Trader Education Tutorial

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Practical Application of Price, Time and Pattern – Part III

Over the last two weeks, I have been detailing a trend-reversal trade in the Dollar Index where the Dynamic Trading approach was used to enter a short position right at the termination of a Wave 5 high. This was a trend reversal trade set-up. Trend-reversal set-ups allow a trader to be positioned at the very beginning of a new trend.

Trend-reversal trade-entry strategies are not the only trade set-ups available to the trader, as there are many trade set-ups that may be employed once a new trend is already underway called trend-continuation trades. Over the past several weeks, I have described three of these trend-continuation trade-entry strategies - the inside day, outside day and Gann pullback. These prior tutorials are all available for download from the Traders Education Archives.

Today I would like to demonstrate the practical application of one of these trend-continuation trade set-ups on a chart of (Aug) crude oil. Here we have a market that has been climbing steadily since the Apr 10 low with no discernible swings off which an Elliott wave count can be based. From a practical trading point of view, how best can a trader approach a market such as this?

A steadily climbing (or declining) market is an ideal market to look for and trade trend continuation set-ups.

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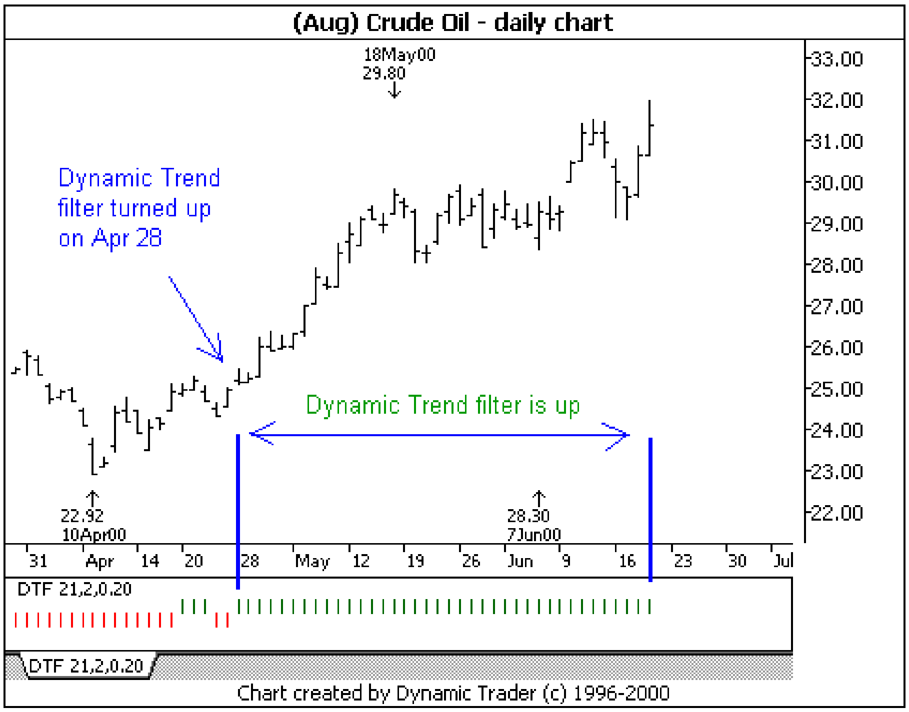
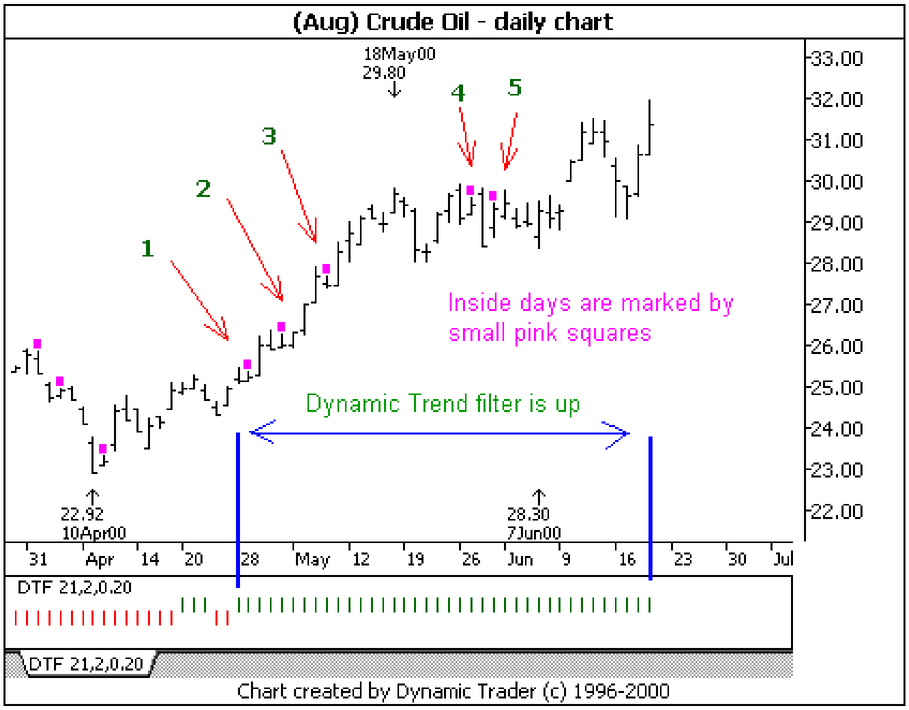
The first step is to identify the main trend. If there are no discernable swings off which a confident Elliott wave count can be identified, this may prove difficult since pattern analysis is an important component of trend identification. This is when a mechanical trend-identification filter such as the Dynamic Trend Filter (one of the indicators in the Dynamic Trader software program) can be used. In the chart below the Dynamic Trend Filter turned up on Apr 28.



The Dynamic Trend Filter is our own "adaptive" trend filter which considers volatility and momentum. Whipsaws or false reversals are much less likely with the Dynamic Trend Filter (DTF) and the DTF usually turns closer to the beginning and end of a trend than most trend indicators.

We should only look to trade set-ups in the direction of the trend as identified by the Dynamic Trend Filter. In this example, buy set-ups should only be considered since the DTF is bullish..

Now we can turn our attention to identifying the inside-day trend-continuation set-up to enter a long trade:



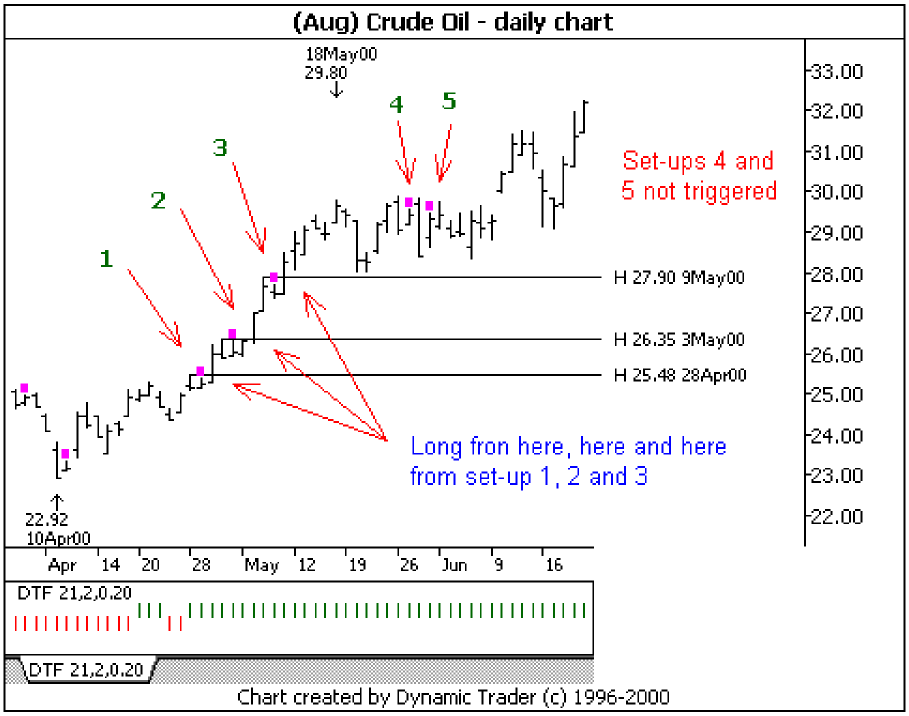
In the chart above, since Apr 28, there have been five separate inside day set-ups. The Dynamic Trader software program has marked these by small pink squares above the set-up bar.

I have covered the rules for an inside day set-up in a prior tutorial but to review:

<u>Inside day trade entry criteria</u>

1. As this is a *trend continuation* set-up, we are looking to only enter *in the direction* of the main trade. Therefore we must already have an opinion of the direction of the main trade. In this case, DTs Dynamic Trend Filter will provide the objective trend direction signal.
2. To enter a long position (reverse for a short position), as long as the low of the prior day has not been exceeded, on the day following the inside day, place an order to buy one tick above the high of the day prior to the inside day.
3. If filled, the protective sell-stop (protective buy-stop for a short trade) is placed one tick below *the lower* of the inside day itself <u>or</u> the low of the day of entry.

For the period in the chart above, the first three inside-day set-ups resulted in a long trade being triggered while set-ups four and five did not meet the trade-entry conditions the following day. See the chart below:



Each of the three trades that were elected (1, 2 and 3) were profitable as crude oil continued to rally without retracing back to the initial protective stop positions.

Lesson Learned

Today's training tutorial demonstrates that although the Dynamic Trader approach to the markets allows traders to be positioned at or very near the actual high or low of a market turn, as in the example on the Dollar Index last week, we also have trend-continuation trade strategies to enter a position once a trend is established.

Not all markets unfold in obvious Elliott patterns. Sometimes markets just either go straight up (or down) as in this example and traders can find it very difficult to enter trades so far away from the last obvious swing pivot.

This is a practical example of how the Dynamic Trader approach to the markets does not limit the trader to one specific type of trading. When there is a obvious Elliott wave count to work with, trades may be taken off the termination of the individual waves. But, as in this example, when a market is in a strong trend, the Dynamic Trading approach allows traders to use trend continuation set-ups to take advantage of this strong trend.

The two components to this approach are:

1. Have a reliable indicator to signal the direction of the trend that usually avoids whipsaws. The Dynamic Trend Filter is an adaptive filter that considered recent volatility and momentum to signal the trend direction.
2. Have reliable and objective trend-continuation trade-entry strategies that will elect a trade with minimum capital exposure. The inside-day strategy is

one. Others are the outside-day and Gann Pull Back which we have written tutorials about in the past.

Next week I will return to another practical example of a trend-reversal trade with a look at another recent specific trade recommendation from the Dynamic Trader report.

For complete information on Trend-Reversal and Trend-Continuation trade set-ups, see the Trade Management chapter in Robert Miner's Dynamic Trading book.