

# Introduction to DecisionBar Trading

DecisionBar trading is real trading. As a DecisionBar Trader you won't get bogged down looking at countless indicators, which give diverging signals, or trying to evaluate arcane mathematical relationships. As a DecisionBar Trader you will come to understand that successful trading boils down to accomplishing four things.

- 1) Identifying When a Potential Trade Exists. 3) Deciding if You Should Take the Trade.
- 2) Determining the Direction of the Trade. 4) Decide When to Exit a trade.

Our DecisionBar Strategy indicator identifies potential trades and the direction of the trade. It also helps you to determine when to exit a trade along with stops based on your own risk tolerance and market volatility.

Our Risk Oscillators will help you decide whether to take a trade along with any other methods or indicators you wish to employ.

The DecisionBar Strategy indicator is our main indicator. It is very important that the strategy indicator be optimized for the instrument you are trading, as discussed in the DecisionBar Trading Manual.

The optimal sensitivity settings are different for each instrument you are trading and for each time frame. **Knowing how and when to optimize these settings is the key to your success.**

The sensitivity setting is an inverse setting. In other words, the lower the setting, the higher the sensitivity. Higher sensitivity settings (lower numbers) will give you more trading signals. Lower sensitivity settings (higher numbers) will give you fewer trading signals.

**The default setting for the high and low sensitivity is 15/15. These settings are much too low for today's volatile markets.**

**Remember, the higher the setting, the lower the sensitivity.** Settings of 30/30 are a good place to start. For volatile stocks and futures with wide ranges, eMinis and especially forex you may have to go to 40/40, 50/50 or even higher.

The idea is to try to filter out random moves while picking up small to large trends.

Both the high and low sensitivity should usually be set to the same figure.

To determine the proper setting, look at your chart. If the indicator gives you too many signals and a lot of "whipsaws" (moves in and out of positions too fast for a lot of near break-even trades), then decrease the sensitivity (by increasing the sensitivity setting).

The lowest sensitivity setting that eliminates the whipsaws is the proper setting.

**It is important to understand that settings are not static. As the market changes, you have to adapt by changing the sensitivity settings and/or the interval you trade. The inability to adapt is the number one reason many traders are not successful.**

**I have a sign that says "ADAPT!!" and I keep it near my workstation so I see it often.**

Most trading instruments have their own personalities. Once you find a productive interval, you can trade that interval for quite a while.

If the interval you have been trading stops being productive, try to adjust the sensitivity of the DecisionBar Strategy indicator. If that does not give you a productive looking chart, change the interval (time frame) you are trading.

Since the DecisionBar Strategy indicator puts historical signals on a chart exactly as they would have appeared, it only takes a few seconds to visually check-out different sensitivity setting.

**We often get asked if a back test can be run on a certain trading instrument and interval to “optimize” the settings. The answer is no. Back tests do not “optimize,” they “average.” To find the optimal settings for “right now,” you have to look at the chart “right now.”**

You will notice an indicator in the DecisionBar folder called the DecisionBar Strategy Warning indicator.

This indicator is used with the DecisionBar Strategy indicator. The DecisionBar Strategy indicator gives signals after the close of a bar; which meets the signal criteria. The DecisionBar Strategy Warning indicator gives an audio alert and/or pop-up each time it appears a signal may be imminent. It is kind of a "Heads Up" or “Warning” that you are on the verge of getting a trading signal. For this indicator to work properly you must make sure the sensitivity setting are the same as the sensitivity setting for the DecisionBar Strategy indicator.

Instructions for changing the sensitivity settings for the DecisionBar Strategy indicator and the DecisionBar Strategy Warning indicator are in the quick-start for the charting platform you are using.

Finally, a word about support. Support for DecisionBar is always free. Don't hesitate to contact our support department for help with installation, one on one training, help with maximizing your set-up and settings, and any other problems you may have.

All we ask is that you read the instructions included in your package before contacting support, so our support department doesn't get overloaded and those who really need help can get it.

Do you have a question about trading? While we can't give specific trading advice, our traders will do their best to give you honest and complete answers to your trading questions.

You can also email me with any questions or comments you may have. I answer all of my emails.

Once again, Congratulations on becoming a DecisionBar trader.

Good Luck and Good Trading.

Les Schwartz  
DecisionBar Trading

# **The**

## ***DecisionBar***

### **Trading Manual**

**by**

**Les Schwartz**

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## **Preface**

DecisionBar Trading is not just a collection of indicators. It is a complete trading method that can allow even a beginning trader to consistently take money out of the markets. Note that we said “method” not “system.” That is because systems don't work. The market is a constantly changing entity. The only constant that you can depend on is that prices are determined by Supply and Demand. How Supply and Demand is affected by outside influences changes from day to day. As a DecisionBar Trader, you will learn how to modify your methods to stay ahead of the market and ahead of other traders.

DecisionBar Trading works in any time frame for any liquid trading instrument. Before you install the DecisionBar Indicators, we suggest you find a quiet place to sit down and read this manual in its entirety. Once you have an understanding of the concepts behind DecisionBar Trading, you will be ready to master the markets.

Good Luck and Good Trading!!

# Introduction

Congratulations! You're about to embark on an exciting journey. At the end of this journey you will view the world in a different light. You will have an understanding of the financial markets that not one person in 500,000 has. You will have all the tools you need to profitably invest in, or trade any financial market in any time frame.

Whether you are a long-term investor, a short-term trader or wish to create a new career for yourself as a day-trader, your goals are now within your grasp.

I have taken the same trip myself, but while my trip took me about 10 years, your trip will only take you just a few of hours.

Like so many others, when I started trading, I too got caught up in the stock market hype. Instead of learning how the markets worked, and how to make money with that knowledge, I spent my time learning about countless indicators, studying complex mathematical concepts, and following one "Trading Guru" after another. I spent thousands of dollars on trading courses and software programs, and subscribed to countless trading services. In the end, I was right back where I started. Just another "wannabe" trader without a clue as to how to accomplish my goals.

I decided to take one more stab at accomplishing my dream, and I decided to start from scratch. I won't take up your time with details of how I found what I believe is the universal key to profiting from financial markets, but suffice it to say that I stopped listening to everyone else and just applied some good old common sense to an entity that everyone said was indecipherable and, you know what? Everything fell into place. The fact is that, despite what the financial establishment would have you believe, the market makes perfect sense. But this is something you will soon see for yourself.

While I can promise you that DecisionBar Trading will allow you to see the market as it really is, and that I will give you the tools to exploit that knowledge, I can't guarantee that you will become a successful trader.

Some people just don't have the psychological makeup to be good traders. Some just can't pull the trigger. Some just can't take the risk. After I show you how the market works, you will know that you have the tools to take money out of any financial market you wish to trade, in any time frame you wish to trade it in. It's a great feeling!!

An "epiphany" is a sudden understanding of a concept that has always eluded you. A "clarity" that you never thought you would have. As you work through our DecisionBar concepts, you will have an epiphany. That is not an empty promise, but a simple fact.

I will do the best I can to help you overcome the psychological hurdles that every trader faces, but in the end, it is up to you to determine if trading is right for you, and what kind of trading is right for you. The good news is that DecisionBar Trading works just as well for long term investing as short term trading. No matter how you decide to take money out of the markets, you will benefit from DecisionBar Trading.

DecisionBar Trading is valid for trading Stocks, Commodities, Currencies, Futures, T-bills or any financial instrument. Just because we may use one type of trading instrument to demonstrate a concept, that doesn't mean the concept is not valid for other trading instruments.

I use stocks for a lot of examples because I started out as a stock trader. Don't tune out because you may be trading forex.

All markets show a basic rhythm based on supply and demand, support and resistance, momentum and exhaustion. With DecisionBar, you can trade any true market.

## A Mind-Set for Success.

Times are tough right now. In fact, for most of us, the world's economy is in the worst condition we have seen it in our lifetime.

As strange as it seems, most people are more willing to spend money looking to improve their financial conditions in bad times than in good times. This gives rise to a lot of scams and hucksters.

All scams have one thing in common: They promise you fast money for little or no work. No matter how intelligent or level-headed we may think we are, virtually everyone is susceptible to this come-on. At least for a second or two.

I could go on and on debunking forex robots and trading systems that will “make you money while you sleep,” but let me ask you just one question:

If giant investment banks like Merrill Lynch and Bear Stearns, that could have afforded hundreds of programmers and banks of computers, couldn't create a profitable, automatic trading system, do you really think a few lines of code running on your home computer will do the trick? Of course not!!

The same thing for the “Pump and Dump” stock offers you get in the mail that promise to show you the next Microsoft. These promotions are sent out by paid advertising agencies that are trying to raise the price of the stock so they can sell their stock to you before the stock tanks again.

As I said, the promise of fast money with no work is enticing, but if you really want to succeed as a trader, allow yourself a second or two to dream, and then delete the email or throw away the direct mail offer and get back to work.

Time after time would-be traders jump from one false promise to another, and when they are finally ready to settle down and actually learn how to trade, they've run out of time and money and it's too late.

In order to become a successful DecisionBar Trader, don't let yourself get side-tracked by false promises. Make up your mind that you will do whatever it takes to make DecisionBar work for you and that **failure is not an option!!**

Now, I want to tell you the one characteristic that causes most would-be traders to fail. **It is the desire to be right!!** Most of us equate a losing trade with being wrong, and our egos won't let us accept being wrong.

Instead of exiting a trade that is moving against us, we hold on in the hope that the trade will turn around and prove us “right.” Invariably the trade keeps moving against us and what would have been a small loss turns into a catastrophe.

We all do this. After 20 years, I still fight the urge to “hold on just a little bit longer.” Sometimes the urge wins out and I pay the price.

How many retirees saw their retirement accounts virtually disappear because they didn't want to “take a loss.” Understand this: When a trade goes against you, the loss is already there. You don't have the option of deciding to “take a loss.” The only option you have is admitting to the loss.

**Real trading is not about being “right.” It is about being on the “right side of the market,” so you are positioned for the next moderate or big move.**

This often involves repositioning yourself and taking a small loss to be in a position to take advantage of a big move and reap big rewards.

DecisionBar Trading Software helps you do this better than any other method I know because it lets you see the market evolve and adds clarity to your trading.

One of the reasons “paper trading” is so important is that it allows you to see the benefits of exiting trades quickly when the bias of the market turns against your current position. Once you start trading with real money, you will once again feel the urge to be “right,” but at least you will know how you should deal with those urges.

# Let Me Prove That DecisionBar Trading Will Work For You

There are four prerequisites to becoming a DecisionBar Trader.

- 1) You must sincerely want to use the financial markets to make yourself financially independent.
- 2) You need to have a passing knowledge of the financial markets to benefit from DecisionBar Trading. That is to say you should know how to buy and sell stocks, futures, currencies (or whatever instrument you wish to trade) and you should know how to read a bar charts and candlestick charts. We at DecisionBar Trading like candlestick charts, and we'll use candlestick charts in our demos. Regular bar charts work just as well, and give the same signals, but candlestick charts give you a better picture of what is happening in the market.

If you need to learn about reading charts or the basics of buying and selling, including short-selling, there are many books in your local library and resources on the Internet that explain how to read charts, and a number of brokers have online Trading Simulators you can learn from. There are many resources on the web to help you learn the basics. One of the best is:

<http://www.investopedia.com>

- 3) A successful trader needs a world-class quote and charting system. These are the tools of your trade. The DecisionBar indicators now run on eight superior software platforms: MultiCharts, eSignal, TradeStation, NinjaTrader, MCFX, MCFX\_Pro, MetaTrader and MetaStock.

If you are currently using a different charting platform, you can use one of these platforms in addition to your current platform. There is no need to change brokers or charting platforms.

This manual was done mostly using eSignal, but the signal would appear the same way, in the same place on the other platforms.

- 4) You must forget everything else you have learned or been told about trading the markets. All markets follow a natural order. You must understand that order, before you even think about using chart patterns or technical indicators to help you trade. After you understand DecisionBar Trading I will show you how to use some indicators to enhance your trading results.

You will learn how to use the proprietary indicators discussed in this DecisionBar Manual, Our Strategy Indicator alerts you when potential trading set-ups occur, and our RiskOscillator will help you determine whether or not to take a trade. (We have separate Risk Oscillators for trading stocks, futures and commodities (including eMinis) and Forex.)

Remember, once you become a DecisionBar trader there is never a charge for upgrades or additional indicators we may develop.

# **Stop The Insanity!!**

Some years ago there was a weight-loss guru who used “Stop the Insanity” for the name of her weight-loss program. The essence of the program was that you should use your common-sense instead of looking for a magic way to take off those pounds. The fact is that anyone can lose weight if they eat less and exercise more. We all know that, but people who are constantly fighting their weight (and I am one of them) continue to look for an alternative. Yet, when we finally get serious about losing weight, we know the old stand-by works: Eat less and exercise more. It’s just common sense.

Trading has its own element of insanity. Elliott Waves, Fibonacci Numbers, Head and Shoulders Patterns, technical indicators ... you name it. If just one of them worked, you wouldn’t need all the others! The truth is, trading is about one thing and one thing only: Price. But, of course, you knew this all the time. It’s just common sense.

The only way to make money trading Stocks, Commodities, Currencies, Futures, or even Bowling Balls is to sell whatever it is you bought for more than you paid for it. So, Let’s Stop the Insanity, stop looking for the Holy Grail, and see how easy it is to buy low and sell high with DecisionBar Trading.

Technical indicators, wave analysis and mathematical progressions may have their place, but you don’t need them with DecisionBar Trading.

# Urban Legends of Trading

Before you can appreciate DecisionBars, you must accept the fact that almost everything you have been told about trading is wrong. Let's debunk some myths.

**The first myth is that you must be able to identify patterns, waves, retracement levels, etc. to be a successful trader. Wrong!!**

As we discussed above, this borders on insanity and is the **last thing** you want to concern yourself with. This is an invention of the Trading Mafia (That's what I call those guys that line their pockets by spreading misinformation.) to keep you convinced that you need them and can't possibly be a profitable trader on your own. When I said **last thing**, I meant just that. After you learn how to predictably take money out of the stock market using DecisionBar Trading, you can experiment with chart patterns and different mathematical concepts to see if they can improve your profitability, but as a means of attaining profitability, they are useless.

**The second myth is that you will benefit by paying a trading service and following their trading selections. Wrong!! Wrong!!**

You must understand that trading is a solitary endeavor. You are trading against other traders. If you were a boxer, would you discuss your next punch with your opponent? Of course not! When I day-trade I often buy a thousand shares of stock for a trade. If just one other trader is trying to make the same trade it could push up the price of the stock I'm trading. On a thousand shares, a difference of \$0.01 in price means that I must pay an extra \$10.00 for the stock. A difference of \$0.10 means I have to pay an extra \$100.00 for the stock. If I tried to make the exact same trade, at the same time, as say 100 other traders it could cost me \$1000's of dollars a week in missed trades and bad fills.

Trading services and trading chat rooms are filled with "wanna-be's." By purchasing DecisionBar trading, you are now a trader. Stay away from the wanna-be's. (We will be doing periodic online seminars, at no charge, for DecisionBar Traders. While we will do the seminars in real time, we won't actually be trading for the reasons just mentioned.)

**The third myth is that, for some reason, you have to identify what kind of trader you are. Wrong!! Wrong!! Wrong!!**

Trading is about making money, not putting yourself "in a box." There is no rule that says someone who usually trades stocks can't trade forex.

There is no reason why a forex trader can't take advantage of a run-up in crude by buying oil futures.

Successful traders must have open minds and be versatile. When you are looking for something to trade, you should have only one demand: "Show me the money!"

Now, to be realistic, many forex traders are trading forex because they can begin trading with just a few hundred dollars, so they don't have the option of switching to futures or stocks.

This is problematic, since you have the most inexperienced traders trading what is arguably the most difficult trading instrument. Forex traders are often trading against their own broker (and you know who has the edge there), and a majority of the current scams are aimed at forex traders.

Forex often doesn't go anywhere, or moves very fast. That is why it is essential to adjust the interval you are trading and the sensitivity of the DecisionBar Strategy indicator, as discussed in the beginning of this manual. Here are a couple of other hints for forex traders.

## **When to Trade Forex**

Just because you can trade forex 24 hours a day, doesn't mean you should trade forex 24 hours a day. Since most currency pairs move very little in the course of a day, the key is to trade a currency pair during time periods when movement is most likely to occur.

The fact is that the most movement occurs when businesses in at least one of the currency markets you are trading is open. You will likely get the most activity when both currency markets are open. This is called "trading the overlap." You can view market schedules for the major currencies by going to:

<http://www.gftforex.com/forex/24houraccess.asp>

Another time to trade is following (not before or during) potentially market moving scheduled news and economic events. For a current list of scheduled events go to:

<http://www.forexnews.com/>

Always exit the market before market moving events like unemployment or interest rate announcements. Don't fall into the trap of trying to guess how the market will react to these announcements. That's for amateurs. If you want to gamble, go to Las Vegas.

**The fourth myth is that stock traders must scan thousands of stocks to find just the right trading opportunity. Wrong Again!!**

Most successful traders trade just a few stocks at any given time. Every stock that has some volatility to it offers a continuing stream of trading opportunities. There is no need to scan thousands of stocks for the perfect chart pattern (which doesn't exist to begin with).

Most stocks will offer you as many as five or six Day Trading opportunities in the course of a day, and two or three Swing Trading opportunities in the course of a month. (Keep in mind that real Swing Trading involves catching an entire swing, not a fearful one or two points of a ten point move, as attempted by most online trading services.)

Stocks tend to have "personalities." These personalities are created by the people who are trading a stock and the "specialist" or "market makers" that control trading in this stock. The more you trade the same stock, the better you are able to anticipate its movement.

**Now that we have that out of the way ...**

## **What the Heck is a DecisionBar?**

**DecisionBars are specific periods in time which present a natural trading opportunity. By “natural,” we mean an opportunity that is in sync with the rhythm of the market. A DecisionBar is a specific bar on a bar chart, or a specific candlestick on a candlestick chart. As such, the timing and direction of the potential trade are pre-determined. All that is left is for you to evaluate risk and determine if you wish to take the trade. DecisionBars are so powerful that even if you took every trade offered, you would make a profit on most stocks with reasonable volatility.**

# DecisionBar Trading 101- Price is Everything

To understand why Stocks, or any trading instrument) change in price, you need a little business experience ... very little. We'll use the word "stocks" for this discussion, but feel free to substitute the words "Forex or "Futures" if you wish.

Traders buy stocks for one reason and one reason only. They buy a stock so they can sell that same stock at a profit. In other words, you are like a wholesaler. You don't buy a stock to use that stock for something. You don't buy a stock to collect dividends. You buy a stock to sell it to someone else.

Even though we know that whoever we sell a stock to is buying it for the same reason we bought it (to sell it), that's not important. They could buy the stock to burn it for all we care. The important thing is that they perceive the stock to be a good value at the time they buy it.

Since there may be hundreds of thousands of people buying and selling stocks, the price of the stock varies according to supply and demand, but there are two critical points:

The first is when a stock reaches a price where investors perceive it to be too expensive. As traders who bought the stock try to take profits they flood the market with stock (supply), but a lack of buyers (demand) pushes the price down. **This is often called resistance.**

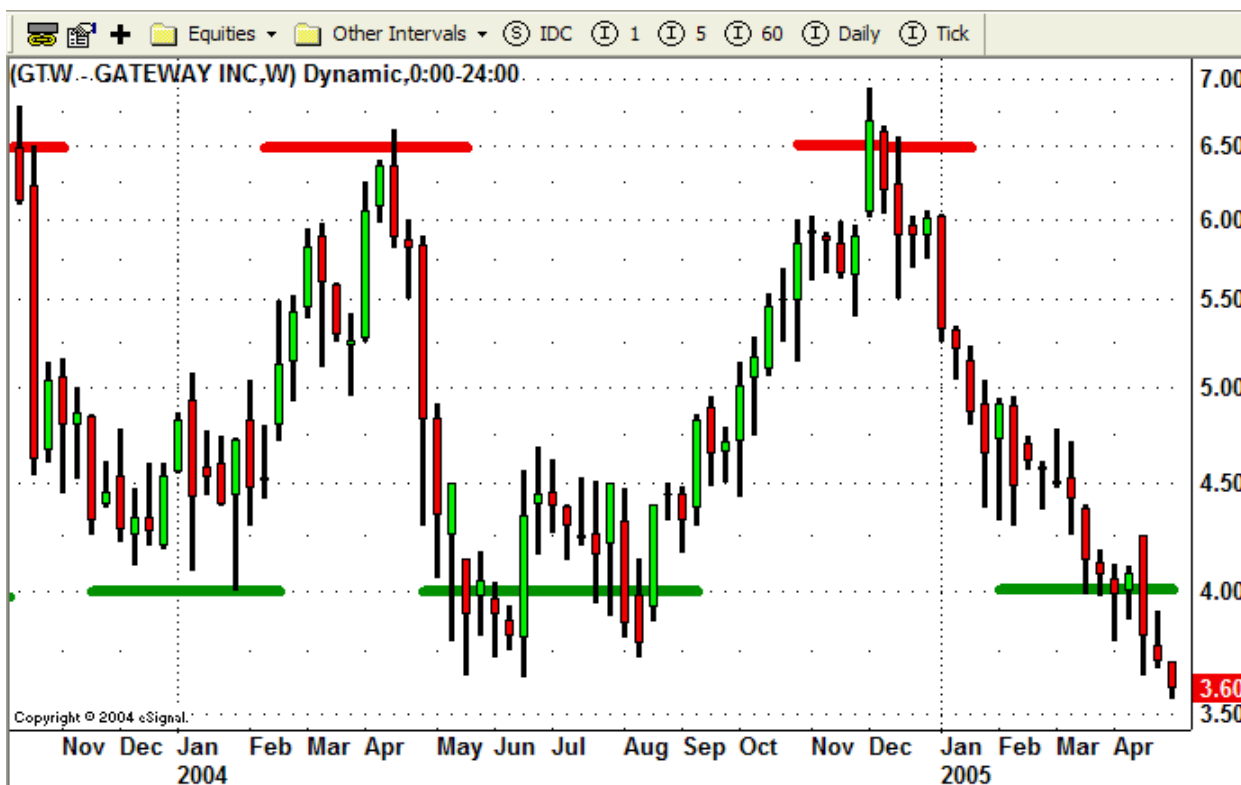
The second critical point is when the price of a stock becomes so cheap that there is suddenly a run on the stock (demand), decreasing supply and causing the stock price to rise. **This is often called support.**



The bottom line is that the price of a Stock is determined by Supply and Demand, and Supply and Demand is determined by Price. Not some of the time, but all of the time. **Price is everything!!**

## DecisionBar Trading 102- Support and Resistance

Decision Bars tell you when to trade, and what direction to trade. There are six types of decision bars. The first two DecisionBar we are going to discuss occur when the stock or trading instrument is unable to overcome resistance, or is unable to drop below support. These decision bars are called Failures.



This chart of computer maker Gateway (GTW) is a weekly chart generated by eSignal. It illustrates how most people think of support and resistance. You'll find a lot of so-called "gurus" showing you a picture like this and calling it a "Rolling Stock." They tell you all you have to do is buy low, and sell high. When GTW drops to \$4.00 you buy, and when it rises to \$6.50 you sell. If only trading were that easy!

Well, Rolling Stocks are just an "Urban Legend" of the Trading Mafia. **What you are looking at is an unusual and random occurrence.** Once you see the pattern, the Trading vehicle will likely break the pattern on the very next swing. Look what is happening on the bottom right hand corner of the chart. How far will GTW fall? I don't know (this is a current chart as I am writing this), but the odds are that the stock will continue lower.

**The fact is that support and resistance levels are constantly changing.** What was perceived as expensive yesterday might not be perceived as expensive today. What was perceived as cheap yesterday might be considered expensive today. Remember, it's all about price, not how pretty the chart is.

An average stock chart might look more like this chart



It looks pretty random doesn't it? Well, actually it's not. **You see, current support and resistance levels are defined by previous highs and lows, but where those highs and lows actually occur cannot always be easily determined.**

For that reason, using a proprietary algorithm, we developed the **DecisionBar Pivot Indicator**. This indicator automatically points out important support and resistance levels and is completely customizable for each time frame and trading instrument.



Here is the same chart of XM Satellite Radio (XMSR) with our **DecisionBar Pivot Indicator** on it. The **DecisionBar Pivot Indicator** points out expected areas of support and resistance in real time. These are areas where the market you are trading has a good chance of reversing direction.

As we stated at the beginning of this section, our first two **DecisionBars** occur when a stock:

- 1) fails to overcome Resistance (refuses to move higher), and
- 2) fails to drop below Support (refuses to move lower)

Most movement between Support and Resistance is random and caused by outside influences that cannot be quantified. In other words, we can't (and don't try to) predict every "wiggle" of every stock. We only look for important "pivot" points which define trading opportunities. We leave the mathematics to the mathematicians. We are traders.

When a stock (or any trading instrument) attempts and fails to move above resistance, or below support, we have a trading opportunity. A stock may challenge support or resistance on just one bar, or for as many as four or five successive bars.

The first bar following that challenge that is completely clear of the support or resistance line is the **DecisionBar**. If a decision bar follows a test of support, it is a buying opportunity. If a decision bar follows a test of resistance, it is a selling opportunity.

When a decision bar occurs it is telling you that the market will likely move in the direction indicated by the **DecisionBar**. When this happens, you should

1) Close out any open positions that are not in agreement with the current decision bar. In other words, if you are in a short trade, and the decision bar follows a failure to move below support, close out your short trade. If you are in a long trade, and the DecisionBar follows a failure to overcome resistance, close out your long trade.

(In a later chapter, we'll show you how to confirm the signal with our Risk Oscillators. For now, we'll just accept that the signal is valid.)

2) The second thing you must do is decide if you should take the indicated trade.

We only look to take trades where the odds are in our favor. The easiest example to understand is that we are biased towards long trades in an uptrend and towards short trades in a downtrend. In choppy or flat markets we may decide to stay on the sidelines.



Once again let's look at our chart of XM Satellite Radio (XMSR), this time with some of the DecisionBars marked with numbers and colored arrows. For now we'll assume all signals are confirmed.

The first marked DecisionBar is identified by a green, upward arrow and the number "1". At this point the stock failed to drop below support, so this is a Failure-Buy DecisionBar. Now we must decide if we want to take a long trade.

Note that the stock crossed support during each of the previous five bars. DecisionBar "1" is the first bar following those five bars where the stock traded above support for the entire duration of the bar.

The second DecisionBar is indicated by a red, downward arrow and the number "2". At this point the stock failed to move above resistance, so this is a Failure-Sell DecisionBar. Now we must decide if we want to take a short trade.

The third DecisionBar is identified by a green, upward arrow and the number “3”. At this point the stock again failed to drop below support, so this is a Failure-Buy DecisionBar. Now we must decide if we want to take a long trade.

The fourth DecisionBar is indicated by a red, downward arrow and the number “4”. At this point the stock again failed to move above resistance, so this is a Failure-Sell DecisionBar. Now we must decide if we want to take a short trade.

These are natural trading opportunities that allow you to trade with the rhythm of the market. Timing and direction are already determined. All you must do is evaluate risk and decide whether or not to take the trade.

Later on we'll show you how to use our proprietary Risk Oscillator to help you both confirm trades and determine whether or not to take the trade. For the moment, if you just look at the chart you'll see that it is relatively flat, but with a slight downward bias, so long trades are slightly riskier than short trades. Do you see what we mean about your common sense being your greatest asset?

Also, later on, we'll introduce you to our DecisionBar Strategy Indicator which will alert you to trading opportunities in real time.

## DecisionBar Trading 103- Breakouts and Breakdowns

Support and resistance levels do not always hold. In this day of “information overload” it is not unusual to have three, five or even 10 news articles released in the course of a day which move whatever market you are trading.

Believe me, when good news comes out traders don't ask what Fibonacci level the stock is at before they buy, and when bad news comes out, traders bail regardless of what the Elliott Wave Pattern looks like.

A move above resistance is called a Breakout. A move below support is called a Breakdown.

Once again, it's all about the price. Traders buy when a stock or other trading instrument is breaking out because they believe it will continue higher. Obviously, this is not always the case.

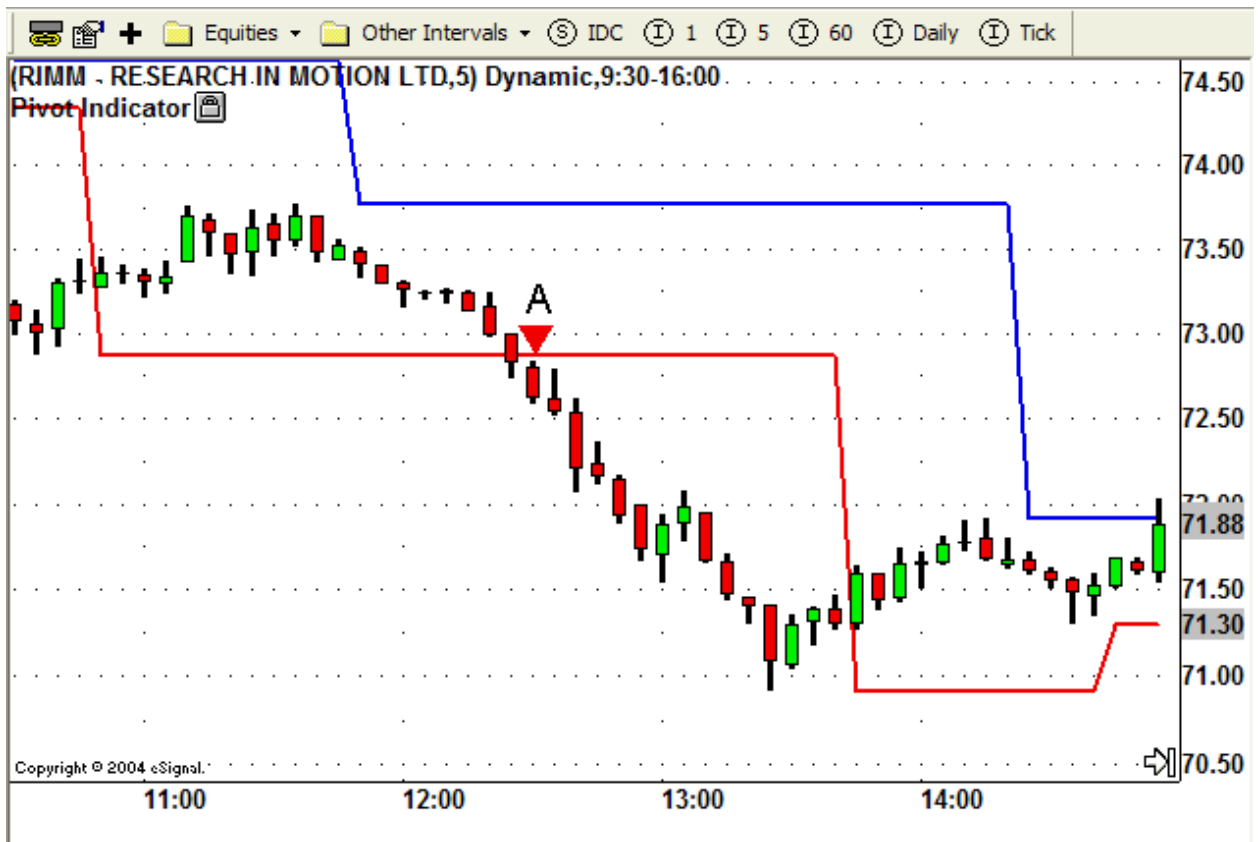
Traders sell when a stock or other trading instrument is breaking down because they believe (or fear) that it will continue lower.

It's not necessary to know the reason, if any, a Breakout or Breakdown, but it can't hurt. If the overall market is moving up because of an interest-rate reduction, that move will likely have legs and there is a good chance your breakout play will be successful.

If a move up occurs because of some pundits comments on TV, the move may only be temporary.

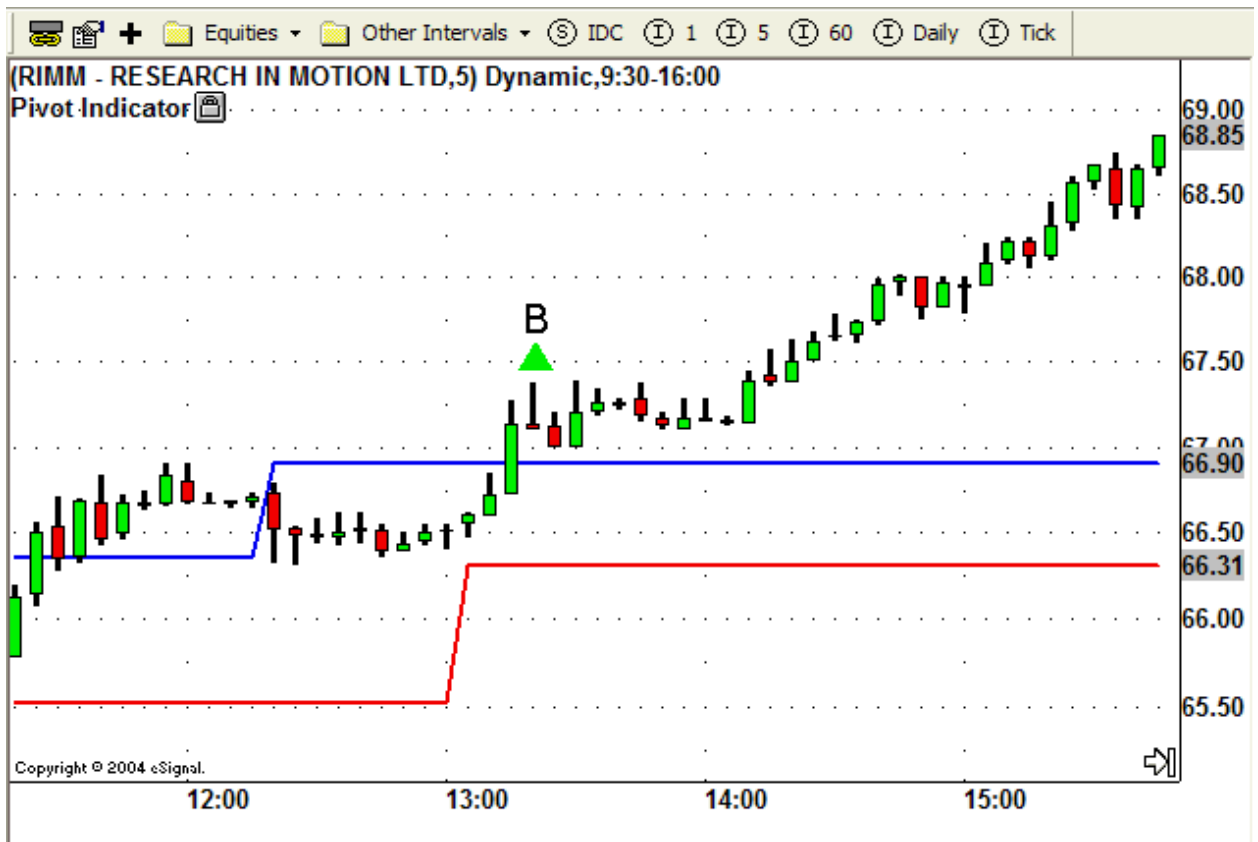
**The first bar that trades completely above resistance for the duration of the Bar is the Breakout DecisionBar. This is a buying opportunity.**

**The first bar that trades completely below support for the duration of the Bar is the Breakdown Decision Bar. This is a selling opportunity.**



This is an intraday chart of Research in Motion (RIMM) with a Breakdown DecisionBar marked with a red arrow and the letter A. When a Breakdown DecisionBar occurs, you should close out your long position, if you are in one, and then you must decide whether or not to take the short trade. If you are already in a short trade, you do nothing as this becomes a reinforcing signal.

If you were not in a short trade, you would likely take the short trade here because our pivot indicator shows a negative bias which decreases risk for this trade. (In other words, the stock appears to be trending downward.)



Here is another intraday chart of Research in Motion (RIMM), this time with a Breakout Decision Bar marked with a green arrow above the bar and the letter B. When a Breakout Decision Bar occurs, you should close out your short position, if you are in one, and then you must decide whether or not to take the long trade. If you are already in a long trade, you do nothing as this becomes a reinforcing signal.

If you were not in a long trade, you would likely take the long trade here because our pivot indicator shows a positive bias which decreases risk for this trade.

## DecisionBar Trading 104 – Failures

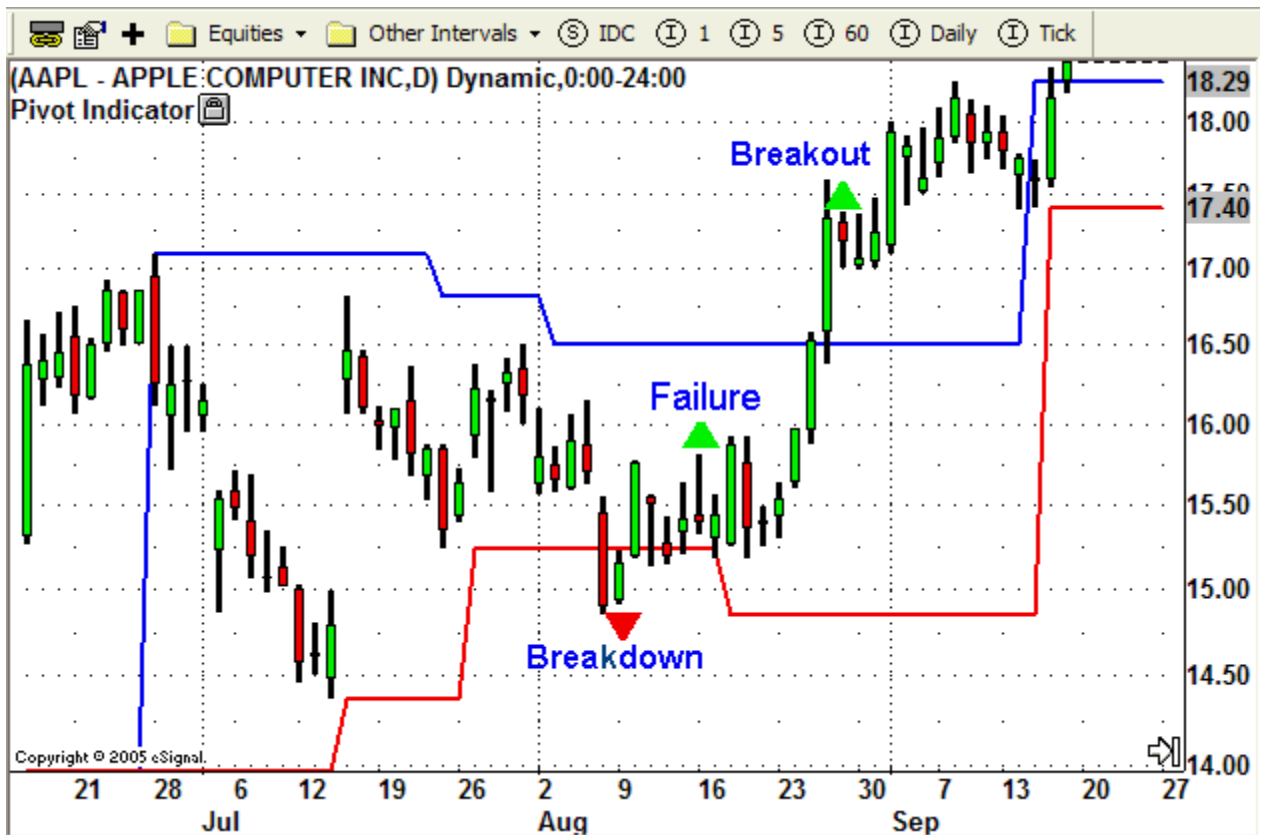
Sometimes, the market fools you. It appears to show a Breakout or Breakdown and then reverses direction and moves back through the same support or resistance level. Once again we have a Failure which creates a trading opportunity.

If you took the last trade, it also means you lost that trade.

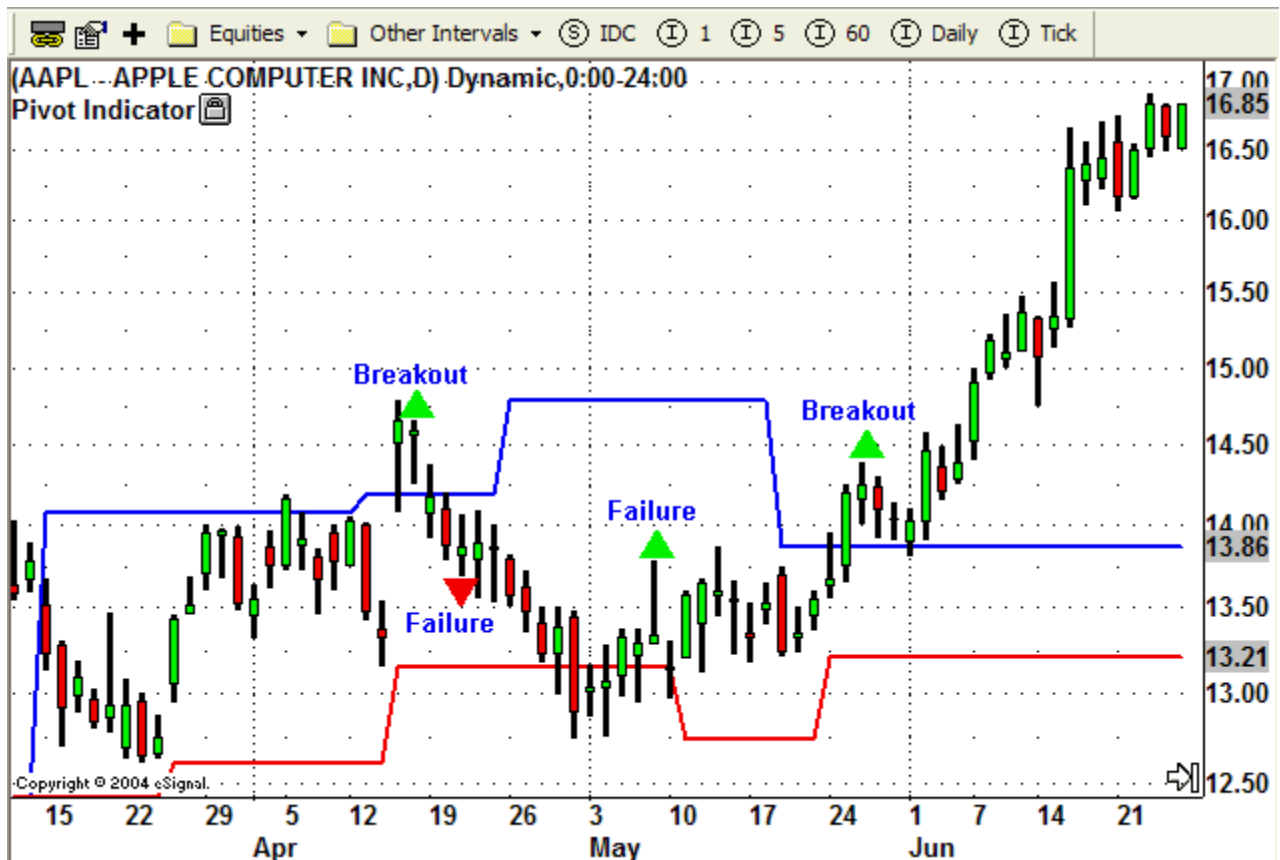
**Here s a fact that you're going to have to get used to; You're going to lose trades.** You have to accept that fact and understand that fact. Strangely enough, it is ego that makes so many losing traders. They are people who just cannot admit they are wrong, and stay with losing trades too long so they can prove that they were right. We all have some of that in us. If you're a competitor like I am, you hate losing. So be it, but this is not about ego.

The best hitter in baseball, Barry Bonds, gets a hit one third of time. That's enough to make him a champion. Tiger Woods doesn't make a hole-in-one every time he tees off. In fact he makes a lot of bad shots. What makes him a great player is that he puts his bad shots behind him and follows them with great shots.

I'm not going to give you any nonsense about “Love Your Losses” or anything like that. I will tell you that as a DecisionBar Trader, your gains will be bigger and more frequent than your losses, and you can take that to the bank.



This daily chart of Apple Computer (AAPL) indicates a breakdown shown by the red arrow. This time the market fooled us. As soon as we made the trade, the stock moved back up and, five bars later, gave us a Failure-Buy signal resulting in a successful trade. (Note the reinforcing Breakout signal a few bars later.



Here is another daily chart of AAPL, this time with a series of signals. Moving from left to right our first signal is a Breakout-Buy signal, indicated by the green arrow above the candlestick. That Breakout fails, resulting in a losing trade, and the next signal is a Failure-Sell signal. AAPL refuses to move below support, and our next signal is a Failure-Buy signal, resulting in what is probably a breakeven trade. The next signal is a reinforcing Breakout-Buy signal which succeeds resulting in a nice winning trade.

**Are you starting to get it? Is it starting to make sense to you now? You can do this. You've just been listening to the wrong people who sold you bad ideas. DecisionBar trading is the real deal!**

## DecisionBar Trading 105 – Exhaustion Bars

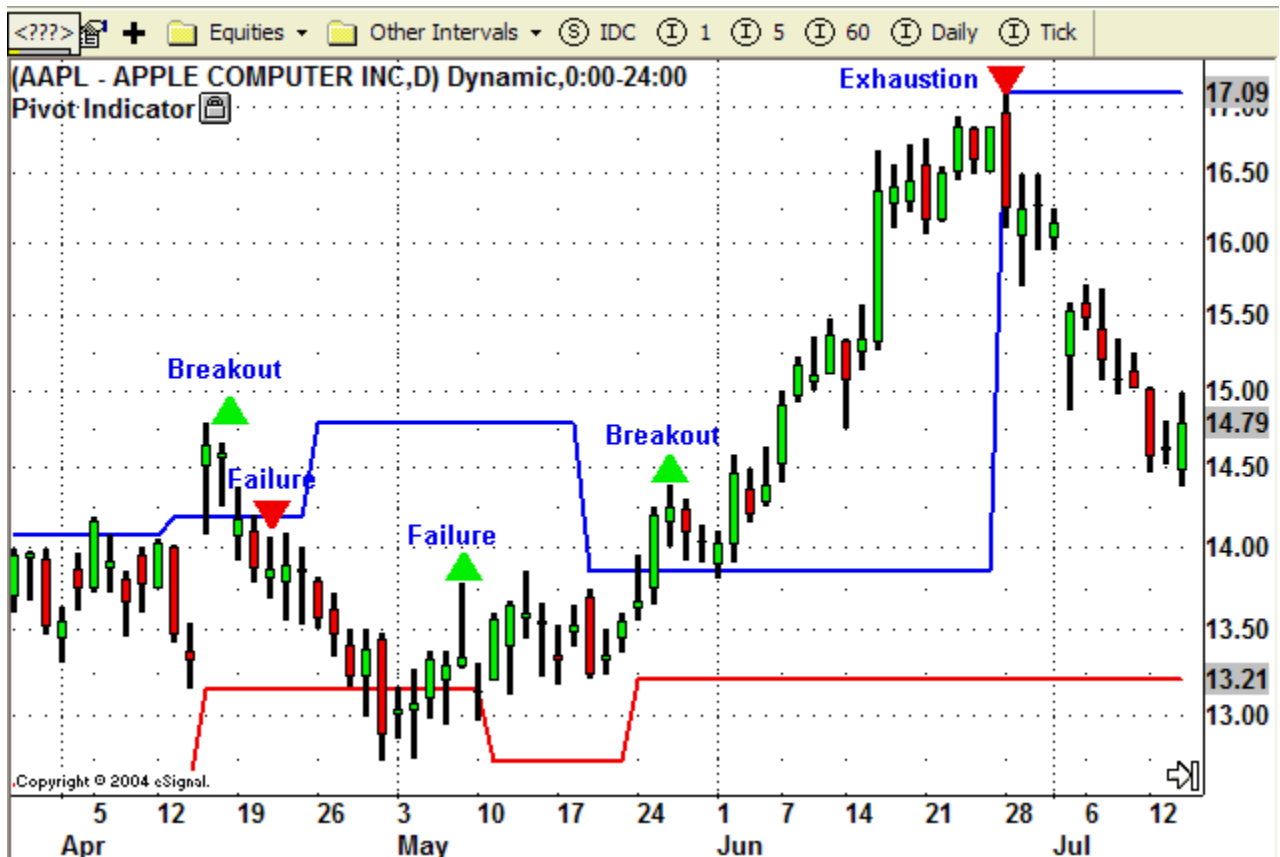
Even the strongest markets don't go up or down forever. This is just more common sense. At some point a Breakout or Breakdown stalls. (Once again, we are using stocks for examples, but the concepts hold for any trading instrument.)

A Breakout stock eventually finds a new resistance level. The stock gets so expensive that demand for it weakens. Once that happens, owners of the stock, feeling it may not go higher, or fearing that it might go lower, sell the stock, increasing supply. This combination of lower demand and greater supply creates an Exhaustion situation.

By the same token, A Breakdown stock eventually finds a new support level. The stock gets less expensive and traders see a bargain, increasing demand and halting its slide. Once that happens, owners of the stock, feeling it may go higher, refuse to sell the stock. Supply decreases. Traders who were short the stock\* must cover their shorts by buying back the stock, increasing demand even more. This combination of increasing demand and less supply creates an Exhaustion situation.

\*You can make money when a stock goes down by “Shorting” the stock. To do this you borrow the stock from your broker and sell it. At some point you must buy it back to repay your broker. If you can buy it back cheaper than you sold it for, you have made a profit.

When a stock moves back into a new trading range following a Breakout or Breakdown we have a trading opportunity. An Exhaustion Bar following a Breakout is a Selling opportunity. An Exhaustion Bar following a Breakdown is a Buying opportunity.



Let's move ahead a couple of weeks on that last chart of AAPL. We bought a **Failure**, and then AAPL managed a successful **Breakout**. The red arrow on the top right of the image is an **Exhaustion Bar**. This is a selling opportunity. At this point you would close out your long position and you must decide if you want to go short.

Take a minute and look at the chart. You can actually see the stock becoming “exhausted” as the upward momentum weakens. Even when you know the rhythm of the market, you really need to use trading smarts to be a profitable trader. What are trading smarts? You guessed it, common sense.

After the second breakout moved well into profitable territory we knew we were in a winning trade. Still, anything can happen in a trade. After the stock was up a point or so, the smart, DecisionBar Trader sets a “stop price.” (You can learn about stops and different types of orders at: <http://www.stocks.about.com>.)

This is simply a price at which you will close out the trade if the stop price is violated. Initially this stop should be just above your entry point. The main thing you want to avoid is having a winning trade turn into a losing trade. If the trade fails, at least you have lost nothing.

At some point in time you may want to raise this stop to attempt to lock in a profit. Be careful here!! Traders need to catch the big moves to be successful. Stocks can be very volatile when they are making big moves. More money is lost by trailing stops too closely than by any other action except ignoring your stops, so give your trades plenty of room once you have locked in a breakeven trade.

A few bars before the official exhaustion bar you can see the stock losing momentum. Here is where you tighten up your stop or decide to close out your trade and wait for the next signal. \$16.00 would be a reasonable place to set your stop, but I would probably close out the trade. AAPL appears due for least a minor correction and we are showing a nice profit. If AAPL consolidates for a while and heads higher, I am prepared to feel like the other word for a donkey, but at least I'll do so with money in my pocket.

A quick word about stops: If you are longer-term trading you can place a stop order, which will exit the trade if the stop price is violated. If you are daytrading, you should consider using mental stops whenever possible. All placing stop orders does is telegraph your strategy to other traders, market-makers and specialists.

DecisionBar Trading works in all-time frames, but jumping from stock to stock is not the best way to trade. Once you find a few stocks with the kind of volatility and liquidity you need, you should stick with them. You never really know when the big move is going to come.



This time we'll look at a weekly chart of AAPL. Moving from left to right our first signal is a Breakdown Sell Signal. You had to be on your toes here, as that Exhaustion Bar moved up quickly, but remember, each bar is a week, so if you didn't anticipate the Exhaustion Bar, you had plenty of opportunity to get out at a profit.

Following the Exhaustion Bar, AAPL moved up to resistance. This was a big trade as the stock moved from around \$8 to around \$13. At that point we see three Failure Signals. The fact that there are three signals really has no significance except that each one is a valid short entry point. Assuming you were long AAPL, the first Failure is where you should close out your long trade and decide if you want to go short. If you decide not to go short at that time, a short trade is still valid as long as a short signal is in effect, and you can get the same entry price or better than the original short signal.

As you can see, the short trade succeeded, and the next signal is in the Failure-Buy signal in the bottom right hand corner of the chart. Again, you might have considered ending the trade a bar or two earlier when support appeared to hold.

# DecisionBar Trading 106 – The DecisionBar Strategy Indicator

The DecisionBar Strategy Indicator alerts you automatically when a DecisionBar occurs. It alerts you with a pop-up window, and an “attention getting” alert sound . It sounds like a bullet ricocheting in eSignal. The other platforms (MultiCharts, MCFX and TradeStation) use each program’s built-in alert system (remember to turn alerts on!), but we have included the ricochet sound on the CD if you wish to use it.

When you are experimenting with the strategy indicator you may learn to hate that sound, but you can turn it off by going to the Edit Studies menu item. When you start trading (if you are day trading), you will learn to love that loud, “attention getting” sound. If you are trading longer term and using daily or weekly charts, you can turn the audio alert off with our blessings.

One of the psychological hurdles you must overcome to be a successful day trader is the boredom of sitting in front of a computer screen all day. If you are an active person, that can drive you to distraction. If your “head isn't on straight” you'll tend to make mistakes like forcing trades and making trades prematurely. The alert sound gives you freedom from the computer.

Once I am in a trade, I look for other things to do. I exercise (I have a weight machine in my trading room), I watch television, I read a book, and if the weather is nice I go out and swim and lie by the pool.)

When I hear the alert, I go to the computer make my decision and go back to living at least some sort of life. Obviously there are days when you will be tied to the computer, but our DecisionBar Strategy Indicator keeps those days to a minimum, and stops you from questioning your choice of professions.

When we first programmed the DecisionBar Strategy Indicator we found it had a “flaw.” That “flaw” was that it alerted you prematurely that a DecisionBar is occurring. In other words, it would alert you at the beginning of a possible breakout bar, even if that bar eventually drops below support, and is not a valid DecisionBar.

As it turns out, that “flaw” is a very profitable feature, and we turned that first version into the DecisionBar Strategy Warning indicator. This indicator gives you advance notice when a DecisionBar may be about to occur, allowing you to set up our trades without rushing, and sometimes anticipate the market for a better entry.

The DecisionBar Strategy Warning indicator MUST have the same sensitivity settings as the DecisionBar Strategy indicator. It does not plot anything on the chart, but gives you audio and pop-up alerts when a signal may be imminent. Be aware that the signal may not be valid by bar close.

Note: The DecisionBar Pivot indicator just puts the Pivots on the chart. You can use it to practice identifying signals without the Strategy indicator, but you should never have the Pivot Indicator and the Strategy indicator on the chart at the same time.

**The sensitivity of both the DecisionBar Strategy Indicator and the DecisionBar Strategy Warning Indicator can be adjusted by changing the sensitivity used to determine when to adjust a pivot. If you are getting whipsawed too often you should decrease the sensitivity. You decrease the sensitivity by INCREASING the Pivot Settings.**

**To decrease the sensitivity in eSignal, right-click on the chart, go to Edit Studies and choose the proper indicator. In MultiCharts, MCFX or TradeStation, right-click on the chart, go to Format**

Studies and double click on the proper indicator. Check the Quick-Start for the charting platform you are using for instruction on how to adjust the sensitivity.

The optimal sensitivity settings are different for each instrument you are trading and for each time frame. The default setting for the highs and lows is 15. This is too low for today's volatile markets.

For trading most instruments, a setting of 30/30 is a good place to start. For more volatile trading instruments you may have to go to 50/50 or higher. At times I have used settings of 75/75 to capture extended moves. Both the high and low sensitivity should usually be set to the same figure.

It is very important that you apply our strategy indicator to a chart of whatever instrument you are trading, in the time frame you are trading, and find the optimal sensitivity settings to use for that specific instrument and time frame. You can do this by trial and error by just eye-balling the chart and seeing when the whipsaws disappear.

If you are not happy with what the chart is offering, check a different interval.

Failure to do this is the only way I know of that you can fail to make money as a DecisionBar Trader.



This is a screenshot of our DecisionBar Strategy Indicator, showing the current daily chart of RIMM as I write this. We demonstrate it in the video presentations on the enclosed CD.

# DecisionBar Trading 106a – Proper Settings, Your Key to Success

Please pay special attention to this section.

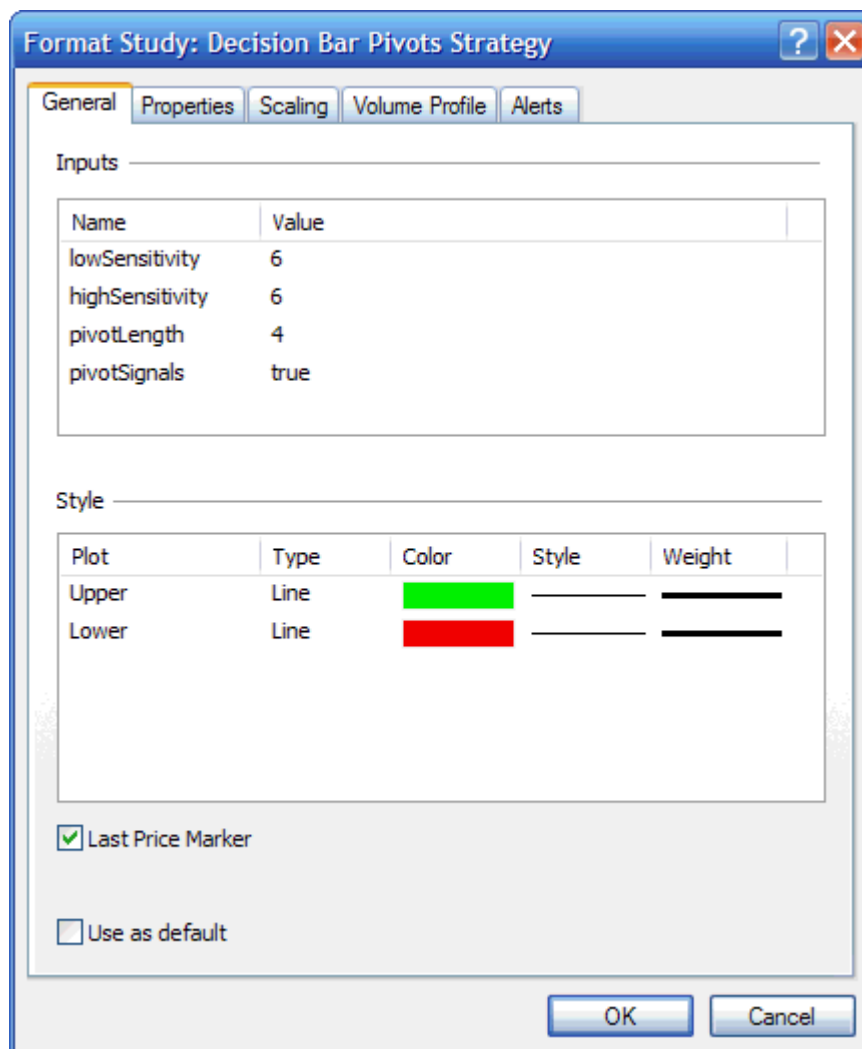
Optimizing the DecisionBar Strategy Indicator for whatever you are trading usually takes less than a minute, yet failing to optimize the Strategy Indicator is the main reason some traders don't succeed.

Time and again our customer service people go online with new DecisionBar traders who are having problems to show them how to optimize the strategy indicator, and time and again they say, I didn't know that!"

You can adjust the settings of the DecisionBar Strategy Indicator when you first apply the study,

To access the settings for the DecisionBar Strategy Indicator once it is on a chart, right-click on the chart. A menu will come up. Depending on the platform you are using, there will be a menu item that says, "Edit Studies" (for eSignal), "Format Analysis Technique..." (for TradeStation), or "Format Studies..." (for MultiCharts and MCFX).

The window you use to adjust the settings looks something like this.



There are additional options as well, as discussed in the Quick-Start for your platform. But for the moment we are concerned with the sensitivity.

The Low Sensitivity and High Sensitivity settings are the settings for the Primary DecisionBar signals and are the settings we are concerned with now. Pivot Length and Pivot Signals refer to Secondary DecisionBars and are discussed in a later section.

While some older version of the DecisionBar Software default to settings of 6/6 as shown in the previous screen shot, newer versions default to 15/15. We now suggest starting with 30/30. This show you how much the markets have changed over the past few years, and how easy it is to adapt DecisionBar to current market conditions.

**In general, the choppy the market you are trading, the higher the settings required to minimize whipsaws and bad signals.**

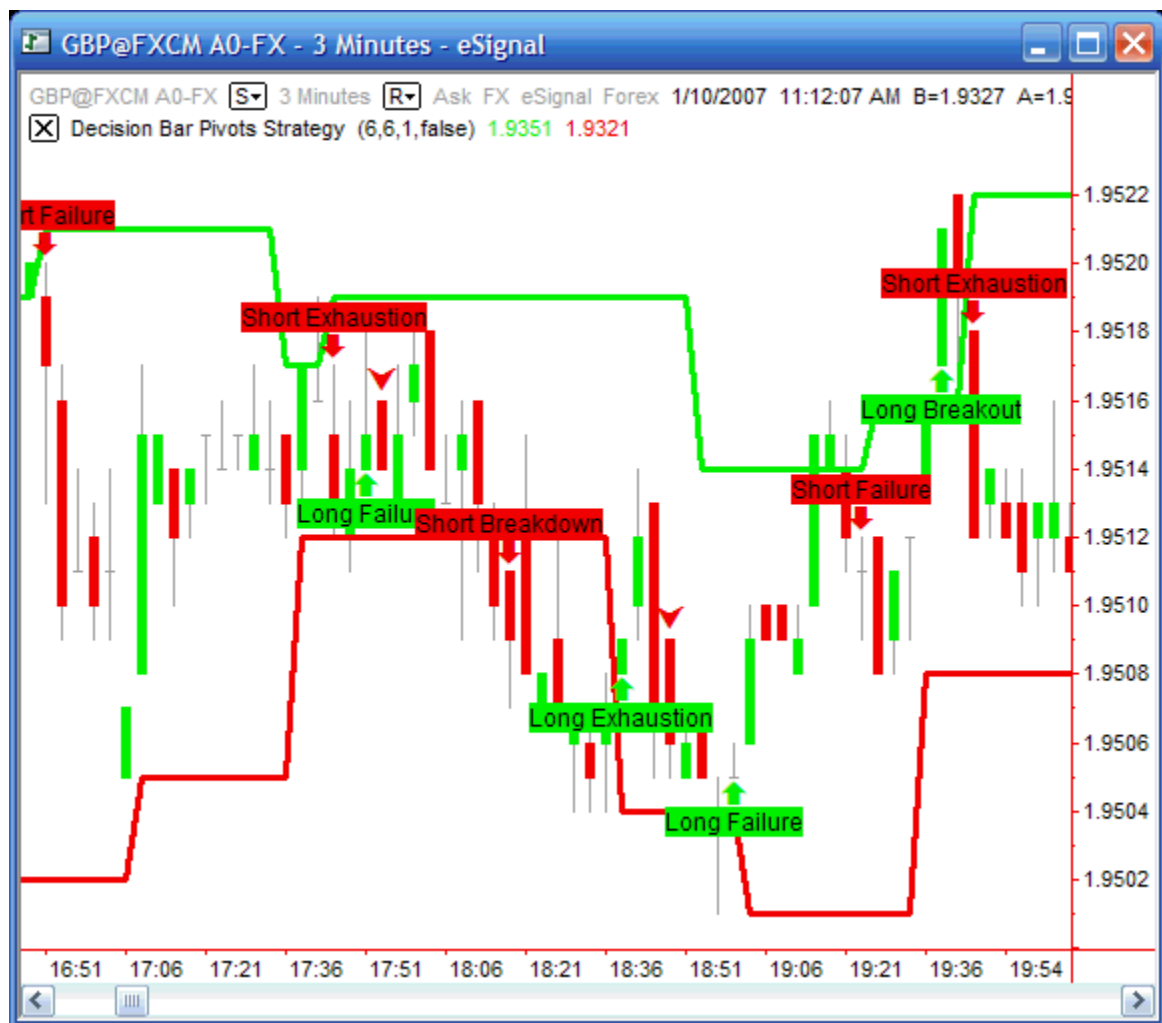
Following are a series of screen shots with different sensitivity settings to give you an idea of the difference proper settings make. You can go as high as 60/60 or higher, if necessary, to get the results you are looking for. In general, the lowest setting that gets rid of most whipsaws is the setting you want to use.



This is a three-minute chart of the eMini with sensitivity settings of 6/6.



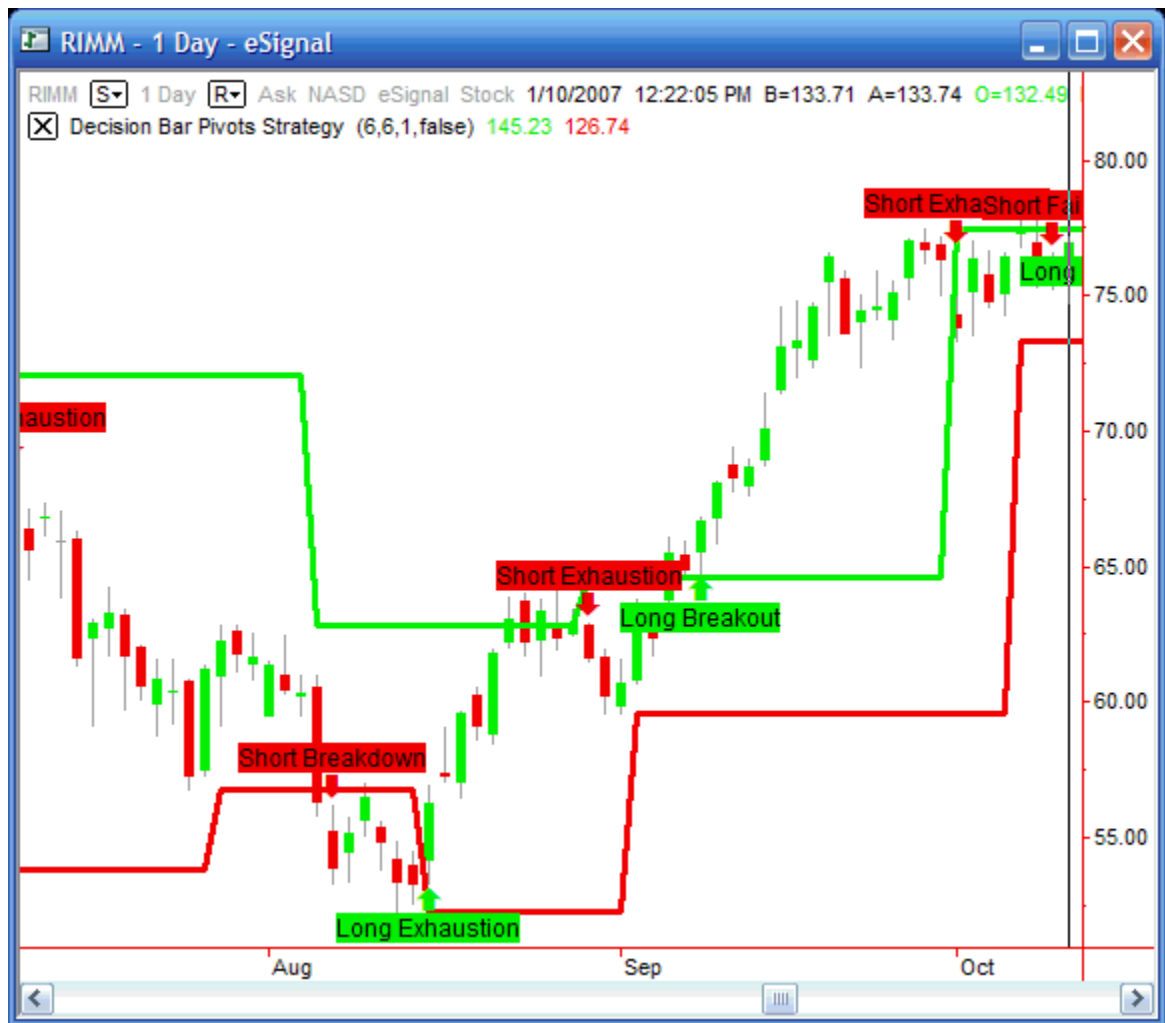
This is the same three-minute chart of the eMini, this time with sensitivity settings of 25/25.



This is a three-minute chart of the British Pound with sensitivity settings of 6/6.



This is the same three-minute chart of the British Pound with sensitivity settings of 15/15.



This is a daily chart of the RIMM with sensitivity settings of 6/6.



This is the same daily chart of the RIMM with sensitivity settings of 12/12.

As you can see, proper settings make all the difference in the world and can be the difference between your success or your failure.

You can usually find workable settings for whatever you are trading in about a minute. Two at the most

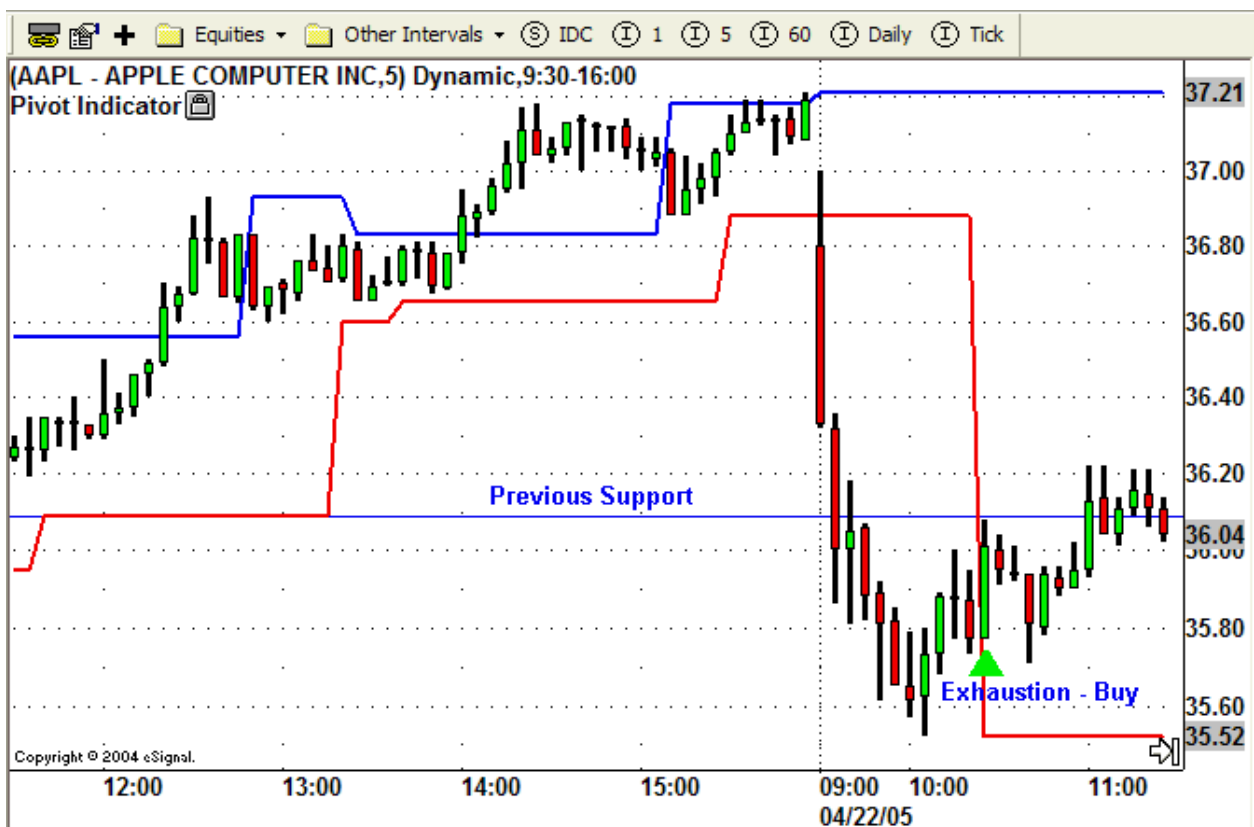
The one or two minute you spend optimizing the DecisionBar Strategy Indicator may be the most profitable two minutes you have ever spent.

# DecisionBar Trading 107 – The Holy Grail - 1

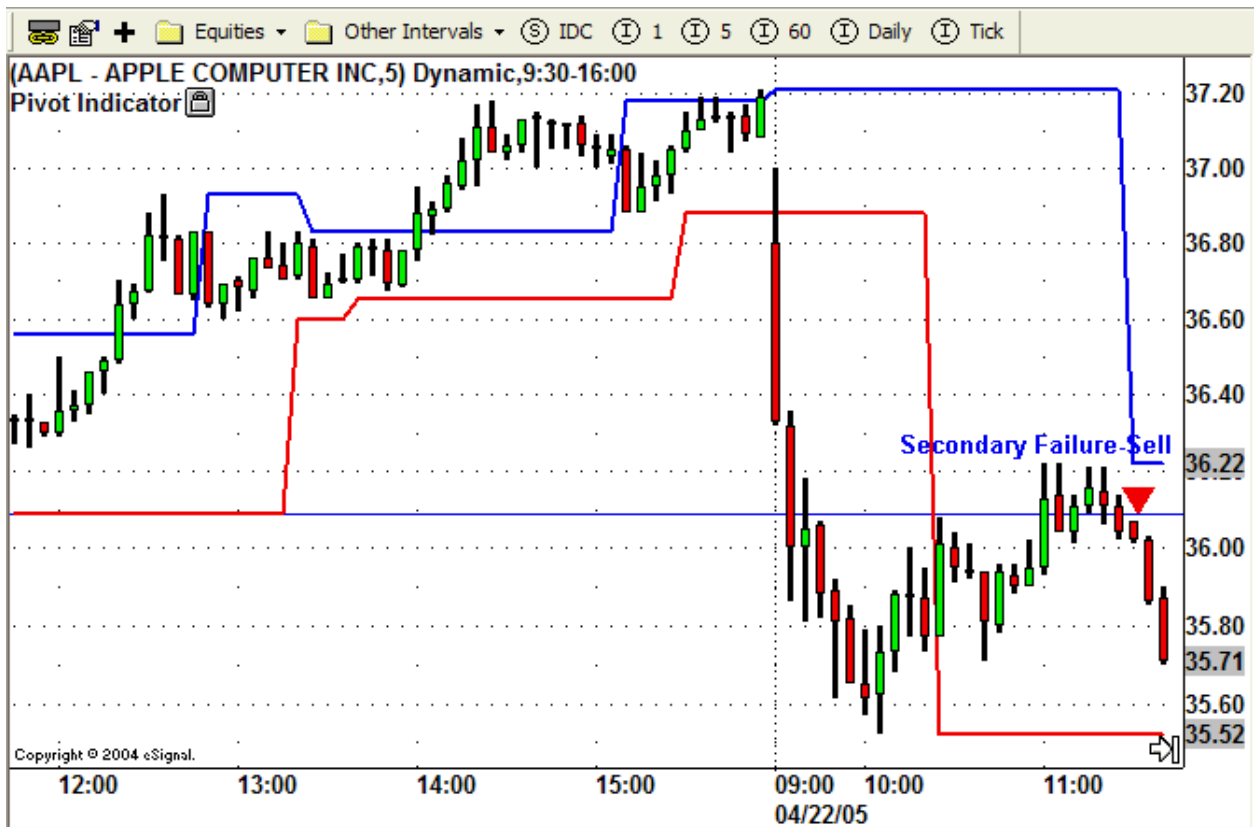
## Previous Support and Resistance

In Previous versions of this manual, I have tried to get people to pay attention to this section and the next section to no avail. For some reason, no matter how many times we tell people that DecisionBar trading is a method, not a system, they continue to think all you have to do is wait for a signal, make the trade and collect the money. I'm sure you will be smarter than that. Understanding and applying the concepts in this section and the next may very well be the difference between your success and your failure as a trader.

Previous support and resistance levels can still provide support and resistance. We address this issue with Secondary DecisionBars.



This five-minute chart of AAPL shows the first signal of the day on 4/22 is an Exhaustion-Buy signal. A few minutes into the trade we see that AAPL has stalled at a previous support level, which is now providing resistance. At this point we do nothing but watch, as AAPL may overcome that resistance, but it is pretty obvious what is happening.



On the next bar, we have a Secondary Failure – Sell DecisionBar. At this point it is usually prudent to go to cash and wait for the next signal. If your risk tolerance is high, you may want to take the Sell signal.

# DecisionBar Trading 108 – The Holy Grail - 2

## Subsequent Support and Resistance

New support and resistance levels are continually being created and broken. Our indicators cannot predict the future, but they are continually looking at past movement to recalculate current support and resistance levels. Sometimes a stock or other trading instrument will reverse at a specific level for no apparent reason. A few bars later, our strategy and pivot indicators will show a new support or resistance level where the reversal occurred.

As with previous support and resistance levels, these levels should be considered secondary DecisionBars.



This chart of QLGC shows the stock reversing to the upside at point A. A few bars later, the lower pivot line is adjusted, indicating our software has determined that the reversal defines a new support level. The green arrow in the lower right hand corner shows when the adjustment occurred, and defines a new, secondary Buy DecisionBar.



This chart of GRMN shows the stock reversing to the downside at point B. A few bars later, the upper pivot line is adjusted, indicating our software has determined that the reversal defines a new resistance level. The red arrow shows when the adjustment occurred, and defines a new, secondary Sell DecisionBar, which suggests we take profits on our long trade.

# **The DecisionBar Strategy Indicator – Version 2.0**

## **Catching the big moves, while avoiding big losses**

Our new version of the DecisionBar Strategy Indicator is the ultimate trading tool. Not only does it generate Buy and Sell signals in real-time, but it also identifies virtually every identifiable reversal point.

The entire concept of DecisionBar trading is that a successful trade is made up of a series of successful decisions. The first decision in any trade is whether or not to accept a trading signal generated by the DecisionBar Strategy Indicator.

Once a trade is entered, version 2.0 of the DecisionBar Strategy Indicator generates a series of Secondary DecisionBar alerts at likely reversal points. A decision whether to hold the trade, exit the trade, or exit the trade and reverse your position should be made at every Secondary DecisionBar.

It is important to understand that Secondary DecisionBars are NOT trading signals. They are “Possible Reversal” alerts, and they are issued when the odds of a reversal are at an increased level.

In general, Secondary DecisionBars require confirmation. The basic method of confirmation is to require a subsequent bar to trade above the high of a long Secondary DecisionBar, or to require a subsequent bar to trade below the low of a short Secondary DecisionBar.

Version 2.0 of the DecisionBar Strategy Indicator identifies the two types of Secondary DecisionBars as discussed in the previous section.

1) Previous support and resistance levels can still provide support and resistance.

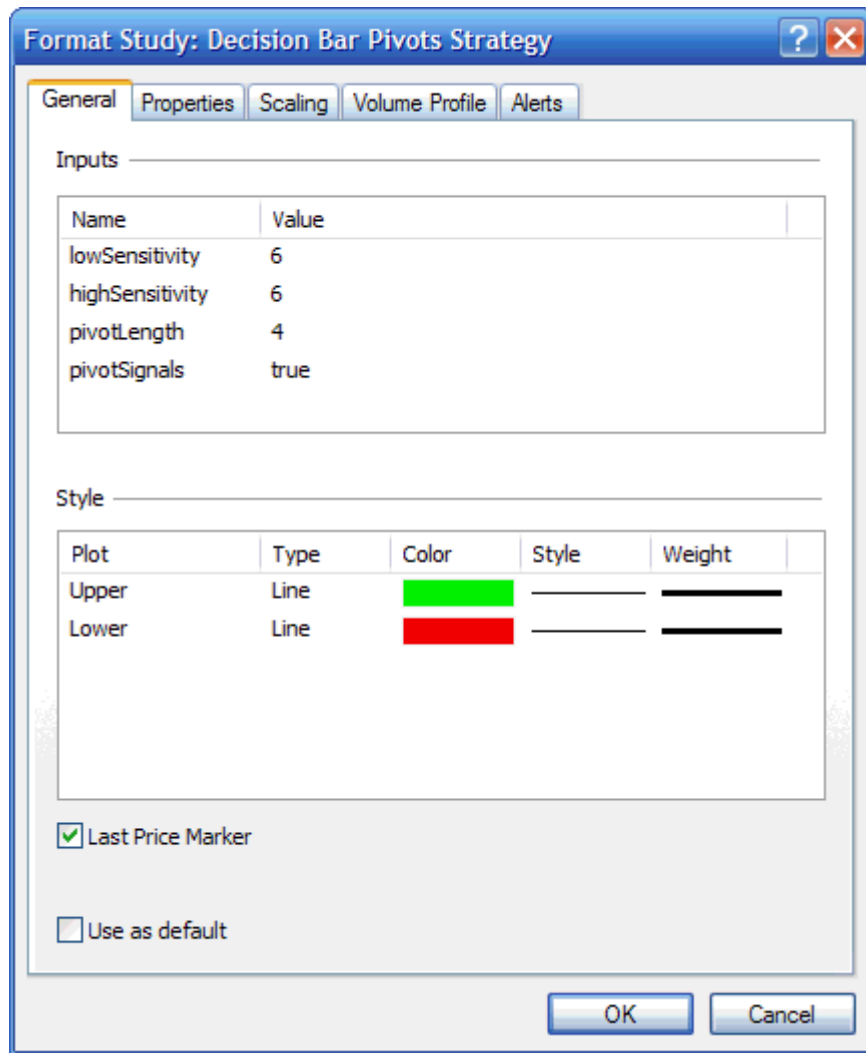
Long “Possible Reversal” alerts are generated when the last primary signal suggests a short trade, but the downward movement of the instrument you are trading appears to have found some support at a previous support or resistance level.

Short “Possible Reversal” alerts are generated when the last primary signal suggests a long trade, but the upward movement of the instrument you are trading appears to have found some resistance at a previous support or resistance level.

The number of Pivot levels the indicator looks back is adjustable from one to nine. (The default is four.) It takes into account both upper and lower pivots and starts counting from the pivot before the current (last changed) Pivot.

In other words if the input is 3 and the last changed pivot (current one) is upper, it takes into account two lower and one upper pivots.

The number of pivots the indicator looks back can be changed by going to “Edit Studies” in eSignal “Format Studies...” in MultiCharts and MCFX, or “Format Analysis Technique...” in TradeStation, which will bring up a window similar to this:



The software can look back at as many as nine previous pivot levels. You adjust this by setting the “pivotLength” or “Number of previous pivots” (depending on which platform you are using.”

Keep in mind that there is such a thing as “too much information (TMI).” The nearest pivots are most likely to provide support or resistance. Setting the number of pivots the indicator looks back at to a high number will generate more alerts, but will likely hinder your trading. It is to your advantage to set the number of pivots the indicator looks back at to four or less until you get used to using Secondary DecisionBars. I would suggest a setting of two, which will take into account the nearest upper and lower pivots, as a good starting point.

2) New support and resistance levels are continually being created and broken. Our indicators cannot predict the future, but they are continually looking at past movement to recalculate current support and resistance levels. Sometimes a stock or other trading instrument will reverse at a specific level for no apparent reason. A few bars later, our strategy and pivot indicators will show a new support or resistance level where the reversal occurred.

Version 2.0 of the DecisionBar Strategy Indicator generates Secondary DecisionBars each time an upper pivot adjusts lower, or a lower pivot adjusts higher.

These signals are more important when the upper and lower pivots have a fairly wide separation. When your trading instrument is trading in a narrow range, the upper and lower pivots will adjust frequently

and you will once again be faced with the problem of TMI (“too much information”). For that reason these alerts can be shut off by going to “Edit Studies” in eSignal or “Format Indicator” in MultiCharts, and changing the value of “Pivot Adjustment Signals” from true to false.

## Example 1



This first example shows an unconfirmed Secondary DecisionBar (1). Looking at a 60 minute chart of YHOO, we are in a short trade when a Possible Reversal alert is generated. Note that subsequent bars never traded above the high of Secondary DecisionBar (1), and a couple of bars later another Secondary DecisionBar (2) was generated, reinforcing our original trade.

We wanted to show a failed alert in our first example to drive home the point that DecisionBars are more powerful than Secondary DecisionBars, and should be given more weight. In most cases you should require confirmation of Secondary DecisionBars, or consider them a “heads up” to set stops that protect profits or minimize losses.



This is how the same chart looks in MultiCharts. Note that Secondary DecisionBars are identified by those truncated arrows in MultiCharts and MCFX.

## Example 2



A large part of trading is mental. The more stress you are under, the more likely you are to make a bad decision based on fear or greed. This 60-minute chart of RIMM shows an example of a trade you couldn't lose if you adhered to the DecisionBar signals. However, by using Secondary DecisionBars you are able to minimize the stress factor while increasing profit.

Following that exhaustion signal on the left of the screen, a Secondary DecisionBar (1) suggests a possible reversal on the next bar. Coincidentally, this is also the bar you might have entered the long trade, although your trading style might have kept you out since this was a negative bar. Secondary DecisionBar (1) is confirmed when the following bar trades below its low.

At this point you would exit your long trade for a small loss (if you entered at all), and aggressive traders might consider entering a short trade. RIMM's downward motion is confirmed by Secondary DecisionBars 2 and 3, and then the Long Failure signal on 12/21 puts both conservative and aggressive traders in a successful long trade.



This sequence of signals for the Euro speaks for itself.



As we discussed earlier, when your trading instrument is trading in a narrow range, the upper and lower pivots will adjust frequently and you will be faced with the problem of TMI (“too much information”). In narrow range situation, ignore, or shut off, the previous adjustment signal and wait for a Breakout or Breakdown, as with this chart of the eMini.



If I were to put into one sentence what successful trading is all about, I would say, **“Successful Trading is the art of keeping yourself In Play to catch the big move, while avoiding big losses.”** Version 2.0 of our DecisionBar Strategy Indicator allows you to do just that, and even affords you the bonus of profiting from intermediate moves. This five-minute chart of GOOG speaks for itself, but notice that unconfirmed Secondary DecisionBar at Point A. To the smart trader this is a “Heads Up” that the current downward move is weakening.

With the release of Version 2.0 of the DecisionBar Strategy Indicator, the DecisionBar Trading Method is now the ultimate tool to help you consistently profit from trading the market of your choice. You can look all you want, but it doesn’t get any better than this. Is it the Holy Grail? Maybe, but only when combined with good common sense and unemotional trading discipline.

# DecisionBar Trading 109 – Map-Out Your Trade

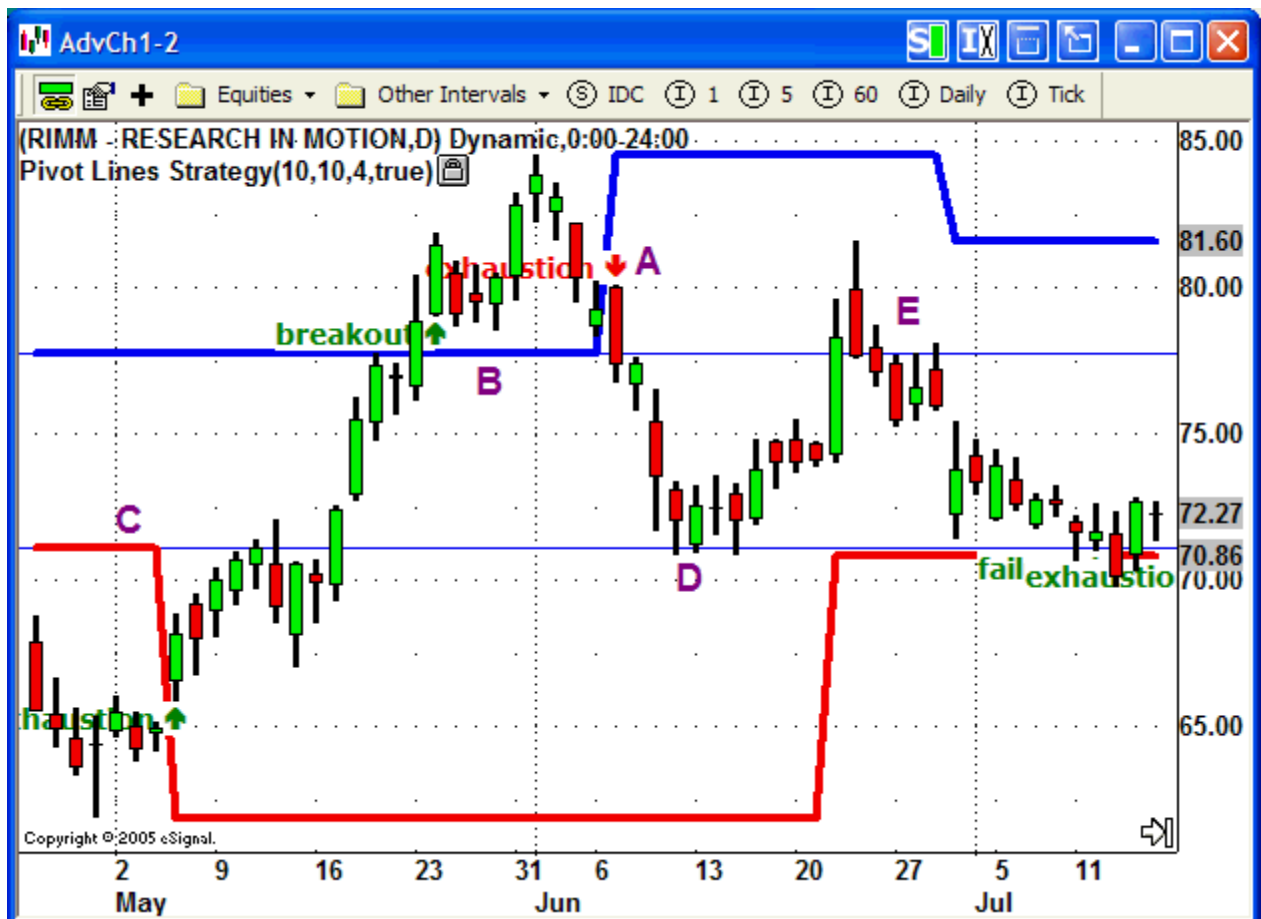
The key to being a winning trader is being smarter than the next guy. This means you always have to plan ahead.

When you enter a trade, you have to look at more than the DecisionBar trading signal. You have to look at the entire chart and map out your trade.

Here is a daily chart of Research in Motion (RIMM). I've made no secret of the fact that I like this stock both as a day trading and swing trading vehicle.

Let's look at that exhaustion Sell signal at point A. Before we enter this trade we note the previous resistance level above point B and previous support level below point C. I like to draw horizontal lines extending previous support and resistance levels.

Please note that we have completely shut off Secondary DecisionBars for this section.



When RIMM's downward motion stalls at point D, we know exactly what is going on. RIMM has found support at a previous support level. The smart trader takes profits and enters a long trade.

At point E RIMM's upward motion stalls at a previous resistance level. If you planned your trade, you were prepared for this and reverse positions at point E, entering a short trade.

As it turned out, even if you entered the trade at point A and exited at the first long signal at the lower right area of the chart, you would have made money. But the smart trader made twice the profits of the "hopeful" trader, and took control of the trade instead of "hoping" it went his way.

Whenever you enter a trade, identify previous support and resistance levels as "danger points" and watch for new support and resistance levels. This is what separates winners from losers.

Version 2.0 of the DecisionBar Strategy Indicator now does much of what is discussed in this section for you, but possible reversal points are only identified in version 2.0 if they go against the primary, DecisionBar trading signal, so you still should map out your trade.

Remember, the best indicator you have is your brain. Make sure to take advantage of it.

# Using Stops

In most situations, the DecisionBar Strategy Indicator's upper and lower pivot lines show you the optimum level to place your initial stop.

For most signals the stop should be placed on the other side of the Pivot Line, above or below the most recent extreme bar.



For example, in the chart above, for the long Failure Signal shown on 12/21, your initial stop would be below the lower pivot line and below the previous (extreme) bar. For the long Breakout shown on 12/22 your stop would be below the upper pivot line and below the previous bar. Always make sure to leave enough “wiggle” room or you may be stopped out prematurely. You can determine how much “wiggle” room is enough by using the Average True Range indicator discussed in the next section on trailing stops.

Exhaustion Signals are usually the most risky signals to trade. An Exhaustion signal may indicate a reversal or consolidation before the trend continues. For the short Exhaustion Signal shown on 12/23, the natural stop would be above the upper pivot line. This is quite far away and you may consider the risk unacceptable. This leaves you with two choices:

- 1) Pass the trade.
- 2) Place your stop above the high of the signal bar, making sure to leave enough “wiggle” room so that you aren’t prematurely stopped out.

# The DecisionBar Trailing Stop Module

While many traders talk about “Trailing Stops,” very few traders know the right way to use them. The Decisionbar Stop module includes automated trailing stops based on both a Fixed Distance and on the Average True Range (ATR) of the instrument you are trading.

The Average True Range (ATR) is a measure of volatility. Essentially, True Range measures the length of a bar including gaps up or down from the previous bar. Average True Range is an average of the True Range of the individual bars over a specified period, usually 14, but you can enter whatever value you wish. Lower values will cause the stops to react more quickly to current market volatility.

We suggest you always add the ATR.efs indicator to your charts so you can get an idea of current volatility (but you may want to turn off the alerts

In addition, the ATR stops have two modes: Regular (“Static”) stops and Dynamic Stops.

For all stop types, the initial stop is calculated from the close of the signal bar. Subsequent stops are calculated from the highs for long trades, and from the lows for short trades.

Regular (or “Static”) Stops use the ATR of the **signal bar** for all calculations. Regular Stops will take you through a well defined trade and allow your trade to survive periods of low volatility.

Dynamic Stops use the ATR of **the previous bar** for all calculations. This means your stops will tighten faster, and the actual value of your Profit Threshold will decrease, if volatility decreases. By the same token, your stops will tighten slower, and the actual value of your Profit Threshold will increase, if volatility increases. (Note: Stops are never moved backward.)

**Dynamic Stops are one of the most powerful trading tools available to a trader. Since I began using them, I would never again trade without them!!**

To set your stops you must enter:

- 1) Type of stop: “ATR” or “Fixed”
- 2) If you choose ATR Stops you must set Dynamic Stops to “True” or “False”
- 3) Direction of Trade: “Long” or “Short”
- 4) Entry Price
- 5) Where to start the stop sequence
- 6) If you chose ATR stops, you have to set Dynamic Stops to true (on) or false (off)
- 7) ATR Length – The default setting of 14 is standard.

If you are using ATR stops:

- 8) **Initial\_Stop\_ATRs** – The distance of your initial stop in ATRs.

9) **Profit\_Threshold\_ATRs:** How much profit your trade should show before you tighten your stops.

10) **Tightened\_Stop\_ATRs:** The distance of your tightened stop in ATRs. If this value is set to zero, the software will give an exit signal when your Profit Threshold is reached.

If you are using Fixed Stops:

11) **Initial\_Stop\_Distance:** The distance of your initial stop in points you are charting. Usually dollars and cents. Forex Traders must enter the actual pip value, not the number of pips.

12) **Profit\_Threshold\_Distance:** How much profit your trade should show before you tighten your stops.

13) **Tightened\_Stop\_Distance:** The distance of your tightened stop. If this value is set to zero, the software will give an exit signal when your Profit Threshold is reached.

**Your Trading Kit includes customized version of this section, including specific directions for implementing the stops on each charting platform.**

There is no magic formula for setting the various parameters. Each trading instrument is different, each time interval is different, and each trader is different. The best way is to put them on a chart and see how they perform.

**The biggest mistakes most traders make is expecting profits that are too large and using stops that are too narrow. Keep your expectation realistic. If you can survive flat and choppy markets, the trending markets and big profits will take care of themselves.**

**Even if you are using fixed stops, before you enter a trade always take a look at the current value of the ATR to make sure you are giving whatever you are trading enough “wiggle” room.**

**By the same token, if the market has been trading in a narrow range, and you feel the stop is too close, you may want to widen the stop parameters to minimize the chance of your stop being triggered once normal volatility returns.**

**Remember, the value of the ATR can be exaggerated following a fast move or gap, so evaluate the risk of your trade before entering.**

You'll have to use tighter stops in Trading range markets so you can scalp a couple of points or a few pips and stay in the game. Most traders constantly look for the home run and it is a deadly mistake. Try setting the Initial Stop at 3 ATRs, with a Profit Threshold of 3.0 and Tightened Stop of 2.0 ATRs in choppy markets. Again, remember that tighter stops will prematurely stop you out of big moves, so it is up to you to evaluate the market and set realistic goals.

One type of stop is not better than the other type of stop, but each type of stop can outperform the other in certain situations. You should experiment with each type of stop when learning to use the software.

**Remember the key to setting stops is to evaluate your stop setting at the first bar of a trade and each bar thereafter in terms of the actual money you are willing to risk and the actual volatility of the instrument you are trading.**

## Stop Examples

For this sequence we are using a two minute chart of RIMM using the TradeStation Platform. We chose this sequence because it demonstrates the power of Dynamic ATR Stops.

In each example, we are trading the same Breakdown Signal with an entry price of 95.50. The entry bar is the bar following the Breakdown Signal.

The first chart was made using Fixed stops.

My initial stop is 50 cents, my profit threshold is \$1.30 points, and once the profit threshold is reached, I want to tighten the trailing stop to 40 cents.



This is how the stops will plot. Note that once the profit threshold is reached ( $95.50 - 1.30 = 94.20$ ) at Bar A, the stops tighten up on the next bar "B". The stop was triggered at Bar C.

Please note that you can only have one stop sequence on a chart at any one time. Here we're using historical data for testing but the stop sequence also works in real time.



If I wanted to use Average True Range for my stops I would add the ATR indicator to my chart and note the value of the ATR at the entry bar. In this case it is about 11.6 cents.

Four ATRs is often a good starting point which would place my initial stop about 46 cents from my entry point. This seems a little tight for this stock, so I decide to place my initial stop at 5 ATRs.

In this case, my initial stop is 5 ATRs. I'm waiting until I have a profit of 10 ATRs and then I'm tightening my stop to four ATRs.

This is how the stops will plot. The profit threshold is reached on the same bar as the fixed stops ( $95.50 - 1.16 = 94.34$ ) and the stops tighten the next bar and are triggered on Bar "C."

Keep in mind that this was an aggressive trade. You would rarely use a goal as high as 10 ATRs. Four is more likely.

Fixed and static ATR stops work essentially the same way. The advantage of the ATR stop is it forces you to look at the current ATR so you can see if your stop is realistic when considering the current volatility.

The questions you should be asking now are, “How do you know that the goal should be place at \$1.30, or 10 ATRs? How do you know how wide to make the stop, when to tighten it, or how tight the tightened stop should be?”

The answer is you don't. For this example, we had the benefit of hindsight, but in real trading, you have to depend on your risk tolerance, experience and intuition to determine stop placement. In all honesty, these are less than reliable indicators.

### Introducing Dynamic ATR Stops

Dynamic ATR Stops use the ATR at **the previous bar** for all calculations. This means your stops will tighten faster, and the actual value of your Profit Threshold will decrease, if volatility decreases. By the same token, your stops will tighten slower, and the actual value of your Profit Threshold will increase, if volatility increases. (Note: Stops are never moved backward.)



Here is how the same trade looks using Dynamic stops with the same settings. Note how the rising volatility in area D keeps the stops from tightening (area E). In fact the stops are much too wide. That is because stops as wide as 5 ATRs are quite aggressive, and a goal of 10 ATRs is one that you would rarely use.



This is the same chart using Dynamic Stops with an Initial Stop of 4 ATRs, a Profit Threshold of 4 ATRs and a Tightened Stop of 2 ATRs. We now have a well defined, tightly controlled trade. Similar settings are effective for many trading situations.

Using Dynamic Stops can take a lot of guesswork out of setting your stops since they adjust for volatility, and you can use similar settings for many time intervals and trading instruments.

# **Advanced Concepts**

## **DecisionBar Trading 201 – Chippy Markets**

Trading is not a cookie-cutter endeavor. One size does not fit all. The DecisionBar concepts we are teaching you are valid for trading all liquid financial instruments in all-time frames, but that doesn't mean you will win every trade. However, there are some advanced concepts which will allow you to filter out many losing trades.

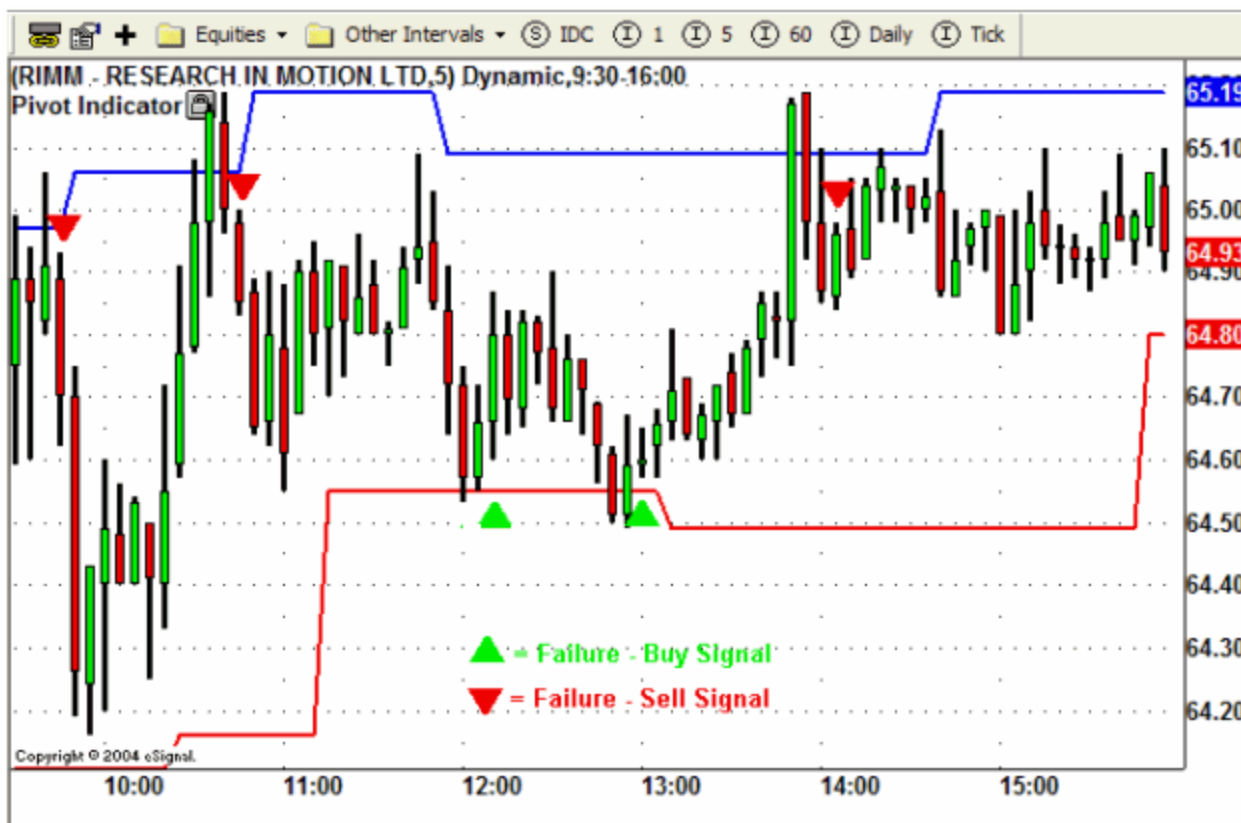
1- The choppier the market, the riskier the trade. -

Long chippy bars or candlesticks which move much of the way between support and resistance indicate extreme indecision and a high risk trading situation. This typically happens at the market open. The problem here is that the first trade of the day is often the most profitable trade, so we are not saying don't trade it, just be aware of the added risk. We usually try to wait until the market is open for at least 10 minutes, and sometimes as much as 30 minutes or more. before making our first trade.

Market openings tend to follow a fairly reliable pattern. Built up orders placed overnight often push the market in one direction or the other for about 20 minutes. Traders fading (trading against) the opening moves usually cause a rebound effect for the next 20 minutes before the market settles down into regular trading.

As a general rule, risk decreases as the day progresses. The problem is that as volatility and risk decrease, so does the potential profitability of the trades, as volatility suggests lack of conviction on the part of both buyers and sellers, and a larger than expected move in one direction or the other may cause panic selling or "irrational exuberance."

The following chart depicts a typical trading day, where you can see how risk decreases when volatility decreases.



This is a five-minute intraday chart of RIMM. I like to trade five-minute charts intraday because they seem to offer good opportunities to catch a move without forcing you to stare at every tick on the chart.

There were no Breakout, so all of our signals were Failures. Ignoring the first two bars, our first signal was a Failure-Sell Signal. We are only a few minutes into the trading day, so we know this will be a risky trade. Again, this is a DecisionBar. You must DECIDE whether to take the trade depending on your risk tolerance.

Assuming you took the trade, you watch as RIMM drops about \$.70 by the next bar. That long bar should be a warning sign to you that anything can happen at this point, and the smart trader would probably grab a quick profit and wait for the next signal.

If you decided to stay in the trade, a few bars later you are probably kicking yourself, as RIMM is flirting with a Breakout. The breakout fails and we have another Failure-Sell signal. At this point, if you are still in a short trade, you do nothing. If you exited that trade, and grabbed a quick profit, you again must decide whether or not to take the trade. The market is still choppy, but not as choppy as before. Risk is elevated but not high.

We exit at a Failure-Buy Signal at support. This trade is successful and shows a modest profit. Since this signal occurs around noon, we decided to pass the trade take a break. There are very few hard and fast rules in trading, but one of mine is I never take a trade around noon. The market rarely goes anywhere as traders break for lunch.

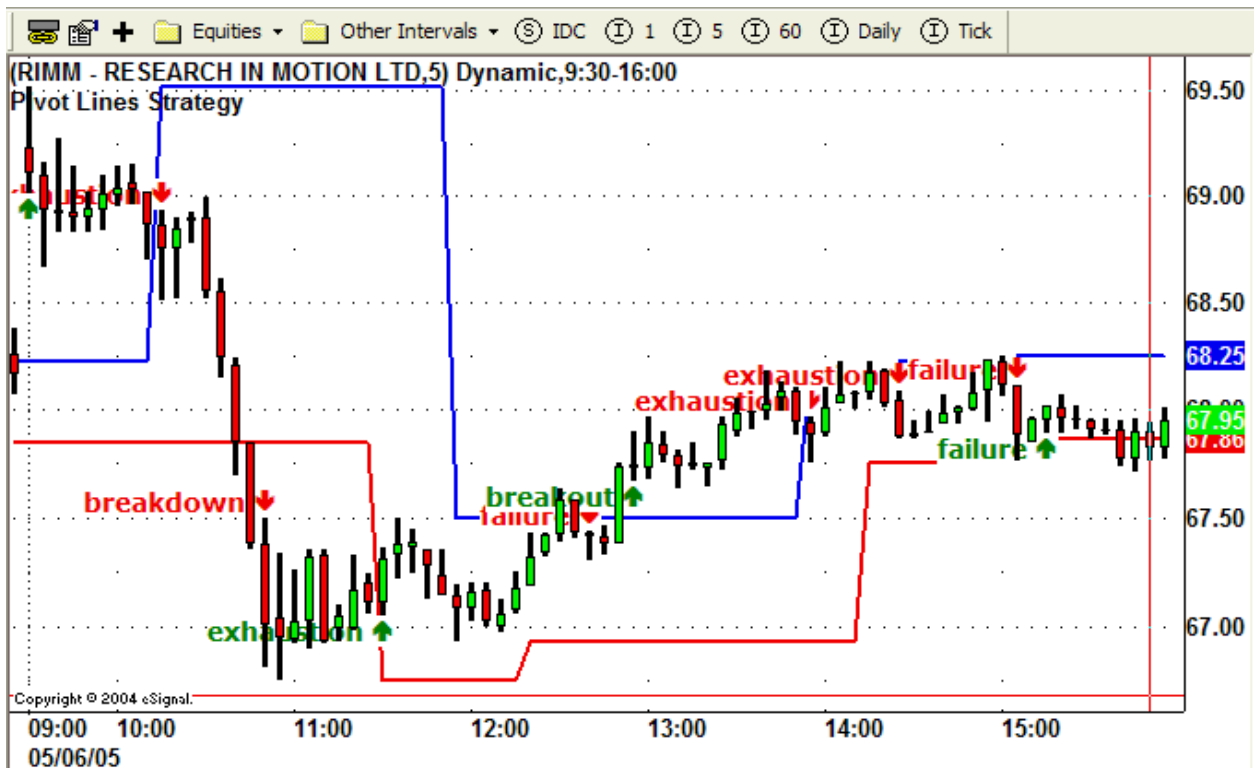
The final signal we'll look at, is that second Failure-Buy Signal. At this point we have narrow range cohesive bars, making this the lowest risk trade of the day.

That trade becomes profitable and gets closed out the last Failure-Sell Signal.

If we decide to take this last trade we will wind up closing it out near the close for about breakeven. Volatility has decreased to the point where our profit potential is very limited.

## DecisionBar Trading 202 – Narrow Range Markets

Narrow range trading makes for risky trading. When support and resistance levels are too close together, you will get a constant stream of Buy and Sell signals signifying nothing.



This is a screen shot of an intraday chart of RIMM, from a Friday in the summer, with the DecisionBar Strategy indicator on it. The first trade of the day was a nice short trade which delivered a profit of almost 2 points. This was followed by a marginally successful long trade, a losing short trade, and another marginally successful long trade. By mid-afternoon, traders had lost interest and were probably heading to the Hamptons for the weekend. RIMM was just bouncing around in a narrow range, and trying to trade it during this period would have been foolhardy. This is a fairly common occurrence on Friday afternoons, but any time you see your trading vehicle trading in a narrow range, look for something else to trade or, just close up shop and wait for another day.

## DecisionBar Trading 203 – Level 2 Quotes

The Level 2 quote screen or Market Depth screen gives us a behind the scenes look at the workings of the NASDAQ market place. (The NYSE calls its market depth screen Open Book).

The Market Depth screen shows not just the inside Bid and Ask, but all the individual market-making firms and ECNs that are buying or selling the underlying stock.

ECNs are the various Electronic Communication Networks that post orders for the public. ECNs and Electronic Exchanges show the Marketmaker ID's in small letters.

Brokers that are "Making a Market" in the underlying stock are identified by four letter Marketmaker ID's in capital letters.

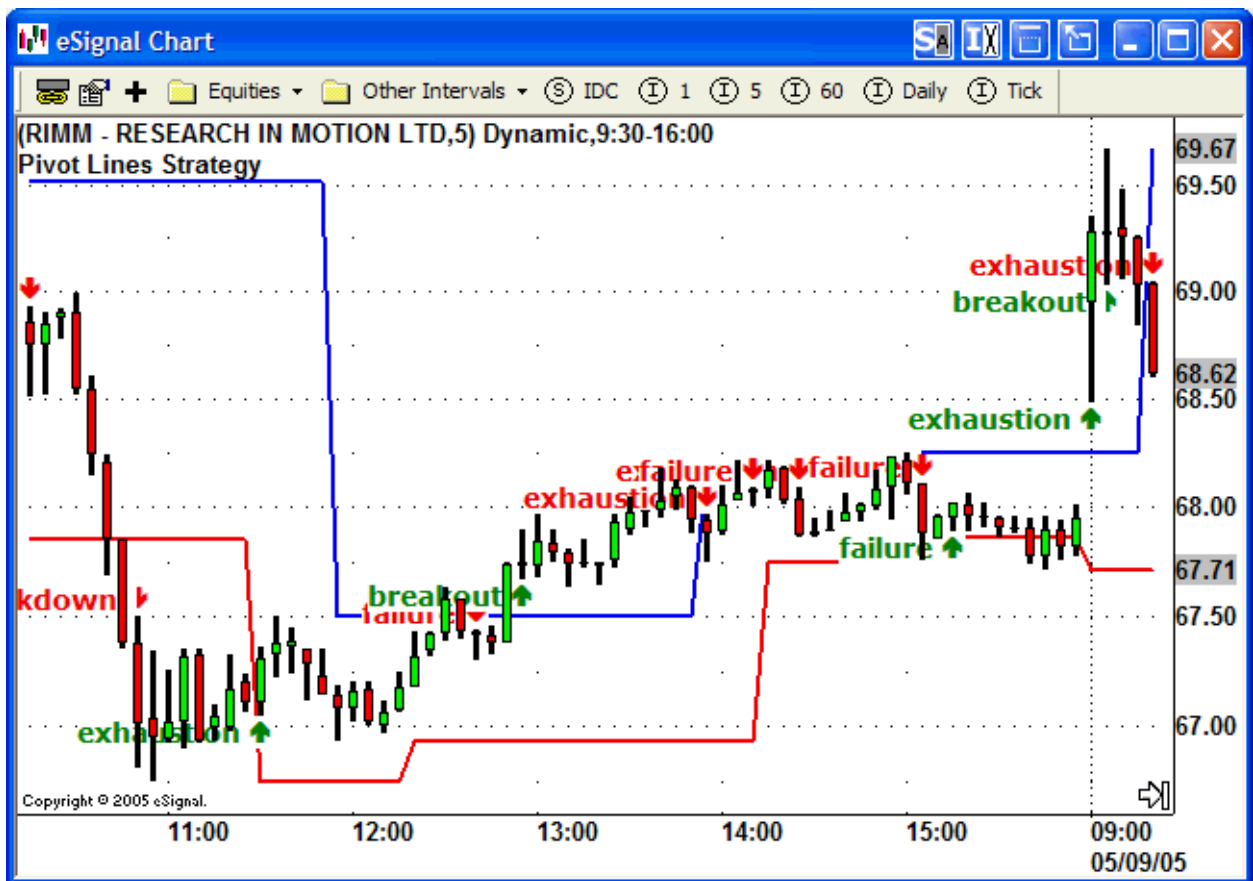
Market Makers that are bidding to buy stock are shown on the left. Market Makers that are offering stock for sale are shown on the right. A preponderance of Market Makers on the Bid suggests that the stock has upward momentum. A preponderance of Market Makers on the Ask (or Offer) suggests that the stock has downward momentum.

Let me state right up front that reading the Market Depth screen is one of my weak points. It need not be one of yours. Traders need every edge they can get, and I urge you to independently study the market depth analysis to give yourself an edge.

The way I use the Market Depth window is pretty simplistic.

The number of shares being bid or offered by ECNs and Electronic Exchanges are accurate, but NASDAQ Market Participants are not required to show the true number of shares they are bidding on or offering. For that reason, I just look at WHO is bidding on or offering stock, not how many shares they are offering.

If you follow the Level II screen on a specific stock for any period of time, you'll see that certain market makers tend to control a stock. Which Market Maker that is changes from time to time. When one of the controlling Market Makers is on or near the inside Bid or Offer, your odds of making a successful trade increase if you take the same side of the trade. By the same token, you should think twice about taking the other side of the trade.



Here's an example using RIMM. Near the beginning of the session, RIMM gives us our first trading signal of the day, an Exhaustion sell signal. RIMM is trading at around 69.00. (Remember, we ignore the first few minutes of trading. Those first couple of signals are caused by pre-market activity.)

Depth1

Change: + 1.07  
Change: + 0.06

+1.57%  
+0.09%

Bid: 69.03  
Ask: 69.06

BSize: 18  
ASize: 3

High: 69.67  
Low: 68.48

Last: 69.01  
Vol: 1.56M

RIMM

LINK

OK

MMID	Bid	BSize	HSize	Time	MMID	Ask	ASize	HSize
BRUT	69.03	12	12	09:48:17	varcx	69.06+	4	4
varcx	69.03	5	5	09:48:17	SIZE	69.06	2	2
ucinn	69.03+	2	2	09:48:17	ucinn	69.07+	4	4
SIZE	69.03-	1	1	09:48:17	BRUT	69.07+	3	3
ETRD	68.93	1	1	09:47:00	LEHM	69.09	1	1
SCHB	68.92+	10	10	09:48:06	AUTO	69.10	2	2
PERT	68.90	3	3	09:47:22	SCHB	69.17	1	1
SWST	68.76	1	1	09:37:20	TMBR	69.28	4	4
NITE	68.76	1	1	09:46:54	NITE	69.30	1	1
FBCO	68.75	1	1	09:34:19	NFSC	69.49	3	3
TMBR	68.74	4	4	09:47:39	ETRD	69.50+	20	20
LEHM	68.73	1	1	09:46:53	COWN	69.60	1	1
COWN	68.60	1	1	09:37:05	MSCO	69.68	1	1
NFSC	68.55	5	5	09:47:40	MADF	69.69	2	2
BTRD	68.50	2	2	09:44:23	chxe	69.69+	1	1
CANT	68.42	1	1	09:35:18	GSCO	69.70	1	1
AUTO	68.40	1	1	09:45:56	TDCM	69.75	1	1
FLCM	68.31	1	1	09:34:44	FBCO	69.75	1	1
ubosx	68.19	1	1	09:46:53	ubosx	69.75	1	1

Time	MM	b/a	Price	Size
09:48	chxe	b	67.04	1
09:48	arcx	b	69.03	5
09:48	arcx	b	69.03	9
09:48	cinn	a	69.07	4
09:48	cinn	b	69.03	2
09:48	arcx	a	69.06	4
09:48	arcx	b	69.03	5
09:48	SIZE	b	69.03	1
09:48	BRUT	a	69.07	3
09:48	BRUT	a	69.05	1
09:48	SIZE	b	69.04	1
09:48	SIZE	a	69.06	2
09:48	SIZE	b	69.03	1
09:48	BRUT	a	69.05	2
09:48	SIZE	a	69.06	3
09:48	arcx	a	69.04	1
09:48	arcx	a	69.04	2
09:48	SIZE	b	69.01	4
09:48	SIZE	a	69.05	1
09:48	BRUT	b	69.03	12
09:48	BRUT	b	69.03	2
09:48	BRUT	b	69.03	1
09:48	SIZE	a	69.04	1

Montage

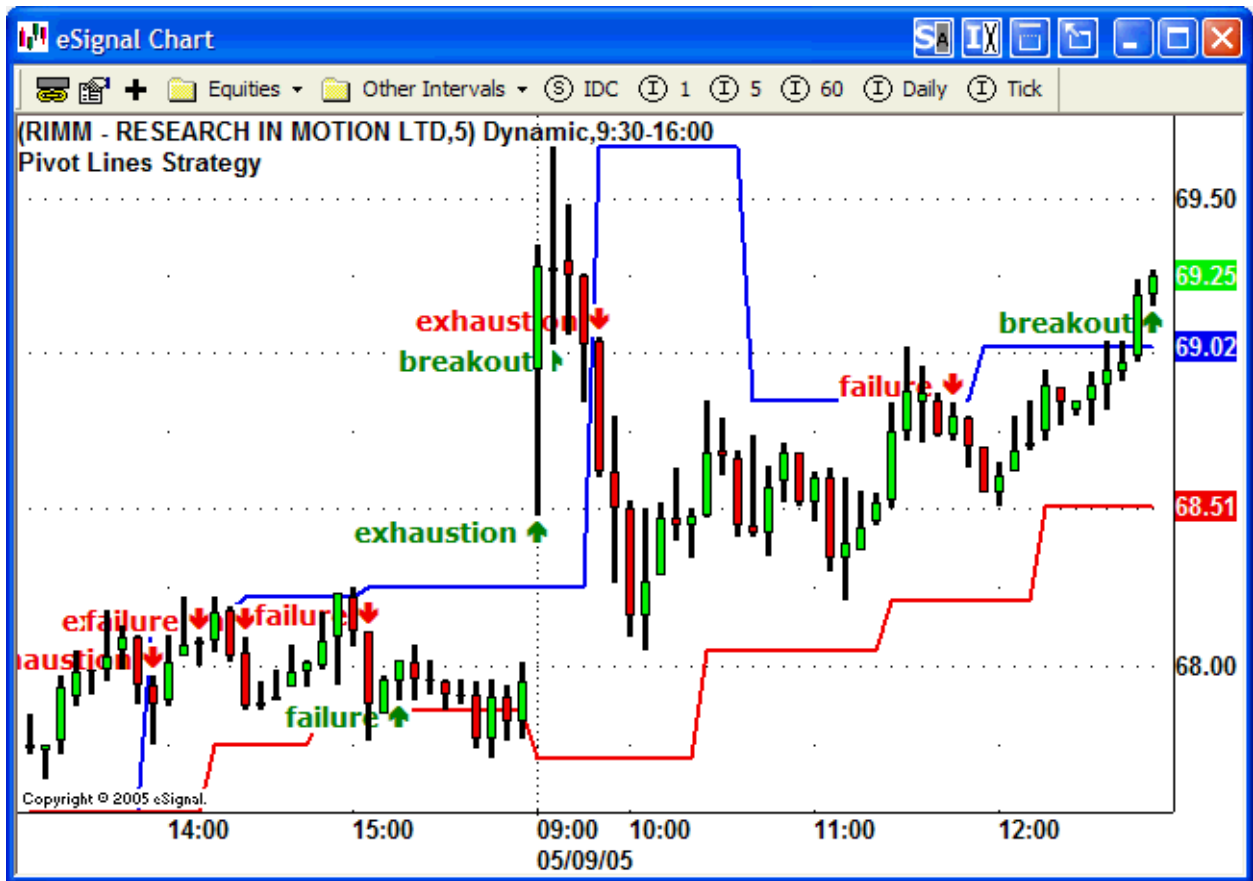
TotalView

Island

Arca

NYOB

Looking at the Market Depth screen, we see that Lehman Brothers (LEHM), one of the more powerful Market Makers for RIMM, is offering stock for sale despite the fact that the stock had been rising. This reinforces our short trade, even though there is more action on the Bid side.

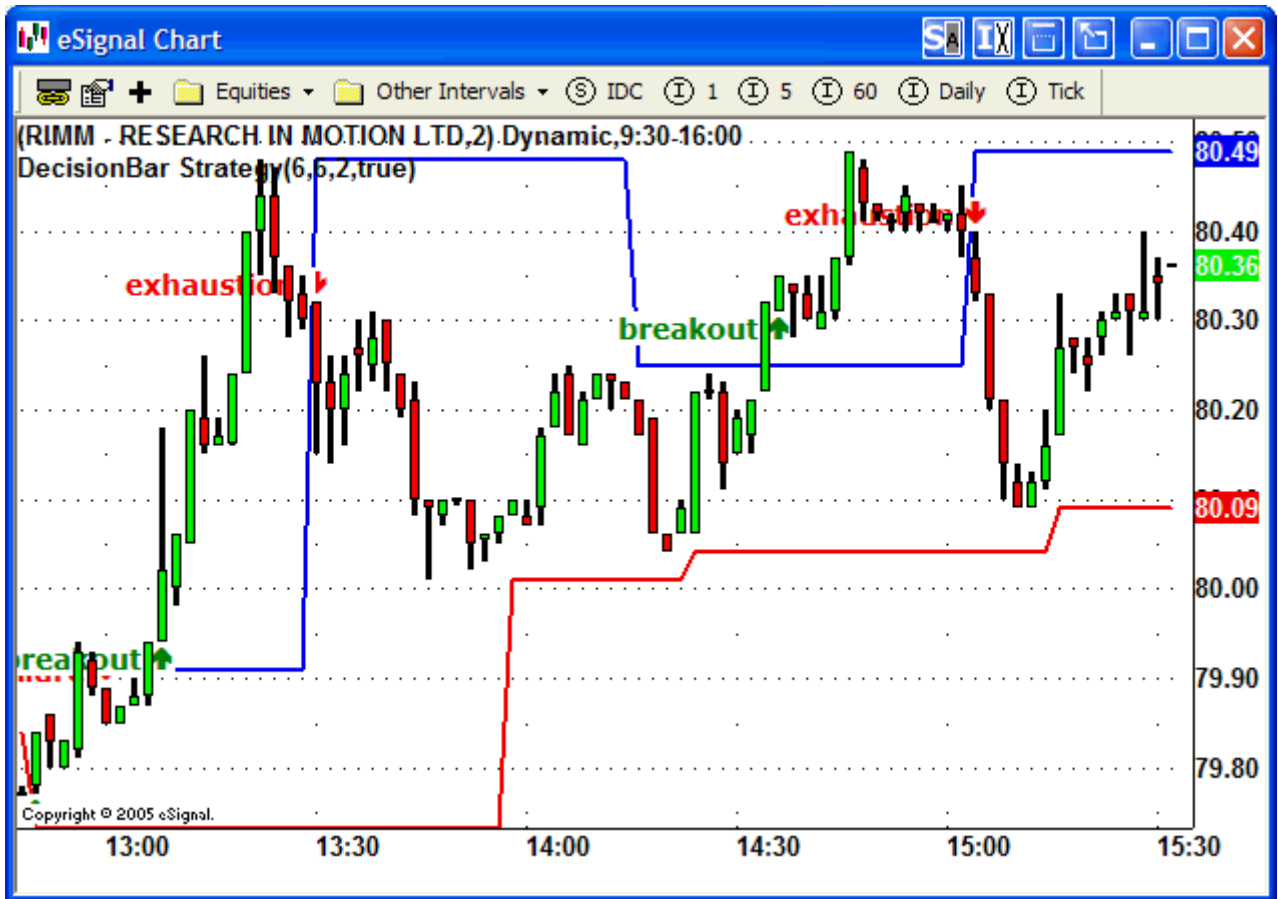


Here is how the trade played out. Although it wasn't ultimately a winner, it started us off in the right direction and there were plenty of chances to protect some profits before the breakout signal officially reversed direction. Also, note that the initial and subsequent downward swings stalled at a prior resistance level (See Advanced Concept #3), where astute DecisionBar trades may have exited the trade at a profit.

## DecisionBar Trading 204 – Tick Charts

Tick Charts are often used by futures traders, but rarely by stock traders. Looking at Tick Charts can give you a significant advantage over other traders.

Anytime a trade takes place, it is called a Tick. A Tick chart creates one price bar for a specific number of ticks of the trading instrument you are watching. This has the effect of making the individual bars relatively equal in activity. It tends to smoothe out the chart and let you see patterns that are not obvious on an interval chart.



This is a two minute chart of Research in Motion (RIMM).



This 72 Tick chart of RIMM covers about the same time period as the two-minute chart. It is much smoother and the second Breakout Signal is easier to anticipate, as you can see the earlier bars challenging resistance. You'll have to experiment with the number of ticks to use depending on how actively the instrument you are interested in is traded.

You should also experiment with Volume Charts. Charts based upon volume make a new price bar (or candlesticks) every time a specific number of shares or contracts have been traded. This is different from tick charts because each trade may be a different size, but still constitutes one "Tick" on a tick chart.

For example, a trade for one contract would show up the same as a trade for 1000 contracts on a tick chart, but a volume chart would take into account the difference in the size of the trades.

Volume charts also adjust to the market, and make price bars more frequently when the market is moving quickly, and less frequently when the market is moving slowly.

## **DecisionBar Trading – Summary**

DecisionBars are natural places in time and price where you have a trading opportunity that is in sync with the market. As such, timing and direction are predetermined, and your only decision is whether or not to take the trade. DecisionBars are so powerful that you stand a good chance of making a profit, even if you take every trade. That being said, smart traders only take trades in the likely direction of the market.

There is no perfect decision-making tool, however our proprietary Risk Oscillator takes many things into account, and you should find it useful. We discuss and demonstrate our Risk Oscillator in the next section.

You can also experiment with the many different studies available in MultiCharts and eSignal to help you determine whether or not to take the trade.

DecisionBars work for all trading instruments in all time frames. I don't know of any professional trader that doesn't use some variation of the DecisionBar concept.

# DecisionBar Trading 301 – Making the Decision

Once a DecisionBar occurs, you must decide if you are going to take the trade. You have to have a method of determining when the odds of a successful trade are most in your favor.

Obviously, you can use whatever indicators, studies, formulas, or psychics you wish to help you determine whether or not to take the trade. What you'll find is that there is no indicator or method that will consistently point out winners or losers. As we keep pointing out, the market is a constantly changing entity, and that is where the challenge lies.

Our Risk Oscillators can be invaluable tools in helping you decide whether or not to take a trade.

We have recently redesigned our Risk Oscillators to be more intuitive and to require less evaluation by the trader.

There are three Risk Oscillators: One for Stocks, One for Futures and Commodities, and one for Forex. These Oscillators require no adjustments.

The Risk Oscillators use proprietary algorithm to evaluate the market bias at the current time, and project the future movement of the market. The resultant output suggests the probability of the market moving upward or downward.

**When the appropriate Risk Oscillator is above zero, it means that the probability is that the market will move higher.**

**When the appropriate Risk Oscillator is below zero, it means that the probability is that the market will move lower.**

**If the oscillator is oscillating about the zero line, the market is neutral.**

**An increasing oscillator value suggests an increasingly Bullish market.**

**A decreasing oscillator value suggests an increasingly Bearish market.**

**When the Oscillator reaches extreme (relative) values and reverses it may indicate the end of a move and a good exit point.**

**When the Oscillator reaches extreme (relative) values and reverses it may indicate the start of a move and a good entry point (for aggressive traders).**

**When the Oscillator moves from positive to negative, after an extended move, you may consider taking profits from a long trade.**

**When the Oscillator moves from negative to positive, after an extended move, you may consider taking profits from a short trade.**

**The relative value of the Oscillators suggests the current strength of the trend. The actual value depends on what you are trading.**

**The Oscillator can be used as a divergence indicator:**

When a higher high in prices results in the oscillator output making a lower high, it may be an indication of a move to the downside.

When a lower low in prices results in the oscillator output making a higher low, it may be an indication of a move to the upside.



This is an example of divergence. A new high by the price chart did not result in a new high by the Risk Oscillator. This suggests a weakening market. Also note that the Oscillator peaked and started moving downward before the actual high was reached, suggesting that the move up was near an end.

You should trade cautiously, or not at all, if the Oscillators are flat or just meandering about the Zero Line.

The Risk Oscillators are very accurate. Depending on what you trade, you can put as much reliance on the Risk Oscillators as you wish.

The idea is to create a trading methodology using the Pivot Strategy Indicator and the Risk Oscillator. Aggressive traders may wish to add the Pivot Strategy Warning Indicator.

(The DecisionBar Strategy Warning indicator gives you advance notice when a DecisionBar may be about to occur, allowing you to set up your trades without rushing, and sometimes anticipate the market for a better entry.

The DecisionBar Strategy Warning indicator MUST have the same sensitivity settings as the DecisionBar Strategy indicator. It does not plot anything on the chart, but gives you audio and pop-up alerts when a signal may be imminent. Be aware that the signal may not be valid by bar close.) The DecisionBar Strategy Warning indicator only warns of Primary DecisionBar signals.

A basic trading methodology might be as simple as:

**Initiate only long trades when the Risk Oscillator is above zero.**

**Initiate only short trades when the Risk Oscillator is below zero.**

Rather than go through all the possible permutations, in the next section I'm going to demonstrate a sample methodology that I use. Just keep in mind that I am not a system trader. I am constantly looking at the chart to try to understand how the market is moving. I may not follow the methodology to the letter on every trade, but I stick to it pretty closely.

I'll demonstrate this in the examples.

(Note: The difference in the oscillators is how they handle choppy markets. Futures are choppier than stocks and forex is choppier than futures.

If you are trading forex and the currency pair you are trading starts exhibiting "trendier" behavior than usual, there is nothing wrong with checking out how the stocks or futures Risk Oscillator would perform under these conditions.

If you are trading a stock that is especially choppy, you may wish to check-out the Futures or Forex Risk Oscillator.)

# Sample Trading Methodology using the Risk Oscillators

While this trading methodology is rule based, traders are encouraged to continually re-evaluate the action of the market by looking at the entire chart, not just the right side where the signals are given.

Here is the methodology. It requires the use of appropriate stops as discussed previously.

1) Long signals are considered valid only if the appropriate Risk Oscillator is positive on the bar the signal is given.

Short signals are considered valid only if the appropriate Risk Oscillator is negative on the bar the signal is given.

Invalid signals are ignored. This means that If I am holding a long position and a short signal is given, I continue to hold my long position until:

- a) The short signal is confirmed by a valid entry bar (see #2 below), or
- b) My stop is triggered, or
- c) I decide to exit because the market has lost momentum and I want to protect profits.

2) Trades are entered following a valid signal when:

- a) The Entry Bar is moving in the same directions as the trade and
- b) Both the slope and value of the oscillator correspond (the oscillator is above zero and rising when entering long trades, and the oscillator is below zero and falling when entering short trades).

3) Following a valid signal, any subsequent bar is a potential Entry Bar as long as condition (2) is met and no new signal (including Signals from Secondary DecisionBars) has been given.

4) For Primary DecisionBar signals, the optimal entry price is BELOW or EQUAL TO the Signal Price (the closing price of the signal bar) for long trades, or ABOVE or EQUAL TO the Signal Price (the closing price of the signal bar) for short trades.

Secondary DecisionBar signals must be confirmed by a trade ABOVE THE HIGH of THE SIGNAL BAR for long trades or BELOW THE LOW of THE SIGNAL BAR for short trades.

In the following examples, keep a couple of things in mind:

- 1) We never know how a bar will close, so the actual entry bar may or may not be a conforming bar at bar close. In real trading, you do your best and live with the consequences.
- 2) Aggressive traders may use the Strategy Warning Indicator along with the Strategy Indicator to enter during the signal Bar if the value and slope of the Risk Oscillator confirms the trade.
- 3) We may not always get our optimal entry price. Whether you enter a trade at other than the optimal price is up to you, but you should never chase a trade too far.

## Example 1



On this chart of the GBP a Short Exhaustion signal is shown above “A” but the Risk Oscillator is just about zero (actually, it is slightly negative). In cases like this, give the benefit of the doubt to the Signal. Especially if the slope of the oscillator agrees with the Signal.

Once we accept the signal we look for an entry bar. The following bar opened and closed at the same price, but was negative intrabar, and may have provided a good entry.

The next bar (above “B”) is obviously negative, and the Risk Oscillator is negative and falling, confirming the entry.

Note that we didn't get our ideal entry (at or above the close of the Signal Bar) but we are not far off and decide to take the trade.

Your first choice for stop placement is above the Upper Pivot. If that entails too much risk, as it often does for exhaustion signals, place your stop above the Signal Bar.

Three bars later, we get a Long Secondary DecisionBar, but the Risk Oscillator is negative, so we ignore the signal and hold our short position.

The Short Signal at "D" is a valid signal, as the Risk Oscillator is negative, but we are already short, so we hold our position while moving our stop to just above the lower (Breakdown) Pivot.

For this example the settings for the Strategy Indicator are (15,15,2,false). This is indicated at the top of the chart.

Note: If you are trading forex using an eSignal datafeed, don't try to trade using eSignal's combined feed (i.e. EUR A0-FX). This combined feed includes over 200 contributors and is virtually impossible to trade. Try to use your broker's individual feed if possible (i.e. EUR@FXCM A0-FX). You can get a list of all contributors by going to the "Symbols" menu item/Symbol Directory and scrolling down to "Forex (Format and Contributors)."

## Example 2



In this example the Short Secondary DecisionBar at “A” is not confirmed (the Risk Oscillator is above zero). The Short Breakdown at “B” is confirmed by the Risk Oscillator, but we wouldn’t enter at the Signal Bar, even if we were using the Warning Indicator, because it shows a green candlestick, meaning the bar is moving against the signal.

The Bar above “C” is a valid Entry Bar (the Risk Oscillator is negative and sloping downward and the bar is negative), although once again we don’t get our optimal entry price. Our initial stop is above the lower pivot (the Breakdown level).

The Long Exhaustion Signal at “D” is not confirmed by the Risk Oscillator, but the Oscillator is rising and the smart trader exits here to protect profits and goes to cash.

## Example 3



One of the problems with rule based trading is that traders tend to stop thinking for themselves. Here a Long Breakout at “A” is confirmed by a valid entry bar three bars later. Then came two invalid short signals at “B” and “C.” The smart trader looks at the entire chart, sees that the market has lost upward momentum, and gets out at the best price he/she can following that failure at “C.” The inexperienced trader is just happy his/her trade is still alive and holds his position, “hoping” for a move higher, rather than take a small loss. When you find yourself “hoping,” get out of the trade.



In this case the market eventually broke down, and while the smart trader was able to enter a short trade at “E” or “F,” the inexperienced trader took a larger loss on his/her long trade and was relegated to playing catch-up with his/her short trade.

I can’t stress enough that it is important to look at the entire chart and evaluate what is happening in terms on support and resistance, supply and demand, momentum and exhaustion, before you blindly follow a set of rules, no matter how effective those rules may be.

## Example 4



This example is similar to Example 3. After a fast move up following a Long Signal and a confirmed entry, the market just flattened out. While the short signal below point “A” is valid, and you might be able to make a case for entry at a subsequent bar, it should be obvious to even an inexperienced trader that the market has flattened out and the prudent move is to go to cash.

## Example 5



You can set the color of the oscillator to be one color when it is above zero and another color when it is below zero, in this case green and red. Keep in mind that the oscillator doesn't change color until the close of a bar. Following a valid Short Exhaustion Signal, the Bar below point "A" is a valid entry bar. Notice at point "B" the oscillator is negative and falling. Also, note that the oscillator color is green. This is because the value of the oscillator, at the close of the previous bar, was very slightly positive causing the next segment to be green. If this confuses you, you can set the Up Color and Down Color to the same color and just look at the value of the oscillator.

## Example 6



This is another one of those judgment calls. The oscillator is slightly positive when that short failure below point “A” is issued. Should you take the trade? This is a tough call. Even though we usually give the benefit of the doubt to the signal, the market has been just meandering around and we might just go to cash (we were in a long trade). The fact is that you’re not going to make the correct decision every time. If you make a wrong decision, just put it behind you and move on.

## Example 7



We have added the average true range indicator to the chart above. As we mentioned in a previous section, when placing stops you need to leave enough “wiggle room” so that you don’t get prematurely stopped out, while leaving the stop tight enough that you don’t risk more money than you want to.

The chart above shows a Short Failure Signal above point “A” which is confirmed on the next bar. The Average True Range (ATR) is about .8.



For this example, we are going to assume that our entry price is the close of the entry bar at 1439.50. We know that we want our stop above the upper pivot (1440.25), but how far above it? Since the average true range is .8, we might decide to use 2 ATRs for our initial stop ( $.8 \times 2 = 1.6$ ) and place our initial stop at 1441.10 ( $1439.50 + 1.60$ ). This is well above the upper pivot.

Now we trail our stop 1.60 points ABOVE THE LOW of subsequent bars. Note that we never raise (short) stops. We just lower the stop if it is more than 1.60 points above the low of the previous bar.



Note that a few bars later the ATR has dropped to about .60. The market is losing volatility. At this point two ATR's is only 1.20 points, so we tighten our stop to 1.20 points ABOVE THE LOW of subsequent bars.

## Example 8



This chart shows a confirmed long signal. For this example we will assume our entry is at the close of the signal bar at 1436.50. Our ideal stop placement is below the lower pivot level of 1434.25, but that is kind of a wide stop for a quiet market like this.

In this case, we want to place the stop below the low of the Signal Bar, but far enough away that we don't get prematurely stopped out.



The low of the Signal bar was 1435.75.



The Average True Range is about .6. If we again use 2 ATRs for our initial stop ( $2 \times .6 = 1.20$ ), we place our stop at  $1436.50 - 1.20$  or  $1435.30$ . Since low of the Signal bar was  $1435.75$ , this is a valid stop placement.

Now we trail our stop 1.20 points BELOW THE HIGH of subsequent bars. Note that we never lower (long) stops. We just raise the stop if it is more than 1.20 points below the high of the previous bar.

Please note that this is a very quiet market. I often use an initial stop of 3 or even 4 ATRs, and then tighten it up once I show 3 ATRs profit.



Try not to get hung up on the mechanics of using trailing stops. The important thing is to recognize the risk involved in entering a trade. The chart of RIMM above shows an ATR of \$.049 when a Long Exhaustion signal is given. If you only wanted to use a stop of \$.25, you would probably be better off passing the trade, since the likelihood is that you would be prematurely stopped out due to the normal “wobble” of RIMM.

You must be willing to risk an amount consistent with the current volatility of whatever you are trading to consistently take profits out of your trades.

# DecisionBar Trading 302 – Making the Decision – Part 2

## Using Technical Indicators

We mentioned at the beginning of this manual that standard technical indicators are best used to enhance profitability, not to attain profitability. In this section, we'll discuss the proper use of some technical indicators.

### Moving Averages

Moving averages are perhaps the simplest, and most useful of the basic technical indicators. A moving average is the average price of the trading instrument, over x periods, calculated at the open, high, low or close (usually the close) of each bar and plotted on the chart. To be of value, moving averages must be used correctly. **Moving Averages are only useful in a trending market. In a flat, choppy market, they are essentially meaningless.**



This is what a trending market looks like. Note how RIMM stays above the rising, 20 period moving average, and occasionally uses it for support, as at point A. When a market is trending you should consider ignoring all reversal signals unless the signal bar is completely below the moving average, for short signals in an uptrend, or completely above the moving average, for long signals in a downtrend.

There is nothing magical about how many periods you use for a moving average, but each trading instrument has an optimum moving average. 10, 20, 40, and 50 periods are most common.



This chart of the S&P 500 emini shows the market in a weak downtrend at points A and B. Those Secondary Long signals should probably be ignored, as they are below the 20 period moving average.. The Secondary signal at point C has completely cleared the moving average and likely represents the end of the downtrend.



As we stated earlier, in a flat or trading range market, moving averages are virtually useless as regards the decision making process.

## Oscillators

Oscillators, such as Stochastics, RSI and CCI are used to determine so-called “OverBought” and “OverSold” levels. Essentially, they assume that once prices get too far from a “mean” level, the trading instrument will reverse direction and head back towards the mean.

Oscillators can be helpful during trading range markets, but will give you a series of false signals in trending markets.

I most often use the CCI or Commodity Channel Index



The CCI gives Sell signals when it moves above and then below a predetermined “Overbought” level, and gives Buy signals when it moves below, and then back above a predetermined “Oversold Level.”

This chart shows a Sell at point A, a Buy at point B, a Sell at point C, a Buy at point D, and a Sell at point E. The number of periods to use for the computation determines how sensitive the indicator is to slight changes in prices. The fewer periods, the more sensitive the indicator. I’ve used as few as 5 periods to swing trade.



# **DecisionBar Trading 401 – The Psychology of Trading: Your Destiny is in Your Hands**

With DecisionBar Trading you can master the markets. By understanding and trading with the rhythm of the markets you will put the odds on your side. Now you have to start thinking like a winner.

For some reason, highly intelligent people seem to lose their common sense when it comes to trading. People spend hundreds and thousands of dollars on trading services and trading software programs that promise the impossible. Even when they're disappointed by the failure of these services and software programs to deliver what they promise, they continue to join one service after another, and buy one software program after another, looking for the answer to their dreams.

As we stated earlier, trading is a solitary endeavor. If you want to be a successful trader you must accept the fact that it's all up to you. To be blunt, trading services and trading chat rooms are for losers.

Before you can be a successful trader you have to believe that you are going about things the right way. If you feel that there is some time-honored method of making winning trade after winning trade that you're not taking advantage of, you'll continue to look for that Holy Grail.

There is no such thing.

The market is a constantly changing entity. It is made up of millions of people, institutions, and businesses all with different agendas, and all trying to make money at your expense.

What worked yesterday may not work today, and what works today may not work tomorrow.

There is only one constant in trading the markets. The price of a stock is determined by supply and demand. Price is everything!

# **DecisionBar Trading 402 – The Psychology of Trading: Consistency Is the Hobgoblin of Small Minds.**

What dooms many would-be traders to failure is that they are looking for logic in an illogical world, yet that illogic is logical. I know that sounds like doubletalk, but let's think this through.

Trading is a “Zero Sum” game. In other words, for each dollar gained, a dollar must be lost. Let's assume you found the perfect indicator. We'll call it the “Super Indicator.” Every time it gave a Buy signal the stock went up. Every time it gave a Sell signal the stock went down. Now let's assume that this indicator was marketed on an infomercial, and almost everyone went out and bought the “Super Indicator.” If everyone made money when the indicator gave a Buy signal, where would that money come from? Since a dollar must be lost for every dollar made, everyone can't be winners.

In this example the stock would probably be bid up to improbable levels, users of the Super Indicator would pay too much for the stock, and when there were no buyers for the stock it would drop in price. All of a sudden, the Super Indicator is giving losing signals.

The point is that in trading, when you do what everyone else is doing, you're likely to lose money. That's why trading systems, chart patterns and indicators are so inconsistent. We cannot all do the same thing and make money. Someone has to take the other side of the trade and lose money, and they're not going to do that just to make you and the “Guru du jour” happy.

Back in the 90s, and early in the 21st century, one self-proclaimed guru became very popular suggesting people buy options on companies that declared a stock split. This phenomenon lasted just long enough for people to lose their shirts, and the self-proclaimed guru, who was charging about \$2000 per month for people to join his web site and had books on the NY Times best seller list, eventually declared bankruptcy.

The DecisionBar trading method is based on the only absolute in trading. Regardless of the cause, all market movement is based on supply and demand. DecisionBars are natural, and logical places to make trades.

As an example, let's assume a company announces an earnings shortfall. There are two logical places to make a trade. When they announce the shortfall (a Breakdown Bar), or when the sell-off seems to have run its course (an Exhaustion Bar).

At the Breakdown Bar we must guess how far the stock will fall after the initial gap down. (We know that the public is selling the stock, and that should set off a warning signal right then). At the Exhaustion Bar we must decide if the stock has further to fall, or if investors will perceive it as a good value at its new, low price.

The answer to these questions has to do with many things, most of which have nothing to do with the stock. Are we at war, or are we at peace. Are we in a Bull market, or are we in a Bear market. Are interest rates high, or are interest rates low. Are interest rates rising, or are interest rates falling. And, most important, how many people are buying and how many people are selling.

Even if we make the right decision, based on all these parameters today, the same decision tomorrow, based on the same parameters, could be wrong.

The most frustrating thing about trading is that what works one day may not work the next. A technical indicator may show a series of successful signals, but the day you decide to use that indicator it gives a bad signal.

By understanding this and taking the “illogical” side of the trade, you're almost guaranteed to become a winning trader.

## **DecisionBar Trading 403 – The Psychology of Trading: Accepting Losses**

I hate to lose!! Everyone hates to lose. If you hate losing so much that it effects how you think and act, you can't be a successful trader. That is not to say that you shouldn't make adjustments when you lose a few trades in a row, but you have to learn to keep your emotions in check.

The first time I went to Las Vegas, I had read a book on Blackjack that said that you should leave the table if you lost two hands in a row. I followed that advice religiously, and went and had a drink at the bar each time I lost two hands in a row. The next day I had the mother of all hangovers, but I was also a winner.

Not all stocks can be traded successfully every day. If you lose a couple of trades in a row, start evaluating if the stock is acting right. Is it trading in too narrow a range? Are there too many wide bars? Whatever the reason, don't chase your losses. Either, look for another stock to trade, or just get up and walk away for awhile.

When you start trading, especially daytrading, you should begin trading small lots. Trading on paper is a lot different than trading with real money. Just get used to pulling the trigger. Don't think about how much you're winning or losing, just think about managing your trade correctly by protecting your gains and minimizing your losses.

I have been doing this for a long time, and I usually buy stocks in thousand share lots. If I allow myself to think about the magnitude of the trade, or the amount to be made or lost, even I get nervous. I just try to think about one share of stock, and try to avoid doing the multiplication in my head.

## **DecisionBar Trading 404 – The Psychology of Trading: Get Away From The Computer!**

When I first started trading I was glued to the computer for almost every minute of every trading day. At the end of the day I was too exhausted to do anything else. That's not much of a life.

Our DecisionBar Strategy Indicator has a loud obnoxious sound that, if you turn up the sound on your computer, you can hear from almost anywhere in the house.

Once you make a trade, and place a stop order (or alert), don't stare at the computer screen as though every tick is life or death. Read a book, exercise, watch some TV, layout by the pool (I've run a speaker wire to the pool so I can hear the alerts), and do anything else you can to make your day full and interesting.

Making a living as a trader has a lot of benefits. Make sure to take advantage of them, and don't let greed get the best of you. If your first trade of the day is a big winner, consider taking the rest of the day off. Enjoy your life. If you're first couple of trades of the day are losers, or you find you're just not into it today, consider taking the rest of the day off. Enjoy your life.

Don't take your computer on vacations with you. Trading is stressful; when you take a break, take a real break.

If you have a bad day, don't take it out on your spouse and kids. Go celebrate, because you know you're going to have a good day tomorrow.

DecisionBar trading has given you the tools and knowledge to be a successful trader, but that is all meaningless if you don't enjoy every day of your life.

## **DecisionBar Trading 501 – It's Time to Trade!!**

You now have all the tools you need to be a successful trader, and you should understand how the market works and why most people go about trying to make money in the market the wrong way.

Now it's time to make some money. The point we have been trying to drive home is that the market is constantly changing. You have to change with it. The only thing you can depend on is that the laws of Supply and Demand are irrefutable, and that with DecisionBar Trading you will always know when to trade, and what direction to trade.

It is up to you to continue to look for new methods to help you make the right decisions, and to stay one step ahead of the crowd.

We look forward to hearing your success stories, and hope to hear from you soon.

The DecisionBar Trading Team