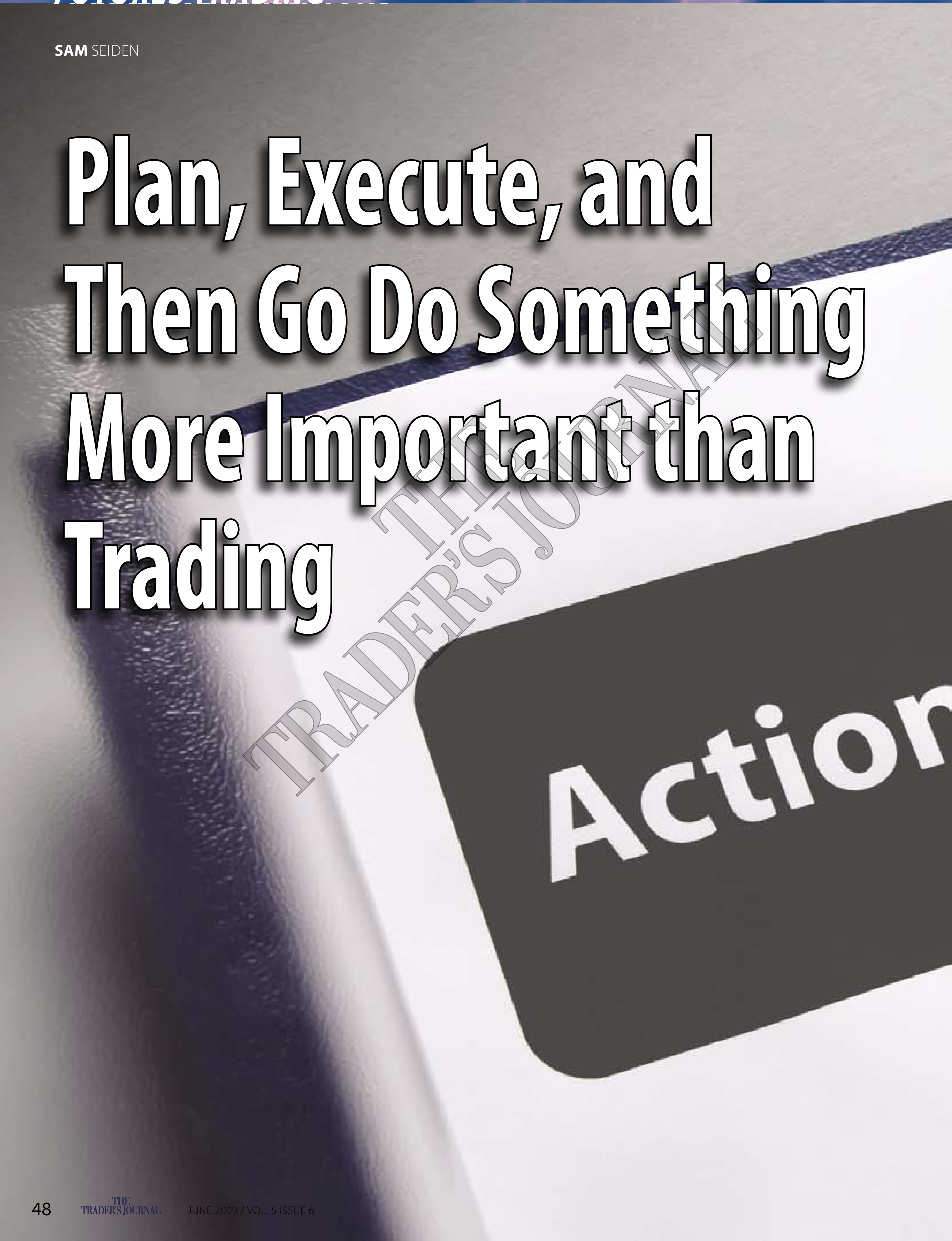
SAM SEIDEN

Plan, Execute, and Then Go Do Something More Important than Trading




Plan
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Sam Seiden shows a trading opportunity and stresses that it is best to research your trades, place them and go do things that are more important.

This piece will focus on a shorting opportunity we identified in the S&P. Many active traders think it is their job to wake up each day and trade. The astute trader knows it is their job to wake up each day and search for low risk, high reward and high probability trading opportunities. If that opportunity is found, the astute trader applies their rule-based strategy and executes like a robot, very little thinking (if any) involved.

Successful trading is not all that glamorous and exciting after you have been doing it for a while. You are simply taking the same successful action over and over, winning and losing, just like Las Vegas. Also just like Vegas, your gains should be larger than your losses. This is what actually got me started in writing. I was trading successfully in my early 20's and because I was so rule-based, I had plenty of extra time on my hands. One day I was asked to write an article about a trade I had in the Japanese yen and that article led to others and so on. Even before I ever wrote my first article, I spent very little time in front of the computer looking at my trades. Once I had a trading routine, I found my opportunity, entered my entire trade and left to do something else like a good workout, a round of golf, spending time with family or some project around the house.

Taking this approach gave me two important benefits. First, I became emotionally detached from the market and my trades as my focus was on other things that were so much more important. Second, I began "smelling the roses" early in life, spending most of my time doing things that were so much more important than sitting in front of a computer screen all day. Sitting and watching your trades keeps the largest risk in your trading world alive, which is human emotion (you). Eliminate that risk with proper rules based on the objective laws of supply and demand and disciplined execution. This means planning your entire trade and letting an unbalanced supply and demand equation naturally move price back to balance.

Let's take a step-by-step look at our trading opportunity. The following chart is a small timeframe chart of the S&P futures. This market is the mother of all global equity index markets as most stocks around the world move in the direction of the S&P. Whether you trade futures or equities, properly identifying quality trading opportunities in the S&P is equally important.

Area "A"

Area "A" represents a supply (resistance) level. This

Figure 1

is an area where the chart tells us supply exceeds demand. We know this because price could not stay at level "A" and had to decline from it. If my statement about supply exceeding demand at level "A" were not true, price never would have declined from it. It would have kept trading at that price level, but the key point for you to understand is that it could not. It had to decline because supply exceeded demand. The exact pattern we look for that represents supply is a Rally-Base-Drop as seen on the chart, "A." This is not a Drop-Base-Drop; we do not look at this as supply because they are found in the middle of moves and typically do not work well.

Area "B"

The decline in price as mentioned above confirms the supply level at "A." More information about the level of supply/demand imbalance at "A" can be gained from observing the rate of decline during "B." The more rapid the decline in price, the greater the supply/demand imbalance at "A." This is key information as it helps us quantify probability.

Area "C"

Area "C" represents the rally in price back up to supply level "A." Notice the strong rally in price with no sign of demand within that rally. This was a great invitation to sell short when price rallied back up to supply level "A." The reason is because the steep rally almost always means that price will fall back through that level at nearly the same rate once it turns at the nearest supply level above "A." The strong rally during "C" was actually the most inviting aspect of this shorting opportunity.

Area "D"

The trading from area "A" through area "C" happened mainly from May 21st through May 26th. The vertical line on the chart marks the opening of trading on May 27th. Shortly after the opening bell in the U.S. stock market, the S&P rallied right up into supply area "A." "D" is the time our rule-based strategy had us selling short. Why sell short here? Simple, there are novice buyers entering the market at "D" who are committing the same two mistakes that every novice trader makes. Mistake number 1 – they are buying after a rally in price. Mistake number 2 – they are buying right at a price level where supply exceeds demand. The laws of supply and demand ensure you will lose consistently if you commit these two mistakes. Can this novice buyer be right once in a while? Sure, just understand that in trading and investing, money always ends up in the hands of its rightful owners. The short entry was at "D" at a price of 911, selling to a novice buyer.

Area "E"

"E" represents the price level just above our supply level "A." This is exactly where our protective buy stop is placed in case our trade does not work out in our favor. The price was 915. This is how we limit risk and ensure that we are not putting more capital at risk than we are willing to. The buy stop order is placed here because the last time price was in this area "A," price was not able to go above that level. This is because there is way too much supply at that level which makes for an ideal placement of the protective buy stop. With a stop of 4 points in the E-mini S&P futures, that means risk is $200 for each contract. Trading five contracts, we would have a risk of $1000.

Area "F"

The blue line at "F" is at 899. This is 12 points from our short entry at 911. If we are risking 4 points on the trade, we want to make sure we have at least a solid 3 to 1 profit target which means we are looking for at least a 12 point gain. "F" is where that 12-point gain was reached and is where the rule-based robot trader would exit some or all of the position if the plan were 3 to 1. With those 5 contracts, that yields a gain of $3000. Risking $1,000 for a gain of at least $3,000 is solid risk/reward trading. Keeping your goals to at least 3 to 1 or greater also increases the probability in your trading, but that is a topic for another time.

I wanted to really walk you through a real trading example, explaining how and why prices move and how and why the astute trader does what he or she does. Furthermore, I want to impress upon you how having a solid understanding of the foundation principles that allow you to see where the "real" buyers (demand) and sellers (supply) are on a price chart allows you to have a rule-based strategy. Having a rule-based strategy is the key to not spending your life in front of the screens but instead, spending it doing things in life that are so much more important.

Sam Seiden brings over 15 years experience of equities, Forex, options, and futures trading that began when he was on the floor of the Chicago Mercantile Exchange. He has traded equities, futures, interest rate markets, Forex and options for his personal interests for years and has educated hundreds of traders and investors through seminars and daily advisory services both domestically and internationally. Sam has been involved in the markets since 1991 both on and off the floor of the Chicago Mercantile Exchange. He has served as the Director of Technical Research for two trading firms and regularly contributes articles to industry publications. Sam is known for his trading, technical research, and educational guidance.