Traders World Online Expo #14

Interview with Mark Minervini
Author of Trade Like a Market Wizard

The Saboteur in the Trader’s Mind
August 16-23, 2013 — Another Crash?

Real Rules of Alan (Pitchfork) Andrews

Predictive Indicators for Effective Trading Strategies

Review of TradeColors

Why Past Performance Is NOT Indicative of Future Performance

The Perfection Trap

Trend Trading using 2 to 1 Targeted Reward to Risk Ratios

Seasonal Analysis in Trading

Secrets of Volume Profiling in the Intraday Time Frames

Two Cumulative Delta Volume Analysis Patterns Every Scalper Needs to Know

Stochastic RSI (Relative Strength Index)

Trader Needs to Know Options

Price and Time Polarized by Two

Auto Trading As An Option Part 2

Trading the Outside Gap
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Larry: What are the key traits for a successful trader?

Mark: When I started trading 30 years ago, I knew stock trading was going to be exceptionally challenging and I knew success was not going to happen overnight. I made a decision that I was going to put in as much time and effort necessary no matter how long it was going to take, because I was confident the eventual payoff would be well worth it.

I believe one of my major strengths is my unconditional persistence. If you’re someone who gets discouraged and quits easily, then stock trading is going to be very difficult for you. Most things worth accomplishing take time and challenge a person’s confidence; the ability to endure the so-called failures and learn from them is a key in any endeavor, and stock trading is no different.

It takes time to acquire and perfect the correct knowledge and it doesn’t happen overnight. If that were the case, then everyone would be rich from stock trading. Strategy has less to do with trading success than the mental aspect. Desire, guts, persistence and a belief in your own potential are all very important. Most of all you need to take 100% responsibility for your results, respect risk, and be willing to learn from “failures” instead of regretting them. You must be willing to do the work and own your failures, and then you can own your success.

Larry: Why is it that most traders fail in the markets?

Mark: Here are 7 common reasons:
1. Most traders follow a flawed strategy with poor selection criteria, usually this is based on personal opinion or bad advice
2. Even when they find a good approach, the majority of traders don’t stay the course; they suffer what we call “style drift”, changing strategy when short-term results are unsatisfactory or become boring
3. The #1 mistake made by virtually all investors is they don’t cut losses
4. Most of the traders that blow themselves up usually do so by adding to losing positions
5. The grand majority of stock traders don’t know the truth about their trading – they fail to conduct in-depth post analysis regularly; they simply don’t know the math, so they have no idea how to manage risk in relation to reward
6. Many traders start with unrealistic goals; they want too much too fast and become disinterested when success doesn’t come quickly
7. Most failures in anything stem from a lack of belief in your own abilities; most people just
don’t believe they can be exceptional at stock trading, but they can, if they really want it and follow the right plan

**Larry: Why does practice not always bring success in trading?**

**Mark:** To get good at something you must gain experience, however, that does not mean that you will get good at trading if you just practice over and over; you must be practicing correctly. Repeating something over and over creates habit. If you’re doing the wrong things repeatedly you will just create bad habits. So, the focus should not be on repetition, it should be on repeating a process worth repeating. You must practice correctly otherwise you will just engrain bad habits.

**Larry: Do you believe in paper trading?**

**Mark:** If possible, I would rather see a new trader trade with a small amount of money than trade with fake money. Paper trading can give you a false sense of security; you definitely won’t make that same type of decisions under the pressure of real money as you would paper trading. So, why not get the experience that will serve you in real life? Start trading with real money as soon as possible. I suggest if you’re new to trading, start with an amount small enough that a loss won’t change your life, but with an amount large enough that losses are at least somewhat painful so you can get accustomed to the pressure that goes with trading.

**Larry: Do individual investors have any advantages over professional fund managers?**

**Mark:** Yes, a huge advantage! The biggest advantage the individual investor has is liquidity which gives you control. Individual traders have pretty much the same tools as the pro; however, the individual trader has instant liquidity. This allows the individual the effective use of stop-loss protection with little or no slippage. With greater control over risk you can have greater portfolio concentration, change course quickly, and in turn produce much bigger returns. Speed and liquidity are major advantages that open up the potential for superperformance for the individual stock investor.

**Larry: What’s the difference between a trader and an investor and which should one be?**

**Mark:** The difference is your time horizon and level of activity. You should utilize a style that best suits your personality. Once you are consistently successful with a time frame, you can then look at trading around positions or in the case of a short-term trader, holding for a larger move. In the beginning stages of a new bull market, I try to take a more “investment” type approach, holding stocks longer than I would during the late stage of a bull market, where I would tend to take a trading approach selling into rallies instead of trying to hold through normal base building and natural reaction pullbacks.

**What in your opinion makes a stock go up?**
Mark: Large institutional investors move the market. The key is to align your buy orders with the big boys as they’re bidding up shares. Knowing how to spot the difference between retail buying and institutional buying is a key skill to develop if you want to make big stock returns consistently.

Larry: What is your SEPA® and why did you develop it?

Mark: SEPA® - Specific Entry Point Analysis® is a strategy of precision. It identifies stock candidates that have the potential to become superperformers, but more importantly, the precise point to buy. The objective of SEPA® is to pinpoint the exact spot at which to enter a high-probability trade in terms of risk versus reward. By putting on trades with big potential at relatively low risk, I achieve a high reward to risk ratio.

Larry: Do you believe in bottom picking?

Mark: If you can do it, great! I haven’t met anyone in my 30 year career that could consistently pick bottoms or tops. Successful trading has nothing to do with picking tops and bottoms. I think this is where many investors go wrong and enter into trading with the wrong perception because they’ve heard buy low sell high. Or, they equate trading to the likes of buying a pair of shoes on sale; doesn’t work that way. Very often what’s cheap is cheap for a reason. Some of the biggest winning stocks have the biggest performance when they seem overvalued. The key is to buy lower than where you sell. 99% of the time, that won’t be at the lowest price a stock traded at.

Larry: Do you use moving averages and if so how do you use them?

Mark: Yes, I use a 200-day, 150-day, 50-day and a 20-day moving average for smoothing. The longer-term moving averages are part of my Trend Template, which identifies if a stock is in a Stage 2 uptrend; 98% of the biggest winning stocks made their huge moves while in a Stage 2 uptrend, so it’s one of the very first qualifications I require. I divulge the parameters of the Trend Template in my book Trade like A Stock Market Wizard (McGraw Hill).

Larry: Do you believe in buying brokerage recommendations?

Mark: I rely solely upon my own analysis. Over time, most broker recommendations lose money for clients. However, I’m happy to see a broker recommendation on a stock that I already own to help push the stock, and might even sell into that strength as a result.

Larry: Do you use fundamentals and if so how?

Mark: In the majority of cases, I want to own companies with strong earnings backed by brisk sales and improving margins. I’m looking for companies that have something exciting going on, which translates into bottom line success. The only time I disregard earnings would be in
situations like a biotech company that’s trading on the prospects of a new drug or something along those lines.

It’s important to understand that a great company is not always a great stock. Timing is everything. You must learn how to determine where a company is within its own earnings cycle and then position yourself in the strongest most profitable part of the cycle.

The majority of exceptional winning stocks had certain things in common; what we found was the biggest correlation had to do with earnings. If a company has a hot selling product and they’re earning lots of money, the stock price will likely appreciate, providing the growth is significant and sustainable.

**Larry: Do you buy the market leaders and if so why?**

**Mark:** Yes, because those are the stocks capable of making the biggest gains. I want to own the best merchandise, not some company that I hope will do well and work through a problem, but a company that is already displaying the characteristics of a big winner. In the stock market it pays to buy the best of breed, if you know how to buy at the right time. Optimally, I want to own companies that deliver strong earnings and sales growth and I want to see some evidence that institutional investors are seeing what I’m seeing. LinkedIn (LNKD) is a market leader and a great example of a stock that displayed huge earnings and sales with great price action. I originally bought the stock on 1/22/13.

**Larry: How do you use charts?**

**Mark:** I use charts to establish the prevailing long term trend and then the precise spot to enter a trade. There definitely are repeatable patterns; the earliest point I try to enter a stock is when it emerges from what we termed a 3C or Cup Completion Cheat pattern. This is when a stock officially starts a new uptrend after a correction phase. There are classic base patterns you can trade off of on breakouts. There are also more sophisticated techniques which I go into great detail about during our 2-day Master Trader Workshop.

**Larry: Explain your tennis ball action?**

**Mark:** The way a stock reacts during a pullback can help you to determine whether your stock is a tennis ball or an egg. I want to own tennis balls. During pullbacks, stocks that are healthy and under accumulation will be met with support; the stock should shoot back to new highs bouncing back like a tennis ball. This is how you determine whether the stock is experiencing a natural reaction or if it’s trading abnormally.

After a stock emerges from a proper consolidation, it should not pullback too much and it should rally back to new highs within a number of days up to a few weeks. The stock price should definitely not break down sharply and fail to rally back. Hyster-Yale (HY) is a recent
example. I bought the stock on 5/16/2013; if you look on a chart you will notice how none of the pullbacks lasted more than 3-4 days before the stock moved back into new high ground. That’s tennis ball action.

**Larry: What is your favorite chart pattern?**

**Mark:** I look for one of 8 basic set-ups that occur over and over; however, each market cycle tends to lean toward certain technical themes. Of the 8 technical set-ups, my favorite is the one that is proliferating and working for me.

**Larry: What is your power play?**

**Mark:** The power play is a rare but very profitable set-up. It’s what I call a velocity pattern. It takes very high momentum to qualify; the first requirement is a sharp price thrust upward. Velocity begets more velocity. This type of price action often signals a dramatic shift in the prospects of a stock.

A recent example of a power play I traded is Alliance Healthcare (AIQ); the stock emerged from a consolidation on 5/29/13. Few people probably traded this one because it’s a small, thin, unfamiliar name. Most big winners are companies you never heard of before. History also shows the majority of big winners have a relatively small number of shares outstanding in the float.

**Larry: How do you use money management?**

**Mark:** I always approach each trade from risk first; before I enter a trade I already know exactly where I’m going to get out at a loss if the trade moves against me. I don’t risk more than I expect to gain. I never ever average down; just the opposite. I trim my activity and size down when trading poorly and ramp it up when trading well; this way I trade my largest when I’m trading my best and the smallest when I’m trading my worst. This is how you manage risk and pyramid into big returns.

**Larry: What’s the difference between a successful investor and one that is unsuccessful?**

**Mark:** Successful traders pay special attention to risk; they know not losing big is the only way you are going to win big. They are patient, selective and consistent. They believe in what they are doing and in their own abilities. They stick to their strategy and understand that every strategy has ups and downs. They’re motivated by making money, not action. They have what I call “sit out power”; the ability to do nothing when risk is high, but are also quick to step on the gas when conditions prove right.
Most successful traders started out with a role model, someone who had already accomplished the goals they were aspiring to. The main thing is to get involved and take action. You’re going to make many mistakes; the key is to learn from those mistakes. You have to get started and gain some experience. You also need a good plan, so find a good mentor. Duplicate success.

**Larry: How do you use stop losses?**

**Mark:** There are several types of stops. The first is a mathematical stop based on a percentage decline below my initial purchase price; I never want to let a loss exceed 10% - my average loss is much less. The second is a technical stop based on the chart. The third is a time stop; if the stock doesn’t do what I expect, I often will sell it based on that reason alone. And, the forth is a fundamental stop; if the fundamental picture darkens, I may sell.

**Larry: How do you use scaling in?**

**Mark:** I never ramp up to big exposure without having some success first. Why would you want to raise your exposure from say 25 or 50% invested to 75, 100% or on margin if your current positions aren’t working? I add to a position if it proves itself; most of the time I add at a higher price than my original purchase. However, the stock must meet certain criteria; I’m not going to add simply because a stock moves higher. Trading is not an on/off business; you don’t have to make all or nothing decisions. I move incrementally until things start working, then when I get the green light, I step up my exposure aggressively.

Starting with only a few thousand dollars, Mark Minervini turned his personal trading account into millions. In 1997 Minervini he won the U.S. Investing Championship with a 155 percent return. Using his trading strategy, in a five-year period Minervini generated a towering 220 percent average annual return with only one losing quarter. To put that in perspective, a $100,000 account would explode to over $30 million with those returns.

Mark Minervini is author of the new best-selling book, Trade Like A Stock Market Wizard (McGraw Hill). He is also featured in Jack Schwager’s Stock Market Wizards: Conversations with America’s Top Stock Traders. Schwager wrote: “Minervini’s performance has been nothing short of astounding. Most traders and money managers would be delighted to have Minervini’s worst year—a 128 percent gain—as their best.”

Minervini recently announced his 2013 Master Trader Program workshop where he spends two days teaching his SEPA strategy and techniques. This year Minervini has a special guest instructor sharing the stage with him; 3-time U.S. Investing Champion, (William O’Neil protégée) David Ryan. The event is scheduled for October 12-13, 2013.

You can find more on Mark Minervini at www.minervini.com