Questions

What is the prevalent market pattern that occurs on Tuesday afternoon? When does it occur?

Answers

The composite chart for S&P futures clearly demonstrates a buying opportunity for Tuesday afternoons. The typical rally occurs at approximately 2:30 P.M. East Coast time.
Market Engineering: How the Market Stages a Rally—and a Decline

George Douglas Taylor first observed this phenomenon in the grain markets in the 1950s. He claimed the market was “engineered from within” to repeat a three-day cycle that consisted of a buy day, a sell day, and a short sell day, hence my designation of LSS to mean long, sell, and sell short. In observing a variety of markets since Taylor first made this observation, it appears that very little has changed. The same patterns appear routinely in the futures, options, and equity markets.
Question

What is market engineering and how does it manifest itself in the market?

Answer

Human nature today is very much as it was fifty or even a hundred years ago. People don't like to lose money and they can be intimidated into acting against their own interests by inducing the element of fear. Likewise, the greed side of the equation hasn't changed, either. One is likely to let down his guard if he thinks the profits will continue to flow. This is the central premise of Taylor's theory of market engineering.

On the so-called buy day, Taylor claimed that knowledgeable market forces sold the market down in order to create a buying opportunity for themselves. Strong hands, according to Taylor, caused the market to decline. The ensuing losses then caused the weak hands to abandon positions and sell out their positions—to, naturally, the strong hands. In the market, these transactions were manifested by a decline followed by a strong rally.

On the second day of the three-day cycle, the strong hands would often take profits at, through, slightly above, or below the previous day's high. By the third day, the market engineering was back in full force. Now the strong hands wanted a selling opportunity, so they created a rally to cause the weak hands to want to jump aboard lest they miss a spectacular opportunity. The weak hands jump in as buyers, and the strong hands sell at the artificial highs. Once the market fails to rally off the highs, the weak hands throw in the towel and sell out their positions at a loss—to, of course, the strong hands, the same people who are now covering their short-sale positions and earning big profits. If you don't think the rich get richer in the market, you better think again.
I cannot find anything illegal about this activity since everyone seems to be operating in his or her own self-interest in the market. On the buy day, the sellers at the bottom are selling because they are fearful the market will break lower. That's the fear component. On the short-sale day buying at the top, the buyers want to get aboard a good thing, albeit three days late, lest they miss an excellent rally. That's the greed component. In a sense, everyone gets what he or she wants. Unfortunately, only those who buy low and sell high can earn the profits.

Looked at another way, the market goes down to go up—and vice versa.
Most people are caught between the proverbial rock and a hard place when it comes to trading. Either their fear of losing keeps them from picking up the phone and taking a trade, or their recklessness causes them to overtrade, in which case they cannot put the phone down.

The ideal is a middle course. The fearful trader needs to reevaluate his reasons for being in the market. Can he endure the risks of day-to-day trading, or must he have certainty before he enters a trade? The reckless trader might view the market the way a teenager sees a video game—perhaps a fun way to pass the time. The trader enjoys the rush, the thrills of trading. But can he make any money?
Questions

You mapped out your strategy last night. You knew you wanted to buy the market at a specific price today. When the market reached that price, however, you said, “Wait a minute. It looks like it might trade lower. Let’s watch it for a while.” Needless to say, that was the bottom. The market surged higher and you weren’t aboard. What held you back from executing your game plan?

Or consider this scenario. You’ve been making reckless and uninformed trades lately and your equity is down. You need to score big today to make up for those reckless losses. So you double the number of contracts on a market order. At first, the market goes your way. You are feeling good. But then adversity hits, and you decide you won’t give up without a fight. At first, you begin to get some of your profits back. But then disaster hits. You sustain the biggest loss of your trading career. How do you react?

Answers

In both instances, the answer is the same: Stop trading. At least for the moment. You are not in a psychological frame of mind that permits dispassionate self-analysis. After the dust settles, you need to go back and reevaluate what you are doing. The fearful trader needs to learn to step up to the plate. The reckless trader needs to learn discipline. Both can be mastered if you are determined to succeed.

If you see yourself here, you are not alone. The psychological aspects of trading are among the hardest to master. It is one thing to know what to do and quite another to do it. Until you can wed your market knowledge with your psychological knowledge, you are going to be at a disadvantage in the market. Never mind that most people face the same pitfalls. This is a little like saying that misery loves company. The challenge is to rise above, and overcome, your shortcomings.
THE PSYCHOLOGICAL COMPONENT

The place to start is with a rigorous self-analysis or with help from a competent professional who understands how self-destructive instincts can hold an individual back. You really have to have it out with yourself. Since everyone is different, it is hard to suggest a single, easy solution. But let's say you are clearly fearful of losing money, and that is what is holding you back from picking up the phone. Ask yourself this: If I don't pick up the phone and take the trade, what is going to happen? The answer is you are going to create a whole sort of other problems. For instance:

1. I won't have the profits, or perhaps losses.

2. I may decide to chase the trade, in which case the profits may be smaller, or the risk higher.

3. I will beat myself up for missing a good opportunity.

4. My account will suffer because I will need those profits that I missed to offset the inevitable losses of trading.

5. I will repeat the same mistake next time.

6. I will think I'm no good at trading.

7. I will attribute the other person's good fortune to simply having good luck.

I think you can see where I'm going with this. First and foremost, you need to decide the most basic question: Do you want to continue trading? If the answer is a resounding "yes!" then you need to resolve to do what you fear most, then continue doing it until you are comfortable. If this means you are determined to take tomorrow's trade regardless of the outcome, then you have to set your emotions aside and take the trade exactly as you planned the very next day. Then you need to repeat this pattern again on
the second day, and so on. By doing this, you will be training yourself to overcome your fear—which, I understand, can be a formidable obstacle to success in the market. There can be only two outcomes to your decision to do this. You will sustain losses because your trading strategies are faulty. This means back to the trading boards. Or you will begin to earn profits and have confidence in what you are doing. If you try and fail, you will have learned a valuable lesson. Perhaps the market isn’t for you. You can move on to something else. There’s no failure in trying.

The outcome for the trader who lacks discipline should likewise prove valuable. By putting down the phone and concentrating on the best opportunities, you will be allowing yourself to succeed. Your account will start to grow, and that should compensate you for any loss of thrills that you used to gain from trading. Having discipline in your life creates an inner confidence that is hard to duplicate in practically any other endeavor. Trading is a little bit like drinking. Having a predinner cocktail can be highly stimulating and enjoyable, but guzzling a whole bottle will create problems in your life like you wouldn’t believe. Think about where you want to go and try to find a path that will take you there. The best traders are disciplined traders.
The Weekly Stock Market Pattern: How the Market Trades

While not every week will trade in this pattern, there is ample evidence that the market has a reliable price pattern. In stronger markets, the rallies will be stronger and the breaks weaker. In weaker markets, the rallies will be weaker and the breaks stronger.
Question

What is the typical weekly pattern for stock prices as reflected in the major averages and indices?

Answer

Given that a variety of factors will determine how any one-day price pattern will appear, there is a consistent pattern that appears:

1. **Monday** tends to be the strongest day of the week with upward price pressure beginning at the open. This is particularly true if the averages closed in the upper range of the day's range on the prior trading day.

2. **Tuesday** tends to consolidate in the morning hours with additional upward pressure on prices in the afternoon.

3. **Wednesday** tends to be the choppiest day of the week. In general, though, bullish markets will see prices closing near the highs on Wednesday, whereas bearish markets tend to close near the lows on Wednesday.

4. **Thursday** is the countertrend day. If the market has been up on the prior three days, look for selling to push prices lower on Thursday. The exception is when you are in a bear market and the prior three days have been lower. In this instance, Thursday typically will rally.

5. **Friday** tends to open strong and rally temporarily. Initial selling will often push the market lower on Friday morning following a higher open. By early afternoon, bargain hunters, in anticipation of Monday's price boost, will bid up prices into the close.
Your First Trade: How to Place an Order

Often the easiest things about trading create the most questions. How does a new trader go about placing an order? In the current world of discount brokerage, there is less hands-on help in the form of helpful brokers and more anonymous order takers on the other end of the line. Because mistakes can prove costly, it is absolutely vital that you place your order with precision. Moreover, because timing is so important, you must be able to give the order both accurately and quickly.
Question

You see an opportunity to make money in the U.S. Treasury bond futures by purchasing bonds in anticipation of rumors of an impending interest rate cut by the Fed. With the nearby September Treasury bond contract trading at 101-03, you decide to place a limit order to buy two September bond futures contracts at 101-00. You also know that once you are in the position, you want to place a stop-loss order six ticks ($187.50 per contract) below your entry price. Assuming the order is filled and the stop is not, you plan to take profits one basis point higher, at 102-00. What do you tell your broker?

Answer

We are talking about three separate orders here: a limit entry order, a stop order (if you are filled), and, assuming the order is filled and the stop not hit, an exit order. To the person taking your order, an order is an order, so you want to treat each order separately. Even before you call the broker, you want to write down the order. Once you call, the broker will read back the order and ask you if you are in agreement with him. Here's what you write down:

"Buy two September bond futures 101-00."

Here's what you tell your broker when he picks up the phone:

"This is John Jones. For Account No. 23848, I want to buy two September bond futures at 101 even, or better, day only."

He will repeat what you just said and ask for your confirmation. Once you agree, he will typically assign this order with a ticket number so that it can be tracked, saying:

"For account No. 23848, you want to buy two September bond futures at 101 even. Your ticket number is 752."

Assuming the market is still above 101-00, your order will go into the floor broker's deck. Should prices move down to 101-00
and he can find a willing seller at that level, he will fill the trade for you.

Your broker will then call you back. “You bought two September bond futures at 101-00.”

This is the time to place the stop. Knowing you want to risk just six ticks, you now give him the stop order. You don’t tell him you want to place a stop-loss order six ticks below the market or the entry. You give him the specific price. The price of 101-00 represents 3232 when translated into 32nds. Six ticks below their number (3232 - 6 = 3226) is 100-26. You tell your broker: “For Account No. 23848, I want to sell two September bond contracts at 100-26 on a stop.”

Now you will receive another ticket number. You now have a resting stop order below the market.

For your sake, hopefully the stop-loss order will not be hit. Rather, as anticipated, the market begins to rally, and soon it is trading at, let’s say, 101-16, resulting in a half-basis-point profit. At this point, you may decide to place your exit order to take profits at your desired limit at 102-00.

You call your broker again. “This is John Jones. For Account No. 23848, I want to sell two September Treasury bond futures at 102 even, or better.”

He repeats the order and gives you another ticket number.

Now the market must cooperate. If prices rise above 102-00, your sell order will be executed and you will have a $2,000 profit, minus commission fees. Since it is understood that most orders are good for the day only, you may then cancel your stop order if the market is trending higher, or simply allow it to expire at the end of the day’s trading. If there is even a remote chance that the market might turn around and hit the stop, you must cancel the order. Otherwise, you will find yourself short two contracts at the stop—after you took profits.

If you want to be out at the end of the day regardless of price, you want to cancel both the stop order and the profit-taking order.
and exit via a market order. Each time you place an order, you want to write down the order. Then, if the order is executed, you want to make a note that the order was filled. Most traders keep a log of all their trades.

Here’s a summary of what the broker needs to know:

1. Your name
2. Your account number
3. Whether you want to buy or sell
4. The number of contracts (1, 2, 6, 10, whatever)
5. The trading month (March, June, September, December, etc.)
6. The futures contract (U.S. Treasury bonds, S&P 500, Swiss francs, etc.)
7. The limit price, if any, or type of order (market, market on close, stop)

While confusing to new traders, order placement is very straightforward once you get the basics down. It is vitally important, however, that when you decide to get out you place the identical order, with one exception: If you initially bought, you must sell; if you initially sold, you must buy. For example, to get in, you might say:

“I want to buy one September bond futures at the market.”

When the time comes to get out, you must sell the identical number of contracts with the same expiration month. So you would say:

“I want to sell one September bond futures at the market.”

Whether you get in or out on a market or limit order is up to you. But the number of contracts, the contract month, and the
YOUR FIRST TRADE: HOW TO PLACE AN ORDER

futures must be the same. Not to confuse matters, but if you anticipate declining prices, you would initially sell short:

“I want to sell one September bond futures at the market.”

When it comes time to get out, win or lose, you must buy:

“I want to buy one September bond futures at the market.”

If you try selling when you are already short, you will simply add to the position.

If you are trading stocks, of course, you don’t have to concern yourself with contract months. But, if you are trading options, you must add a number of qualifications to your order.

Do you want to buy or sell a put or a call? What is the name of the underlying stock or futures? What strike price option do you wish to buy or sell? Are you entering into an opening (new) or closing (old) transaction. Options are more complicated than stocks or futures; use extra caution when placing them. Your brokerage house will provide you with information on placing option orders.
Market on Close Orders: A Useful Exit Strategy

You will often get an excellent fill if you buy or sell to exit a position with a market on close order, known as a MOC order. Such orders are executed in the final minute of trading. As with any type of order, there are pros and cons to using this one.
Questions

What is the best type of market to use a MOC order? When should you place the order? What's the advantage to using a MOC order, versus a normal market order, 10 or 15 minutes prior to the close? Are MOC orders always filled? Why not hold a position overnight and get out on the open the following morning?

Answers

These are all good questions. They can help you create a winning exit strategy. MOC orders have the advantage of being filled in a moment of high liquidity. This means there typically are many buyers and sellers at the close. Whether you want to buy or sell, therefore, there will be someone to take the other side. The best time to enter a MOC order is 5 to 7 minutes prior to the close on a day when the market is trending. You also want to make sure you are using this order on a day on which you are on the winning side.

Why wait until just before the close to place the order? First, if you place the order more than 10 minutes prior to the close, the market may change direction. Then you will have to exit the market and call up your broker and cancel the MOC order. If you don’t cancel in time, the order may be executed anyway, leaving you with an open position overnight. Second, if you wait too long (say 1 or 2 minutes prior to the close), the broker may not be able to get the order into the pit in time.

To understand why you want to be on the winning side of the trend, you have to understand the psychology at work in the market as you approach the close. The winning side is starting to squeeze the losing side. That means if prices are rising, the short-sellers are going to grow more panicked as prices continue to rise. This panic translates into emotional buying, anything to stem the growing losses. For the buyers, this means more profits as the short-sellers become emotional buyers to escape continued losses
in the market overnight. If you are long, therefore, this scenario works for you. Get out MOC, selling into a mob of buyers. If the trend has been down, however, this works in the opposite fashion. Panicked buyers will only work to the advantage of the short-sellers by offering down the market as prices trend lower. The rule: if you are winning, wait for the close; if the trend is against you, get out before the close.

Going overnight involves taking on a lot more risk. The rule here is: Winning positions tend to improve in the overnight market, and losing positions tend to get worse. There are always exceptions, but why risk the exposure? If your perspective is long-term, going overnight is fine, assuming you understand the risks. Otherwise, cut your losses short by getting out well before the close.

Another time when it pays to avoid the close is when you have a choppy market. In the absence of a trend, the probabilities favor a move back to the middle, so holding on in hopes of a trend into the close doesn’t make sense. Market on close orders are almost always filled. The only exception to this would be when you wait too late to place the order and get a busy signal from your broker. Once the closing bell rings, all trading must cease.
It is not enough to place stops—mental or actual—to limit your losses in the market. You need to know when to place your cards on the table and get up and leave. So many trading disaster stories begin with a small loss. With time, the small loss grows larger, and soon the hapless trader is grasping at straws in a vain attempt to win at all costs. By that time, of course, it is already too late. So do yourself a favor and learn the warning signals.
Questions

What is the classic market pattern that is almost impossible to beat? How often does it occur? What should you do if repeated attempts to win are frustrated by the market? What do floor traders know about market patterns that goes unrecognized by the trading public? How do you adapt to changing market conditions?

Answers

To begin, you have to recognize that everyone has losing cycles in the market regardless of what he does. The idea is to minimize the negative impact of these cycles and to, indeed, expect them and learn to capitalize on them. Perhaps the most difficult market to trade is known as the search-and-destroy pattern. This occurs when the market repeatedly violates both the intraday highs and lows. For the aggressive trader, this pattern is especially problematic because his aggressiveness only serves to dig him in deeper. This pattern manifests itself when a whipsawing price pattern refuses to trend. In such an environment, getting aggressive only compounds the losses.

Ironically, you will find the search-and-destroy pattern in the market on two very distinct types of days—when nothing happens, and on report days when the news is subject to varying interpretation. Both can generate a whipsawing market, and both can defy conventional analysis. How do you make sense of random patterns? On the report days, you can do yourself a favor by waiting until the report is issued. Once the dust settles, you can begin to try to make sense of the price action. Just remember that market action is often the very opposite of what might be expected. One explanation for this behavior might be the old “buy the rumor, sell the news” market pattern. The market has risen on hopes of a bullish report. The report hits and the market declines. This would be an easy call if the market were cooperative, but on
the heels of this news, the market might soar higher only to crash lower. How do you make sense of this? One suggestion is that you don’t. You simply leave the report days alone until some sanity returns to the market.

The more classic search-and-destroy pattern often occurs not on the heels of the news, but in anticipation of it. So, if there is a report due tomorrow, most of the players will be on the sidelines. This leaves a narrow-range market that can be more easily manipulated one way or another. Even liquidity can be a problem in a market like this. One rule is to give it a shot three times. If you come up on the losing end on each one, walk away. It is not worth losing a major portion of your equity on one particularly bad day. Fortunately, this particular pattern is not all that prevalent. If you were to characterize every trading day, you would probably find that less than five percent of all trading days exhibit similar patterns.

Apart from knowing when to run, you need to have a strategy for coping with changing market conditions. If a market has just completed a major run higher, it needs time to consolidate before returning to its trending ways. That’s when you have to rethink your strategy 180 degrees. For instance, if you have been winning on a consistent basis by buying breakouts, you’d do well to think about fading that strategy on a day when the market opens unchanged and shows very little directional trend. In day-of-the-week trading patterns, this is the quiet Tuesday morning following the barn-burner Monday rally. The market needs a break if only for three or four hours in the morning. Put another way, you want to do the very opposite on Tuesday morning of what you did on Monday morning. In this scenario, a Monday morning higher buy would be followed by a Tuesday morning higher sell. The simple reason is the market needs time to rest.

Cultivating this specific type of flexibility is a difficult challenge for most traders. However, if you are open to the experience, you might be able to make the transition from a more rigid approach. The goal, of course, is always the same: to limit losses while capitalizing on the genuine trends.
Many traders use slow stochastics as a relative strength indicator. High readings suggest an overbought market and low readings suggest an oversold market. The problem with this approach, as with the bullish consensus, is that this indicator can get high—and stay high. The reverse is also true, of course, at market bottoms. If you are selling into a strong market, the premature selling may result in profits left on the table or, worse yet, a short position in a rising market. Better to use slow stochastics as a divergence tool, running them on a line chart below the one- or five-minute bars.
Question

Prices have been rising and profit-taking occurs. A clear-cut top is formed. Then prices rise to new highs. You consult your slow stochastics chart at the bottom of the screen. The first rally is matched identically by the slow stochastics chart. The second rally to new high ground, however, is not matched by slow stochastics. Rather, the second rally on the slow stochastics chart fails to rise to new highs. What is going on?

Answer

You have a reversal occurring. The second high on the price chart was probably the final high. The market is not returning to that price. The next trend, at least temporarily, is down. Get out immediately. The move is over. This is particularly true if the second rally in prices occurred over the same time period as the first rally. In this instance, the pattern was symmetrical in time, suggesting completion of the upward price pattern. When confirming indicators fail to match price patterns, they create a divergence. This is usually a sign that the move is over.