FOREX PRICE ACTION
SCALPING

an in-depth look into the field of
professional scalping

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Preface

Ever since the days of old, the markets have suffered no shortage of volunteers ready to sacrifice themselves on the ever-growing battlefields of supply and demand. Fortune-hunters, plungers, gamblers, misfits, and a motley crew of optimists and adventurers, all have roamed, and will continue to roam, the marketplace in search for quick-and-easy gains. Yet no other venture has led to more carnage of capital, more broken dreams and shattered hopes, than the act of reckless speculation.

Strangely enough, despite the ill-boding facts and the painful fate of all those who perished before him, the typical trader still shows up on the scene wholly unprepared. And those who do take the trouble to build themselves a method, in most instances seem to only postpone their inevitable fall. On the slippery slope of the learning curve, things can get pretty unpleasant and many never recover from the tuition bills presented on the job. Not surprisingly, this has led to an endless debate on the actual feasibility of profitable trading, in which skeptics and romantics fight out a battle of their own.

To the skeptic, no doubt, the glorified image of a consistently profitable trader seems highly suspect. After all, the only ones who have always prospered in the trading field, at the expense of the ignorant, are brokers, vendors and clever marketeers. And if it is already hard to picture himself a proficient long-term investor surviving the odds, then, surely, the idea of a consistently profitable scalper must be bordering on the idiotic. To see the skeptic's point, one only needs to follow the route of common logic: in a line of business where so many traders have tried, and failed, to successfully trade the long-term charts, those venturing out on the miniature frames can only be setting themselves up for an even uglier fate, and a faster one at that.

And indeed, the shorter the time frame, the more erratic the moves on the chart; and with spreads and commissions cutting deep into a scalper's average trade, the odds seem stacked against the enterprise from the very onset. Success stories are few and far between and it's hard to not take note of the sobering statistics that appear to confirm all reservations, at least way more than defy them.

That being said, skeptics and statistics, of course, should never demoralize the dedicated. Scalping the charts profitably on a consistent basis is by no means an illusion. Nor does it have to take years to acquire the necessary skills. It is done every day again by many traders all over the markets, and it can be done by anyone who is determined to educate himself properly and diligently in all aspects of the field. The true issue is not the feasibility of profitable scalping but simply the quality of one's education.

Even so, scalping may not be for everyone. If nothing else, this book could be an excellent way to find out. Its sole objective is to show the reader all there is to know about the profession to effectively take on the job himself. Countless charts, setups and trade examples will be presented to fully ingrain the necessary techniques into the mind.

The contract of focus in all of the coming chapters will be the eur/ usd currency pair. To a nimble scalper, this instrument is an absolute delight. It offers highly repetitive intraday characteristics, a low dealing spread and is accessible to even the smallest of traders; however, since price action principles are quite universal, not too many adjustments would have to be made to take the method to another market with similar volatility and attractive trading costs. In that respect, this guide may serve many non-Forex traders as well.

The benefits of scalping are plenty and speak for themselves. Just one single chart. No fancy indicators. One-click in and out. Everything preset. And opportunities abound in an almost repetitive loop.

Have a look at the example below. Figure P. 1 is a snapshot impression of what a scalper's chart of the eur/usd can look like. The vertical axis shows the price of the instrument; the horizontal axis displays the passing of time and the curved line in the chart is an exponential moving average, the only indicator allowed. The boxes encapsulate some of the price action patterns that we will get to discuss later on.

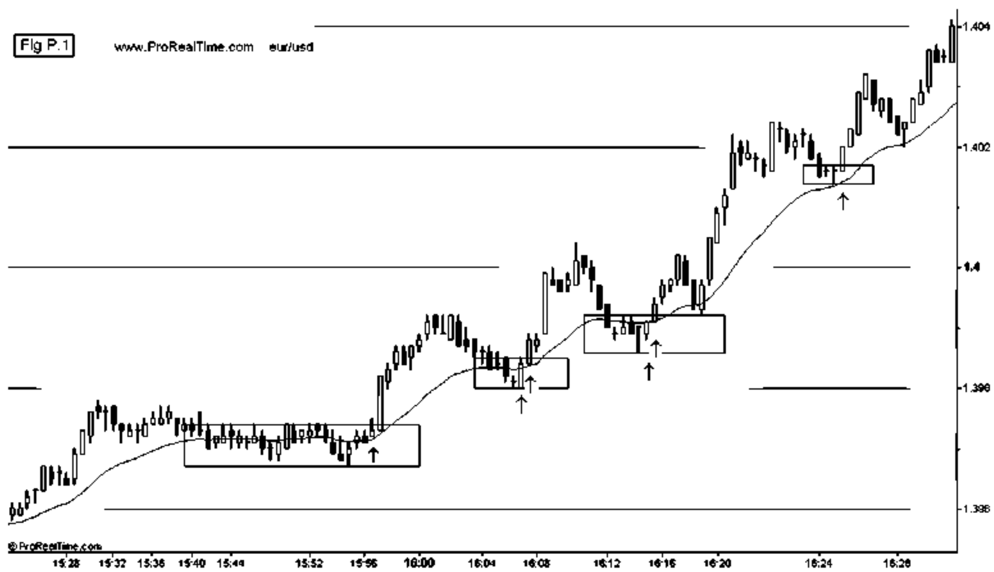

Figure P.1 In just a little under an hour, the market offered an alert scalper numerous textbook trades.

To build a solid foundation beneath a scalping method, it will not suffice to merely deal with the technical side of trade selection. We have to examine all aspects of the profession from every possible angle so as to filter potentially disruptive elements completely out of the equation.

Each of the coming chapters will take on a part of the journey. We will delve into the specifics of chart selection, price behavior, pattern recognition, favorable and unfavorable markets, setups, entries and exits, targets and stops, traps and tricks, psychological issues, accounting matters-basically anything that comes to pass in the field of professional scalping.

Whether a beginning trader, a struggling one, or even a veteran in other fields of speculation, I sincerely hope this book will be enjoyed by all and that within its pages the necessary information is found to be able to scalp one's way through the market for many profitable years to come. This work will not insult the reader's intelligence by showing him all kinds of stuff that do not reflect the reality of trading. There is no plowing through endless chapters of meaningless babble and industry gobbledygook. *Forex Price Action Scalping* truly *is* about scalping. It is written by a trader at heart, and at all times with the aspiring trader in mind.

Chapter 1

Trading Currencies

Since the advent of high-speed electronic trading platforms, it has never been easier to set up an online account to join the daily tug-o-war in the foreign exchange. Little demand is made in terms of capital requirements and even less on the matter of proficiency. Pick a broker, wire some funds, set up a chart and one could be trading in less than an hour.

As straightforward as this may sound, behind the curtains of online currency trading hides an immensely complicated network of central banks, institutional organizations, investment corporations, hedge funds and global market operators, all doing business with each other in amounts that simply defy imagination.

The foreign exchange resembles in no way the average stock market or futures pit where all shares and contracts are traded orderly in one place; it is literally a melting pot of over a million participants, big and small, scattered all over the globe, trading in every time zone, and it is well beyond comprehension how all this activity is meticulously tracked, processed and ultimately transfigured into the dealing quotes on everybody's trading desk.

The Forex markets spring to life when the currencies are compared to one another. Hence the so-called *currency pairs.* Barring the occasional exception, most countries allow their national currencies to be freely traded against other currencies, which can result in some pretty exotic combinations. There is no point in trying to figure out the reason why the market at any given moment shows preference for one currency over another. It could be monetary obligations, fundamental prospects, interest rate decisions, fiscal policies, hedging purposes, ordinary tactics - basically anything could cause the flow of money to shift from one side to another.

As much as this may bear little relevance to the small independent scalper, he needs to understand that he will be up against some of the mightiest opponents in the business. To level the playing field to an acceptable degree, he has to operate under conditions that will not put him at an immediate disadvantage. That means he has to find himself a broker that deals him fair prices.

It is no secret that brokers are often regarded as a necessary evil and when it comes to choosing one, the options are just as plentiful as they are obscure. It is almost impossible to find a company with unblemished reputation. Freezing platforms, widened spreads, failed executions, terrible fills, requotes, hostile helpdesks, funds gone missing—these are but a handful of complaints that pop up left and right. And indeed, doing business with a shady company can be quite a roller coaster ride. It should be stated, though, that broker experience has improved considerably in recent years as more stringent rules and regulations have forced the industry to shape up.

There are basically two ways for brokers to go about their business. They either offer the pairs to be traded at their current value in the market and for this service demand a commission, or they waive that commission in favor of marking up the spread. This is the somewhat controversial practice of allowing both buyer and seller to trade through their system at a less favorable price than the actual quote of the underlying pair. The difference is pocketed by the broker.

Accepting the latter concept can be quite a tricky venture, not in the least since this mark-up tends to be subject to rather questionable flexibility. It is not uncommon for a broker to lure traders into opening an account by advertising acceptable dealing spreads, only to adjust these spreads disadvantageously in a live trading environment. Needless to say, this could severely compromise a trader's plan of attack, if not fully disrupt it. The scalper in particular will be seriously affected. After all, he is the one paying the dreaded spread many times a day.

Still, it is safe to assume that the vast majority of independent traders are signed up with this type of company, the so-called retail broker, and for good reason. Whereas the commission type broker targets the more professional (or more capitalized) trader, the retail broker, in general, entertains a policy that welcomes all kinds of customers and even provides them with cost-free and very user-friendly platforms to boot

However, trading through these brokers does mean that one is not connected to the real volume of the market. Their platforms are essentially sophisticated copycats, mimicking the action created by the professional currency traders. This is not necessarily a bad way to trade, though, particularly when still operating on the smaller scale. When dealing with a reliable broker, it doesn't really matter whether the orders are sent to the market or not, as long as they are filled smoothly and correctly. Bear in mind, the Forex markets are not located on a centralized exchange, so, in a way, each and every order is a virtual one, true volume or not.

Since the spread, by far, puts a heavy toll on any scalper's daily business, the method in this book is designed around the one currency pair that should be able to meet all the necessary requirements of a tradable instrument: the immensely popular eur/usd contract. In terms of quotation, intraday opportunities and repetitive characteristics, this pair simply has no equal.

The aspiring scalper is advised, however, to only trade this instrument when dealt a spread of no more than 1 *pip* (price interest point) per round-turn. In the scalping business, it is a fine line between a winning strategy and a losing proposition, and that line may easily be crossed to the wrong side when the costs to participate surpass the 1 pip mark. If a broker cannot offer a scalper a bearable spread 99 percent of the time, it is best to look elsewhere. Even brokers advertising zero spreads in exchange for a commission should be carefully monitored. Reality has shown that one can still expect to pay half a pip in spread and another couple of pipettes (tenths of a pip) in commission. On some of the other pairs this may be the better deal but on the eur/

usd it usually boils down to about the same full pip spread per round-turn as with the no-commission model.

Despite the obvious need for caution when selecting a broker, there is no call for paranoia. The days of the scandalous companies residing on tax-friendly islands in the middle of the ocean are virtually gone. Nowadays, most funds are secured, platforms appear fast and stable and spreads are tightening more and more across the board. Almost every respectable broker will offer a 1 pip spread on the high and mighty eur/ usd pair, or else they'd lose customers pretty fast. But do take time to select. Download as much demo platforms as your screens can handle, check the order type functions for ease of use and make sure they can be set to one-click mode. Above all, carefuUy scrutinize their spreads for at least a number of days. It's all part of the job.

Many readers, no doubt, will have already gone through this process, one way or another, but those new to Forex are strongly recommended to diligently check out the available options and not just fall for hype and flashy looking platforms. It is vital to understand that broker platforms not merely facilitate one's trading ventures, they literally form a lifeline between death and survival in the markets. In order to fully concentrate on the task of scalping there has got to be total trust in the speed and accuracy with which the orders are handled. Nothing can be so disruptive and detrimental to one's peace of mind as a low quality platform or a malevolent broker in the back.

Once a scalper has set up his account, wired over some funds and decided on his market to trade, he now has to craft himself a chart to trade from. In our next chapter, we will look into the matter of setting up this one special chart that should be able to serve a scalper's needs and wishes perfectly, all through the day. And everyday again.

Chapter 2

The Tick Chart

Anyone who has ever picked up a book on Forex will surely have come across the typical bombast of how the volume in the eur/usd pair dwarfs that of all other financial markets combined. The fact that this market is the most actively traded instrument on the face of the earth is often used as a sales pitch by clever marketeers in the brokerage industry. But sheer numbers alone should not inspire traders to venture out in the currency game.

A more crucial factor to consider, apart from the mandatory tight spread, is the way an instrument behaves price technically on the chart. Within his frame of choice, the scalper needs to see the typical characteristics of a tradable market: an acceptable number of intraday moves, repetition in behavioral patterns, buildup before breaks, pull-backs, breakouts, trends, ranges and the like. In other words, a very technical market that meets the demands of a technical trader. Not too many currency pairs will do. The eur/usd pair, however, does not fail to oblige. With an average daily range of close to a 150 pip, the intraday moves on the chart are highly exploitable from the long as well as the short side and there appear to be plenty of opportunities in almost any session.

Of course, there are many ways to go about one's trading and strategies and tactics are probably just as plentiful as there are traders around. Most any method, when sound, will have at least incorporated all the universal concepts of crowd behavior and price action principles, as well as a specified plan to take on the chart from a more personalized angle. It is important to understand, though, that trading in general, and scalping in particular, is not a hobby or a game that one can pick up by flipping through a couple of charts. Aspiring scalpers who look upon the profession of trading as a get-rich-quick scheme will soon come to realize the folly of it and not uncommonly after having wasted a large amount of their capital in the disheartening process of getting-poor-quicker. As any struggling trader may tell, developing a strategy on a technical chart is one thing, taking that strategy to the market is quite another. As we will soon discuss, there is a lot more to it than initially meets the eye and all aspects of it demand equal attention.

Indisputably, the beating heart of any scalping operation is the tech-nical chart All a scalper ever needs in terms of information can be found within a single graph. Since there is little sense in trading intraday movements on fundamental vision, an aspiring scalper has no option but to get acquainted with all the specifics of price action charting.

But what chart should he look at? The time frames to choose from are practically limitless and surely there are pros and cons to each and every one of them. In a way, deciding on the source of information is a fine balancing act between opting for a chart fast enough to deliver mul-tiple opportunities throughout the day and one slow enough to still bear technical significance. Although all charts relentlessly monitor the ever-lasting battle between supply and demand, each frame will also have its own individual pulse. This can be measured by the length of the average moves, the buildup of pressures leading up to the breaks, the presence of tradable patterns and even by the way most classic tricks and traps will play themselves out. Once a trader decides on his chart, it is crucial to commit to it, to study it inside out, to learn how it breaths, moves and dances, to understand its beat.

A great chart to explore is the 70-tick. This is the sole chart we will be focusing on in all of the coming chapters and it is actually not a time frame in the usual sense. It forms a new bar after every 70 transactions (ticks) that take place among traders - regardless of volume - and on the eur/usd this should easily print a couple of thousand of bars in the course of a day. Sometimes this frame resembles a 30-second chart, but when volume picks up, it takes on a life of its own.

Note: Not all charting packages offer the adjustable tick chart setting (x-ticks), so it is recommended to check this out before subscribing to a provider. Furthermore, the actual tick count is dependent on the data feed connected to the chart. Since the decentralized nature of the foreign exchange does not allow for an absolute transaction count, volume data may differ from one provider to the next. The reader may have to experiment with the proper tick number in his personal graphics to produce a chart that approximates the setting of the ProRealTime charting package used in this book. This is no reason for worry, though. Close is close enough. In fact, if the tick count in all of our charts was set to something like 65 or 75, it really wouldn't have altered the patterns, nor their tradability, much. Within another package, however, the number may have to be set to something like 40 or even to a 100 or more. It all depends on how charting companies filter their incoming data. When comparing your bars to the ones is this book, look closely at the time scale below the chart and monitor also the average height of the bars. A calm market will show most of them in the range of 2 to 4 pip; a vivid trend may easily exceed that, but usually not for long, A good trick is to set the tick number to a level that resembles a regular 30-second time frame chart; if so, then you are very close. Bear in mind that Asian sessions (more or less from 02:00 to 10:00 in the examples presented) show substantially less bars per hour on a tick chart than do the European or American sessions; it is best to figure out the tick setting in the more active phases of the market.

Arguably, tick charts possess a distinctive advantage over time charts, primarily because the patterns in them are more compact in shape, which makes them somewhat easier to identify. When trading is slow, a tick chart will not print that many useless bars that flatten out the chart and take up unnecessary space; when trading is fast, it gives one all the more to work with.

This 70-tick setting is not a magical number, nor is it the best chart setting you will ever come across. Because such a setting simply does not exist. Choosing the source of information is a personal matter and depends very much on strategy particulars. Above all, we need a chart from which to time our trades with sniper precision. In that respect, the 70-tick mode captures the scalping beat of the eur/usd pair with remarkable accuracy. At times, following the bars on their march through the chart is like watching a brigade of colorful majorettes doing their routine. In many instances, these price moves may seem rather chaotic, complex or at least highly diverse, but to an observant eye the actual variables are quite limited. In the end, there are only so many moves choreographically possible before repetition sets in. It is this repetitive tendency of price behavior that we must try to anticipate in order to cleverly time our way into the market or to find our way out.

The 70-tick mode is a fast chart, but not so fast as to be completely disconnected from the more classic time frames used by plenty of others in the field. This is essential because we need those other players to come in after us to bring our trades to target. Basically, a clever scalper wants the majority of other traders to see the same thing, ride the same trends, catch the same pullbacks and trade the same breaks; he just wants to beat them to it.

This one single chart should be able to produce all the information necessary to make sound scalping decisions. Apart from a single moving average there will be no indicators messing up the screen. There is no need to know yesterday's high or low, whether the market is in an up or downtrend on a bigger frame, or if it is running into some kind of major support or resistance level from the day before. In fact, in most instances, it is totally irrelevant what happened a few hours back. A chart that shows about one and a half hour of price bars in one go should definitely suffice. The more information a scalper tries to cram into his chart, the more all this data will start to conflict. In order not to freeze up in the line of duty, it is best to not complicate the decisionmaking process, but rather to simplify it.

As for the technical side of our entries, there will only be seven individual setups to get acquainted with. These patterns form the core of the scalping method about to be presented. Each setup will be discussed in full detail, along with many examples taken from actual market activity. Entries and exits of trades will be pointed out precisely to the pip. All of these entry patterns will have both a bullish and a bearish version and serve to set up either a long or a short trade. Trend, countertrend, ranges, everything can be traded. When the objective is only a quick scalp, why discriminate. Allowing oneself the freedom to trade anything at anytime, that is the prerogative of scalping.

Chapter 3

Scalping as a Business

No matter how many years a trader has been active in the markets, the undeniable marvel of a price pattern coming to fruition will never cease to amaze the technical eye. One might think that the hundreds of books on crowd sentiment and technical analysis over the years would have fully destroyed the tradability of price action patterns, but nothing could be further from the truth. Just open up any chart, in any time frame, of any instrument, and before long the phenomenon unfolds.

These price moves are solely the result of traders with opposing opinions fighting it out in the marketplace. There are only two groups to distinguish: the *bulls*, thinking the market will go up, and the *bears*, thinking the market will go down. It is irrelevant whether they are in it for a short ride or a long ride, whether they are trapping other traders or showing true directional preference, whether they will fight till the end or betray their companions by joining the other team. The only thing that truly moves prices is their actual buying and selling of contracts at the present moment in time. If one group is more aggressive than the other, price will travel in favor of aggression.

It is widely believed that the activity in the chart is sending out clear signals as to who is currently toppling who in the market. There would be little point in technical trading if that was not the case. But that leaves us with a rather interesting question: If all these moves and patterns are so well-documented and their implications essentially unambiguous, why then is it so hard to succeed in the trading game? And even if the readability of the market was a false assumption and prices were completely random, rendering any strategy practically useless, why don't we see more traders break even instead of blowing their accounts with such laborious zeal.

We can safely state that at the core of a typical trader's misery lies a very simple fact that is often overlooked. The typical trader does not look upon his trading as a business. As a consequence, he approaches the market without a sound business plan. This is a classic and very common mistake that, strangely enough, somehow seems to come with the territory. In almost any other field, a sloppy attitude towards one's own profession will quickly stand corrected. Banks will not grant credit without seeing a proper business plan; partners will not hook up when confronted with a flaky organization; if one carries a flimsy product, customers will soon play judge and jury. Yet when it comes to trading, the freedom is overwhelming, the anonymity complete. A trader could simply decide not to take any responsibility at all, to hide himself completely in a make-believe world, to deviate at whim from whatever rules he laid out for himself and not give it a moment's thought. He has no customers to satisfy, no partners to answer to, no banks to please. As long as there are still funds left to trade, it is just so easy to entertain the illusion that things will turn around, that good times will come and that eventually the inevitable profits will come falling from the sky.

A trader should consider himself fortunate to recognize this absence of structure, and the self-foolery it brings about, before his funds run out. Interviews with top traders have discovered that even these widely acclaimed masters had to learn many of their valuable lessons the hard way and not having a proper plan was usually one of them.

But what exactly constitutes a proper plan in trading? Is it a bunch of rules that one should never break? Is it rigid formula to abide by? Is it a checklist to run before each and every trade?

Unfortunately, this is not so easy to answer. What works well for one trader may prove detrimental to another. Many professionals will surely have built themselves a method that leaves absolutely no room for freehand interpretation, whereas plenty of others would completely freeze up in such an inflexible environment. However, we can be certain that successful traders do share at least one common trait: they take their trading very seriously. We could say they have acquired the mindset of a regular business entrepreneur. It means they have invested in education, know their field well and do not indulge in unrealistic expectations. Since they understand the long-term aspect of their enterprise, they seldom get caught up in the heat of the moment. They are confident in what they are doing and as a result have no trouble putting capital at risk. They fully understand the cost of doing business and accept the losses that come with the job. They will not walk around with a checklist of dos and donts in their pockets, nor will they be constantly anxious about their capital at work or feel the need to check their bank accounts to see if they are up or down on the day. Even through times of adversity, they will remain calm and focused and always have the bigger scheme of things in mind. They operate from a structured frame. They are businessmen.

Although we may not be able to tell what exactly drives a trader to the markets, we can safely assume that very few will be attracted by the prospect of earning a living in yet another line of work. Many will have fled the monotonous drum of whatever they were previously engaged in, either discontented with their daily routine or with the wages earned. In search for a better life or income, many come to the markets accompanied by fantasies and dreams and, no doubt, a glorified vision of what it means to be a trader. Needless to say, the majority of them arrive totally unprepared. They may have picked up an introductory course on technical analyses and maybe got themselves all excited about the surprising simplicity of it all. Look at these patterns. Anybody can do this. Never mind the statistics. All the others must be fools. And with the fearless mind of the ignorant they burst upon the trading scene.

To avoid this very common route, or to escape it when already trapped, requires a totally different mentality. Without question, the single most important factor contributing to either success or failure in the markets is a trader's ability to distinguish fiction from reality. Much more than technical skill, mental health accounts for the decision-making process to run smoothly or not. But even people who have proven themselves fully competent and rational in other fields and vocations, when thrust into the markets, they are just as prone to emotional folly, false perception and irrational behavior as any ordinary fool. Such is the treacherous nature of speculation. In this line of work, one cannot depend on former achievements or powerful personal traits. When exposed to the markets, all previous images of the self can crumble in a very short space of time.

In a way, this process of self-destruction can be very beneficial. It is even argued that in order to ever reach the desired rationale of the master, a trader first has to pay the obligatory visit to the very depths of desperation and emotional despondency. If strong enough to survive and rise from the ashes of the self, he can then reinvent himself from scratch and emerge as a trader who looks upon the profession in a complete different light.

At some point in their careers, most traders, one way or another, will have to deal with this process and it may not be a pretty one, nor will it be pleasurable on the psyche. When dragged through this transitory stage, a disconcerted trader may deeply question all he knew about himself and even wonder if he is cut out for the job. It is all part and parcel of this wondrous business that can bring such generous rewards and misery alike.

It would be out of place for anyone not thoroughly trained in the psychological field to pretend expertise on the mysterious ways of the mind. All that can be offered within these pages is a personal take on these matters as seen through the eyes of someone who has traveled the rocky path himself. Even when dealing with the technical aspects, this guide serves no other purpose than that. Therefore, throughout this entire work, all relevant issues, whether technical or psychological, will be addressed from a very practical perspective.

But addressing just these two matters will not complete our journey into the realm of professional scalping. The viability of our method would be seriously compromised if we did not dig into the virtues of clever accounting as well. In a later stage of the book, we will take on this very crucial side of the business, in which the essentials of volume, risk-control and account buildup are extensively discussed. We will see how it is possible to substantially run up a small account, even when marginally profitable across the board. The aspiring scalper who is truly capable of looking upon his trading as a business will find this chapter most promising.

We will start out our journey by looking at the technical aspects first. The next chapter will take up the particulars of trade objective, damage control and order types. In a number of chapters after that we will run through all of the setups that form the basis of our technical approach. From then on, we will delve into the finesses of trade management, and further on into those of proper accounting.

Chapter 4

Target, Stop and Orders

Let us look realistically at the possibilities within a single scalping day. Many readers new to the ways of the faster chart will be anxious to know what kind of profits can be expected on a daily basis should one ever reach that pleasurable state of mastery. The answer to that is very straightforward. In trading, it is foolhardy to *expect* anything, so we best not go that route. Similarly, it would be silly to think one can simply switch on one's trading platform in the morning and start scalping away. At all times, the price action in the chart needs to align itself in a favorable way before we can even begin to think of trading a particular setup for profit. This holds up for any chart, regardless of time frame or instrument. On a scalping chart like the 70-tick, it may take minutes for something to set itself up, or it may take hours. To a smart scalper it is all the same, because he has no need for a trade. He will be able to idly watch the market from the sidelines, for hours on end if need be, and be totally okay with that. At other times, he will fire off his trades in quick succession, exploiting every possible opportunity a favorable market may present.

On balance, the 70-tick chart will offer numerous opportunities throughout the day. This tick frame is carefully chosen and it can serve a trader excellently in trending conditions as well as in slow and ranging ones. When planning a trade, however, it is of crucial significance to opt for a reasonable profit target that should be obtainable within the length of a typical move. Also, to not have the mandatory 1 pip spread weigh too heavily on our trades, we have to choose a minimum target that sufficiently offsets these costs without compromising the likelihood of it being reached. We also have to take our protective stop into consideration. Preferably, we will like to see it set as close to the entry as possible, but not so close as to run a risk of constantly getting hit before our position has time to prosper.

Obviously, these are matters to consider before delving into the heat of the market and they are best taken up as a rigid part of the method that is not to be tampered with. To neutralize the ever-present demons of fear and greed, it makes sense to prefer hard targets over adjustable ones. Many trading strategies are designed around the latter, though. The objective, no doubt, is to reap as much profit from a favorable market as possible. This may present a trader with the occasional huge winner, but more often than not, the market will turn sour on the trade and demand back a large part, if not more, of earlier profit. Naturally, there are ways to protect a profitable position with an adjustable stop. But that may cut short the proceeds prematurely. In the end, it is all a matter of choice and much of it depends on time frame and a trader's ability to cope with volatility and setbacks. It should be no surprise, though, that most *scalping* strategies are not geared towards catching that occasional huge winner but more towards reaping small profits from the market on a regularly basis throughout the day. In any case, our settings should not just reflect our personal desires; they have to comply with what is technically obtainable within the span of a typical price move on our 70-tick chart.

The following settings have proven their value over time and they are used in all of the examples discussed in this scalping method without exception. The target on each trade is a non-adjustable one and set to 10 pip of profit. Likewise, the stop is also set at a 10 pip distance from entry, but it is adjustable in the direction of the target only; either to close out a losing trade with minimal damage, or to close out a profitable trade that has lost its validity and needs to be scratched. Certainly, this will not prevent a scalper from getting fully stopped out on occasion, nor will it prevent him from exiting a trade that would have been a winner had he not hit the close-out button. Regardless of these outcomes, there is a fine technique that could be applied to help a trader decide on the proper course of action. In the section on Trade Management, we will deal with the subtleties of the so-called *tipping point of trade validity*. It is an exit technique that allows us to time our way out of a trade with the same precision as we plan to enter one.

Next to these price technical settings, we have to decide on the matter of volume per trade. This is where the currency market, more than any other, provides excellent possibilities. Whereas many stock or futures brokers demand a minimum commission to enter a position, making it rather expensive for the smaller trader, in currency trading the costs of stepping in are the same for both small and big participants in the sense that they are derived as a percentage of one's volume. A 1 pip spread on a full eur/usd contract of 100,000 units will equal $10; on a so-called mini contract of 10,000 units, it is simply a tenth of it, $1. This works out great because it allows a trader to start out as small as he likes without suffering an immediate disadvantage. Even most commission type brokers will only charge a trader a few pipettes based on his chosen volume, so that boils down to the same. It is a trader's personal choice to decide on his volume per trade. My advice would be to start out very conservatively until one slowly starts to come out ahead. In the section on Account Management, we will look into the matter of volume in more detail, and in particular on how to build up it up in stepwise fashion to effectively run up an account.

Note: The novice trader is always offered the opportunity to work himself through the learning curve on a papertrade account, trading virtual money; there are practical as well as psychological reasons why this may not be the best approach. It is recommended to at least apply a tiny amount of true capital, even on a micro scale of a 1,000 units, if need be. That way one stands to pick up the feel of actual trading more realistically and on top of that, the positions taken in the market represent true price levels and are based on actual broker fills. However, it could never hurt to explore a papertrade account for a number of days to get acquainted with all the particulars of order tickets and the such.

Being content with a relatively small and predefined profit target like

10 pip is arguably one of the better ways to scalp the eur/usd. All else equal, striving for very obtainable targets is a much more relaxed way of trading than aiming for extensive profits that may or may not be reached. And what's more, pocketing a 10 pip profit on a trade does not forfeit the right to nimbly re-enter and scalp another 10. Scalping 20 to 30, or even 40 pip out of a 60 pip swing is definitely not uncommon in a favorable market. Add to this the potential gains from a plethora of meaningless moves - that would most likely have produced zip profit on any of the bigger time or tick frames - and one may even start to appreciate all the senseless backing and filling of the market that could go on for days without direction, yet is still very likely to produce countless scalping opportunities.

Nowadays, almost any trading platform will provide a variety of ways to execute a trade. Next to the mandatory market and limit orders there may exist a whole array of esoteric order types that allow for a specific entry and exit techniques. Since scalping requires split second execution, we will keep things extremely simple and only use orders that will be executed either *automatically* by the platform or *manually* in one-click mode. This means we have to be able to set them beforehand to represent the right amount of volume and distance from entry. So, before choosing a broker and the platform that comes with it, a scalper has to make sure the following options are provided.

On the entry side of our method, we will only make use of the market order type. There is no fumbling around with limit orders in the scalping game. If we want in, we simply click the buy or sell button the moment the market hits our chosen level of entry.

Since we already decided on a 10 pip target and a 10 pip stop, it makes sense to have the platform send out these orders automatically the moment we take position in the market. This is referred to as the very popular *bracket order*. When engaged in a *long* position, anticipating higher prices, the target order pops up automatically 10 pip above our entry and the stop order 10 pip below it. Conversely, in a *short* trade, anticipating falling prices, the target order automatically shows up 10 pip below our entry and the stop 10 pip above it. If either of these orders are hit, whether for a profit or a loss, the order at the other side is automatically canceled. Hence the order also being referred to as an OCO, One-Cancels-the-Other.

If the bracket order is set properly, a trader, when in position, could basically leave his screen and come back a little later to either a 10 pip profit or a 10 pip loss. The target order, when hit, will be executed as a limit order, meaning it will be filled at precisely 10 pip from entry. The stop order at the other end is always a market order and once hit it will close out the trade either for a 10 pip loss or slightly worse than that. By the way, depending on the size of one's spread, on most platforms the stop order may have to be set at a distance of 10 pip minus the spread. For the purpose of simplicity, in all the coming chapters we will assume the 1 pip spread to be standard. Eventually, competition will force the spreads to go down even more. At the time of writing, the no-commission type 1 pip spread and its half-pip commission type counterpart seem pretty much industry standard.

It is the very nature of a market order to occasionally occur some *slippage.* Since it represents an order to be filled at any price the moment the market hits a particular level, there is the possibility of the market moving away from that price (after first hitting it) in the split second it takes the platform to work the order. In speedy market conditions, this may result in a less economical fill (occasionally, it may even work to one's benefit). On the good side, if a trader wants out or in, a market order will always be filled. A limit order, on the other hand, is set to be filled at a specified price, which brings with it the risk of either missing the trade (by not getting filled) or not being able to get out when its time to get out. For this reason, we will only use market orders to get into our trades and to exit them manually in case we need to bail out before the limit order of the target is reached.

Using the bracket order option and then let the market cast its verdict on the trade is a pretty relaxing way of managing an open position, but it may not represent the most effective approach. Arguably, a better way to go about it is to follow the price action attentively from the moment of entry and look for technical clues in the chart that could possibly negate a trade's validity status. Of course, this level to get out will be determined on technical grounds. This is where our tipping point technique comes in.

To close out a trade, we simply hit a market order in the opposite direction. For example, if a scalper fired off a market order to open a long position with, say, a full contract of a 100,000 units, a simple click on the sell button will flatten his position (close out) in an instant, because this order will send a 100,000 units the other way, bringing the position from open to flat. Depending on one's trading platform, this could also be done by hitting a close-out button. However, many less sophisticated platforms will not offer this option in one-click mode (after hitting the button, it may ask for confirmation to close out the trade, a setting that can not always be unchecked).

At all times, we should strive to send our orders in one-click fashion. In doing so, inexperienced traders may occasionally slip up by hitting an order to exit not in the opposite direction but accidentally in that of the original position. Instead of flattening out, that will leave them with a double open position. It happens. If a one-click close-out button is not offered and the opposite order technique provokes anxiety, then a way to go around it is to immediately hit the close-out button the moment an entry is taken. That will pop up the confirmation ticket, which can then be activated with a click of the mouse when it is time to exit the trade.

An excellent way to set up one's order tickets is to show the buy and sell buttons in a small window on top of the chart. To do this without having them ever disappear behind the chart, a platform should provide the option of showing the tickets *always-on-top*. That way, they will always remain visible, even if the chart is touched with the mouse.

In this fashion, a trader has only one screen to look at. It will show him the technical chart and allows him to enter and exit with a simple click of the mouse. Another reason why the single screen setup is preferable is because it hides all other information from view. Once in position, all we have to monitor is how the market responds after our entry. We have no need to know the status of our account, nor the current loss or profit on the running trade. That kind of information is not only useless, it may affect the decision-making process in a non-desirable manner (fear or greed may kick in). It is vital to realize that mental stability, more than technical skill, is the most important ingredient in the process of doing what needs to be done. The more we create ourselves an environment that protects us from harmful distraction, the more we will be able to focus on the chart and diligently execute our plan.

attention to the forces that oppose his potential trade as to those in favor of it. He will show no preference for direction, nor will he try to predict the next coming move. At times, he may take a conservative stance; at other times, he will show more aggression. It is all up to the scalper. But whatever he does, he will make sure it is in accordance with his personal method or else he will not put his capital at risk.

A tiny little edge can go a long way; it could even run up the smallest account to any desirable height. But it will only serve those who understand to concept of probability and the long-term aspect of it.

Now let's find out how all this relates to a 70-tick intraday chart of the eur/usd currency pair. It is time to let the charts do the talking.

Chapter 6

The Setups

Scalping a market profitably requires a very disciplined mindset and a carefully chosen array of trade setups that allow for a minimum of freehand interpretation. Even the novice trader will quickly come to understand that simply shooting from the hip is the fastest way to blow up an account- The problem lies in the misleading assumption that a trading plan is in place when in fact there is no such thing as a solid plan at all. This can be a painful basis to trade from and it is not uncommon for even the promising trader to be fully unaware of it. Especially when there are some successes along the way, a trader may be led to believe that he is doing everything right, even though his results keep lagging far behind the potential of the strategy at hand. More often than not, this will bring all sorts of negative emotions into play, such as frustration, anger, agony, vengeance, fear—ultimately pushing the baffled trader only further downhill. When it comes to trading, misinterpretation of the notorious rut is not exactly atypical and often leads to an erroneous revision of the original plan, if not a total distrust towards the setups used. And so the dire quest for the holy grail can start all over again.

Fortunately, there are ways to avoid this very predictable route and it starts with looking at the plan from an analyst's perspective. Strip that trading plan to the core and analyze it as if it were somebody else's. Put this plan to the stand and let it defend itself. This is no time to be gentle on it See how this plan holds up under severe cross examination and find out if it is guilty of either vagaries or deceit. If this is the plan that will accompany a trader in battle, better make sure it will not crumble apart under enemy fire.

A number of questions need to be thoroughly addressed before any trading plan could ever pass the viability test. Are the setups well defined? What are the conditions to trade them in? What are the conditions to stay out of the market? What target objective accompanies what setup? When is a running trade no longer valid? How to exit an invalid trade? What is the maximum stop-loss level on the trade at hand? When it looks like a setup but differs slightly, can it be traded? How to handle missed entries? How to handle slippage? When to scratch a valid trade? How to handle a new setup when already in position? And probably much more of this.

And these questions are just addressing the technical mechanics of the plan. We haven't even touched upon the psychological pitfalls that await any unprepared trader for sure.

As already stated, a trading plan, by itself, is not a checklist of dos and don'ts. That kind of rigidity will only serve to stifle a trader in a field of work where he may need to be flexible more than stiff-minded and apply logic more than rules. For the market itself is never rigid and no situation will ever present itself exactly as it has done in the past.

Arguably, the best way to obtain an understanding of what scalping is about is to dive into the waters and learn to swim with the sharks. Yet very few will survive the audition. Fortunately, there is a much healthier way that is almost just as effective, which is to rehearse every imaginable situation beforehand by studying countless examples of setups, trades, half-trades, missed trades, re-entered trades, and basically anything that might occur in the line of duty. The coming chapters of this book will have that mission in mind and hopefully provide most of the answers to the questions above.

This second section is dedicated specifically to identify the seven setups that make up the technical core of this scalping method. But it is important to understand that the setups by themselves have very little meaning. They are just tools to get us into the market. Our first aim is to assess the overall price action in terms of possible future direction. Only when the current forces in play put pressure on prices more one way than another can we begin to consider deploying our entry techniques. In a later stage of our technical journey, we will discuss when and why to forgo even the best looking setups on account of unfavorable conditions.

Every setup has its own set of characteristics although some of them can appear rather similar in structure. It is not uncommon for one setup, at a particular moment in time, to contain all the makings of another. Some setups perform extremely well in trending price action, while others set themselves up to exploit the many ranging phases of the market. Most of the setups will appear several times during the day, yet the conditions under which to trade them may not always be optimal. Furthermore, not every taken trade will lead to the desired 10 pip profit—far from it—but overall these patterns should provide the disciplined scalper with enough opportunities to come out ahead in virtually any session, although that should never be an objective by itself.

To identify the particular setups, all of them are named according to their main characteristic and each will have a chapter of its own to study its specifics in detail.

The setups are:

1. DD. Double Doji Break
2. FB. First Break
3. SB. Second Break
4. BB. Block Break
5. RB. Range Break
6. IRB. Inside Range Break
7. ARB. Advanced Range Break.

All of these setups, one way or another, revolve around the 20-bar exponential moving average, the *20ema*. This widely followed indicator plots the average closing price of the last 20 candles (bars) with a slight tweak in calculation (the exponential), giving the present closing prices somewhat more weight than the earlier ones. Some traders may prefer an 18ema or 21ema, but that doesn't really alter much. Any number of bars between approximately 15 and 25, either exponentially plotted or as a simple moving average (sma), will usually give the short-term trader a dependable guideline as to whether the market is currently trending or merely drifting sideways. Is the average sloping up, most traders will be operating on the buy side (go long); is the average sloping down, traders will look for entries on the sell side (go short).

The average can also be used to anticipate a shift in price direction when it is going from sloping to flat or from flat to sloping, and in many cases it can almost literally push prices out of a sideways pattern. When the average is not trending but more waving sideways, with prices not staying on one side of the average but alternating above and below it, it acts as a warning sign to be more selective in picking trades. The market apparently has entered a very indecisive phase that needs to be cleared up first.

Faster averages, like 15 and below, track price even closer but have the tendency to be constantly breached by individual bars without the trend really changing; the slower averages, like 30 and up, tend to point out the trend rather well, but, to a scalper's fine taste, may be lagging behind too much or simply produce too little setups.

Bear in mind that this 20ema should always act as a guide, not a law. Sometimes a trader may even have to discard it. Frankly, it is perfectly possible to trade the markets without it, but overall its visual value will be proven in almost any trade setup and since it doesn't clutter up the screen, it is a great average to have in the chart.

In a bullish trending market, with the average sloping up and most of the candles traveling above it, the safest trades are to the long side and so a trader should be on the lookout for setups to go long, preferably in the vicinity of the 20ema.

In a bearish trending market, with the average sloping down and most candles traveling below it, the safest trades are to the downside, so a trader should be on the lookout for setups to go short, preferably in the vicinity of the 20ema.

In topping markets or heavy chart resistance, when prices cannot seem to make further advances, a trader should look to go short but still have an open mind towards going long.

In bottoming markets or strong support, when prices cannot seem to make new lows, a trader should look to go long, but still have an open mind towards going short.

The Double Doji (DD), the First Break (FB) and the Second Break (SB) are typical w*ith-trend* setups, meaning that they deliver their best results when originating from a *pullback* situation in a strong visible trend. A pullback is a number of bars that travel in the opposite direction of the trend. One could say that the trend is temporarily taking a breather by allowing prices to go against it. It is also referred to as *countertrend* traders countering the trend. The general assumption, however, is that the pullback in a trend is ultimately short-lived and that a true trend will soon pick itself up. With-trend traders, using their with-trend setups, try to capitalize on that continuation, and, thanks to the pullback, at more favorable prices to boot.

The Block Break (BB) is seen in all markets, trending and ranging, topping and bottoming. The Range Break (RB), Inside Range Break (IRB) and Advanced Range Break (ARB) are setups that appear in side-ways markets and topping and bottoming markets. Range formations could also appear in trending markets, but since these consolidations, by nature, are somewhat extended, it is best to look at them as stand-alone patterns and trade them without too much regard for the current trend.

When it comes to the difference between a pattern and a setup, both terms can be used interchangeably, for a setup is always a pattern, even if it contains only one bar. But technically, the term *pattern* is mostly used for a somewhat larger formation or a number of bars in which a smaller formation, the *setup*, can appear. This setup formation will then be used to trade the break of the bigger pattern.

Despite the sometimes confusing terminology, trading, of course, is first and foremost a visual endeavor- However, getting oneself acquainted with the names appointed to each individual setup may actually serve a structural purpose as well. On the brink of taking a trade, identifying a particular setup, by naming it, will lessen the tendency to shoot from the hip. The names by themselves are not significant. Let's start by examining the DD setup first.

Chapter 7

Double Doji Break

The Double Doji Break (DD) is the most straightforward setup in the method and is just as easy to identify as it is to trade. For those readers not familiar with the basics of candlestick charting, a doji is a price bar (candle) with more or less the same opening price as closing price. Prices may travel up or down within the duration of the bar, forming bar extremes (tails), yet if they return to the area of the opening level upon the closing of the bar, then we are dealing with a doji. In any bar, the area between the opening price and the closing price is called the body. The price levels outside the body are called the tails of the bar. In case of a doji, the body is almost non-existent since the opening and closing price are more or less the same. These bars are essentially a sign of market indecision. When the chart prints another doji next to the first, the temporary indecision obviously builds up. In most instances, however, a brief stalling of prices bears little significance; but when two or more dojis appear in what might be the end of a pullback to a nice trend, somewhere in the 20ema zone, a trader better place his finger on the trigger and get ready to trade.

Once prices have retraced about 40 to 60 percent of the most recent swing (due to the activity of countertrend traders), the original trend stands a good chance to resume. It is fair to imagine that a large number of traders who missed out on the move will not let this opportunity escape. Grateful for the more attractive levels to trade from, they will fire their orders with-trend the moment they sense the pullback to peter out. This is a well-trodden strategy, and a clever one at that. After all, more attractive levels not only reduce the potential loss on a trade, a trader also stands to reap more profit from the trend should it indeed continue on its march. Still, it can be a tricky proposition to decide when exactly to step in.

In the scenario of a waning pullback, countertrend traders face an important decision of their own: either book their profits and get out of the way, or hold on still, in anticipation of more countertrend activity, or, who knows, even a complete failure of the trend.

It is impossible to predict whether a pullback is just a harmless little countertrend, or the beginning of a new trend in the opposite direction. But that is essentially irrelevant. In a probability play, we have no need for guarantees. We just trade probability. And trading a pullback situ-ation in the area of the 20ema is simply one of the better ways to enter the market with-trend on any chart. However, we do have to assess the validity of the trend itself.

A firm trend on a 70-tick chart is characterized by having the major-ity of bars close in the trend's direction, while at the same time these bars, on average, are a few pip taller than the overall bar in a non-trend-ing market phase. We could say that trending bars look somewhat more aggressive than non-trending ones. In our charts, a bearish trend will print mostly black bodied bars (closing price lower than opening price); a bullish trend will print mostly white bodied bars (closing price higher than opening price). Logically, in the pullbacks the coloring will mostly be reversed. Therefore, a nice white bodied uptrend, for example, will show a smaller black bodied pullback. Assigning colors to the bodies is just to aid the visual process of recognizing price action. Many traders have no need for it and they may have their charts set up in one-color fashion.

In all its simplicity, the DD setup is a powerful tool to capitalize on a continuation of a trend and in most instances it is best acted on without second thoughts. The trend itself does not necessarily have to be overly explicit for this setup to prove its value; in fact, it could even be a new-born trend—in essence, a fresh move that just broke out of a sideways consolidation phase. An important requirement, though, is that prices, from the moment of entry, have to have a clear path ahead of them, at least on the chart at hand (we wiE never know what looms in the dark). Therefore, the DD trade should only be taken in the absence of immediate *chart resistance,* meaning the path to the 10 pip target should not be blocked by visible clustering price action not far to the left of the setup.

Not uncommonly, it is the pullback itself that obstructs the path to target. The pullback, when deemed harmless, is ideally running diagonally against the trend and pretty much one-directional. When it presents itself as a block of clustering and sideways trailing price bars, it could seriously cut short a future advance or decline. Some examples will clarify this for sure.

The dojis in this setup do not have to be dojis in the absolute sense. Small candles, usually no more than 3 pip in length, are best considered to express similar indecision as any regular doji and therefore can also serve as valid candles in this particular pattern. The more compressed the doji bars are compared to the overall price action, and in particular to that of the trend, the better the market's current indecision is displayed within the DD setup. In contrast, the smaller the average bar in the trend, the less the DD setup, with similar small bars, will stand out among the rest. It is not uncommon, in these cases, for the market to show a rather subdued reaction to the break of the DD pattern (if at all).

In all instances, a trader has to call on his personal experience to determine whether the current technical conditions are supportive enough to engage in a particular setup play. In other words, due to circumstance, he may have to skip what appears to be a solid setup on its own. In Chapter 15 on Unfavorable Conditions, we will look into this more closely. For now, it is best not to worry too much about the subtle-ties of skipping or taking trades. In general, most setups will show up under conditions that will not put much strain on the decision-making process. We either trade the setup or we just skip it.

Note: Although we should basically *strive* to scalp the chart like we would in the safety of a solid backtest, obtaining similar results in the actual market will be extremely difficult, if not completely impossible to achieve. Therefore, as much as even a thin edge theoretically should hold up over time, it may not do so when taken into account all the situations that could affect its potential. This is the main reason why so many strategies that show excellent performance records derived from historical testing simply fail to deliver when taken to the real market. Because they do not incorporate the disruptive effect of the human hand. The solution: refraining from strategies that show a marginal edge under ideal circumstances. It is not the strategy itself that should be distrusted, though, just the crippling effect of those at helm of it (ourselves included).

Ideally, all bars in a DD setup show equal extremes on the trend-side (the side from which the break is to be traded), but more often than not that is just not the case. For this reason, the most important candle to watch in the DD setup is the one with the highest high - for possible long trades - or the one with the lowest low—for possible shorts. The position of this bar in the doji group is irrelevant; its extreme on the trend-side, on the other hand, is crucial. This bar is called the *signal bar*. When dealing with a setup in the making, the signal bar is the one to watch most attentively. The moment its trend-side extreme gets taken out by another bar, we've got ourselves a signal to trade. The bar that takes out the high or low of this signal bar is called the *entry bar* Obviously, this is the bar in which to take position. This terminology holds up in all of our other setups as well.

One more distinction can be made regarding the tradability of the pattern. When the setup is currently showing two dojis that have their trend-side extremes more than one pip apart, the pattern has to be judged in relation to the trend before it to see if it is still eligible as a tradable event. In case of a rather weak trend, for instance, it may be wise to skip the DD trade altogether when the extremes are more than one, but certainly more than two pip apart. In a very strong trend, on the other hand, it may pay off to be less conservative and just trade the pattern on a break of the extreme. All this will be clarified in the upcoming examples.

Before we get to the charts, let us walk through a DD setup example and see how it is best approached in the situation of a possible upside break: Once the uptrend has been identified, either well on its way or just starting out, it is simply a matter of waiting for a pullback to emerge. The 20ema should now be sloping up with most bars traveling above it. At some point, the trend may lose a bit of steam and a number of bars will start to travel in the opposite direction, towards the average that is. Not long after, average and price may collide. Since the trend is up, this pullback is widely considered to be a temporary event and so a lot of scalpers will be watching the possible low of it attentively. It would be silly just to fire a long order on account of prices reaching the 20ema. It is better to watch out for some sort of sign that prices may be about to reverse. Watching a bar pierce the average to the downside, for instance, only to see it quickly close above it again, is a pretty good starting point. In case the current bottom of the pullback is represented by two or more neighboring dojis, more or less resting on the 20ema (their tails preferably dipping below it), a scalper calmly waits for a new bar to take out the highest high of the doji group. By definition, the high of any signal bar is taken out when the current price bar in the chart goes exactly one pip above it. Upon seeing the signal bar being taken out by another bar (the entry bar), the scalper immediately enters long at the market

In the event of a downtrend and a potential short position, all of the above is simply reversed: once the inevitable pullback emerges and prices arrive at the now down-sloping 20ema, the alert scalper will start to monitor the price action with close scrutiny, comfortably knowing that a number of setups are at his disposal to trade this market from the short side. Once he spots two or more dojis colliding with the average, and then another bar that takes out the lowest low of the pack, he knows he is dealing with a DD break and he will fire an order to sell an already predefined number of units at that spot. This sell order, when set properly, will be instantly bracketed by a 10 pip stop above the entry price and a 10 pip target below it.

It is important to understand, though, that the highly regarded 20ema is just a tweaked moving average of the last 20 closing prices and does not in any way offer support or resistance to the market on account of its presence. It does point out a dynamic visual level of where prices *tend* to stall when countering a particular trend. But that, most probably, has more to do with the seesaw characteristics of the market than with the average itself. Quite similar to the two-step-forward-one-step-back principle. This 20ema just so happens to catch the bulk of the pullbacks quite well. On any chart. Hence its practical usefulness. Admittedly, there may be a strong self-fulfilling prophecy aspect attached to this average, but then again, that basically holds up for price action in general. A clever scalper will not concern himself with the actual reasons behind the, moves in his chart. For there is no point in speculating over other traders' motives. All he has to go by is what takes place in the chart on a recurring basis. And his task should be to exploit repetition.

Now let us see how the DD setup, the first in a line-up of seven, is effectively traded in the real-world environment on a 70-tick chart.

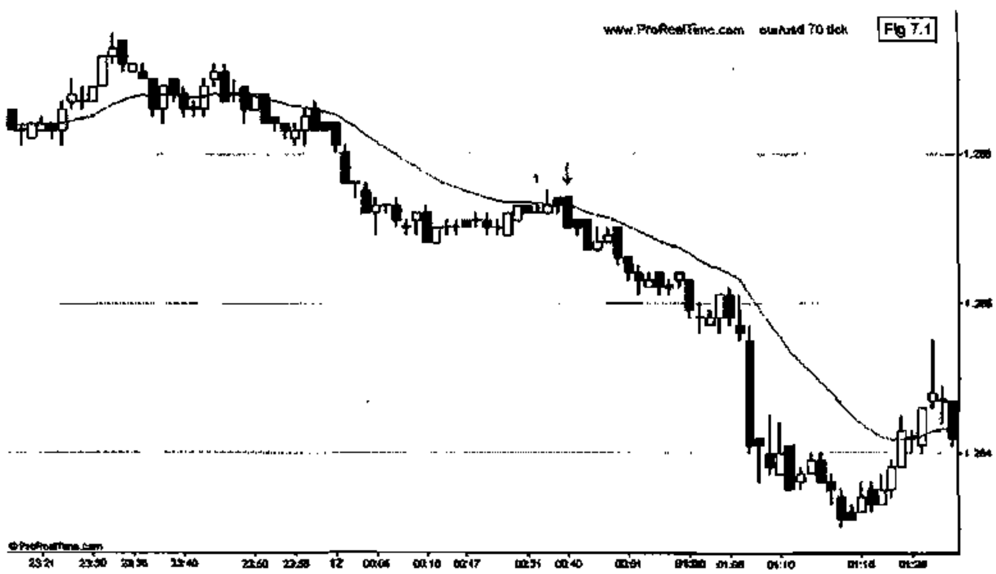

Figure 7.1 This first chart shows us a classic DD break example. In this case, no less than four dojis had formed into the 20ema zone (1). One of them broke the average briefly to the upside, but all four of them shared equal lows below it. True, the pullback was more a thin horizontal string of price bars than a diagonal move against the trend; as a result, it did not really bring prices any closer to those players on the

sidelines. But that is not necessarily a requirement. The very fact that prices are unable to travel against a trend often betrays a lack of coun-tertrend interest. This could very well be interpreted as a with-trend play incentive. Not uncommonly, sideliners harboring with-trend views on the market only need to see a tiny break in the direction of the earlier trend to deploy new with-trend positions at the speed of light. One price bar taking out another bar's high or low by a pip can already trigger a waterfall of with-trend orders cascading into the market. This activity could leave a serious trail of countertrend sorrow in its wake. In many instances, the degree of with-trend aggression *after a* pullback mimics the strength of the trend *before* it. In this chart, for instance, the follow-up action between 00:40 and 01:00 is very similar to the pre-pullback action from 23:58 to 00:10. This *trend-equals-trend* principle is only a rule of thumb, so by no means a rule, but it is handy to keep in mind when contemplating the likelihood of a possible 10 pip ride. The weaker the trend before the pullback, the more any potential chart resistance after it might play an obstructing role. In general, the most dependable DD setups are the ones occurring at the end of a one-directional, diagonal pullback in a very strong trend.

Each of the four dojis here could pass as a signal bar, because they all share equal lows. The arrow in the chart points towards the first bar that took out these lows, and this bar is therefore called the entry bar. A scalper does not wait for this entry bar to finish. The moment it takes out the signal bar's low, by traveling exactly one pip below it, a market order is fired and the short trade is on.

Note: It should be stressed that no matter what charting software the scalper holds preference to, the bars in it should have a price scale in increments of one full pip. The trading platform may show prices in increments of pipettes (tenths of a pip), but that will not do for the chart. If this is neglected, a series of price bars with otherwise equal extremes will most probably show a jagged edge of fluctuating extremes, making it seriously harder, if not impossible, to determine a proper break level to base an entry on. If this could already pose a problem in the event of a simple DD setup, then it will certainly do so when it comes to the more streamlined setups that we get to discuss later on.

Furthermore, it is strongly recommended *not* to use the chart on the trading platform as the source of information, even if it offers the tick chart setting and is set to 1 pip intervals. Get yourself a decent stand-alone package solely for charting purposes and leave the trading platform completely running in the back. Do make sure, though, that the price in the chart corresponds with the bid-ask spread on the trading platform. Monitor this carefully. Sometimes the *bid* will resemble the price in the chart, at other times the *ask* is more close. It may differ a few pipettes here and there, which is only natural; but if either one is constantly off by more than a pip, then something is not right. Logically, the tighter the spread, the more chart and platform will align. If it doesn't look right, either change broker or charting provider until you get them both to align.

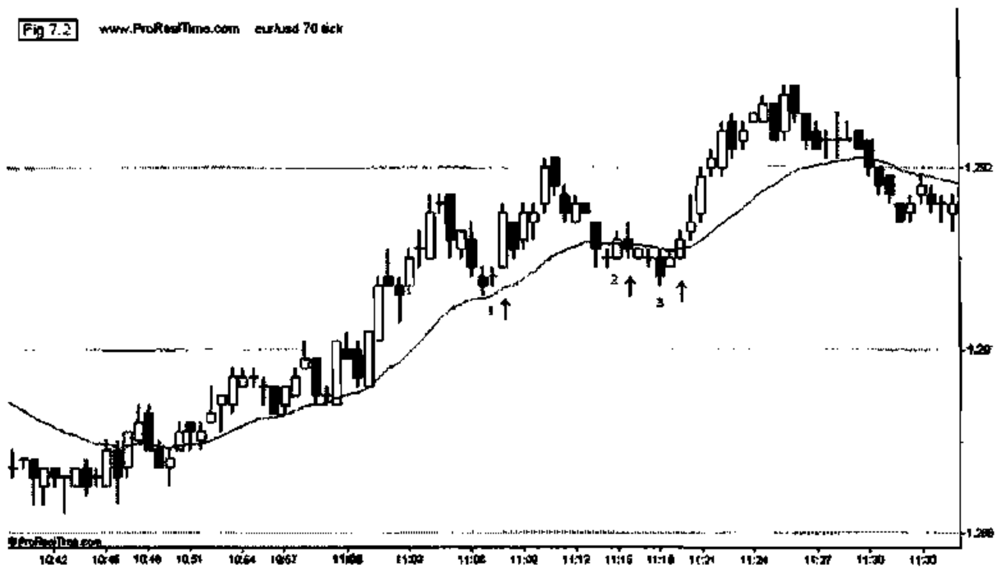

Figure 7.2 Look how small the two little dojis are (1) compared to most of the other candles in the trend. This exhibits the compressed indecision a scalper likes to see. Any trend, no matter how strong, will have puUbacks in it. That is just the nature of the markets where so many opposing ideas are traded up and down. A trader may not like it while in a trade, but when seen from a sideline perspective, the pullback brings

great opportunities about. For instance, to trade a nice little DD in the 20ema, like the first setup in the chart above.

The second DD setup (2) broke eight minutes later. There is nothing wrong with this particular trade. The setup is slightly inferior to the first since the doji highs are not equal but two pip apart. Still, there is no technical reason not to take the trade. The trend is clear and so is the pullback. Fact is, though, that this trade would have had to be scratched for what looks like a 7 pip loss when price dipped below the setup lows (don't worry about the exits yet). It shows us actually a very good example of how important it is to immediately accept any loss as just a cost of doing business and to remain on the alert for another setup in the same direction. Not from a vindictive stance towards the market, but simply because the chart may still be eligible to be traded in the same direction of the earlier trade. Any proper setup will do. In this situation, the market printed another DD pattern just a few minutes later (3). Have a look at the four little dojis, all with equal highs pushing against the 20ema. The moment this tiny block of price action was broken to the upside, with-trend players quickly stepped in. And equally fast, countertrend traders ran for cover.

Note: By definition, when a countertrend trader bails out of his position, he can only do so by fixing a with-trend order, turning himself into a with-trend trader, whether he likes it or not. When enough countertrend traders are forced to bail out (to protect themselves) and at the same time enough with-trend traders step in, the chart is likely to show a continuation of the trend because of *double pressure* in the trend's direction. And vice versa for with-trend traders who are forced to bail out due to strong countertrend activity. That will turn a with-trend trader in a countertrend one the moment he bails out. The principle of double pressure is a crucial concept to grasp; in fact, it forms the core of our edge in the market. If we cannot picture double pressure to kick in, we simply do not put capital at risk.

Figure 7.3 Here the downtrend was unmistakably strong. Just look at the many tall black bars in it and compare them to the smaller white bars in most of the pullbacks. Still, that does not mean that all bears are on board. It just shows a temporary lack of bullish enthusiasm. In fact, it is fair to assume that the sharp downswing in the first half of the chart caught many bears by surprise. As a result, there will always be a large number of traders on the sidelines with only one thing in mind: to find a tradable pullback to get in on the party, and sooner rather than later.

It can be a painful sight to see an obvious trend take off and not be in it, but patience and discipline need to be practiced. The pullback will come. If it does not set up a proper trade, then so be it. In this chart a very tradable DD setup emerged once prices finally reached the 20ema (3).

As far as the DD setup is concerned, basically three things can hap-pen when a pullback approaches the 20ema. Let us look at it from the perspective of a downtrend. 1: The highs of the dojis barely touch or not even touch the average before prices turn south again and break the low of the DD. This could be traded in a very clear trend but every now and then it may suck a scalper into the market a bit too early, meaning the pullback may not be quite finished yet and is likely to have another go at the average. It is not uncommon for this kind of price action to activate the exit strategy. It should be noted that countertrend traders, the ones causing the pullback to happen, can be very persistent. But how can we blame them. They just want to make a profit and show guts in their attempts. Should they manage to take control of the 20ema and keep prices above it, the first part of their job is accomplished, for they have turned the trend from down to sideways (at least temporarily). 2: The dojis (or just one of them) pierce the average, but are immediately pushed back and close below it again. This is arguably the most favorable way to trade a DD. A good example of it is the first DD setup in this chart. 3: The dojis pierce the average but are not pushed back so easily. This is the somewhat riskier version because it shows conviction in the pullback. Still, it can be very tradable, provided the trend is very strong and the break of the low of the DD is not occurring too long after the average was taken back. Once a number of bars start to rest on the average, using it as support (relatively speaking), turning it sideways or even lifting it up, the market may be dealing with a trend change. In these situations, it may be wise to wait for a more distinctive setup like a SB or BB (see Second Break and Block Break, Chapters 9 and 10),

The second DD setup in this chart (5), although less attractive, is still very tradable. The first doji in the setup is the one that pierced the average. The two neighboring doji bars remained below it. This setup is slightly inferior to the first on account of the distance between the highest low and the lowest low. It is two pip apart. Preferably, we like to see the extremes just one pip apart, or better yet, have equal lows. However, with a downtrend still very much in tanking mode and the pullback being very orderly and diagonal, this setup is good enough to trade.

It may be interesting to compare for a moment the first DD setup at (3) to the situation at the end of the chart, at (8). Here we can see why the latter setup, a triple doji pattern in the 20ema zone (technically a DD), is best skipped on account of its inferior quality. There are a couple of reasons why that is the case. First of all, the pullback leading up to the three dojis it is not an orderly, one-directional countermove against the trend. In it, we can spot a higher low (7), which is technically a sign of bullish strength. It means that countertrend traders bravely aborted a trend continuation. It is a higher low because the bottom of it sits higher than the low of the previous bottom of (6). If we also bring the earlier low of (4) into the equation, then we can count three lows in the area (4-6-7). To a classic technical trader that spells a well-known bottoming pattern, also known as a *reversed-head-and-shoulders* formation (far from picture perfect, though). It is not necessary at all to be acquainted with these rather esoteric patterns that will surely warm the heart of the typical technical analyst Applying a bit of logic to our chart reading may just as well do the trick. In its most basic form, technical trading is no more than (a) reading the overall pressure of the market, (b) opting for a trade that corresponds with that reading and (c) to assess whether the path to the target is paved with chart resistance or relatively safe to venture out on.

Looking at the first DD setup, for instance, it is not hard to see that it is showing up in an unmistakable downtrend. Not even the little *double bottom* pattern from ten minutes before (another technical marvel) could challenge that fact (1-2). In more subdued markets this pattern may have given off a clear warning sign, but compared to the power of the trend at hand it is best perceived as a countertrend attempt that is most likely to fail (in terms of probability). In fact, had the three dojis from the skipped setup at the end of the chart (8) shown up in the area of the first setup (3), similarly a bit above the average, then trading a break of them to the downside should have been administered without hesitation. So, in other words, the reason for skipping the DD short trade is not necessarily the fact that the doji bars display themselves on top of the average, but more that they do so in combination with a couple of other hints that could be interpreted as warning signs that the current downtrend may be coming to a (temporary) hold.

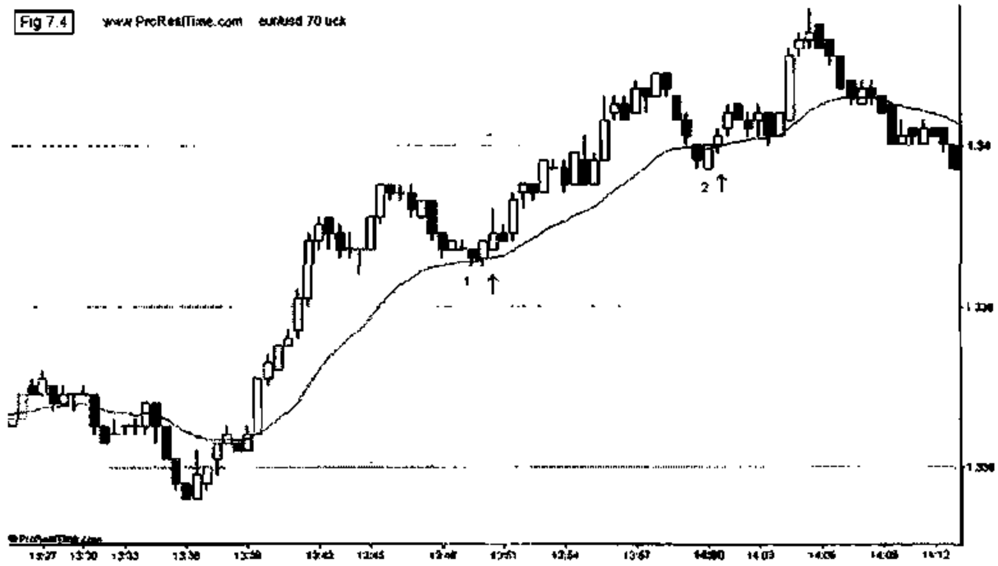

Figure 7.4 Things are not always so evident in the market as displayed in the wonderful chart above. All the more reason to fully exploit the opportunities when they are offered on the proverbial silver platter. Both setups here are quite self-explanatory.

How could a scalper not grab his chance when confronted with a per-fect DD setup in what looks to be the end of a pullback in the 20ema(l). Four tiny dojis, gently nestling in the average, three of them with equal highs - if that doesn't spell a great opportunity, then what does.

The second pattern (2), though much higher up in the trend, still provides an excellent opportunity to reap some more profits from this generous market. The fact that the trend was already 50 pip underway does not in any way diminish its longevity prospect. At least not from a technical perspective. Only when the pullbacks start to be more persistent, maybe forming double tops or double bottoms or clustering blocks of horizontal price action, should a scalper be more careful in picking his next with-trend trade. With no signs whatsoever even remotely suggesting that the market is about to give up on its trending inclination, a scalper is best advised to just bite the bullet and pull the trigger on any next trade that comes along. If that trade does not work out, then that is okay. What would not be okay, is a scalper being affected by it.

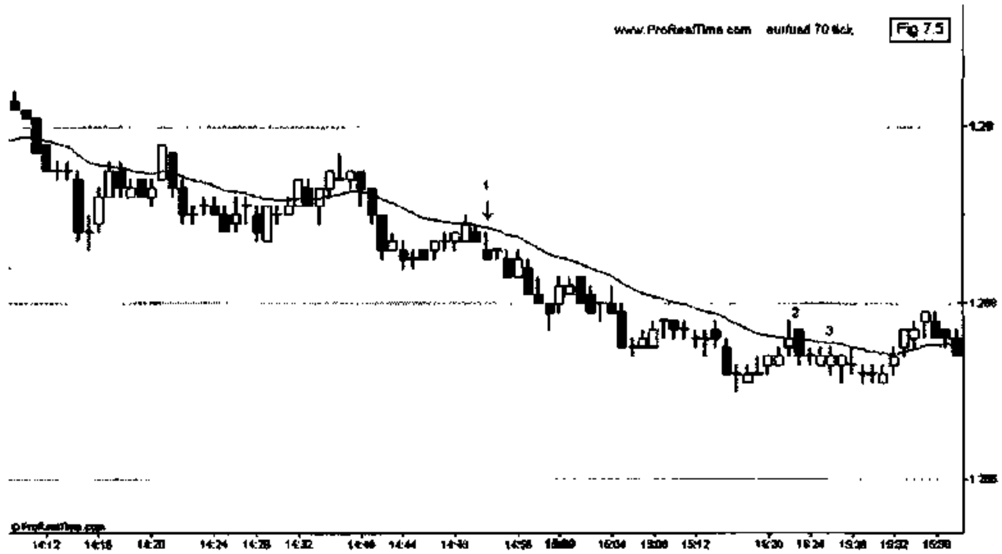

Figure 7.5 Although the market at the point of entry is hardly trending, this DD break (1) can be safely traded because the little pullback leading up to it is actually not only a pullback in the 20ema, but also a *test* of the range breakout zone from about 10 minutes before (the 1.2890 area). When prices reside above a horizontal level (a support zone) and then finally break through it by a number of pip, the market has a strong tendency to climb back up to that former support level to touch it from below. This is technically called *testing the breakout zone,* and it is very likely to be welcomed by traders on the sidelines, for these higher prices now give them more favorable odds to start shorting the market. This principle is equally capitalized on if it is not a level of support that cracks to the downside but a horizontal level of resistance that cracks to the upside and is then tested back. In fact, one could say that all the market ever does is cracking and testing support and resistance, even on the tiniest of scales. Fullbacks, for instance, quite often have their bottoms or tops acting as a test of some former resistance or support level. So, as much as we think the 20ema is stopping the pullback in its tracks, in many cases it is the former price action a bit to the left that is either offering support or showing resistance.

And just like the pullback in a very strong trend is likely to be short-lived, so is the typical pullback to a broken horizontal zone. Countertrend traders, by nature, anticipate the break to be false and they will buy it back up or short it back down. In most instances, it won't take long for them to see the folly of it because no matter how you look at it, they present their opponents, those that did not trade the initial break for whatever reason, with more favorable levels to trade from. Of course, either party could win in any kind of battle, but it in the long run it will pay off to not trade against a trend, nor against a proper horizontal break, for that matter.

Take a look at the two bars in the 20ema zone at the end of the chart (2). They provide a good example of when to ignore a setup that under other circumstances may have been tradable. First of all, the second bar, the black bodied one, is not really a doji, but still it is attractively bearish (price closed in the lower region of the bar) and not overly tall. So, seeing this two-bar pattern appear in the 20ema, we could basically regard it as a proper DD short setup. On top of that, the trend is pointing down and the pullback rather straightforward; why would it be wise to skip this DD? Because the DD bars, compared to the overall length of the price bars preceding them, in both trend and pullback, are not compressed at all. In fact, they both are about the biggest bars in the neighborhood. One could argue, and rightly so, that a break of the DD did not materialize until two new, and this time *little* dojis underneath the average were broken by a third candle a few minutes later (3). Even so, with the entry on this trade almost equaling the low of the pullback and the overall price action quite slow and subdued, it is recommended to not engage in a short at this point in time.

Note: It may be interesting to contemplate for a moment the reason why any trader would want to buy or sell something at any moment in time. After all, even if the value of the underlying instrument was to be accurately estimated, it is highly unimaginable, if not plainly impossible, for anyone to be able to put an absolute price tag on it. At the end of the day, value is nothing more than a perception in the eye of the beholder. And price a mere reflection of consensual appraisal of many. The real world shows us that both are very brittle items with a rather short lifespan. The more obscure and unfathomable the underlying instrument, the crazier the notion that the average trader would be qualified to make a proper call on the price/value relationship. Trading currencies by the trillions just about tops the list of daily irrational behaviors, for there is no way a mere mortal would be able to make sense of the many global Powers That Be on a fundamental basis. With that in mind, how is it possible that a trader would be able to trade anything at all, and walk away with consistent profits to boot? The answer to that is simply that the smart trader does not trade the underlying instrument, he trades other traders. And more so, he trades their pain and incompetence. He trades the fact that they have to react to their many mistakes to protect themselves. He exploits predicament and agony, all of it highly visible on a technical chart. To exploit others more than being exploited himself should be the ultimate satisfaction of any trader who is not in this business out of philanthropic idealism or to indulge in masochistic tendencies.

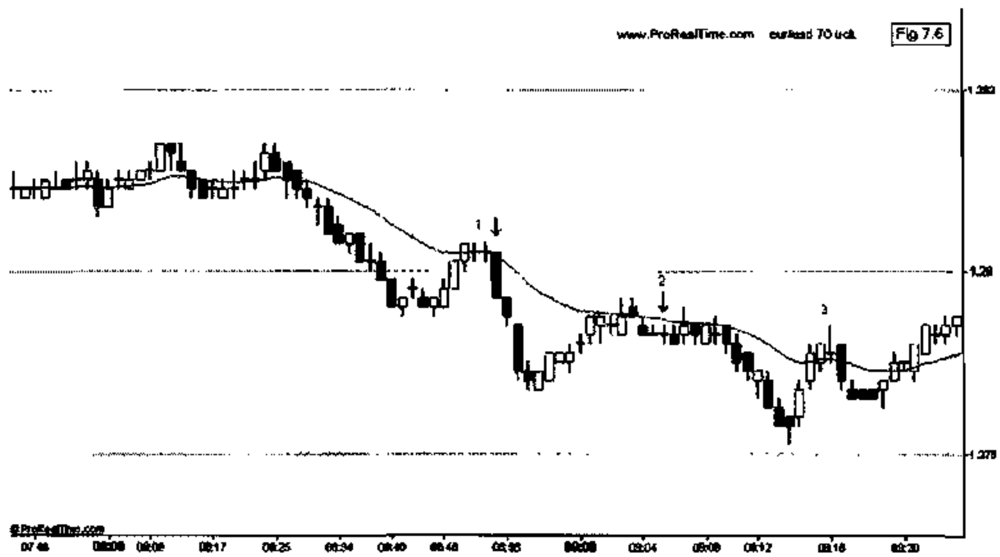

Figure 7.6 The sideways action in the beginning of the chart was broken to the downside by a series of distinctive bearish candles. Then formed a classic pullback eating back about 40 percent of the move, stalling into the 20ema (1). Two nice little dojis, both no more than 2 pip tall and with identical lows, presented a patient scalper with a safe opportunity to enter the market short once the lows were broken.

Note: Since a trader has to be very alert and immediately act on a break of a candle's extreme, it is handy to check the box of the *tick counter* in the charting software should this option be provided. This tick counter will appear on the vertical axis of the price chart and counts down the number of ticks per bar (in these charts from 70 to zero), and then starts all over again in a new bar. Why is this handy? Quite often, a signal bar will show a closing price at one of its extremes; should a trade have to be entered on a break of this bar, chances are that this trigger may be presented right on the first tick of the next bar in case this entry bar opens with a one pip *gap.* A gap is the difference between the closing price of one bar and the opening price of the next Although most new bars will show an opening price equal to the previous close, gaps do occur quite frequently, and particularly in setup situations, where the price action could be a bit jumpy. A scalper, not alert enough to act on an entry bar that takes out a signal bar, runs a risk of missing his trade. Surprises are not uncommon, even to the focused, which is why it is good to keep track of the signal bar's lifespan. Hence the very handy tick counter. It also works the other way around, by helping a trader to relax a bit when there are still quite a number of ticks to go in a particular bar of interest.

The second DD setup broke about fifteen minutes later (2). With both trend and pullback of very fine, almost harmonious quality (trend bars all bearish, pullback bars all bullish), it was safe to anticipate the market to fall further still. The five-bar doji formation in the top of the pullback, four of them sharing equal lows, presented the scalper with a great *signal line* (a series of equal trend-side extremes) to trade a downward break from. A small discomfort had to be weathered when, two bars after the break, prices briefly pierced the average a bit. That's all part and parcel of trading. A trader cannot expect the market to not put up a fight. As long as that fight remains within the boundaries of his risk profile (as will be discussed later on), the scalper has no option but to stand pat and see what happens. In any case, it's only a trade.

The third DD setup in this chart (3) presents us with a bit of a judgment call. Trade or skip? Technically, it is a DD pattern in the 20ema at the possible end of a diagonal pullback. However, it has three things going against it that would make me want to skip this offer: first, the pullback, though diagonal and one-directional, retraces not just a part of the with-trend move before it, but all of it, implying growing bullish enthusiasm in the area; second, the pullback bars are taller than those in the with-trend move it is countering, which may be another sign of countertrend strength; third, the setup stands rather tall, which would make a possible scratch rather expensive (we will get to that later as well). Prices did halt nicely, though, in the resistance of the previous DD setup's signal line. Still, a conservative scalper would probably decline this offer. But we couldn't really argue with a more aggressive individual having a go at it.

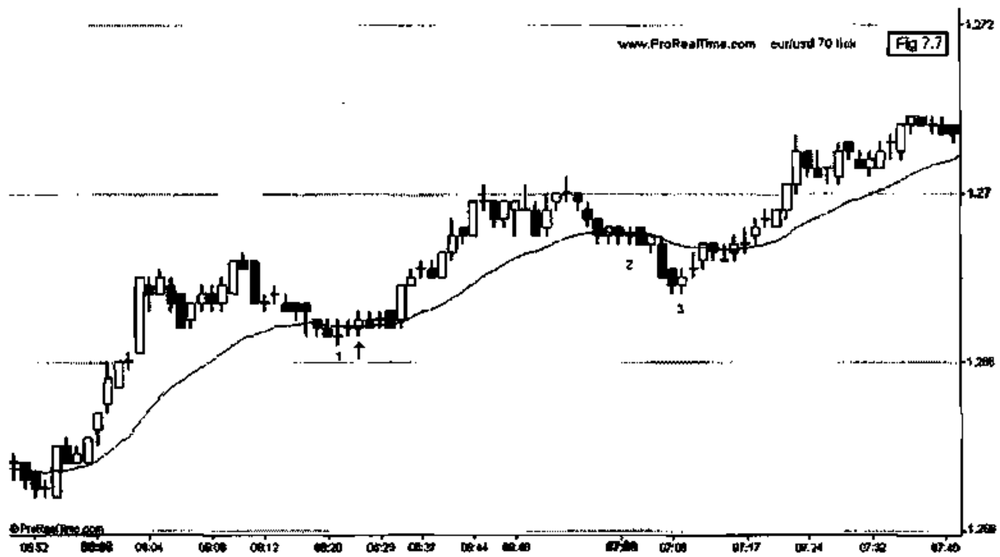

Figure 7.7 It is important not to *jump the gun* when it comes to taking trades. Always wait for the proper setup to be broken before entering, no matter how much you can already picture prices to move a certain way. Expectation and bias are terrible companions to put faith in.

When presented with a group of four or five neighboring dojis, like setups (1) and (2), all with equal extremes, it can be tempting to already fire an order to the trend-side of the market without waiting for the setup to be actually broken. Such can be the anxiety of anticipation (or greed). But not being able to wait for a true break to materialize is a serious shortcoming that is best addressed as soon as possible in a scalper's career. Quite ironically, the impatient trader, after pulling the trigger, is prone to not only find himself caught up in a market that somehow does not want to break as anticipated, his very patience may now stand to be tested with a lot more venom to it. Of course, from an educational viewpoint that is an excellent reprimand. Another thing that might help to avoid this kind of behavior, is to ask oneself what exactly is gained by front-running a break. In case the anticipated continuation of the trend indeed emerges, then, in the event of a profitable trade, the standard entry would have probably delivered the same 10 pip profit. So little gain there. In case the trade did not set itself up as a tradable event, because the break never materialized, the scalper actually loses out due to his own impatience, maybe so much as by having to close out this non-trade for a 5 pip loss (a *scratch).* The gain that may come out of this is when a valid trade, too, would have had to be scratched; now his more economical entry (probably no more than a pip to his advantage) will provide the front-running scalper with a more economical exit compared to the patient trader who entered on the actual break. Is it worth it, one may ponder.

The first DD setup (1) consisted of no less than four neighboring dojis, all sharing equal highs. Patiently waiting for the break of the highs is always the proper thing to do.

Note: Next to the trend being obvious here, alert traders could also anticipate further price advance by keeping track of the *round number zone* of 1.2700. The currency chart is full of round numbers (the last two digits ending at 00, 10, 20, 30 etc) but two zones in particular stand out on any currency pair as being the most relevant: the 50-level and the 00-level round number zones (the half cent and full cent levels). It means that these zones have a tendency to represent—either visible or hidden-chart support or resistance, making it rather difficult for prices to proceed straight through them without some hesitation at best, if not a serious bull/bear clash. Bear in mind, these are zones, not actual pip levels, so when they get breached, even by a fair amount of pip, they could still hold up as support or resistance (we will take on this phenomenon in more detail in the Range Break chapters). Big banks, institutions and the like, are the players actually taking prices up or down in the currency game, not the average independent trader trading from his home. These big guys usually do not fret over a couple of meaningless pip in the middle of nowhere, but they do tend to attack and defend the round number levels rather vigorously. Trading can be rather thin when prices approach these zones, meaning that a lot of traders prefer to stay on the sidelines to await how the market handles these major levels. This can show a very peculiar side-effect of prices being literally drawn towards these round number levels, simply because there are not too many traders standing in the path of them. What will happen when these round numbers are hit is impossible to tell, but before impact has taken place, prices tend to be sucked straight towards them. We will refer to it as the *vacuum effect.*

In case of a proven trend, it is not necessary to be intimidated by these round numbers. They are easily breached enough for a trade to still finish profitably. What's more, it is fair to assume that a number of stop-loss orders will reside beyond these obvious levels and once hit they may even help a trade along. Still, when it comes to the DD setup, it may pay off to be a bit more conservative when contemplating a possible trade straight into a round number level. Since the DD setup anticipates an immediate continuation of the trend, we need a large number of players to think the same thing (double pressure). And participation in the round number zones may just be too thin to call a break of the DD setup a high probability trade. Some of the other setups are better suited to take on these situations, because they really build themselves up. The DD setup, often representing just a tiny two-bar buildup at the end of a pullback, is always best acted on when there is nothing standing in the way of the direction of the trade, not even a round number that, chart technically, appears to be quite harmless. For example, the second DD setup at (2) is of inferior quality when compared to the first (1). Not only is the round number zone of 1.27 directly hovering above it, to the left of the setup some *clustering price action* has formed, no doubt as a result of that same round number resistance. Any cluster of price bars nearby on a level higher than a long entry, or on a level lower than a short entry, is likely to represent resistance. It would depend on the chart at hand whether that resistance is perceived too big to overcome to grant a trade permission. So, it would be best to see if there are some other signs pointing either in favor of the trade or against it. Quite often, determining whether to step in or not, weighing the pros and cons, can be a delicate proposition. For example, some might argue that the price action preceding the first DD setup is also of the clustering kind. Still, I would not hesitate one moment to fire off that trade. Sometimes it is hard to explain, because the differences seem so subtle; but 1 would not go so far as to suggest that gut feel has anything to do with it. At all times, the decisions should be based on technical grounds. On balance, when the trend is not overly explicit and things look a bit shady in terms of possible resistance, it is best to stay out in DD situations.

The third DD setup (3) is even worse than the skipped second. The entry price may be more economical, since it is lower in the chart, but way more important than that is what lies above it on the path to target. The clustering price action below that round number is clearly blocking the path, so it is best to not risk capital on this trade. Prices actually ran through it without any trouble, but that is totally irrelevant. Scalping is all about probability, not about outcomes.

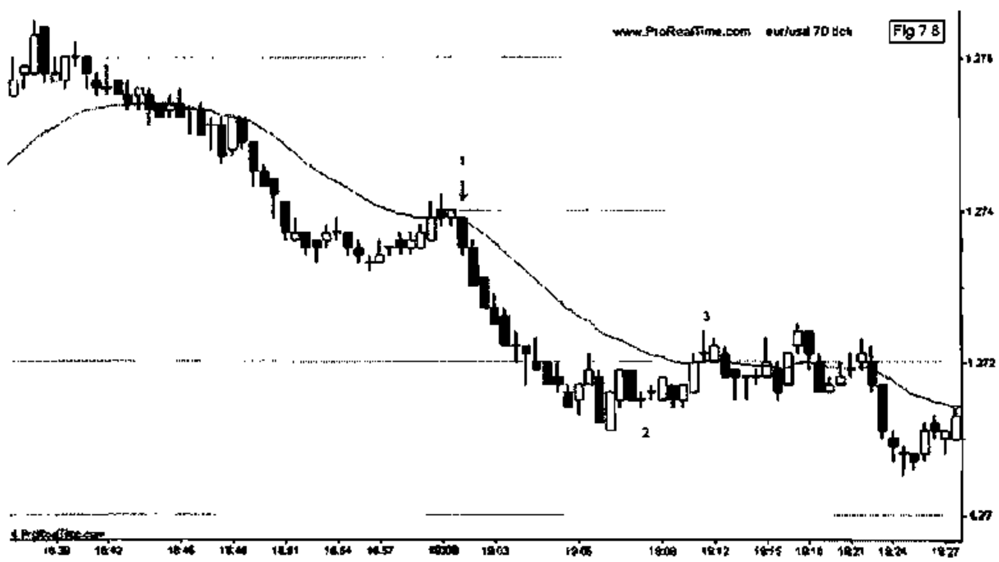

Figure 7.8 Another nice DD break in the 20ema (1). How hard is it to trade these sort of setups? Not hard at all, one would think. As a nice

bonus, we can clearly spot the *trend-equals-trend* possibility on this trade. The more distinctive the trend before the pullback, the more the one after it is likely to mirror the first. This is not a perpetual phenomenon, though; it works best on a strong first move, followed by either a first pullback or a sideways progression from which the second move is built up.

How about the DD setup about twelve minutes later (3)? Had the pullback preceding it been more straightforward and more diagonal, like the one leading up to the first DD, then this setup, too, would have been quite tradable. In this situation, however, the pullback is presenting itself more as a block of prices (2) than as an angular pullback into the 20ema. Shorting a break of the DD pattern from the perspective of the overall pressure is essentially the proper thing to do, if not for the fact that prices now face the troublesome task of having to pave their way through *chart resistance*, as any horizontal cluster of bars blocking the way can be looked upon. That is not to say that the current down-trend is perceived to be over, not in the least, but just that the likelihood of reaching a 10 pip target without being forced to scratch the trade first has now clearly diminished. If it has diminished up to the point of resembling a mere coin flip or worse, a scalper is better off at the side-lines than inside the market.

At this point of the journey, telling the subtle difference between a proper setup and its questionable counterpart could appear to be quite challenging; if so, it should be comforting to know that everything will fall into place soon enough. Well before a trader has earned his full degree of proficiency, he will have seen just about any trick the market might pull. After all, patterns, ranges, trends, minor ripples, shock waves, traps, even the freak oddity - if the seasoned trader has seen them all a thousand times before, then so too will the dedicated novice once he gets the hang of these price action principles.

Chapter 8

First Break (FB)

The First Break setup (FB) provides an alternative way to pick up the trend in the event of a stalling pullback. Whereas the DD setup needs a minimum, of two neighboring bars to locate a possible turning point, the FB setup, under the right circumstances, is perceived to be such a powerful signal that no further confirmation is needed to trade a break of it. The signal bar to the break is simply the *first* bar in a substantial pull-back that gets taken out in the direction of the trend. Once that break is set, a scalper enters with-trend to capitalize on a quick resumption of the market's original intent.

There are some requirements to be met, though, before the FB pattern can be considered a valid trade setup. In fact, in the majority of cases, a scalper may be better off skipping the trade altogether. Despite its discretionary nature, this setup is certainly worth studying because in the right environment it produces excellent odds.

The first condition concerns the trend itself. In ideal situations {in terms of FB acceptance), the trend is formed by a very determined one-directional surge of price action, preferably shooting out of a sideways consolidation. The price bars in it should ideally be longer in length than the overall price action before it and also be printed in rapid succession. At times, these moves can appear out of nothing, but they are most likely to show up when the market has already been slowly building up pressure to set a significant break. Once that break becomes a fact, the market may see a sudden burst of activity that logically traps a lot of traders on the wrong side of the field. In a downward surge we will see the chart spit out a number of black bars closing on their lows; in an upward surge, a number of white bars closing on their highs. By the looks of these sudden moves, or *spikes* as they are often called, it can safely be derived that the current action is not just a reflection of tiny scalpers stepping in and out but that the bigger time frame participants are also involved in them.

The second condition deals with the shape of the pullback that tries to counter this flurry of one-directional activity. Nothing ever climbs or falls in a straight line, so even an aggressive move sooner or later will find the notorious countertrend traders on its path. Logically, seeing these new players come in against the trend, a number of with-trend players will quickly start to pocket some profits. This double pressure will accelerate the speed of the pullback and chances are we may easily see a retracement of 40 to 60 percent of the trending move before it.

When opting to accept the FB setup, we indeed want to see this pull-back materialize in full-fledged fashion. Not necessarily equally strong as the move it is trying to counter, but definitely not as a weak attempt either. Preferably, the candles in the pullback are also one-directional in their closes, meaning that if the trend was down, printing black bodied candles, this pullback will have mostly white bodied candles in it. And it should not stop or falter in its run before the area of the 20ema is reached. Take heed of the'word *area,* because when the trend is formed by only a few very tall bars that broke free from a consolidation zone, the moving average may be lagging behind and thus be out of reach, even to a substantial pullback. At other times, the pullback itself is so violent that it might easily perforate the average more than it normally would before calming down. So the 20ema is a guide, not a barrier.

When both required conditions are met—a strong trending surge and a firm straight pullback in it - the chart will show a very visible fishhook pattern. Most of the time, the pullback (hook) will not exceed the halfway mark of the trend, although it is not exceptional to see a retracement even further than that.

The third and last condition to grant the FB setup validity is that the pullback is the *first* to go against the trend. The first pullback in any newborn trend is highly prone to be slammed back itself by with-trend traders the very moment it stalls. Later pullbacks, on average, tend to put up more of a fight in the 20ema zone before giving in to the with-trend traders (if at all).

By now a very legitimate question may have arisen among readers trying to figure out the. logic behind some of the price action principles already discussed: what is it with these countertrend traders, what makes them so persistent in their need to constantly swim against the tide? Are they self-indulgent masochists, suicidal maniacs, utterly mad? Cant they tell when a trend is on and don't they know the odds are technically in favor of the trend to continue?

To answer these questions we may have to ask another. What is a trend to begin with? *We* may perceive our trend to be so obvious that even a novice could spot it a mile off, but still the move itself may only be a minor ripple in the trend on a bigger time frame. And this other trend, in turn, may simply be a pullback in an even bigger trend. This pattern of hierarchy could even go on until we're looking at the monthly charts and beyond. So who is actually countering who at any given moment in time? There is no feasible answer to this riddle. It all depends on perspective and opinion. That is why trading is such a fascinating clash of opposing ideas and insights. It is this perpetual disagreement on price and value that causes the market to provide endless liquidity to all participants involved. And luckily so, or there wouldn't be any trading done. Just imagine a market where everybody would agree. Who would be so generous to sell us a contract should we want to go long, or buy our contract should we want to go short? Nobody would. Therefore, a trader should be very happy knowing that he can buy and sell his contracts at any moment in time.

Despite the multitude of strategies bombarding the marketplace, for the scalper there is only one world to consider and that is his own particular chart of choice. Everything else is irrelevant. That one chart is the frame in which to decide whether the market is trending, ranging or pulling back, and any decision to enter or exit the market should be based on the setups and the candles in that chart alone.

Now Let's have a look at this FB setup and see if it is easy to identify. Keep the three required conditions in mind: a bursting move, a straight pullback, the first pullback to the move. The moment a bar in the (substantial) pullback gets taken out by its neighbor in the direction of the trend, we have our signal to enter the market with-trend for a quick 10 pip scalp.

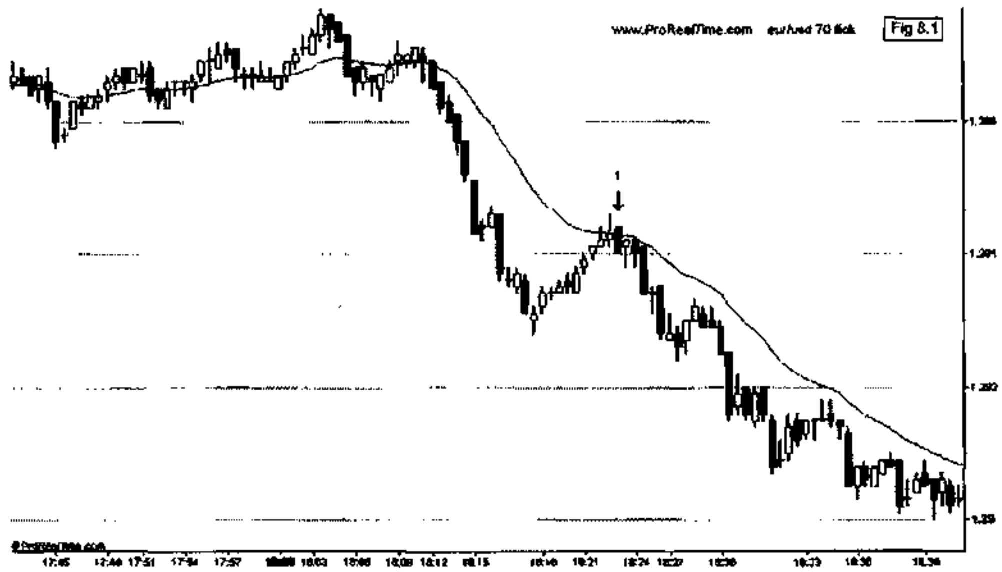

Figure 8.1 This chart shows a perfect example of the FB trade (1). Although not necessary, it can be a nice bonus to see the candle that needs to be broken (the signal bar) turn out to be a full-grown doji, with its closing price very close to the side of the break. Despite the fact that such a bar closes more or less at the same level as it opened, it shows visible evidence of the bull/bear fight within it. When it closes back on its lows in a downtrend, it hands us a strong signal that the trend may be about to resume. But basically any candle in this setup will do. They should not be any taller than 7 pip, though, in order for us to still be able to wrap a 10 pip stop around them (7 pip for the candle, 2 pip for the break on either side, and 1 pip to account for the spread. More on this in Section 3 on Trade Management).

Note how most of the bars in the downswing are firm black bodied candles, whereas those in the pullback are all smaller in size, yet nonetheless white bodied and non-hesitant, aiming for the 20ema or beyond. Not even one bar in the pullback got broken to the downside until the signal bar in the 20ema appeared. It is also the first pullback to materialize. One couldn't ask for a better FB setup.

Technically, this particular FB is also a DD setup. After all, there are two dojis - with equal lows - appearing in the 20ema. That would render the necessity of the pullback to be the *first* a non-issue, because now a scalper could simply trade a DD setup, which does not have that kind of restriction.

As we march through all of our setups in this book, we will most likely see many more examples of situations in which one setup is part of, or equal to another. The reader should not let himself be confused as to what to call it. The names of all patterns are essentially irrelevant.

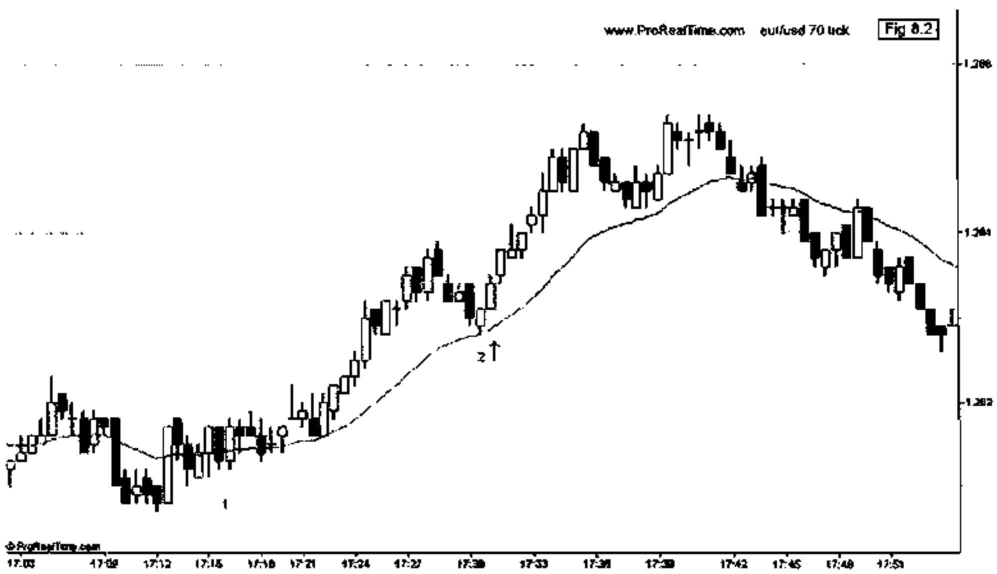

Figure 8.2 In the beginning of this chart there is a nice ten minute buildup to break the 1.2820 zone (1). The tops of most of the bars remain capped at a horizontal level, but the lows are slowly progressing upward. That is a clear sign of tension building up towards an upside break. The reader is prompted to always check the chart for any kind of clustering price action in it. Whatever is compressed will eventually unwind, simi-

lar to a spring jumping free. It is referred to as *pre-breakout tension* The later to be discussed BB setup (see Block Break, Chapter 10) is solely designed around this principle. But all throughout the chart, setup or not, we can expect tension to build up, one way or another.

Once a break is convincingly set and the move jumping out of it sufficiently strong and one-directional (no mini pullbacks in it), it is a matter of waiting for the shape of the inevitable pullback to assess whether the situation will present us with a legitimate FB. Pullbacks that retrace about 40 to 60 percent of the trend and simultaneously collide with the 20ema provide excellent opportunities for a with-trend scalp. Whether it is a DD, FB, SB or BB that sets itself up, a scalper welcomes them all. In this chart, it turned out to be a proper FB setup (2). However, when compared to the previous chart, Figure 8.1, the bars in both trend and pullback are not so outspokenly one-sided. The trend has some black bars in it, the pullback some white ones. On close inspection, though, we can see that no bar in the trend had its bottom broken to the downside until the last one in the top; in the pullback, no bar was broken to the upside until the signal bar appeared in the 20ema. All in all, that makes for a tradable FB. A long order can be fired the moment the signal bar gets broken to the upside.

This setup provides a good example of how a tick counter can help to indicate when a signal bar is about to end and a possible entry bar about to begin. When prices travel in the top range of a potential signal bar (for an upside break), or in the bottom range (for a downward break), it is smart to keep track of the tick count in it There is always the possibility that the entry bar will open with a one pip *gap,* which will be an immediate break of the signal bar on the first tick, and thus a valid reason to fire an order. Hesitating in that spot may result in a worse entry price or even lead to missing the trade altogether.

When using market orders instead of limit orders, it is unavoidable to occasionally incur some *slippage* when entering on a trade. Since a market order aims to grab the price of the moment, but has no specific price attached to it, it could be filled disadvantageously in the event of the market moving away. There are basically two reasons that could cause this to happen. The first is a technical one, meaning the market moved away from the entry price in the split second the order was surfing the internet to get filled. That happens even on the best of platforms. The second reason is self-inflicted, as a result of acting too slow.

The technical reason, obviously, cannot be avoided. We will certainly not be using any limit orders and see half of our trades move away from us without being filled. Even if we were to operate a high-tech platform that allowed us to put in limit orders at the speed of light, that would not eliminate the risk of not getting filled. Therefore, if we want in, we hit the market order button.

The self-inflicted slippage as a result of hesitating at the moment of entry is more common than one might think. Balancing on the brink of a trade can trigger a lot of anxiety within a trader's mind. As a result, some will act prematurely without waiting for a proper break; others simply act too slow and some may not act at all. These things happen and they are only natural. It may take many months for a trader to routinely fire off his trades without the slightest sense of discomfort. A thing to strive for, of course, is to act when action is required, whether that still provokes anxiety or not. Eventually all these feelings will wear off.

Should a trade be entered with somewhat larger slippage, like a pip and a half or so, just remain calm and manage the trade as if it was executed properly. Most winning trades surpass the 10 pip target without too much trouble, so even being filled uneconomically, and thus having a target objective a little further out (by the same amount the entry got slipped by), should not make that much difference. It may cause the damage control to be more expensive, though—so be it. But on occasion, it does happen that purely due to slippage, a trade never makes it to the target and eventually has to be scratched, maybe even for a loss. Still, that is no reason to get upset. Nothing in the market ever is.

Should a trade be missed, for whatever reason, it is important not to whine over it but to quickly adapt and see if the situation can still be saved. Just as often as the market tends to shoot off and not look back, it shows a tendency to stall right after the break. And even if it spikes away without us in it, in many instances, just a few bars later, price will quickly pull back to revisit the breakout level. Both situations provide us with an excellent opportunity to step in after all. We may even be dealt the exact same price as the original missed entry. However, in case a trade is truly missed and does not pull back, it is essential to not chase price up or down, no matter how much a scalper wants in. That is very poor trading and reeks of amateurism. If the moment is really gone, it's gone and a scalper moves on.

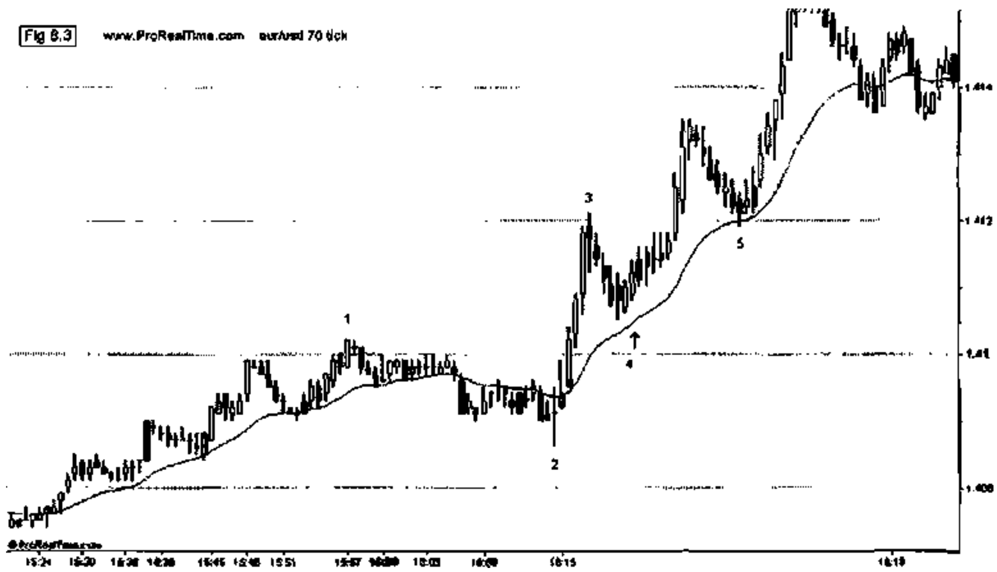

Figure 8.3 The speed of that spiky trend around 16:15 says it all. Price action like this is very often caused by traders responding to a news release. The fact that it also broke a technical pattern (1-2, a so-called *bull/lag,* don't worry about it) and cracked a round number zone (1.41), no doubt caused this sudden burst of one-directional activity to be even more violent. Whenever a trader sees something like this happen on his chart, he should immediately think: FB! For that is the fastest entry into a new trend after a pullback (4).

Notice how the 20ema could not keep up with the strength of this move, in spite of the reasonable pullback that ate back about 40 percent of it. This is typical for sharp moves that contain only a few very long bars. The average may have an exponential calculation to it, which puts more weight to the most recent closing prices, it is still an average made up of the closing prices of *the last 20 bars,* and at the end of the pullback about half of them had their closes way lower in the market (below the average). This is why the 20ema can only act as a visual aid and not as a definitive level that needs to be touched first,

A handy trick to determine whether a FB entry may be imminent in situations like this is to watch out for an opposite colored bar to get printed in the puUback (could also be a doji without a colored body). In this example the pullback is bearish, with the candle bodies being black; the moment a white bodied candle appears, the scalper may be dealing with a possible signal bar. But only once the high of that bar gets taken out does it signal an entry to go long. This is only a handy aid, though, because by itself the color of the signal bar is irrelevant. Any bar in this setup that gets broken in the direction of the trend should be considered a valid signal bar.

The time scale below this chart gives the reader a good impression of the occasional huge difference between a tick frame and a time frame chart. The action between 16:15 and 16:18, just three minutes, printed about the same amount of bars as in the 40 minutes before that. That is about 13 times as fast. Shock effects, like news releases, can be extremely volatile and fast paced, but with a bit of luck, an alert scalper may still reap some profits from them before they wear off. It is not uncommon for a target to be reached within a matter of seconds. To the downside, it should be noted, there is the possibility of being stopped out equally fast Under calm conditions, it is quite rare for a full stop of 10 pip to be hit, yet it is a market like the second half of Figure 8.3 that makes for an excellent candidate to produce this feat. The mere speed of it could make it impossible to scratch an invalid trade at a better level. Therefore, accepting a FB trade in super fast conditions is synonymous to accepting the risk of a larger stop than normal. But since these trades come with nice odds, getting stopped out on occasion is just part of the normal distribution of outcomes in a probability play.

In this chart, the market, within a minute or so, almost printed an exact copy of the earlier situation that led up to the first FB trade. Both trend and pullback are almost identical. It is a bit of a judgment call to decide whether or not to trade the break of the second puUback (5) in similar fashion as the first. The pros to this trade are the facts that the market's pressure is still pointing very much in the direction of the current trend and that the bottom of the second pullback neatly tested the top of the earlier upswing {5 tests 3). And, of course, that a signal bar got taken out to the upside. On the other hand, the pullback is not the first to the trend, which basically renders the option of a FB invalid, due to strategy restrictions. It is not for nothing that a FB trade is often skipped in favor of a better setup under relatively normal conditions. But these are not exactly normal conditions. So the judgment call is purely a result of the exceptional quality of the market. Does it matter what a trader decides to do, skip or trade? Probably not. It would only matter if these situations occur almost every day, for then they need to be implemented into the strategy and not be looked upon as an oddity anymore. For what it is worth, skipping the trade here is probably the best thing to do, because, after all, we are dealing with a second pull-back. Taking the trade anyway and getting stopped out could harm the not yet confident scalper, for he may be prone to the negative illusion of being reprimanded for strategy deviation, Should the trade work out, then he may start to foolishly entertain the idea that he is allowed to deviate from his strategy at will on account of his excellent insights. The proficient scalper, on the other hand, will just look upon any trade as just another trade. It either delivered on its potential or it did not.

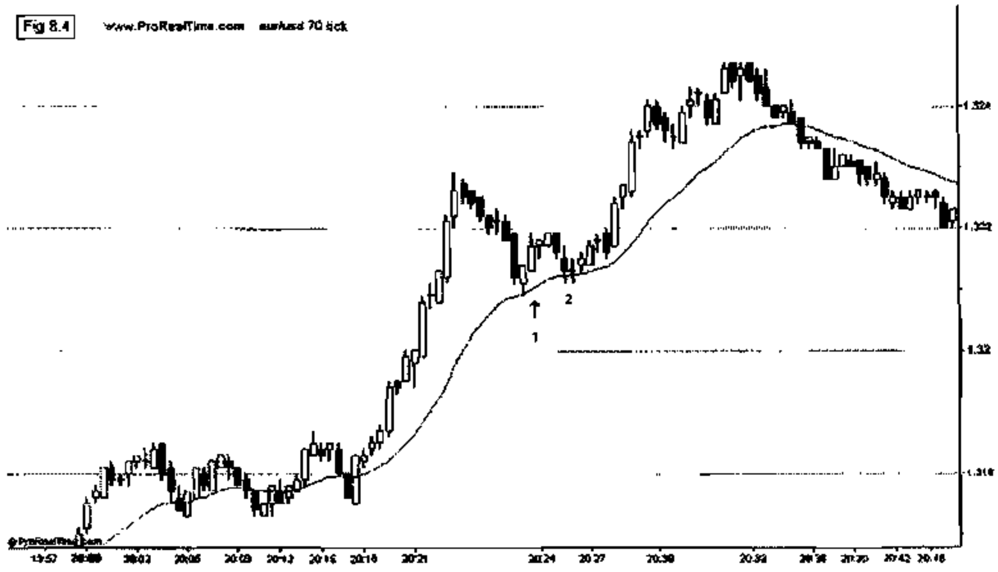

Figure 8.4 The first twenty minutes of this chart show what is referred to as a sideways consolidation, also called a *range*. It actually appeared after an already extensive run-up of the market (not visible on the chart). Still, it makes sense to regard a trending move that shoots out of a side-ways consolidation as a *new* event. And so we can look upon that huge move here as a newborn one; therefore, the pullback in it should count as a first. In scalping, it will pay off to keep things very simple and not scroll too far back in time to search for more information, and in particular for information to either validate or reject a trade. On average, about one and a half hours of price action on a 70-tick scalping chart will show more than enough bars to assess the current forces in play in proper light; and so it is best to just act upon a valid signal without too much second thoughts. In hindsight, sometimes a trader may regret not having scrolled a little further back in time to spot the huge resistance that caused a particular trade to lose. But then he should also consider the possibility of not having traded a large number of his winners on account of similar perceived, resistance further back in the chart.

In the faster paced markets, it is not uncommon to be filled with some slippage. Being aware of a terrible fill and at the same time seeing the trade not want to take off can be quite a mental challenge. Just imagine to be filled at about three pip above the close of the signal bar (1). That would have taken the trade about 6 pip in the minus at the low of mat tiny pullback a few minutes later (2). Technically, though, all the market did was pull back a couple of pip. Despite the discomfort of being so many pip in the minus, it is vital to stay calm and composed throughout any trade and only resort to bailing out when the technical conditions warrant such action (see Chapter 14 on Tipping Point Technique). And never because the current loss becomes mentally unbearable. What point is there in setting a 10 pip stop to anticipate an extraordinary condition, only to reject that measure when such a condition finally arrives. It is crucial to understand, and accept, that a large number of trades at some point before the target is reached will see at least some, if not all of the paper profits being eaten away; and a great many more will simply have to endure the initial hesitation before finally taking off. It is just the way the markets work and in essence also the very mechanism that makes pullback trading possible in the first place. It would be very selective reasoning to welcome a pullback when looking to trade, yet to despise one while in position. When in the market, a trader, at all times, should keep his eyes on the chart and not on the mesmerizing fluctuations of his profit and loss window. If the traded break is picked with care, it most probably will defend its very existence and send these countertrend traders packing. The uncertainty of whether a trade will work out or not, and the fear of having capital at risk, can trigger all sorts of unhealthy emotions that will hardly contribute to managing the open position in proper manner. It may help to ask yourself what exactly there is to be uncertain about? Since we all know that certainty is nothing but an illusion in the marketplace, how could uncertainty really be an issue? Many times, though, a trader's discomfort is not caused by the possibility of a losing trade, but more by the disturbing uncertainty of whether it was the right thing to do to take the trade in the first place. This immediately shows us the necessity of proper education. Whereas a trader can never be certain about the market's response, he has got to be certain about his methodl All a trader can go by is the likelihood of his edge to comply with probability over a longer term. Therefore, he has got to trust his setups and take every valid trade. It is pointless trying to ner and regarded as equal in terms of probable outcome. They either work or they don't. Accepting a trade under terrible conditions—which would be considered wholly untradable under other circumstances—is the same as saying: I can afford this because I *know* what's going to happen next. Delusions of grandeur are not uncommon amongst those traders not yet ready to grasp the probability principle.

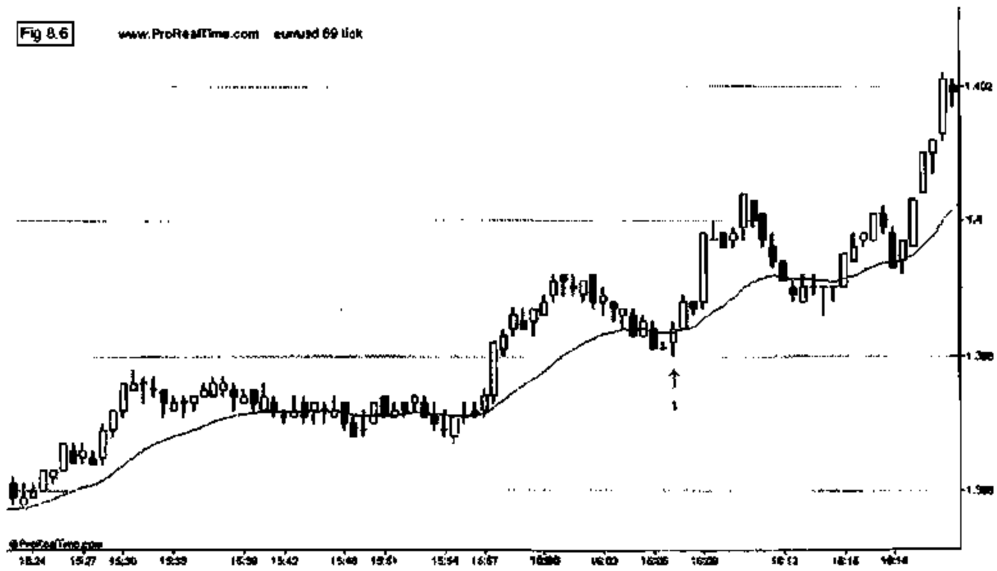

Figure 8.6 Another very straightforward example of a quick trend shooting out of a sideways pattern and a pullback taking back about 50 percent of the move. The pullback candles neatly follow one another to the 20ema zone without the with-trend traders trying to take over yet. It is also the first pullback in the (new) trend, so this action makes for a great FB setup (1). What is different, compared to the FB examples seen so far, is the shape of the signal bar leading up to the first break. That one could not be more tiny, yet is a very valid signal nonetheless. Small as it is, there are just as many transactions done in it as in any of the other bars (not necessarily the same volume, though; tick bars do not the count the number of contracts changing hands, they only indicate the number of transactions taking place). The fact that price is stalling in it does not make it any less a signal bar. On the contrary. Sellers and buyers are apparently in complete harmony with each other, at

least for the duration of that one bar. When that happens at the possible end of a pullback, an alert scalper should get very ready to trade. Every time prices stall in the area of the 20ema, countertrend traders will be extremely quick to exit their positions once the chart starts to move in the opposite direction again—especially so when the pullback was countering a very strong move, A scalper should capitalize on these countertrend traders running for cover and fire his order as quick as he can in the direction of the trend once a signal bar gets taken out. If all goes well, then in just a matter of seconds new with-trend traders will pick up on the action and jump in themselves, helping the trade along. **Note:** To produce the 1 pip signal bar, for educational purposes, I actually cheated on this particular chart by setting it not to 70 but 69 tick. Compare this chart to Figure P. 1 in the Preface pages. They are essentially the same, if not for the tiny difference in tick setting. As you can see, adjusting the tick number by a mere tick can already alter the way most bars are displayed. Yet both charts are equally tradable.

The situation above does present us with a technical issue regarding proper trade management. In concerns the matter of stop placement. Although we will delve into this in a later section in more detail, this chart shows a rarity that we might as well address straightaway. In a normal FB situation, a stop will be placed a pip below or above the signal bar that gets taken out at the other end. But there are circumstances under which the stop is best placed a little further out to give the trade a little *wiggle room.* When signal bars are extremely tiny, as is the case in this chart, it may be wise to apply this; but it should never be applied indiscriminately. Usually a technical point of resistance or support will be taken into account to derive the maximum amount of this extra leeway. In the section on Trade Management, we will look into this more closely. Note that the opening of the entry bar (on top of the arrow) coincided with the level of the high of the signal bar. By looking at the bar alone, it is not possible to tell whether this trade would have been entered before prices briefly dipped below the signal bar or after. Such is the limitation of hindsight.

Here the 20ema is not supporting the trend literally, but that is not necessarily an issue in these sort of trades. Come to think of it, it can even be a plus to see prices pierce the 20ema and close below it. The deeper the pullback, the lesser the chance of the market trying to test an even deeper level in the trend, which makes for a reasonable safe trade. On the other hand, if the pullback is dipping so deep that it retraces about 70 percent or more of the with-trend move, then, despite the lower levels, sideline players may get a little bit more cautious, which may cause the trade to fail. Regardless, when it comes to taking a *valid* trade, a scalper should not make distinctions between deep and not so deep, or safe and not so safe. A setup is a setup and a trade is a trade. And a 20ema is just a 20ema that may be lagging behind or even be too fast. Still, it cannot not be denied that some trades just look a lot better than others. But as long as the setup meets the requirements of validity, the trade should be taken. After all, any setup that stands a better chance than 50 percent to work out, no matter how shady its appearance, is a tradable event. Such is the nature of long-term *positive expectancy*.

Note: A trade that stands a better chance than 50 percent to work out does not necessarily imply that in more than half of the occasions the target will be reached. Since a winning trade results in 10 pip of profit and a losing one in about 6 pip of loss on average, the target only needs to be reached in about 40 percent of the occasions for our trades to be profitable in the long run (though marginally). In a random play, like a game of dice, a bigger profit on a smaller chance of winning would offset the smaller loss on a bigger chance of losing. Eventually both players would statistically break even. But not so in the markets. If we truly have an edge, we can tip the scale of fortune to our benefit by playing only these situations that deliver favorable odds. That is a major advantage. In fact, it even allows us to throw in the spread and still come out ahead. Naturally, stating to have an edge in the market is a daring assumption, and one that is often scorned. But those that educate themselves diligently and in proper manner will find it. And the best place to look for it is in the disability of other traders to educate themselves in similar fashion.

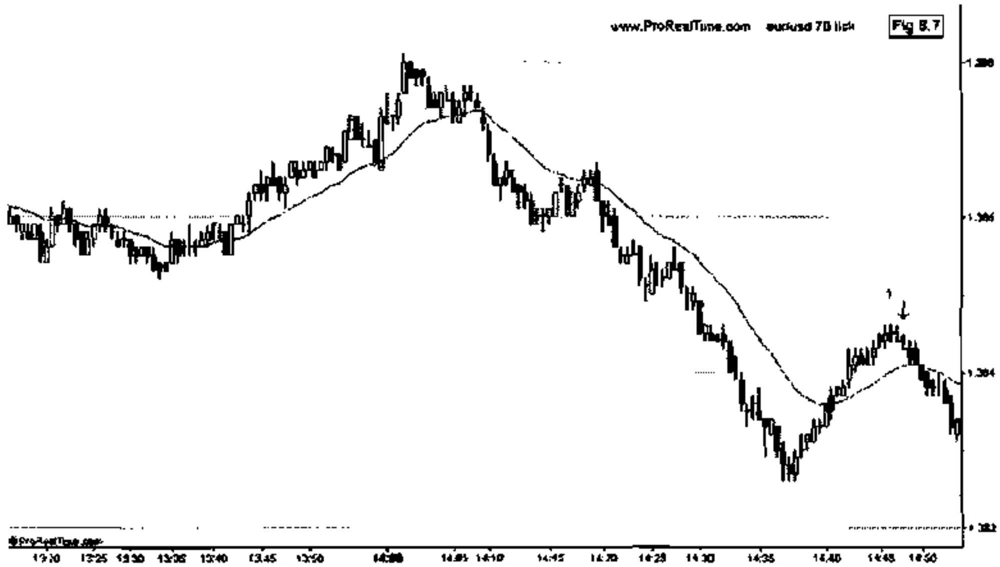

Figure 8.7 This chart should not leave any doubt behind as to whether that pullback in the right-hand comer was a valid pullback in terms of price action. Nothing but white colored bodies, and not one candle in it broke the bottom of another until the very last bar at the top (1). A point of discussion could be the origin of the trend leading up to it. Should we consider the trend to have started at the top of the chart around 14:00, then this very nice pullback is technically not the first. But how can we ignore such an harmonious pullback to such a lovely trend? Even despite the fact that it broke the 20ema to the upside, it is just begging to be shorted on first break. Granted, allowing oneself the freedom to deviate from an original plan of attack could be a tricky proposition. But every now and then it may be wise to let logic prevail over rigidity. With time and experience, this win become second nature; however, it should only be applied sparsely and certainly not as a means to jump the gun on a trade. As to the situation in the chart at hand: imagine this kind of a pullback to surface, say, fifty times in the course of a year's trading, and every one of these situations would have been traded on first break. Chances are extremely high that, on balance, these trades would have rendered themselves profitable. That is what *positive expectancy* means in trading. And why a trader cannot go around cherry-picking his *valid* trades. He has to take them all.

Chapter 9

Second Break (SB)

Next to the DD and FB setups, which are very straightforward standalone reversal patterns, the Second Break (SB) is one more chart formation that sets itself up to reverse a pullback in the area of the 20ema. But this time it requires a little more chart action to determine the exact spot to step into the market. It is a pattern that could be seen as two FBs following each other in relatively quick succession.

As was explained in the previous chapter, a reliable FB trade is a rare occurrence. It was recommended to wait for certain exceptional circumstances to take advantage of this particular setup. That leaves it fair to deduct that, under normal conditions, the first break is considered an inferior proposition. If we cannot expect a particular setup to return a healthy profit over the long haul, then the only sound thing to do is to skip such a setup.

The good news is that skipping a first break does not mean the potential for a trade in the direction of the trend has fully blown over. On the contrary. The first break, if it indeed fails, can actually play an important role in the development of a much better trade setup, the so-called *Second Break.* If the chart sets itself up favorably, a scalper may have an excellent trade on his hands to capitalize on the resumption of the trend after all.

Let us see how this SB setup is ideally constructed. Since it is a pull-back trade, we first need to see a trend to begin with. This does not have to be a very outspoken trend, but we do need to see the overall market pressure point in favor of the trend's direction. The pullback should be very orderly and preferably somewhat diagonal. In all cases, a potential trade should not have to crack a lot of chart resistance in order to get to target We could say that the conditions that favor this setup very much resemble those of the earlier discussed DD setup. And as is the case with most with-trend plays, no matter how inviting the trend in the chart at hand, ultimately it is the shape of the pullback that has the biggest say on the matter of participation.

If you think of it, there exists a strange symbioses between with-trend traders and countertrend traders, for either parry needs the activity of the other. Since trends sooner continue than reverse, it is not hard to imagine who is losing out the most in this fragile cooperation. That is not to say that a consistently profitable contrarian is merely an illusion. When equipped with great technical insight and a magical sense of timing, a clever countertrend scalper can really live it up, even in the best of trends. But the trick is not to overstay the hospitality of the market. This can be a delicate balancing act between pushing for profit and running for cover. Fortunately, it is not our task to defy the countertrend professionals. We will just let them be and even thank them for bringing prices to more favorable levels. Our tactical aim is to cleverly exploit the predicaments of less skilful players who have little concept of what they are doing and who will find themselves repeatedly trapped on the wrong side of the market.

Let us walk through a hypothetical short example in a downtrend to see how this could play itself out. After having witnessed the bullish pullback from the sidelines, with-trend traders, at a certain moment, will start to re-enter the market somewhat more aggressively. Many will try to pick a spot in the vicinity of the 20ema to deploy new short positions. This renewed with-trend enthusiasm will put pressure on the pullback and force a lot of contrarians to quickly bail out. As a result, prices may stall and slowly turn around in the direction of the trend again. If this is done aggressively enough to take out a signal bar's low, then a first break is a fact. As has already been stated, under normal circumstances this break is not acted upon in our method. Still, the market has given off a clear signal that the pullback party may be coming to an end. Naturally, not all market participants will pick up on the hint or deem it trustworthy. In fact, sideline contrarians may look upon the with-trend bounce as a welcome opportunity to now counter the market at more economical levels. If so, they will put pressure on the trend again and as a result prices may once again be lifted up towards the 20ema.

From our sideline perspective, things are now getting very interesting; at this point, we like to see a second with-trend attempt to topple the pullback, and preferably executed with a little more aggression. But as clever scalpers will not do the dirty work ourselves. We will remain on the sidelines and simply sit back to watch how the situation unfolds. We should be on high alert, though, and ready to fire off our shorts in one-click fashion. After all, since the overall trend is still down, the chart may soon present a major with-trend opportunity to put these obnoxious and resilient contrarians where they belong: out of the mar-ket. A second with-trend attack will most likely do the trick. If it indeed materializes, our task is to hop on the bandwagon as soon as we can. The moment a *second* signal bar gets broken in the direction of the trend, we will enter the market short and hope to enjoy a nice ride of pullback implosion.

So, why not trade that first break to begin with? After all, should the market immediately take off, then we are already on board; and if not, then at least we would be nicely positioned for that possible SB later on?

That is a very fair question, but since we haven't yet touched upon the various exit techniques regarding the faltering trade, it may prove a little difficult to provide a satisfying answer just yet. For the moment, it should suffice to explain that a failed first break is often looked upon as a countertrend signal to push new life in the pullback; and thus an incentive to once more attack the trend. Although this second thrust runs a solid chance to be countered itself, it may just be strong enough to activate our exit strategy, meaning the FB trade has to be closed out for a small loss in order to protect the account. Remember that the maximum stop of a full 10 pip is solely a worst-case scenario measure. That means our average stop will be much closer than that. To avoid the

ɹet us recap what we have gathered so far on the hypothetical
l then dig in a little deeper. First there was a firm swing dow
nd), then a minor swing up (the pullback to the 20ema), then
ve down (the FB), and then a tiny move back up (second thrust
lback, defying the with-trend bounce).

Having fenced off the first with-trend attack, countertrend tr
v face the critical task of having to crack the high of the pul
n just moments ago. That would be a technical feat of signific
e general premise may very well be that upon cracking that
n by as little as 1 pip, a least a respectable number of with-
ders will start to get cold feet. No doubt, a big part of their
fit has already been eaten away during the pullback and at
n point they have to protect what's left of it. If scared enough
y very well bail out on a break of that earlier high, and in doi
ome countertrend traders themselves. After all, one can only
a position by taking an opposite position, such is the nat
game. And while these with-trend traders are bailing out to p
mselves, new contrarians, smelling predicament, will quickly
pitalize on the situation by taking fresh countertrend positions,
ging the trend even more. Brilliant as the plan may be impro
re is one little oversight that might just spoil the fun: it is a
ainst the trend.

Therefore, despite this countertrend persistence, it is safe to as
at in most instances with-trend traders will not let themsel
imidated that easily. They know they have the trend on *thei*
d the stronger it is before the pullback, the more they will look

point, will print a bearish candle that takes out the low of a previous candle. This is the second break (SB) a sideline scalper has been waiting for. He will short the market the moment the break becomes visible on his screen.

Hopefully the point is taken that the smart scalper does not recklessly join in because he *expects* the countertrend attack to fail. He waits patiently for his fellow with-trend traders to start pushing their weight first.

With a bit of imagination, one can picture in a downtrend a M-pattern at the top end of the bullish pullback, usually in the area of the 20ema (resistance). In case of an uptrending market, the pullback will be bearish and in the bottom end of it one might see a W-pattern in the 20ema (support). Both are extremely dependable stepping stones for a continuation of the trend. Technical traders may recognize the very common double top and double bottom reversal patterns. Here they are called reversal patterns because they reverse the pullback (not the trend).

Since the SB setup is made up of two individual breaks that very much appear on their own terms, its formation comes in many shapes and forms. The most visual variations deal with the number of bars between the first break and the second. In similar examples as the one described above, the second break will occur not long after the first, maybe within one to four bars. This will keep both breaks rather close together, making the pattern quite compact in shape and easy to identify (the M- or W-pattern). Quite frequently, however, the number of bars between the first and second break will surpass that of only a handful, turning the SB pattern in a more elongated, wave-like formation. Still, this does not compromise the high probability factor in any way. The exact same forces and principles are at work, it just takes the market a little more effort to get the message across.

Now let us see how some of these SB setups present themselves on a real-time chart. There is no need to memorize any of the particular bar sequences because in practice the market may come up with an infinite amount of variations. If one understands the idea behind the setup, recognizing it in the market will soon become second nature. The concept by itself is rather simple to grasp: countertrend traders try something twice, fail on both occasions and then, either demoralized or panic-stricken, give up on their plan by quickly bailing out

This simultaneous activity of with-trend traders entering and coun-tertrend traders exiting creates a temporary hiatus of countertrend interest, which reinforces the trend with every newly conquered pip until it simply wears off.

Needless to say that somewhere down the line, countertrend traders will come out on top or else the markets would indefinitely rise or fall. It is crucial, though, to not let ourselves be scared out of perfectly healthy trades just because we are afraid to get trapped in what might be the exact turning point of the trend. As long as the market is trending and not running into obvious resistance, we should consider *every* orderly pullback a temporary event and use it to our advantage by trading our setups at every possible turning point. Once we start denying ourselves trades because we think the market has gone too far, we enter the realm of the paranoid amateur who lives in a fantasy world of being able to predict what is going to happen next. Essentially, there are only two reasons to skip a valid trade: obvious chart resistance and unfavorable trading conditions. In all other instances, probability traders should just trade probability. And there is arguably no higher probability of a winning trade in the markets than to take that trade with-trend after a pullback peters out.

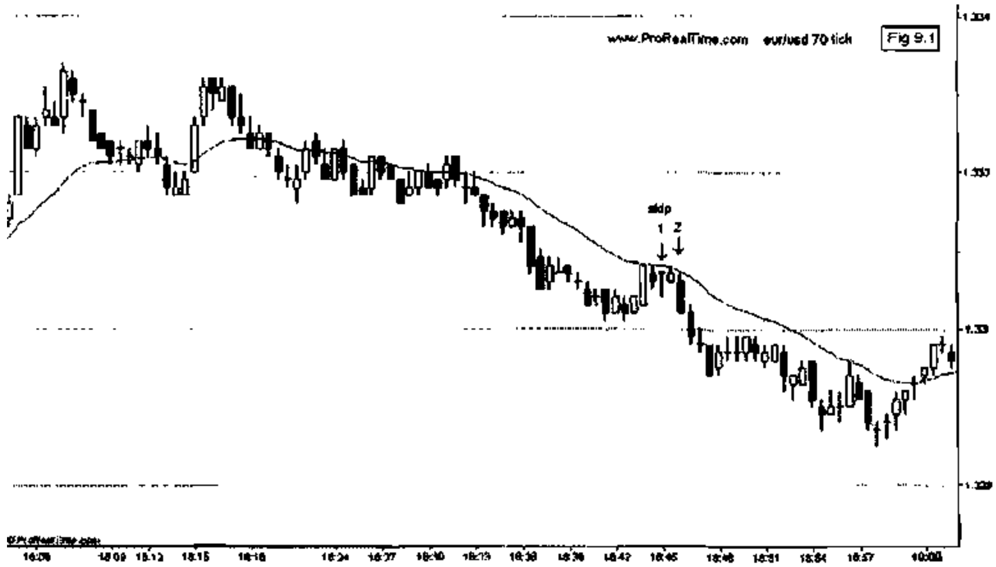

Figure 9.1 Classic SB setup with only one bar between both breaks. From a technical viewpoint, it would have been defensible to regard that first break (1) as a regular FB setup and trade it as such. After all, the market did crack a nice level of support earlier on (the 1.3315 zone), to which prices were definitely responding to the downside. However, both trend and the two-bar pullback somehow lack the distinctiveness and fervor necessary to allow for that kind of aggression. But sometimes this hinges on personal preference more than on chart technicals. My favorite FB should ideally come out of a strong pullback that ate back at least 40 percent of an even stronger move, with the market showing obvious signs of shock or *turmoil. If that is not the* case, my bet will be *on* the occurrence of a second break. In practice, though, the market will hand the trader a lot of borderline situations that balance on the brink of being either this or that. Aggressive scalpers may trade these borderline cases with similar enthusiasm as they do the textbook setups, whereas more conservative individuals may opt to wait for a superior trade. It will take hundreds of trades to determine which of the two is the more profitable approach. In the end, the differences may very well be negligible. From a psychological point of view, however, being consistent in the approach may prove to be more relevant than the actual strategy itself. If nothing else, it will bring peace and harmony to the table, and

leave doubt and regret out the door.

One look at the chart above and you can see why it is so important to not lose track of the bars in the area of the 20ema, and particularly once the FB is set. It took the market just two candles after the first break to print a second break (2), and off it went again. The trend may be our friend, as goes the saying, but it will not exactly ask us out on a date. As scalpers we have to be assertive and grab whatever opportunity is offered.

By the way, did you see the M-like pattern unfold in the 20ema? As already explained, we can also look upon the SB short setup as being a double top at the end of a pullback. As any technical trader will acknowledge, a single top is perceived much less a tell-tale sign than a double or even triple top. Hence the SB being superior over the FB.

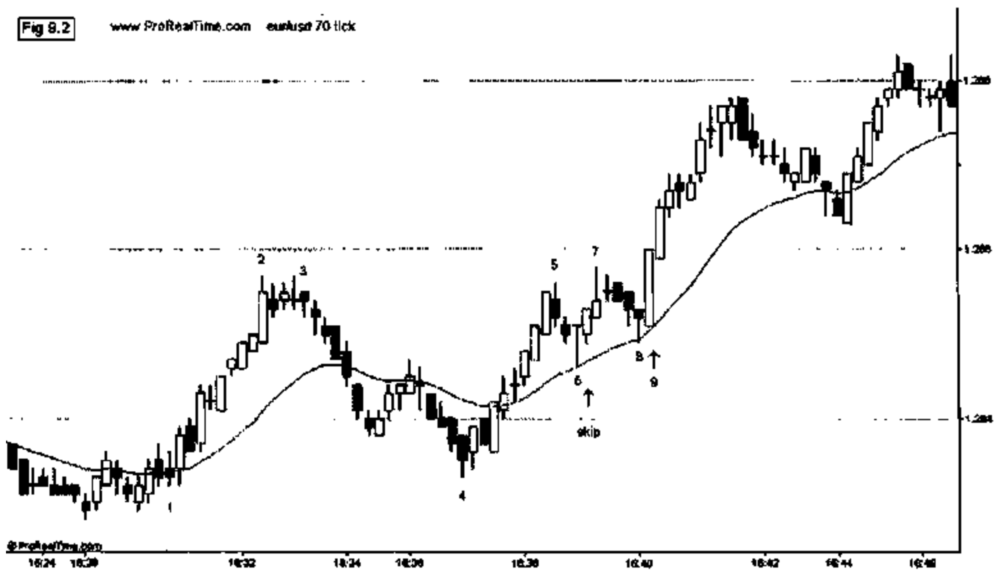

Figure 9.2 This chart seems a little rough at first glance, but if one follows the forces in play, it is actually quite a decent chart price technically. It needs no further clarification why skipping that FB (first arrow) is the logical thing to do. At that point, the market may have been showing a preference for the upside (printing higher bottoms as it goes along), but it is way too early for a trader to display FB aggression.

If you look closely at the price scale on the vertical axis, you can see that the 1.2850 round number level is playing a major role in this chart. When breached for the first time (2), it must have made a lot of counter-trend traders very happy, for these important levels are best not broken in an overly eager one-directional move. A better way to go about it, is to do it in a stepwise fashion.

As is often the case after an extensive run-up, once prices start to stall and then break down (3), clever countertrend traders aggressively step in. In this chart, they managed to force back the bulls quite significantly. Prices did not stop to drop until they found support in the chart (4 tests 1). That pretty much evened the score. However, it did not take long for the bulls to try their luck again. Not encountering too much resistance on their path, they quickly brought prices back up to challenge the round number zone once more (5). A pip below the previous top, countertrend traders typically deployed a fresh wave of shorts, forcing prices back again, but with a little less zeal. This time the pullback neatly halted in the 20ema (6).

When this signal bar to the FB cracked to the upside, so did the round number and prices now even surpassed the former top to the left by a pip or so (7). And then were forced back down *again.*

This is the point where a sideline scalper has got to be on high alert. There is only one pressing question that needs to be answered by the market and chances are it won't take long for that answer to arrive. Is that round number zone going to hold up as resistance or will it give in to the bullish forces that are attacking it? In the space of just a few minutes, the market has seen three breaches of it, all three of them cut short. Something's got to give. Either the bulls will give up on their attempts, or the bears will succumb to the upward pressure.

At the point of the second touch on the 20ema (8), obviously by a very bearish looking candle at the moment of impact, there is still no telling which side of the market is the more dominant party. Prices could bounce up once more, stall completely, or drop like a rock and never look back. Still, in these situations, it would be wise to already place the cursor on the buy button and anticipate a bullish breakout. Not because of preference but simply because only a bullish breakout will require immediate action, which is to enter long at the market after a second signal bar gets broken to the upside (9); a victory of the bears, on the other hand, will most probably not generate a short setup for at least a fair amount of bars.

Let's look at this SB situation more closely. It is safe to assume that at this particular moment in time, little scalpers are not the only ones ready to trade that upside break. All sorts of traders, big and small, active on a variety of time frames, will be sitting up straight, either dreading or hoping for the market to pop. Although the cracking of a round number zone regularly passes as a total non-event, this particular chart shows the level being strongly defended as well as attacked. It isn't hard to imagine a large number of stop-loss orders floating above it (of traders currently short); should the number crack, the market could show a mean reaction that could even be the start of a major rally. Big players love to take these orders out when given the chance. They thrive on other traders' paranoia and take pleasure in testing these resistance zones multiple times, just to see how the defenders react to either pinpricks or more aggressive attacks. Bear in mind, though, that big players cannot have their way with the market completely unchallenged. It would be incorrect to assume that they are only opposing the smaller participants. On their path, they will encounter loads of other big players for sure. And each of these opponents will also have great technical insight and no doubt a bunch of allies to join forces with; together they just may possess the power to swing the market in another direction. And each party will feel no shame revising its strategy in a flick of a moment. To the tiny scalper, the trick, of course, is to not get trampled in this parade of dancing elephants, but to cleverly ride their backs.

Note: In hindsight everything is easy and the chart, like the one above, may show perfect looking bullish dojis in the 20ema that make for excellent signal bars to a possible break (bars 6 and 8). But try to imagine that in real-time these candles looked very bearish *the moment* the average got hit. So, when it comes to reading candles, do not let first impressions deceive you, but stay alert and expect any bar to fully change shape when there are still ticks to go in it. What's more, very bullish or bearish candles with a perfect hindsight hit on the 20ema (no piercing), in real-time may not even have touched the average at all up until the very last tick that closed the bar. Exponential averages, after all, put more weight to current prices than older ones, which explains a possible sudden lift or drop of the average in case the current candle is very strong and ends on its high or low. Keep this in mind when looking for a signal bar to set up a possible trade. Although we do not actually need visual confirmation in the shape of a tell-tale bar (we trade breaks, not bars), it is always nice to see some distinctiveness in a particular signal bar.

Let's compare this SB setup to the one in the previous chart, Figure 9.1. Apart from the fact that the first chart is bearish and the second one bullish, are these patterns really that different? Visually, sure. But technically, the same unmistakable forces are in play. A trend (or strong move), a pullback, a failed continuation of the trend, another pullback, a continuation of trend. The bearish chart shows the M-pattern, the bullish one the W. In any case, both reactions to each second break literally speak volumes.

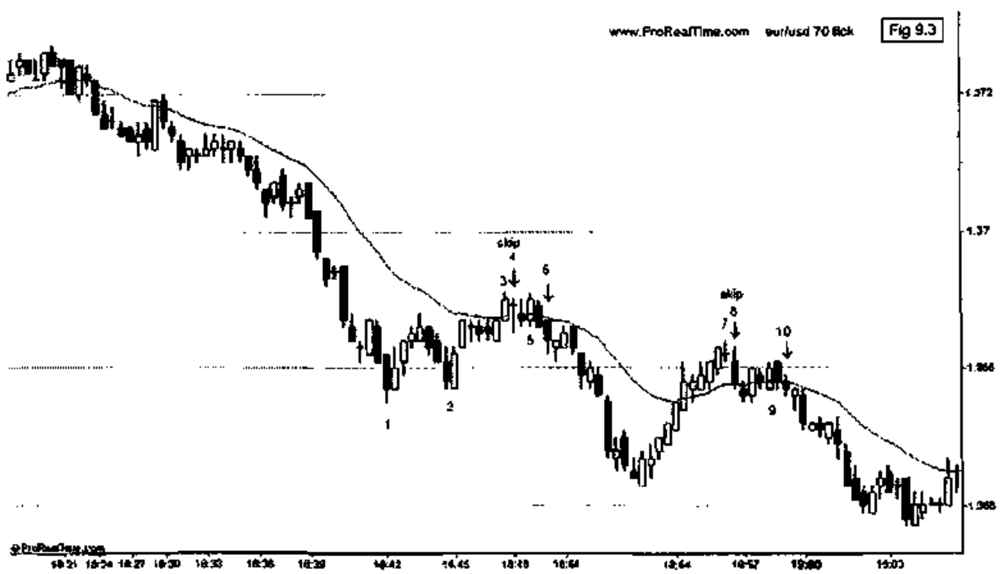

Figure 9.3 It is a great technical plus to see a trend present itself with indisputable clarity. The 70-tick chart may be a speedy one and set

to serve a scalper's short-term strategy, it is not so tiny a chart that it is completely disconnected from the somewhat slower tick or time frames. That means that a nice solid trend on our chart is very likely to be picked up by a great number of other participants as well. Maybe all the way up to traders trading a 10-minute chart. The more clear the trend, the tougher the job to counter it. Although countertrend traders can be rather persistent and courageous in their attempts to fight the market's direction - and at times quite successful—it would suit them to make a clear distinction of when and when not to undertake these tricky ventures. Those that entertain the folly of trying to obstruct a very determined trend will simply find themselves tossing pebbles at a giant. There are just too many with-trend traders around hoping to treat themselves to a piece of the pie., and they will welcome any countertrend attempt with open arms.

The first SB pattern in the chart above has a FB in it that is rightfully skipped (4). The pullback leading up to it does not have the makings of a standard one-directional countertrend move, nor is it the first to counter the trend. It is best to wait and see how the situation unfolds.

On close inspection, we can see that the signal bar that led up to that first break actually first cracked a series of highs to the upside (3). In combination with the little double bottom pattern from a few minutes before (1-2), this must have looked very promising from a contrarian perspective. And it must have inspired at least a number of with-trend traders to start dumping their profitable positions out of fear of seeing their paper profits being fully eaten away. And still the market didn't budge. That spells short with a capital S.

When searching for a with-trend setup, and then be presented with one, a novice trader is still very prone to make a rather classic mistake. And that is to be intimidated by the very activity that brings prices towards him. False perceptions show the nasty habit of emerging right before having to take a trade. Fight them and trade (6).

In a way, it is highly understandable for a trader to become at least a little paranoid in a line of business where every move simply revolves around trapping and trampling, or luring and betraying die fellow busi-nessman. But let's face it, this is what it is, and a trader is best advised to come to terms with the treacherous nature of his profession as soon as possible. If it is any consolation, even the seasoned trader gets trapped. Everyday again. No trader will ever have control over the market. But it is important to not let the market control the trader, either. In other words, you cannot go around predicting when your setup will *not* work. If it is a *valid* setup, you have to take it. In a later section, we will look into those situations where an otherwise valid setup loses its validity on account of the current conditions being unfavorable to the trade. For now, that is not relevant

The second SB pattern is a beauty, and quite of the textbook variety. First there was a strong one-directional pullback leading up to a first break that could be legitimately skipped at that point in time (8). But look at these white bodied candles, not even a black body in it; it means that every candle closed higher than it opened, which is a strong display of bullish sentiment. Should such a move scare a trader out of the idea to still go short on a possible second break? Not in this chart. Moves like this, in the opposite direction of a strong trend, are extremely prone to exhaust themselves; it's like running up a hill without a break. Running downhill without a break is a lot easier, hence the principle of the trend being a friend.

The little doji at the top of the pullback is the signal bar to the first break (7). A scalper can rightfully skip the FB (8), but he should not lose sight of the activity in the 20ema zone. The market now resides at a crucial spot. Will the next coming candles manage to stay above the average, or will prices continue their decline? The odds strongly favor the latter. Firstly, because the trend is down to begin with. Secondly, because that pullback is running into the technical resistance of the previous pullback from 20 minutes ago, no doubt making a lot of traders want to short it; remember how pullbacks tend to *test* earlier broken levels, and then bounce back. Here that pullback tested the level from where the first SB setup broke down (7 tests 5). Thirdly, because in a strong downtrend new highs as well as new lows are very likely to get shorted. New highs, because they provide more favorable prices to short from. New lows, because they break in the trend's direction. Look what happened when a second signal bar low was cracked and the SB setup completed (10): the market dropped like a stone, just like it did 10 minutes ago.

Traders that can appreciate a nice touch of pattern repetition should have a close look at both of the SB setups here, and particularly at the three-bar price action leading up to each second break (the bars above 5 and 9). Both situations, though minute in shape, provide excellent examples of how the psychological warfare among traders can be displayed in a small number of crucial bars. We *could* simply see a doji, a bullish bar and a bearish bar. Or we could read: countertrend doubt, countertrend hope and countertrend fear. And one only needs to look at the ensuing price action to see what happens when fear turns into its uglier variant: panic.

Looking at all of the setups so far, the impression may have arisen that in the majority of winning trades prices will make a one-directional, dedicated dash for the profit target from the moment the break is set. What a wonderful world that would be. It may be a bit disheartening to realize that this will simply not be the case in a vast number of our trades. Understanding this principle is one thing, accepting it is quite another. Staying calm after entry and not being tricked into prematurely bailing out of still very valid trades (although slightly in the minus) is what separates the professional from the amateur. The reader, by now, may have become a bit anxious to learn about the specific exit techniques attached to this scalping method, but it is really deemed preferable to go through all of the setups first and not front-run any of our future lessons. For now, it should suffice to say that, as a rule of thumb, most running trades will simply keep their validity as long as prices travel in the target's direction, and if not, as long as they do not take out any specific highs or lows, particularly those of a setup.

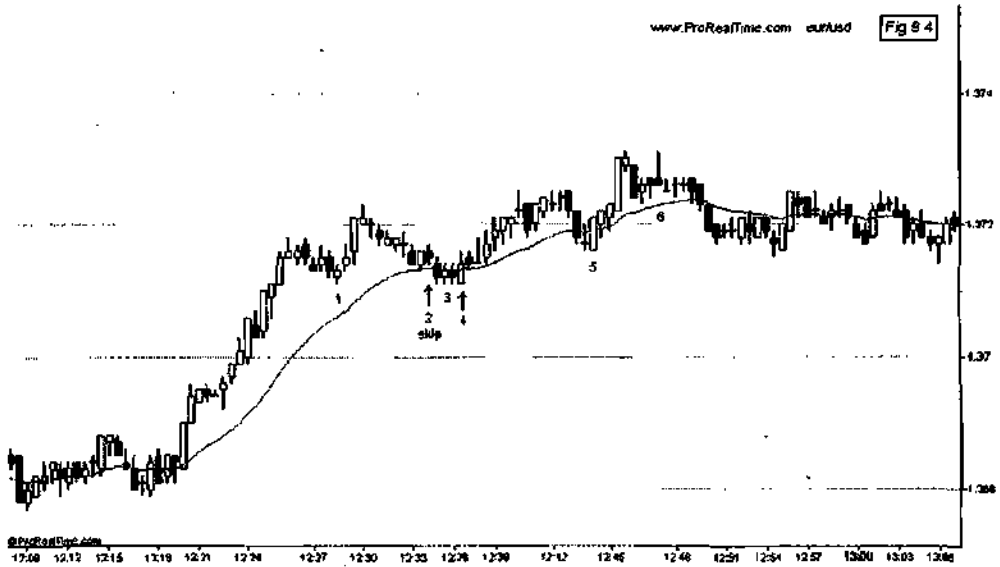

Figure 9.4 Irrespective of strategy and bail out technique, let's contemplate a hypothetical situation in which a trader acted upon that first break in the chart above (2). It shows the typical predicament of having to decide whether to stay in and still believe in the trade, or bail out to prevent further damage. Technically, this trader did the right thing by trading a very trending chart from the long side. Should his strategy allow him to trade any first break in a respectable pullback, then he did not slip up in that department either. Still, his trade is about 6 to 7 pip in the minus at the lows of the pullback (3), with no certainty of that being the end of the agony. What to do?

It is irrelevant what this particular trader would do. What is important, is to realize that getting trapped in a tough spot is not merely the privilege of traders acting before their turn. Situations like this will most certainly present themselves in almost any session, no matter what setup is involved or what strategy is used.

Trades do show the tendency to stumble and falter *in relation to the entry price* probably more often than not. Chart technically, however, the market may only be exhibiting its typical hesitation before making another swing in the direction of the trend (and the trade). If we look at the chart in question, for instance, and imagine ourselves to be in that first break trade, then being so many pip in the minus is hardly a comforting prospect for a winning trade. The market, on the other hand, is completely oblivious to a trader's hopes and fears. All it did here is what it usually does before moving on, and that is to test, very technically, a former level of support or resistance. Here it tested, to the exact pip, the low of the first little pullback from about seven minutes before (3 tests 1).

Still, this is where a trader, quite unwillingly but forceful nonetheless, may get swept into an emotional battle with the market should the latter force him to take a loss, only to treacherously turn around and provide the anticipated swing after all. Unfortunately, this is a very common and often painful experience, and even more so to those not alert enough to recognize the trap and immediately re-enter (4).

First of all, not being able to re-enter as a result of having faced a little loss just moments ago is a clear case of burnt-finger anxiety. Apparently, a recent loss has negatively affected the decision-making process—at least long enough to miss the next trade—which is a sign that the trader is no longer tiinking in probabilities. Having one's emotional balance rock up and down as a function of the outcomes of one's trades is a surefire way to burn out sooner or later. Whether a trader freezes up after a loss or prematurely re-enters to vindicate himself, both equally common, his decisions are no longer based on exploiting a technical edge but find their footing in emotional instability. Needless to say, things can quickly go from bad to worse.

But let us also examine a common psychological knot even a more stable scalper might find himself wrapped up in. Seeing his stop getting hit for, say, a 6 pip loss, but alert enough to re-enter (technically) and obtain the 10 pip winner after all, this trader may still experience very uncomfortable feelings of being trapped, tricked and even bereft by the very market that just allowed him to make a 4 pip profit on balance. Why would that be? Most probably, because even a lot of experienced traders cannot shake the idea of having to prove themselves right in *every* trade—to justify the risk they take with each position in the mar-ket. They are not thinking in probabilities either. They may survive on technical proficiency, but inside they are a psychological mess. Imagine for a moment that the market had neither presented the first nor the second trade and no position had therefore been taken. Our trader would probably feel alright, calm and open minded towards the market. But now that he got his 4 pip profit, he feels bad and bereft! And it is very logical why he would feel that way; after all, since he was right on the direction of the market, he feels the market *owes* him these 10 pip, but he only got a measly 4.

Really, all this agony—the inner battles, the compulsive desire to prove oneself, the irritation when contradicted by the market—will simply pass once a trader fully accepts the risks, the losses and any outcome the market may come up with. In other words: once he starts to think in probabilities. It is the only road to relaxed trading and ultimately to consistent, profitable results. No individual trade, not even a nasty string of losers, should be able to disrupt a trader's confidence in his abilities or in the method used. As long as a particular strategy is not proven counterproductive—which is to be assessed by analyzing many hundreds of trades over a specified period of time—a trader should just trade his setups, and thus probability. There is no point in counting pip on a trade per trade basis. Count them at the end of a session or over the weekend. Inside a session it is simply trading time.

Let's get back to the chart; although not every first break trade will falter like this, this case serves to show how dangerously these FBs can be challenged; and it also shows us how well a second break in the pullback is likely to be picked up by with-trend traders awaiting their chance (4). The signal bars to the SB trade (two dojis with equal highs) also function as a regular DD setup in this chart (3).

Note: If the entry on the SB (in the bar taking out the two dojis) was somehow missed, it does not have to mean the opportunity is lost. The market, quite frequently, will offer a trader a second chance to get in, usually within the first couple of bars after a break. After all, there exists a strong tendency of prices to revisit (test) the level they just broke out of. This phenomenon, if it indeed presents itself, may even allow a trader to get in on his missed trade at no extra cost. It may depend on the situation to determine the point where trying to get in is best forgone. This is more a matter of bars than it is of price. On average, it is fair to say that in calm markets a trade can still be entered within the next couple of bars. If one is lucky, it may even result in a slightly better entry price. But that should never be a reason to deliberately miss an entry! Thousands of good trades, no doubt, are missed out on each day because of traders trying to outsmart the market by waiting for a more economical level that never shows up.

If you look closely, in the strict sense of the setup there was another SB about 12 minutes later (the FB at 5 and the SB at 6), but it is not hard to see why this market situation is definitely of inferior quality. Let me explain: in a bull trend, for instance, the low of the pullback leading up to the first break counts as a standard measure to be tested later on should the market not immediately want to proceed (the first low in the W-pattern). If it is tested and holds up (the second low in the W-pattern), the trend is often perceived to be technically sound and thus prices could very well live up to their upward projection. The idea of the second break being such a high probability trade is based on the premise that this low is indeed tested, even if it is not exactly to the pip. But having to enter a second break about 7 pip above the entry of the first, without having seen a proper test of the earlier low or even the 20ema, just does not make for a high probability trade anymore.

Admittedly, in this chart the distinction between the proper SB trade and its ugly counterpart was not exactly subtle. In many situations, however, there will run a much finer line between taking and skipping a trade. That may put the trader a little more to the test. In the end, a trader can only make do with his current state of proficiency and hope to grow with each new day in the market.

Note: When studying a questionable situation in hindsight, it is always essential to evaluate the case with an open mind. That way one stands to learn and benefit the most from whatever happened in the past Skipped trades, for instance, that turn out a winners, and accepted trades that turn out a losers, may only represent outcomes in the normal variance of a probability play and should not necessarily be interpreted as a reason to act differently next time.

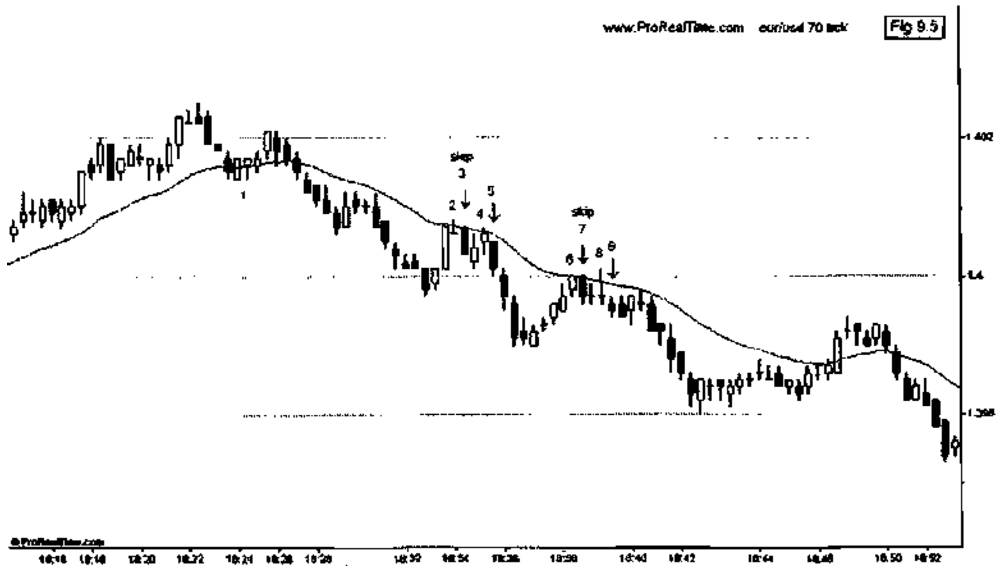

Figure 9.5 Although not technically identical, these two setups are very similar in price action, but there are some subtle differences that may be interesting to point out. In the first setup, the skipped FB (3) resulted in a short resumption of the trend before countertrend traders brought the market once again up to the 20ema (4). The thrust of this second leg of buying activity, however, never made it past the earlier high of (2). Apparently, not even the comforting thought of having the round number level of 1.40 right below the current prices (as support) could inspire new countertrend traders to finish what their companions had started. That may be an indication of underlying weakness. Still, things in the market are never fully evident and not seldom it takes only a couple of bars to change an outlook completely.

Nevertheless, when prices could not muster the strength to lift themselves any higher, the situation got nasty quite rapidly for the bulls. An alert scalper would surely have recognized a very promising M-pattern develop below the 20ema and not much later a textbook SB entry (5). In situations like this there is no need to postpone entering on the SB out of fear of that round number support (as resistance to a short). Waiting for the round number to crack first, as if to have weakness confirmed, is certainly not advisable. Not only does it deliver a terrible entry (in relation to the stop), the same danger of the level holding up is still luring. Because the possible resilience of a round number is more a zone than it is an exact level. In other words, for the sake of a more healthy scratch, it is better to be short a pip above a round number than one below it.

There is arguably no notion more highly regarded among technical traders than the popular wisdom of cracked support becoming resistance and cracked resistance becoming support. This is indeed a wondrous phenomenon that relentlessly shows up in any time frame, in any market. A fine example can be seen in the chart above when the first pullback to the second setup touched the 1.40 level from below (6). Why any scalper would want to buy straight into a *first test* of cracked support (now resistance) simply baffles the smart trader's mind, for it must be about the lowest probability trade in the field. Put yourself in the position of a bull for a moment and imagine your buy order being filled right there in the 20ema at 1.40. What do prices need to do for this trade to render itself profitable? They would have to dig their way through the very visible resistance of the clustering activity directly to the left (the M-pattern of the first setup). And not only that—they would have to do that after already having climbed up about 10 pip against the trend without pausing. These conditions provide a bull with terrible odds. Needless to say that a clever bear will welcome any bull with open arms, for such foolish bravery provides his own setup with the near power of foresight. After all, if going long at a particular spot makes for a terrible low odds trade, then taking the other side of that contract should basically be a formality.

Of course, it is not any of our business to judge whoever is doing what at any given moment in the marketplace. It is just information. In that light, we would simply see prices stall in the 20ema after a nice pullback. That makes it interesting for us. If two tiny dojis would set themselves up, then maybe we've got ourselves a nice DD trade in the making. If a first bar gets broken to the downside and prices travel up again, then a very dependable SB may still set itself up. All the more reason to stay focused and alert.

This particular setup shows a fine example of why it is wise to skip most first breaks in favor of a possible second break. The reaction to the first break (7) was simply non-existent. No doubt some countertrend traders will look upon this as a sign that the bears were a bit reluctant to push on. And with-trend reluctance equals countertrend hope: if somehow prices could be brought back up above 1.40, cracking the high of the earlier attempt in the process, maybe that would scare a number of with-trend traders out of their shorts, trigger some stops and convince new buyers to join the countertrend attack.

The reason for being so elaborative on this four-bar setup, is to explain the buildup to yet another technical marvel that in the hierarchy of tradable patterns may rank among the top of them all: the notorious *false break.*

Take a close look at that fine doji (8) that becomes the signal bar to the second break just moments later (9). For a brief moment, at least within the space of 70 ticks, that bar must have looked very bullish, white bodied and leading the countertrend parade. But the moment it stuck its head above the previous high (and simultaneously above the round number), with-trend traders ruthlessly slammed back the countertrend attack, warning every potential buyer on the sidelines to either back off or perish. Seeing a strong bullish candle transpose into a very bearish looking doji is the perfect deterrent to anyone still entertaining countertrend affinity. Particularly so, when that candle also represents a very classic false break (it falsely broke the earlier highs of bar 6 and 7). By definition, a false break traps any trader trading it as a true break, so these unfortunates are the first to feel the pain and they will have to act almost immediately to stop it. Of course, they can only do so by closing out their trades in the opposite direction, enhancing the falseness in the process.

What makes the false break more dangerous than most other market traps or tricks (from the perspective of those trapped in it) is its visual clarity. Especially when it tried to break the trend. The more traders see the same thing, the less chance for countertrend folly. Up to a certain point, of course. But usually long enough for us to scalp another 10 pip out of the market.

Just looking at these two SB setups shows us clearly the path of least resistance in the market. Why go against it, when you can go with it?

Note: This chart also provides a nice example of why being biased on the direction of the market could prove to be a terrible guide in scalping. At the left side of the chart, just 10 minutes before the first SB setup, the market looked to be trading in an uptrend (prices well above the 20ema). We cannot derive from this chart whether the 1.4020 zone represented chart resistance further to the left, but let us assume for a moment it did not. Then the chart presented a scalper with a textbook DD setup in the 20ema (1). The trade that came out of it, obviously, never got anywhere. Clever bulls will immediately switch into neutral, accept the loss and move on. A biased scalper, on the other hand, after being stopped out, would probably feel slightly uncomfortable with this little mishap. Since he pictured the market to travel higher, seeing it travel lower instead just doesn't feel right. How could the market be so wrong? The point is: would this scalper be able to reset his mind from bullish to neutral to bearish in time to take that first SB short entry just a few minutes later? A good question.

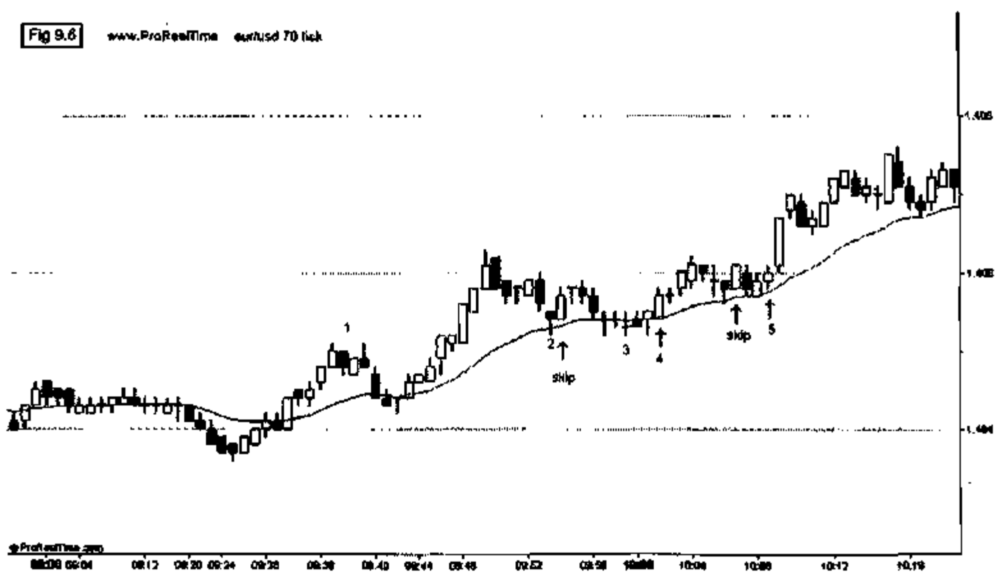

Figure 9.6 The first SB entry (4) in this slowly trending chart broke a cluster of no less than five dojis, all sharing equal highs. Notice how nicely the lows of the dojis (3) tested the earlier low of the signal bar

leading up to the first break (2), which in turn was a test of the 50-level that had been broken a few minutes before (1, resistance becoming support). **Note:** A test of a level does not necessarily have to occur in opposite direction. In this chart, the lows of (3) test the low of (2); the low of (2) tests the earlier high of (1).

By now, the observant reader will surely have noticed the remark-able tendency of prices to move in an orderly, stepwise fashion when traveling from one level to the next. Our 70-tick chart provides us with a wondrous view on these technical dynamics. With amazing clarity, it portrays, often to the very pip, the way most levels get attacked, defended, conquered, tested and abandoned. And that is not all. Technical chartists could have a field day just counting the many popular *chart patterns* that keep on reappearing in this excellent chart. Bull flags, bear flags, triangles, channels, double tops, pennants, head-and-shoulders, cup-and-handles, triple bottoms—it's a nonstop parade of technical phenomena.

So, if that is the case, are we not missing something here, and in all of the examples shown so far? Why aren't there any trendlines or pattern boundaries drawn on these charts?

The answer to that is even simpler than the question itself: there is no need to. All you ever need is already within your grasp. It is easy, effective and very, very profitable. Why look for more?

Surrendering to simplicity, it is fair to say, does not come natural to the human mind. Even when the desire is very much present. In fact, it can be a daunting struggle, almost like a ritual event, a rite of passage of some sort. And it is a journey that must be traveled alone, in the solitude of one's own perception. One might even call it a leap of faith. But believe me, once a trader makes it through that gate, he will experience a sense of freedom that seemed unreachable just days before.

The second SB setup in the chart could not be more tiny a pattern, yet it has all the makings of a perfect W-formation, comfortably supported by the gentle slope of the 20ema. You can almost visualize how the average is holding up its palm to cup the price bars in it, providing just enough push to help them through the current 1.4060 resistance.

But this situation does present us with a classic dilemma that sooner or later will surface on any trader's screen: what to do with a new setup (5) while already in position?

Since the appearance of a second trade is by no means a rarity, we have to reflect on it for a moment to see how it is best resolved. In trading there can exist some interesting conflicts among what is statistically justified, practically preferred or logically demanded.

Let us first examine some of the typical options that come to mind when presented with that second trade while already caught up in a first. 1: Ignore the new trade. 2: Take the new trade as a stand-alone event and manage both trades individually. 3: Skip the new trade but adjust the stop and profit levels of the current trade to those of the new trade, had it been taken.

And one could even opt to add some subtleties like pocketing the current profits on the first trade right before the break of the next, and then re-enter again when this second trade comes into effect; that doesn't sound so bad, if not for spread and slippage.

If we look at the options from a mere statistical viewpoint, then it leaves us little room for discussion as to what the proper action should be: take any trade that provides an edge.

But that may not be enough to go ahead with the trade. To evaluate our options wisely, we have to take into account every possible factor—physical, mental, technical and financial—that could theoretically compromise our play.

When opting for the adjustable target model, for instance, having to juggle two trades simultaneously may turn out to be a challenging task, even to the experienced trader. Adjusting stop and target levels correctly with only seconds to spare will be virtually impossible in any market, let alone in one that is moving fast. Even worse, manual scratches may accidentally cause unwanted open positions. Why? Because many traders are used to exit their positions by clicking on the opposite order ticket. For instance, when in a long trade, instead of hitting a close out button (on many platforms, a multiple mouse-click process), they just click on the sell ticket. This one-click exit usually works fine, because the majority of trades get scratched well before the market has time to activate the automated bracket-stop. But if one starts to hastily adjust the bracket levels, due to a second position overlapping a first, a trader may lose valuable seconds to act appropriately and he may find himself exiting his position just as the platform beat him to it. The result: a freshly taken, yet uncalled-for position.

Even in a calm market with no intention to adjust anything, taking the second trade may prove to be too heavy a burden on either the account or on the trader's comfort zone.

In other words, things can go from very orderly to very messy in just a small space of time. The culprit: blindly following a statistical edge and disrespecting practical circumstances.

Am I painting too negative a picture here, or just being realistic? That may depend on the trader in question, the sophistication of the platform used, the amount in the account, the experience in the market, or what have you.

My personal preference, as you may have already guessed, goes out to sticking to the original trade and letting everything else pass by until that trade is over. Firstly, with so many possibilities to scalp the market in a relaxed state of mind, I do not see the need to complicate matters for the sake of a few extra pip. But there is another reason I would have to pass up on that second trade, and one that easily outmatches the mere freedom of skipping trades for the sake of simplicity. It is called maximum risk per trade.

Although we will delve into this in more detail in a later section on Account Management, let us look into some of the particulars briefly to clear up some common misunderstandings regarding this matter. First of all, there is the issue of margin requirements. Margin, in general, is the minimum amount of capital in the account required to trade a certain amount of volume (units) with. This differs per company, but Forex brokers, on average, allow a trader a huge leverage to play with, going from as low as a 20:1 up to a whopping 400:1, or even higher than that. A leverage of a 100:1 simply means that a trader can trade a $100,000 worth of units, but only needs a $1,000 in the account as margin. What does this have to do with not being able to trade a double position, the reader may wonder; would a consistently profitable trader, especially with the huge leverage offered to him, not have enough funds in his account to trade that second position? The answer to this is that it may not be an issue of funds.

There are a few things to address here that may be of importance to a trader unfamiliar with proper account management. First there is the common mistake of confusing broker margin with allowable risk. As much as a 1000:1 leverage may represent an ideal circumstance for trading, to actually use that kind of leverage would border on the suicidal. It is not a broker's call to decide on the matter of risk. The smart trader puts no more than a certain percentage of his capital at risk on any one trade; he will then simply adjust his volume to match his risk model. For instance, should he want to use a 10 pip stop on a trade, his volume will be twice as large in comparison with another of his strategies that requires a 20 pip stop. But his risk per trade will be the same. This is an important concept to grasp. Even traders who have proven themselves to be consistently profitable over time are highly unlikely to go overboard on allowable risk per trade. Chances are, they would not have reached their state of consistency in the first place had they not respected the universal law of account protection: Anything can and will happen, even to the best of traders, so rule number one, at all times, is to protect the account Many experienced traders do not risk more than 2 percent of capital on a single trade. Overall, that is a fair percentage and it would probably suit the consistently profitable scalper in similar fashion. But the key issue here is consistency. Any scalper not yet proficient enough to reap profits from the market on a regularly basis (many weeks on end) is best advised to approach the market with a lot more prudence, preferably risking no more than 1 percent of capital per trade. But regardless of the percentage chosen, once a trader has agreed on his maximum risk per trade, he should exploit his granted leverage to the fullest and assign the maximum volume possible to his position without violating his choice of risk. That simply means that there will be no trading a second position while already caught up in a first, because the maximum amount of units are already at work. Doubling up would seriously violate the risk per trade rule, with no less than 100 percent. Of course, one could argue that the second position is a trade on its own and therefore is entitled the same amount of volume as the first position, but that doesn't really hold up, if you think of it Trading two positions simultaneously in the same market and in the same direction is essentially one position entered in two instances. There is much more to be said on the relationship between volume, leverage and risk and all of it will be discussed in Chapter 16 in the section on Account Management.

Figure 9.7 The first SB setup here looks a bit messy at first glance, but on close inspection it meets all the demands to qualify for a perfect W-pattern in support (2 and 4 test 1). The average, clearly, had a hard time keeping up with the sudden burst of activity: first a bullish buying frenzy that came out of nowhere (long line of white bodied candles around 20:00) and then that sharp, three candle decline (tall black bodies) that ate back almost 50 percent of the earlier swing. But look where that pullback came to a halt; straight into the earlier resistance (now support) of the 1.3860 zone.

That sharp sudden upswing could have led to an excellent FB setup (3), if not for the pullback failing the requirements (it showed a two-step decline, basically a double top). No reason for disappointment, because a scalper can always switch to plan B, which is to patiently wait for a superior break to appear (6).

Interesting how that very bearish black bar (4)—that tested the earlier low of (2) to the exact pip, forming the second bottom in the W-pattem— was immediately countered by an equally bullish bar that managed to close back just above the 20ema (5). Such can be the power of support. If you don't know what to make of a strong bearish bar countered by a similar strong bullish bar, whether that is neutral or bullish (relatively speaking), then try to imagine them as one, meaning as if the chart printed not 70, but 140 ticks per bar. Then you get a bar that opens on its high, runs all the way down, looking very black and bearish, only to close back on its high again. The result: a perfect looking bullish doji— just like the signal bar leading up to the first break. Two dojis in the bottom of a pullback in technical support: that spells W-pattern!

Note how the technical buildup to the second SB entry (11) is quite similar to the first. In the first setup the lows of (2) and (4) made up the bottom of the W-pattern. In the second setup, the lows of (8) and (10) do the same. Now that the market calmed down, the 20ema is once again typically running below the lows of the setup. Even more technically, these lows find support in the highs of the previous setup (the highs of the first W-pattern). All in all, this represents very stepwise price action and things look quite good from a bullish perspective.

A nice bullish doji (10) became the signal bar to the ensuing break. However, as discussed in the text below Figure 9.6, this second SB trade is skipped when already in position on the earlier SB. If still on the sidelines, for whatever reason, it provides a nice opportunity to get into the market after all. That being said, chances are a sideline trader may feel a bit uncomfortable getting in on that second SB trade knowing that he missed a more economical entry just moments before. All very logical, in a way, but remember that entering a trade is never an issue of price. It is just a matter of probability.

Let us go back to that first SB setup for a moment. If we follow the path of this trade from the point of entry (6), we can see that it flourished for about 8 consecutive pip, only to see the market take a sudden turn and demand back all of the paper profits in its trip back to the 20ema (8). Very few traders remain completely unaffected by this drastic change in prospect. Seeing a trade almost hit target and then crumble apart like a house of cards is often perceived as a personal attack, a mean and vindictive act of the market, just to spite a hard working trader aching for profit. Needless to say that this perception sneakdly triggers all sorts of unhealthy emotions, with feelings of bereavement, unjustness and deception ranking among the top.

This personal fight with the market, looking upon it as if it is an entity, a living, breathing organism, a mighty opponent, is a typical trader's illusion, and not only on the part of the novice. As usual, the enemy here is obviously not the market but the demon within. If you find yourself being able to look at the market technically, analytically and above all in a calmly manner when *not* in position, only to see yourself lose all objectivity and emotional serenity when stuck in a trade, particularly one that appears to be faltering, then you have no option but to embark on some serious soul-searching. What is it that you want out of this trading business? What do you *expect* the market to offer you? What do you expect yourself to accomplish? What makes you want to obstruct your own path to success, time and time again, by warping your sense of reality every time you are exposed to either losses or gains? Why can't you look at the market from a statistical viewpoint? Or better yet why *can* you think in probabilities in hindsight, but *fail* to do so in the reality of a running trade?

Maybe there is one single question that encapsulates all queries more than any other: what is it that you are afraid of?

The answer to this will undoubtedly differ from trader to trader and one could probably take his pick from an almost infinite supply. Just to name a few: Fear of being ridiculed. Fear of being wrong. Fear of losing capital. Fear of getting trapped. Fear of missing out. Fear of commitment. Fear of boredom. Fear of pressure. Fear of failure. And, who knows, even fear of success.

Unfortunately, there is no ready-made solution on how to distance oneself from the many perceptions that obstruct clear and analytical thinking when under pressure. A trader could be told a hundred times over to think in probabilities, but when the mind is not yet ready for structural change, it will simply ignore even the most sound advice. Just like it is pointless to tell somebody grieving over a shattered dream, for instance, to just get over it. It's a process.

And therein lies also the good news. We know it can be done. Eventually, a trader will come to realize that he has no alternative but to start detaching himself emotionally from all his actions in the market. Only then can he begin to look upon his trading as merely exercising a carefully crafted business plan. This thought-process may take its time to surface—weeks, months, sometimes even years. In many cases, this transition comes about so gradually that the trader may not even be aware of it; other times, it may occur rather unexpectedly; who knows, one might even hear the proverbial *click*.

Excerpts

Excerpts from Chapter 10:

Block Break (BB)

If all setups were to qualify in one of three categories, the options being either with-trend, non-trend or countertrend, then the patterns we have discussed so far—DD, FB and SB—are unmistakably with-trend ventures. They not only acknowledge the presence of a trend, they try to capitalize on its continuation as well. And that makes sense, if you think of it. Although opinions on its definition may differ widely across the board, the love for the trend in general is quite universal. Almost any trading method will incorporate at least a couple of clever with-trend plays to hop on or ride out a good move.

Unfortunately, as any chartist will surely admit, things seldom materialize in the most desirable way. Many times there is a lot of pulling and pushing and backing and filling, even in a very visible trend, and this often ruins the possibility of using the classic with-trend setups to get ourselves in position. It is all part and parcel of the trading game. However, in many such instances, the opportunities are not necessarily lost and with a little luck and patience we may just be able to pull a nice trump card from our sleeve: the multipurpose Block Break setup (BB).

This setup comes in many shapes and forms and we would probably not do it justice if we were to casually generalize on its appearance. A most simplistic description would be to characterize the pattern as a cluster of price bars tightly grouped together in a narrow vertical span. Preferably, the barriers of this block of bars are made up of several touches each, meaning that the top and bottom side of the pattern clearly represent resistance and support. On occasion, depending on the speed of the market, this group of bars could appear and be broken in a matter of seconds, but the formation itself could best be seen as a miniature trading range.

If we were to draw a rectangular box around all the bars that make up this pattern, what should emerge is a distinctive block of price action in which a relatively large amount of contracts changed hands without price being really affected. But the tension within should almost be tangible, like that of a coil being suppressed by a weakening force that is bound to give in. If prices eventually break free in the direction of the path of least resistance, we immediately enter the market on a break of the box. This makes the broken horizontal barrier the *signal line* to our entry point. Should prices break out at the less favorable side, then no action is taken just yet.

When encountering this cluster of bars at the possible end of a pullback in the area of the 20ema, a trendside breakout would require similar action as would a break of a regular DD or SB setup. In fact, if we would also wrap a box around a group of dojis that make up a typical DD, we would basically create a miniature BB setup. The same goes for the SB pattern as a whole, though be it that the entry in this setup usually shows up *before* the highs or lows of the complete pattern are taken out.

But make no mistake, when it comes to the BB setup, we are not just dealing here with another trick to take a with-trend trade at the end of a pullback, although that is one of its functions. What gives this pattern its unique quality and personal character is its multipurpose application. This setup could essentially show up anywhere in the chart, while still conforming to the requirements of a tradable event. Its abundant presence makes it one of the better weapons to tackle almost any market, trending or not.

There are some factors to assess, though, before we can start to regard this pattern as a valid setup. We cannot simply trade any odd block break and expect the market to take off for at least a 10 pip run. As is the case with any other setup, the block break, too, should be seen as just an *aid* to get in on a market that has already been identified as favorable; it would be a painful mistake to use it as a pet setup with little or no regard for underlying conditions.

But what exactly is a favorable market?

As we have already observed, a pullback in a trend, for one, leaves little room for discussion on that part. But how about a sideways market that just printed a nice double bottom and a higher bottom in support? How about a market that broke so violently that countertrend traders cannot even force a noteworthy pullback in it? How about an uptrending market that shows clear signs of resistance, like double tops and lower tops? And what about a market that seems chaotic in any respect, apart from the fact that it successfully slammed back all attempts to break a round number zone?

The situations above, just randomly chosen, may be as different from each other as night and day, but they do have one particular characteristic in common: not so much that they paint a very vivid picture of the perpetual clash between the bulls and bears, but more that they show us who is currently winning. The market may put up a fight, as it tends to do, but in the end, prices simply have no choice but to succumb to whoever is pushing the hardest. Just when and how, that is for a trader to find out. But maybe it is nice to know that the point of surrender is often preceded by a suppressed block of candles ready to pop.

Since there are just too many variations of the BB setup, it is best to get to the charts and see them in the flesh. Before we do that, let us first point out the most likely places for this setup to show up. In essence there are only three. 1: As a block of bars in the end of a pullback. In case this pullback is quite extended, the setup may at times show the characteristics of a countertrend trade. 2: As a horizontal pullback in a strong trend. This block usually shows up in a very brisk move that just cannot seem to pull back. Whereas a typical pullback seems to move somewhat diagonally against the trend, this one merely travels sideways, forms a block, and then breaks out in the direction of the trend. 3: As a block of bars in a non-trending market. This block can be found in topping or bottoming price action and even in the midst of a sideways consolidation. It can be played with-trend as well as countertrend.

As we will see in the next three chapters on Range Breaks, the BB setup can also be involved in the breakout of a bigger pattern, the range, but we best take on that correlation once we have familiarized ourselves with the more individual block breaks first.

In the coming charts we will see all of the BBs encapsulated by a rectangular box, aiding the visual process of identifying the highs and lows within each block. Although it is not necessary to draw these boxes when engaged in a live session, it does come in handy to at least plot the signal line in the chart. That way we can keep a real good eye on the exact break, because the highs or lows that make up the signal line may be several bars apart.

Note: When looking at the chart, it is quite tempting to focus mainly on the moving price action and on the possible development of a tradable setup. Yet the status of the overall picture deserves the most attention. Whatever price bar is currently being formed, it can only derive value from its relation to the bigger picture. It is this wider view on the price action that ultimately determines our setups to be valid or not. On average, an hour and a half of price action will usually do just fine. To stay sharp and not lose focus, repeatedly force yourself to judge the price action in its present light. Do you see higher bottoms, lower tops, horizontal breakouts, round number fights? Is the market trending, running in resistance, testing support? Keeping track of the 20ema is just one way of assessing the current pressure in the market, and an excellent one at that. But the whole array of actual tops and bottoms in the chart determines the overall pressure. More distinctive higher bottoms than lower tops: the pressure is currently up. More distinctive lower tops than higher bottoms: the pressure is currently down. Alternating tops and bottoms: the current pressure is evenly distributed.

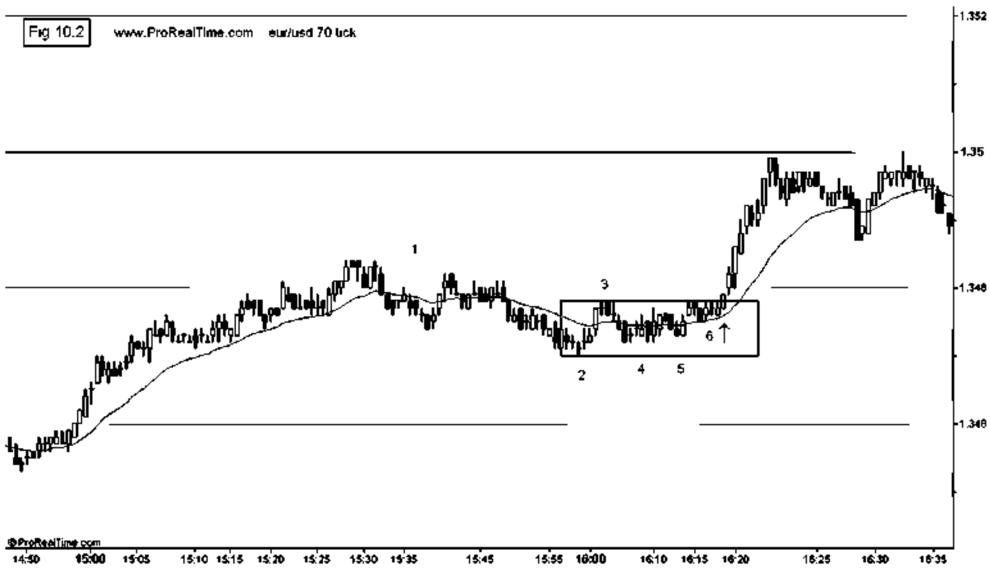

Figure 10.2 Painted by the magical hand of the market in the space of just twenty minutes, the BB setup in the chart above looks treacherously non-descriptive. However, this one little pattern may very well represent the near perfect box, should there exist such a thing as perfection in the tricky nature of the market.

Let us see how exactly this pattern earned its credentials. Earlier on, the bullish character of the market was somewhat curbed by the resistance of the 1.3480 level (1). After a little *backing and filling*, as aimless price action is often referred to, the market drifted lower in the next 30 minutes of trading and then established its most distinctive low so far (2). Of course, we can only identify this low once the bulls start to buy themselves into the market again and take prices back up. Since it is our primary intention to trade this particular chart to the upside, we have to wait patiently for some sort of resistance to come in. This resistance can then later be cracked. The first sign of it was portrayed by the first distinctive top of (3) that followed the low of (2). That gives a scalper a potential level to put his signal line on.

Now that we have a high and a low to go by, it is just a matter of following the price action until anything tradable develops. Preferably, we like to see a number of equal highs hitting the potential signal line, but the market is not always so kind as to serve a trader on his every wish. Should prices break out immediately, then that is just too bad. There are many ways to play the market and should a scalper have to forgo a particular setup, then he just moves on to the next tradable event. In this case, prices very orderly stayed within the boundaries of the low and high and even managed to produce 7 equal tests of the first high in the box, which is excellent. The stronger the significance of the signal line, the more traders will spot the break and have to react. Either to get in or to get out.

Within the setup, a number of higher bottoms can be counted (4, 5 and 6), lending extra credit to the possibility of a bullish breakout. As the coil is now being suppressed to the max, something has got to give. We can imagine it to be the signal line, but as clever scalpers we will never act before our turn.

Notice how gently the 20ema eventually guides the bars through the top of the box, literally pushing them out. The six small bars right before the break, five of them sharing equal highs, represent what we will refer to as classic *pre-breakout tension* (6). We could say it is a miniature box within the box itself. The subsequent reaction to the break speaks volumes. With the 1.3480 resistance area now cleared, prices were simply sucked into the vacuum below the round number zone of 1.35.

Note: Similar as in the previous chart (Figure 10.1) there is a little overhead resistance to be spotted to the left of the setup (1). Would that not be worrisome? To a tiny DD pattern it most probably would. There may just be too little tension building up within the dojis to counter the resistance overhead. But the BB pattern, in that respect, is quite different: it has tension written all over it. What's more, the most likely reason why the BB set itself up in the first place is because of that same overhead resistance. Which is also why the break of it stands to cause a sharp reaction. Once the defenders give up and step out of the way, the path is usually cleared for at least a number of pip.

Aspiring scalpers, when slowly taking a liking to this method, are recommended to study the characteristics of boxes like those of Figures 10.1 and 10.2 (and their reversed counterparts) with great attention to detail. Hardly a session will go by without these very tell-tale patterns showing up in the chart, one way or another. However, it is important to never lose sight of the overall pressure in the market, because that is what ultimately determines the future direction of prices. Obviously, assessing the overall pressure in a trending chart will not cause much problems. In more sideways progressions, this process requires a little more subtlety on the part of the chartist, as is the case, for example, in the next chart below.

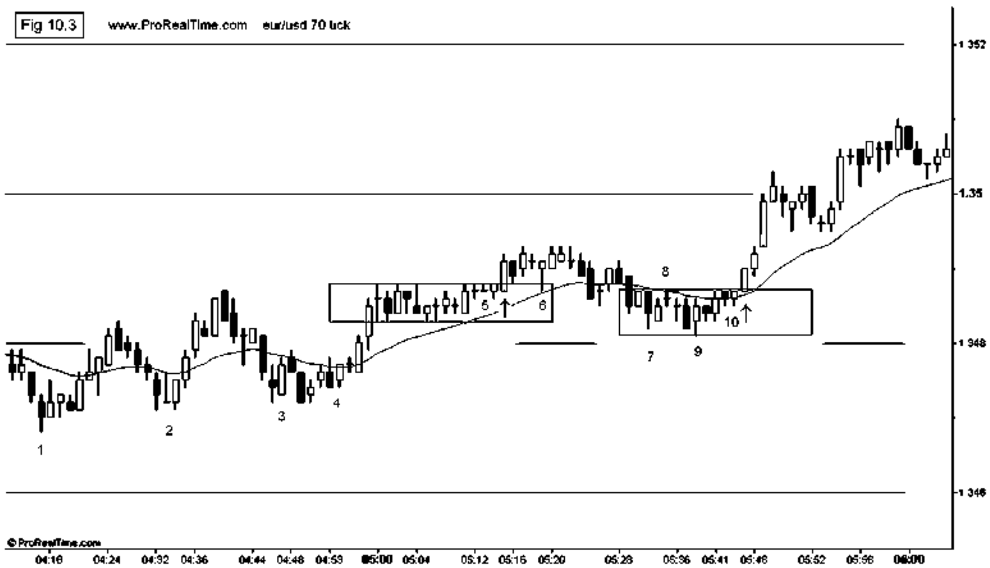

Figure 10.3 When casually regarded, the sideways action before 05:00 could be interpreted as ordinary backing and filling; after all, price merely dances above and below the sideways trailing 20ema without showing particular preference to go one way more than another. Still, the observant scalper may have already spotted a series of almost nonchalantly printed higher bottoms in this sideways progression (1,2, 3 and 4). When that fourth higher bottom was printed, forming a cluster together with the handful of price bars next to it, things are starting to get interesting. Take a moment to compare the sharp upmove initiating from the second bottom (2) with the move that emerged out of the cluster (3 and 4). Although they look quite similar in their thrust, the first one shot through the average with hardly any buildup preceding it, whereas the latter first saw a cluster of bars build up tension before breaking out. As subtle as these differences may be, they are of great significance

technically. Both moves seem to appear equally strong, but the one that emerged out of the cluster stands a much better chance of holding up. Not only does it stem from a slightly higher bottom, the fact that it broke free from a cluster puts a solid foundation beneath the current market. This means that if prices were to retrace back to where they broke free from, as they often do, they are most likely to be halted right at the level of the earlier break (resistance becoming support). After all, it is much harder for prices to dig themselves a way through a solid group of bars than when there is very little standing in their way. The mere implication of potential support can already be so strong that a market doesn't even feel the need to test its validity.

In a similar way, tension was also building up within the first BB setup in the chart. No less than seven equal touches of the top barrier can be counted within that block before the market finally broke through to the upside. Notice how prices bounced off of the signal line, a few bars after the break, which clearly shows us the power of cluster support (6).

Have a look at the three very small dojis leading up to the break of the box (5). They are displaying in miniature the same pre-breakout tension as the complete box is displaying in the bigger picture of the chart (just wrap an imaginary box around the highs and lows of the price action from 04:16 to 05:16). At the risk of being overly elaborative, I am pointing this out for a very valid reason. If you learn to train your eye to recognize these subtleties in a live market environment, you will eventually be doing yourself a tremendous favor. The rise and fall of prices is not a result of somebody swinging a giant wheel of fortune. There are actual people in the market, trading actual ideas, feeling actual pain and actual pleasure. You may never know for sure what motivates them to do what they do at any given moment in time, yet of one thing you *can* be sure: their actions are reactions to other traders actions, which is why most of the time everything happens in such repetitive manner. Markets may be random, as it is often stated, but traders surely are not.

Despite the upward pressure, the cluster below and the magnetic pull of the round number above, with-trend participation after the break quickly died out. Eventually, this trade would have had to be scratched for a loss (where exactly to bail out on a failing trade will be discussed in Chapter 14 on Tipping Point Technique).

Although they clearly lost a round, we can expect the bulls in this chart to not just crawl up in a turtle position. Given all the higher bottoms earlier on, they will surely be on the lookout to buy themselves back into the market at more economical levels. The most logical area to pick up new contracts would be in the 1.3480 support zone. In fact, they didn't even wait for prices to hit the level spot on (7).

With the market traveling a few pip higher because of this buying activity, touching the 20ema from below, the bears were now offered a more favorable level to become a little more aggressive (8). And indeed, they managed to squeeze out one more low (9). They were given little time to enjoy that feat, though, as a large number of sidelines bulls quickly stepped in. It is the information necessary to keep a trader on high alert for another bullish attempt to take control of the market.

With no less than six equal highs testing one another, a scalper did not have to think very long about where to draw the signal line of the second box.

What is the major difference between the first box and the second? At first glance, box number one originated from a more favorable position (above the 20ema), whereas the second box popped up in sideways action (flat 20ema). Keep in mind, though, that the market couldn't care less about our 20-bar exponential moving average. That is only an instrument in our own personal toolbox. In fact, in a somewhat sideways environment, buying above it could at times be more dangerous than buying below it. Therefore, from a technical perspective, both patterns here are very similar in nature: sideways action, support holding up, a buildup of tension and a subsequent break. Take a mental note of the two little dojis right before the break of the second box (10). We will see this duo many times over throughout this guide. They represent classic *pre-breakout tension:* a final attempt of those who operate against the current pressure to keep the box from breaking. Both bulls and bears will be very quick to act, though, should the proverbial jack pop out. In the first block pattern there are even three of these dojis to be detected, together forming not only a higher bottom in the box but also the very welcome pressure underneath the signal line (5).

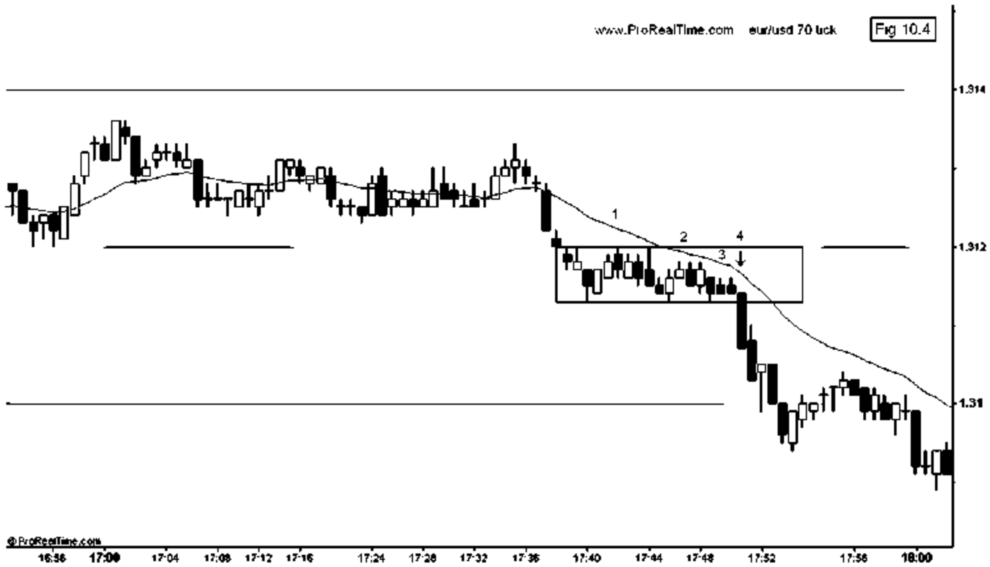

Figure 10.4 No less than six reasons immediately come to mind why this short trade has excellent potential to pocket a trader another 10 pip of easy profit. 1: The market gave up a rather lengthy support zone (first half of the chart). 2: Countertrend traders lacked enthusiasm to test the broken support properly (1). 3: Instead, a lower top got printed in what can only be described as a horizontal pullback (2). 4: Two tiny dojis represented pre-breakout tension (3, basically another lower top). 5: A solid signal line succumbed to the bearish pressure (4). 6: The magnetic pull of the round number below may just finish off the job (1.31).

As pleasurable as it may be to occasionally stumble upon the near perfect trade, it also poses a rather interesting challenge on the topic of volume versus predictability. If we were to assign a rating to each individual trade—by counting the number of valid reasons to either skip or trade a setup—and came to conclude that the probability factor is apparently not a constant but varies visibly from setup to setup, should this not force an intelligent strategy to alter the volume per trade in compliance with the degree of predictability?

As you may recall, I strongly suggested to not put more than 2 percent of capital at risk on any one trade (when consistently profitable). I also suggested to cram as much volume in these 2 percent as allowed in order to exploit our edge to the fullest. If so, then that rules out adding anything extra, no matter how good-looking the trade, because the maximum amount of units are already at work. On the other hand, one could argue that if there is such a thing as a superior trade, then, naturally, there must also be its counterpart, the inferior trade (though still possessing a positive expectancy); when opting to trade the latter, could one not *take off* volume and tread lightly?

The true statistical mathematician, the one that eats bell curves and standard deviations for breakfast, would probably cringe at the typical layman's view on probability. And rightly so. Still, it remains to been seen whether his clinical calculations hold up in a real market environment, where nothing is what it seems, where dubious emotions play a major role in assessing the odds to begin with, and where his faithful law of probability may even be defied by the very same forces that are causing it.

Once again, my take on this matter is to not delve into the complexities of individual outcomes, but to at all times keep things simple, with the bigger picture in mind. Once consistently profitable in the market, even marginally, a trader could best explore every *valid* setup with appropriate passion and just load up. Whenever we picture ourselves to have an edge, each setup deserves to be treated with equal respect, no matter how shady or pretty its appearance. And that means assigning the maximum allowable amount of units per trade to fully capitalize on the principle of positive expectancy.

Note: Contrary to common perception, the least important of all your trades is the one you are currently in. All your previous trades, though insignificant by themselves, at least have a statistical relevance. Together they determine the power of your edge. Your current trade, on the other hand, has yet to earn its notch on the historical slate. It is just a trade in process. And it is totally irrelevant whether it will win or lose. In fact, in a consistently profitable strategy that has proven to stand the test of time, a losing trade is basically a false assumption. Why is that? Reflect for a moment on the following: if a 1000 individual outcomes would show an assembled profit of 2000 pip and your next trade came up a loser of 6, would you say you just lost 6 pip, or rather that you made another 2 on balance? Granted, embracing a losing trade as if it were a winner may be stretching it a bit. But the point does show the importance of a proper understanding of distribution in a probability play. All individual outcomes are just data. The only thing that truly matters is the collective result of all your scalping actions in the market.

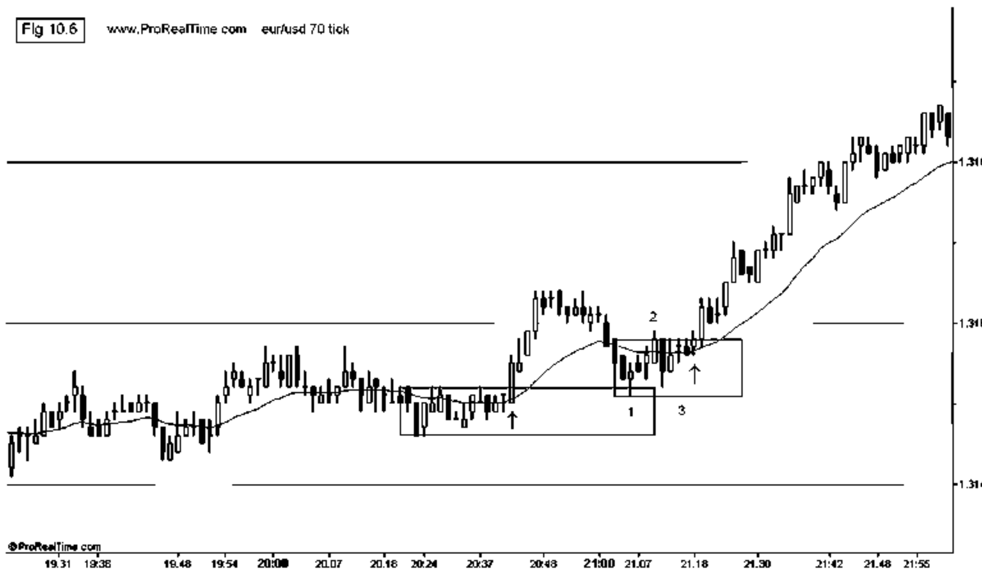

Figure 10.6 When confronted with a dull and rather lengthy non-trending market, like the first half of the chart above, it is not uncommon for a trader to start experiencing a somewhat uncomfortable mixture of impatience, boredom and even agitation. It can indeed be a mental challenge to have to sit out these times of inactivity, hoping for action and not getting any, especially to those traders who look upon their trading platform as a slot machine in a penny arcade. A word of caution may be in place here, because these sideways ranges do have the nasty habit of luring a trader in one of two very classic mistakes.

The first one is to start seeing and taking trades where there are none to be found. This warped sense of reality is typical for a trader who just *needs* action. And wrath be upon the market if he doesn't get it. Apart from the occasional winner that may come out of this, seeing a growing bunch of scratched trades eat their way into earlier profits will sooner or later present this trader with the unsettling notion of being reprimanded by the very market he is trying to punish. Needless to say that this sort of attitude towards trading is of the backfiring kind, and it remains to be seen whether this trader can pick himself back up in time for when the real action begins.

The second classic mistake is made by traders who on the surface seem to stay composed rather well in a sideways market. You won't catch them doing anything irrational like taking silly trades, nor will you see them get angry with the market or force their will upon it. They can watch the proverbial grass grow for what seems like an eternity without any sense of discomfort. Proficient enough to recognize the current indecision of the market as something that needs to cleared by powers bigger than themselves, they simply sit back. Up until that one amazing moment that boredom abruptly kicks in. For reasons unbeknownst to themselves they suddenly have to get up to make these phone calls, do their exercises, watch the news on the TV or even take a stroll outside. Anything to get away from that screen and that market!

Although not nearly as detrimental to a trader's overall results as the other case, giving in to a sudden burst of boredom after a prolonged spell of inactivity is like walking away from an investment that is just about to sprout. It is a pity that traders are so caught up in the notion that trading trending markets is the only way to go. Contrary to popular believe, sideways markets deliver excellent opportunities, for the simple reason that they have to break out eventually, just like a trending market will eventually come to a halt or even reverse. Whereas it is impossible to define the exact moment when a trending market will move into the sideways phase, the sideways market, on the other hand, can give off very strong signals that it is about to move into a trending phase.

A good example of such a predictable breakout can be found in the chart above. The first hour of price action obviously shows the market in consolidation mode. With the moving average traveling sideways and price bars alternating above and below it, there is not much to make of it. This is your typical round number zone tug-o-war in the absence of a clear incentive (1.3150). But of one thing we can be sure: unless it is a national holiday, late Friday evening, or lunchtime in an already dead Asian session, price will not stay put for hours on end. Sooner or later some party will give the market a push and that will be incentive enough for others to react.

The trick is to recognize the buildup that most often precedes it. This is why it is so important to familiarize yourself with *pre-breakout tension.* What will help is to draw, or imagine, a box around any clustering price action that might lead to a break. It may take some practice to recognize the right set of bars to wrap a box around, but essentially there are not too many variations to grasp. The first box here, for instance, is almost an exact copy of the fourth box in the previous chart (Figure 10.5, box 4).

By extending the signal line to the right, we can see that the pullback following the break successfully tested the breakout level as well as the broken round number of 1.3150 (1). That will certainly have inspired a number of bears to just throw in the towel. And a number of bulls to quickly enter the ring. However, despite this potential for double pressure, markets do not always immediately pop. In this chart the bears still put up a reasonable fight, as we can tell by the cluster of hesitating bars (3) that eventually led up to the forming of the second box.

If you look closely, you can see that the top barrier of this second BB setup is not exactly running across the absolute high (2) but one pip below it, across the equal extremes of four consecutive bars. As much as it may be preferable to see a signal line unbroken by an earlier bar, we definitely do not need to see the perfect box in order to trade. Whenever there is room for a little doubt regarding the actual breakout level, it is best to let yourself be guided by technical logic. Here it seems logical to put more weight to the four equal highs than to that one single high sticking out on the left. It would be overly prudent to wait for this high to be taken out, too. But let us ignore our setup for a moment and see what the market has to say about this: it put in a series of distinctive higher bottoms within the course of two hours; it broke a round number zone and saw it successfully tested; it built up towards a possible bullish breakout and now it breaks a cluster of four bars with equal highs. I think it is telling us to trade.

Excerpts from Chapter 11: Range Break (RB)

Figure 11.2 This chart is almost the mirror image of the previous example (Figure 11.1). Once again, the breaking of around number zone trapped traders on the wrong side of the market. In the previous chart, it was a downward break through the zone that not long after turned bullish, here it was an upward break that soon turned bearish.

Is there a reason these round number breaks don't hold up? Probably no more than there is to any other break or move that fails or falls short: a lack of follow-through. It is not uncommon to see enthusiasm dwindle in rather subdued markets, or in situations where the round numbers are more of a symbolic nature than that they actually represent true technical levels of resistance and support. In these cases, it is fair to assume that not too many stop-losses reside above or below the levels. As a result, the price action remains calm; as much as those in position do not see the need to get out, those on the sidelines are not exactly scrambling to get in, either.

More practical than trying to figure out the reason (foolish in any respect) is asking ourselves if these failed round number breaks could somehow be anticipated and possibly exploited. Interestingly, in the majority of cases there is indeed a pattern to be spotted. First the round number is broken, quite often with hardly any fight. Not much later the break is tested, usually successful. On seeing this, a number of new players step in, thinking they're in for a treat. And then, for some reason or another, the play dies out like a flame. Traders at any moment in time may buy as cheaply or sell as dearly as the market allows them, but if no new players pick up on their idea of direction (follow-through), they are trapped on the wrong side of the field. All of this is not uncommonly captured within the confines of an unmistakable range very close to the round number of interest. It is a scalper's task to figure out when the predicament of the trapped becomes unbearable from a technical perspective. Naturally, the idea is to capitalize on their instinct of flight.

Everything is very easy in hindsight, yet if you managed to grasp the concept of the forces in play that caused the upside break in Figure 11.1, I am sure you can also see why this particular range, halfway through, started to develop a fancy for a downward break.

Let us examine up close what exactly went on from the moment the third top was set (4). It started to go wrong for the bulls when the reaction to this top (a tiny countermove) was not being picked up by new bulls in the 20ema a few bars later. That would have been a perfect opportunity to swing prices back up. From there on, they could have created themselves a nice squeeze by not giving in to whatever bearish pressure and then force themselves away through the top barrier of the range. In fact, the three earlier tops (1,3 and 4) would have made for an excellent barrier to trade that upside break from.

However, instead of working on that upside break, the market set out on its way to the bottom of the range again (5) and now even showed a classic triple top in its wake. These are not bullish signs.

But there was hope still. After all, the round number zone was cracked to the upside and successfully tested earlier on, and that should at least amount to something. If somehow new bulls found it in their heart to aggressively step in above the 1.33 level, inspiring even more bulls to jump in after them and bring prices once again to the top of the range, the chart would show an unmistakable double bottom in round number support (2 and 5). And that would look quite bullish.

Sometimes it only needs one bar to turn pleasurable hope into the idle variety. How about that little doji (7) that stuck its head a pip above the high to the left of it (6). A higher high in a bullish market after a possible double bottom in round number support, that should have attracted new bulls to the scene. What kept them away? We can imagine it to be the triple top pattern to the left; but it is not our business to decipher or explain the actions or non-actions of our fellow traders. Everything is just information.

As observant scalpers our task is not just to monitor a chart, but to look for clues in it. The more crucial the signs we can assemble, the more we can solve the puzzle of who is possibly toppling who in the market. Any sign or hint that leaves a distinctive mark in the chart will work to the benefit of our assessment. These signs, at times, can be quite obvious, like triple tops and other well-known reversal patterns, but they can also be rather tiny, like a one pip false break. The best indication to determine the value of a particular chart event is to consider its place in the chart in relation to whatever price action preceded it. To give an example, the tiny false upside break of (7) would have been considerably less indicative had the market not printed that triple top shortly before.

With prices now trapped below the 20ema, the market was on the brink of being sandwiched into a bearish breakout through the bottom barrier of the range.

That brings us to the interesting part that you may have already spotted: the first breakout below the barrier. Why did I mark this one as a tease (T).

Granted, this one reflects the proverbial close call and I couldn't really argue with anyone looking upon it as a valid break. For my own personal comfort, I would like to see prices get squeezed a little bit more before breaking down. Preferably, I would like to see the market print a couple of dojis right on the bottom level of the range (as in a regular BB setup). It must be stated, though, that a conservative stance is not always the most successful approach.

It would be nice if we could really put a rule of thumb on these false breaks, particularly on the tease variant, but alas, it often depends on the situation at hand. Here the market was extremely slow and the price action very subdued (almost every bar a doji). That makes me want to wait for superior conditions just a little bit longer than, for instance, in case of a speedy market, where I might run the risk of fully missing the break on account of being too conservative.

Note: As for the difference between the false break trap and the tease break variant, imagine for a moment the 05:00 low (5) to have dipped a pip below the range barrier. That would have turned it into a false break of the earlier bottom of (2) and not a tease. Why? Because prices came straight down from the high of the pattern (4) to the low of it and then immediately broke through without any buildup. That typifies a classic false break (in terms of potential, of course, for any break, even a silly one, may find follow-through and prove itself true). When it comes to the tease break, on the other hand, the cracking of the range usually starts with a move that originates not at the top or bottom of the pattern, but more from the middle of it, or at least from the 20ema zone. In case of a downward break, for example, before breaking out, prices usually first touch the bottom barrier and then bounce up to make an intermediate high in the 20ema. From that point on there may be some squeezing between the average and the bottom barrier, but usually too little of it to consider it sufficient buildup to a tradable break. It would be preferable to see prices bounce up and down at least a few times between the bottom barrier and the average, until they are finally being squeezed out. And that makes sense; the more contracts change hands in the squeeze, the more traders will find themselves on the wrong side of the market once support gives in. And most of them will have no choice but to sell back to the market what they had bought at bottom prices just moments before. Add to this a number of sideline bears eagerly stepping in and we have ourselves the perfect ingredients of double pressure and thus follow-through.

At times, the anticipation of this little chain of events is very straightforward. At other times, the assessment of the squeeze can be a lot more subtle and it may leave a scalper wondering whether or not to trade. Particularly when the space between the 20ema and the barrier line is no more than a few pip in width, the tease break may be almost indistinguishable from a valid break.

If you ever find yourself caught in a tease break, or in any other valid break that acts as a tease, similar calm is required as in the case of the BB trade where prices break out of the box and then crawl back in. As we have seen already in several examples, the 20ema, just like in the chart above, can still guide prices back out in favor of the trade. In many cases that is also the final incentive for the market to really pop.

Take a moment to compare the string of black bars after the break in this chart with the string of white bars after the break in Figure 11.1. What do these moves represent? They clearly show us the unwinding of positions of those traders trapped on the wrong side of the market. In the chart above, for instance, *all* scalpers that picked up long contracts inside of the range are carrying losing positions the moment prices break down below 1.33. That string of black bars represents their predicament and their panic, so in essence a rapid unwinding of long positions that are being sold back to the market. Naturally, clever bears on the sidelines, smelling blood, will be happy to add fuel to the fire by quickly selling contracts to whoever still entertains bullish fantasies. Of course, even a falling market will always find traders ready to buy, but these bulls will not be so eager as to not demand lower prices to trade at. As a result, prices will fall even more until eventually the market calms down and more bulls than bears are willing to trade. This, in short, is the principle of supply and demand. It works the other way around in equal fashion. And it is our job to anticipate it before it even takes place. To the non-initiated this may seem like quite a daunting task. Yet those who observe, study and learn will most likely come to see the repetitive nature of it all. And soon they will be able to exploit those who do not.

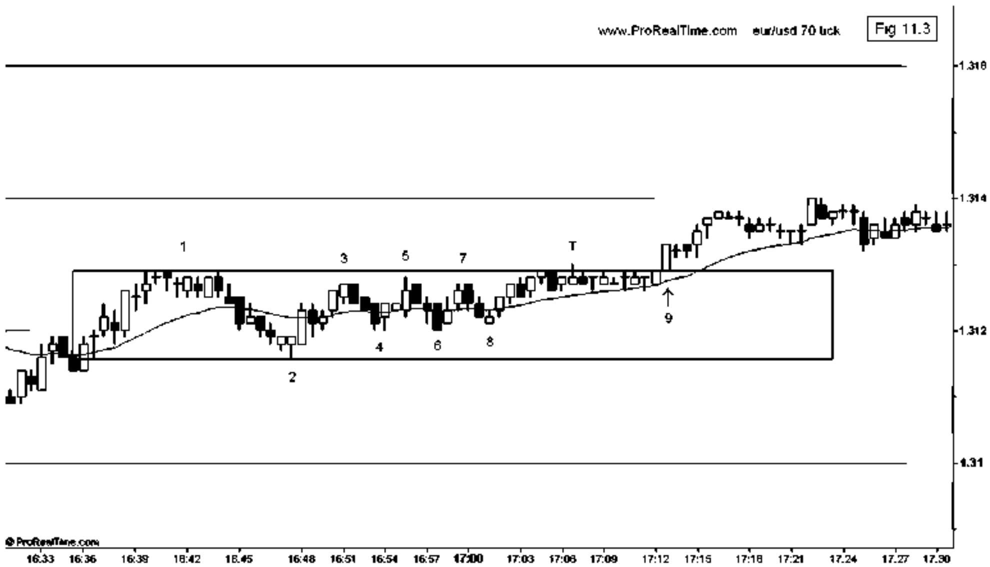

Figure 11.3 Anyone who has ever studied the eur/usd pair on intraday basis will surely have noticed this market's remarkable tendency to move in stepwise increments of 20 pip. For example, if, say, 1.3120 is cracked to the upside, as in the chart above, and then tested back and proven sound, then, more often than not, the market's next stop will be 1.3140. Variations on this pattern repeat themselves with such relentless persistence that it is not hard to imagine how numerous intraday strategies are solely built to exploit this phenomenon. And yes, the market's fixation with these round number levels at times is truly astonishing. Of course, as scalpers we are only interested in one thing: can we exploit it?

Psychologists have us believe that the omnipresent round number effect, visible also in many other aspects of life, has no coherent relation to value whatsoever but is simply a way for the human brain to filter out noise to protect itself from information overload. From a practical perspective, there may even be a strong self-fulfilling aspect attached to it: if we all believe that round numbers bear significance, then, naturally, our actions concerning these numbers bring significance about. Anyhow, if nothing else, round numbers do have the pleasant side-effect of framing things in organized manner, just like wrapping boxes around ranges gives us clarity on resistance and support. When it comes to the 20-levels (00, 20, 40, 60 and 80), you will have noticed that I have set up my software to plot these levels thinly in the chart; but I use them solely for guidance and try not to look upon them as absolute levels of resistance and support. They may do so at the moment, but I rather leave that to the price action itself. Frankly, in the never-ending quest for simplicity I have tried to scalp with a clean chart, meaning without the 20-lines in it, but somehow my conditioned brain felt less comfortable without these levels framing the action. This may very well be a personal quirk and any scalper can try for himself what suits him best. One last thing: on the road from 40 to 60, and the other way around, things can get very tricky. Currency trading, like it or not, is a big players game, and the 50-level is arguably their favorite toy. Unlike the 00 round number, this level is not a 20-level itself. Hence the occasional conflicting mishmash between 40 and 60. However, do not *expect* anything to happen around this level. Just be on the alert. Always monitor any action carefully, but keep a special eye on the two major round number zones of 00 and 50. More often than not, these levels are what the bigger chart is all about and why we see so many ranges appear as a result.

Let us look at Figure 11.3 and see if that RB trade was easy to spot. Halfway through the chart, the options are very much open. There are no trades near and a scalper should just relax and apply patience. To obtain an idea on support and resistance, he may have already drawn a horizontal line across the first top of (1) and then another below the low that followed it (2). Tip: you do not necessarily need to draw boxes, a horizontal line across the tops and one beneath the lows will do just fine.

At any moment in time there are always three ways to look at a chart. Through bullish eyes, bearish eyes, or neutral eyes. Needless to say, observing the price action with a neutral disposition is the way to go. Many traders, however, can't help themselves looking at the market from the perspective of their current positions (or intentions), so either from a bullish or a bearish stance. It is a bit the same as with the novice chess player who only moves his pieces around in order to attack; this player usually pays very little attention to position play or even to the many gaping holes in his own defense.

When biased towards the upside, a bull may view the triple bottom pattern (4, 6 and 8) as a very healthy token that the market is building up towards a bullish breakout. And with reason; the market definitely shows signs of support in the 1.3120 area. Should it continue its pattern of slightly higher bottoms, then breaking out to the upside, eventually, would technically be the most logical result.

When looking at things from the bearish side, traders may find comfort in the triple top pattern (3, 5 and 7) that appeared on a lower level than the earlier, more dominant top of (1).

As neutral scalpers, we can only sit back and enjoy whatever the market has in store for each party. If you place your thumb on the chart for a moment, to block the prices after 17:00, you can see that it wouldn't have taken that much of an effort from the Powers That Be to give this chart a more bearish look; cracking the 1.3120 level by a few pip would have probably done the trick. One thing is of importance, though, and that is to not walk away from this chart in a silly act of boredom. If the bulls show a bit more persistence, particularly when entering a potential squeeze phase, we may have a trade on our hands in a matter of minutes.

The first break through the upper barrier could be classified as a typical tease on account of it not originating from a proper squeeze situation yet (T). In order for the market to deliver a more reliable break, it is preferable to see prices first retest the 20ema again and then attack the barrier in buildup fashion. As a matter of fact, the subsequent price action after the tease, that is the perfect squeeze that led to an excellent textbook RB trade (9).

If these tease breaks, after breaking back, are so often caught by the 20ema and then still manage to break out eventually, couldn't we just always look upon them as valid breaks and trade them no matter what? That is a very fair question. So far the examples here show outcomes that point in favor of that option. It is my observation, though, that in most cases you can get away with being a little more patient. In other words, missing a range break trade due to a conservative stance is less common than one might think.   Secondly, there is also the matter of protection to take into consideration. As we will see in the section on Trade Management, squeezes provide excellent levels for stop placement. Conversely, a tease break situation, in essence a somewhat hastier break, seldom delivers the same technical clarity in terms of where to place the stop. When trading breaks, patience truly is a virtue. Therefore, my advice would be to shun the non-buildup breaks entirely (false break traps) and those resulting from little buildup as much as you can (tease break traps).

Note: If prices after a tease break are pushed back inside the range but not much later break out again as in a valid RB, then it is not necessary to postpone entering until the tease level is taken out, too. It is usually best to just take the trade as if the tease had not occurred, which means firing a market order on a break of the original range barrier. An exception would be if there are multiple tease breaks in a row that together form a new barrier by themselves. Then it may be recommended to assess the situation from the perspective of that new barrier (see Figure 11.6 for a good example).

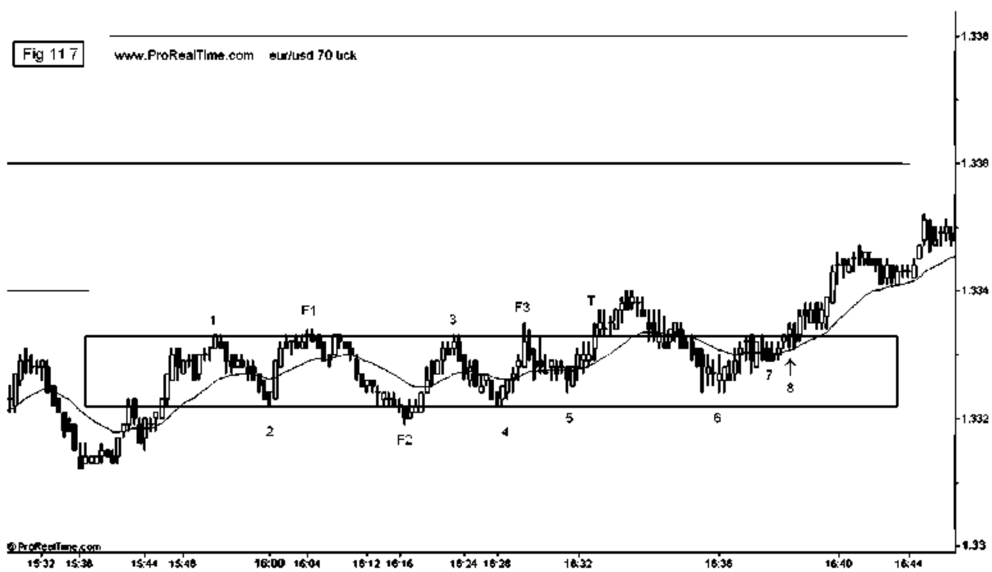

Figure 11.7 This range may look a little rough around the edges but all in all it contained pretty straightforward price action. Despite the many false breaks, there was no need to get caught in any of them. In fact,

a scalper would probably not even have started plotting his barriers before the top of (3) equaled the top of (1), and the low of (4) equaled the low of (2); and that would have already eliminated two false breaks (Fl and F2).

This chart, obviously, shows the market being a bit nervous. If you look closely at the time scale below it, you can see that the second half of the range printed the bars about three times as fast as the first half of it. By that information alone, it is quite safe to assume that halfway through it, the market was bracing itself for a typical news release. News releases bear an intrinsic potential to really rip a chart apart. They are mostly dreaded by those in position, of course, for there is no way of telling how hefty the market will respond. The first sign of news hitting the market is the way the chart speeds up. It means that contracts change hands so feverishly that it looks like the bars are literally being spit out on the screen. Seeing them get printed ten times as fast as their normal production rate is definitely not uncommon. It is also the time when you can really tell the difference between a tick chart and a time frame chart; tick charts can still show the ebb and flow of even the wildest markets, whereas a 1-minute chart, for example, may just show a huge 1-minute bar. A second characteristic of news hitting the market is that resistance and support levels can evaporate in a matter of seconds, regardless of their earlier significance. And then there is the potential for huge spikes, even 50 pip or more; these arrows of death are not only known to shake traders out of their positions at the speed of light, they tend to cause enormous slippage to boot. Not seldom, these spikes are extremely short-lived, but that is of little consolation to those shaken out. All in all, news breaks offer a dangerous environment to scalp in. To avoid getting caught by surprise, traders can check the economic calendars (freely available on the web) for the exact moment of *major* announcements (like interest rate decisions and non-farm payroll numbers). If caught anyway, and not immediately shaken out, just remain calm. Always aim for a technical way out of a trade. With a bit of luck the market hits the side of the target first. If it shoots off the other way, then there is always the automated stop to prevent excessive damage. It may get hit with slippage, but that is just part of the game (and a good incentive to be more cautious next time).

But the market's erratic reaction to a news release may not be the only danger to worry about; retail traders trading through a no-commission retail broker are advised to check their company's policy on spread mark-up, because some spreads are known to go as high as 10 pip during news breaks. Of course, traders should avoid these brokers in the first place. But then again, trading through a retail broker is a game of give and take. If the broker is okay in any other respect, offers a solid platform to trade from and keeps the spread at 1 pip throughout 99 percent of your sessions, then a simple solution would be to avoid the occasional mark-up by simply not trading during a hefty news release. The brokers to absolutely avoid are those who mark up their spreads more sneakily for no particular reason and for hours on end. Even if they just add a few pipettes either side, it can have a devastating effect on even the best of scalping strategies.

In terms of turmoil, the reaction to the news in this chart was rather subdued. But not without tricks, though. First appeared another false upside break (F3), which got slammed back pretty fast. Next in line was the tease break (T) that suffered a similar fate.

We have to give the bulls some credit for not throwing in the towel then and there. Instead, they played their last trump card, which was to keep the pressure up by not allowing prices to slide below the last low in the range. And that worked out wonderfully well. The low of (6) matched the low of (5), forming a double bottom, and not much later prices were pushing against the top barrier once more (7). Notice the pretty little squeeze and how nicely the 20ema guided prices out of the box. Out of all the breaks through that top barrier, this was the only one that deserved true RB status (8).

Excerpts from Chapter 12: Inside Range Break (IRB)

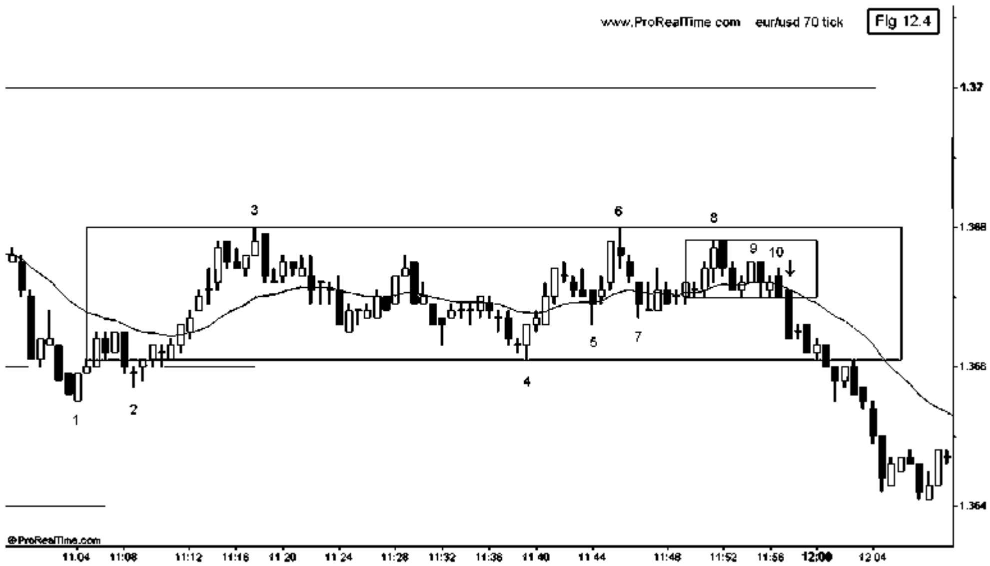

Figure 12.4 Once again, we got ourselves a range formation that gets resolved in about an hour's time. As we have seen already many times before, it is not essential for the market to have prices attack a particular barrier up to the point of exhaustion. Quite often, it needs no more than a double top or double bottom to show all participants who is in charge. At times, it can make you wonder, though, why at some point the strongest walls of resistance get attacked with a relentless fervor, while elsewhere in the market a mere halfhearted expression of power remains completely undisputed. But the market is what it is and does what it does. In the end, the direction of prices is a big players game and the mortal scalper has no business asking questions. The good thing is, however, that although the tiny trader may never know the *why* behind the big player's agenda, he may just be able to tell the *when* if he pays close attention.

Up until the encapsulated IRB setup there was not much to make of this range in terms of possible direction. Prices had printed a clear double top (3-6), indicating resistance, but a series of consecutive higher bottoms betrayed unmistakable support (2, 4, 5 and 7, all higher than 1). But once again, signs of support and resistance, no matter how prevalent in the chart, are not necessarily reflecting major levels in the market that need to be conquered unambiguously in a heroic fight, with one party ultimately succumbing to the other. In fact, they could dissolve in a matter of seconds without any signs of protest. That is why it is probably not a very good strategy—at least not for the aspiring scalper—to simply sell in resistance or buy in support, not even for the sake of a brief little scalp. Overall, the safer approach is to see how the market handles these zones and *then* try to trade them.

Whenever the market is approaching a barrier, or even just a former top or bottom, basically three things can happen. 1: the level is broken as if non-existent. 2: the level is fully respected and prices bounce off of it as if hit by a hammer. 3: the level is heavily attacked as well as defended.

It is the latter situation that presents the best opportunities in sideways progressions. And the longer the fights lasts, the bigger the pain of those who eventually lose out. In order to stop it, they can only do one thing, which is to flee from the scene as fast as they can. This hurried flight to safety, a mass exodus at times, is what presents the sideline scalper with an excellent opportunity to earn some pip at the expense of those on the run.

Almost by definition, any tension in the chart represents the dreams and hopes of two opposing parties. A bull, for instance, is basically telling the bear: I am buying your contract but I am shorting your dream. And, likewise, so does the bear scorn the bull in return. Inevitably, one of these two will soon pay the price for their bravado and the bill can be a painful one. Each and every trader on the sidelines, aiming for profit, has essentially just one thing in mind: to find out who gets the bill presented and then quickly capitalize on a burst of demoralization as many hopes and dreams get crushed. It should come as no surprise that the average trader is not particularly burdened by moral inhibitions, nor does he feel the need to pledge a humane disposition towards his fellow trader in the market. After all, he knows very well he is not exactly operating in the welfare industry and that at any moment in time he himself may get trampled by another. But the game, at all times, should be played fairly, with equal chances for all involved, big or small, bull or bear, novice or experienced. It is the novice, no doubt, who will get burnt the most in his line of duty; that is why it is so important to escape that status as soon as possible through sound preparation and extensive study, and with the inevitable lessons in the market costing as little as possible.

The IRB pattern in the chart above is another great example of how to trade a top barrier bounce. Or we could say, it shows how to capitalize on the pain of demoralized bulls running for cover after their dreams of higher prices got shattered by a simple break of the pattern lows. The pattern itself shows three arches, the second and third lower than the first, colorfully named a *reversed-cup-and-two-handles* formation by those who love their classic patterns (8, 9 and 10). No less than six identical bottom touches formed an excellent signal line before prices finally gave way to the downward pressure.

It would be a misconception to think that prices, at any one time, could tank or rise more than 30 pip straight on account of such a tiny IRB setup alone. Predominantly, the markets move because of the overall technical conditions. There could be a number of other reasons for markets to rise and fall as they do, even against the current trend, for that matter. But it is highly unlikely that a little tug-o-war with a vertical span of a mere 5 pip can cause the market to move six times the width of that pattern. The setups are nothing more than tools for entering at the best possible spots. The pattern here, for instance, was put in by the market at just the right place and the break occurred at just the right time; it only provided the proverbial trigger for the bulls to get out and for the bears to get in.

Whenever one party yields to the pressure of another, bulls and bears alike, though be it for complete different reasons, will start to aggressively hit prices in the same direction. In many instances, it only needs one single pip to surpass a certain level to provoke this unanimous act. It is a scalper's task to locate that very crucial spot beforehand and trade it the moment it breaks. He may only have a split second to act before it may be too late. But a split second is all it takes to fire an order that is already set.

Figure 12.6 Price action does not always have to win a beauty contest to deliver a tradable event. Granted, if the chart truly shows a mishmash of erratic movements that make no technical sense then it is best left alone until the picture clears up. But do not give up on a chart too easily. More often than not, from below the surface of non-descriptive price action clarity will emerge and before you know it the pieces of the puzzle may fall neatly into place. One more reason to always stay alert and focused, even throughout the less attractive doldrums of lunch hour ranges.

Like the proverbial ball that is pushed under water, so is the price action within a range suppressed and contained. But the equilibrium in both upward and downward forces is an artificial one and can only be of a temporary nature; eventually, like in any tug-o-war, one side will simply have to let go of the rope. When that happens, prices usually do the one logical thing: they pop. Of course, in the marketplace the pressure can escape at either side and it may not be in textbook fashion. What's more, even a classic break may turn out to be a trap. But does it really matter? Classic breaks are valid breaks and the occasional trap is just part of the game. The point is not to question the valid break but to avoid the classic trap. Regardless of his years in the market, a scalper will never be able to tell whether his break will be true or false.

All he can do is follow the clues in the chart and trade any valid break that comes along.

Let us look at the chart above and see if we can detect the signs that may have inspired a scalper to trade the IRB breakout. In the beginning of the chart, prices came down from a 20-level to test the round number of 1.33. They subsequently bounced up and rose to test the former highs. Things got interesting when prices surpassed the earlier high of (1) by a mere pip (F). A classic trap. Countertrend traders, always ready to punish those less able, quickly rose to the occasion and started slamming prices as fast as they could. Just by watching this, our scalper is already offered two very technical clues that may prove to be of value later on: support in the round number zone and resistance about 20 pip above it. He may not be able to draw exemplary and workable range boundaries yet, or feel the need to, but at least he has gained an impression of what the future price action may be about. Should prices travel all the way down to support again, then the most prompting question, of course, will concern the round number defense. Will it hold up, or give in to bearish pressure?

The false break aside (F), we cannot blame the bears for shorting the market in an area of a former top (5). It is often seen that when prices initially bounce up from a round number (2), the market will attempt to revisit the level at least once not long after. It can even be defended that traders initiated new shorts when the market, a little later, cracked below the 20ema (6). At that point in time there was still plenty of room for a quick scalp into the vacuum above 1.33.

However, it soon became obvious that the market had no intention of revisiting the round number to the pip. Instead, it formed another double bottom (7-8), reinforcing the base of support put in by the earlier lows (3-4). An important clue.

Next up was about fifteen minutes of very choppy price action (8-11). Although the bears did manage to keep a lid on the upward pressure, fact is that they were not powerful enough to prevent the bulls from putting in another double bottom in support, and a higher one to boot (9-10).

Now that the price action was slowly starting to tip its hand, how hard was it to find the setup within? First of all, with prices in an area of support, there was no point in looking for a DD, FB or a SB setup, because these patterns are best played from a pullback situation in a trending market. Nor was there any need to think RB with prices slowly moving away from support. As the market moved between hope and fear within that sideways cluster, the only workable setup to contemplate was an IRB.

In this particular chart, the setup seems a little rough and one might think it was not that easy to locate. Still, if we ignore the tease break (T), the pattern showed an excellent signal line of five equal touches, the last two put in by a very familiar duo of pre-breakout dojis. Not only did the two little bars help to form and complete the breakout level, they also built up tension beneath it. On top of that, the lows of these dojis found support in the 20ema, adding one more cherry to the cake.

All in all, this chart presented numerous practical clues. The setup may have required some focus, but it was very tradable nonetheless. A good reason to really study these type of IRBs in round number support (or the reversed variety in round number resistance) is because these breakouts can be so powerful that they considerably diminish the potential of seeing a regular RB show up at the other end of the range. Remember, a little a aggression may be called for in a barrier bounce trade; the speedy nature of the breakout reduces the possibility of a pullback to the signal line and thus the opportunity for a scalper to get in on second instance.

Excerpts from Chapter 14: Tipping Point Technique

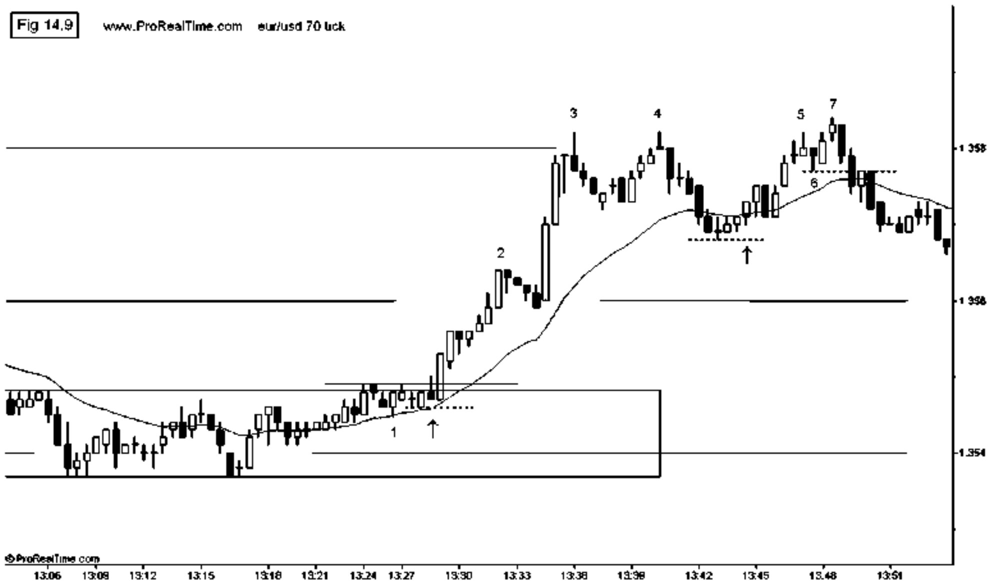

Figure 14.9 After three attempts to break the barrier (hence an ARB instead of a regular RB), we want the market to just take off and not look back (first arrow). That allows for a tipping point of the tightest variety (first dotted line). Placing it one pip lower, below the bar of (1) is doable, but, from a bullish perspective, it would not look pretty to see prices once again dip below the dotted line. If this ARB gets disrespected, the bulls might very well throw in the towel. The tight stop still allows for one last little pullback below the barrier, but no more than that. Had there been less struggle to force the break, then maybe it would have been safer to opt for the extra pip, as a token of insurance. In general, only apply the bigger stop when questioning the technical significance of the more economical one.

The second dotted line, beneath the DD setup lows, is beyond question. It is placed at the most economical spot and below a prominent low in the chart. If challenged, the low will either hold up or crack, but there is no point in giving it an extra pip, at least not from a technical standpoint. The nearest level below the low that may offer some support is presented by the top of the little bull flag pattern of (2). That is way too far out to be of any help.

Just briefly before, I mentioned the rule of thumb of not scratching a long position when prices are still above the 20ema. This chart shows a nice exception. Have a look at where the third dotted line is placed. It represents a lifted tipping point in the DD trade, quite against standard procedure. Why would it be wise to put the stop underneath that low? To answer this we have to look a bit to the left and take note of the earlier, and rather distinctive, double top (3-4). These tops should not keep a scalper from trading the DD break, given the bullish credentials of the chart, but it is good to not lose sight of them. They do represent unmistakable resistance.

Let us sharpen our focus for a moment and contemplate the situation in that top area in detail. Once the tiny pullback doji of (6) gets broken topside, the market basically has only one option to keep the bullish pressure up and that is to take out the double top highs of (3) and (4). If not, and prices dip below the low of (6), then that will print a triple top pattern in the chart (3-4-5). It does not have to mean the end of this nice uptrend, but to a scalper in a long position, it would be extremely uncomfortable. The market's reaction to that technical feat may be quite hefty and therefore it is recommended to just get out of the way by exiting as soon as the tipping point low is taken out. In this chart the DD scalper got lucky because the false break above the highs of the double top took the DD trade to target just in time before prices dipped heavily south (7).

This example gives to show that the 20ema, no matter how faithful a companion, should not be looked upon as an absolute. It guides us 90 percent of the time, but every now and then it just has to be discarded on account of stronger technical development.

A question of conscience: when the bar of (5) matched the highs of the double top next to it, the DD trade may have been up over 9 pip. Is it truly wise in a situation like this to wait for the market to take out such strong resistance for the sake of a few extra pipettes? Yes and no. No, because of technical considerations. It may not be worth to risk a big part of profit in strong resistance for a few measly pipettes. But to just let the trade be may very well serve a purpose of its own. Once a scalper starts to allow himself the luxury of premature scratching in his daily routine, he may not be able to control himself in the many instances where he should just stand pat. After all, it is rare for a chart not to show *any* obstacles to a trade. Yet it is very common to ascribe more value to obstacles than necessary.