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DiversifiedTradingInstitute

Firing Your Pistol

Determining probabilities for market direction is only one part of the process for making a successful trade in the financial markets. Execution is yet another part of the art that can trip up even the most experienced of traders. The market has a way of hypnotizing you into a trance that makes you powerless to enter or exit or do what you need to do. One of the most important parts of the personal psychology section of the trading school we operate is the section we call "Pulling the Trigger." We explore the natural aversion that most people have to decision-making and suggest ways to overcome the hesitancy that can make the difference between a winning and losing trade.

In my early years, I would enter a position and only after completing the transaction would I even consider that at some point I might have to exit it. Since I was young and without fear, it would take the market approaching the "ouch" point before I would even think about liquidating the trade. The results were always the same: if only I would have sold, I could have made some money or I should have taken an early loss which was small as compared to the "ouch" point loss that my hesitancy had let it get to. After trading the market for over twenty years, eventually I came up with a procedure that would tell me when to re-holster my gun while I still had some bullets left.

Decision-making is vastly easier when it is based on a plan developed before the pressure of the trade begins. Depending on what market you are trading, it will help you have a predetermined entry or exit procedure in place. Prior to entering a trade, you are better able to determine these points by methodical calculation and without the distraction of the heat of the moment that occurs once you are in a trade.

At the Day Trading Institute, we teach principles for trading the S&P 500 Futures market to illustrate the dynamics of the financial markets generally. First let's be clear about what the S&P are and where and how it trades. The S&P 500 Futures Contract is an agreement to buy or sell a predetermined amount of the securities that make up the broad-based index called the Standard & Poors 500. It trades like any other commodity on the Chicago Mercantile Exchange and offers a number of important features that contribute to its being an especially attractive trading vehicle. Its substantial trading volume makes it highly liquid allowing the trader easy entry and exit from trades. This means slippage from the specified trigger price is typically minimal. There is sufficient volatility in the S&P Futures market to offer abundant opportunity to capture multiple point price moves in intra-day time spans. Margin requirements to trade this instrument are typically low making it one of the most leveraged trading vehicles available in the market. With the S&P Futures Contract, a margin deposit of a few thousand dollars makes it possible to control hundreds of thousands of dollars of securities. You may trade it either through a traditional commodities brokerage or via any of several excellent on-line electronic Web broker systems now available. As we teach in our school, you may and should always use a stop loss order in combination with each trade you make of the S&P 500 Futures Contract. Learning about the S&P offers knowledge useful in trading any number of other markets including stocks, mutual funds, and other commodities.

Let me illustrate the method I use for pulling the trigger by referring to an actual trade using the S&P 500 Futures Contract. We teach this method to our students at the Day Trading Institute. We look at the 30-minute bar chart to first determine the overall direction of the market you are trading. We use this review to determine whether it be long, short, or on the sidelines.

For example, referring to Chart 1, we see four consecutive up bars followed by a major breakdown shown in the next two bars. When the market trades back down below the bottom of the fourth up bar at about 1480, and fails to rally back above the mid-point of the last up bar, it tells me that the probability is that we are headed lower. Once alerted to what appears to be a likely trend reversal, I then go to the 5 minute chart. See Chart 2. I observe a double bottom on the 5-minute bars at about 1480.50. This double bottom becomes my trigger point to enter a trade on the short side. You notice that my analysis is done before I enter the trade, however. Once I'm alerted to the likely reversal on the 30-

minute chart, I start looking for the double bottom to set my trigger. Then I'm ready to pull it when the market trades through it at about 1480. This predetermined game plan overcomes my hesitancy and allows me to execute calmly despite the pressure of the trade itself.

I go back to the 30-minute chart to set my stop. I observe that we had a double top on the two last up bars at about 1486 and conclude that the probability is that this should be a safe stop if I'm right on the trend. So I use 1486.60 to set the safety stop and then return to watching the trade on the 5-minute chart. Although I see a quick double bottom at about 1473 and might be tempted to look for a reversal to the upside after them, I hold off because the next 5-minute bar opens lower than the close of the second of the double bottom bars. I smell a head fake on the reversal and stay short. I'm protected by my stop (and actually, because we teach the use of trailing stops.

I've now moved it down from the original level of 1486 to just above 1476, the top of last several bars). When, in fact, we continue downward and break the double bottom, I'm even more convinced that I'm right on the trend and continue with my trade, now moving my stop down to 1475.60, just above the double top we see in the local bars.

You can see how we use the numbers. Like old-time tape readers, we read the numbers and learn ways of using them to show us likely trends, tell us entry points for trades once trends are identified (big picture), and where to set stops and exit our trades before we get to the point of execution. This is the premeditated method we teach our students and it underlies the market indicator software we have developed to assist traders monitor and decode these key numbers.

Always we go from the bigger picture to the smaller picture, from the 30-minute tracking to the 5-minute. And as we teach in our school, you can use this approach with any market you trade to plan your decisions before you need to make them. You can use the same time ratio 6:1 (30-minute to 5-minute) for virtually any time period. For example, if you are a longer-term trader, 6 days to 1 day. You can use this method for trading individual stocks. In all cases, you should consider your own style and comfort when you trade the markets.

Methodical analysis of the markets' language — numbers -- is the key to planning your trading. You must avoid putting yourself in a position that leads to haphazard order entry and trying to fly by the seat of your pants. Learning to use numbers, understand charts, indicators and other trading elements is like learning to read a road map. It allows you to plot out the route to take before you get to the fork in the road. As we tell our students, you owe it to yourself, before you sit down to trade, to stand up and learn. This is one of many approaches that I use when I attempt to determine trends, probabilities, reduce risk, and analyze whether or not to take a trade and when and how to pull the trigger.

Tom Busby is the founder, President and Chief Instructor of the Day Trading Institute in Mobile, Alabama. Tom has traded the S&P 500 every day (but six) since its inception in 1982, and is well known throughout the trading community. In 1996, he founded the Day Trading Institute to teach others his unique method of using the S&P 500 as the market leader for trading futures, options, equities and other securities. The Day Trading Institute teaches its students how to approach the market using technical analysis combined with risk management techniques. More information about Tom Busby and the educational and informational services of the Day Trading Institute may be obtained by calling toll-free 800.745.7444 or by email to info@dtitrader.com. Visit their web site at <http://www.dtitrader.com>.

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