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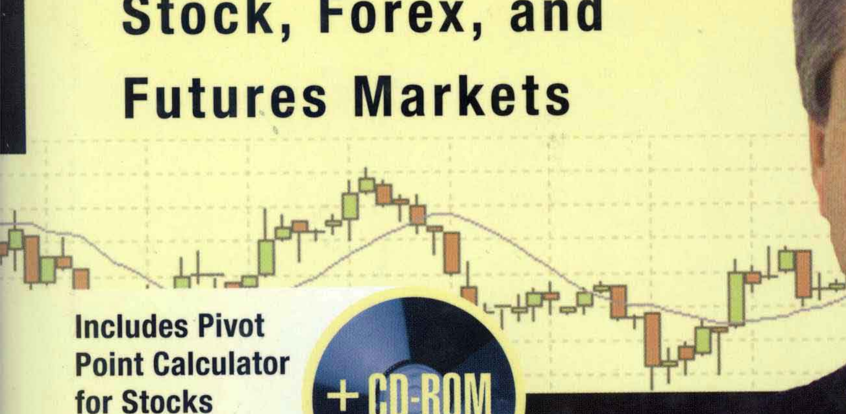

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+ CD-ROM

JOHN L. PERSO

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To my wife, Mary,
who is always by my side and who gave me
encouragement and assistance in completing this book.
Thank you from the bottom of my heart
and with all my love.

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I wish to thank all my past students for taking the initiative to apply these principles and for testing me while trading. I wish you all the very most life has to offer!

To my son John, you have made your father proud! Then to Mary, my wife of 19 years, your help in fixing all my computer and technical issues was instrumental in helping me finish this project, including completing the Pivot Point Calculator CD.

JOHN L. PERSON

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Introduction

To all the individual traders reaching out to learn how to invest and trade wisely and to all those who are looking for new ideas and who have been around looking to learn a more positive approach, I say that after reading this material, you will find a great approach to trading and will learn the importance of or at least will expand your knowledge on how to develop your personalized mechanical trading system and learn why that is important. You will learn specifically what methods and parameters to use with time-tested material. My first book, *A Complete Guide to Technical Trading Tactics*, was released in April 2004. It was a great introductory on how to incorporate pivot point analysis with other forms of technical indicators and how it related to trading commodities. The foresight that book offered suggested that we would see resurgence in commodity activity and that commodity markets would soon be in vogue. I had chart examples of silver at 4.50 per ounce and gold at 350 per ounce. On page 211, I gave an example of a potentially great scale trading opportunity in coffee when it was as low as 49.00. Sugar was at 7.00. Crude oil was at 21.00. The 30-year bonds were at 111. The Federal Funds interest rate was at 1.0 percent. There were great trading opportunities, many of which I was able to take advantage.

THINGS CHANGE

Times changed, as did prices of these raw commodities. Other hard asset products, including housing and real estate, besides the commodity markets, skyrocketed in value. Things changed; global tensions mounted as we invaded Iraq trying to set a country free. Nations' economies grew as new opportunities emerged in places such as China and India. Global economic growth pushed demand for products through the roof, creating spectacular price gains. Things changed alright, even intermarket relationships. Gold went up on fears of inflationary pressures in light of the Federal Reserve (Fed) raising interest rates. In turn, the U.S. dollar rallied as the interest rate differentials widened here in the United States against foreign central banks.

THE CONUNDRUM

One favorite word among economists in 2005 was *conundrum*, which was used by then-chairman of the Federal Reserve Alan Greenspan. This was the term he used to describe the event of Treasury yields declining while the Fed was raising interest rates. The Federal Reserve moved to raise interest rates 14 consecutive times in 0.25 percent increments in an effort to reduce inflationary pressures. Bond yields, instead of moving in tandem with the Fed's rate hikes, declined. Short-term Treasury instruments were yielding more than longer-term, and what developed was known as a flattening of the yield curve. At some points, we even had an inversion effect, where longer-term interest rate instrument yields were lower than shorter-term. Throughout history, that is a sign that the economy will soon proceed into a recession.

HISTORY SHOULD REPEAT ITSELF

Often it is said that history repeats itself. Economies and the world move in cycles. Based on the market's price behavior and the climb that commodity prices had, intermarket relationships were not moving in a traditional way in 2005, or at least not in a manner in which they had in the past. History should have repeated itself, but it did not; or if it does, it will be a delayed reaction. Due to this keen observation, there was one solid piece of advice I was constantly giving to people through our trading room or in my newsletter advisory service. It was, "Trade the markets independently of each other." One reason for this advice was this: Not much was making sense at times in the traditional way. Let's face it, when crude oil or energies shoot to the moon, it is inflationary and has a taxing effect on consumers. We would have expected stocks to sell off sharply, and they did not (they did not rally much either in 2005). When federal deficits soar, it creates inflationary pressures; when the Fed raises interest rates, yields should go up and Treasury prices should go down. The key word is "*should* go down." What happened was just the opposite. Gold was the only mover that acted in response to investors' demand for protection on resurgence in inflation. In fact, at times, price swings of gold interacted well with crude oil.

DELAYED REACTION

As of February 2006, the U.S. economy was in its third year of an economic recovery. It remained a stock picker's market, as we did see stellar moves from Apple, Rambus, AMD, and other lost hopefuls. But there were other investors who were expanding their knowledge in trading other investment assets, such as foreign currencies. There were others who made fortunes in real estate. Unemployment in January 2006 was reported at 4.7 percent. Times were good and were probably going to remain good forever! Well, that's where I must say, "You can't cheat history." As the old saying goes, if it's got four legs and a tail, it's probably an animal. I see a delayed reaction and an economic downturn. Will it be the end of civilization as we know it today? I doubt it. However, I believe we will go into a period of an economic slowdown. Why? For starters, usually we see energy and commodity prices rally near the peak of an economic upturn. Then, as the Fed fights inflation, they will continue to put the brakes on and continue to raise interest rates. Since no one knows for sure how soon or by how much consumers will adjust their spending habits, usually the Fed will go too far. That will slow borrowing and increase debt payments, especially on all those adjustable mortgage rates (ARMs) that so many people have. Yes, I believe an economic downturn will occur. I just believe it will be a delayed reaction. It seems that most cycles have stretched a little further than people believe. Just ask all the folks who predicted a stock market crash in 1999. They were right, but quite a bit off in their timing. That leaves one to wonder where to go to make money.

TRADING FOR A LIVING

If you don't already know of my past, I started in the business as a runner on the floor of the Chicago Mercantile Exchange back in the late 1970s. I had the privilege of working with a true master trader, George Lane, the creator of stochastics. I had a knack for the financial markets and learned to trade the 30-year bonds. I also discovered how to use pivot points and how to incorporate longer-term time periods in my analysis. Then came options on commodities; and in 1986 I made a fortune for myself and others in the bond market. I gradually improved my techniques; and through the understanding of candle charts while using them in conjunction with pivot points, I have developed quite a methodology that shows a high frequency of recurring patterns. This is what I believe is one of the single best methods for identifying market moves for various trading vehicles. Trading for a living is a fabulous career. Now more than ever, we have global market influences, advanced technology, equal access, market liquidity, and, best of all, diversified markets investment vehicles. We have forex, or foreign currency exchange; futures products to day trade; and commodities that allow speculators to participate in a structured, regulated, open marketplace that offers leverage. Then we have stocks to participate in investing for long-term growth. And there is a new breed of investment asset, exchange traded funds. Most of these products offer options so as to hedge or speculate to fully capture a market opportunity and develop the right strategy to enhance rewards wile reducing risks.

THE NEW AGE TECHNICIAN

As a *technician*, one who practices the art of technical analysis, I have now more than at any time in the past a greater edge in the marketplace. Through electronic market access and charting software with the power of today's computers, I can take my refined market analysis methods and implement these strategies and apply them to all markets. As long as there is liquidity and a structured environment, and as long as I keep my trading capital intact, follow specific trading rules to manage risk, there will be a bonanza of opportunities in the years ahead. I fully expect the techniques that I am sharing with you in this book to help you discover how to be a consistently profitable trader. This book opens the door to how you can learn to read charts and rely on price rather than on indicators. You will learn what triggers momentum and what to look for in order to spot when a market changes direction. Another important element of this book is that it will help you learn techniques to cut your losses quickly and to stay with the winning trend, to ride a winning tide.

CHAPTER 1

Trading Vehicles, Stock, ETFs, Futures, and Forex

Welcome to *Trading Triggers*. If you are an active trader or a first-time investor looking for a trading method that suits your personality, then you have the right book. Trading for a living is an amazing and yet risky business. There is more to trading than buying and selling. There are often-missed but important issues that many books do not mention, such as not only how to make money in the market but also how to keep it and create a positive cash flow. The purpose of this book is to take you to a new level of trading knowledge by giving detailed explanations of technical tools that will help you develop your own trading system so you can cultivate and extract money from the market, especially those traders who want high alpha (big returns) with reasonable standard deviation (volatility). I will explain some of the most obvious yet simple concepts of how to interpret technical analysis and improve your chart-reading skills so you can make money in the markets.

There are two theories on how markets perform: efficient market theory and random walk theory.

1. *Efficient market theory* lends to the belief that markets are always priced correctly because the current price reflects all factual information. If the markets are efficient, then no fundamental information will give an investor an edge in the market.
2. *Random walk theory* lends to the belief that price movements do not follow any pattern or trend and that past price behavior cannot be used

to predict future price movements. In other words, the markets are completely unpredictable.

I fall in the category of believing that history can and does repeat itself. People can and do make money based on technical analysis, and I am here to help prove it.

IMPORTANCE OF A RULE-BASED APPROACH

You may have heard of Jesse Livermore, who was immortalized by Edwin Lefèvre's book *Reminiscences of a Stock Operator* (G. H. Doran, 1923; Wiley, 2006). Jesse was considered one of the greatest speculators of his day. Many of his principles and ideas are still used. His three key concepts of trading are (1) timing, (2) risk management, and (3) emotional control.

This quote from Richard Smitten's *Trade Like Jesse Livermore* (Wiley, 2005, p. 70) sticks with me because it is as true now as it ever was (keep in mind that Jesse committed suicide in 1940, so this was stated nearly 70 years ago): "All through time, people have basically acted the same way in the stock and commodity markets as a result of greed, fear, ignorance, and hope: that is why the formations and patterns recur on a constant basis. The patterns the traders and technicians observe are simply the reflections of human emotional behavior."

Most traders who are consistently profitable have learned to develop a rule-based approach that doesn't change. They have within their arsenal of trading tools, definitive, recognizable, and frequently reoccurring patterns that can be used to trade by a set of established trading rules. They can clearly define, without guessing or using a vague approach, support and resistance levels and what to do once prices reach those levels. Moreover, they have the ability to clearly define their entry, stop-loss, or risk parameters and their profit objectives in a consistent, repetitious fashion each time they place a trade. This is what I do when trading my own account and what I have taught my son and even my own father. My dad used to think trading commodities was like gambling until I showed him a method. This is the same method that will be disclosed in these pages.

It is important for you to realize that it is the emotional balance that helps keep you on the profitable side of the ledger. You must never anticipate what the market might do, but rather wait for confirmation on your triggers.

Most traders who are profitable are flexible as to the anticipated outcome that may occur on each trade. Successful traders have the mindset to develop the perspective that their trading business is to manage their money rather than to predict the future. Successful traders can emotionally handle losing trades or the negative trades that result from an error or trading equipment malfunction. Remember that the business of trading for a living requires that you establish some kind of structure in a marketplace with countless variables. Why not consider trading by a set of rules? Most traders do not trade by a system; the term "black box" just means that a trader has input a set of trading parameters and automatically executes a trade based on a specific set of criteria—strict rules to automatically trade by.

START TRADING AS A BUSINESS

If you are currently trading for a living or if you are expanding your knowledge to learn how to trade for a living, remember that this is a business. You need to treat it like a business. Therefore, some considerations need to be made, for example, forming a corporation in order to deduct such expenses as your computer equipment, quote feed, DSL (digital subscriber line), office rent, travel to investment conferences, and continued education seminars. What matters most to every trader and investor is creating a positive cash flow. You wouldn't want to finally start learning to make money consistently in the market and find out that you cannot take any expense deductions. You should seek advice from a tax specialist so that you can take advantage of all regular and necessary expenses as business deductions and save thousands of dollars each year.

Let's add up the examples I mentioned: Suppose your quote feed is $200 per month and your DSL is $40 per month. Renting a small one-room office could run $500 to $700 per month. Then there are equipment expenses, such as your desktop computers, a laptop for travel, monitors and printers and ink cartridges and general office supplies to purchase and upgrade from time to time, say $2,000. Attending an investment conference could mean $700 roundtrip airfare, plus $250 per night for hotel and meals. If you have business entertaining expenses and went to at least two conferences per year, you could be talking as little as $5,000 to as much as $25,000 in actual business expenses that can be deducted if you are running trading as a business.

If you are a first-time smaller investor and decide that trading for a living is something you have the financial resources, time, and emotional makeup to do, what business plan do you have in place to protect the money you make in the market? Where will you put your profits as a short-term trader? Some traders have had many problems with this issue; it is similar to the old expression of "Robbing Peter to pay Paul." After all, who wants to make money in a buy-and-hold long-term position strategy only to give it back day trading, and vice versa.

I am going to show you a trading method based on combining candle charts, to help identify shifts in momentum, and pivot point analysis. I will teach you very succinct rules, which is what I have taught to professional traders on the floor of the exchanges and introduced to thousands of private investors, including other leading trading educators who now effectively teach my trading methods. I will walk you through deciding what investment vehicles are available, when and how to decide which investment vehicle would better suit a trader under various market conditions, and how to develop a trading strategy based on the specific trading triggers.

EDUCATION IS THE KEY TO SUCCESS

Traders need and, moreover, have an *obligation* and responsibility to understand as much as possible about how the markets that they trade work and what makes them function. It is vital to your success that you continue to learn not only about the market but also about your trading hardware or computer equipment. For example, if you trade off a laptop, you should know how to disable the tapping feature on the touch pad. After all, who wants to accidentally place the wrong order on line? That has happened to traders because the touch pad is ultrasensative. Simply moving your finger or having your shirt sleeve touch the pad can act as an action click. Traders should know how to set up and troubleshoot office or home Internet connections or at least have a brokerage account that offers assistance in taking over-the-phone orders.

Traders need to learn and comprehend all the features and benefits that charting software packages offer and should know all about the order entry platforms and, more specifically, the brokerage firm rules and procedures for trading. Traders should make sure the brokerage firm has the title of the account set up so if ever there is a situation where you wish to wire money into an account, it matches the name on the bank to your trading account. You don't want an important wire to be rejected. In a situation where you want to either put on more positions or add a second account to trade a great opportunity, how sad it would be for back-office personnel to reject the wire, resulting in a lost opportunity.

A great trader is always looking to learn. One of the best processes to learn is asking a series of questions; evaluating the dynamics of a situation or event; and seeking out how to take advantage of that event within the financial resources, risk factors, and time constraints in place.

The traits that most professional and consistently profitable traders possess are that they follow a trading plan on extensively tested research and limit losses while letting winning positions ride. Winning traders exhibit the qualities of patience and discipline. The techniques that will be taught in this book will help you master those two qualities.

Other traits that winners possess are that they diversify into various trading positions, while committing only 10 to 40 percent of accounts equity in the markets. Successful traders commit their full attention to the market trends and prices, and they act on trading signals immediately.

They also seem to possess the ability to accept winners and embrace losers, and they don't let either of these outcomes generally influence their next trade decision. They stay in the now and react to what the market is currently doing. Winning traders take breaks from trading. Through continued education and the process of asking questions, they gain an edge and stay on top of their competition through diversification or other more advanced trading strategies.

TRADERS NEED TO ASK MORE QUESTIONS

The process of asking questions is what is needed in order to gain more knowledge. The trouble is, most traders do not have enough experience to know what the right questions are. If you apply simple common sense, then you will be on a great start to learn how to identify investing or trading opportunities and find the right strategy to take advantage of those opportunities.

Some questions traders need to ask themselves include, just for starters: How much time do I have to dedicate to the markets? If I enter a day trade, do I have the time to watch this position, or do I have an appointment or meeting scheduled for that day? What are the possible outcomes of what I am about to do, based on what I have control over?

Focus on what it is you want to achieve, write it out, and concentrate on that goal. Think of the consequences or possible outcomes of your actions so you will have a more balanced emotional reaction if the outcome is not as positive as you expected. Ask questions such as:

- Do market conditions warrant increasing or decreasing my position size?
- Are there reports coming out that may impact the market or my position?
- Are my entry and exit targets justified?
- If the market is so bearish, why won't it go down?
- If the market is so bullish, why won't it rally?

Trading without asking questions or without probing leads to trading blindly or without a plan. It opens the door for destructive emotional interference. Another quote from Jesse Livermore helps confirm this: "There is nothing new on Wall Street or in stock speculation. What has happened in the past will happen again and again and again. This is because human nature does not change, and it is human emotion that always gets in the way of human intelligence. Of this I am sure." (Smitten, *Trade Like Jesse Livermore*, p. 167)

That statement was made over 65 years ago and is without a doubt still applicable to this day. Do not let your emotions get in the way of your trading decisions. If you ask the right question before placing a trade, you stand to gain an edge on winning the emotional battle of trading. It is generally those who are afraid of losing through fear itself who stand to lose because that emotion will interfere with rational, well-thought-out trading plans.

Asking yourself the right questions will help you to choose a more apropriate investment vehicle or trading strategy. For example, ask yourself before entering a trade: What are the time expectations for a result to occur? Do I have availability of time to see the trade through? Would short-term day trading or swing trading be possible if I have a regular day time job? In what time zone do I start work? This is relevant because a person living on the West Coast could trade an early morning market such as the Chicago Board of Trade (CBOT) bond contract opening session; however, a person with an early morning job may want to consider foreign currency or forex (Foreign Exchange) trading on the European session starting at night.

In order to know what time demands you need, you should also ask yourself if you have the tolerance for trading a leveraged product and if you have the tolerance for the risks: Should I use a time period stop—if the market does not move or react within a specified time period, should I exit the position? Should I use a conditional stop, such as a "stop-close only" order? Does my order platform take such orders, or do I need to manually watch and then implement such an order? (In intraday trading, the answer is yes, you need to manually watch the close of the time period you are trading in.) Can I afford to place a stop, say, 10 or 20 percent of my overall account value?

You need to be clear and honest with yourself when answering these evaluation questions. Remind yourself by asking: Why am I trading? What are my expectations? (I have met too many people that look at trading as an easy and quick way to make money or to replace their current career.) Based on your trading account size or your risk capital, ask: What returns will I need in order to generate sufficient income? Is my starting equity size or bank roll inclusive of my living expenses? Are my expectations on that return realistic on a constant basis?

These questions are important because they will help you to determine