CHAPTER 1

Where to Find Trades

An Overview

Finding trades is like finding fish. Fish can be randomly caught in any part of a lake, but they tend to congregate in specific areas at different times of the year. Similarly, big trades can be hooked at any point on a chart, but they appear with greater frequency around the edges of trading ranges.

Trading ranges do not have set patterns. Prices may twist and turn in a myriad of ways before a trading range is resolved. In general, however, trading ranges are rectangular shaped with prices swinging back and forth between the upper and lower boundaries or coiling into apexes. But we are concerned with the dynamics of trading ranges rather than any geometrical shape. When trading ranges evolve over many months or years, they often expand their boundaries and contain numerous smaller ranges. The boundaries of trading ranges are repeatedly tested and/or penetrated as the buyers and sellers struggle for dominance. Whenever the boundaries are breached, follow-through or the lack of follow-through becomes the deciding factor. After breakouts or breakdowns occur, prices often retest these areas.

In the next few chapters, we will examine the characteristics of price/volume behavior at these various points. Keep in mind we are dealing with trading ranges of all sizes and not solely at tops or bottoms. The behavior described here occurs on all charts regardless of their time period. With practice, one can readily identify the behavior areas circled on Figure 1.1.

The first step involves drawing the trading ranges—a seemingly easy task that requires an eye for horizontal relationships.

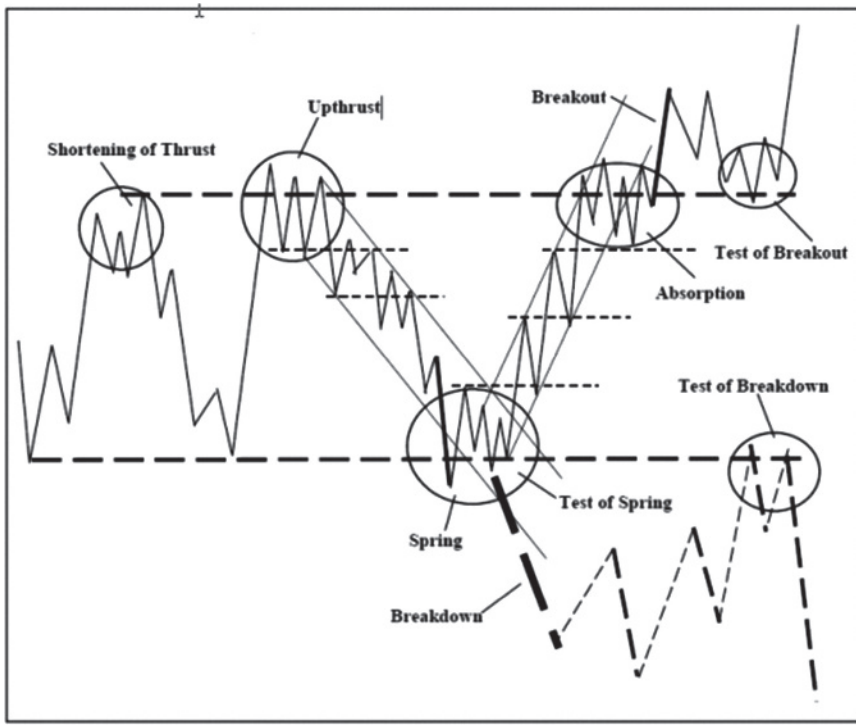

FIGURE 1.1 Where to Find Trades Diagram

Look at the six trading ranges (TR1–TR6) on Figure 1.2 of Nasdaq futures. By repeatedly framing the support and resistance lines, we see how trends consist of individual ranges and the turning points emerge from the otherwise tangle of price movement. These turning points—springs, upthrusts, absorption, and tests of breakout/breakdowns—serve as action signals.

In later chapters, volume will be incorporated into the understanding of this price behavior. But, first, we will focus on the lines. Reading a chart without lines is like studying a world map without boundary lines. It's the subject of the next two chapters and serves as the first step in my method for reading charts.

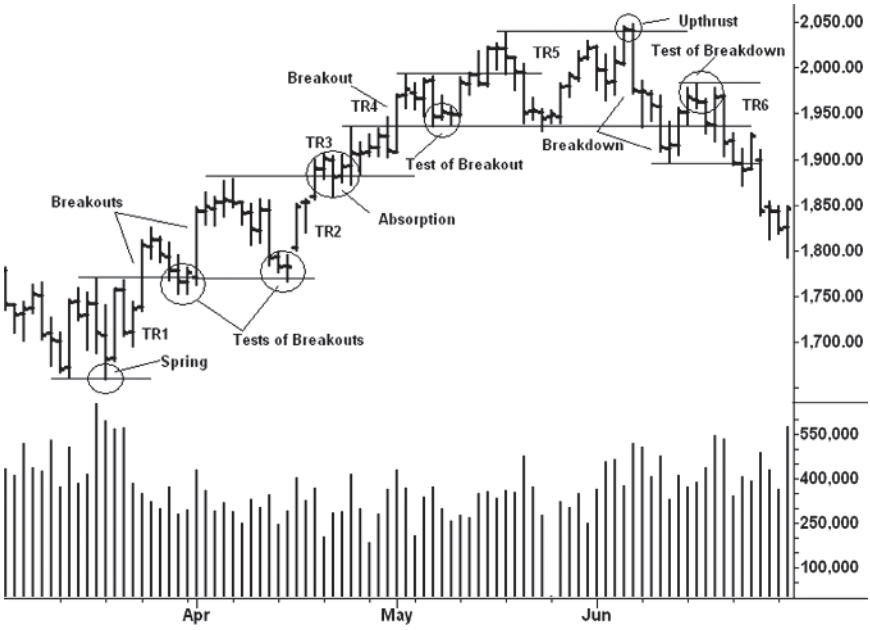

FIGURE 1.2 Nasdaq Continuation Daily Chart
Source: TradeStation.