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KISS Theory: The Art of Obtaining the Best Entry Is to Keep It Simple
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[Editor's note: At a recent trading conference in Chicago, Peter Borish, senior managing director at OneChicago said in a speech that, "trading is like relationships – getting in is easy, but the hard part is getting out." This article tackles the first part of that equation. While getting into a trade may be easy, proper trade entry can make all the difference in the world when it comes to profit and loss. No matter what your trading methodology is, the author of this article suggests getting back to the basics and relying on a few simple rules for successful and profitable trade entry.]

Does your trading lack the "traders edge" needed to be a consistent winner in the markets? Do you find yourself entering positions at the very wrong time? If the answer is "yes," you're not alone. The good news is that there is a very specific reason why the majority of traders enter and exit trades with very poor timing. Also, the answers available to fix this problem are far simpler than you may think.

To gain the edge and learn how to stack the odds in your favor, let's go back to the school of basics, not just to review the basic concepts, but more importantly, to look at them in a different light than before. If we look at charts, indicators, and any other tools used to perform market analysis the same way most traders do, we would just be entering and exiting positions along with them as well, which offers little or no edge.

To gain the consistent winning edge, which means low risk/high odds entries, a trader must:

• Have a solid understanding of just why many players enter and exit at the very wrong times;

• Realize that moves in the markets are driven by mass psychology;

• Know how to properly identify and utilize support (demand) and resistance (supply); and

• Be able to see what this looks like on a chart as well as have a mechanical set of criteria for execution.

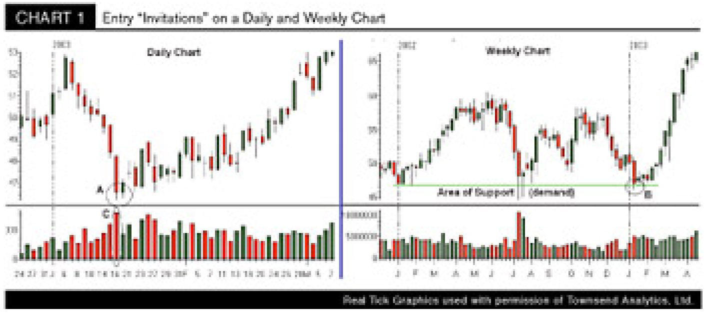
Let's go back to school and re-learn some basic concepts that you may have already been taught in the wrong way.

Best Entries Can Be When It Looks Really Bad

So, why do the majority of traders enter and exit the markets at the wrong time? It is most likely because they were never taught how to properly "think" the markets. Support (demand) and resistance (supply), which will be covered in depth shortly, is where we will always find our low risk/high odds entries for both long and short positions. For a long position (buying), the ideal entry often is found at significant price support, be it major or minor support. Why do so few traders actually take entries at support then? It is because only a few traders actually see the invitation to buy that comes with a low risk/high odds entry, at support. Think about how prices get to support (which is where we want to buy). Prices in any market move down to support on bad news, large, ugly red candles and so on. In fact, the best long entries typically come just after the majority has sold, and that picture does not look inviting to most for a long entry.

Good news or a bullish picture on a chart is not likely to bring prices down to support, yet most traders are only comfortable buying when things are good. This confirmation or invitation to enter a position from "good news" or a rally that is under way almost always offers us nothing more than a low odds/high risk entry. Chart 1 is a combination of a daily and weekly chart. Notice the climactic sell off (point A) on the daily chart. Bad news and plenty of selling most likely drove this decline. The candle that puts in the bottom is a momentum candle (A) accompanied by climactic volume (C).

CHART 1 Entry "Invitations" on a Daily and Weekly Chart



This picture is as bearish as it gets, but there is one thing to which the sellers are not paying attention. This climactic sell-off is taking prices right into a very solid area of support on the weekly chart (B). In other words, by observing the action in this area on both time frames, we can see that two "invitations" are being sent out. One is the invitation to sell because things are bad, and prices are falling fast. The other is to buy because things are bad and prices are falling right into larger time frame support (demand). Obviously, the majority chooses the first invite. The market-wise trader consistently will choose the later, as that is the invitation that offers the low risk/high odds entry on the long side.

It All Comes Down to Psychology

As mentioned earlier, moves in the markets are a result of mass psychology. We make money in the markets by being masters of human psychology. Being successful in trading is much more defined by a trader's mental make-up than by his trading style. Learning the strategies and tactics for a low risk/high odds entry is not difficult. The action of executing an order to take the high-probability trade will challenge one's mental make-up immensely.

It is well known that trading is 90 percent mental. There is a reason for this. What is comfortable to human nature and how we make money trading are completely inversely related. To keep things simple, think about how we make money trading. When we sell (go short), the only way we can profit is if others are willing to sell at lower prices after we sell. Therefore, the goal is to be first in line or close to it, at the right time. To do this, our thoughts need to be anticipatory, but without forward thinking, the low risk, profitable actions will lag. In the prior chart example, being able to identify the buying opportunity that is right around the corner while the masses are selling is the kind of forward or anticipatory thinking that is needed. This is not to suggest picking tops and bottoms. The goal is to identify the turn in price, be it a reversal (top or bottom) or a pullback within a trend, before others and on any time frame.

The Tools

The most important tool we have at our disposal is support and resistance. Many indicators and oscillators, which are derivatives of price, leave room for subjective analysis, which can lead us into trouble. Price (support and resistance) is the most important tool because it offers the most objective information.

Another word for support is demand. Demand is the price at which someone is willing and able to buy something. When demand exceeds the available supply at a certain price level, prices are going to rise. Conversely, another word for resistance is supply. Supply is the price at which someone is willing and able to sell something. When supply exceeds the demand at a certain price level, prices are going to fall.

The markets are purely a function of supply and demand. We can accurately identify areas of demand and supply on charts by looking for three specific support and resistance formations: bases, pivots and gaps.

CHART 2 Support and Resistance Formations

Real Tick Graphics used with permission of Townsend Analytics, Ltd.

Notice the base (point A) on Chart 2. Before prices broke down from the base, it was simply a sideways trading range (base) where supply and demand were in relative balance. Prices broke down out of the base for one simple reason – there was too much supply and not enough demand at that price level. What came next was a series of pivots, inflection points (B). These pivots were formed at the base (resistance) because there was too much supply and not enough demand to absorb all the supply within that base. Bases are best described as a cluster of opens and closes (activity) or highs and lows in the same area. What naturally follows a base is a series of pivots (B). Gaps are not shown in this example but they also represent areas of support and resistance, as they are obvious areas of supply and demand imbalances. Areas of support and resistance are where we will find our lowest risk / highest odds entries.

Stack the Odds and Trade with the Trend

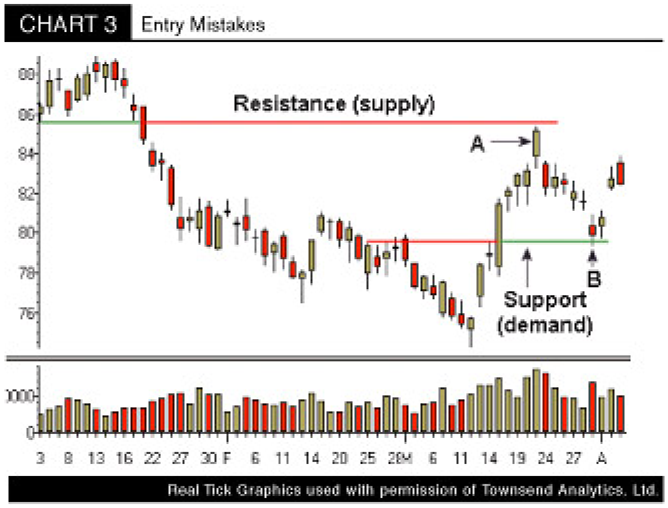
Another piece of information traders always should be aware of is the trend. Trades taken in the direction of the predominate trend, which is the path of least resistance, carry greater odds than trading against the trend. Though trends may seem very basic, most traders don’t operate properly within a trend. One of the concepts we spend a great deal of time teaching is the four transitional stages of a trend and recognizing the movement from one trend to the next. This is where many traders can get into trouble. Knowing which trend the market is in and where and when it is likely to change (anticipatory analysis) will help stack the odds in a trade’s favor.

The trend is not just important for entering trades but also for exiting trades. For example, if one was trading with the trend, he would want to take incremental profits in perhaps two to four different places. If one is trading against the trend, the odds suggest taking profits more aggressively, perhaps in one to two different places.

Be a Professional

How does one find high-probability entries? Let’s begin to build the mechanical set of criteria needed for execution. Many traders look at a chart and try to figure out how to trade properly. Some seek education, yet still the percentage of traders that fail is enormous. Perhaps people are looking in the wrong place for the answers to successful trading.

Trading is like anything else – it’s professionals taking money from novices. Instead of taking the approach everyone else does, which is trying to trade like a professional, let’s take the easy and more productive route and focus on how a novice trades, as his actions are very easy to recognize and profit from. If we can consistently recognize specific events that suggest novice trading in the markets and have the precise tools required to take action, haven’t we then figured out the proper way to take a high-probability entry? For definitions sake, to this author, a professional trader is one who is consistently profitable, whoever that person may be.



On Chart 3, candles (A) and (B) represent a group of traders we should get to know very well. These are novice traders making the same two mistakes they consistently make. Candle "A" is a momentum candle to the up side after a multi-day advance and into an area of resistance. Are those that bought on candle A smart buyers (professional traders)? Most likely, they are not. What are the chances that those buyers are going to make money entering long on that candle? They are making the same two mistakes novice traders consistently make – first, buying after a multi-candle advance (high risk) and, second, buying into resistance (low odds). Candle "B" represents the same group of traders as they sold after a multi-day decline (notice the "novice gap") and into support.
Again, all we have to do as astute, market-wise traders is ask the question, "Would a smart trader be selling here?" The answer is no. The odds of those sellers making money is very low and is a clear sign of a novice trader. A pro does not sell after a period of selling nor do they buy after a period of buying. Also, they most certainly don't buy into resistance or sell into support. If they did, they would not be consistently profitable.

Professional traders are trained to spot novice trading as that is how they reap their profits in the market. Novice traders more often than not fall victim to their own emotions that cause them to jump on the bandwagon right before the wheels are about to fall off. If we have strong evidence that the most novice group of traders has entered the market on the long side, for example, who is left to buy from them? This is how psychology moves the markets and why prices turn.

The Strategies
Traders need to learn to consistently identify areas where prices are likely to turn and the path of least resistance. There are several strategies that take advantage of supply and demand imbalances in the market, driven by the ever-so-powerful human emotions of fear, greed and uncertainty. Uncertainty is the resting point between fear and greed.

Let's focus on one strategy that is somewhat easy to recognize on a chart, the MarketWise Climactic Sell Setup (Buy Setup is just the reverse). Though traders may have seen or heard this type of strategy mentioned throughout their trading careers, we teach it in a different way. Remember, if we enter a climactic reversal situation like others do, we have little to no edge and, therefore, will have a very difficult time staying on the right side of the market and staying constantly profitable. As mentioned, our thought process needs to be anticipatory, and our entry must be high odds and low risk. The goal with all our entries is to only enter when the odds are stacked in our favor.

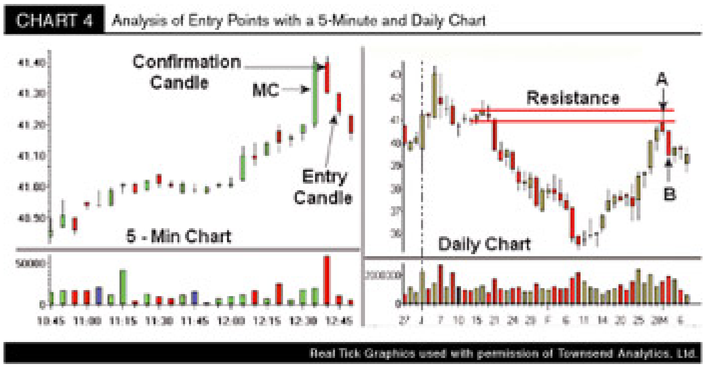


Chart 4 shows the combination of a daily chart on the right and a 5-minute chart on the left. The 5-minute chart represents the intraday trading of candle (A) on the daily chart (right). We use this combination in our analysis to help gauge the strength of a potential opportunity and to obtain the lowest possible risk entries. On the daily chart (right), we notice that prices are moving higher and are nearing an area of resistance (supply). During the candle that puts in the pivot high (A) on the daily chart, we are watching intraday for a potential short entry (anticipatory thought). During that day, we get our high odds/low risk opportunity in the form of a MarketWise Climactic Sell Setup on the 5-minute chart (left). These time frames can be the 2, 5, 10 or 60-minute charts. As the day unfolds on the 5-minute chart, prices rise. After the multi-candle advance is well under way, we get a Climactic Momentum Candle (MC) which is into larger time frame resistance (daily in this case).

What kind of trading would produce this Momentum Candle? Not sophisticated traders. This group is buying after the move is well underway (high risk) – mistake number one. The second mistake is that they are buying into larger time frame resistance (low odds), which is where all the willing sellers are.

These are the signs of novice trading which offer the more sophisticated trader some opportunity, as a turn in price is typically right around the corner. If the turn is not right around the corner and we are wrong, we exit with a small loss.

As traders, we are not looking for certainty, we are looking for better odds. Notice with this entry, we have already established a short position by the time candle (A) on the daily chart closes. This is important but why? Candle (A) on the daily chart once closed is now a reversal candle that will typically invite the large number of traders to enter short the next day. The confirmation they need to see on the daily is now evident, and they feel comfortable shorting at this point. This is exactly what we want and is exactly what we get as candle (B) shows them entering with force and paying us nicely. In other words, we are a part of the invitation to enter. Furthermore, our entry is much lower risk than those who short the next day (B) and carries much higher odds. In conclusion, we use the trading actions of the masses (B) as confirmation to confirm a decision we have already made.

Three Questions Can Lead to Low-Risk Entries

In order to be consistently successful in identifying high odds/low risk trading opportunities, there are three questions to keep in mind when performing analysis:

• What is the trend? This question helps traders assess the odds.

• Where is the support and resistance? This question will lead traders to a low-risk entry.

• What is the path of least resistance?

Answering these questions allows individuals to be objective in assessing whether a low risk/high odds trading opportunity exists. If the anticipatory thought and objective analysis lead to the conclusion that a high-probability opportunity exists, make the trade!

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