Questions and Rating Scales

Introduction

To win in trading, you must outperform masses of competitors. The majority must lose in order to pay those who win. To become a successful trader, you must beat the odds against you. You must learn to think and act differently from the market crowd.

The New Trading for a Living contains several unorthodox trading ideas. The aim of this Introduction is to pause at the beginning of the journey and to see whether you are in tune with some of the unconventional thinking about trading.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
Correct answers					

Question 0-1

Which of the following methods of making trading decisions can serve traders well in the long run?

   I. Fundamental analysis

  II. Inside information

 III. Hunches and tips

 IV. Technical analysis

A. I and II

B. II and III

C. I and IV

D. III and IV

Question 0-2

Which of the following isn't needed for trading success?

A. Trading psychology

B. Analytic method

C. Connections with market insiders

D. Money management method

Question 0-3

The best approach to reading a book on trading is to

A. test all the ideas that interest you on your own market data.

B. incorporate all the ideas in your work.

C. not trust what you read—why would anyone share good trading ideas?

D. ask other traders whether the ideas in the book worked for them.

Question 0-4

Which of the following is not a major cause of trading losses?

A. Slippage

B. Commissions

C. Emotional trading

D. Theft

Question 0-5

Trader Jim and Trader John take the opposite sides of a trade. Both pay commissions, and both get hit with slippage. Trader Jim, the winner, collects $920, while Trader John, the loser, is out $1080. The result of this trade illustrates the fact that trading is a:

A. Zero-sum game

B. Positive expectations game

C. Random Walk

D. Minus-sum game

Question 0-6

You find a stock trading at $20 and plan to buy 100 shares. Your broker will charge a commission of $10. Which of the following statements is *incorrect*?

A. When dealing with thousands of dollars, don't quibble about $10.

B. You need to make 1% profit to avoid losing money on this trade.

C. Using 50% margin, you need to make more than 2% profit to avoid losing money on this trade.

Question 0-7

You place a market order to buy 100 shares of a rising stock that currently trades at $20. Your order gets filled at $20.08. Your slippage on the trade is

A. 80 cents

B. $8

C. $16

D. $80

Question 0-8

The stock you bought in Question 7 rallied to $22. You expect the rally to continue but raise your stop to $21 to protect half of your paper profit. The stock sinks and hits your stop—you get filled at $20.88. Your slippage on this trade represents what percentage of your gross profit?

A. 5 percent

B. 10 percent

C. 25 percent

D. 50 percent

Question 0-9

In the trade described in Questions 7 and 8, the trading industry took what percentage of your gross gain?

A. 25 percent

B. 50 percent

C. 75 percent

D. 100 percent

Individual Psychology

Your greatest danger in trading comes from the person holding this book—you. Our emotions often tip the scale between winning and losing. If you can stay cool and make rational decisions, trading profits will follow.

A professional trader is calm and collected. He knows what he'll do if the market goes up, down, or sideways. On days when he is not sure, he stays out, patiently monitoring the market from the sidelines. A pro feels in control.

If you feel giddy with joy when the market goes your way but freeze in fear when it swings against you, your actions will be emotional and your account will suffer. When the mind becomes clouded by greed or fear, even the best trading systems fly out the window. The questions that follow are designed to help you focus on trading psychology.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
Correct answers					

Question 1–1

A successful trader's attitude toward risk is usually one of

A. avoiding risk.

B. thriving on risk.

C. enjoying risky situations, even though losses hurt.

D. measuring each risk.

Question 1–2

The goal of a successful trader is to

A. become the best trader he can.

B. make more money than other traders.

C. buy things that will set him above other traders.

D. win respect of family and friends.

Question 1–3

A trader on a losing streak has lost 20 percent of his account. He would best be advised to

A. subscribe to a newsletter with a verified track record.

B. purchase a trading system with a history of profitability and low drawdowns.

C. stop trading until he has analyzed his losing trades and determined their causes.

D. continue to trade because the laws of probability indicate a likely turn in his favor.

Question 1–4

Having a large trading account is desirable for all of the following reasons *except* that

A. you can afford to lose more.

B. you can diversify among more markets.

C. you can trade different systems.

D. your expenses represent a smaller percentage of your account.

Question 1–5

Which two of the following statements about commercially sold trading systems are most accurate?

   I. A track record provides confidence that a system will continue to perform well.

   II. The fact that a system is sold by a prominent trader provides an extra margin of confidence.

   III. Trading systems are designed to fit old data, and they self-destruct when markets change.

   IV. You can buy a system from a top analyst and lose money using it.

A. I and II

B. I and III

C. II and III

D. III and IV

Question 1-6

Which of the following is a key sign of a gambling attitude toward trading?

    I. The inability to resist the urge to trade

   II. Feeling elated when trades go well and ashamed after losing

  III. Always reversing losing positions

  IV. A string of trading losses

A. I only

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 1-7

Within a year, all of the following occur in the life of a trader: he receives three traffic tickets, pays a penalty for filing his taxes late, gets two reprimands for tardiness on his non-trading job, and his trading account is down 35 percent. Which of the following would be the best advice for this trader?

A. It's a hard life. Try to make a lot of money trading, quit your job, and hire someone to handle your finances.

B. Traffic tickets have nothing to do with trading—don't worry about them.

C. You're sabotaging yourself and need to work on changing yourself as a person.

D. Hang in there; it is hard to keep a job and trade at the same time.

Question 1-8

Pick two correct statements about trading psychology.

    I. Your feelings impact your equity.

   II. To win you have to be more intelligent than most traders.

  III. Feeling elated after profitable trades reinforces good trading habits.

  IV. Fear and greed have a greater impact on your equity than a brilliant trading system.

A. I and II

B. II and III

C. III and IV

D. I and IV

Question 1-9

You've made a series of successful trades in recent months. Now is the time to

    I. congratulate yourself and increase the size of your positions.

   II. use fewer stops.

  III. take a vacation.

  IV. realize that you have become a competent trader and can spend less time studying the markets.

A. I and II

B. II and IV

C. I and III

D. III and IV

Question 1-10

The main similarity between a losing trader and an alcoholic is:

A. Losers are addicted to the excitement of trading the way alcoholics are addicted to alcohol.

B. Losers hide the extent of their losses from themselves and others, just as alcoholics hide how much they drink.

C. Losers try to trade their way out of a hole, just as alcoholics try to switch from liquor to wine.

D. All of the above

Question 1-11

The psychology of losers involves all of the following *except* that

A. Losers find trading very exciting, even when it leads to losses.

B. Few losers recover after they destroy their accounts.

C. Losers know that they have a personal problem with trading.

D. Losers usually shoot for a "big win."

Question 1-12

The first step in a losing trader's recovery is to say,

A. "I need a better trading system."

B. "I must find a bull market."

C. "I need to learn a new trading method."

D. "I am a loser."

Question 1-13

When a trader says, "My name is so-and-so and I am a loser" the result is

    I. a fearful attitude toward trading.

   II. cutting losses short.

  III. avoidance of overtrading.

  IV. lower commissions and slippage.

A. I and II

B. II and III

C. III and IV

D. I and IV

Question 1-14

The most important factor in becoming a successful trader is

A. starting with a good-sized trading account.

B. being able to learn from other successful traders.

C. using written trading plans and avoiding emotional decisions.

D. relying on useful skills in your business or professional background.

Question 1-15

If, after a year of trading, the markets seem mysterious to you, it is because

A. your trading behavior is impulsive.

B. you lack good fundamental or technical information.

C. your account is too small.

D. the markets are chaotic (Random Walk).

Question 1-16

A trade begins when

A. the market appears overbought or oversold.

B. an indicator gives you an entry signal.

C. you decide to place a buy or sell order.

D. a newsletter makes an attractive recommendation.

Mass Psychology

Whenever you buy or sell, you're surrounded by a huge crowd of other buyers and sellers, many of whom are driven by greed and fear. The sum of their orders creates huge waves of mass optimism and pessimism. Waves become tides that sweep the markets, causing prices to rise or fall. Crowds are extremely powerful—it makes no sense to fight them. Crowds are strong but primitive. Recognizing this will help you trade in the direction in which the crowd is running but hop off when a trend is about to end.

It is hard to remain objective when analyzing markets because crowds suck us in. Anyone who has attended a political rally or a big concert has felt the pull of the crowd.

Some questions in this chapter test your knowledge of the basic laws of crowd psychology. Others help you become aware of the impact of the trading crowd on your own feelings and judgment. Now is a good time to reflect on your reactions, rational or irrational, when you trade. Aim to relate your answers to the following questions to your trading experiences.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
Correct answers					

Question 2-1

Price is

A. the intersection of supply and demand curves.

B. the value of a trading vehicle.

C. a reflection of company assets in the stock market or a demand for a commodity.

D. the consensus of value of all market participants at the moment of the trade.

Question 2-2

Which of the following statements is *incorrect*?

A. Bulls bet that prices will rise; they try to buy as low as possible.

B. Uncommitted traders put pressure on bulls and bears by their presence.

C. The goal of a technical analyst is to forecast whether bulls or bears will win.

D. Bears bet that prices will fall; they want to sell as high as possible.

Question 2-3

When you are unsure whether to buy or sell, it pays to

A. surf the net to find out what others are doing.

B. trade a smaller size than usual.

C. stay out of the market.

D. seek advice from a currently "hot" guru.

Question 2-4

Any profits you make in trading come from

A. the brokers.

B. the traders.

C. the economy.

D. the exchanges.

Question 2-5

When a person joins a crowd, he

   I. becomes more impulsive and emotional.

  II. benefits from the strengths of others.

 III. trusts crowd leaders more than himself.

 IV. can leave the crowd when he wants to.

A. I and II

B. I and III

C. II and III

D. II and IV

Question 2-6

People join crowds out of a

    I. fear of uncertainty.

   II. lifelong habit.

  III. desire to be led by strong leaders.

  IV. search for comfort.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 2-7

Which of the following is correct?

    I. Crowds are primitive; it is OK to use simple trading strategies.

  II. Being smarter than the crowd assures you of winning.

  III. A good trader feels elated when the market goes in his direction and depressed when it goes against him.

  IV. Market crowds are almost always wrong.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 2-8

Identify the main leader of market trends.

A. Powerful financial interests

B. Prominent gurus

C. Price itself

D. Fundamental changes in the economy

Question 2-9

Markets rise when

    I. there are more buyers than sellers.

  II. buyers are more aggressive than sellers.

  III. sellers are afraid and demand a premium.

  IV. more shares or contracts are bought than sold.

A. I and II

B. II and III

C. II and IV

D. III and IV

Question 2-10

When the trend is down,

    I. short sellers tend to increase their positions.

   II. longs tend to quit in disgust.

  III. longs agree to buy only at a steep discount.

  IV. short sellers are willing to sell at a lower price.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 2-11

A price shock during an uptrend

    I. is a sudden jump in price.

  II. is a sudden drop in price.

  III. makes bulls feel vulnerable.

  IV. frightens the bears.

A. I and III

B. II and III

C. II and IV

D. I and IV

Question 2-12

A price shock interrupts a rally, but prices recover. When they rise to a new peak, several indicators reach a lower peak. This pattern is called a

A. bullish divergence.

B. sudden drop in price.

C. bearish divergence.

D. sudden rise in price.

Question 2-13

The main goals of a trader are to

    I. identify the current trend.

   II. forecast prices in the near future.

  III. forecast long-term prices.

  IV. stay objective and unemotional.

A. I and II

B. I and IV

C. II and III

D. III and IV

Classical Chart Analysis

The original chartists had a revolutionary idea—to use price and volume data rather than fundamental factors for deciding what and when to buy and sell.

Each fundamental analyst has to specialize in a fairly narrow field. Technical analysis, on the contrary, is universal. Once you understand the principles of charting, you can apply them to stocks, bonds, currencies, futures, or any other market. As the number of trading vehicles around the globe increases, technical analysis is becoming more popular.

As long as you have the data on high, low, opening, and closing prices, along with that on volume and open interest, you can make intelligent judgments about the balance of power between bulls and bears in any market. Then you can trade in the direction of the dominant market group.

In this chapter you'll be asked to make trading decisions using charts. It's relatively easy to recognize patterns in the middle of a chart, but good trading signals are much harder to identify near the right edge. That's where you'll have to make your trading decisions—amid the uncertainty, noise, and tension of the markets.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
Correct answers					

Question 3-1

Match the following two sets of statements regarding prices.

   I. The high of the day

  II. The low of the day

 III. The closing price

 IV. The opening price

A. Amateurs' opinion

B. Professionals' opinion

C. Maximum power of bulls

D. Maximum power of bears

Question 3-2

Three analysts look at the same chart. One argues that the trend is up, the other that the trend is down, and the third that the trend is sideways. In all probability,

   I. one or two of them may be guilty of wishful thinking.

  II. they may not have agreed on the basic definition of a trend.

 III. they may be looking at different timeframes.

 IV. if each did a better job, all three would agree.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 3-3

When trying to enter a liquid market on a quiet day, you are likely to encounter

A. higher slippage.

B. higher commissions.

C. lower slippage.

D. lower commissions.

Question 3-4

FIGURE 3.4 Medtronic, Inc. (MDT) weekly chart. *(Chart by Stockcharts.com)*

The Lines of Support and Resistance

Which lines on the chart in Figure 3.4 mark the levels of both support and resistance?

1. Line A
2. Lines A and B
3. Lines A, B, and C
4. Lines A, B, C, and D

Question 3-5

Support and resistance lines should

   I. be drawn across the edges of congestion areas.

  II. be drawn to touch extreme high or low prices.

 III. connect highs with lows and lows with highs.

 IV. connect highs with highs and lows with lows.

A. I and II

B. II and III

C. III and IV

D. I and IV

Question 3-6

The strength of support and resistance depends on

   I. the number of times prices hit that area.

  II. the volume of trading in that area.

 III. the height of that area.

 IV. the length of time prices spent in that area.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 3-7

Prices spend several weeks in a congestion area and then drop below support. Which of the following trading choices should be considered on the following day?

   I. Sell short if prices fall to a new low, with a stop above yesterday's high

  II. Go long if prices rally back into the congestion area, with a stop below yesterday's low

 III. Sell short at the opening

 IV. Go long at the opening

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 3-8

FIGURE 3.8   Walter Energy Inc. (WLT) daily. *(Chart by Stockcharts.com)*

A Congestion Zone

Match the letters underneath the last four bars in the chart in Figure 3.8 to the following statements.

   I. A lower low and a lower close—monitor the downmove.

  II. Start moving up your stop.

 III. A false downside breakout—go long.

 IV. A breakout to a new low—monitor whether the downmove will continue.

Question 3-9

Mark the statements below with a **T** if they apply to trends and with an **R** if they apply to trading ranges:

A. Each rally reaches a higher high.

B. Each decline stops at approximately the same level.

C. Keep adding to your positions.

D. Run at the first sign of a reversal.

Question 3-10

FIGURE 3.10   JetBlue Airways Corp. (JBLU) daily. *(Chart by Stockcharts.com)*

Decisions at Support and Resistance

Match the areas marked by letters in the chart in Figure 3.10 to the following statements.

    I. Inability to reach resistance indicates weakness—consider shorting.

   II. Inability to reach support indicates strength—consider buying.

  III. Hitting resistance—sell.

  IV. False upside breakout—go short.

Question 3-11

Which of the following tactics work well in uptrends?

    I. Buy breakouts to new highs.

   II. Buy pullbacks into support.

  III. Buy when profits on your previous long position are protected by a stop.

  IV. Buy when prices take out the previous low.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 3-12

FIGURE 3.12 Boeing Co. (BA) daily. *(Chart by Stockcharts.com)*

Kangaroo Tails

Which of the following *does not* apply to "kangaroo tails," marked "T" in Figure 3.12?

A. When a tail points down, go short.

B. Tails are single bars protruding from compact congestion areas.

C. When a tail points up, it gives a sell signal.

D. Markets usually recoil from their "tails."

Question 3-13

If you buy in area T near the right edge of Figure 3.12, you may do all of the following, *except*

A. place a protective order midway down the tail.

B. add to your long position on the next bar that trades higher.

C. take profits when the rally stops making new highs.

D. place a protective stop below the tip of the tail.

Computerized Technical Analysis

Today it would be unusual to see an analyst or a trader who doesn't use a computer. The dropping cost of equipment, software, and data has evened out the playing field between individuals and institutions.

A computer can help you process the torrent of market information and make your analysis more objective, but it is only a tool. Buying the best car will not automatically turn a beginning driver into an expert. In this section, you'll test yourself to see how well you've mastered the lessons on computerized market analysis. If you own technical analysis software, please feel free to use it while answering questions in this chapter.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
17					
18					
19					
20					
21					
22					
Correct answers					

Question 4-1

Computerized technical analysis

    I. is more objective than classical charting.

    II. allows traders to forecast the future.

    III. removes emotions from trading.

    IV. assures success in trading.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 4-2

Match the following three types of software with their descriptions:

    I. Gray box

    II. Toolbox

    III. Black box

A. You feed this program current market data and receive specific buy and sell signals.

B. Same as above, but you can choose indicator settings.

C. A collection of charting tools and indicators.

Question 4-3

Match the following three main groups of technical indicators with their descriptions:

    I. Oscillators

    II. Trend-following indicators

    III. Miscellaneous indicators

A. Provide insights into mass psychology of the markets.

B. Catch turning points in flat markets but give premature and dangerous signals when the markets begin to trend.

C. Work best when markets are moving but give bad signals when the markets are flat.

Question 4-4

A stock has closed at 23, 22, 21, 20, 23, and 24 during the past 6 days. What is its 5-day simple moving average on the last day?

A. 21

B. 22

C. 23

D. None of the above

Question 4-5

Exponential moving averages work better than simple MAs for all of the following reasons, *except* that EMAs

A. are easier to calculate by hand.

B. respond to changes in prices faster.

C. do not jump in response to old data.

D. track the mass mood of the crowd more closely.

Question 4-6

The most important message of an exponential moving average is

A. the width of its time window.

B. its ability to rise to a new peak.

C. its ability to fall to a new low.

D. the direction of its slope.

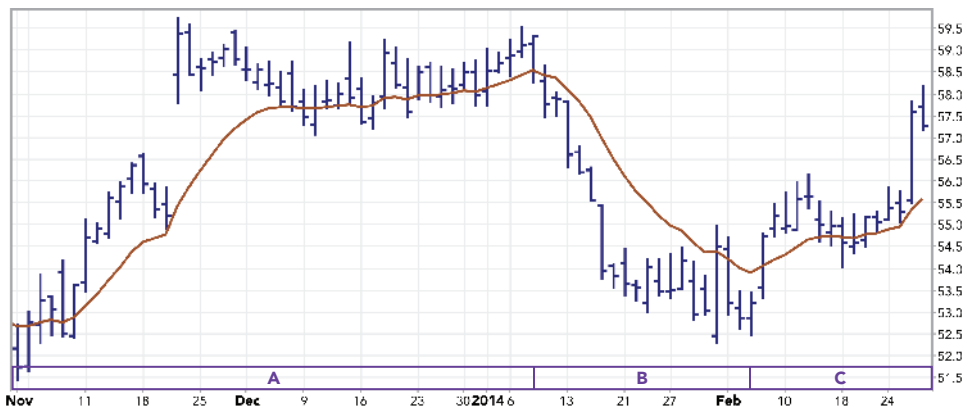## Question 4-7

FIGURE 4.7   Williams-Sonoma Inc. (WSM) daily, 13-day EMA. *(Chart by Stockcharts.com)*

EMA Signals—Daily

Match the lettered sections at the bottom of Figure 4.7 to the following EMA-based strategies.

1. Trade only from the long side.

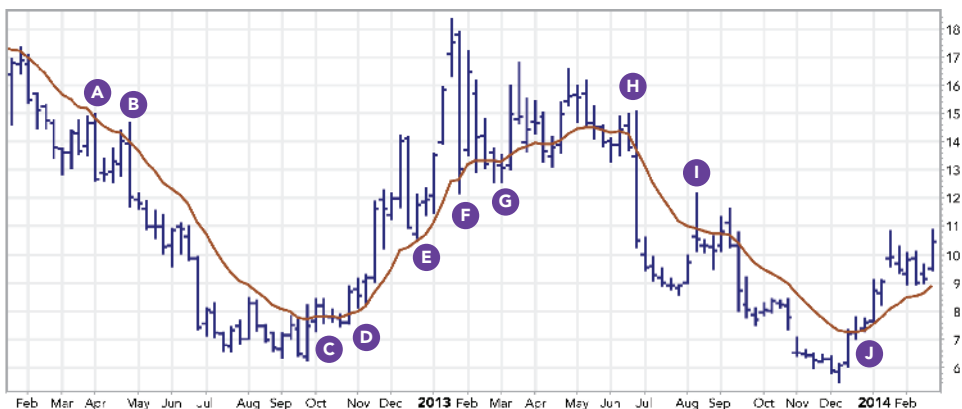2. Trade only from the short side.

Question 4-8

FIGURE 4.8 BlackBerry Limited (BBRY) weekly, 13-week EMA. *(Chart by Stockcharts.com)*

EMA Signals—Weekly

Match the lettered areas of Figure 4.8 to the following EMA-based tactics.

1. Go long, with a protective stop in the vicinity of the latest low.
2. Go short, with a protective stop in the vicinity of the latest high.
3. Liquidate positions and stand aside—the market may be turning.

Question 4-9.

Which of the following statements regarding Moving Average Convergence-Divergence (MACD) are true?

 I. The fast line of MACD reflects short-term bullishness or bearishness.
 II. The slow line of MACD reflects long-term bullishness or bearishness.
 III. When the fast line is above the slow line, bulls are in control.
 IV. When the fast line is below the slow line, bears are in control.

A. I and II
B. III and IV
C. None of the above
D. I, II, III, and IV

Question 4-10

Which statement about MACD-Histogram *isn't true*?

A. It measures the spread between the fast and slow MACD lines.
B. When it rises, it shows that bulls are in control.
C. It forecasts higher or lower prices ahead.
D. It identifies the dominant market group.

Question 4-11

FIGURE 4.11   DR Horton Inc. (DHI) daily, 26-day EMA and 12-26-9 MACD. *(Chart by Stockcharts.com)*

MACD Lines and MACD-Histogram

Match the following statements to the lettered areas in the chart in Figure 4.11

1. MACD-Histogram rises to a higher peak—expect prices to retest or exceed their price peak.
2. MACD-Histogram falls to a new low—expect prices to retest or exceed their latest bottom.
3. Breaking the power of the dominant group.
4. A bearish divergence is occuring.
5. A bullish divergence is occuring.

Question 4-12

At the right edge of Figure 4.11, MACD-Histogram, EMA, and price are telling us that

A. the latest price peak is likely to be retested or exceeded; go long immediately.

B. bears are in control; go short immediately.

C. lower your stop and be ready to take profits on the short position from the bearish divergence D-F.

Question 4-13

Which of the following statements describes Directional Movement?

A. The part of today's bar that is above the previous day's bar

B. The part of today's bar that is below the previous day's bar

C. The largest part of today's bar that is outside the previous day's bar

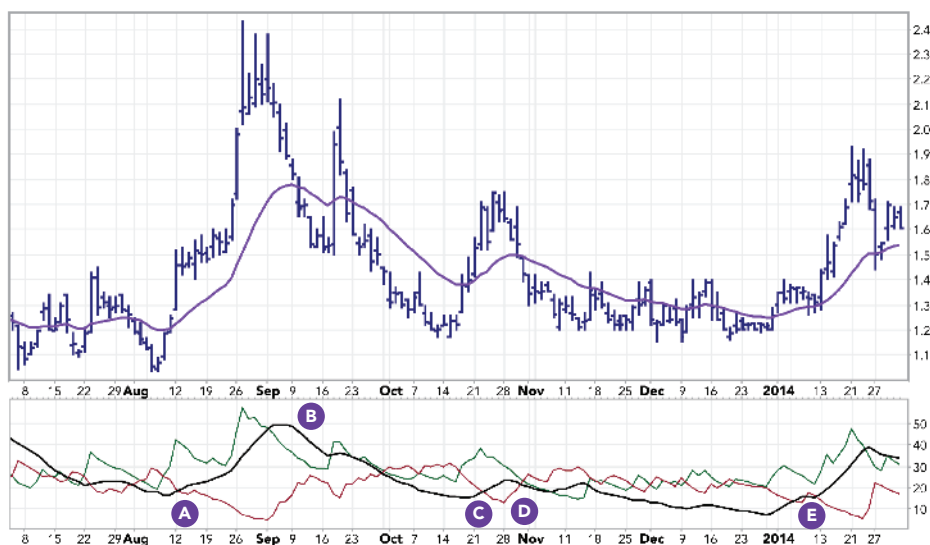D. None of the above

Question 4–14

FIGURE 4.14   Alexco Resource Corporation (AXU) with 22-day EMA and a 13-day Directional System (green +DI, red −DI, black ADX). *(Chart by Stockcharts.com)*

Directional System

Match the lettered areas in Figure 4.14 to the following actions.

   I. When the Directional Indicator (ADX) turns down from above both Directional Lines, take at least partial profits.

  II. When the Directional Indicator penetrates above the lower Directional Line, trade in the direction of the upper Directional Line.

 III. Do not use a trend-following method when the Directional Indicator is below both Directional Lines.

Question 4–15

At the right edge of Figure 4.14, the Directional System is telling us to

A. go long.

B. go short.

C. stand aside.

Question 4–16

Oscillators can help traders accomplish all of the following *except*

A. identify the extremes of mass pessimism and optimism.

B. catch all tops and bottoms.

C. find whether bulls or bears currently predominate.

D. bet against deviations and for a return to normalcy.

Question 4-17

When an oscillator reaches its highest peak in several months, which of the following is *least likely*?

A. The rally is likely to pause.

B. Prices are likely to rise to a higher high.

C. Long positions can be held.

D. Prices are likely to drop.

Question 4-18

FIGURE 4.18 Leapfrog Enterprises Inc. (LF) with 26-day EMA and 7/3 Slow Stochastic. *(Chart by Stockcharts.com)*

Stochastic

Match the letters in Figure 4.18 to the following formations of Stochastic:

  1. Overbought
  2. Oversold
  3. Bullish divergence
  4. Bearish divergence
  5. Failure swing

Question 4-19

At the right edge of Figure 4.18, the trading message of Stochastic is:

A. Stochastic is overbought; go short.

B. Stochastic is rising; go long.

C. The downtrend is still in force; go short.

D. Stochastic is neutral; stand aside.

Question 4–20

FIGURE 4.20   Tiffany & Co. (TIF) with 26-day EMA and 13-day RSI. *(Chart by Stockcharts.com)*

Relative Strength Index

Match lettered formations of RSI (Relative Strength Index) in Figure 4.20 to the patterns listed below.

  1. Overbought
  2. Oversold
  3. Bullish divergence
  4. Bearish divergence

Question 4–21

At the right edge of Figure 4.20, RSI is telling us that:

A. The stock is oversold; go long.

B. There is a bearish divergence; go short.

C. RSI is trending lower; stand aside.

D. Signals are mixed; stand aside for now.

Question 4-22

With the market in a downtrend, an oscillator, such as Stochastic or RSI, identifies

    I. shorting opportunities.

   II. selling areas.

  III. buying opportunities.

  IV. short-covering areas.

A. I and II

B. III and IV

C. I, II, III, and IV

D. None of the above

Volume and Time

Beginners watch only prices. It's easy to become hypnotized by stocks moving up and down.

Experienced analysts gain a much deeper understanding of the markets by including volume in their analysis. In addition, price changes need to be linked to the length of time it took for them to occur. All trading decisions have to be made by analyzing more than one timeframe.

This chapter also reviews open interest, a measure relevant only for the derivatives markets, such as futures or options. If you don't trade derivatives and don't wish to study open interest, skip questions 5–7, 5–8, and 5–9 and add three points to your score.

Questions	Trial 1	Trial 2	Trial 3	Trial 4	Trial 5
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
17					
18					
19					
Correct answers					

Question 5-1

Volume reflects all of the following *except*:

A. How market participants will react to future price changes

B. How many winners and losers are active in the market

C. Whether masses of losers are staying put or running

D. The degree of emotional involvement among traders

Question 5-2

The market has been rising for several months in an orderly pattern of rallies and shallow declines; a new rally is in progress. Match the following pairs of statements concerning this rally's volume:

1. Volume is slightly higher than during the previous rally.
2. Volume is double what it was during the previous rally.
3. Volume is half of what it was during the previous rally.
4. Volume is approximately the same as it was during the previous rally.

A. Bears are panicking; take at least partial profits on long positions.

B. The uptrend is healthy; hold longs or add to them.

C. The uptrend is running out of steam; take at least partial profits on long positions.

D. The uptrend is healthy; hold longs.

Question 5-3

FIGURE 5.3   Capstone Turbine Corp. (CPST) with 26-day EMA and daily volume.
(Chart by Stockcharts.com)

Volume

Identify the following patterns of volume by matching them with the appropriate letters in Figure 5.3.

1. Volume traces a lower peak while prices trace a higher one—expect a deeper reaction, take profits on long positions.
2. Volume shrinks while prices slide near the bottom of their range—look for a buying opportunity.
3. Volume expands on a rally—expect higher prices ahead, hold through any correction.
4. Volume shrinks during a pullback to value—look to go long or add to longs.

Question 5-4

At the right edge of Figure 5.3, the pattern of volume and prices shows that

A. prices are rising on heavy volume; go long immediately.
B. prices are pulling back to value on falling volume—wait for the decline to stop and then go long.
C. the last rally had an unsustainable volume level—go short.
D. it's better to stand aside for now.

Question 5-5

Which one of the following statements is correct? On-Balance Volume (OBV)

    I. confirms bear moves when it falls to a new low.

   II. tracks the running total of traders' emotional commitments.

  III. often reaches a new peak before a new peak in price.

  IV. rises whenever the market closes lower.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 5-6

Match statements about Accumulation/Distribution from the following two sets.

   1. Prices open below the previous day's close and close lower.

   2. Prices open above the previous day's close and close higher.

   3. Prices open above the previous day's close, but close at the lows.

   4. Prices open below the previous day's close, but close at the highs.

A. Amateurs relatively bearish, professionals relatively bullish

B. Amateurs relatively bullish, professionals relatively bearish

C. Amateurs and professionals bullish

D. Amateurs and professionals bearish

Question 5-7

The Chicago Board of Trade reports that open interest in soybeans stands at 300,000 contracts. This means that

A. 150,000 contracts are held by the longs and 150,000 owed by the shorts.

B. 300,000 contracts are held by the longs and 300,000 owed by the shorts.

C. 600,000 contracts are held by the longs and 600,000 owed by the shorts.

D. there isn't enough information to tell who holds how many contracts.

Question 5-8

Match the following actions with their impact on open interest.

1. A trader who is long sells to another who is short.
2. A new bear enters the market and sells short to an earlier bear who buys to cover his shorts.
3. A new bull enters the market and buys from an earlier bull who sells his position.
4. A new buyer and a new seller trade with each other.

A. Open interest increases.
B. Open interest decreases.
C. Open interest stays unchanged.

Question 5-9

Rising open interest shows that

1. bulls are confident and aggressive.
2. the supply of losers is growing.
3. the trend is likely to continue.
4. bears are confident and aggressive.

A. 1
B. 1 and 2
C. 1, 2, and 3
D. 1, 2, 3, and 4

Question 5-10

As prices change, which factors reflect the force of their move?

1. The amount of price change
2. Volume of trading during that move
3. Direction of the move
4. Related markets

A. 1
B. 1 and 2
C. 1, 2, and 3
D. 1, 2, 3, and 4

Question 5-11

The Force Index formula is

A. $\text{Close}_{today} \bullet (\text{Volume}_{today} - \text{Volume}_{yesterday})$

B. $\text{Close}_{today} \bullet (\text{Volume}_{today} + \text{Volume}_{yesterday})$

C. $\text{Volume}_{today} \bullet (\text{Close}_{today} + \text{Close}_{yesterday})$

D. $\text{Volume}_{today} \bullet (\text{Close}_{today} - \text{Close}_{yesterday})$

Question 5-12

Why smooth Force Index with a moving average?

   I. The histogram of the daily Force Index is too jagged.

  II. A 2-day EMA of Force Index helps find entry points into trades.

 III. A 13-day EMA of Force Index helps find major shifts in the force of bulls and bears.

 IV. Divergences between the smoothed Force Index and prices help to identify turning points in the markets.

A. I

B. I and II

C. I, II, and III

D. I, II, III, and IV

Question 5-13

FIGURE 5.13 Scorpio Tankers, Inc. (STNG) with 13-day EMA of price and a 2-day EMA of Force Index. *(Chart by Stockcharts.com)*

Force Index, 2-day EMA

A short-term Force Index, smoothed with a 2-day EMA, helps decide when to put on trades in the direction of the current price trend, which we may define using the slope of a price EMA. Force Index can also show when to take short-term profits. Match the lettered areas in the chart in Figure 5.13 to the following statements.

1. Buy
2. Stop shorting, look to buy
3. Sell short
4. Cover shorts

Question 5-14

At the right edge of Figure 5.13, the message of the 2-day Force Index is:

A. Stand aside.

B. Go long.

C. Sell short.

Question 5-15

FIGURE 5.15   EMC Corp. (EMC) with 13-day EMA of price and a 13-day EMA of Force Index.
(Chart by Stockcharts.com)

Force Index, 13-day EMA

A long-term Force Index, smoothed with a 13-day EMA, delivers several strategic messages. Please match the lettered areas in the chart in Figure 5.15 to the following statements.

1. Bearish crossover—trade short.
2. Bullish crossover—trade long.
3. Dominant force is weakening.

Question 5-16

At the right edge of Figure 5.15, the message of the 13-day Force Index is:

A. Stand aside.

B. Go long.

C. Sell short.

Question 5-17

The presence of cycles in market data depends on

    1. changes in the economic fundamentals.

    2. greed in good times and fear in bad times among producers and consumers.

    3. swings between pessimism and optimism among traders.

    4. planetary influences.

A. 1

B. 1 and 2

C. 1, 2, and 3

D. 1, 2, 3, and 4

Question 5-18

FIGURE 5.18   Molycorp, Inc. (MCP) with 13-day EMA of price and a 12-26-9 MACD-Histogram. *(Chart by Stockcharts.com)*

Indicator Seasons

Identify the "indicator seasons" by matching them with the appropriate letters in Figure 5.18.

    1. Spring; go long.

    2. Summer; start taking profits on longs.

    3. Autumn; go short.

    4. Winter; start taking profits on shorts.

Question 5-19

Traders can analyze markets in greater depth by looking at them in two timeframes. Which of the following combinations makes the most sense?

A. Weekly and daily

B. Monthly and daily

C. Yearly and daily

D. Yearly and weekly