

SHADOWTRADERPRO SWING TRADER USERS GUIDE

How to get maximum value from your **ShadowTraderPro Swing Trader** subscription.

ShadowTraderPro Swing Trader delivers value to its subscribers on multiple levels. The newsletter stands alone as either a purely informational vehicle for those who like to find and trade their own ideas, or as a daily resource for high probability trade setups, both listed in Bulls & Bears section in the morning and also via real-time emails. Following is an explanation of each specific section of the report and how to utilize it. The newsletter is sent out daily and each morning's edition arrives at midnight the evening before, assuring that users have ample time in the morning (no matter HOW early they get up) to digest the information.

LOOKING AHEAD:

Every Swing Trader starts with the Looking Ahead. The Looking Ahead section takes a snapshot of one particular technical event that is happening in the market at the time and gives a full commentary on it including bias its implications in the "bigger picture". Commentary often includes snapshots of daily broad market averages with fibonacci levels and other support and resistance pivots marked off. A brief rundown of how the market acted in the prior day is usually included for those individuals who need to get a brief rundown of the prior day's action at days end. ShadowTrader makes every effort to constantly deliver commentary that truly looks ahead, rather than in the rear-view mirror. Information that is predictive and that the user can actually trade off of.

UNDER THE HOOD:

A listing of the prior day's closing figures, including the major averages and the market internals such as breadth and a/d lines. Closing prices on spot gold and crude are also included as are the top 3 strongest and top 3 weakest sectors the day before. Readers are encouraged to print out the Swing Trader daily to look for convergence and divergence in the moves in the averages and the market internals to look for clues as to future direction.

A short explanation of some key numbers and how to interpret them in "Under the Hood" follows:

NYSE AND NASDAQ OVERALL VOLUME – This is measured in actual shares traded on both of these exchanges. The amount of volume is then compared in percentage terms to the previous close. If the markets close above the prior day's close (up) or have advanced strongly off of lows creating a sizeable 'body' on their daily charts, and have a percentage increase in volume, then this is called an "accumulation day" which is indicative of institutional traders accumulating shares. The opposite is true for days that are down on increases in volume and are called "distribution days". If the market is to maintain an uptrend then it needs accumulation days and to maintain a downtrend it needs distribution days. Pay close attention to days where overall volume increases greatly but the market either does not make a new high/low or fails its intraday high/low.

This is a sign of “churning” where institutional traders (think, smart money) are either selling to retail traders at a high or buying from retail traders at a low in anticipation of a reversal.

NYSE AND NASDAQ BREADTH – This is expressed as a ratio which is simply the amount of up volume (volume that flowed into stocks advancing) compared to the amount of down volume (volume that flowed into stocks declining). If the ratio reads 2:1 then the amount of up volume was simply 2x the amount of down volume. In periods of lower volatility, look for breadth readings of better than 2:1 to be meaningful and indicative of strong momentum. In periods of higher volatility its common to see readings of 10:1 or greater on either side. A general rule of thumb is that anywhere between 2:1 positive and 2:1 negative, the market will not be able to sustain moves. There is simply too much push/pull going on between up and down stocks. Check out these numbers daily and see how they closed on trending days of expansion of range and congested or inside days where there was a contraction of range.

BREADTH RATIOS – This is a way to compare how much in percentage terms the up volume was in relation to the rest of the market. The formula for the ratio is simple: ((up volume) / (total volume)) * 100. This will give a number between 0 and 100. If the number is 50, then obviously the up and down volume was at parity. You want to look for readings above 80 to confirm strong bullish price action and readings below 20 to confirm strong bearish price action. On strong trending days up this number can read well over 90 into the close and on strong trending days down, this number can read less than 10.

NYSE AND NASDAQ ADVANCERS/DECLINERS – The number of advancing stocks minus the number of declining stocks on the NYSE and Nasdaq. Be aware that like all of the market internals listed in the ‘Under the Hood’ section, these readings are taken at 4pm EST when the market closes however during the course of the day, the a/d line can vary greatly from anywhere to minus 2500 to plus 2500. Your best bet is to always compare an intraday chart of the S&P with an intraday chart of the a/d line to see if there was convergence or divergence that either supports or denies the price action in the markets. If you are bullish you want to see these a/d lines close well over +1000 on strong days and well under -1000 on weak days if bearish.

NYSE AND NASDAQ TRIN – Also called Trader’s Index or Arms Index (after inventor Richard Arms). This is a complex fraction that takes the amounts of advancing stocks and declining stocks and advancing and declining volume into account.

$$\frac{\text{Advancing Issues / Declining Issues}}{\text{Advancing Volume / Declining Volume}}$$

If the above fraction returns a value that is lower than 1.0, then it is an indication of buying pressure across the market. If the value is above 1.0, then it would indicate selling pressure. Readings that are above 2.0 (very bearish) and below 0.30 (very bullish) should be paid attention to closely. Like all market internals, the trin can be charted and

it makes sense to chart it in the same timeframe that you do when you are charting your broad market index such as S&P or Dow.

Note: We don't use the TRIN as much as we used to here at ShadowTrader HQ. Certain indicators seem to work well for a long time and give clear signals and then later on do not. We think the recent deficiency may have something to do with an inordinate amount of contra-etf's coming to market which are bought by traders who are betting the market will go down. Thus you have a lot of false buying pressure coming into the market even when its going down sharply. We are currently using the \$TICK as our "3rd internal" (after the Breadth and A/D line). The \$TICK which measures the difference between the total number of stock trading on an uptick minus the total number trading on a downtick at any given moment is not listed in *Under the Hood* because it must be watched intraday in order to have any value and its closing number is meaningless.

\$VIX – The VIX or CBOE Volatility Index measures the implied volatility of S&P 500 Index options. While that's good to know, what is essential is what this number really means when seen in the *Under the Hood* and how you should interpret it. The VIX is quoted as a number but is actually a percentage reading. If, for instance, the \$VIX says 42.7, then what this means is that there is an expected change of 42.7% (annualized) over the next 30 days. The annualized part is important. How much the actual expected change for just the next 30 days (which is what we care about) is taken by dividing the vix percentage by the square root of 12 (for the 12 months of the year). In our example above, we would divide .427 by 3.464, giving us .1233, or 12.3%. This means that S&P 500 Index options are priced with the assumption (read: implied) that the magnitude of the S&P 500's return over the next 30 days will be less than 12.3% in either direction. For you math geeks out there, note that this assumption is only that there is a 68% likelihood that this will happen because in a normal distribution each standard deviation is roughly 34% from the mean. Think of all of the prices that the SPX could land on over the course of a month as a big bell curve. Right in the middle is the peak area where we calculate the mean. The prices then fan out in either direction both up and down. In such a normal distribution, the first two bands or standard deviations represent roughly 34% of all the values in either direction. So because the market goes both up and down, the VIX is telling us that there is a roughly 68% chance that the market will move somewhere between 0 and 12.3% over the next 30 days.

The CBOE uses current market prices for all out of the money calls and out of the money puts for the front month and second month expirations. Knowing this in and of itself is important because it helps us to understand what creates high or low VIX readings. When the VIX value is high (let's say over 30), then the prices of those way out of the money calls and puts is high because those who are selling them are expecting a high premium for the risk that the market could "go there". Conversely, those that are buying must pay a high premium because the market has a good chance that it could "go there" and those options might actually be worth something. Many people think that it's only the expectation of a large move down that causes a high VIX, hence the name "fear index". This is sort of a misnomer because as we have pointed out above, the calculation takes into account the current prices of both out of the money calls and puts. So, high VIX readings mean that traders of options are pricing in significant risk or chance of a

sharp move in either direction. The VIX will be low when those same traders perceive very little risk or chance of the market moving in either direction.

ES MARKET PROFILE – In the early '80's a gentleman named Peter Steidlmayer developed a new way of looking at the markets, creating a daily "profile" showing where trades went off in terms of volume and time in relation to each different price point traded. If you have seen the volume by price study on your thinkorswim platform, you have seen the building blocks of Market Profile.

Market profile is generally presented in two different ways, either by volume or by time. Time based profiles or "TPO's" (Time Price Opportunities), show us where price spent its time during a particular session. Volume based profiles show where volume traded at each particular price during that session. ShadowTrader believes that volume based profiles are more accurate and hence the information provided is a Volume Based Market Profile.

ShadowTrader has chosen to focus on the three main components of Market Profile which are the high and low value areas and the point of control.

The Value Area is where roughly 70% of the prior days volume went off. If you look at volume by price on any instrument, you'll note that the usual pattern is one of a bell curve distribution (turned on its side) with some sort of peak at the price where the most volume traded and then tapering off to either side. From this peak 34.1% to either side denotes one standard deviation. Hence the Value Area is where roughly 70% of the volume traded during the prior day's session. Value Area High is the high of that area and Value Area Low is the low of that area.

The Point of Control is the price where the greatest amount of volume traded in the prior day's session.

Traders should use Market Profile levels in a similar fashion to the Pivot Points as possible support and resistance areas. It's very common for the market to test the Point of Control at some point during the trading day. The Point of Control is tested over 80% of the time. Meaning that at some point during the current trading day, whichever level was the Point of Control from the prior day's trade (the number listed in the newsletter), price will usually test that level at some point. Be aware that futures trade almost 24 hours, so this level may have been tested while you were sleeping! A wobbly market that is advancing or declining towards the POC may have short term resistance or support at that level which can be traded against for short term gains.

When price trades inside of the Value Area (between low and high), remember that this is where roughly 70% of the prior days trade went off, so traders see this as "value". Don't expect much to happen inside of this area, be aware that it could be choppy as contracts just get passed back and forth at "value". If price opens below the Value Area Low (VAL) and then moves up into it, there is also an approximately 80% chance that the VAH (Value Area High) will then also be tested.

Mark these levels off on your intraday /ES charts and play with them. What we have presented here is by no means a set of hard and fast rules as to how the market will behave. We are simply giving a brief overview of how many traders use these levels. Seek to develop your own style after marking off and watching the Profile areas for an extended period of time, while taking notes or paper trading various strategies along the way.

ES PIVOT POINTS – These are the pivot points for the current day that the Focus Report is dated. The calculations are based off of prior days data. We get tons of questions on how we calculate these and why they ours are different from the TOS platform or other data sources. The formula we use follows:

$$\text{PIVOT} = (\text{High} + \text{Close} + \text{Low})/3$$

$$\text{R3} = \text{High} + 2(\text{Pivot} - \text{Low})$$

$$\text{R2} = \text{Pivot} + (\text{R1} - \text{S1})$$

$$\text{R1} = (2 * \text{Pivot}) - \text{Low}$$

$$\text{S1} = (2 * \text{Pivot}) - \text{High}$$

$$\text{S2} = \text{Pivot} - (\text{R1} - \text{S1})$$

$$\text{S3} = \text{Low} - 2(\text{Hi} - \text{Pivot})$$

The “big secret” to why the values are sometimes different is that although futures trade 24 hours per day, ShadowTrader uses only the high and low from the prior days’ trading hours only (9:30 – 4pm EST). The “close” value used to calculate the PIVOT is the CME Settlement Value which comes from the CMEgroup website. The link to this is in the glossary section of our website at www.shadowtrader.net. Just click on the “about us” tab and choose “glossary”. Once there, scroll down to Pivot Points.

SHADOWTRADER SECTOR TREND SCORE MATRIX:

The sector trend score matrix is one of the most useful parts of the *Swing Trader* newsletter. Through the use of the matrix, ShadowTrader essentially does a lot of the legwork of daily sector analysis for you the user, combining our findings into an easy to read heatmap type of matrix which will show you overbought and oversold trends amongst various industry groups at a glance.

The matrix is essentially composed of three columns. The first two columns are self explanatory, comprised of simply the ticker symbol and the name of the sector or industry group.

The third column lists the cumulative trend score of each sector.

HOW THE TREND SCORE IS CALCULATED - Every day, sectors are some percentage up or down from the previous day’s close. This information on its own does not have

much predictive value as it only shows you what the sector did in the prior day. There may have been an explosive move or reversal in the group, but you would be looking in the rear view mirror. Money flow in and out of various industry groups tends to be cyclical, with some sectors staying strong for multiple days in a row and some being weak for multiple days in a row. Thus, every day, a daily trend score is calculated for each sector which takes into account how many days up or down in a row that group has been.

All of the trend scores assume a starting date of the market close of June 17th, 2010. So, for example, let's say that the IUX or Insurance Index closed up 0.50% on June 18th. The June 18th trend score would be +0.005 because it is the daily percentage change in the index multiplied by the number of days up/down in a row which in this case is just one because of the start date. If on June 21 (which is the next trading day), the IUX is up again, this time 1.39%, its daily trend score will be +0.0278 which is 1.39% multiplied by 2 ($0.0139 * 2$) because now the index is up two days in a row. If by chance on June 22 (the next trading day), the IUX was down 0.86%, then the daily trend score that day would be -0.0086 because it's the percentage change on the day multiplied by the number of days up or down which in this case reverts back to one as its only been one day down in a row.

The cumulative trend score is simply the cumulative rolling addition of every daily trend score since our inception date of the night of June 17th, 2010. This cumulative number is then multiplied by 100 just to present a larger value which will be easier to read. In the short example above, if the figures were actual (they are not) and you were reading the matrix on the night of June 22nd, you would see a trend score next to the IUX of 2.42 which represents the cumulative total of all of the daily trend scores to date, multiplied by 100. In our example above, this would be $(0.005 + 0.0278 - 0.0086) * 100 = 2.42$.

The cumulative trend scores of each sector are then sorted from highest to lowest and the sectors are listed accordingly. The heatmapping of colors in the trend score column is set up in grades of 5. This means that every trend scores between 0 and 5 will have the lightest green, from 5-10 will have a slightly darker green, from 10-15 will be darker still, and so on. Reverse this scheme for the sectors which have negative trend scores.

GREATEST GAINERS AND LOSERS – Within the matrix, you'll note that there are always two sectors that are highlighted in bold green and bold red. These are the two sectors which experienced the greatest amount of gain or loss in daily trend score versus the previous day's trend scores. This comparison is done in absolute terms, not in percentage terms.

HOW TO BENEFIT AND TRADE USING THE TREND SCORE MATRIX – As opposed to just looking at a sector list every day that shows prior days percentage change, the Trend Score system takes into account actual recent trends that have been forming in the various sectors. Let's take an actual Trend Score Matrix from a recent issue.

SYMBOL	Sector Name	ST Trend Score
\$DJUSCL	Dow Jones U.S. Coal Index	-0.72
GOX	CBOE Gold Index	-0.99
TOB	Tobacco Index	-2.33
BTK	Biotechnology Index	-3.04
\$DJUSRR	Dow Jones U.S. Railroads Index	-3.38
XTC	North American Telecommunications Index	-3.91
DRG	Pharmaceutical Index	-5.12
\$DJUSCA	Dow Jones U.S. Gambling Index	-6.05
IUX	S&P Insurance Index	-6.47
HCX	S&P Health Care Index	-8.61
UTY	PHLX Utility Sector	-8.85
DTX	Dow Jones Transportation Average	-8.90
\$DJUSRE	Dow Jones U.S. Real Estate Index	-9.28
SOX	PHLX Semiconductor	-9.58
XBD	Securities Broker/Dealer Index	-9.90
BKW	KBW Bank Index	-10.88
RLX	S&P Retail Index	-12.85
CEX	S&P Chemical Index	-12.99
\$DJUSHB	Dow Jones U.S. Home Construction Index	-13.64
\$DJUSNS	Dow Jones U.S. Internet Index	-15.38
OSX	PHLX Oil Service Sector	-17.65
\$DJUSSW	Dow Jones U.S. Software Index	-17.68
XNG	Natural Gas Index	-18.42
XOI	Oil Index	-20.76
XAL	Airline Index	-35.17

The first thing you want to note about the matrix is which sectors are at oversold or overbought extremes. You do this by noting the darkness of the color of the trendscores. The shades of either red or green are graded a different color every five point move. Sectors at the extreme upper and lower ends of the spectrum should be noted. In the sample above, you have to reason that the airline index (XAL) must be down many multiple days in a row because that is the only way that it can receive such a low trendscore. Remember that the more days down in a row, the more weight it has on the trendscore.

On the other extreme, note that there are obviously sectors at the top of the matrix but none of them are showing positive values. This can confirm for you whether or not the market is in an uptrend or downtrend. All sectors negative probably shows that the market is soft and days up in sectors are running few and far between.

With the information above, you can use the matrix to gauge relative strength or look for contrarian moves to tip you off to sectors that have been moving too many days in a row in one direction. The example above was an actual trendscore matrix compiled after four heavy selling days in the market. One could glean from the matrix that the sectors near the top such as Coal, Gold, or Tobacco didn't sell off as hard as the rest of the market and may be the first sectors to get some bids when the market turns. Airlines and Oil would

be two examples of contrarian thinking, tipping you off to industry groups that are oversold.

GREATEST GAINER / GREATEST LOSER SECTORS - As discussed above, this is good information to note which sectors have made a move that could be a game changer in the prior day. The green/red bolded sectors have the greatest amount of absolute difference in trendscore from the prior day. This is important to note because very often the greatest gainer or loser is experiencing a breakout or strong reversal which can change the tone of that group for some time going forward.

Various parts of the trend score matrix will be discussed and alluded to in the *Looking Ahead* section of the newsletter as well, and *Bulls and Bears* trades may often reflect things we see developing in the matrix.

HEADS UP:

Your one-stop-shop to know what is happening regarding economic data in the days to come. The Swing Trader lists all important economic data for the next 3 trading days, highlighting items which we feel will have the greatest propensity to move markets in bold.

BULLS AND BEARS:

This is where readers go for long and short trade ideas every day. Bulls and Bears generally lists 2-5 trade setups per day with defined entry and stop, along with a very brief description of what we feel is putting the stock in play. Stocks listed in this section may or may not end up as official ShadowTraderPro plays that are part of the ShadowTraderPro Model Portfolio. If we know that an entry for the Model Portfolio is possibly setting up the next day we will more than likely make every effort to list the stock as a trade in this section but its not required or guaranteed. The section would also include stock ideas that might not fit the price and volume requirements of official ShadowTraderPro Model Portfolio plays.

THE SHADOWTRADER PRO MODEL PORTFOLIO

In addition to plays listed in the Bulls and Bears section, ShadowTraderPro Focus Report includes a daily updated Model Portfolio which traders can easily simulate themselves by entering and exiting positions in sync with ShadowTraderPro's real-time emails. Entries, exits, stops and changes to stops and targets are emailed out constantly to current subscribers. Once a stock is in play either to the long or short side, it is entered here into the Model Portfolio. Any and all changes to the portfolio, be it a closing of a position or adjustment to a stop that happened since the last report came out are updated here.

“TARGETS” IN THE MODEL PORTFOLIO TRADE ALERTS

When a model portfolio trade alert to initiate a trade gets sent out through RedOption it will always include an entry price, a stop price, and a target price. The entry and the stop are self explanatory, however, we seem to get lots of emails on the targets. Firstly, the target does **NOT** in any way shape or form mean that we are exiting the position at that

level. ShadowTraderPro prides itself on being a true, live, dynamic full service trading service which will always send you an alert if we are doing some action. **We are only in if we send an email, and we are only out if we also send an email.**

The price listed as a “target” is nothing more than a guideline for ‘do it yourself’ traders to use. Sometimes we pick an area of obvious resistance or support as this target and sometimes we simply calculate what would be 1.5-2 times the amount of our stop and set the target there. Either way, the market changes daily and rapidly. Once you follow ShadowTraderPro for awhile you will see that we are very often out of trades for a nice profit well before the target and on other occasions the trades sail right through the targets and we are then looking for better exit areas. Again, just to be clear, the targets are nothing more than arbitrary numbers posted in the trade alerts in the interest of giving a more comprehensive trade alert.

ORDER TYPES USED IN THE EMAIL TRADE ALERTS:

There are essentially seven different types of orders that are sent when our portfolio managers are trading stocks in the *Model Portfolio*. These are found in the “Action:” line of your REDOption trade emails as in the sample below:

REDOPTION[®]

Home About Red Option Strategies Classes Resources

May 20, 2009

Company: Dolby Laboratories (DLB)

Action: Setting buy stop

Shares: 225

Price: 39.65

Stop: 37.00

Target: 43.00

Trade Explanation: Setting buy stop to get long DLB over the downtrendline of the minor pullback at stock prominently in the ShadowTraderPro Swing Trader recently. The buy stop area has moved at time has moved the trendline lower. Yesterday's doji is an auspicious sign as it builds pressure in

If DLB trades 39.65 this morning, our buy stop will turn into a market order and we will be long 225

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Please note: All emails are price sensitive. Therefore, all recommendations, unless otherwise noted, are applicable for 'DAY' orders only, not good-till-cancelled. If a

Buy the stock – This means that you should buy the stock asap as soon as you receive the email. In our case we have already bought the stock and are telling you what price we got filled at. As the market is moving, your own entry may be better or worse than ours

depending on how the stock acts. We do make every effort to list plays we like in the *Bulls & Bears* section of the report just to give subscribers a courtesy “heads up” but its not a rule. Be prepared!

Sell the stock – This means you should sell a long position as soon as you receive the email. In our case we have already sold the stock and are telling you what price we got filled at. Like “buy the stock”, you must use your own judgement as to whether to use a limit or market order depending on how the market/stock is currently acting. Generally faster moving stocks that are “thick” with good volume should be entered at market when time is of the essence. ShadowTraderPro only trades stocks in the *Model Portfolio* that are over \$20 and trade at least 500,000 shares daily on average.

Short the stock – This alert means to initiate a short position as soon as receiving the email in the stock. Again, the price listed in the email is the price we received.

Cover short position – This means you should buy to cover a short position as soon as you receive the email. The price listed in the email is the price that we covered at.

Setting buy stop – When you see this alert, it means that we are looking to enter a stock long that is currently below and has not yet traded up to the price listed in the email. In your thinkorswim platform, you should select “stop” as your order type and enter the price that is in the email alert into the price column. A correctly filled out order is below:



This will set a live “buy stop” at the price you selected. In the above example if IBM traded up to \$104.75, then as soon as that price printed the first time, your order would turn into a market order to buy 100 shares of IBM and you would be filled immediately. We use these orders to get us long at “trigger points” that are either over daily or intraday highs or at some other technical pivot that we want to see crossed before we take action. The buy stop order is a nice way to have your platform “do the work for you”.

Setting sell stop – Same exact order as the one above but in reverse. In this case we are setting a “sell stop” order which will turn into a market order to short a stock that is currently trading *above* the price listed in the alert email. So, the stock will then have to trade down to the price you entered whereupon it will execute a short at market.

Moving stop – Every trade alert issued to enter a new position always includes a stop where we will get out of the position automatically if it goes against us. During the course of the trade we often move the stops once the stock starts moving in our favor. Note: on long positions we never move a stop down and on short positions we never move a stop up. Moving stop is always for decreasing risk or to protect profits. When you receive the email alert, you can set a physical stop at the price listed which will be the same type of order as above, the only difference being that it is always set for a price

that is below the current price for longs and above the current price for shorts which is the opposite of “setting a buy stop or setting a sell stop”. One is for getting you out of a current position and the other is for getting you into a new position.

HOW TO STRUCTURE YOUR PORTFOLIO TO HAVE THE SAME RISK REWARD AS THE SHADOWTRADERPRO MODEL PORTFOLIO:

The ShadowTraderPro model portfolio is based on a hypothetical starting balance of \$100,000. Each position taken, either long or short, strives to utilize approximately 10% of unmarginated capital, or \$10,000. Although, the model assumes that standard 2:1 portfolio margining is allowed, our goal is to basically not use margin unless necessary. Total capital committed should usually be somewhere between \$50,000 and \$100,000. So, firstly figure out what percentage of 100,000 dollars your portfolio or total buying power will be and adjust your share size proportionally. If a play calls for 300 shares and you are trading a \$200,000 account, then 600 shares would be your size. For a \$50,000 account, 150 shares would be more appropriate.

RISK:

ShadowTrader firmly believes in a swing trading model that has a defined dollar risk per trade, rather than a fixed percentage of the share price of the stock that is in play. Keeping this risk amount as a constant, allows us to dynamically adjust position size on every trade to allow us to play the big movers with the same risk as stocks that move slower. This means that an entry into a \$100 stock may require a smaller position than a trade on a \$50 stock. Simply dividing 1/10th of the portfolio by the share price is not however prudent because it does not take into consideration how far away your stop may be. More expensive stocks that have bigger beta (volatility as measured against the broad market) often require wider stops than slower moving issues. So, what we do when calculating share size is to use technical analysis to determine a "line in the sand" where we feel that the play will no longer work if price goes to that level. That distance from the entry is then divided into \$500 which represents our maximum risk per trade. This \$500 represents one half of one percent of the starting value of the portfolio, and is the maximum allowed loss per trade. Size is then rounded up or down to the nearest 100 lot at our discretion paying close attention to how much capital is being used up at all times. Although clients are of course free to adjust position size to their own particular comfort levels, we feel strongly that risk per trade should be kept to a minimum.

Let's look at an example to illustrate how this works.

We identify a bull flag pennant in XYZ that is in the middle of a gentle pullback at a moving average support. We decide that an entry should be made long over the downtrendline that defines the pullback at \$42.40. The chart tells us the recent swing lows of the pullback were at \$40.10, and we decided to therefore set a stop at \$39.90. So

knowing that our risk per trade is \$500, we take $\$500 / \2.50 (the difference between entry price of \$42.40 and stop of \$39.90), which equals 200 shares. 200 shares @ \$42.40 per share is a capital commitment (unmargined) of \$8480. The second we know the stock is crossing the pivot at \$42.40 we send an email out immediately with the time and price of entry, where our stop is and a brief description of our reasons for entering the trade.

STOCKS THAT GAP UP OR DOWN THROUGH OR VERY CLOSE TO STOPS:

When stocks gap up or down through or very close to stops, ShadowTraderPro uses what we call the “gap rule” to exit the position. In the same vein as the way that we often use price clearing first 5 minute or first 15 minute bars to determine “real” strength or weakness, we are not exiting positions on mechanical stops at the open because we know from experience that stocks often gap and reverse immediately and we don’t want a GTC stop to be unnecessarily triggered. The rule of thumb is this: If a stock gaps down below the stop that has been established, wait for the first 15 minutes (up to 9:45am EST) to trade before doing anything. Then place a new protective stop just under (adjust this amount for the volatility of the issue) the low of that first 15 minutes of trade. Reverse this entire scenario for shorts.

If a stock opens close to the stop but not below it and trades down through the stop within the first 5 minutes of trade, then we use the “5 minute rule”. Again, we are not out of the position on the original stop, but rather will let the stock trade for a full 5 minutes (until 9:35am EST) before taking any action. Once 9:35 has elapsed, we place our new protective stop just under (adjusting the amount for the volatility of the issue) the low made in that first 5 minutes of trade. Reverse this entire scenario for shorts.

STOCKS THAT GAP UP OR DOWN THROUGH ENTRY TRIGGERS

If a stock is listed in *Bulls & Bears* with a specific trigger point and it gaps up or down either over or under that trigger point, then some amount of discretion needs to be applied. Our basic rule of thumb is that we do not want to chase any stock more than 1% from its entry. This 1% is the absolute furthest point away from the entry that we would accept if it was a play that we had a high level of confidence in. The preference would be a gap well below the 1% limit. So, if XYZ is listed with a trigger point of \$43.40 in the *Bulls & Bears*, we would deem it ok to take the play as long as the opening price was not above \$43.83 (1% of \$43.40 is roughly \$0.43).

Now, here is the tricky part that a lot of traders miss. If you are going to buy above the trigger point then you **MUST** adjust your share size lower to increase for the greater distance to the stop. Regardless of where you enter, the stop is in the same place, because a stop should never be an arbitrary dollar amount, but rather must be some specific technical pivot. So in our previous example, if the stop was at \$41.00 with \$43.40 as the trigger, and our listed size was 200 shares, the new size would be only 175 shares.

Original setup

$\$500 \text{ risk} / (\$43.40 - \$41.00) = 200 \text{ shares}$

New setup, buying stock at \$43.85

$\$500 \text{ risk} / (\$43.85 - \$41.00) = 175 \text{ shares}$

A good technique to use for swing play entries is the 5 minute high. Calculate the difference between a few cents over or under the high/low made between 9:30 and 9:35am EST and the original listed trigger entry. If this difference is less than 1% of the trigger price, then adjust the share size for the new entry point and set your buy and sell stop accordingly.

Be aware that in stock trading there is only so much that can be reduced to simple rules of “if this, then that.” We would be greatly amiss if we tried to convey that this was all there was to it. There is definitely some intuitive feel that a good trader develops after many years of studying and actively trading the markets. While these entry rules can be applied “hard and fast”, always remember that there are always a nearly infinite number of market factors that are coming into play during any given trigger point that will have impact on your decision. Use your head. Keep the big picture in mind at all times. If everything about trading were completely black and white, then it would only be a question of discipline and nothing else.

Good Trading to you all.....

-Peter Reznicek

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