Entries & Exits

Visits to Sixteen Trading Rooms

Dr. Alexander Elder

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In memory of Eddie Ching,
my best friend Patricia's kid brother,
who on September 11, 2001,
went to a business meeting at the World Trade Center
and vanished from our lives.

Contents

Entries & Exits

Introduction

You are about to meet 16 private traders. Some trade for a living, while others are still at a semiprofessional level, clawing their way to the upper rung. These men and women live in different countries, trade different markets, and use different methods, but all share several traits—most importantly their dedication to trading. They are utterly serious about their work, while most amateurs, who supply the bulk of their winnings, are chasing the excitement of an adrenaline rush.

The people you are about to meet have generously agreed to describe their methods and show their actual trades. Why would they do that? Why would a person who knows how to trade talk to anyone instead of keeping his or her mouth shut and grinding out profits in silence?

The secret of trading is that there is no secret. There is no magic formula you can buy or steal and plug into your computer to automatically make money. Success is based on discipline, hard work, and a bit of flair. These traders know that their success will not be diminished by the success of others, which is why they are willing to show you what they do. Also, many have traveled a hard road and feel kind toward beginners.

Trading is an immensely rich field, and no one can become an expert in all aspects of it, just like a doctor cannot be an expert in every field of medicine. Many beginners spread themselves painfully thin between investing and day-trading, between stocks, futures, and options. You're about to see that almost all successful people find one area that appeals to them and specialize in it.

People become successful when they focus on what they love to do. In reading this book you will probably come across a trading vehicle you like or a concept that appeals to you. Once you find it, stay with it and mine that area for its rich deposits. I wrote this book to help you break out of isolation, learn from others, pick up ideas that suit your style, and return to your trading room a better, more confident trader.

HOW I MET THESE TRADERS

Eight years prior to writing this book, I went on a Caribbean vacation and by the end of the week felt thoroughly bored. The blue sky, the warm beach, and the rich food became a little repetitive after a few days. I realized that my favorite vacation was a working trip during which I could alternate work with sightseeing. I thought there must be others with similar tastes, and the following winter scheduled my first Traders' Camp. Eighteen traders signed on, and we went to the Dominican Republic for a week. We ran on the beach every morning, had classes from 9 AM to 1 PM and again from 5 to 6:30 PM, spent several hours around the pool after lunch, and partied every night. The group loved the classes, the resort, and the company. They told their friends about our Camp, and people started calling and asking to join. From then on we ran Traders' Camps several times a year on islands in the Caribbean, Pacific, and Mediterranean.

After working and playing together for a week, many campers became friends and kept in touch. I started having monthly campers' meetings in my apartment in New York. Many campers returned to subsequent Camps for refresher courses. After watching their progress over the years, I knew who I wanted to interview for this book. They included Sherri Haskell, Sohail Rabbani, Ray Testa, Mike McMahon, Michael Brenke, Kerry Lovvorn, and Diane Buffalin. I would have interviewed several more, but we could not mesh our schedules.

I always invited at least one guest instructor to every Camp to offer a greater diversity of views. I taught in the mornings, and they taught in the afternoons. Four people in this book—Fred Schutzman, Gerald Appel, David Weis, and Martin Knapp—taught in two or more Camps. I kept inviting them back because traders loved their lessons. As soon as I began working on this book, I knew I wanted to interview them.

I had been hearing of Bill Doane for several years and invited him for an interview to expand outside the camper circle. I ran into Peter Tatarnikov in Moscow and was impressed by the maturity and depth of this very young man; we conducted an interview in his securely locked office a few days before I flew back to New York.

MALE OR FEMALE?

Almost every nonfiction writer faces this dilemma—which pronoun to use. He? She? He or she?

Male traders outnumber women, although the ratio is rapidly becoming more balanced, as more and more women come into the markets. I find that the percentage of successful traders is higher among women. They tend to be less arrogant, and arrogance is a deadly sin in trading. The male ego—that wonderful trait that has been bringing us wars, riots, and bloodshed since time immemorial—tends to get heavily caught up in trading. A guy studies his charts, decides to buy, and now his self-esteem is involved—he has to be right! If the market goes his way, he waits to be proven even more right—bigger is better. If the market goes against him, he is tough enough to stand the pain, and waits for the market to reverse and prove him right—while it grinds down his account.

Women traders, on the other hand, are much more likely to ask a simple question: *Where's the money?* They like to take profits and avoid losses instead of trying to prove themselves right. Women are more likely to bend with the wind and go with the flow, catch trends, and hop off a little earlier, booking profits. When I tell traders that keeping records is a hugely important aspect of success, women are more likely to keep them than men. If you are looking to hire a trader, all other factors being equal, I'd recommend looking for a woman.

Still, there are many more male than female traders. The English language being what it is, "he" flows better than "he or she" or even jumping between the two pronouns. To make reading easier, I'll use the masculine pronoun throughout this book. I trust you understand that no disrespect is intended towards women traders. I want to make this book easier to read for everybody, of any gender, anywhere in the world.

Adapted from *Come into My Trading Room*

After reading my books, several traders approached me with very thoughtful questions and showed me their work, which was extremely serious and instructive. I enjoyed swapping ideas with them, and in the process of writing this book, invited them to be interviewed—Andrea Perolo from Italy, Damir Makhmudov from Latvia (he signed up for our Camp later), and Pascal Willain from Belgium.

Finally, there were several traders with whom I explored the possibility of an interview, but it never materialized. There were two campers who made massive amounts of money, moved offshore to tax havens, and did not want the visibility of an interview. There were also a few people with whom I discussed a possible interview—they talked a good talk but could not provide documentation of their trades.

I visited some of these traders, while others flew to New York to meet with me, and a few came to see me in Sicily and Amsterdam when I traveled in Europe. These days, with readily available Internet access, a trader's office is wherever he can put down a laptop.

HOW THIS BOOK IS ORGANIZED

At the start of each chapter I'll introduce you to a trader and tell you about his or her background and method. Each person will show you two trades, and I will comment on both entries and exits. I will conclude each chapter by discussing an important theme or topic arising from that interview. In addition, I invited each trader to write a personal statement after our interview. Some described their personal development, while others sent more technical e-mails.

The entry into each trade will be shown on the right-hand page, with charts looking exactly how they did when that trader made his or her decision to go long or short. Do not rush to turn over that page—study the charts to decide whether that trade is likely to be a winner or a loser. Review the trader's comments on his or her charts. Ask yourself whether you agree or disagree with that trader's reasoning. Once you've made your decision, turn the page to see how the trade came out. Review the exit charts and read my comments on both the entry and exit. Proceed to the second trade and repeat the process.

Several traders wanted to show how their trades looked a month or two after the exit. I let them do it, but did not encourage such "hindsight charts." All of us are smart after the fact, with buy and sell signals plainly visible in the middle of the chart. The closer we get to the right edge, however, the murkier it becomes. Since we have to make our decisions there, I wanted the charts in this book to look as close as possible to the real thing. The middle of every chart looks easy, but we have to do our job at the right edge.

I want you to focus on the work of traders I visited, but since I comment on every single trade, I want to make my approach clear to you. I will begin this book by offering a very brief outline of my method.

It always shocks me to pick up a technical book without a bibliography. Any author of such a book must be a genius who doesn't owe thanks to anybody. You will see not one but two bibliographies in this book. First, there is a list of books mentioned during the interviews. Second, I asked every trader to give me their recommended reading list—they all did, and some added comments to their picks.

While I was working on this project, a steady stream of questions came in from campers and webinar participants. I saved some of their e-mails and included them, along with my answers, in the Q&A boxes throughout this book.[1]

[1]This might be the right place to mention that I have no "technical support person" for my books. I am the only trader in my office. My manager receives a steady stream of questions for me, but unfortunately, I cannot answer most of them for sheer lack of time. I answer questions from campers or participants in my private webinars, and also reply to e-mails from serious traders—which is how I met Andrea, Damir, and Pascal.

We are embarking on a journey together. It took me more than a year to create this book, and the people interviewed spent years rising to their current level. Slow down and do not rush—take your time, keep notes while you read, and study the charts. The more you put into this project, the more you'll get out of it.

WARNING: OBJECTS IN THE MIRROR ARE FARTHER AWAY THAN THEY APPEAR

Most of us like to brag about our successes and hide our failures. Traders in this book have broken the mold—they will show you losing as well as winning trades. You are about to see real trades, made with real money. Still, there are several caveats you should keep in mind.

It is human nature to select especially attractive winners and relatively innocent losers when showing one's trades. I would think that most winning trades are not quite as great as what you see here, and many losing trades are a lot worse. Success is always a little farther away than it seems, while the risk of failure is a little closer than we imagine. To paraphrase the warning car companies engrave on side-view mirrors—objects in the mirror are farther away than they appear.

You'll meet several traders who are already famous, but most are unknown to the public. I have known almost everyone interviewed here for several years and feel sure that some of them will rise to prominence as money managers or analysts. At the same time, it would be unlikely for all 16 to remain successful. Markets are harsh, and some people inevitably fail. Please keep in mind that this book does not offer an unlimited lifetime endorsement of any interviewee.

Yet another word of caution is about my own comments. They express my opinion about each trade, its pluses and minuses, its strengths and weaknesses. At the same time you have to keep in mind that all of these comments were written after the fact—after each trade was already closed. All of us are smart after the fact. Being smart about the future is much harder. Hindsight offers a terrific advantage.

It is easy to see good trades in the middle of the chart, but the closer you get to the right edge, the more confusing the markets are. There is a big difference between exploring a battlefield after a fight and making decisions amidst what the great military historian John Keegan calls "the fog of war." This is why the level of clarity you see in these comments would be difficult to achieve in the middle of a trade.

To achieve clarity in your own thinking, you must keep good trading records. Make an entry in your diary after putting on each trade, paste up the charts, mark up their signals, and write down your reasons for going long or short. After exiting a trade paste up an updated chart, mark up its signals, write down your reasons for exiting, and analyze the pluses and minuses of that trade. When your own diary gets to be as thick as this book, you'll be well on your way towards becoming a successful trader.

ON THE MENU

In recent years I've developed a friendly working relationship with the people who own and run Intershow, the largest conference company for traders and investors in the United

States. They often invite me to Traders' Expos and Money Shows to conduct day-long intensive workshops.

Speaking at their conferences allows me to meet hundreds of traders, many of whom have taken my classes repeatedly. I notice massive differences in what traders at various levels of development try to take home from the workshops. Several dozen people sit shoulder to shoulder and listen to the same talk, but each tries to capture something different.

Beginners scramble for hot tips, writing down any symbol that comes up. We often find a few good tips; the problem is that after a while these tips will play themselves out, and then what? Intermediate traders ask about indicator parameters and crane their necks to copy my numbers from the screen. They appear suspicious when I tell them there are no magic numbers and that the exact settings are not that important. Experienced traders sit back and watch, taking a few notes. They keep telling me the best part of the class is seeing a professional trader make decisions in real time in front of a live screen and explain how he makes them.

After hearing those comments I restructured my presentations—less lecturing, more sharing. This approach has carried over into my writing. Instead of lecturing you, I want to show you how professionals go about making decisions. Traders in this book share a wealth of information; what you take home is entirely up to you.

MY METHOD

Since you will be seeing my comments on every trade in this book, I need to outline my own approach to the markets. This is an extremely brief overview because I do not want to repeat my previous books. To learn more about my views on trading psychology and technical analysis, please read *Trading for a Living*. For an in-depth review of my trading techniques, money management rules, and record-keeping practices, please read *Come into My Trading Room*. There is very little overlap between the two books; if you're going to read both, start with the first, but if you're going to read only one, read the second.

I believe that successful trading is based on three M's—Mind, Method, and Money. Mind is your trading psychology; Method is how you analyze markets and make trading decisions; Money is risk control. An ironworker client told me he renamed this formula the three B's—Balls, Brain, and Bankroll. The 3 M's are like the legs of a three-legged stool: If any one is missing, a person will end up on the floor.

Beginning traders, especially those with scientific or engineering backgrounds, tend to underestimate the importance of psychology. It always surprises them that the methods they tested so well on paper fail when they start trading real money (see Chapter 8). Those who survive come to realize that when the level of emotion goes up, the level of intelligence goes down—and this doesn't apply only to trading. I could lecture you for hours on the need to be cool, calm, and collected, but you are likely to forget everything within five minutes of sitting in front of a live screen, with prices ticking up and down in front of your eyes. The best way to remain calm and preserve discipline is to keep good records. Write down your plan for the day ahead, put it next to the keyboard, and follow it. Do not change your plan during trading hours.

THE 2% RULE

Beginners are easily seduced by technical indicators, but successful traders know that money management is equally important. The two pillars of risk control are the 2% and the 6% Rules. The 2% Rule states that you may never risk more than 2% of your account equity on any single trade. People often misunderstand this rule and wonder why a person with a $100,000 account may only buy $2,000 worth of a stock. You may buy a lot more, but you are not allowed to risk more than $2,000. If you know your entry price, stop level, and permitted risk, it is easy to calculate the maximum number of shares you may buy or sell short. Let's say you're buying a $12 stock with a $10 stop. Since you're risking $2 per share and your maximum permitted risk is $2,000, you may buy up to 1,000 shares. You can buy a smaller position if you wish, but never go over the 2% limit.

THE 6% RULE

The 6% Rule limits the risk in your account as a whole by stating you may never expose over 6% of your account equity to the risk of loss. For example, if you trade a $100,000 account and risk $1,000 on every trade, you may not have more than 6 open trades at any given time. Suppose you lose money on two trades—now you are not permitted to have more than four open trades. You've already lost 2% and have only 4% open risk available for the rest of the month. This rule allows you to have more trades when you're on a roll, but slows you down when you are starting to lose money.

A good trade begins with a money management question: *Does the 6% Rule allow me to trade? Do I have enough available risk in my account?* If the answer is yes, you can analyze the stock using your method. Then, if you find an attractive trade, just before putting it on, return to money management and ask: *Based on the 2% Rule, how many shares may I buy or sell short?*

TRIPLE SCREEN

Between these two money management questions lies the vast field of market analysis. These interviews will expose you to a variety of analytic methods. My own approach is based on the Triple Screen trading system that I developed in the 1980s and continue to improve to this day. Since every market can be analyzed in several timeframes, Triple Screen insists that you begin by defining your favorite timeframe. Once you know what it is, do not look at it! You must first go to the timeframe one order of magnitude higher, make your strategic decision there, and return to your favorite timeframe only to make a tactical decision—where to buy or sell, going in the direction given by the longer timeframe. Since my favorite timeframe tends to be the daily, I use weekly charts to make my strategic decisions, and return to dailies to implement them. The weekly and daily charts are my first two screens. The third screen is the entry method, for which you can use either an intraday chart or simply place a standing order using a daily chart.

Fundamentals drive long-term economic trends, and I like to know something about them, but the bulk of my work is in technical analysis. I tend to stay away from classical charting because it is too subjective; I prefer to use computerized indicators.

In choosing technical tools I believe that less is more, just as in many other areas of life. Many programs for technical analysis have 200 or more indicators. All of them juggle the same few bits of data—open, high, low, close, volume, and, for futures, open interest. My rule of "five bullets to a clip" limits the number of indicators to the number of bullets in a century-old army rifle. You will see my favorite five on the charts—two moving averages, an envelope, MACD Lines with MACD-Histogram, and the Force Index. Let us take a quick look at each of these indicators, as well as a system that combines two of them—the Impulse system.

MOVING AVERAGES

Each price is a consensus of value at the moment of a trade. A moving average (MA) reflects an average consensus of value in its time window. If price is a snapshot, a moving average is a composite photograph. It provides two important messages to traders. First, its slope identifies the direction of change in the public's mood. A rising moving average reflects growing optimism (bullish), while a falling MA reflects growing pessimism (bearish).

Another important role of the MA is differentiating between what I call "value trades" and "greater fool theory" trades. If you buy near the moving average, you're buying value. A person who buys well above the moving average is in effect saying—"I'm a fool, I'm overpaying, but I hope to meet a greater fool down the road." There are very few fools in the financial markets, and a person who keeps buying above value is not likely to win in the long run. He may get lucky once in a while, but buying near value is a much more sensible strategy. I like using two exponential moving averages (EMAs) on my charts, one showing a longer- , another a shorter-term, consensus of value. I call the area between them "the value zone."

There are several types of moving averages, but I always use exponential ones. EMAs are more sensitive to incoming prices and less sensitive to old prices. I only use EMAs on my charts, although several people interviewed for this book were perfectly comfortable with simple MAs.

ENVELOPES OR CHANNELS

One of the very few scientifically proven facts about the markets is that prices oscillate above and below value. You could say that markets are manic-depressive—rising too high and falling too low, only to swing back.

There are several types of channels, and my favorite is a straight envelope—the lines above and below the EMA, both parallel to it. A well-drawn channel fits like a good shirt, covering the body of prices, with only the most extreme prices—the neck and the wrists—sticking out. Amateurs love to buy breakouts, but professionals tend to look for buying opportunities near the lower channel line and shorting opportunities near the upper channel line.

Some traders like to use standard deviation channels, often called Bollinger bands, which expand and contract in response to market volatility. They are only useful for options traders because volatility is a key factor in option pricing. If you trade stocks, futures, or forex, you are better off with straight envelopes.

MACD LINES AND MACD-HISTOGRAM

Moving Average Convergence-Divergence (MACD) is an indicator invented by Gerald Appel (Chapter 7). Its fast line represents the short-term consensus of value, and the slow line the long-term consensus. When the fast line rises above the slow line, it shows that bulls are dominant, and when the fast line is below the slow line, the bears are in charge.

MACD-Histogram measures the power of bulls and bears by tracking the difference between the two MACD lines. When their spread increases, it shows that the dominant market group is becoming stronger—it is a good time to trade in that direction. Divergences between peaks and bottoms of MACD-Histogram and price may be the strongest signals in technical analysis.

MACD-Lines and MACD-Histogram are derived from three exponential moving averages of closing prices. Gerald Appel used 12-day, 26-day, and 9-day MAs. Those settings—12, 26, and 9—have migrated into trading software and have become default settings in many packages. In writing my books, I used those settings to illustrate this indicator.

What settings should you use? Well, if you want to use the same ones as everyone else, use 12, 26, and 9, because the crowd is basically lazy and uses the default values. You can also choose settings that are a little faster or a little slower. It depends on whether you want to receive your signals a little ahead or a little behind the crowd. Think about it and experiment with the values, or use the defaults.

FORCE INDEX

Everybody watches prices, but it is volume that moves them. Volume reflects the intensity of traders' commitment, the heat of their exuberance, and the depth of their fear. Instead of looking at a plain plot of volume, I use Force Index, which links volume with price changes. On one hand, divergences between Force Index and prices tell me when a trend is becoming weak and ready to reverse. On the other hand, new highs or lows of Force Index tell me that the trend in force is strong and likely to continue.

Prior to the computer age I used to calculate Force Index by hand and still remember how excited I felt by its signals, which no other trader had. I also remember my inner struggle whether to reveal this indicator in my first book. My friend Lou Taylor, to whom *Trading for a Living* is dedicated, encouraged me to write about it, and I am grateful for his advice. The indicator continues to work just fine since I published that book.

THE IMPULSE SYSTEM

This system identifies bullish and bearish phases in any market and timeframe by combining two indicators. The slope of the moving average identifies the inertia of the market, while the slope of MACD-Histogram identifies the push of the bulls or bears. The Impulse system gives a buy signal when both the EMA and MACD-Histogram rise, and a sell signal when both decline. The two indicators get in gear during especially bullish or bearish periods. Just as importantly, the Impulse shows when bulls or bears start slipping, and a trend starts growing weaker.

One of my campers, a brilliant programmer named John Bruns, programmed the Impulse system for several popular software packages, coloring each bar in accordance with the Impulse system. When the EMA and MACD-Histogram rise at the same time, the market is in gear to the upside and the bar is green. When both fall, bears are in control and the bar is red. When the two indicators point in opposite directions, the bar is blue.

Impulse system	Slope of EMA	Slope of MACD-Histogram	Trading message
Green	Up	Up	Long or stand aside; no shorting
Red	Down	Down	Short or stand aside; no buying
Blue	Up	Down	Either long or short
Blue	Down	Up	Either long or short

At first I tried using the Impulse system as an automatic trading method, but discovered that it worked best as a censorship system. When the Impulse is green, you may buy or stand aside but absolutely no shorting is permitted. When the Impulse is red, you may go short or stand aside but buying is prohibited. I wait for the Impulse system to go "off green" before shorting and "off red" before buying.

Some programs do not allow users to change the color of their bars on the basis of conditional formatting, but you can still identify green or red Impulse by noticing the slope of the EMA and MACD-Histogram. Coloring the bars is a convenience, and I am so used to it that I apply the Impulse to all my charts.

Name:	Sherri Haskell
Lives:	Sausalito, CA
Previous profession:	Fundraiser for technology companies
Trades:	Stocks and futures
How long:	Since 1985, full time as of 1999
Trading account:	Medium ($250k–$1m)
Software:	www.stockcharts.com, TC2005, eSignal
Traders' Camp:	St. Maarten, January 2003

CHAPTER 1

Sherri Haskell

A Logical Way of Looking at Things

I met with Sherri twice while writing this chapter—first in 2003 when I was just planning to write this book, and again a year later. Sherri kept excellent records—in 2004 she could pull out the trades we had discussed a year earlier as easily as the trades from the previous week. These two interviews, held 12 months apart, offer a glimpse into how a serious trader's approach can change within a year.

In October 2003 I flew to a conference in San Francisco one day early in order to visit Sherri, who lives in Sausalito. I took a shuttle from the airport, crossed the Golden Gate Bridge, and got off on the other side of the bay. The air smelled of eucalyptus trees. Sherri was waiting for me in her sporty Lexus two-seater. When we arrived at her hillside house, a Mercedes convertible was parked in the driveway—Sherri liked her cars small and nimble, much like herself.

We had a campers' meeting that night, and the following morning Sherri picked me up at the hotel and brought me back to her trading room. Wall-to-wall windows overlooked the expanse of the bay and the hills on the other side. A table underneath the windows that ran the length of the room was crammed with computers, screens, and other gear. An exercise bike and a weight-lifting rack stood against the back wall. Sherri's fat cat, whom she did not have the heart to put on a diet, kept wandering in and out through the open windows, onto her trading desk, and back into the garden.

Sherri complained to me about what she called her poor performance. "I am up 90% this year," she said. "But the year is not over yet; I'll push to do better." I laughed and said, "Lay off a bit, relax—your results are fantastic, way outside of the envelope. You're at the upper edge of the top one percent of traders." Sherri did not think so. "I'm not good enough because I see stocks that go up 400% and I only make 90%," she said. "At the end of this year I want to be up 200%."

She told me that pushing for more had different meanings for men and women. Sherri always felt compelled to push extra hard to succeed in a male world. She had done very well in two traditionally male areas of business—medical equipment sales and fund raising for start-ups. Now she was just as determined to do well in trading.

I asked Sherri to tell me about her trading and show me two recent trades—one winning and another losing. She opened a hard-bound notebook, its pages full of scribbles. "I trade a couple of different ways—one way is following breakouts. I troll at night, looking for consolidating stocks with unusual volume. Something that hasn't moved very much but has big volume—that tells me momentum is building and it may bust out."

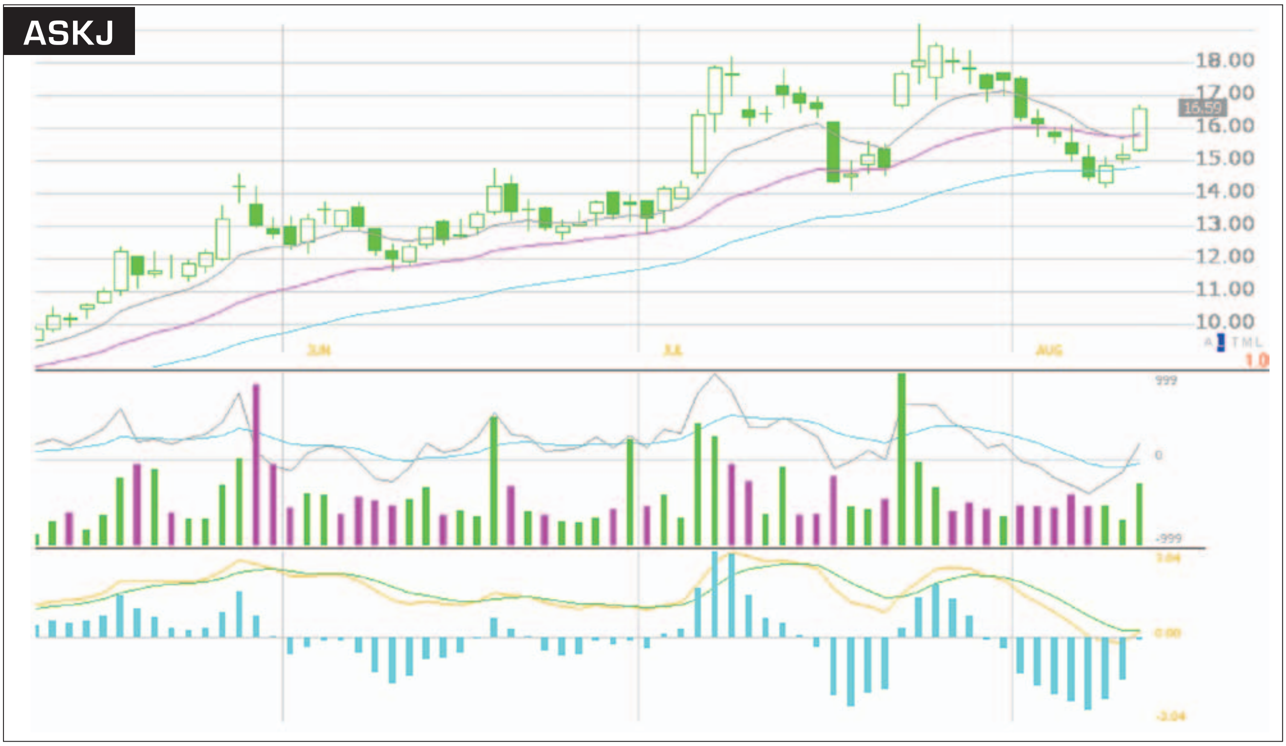
Sherri's notebook had four columns, and I read several lines. Some symbols, such as EWT and SNIC, were highlighted in yellow.

Symbol	Comment	SafeZone	Stop
ABAX	Looks OK but ADX turned down	15.23	15.69
ATYT	Really tight—clear to 16.5	14.94	14.87
EWT	RSI < 70, MACD-lines getting ready	11.09	11.32
SNIC	Nice tight range	14.62	17.74

> I jot down ideas every evening—the yellow markings mean the stock looks wonderful and I put those into my eSignal alert system. When a stock is yellow, it usually hits my mark within a day. I have no problem finding stocks or understanding technicals. My problem is deciding where to add to positions and where to set stops. I am still refining that.
>
> Every night I go over all my positions—this morning I have 13, on most days I have about 8, but even that is too many. I write a note on each position every night and then the chart image stays in my mind, so I do not need to look at charts intraday, but simply watch price levels.
>
> I do my initial review in Stockcharts or TC2000, then track my list using eSignal in real time. End-of-day Stockcharts are the easiest to read—I do not want to pay extra for intraday real time, and 20-minute delayed quotes are useless. I put the symbols of the stocks that I selected in Stockcharts into eSignal, which lets me know when a symbol hits my price. It sends me an alert by phone, an e-mail, or a pop-up window, which is what I prefer because I am in the office most of the time.

Sherri writes herself notes in eSignal, attaching them to each ticker. All notes are dated and she cleans out old notes once a week. When Sherri likes a stock a lot, she marks it with a star, and when she does not like it, she writes **Watch!** next to it. "When the page is mostly stars, the market is bullish. When it's mostly 'Watches', it is more bearish. Before I enter a trade, I check that stock's volume—if it is strong, I go. If it is 50% above the normal daily level, it is a sure buy; otherwise I think the move has no staying power."

TRADE 1 SHERRI'S ENTRY



Upper pane: Candlestick chart (daily) and three exponential moving averages—10, 28, and 50 days
Middle pane: Bar chart of volume (green = rising price day, purple = dropping price day); grey line—14-day TSV (time-segmented volume); blue line—a 10-day simple moving average of volume
Lower pane: MACD Lines and MACD-Histogram

ASKJ

My initial buy was on 8/12/03 at $16.21. At that time several indicators were giving similar signals, confirming each other. The RSI had just crossed above 50, the price was moving up on strong volume, MACD-Histogram and both MACD Lines were rising, crossing above the zero. Stochastic was turning up from below 20. How nice! The indicators were screaming to buy, and I happened to be listening.

Will this trade make or lose money?

TRADE 1 SHERRI'S EXIT

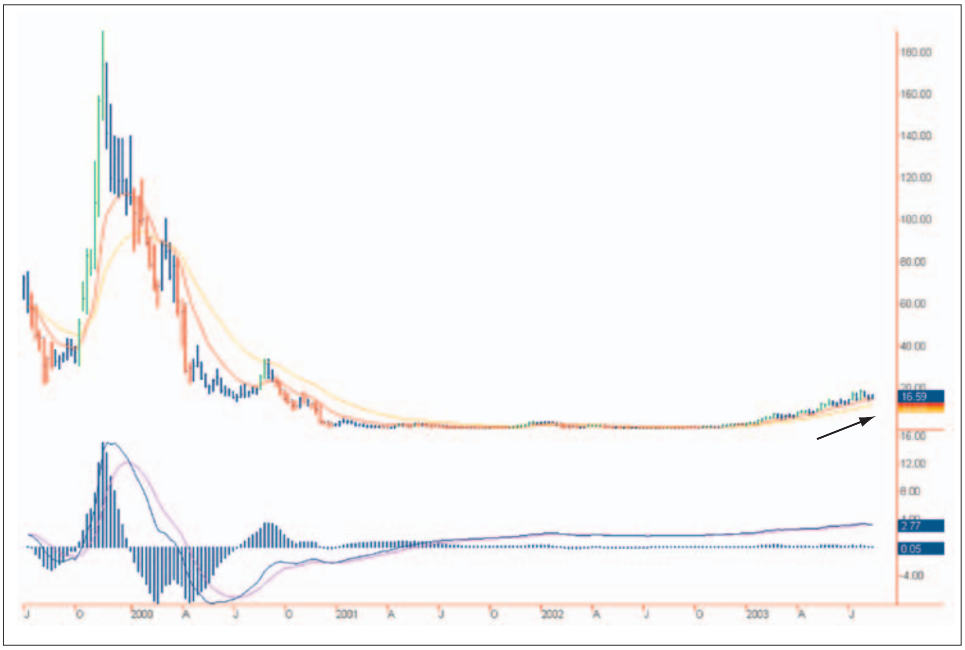
I added to my long position on 9/2/03. The stock had been moving up nicely, then developed a lateral consolidation. After four trading days, it broke out of its consolidation on extremely strong volume. RSI was advancing, MACD was strong, and Stochastic was continuing to climb. The most important factor was the breakout from the consolidation pattern on such strong volume, while all the indicators supported my action.

I sold on 9/22/03 at $20.74. The stock had been moving up for a couple of weeks, but the volume was gradually diminishing, and that got my attention. On 9/19 the price traced a *doji*, a bearish candlestick pattern. That set off an alarm, especially since the doji was on a much higher volume. I thought the price was topping out. While the price was going up, MACD-Histogram started falling off. The combination of all these factors was my cue to get out, saving my profit. I exited the next day at $20.74, just as MACD lines crossed on their way down and MACD-Histogram crossed below zero. It was time to bail out. My timing of the exit was fortunate, as the stock has continued to tumble since that day.

TRADE SUMMARY

Long ASKJ 8/12/03 @ $16.21
Added 9/2/03 @ $19.30
Sold all 9/22/03 @ $20.74
Profit = $4.53 per share on the first position,
$1.44 per share on the second position

TRADE 1—ENTRY COMMENT



Whenever I load up the file of a stock I have not seen for a long time, I begin by compressing its weekly chart until the entire history fits into a single screen. This allows me to tell whether that stock is cheap or expensive relative to its lifetime history.

The history of ASKJ reveals that the stock had been sold to the grateful public in an IPO at approximately 70 (split-adjusted) and ran up above 190 in a final dizzying vertical rally in 1999. From there it crashed and then ground down to a low of 75 cents in 2001. Any stock that falls more than 99% from its peak, like ASKJ, has every right to die. But this puppy decided to live. ASKJ lay quietly on the bottom in 2001 and 2002, just trying to breathe, and in 2003 it lifted its head and started getting up, climbing into double digits. At the right edge of the weekly chart, both moving averages are trending higher, confirming the bullish trend and allowing us to buy.

THE MOST EXPENSIVE $50

I told Sherri about a client who had consulted with me a few years earlier. He had been trading stock index futures and after a long stretch of very poor performance started making money. At that point he set the goal of $1,000 profit per day. One day he entered a long position just right and soon was up $1,950. He decided to hold until that trade netted him a round $2,000 and took it overnight, overriding his technical rules. That day happened to have been the top of the 1999 bull market! Soon his gain shrunk to $1,000, then down to zero. He continued to hold, determined to reach his new $2,000 goal, while his trade went negative. Trying to recoup it, he doubled his position and then doubled again. By the time he threw in the towel and closed out that trade, his account had been reduced from almost $100,000 to $14,000. He then had to go to his father and ask for money, opening a whole new can of worms. —*AE*

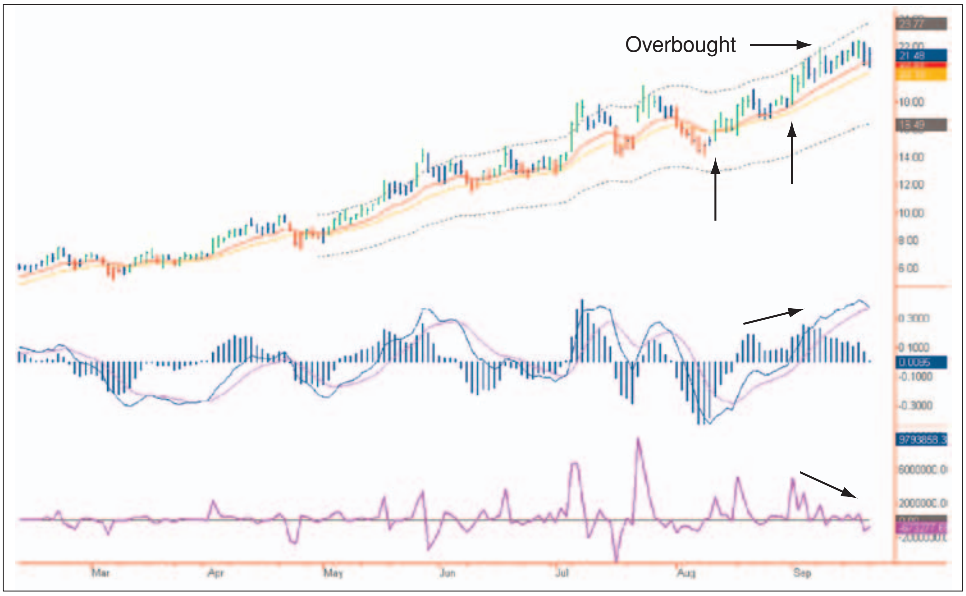
When the weekly charts give a buy signal, I turn to the dailies. There I decide to go long or stand aside, depending on the message of the daily charts. One thing I will never do is go short if the weekly charts tell me to buy. I will not trade against the message of the weekly Impulse system.

The extreme bar at the right edge of the daily chart is green—the Impulse system is giving a bullish signal. This occurs when both MACD-Histogram and the EMA are trending higher. This means that market inertia, reflected in the slope of EMA, is on the side of the bulls, and those bulls are becoming even stronger, as reflected in the rising slope of MACD-Histogram. An even better buy signal occurred a day earlier, when the color of the daily bar had changed from red to blue. When the bars stop being red, they indicate that the bears are starting to lose their power and the bulls are about to take control.

This chart is bullish, but it is not the best-looking daily chart. There are a few troublesome signs, including the bearish divergence of MACD-Histogram that occurred just before the decline near the end of the chart, which gave an extra powerful sell signal. Declines that follow bearish divergences tend to persist. A fresh multi-month record low of MACD-Histogram also points to the strength of bears.

Trading for my own account, I probably would have skipped this trade; at the same time I would not have argued with Sherri had she told me she was going to take it. Still, a serious trader like Sherri never asks anybody before making a trade. I am mentioning this only to show that different people trade differently. This is certainly a "legal" trade from the point of view of the Impulse system.

TRADE 1—EXIT COMMENT



Notice how the first pull-back at the end of August had returned prices to their value zone, and a few days later they returned to kiss that red line. This fast moving average represents the upper border of value. It is a measure of Sherri's skill that she was able to add to her longs on that slight pullback.

Sherri caught a beautiful Impulse trade, capturing an eruption from the bottom of a sharp decline, added on a slight pullback, and jumped off as the trend began to weaken. This trade felt iffy for the first two weeks, as prices remained stuck below $20 and the daily bars alternated between green and blue. Then a breakout, confirmed by new peaks of MACD-Histogram and Force Index, confirmed that the bulls were becoming stronger.

In early September, the bulls became especially strong. On September 4, 5, and 9, they drove prices to the upper channel line. Those contacts with the upper channel line confirmed the strength of the bulls, but afterwards, even as the rally continued, prices could not come up to that line. That was a sign that the bulls were starting to run out of steam. MACD-Histogram started sloping down and Force Index drew a broad and ominous bearish divergence, illustrating the weakness of the bulls. At that point, prices continued to rise simply out of inertia.

It is a reflection of Sherri's experience as a trader that when prices started pulling back into the sweet zone between the moving averages she sold instead of buying. Same signal, different action! Sherri did not catch the bottom of the move, nor did she nail its top. Instead, she accomplished the goal of every serious trader—she took a massive chunk out of the middle of a big move.

ACCOUNTABILITY

Sherri was the only trader I interviewed twice for this book. When the folks at Intershow first asked me to speak in San Francisco, I took the opportunity to schedule an interview with Sherri who lived just across the bay. When they invited me to return a year later, I called and asked Sherri to schedule a monthly traders' meeting to coincide with my visit. It felt only natural to schedule another interview and see what had changed during that year.

The one thing that absolutely did not change was Sherri's sharp focus on performance and results. She is determined to succeed in everything she does, and extremely serious about her trading. One of the best reflections of her focus on results is the quality of her records. Sherri can tell you with total precision when she traded any stock or future and why she traded it, how it looked on entry, how it looked at the exit, the result of the trade, and the lessons she learned.

Keeping good notes introduces an essential learning loop into a trader's performance. Whenever you put on a trade, you have two goals. The first is to make money; the second is to become a better trader. You may or may not reach your first goal in any given trade, but you must always reach the second. You can learn from your winning trades as well as from your losing ones. If you fail to reach that goal, the trade has been wasted.

Markets change, and good traders change with them. At the time of our first interview in October 2003 the stock market had been rising in a pretty straight line for much of the year. Sherri's account was fully committed to stocks, often going on margin. The following year was very hard for stock traders, as the market was essentially flat, with no sustainable trades, faking out both bulls and bears. When I saw Sherri in October, I learned that she did not stick around to take the punishment the way most people did. She did independent research, discovered that many futures were starting to rally from multi-year bases, and shifted her attention to those markets. She studied and traded them so seriously that by the time we met a year later, she was sending her daily spreadsheet to several friends.

There was another notable change during the year between our meetings. I could see how Sherri's charts had become cleaner and less cluttered. Beginning and intermediate traders almost always use too many tools—partly because they are just learning and partly because of a common fantasy that more tools lead to better analysis. Accomplished traders tend to use just a small number of analytic techniques, distilled by experience.

I look forward to my next visit to San Francisco, another look at Sherri's latest trades, and another visit with her traders' group. Perhaps next time I will get enough courage to go on a horseback ride with her! —*AE*