Price Action Trading the S&P 500 Emini

The following set of trading lessons are elements of Price Action Trading mixed in with some common sense and other trading concepts.

Price Action & Pattern Recognition VS Other Methodologies

Most traders have a stack of variables they analyses every day to establish their daily trading strategy. The usually don't start off with so many variables, because when they start their trading career they have a handful of indicators that seem to work. When they start to fail, they identify reasons for the failures and add new variables to handle those special situation. After a year or two, they dozens of variables they track. And their list continues to grow.

This is normal and logical progression, but there is one outcome reflected by all of those variables – PRICE. Price is the reflection off every variable you can imagine from heat waves to computer selloffs. Price reflects it all. Once you learn the patterns and trends reflected by price, you can learn to recognize the next movement to complete the trend or pattern.

This is Price Action Trading and Trend/Pattern Recognition.

History is History

History is a good indicator to identify patterns, limits, boundaries, etc. Even though Price Action Trading discounts much of the historical indicators, history does play a part in knowing where you've been and where you might be able to go. However, history does not predict the future.

So, what is history? History is anything in the past. It may be a fraction of a second ago, but it is still the past… history. All average indicators, trend indicators, and oscillators are historical. People will argue, for example, that a 1 minute ergodic is current. It is not. It is history. It's that simple.

Personally, I use historical indicators. But I only take them as a guideline as to give me a picture of the trading environment. There are a couple exceptions, such as a high performing EMA trend indicator I call my Early Morning Avenger trade. But only a few exceptions.

Entering and Exiting Trades

Every trading system in the world worth its salt can tell you when to get into a trade, but they don't tell you when to get out.

It is essential that you know ahead of time when you are going to exit the trade.

Let me make it very clear that when you are exiting trades properly, you will be leaving a ton of money on the table. In fact, you will probably exit your trade and leave more money on the table than you took off. THAT IS GOOD! That is what is supposed to happen.

It doesn't take a trader (of any good trading system) long to see how much money is being left on the table when exiting trades correctly. Delta Trading Group uses statistical analysis on its trades to know when to exit, BEFORE THE TRADE IS ENTERED based on Risk VS Reward.

Risk VS Reward

Knowing your risk is the most important part of money management, just as any real-estate developer, stock broker, or poker player.

The table on the following pages explains the risk versus reward concept as applied to the Delta Trading Group, Inc. Simple Doji Turnaround Trade.

The table reflects the average two-week performance (over 5 years) broken into two parts.

The top part shows the statistics on taking the trade signal whether the "Turnaround" signal is in the same direction as the Exponential Moving Average (EMA) trend or not.

The top part shows the statistics on taking the trade signal when "Turnaround" signal is in the same direction as the Exponential Moving Average (EMA) trend only.

Let's compare the two tables.

If you are looking at how many times the market moves 4 points to the good when trading with or against the EMA trend, you see the following header data:
1) The average number of setups was 22 for a two-week period of time.
2) The stop loss was set at 3.
Let's study row where the market moved 4 points and didn't stop out, by column:
3) Out of the 22 trades there were 11 wins.
4) Out of the 22 trades there were 11 losses.
5) The number of points gained on the winners is 44 (11 trades * 4 points)
6) The number of points lost on the losing trades is 33 (11 trades * 3 points stop loss)

7) The New points gained or lost was + 11 (44 wins – 33 losses)
8) The average number percentage of wins was 50% (50 : 50)

Now, let's examine the same 4 point gain to 3 point loss but on the With Trend table.

1) There were only 10 trades, not 22. Remember the criteria for the trade is stricter. We are ONLY trading with the EMA trend.
2) Wins = 8
3) Losses = 2
4) Points on winners = 32(8 wins * 4 points)
5) Points on losses = 6 (2 losses * 3 points)
6) Net = 26 points (32 wins – 6 losses)
7) Win percentage on trade = 80% (4:1)

At first glance it may seem obvious to just trade with the trend. This may or may not be true depending on your trading habits. For example, these statistics were taken on the entire days of trading you may not trade all day.

You may have the discipline to wait for a trade with the trend, and you'd rather trade lots of trades and net less, than be bored waiting for the perfect trade. Better to trade all these trades than to just trade with the trend and take bad trades elsewhere.

THE WAY YOU MANAGE YOUR RISK IS 100% UP TO YOU.

If you ask most people how often you have to right in order to be successful at trading stock, they will say, "51%". This is entirely not true. IT depends on your risk reward rations and good money management.

One main reason Delta likes the 4 point gain with a 3 point stop loss is because you only have to right 45% of the time to be ahead in the trade.

You will see big movements that you didn't take by getting out at 4 points. INGNORE THEM, because that is the downfall of many traders. You will lose trying to capture money you see left on the table.

Let's examine the math behind winning with less than 50% winners.

Let's assume:
1) You make 100 trades and you exit on a 4 point gain and stay in for a 3 point loss on every trade.
2) You win 45 trades and lose 55 percent of your trades. That's only a 45% win rate.
3) 45 winners at 4 points = 180 points.
4) 55 losers at 3 points = -165 points
5) Your net trading yields 15 points (180-165)
6) 15 points at $50 per contract = $750.00

You are a winner even though your winning percentage is only 45%. Now what say the people who say you need to be right 51% of the time? They are simply unknowledgeable of money management and risk : reward. But yet, most "professional" will give you the same answer.

Use the statistical table below to help determine what risk you are willing to take on a trade?

Don't just go by the Net result, examine all the factors that fit your trading personality as time goes on, and especially pay attention to tracking your results.

RISK TABLE ON SIMPLE DOJI TURNAROUND TRADE

Trades	22		Stop	3		
Move	Wins	Losses	Win	Lose	Net	Pct Win
2	13	9	26.0	27.0	-1.0	0.591
3	12	10	36.0	30.0	6.0	0.545
4	11	11	44.0	33.0	11.0	0.500
4.5	10	12	45.0	36.0	9.0	0.455
5	10	12	50.0	36.0	14.0	0.455
5.5	9	13	49.5	39.0	10.5	0.409
6	9	13	54.0	39.0	15.0	0.409
7	6	16	42.0	48.0	-6.0	0.273
8	6	16	48.0	48.0	0.0	0.273
9	5	17	45.0	51.0	-6.0	0.227
10	3	19	30.0	57.0	-27.0	0.136
15	3	19	45.0	57.0	-12.0	0.136
20	2	20	40.0	60.0	-20.0	0.091
25	1	21	25.0	63.0	-38.0	0.045

With EMA20 Trend						
Trades	10		Stop	3		
Move	Wins	Losses	Win	Lose	Net	Pct Win
2	9	1	18.0	3.0	15.0	0.900
3	8	2	24.0	6.0	18.0	0.800
4	8	2	32.0	6.0	26.0	0.800
4.5	7	3	31.5	9.0	22.5	0.700
5	7	3	35.0	9.0	26.0	0.700
5.5	6	4	33.0	12.0	21.0	0.600
6	6	4	36.0	12.0	24.0	0.600
7	5	5	35.0	15.0	20.0	0.500
8	5	5	40.0	15.0	25.0	0.500
9	4	6	36.0	18.0	18.0	0.400
10	2	8	20.0	24.0	-4.0	0.200
15	2	8	30.0	24.0	6.0	0.200
20	2	8	40.0	24.0	16.0	0.200
25	1	9	25.0	27.0	-2.0	0.100