Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min

What a way to start a weekend! I'll first start by discussing the structure and idealized trades and then move into a discussion of current market structure and the dominance of the Bulls - and an example of a failed expected pattern and the outcome. That's been the theme I've been trying to get you to pay attention to all week - when price breaks an expected resistance level, there is often a burst of momentum you can trade just due to stop-losses being triggered violently. Even if yours if one of the stops triggered, do not get upset, but realize that so many other traders acted in the same manner you did and - for lack of a better word - take advantage of their stop-losses triggering by playing long to capture these 'unexpected' stop-losses.

Let's take a look.

The first trade we like to make is a "Gap Fade" provided the SPY gaps less than $0.60. Today, we had a large gap of $0.80 which tipped us closer to the "Gap is NOT likely to fill" statistic and perhaps just beyond the 'netherworld' which is from $0.65 to $0.85. So the bias for the morning was slightly tipped towards "gap less likely to fill" and just about outside the 'netherworld.'

So, your bias should have been "I doubt the gap will fill but let's take a wait and see attitude perhaps on the sidelines". If you chose to enter short to play for a gap fill, your stop should have been just above $102.00 which would have reflected 'psychological' resistance.

The moment price broke above $102.00 on a strong and strengthening impulse, you should have remembered the lessons from earlier "Idealized Trades" discussions and experiences - meaning when price breaks above resistance - and the $102 level would have been the location for stop-losses of (virtually) all gap-fillers (meaning, if price broke above that level, we would see them bail en masse on the trade, giving you a scalp long buy opportunity).

Plus, the last few weeks have shown days that open in one direction and never give a pullback to get in - that's also the value of these reports - you can see changing market dynamics and anticipate current quirks in intraday behavior to repeat.

So the aggressive play would have been to get long about the $102.05 level (making sure we were continuing higher, depending on your risk-tolerance) and then held until we had some sort of countervailing sell (exit) signal (such as a divergence or bearish candle, etc).

The 'ideal' exit would have been to take the sell (red) candle after the shooting start that nearly touched $103.00 left a long upper shadow just above the upper Bollinger Band. I mentioned in the chart that the new momentum, volume, and TICK high should have clued you in that odds favored a higher price swing yet to come, which would have had you buying the first pullback you felt comfortable, which came either just before 11:00am or at 12:30 with an official pullback to the 5-min 20 period EMA (complete with doji candles). A stop would have been placed conservatively beneath the rising 20 EMA (which, unfortunately, would have been likely tagged out) or aggressively beneath the rising 50 EMA (which would have held you in for the expected price high, only much later than anticipated).

This serves as a testament to the "tight vs loose" stop-loss discussion that we all have to decide for ourselves. Looser stops yield higher-accuracy trading (over time) but open you up to larger losses, while smaller stops yield a less accurate (more trades 'fail') strategy with much smaller losses. The key is to make a decision based on experience and personality and stick with it.

So the final 'idealized trade' came in as price formed a doji off the lower Bollinger Band and rising 50 EMA at the $102.50 level (which also gave us an internal TICK divergence) as price found support and rallied higher in a "Trend Day" structure. This was also the "Make or Break" or "Line in the Sand" position as described in last night's and many other reports on Trend Days - the 50 EMA is the line of demarcation that - when broken - triggers a "Rounded Reversal" structure and when held as support, triggers a continuation of the expectation of a Trend Day structure.

We got a positive push higher into the close as funds squared away positions ahead of Options Expiration tomorrow. Notice how price of the SPY closed right at $103 - this is called "Pinning the Strike" and is quite a common practice.

I'm highlighting the new TICK, Momentum, and Price high, which led us to believe that higher prices were yet to come.

It's just that today's "Options Expiration" bias (that of a very flat, choppy day) prevailed mid-day until the close. Many traders prefer to stand aside or have fun outside their offices on Options Expiration days because patterns can be tricky and price movements are often 'random' due to large fund rebalancing - meaning classic patterns tend to fail more frequently.

Though this is the bias, I saw no major failed structural patterns that deviated from expectation (in terms of the 'Idealized Trades" I frequently define here) so today was not necessarily a 'hideous' day from that perspective.

That speaks for intraday. On the higher timeframes, there was some major damage that is causing widespread anger/disgust/confusion/stress to higher timeframe traders along with swing traders. Let's take a look.

The thing I like about being predominantly a Day Trader - as I'm sure you feel as well - is that we can have biases of what to expect for the trading day ahead that can help guide decisions, but if our biases are wrong, or if price moves unexpectedly due to unexpected economic news, then our account is fine. Our pride might not be, but our account is.

Swing traders were given a clean and clear sell-short signal on Monday as price shattered support, breaking arc resistance I've been describing all week and forming new momentum lows.

However, just like in the case of June's 'obvious' clear and confirmed Head and Shoulders price breakdown (and classic short-sale trigger entry), today marked the day that price broke back above the arc and above the expected 38.2% Fibonacci resistance at 1,017, triggering out intermediate and swing traders to take a rather painful stop-loss (not painful in terms of the cost in relation to the reward had the price continued to the downside, but painful in the sense that negative divergences, breadth divergences, a classic 'arc distribution' pattern, and major Fibonacci resistance failed).

In other words, that's two times in one month that major clear sell-short signals were generated and then immediately busted. Let's see the failed head and shoulders sell-short trigger:

You're looking at the "lows" at 870 that immediately gave birth to three major up days which were the genesis move of where we are now at 1,026. I'd said in a previous Intraday Report that we could get one more push up to complete the arc, and I've given 1,030 as a "line in the sand," not because there's anything significant about 1,030. I chose that number because that was about 15 points higher than the 'line in the sand' at 1,017, so were there to be a 'stop-loss run,' we would need protection above that. This could be a combination of a "Bull Trap" and a "Short-Squeeze," but a close solidly above 1,030 will send price up to the 1,100 or 1,150 level as the next target - leaving bears bloodied, bruised, and broken... as well as dealing damage to "obvious" patterns.

Remember that trading is not about knowing the future - it's not about crystal balls or foreknowledge. If anyone had foreknowledge, there would be no need for risk-management or stop-losses because he or she would simply rush out, buy options (or leveraged ETFs... or perhaps options on leveraged ETFs!) and then put the whole account on the line to capture the maximum profit from a known price move.

We know this is ludicrous, and we know that all professionals stay in the game thanks to risk and money management (due to situations like this!).

It's about gathering the facts, analyzing the charts, making a decision as to whether the reward is large enough to justify the risk, knowing the exit and target prices, and taking the risk. It's still frustrating when the odds stack up nicely in our favor, but the lower-probability outcome turns up to stop us out, but remember, our goal is to combine the Accuracy Edge (that your trade has a greater than 50% chance of succeeding) and the Monetary Edge (in that IF you trade achieves its target, it will yield a larger multiple than the stop-loss).

I speak this portion mainly to swing traders, but the logic is identical if not more so to intraday traders.

I told a colleague that the Summer of 2009 will be remembered as the "Summer the Market Just Wouldn't Go Down!"

Remember - supply and demand drive price movements - not charts, not fundamentals, not complex quantitative strategies.

Whoever the buyers are, they are applying more pressure than the sellers, which is resulting in a price rise of stellar proportions.

We default back to the position I've been espousing for the last few weeks - bulls are in control so this is the dominant reality in the market, and wait to get short only in the event of a confirmed sell signal... I should restate that now to read "only get short in the event of a really, really, really confirmed sell signal... or perhaps wait two to three days before getting short AFTER a confirmed sell signal."

It's very, very tough to be bullish here due to the gross overextension of price - but that's the dominant current of the market.

Trade very carefully, manage risk, focus on the probabilities and edges, and keep your motivation up.

If need be, stick only to the intraday markets where it's easier to manage risk and take opportunities and go home flat.