Common $ense Commodities

"A Common $ense Approach To Trading Commodities"

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Charts Prepared Using Track-n-Trade Pro

THERE IS A RISK OF FINANCIAL LOSS IN TRADING FUTURES AND OPTIONS

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Forward written by
Lan H. Turner, CEO of Gecko Software, Inc.

It is my pleasure and honor to be asked to write the forward for Common Sense Commodities. David has been working closely with Gecko Software Inc. in providing new and experienced traders with a further understanding of the futures and commodities markets. It is a rare individual who can take their trading talents and not only capitalize on them for self gain, but to also put them into a simple to understand and enlightening educational format for all to learn from.

David is not simply the author of a book; David has turned his vast trading knowledge and experience into an educational course, loaded with examples, charts, and in depth detailed personal experiences.

David is truly a genius at work, and it is an honor to be associated with him, his course work, and his materials. Anyone who might have the opportunity of spending time with David, and learn from one of the masters, is certainly in for a knowledgeable and pleasurable experience

Good luck.
Lan Turner
CEO Gecko Software, Inc.
Logan, Utah USA

Lan Turner was the primary designer of the well-known futures charting application Gecko-Charts and the Author of the multimedia CD-ROM seminar Track 'n Trade. Mr. Turner has been a champion of futures trading since 1995 and loves teaching people of the great opportunities found in trading commodities Mr. Turner resides in Logan, Utah.

Statement of Purpose

The purpose of this course is to teach you the basic fundamentals of trading commodities, but I will also go into more advanced material after covering the basics. This course has one purpose; to teach you to be a profitable trader. It is my intent to make this the most through trading course on the market yet easy to understand. Common Sense Commodities has been rated the #1 course to learn to trade.

I'm going to have homework assignments in this course at the end of each chapter like I did in my other courses. Do not skip this. Do your homework! You will also be instructed to watch a specific video as you go through this course. The videos are designed to visually show you how to apply the different techniques in the course. Again, just like your homework assignments; watch them.

As you will soon discover, all the charts in this course were done with Track-N-Trade Pro and Track-n-Trade Live from Gecko Software. As a subscribing student, you will get lessons from time to time via e-mail that I have done in Track-N-Trade Pro. If you own this software, you can open these lessons on your computer and update the lesson with live data every day.

I will be doing analysis on many different timeframes; 5, 15, 30, 60 minute as well as the "daily" charts. Most everything you will learn in this course can be used on any time frame listed above. Of course the risk, goals and strategies will be different for the various timeframes.

David Duty,
Boquete, Panama

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Comments from Other Students

Each topic was very thoroughly covered. I also feel that your choice on the technical analysis selections was right on. It's taken me YEARS, not to mention thousands of hard-earned dollars, to learn what you are offering your students with this manual. I am very pleased with this course. The foundation is in place to really bring something new to traders. Your chosen direction is right on mark.

Raghee H. - (Full-time Commodities Trader) - Coral Springs FL, USA

I'll take this opportunity to drop you a word of thanks for a ton of knowledge I picked up in your class. I am a full time trader, and in my three years of trading with a lot of hours and money invested and lost in numerous courses, nothing beats your course. The truth of the matter is it's very easy to understand and if you apply the concepts learned, there is no reason why one shouldn't have a competitive edge required to trade efficiently. In my case, it is everything I've always searched for.

Peter L. - Denver, CO USA

I thoroughly enjoyed the class, I thought it was very informative, gave me a great foundation to build on, and instilled a sense of confidence and a willingness to learn further, or, to say it another way, it demystified the commodities markets to some extent. I have been paper-trading since taking the class and at least on paper, have had winning trades, or the underlying commodity actually went in the direction I thought it would.

Bruce K. - Longmont, CO USA

The pamphlet I received in the mail from another commodities trader made it sound like I would be smoking cigars and wearing a Stetson in no time at all if I took his course and followed his teachings. Wrong! It was no more than a basic introduction to the market. Then I discovered "Common $ense Commodities", and really learned how to trade the market.

Mike K. - Denver, CO USA

I have finally fallen into somewhat of a routine for watching all the charts. It takes me about an hour, depending on how many interruptions I have of course, but at least I'm getting through them.

Comments

I know I've said this before, but I can still hardly believe how easy your system is!! There are some things that I'm still having problems with (figuring profits/loses) but I read your book again this past weekend, and more of the techniques have gotten easier to recognize.

This morning, I found 8 trades to put on (paper-trading), and that amazes me. Last week I put on 18 paper-trades, of which 16 completed the formations, and I would have been in the market/in a contract. Of those 16, NONE were losers. That just really amazes me. NONE were losers.

Terry S. - Colorado Springs, CO USA

I lost $300 in the actual trading of July wheat for the period of 1/5 - 2/23 by just using 123 bottom and trailing stops according to the instruction by TWMPMM course. But, after reading the chapter of "Ascending & Descending Channels" of your book, I reviewed the same trade of my July wheat, and realized that I would have made more than $1,400 by implementing the analysis in your textbook.

Masamichi Y. Chicago, IL USA

This is the best course I've taken so far, because it is so comprehensive. Had I started with this course, it may have seemed overwhelming. But having had some exposure to trading, your lessons made sense, and give very good value for the money. Like new formations. Blips. Like the 123 Top/Bottom rule, which makes a lot of sense. Also I believe your strategy for entering market that breaks out of a channel - or whatever, a blip, too - is incredibly wise.

Douglas M. Beverly Hills, CA USA

The seminar in Denver was well worth every penny and every minute. If you are serious about learning to trade, or improving your trading, I STRONGLY suggest you attend. David is not only sincere, but knowledgeable and helpful. The seminar drew an excellent group of people, also. I learned a good deal from fellow students as well. Where's the next one?

Larry S. Long Island, NY USA

David, before I comment on the seminar, I wish to say that meeting you and your wife was truly a pleasure. You both are a very caring and genuine people, concerned for your students and the people you meet. I feel privileged to know

you. I was very impressed by the extension of yourself to us, and making us feel at home in Denver.

The seminar was fantastic. I learned a lot. The new concepts and information will FOREVER change my future trades. Learning key concepts, such as: entering and exiting the market, charting and properly reviewing my Reward/Risk level, was key. After Saturday, I had a new level of confidence in my trading ability.

Finally, the limit of 10 students provided a very intimate atmosphere for us to both learn and interact. It was a great networking time to share past and future trades. I learned quite a bit from my fellow students. I truly appreciated the time I was able to spend with them.

Again David, THANKS. I received good value for my time and money and would never hesitate to recommend the seminar to any other person.

Chris M. La Palma, CA USA

For anyone who is considering going to one of David's' seminars, I just have one piece of advice- DO IT. It was a very rich and rewarding experience for me. David has a way of presenting the different facts of this business in a very clear and understandable manner. You will quickly see the gift that he has for teaching the material that he covers, and the genuine love that he possesses for it and the people that he is working with, you the student. The network of people that you will meet is worth the price of admission alone. Thank you David, and all the people that you brought with you, who by the way came on their own without monetary compensation, simply because they truly enjoy what they do.

Jim K. Corneal, NY USA

I was getting frustrated that my trades weren't working out overall, so I went to the seminar to try to find out why. It was very helpful, and I discovered some of the mistakes I was making.

David was eager to answer our questions and give us his time 'round the clock. The options day was great too. I have always shied away from options, because I didn't understand them. They are actually a great way to go in many markets,

and a needed strategy for my account. Thanks David. Just the networking alone was worth it.

Zachery R. Boulder, CO USA

Great learning experience. It was a dynamic seminar, with very knowledgeable leaders. David presented a comprehensive, two-day, "hands-on" program that was packed full of information and strategies.

I came away with a better understanding of how to read charts and use them to find better trading opportunities. The extremely informative session on options gave me super risk management and money management tools that I need for successful trading.

The most impressive thing about this seminar is that the instructors are experienced traders - They didn't give us "theory or sugar coated". It was straight from the shoulder, real world stuff!

Carole J. Oakland, CA USA

Well, I came all the way from Toronto, and it is was worth every cent. David is not only, knowledgeable, helpful, and caring, but a heck of a nice guy. I finally understood a whole bunch of concepts that had been very blurry before.

The second day on Options was also HUGELY informative. It was also very cool to meet 9 other students from around the world. I could go on and on and on about good stuff about the seminar, but it is 5:00 am, and a cup of coffee is calling my name!!!!

Keith A. Toronto, ONT Canada

Anyone interested on trading commodities should attend your seminar. There were no negative comments in conversations with other participants, only positive. I think you knocked yourself out to make sure that everything was perfect for us, including accommodations, meals, and transportation. The seminar was great in clarifying information I'd already read but didn't fully understand, in teaching new (to me) trading techniques, in gaining insight from other students. Most of all, you just have to "be there". The hands on experience is priceless.
Claudia W. St. Paul, MN USA

Introduction

I started trading a few years ago and have found that it's the most exciting business I've ever been in. Yes, I said business. It's not a game; it's a business. **If you don't treat it like a business, you are doomed from the start.**

This course is designed to help you learn to trade, but it, as well as all other courses out there, has its limitations. This course is a starting place, not an end-all. You must study the material in this book over and over until you grasp it, and then you must study and learn other techniques being taught.

In the reference section, you will have books to choose from to further your education. Each and every one has something of value. There are many ways to learn how to trade, and this course is just a starting place for most.

Some other people who sell courses will tell you that their course is all you will ever need to be a full-time, successful trader. Hogwash! There is no one course that will teach you everything you need to know in order to trade successfully, mine included. I do feel that this course has a vast amount of useful information. My students have told me that they learned more from this course than from any other course they have ever taken; some of which cost several times as much.

Get in or Get Out

"If You Can't Get 100% Into What You're Doing, Then You'd Better Get 100% Out of What You're Doing." (Quote from Zig Zigler)

Before I learned (yes, I said learned again) to trade, I had several different businesses. Some were successful, some not so successful, and some went straight down the tubes along with more money than I care to remember. Then, one day, I looked at what I was doing with my life, and discovered I wasn't happy, wasn't satisfied, and I wasn't making any significant money. Ever been there? It's called "burnout." That's when I decided to get 100% out of what I was doing. But I didn't think I had many choices at the time. Little did I know that my life was about to change, and change in a big way.

Introduction

I was introduced to trading through an offer in the mail, and like many others, bought a mail order course. I learned enough to be dangerous. I thought that was all I needed to know because the author told me that his course was "All I ever needed to know." Boy, oh boy, was I wrong. I hadn't even learned the basics but jumped in anyway and started trading. I won't go into all the details, but I will say that I "paid" over $10,000 for that $200 course. This is one of the reasons I wrote, and teach, this course: so that others don't do the stupid things that I did when I first started trading.

I later learned that the person who put out that course was a great promoter, but his trading methods were a far cry from what someone needed to know to trade for a living. I then went to work reading and studying everything I could about commodities. I invested the time to learn. I invested in good books. I invested in good tapes, good videos, and spent a year studying and paper-trading. Paper-trading is simply trading an account on paper, without using real money. It's a great learning tool.

What I found is that most of the books and courses talk about many of the same things, they just explain it in a little different way. That's when I realized that there are some basic principals, rules, if you will, that anyone can learn, and once you do, like others before you, you can become a successful trader.

The intent of this course is to teach you many of the basics, and to give you a good foundation to build on. Learning anything is a continuing process, and the longer and harder you work at it, the better you become.

I hope you enjoy and learn from this course. It has been an ongoing "labor of love". I want to give special thanks to my wife Ludmila, who has kept the coffee hot for me on many a long night while I wrote this.

If you have comments and/or suggestions on how I can improve this course, please let me know. There is also a little questionnaire that I have included with the course. If you could fill it out and drop it back in the mail to me, I would appreciate it greatly.

There is a risk of loss in trading futures and options.

Commodities Yesterday-Today-Tomorrow

Yesterday

Back in the mid-1800's, the McCormick reaper was invented, which greatly enhanced the production of wheat in America. About the same time, Chicago was becoming a major commercial center. Wheat farmers from across the country were coming to Chicago to sell their wheat to the grain dealers, who then sold it to commercial buyers all over the county.

At that time, Chicago had almost no place to store wheat and had poor methods for weighing and grading it. This left the farmer at the mercy of the grain dealers.

In 1848, a central exchange was formed where farmers and dealers could meet to deal in "spot" grain, which is selling wheat for cash and immediate delivery.

Soon after this, farmers and dealers began to deal in "futures contracts." This simply means that the farmer (seller) would contract with a dealer (buyer), to deliver wheat at a specific date in the future for a pre-determined price. Hence, the name "futures" trading evolved. This worked well for both parties, as the farmer knew in advance how much he was going to be paid in the future, and the buyer knew his future cost beforehand.

These contracts became so common that banks started to take them as collateral for loans. Sometimes the farmer might not want to deliver the wheat, and would sell his contract to another farmer, who would take on the obligation to deliver. Other times the dealer might not want to take delivery, and would sell his contract to someone who wanted to take delivery. Before long, speculators, who saw an opportunity to buy and sell these contracts, hopefully at a profit, came into play. These were the first commodities "traders" as we know them today, and they had no intention of ever taking actual delivery of the wheat. They began trading these contracts among each other, hoping to buy low, and sell high, or sell high, and buy low.

Today

If you start to trade thinking that you are going to get rich overnight, you'll probably lose all that you invest.

Commodity trading is a business like any other, and must be treated like a business. If it is not, you won't see success. However, if you are diligent in your studies, and have the persistence and fortitude to learn what's needed, this can greatly contribute to your success as a trader**.**

Becoming wealthy in the commodities business is not uncommon. Many people have done it before, and many more will do it in the future. Even if you don't have a lot of money to start trading with, you can still be successful. Richard Dennis, as an example, borrowed $1,600 and turned it into $200 million dollars in about ten years. He didn't do it overnight and without tremendous effort. He studied, applied himself, and made a plan, and followed his plan exactly.

Millions of dollars have been lost by people who enter the commodities market without sufficient training with the idea of getting rich overnight. When they don't get rich, and even worse, lose all their money, they blame the commodities market itself. The person they should blame is themselves. This accounts for the negative stigma associated with commodity trading. Many people see it only as a form of gambling. In some ways it is, but we can stack the odds in our favor.

Trading commodities is different than trading stocks. When you buy a stock, or a piece of real estate, you actually own it. When you buy, or sell, a futures contract, you are speculating on the future direction of the price without ever really owning anything. You simply own the right to buy or sell the commodity, at or before a future delivery date, at a pre-determined price.

As a speculator, this right to own is sold back to the market before delivery obligations are triggered. If you "buy," then you are considered "long", and are speculating that prices will rise. If you "sell", you would be "short", and speculating the prices will decline. In other words, you are trying to buy low and sell high, or to sell high, and buy low. We will be discussing this in detail later.

There are three positions in trading: long, short, and out. Most of the time the third position is the correct position, but it's not used often enough.

To understand how you, a speculator, fit into the picture, let's look at a commodity from start to finish. Now, put your farmer hat on for a minute, and hop on the plane to Wyoming. You're a wheat farmer now, and you planted your crop about three months ago. In a few months it will be ready to harvest. After careful analysis, you figured out that it cost you about $2.00 a bushel to grow it, including paying for your entire overhead. Anything you can sell it for over $2.00 a bushel is profit for you.

Let's assume that right now, wheat is selling for $3.00 a bushel, but the price has been going down over the last few weeks. Since it's going to be three months before your crop is ready for harvest, what can you do to assure yourself a profit on your crop? You are concerned that if the price continues to drop, in three months the price may be lower than $2.00 a bushel, which is what it cost you to grow it. Now what do you do? You sell your future crop by calling a commodities broker and selling a futures contract for $3.00 a bushel to be delivered three months from now, in December, as an example.

Your risk in doing this is that, if the price of wheat goes up to $3.50 a bushel during the next three months, you are going to get only $3.00 a bushel because you pre-sold it today for $3.00 a bushel. But, on the other hand, if the price of wheat drops below $3.00, you have locked in your price of $3.00 a bushel. You feel this is a good way to go, since the price of wheat has been going down, not up, in the last few weeks. This process is called "hedging." You have probably heard that term before.

When you called your broker to "sell" (also called "going short") a contract, he acted as a middleman, and helped find someone to "buy" (also called "going long") your contract. Now who would want to buy your wheat contract at $3.00 a bushel? It could be a large company, like Wonder Bread, who is buying wheat and is concerned that the price of wheat will go up, not down, three months from now, and they want to protect themselves in case of a price increase. Of course it could be a speculator who is looking to make a profit.

So you sold a contract to lock in your profits, the other person bought a contract to guarantee their price, and your broker, acting as a middleman, earned a commission for doing this, and you slept a little better that night.

Let's change hats again. You fly back home, and put your speculator hat on. You carefully analyze your charts on wheat, and, yes indeed, the price has been dropping, but it looks like the price is going to stop dropping and start to go

back up again. You think that in three months, it's going to be $3.50 a bushel, not $3.00 a bushel that it's selling for today. (You will learn later how to analyze charts to get a good idea where prices may head.)

You sense an opportunity to be able to buy a contract at today's price of $3.00 a bushel and sell it a few months later for $3.50 a bushel. If you are correct and the price goes up, you are making a profit on your commodities contract. When you buy the contract at today's price of $3.00, you are guaranteed that price by the person who sold you the contract. They must honor their end of the agreement, and sell it to you for $3.00 a bushel at the end of the contract, even if the price goes up.

On the other hand, if the price of wheat goes down, you lose money. How would you lose money? If the price of wheat three months from now is $2.50 a bushel and you agreed to buy it for $3.00 a bushel, you have lost 50¢ a bushel, for the total number of bushels in your futures contact, which in the case of wheat is 5,000 bushels.

The major difference between stocks and commodities is leverage. I'll show you what I mean. A contract in wheat is for 5,000 bushels. You don't actually buy or sell 5,000 bushels, you just control 5,000 bushels. You would put up a "deposit" with your broker for the right to do this. In the case of wheat, that "deposit" which is also called your "margin," is only $540. So $540 controls one contract for 5,000 bushels of wheat.

If you had paid all cash rather than buying a futures contract, you would have to spend $3.00 X 5,000 bushels or $15,000. This is the power of leverage. With a futures contract you still control 5,000 bushels, yet you only put up a deposit of $540 to do so. It's almost a 30-to-1 leverage in wheat.

Let's look at how much you would have made by paying cash for 5,000 bushels if the price went up

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Bushels purchased	5,000
Current Price	x $3.00
	_____
Total Cash Paid	$15,000

If the price of wheat went up to $3.50 per bushel, you would make 50¢ per bushel, or $2,500 profit (5,000 x 50¢). A 17% return on your investment in just 3 months. Not bad.

Let's take a look at what your return would be if you had bought a futures contract (went long), rather than paying all cash. Remember the margin, or deposit, on a wheat contract that controls the same 5,000 bushels is just $540. If wheat did in fact go up to $3.50 a bushel and you sold it, you would of course still make 50¢ a bushel, just like you would have if you had paid cash for 5,000 bushels, or the same $2,500. The difference is that you made a 463% return in three months with the futures (because you only put up a deposit of $540) verses a 17% return for cash. That's what I call leverage! This, by the way, is a huge move in the price of wheat and I used it only as an example.

Anytime you have the potential of making a profit, you also incur the potential of taking a loss. **Keep in mind that your potential loss is also leveraged**. In the example above, if the price of wheat dropped 50¢, to $2.50, you would have lost $2,500 (50¢ a bushel X 5,000 bushels). Now for the good news! You can in some ways limit your losses. In other words, you can stack the odds in your favor. There are several ways to do this, and you will learn about them as you go through the course.

Tomorrow

Many people who trade commodities are average hard-working people, probably a lot like you, who are just trying to supplement their income and trade on a part-time basis. Based on my experience, I'd bet that less than 1% of the speculative traders are full time.

There are basically two types of traders, although some people mix a little of both in their trading style.

The fundamental trader, or a fundamentalist, is someone who studies the supply and demand of a given commodity. They look at things like the weather patterns around the world, droughts or floods for example, that would affect the world's supply of a commodity like wheat. Remember that commodities are a worldwide market, not just here in the USA. As a fundamentalist, you might buy a wheat contract because you think there is going to be a drought this

summer in Russia, causing the price of wheat to go up because the supply will be down.

The technical trader, or a technician, bases his decisions on current and past market trends that are reflected on charts. Let's say that you are looking at a chart and you see that the price of wheat is the lowest that its been in 20 years. Based on that and other technical indicators, you might "go long" on a futures contract in wheat, thinking that the price is going up.

In this course, you are going to learn about technical trading. One of the advantages of being a technical trader is that you don't have to become an expert in the fundamentals of the underlying commodity. **Technical trading is trading based upon technical information found on the charts**. Let's say that you wanted to trade Cocoa. As a technical analyst you don't have to know anything about where Cocoa comes from, weather conditions, etc. That's why I like to teach people to trade using technical analysis.

When you are ready to trade, you can open an account with as little as $2,000. Don't expect to make much with a $2,000 account but you can certainly make a trade or two a month with this size account. I always recommend that you never start with more than $50,000, no matter how much money you have. The reason is, that if you can't learn to make money with $50,000, then you probably won't make it with $500,000 either. If you are doing well and want to add to your account later, you can do that, but learn to crawl before you walk, and walk before you run. Take it easy! **Learning to trade is a marathon, not a sprint**. Also, before investing any real money you must learn to paper-trade. This is how you practice and learn to trade. **If you can't make money "on paper", you can't make it with real money either. Also, don't invest more than you can afford to lose, and assume you will lose it all. If you can't live with that thought, then don't trade at all.**

You might find this hard to believe but when you first start trading, you'll probably spend less than 30 minutes a day, maybe an hour, on your trades. If you are trading on a full-time basis, you will spend two or three hours a day, more on some days and less on others. Until you start to paper-trade, you won't understand just how little time it really takes.

You might be wondering what kind of equipment and supplies you need. How about a telephone, a computer, and some inexpensive software? That's all you really need.

In this course, you will learn dozens of techniques to interpret charts. Once you learn to do this correctly, you could make a comfortable living in the commodities market. Some may even do much better.

You must learn to limit your risk to a level that is within your own comfort zone. You will be able to use several techniques to do this. Learning to control risk is equally, if not more, important than learning how to make profits.

Knowing when to take profits is a key to making a fortune in this business. If you don't know when to take profits, you can end up giving back everything you make. Even more important than taking profits is knowing how to control your losses. You also will learn some powerful techniques to do this.

Again, I want to stress that you must first learn to paper-trade. You can practice trading on paper without risking a penny. You can paper-trade for weeks or months if you like. **After you feel confident that you know what you are doing, and are consistently making money on paper, then, and only then, should you put real money in the market**. Trust me on this, as I speak from experience! I won't sugarcoat anything and I'll tell you right now that you can lose your shirt, your pants, your socks and your shoes, and no one but you will care.

Do you want a discount broker or a full-service broker? What is a fair commission to pay? How do you know if you've got a good broker? All of this and more is covered to some extent in this course.

You'll also gain a good understanding of how to trade by the time you finish this course. As a matter of fact, I think you'll know more than many people who have been trading for years!

I hope this course is just the beginning for you. Every day you trade, you'll learn a little more. You will also want to read a few good books from time to time**. The Reference Section contains a list of books that will help you increase your understanding, and supplement what you learn in this course.**

As a Student, you'll receive my personal support in several ways.

1. **Free phone support**: Feel free to call me if you have a question. I'll be happy to talk to you about what you are doing and will do my best to answer your questions. If I don't have an answer, I'll try my best to find one. (During your support period only)

2. **Forum**: We have a forum for questions as well as a chat room. The Website is also available to you as a Student. (During your support period only)

3.**Website**: I also have my own Website up that has lots of information to help further your education. You can find it at **www.commonsensecommodities.com.**

4. **E-mail**: You will also be getting a lot of e-mail support and ongoing training. (During your support period only)

5. **Seminars:** Several times a year I do a seminar and you can check the Website for dates and locations. As a student, you get a $200 discount.

An old Chinese Proverb says **"**A teacher may open the door, but you have to walk through it by yourself." I truly believe that I can open the door for you, but only you can walk through it. So, let's open that door, together, right now.

End of Introduction

Lesson One

Looking at The Markets - The Charts

There are three "views" for each commodity.

Monthly. The longest-range view is the monthly chart, which shows the price movement over the last 10 to 30 years. Each vertical line, called a "bar" on this chart, represents one month's price movement. **The monthly chart is very important to get a long-term view over a period of many years.**

Take a look at the monthly chart below. It shows the price of Silver over the last 20 years. The highest price paid was about $50.00 an ounce in 1980, and the lowest price was $3.80 an ounce in 1972.

Weekly. The next view is the weekly chart. It shows the same type information as the monthly chart, except it is for a shorter time frame and shows the price fluctuation week by week. Each "bar" represents one week's prices, just like the monthly chart represents monthly prices, but on a weekly basis.

The weekly chart will also prove to be invaluable in planning your long-term trades. Later, I'll show you how to use both of them.

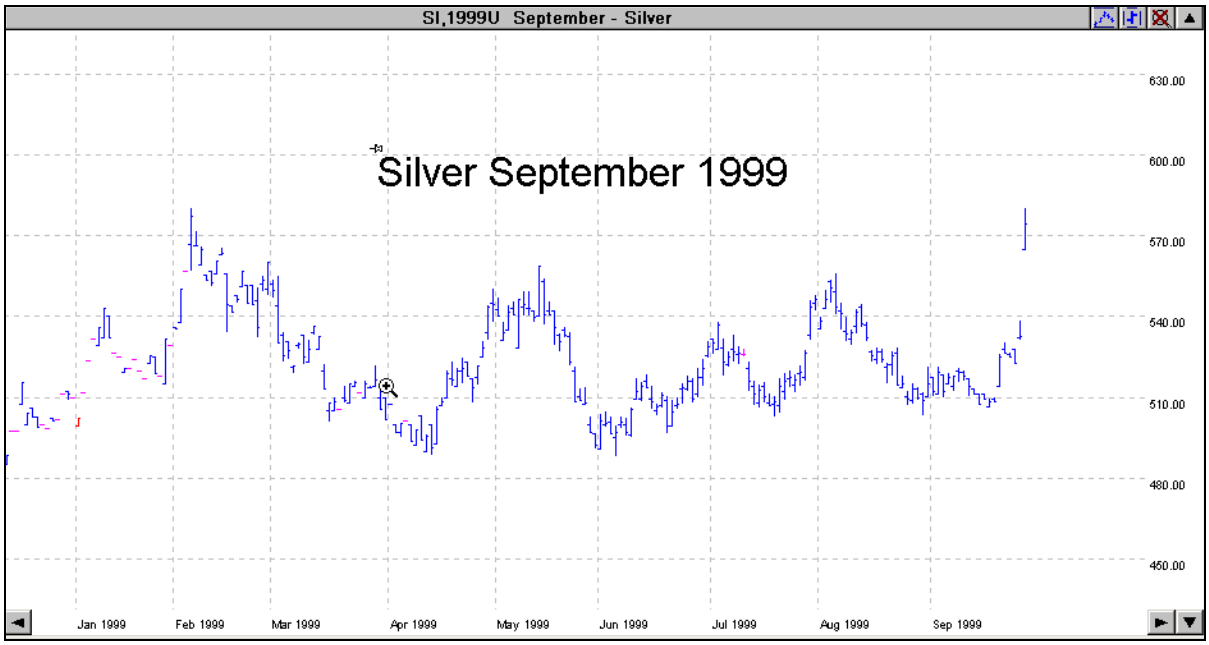
Take a look at the weekly chart for Silver below. As you can see, the lowest price on the chart is $4.20, and the highest price is $7.20.

Daily: Let's look at the daily chart for Sept 99 Silver on the next page.

Each commodity trades in a specific contract month (see Reference Section for a list). This particular chart is for September 1999 Silver. This means when you place an order for Silver, you would instruct the broker which contract month (delivery month) you wished to buy or sell a contract in. As an example, the following Silver contract for September 1999 Silver started trading back in July 1998 and expired 14 months later.

Delivery months for each commodity are in the Reference Section.

Now, you might want to trade another contract month that is "further out," a more distant month, like December 1999 Silver. The delivery month is the month that you are contracting to either deliver, or take delivery, of the commodity. (As a speculator, you will never take delivery, though.) We will discuss the pros and cons of doing this later in the course. For now, I just want you to understand the different "views" that you can see of a particular commodity.



There are a few terms that you will need to become familiar with. Most of these will be shown in the legend of the chart. Gecko Charts has this listed and is available at a click of a mouse.

While I'm thinking about it, every chart in this course was prepared using Gecko Charts 2000 software. I'm in "love" with this software and could not imagine anyone trading without it.

Trading Lingo

The following is an explanation of several different terms, and I'll explain a little about each one of them.

The Contract Month: As you can see, the daily chart reads, SI, 1999U, September - Silver. The last part is pretty obvious: Sept. 1999 Silver. This means that this contract, or delivery month, is for the month of September 1999. The "code" SI 1999U means the same thing and I have included a list in the reference section that shows you what these codes stand for. (SI=Silver & "U"=September).

Trading Hours: (Not shown on most charts.) The trading hours simply tell you when the market is open for that particular commodity. You can buy or sell only during these hours. Some charts also show you the exchange that it trades on. In the case of Silver, it's the COMEX where all the metals are traded. You

don't need to worry about this, as your broker who places your trades knows which exchange trades which specific contracts.

Margin: This is the "deposit" amount that you need to put up in order to buy, or sell, **each** contract. If you wanted to trade two contracts, you would put up twice as much, three times as much for three, etc. Currently, the margin on Silver is $1,620 per contract. **Remember, your margin is just a deposit to offset any loses you might incur**. You don't actually spend that money. If you make a profit on the trade, 100% of your margin money is credited back to your account. On the other hand, any loses will come out of your "deposit." (Also see Margin Call in the Glossary section.)

Contract Size: This tells you how much of the commodity that you actually control for each contract purchased. In this case, its 5,000 Troy Ounces of Silver. This is where the leverage comes into play. You are controlling 5,000 ounces of Silver for just $1,620. If Silver is currently selling for $5.00 an ounce, that means you are controlling $25,000 in Silver for a deposit of $1,620.

Point Value - 1¢ = $50: This means that each 1¢ change in the price of Silver either makes or loses you $50. As an example, if the price moved up 10¢ and you were "long", then you made $500, and you lost $500 if the price went down 10¢. Pretty simple!

Daily Limit: This is the maximum amount that the price can go up or down in one day. In the case of Silver, there is NO daily limit. It could go from $4.00 to $10.00, or more, in a day. **Be careful trading contracts that don't have a daily limit.** The reason is that without a daily limit, your losses can't be controlled as well, even when using a stop loss that you will learn about shortly.

Min. Move: 1/10¢ = $5: This means that the minimum the price can go up or down is 1/10 of a cent. It's not possible for it to move 1/20 of a cent, in other words. People refer to this as "one tick".

Quoted in CTS/OZ (1¢=$50): As stated earlier, 1¢ move in price reflects a profit or loss of $50.

FND: 4/30/99: This is First Notice Day which means that you will get a notice of intent to accept delivery (and pay for the full contract amount) of the specific commodity. In the case of Silver, that means you would take delivery of 5,000 ounces of Silver**. To avoid taking delivery, you must liquidate any long posi-**

tion before this date. If you are irresponsible and miss this date, your broker can make arrangements to sell your contract, but you will be charged a fee for doing so. **Don't miss the FND date!** Your broker should keep you abreast of this upcoming date.

LTD 5/26/99: This is the Last Trading Date for this specific contract. You can't buy or sell after this date. **All short contracts not closed by this date will be settled by actual delivery**.

Opt. Exp: 4/9/06: This is the date that options expire for this contract. Notice that options expire quite a bit earlier than the contract expires. You will also learn a little about options later in the course too.

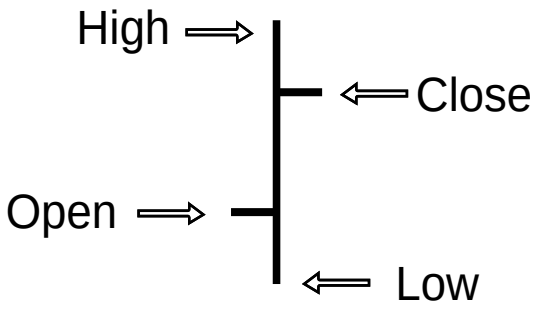
Mini Contracts Traded: This means you can purchase a contract that controls a smaller amount of the commodity and put up a smaller deposit. As an example, you might buy a mini silver contract that controls 1,000 ounces of Silver, rather than a full contract that controls 5,000 ounces. Of course you make, in this example, 1/5 of the profits, since you only control 1/5 as much Silver. By the way, you still pay a full commission when you purchase a mini contract. Unfortunately, there is no such thing as a "mini commission".

The Chart Itself

Dates at the bottom: This is the day of the week on the daily contract. It starts on Monday, ends on Friday, and shows prices daily, except for certain holidays and weekends. Weekly and monthly charts show the prices by the week or month.

Vertical Prices: This is the price that Silver has been trading at each day. These prices are listed on the right side of the chart.

Bars: The prices are reflected each day via a "bar." This is where we get the name "bar chart." In the following diagram, I will show you how to read a "bar."



As you can see, there are four different prices reflected here. The first is the "**Open**." This is the price that it opened for trading that day. The next is the "**Low**." This is the lowest price it traded for that day. Next is the "**High**" or the highest price it traded for that day, and last we have the "**Close**," or the last price paid that day. **Many people feel the closing price is the most important price of the day.** On this bar, the price closed higher than it opened.

The reason is that every day, there is a battle going on with the bulls and the bears. **The bulls want to see the price go up and the bears want to see the price go down. The closing price shows you who won that day.**

Taking a Position - The Long and Short of It

When you place a trade, you are either long or short the market. When you are long, you expect the price to go up; and if it does, you make money. When you are short the market, you expect the price to go down; and if it does, you make money.

When you buy a contract, you are long, and expect the price to go up.
When you sell a contract, you are short, and expect the price to go down.

So, going long is buying, and going short is selling. Of course, if you are long and the market goes down, you lose money. Just the opposite if you are short.

The key is to be in the right trade: long when the market is rising, and short when the market is dropping. You are going to learn techniques that will help you understand which way the market may go. **Remember, these techniques are not foolproof, but they can be pretty darn accurate.**

You're going to learn to find your profit targets, which is where you feel the price should go. Before we do that, let's learn a little about some of the risk you

will incur when trading. **If you can learn good risk management, you can be successful at trading. It's the most important area of trading**.

Keep in mind too, that without people like you, we would not have a commodities market as we know it today. The reason is, we provide liquidity for everyone.

Technical Analysis - Does It Really Work?

In the opinion of myself and many others, technical trading is the best way to trade commodities. I could care less about the news! That's a bold statement, so let me explain why I say that. By the time you read or hear the news, it's already happened. You see, you and I are on the bottom of the news chain. If you think otherwise, I'm sorry—you're wrong!

To give you an example, as I was writing this, the price of gold dropped because some countries were "dumping," or selling off, their gold reserves. There were people who knew this was going to happen beforehand. These people took advantage of this information and sold Gold (went short), because they knew that when these countries started to dump their Gold supply, the price would go down. So, by the time you hear about it on the news, it's too late to do much about it. However, if you had been watching the charts, you would have seen the price start dropping and could have made a trading decision, based on technical rather than fundamental information.

Also, fundamental traders have to be aware of the weather patterns around the world and how they might effect production. They also have to be aware of world "inventory," and who's dumping product on the market, etc. It would be a full-time job just to keep up with one commodity, much less with dozens that you might want to keep an eye on.

There are times, however, when certain fundamental information can be incorporated into your trading. The study of seasonal patterns is one thing that is not difficult to learn and can prove helpful at times. **I have included a section on "Seasonals" in the Reference Section.**

Now, on the other hand, we have technical analysis. I love the charts! **I feel they tell you almost everything you need, once you understand how to read them**.

You're going to learn a lot about technical trading in this course, and I hope you can master it. It's not rocket science, it's an art— but it's not as complicated as you might think.

Reward/Risk Ratios

In any trades you make, you should always know your reward/risk ratio. How much are you willing to risk? What's your upside (what you think you might make)? What's your downside (the amount you might lose)? How much of your trading account should you risk on any one trade? It's not as much as you might think!

Although no one can control which way the market is going, you can usually control your risk. If you don't control your risk in trades, you won't be around very long to have to worry about it. Would you risk $5,000 to make a possible $1,000? Those are horrible odds, yet I've seen people do this over and over until they are broke. However, would you risk $1,000 to make $5,000 if the odds were in your favor? Probably.

The key is to understand the reward/risk ratio on every trade you do and only trade the ones that have a lot more reward than risk. One way to look at reward/risk is by remembering the coin toss game we've all played as children. If you played with a nickel and your opponent played with a dime, and each time you won, he gave you a dime, and each time you lost, you gave him a nickel, who is going to win in the long run? Of course, you would. You might lose the first 5, or even 10 tosses in a row, but over time, you would win twice as much as your opponent, because your risk was 1/2 as much as his. Right? That's exactly what we want to do when trading. We want the risk to be in our favor.

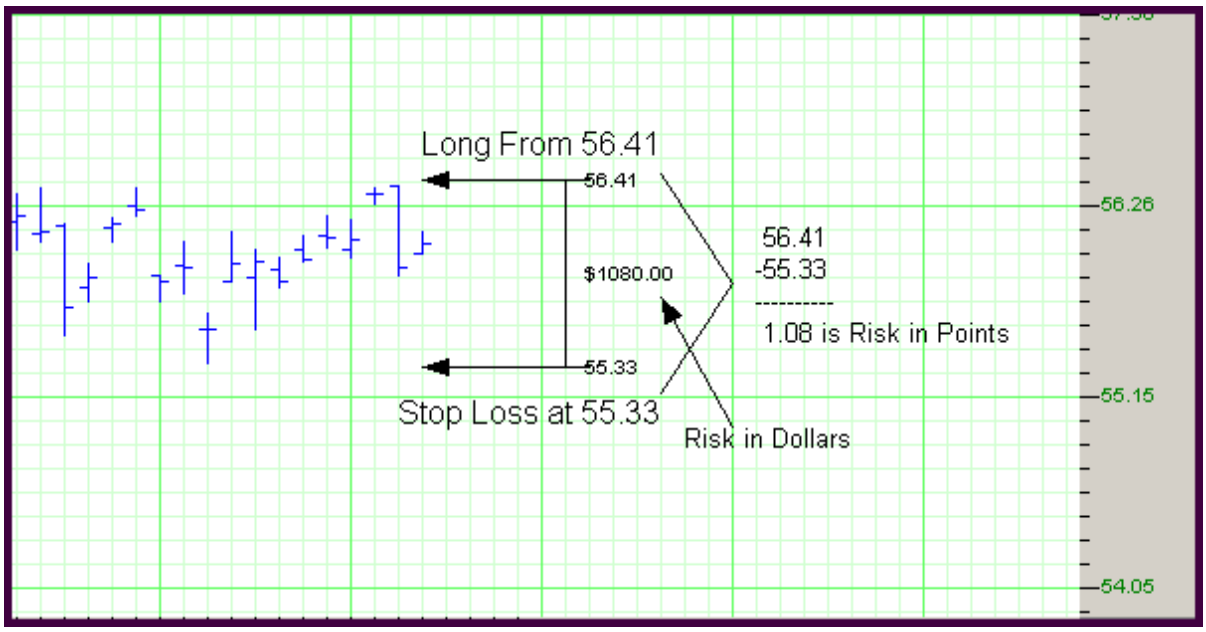
Just like in the coin toss example, we want the odds in our favor before we make a trade. Personally, I like my students to see a Reward/Risk ratio of 2:1 or better. In other words, if you have a chance of making at least $1,500 if your target is hit, then you don't want to risk more than $750 on the trade. I've seen trades that have 3:1 or even a 4:1 ratio. I like to see these trades, and you will too. At times, you can put on a short term trade where you can have a little less than a 2:1 Reward/Risk ratio, but don't do it all the time.

You are going to learn how to figure your profit targets and when to get into a trade a little later. You will also learn how to protect yourself, and how to control your risk. To do this, you need to know how to use stops.

The Stop Loss

"Stops" are simply orders to exit a trade at a predetermined price. Let's say that you think the price of a certain commodity is going up, so you want to buy a contract (go long).

The stop loss is an order that is opposite of your entry order. In other words, if you go long on a contract, you would place a stop (an order to sell the contract and exit the trade) somewhere below your entry price. Let's look at a generic example of going long on the following chart.



Since you expected the price to go up, you "bought" a contract to "go long." You make money when the price goes up. But if the price goes down, you want to protect yourself. You want to limit your losses. In this example, you risked 108 points because you entered long from 56.41 and your stop loss (your sell order) was at 55.33. This means if the price went down to 55.33 or below, you would be "stopped out" with a loss of 108 points, because if the price dropped and "hit" your stop, your contract would be sold for a loss at that price. This loss would be paid from your margin "deposit." Stops are just one way you can limit your losses when trading. We will cover other ways a little later.

THERE ARE CERTAIN TIMES THAT EVEN A STOP LOSS WILL NOT PROTECT YOU.

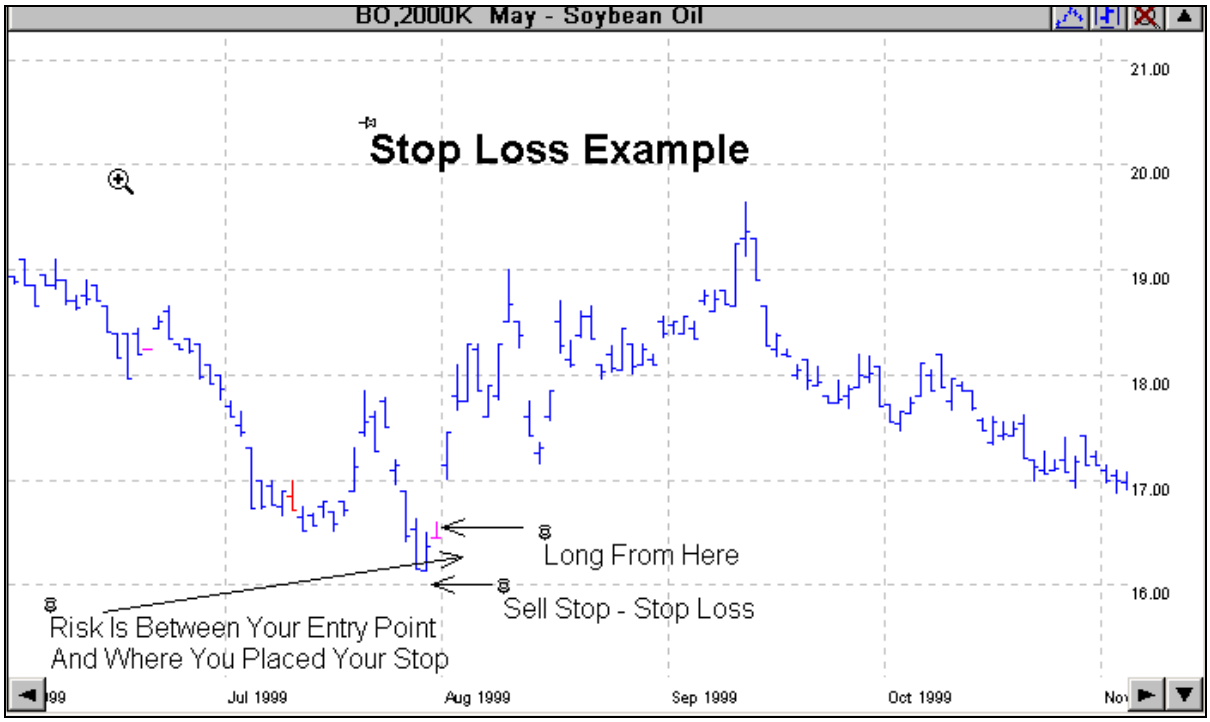
As an example, let's say you were long the Silver market from $3.50 and you had a protective stop at $3.25. This means if the market drops down to $3.25, you would be stopped out with a loss of .25 cents, or $1,250 (25 X $50). But what happens if you go to bed one night, wake up the next morning, and the price of Silver opened at $3.00? It never "hit" your stop in this case and you were stopped out at the opening price of $3.00, for a loss of .50 cents, or $2,500! Don't ask me how I know! It's just one of the many risks in trading and something you need to be aware of. There's not much you can do about it, either. It probably won't happen to you at all, or not very often anyway, but you should be aware of it. (Remember my promise not to "sugarcoat" anything).

Every time you place an order, you should always place a stop at the same time. Never trade without a stop loss of some kind. Later in the course, you will learn to use options as a stop. You don't want to put your stops too close to your entry price, because if you do, you will get "stopped out" during the normal day-to-day price fluctuations. I'll cover the best place to put your stops later in the course. Right now, I just want you to be familiar with how they work.

Of course, the opposite would hold true if you were short, expecting the price to go down. If you place your "sell order" to go short Silver at $3.50, then you would want to place a buy stop at maybe $3.75, which means you will get stopped out for a loss if the price went up to $3.75. Again, this will be covered in more detail later.

Remember, I told you that sometimes the price may "open" the next day at a much higher or lower price than high or the low of the day before? This is called a Gap and you will learn a lot about them later. Notice on the following chart, the price did just that— it "gapped" open the next morning. In this case it worked in your favor, since you were "long" the market.

Your fill price would be where the market opened the next day (about 17.10 in this example), not from where you had your order placed to go long. This would be considered a bad "fill" price in this case since you are now long from a higher price due to the gap. We will talk more about this later in the course.



Types of Orders (Also see Reference Section)

There are many different ways to place an order, and I want to give you some specific explanations of the most common types of orders.

Which type of order you use will depend on several different factors, based on your objectives for each particular trade. It is extremely important that you and your broker understand the type of order you are placing**. Millions of dollars have been lost by entering the wrong types of orders**. Once placed, it's a done deal. Mistakes can be very costly, but they can be avoided by having a good understanding of what you are doing. Make sure your broker has a clear understanding of what kind of order you are placing.

With Track-n-Trade charting software, you can actually place your comments on a chart with your entry price, stops, etc. and e-mail it to your broker. This is a great way to avoid "miscommunications" that sometimes happen.

Make sure you broker repeats your order back to you. If you are not certain that what he or she is telling you is what you meant, stop right there and get it straight! Tomorrow is too late!

The following are the most common types of orders:

Market Order. This is the most common type of order. When you enter a market order, you do not specify a specific price. You simply state that you want to go long, or short, "at market." **When you place this type of order, it goes to the trading floor and is filled at whatever the current price may be.** Most of the time, it's filled fairly close to what the price was when you placed the order, but in "fast" or "thinly traded" markets it could be very different, so be careful, and learn about the markets you are trading. This is also known as "slippage."

Limit Orders. Limit orders simply state a price limit that your order must be filled. In other words, it must be filled at the price you specify, or better. Limit orders have the advantage that you will know the worst price that you will pay. One disadvantage is that you might not get filled at all if the price that day does not trade within the price you requested.

Stop Orders. Stop orders are not executed until the price reaches a specific point. When the price reaches that point, the stop order becomes a *market order*. Most of the time, stop orders are used to exit a trade. You may have a stop order to get out if the market hits 65.00, as an example. When the market hits 65.00, your stop order becomes an open order at 65.00 to exit the trade. You will probably "get out" at that price or very close to it.

You can have a "buy stop" order, which means you want to buy a contract, or go long, and you can have a "sell stop" order, which means you want to sell a contract, or go short. This way, your order is filled at that price or better.

Day Order. Day orders are good for only one day, the day you place the order. Let's say you want to go long Sept. 1999 Sugar. You call your broker and place a day order (as a limit order or a buy stop order) at 6.50. This order would be good only for the day you placed it. If the market did not reach 6.50 that day, your order would not be filled. As an example, if the highest price Sugar reached that day was 6.49, and your order was at 6.50, your order would not be filled. Sugar could open the next day at 6.50, and rally to 7.00, but you would not be in the market since your order the previous day was a day order and good only on that day**. If a Day order is not filled the day you place it, it's canceled at the end of the day. You have to place the order again the next day.**

.

Good till Canceled (GTC). A GTC order simple means that you place your order and it "sits there" until it's filled. **It's also called an open order.** You must tell your broker that it's a GTC order, or he/she might place it as a day order, and you might not want that to happen. **I don't suggest that you use these very often unless it's your protective stop order.** You will learn why later.

As an example, you want to go long September Wheat at 290 because of something you see on the chart, and if it reaches that price, you want to be long the market. You would call your broker and place an open order GTC to go long, just above 290. This order sits there until it's filled, even if it takes three months to fill it. The order is always "open" until you cancel it or the contract expires.

You must keep a very close watch on your open orders. If you place an open order and forget about it, it may get filled weeks later, and that might not be what you want at the time. Again, don't ask me how I know about this! You should keep a list of all your open orders and look at it every day. **If you decide that you no longer want one of these as an open order, you have to call your broker and cancel it. It's your responsibility to keep track of your open orders.**

Also, when you place a stop loss order, make sure it's a GTC Order, or your broker might think that it's a one-day order, which means it's only good for one day, and the next day, you don't have a stop loss order at all.

Needless to say, a mistake like this can be costly. Don't ask me how I know this either!

End of Lesson One

Homework Lesson One

1. Commodity trading in the USA started in the 1840s in which city?
a. __ Chicago
b. __ St. Louis
c. __ New York
d. __ Kansas City

2. There are three positions one can take when trading commodities. One is "Long," the second is "Short," and the third one is _____.
Hint: most people don't take the last one often enough.

3. Commodity trading is also known as _____ trading.

4. When you "go long" the market, you expect the prices to:
a. ___ Go up
b. ___ Go down

5. When you "short" the market, you expect the prices to:
a. ___ Go up
b. ___ Go down

6. When you "sell" a contract, are you going long or short?
a. ___ Long
b. ___ Short

7. When you "buy" a contract, are you going long or short?
a. ___ Long
b. ___ Short

8. As a "Speculator" in the market, when would you take delivery of a commodity?
a. ___ At the expiration date of the contract
b. ___ 30 days before the contract expires
c. ___ You would never take delivery

9. When someone "sells" a contract and keeps it until the end of the contract, he/she is committing to _____ (Hint: Remember the farmer)
a. ___ Deliver the commodity
b. ___ Purchase the commodity
c. ___ Neither one

10. The role of the speculator in the market is to provide:
a. ___ Actual buyers and sellers of the commodity
b. ___ Cash so that farmers can make a living
c. ___ Liquidity for everyone in the market

11. If you are "long" the market, and the price goes down, you:
a. ___ Lose money
b. ___ Make money

12. If you bought a futures contract in wheat that controls 5,000 bushels, and the price went up 50¢ a bushel, how much money did you make?
a. ___ Nothing. I lost $5,000
b. ___ I made $250
c. ___ I made $2,500

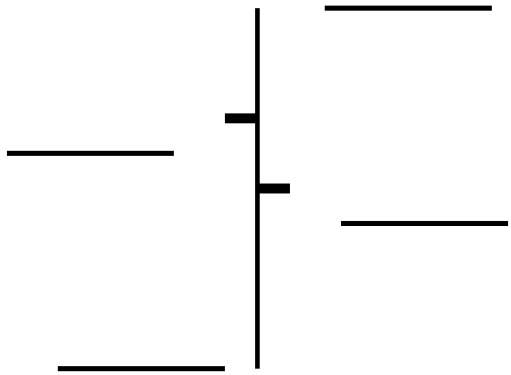
13. There are basically two types of speculators. One is the _____ trader and the other is the _____ trader.
(Hint: some people use a little of both.)

14. The chart with the longest price history is the _____ chart. The chart that shows today's price is the _____ chart.

15. The margin on a contract is like a good faith deposit.
a. ____ True
b. ____ False

16. Daily Limit is:
a. ___ The maximum amount that the price can go up or down in a day.
b. ___ The minimum amount that the price can go up or down in a day.
c. ___ The daily amount that I have to keep in my margin account.

17. On the price bar shown below, fill in where the high, low, open, and close would be.



18. What price do most people think is the most important price of the day?
a. ___ Open
b. ___ High
c. ___ Low
d. ___ Close

Why? _____

_____

_____

19. If you are long the market, what did you do?
a. ___ Bought a contract
b. ___ Sold a contract

20. A stop is used to limit risk.
a. ___ True
b. ___ False

21. On page 33, the diagram shows that your risk was 108 points. If each point was worth $10, how much risk in actual dollars is it? $_____

ANSWERS ARE IN BACK OF THE COURSE, BUT DON'T CHEAT

Lesson Two

Charting in General

The charts can be effective tools to help you learn to trade with confidence if you know how to "read" and analyze them correctly. Once you finish this course, I think you will understand why I feel the charts contain almost all the information you need to trade. You will learn to get a "feel" for charts and learn to "hear" what they are telling you. Sometimes they will even "shout" at you!

In this lesson, we are going to look at several different formations. Don't worry about the specific ways to trade them right now. We will cover this a little later. Right now, I just want you to see the charts—follow along with me for a little while.

Trends

"The Trend Is Your Friend." What this means is that the price may trend in one direction for a long time. You usually want to trade with the trend. Usually if the long-term trend is down, you want to be short; and if the long-term trend is up, you want to be long.

There Are Three Types Of Trends

1. The Major Trend
2. The Minor Trend
3. The Near Term Trend (also called The Current Trend)

The Major Trend. Charles Dow, author of the *Dow Theory*, said that the major trend lasts a year or longer. However, he was referring to stocks when he said this. When looking at a commodities chart, you can shorten that to six months. However, some long-term trends can last for years.

The Minor Trend. Most people look at the minor trend as being between three weeks and three months.

The Current Trend. This is sometimes referred to as the near-term trend, and should be looked at as the trend in the last two or three weeks.

When you look at charts, you will notice that in the major trend, you will see minor trends that could be opposite the major trend. Within the minor trend, you will see near-term trends that could be opposite the minor trend.

Look at the very long-term downtrend in Cocoa on the following chart. It's obvious that the major trend is down, but you will also notice that during the downtrend, the price rallied several times for a week or so. This is quite normal, as you will soon see.

The price was way up at the start of the contract, and then changed trend as the price began to drop. This downtrend started in November, hit "bottom" in May, and then headed back up.

Obviously, if you had caught this trend back in November and stayed with it until June, you could have made a lot of money.

Learning to draw trendlines is important in learning to trade correctly. To understand what a trend is, you need to define it first. **A downtrend, as shown on this chart, is a series of lower highs and lower lows. An uptrend is just the opposite—a series of higher highs and higher lows.**

An uptrend can be intact until a previous support has been broken. Support is a place the price has a hard time breaking past or through. Same thing for resistance. You will learn a lot about this in Lesson Three. In the case of a down-

trend, a breakout to the top of the trendline (when the price **closes above** the trendline for more than two consecutive days) is a good indicator that the trend might be broken. Of course the opposite holds true for an uptrend.

When the price jumps above or below the trendline for one or more days but the closing price remains within the trendline, it's called a "False Breakout," and the trend is still considered to be intact.

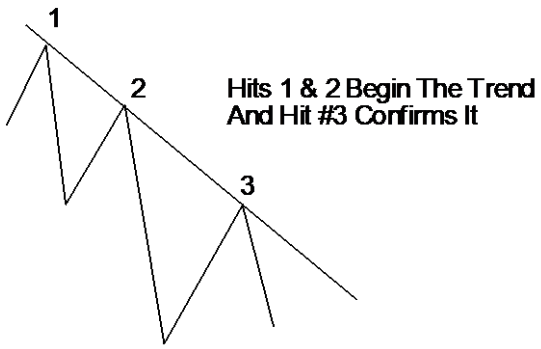
By drawing trendlines, you can see when the price breaks out, and when the trend may be broken. Look again at the previous chart for July 1999 Cocoa. I've drawn the trendlines for you. It's obvious when this trend ended and the price reversed direction. When the price reversed and went up, you would have wanted to get out of all your short trades and go long, or buy a contract.

Drawing Trendlines

I like to draw my trendlines across the tops **AND** the bottom prices. I feel this gives me a better visual feel for what the trend is doing. You don't have to draw both lines if you don't want to. Look back at the Cocoa chart and you can see that I drew both lines on this chart. I think it's just easier to "see" the trend this way.

Confirming The Trend - Getting Three Hits

When you draw your trendlines, you must get three "hits" in order to confirm the trend. Let's look at the following diagram to see what I mean.



As you can see, the first two times the price hit the top of the trendline, it started the downtrend. However, it takes the price hitting the trendline the third time for the trend to be confirmed. Of course, the same holds true of an uptrend.

What Significance Does This Have?

Remember in school—we learned that a body in motion tends to stay in motion? The same holds true for trends. It takes a lot of energy, or momentum, to reverse a trend.

You might be wondering how to determine the strength of a trend. There are several ways I like to do this:

1. Number of hits
2. How long the trend has been established
3. Rate of ascent or descent

Number of hits. The more times the price touches or hits the trendline, the more valid the trend. This is just plain old common sense again. Ten hits are more important that three hits. Right? Of course they are. Look at how many times the trendline was hit on the Cocoa chart.

How long has the trend been established? A trend that is six months old is obviously stronger than a trend that is six-weeks old; again, just common sense. Of course, a trendline on a monthly chart is stronger than a trendline on a weekly or daily chart.

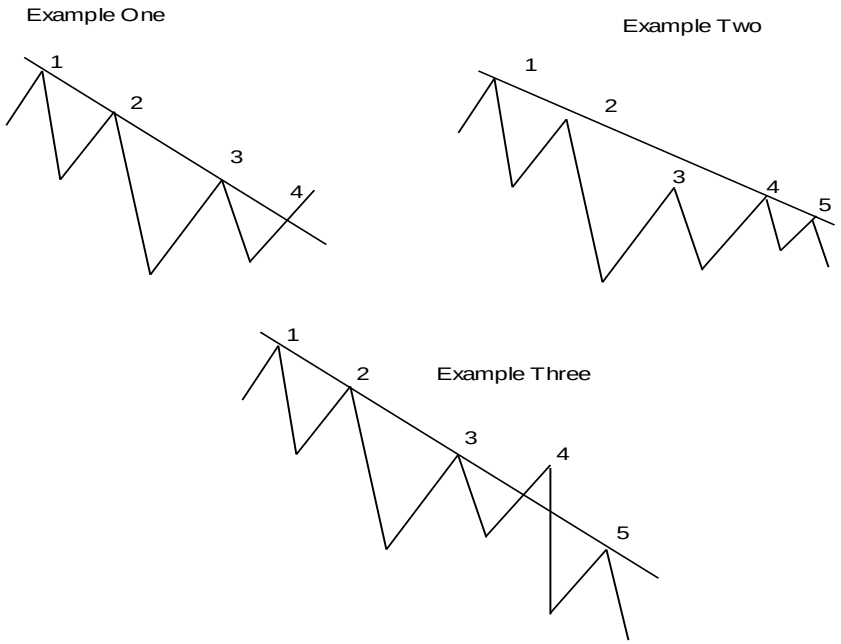
Rate of ascent or descent. One of my students is a pilot, and we were talking about this once. He used the analogy of how fast a plane is descending. A plane on a 10% descent is much easier to pull out of the dive than one on a 30% descent. So keep this in mind when you are looking at trends. Is the trendline on a nice steady slow descent, or is it in a nose-dive?

Redrawing the Trendlines

Sometimes "Old Man Trend" will try and fool you. Let's use some common sense and see if we can stay on track. In the following diagram, in Example One, you will notice that the prices kept hitting the trendline over and over, and then it suddenly breaks out of the trend one day (point #4 in Example One). What do you do? Is the trend broken? Do you redraw the trendline? The following diagram may help in your decision-making process.

The way that I suggest is to wait until the fourth or fifth "hit." In Example Two below, the next hit would confirm that the trendline should be raised, and connected between points 1, 4, and 5.

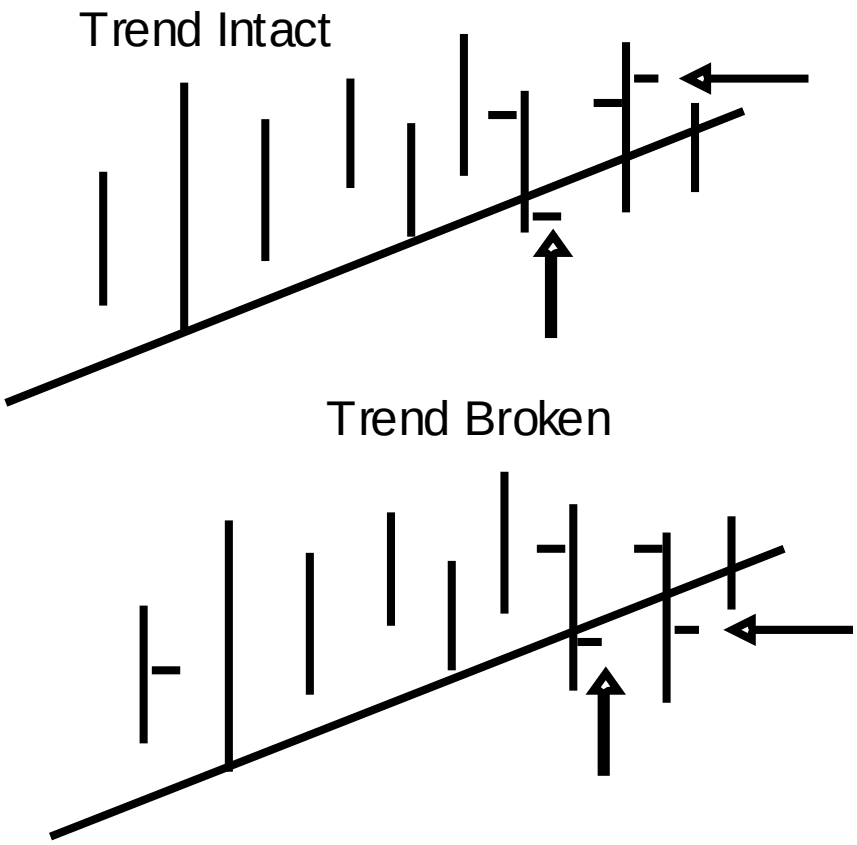
On the other hand, if the price did not rise (Example Three), then I would continue the trendline as it was in Example One, and would consider point #4 where it broke out of the trend as a false breakout.



How To Tell If The Trend Is Actually Broken

There is no absolute way to be 100 percent sure except to just wait and see. One way that might help is to watch the **closing price** each day. If the closing price is beyond the trendline for **two or more days**, then it is a good chance the trend is broken.

You should usually not trade the first day the price breaks the trendline. It's best to wait at least two days to confirm the trend is broken. Look at the following diagram to see what I mean.



In the above diagram, the top example shows you that the trend is still intact since the price did **not** close below the trendline for **two consecutive** days.

The bottom example shows the trend being broken, since the price **did** close below the trendline for **two consecutive** days. Hopefully, this will keep you out of some bad trendline breakouts. Sometimes the third day is the one that tells the true story.

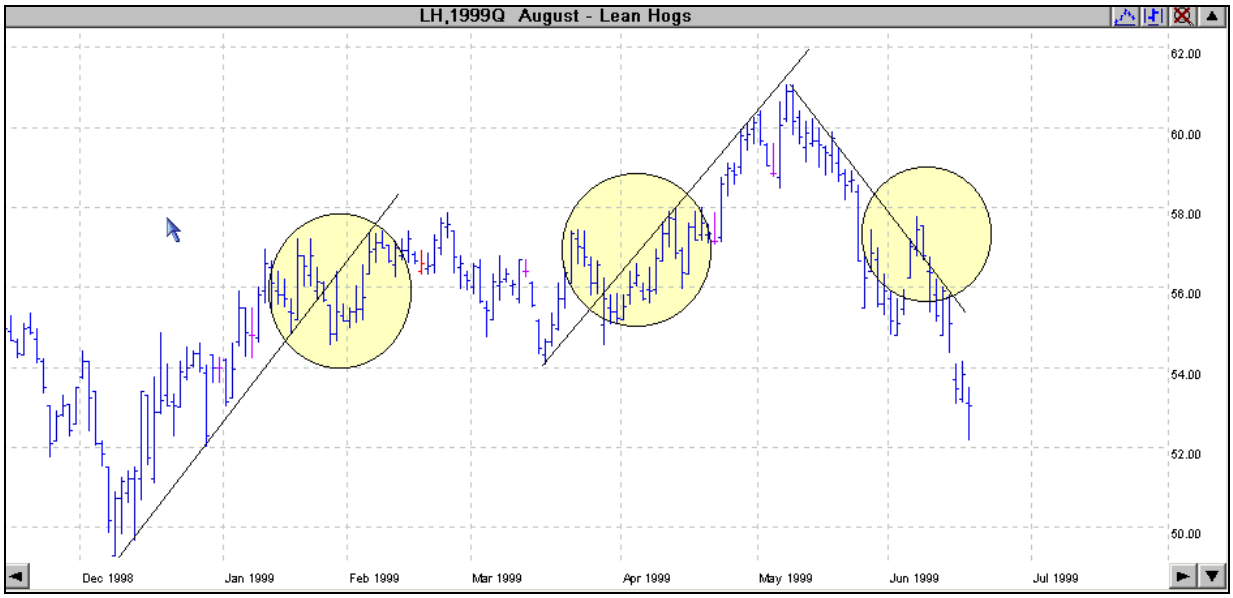
The Magnetic Trendline

Many times you will see the trendline act like a magnet. Look at the following diagram to see what I mean.

Many times, the trend will reverse from up to down, or down to up. When it does, you will often see the price hover around the trendline again. In other words, support becomes resistance, or resistance become support. The prices tend to hover around the trendline, like it's a magnet.

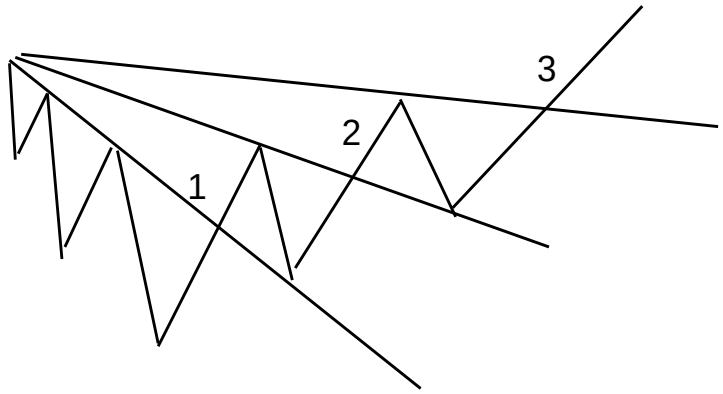
One way to profit by this is to use the trendline as support or resistance for entering trades or for placing your stops.

You can see that this happened three times on the following chart of Aug. 2000 Hogs. Isn't this interesting! So keep your old trendlines on the charts, as they may act like a magnet and draw prices to them. We will cover this later in more detail.



The Fan Principle

As you have seen, prices will often bounce between trendlines. Let's look at an uptrend diagram.



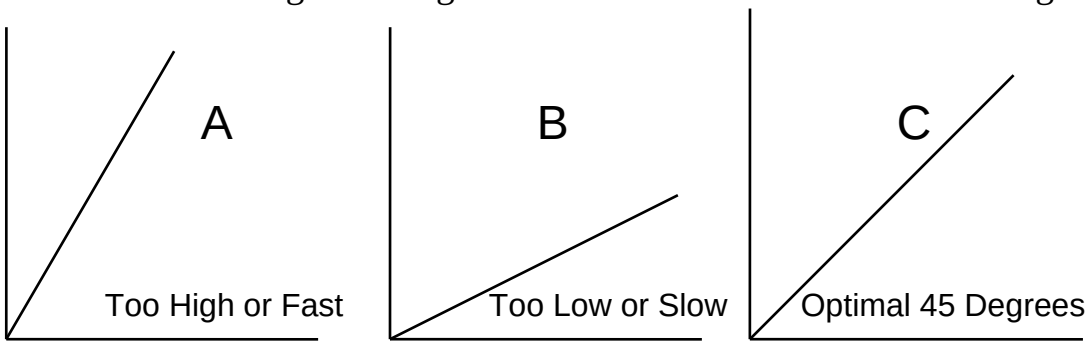
As we have discussed, prices will tend to bounce back and forth between these trendlines. Many chartists believe that in order to confirm a trend reversal, the trendline must be broken three times. Look back on some of your own charts to see how uncannily accurate it is.

In John Murphy's Book, *Technical Analysis Of The Futures Market* (highly recommended reading, by the way), he talks about the importance of the number three. He says that the Fan Principle has three points, major bull and bear markets go through three phases, (Dow Theory and Elliott Wave Theory), there are three types of Gaps, there are Triple Tops and Triple Bottoms, Head and Shoulders that have three main peaks, three classes of trends that we talked about earlier, three trend directions (up, down and sideways), three types of triangles, and there are three principal sources of information— price, volume, and open interest. We will discuss all of these items later in the course. I just find it very interesting and did not want to forget to mention it.

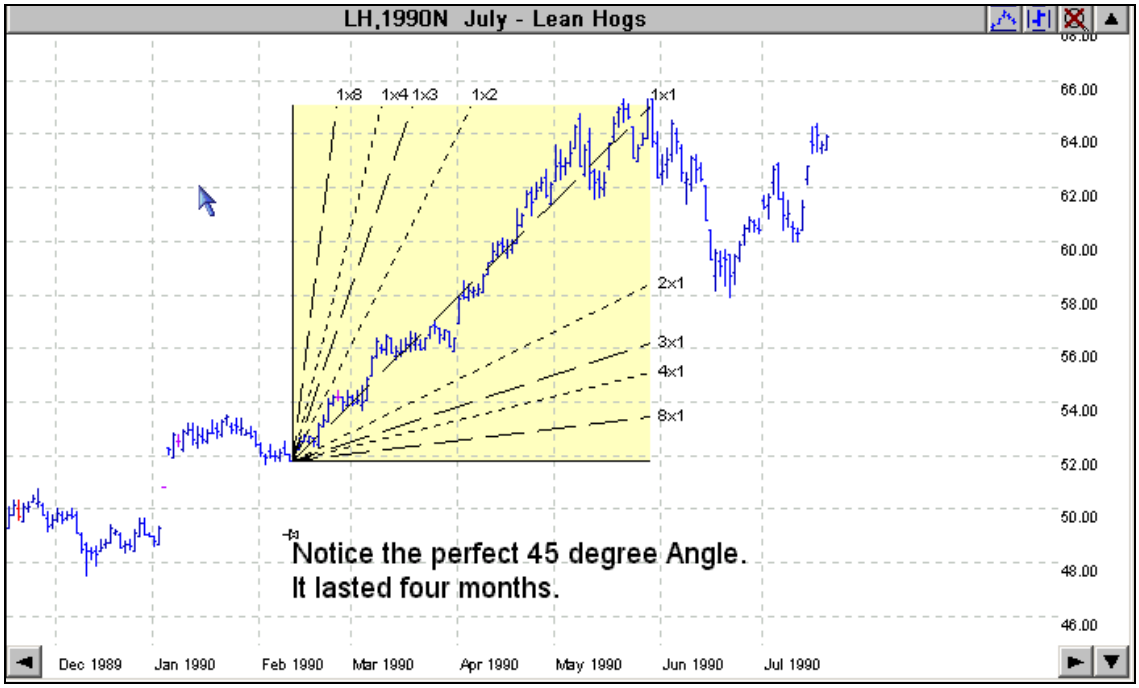
45 Degree Angles

W.D. Gann liked to use 45-degree angles with all his trendline projections. His theory was that most "true" trendlines would angle at an almost perfect 45 degrees. If the angle is greater than or less than that, then it won't hold.

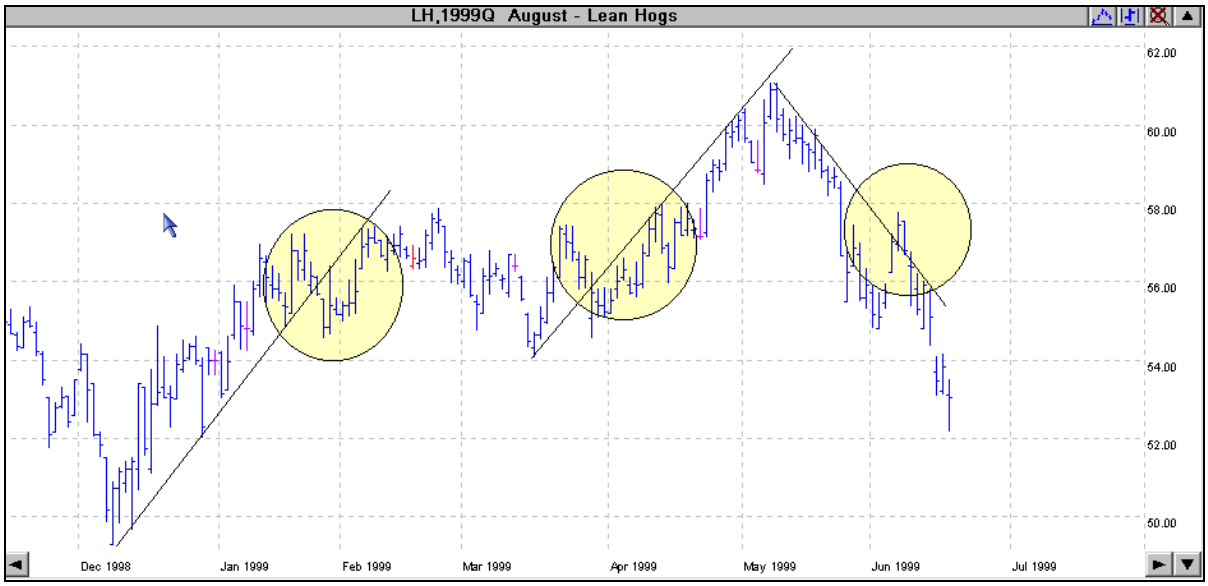
Look at the following chart to get an idea of what Mr. Gann was talking about.



So when you see a trendline that is just too slow, or too fast, don't trust it in most cases. The trendline on the following chart was a perfect 45-degree angle and as you can see, it lasted for several months.



Lesson Two



Remember this chart? Look at the three lines I drew on it. As you can see, all three of them were approximately a 45-degree angle and they all lasted for two to three months. Aren't these charts interesting?

I do not personally hold much merit in this "rule" and just use my "eye-ball" to see if it's trending normally.

End of Lesson Two

Homework Lesson Two

1. “The Trend is your _____.”

2. What are the three types of trends?

A. _____

B. _____

C. _____

3. Most people look at the minor trend being between three _____ to three _____.

4. An uptrend can be intact until a previous _____ has been broken.

5. Sometimes the _____ trend is referred to as the near term trend.

6. There are several ways to determine the strength of a trend. Name three.

A. _____

B. _____

C._____

7. How many “hits” does it take to confirm a trend? _____

8. One way that might help you to see if a trendline is really broken, is to watch the _____ price each day. If this price is beyond the trendline for _____ days, then the chance is pretty good the trend may be broken.

9. Many times, the trendline will act like a magnet.

True _____
False _____

10. The Fan Principle has how many points? _____

11. Many chartists believe that in order for a trend to be reversed, the trendlines must be broken _____ times in order to confirm the trend reversal.

12. "Perfect" trendlines have an angle of _____ degrees.

13. You should always trade on the first day a trendline is broken.

True ___
False ___

Answers are in the back of the course, but don't cheat.

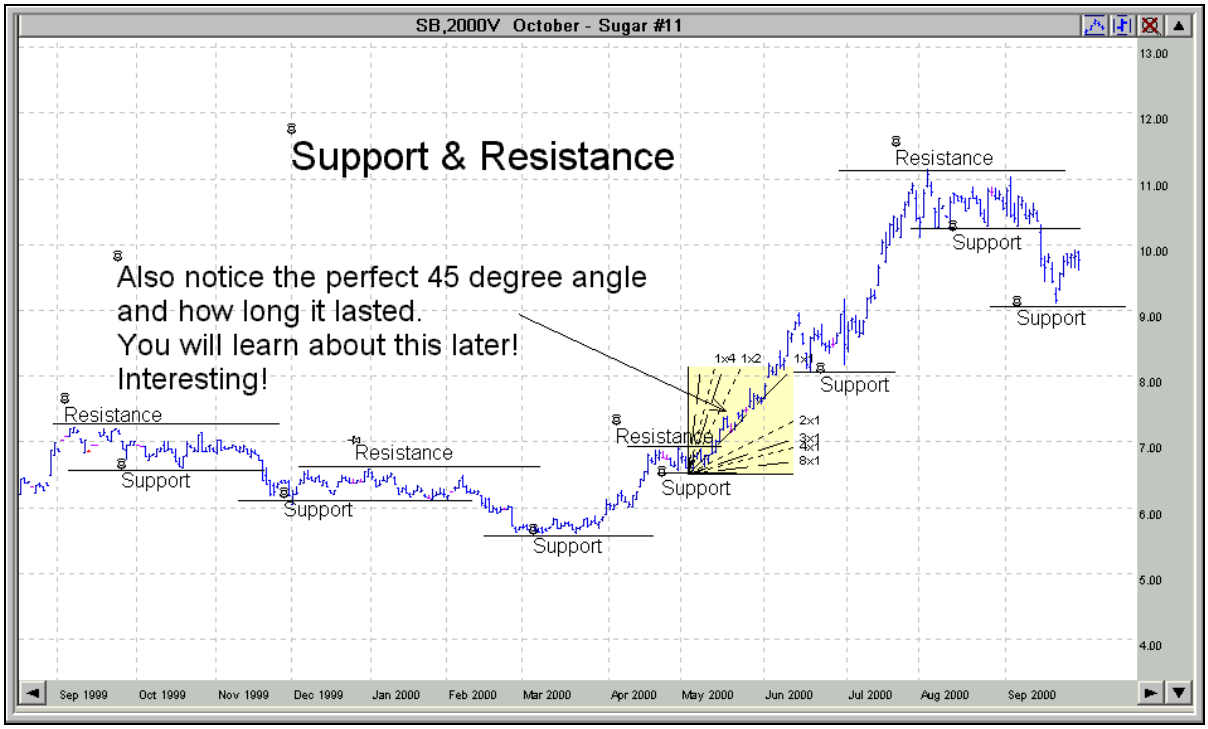
Lesson Three

Support and Resistance Levels

Support and resistance are important terms to understand. They will play a major role in learning when and where to place your orders, when to get out of a trade, and where you might want to place your stops. **Think of support as the "floor" and resistance as the "ceiling."**

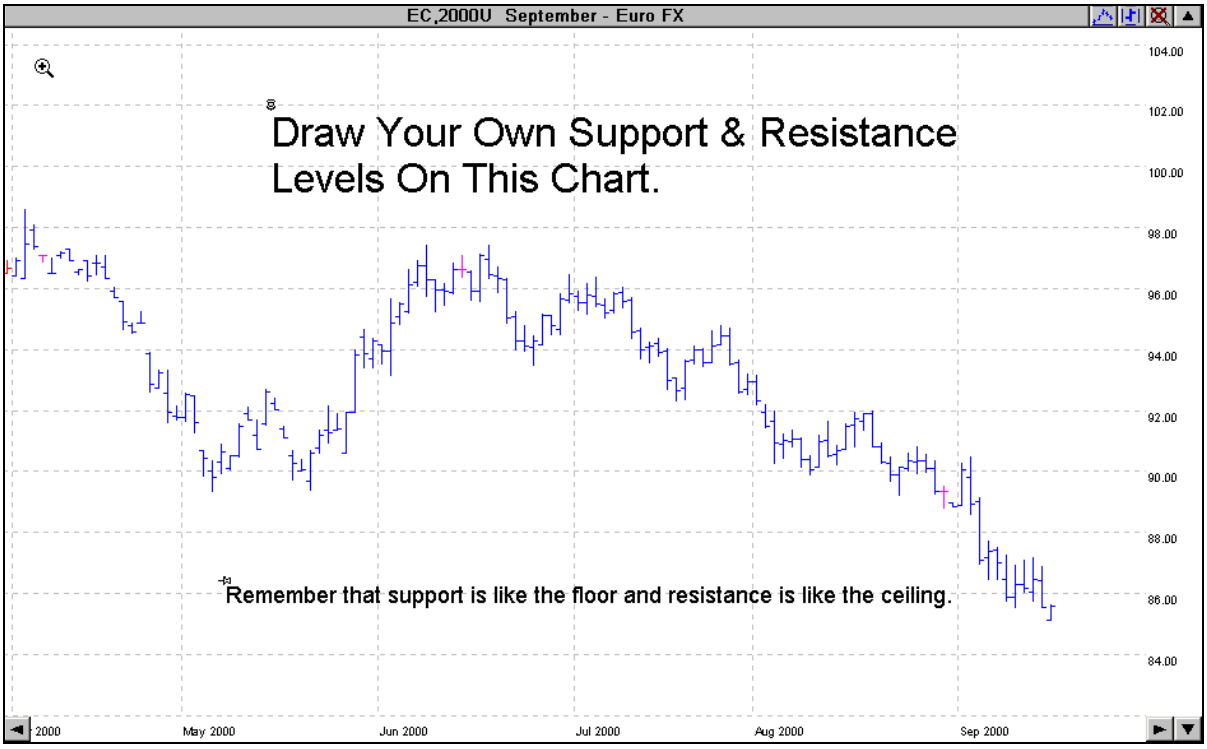
It's important to understand that these support and resistance levels are there for a reason. It simply means that the price reached a point that it could not, or had difficulty, going through. This is why people refer to it as "resistance" when the price could not go above this point, and "support" when the price could not go below this point.

For now, just understand that prices are like a rubber ball and they will tend to bounce between these support and resistance levels until they break through. Now, let's look at some support and resistance levels on the following chart. Remember, support is the floor, and resistance is the ceiling.



In this lesson, you're going to learn when to place some trades and where to place them. You will learn how to read these charts and to understand some technical formations that take place, as well as how to take advantage of them. Soon, you're going to learn to use these support and resistance levels in placing your orders and your stops. For now, I just want you to be able to see them and label them.

On the following chart, take a ruler and a pen and draw the support and resistance levels yourself, just like I did on the previous chart. It may seem like a simple exercise, and it is but it's important to learn how to do it.



Market Corrections - Why They Happen

There are just three types of traders if you think about it. Those who are long, those who are short, and those who are uncommitted. The people who are long are, of course, those who have purchased contracts, while the opposite holds true for those who are short, who have sold contracts. Then there are those who have not committed themselves either way.

Have you ever wondered why the prices sometimes just bounce up and down between these support and resistance levels? I'll give you a C*ommon Sense* viewpoint.

How many times have you seen prices hover around a support area and then the price starts to rally all of a sudden? The people who are holding long contracts are very happy. The only thing they are regretting at this point is that they did not buy more when the price was lower. They are hanging around, waiting for a small market correction (price to drop back), so they can buy additional contracts at a lower price.

On the other hand, we have the people who were short the market. They are not real happy about this because they wanted the price to drop because they are loosing money. About this time, the shorts are thinking they are on the wrong side of the trade, and it might be time to get out with a small loss rather than risking even greater losses. But they are waiting for the same market correction that the longs are waiting for, so that they can get out at a better price and have a smaller loss.

The thing is, **both** the longs and the shorts want the same market correction to take place! Think about that for a moment. Both sides of the market want the correction to take place, just for different reasons.

The other group, the "undecideds", sees that the market is taking off, but they too want to see a price correction take place before they jump in. So now we have everyone, the longs, the shorts, and the undecideds, wanting the price to reverse a little. Each one has a different motive, however.

So now you have everyone trying to push the price down. That's why you see these pullbacks. Of course, the opposite scenario holds true if the market is in an uptrend and the trend reverses. Everyone wants the price to go back up a little for the same reasons.

But what happens if the price goes back down? Glad you asked. Previously, we talked about the price going up and then dropping back down a little. This, by the way, is also called a "pullback." When everyone started buying contracts on this pullback, this created another support area, didn't it? If this pullback continues and the previous support is broken, then the following scenario takes place.

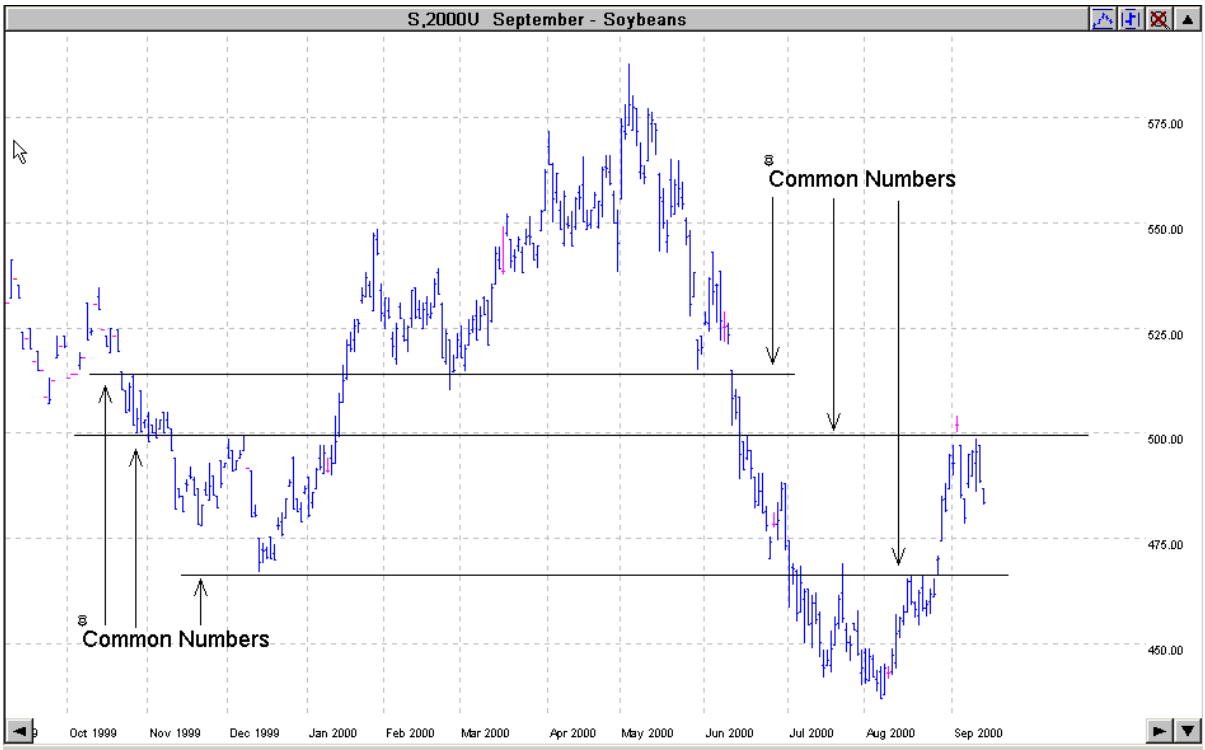
Everyone who was buying is now looking at it like they made a mistake, and they want to get out of their long positions by selling their contracts. The shorts, on the other hand, wish they had not bailed out, and want to go short again, or at least add to their positions if they did not get out already.

This "yo-yo" effect is what keeps prices hovering around the trendline so much of the time. So keep in mind, when a trend is deeply penetrated, it took a lot of energy to do it. This is one of the reasons that the **third** time the trend is broken is usually a really good indicator that the trend has changed direction.

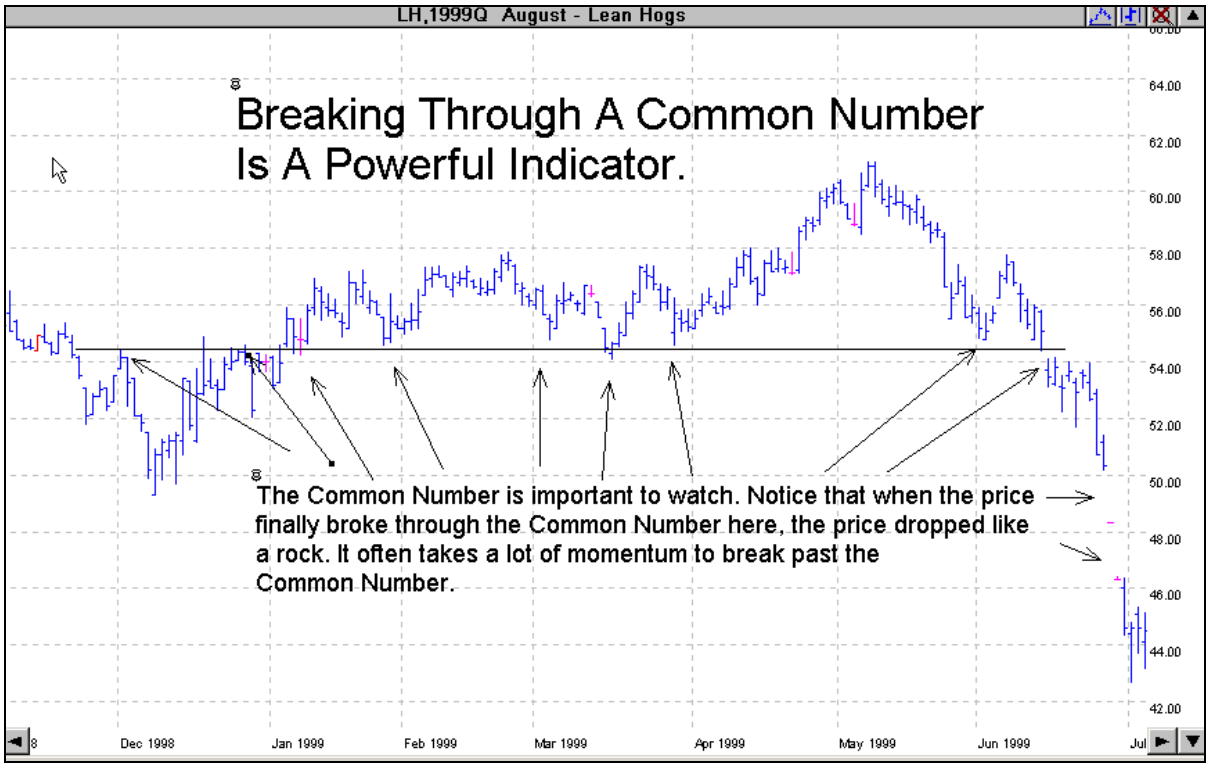
The Common Number or "CN"

Many times there will be a major common number, or a "CN," on a chart. What I mean is, there is a specific price that will show both support and resistance during the contract over a **long** period of time**. This is a very powerful indicator**. Many times, the 50% level (you will learn about this next) becomes a CN.

When looking at any chart, be sure to watch for CNs. It's a very good place to place your order and/or your stops.



Think about it for a moment. I bet you have already figured out several ways that you can use the CN to place trades. Remember, we talked about buying on support and selling on resistance. That's really all we are doing here, except that the CN is a very powerful level of both support and resistance.



When looking for the CN, be sure to check the CN on the weekly and monthly charts too, as they are even stronger indicators than the daily chart.

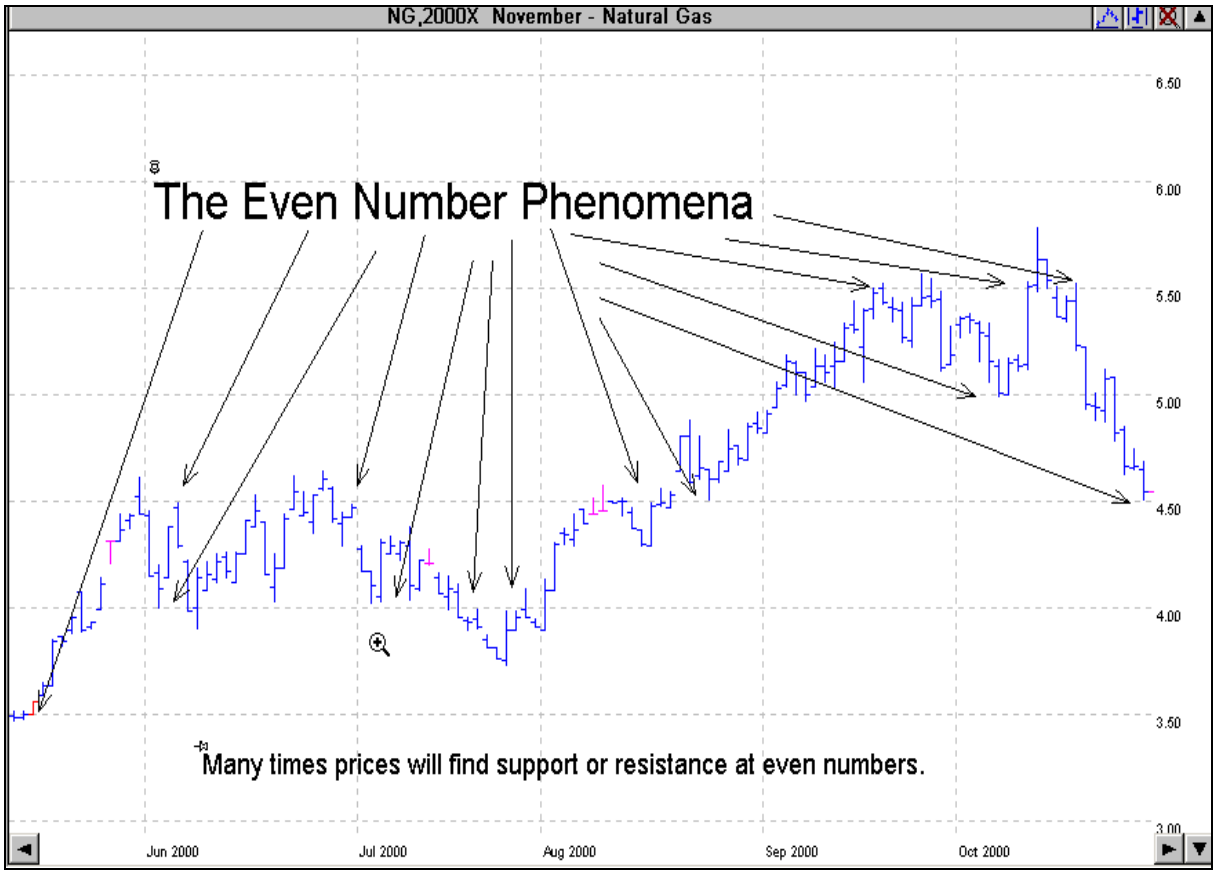
Go back to charts in the previous lessons and see if you can find some of these CNs. How accurate would they have been as indicators?

Later in the course, you will learn how to use these CNs in placing your trades. Right now, just understand they happen quite often.

The Even Number Phenomenon

For some reason, prices tend to find major support and resistance at even numbers. Many times the price will rally or decline, and stop at an exact even number. Many times it will be a multiple of 10: like 10, 20, 50, 100, 150, etc.

I'm not sure why this actually happens. I've just noticed it many times on charts. Go back to your own charts and see for yourself. Look at the following chart.



The question is, how do you use this to better your trades? There are several ways to do this. One is in placing your stops. You should **never** place a protective stop at an exact even number. You should place it just below an even number if you are long, or just above an even number if you are short, especially if that even number is a multiple of 10.

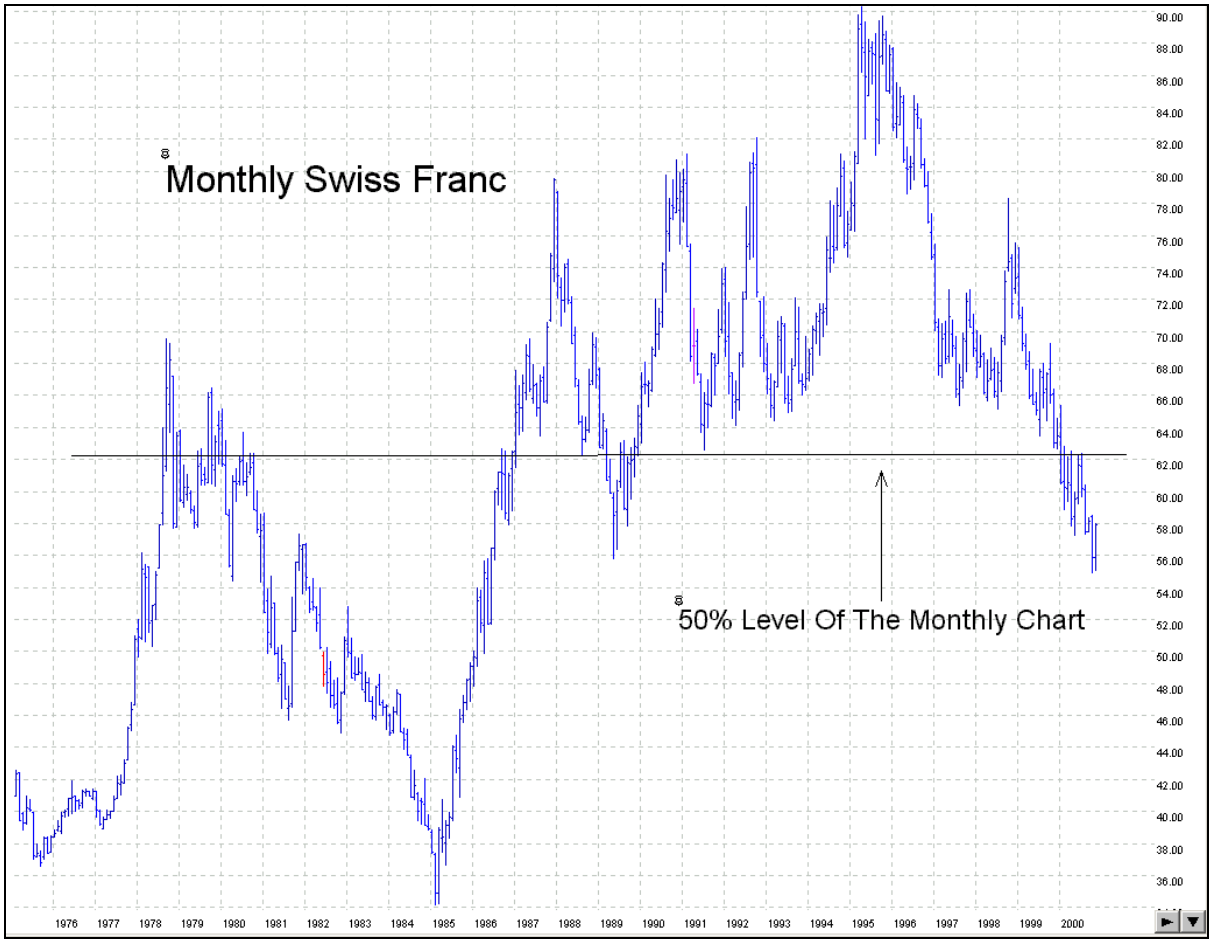
The reason you don't want your stops at an even number is that many times the price will come up and touch this even number, stop you out, and then head back in the same direction. Also, by their very nature, even numbers tend to be an exact support or resistance level more often than odd numbers.

Another way is to look at them is for profit or exit targets. Think about it for a few minutes and I'm sure you will find other ways to use them. **A simple way to remember this is to always "be odd" when placing your protective stops.**

Heading Home - The 50% Levels

The 50% level is simply the average price that was paid during a specific time frame, and it's simple to calculate. I call this price "home."

To start, let's calculate a 50% level on a monthly chart on the Swiss Franc. This particular chart reflects the prices paid over the last 25 years. You can see the lowest price paid was in 1985 (34.00), and the highest price paid was in 1996 (90.00).



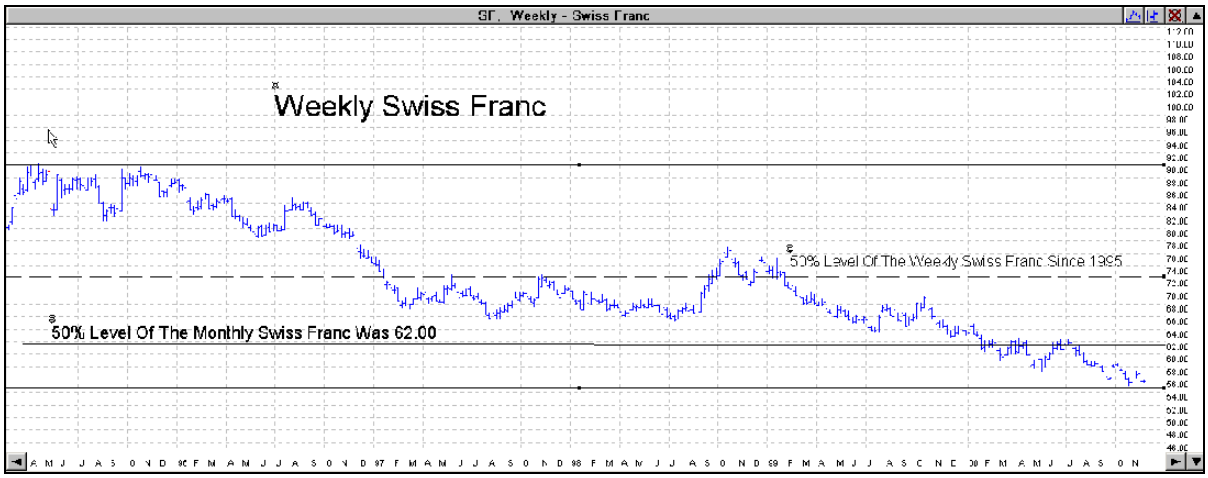
It's simple to find the 50% level. Just add the highest price together with the lowest price, and divide by two. The low of 34 plus the high of 90 equals 124, divided by 2 equals 62. So the 50% level of the Monthly Swiss Franc is 62.00.

This calculation does not have to be exact, as we are just trying to get a good idea of where prices have been and where they may go in the future.

All prices will do a 50% retracement of their last major move. We just don't know how long it will take for that 50% retracement to take place. What this means is that the price should turn around, or reverse its trend, and then head back up or back down, and **meet** or **exceed** the 50% level. Notice that the previous chart shows prices hovering around the 50% level on several occasions.

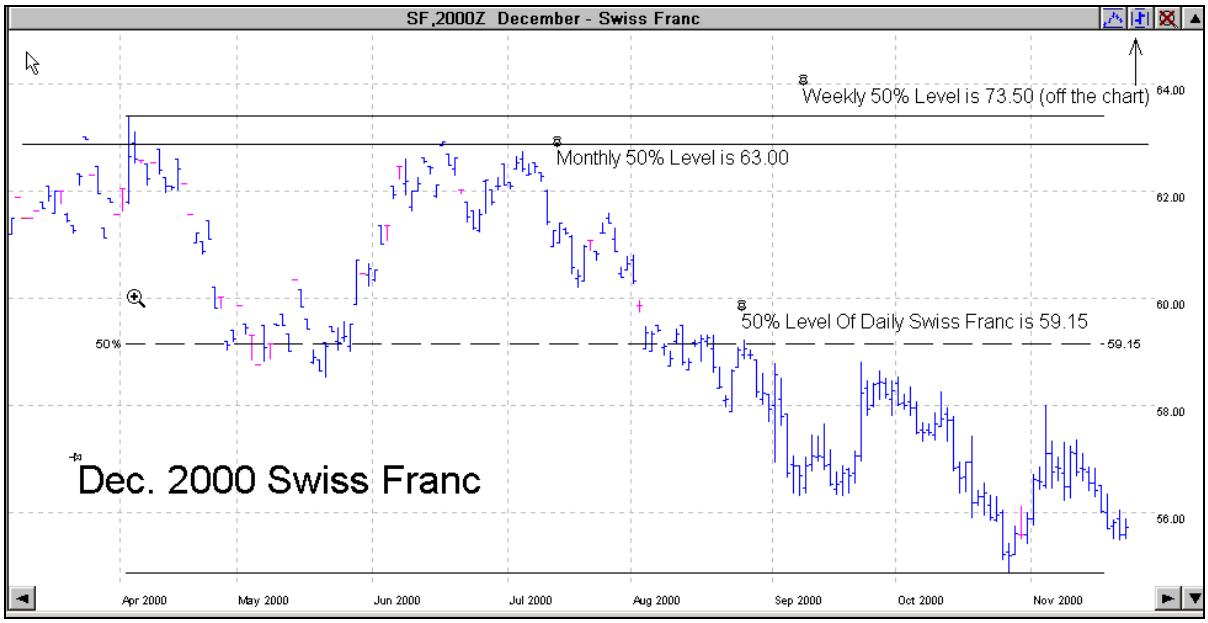
We can easily figure the 50% level and use it to our advantage. We can figure the 50% level on monthly, weekly, and daily charts. **For long-term trades, I always figure the 50% level on the monthly chart first**. This is where prices will eventually head. It may take months, or in some cases years, to get there, but it will always head there. It's just a matter of time.

Next, I figure the 50% level of the weekly chart, then the 50% level of the daily chart. I then plan all my **long-term trades** using these 50% levels as profit targets. Then I mark those points on my daily chart. Now, let's calculate the 50% level of the weekly chart.



The highest price paid was 91.00 in 1995, and the lowest price paid was 56.00 in November 2000. We figure it the same way we did on the monthly chart: 91 plus 56 equals 147, divided by 2 equals 73.50. So 73.50 is the 50% level of the Weekly Swiss Franc.

Finally, let's do the 50% level of the daily chart below.



Without knowing anything else, it's not hard to see that prices are at record lows on this chart. It's only a matter of time before they head back up and do a retracement of 50% or more.

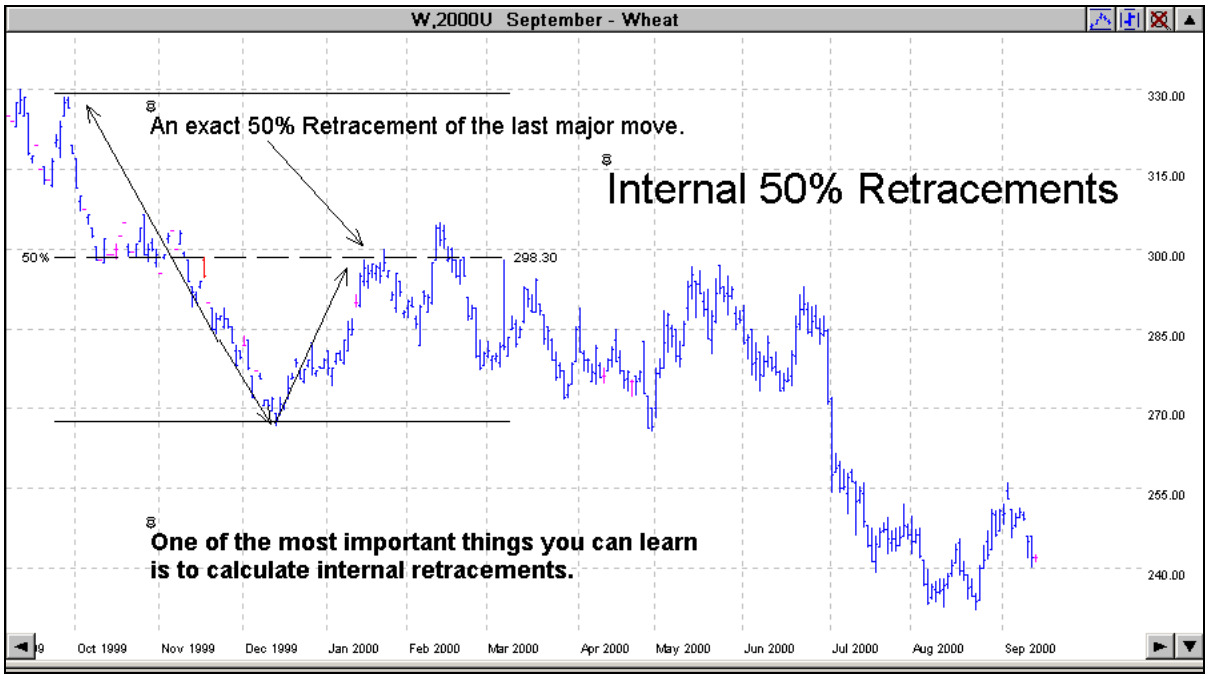
At some time, prices will do a 50% retracement of the daily, then the weekly, and then monthly charts, but not always in that order. On the previous chart of the Swiss Franc, they would have to make a 50% retracement of the daily, then the monthly, and lastly, the weekly.

As you might guess, the key is to know when the price is going to turn around and head back towards the 50% level, so that you can take advantage of it.

That's the tricky part, but I'm going to show you later how to predict when this "reversal" might take place, or at least when to be watching for it.

Internal 50% Retracements

Just like on the monthly, weekly, and daily charts, you will find that prices make a 50% retracement within the short-term as well. How can you profit from this knowledge? Simple. By figuring the 50% level of the last major and last minor price moves, you can predict where the current price should head.

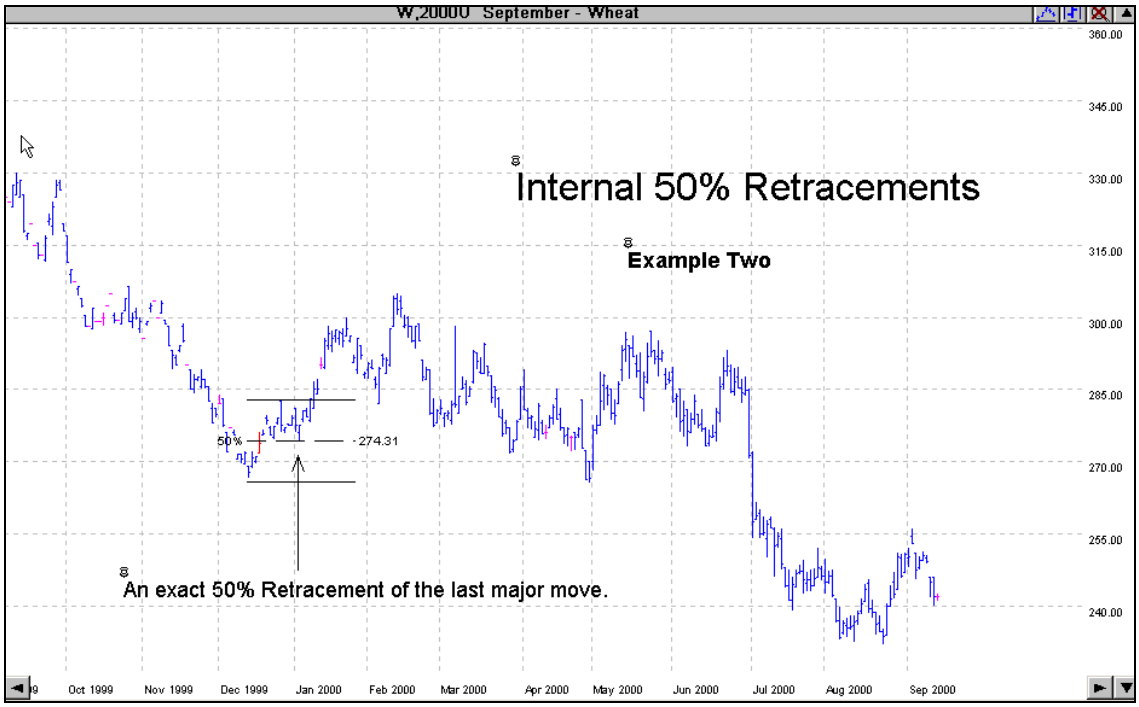


Let's look at the previous chart to see how these 50% internal retracements work, and then I'll show you how to profit from them.

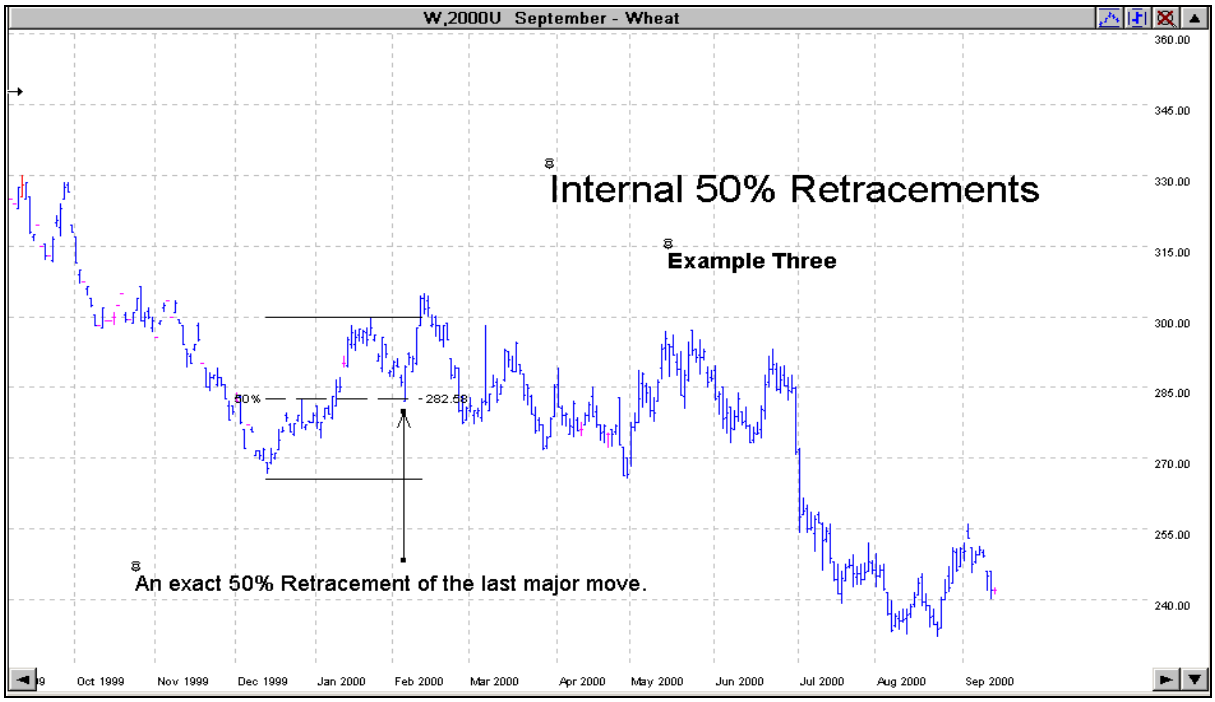
As you can see on the previous chart, the price of Sept 2000 Wheat had a major price move between October and December, from 330 down to 270. I drew an arrow for you so you can see it more easily. **The important thing to understand is that almost all major and minor price moves make at least a 50% retracement**. I'll show you what I mean.

The move on the previous chart, between October and December, made an internal 50% retracement—exactly 50% (back up to 300), as you can see. You will soon discover that 50% retracements happen all the time, whether it is a major move, like a monthly or weekly 50% level, or a less major move, like in the above chart. **Retracements that are not from a contract high to a contract low are called internal retracements**.

I'm going to show you the same chart as above, September 2000 Wheat, in several different views. I want you to notice how many times these internal 50% retracements take place. Many times they will make more than a 50% retracement. The point to remember is that most of the time they make at least a 50% retracement before turning back around again. We will study more on the different areas of price movement when we discuss Fibonacci later in the course.

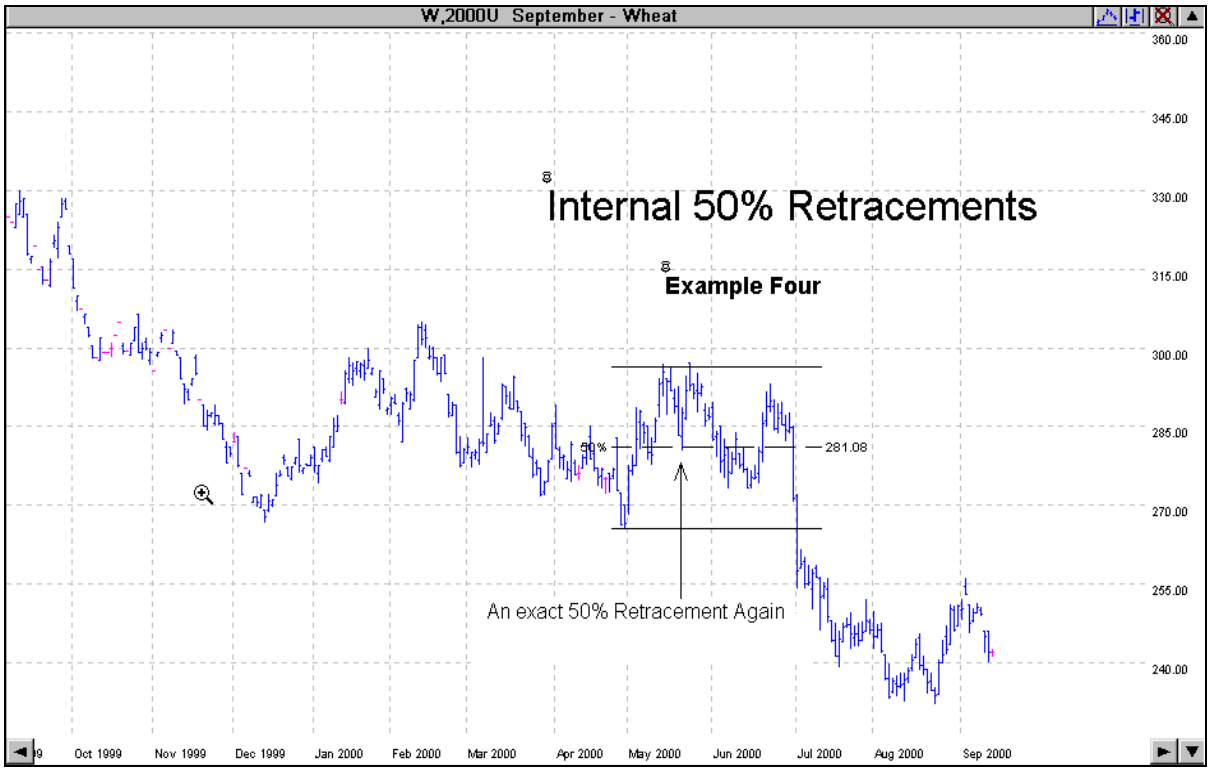


Let's look at another example of the same chart below. This concept is important to understand. I will show you how to take advantage of it later.



Do you see another retracement on the following chart? This time it did make a 50% retracement, and then some. Actually, it made a 62% and a 76% re-

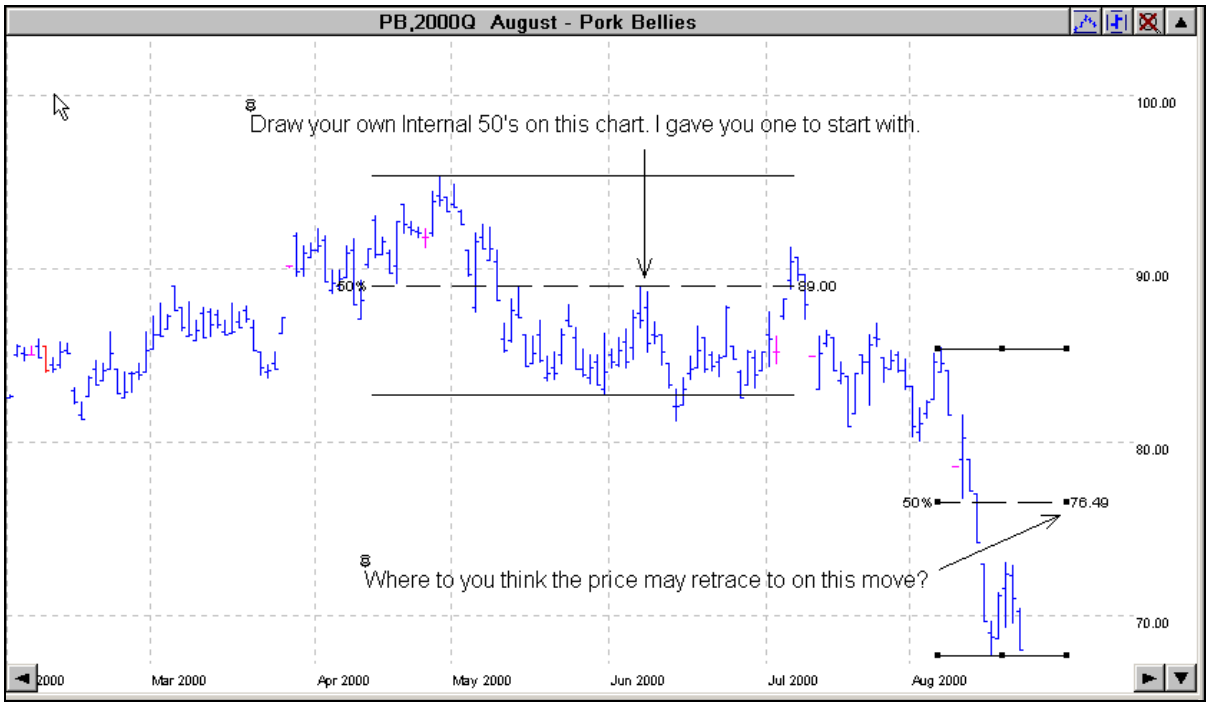
tracement on the nose. We will get into this in much detail in our study of Fibonacci Numbers in a later lesson.



Are you starting to catch on to how important these 50% internal retracements are? If not, don't worry about it too much right now. We will discuss it again in more detail later in the course. Right now, just be aware of them.

On the following chart I would like you to draw out some internal 50% retracements that have already taken place. Then, on the last major move that took place, do you think it might also make a 50%, or more, internal retracement? Get use to drawing these out on the charts. **By the way, Gecko Charts does this for you. Just select the 50% tool and drag it from the high to the low, and presto—you've got the exact 50% level drawn for you!**

If you are serious about trading or learning to trade, an investment in Gecko Charts will pay you back many times over. There is a link on my Website to order the software at a discount.

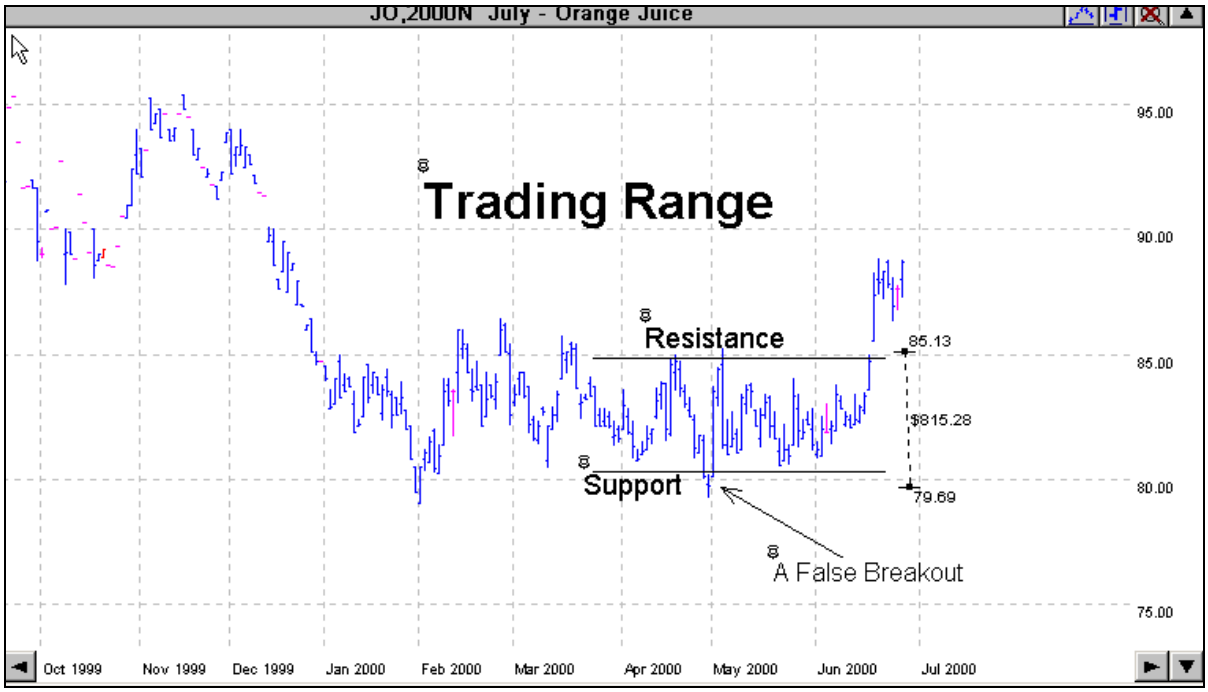


Trading Ranges

Many times the price will not be in a long-term trend. The price will move up and down between specific support and resistance levels. A trading range is a horizontal "channel" that contains the price for an extended period of time. Most of the time, prices tend to spend their lives within a trading range. Trading ranges are difficult for a new person to trade, and a good rule of thumb is not to trade within a trading range unless you are day-trading or very short-term trading. We'll also talk more about that later.

For most new traders, it's best to wait until the price breaks out of this range and then enter a trade. The top of the range is its resistance level, and the bottom of the range is its support level. Once the price breaks out of this trading range, it is usually a good indication that it will continue in that direction, at least for a time.

Let's look at the following daily chart of July 2000 Orange Juice to see what a trading range looks like.



On the above chart, the top of this range is 85.00, and the bottom of the range is just above 80.00. Also notice that the price has been in this range for almost three months.

The key to trading a range like this is to be prepared for a breakout. You always want to be prepared for a "false breakout," which is when the price breaks out of a trading range and then jumps right back into the range again. A safeguard, is to never trade the first day that it breaks out of the trading range. **I always suggest you wait until the second or third day before placing an order. This way, you're more assured that it's a true, not a false, breakout. Remember too, it's the closing price that you should be looking at.**

There is one thing to be aware of, and that is the length of time the market has been within a certain range before you can call it a trading range. **A good rule of thumb that I use is 10 trading days, or periods, depending on whether it's a daily, weekly, or a monthly chart.**

In the example above, you would have been long (bought a contract) when the breakout to the top occurred, and you could have placed your stop just below the bottom of the trading range, depending upon the reward/risk ratio. You will learn a little later to calculate your reward/risk ratios on all your trades.

As you can see, the width of this trading range is about 5 cents, and each 1-cent move in Orange Juice is $150 in profits. So the width in dollars is about $750, which is the amount you risk if you place your stop just below the range and enter the market just above the range. Later in the course, you will learn some other methods to reduce your risk even more.

Channels in General

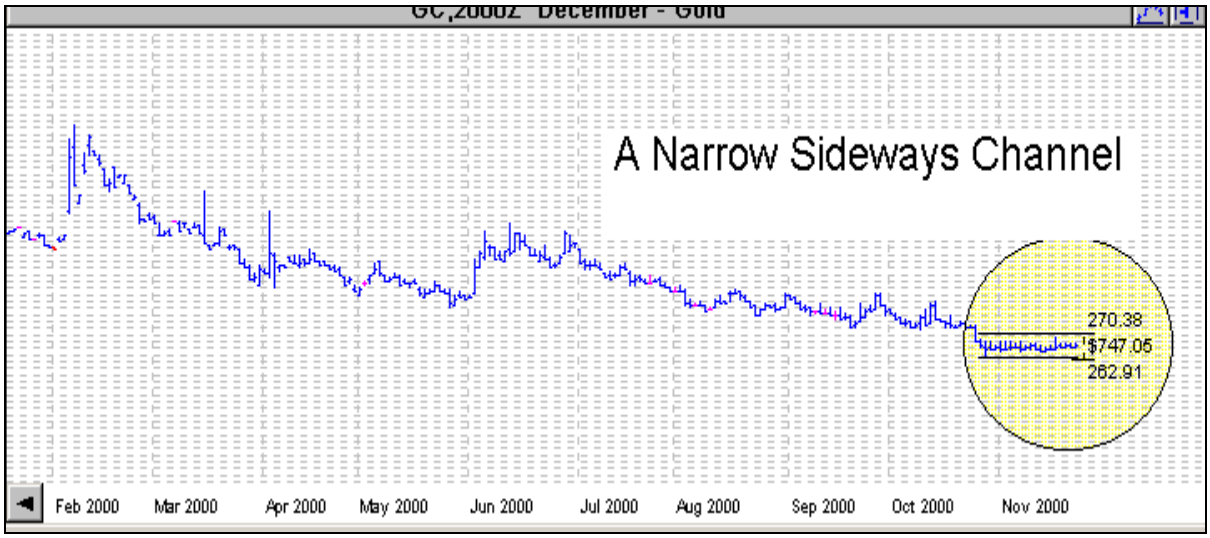
There are several types of channels, and I love them all! They are some of the most reliable formations you will find on any chart. They don't happen often, so you won't get to trade them much, but when you do, you'll learn to love them like I do.

The difference in channels and trading ranges are that trading ranges tend to be wider in price than channels, although channels are in themselves a narrow trading range. Also, channels can ascend and descend, whereas trading ranges go across the charts between two high and low prices. You will want to trade channels like you would trade trading ranges, as far as putting in your stops and your orders.

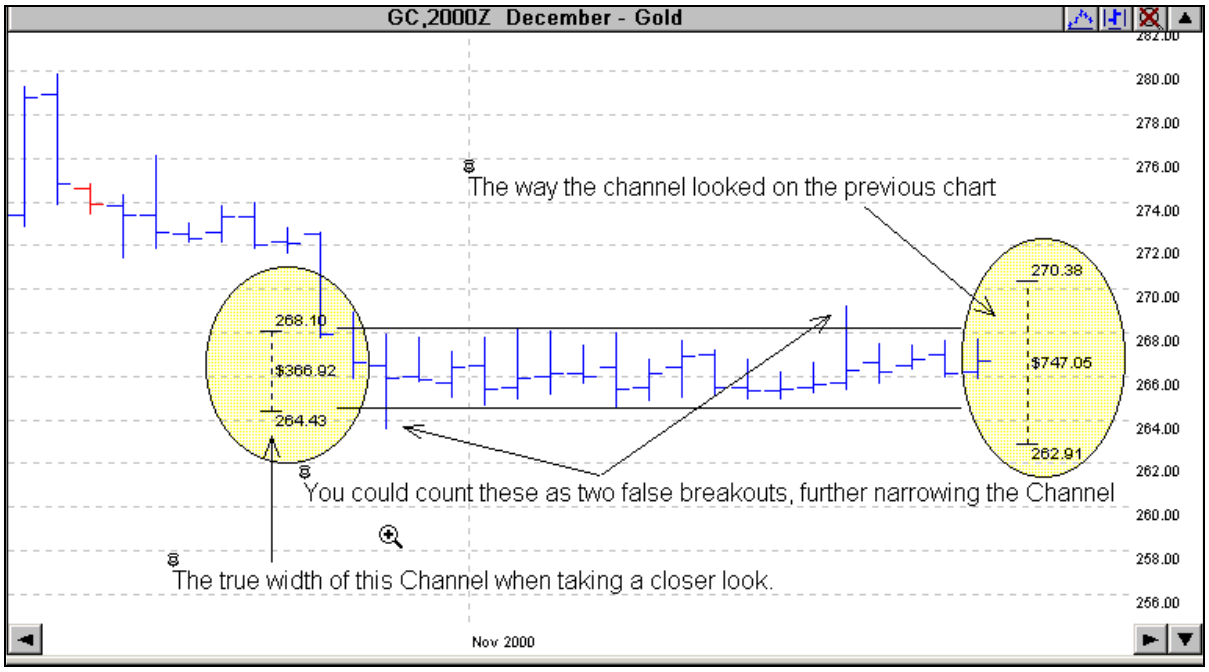
Narrow Sideways Channels

There are only three directions that prices can go. I'm sure you know two of them: up or down, right? But how about sideways? That's right! Sideways. Let's look at the following chart.

I have included two charts on December Gold 2000. The first chart shows you a longer time frame so that you can see just how narrow the channel really is. The second chart of the same contract is enlarged so that you can see the channel prices a little better.



The following chart is also of December Gold 2000. It's just enlarged.



One of my favorite features of Gecko Charts 2000 is that you can enlarge the charts like I did above. If you were not able to really "see" the width of this channel (like on paper charts), you could be placing your orders and your stops too far apart, therefore increasing your risk needlessly.

When trading a channel, you would place your order to buy (go long) on a breakout to the top of the channel, and an order to sell (go short) on a breakout

to the bottom of the channel. You could put your stop on the opposite side of the channel from your order. If you were long, your stop would be just under the bottom of the channel; and if you were short, your stop would be just above the top of the channel.

On this particular channel, your risk would be about $366 plus commissions. For Gold, this is a very small risk. Gold usually trades in a much wider range than this. Like I said, channels don't happen often.

Keep in mind that you never want to trade the first day of the breakout, since many times it will be a false breakout. Wait at least two days, if not three days, before entering the market. Notice the two false breakouts on the previous enlarged chart. By waiting for a day or two, you would have saved yourself from a bad trade, because the price jumped back into the channel.

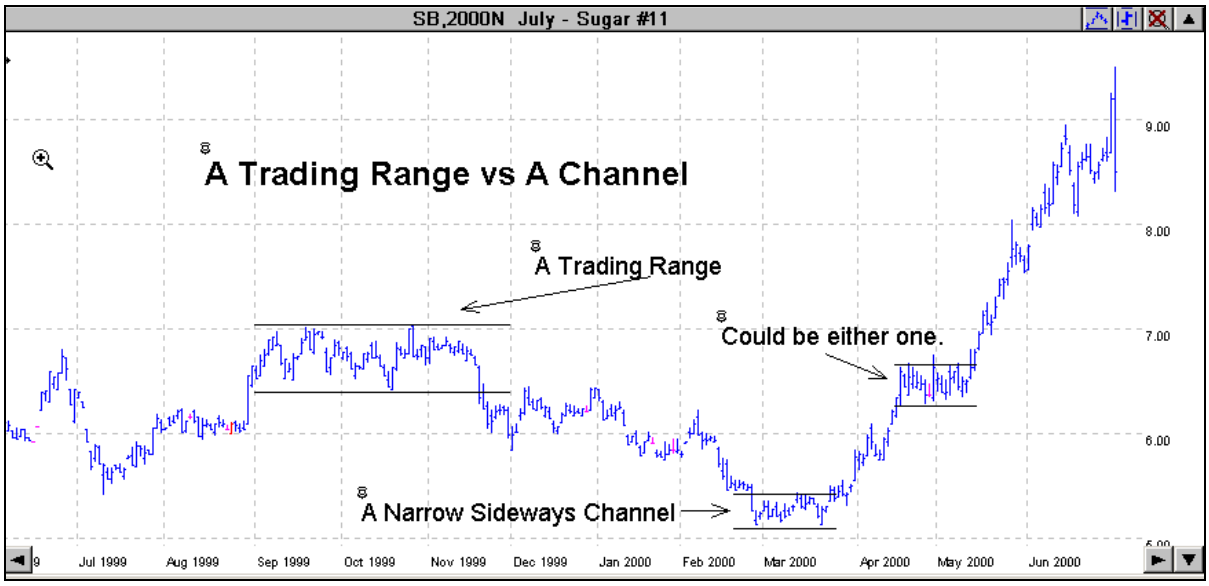
When you place open orders, this means that they are just "sitting there" waiting to be filled. Most of the time, I will use *alerts* rather than open orders. An alert is just as the name implies—it alerts you when something happens. To use alerts, you would call your broker (most are set up to do this) and ask him/her to alert you when the price of Gold (in this example) goes above 268.20 (the top of the channel) or when it goes below 264.50 (the bottom of the channel). This way you can watch it more closely and get ready for a trade. Of course if you have Gecko Charts, you can draw this out on your own chart, just like I did here, and you can watch it every day yourself.

Keep this in mind—if it looks like a channel, it probably is a channel.

Sometimes, it's hard to tell the difference between a trading range and a narrow sideways channel. Really, the only difference is the width of the formation.

On the following chart of July 2000 Sugar, I have drawn out three formations for you. One is an obvious trading range, one is an obvious narrow sideways channel, while the other one could be either. Remember, it's an art, not a science.

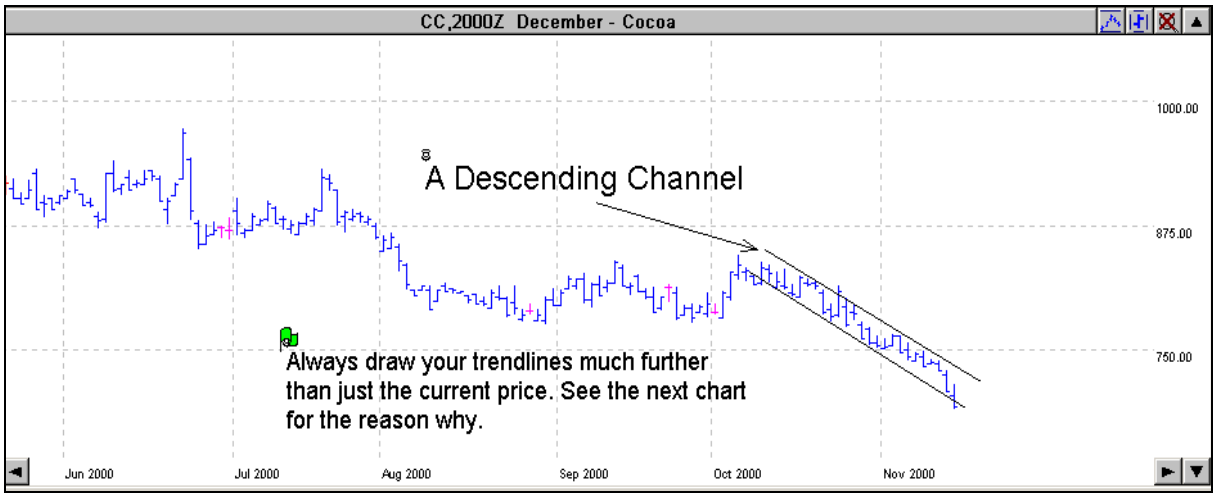
Do you see another trading range on the following chart? How about another narrow sideways channel?



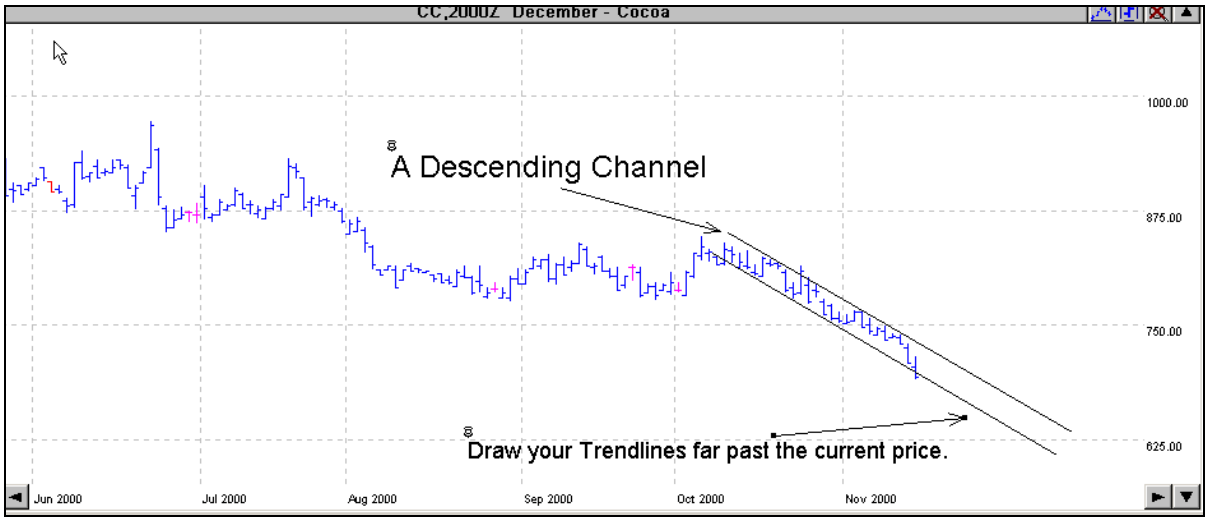
Ascending and Descending Channels

Ascending and descending channels look like narrow sideways channels, but can be wider in price and, of course, they are either ascending or descending. At some time the price will break out of this channel. When it does, you want to be long if it breaks out to the top, and short if it breaks out to the bottom of the channel.

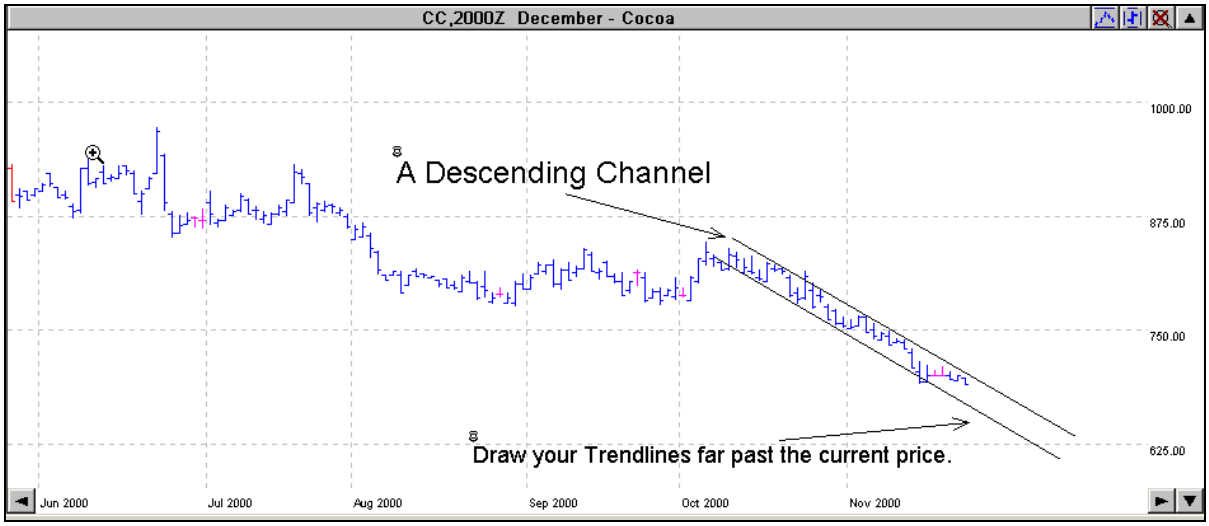
Just like in narrow sideways channels, wait one or two days after the breakout to make sure it's not a false breakout. The small amount of money that you sometimes lose by waiting will be made back many times over by the amount of money you save by not jumping into bad trades early.



When I first started learning to draw trendlines, I would not draw them past the current price on the chart. I found this to be an error in judgment. You should always draw the trendline far past the current price. Notice on the previous chart, I just drew the trendline to the current daily price. On the following chart, I drew the trendline far past the current daily price. (Gecko Charts are great at doing this, by the way.)



On the first chart, it looks like we may see a breakout to the downside. If you had placed your order the first day of the breakout (the last day on the above chart), we can see what would have happened by taking a look at the next chart.



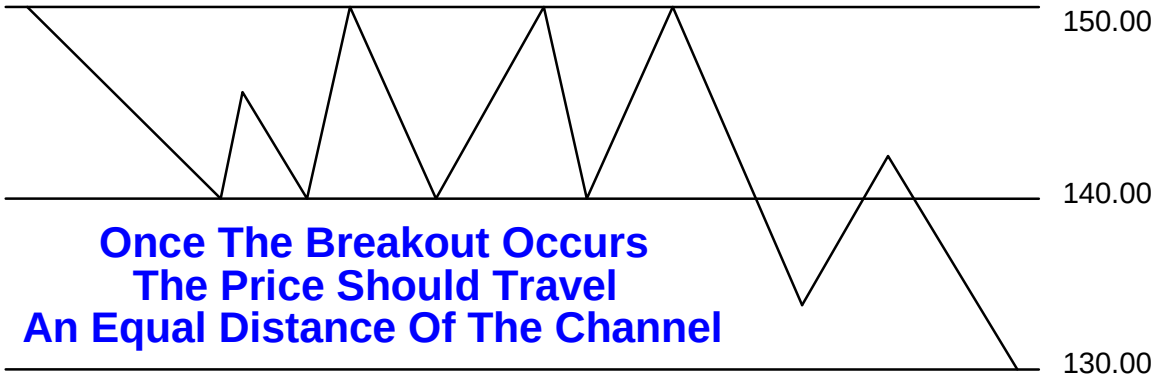
As you can see, the price went sideways and is still in the channel as of the date of this writing. It will be interesting to see which way it goes when it does breakout of this channel.

You would place an order to go long above the breakout and an order to go short below the breakout. Your stops would be on the opposite side of the channel in this example.

How Far Should Prices Move?

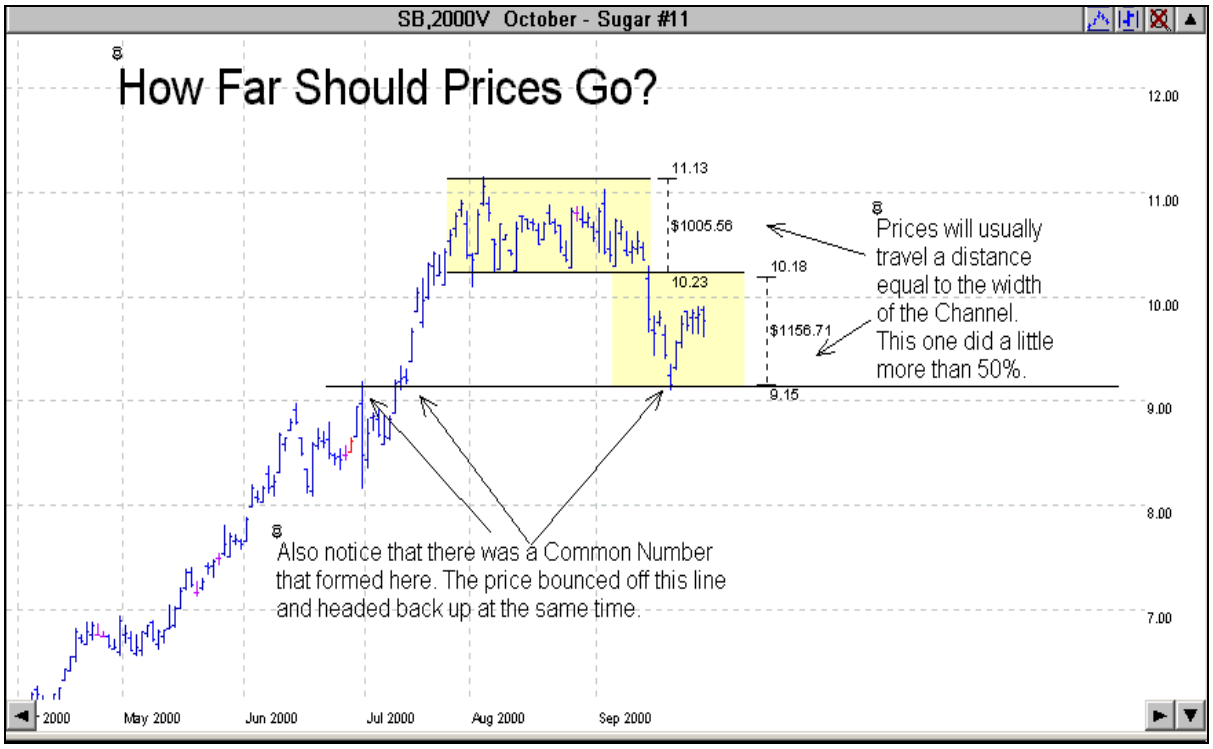
When the price finally breaks out of a sideways channel or a trading range, it should continue the distance that is the width of the channel it just broke out of.

Let's look at the following diagram for a visual look at this rule.



Let's also look at a perfect example on the following chart. Notice the distance the price rallied once it broke out of this trading range. It is almost exactly the width of the channel that it broke out of. You can use this rule to anticipate where you might want to take profits, and if it goes past this point, you can also consider adding another contract.

Another interesting factor to consider is that when the price did turn around and head back up again after the breakout, it did so almost exactly at the place a *common number* formed. **Common numbers will act as both support and resistance numbers on the same chart**. I always draw out my support and resistance lines as well as any common numbers I see on any chart that I am studying. Again, Gecko Charts does a great job at this.



Knowing that the price should go at least as far as the width of the channel, or trading range, that it just broke out of, how can you use this knowledge in your trades? Think about this for a moment! How about using this price point as a profit target, a place to add contracts (if the price breaks through), or a place to reverse your position (if the price hits this point and bounces off as it did in the chart above)?

Gaps

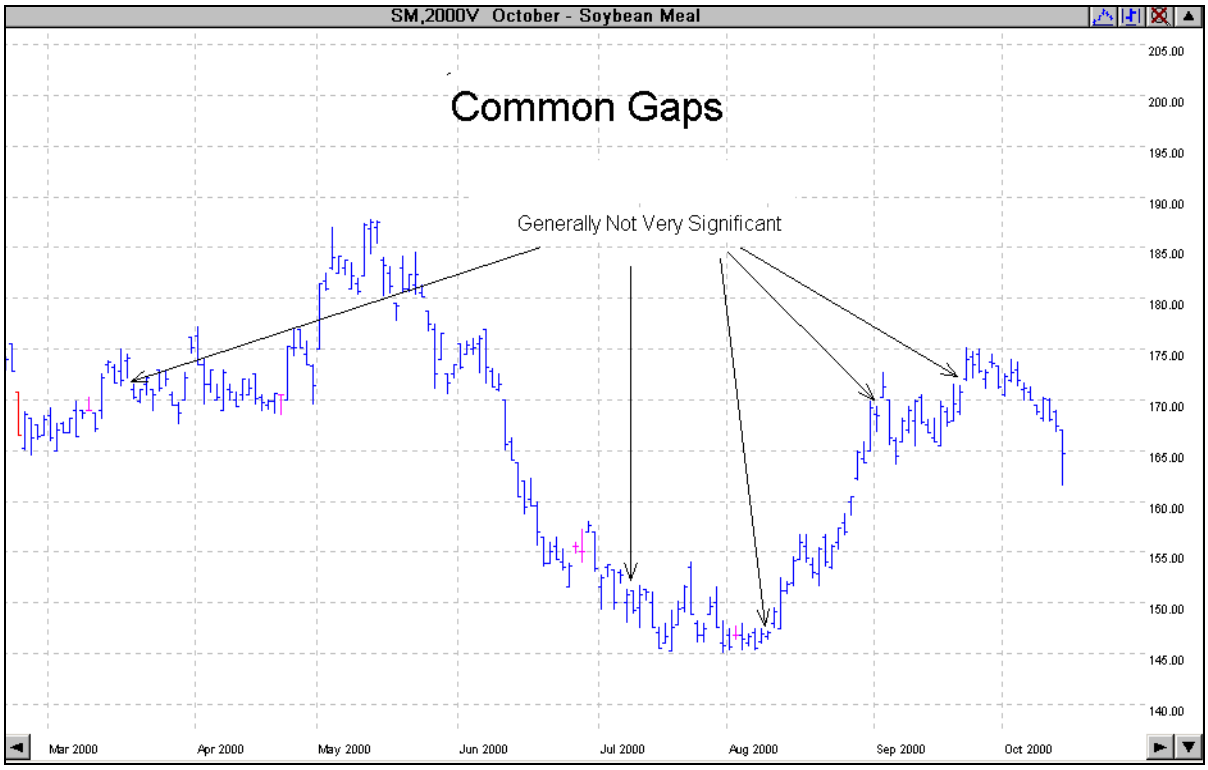
There are four types of gaps. I'll give you a short explanation and a chart of each of them. Many people think that all gaps are filled. That's not true. Some gaps are not expected to fill, but many will. We will cover each one of them.

Gaps are simply places on a chart that did not have a price action that day. As an example, say the low today for Sugar was 9.00, and the next day it opened at 8.00 and did not go above that. There would be a gap (space) in the price that day of 1 cent, between 9 cents and 8 cents. Not complicated at all.

You will find out that some types of gaps are important indicators, and others are not important at all.

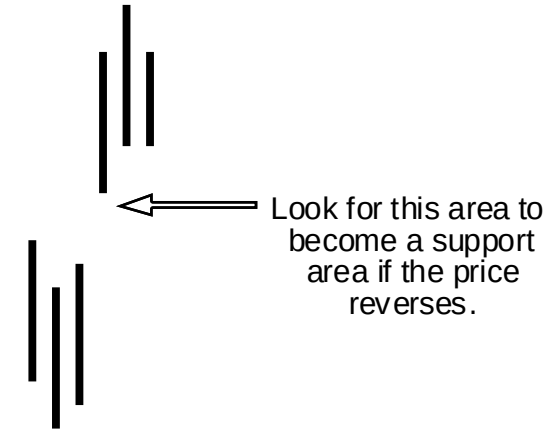
1. Common Gaps. These usually occur within a trading range and are not indicative of a major price move. In other words, they are usually insignificant.

Some people feel they occur because of a simple lack of interest in the market that day. We will talk about looking at volume (the number of orders placed that day) a little later.

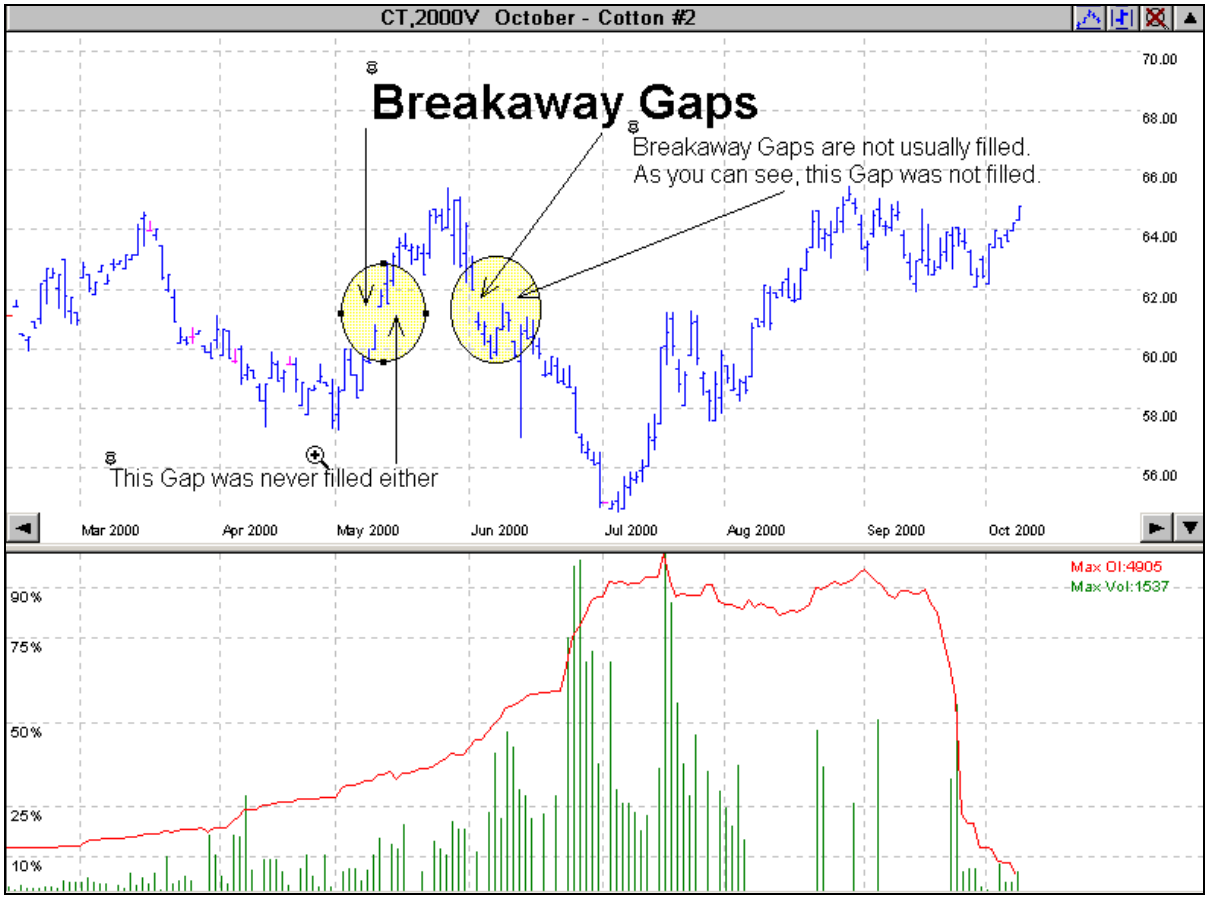


2. Breakaway Gaps. A breakaway gap is an extremely reliable indicator. These often occur when a particular price pattern completes. When they do occur, they leave a space that has not been filled in yet. They are usually indicative of a big market move.

Also, when these gaps occur, you will usually, but not always, see a significant increase in the volume that day. Breakaway gaps are not expected to be filled, and the heavier the volume the day it gaps, the less chance that it will be filled.



On the occasions that a Breakaway gap does fill, it's a good sign that it's a false gap and the trend will not hold. Look for the gap to become a support or resistance area later, too. Let's look at the following diagram to get a better idea of what this means.



The vertical lines at the bottom of the previous chart reflect the volume. Volume is always a day late on the charts. As an example, volume on Tuesday reflects trading done on Monday. We will study volume in more detail later in the course. Notice, the first breakaway gap did not have much of an increase in volume, but the second one did.

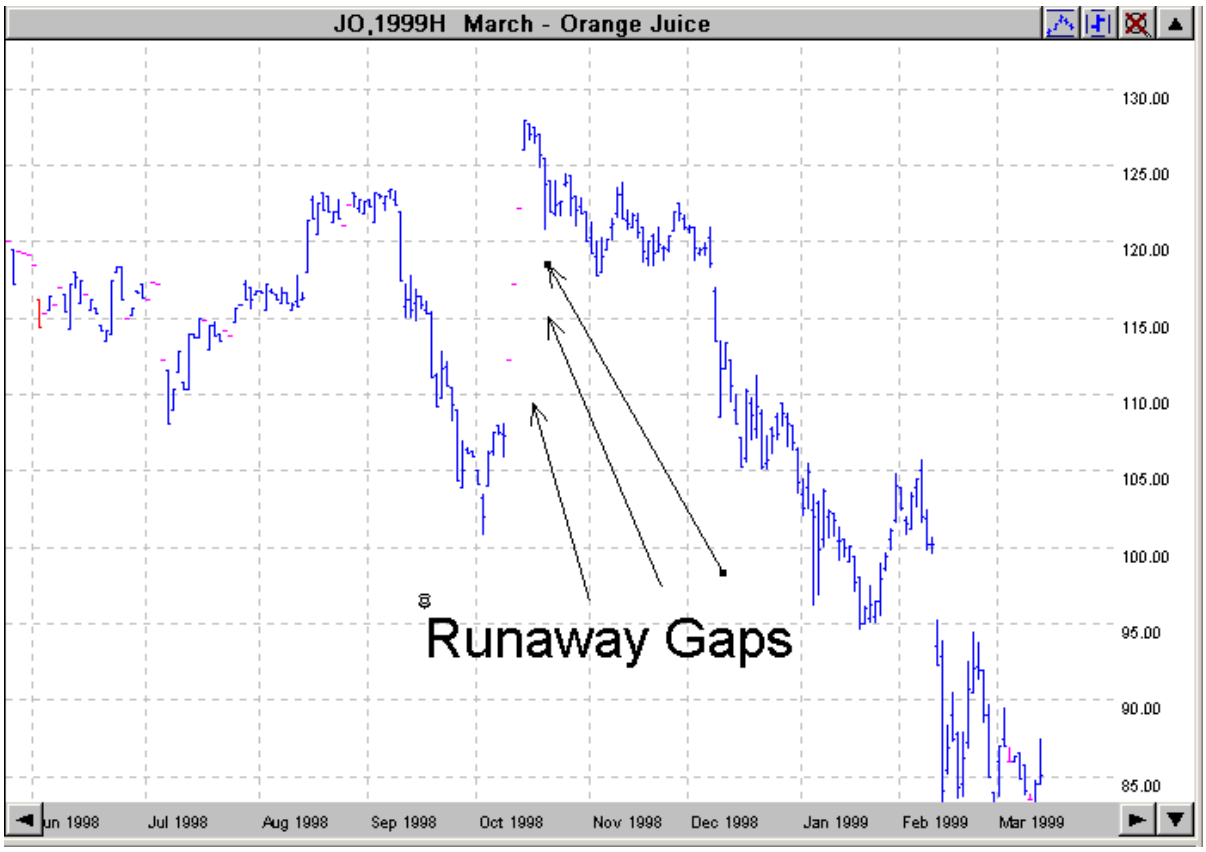
The wavy line on the bottom section of the chart reflects the *open interest* on this contract. Why do you think we see a big drop in open interest (the total number of "open" contracts) starting in September in this contract? Answer: because the contract is about ready to expire, and everyone is probably trading the next contract month and not this one. So you should also be looking to trade the next contract month, not this one. **Pay close attention to this when placing your orders**. Make sure the contract has at least 30 days before FND. Your broker can give you the exact dates.

Do you notice a nice trading range forming at the end of the chart? Do you think the resistance at the top of this range is strong or weak? How many times has the price come up to just above the current price, and headed back down again? Do you see a potential opportunity to short the market if the price hits the top of this range and bounces off again? You should if you don't.

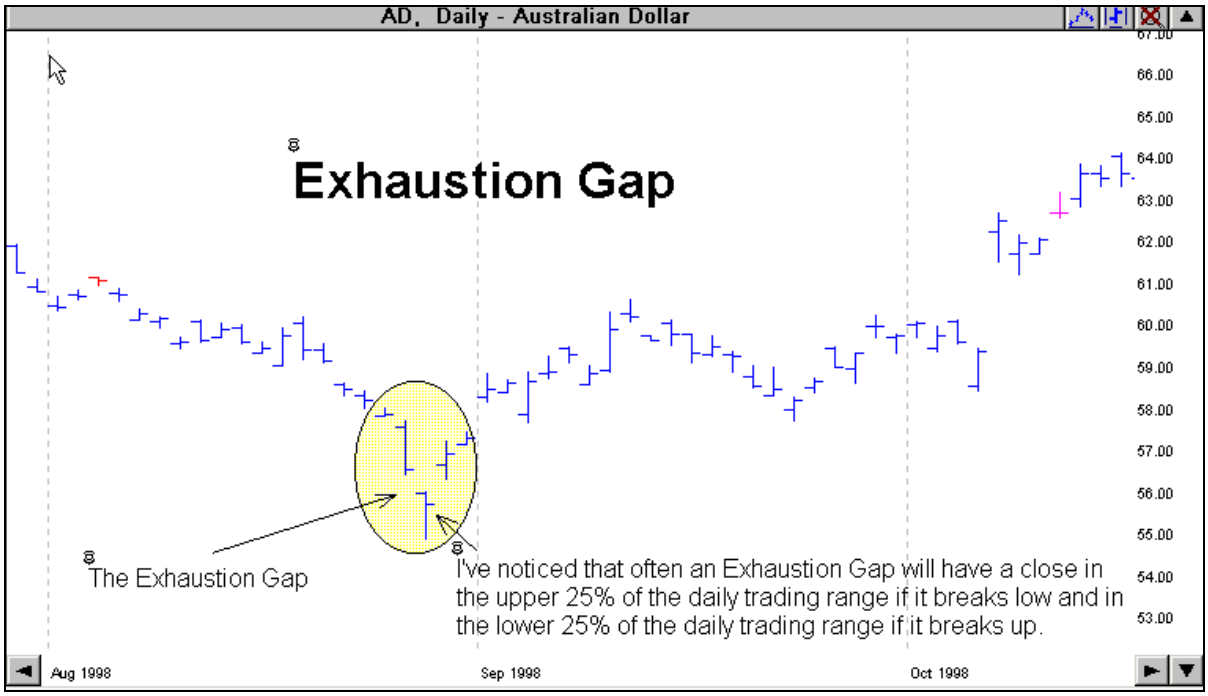
3. Runaway Gaps (sometimes called Measuring Gaps). These don't happen as often, but when they do, it usually indicates an accelerating trend and a strong bull (or bear) market. Many times these gaps happen in limit-up days, or limit-down days (the maximum amount they allow the price to move, but some markets don't have any limits), and may continue for several days. Unlike other formations, it does not take large volume for them to take place either on the upside or the downside. As a matter of fact, they usually start on moderate volume.

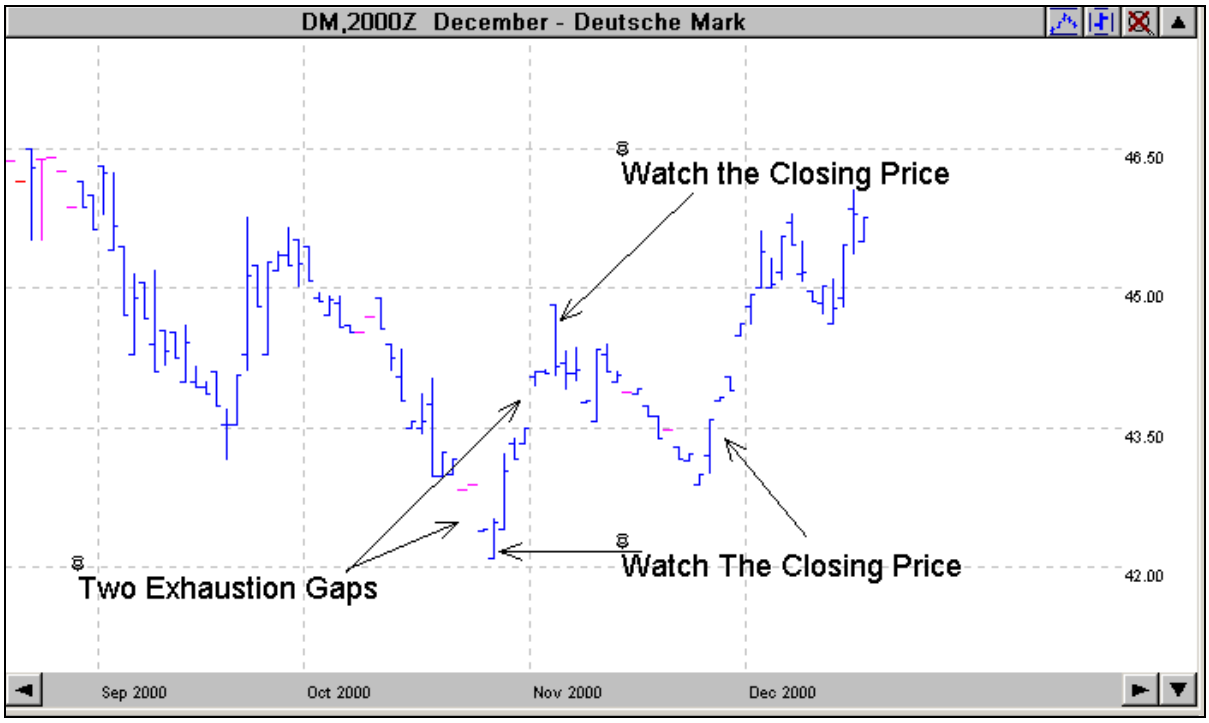
Most of the time these gaps are not filled right away, but if they are, it's an indication that the move has lost a lot of its strength. A good place to put protective stops in on the top or the bottom (just above or below) the Gap.

The reason that these are sometimes referred to as measuring gaps are that they will take place midway in a trend. So, if that's the case, you can "measure" the expected move. Since they often start in the middle of a trend, when you see one you can expect the price to increase an equal distance from the start of the most recent trend to the first runaway gap. In other words, when the move is over, the first gap will have occurred in the middle of the trend.



4. Exhaustion Gaps. These occur when the price has been rallying or declining over an extended period of time. Exhaustion gaps are not indicative of a continued bull or bear market. As a matter of fact, sometimes just the opposite happens and you will see a trend reversal. Be careful when you see these, because you might think they are the start of a runaway gap.





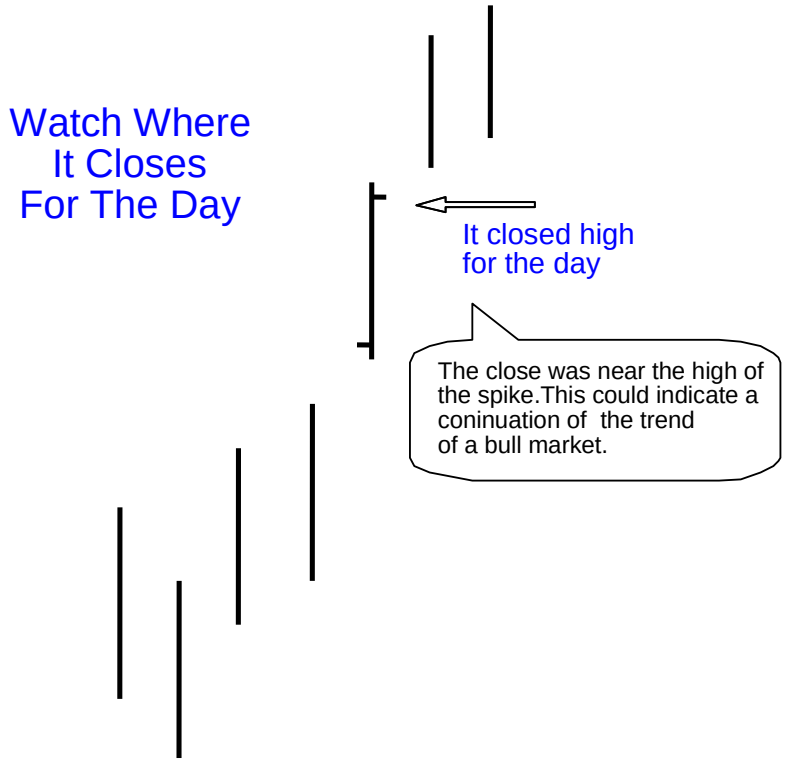
Exhaustion gaps don't happen that often, so don't waste a lot of time looking for them. To give you an example, I looked through all my charts for over an hour to find two of them to show you.

Spikes

Spikes are wonderful indicators and I love watching for them. Everyday I look at my charts to see if a spike occurred that day.

A *high spike day* is when the current day's high is "way" above the high of the previous day. When a high spike day occurs, look and see if the closing price that day is within 25% of the low reached that day. If it is, most likely you will have a price reversal the next day, and the prices will head back down. The opposite is true of a low spike day, so look and see if the close of the day is within 25% of the high reached that day. If it is, look for a price reversal the next day and for the price to head back up.

Notice in the diagram below, where we had a high spike day, the trend did not reverse.

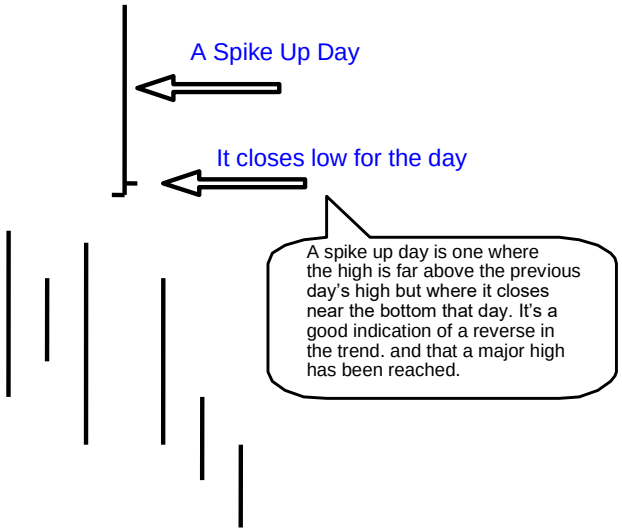


An indicator that the trend might continue was that the **closing price** on the spike day was in the **upper 25%** of the day's trading range. This indicates a possible continuation of the trend and not a reversal.

If the price had **closed** in the **lower 25%** of the day's trading range, then you would look for a possible trend reversal to take place the following day.

Spikes are easy to spot, and offer a good trading opportunity. Watch closely for these formations to take place. In the following diagram, you will see a high spike day that closed in the **lower 25%** of its trading range.

When this happens, it might continue going up the next day, but in many cases, it's going to reverse trend and head south. When it does close in the **lower 25%** of its trading range, I suggest you place an open order to go **short** at market the following day, but keep tighter stops than usual.



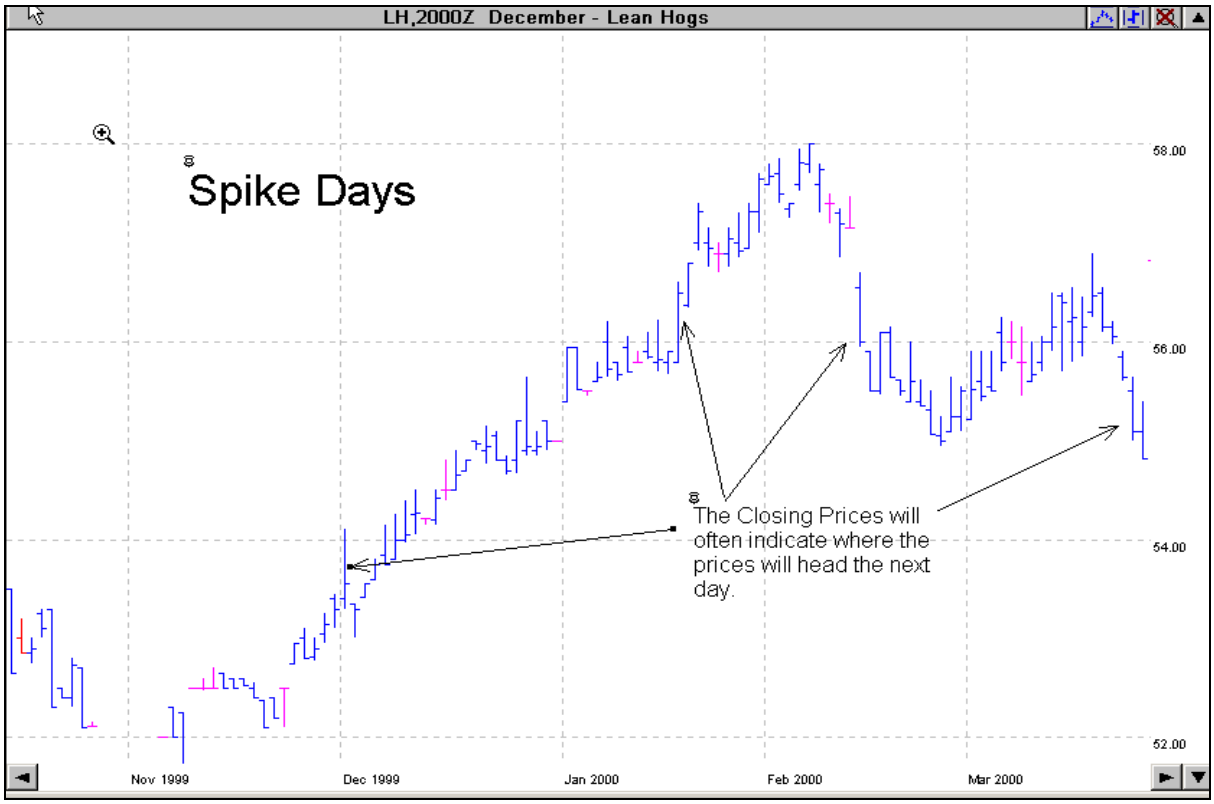
Trading Spikes: Spikes offer some of the best opportunities for making money that you can find. As you know, there are spike-up days and spike-down days. Both can be great opportunities if you learn to trade them correctly.

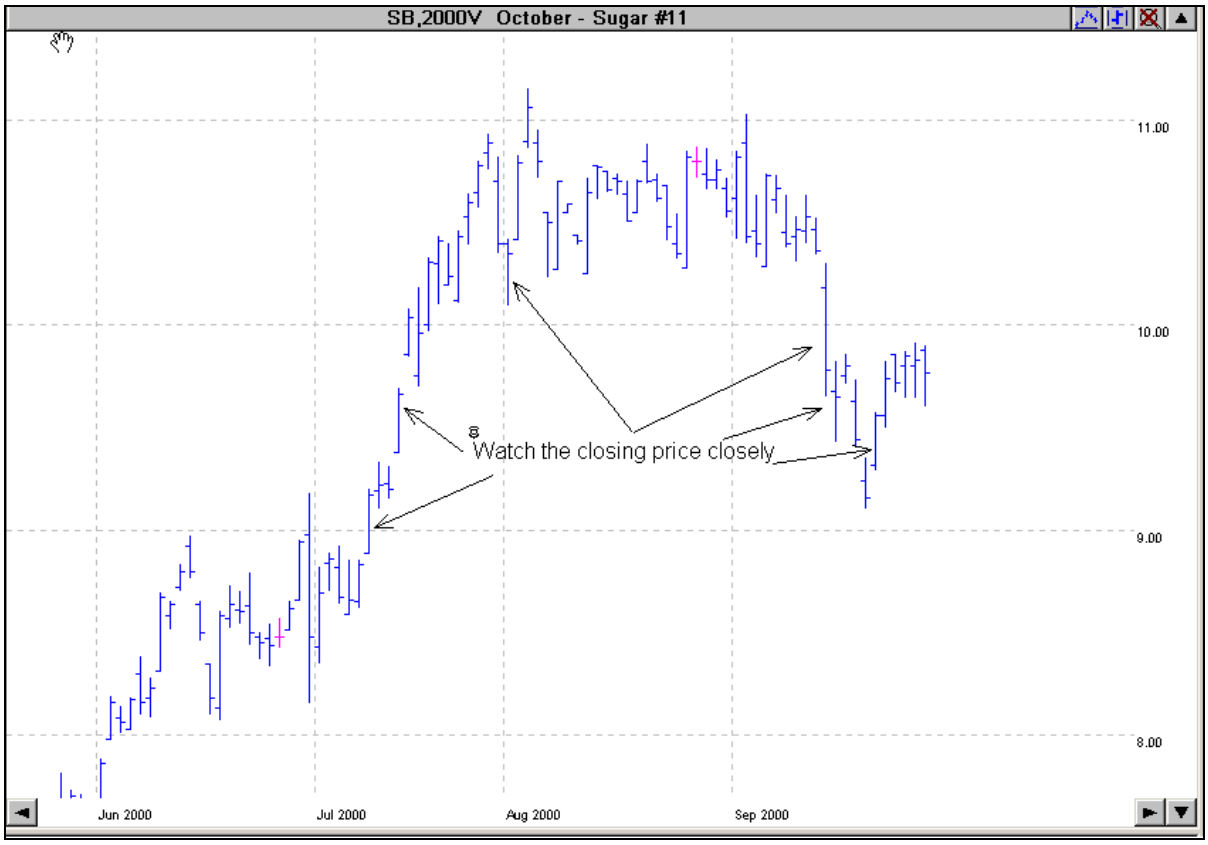
If a spike-down day closes high, I suggest you place an order to buy (go long) the next morning at the opening price, because it will usually rally the following day.

Now, where should you place your stops? Your initial stop should be below the low of the spike-down day from the day before, provided it meets your reward/risk ratio. If not, you should look at placing it below the low of the day, before the spike-down day.

On the other hand, if the spike-down day closes in the lower 25% of that day's range, I suggest you place an order to go short the next day at a break below the low of the spike-down day. I don't suggest you place an order to go short at the opening price, but rather use a sell-stop order to go short, just **below** the low of spike down day.

Let's look at some examples of some spike days on the following chart to see what they look like.


LH,2000Z December - Lean Hogs
Spike Days
The Closing Prices will often indicate where the prices will head the next day.
58.00
56.00
54.00
52.00
Nov 1999
Dec 1999
Jan 2000
Feb 2000
Mar 2000


SB,2000V October - Sugar #11
Watch the closing price closely
11.00
10.00
9.00
8.00
Jun 2000
Jul 2000
Aug 2000
Sep 2000

Homework Lesson Three

1. Think of _____ as the floor, and _____ as the ceiling.

2. The _____ level sometimes becomes both support and resistance level.

3. A _____ number is a price point where both support and resistance have formed, just at different times.

4. Prices tend to find major support or resistance at even numbers.

True _____
False_____

5. The 50% level simply represents the _____ price over a specific period of time.

6. All prices will do a 50% retracement over a period of time.

True _____
False_____

7. The 50% level is a valuable key to technical trading.

True _____
False_____

8. You can use 50% internal retracements to figure entry and/or exit targets.

True _____
False_____

9. A _____ is a wide horizontal channel that contains the price for an extended period of time.

10. You should usually wait how many days to place a trade after a breakout of a trading range. _____

11. The difference in _____ and trading ranges are that trading ranges are wider in price.

12. There are three ways a price can go: up, down and _____.

13. You would place an order to _____ if the price breaks out of the top of the channel, and _____ if the price breaks out of the bottom of the channel.

14. In a sideways channel or a trading range, when the price finally breaks out, it should continue a distance that is the _____ of the channel it just broke out of.

15. List the four types of gaps:

A. _____

B. _____

C. _____

D. _____

16. Which of these gaps is usually insignificant? _____.

17. _____ gaps are usually indicative of a big market move.

18. Runaway gaps are also called _____.

19. _____ gaps occur when the price has been rallying or declining over an extended period of time.

20. Spikes are not good trading opportunities and should be avoided.

True _____ False_____

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It is bigger, better, more charts, more graphics, more videos. Simply put, it's better in every way. The first version was under 100 pages and as time went on I added to it until it became a whopping 450 page course with dozens of videos.

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The new Version II is COMPLETELY updated with much of it being rewritten. It now has over 50 videos that are 10 hour long and is on online in an eLearning center.

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Best wishes,
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Boquete, Panama