MY TRADING PART 3

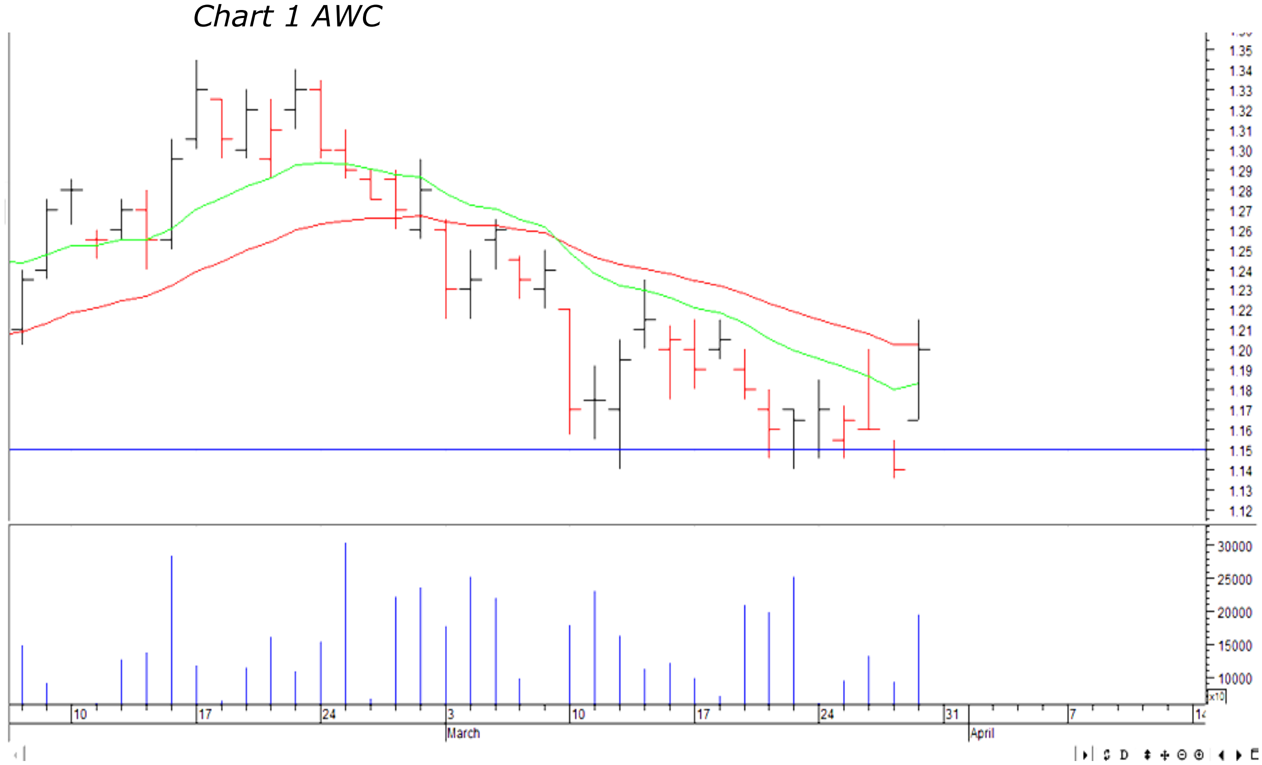
By Simon Mawby

Stop Placement

I do not use indicators , oscillators , ATR calculations or moving average lines for stop placement as they are not a reflection of pure price , but a manipulation of it . No trader ever bought or sold a share at an ATR value or moving average value ,they paid an actual real price . I place a large degree of weight on particular price points that have either deflected or rejected price movement. The following example hopefully illustrates my point .

The chart below is Alumina AWC . Notice how as price slowly falls towards the support line at $1.15 , it briefly closes below it at $1.14 but then clearly rejects this point and on the last bar shown rises strongly on increased volume to close at $1.20 . This is the highest close for 7 days and to me represents a very clear rebound from support and a trade entry at the open of the next day . My stop would be placed at $1.14 , the lowest close achieved in the downtrend before the reversal. Looking at the chart , see how the price touched $1.14 on two of the prior bars . This to me adds further weight to the importance of $1.14 as a price rejection point. The actual trade entry details are below :

Chart 1 AWC



AWC				Position Size	
				$20,000	***$ at Risk***
Entry	$1.205				
Stop	$1.140		Number of shares	16,598	**15385**
Risk (R)	$0.065		Total Cost	$20,000	**$18,538**
Target	$1.400		Risk Amount	$1,078.84	**$1,000**
R Multiple	3.00				

With reference to stop placement ,I am talking about a mental or calculated stop , not an actual stop order . Most of my trading is end of day and so any breaches of stop levels with only be discovered once the market is closed . My preference then is to always place the order to close out a trade at the open of the next day. I have found this to be an invaluable practice to follow as the open price auction generally provides the greatest daily liquidity (much needed for trading smaller shares) and the sooner you close a trade the better .

This is especially true with a losing trade , as this practice will remove any chance of hesitation and indecision. If your analysis is correct and your stop selection point is part of a proven trading plan , then it should be rare for a share to rally back against your stop. It may happen from time to time, but you should always trade with probability on your side.

In follow up articles I will detail actual trades using my selection methods , position sizing and initial stop placement and how I determine when and where to place rising stops.

ETF's

Exchange Traded Funds (ETF's) have been available in the US for many years and now form a massive part of the daily action on their share market. The number of offerings in Australia is growing rapidly and all traders and investors should embrace these offerings for use in trading .I manage my own super account and find ETF's a low management alternative to direct shares as well as gaining exposure to overseas markets , commodities , currencies and hedging.

When buying shares your capital is exposed to the risk of the company going broke and taking all of your money with it . The management company of an ETF is forced to physically hold the percentage weighting of actual shares in the index or category it is trying to represent , therefore it is essentially impossible for an ETF to lose all of it's value.

This makes most ETF's ideal for use in a SMSF as they are inherently safe and will track the market they represent , and so take very little time to manage. The subject of using ETF's as a low risk and low management strategy for SMSF's would form several separate articles, but in short it is possible to have a balanced super fund by simply holding a portion of the money in cash and holding only one ETF which tracks the ASX200.

In the ETF market there are several choices of ETF's which track the ASX200 , but the best choice for this scenario would be STW, offered by State Street Global Advisors. STW has a mkt cap of $2.6 Billion and offers a dividend yield currently around 4% with some franking.

CFD's

I use CFD's for many different and varied trading approaches both to gain leverage when trading shares long , but more importantly they offer easily the best solution to trade shares short .I have explained in previous articles my use of short trading specific shares to take advantage of the price drop when they go ex dividend .

CFD's offer the opportunity to trade shares based on other global exchanges , currencies ,commodities like oil , gold , copper , soybeans etc and most important to me global index's. You can trade our local index , the XJO if you have the available time during the business day , but my preference is to trade the London market index as represented by CMC Markets by the UK 100 –Cash . During winter the UK100 starts trading in real time at 5pm which makes it ideal for most people to trade it. Below is a screen shot showing the UK 100 index CFD as my default trading screen.

CMC Markets UK 100 – Cash

My preference is to use a 1 minute time scale and candle charts , green for up and red for down . The 4 blue moving averages are my short term (3,5,9,15 minutes exponential) and the red are my long term (30 ,40 ,50 ,60 minutes exponential).

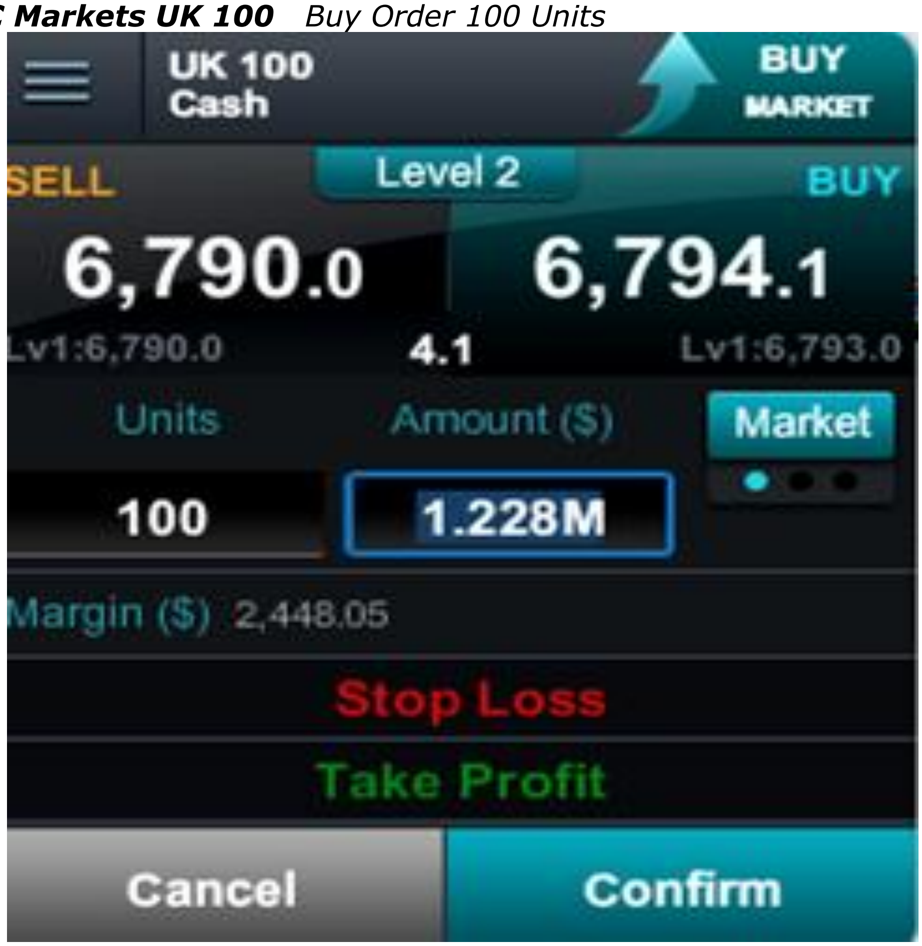
When trading this instrument , all trades are purely momentum based using the same standard rules as applied by Daryl when using his GMMA . A whole series of articles was published previously in the Guppy newsletter based on index trading using CFD's and I essentially follow a very similar methodology. This is not trend trading and open trades should be monitored at all times as the index can and does change direction very rapidly .

The actual process of placing a trade is very easy by simply selecting if you wish to buy or sell the index , and then select the dollar amount or the number of contracts or units you wish to trade. The screen shot below shows an example of Buying 100 units , the total dollar exposure and the Margin amount. The Margin amount is what you have to put up to cover the actual trade .

With the example below , the UK 100 has a margin rate of 0.2% , so an order for 100 units has a face value of $1.228 Million , but you put up $2448 . Each 1 point movement in the index is worth 1 pound multiplied by the number of units you trade , i.e. $100 pounds or $180 AUD .

There are no commission costs to trade indexes provided the trade is not left open past a specific settlement time , usually 7am New York time. ***Always close the trade the same day!!***

CMC Markets UK 100 *Buy Order 100 Units*



The zero cost makes trading indexes accessible to all levels of traders as you can simply trade only 1 contract if you wish while you are learning . With the UK 100 this equates to $1.80 per point movement and as the trade moves in your favour you can add to your position with no cost involved. To close out the trade you simply buy or sell the same number of units you have open . The index can be traded both long and short ie if the index is falling you simply place an order to *SELL* , and then when ready place a *BUY* order to close out your position .

Due to the huge leverage involved, once your position size increases it is a smart idea to place a protective stop order in the market while your trade is open to protect you from sudden large swings . News travels very fast in the modern era and an unexpected catastrophe any where in the world will be felt very quickly in the financial markets.

I always place a stop as soon as my order is confirmed , and then if the index moves in my favour I will adjust my protective stop in my favour . This stop also protects you from losing contact with your trading screen for all sorts of electronic device failures or internet connection issues . Trust me there is nothing more unnerving than losing your trading screen when trading a large position on a volatile fast moving index .

If you place an order to close out your position , you must always remember to cancel your stop order as it will stay active in the market and may unexpectedly be triggered opening an a new order .