Chart Pattern Secrets Newsletter

Issue 8

Welcome to the latest issue of the Chart Pattern Secrets Newsletter.

We hope that you find it useful and are able to implement some of the ideas into your own trading methodology. Chart patterns can provide an interesting insight into potential price action and form an integral part of successful trading strategies.

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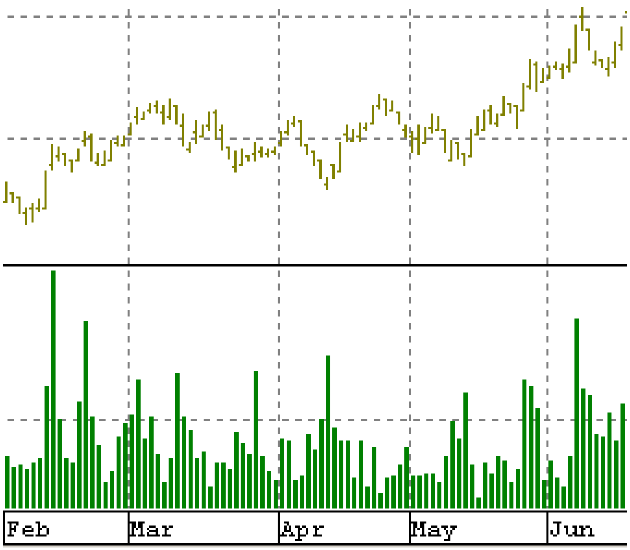
Look out in your inbox for the next issue of the Chart Pattern Secrets Newsletter. In it, we will discover the **head and shoulders pattern** and how so many people foolishly conduct a ruthless **search for the holy grail** of trading.

Volume

Volume simply represents the number of shares that have been traded in a given period of time, normally a day. Volume is a very important tool as it provides an indication of the strength of a particular move and should be one of your primary confirmation tools. In charts, volume is normally represented as a bar chart below the price plot, as shown in the chart below.



When large companies begin an up trend, there is normally an increase in volume representing the aggression of the buyers forcing the price upward. Once the trend is established, it is quite normal to see relatively low volume, which represents insignificant opposition to the move. Most trends experience small retracements against the direction of the trend along the way and they have an interesting link to volume.

In a healthy uptrend, the volume is generally greater on the upward moves, than the volume during the small retracements (downward moves). This situation is reversed for healthy downtrends. Increases in volume are also very common near the end of a trend, especially in a downtrend. Normally near a market bottom, volume will increase due to the last of the sellers panicking. Low volume is normally characteristic of a consolidation period, where a security effectively trades sideways in a narrow trading range. Divergence can be used quite effectively with volume.

Volume can also be directly linked to another important consideration, that of liquidity. Liquidity is a measure of the ease of buying and selling shares without adversely affecting the market price.

As an example, if you owned 5000 ZYX shares and wanted to sell them yet there were only two buyers in the market for ZYX shares who between them wanted to buy only 3500 shares, you are in an uncomfortable predicament. More so, if the price they are asking is much lower than you are prepared to receive for them. You are more or less stuck with them. That is an example of an illiquid share and it is a situation that is best avoided.

It is useful to consider therefore, the average daily turnover in a security before trading it. A commonly accepted rule is to ensure that your normal trade size is less than 10% of the average daily turnover. Using a filter of this type will remove many hundreds of shares from the market that are probably best avoided.

Congratulations for the Profit

So what is it that separates the successful from those who fail? If you ask anybody who has studied trading for any period of time, they will answer 'psychology'. Essentially, your mental ability to manage losses and profits and the good and the bad times in trading, manage risk, to not become too greedy and many others are all encapsulated under the heading of 'trading psychology'. There have been numerous professional articles and books written on the subject of 'the psychology of trading' and therefore this article is not intended to elaborate any further on an already well debated and discussed topic.

Often when people talk about the importance of psychology, the need to be as unemotional in your decision making as you can be is frequently mentioned. Decisions are required often when trading and a fair percentage of the decisions that are required will be difficult. Humans are naturally inclined to break the time tested trading rules and this is why your psychology and decision making is such a vital part of your success. Successful traders have great internal control and discipline to overcome the natural tendencies.

When you have a great trade, why not reward yourself for it? When it is often considered that trading well for an extended period of time can be difficult for many, yet you have a trade that all goes well, you may think it appropriate to congratulate yourself for it.

For example, you may have followed all of your selection criteria, and you considered all the things your trading plan insists you follow when deciding to enter a position. Once the trade was open, you monitored your initial stop loss point and then started to trail the price with your trailing exit.

Some time later when the position reversed sufficiently on you and your trailing exit was hit, you executed the sell order without emotion and realised your profit in the trade. All in all, it was as close to a perfect trade as you can have, and it was your largest profit you have had in 12 months.

A situation like this will occur for almost everybody at some stage and more often for some. When this does occur, you should consider rewarding yourself. Depending on the size of your profit, you could take the family out to dinner, escape to a country retreat somewhere with your spouse for the weekend, or perhaps buy that new #1 wood for your golf set you have been eyeing off for months.

In some way, reinforce to yourself that you have had a great trade and have followed your trading plan to the letter in doing so. It helps reinforce the positive and instill in you that good things can happen when you follow your plan.

Comments / Feedback:

Any comments on the contents of this publication or suggestions for future publications will be warmly welcomed. Please email to cpfinder@tradingxl.com.au, fax to +61 3 9870 1738 or phone us on +61 3 8802 0593.

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