SCALE INTO TRADES

By Daryl Guppy

A few days ago I was a keynote speaker at a futures trading conference. Our focus was on handling volatility and in particular how traders can scale into trades to boost performance. This means adding one or two new positions to an already successful trade.

There are two issues involved here. The first issue is to decide when it is the correct time to add a new position, and how to set the stop loss. The second issue of how much to add for the second position. This is a money management issue and we will not cover it in these notes.

The scale in process should identify exact conditions that tell us several things. These are:

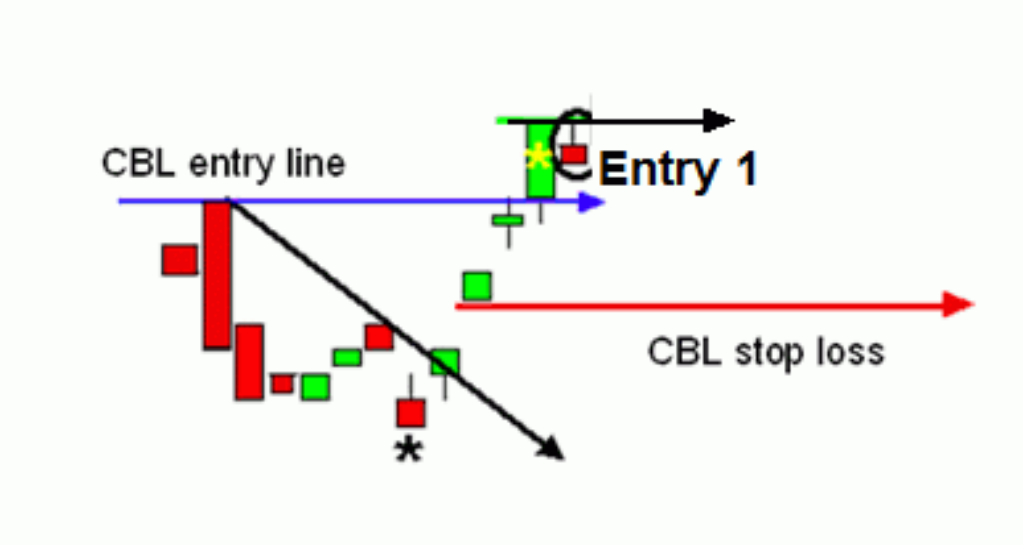
- When the trade is successfully moving in our direction – moving into the money
- Reflect the increase in probability that the breakout trend is durable and sustainable
- Set a stop loss calculation that protects trading capital in the new position and protects profits in the original position
- Manage new entries with a minimum of risk
- Set new entry points that are directly related to the development of the trend.
- And finally, in this method, when an exit signal is received, ALL open positions are closed.

We use a trend volatility measure to give solutions for all these questions. The volatility measure also sets the stop loss and protect profit conditions and these are used to add new trades in a rising trend with a low level of risk. The foundation of this approach is the count back line. The same logic can be applied to other volatility methods which are used to set stop loss conditions such as the trend volatility line.

We can also call this a move from Hope, to Confidence and then to Certainty. At each of these objectively defined points we can add a new position. This is the HCC method, but again it can be applied using the same logic to any volatility based stop loss method.

ENTRY 1

Here is how the situation develops for multiple entries in a long side trade. The CBL is used to follow the downtrend and confirm the entry point for trade 1. The CBL calculation is applied to the lowest point in the current downtrend. This is shown with the * and the CBL entry line is calculated from this candle.

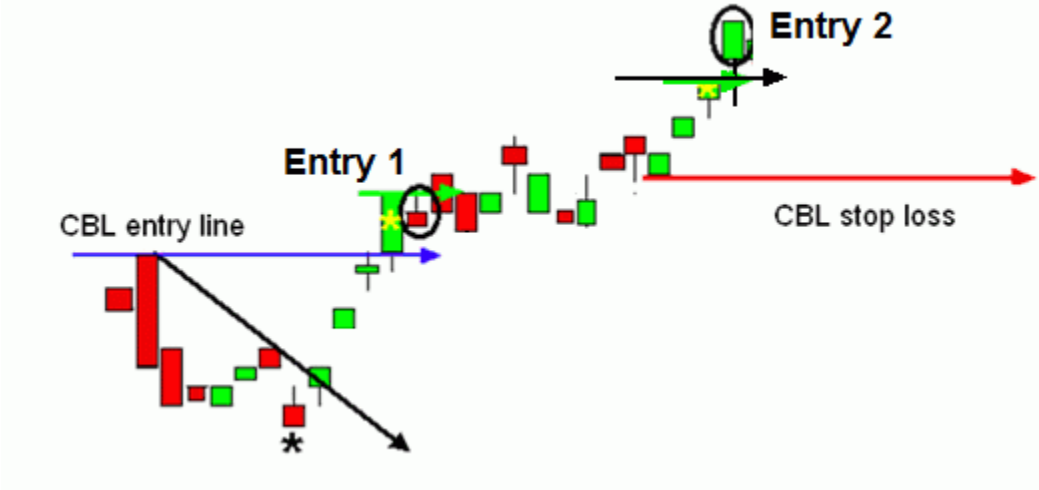


The entry is triggered when there is a move above the downtrend line and a close above the value of the count back line used as an entry signal. This is shown with the yellow * in the green candle. The entry 1 is made on the next day. We can call the first entry Hope.

The candle that signals the breakout is used as a reference point for the calculation of the CBL stop loss. This is shown as the red line. The trade remains open while the price remains above the CBL stop loss. A new CBL stop loss calculation is made whenever a new high is created.

ENTRY 2

Each new high is used to recalculate the position of the CBL trailing stop loss. This stop loss has two function s. When it is first applied it is used to protect trading capital. When the stop loss level is above the price paid to enter the trade, then the CBL becomes a trailing protect profit stop.



This is a critical change in the character of trade management. It means that if we get an exit signal – a close below the CBL protect profit line – then the trade

will probably be closed at a small profit. When the CBL calculation becomes a protect profit calculation then the risk is largely removed from the trade.

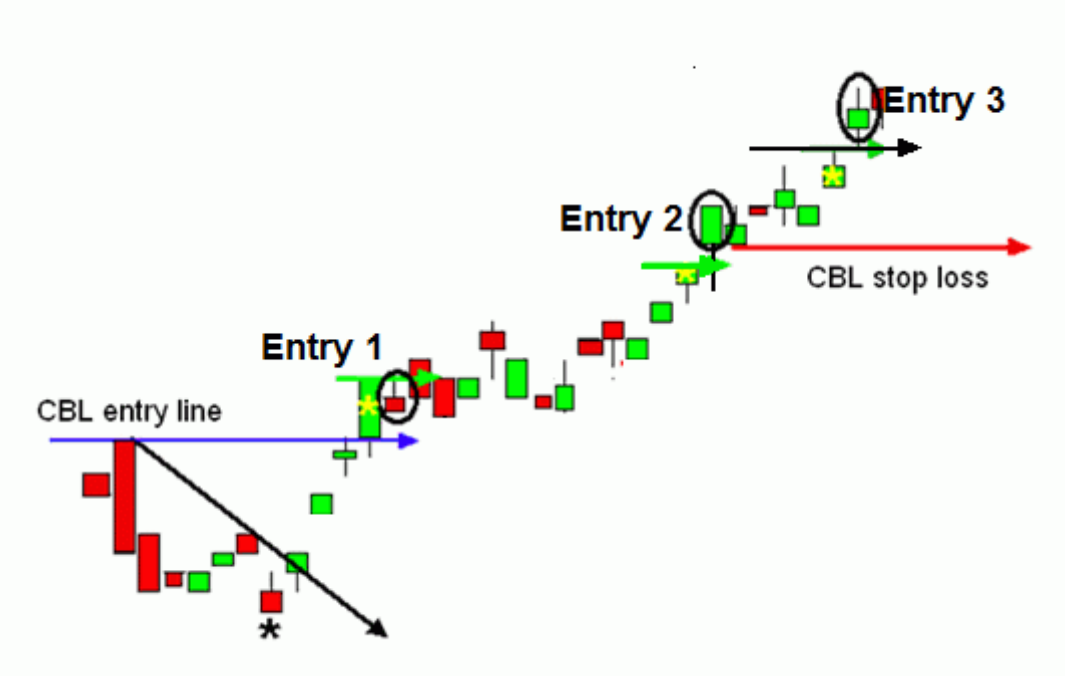
The green candle with the yellow * is the first calculation point in the rising trend where the CBL calculation places the CBL stop loss line ABOVE the price paid for Entry 1. This is the signal that we can safely add Entry 2 on the next day. We can call this Confidence.

It is a safe signal because it means that if we are wrong and have to close trade 2 very quickly then we have limited our losses. Trade 1 – entry 1 – if closed on a fall below the new CBL stop loss would probably be closed at a profit. Trade 2 would be closed at a loss. On balance this becomes a profitable trade with one winning position and one losing position.

Its important that if an exit signal is delivered – a close below the CBL stop loss line – then all trades are closed immediately. It is this discipline that makes this scale in method profitable.

ENTRY 3

The same methodology is used for the third entry. We prefer to limit the number of scale in positions to three, but you can continue to add new positions until the trend is exhausted.

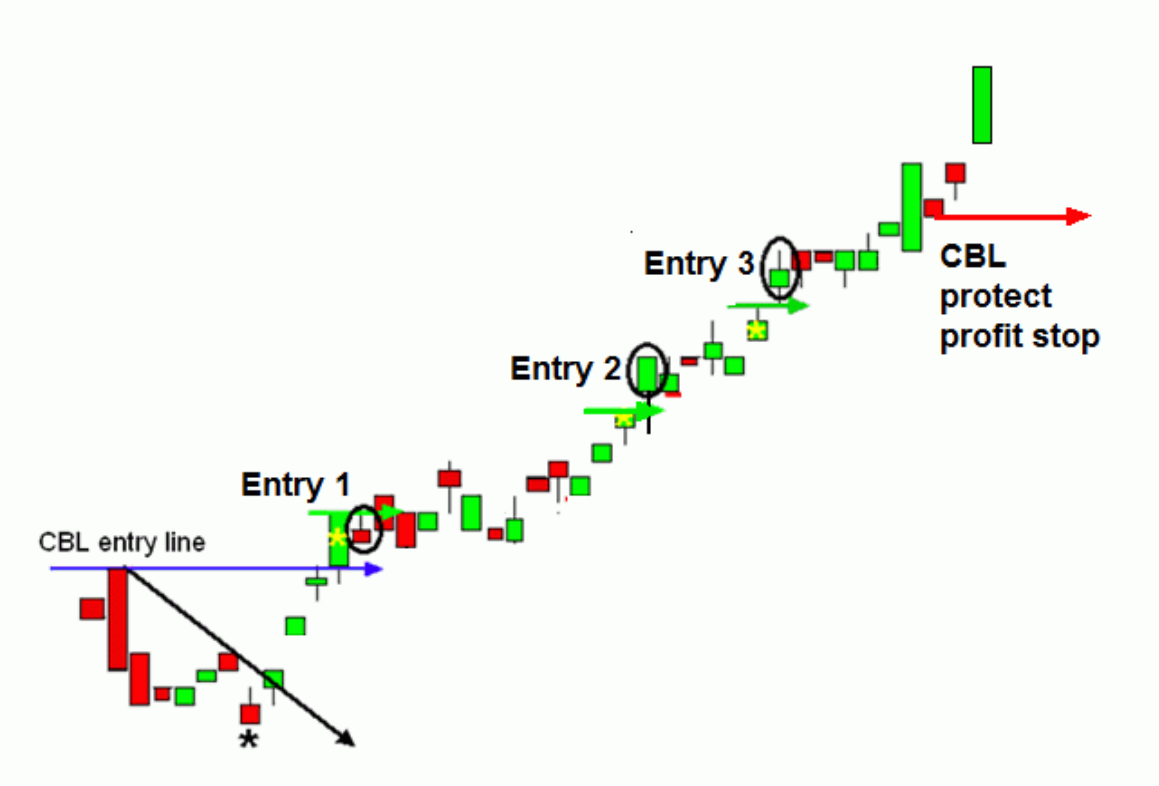


The key trigger is a new count back line calculation where the CBL stop loss is higher than the entry price made for trade 2 – entry 2. The calculation candle is shown with the yellow *. The entry is made the next day. Yes the entry price is higher but this only confirms the trend continuation. This third entry can be called CERTAINTY.

If price drops below the new CBL stop loss that the third trade is closed at a loss. Trades 1 and 2 are closed at a profit so the overall position is profitable.

TREND CONTINUATION

The scaled in trade becomes completely profitable when the next count back line calculation has a value that is higher than the entry price for entry 3. When this condition is achieved then the trade is fully profitable. It is profitable because an exit based on the protect profit stop would trigger a close in all open positions and all of these are in profit.



This HCC method based on the changing nature of a volatility based stop loss can be applied in any time frame. We can use it with end of day charts where each candle is one day. It can be applied to intraday charts where each candle is one minute, or one hour. The logic of the position scale in remains the same. It's the position of the stop loss in relation to the most recent entry point that determines when to add a new position. The method can also be applied to futures, currencies, indexes trading, stocks and warrants.