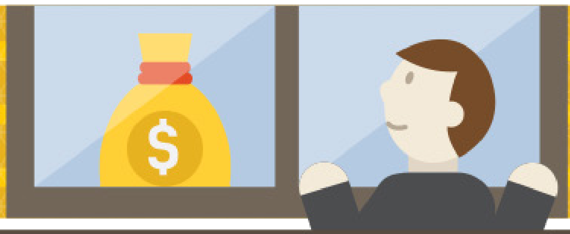
How to Stalk a Low Risk/High Reward Entry Point

LESSON #10



HOW TO STALK A "LOW RISK /HIGH REWARD" ENTRY POINT

> *Although the cheetah is the fastest animal in the world, and can catch any animal on the plains, it will wait until it is absolutely sure it can catch its prey. It may hide in the bush for a week, waiting for just the right moment. It will wait for a baby antelope, and not just any baby antelope, but preferably one that is also sick or lame; only then, when there is no chance it can lose its prey does it attack. That to me is the epitome of professional trading.* – Mark Weinstein, Market Wizard*

You've done your homework.

You've found a damn good set up, and now it's time to execute.

The temptation is to jump in straight away. But now is the time for patience. It's time to stalk your entry like the cheetah stalks its prey.

As a Forex trader, you should have an array of simple entries at your disposal that help you uncover low risk and high reward times to enter into your chosen positions.

This will allow you to wait patiently for a time to enter that will improve the odds of having a winning trade, while at the same time maximising rewards and minimising risks.

Simple is better

> *"I think implementation is the key in everything. Implementation is more important than the trade idea behind it" – Colm O'shea, Market Wizard*

Decisiveness is critical when it comes to your entry.

In a fast moving market, or if you are trading with the trend, you need to be ready to pull the trigger or else you could miss out on the move.

A confusing and complex entry approach is to be avoided. You don't need five indicators on a chart to all line up perfectly to time your buy. Instead, look to use tools and chart patterns that help you to recognize the market for what it is, and allow you to execute flawlessly when the time is right.

With entries, simple is very much better!

Stalk on a lower time frame to improve the risk/reward

> *"Stalking means making sure the odds are even more in your favour by paying attention to the smallest time-frame possible for you" – Van Tharp, Market Wizard*

One of the goals of a patiently stalked entry is to improve the risk/reward on the trade.

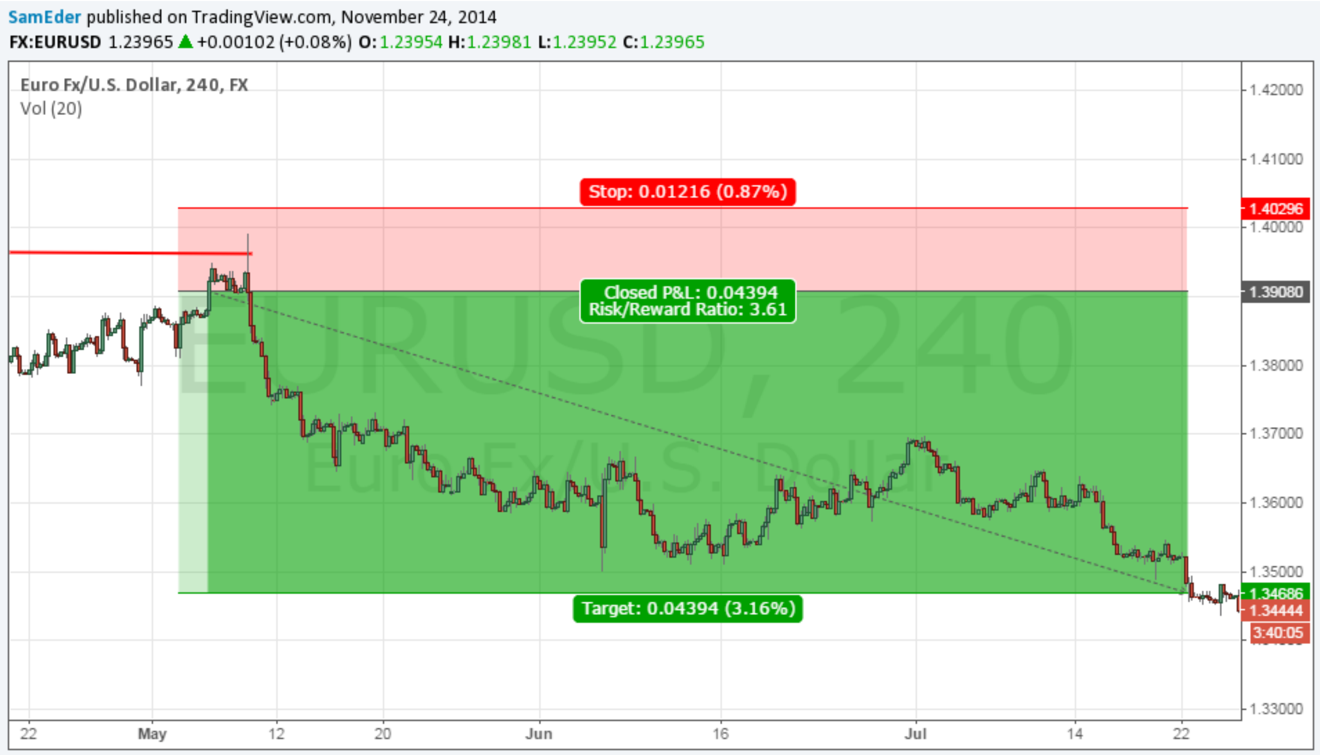
By moving to a lower timeframe, it allows you to time your entry so that you can tighten your stop-loss.

If you have a tighter stop-loss, you can take a larger position with the same amount of dollars risked, meaning your profit on the position can be much greater.

If you had a set-up that gave you the potential to make 300 pips, with a risk of 100 pips, you would have a risk/reward ratio of 1:3. If, during your process of stalking an entry, you were able to get into the trade with a risk of only 50 pips, then you would have a potential risk/reward on the trade of 1:6.

On the weekly chart of the EUR/USD, we have a double top formation off resistance, signalling a change in trend. If our profit target is on the next level of support, we have a risk/reward ratio of 1:1.06 which is not great.

If instead we stalk an entry on the 4-hour chart, we can enter the trade with a significantly improved risk reward ratio of 1:3.61.



Do nothing unless there is something to do

> *"I just wait until there is money lying around the corner, and all I have to do is go over there and pick it up. I do nothing in the meantime" – James Rogers, Market Wizard*

Many traders don't trade to win. They trade to get something else that they want from the markets.

So instead of patiently stalking an entry, they feel the need to always be playing. But you can't rush the markets. If you try and force a position, it's pretty much guaranteed to come back to bite you in the a***.

If you don't know what's going on, and if you don't have a superior risk/reward trade lined up, then you should not be trading. Simple as that.

If you have made a profit, there is no need to go out and place a new trade in a rush of overconfidence. It will come if you give it time. If you have a losing trade you don't need to do something to make it back – in fact that is the worst thing you can do. Revenge trading is not a fruitful exercise.

So, get comfortable with "doing nothing". Make sure you centre yourself after a winner or a loser, and only place a trade if you have a great deal of conviction in its success. A good trade should feel like you are "shooting fish in a barrel" not like you are taking a punt or hoping it will go your way.

Is there a fundamental catalyst?

> *"You always need a catalyst to make big things happen" – James Rogers, Market Wizard*

When you assess an entry, it is good to check if there is a fundamental catalyst that is coinciding with the entry point. For example if the price is breaking out, is it because of a positive surprise in some economic news that has the potential to move the currency further?

If there is a good fundamental catalyst, then it can improve the probability of your entry's success. You may even want to increase the position size on trades that have strong fundamental reasons for the entry.

Specific entries that you can use today

> *"I developed and synthesized a number of indicators that I used to determine when the market was at a lower risk entry point" – Marty Schwartz*

Here are a collection of entries that you can use for your trading system. These can be used both on the original timeframe of the trade (on the weekly chart of a weekly set-up for example) or they can be used on a lower time frame, so you can be very precise in your entry.

Candle stick patterns

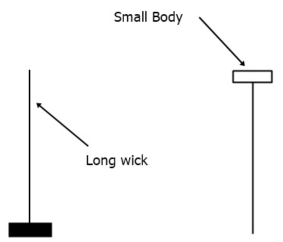
> *"I let the market tell me where it is going" – Mark Weinstein, Market Wizard*

Candle stick patterns can be excellent representations of the short term buying and selling pressure in the market, and can be used to time entries.

There are a lot of candle stick patterns and formations, but for our purposes we will look at two. Just remember they only tend to work well if they are used in conjunction with a damn good set-up.

The first pattern is known by a few names, but we will call it a pin candle. To see this pattern, you will need to switch your chart to a candlestick chart. A pin candle occurs when there is a sharp reversal of the price within a time period, and is a strong sign that the price is about to change direction and reverse.

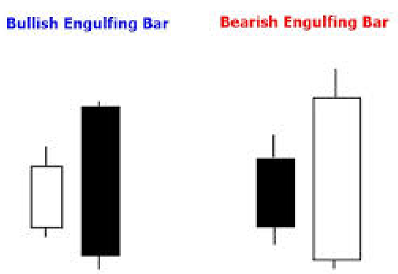
Here is an example of what a pin candle looks like:



As you can see, the candle has a small body and a long tail or "wick". You would enter into a trade in the direction of the market – especially if there is a fundamental reason for doing so.

The next candlestick pattern that is of interest is called a bullish or bearish engulfing candlestick pattern. This pattern is prevalent at market reversals and during trends.

Here is an example of bullish and bearish engulfing candles.



The key in each case is that the second candle in the pattern is larger than the first. The second candle should 'engulf' the first candle. If you get a bullish engulfing, it is a sign to buy. If you get a bearish engulfing it is a signal to sell.

Here you can see the candlestick entry in action in the GBP/USD.

Trend breakouts after consolidation

A breakout from consolidation entry is used when an existing trend pauses and consolidates for a period of sideways movement, before the trend resumes.

Ideally, what you want to do is look for a consolidation set-up and then move to a lower chart to stalk the entry. The entry occurs when the price breaks out and closes above the range. With this entry, you should generally have a tight-stop loss, as price will either break out and continue in that direction, or fall back within the range quickly.

Low volatility breakouts

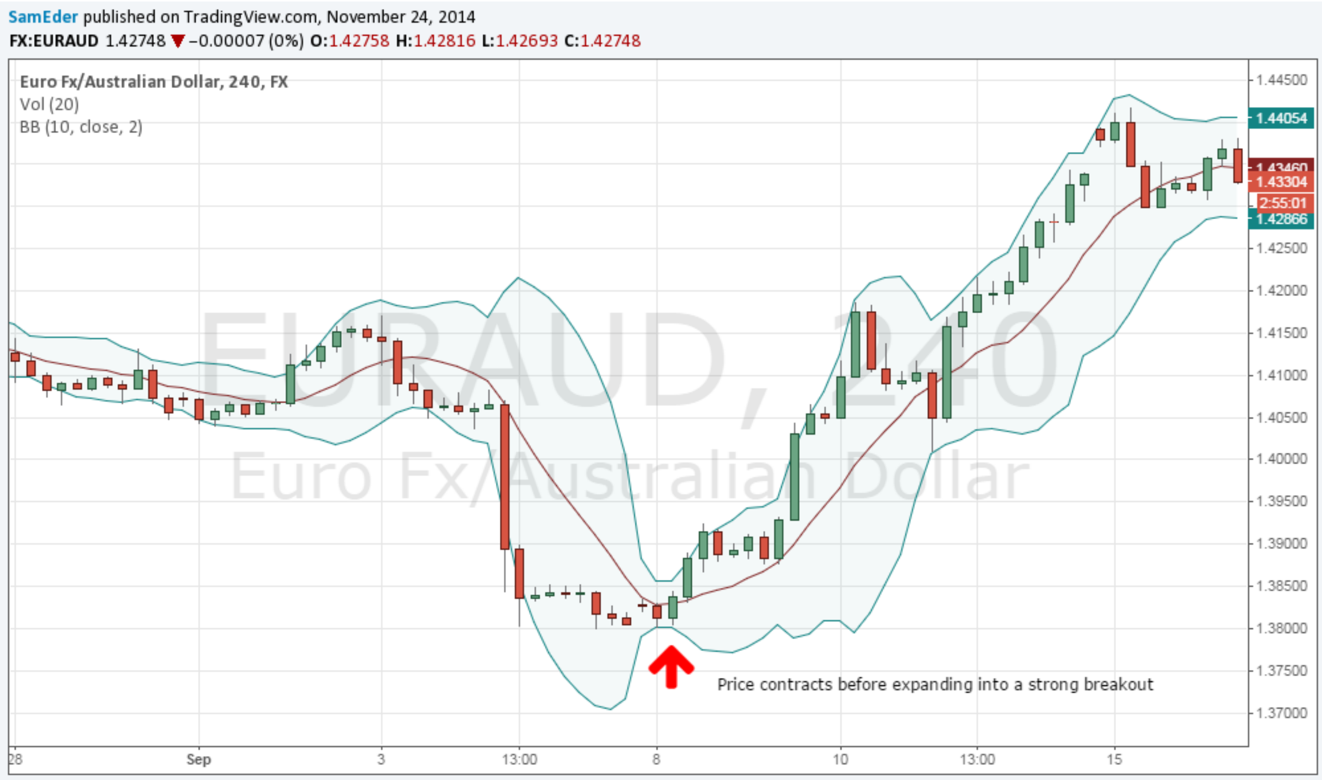
> *"Charts are extremely important" – Joe Vidich, Market Wizard*

Perhaps my favourite type of entry, the low volatility breakout, is the epitome of the low risk/high reward trade idea.

When prices compress into a tight range, they can expand rapidly in to a strong directional move. This gives you a good place to put your stop-loss. And, if the trend continues, it could result in a big win. Low volatility entries can also be used to scale into positions as the move goes for you.

To trade this set-up, I use the Bollinger Bands. Simply wait for bands to compress, and then take a position once the price breaks out.

Here is an example on the EUR/AUD currency pair.



The old fashioned moving average cross over

> *"I always check my charts and the moving averages before I take a position. Is the price above or below the moving average? That works better than any other tool I have. I try not to go against the moving averages [as] it's self-destructive" – Marty Schwartz, Market Wizard*

It's very easy to identify a moving average cross-over, which is a big plus for using them as entries. You can also vary the speed of the moving average to suit your objectives.

The way a moving average works is to identify the strength of the trend. Once the trend reaches a certain velocity, the faster moving average will cross over the slower one, which gives us a signal to take a position. This means that you are always buying or selling with the trend.

A moving average cross-over can also work as a counter-trend entry. If the price bounces off a support or resistance level, and the moving averages cross, it could be a good time to enter.

I like to use a 3 period moving average combined with a 7 period moving average. Once the 3 period moving average crosses over the 7 period moving average, it provides an entry signal. I will also displace the shorter moving average by 1 period forward in time to make it easier for live trading.

Here it is on the GBP/USD.

As you can see on the above chart, the moving average crossover can get you into some nice trends.

Simplicity will have its rewards

> *"Don't trade until an opportunity presents itself. Knowing when to stay out of the markets is as important as knowing when to be in them" – Mark Weinstein, Market Wizard*

One of the best ways to master the art of trading is to pick and choose a limited number of techniques first and get to grips with them. Select one or two entries that you like and practice them.

Be patient when you hunt for your entries, and keep them simple too so you can act decisively when the time comes.

Until next lesson,

Sam

Course Work

- Add the entry points you will use into this weeks course work.

**This might be a great analogy for being a patient trader, but it is not an accurate depiction of how a Cheetah hunts its prey. Cheetahs prefer to be out in the open on a rise, so they have a clear field of view, and they tend to avoid bushes as they hamper speed.*

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