



Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min



I'll call today "Divergence Day," since the three best trades (educational examples and in real-time) were confirmed with divergences on the 5-min chart. Also, today showed again why it is important to watch the higher timeframes and develop strategies - "If/Then" statements - so you are prepared when price reacts to key levels that are known well in advance - such as the 1,121 in the S&P 500. That translated to \$112.00 in the SPY and 1,115 in the @ES. That is the critical level everyone in the trading world is watching, and so it would have granted a trade set-up on a break above that level but also one on a reversal down off that level. We'll discuss this concept in more detail in today's report.

1. MAJOR INFLECTION POINT, 1,121 IN SP500, NEGATIVE DIVERGENCE, 5-WAVE FRACTAL, DOJIS

This is the major line in the sand between the Bull and Bear Market. A break above 1,121 - the 50% Fibonacci Line of the "entire bear market" would be very difficult to argue a bearish case going forward, tipping the larger timeframe odds over to the buyers/bulls. As such, this level is going to reflect a deep battle in the supply/demand relationship... and offer intraday and swing traders opportunities as buyers and sellers of the higher timeframes battle at this level.

But first, the market opened with a 22 cent gap which was clearly within the odds of filling, but the second bar gave plenty of evidence that the market was in an upward surge (similar to that of yesterday) and the best strategy was probably to stand aside and see how the market reacted to higher levels. Aggressive traders could have capitalized by this sudden upward action by trading long - especially the morning pullback just shy of the 20 EMA - but if you were trading this in real time, you know just how volatile, choppy, and chaotic this period was. It might have even been safer for aggressive traders to sit sidelined in anticipation of how price was going to react to the key resistance level instead of trying buy into it or short against it prior to a possible breakout. That's why I don't label any 'ideal' trades in this zone.

Price peaked on the S&P 500 at 1,120, less than a point shy of the critical and important 1,121 price. Stop-losses of the short-sellers rest above that area and most likely so do "buy to go long" orders to play the breakout. It's likely that a 'powder keg' of orders rests just above that level so be prepared to trade long on any solid break of this level.

However, until price breaks out, let's still grasp the big picture structure. Price is at critical overhead resistance. We expect resistance to hold until proven otherwise.

Thus, by the nature of resistance on higher timeframes, 1,121 (and \$112.00 in the SPY) was reason to look for confluence to see if we had evidence/edge to put on a short-sale. We did.

Price began to form long upper shadows (five of them to be exact) and two shooting stars and a spinning top at the upper Bollinger - bearish. To add further edge/odds, price exhibited a negative momentum divergence on both the 5-min and 1-min charts - along with a slight TICK divergence. That was plenty of reason to get short on any break of candle lows, which could have triggered shortly after the two 'shooting star' candles at 10:15EST at the \$111.90 level, or once price broke the \$111.85 low of the final spinning top/doji at 10:30. Either way, price formed a strong selling bar, revealing the price rejection and frustration (stop-losses) of the buyers/bulls, and aggression of the short-sellers/bears who held resistance at this level.

Odds favored a move down to test the prior lows, giving you a trade set-up, and clear stop loss above the intraday spike highs at \$111.95. The conservative target was a retest of the 20 EMA at the \$111.65 level and aggressive target a retest of the 50 EMA at \$111.55. Both targets were hit.

Price came into the support of the 50 EMA at 11:00am, giving us a trade exit and potential set-up for aggressive trader to flip and trade long.

2. TEST OF 50 EMA, POSITIVE DIVERGENCE, HAMMERS, 50 AND 61.8% FIBONACCI RETRACEMENT, LOWER B. BAND

I've labeled this twice on the TradeStation Chart and Once on the StockCharts.com graph. That's not a mistake. In hindsight, things look great and I teach these concepts to you each night after going through the trading day and then looking back on what works well as teachable moments for you to understand these concepts, grow your knowledge/confidence, and trade these concepts/set-ups in real time the next time they form in the future.

So, I always try to make a distinction between the "Ideal" and the "Real."

Let's start with the Real.

Aggressive traders enter with less information as price comes into support - they do so thanks to the tighter stops and better fills they can get -and their ability to take risk which usually comes with experience.

Price formed a bullish engulfing bar at 11:10am on a bounce off the 50 EMA. Aggressive traders might have bought as price touched the 50 EMA at the \$111.50 level and put a stop just underneath it, or at least 10 cents (1 @ES point) away at the \$111.40 level.

Here's where reality sets in. This was an edge-based set-up with low risk and a decent probability of a bounce - price was also testing morning support from the open.

Suddenly - as if without warning - price fell one more time to the downside after mounting a rally and then formed a "Rinse and Wash" bar, or as many people call them "Finger" Bar (think vulgar) where those "market makers got me again." That extreme bar marked the low of the day, touching the lower Bollinger Band as price retraced strongly back above the 50 EMA.

Conservative traders who entered before this bar were likely stopped out, though aggressive traders - also entering before this bar - might have been ok (saved?) by a liberal/aggressive stop-loss strategy (as in, not placing stops a few pennies under an expected support zone. For reference, the 50 EMA was situated at the \$111.53 level and price spiked to \$111.43, marking the intraday low. Aggressive traders who put a stop under \$111.40 were ok, but anyone placing a more conservative/tight stop was taken out at the low of the day.

Let's now move to the ideal.

This is a "Finger Trade" and is a precursor many times to a price reversal. Finger Trades are also called "Rinse and Washes" (among other less pleasant names involving vulgarities) and - for those who can recognize them - offer great trading opportunities, particularly as traders who just got stopped out now see price rising and then rush - angrily - to 'chase' or get revenge with the market buy buying... causing price to rally higher.

A second opportunity to get long came as hammers formed at and above the 50 and 20 EMA at noon at the \$111.60 level, with a stop back under the 50 EMA (conservative) or - more appropriately - under the intraday spike low near \$111.40.

This time - unlike before the "Finger Bar," we had a positive momentum divergence as well as a test of the lower Bollinger Band. Conservative traders would have had that in their arsenal to trade (aka waiting to get long AFTER that developed) while aggressive traders would have entered long with the engulfing candle at the 50 EMA.

Price rallied steadily for the rest of the afternoon, challenging once again the overhead resistance level... and the TICK and Momentum Divergences gave us yet another short-sale opportunity.



3. NEGATIVE TICK/MOMENTUM DIVERGENCE, UPPER BOLLINGER, OVERHEAD RESISTANCE

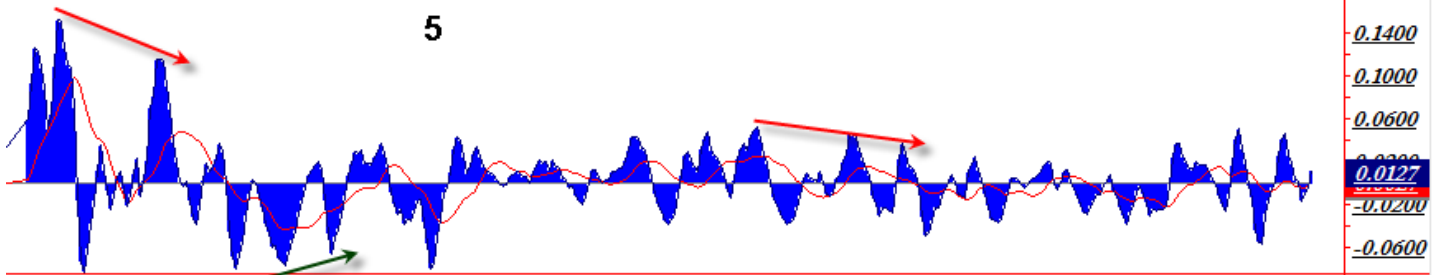
To shorten the commentary, notice the clear negative TICK and Momentum divergence going into the 2:00pm highs and the clear resistance boundary at \$111.87. Aggressive traders shorted near the high, while conservative traders waited for a break under the 20 EMA at the \$111.76 level. Price bounced slightly off the 50 EMA and then fell back again to test lower levels back down to \$111.60 where price formed a bullish engulfing (exit signal) and rose choppily into the close.



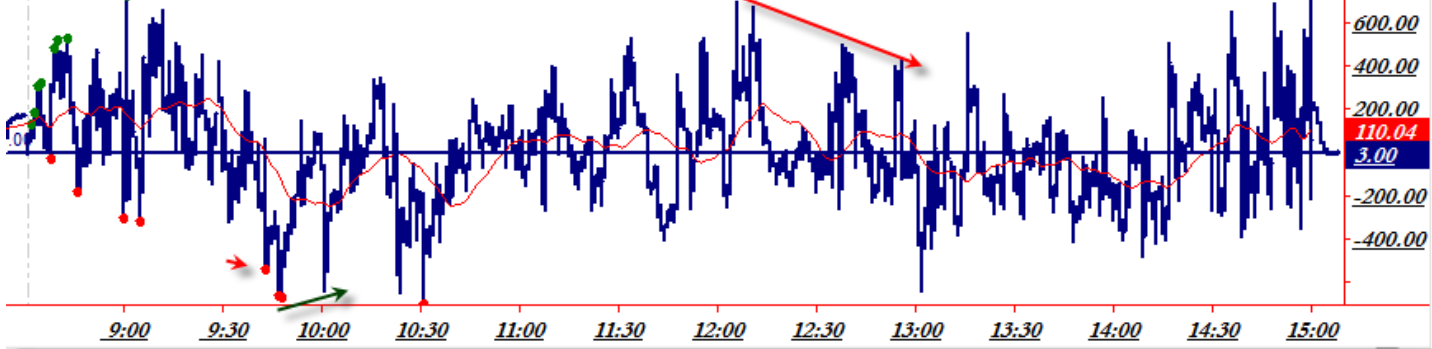
The @ESH10 contract appears to be forming a "Head and Shoulders" pattern when you include this morning's rally then decline which preceded the sharp rally (that was the morning gap in the SPY).

Notice how the 200 period SMA contained (supported) price on tests of this level - with the exception of the "Finger Trade!".

SPY - 1 min ARCX 12/22/09 L=111.75 0.42 0.38% O=111.57 Hi=111.97 Lo=111.43 C=111.73



STICK - 1 min NYSE 12/22/09 L=3.00 -170.00 -98.27% O=-4.00 Hi=748.00 Lo=-701.00 C=3.00



The morning decline showed a clear and fractal 5-wave Elliott Move into the lows at \$111.43.

Also, a trendline break (not shown) at 13:00 (1:00CST) could have triggered entry short for you using the 1-min chart as a trading entry tool based off observing the negative TICK and Momentum divergences either here on the 1-min frame or the 5-min chart.



There is a subtle shift that I want to call your attention to on both the 30min and 60 min charts. First, divergences are working well in calling turning points in the market and setting up targets (the opposite trendline) - this is better seen on the 60min frame.

Second, there is a potential 5-wave fractal complete with negative volume and momentum divergence setting in as price tested overhead resistance at \$112.00. That's a bearish non-confirmation.

Third, the possibility exists that we are shifting to a rising trendline boundary (see 60min chart) instead of the flat lines that were well-established at \$111.25 and \$118.50 (after Friday's dividend, the prices were adjusted).

Fourth, we will expect to trade long (buy) on any upside break above \$112.00 to play the "Popped Stops" of the short-sellers forced to cover at the highs. You can profit from this as an intraday trader who understands this principle.



The 60min chart shows the divergences, range (support at the \$108.50 level) and the 'new' upward sloping trendlines I've drawn.

We're still seeing a negative volume and momentum divergence, so that argues that the next likely move is back down to test \$109.50 at a minimum and \$108.50 (prior support) at a maximum.

But again, our goal as traders is NOT to predict the future, but to make money. Trade Long aggressively on any break above \$112.00 - particularly as the Christmas Holiday week has a bullish bias and lower volume. Otherwise, watch for intraday signs of weakness and began to trade short accordingly.



We're still - technically - within the trading range between 1,085 at the bottom and 1,120 (or 1,121 - the 50% Bear Market Fibonacci retracement). With price and momentum compressed as much as it is - look to trade long any breakout. Markets can move quickly on low volume, and that's exactly what low volume holiday weeks can give - volatility.

Be prepared for either possibility - a swift, sudden breakout to trade intraday long or a gentle rollover down and be prepared to trade short. Either way, everyone sees the same boundaries and I'm reminded by the phrase "Dog-pile In and Dog-pile out" meaning that when the market breaks, everyone will jump on board either way - the trading range is evidence that neither bulls nor bears are willing to get overcommitted here and are all playing the waiting game.

Follow and trade closely here.