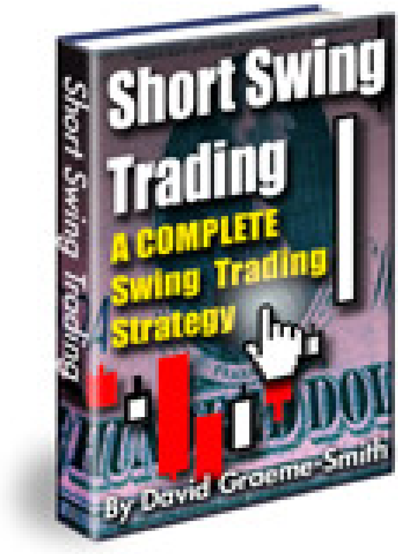
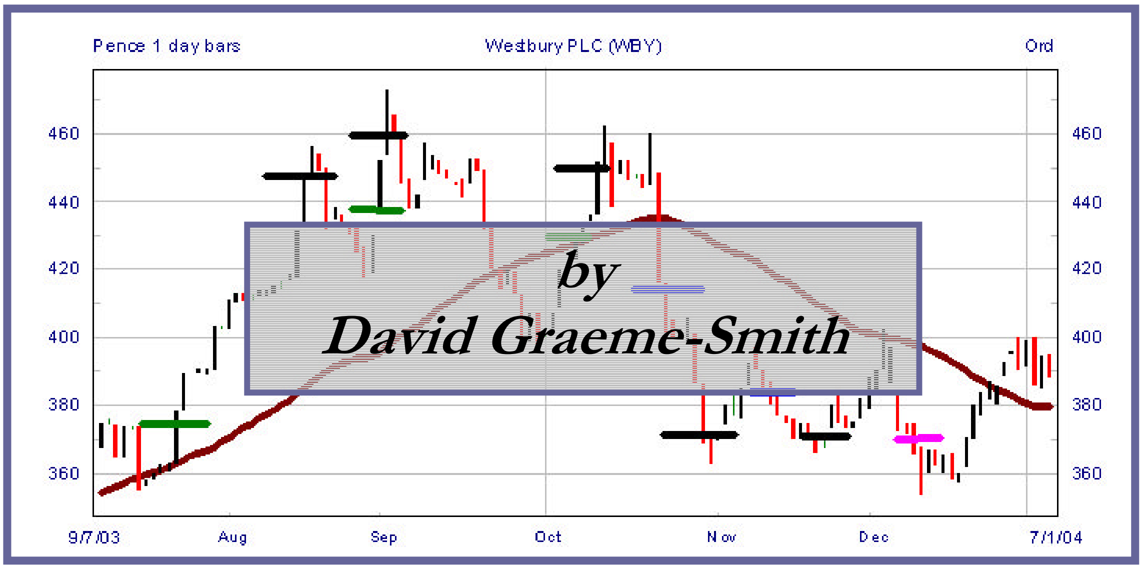
Short Swing Trading



- A <u>complete</u> trading strategy to profit from short swings in a share's price
- Low pre-determined risk at entry
- Just 6 rules that give you entry point, maximum risk level and exit point



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DISCLAIMER

Trading carries a high risk and you should never trade with money you can't afford to lose. The contents of Short Swing Trading are for educational purposes and should not be considered in any way as investment advice. Ultimately you, the trader, must take responsibility for your own trading decisions. Although every effort has been made by the author to ensure accuracy (as at Feb 2004) the content of this book cannot be guaranteed as accurate into the future.

Past performance is no guarantee of future results.

The Author and Short Swing Trading accepts no liability whatsoever for losses or damages resulting either directly or indirectly from the use of the information contained in this book.

1.0 Introduction

This book is designed to take you from the absolute basics, right through to a position where you can trade using the ***"Short Swing Trading Strategy".*** We will go into the strategy later but it is one I trade myself with regular and consistent success. It has taken over three years to develop and can be used whether the markets are going up or down.

First of all let me say that if trading the stock exchange were easy, everyone would be doing it. Of course lots of people try but approximately 90% end up losing enough money to make them quit. However, it **is** possible to make money on a consistent and regular basis provided you have a sound trading strategy and then trade it religiously.

The trouble is that there are endless methods of developing a trading strategy. It can take years and many thousands of pounds of losses before you develop one that works for you. Of course there are periods of time when trading is relatively easy. From January 1995 to January 2000 there was a strong upward trend and you could pretty much buy any sensible stock and wait for it to make money (See Fig 1). But nothing is quite that easy and without a good strategy you would have seen all your profits disappear between January 2000 and January 2003.

Figure 1

It's easy to make money in "the good times" but trading is much more than jumping on a bandwagon and hoping you are right. We are looking for profit on a regular basis, month in and month out, in a variety of market conditions. Of course any investment is about risk and reward but risk must be kept within your comfort zone.

Real Example:

If you had invested £50,000 by buying shares in Celltech Group (a UK pharmaceutical company) in August 1998 and then sold your shares in March 2000 (just two years later) your £50,000 investment would have grown to a fantastic £407,575.
That's reward

However, if you had invested your £50,000 in Celltech Group in March 2000 and sold your shares in April 2003 (three years later) your £50,000 investment would have dropped to just £6,755.
That's risk

Once you develop a robust and complete strategy and master the "business" of trading, the rewards are unequalled. How else can you have unlimited income as well as:

- Decide how much time you spend working and when you work
- Work from anywhere in the world
- Have no competition to worry about
- Not need to employ anyone
- No need to look for customers or sell anything

I have called it work but in truth, it never feels like work to me. When I was employed I used to think about what I would do when I reach retirement age. I would look forward to finishing work but wonder what I would do with all that extra time and whether I could afford to do the travelling I want to do. Now, I know what I will do – carry on trading in between my travelling and love every minute of it.

1.1 The Purpose of This Book

The purpose of this book is to shortcut the painful time and expense for you by giving you a simple but effective strategy to use. The book is more like a manual that details everything you need to know to trade the ***Short Swing Trading (SST) Strategy.***

I have paid the price and "done the time" and have developed a strategy that works on a regular basis month in and month out whether the market is going up or down. All you have to do is trade it – religiously!

Of course there is much more to trading than this book contains but what I have tried to do is give you all you need to be able to trade a successful strategy. You will not know everything there is to know about trading, that would be an impossible task and in any case, it is not necessary. One of the greatest things about trading is that you never stop learning, but you need a base to start from.

This book WILL give you a head start. It will give you a simple but detailed and complete strategy which will allow you to trade profitably right from the first month. I have read dozens of books and looked at dozens of other trading strategies but not one that I have seen will give you the complete and clear rules for entry, exit and risk management that the ***Short Swing Trading (SST) Strategy*** gives you.

This is a complete strategy containing just **six rules** for you to follow.

> This is a comprehensive manual that will take you from the basics to everything you need to know in order to successfully trade the six rules of the ***Short Swing Trading Strategy***.

But it doesn't end there. The manual also tells you how to select the right shares to trade – the shares that complement the strategy.

1.2 Is it Geared to the UK Market?

I trade the UK market and therefore the examples I use are from the trades I have made. I am also able to explain things better if I use the UK market as a model.

However, the strategy can be applied to any market provided you fully understand and apply the six rules. The other VITAL ingredient is that you trade the right type of stock (shares). We will return to this later.

I realise that in some countries like USA stocks can be far more expensive than in the UK, so sometimes you will see me talk about shares with a value of say, £3.00 and a typical share in the market you trade might be say, $33.00. The trading principles however are the same and the strategy you will learn will easily translate to other currencies and markets.

Because of the higher price of US shares, your initial risk for a trade will be higher than that described in the book. However, given the price of the share it is still a low risk strategy and your potential reward will be much higher because of the amount of daily movement you get with a more expensive stock.

I refer to the FTSE 100 index on occasions. Using an Index is not a part of the strategy. I dare say that the major Index in any country would look pretty similar if you take a two-year view. All indices tend to follow the US (Dow Jones Industrial Average) to a large extent.

1.3 Why am I Telling You About My Strategy?

You must be wondering why I have written this book about my strategy if I am making so much money simply by trading it myself. The answer is simple.

- Firstly, unlike any other business, you will not be setting up in competition with me. It doesn't matter how many people trade my strategy, it will not affect the market – you only have to look at the scale of shares bought and sold each day to see that.

- I know how tough it is to get started and get to the point of trading successfully and I just wish that I had been able to buy a book that could have saved me that financial and emotional pain.

- Trading is fantastic fun and can be extremely rewarding financially as well as emotionally. It is nice to think I can help others achieve that.

- Most importantly, before I started trading I was a professional trainer and training manager for many years. I have a passion for educating, coaching and developing others. I really enjoy writing manuals and books like this and training others who can go on to achieve even greater success.

I do this because I enjoy it as much as trading itself!

So, let's start at the beginning - with the basics. If you are new to trading it is vitally important that you read this book (and re-read if necessary) and understand each chapter in the order it is presented and DO NOT skip ahead.

If you are a very experienced trader you can "speed read" some of the earlier chapters but please be careful. I recommend that you do not skip chapters completely in case you miss some important information.

2.0 The Basics

Figure 2

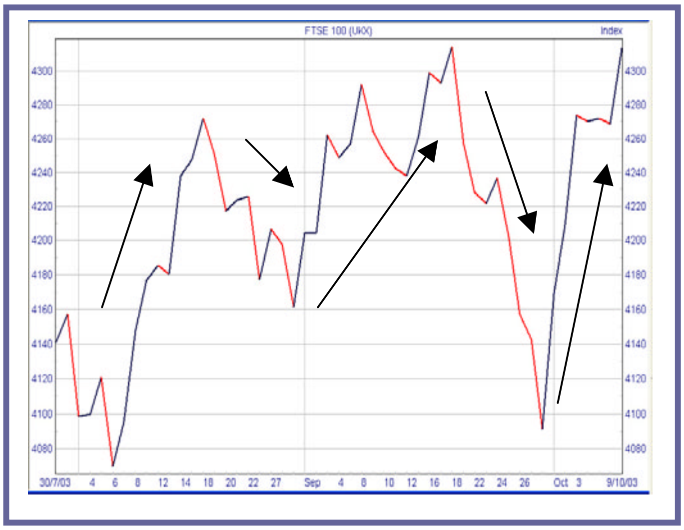


Figure 2 shows the FTSE 100 Index over August, September and October 2003. As you can see, prices go up, then down, then up again, then down again. All you have to do is buy when the price is low and sell when the price is high! Easy **!!!!????**

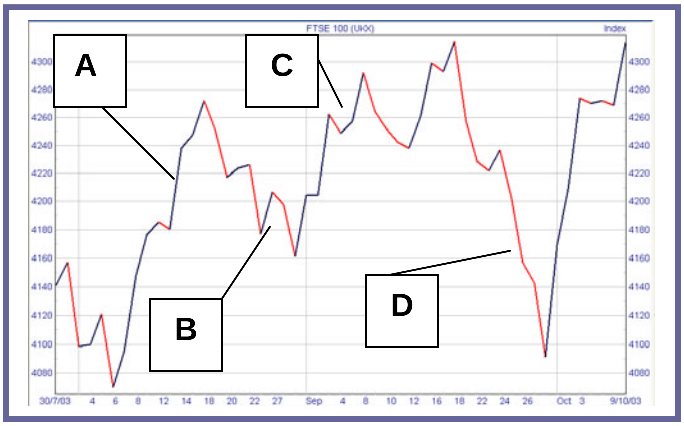
However, most people do completely the opposite!

WHY? Because trading goes against our natural instincts. What usually happens is that you see the price going up strongly so you buy at **A** in Figure 3 because when the price continues to shoot up, you want some of the action. There is nothing worse than seeing the price rocket up while you are sitting on the sidelines. Then, soon after you buy, the price starts to drop. You are sure it is going to be a small drop and the price will then bounce and resume the strong push up to new and greater highs.

Unfortunately, the price continues down and your losses mount. You start to feel uncomfortable with the loss and you are mad that you have been caught out while everyone else must be making loads of money. You are still sure you are right so you hang on a while longer. The price carries on dropping and you decide that if it drops any more you will **have** to get out. It does and you sell at **B** for a loss that is much larger than you would have wanted but you fear it is going to continue to go lower.

Figure 3

What most people do!



Then, soon after you sell, you see the price move up strongly again and you wish you had hung on but you are left licking your wounds. You are now even more angry because you have missed out on the rise that would have made you profit.

You want to get your money back! So, you re-enter at **C** – just as the price starts to fall again. You sell at **D** and give it up as a mugs game.

If this rings any bells with you then take some comfort in the fact that you are amongst the **majority**. The market is a very poor trainer. This is exactly what most people do because they have no real strategy, no rules to work to and their trading is ruled by the two destructive emotions:

GREED and FEAR

Every trader fights these two emotions on a daily basis but do not despair, they can be beaten. The way to beat them is simply by taking the emotion out of your trades. We will return to look at this in more detail later but fundamentally this is done by having a set of rules that tell you exactly what to do and when to do it. A good set of rules (a trading strategy) should be like painting by numbers where you do not have to make judgements and emotional decisions, the rules tell you exactly what to do and when to do it.

A good trading strategy should be like ….

painting by numbers

What a good strategy should contain:

- **When to enter a trade**
- **How much to risk**
- **When to exit the trade**

That's all there is to it!

Well not quite. Certainly the ***SST Strategy***, which is described in detail in this book, contains EXACTLY where to enter, how much to risk on each trade and when to exit but the reason WHY the strategy works is important. If you don't become familiar with the reasoning behind it, you won't have faith and confidence in it and if you don't have confidence in it your emotions will make you override it and that's when you get back to greed and fear based decisions – the recipe for disaster.

So, although the ***SST Strategy*** is a very simple one (most good things are) in order for you to understand what you are doing and have confidence in it you will need to understand some of the basics. I apologise if you already know some of this but please do not skip over parts of the book unless you are sure you know it.

Please read the material in this book in the order shown and resist the temptation to skip on to later chapters.

Let's start by looking at what stocks and shares are.

2.1 Stocks & Shares

Essentially stocks and shares are the same thing. In fact, in the USA company shares are more often referred to as stocks whereas in the UK we tend to use the term shares. The Stock Exchange is the place where you can buy or sell stock (company shares). Just to make life more interesting shares are also sometimes referred to as "securities" or "equities".

The best way to explain the concept of shares is to look at how it all started. Many years ago, London merchants would take a ship to a foreign country to buy goods such as coffee, tea, metals, in fact anything that they could sell back in the UK for profit. The goods were known as the stock much in the same way as a shop has stock.

It became too expensive to do this for one merchant so he would form a Company of people to fund the venture. Each person would own a share in the company and therefore a share in the stock based on how much money they put into the venture (their investment). They would benefit by receiving their proportion of profit once the goods or stock was sold. Their profit was based on their share of the company. Naturally there was risk because if the ship were lost at sea they would lose all of their investment.

This system of shareholding became more popular and more sophisticated. Let’s take the example that a new company might choose to sell one hundred shares for £1 each. This would mean that you could invest one pound, receive one share and get one percent of the profits. Or if you were particularly rich you could invest £20 to buy 20 shares and receive 20% of the profits. The value of the company would be 100 shares x £1 = £100.

Then came an important development. Some people who had bought shares in a company found that the time taken for the ship to return was too long and they wanted their money back. So merchants started to buy and sell these shares in the coffee houses in London. Of course if news came back that a ship had a good cargo and the shareholder only had a short time to wait before the stock could be sold, then those company shares would be sought after and they would fetch a higher price. Companies then started to run several ships, so instead of breaking up the company after each venture, it would stay intact. If they needed to raise more money they would issue more shares for people to buy.

The idea of buying shares and selling them again at a profit became so popular that one of the coffee houses in London became the centre for trading and became known as the Stock Exchange.

One further fact was important. As time went on, a successful company would see the value of its shares steadily increase. Some people would buy a company’s shares at a premium just before a ship docked and hold the shares until the stock was sold.

That way you would receive a percentage of the profit on that cargo. Other people would buy the shares as the next journey began because the shares would be cheaper but the risk would be higher. Share prices would therefore go up and down as the ships returned and departed.

The share price is governed by only one thing – how much somebody else will pay for it on the day you wish to sell. For every person who has a reason to sell a share, another person has a reason to buy. Every share in every company must be owned by somebody.

Things are very similar today. If a company is quoted on the Stock Exchange it means that anybody can bid to buy shares in that company. The company is owned by the shareholders who will benefit when the company makes a profit. A percentage of the profits each year might be reinvested in the company and a percentage given to the shareholders. This is called a dividend (an income from your shares). Dividends are generally paid twice per year. If the dividends are good, that is one reason why the shares become more sought after which pushes the price up. Obviously there are many reasons why share prices can go up and down remembering that it is only worth what someone else will pay for it.

The FTSE 100 Index reflects the change in share price of the largest 100 companies in the UK. The companies in the FTSE 100 are known as “Blue Chip” companies. The FTSE 250 Index reflects the change in share prices of the next (smaller) 250 companies. There are many other indices in the UK covering, for example, the various sectors such as Building & Construction, pharmaceuticals, mining and so on.

There are other indices that reflect share price movements in other countries. For example, the Dow Jones Industrial Average comprises the largest 30 companies in the USA and the S&P (Standard & Poors) 500 reflects the price movement of the top 500 companies in the USA.

Just take a moment to think of things that could affect the share price of a company to make it go up. The opposite will cause it to go down.

Things which might cause the share price to go up (Print out to complete)

Billions of pounds change hands in the London Stock Exchange alone **every day**. The figures are truly staggering. It is easy to think that "people are not buying shares at the moment because they are going through a bad patch". This is simply not true. Volumes may drop but the daily turnover is still massive. Some investors are private investors – ordinary people who wish to invest in individual companies, and some are fund managers investing hundreds of thousands of pounds on behalf of others who invest indirectly in the stock market.

Fund Managers manage "pooled" investments such as pension funds, life assurance funds and unit trusts. This means that millions of people may not hold shares personally but are indirect investors in the stock market.

As an example of the amount of money that changes hands every day on the London Stock Exchange, on the 2nd February 2004, a typical day, the following volumes were recorded for FTSE 100 companies:

Company (Share)	Number of shares that changed hands on the day	Total value of shares bought & sold on the day
Tesco	*31 million*	*£74 million*
BP	*76 million*	*£324 million*
Lloyds TSB	*133 million*	*£608 million*
Vodafone	*445 million*	*£600 million*

The following volumes were typical of FTSE 250 companies:

Company (Share)	Number of shares that changed hands on the day	Total value of shares bought & sold on the day
Rank Group	*11 million*	*£34.7 million*
Woolworths	*9 million*	*£3.65 million*
W H Smith	*1 million*	*£2.7 million*
Bovis Homes	*250,000*	*£1.1 million*
RAC	*212,000*	*£1.4 million*

Once again I will say that this represents a typical day, not an outstanding one. Yet look at Vodafone and Lloyds TSB, over 1.2 billion pounds of shares changed hands between those two companies alone in one day. The same happens in other stock exchanges all over the world.

2.2 Price Movement

So why does the price go up, then down, then up again? Surely if the company is making good profits month after month, the price should just continue to go up. Almost everything we buy goes up steadily, not up and down then up again.

What makes the price go up? The list below is not exhaustive but see if you included some of these in the earlier exercise.

- Announcement of good profits
- Good order book (orders won)
- Another company in the same sector producing good results
- Increase in dividends
- Decrease in bank interest rates

- Strong economy
- Favourable currency exchange rates
- A Director buying shares in their own company (called "Director dealing")
- Price penetrating a price resistance (for example the price will often stall when it reaches a round number such as £5 in the same way as goods for sale in a shop)
- After a long period of the price dropping people will begin to feel the price is now cheap and begin to buy again
- Sentiment – if most people are of the mind that the market generally will increase
- News – can take many forms from the announcement of a change in oil (fuel) prices to the threat of war or civil unrest. You would be surprised how some announcements can immediately affect prices. Sometimes it is only for a matter of seconds; sometimes it can trigger a more major price reversal.

The causes of prices going down are generally the opposite of those above.

The fundamental thing we must remember is that almost every company quoted on the Stock Exchange is traded on a daily basis. In other words some people are buying the shares, which means that others are selling the same shares. Every share must be owned by someone. The Stock Exchange works on a principle of willing buyers and willing sellers striking a deal for every transaction.

> For every person who buys thinking the price will go up, another person sells thinking the price will go down.

Why would somebody be buying if the price is falling like a stone and you are desperate to get out? The answer is because we are all different and people have different strategies, time frames and reasons to buy or sell. Let's take an example:

You bought Tesco, the high street supermarket shares a week ago and although they went up initially they have now started to fall pretty fast. You normally look for the price to increase within a few weeks then sell to take your profit and you certainly do not want to see your shares continue to fall over the next week or two and turn a profit into a loss, so you decide to sell before they fall further. At the same time, a large pension fund has received another £1m of new cash contributions from its members and wishes to invest more in the retail sector. The fund manager has decided to spread the money between the high street food retailers because he or she believes that they will provide steady growth over the next 5 to 10 years. They are not concerned about what happens over the next few weeks. So your reason to sell coincides with a pension fund manager's reason to buy.

You see there are all sorts of investors (longer term) and traders (shorter term) with different time frames and objectives. Day traders will look for just a few pence (or cents) gain and a trade might only last a few minutes. Large insurance and pension funds might be looking to invest in a company over several years.

Our time frame will typically be anything from a day to a few weeks. My average trade is around eight working days.

2.3 Fundamental v Technical Analysis

There are different ways of analysing a share's performance and trying to predict what it will do into the future. There are two methods of analysis, fundamental and technical, plus of course, a combination of the two.

FUNDAMENTAL ANALYSIS

Fundamental analysis involves looking at the fundamentals of the company. Profits, price/earnings ratios, dividends, order book, quality of management and so on. Generally these things will have a significant influence on the share price over a longer period of time than we are concerned with. The ***SST Strategy*** does not consider any fundamental analysis for the reasons explained below.

TECHNICAL ANALYSIS

Technical analysis is the "art" of analysing charts of the share price movement. The ***SST Strategy*** relies entirely on that price movement shown in charts. With the advent of pc's and laptop computers together with very clever but inexpensive software, technical analysis has been made easier and is now available to everyone.

But why do we rely purely on technical analysis? It is because of the fundamental belief that whatever affects the price will be shown in the price movement represented in the chart. Price is everything!

To illustrate exactly what that means, let's consider one example. The market (traders and investors) will always try to estimate what profits are likely to be for a company before they are announced. Therefore, if the market predicts that good profits will be announced, the price will increase to reflect that level of profits **before** the profits are actually announced. So that level of profits will already be built into the price long before you and I have any idea what the profits will be.

The same can be said for almost everything that will affect the price. Share prices are similar to house prices or auction prices. The house or item is only worth what someone is prepared to pay for it no matter how much **you** believe it should be worth. There is no point in saying that the price SHOULD go up if it is clearly dropping.

IMPORTANT:

A share is only worth what someone will pay for it right now. The price right now is always correct, even though it may change soon.

You need to learn to accept this otherwise you will end up fighting the market and believing it is unfair.

How the price has behaved in the past gives us a good idea of how it will behave in the future. History has a habit of repeating itself. If the price has stalled at £5 three times before, the odds are that it will do it again.

Technical analysis is all about increasing the odds of being right when predicting the future. If you have ever been to a casino you will know that they work on having the odds stacked in their favour by only a few percent to make considerable profit. The professional gambler aims to develop a system to swing the odds in his or her favour by only a few percent.

I do not regard trading as gambling although I can appreciate the view of those who do. There are similarities. To me, trading is exactly like running a small business and I suppose that starting any small business is a gamble. I will expand on that point later. The point is that our aim is to use technical analysis to improve our chances of being right when we predict which way the price of a share will move.

Technical analysis can be extremely complex, some very clever people make a lucrative career of it and advise fund managers and investors on short and long term price movements. Don't get concerned over the level of knowledge you will need. The ***SST Strategy*** relies on some pretty simple technical analysis that I will teach you in this book.

This book will only go into the level of technical analysis you will need for the ***Short Swing Trading Strategy.***

Earlier we looked at a number of things that can affect a share's price. You may like to refer back to that list to refresh your memory.

3.0 Why is it called the Short Swing Trading (SST) Strategy?

Let's consider the price movements that give us a good opportunity to trade. These are the movements that are the easiest to predict and give us the best chance of success together with the smallest risk.

Trading is very much about risk and reward. This ratio is vital for trading success. There is always the risk that the trade will not move in the direction we are expecting. Things will sometimes contrive to trip us up; we will never get every trade right. We will look at this in detail later but it stands to reason that if we can keep the risk and therefore the potential loss to a minimum, we do not have to look for very large gains in order to cancel out losses as well as make a profit.

The ***SST Strategy*** uses very tight risk management and therefore allows us to look for smaller, more reliable and profitable price movements.

If risk and therefore potential losses are kept low it also becomes far more comfortable to trade. Would you risk £10 to make £50 – probably yes, after all for most people, losing £10 would not present a major problem and making £50 would be useful. Would you risk £10,000 in order to make £50,000 – well I'm sure you would like the £50,000 but not many people can afford to lose £10,000. How about risking £1,000 to make £5,000? How would you feel if you were £800 down on the trade and saw no sign of the price turning? Would you feel worried, angry and fear losing the £1,000? My guess is that you would, particularly if you had no confidence in your strategy.

We are looking for short term price movements or swings in the price. The example below is Westbury PLC, a building company share I trade quite often, and shows some of the trades I made.

Figure 4

Green arrow – underlying trend is up
Black arrows – actual short swing trades taken

Take a good look at the price movement above for Westbury. The first thing you will notice is that prices don't move in a straight line for long. There is a spurt up then a retracement, a spurt up and another retracement. Although the underlying trend is up (green arrow) the price line can fluctuate up and down and each time it comes down there is no guarantee that it will not continue down to eventually reduce your profit or even go into loss.

3.1 Buying & Selling Pressure

Why does the price behave this way? Firstly, the underlying trend is up so the market generally is looking for the price to increase. However, once the price has moved up by a reasonable amount, many traders will feel that another retracement is likely so they will begin selling to take their profit. At the same time the number of buyers is likely to decrease because the price is now higher.

Once the price begins to fall, more traders will decide it's time to take profits and the selling will increase. This will happen until the buyers feel that it is worth the price again. Buying pressure will then increase and selling pressure will decrease.

The law of supply and demand then forces the price up again. This happens on a continual basis for all shares.

> BUYING PRESSURE and SELLING PRESSURE generate share price movements. If the number of buyers increases and/OR the number of sellers decreases, the price will move up due to the law of supply and demand.
>
> If buyers decrease and/or sellers increase, selling pressure will outweigh buying pressure, which will drive the price down.

The ***SST Strategy*** capitalises on the up swings represented by the black arrows in Figure 4 and gives an exit before the price retraces too much. So the risk at entry is kept to a minimum but equally we can lock in profits very early before they are eroded away by a large price retracement.

As you can see from the chart in Figure 4, down swings were not traded and not every upswing was traded. Which ones you trade and which ones you leave is all part of the strategy that we will cover later in the manual.

4.0 Basic Chart Knowledge

Price movement can be represented on a chart in three ways:

- Line chart
- Bar chart
- Candlestick chart

Let's look at each in turn.

4.1 Line Chart

Figure 5

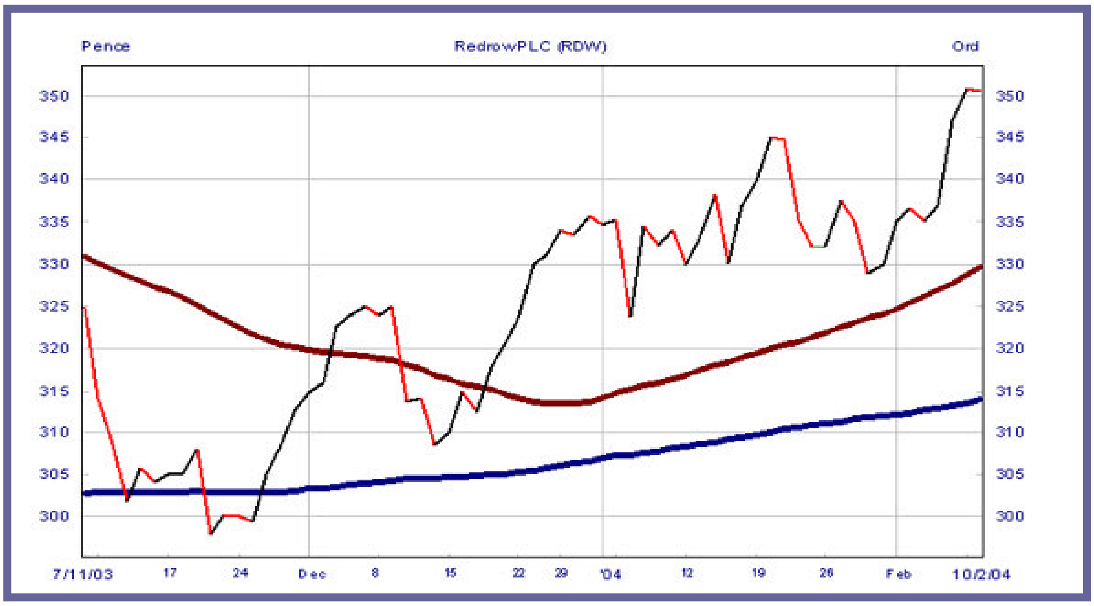


Figure 5 shows a line chart for Redrow PLC over a three-month period. The line plots the closing price for each day with the up days shown in black and down days in red. The months are shown along the bottom and the price in pence up the side. The brown line and the blue line are moving averages of the price, which we will cover in a moment.

4.2 Bar Chart

A bar chart tells us more about the daily price movement than a line chart. The chart in Figure 6 has each day represented by a vertical bar. Up days have a black bar and down days a red bar.

Figure 6

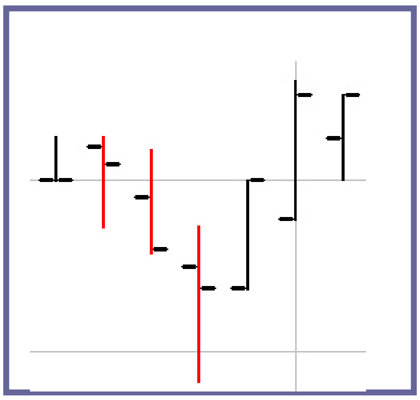


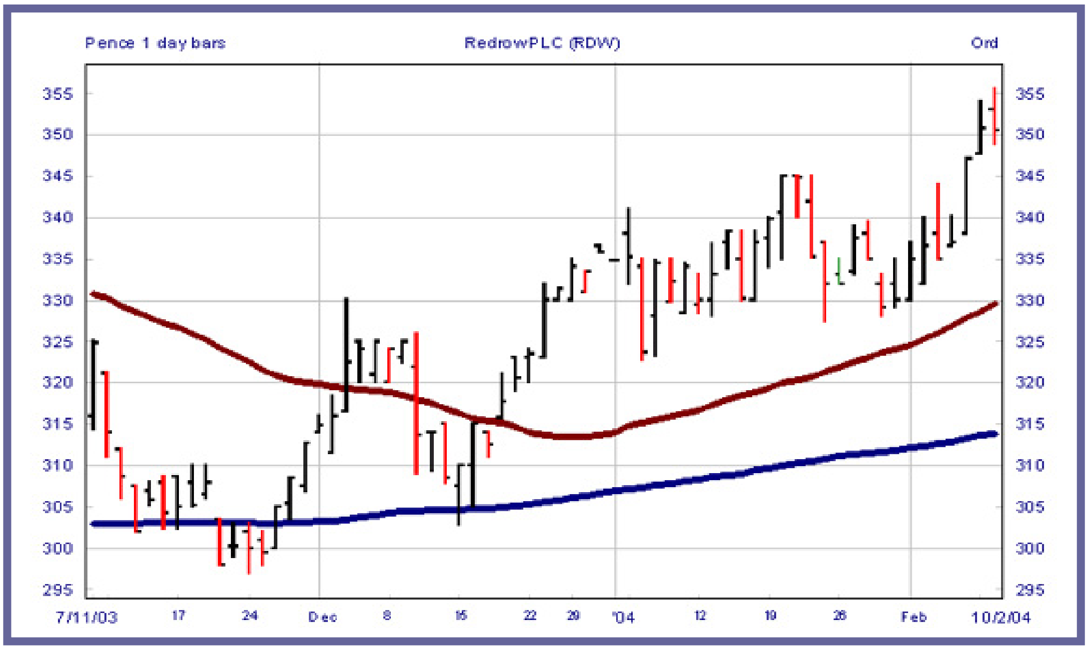
Figure 6 shows seven bars or days. Each bar has a dot or line on the left, which represents the opening price for the day. The dot or line to the right of the bar shows the closing price for the day. The top of the bar is the highest price during the day and the bottom represents the lowest price for the day.

Bars therefore tell us how the price moved during that day. On day one (left hand side) in Figure 6 we can see that during the day the price went above the open then dropped back again during the day. Finally the price came back to close at the opening price.

On day five of the seven days shown, the price opened at the same level as the previous day close, it then rose through the day and closed at the highest price of the day.

Take a few minutes to understand what happened over the other 5 days.

Figure 7



As you can see, bar charts give us much more information than line charts. Figure 7 shows Redrow PLC over the same period as the line chart in Figure 5 but the bars give much more detail of daily price movements.

4.3 Candletsick Chart

More accurately, it is called the Japanese Candlestick chart, as this method of showing daily price movements started in Japan.

Figure 8

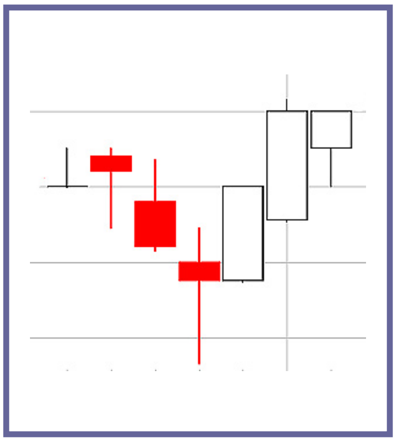


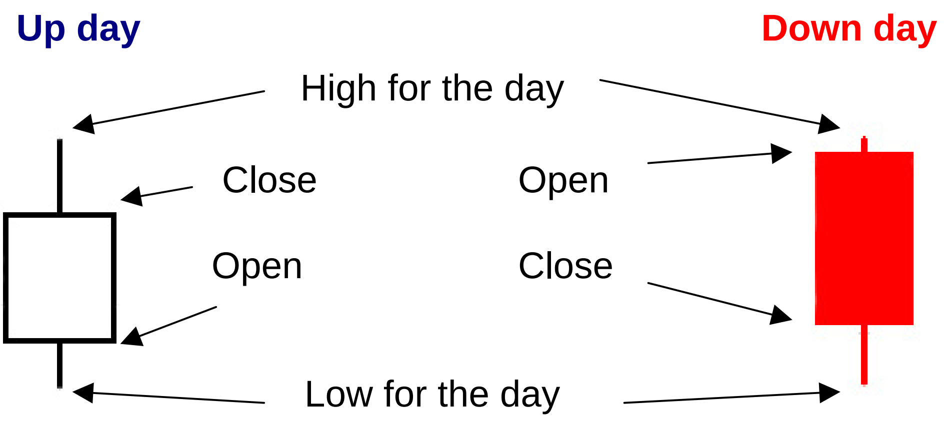
Figure 8 shows the same seven days that are in Figure 6 (bar chart) but this time each day is represented by a candle. As before, up days are black (outline) and down days are red (solid) but the way that the open, high, low and close are shown for each day is different. A day where the price closes at the same level as the previous day is sometimes shown in another colour, such as green.

Candlesticks are excellent once you get used to them because they provide a very visual representation of the price movements.

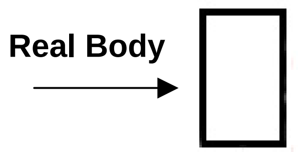
The study of Japanese candlesticks is an art in itself and if you are interested in learning more about them you can buy books dedicated to explaining this skill in detail. For the purposes of learning the ***SST Strategy***, you only need to be able to identify the open, close, high and low for the day.

You first need to know if you are looking at an up day or a down day. This is pretty simple because of the colour. The solid portion is called the real body and the lines at top and/or bottom are called shadows. Take a look at Figure 9 below and you will see how easy it is to identify the open, close, high and low.

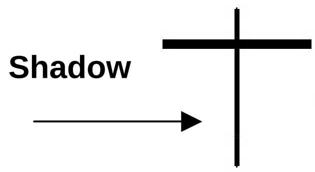
Figure 9



The real body for down days is usually shown as solid colour and the up days as an outline.



There is no shadow at the top or bottom of this up day, which means that the open was at the day's low and the close was at the day's high.

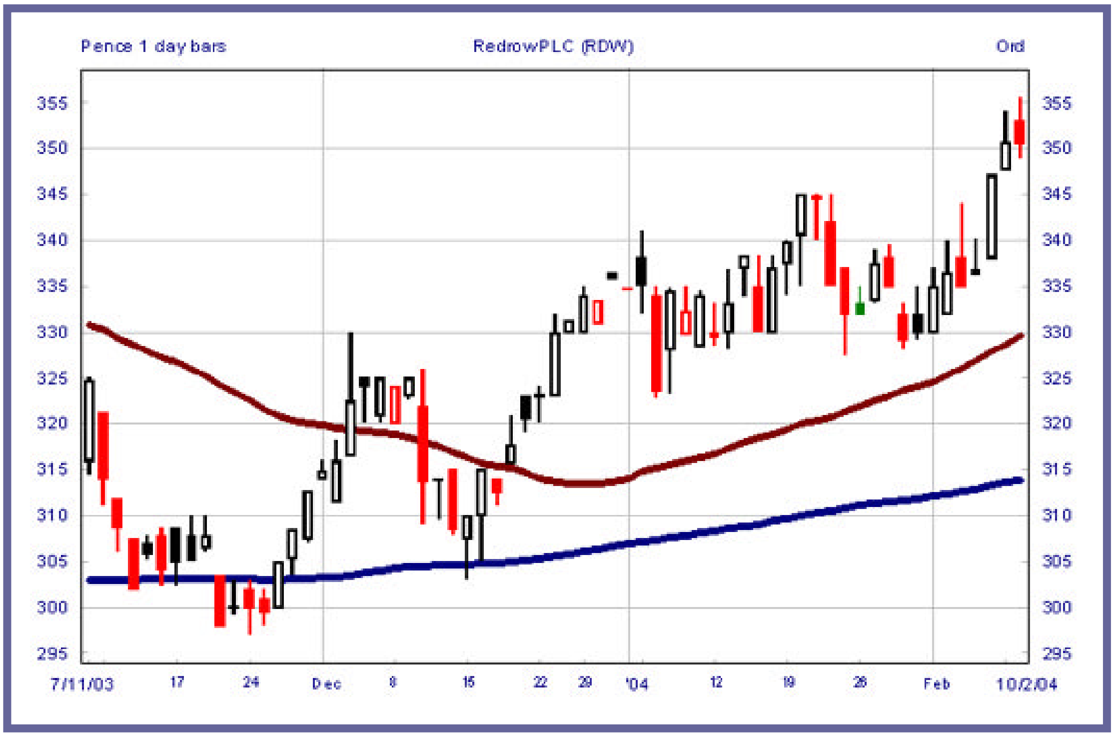


If there is no real body, that means that the open and close were at the same price even though on an intra-day basis (during the day) the price went up and down.

Figure 10 shows a candle chart of Redrow PLC over the same period as the line chart and bar chart we looked at earlier. I recommend you take some time to familiarise yourself with candlestick charts. I use them almost exclusively for the ***SST Strategy*** although, essentially, you only need to identify the open, high, low and close for each day.

Modern trading software allows you to switch between line, bar and candle charts at the click of your mouse.

Figure 10



4.4 Moving Averages

Using charting software, you can add moving averages of the price and select what period of moving averages you use. The charts in Figures 5, 7 and 10 show two moving averages. The 50 day moving average is in brown and the 200 day moving average is in blue. A moving average shows the effect of smoothing out the price movements.

For example, the 50 day moving average plots the average closing price over 50 days on a rolling basis. As each new day completes, that day is included in the calculation and the earliest day (51st) is excluded.

As you can see from Figures 5, 7 and 10, the price is jumping around quite a bit while the 50 ma (50 day moving average) sweeps up then down then up again in a much smoother fashion. The 200 ma is pretty much going steadily up all the time.

In terms of the ***SST Strategy***, the 50 ma is the one we are most interested in as it indicates the medium term trend of the share price. How to use it we will cover later.

4.5 Why Technical Analysis Works

Technical Analysis is often called “Charting” and the people who use this method of analysis are called “Chartists”. Charting has been around for many years. For much of this time it was done by painstakingly drawing charts on paper but the whole process has now been made infinitely quicker and easier with the advent of computers and clever software charting packages.

The charting software allows you to switch between line chart, bar chart and candlestick at the click of a mouse but also gives you a massive variety of other tools to help your analysis. The ***SST Strategy*** keeps things simple by telling you which ones to use.

Before we look at why charting works it must be made absolutely clear that:

Charting is NOT an exact science.

There is no perfect strategy. You will always be proved wrong some of the time and it is vitally important that you accept this fact.

YOU WILL HAVE LOSING TRADES!

You cannot be right 100% of the time BUT you don’t need to be – you just need to have the odds in your favour.

Charting is the “art” of increasing the odds of being right and a good strategy comes out of looking for price patterns that tend to repeat in order to improve your chances of being right more often.

Charting will increase the odds of being right, but why does it work?

Let's look at an example of it working in practice. Notice in Figures 5, 7 and 10 that the price has a tendency to bounce off the moving averages from time to time. The reason for this is really quite simple and is fundamental to charting.

The vast majority of investors and traders who are successful (and even many who are not) use the same charts with the same moving averages. Most believe that these significant moving averages will provide resistance to a rising price and support to a falling price. Therefore they tend to buy as the price bounces from above and sell as the price rebounds off the bottom.

So guess what, most of the time - IT DOES! It becomes a self-fulfilling prophecy. Lots of people are playing by the same rules.

However, I'm afraid that trading is not quite as simple as looking at a moving average. Most chartists are using a combination of indicators and even if most people think the price will bounce off the 50 ma, not all will. So on its own it is not reliable enough.

A good strategy uses a simple combination of indicators that have been proven to be reliable most of the time and under different market conditions. That's exactly what the ***SST Strategy*** does for you.

Important:

This book does not intend to teach you about the massive subject of technical analysis (or charting). We will only concentrate on the aspects that are relevant to the Short Swing Trading Strategy.

I have spent three years researching charting methods and different combinations of indicators and I believe that there is a real danger of you being side tracked into using patterns or indicators that do not work or only work in certain market conditions if we were to go into them at this stage in your trading.
I have therefore taken the decision that this book will teach you my basic strategy and nothing else.

In time, and with some profitable experience, we can develop that basic strategy further. There is always the opportunity to refine and improve a strategy once you understand it and have tested it. You also need to gain experience to understand yourself as a trader to ensure that changes in strategy compliment your trading personality.

5.0 Understanding Your Trading Personality

You may think this is an odd subject to cover but it is vitally important and is another fundamental ingredient to making the ***SST Strategy*** so powerful. Let me explain.

We all have different personalities, some people are very extrovert while others are shy and retiring. Some people thrive on taking risks, others want guarantees on everything before they make a decision and even if they do take a risk, they want to sue someone if it goes wrong.

My guess is that if you have got as far as reading this book you are prepared to take some risk at least. The trouble is, unless you have some experience of trading, you will not know where your risk threshold is. Do not worry; the ***SST Strategy*** automatically accommodates any level of risk profile because the monetary risk is determined by you before you choose to enter any individual trade.

Try the following test. This is not scientific; it's mainly for fun. Score yourself on a scale of **0 if you strongly disagree to 10 if you strongly agree.** *(If you wish to write your score in the space provided, you will have to print the page.)*

Statement	Your score
I believe you have to take risks in life or you will look back with regret	
Fixed interest investments don’t even keep pace with inflation	
If you don’t have an overdraft you lack imagination	
I drive fast even when I am not in a hurry	
I regard a loophole in the rules as a window of opportunity	
I like the adrenaline rush of risky and extreme sports	
I always add on a few extra items to an insurance claim	
I would sell a car for more than it’s worth if I could get away with it	
I always try to knock the price down on things I buy	
I always respond to chain letters promising to make me a fortune within the next few weeks	
I am always so rushed for time that I have to eat or do my make up while I’m driving	
I regularly try to anticipate when the lights will change at a junction to beat the other cars away	
If my credit cards mount up, it doesn’t worry me as long as I can make the minimum payments	
I always say what I think and don’t care if it upsets people	
If I can find a way of doing something quicker I will	
YOUR TOTAL	

Total your score and check your risk rating on the following page.

Score	Your risk profile
0 to 40	See if you can sell this book to a friend but make sure you don't overcharge them. Better still, just put it away, make a cup of hot chocolate and get an early night! Try to start life tomorrow.
41 to 80	It's ok, you are pretty normal but be worried about any individual score where you have 11 or more.
81 to 100	Get therapy immediately! Do not use sharp implements and cut down on caffeine. Try to sell this manual to your grandmother at double the price and think about a career as a bank robber.

That was just a bit of fun but the statements are based around three basic but important personality traits:

- Worry
- Patience
- Risk taking

Let's look at these in more detail.

The amount you worry about things will determine how you will react if a trade begins to go against you. If you are a worrier you could also have real doubts about the strategy if you get three or four consecutive trades that don't work out – you will not have the confidence to continue and let the law of averages work over a longer period. You could also be tempted to take a profit and run in case the trade turned against you instead of sticking to the strategy that could make an even larger profit.

> There will often be times when trading feels uncomfortable – it usually means you are doing it right!

You need patience at times. You could enter a trade where nothing happens for a few days or the share goes in your direction for a while then goes against you a little bit each day for the next few days. You need the patience to continue with the strategy and not jump in and override it.

Risk and reward are inextricably linked. It is absolutely true that the more risk you take, the more POTENTIAL reward you might get - BUT:

- Only if the risk is one you can feel comfortable in taking or you will override the strategy.

- There is no point in wiping yourself out with two or three trades that don't work out.

I have already said that the ***SST Strategy*** takes care of risk for you. However, I will dwell on the subject for a while because:

The more risk you take, the more worried you are likely to be and therefore the more you are tempted to make an emotional decision rather than stick to the strategy.

Trading decisions based on emotion rather than a set of rules (the strategy) will ALWAYS get you into trouble in the end. Sometimes you will be lucky and your hunch will be right. Unfortunately, that will lead you to make even more emotional decisions and at that point you might as well forget any strategy completely and trade on instinct.

TRADING EMOTIONALLY IS A RECIPE FOR DISASTER!

There is a good saying for traders, which is, "Cut your losses quickly and let your profits run." However, this oversimplifies a complex problem and the answer actually lies in using a sound strategy AND sticking rigidly to it. Being able to stick to the strategy is where your personality comes in.

It is also said that traders who let losses run hoping they will turn round will go bust very quickly whereas traders who take profits early will go bust slowly but BOTH will go bust.

<table>
<tr>
<td>UNDERSTANDING RISK IS ABSOLUTELY FUNDAMENTAL TO SUCESSFUL TRADING</td>
<td>The first rule in trading must always be to preserve capital – without it you cannot trade at all. My guide is:

Never to risk more than 5% of your capital on any one trade (MAXIMUM).</td>
</tr>
</table>

The ***SST Strategy*** is designed to help you manage risk to suit your own personality. It will allow you to determine the maximum risk you are prepared to take when you open the trade and it will allow your profitable trades to run without watching a large profit turn into a loss. You will see how this is done when we get into the strategy detail.

YOU MUST LET THE STRATEGY WORK FOR YOU ……………WITHOUT OVERRIDING IT!

KEY POINTS SO FAR:

- **The traders worst enemies are GREED and FEAR**
- **Different people have different trading objectives, timescales and reasons for buying and selling**
- **Prices move due to the balance between buying and selling pressure**
- **Charting (technical analysis) is not an exact science but does improve the odds of getting it right**
- **You must only risk an amount of money that you can comfortably afford to lose**
- **TRADE THE STRATEGY; don't let emotional decisions override it**

6.0 Your Trading Business Plan

Whether it is your intention to trade a few times a year or every day you must treat it like a business. Later we will look at keeping statistics in the same way as any successful company keeps books and management information that allows them to spot trends and identify strengths and weaknesses in their operation.

I strongly advise you to write a business plan for your trading.

6.1 Trading Purpose

You need to clearly understand WHY you are trading – your trading purpose. Money is not the answer to that question. Obviously you are trading to make money, it's the only thing you can make (or lose) but there is always more. Let me give you some examples, in no particular order, to get you thinking:

- For the buzz, the adrenaline rush of getting it right
- For the challenge of conquering a difficult task
- For the lifestyle – dictating the hours I will spend and when I spend it
- To develop trading to a point where it becomes my sole income
- To keep my mind active in retirement
- To have the freedom to trade from anywhere in the world where there is a phone line (and a computer)
- Because of an interest in the stock market and a desire to increase knowledge

Money is probably important but think about and write down what the money will do for to you and/or what it would buy for you.

Of course there are many things that could motivate you to trade but really understanding why you trade is important. You can keep your mind active in many ways but if you choose trading and that is your prime reason then you can trade with very small risk.

If you are trading for the buzz of it and that is your prime reason, then be aware that you are likely to trade with large risk and you must be very careful not to move from trading a strategy to gambling.

You get the idea. Your reasons for trading are important because they can influence your judgement and emotions in the same way as your personality and cause you to interfere with the strategy.

My Trading Purpose ***(Print out to complete)***

6.2 Trading Aims & Objectives

Think also about your trading aims and objectives. Such as how many hours per day, week, month do you want to devote to it? How much do you aim to make each month or year? What capital can you risk? Is your aim to build capital or take income from your gains? And so on. Most of your aims and objectives should have a time frame on them. In other words they will say something like, " I wish to devote no more than one hour per day by the time I have traded for 6 months".

My Trading Aims & Objectives ***(Print out to complete)***

Remember, these things are not set in concrete. They are YOUR aims and objectives and you are entitled to change them at any time but I urge you to go through the exercise.

Trading is a serious business. You can make substantial amounts of money but equally, if you do not take it seriously and you approach it in an undisciplined way, you can lose substantial amounts of money.

When you think about money, write down your financial objectives in terms of how much you wish to make on average per month after 3 months, 6 months, one year, two years and so on. You will not be in a position to do this until you have read the entire book. Even then, remain flexible enough to modify your figures up or down after you have gained some experience.

It is always good to focus your mind and prevent you from becoming reckless if you have a target to go for, even if you decide to modify your future target having gained some experience. A word of warning though – do not be too ambitious with your financial objectives or you will be tempted to take large risks in order to achieve high gains. Then you will start to trade emotionally which will undoubtedly prevent you from achieving your objectives.

My financial objectives ***(Print out to complete)***

To achieve £/$ …………… p.m. after 3 months trading

To achieve £/$ …………… p.m. after 6 months trading

To achieve £/$ …………… p.m. after 1 year trading

To achieve £/$ …………… p.m. after 2 years trading

6.3 Trading Capital

You must also decide how much capital you are prepared to risk. This will be your trading capital and here I will give you another serious health (or wealth) warning.

You can start trading without any capital risk at all by back testing and paper trading – we will cover this later, but when you decide to use real money it can suddenly get more serious. You can begin with only a hundred pounds in the UK and trade very small positions but you MUST …….

ONLY TRADE WITH MONEY YOU ARE PREPARED TO LOSE.

The first step is to prove you can trade the strategy, build your confidence and gain some experience. Then you can think about **gradually** increasing your risk and trading capital. Remember that your FIRST PRIORITY must always be to PRESERVE YOUR CAPITAL.

This brings us to our first trading rule in the ***SST Strategy***. We touched on this earlier.

RULE 1

Do not risk more than 5% (maximum) of your trading account on any one trade.

My trading capital ***(Print out to complete)***

Trading capital value £/$ ……..……………..

x 5% = maximum individual trade risk £/$ …………………..

6.4 Potential Trading Benefits

We have covered some basics, we have an understanding of how our emotions can affect our trading and we have discovered that trading, even as a hobby is not to be taken lightly – it should be treated as a serious business.

Every new business carries risk and the possibility of losing money. Every business requires working capital but very few businesses offer what trading can offer when done successfully.

Potential benefits of trading:

- You determine how much time you spend trading and it can be done in an hour or less a day
- You can start with very little "working capital"
- You can trade from home or anywhere in the world with a computer and a link to the internet
- Your earnings are only limited by the capital you are prepared to risk when you have a successful strategy
- You can make money when the market goes down as well as up
- Unlike other businesses, you have no competition
- You don't have to find customers or clients and you don't have to sell anything
- You don't have to trade every day – the market will be there tomorrow with fresh opportunities
- You can go on holiday whenever you choose without worrying how your business might suffer while you are away
- You don't have to employ anyone and capital outlay is minimal

7.0 The Short Swing Strategy - Entry

There is no doubt that trading for me is my ultimate business. I'm sure it doesn't suit everyone but if you are as lucky as me (and work hard on your trading) you can end up doing something you are passionate about for a living and have great fun earning money while you go off to play golf. So exactly how does it work?

Let's start to get into the detail of the ***Short Swing Trading Strategy.***

We will do it by building a set of rules and it is important that these rules are adhered to. However, once you start trading I cannot make you stick to these rules - that is up to you. If you experience a few losing trades early on, stick with it to let the law of averages work for you. Losing trades are just part of the business.

> No strategy is perfect. You will have losing trades. All you need in order to make a profit and be successful is the odds in your favour.

The ***SST Strategy*** will give you the edge you need to swing the odds in your favour.

7.1 Trade With The Trend

Rule 1 we have covered – Never risk more than a maximum of 5% (maximum) of your trading capital on any one trade. My own rule is a maximum of 3% so please treat the 5% as an absolute maximum.

We will now move to the second rule in the ***SST Strategy***. Always trade with the share's trend. This is not rocket science, it makes complete sense that if the underlying trend for a share is up, it will be spending more time going up than down. The odds are already in your favour if you only go long (make money if the price increases) when the trend is up.

Conversely if the underlying trend is down, you only go short (make money if the price falls). Exactly how you do this we will cover later.

TERMINOLOGY TO REMEMBER

- **Going LONG is when you will make money when the share price goes up**
- **Going SHORT is when you will make money if the share price goes down**

GOING LONG

GOING SHORT

How do you know what the underlying trend is? Well for the ***SST Strategy*** it's actually very simple and we use the 50 day moving average (50 ma).

RULE 2 – Trade with the trend

As long as the share price is above the 50 ma we regard the trend as up and only look for opportunities to go long.

As long as the share price is below the 50 ma we regard the trend as down and only look for opportunities to go short.

All charting software allows you to put moving averages on your charts. You can add moving averages based on almost any period of days and in addition there are variations on how the moving average is calculated. For example you can select an Exponential Moving Average, which places more importance on the more recent prices. The ***SST Strategy*** uses the most straightforward of these variations called the "SIMPLE" moving average.

Figure 11

Why select 50 days as the time period? First, it is important to use moving average time periods that are commonly used by chartists because they have more meaning. The most commonly used are 200, 100, 50, 20 and 10 day. Longer-term investors will often place a lot of importance on the 200-day moving average and it does indeed form a very significant barrier to price. However, 200 days is too long a period to use as a trend indicator for the ***SST Strategy***. The 50 ma gives us ample trading opportunities and allows us to change from an upward trending market (long positions) to a downward trending market (short positions) reasonably quickly. Shorter time periods than 50 ma can give too many false signals.

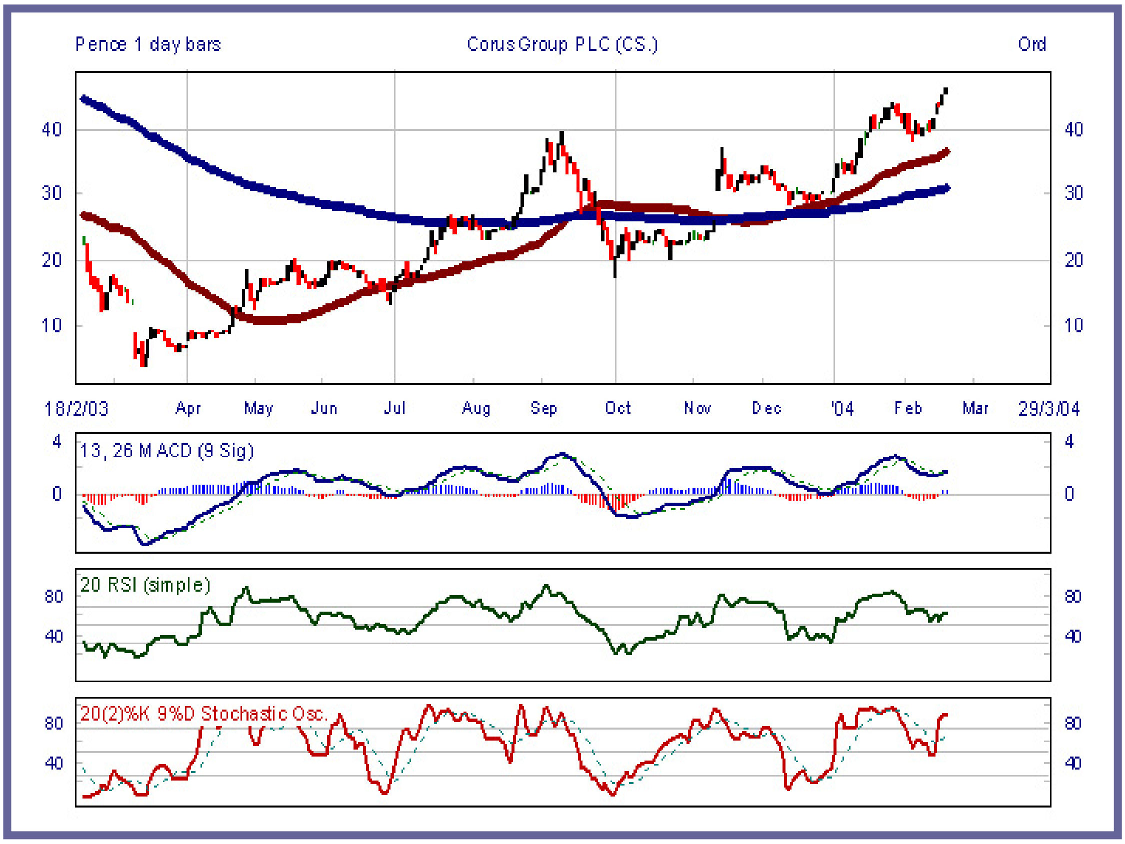
7.2 Directional Movement

In some ways, this is the most complicated part of the ***Short Swing Trading Strategy***, yet in practice it is very simple indeed.

First some background. In any charting software package there is a vast array of "Indicators". Indicators are developed from ideas that people have had to help them understand the charts and assist in predicting future price movement.

In the past, chartists had to manually calculate these indicators and draw them on the charts. Fortunately for us, the charting software now calculates them for us and displays them beautifully in colour. Figure 12 shows the chart for Corus Group with three different indicators at the bottom.

Figure 12



Indicators have some wonderful names like Stochastic Oscillator, Relative Strength Indicator and Moving Average Convergence Divergence (MACD) which are the three shown above. In the software package I use there are **over thirty** of these indicators. In addition, you can change the parameters within most of the indicators.

In some charting software packages you can even build your own indicators by entering the formulae for calculation.

Understanding how to use an individual indicator is difficult enough but you can use ANY COMBINATION of indicators. There are literally thousands of permutations! It is hardly surprising that people give up, or go bust trying to find a good combination that works for them. It also begins to explain why it can take years to develop a reliable trading strategy.

FORTUNATELY the ***SST Strategy*** tells you exactly what to use and the even better news is that you only use ONE INDICATOR which is available in most charting software.

The Indicator we will use is called "Directional Movement".
Sometimes referred to as:

- Average Directional Movement
- DMI (Directional Movement Indicator)
- ADX or Average Directional Index
- Wilder's Directional Movement Indicator/Index. (Wilder was the person who devised it.)

I do not intend to go into any of the other indicators available because it will only serve to confuse and at this stage and there is absolutely no need. Whatever charting software you use or choose, it MUST have this indicator or you will not be able to trade the ***SST Strategy.***

You don't even need to know how Directional Movement is derived. It is an extremely complex mathematical calculation. In fact, in the book, "Technical Analysis from A to Z" by Achelis (one of the bibles of technical indicators) he says that the formulae is

"Beyond the scope of the book". So please don't ask me to tell you what it is, let alone understand it!

Fortunately for us, all that matters is:

- How to use it and

- The fact that IT WORKS when used in conjunction with the rest of the ***SST Strategy.***

Before we continue, let me make one thing absolutely clear. If you were to talk to a dozen other traders, not all of them would use the same indicators. Some may not believe in using Directional Movement at all because it does not fit with their overall strategy, trading objectives and time frame.

A number of different things have to come together and compliment each other in order to produce a reliable strategy; so do not think that Directional Movement will work in all conditions and with all shares. There are more pieces to the jigsaw than we have covered so far.

Let's take a look at Directional Movement on a chart and I will give you some more detail. Figure 13 below shows the indicator in the window at the bottom of the chart. Although the default setting for Directional Movement is usually 14 period (14 day) we adjust this to **8 period** (8 day) because it gives more reliable signals for our strategy. This is very easy to do and takes seconds. The software helps you enormously and the on screen help tells you exactly how to set it up. Once set it will remain the same for all the shares you view.

So what is Directional Movement showing us? The definition given in the on screen help within ShareScope (the charting software I use) says:

"Taking each day's high and low prices, directional movement is given by looking at the largest section of today's high/low range that is above or below yesterday's range. For example, if today's high is four pence above yesterday's and today's low is one penny below yesterday's, the directional movement uses the four pence as this is the larger of the two; and further, as this difference is

above yesterday's range, the directional movement is positive (and if the larger difference was below yesterday's high/low range, the directional movement is negative).”

Remember also that we are looking at the averaged directional movement over a period of time, in our case 8 days.

If that means nothing to you, don’t worry! All you really need to do is understand how to use it as part of the ***SST Strategy*** – and that is easy.

You will see that the indicator has two lines. One I have set to green and the other I have set to red. The green line is the Positive Directional Index line (+DI) showing the strength of the price pushing up. The red line is the Negative Directional Index line (-DI) showing the strength of the price moving down.

There are other lines that the software allows us to add such as the “Average Directional Index” line (ADX) but the +DI and –DI lines are all we need for this strategy.

So what are we looking for? This is simple, we look at the points where the two lines cross or meet then move away again. You will see in Figure 13 that they cross five times over the 3 month period for Singer and Friedlander.

However, remember we are only interested in **trading with the trend**. The price is above the 50 ma so we are only looking for long trades (trading upward movements in price) so we only take notice of the lines crossing when the green line (+DI) crosses UP over the red line (-DI).

It is also OK to take a trade when the two lines converge to touch and then move away again. This tends to happen if the share is in a relatively strong trend.

An example of this is in Figure 14.

Figure 13

This gives us THREE potential trigger points, three occasions when we could have entered a trade, three opportunities to take a long position.

So when we look at a chart, the first thing we do is (Rule 3):

RULE 3

Look for the times when the +DI line crosses or meets the –DI line. Then only take notice of those that are in the same direction as the trend.

TERMINOLOGY TO REMEMBER

A “position” is a trade.

For example, “taking a position” is opening a trade.

A long position is a trade where you make money if the price goes up.

A short position is a trade where you make money if the price goes down.

How are you doing so far????

If you have never traded before, this must seem very technical but it really is just an introduction to a different world that you will soon get used to.

New terminology, reading charts, moving averages and things like positive directional index must seem strange but it really is remarkably easy and it doesn’t take long at all to get used to it – I promise!

I bet you are amazed at how much you have learnt already and you haven’t put anything into practice yet. I firmly believe that you start to learn for real when you put the theory into practice.

The chances are that if you are new to trading, you haven’t got any charting software yet. If that is the case don’t worry, you can usually download a trial version before you decide to buy. In the mean time you can practice what we have covered so far by using the chart in Figure 14 below.

After that we will move onto the next step in the strategy and the final step to determine the entry point (exactly when we should enter a trade).

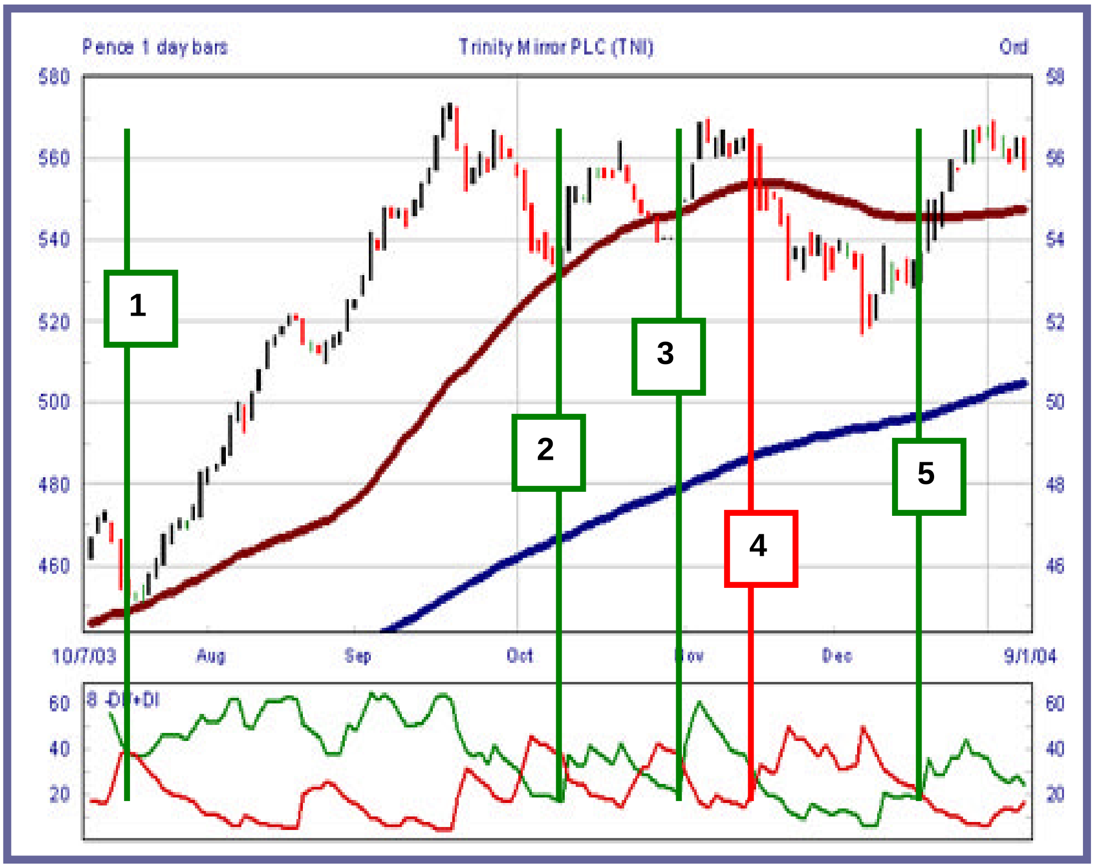
Figure 14

The above chart (Figure 14) shows Trinity Mirror over a six-month period. You can see the 50 ma in brown on the chart and the Directional Movement indicator in the window at the bottom. The +DI is green and the –DI is red. Remember they don't have to always cross; they can meet and then part again.

Draw a vertical line on the chart (after printing it out) when you believe there is an opportunity to open a trade. Look for LONG (up) and SHORT (down) trades.

The answers are on the next page but do not be tempted to look until you have had a go yourself. Refer back to relevant sections of the book so far if you are unsure.

Figure 15



Here is the answer to the exercise and refers to Figures 14 and 15.

There are five potential trades. By the way, your lines might be slightly more accurately drawn than mine. My software does not always allow me to place my lines at exactly the precise point where the +DI and –DI lines cross.

Numbers 1, 2, 3 and 5 are LONG trades because the price is above the 50 day moving average. Number 4 is a SHORT trade because the price moves below the 50 day moving average. Here it is permissible to enter the trade just after the Directional Movement crosses but the price must cross the 50 ma before we enter. We will look at this type of situation in more detail later.

The next bit of the strategy will give you precise prices to enter your trades. So far we are looking at POTENTIAL trading points.

Notice that on two occasions the Directional Movement lines cross and you do NOT take the trade because it would be trading against the trend.

7.3 Price Confirmation

So far we have established that:

- We only trade with the underlying trend – determined by the price being above or below the 50 day moving average
- We only go long if the trend is up and short if the trend is down
- The + DI line crossing the –DI line on the Directional Movement indicator gives us a POTENTIAL entry point

The final part of the entry is price confirmation. This allows us to confirm that the entry is justified and gives us a precise entry price.

This part of the strategy requires you to take a closer look at the price action at the point where the +DI and –DI lines are crossing. It is important to enter as close to the trigger point as possible to ensure maximising your profit or minimising a loss. The overall success of the strategy relies on this type of accuracy. You could use either a bar chart or a candlestick chart here. I tend to prefer candlesticks. Let's look at a LONG entry first.

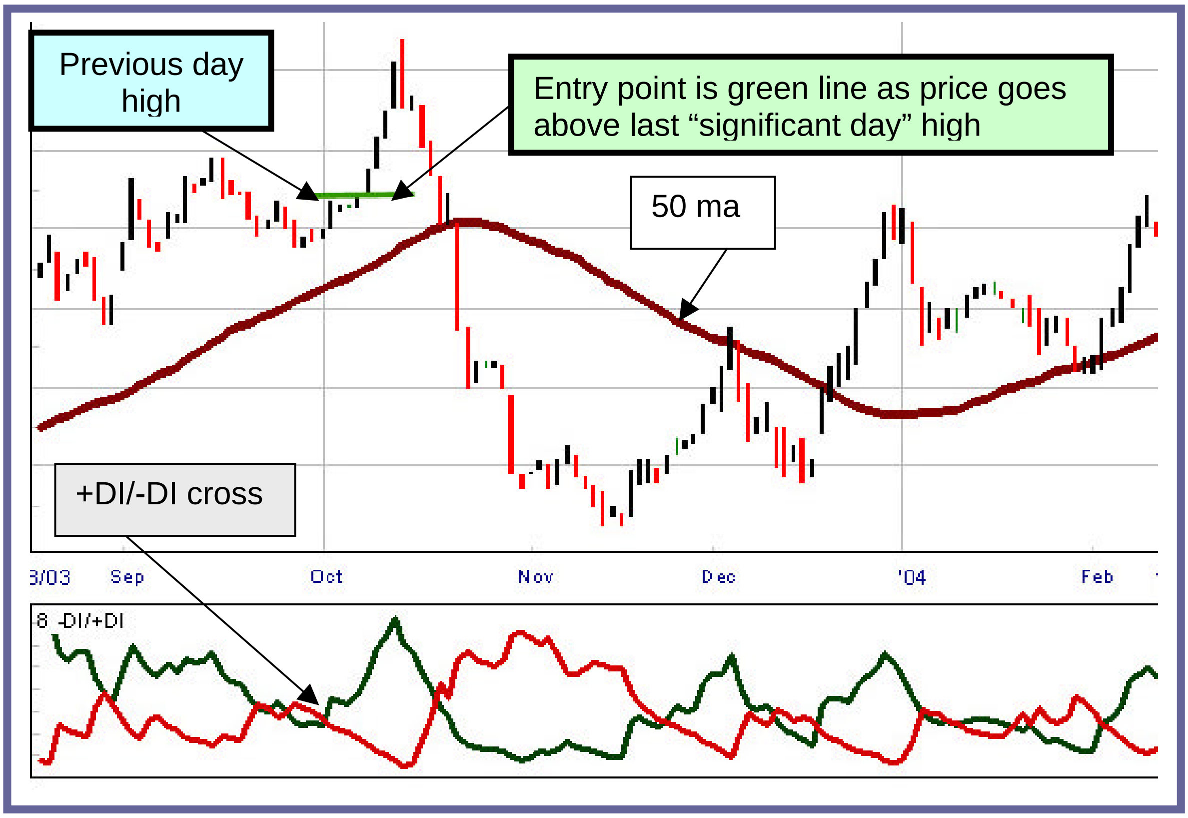
You can see in Figure 16 below, that the price has dropped steadily over several days and the +DI is then coming up and the –DI going down to a point where they cross. This is a long trade because the price is above the 50 ma, so we are looking for the price to go up but we need a precise entry point.

RULE 4

Wait for the price move to be confirmed before entry.

For a long trade, we stand an even better chance of being right if buying pressure (long) has confirmed that a price increase is likely. We look for the price to be forced above the highest price achieved on the last "significant day".

Figure 16

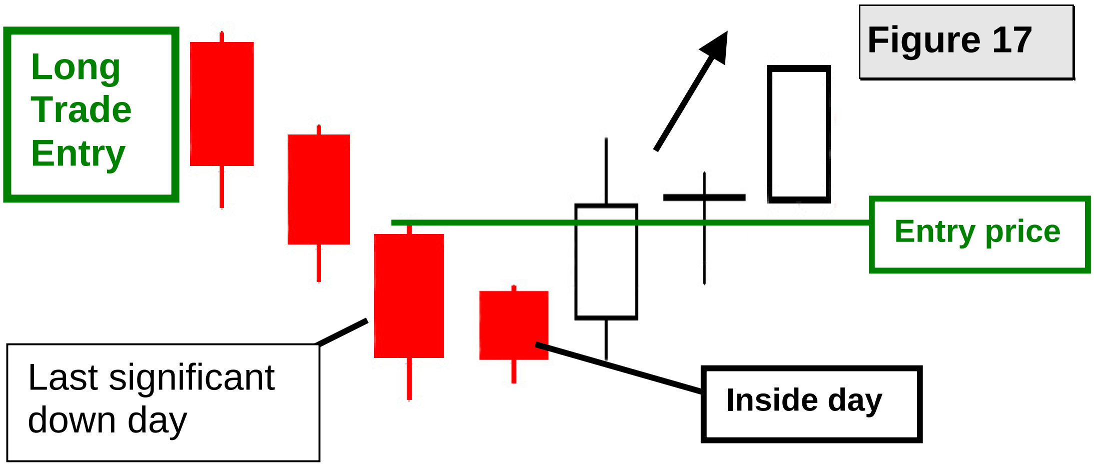


What do we mean by a “Significant day”? Well we simply want to:

Ignore inside days – they are insignificant

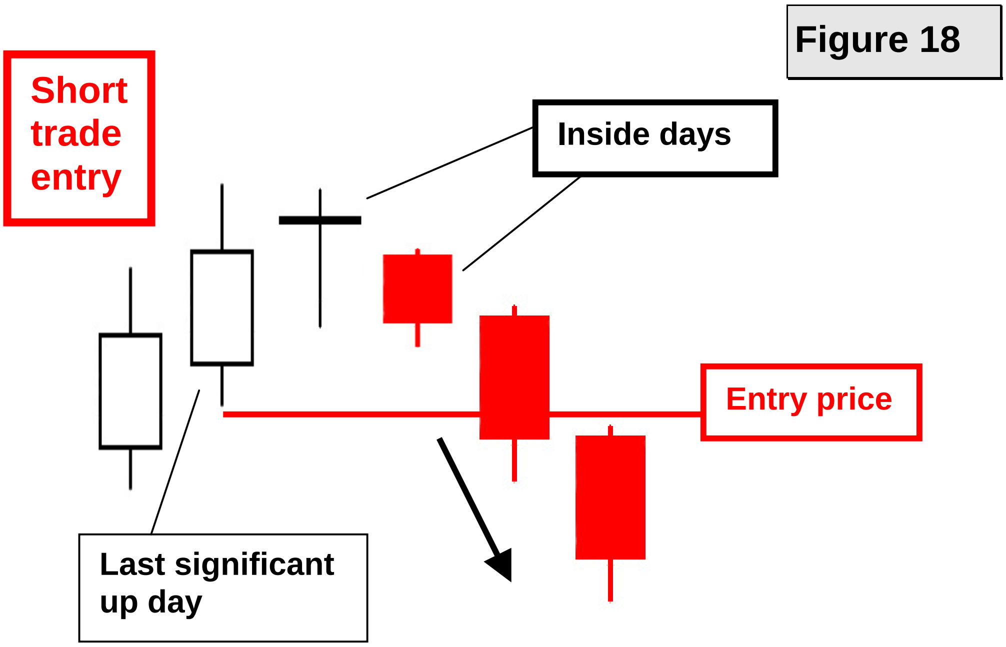
An inside day is where neither the price high nor the price low exceeds the previous day. Here’s an example of a long trade entry.

Figure 17



The inside day did not break the previous day's high or low so we ignore it and wait for the price to **exceed** the last significant day's high before we enter long.

Now let's look at Rule 4 as it applies to going short.



Here there are two inside days before the trigger price is passed to go short.

Of course you don't always get inside days but it is important that you are aware of them and are patient to be sure you take the correct entry point. Here you would go short as soon as the price drops BELOW the low of the last significant day.

AND FINALLY, some important points to consider:

- When you are looking for entry points there will be times when you are not sure. Some entry points are not quite as clear as you would like them to be. The key here is, if in doubt – leave it, there will be plenty of others to choose from. Pick the low hanging fruit first. In fact, until you gain experience, ONLY pick the low hanging fruit.

- Do not over trade. In other words, when you start, trade only a couple of positions at any one time. Do not be tempted to trade every potential entry point on a large number of shares. You will end up having more trades open than you can manage.

- Sometimes you will spot an entry a day or two after it has triggered. Be very careful about entering a trade late because you will have automatically decreased the potential profit and increased your chances of making a loss. Better to leave it and look for another one.

- Remember the comments earlier about the 200 day moving average being a significant barrier to price movement. For this reason it is best not to enter a trade if the price will hit the 200 ma before you get into profit.

- Sometimes the Directional Index lines cross at the same time as the price crosses the 50 ma. It is OK to take these trades provided they cross close to each other but both must cross before the trade can be taken. The 4th and 5th trades in Figure 15 had examples of this.

- Charts update based on data at the end of the day and sometimes the DI lines are already very close to crossing from the previous day. In these circumstances a big movement day can mean that the DI lines cross AND the price confirms all in the same day.

  If you can see that this might happen you can open the trade during the day as the price confirms knowing that the DI lines will have also crossed. If you miss this point you can open the trade at the beginning of the following day but be aware that you are now entering a few points later than the ideal point (see late entry above).

So we now have our entry point for both long and short trades but please do not go off and open trades based on this alone. We have some more things to cover that are extremely important before you will be ready to trade the ***SST Strategy.***

The Short Swing Strategy rules so far:

- **RULE 1 – Do not risk more than 5% of your capital on any one trade (maximum).**
- **RULE 2 – Always trade with the trend** (determined by price above or below the 50 ma)**.**
- **RULE 3 – Look for +DI & -DI crossing or touching on the Directional Movement indicator** (to show a potential trade entry)**.**
- **RULE 4 – Enter after price confirmation** (price must go above the last significant high for a long position or below the last significant low for a short position)**.**

That gives us our *Short Swing Trading Strategy* entry point.

PLEASE BE SURE TO READ ANY SECTION AGAIN IF IT IS NOT CLEAR. You must understand each section before moving onto the next chapter.

8.0 SST Strategy – Stop Losses

Many people believe that defining the entry point is the most important part of a strategy. Indeed I have come across people who have paid significant sums of money for an entry strategy in the belief that it is the secret to trading success.

IT IS NOT!

Of course the entry point is important but
it does not constitute a trading strategy.
Managing risk, knowing what to trade and knowing when to exit are just as important, if not more important! It is putting it ALL together that makes a good strategy.

The ***SST Strategy*** relies on tight and accurate stop losses to control both the entry risk and determine the exit point.

8.1 What is a Stop Loss?

If you have any experience in trading you will probably know what a stop loss is. For those who don't, let me explain.

Let's say that you enter a trade at a price of £4.26 and you are long. You may decide that if the price drops to £3.80 you want to cut your losses and get out.

So you can place a stop loss (sometimes referred to simply as a "stop") at £3.80 with your broker or on-line trading company to ensure that if the trade goes against you, you can limit your losses. I will give a little more detail on exactly where and how you place a stop loss later.

Many traders continually wrestle with stop losses because knowing where to place a stop loss is probably the biggest challenge in trading.

TERMINOLOGY TO REMEMBER

A **stop loss** is placed where you want to close the trade.

The name is a little misleading because you can place a stop loss in a position to close a trade for profit as well as for a loss.

If the price hits your stop loss level (or "stop") you are "stopped out".

Personally, I believe that using a stop loss is ABSOLUTELY ESSENTIAL for a couple of reasons.

Firstly, it is always possible that some sudden bad news is announced and you can lose more than can afford before you get a chance to close your position.

Secondly, if you don't use stop losses, you do not have a complete "set of rules", you do not have a complete strategy and you are exposing yourself to emotional decisions ruled by fear and greed. Mental stop losses (rather than ones placed with your broker or trading company) are fine PROVIDED you have the mental strength to stick to them and you can watch the screens all day. I much prefer "placed" stops.

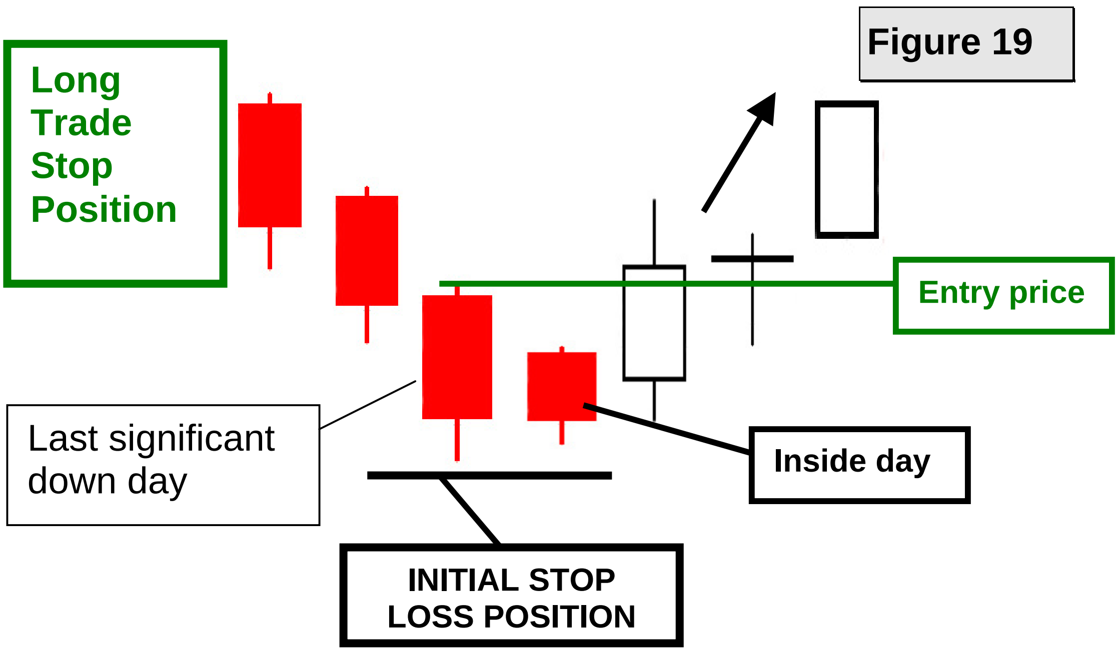
There is NEVER an ideal place for a stop loss, it is always a compromise and you will, on occasions, experience being stopped out and then watch the share charge off in the direction you anticipated. However, I believe it is STILL better than making emotionally based decisions on when to cut your losses or take your profits.

I do know some very successful traders who do not use stop losses at all but they tend to be very experienced and base their exit point on some sound charting criteria. They are also strong enough to exit when that point is hit. Most less experienced traders will find the temptation of "giving it a chance to turn around" too strong to resist with the result of seeing a loss turn into a bigger loss but after all, it's only a paper loss until you close the position isn't it? **NO**, it is a very real loss! The next step is the really dangerous one – the loss gets so big that you do not dare close the position because you can't afford the loss. Guess what – you **have** to be able to afford it!

8.2 Initial Stop Loss

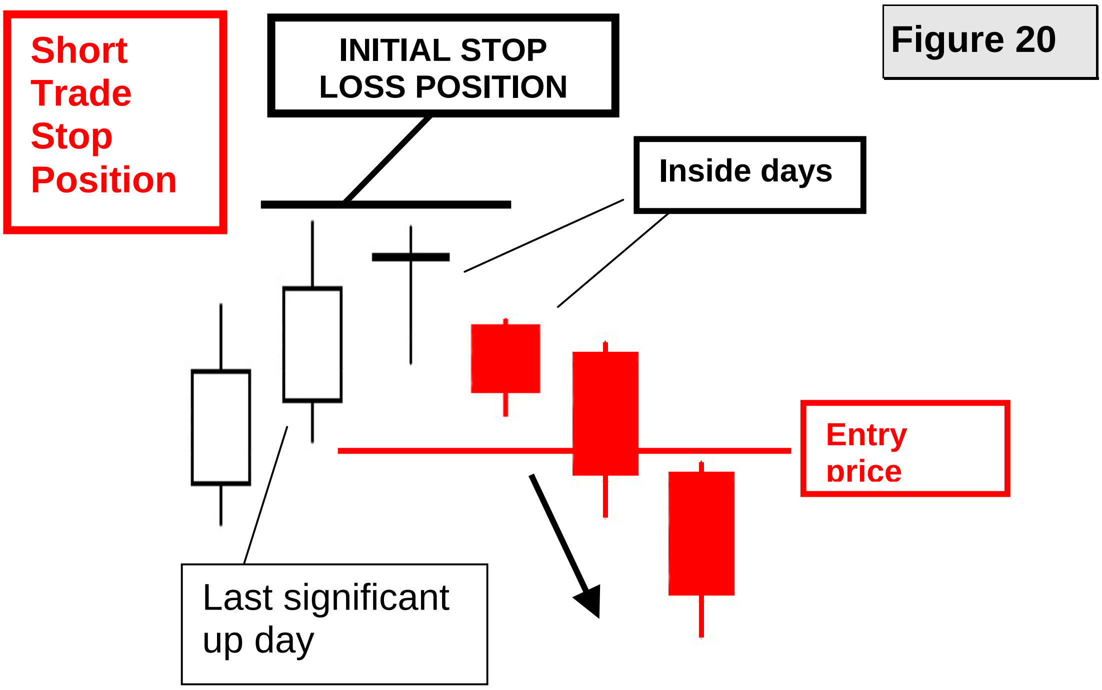
That's the wealth warning over. The good news is that if you follow the ***SST Strategy*** rigidly, you will never get into that situation. You will know exactly what your maximum risk is BEFORE you take a trade and it can only get smaller after that! Let's look at how it works.

If we look at the entry point from the earlier example we can see that the initial stop loss is placed just BELOW the LOW of the last significant day for a LONG trade (Figure 19).



So, the maximum risk at entry is based on the difference between the high and the low on the last significant day. Remember though, that you should ignore any inside days that occur between the last significant day and the entry day.

The SHORT trade stop loss is placed just ABOVE the HIGH made on the last significant day as shown in Figure 20.



RULE 5

Place the initial stop loss just below (if long) or just above (if short) the previous significant low (if long) or high (if short).

Why do we set the stop "just below" or "just above" the last significant day? The reason is that sometimes the price will re-test the high or the low. You can think of these situations as battles between the Bulls (traders who are buying and pushing the price up) and the Bears (traders who are selling and pushing the price down). Remember that it is the balance of buying and selling pressure that moves the price. The high or low will provide support or resistance so that the price will often bounce off these levels. However, on occasions, the momentum of the price move can mean that the precise high or low price can be broken by a small amount before reversing.

So, how much additional "space" should you allow? In other words how much above the high or below the low should you place your stop? This depends on:

- The share price. A 1p movement on a 50p share is significant whereas on a £10.00 share it is not.

  In the USA where share prices can be high you could say that a 10 cents move on a $3.00 share might be a lot where on a $35 share it is not.

- The "personality" of the share is a vital ingredient here. We will explore this further in a later section of the book but for the share type I trade and describe later in the book, I have found 0.5% of the share price gives the best results.

Rule 5 continued

Allow additional "space" of 0.5% of the share price.

Let me reiterate, setting stop levels is not an exact science but I have found that these levels to be the best compromise when trading shares of the type I recommend.

N.B. The above "space" only applies to shares traded that fit the profile for the ***Short Swing Trading Strategy*** (see later chapter). Please refer to the section describing what to trade, how to select shares and a share's "personality".

However, I am aware that some traders use the ***Short Swing Trading Strategy*** **entry point** for shares or an index that does not fit my "personality" description.

I DO NOT RECOMMENDED THIS because you are basically developing a new variation on the SST Strategy. However, I have had reports from traders who have had success doing this. If you do, the 0.5% extra "space" you give the stop is the most important consideration to adjust. You will need to allow additional space, sometimes considerably more, which will increase your initial risk. The amount you will need is for you to judge based on the past profile (personality) of the share or Index.

TERMINOLOGY TO REMEMBER:

Bulls – Traders who are buying and pushing the price up.
Bears – Traders who are selling and pushing the price down.

Support – A level where, if the price drops, it could bounce and begin to rise again.

Resistance – A level where, if the price rises, it could turn over and begin to fall again.

When the share price breaks up through a resistance level, that level will then become a support level.

A support/ resistance level is not a precise price, It is an area and some "space" should be allowed.

One final point on the initial stop loss position:

Once you have set your initial stop loss – KEEP IT THERE! Until the rules allow you to move it.

It can be very tempting at times to move your stop in the hope that the position will come right. You MUST resist this temptation to trade on a "feeling" or hope that something will happen. Do not trade on emotion.

There is a fundamental principle when trading a strategy and that is – to trade the strategy exactly, that is your test as a good trader. If your records then show that the strategy needs to change, you can change it but if you break the rules on an ad hoc basis you will not be in a position to prove or disprove the strategy and you will not have the appropriate records and evidence on which to base a strategy change. What records you should keep will be covered in a later chapter.

8.3 Trailing Stop

We have covered the entry point and the initial stop loss position. Let's now go on to look at managing the open trade once it starts to move in your favour.

Obviously the initial stop represents our largest potential loss. Our next objective is to reduce the potential loss as soon as possible and then get to a point where we can lock in profit by using a trailing stop.

As with the entry point and the initial stop we ignore inside days.

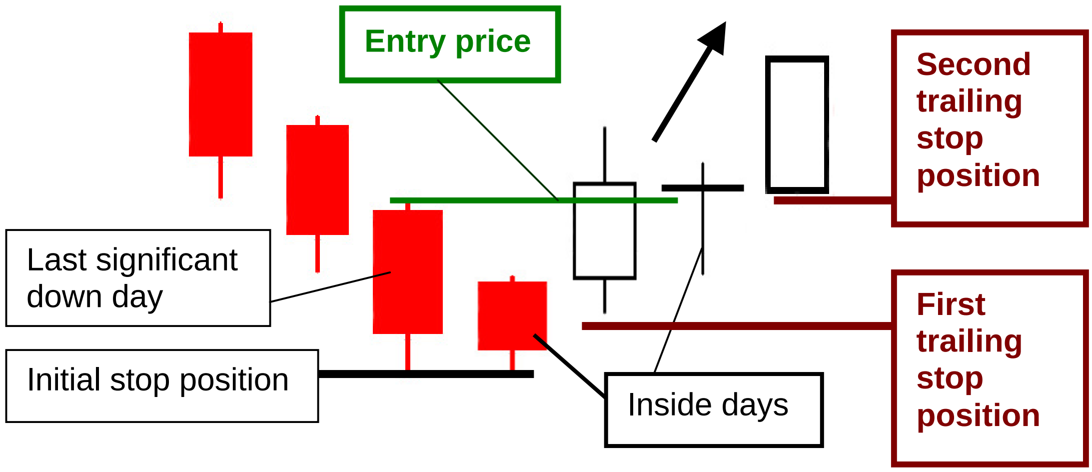
Let's look at a long trade first. The first thing we look for is a new day's high since the entry. This will always be the day of entry since we waited for a new high to trigger the trade in the first place. Therefore, at the end of that first day we can usually move our stop to just below (0.5% of the share's price below) the low of the entry day.

You can see that our maximum risk, which is determined by our initial stop position can in most cases, be reduced very quickly indeed (see Figure 21).

From here the trailing stop principle continues. Ignore inside days but each time a new significant day is made, simply move the stop to just below that day's low. In other words we move our stop each time a new high is made.

Long Trade Trailing Stop

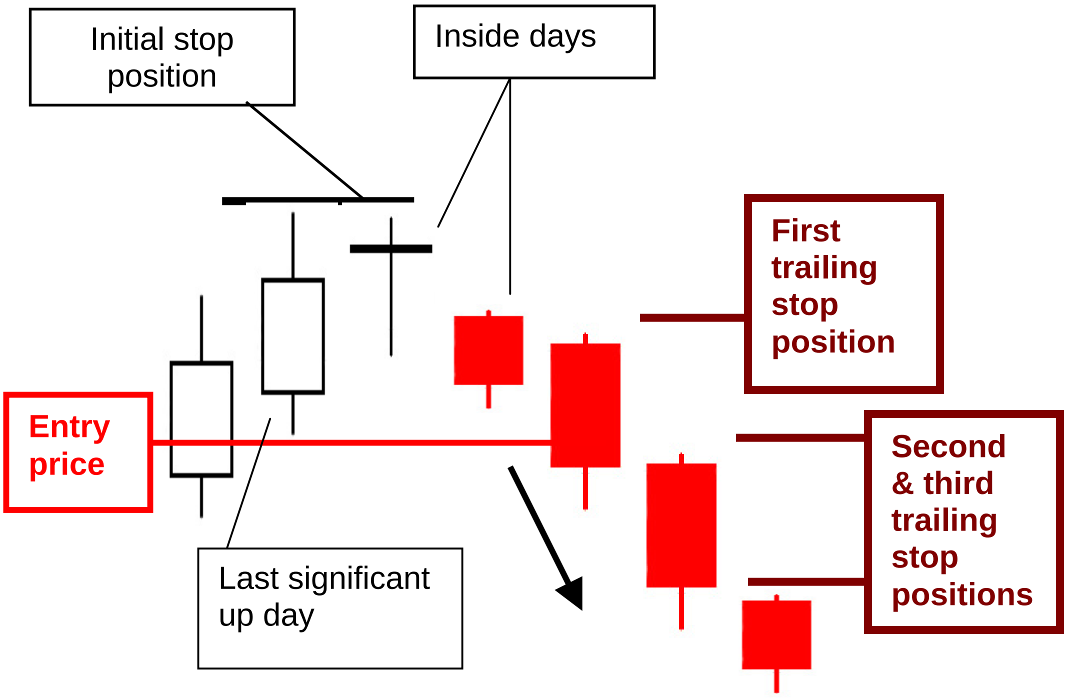
Figure 21



The short trade uses the same principle as the long trade. The first opportunity to move the stop from the initial position is at the end of the entry day where we can move the stop to just above (0.5% of the share's price) the high for that day. Ignoring inside days, we move the stop each time a new significant day is made. In other words when a new low is made (see Figure 22).

Short Trade Trailing Stop

Figure 22



Using a trailing stop in this way very quickly reduces the risk of loss and begins to lock in profits.

This is a key part of the ***SST Strategy*** - our maximum risk therefore is only ever the amount of price movement on the most recent significant day before entry and that risk starts to reduce immediately after the end of the entry day.

The "Space" we give a trailing stop is the same as the initial stop - 0.5% of the share price.

9.0 The SST Strategy – Exit Point

The exit, or closing the trade is very simple. The trailing stop will do it for us, so we don't have to think about where or when to close the trade; we just wait to get stopped out!

Many traders use charts and chart patterns to calculate targets for a trade and close the position when their target is hit. This can work well but requires much greater knowledge of charting than that required for the ***SST Strategy***.

The reason traders use targets is often because they do not use such a clear trailing stop strategy as the one we use. They use much looser stops, which often means watching a good profit turn into a loss if the price reverses to hit their stop level.

In addition to this, using a target can mean missing out on some big moves. At times, the bulls or bears can exert so much buying or selling pressure that the price can push straight through a target and carry on going.

TERMINOLOGY TO REMEMBER:

Closing a trade is known as "covering". To "cover" is to close a trade.

If you are very experienced and can accurately predict target prices, you may want to continue to do this but I do not recommend it for the less experienced trader.

Because we do not normally use targets or try to guess when to cover (close the trade), we will always "give a little bit back" at the end. With the ***SST Strategy*** the most profit you will forego (give back) is the price movement on the last significant day (only one day's movement). This is the price you pay to stand the chance of staying in the trade to make even more money.

There are times though, when we don't even have to forego this much – I will explain.

9.1 A Big Move Day

Sometimes you get a fabulous “big move day”. This is a day when the price movement is 5% of the share price or more. For example, a £4.00 share can move over 20p (£4.00 x 5%) in a day. In this case, we do not want to see all this exceptional profit disappear again so we move the trailing stop to just below 50% of the big move day if long or just above 50% of the big move day if short (see Figure 23).

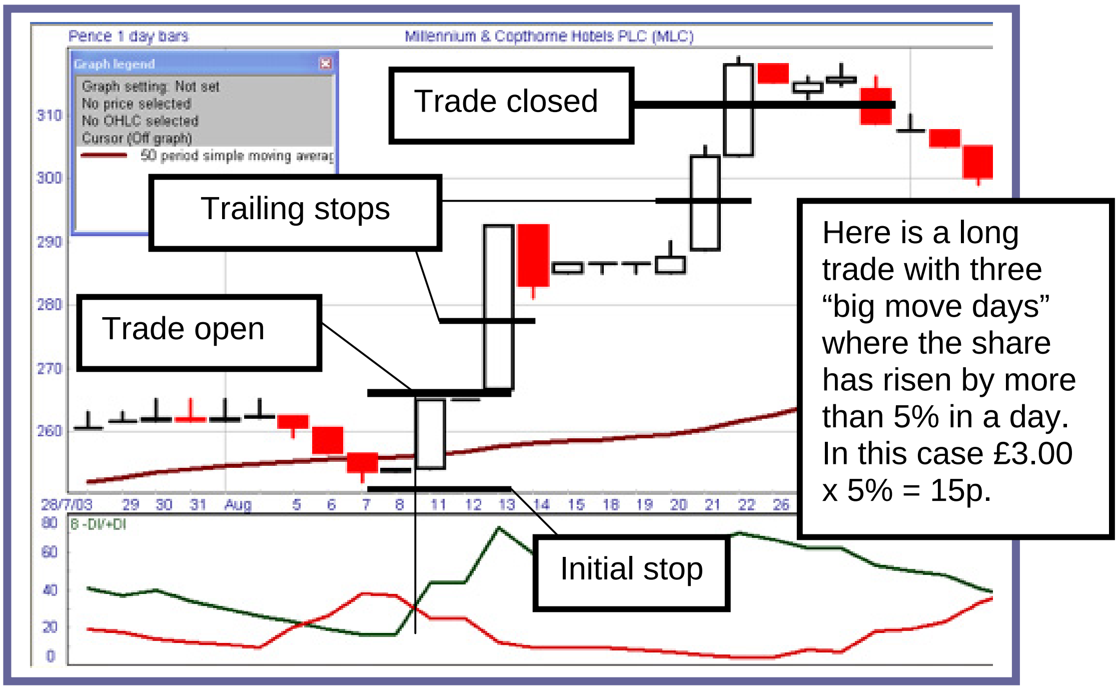
We now have Rule 6 of The ***SST Strategy*** that governs the trailing stop and trade exit point.

RULE 6 (Trailing Stop)

When a new significant day is made, move the stop to below that day’s low if long or above that day’s high if short. Use 50% of a ”big move (5%) day”.

Note: Just above or below means giving the stop 0.5% “space”

Figure 23 An example of “big move days”.



REMEMBER – PLEASE RE-READ ANYTHING YOU ARE UNSURE OF BEFORE YOU MOVE ON!

***The six Short Swing Trading Strategy* rules:**

ENTRY POINT:

- **RULE 1 – Do not risk more than 5% of your capital on any one trade (absolute maximum).**
- **RULE 2 – Always trade with the trend** (determined by price above or below the 50 ma)**.**
- **RULE 3 – Look for +DI crossing or touching -DI on the Directional Movement indicator** (to show a potential trade entry)**.**
- **RULE 4 – Enter after price confirmation** (price must go above the last significant high for a long position or below the last significant low for a short position)**.**

INITIAL & TRAILING STOP + EXIT

- **RULE 5 – Initial stop -** Place the initial stop loss just below (if long) or just above (if short) the previous significant low (if long) or high (if short).
- **RULE 6 – Trailing stop & exit -** When a new significant day is made, move the stop to just below that day's low if long or just above that day's high if short. Use 50% of a "big move (5%) day".

  Just above or below means giving the initial or trailing stop 0.5% of the share price as additional "space".

Print this page to keep a copy of the six rules for the ***Short Swing Strategy.***

10.0 Putting a Trade Together

Before we move on to the next topic, let's take a look at putting a trade together.

Consider Figure 24. This is the chart for Intertek Group PLC from 14/8/03 to 21/10/03. The 50-day moving average is in brown and the Directional Movement indicator is in the window at the bottom.

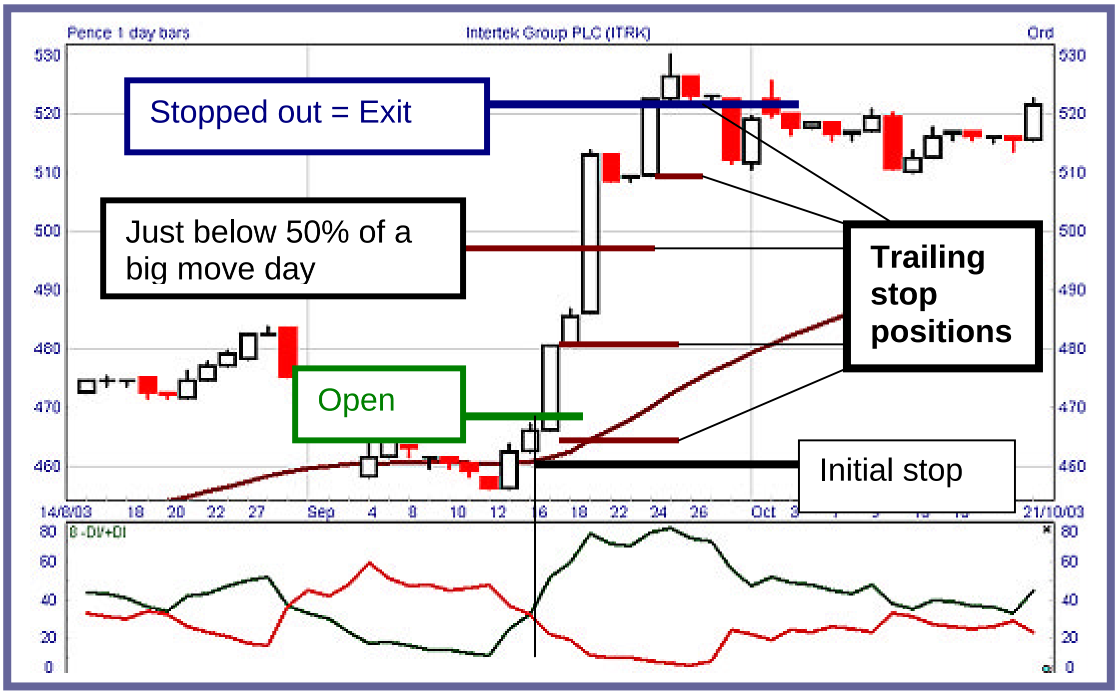
Print out then draw on the chart below:

- The point of entry and initial stop
- The position of each trailing stop
- The exit point (final trailing stop position)
- Calculate roughly (given the scale on the chart) the number of pence that the share price increased from the open price to the close price.

The answer is in Figure 25 on the next page.

Figure 24

Figure 25



Entry was actually at £4.68 and exit was at £5.20 representing a rise of 52 pence, a trading gain of approximately 10% (before costs) over the10 days that the trade was open.

***Notes** (Only for use if printed):*

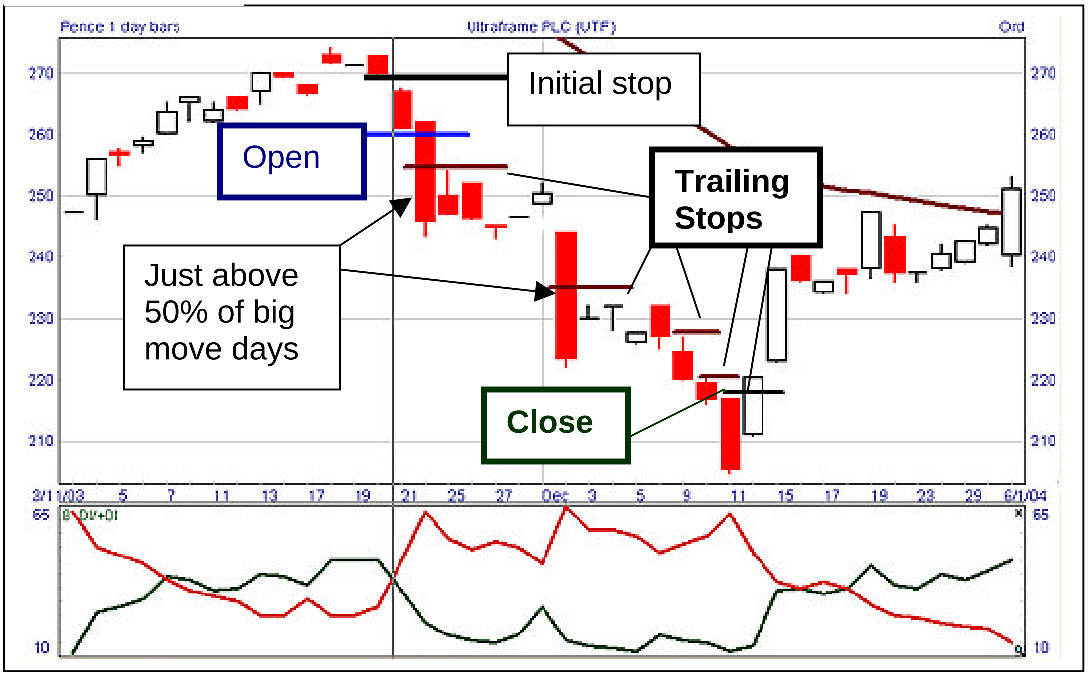
Now look at Figure 26 of Ultraframe PLC during November & December 2003. Do the same exercise as before but this time for a short trade. You can see that the price is below the 50-day moving average (shown in brown).

Draw on the chart:

- The point of entry and initial stop
- The position of each trailing stop
- The exit point (final trailing stop position)
- Calculate roughly (given the scale on the chart) the number of pence that the share price decreased from the open price to the close price. (Answer is in Figure 27)

Figure 26

Figure 27



Entry was at £2.60 and exit was at £2.18 representing a drop of 42 pence, a trading gain of approximately 16% (before costs) over the15 days that the trade was open.

***Notes** (Only for use if printed):*

We now have our six rules for entry point, initial stop loss position, trailing stop and the exit. In terms of day-to-day trading, you would be forgiven for thinking that the ***SST Strategy*** is complete. Please do not start trading based on this alone because there is still vital information to come, without which the strategy simply will not work.

11.0 What to Trade

If there is a real secret to the ***Short Swing Trading Strategy***, this section of the book probably contains it. I have read a great many books, been to seminars, read trading magazines and articles yet nothing has provided me with a complete list of ingredients with which to form a robust trading strategy.

I have studied, evaluated and traded many strategies in the past and spoken to other traders but the one thing that nobody has ever mentioned is that EVERYTHING associated with your trading strategy must fit together like a perfectly engineered Swiss watch or a hand crafted car. This may seem obvious when it is pointed out to you but believe me it is not as obvious as it seems when you are trying to develop a strategy that **really** works month in and month out rather than something that works for a week or two then wipes out all the profit you have just made and more over the next few weeks.

Let’s go back to the Swiss watch or hand crafted car analogy and by the way, we are not talking about a battery driven watch or a Ford here! Can you imagine what would happen if you had a Rolex watch and put a different make of mainspring in it? Or what would happen if you had an Aston Martin car and put a set of Toyota pistons in it? You could have the most beautifully engineered watch or car and it would be rendered completely useless if just one part was wrong.

So far we have our six rules that give us:

- An entry point
- A method of controlling losses – our initial stop loss
- A method of quickly locking in profits – our trailing stop
- And an exit point – being stopped out

We have also said that your personality must fit with the strategy or you are likely to break the rules and trade emotionally.

The next point is as vital as the watch mainspring or the car pistons, it is:

The personality of the shares you trade.

The ***SST Strategy*** is a sound strategy that works extremely well but, and it is a very big **BUT**…….

…….it only works with shares that have a certain "personality"!

For example, I know it works on Ultraframe PLC but it doesn't work so well on BT Group. Yet a different strategy would work on BT Group but not on Ultraframe PLC and the strategy that works on BT Group may not fit your own trading personality. What's more, Directional Movement may not be the best indicator to use for BT Group, and so on.

So, developing a COMPLETE trading strategy such as the ***SST Strategy*** is about going round and round in circles, testing different iterations until you finally complete your Swiss Watch or Aston Martin with everything fitting perfectly. The closest description to this I have read in a book is when one very successful American trader described the feeling of being "at one" with the market but offered no explanation on how this could be achieved other than through years of experience.

I believe the three main components are:

- The rules of the strategy
- Your personality
- The share's personality

And they must fit together as perfectly as possible.

- The rules for entry, exit and risk management we have covered.

- Your personality we have covered and, as a reminder, the key point is that you must feel comfortable enough with the rules not to over-ride them.

I believe that most people are much more comfortable with a pre-determined LOW risk (as I am) and the ***SST Strategy*** has been designed to provide exactly that.

People who want more risk can simply use larger position sizes. So the ***SST Strategy*** can cope with all levels of risk and therefore most trading personalities.

- The share's personality is what we will explore now.

Before you read the next chapter, see if you can think of a few things that would affect or dictate a share's personality.

***Notes** (Only for use if printed):*

11.1 The Share's Personality

A share's personality can be almost as complex as our own. The key components are:

- How closely does it conform to generally accepted charting theories and patterns?
- How far does it usually move before it turns (retraces)?
- What is the average daily move?
- Does it shoot up or down for a few days then back again or does it make slower but steady progress over a longer time (volatility)?
- How often does a big move happen compared with periods of going nowhere (consolidations)?
- How closely does it follow the market (FTSE 100 or 250 Index in the UK)? This is called correlation.
- How volatile is it on an intra-day basis (during the day)?
- How does it react to market or sector news?
- The price of the share. This will affect the amount the share moves but also the initial risk of the trade in points (pence or cents).

How many of the above "share personality" traits did you get?

The best way to understand this is to look at some examples. See Figures 28 and 29, which compares Bovis Homes (a FTSE 250 company which I trade) with BT Group (a FTSE 100 company that I don't trade). You are looking at the same 6 month period for both. An explanation of the main differences follows.

Figure 28

Figure 29

Figure 28 shows Bovis Homes, a company I trade and that fits with the strategy. Figure 29 is BT Group, a company I do not trade and that does not fit the ***SST Strategy***.

If you look closely you will notice a few critical differences although the chart size on the page might prevent you from seeing some of the detail.

- Each day, BT has a much larger price movement (as a percentage of price) both up and down so our initial stop would need to be a further way from the opening price.

- The shadows (intra-day highs and lows) are much larger on BT and often exceed the previous day high and low therefore our trailing stop would be hit regularly before we have a chance to capitalise on the move. Bovis has fewer and shorter shadows (less volatile intra-day).

- BT drifts in a general direction but appears to get there in a pretty untidy and haphazard fashion. Bovis looks like a series of orderly steps that allow a trailing stop to be much tighter.

- BT price crosses the 50 ma on a regular basis whereas it provides much clearer support/resistance for Bovis.

- If you were to compare both shares with the FTSE 100 Index you would see that BT reacts strongly to market news and sentiment whereas Bovis does its own thing to a large extent.

- If you can see BT clearly enough in Figure 29 to spot ***SST Strategy*** trades, you would find that there would be 4 out of 10 winning trades (40%). The same period of time for Bovis produces 6 out of 9 winning trades (67%) but what is more important is that the losing trades for Bovis would be much smaller and the winning trades much larger than for BT.

  In fact, Bovis produced a PROFIT (after all losses and expenses) of 117 points over that 6 month period. That represents a gain of 25% from one share in 6 months.

11.2 What to Look For

Here are the key things to look for in a share to trade using the ***Short Swing Trading Strategy:***

- Clear, easy to spot entry points that do not suddenly turn around and hit your initial stop. This is called a “whipsaw”.
- A nice regular step pattern so that the trailing stop can work without being hit on a regular basis.
- The average traded move must be long enough to provide a reasonable profit.
- The share should be traded in reasonable volume each day (reasonably liquid).
- You may find that smaller company shares fit the profile much more closely than large, highly liquid shares. This is not a rigid rule but certainly applies in the UK.
- Many major indices are tradable but are volatile and difficult to trade. I strongly suggest you leave them alone.

TERMINOLOGY TO REMEMBER:

A **“whipsaw”** is when the price turns very soon after entry and hits your initial stop.

How closely a share follows the main Index is called **correlation**. A correlation of 1.0 means it follows the index precisely. 0.5 to 0.7 is high. 0.2 down to as low as 0.05 is the area I like to trade. As a general rule, the smaller the company, the lower the correlation.

Volatility is the amount that the share price jumps up and down over a given period. Volatility ratings in charting software often don’t mean that much on their own but are a means of comparing one share to another.

Intra-day is a term that means during the trading day.

Liquidity refers to the average number of shares traded each day.

Watch list is a list of shares that a trader monitors for potential trades.

It’s worth spending some time on this subject because:

- It is fundamental to the strategy and vital to success.

- You must understand what the best share “personality” looks like and how to identify new additions to a watch list.

The single most important thing that upsets the ***SST Strategy*** is intra day volatility. Often this is caused by a reaction to the market as a whole. In other words, the share does not totally do it’s own thing but reacts to the intra day ups and downs of the market. A comparison in volatility is evident in Figures 28 (Bovis) and 29 (BT Gp) above. These are very good examples of a good SST share and a poor SST share.

The same personality difference can be seen in the indices below. In the UK, if you were to look at an intra day chart of the FTSE 100 and compare it to the FTSE 250 you will see a massive difference. The FSTE 100 is very volatile with large and rapid movements in both directions during the day where the FSTE 250 index is a much more steady and smooth line.

Study the two charts below. I hope you can spot the difference.

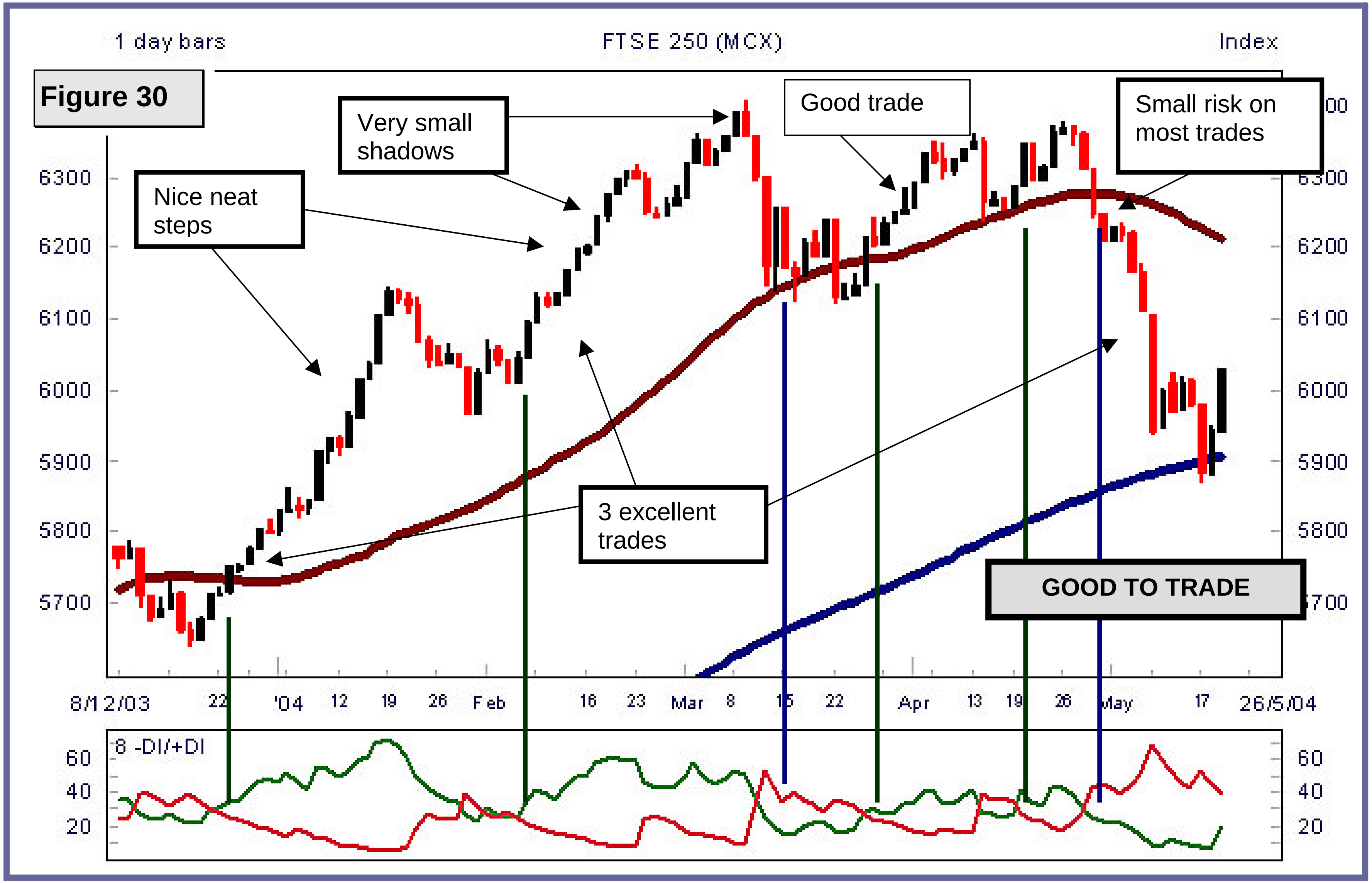
The FTSE 100 would not have traded well where the FTSE 250 would have traded very well indeed. In fact the only reason I don’t trade the FTSE 250 Index is because it is not offered by my trading company (Finspreads).

If you are building your own watch list or looking for shares to add to your watch list, I urge you to study:

- Bovis (Figure 28) as a good SST share versus BT Gp (Figure 29) which is not a good SST share.

- FTSE 250 index (Figure 30) which is suitable versus FTSE 100 index (Figure 31) which is not suitable.

Use these as models when studying stocks.


1 day bars
FTSE 250 (MCX)
Index
Figure 30
Very small shadows
Good trade
Small risk on most trades
Nice neat steps
3 excellent trades
GOOD TO TRADE
6300
6200
6100
6000
5900
5800
5700
8/12/03
22
'04
12
19
26
Feb
16
23
Mar
8
15
22
Apr
13
19
26
May
17
26/5/04
8 -DI/+DI
60
40
20

1 day bars
FTSE 100 (UKX)
NOT REALLY SUITABLE
Figure 31
Long shadows and intra-day volatility means a high risk of being stopped too early
Big initial risk on many trades
Would have been whipsawed
4600
4550
4500
4450
4400
4350
4300
9/12/03
26
Feb
9
16
23
Mar
8
15
22
Apr
13
19
26
May
17
26/5/04
8 -DI/+DI
40
20

We are more interested in shares that do their own thing with low intra day volatility. If you do have "correlation" in your charting software that can save some time although it is not essential. Look for shares with low correlation. The lower the better. In fact I will sacrifice liquidity for low correlation. As a guide, I would look at a rating of below 0.20.

If you need to test a stock for inclusion in a watch list, I would go about it like this:

1. Does the stock move in nice neat steps (e.g. if long, the next day's low does not go below previous day's low) so that our trailing stop would stay in place over a nice run. This is the single most important factor and is essential. Look at the FTSE 250 (Figure 30) and Bovis (Figure 28) as examples to see how the candles often form a nice neat row of steps. Short or nonexistent shadows is a bonus but not essential. It is usually best to look at a 3-month period for this in order to get the detail.

2. Look at a six-month period. Does the average price move make enough points for us to make a profit? We want most of our trades to break even or better and some nice trades showing GOOD profit over a six-month period. This is very important because some stocks have very short runs that will not cover costs before turning again.

3. Low correlation (0.2 or less) - LESS important than 1 & 2 above so don't worry too much if your software does not show correlation.

   The aim is that we don't want to be whipsawed simply because the market has gone against an already open position. Try to establish by looking back over the last 6-months, if the stock is it capable of continuing it's own trend even though the market has turned against it (does it do it's own thing?).

4. Having got a (possibly fairly large) list on the above criteria you then set to work with the ***SST strategy*** (Directional Movement & 50 ma) and find those that give the best results over 6 months.

Ultimately, this is the best test of a share's suitability to fit a strategy. Using your charting software, pretend to have traded it as accurately as possible going back initially over a six month period. This is called "back testing" and is explained in more detail later.

Weed out the worst performers then look at the 6 months before that. Weed out the worst performers again.

Then paper trade (see below) the list you have got and weed out the worst performers again.

Then trade with small positions and weed out again. Then increase your position sizes.

After that, constantly monitor your results with each stock and look for new stocks to test. I am constantly testing new stocks to replace my worst performers.

Continually look to improve the quality of the **bottom third** of your watch list and the overall profitability of your trading will **always be improving.**

I know it is time consuming initially and it also means ongoing work BUT believe me, this is where many traders go wrong. They may have a good entry system, they may even use good stops but they will not achieve consistently good results if they don't put the work into finding the right stock or Index to trade.

Everything must fit together to make a REALLY GOOD strategy.

You must be absolutely honest with yourself when back testing. It is very easy to ignore a trade that you can see would have made a loss.

You can easily determine your entry and exit price and calculate how far the share moved and hence your gross profit or loss for each trade. You must then subtract your estimated trading costs.

TERMINOLOGY TO REMEMBER:

Traders tend to talk about **"points"** gained or lost rather than pence or cents that the share price has moved.

In other words, if a share moves up by 20 pence (or cents) it has moved 20 points.

UK share prices are usually written in pence (without the decimal point) so £4.35 would be written as 435.

For the moment, the only thing that matters is how many points (pence or cents) gain or loss you have made. Your position size will determine how much money that represents.

Back testing should give you the percentage of profitable trades and the average points gain made per trade as well as the total points gained over a period of time.

As a yardstick your back testing should show at least 60% SST trades that break even or better. I prefer to see over 70% because it will never be quite so good in practice!

Also, over a six month period I would want to see at least a few SST trades that make a good profit of say, 8% or more of the share price. This may vary dependant on your trading costs and if you are trading outside the UK market. A move of 8% gives me a healthy profit.

STRATEGY REMINDER:

Remember that we are trading short swings so do not expect massive profits from each trade. The success of the strategy lies in lots of reliable, low risk trades rather that a few big risk big reward trades.

Based on my UK trading - if, out of 100 trades, you get:

- 60 break even or better
- and 20 that have good moves of over 8%

You are going to make a VERY good profit!

12 .0 SST Members' Web Site

I am mentioning the SST Members' Site at this stage because it is relevant to building a watch list of shares. Let me first give you a quick overview of the site.

The SST Members' Site is developing all the time but is designed to give you up to date information of all sorts to help you with ***Short Swing Trading.***

The best thing is to visit the site and take a look. The address is:

www.shortswingtrading.com/sstmembers.html

The site is FREE to traders who have purchased ***Short Swing Trading***.

I will be building up lots of useful information on the SST Members' Site over the coming months. Please visit it regularly. Once you have had a good look, if you have any suggestions for improvements please email me.

12.1 UK Market Traders

If you trade the UK market I can save you a great deal of time hunting for shares that fit the ***SST Strategy***, because they are published on the SST Members' Site. I update this monthly so if my watch list changes you will be kept in formed. You can choose some or all of these to trade if you wish.

I have also given you the EPIC code for each share. The EPIC code is a three or four letter abbreviation for the share. Most traders know the name of a share by the EPIC code and when you use your charting software you can set it up so that you put in the EPIC in order to pull up the chart for that share. This can save quite a bit of time.

Usually the EPIC is easy to remember because it is derived from the share name. The only thing to watch out for is that some EPIC codes have a dot (full stop) in them such as Corus Group (CS.).

I strongly suggest that before you start trading the ***SST Strategy*** for real, you use at least some of my watch list of shares and back test them using the strategy over at least a six-month period.

It may take you some time to do but I'm sure you will be extremely happy with the results and it will give you valuable free experience as well as greater confidence to trade the strategy without bending the rules. We will return to look at back testing in more detail later in the chapter on "Getting Started".

12.2 USA & Other Markets

I will refer to US stocks but the same applies to other markets outside the UK.

Although I do not trade the US market myself I am building and maintaining a watch list of US stocks on the SST Members' Site for you to consider. These are based on my view of the stocks together with feedback from US SST Traders.

There is another very important point to cover around the difference between trading UK and US stocks. Because US stocks are generally more expensive, they move a lot of points (cents) in a day. This means that the risk in points is much higher than UK stocks like the ones shown as examples in this book.

However, it also means that the potential gains (in points) are very much higher than with UK stocks. Some of the stocks I trade will move 6 points (pence) on a good day where many US stocks will comfortably move over 100 points (cents) in a day. The risk/reward ratio still works.

There is another point worth making. These days we have totally global trading. I sometimes day trade the Dow or the S&P 500 from my office in Real Time up to 9:00 pm UK time – I do NOT use the SST strategy for these trades.

I could spread trade most US stocks in the same way if I wish and many UK traders do trade US stocks.

I have also come across traders who trade UK markets from other parts of the world and there is no reason why this can't be done. It sometimes goes against the grain and can feel strange to trade markets outside of your country but to be honest, I would rather trade ANY market successfully than stick with my home market and be unable to trade a good strategy. In some countries stocks simply do not move enough each day to be tradable.

As a chartist you don't need to be familiar with the stocks you trade. I have traded many stocks without having a clue what business they are in.

ShareScope, the end of day software I use, is not expensive, will update from any Internet connection and on-line brokers will allow you to trade UK stocks from pretty much anywhere in the world.

A final point for traders outside the UK: There are Short Swing Traders all over the world. If there is sufficient demand and sufficient feedback from traders who trade other markets I am happy to consider building watch lists for other major markets and posting them on the SST Members' Site. Please contact me if you would find this useful or can help build a watch list for other traders to benefit from.

13.0 Market News

Market news can affect trade prices – we touched on this earlier. For example, an increase in interest rates can send share prices lower because more money will be attracted to fixed interest investments. Major news can throw the strategy for a very short while however; with the types of share we are trading (such as those in my watch list) day to day news is unlikely to have a major effect. They tend to have a "personality" of their own, which is one of the reasons I like them.

The only news you do need to take notice of is the announcement of trading figures or news specific to that individual share. Within your trading software programme you will probably be able to find the dates when Interim and Final profits will be announced as well as the AGM and any other important dates.

If these dates are not available to you, visit the SST Members' Site and you will find addresses of free articles that give these dates for UK and US markets.

DO NOT open a trade on a share during the TWO-week period leading up to these announcements in case figures are better or worse than the market expects.

The reason I say not to trade the stock for two weeks prior to the date is that if the company has done poorly in the last trading period, they can announce a "Profits Warning". In other words, they warn the market that figures might not be as good as expected. This will always send the price down immediately so it's best to just keep clear in case that happens.

Below is an example where Bodycote International had a profits warning in December 2003. As it happens, the strategy might have led you to go short eight days before the profits warning and you would have profited from the drop but that would have been more luck than judgement.

Figure 32

13.1 Price Gaps

While we are on the subject of gaps, it can sometimes happen that a share will gap up or down and at the same time, trigger a trade to open.

My advice is not to take these trades. Although the price can continue to roar in the same direction as the gap my experience is that it is more likely for the price to go back and “Fill the gap” which usually will lead to a whipsaw.

Remember the earlier comment about taking the low hanging fruit. If you have a reasonably healthy watch list you will find that more than enough trades will trigger so why risk a share that has gapped?

If the price gaps in your favour after you have entered a trade you can be a little confused as to where to place your trailing stop. The trailing stop rule still holds good. For example, if long, a new high has been made so your stop goes just below the low of that new day. This locks in your profit in case the price goes back to fill the gap yet allows it to continue into further profit if there is sufficient momentum.

A “big move” day following a gap is best measured from the open to the close on the new day, which needs to be over 5% of the share price to qualify. Refer back to the chapter on trailing stops.

14.0 When to Do Your Chart Work

Assuming you use End of Day charting software, you will not be able to update your data until after the market has closed and the software company has prepared and released the data for you to download. In the case of ShareScope, which I use, the data is always available by 6 pm. Downloading the data at the end of the day is extremely easy and does not require a broadband connection. Download time is only a few minutes. If you miss any days, don’t worry, all data will be brought up to date the next time you connect.

You can then examine your updated charts for new positions to enter and to decide on new stop levels.

Initially, this is likely to take you some time but once you get used to it, you will be able to page through a watch list of 30 shares in less than 5 minutes in order to select those that you want to take a closer look at.

Opening positions and adjusting stops can usually only be done on-line during market hours. Of course, if you can't get to a computer to adjust your stops on-line, then you can always phone them in the next morning when the market opens.

Normally, you can also phone in an "Order to open". This means that you don't have to watch the screens the next day in order to open a trade at a specific level. You can leave an instruction for your broker or trading company to open a trade if the share price reaches a certain level.

15.0 Getting Started

Before you to start trading there are a few things you need to do:

- If you don't already have suitable charting software you will need to obtain it and set it up for the ***SST Strategy***. This is covered in more detail in a later chapter. Take some time getting used to the software.

- Open your trading account with an on-line broker or if available to you, a spread trading company. Some recommendations are on the SST Members Site.

- Test your ability to trade the ***SST Strategy*** before you go live.

To test your trading ability I suggest you work through the following stages:

1. Back test the strategy
2. Paper trade
3. Trade small positions for real
4. Gradually increase your position size while you gain experience and confidence.

15.1 How Do You Trade?

These days there are a number of ways to trade the markets. The ***SST Strategy*** gives you all the rules to enter, manage risk and exit a trade as well as what type of stocks to trade. But there are a number of ways to actually place your trade in the markets other than simply buying and selling the shares.

If buying and selling shares is what you want to do or are comfortable with then carry on. Remember though, that you need to be able to go short in order to capitalise on a Bear market or an out of favour stock. Ask your broker about this is you have not done it before.

You can also use Contracts For Difference (see STT Members' Site), futures and options. There may also be other derivatives in your part of the world. It is beyond the scope of this book to go into all these financial instruments covering all countries around the world.

Personally I use Financial Spread Betting – often called Spread Trading - purely for the tax advantages in the UK.

Do not confuse this with the practice of taking two separate positions with related instruments to profit from the narrowing or widening value of spread between the two. This is a completely different form of Spread Trading. (Confusing isn't it!)

Financial Spread Betting is **NOT** available extensively outside the UK and you will need to check your local laws, tax rules and regulations. For example, at the time of writing (Feb 2004) it is NOT available to USA residents.

If you are a UK resident or are able to spread bet, I strongly urge you to read my book "All You Need to Know About Financial Spread Betting" and give it a try.

I have written this book because I have found that although spread betting has exploded in popularity in the UK, there are no sources of good, practical information on the subject. I have written the book for <u>everyone</u> to understand and it gives you more information than any other publication I have come across.

The basic principle of Financial Spread Betting is a very simple one. You place a "bet" on whether the price of the share or Index will go up or down and you can choose how much money per point you want to bet. Let's say that you decide a certain share will go up and you place a long bet for £10 per point. If the price goes in your favour and you close the position for a 20 point profit (after the spread) then you will make 20 points at £10 per point giving you a profit of £200.

I do not propose to go into it further at this stage. For more information, please visit:

www.shortswingtrading.com/sstspreadbet.html

15.2 Back Testing – Trading Exercise

Back testing is simply looking at historic charts to see if trades would have worked out. Obviously you need trading software to do this and you might not have that yet so in the following pages there are three charts for you to look at. These are three companies from my watch list and they cover a six-month period.

There is no great secret to back testing but here are a few tips:

- Use exactly the strategy you intend to use for real
- Back test as extensively as you can to give yourself practice and confidence in the strategy
- Don't cheat. It is very easy to want a strategy to succeed and therefore, because you can see the future (not exactly realistic!) you can easily convince yourself that you wouldn't have taken that losing trade or that you would have bent the rules a little to open that very successful trade.

- When you back test, NOTE DOWN, as accurately as possible, points gained and lost but also note the risk attached to each trade. A good guide is to see how many points profit (or loss) you would have made over a six-month period then divide it by six to get the average per month.

Remember:

- You are bound to have good months as well as months where the market is not so decisive.
- Pick low risk trades and trades that are the "best fit" for the strategy.

- Don't forget the trading costs! If you have access to your Internet trading account you can check them out properly. If not, make some educated but generous estimates.

It's time to put your trading skills to the test. Not for real yet but by looking at three typical charts. I appreciate that you will not be able to get accurate prices because of the lack of detail on the price scale, you will need to approximate.

Also, you may not be able to estimate the spread or other costs. If this is the case just work with the gross profit or loss for each trade before costs. At the end of the exercise I will show you the costs I incurred with these trades by spread trading.

Figures 33, 35 & 37 are three different company charts for you to print out, analyse and mark up with your trades. Figures 34, 36 & 38 are the model charts with the trades marked. Following that is a page detailing exactly how many points were made or lost on each of the trades for each of the three company charts.

Below is a reminder of the six trading rules:

The six *Short Swing Strategy* trading rules:

ENTRY POINT:

- **RULE 1 – Do not risk more than 5% of your capital on any one trade (maximum).**
- **RULE 2 – Always trade with the trend** (determined by price above or below the 50 ma)**.**
- **RULE 3 – Look for +DI crossing or touching -DI on the Directional Movement indicator** (to show a potential trade entry)**.**
- **RULE 4 – Enter after price confirmation** (price must go above the last significant high for a long position or below the last significant low for a short position)**.**

INITIAL & TRAILING STOP + EXIT

- **RULE 5 – Initial stop -** Place the initial stop loss just below (if long) or just above (if short) the previous significant low (if long) or high (if short).
- **RULE 6 – Trailing stop & exit -** When a new significant day is made, move the stop to just below that day's low if long or just above that day's high if short. Use 50% of a "big move (5%) day".

  Just above or below means giving the initial or trailing stop 0.5% of the share price as additional "space".

Figure 33

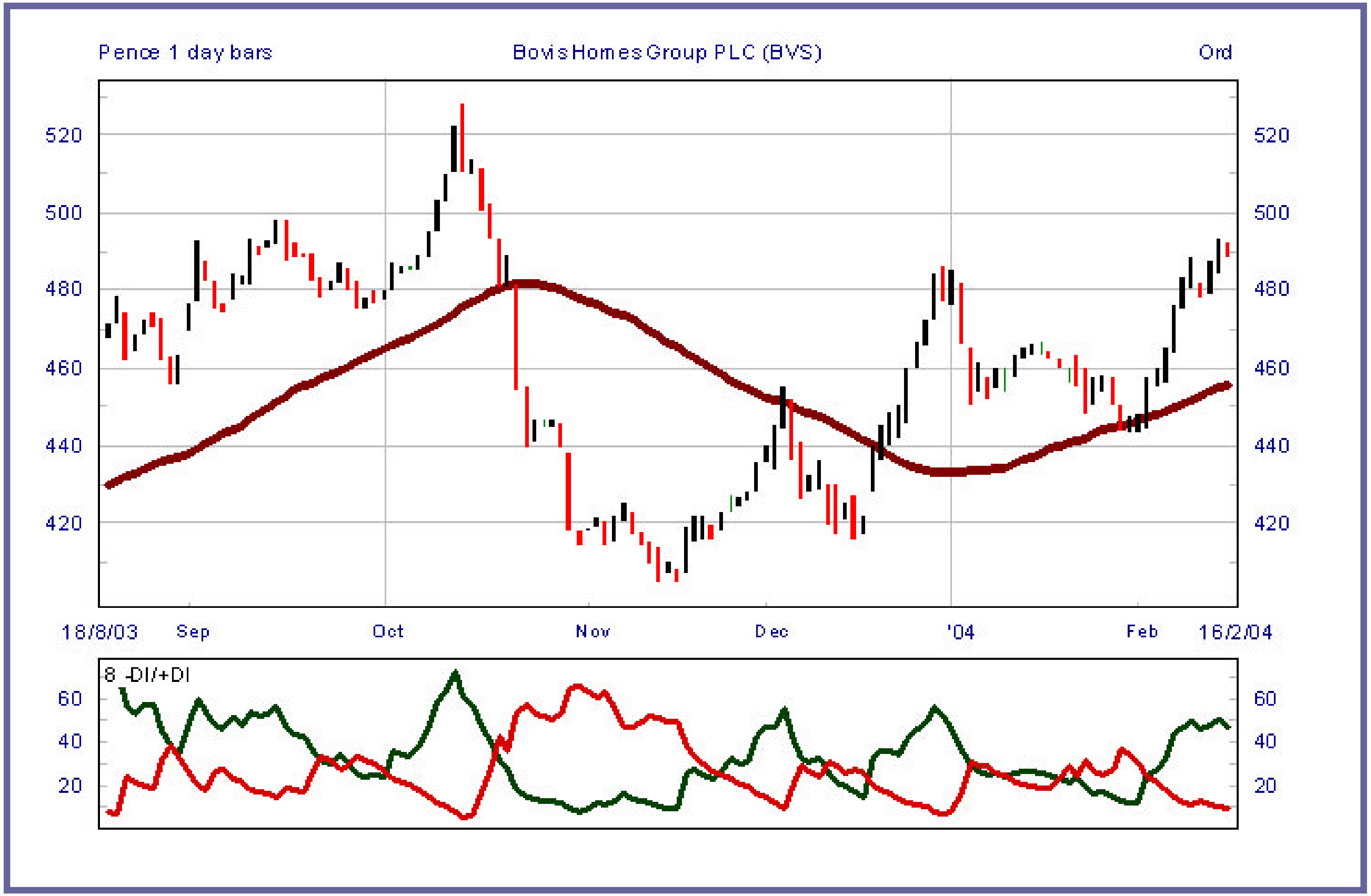

Pence 1 day bars
Bovis Homes Group PLC (BVS)
Ord
520
500
480
460
440
420
18/8/03
Sep
Oct
Nov
Dec
'04
Feb
16/2/04
8 -DI/+DI
60
40
20

Figure 34


Pence 1 day bars
Bovis Homes Group PLC (BVS)
Ord
Trade results are given later.
520
500
480
460
440
420
1
2
3
4
5
6
7
8
18/8/03
Sep
Oct
Nov
Dec
'04
Feb
16/2/04
8 -DI/+DI
60
40
20

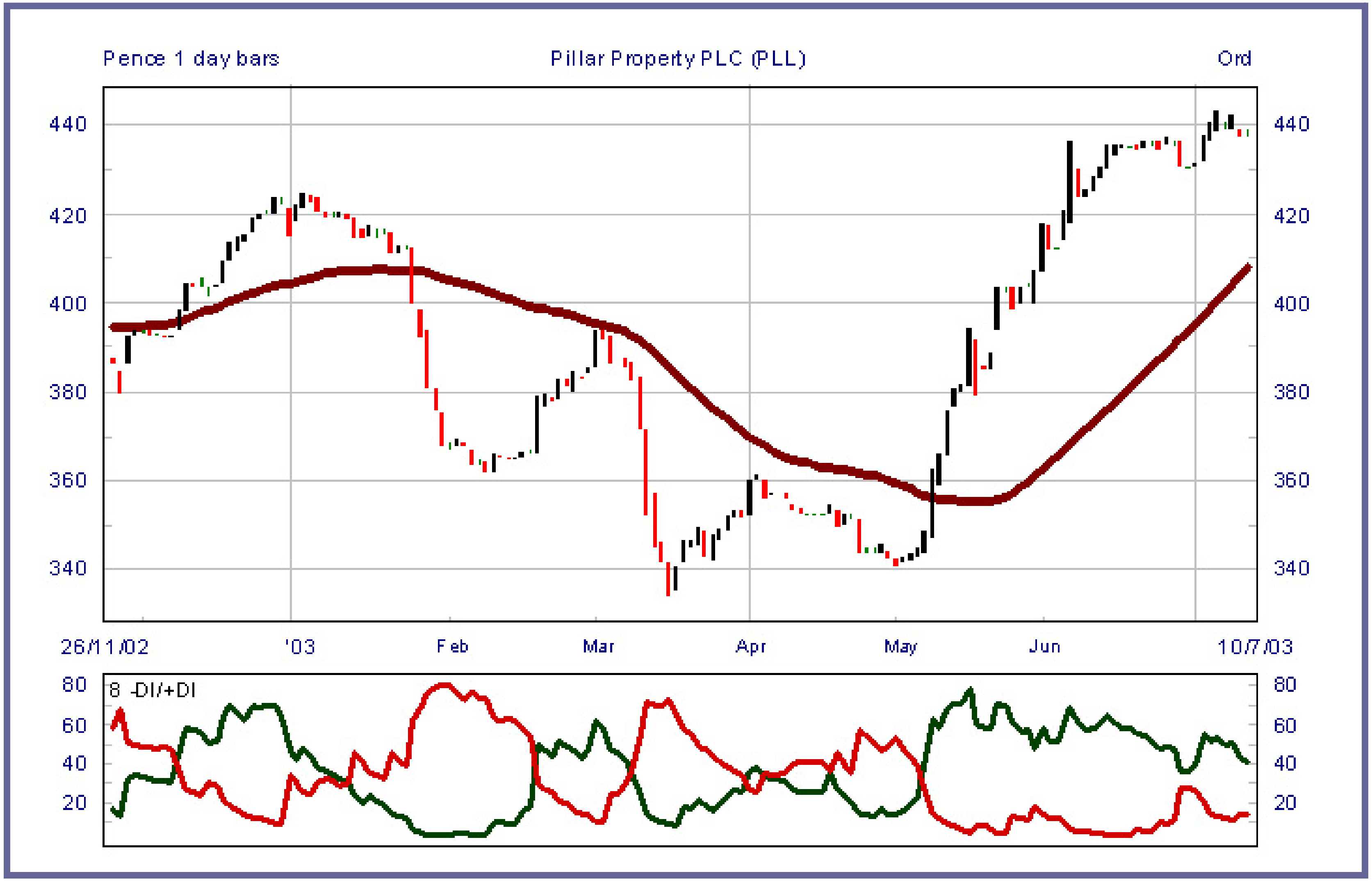
Figure 35

Pence 1 day bars
Westbury PLC (WBY)
Ord
460
440
420
400
380
360
9/7/03
Aug
Sep
Oct
Nov
Dec
7/1/04
80
60
40
20
8 -DI/+DI

Figure 36

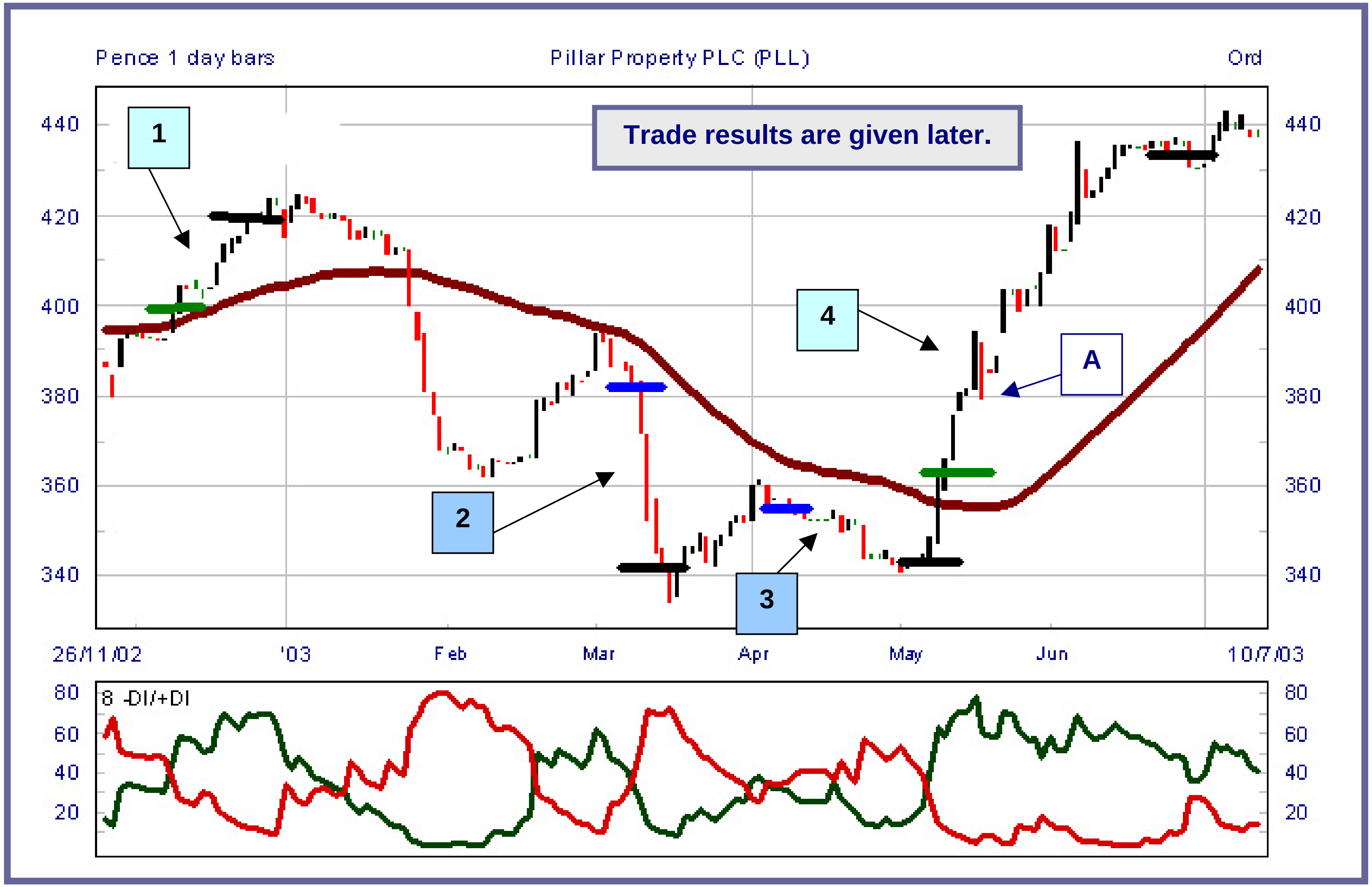

Pence 1 day bars
Westbury PLC (WBY)
Ord
Trade results are given later.
1
2
3
4
5
6
A
460
440
420
400
380
360
9/7/03
Aug
Sep
Oct
Nov
Dec
7/1/04
8 -DI/+DI
80
60
40
20

Figure 37



Pence 1 day bars
Pillar Property PLC (PLL)
Ord
440
420
400
380
360
340
26/11/02
'03
Feb
Mar
Apr
May
Jun
10/7/03
80
60
40
20
8 -DI/+DI

Figure 38



Pence 1 day bars
Pillar Property PLC (PLL)
Ord
Trade results are given later.
1
2
3
4
A
440
420
400
380
360
340
26/11/02
'03
Feb
Mar
Apr
May
Jun
10/7/03
8 -DI/+DI
80
60
40
20

15.3 How Did You Do?

Here are the actual trading results for the three charts above. Please remember that the spread shown represents the expenses that I pay with spread trading, your spreads may be less for this price of share but you may incur other costs. Overall, your results should be similar to those below.

Bovis Homes Gp (Figures 33 & 34)

Trade No	Entry	Exit	Actual Spread *	Points Profit or loss
1 long	463	474	6.5	+ 4.5
2 long	484	479	6.5	-11.5
3 long	487.5	507	6.5	+ 13
4 short	478.5	423	6.5	+ 49
5 short	419	433	6.5	- 20.5
6 long	441	474	6.5	+ 26.5
7 long	461.5	460	6.5	- 8
8 long	450	478.5	6.5	+ 22
			Total	**+ 75**

Notes: Not a particularly good trading period for Bovis with three losing trades but still showing a good profit overall of 75 points.

Westbury PLC (Figures 35 & 36)

Trade No	Entry	Exit	Actual Spread *	Points profit or loss
1 long	330	365	3	+ 32
2 long	437	458	3	+ 18
3 long	430	449	3	+ 16
4 short	414	372	3	+ 39
5 short	383	371	3	+ 9
6 short	370	370	3	- 3
			Total	**+ 111 pts**

Notes: The two trades at A should not have been taken as the +DI & -DI didn't touch or cross. If you had taken both you would have lost a total of 8 points on the two trades.

Pillar Property PLC (Figures 37 & 38)

Trade No	Entry	Exit	Actual Spread*	Points profit or loss
1 long	400	418	5	+ 13
2 short	381	343	5	+ 33
3 short	355	343	5	+ 7
4 long	364	434	5	+ 65
			Total	**+ 118 pts**

Notes: Notice point A where the low went 2p below the previous day's low. You would not be stopped out if you had allowed it "space" (0.5%).

You will also notice from the above exercise that a number of very good moves were not traded because the strategy did not trigger an entry. This is the case with every good strategy. You simply CANNOT develop a strategy to catch every good move.

You do not know if it is going to be a good move until it is well under way – and then it's too late!

Also, if you want to catch every big move, you will end up trading EVERY move – that's not a strategy, it's called over trading and it doesn't work! Believe me, I have been there!

It is another example of controlling your emotions. Do not get upset or angry because you have missed a big move.

The secret is to make consistent gains and catch the occasional big move, not **EVERY** big move. You **MUST** become comfortable with that.

If you have access to charting software, you can use it to carry on back testing shares and also working on your watch list.

15.4 Paper Trading

The next stage I suggest you go through before using real money is to paper trade.

This is similar to back testing in that you are pretending to trade but with one very important difference. You do it day by day as it happens. You do not have the advantage of seeing the price action after the entry, until you have committed to the trade.

You will need to purchase charting software (see later chapter) if you don't already have it in order to paper trade.

Once your trading software is up and running you need to look for real trades as they come up. Note down the level where you would enter the trade on the day that you get price confirmation. Note down your initial stop loss position and your risk. Decide on a notional position size. Note each trailing stop position and your exit point. Calculate your points gain or loss and the amount in money that you would have gained or lost for the trade.

You can run a number of paper trades simultaneously and I suggest you paper trade over a reasonable period of time until you feel confident to move to the next stage which requires real money on your trades.

Don't forget the spread and costs on each trade and be as realistic as you possibly can. This is your opportunity to practice without risking your capital. Some trading company web sites allow you to trade on a practice site. This is well worth looking at.

16.0 Trading Software

If you already have good quality trading software with the Directional Movement (ADX) indicator you are ready to go.

If you are shopping around, here is a word of warning. I come across quite a few trading beginners who feel that they can trade using the free chart sites. Some of these sites are indeed very good but I have yet to come across one that would allow any serious trader to trade profitably. They simply are not flexible or detailed enough. You might also struggle to get the right indicator (8 day Directional Movement).

> Make sure before you buy that software has the Directional Movement indicator
> (see the earlier chapter for the other names for this).

As I say, shop around, use your search engine on the Internet, it will come up with a number of choices. Also, have a look at the SST Members' Site; I am building information on trading software for SST traders around the world.

If you are trading the UK market I can certainly recommend ShareScope. This is the software I use and it does everything I want and a whole lot more. I also find the support and data feed very reliable.

You can go to the ShareScope website **(www.sharescope.com)** and download a **FREE DEMONSTRATION COPY** of the End Of Day software. This will allow you to back test on historic charts using UK stocks in my watch list but they do not bring you up to the present day. You do not need to get the more expensive Real Time version at this stage. When you buy your copy of ShareScope, there is a dropdown menu asking how you heard of it: select "***Short Swing Trading"*** from the menu.

There is more information on ShareScope at the SST Members' Site.

17.0 Going Live

Now is the time to put real money on your positions. You can start trading for real!

A word of warning:

It all becomes a bit different when you are trading with real money.

If you are new to trading, this will be the first time your emotions will really come into play and you will experience things that even perfect paper trading cannot prepare you for. Therefore, please start with small trades. Set yourself a low risk limit and stick to it for at least a couple of months.

If you are happy with the way things are going you can GRADUALLY increase your risk level and therefore your position size. You must do this gradually for two reasons:

- Your emotions can go through the roof if you suddenly are into big numbers. You need to gradually feel comfortable with larger risk and reward

- You can bet your life that if you suddenly increase your position size, the market will teach you a lesson by giving you an unkind trade or two.

Remember that you can have good periods as well as periods when the market does not fit the strategy quite so well. By gradually increasing your risk you are less likely to get into "yo-yo" trading.

"Yo-yo" trading is my expression for the following common fault.

You increase your risk (and position size) and have a poor period. It hurts a bit so you decrease your risk again. You have a good period so you increase your risk again just as another poor period starts.

What this means is that all of your poor trades are large positions and all of your good trades are small positions. Therefore, overall you are potentially making a loss. If you had kept a consistent position size throughout, you would have made a profit.

17.1 Take the Rough With the Smooth

The key to any strategy is to accept poor periods as PART OF THE STRATEGY and keep trading with the same risk profile so that you are in a position to capitalise on a good period. In my experience, the poor periods do not last long, usually only a few days. Understanding why this happens will help you to trade through it.

You will find times when a number of trades trigger within a few days of each other and they will all be in the same direction. Let's assume you are long on everything. That situation is normal and will usually result in good profit. There are times however, when you have just gone long on a number of trades and something happens like a significant piece of news which reverses market sentiment so that all the major indices go into reverse.

Our strategy trades shares that largely do their own thing. However, there comes a time when market sentiment can still take over, resulting in some positions being stopped out for a loss.

If the market continues to fall, you will find that shares will drop below the 50 ma and short trades will start to trigger fairly quickly allowing you to capitalise on the falling market. If the market falls for just a day or two then bounces again your long trades will start to trigger once more. You may even find yourself re-entering the trades you were stopped out on …… and that's fine.

The principle is that you just TRADE THE STRATEGY. The good periods will outweigh the poor periods. With the ***SST Strategy*** a poor period should not last long and it doesn't mean that ALL your trades over that period will result in losses. The thing is that you do not make emotional decisions such as trying to guess when a good period will start or stop. You also do not try to guess the direction of the market over the next few days.

JUST KEEP TRADING THE STRATEGY.

18.0 Keeping Records

Without records you do not know how you are doing. You do not know if the strategy is working and what's more, you do not know if you are trading the strategy well.

The two vital ingredients for success are:

1. Have a good strategy
2. Trade the strategy

Number 2 is actually the most important because if you do not stick to the strategy you will not know where it is going wrong. Let me say that again in a different way.

If you don't stick to the rules, how will you know if the rules work.

YOU ARE RUNNING A BUSINESS.

No business can run without keeping books.

If you want to just play at it and gamble you can, but that is not trading.

I do this to make money and enjoy a lifestyle, for me it is a serious business.

It's also a lot of fun once you get it right!

You have a choice.
You either trade a strategy OR you trade on intuition and emotion. If you choose the latter I believe that you will either bleed to death gradually or you will have some success then take a big hit and go out with a bang.

If you trade the strategy to the letter AND keep appropriate records you will have the ability to analyse your strategy and your ability to trade it.

Sometimes you will be entering trades a few points late or setting stops a few points too tight. You will be amazed at the difference things like that can make over a period of time.

I open and close around 25 trades per month. Imagine the difference in my results if I got sloppy and missed out on 3 points per trade. That's 75 points for the month!

18.1 Individual Trade Records

Firstly, have a sheet for each trade you open. This should contain:

- Date opened
- Opening market price
- Long (buy) or short (sell)
- Opening spread (buy and sell prices)
- Reasons for opening (was it pure SST strategy)
- Initial stop loss level
- Maximum risk in points
- Maximum you are risking in money
- Position size

Then, as the trade progresses, you need to note down:

- Each trailing stop level - market and quote prices
- Close (cover) level market price and buy or sell price
- Points made or lost
- Money made or lost before and after trade expenses
- Comments on the trade including how well you traded it. In other words, how well you stuck to the strategy.

Then, approximately two weeks after closing the trade:

- What does it look like after the event?
- Were your stop levels correct?
- What lessons can you learn for the future?

I know it sounds a lot but with a standard form it only takes minutes and it is invaluable. It is an unfortunate truism that you learn the most when your trades do not work out.

> Unfortunately, you learn more from your losing trades than you do from your winners.

A sample form is shown on the next page for you to print out and use if you wish or use it as a guide to design your own. If you can use a spreadsheet program like Excel it can save a lot of time when pulling stats together for analysis.

18.2 Trade Form

Stock Traded ……………………………… Date opened …………………

Open market price …………….. Spread …………. / …………..

(circle)

Long

Short

Reasons for opening:

Initial stop level – market price ……………. Buy/Sell price ………………

Risk – points …………. Risk £/$ …..……… **Position size £/$**……………..

Trailing stop levels

Date ……… Market ………. Buy/Sell ………. Comments …………………

Date ……… Market ………. BUY/Sell ……... Comments …………………

Date ……… Market ………. Buy/Sell ………. Comments …………………

Date ……… Market ………. Buy/Sell ………. Comments …………………

Date ……… Market ………. Buy/Sell ………. Comments …………………

(Continue overleaf)

Closing date ………….. Market price ….……….. Buy/Sell price ………..

Points gain/expense ………………..… **£/$ gain/expense** ………..………

Comments on close:

Post trade review:

18.3 General Trading Records

From your individual trade records (Trade Forms above) you can collate your records for the week, month and year.

At this stage, I would like to return to the subject of trading as a business. I know it is just words and terminology, but I do not refer to my trades as profit or loss trades. I prefer gain and expense. Losing trades are part of the expenses in running the business. I wait until the end of a month to see if I have made a profit or a loss because there could be other charges that need to be taken into account. Things such as:

- Cost of charting software data
- Cost of Internet connection
- Cost of phone
- Capital depreciation on computer

I tend to go further than this and recommend that you do as well because you can learn a great deal from keeping statistics over a period of time. I keep a very comprehensive set of monthly totals and averages, including:

- Average risk (money & pts)
- Average of gain trades (money & pts)
- Average of expense trades (money & pts)
- Number of trades per month
- Average gain over all trades
- Percentage of gain trades
- Percentage of expense trades

And more………

I then have a way of testing how well I traded my position size because I am guilty of weighting some positions more than others (well I never said I was perfect!). I make the following calculation each month:

Total points profit in the month x average position size
= profitability

This gives me a theoretical profit for the month (profitability) and I then see if I have beaten that figure (traded well) or not (slapped wrists). If the answer is slapped wrists I look for why, then learn from that.

The other record I thoroughly recommend you keep is a running total of points (and/or money) gained or lost for each share you trade. The reason that this is so valuable is because it will become apparent to you that you have more success with some shares than others. This gives you a chance to reject shares that are not profitable and test others that you might want to add to your watch list. Always try to improve the bottom third of your watch list.

I do make life relatively easy for myself by using spreadsheets for all my calculations. Figure 39 shows an example of my monthly points record.

Figure 39

Date open	Date close	Long Short	STOCK	Max risk pts	Points gain	Points exp	Comments
16-Dec	02-Jan	S	Countrywide Assured	6		5.3	Market against & whipsaw. Re-entered in opp direction (below - profit)
19-Dec	05-Jan	LR	Westbury	15.8	9.3		ADX entry. Strict EoD stop. Gd trade but then pushed higher.
22-Dec	05-Jan	L	Berkeley	16.7	15		New high DT. EoD stop. GOOD TRADE.
19-Dec	05-Jan	L	Bovis	16.2	22.5		ADX 4 pts late. Strict EoD stop. GOOD TRADE
19-Dec	06-Jan	L	Redrow	9	6.2		ADX 2 pts late. Strict EoD stop. GOOD TRADE
19-Dec	06-Jan	LR	Carphone Warehouse	6.7	5.2		Gd ADX entry. EoD stop but big spike down. GOOD TRADE
6-Jan	07-Jan	SR	Bodycote	4.9		4.9	ADX & 200 maX but immediate whipsaw. Should have reversed trade.
22-Dec	07-Jan	LR	Davis Service Gp	12.3	1.2		ADX retraced after breaking 200ma. Mkt against. GOOD TRADE.
19-Dec	07-Jan	LR	Pillar Property	15.2		8.9	ADX. RT not allow as tight as EoD suggested. Mkt went against then came good
5-Jan	07-Jan	LR	Corus	1.5	0.6		ADX. EoD stop. Mkt hesitation. GOOD TRADE but should have re-entered
23-Dec	07-Jan	LR	Trinity Mirror	6.2	4.8		Gd ADX entry. Strict EoD stop. Cld have made few more pts but away.
30-Dec	07-Jan	L	J D Wetherspoon	10.4	9.4		Gd ADX. Strict EoD stop. Mkt hesitation. Entered 3 pts late. GOOD TRADE
7-Jan	08-Jan	LR	Carlton Comms	2.6	5.6		ADX & trend supp. Closed on ret ID - mkt hes - WRONG USE EoD
5-Jan	12-Jan	LR	Johnson Press	9	15		Gd EoD stop
6-Jan	12-Jan	L	Countrywide Assured	7.9	8.7		ADX & strict EoD stop. Gd Trade but it was 50% res.
8-Jan	12-Jan	L	Colt Telecom	3.4	13.1		ADX - EoD - Good trade
9-Jan	13-Jan	LR	Westbury	9.6		8.7	ADX - Used ID stop WRONG Keep to EoD
9-Jan	15-Jan	LR	Enterprise Inns	15.2	47		ADX - Good trade, cld have made +15 pts if I'd been in the office.
8-Jan	15-Jan	L	Taylor Nelson	7.7	6.8		ADX - used 50% of big up as stop - VG trade
9-Jan	16-Jan	LR	Carlton Comms	4.6	30		ADX excellent trade - came out at tgt (ID stop!) Mkt going against - Good call.
6-Jan	19-Jan	L	Singer & Freidlander	7.3	0		ADX - Good trade
8-Jan	19-Jan	L	Spirent	2.2	16		ADX - ID stop to close - mkt going against - Good call.
16-Jan	21-Jan	L	GKN	8.5		1.9	Mkt coming off - used EoD but not EoD -2p - Good call.
9-Jan	22-Jan	L	Thus	2.1	0		ADX & strict EoD - Mkt retraced - good trade.
16-Jan	22-Jan	L	Pillar Property	12.4	0		ADX 7 pts late - EoD . OK trade.
19-Jan	22-Jan	L	Redrow	9		3.3	ADX & ID stop @ 339 - Mkt retracing. Good call.
19-Jan	22-Jan	L	Britannic	9.3		10.1	ADX & EoD - 2p - whipsawed - mkt strongly against after entry. Gd trade.
15-Jan	22-Jan	LR	Trinity Mirror	7.5	25.4		ADX + 50% cons. EoD - good trade
22-Jan	23-Jan	SR	Carlton Comms	4.4	7.6		Mkt retracing - closed at target 250 - good trade.
20-Jan	23-Jan	S	Ultraframe	14.4	2.7		ADX Closed - gapped down to supp then up through Res & yest close. Gd trade
Trading days				Max risk pts	Points gain total	Points exp total	POINTS PROFIT FOR MONTH
21				258	252.1	43	209
Ave trades per day	Av trade time (days)			Ave max risk	Number gain trades	Number exp trades	Comments
1.5				8.06	23.00	7	

The table above shows my trading records for January 2004. I have NOT shown this because it is an exceptional month but it is simply the most recent month at the time of writing this section of the book. There are a few things worth pointing out:

- I closed 30 trades in the month – an average of 1.5 per day
- Only 4 trades were short because the market was bullish for most of the month
- The R after L (long) or S (short) means I used a rolling spread. This is explained in “Spread Trading for Beginners”.
- My average maximum risk was 8.06 points. Highest risk was 16.7 points. Lowest 2.1 points
- Points gained in the month was 252.1. Expense of 43 points giving a profit of 209 points. At £30 per point (for example) that represents a net profit of **£6,270** for the month. In an employed job you would have to earn well in excess of £100,000 per year to equal that (around $175,000 at Feb 04).
- In comments, ADX means Average Directional Movement cross. In other words the ***SST Strategy*** entry (+DI crossing –DI). EoD means End of Day, this refers to my trailing stop (as per SST strategy)
- Where I have written “Good Trade” it usually means that I have followed the ***SST Strategy*** well. Even I am tempted to deviate from it on occasions! An example is Westbury closed on the 13th January where I tightened to an intra-day stop level and should have stuck to the EoD trailing stop
- As you will see from my comments, I am not super human, I am not perfect at trading my own strategy but I still made 209 points profit
- The only thing you can’t see from my records, are the trades I didn’t take – I have learnt to become much more selective over the past year or so, refusing the ones that “almost triggered”.

My percentage of gain trades (break even or better) was 77% for the month.

Interestingly, because my average gain was higher than my average expense trade, I would have broken even with just **36%** gain trades. You can make money with LESS than 50% of your trades making break even or better provided you control your risk.

- I do sometimes close at a target price such as the trade on Carlton Communications (now ITV) closed on 23rd January. The reasons for this and how to identify price targets are beyond the scope of this book and really not an essential part of trading the strategy. Without considerable experience you will get it wrong more often than getting it right.

I keep these records each month and then feed the results through to another spreadsheet that keeps a running total and averages for the year.

I cannot stress enough, the value of keeping these records and statistics. When I started keeping detailed records that could be accurately analysed it highlighted weaknesses in the strategy that I would otherwise never have spotted. It also showed that a few points on each trade will make a significant difference when you multiply them by twenty to thirty trades per month.

2 points per trade x 30 trades per month = 60 points
60 points x £30 per point = £1,800 per month!

It tends to focus the mind on how important it is to refine the strategy and trade it accurately.

From time to time you may be tempted to open a trade that doesn't exactly fit the strategy. You may have some other reason to try the trade. If you do this, the only thing I ask is that you **MUST** keep separate records for those trades. You need to be in a position to compare the ***SST Strategy*** with your other trades as well as test yourself and the strategy in isolation.

19.0 Websites and Sources of Information

There is a wealth of information available on the Internet and I am sure you will find many useful sites in time. Your search engine will turn up dozens to look at.

To be honest, I steer clear of chat rooms or other people who have a view on the market direction or tips on shares. I trade the ***SST Strategy*** and I am not interested in forming a "view" because it introduces emotion. We might be nearing the end of the book but I have saved one of the best expressions for now.

Trade what you see – not what you think!

The point of a strategy like this is that we try to make trading more mechanical and less emotional.

I am certainly not interested in what "the man at the bar" has to say. If I am making money trading, why should I listen to one of the 90% who isn't!

You will hear many so called "experts" say what they think the market will do, even on television. Please remember that they trade different timescales to us. They may say that the market is set to fall but they might be talking about the next six-month period and you are only interested in the next few days. Also, I am afraid most of the time (yes, I do mean most) they are simply WRONG!

My advice is to just trade the strategy and ignore all other market commentary.

Having said that, the television can be a useful source of information. I do occasionally watch Bloomberg during my trading day – or rather, it is on in the background. It shows live (real time) share prices and major indices on a ticker as well as worldwide market news and commentary from analysts and chartists. It is also available on radio. You can hook into their website to pick up the commentary. CNBC is a good alternative. I watch Bloomberg less and less these days but sometimes tune in on days of major news.

You might also find share prices on teletext useful.

“Traders’” magazine is a good publication. It is published every two months and contains interesting articles from charting ideas to interviews with traders. To find out more go to www.traders-mag.com

Below is a short list of some of the websites I have found useful in the past and some that I still use. They are in no particular order.

Web Site	***Main Content***
www.signalwatch.com	Good commentary on US indices
www.bigcharts.com	Analysis and charts
www.advfn.com	Good site for live prices and charts
www.tacticaltraider.com	Mainly trading chat line
Cbs.MarketWatch.com	News & commentary
www.financialspreadbets.info	News & information and virtual spread trading
www.reuters.com	World news
www.bloomberg.com	World news
www.londonstockexchange.co.uk	Live prices and real time news
www.incrediblecharts.com	Good technical analysis information
www.global-investor.com	Books & resources for the financial community

Don’t forget to keep an eye on the SST Members’ Site:

www.shortswingtrading.com/sstmembers.html

20.0 Further Help

With the purchase of ***Short Swing Trading***, I offer one month email support FREE OF CHARGE. If you need some further clarification on the strategy or have a question you would like an answer to, please email me.

The email address is:

support@shortswingtrading.com

I cannot promise to get back to you within a certain time because I might be travelling around the country or even abroad. However, I will do my best to answer your query as quickly as possible.

20.1 A Note For New Traders

I have designed this book to give you a simple but very effective strategy that will give very good results over a reasonable period of time in all market conditions. It is aimed to take you from the basics to a position where you can trade profitably.

This is an enormous stride for a new trader.

I cannot stress enough how difficult it can be for a new trader to achieve success without being able to follow a tried and tested strategy like this. The amount of information available is mind blowing. Which bits work and which don't, what to use and what to leave alone can usually only be found by trial and error over a long time, which can be an expensive process.

I started the book by saying that only 10% of traders consistently make money. I REALLY hope (and expect) that by buying this book you will get into that elite 10% very quickly. Knowing that you have would give me enormous pleasure and I would LOVE to hear from you!

20.2 A Note For Experienced Traders

If you are a more experienced trader you may well be familiar with some or even most of the contents of the book. This will be the case with almost any book you buy once you have traded for a few years and read a few books.

However, we all look for those little nuggets of gold to come out of sifting through the pages. Sometimes you learn one new thing from a book but that thing can earn you the cost of the book time and time again. I hope you have found at least that with ***Short Swing Trading.***

I am sure that parts of the SST Strategy will have been known to you already – for example, the use of a moving average is not exactly advanced charting knowledge and you may already have been aware of the Directional Movement indicator.

But I am certain that the contents of the six rules together with the "personality" of the share traded gives you an overall strategy that you will not have come across before.

In buying *Short Swing Trading*,
what have you REALLY paid for?

Ultimately, it is the SST Strategy you have paid for. The cost of this book is your licence to trade my strategy.

It has cost me three years and a great deal of money in previous losses to develop the SST strategy – it is yours to use "off the shelf" for the cost of this book. I sincerely hope it is as profitable for you as it has been and still is for me.

Please keep in touch and let me know how you are getting on. Trading can be a lonely business. A pc does not make a good friend! It is often good to keep in touch with other traders.

At very least, keep an eye on the SST Members' Site or better still help to contribute to it – it would be great to hear from you.

20.3 A Note to ALL Traders

Buying ***Short Swing Trading*** can give you far more than a book – it's up to you.

- If all you want is a book to build up your overall knowledge - that is fine.
- If you intend to trade the SST Strategy for yourself – that is GREAT!
- If you want to become an SST Trader – that is FANTASTIC and you are very welcome!

What do I mean by an SST Trader?

There are SST Traders all over the world:

UK, USA, Australia, New Zealand, Italy, France, Bahamas, Portugal, Japan, Singapore, Denmark, Belgium, Hong Kong, Germany and Canada with more countries being added all the time.

Many of these traders are in regular contact with me beyond the one-month free support. They send me information for the SST Members' Site to help other traders, share tips and news.

The more that people contribute, the more we can all benefit. I am currently considering further developments for the SST Members' Site and possibly a bulletin board. Let me know what you would like.

21.0 Summary

Thank you for taking the time to read my book and thank you for having the faith to pay for it without knowing the full content.

Trading may be a serious business but it is also a fantastic way of achieving what you want in life. Nothing else can give you the freedom and unlimited income. Here is a reminder of some of the unparalleled benefits.

- You determine how much time you spend trading
- You can trade from home or anywhere in the world with a computer and a link to the internet
- Your earnings are only limited by the capital you are prepared to risk when you have a successful strategy
- You have no competition. Unlike other businesses, it doesn't matter if your neighbour starts trading
- You don't have to find customers or clients and you don't have to sell anything
- You don't have to trade every day – the market will be there tomorrow with fresh opportunities.
- You can go on holiday whenever you choose without worrying how your business might have suffered while you were away
- You don't have to employ anyone
- Capital outlay on equipment is minimal. All you need is a modern computer (laptop or pc) that is connected to the Internet, your charting software and your trading account.

I hope you can take the time to email me to tell me how you are getting on. Nothing would please me more than to know you are trading profitably. It only remains for me to wish you happy and successful trading.

I hope you achieve **everything** that you are looking for in life.

ENJOY YOUR TRADING!

David Graeme-Smith

Short Swing Trading
Email – support@shortswingtrading.com
SST Members' Site – www.shortswingtrading.com/sstmembers.html

DISCLAIMER

Trading carries a high risk and you should never trade with money you can't afford to lose. The contents of Short Swing Trading are for educational purposes and should not be considered in any way as investment advice. Ultimately you, the trader, must take responsibility for your own trading decisions. Although every effort has been made by the author to ensure accuracy (as at Feb 2004) the content of this book cannot be guaranteed as accurate into the future.

Past performance is no guarantee of future results.

The author and Short Swing Trading accept no liability whatsoever for losses or damages resulting either directly or indirectly from the use of the information contained in this book.