WILEY Trading

THE GARTLEY TRADING METHOD

NEW TECHNIQUES TO PROFIT FROM THE MARKET'S MOST POWERFUL FORMATION

ROSS L. BECK

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Foreword

Ross Beck has done a splendid job describing one of the most logical and consistent patterns when trading any market whether it be stocks, bonds, commodities, or forex. Mr. Beck explains in detail how a Gartley Pattern is formed and also integrates part of the Elliott Wave principle in conjunction with the Gartley Pattern. I would think that H.M. Gartley would be proud of the effort and detail Mr. Beck conveys to his readers.

H.M. Gartley's book, *Profits in the Stock Market*, was published in 1935—in the middle of the Great Depression—and sold at the incredible price of $1,500, roughly equivalent at the time to the price of three new Ford automobiles. To my mind, that was a small price to pay as the Gartley insights into the market are worth far more than three new cars.

In his book, Gartley described a chart pattern that we now call the AB = CD pattern. The pattern illustrated how the market will rally in an uptrend and then retrace; rally again and retrace again. The second rally forms an up-sloping parallel channel, making the overall pattern look something like a lightning bolt.

The AB=CD pattern is found in all markets and all time frames. The pattern is the foundation of Gartley buy and sell patterns and is also an integral part of other market patterns. Importantly, the pattern is a measured move where the CD leg should be similar in length to the AB leg, although sometimes the CD leg will extend. There are other rules regarding interpretation and structure that readers should endeavor to understand before attempting to trade the patterns.

Mr. Beck's book is noteworthy in that it provides excellent examples of the patterns and how to best use money management principles that are so important to becoming a consistently profitable trader. Personally, I think Mr. Beck has produced an important piece of trading history that will help anyone in need of a methodology that is consistently profitable over any time frame! I know nothing can make an author happier than presenting something that can change lives for the better.

Mr. Beck's book is part of a larger area of financial market study, market geometry, which began in the 1930s with the work of W.D. Gann. Gann became famous for the use of Gann angles, which are now found in many charting software packages. Another important but often overlooked market technician was George Bayer who wrote a book called *The Egg of Columbus*, which once sold for $25,000 in the mid-1980s. The book described the progression of Fibonacci series using diagrams of birds, fish, and mammals as a type of mystical code that has parallels to the financial markets.

One unique interest Gann and Bayer shared was an interest in cycles. It is worth noting in an article by Lisa Burrell in the *Harvard Business Review* of November 2006 that cites research by Ilia D. Dichev and Troy D. Janes into stock prices during the 28.5 day cycle between a new moon and a full moon. The article states the cycles may have application to predicting stock prices.

This is not at all surprising, given that markets are fueled by the energy of market participants. Changes in peoples' moods and behavior around moon cycles have been well documented throughout the years. And, of course, investor moods and emotions play a huge role in price behavior in the markets.

Finally, we should mention Bryce Gilmore of Australia—in many ways the father of contemporary market geometry—and author of the book *Geometry of Markets*. All of us owe Bryce a great deal of gratitude for discovering market geometry in the same manner that Gartley shared his discovery of the Gartley Pattern.

Mr. Beck's book is a worthy addition to the long line of technical analysts and their books that have helped to unlock the secrets of the financial markets.

Larry Pesavento

Preface

Many successful traders around the world agree that there are distinct patterns that repeat in the financial markets. Each trader has a favorite—head and shoulders, Elliott Wave, and so on. However, you have to ask yourself, Are some of these patterns more reliable than others?

In *The Gartley Trading Method,* I will prove to you beyond any doubt that the Gartley Pattern is the mother of all trading patterns.

As a professional derivatives trader, I have been using the Gartley method for over a decade. I will begin our discussion with an explanation of the foundation laid by H.M. Gartley in his classic book *Profits in the Stock Market.* This discussion will be followed with a description of the historical evolution of the Gartley Pattern over the decades and uncover a dimension of the setup that has been overlooked for over 70 years.

Elliott Wave traders will be relieved to find out that Elliott Wave counts don't matter anymore if you simply look for Gartley Patterns. In addition, you will learn how the original Gartley Pattern is actually a trade setup to trade Wave 3. Gann traders will be happy to read the information on W.D. Gann's mystical emblem of the circle, square, and triangle symbol in Appendix B. Is the secret of this symbol finally unlocked?

After studying many books on technical analysis, I often noticed how often the techniques they presented almost overlap each other, yet I couldn't seem to logically describe these similarities and put them to practical use for trading. I call the Gartley Pattern the missing link of technical analysis, because it is the mortar that binds most of the technical disciplines together. As you will see in Part Two, the Gartley Pattern fits within the context of most of the common classical trading patterns. In this sense, the pattern can be described as an "all-purpose" pattern. As with most patterns, it is a pattern that represents the psychology of the participants and therefore can be used on most liquid markets and most time frames.

It is my solemn responsibility as one human being to another to try to save you from yourself. If you continue to read this book, it will require you to undertake a vigorous self-examination to determine whether you should enter the trading arena. I will not make the occupation of trading look glamorous and a surefire way to get rich. It can be one of the most brutal and at times nauseating occupations of all time. Yet, if you have what it takes, you *might* be rewarded handsomely. If you don't have what it takes, that's OK, just admit it and stop fooling yourself and others. Admission is the first step of any twelve-step program. If you admit that you are more of a gambler than a trader, then return this book and buy one that will teach you how to count cards.

This book is more objective that a lot of the rather sensational material available in the trading field. It reminds me of the muscle magazines I would read as a teenager. It didn't matter how many protein shakes I drank, supplements I took, or workouts I did. I could never come close to looking like the behemoths in the magazine advertisements. I really *wanted to believe* that there was a new scientific breakthrough that would allow me to purchase a supplement to give me the body of a Mr. Olympia competitor. But is that realistic? No. The realistic part of competitive bodybuilding has more to do with the illegal use and abuse of anabolic steroids, a subject avoided by most of the sponsors of bodybuilding competitions and magazines. So it is with trading advertisements that make unrealistic claims. Remember the poster behind Mulder's desk in *The X-Files*? It had a picture of a flying saucer with the caption, "I want to believe."

I will not teach you any technical method that I have not used myself. In my quest for the holy grail, I have rediscovered a pattern that, has served me well over the years. Some may ask, If it is that good, why don't you keep it to yourself and not share it? That is a good question and should be asked of anyone who is selling you *anything* to do with trading. Remember the movie *Back to the Future 2*? The character Biff obtained a sports book with the final scores of sporting events that were going to happen in the future. He quickly started placing bets on future events and became fabulously wealthy. In a similar vein, we may fantasize about having tomorrow's *Wall Street Journal* today. I'm sure we could all agree that we could become rich with such information.

However, the more important point that I'm trying to make is this: Is it possible to lose money trading with tomorrow's *Wall Street Journal?* Yes! Have you ever had the experience of putting a trade on perfectly, where it instantly started to make money, only to watch it over subsequent days turn into a loss? In view of the foregoing, it is a certainty that someone can have the best trade setups on the planet, the proverbial "holy grail," and still lose money. Why? As we all know, the entry is only half (or less) of the equation. Trading is not just about good entry signals, it's about good entry signals combined with even better exit strategies. Trade management is crucial and it wasn't until I combined the best trade setup (the Gartley trading method) with proper exit strategies that I was able to make the Gartley Pattern work as part of a comprehensive trading system. A quick, cursory look for Gartley Pattern setups on a chart may lead someone to quickly write off the Gartley as a viable way to make money trading. However, as we will see in Part Three, "Application," with proper money management, we can make a good system great, or turn a potential losing trade into a winner with sound money management principles.

Novice to expert traders should be able to glean something from *The Gartley Trading Method,* which has as one of its main messages "Do more of what works and less of what doesn't." After reading *The Gartley Trading Method,* you will start to question all that you ever knew about technical patterns, and you will learn a comprehensive trading method, from start to finish, based on natural law and timeless principles.

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First, I would like to thank my mom and my loving wife Lindsay—thanks for your patience, Zeeta! Next, my children Ceara, Hadrian, Aisha, and Trajan (aka Cearup, Gin, Lala and Purple Fish)—I will always love you. In addition, I must thank the legendary technicians who were not afraid to introduce original thought: W.D. Gann, H.M. Gartley, and William Garret. Further, I must acknowledge those market geometers still with us: Michael Jenkins, Robert Miner, and Larry Pesavento, along with special thanks to Bryce Gilmore for pioneering the use of modern market geometry for the twenty-first century! Last, but not least, I must thank Mathew and the boys at Market Analyst; Nikki and Cody at Lambert Gann; and Kate, Kevin, Meg, and Michael at John Wiley & Sons.

Contents

PART I

Foundations

Because this book has been designed for traders at all levels as an exhaustive reference about the Gartley Pattern, we will first provide beginners with some basic technical analysis in Part One, "Foundations." This section focuses on the technical methods that will be employed later on to allow us to identify high-probability Gartley Patterns. Some veteran traders will still enjoy Part One as we will be discussing some methods that they might have taken for granted, but these will be covered in the context of the Gartley Trading Method. You might find that this section fills in the gaps of your technical knowledge. Remember, a review of the basics may help you, regardless of how good you are at your occupation. Apparently Tiger Woods will often play an additional nine holes even when he wins a tournament, just to stay sharp (at least that is what he tells his wife).

CHAPTER 1

Trading Myths and Reality

Before we can progress beyond the neophyte level, we must establish a foundation of trading knowledge based on reality. In Chapter 1 we answer such questions as What is a trader? What is trading success? Is trading gambling? Do I need a computer?

WHAT IS A TRADER?

The common definition of a trader is someone who buys or sells financial instruments with the intention of realizing a profit. Examples of these financial instruments are equities, options, futures, and Forex (foreign exchange). As mentioned in the preface, H.M. Gartley wrote a book in 1935 entitled *Profits in the Stock Market.* In it, Gartley stated, "The average reader should leave the stock market alone." Gartley's statement is correct; some of us honestly have no business trading as we may be confusing speculating with gambling. (More on this will follow.)

Let's first discuss what trading is not. Some of us might think that trading is glamorous—trading floors, posh offices in Manhattan, high-end suits, limousines, and more. If you have traded, you know that this is not what trading typically looks like. It looks more like an individual who works out of his house, doesn't get enough sunlight, lacks personal hygiene, and has dirty dishes and half-empty coffee mugs stacked up on his desk beside his computer. And what about the professional trader's official uniform? Is it a brightly colored jacket from the Chicago Board of Trade? No; most traders get through the work day in a bathrobe that hasn't been washed in a while!

What are the character traits of a professional trader? A trader is someone with determination, dedication, patience, humility, perseverance, balance, contentment, dedication, passion, and a commitment to lifelong education of the financial markets. What? Contentment? Humility? I want to be like the proud Gordon Gecko of the movie *Wall Street* who said, "Greed is good!" Maybe you've heard the saying, "Bulls make money, bears make money, pigs get slaughtered." If you are a greedy pig when it comes to trading or anything else in your life, you will never be happy. A Buddhist student of mine once told me that we have to be happy and content with *nothing* in order to realize that everything else in life is a bonus. If you can manifest this attitude in life, including trading, you will be much happier than a greedy pig. Remember that the rich J.P. Getty once stated, "Money does not lead to happiness—if anything, unhappiness."

Often students ask me what book they should read to learn how to trade. I would have to agree with the late W.D. Gann and say *The Holy Bible*. All of the principles required to make one a successful trader can be found in the Bible. Humility may be the foremost quality required for trading. Why? A humble man knows he *will* make mistakes, expects them, embraces them, learns from them, and then makes fewer mistakes going forward. An arrogant man thinks he is perfect, takes his losses personally, pretends that the losses didn't happen, doesn't learn from his mistakes, and is doomed to repeat them.

In Jack Schwager's *Market Wizards*, the common theme of the great traders is that at some time they all have "blown up" or experienced a loss of most of their trading capital. It almost seems like a prerequisite to becoming a legend! However, there seems to be a common attitude that precedes their eventual collapse—pride and overconfidence. King Solomon's proverb states in effect that "pride comes before a crash." This could not be more true than when it applies to trading. Pride is our Achilles heel.

Whenever we have a string of wins, it is our nature to believe that we are "special" or that we have "a gift." We rationalize that we have finally matured as traders and that maybe we were a bit too cautious prior to our newfound epiphany. At this point, we may be more inclined to relax and simply use our natural ability more than the statistical models we may have been using previously. Then something happens; we lose, not just once, but quite a few times in a row. After blowing your horn in front of your trading colleagues about your market wizardry, you may be inclined to have the gambler's mentality of "getting back to breakeven" to heal your injured ego. We now take our losses personally and have a need to prove to everyone, including ourselves, that we are still a trading god. Does this sound like a humble person? Bottom line, be humble. You will still get hurt trading, but not as badly as the arrogant, greedy, trading pig.

PULLING THE TRIGGER

Another important aspect, often overlooked in trading, is the ability to make a decision. More importantly, once we have made a decision, we have to take responsibility for it even if it's wrong; we can't play the "blame game." If you are an indecisive person, then trading will be more difficult for you than for the average person. How do I know this? I have ADD (attention deficit disorder)!

After performing his analysis, a trader ultimately needs to make a trading decision on his own. Many new traders don't relish this idea and find themselves unable to "pull the trigger." Why? Because they are worried that they might be "wrong," and due to an inflated ego, they can't admit that they are capable of making a mistake. One point they forget is that it is not about being right or wrong, it's about making money. Does anyone like to be wrong? Of course not, especially someone who has a big ego. No one ever questions your ability to make a good trading decision when you are right, when you are making money hand over fist. However, what if you make a trading decision and you are dead wrong and have lost a substantial amount of money? Do you step up to the plate and say, "Yes, that horrible trade—it was all me!" Isn't it easier to have a scapegoat standing by, ready to blame for your bad trading decision?

Ask Nick Leeson, who put all his bad trades into a hidden account that Barings Bank didn't know about (there's another movie you should watch: *Rogue Trader*). You might be "pulling a Nick" if you have to keep a convenient scapegoat around to blame for your poor trading decisions. "It was the fault of the broker, the newsletter writer, the software, God, my spouse, the stars," we might lament, but really, whose fault was it? One of the reasons Ayn Rand glorified the trader in *Atlas Shrugged* is that his success was self made. Trading decisions should not involve anyone else; they are yours only.

So a professional trader is someone who can "pull the trigger" and make a trading decision. If it doesn't work, he accepts it, learns from it, and moves on. He learns from his mistakes. We typically don't learn much from a winning trade, because the trade probably worked out the way we thought it would. It's usually when we have a loser that we can learn. But, unfortunately, it's human nature to avoid painful situations including the recollection of a trading loss. We have a tendency to want to bury our heads in the sand. The classic broker response to a client that has lost money is, "Let's win it back!" This appeals to many neophyte traders because they instinctively choose to ignore the loss (pain) and quickly make up for it (pleasure) by hastily putting on another trade. This is like going from the frying pan into the fire. The trader in this example had probably spent a lot of time with his analysis to do the first trade. After suffering a loss, he is typically not going to spend as much time with his analysis on the next "let's win it back" trade. How do you think that is going to work?

TRADING VERSUS GAMBLING

H.M. Gartley wrote in *Profits in the Stock Market*, "Unfortunately for most dabblers in Wall Street, the gambling approach is most often used. The reason is simple. The average person is too often governed first by downright laziness, and secondly by the silly desire to gain something for nothing."

Most define gambling as placing a wager on an uncertain event with a monetary result (win or lose) in a short period of time. Ultimately, the choice is yours. Will you spend the time necessary to learn how to achieve a trading edge? Or will you be lazy? H.M. Gartley made the following observation in his book *Profits in the Stock Market*:

> It is a sad commentary upon human nature that so many individuals go into the stock market with surplus funds which have required considerable effort to amass, and assume the risk of stock trading, which is far greater than in ordinary business, with only a fraction of the knowledge which they would expect to employ on the business or profession in which they make their living. This is why stock trading, for most people, is gambling, rather than speculating.

If you haven't seen the movie *21*, please do so. You will see that though someone might be playing a table game in a casino, it doesn't mean he is gambling. The movie is the true story of MIT students who applied a system to blackjack that would give them an advantage over the house. They spent months and months of practice on their system; the fact that they were brilliant mathematicians didn't hurt either. In my opinion, their method was not by any means gambling. Why? Yes, they were placing a wager on an uncertain event, but if they kept applying the same rules over enough hands, the result would not be uncertain. This is very similar to trading in that you can lose on some trades, but what does the picture look like after 100 trades? If a good trading methodology is used, it should be profitable over a 100-trade sample.

Another movie that makes this clear is *Rounders*. The question asked at the end of the movie is "Why do the same people keep winning the World Series of Poker?" Poker is referred to as advantage gambling; the term seems like an oxymoron. Doesn't the house always have the advantage? Not if you are playing poker. If you have enough skill, it is possible to have an advantage over the other players at the table. Trading is similar in that if you apply your sharply honed skills, you can have an advantage. Conversely, if you are lazy and don't have enough skill, you are guaranteed to fail.

One Commodity Trading Advisor (CTA) I used to work with said that a good trading system is—get ready for this—boring! Yes, trading for the most part is boring. If you need adrenaline in your life, don't find it trading financial instruments. Skydive, bungee jump, or engage in some other extreme sport if you need "action." If you are looking for "action" with trading, you instantly put yourself at a disadvantage when trading against professionals. To illustrate, I met a student of mine in Las Vegas who put himself through college by playing poker. He said the best time to play was on the weekends because there are more people visiting Las Vegas on the weekend than on the weekdays; they come to have a good time, drink, and gamble.