THE

StockTwits®

EDGE
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The StockTwits Edge *is dedicated to our incredible community of traders and investors, who have brought forth the amazing talent in this book.*

*Thanks Friends!*
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Introduction

At StockTwits, we believe the stock market can be a fun and profitable place. Whenever you bring together a group of highly talented and motivated people chasing profits and ask them to talk about what works for them, you’re bound to hit upon some valuable ideas and unforgettable stories. Whether you trade once a year or every day, the learning never stops. And that’s one of the key messages of *The StockTwits Edge*. It takes time, repetition, and strict discipline, but if you dedicate yourself to learning, you will discover the true power of money and your inner self.

StockTwits is an online “idea network,” a Facebook for finance, an *American Idol* or farm system for traders and investors, a virtual global trading floor. We strive to help people share and receive ideas, discover like-minded people, leverage a community of passionate people, build a publishing and research brand, and help people monetize their work. The community is made up of more than 100,000 people from all corners of the world who trade thousands of instruments. You can customize your StockTwits streams to get the ideas you want from the people you want and about the stocks that matter to you most. You can get them on the web site at http://stocktwits.com, or pushed to you on your phone or e-mail.

The real-time Web has changed many things for stocks, markets, and finance. Rapid connections and the miracle of discovery, curation, and serendipity have made the entire social networking industry difficult to value on Wall Street. I wrote extensively about this in my first book, entitled *The Wallstrip Edge* (Business Plus, 2009). The social Web and technology advances have evolved to create tools and platforms that will fuel finance and the sharing of ideas. With StockTwits, traders and investors are empowered more than ever before to learn and learn quickly through the leverage of others.

And since StockTwits is about crowdsourcing the best ideas and talent, that’s just what you’ll find in this book. It’s our first book and therefore a labor of love. For this book, we invited 46 of our community members who love, live, and breathe the markets to each write a brief chapter in which they detail their favorite setups, including background, rationale, and examples. *The StockTwits Edge* features setups from different time frames, asset classes, and market styles.

Based on our research and thousands of interviews with traders and investors, we came to the conclusion that most successful people specialize in a favorite setup. A setup is a combination of factors that need to align in time and space in order to produce a buy
INTRODUCTION

or sell signal. In The StockTwits Edge, each trader presents a favorite setup in detail as well as the approach for finding new ideas and managing risk that the trader uses successfully on a daily basis. It is amazing how diverse the chapters are.

Some of the traders you’ll meet in this book have been trading for 40 years and others for four, but each has an amazing focus and belief that if you can master one thing well in the markets you can succeed. While all of us may not always practice what we preach, the idea-generation engine of StockTwits makes it that much easier to stay focused and disciplined.

The idea for this book started with Ivaylo Ivanhoff, a community member who was finishing his MBA work in St. Louis when he reached out to me via e-mail. As I normally do when hit with a great idea, I called him directly. Ivanhoff has since come to work at StockTwits (shockingly, he calls it his dream job!) and was instrumental in pulling everything together for this book. My pal Phil Pearlman, head of content at StockTwits, is my trusted source for idea curation and he, too, has been on board since day one. I called the good people at John Wiley & Sons, and they said let’s do it.

If you feel like you might be underinvested or that maybe you overtrade, this book is for you. This book is for all of us! It’s no secret that I love stocks and I love trading and investing. I also love sharing ideas and, if I can, a few laughs. When I co-founded StockTwits in 2008, I knew it was a big idea and not sure I had the energy to get it off the ground. Over the years, StockTwits has become that perfect platform for me and so many others. Now we are a team of 20 and just plowing ahead into the social Web frontier.

We hope this book is a beginning point on your investing/trading journey. Armed with each contributor’s favorite setup, you can visit the StockTwits web site and see the same people sharing live ideas around these setups. You can hold them to their own words. You can become friends and I hope challenge them when they drift from their styles, as we all inevitably do sometimes.

Though I don’t believe in tips, I do have one for you here: If you come to the site, don’t be concerned with contributing; it’s likely that 80 to 90 percent of the audience is just eavesdropping anyway. There is nothing wrong with that. Positive and constructive feedback never hurts, though, and in the social world of the Web you will indeed catch more flies with honey.

We are excited about all the new and young faces that show up on StockTwits every day leveraging their ideas and sharing information. We hope you enjoy this book and get as much out of it as we did in putting it together for you.

A special thanks goes to my friend Doug Estadt, who has championed StockTwits from when he first met me, gave me a big bear hug, and ran to get his checkbook. Doug has been a huge supporter of StockTwits and a mentor to many young traders on the stream. Doug was traveling in China while we finalized chapters. You can follow him on Stocktwits@wsmco.

Because of the intense mentoring that occurs on StockTwits there are new stars discovered each and every day. To taste the true experience of StockTwits, head to the site.

Howard Lindzon
Co-Founder and CEO of StockTwits
THE

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EDGE
PART I

Trend Following
LES S IS MORE

In 1987, after earning my undergraduate degree, I took a job in the back office at a small brokerage firm in Toronto called Davidson Partners. I was in order entry. Brokers would fill out tickets and drop them in a box for me, and I would enter the orders to be filled. Two months into my job, the market crashed. I saw people lose everything. I was on the ground floor of a panic, and I was hooked.

It is now 2011 and I do not have the same 24 years to catch up on all my mistakes and wins, so I want this chapter to be about speed. My goal is to get you to an “aha” moment about the value of trend following whereby you can catch big moves in stocks and markets.

I trust everyone and trust no one. I can do that because I have tried just about every type of investing known to man. Today when I invest or trade in the global markets, I am in control. I make every decision. I take responsibility at some level for every made or lost dollar of mine in the markets.

I believe the markets are opportunity machines. We built StockTwits to offer investors and traders an endless supply of ideas with more context and less opinion. It will mean different things to different people, but your goal should always be to seek out investors and traders who make your job easier, and to give back when possible.

I believe investors should swing for the fences. If you invest properly, your best investments will become trades (you can call yourself a trader). If you know how to manage losses, those trades will not become investments; you will kick out losing positions from your portfolio so that you hold only winners and manage profits.

Do anything well for 10 years and you will be a success. If investing is in your 10-year plan, you just need to stay in the game and get started as soon as possible. I wish
I’d had the proper perspective in 1998 when I started my hedge fund. After 20-plus years of stock investing, I can’t believe how much time you can spend away from your screens and still be successful as a trader and an investor. In a nutshell, “less is more.” The best investors and traders prune, shed, purge, hold, and even add to winners and sometimes start over.

I believe most people will never allocate the proper amount of time to learn how to trade, but all of us can invest. We live in spectacular times. You can leverage the Web in so many ways, especially around knowledge. You can *Do More Faster* (the title of Brad Feld and David Cohen’s most excellent book on start-ups [John Wiley & Sons, 2010]) than at any time in the history of mankind. Our community at StockTwits is filled with tens of thousands of traders, a global trading floor that collectively digests and shares prices, ideas, and news.

**CATCHING BIG TRENDS**

I believe you can outwork everyone to get an edge but don’t need inside information to be successful. In fact, I would argue that the further you remove yourself from the worries of all the noise, inside information, and tips, the better your investing results will become. Surround yourself with voices and people you trust and carefully let new voices into your routine over time.

I believe the opportunity of an investing lifestyle is an amazing freedom to pursue. You can learn to watch and enjoy the markets. Knowing what I want to do has helped me focus on a plan. My strength is the network I have built over 12 years as a hedge fund manager, investor, and entrepreneur. I have been very fortunate to benefit from the Internet explosion during the meat of my investing years. Finding mentors has never been easier. I use the term *social leverage* for this phenomenon. You should slip into my social stream if you want to take part in the process. You are not locked in, and that is the power of the Web today.

As a trend investor, I have caught some big moves: Chipotle, Apple, Amazon, Rackspace, Crocs, and many private Internet companies. You did not need inside information to catch 200 points in Apple stock or 100 points in Netflix in 2009 and 2010. I am open-minded, and experience has taught me that patterns exist and they repeat. If you build a daily routine and focus on the right lists, you can learn to catch big stock moves.

To catch a large basket of trends, one should start at the macro level and work to the micro level. My friend Ivan says this about trend following: “Short-term price trends are fueled by momentum, medium-term price trends are fed by earnings-related catalysts, and long-term price trends are sustained by social and business trends.”

It also makes sense to focus on your areas of passion. Doing the work necessary to catch trends will be easier if you are immersed in the work you love. And of course,
selling is a discipline that must be honed. I am very mechanical when it comes to exiting positions.

I have missed so many winners, and, as all investors do, I never own enough of the winners I do eventually own and ride. I keep on investing because I know a new opportunity is around the corner and I will get better at spotting catalysts that will lead to big moves.

I believe that you should not worry about valuations or price-earnings (P/E) ratios for your liquid investments. Valuation matters when you can’t sell a security. I don’t think many investors or analysts can successfully determine forward prices. If they could, markets would be way more efficient. Having a defined strategy is all that matters. I am known as an “early seller,” but I like the moniker. Being an “early buyer” is a moniker I seek to avoid.

I used to trade and hire traders. Daily performance mattered. Now 10-year performance matters to me. I survived 10 years with pretty much my original limited partners in my hedge fund, despite making every mistake in the book. Daily performance anxiety is the stress of the entire financial industry. It will never disappear. That stress is our opportunity. The louder and more active trading and Wall Street become, the quieter you should become. Technology will continue to make it possible for both sides to do their jobs, cheaper and faster.

SIMPLE IS GOOD

When I read Malcolm Gladwell’s *The Tipping Point* (Little, Brown, 2000), I wondered why tipping points were not linked to stock prices. Stocks “tip” just like products and ideas. If you look back at the great stock winners of all time, you can spot a myriad of points where you could have matched “aha” moments with large stock advances.

I believe that if I follow my simple routine, the right stocks will find me. Every Saturday morning, I go to www.stocktwits50.com to get a quick snapshot of money flow and momentum. It saves me time. In 20 minutes I have a good picture of the momentum in the markets.

During the week, I follow Joe Fahmy (@jfahmy), as well as @stocktwits50, @biggercapital, @ivanhoff, and @upsidetrader. Discovery is a fantastic feature of today’s social Web platforms, so ask others on the StockTwits streams whom they trust. New voices are constantly surfacing. I check Techmeme at http://techmeme.com and Abnormal Returns at http://abnormalreturns.com and scan the headlines and read many stories. By doing so consistently, you will start to pick up the company and ticker symbols that entrepreneurs, angel investors, financial bloggers, financial journalists, and hedge fund managers are talking about. I read venture capitalist Fred Wilson at www.avc.com, Brad Feld at www.feld.com/blog, and TechCrunch at http://techcrunch.com as well.
UNDERSTANDING MOMENTUM

Momentum is a way of life. It is a style. For most people it’s psychologically difficult to embrace momentum. When I launched my daily Web video show called Wallstrip in 2006, I wanted to express in a short video format that you only need one good trend idea to change your life. We presented a new stock almost every day, trying to reveal the catalysts behind big price moves.

Price is the ultimate leading indicator. It reflects the collective consciousness of the market. If a stock is trading at a new all-time high, the odds are the underlying company is growing very fast and under accumulation from institutions. When a stock is trading at all-time highs, every holder is in a winning position, and everyone who is short is in a losing position—a powerful combination that is often a recipe for further price appreciation.

Every stock that goes on to make 500 percent passes 100 percent and many new highs along the way. A stock that is breaking out to a new all-time high after a long period of consolidation is always worth further investigation.

However, price is not the only data point for me buying stocks. I like to keep my turnover rate low and I am very picky when it comes to opening new positions. I need to understand the catalysts that will sustain future price appreciation.

Once a stock reaches a new all-time high, I start to follow it. I always do my homework and if I find a strong catalyst that is likely to sustain the price trend, I buy.

I will never pay the lowest price and sometimes do pay the highest price, but I won’t let one bad stock or investment wreck my life. There will be times when investing seems easy, but do not confuse a bull market with brains. There are times when most stocks go up as fresh money enters the equity markets and higher prices boost risk appetite.

MACRO TRENDS TODAY

My goal is to own shares in companies that will monetize the big social and business trends of the next decade. As we enter 2011, I can’t imagine a world without inflation in commodities and deflation in technology and start-up costs, including talent. In 2010, we saw the continuation of some major trends—cloud computing, the mobile Web, the social Web, and the consumer Internet. Most interesting is the phenomenon I describe as “the $50 club sandwich and the $5 smart phone.” While traveling to Paris recently, I encountered the $50 club sandwich at The Four Seasons Hotel and, while not typical, this is surely a sign of the times amid global commodity inflation. As 2011 ends, we will likely see some unbelievably low prices in smart phones as the war heats up among the telecoms, handset makers, and Skype, and as the operating systems of Apple, Google, and Microsoft fight for market share.
EXAMPLES

With the themes I’ve described in mind, I’ll elaborate on three positions of mine (as of January 2011).

Rackspace Hosting, Inc.

When you hear the word *cloud* in the investing space, Amazon may be the first company that comes to mind. But for me it’s Rackspace, and I first talked about it on my blog in January 2010. I wrote: “Every smart person says Rackspace is overvalued. I say many smart people go broke on that argument. The cloud is the buzz and Rackspace is the cloud for many institutions that manage money. All roll-ups end badly, but guessing when is too hard. Trend guys are making a killing here as the ‘dumb money.’”

I did not wait for an all-time high in this case. I had been following the industry and the stock closely, and when the markets began to streak higher in September 2010, I purchased the stock. (See Figures 1.1 and 1.2.) Rackspace had also recently launched

![Figure 1.1: RAX Monthly Chart](source: © StockCharts.com)
a project called Open Stack that would make the company less focused on acquisitions and more focused on organic growth. I entered just under $20 and while I have sold some stock along the way, the stock today is at $34.

**Intuit**

Intuit is not a sexy company. They do not seem to care and I like that. Intuit owns the small and medium-sized businesses (SMBs) in the United States when it comes to accounting and tax preparation products. It may not be as sexy as the enterprise or the consumer markets, but profits and market share are super-sexy to institutional investors, and Intuit sells the hammers and the shovels to the SMBs. (See Figure 1.3.)
Intuit recently spent $170 million to further entrench itself in the consumer market when it purchased Mint.com.

Intuit has not been a rocket ship since hitting all-time highs (see Figure 1.4), but I believe there are catalysts. The company has fantastic margins from recurring revenue, little competition in many areas of its software distribution, and operating leverage.

One area I would love to see Intuit announce expansion into is retail. There should be Mint stores in thousands of towns and cities across the United States. The personal finance industry and SMBs need a fresh, comfortable, and contemporary learning environment to experience Intuit products. I can envision Mint and Quicken “genius bars” in a retail environment that dares to immerse the consumer and SMB in personal finance.
Ariba, Inc.

I added Ariba to my portfolio in November 2010. Ariba was breaking to six-year highs and I found it by reading the *New York Times*. (See Figure 1.5.)

It is important to note that again awareness and serendipity matter. Checking prices matters. I was not searching for Ariba, but Ariba found me during casual business reading. As you do this more and more, you develop a different level of awareness. Intrigued by the article, I checked the price and the stock was trading at major highs. I liked that Ariba was a marketplace and focused on software and a long-forgotten leader from the Internet bubble.

Within a few days I purchased the stock.
HERE COMES THE SUN

I have witnessed four panics and crashes in my investing career. The shortest was in 1987; I had a cigarette and missed it. The 1998 Asian contagion/Long-Term Capital Management crisis lasted a summer and gave way to the spectacular rise and bursting of the Internet bubble in the year 2000. Most recently, there was the mortgage and banking panic of 2008 and 2009. All were messy, all caused great pain, but all the crashes created massive new opportunities. Preserve capital in bad markets, and you will live to ride the next great trends, which are always around the corner.
Keith’s messages and links on StockTwits have stood out from day one. Most professionals do not think sharing is useful to them, but Keith does and for that our community has embraced him. Keith runs a virtual hedge fund in an innovative way—by offering full-blown research and not trading any positions. His firm’s sole focus is to provide investors with deep, knowledgeable research and ideas as if he were running the money himself.

MAKE MONEY OR GO HOME

I didn’t learn anything useful about trading markets in school. The proverbial hockey stick in my learning curve came by doing. The only struggle that matters is coming to terms with the reality that trading markets isn’t something you learn in a textbook. Experience is earned by making mistakes.

I had spent just enough time on the sell side to realize that I didn’t want to be there anymore and was hired by a hedge fund manager by the name of Jon Dawson who was, at the time, breaking up with another hedge fund manager by the name of Art Samberg. As Samberg moved along to start one of the largest hedge funds in the game (Pequot), that left poor Jon saddled with guys like me: inexperienced and aggressive, young and naive. I had the perfect skill set to learn the hard way—by making mistakes using live ammo.

My first three years as an analyst, being groomed to be a portfolio manager (PM) on the buy side, were down markets for stocks—2000, 2001, and 2002—so I effectively learned by doing on the short side. Simple mandate: make money or be fired. That probably explains why I’m much more adept at making sales than chasing rabbits.
I started Hedgeye so that I could learn out in the open. I operate in an open architecture now for anyone in the game to see. I get much more useful feedback this way and, by design, I’m forced to be as honest as my positioning makes me. Essentially I operate a virtual hedge fund, so that I can bring transparency, accountability, and trust to investors at all levels.

**PAY ATTENTION TO VOLATILITY**

Real-time market prices rule. Everything else is all about storytelling around those prices.

Gains on the short side are meant to be taken. On the long side, pretending you are Captain Stock Picker is fine, as long as volatility is low. In a game of heightened volatility, you need to shorten your holding periods. The plan always needs to be that the plan is going to change, but you have to be duration agnostic so that you can capitalize on playing the game that is in front of you.

**BEARISH AND BULLISH FORMATIONS**

Our risk management setup is primarily derived by mathematical assumptions in chaos/complexity theory.

Our Trade, Trend, and Tail lines are quantitatively manufactured using a baseline model of 27 global macro factors that span countries, currencies, and commodities market prices. Then we overlay our top-down view with a bottom-up three-factor view of the security in question (price, volume, and volatility).

*Trade:* an anticipated duration on a portfolio position of three weeks or less.
*Trend:* an anticipated duration on a portfolio position of three months or more.
*Tail:* an anticipated duration on a portfolio position of three years or less.

All of our signals (entry/exit) are driven by closing market prices. All durations are measured simultaneously. Violating a Tail level is an explicit sell signal as much as breaking out above a Trade level is a buy signal.

They occur when all three of my risk management durations (Trade, Trend, and Tail) are confirmed by the market’s price. In English, a bullish formation means that the Trade line of support is also supported by the Trend and Tail lines.

The logic here is pretty straightforward: All monkeys are in the pool—short-term day traders (Trade), intermediate-term sophisticates who have a good read on things like quarterly analytics (Trend), and long-term Warren Buffett wannabes (Tail) who buy and hold. Nothing perpetuates bullish price momentum like higher highs and higher lows in price from the short term to the long term.