

Steidlmayer on Markets Trading with Market Profile

Second Edition

J. Peter Steidlmayer

Steven B. Hawkins



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Published by John Wiley & Sons, Inc., Hoboken, New Jersey
Published simultaneously in Canada

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Library of Congress Cataloging-in-Publication Data:

ISBN 0-471-21556-2

Printed in the United States of America

10987654321

FOREWORD

A chart is a communication vehicle. Its purpose is to communicate what is transpiring at point A (trading pit) to an observer at point B (some distant location). One can look at any charting system (e.g., bar, point and figure, candlestick) as a language. Each was developed to communicate market condition to an observer. The language of trading has its own vernacular. Examples include: “it feels heavy here,” or “it feels like we have more to go.” Market Profile is the product of a professional floor trader’s ability to communicate the pit trading experience symbolically in chart form. Here is how this is accomplished.

The standard 30-minute bar chart automatically moves to the right to start a new bar every 30 minutes. The horizontal dimension in this chart is automatic—dictated by chronological time, not market activity. The involuntary nature of this action inhibits the ability of the bar chart to communicate market activity in the horizontal. This limitation is analogous to trying to communicate detail or nuance using only nouns and verbs but no adjectives or adverbs—less than adequate communication.

Market Profile has no chronological restriction. It expands horizontally only when prices repeat. Horizontal expansion of the chart reflects only market activity, never chronological activity (the passage of time). Market Profile more clearly illustrates to the trader a new directional move beginning in a dead market or a directional move losing momentum. The feel of the market is objectively illustrated using the horizontal dimension.

Visual focus = Accurate communication = Better trade identification

Jim Mayer—President
Mayer Investments

ACKNOWLEDGMENTS

First of all, I would like to thank Pete Steidlmayer for the opportunity to work on this book. He has been a tremendous mentor, and has offered direction, yet allowed me to stumble, bumble, and make mistakes along the way, all of which are necessary in the learning process. His vote of confidence in my understanding of this methodology is greatly appreciated.

Second, the sacrifices of my wife, Jackie; and children, Steven, Nicole, Joshua, and Bennett have in general been unacknowledged yet not unappreciated. Without their support, understanding, and encouragement, this work wouldn't have been possible.

And lastly, I would like to thank all those who have supported me during my professional career as well as those involved in my early life development. They helped lay the foundation for my future and helped me understand the need for balance in one's life.

Steven B. Hawkins
October 2002

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Section I

The Steidlmayer Method

Chapter 1

EARLY LESSONS

The most important element in becoming a successful trader is having a sound background consisting of a strong base of knowledge acquired from being active in the markets through time. Building this background is in some ways the easiest and in other ways the most difficult thing for a trader to accomplish. Trading experiences, observations of all kinds, a focus on what is most important, and a clear understanding of business principles are all necessary ingredients in a strong trading background. Awareness and patience are also required to further develop one's background. Without a sound background, one's trading cannot be consistently successful. With it, one can develop clear, correct ways of thinking and confidence in one's trading judgment. In today's fast-moving world, some traders try to bypass the crucial first step of developing a sound background, and then rationalize the lack of background for the rest of their careers.

But the opportunity to develop the needed background is always there. I would like to share the background that underlies my own understanding of the markets. The experiences that went into building it are varied and required a lot of time and hard work. If you can learn the principles that these experiences illustrate, you will find that the same principles figure in your own experiences as a trader. I think you will also learn some things about today's markets.

Trust and Freedom

In my formative years, from 1944 until I completed high school in 1956, I gained both education and knowledge. Education pro-

vides a foundation and method for learning, but knowledge comes through experience. Thus, a lot of knowledge develops on a subconscious level. I was not aware of this subconscious learning process when I was growing up, but in later years I found that I had a large storehouse of knowledge to draw on to gain a good understanding of any subject. I had stored in my subconscious a database of real knowledge that came from varied experiences.

I grew up on a ranch in California and much of my early learning came from being exposed to the family business. Skill was greatly respected in my family, but more important than skill was integrity. People who were disloyal, dishonest, or untrustworthy were not needed regardless of how skilled they might be. If my family was doing business with someone who turned out to be untrustworthy, we stopped doing business with him or her no matter how rewarding the deal might appear to be on an immediate basis. We used this principle to avoid major losses in the future, and I stick by this principle to this day.

In my family, no one was condemned for making mistakes. We understood that all knowledge came from making mistakes. This idea became dominant as I ventured out into the world and got bumped occasionally. "That was a good experience," my parents would say. "Learn from it and go forward."

My parents did not criticize or analyze the mistakes we boys made. We did that on our own. The burden of facing up to our mistakes and learning from each experience was on our shoulders. Patience was always stressed because it reflected and developed our inner self-confidence. We were not expected to show quick results; it was understood that "slow and steady wins the race."

My parents encouraged me to take my time to find a profession that I enjoyed rather than one they would like me to pursue. The object was to do things and to find out what I could and could not do—then I would be able to make choices for the future. Later I learned about the American Indian practice of putting a young man of 11 or 12 years old out alone on a mountaintop or in the desert to spend several days searching for the meaning of his life. The revelation might come through a sign or perhaps through a dream. Either might reveal the young man's destined path. I was raised in the same spirit, and it has become an important part of my background as a trader.

Home was a base from which we could venture and a sanctuary to which we could always return. My parents assured us that we would always be welcome to stay with them no matter how bad things were. But we were responsible to ourselves, to those surrounding us, and to the community. If we ever violated that trust, we might lose our sanctuary. Success was viewed as temporary. We were encouraged not to get too excited when things went well or too depressed when things did not, but to remain emotionally balanced. Time was the most important measurement of all. A person or an idea had to stand the test of time. New ideas and dreams were not disregarded, even if they did not work out. They were considered opportunities for learning and growth.

The Importance of Fixing the Gate

When I worked for my father, I learned not to run away from a problem and to finish what I started. Our philosophy was to do the job once and do it right. My father never understood why people would fail to recognize a problem or, if they did, why they would not deal with it unless forced to. We had many wooden gates on our ranch, and from time to time they would need repair. When our ranch hands went through a broken gate, they would open and close it without stopping to fix it. By contrast, my father would fix the gate then and there. That was his way.

Years later, when the markets changed in 1969, the trading method I had developed no longer worked—it was “broken.” Although I was trading in the markets every day, I did not want to face the reality of the broken gate. Once I realized that I was running away from the problem, just as the ranch hands had ignored the broken gate, I motivated myself to stop and correct the problem. I also learned from my father the importance of the last 10 percent of any job. He always said that this was the most important part of any task—the part that required the greatest discipline. This final effort separates success from failure; it separates the person who always has 10 projects 90 percent done from the person who successfully finishes each task. It separates the many climbers who reach the 25,000-foot level on Everest from the few who reach the summit.

The same philosophy applies to trading. The willingness to follow through on a task marks the difference between those who are almost successful and those who achieve their goals. In my family, we also learned to recognize the abilities of others. Some people have more talent than you, others less. Do not compete outside yourself; try to be the best you can within your own abilities. But learn from observing yourself and the many types of people around you.

The Secrets of Order and Control

In August 1946, when I was 7 years old, my father and I were moving a tractor from our valley ranch to our ranch in Nevada. As we reached the foothills around 4 P.M., about 4 hours from our destination, we got a flat tire and stopped at a tire shop in Orville, California. In those days, truck tires were complicated to take apart and put back together, so at about 4:50 they were still working on it. My father was anxious to get on with the trip. The mechanic wanted to quit work at 5:00, so both men wanted to get the job done. I watched them take the tire apart trying to put it together again and again, emotionally beating at the tire with a hammer and swearing at it. Finally, I piped up, "Why don't you put the tire back together the opposite way you took it apart?" I can still see the mechanic's face as he turned his head toward me—his face covered with dirt and sweat—and said, "Well, how is that, sonny?" I proceeded to tell him how, and 5 minutes later we were on our way.

I learned that by watching you could perceive a sense of order. Emotions and impatience do not produce results—observation and understanding do. I have found the same to be true in trading. When working the land, there was pride in the different chores we were given. A job had to be done according to standards that were acceptable to our parents and to the ranch. More importantly, it had to meet our own standards first, before we even showed anyone the completed job. In my family, your job was you—a reflection of your standards. The full-time ranch workers did a good job with the income-producing crops, but not as well with the fill-in jobs, which kept them occupied during

slack times. One of these jobs was irrigating the back pasture. You could not get water across the back pasture because it had never been leveled. If you were irrigating a bean or corn crop, which was planted on level ground, you were expected to make sure water got over every inch. But everybody slacked off on the fill-in jobs because no one ever checked them. But when I was asked to irrigate the back pasture, I designed a system of dams to get water all over the field, which had never before been fully irrigated. No one ever knew, but that did not matter because I got personal satisfaction out of doing it. I realized that if I stayed within the accepted standards for the job, I would not learn anything. By stretching myself beyond the standards, forcing myself to do more, I learned a lot.

Another experience taught me to have confidence in my abilities and to take control of a situation. I was riding with our dogs on the back edge of a trailer that my dad was pulling behind the pickup truck. We were moving down a rugged road at about 25 miles an hour. Suddenly, the trailer hit a bumpy stretch of the road, and I realized that I could not hang on because there was no place to grip on the back of the trailer. I pictured myself falling off the truck onto the rocky road. I could see that if I fell, I would probably break my arms and possibly die. I panicked. I started to scream, and the dogs began to bark, but my dad could not hear over the noise of the pickup and the rattle of the bounding trailer.

Fortunately, I figured out a way to avoid disaster. By lifting my body off the truck with my arms and tilting my weight back toward my head, I was able to absorb the bounce in my arms and keep my balance. I rode that way for about three-quarters of a mile, until we got to the shop. I never told my father about this experience, although I had been really scared by it. I learned not to accept disaster. In this episode I fought off disaster with my brains and my muscles and I gained confidence in my own abilities as a result.

Looking Beyond the Self

One Saturday when I was about 11, I wanted to hunt ducks. It was a rainy day with a strong south wind, and there were ducks

and geese all over the ranch. My brothers and I had to move about 1,500 sheep from one ranch to another before I could go hunting. My father warned me not to cut across the fields with the sheep. But as we proceeded, I grew more and more anxious to go hunting because we were passing right by the ducks and geese. Finally, I told my brothers that we should take the sheep across the field to get to the other ranch faster. As we approached the middle of the field, about 150 sheep got stuck in the mud. If you can image 150 sheep up to their bellies in mud—each weighing more than I did—you know what we were dealing with.

Normally the ranch hands got off at noon on Saturdays, but not that week. Everyone worked until 3 P.M. pulling sheep out of the mud—I was too small to move them myself. No one complained, but I realized that my selfish interest had given a lot of people a lot of extra work. From that experience I learned not to put myself first.

To me, success in trading also requires unselfishness. When you are in the pit, you have an obligation to other traders and brokers in the pit to contribute to the well-being of the marketplace, not just to seek your own profit. The marketplace comes before you or any other individual trader.

Glimpses of Markets at Work

Observing the ranch hands trading in used guns and cars and my father trading in land, equipment, and crops taught me to take advantage of situations rather than letting them take advantage of me. At harvest time, my father was not speculating for big gains. He wanted a fair price for his crop to make a normal profit for his work and his capital investment. If the price at harvest time was fair, he sold. If he felt the price was not fair, he held and stored the grain.

When buying, my father wanted a fair price as well. I remember going with my father shopping to buy all the groceries for the camp. He knew the price of everything, and he always bought sale items. If the price was too high he would not buy; he would substitute or go without. He had a list of what he thought each item should cost, and he would check off the list when he