

E-mini Trading Course™

“Learn How To Trade S&P 500 and Nasdaq-100 E-mini contracts.”

By Zoran Kolundzic

There are only two kinds of traders. **Winners. ...and Losers.**

Ninety-five out of one hundred don't make it in this field.

For their failure they blame everyone but themselves.

Wrong. There is only one person to blame.

You.

This course is about joining five in a hundred.

It's about winning.

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Part I

Introduction



The purpose of this course is to prepare you to enter the exciting field of stock index futures trading and what is more important, to put you on equal ground with successful traders. If you are interested in active day trading, stock index futures should be your trading instrument of choice. No other trading instrument will provide you with such levels of **liquidity**, **volatility** and ease of entry and exit into your positions. Volatility is the single most important factor to look for when choosing a day trading instrument. Volatility is a life line of futures markets participants.

The most popular stock index futures are **S&P 500** and **Nasdaq-100** index contracts. Depending on the size of your account you may choose to trade either full contracts or **e-mini** contracts. E-mini contracts are more attractive to beginning traders due to their low initial margin requirements. Even if you are planning to trade with a large account it is recommended that you start trading with e-mini contracts. Another benefit of mastering the art of stock index futures trading is the fact that you will be a step ahead of the traders of all the other trading instruments (stocks, currencies, commodities). Why? The reason is the fact that stock index futures do not have a leading indicator. You will learn how to trade against other traders emotions. When a successful S&P futures trader switches to stock trading it is similar as if a NBA basketball player starts playing in Europe.

Many books on the subject of futures trading say that it is normal for beginners to lose money at first. Some even go as far as to say that it is normal to have a losing streak that lasts several months! This philosophy stems from the rationale that after losing significant amount of money, you will have more experience and knowledge in your future trading endeavors. If you went by their standards, how much of your hard-earned money will be left in a few months? This type of attitude sets you up to fail. Why enter a

battle if you are destined to lose? The only purpose for such advice is for day trading firms and day trading and investing brokers to make money on the commissions you will pay to them.

1.1. Understanding Trading Dynamics

From a historical perspective, trading stock index futures sounds easy. The general direction of the stock market has historically been positive. Unfortunately, this generalization misleads many people to believe that the odds are always on their side. They may think that even if they randomly choose their entries, markets will eventually turn upwards and they will eventually make money. Such strategy may work for people who buy stocks and then hold onto them for years. However, active traders may experience opposite effect. Active traders make trades, on the average, several times per week to several times per day. The odds for randomly-generated success decrease in this case. Let's say that on the average stock index appreciates 10% per year. There are approximately 250 trading days per year. Your daily expected return would then be 0.04%. If you have a capital of \$10K you would expect to make \$4 on an average trading day. However, there are two variables that will take that \$4 profit from you if you trade often:

- **Spreads**
- **Commissions**

How this works? Let's say that you trade 5 times during one day and randomly choose your entry positions. ("Randomly choose" means that you have no relevant information that justifies your entry in either direction, similar to playing random lottery numbers.) By playing the market this way, the only variable that is on your side is the positive historical direction of equity markets. If you buy 2 S&P 500 contracts at 940.00 and immediately turn around and sell them you will get 939.75. The difference of 0.25 is called spread. It is also called the difference between bid and ask. It equals to \$12.50 per contract. On top of that each time you buy and each time you sell you need to pay commission to your broker. Average commission is about \$3.50 per side per contract. So if you trade 2 contracts five times per day your costs are $(2 \text{ (contracts)} * 2 \text{ (sides)} * 3.50$

$(\text{dollars}) + 2(\text{contracts}) * 2 (\text{sides}) * 12.50 (\text{spread dollars}) * 5 (\text{trades}) = \320 . In this case \$320 is your daily cost of doing business of e-mini contracts trading. If you do not have relevant information that will justify your trades, how long will you \$10k last. You would be better off going to Vegas. At least you would have some fun in the process of losing your money. The purpose of this course is to give you an edge over the markets that will overcome the costs that are caused by commissions and spread.

1.2. Trading vs. Investing

Many people confuse trading with investing. What is the difference? In reality, these two terms are very far apart. The main difference between them is the time period of holding the assets. An investor is not concerned with short term fluctuations in the asset's prices, and is generally more oriented toward long term appreciation in the value of his holdings. In making an investing decision, an investor relies mostly on Fundamental Analysis. This is the analytical method of predicting long term prospects of the given asset. The most popular approach among long term investors is called "buy and hold". It means that you should buy shares of some company and forget about them for a long time. Such approach can be very dangerous, even devastating in the extremely volatile market such as today's Nasdaq. Let's consider someone who bought shares of Amazon.com at their peak value of around \$100 per share at the beginning of year 2000. Two years later they are worth \$20 per share. If that person had invested \$100K, two years later his holdings would be worth \$20K. Such devastating losses can occur if "buy and hold" strategy is literally followed. Investing should not be about weathering storms together with your "loved" company; it is about making money.

On the other hand, a trader is trying to profit exactly on those short term price fluctuations. Holding periods for active traders and day traders are very short, in many cases minutes, even seconds. All the active index futures trader needs to make a comfortable living is to catch 2-3 index points on an average day. The most powerful tool in the hands of an active futures trader is his ability not to take a trade. He or she only takes those trades that have the highest probability of success. In their decisions, day traders rely mostly on Technical Analysis, a form of market analysis that is trying to

predict short term price fluctuations. The most popular forms of active trading and day trading are:

- **Scalping** – scalping is a form of day trading that has the shortest holding time frame. Scalper is trying to profit from very small movements in the index value such as 1 point or even 0.5 points. There are very, very few traders who are able to scalp successfully. Scalping is profitable only for brokerage house and therefore we will not consider it as a viable trading option.
- **Swing**- swing trading is a form of day trading or short term trading in which you are waiting for a price to hit certain support or resistance level and reverse it's trend. This is a very popular and viable trading approach, especially in markets that do not clearly trend in either direction.
- **Breakout** – breakout trading is a form of day trading in which you are waiting for a price to pass through certain support or resistance level as a clear sign of continuation of that trend. It is especially viable approach in clear bull or clear bear markets.

1.3. Trading vs. Gambling

Many people think that trading is similar to gambling. Is this really the case?

For example, let's take a look at Black Jack.

If you start with \$10,000 gambling capital, placing bets of \$100 per hand and play 100 hands per day, how long will you last?

In the game of Black Jack, with Las Vegas Strip rules, a casino has a built-in advantage of 1.5% over the player in the long run. That means that on average, a player will lose \$1.5 per any \$100 he bets with. After 100 hands, on average he'll be down \$150. Starting with a capital of \$10,000 a player could last about 67 gambling days. That is very similar to the previously described trading scenario. In such case I would choose gambling because at least I would be losing my money in a more pleasant environment. I chose Black Jack for our example because it is the only casino game in which it is possible for a skilled player to increase his odds to such extent as to be able to beat the House in the long run. A skilled counter can obtain advantage of up to 1.5% per hand over the House in the long run. That means that such player playing 100 hands per day and average hand being \$100 could double his gambling capital of \$10,000 in less than 50

days. Similar odds apply to futures trading, with more potential for profit and less chances for being kicked out of a casino. In order to make it work for you, we'll need to get the odds on your side.

Entering the day trading field may be similar to entering a war zone. Without the proper tools, scouting devices, ammunition and strategy your chances of success are small. Whether you are a beginner or a more experienced trader, this course will transform you into a competent futures market combatant.

1.4. 8 Steps To Successful Trading

Many “would-be” traders believe that trading is a skill that they are born with. Their reasoning is that all you need to do is to buy contracts at a lower prices and sell them at a higher price. “How hard can that be?” they ask themselves.

If you share that kind of reasoning then why don't you compete in professional basketball? All you need to do is to throw the ball into the basket. Never mind that guys like Shaq will be trying to stop you. If you feel that you can be a day trader and live off of talent alone, but wouldn't dream of jumping into a pro basketball career; ask yourself this: Why do you think that professional basketball players train so hard? They do so because pro basketball is an extremely competitive business. And so is futures trading. These professions are similar in this sense. Both businesses reward competent and successful participants with great amounts of money. Futures trading is more attractive to the average person because success doesn't require any physical talents. Young or old, tall or short, doesn't make any difference. What makes the difference is discipline and focus. And of course, hard work.

We have designed an eight step program that will gradually transform you into a competent market participant. To understand the importance of each element, think of each step as a link in an eight link chain. The chain is only as strong as its weakest link. Your trading success depends on each of those seven elements. If one “link” is not up to standards, your chain will break. You'll lose money. If you are beginning trader, you should follow these steps in the order they are presented. If you have some trading

experience you will find some of the parts boring and you may want to skip onto those areas that you feel need improvement.

These are the steps:

Step 1. Understand how the futures market works

Before you begin trading, you need to gain solid understanding of Futures and Stock Markets in general and the driving forces behind them. Even though it may seem to you that some of this information is not directly related to your trading, you'll never become competent trader without this understanding. How would you like to buy 5 S&P 500 E-mini contracts 10 minutes before Federal Reserves Chairman announces rising of the interest rates? Without understanding of how this affects the market, you could lose 20% of your capital in minutes. Read as much as you can about history of the markets, order executions, market indexes... In Part II you will find some general info that can be a starting point in your learning process.

Step 2. Carefully choose an online broker

After you have gained solid knowledge about Futures Markets in general, you will better understand the importance of having a reliable broker. Part III which deals with choosing an online broker has all the information you will need to find a decent broker that will meet you requirements.

Step 3. Set up a trading workstation

Your computer will be one of the main tools of your profession. If you were a gunfighter would you want to go in a duel armed with a rusty old gun. You'd be an easy prey. Part IV will provide you with all of the necessary info that will help you set up your own professional trading workstation.

Step 4. Get a superior Internet connection

Active trading requires high bandwidth, high performance and reliable Internet connection. How do you find what is right for you? Part V will show you how to find the best Internet connection possible.

Step 5. Secure an adequate amount of trading capital

If you look at day trading as a war, (trust me, there are many reasons for you to do so) then your trading capital can only be compared to the ammunition. Once you run out of ammunition, the war is over. Part VI will answer all your questions regarding the trading capital.

Step 6. Learn how to properly use TA tools

The secret that successful traders don't like to share is that TA works but not necessarily for reasons that most people believe. It works because many people use it and successful traders are able to predict how other people will react on the different TA indicators and signals. Part VII will show you which TA signals you should follow.

Step 7. Choose trading software that meets your needs

Without reliable and comprehensive trading software, an active trader won't be able to make informed trading decisions, and therefore can not trade successfully in the long run. There is a great number of companies that provide trading platforms, data feed, charting software and it can be a difficult task to choose one that is right for particular style of trading. Part VIII will help you choose the software that will meet your needs.

Step 8. Learn how to utilize a proven trading strategy

Once you have decided that you are willing to invest your time, money and effort in the profession with a low success rate such as stock index futures trading, you will be confronted with a few simple but extremely important questions. How to set up the screens? When should you enter the trade? Should you go long? Should you go short? How many contracts to buy? When to exit the trade? Our strategy that is outlined in Part IX will supply you with answers to those questions.

Part II

Stock Index Futures



The role of a stock market index is to measure changes in the value of specific groups of stocks and help measure changes in the entire market. Indexes can provide a quick snapshot to see how a specific group of stocks performs compared to other groups of stocks. Stock index futures are traded in terms of number of contracts. Each contract is to buy or sell a fixed value of the index. The value of the index is defined as the value of the index multiplied by the specified monetary amount. Index futures contracts closely follow the price movement of their respective underlying indices. Stock index futures that are traded on CME (Chicago Mercantile Exchange) are: S&P 500, E-mini S&P 500, Nasdaq-100, E-mini Nasdaq-100, S&P MidCap 400, E-mini S&P Midcap 400, Russell 2000, E-mini Russell 2000. The two indexes that are of most interest to active day traders are S&P 500, Nasdaq-100 and their E-mini versions and they will be the main focus of this course.

2.1. S&P 500 Index

The S&P 500 stock index is based on the stock prices of 500 large-capitalization companies. The S&P 500 is capitalization-weighted, representing the market value of all outstanding common shares of the firms listed. This means that a change in the price of any one stock influences the index in proportion to the relative market value of that firm's outstanding shares.

S&P 500 Futures

Ticker Symbol SP

Contract Size \$250 times S&P 500 futures price

Minimum Price Fluctuation (Tick) .10 index points = \$25 per contract

Contract Months March, June, September, December

Regular Trading Hours 8:30am – 3:15pm

GLOBEX Trading Hours 3:45pm – 8:15am

Last Trading Day The Thursday prior to the third Friday of the contract month

Final Settlement Date The third Friday of the contract month

S&P 500 E-mini futures

These contracts are based on the same leading S&P 500 index as the most actively traded stock index contract in the world, but are a fraction of the size.

Ticker Symbol ES

Contract Size \$50 times E-mini S&P 500 futures price

Minimum Price Fluctuations(Tick) .25 index points = \$12.50 per contract

Contract Months March, June, September, December

Regular Trading Hours from 5:30pm Sunday to 3:15pm Friday

Last Trading Day Trading can occur up to 8:30am on the third Friday of the contract month

Final Settlement date The third Friday of the contract month

2.2. Nasdaq-100 Index

The Nasdaq-100 Index is composed of 100 of the largest domestic, non-financial common stocks listed on the Nasdaq Stock Market. The Nasdaq-100 index is rebalanced quarterly and has a modified capitalization weighting to ensure a more diversified index.

Nasdaq-100 futures

Ticker Symbol ND

Contract Size \$100 times Nasdaq-100 futures price

Minimum Price .50 index points = \$50 per contract

Contract Months March, June, September, December

Regular Trading Hours 8:30am – 3:15pm

GLOBEX Trading Hours 3:45pm – 8:15am

Last Trading Day The Thursday prior to the third Friday of the contract month

Final Settlement Date The third Friday of the contract month

Nasdaq-100 E-mini futures are offered at one-fifth the size of the original Nasdaq-100 futures

Ticker Symbol NQ

Contract Size \$20 times E-mini Nasdaq-100 futures price

Minimum Price Fluctuation .50 index points = \$10 per contract

Contract Months March, June, September, December

Regular Trading Hours 5:30pm Sunday – 3:15pm Friday

Last Trading Day Trading can occur up to 8:30am on the third Friday of the contract month

Final Settlement Date The third Friday of the contract month

2.3. Chicago Mercantile Exchange

Stocks index futures are traded on CME (Chicago Mercantile Exchange). CME is one of the world's leading exchanges for the trading of futures and options of futures and a marketplace for the global risk management. It has been founded in 1898 as a not-for-profit corporation and in November 2000, it has become the first U.S. financial exchange to demutualize and become a shareholder-owned corporation. CME has the largest futures and options on futures open interest of any exchange in the world. Open interest is the leading indicator of liquidity. There are two ways to trade contracts on CME: via

open outcry and electronically. Open outcry system of trading is an auction in which traders stand in a trading pit and call out prices and quantities that indicate their willingness to buy or sell. They use hand signals to convey such information. Open outcry is an efficient means of “price discovery”, allowing buyers and sellers to arrive at the best prices given the supply and demand of a given futures product. Electronic trading system that is used by CME is called GLOBEX. It allows market participants to buy and sell futures contracts whether they are sitting at the computer terminals on the trading floor or they are sitting in front of their home computers. GLOBEX also allows traders to trade during and after regular trading hours. After hours electronic trading is exchange of contracts after the Exchange floor is closed. The GLOBEX system has also made possible another innovation in the futures trading: futures contracts that are developed specifically for online trading. Generally, these contracts are called “E-mini” contracts. The most successful among these products are S&P 500 E-mini and Nasdaq-100 E-mini.

2.4. Order Types

Market Order

A market order does not specify a price, it is executed at the best possible price available.

Limit Order

The limit order is an order to buy or sell at a designated price. Limit Orders to buy are placed below the current price while limit orders to sell are placed above the current price.

Stop Order

Stop orders can be used for three purposes:

1. to minimize a loss on a long or short position
2. to protect a profit on an existing long or short position
3. to initiate a new long or short position

A buy order is placed above the current market and is elected only when the market trades at or above, or is bid at or above, the stop price. A sell stop order is placed

below the current market and is elected only when the market trades at or below, or is offered at or below, the stop price.

Stop Limit Orders

A stop limit order lists two prices and is an attempt to gain more control over the price at which your stop is filled. The first part of the order is written like the above stop order. The second part of the order specifies a limit price. This indicates that once your stop is triggered, you do not wish to be filled beyond the limit price. Stop limit orders should usually not be used when trying to exit a position.

Part III

How to choose a broker?



Without a reliable broker, even the best traders may have a limited chance of success. Every trader I know has at least one horror story about his/her broker. What happens if you try to sell your position because the value is quickly depreciating only to find out that your broker's server is down. By the time they fix the problem you may be out of 100's even 1000's of dollars. This is especially true when trading E-minis.

When choosing your broker, you'll need to take into account several factors. You also need to understand that while one broker may be an excellent choice for one form of trading it may be a terrible choice for another form of trading. If you are not happy with service and performance that you receive from your broker you should look for another one. It is not worth your time or money to be loyal to someone whose service isn't working for you. While it is not in the interest of your broker to cause you to lose your money you need to remember that your broker makes a profit whether you win or lose. More trades you make, more money your broker makes in commissions. This is why many brokers that cater to day traders give advice or even hold courses on scalping. Scalping is a form of day trading in which a trader makes up to a hundred trades in one day. Scalpers are closely monitoring 1-minute chart and are attempting to catch small movements in the price and as soon as the trade turns against them they get out of the trade. Although this approach has worked out for some traders who were trading high flying Nasdaq stocks in the late 90's for an e-mini futures trader it is a sure way to slowly lose all of his money. For most traders, scalping is a slow death while at the same time for your broker it is the most profitable way of trading. How much would an average scalper pay in commissions while trading e-minis. If he trades 50 times a day, two

contracts at a time and his commission is \$3 per contract each side, such trader would pay approximately \$600 per day or \$12,000 per month in commissions.

There are literally hundreds of brokers that you can choose from. When it is a time to choose your broker, take the time to get informed about several prospective brokers. Although you can always change your broker later it is often a frustrating experience, so try to do everything in your power to make sure that you do it right the first time. By choosing your broker carefully you will save valuable time and money.

3.1. System Reliability

System reliability is the most important factor when choosing a broker. You should find out how often the system that they use is down. How redundant is the system. Does the backup system immediately kick in? There is nothing worse than being disconnected from your broker's server while you are in the middle of the trade. By the time you find out what is going on and place the exit order over the phone you may lose a big chunk of your account. E-minis can move several index points in a few minutes time. With two contracts it can mean a few hundred dollars loss. Some brokers will say that while at one time price will move opposite of your trade another time it will move in the direction of your trade. "Sometimes you will lose, sometimes you will win. In the long run it should have no effect on your trading success."

I strongly disagree. The most powerful weapon in the hands of a day trader is his/her ability to control losses. If you lose 50% of your account (e.g. your account goes from \$10,000 to \$5,000) you will now need to increase your account by 100% just to break even. Conclusion is simple. If the broker is down too often you should definitely stay away.

3.2. Fee Structure

To a day trader, the price of commissions is a factor that can not be underestimated. The importance of commissions depends greatly on your trading style and your trading strategy. If your strategy generates several entry signals per day and you are using relatively tight stops in order to limit your losses then commissions are very important to you. With such trading style the difference in commissions may be up to

\$15-\$25 per contract per day. To a beginning trader and as a matter of fact, to any trader that is an important chunk of change. \$20 per day, \$400 per month, \$5,000 per year per contract. Adds up quickly, doesn't it?

3.3. Execution Speed

In order to succeed in day trading you need to be able to get the most favorable price at any given time. This is especially true for market orders. When trading e-minis, prices move extremely fast and by the time your order gets filled it may be at the price that is very different than the price you were trying to get. If you are using mostly limit orders you may have trouble getting them filled at all. Look for the brokers that provide quick confirmation of executed orders. Even the brokers that normally provide fast executions occasionally may take longer to fill your order. High trading volumes may affect the speed of their executions, and when prices move quickly your limit orders may become outdated.

3.4. Quote Reliability

Most brokers provide basic real-time quotes to their customers, however many of them are often unreliable. Accuracy and real-time delivery problems may arise due to several factors. Sometimes problems arise due to broker's servers, sometimes there is an "Internet traffic jam" and sometimes the original quote provider experiences technical difficulties. As you would expect, your broker will always say that the fault is someone else's. It is up to you to estimate if your broker's quote delivery system is preventing you from trading efficiently. You should also NEVER rely solely on your broker's quotes. You should always have a second quote provider as that is the only way that you will have a clear peace of mind when placing a trade. Many successful traders even use three different quote providers as there are situations when two providers are not functioning at the same time.

3.5 Charting Software

Charting software is a must for active traders. If your broker provides it for free that is an important factor to consider. Some of the free or discounted software that a broker may

provide are: Real Tick, Qcharts, Esignal, TradeStation. Be aware that the value of free software is not enough to compensate for some flaws that such broker may have. One bad execution can cost you three months worth of Qcharts or Esignal subscriptions.

3.6. Technical Support And Phone Service Reliability?

If you are in trouble, you'll want to get help fast. Technical support should be there to help you with any problems you may have regarding your order executions, lost orders, order confirmations, trading platform etc. Don't expect them to give you any trading/investing advice. That's not their job. If your Internet connection is broken and you need to get out of your trade, you need someone to answer the phone quickly. Technical support is important because when a broker experiences technical difficulties, many traders will call at the same time. This can create a situation where no one will answer your phone when you need them the most. You should look for a broker that is able to operate with reasonable efficiency at such times.

Here is a list of brokers that may be suitable for active e-mini trading:

Interactive Brokers

<http://www.interactivebrokers.com>



TradeStation Securities

<http://www.tradestation.com>



GlobalTradz

<http://www.globaltradz.com>



Alaron Trading

<http://www.alaron.com>



Dorman Trading

<http://www.dormantrading.com>

Dorman Trading

JP Futures

<http://www.jpffutures.com>



Castle Trading Inc.

<http://www.castletrading.com>



Orion Futures Inc.

<http://www.orionfutures.com>



Chicago Futures

<http://www.chicagofutures.com>



Part IV

How to set up a trading workstation?



We now need to discuss computer hardware configurations, monitors, operating systems and Internet connections that are suitable for active day traders. Unfortunately, if you think that you can get by with an outdated computer system, a 15" monitor and a Windows 95 OS, you're out of luck. Although such system may be good enough for someone who is placing a few trades per year, for an active e-mini trader it is not enough. You want to make a living out of online trading. Therefore you should think of your computer as the main tool of your profession. If you were a car racer would you consider driving a Ford Tempo to compete with people who were driving Pontiac Trans Ams? Of course not! You would be an easy prey. Trading is an extremely competitive business and you need all the help you can get. A successful trader is usually knowledgeable about computers. He doesn't learn about computers for the fun of it, though. Because the key to his profession is reliable technology, he is forced to become knowledgeable. You should also spend some time at gaining general knowledge about computers and operating systems. In addition to making you a more successful trader, it will also make your life a lot easier in the future.

4.1. What Kind Of Computer Do You Need?

As we all know, advances in computer speed and power happen almost on a weekly basis. It is impossible to give you precise advice that can hold for more than a few months. At the same time your goal is to spend as little money as possible for the system because no matter how much you spend in due time it will become obsolete. The most important component of any computer system is microprocessor. At the time of this writing (summer 2002) if you are planning to trade with your existing system make sure that your microprocessor is Pentium III 800 MHz or higher. If you are planning to purchase a new system you should go with Intel Pentium IV 1.8 GHz or higher. Do not

pay for the hottest new chip because they are always overpriced and in a 2-3 months time their price is reduced by 40%. The second most important component of a computer system is RAM (random access memory). It is the place in a computer where the operating system, application programs and data in current use are kept so that they can be quickly reached by the computer's processor. Your RAM should be at least 256 MB SDRAM. Your hard drive is not very important, 20 GB should be enough. You are better off spending your hard drive money to buy more RAM.

Make sure to regularly defragment your disc as that will dramatically improve your system's performance. You should also eliminate unnecessary programs that load during start up as that will free up memory as well as speed up the boot time. Sometimes you can also get a surprising performance boost by upgrading your video driver. It is usually the case if the video controller was a new model when you purchased it and the drivers were in a beta state. Here are links to some of the best places on the Net to find affordable computer components:

Best Buy

<http://www.bestbuy.com>



Tech Depot

<http://www.techdepot.com>



Computers for Sure

<http://www.computersforsure.com>



Dell

<http://www.dell.com>



Ebay

<http://www.ebay.com>



4.2. How Many Monitors Do You Need?

Active day traders will need at least two 19" regular monitors or two 17" flat panel monitors. For active day trading one monitor is not enough. Why two monitors?

As you will see later, you will need access to a great deal of real time information simultaneously and it can not fit on one screen. If you are short on start up capital you will probably try to pass by with two regular 17" monitors. Although it is possible to trade with 17" regular or 15" flat panel monitors it is much tougher on your eyes. Save yourself the trouble. You'll end up buying 19" monitors anyway. Many beginning traders think that if they buy the most expensive hardware and monitors that it will have an effect on their trading. If you have money to throw away then go ahead, I however think that you are much better off saving your money for trading. Flat screen monitors may look aesthetically pleasing, but are they worth the money? Probably not. I think that you are best off buying two regular 19" monitors. You should be able to find them for about \$200 – 250 US each. That's not bad considering that 2 years ago they were costing \$400US and up. Some experienced traders use three to four 19"-21" monitors. If you are a novice trader you will probably not be able to simultaneously follow and interpret real time information from four screens. Invest your money in four monitors only when you can do so by using your trading profits. As far as the difference between 19" and 21" monitors goes, it depends how far away from them are you sitting. If you are going to use 21" monitors you will have to sit further away and you will have to set up your display resolution at 1600x1200 pixels. For the 19" monitors your display resolution should be set at 1024x768 pixels. In order to install a second monitor you will need a multiple

monitor graphics card. It lets you increase the virtual size of your desktop. The card will allow you to view your running applications at the same time without clicking between windows. If you already have a decent (16MB or more) graphics card you need to find out if it supports multiple monitor display. If it does, you will need to buy one more compatible card. To find out if your card supports multiple monitors go to:

For Windows 2000

<http://support.microsoft.com/default.aspx?scid=KB;EN-US;q238886&>

For Windows 98

<http://www.microsoft.com/insider/ms/monsupport.htm>

Another, easier, more reliable but at the same time more expensive way to install multiple monitors is by buying a graphics card that has two or more display slots built in. A card that is gaining more and more popularity due to its relatively low price and rock solid performance is Matrox G450 Millennium. To find out more you can find out more at

<http://www.matrox.com>



Another popular but more expensive multiple monitor graphical card is Appian "Typhoon". You can find out more at:

<http://www.appian.com>



4.3. What Kind Of Operating System Should You Use?

An operating system is a program that provides software platform on top of which other application programs can run. From a perspective of an online trader the most important factor when choosing an operating system is stability. The bad news? You are probably using Windows 98 or Windows ME. Although they are good enough for short term/swing trading their stability is not adequate for active day trading. Windows 98, when running several applications at once, tends to freeze up very often. You will need to manually restart it. If you were in the middle of the trade your winning position can quickly turn into losing one. The operating systems of choice at the time of this writing are Windows 2000 Professional and Windows XP. I would recommend Windows 2000 because it has been around for longer time and it has been properly tested. It is stable and fast. If you have an adequate amount of RAM it can run for weeks without ever freezing up. Another good choice is Windows NT 4.0 Workstation. It is even more stable and robust than Windows 2000, but it is getting more and more difficult to find compatible drivers for the different devices that you will be using. Windows 2000 Server and NT 4.0 Server are also good choices, however they require better than average computer knowledge and if you are not computer expert you should stay away from multiple user OS's. You should only use them if you need two or more people to be able to use the computer at the same time and in that case you will also need more powerful processor and more RAM. If you are thinking about using Linux OS for your trading, you should probably wait until there is enough compatible software. Most of the trading software is written for Windows only and you will have to take that into account.

Part V

What kind of Internet connection do you need?



Active day trading requires high bandwidth, high performance and reliable Internet connection. Dial up connections are suitable for short-term/swing trading, however although it is possible to day trade using regular dial up connection, it is not recommended. Dial up connections are often slow and unstable. If you use them, you will have to redial at least a couple of times during one trading session. On top of that you don't need delays in your real time data feed because that can cost you money. Several years ago, the only alternatives that you had to the regular dial up connection were T1, T3 and ISDN connections. Their high cost was the main reason that stopped them from being widespread. Thanks to the huge amounts of money being pumped into high speed Internet access divisions of main cable and phone companies, there are now several alternatives. The best and most reasonably priced choices are: Cable Internet service and DSL Internet service. Both of these connections have their pros and cons.

5.1. Cable Internet Connection

Cable companies and cable Internet service providers are claiming that cable modems are as much as 100 times faster than a regular dial up connection. They say that you can get a speed of up to 5Mbps compared to 50 kbps dial up speed. Theoretically it is possible. Realistically you should be happy if you get 1Mbps. It is still more than enough for your trading needs. If you are a TV cable subscriber you will probably be charged for your cable Internet service on the same bill. At the moment costs range from \$30 - \$50 per month including cable modem rental. You will also pay installation charges that run from \$50 - \$150. The main benefit of cable modem is that it is always on, there is no need to dial up every time you want to connect to the Internet. The drawback of cable access is that it is shared by people in one neighborhood, meaning that if more people are

online at the same time your connection will be slowed down. Fortunately, between 8:30 am and 4:00 pm Eastern time and 5:30 am and 1:00 pm Pacific time most people are working. This is the time period that financial markets are open for trading. Because cable lines are shared it makes it easier for someone to hack into your computer. To reduce the risk you should install firewall protection software. I would recommend a free software called “Zone Alarm”. You can download it at <http://www.zonelabs.com> .

5.2. DSL Internet Connection

A Digital Subscriber Line (DSL) is the other reasonably priced high speed Internet access choice. In theory it is not as fast as cable. In practice, its performance is almost equal to that of a cable modem. Depending on your distance from the provider’s central office, it can perform at even higher speeds. As the distance increases, the signal quality decreases and reduces the connection speed. At the extremes of distance limits you can have a speed that is far below the promised maximum. DSL connections use your regular phone line at different frequency, allowing you to use your telephone at the same time. DSL connections have faster download speeds than upload speeds, which means that they work faster when receiving data than sending the data over the Internet. The security of DSL is greater than that of cable, because your DSL connection is not shared with other users. One of the problems with some DSL companies has been poor technical support. They have such problems because it is difficult to hire skilled employees while maintaining high growth levels.

You can test your Internet connection speed at following sites:

<http://dslreports.com/stest>

<http://speedtest.mybc.com>

<http://www.toast.net/performance>

As far as active trading is concerned differences between cable and DSL connections are minor. You should make your decision based on price and availability. If only cable is available you will have to go with cable and vice versa. If neither option is currently available in your area, regular dial up will have to do the job. Check with your phone and cable companies to be notified when they will be able to provide you with high speed Internet service.

You should never rely on one ISP only. If you have either cable or DSL high speed access you should also have one extra account with a regular dial up provider. Both cable and DSL services often experience technical difficulties and you may not be able to connect to the Internet for hours at the time. If that happens while you are in the middle of the trade, you will need an extra connection to be able to get out of that trade. Think of the extra \$15 that you spend on the additional account as a form of insurance.

Part VI

Trading Capital



If you look at day trading as a war, and there are many reasons for you to do so, then your trading capital can only be compared to the ammunition. Once you run out of the ammunition the war is over. Always remember that if you lose 50% of your trading capital you now need a hundred percent increase just to break even. It is more important not to lose than it is to win. Do what it takes to preserve your capital. You'll always have another chance tomorrow to make a profit.

You should only use money in your day trading that you can afford to lose. Depending on your current financial and employment status, you might not have the opportunity to make the lost money back. If you're drawing funds from your retirement accounts, you should have more conservative trading strategy than someone who is saving for their next family vacation. Do not use money that you have set aside for family emergency situations, children's education, etc.... Trading with such money will impair your trading abilities and greatly increase your chance of failure.

6.1. How Much Capital Should You Start With?

Don't count on day trading to cover your living expenses. If you count on your profits to cover your daily expenses, you'll be a nervous and unstable trader. You should be able to trade confidently and not make irrational, erratic decisions based on your need to cut a profit quickly. You'll have a clear head as long as you don't have to worry about losing the only money you have, so be reasonable with both your start-up capital as well as your expectations.

As a beginning trader, you are a long way of being able to live from your trading profits. You can begin your trading career with relatively small startup capital as long as you don't count on your trading profits to cover your living expenses. If your trading

capital was \$5,000, you would have to make monthly trading profits of 50% to be able to survive on it. Even the best traders can't count on that kind of return.

Begin your career in trading gradually. Don't jump right into full-time trading. (In other words, don't quit your day job!) You don't want to make any life-altering decisions such as selling your business or quitting school until you have already made consistent profits. You should make consistent profits during a reasonably long time period to justify any life-changing decisions.

Depending on the amount your broker charges you for commission, you can start trading with an amount as low as \$5,000. Remember that starting out with such low trading capital may put you at a disadvantage. You'll only be able to trade one contract at a time. Commissions will likely take big chunk of your potential trading profits. You may also end up with severely reduced capital if you suffer a losing streak. If your capital allows you to trade one contract at a time, and your broker charges you \$10 per transaction, you will clearly be at a disadvantage. In such case the contract you are trading needs to move 0.25 index points in the direction of your trade for you to just break even. In such conditions, your chances of success are very slim. If the price moves 1 index point in the direction of your trade, and you were trading a single ES contract, your net profit on that trade would be only \$35.

If starting with a small amount of capital is too risky, what amount of capital is better? Start with an the amount that is low enough to make it affordable, and high enough that you are able to weather losing streaks as well as commission costs.

6.2. How Do You Find Startup Capital?

What if you have confidence in your abilities, but not enough money to fund your ambitions? Many traders that have success in the paper-trading find themselves ready to trade, but without the ammunition to enter the battle. One of the best ways to obtain some quick cash is to sell some of your toys, gadgets, and other items you may own but very seldom or almost never use. You can auction them on the Ebay.com, and a few days later you may have a few hundred extra dollars that you didn't count on.

You'll want to avoid borrowing off of your credit cards. It's too risky and the costs are too high; If you lose, you'll have to repay that money with 18 – 20% rate of interest. If you have decided to borrow money for your startup trading capital, the best way to do so is to use personal line of credit. You will pay much less in interest and there is no minimum payment other than the accumulated interest for each month.

Obtain the money you need with the minimal amount of risk. If you can't afford it without risking your daily expenses, don't do it. "Better safe than sorry," is the mantra you'll want to follow when weighing your startup capital risks.

Part VII

Technical Analysis



7.1. Why Does Technical Analysis Work?

Once you're got your hardware set up ready, you'll need to know what kind of odds you're up against. This will help you plan your strategy accordingly. Futures traders usually use **technical analysis** to determine the risk factors involved. **Technical analysis** describes different ways of predicting the future of the underlying market based on its history. Unfortunately, technical analysis is not an exact science. Many prominent scientists label it as "voodoo science". They claim that due to **market efficiency**, if you use TA to find your entry positions, you're no better off than someone who chooses those positions randomly. **Market efficiency** means that all the available information is already calculated in the market prices, and that you can only guess how will the price behave in the future.

The "voodoo science" theory would make sense if it wasn't for the fact that there is a significant number of traders who are able to consistently make profits in financial markets. These traders use technical analysis as their main tool. Since any trader has or can have access to the same TA tools we have to ask how can small group of traders consistently win and the other larger group, more or less consistently lose in the futures trading game. What is it that winning traders know about technical analysis that gives them the upper hand?

The answer is simple: **Technical Analysis works but not necessarily for the reason most people believe**. Many successful traders don't want to share this secret. TA works because many people use it, and successful traders are able to predict how other people will react on the different TA indicators and signals. In other words, while the losing traders are using TA to determine their trades, the winning traders are winning because they know how the losers are going to react based on this data. For example,

when a price goes below one of the key moving averages, MA, many investors sell that instrument to protect themselves against additional losses. By doing so, they will drive the price of that instrument lower and that will prompt some traders to start short selling that instrument in anticipation of further decline. Prices continue the downward trend, forcing traders who were long on that particular instrument to sell their positions because it is going below their stop limits. This creates a domino effect as the price continues to decline. However, at this point, successful traders realize that most of the current price action was created artificially. They start to enter positions on the buy side and more often than not price starts to reverse. The losing traders have already sold their positions based on the TA tools. The winning traders buy the instrument because they understand that the fluctuation was temporary, and they seize the opportunity based on the losing trader's reactions.

No TA tool by itself will give you reliable buy or sell signals. There is no holy grail or magic black box that will give you the perfect, accurate signal. However, combining of the right group of TA indicators with discipline and adequate trading capital has been the road to fortune for many traders. There is no reason why you cannot emulate their success.

Technical Analysis is similar to studying history. Historians are usually able to make the most accurate predictions of future and outcomes of events. Usually, the past repeats itself. History proves that people historically behave in the same manner in the similar situations. Great empires start to fall when everybody starts thinking that they are invincible. The same thing happens with stock market. Every time there has been a long lasting bull market, new experts come from the woodwork claiming that this time it is different, that this time there is new technology, that this new bull will never stop because unlike in previous bull markets fundamentals are now much stronger... Out of fear, people start to invest more so they don't get left out of the boom. This results in them spending more than they can afford. Some may even borrow money to be able to play the financial market. When there is no more fresh money to feed this beast, it has to start to feed of itself. Then comes the bear market. If investors who were among the last to join the party looked at the charts of previous bull markets, they would have noticed that many technical indicators were behaving similarly as they had in the past.

When you're unprepared and unaware of historical facts, history is doomed to repeat itself. This is the last lesson you want to learn the hard way when entering the day trading battle. If you learn it while in battle, not beforehand, your chances of success will most likely be lost.

We will now examine the most important TA indicators and how can they be effectively used in predicting future movements in futures prices.

7.2. Price Chart

The price chart is a basic TA tool. Its horizontal axis indicates time and the vertical axis indicates price.

Figure 7.1. shows a S&P E-mini 5 minute **line chart** for March 3, 2002. It is the most simple price chart because it doesn't show price behavior inside the 5 minute intervals.



Figure 7.1.

Figure 7.2. shows S&P E-mini 5 minute **bar chart**. Bar chart shows us more information than line chart since it is possible to see approximate price behavior inside the intervals. We can see price at the start, price at the end, highest price and lowest price of each interval (in this case it is a 5 minute interval).



Figure 7.2.

The price chart that is most widely used among active traders is the **candlestick chart**. It reveals basically the same information as a bar chart. Figure 7.3. is an example of a 5 minute candlestick chart. Note that those intervals with opening prices higher than closing prices are in white color and intervals with opening prices lower than closing prices are in red color.



Figure 7.3.

7.3. Volume

Volume is the simplest, yet single most important indicator of the current price trend. Volume measures quantity of contracts of a given instrument that changed hands during a specific time period. From figure 7.4. we can see how the changes in the future price and changes in the volume are closely related. Note how at the period from 11am – 2pm when the volume was low, the price was not very volatile. Sudden increases in volume are usually followed by quick movements in the price (both up and down).



Figure 7.4.

7.4. Moving Average

Moving average is one of the most widely used TA indicators. Moving average is calculated by finding the average price of the trading instrument over a set number of periods. It is called a “moving” average because as the newest period is added, the oldest period is dropped. MA crossovers are used in many trading systems as buy or sell signals. Usually, combinations of two or three MA intervals are used.

In our example we will use 4 and 12 period MA intervals. A buy signal occurs when longer term MA (12 period) crosses shorter term MA (4 period) from above to below. A sell signal occurs when longer-term MA's cross shorter-term MA's from below to above. You should never use these signals if they are not confirmed with a number of other signals.



Figure 7.5.

Figure 7.5. is a five minute candlestick chart for S&P E-mini contract. Red line represents 4 period MA and blue line represents 12 period moving average. One of the TA indicators that should be used together with MA is volume. MA crossover should be coupled with increase in volume in order to create a buy signal. As we can observe on the chart above at 2:05 pm MA crossover was combined with the substantial increase in

volume thus creating a strong buy signal. Another popular way of observing buy and sell signals is by using single, longer term MA such as 20 day MA. Buy signals occur when the current price crosses EMA from below to above. The sell signal occurs when current price crosses MA from above to below.

7.5. Time & Sales Window

Time and Sales window is a technical tool that is used to determine the speed and momentum of trades as the price approaches one of its breakpoints. Figure 7.6. is a T&S window for S&P 500 E-mini contract at 10:47 am. As we can observe the last trade was at 10:47:08 when 23 contracts exchanged hands at 1164.75 per contract.

Index	Date	Time	Price	Size	Exchange	BATE	Indic
474	03/11/02	10:47:08	1164.75	7	g	Best ask	
473	03/11/02	10:47:08	1164.50	289	g	Best bid	
472	03/11/02	10:47:08	1164.75	160	g	Best ask	
471	03/11/02	10:47:08	1164.50	25	g	Best bid	
470	03/11/02	10:47:08	1164.75	23	g	Trade	
469	03/11/02	10:47:07	1164.75	25	g	Best bid	
468	03/11/02	10:47:07	1165.00	160	g	Best ask	
467	03/11/02	10:47:07	1165.00	1	g	Trade	
466	03/11/02	10:47:07	1165.00	25	g	Trade	
465	03/11/02	10:47:07	1165.00	2	g	Trade	
464	03/11/02	10:47:07	1165.00	1	g	Trade	
463	03/11/02	10:47:06	1164.75	18	g	Best bid	
462	03/11/02	10:47:05	1164.75	1	g	Trade	
461	03/11/02	10:47:05	1165.00	189	g	Best ask	
460	03/11/02	10:47:05	1164.75	19	g	Best bid	
459	03/11/02	10:47:05	1165.00	70	g	Best ask	
458	03/11/02	10:47:05	1164.75	287	g	Best bid	
457	03/11/02	10:47:05	1164.75	70	g	Trade	
456	03/11/02	10:47:05	1164.75	70	g	Best ask	
455	03/11/02	10:47:05	1164.50	287	g	Best bid	
454	03/11/02	10:47:05	1164.75	10	g	Trade	
453	03/11/02	10:47:05	1164.75	9	g	Trade	
452	03/11/02	10:47:05	1164.75	1	g	Trade	
451	03/11/02	10:47:05	1164.50	282	g	Best bid	
450	03/11/02	10:47:04	1164.75	87	g	Best bid	

Figure 7.6.

Trades that are displayed in green took place at the best ask or above. Trades that are displayed in red took place at the best bid or below. If a trader observes that majority of trades flying by on the screen are green, at a speed higher than usual, it is used as a bullish sign. This is because a majority of the trades are taking place at the ask or above, this means that traders are starting to chase the price, and are offering prices that are higher than the current ask. On the other hand, if a trader observes that the speed of trades is increasing while the majority of trades are red, this is considered as a bearish sign. Red color means that sellers are not able to sell their contracts at current bid prices and are forced to sell them for less.

7.6. Pivot Points

Pivot points are those price levels that are most likely to act as levels of support and resistance on any given trading day. As we already know, Technical analysis works because many people use it. For the same reason, the most influential pivot points are those that are used by majority of traders. The most widely used formula for calculating pivot points is as follows:

H = previous day's high

L = previous day's low

C = previous day's close

Pivot Point $PP = (H + L + C)/3$

Resistance = $2*PP - L$

Support = $2*PP - H$

Previous day's last two hour high L2HrHigh

Previous day's last two hour low L2HrLow

When the price moves through the known pivot point on increased volume it is most likely to continue current trend, and if the price hits the known pivot point but is unable to move through it is most likely to reverse the current trend.



Figure 7.7.

Figure 7.7. is a 5min candlestick chart for S&P 500 E-mini contract and you can observe how the Pivot Point PP was acting as a major support line throughout the trading day.

7.7. Support and Resistance

Support and resistance S/R is the most basic concept of technical analysis. Support is created at points below the current price where there is enough buyers to prevent and eventually reverse decline of the contract price. Resistance is created at points above the current price where there is enough sellers to stop and eventually reverse the advance of the contract price. Support or resistance is often established around key pivot points as well as around key Moving Average points such as 20 Day MA or 50 Day MA.



Figure 7.8.

Support and resistance should not be used alone when looking for potential entry signals, but in the combination with other TA indicators. Figure 7.8. is a 5min candlestick chart for S&P 500 E-mini contract. As we can observe on the chart the price was unable to move through key S/R areas at any point during the trading day. The trading approach that should be used on such days is called swing trading. Swing trading is a trading approach in which a trader anticipates the price to bounce off support/resistance levels. On the other hand, traders who anticipate continuation of the current price trend after the price crosses support/resistance levels are said to be using breakout trading approach.

7.8. Trend Lines

Straight lines that can join series of ascending or descending tops or series of ascending or descending bottoms on a price chart are called trendlines. Trendlines are simple, but very powerful trading tools. Figure 7.9. is a 5 min candlestick chart for S&P 500 E-mini contract. When the price declines, touches the established trendline and starts to reverse, it is considered a bullish signal. When the price falls straight through the trendline it is considered a bearish signal. On the other hand, if the price rises, touches the established trendline and starts to reverse, it is considered a bearish signal, and when the price rises straight through the trendline it is considered a bullish signal. As was the case with S/R levels, such signals have always to be confirmed with other TA indicators.



Figure 7.9.

7.9. Relative Strength Index RSI

Relative strength index is a momentum indicator. It usually moves ahead of price. It is an indicator that measures a stock's price relative to itself. The values that it can have are between 0 and 100. It is not affected by sudden short term movements in a stock's price. Therefore, it looks at the overall picture and eliminates much of the marketplace noise.



Figure 7.10.

Figure 7.10. is a 5min candlestick chart for S&P 500 E-mini contract. The RSI value is represented by the blue line, which is most of the time moving between the two straight horizontal parallel lines. The upper line has value of 70 and the lower line has value of 30. For the purpose of this course. When the RSI is crossing the 70 line from below to above it means that there is a good chance that resistance line is being broken and therefore we will use it as a bullish signal. When the RSI crosses the 30 line on the way down it means that there is a good chance that support line is being broken and we will use it as a bearish signal.

7.10. Chart Patterns

Traders who make the majority of their trading decisions based on recognizing familiar chart patterns are called “chartists”. This type of trading is based on the theory that history repeats itself, which is also the theory behind technical analysis as a whole. However difficult it may be to assign any scientific credibility to charting, most often it works. Patterns are created because trends do not last forever. Sooner or later, prices slow down, pause and then change direction. The importance of a price pattern is the direct function of its size and depth. Usually, the longer a pattern takes to create, the more significant the following price move is likely to be. Some of the most typical price patterns are:

7.10.1. Head and Shoulders

The head and shoulders price pattern is the most widely used and recognized bearish chart pattern. Figure 7.11. is a 5min candlestick chart for S&P 500 E-mini contract for the two day period.



Figure 7.11.

From the chart above we can observe that the first shoulder was created between 11am – 1 pm on Wednesday. The price was looking for the direction between 1pm and

2pm and around 2pm a rally started and took the price to the new high (head). Price was able to hang on to the new high for a brief period of time and it was followed by the swift decline. It returned to the first shoulder level. When the price creates a second shoulder it is considered as a strong bearish signal. Opposite to the head and shoulders pattern is the Inverse head and shoulders formation. It is recognized as one of the most widely used bullish price patterns.

7.10.2. Double Tops

A double top is a price pattern that signals the beginning of a downward trend. It is therefore a bearish indicator. It is created as the price climbs to resistance levels two times but is unable to breach it. Figure 7.12. is a 1min candlestick chart for the S&P 500 E-mini contract.

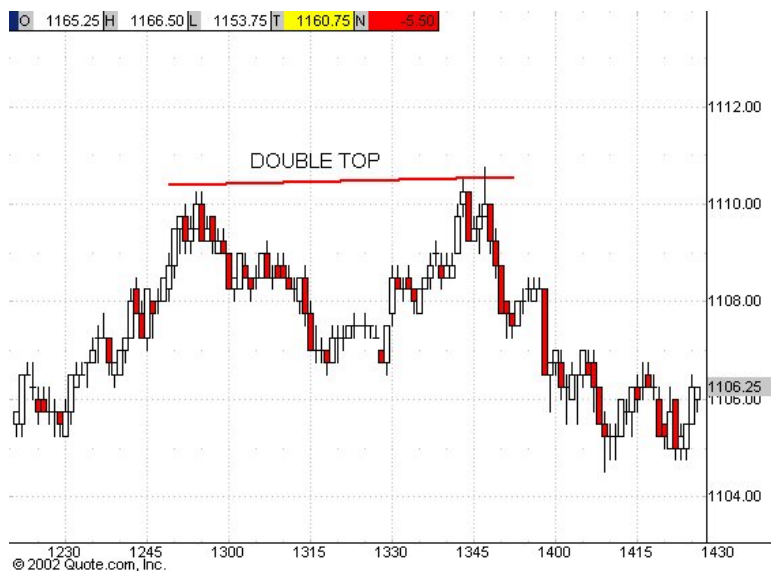


Figure 7.12.

As we can observe on the figure above the price was unable to move through the resistance level for the second time and at 13:49 it would have been as excellent sell signal.

7.10.3. Double Bottoms

A double bottom is the opposite of the double top since it signifies beginning of an up trend and is considered as a reliable bullish indicator. It is created as the price falls

to the support level two times and is not able to breach it. Figure 7.13. is a 1min candlestick chart for the S&P 500 E-mini contract.



Figure 7.13.

As we can observe on the figure above the price was unable to move through the support level for the second time and at 12:12 it would have been an excellent buying opportunity.

7.10.4. Rounding Tops and Rounding Bottoms

Rounding tops are formed when sentiment gradually shifts from bullish to bearish and rounding bottoms are formed when sentiment gradually shifts from bearish to bullish. Figure 7.14. is a 1min candlestick chart for S&P 500 E-mini contract and is an example of a rounding top chart pattern.



Figure 7.14.

Figure 7.15. is a 1min candlestick chart for S&P 500 E-mini contract and is an example of a rounding bottom chart pattern.

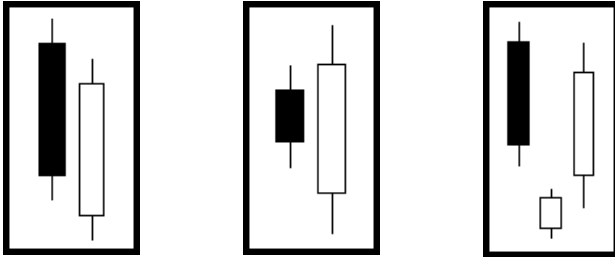


Figure 7.15.

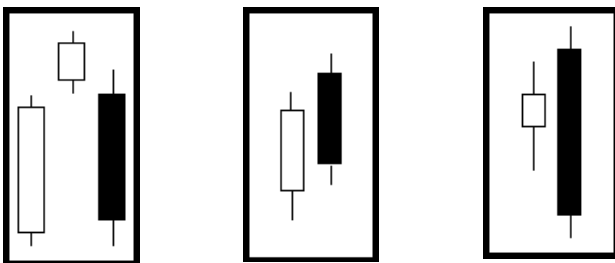
7.11. Candlestick Patterns

Candlestick patterns are formed on the real time candlestick price chart and can be additional technical help when choosing your entry/exit positions.

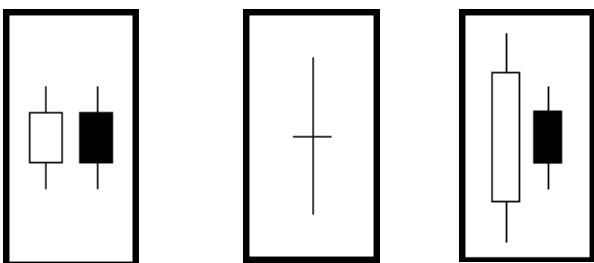
Bullish



Bearish



Neutral



7.12. S&P 500 Squawkbox

S&P 500 Squawkbox is a real time audio feed from the CME S&P 500 trading pit. It is usually coupled with a commentator who is explaining in real time what is happening on the trading floor. The most important thing to listen to is a background noise. When the noise starts to get very loud it is usually sign of a strong movement, either up or down. When the noise goes quiet it and then suddenly gets loud it is usually sign of a reversal.

One of the problems with Squawkbox service is the time period that takes for the audio feed to get to your computer. Depending on your connection it may take up to 15 seconds which is a long time when trading index futures contracts. In order to determine what is your time lag, you should adjust your computer clock with the atomic clock in Colorado, <http://www.time.gov> and listen every 15 minutes for the floor ring. You should then be able to determine what is your lag time. Here is the list of the websites that provide Squawkbox services:

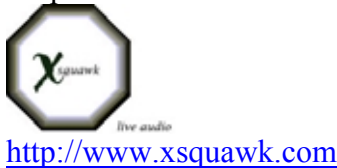
Real Time Futures



Los.net



Xsquawk.com



Part VII

How To Choose The Trading Software?



Without reliable and comprehensive software an active trader can not make informed trading decisions and therefore can not trade successfully in the long run. Such software is essential in watching and establishing patterns. Without seeing the moves your competition is making, comprehensively and in real time, you may miss the chance to make your move. There is a great number of companies that provide trading platforms, data feed and charting software. It can be difficult to choose one that is right for particular style of trading. A trade execution platform provided by your broker usually lacks decent charting and TA tools that are necessary to your trading success. Such platforms, in most cases let you execute trades, calculate your portfolio and provide you with some basic data feed for the instrument of your choice. Such software platforms are usually provided to you at no cost, and because they greatly vary from broker to broker we will not discuss such platforms in more detail.

The software that we are interested in is the third party data feed and charting software. In some cases you may be able to get this software from your broker at discounted price. If you generate lots of income for your broker by trading often, you may even be able to get it for free. If you have already chosen your broker based on factors that we have discussed earlier, find out if he offers a cheaper alternative to get the software you need. If he offers it, you should go for it. You can always change your software later if you find out that it is not up to your standards. When choosing your TA and data feed software, you'll want to look for: reliability of data feed, number of real time TA indicators (MA, T&S, RSI...), cost... It would also be of benefit if the software you choose can be integrated with your trading platform. When scouting out trades, the reliability of a software's data feed is the most important factor. You will need to have accurate information on bids, offers, and last prices at any given time. Without reliable information, it is impossible to trade. Every data feed sometimes experiences technical

problems. However, this should be a rare occurrence. The TA indicators your software should provide may also depend on your trading style. The standard features you'll want to look for are: Volume, Moving Average, RSI, Candlestick charting, the ability to draw trendlines as well as S/R lines, Time&Sales window. Price may also be an important factor for beginning traders who have a small start up capital to work with.

Here is the list of some of the software products that you may consider:

8.1. Qcharts

<http://www.quote.com>

Qcharts is a very popular, real time quote feed and charting application. It currently costs about \$80 per month + exchange fees. It is a highly scalable and relatively inexpensive software. Some of the Qcharts positive features are:

Live updated charts

Time and Sales Window

Variety of TA tools

Ability to draw trendlines and S/R lines

High reliability

Relatively low cost

High scalability

Figure 2 is an example of a Qcharts two screen set up. As you can observe from the figure below, on the left part of the screen there are real time 5min candlestick charts for Microsoft, Dell, Cisco, Oracle and Intel. Those 5 stocks should be observed when trading Nasdaq-100 E-minis. In the center of the screens there is a Time&Sales Window for Nasdaq-100 NQ E-mini contract. On the right screen there are 1day, 5 min and 1 min real time NQ charts respectively.



Figure 8.1.

8.2. Medved Quote Tracker

<http://www.quotetracker.com>

Medved Quote Tracker is a very reliable and resourceful software. It also has one more very positive characteristic. It is free! When I first downloaded this excellent trading tool I found it hard to believe that it was completely free. Figure 3 is an example of how you can set up a single screen with Quote Tracker.



Figure 8.2.

As you can see on the figure above we have opened five separate charts, in this case General Electric, Microsoft, Pfizer, Exxon and Wal-Mart which are the five most important stocks to look for when trading S&P 500 E-mini contracts. Quote Tracker does not provide a quote feed of its own. It is however compatible with many popular quote providers such as Yahoo, Datek, Quote.com. To get started, you will need to register with one of those providers and then specify which one you have chosen. In the figure above, the data provider is Scottrade, which doesn't require you to be their customer. You can register for free on their web site. If you are wondering how can such a software be free, the answer is advertising. Because it is free, Quote Tracker has many users so it can charge more money from it's sponsors. Here is the list of some of the services Quote Tracker provides: Multiple simultaneous, self updating intraday charts, streaming Level I quotes, intraday and historical chart trendlines, advanced alert system, news monitoring, multiple portfolios support, scrolling ticker tape. Quote Tracker is an excellent choice as a back up software. It's main drawback is that you can only open an intraday chart for a current trading day and you can not go back in time. However, if you are planning to do some stock trading together with E-mini trading, Qcharts is a great choice of software.

Other software platforms that you may consider are:

Real Tick III



<http://www.realtick.com>

eSignal



<http://www.esignal.com>

pcQuote



<http://www.pcquote.com>

Quicken



<http://quicken.com/quickenquoteslive>

Part IX

Trading strategy



Now the battle is about to begin and you should get ready for it. Before you go any further ask yourself the following questions:

Are you willing to invest your time, money and effort in a profession in which success is not guaranteed? Are you comfortable with and aware of the fact that the chances of failure are high?

Do you have a comfortable, basic knowledge of the Futures Market in general? Are you familiar with key concepts and terms as related to futures trading, stock index futures in particular?

Have you opened an account with an online broker that meets the criteria that we have outlined? Have you set aside the amount of money that you are willing to risk?

Are you set up with the necessary hardware and Internet connection? We will assume that you will be using two monitors for the purpose of this strategy. If you haven't installed two monitors yet, you will have to jump between the screens. Eventually, if you are serious enough about trading, you will realize that using only one monitor puts you at a huge disadvantage.

Have you gained a solid understanding of key Technical Analysis concepts?

Have you subscribed to a data feed provider and have you installed a decent charting software?

9.1. When And How Will Your Trading Day Start?

For the purpose of this strategy we will be using Qcharts charting software, Medved Quote Tracker, and Interactive Brokers TWS trading platform. Which software you will be using is entirely up to you, however our setup will give you a general idea of what capabilities should your software have.

Our trading day will start either night before or early morning before the start of regular trading hours. There are several variables that we need to calculate before the start of the trading session. Figure 9.1. is the daily candlestick chart for S&P E-mini (ES).



Figure 9.1.

9.2. Calculating Major S/R Areas

We are interested in the previous trading day (in this case Tuesday, Aug 7). As we can observe from the chart 20DMA (20 day moving average – blue line) was briefly touched at some point during the trading hours however the day closed well below the 20DMA. We can also observe that current price is way below 50DMA (50 day moving average – red line) which is another bearish indicator (for the purpose of our strategy 20DMA will be given more importance). Another information that we are interested in is:

Previous day's high $H = 875.00$

Previous day's low $L = 828.50$

Previous day's close $C = 861.75$

From those numbers we will now calculate 3 key areas for the next trading day.

$$\text{Pivot Point PP} = (H + L + C)/3 = (875 + 828.5 + 861.75)/3$$
$$\text{PP} = 855.08 \approx 855$$

$$\text{Resistance} = 2 * \text{PP} - L = 2 * 855 - 828.5 = 881.5$$

$$\text{Support} = 2 * \text{PP} - H = 2 * 855 - 875 = 835$$

We will now open 1min candlestick chart for the last two hours of the previous trading day.



Figure 9.2.

As we can observe from the chart above during the last two trading hours:

$$\text{L2HrHIGH} = 875 \text{ (which by accident is also daily high)}$$

$$\text{L2HrLOW} = 856.75$$

Those two numbers are important because the last two trading hours of the previous day is the time that is the closest to our trading session and therefore we have to take into account it's key price points.

You should write down all of those numbers on a new sheet of paper, and you should use that piece of paper to write down any notes and observations that you may have during the trading session. You should keep the papers from all of your trading sessions in a separate binder for future reference. Keeping a trading journal even though sometimes

you don't feel like it is a very important part of your strategy. In a few months when you are going through your journal you will be surprised how much you will be able to learn from your own writing.

The important numbers are:

Pivot Point PP = 855

High H = 875

Low L = 828.5

Close C = 861.75

Resistance = 881.5

Support = 835

L2HrHIGH = 875

L2HrLOW = 856.75

Our next step is to research the financial websites to find out if there are any important earning reports, federal reserve board meetings, market sentiment reports etc... scheduled for the following trading day. If there are some of those events scheduled you need to write it down on your paper sheet and you need to be extra careful around those time frames or it may even be wise not to trade at those times for beginning traders. E-minis are volatile enough even when nothing happens, you don't need extra volatility. If you find yourself on a wrong side of the trade when a report comes out you may lose a few hundred dollars per contract in a matter of minutes.

The best places to find out about such events are:

CNN Investor research center

<http://money.cnn.com/markets/IRC/>



Yahoo! Finance

<http://finance.yahoo.com>



Globe Investor

<http://www.globeinvestor.com>

FINANCE

9.3. How To Set Up Your Screens?

OK, our trading day is about to start. We will now set up our monitors with the necessary charts.



Figure 9.3.

Figure 9.3. is a snapshot of the monitor set up on Wednesday Aug 8, based on the data that we have collected from the previous trading day. As we can observe on the chart above we have placed Quote Tracker onto the left monitor and Qcharts onto the right monitor. Let's have a closer look at each monitor:



Figure 9.4.

Figure 9.4. is a set up with 1minute candlestick charts of the five most important S&P 500 stocks: General Electric GE, Microsoft MSFT, Wal-Mart WMT, Exxon XOM and Pfizer PFE. It is important to closely follow this stocks because any important movement in any of this stocks is closely reflected on the S&P 500 futures contracts.

If we were trading Nasdaq E-mini contracts we would chart the following stocks:

Dell Computers DELL, Cisco CSCO, Microsoft MSFT, Oracle ORCL and Intel Corporation INTC.



Figure 9.5.

On the second monitor we will place 1day, 5min, 1min ES charts together with Time and Sales Window. As you can see from the figure above we have drawn Resistance, L2HrHIGH, Close, L2HrLOW and Pivot Point lines. We have also drawn Daily Low and Support lines, however you can not see it on the chart.

Here is the closer look at the each component of our set up:



Figure 9.6.



Figure 9.7.



Figure 9.8.

Figures 9.9. and 9.10. are examples of two other possible monitor set ups:



Figure 9.9.

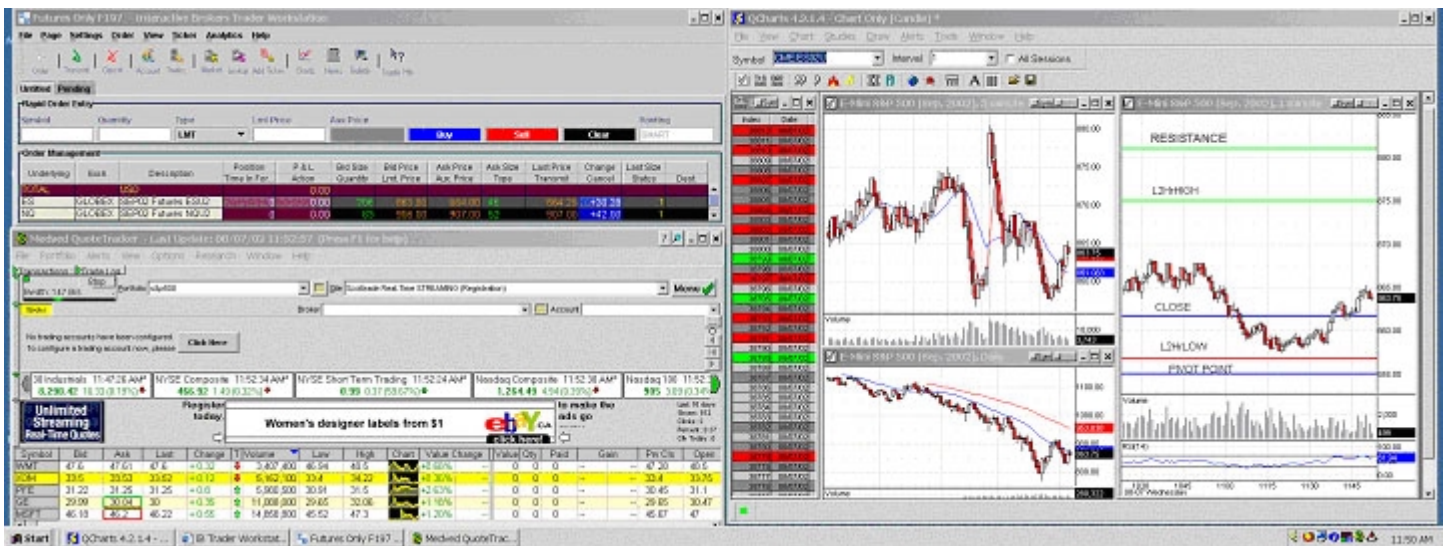


Figure 9.10.

9.4. When To Enter The Trade?

We will now define our entry strategy.

If the price opens above 20DMA (daily moving average) it means that the market is trading in an upward short term trend and therefore we will adopt a bullish strategy.

If the price opens below 20DMA it means that the market is trading in a downward short term trend and therefore we will adopt a bearish strategy.

If bullish we will be looking to enter our position on upside breakouts through (Pivot Point, High, L2HrHIGH, Close and Resistance) resistance lines on upside and on the upside bounces from the (PP, Support, Close, Low and L2HrLOW) support lines as those lines are most likely to act as S/R points for the current trading day.

Other bullish signals that we will be looking for are:

Increase in positive volume (closing prices being higher than opening prices for periods being observed)

Squawk box – increase in noise

Easily recognizable bullish pattern is being formed on 5min chart

Easily recognizable bullish pattern is being formed on 1min chart

12 5minMA about to cross 4 5minMA from above to below

RSI breaking level of 70

Price bouncing off a trendline after declining or moving through a trendline if rising

Bullish candlestick pattern is being formed on 5min chart

Price moving through 50DMA on the way up

One or more of the stocks on our watchlist starts suddenly moving upwards

Green color dominates T&S Window together with increase in speed

If bearish we will be looking to enter our position on downside breakouts through (Pivot Point, Support, Close, Low and L2HrLOW) support lines and on the downside bounces from the (Pivot Point, Resistance, Close, High, L2HrHIGH) resistance lines as those lines are most likely to act as S/R points for the current trading day.

Other bearish signals that we will be looking for:

Increase in negative volume (closing prices being lower than opening prices for periods being observed)

Squawk box – increase in noise

Easily recognizable bearish pattern is being formed on 5min chart

Easily recognizable bearish pattern is being formed on 1min chart

12 5minMA about to cross 4 5minMA from below to above

RSI breaking level of 30

Price bouncing off a trendline after advancing or moving through a trendline if declining

Bearish candlestick pattern is being formed on 5min chart

Price moving through 50DMA on the way down

One or more stocks from our watchlist starts suddenly to move downward

Red color dominates T&S Window coupled with increase in speed

After we have spotted 3 or more bullish or bearish signs we will start to observe our chart more closely in order to determine specific point where we will enter the trade. All of the TA tools that we have at our disposal do not carry equal weight. In order to make our trading decision as mechanical as possible we will now develop a table that assigns different values to different TA tools according to their importance.

9.4.1. Entering On The Long Side (buying)

Increasing positive volume 8 points

Squawk box – increase in noise..... 6 points

Price bouncing off support level (L, Support, C, PP, L2HrLow) and moving up..... 8 points

Price moving through resistance level (H, Resistance, C, PP, L2HrHigh) on the way up..... 8 points

One or more of the stocks from the watchlist starts to suddenly move upward..... 6 points

Easily recognizable bullish chart pattern developing on 5min chart..... 4 points

Easily recognizable bullish chart pattern developing on 1min chart..... 2 points

Orders that are executed at ask or above dominating the T&S Window (green color dominating)..... 4 points

RSI is 70 or above..... 6 points

12 period MA about to cross 4 period MA from above to below on 5 min chart..... 6 points

Price bouncing off the trendline after declining or moving through the trendline after rising..... 4 points

Bullish candlestick pattern on 5min chart..... 4 points

We will enter the trade if the current score is 36 or more

9.4.2. Entering On The Short Side (shortselling)

Increasing negative volume..... 8 points

Squawk box – increase in noise..... 6 points

Price bouncing off resistance level (H, Resistance, C, PP, L2HrHigh) and moving down..... 8 points

Price moving through support level (L, Support, C, PP, L2HrLow) on the way down..... 8 points

One or more of the stocks from the watchlist starts to suddenly move downward..... 6 points

**Easily recognizable bearish chart pattern
developing on 5min chart..... 4 points**

**Easily recognizable bearish chart pattern
developing on 1min chart..... 2 points**

**Orders that are executed at bid or below
dominating the T&S Window, red color dominating..... 4 points**

RSI is 30 or below..... 6 points

**12 period MA about to cross 4 period MA from below to
above on 5 min chart..... 6 points**

**Price bouncing off the trendline after rising or moving
through the trendline after declining..... 4 points**

Bearish candlestick pattern on 5min chart..... 4 points

We will enter the trade if the current score is 36 or more

What kind of order should you use to enter the trade?

The only negative consequence you may get from not entering a trade is just that; you haven't entered a trade. It is better to miss a trading opportunity than to have your order filled at a price that is far from your entry target price. If you feel the opportunity gap is closing too quickly, simply wait for the next opportunity to come along. To get into the trade you should always use Limit orders.

How many contracts should you be trading with?

If you are a beginning trader you should start with one contract and when you are able to build up your account you should move to trading two or more contracts. This applies even if you have substantial trading capital. You need time to perfect your trading strategy. It's much better to preserve your trading capital for later on, when you become more formidable market participant. For the purpose of our strategy we will cover both one and two contract trading strategies. You can apply the two contract strategy if you are trading any even number of contracts (4,6...).

If we are trading with one contract we will place a limit order to buy/shortsell one contract.

If we are trading with two contracts we will place a limit order to buy/shortsell two contracts.

9.5. When To Exit The Trade?

“Let your profits run, cut your losses short.” Sounds easy, doesn’t it? It is actually much harder than most beginning traders realize. The majority of successful traders will tell you that proper trade management, once you are in the trade, is the single most important factor that will either make you or break you in the active trading business.

9.5.1. Cut Your Losses Short!

Immediately after our order is executed we will fully concentrate on our exit.

We need to decide how much capital can we risk on one trade. Let’s assume that our working trading capital is \$5,000 per contract (even though margin requirements for both ES and NQ are less than \$5,000 it is always wise to have some extra funds available). So if you are trading two contracts we will assume that your working trading capital is \$10,000. If you have more capital in your account but are not using it to trade more contracts it is not considered as working capital and therefore it is not relevant for the purpose of this strategy. Our first rule is that we will not risk more than 4% of our capital on any single trade. Therefore our maximum loss on any trade is 4 index points on S&P 500 E-mini and 10 index points on Nasdaq-100 E-mini.

S&P 500 E-mini 1 index point = \$50; 4 index points = \$200 which is 4% of \$5,000

Nasdaq-100 E-mini 1 index point = \$20; 10 index points = \$200 which is 4% of \$5,000

9.5.2. Where To Place Your Stops?

If we have entered a buy order we will place our stop loss one index point below the closest line of support (C, PP, L, L2HrLow, Support) if we are trading S&P E-minis and 2.5 index points below the closest line of support if we are trading Nasdaq E-minis. We can do so only if total possible loss amounts to less than 4% of our trading capital. If it is

not possible to place our stop loss below the closest support line and still keep our stop loss at less than 4% we will have to move it up and make it a maximum of 4%.

If we have entered a shortsell order we will place our stop loss one index point above the closest line of resistance (C, PP, H, L2HrHigh, Resistance) if we are trading S&P E-minis and 2.5 index points below the closest line of resistance if we are trading Nasdaq E-minis. We can do so only if total possible loss amounts to less than 4% of our trading capital. If it is not possible to place our stop loss above the closest resistance line and still keep our stop loss at less than 4% we will have to move it down and make it a maximum of 4%.

If our stop loss is reached we will get out of the trade immediately, no questions asked. You can not cut corners with the stop loss rule. It needs to be followed every single time without exception. Failure to follow the stop loss rule is the number one reason for failure among beginning traders. It is true that sometimes price will turn around just after you get out, but there is no way to know this in advance. It only takes a few stubborn incidents to entirely devastate your initial trading capital.

9.5.3. Let Your Profits Run!

Once you are in the trade and the price has started moving in your direction, you need to extract as much profit as possible. Not being able to do so will make you a losing trader in the long run. How can a trader lose if he only takes small profits at a time? Profit is profit, isn't it? Not exactly...Profit of \$550 is not the same as a profit of \$850. If such profits were followed by three losses of \$200 each, profit of \$550 will become a \$50 loss, while profit of \$850 will become a \$250 win. Do you get my point? Profits are always followed by losses and if the profits are small they will not make up for the losses that will eventually and surely follow. However, becoming too greedy can turn a small profit into a loss. This will also make you lose money in the long run.

The best solution to resolving these conflicts is to use trailing stops.

9.5.4. Trailing Stops

As the name says, trailing stop loss follows the price that is moving in your direction. For example let's say that we have bought two S&P 500 E-mini contracts at 875 points. We will automatically put our stop loss 1 point below the next support line or if that is over our 4% limit we will put our stop loss at 871. The price starts to move upwards and reaches 876. We will move our stop loss at 871.75. For every 1 point positive move in the price of the contract we will move our stop loss 0.75 points up (or down if we were in a shortsell trade). However if we were trading two contracts and the price has in our example hit 879 (4 points profit for ES and 10 points profit for NQ) we will sell one contract to lock some profits and for the remaining contract we will continue to use our trailing stop. If we were trading one contract only than we will use trailing stop as well as we can not sell half of the contract.

What type of order should you use when exiting the trade?

When entering a trade I have recommended using a limit order because you can afford not to take a trade at a price that doesn't meet your standards. When exiting a trade the opposite is true. You can not afford to stay in a bad trade. Therefore, when exiting we will use market order, which will get us out of the trade quickly, even though it will cost us an occasional 0.25 points.

Let's put our strategy to practice.

9.6. Example 1: S&P 500 E-mini Trading

Figure 9.11. is a S&P 500 E-mini daily candlestick chart.

As we can observe from the chart previous trading day has had following data

High H = 906.75

Low L = 873.75

Close C = 905.75



Figure 9.11.

From that data we will now calculate Pivot Point, Support and Resistance.

Pivot Point $PP = (H + L + C)/3 = (906.75 + 873.75 + 905.75)/3 = 895.5$

Resistance = $2*PP - L = 917.25$

Support = $2*PP - H = 884.25$

From the chart above we will also note that 20DMA has been broken and the current price is well above the 20DMA.

Figure 9.12. is a 1min candlestick chart for the last two trading hours.



Figure 9.12.

From the chart we can observe that

L2HrHigh = 906.75

L2HrLow = 891.50

The trading day has started and we have set up our monitors with the necessary data.

As we have observed earlier 20DMA has been broken and therefore we will adopt a bullish strategy for the day.

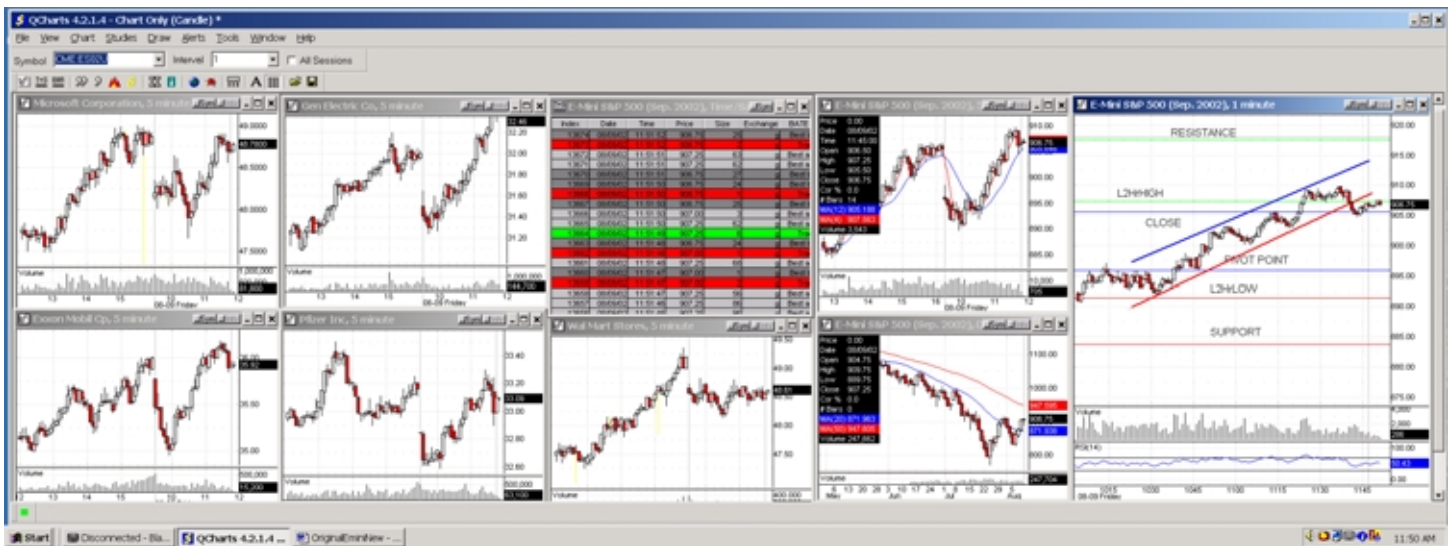


Figure 9.13.



Figure 9.14.



Figure 9.15.



Figure 9.16.



Figure 9.17.

As we can observe from the charts above an excellent trading opportunity has occurred at 10:47. The price has moved through the Pivot Point on the way up, there is an increase in Volume, the price has bounced off the lower trendline, RSI is at about 70. On the figure 3 we can also observe that there is a bullish candlestick pattern being formed and 12 period MA has crossed 4 period MA from above to below. We would have entered our trade at 10:47 at approximately 897 points and we would have placed our stop loss at 894 which is one point below the PP line. If we were trading two contracts we would sell one contract 901 at 4 point profit, and the remaining contract we would manage using our trailing stop loss system.

9.7. Example 2: Nasdaq-100 E-mini Trading

Figure 9.18. is a Nasdaq-100 E-mini daily candlestick chart.



Figure 9.18.

As we can observe from the chart, previous trading day has had following data:

High $H = 1040.5$

Low $L = 1008$

Close $C = 1038$

From that data we will now calculate Pivot Point, Support and Resistance

Pivot Point $PP = (H + L + C)/3 = (1040.5 + 1008 + 1038)/3 = 1029$

Resistance $= 2*PP - L = 1050$

Support $= 2*PP - H = 1017.5$

From the chart above we will also note that both 20DMA and 50DMA have been broken and the current price is above both of them.

Figure 9.19. is one minute candlestick chart for the last two hours of the previous trading day.



Figure 9.19.

From the chart above we can observe that:

L2HrLow = 1017

L2HrHigh = 1040.5

The trading day has started and we have set up our monitors with the necessary data. As we have observed earlier both 20DMA and 50DMA have been broken and therefore we will adopt a bullish strategy for the day.

Figure 9.20. is an example of a 2-monitor set up.

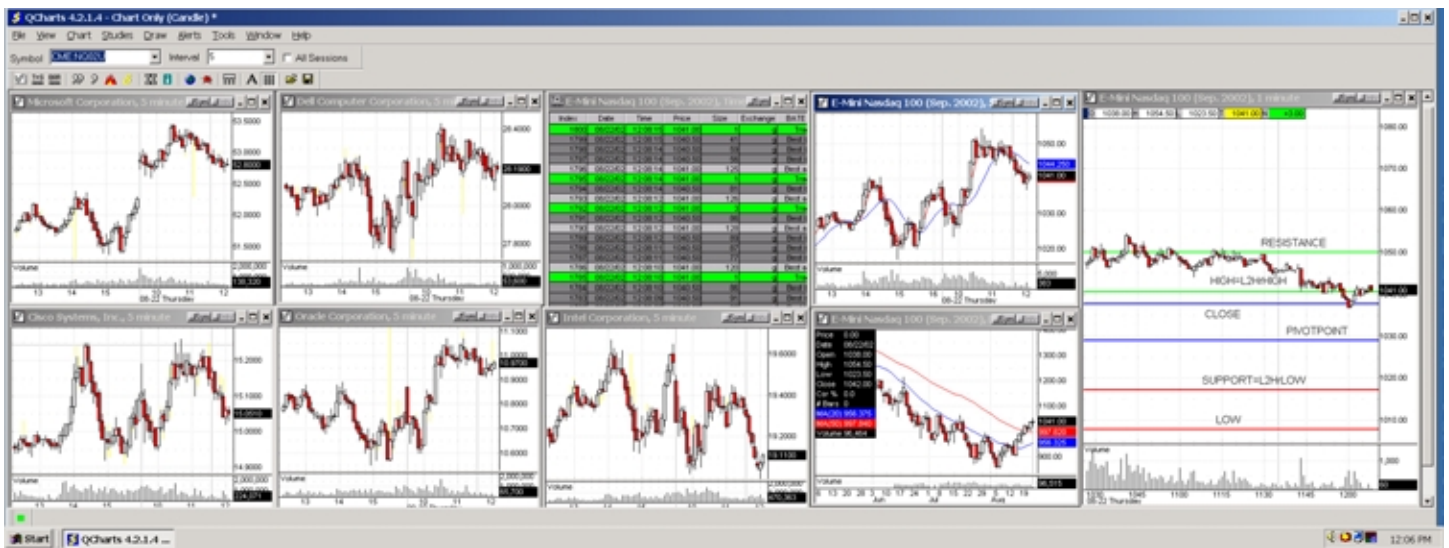


Figure 9.20.

To the left we have placed five minutes candlestick chart for the five most important Nasdaq-100 stocks: Oracle, Intel, Dell, Microsoft and Cisco. In the middle of the screen we have placed Time and Sales Window and to the right we have place 1-day, 5-minute and 1-minute candlestick chart for Nasdaq-100 E-mini contracts.

Figures 9.21. and 9.22. are 5-minute and 1-minute candlestick charts.

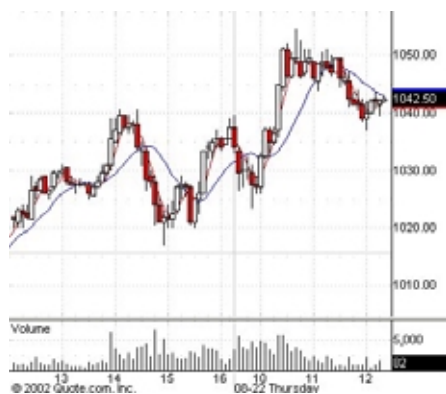


Figure 9.21.



Figure 9.22.

As we can observe from the chart above an excellent trading opportunity has occurred at 10:23am. The price has moved through yesterday's close on the way up, there was an increase in volume, RSI is above 70, there is a bullish candlestick chart being formed on 5-minute chart and 12 period MA has crossed 4 period MA from above to below on a 5-minute chart. We would have entered our trade at 10:23 at approximately 1040 points and we would have placed our stop loss at 1030 which is just above the PP line. If we were trading two contracts we would sell one contract at 1050 at 10 point profit, and the remaining contract we would manage using our trailing stop system.

9.8. Paper Trading

If you don't already have some trading experience, you shouldn't just jump in into trading with real money. You will still have many things to learn, even if you think otherwise. You need to get comfortable with placing buy and sell orders, the idea of short selling (some people have difficulty contemplating the idea that they can profit from the decline in the price) and trading platform itself. When you are trading for real you can't afford to be occupied with any kind of trivial problems. But even those trivial problems take time to master and should not be underestimated.

Paper trading is a term used to describe the simulation of trading. You can use it by choosing your entry and exit positions and recording them on the piece of paper. Later

on, you add commissions and spread and calculate how much have you won or lost for that day.

Most of the online brokers (including Interactive Brokers that we have used for our examples) provide software that simulates trading to their customers. You should consistently win for at least 10 trading sessions of paper trading before attempting to trade for real.

Once you have tried the simulation and found a modicum of success, you are ready to trade for real. Be careful, watch your finances wisely, and don't be afraid to pull out of a trade if it is not going in your direction. Trading shouldn't be a gamble. With the right tools, ammunition, scouting and experience, you'll be able to make your trading endeavor a success.