Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min

Today saw a stable and predictable (easy trading) environment which gave way to a sudden reversal towards the end of the day which turned into a massive short-squeeze (rallying $2.50 or 25 @ES points in the afternoon session). Let's take a look at today's opportunities, learn lessons from them, and then take a look at the current higher timeframe structures and prices to watch.

1. PULLBACK BUY, RETRACEMENT TO 50 EMA, UPPER SHADOW

Due to the power of the downtrend (lower price lows and highs combined with a negative orientation to the 20 and 50 EMAs), odds still favored a continuation of the down move, meaning the best (easiest) trades would come in the direction of the trend (down) and executed at the EMA levels.

The morning spiked into the 20 EMA with a long upper shadow doji, which certainly was a trade set-up, but it occurred so quickly that most people likely missed it and there was little to learn from it, other than it was a sudden pullback into resistance after a mixed Jobs Report (the unemployment rate declined unexpectedly, though job losses increased by 20,000 and prior months numbers were revised higher (losses) than expected). That yielded a choppy move without a clear direction (asking "What would traders focus on?"). As such, that's why it was probably better to pass on the first opening move and short the next rally into resistance.

This occurred at 9:45am CST as price formed a spike high into the 50 EMA at $106.70 and then formed a doji candle and broke under the 20 EMA. Aggressive traders would have shorted as close to the 50 EMA as possible while conservative traders would have waited for price to confirm its odds favoring a down move once the 20 EMA was broken at $106.40. In either case, the target was a move back to test the morning lows of $105.60 - which is a full dollar target (underscoring the volatility which is returning to the market).

Price formed a mini bear flag as price traveled back to the target (see 1-min) which provided either a late entry or spot to get short again at the break of the trendline. Price formed two lower shadow candles, including a bullish engulfing hammer, at the $105.60 level (target) - prior support and lower Bollinger Band. This was your trade exit.

An aggressive trader could have bought long on the break above the hammer/engulfing candle at the $105.80 level to play for the upper 20 EMA on a scalping basis, but the maximum this trade would have yielded was 20 to 30 cents in a counter-trend move. As such, it was preferable to wait for price to retrace to the EMA and put on a short trade to see if resistance would hold.

2. BEAR FLAG, PULLBACK INTO 20 EMA, DOJI CANDLE

This was a make-or-break trade, as the prior test of the low failed to produce a new momentum or TICK low, which hinted that we could be about to break through the 20 EMA to form a trend reversal, so perhaps a conservative "wait until the trendline (1-min) is broken to enter" bias would be preferred.

As such, price formed a doji at the $106.00 confluence resistance level (Round number and 20 EMA) which triggered an entry as soon as price broke the low of the doji at $108.85. The minimum (conservative) target was a retest of the support line at the $105.60 area, though an aggressive trader might have held on for a larger target. Depending on how you played this move - and your aggression level - will determine the official "amount possible" today. In the chart below, I assumed that we held through the support break instead of exiting at the $105.60 level. If you exited - which was very reasonable here - then the amount possible would be $1.60 instead of $2.20. Remember to take your own trading personality and style into account when calculating your efficiency analysis when comparing your entries and exits to the commentaries I provide in the reports.

In the event that you took a profit target exit at the $105.60 area, it was certainly advisable to re-short if need be when the support level broke with a strong candle just before 12:30.

The exit was as price either bounced off the lower Bollinger with a long lower shadow or - preferably - with the bullish engulfing candle. This was not a long (buy) trade except for the most aggressive traders among you, who would try to trade the retracement back to the 20 EMA after a new TICK and momentum low, which forecasts a lower low yet to come.

3. BEAR FLAG, IMPULSE SELL, DOJI, 20 EMA, TREND DAY TRADE

This trade should be used as a reference of why:

1. Trading is an exercise in probabilities, never certainties
2. Why you should honor your stop-losses when price has broken into your stop-loss zone
3. Anything can happen at any time (Mark Douglas)

After the new price, momentum, and TICK low, odds strongly favored lower prices yet to come after a retracement - preferably to the 20 EMA for a clean entry.

Price formed an almost perfect bear flag 45 degree rally into the 20 EMA, formed a perfect long-lower shadow doji (dragonfly doji) and then broke the low of the doji with a strong candle. Aggressive traders would have entered as price tested the 20 EMA at the $105.20 level, while conservative traders would have entered on a break of the doji low and under $105.00 (potential support). Unfortunately, both conservative and aggressive traders were stopped out, as there was no way to avoid this trade due to the high odds of getting a successful retest of the $104.60 lows.

In this case, news events which triggered a short-squeeze rally destroyed the 'positive expectancy' of this trade, resulting in a frustrating loss by anyone's standards. The initial stop would be placed conservatively above $105.30 while aggressive traders - which I would advise being when the confluences line up nicely - would have placed it at the $105.40 level. Look closely at the 1-min chart to see the Wyckoff Sign of Strength that formed as this trade was stopped out. Under no circumstances should you have held short - fighting the tape - as price broke above the "Line in the Sand" of the 50 EMA at $105.60. In fact, the Wyckoff Sign of Strength (which preceded the large rally/squeeze) combined with a breaking of the Line in the Sand set up the next trade for aggressive traders.

4. POPPED STOPS, WYCKOFF SIGN OF STRENGTH

Use this as a reference of what often happens when a powerful trade set-up - that most traders across the spectrum are trading or watching - fails. Namely, you get a popped stops rally or a short-squeeze (or a long-liquidation if it goes against the buyers).

This creates opportunities for advanced, aggressive, or experienced traders who have been through many failed trades that are "supposed" to work. Instead of getting frustrated, the understand the trading is a numbers game of probabilities, and when something that has high odds of producing a winning trade fails, then those caught on the wrong side of the market will stop-out at different levels (as they continuously raise their stop, trying to prevent a loss). The panic of a failed trade can create the "Popped Stops" rallies that provide sudden and instant profits for those savvy enough to recognize and trade them. Popped Stops plays worked very well for me in the latter parts of 2009 as the market continued to flash sell signals and negative divergences that were routinely eliminated with bullish surges similar to this one.

Entry was as price took out the 50 EMA on strong momentum and volume. Take a look at the zoomed-in chart to see how a New TICK High, Volume Surge, and subsequently the Wyckoff Sign of Strength triggered a few minutes prior to the flood of buy orders that triggered the short-squeeze and popped stops play. Once price broke the 1,048 level (@ES futures), then you should have taken your stop. Otherwise, you would have got caught in the bullish surge that occurred.

The goal of the popped stops trade is to hold on as long as possible, or until a compelling sell-signal occurs, which happened at the $106.50 level at 2:15. Price still carried higher, as forecast by the new price, momentum, and TICK high (strategy is to buy the first pullback), but a clean pullback never came (except on the 1-min chart).

Take some time to learn the lessons of today, particularly with regards to strong moves (popped stops) occurring directly after a high-probability set-up fails.

SPY - 5 min ARCX 02/05/10 L=106.45 0.01 0.01% O=106.56 Hi=106.88 Lo=104.58 C=106.57
1
2
3
4
Wyckoff
$TICK - 5 min NYSE 02/05/10 L=487.00 1462.00 -149.95% O=-6.00 Hi=1267.00 Lo=-1430.00 C=487.00

Today's "efficiency" chart shows the 4 trades and the potential profit using a moderate aggression level.

Newer traders should seek to achieve 50% of the total, while more experienced traders should seek a level closer to 75%. Adjust the entries and exits to your style of trading on these set-ups (early entry for aggressive traders; later entries for conservative traders).

A quick "zoomed in" view of how the Wyckoff Sign of Strength (new TICK high) and volume surge at 2:00pm CST occurred five minutes prior to the massive surge.

This triggered your exits on your short trade and then - for those who are aggressive - a 'flip and buy' as soon as price momentum began to pick up in 'popped stops' fashion.

SPY - 1 min ARCX 02/05/10 L=106.48 0.04 0.04% O=106.56 Hi=106.88 Lo=104.58 C=106.66
1
2
3
4
5
Popped Stops
Wyckoff Sign of Strength
$TICK - 1 min NYSE 02/05/10 L=487.00 1462.00 -149.95% O=-6.00 Hi=1267.00 Lo=-1430.00 C=487.00
106.75
106.50
106.00
105.50
105.00
0.4000
0.1533
0.0293
-0.2000
1,000.00
487.00
302.64
0.00
-500.00
-1,000.00
2/5
9:00
9:30
10:00
10:30
11:00
11:30
12:00
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15:00

This is one of my fun "Elliott Wave" charts - feel free to skip if you don't do Elliott Wave work.

The main idea - and really the only use I have of Elliott intraday - is the 3rd of 3rd wave, or the sudden impulse that occurs which represents the "heart" of a move. You can often find these situations with a sharp rise in the 3/10 Oscillator.

It hints that higher prices are yet to come, particularly after a 4th wave pullback to play for the 5th wave.

Watch for divergences on the 5th wave to short or exit with a profit as well.

Price rallied into the 38.2% Fibonacci Level as seen above at the $106.87 level. Watch this price going forward into Monday's session. There was a positive momentum divergence that formed at the lows of today ($104.50) interestingly enough (again, notice the divergence on the 5th wave and the momentum low at the heart of the 3rd wave as labeled above).

Volume surged bullishly into the close, suggesting the market can easily rally beyond the $107.00 level into the $107.50 level. Should the market rally beyond $108.00... it would suggest that we could be looking at a move that is no longer an upside correction. Thus, $108.00 is key in the next few days.

The larger 38.2% retracement rests at $108.61, making $108.50 again important to distinguish between a counter-trend retracement to the upside (favored) or a more impulsive move.

Again, $107.00 is important resistance to watch short-term. I would expect a move back to the $108.00 level as being very reasonable to expect going forward.

I mentioned in last night's report that the 1,040 level was the most logical and expected target... and price came just a few points shy of that today, bouncing solidly off the 38.2% Fibonacci retracement at 1,044.

A powerful hammer candle has formed at this level, so again, it is quite reasonable to expect and even trade a bounce higher off this level short term and monitor the overhead resistance levels - especially 1,100 - to see if this might be something more than a standard 'retracement' rally.

Compounding the support level as expected, the 50 week EMA rests at 1,042 - two points under where price found support today.

It's amazing when the market follows a script as it seems to be doing now - falling as expected to test these lower support levels, and now it would appear we are in a 'bounce mode' off support for the time being.

Have a great weekend!