PRICE ACTION

MARKET TRAPS

7 Trap Strategies
Market Psychology
Minimal Risk & Maximum Profit

RAY WANG

Price Action
Market Traps

A practical guide for traders to understand market psychology & exploit price action traps in everyday trading

Ray Wang

“Most of the money lost in the markets is lost by traders who thought they knew which way the market was supposed to go.”

----- Mark Douglas

Prologue

During my many years of trading, I was never consistently profit. I started out by reading books and watching trading course videos, like majority of traders. I have read over a hundred books on trading and experimented hundreds of different trading ideas: from the classics to most recent publications; from technical analysis to market fundamentals; from indicators to price action, so many methods and strategies that I can’t recall. Some are more informative than others, some are just unproductive. I have found out that none of the ideas works for me constantly. Some methods and strategies work best for the inventors but not for me, simply because the way everybody thinks is different. From that moment on, I have decided to develop my own method of trading. I wanted to discover a particular strategy which can be used by anybody and profit consistently.

I have always heard about that market is dangerous; Wall Street genius are con artists. Well, it interested me. I was wondering the ways how they manipulate the crowd and try to avoid these dangers. Also, there are moments on the chart are simply confusing, questions I couldn’t find the answer to from all the books and videos. Until I read the book *“Master the Markets”* by Tom Williams. It opened a gate for me, this book declared some of the dark hidden tricks of the market. I began to dig more and soon realized there are traps all over the chart. These traps are the veils which makes the market so mysterious to the novice traders.

Traps were always there. You just never realized it. Your job is to memorize them, just like memorizing the fundamental math formulas in high school. Learn to get in when people are trapped on the wrong side and exit immediately when you are trapped.

I have never believed anybody can hand you the “magic formula” and start making money instantly. Market is a serious place, where investors, bankers, institutions, business entrepreneurs put their money. You have to take it seriously in order to take a piece of that pie. It involves with caution, discipline, analyzing, planning, consistency, positive attitude and decision.

I have written this book in simplest English. The purpose is that anybody can understand it and learn it in days. You will have to pardon me if you see any grammar mistake, as English is not my first language. I have divided this book into two parts. The first part contains fundamentals of price action and my personal interpretations of some concepts. The second part is the Trap concept in details along with example of CL. I have chosen Crude Oil Future (CL) as my only chart to use because I have been trading CL since the start of my trading journey. It is the only thing I trade because of the great volatility and clarity of price action. I believe CL is a great choice to start with, whereas ES (E-mini S&P500) is traded only by the professionals. ES moves relatively slower and the trading session is quite lengthy. On the other hand, CL moves rather quickly and most of the activities happens in the morning session before noon. Anyway, beside CL, TF (Mini Russell 2000) and NQ (E-mini NASDAQ 100) are both great choices to trade. I’m a day-trader and I close all my contracts at the end of the day. I don’t hold any open positions simply because I want to have a good sleep every night, without worrying about the European session or some expected news happened overnight.I use 5-mins candlestick chart and 20 EMA as my only indicator. No matter which future you are trading; no matter what time frame you use, you will find the Trap concept can be found everywhere in the market.

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Part I

Chapter 1 - Market is a battlefield

Market is a battlefield. This war zone is filled with traders from all different kinds of background. But no matter who you are, whether you are a buyer or seller, the moment market fills your order, you are in this war for one reason only: profit. Although we may not meet our opponent, the cold hard math is: your lost is somebody’s gain.

The competition is fierce between major trading firms, Wall Street elites, investors, hedge fund managers and the public. Yes, the enormous yet poor, powerless and hopeful mass, built by individuals who wish to trade their ways to success. Well, sorry to burst that bubble. Majority of public traders fail and don’t even last over a year. Most quit after tremendous financial loss, blaming bad luck or randomness of the market. They acclaim trading is extremely difficult and individual trader can’t profit. Well, trading is like everything else, the skill to trade successfully develops over time. First, you need to learn the basic knowledge of the market and price movement. Then devoting yourself into thousands of hours of practicing. Lastly, developing a positive attitude of emotion-free and consistency. These steps are the essential journey of becoming a successful trader.

Wall Street and major firms thrive on public’s generous contribution. Imagine how bloody difficult trading would be, if it only permits trading elites to make money from each other, on the battle of wits, without the public’s participation. They would shake their head: “No thanks. We like the public, because they almost always bring a knife to a gun fight!” The conventional knowledge which public traders possess are essential to themselves because they link what they learned to explain what’s happening on the chart.

Many trading books, in essence, are books of tools. Tools mostly consist of indicators, patterns, strategies, images, entry signal and rules. These tools are promoted as “practical” and “magical”, which led people to believe there is a “Holy Grail” to exploit. Traders couldn’t wait to finish the book to experiment the strategy to make money. They became slaves of these methods and strategies, which paralyzed their analyzing ability. Rarely do they ask themselves why market is doing what it’s doing. **The whole analyzing process and exploring the psychological truth behind a certain price action is ignored and forgotten.** To them, it’s much easier to just follow the “Guru”. Objectively analyzing requires too much brain power, and it’s exhausting. Therefore, when something didn’t go as planned or predicted, they panic and lose their minds. Not knowing the psychological truth behind certain price action plays a significant role in clouding traders’ judgment.

For example, Japanese candlestick fanatics use the term “Marubozu” to indicate a trend bar with no tails, body only. It represents strong strength and urgency, a great signal to exploit. The impatient traders will enter while the bar is forming by placing buy orders 1 tick above the green “Marubozu”. Because it’s a very strong bar, which has led them to believe price will continue to go up in the near future, that’s what they have learned in Japanese Candlestick book. This kind of “Confident” “Happy” “It’s a gift from the trading God!” “Imminent Profit” mentality has cloud their judgments for analyze the chart objectively. What happens next? The price goes up 1 tick to trigger them all in, then formed an equal-sized red bearish trend bar. They start to panic and some will run for cover. When price keeps on going lower, eventually triggers all of their stop-losses below that green “Marubozu”, the remaining traders closed the trade with a big loss. Why? Because people believe what they see and act on what they learned without the thinking process.

They neglect to consider the CONTEXT! Wall Street elites play these tricks all the time in order to get their orders filled. Major trading firms holds considerable amount of money to affect the price movement. Remember that! They have the "Edge" which the individual trader like you and me do not possess. They have the funds to push price up into a huge bull bar and counter it right after. To trap the traders who don't know better. It's crucial that beginners have to recognize these traps in order to keep their trading account intact. These traps can be found in almost all charts. I will illustrate chart examples along with case study in Part II if this book.

"Buy Low Sell High" still remain the motto in the trading world. A green "Marubozu" in a strong downtrend is nothing more than a "Shakeout". It shakes out the weak hands and lures the greedy traders who are trying to pick a bottom, fear and greed. The battle of trading holds no mercy, you are either a winner or a loser. The job for every trader should be spotting price actions associated with the psychological weakness of the crowd- fear and greed. Only if you can see the manipulation of these weakness on the chart, then you can exploit them for profit. Essentially, get in when they are getting out with a loss.

Chapter 2-Price Action: The unique language of Market

We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.-Warren Buffett

Market is speaking to you in its unique language. To many people, price action is a foreign movie without subtitles. Vast majority of traders and online Gurus are still replying heavily on indicators, developing advanced new indicators, algorithms systems and graphic pattern. Not only are they lagging in action, most of them are price based inventions. First price has to move 1 tick, then it reflects back to the system in order to generate signals. The smart public traders knows that but why indicators are still so popular in demand?

Fear and Greed. It’s the manipulation of the crowd, using our weakness- afraid to lose money and greedy for more profit. No trader wants to lose money, if there is a tool can “help”, why not? It makes perfect sense on the surface. But if you have many years of experience in trading, you would find the “help” concept is contradictive in nature. You are on your own, your ability of being cognitive and objective to the price movement is your weapon. Your consistency, self-control and emotional-free attitudes to either winning or losing are your shields.

When it comes to trading, winning or losing; right or wrong are no longer important. Trading is a game of probability. Trader’s only focus should be how to increase that probability, to have a better edge. That’s it. The rest are simply distractions.

Traders who rely heavily on indicators are convinced that indicators represent some sort of advanced technology, which give the traders a “peace of mind”. They feel necessary to use them because they don’t want to be old-fashioned and left out in the modern world. It’s true that we live in a digital world of computers, internet, algorithms and technology. All the transactions are no longer accomplished by phone or paper contracts like the old days. Now contracts are exchanged by just a click of the mouse. These improvements have mislead the traders to believe the fundamental of trading is changing also. Well, it’s not. In “Reminiscences of a Stock Operator” written by Jesse Livermore, which was acclaimed as the “classic” by Wall Street Journal, Livermore wrote:

“*There is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market today has happened before and will happen again*”.

Indicators are advertised as “Helpful” and “Trust-worthy”, backed up with statistic data, advanced technology and various live trading evidence. The goal is to confirm its reliability in order to convince the public to buy the product and use it relentlessly. Very often I see traders have 10 or more indicators on their chart. The funny thing is that they would magnify the indicators to a large size and shrink the actual bars to the smallest. They say it’s easier to see the analysis of the indicator. What’s even more hilarious is that they have the ability to collect and analyze the results from 10+ different indicators and make a “sound” trading decision, despite any knowledge of why price moves the way it does.

It’s very difficult for EMA strategic traders to explain why they wouldn’t initiate a sell order when market is dropping aggressively above the EMA. Same for stochastic traders who don’t understand why price keeps rising when the stochastic number hits beyond +80 (overbought). As a result, the EMA trader spend more time waiting for setups and Oscillator trader keeps entering against the strong trend and losing money on every attempt to pick reversal. These so-called “Help”, packed with beautiful colors, complicated algorithms, specific manuals and fancy visualizations which lured traders to spend a lot of money on, but in fact has mislead the trader to forget the nature of trading. The market is us, every tick reflects the nature of human emotions. The price movement is right in front of you!! Despite all the money spent and all the brain power to associate all the “help” in order to make a decision, the process just seems too complicated and unproductive. The simplicity is the key to success.

"People often associate complexity with deeper meaning, when often after precious time has been lost, it is realized that simplicity is the key to everything." – Gary Hopkins

The image above shows the clear distinction between two charts. They represent the same chart of Crude Oil Future (CL) on Jun.9 2016. The chart on the top is filled with 6 common indicators, MACD, Stochastic, Volume, 20&50 EMA, Bollinger Band and Woodies CCI. The bottom one is the pure price action chart. See the clarity?

To be clear, I’m not negating the values of indicators. I admire all the inventors of indicators because they did contribute their value to the trading world. In fact, I have tried all kinds of indicators when I was starting out. It’s the complexity and uncertainty which made me questioning their efficiency. However, there is only one indicator I have used for a long time, the EMA (Exponential Moving Average) because it’s simple and effective. Use the 20 EMA as a trend identifier and dynamic support/resistance. There is more explanation of the usage of EMA in later chapters.

There is no absolute definition for price action. In a broad sense, **price action is any change in price**. To me, price action trading is the process of understanding the reason behind every movement in price. By analyzing the current movement of the price in relation to the past in order to speculate a potential price movement for the future. By analyzing its relationship, the feedback will affect my decision when initiate an order. On a 5-mins Candlestick chart, the relationship between each bar represent the movement of the price for each 5 minutes. To me, price action is my favorite indicator because it always tells me the truth about price. It doesn’t produce any false signal.

Day traders often have this big obstacle: be able to recognize if the market today is Trending or Ranging. The moment you recognize what type of day you are dealing with, then you can apply the appropriate methods for trading. If it’s trending, pullbacks are the best choices. It doesn’t matter whether it’s the first or second pullback; one bar pullback or complex pullback, you can literally enter anytime to make money, as long as you place the right stop loss and don’t countertrend. If it’s a trading range day, reverse the concept above and only enter countertrend at the extremes of the range, wait for clear confirmation and stay out of the middle because it can be very choppy.

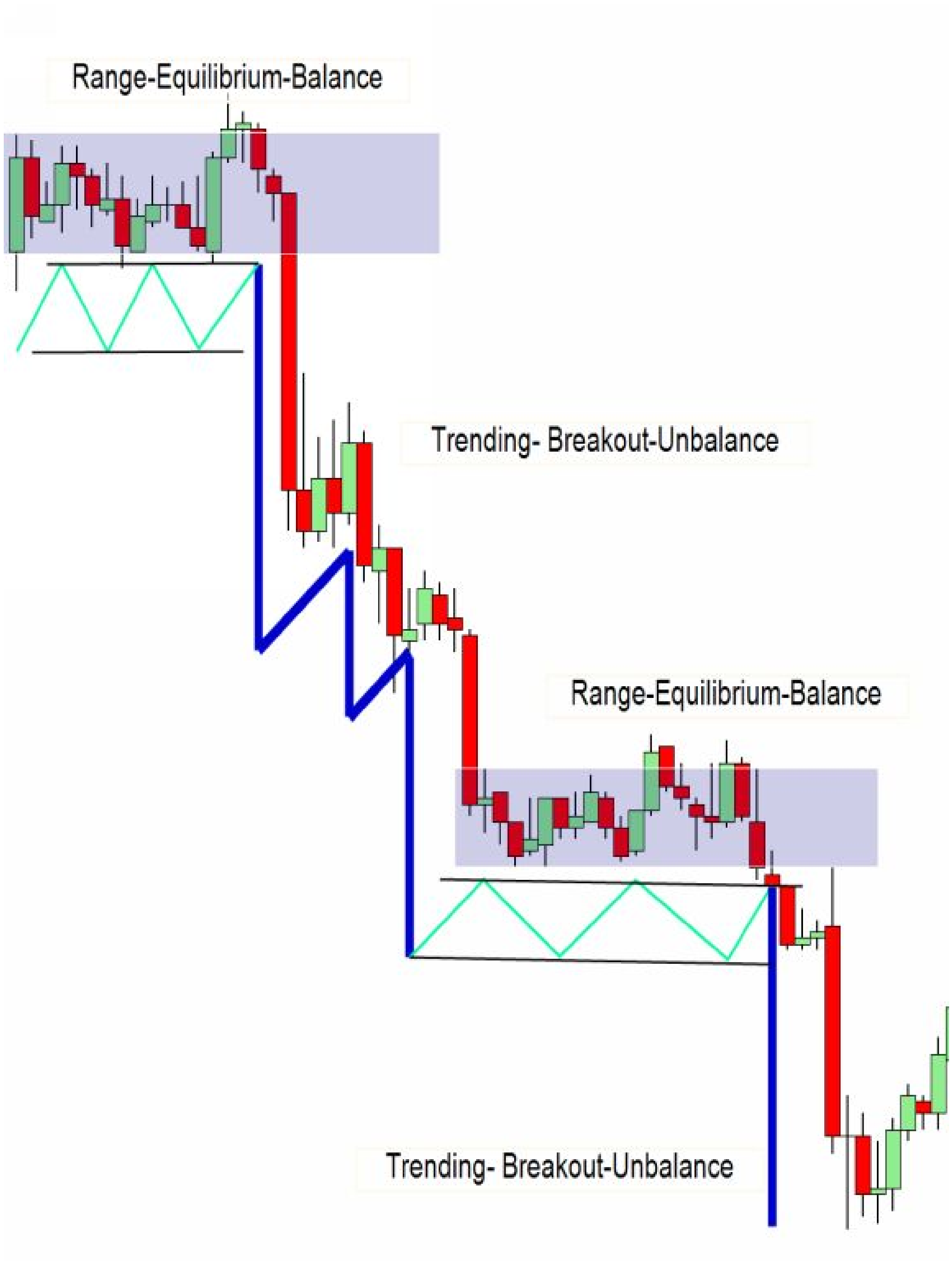
The main reason I prefer “naked” chart instead of employing indicators is that indicators lost their magical powers when the market is not trending. They create all kinds of false signals on a Range day. That is a big problem because

market is rotating in sideway motion 75% of the time. One thing I discovered through many years of trading is that trading range is surprising predictable! The reason behind this is because the market is in equilibrium state or zone of “fair value of price”, where the buyers and sellers are somewhat “passive” and neither side wants to break the peace. This may cause some worry among the long term investors, but for day traders, Range days are often lucrative days to scalp back and forth.

The price action on a Range day could be best described as swapping action. When buyers push the price from bottom to top and taking profits, sellers swap the buyers, start entering shorts and pushing the price towards the bottom of the Range. Often, one side is pushing the price too aggressively or too far towards one direction, it will create an illusion of Range breakout. But in most cases, it fails within 2-3 bars. Then price will return back to the original Range and keeps on swapping. This is where the Trap concept comes in play. Avoid false breakout trap at the extremes of the Range can save a tremendous amount of money. The ability to correctly identify the authenticity of the Range breakout would avoid being trapped in and make money consistently on the ones who did get trapped.

When most indicators are failing to distinguish between Range day and Trend day, the basic price action concepts in a “naked” chart can produce an astonishing result. Market has its own mood, and every day is a different day.

Traders claim trading as “more of an art than science”. It’s very true because of its aleatoric nature. This uncertainty creates a flow, like the ocean, sometimes tranquil and sometimes raging. The ultimate goal for a trader is to adopt into the flow as soon as possible. You are the market, and market is you. Sync! Once you can be in sync with the market, then you can swim in and out of the trades like the pros.



Range-Equilibrium-Balance
Trending- Breakout-Unbalance
Range-Equilibrium-Balance
Trending- Breakout-Unbalance

Chapter 3-Trend and Range

There are many ways which can help traders to potentially tell what type of day is ahead of us.

<u>For Trend days</u>:

First, strength and follow ups. On trending days, whether it’s an uptrend or a downtrend, the bar which initiate the trend usually have decent follow ups. Market has a rhythm, like music. You can sense the urgency in tempo and strength behind every bar when it’s forming. The determination of one side is dominating over the other should be fairly obvious.

For example, in a strong uptrend, the chart is filled with green trend bars with average size body, but closed high. Slowly and consecutively moving upwards which can create a parabolic curve. Any pullback red bar is short lived with narrow body and long wicks at the bottom. At a glance, there are just simply more green bars than red bars! Both quality and quantity of the bars create an inevitable energy, makes you regret not entering earlier.

When a strong uptrend is in progress, it’s very hard to make money selling. But for buyers, you should see profit not long after you entered. The determination is to push price up and everyone is in sync buying, nobody is taking profit yet until it reaches a fairly strong supply zone. **Any countertrend attempt will fail and becomes the most reliable setup to resume the trend.**

Wick is very important in price action trading, it shows both rejection and strength. It’s the hidden truth about domination. In an uptrend, you should see long wicks at the bottoms of the bars, not on top. It means any selling is being rejected and pushed up. Once you spot these signs, your job is to BUY! You don’t countertrend and sell, if you do, I’ll be on the other end of you turn your loss into my profit.

The same principles apply for downtrend. More consecutive red bars with average size body, wicks on top of the bars. Any green bar pullback is small and short-lived.

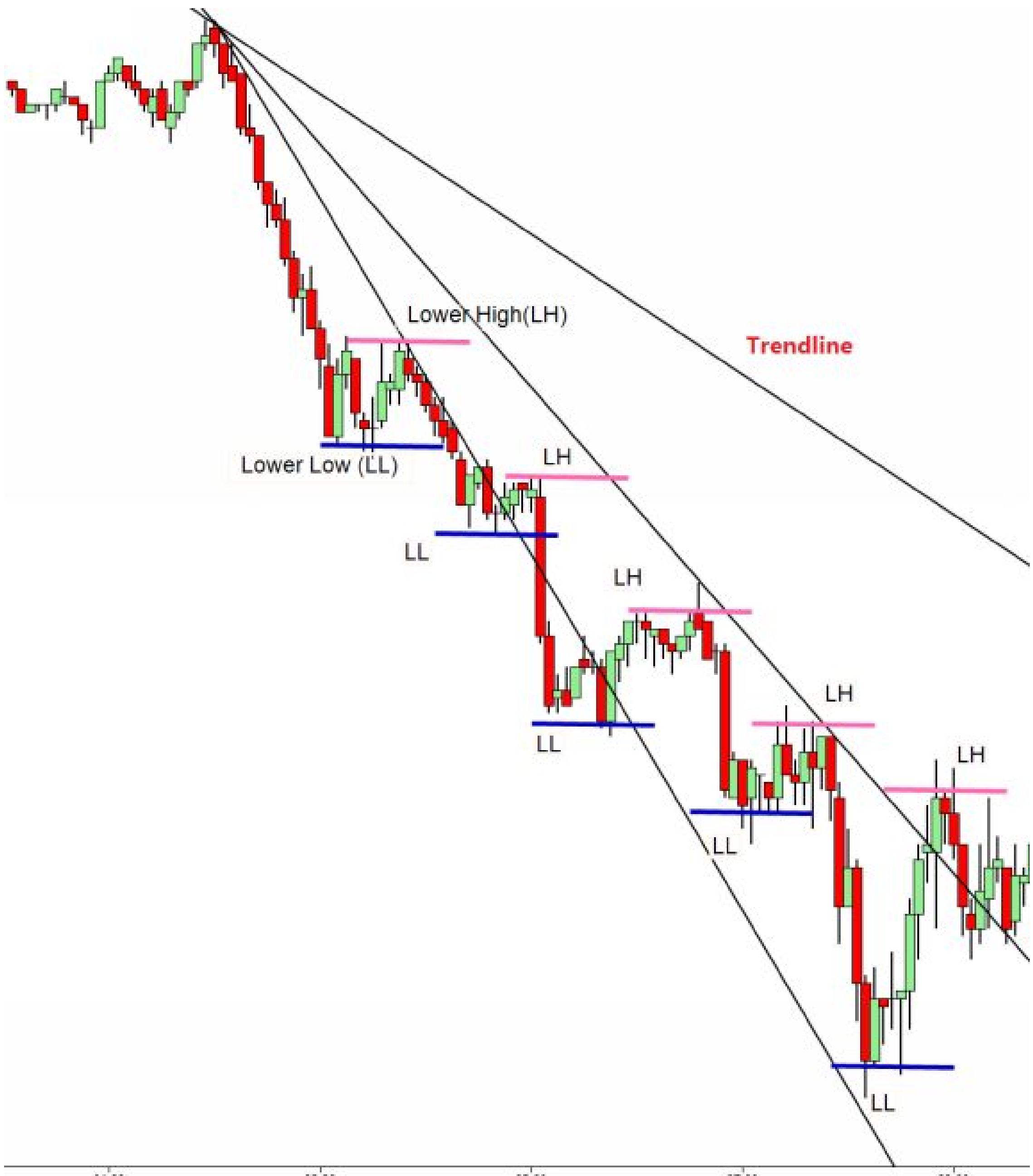
On June.13 2016, CL had a very strong uptrend. All the green arrows indicate any attempt to sell below is being bought. There are only 6 red bars, 16 bullish bars. The close of each candle is higher than previous close. It’s in parabolic curve rather than boxed-in. Day like this, you can buy above or below any bullish bar, buy the close of red bars (scale in). You have to be in this flow. Market is trending only 30% of the time.

Second, the old-school Higher High & Lower Low. (Two-Fold)

First, the follow-up bars should be breaking out previous bars, making either Higher High in an uptrend or Lower Low in a downtrend. For example, each follow up green bar in an uptrend should have higher low, higher high and higher close to the previous one. Vice versa for downtrend, red bearish bars should be making lower low, lower high and lower close than the previous bar.

Another interpretation is based on structural pattern: **The pivot point of each swing. Higher High and Higher Low of each wave for uptrend & Lower High and Lower Low of each wave for downtrend. Price never moves in straight line, it moves in waves. And each wave will create pivot point on the chart.**

These pivot points can often be found in pullback of a trend. They are important turning points which represent zones of the demand/supply (buyers /sellers). The best way to use these pivot points to identify the trend is to create a trendline by connect them with straight lines. You don’t need advanced knowledge to draw complex trendlines. Just connect a low and higher low, you get a simple trendline pointing in an up direction. For downtrend, connect any high and a lower high. This trendline gives you both the direction of the trend and great reference points for support/resistance for future price movement.


Lower High(LH)
Trendline
Lower Low (LL)
LH
LL
LH
LL
LH
LL
LH
LL

Third, the dynamic support/resistance tool, EMA (Exponential Moving Average). EMA is a variation of the simple moving average (SMA). Simple moving average is an arithmetic calculation which adds all the closing price data from a certain period of time, then average it out. EMA aims to put more weight to recent price data, therefore it reacts to price much quicker than the SMA. I personally use the 20-day EMA on my 5-mins candlestick chart when day-trading because it's reacts to price quickly and follow the price action closely. There are many ways of using the EMA, but I found two methods are quite effective.

First, I use the 20-day EMA to give me a broad idea of what to expect for the day, whether it's trending or ranging. **For trending days, bars usually stay consistently above or below one side of EMA, most of the time not touching the EMA for hours until a deeper correction. For range day, it's very obvious that price is interact with EMA very closely.** If you draw a box around a range, it's obvious that EMA is cutting through the center of the box. Price is twining around the EMA line like white on rice. See the distinction below.

Another usage for EMA is to watch the price action around the EMA when it's touched, based on the reaction, find tradable setups. EMA isn't like trendline, a straight line. EMA follows the price, it's dynamic. It serves as strong support/resistance reference point. But it only works best when price is trending in one direction. When price move sideways, EMA lose its efficiency, does not produce any reliable setups.

EMA based trading strategies are quite popular, sideliners are watching the EMA like hawk. **The axiom is that "as long as price stays above the EMA, you will only buy, never sell. The opposite is true for downtrend."** One of the trade model I employ often is to enter on the "1st Deep Pullback". In a strong trend, price goes too far away from the EMA and not touching for hours, but when it does for the 1st time, this deep pullback is a very reliable setup to resume the original trend. Some experts call the EMA "the Mean". When price moves too far away from the "Mean", it can create a rubber-band effect, price would stretch back to the EMA. Sideliners are watching for the EMA, they know the odd that 1st pullback of a strong trend turns to reversal is quite rare. So when price return to EMA, they would consider it's a gift and entering to resume the original trend.

Word of caution: Never subjectively determine how far is far! Market can go much further than you think. Wait for confirmation and proof before you counter.

Case Study:

This is the chart of the overnight session on June.23 2016. Price was trending down all the way to the dotted line without touching the EMA, it shows the sellers are very strong. But the price is getting very far away from the "Mean". The wick of that last red candle by the green arrow, it tells us buyers are scaling in long position and sellers start taking profit. It followed by a significant pullback to the EMA. The green circle would be the perfect example of EMA 1st Pullback. Price touches the EMA, found heavy supply, the downtrend resume to a new Low.

There are two obvious traps can be found here in the green circle. This will serve as an introduction for the "Trap" concept, which I will illustrate more in details in Part II. The bar 2 is an obvious "Stop-Loss Hunt" Trap. Traders always complain that institutions know where their stop-loss placements are and hunt these spots to take them out. Of course! Everybody knows the obvious location for stop-loss placement, not to mention the institutions can actually see your orders. Think from institutional trader's perspective. Their job is unloading the shares in hands. For example, Bar 1 is a massive bearish bar, which breakouts out the tiny range on the left and followed with another two equally strong bearish bars. Traders who shorted earlier would put their buy-stop order 1-2 ticks above that initiative bar. Institutions can see the orders, when they see there is load of buy-stop orders are just piled up there waiting to be taken out, they will hunt for them.

One definite motto for trading is: "Buy low and Sell High". In order to unload a sell order, someone will have to buy it from them. Sell low is not an option for the institutions, they have to sell high.

Which spot has both the highest volume of buy orders and optimal location? Above Bar 1! They manage to take out both the high of Bar 1 and EMA enough amount to unload their sell orders and also create an illusion that buyers are taking control, which would lure more amateur buyers to buy, to fill more of the sell orders for the institutions. Although the Bar 2 did close above the EMA, which generally shows that buyers are taking control. But look at the follow-ups: one tiny inside bar and a bull Doji. That is not what you want to see if you are going long. It simply means the sideliners are no longer interested to support this potential Bull Reversal, they are not done selling. So if you are a buyer, you should change the mentality, be flexible, admits that the market sentiment is changing instead of “hoping” price will continue raising. If you are still doubtful, then bar 3 is your last chance to exit, the final call.

When Bar 3 was forming, it seemed to be a very strong bullish green bar. But look at the wick on top when the bar is done, the effort to go up is failed. A wick is nothing more than a price rejection, a failure. You can see there are buyers who put their buy-limit orders 1 tick above the bar 4, because it did go up 2 ticks. These buyers get filled and immediately get trapped. As a trap hunter, your job is to objectively analyze what is happening on the chart and use it for your own benefit. When I saw bar 3, I would put my sell-stop order 1 tick below bar 4. I know buyers are now trapped, their stop-loss placement is not far, the nearest is below bar 4. I would hunt for their stop loss. When they bail out, their loss turns into my profit. Both bar 2 and bar 3 traps are very common in day-trading. Learn to spot and use them.

Trading Range (Sideway price action)

Trading range can be very tricky for majority of traders. It's very difficult for traders to distinguish between range and trend. Well, it's very understandable because they have some similarities which can mystify our eyes. **Trend is essentially a breakout phase. Range is essentially a consolidation phase. Market is rotating between Trend and Range.** It's like climbing a mountain. You climb to a point where you think it would be a good place to rest and refill your energy. You rest for a while then you continue climbing if you have the strength. Otherwise you will quit and go downhill. Market works exactly the same way.

For example, price trends up for a while, then goes to the consolidation phrase (range) either to resume or reverse. At one point, there will be an initiative up or down move which breaks out of the consolidation parameter. If a breakout to the upside attracts more buyers, price will go up. The previous uptrend will continue, a successful breakout. If the equilibrium is not broken, the excessive bullish move outside of the consolidation parameter will be sold into. It will leave a long wick on top of the bar, price will return back to the original range and continues swapping. The consolidation phase continues. If more people think the current price is not fair anymore, or the buyers are showing weakness, the sellers will take control, breaking out to the downside, a potential Bear reversal. The relationship between Trend and Range is that they are interactive. One can't survive without the other.

Your job is not predicting between trend or range. It would be a waste of time. Your focus should be how to get into the flow and trade accordingly.

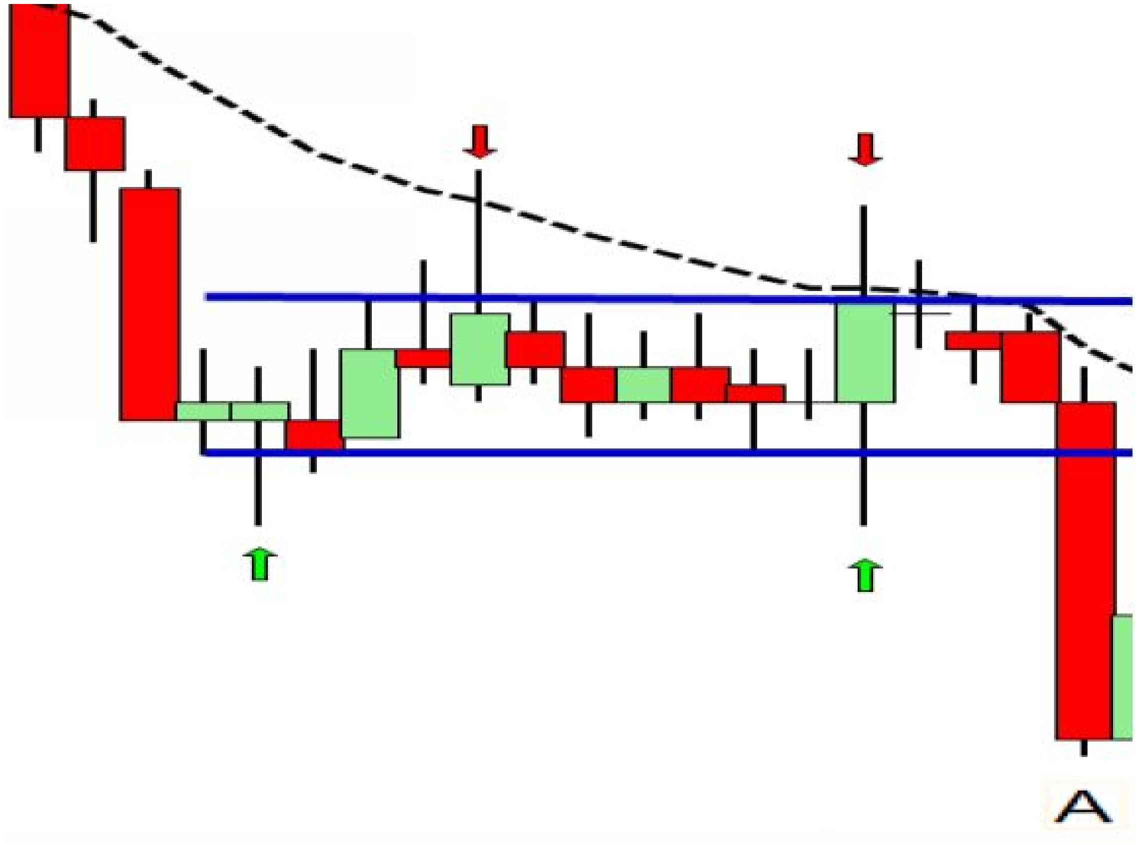
Be flexible and be prepared! If it's been trending up in the morning session, expect a consolidation at noon. Expect it, don't predict it! Prepare for it, don't try to impress yourself by proving your predictions are right! Thinking in probability and act on what the chart is telling you.

Characteristic of the Range

First, the wicks. Trading range is filled with wicks especially more on top and bottom of the approximate range parameter. The reason behind this is back to back failure. When price is being pushed up to the upper boundary of the Range, sellers are letting it go, see how far price can go. The higher it goes, the more profit for sellers when they sell into it. It creates a vacuum effect. That’s why as the price is approaching to the boundary line, it will speed up, bar becomes large in body. But don’t be fooled. Sellers are not disappeared! They are waiting and watching the levels closely. When price becomes excessive, sellers will jump in and sell into buyers, pushing the price towards the lower boundary of the range. A perfect-looking bull bar turns into a shooting star when the bar closes. Entering at the extremes offers great risk-reward ratio for traders. Smart traders love Range day because it’s so “predictable”, they just scalp at the extremes back and forth. This leaves many long wicks around the edge of the range.

Wicks are failures. Top wick means buyers failed and bottom wicks means sellers failed. **Remember this: Range will have multiple failed Breakout attempts before the real breakout.** When the real breakout occurs, you can’t miss it because it’s convincing both in volume and bar size! Any inferior breakout will fail within a short time, generally within 5 bars.

The green and red arrows refer to the wicks of the failed breakout attempts of the range. Look at the wicks within the range. See the congestion area filled with Dojis and bars are overlapping. See the bull-bear-bull-bear alternation, which shows lack of consistency for either side. The bar A shows the real breakout of that range. The bar is forceful, large in size, closed very low and minimal wick.



Second, alternation between bullish and bearish strength shows both sides are active. There is no feeling of continuation of either side. There is no consistency in strength from either side. The red bars and green bars are somewhat equal in quantity. The strength is weak, like a sparkle, it shines and dies very quickly. Often you will see a gigantic red bar in range, it take over the whole space. Then the follow up is bullish, traders who shorted below that bar is now trapped. Price kept going up and never looked back. **Again: There is no sense of consistency.**

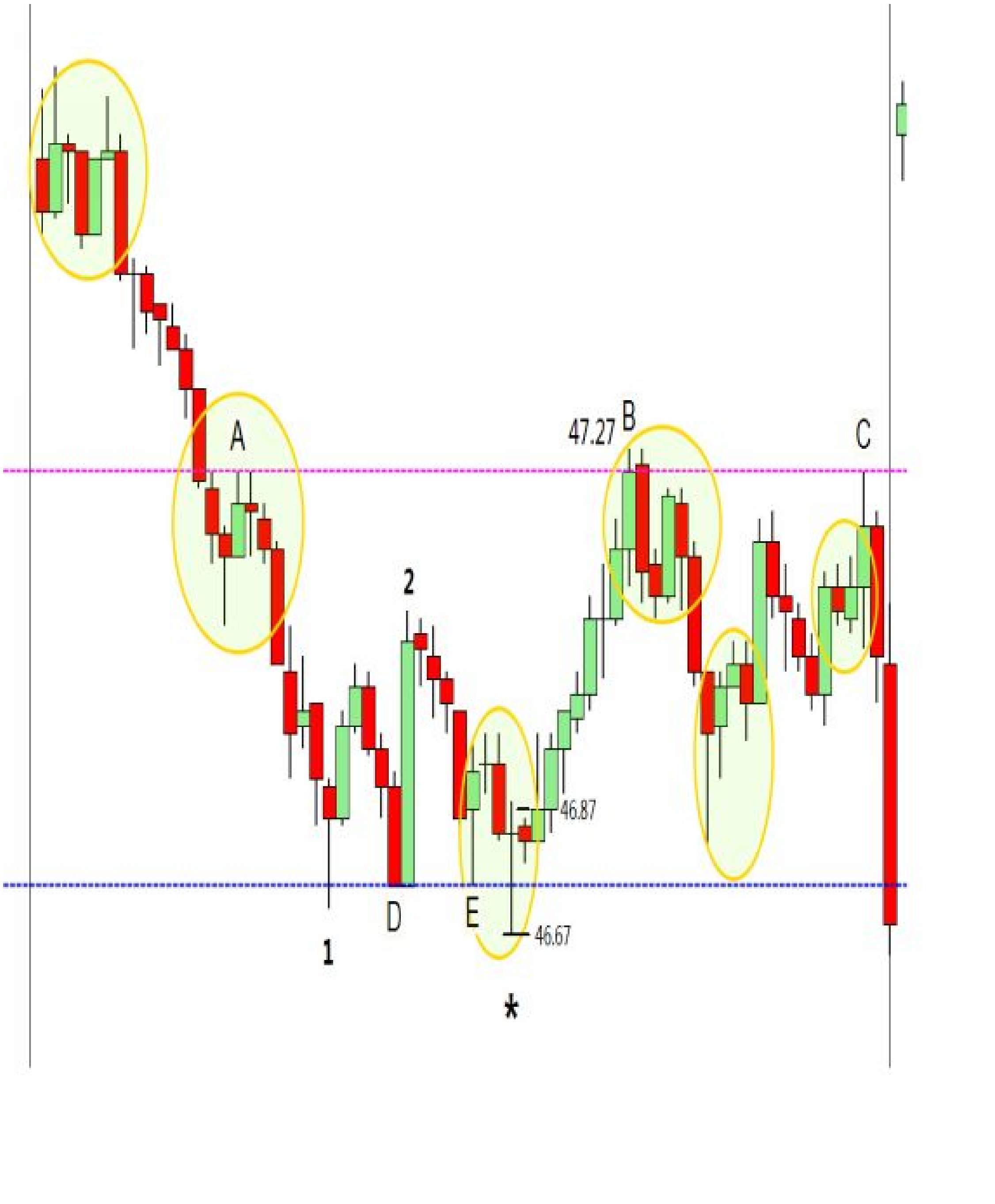
Range day can create a weird feeling that market is not really active today and it feels lazy. But actually both sides are very active, it creates an equilibrium between buyers and sellers. That's why the price is not breaking out to any one direction. Range day has a feeling of ambiguity, unclear, unwilling and hesitant. All the setups which worked best in trend trading are losing their magical power. **Range day is a day of confusion, when you start to feel confused, you are probably in a range.** To me, range is like a cloudy day, it looks like it's going to rain or shine, but it just won't. **Key to remember when trading range: Patience! Wait for confirmation and proof one side is actually failing, then enter at the extremes!!!**

Third, Dojis and Overlapping price action. When you start to see lots of Dojis and bars are overlapping (hint: sideways action), market is probably ranging. The Dojis are the early signs for Range formation. When you start to see them, it's time to take some profits off or sit on your hand. **A Doji is a one-bar trading range in essence** and it has many family members with fancy names, “Gravestone”; “Dragonfly”; “Hammer”; “Inverted Hammer”; “Hanging man” and “Shooting star”. The names are not important, they all **indicating the same character: Indecisiveness.**

The same bar can have very different meanings depends on the context and location.

Overlapping price action simply means the High, Low, Close, Open and size of the bars are either similar or inside of each other. It’s moving sideways. Frankly, price is not going anywhere. See the example below for distinction between Overlapping and breakout price action.

*Sometimes in live trading, you will see two or more bars have the same High or Low. Then you look to your left, you will find past corresponding price action halted at that level also. At the end of the day, you will see price was halted at that area again. This means there is a strong supply/demand zone for that level. It’s like a “wall”, it’s hard to trespass. It might be a whole number, like $50. But most of the time it’s an area of interest, a strong supply/demand ZONE. So whenever you see two or more bars have the same High/Low, mark that level, and watch for reaction when price revisit that level. Look for reliable setups of real breakout or failed breakout.



Case study:

The circled price actions are examples of congestions (range) with lots of Dojis and overlapping. From the 1st circle to area A, price is trending with consecutive follow-ups. Area A to D shows somewhat trending, but congestion starts to show.

Area A has same High, marked by the magenta line. It indicates that particular price level could be significant. Also it could be the upper boundary line of a potentially Range. After drawing the bottom line using the closes of bar D & E, that level could be the bottom boundary line of the range. Later, area B, C and the closing bar confirmed the parameter of that range.

The bars between E and B are displaying very convincing strength from the Bull side. Could it be a successful reversal of the bear trend? Look at the price action at B. The green bar was breaking the magenta line, but couldn't close above it. The next bar is an engulfing bearish candle which shows the initial breakout effort is failed and sellers are stepping in to defend their upper boundary. When price visited this boundary again at C, same thing happened, the buyers are very weak, long wick and followed by a huge bearish bar.

Look at D & E, the same thing happened at the lower boundary of the range. Look at all the wicks at E, that's confirmation of rejection. Bar 1 is what Japanese candlestick trader refers to as the "Hammer". Name is not important, what's important is that this Doji shows price rejection after a protracted bearish trend. Bar 2 is showing great bearish strength, but the follow-ups are horrible. And if we did enter 1-tick above the bar 2 to go long, not only we would not get filled, we are entering at the middle of a potential range, bad location!

Never initiate position in the middle of a Range!! The reward is too small with big risk. Bar E is a good setup bar, but horrible follow-ups, a Doji.

Now let's look at the * bar. When the bar was forming, it probed below the bottom boundary, triggered all of the buyers' stop-loss, and closed at high. That's a TRAP! That is our signal bar to go long! The confirmation came on the second bar. This tiny little bearish bar shows the sellers are losing interest. Place a buy-stop order 1 tick above that bar

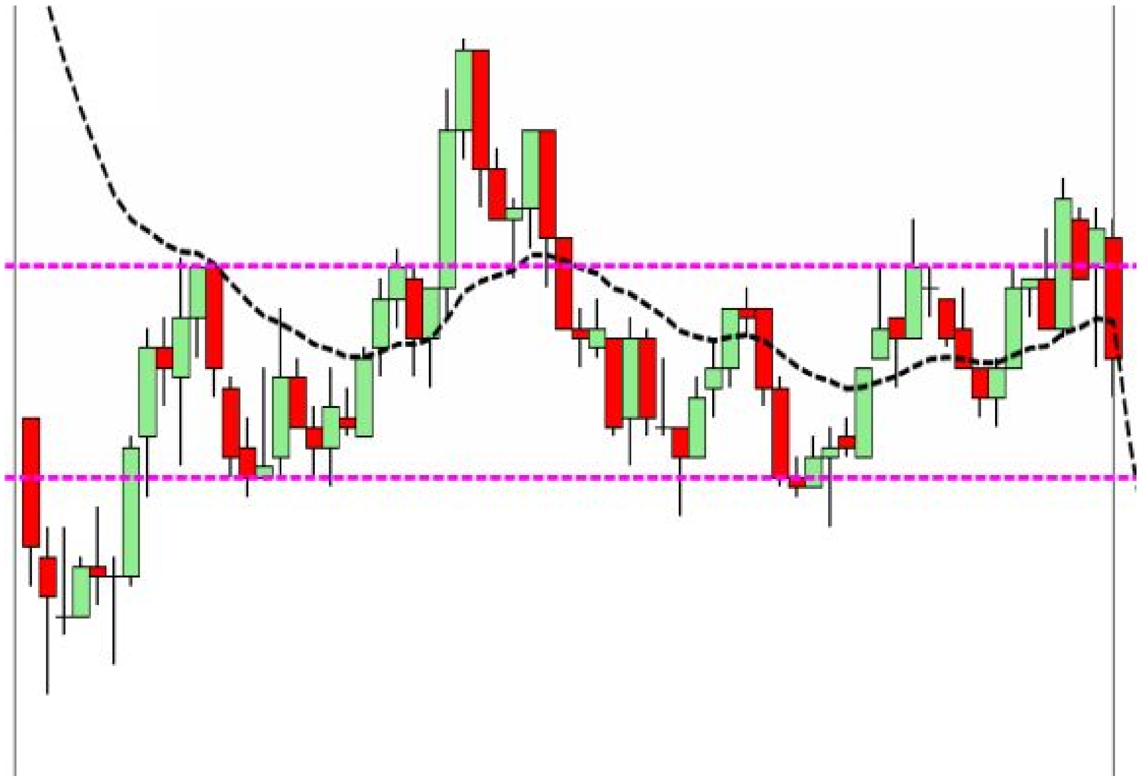
(46.87) and stop-loss below the * bar (46.67). Measure the target by risk-reward ratio 1:2, exit at 47.27. And that’s exactly what happened, to the tick! When price got rejected at 47.28 and got slammed down, it shows a lot of traders were taking profit at the same spot. Another way is to enter with market buy orders as the price was trading downward, approaching the bottom boundary line. You are betting that multiple breakout attempts will fail in sideway price action. Set a specific stop loss placement, i.e.:$150 or $200. It’s a probability bet with pre-defined loss, your edge is most breakout of range fails and your confirmation is long the wick. Once that bar did close and confirmed your edge, then you can move your stop to 46.67. Target is same, 1:2 ratio or more (1:3), since you enter at the very extremes, risk is relatively smaller.

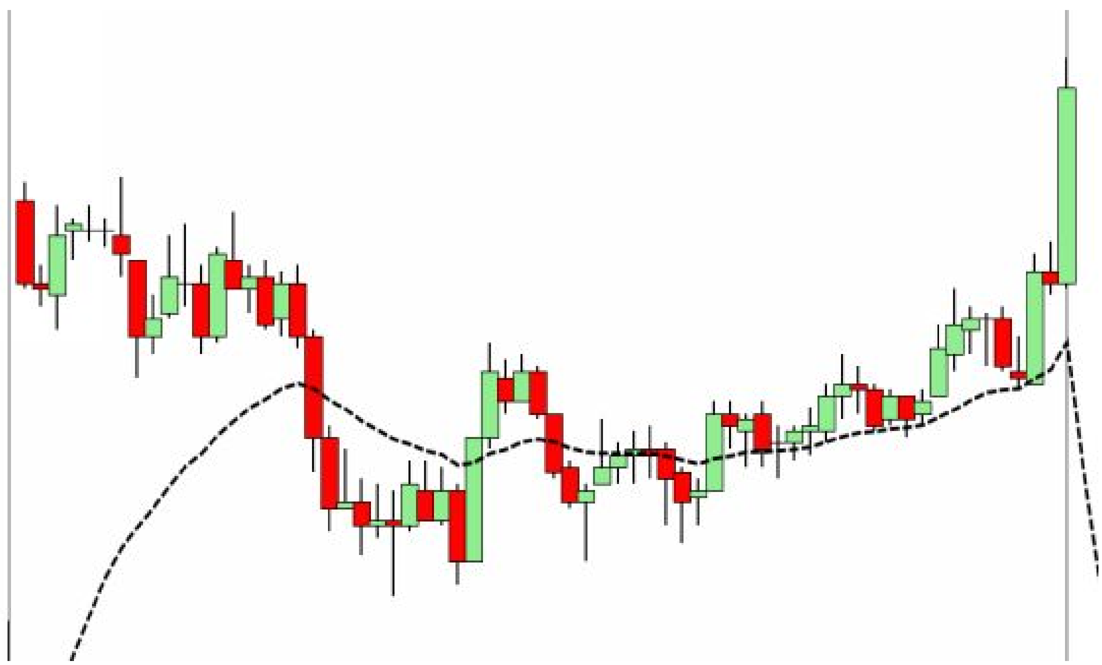
Fourth, the 20 EMA. EMA is arithmetic calculation. When price is trending strong and fast, it's hard for EMA to catch up with the calculation. Therefore, in a strong trend, there is distance between EMA and bars. In trading range, it's the opposite, there is lots of touching. Sometimes it's the body, most of the time is the wick. The "physical" contact is frequent. Because price movement in a Range is not very volatile, most of the time it's not going anywhere. The EMA cuts through the range, often in the middle. The 20-day EMA is like an axis where price is moving around it, from top to bottom.

There is one scenario to note here: when a Range is about to breakout, watch the price action closely, you will notice the EMA is somehow holding the bars and push them out to the breakout direction. For an upside breakout, price will halt around the middle of Range around the EMA. Though many bars may probe below the EMA, they never close below it. Vice versa for downtrend. Price will halt at the EMA and being pushed to the downside. Nothing is written in stone, but watch closely on the closes of the bars and relationship between bars and EMA. A bearish breakout is more likely when it's below the EMA, and a bullish breakout is more likely when the bars are above EMA.

Imperfect Trading Range

In the previous chapter, I described the relationship between Range and Trend, also some intuitional techniques to recognize the Range. The images I presented in the previous chapter are somewhat “perfect” examples of the range. But in reality, range formation can be very ambiguous. Most of the time, it’s hard to box it in with 2 paralleled lines. The images below are examples of imperfect range. But don’t be fooled to think there is a trend in progress. No, there isn’t. The method to trade these variations of Range are the same: find the approximate boundary and fade all the failed attempt of breakout.





Chapter 4- Reversal

Reversal simply means change of the current short-term trend. When a trend is going strong, any attempt to reverse will fail. These attempts would end up becoming pullbacks and great with-trend setups. But reversal does happen quite often in day-trading environment. These so-called "reversals" are not the primary change of the major trend, the trend which long term investors are watching. These reversals are just countertrend swings in considerable size and volatility. They are good enough for day-traders to swing trade and profit without holding. They are short-term trend which can last for days, so it's important to learn how to trade them.

First criteria: break of trendline or control of the EMA. Breaking the trend line does not guarantee reversal, but it's a very strong sign of potential trend change! It shows the strength and determination from the countertrend side. But be extra careful when dealing with the 1st trendline break or EMA break. They are rarely successful reversals, in fact they are the most frequently traded setups to resume the original trend, so don't get trapped. Any trendline break is not a convincing reason to countertrend, but the reaction after that break is most important to watch for. To me, I prefer to countertrend when I see clear dominance of the EMA. I want to see those countertrend traders showing strength.

Second, after breaking the trendline or EMA, strength of the follow ups. When I say taking control, I don't mean touching or close beyond EMA with dojis. I mean slash through the EMA with relatively large body bars and stay!

For example, in a reversal uptrend, when you see one strong bar closed above EMA, but the follow ups are horrible. They are either Dojis or small body bull bars, just wonder around the EMA without any clear direction. That's a warning that this reversal might fail! Bearish sideliners are watching the EMA closely, if they see any weakness, they will jump in to push price down! If there is no strong consecutive bull bars to support this reversal, no matter how strong the breakout bar is, it will fail. When you see consecutive green bars after the break, then it's convincing that uptrend will continue. Not only to watch the bull strength, also look out for any strong bear strength. Often countertrend traders would push the price beyond the EMA for enough distance in order to trap buyers, then flush the price down. If you see small body bear bars, or bear Dojis, that’s your confirmation that sellers are losing their interest to continue. Nothing is written in stone. Trading is game of probability, if everything looks supportive, just enter, don't over complicate things, place stop-loss below the breakout bar.

Third, watch the Higher High or Lower Low after the break. A trend is strong only if it makes Higher High in an uptrend and Lower Low in a downtrend. When price breaks the trendline or EMA, it's considered as a deep pullback, not a reversal. But when the price can't form new high or new low for the original trend, then it's not trending! The trend is on pause and potentially reversing. For example, in a downtrend, if price can't make a new lower low after the break of the trendline, instead it formed higher low, then possible reversal is on the way. Same principle goes for uptrend, if it's forming lower high after trendline break, be careful. They are considered as Double Top/Bottom Major Reversal Patterns.

When the trend is very strong, countertrend traders don't stand a chance to make money. The best reversal countertrend traders can get is a trading range. When the trend is weak, like a channel or with frequent pullback, then reversal is more likely to happen. Therefore, as a trader, the main focus is to always checking the strength of both sides, see which side is dominating and be flexible.

Case Study:

Market was trending down from the early morning. It formed somewhat a channel. But if you look closely, you can see the strength of the downtrend is weak. Lots of Dojis and frequent pullbacks. It formed the 1st major pullback to the EMA and broke the minor trendline (The red line), but it got rejected right away. But look at the green arrow bar, it indicated strong strength from the bull side. But since it's been trending down all morning, the 1st pullback to the EMA usually fails. Then buyers tried again and formed a Higher Low, that's a great setup. Now buyers have a better probability to enter for at least a scalp. The bear trend is not making any Lower Low/ Higher Low, which shows sellers are losing the strength. On the way up, this reversal trend trapped a lot of sellers. At trap 1, when the bar was forming, it showed great bear strength after the previous big bear candle. But it closed bullish, trapped all the sellers who believed the continuation of the downtrend. Same thing happened at Trap 2 & 3, every attempt to sell is being bought. Something is wrong with the Bear case. If sellers are strong, no way they would let buyers pushing every bearish bar up. The bar which broke the EMA and trendline is a strong bar in size and closed high. There are 7 consecutive bull bars after the Higher Low and 4 bars closed above the EMA, that's what I mean by taking control of EMA. It adds up the probability for the successful reversal.

Major Reversal Pattern-Double Tops/Bottoms

There are many reversal patterns, Head & Shoulders; Round Tops/Bottoms; Cup & Handle; Triple Tops/Bottoms; Triangles; Wedges and my favorite of all: **The Double Tops/Bottoms**. Memorizing every pattern and its details is not productive. I divided them into 2 groups: pattern with 2 pushes and 3 pushes. By pushes, I mean a swing; an attempt or pivotal points on the chart. For example, Double Tops are made of two failed attempts to go higher. Two pushes higher but failed.

Essentially, all major trend reversal patterns are variations of Double Tops/Bottoms. In my opinion, “3 pushes” is the variation of the “2 pushes”. Triple tops/bottoms, and Head & Shoulders are essentially variation of Double Tops/Bottoms. They are all based on the same failure philosophy. If we cut the left shoulder off in the Head & Shoulders pattern, you will see it’s as same as Double Tops/Bottoms.

Key: Double Tops/Bottoms are never exact. The top/bottom on the right side can be equal, lower or higher than the left one. The image is not important, the confirmation of strength is the key to successfully trade Double Tops/Bottoms.

Double Tops/Bottoms can be found on everyday chart, they are the most frequent traded pattern. As matter of fact, you can making a living just trade this pattern alone. When price halts and reverses at particular level, it shows imbalance, either supply or demand is outnumbered than the other. **When the price comes back to test that level again, one of two things can happen: failure again & successful breakout. Remember: You can find great Double Tops setups in downtrend & Double Bottoms setups in uptrend.**

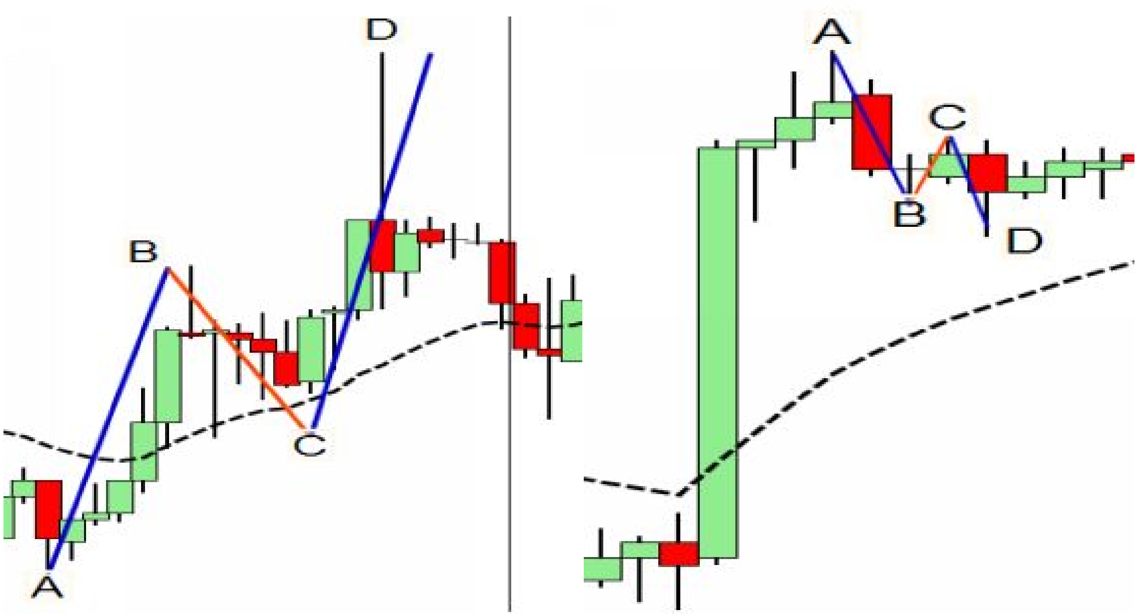
Key: Market moves in two.

For example, pattern AB=CD is constructed with two legs and a pullback. A complex pullback is formed with two countertrend legs and a failed attempt of the original trend. You can find this phenomenon everywhere on the chart.

Key: When market tries something twice and fails, it often goes the opposite direction.

That's why double tops/bottoms works so well. The psychological reason behind this phenomenon is that either buyers or sellers would not let themselves be stopped out twice. If the first attempt is failed, they would try again. But if the second attempt failed, they would hesitate out of fear. Therefore, if they failed twice in a row, they are very reluctant to continue entering in the original direction. Instead, they will reverse their positions and this adds the extra fuel to the new direction.

The three examples below showed how market moves in two legs. The size and shape can be very different. There is always a Macro and Micro view in any 2-leg move. A single bar can be considered as one leg. Interpretation of what’s considered as a single swing can be subjective. The key is to use this concept to find setup and potential profit target.




A
1st Leg
Pullback
C
B
2nd Leg
AB=CD
D

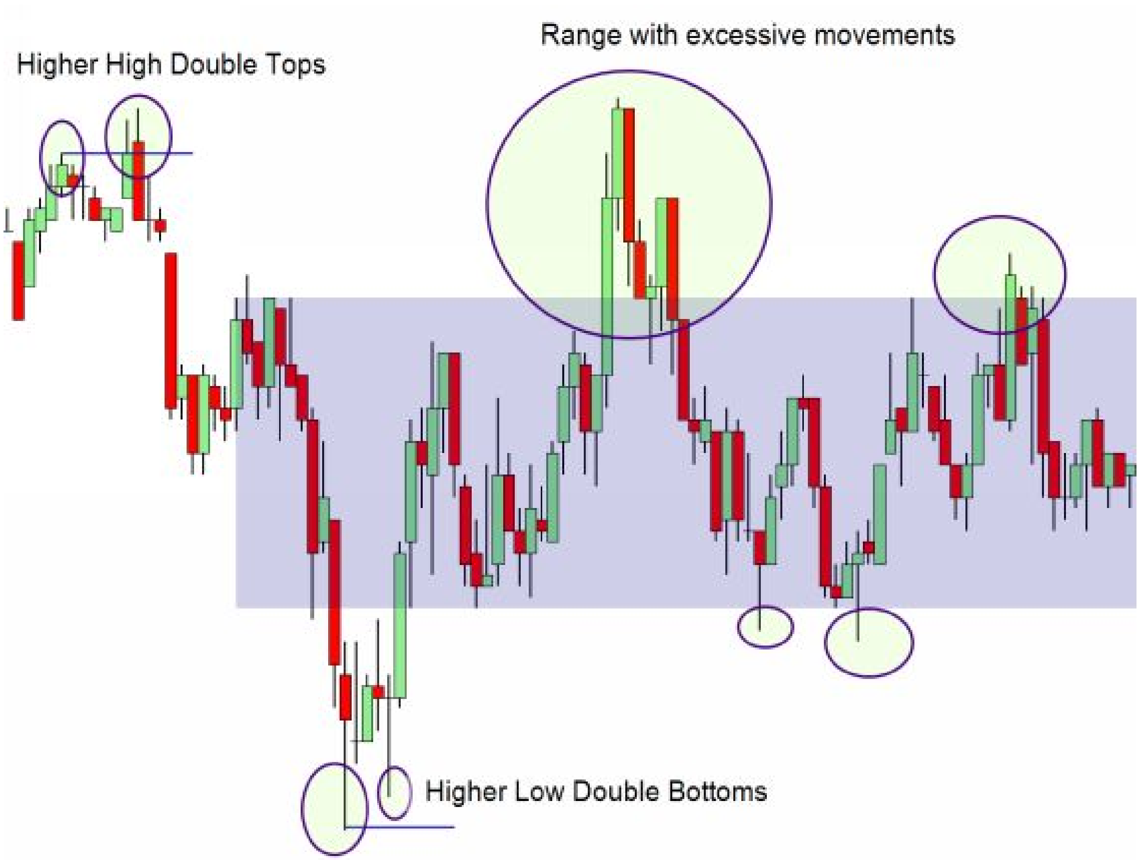
Thoughts on AB=CD, the imperfection

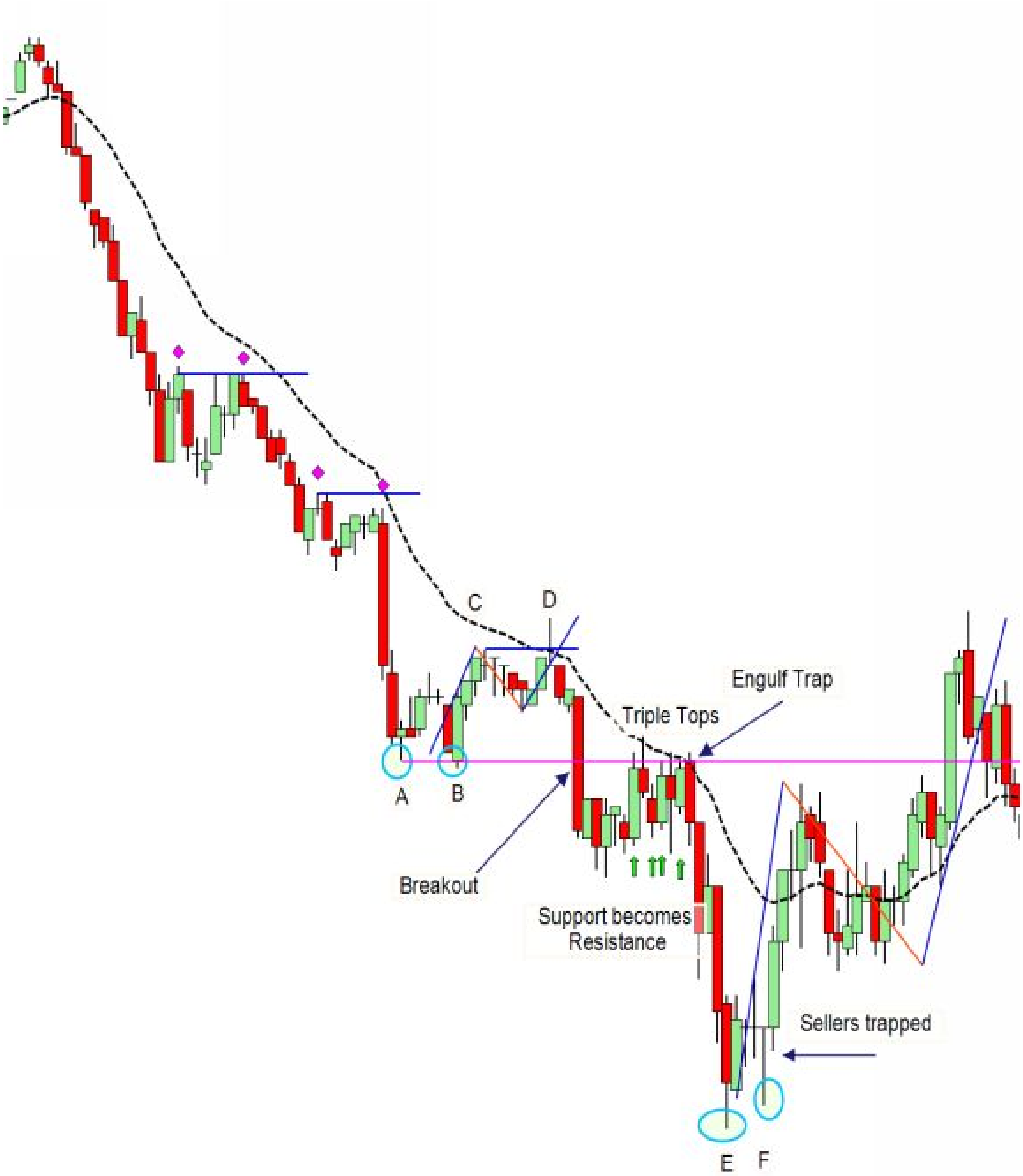
Many trading methods states a lot of patterns are made of perfection in terms of symmetrical length. Patterns such as AB=CD or Double Tops/Bottoms should have the pivot point to the tick; trading range should have the perfect top/bottom boundary lines and many other axioms. Personally I find it's the exact opposite.

To me, Market is perfect with "imperfect" details. It’s perfect because every move of the price action makes sense. It's a logical and can be explained. It's imperfect because all the patterns have flaws. Among all things, nothing in this world is prefect, it's all relative! Market is moving in probability. And probability is relative. For example, you can have a relatively higher probability of winning with a relatively lower probability of losing. Nothing is absolute in trading and in life. This concept applies for all the trades. Patterns are the same. Don’t try to draw some lines and contain a pattern in the way you wanted. These “imperfections” have made the market more alive and mysterious. Instead of predicting how the pattern will unfold, just go with the flow. You won’t get disappointed and become more profitable.

My point is this: if a pattern looks like a pattern, it's going to behave like one. Close is close enough. For examples, Double Tops/Bottoms are rarely exact. AB or CD rarely has the same length. The shoulders of Head & Shoulders pattern are rarely parallel.


AB≠CD
A
B
C
D
A
B
C
D


Higher High Double Tops
Range with excessive movements
Higher Low Double Bottoms



Case Study:

On June.9 2016, Crude Oil was trending down strongly, all the purple diamonds indicates great Double Tops setups. Price is trending down heavily until it finds support at A. When price comes back to test it again, it failed at B by this strong bull bar. Then it formed a 2-legged up move, broke the trendline and touched the EMA for the 1st time. We know possible reversal might be one the way, but we need more proof of strength from the Bull side. So far none. At the EMA, it formed a perfect Double Tops at C & D. The long wick of bar D is showing the weakness of buyers and offers a perfect signal to enter short. The previous support created by A&B is smashed by this gigantic breakout bar, a strong breakout! Support and Resistance levels are interchangeable. If support is broken, it will become a strong resistance zone when price revisit that level. Vice versa for resistance, if price broke the resistance, it will become support for future price action. In this example, the support created by A&B is broken, and become resistance for the triple tops at the EMA. Look at the last bar of the triple tops, it went up to trap the buyers and immediately reversed. It engulfed the previous bull bar. That's a perfect signal to enter. Price once again found support at E&F, it trapped bunch of sellers at F and formed a 2-legged move above the EMA. We are told never to countertrend trading. But given the condition: previous trendline break; trap at F; Higher Low Double Bottoms, it's an opportunity for a scalp, at least to the EMA with minimal risk. Always find more reasons to enter the market. Don't enter just for any single reason such as Double Tops/Bottoms, find more corresponding evidence to support your entry.

Chapter 5-Importance of confirmation

Confirmation is crucial in price action trading. It's the solution to most of our trading errors. It doesn't matter if you are a scalper or swing trader; trending or ranging, confirmation provides that extra confidence and proof for you to enter. What is confirmation in price action? Confirmation can indicate many concepts, but the bottom line is:
confirmation is the edge.

First, confirmation can help traders NOT to make a random decision. Randomly enter and exit because it "feels right" is one lethal problem in trading. Randomness is irresponsibility in mirror. In trading, you can't afford to be irresponsible. Every entry you choose must be carefully chosen, along with the optimal stop-loss placement. You are not only responsible for, but also be willing to fully accept the outcome of your decision.

In "Trading in the zone", Mark Douglas wrote:" ***in market, anything can happen*"** as his first truth among the five fundamental truths about stock market. Although that's very unsettling, in my opinion, the ambiguity of market behavior is not lethal, but your emotion can be your most dangerous enemy. Fear, over-confidence, greed can overtake rationality. Always wait for that "a bit late" confirmation, it might cut your profit less, but it will help you to think objectively and rationally. It has the power of forcing you to trade what's happening on the chart instead of what's in your mind.

Second, don't step in front of a freight train! It's important for day traders to be sideliners. Sideliners are usually successful because they are very patient for the best setup. In "Price Action trading: Bar by Bar" Al brooks wrote: "***the hardest thing for a trader is to wait for the best setup".***

Confirmation and patience are the ultimate combo. The public traders don't have enough money to potentially influence the price movement. So forget about it, leave the fight for the big dogs! Their “leftovers” are enough to keep the smart trader profitable on a daily basis.

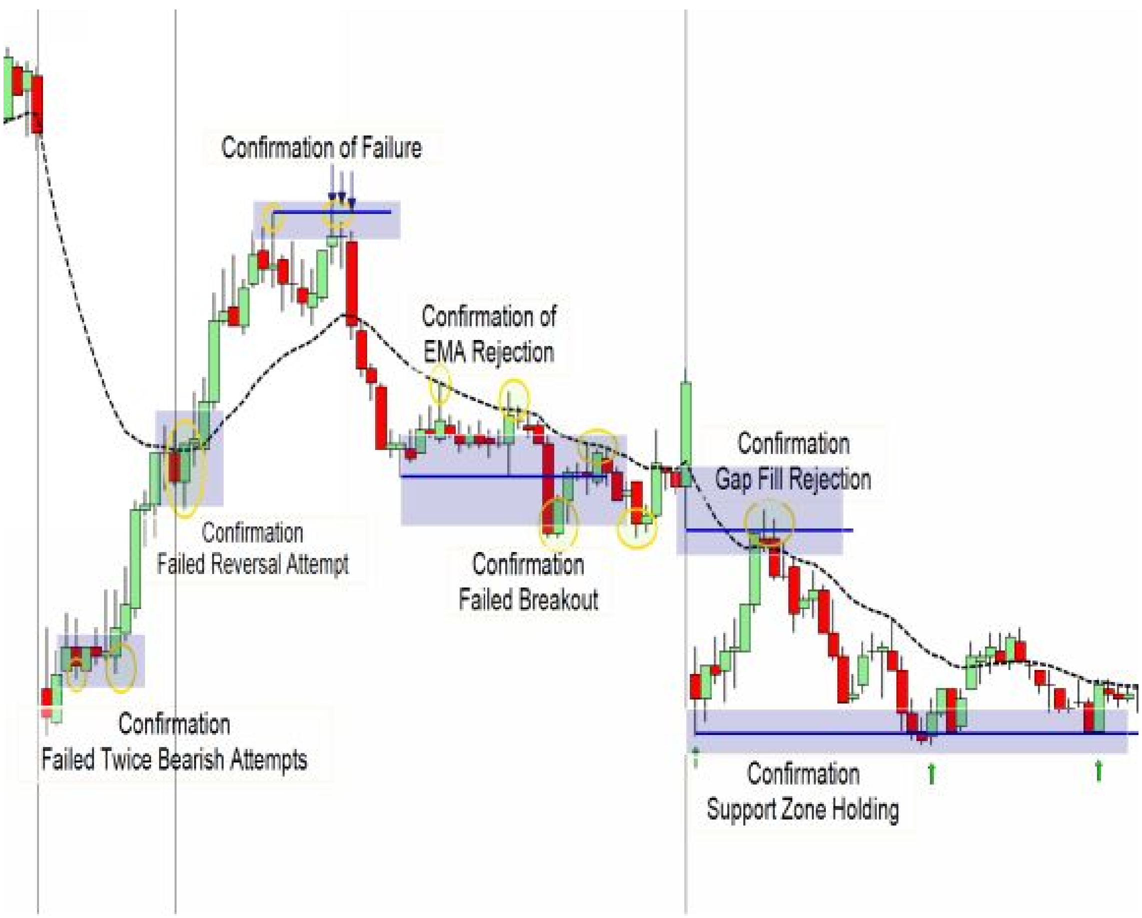
The best metaphor is the remora fish. The remora fish is also called sucker fish. It's a very interesting breed because it attaches to shark using his sucking-disc inside its mouth. It travels anywhere the shark goes. Remora fish eats the parasites on the shark's body and leftover of the shark. The remora fish gets to eat and shark stays clean. I find this concept quite interesting and important for public traders. Because we don't have the fund to influence the price movement, it's important to follow the big sharks' move. When they are making a move, we will follow them. This mentality of "thinking like the professionals" can help us to stay on the right path.

Confirmation in detail

Every bar is confirming something. In general, a large-body candle is confirming strength; a small-body candle is confirming weakness and a Doji is confirming indecisiveness (Range). The current bar is either confirming continuation or failure of the previous bar. The keyword is context! The big picture! Having tunnel vision in trading is expensive and limited. Analyzing every bar is very exhausting and unproductive. Looking for confirmation at significant locations is most effective.

Significant locations refers to controversial spots such as range boundary, previous day High/Low, prior day close price, and support/resistance and so on. These locations are controversial because they are area of interest.

Professionals, institutions and experienced traders are watching closely on the reactions around these spots. Their strategies are based on the reaction. The future price movement is based on these reactions. These areas are the significant places for us to look for trades. It's true that market is offering trading opportunities almost every second. Every 1-minute bar can produce entry opportunity. Legendary Paul Rotter sometimes trades almost 1 million contracts a day. It certainly can be done. But it's too exhausting and lack of consistency. Traders who don't have the ability to think that fast will end up trade like Casino slot machine. That's a very fast way to bankrupt your account. We want to be relaxed and trade with ease. We want to be happy in what we do, not being tense and hard on ourselves as price is moving up and down. Therefore, only choosing the best trade setup in these areas can prevent you to trade randomly and produce consistent results in a long run. Below is the chart marked with confirmations at different locations throughout that day.



Chapter 6-Support & Resistance

Support & Resistance are zones where price will either halt and reverse or break through. Trading using Support & resistance concept is considered old-school methodology. It has been popular for a long time. These zones can also be called supply & demand zones, where buyers and sellers are active. If price is dropping to a certain level and halts, it shows that level has more buyers than sellers. It's called support. Vice versa for resistance, more sellers are invested at a certain level which stops price from raising higher. The past price action indicates where these zones are. Mark them on the chart for future reference.

An important concept to remember is that Support & resistance zones marked from higher time frame chart is relatively more reliable. If you trade the 5-min chart, then go to 15-mins or hourly chart to mark these levels and import them to your 5-min chart and observe the reactions off these levels.

Support & resistance levels are interchangeable. Once support is being penetrated, it will act as resistance for future price action. Once resistance is broken, it will act as support when price revisit that level. These interactions are very important for traders because they are often reliable. For example, there is an upside breakout of the previous swing high, a resistance point. Buyers who profited from the initial breakout will buy again with confidence when price re-visit the breakout level (support). Conversely, the sellers who lost money holding that resistance level will not sell again when price comes back, they are afraid. Therefore, nobody is selling, everybody is busy buying. A previous resistance point becomes a support level. But it's crucial to always wait for confirmations when trading these zones. Don't get trapped!

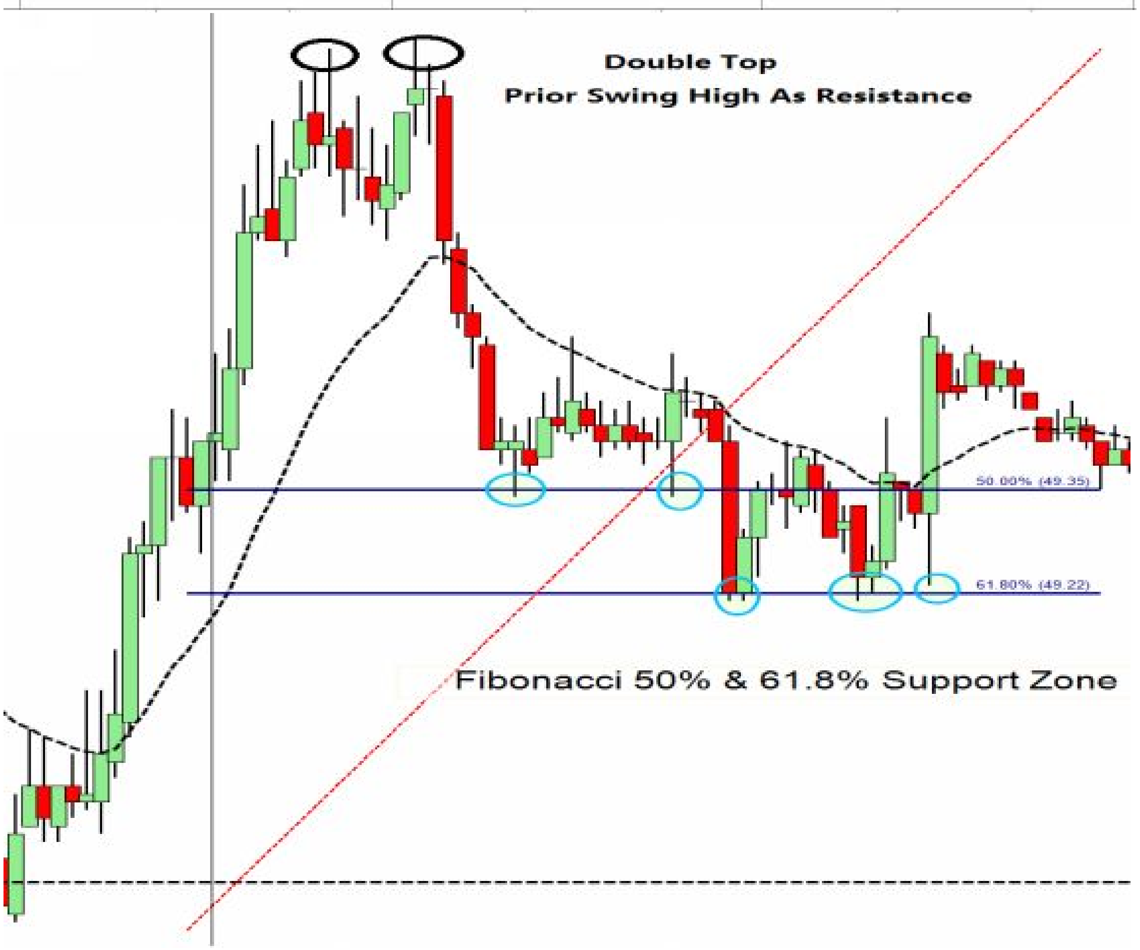
Support & Resistance levels can be found through the price action in the past. Just extend the levels to present. You will see price reacts around these levels. Don't assume all Support & resistance Levels are parallel, it can be formed in all different shapes. Support & Resistance Levels also can be "predicted" for the future. For example, AB=CD, once you have ABC, you can have an approximate level where D will be. That's the level for profit-taking and potential reversal. Another example, channels. When price is rotating up and down within the channel, you can buy when price is approaching the bottom line and reverse when it reaches the top of the channel.

Below is the list of possible patterns for Support & resistance Levels to consider when trading:

- Prior day High, Low & Close
- Gap & Previous unclosed Gap
- AB =CD
- Trading Range High, Low & Middle boundary
- Channel lines & Trendline
- High & Low of large trend bar
- EMA
- Opening price of the day
- Swing Highs & Lows
- Whole number (such as $50, $120)
- Fibonacci retracement level: 50%, 61.8% and extensions
- Daily, Weekly, Monthly High & Low & Close
- Measured Move
- Past 3-days High & Low
- Strong Breakout Bar
- Any Long-Wick Bar, the rejected portion
- High Volume Bar’s High, Low & Close
- News Bar’s High, Low (News such as FOMC report, Inventory Report, Consumer Price Index (CPI) and Producer Price Index (PPI) and others.

There is an axiom for support/resistance zone: the more touches it has, the stronger it will become. I find that quite untrue for intraday traders. In my opinion, more tests for a certain level only weakens it rather than strengthen it. Support/Resistance zone are made to be broken. For a level that's been holding for long time, we mark it on our chart and leave it there for future. But usually that level is far away from day traders' perspective. It could take days to reach that level. I consider the nearby support/resistance levels are more important for intraday traders. Price often reverse or penetrate levels which are not far from chart today. The reactions off these zones are more practical for initiating positions.


Prior Day Low
Turns to Resistance
Gap Fill ~ Resistance
Prior Day Low
Turns to Support


Double Top
Prior Swing High As Resistance
50.00% (49.35)
61.80% (49.22)
Fibonacci 50% & 61.8% Support Zone

Chapter 7- Gap

Gap is simply a blank space between prices on the chart. It can be caused by news, urgency or the overnight sessions. There are many kinds of Gaps on the chart, breakaway gap; runaway gap; exhaustion gap and common gaps. The names are irrelevant, the relationship between the gap and price action matters the most.

I always consider gap as one big bar and trade accordingly. For example, if it's a big gap down, I consider it as one big red candle. The reaction after the gap down matters to me the most. If the opening bar is bearish, it means sellers want to continue the down trend, look for signs of failure of sellers. If it's bullish, it means price might halt for a pullback or reversing, possibly close the gap. If it's a Doji, that means sellers and buyers are going to fight at this level, a possible range. Look for the clear sign of breakout and trade in that direction.

There is an old saying: "gap will always be filled". Well, it could take minutes or days to close some gaps. Waiting for gaps to fill can takes a lot of time. Gap fill strategies often are unproductive. **What's important about these open gaps is that they are "unfinished business ", waiting to be closed.** This creates opportunities for great setups. Often some old gaps are the targets to hunt for in the present.

Gap levels are strong support/resistance levels. Watch for the opening 30 minutes, there are usually clues whether the gap will be closed or not. Also watch for the reaction after the gap is closed, reversals are quite frequent. But sometimes the gap is small, price will fill the gap quickly and continue. Think in this way, if there is a huge gap down, buyers have to climb all the way from bottom to the top to close it. This trip can be exhausting.

The moment price finally reached the top, what do you think buyers will do? Yes, take their profit. They have been working all day to fill this gap! As they are exiting, price will halt and potentially reverse. Always on alert for any failures after the gap is closed, wait for confirmation!

When bull or bear is very strong, orders are getting filled so quickly, there would be a small gap between bars. 1 tick gap are frequent. It's a sign of strength. But always check the context. If it happens at the top/bottom after a protracted move, it could be a possible trap, be careful. When the day starts without any gap, followed by Dojis, sometimes it's a sign for potential Range day. Not always.

The relationship between Gap and prior day price action has an important impact on current day market. For example, if prior day ends in Range, today market open with no gap. It's possible that Range is going to continue. So fade the extremes of the failed breakouts. If prior day was a strong uptrend day, but today market opens a gap down, then expect a possible gap fill and trend continuation because that gap down has finished the job of deep pullback. Buyers will see that as a "good price", a great opportunity to resume the trend. If the market was trending up yesterday, today it opens with gap higher. Expect retracement because the buyers are going to take some profits off. Anyway, don't assume what's going to happen. Always for confirmation of failures before you enter.

The followings are potential setups related to Gap

1. When the Gap is filled, watch for Double Top/Bottom for second-entry countertrend.
2. When the Gap is small and nearby, it’s much easier to close it. Wait for the convinced breakout or failed breakout.
3. When there is a long trip to fill a particular Gap, chances are buyers/sellers are exhausted, expect a price rejection.
4. When there is none or tiny Gap, expect sideways price action.

Gap fill creates Strong
Support/Resistance Zone
When the Gap is small
it's easier to fill
Some Gap won't be filled on the same day
This Gap is finally filled three days later
The trip to fill this Gap is exhausting for Sellers
When it got filled
Strong Rejection

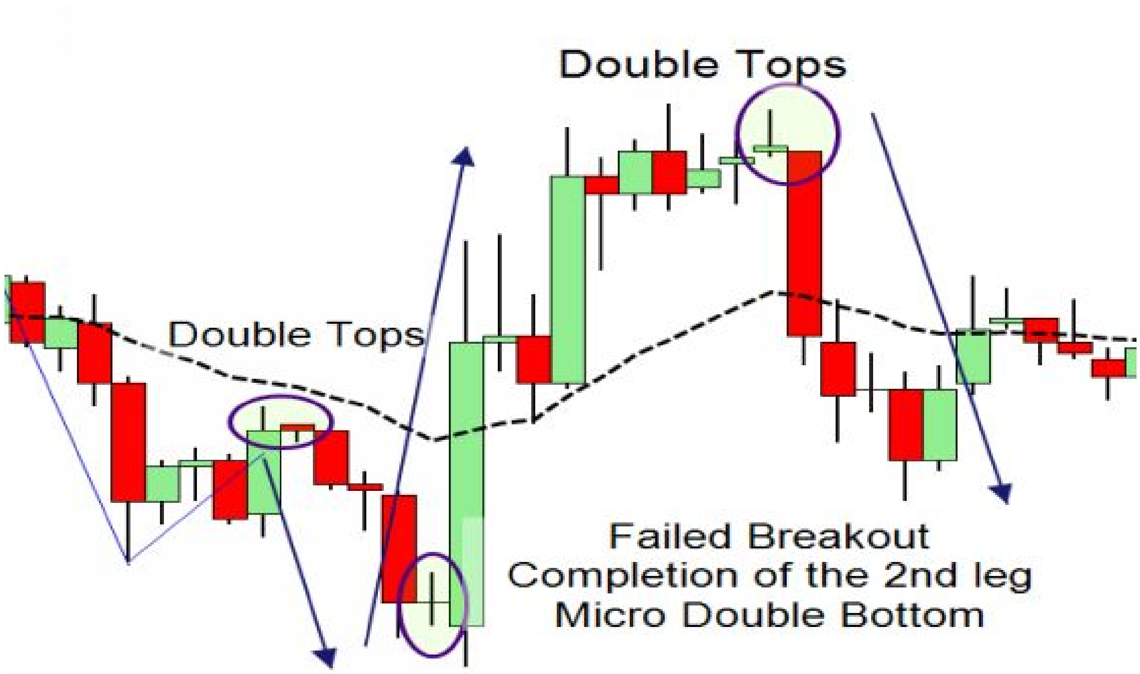
Chapter 8- Contraction & Expansion Theory

The market is in a cycle of constant Contraction & Expansion. Many characters of market are related to physics, science, psychology and philosophy. For example, “splitting the atom” is also called Nuclear Fission. By splitting the atom, which is the smallest amount of substance in chemical reaction, it can releases a very large amount of energy. This theory is the principle theory behind the nuclear bomb. Market works in a surprisingly similar fashion. **Often the strong moves are ignited from the smallest bars.**

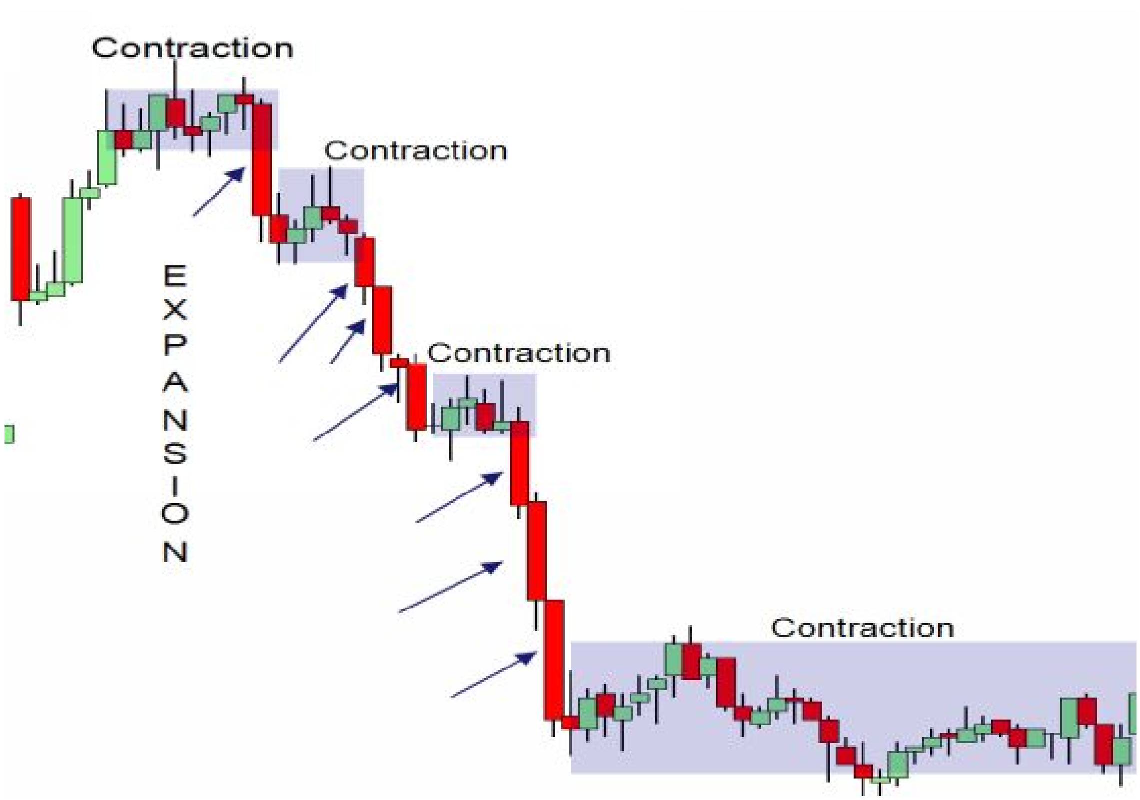
Trend is an expansion of the range. Range is the contraction after trend. In a micro view of the chart, you will find that every “big” move is often caused by the smallest bar. From a macro view, the strong breakout or trend often comes from ranges or congested areas. The smallest bar or range formation can ignite the biggest move. Why is that? It’s because the price (bar) is being contracted to the smallest size possible, there is no any other way to go except explosion.

The bar before a gigantic trend bar is often a Doji or a narrow body bar. The strong breakout often comes from a tight range. Every trader wants to catch the big move. **The key is Location, Location and Location!** You don’t want to enter after every small bar, the context plays an important role here. The locations to look for these tiny bars are major support/resistance zones, prior Swing High/Low, prior day High/Low, pullbacks and so on, the controversial locations.

Small bars sometimes are the best setup you can exploit, simply because of the minimal pre-defined risk and maximum potential profit.



These three bars are the smallest bars on chart.
But look at the explosive movement afterwards.



Part II

Recognize and Exploit Traps

Part I focused on basic market psychology and some important price action concepts. These concepts are crucial for you when analyzing the market. When you finish this book, you will realize that trading is about constantly analyzing the action and spot the weakness of others and exploit it for your own profit.

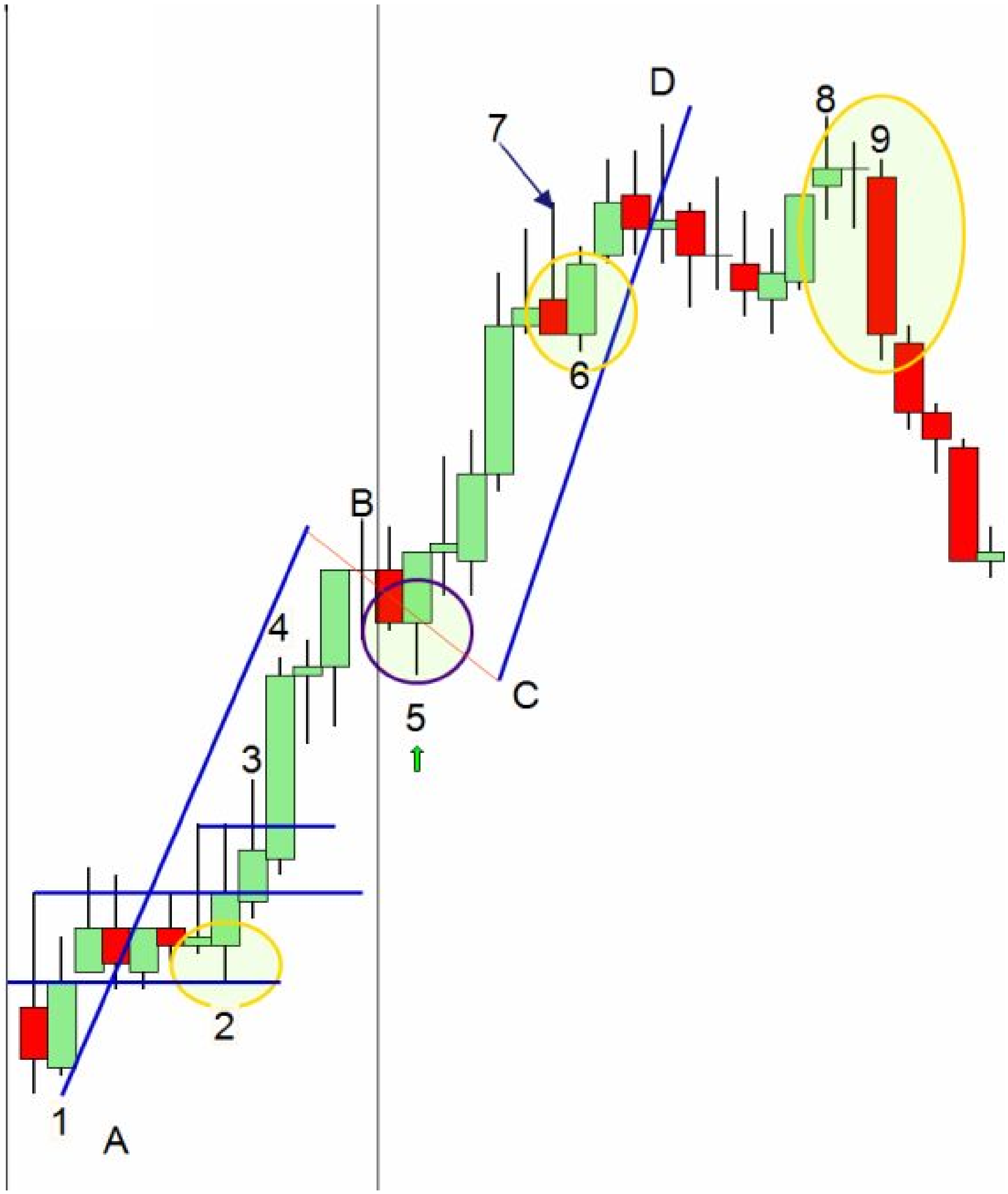
Traps are patterns, like every other pattern, they will happen relentlessly. These traps are my edge, my odds. You have to memorize them well in order to recognize them quickly on the chart when trading live and exploit them. Traps are happening every day, on every chart. They are the consistent setups. All you have to do is to be patient and wait for the trapped traders to bail out and then enter against them.

We all make mistakes, very often we will get trapped in also. Now we know these traps, so don’t be hesitate to exit. Hoping market will do something you want is not realistic. Therefore, wait for that extra confirmation before entering. Part II is focused on explaining what each trap looks like and followed up with Case studies, in order for you get a good understanding of the psychological reason behind every trap and how to exploit them for your own profit.

Chapter 1-Common Trap

Common Trap is the easiest to spot and most frequently used pattern. It’s an illusion because when the bar is forming, it looks very strong. Then it moves 1 to 5 ticks in the wrong direction and then immediately reverse to the opposite. It happens very frequently because traders don’t always pay attention to the context the market is currently in. For example, when the market is trending down all morning, don’t get trapped with any strong bull pullback, being greedy and hoping to catch the bottom of a potential bull reversal. When the trend is strong, any reversal attempt will fail. In fact, when these buyers realize they are trapped and bail out, their loss is that extra fuel for the stronger bearish move down.

Common Trap happens very frequently, but do we take all of them? No. We look for them in certain locations, such as pullback. **Context and confirmation are the two most important criteria to filter out the bad ones.** Common traps can mostly be found at second-entry setups. See example below:



Case Study:

The 1st bar of the day often gives important information. Well, it's a bear Doji with a long wick at top after a gap down. It's a strong signal bar for more bearish movement. But it immediately failed when Bar 2 formed. The image of red-green alternation with long wicks, the first two bars shows symbols of a potential Range. And it did, it formed a small

Range for the 1st hour. I have outlined it with blue parallel lines. So if we are in Range, we should buy low and sell high at the extremes of the Range.

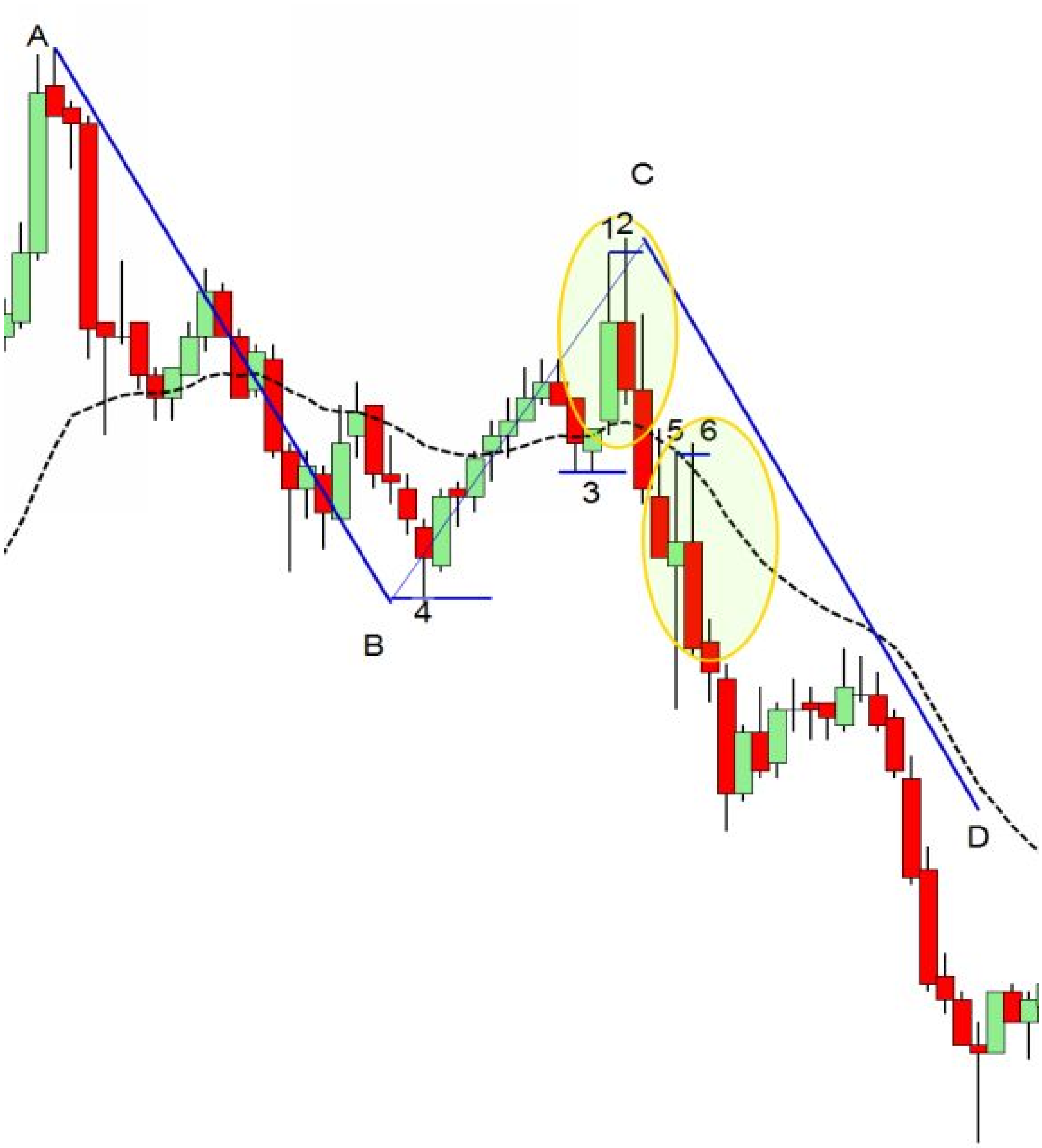
Bar 2 is the 1st trap, it went down 3 ticks below the “shooting Star” (which is a strong reversal bar) but closed bullish. Although it’s a trap, since there is no conviction of any strong breakout of the range, one should wait for more proofs. Also the bar 2 has a lot of wick on top, it’s not a great signal bar to go long anyway. **Buying at top of the range or selling at bottom of the range is very dangerous and should be avoided.** If anything, we should short the extremes at top and expect it to go down to the bottom of the Range, the Range rotation. Surprisingly, there is no rotation. Bar 3 closed bullish and above the Range top boundary level. Every bearish attempt so far is being bought, it shows buyers are strong. Bar 4 confirms that, this huge bar broke the small range and closed high.

Then it enters to a small pullback at area B. Bar 5 is the perfect trap. It went down for 4 ticks, trapped all the sellers who shorted and closed high to the tick. It’s a great entry bar. Now check the context and strength for confirmation. Price action from A to B shows strong bullish movement and Bar 4 (breakout bar) has good follow-ups. There are simply more green bars on the chart.

There are 2 traps, Bar 2 and bar 5. It gives the bullish confirmation and it has good probability that the AB leg will continue going up for another leg in approximate similar length. Therefore, enter 1 tick above Bar 5 has good risk/reward ratio. The risk is only 14 ticks, but the upside potential is huge. Price eventually went to D and complete the AB=CD pattern. If you hold all the way to D, that’s 48 ticks ($480) in profit.

Note: Bar 6 is another trap, but after this protracted bullish move all morning, I would question the authenticity of this trap. Any strong bar after a protracted move is possible trap for the opposite side. Be Careful! I would scale in for a quick 1:1 scalp, but not initiate any swing trade.

Bar 7 is also a trap, it trapped all the buyers and closed low to the tick. Why it’s not a good entry bar? Because of context. Always consider the context when trading. Market is trending up all morning, yet no price broke the trendline. The environment is not favorable for sellers. In addition, bar 7 is the first attempt to reverse this strong bull trend. It usually fails, wait for more confirmation of bull weakness. Never be the first one in when countertrend. When buyers fail to breakout the high in area D and formed a double top, that’s the kind of sign you should look for. Bar 8 & 9 are confirmation that buyers are losing interest of buying at high prices, they want a deeper pullback to reload. Now that’s a great opportunity for a countertrend scalp. Overall, if you are aggressive trader and enters all three traps (Bar 2, 5, 6), you would have no problem accomplish the 1:1 risk/reward ratio, and it would be a very lucrative day.



Case Study:

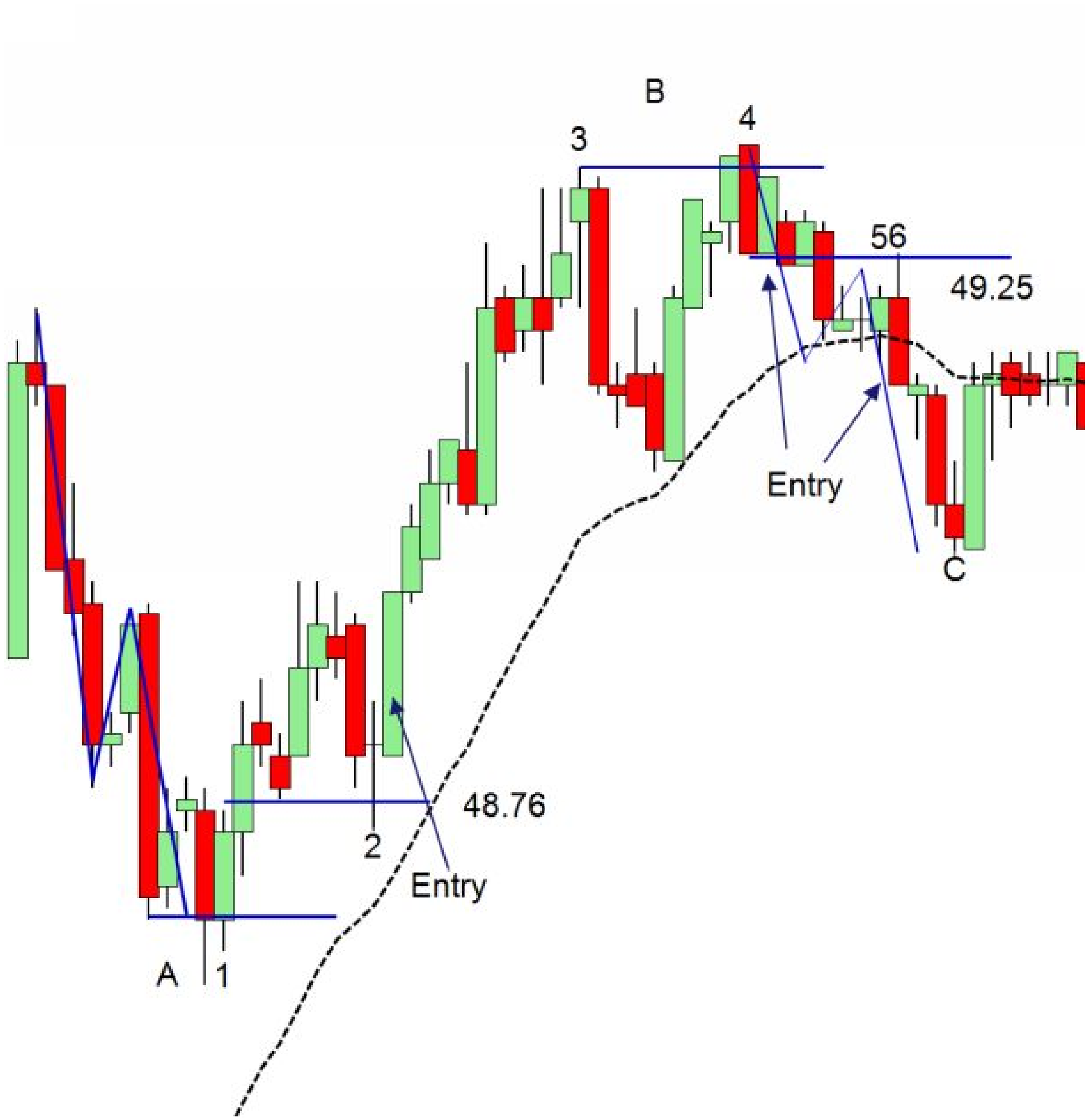
Market has formed a strong bearish move from A to B. Market moves in two, if one leg is strong, expect the flow will continue and form another leg in approximate length. The deep pullback has broken the EMA and trendline. It’s considerable in size and it consists 2-legs countertrend moves from Bar 4 to Bar 2. But we know the 1st major pullback of a strong trend usually fail and resume the original trend. Now we are just waiting for trapped buyers. The opportunity comes at Bar 2. Here it did trapped a lot of buyers who bought above Bar 1 and immediately flushed down to the low. The buyers who bought above Bar 1 are going to hate everything about bar 2. Their stop-loss is below Bar 3 and bar 4. They all got triggered eventually.

Lesson here: you can't afford to be stubborn in the trading world. If you see yourself trapped, exit! Move on to the next, don't pray and hope market will turn your way.

Bar 4 represents somewhat a strong support zone where price did bounce when it re-visit that level at Bar 5. You can tell buyers are still active because of the long wick at bottom and Bar 5 did close bullish. The buyers who bought above Bar 5 got trapped almost immediately. Bar 6 went up 1 tick and flushed down for one more bearish leg. If you entered either trap, below Bar 2 or Bar 6 and set stop-loss above the same bar; you would achieve 1:2 risk/reward ratio easily. At area D, as the target of AB=CD is reached, a lot of traders were taking profits, as it created a pullback towards the EMA.

Chapter 2- The “Stop-Loss” Trap

The “Stop-Loss” Trap is bit more complicated than the common trap. I found two scenarios which happens most often. **First, after market has moved in one direction for a while, it tends to test the entry price.** By testing, I mean taking the stops of the traders who moved their stop loss to the entry price after profit. Traders who traded 2+ contracts often take the initial profit off after price moves in their favor, and move the remaining stop loss to the entry price to break even in case market reverses. It’s considered as a “Free” trade. To me, there is no such thing as a “Free” trade. The initial profit you made is your risk. Traders who moved their stops are doing it out of fear. They fear price will reverse and eats all of their profit. The institution knows this. When they see the book of orders, they can see there are a lot of stop-loss orders piling up there. The main job for institution traders is to unload the shares they have in their hands. If they unload their shares instantly, it’s too obvious to the public. It’ll be like an elephant in the forest, it’s huge and you can’t miss it. In addition, the price they entered would be relatively expensive. They don’t want that, they want to buy low and sell high. So they manages a “shake out” by moving the price to these entry prices and taking the stop-losses. Not only they can unload their shares at a great price but also this disguised action will never be known to the public eyes. How often do we see price triggers our stops almost to the tick and move in the original direction, the direction we thought it would go? We sigh and blame for bad luck, blame the institution tricked us off. Well, it’s all about confidence. For the public traders, it’s important to have faith in your judgment, trust your stop. Don’t move it too early. Trend will go much further than you think, just give it time and room to develop itself.



Case Study:

When price has made a micro Double Bottoms at area A, Bar 1 was a great signal and entry bar. It’s above EMA and it’s a 2nd-entry long after the 2-legged bearish move. Enter 1 tick above Bar1 at 48.76 is good probability long trade. Since it was still early (9:00 AM), you can hold it and expect for a swing trade. After moving up for 20 ticks, it started to pullback. Bar 2 managed to go down to the entry price of Bar

1. But it’s only a trap for the people who moved their stops to break even at 48.76 after profited 20 ticks. If price was truly reversing to the down side, you wouldn’t see a Doji with long wick at bottom, that’s rejection. It was a shakeout, just poked down enough to trigger the weak hands’ stop-losses. If you didn’t move your stop, you would not get stopped out, eventually you would make 50 ticks easily.

At area B, it formed a Double Top. Bar 4 is great short setup after a protracted bullish move. The bull failed to breakout the high of Bar 3. Bar 4 is very strong bear bar to show that sellers are active. If we look at the price action up to bar 4 (11:20 AM), there is really no trend. Big down move followed by big up move: sideway price action. That gives us extra confidence and confirmation to sell high. The bull tried twice after Bar 4, but both times failed miserably. Bar 4 triggered all the buy stops above Bar 3 and closed low to the tick. It’s also an engulfed trap. That’s a great setup to go short. Bar 6 is both common and stop-loss trap for the weak hands. It reached exactly to the tick of the entry price 49.25, taking their buy stops and buyers who bought above bar 5, then closed bearish to the tick. That’s your sign to enter for the 2nd leg of bear move, which ends at C.

Another scenario happens quite often when a trend is transitioning into a trading range. The High/Low of the last push usually get tested by 1 tick, no more, no less. It’s really annoying when it happens, but it also creates awesome trading opportunity for the smart traders. You can call this setup “1 tick stop-loss trap”. The concept is the same, there are heavy numbers of stops at these obvious level. Therefore, always watch out for previous swing points and range extremes. Don’t put your stop so close, such as 1 tick. Give it more room such as 3-4 ticks. Once the price is moving in your direction or you saw “1 tick” trap, then move your stop above/below that trap Bar.

If you did get stopped out, once you spot the trap, enter again! Don’t hesitate! Don’t trade with your emotion! Mark Douglas wrote: ***“Every moment in the market is unique.”*** Your previous loss should not create any influence on your current moment. If you could identify your edge and accept your predefined risk, JUST ENTER! Below are examples of two days in a row of Crude Oil June.9- June.10, where price takes out the High/Low by 1 tick and resume the original direction. The entry model is to enter 1 tick below/above that trap bar.

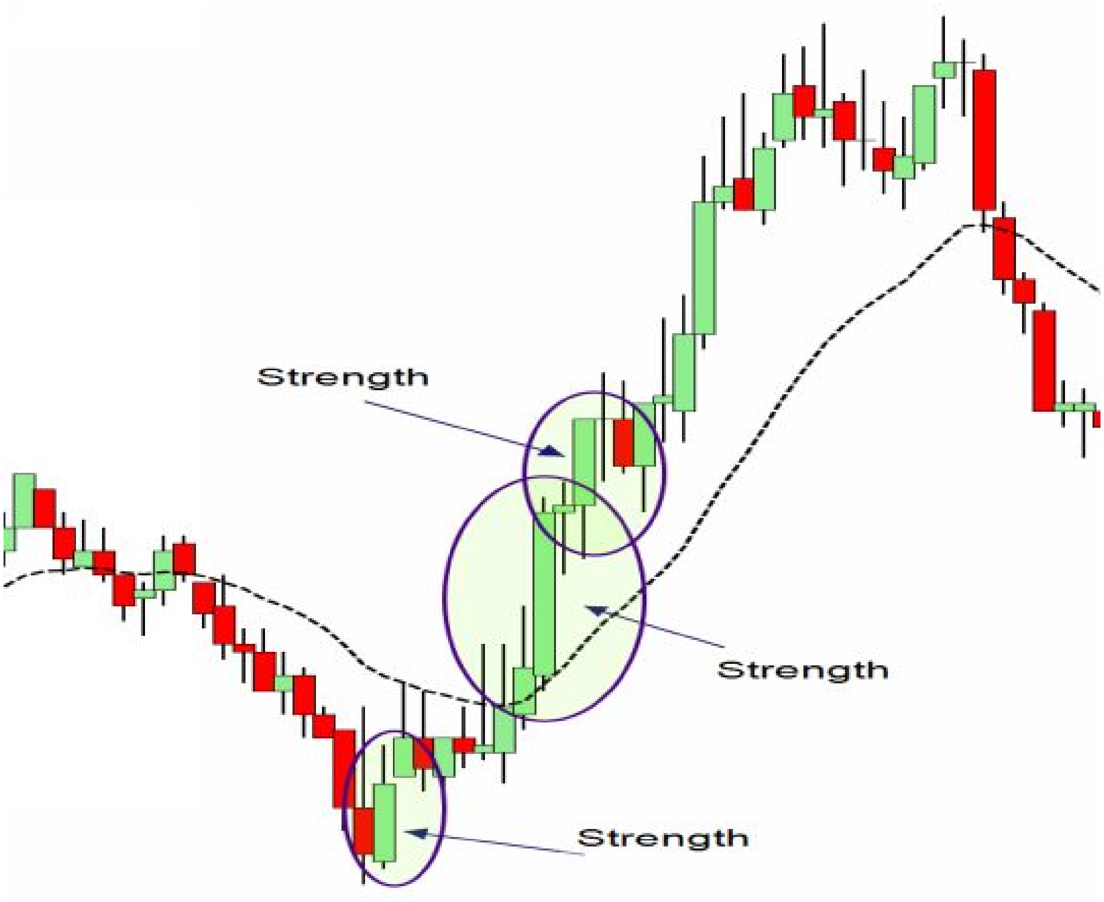

51.48
51.49
Entry
Entry
51.01
51.00

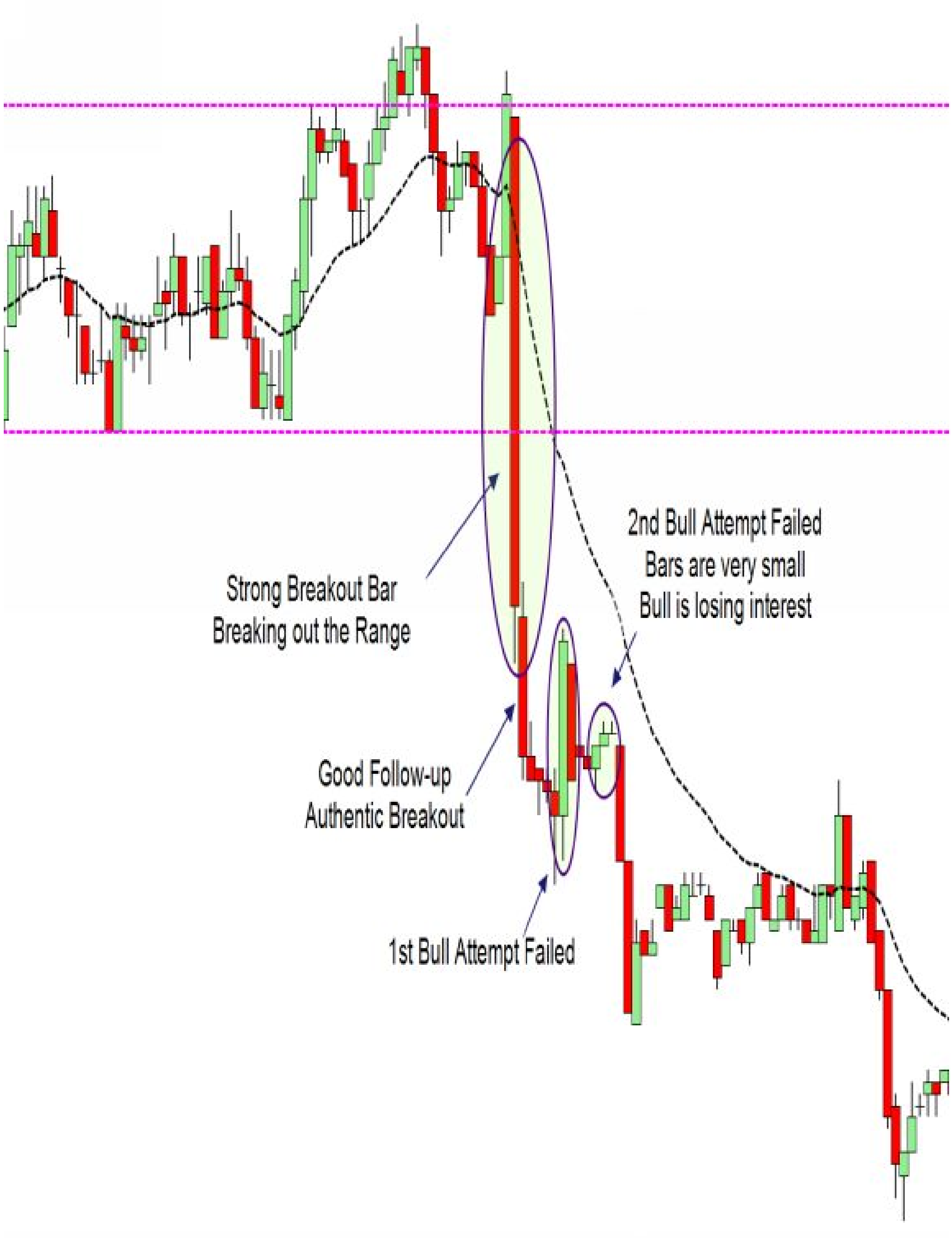

50.38
50.39
Entry
Entry
49.91
49.90

Chapter 3- “The Giant” Trap

Bar with a large body usually represent strength, but when a huge or gigantic bar appears, it usually means the opposite. The definition of a healthy trend is made of regular sized bars, consecutiveness is the key. But if the bar is too big, too fast, the countertrend traders will consider that as an opportunity to scalp. There are two important concepts regards to how to trade giant bars.

First, when you see a giant bar as a breakout bar for any congestion or as a breakout bar to initiate a new trend, it usually represent positive strength. Expect follow-ups.




2nd Bull Attempt Failed
Bars are very small
Bull is losing interest
Strong Breakout Bar
Breaking out the Range
Good Follow-up
Authentic Breakout
1st Bull Attempt Failed

Note: Whenever a giant bar appear at the end of a protracted move, it's usually the trap. It traps traders to believe more strength, but in fact it's the sign of exhaustion. It's the last push.

This concept is much alike to runners. When the runner approach the finish line, he's going to use every strength he has left to finish. But after pushing through the finish line, the strength is gone, he will rest until the next round. It's the same for market. After the last push, market usually transitioning into a Range or reversal. People invented market, and trading is not rocket science. A lot of concepts are directly related to our ways of things in physics, philosophy and psychology.

Second, never trust the giant bars within a trading Range. Often you will see a giant bar with little or none wick, taking all the space of the range. It looks very strong, it can trap a lot of traders to enter. Well, range is a box, price is rotating inside, sometimes peak out for a bit, but it is usually contained within an approximate range. If a giant bar is taking all the space, there is actually no more room to move, price has to reverse. The range lost its purpose of offering an environment for price to rotate. **Therefore, when you see a giant bar in the middle of the range, don't enter! It's a trap, fade it! In fact, most giant bars inside of the range are countered instead of being followed up.**

Speaking of follow-up after a giant bar, another thing to always keep in mind: **there are always traders on the other end of the giant bar, ready to counter it and scalp for a quick profit.** If you pull up a chart, you can see giant bars are usually not followed up with continuation. The psychology behind this is two-fold: **most traders just simply don't believe this "super" strength & traders who profited after this "gift" are exiting.** Therefore, there are more circumstances where giant bar is followed with a small pause or pullback before it's continuing its strength. Often without any follow-up whatsoever and simply reversed. The traders who countered the giant bar has awesome risk/reward ratios, they are scalping with minimum risk. They are simply picking a top or bottom and they loving doing it all day long.

The examples below shows the failed giant bars. They are huge in size, but they are not representing any strength. They have no follow-up and being countered one after another. Learn to use market order to fade it (trade against) at the closing price after the giant bar is closed.

Note: Not all the giant bars are fake, key is analyzing them within context! Be aware of the size of the range when scalping against the giant bars. If the range is big in size, where you can making money with limit-order. Then it’s an option to scalp. Not the best option, it’s still better to fade the extremes than trade in the middle of range. But if the range is small, can only contain 3-5 bars at most, such as the opening range in the example below, then **avoid trading in the center!** It’s very dangerous. The choppiness is very unsettling for traders. You would end up changing your minds frequently, your profit will drain quickly.

Chapter 4 - “Failed Breakout” Trap

Every bar can be an attempt to breakout its previous bar and every breakout can either success or fail. When the market is trending, successful breakout of previous swing High/Low is a sign of a healthy trend. If it failed to trespass the previous points, it will enter either a Range phrase or possible reversal. When market is moving sideways, there will be numerous times of breakout attempts before the real breakout. These failed attempts offers great opportunity to trade around.

There are many ways to define what a successful breakout is and what a failed (fake) breakout is. The clues are in the chart, you have to learn how to spot them. To traders who don’t know better, they will standby when there is a real breakout and enter when it’s a fake breakout. The key is confirmation. You have to wait for the clear confirmation before you enter. Nothing is written in stone in trading. The guidelines are just tools for you not to get trapped. And if you did get trapped, exit immediately, don’t pray and hope.

First, the wick. I have mentioned in previous chapters that wick is the hidden clue. It indicates the strength and area of rejection. When a bull bar has a long wick at top, that wick portion is the area of rejection. Sellers are defending that area. It will take more buyers to potentially break that level. Bulls will try again, but if they failed again, expect a pullback or reversal. When market is in a Range, the wick at the bottom of a strong bear bar simply means buyers are defending their lower boundary area.

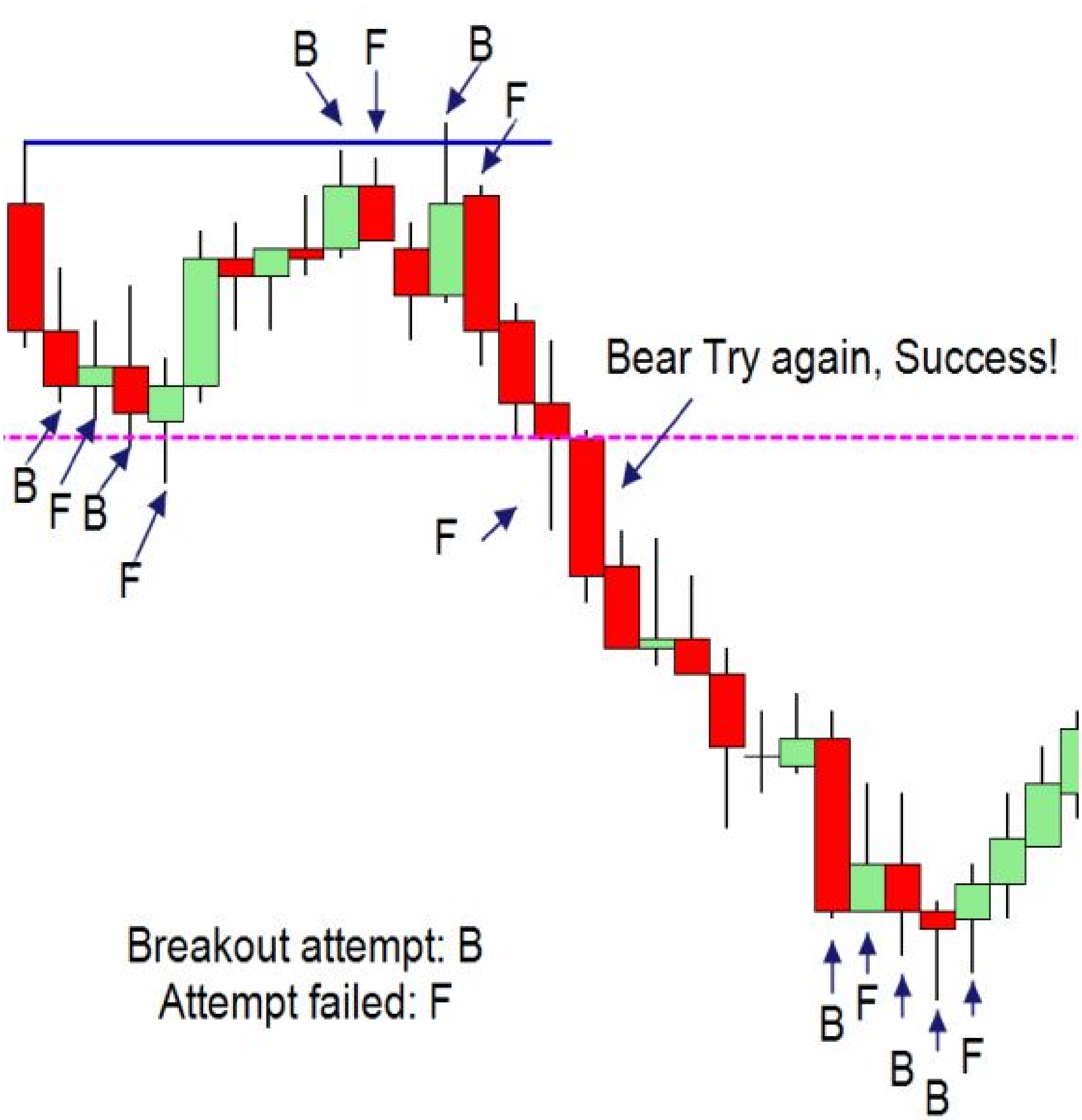
The close of the breakout bar is extremely important. Often when the bar is forming, it showed a lot of confidence. It broke out the previous high/low, but when the bar closed, it leaves a long wick on top/bottom.That’s your sign for failure.

That initial strength is the trap. It can trap a lot of traders to go in the wrong direction.

You don’t enter a position simply because there is long wick, but that wick is giving you a warning: a sign of potential reversal. It’s always better to wait for “the big sharks” to show faces and follow what they are doing. The “big sharks”, I meant the institutions, hedge funds and companies which have the fund to potentially move the price. Be a sideliner, always watch for double failures and trapped traders. Enter when they are exiting their losing positions.


These bars went higher of previous wick
But they could NOT close beyond that High
Sign of Failure!
Trap Bar
Failed to close above the previous
rejection level
This huge Bear bar is your confirmation
Bulls are unable to carry on
Enter Short 1 tick below this bar
See the wicks at top?
Each wick is a failed Bull attempt to breakout
This huge bar is the successul Breakout
It broke out all the wicks
And closed High

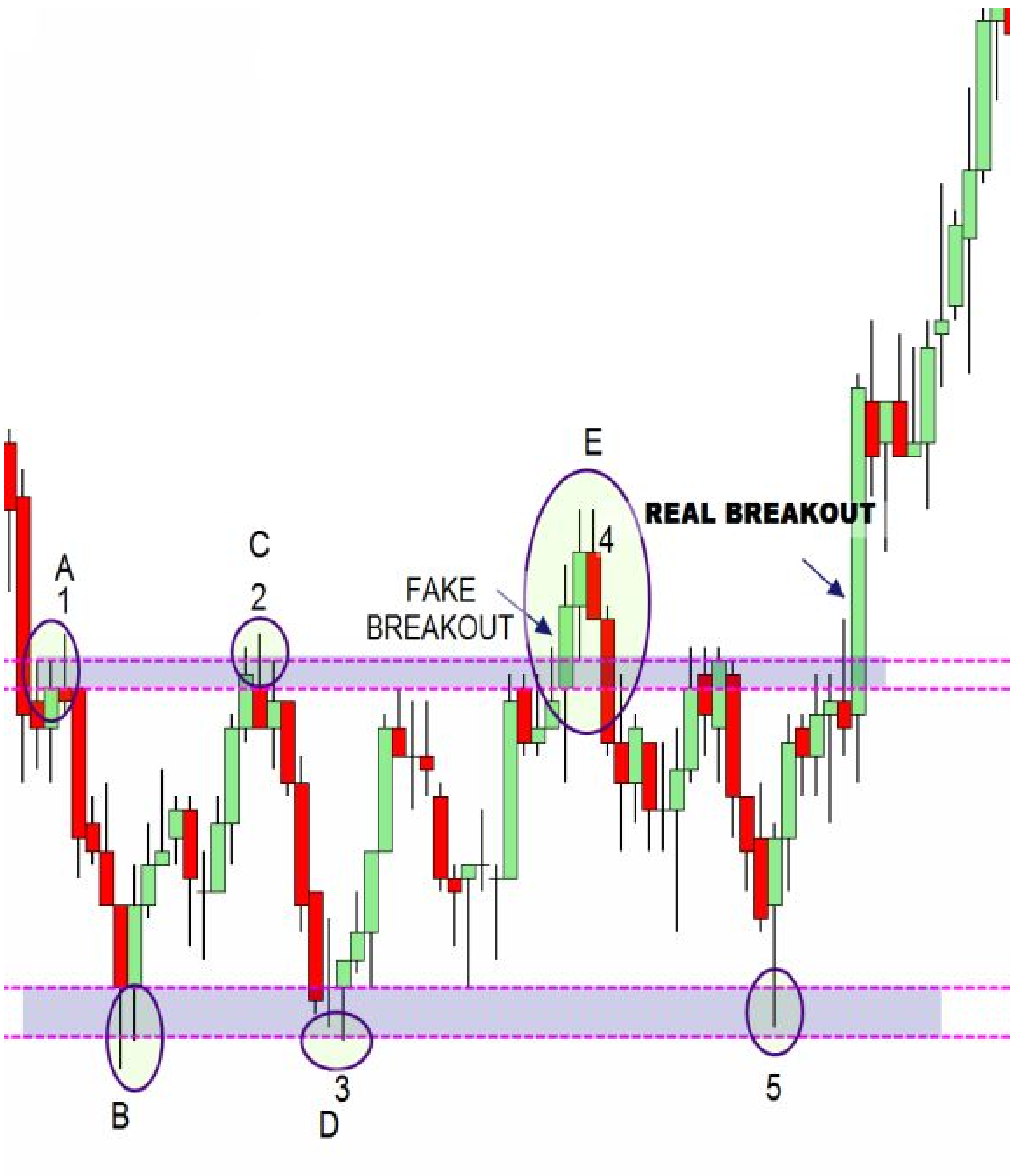
Second, the follow-up (green-red alternation). Often you will enter a position after a very strong bar, but there is simply no follow-ups. It triggers your order and goes the opposite direction. Simply put, if you see a strong green bar followed with a red bar, bull has temporarily failed. Vice versa for bears, red-green means sellers will have to try again to overcome the buyers.



The most common “Failed Breakout Traps” occur when price is moving sideways in a Range. As I stated many times before, there will be multiple breakout attempts before the real one. These failed breakout attempts can trap a lot of amateur traders. Typically, you can tell if it’s a trap by the wick and the follow-ups. The failed breakout trap is very much similar to the “1 Tick” trap. But often it’s not just one tick, it will be more ticks. But the concept remains the same, it failed to continue or carry on that strength no matter how many ticks it exceeds the previous level. We are using the trapped traders’ stops to fuel that extra move. We are profitable when they closing their losing trades.

Note: Often price will breakout the levels and carry one for a short while, then fail and return back to the original Range. It’s very common! No Range can be boxed with two parallel lines in perfection. Close is close enough. Even the breakout is temporarily successful, still remain alert for any signs of failure. Most temporary breakout will fail within 3-5 bars and rotate back to the original range.

Note: Within the Range, price is rotating in two legs as always. You can always find 2-legged moves inside any Range. They might not be symmetrical, but they are there. Also remember the vacuum concept. When price approaching the either boundary of the Range, it will speed up and bars will be large in size. Don’t be surprised or fooled! That’s not strength! It’s exhaustion. Trade the reaction after it.



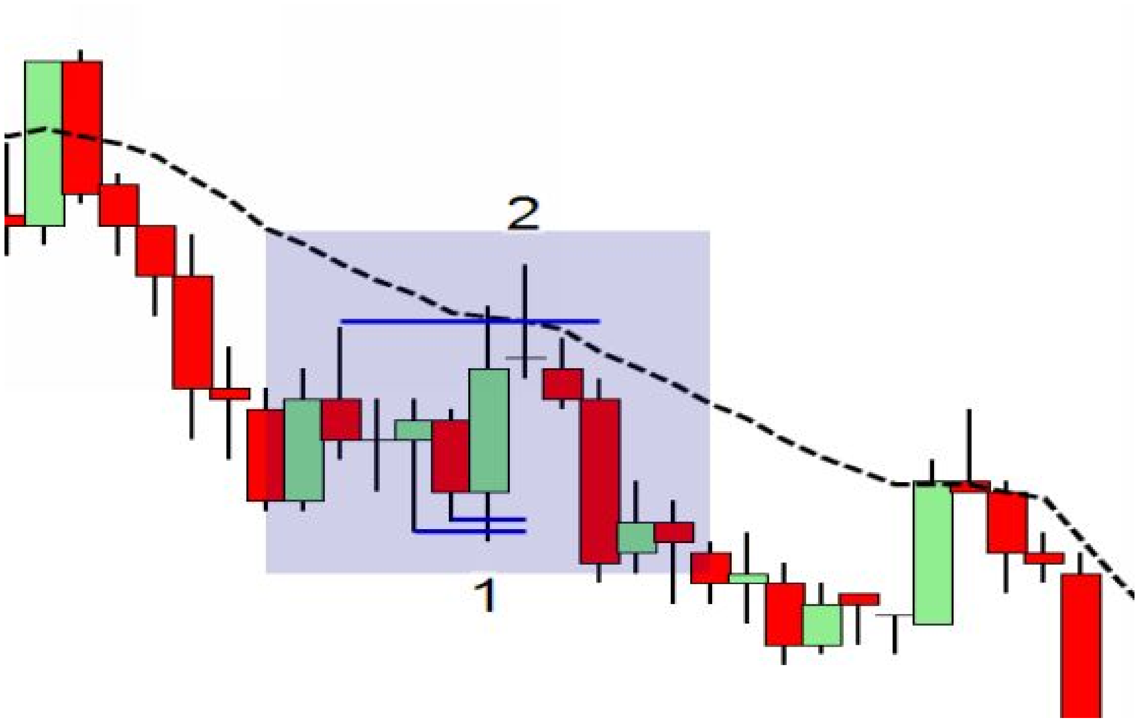
Case Study:

We mark the level with two matched Highs in A, it’s a resistance level. Bar 1 went up 2 ticks and reversed instantly on the same bar. It’s a trap. At B, we have a red-green failed pattern.By the long wick of the red bar, we can see that buyers are present at that level. When price moves to area C, the level with matched highs confirmed the upper boundary of a possible Range. Bar 2 is another trap, it went 1 tick above the green bar and closed bearish. Bar 1 and bar 2 formed a Double Tops in a downtrend. That failure on Bar 2 offers a great setup to short. When price moves down to the demand zone B, bar 3 confirms the lower boundary of the Range. Now we know a range is present, price is rotating within it, we can start look for failed breakout traps.

Price did break out of that upper boundary and stayed above it for 2 bars at E. But if we exam this breakout, you will see this breakout is nothing but a failed breakout, a trap. The bar which broke the level is weak in size and has a considerable wick on top. That’s not a strong breakout bar. Afterwards, the follow-up is another green bar with wick on top, and it closed only 1 tick above the previous breakout bar’s high. That’s a sign for more weakness. Successful breakout should have consecutive support, there isn’t any at E. Bar 4 is strong bearish bar closing on the low. That’s the confirmation indicates this breakout attempt is failed. This failed breakout is the perfect example of “failed breakout trap”. Price eventually return back to the original range. Bar 5 is an interesting bar because it didn’t even reach the bottom boundary. It got rejected heavily. It’s a warning that something is up. Price is supposed to rotate up and down in a Range. When it doesn’t, you have to be skeptical. When price could not reach to either boundary or halt around the middle of the Range, a possible true breakout is near. Eventually it did successfully broke out to the upside with the gigantic break bar.

Chapter 5 - “Back to Back” Trap (Double-Trap)

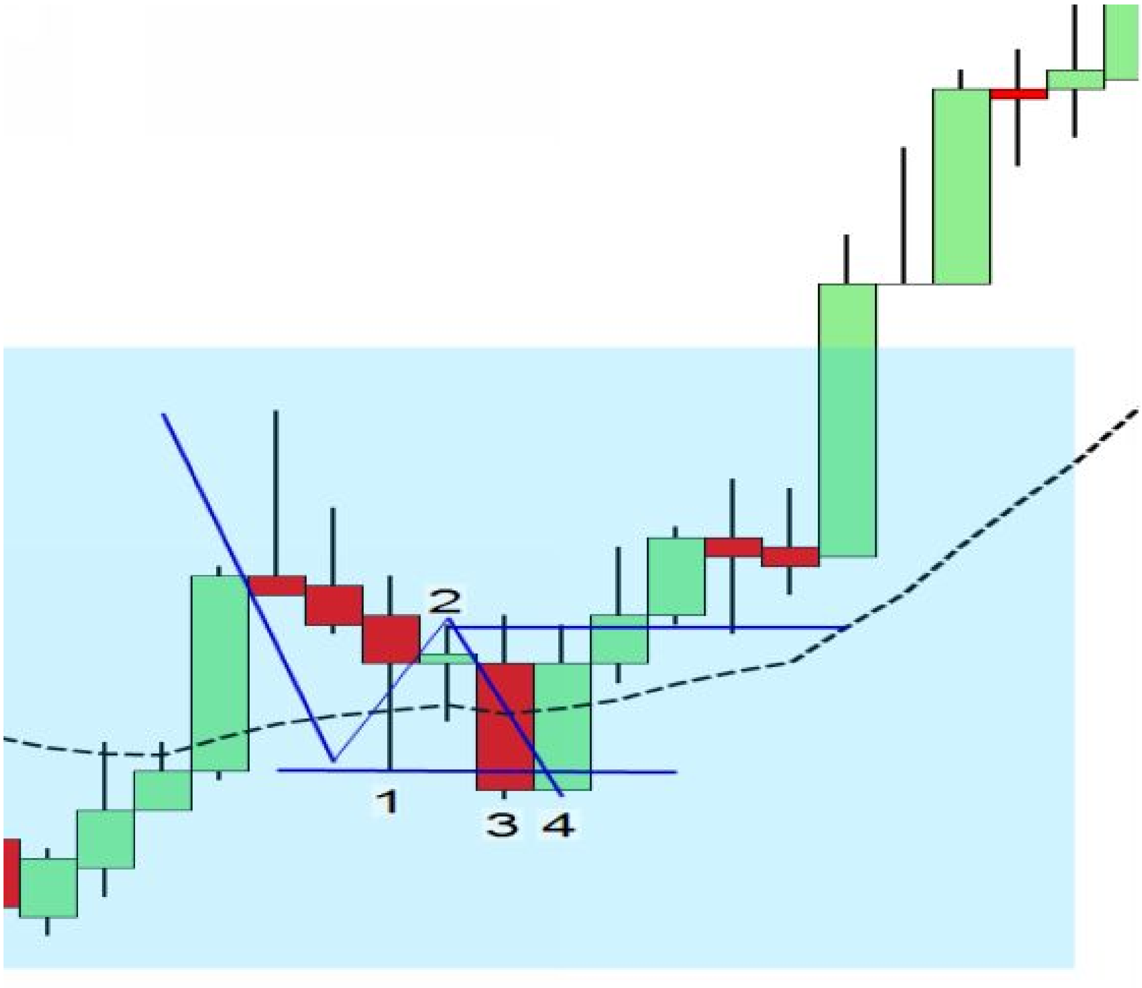
“Back to Back” Trap is essentially a double trap: an outside bar which traps both buyers and sellers at the same time. This is a dangerous trap because it can confuse a lot of traders! For example, while the bar is forming, first it traps sellers by going down for 1-2 ticks, then immediately reversed up to trigger buyers and sellers’ stop-losses. As you thought you were on the right track to be a buyer, it surprise you again by going downward on the following bar. It’s usually shaped as an outside bar: a bar which engulfs the previous bar. “Back to Back” Trap happens often in pullback and congested areas. When you see a double-trap bar, the best thing to do is wait! Outside bar is never a good entry bar. The best setup would be a tiny bar either at the top or bottom corner after the trap bar. That is your signal bar to enter.



Case Study:

The example below is a “Back to Back” Trap. Bar 1 initially traps sellers and triggers buyers’ stop-losses. Then it goes up to trigger sellers’ stop-losses and buyers’ limit-orders. The same bar is creating confusion, best to wait. Bar 2 is the optimal entry bar because it’s on the top corner of the trap bar. Although it’s a Doji, usually not a good entry bar. But given the context of the downtrend and long wick rejection at the EMA, it shows the buyers are failing to take control. The early downtrend shows the sellers are dominating. Six red candles without a pullback, it’s quite a strong momentum, expect continuation (second leg). It would have higher probability for betting short.

Key to remember: If market failed to go down, then it failed to continue up, consider that outside bar as one-bar trading range, fade the extremes. A Double Failure is a very reliable signal and it usually provides great trading opportunity.



Case Study:

Here is another example where the entry bar is a strong trend bar instead of a tiny bar at a corner. Bar 1 shows clear EMA rejection with the long wick at bottom. You can see there are strong buyers pushing price up at the level marked by the blue line. Bar 2 is a tiny bull bar closed above the EMA with narrow body. It’s not a good entry bar whatsoever. **Key: When the context is right, but the entry bar or signal bar is bad, WAIT! If the signal bar or entry bar is awesome, but under wrong context, it’s usually a trap.**

Bar 3 is the double-trap bar. First it went up by 1 tick to trigger buyers, then flushed down to trigger sellers and buyers’ stop-losses below Bar 1. As I mentioned earlier, never initiate any position of any outside bar, wait for the next bar. At sight, Bar 3 broke the EMA and previous low of Bar 1. The trend seems to be pointing to the downside. But it’s an outside bar, it’s best to wait. Wait to see if bear sideliners are going to join or it’s just a trap.

Key: It takes two moves to break anything. Any break, such as break of EMA; break of Prior High/Low or break of range boundary, is not an authentic break by one bar alone. Any break has to be confirmed by 2 bars at least, meaning two consecutive bars closed below/ above an important level. Any single bar break followed by a counter bar is a trap indeed.

Bar 3 is the perfect example of that, the typical red-green alternation. Bar 4 didn’t even trigger any sellers’ limit-orders below Bar 3, it just went straight up. That’s a sign for strong bull strength. Now look at the context. Price was trending up earlier with quite a strength. The pullback bear bars are made of two Dojis and a double-trap bar which got countered immediately. It’s not a convincing strength from the sellers. There is a small but complete 2-legged move for the bear, not symmetrical, but it got the job done. When bar 4 is done forming, going long by putting a buy limit-order above it would have a greater probability of winning.

Chapter 6- News

News is the adrenaline for traders. The erratic, explosive and volatile price movement is its signature. News are dangerous to novice traders because you could have a huge loss within seconds. Whatever stop-loss you placed nearby will be triggered. The risk is great. But the profit is awesome too. You could make a fortune within seconds if market moves in your favor. That sounds like gambling, isn't it?

In my opinion, the correct way to trade the news is to trade the reaction after the news, not news itself.

News is periodical and recurring. There are many important reports occur on a weekly basis, such as FOMC, PMI, inventory and storage report, Bond auction and others. For example, Crude Oil Inventory Report comes every Wednesday at 10:30 AM (EST), exclude Holidays. Make a routine to check the calendar for important news announcement of the day. Knowing the time and date ahead can help you to be well prepared. Otherwise, a lot of price actions wouldn't make sense to you. It is part of consistency. Go to http://www.Forexfactory.com and click the calendar section to see all the news for the day.

Some news are not recurring, they are the unexpected events. These events can affect investors' decision whether to hold or exit their current positions. For example, the market crash after the "9.11". People were panicked and feared, it was a chaos. On the first day of NYSE trading after 9/11, the market fell 684 points, a 7.1% decline, setting a record for the biggest loss in exchange history for one trading day.

For price action day-traders, all the news are same to us. The chart never lies. All the emotions and reactions related to the news are clearly presented on the chart. For example, the inventory report for Crude Oil is the 5-mins candle from

10:30-10:35 AM. We wait for the candle to finish and trade the reactions afterwards. We don't care what the result is. We just trade accordingly.

Is News irrational and unpredictable? Not really. If you look at the charts in the past, you will see that **every News candle makes sense.** It respects the structure of the market. Although the candle may be huge in size, it's still restrained to certain important level. It's made of crazy price movement, sure. But the movement is not illogical. All the volatility is a tool to mess up your eyes and your decisions. For human, the eye sees and the mind believes. But news can be deceptive. Often it creates misdirection, trap traders in one direction and reverse. The speed is so fast, you don't even realize. That's why news is dangerous to many traders.

However, the News candle usually completes something, fulfilling a purpose of expedited service. It usually get the job done by extending a second leg; a deep pullback or Double Tops/Bottoms retest. Keep this in mind when examine the News candle. Again, it's always better to trade after news.

The high or low of the news candle is often the safest locations for stop-loss placements.

Case Study:

On Aug.3, CL gapped up after a strong downtrend of the prior day. This gap is created by sellers taking profits from yesterday. Will there be a continuation of downtrend or a deep pullback? Let’s wait and see. The sellers dominated the first 15 minutes. Bar 1 closed the gap and got rejected immediately. Sellers try again and failed at Bar 2. When one side is failing twice, go opposite. Buy above Bar 2 would be a textbook second-entry long. This double rejection of the gap indicates there might be a deep pullback to the upside before selling again.

The inventory news came at 10:30 AM. Bar 3 flushed down heavily to re-test the prior day's low and triggered all the buyers' stop-losses. Then it pushed up to close bullish above the EMA. This bar tells us three things. **One, it completed the mission for the sellers to test of prior day low. Two, the rejected wick and bullish close indicate buyers are very strong. Lastly, many buyers are going to take a profit after this candle.** We don't initiate any position yet, we want to see trapped traders. Bar 4 is a trap after buyers try to break out of the news candle high and failed. Another text book second-entry short. You can take this trade, but be aware buyers are very active, so don't expect to hold a swing trade, just a quick scalp should be no problem at all. If you did enter, there are 35 ticks of profit.

This bearish move soon got countered when Bar 5 finished. If you entered above Bar 5, the correct stop should be below the low of the news bar 3. Bar 6 is the "1 tick" trap of the sellers, also a strong bar to break the high of the news candle. It's a good setup to enter. But it's very close to the New candle high, a possible Double tops and reversal. Therefore, it's not optimal entry bar. But if you did put the right stop-loss below Bar 3, you would be fine.

Bar 7 trapped some buyers but bar 8 immediately corrected it. Bar 8 is not the ideal bar to enter, but it did close above the news candle high and risk is quite small. Look at the strong uptrend all morning, there is simply no reason to sell. Enter 1 tick above Bar 8, aiming for the AB=CD pattern and prior day's high. And it did reach there eventually. By this example, you can see the benefits to trade after the news. Also, News is logical, not irrational. Clip that long wick, it don't look any different than a regular bull trend bar. News doesn't change the overall picture of the day, it's an important part of it.

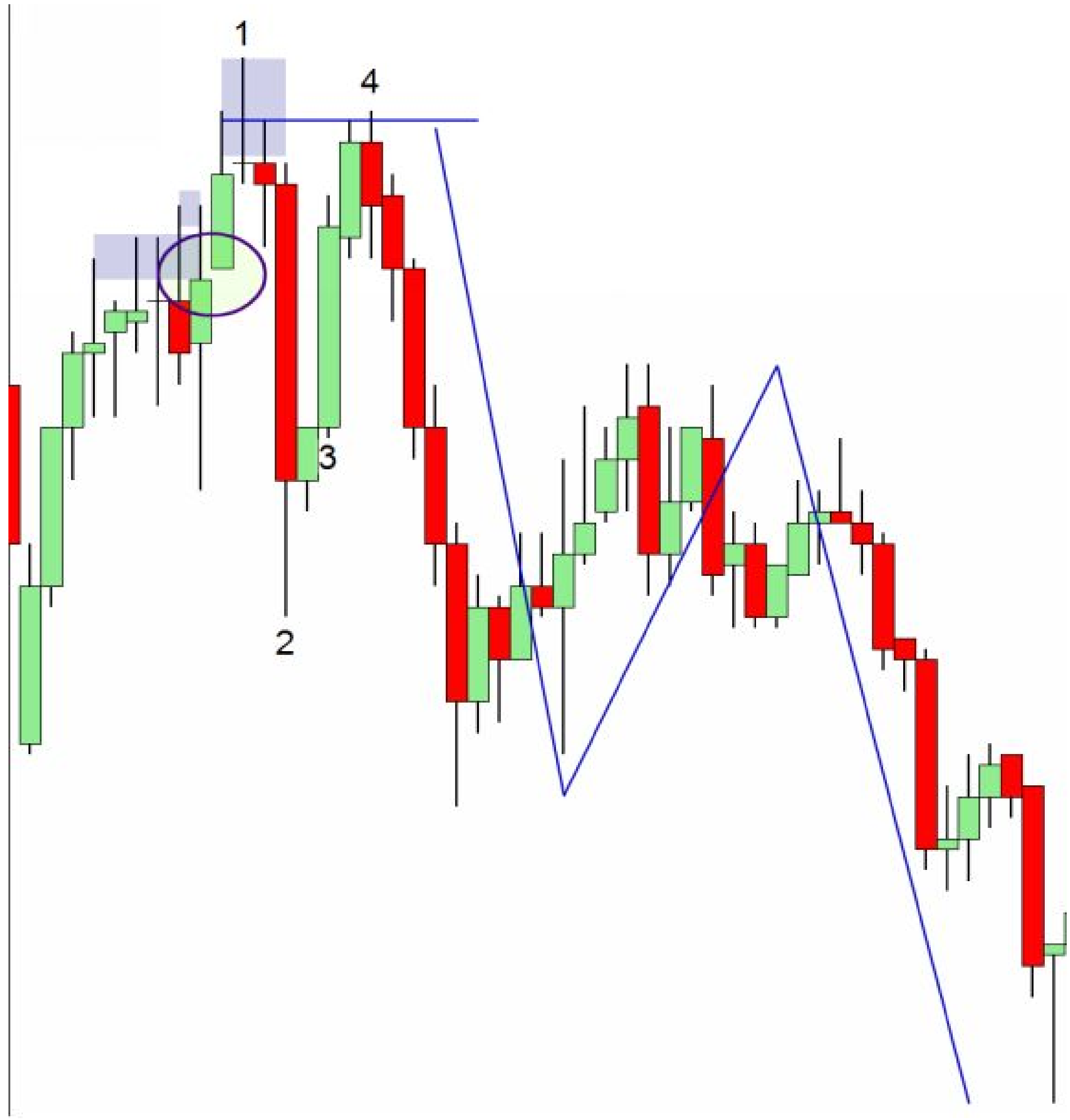
Chapter 7- Morning Specials

The “Morning Specials” is composed with two scenarios which can trap novice traders to believe market is moving in one direction, but in fact, reversal is just around the corner.

First, the morning reversals. Often you see price is moving in one direction very strongly from the opening bell. The momentum is so strong, it creates a parabolic curve. It makes you regret not entering early. But don’t get trapped, this parabolic move often get reversed.

The psychology behind this is that trend is healthy when it’s made of average trend bars closing near the extremes, consecutiveness and small corrections. But when the momentum gets out of control, such as a parabolic curve with gigantic bars without pullbacks, control has to be restored. Too fast too big is a problem because there is no consistency. Market is balanced, where both bulls and bears can profit. If price is only favoring one side, resistance will be met. Keep this in mind when you see volatile movement in the early morning. When you see clear signs of failure or exhaustion, counter it.

For the Crude Oil (CL), I only trade from 9:00 AM to 11:00 AM, the morning section. Usually price is moving quite nicely during this period. I try to finish my trading before the lunch time, as the action can get very slow and “choppy”. I found morning reversals often occur around 9:30 AM, not always, but happens quite often. Reversals offers great risk/reward ratio, with a small risk. You could be catching the “Top/Bottom” of a potential reversal and hold it for a nice swing trade.



Case Study:

On Aug.9 2016, Crude Oil is trending up heavily right from the opening bell. It was a Gap down from yesterday but this gap immediately got filled. Six bull bars without pullback, two of them are huge in size. The circled area is another small gap, which represents urgency of the buyers. Is it a breakaway Gap or an exhaustion Gap? Let's see the follow-ups. Huge green trend bars, gaps, only one red bar in the 1st hour, everything is pointing up for the buyers. But if you look closer at the shaded area, you can see all the bull bars have considerable wicks on top. It’s true that price is still raising, but all the wicks are the clues to abnormality. Something is up. The circled gap is the exhaustion gap. If it were a breakaway gap or a continuous gap, the follow-ups should be strong. Here bulls failed at the second bar after the gap, it shows bulls are weak and losing strength. That exhaustion gap is a trap for buyers.

This parabolic move halts at Bar 1 and the countertrend traders are showing faces. But the problem is that Bar 2 formed too fast too big, which got countered at once. Buyers try one more time with strength, but failed miserably at previous rejection area, Bar 4. Bar 4 is a trap, it went up 1 tick and closed bearish. Double Top, Lower high, 1 tick trap, green-red failure and second-entry short, all the signs are pointing to a morning reversal. Bar 4 is a great entry bar. And the time is exactly 9:30 AM. If you did enter below bar 4, you are at the top of an awesome 2-legged bearish swing.

The second scenario is the Fake Range Breakout. The mentality plays an important role in this scenario. Again, the eyes see, the ears hear and the mind believes. Often we see strong moves breakout out of the range and have strong follow-ups as well. We tends to believe the breakout is the successful one, and we enter in that direction hoping for a swing trade. But more often, market has a mood for certain pattern of formation every day. If the first hour of the day is consisted with sideways price action, the rest of the day most likely will behave like a range. That means no matter how strong the breakout is, the mentality is that we have to be skeptical about range transforming to a trend. Instead, we should try and look for failures and fade them. These “successful” breakouts of the range, most of them never lead to a trend. Instead, price moves to another range and rotate within the new boundary lines. But if it fails, it will often return back to the previous range. Fade, Fade, Fade! That’s the motto for trading sideways price action.

Case Study:

The example below shows us the Fake Range Breakout. The 1st and 2nd bar of the day are both Dojis, first sign of a potential Range Day. **In the early morning, “Big Down”, “Big Up” price movement is another important sign of Range.** The Big up move can trap a lot of traders who thought it’s going to transform into a Bull trend. Unfortunately, not on a range day. Look for signs of failure, the rejection of the triple tops. Price moves back to the range and rotate.

Then it tries to breakout to the down side. It failed at first, but the 2nd bar is this gigantic bearish bar that slash through the bottom boundary. This beautiful bar became a perfect trap for sellers.

If you think market is finally breaking out to the downside, then you are trapped again. In any other day, it would be an awesome signal bar. But not on a Range day, especially not when it was 12:40 PM lunch time. Well, it failed after three bars and the Bulls eventually rotate back to the original range. Fade the highs and lows.

Be flexible when trading a day like this because there is simply no trend. You have to shut down the trend trading mentality.

Final thoughts

Consistency is acclaimed to be the most important aspect in trading. What is consistency in trading? **Well, always pre-define your risk and maintain the 1:2 risk/reward ratio are the two primary examples.** Others such as taking partial profits, daily maximum loss, numbers of trade you initiate, patience of waiting for setup and no excessive trading are all crucial. There are methods and strategies only work in certain conditions. Often you have to wait long time for a particular setup. Sometimes that setup might not even come. Even if you can memorize every pattern there is in "Encyclopedia of Chart Patterns" by Thomas Bulkowski, which is an 849 pages book, you still might not find one pattern that never fails. Market is perfect with imperfect movement. In my opinion, trap is the only consistent setup you can find all the time, every day, on every chart and any market. Consistency in hunting for traps has the better probability of winning. Also trap setup is easy to spot, confirm and exploit. Nothing is better than simplicity.

Once again I apologize for the language if sometimes it seems awkward. I wish I have demonstrated the trap idea clearly and you would found them helpful in your trading.