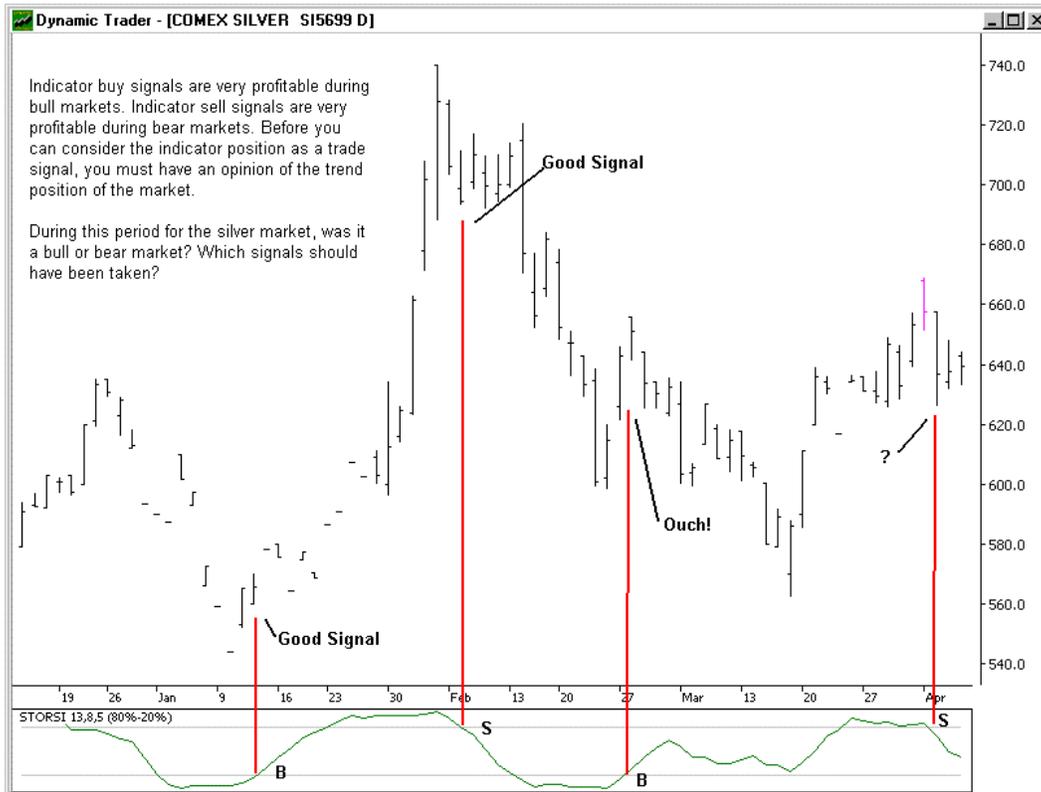


Dynamic Trading and Indicators

Indicators and Market Position

The terms indicators and oscillators are used interchangeably. Indicators only provide useful information within the context of the market position. The daily silver chart below includes the 13-8-5 StoRSI (stochastic/RSI) indicator and the “overbought/oversold” buy/sell signals.



The first buy and sell signals were perfect. They captured the vast majority of the bull trend from mid to late Jan. The second buy signal following the late Feb. low was a disaster. It was made on a two-day reaction against the bear trend. A sell signal was not made until early April, more than a month later. The indicator never declined below the extreme level at the mid-March low. Indiscriminate use of this indicator as a buy-sell signal system would eventually lead to the poor house.

If there were a way to filter the signals by trend direction, only buy signals would be considered in bull markets and sell signals in bear markets. Dynamic Trading analysis allows us to filter the signals.

The chart below shows the data that preceded the limited period shown in the chart above. Silver made a text book five-wave pattern going into the Feb. high. I have chosen this period for silver because it is not an after-the-fact example. Subscribers to the Dynamic Trader Weekly Report know that the five-wave structure was identified in Jan. and the Feb. top was made precisely in the dynamic time and price projections for a wave-five high.

With this knowledge of the market position, the mid-Jan. buy signal was valid. It was a buy-signal within a bull market. The early Feb. sell-signal was also valid. It was made after silver reached the time, price and pattern objectives for a wave-five high. The assumption was then that a bear trend began following the early Feb. high. Sell signals would be acted upon.



The second buy signal shown in late Feb. was not valid. It was made in the context of a bear trend following the Feb. high. Whether it was a new impulsive bear trend or corrective bear trend is irrelevant. The decline from the Feb. high

was only in the initial stages. Indicator buy signals should not be considered in a bear trend, only sell signals.

What about the second sell signal in early April? The pattern position indicates the decline is not complete. The decline from the Feb. high to the March low was clearly five-waves. Usually, corrections are not complete on a five-wave structure. The assumption must be the larger degree trend is still bearish.

The bull trend began in mid-July, 1997. The indicator reached the extreme “overbought” level several times during the bull trend into the Feb. 1998 high. Most of those “overbought” signals would have resulted in big loses if they would have been treated as sell signals.

All of the “oversold” buy signals during the bull trend would have been ideal signals to enter long positions – right up to the end of the five-wave bull trend in early Feb.

Key Concepts For Indicators and Dynamic Trading

Indicators may only be considered within the context of the Dynamic Trading analysis of the position of the market. If the Dynamic Trading analysis does not provide a firm opinion of the trend position of the market, ignore indicator position as a part of the analysis and trading plan.

If a trend is bullish, an extreme low indicator position may be considered as a buy-set up. If a trend is bearish, an extreme high indicator position may be considered as a sell-set up.

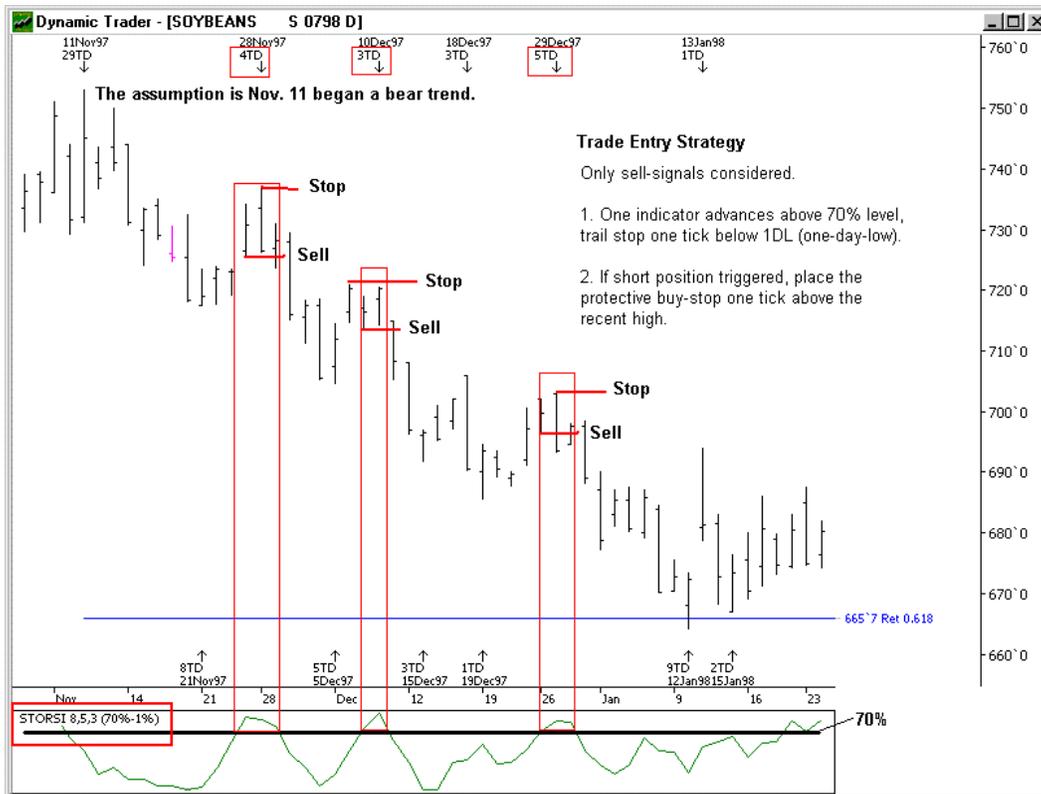
The Best Use of Indicator Signals and Dynamic Trading

I believe the indicator signals are best used to identify low-risk, high-probability, trade-entry set-ups on reactions against the trend. The following examples will illustrate this.

The StoRSI (stochastic of the RSI) indicator in Dynamic Trader is my favorite. The 8-5-3 set-up is an excellent short-term position indicator that usually reaches an extreme (above 70% or below 30%) on minor reactions against the trend. This indicator set-up recognizes that minor reactions against a trend usually last 3-6 trading days. If we are considering larger degree corrections, we would use the 13-8-5 or 21-13-8 set-ups.

One way to use this indicator is as a trend-continuation, trade-entry set-up. The set-up rules we will use in this illustration are:

1. Identify the trend direction. Only consider entry set-ups on reactions against the main trend.
2. In the case of a bear trend, if the 8-5-3 StoRSI advances above 70%, trail a sell-stop to enter a short position one tick below the one-day-low.
3. If the sell order is elected, place the protective buy-stop one tick above the recent high.



For the period of soybeans shown in the chart above, the 8-5-3 StoRSI short-position entry strategy worked perfectly. The indicator did not reach above 70% on every minor reaction. But what is important, every time the indicator reached above 70%, the minor correction was over within one or two trading days and the bear trend resumed.

What is the most important value of using this indicator, trade-entry set-up?

1. It provides a completely objective set-up strategy to enter a position in the direction of the trend. No judgement is necessary.
2. The entry price and initial stop-loss price are completely objective.

This indicator entry and initial protective stop-loss strategy requires the trader to have an opinion of the trend direction of the market. In the example above, it was assumed that the Dynamic Trading analysis indicated Nov. 11 completed a bull trend and began a bear trend.

This indicator trade-entry strategy provided a disciplined and completely objective method for trade-entry and initial protective stop-loss placement. Is it like another entry strategy described in the course? How about the Gann-Pull-Back? It is exactly the same concept. Both recognize markets make 3-6 trading day reactions against a trend and provide a discipline approach to trade-entry and initial stop-loss placement.

Take note. The Gann-Pullback and Indicator Extreme strategies may be combined for even higher probability set-ups by requiring the indicator to be in the 70%/30% or greater level and the reaction to be a minimum of three trading days.

GPB-Indicator Trade-Entry Strategy – Bear Trends

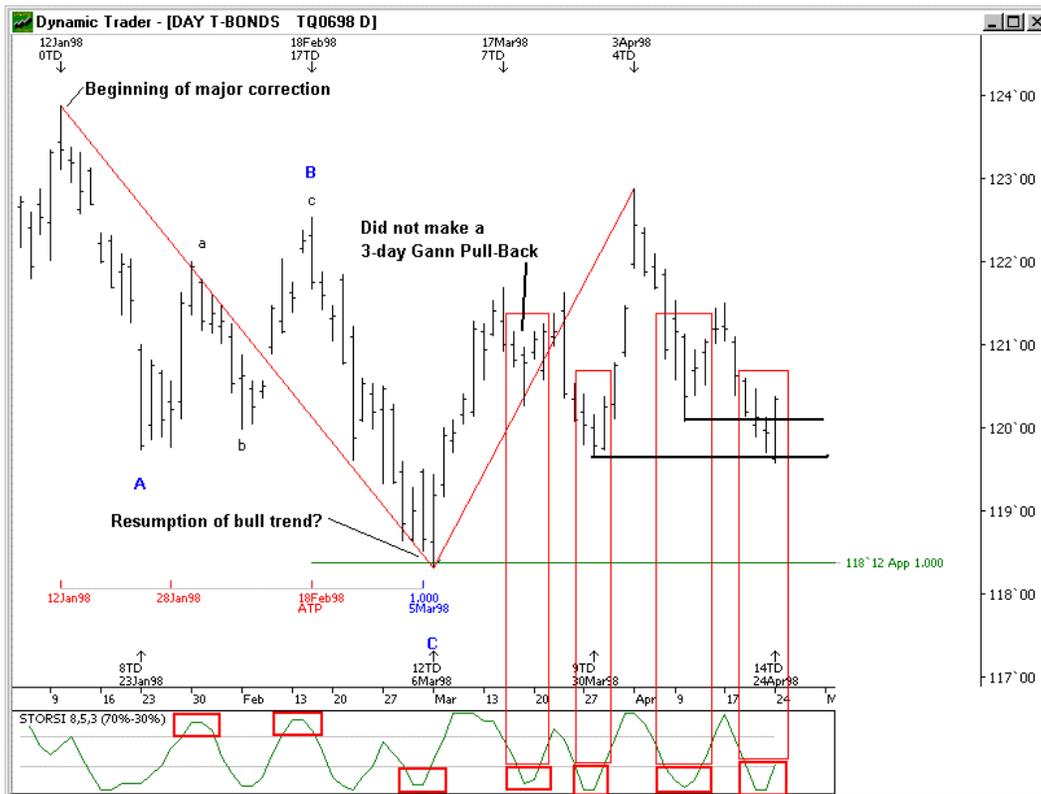
1. Only enter in the direction of the trend.
2. The 8-5-3 StoRSI must be greater than 70% and the counter-trend must be a minimum of three trading days.
3. Once the conditions are met, trail a sell-stop to enter a short position one tick below the 1DL (one-day-low).
4. If the short position is elected, place the initial protective buy-stop one tick above the recent high.
5. If stopped out, continue the strategy as long as the conditions are met.

Trend Direction Identification Important

The profitability using the indicator entry technique is dependent on how accurately the trader can identify the underlying trend. The next example will take a look at bonds following the Jan. 12, 1998 high. The assumption is Jan. 12 completed a bull trend and a major correction should follow. I'm using this example for bonds during this period because this is the analysis that was made in the Dynamic Trader Weekly Report. In other words, the trend position is not an after-the-fact example. The Dynamic Trading analysis correctly identified the time and price targets for a top in Jan., in advance.

Following the Jan. 12 high, bonds made two ideal indicator sell set-ups at the W.a:B and W.c:B highs. The March low was made on a reversal day at the 100% alternate time and price projections. It appeared March 6 completed a major ABC correction and the bull trend should resume from there. If this is the case, only buy set-ups should be considered and sell set-ups should be ignored.

The indicator was below 30% at the March 6 low, confirming a buy set-up of the time, price and pattern position. Following the March 6 low, four indicator buy set-ups were made through April 24 (the date this section is being written). The first indicator set-up was made on a two-day correction. If we included the 3-day Gann Pull-Back requirement, this correction would not qualify for an entry strategy. The second set-up at the March 30 low was clearly a winner. The third was clearly a loser. The fourth set-up at the April 24 outside-reversal-day is not resolved.



What is the important question at this point in time for bonds? What is the trend? Going into the late April low, bonds declined below the most recent minor low. The April 24 outside-reversal-day-low was made a few ticks below the March 30 swing low. Should we still consider the bond trend bullish? The April 24 low

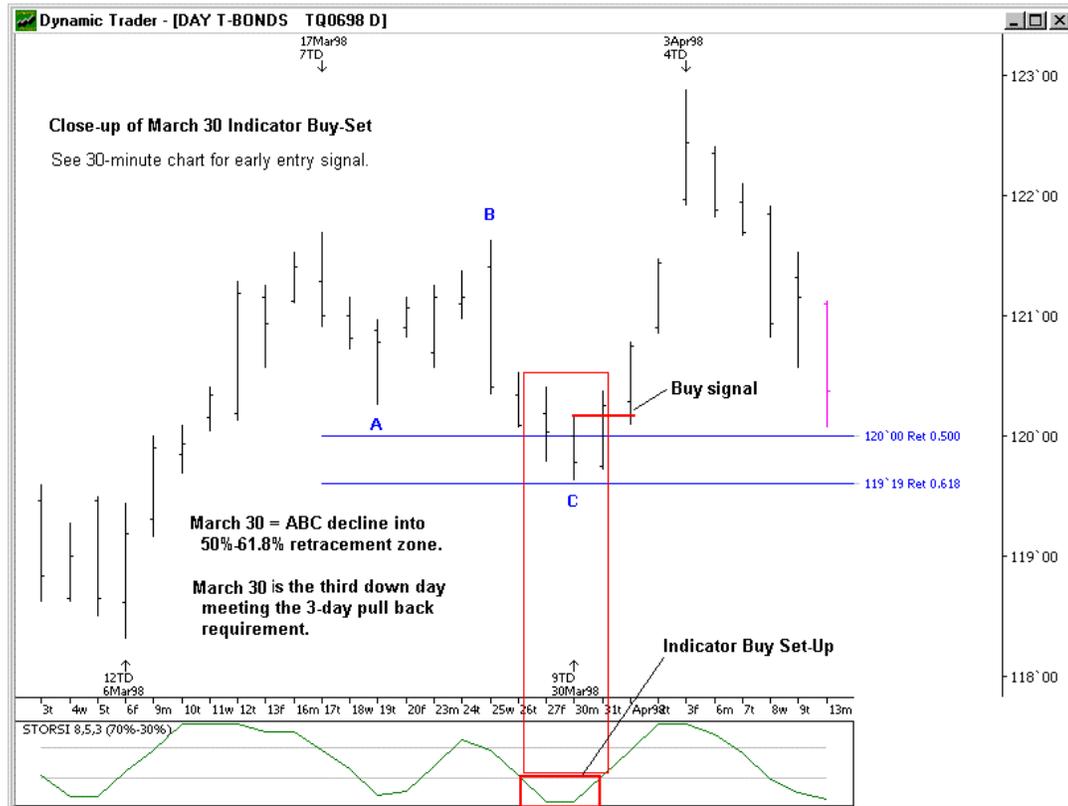
should only be considered an indicator buy set-up if the trend is still considered bullish. From only the information on this chart, we should probably not consider the trend bullish as of late April. The indicator buy set-up should be ignored.

It is important to have an opinion of the trend position of a market before considering an indicator trade-entry strategy. If you do not have a firm opinion of the trend position, no trade-entry strategy should be considered. “When in doubt, stay out.”

Intraday Data and the Indicator Entry Strategy

The indicator entry strategy may be used with intraday data for very short-term positions or to provide earlier entry signals once the daily data has made the set-up. The example below will take a closer look at the March 30 buy set-up shown in the chart above.

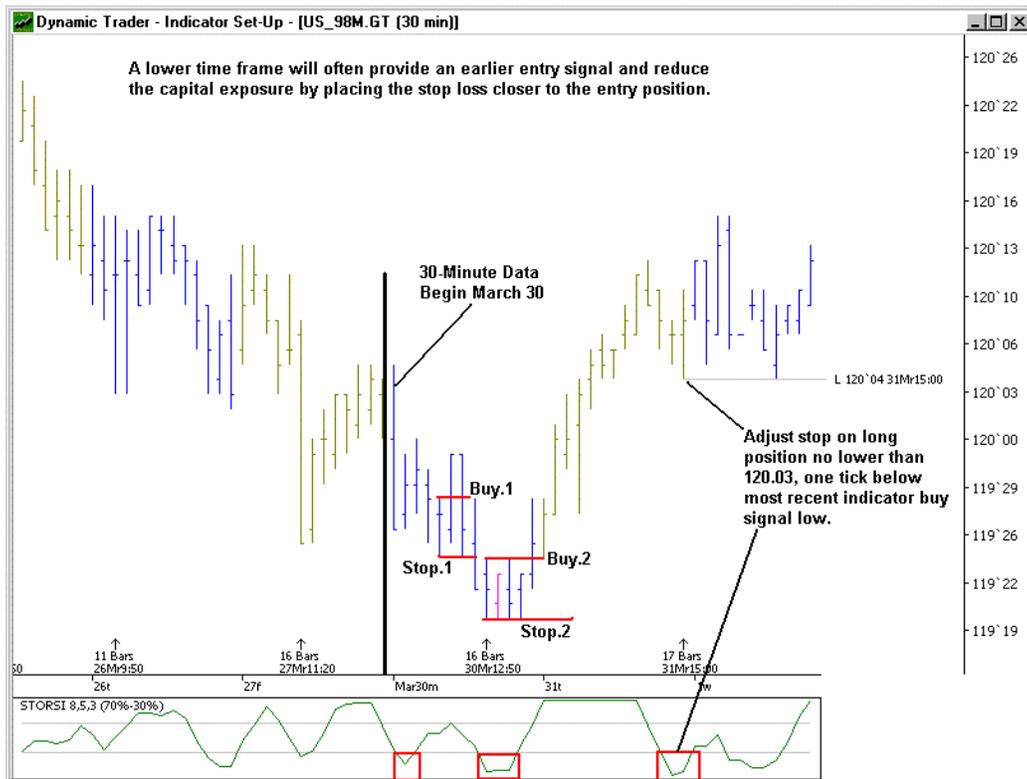
The assumption is March 6 began a resumption of the bullish trend and buy set-ups will be taken advantage of. On March 27 (one trading day prior to March 30), bonds had made an ABC decline into the 50%-61.8% retracement zone. March 27 was only the second day of the reaction down. On March 30, bonds made a new low meeting the 3-day requirement.



The indicator was below 30%. Using just daily data, the buy-stop to enter a long position would be placed one tick above the March 30 high. Let's see how the intraday data may be used with the entry strategy to reduce capital exposure.

The chart below is 30-minute bond data around the March 30 period. The heavy black vertical line shows where the March 30 data begins. According to the daily data, March 30 was the first day the buy set-up conditions had been met. If we only used daily data, the buy-stop would be placed one tick above the March 30 high. If the buy-stop were elected, the protective sell-stop would be placed one tick below the March 30 low for a capital exposure of 18 ticks. Not bad at all for using just daily data.

If we use the 30-minute data for trade entry, a buy entry was triggered on the 6th bar (Buy.1) of March 30 and was stopped out two bars later (Stop.1) for a five tick loss. The conditions for another buy were made later in the day (Buy.2) with a protective stop-loss just five ticks away (Stop.2). Bonds took off straight up from this buy signal. The capital exposure for these two entry signals was a total of 10 ticks. One entry resulted in a five tick loss.



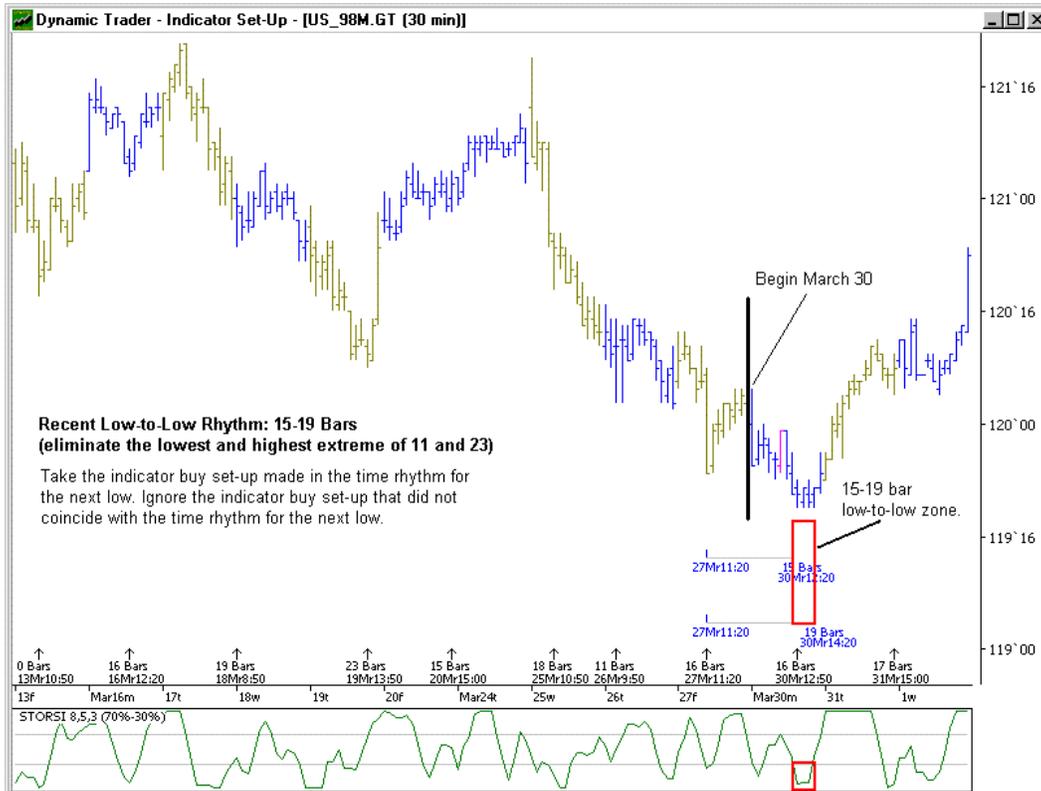
The entry price on Buy.2 was at 119.26 using the 30-minute data. The entry price using the daily data was at 120.06, 10 ticks higher. Five ticks were lost on the first entry. Ten ticks were gained on the second entry for a net gain of 5 ticks on the trade using the 30-minute data versus the daily data. While this is a relatively small gain, numerous small gains add up over time. More importantly, if the daily set-up proves to be a loser, the loss is usually reduced by using the intraday data for the entry and stop-loss signals.

The next indicator buy set-up on the 30-minute data was made late the following day, March 31. This set-up could be used to add an additional long position or as a set-up where to adjust the protective stop-loss on a short-term long position taken at the previous set-up.

If the short-term intraday indicator set-ups are used to provide early entry for the larger degree set-up from the daily data, there will often be premature signals that result in losses. The good news is – the losses should be very small because of the nature of the short-term data. The better news is – the false entry signals may usually be avoided by filtering the trade set-up with simple short-term time analysis.

Filter The Set-Ups With Time Analysis

The chart below is 30-minute bond data for the mid to late March period. Bonds had a recent low-to-low time rhythm of 11-23 bars. If we eliminate the shortest and longest bar (11 and 23) all the rest of the lows fell in a fairly tight range of 15-19 bars. We can use this time rhythm to filter the indicator buy set-ups.



If we count 15-19 bars from the March 27 low, the next low should be made between the 12:20-14:20 bars on March 30. If we only take an indicator buy set-up that meets the minimum low-to-low time rhythm, the first set-up made early in the day of March 30 that resulted in a loss would not have been taken. The second buy set-up was made precisely within the time window for a low.

Key Concepts To Consider When Using The Smaller Time Frame Data To Enter The Larger Degree Trend

1. First identify when the market has met the set-up conditions on the larger degree data - in this case, daily data.
2. Go to the next smaller time frame. Beware of going to a time frame that is too short-term. If the set-up is identified on daily data, do not go to shorter than 30-minute data for the entry trigger. If you go to a time frame that is too short-term, there will be too many false entry signals.
3. Filter the short-term entry set-up with simple time rhythm analysis to eliminate too early entry signals.
4. For short-term trade positions, use the indicator trade set-ups following the entry signal to adjust the protective stop-loss. Once the next signal is confirmed, adjust the protective stop-loss to no more than one tick below the low of the next entry signal in the same manner as if a brand new position was taken on that signal.

What Indicator Parameters and Extreme Levels To Use

The examples above use the 8-5-3 StoRSI indicator and 70%/30% as the extreme levels for the entry set-ups. As a default, these settings will work most of the time in most markets and most time frames. How do you confirm if these are the best settings at any given time?

It's very simple. Bring up the last 3-4 months of daily data. Do these settings catch most of the corrections against the main trend? Remember, we are only interested in set-ups on the corrective highs and lows against the trend. Extreme indicator readings are not useful in the direction of the trend. If the parameters do not catch the corrections, simply adjust the indicator parameters until they do. The assumption is always that the current rhythm will continue until proven otherwise.

I have used the StoRSI indicator for these examples because it is the indicator that I have found to be the most consistently reliable. You may have more experience with another indicator and find it to be equally or more useful than the StoRSI. If so, use it. The approach will be exactly the same as just described for the StoRSI.

The Big Advantage of the Indicator Trade-Entry Set-Up

It provides a completely objective entry trigger and initial stop-loss placement.

The Disadvantage of the Indicator Trade Entry Set-Up

Entry signals will not often be made in a strongly trending market during a period that does not experience 3-4 day or more corrections against the trend.

If you would like to learn more about the unique and comprehensive dynamic trading analysis and trade strategies, you must have a copy of Robert Miner's new book *Dynamic Trading*.

The *Dynamic Trader Software and Trading Course* is the most complete trading education experience you can get.

For complete information, go to our Web site at www.dynamictraders.com.