



Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min



There have been numerous "Rounded Reversal" Days lately, and today was - technically - not an exception.

The day began with a \$0.50 gap, which was in the 'fade-able' range, but price made no attempt whatsoever to push back into the gap zone. By the 3rd and 4th candle, it was clear price was impulsing lower (breaking morning support on two very bearish candles) and then any pullback (two bars) was met with another powerful bearish candle. This gave us an

early expectation that a possible Trend Day down was ahead of us, though it was unlikely to be a powerful Type III trend day due to the moderate overnight gap (the best trend days often begin with gaps greater than \$1.00).

So we should have been expecting either a Trend Day Down or the possibility that the morning down move could devolve into a Rounded Reversal, so we should have been also aware of any momentum or TICK non-confirmations as the day progressed... which is exactly what occurred.

Unless you aggressively shorted the morning move down, there was not an 'idealized' trade during the morning plunge. There was a quick, aggressive scalp to be made off the two dojis that formed at the lower Bollinger Band just after 11:00am on a positive 3/10 Oscillator Divergence. See the 1-min chart for a description/example of the lower timeframe set-up at this time.

Price then formed a 'flag-like' retracement back to the falling 20 EMA, which could have set up a nice short-sell trade once price broke beneath the lower trendline at \$99.70. Unfortunately, downside was quite limited, as price merely managed to test the morning low of \$99.50 and then continue the positive momentum divergence and - this time - form a very slight TICK divergence at the 1:00pm EST lows. Remember, there is often an "Afternoon Breakout" that begins at 1:00 - and it can occur in either direction. It forms when traders come back from lunch and assess the morning trend and put on afternoon positions, which often results in a sustained move.

This time, the price consolidated, formed an internal divergence (see 1-min chart) as price formed a 'triple bottom' at the \$99.50 level (which was the lower boundary of the 5-min Bollinger Bands) and rose sharply off this level to confirm the expectation of a "Rounded Reversal" day (and destroy the expectation of a continued "Trend Day Down" with the break and close above the 50 period EMA).

At this point, your bias should have shifted to the upside as the rounded reversal was completing and price closed above the 50 EMA... though numerous dojis and then bearish candles took us in a downswing to test the rising 20 EMA, which held as support and formed another mini-bull flag (AB=CD Measured Move) trade.

This move terminated at the \$100.10 highs on a negative momentum divergence and two long(ish) upper shadow candles that peaked above the upper Bollinger Band. The bearish engulfing candle at 3:00pm EST should have been clue enough to exit any long position to wait to see the market's next move, or for conservative traders, to finish the day because the last 30 minutes can be somewhat "random" or at least less predictable (edge-wise) than the rest of the day. Today was no exception.

For example, thinking we had a bullish Rounded Reversal structure, you should have been tempted to take either of the three doji candles that formed at the bullish crossover of the 20 and 50 period EMA - what I call the "Cradle Trade" which is a bullish development.

However, just as soon as price began to rally upwards off this confluence support area, two sudden bearish bars swung price down almost \$0.30 in the last few minutes, destroying any upward expectancy and tainting the bullishness that was forming into the close.

Remember, Wednesday is a type of "Fed Day" so we could have rangebound early morning action which would give way to a sudden three-swing volatile move as the minutes or policy from the Federal Reserve is released. Conservative traders might prefer to avoid this volatility (which often hits the market at 1:15 EST / 2:15 CST), or at least not be caught off guard by it. Aggressive traders might enjoy the volatility/opportunity a Fed announcement brings, but do be careful and take the time to look back at prior "Fed Days" for clues as to how the "three swing" pattern often unfolds.



I tried to label a "three push" into the close which really isn't an 'ideal' pattern since the final swing failed to generate a new high, but this pattern was the only early warning of a possible down-move (if even a very slight warning). Otherwise, the move arose from hedge/mutual fund rebalancing most likely, or funds preparing for the Fed Day.



The 1-min chart gives us a chance to describe "unexpected" or "frustration" swings that appear after a decent divergence, though the market gives one last thrust after the divergence seems to be 'working' in our direction.

First, at 9:30 CST, price had formed a clear 3/10 Divergence and a smaller positive TICK divergence where I have drawn the yellow highlight. This could have been expected to be a potential turning point, or at least a spot to exit the morning short-sales, but notice at 10:00am CST, price fails to overcome the 1-min 50 period EMA, creating a minor (small) bear flag (or AB=CD Pattern) which then breaks the lower trendline completing the AB=CD Measured Move pattern with a swing low that forms a new TICK low on the session. However, price begins to rally as expected (or anticipated from the divergence). The same thing happens at 11:00am CST when price forms a gentle (small) 3-push negative divergence into the 11:00am high, but just as we think price might be ready to reverse, we get one 'last gasp' or thrust to the upside which either threatened or took out any stop-loss that anticipated a reversal swing. One thing to note here as well is that - just like the morning example - the rising trendline was not broken until after the 'surprise' swing. The best remedy is slightly larger stops (not playing too close to the market). Keep in mind that divergences have greater odds of

producing a retracement swing than a higher high, particularly when a 'three push' occurs so this gives us a good chance to discuss (slightly) failed divergence patterns - and that tight stops would take you out while looser stops would have kept you in to achieve a winning/profitable trade.

Finally, at the end of the day, we had a simple negative momentum divergence into the 2:00pm CST highs at \$101.10 (new relative price high) on a slightly higher TICK reading. Any short from this level would have been met with a quick swing back to the \$100.10 level (though not making a new high) which would have been frustrating if you expected a sudden swing down from the 2:00pm \$100.10 peak. Price did crest down to close lower, but not without a frustrating, unexpected 'extra' swing.

Half of the battle comes down to pattern recognition and trade entry into price structure. The other half of successful trading is the risk/money management, in that TIGHTER stops often produce a lower accuracy rate (with trades being unnecessarily stopped out that would have worked if the stop was larger) - today's action drives that home.

We're looking to achieve a balance between the "Accuracy Edge" (having a winning trade more than 50% of the time) and the "Monetary Edge" in that WHEN we have a winning trade, it should be two or three (or some multiple) times larger than our stop-loss were it to be hit.

Today's action gave us a nice lesson both in stop-loss placement (larger tends to be slightly better intraday... but not too wide) and that we trade concepts that have greater than 50% chance of working, but of course, they will not always unfold like clockwork.