Tips for Traders | 5/4/2009 12:04:00 PM

How I Look for “Home Run” Trades

"Many men go **fishing** all of their lives without knowing it is not fish they are after."
~ Henry David Thoreau

Spring is finally here in full force in Chicago. The sun is warm, the White Sox are in first place, and I am still fishing for home run profits! This has been an unusual trading year in many ways: The world's economy spiraled lower and there are no strong signs of recovery in sight; the markets have been extra volatile as institutions and traders adjust and readjust their risk portfolios; and many governments have become part "owners" of the largest institutions in their own countries. Some people think the worst is behind us, while some think the worst is just about to hit. How all this will end is about as clear as whether or not the White Sox will win the World Series, but one thing is clear: I'm still fishing!

It's been a good spring to "fish for profits." I haven't hit a "home run," or a "runner," as I call them in my mentoring program, but then again, I have gotten to break even quickly on every long-term trade I have taken this spring. And even better, I have taken partial profits on almost every trade and been profit stopped on the rest of all of the positions. Most springs, I am quite happy to have about 50% winners, because the risk-reward ratios on these "home run" trades are so high.

Lets take a look at some current trades and see what I am seeing this spring-between baseball games!

What would a spring portfolio be without a grain position? I took a very nice chunk of money out the markets being long November beans, even though price never hit my profit target. I also made a small amount of money in December corn, but the two charts behaved very differently. Soybeans rocketed once I got long, while corn had a few days of active trading and then sold off gently.

During my live pre-market sessions, I had been telling traders to watch for November beans to re-test the blue, up-sloping lower Median Line parallel. I also mentioned that I was worried about corn underperforming this market, but to me, there was a way to decide whether or not to take a long position in the November beans. If price came down and tested the up-sloping lower Median Line parallel *and* left an acceptable swing low that would allow me to hide my initial stop loss order underneath it, I would attempt a second long in November beans. If price came down and tested the lower parallel, but there was no acceptable stop (a swing low that would attract limit buy entry orders), I would pass on attempting a second November bean position.

Price came down to the blue, up-sloping lower Median Line parallel and spiked lower through it, but managed to close well above it. This was a sign of strength, and in my opinion, there were now likely to be resting limit buy entry orders at or just above the low of that spike. I pointed out this test and re-test on the free, live "Market Maps" sessions and put orders in the market to establish a long position in the November beans. I was filled the next day, and as the chart shows, I was filled on my 1/2 profit order for a little over 66 cents in the November beans this past Friday, a very nice profit to start off the week! I am currently working a break-even stop loss order on the second half of the position, as well as a profit order at 10,400. If price leaves me a higher swing low to hide my stop profit order underneath, I will quickly snug my stop profit order higher

Now, we'll look at another of my spring favorites: The crude oil market.

I was profit stopped out of my original long crude oil position just above $47 a barrel on a Friday afternoon. And wouldn't you know it, price gapped higher over the weekend and started to make a series of higher highs and higher lows—I had been "washed and rinsed!"

Well, that's part of being a trader. The most important thing you can do when that happens is clear your head and wait for another solid opportunity. I started watching an 89-cent range bar chart, which means that each bar is 89 cents from high to low. This takes the time out of the chart and helps deal with the uneven nature of the trading in the crude oil market.

I added in a blue, up-sloping Median Line and its parallels and then waited to see if these lines were meaningful to price. After watching for a week or so, price did a good job establishing itself above the blue Median Line, and when I saw a nice gap close with good separation above the Median Line, I entered an order to get long crude at $49.30, with an initial $1 stop loss that was tucked below a prior swing low.

Price worked its way higher in an orderly, sustainable rally. This wasn't a fast run higher, but it was a steady increase in price, and that works just as well if you are patient. Price eventually left a swing low just above $50 a barrel and I moved my stop loss order up to a stop profit order at $49.91, which allowed me to use the likely limit buy entry orders as protection. This past Friday, crude finally hit my first profit target at $53.50 and I took half my position off at that level. Now we'll see if crude can climb to my second profit target above $55 a barrel, but since I am working a stop profit order on the rest of the position, this will be a nice winner no matter where crude trades from its Friday close.

If I'm long crude, you can bet I'm watching the Canadian dollar. Let's take a look at that chart as well.

Let's take a look at another market I'm watching: The Canadian dollar.

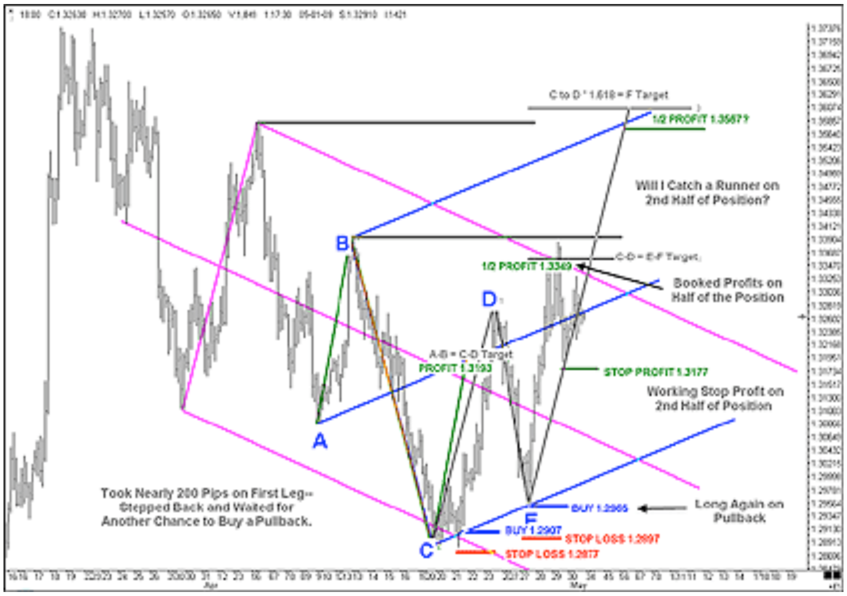
The Canadian dollar has been strengthening against the US dollar, and of course, I believe it's because they are producing three times as much oil per capita as they consume-so the cash just flows across the border when the demand from crude picks up. And as my wife always reminds me, "They'll find a way to get prices up for Memorial Day—they always do!"

Remember this is a cash forex chart, so as the Canadian dollar strengthens, it's price heads lower because it takes fewer Canadian dollars to purchase one US dollar. And you can see that Canada's dollar has been strengthening for some time. I wanted to find a quality test and re-test entry with an acceptable stop hiding above a prior swing high—and I finally found one!

I got short this currency pair on a re-test of a down-sloping modified Schiff epper Median Line parallel at 1.2430 with an initial stop loss order at 1.2530-which was the initial test of this upper Median Line parallel and a swing high. I then simply measured how far price had traveled during its prior swing lower and then transferred that same distance to the current swing lower. This is a simple A-B = C-D measurement.

That gave me a profit target on the first half of my position of 1.1847, which was hit this past Friday (which was apparently partial profits day for me!) My second profit target is simply that same distance, but instead of assuming it will travel 100% of the distance from A to B, beginning at C, I measured where price would be if it traveled 161.8% of the distance it travelled from A to B starting at C. This gave me a profit target of 1.1327 on the second half of the position. I am currently working a stop profit order of 1.2284 on the balance of the position, which is above a prior swing high.

Now let me show you how fishing is going in the euro against the US dollar market:



The euro FX was in a nice uptrend and then began a pullback. I was long for the first explosive leg up and then took profits on 1/2 my position and exited the second half of that position on a stop profit order. Look closely at the area marked as pivot 'C' on the above chart. There is a gorgeous test and retest following a spike low that failed to make any new downside progress. This spike lowers and then closes back above the blue lower Median Line parallel and is a significant sign of strength. I bought the euro on the retest at 1.2907 and put my initial stop loss order at 1.2877. My profit target on this first trade was a simple price target generated by taking the distance price traveled on its upswing from pivot A to pivot B and then projecting that same distance from the pivot marked C. This gave me a profit target of 1.3193, and you can see that once I was in the trade, price climbed in a vertical fashion, hitting my profit target easily.

Once out of this first trade, I began watching for another opportunity to "fish" in this currency pair on the long side, since these lines were working so well. The key for longer-term trade fishing success is to be patient and wait for a high-quality entry. It may take days or weeks for price to come to an area you feel has a quality stop and then develop a high probability trend entry set up, but the secret to good fishing is waiting for the good "fishing holes" to show themselves! You won't catch fish in the bathtub! You need to find a quality fishing hole, and sometimes, that takes patience.

I waited patiently while price headed higher for a bit and then waited while it began to trade lower. Did the selloff worry me? Not a bit, because price would need to sell off to get to an area that I felt was a high-quality fishing hole! I wanted to see price come back down to the same lower Median Line parallel that worked so well on the first trade.

On my second entry, I waited for price to approach this lower parallel, and when it got close, I began working limit buy orders at the area where price would intersect with the lower parallel. This line had already proved its worth to me, and I had 286 pips of profit in my account from this line to roll forward into this potential trade.

Those of you who read my articles on a regular basis know that I love to hide my stops below prior swings because the limit entry orders sitting at those swings offer my stops protection. But as I began working the limit buy orders for this second long position, I knew there wouldn't be a quality swing low beneath which I could hide my stop. I was very confident that this lower parallel would generate a quality long entry if price tested it, and in fact, I was so comfortable with this lower parallel that I was willing to get long on a simple test of the line, instead of waiting for a test and retest, which is my favorite entry set up.

I thought about it this way: I had rolled forward 286 pips of profit from the earlier trade into my account and I was willing to risk a portion of those on a second attempt to fish in this area. My long entry came at 1.2965 and I used an initial stop loss order at 1.2897, so I was risking 68 of the pips I had made off of this line on the first trade. My first upside target was a combination of two things:

1) I measured the distance price traveled in its last leg up from pivot C to pivot D and then projected that same distance from my entry (which I've marked as pivot E) and this gave me a price target just above 1.3349.

2) Once I marked where the C-D = E-F target was (just above 1.3349), I immediately noticed that price would also be running into the pink, down-sloping upper modified Schiff Median Line parallel.

This gave me confidence because the confluence of both methods told me price may pause as it approached this level, so I immediately entered a limit sell order at 1.3349 to take profits on half the position if price climbed to that high. And price climbed in a near vertical fashion to test that area, taking me out of half my position for a very nice profit of 384 pips. You can see that price struggled to stay above this area of confluence, and after consolidating it sold off by roughly 150 pips before turning back higher. The low it left behind became a new swing low and I was soon able to hide my stop profit on the balance of the position underneath this area, at 1.3177.

Where should I take profits on the second half of my position? I used a simple Fibonacci expansion ratio of 1.618 applied to the same swing higher that I used for the first profit target. I measured the distance price traveled in its leg up from pivot C to pivot D and then projected that same distance multiplied by 1.618 from my entry (which I marked as pivot E]) and that gave me a price target just above 1.3610. I then immediately noticed that near this area, price would be intersecting with the blue, up-sloping upper Median Line parallel. Putting these two areas together, I feel that it would be wise to take profits on the second half of my position just below these two areas, so I enter a limit sell order to take profits at 1.3567.

You can see that I have already taken 286 pips profit out of the market on the first trade, and now I have taken 384 pips out of the market on the first half of the second trade. I have a stop profit in the market on the balance, which would net me 212 pips on the second half of my position if my stop profit order is hit. And if my profit target is hit, I will take 602 pips in profit on the second half. Not bad for fishing!

We will conclude by looking at one last market in which I was interested in fishing: The gold market.

This is an interesting chart because instead of using time-based bars, I told the charting software to generate bars every 89 cents. I find that gold often has volatile periods followed by periods of consolidation, and by using bars based on the range of price (89 cents from high to low, per bar), the gold chart seems to flow better.

Gold was in a nice downtrend and I wanted to fish for a short position. I added a simple red, down-sloping Median Line and then waited patiently for price to test the upper Median Line parallel. When price finally tested it, the bar that tested it briefly peeked above it but then closed on its lows, well below the red upper parallel. This is a sign of weakness, and I then began to look for a retest of this same upper parallel.

And I didn't have to wait long! As the next bar began to unfold, it rallied hard towards the upper parallel. I quickly measured where price would intersect with the upper parallel and entered a limit sell order at 900.70. My initial stop loss order would be 50 cents above the spike high price just made above the upper parallel. If price was strong enough to break above the prior bar's high (because it had closed on its lows), I wouldn't want to be short.

Price made it to the upper parallel, filling my limit sell order at 900.70, and once again, price closed on its lows, another sign of weakness. My initial profit on the first half of my position would be right before the test of the prior major swing low, at 885. Price made it to this level and I was able to take a quick 5.70 in profit on the first half of the position. And note that I marked an area on the chart "Multi Tops." I hid my stop profit order on the second half of my position just above the first of those multiple tops.

You can see that price sold off to 880.50 and then rallied back to form the second multi top. My stop profit order wasn't hit and I watched as price sold off hard again, stopping right at the 880.50 area again! Now I had solid support at 880.50 and solid resistance at 893. When price left mirror bars with tops at 885 (there are three bars of just about the same range and highs in a row at that area), I moved down my stop profit order to 886, just above the high of these three bars. If price plunged through the double bottoms at 880.50, it should run quite a bit lower, and if price was going to trade back and forth in a 13-point range, I'd rather take my profits off the table.

Before I could even calculate a profit target below the double bottoms at 880.50, price broke through the triple tops, taking me out of the second half of my short gold position for a nice 14.70 profit.

Now that I was out of my gold position, I watched the chart with interest. I soon noticed that price was making higher highs and higher lows, well above the double bottoms. When price broke above two swing highs, I marked the chart with "Change in Behavior" to remind myself that I may be seeing the start of a new uptrend in gold, and with that, I guess it's time for me to start fishing for a long position in gold!

Let me point out one more time that this has been an unusual positive run for me this spring. I do not expect that all my trades will be profitable, especially when taking longer-term portfolio trades. Even though none of my spring "fishing" trades have hit their ultimate profit targets, all have been profitable. This is an unusual string of winners, something called a 'positive run' in statistics. I don't expect it to continue, but I'll enjoy it while it lasts. Over a very long period (twenty plus years), my longer-term portfolio trades tend to be profitable about 55% of the time and they have very solid risk-reward ratios.

I hope you found these examples interesting and informative. Spring isn't over yet, so I'm still fishing, and I'll update you again later on this spring.

I wish you all good trading.

Timothy Morge

timmorge@gmail.com
www.medianline.com
www.marketgeometry.com

Timothy Morge
President
MarketGeometrics, and Blackthorne Capital, Inc.
Web sites: www.marketgeometry.com or www.medianline.com