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LETTER FROM THE DEVELOPER

Who's ready for 2016?

Hopefully, all of you are since by the time you read this we're already moving quickly through Q1.

It has been a rough start for stocks this year with a lot of fear-based selling. Concerns over valuations, the global economy and interest rates. Sound familiar? Seems like we hear that every year. Just sometimes it impacts equities much harsher.

When I see a start to the year like this and all the concern, it's when I am grateful again that I can classify myself as an "Active Trader." An Active Trader doesn't mean you have to be someone who day trades and stares at the chart all day.

However, it does mean you are fully willing to move into and out of markets. You are willing to consider staying on the sidelines or even selling/shorting a market. You also are someone who doesn't have any conviction or agenda in either direction.

Think about it. If you have a 401K, retirement account, mutual funds you have an agenda. More than likely you have to see the stock market move higher to make any money. If it goes sideways or down, you are going to lose. You end up being a cheerleader for one direction only.

An Active Trader, however, can simply hope for volatility. We really couldn't care about the overall direction. Without any bias, we're looking to take advantage of what the market is willing to give us. However that turns out.

If you wouldn't currently classify yourself as an Active Trader, I'd say use what is happening 'out there' and take that as your motivation to start now.

Like to day trade? The Counter Punch Trader is a perfect place to be. Day trading the futures (my favorite) or forex. Prefer to Swing Trade? Smaller accounts, in particular, should consider the Dynamic Swing Trader. Or, if you're ready to enter the big leagues master options trading (another favorite of mine) and get involved with our Options Fast Track program.

This is not a 'pitch' for our products and services but given we've been doing this for two decades (20 years!) we know a thing or two about becoming a successful Active Trader and showing you how to get there.

If you prefer to look into our free resources, then make it a habit of going to our Trading Tips blog a few times per week: www.netpicks.com/trading-tips

No matter what you decide I suggest you kick it into gear and make 2016 the year you transform yourself into an "Active Trader." Once you do, you'll never be fearful of the markets again. Each day will bring new and exciting opportunities. You'll look forward to waking up each day to face the markets and the challenges ahead.

See you there!

Mark Soberman

Mark Soberman

LEARNING HOW TO BE A WINNING TRADER

by TJ Noonan

There's learning how to trade, there's learning a trading strategy, there's learning how to trade with that strategy, and then there's learning how to be a 'winning trader.' Each step along the way is necessary to finally put it all together for consistent success. The quicker one can get to the final learning step, the better.

When 'would-be' new traders first set out to learn how to trade, it reminds me of a new puppy learning how much fun it is to play with a rubber ball. Bright eyed with their tail-a-waggin', full of enthusiasm and enough energy to take over the world, they see it as the answer to everything they've ever dreamed about. Finally, the easy pathway to riches and a way to achieve ultimate freedom has arrived.

Their minds are like sponges, soaking up every piece of information they can get, taking classes, expensive trading courses that will teach them everything they need to know about trading. Going long, getting short, being able to take advantage of the fluctuation between the values of one currency to another, margin, discount brokers, the miracle of being able to control hundreds of thousands of dollars for a fraction of said value, etc. Wow!

Finally, after jumping through all sorts of hoops, and much effort in getting set up to trade, they are faced with the reality of having to make an actual trade, looking at the current price bar, in real time, at the far right edge of the chart, trying to figure out what to do next. Buy? Sell? It sure looked a lot easier when perusing those charts where the obvious trades jumped off the screen. Stop loss? Naahhh! Who can stop me from winning? I don't intend to lose!

Perhaps the new trader gets lucky and wins his first trade. Maybe even several. Ironically, that would be the worst possible thing that could happen as confidence soars and the feeling of invincibility abounds. "If only I could have discovered this sooner, I could have fired my boss and could be living on my yacht by now, sailing around the Greek Islands."

Probably the best thing that could have happen to our new trader is to have experienced a few quick small losses. There's nothing like a quick slap to the face to learn respect for the dangers of the market. Everyone has heard the cliché that if trading were so easy, it would be illegal. No one ever really reflects too much as to just how true that statement is. Do you really think governments are just going to let someone 'mint' money? There has to be risk and when there's risk, there are inevitable losses. The sooner a new trader learns this lesson, the better off they are and the faster they will get to the next step, discovering strategies for trading.

It's funny how the above scenario actually plays out again, once the 'would-be' trader discovers his/her first strategy. It looks so easy. "I just have to place my trade where the strategy says." Here's the thing about strategies though. They still have to be traded by a good trader. The greatest strategy in the world is going to do serious damage in the hands of an ill prepared trader. Over enthusiasm as I just described, typically leads to someone jumping into trades without taking the time, to not only learn the strategy, but to actually understand it; how and why it is supposed to work the way it does. That leads to continued losses and confusion because our would-be trader already went through that step, found a good strategy and yet, is still losing money.

What most inexperienced would-be traders don't realize is that good strategies are not promises that every trade is going to win. Remember the cliché mentioned above? Good strategies, and believe me when I tell you that you are lucky when you find one (and even luckier if and when you actually realize it) because they are far and few between and most strategies are either half-baked or only work under very specific market conditions. Remember the right edge of the chart and that very real price bar that is forming in real time? Again, the would-be trader is still faced with that hard reality and those charts sure were SO easy to see the trades on – after they happened.

Of course this process filters out a lot of people. Many don't make it this far. Especially those unlucky ones that had fast success, felt invincible and then proceeded to blow up their accounts. Ever try to regain losses from a trading account? That part of the trading lessons never really seemed to be taught in any meaningful way and yet the lesson IS going to be learned, costing way more than the price of the education in the first place.

Those that do survive though, are now ready to embark upon the next step, learning how to trade with a strategy. It wasn't enough to just learn the strategy. It's time now to actually learn how and why the strategy works and more importantly, how it fits within one's own personality. Remember, the strategy still needs to be traded. There still will be risk. Trades are still going to lose. If a trader is lucky, they will realize that a good strategy, even one that fits within a trader's personality, still will produce losing trades. It's now up to the would-be trader to learn how to use the strategy to be profitable. It winds up being a numbers game, just like any other money making business.

A good strategy can only promise one thing, really. A good strategy can only promise to put the odds in the trader's favor IF it is traded in the manner in which it was intended to be traded. I believe that a good strategy has to be able to make that claim. Now, it is incumbent upon the actual trader to be a good trader, learn the strategy through and through and then use it as it is intended to be used. It should have money management principals and clear rules to follow from start to finish. Remember that right edge of the chart. That part of trading is not going away. Ever!

Trades will win and trades will lose. A good strategy that puts the odds in your favor will grow your equity, winning more than it loses on a consistent basis. That leads us to the final chapter of learning which is, learning how to be winning trader.

What exactly does that mean though? I won a trade today. Does that make me a winning trader? It's amazing how many definitions of 'winning trader' exist. Ask 10 traders that question and you'll probably get several different answers. To me though, a winning trader is someone who can consistently grow their equity over time. After all, if you're a trader, then you trade. It's not some place you magically appear at one day. There is always the next trade to take. There is always that right edge of the chart. There is always the fact that there is risk to trading and that means losing trades are inevitable. Trading is a never ending journey that one never really arrives at, because as I said, as traders, we have to take the next trade. That's what traders do. What is the next trade though? Hopefully, if you have arrived at this point in your learning, then that question is answered objectively by your strategy rules. It's a numbers game and so long as your strategy puts the odds in your favor, the would-be winning trader has to trade to the odds with smart risk and unwavering execution.

The winning trader is the trader who realizes that every trade is just another transaction in the business of trading. Some trades will lose but MORE trades will win. So long as that trader can limit his losses and continue executing his winning strategy, the one that grows equity over time, then he will continue to be a winning trader. It makes so much sense but for whatever reason, it is the hardest lesson to learn.

LEARN A SIMPLE RANGE TRADING STRATEGY

by Shane Daly

It's been said that a market only trends 30% of the time.

I can't quantify that figure but having a range trading strategy to take advantage of the other 70% is good business.

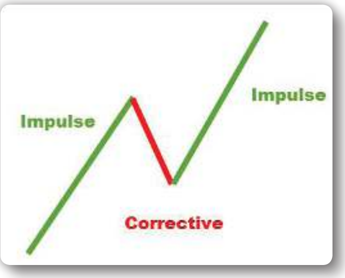
Range trading is not difficult however it does require discipline and a method of determining when a trading range is in play.

What Is Range Trading

When a market is trending, you will see a stair stepping pattern of higher highs and higher lows in the case of an uptrend. There is an imbalance of buyers and sellers and you can generally see the difference between an impulse move and a corrective move.

Impulse moves are stronger and bigger in scope than a corrective move.

Once that condition stops, markets tend to find themselves stuck between a high and a low and continue to oscillate between these two points.



Buyers and sellers have found a point of relative equilibrium and you can find yourself in a very choppy environment if attempting to trade between the extremes.

This is when traders will place trades against the high/low extremes and will continue until price breaks out of either side.

We've just come to the first issue with range trading and that is finding the two points that will act as potential support and resistance levels to trade against.

I did a piece on support and resistance where I blanked out the chart and randomly laid on some horizontal lines. Turning the price bars back on, price found both support and resistance on every single line.

Of course, that **does not discount the validity of S/R** but it does bring home the fact that price can and will bounce seemingly from a random level on the chart.

To ensure you are using a level that may have some importance, **levels that are obvious** would be a better place to watch for price action and potential trading opportunities.

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This instrument is trending down and puts in an obvious low at #1. For the down trend to continue, you would need to see this low taken out to continue our pattern of lower highs and lower lows.

Price rallies and when the price starts to drop, we have our high at #2. The issue is you have a potential pivot at #3 and is confirmed when the price at #4 takes out the #2 high.

Has this market gone right from a down trend to an up trend?

No.

You will later see that price falls back and takes out the #3 low and you can clearly see that price is not in a trending pattern.

You have the extremes of our range labeled as #1 and #2 but #4 highlights an important fact about these levels.

They are not a defined price.

When looking at these turns, consider them to be zones with a margin of error both outside and inside the range.

Range trading will take into account both extreme zones and a trader will look to position a trade against the potential zones of support and resistance that form the range.

Why potential support/resistance?

You don't know what will happen when price returns to those extreme zones.

- It could stop.
- It could reverse.
- It could breakout.

These zones *potentially* have an effect on price and keeping that word in mind will keep your expectations in check when confronted with the meeting of price and zone.

It will stop you from simply pushing the buttons and taking a trade and will force you to look for signs of what the probable move may be.

Trading Range = Consolidation

When trading trends, most people are used to the impulse and corrective swings in the market. These pullbacks/rallies are continuation patterns of the overall trend.

The same thing can be said about trading ranges.

More often than not, a range is a price consolidation as part of the overall trend move. It certainly can be the ending of the current trend and a reversal is imminent but that has to prove itself and not to be assumed.

4 phases of a market are accumulation, mark up, distribution, and mark down. It is possible that the consolidation you are looking at is either accumulation/distribution. Let it prove itself to be a trend change or show a clue such as higher time frame divergence but assume a continuation play if trading the smaller time frame.

Ranges can also occur when the higher time frame becomes overextended and the range is where that condition is being worked off.

The first chart shows a range on the daily chart that occurred after 148 days of an overall down trend in the market and 27 days of an impulse leg that terminated at the #1 low.

This chart shows the weekly chart of the same point in time.

You can see that price had two weeks of a momentum push to the downside and our indicator shows an oversold state.

Our daily range played out for 63 days but a quick look at the larger time frame showed an extended and oversold market but the lower highs/lows, lack of divergence, and lack of reversal price action pointed towards a trend continuation and not a reversal.

Risks Of Range Trading

There are a few issues with trading the range but many of them can be avoided if the trader is disciplined in their trading approach and knows what to look for.

Having a read on price action will also go a long way in helping you take advantage of the opportunities that range trading provides.

Runs to the range extremes

You've probably heard it said that the more times something is tested, the stronger it becomes. *"Look for multiple touches to confirm strength".*

No.

I go on the opposite premise that multiple runs to a level weakens it, not strengthens. If a price level is important enough to reject price, why should it continue to revisit that area multiple times?

If it is going to revisit multiple times, I would also expect to see the move away getting stronger and not weaker to indicate strong interest at the extreme.

I also look at the number of times traders take positions against the extreme and place their stops just on the other side. If that breaks, especially in the direction of the higher time frame trend, a protective stop cascade could propel price hard, fast, and when those protective stop orders get hit and turn to market orders, how much slippage is going to occur?

The point is **not to blindly take a position simply because the price has moved to an area** from the past especially after multiple hits at the extreme. Remember that markets cycle through ranges and trends so eventually, one of the extremes will break.

If you want to fade the extremes, you want to see some type of failure or signs of a reversal at the extremes.

Related – Profit From The Failure

On the other side of the coin, you don't want to assume you are going to have a trading range breakout simply because price moves strongly towards an extreme.

This chart shows a range and at #1, you can see the strength in the candle as price pushes towards a potential resistance area. You know people bought into this move and the small upper shadow shows a very small number of sellers.

Just as strongly as price advanced, it collapsed and once it was obvious the range breakout was not going to happen, a large momentum candle shows up that could indicate the buyers exiting their positions. It could also indicate that those who bought at the small consolidation or at the support extreme, are taking their profits.

Regardless, anticipating the trading range breakout served up a healthy amount of losers.

Price advances once again to the potential zone of resistance and price action at #2 shows the imbalance of sellers and buyers at the extreme that could be used for a trade entry. This is a picture perfect reversal although it was not a strong continuation away.

You wouldn't know that of course and that is why **trade management must be part of any range/trend trading strategy**.

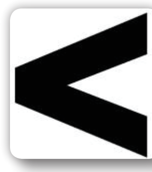
If you are looking to fade either extreme, this next chart shows the type of action you do not want to see. It's not a perfect example but understanding what is happening is important.

The extreme has been in place for a while and has seen multiple reversals in the area. This last one is different. The reversal on the left had signs of indecision until sellers took over. The last push up has consolidation right at the extreme and there does not appear to have much of a bull/bear battle taking place. You can also see part of the uptrend pattern of higher lows taking place.

We do not want to see a pattern of higher lows into the resistance extreme nor lower highs into the support extreme.

We do not want to see accumulation at either extreme.

While a reversal could still happen, this type of price action and structure at the extreme does not give much confidence for shorts (longs). If anything, some traders may find an entry inside of the consolidation at the failure test candle marked with the arrow.



Expanding trading ranges

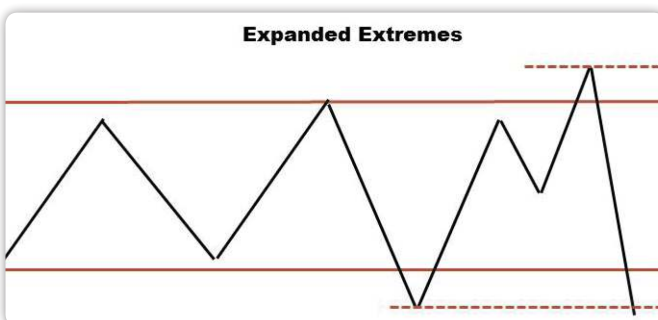
When you see price breakout out of both extremes and failing to trend, plus each swing is larger than the previous you get a range that is expanding.

These are not something I want to take part in as the market has no clear cut consensus on what it wants to do.

Also, if taking a position in this type of environment, where would you put your stop?

Being unable to define the stop on the trade can interfere with your risk profile for your trading plan.

Keep in mind that a simple breach of either extreme does not invalidate the range as the range could simply be expanding to a larger size.



This is quite different than erratic swings in each direction and while it may turn into an erratic expansion, at this point we can still find positions.

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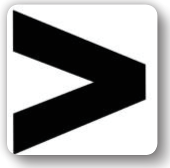
Converging range



While there are different names for each chart pattern, I keep it simple and if the market is not in a trending state, I call it simply a range bound market.

This is the opposite of the expanding range and here price appears to zero in on a particular price point. Compression is occurring and generally, a trader will look to position themselves in the breakout of the move when it occurs.

Noting there is **compression is important** because when it breaks, there could be a strong move behind it. Given that, looking to fade breaks of these types of compression ranges is probably not a wise trading plan.

Why Range Trading Works

We covered a few things to look for when trading ranges including not assuming the range will hold and looking for a sign that a fade of the range extreme is the right play.

You also noted that a range can take various forms and some are easier to get a handle on than others.

Seeing a market in an expanding range would probably take that market off my list of tradable instruments.

The converging range would have a breakout play in mind and while some will still fade the extremes, it doesn't suit my plan.

I actually don't know of anybody who trades inside the converging range. While there may be some, looking to position in a breakout in the direction price was headed prior to the range seems to be the most common play.

Let's cover why range trading works as a viable trading method

Once a range has formed and you have determined where the extreme zones are, **you now know exactly where you are to look for a trading opportunity**. There's no guesswork involved. Price will either break out of the extremes, reverse at the extremes, or expand at the extremes.

The middle of the range is not an area you want to play in.

Support and resistance levels *(remember you are looking for obvious ones)* make up the extremes of the range and S/R are zones that garner a lot of trader interest. **You will have some type of action around these levels** that can range from a clean test of the level to price whipping around the zone.

The key is to have a trading strategy that sets up what you are looking for and how you are going to trade it.

- What type of price rejection are you looking for?
- Where will you place your stop?
- Will you use other tools to help in your decision?

Just remember that ranges end and a trend will begin. Before that happens, taking trades while in a trading range can offer up another opportunity for those looking to make money in the markets.

Using Range Trading Indicators

Trading indicators can aid in your decisions and when trading ranges, oscillators can have a place as part of a trading plan. Let's look at the slow stochastic trading indicator as a tool you can use when looking to trade the extremes of the range.

The extremes are marked by the circles but you can see later that the top gets exceeded in a breakout failure type of action.

At "A", price pushes into the extreme and sets up a reversal candle. The indicator plots into the overbought area **(not a signal by itself)** and you have a shift in momentum which is shown by the cross of the indicator lines. It's a combination of each event that may/may not constitute a trade.

Price drops to the lower extreme at "B" and you get an engulfing candle, an oversold indicator plus a momentum line cross.

Is "C" close enough to the new extreme put in at "A"?

Is there a reversal type of candle pattern?

Is there a slowing of momentum seen in price?

Besides the indicator position, I don't see much enticing with this trade especially since **price action did not show any sign of a potential reversal.**

Finally, at "D" price pushes to the new extreme, shows weakness while the indicator is overbought and you see a momentum line cross.

The indicator is part of an overall range trading plan and should not be the only variable you use for making a trading decision.

Range Trading Strategy Outline

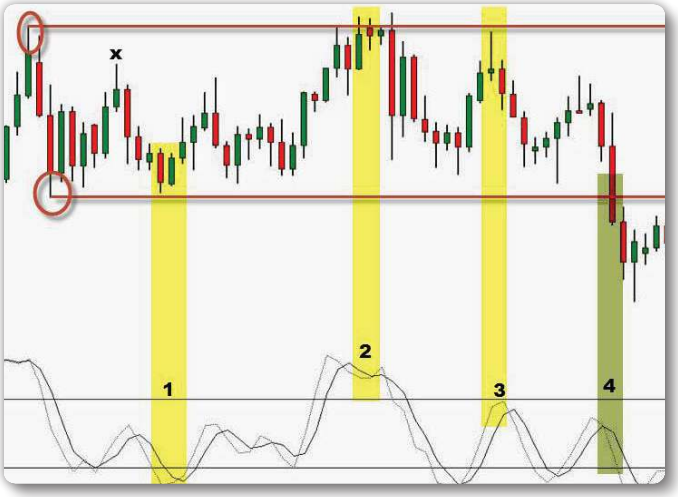
Simple still works in trading and the key is discipline and consistency. Without those, any type of success will be short lived regardless of the merits of your trading system. As you head into the trading strategy, keep in mind everything you've covered up to here.

Find Our Trading Range

Trading ranges are formed with support and resistance zones. You can look for current ranges or find trending markets that are starting to slow down. Ranges turn to trends and trend turn into ranges.

I also consider pullbacks a range in the general sense but those won't be a covered topic here.

This chart has an uptrend in play and then price started to pullback. The high is marked off and once the pivot low is in place, that is marked as well.



For the trend to continue, you need to see a higher high. If that does not develop, you can start thinking of a range play. The chart shows that price didn't advance into a trend continuation after the low as you put in a lower high marked "X" but fail to make a lower low.

I choose a not so perfect example of a range as showing perfection is always easy to do.

Location Of Price

With the extremes of the range marked off, you now have areas where you can monitor what price does and if you have a trading opportunity. In our example chart, the yellow highlights areas of interest.

Price revisits the low. Indicator is oversold. Momentum line cross. Inside bar candlestick.

High is tested. Consolidation below extreme calls for caution. Candlesticks start showing a lack of momentum and inside pattern. Indicator oversold and cross.

Price fails before an extreme test. Indicator not in the overbought zone. Good reversal pattern but no trade.

The indicator in the middle zone. Bearish momentum cross. No reversal pattern. Price breaks through extreme.

Quick strategy recap

We needed price to make an attempt at the extremes. When that condition was met, we wanted to see an oversold/overbought indicator position. A bullish/bearish momentum cross helped build our case for a trade and then we needed to see a reversal pattern in the price action.

Place The Protective Stop

You would think that placing your stop just outside of the extreme would make sense. After all, you often read that you should place the stop where you would be proven wrong.

The problem is that you can have the extreme broken and the trade (and range) is still valid.

Think back to the expanded range chart and you can see that the range play is still a valid trading opportunity.

The range still exists but with different extremes.

There is a pattern called a failure test that needs to break an extreme and can take you out of your current trade when you should actually be getting into a trade.

What about a distance away from the extreme? How far is far enough?

Given that most people base their position size on their stop size, this could lead to very small positions or, depending on the market and your capital, no trade.

Inside the range? Thinking about where the majority of people put their stops (textbook stops), where do stop runs usually go?

If you know that most traders use either the extreme or a little bit beyond, those that can run the stops know that as well. Depending on the market and trading volume, a stop run could have traders exiting at prices beyond their stop due to slippage.

Stop orders once triggered turn to market orders to be filled at the best price.

If you were short from the extremes and your stop was placed just outside the extreme, you'd be taken out before the trade is able to mature. If stopped out, this trade may have had slippage giving you a worse risk profile than you planned for.

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If the price is going to come close to the extreme, it is probably going to test the extreme and slightly beyond. A stop just inside of the extreme will have you out of the trade before the stop runs trigger.

The fact is there is not a perfect location for the stop that will still allow an optimum position size.

Thinking of yourself as a risk manager will aid you in your stop placement decision.

Range Trading Blueprint

How you end up trading ranges is going to depend a lot on the type of trader you want to be. There are a few important variables to pay attention to however it can be simply summed up with:

Find the extremes of the trading range. Look for signs of reversal. Take a position and manage it.

Whether you are range trading Forex, Futures, or any other market, the basics that were covered here apply. Take your time, test, develop your trading plan, and be consistent with how you have chosen to trade.

DID I JUST CALL THE BOTTOM?

by Ron Weiland

I remember the day, Wednesday, January 20th about 12:30 in the afternoon. I was at the gym on an elliptical machine, flipping between Fox, and CNBC. The Dow was down more than 550 points at that time, mostly because Oil was selling off again. The Market has been down so much this year and seems very erratic. How can you profit in markets like these?

Well let me show you a few charts. I was not looking at any charts when I called the bottom of the market. As I said, the Dow was down 550 points and had pulled up to about minus 520, and then it went back down and tested and broke to minus 560. As soon as it improved to minus 540 again, I grabbed my phone and placed an order to buy the DOW. I was filled at 15395 and rode it up to 15684. That is 289 ticks on the Dow at $5 a tick, per position. A very profitable afternoon. Let's start out by looking at a daily chart and see how that looks.

As you can see, on a Daily Chart, Counter Punch called the Market sell off on January 6th and had a very nice trade. Currently, it is long, but it looks like my call of the bottom of the market will hold. I was crazy lucky and don't recommend you trade without charts. So, let's take a look at a 5 min chart and see how Counter Punch gave you some nice day trades.

That is a nice looking chart. A short signal about 10:30 AM NY for a very nice win, then another nice short, with the bottom of the market call trade just before 1 PM. There might have been a small loss if you did not adjust your short entry from 15409 to 15399, a wise move with the large swings. Even if you did not adjust your entry, you only lost a few hundred ticks with 3 positions. You would be up over 700 ticks, which is $3500.

Understand that the markets have been crazy, but we don't care if they go up or down, we make money most every day in our trade room. Let me show you one more screen shot of today's morning Dow Trade from the trade room.

A very nice "One and Done" Trade, and we made our money for the day in the first 5 minutes. This is called **Power of Quitting** and it allows you to pull money out of the market almost every day, with very low risk and with not having to trade all day. Can you think of a better way to trade? All of the numbers for the entry, stop and target are displayed in the data window. In addition, you can see the "Entry Plus" and Money Management Dots, on the chart, so you know exactly what to do and where to move your stop and trail the market up. Plus, with the live trade room, we are talking you through the trade. Saying things like, "OK, get ready for a long trade. There you go, place your entry at 16246 and your stop at 16213". Once it hit Money Management at 16273, we took all risk of the trade and moved the stop up to lock in a tick. There is nothing like a risk free trade and then you go on to make 42 ticks to target 2 and then trail out for another 23 ticks. If you want to trade more you can, but we trade one winner and done. Here is the next trade in case you tested and wanted to take two wins and positive.

This would be the second trade, if you took it. Notice that the first short trade was very Dim in Color. That is because it was filtered out due to our Directional filter. Now looking at the chart, the directional (the red and blue color line) changed to Red and so the setup became valid, but it moved to Target 1 (dot) before we could get in, so we passed on that trade. The Second short, worked to Target 1 and took all risk off. Then the trailing stop moved down some more and locked in 22 ticks on the trailer, so another winning trade and winning day.

If you have not looked at Counter Punch, you need to register for a webinar or come to our live trade room. I can get you a 1 week free trial at the link below. The Dow is a great market and you can trade it with a small $5,000 account. Risk is low at $5 a tick, so if you do lose a trade your loss is small, around $195 on the trade above, so that is a low total risk percentage on a $5,000 account. You will have losses, but with our plans, you will have a serious edge in the market and win much more than you lose. Here I showed you 3 different time frames and they were all winning days. Sign up for the trade room at the link below and watch us guile you through our system.

http://netpickssignalservice.kajabi.com/sp/15335-ptu-training-room-1-week-trial

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WOULD $3500 OF EXTRA PROFIT INTEREST YOU, SEE HOW WITH THESE 2 EASY STEPS!

by Mike Rykse

Looking for an easy way to increase your trading profits? There are a few easy steps that can give your bottom line a boost. In fact, these steps should be followed by everyone regardless of account size or experience. It's always amazing to me when I get a monthly or year end broker statement just how much money I spend on trade costs. In the heat of the battle paying $1 per options contract traded doesn't sound like a lot. However, add that up over thousands of contracts over the year and it's a significant number. This is why you should do your best to negotiate your commission costs on a regular basis. We will talk more about that in a moment. The second area that you can focus on is trade execution price. Being picky on your order prices can also add up to big savings at the end of the year. **These two areas are crucial to address if you want to improve your results. Let's take a look at how it's done.**

Commissions are a necessary evil in the trading game. We have to pay someone to place our trades each day. In many cases, newer traders research different brokers to find out who has the cheapest rates. The problem kicks in when you just accept the standard rates posted on a broker's website. There are so many choices for brokers these days that it has become a very competitive landscape. As a result, brokers are willing to bend over backwards in many cases to attract new customers or to keep existing customer happy. I recommend you contact your broker at least quarterly to negotiate your commission rates. In many cases they are willing to do just that. For example, TD Ameritrade charges around $10.00 + $.75 per contract for a standard commission rate for an options trade. I have students that have negotiated this rate down to less than a $1.00 per contract with no ticket charge. This can be a huge savings over time. In this example, by getting rid of the $10 ticket charge you are saving $1000 in the first 100 trades alone. Not too bad considering all it takes is a phone call to your broker to negotiate your rate lower.

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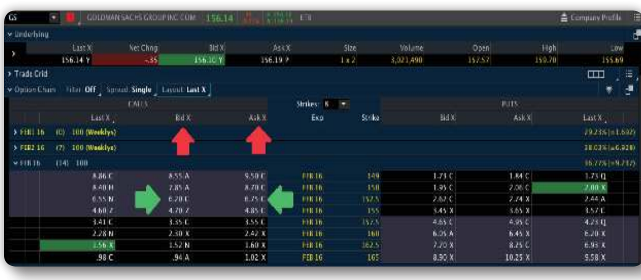
The second area that can lead to easy savings is in your order executions. My main area of focus in my personal trading is the options market. Options are great products to trade because of the flexibility that they offer and the great liquidity that is found in many stocks and ETF's. Like all other markets, there is a bid price and an ask price when trading options. The difference between these prices is known as the bid/ask spread. Often times, traders will go in and just pay the full 'ask' price when buying an option. This is an easy way to get a quick fill on a trade. The problem is that by doing this you could potentially leave thousands of dollars on the table over time.

Let's take a look at an example. Let's say we are looking to buy a call option on Goldman Sachs (GS) to play a move higher in the stock. We go into our broker platform and see that the 152.5 call is trading for $6.20-$6.75. This means the bid price is $6.20 and ask price is $6.75. There is a $.55 difference between these two prices. This is the bid/ask spread. If we wanted to pay full price to buy this call we would pay $6.75 or $675 per contract. The problem is that we could potentially get filled at a cheaper price.

I like to teach my students to try and place their orders at the mid price between the bid and ask. We just mentioned there was a $.55 difference between these prices. If we try and split the difference we would place our order to buy at $6.50 instead of $6.75. **This would give us a $.25 savings or $25 per contract!** All we did was change the price of our order.



Why wouldn't we do this every time? The problem with this approach is that by placing the order closer to the mid price we aren't guaranteed an instant fill. We might have to let the order work for a few minutes before getting in the trade. Some traders aren't patient enough to do this. In my opinion, it's well worth the time. If we aren't filled at the mid price, then we can adjust the order up by $.05. We would still be saving $20 per contract.

If we add up a $25 savings on each trade over 100 trades that's a $2500 savings right there. That is only on one stock. Start to do these figures on a watch list of 20 different stocks and you can see that this is a significant savings over time.

Sometimes we get so focused on finding the perfect system and perfect market to trade to try and boost profits that we overlook some of the basics sitting right in front of us. A simple call to your broker to negotiate your commission rate can lead to a $1000 savings over 100 trades (like we talked about earlier). Being picky on what price we place our orders at can lead to $2500 savings over 100 trades. This is based on trading one contract. **That's $3500 of extra profit that you could add to your trading account.**

So why don't we all do this? Most people don't feel comfortable negotiating for anything these days. If it could lead to confrontation, most people will run the other way. Just remember the broker is there to serve you not the other way around. On top of that, most people don't have the patience to try and get in and out of trades at good prices. Working their orders takes time and many of us want things as easy as possible. The bottom line is that we are all trading because we want to make money. These are easy ways to help you make more money with very little effort. I would highly encourage you to take advantage of these ideas and enjoy the boost to your bottom line.

GENETIC OPTIMIZATION IN TRADESTATION

by Will Feibel

Automated back testing can be a great time saver for us traders. Although an automated test will miss many factors that are in play during live trading, such as news event, significant support/resistance levels, session highs and lows, it helps us narrow down the universe of markets and time frames that will work best with our system. Treat it as a prospecting tool to identify your best candidates and then perform manual back tests on the best of those to come up with more accurate results.

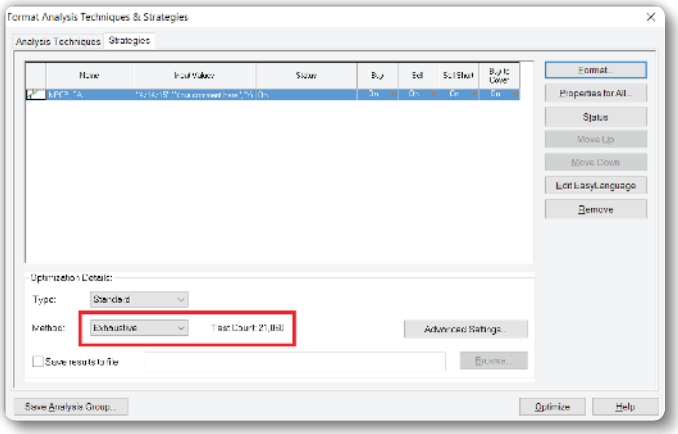
Exhaustive Optimization

When we use automated back testing one of the first decisions we are faced with is whether to optimize input variables one at a time or in combination. Testing them one at a time helps us identify ranges of profitability in the variable being tested. For example if we test the length of a moving average between 9 and 36 we may find that the range of values between 15 and 23 all give us a good results. This indicates a robust performance in this range and may lead us to select the midpoint of the range. After repeating this process for all the variables under consideration we arrive at a solution that should prove stable.

Testing the input variables one at a time also greatly reduces the total time needed by the computer to complete the test. I ran a sample back test with five separate input variables and the automation only had to run about fifty tests in total. The test was run on six months of 377 tick data in the crude oil continuous contract.

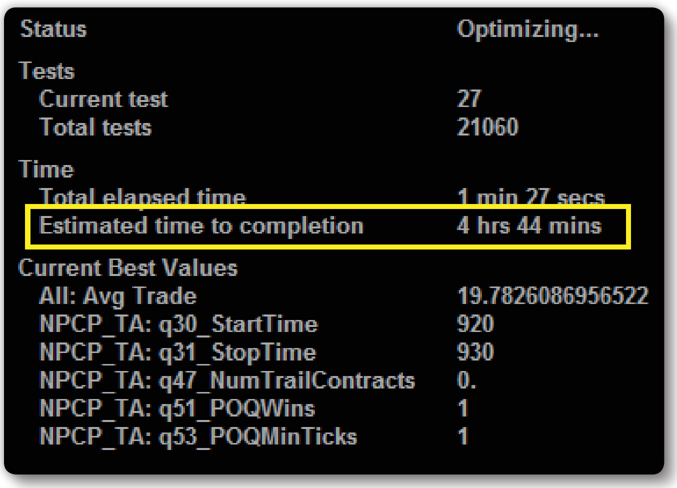
The risk with this approach is that complex interactions between the input variables may not be factored into the testing. For example if we test a moving average crossover the individual results may indicate stable results when the first moving average length is between 15 and 23 and the second moving average length is between 70 and 85. When we test the two variables in combination however we may find that the system has best overall results when the moving average lengths range between 28 and 32 for the first and 45 and 50 for the second. Testing the variables individually would have completely missed this convergence zone.

The drawback of testing the input variables in combination however is that the number of tests performed by the computer increases exponentially. In the five input test described earlier I found that the total number of tests increased from fifty to over 21,000 with a commensurate increase in the time it took to run the tests. Below you'll see the "Format Analysis Techniques & Strategies" window with its default optimization method of Exhaustive.



Default Optimization Method – Exhaustive

The next chart shows the beginning of the optimization run. Note that the time to complete all the tests is nearly five hours. This of course will vary depending on your computer.



Duration Estimate for Exhaustive Test

To address the problem of exhaustive simultaneous testing of multiple variables we can take a look at genetic optimization.

Genetic Optimization

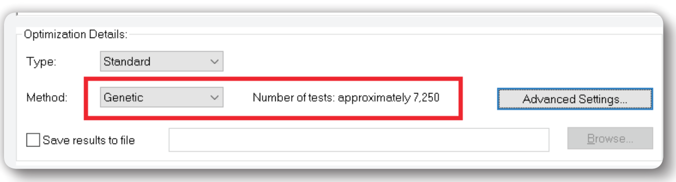
Genetic algorithms have been around for decades now and have been used to solve complex problems in the sciences. These algorithms are based on the concept of inheritance, mutation and evolution. An initial set of testing chromosomes are generated randomly, then they are tested over a number of generations and the result of succeeding generations is culled so that only the best set of chromosomes survive by the last generation.

Let's see how this applies to genetic optimization of a trading system test:

- The chromosomes are the combination of input variables to be tested. In our example we are testing five input variables so each chromosome has five elements.
- We define our fitness function. This is the result that we want to optimize and could be net profit, profit factor, average net trade, return on capital, etc. To set the fitness function click on the View menu, select "Chart Analysis Preferences" and go to the Strategy tab.
- We randomly create an initial set of chromosomes by assigning random values to each of the five elements. Each of these values is taken from the optimization range we set for the input.
- Each chromosome is tested and the next generation of chromosomes is created by selecting those that best fit the fitness function and combining them to create children for the next generation to be tested. The chromosomes with the worst results are culled from the population and do not reproduce into the next generation.
- Mutations are introduced by randomly changing the values for some of the children chromosomes.
- The process is repeated for each new generation until either the last generation is reached or no further improvements are found for a predefined number of generations. The TradeStation default, if selected, is to end the optimizations if no further improvement is found after 15 generations.

The above is a bit of a simplification of course. The TradeStation literature explains that during the optimization areas of n-dimensional stability are also identified so that the final optimization result is not a single peak of profitability that is purely curve fitted. You can read more about it in this article.

To use genetic optimization you first change the optimization method in "Format Analysis Techniques & Strategies":



Select Genetic Optimization

Next we need to initialize the genetic optimization methods. The easiest way to do this is to click the "Advanced Settings…"

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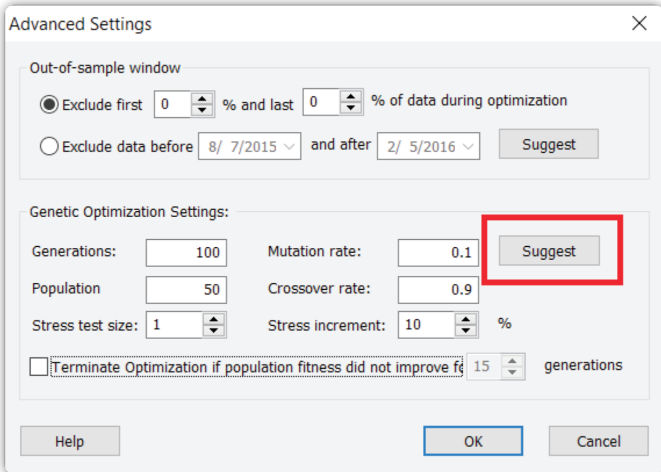
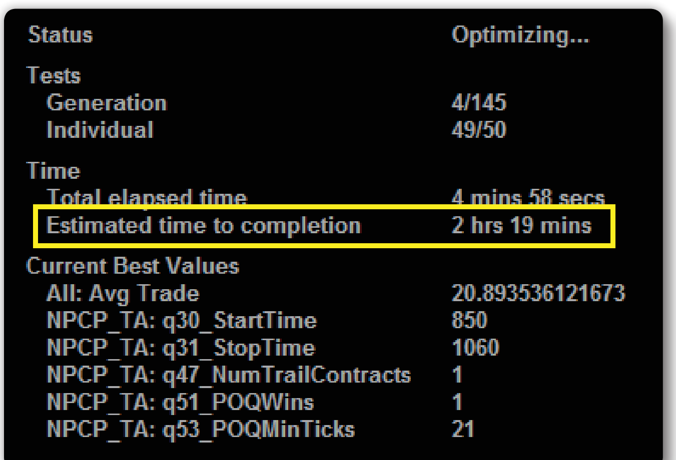
button to open the corresponding window and then clicking on the Suggest button as seen below.



Press "Suggest" to Initialize Genetic Optimization Settings

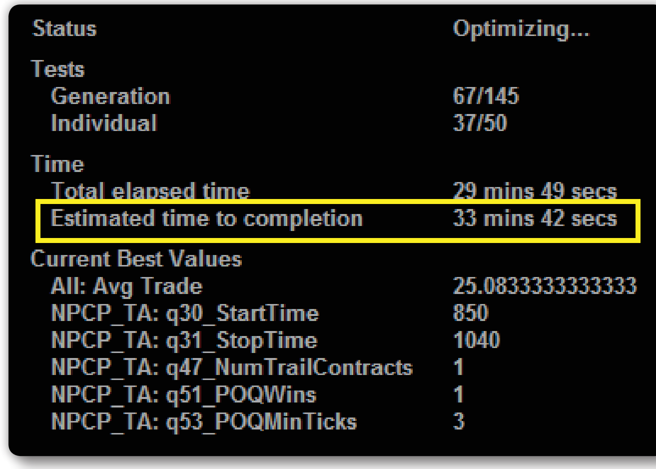
You are now ready to start the genetic optimization. You'll notice that the optimization status display is slightly different. You're presented with two values for the test. The first indicates which generation is currently being tested and the second shows which of the chromosomes within that generation is currently being evaluated. The first thing that stands out after a few tests is that the initial estimate for completion time is half of what it was for the exhaustive test.



Initial Genetic Optimization Estimate

This still seems like a long time but what you'll find as the genetic optimization continues is that the progress accelerates. It accelerates because as the generations progress the chromosomes start to converge around an optimal set of values and fewer tests are needed to progress to the next generation. The next picture shows that half way through the generations the total time estimate for the genetic optimization run has already been halved.

In the end the genetic optimization run took only 44 minutes. I've run other more dramatic tests. One particularly complex test with numerous input variables had an exhaustive test estimate of 3 ½ days. Using the genetic optimization it completed in less than two hours.



Genetic Optimization Estimate at Midpoint

Is This the Holy Grail?

Genetic optimization is a very efficient method of simultaneously testing a large number of input variables. Based on shorter tests that I've run its results are usually very similar to the exhaustive optimization results. Unfortunately it shares the same problem that all multi variable tests have and that is curve fitting. The results are optimized for the six months of 377 tick data covered in my test but if that data were slightly different then the optimal result would also have been different. Given that market conditions change based on news events and seasonality this can easily result in disappointing forward testing results. There are a few things that you can do to reduce the risk of curve fitting:

- Exclude a portion of the available test data from the optimization. A good rule of thumb is to only perform the optimization on two thirds of the data and leave the remaining third for the out of sample test. There is an easy way to do this in the Advanced Settings window for the optimization (see the picture above). You can specify a percentage of data to exclude either at the start or end of the sample or you can simply specify a date range to exclude from the optimization. The easiest way to do this is to use the Suggest button in the Out-of-Sample settings.
- Optimize over short time frames and perform rolling optimizations every month or every couple of months. This will tune your system based on the recent performance of the market. We all know that news and seasonality affect markets. It is unreasonable to expect similar performance during the end of year holiday season as during the spring or in the aftermath of major news that directly impact your market.
- Combine both of the following approaches and perform a walk forward optimization. A series of optimizations is performed over an in sample period and both in sample and out of sample results are recorded and evaluated. The test period is rolled forward and the optimization is repeated until the sample data is exhausted. This approach gives the best picture of how the strategy will perform with live data over a period of time. TradeStation has a walk forward optimizer built in and we will cover this approach in a future article.

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- Perform a Monte Carlo simulation. In a Monte Carlo simulation not only are the input variables tested but the underlying test data is also randomly altered (within constraints). Data drift and randomness are added to the data to reflect the uncertainty of future market prices. Multiple tests are run using slightly altered test data so that the risk of fitting the results to a particular set of data values is greatly reduced. TradeStation has Monte Carlo analysis built into its walk-forward optimizer, but again that is a topic for a future article.

Back testing is fundamental to developing a profitable trading strategy and we need to use the tools at our disposal to facilitate that process. Automated back testing is one of those tools but it does have its limitations as we've seen. Understanding these tools therefore helps us be more effective traders. We'll conclude this two part series with a discussion of the TradeStation walk forward optimizer in a future article.

ADVANTAGES OF EXCHANGE TRADED FUNDS FOR INDIVIDUAL INVESTORS

by Brian Short

If you're tired of the low rates of return and high costs of buying mutual funds, you have an option. Exchange Traded Funds (ETFs), are a great way to invest for your retirement, 401k, or trading account. With a higher performance rate, and low to no cost in commissions, it's time to take a hard look at ETFs to boost your investment portfolio.

The transparency of ETFs is clear, while trying to figure out what you are actually invested in with a mutual fund requires careful scrutiny. With ETFs, you don't run the risk of overlapped investments in the same company. With a mutual funds, you may learn that you are actually over invested in one particular company, simply because both funds have purchased their stocks. ETFs give you a true picture of where you are investing your hard earned dollars.

When you don't have a ton of money to invest but you want to start saving for your future, ETFs don't require a minimum investment. As long as you have enough money to purchase one share you can get started with ETFs and spread your money throughout a large variety of companies offering. This lowers your overall investment risk and allows you to invest in just about anything.

One major advantage are the low fees. The SPY which is the S&P500 ETF has an expense ratio of just 0.09%. The PowerShares QQQ which trades the Nasdaq 100? Just 0.20%. You can see why this is such an advantage. Compare that to most mutual funds or even worse actively managed portfolios and the savings can be significant.

ETFs provide you with certainty. Traded like stocks, ETFs are bought and sold at a specific price, and not simply valued at the end of the day. When you sell a mutual fund, you are guessing at the overall value. It's easier to watch over an ETF and understand when it is in your best interests to buy or sell.

Investing for your future doesn't have to be complicated. When you purchase ETFs, you are giving yourself another potential source of revenue that is affordable to invest in and has low risk options for the investor.

Remember, there is always risk with trading and if you trade the NetPicks way we always are sure we know our exit strategy. Never enter a trade without knowing exactly how you intend to exit. Our preferred way to trade ETFs however is not on a day trade and not in and out typically. We plan on launching an ETF Investor service soon and you'll get to learn how we've started to trade these instruments. You'll see why we think it is a vast improvement over typical Buy and Hold or Mutual Funds.

Look for more details on our NetPicks ETF Investor very soon!