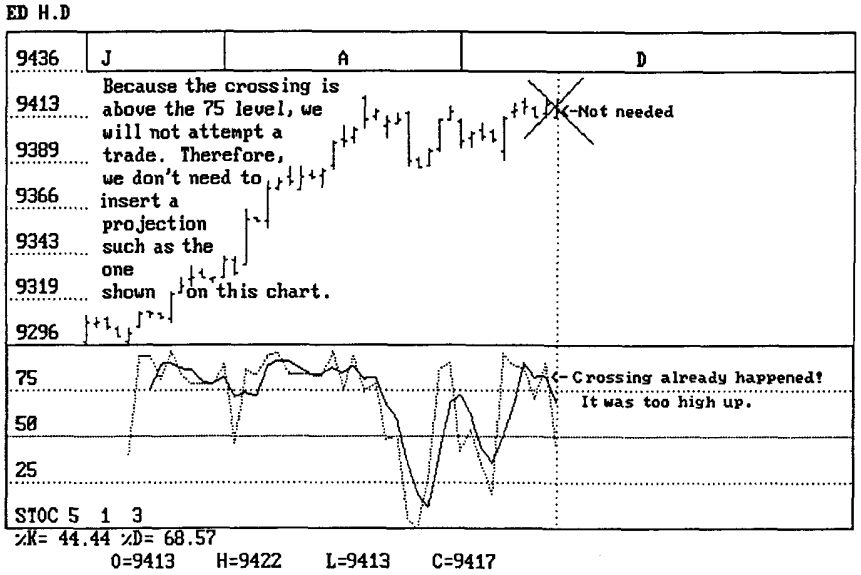
On the next chart, we'll see what really happened.

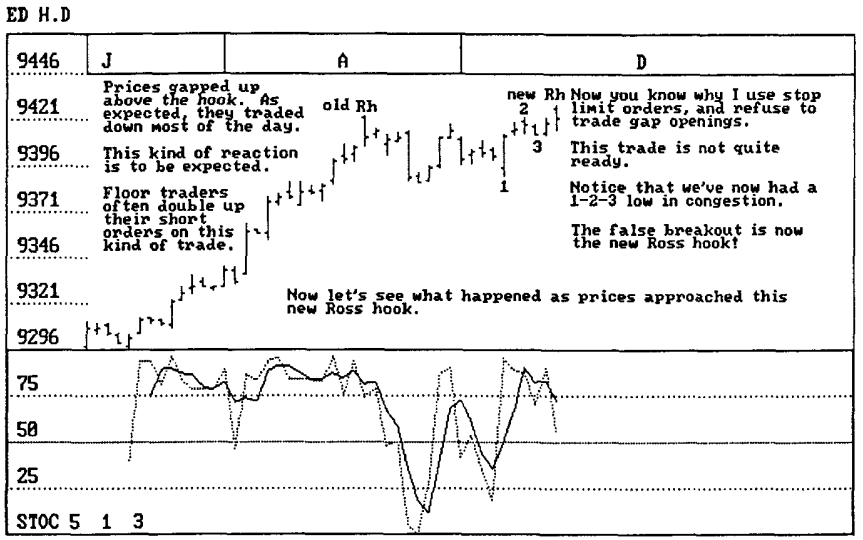
ED H.D

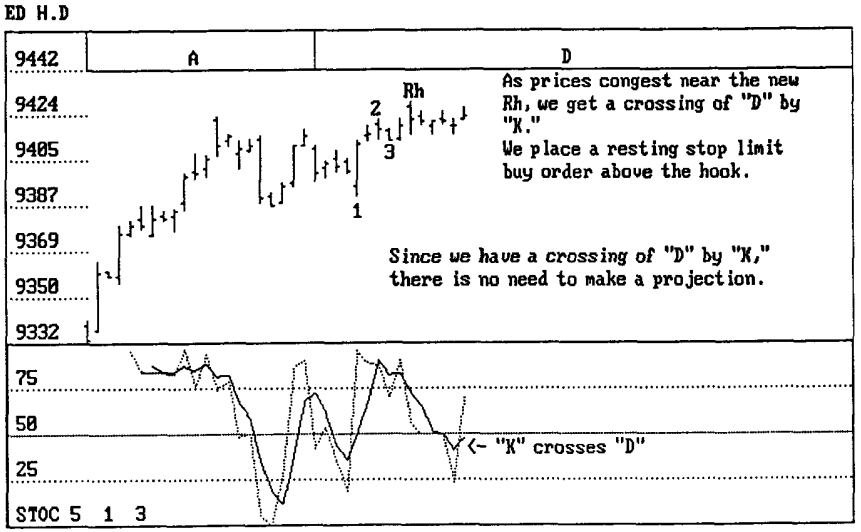


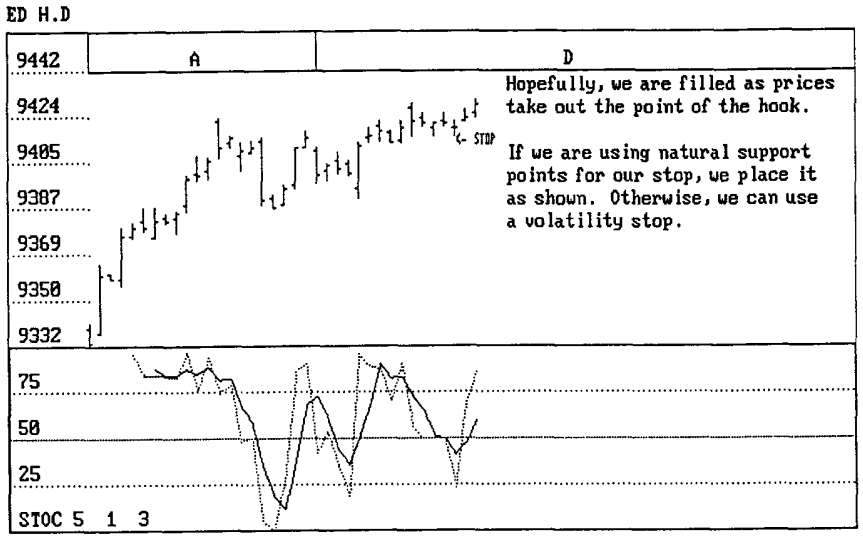
ED H.D



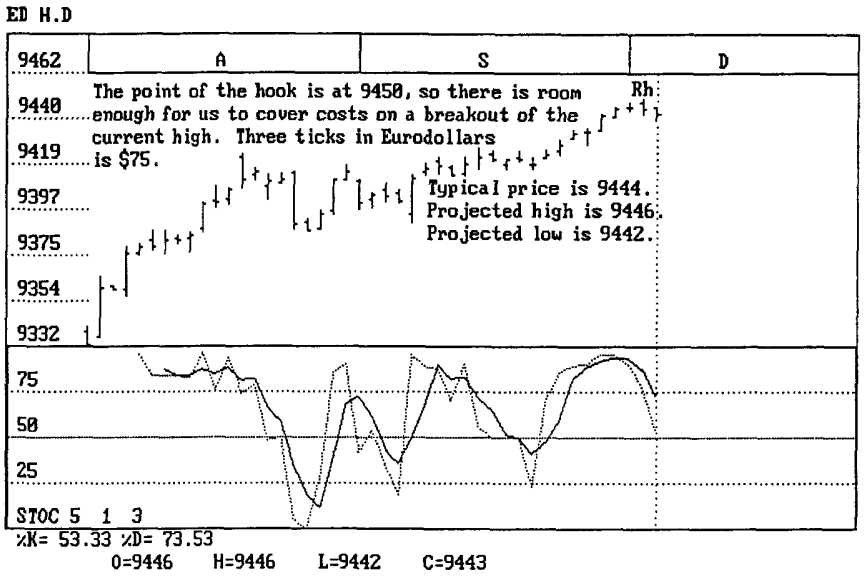


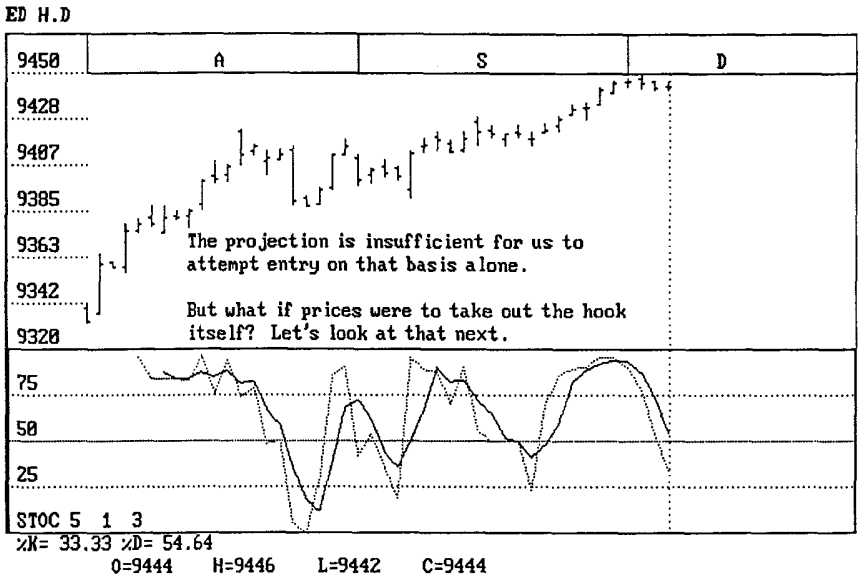


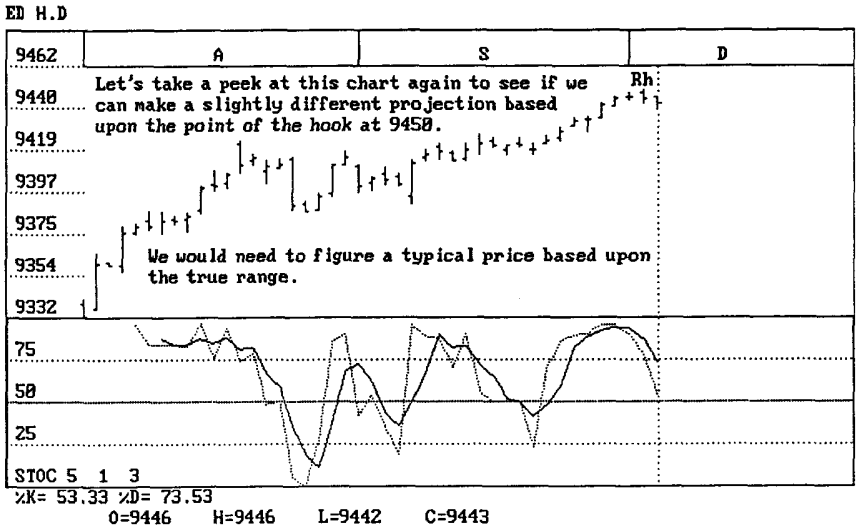




We can see how the trading progressed, and show the chart at the next decision area.

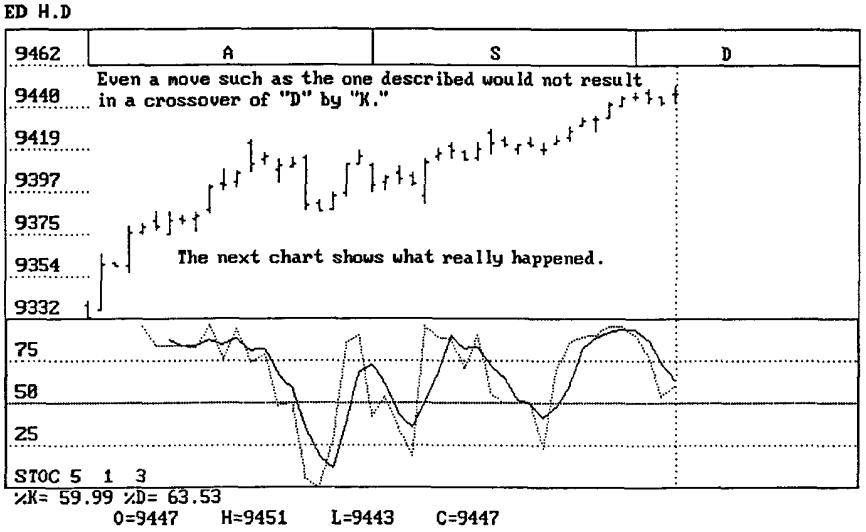


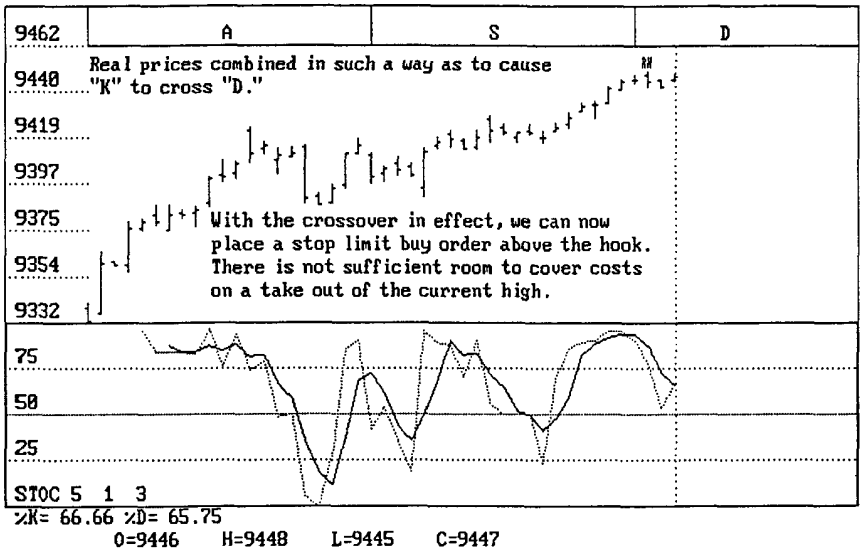


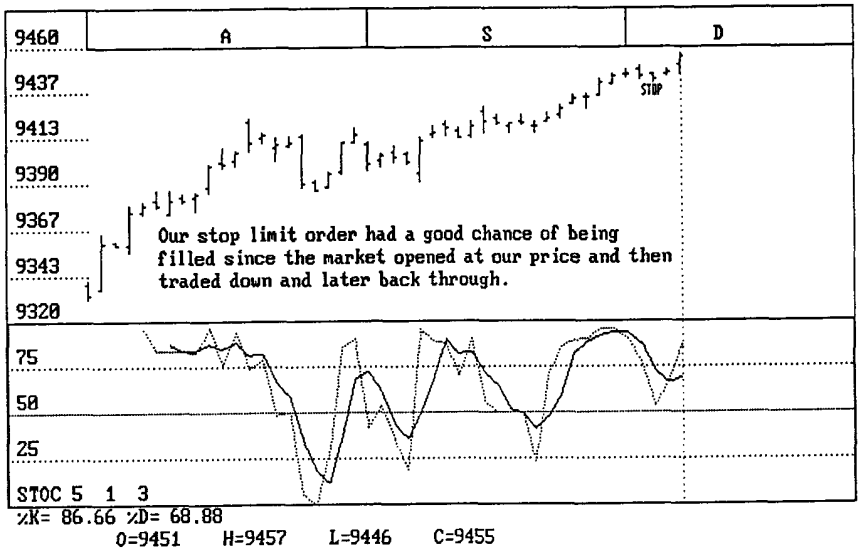


The true range would be from today's close at 9443 to one tick above the point of the hook at 9451. We could figure today's Typical Price as (9443+9451)/2=9447. That would give us a bar with which to insert a projection for tomorrow.

Let's check out the projection to see if it gives us a crossover of "D" by "K."

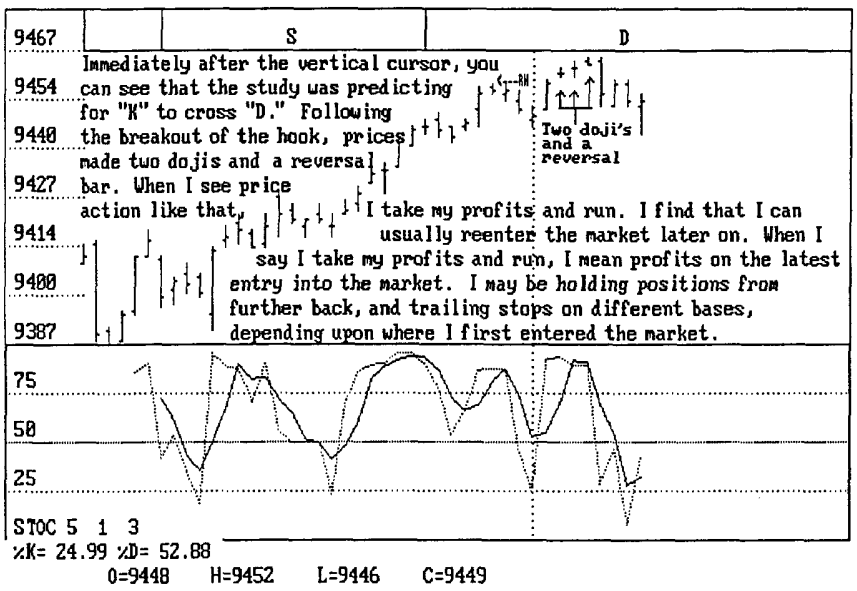






The next trading opportunity is very similar to the preceding ones, the difference being that a stop placed at a natural support point would have been taken out.

This is why it is so important to cover costs as soon as possible, and then to take some sort of profits early in the trade. The next chart shows a concept you might want to consider learning.



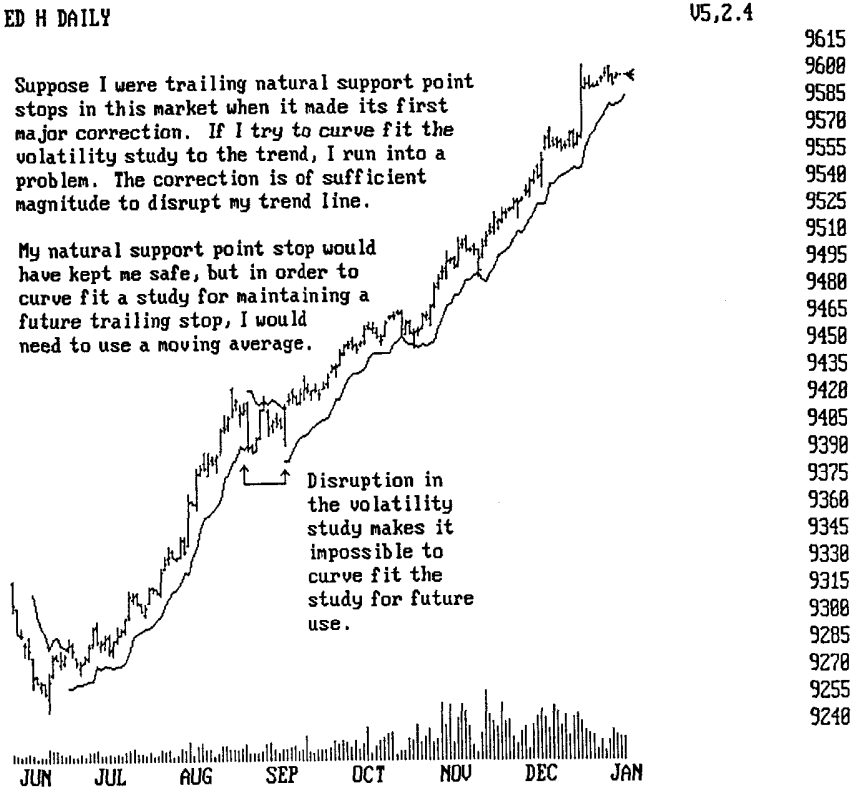
There is no need to wait around holding your breath, and watching yourself take a bath. The market is talking. Dojis indicate indecision in the market. A series of them is a way the market has of telling you something is about to change. That doesn't mean it will always change, but more often than not, some underlying factor you are not aware of is causing a stand-off between the bulls and bears. One doji is important to consider, and may cause you to tighten your stops. Two dojis should always cause you to tighten your stops. The added weight of the reversal bar (open higher - close lower) is cause to liquidate the position. Take your profits while they are still there. On the reversal day, the bears have won. The likelihood of a trend change is extremely high at that point, especially when preceded by the two doji bars.

There will be times when this action turns out, with hindsight, to be incorrect. However, most of the time it will prove to have been the right thing to do.

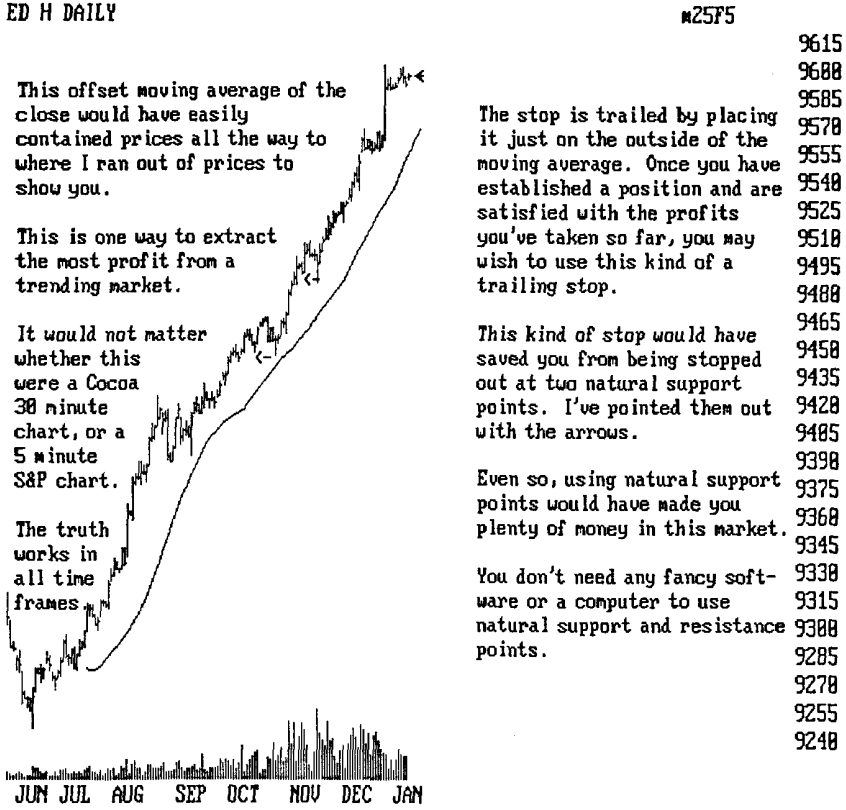
I treat each position on its own merit. If I have been able to cover costs, take a small profit, and am still in the position from earlier in the trend, I will be trailing a stop on a different basis.

My objective for the earlier positions is to be stopped out because prices have touched a curve fitted moving average or a curve fitted volatility study. At times it may be both.

I have studied the markets over many years, and have simultaneously used differing trailing stop methods for different entries. That way I've been able to test and compare how each works. All the while, I'm earning money while I find out.



I could have used any number of different combinations of moving averages. The one I've shown on the next chart is a 25 bar moving average of the close, offset, or moved forward in time by 5 bars.



These moving averages can also be computed by hand. It's a chore to get them set up, but once you do, you can easily maintain them in tabular form from day to day. It's simply a matter of dropping the oldest day and adding the latest day.

Before the advent of computers and daytrading, I kept such studies by manually entering the figures each day. Naturally, unless I wanted to work myself very hard, I was able to monitor only a few markets.

Then along came Messrs. DiNapoli and Damusis with their software for the Epson computer, running under CP/M. What a joy! I was ecstatic, freed forever from the drudgery of doing all these things with a high intensity of labor. I am now able to do in moments what took hours of my evenings to do.

Then I visited Joe DiNapoli on a trip I made to California to be with my parents. Wonder of wonders, he had live data. I was flabbergasted. I knew the big brokerage houses had such things on main-frame computers, but here was this thing called CQG, and it was displaying charts with live data.

This was my awakening. I had been an almost total recluse. I had traded privately and secretly for so long, I had forgotten there was another world out there.

Now, through the marvel of the computer, I am able to share with others the many things I learned over the years.

I think I've shown enough of the Eurodollar trade that you can get a pretty good idea of how the Study can be used to filter Ross hooks.

It's time now to move onto something else.

In the chapter that follows, I will be showing you how to use volatility bands to screen and filter your trades.

There is a market for everyone. There is a suitable time-frame for everyone. There are studies that suit the tastes of everyone who trades.

The next study, if it suits your temperament, may be all you need to become a winner. This study is taken from real life experiences of more than one trader. A lot of money has been made using the concept. See if it fits your style of trading.

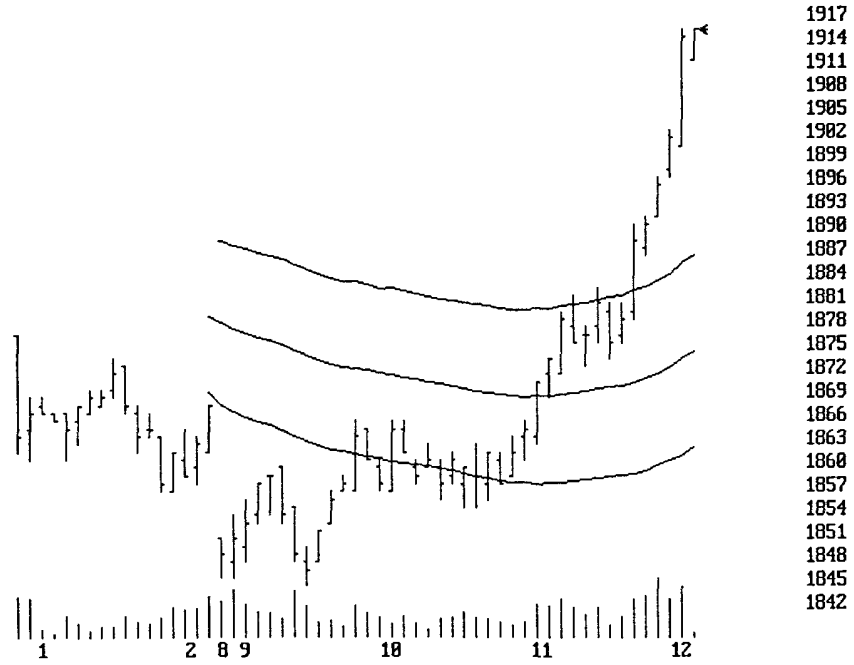
Chapter 14

Envelope Filtering

I have long been an advocate of the use of envelopes and envelope breakouts in my trading. With the advent of the computer, it has become very easy to do this type of work, live, and with a variability that more correctly reflects market action.

This chapter and a later one will show two entirely different concepts for using envelopes with the Ross hook.

Let me show you a picture. See if you can figure out how to use Ross hooks with the accompanying studies. We'll start out with the five minute oil chart I showed in the previous chapter.



The study shown on the chart is the Keltner Channel. The information I have on this study states, "The Keltner Channel is based on volatility expressed as a bar's range. A channel is created on both sides of a moving average. The average true range of each bar is multiplied by a constant, and then added and subtracted from the moving average to create the channel on each side of the moving average."

The center line is an exponential moving average, in this case a 39 bar exponential moving average of volatility.

Formula: Center Line: XMAC = (AV * (N-1) + Price) / N
Av Range: Av Range = (Range * (N-1) + High - Low) / N
Channel: Upper = XMAC + Range * C
Channel: Lower = XMAC - Range * C

Parameters:

1st: N = Number of bars in the exponential average.
2nd: C = Multiplier constant, I used 1.618

Typically, you buy when prices penetrate the upper channel, and sell when prices penetrate the lower channel.

It doesn't make much difference if you use a simple moving average of the close in place of an exponential moving average. Therefore, if you wanted to do this by hand, simply maintain a 39 bar simple moving average of the close, and also maintain a simple moving average of volatility (the difference between the high and the low each day).

The upper channel would be created by adding the moving average of volatility times 1.618 to the moving average of the close.

The lower channel would be created by subtracting the moving average of volatility times 1.618 from the moving average of the close.

I wish I had more information to pass on to you, but the above, is all I know about the Keltner Channel. Most importantly, it's all I need to know.

If you recall, Ross hooks occur only in trending markets. To the best of our ability, we want to filter out anything that looks like a hook if it is not occurring in a trending market.

The Keltner Channel (KC) can be used to do precisely that job. By using a 39 bar Keltner Channel we are forced to trade with the long term trend.

We take hook trades only when they occur outside the channel, or if the taking out of a hook would position your trade outside the channel.

We want to be sure that the market is indeed trending, so we must see the trend begin while it is still in the channel, if we are anticipating a breakout from the channel. If prices are already outside the channel we will filter them with the Study.

The Keltner Channel is such that when a market is moving sideways for awhile, the entire sideways move may be outside the channel. We want to avoid trading "pointy" places when a market is moving sideways outside the channel. I'll be showing examples of this. At that time, we will use the Study to filter our trades.

We want to use the KC as a filter for trading the Ross hook. We trade only the hooks in the direction of the trend on the side of the channel that corresponds to that direction. We trade long if prices are above the channel. We trade short if prices are below the channel.

We ignore anything that looks like a hook if the trade will occur inside the channel. This is the price we pay to accomplish not over trading, and making sure we are with the **long term trend**.

The market does not need to make a 1-2-3 high or low prior to taking hooks outside the channel.

We can also trade breakouts of 1-2-3's, if the number 2 point is outside the channel or a takeout of the number 2 point will take us out of the channel.

However, we do want to use our discipline of identifying when we are in congestion, and when we are in a trend. All the rules for trading the Ross hook are still in effect. The channel is there solely for the purpose of telling us when we are in a trend.

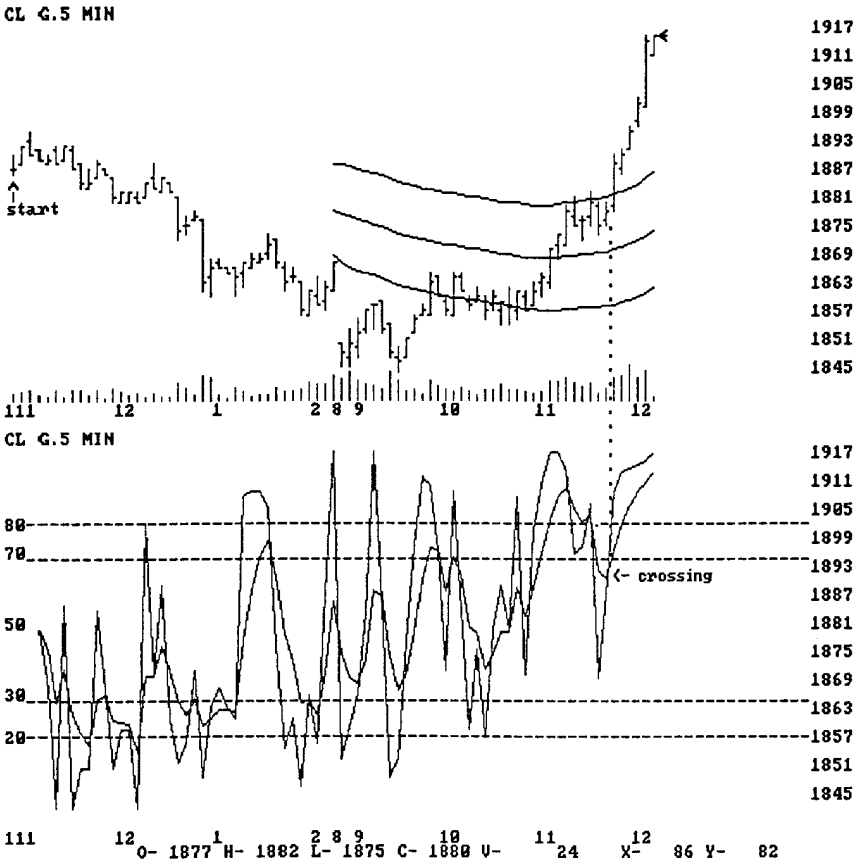
At times the market begins to congest while it is still outside the KC. At that time we have two options. The first option is to wait for the KC to catch up to the congestion area before we resume taking hooks outside the channel. The second option is to filter those trades with an appropriate version of the Study.

Our discipline must be exacting in following the rules I've just laid down.

Because we want to be very careful, we will add a filter to this trading. We will add the Study to screen out some of the trades we might otherwise have taken. As you will see, this is a very conservative method of trading.

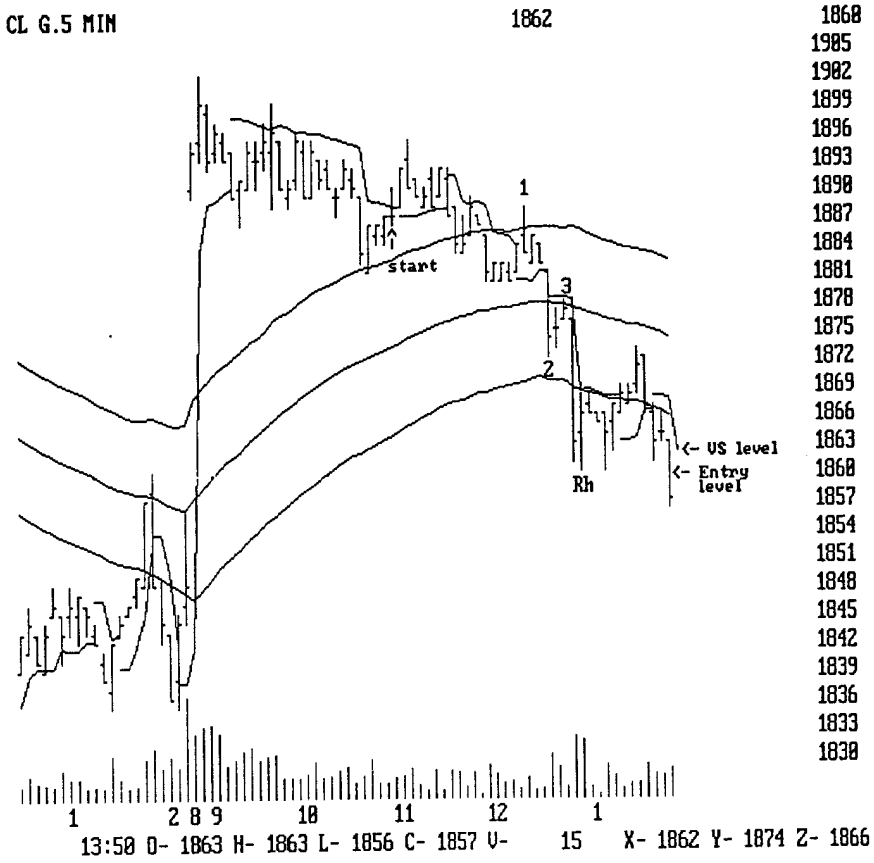
The name of this kind of trading is patience. It is not unheard of to have to wait for more than a week, trading a five minute S&P chart, for prices to begin to move out of the channel.

With these considerations in mind, let's look at the five minute Crude Oil chart, followed by a number of other charts showing this concept. All of the charts shown occurred within a three day period. There are plenty of markets and opportunities to trade.



There are three Ross hooks on the chart. See if you can spot them. The first was tradable and resulted in a loss. The second was not tradable because of a gap opening on the following day. The third was tradable and made a sizable move for a sizable profit.

Now, where do you put the stop? Take a look. I'm going to move the chart back in time to where the first trade took place.

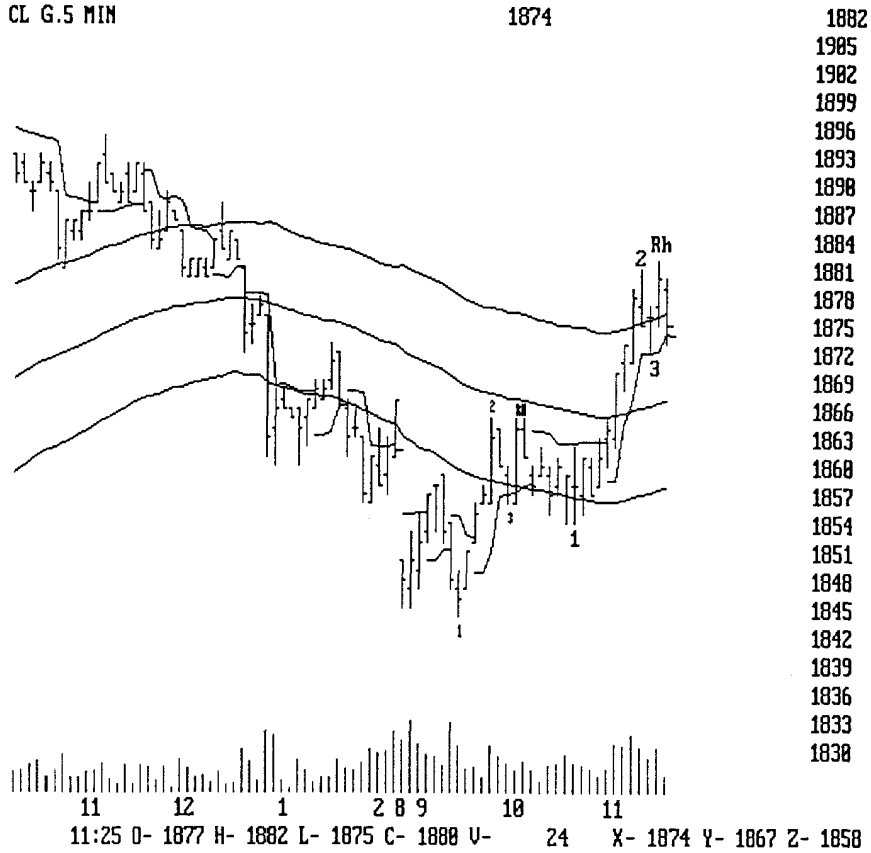


You could have used the Volatility Stop Study. On the chart above, the point of the hook was at 1861. Had you entered the trade at 1860 (shown in the upper right corner of the chart), your stop would have been at 1862 (shown to the right of center at the top of the chart).

One arrow shows the Volatility Stop price level. As you can see, immediately upon completion of a price bar the study is updated and extended forward to where the next price bar begins. Another arrow is shown at the level of the entry into the market.

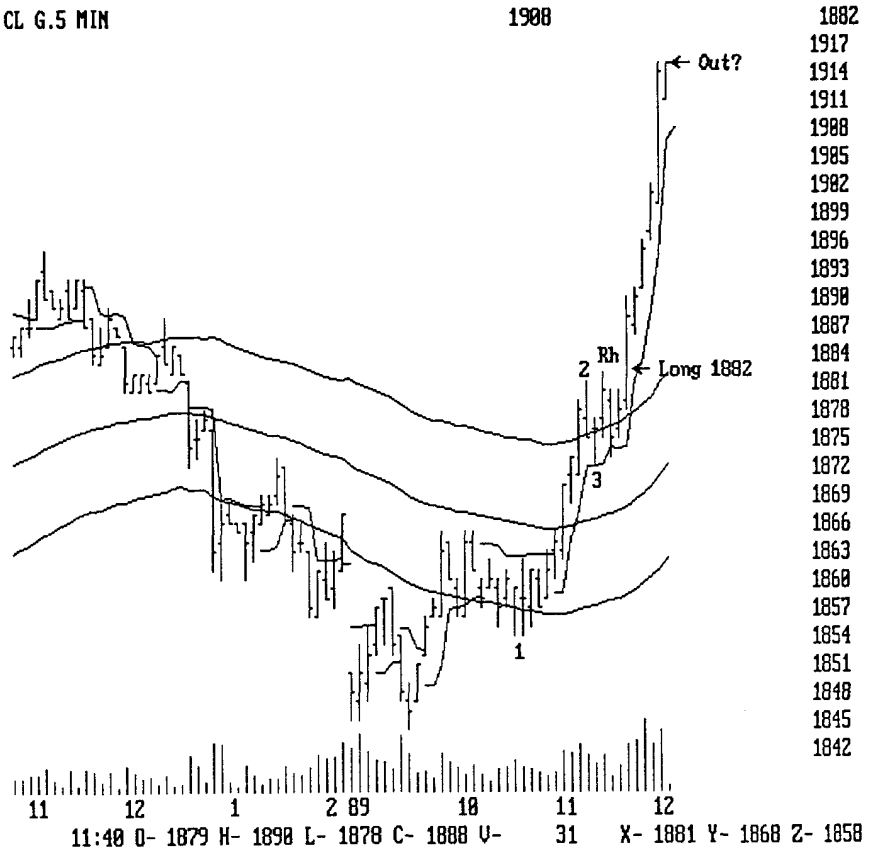
The trade resulted in a loss of two ticks.

Now let's look at the next trade.



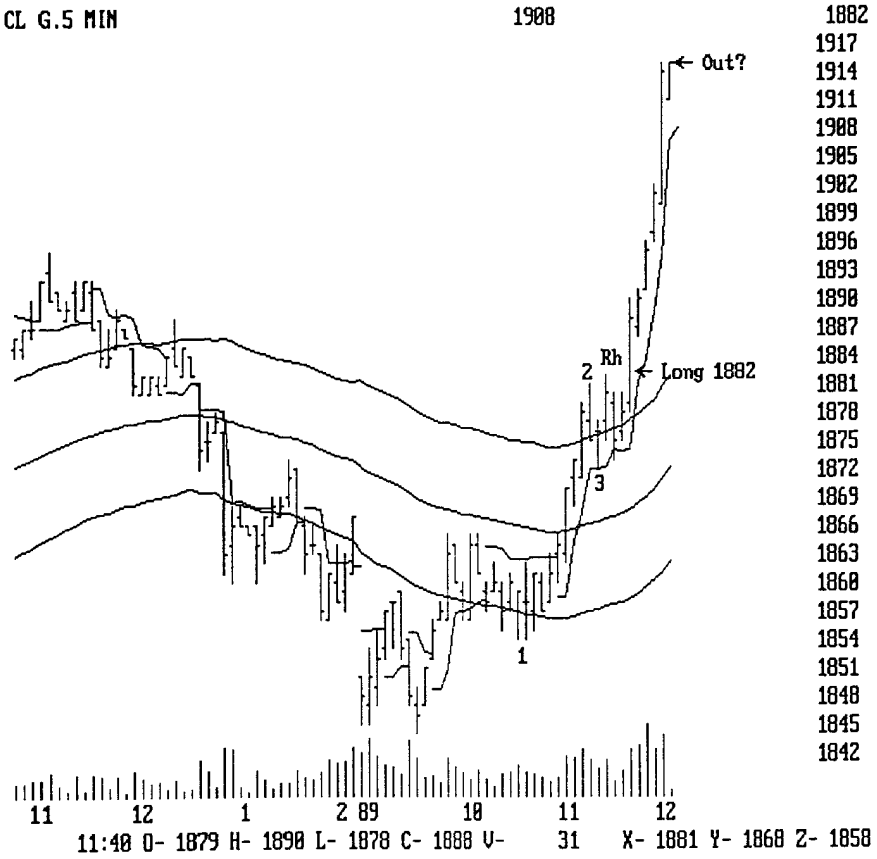
We have had a swing up from the bottom of the channel to a high that made a number 2 point, a correction to a number 3 point, and a Rh. If we take out the Rh, we want to be long.

Note that the earlier 1-2-3 did not give us a number 2 point outside the channel.



A maximum of 32 points could have been made if we exited on the top tick. That's not likely. But what would the results of this series of trades have been?

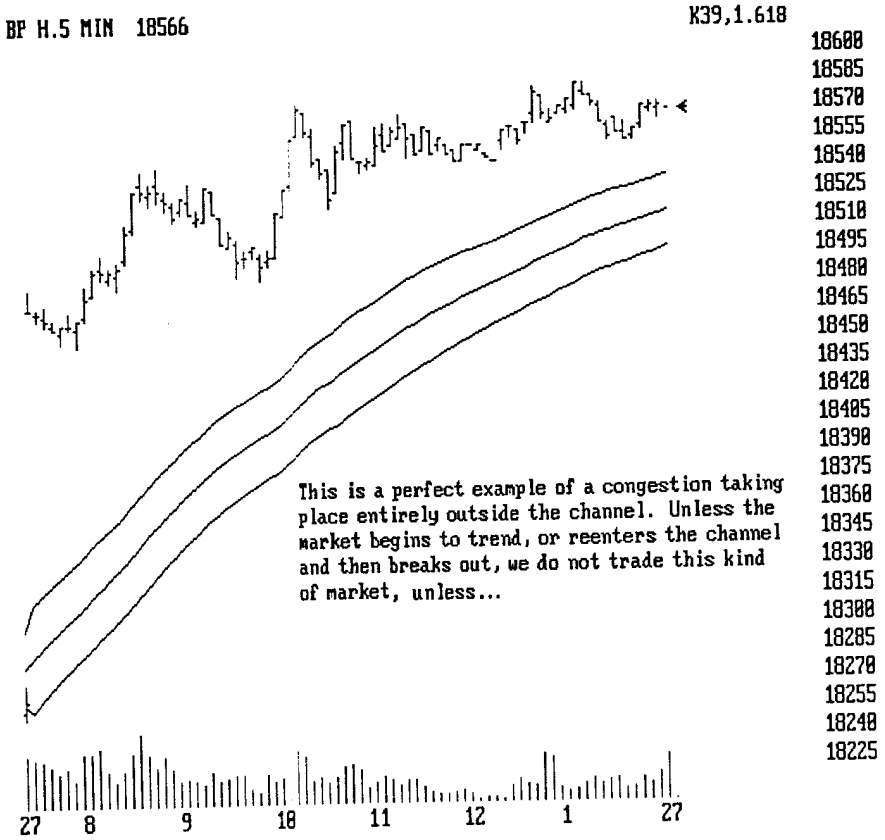
Trading three contracts at $25 a round turn including fees, we would have lost $60 + costs of $75 on the first trade, for a loss of $135.



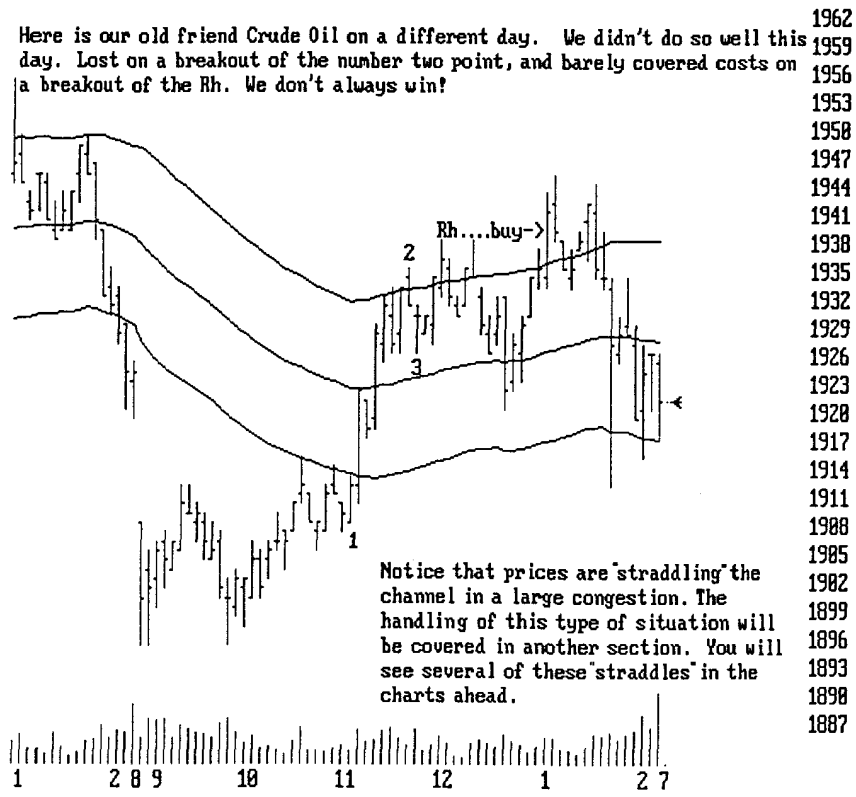
On our winning trade, we would have costs of $75. We would cash one contract after eight ticks to cover costs, and then would have pulled our stop to breakeven on the remaining two contracts. At that point, we are ahead of costs for this trade by $5. Being conservative, we could have trailed a 50% stop which would never have been hit. The two remaining contracts could have made as much as $320 net for each one.

Was this a sensational trade? No. But it was very typical of what happens when you trade hooks using the Keltner Channel as a filtering envelope.

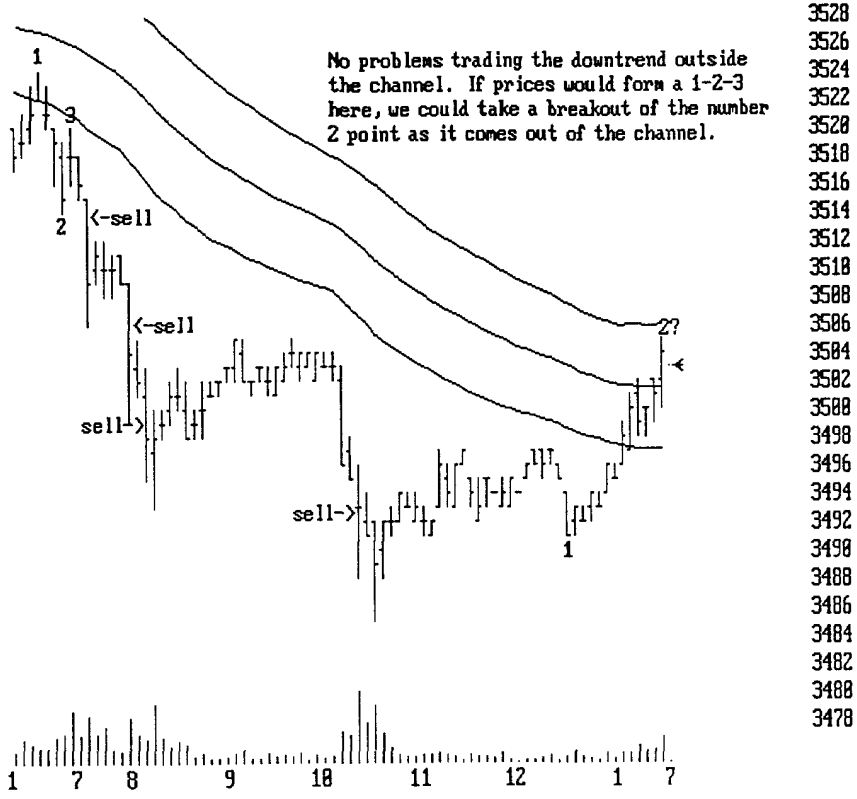
Next, we will look at some other markets in other time frames, showing this same channel concept.



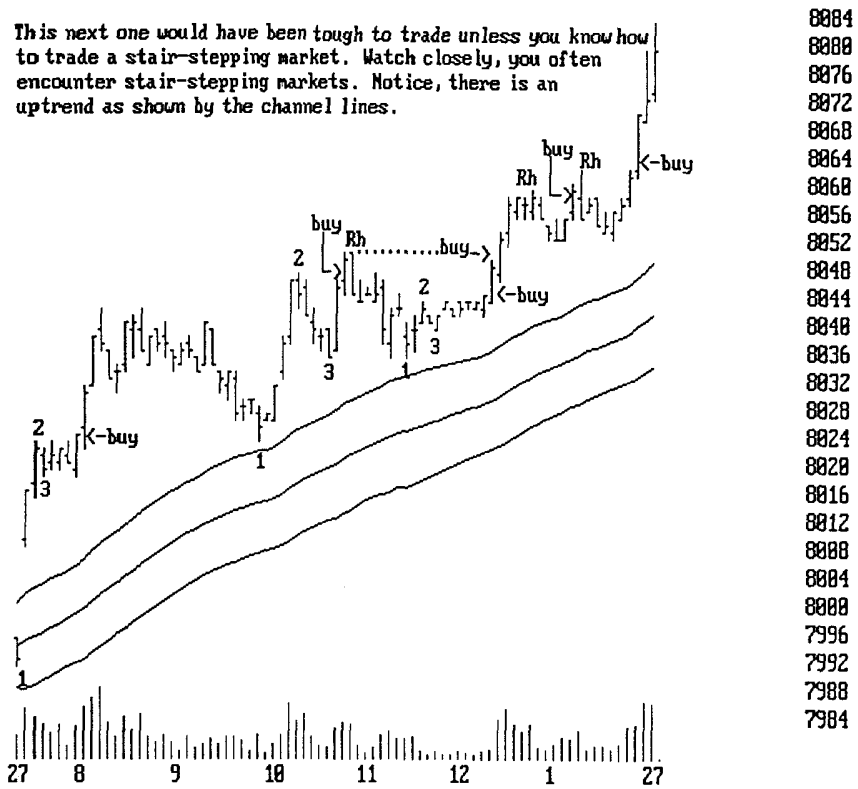
...we filter the trade our regular way with the Study. In other words, when prices are entirely out of the channel, we do not use the channel. At that point we are being told one of two things: 1. The market is going sideways on a 39 period basis. 2. The market is trending outside the channel on a 39 period basis.



When I'm daytrading, I will make no more than three attempts at a market. That means three attempts at a single market. Usually, I'll make no further attempts for the rest of the day in **that** market.



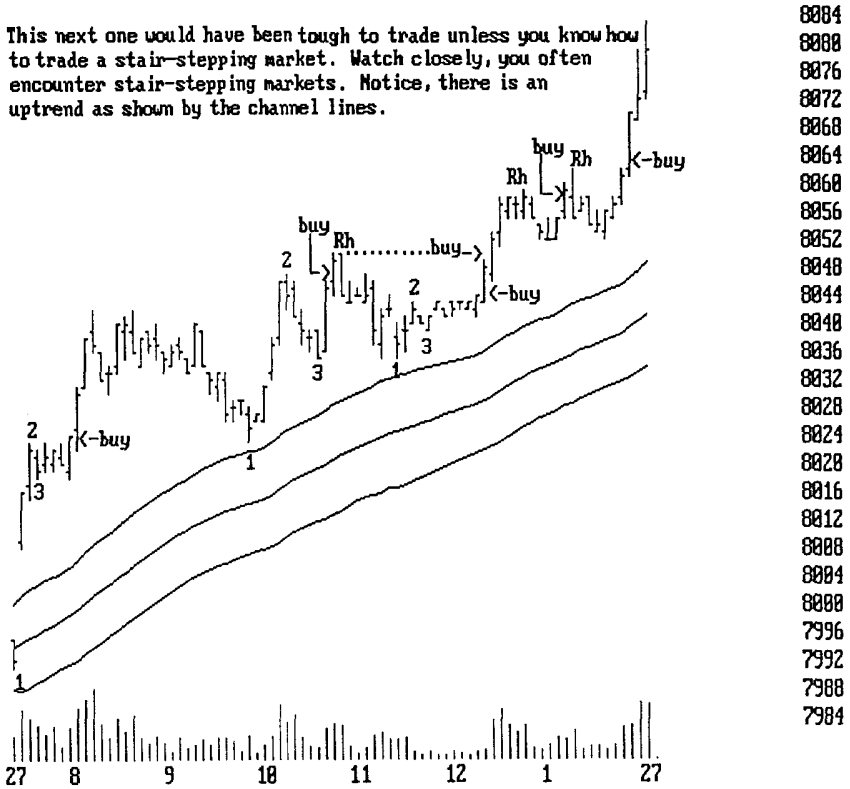
On some of the Charts, I am marking many of the possible entry signals that could be considered. That doesn't mean that I or you would take every one of them. Each has to be considered in light of a great many other things that may be going on. But if you wanted to intensively trade a particular market, you would take all the signals presented. To do it, you must maintain tight control over your trading. You must insist on low commissions, good fills, and place tight stops. You also need an awesome amount of self discipline.



The first area I've labeled as a 1-2-3, may not actually have been a 1-2-3 low. That's not important, because what we're really interested in is the "pointy" place I've marked as number 2. We want to buy a breakout of the number 2.

The second and third trades come as the result of 1-2-3's, one is a possible loser, the other is okay. I suppose it all depends upon where you place your stop.

Notice that placing stops below natural support points would have held in every case. Notice also, that placing a stop just below the upper channel line would have easily held this trend.

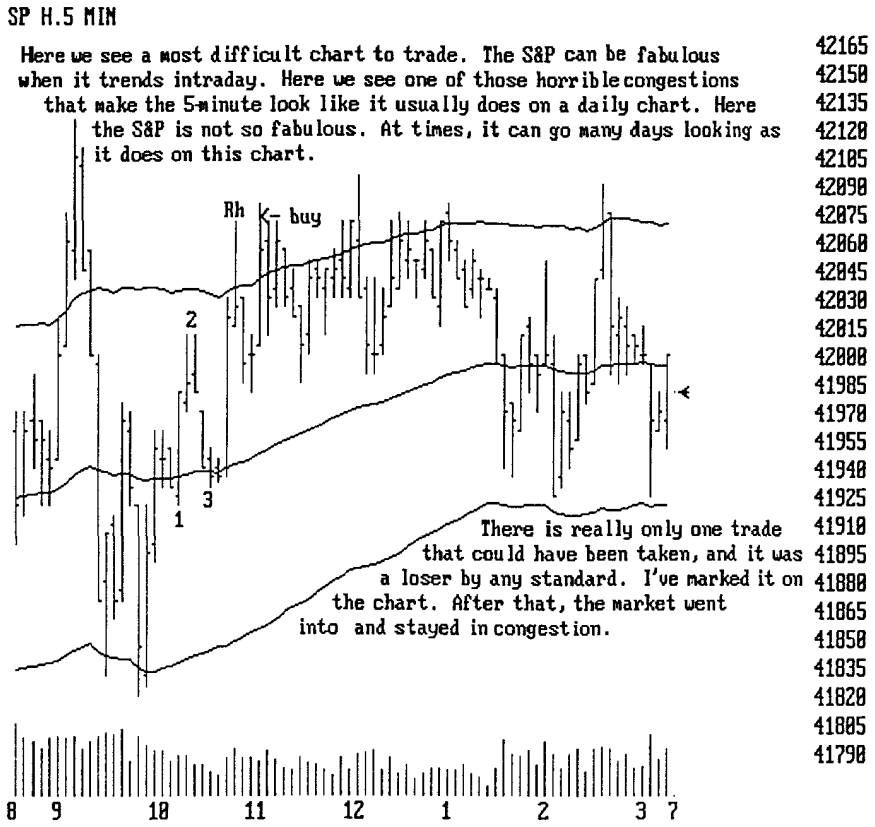


The fourth, fifth, and sixth trades were also successful according to stop placement.

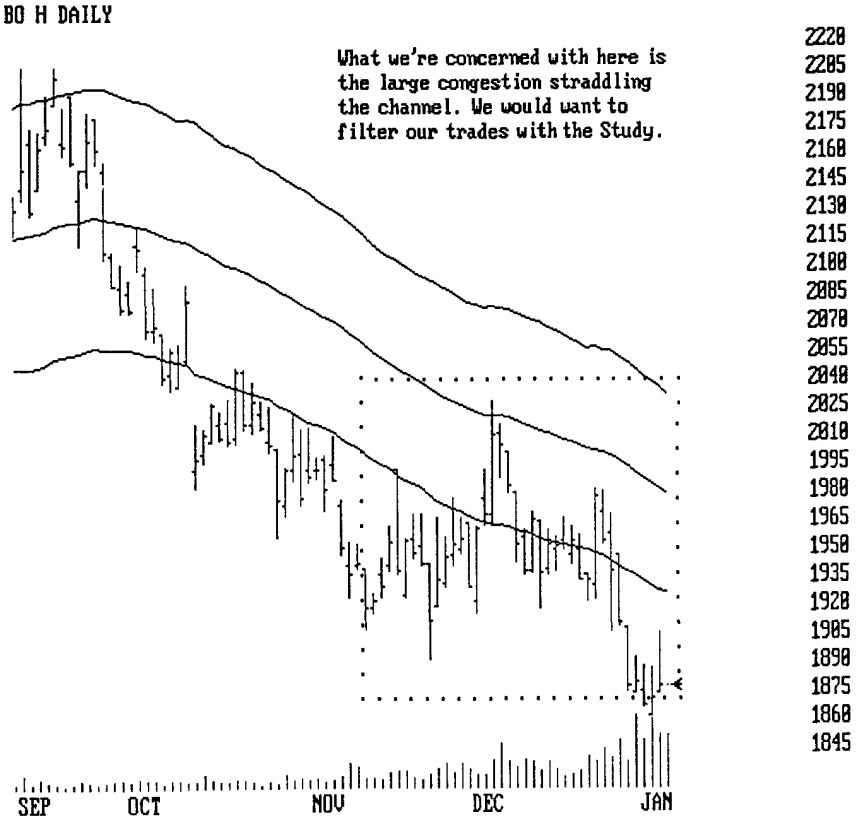
A daytrader could have garnered quite a few points out of the Japanese Yen on this day when it seemed to do so little overall.

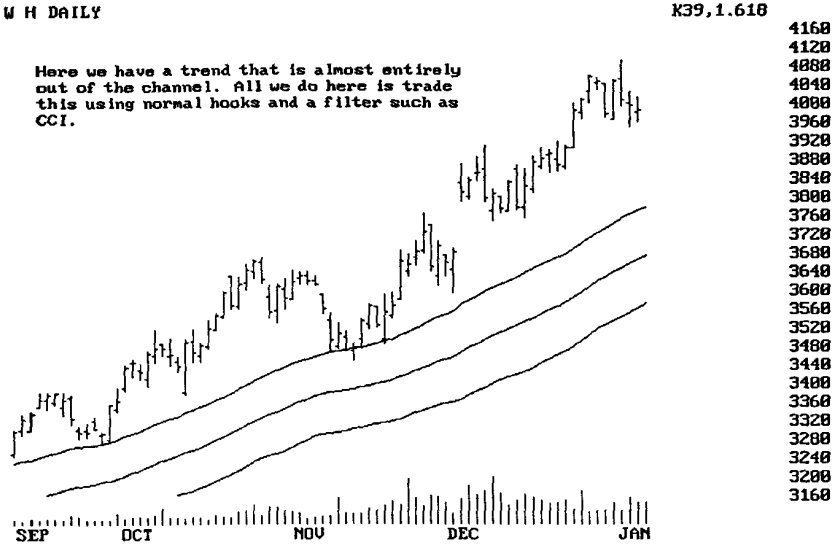
A position trader, looking at a similar daily chart, would have done just as well, except that it would have taken a lot longer.

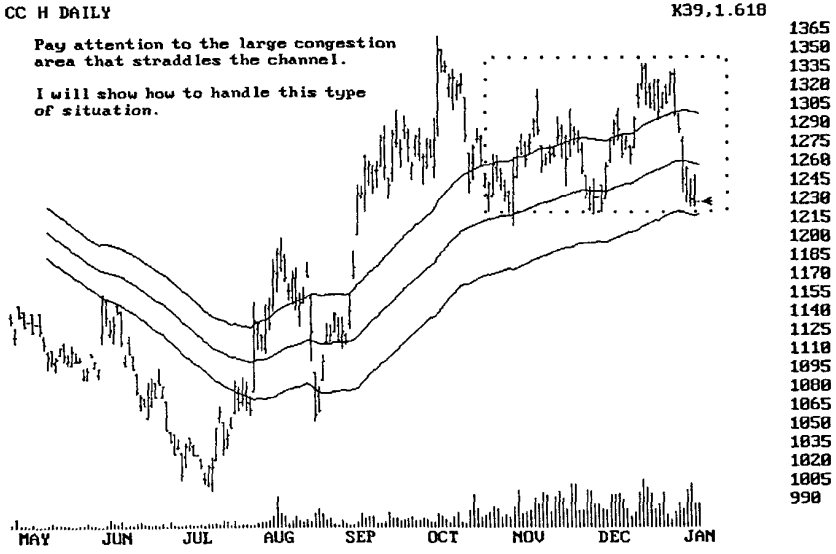
The next chart is of the S&P. It shows how you have to be patient.

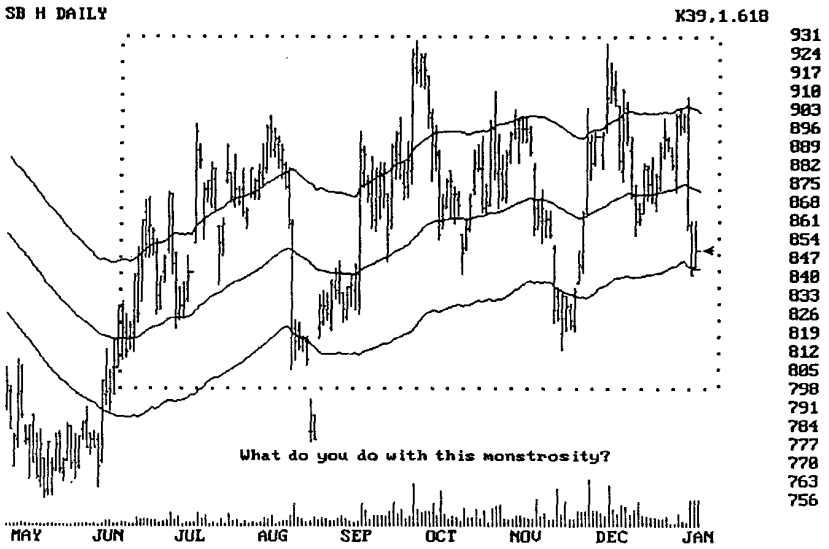


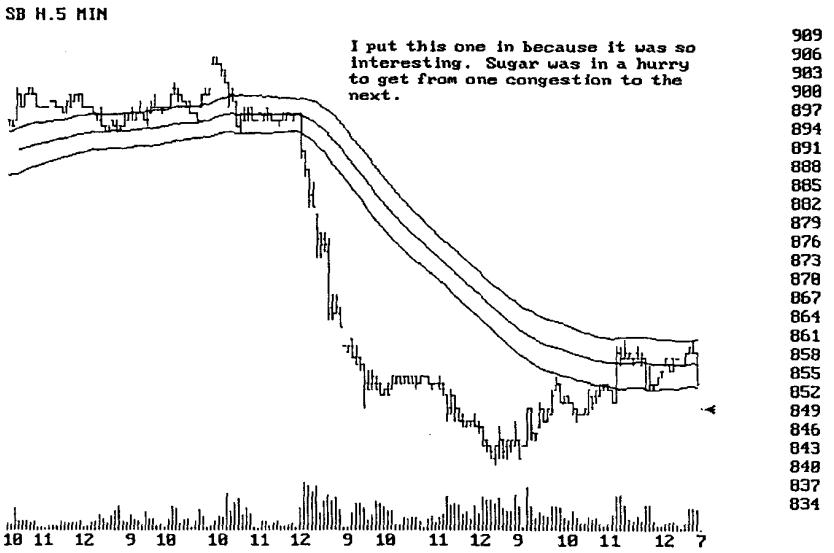
Because of the incredible disorder, trades coming out of the congestion must be filtered using the Study. We'll be looking at a few more of these chaotic charts, along with trending charts, and then see how the congested ones may be traded in relation to the Keltner channel. Be patient, I have only a few more charts to show you.

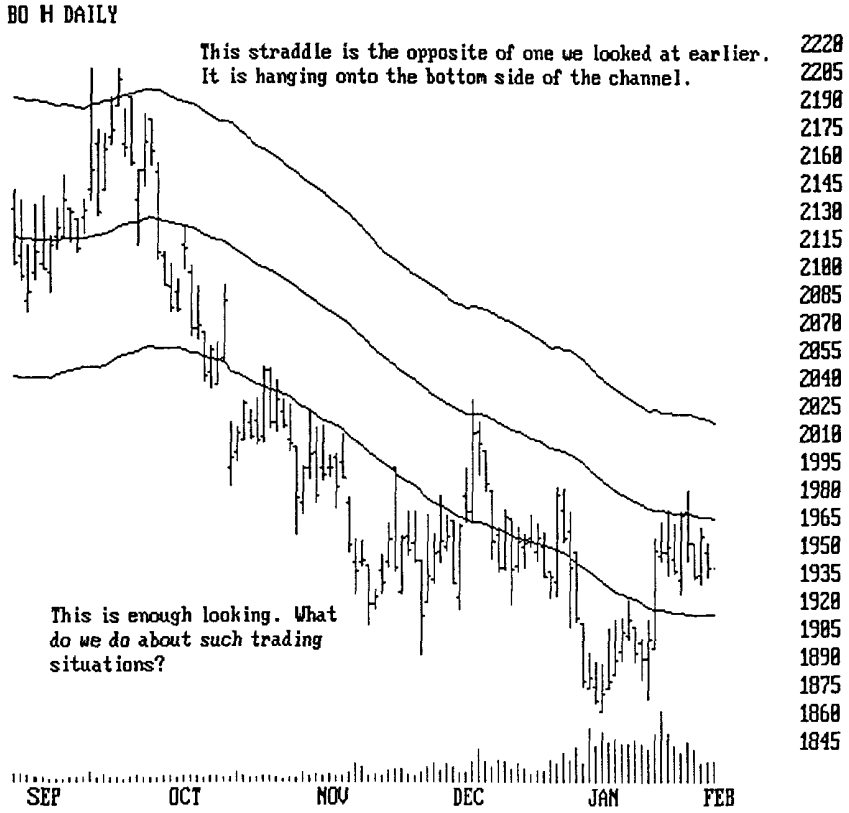



W H DAILY
K39,1.618
Here we have a trend that is almost entirely out of the channel. All we do here is trade this using normal hooks and a filter such as CCI.
4160
4120
4080
4040
4000
3960
3920
3880
3840
3800
3760
3720
3680
3640
3600
3560
3520
3480
3440
3400
3360
3320
3280
3240
3200
3160
SEP
OCT
NOV
DEC
JAN


CC H DAILY
K39,1.618
Pay attention to the large congestion area that straddles the channel.
I will show how to handle this type of situation.
1365
1350
1335
1320
1305
1290
1275
1260
1245
1230
1215
1200
1185
1170
1155
1140
1125
1110
1095
1080
1065
1050
1035
1020
1005
990
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC
JAN


SB H DAILY
K39,1.618
What do you do with this monstrosity?
931
924
917
910
903
896
889
882
875
868
861
854
847
840
833
826
819
812
805
798
791
784
777
770
763
756
MAY
JUN
JUL
AUG
SEP
OCT
NOV
DEC
JAN

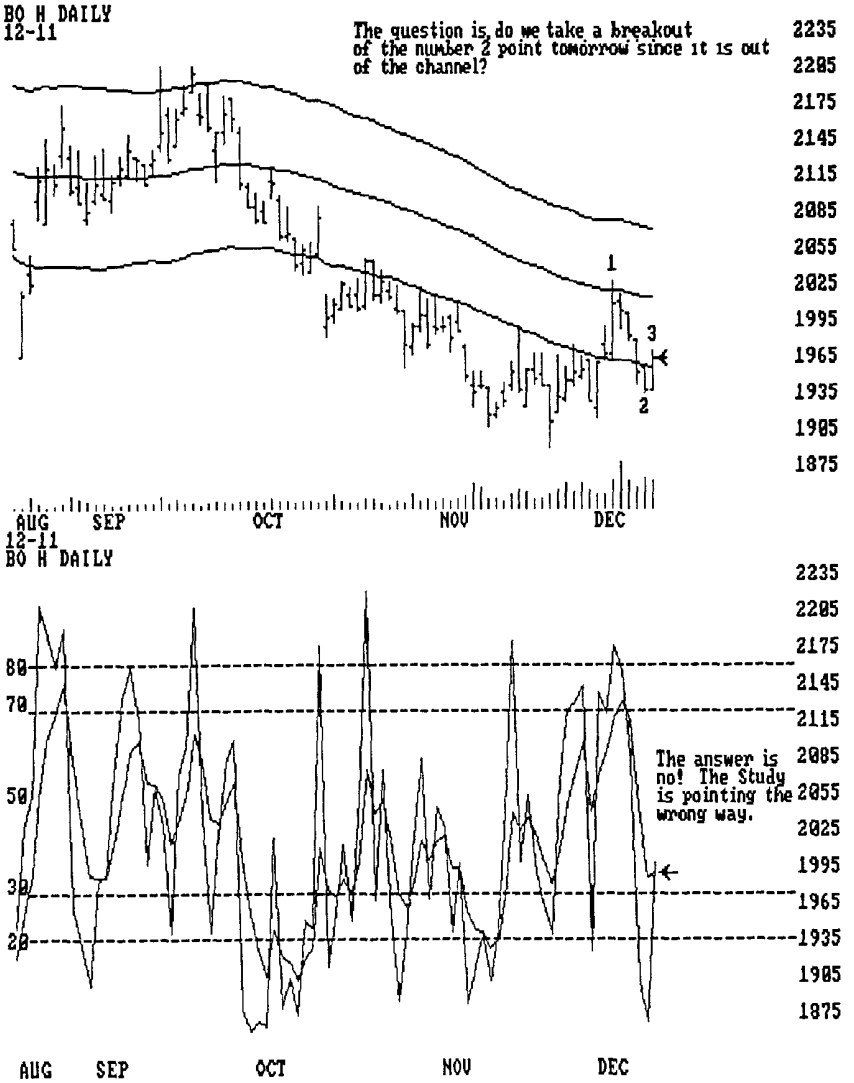

SB H.5 MIN
I put this one in because it was so interesting. Sugar was in a hurry to get from one congestion to the next.
909
906
903
900
897
894
891
888
885
882
879
876
873
870
867
864
861
858
855
852
849
846
843
840
837
834
10 11 12 9 10 10 11 12 9 10 11 12 9 10 11 12 7



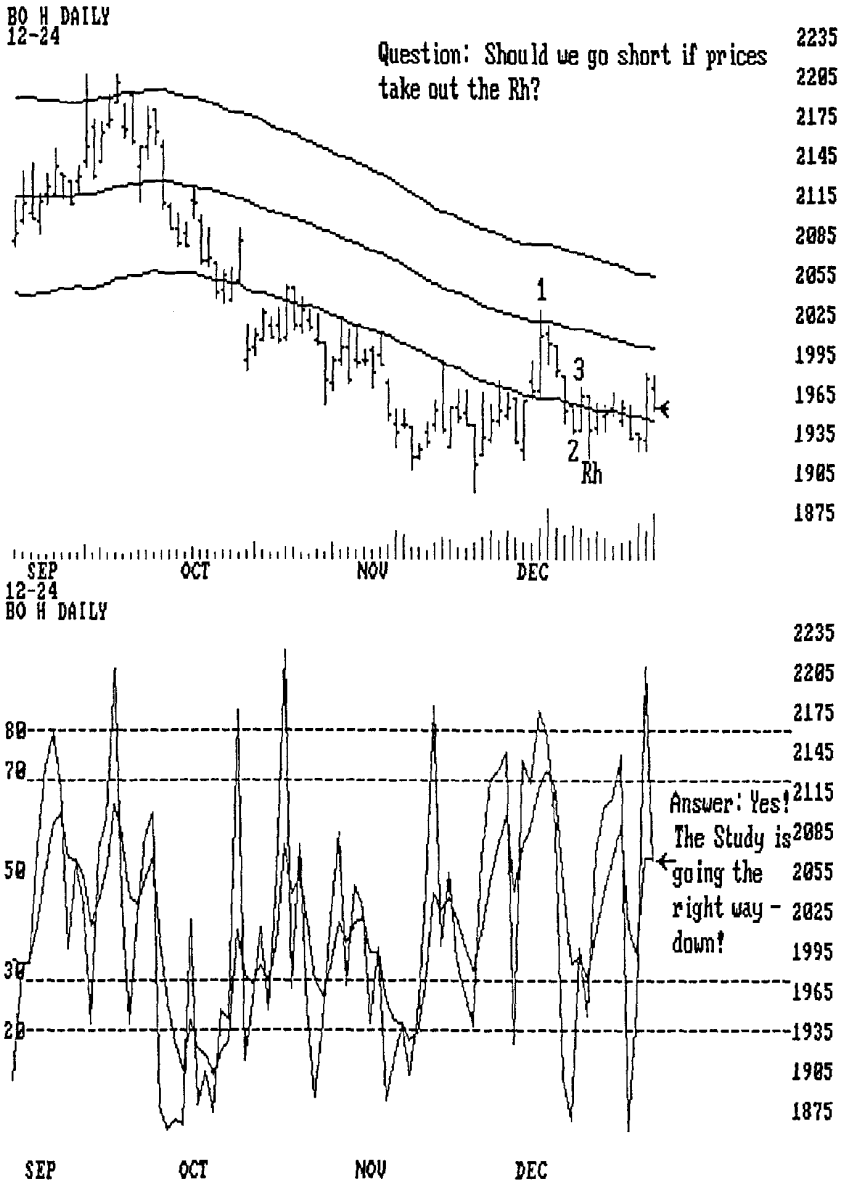
The easiest and safest answer is to simply stay out of the market when you see a congestion area. In practice, this might be the best way to handle the situation.

But knowing how most traders are, even if they stay out in congestion, they want to know how to get in or whether to get in when prices come out of the channel.

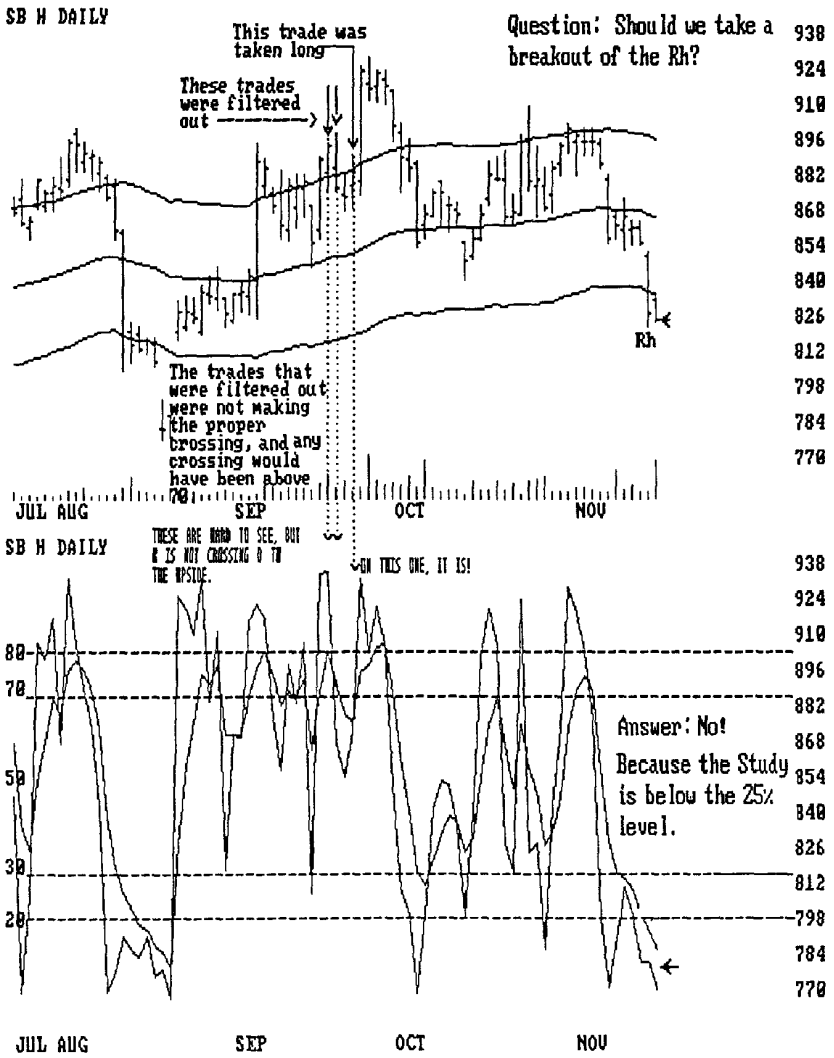
So, let's revisit some of these congested channel straddles to see how they may have been traded.

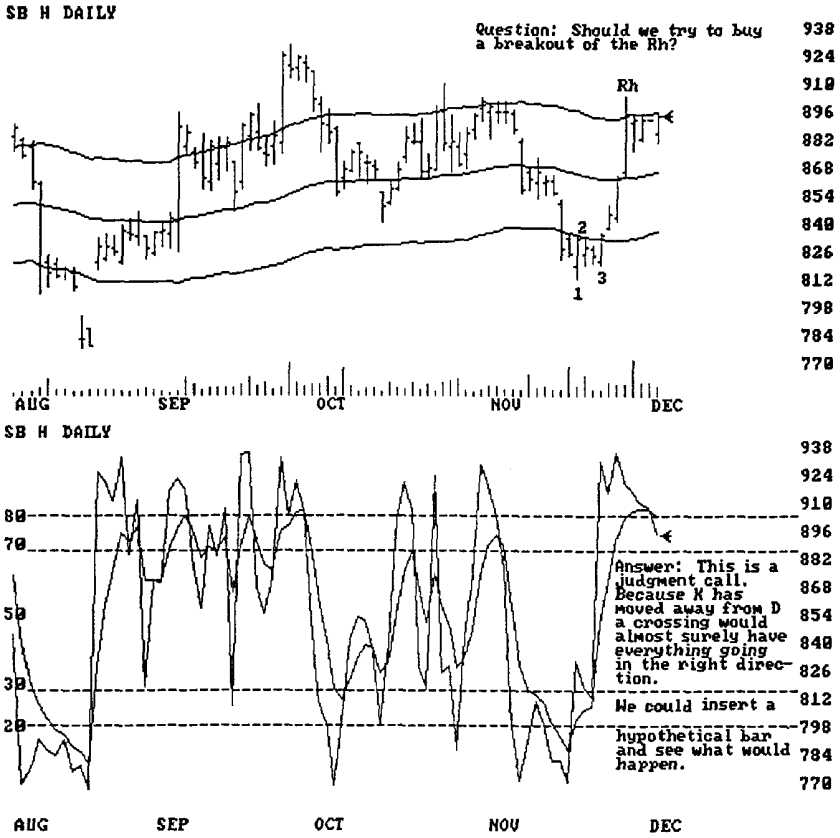


There is somewhat of a judgment call on this chart. If prices were to take out the number 2 point K might very well cross D. But I'd like to see it have a bit more room in which to turn around.



I'll go through two trading decisions for trades from the Sugar monstrosity I showed a few charts back. I've decreased the number of bars shown in the chart for purposes of increased clarity.

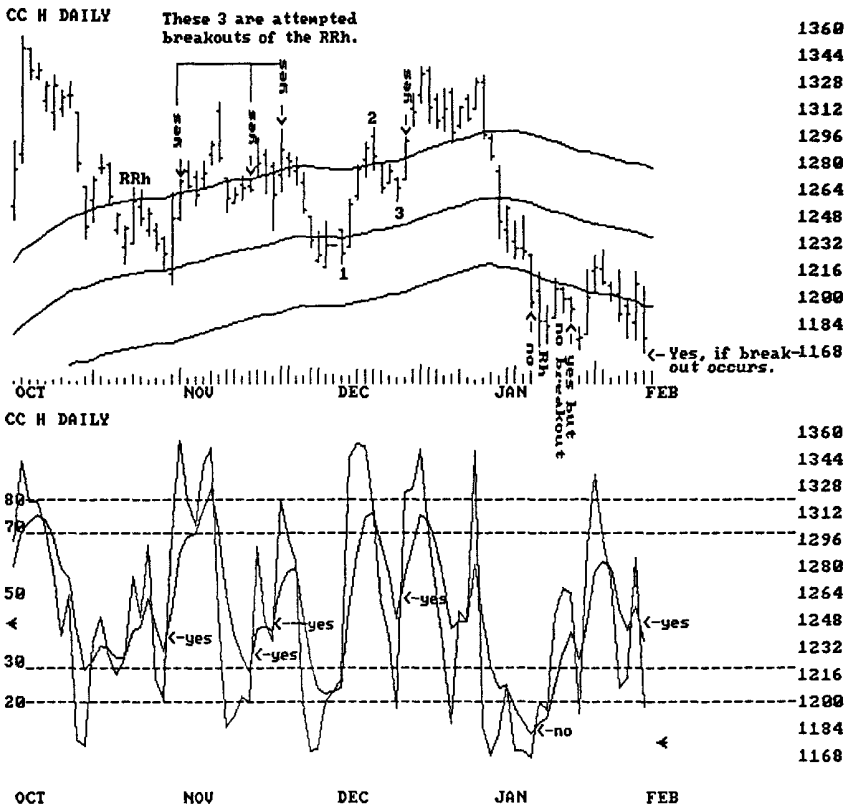




But, the crossover would have to take place below the 75 level, which it never did.

This trade, if it had been taken, turned out to be a money maker and resulted in the December high.

I guess we still haven't found the Holy Grail.



This style of trading can prove to be very interesting regardless of time frame. Although a lot of good trades are missed, so, too, are a lot of bad trades. The filtering technique using the Study, has proved to be more than adequate.

This is a method I would suggest to anyone who is an over-trader, because it forces you to trade in the direction of the 39 period moving average.

In the next chapter, I'm going to show you a neat trick. It takes advantage of a natural occurrence at market tops and bottoms.

Variations

A great deal of success has been derived from trading the S&P 500 by using a 40-bar Keltner channel with a multiplier constant of 5, and filtering hooks outside the bands using a **3-1-3** version of the Study, on a 3-minute chart. Once again, the purpose is to keep from overtrading and taking only the best trades.

A good money management technique for trading the S&P this way is to watch the market carefully as it approaches a profit of 40+ points.

At fifty points a profit should be taken, and stops brought to breakeven on any remaining contracts. If the market blasts through and is really moving at 50 points, the stops may be held back some in order to let the trade ride.

About ninety percent of the time a stop is not even needed, though at the very least a mental stop should be used. A majority of trades will reach 50 points of profit. Unless there is great momentum, take profits and exit.

If at any distance between forty to fifty points the market appears to hesitate, take profits and pull all remaining stops to breakeven.

This type of trading will give lots of action on the days when prices are outside the channel. Be careful of trading ranges outside the channel. Until you see a 1-2-3 followed by a Ross hook, do not attempt entry despite the fact that prices are outside the channel.

I do not vouch for this technique for markets other than the S&P 500 intraday. However, it would appear that it should work for any market. Using forty bars ensures that in most instances you will be trading hooks when a market is trending.

Moving Average Bands

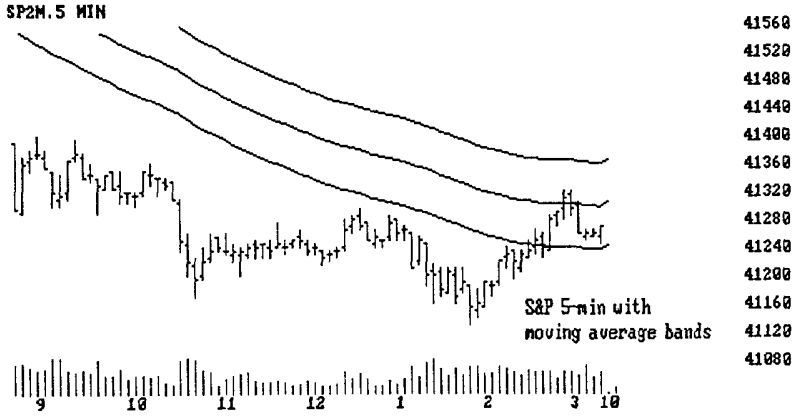
For those who wish to trade this way but do not have access to the Keltner channel, there is another solution.

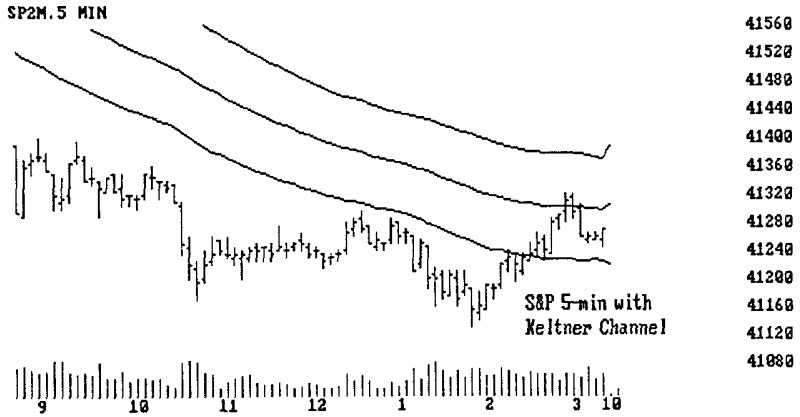
If you have software that allows you to calculate what has been called "Uni-Channel", or moving average bands, you can approximate the same conditions as the Keltner Channel.

Choose a thirty-nine or forty bar moving average of the close, and then place the bands at a distance of about .15%. You may have to play with the numbers until it comes out right.

How will you know when it is "right?" When a market has been outside the bands for forty bars, it should begin to reenter the bands.

The best way to show this is by illustration.





Although they are not precisely the same, the two channels are close enough for purposes of trading. Whether you use the Keltner Channel or Moving Average Bands, you adjust the size of the channel to suit your own comfort level. You don't want them so narrow that you are taking too many trades. You don't want them so far apart that you are hardly ever trading.

From time to time due to changes in market volatility, you may need to change the setting for either one.

You might also want to change the settings or the time frame so that you are more comfortable with them.

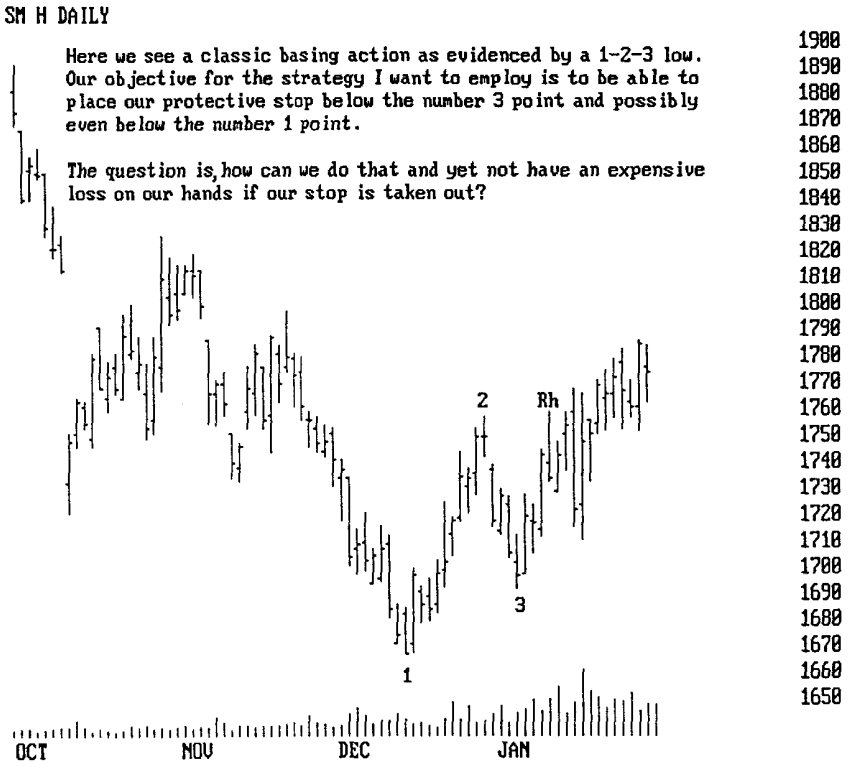
Chapter 15

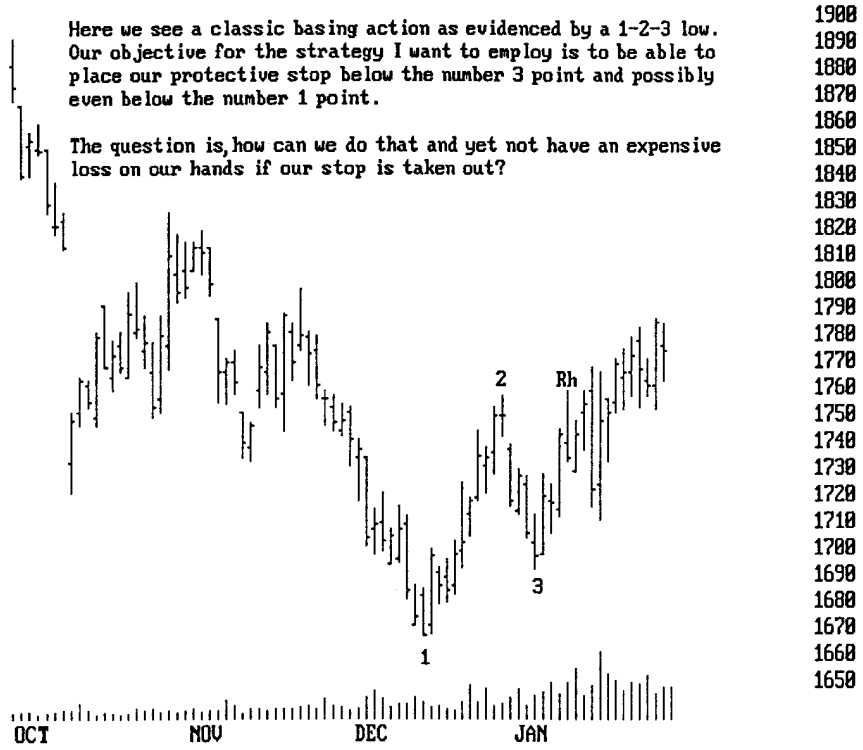
A Neat Trick

In this chapter, I'm going to show you a neat trick that will enable you to give a trade more room. In a sense, it allows you to set a "free" stop.

The strategy revolves around recognizing a 1-2-3 high or low.

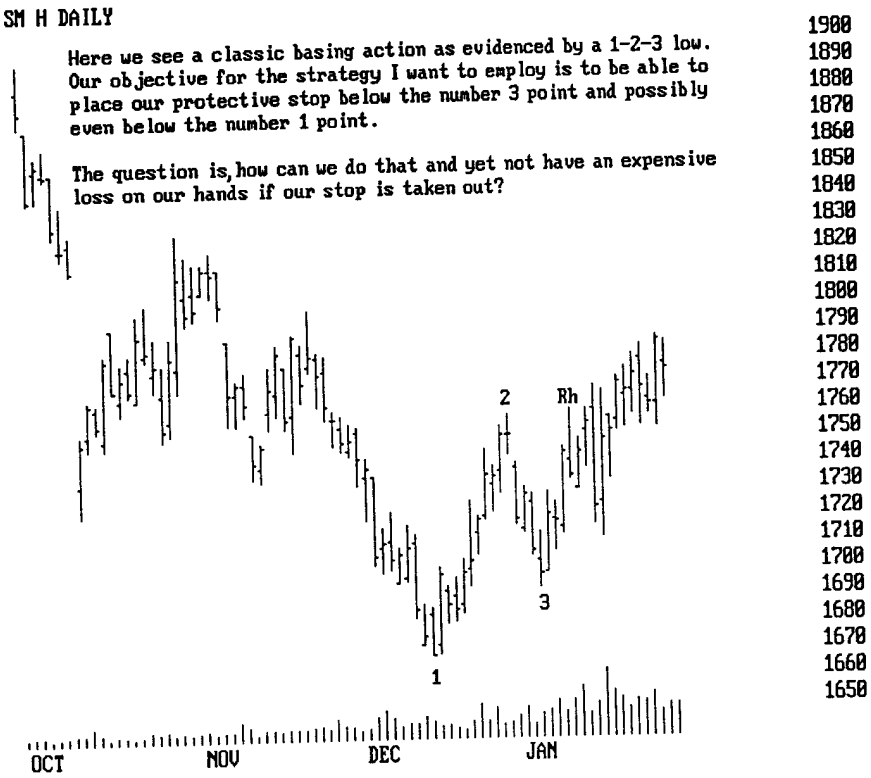
The reason I'm showing it in this book is because it fits in well with trading the Ross hook.





This typical basing action we see in the Soymeal chart usually forms a 1-2-3 low. Earlier in the book I described the fundamentals that cause such a formation to occur. Now we have an opportunity to take advantage of that knowledge.

You will recall that the number 1 point is created when there are simply no more sellers in the market. Prices are so low that suppliers are not willing to bring their product to market at these prices.



Consequently, buying comes into the market because prices are low, and supply is drying up. The only people left in the market are buyers. Some of these buyers buy for fundamental reasons as they are consumers of the product looking for a bargain. Other buyers do so because of technical reasons. When they see that prices are starting to rise, they enter the market to take advantage of what appears to be a bear market rally, or correction of some sort.

Subsequently, prices move up to the number 2 point due to buying entering the market.

Being the smart traders that we are(?), we know that as prices rise from the initial number 1 point, soon some of the technicians and short term traders are going to take profits. To accomplish that, they will have to sell.

When they sell, those traders who are still bearish and view this upmove as a bear market rally will join in and sell too. This will drive prices downward.

Now, here's what we will do. When we realize that the initial upthrust is over, and that the market is ready to turn toward the number 3 point (which may even result in a continuation of the downtrend), we will sell short, and attempt to scalp a piece of the market by staying short with a profit objective of 50% of the initial upthrust.

How will we know when the initial upthrust is over? As prices move up, we will place sell stops beneath the lows of each day. If our stop is hit, we will place a profit taking objective stop at a point equal to 50% of the leg up.

This strategy will result in a counter trend trade on our part. If we manage the trade and our money properly, we will seldom be hurt by this tactic.

As always, we must use one contract set to cover costs. We cannot think of taking profits until we have done that. If we can afford it, we will take another small profit at a distance of 1/3 of the initial upthrust. If you are dead set on being a Fibonacci trader, you can try for a small profit at a distance of.382 of the initial upthrust. Our final profit, after pulling up to breakeven, will be when prices have moved a full 50% of the distance of the initial upthrust.

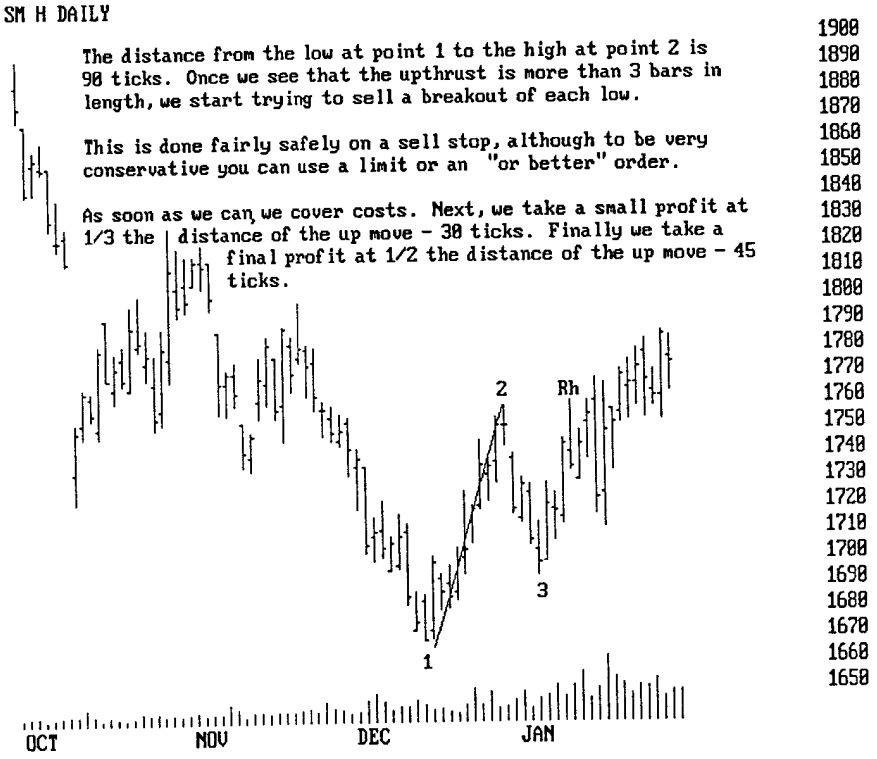
If we have an account that can afford only two contracts, we must cover costs and then hope for a 50% retracement. As soon as possible, move the stop to 1/3 the distance of the initial upthrust.

We are not in this trade to make scads of money. If prices continue down past the number 1 point, we must not grieve over profits missed. Once prices have retraced 75% or more, we can attempt to short the market ahead of the hook that will have been left at the number 1 point.

If we do make money, we can use this money to enable us to set our stop further away from the price action.

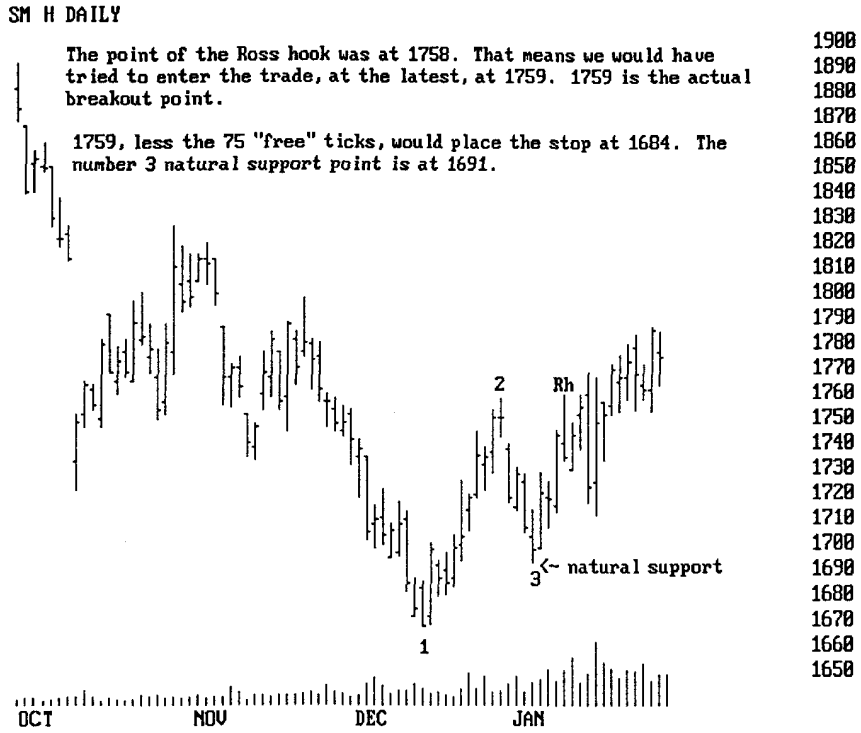
Why would we want to do this? Because if a large 1-2-3 bottom is being made, it signifies an eventual long term trend to the upside. We can add the money earned from our scalp to the amount we would normally risk on this trade, and more comfortably trade with a natural support point stop.

Let's look at a few charts to see how this would have worked out.



In the preceding example, the actual amount of the retracement was 65 ticks. The approximate amount we could have made was 75 ticks. We would then have 75 ticks of "free" money to play with for our long term stop placement.

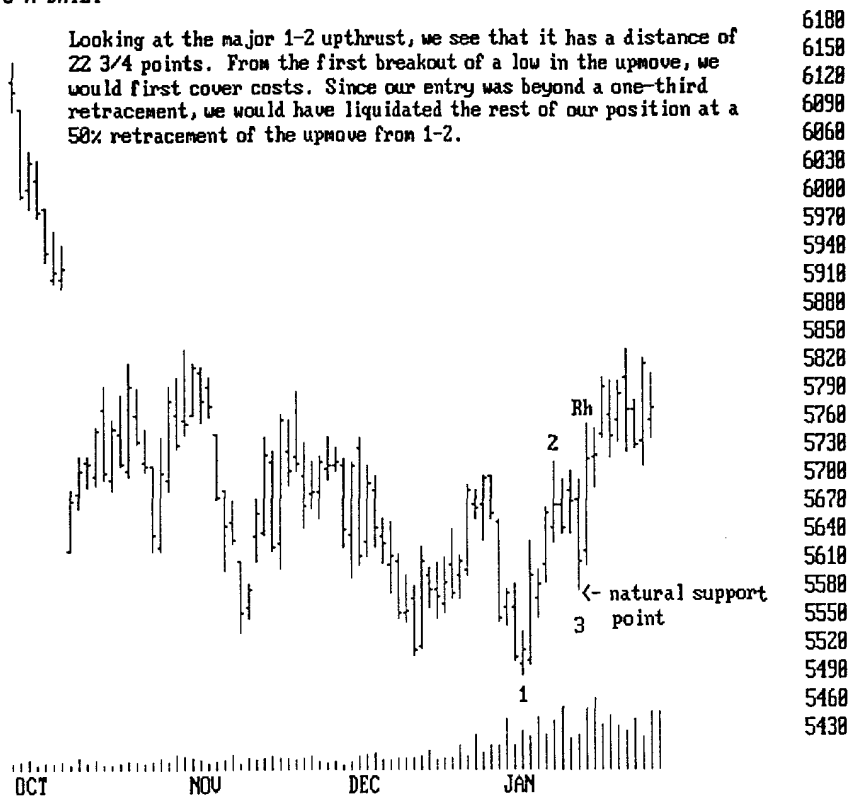
Now let's see how that would have worked out in actual practice.

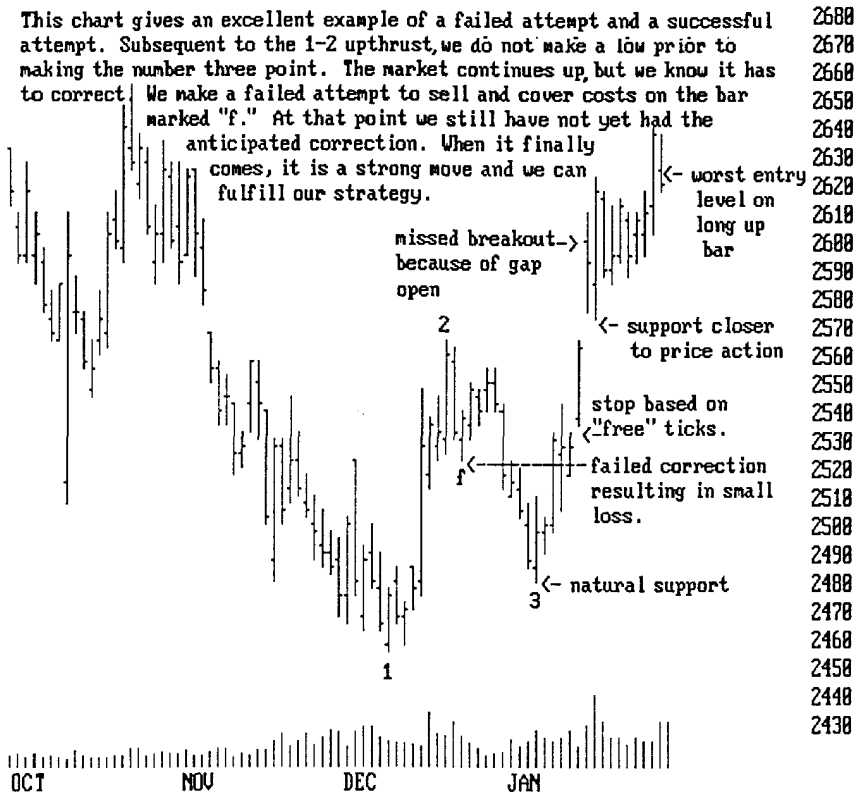


If we were willing to place the stop at the amount of volatility plus the "free" ticks, we could place the stop even further back than 1684.

In this case, we can comfortably place the stop at 1690, one tick below natural support. If we are stopped out there, we are really not hurting. We may be a bit disappointed, but there has been no harm done to our account.

Let's look at a few more of these situations.





The upmove from point 1 to point 2 is 11 points or 44 ticks. After taking a small hit on bar "f", the market retraces 8 1/2 points or 34 ticks to the number 3 point. After covering costs, we can take a small profit at the 1/3 retracement or 15 ticks. We then take our final profit at 22 ticks. That gives us 37 "free" ticks to add to our stop.

What about intraday charts, will it work there too? Yes it will, but you must make sure there is sufficient volatility to make the needed ticks.

A good bet is to start with 120-minute charts and work your way down. You can try 60-minute, 30-minute, and even smaller intervals. Following the tick banking strategy, you can even use 5-minute charts in the S&P. But be careful because a 5-minute S&P can be very fast.

Chapter 16

Bollinger Bands for Filtering Hooks

In this chapter I'm going to show you how to use Bollinger Bands for filtering Ross hooks. I believe the Bollinger Band study alone is sufficient reason for purchasing a computer if you don't already have one. If you do, and your software does not have Bollinger Bands, contact your software vendor and strongly request its inclusion in the next update version.

The method I'm going to show you here is so good, I almost hate to part with it. But in keeping with my purpose of sharing what has been so good for me, get set for something special.

According to the information I have, Bollinger Bands are bands that vary in distance from a moving average as a function of the market's volatility. A simple twenty period moving average of the close is used as the center line. Moving bands are calculated concurrent with the moving average and placed two standard deviations above and below the center line.

I feel that trading bands are one of the most useful concepts in technical trading that have come along in a great while.

The formula as I have it is:

AV(erage) = the SUM OF THE LAST N PRICES/N

DEV(iation) = (PRICE - AV) ^{2}

M(ean) D(eviation) = SUM OF DEV(iations)/N

S(tandard) D(eviation) = SQRT(MD)

BOLLINGER = AV ± 2(SD)

The way Bollinger Bands are normally used is that sharp moves tend to occur after the bands contract towards the center line.

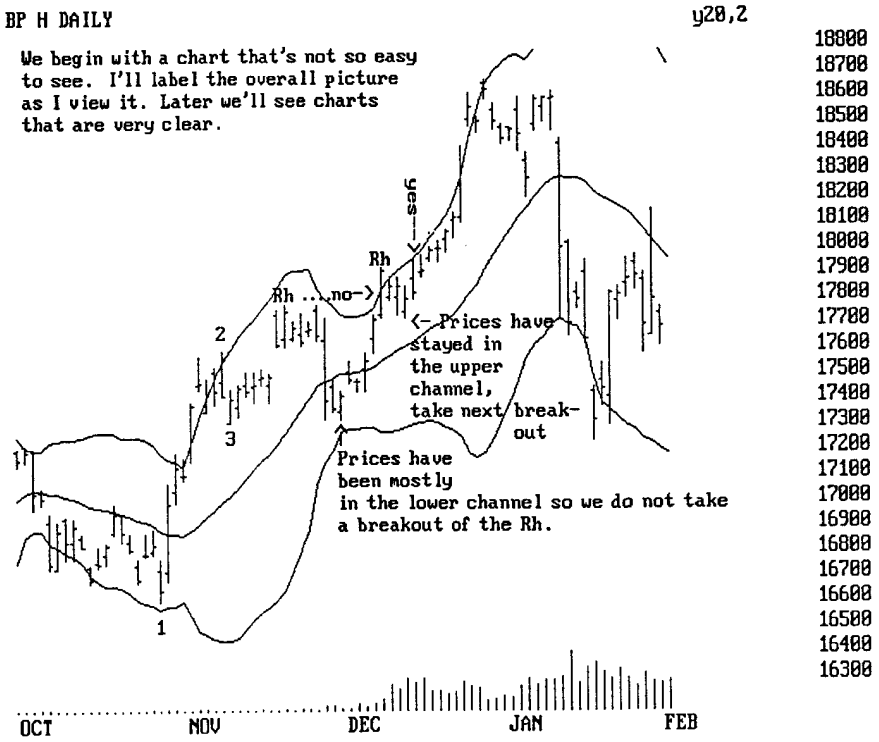
A move outside the bands usually means continuation of the trend, not an end to it. (I tend to partially disagree with that.)

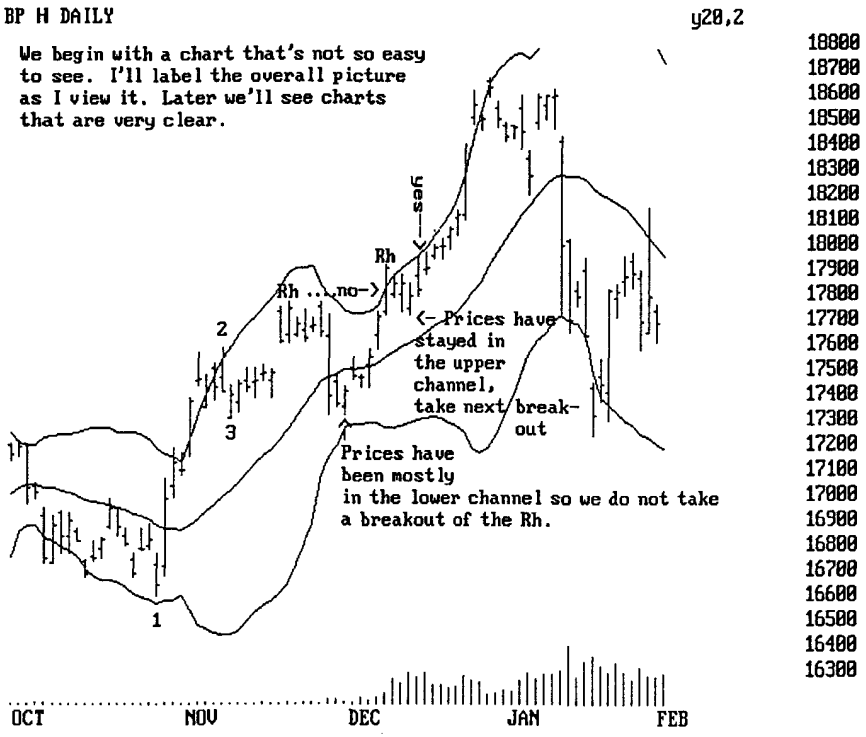
Bottoms made outside the bands followed by bottoms made inside the bands call for upward reversals of trend. Tops made outside the bands followed by tops made inside the bands call for downward reversals of trend.

A move originating at one band tends to go all the way to the other band. This tendency enables you to project a price objective for such moves.

Now, let's look at the way I use these bands to trade the Ross hook.

This next series of charts should be a real eye opener.



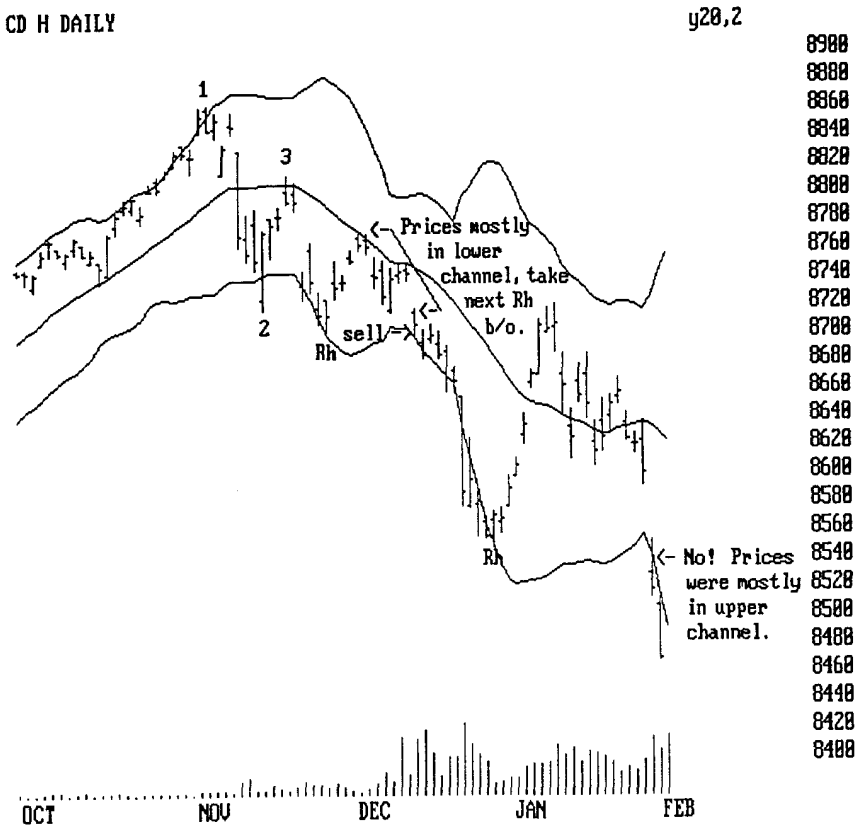


We see an overall 1-2-3 formation followed by a breakout and formation of a Ross hook. Then prices take out the Ross hook. Should we trade that breakout? No! Why? Because prices need to be almost entirely in the upper channel prior to our attempt.

Prices then fall back to make another hook. Should we trade that breakout? Yes? Why? Because prices have been entirely in the upper channel.

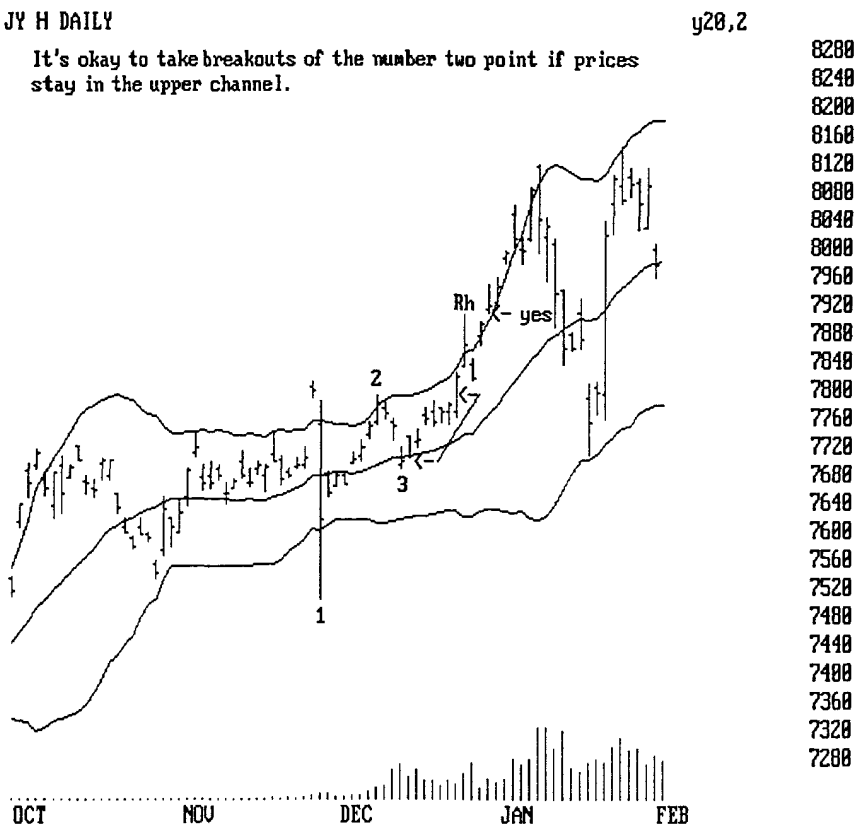
Don't forget, you can use the Trader's Trick on any of these to get in early. Although I won't be showing it, you can also use the Study or CCI for additional confirmation if you have the need.

Bear with me, you'll get used to spotting these.



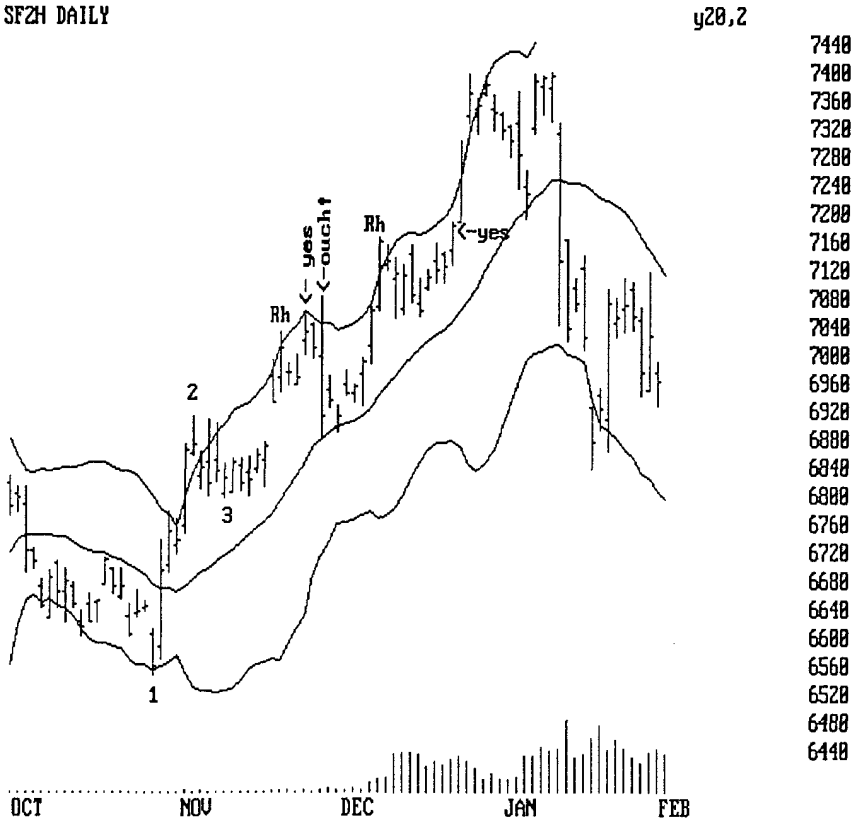
We want to take the hooks when prices are predominately in one channel. We don't want prices to be criss-crossing the center band to the outer band on the opposite side of our trade.

We wouldn't take the last hook because of the gap opening. But we also wouldn't take it because prior to the enormous gap down, prices were mostly in the upper channel and near the center line.



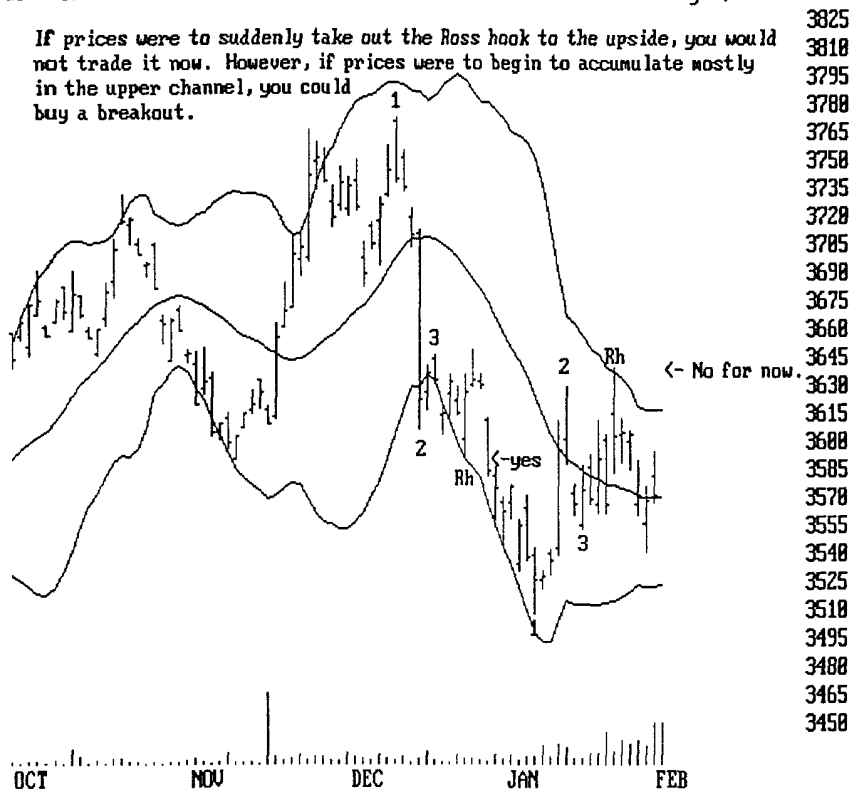
If you would like to take the breakouts of the number 2 point prior to the hook, it's okay. Just make sure prices have been predominately in the upper channel.

Personally, I do not take the 1-2-3's when I'm trading Ross hooks.

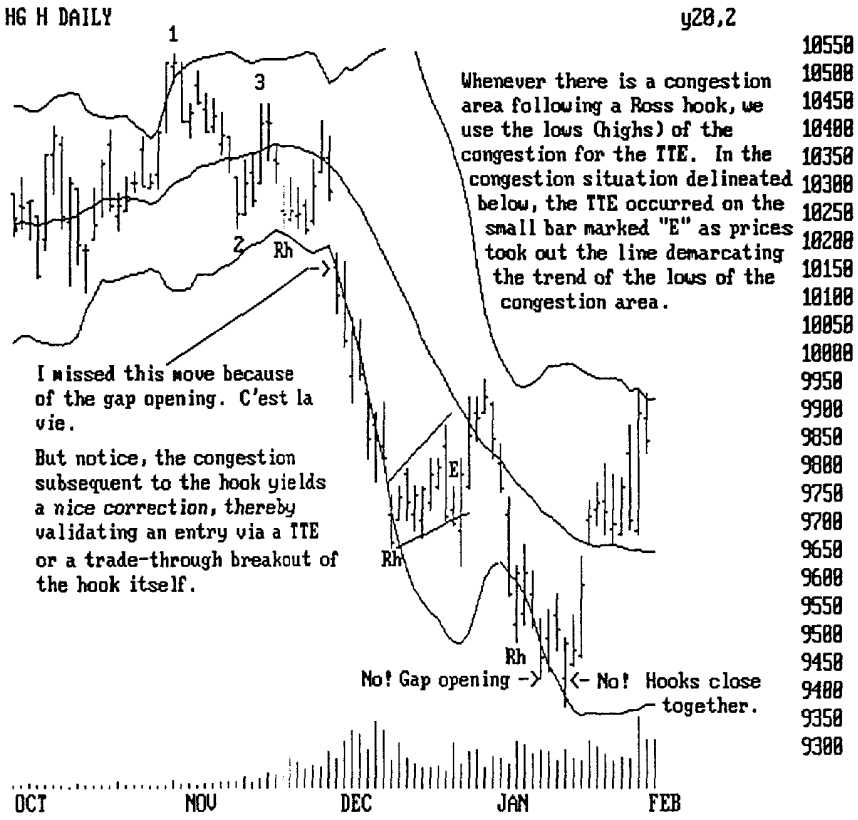


Sometimes you have to view 1-2-3's in context of their overall pattern. This one wasn't very clear. The bar labeled "ouch" took out an Rh (not labeled). Depending upon where your stops were and whether you entered that last Rh, you were hurt only a little or a lot.

When you're trading you never win them all. Obviously, day traders with live data could have done better here.

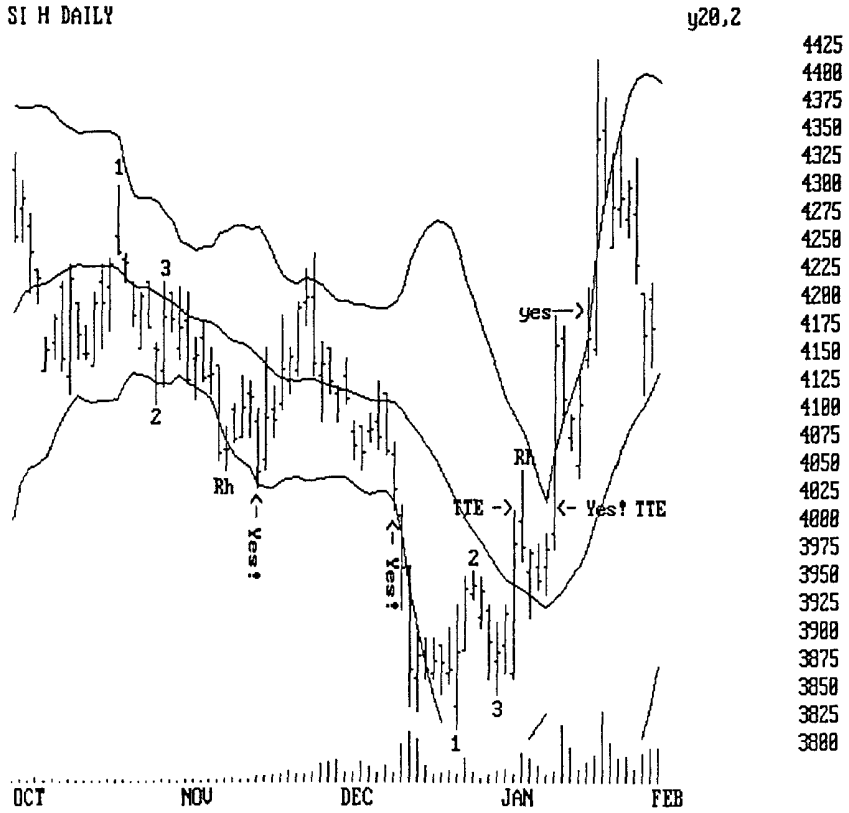


We wouldn't take the trade NOW because prices have not accumulated in the upper channel. Taking the trade now would be going against the trend. The odds are overwhelmingly against success. Prices are at the upper band of the channel and the trend of the upper band has been steeply down. If prices would accumulate in the upper channel, the upper band would turn as it's starting to do. Another bar or two in the upper channel and the opportunity would change to a good one. A take out of the Rh at this point may do nothing more than confirm the congestion.

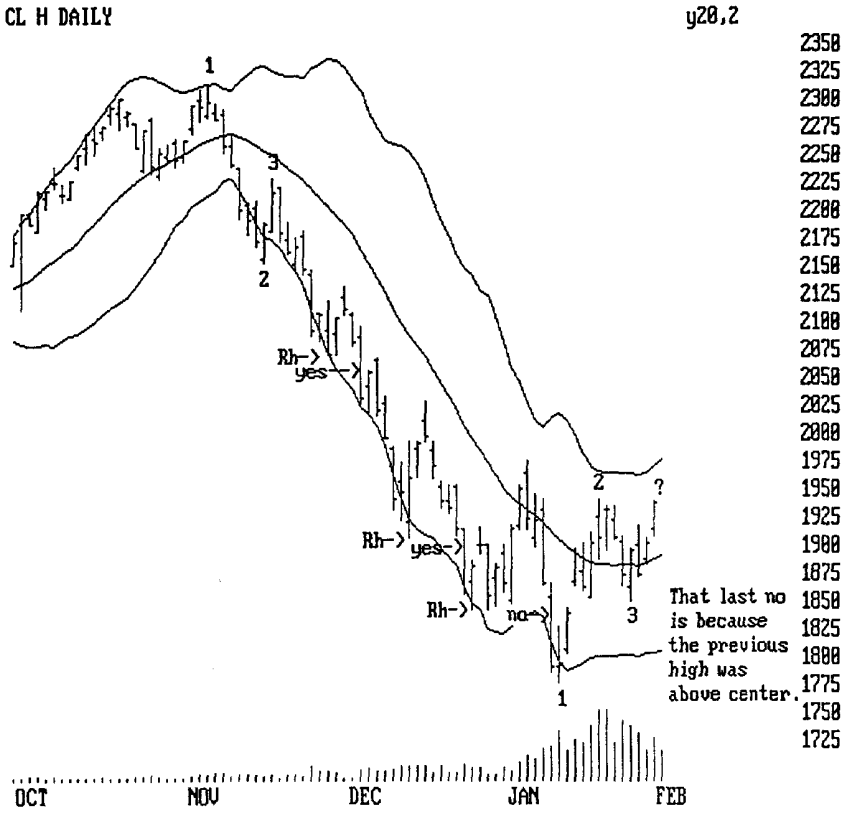


On the above chart, a congestion area is delineated by the upward slanting lines. It qualifies as a congestion area due to the alternating bars in which opens and closes go from low to high and high to low.

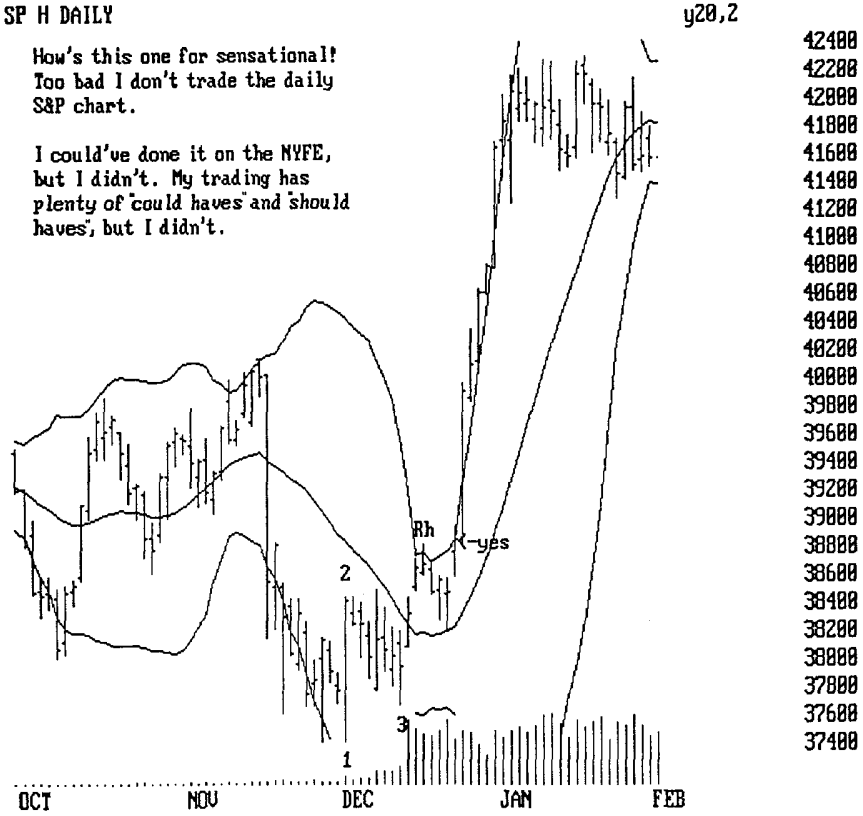
NOTE: When Ross hooks appear very close together, you are often about to enter a major congestion, or you are going to get a trend change.



An important thing to realize when trading with the Bollinger Bands is that the price action takes precedence over the Bands. Once you have a tradable formation inside the bands, you trade it.



Remember, we want prices to be predominately below the center line in order to consider going short on an Rh signal, unless price action gives us a tradable formation. In the case of that last "no", we do not have a tradable formation.


SP H DAILY
y20,2
How's this one for sensational! Too bad I don't trade the daily S&P chart.
I could've done it on the NYFE, but I didn't. My trading has plenty of "could haves" and "should haves", but I didn't.
Rh
<-yes
1
2
3
OCT
NOV
DEC
JAN
FEB
42400
42200
42000
41800
41600
41400
41200
41000
40800
40600
40400
40200
40000
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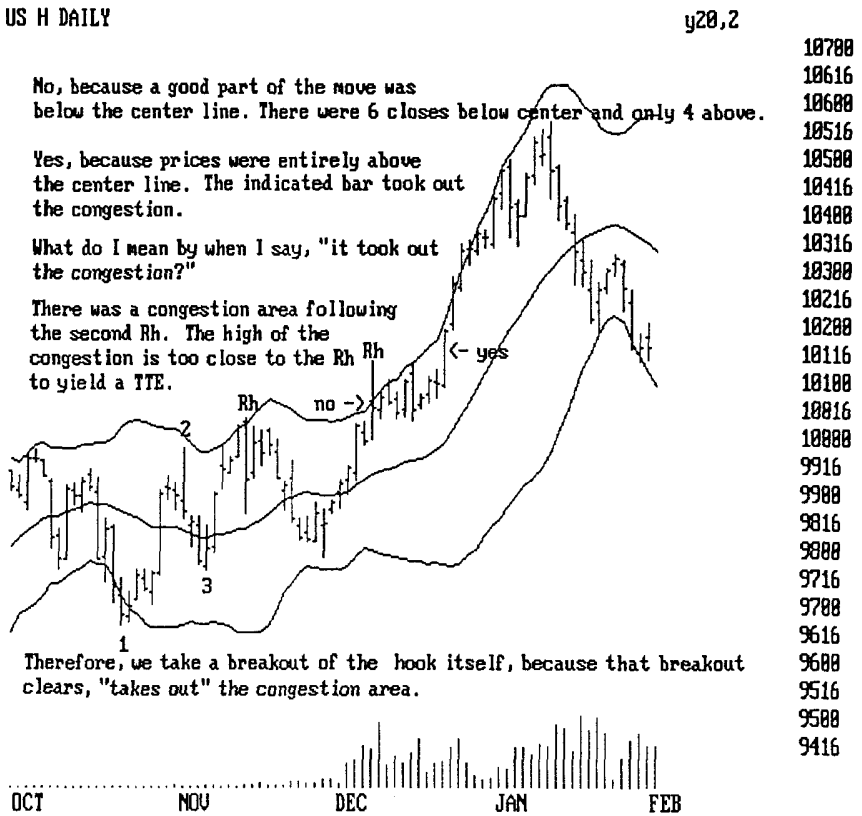
38600
38400
38200
38000
37800
37600
37400


US H DAILY
y20,2
No, because a good part of the move was below the center line. There were 6 closes below center and only 4 above.
Yes, because prices were entirely above the center line. The indicated bar took out the congestion.
What do I mean by when I say, "it took out the congestion?"
There was a congestion area following the second Rh. The high of the congestion is too close to the Rh to yield a TTE.
Rh
no ->
Rh
<- yes
1
2
3
Therefore, we take a breakout of the hook itself, because that breakout clears, "takes out" the congestion area.
OCT
NOV
DEC
JAN
FEB
10700
10616
10600
10516
10500
10416
10400
10316
10300
10216
10200
10116
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9600
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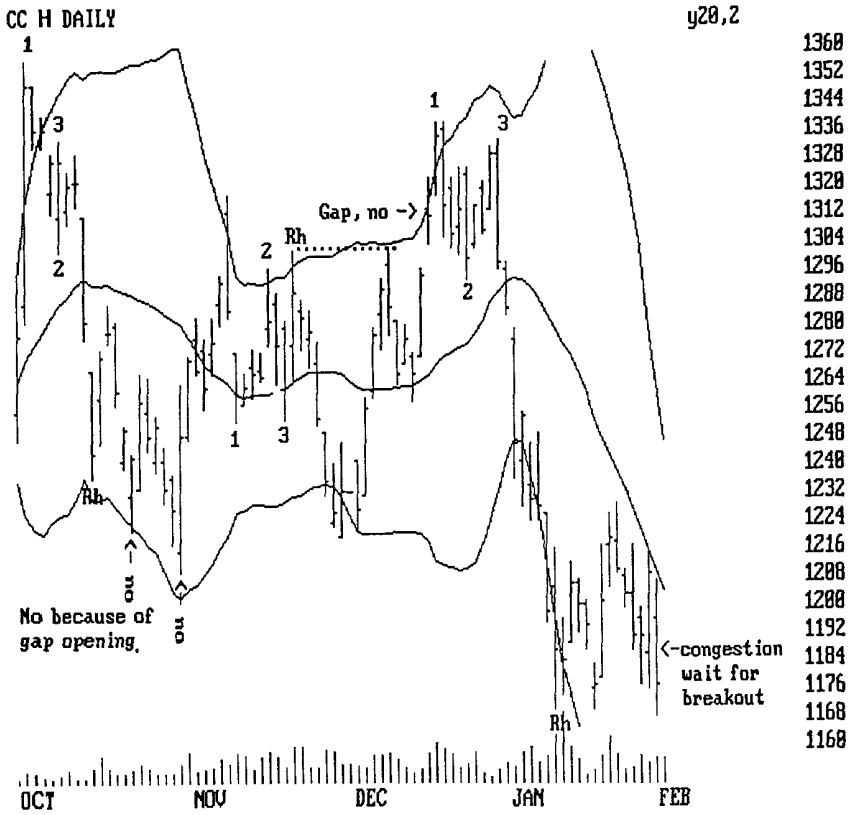
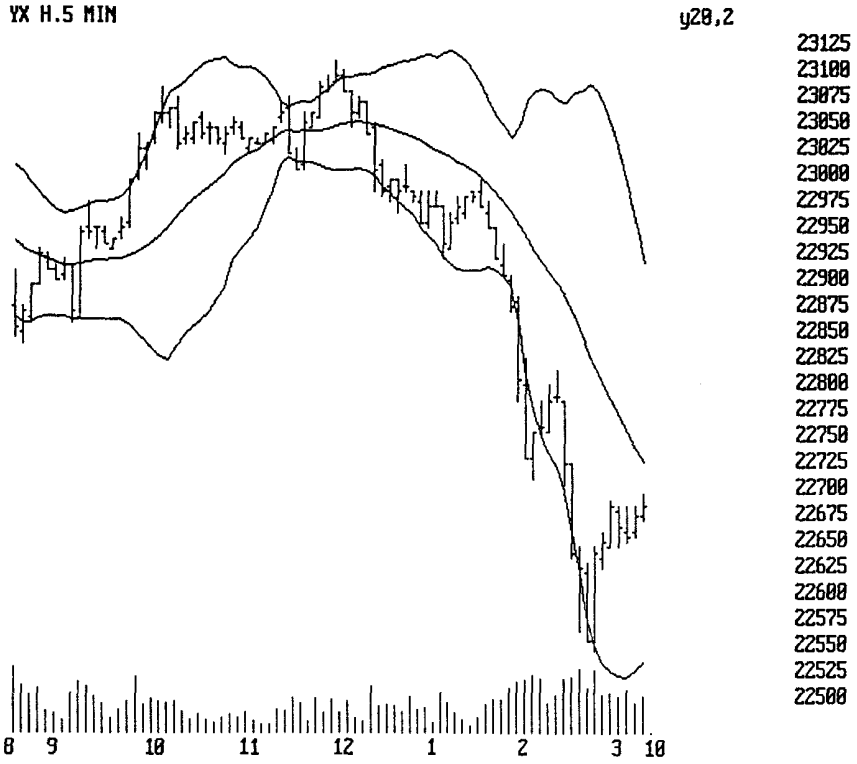
9416



On the upper part of the chart, notice that the upper band is fairly flat to rising. The upper band is not in a downtrend. The latest prices are mostly in the upper channel. A breakout of the Rh signals an upside move as opposed to a correction.

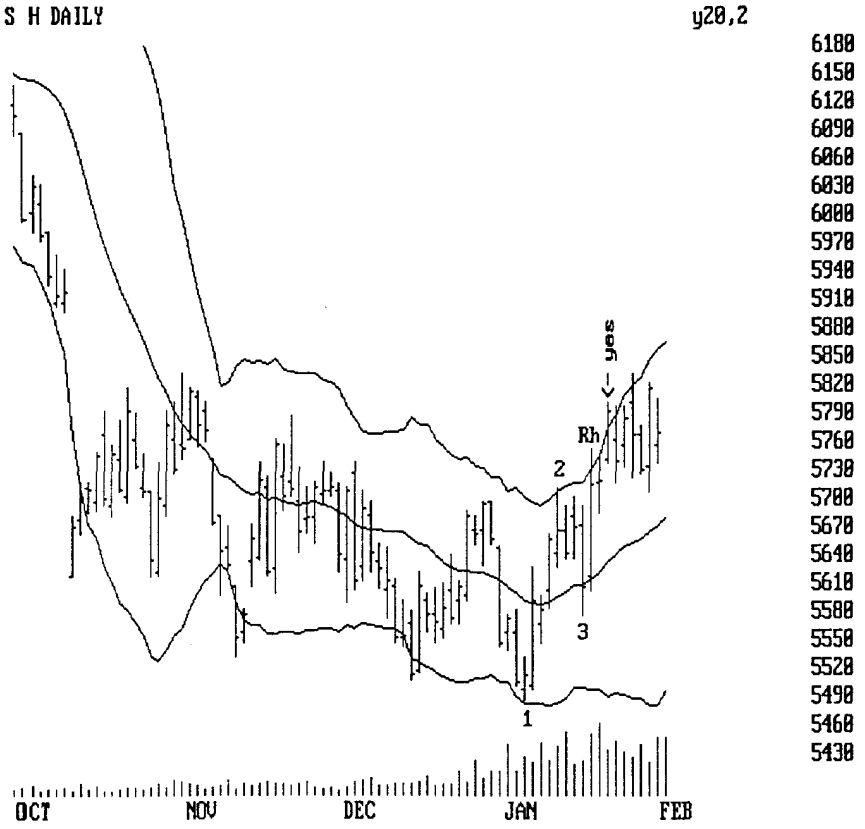
Be patient, wait for a breakout of the lows at the right-hand side of the chart. We would want to see a breakout of the lowest low (the Rh) by about 3 ticks to be sure of the breakout. Another way to know if there is a continuation of the downtrend is if the breakout is preceded by a strong down move or gap.



On this chart there was 1-2-3 high prior to the first Ross hook shown. Unless you are in early on a stair-stepping market, it's best to stay out of them using most trading techniques.

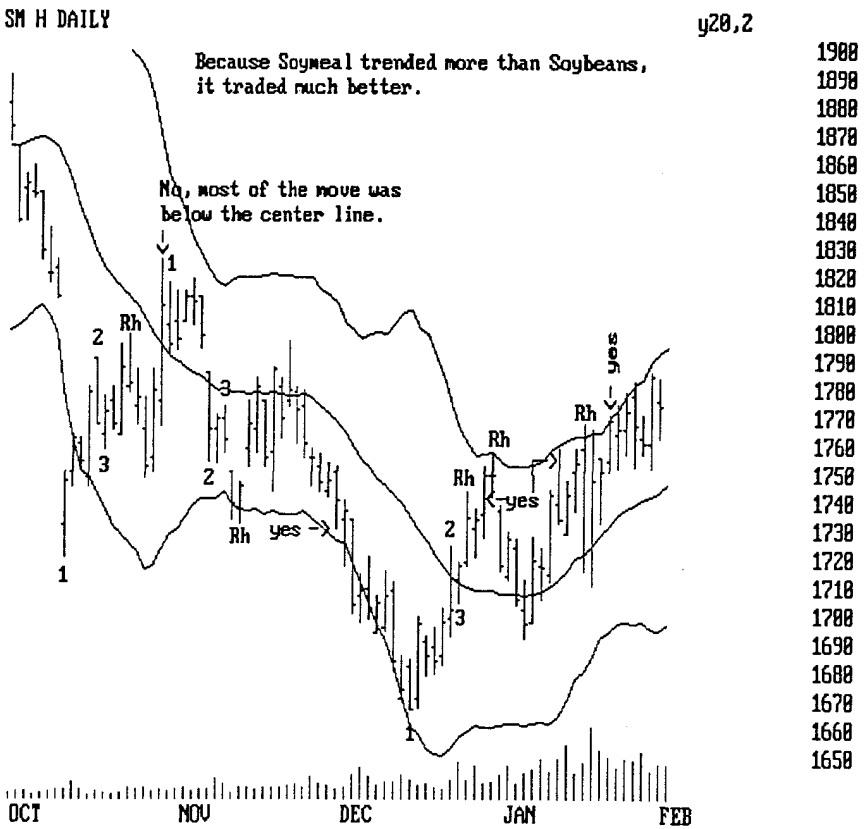
If you happen to get in early on the move, then maintain a distant stop and let the market run. It usually will run far longer than you might expect.

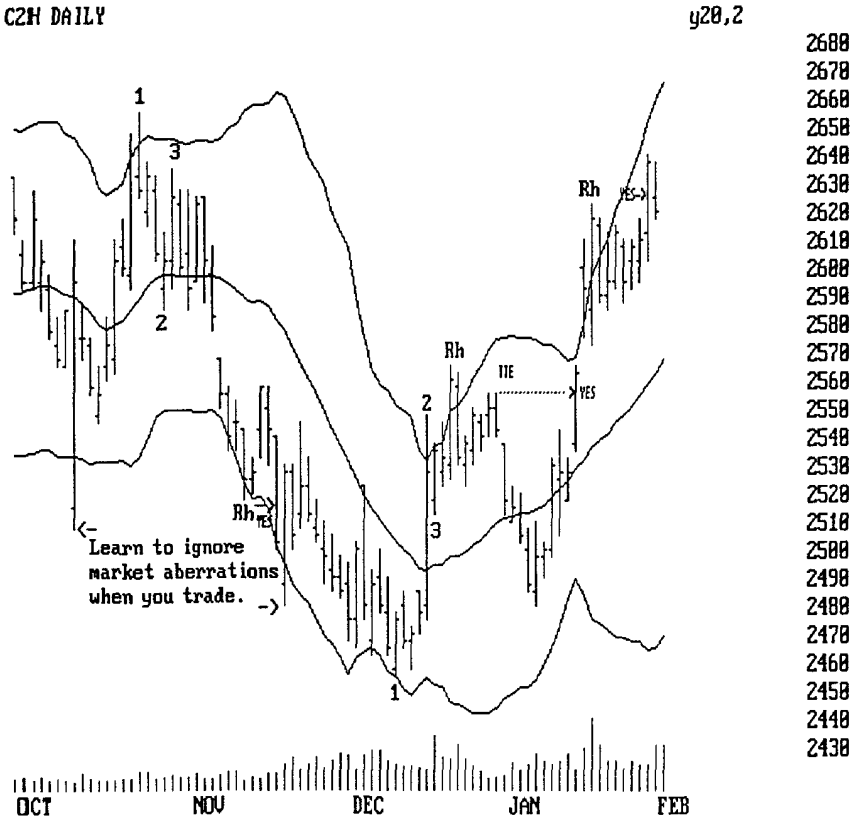
Silver, from 1987 through 1991, stair-stepped in just this manner. In **Trading by the Book I** showed how to trade this kind of market under the subject of ledge trading.



I didn't see any other moves on this chart, did you?

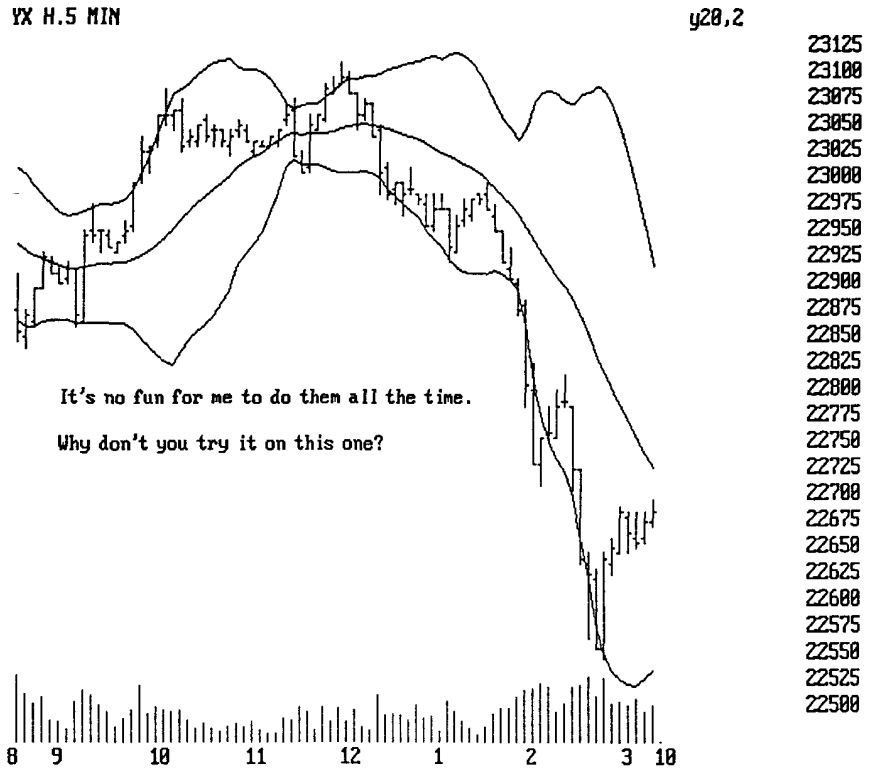
Hooks are best traded in trending markets.





One of the best lessons I ever learned was to ignore price aberrations in the market. When some weird political event, announcement, news, or rumor causes a one or two day abnormality in the markets, look to where the real price action is and design your trades from that reality.

Now let's look at an intraday chart. I get tired of watching the S&P all the time. For a change, let's look at the New York Stock Exchange Index.

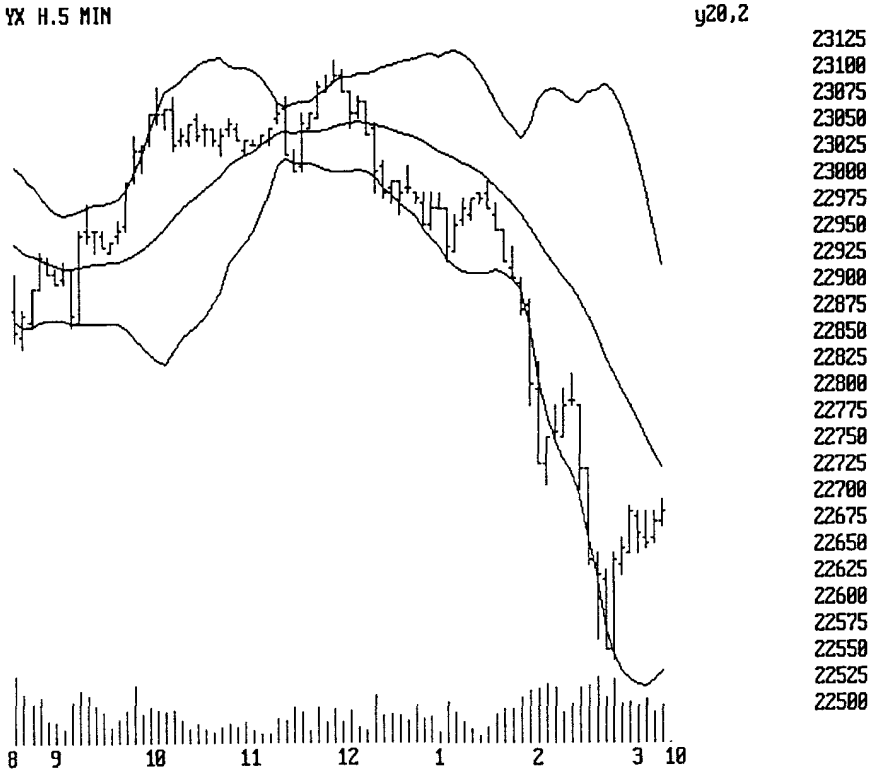


You should have found at least one good trade on that chart.

Rather than try to set a number of rules around trading with the Bollinger Bands, it seems to me it's better to give you the overall approach.

What we're really looking for is to catch a trend just as it starts.

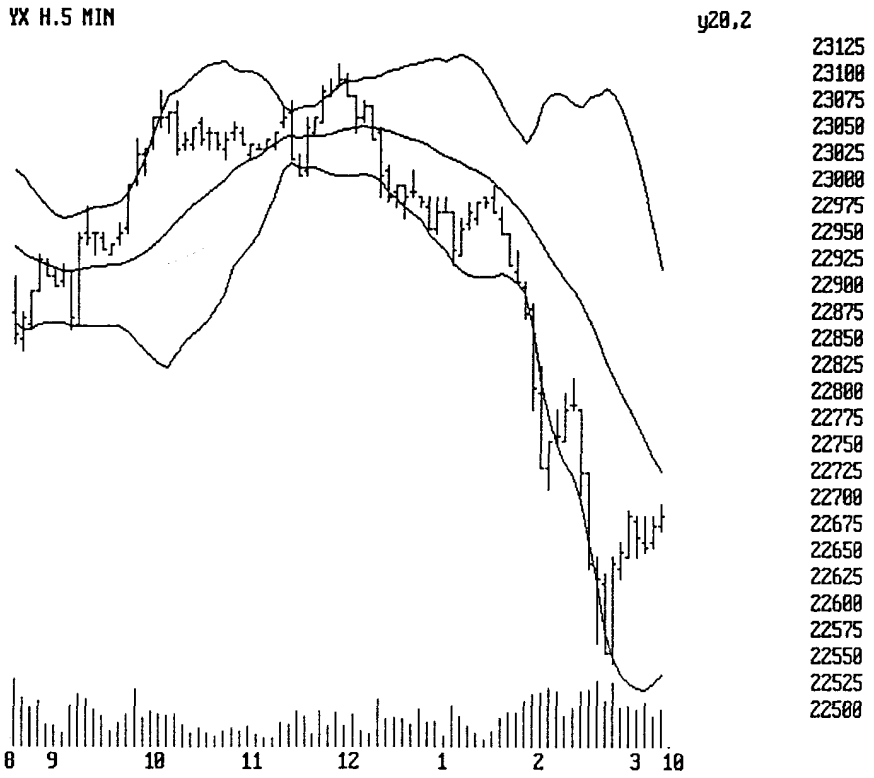
Typically, the market will have been in a trading range of some sort, and we want to catch it as it breaks out, or shortly thereafter.



Once the bands start trending, we can expect them to continue to trend for awhile.

What we look for first is a market that is in congestion. Next, we look for prices to begin to cluster on one side of the center line. When that happens, we anticipate a trend in the direction of the side of the center line on which the cluster begins to form.

If the cluster is above the center line, we anticipate going long. If the cluster is below the center line, we anticipate going short.



Usually, a Ross hook will have been made somewhere along the way, very often just at the start of the cluster. When that hook is taken out, with prices having remained predominately on one side of the center line, we can take the trade.

In the preceding examples, I purposely included some markets which were already trending. As you can see, once the market begins to trend, the Bollinger Bands don't do much good.

Please note that I tried to mark and take just about everything possible. This is not the way I would normally trade. In fact, this is over trading.

Each market is shown as if it were the only game in town. Of course, if you regularly trade just one market, you may have to use additional filters for your trades.

In the examples above, I did not use any filters other than the bands themselves. In actuality, I could use The Study, and CCI to filter many of them.

Another thing I want you to realize is that I most certainly didn't trade most of the situations shown in the examples for this chapter.

I did not attempt to show you where to put your stop. You should find all the information I can possibly give concerning stop placement in the chapter on stops and in the chapter that follows.

Chapter 17

Vanilla Hooks

I've spent a good deal of time and space showing you how to use and trade the Ross hook along with some of the more popular indicators being employed by some of my students.

In this chapter, I'm going to show you how I trade the Ross hook with no indicators or oscillators of any kind.

I traded and still do trade Ross hooks this way. It's my favorite way, it brings me my best results, and you need nothing more than a simple chart. As a matter of fact, all you really need is a newspaper! The chart is there for visual confirmation of the truth that I have found in the markets.

I'm going to prove to you conclusively that my method works. It has been working for me for virtually all of my trading career. You can take data going back over one hundred years and prove that it has worked consistently for that length of time.

During the years I have traded, the markets have undergone considerable change. When I began my career, futures trading consisted primarily of trading in contracts that centered around things people consumed: plywood, oils, meats, and food items.

Later, metals, currencies, financial instruments, and the stock indices were introduced. New contracts are still being presented, until there is now a plethora of contracts in which to trade.

Gone are such futures markets as potatoes, onions, and ocean freight. Reintroduced, but not much traded, are broilers and sorghum.

I have seen markets come and go. I have seen traders come and go, and yet the methods that have consistently made me money are still there. They have not failed me.

I have seen the trading community go from a few thousand traders worldwide, to many thousands, perhaps millions of traders worldwide.

This has changed the nature of the markets, but still my way of trading the Ross hook works.

I have seen the introduction of computerized trading utilizing models, programmed trading, intraday trading by computer from one's home, the concept of intraday charts down to the tick level. Still none of these have caused me to change one iota from the way I was taught to trade or from the truth that is extant in the Ross hook.

I have seen what had been orderly trending markets turn into frenetic, jittery, temperamental markets due to introduction of many of the items mentioned, yet plain vanilla, simple trading of the Ross hook has never had to be changed.

If you detest complicated trading, as I do, you are in for a treat.

If you are tired of all the phony hype about "this indicator" or "that oscillator," this chapter is for you.

If you are worn out by backtesting of mechanical systems, multiple modification of parameters, and complicated technical analytical striving, then you will have found what you are looking for.

If you are angered or bored to tears and frustration trying to make sense out of Elliot Waves, Cycles, Seasonals, Astrological concepts, Andrew's pitchfork, Gann, Fibonacci, fractals, chaos, scale trading, or any of the myriad synthetic approaches to the markets, then you need to learn how I trade the Ross hook.

Am I now about to present you with the Holy Grail? No! I have been laughed to scorn by many of the so-called technical geniuses who peddle their wares in the markets.

When I presented the simplicity of the Ross hook to one of the great Fibonacci luminaries of our time, he snickered. He patronizingly told me about the magic of Fibonacci retracements.

When I explained what I do to another famous hustler (trader?) of a magic triple-ripple trading system, he laughed, and wondered aloud how such nonsense could ever work in today's sophisticated markets.

Although I have written over and over again about the simplicity of my trading, even my own students find it difficult to accept without modification what I'm going to show you in the chapters ahead. That is why they have introduced many of the concepts previously shown in this book. The combining of technical studies with the Ross hook is not my idea. They are ideas and concepts that work. However, in my opinion they are totally unnecessary.

I say this because the way I trade, such filters are nothing more than assistance, a help perhaps, if such a device is even needed. I wanted to share them with you because they work.

We do not all have the same orientation. We do not all see the markets in the same way. Certainly, with my dyslexia, I do not see markets as would most people. Since I cannot teach you how to become dyslexic, I have shown you successful ways that are used by my students. However, I do have students who are not dyslexic who use my "plain vanilla" methods with as great success as my own.

What I do with the Ross hook works. It has always worked under the conditions I have established for its use. It has withstood the test of time. It works in every time-frame for which I've tried it. However, it does not work in every time-frame for every market. This is because in the lesser intraday time intervals, a chart may not form properly to enable the visualization needed for trading the hooks.

Examples of this would be a five minute bond or five minute corn chart. These rarely make formations other than "boxy," flat charts, in which the same prices are hit repeatedly.

My solution to this is to simply trade a greater time-frame.

There is only one time when Ross hooks do not work, and that is when a market is not trending. Since, by definition, a hook cannot be formed when a market is not trending, this presents no problem. The Ross hook by its nature cannot and will not work in congestion, because it cannot be identified in congestion. How I trade in congestion is beyond the scope of this book.

The Ross hook cannot be identified until and unless a market is trending, or is about to trend. The identification of the Ross hook is simultaneous with the identification of an established trend.

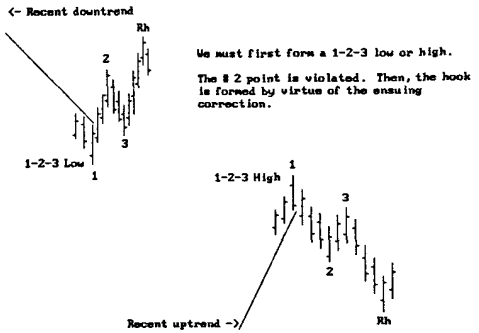
Let's look closely.

We must first identify a 1-2-3 high or low. On intraday, weekly, or monthly charts the 1-2-3 formation may consist of only three bars. On daily charts, it's better to have at least four bars comprising all three points.

We must next form a Ross hook.

No matter what happens in the market, we cannot consider that we have a trend reversal until and unless we form a 1-2-3 high or low in the direction opposite to the recent trend.

Once we have had a trend reversal, we can trade the Ross hook that establishes that reversal as a new trend, and any subsequent hooks. I will now illustrate what I have discussed to this point in the review.

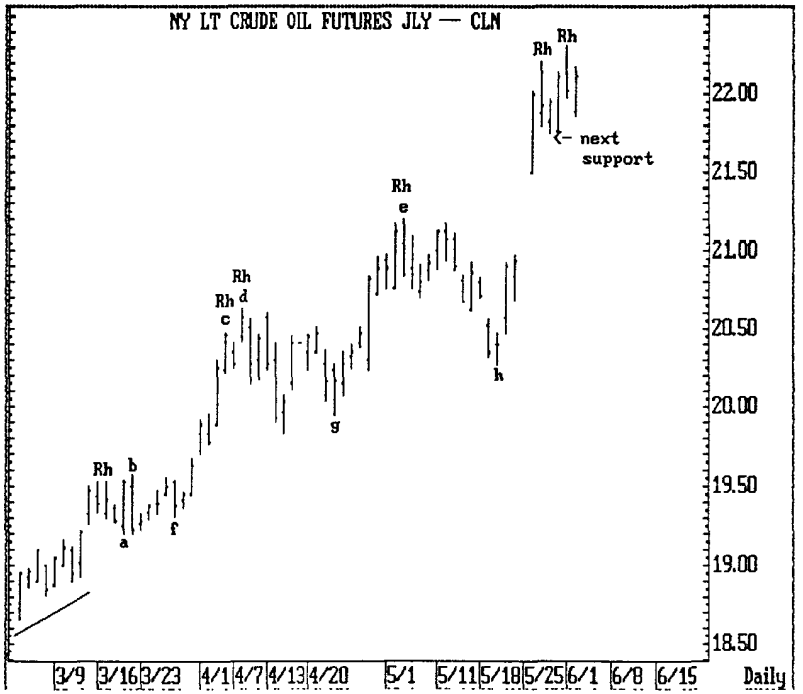


Now, allow me to answer some simple questions:

1. Where do I place the stop?

When trading without technicals such as the Volatility Stop study, I use only natural support and resistance points. The next series of charts will show where I place the stop, coupled with my money management scheme.

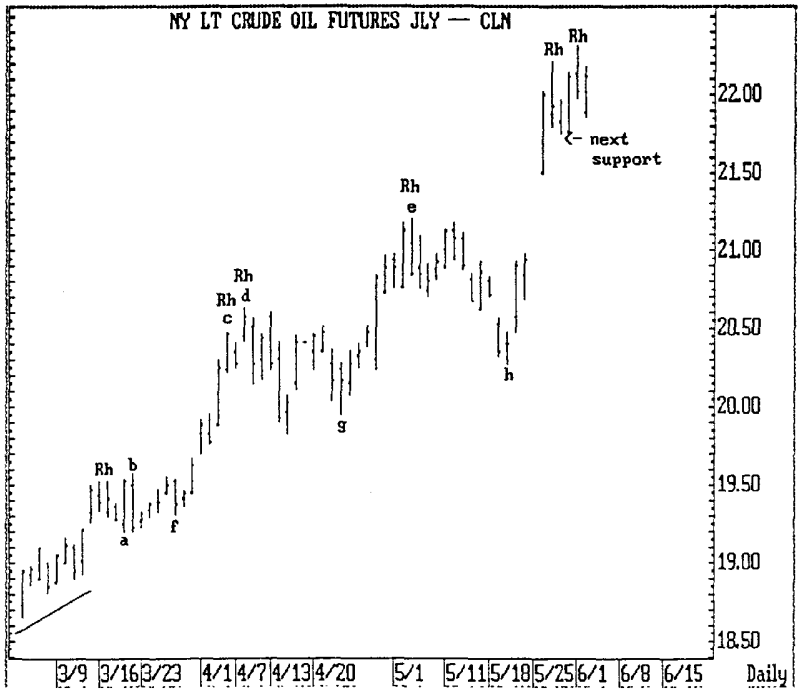
I'll be showing charts in time-frames from monthly down to five minute.



As soon as possible after entry, I use one contract set to cover my costs.

Now let's look at a sequence of events. When the bar labeled 'b' takes out the point of the Rh, I place a stop one tick beneath it at 'a'. Since 'a' made a new low, and then bounced, it is now support.

I will be going into further detail about ***when*** to move stops later on. At this point, concentrate on the ***where*** of natural support and resistance.

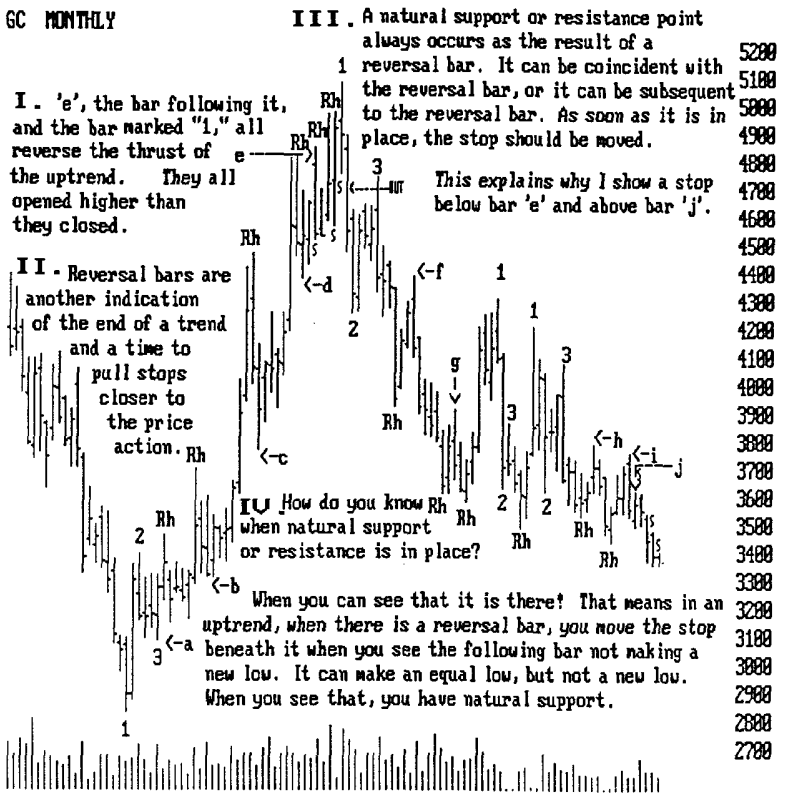


Bar "b" did two things: it took out the hook, and became double support because it has the same low as "a".

When the point of the next Rh, 'c' is violated, I will move the stop to one tick below 'f'.

When the point of the next Rh, 'd' is violated, I will move the stop to one tick below 'g'.

When the point of the next Rh, 'e' is violated, I will move the stop to one tick below 'h', etc.

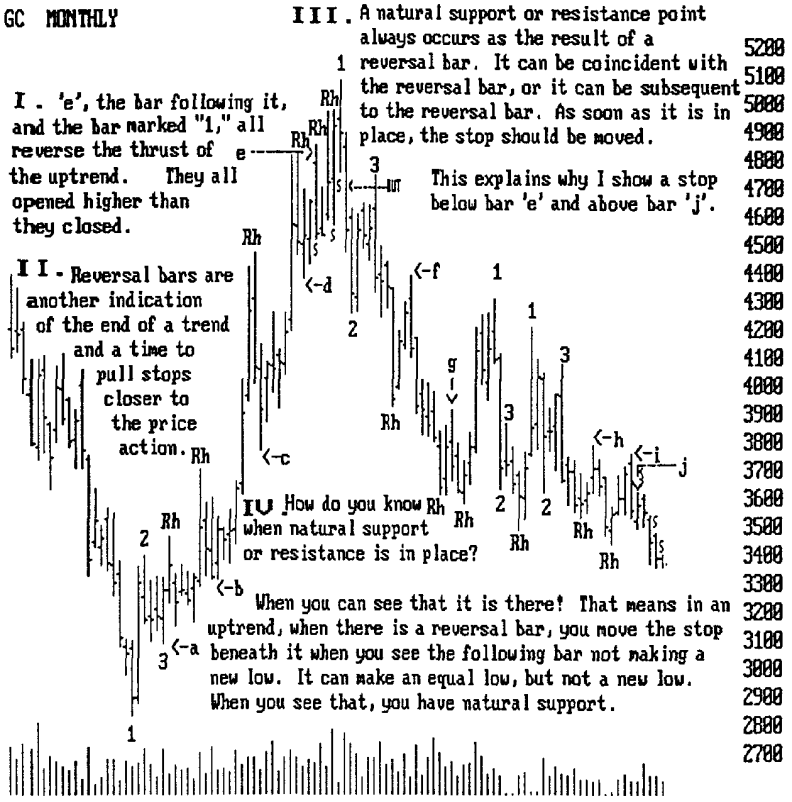


Let's go through the above monthly Gold chart in great detail. We'll start with a 1-2-3 low. Subsequently, we have a Ross hook. When the hook is taken out, we place a stop at 'a' which is a natural support point consisting of two equal lows.

Next, we make another Ross hook. When it is taken out, we place a stop at 'b.' This process is repeated at both 'c' and 'd'.

Notice, beginning with the reversal bar 'e' the hooks are forming at a much greater frequency. The market makes its last move up. The trend is about to end due to exhaustion. The market is running out of buyers.

Consequently, we begin to move the stops, '*s*', up tight. We trail them just below the low of each month until we are stopped out.



Subsequently we make a 1-2-3 high followed by a Ross hook. We trail our stop at natural resistance points, 'f' through 'j'.

Then the hooks begin coming close together, one right after another, and the angle of descent has flattened out considerably, typical of bottoming/topping or congestion. We are, at least for the moment, running out of sellers. We then start to trail our stop, '*s*,' just above the high of each month.

Now, with reference to natural support and resistance, some will ask:

A. *"Why did you show this using monthly charts?"* I use monthly charts for the following reasons:

1. Some of my readers and certainly some of my students can afford to trade the monthly charts. They have become seasoned, patient traders, and add monthly chart trading to their regular trading activity — yes even some of my students who daytrade the S&P on a three minute chart can find time to pick up these beautiful monthly trends!

2. I will not penalize the trader with deep pockets in favor of the trader with a small account.

3. The opportunities with Ross hooks are numerous if you have a long-term outlook on markets.

4. Too many traders have gotten away from the monthly chart in favor of the daytrading mania that has taken hold of the trading world. For those who can afford to trade the monthly charts, and refrain from doing so, you are missing out on a lot of fat profits.

5. For those who daytrade, please notice that with the exception of the amount of money involved, the price action on the monthly Gold chart is not at all unlike a five minute S&P chart.

B. *"How can you afford to keep the stop so far away?"*

By patiently building an account to a size suitable for trading monthly charts.

C. *"How can you afford to keep stops at natural support or resistance?"*

By reducing the time frame in which you trade to an affordable level. This means that if you have a very small account, you may have to trade a one or two minute chart.

D. *"Are there problems with trading a one minute chart?"*

Not if you position trade. Problems with one minute charts arise only when trying to scalp the markets. In those instances, turn-around time becomes critical.

E. *"Are some hooks better than others, and if so, which are the best?"*

Some hooks are better than others, but I have never been able to determine ahead of time which they will be. Sometimes a shallow retracing hook does best, but all too often deeply retracing hooks do best.

F. *"How can you get in early, ahead of the breakout?"*

1. I've already shown one technique for doing this, the Trader's Trick.

2. My friend Doctor Steve Slaughterbeck has come up with another that statistically has proven to be of great value. I'll illustrate that next. It has been tested over thousands of occurrences.

The bar that has the letter 's' beneath it had a slightly higher close than the open. We want to sell a breakout of the low of that bar. 's' stands for Steve or Slaughterbeck, and refers to his entry point.

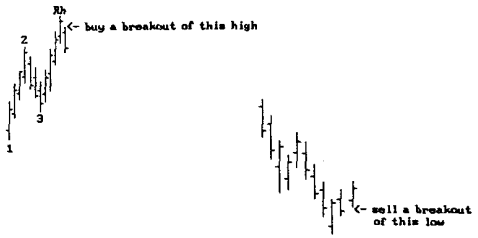
In a downtrend, when we have a correction that forms a hook, we want to sell a breakout of the low of the first bar subsequent to the point of the hook whose close is higher than the open.

In an uptrend, when we have a correction that forms a hook, we want to buy a breakout of the high of the first bar subsequent to the point of the hook whose close is lower than the open.

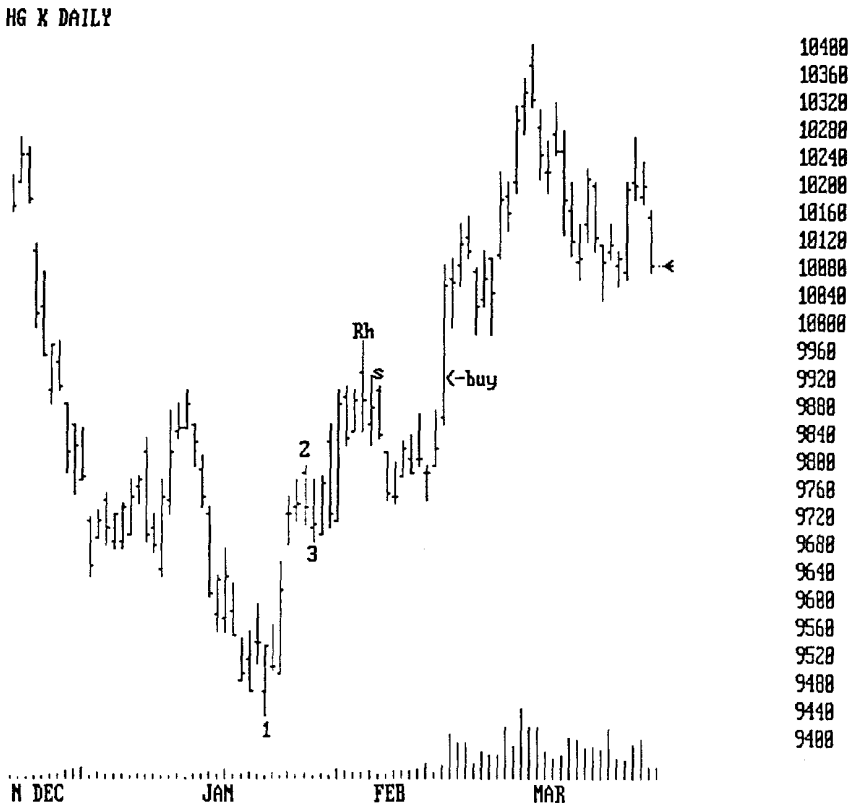
There can be only one SE. It is always the first bar that reverses the open and close, counter trend. It can happen on the first bar, the second bar, or the third bar of correction. Beyond that it is void and you would go to the TTE.

I'll show you two examples, and then we'll look at some charts.

In an uptrend, when we have a correction that forms a hook, we want to buy a breakout of the high of the first bar subsequent to the point of the hook whose close is lower than the open.

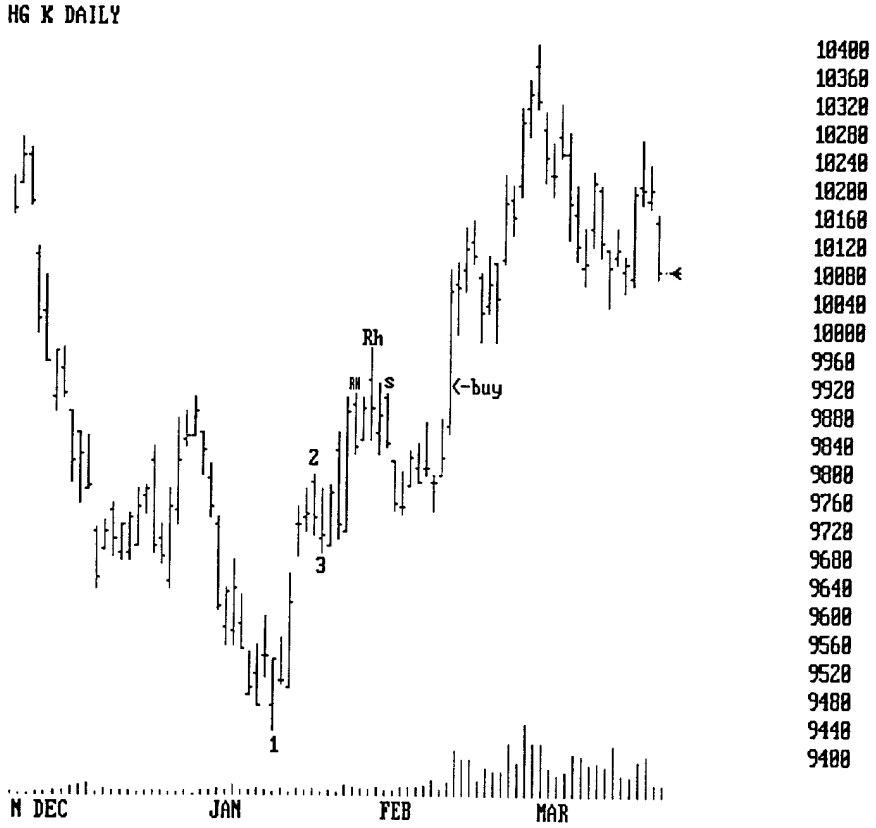


In a downtrend, when we have a correction that forms a hook, we want to sell a breakout of the low of the first bar subsequent to the point of the hook whose close is higher than the open.



The Slaughterbeck entry can be used as a filter, we don't take the hook unless we get one! The choice, of course, is yours.

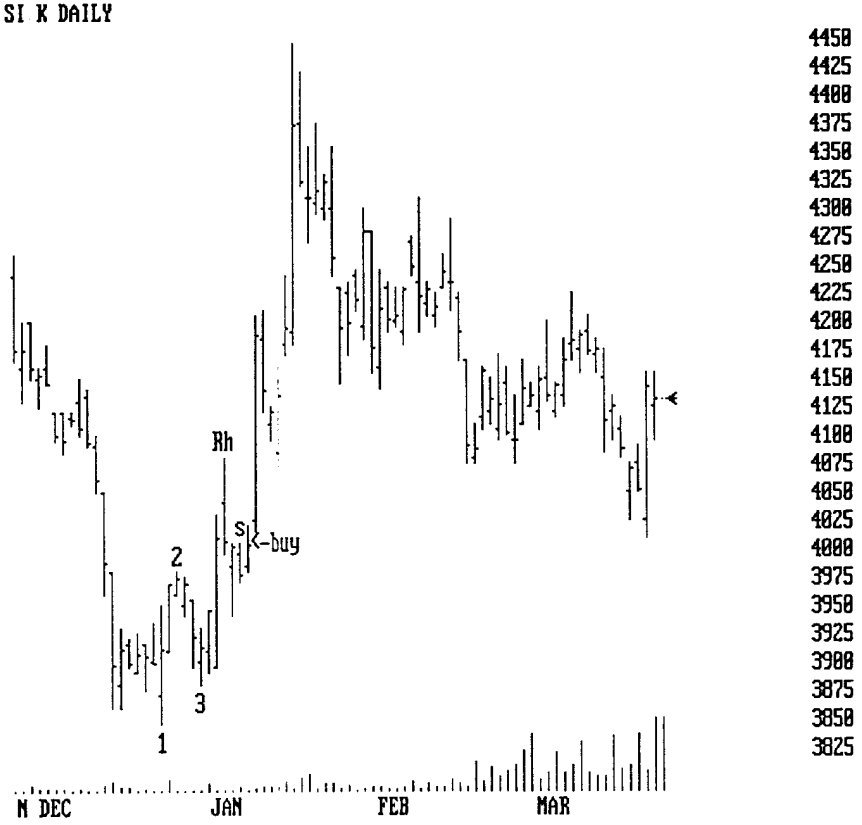
In the preceding example, there was a Ross hook prior to the one shown. Did you catch it? I'll show the chart again. But because we did not get a Slaughterbeck entry point, we did not take a breakout of the hook.



Because thousands of tests have shown that the Slaughterbeck entry works so well, it can actually be used as a filter for hooks. You have the choice of taking the point of the hook, the Trader's Trick, or the Slaughterbeck entry.

Naturally, you will miss some good trades, and some will turn out to be not so good even though you waited patiently for the Slaughterbeck entry to develop. But overall, you will win a higher percentage of the time following this entry point.

Sometimes you simply have to choose based on other things you see on the chart, or even on the chart of related contracts.

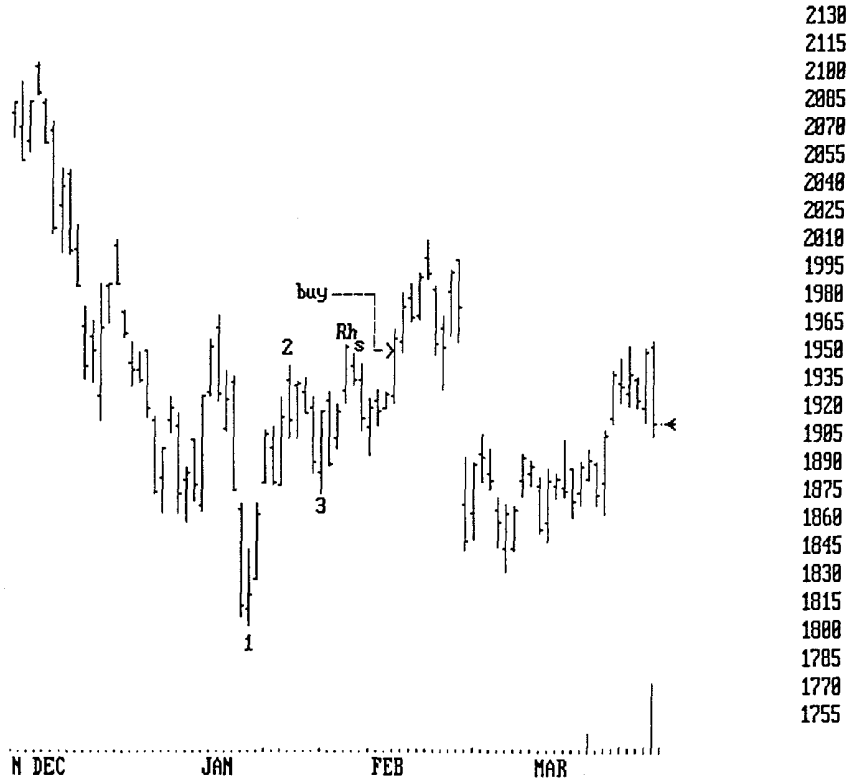


I'm not going to try to show you every trade on these charts. I simply want to point out the obvious 1-2-3's, followed by Ross hooks with a Slaughterbeck entry point.

Remember, the bar that makes the point of the hook cannot be considered a Slaughterbeck entry point. At times, it may be the only bar that meets the criteria. In that case, you will want to consider trading a breakout of the point of the hook itself.

Does it matter that I've been showing the Slaughterbeck entry only on daily charts? No! You can see these on charts of most any time frame. Later I'll show some intraday charts, and in another chapter I'll show some weekly and monthly charts.

CL K DAILY



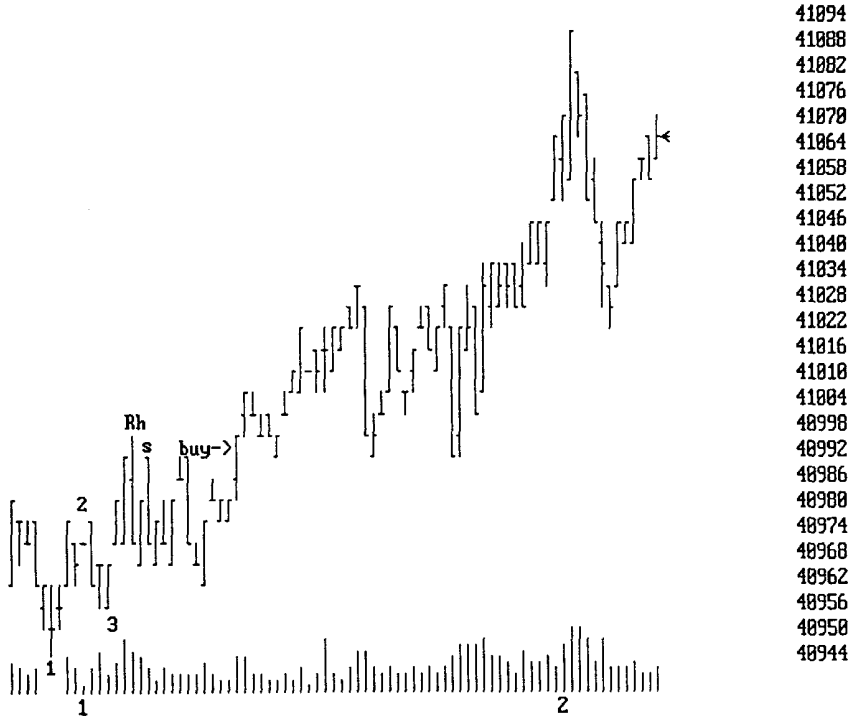
The Slaughterbeck entry point is present for the Ross hook, and the trade would have resulted in a profit provided you had exited all positions prior to the huge gap down that followed some days later.

No, we don't win them all. Even when we are right, we can end up wrong. But if you had followed my management scheme you would have come out okay. You would have banked ticks from the #2 to the #3 point. You would have covered costs. Hopefully you would have taken at least another profit when you saw the congestion, and perhaps even exited at that time.

Money and trade management have a lot to do with the final outcome of a trade.

I often will trade a one minute S&P chart. I do this to keep my risk very low. For some, it's the only way they can afford to trade the S&P. As long as you position trade on one minute charts, you will have no trouble with turn around time. It is only when you try to scalp on one minute charts that you can get in trouble. There is no way to keep up with the floor. They are faster than you can ever be.

SP M.1 MIN



"How can Ross hooks be traded from a newspaper?"

Investor's Business Daily, with its free graphs, make it possible. Another way is by keeping a columnar table containing the necessary information. Here's how to do it:

Record the daily, weekly, or monthly high and low for all contracts you wish to follow.

Notice when a contract is making consistently higher highs. As soon as the contract makes a lower high, you have a Ross hook. Call in an order to buy 1 tick above the highest high. Place a profit objective order for however many points you need to cover costs. This will result in your trading the breakout of the hook.

To use the Trader's Trick, refrain from placing an order as soon as the contract makes a lower high, unless there is room between the lower high and the point of the hook for you to comfortably cover costs. If not, place an order above a high previous to the point of the hook (up to three bars) that gives room to comfortably cover costs. Or, you can choose to wait for a lower high subsequent to the point of the hook that yields room to cover costs.

To use the Slaughterbeck entry, refrain from placing an order as soon as the contract makes a lower high. Keep track of the opens and closes. Place an order above the first bar after the point of the hook that has a lower close than the open. It's a good idea to be sure this bar leaves room to cover costs.

Notice when a contract is making consistently lower lows. As soon as the contract makes a higher low, you have a Ross hook. Call in an order to sell 1 tick below the lowest low. Place a profit objective order for however many points you need to cover costs. This will result in your trading the breakout of the hook.

To use the Trader's Trick, refrain from placing an order as soon as the contract makes a higher low, unless there is room between the higher low and the point of the hook for you to comfortably cover costs. If not, place an order below a low previous to the point of the hook (up to three bars) that gives room to comfortably cover costs. Or, you can choose to wait for a higher low subsequent to the point of the hook that yields room to cover costs.

To use the Slaughterbeck entry, refrain from placing an order as soon as the contract makes a higher low. Keep track of the opens and closes. Place an order below the first bar after the point of the hook that has a higher close than the open. It's a good idea to be sure this bar leaves room to cover costs.

Because I'm dyslexic, it was always a great chore for me to manually mark and maintain charts. The table made it easier for me to work until the time came when I was able to use a personal computer.

With the table, even a blind person can trade Ross hooks.

Chapter 18

Fine Points

There is a lot more to trading Ross hooks than you might initially think. I feel they are the single best trading formation I've seen in the markets when preceded by a 1-2-3 formation.

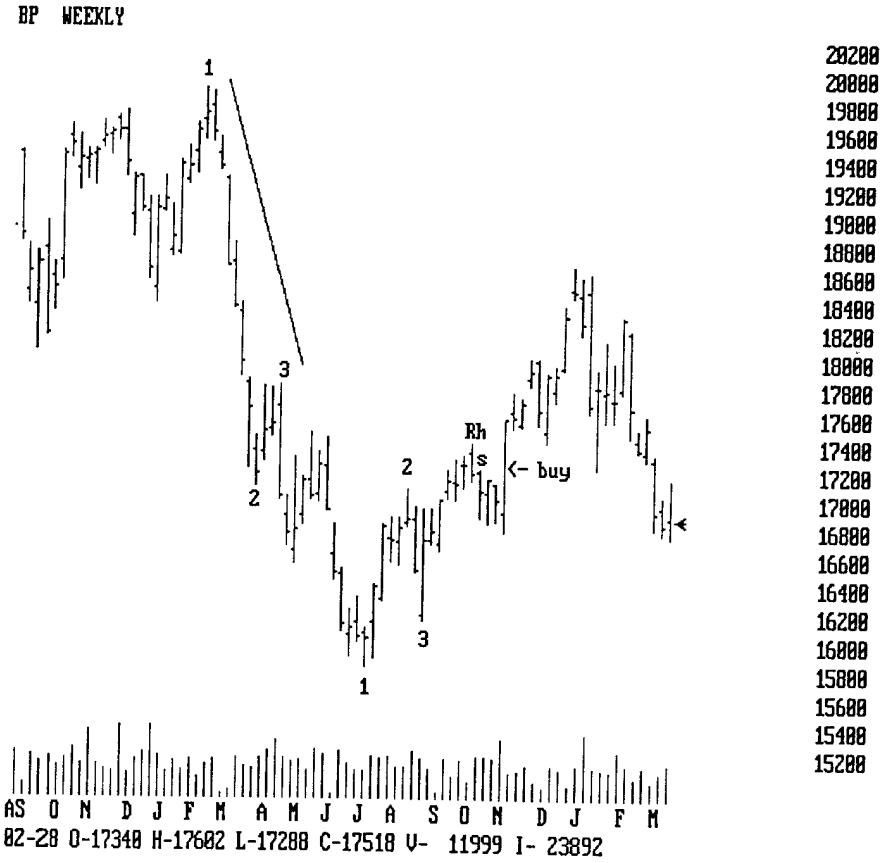
Ross hook trading can last from several minutes on an intraday chart to several months on a daily chart. They can be traded on weekly or monthly charts for long term trading.

I'm going to make some statements with regards to the following charts. What I say will help you fine tune your trading of Ross hooks. The things I point out will be true for trading in all time frames.

Be patient to trade from well formed charts. You want a well formed, clearly seen 1-2-3 to precede the hook.

Trade only in a time frame in which you can afford to place the stops according to the Volatility Stop study, or better yet, a time frame in which you can afford to place the stops at natural support and resistance points.

For some, that will mean trading a one minute chart. Yet I know that some of my more affluent readers and some of my large traders and commercial students can afford the natural support and resistance stops on the monthly charts.



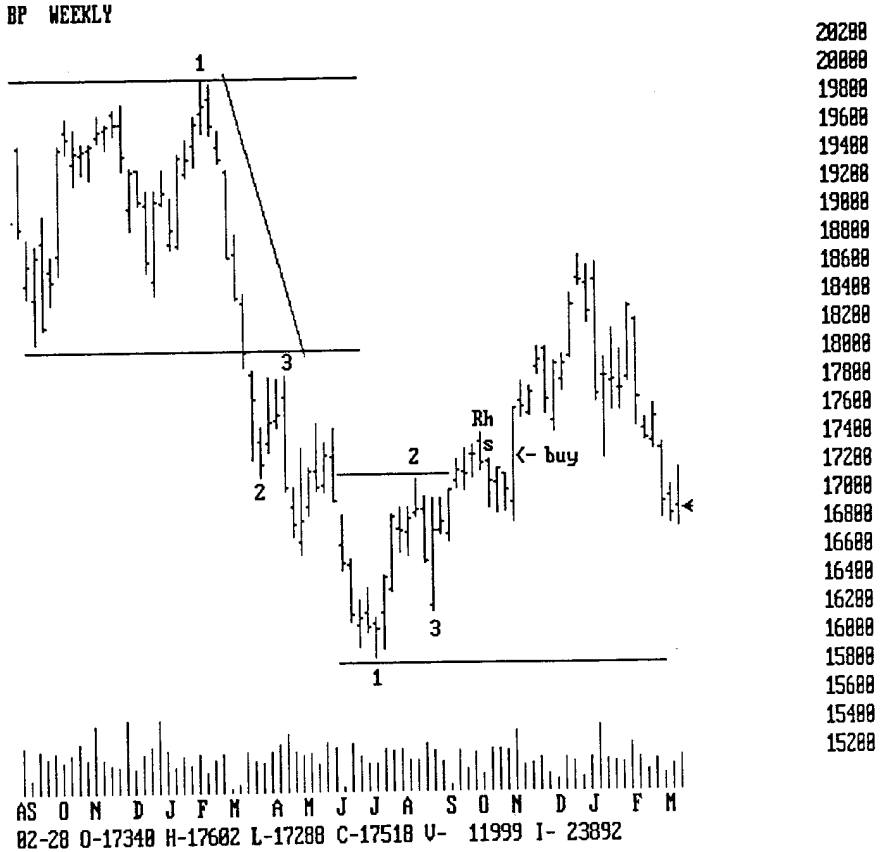
Avoid hooks that are made subsequent to a very long 1-2-3 formation.

The #2 point in the chart above is much too far from the #1 point. This causes the #3 point to be very short in relation to the move from #1 to #2. The best 1-2-3's are more proportionate, with the #3 point being anywhere from less than 1/3 to a 2/3 retracement from the #1 point to the #2 point. In other words, on the chart above, the 1-2-3 high preceding the hook is not well formed. However, the 1-2-3 low on the chart is reasonably well formed.

1-2-3 formations should be well formed and "tight." One way to tell this is to make sure the #2 point is contained within, or is formed just outside the most recent congestion.

The Slaughterbeck buy point (marked 's') gave a good entry.

I'll show you what I mean.

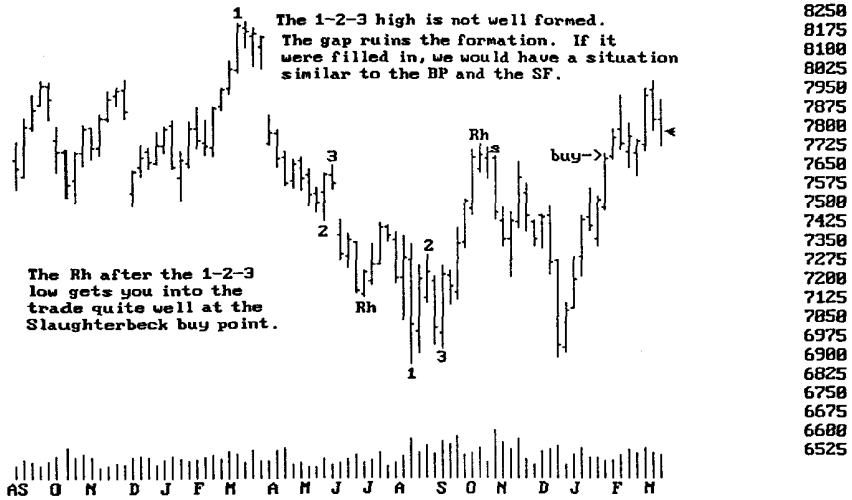


On the above chart, the #2 point of the 1-2-3 high is formed well below the recent congestion. The #2 point of the 1-2-3 low is contained within the recent congestion.

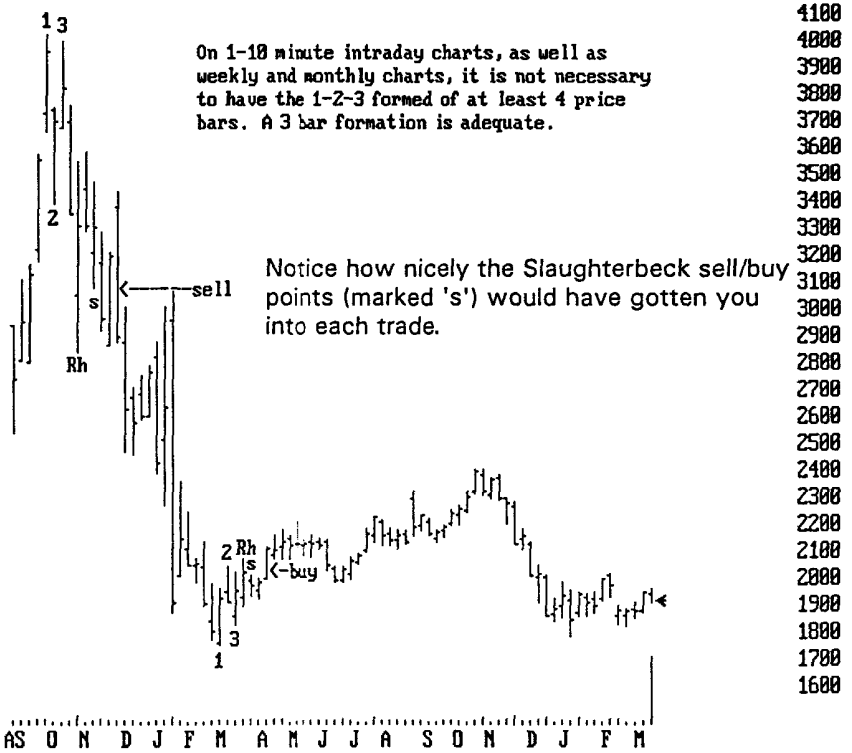
Now let's look at some additional charts. After all, the whole world doesn't revolve around the British Pound.

SF WEEKLY

LC WEEKLY



CL WEEKLY

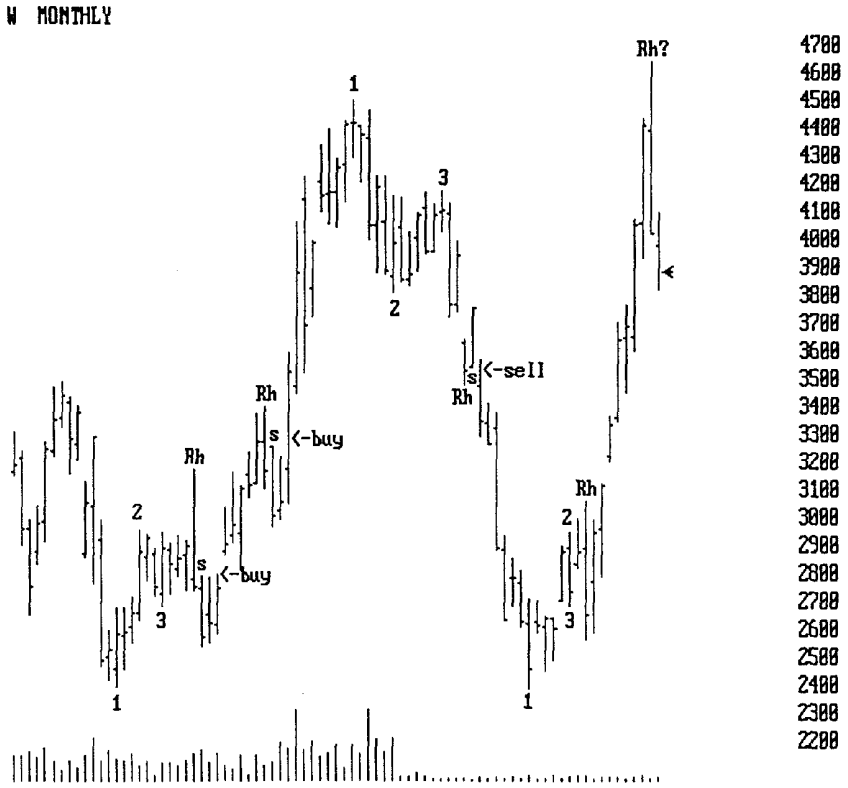


Although the Crude Oil chart above was a tough one to work with, the formations are clear and would have resulted in good trades.

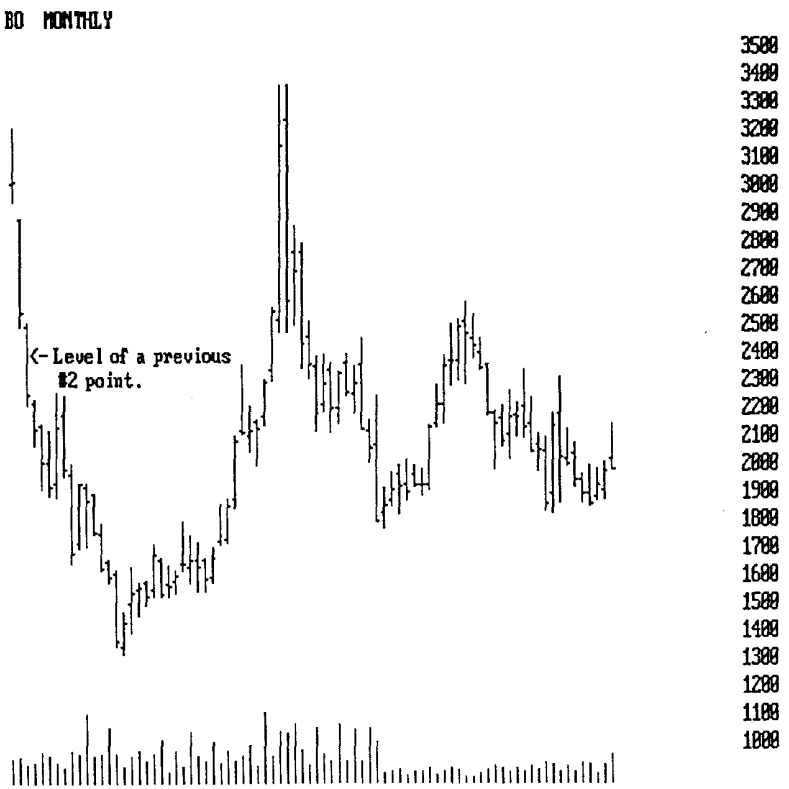
The only thing wrong with the 1-2-3 high is that the #3 point retraces more than 2/3 the distance from #1 to #2.

Notice that the #2 point of the 1-2-3 high culminates in what turned out to be a congestion area.

The 1-2-3 low, and the subsequent hook turn out just fine. A nice profit would have been made.



The Rh following the first 1-2-3 low has a Slaughterbeck buy point. The Rh following the 1-2-3 high has a Slaughterbeck sell point, but we miss the move due to the gap down opening beyond the trading range of the bar giving the Slaughterbeck entry. The third 1-2-3 (poorly formed, but there), followed by a Rh does not give a Slaughterbeck entry, but it does give a Trader's Trick entry. In the case of neither signal, we would trade the breakout of the hook itself.



This is your chance to practice. Write down everything you know about this chart. My own observations will be found in Appendix A. Hint: The chart began, prior to what is shown, with a 1-2-3 high. I marked the level of the previous #2 point.

Chapter 19

Plain Vanilla Money, Trade, and Risk Management

I've shown you how I trade the Ross hook without any oscillators or technical studies. Now, how do I manage my money, my risk, and the trade itself?

To my way of thinking, each one of these items, normally lumped together as "money management," are each separate entities and are to be treated as such.

Trade Management

Unless I can get a trade off properly, I have no need to be concerned with risk or money management.

These are the things I include in trade management.

1. Placing the entry order.
2. The type of order to use.
3. Placing the stop orders, both protective and objective.
4. Placing the final exit order.

Inherent in the above is my relationship with those who take and execute my orders.

I have very strict rules as regards trade management.

I write out each entry order on an order ticket before calling it in.

I tape record every order. I date and time stamp every order by verbally stating it on the tape.

I verbalize the fact that this is a recorded order.

My orders are like this: "Account 144, May 11, 9:15 A.M., this is a price order: buy 100 contracts of July Wheat, 369 3/4. If filled, sell 30 contracts of July Wheat 370 3/4, MIT.

The MIT order is my initial profit objective designed to cover my costs and give me a small profit.

I ask the order taker to repeat the order. That also goes onto the tape. I then play back the entire order process and double check what I said and what the order taker said, against my script.

I do this even when the broker also records orders.

Over the years, this has saved me thousands upon thousands of dollars by avoiding costly errors, arguments, law suits, and time spent quibbling over trades.

Whenever possible I use price orders. I use "or better," limit, stop limit, and fill or kill orders. On 100 contracts of wheat, I cannot risk slippage. Either I get my price or I don't want the fill. If prices move past me without a fill, I cancel. I do not like to be filled by prices moving back to my entry price, they are going the wrong way.

There are plenty of times that I'm not filled and the trade goes on to make a lot of money without me. I do not care. I follow my discipline and my rules. My price, or no price.

Someone will say, "But my broker won't take a price order on the CBOT." My advice is, get another broker. The traders on the floor at the CBOT **will** take a limit order, but only if prices are below the entry point if you go long, or above the entry point if you go short.

Not every floor broker will do this. It's up to you to find the ones who will.

When I am notified of my fill, I do one of two things depending upon how busy I am. 1. I place a protective stop order in the market. 2. I retain a protective mental stop, and place it quickly if things go wrong.

Risk Management

The things I include in risk management are:

1. Covering costs with an objective stop.
2. Timing and expectation.
3. Position apportionment.
4. Amount of risk and loss minimization

Most of the time, prices move my way sufficient for me to cover costs (commissions & fees).

If the market moves quickly toward my cost covering objective, I move my protective stops (2/3 of my position) to break even. In this situation, I usually cover costs with 1/3 of my total position. Since I've covered costs, break even means just that, I can do no worse than break even except for slippage. Once I've covered costs, if the market makes a serious move towards my breakeven stop, I will leave 1/3 of my position at breakeven, and liquidate 1/3 of my position so I am assured of a profit on that 1/3.

If the market pokes around and doesn't quickly move towards my cost covering objective, I will increase the number of contracts to 2/3 of my position at the cost covering objective. If the market continues to deny me my cost covering objective, I liquidate all contracts in an attempt to come out ahead, or at least minimize the cost per contract.

I want to make the next statement very clear: **I do not and will not risk more than $50 per contract when trading the Ross hook.**

I can live with many small losses, I cannot abide large losses.

What is the proper anticipation? Most of the time I will cover costs, and make a small profit. This will happen two out of three times. Of ten times that I cover costs and make a small profit, seven or eight of these trades will end there. Two or three times out of ten, the market will run and I will make a very substantial profit.

Of the times I lose, I try to minimize the loss and keep it at no more than $50. If I cannot watch the market, I will lose the $50 plus costs. When I can watch the market, I rarely lose as much as $50 plus costs. I am very quick to get out if things are not going my way.

When you win two out of three times, and keep your losses small, there is no way you are going to be a loser in the markets.

Money Management

Items I include in money management are:

1. Protecting profits.
2. Trailing stops.
3. Timing exits.

Once I am comfortably settled into a trade, have covered costs, and not had my breakeven stop taken out, I then trail a stop one of two ways: 1. I trail a 50% stop. 2. I trail a natural support or resistance stop. These can be intermixed.

If a natural support or resistance stop is greater than a 50% stop, I will use a 50% stop. I prefer to stay with a natural stop.

By 50%, I mean trailing a stop so that I don't risk more than 1/2 of the unrealized profits I've seen in the trade.

If I am unable to watch the market intraday, then one of these two methods will have to do.

If I am watching intraday on a day trade, I will trail the stop by one of these two methods until I see that hooks are coming close together, the market is making new extremes on reversal bars, dojis or near dojis, volume, or closes that are in the lower half of the day's trading range, even though they are above the open. These are things that make me suspicious and indicate to me that the move may be over.

I will then tighten my stops until I am stopped out by the market. My goal then is to be stopped out with a profit.

If I am trading the daily or longer term charts, I do not need to and will avoid watching intraday data with the possible exception of report days which affect the particular market I'm in. If I'm not watching the market intraday, the profit protecting stop will have to do the job.

Once a trade is profitable, I will consider adding to my position as each additional hook is formed. I will continue to do this as long as the hooks are not coming too close together, i.e. no closer than three bars, and volume is not drying up in the direction of the trend.

I also watch for symptoms of exhaustion. After the market has made and taken out two hooks, if it begins to make long bar moves in the direction of the trend, or begins to gap in the direction of the trend, this is an indication that at least temporarily, the trend is ending, and there will be either a congestion or a trend reversal.

Another way to know when a correction is imminent is when there have been five or more successive higher lows in an uptrend, or five or more successive lower highs in a downtrend.

Yet another way to know when a correction is at hand is when you see five or more successive open-high, close-low bars in a downtrend, or five or more successive open-low, close-high bars in an uptrend.

Chapter 20

Don't Take That Hook

Are there conditions under which you do not want to take a Ross hook?

Yes, there are. They are not all absolute, and certainly you would want to proceed with great caution. I will explain each after this brief summary.

Be careful taking hooks...

When markets suddenly become volatile.

When hooks come too close together.

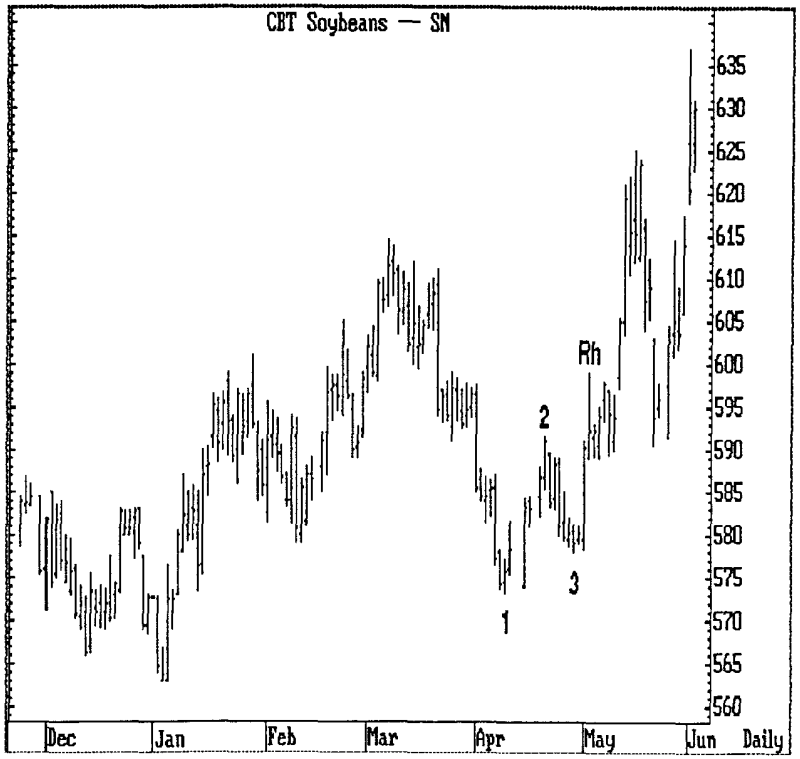
When volume dries up.

When a hook is too far away.

When the point of the hook is not taken out within three bars following a correction.

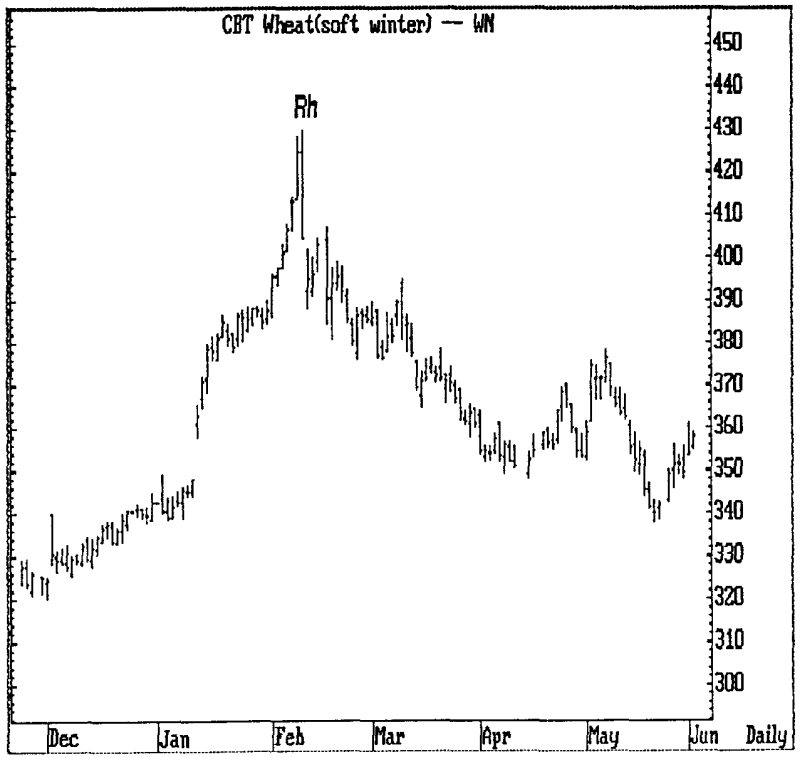
I will explain each of these concepts more fully for you.

A Market Becomes Too Volatile



I would tend to be very cautious about taking the Ross hook if it had been taken out within a couple of days of being made. As you can see, the market has settled down and is now more orderly.

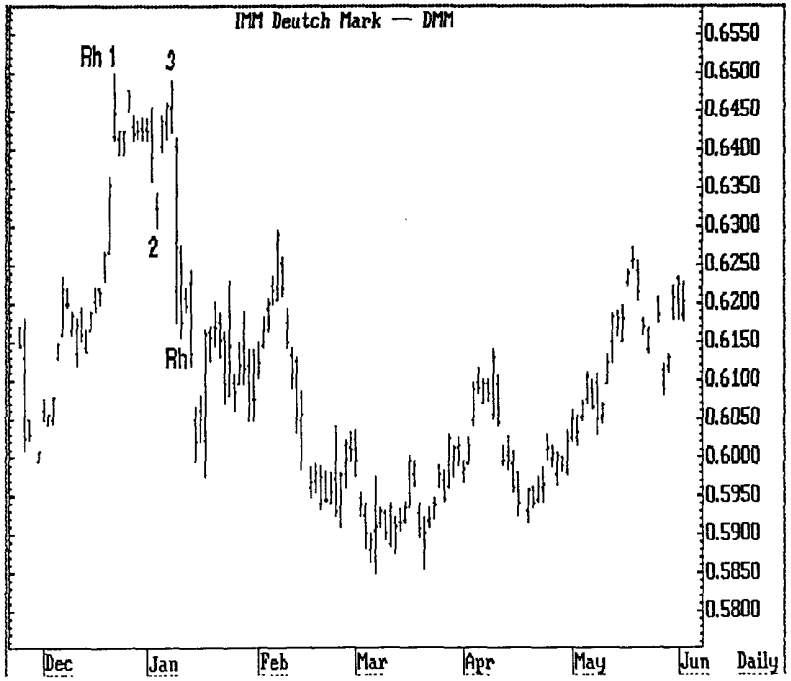
The problem with sudden volatility as seen on the Soybean chart is that the market moves too fast. It does not trend up, it explodes up. A correction is inevitable. The correction, if it results in a congestion area as above, gives market makers a perfect place to run stops just above the point of the hook. I would want to see at least one close above the hook, and then go long on a second time through the point of the hook.



In February, the Wheat market suddenly became very volatile. Had prices risen up to challenge the hook marked on the chart, I would not have attempted entry by any available means. Such events take place in conjunction with weather, political, war, or other major news scares.

At points a and b, the market is much too volatile to attempt to take upside hooks had they been challenged. At d, we see the market is much more orderly when it takes out the point of the hook at c.

A couple of thoughts must be kept in mind. Volatility, as seen by long bars and gaps, is not as meaningful in a downtrend as in an uptrend. Markets as a rule drop much faster than they rise. However, this is not true for the currency markets. That is because currencies are traded relative to one another. If one goes down, another must correspondingly go up.



I would not take either of the Ross hooks shown on the chart. The market is too volatile. Even though I would have made a nice profit on the downside hook, I am willing to bypass such moves in favor of a more orderly market. All too often, when a hook is very far from the #2 point, the move is all but over, and I'm sorry I got in. Experience has shown that most of the time these do not work well.

When Hooks Come Too Close Together

Normally, when a market is trending and making Ross hooks, each hook will have from one to three days of correction and then the market will resume its movement in the direction of the trend.

Each move in the direction of the trend will consist of three to five bars. A move in the direction of the trend may consist of only one or two bars if they occur as long bar moves or gaps.

However, if the market begins to have only one or two bars in the direction of the trend, without the benefit of long bars or gaps, and then after one or two bars it corrects, Ross hooks will be very close together. When this happens it is a warning that the move, at least temporarily, probably is over.

When Volume Dries Up

When a market has trended for awhile, sometimes a long while, it will reach a point of exhaustion. It cannot continue to make new highs or to make new lows. Normally, exhaustion is reflected in a market coincident with a drying up of volume. New highs are made on low volume, or new lows are made on low volume. The market simply can no longer sustain new extremes without many participants. The market is either running out of sellers or running out of buyers.

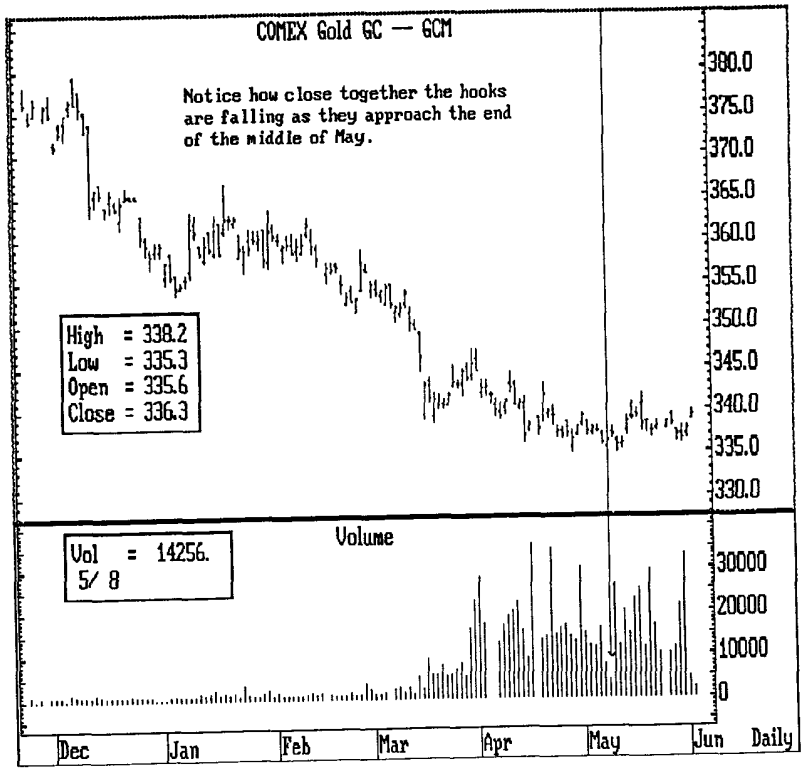
It is hard to know how to account for volume especially since today's volume may be shown on tomorrow's bar. I cannot satisfactorily explain how to use it. It is not necessary, and only coincidental to my trading. But when I see a large move on low volume, typically after a large bar move or a gap, I *sense* that for the time being the move is over. I suspect a hook will occur and most of the time it does. But a severe reduction in volume may occur on either side of what turns out to be a selling or buying climax.

When you see the point of a hook made on low volume, refrain from attempting that hook. Do not trade a takeout of the point of the hook, nor attempt a TTE or Slaughterbeck entry.

This is true no matter what the time frame. On the daily chart, we look at the volume for the contract we are trading. It comes a day late. Estimated volume is not usable for hooks. Use actual trading volume as reported for the day of what becomes the point of the hook. You will usually have a day or two to obtain it as the market corrects.

Intraday, use the tick volume. Tick volume is current although not perfect. It counts the number of times trades are made. It does not give any indication of the lot size. A single tick could represent a one lot or a fifty lot trade.

Take a look at the Gold chart as it made a low just prior to a correction. The day of the point of the hook, volume dropped off sharply. The point of the hook was made on low volume. The next day, the reason the volume was higher than the previous days, was because of all the people covering their short positions. Note the reversal bar at the point of the hook. The market has run out of sellers. Near the end of the downtrend, most of the volume is coming on days where the close is higher than the open. This, too, indicates the market is running out of sellers.



Copper did a similar thing. Volume dropped off just before the point of the hook was made on April 2. The high was made on relatively low volume. It wasn't until the next day, when prices reversed, that the volume picked up sharply, showing that the market had run out of buyers. The volume was made up of sellers, those covering their long positions, and bears who felt the move was now over and wanted to get short. Who did the buying from these sellers? Mostly the public, who, in their greed to "get rich quick," felt the move up was not yet over.

When a Hook Is Too Far Away

A hook is too far away under two conditions:

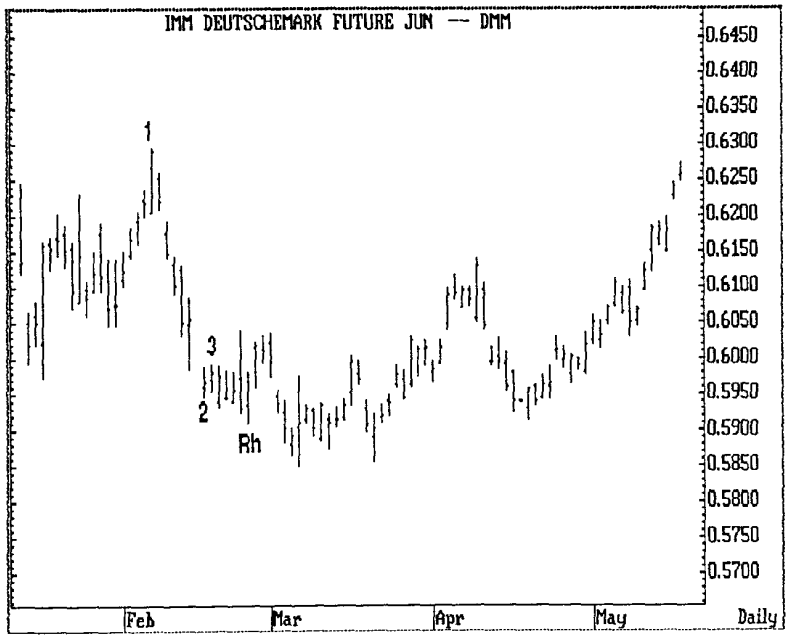
1. When the 1-2-3 which preceded it is very large from the number 1 point to the number 2 point.

2. When the point of the hook is far from the number 2 point.

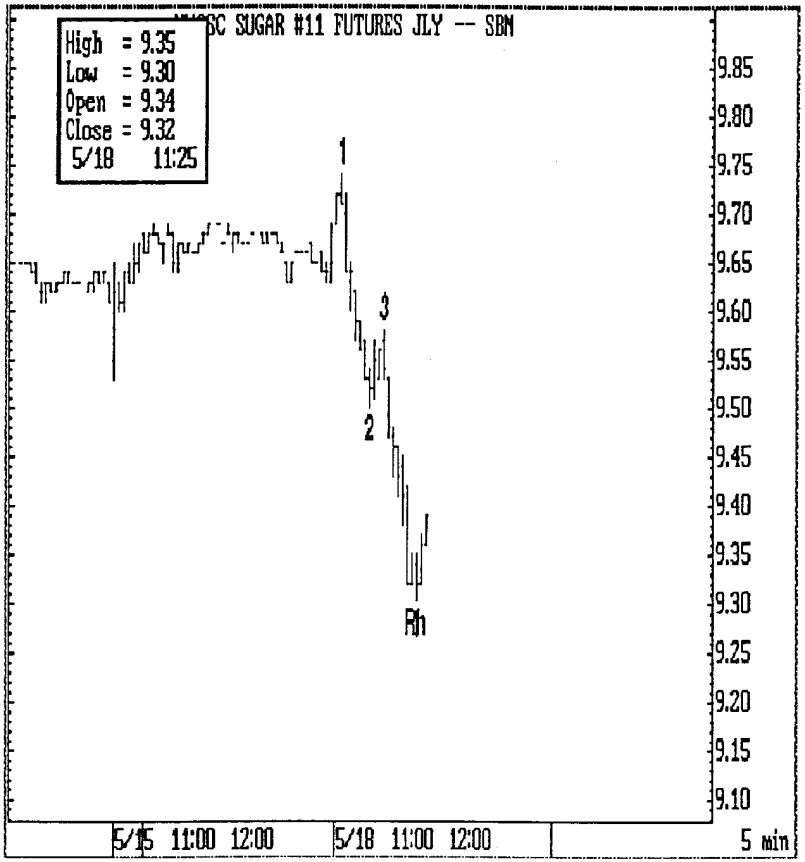
When either of these occur, there is usually very little room for prices to move subsequent to the hook being taken out.

This situation occurs more often in down markets than in up markets. However, it can occur in any market in any time frame, regardless of the direction of the move.

The D-Mark chart below is an example of the #2 point being too far away from the #1 point. There was little downside potential for a takeout of the point of the hook.

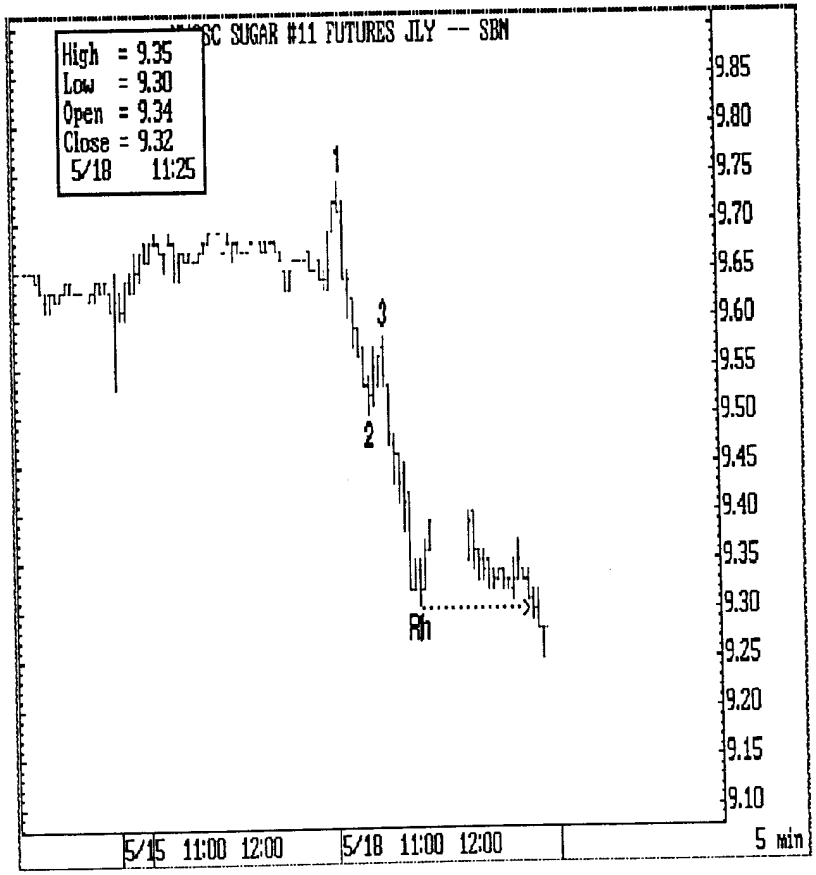


The five minute Sugar chart below illustrates a situation in which the point of the hook is too far from the number 2 point of the 1-2-3, and the number 2 point of the 1-2-3 is too far away from the number 1 point of the 1-2-3.



I wouldn't want to take a breakout of the hook, a Slaughterbeck entry, or a TTE, with the market having moved so relatively great a distance.

Here's what happened later in the day. You can see that it was indeed wise to let the breakout of that hook go by. Most of the move was consumed by the relatively great amount of movement by price in forming the 1-2-3 and the Ross hook.



Too Long a Time Period

This is a very important consideration regarding hooks. It is this situation under which most traders will make mistakes.

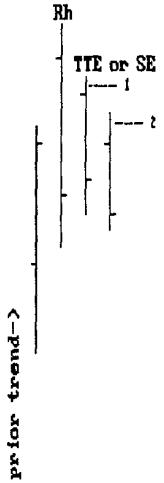
It is a virtual certainty that the last hook in a series will come and develop into some form of congestion. The only time this doesn't happen is when a market makes an abrupt Vee top or bottom. True \/ tops or bottoms are rare, and not worth the risk involved in trading them. There is certainly no way to predict them ahead of time.

What start out to be /\ tops usually end up becoming some sort of /\/\ tops. What start out as \/ bottoms usually end up as \/\/ bottoms. These are actually forms of congestion and therein lies the danger of the Ross hook that forms just prior to congestion.

Please note the following:

As long as volume has not fallen off, take a breakout of the Rh. the Trader's Trick, or the Slaughterbeck entry.

As long as volume has not fallen off, take a breakout of the Rh. the Trader's Trick, or the Slaughterbeck entry.



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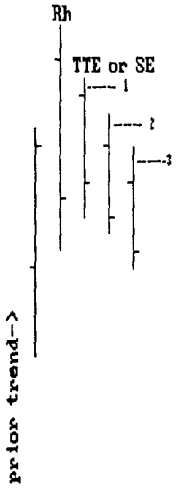
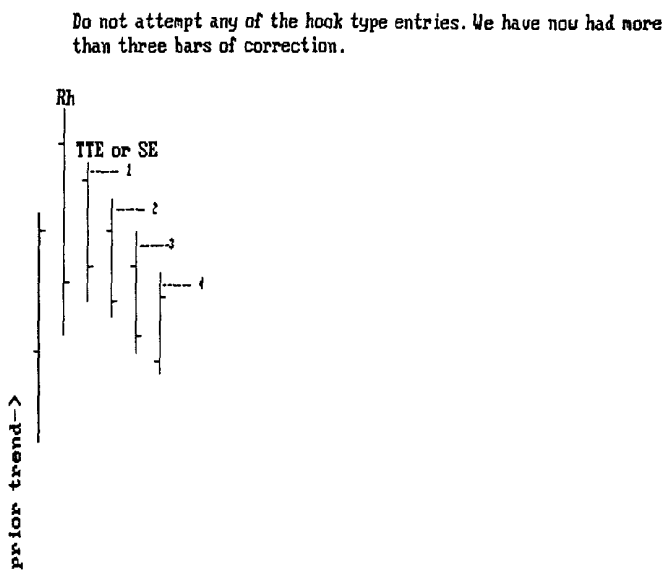
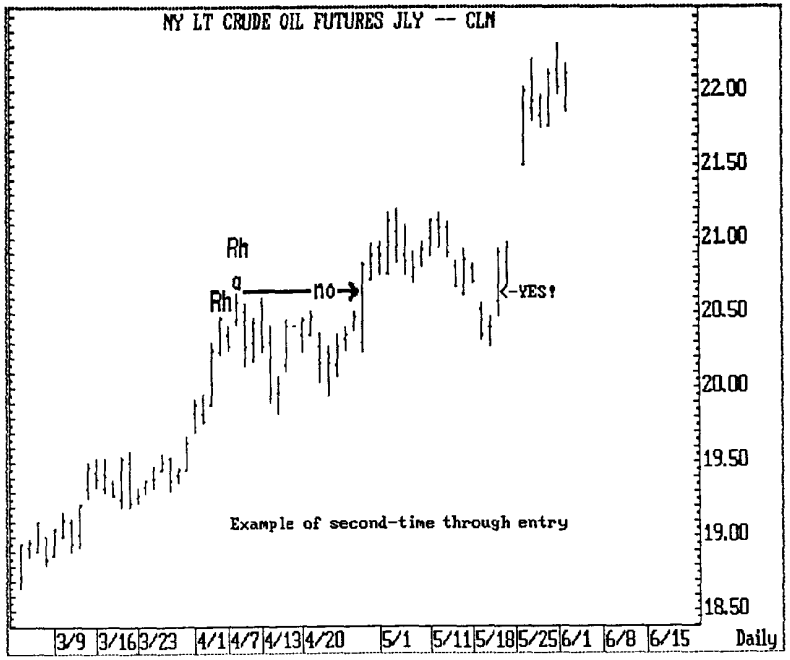




There is an extremely important concept to grasp here. When a trend has a correction containing more than three bars, we have what I call a defined trend. The original trend is broken, and we have now defined a minor trend that may prove to be a trend reversal or a congestion. (For more detail on defined trends, see my book **Trading by the Minute).**

The Ross hook is still there, but in order to trade it on a plain vanilla basis, the point of the hook itself must be taken out not once but twice. It is on a second time through breakout that I will take entry of the hook. Additionally, if there has been congestion, I want to see a close beyond the hook, a retracement back into congestion, and then a second time through breakout of the point of the hook.

If it doesn't happen that way, I will let it pass me by.



The Rh at 'a' gets taken out only once. I would not take that first breakout even though it turned out to be a good trade.

You must be very careful about taking the Ross hook that occurs at the beginning of congestion.

Why? Because it is just beyond those hooks that the floor traders will run stops. They can see those stop orders. You, too, must train yourself to see them. Once the stops are run, it's okay to take the breakout of the hook. Generally, once the stops are run, a move beyond the hook will result in a valid breakout and a continuation of the trend.

Chapter 21

Another Kind of Filter

At times traders, either because of limited funds, or because of unwillingness to commit sufficient money resources, find themselves undercapitalized for the trading of some markets.

Naturally, if market volatility is sufficiently great in any market, the risk may prove to be more than can be comfortably traded for the size of the trading account.

In that event, sufficient thought and consideration should be given to daytrading the markets in order to take advantage of the lower volatility available in the shorter time frames.

The investment in a live data feed, software, and a computer may seem expensive. However, it may be less costly than the amount of losses that can quickly accrue by trading the daily charts, which may often require larger stops than those with which the trader is comfortable.

This, of course, will hold true only for those who have sufficient time to devote to daytrading. I have a number of students who have been able to arrange their full-time work hours to accommodate daytrading on a part-time basis.

If this cannot be done, and the account is to be small, the only way to logically trade and not gamble is to be extremely patient and wait to take only those trades that offer opportunities well within the liquidity and size of the account.

This can mean waiting for weeks or months to take a trade that exactly fits the account size. There are not many new traders willing to exert this kind of discipline and patience. Typically, traders are eager to place a trade in the market. If only they would patiently wait for the right situation, there would be a great many more traders who would succeed rather than fail in the markets.

The volatility on a one minute, three minute, five minute, or ten minute chart will fit well with many small accounts. The wins will be proportionately small, but with careful trading, an account can be built to sufficient size to move up to a larger time-frame.

On a lesser time interval chart, stops can be placed at natural support and resistance levels without the greater risk that occurs on the daily charts.

This will afford additional trading opportunities more quickly.

The concept I'm setting forth here is the use of time-frame as a filter for trading. Use a time-frame in which sufficient trading opportunities arise that are consistent with your temperament and the size of your margin account.

Trading Ross hooks with the proper filters helps you to get into trades early. Trading Ross hooks virtually forces you to trade with the trend.

I have consistently and persistently taken a simple approach to my own trading of the markets. Most people who want to trade make trading far too complicated. It's as though a simple method is not worthy of the markets.

Perhaps some feel guilty about making money easily. They feel unless something is sophisticated, intellectual, scientific, or mathematical, that it can't possibly be any good. That attitude and mind-set seems to be a result of the technical society in which we live. Too bad, because so many have lost so much attempting to trade in a complicated manner.

Stop placement when trading is a matter of individual choice. The sooner you realize that, the better off you will be. Run far and fast from anyone who tries to tell you otherwise.

Ross hooks, by themselves, constitute a trading method that is about 65% accurate depending upon money and trade management.

Adding the 1-2-3 formation and the filters of your choice can bring the percentage of winning trades much higher than that.

The most important statistic in your trading must be money won versus money lost. Once you have a sound method for trading such as the Ross hook, the amount of money you win or lose becomes a function of managing the trade, your money, the amount of risk, and yourself.

To properly engage in good management, you must learn to discipline yourself. Unless you have vast amounts of capital, you cannot change the market, nor can you become a part of the solution in solving the problems the markets present to you when trading.

You must come to realize that the only thing you can change is yourself, and the way you react to market stimuli. Your self-discipline, or lack of it, will determine in large part the way you manage your money, trades, risk, and self.

You must trade with the realization of what trading is all about. To do that you need to study.

You must learn how the floor operates, how they determine "safe" sell areas and "safe" buy areas. You need to know how the floor determines where today's high is supposed to be, and where today's low should be.

You need to know at which point floor traders will bail out of the market and abandon it, and why. You should learn to recognize that condition when you see it on a chart. Why? Because when they abandon a market, that is exactly when you want to be in the market.

You must come to realize that trading is a high risk business. Even when you are right about a trade, you can lose money.

There are plenty of vultures out there who can turn wonderful winners into sudden losers. Risk lies at every level of trading. From your broker, to the trading desk, to the floor, you can be cheated and robbed of your profits. If you trade without realizing this fact, you will soon be parted from your money.

As if that were not bad enough, large commercials, funds, other large traders, and market makers can all run the markets in such a way as to cheat you of your potential profits. Markets are engineered by these interests, and you can be sure they do not have your interest in mind.

They can make markets go limit up and turn around and make them go limit down — all within a single day. If you don't believe it, I suggest you take a look at the grain markets of February 10-11, 1992, as a single example of the many hundreds I've witnessed throughout my career.

Any intraday chart will show you the way markets are engineered by those on the floor. Whenever trading becomes too tight, the market makers will run prices, first one way, and then the other. They do this to create "trading room" for themselves.

That doesn't mean you can't make money in the markets. It does mean you have to use guerrilla tactics. You must be nimble and quick. You must learn to take profits when they exist. You must learn to use strategy when you trade.

Chapter 22

A Word to the Wise

The following paragraphs are presented in the hope that I can convince you to be realistic about your trading.

Far too many traders are undercapitalized. I have had them come to my seminars, recently out of work, with $5,000 or less trading capital, hoping for a miracle. If this fits you, you will not be trading, you will be gambling. No matter how determined you are to do well, it will take a small miracle for you to be successful. The odds are heavily against you.

All too often traders tell me they can't afford to place stops at natural support or resistance on the daily charts. Yet they also cannot afford, or are unable to have intraday live data. This happens when the trader is undercapitalized, or must work full time at a job, business, or profession. Some overseas traders are unable to obtain live data.

Whatever the case, you have only three choices:

1. Learn to bank ticks and build your account.

2. Patiently wait for hooks that have acceptable risk.

3. Delay your trading until you have sufficient capital with which to begin trading.

If you could arrange your schedule so that you would be able to use live data to at least enter the trade, then it will be cost effective to obtain a live data feed and the appropriate computer hardware and software. You can build an account much faster by taking the lower risk associated with intraday natural support and resistance. In many cases, a few successful trades will more than pay for the additional costs associated with live data.

Software to read and chart live data does not have to be purchased. It can be leased on a month to month basis. If it doesn't work out for you, you can stop using the software, and return your receiving equipment for a refund.

To make money in the markets, you must position yourself properly. If you do not have sufficient capital to trade the daily, weekly, or monthly charts, then the only other choice that allows you to trade is the lesser volatility of intraday trading.

If you should choose to trade intraday, please do not attempt to trade from a delayed data feed. That is tantamount to committing financial suicide.

Remember, intraday, you are up against traders who are marvelously equipped with live data, sophisticated software, and who are in many cases much better connected on the floor. Their turnaround time is faster and their fills are better. If you do go for live data, get the best.

That does not by any means involve paying the most. One of the best data feeds in the business also happens to be the least expensive.

Top notch trading software also does not have to cost the most. You can obtain some of the best for far less than some of the worst.

If, after examining all avenues, you realize that trading is an expensive proposition, then by all means do not feel badly if you choose not to trade at all.

If you are bound and determined to trade without proper preparation and facilities, please realize that trading futures is a very expensive hobby. Surprisingly, there are many for whom that is what trading really is. If you can afford it, and don't mind losing the money, then go for it. I will be very happy to spend my share of what you lose in the markets. It will be a win-win situation. You will have fun, and I will add to my wealth.

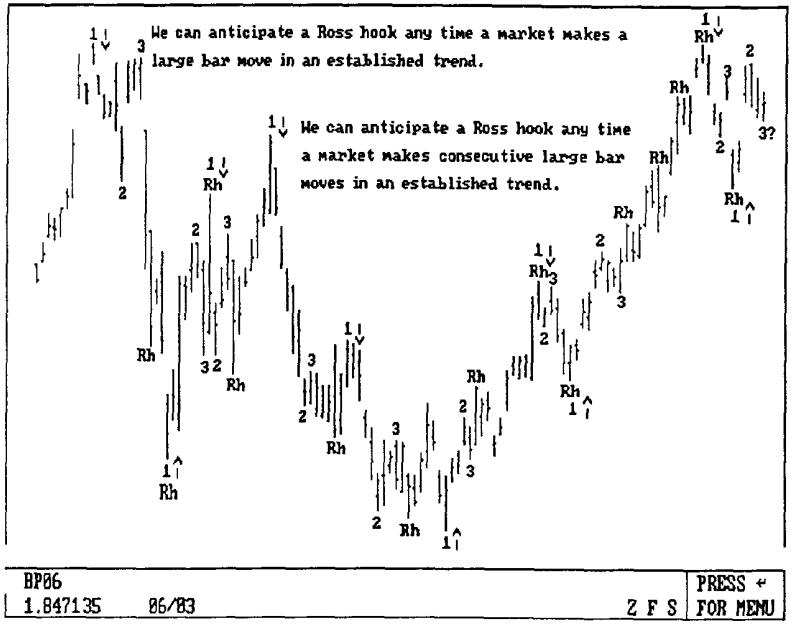
Chapter 23

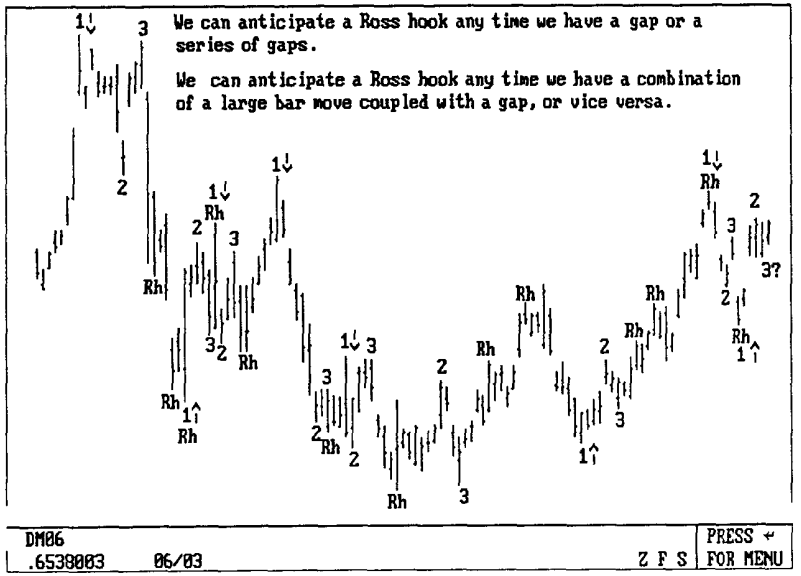
Anticipating Hooks

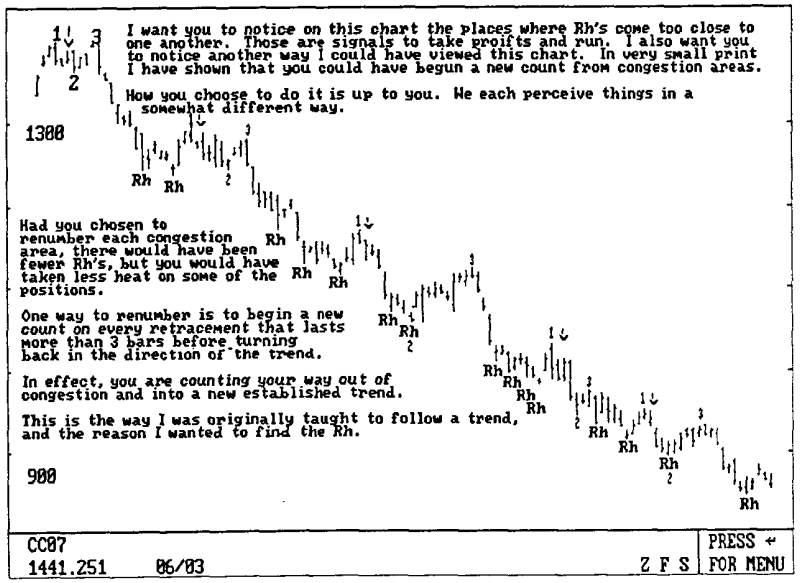
When can we anticipate a Ross hook?

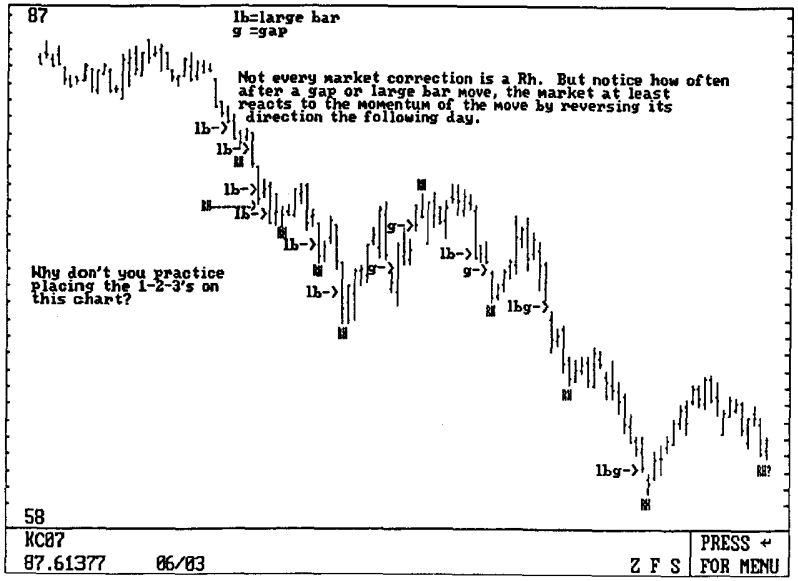
Since Ross hooks are caused by profit taking during and at the end of a trend, there should be times when we can anticipate their formation.

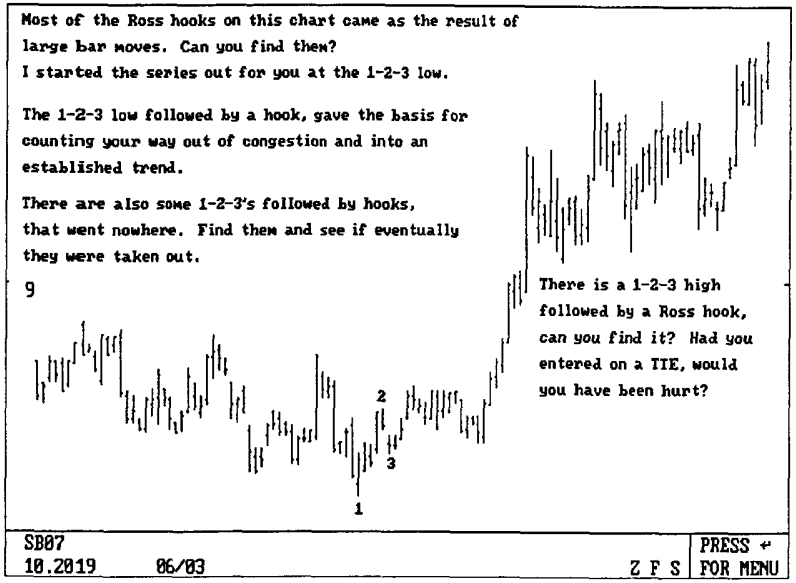
In the next series of charts, I will endeavor to show you when and how I surmise that they might occur. While I'm at it, I'll label all 1-2-3's and Rh's so you can see how I view these charts. Next to each number "1," I've pointed the direction to the number "2" with an arrow.

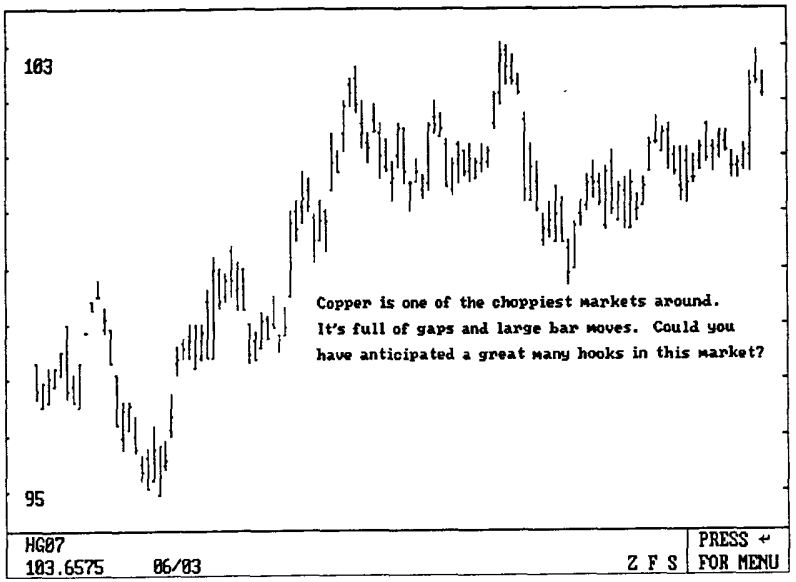


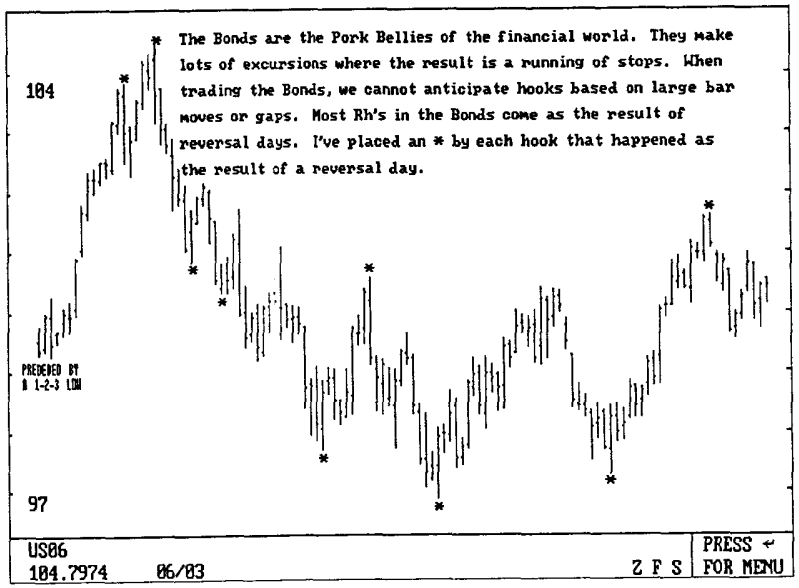


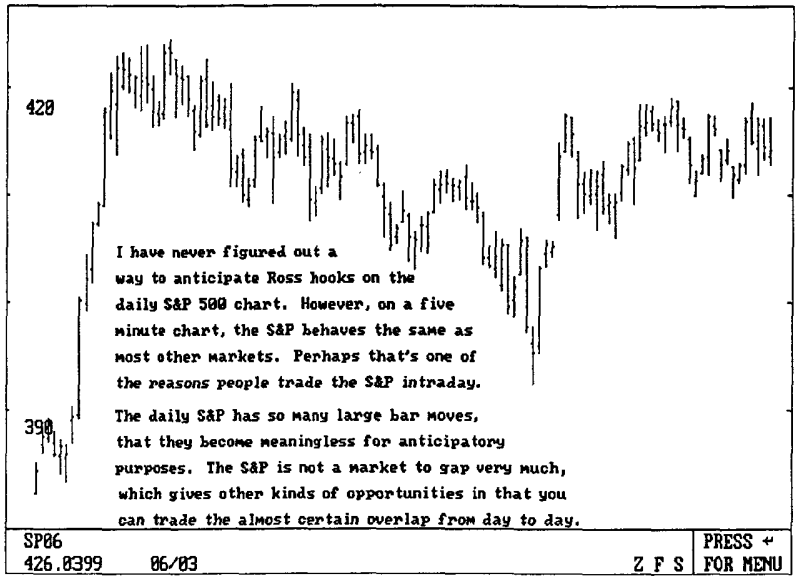


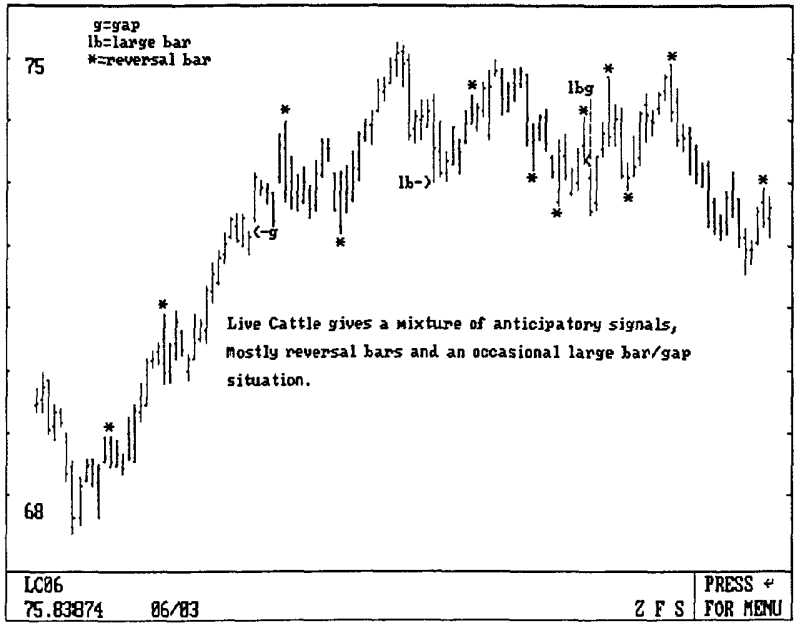

87
lb=large bar
g =gap
Not every market correction is a Rh. But notice how often after a gap or large bar move, the market at least reacts to the momentum of the move by reversing its direction the following day.
Why don't you practice placing the 1-2-3's on this chart?
58
KC07
87.61377 06/03
Z F S
PRESS ↵ FOR MENU

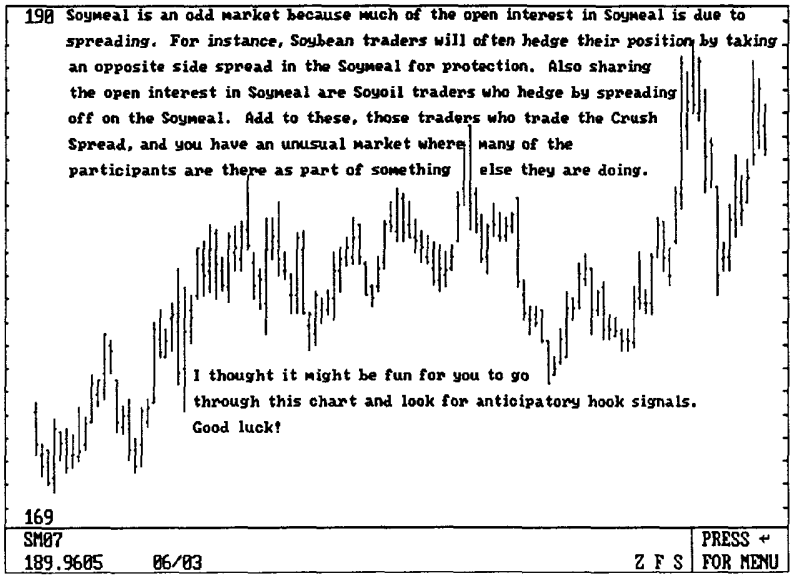

Most of the Ross hooks on this chart came as the result of large bar moves. Can you find them?
I started the series out for you at the 1-2-3 low.
The 1-2-3 low followed by a hook, gave the basis for counting your way out of congestion and into an established trend.
There are also some 1-2-3's followed by hooks, that went nowhere. Find them and see if eventually they were taken out.
9
There is a 1-2-3 high followed by a Ross hook, can you find it? Had you entered on a TIE, would you have been hurt?
SB07
10.2019 06/03
Z F S
PRESS ↵ FOR MENU


103
Copper is one of the choppiest markets around. It's full of gaps and large bar moves. Could you have anticipated a great many hooks in this market?
95
HG07
103.6575 06/03
Z F S
PRESS ↵ FOR MENU


The Bonds are the Pork Bellies of the financial world. They make lots of excursions where the result is a running of stops. When trading the Bonds, we cannot anticipate hooks based on large bar moves or gaps. Most Rh's in the Bonds come as the result of reversal days. I've placed an * by each hook that happened as the result of a reversal day.
104
97
US06
104.7974 06/03
Z F S
PRESS ↵ FOR MENU







By anticipating when Ross hooks may occur in the market, we have a basis for planning our trades. Simply the act of anticipating helps in obtaining market perspective. We have something concrete to look for.

By examination of the chart and looking for potential hook situations, we become more familiar with price behavior as depicted on a bar chart. This exercise in itself will help you to become more astute as an observer of market action.

I have developed entire methodologies based on what I have learned by anticipating Ross hooks. For instance, the aforementioned fact that the daily S&P 500 almost always overlaps the previous day has resulted in a way to trade the daily S&P that gives winning trades over 85% of the time. I want to go on record here that I do not and will not trade the daily S&P chart and hold it overnight because of the outrageously overpriced margin requirements. But the overlapping phenomenon has aided and abetted my intraday trading of the S&P on a five minute chart. If you think about it, you will see ways to take advantage of that fact.

Chapter 24

Wrap-Up

At my seminars, I teach you workable strategies. I teach you how to take home your piece of the market.

I teach you how to trade profitably. You must know what the insiders are doing and trying to do. This can be read from a simple bar chart. I show you how to accomplish that.

You need to know a whole lot more about brokerage than most of you do. I give you the inside knowledge you need to trade properly.

There is a lot of truth in the market, but few know how to find it. Yet when I show you, it becomes simple. On your own, you can spend years struggling and never discover the reality of how to trade profitably. Most go broke before they learn how to trade and make money.

My experience with my students has set me aghast at the appalling ignorance of most people who attempt trading. Even those who have been at it for a number of years do not seem to realize how little they know of the markets and how to trade them. Is it any wonder that so many lose? Is it any wonder that so many leave the markets frustrated and utterly defeated? They have lost their money, their integrity, and their pride.

Some of the things you will want to know are beyond the scope of this book, but are contained in my teaching letter, **Traders Notebook**, my books, **Trading by the Book**, **Trading by the Minute**, and **Trading Is a Business**, and in my private seminars.

I hold regularly scheduled (and sometimes unscheduled) seminars for those who wish to pursue their education even further. If you desire to be a full-time trader earning your living in the markets, my seminar will be of great benefit to you. The same is true if you are already a full-time trader.

I've never had a professional trader say he was sorry he came to one of my seminars. On the contrary, most have taken the seminar more than once and have become regular subscribers to my teaching letter. They leave glowing with new knowledge.

Now, at the tail end of my trading career, I have dedicated myself to teaching others how to trade profitably. It is with that purpose I have written this book.

I hope you have enjoyed it and profit from it. There is a lot more in this book than you can absorb in a single reading. It is my desire that you read and study it over and over again.

I still trade most days, so if you call and I ask you to hold for a minute, hang on, and I'll get right back with you. If you can't wait, hang up and call again. My number is (512) 259-0727.

Because so many of you have asked, I have made arrangements for you to purchase a computer at a reasonable price, especially configured for trading. If you want or need one, call. Sometimes we have used computers.

If you would like to know about live data feeds, call. If you would like a referral to Bonneville, I get "goodie" points for sending you. I'll see to it that you get preferred treatment.

I get a gold star if you decide to use Ensign, or Aspen.

Market Detective for end of day analysis is available only through Ross Trading. It has many outstanding features. It's $595. If you want it, call.

Investograph Plus Special Edition / RT for end of day analysis is available only through Ross Trading. It's $595 if you want it. The program does all the studies you see in this book as well as many proprietary studies created by Bob McCullough . If you would like to purchase this special edition let us know.

If you would like a private consultation, either by phone or as a guest in my home, the rate is $400 an hour, during regular business hours. If I must come to you, the rate is $400 an hour during business hours plus expenses (8 hour minimum).

If you would like referral to a few honest brokers, I will be happy to supply you with their names. Being an unlicensed person, I cannot recruit for or refer to any single broker. But over the years I have used and come to know a few who will give you a fair shake at a reasonable price.

In some cases you will be able to obtain very low commissions and still get good service. In some cases, where qualified, you will be allowed to call directly to the floor. If you would like such a referral, call.

If you want personal references from those who have read my books, currently read my newsletter, or have taken my seminar, call.

If I can be of further help, call. If you do call, please have your questions organized and ready to go. I don't mind talking to anyone who needs help. Don't decide for yourself that I'm too busy or too important. That's my decision to make, not yours. I'm here to serve. I'm available from 7 A.M. to 5 P.M. Central Time Monday - Thursday.

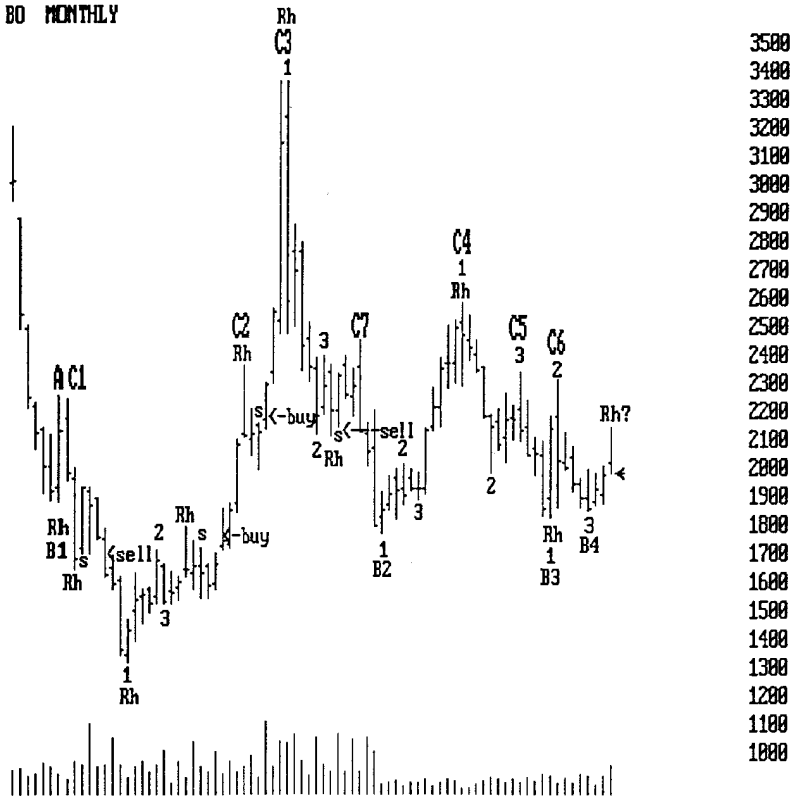
If you have a FAX and would like to send us a message, the number is (512) 259-0747.

If you have specific questions that require a written answer, please include a self-addressed, stamped envelope. Normally you will need two stamps.

Joe Ross
Ross Trading International Inc.
POB 1509
Leander, TX 78641
(512) 259-0727, 7 A.M. - 5 P.M. Central Time, Monday - Thursday.
FAX (512) 259-0747

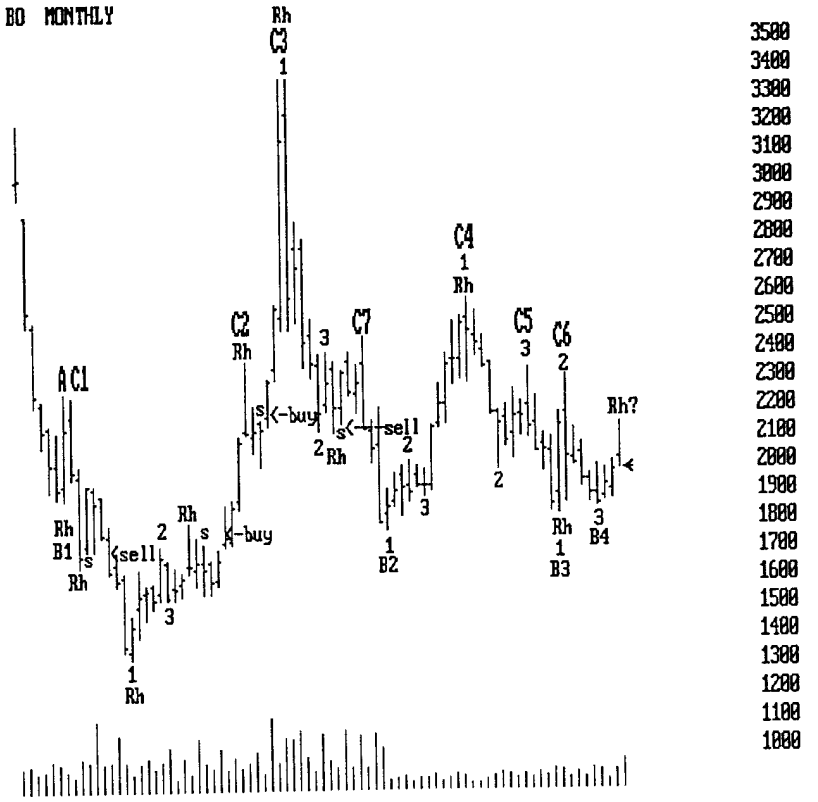
With all sincerity, I wish the very best for you in your trading.

Appendix A



I've marked the chart as I would have were I trading it. We may not agree on all points, but when I trade I don't always see everything that's there. There is no absolute right or wrong. It's possible to miss a bar and get a different result in the way it is marked. The important thing is what you see, and learning to trade what you see.

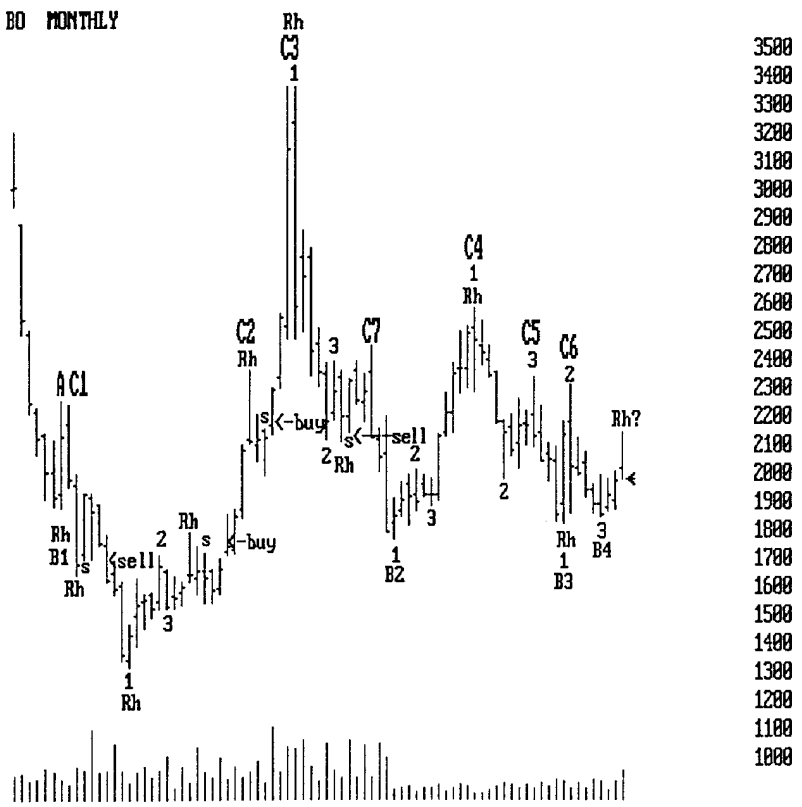
For instance, at the beginning we see a steep drop in Bean Oil prices down to a support point in the 1800 price zone.



As you look across the chart, you see that the same area acts as a support area throughout the time length shown on the entire chart. A period of approximately ten years is shown.

Note that the steep downtrend ended on a reversal bar. I've labeled it 'A'. The reversal bar was a near double low along with the previous bar. The reversal bar forms an Rh. Although not labeled, the bar immediately prior to it gave a TTE of 12 points.

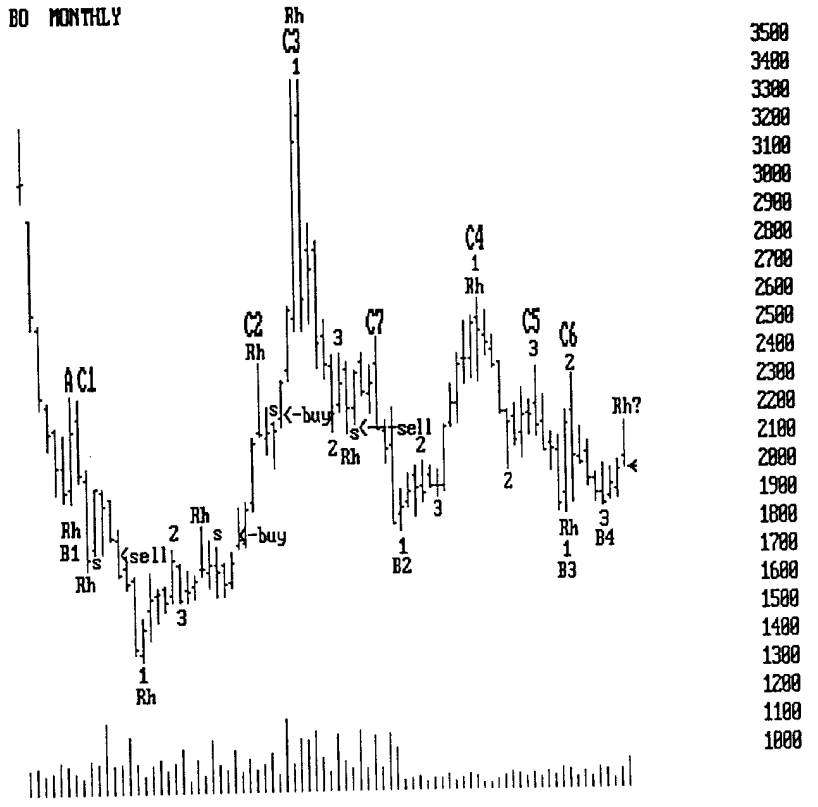
This near double low at the 1800 price level two months in a row is significant. Later, significant lows occurred in that approximate price area. I've marked them B1-B4. These would have made excellent buy points.



In addition to being good buy points, B1-B4 are natural support. It's interesting to note that with the exception of B4, all of them hit bottom on a reversal bar. On B-4, the reversal came a bar later. Would this not suggest to you that reversal bars are extremely important. The taking out of the point of a reversal bar is also important because natural support is being violated.

Now, look at the highs, the points of resistance. With the exception of C1, they all occur on reversal bars.

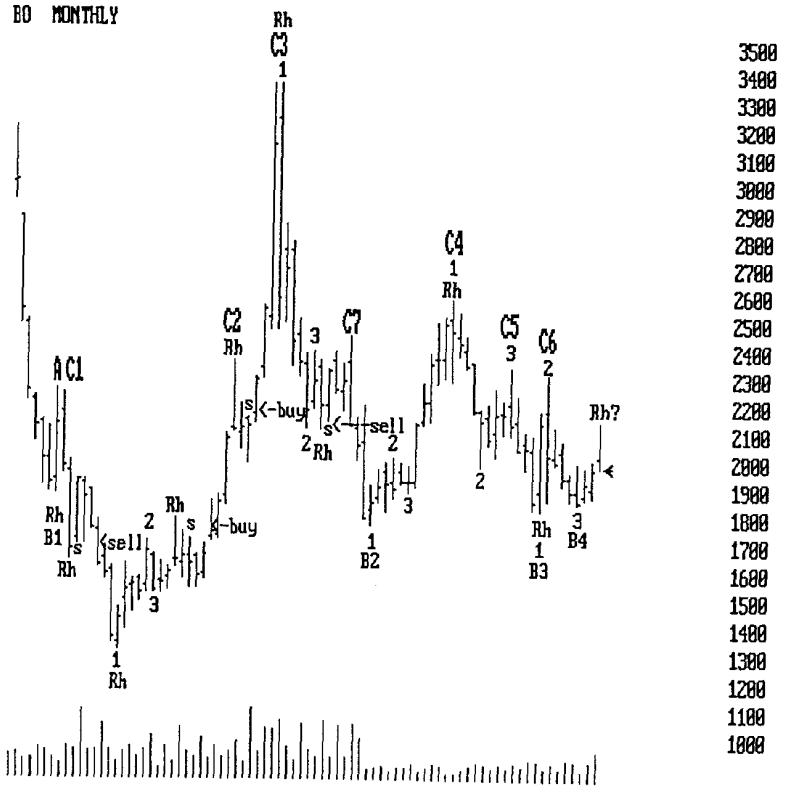
Next look at the 1-2-3 lows. Every one of them began with a reversal bar.



Are you beginning to see the importance of the concepts I've been showing throughout the book? 1-2-3 lows are extremely important basing points. Rh's occur at extremely important support and resistance points after a correction.

The taking out, the violation or breakout of these areas, generally results in important moves in the markets. Obviously, a breakout on a monthly chart is far more significant than a breakout on a 5 minute chart. The resulting moves are many times greater in magnitude. These are worth waiting for.

Now let's look at the congestion areas.



Every one of them is preceded within a bar or two by a large single bar move. It's as though after a significant market move, the market must rest.

Every single congestion on the chart meets one of our criteria for defining congestion. We have congestion by alternation, whose bottom is B1. We have congestion by virtue of four closes within the price range of a measuring bar just to the left of C7. To the left of C5, we have congestion by alternation with a wild card doji bar. Above B2, we have congestion by pairs.

What I'm trying to do with this example is to show you that you do not need to trade exactly as I do. If you understand the basic anatomy of markets, and how to read a chart, you can come up with your own techniques. You do not need an oscillator to tell you what is so plainly on the chart before you. There is a rhythm in the markets.

All markets do essentially the same things. They congest at and around major support and resistance points. Then they test those points. Stops that have accumulated around those points are run by the floor traders. Then the market is free to breakout and trend. You can choose to trade the trend, the trading range, or both.

Remember these important points when trading an Rh that has been in effect for awhile or has occurred at the beginning of a subsequent congestion.

1. Once the congestion is established, you need a second time through the hook to re-establish the trend. You have to realize that once the market goes into congestion, stops will accumulate beyond the hook. It is a natural resistance/support point. The first time through, the probability is great that in any time frame, stops are being run. This may result in a new high/low. Typically, the market will retrace to the hook or into the congestion subsequent to the hook. Therefore, the next time through the hook is an excellent entry point for a continuation of the trend. The stops have already been run, and there should be clear sailing from then on to the next resistance/support. This is why many professional traders will tell you to buy new highs and sell new lows. There are no stops to be run and no resistance/support areas to get in the way.

2. When is a hook too old? This is a question I have wrestled with all my life. As far as I can see, old hooks never die, they just fade away. They are gone when I can no longer see them on my chart. Once in congestion, there is no TTE or SE. The hook itself becomes the entry point for the second time through.

Listing of Charts

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