



Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min



Today serves as a powerful reminder of at least two critical concepts:

1. Market Internals often tell the truth well in advance of price (Internals Forecast Price Swings)
2. Large Range Expansion Moves emerge from 'dead' periods, often when no one is watching

We'll discuss these two points in the report.

Today - in my opinion - did not offer many good (ideal) trading opportunities at all. The lessons from today come from the broader concepts and not necessarily the trades themselves.

1. GAP FADE

As has been the case for more than a week, the first trade we usually take is a gap fade, provided the gap is generally less than 50 cents in the SPY (5 @ES points). Today's gap was roughly 20 cents - not much of a gap - but odds were strong for a gap fill. Thus, that was the first trade of the day and it happened suddenly with little time to act if you give gap fades at least 5 to 10 minutes to shake out.

Price came back into support on the 20 EMA and formed a long-legged hammer/dragonfly doji... but price did not take out the high of that candle and so a long entry was not triggered. The next bar was a powerful sell bar that cracked under the 50 EMA - again, no trade yet.

The next 'ideal' set-up came from trying to buy long the 5-wave fractal move (see 5-min chart) that ended at the \$112.20 level - the lower Bollinger Band. A spinning top candle formed, triggering an entry for aggressive traders.

2. 5-WAVE FRACTAL, SPINNING TOP, LOWER BOLLINGER, (slight) TICK DIVERGENCE

This trade was to play off potential support from the lower Bollinger as a candle reversal signal formed and then price took out the high of the spinning top at 10:45 EST. A very slight positive TICK divergence also accompanied this new intraday swing low. This was a 'reversal' trade to play for a minimum scalp back to test the underside of the 20 and 50 EMA crossing over (cradle) at the \$112.45 level... though price formed a doji just shy of this level and began to fall quickly to form a new low on the session.

I suspect most of us who took this trade exited with a scratch or small loss - not all trades work out perfectly, but the goal is to keep losses averaging smaller than winners, and to take positions with greater than a 50% chance (random) of producing a winning trade. This set-up had those factors, and a small loss was taken.

Price then formed a lengthy sideways contraction/rectangle pattern, where multiple reversal candles formed at the upper and lower Bollinger Bands (and trendlines) between \$112.34 and \$112.17. I'm not labeling these specifically as "idealized trades" because the target was too small and it can be very frustrating to trade inside of a price consolidation.

The best thing to do is to avoid trading (unless you can't resist) inside a known and obvious consolidation pattern, but wait for a confirmed break of the trendlines (to the upside or downside) and then take a position there to play for a range expansion move.

Remember, price alternates between states of range contraction and range expansion. If we are seeing a clear range contraction mode, then odds favor the structure forming a range expansion move for the next play (swing). Be prepared to trade that - in essence, you're setting up your expectation in advance and when price triggers an entry, you enter to

put on a trade. The target would be (theoretically) unlimited (countervailing signal) and the stop would be on the other side of the rectangle. This triggered at 3:35/3:40 EST (that's right - with 20 minutes remaining to trade in 2009).

3. BOLLINGER BAND SQUEEZE, RECTANGLE BREAK, RANGE EXPANSION PLAY

Again, we want to put on a position when the range - clearly established - is broken to play for a range expansion move in either direction. We need to be neutral so we are not caught the wrong way if we try to position ourselves within the rectangle. Stop-losses are what help give range expansion plays the 'power' needed - don't be one of the people throwing a market order in panic stopping out - be one of the ones trading IN the direction of a breakout and profiting from those who are stopping out.

There were two clues which could have prepared you to expect the magnitude of the range expansion.

First, I've been showing you (loudly calling your attention to) the severe and obvious deterioration in Market Internals, including Breadth, TICK, and Volume Differential. Market Internals LEAD price action more times than not (though - of course - no indicator registers 100% accurate signals). When we see such a lengthy divergence in volume and market internals as price continues to rise, it is a signal that price is very likely to reverse... and sometimes it can reverse hard. This is what happened today.

Second, I mentioned in Wednesday and Thursday's report to short any move under \$112.00. That's because key support from important EMAs rested at \$112.25 and \$112.00 (see prior reports on the 60 and 30 min frame). It is important to watch higher timeframes because larger traders use them to place stops and targets. Remember the market is fractal, and different traders and funds react to different timeframes. Meaning, when key levels on the 30 or 60 minute chart are broken, buyers will have stop-losses placed there and then short sellers may enter short on the break of a support zone. You don't need to watch these higher frames all day long, but at least know where the key levels are and maybe write down those levels and be prepared to act if price touches or breaks a key level intraday. That's why I show you higher timeframe charts.

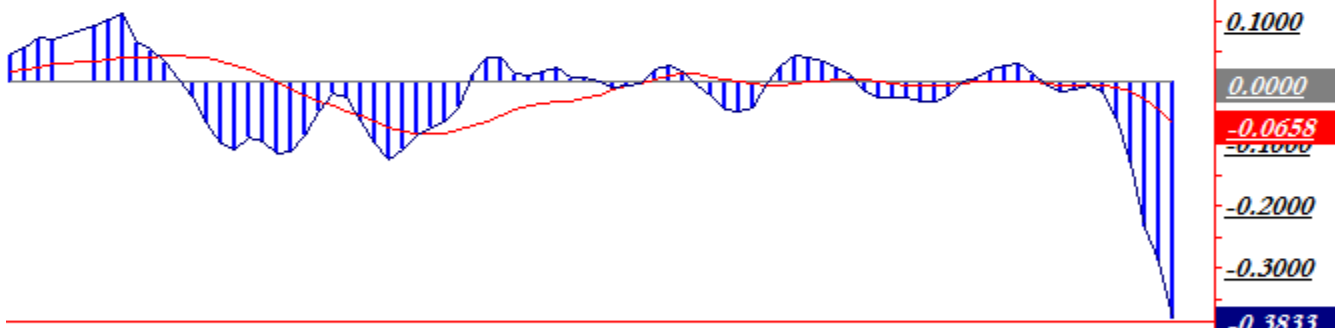
The price decline accelerated violently when \$112.00 was broken to the downside.

The only way to take advantage was to piece together your game plan in advance and be prepared to act. Try to prepare one or two scenarios in advance and act accordingly (that's the power of "IF/THEN" statements).

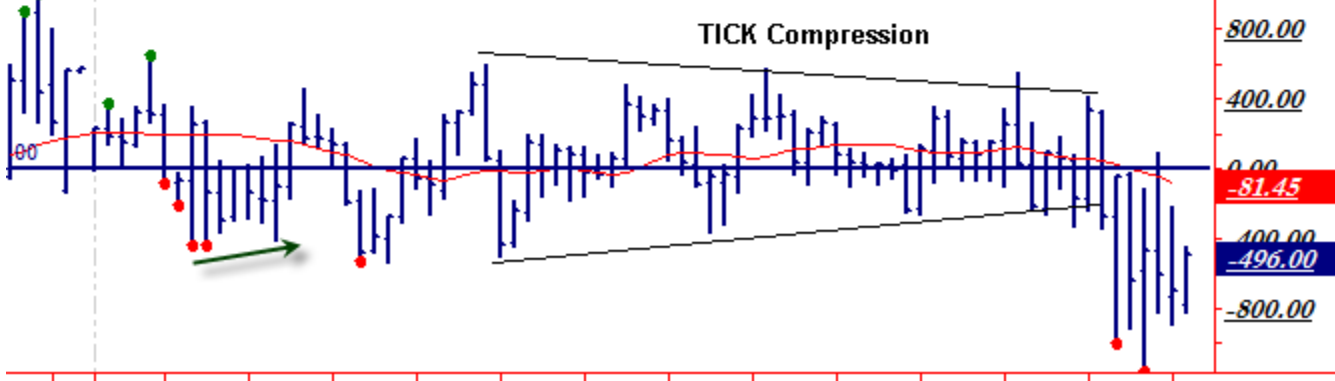
Otherwise, you were caught off-guard and most likely said "I can't get short now - price has fallen too much."

Remember, it's fine to miss a trade if you were not prepared, and best not to chase, but if today didn't go as planned, don't beat yourself up - step back and learn the valuable lessons from today's action.

SPY - 5 min - ARCX 12/31/09 L=111.56 -0.96 -0.85% O=112.77 Hi=112.80 Lo=111.39 C=111.54



STICK - 5 min NYSE 12/31/09 L=-494.00 -1067.00 -186.21% O=6.00 Hi=649.00 Lo=-1157.00 C=-494.00



12/31 9:30 10:00 10:30 11:00 11:30 12:00 12:30 13:00 13:30 14:00 14:30 15:00



The @ESH10 chart shows a clean "Measured Move" structure that dominated the day. Price fell over 14 futures points from peak to bottom today - a testament to the power of Market Internals (flashing a sell signal since Wednesday).



Once again, we see the \$VOLD (Volume flowing into advancers minus volume flowing into decliners) leading price action by making new intraday lows as shown with red dots when price was NOT making new intraday lows. As seen on the higher timeframe charts, \$VOLD has been a great leading indicator and non-confirmation of recent price highs, forecasting the end-of-day sell-off.

Otherwise, the simple play was to 'get short' on a break beneath the clear lower trendline of the price pattern rectangle.



This is the same chart I've been showing since Wednesday which loudly proclaimed "all is not well with the market."

A lengthy negative divergence in Breadth, TICK, and especially \$VOLD preceded the rounded reversal structure we're seeing and today's sell-off into the close. I mentioned the big funds would do anything they could to keep the market up until the close of 2009. They did that until the last 20 minutes of 2009.



With a three-day holiday ahead of us, the market is subject to any positive or negative news, so take these levels and biases with that fact in mind.

There appears to be a possible support zone at \$111.20, so watch price action here and remain short if this area is broken.

The Negative Momentum and Volume Divergence forecast a deeper than normal pullback, possibly as low as the \$109.50 area, but let's take this day by day and reassess as the New Year begins (Monday's trading).



We're seeing a potential Fibonacci support confluence at \$110.70 from two levels of Fibonacci Grids. This area also intersects with the rising 200 SMA, so watch this closely as potential support.

Otherwise, continue with a downward bias going forward and especially if price breaks under \$110.70.



I mentioned a likely target on the downside was the rising 20 EMA at 1,112 and we almost hit that officially with today's low of 1,114.

The doji candles at the upper Bollinger Bands "worked" for a trade set-up, though the majority of this move down came suddenly at the end of the day. With 2009 at an official close, the 'powers that be' held the market up as long as they could until the final few minutes. It will be interesting to see if sellers can push prices lower just on a counter-swing down as 2010 begins.

It's also very likely that a large group of funds or traders did not want to wait until Monday to sell - they wanted officially to lock-in their gains for 2009 and put the profits "on the books."

Have a safe and Happy New Year! Cheers to a Great 2010!