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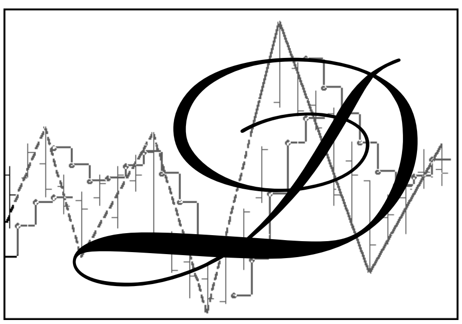
Setting Targets & Stops For Your Trading Plan Part II



Dear Trader

This issue carries on where Issue #8 left off, showing a technique for identifying targets and stop loss points. To determine these two important parts of a trading plan without some supportive statistical evidence is impossible. That is what the MFA and MFE provides for you. Of course, there are many ways to handle stops. I found this concept both valid and useful.

Important Announcement

A new baby is born!
Name: Wizard On Wall Street Inc.
Weight: A heavy weight to be sure.

Thom Hartle and I have joined forces to create the finest Professional Trading course on the planet. Some of you may already know that Thom Hartle has left his position, after nine years, as Editor of the most respected and largest circulation magazine in the industry, Technical Analysis of Stocks & Commodities magazine. He brings with him twenty years of trading on top of the nine years as an Editor. This is experience at the highest level. I welcome the opportunity to work with a true professional. Together we can assure you a product that will be worth every penny we charge. After completing the course you may even say “that was the cheapest” education for valid trading knowledge. Please read the enclosed preliminary information sheet at the end of this issue and give it your consideration.

I wish you excellent trading,
Robert Krausz, MH, BCHE

SETTING TARGETS AND STOPS FOR YOUR TRADING PLAN, PART II

In the last issue of the Fibonacci Trader Journal we introduced two concepts. The first was Maximum Favorable Excursion (MFE), which is the maximum profit level attained while in a trade, whether the final outcome was a profit or a loss. The second concept was Maximum Adverse Excursion (MAE), which is the level of loss experienced for each trade, whether profitable or a loss. We then tested a trading system over the month of April, 1999 on a 10-minute/50-minute/Daily plan of the June T-bond contract using a system that used the Dynamic Trio Next for our *entry and exit* signals with the Dynamic BP Step High as our *trend* indicator.

We would take a buy signal to go long based on the Dynamic Trio Next if the Dynamic BP Step High is below the prices (the trend is up).

Sell short signals based on the Dynamic Trio Next would only be taken if the Dynamic BP Step High is above the prices (the trend is down). Any other signals would be an exit and go flat scenario.

Next we analyzed the individual trades to determine the MFE and MAE of this system for one month's worth of trades. Figure 1 shows a composite histogram of the trades with the MFE, MAE, Profit or Loss, and the Equity Line for the month of April.

Our ultimate goal was to enhance profitability by using a two contract trading approach. The first contract would be exited if the target price (based on the MFE analysis) was hit and the second contract would be exited based on the system's indicators flipping direction. Through the MAE analysis we also determined a reasonable place to use a stop loss exit because we found that there was a point that a losing trade never recovered.

Now we want to take what we learned and apply the information to trading in the month of May.

Figure 2 is an example of our target method

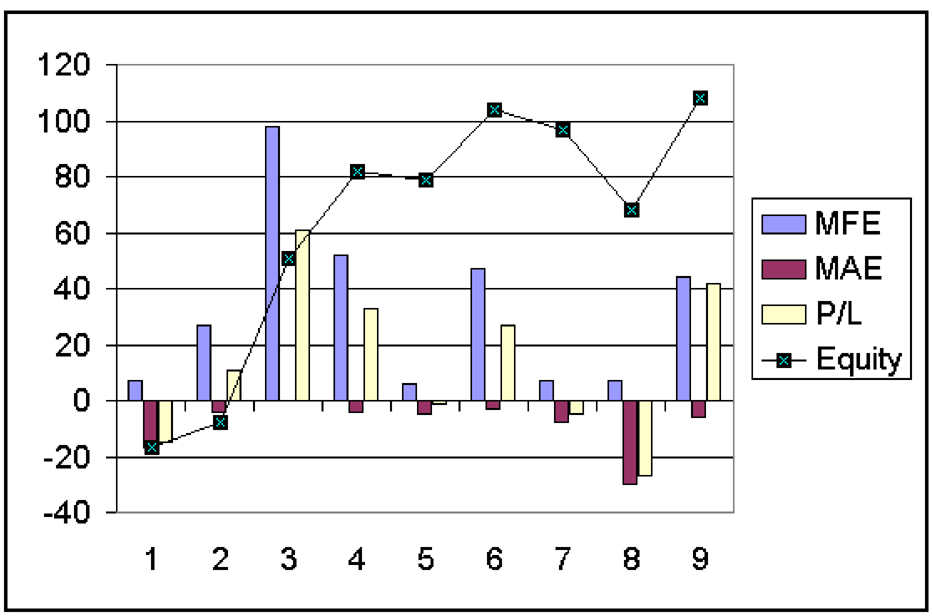


Figure 1: June 99 T-bonds 10/50/Daily Plan. Here are the trades for the month of April. The winning trades went at least 20 ticks (MFE), the losing trades exceeded a10-tick loss and did not recover. The system made over 100 ticks including slippage and commissions.

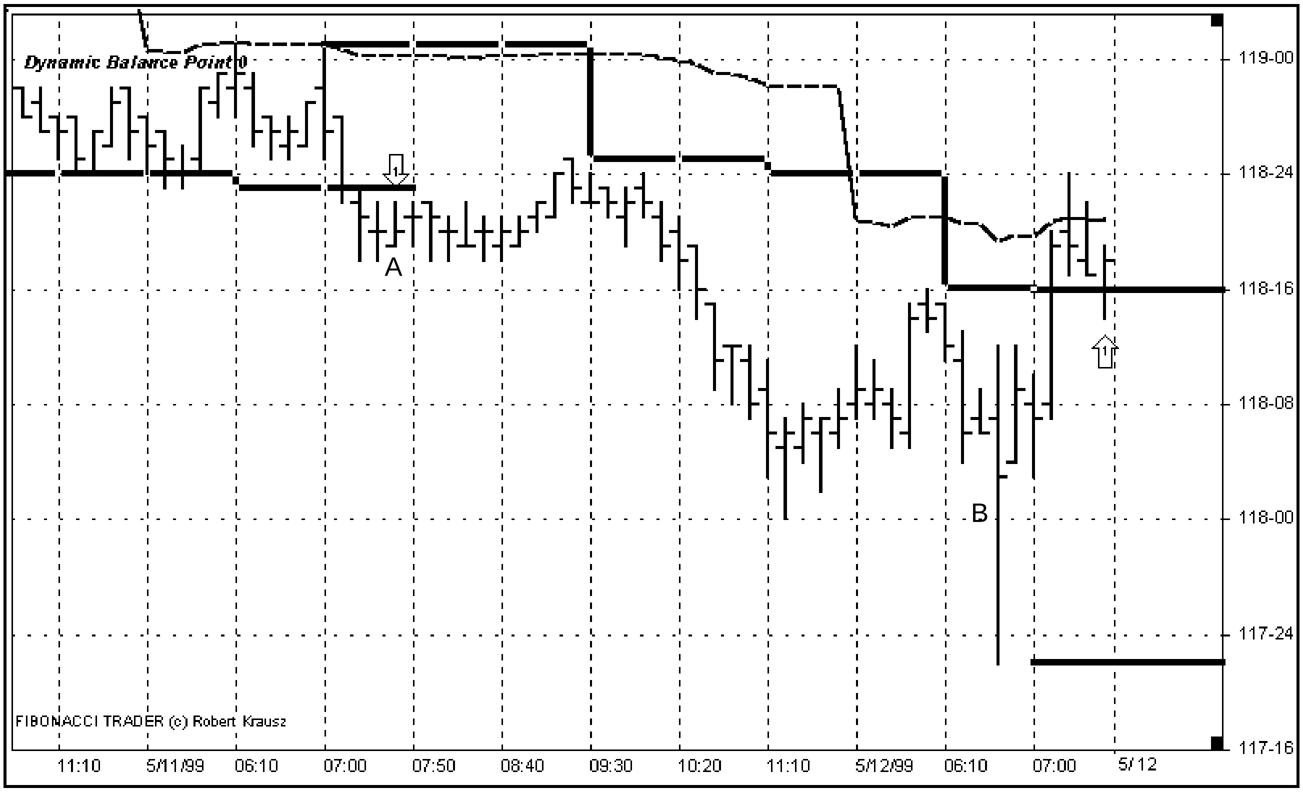


Figure 2: 20-Tick Target. Using our analysis from April we set a 20-tick target for trading in May. After going short on Bar A, the target was hit the next day on Bar B.

in action. From the MFE analysis of the month of April we could see that a twenty tick target was a reasonable objective. For example, in Figure 2, the system went short at Bar A at 118-20. Then, later on in the same day, the target was touched at 118-00, but we would not expect a fill because the price did not trade through the 118-00 level. Fortunately, the next day the market traded through the target price of 118-00 and therefore the target was filled. That same day the system went flat at 118-18 for just a two tick profit.

This is a nice example of our goal: If the market trends we will be smiling, but if the trend aborts, hopefully, we will put something in the bank for our efforts.

Our ultimate goal was to enhance profitability by using a two contract approach.

Figure 3 is an example of using our ten tick stop loss technique as well as a realistic picture of the challenges of trading. At bar A the system went short during a rebound into the close after a

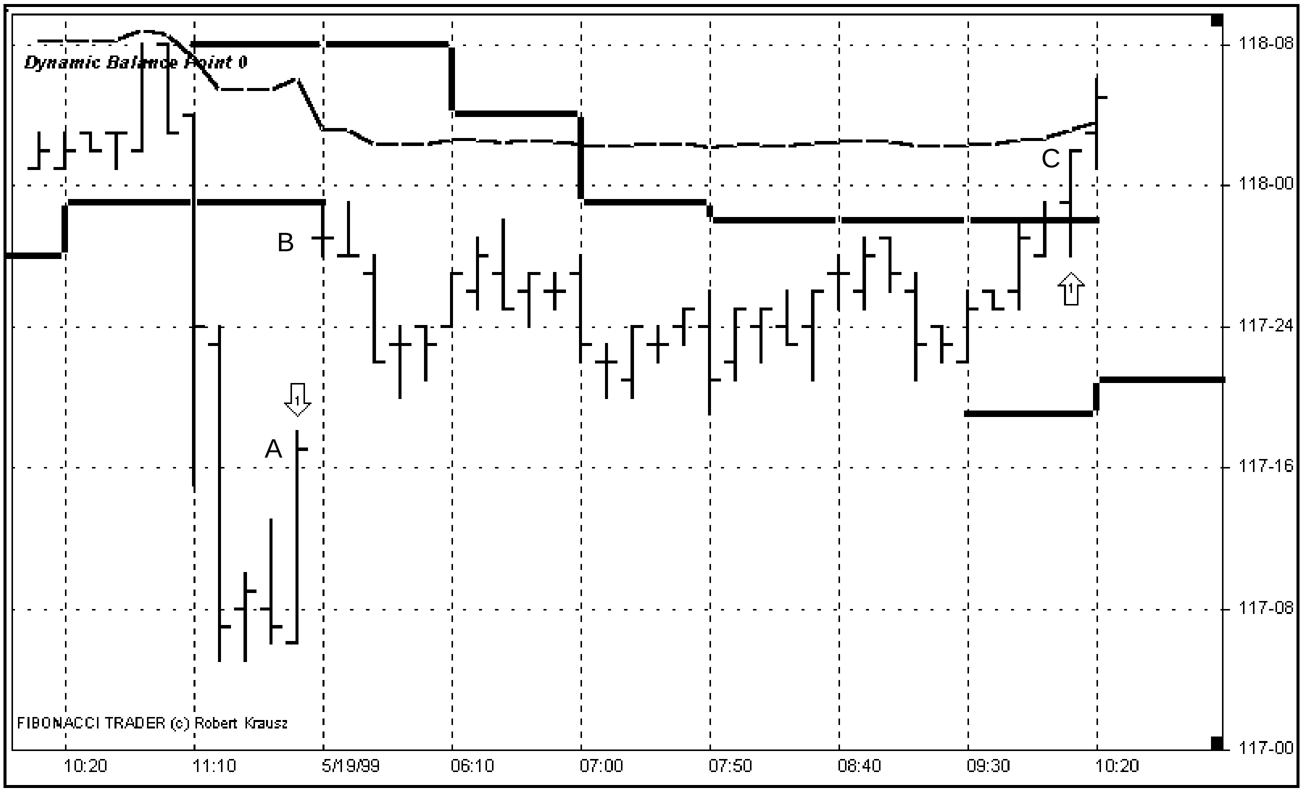


Figure 3: June 99 T-bonds 10/50/Daily Plan. Here, we see a late signal to go short on a rebound after a full point sell off. The market gapped against us, the gap was filled, then the market advanced and the trade was exited for at least a 17 tick loss.

one point sell off. The next day the rebound continued on the open with a 12 tick gap up opening. Then the market spends most of the day trading sideways, filling the gap, and then rallies to the point where the Dynamic Trio Next flips, and the system exits with a 17 tick loss. The novice trader would say "What kind of a system goes short after a one point sell off and then exits near the origin of the trend?!".

This is the reality of using fixed rules, in that there is no Holy Grail, and there will be times when the rhythm of the market and the fixed rules of the system are not in gear. But not all is loss here.

Recall that our MFE analysis taught us that the trades that exceeded more than a ten tick loss did not recover. Using that new rule, we would have exited on the open at 117-29 (Bar B), with slippage we would have loss 12 or 13 ticks, and now we are done, that's it.

No fretting about the market being against us; no wondering if you should cover if the market trades lower or should you sell more to improve your average price. You don't have to ask yourself does the gap mean strength and therefore you should stop and reverse your position. There is no pressure because we know precisely what to do, and we forget the losing trade and wait for the next signal. In this case the stop loss saved us some money as the market ultimately traded higher with the original system losing 17 ticks on the exit (Bar C).

Now we will look at trading the original system during the month of May and include the 20 tick target and 10 tick loss, and see if the new procedures enhance the profitability.

First, though, because we closed out the short single contract position at the end of April for our original test we are faced with questions: Do we assume a new trade on Monday at the open and then use a ten tick loss from entry? Or, do we wait for the next signal and maybe miss out on a trend that started during April, or do we see if the market retraces towards our Dynamic Trio Next for a low risk entry.

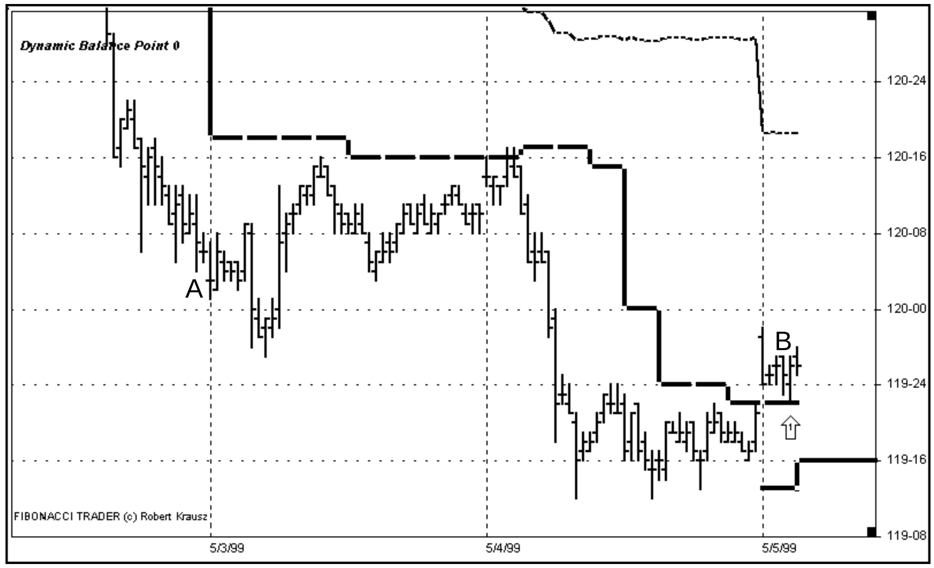


Figure 4: June 99 T-bonds 10/50/Daily Plan. Here, we established the trade on the open because the trend is already underway.

The fact is, we don't know what will happen the first day! Our indicators are definitely saying to be short. Does going short, and using a ten tick stop loss from the opening seem reasonable? No, because our original MAE is based on our trend following tools indicating a trend has reversed direction. We have *no* information regarding the retracement activity *while* a trend is underway, and so we are asking to be stopped out for a ten tick loss due to the random fluctuations of the price movement, and nothing else. So, we can either wait for a new signal or respect the indicators and go short one contract on the open. For this test, we'll go short one contract on the open the first day, May 3rd.

Why not two? Because the trend is well underway in this case and the target was hit the day before based on the original signal.

Now let's take a look at how the first trade unfolded in Figure 4. Our entry was 120-03 (Bar A), the opening, and the market did trade lower, but then retraced right to the Dynamic Trio Next, reversed and trended down quite nicely. We exited our trade the next day on Bar B for a nine tick profit.

Figure 5 (next page) is a table showing the MFE, MAE, Profits and Losses, and Equity for the month of May using the original system rules (one contract) used in April. Here we used a two tick slippage, and the system lost 31 ticks for the month. Figure 6 shows the composite histogram of each trade with the MFE, MAE, Profit or Loss, and Equity Line.

Trade	Date	Time	B/S	Entry	Date	Time	Exit	MFE	MAE	P/L	Equity
1	5/3/99	7:20	-1	120-03	5/5/99	8:00	119-26	23	-14	9	9
2	5/6/99	8:00	-1	119-16	5/10/99	10:30	118-28	40	-4	20	27
3	5/11/99	9:40	-1	118-20	5/12/99	9:40	118-18	20	-5	2	27
4	5/12/99	10:00	1	118-24	5/12/99	10:10	118-18	1	-6	-6	19
5	5/12/99	11:10	1	118-25	5/12/99	12:00	118-19	4	-9	-6	11
6	5/13/99	7:20	1	118-29	5/14/99	7:30	118-19	23	-14	-10	-1
7	5/14/99	8:00	-1	117-27	5/18/99	8:00	117-30	30	-6	-3	-6
8	5/18/99	13:50	-1	117-17	5/19/99	12:10	118-02	0	-17	-17	-25
9	5/19/99	12:40	1	118-06	5/20/99	10:30	117-27	7	-12	-11	-38
10	5/21/99	8:00	1	118-08	5/25/99	8:00	118-17	26	-7	9	-31
11	5/26/99	12:10	-1	118-06	5/28/99	9:40	118-04	28	-9	2	-31
Slippage =2 Ticks/Contract											

Figure 5: May's Results (One Contract).Here are results of the original system applied to trading the month of May. The system lost 31 ticks, including slippage and commissions.

Figure 7 is a table of showing the MFE, MAE, Profit and Losses, and Equity for the month of May using the same system rules used in April plus our target rule and stop loss provision. We trade two contracts, the first is a target based trade and one contract is a trend following trade.

The Target column will generally have an upside limit of 20 ticks (sometimes a gap opening may increase this profit in our favor) or show the same profit/loss result of the trend following position if the target was not hit. The losses should not exceed ten ticks

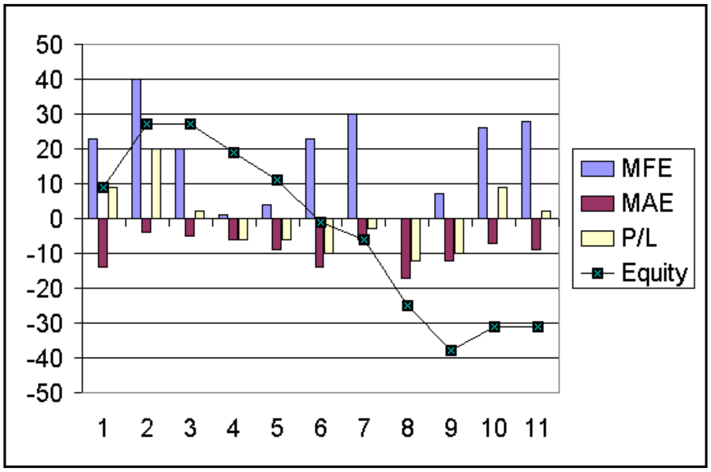


Figure 6: May's Results (Figure 5) Composite Picture. May lost 31 ticks using the original system.

Trade	Date	Time	B/S	Entry	Date	Time	Exit	MFE	MAE	P/L	Target	Equity
1	5/3/99	7:20	-1	120-03	5/5/99	8:00	119-26	23	-14	9	0	9
2	5/6/99	8:00	-1	119-16	5/10/99	10:30	118-28	40	-4	20	20	45
3	5/11/99	9:40	-1	118-20	5/12/99	9:40	118-18	30	-5	2	20	63
4	5/12/99	10:00	1	118-24	5/12/99	10:10	118-18	1	-6	-6	-6	47
5	5/12/99	11:10	1	118-25	5/12/99	12:00	118-19	4	-9	-6	-6	31
6	5/13/99	7:20	1	118-29	5/14/99	7:30	118-19	23	-10	-10	20	37
7	5/14/99	8:00	-1	117-27	5/18/99	8:00	117-30	30	-6	-3	20	50
8	5/18/99	13:50	-1	117-17	5/19/99	12:10	118-02	0	-10	-17	-17	34
9	5/19/99	12:40	1	118-06	5/20/99	10:30	117-27	7	-10	-11	-11	10
10	5/21/99	8:00	1	118-08	5/25/99	8:00	118-17	26	-7	9	20	35
11	5/26/99	12:10	-1	118-06	5/28/99	9:40	118-04	28	-9	2	20	53
Slippage = 4 Ticks/Contract												

Figure 7: May's Results Including Target and 10-tick Stop Loss. Here are results of the original system but including the 20 tick target and stop loss provision. The system made 53 ticks.

unless there was a gap opening against the position. The Equity column for Figure 7 includes the Target trades and those trades that were stopped out for a ten tick loss. We have also raised the slippage to four ticks to account for the extra contract. Of course, real market conditions may have produced more slippage than this table accounts for.

Notice that the system went from a negative 31 tick loss to a profit of 53 ticks. Let's take a closer look at May's trading.

Figure 8 shows a combination histogram chart of the MFE for each trade, the final result of each trend trade (P/L) and each target trade. Trade 1, as you may recall did not have a target contract. Notice Trade 3. At one point the trade had an open profit of 30 ticks, but the trend following contract exited with just a two tick profit. The target contract hit the 20 tick objective.

Figure 9 is the MAE each trade (both contracts will have the the same MAE unless the target is hit). Trade 1 was greater than -10 because we entered the trend the first day of May. Trades 8 is -12 ticks because of a gap opening against the position. Figure 10 is the composite histogram showing the MFE, MAE, Profit or Loss (Trend trade), Target Profit or Loss, and Final Equity Line for each trade. Compare this to Figure 6, the original system applied to May.

Now, why did the original system rules do poorly during May compared to April? As we stated before this set of procedures is a trend following technique and assumes that there will be enough trends to offset the congestion periods that produce losses.

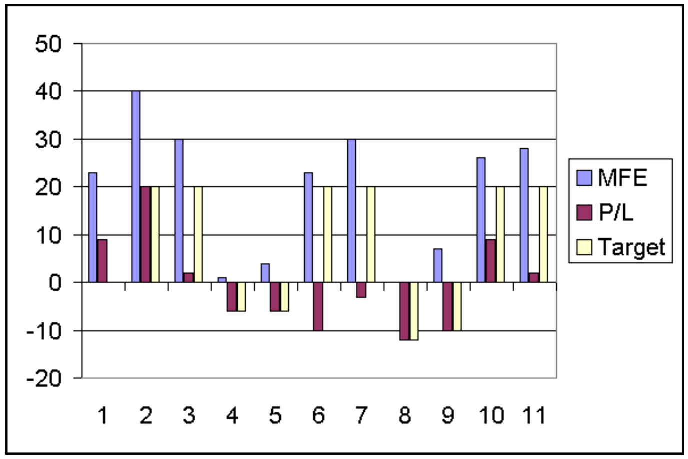


Figure 8: MFE, Profit or Loss, and Target. This chart compares the MFE of each trade, the final result for each trend trade (P/L) and each target trade.

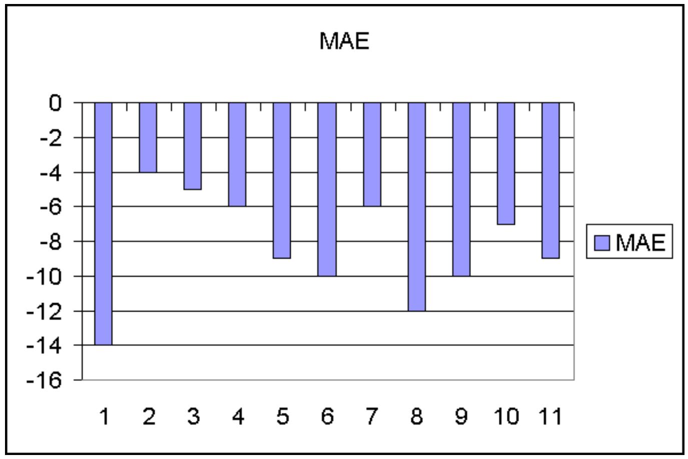


Figure 9: MAE. There was a -12 tick loss on trade 8 due to a gap opening.

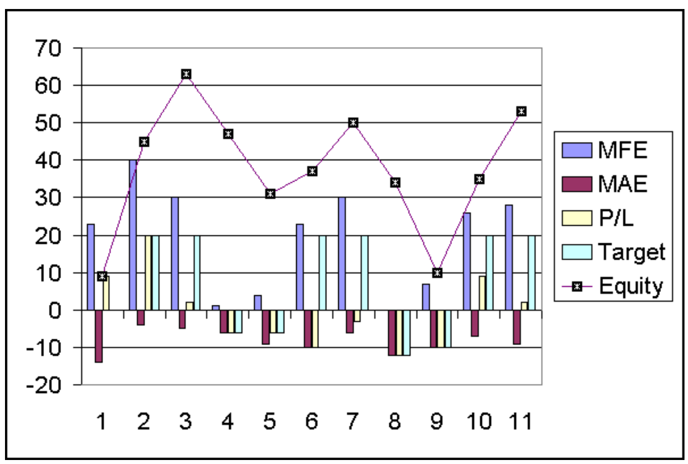


Figure 10: Composite Picture For All Trades.

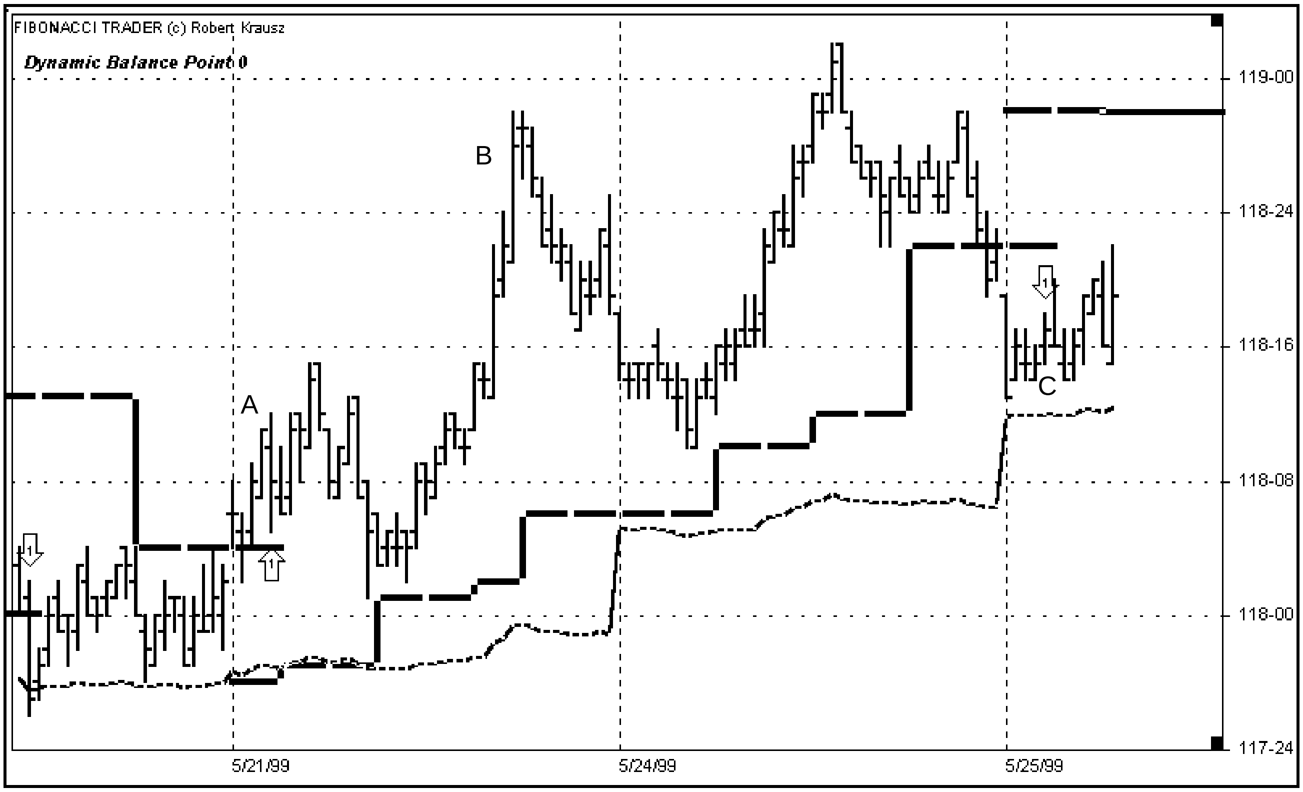


Figure 11: Trade #10. The buy signal occurred at 118-08 (Bar A), and the market rallied nicely, hit the 20 tick target, Bar B, and then fell back, rallied again, and then the system exited at 118-17 (Bar C).

During May the market did not trend nearly to the degree that the market trended in April. But we developed a procedure, using a target, to help offset that potential problem.

For example, Figure 11 shows Trade #10. The buy signal occurred at 118-08 (Bar A), and the market rallied nicely, hit the 20 tick target, then faltered, made another new high and reversed. The system exited at 118-17 for a nine tick profit, but we added an additional 20 ticks using this rule.

As we stated in the last issue, other months may be better or worse using this mechanical system. Therefore, this set of procedures should be reviewed over a number of years worth of data before considering using your capital. Please test your ideas.

The goal was to present one way to identify the subtle nuances of your system and how well they match the rhythm of the market. Take this analysis and apply it to your system.

I wish you excellent trading,

Robert Krausz, MH, BCHE

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WIZARD ON WALL STREET INC

Guidance For The Professional Trader

Robert Krausz, MH BCHE
Thom Hartle

Multiple Time Frame Structure™

WIZARD ON WALL STREET'S goal is to offer a professional study course that will take you to a professional level of trading. Traders who are already proficient will be shown insights into the proper use of trading multiple time frames, and not just through the narrow view of a 100% mechanical trading plan. As part of the course there will be a valid trading plan for stocks or futures including a back test. For T-bond and Ten-year T-note futures traders we are offering a plan based on the Fibonacci Trader Expansions™ in multiple time frames. The trading plan is only part of the course, as we want to give you an educational foundation and then you will be able to use multiple time frames as a reference for analyzing the markets.

As you may know, according to the Wall Street Journal, there are five million plus "on-line traders." As the course will handle stocks as well as commodities (especially the Financials and the Index Futures) we have no idea how many people will be interested in our home study course. Obviously there is a limit to the number of people we can work with. For this reason we are offering 1st choice to the owners of the Fibonacci Trader™ program. As you read the rest of this information, you will see that the Fibonacci Trader real-time program is a prerequisite for this course, and most of you already have the program.

The Multiple Time Frame Structure™ professional study course will cover the following topics (a full brochure is being prepared and will be sent to you):

1. Multiple Time Frames – A solid framework of multiple time frames and its applications.
2. Market Structure – A broad based theory and practice.
3. Psychology of Trading – In addition, Robert Krausz's Mental Harmonics tapes, as mentioned in Jack Schwager's book New Market Wizards, are part of the course.
4. Advanced Swing Trading Techniques – Intraday, short term and medium term strategies. Applications to trading stocks and commodities. The Matrix of 9 will be taught. A special "THEWOW" add-on to the Fibonacci Trader™ program is included.
5. Fibonacci Trader Expansion™ Plans – Two modes of this trading plan will be taught (aggressive and conservative for T-bond futures). This trading plan is original work and has not previously been shown to the public. The complete set of rules, structure, back tested results will be disclosed. In fact, we will be trading this exact plan for T-bond futures ourselves in real time – with real money. The course lasts for six months, but at the end of the first three months you will have all of the know-how needed. We will take every trade, and send out a weekly fax/e-mail update to keep you on the straight and narrow. A description of this plan and the results of a multiple year back test will be included in the course description brochure. Needless to ask, would we put our money on the line if it was if it was not a winning plan?
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3. Mental Harmonic audio tapes, a $99 value.
4. My book, *A Gann Treasure Discovered*, a $161.80 value.

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- All postage and handling charges are included in the price.
- If you already have items 3 or 4 you will receive a credit towards the price.
- The course requires the Fibonacci Trader™ real-time program to take full advantage of the Swing Plans (especially the intraday methods) and the Fibonacci Trader Expansion™ Plans.
- We reserve the right to refuse any applications.

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Thank you for your interest,

Robert Krausz, MH BCHE
Thom Hartle

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