

PROFITUNITY TRADING SYSTEM

(Taken from the book *New Trading Dimensions* by Bill Williams, PhD - 1998)

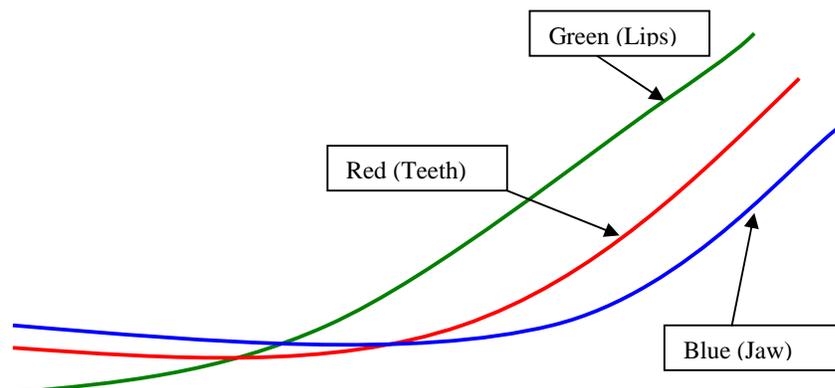
1. The ALLIGATOR.
2. The FRACTAL – The Breakout Trade.
3. The AWESOME OSCILLATOR (AO).
4. The MARKET ACCELERATOR (AC).
5. Trading in the ZONES.
6. The BALANCE LINE Trades.
7. Profit Taking.

STEPS FOR TRADING

1. Find a tradable market by looking for the “*sleeping Alligator*” and, the *AO* and *AC* are near the ZERO line.
2. Take the **FIRST FRACTAL BREAKOUT** which is above (buy) or below (sell) the *red* (teeth) line (or, at least the middle of the fractal price bar cuts through the red line).
3. Once first FRACTAL signal has been hit, take ANY and ALL signals in that direction (add aggressively).
4. Place first protective STOP using the **RED** line (teeth) once the close is above the **Alligator’s Teeth (red line)** (If *mouth* does not open immediately and the red line is too close, place a stop and reverse at the first *fractal* in the opposite direction that is outside the Teeth).
5. Continue to add on any/all *signal* and start looking for signals to take profits (next point).
6. Take profits when:
 - a) **close** is below/above **RED Teeth Line** (sometimes red line may give away too much profit: if so use next point b)).
 - b) **5 CONSECUTIVE BARS OF THE SAME COLOUR.** Place a STOP just below the LOW (Long) ,or HIGH (Short) of the 5th bar and then keep trailing the stop after each new bar low/high until stopped out.
 - c) **GREEN LINE STOP (Alligator’s Lips)** may be used when the market “takes off” at an angle of the green line (away from Alligator’s mouth) in the “right” direction (such as in Elliot Wave 3).
 - d) **A Signal in the Opposite Direction.** Taking a signal in the opposite direction. Least used.

THE ALLIGATOR

This acts as a *market monitor* and a compass to show the direction of the current trend.



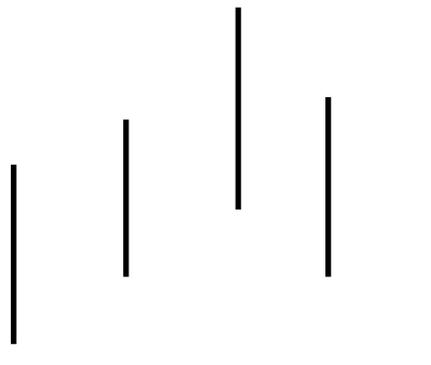
- We wait for the trend to prove itself by giving a FRACTAL signal that is moving above/below the Alligator's mouth.
- Ideally, but not always, all five highs (or lows, in the down move) should be on the same side (higher for buys and lower for sells) of the **BLUE** Balance line (Jaw).
- Take the first entry and then add aggressively in that direction for all/any of the five signals.
- Place STOPS to EXIT just inside the Alligator's **Teeth (RED)** for close that crosses the red line
- Trail STOPS after 5 consecutive bars of the same colour (green=long, red=short).

See pages 53-64 from the book for further details and diagrams.

THE FRACTAL

A Fractal must have 2 preceding and 2 following bars with lower highs (higher lows for down moves). In a *buy* Fractal we are only interested in the bars' HIGH. In a *sell* Fractal we are only interested in the bars' LOW.

See Fig.4-4 on page 70 from the book to see variations of fractals.

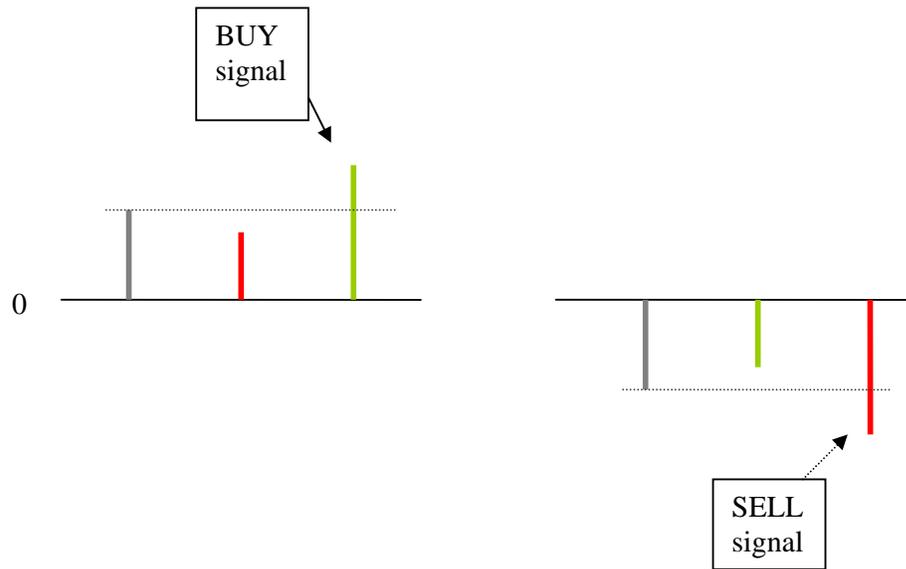


- If the buy fractal signal is *above* the **RED (Teeth)** line then place a *buy order* 1 tick above the HIGH of the up fractal (or LOW of the down fractal for sells). Remember to wait for the 1st Fractal signal before using other buy/sell signals.
- DO NOT take a Fractal buy signal if, *at the time it is hit*, the price is *above* the **RED** Balance Line (or not to take the Fractal sell signal if the price is *below* the **RED** Balance Line).
- The critical factor is where the fractal signal was HIT, as opposed to where the signal was FORMED. If the signal is HIT outside the **TEETH**, we take *that* trade no matter where the fractal might have been formed.
- For fractals that are formed “inside” the Alligators mouth, the bar must intersect the red bar to be valid and *then* take orders for any signal which intersects and crosses the red line. See pages 77-81 from the New Trading Dimensions book for details.
- Remember: “*Do not feed the Alligator*”.

AWESOME OSCILLATOR (AO)

This can create 3 possible buy or sell signals. ***Do not*** take any AO signals until after a FRACTAL signal is formed outside the Alligator's mouth. ***ONLY*** buy on an AO signal *above* the zero line (sell *below* the zero line).

1. Saucer signal – a change in momentum

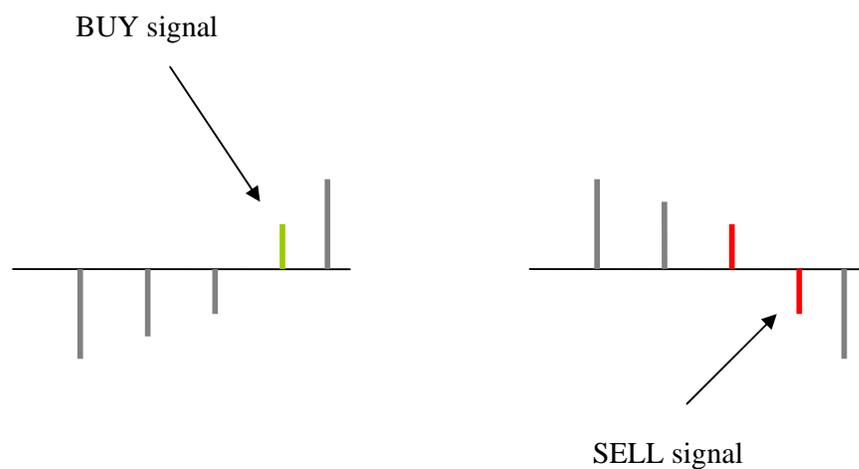


- A minimum of 3 bars is required for a signal.
- Always read from left to right.
- There is no limit to how many bars can be inside the *Saucer*.
- All bars in a *Saucer* must be above the zero for a buy (below for sell)
- The signal bar must be **GREEN** bar for a buy (**RED** for sell)
- There cannot be a buy and a sell signal at the same time.
- After creating a signal, there **MUST** be a change of direction (colour) before creating another signal.

- Once a signal is created, see the corresponding price bar and add/subtract 1 tick to the high/low for the BUY or SELL order.

See pages 86-88 for details and diagrams

2. The AO Cross

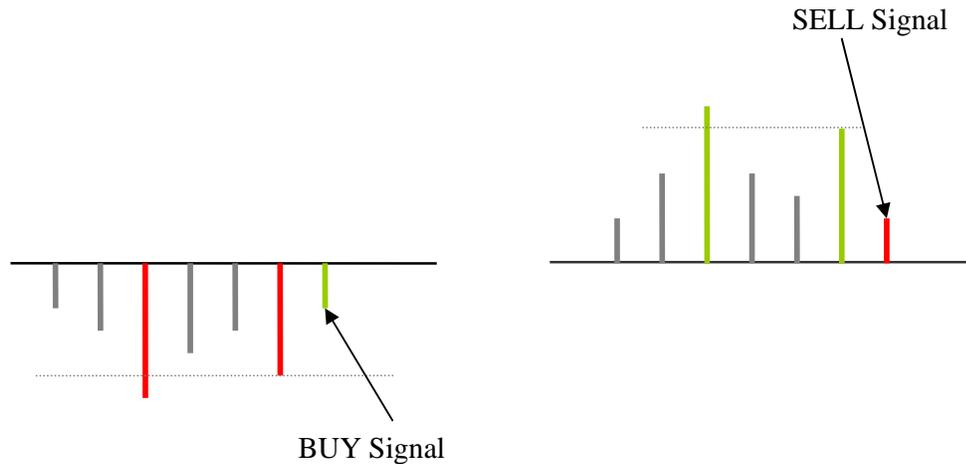


-
- Always read from left to right
 - It only takes 2 bars to create a signal
 - First bar must be below (buy) or above (sell) the zero line, second bar must cross the zero line.
 - There cannot be a buy and a sell signal at the same time.
 - Once a signal is created, go the corresponding price bar and add/subtract the high/low for the buy/sell price order.

See pages 88-91 and 97-100

3. Twin Peaks

This is the *only* buy signal that can be created *below* the zero line (or sell signal created *above* the zero line).



Buy signal must always be **GREEN** (**RED** for sell)

- The first peak must be larger than the second peak (negative peak for buy and positive peak for sell)
- The trigger bar will be a green for BUY or red for SELL and should be smaller than both peaks.
- A Saucer *SELL* will be created before a Twin Peaks *BUY* (or Buy first for a Twin Peak Sell).
- Once a signal has been created, go to the corresponding price bar and add/subtract 1 tick for the price buy/sell order.

The use of **DIVERGENCE** can also be used in the AO histogram to show change in trend direction (see later).

THE MARKET ACCELERATOR (AC)

- To create a signal there must be a change in acceleration (colour change).
- The zero line is where the momentum is balanced with acceleration.
- It is easier to buy above the line, therefore only a couple of bars are needed to create a signal.
- You *cannot* have a BUY if the current bar is **RED**.
- You *cannot* have a SELL if the current bar is **GREEN**.
- Acceleration will change before Momentum, and Momentum will change before price. Knowing that, we can use this signal as our first indication of where the market is heading.

BUY		SELL
2		3
3		2

2 Bars with Momentum (zero line)

3 Bars against Momentum (zero line)

AC with Momentum

1. A BUY/SELL signal is created when there a **2** consecutive histogram bars with higher highs (BUY) or lower lows (SELL).
2. A BUY/SELL order is placed 1 tick above/below price bar as usual.
3. A second buy/sell *cannot* be created until the histogram moves at least one bar lower (buy) or higher (sell) creating either a RED

(buy) or GREEN (sell) bar. A new signal can then be created after two higher (green buy) or lower (red sell).

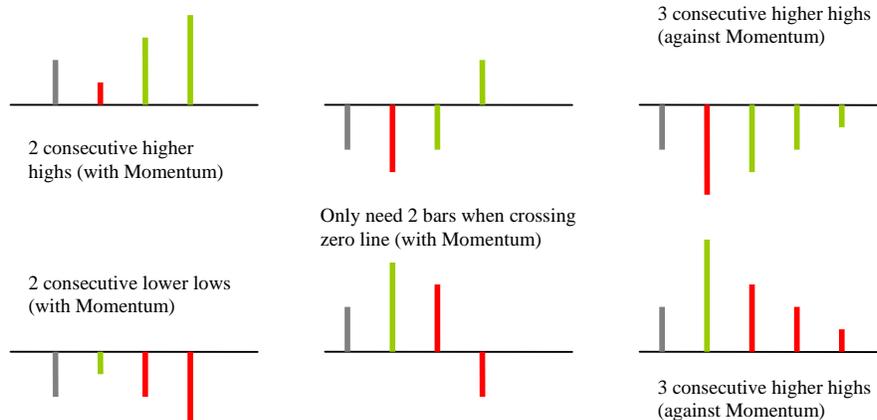
AC against the Momentum

1. A BUY/SELL signal is created when histogram forms 3 bars that have higher highs (buy) or lower lows (sell) than the most recent low (buy) or high (sell). All three must be GREEN for BUY or RED for SELL.
2. A buy/sell order is placed 1 tick above/below corresponding price bar.

AC cross signal

When the AC bar crosses the zero line, only 2 bars are required not 3 any more. Crossing the zero line only changes the *number* of red or green bars that are needed for either a buy or a sell signal against the momentum (although that has now changed once crossing the zero line).

AC BUY signals



AC SELL signals

Use the 1st Fractal outside Alligator’s mouth to initiate AC signals. The AC signal created is cancelled if the price bar is the opposite colour to the AC signal.

TRADING IN THE ZONES

MAP = MOMENTUM – ACCELERATION – PRICE

The **ZONE** is determined by the AO and the AC.

- If the Momentum (AO) and the Acceleration (AC) are in the same direction then we are either in the **GREEN (buy)** or **RED (sell)** zone (price bar will indicate this with either Green or Red colour)
- If the AO and AC or not in sync then we are in the **GRAY** zone.

The ZONE:

1. Allows us to get aggressive at the market
2. Gives us a great profit taking technique
3. Adjusts the ***Balance Line Signal*** in the different Zone

Whenever you are “in the zone” you want to be aggressive in adding to the current position. It takes at least 2 consecutive green/red bars to buy/sell; we add on the second consecutive green/red bar.

Stop adding to current position after 5 consecutive green/red bars and place a STOP 1 tick above/below the 5th bar and trail each bar as before no matter what colour the price bar. If STOP has been hit, profits are taken and the position will be flat.

DO NOT add to position if Green/Red bar is lower/higher than the previous bar.

See pages 139-150 for details.

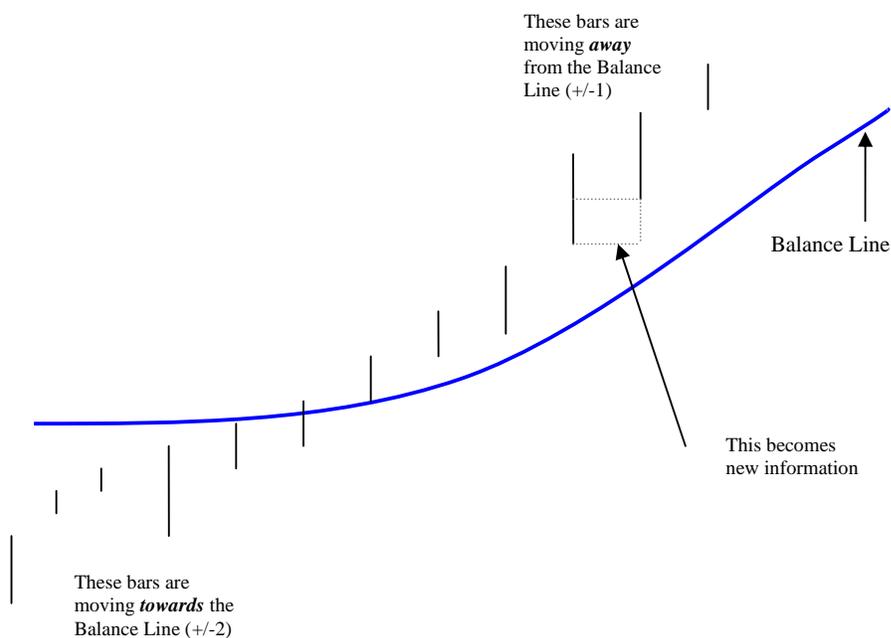
BALANCE LINE TRADES

REMEMBER:

1. Moving toward the BALANCE LINE is difficult that moving away from it.
2. The number of high/low's required for a signal

AWAY from balance line, base => +/- 1

TOWARDS balance line, base => +/- 2



- Always read from RIGHT to LEFT.
- Look at the HIGHS *only* when looking for a BUY signal.
- Look at the LOWS *only* when looking for the SELL signal.
- Establish base bar first:
 - base bar is the starting point
 - To find the base when looking for BUY signals, look at the current bar or the bar with the LOWEST HIGH.

- To find the base when looking for SELL signals, look at the current bar or the bar with the HIGHEST LOW.
- Once base bar has been established:
 - For a BUY you need 1 new HIGH if going *AWAY* from Balance Line and 2 new HIGHS if going *TOWARDS* the Balance Line.
 - For a SELL you need 1 new LOW if you are going *AWAY* from the Balance Line and 2 new LOWS if going *TOWARDS* the Balance Line.

Two final filters are:

1. Do not SELL *above* the Alligator's mouth and do not BUY *below* the Alligator's mouth (remember, don't feed the Alligator).
2. If the current bar is in the **RED** Zone, then *double* the number of *Higher Highs* to create a BUY signal. If the current bar is in the **GREEN** Zone, then *double* the number of *Lower Lows* to create a SELL signal.

See Fig 8-9 on page 159 for detail diagrams.

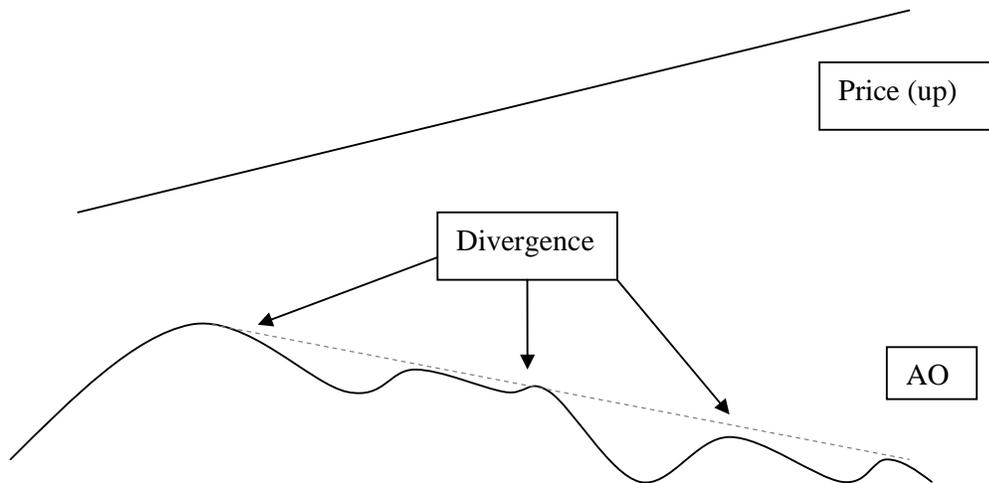
STOPS AND PROFIT TAKING

1. The best overall STOP for staying in a trend in the *long* has been the **RED LINE (Teeth)**. This is a *stop on close only* order.
2. The 5 consecutive bars of the same colour is the next best. Once in the market and the prices move in your direction, a good place for a STOP is at the BOTTOM (LONG/BUY) or TOP (SHORT/SELL) of the **5th bar** of the same colour. This is best used at times when risk needs to be reduced.
3. The **GREEN LINE STOP** is appropriate in a 'runaway' impulsive market where you want to preserve profits in the *short* term. This is a *stop on close only* order.
4. A BUY or SELL in the opposite direction means taking a signal that is going towards the Alligator's mouth instead of away from the mouth. This should be used in uncertain trend change and is the least used method of stop/profit taking.

DIVERGENCE BETWEEN PRICE AND MOMENTUM (CHANGE IN TREND)

- Most markets tend to turn on a **Double Divergence** between the **PRICE** and the **AO** (meaning for example, that the Price is making a *higher high* but the Momentum is not).
- Periodically markets may turn on a *Triple Divergence*.
- Only once in a great while will you see a **Quadruple Divergence**.

See 179-183 from the book. Also Elder, A. *Come into my trading room* (2002). Pgs 102-109



To aid us in being more positive that a trend is ending, we have 5 Profitunity “Magic Bullets” that will end a trend:

1. **Price in the Target Zone.** The ZONE is arrived at by using the Elliot Wave Count, noting the distance between the beginning of Wave 1 through the end of Wave 3, and adding that price difference to the bottom of Wave 4. Then take 62% of the difference. Over 90% of the time, the trend will end between the 62-100% marks (can use Fibonacci Percentage Retracements on MetaStock). [See Murphy, J. *Technical Analysis of the Financial Markets* (1999) pgs 85-87, 335-338]
2. **Divergence (between Price and AO).** This indicator becomes stronger if there is a double or even a triple divergence.
3. **Fractal.** A Fractal is created at the top/bottom of a trend.
4. **Change in Momentum.** The AO indicator shows a change in colour and hence a change in momentum.

Reference:

Elder, Alexandra. *Come into my Trading Room* (New York: John Wiley & Sons, Inc – 2002).

Hill, J; Pruitt, G; Hill, L. *The Ultimate Trading Guild* (New York: John Wiley & Sons, Inc – 2000).

Murphy, John, J. *Technical Analysis of the Financial Markets* (New York: NYIF – 1999).

Pring, Martin, J. *Technical Analysis Explained - 4th Edition*. (New York: McGraw-Hill – 2002).

Velez, O; Capra, G. *Tools and Tactics for the Master Day Trader* (New York: McGraw-Hill – 2000).

Williams, Bill. *New Trading Dimensions: how to profit from chaos in stocks, bonds, and commodities* (New York: John Wiley & Sons, Inc -1998).