Daily "Idealized Trades" Report

SPY (SPY 500 ETF) 5-min

If yesterday was a stable, predictable trading session, today was a chaotic, disorganized, volatile session marked by overreactions to news events - particularly in regard to the "We are going to save Greece... no, actually, that report was false" stories and rumors.

The main lesson we can learn from today is that there are forces beyond the technicals (charts) that drive price, which reminds us that - while chart patterns and structure may be easily read, the actual movement - or the actual trades/price action - is determined by probability and never certainty. By that, I mean that there is always a surprise news event or large fund buy/sell program that can destroy the most perfect chart set-up.

Today's report should help clarify that point that experienced traders know, but new traders struggle with: "Trading is a game of probabilities, never certainties, and long-term success comes from recognizing opportunities, acting on them, but then stopping out when a trade fails and maximizing return on trades that succeed as expected, all within risk-controlled parameters."

On a membership announcement, be sure to check out the new "Research" section of the Premium Site:

http://premium.afraidtotrade.com/research

where you can find the newly published "2009 Gap-Fade Research" article and future research posts I will publish.

1. PULLBACK, DOJI, IMPLUSE BUY (AFTER GAP)

If you had the chance to read the newly published research report (or at least referenced the probability grid), then you would know that an opening SPY gap of $1.25 is "off the chart" in terms of probability. I did not test for values that high and stopped the testing at $1.00 with the following result:

In 2009, there were 43 of 247 days (17%) that registered a gap of at least $1.00 in the SPY, and of these gaps, only **34% of them filled**. Thus you should NOT have faded today's gap according to the probabilities - and in fact, the gap did not fill as expected.

The first trade, thus, was to buy the initial retracement if possible to play for a retest of the high, or a momentum move higher in a potential Trend Day fashion (bias).

I say that also because the large opening gap came as a 'shock to the system' (again, unexpected news based) because the overwhelming odds suggested a continuation of the sell swing that began mid-day Monday. When that expectation/bias was thwarted, the 'counter' expectation is to have a move higher as swing traders' stops are taken out (short-covering), which can benefit nimble intraday traders.

It's good to have a bias for what the market 'should' do at the open, so that you can trade it confidently if the market follows your bias/script, but just stand aside if not.

As such, a pullback occurred, ending just under the 'round number' $107.00 level with a doji closing just under $107.00 (slightly above the 20 EMA). The trigger was a break above the high of the doji at $107.01 with a minimum target a retest of the prior opening high of $107.35 or slightly beyond. Price did rally up in simple formation to test the high, formed a hanging man candle at $107.40 (with upper shadow -signaling an exit) but there was not enough evidence to get short unless you are a very aggressive trader.

With price in rally mode, the downward bias broken, and a new TICK + Price high forming, the next trade (in anticipation) came from waiting to buy the pullback into support (lower EMAs) should it occur, and particularly if a candle reversal formation occurred. It did... but unfortunately the trade failed.

2. RALLY PULLBACK, 20/50 EMA, DOJI & HAMMER CANDLE

We usually want to buy pullbacks to EMA (or Fibonacci) support in a rising trend, particularly when new momentum and TICK highs form (discount the momentum oscillator after a large gap). This could easily have been a Trend Day, so we can't see the chart ahead of us, and that was the safest assumption to make.

For aggressive traders, you would have entered at the pullback to the 50 EMA at $106.80 as the two lower shadows formed (allowing for a tighter stop) while conservative traders would want to see price above these candles and above the $107.00 'round number' level. The trigger came at 10:00am as price cleared both these hurdles... triggering a long trade at the absolute high of the swing and then falling down immediately to stop us out, depending on whether we used a conservative (tight) or aggressive (loose) stop-loss strategy. Either way, the stop should not have been much lower than $106.80 (the 50 EMA and a prior support level from yesterday's swing high into the close).

This is a lesson that "you can't win them all!" and that trading success comes from earning more money on winning trades than on those that stop you out.

3. DOJI BUY (5-MIN) EMA BREAK (1-MIN), POSITIVE DIVERGENCE, 5-WAVE FRACTAL, DOUBLE BOTTOM, BOLLINGER

Trade #3 was in the aggressive domain, given that price then broke the upward bias that was expected, complicating the structure. The sell-off took a 5-wave fractal formation into a double-bottom with a positive 3/10 Oscillator Divergence (though it made a new TICK low) as seen on the 1-min chart. Then price broke above the 20 and 50 EMAs on the 1-min chart - the 1-min chart is used best for execution tactics, while the 5-min is used best for structure.

On the 5-min chart, a long-legged doji formed at 10:25 after two prior candles formed lower shadows. We would want to be long above the doji if so inclined, given the divergences on the 1-min chart. The doji high was $106.60, triggering a conservative entry there. An aggressive trader could have tried to pick up the trade long at the lower Bollinger and 'double bottom' price pattern at the $106.30 level.

A conservative target - reasonable - would be the 20 or 50 EMA at $106.80, but given the power of the up-bar that literally sliced through these averages (and power bar that sliced the 20 and 50 EMAs on the 1-min chart... meaning if you weren't long at the lows, it was difficult psychologically to get long into such a power bar), we could have expected the maximum target to be the retest of a prior high at $107.40. Obviously, price overshot this zone, into the fourth trade, which also was a very aggressive set-up. It was best to exit trade #3 as the bearish engulfing(ish) candle formed at the upper Bollinger at 11:00am. Remember, a trade exit with profit does NOT necessarily mean flip and go short. It just means odds have decreased to expect further upside potential. We'd need other information to clue us in that odds favored an actual move down (as opposed to a sideways move or a continued rally on very low probability).

4. FIVE-WAVE FRACTAL INTO MULTI-NEGATIVE SWING DIVERGENCE (1-MIN), 3/10 DIVERGENCE (5-MIN), BOLLINGER

This a relatively simple trade to short at the overextension from the 20 and 50 EMA, given the 5-wave structure on the 1-min chart and the lengthy negative momentum divergences (though the TICK did make a new high - TICK was particularly ineffective today).

We also pulled into the overhead resistance of $108.00 (an upside target I mentioned in Friday, Feb 5th's report, though I suspected Monday's action might invalidate that) as two long upper shadow candles formed at the upper Bollinger Band.

That's what I mean by "you need more to get you to flip and reverse a trade" - look at all the evidence we have now that we did not have at trade #3's exit at the $107.60 level).

The stop was above $108.00 naturally, and initial target was a retracement back to the 20 or 50 EMA at $107.45 or $107.20 respectively.

This is an example where the news "worked" in favor of the technical structure. I got word from a colleague that the positive report that Greece would (likely) be bailed out was just a rumor and the news rescinded the initial bullish news, resulting in the sudden plunge.

We all have a tendency to fear 'headline risk,' but remember that sometimes it can be beneficial - given that the pullback (although certainly not forecast in magnitude) was at least anticipated in structure due to the resistance, overextended rally, five-wave fractal and negative divergences.

I'm doubtful most of us held to the 50 EMA (most likely, we had profit targets/market orders resting at the $107.40 level which were hit too quickly to move) so I'm counting the exit at the 20 EMA to be reasonable unless luck played a role for you in this trade.

5. DEAD CAT BOUNCE, BEAR FLAG, TWO UPPER SHADOWS

After such a massive momentum move, we would want to short the immediate pullback into resistance. In this case, we had that occur in a bear-flag style rally to the $107.80 level (the 61.8% Fibonacci Retracement of the $108.15 high to the spike low of $107.10 was $107.75 - one penny away from the high of the retracement). This could have called for an aggressive entry near $107.70, or a conservative entry with a break under the two shooting star/doji candles at $107.50.

If you did the standard Bear Flag (Fibonacci Extension/Projection) target, then you arrived at a target of $106.72 for a 100% projection (expected target) or $107.12 for the 61.8% "truncated flag" projection. As you can easily see, we did not near the 100% target but did touch the $107.12 level at 2:00... but it's unlikely you held that long too due to the choppiness of the action that developed. Price did not rally above the flag stop-loss at $107.80, so it's likely if you took this trade, you exited in the profit zone, but much less than expected.

Due to the choppy conditions, and - in my opinion - chaotic structure of the day, there were no other 'ideal' opportunities other perhaps than to short-sell the pullback to the $107.70 level with a doji at the upper Bollinger Band.


SPY - 5 min ARCX 02/09/10 L=107.16 1.27 1.20% O=107.13 Hi=108.15 Lo=106.27 C=107.16
1
2
3
4
5
108.00
107.80
107.67
107.60
107.40
107.24
107.10
107.00
106.80
106.60
106.40
106.20
106.00
0.60
0.40
0.20
0.00
-0.22
$TICK - 5 min NYSE 02/09/10 L=290.00 697.00 -171.25% O=13.00 Hi=1389.00 Lo=-861.00 C=290.00
1,200.00
800.00
400.00
290.00
55.14
-400.00
-800.00
13:30
14:00
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2/9
9:00
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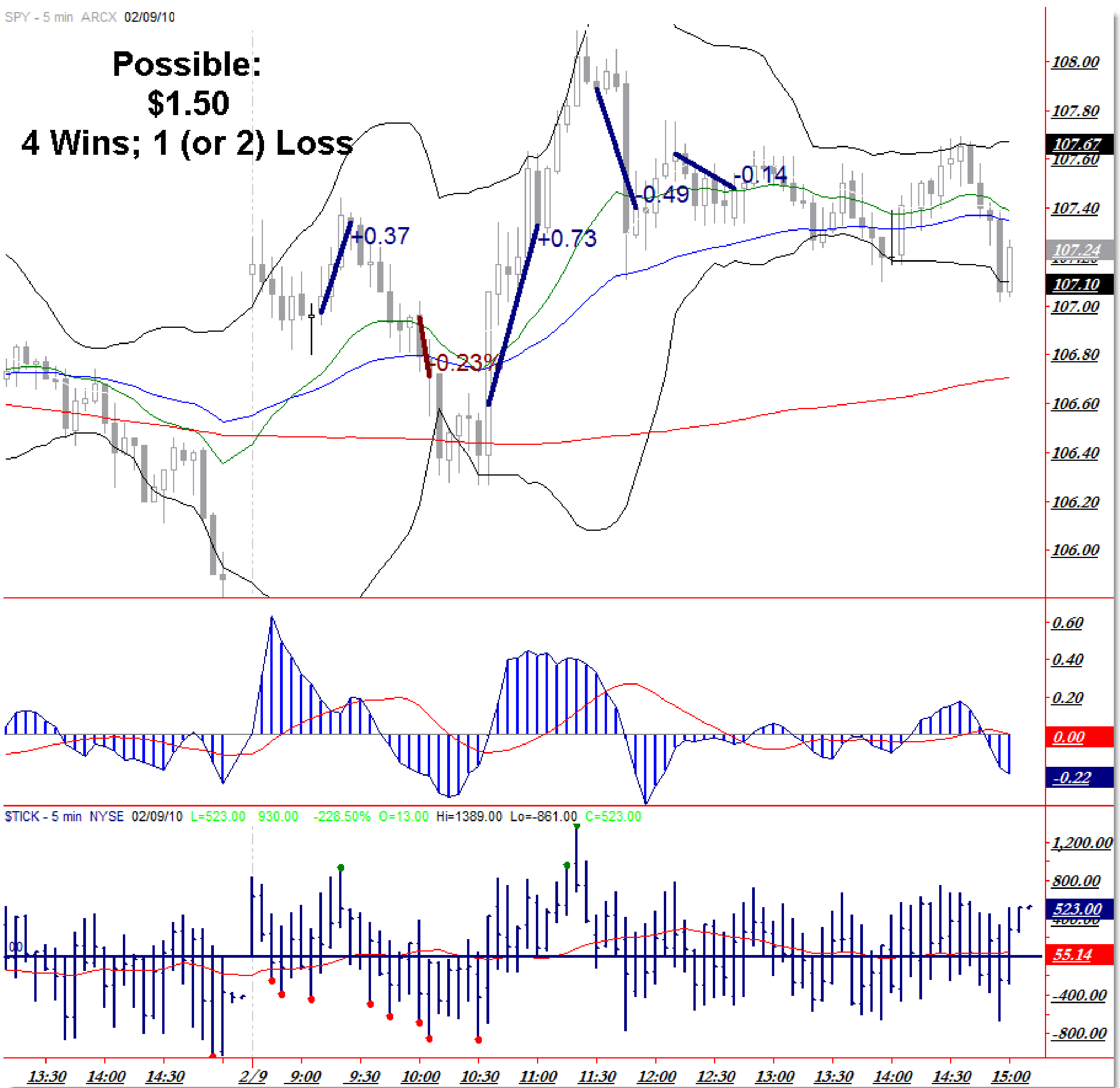
15:00

Example of the 61.8% retracement at 12:15 CST (I called the "Bear Flag" or "Dead Cat Bounce").

Also, a price projection example of the bear flag (that failed to get the full target, but hit the prior price low which happened to be the 61.8% projection of the flag).

This is done with your Fibonacci Retracement and then Projection Tool.



Trade #2 and Trade #5 were failures.

I try for a moderate aggression level when determining potential profit, which means NOT entering/exiting at the highs or lows.

These charts are for you to do your "Efficiency Analysis," or to compare your trade entries and exits with the ideal trades to see what percentage 'efficiency' you achieved. Adjust as needed, depending on whether you are aggressive (entering AT support/resistance) or conservative (entering ONLY after a candle has formed/price broken trendline/candle).

New traders should strive for at least 50%.

Notice the two key simple trendline breaks that triggered trade entries at 10:45 and 11:45am.

Notice also the powerful (solid) impulse was most likely some sort of third wave, forecasting higher prices yet to come.

They came... only with a 5-wave structure (5th wave extended) into a distinct three-push or multi-swing negative oscillator divergence that was confirmed with a break of the trendline at the $108.00 level (short).

The 30min chart shows an "abc" correction (resembling a bear flag) into the 61.8% Fibonacci retracement level at $108.23 (just above today's intraday high).

We're also seeing a negative 3/10 Divergence into this resistance zone, which is a bearish non-confirmation.

See the other charts, but watch $108.50 for overhead resistance and $107.00 for support, and be prepared to trade any breakout move intraday beyond these levels.

Structure and bias remain negative (bearish bias) while we're under the $108.00 level, placing this move as another "corrective" rally just like that of early February (instead of impulsive). Thus, we would expect $108.50 to hold as resistance on any move higher to that level, stopping out swing traders and potentially creating a momentum burst to the upside as those stops are taken out.

Otherwise, we see the $107.00 level as support, so any move under that would break the 38.2% Fibonacci line at $106.75 and lower trendline at the $107.00 level.

Using an Elliott Wave perspective, it's possible to see a final 'fractal fifth' wave move up into the confluence resistance area at the $108.20 level (1,080) to complete the "ABC" three-wave correction, so watch for that possibility.

Otherwise, any move under $107.00 (1,070) would break Fibonacci, trendline, and EMA support and would be expected to accelerate the move to the downside.

From this perspective, the move "looks like" a bear flag into resistance. A move over $108.50 would disconfirm this view and place the expectation to play "Popped Stops" above.

The daily chart shows us overhead EMA resistance at the 1,090/1,100 level, so expect that to be extreme resistance should price move into that level. Otherwise, the expectation remains for lower prices to test the 1,030 level until proven otherwise (by a move above 1,090).

It's possible the long lower shadow is a classic hammer 'buy signal,' but we would need to be back above 1,080 to confirm that. Otherwise, it just appears we're in a counter-swing retracement up as seen on lower timeframes into EMA and Fibonacci resistance.