"Absorb what is useful,
Discard what is not,
Add what is uniquely your own."

- Bruce Lee

Join Discord! https://discord.gg/P3tpF5Z
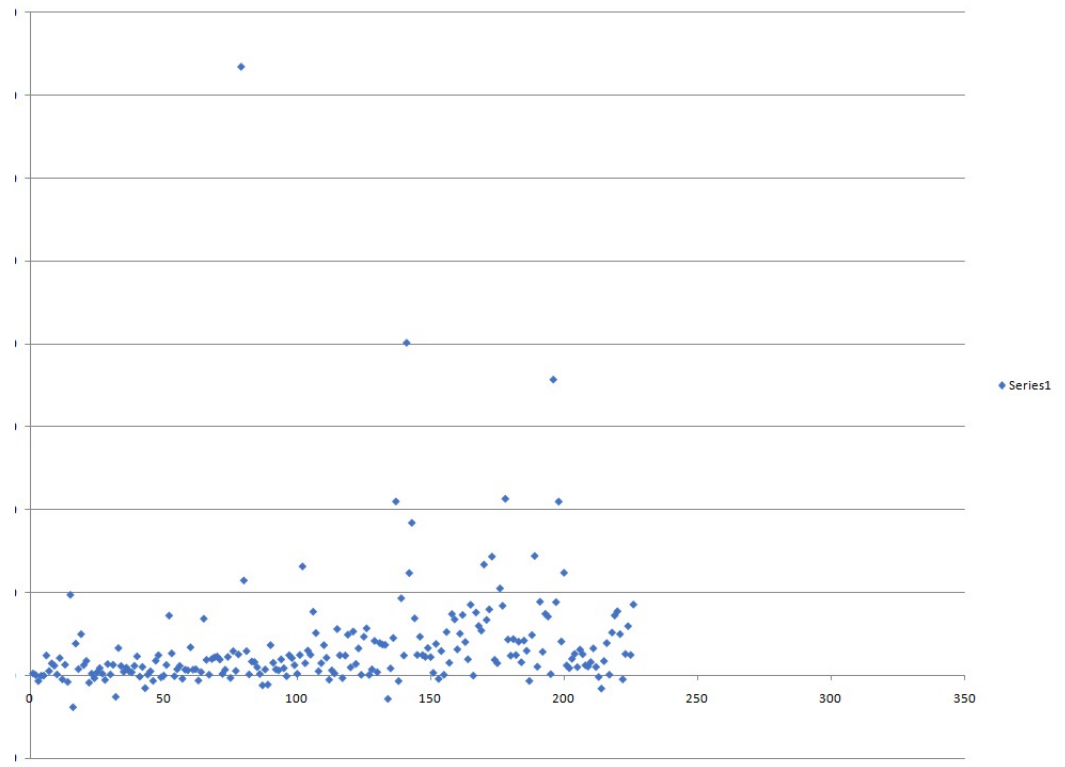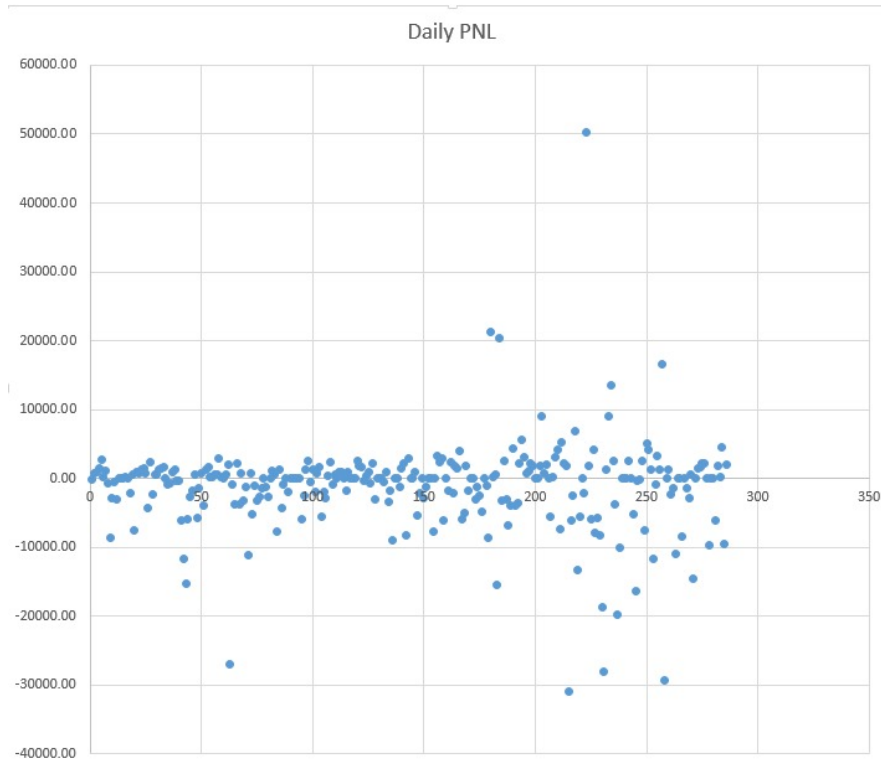
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Questions

- What is the purpose of trading?
- How do we achieve this purpose?
- What prevents us from achieving this?
- How can we overcome our challenges?

Facts

- Make money by being right half the time
- It's a numbers game, you need a lot of trades
- Trade results need to be consistent with statistical model
- Random outcomes prevent consistency
- Win-only scenario's = death

Facts

- Individual outcomes can be a random distribution of wins and losses, but if consistently inside model parameters, model will create consistent results over time
- If you do not plan how much risk you take or know how much you will lose when you are wrong, before you trade, you are doomed to fail
- Limiting the amount of risk that you take by forcing yourself to think about risk and how much you can lose BEFORE you enter into trades, is the only was to survive
- Survival is the prime directive
- To survive you must defend your capital above all else

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The core concept

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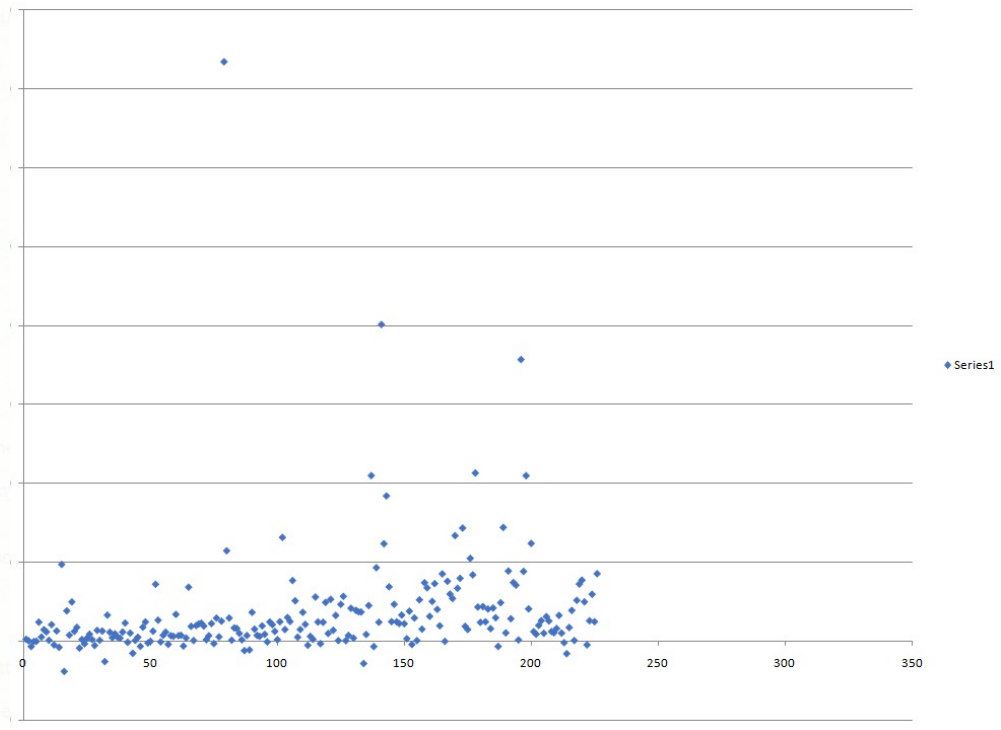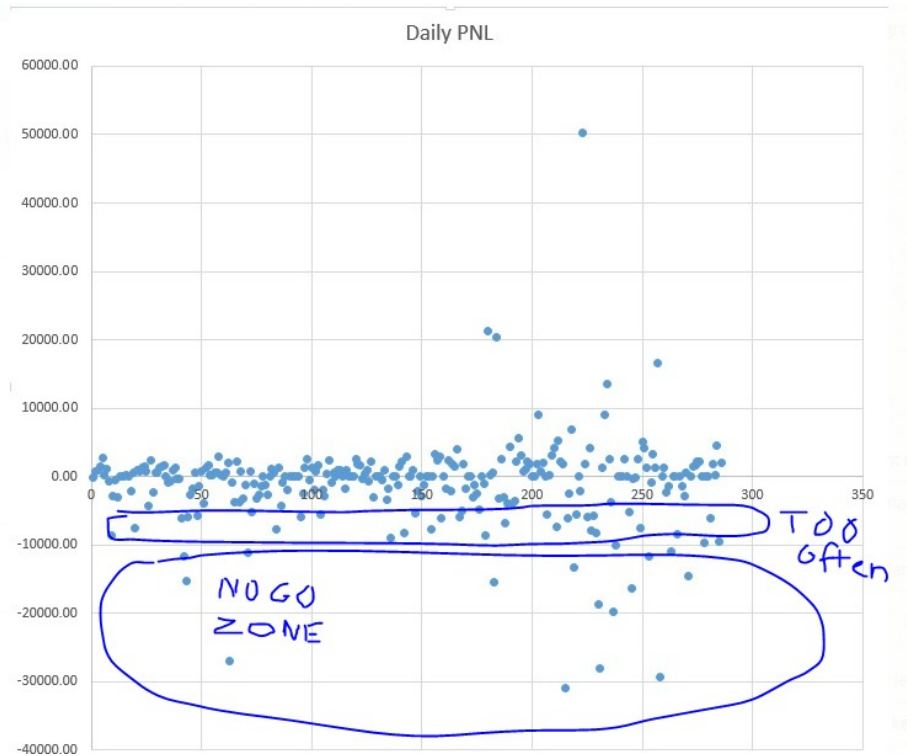
Predetermine stop loss and manage position size to only lose 2% of total capital if stopped out.

- Predetermine
  - know where to place your stop loss
- Manage position size
  - work out how big/small you need to trade
  - Include/exclude costs – know the difference
- *Only lose* 2%
  - Allows a large sample size
  - Small enough to not solicit a strong emotional response
- Stopped out
  - Stubbornness around being right will kill you
  - Make clear rules and stick to them
  - Freedom demands discipline – manage your emotions

Calculating position size

$$^{2\%}/_{Risk} = position\ size$$

Capital = R 250 000
2% of capital = R 5 000

Price = R 100
Stop loss = R 95
Risk = Price – Stop loss
∴ Risk = R 100 – R 95
∴ Risk = R 5

$$^{2\%}/_{Risk} = position\ size$$

$$^{5000}/_{5} = 1000\ shares$$

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Average True Range

- Developed by J. Welles Wilder 1978

- Measures volatility

- Does not indicate direction, only volatility

Goal of incorporating ATR

- Improve the 2% by allowing stop losses to trail price once trades no longer pose risk of loss

ATRx2 trailing stop loss method attempts to take as much out of a trend/move as possible

True Range

- Method 1: Current high less the current low

- Method 2: Current high less the previous close (absolute value)

- Method 3: Current low less the previous close (absolute value)

True Range

- (method 1 – outside day) If current high > previous high & low is < previous low = then current high-low range is used

- (method 2 & 3 – gap or inside day)

- **Example A:** A small high/low range formed after a gap up. The TR equals the absolute value of the difference between the current high and the previous close.
- **Example B:** A small high/low range formed after a gap down. The TR equals the absolute value of the difference between the current low and the previous close.
- **Example C:** Even though the current close is within the previous high/low range, the current high/low range is quite small. In fact, it is smaller than the absolute value of the difference between the current high and the previous close, which is used to value the TR.


True Range (TR)
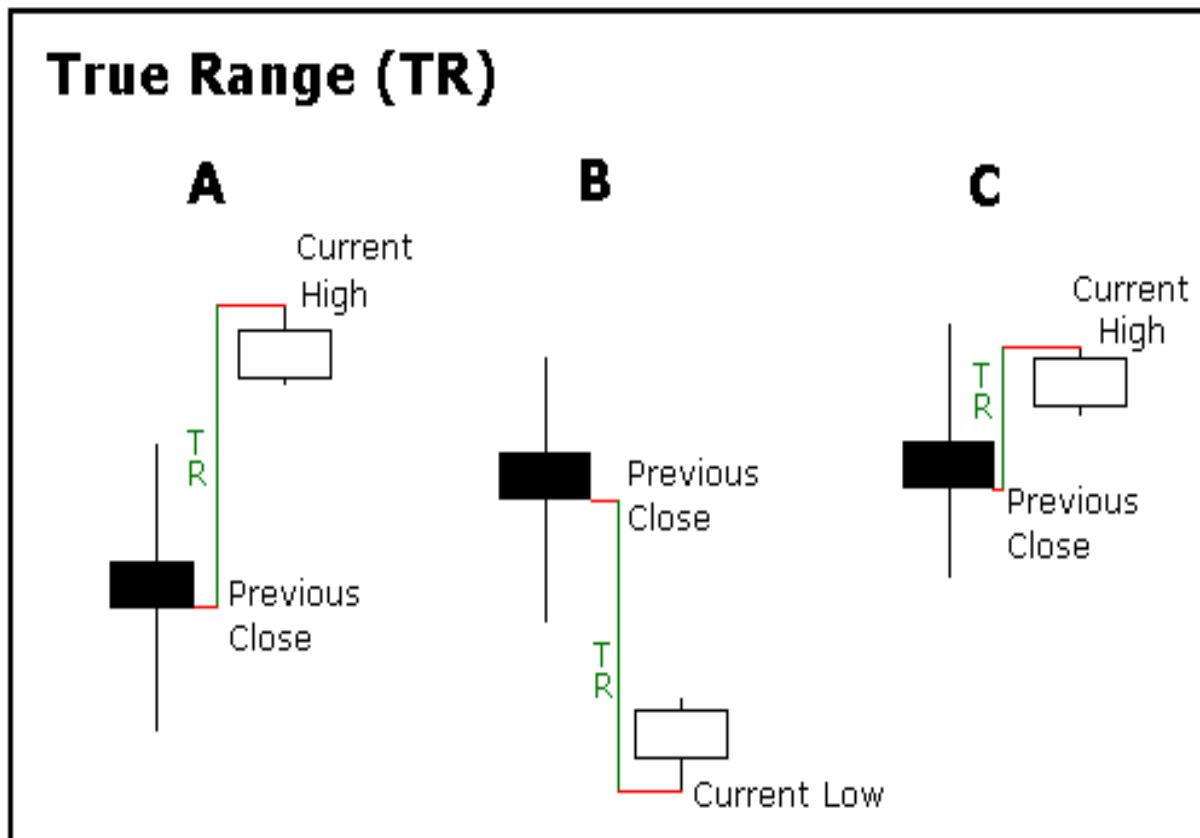
Average True Range
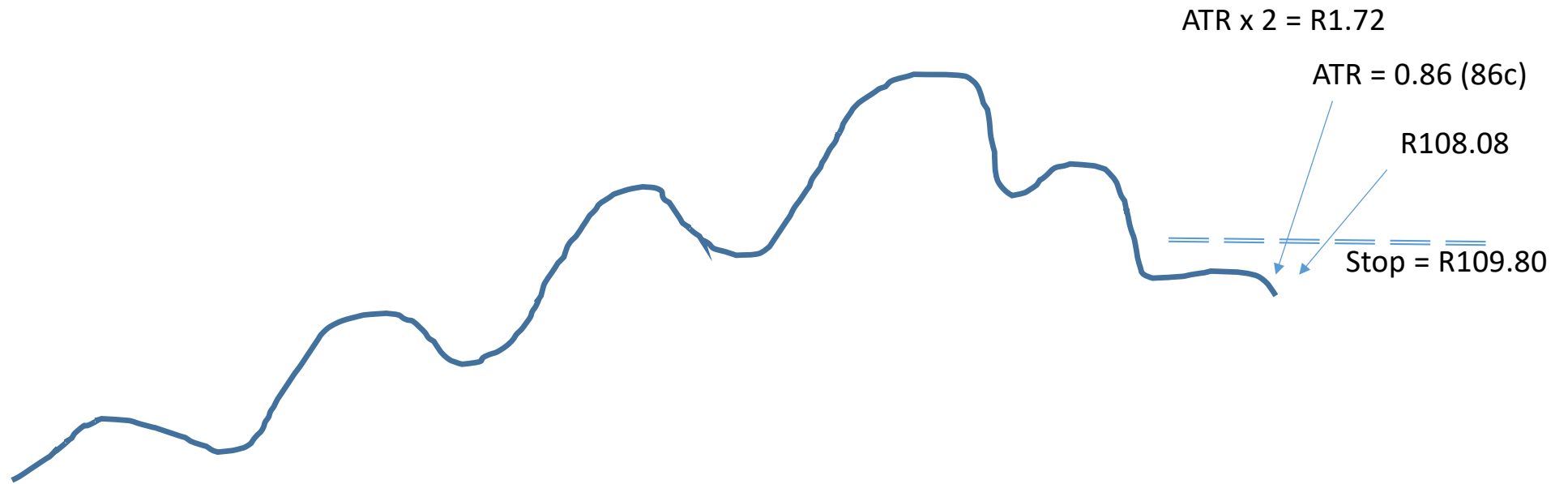
Current ATR = [(Prior ATR x 13) + Current TR] / 14

- Multiply the previous 14-day ATR by 13
- Add the most recent day's TR value
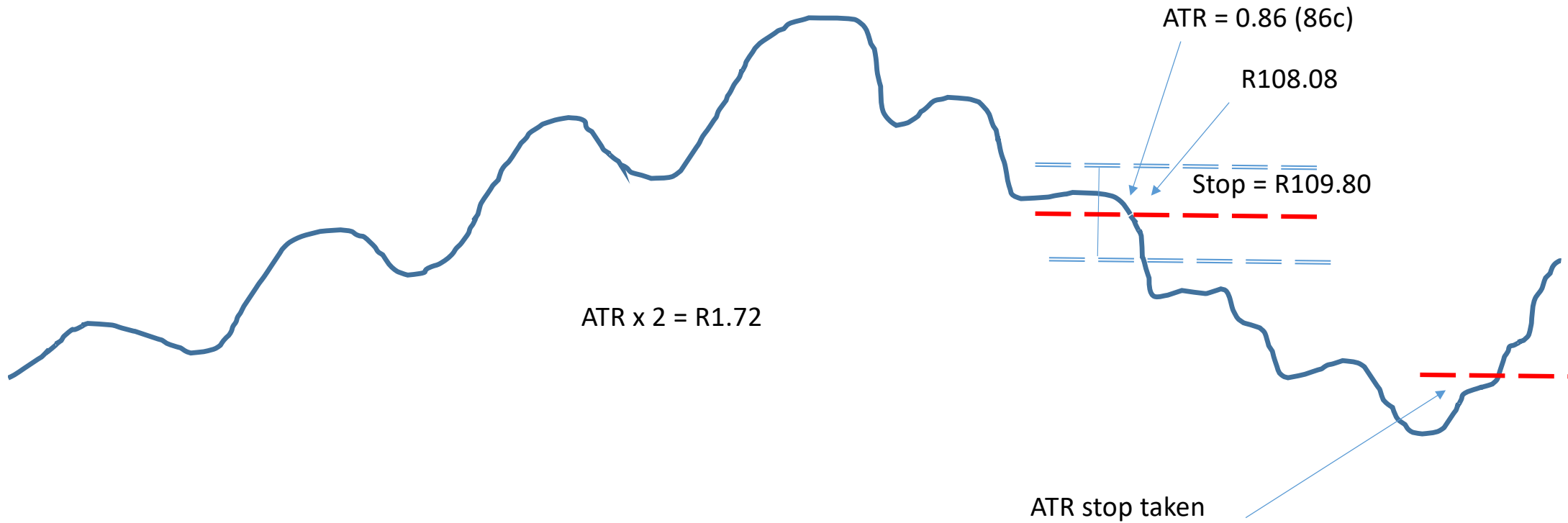- Divide the total by 14
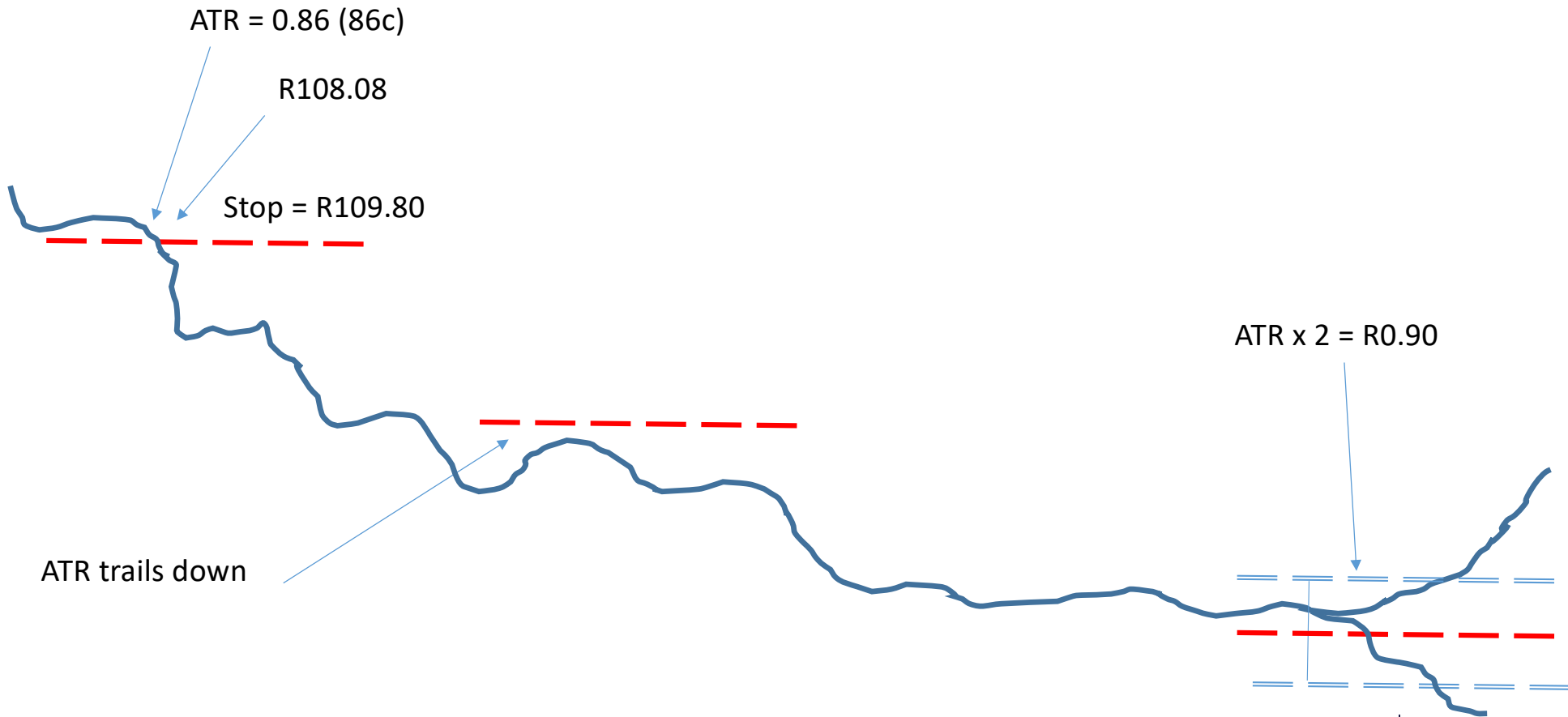
Average True Range (ATR)

		High	Low	Close	H - L	I H - Cp I	I L - Cp I	TR	ATR
	01-Apr-10	48.70	47.79	48.16	0.91			0.91	
	05-Apr-10	48.72	48.14	48.61	0.58	0.56	0.02	0.58	
	06-Apr-10	48.90	48.39	48.75	0.51	0.29	0.22	0.51	
	07-Apr-10	48.87	48.37	48.63	0.50	0.12	0.38	0.50	
	08-Apr-10	48.82	48.24	48.74	0.58	0.19	0.39	0.58	
	09-Apr-10	49.05	48.64	49.03	0.41	0.31	0.11	0.41	
	12-Apr-10	49.20	48.94	49.07	0.26	0.17	0.09	0.26	
	13-Apr-10	49.35	48.86	49.32	0.49	0.28	0.21	0.49	
	14-Apr-10	49.92	49.50	49.91	0.42	0.60	0.18	0.60	
	15-Apr-10	50.19	49.87	50.13	0.32	0.28	0.04	0.32	
	16-Apr-10	50.12	49.20	49.53	0.92	0.01	0.93	0.93	
	19-Apr-10	49.66	48.90	49.50	0.76	0.13	0.63	0.76	
	20-Apr-10	49.88	49.43	49.75	0.45	0.38	0.07	0.45	
	21-Apr-10	50.19	49.73	50.03	0.46	0.44	0.02	0.46	0.56
1	22-Apr-10	50.36	49.26	50.31	1.10	0.33	0.77	1.10	0.59
2	23-Apr-10	50.57	50.09	50.52	0.48	0.26	0.22	0.48	0.59
3	26-Apr-10	50.65	50.30	50.41	0.35	0.13	0.22	0.35	0.57
4	27-Apr-10	50.43	49.21	49.34	1.22	0.02	1.20	1.22	0.62
5	28-Apr-10	49.63	48.98	49.37	0.65	0.29	0.36	0.65	0.62
6	29-Apr-10	50.33	49.61	50.23	0.72	0.96	0.24	0.96	0.64
7	30-Apr-10	50.29	49.20	49.24	1.09	0.06	1.03	1.09	0.67
8	03-May-10	50.17	49.43	49.93	0.74	0.93	0.19	0.93	0.69
9	04-May-10	49.32	48.08	48.43	1.24	0.61	1.85	1.85	0.78
10	05-May-10	48.50	47.64	48.18	0.86	0.07	0.79	0.86	0.78
11	06-May-10	48.32	41.55	46.57	6.77	0.14	6.63	6.77	1.21
12	07-May-10	46.80	44.28	45.41	2.52	0.23	2.29	2.52	1.30
13	10-May-10	47.80	47.31	47.77	0.49	2.39	1.90	2.39	1.38
14	11-May-10	48.39	47.20	47.72	1.19	0.62	0.57	1.19	1.37
15	12-May-10	48.66	47.90	48.62	0.76	0.94	0.18	0.94	1.34
16	13-May-10	48.79	47.73	47.85	1.06	0.17	0.89	1.06	1.32

ATRx2 stop loss method
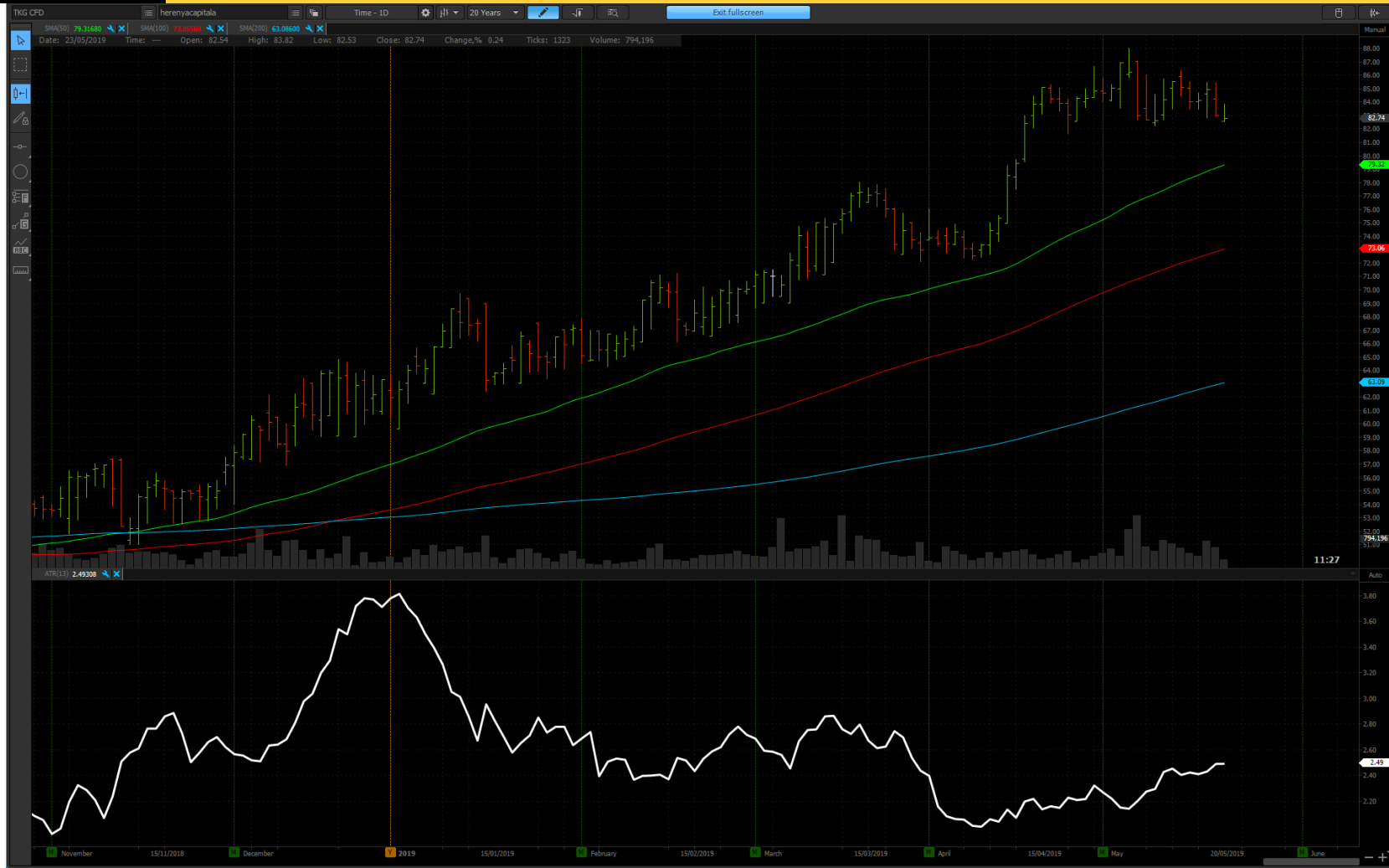
- Start with a hard stop loss in accordance with the setup using 2% rule

- Take note of ATR on relevant timeframe at time of entry

- Once trade is in the money by ATR x 2, start using trailing stop loss of ATR x 2

- Each period that passes, ATR will change, and thus the 'stop distance' of your trailing stop will change

- As market trades in your favour over a period of time, trailing stop should tighten up

- Periods of consolidation will tighten up stop a lot

- A break out will increase 'stop distance value' as ATR increases, but you must never adjust stop bigger

  - Breakouts against you will thus stop you out, but in your favour will keep you in

- If 'stop distance' is greater than stop level, leave stop until ATR drags it up again or you stop out

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ATRx2 stop loss method

ATR x 2 = R1.72

ATR = 0.86 (86c)

R108.08

Stop = R109.80

ATRx2 stop loss method

ATR = 0.86 (86c)

R108.08

Stop = R109.80

ATR x 2 = R1.72

ATR stop taken

Using spread sheets to track and log

- Must trade closing price each period/day

- Helps keep track of whether or not you should stop out

- Building sheets like this and using them to track your trades, helps you with the discipline you need to stop out when the time comes

- Becoming obsessed with the process will ensure consistent results

ATRx2 Trailing stop calculator

HCA
062 503 0642 | www.herenya.co.za

| Entry | 61.42 | |
| Stop | 57.52 | Long |

Period	ATR reading	ATRx2	Closing price	Stop loss	Risk	ATR stop	Stop adjustment	Stop out?
1	65.75	131.5	61.42	57.52	-3.90	60.11	no	no
2	68.34	136.68	62.25	57.52	-4.73	60.88	no	no
3	72.53	145.06	62.76	57.52	-5.24	61.31	no	no
4	71.42	142.84	63.04	61.61	-1.43	61.61	yes	no
5	71.32	142.64	63.60	62.17	-1.43	62.17	yes	no
6	73.37	146.74	63.29	62.17	-1.12	61.82	no	no
7	70.2	140.4	63.00	62.17	-0.83	61.60	no	no
8	73.04	146.08	62.69	62.17	-0.52	61.23	no	no
9	74.18	148.36	62.94	62.17	-0.77	61.46	no	no
10	73.02	146.04	63.30	62.17	-1.13	61.84	no	no
11	75.02	150.04	64.17	62.67	-1.50	62.67	yes	no
12	78.09	156.18	64.04	62.67	-1.37	62.48	no	no
13	80.3	160.6	64.45	62.84	-1.61	62.84	yes	no
14	78.73	157.46	64.42	62.85	-1.57	62.85	yes	no
15	76.32	152.64	64.32	62.85	-1.47	62.79	no	no
42	74.76	149.52	67.68	66.83	-0.85	66.18	no	no
43	70.99	141.98	67.90	66.83	-1.07	66.48	no	no
44	82.28	164.56	68.84	67.19	-1.65	67.19	yes	no
45	81.33	162.66	69.04	67.41	-1.63	67.41	yes	no
46	80.09	160.18	68.50	67.41	-1.09	66.90	no	no
47	77.37	154.74	68.15	67.41	-0.74	66.60	no	no
48	76.2	152.4	67.77	67.41	-0.36	66.25	no	no
49	74.4	148.8	67.74	67.41	-0.33	66.25	no	no
50	74.73	149.46	67.12	67.41	0.29	65.63	no	yes
51	76.25	152.5	67.46	67.41	-0.05	65.94	no	no
52	70.94	141.88	67.44	67.41	-0.03	66.02	no	no
53	81.45	162.9	65.70	67.41	1.71	64.07	no	yes
54	108.13	216.26	63.60	67.41	3.81	61.44	no	yes

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Identify the trend

- Consecutive higher highs and higher lows

- Primary, secondary or tertiary trend?

**Trends exist until definitive signals prove that they have ended**

- Trends exist despite "market noise"
- Markets temporarily move in the direction opposite to the trend, but soon return the primary move
- The trend should be given the benefit of the doubt during these reversals
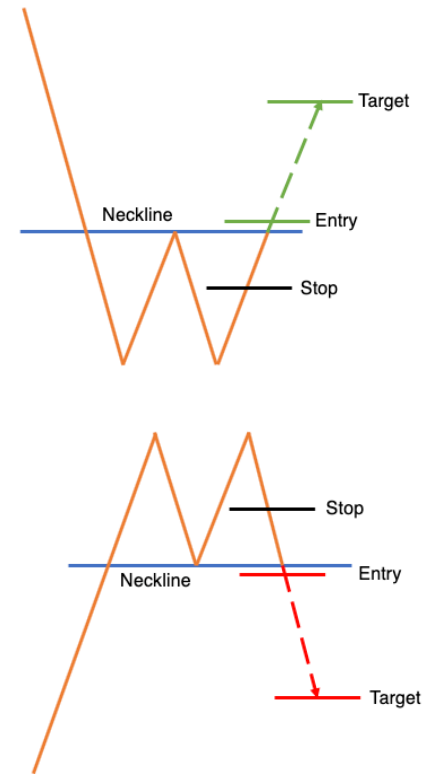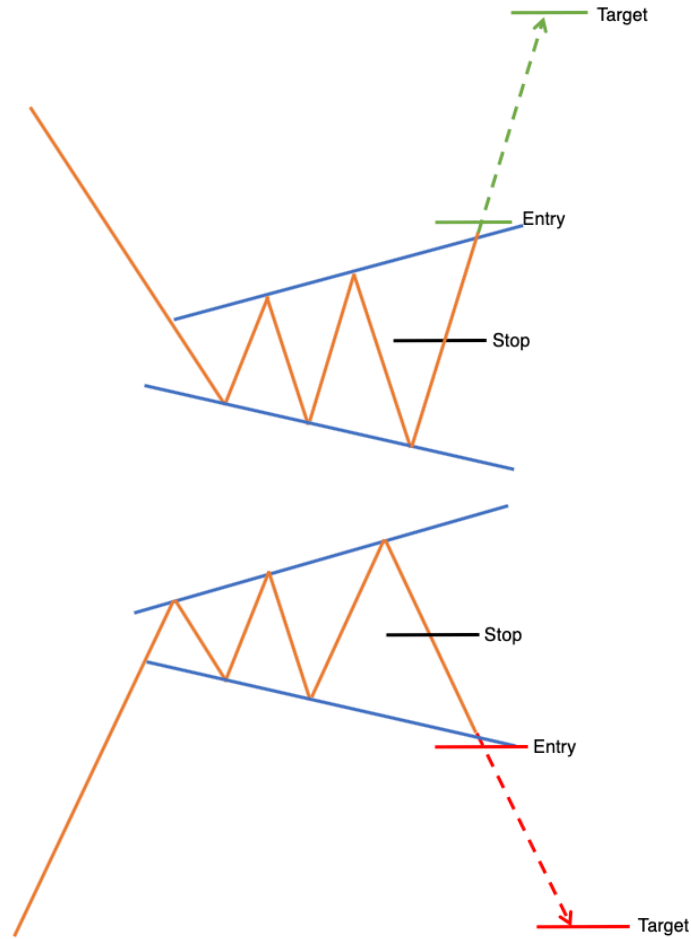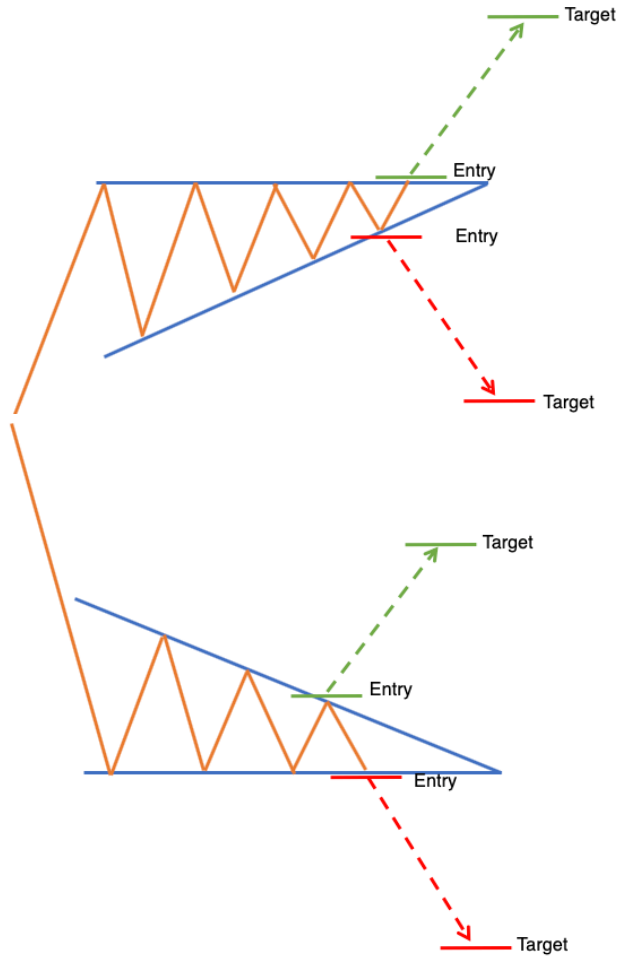
Identify support and resistance

- DeMark or Williams Method

  - Using number of bars on either side of suspected reversal point

  - Low bar, we might look for two bars with higher lows directly on either side of suspected trough bar

  - Number of bars on either side can be increased to increase importance
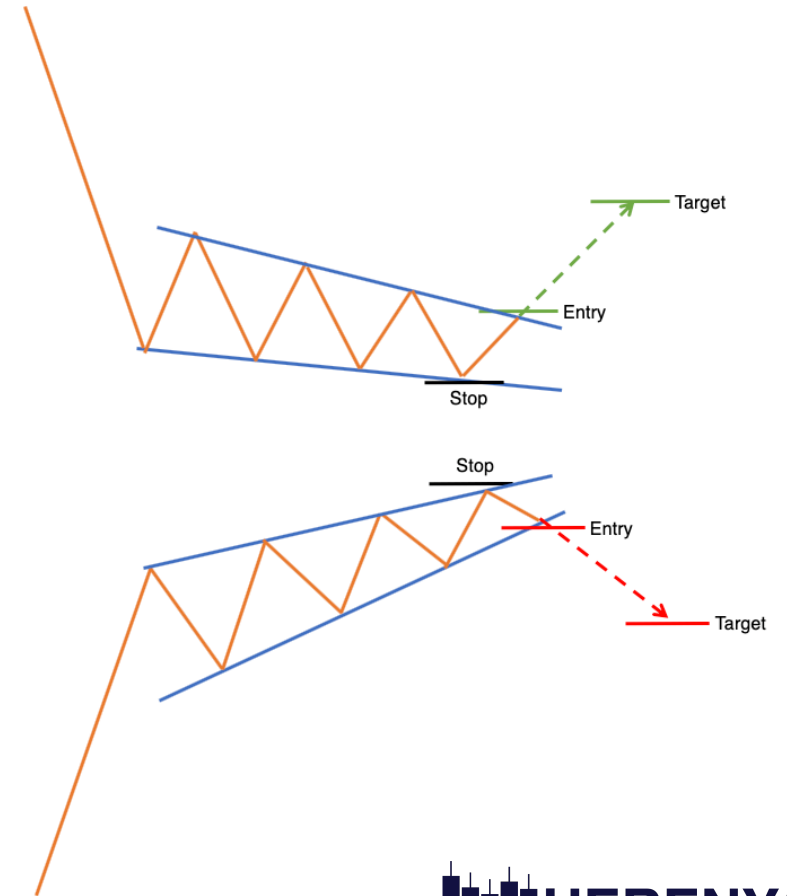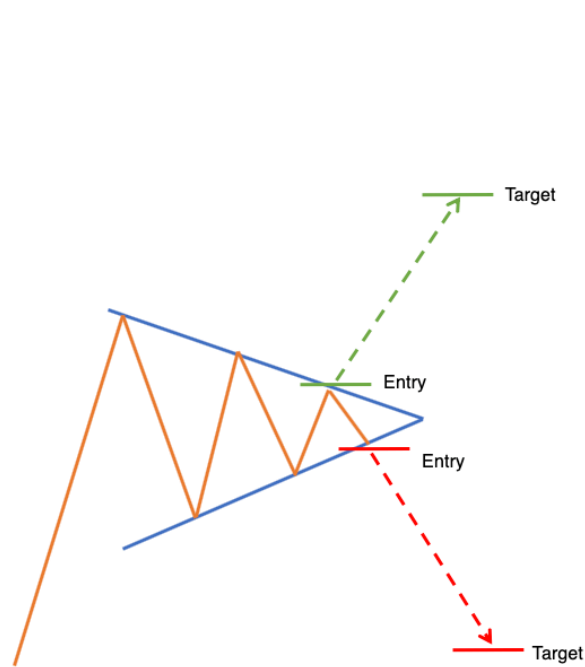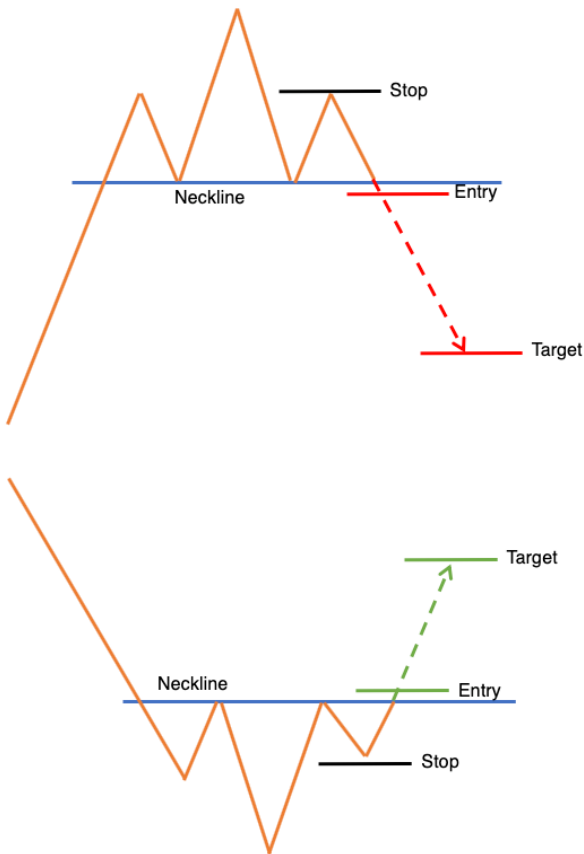
  - Visa versa with high bar
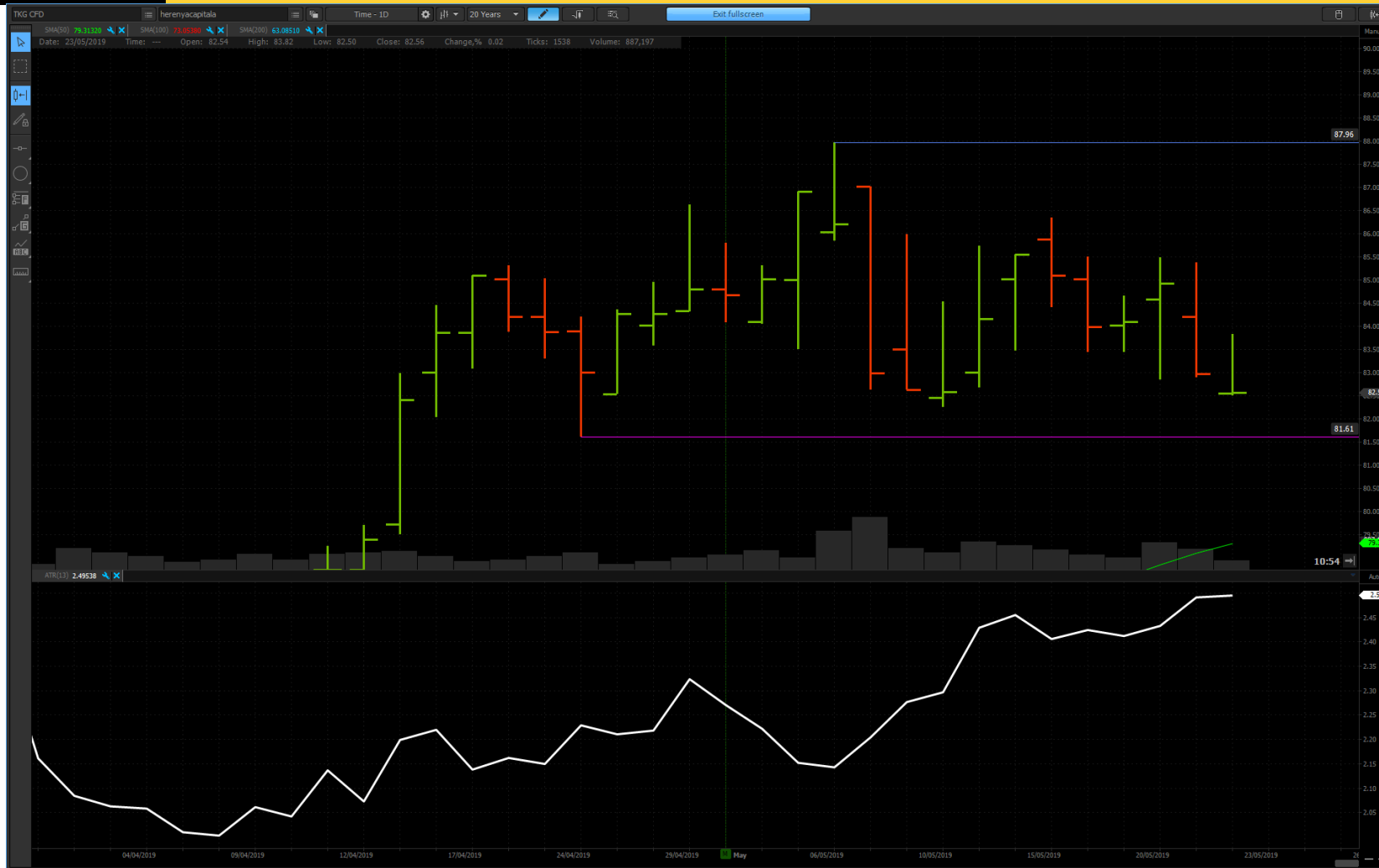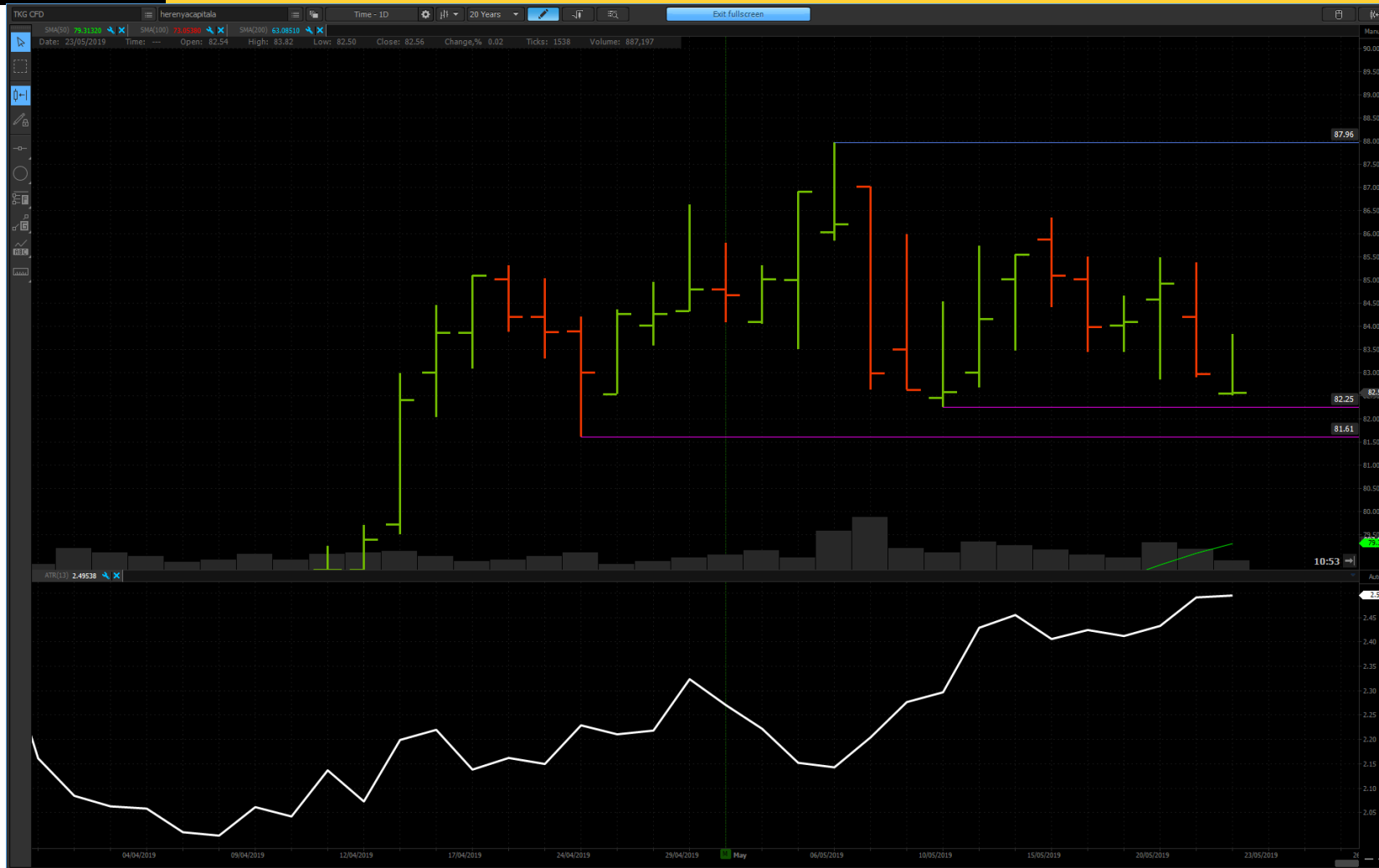
Breakaway Gap / Runaway Gap
Explosion gap pivot

- A reversal point called a pivot

- Explosion gap pivot looks for a pivot low where the pivot low is the low of a bar that is surrounded on both sides with higher lows (much like a De Mark or Williams method for point of support)

- Low bar is the pivot

- To prevent false signals, breakaway gap must establish a new high, for at least the past 20 days (bars) and for the subsequent retracement not to fill the gap

  - If these requirements are not met, the gap must be ignored

- When/if retracement does occur, eventually it will form a pivot low

- Buy entry is placed above the high of the next bar from the pivot low

- **Stop loss placed at the gap lower edge (just below the pivot low)**

- Occasionally the pivot low is pierced, but gap is not filled

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Chart (AGL.JSE)

AGL.JSE   Add   Compare   AutoSave

D   Indicators   Buy   Sell   Save   Load

Anglo American plc, 1D, JSE   O 39066.00 H 39951.00 L 39066.00 C 39852.00

Breakaway gap
(new high for 20 days)

Long entry

Pivot low

Stop loss

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Short-term patterns - Gaps

Opening gap

- Opening price for the day is outside the range of the previous day

- Prices may continue in direction of gap and then opening gap becomes breakaway gap, or price can retrace and fill the gap

- Downward openings a gap fill is not as common

- A gap fill will not occur in a breakaway gap

- If gap is not filled, usually in the first 30 minutes, odds are the trend will continue in the direction of the gap

- Three 5min bars (three-bar range) determine a range

- A breakout of range in direction of gap is likely to trend in direction of gap

- A breakout in direction of gap fill is likely to continue to fill the gap

- Range must be obvious

- Stop loss at range extreme

Short-term patterns - Gaps

Thank You

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