done only in the direction of the trend. When the ADX is declining, the trades can be in either direction. Be patient and don’t anticipate the divergences.

Here are the specific rules:

1. Use a 30-minute bar chart on the S&P with a six-period RSI based on closes.

2. Look for divergence patterns in which the first RSI spike has penetrated the 80 or 20 levels on your screen. The second RSI spike doesn’t need to reach these levels. Buy or sell immediately after the divergence is confirmed by a 30-minute close in the direction of the signal.

3. Use an entry stop of 100 S&P points or two ticks above or below a recent high or low, whichever is closer.

4. Exit at the stop or at the close of the day.

5. Don’t enter any new trades in the last 45 minutes of the market. (See Exhibit 10.)

In markets other than the S&P, this day-trading method could be modified by changing the 30-minute bars to a shorter time period. If that were done, the 80/20 levels of the RSI might have to be adjusted to a higher or lower level.

It is worth noting that, in periods when the market is less volatile, 70/30 works better than 80/20, because the RSI doesn’t get as overbought or oversold. However, one of the important virtues of this system is that it takes a fairly volatile market to make the RSI reach the 80/20 level, and trades don’t get signaled unless there is enough volatility to make trading worthwhile. Don’t be tempted to defeat that valuable feature of the system by adjusting the levels downward beyond 70/30 just to get more frequent trades.
Dec S&P 30-Minutes

Bearish Divergences

Bullish Divergence

6-Bar RSI

Bearish Divergences

Bullish Divergence

Daily S&P

18-Day DMI

ADX Falling

ADX Rising
The following is a system for day trading the NYSE Composite Index (commonly referred to by traders as the "Knife," because it trades on the New York Futures Exchange). It is brought to us by our old friend and mentor of 25 years ago, Jim Sibbet, who is probably best known for his "Demand Index" and his newsletters on silver and gold. Jim says he prefers to trade the NYFE, instead of the S&P, because on a per dollar of margin basis he can make more money using the NYFE. He also believes it is a more orderly market with less risk. Here is his explanation of the strategy:

1. Use 5-, 10-, or 15-minute charts on the nearest NYFE contract. You just need price data, not patterns of any kind—so the time intervals don’t matter.
2. Identify a fairly recent significant high or low point on the chart. (Just eyeball it for now.) If the point was a high, we will be looking to go short as soon as the market has declined by 0.70 from the high. If the significant point was a low, we will be looking to buy as soon as the market goes up by 0.70 from the low. Once the market has moved 0.70 from a high or low, we want to follow the current direction under the assumption that it's going farther. You should use a buy stop or sell stop at the 0.70 change in direction to automatically put you into the trade.

3. Once you have started a trade, protect yourself with a very close stop loss order at 0.30 from your entry point.

4. If the trade goes in your favor, as soon as you are ahead by 0.30 move your stop up to your entry point. As soon as you get ahead by 0.70 move your stop again to 0.50 points away, so you lock in a 0.20 profit. When you are ahead by 0.90, use a 0.70 trailing stop and be prepared to not only exit but to reverse the trade. (You may not want to reverse late in the day, unless you are prepared to carry the trade overnight. Jim will carry the trade overnight only if he is on the right side of his other indicators.)

5. If you are unlucky and get stopped out before you reach the point where your stops are 0.70 away, you should try and re-enter the market in the same direction. On the re-entry, you will put the trade back on as soon as the market moves 0.20 in the direction of your first trade. (The fact that the market has not reversed by 0.70 since the previous signal indicates there is still a trend in the same direction you attempted to trade before.) Jim says he often is able to re-enter the market at a better price than his exit and make money on the second try. (See Exhibit 11.)

We were more than a little worried about the potential activity and market watching that is required by Jim's methods. If we go out for coffee we might miss two or three stop changes and a couple of reversals.

We would also need a very patient and understanding broker, one who would put up with the frequent stop changes. However, there is some basic merit to the system, and we thought it was worth passing along as food for thought. It might be the basis for a more practical system with wider parameters.
June NYFE 10-Minutes

Sell when drops .70 from this high.

Sell short here.

Buy here.

Buy when advances .70 from this low.
STOCHASTIC DIVERGENCES

This day-trading method combines the ADX, half-hour stochastics, and three-minute stochastics. This system works best in S&P futures and currencies.

1. Use the 18-day ADX/DMI to measure the strength of the daily trend. If the ADX is rising, trades should be done only in the direction of the trend. If the ADX is declining, trades can be done in either direction.

2. Check the direction of the short-term trend using half-hour bars on the slow stochastics as an indicator of the direction of the trend. It is O.K. to trade either with or against the stochastics trend as long as the 18-day ADX/DMI is declining.
3. Use three-minute bars on the futures contract. Set up another chart using three-minute bars with a 21-period slow stochastic.

4. Trades are entered after a divergence between the three-minute futures chart and the three-minute stochastic chart. The first point of the divergence must occur with the stochastic either above 80 or below 20. Look for occasional three-point divergences. These are less frequent than the two-point divergences, but they are particularly good signals. In fact, you can take the three-point divergence trades regardless of the daily ADX or stochastics trend. (See Exhibit 12.)

5. Set your stop loss. The initial stop loss point for S&Ps should be 20 points above the most recent high for short positions or 20 points under the recent low for long positions. The stop can be changed after each new peak or valley in the stochastics, with the stop 20 points from the new peak or valley on the S&P chart.

6. Take profits or exit on the close. If the three-minute stochastic gives a signal contrary to your position from a point below 20 or above 80, this is where you should take your profit. Make sure you are out by the close, if not stopped out.
This day-trading idea combines several technical elements: pattern recognition (something we haven't talked much about), stochastics, and divergence. We assume that most of our readers have some understanding of stochastics and stochastic divergence, since we've described them in detail in the previous chapter. However, the pattern recognition portion is a new element and requires a brief explanation.

The goal of pattern recognition is to try to predict market turning points by observing a sequence of price movements that occur regularly and that have some predictive value. The one described here is called a "key reversal" or "swing reversal" (see Exhibit 13.) This is a three-bar pattern with a swing low that makes a new short-term low followed by a third bar, which does not make a low and whose close is above the swing.
close. The reverse of this pattern would be used for identifying market tops.

With this pattern in mind, the trading system is as follows:

1. Use 30-minute bars on the S&P futures and a nine-period slow stochastic.

2. Watch for the short-term key reversal or swing reversal patterns we described above.

3. Enter the trade when you've observed a key reversal pattern that is accompanied by a stochastic reading (%D) below 30 for a buy pattern, or above 70 if it's a sell pattern.

4. Set a protective stop a tick or two outside the swing high or low. If this stop is too far away to be comfortable, use a tighter dollar stop.

5. Exit on any key reversal patterns in the opposite direction or at the close. (Again, see Exhibit 13.)

Your chances for success will be greater if you wait for a divergence between the stochastic and the underlying futures prices. However, the divergence is not strictly necessary.
EXHIBIT 13

Dec S&P 30-Minute

Bar 1

Bar 2 makes new market low and close is below the close of Bar 1.

Bar 3's low is above Bar 2's low and Bar 3's close is above Bar 2's close.

Dec S&P 30-Minutes

Buy open of Bar 4

Divergence

9 Bar Slow Stochastic

%D below 30

Divergence
APPLYING WHAT YOU'VE LEARNED

by Jaye Lasine Abbate

USING ON-LINE AND SOFTWARE SYSTEMS TO ASSIST YOUR DAY TRADING

You have just been introduced to nearly a dozen different day trading systems and methods, and cautioned to use them with care. As emphasized at the outset, Day Trading can be a risky business. Because of the short term nature of the trading period, the tremendous volatility in the market recently, and the greater number of trades conducted which increases total transaction costs, Day Trading has often been a tough way to earn trading profits - though the potential for profits can be spectacular. A huge number of technological advances have occurred, though, that make it easier than ever to day trade. The critical information needed to do so is now completely accessible at an affordable price to anyone with a PC - rather than being available exclusively to the professionals.
With this in mind - the challenge becomes learning how to integrate these new online services and software systems with the methods and techniques discussed in previous chapters. A growing number of web-based and software products - including the CD included in the back of this book - offer a wide range of services. But which ones are critical to your success as a day trader? The definitive answer will become obvious only as you perfect your own unique style and method of day trading. However, the following criteria are essential tools for day trading success, and should be considered when evaluating any new system:

- **Quotes:** Good, quick and accurate quotes are fundamental to all short-term traders. Most day traders, though, require NASDAQ level 2 quotes because they show which market makers and ECN's (Electronic Communication Networks) are bidding and offering stock at what prices, which helps to indicate whether there is support for or resistance in a stock and what those support and resistance levels are. Additionally, through the use of level 2 quotes, traders may notice patterns in the market maker activity which, in turn, assists the trader in determining entry and exit points and strategy. One stock, for instance, may run up a half point every time the same three market makers are on the bid while a fourth market maker is not on the offer. So, choosing the right quote level to meet your needs is imperative.

- **News, Charts, technical analysis and market summaries:** These are common elements of most systems nowadays - and provide instant access to the ongoing research and analysis tools you need to make quick decisions that capitalize on fast breaking market movements. Often, due to a single news headline the day trader will be minutes ahead of the general public - during which time the stock may have gone up many points.

Likewise, charts and technical analysis tools can reveal rapidly changing conditions the day trader can take advantage of. For example, if Bollinger Bands are available on your system, they can be an extremely powerful aid. Bollinger Bands vary depending on the volatility of a security. As a security’s volatility increases, the bands will widen; as volatility decreases the bands narrow. When the width between the upper band and the lower band narrows, the odds of a tradable rally increases. The direction of the resulting breakout is not known. You can either use indicator readings to determine the direction of the move or simply wait until the move occurs by placing the trade as soon as the security breaks above or below a Bollinger Band. If the bands are close together and the security breaks above the upper band, go long. If the bands are narrow and the security breaks below the lower band, go short. Either way they can help keep trading losses to a minimum - as can other charts and technical analysis tools.
Market summaries are also a useful tool for the day trader to have access to. Traders can monitor issues which have the highest percentage increase in price or volume on a particular exchange, and then research news or fundamental data that may be triggering these increases. The key is to sign up for a service that includes all these important features.

- **Portfolio Tracking**: The new technology is supposed to make your job easier. Therefore, any system you choose should track multiple portfolios - showing both your P&L and your positions, updating your account, keeping track of open orders and available buying power - and it should all be easily accessible to you.

- **Customer Service and Chat rooms**: Prompt customer service and the ability to talk to a real person when you need a quick answer regarding your account is a 'must'. "Chatting" with other traders to share experiences and information, and being able to participate in free seminars with industry pros, is extremely helpful and can lead to more effective trading techniques and decisions. Technology is allowing "professional" traders to come together in one location to share their ideas and "war" stories. The chat room, therefore, is now an equalizer - and geography no longer an inhibitor.

Plus, you should carefully consider:

- **Ease of use**: Dynamic screens, scrolling ticker, pop up screens, continual updating, and alerts simplify gathering info and are just a few of the elements that will make your trading easier and more efficient.

- **Customization capabilities**: Is the system set up so it's easy for you to obtain only the information you want, without having to sort through a lot of extraneous material? Does it monitor enough symbols? Does it cover all the charts you need?

Ask yourself these critical questions and others before choosing a system so you're not stuck with one that doesn't suit your trading style and needs. Remember: YOU must be comfortable with the system you choose, regardless of how many people may swear by one system or another.

Also try to determine:

- If the system is really safe and reliable, or prone to crashes and hackers cutting in.

- If it is compatible with any hardware or software, so you won't need to buy a lot of new products now, or down the road if you upgrade your PC.

- Can you run the system at home and at your office, on different computers, without having to reenter the securities you are following?

- If you need to leave the system running all the time to receive data on the computer, or if it is available on the quote providers end so you can access data anytime, anywhere, without worrying about missing a quote.
There are many similarities - and many differences - in the systems available today. But you should start with the basics noted here, as they will help you successfully implement the day trading systems and methods you choose to adopt from this book and other sources. For your convenience, a software CD is enclosed in the back of the book that will immediately allow you to get up and running, testing out any of the systems outlined.

We think this will be a tremendous asset to you as you improve your skills as a day trader. Take advantage of the free software that's provided, so you can learn to apply what you've just learned in the book with state-of-the-art research and charting applications. Once you've mastered the basics - you'll be ready to take your trading to the next level.

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Charles Le Beau is one of the most respected names in the futures industry. As editor and publisher of Technical Traders Bulletin and founder of the System Traders Club, he is well known for his trading skills and specialized knowledge of technical analysis. He is a former regional futures director for E.F. Hutton and Co., and the founder and president of Island View Financial Group, Inc., which manages money in the futures markets.

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