

The Technical Trader

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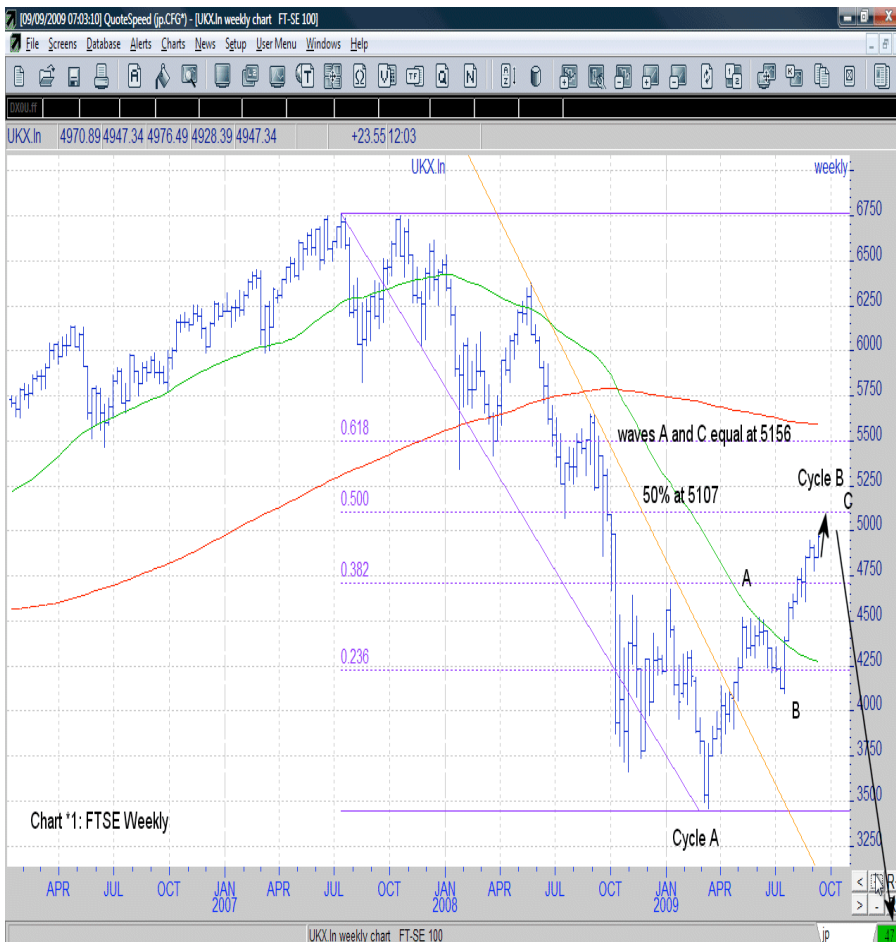
In our 21st Year!

10th September 2009

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The Month Ahead



1. Introduction

Markets were falling a few weeks ago and people often ask for reasons behind such moves. As ever, there are plenty of pundits only too happy to play “pin the tail on the donkey” but ultimately it all comes down to there being more sellers than buyers. I was talking to an investor friend of mine two weeks ago and I told her that with FTSE nearing 5000 and the Dow nearing 10000 it might be time to lighten up as I did not see much more upside potential. Another 5% would have taken us to those key levels and I think it is important to balance potential reward with potential risk. But it is also important to examine our underlying assumptions. Clearly if this rally is a bear market affair then caution becomes critical. But what if we are back in a bull market?

This takes us into a different arena and it is one to do with those twin pillars of trading success – risk control and money management. Of course this applies equally if we are in a bear market but the advice “lighten up” could be seen to cover that.

But I am skipping a few stages. Another friend of mine has recently started investing in stocks. He has had previous experience in share valuation but has not had too much direct investment experience. Being a successful guy

Trading Summary

	LONG	TREND MEDIUM	SHORT (TRADING)	RECOMMENDATIONS
FTSE 100	DOWN	UP*	UP*	LONG - tight stop
DOW	DOWN	UP*	UP*	LONG - tight stop
DAX	DOWN	UP*	UP*	LONG - tight stop
US T-BONDS	UP?	UP?	UP?	SHORT - tight stop
NIKKEI DOW	DOWN	UP?	UP*	LONG - tight stop
GOLD	UP	UP	UP	LONG
* Trend change maybe imminent ?May be corrective action #Monitor Hotline				

he has a fair bit of cash on hand and has put in several hundred thousand pounds.

The history may be viewed as encouraging in that he got in early (prior to March 2009) and saw initially heavy losses but he hung on and added to the portfolio after that date – he now has impressive profits. But he has been “taught” by the market that if you stick with heavy losses the market will reward you. This worries me as part of the portfolio is based on borrowed money and a drop of 50% would cause him major problems.

In effect he may break two rules and this could spell disaster. First he has too much money in the market – in relation to his net worth. Second he may be slow to cut losses, partly because of the lessons he has learnt and secondly because he is not a seasoned investor and may not know himself as well as he needs. As his results are impressive at this point I do wonder whether I should just let him get on with it but with the spectre of possibly the biggest bear market of our lifetimes looming I do have some concern.

2 FTSE 100

Sometimes markets tell us fascinating stories and I think this is one of those times. The strength in Gold tells us that Governments are succeeding in their goal of devaluing their currencies so we go back to the oldest currency of all. They are telling us that as

our currencies get debased we are better off in assets so we buy shares and property. For the same reason we see companies wishing to buy others, better to have assets other than cash. But the fact that one asset, ie cash, is not attractive does not mean the alternatives are. At least not necessarily. Nor does an inflationary environment necessarily mean that corporate profits are going to increase. **I have been saying that we would rally for most of this year and I see no reason to call any highs at this point but we are nearing the time when we will see those highs.** FTSE has now hit the 5000 level and is thus entering an area of greater risk - see Chart *2.

TRADING TREND. TT is UP*.

3. The DOW

The Dow is lagging at this point and could still turn down from here. Chart *3 shows a possible five waves down off the peak at 9629 (28th August) followed by what could be a corrective rally. **The pattern is hardly conclusive and I still think the Dow will see 10,000 but a pullback first is possible.**

TRADING TREND. TT is UP*.

4. The DAX

Along with FTSE and the Dow, the DAX may be near a peak and is due a pullback. **But, hereto, I think this will be corrective before**





we go higher and the 50% retracement level on the DAX comes in around 5870 with a Fibonacci 61.8% retracement around 6400.

Currently the form of the decline is not clear but this should clarify shortly.

TRADING TREND. TT is UP*.

5. US T-Bond

The rally on the T-Bond has continued but we did see a small sell-off on Friday (4th September) which may be the start of a more determined decline. **The weekly chart (not shown) is not so clear now but as long as the current rally continues to lack fire power I will look for more downside.**

TRADING TREND. TT is UP*

6. Japan

As with the Dow there is a possible reversal pattern on the Nikkei but we rally need to see acceptance below 10000 to give any confirmation. There is certainly a case that the rally may have done all it need do. **On the Dow and FTSE we have 10,000 and 5,000 exerting the usual magnetic influence but the Nikkei has already topped 10,000 so**

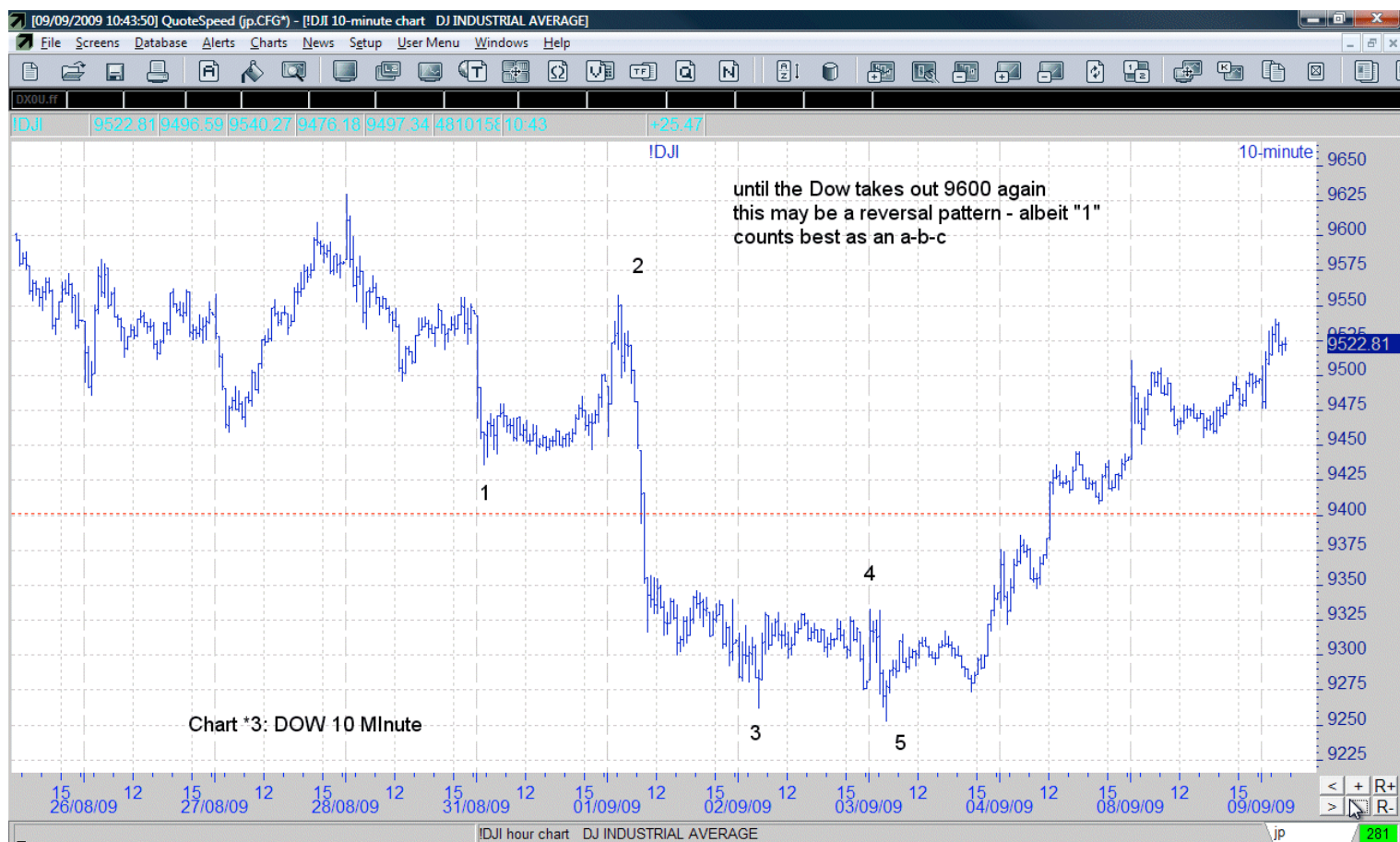
that factor is absent.

TRADING TREND. TT is UP*.

7. GOLD

Gold has now broken out of the triangle to the upside – see Chart *4 – and has made an initial move above \$1000. This initial move has been met with some selling and Gold has retreated back into the \$990s. It is possible Gold may want to re-test the upper trendline of the triangle around \$975 and such a move would not question the positives but a sustained break back into the triangle would. **For now we remain officially LONG and we will use \$960 as our stop for now.** Incidentally I have recently read a comment to the effect that markets are not driven by technical analysis. Well, of course they are not. Technical analysis is merely a tool which can help in isolating profit opportunities and in the case of the Elliott Wave Theory may provide a road map based on the psychological behaviour of a crowd.

TRADING TREND. TT is UP.



DVD set

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Trading the News with Binaries - an extract from BINARY TRADING - continued

That report set the scene and the following day I started to gear up to trade the news...

TTM – 12h34 Wednesday, 30 January 2008

FTSE did dither about after my report yesterday and it's dithering some more today. Indeed, it is likely to keep dithering into the close tonight as we wait for the all-important news from the US at 7:15pm. Will the Fed cut rates because the situation is truly hopeless or will they leave rates unchanged and face the market's anger as a consequence?

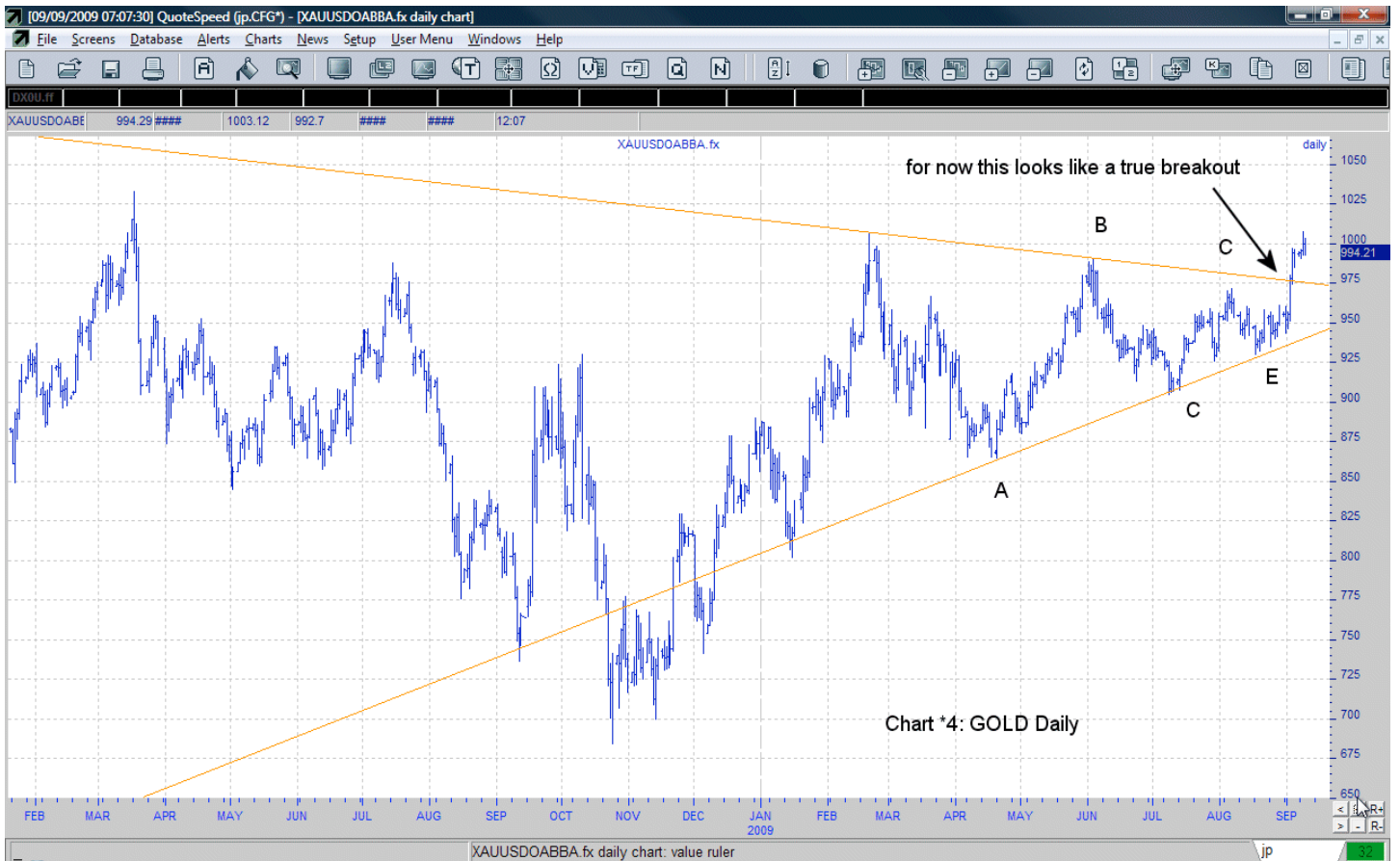
Whatever they do, there seems scope for some solid moves. Chart patterns suggest these moves will come into the downside but we cannot completely rule out upside moves and if we can find some low cost bets then we should go for them.

The daily bets on the FTSE that expire at 4:30 this afternoon are not going to be much use to us in playing market moves in response to the US news, but the FTSE bets that open with IG at 5:00pm may be very useful.

These bets are based on tomorrow's action and expire tomorrow at 4:30 pm. But there are no exotics (tunnels, HiLos, and OneTouches) as these are only available when the underlying market is open. Nevertheless we have plenty of binary indices to play with.

My first thoughts are the FTSE to finish up/down 50 points (those are two separate bets: up and down) but I might consider the FTSE to finish up/down 150 points if they are cheap enough.

[Note: I was not suggesting these bets until after 5pm that day.]



My preference will be for the down bets but I will also buy the up bets if the odds are right. We will also have the full range of bets on the Dow and I will be looking for a decent opportunity. The weekly bets on the Dow might also be useful.

I will get back to you after 4:30 if I see something I like.

LTT – 17h48 Wednesday, 30 January 2008

Good Evening. FTSE went broadly sideways all day, as expected. It actually closed down 47 points which, in normal times, would be considered quite a big day. But we are not in normal times – far from it!

In less than two hours the Fed (at 7:15) will make an announcement which may (and probably will) have a big effect on markets in the short term.

I reckon the effect longer term will be around zero for two reasons:

1. Interest rates are governed by markets in the first place and not by Fed announcements.
2. I do not believe tinkering with interest rates is going to solve the problems on this occasion. But as binary betters it is the short term that interests us and we want to find a bet that:

- a) stands to do very well if we see sharp action, and
- b) is cheap.

Looking at FTSE first the FTSE to finish up/down 50 points (those are two separate bets) are both priced to buy at around 40.

As we are not sure of direction and need to buy both that means a total cost of around 80 which is not too appealing. But here is one idea. Don't buy before the news. Consider buying after the news if one of those bets becomes very cheap.

Often you see knee jerk moves on news which are then totally reversed and such a move cannot be ruled out. But if you do a trade like this, keep it cheap and you will need to be watching the markets, hawk-like, as the news comes out.

The bets FTSE to finish up/down 150 points are both priced around 15 to buy so you could buy both for 30 and that makes some sense but there are no guarantees that we will see action that sharp and/or it may all be over by the time the Dow closes. So the Dow may shoot 200 points up, then shoot 200 points down but finish unchanged and FTSE may have a quiet

day.

If you buy these bets and we do see sharp action after the news it may be worth closing the leg that benefits and leaving the other leg to run at, hopefully, zero cost.

Of course the ideal bets would be to sell the Dow tunnels but the +200/-200 is only 54/59 and 200 points is a fair move.

Probably better to buy the two bets:

1). Wall Street cash high to be >+200 – current price 10/14

2). Wall Street cash low to be <-200 – current price 27/33

That way you may even win on both if it gets truly volatile although that is unlikely.

I appreciate there is quite a lot in this report but just choose one bit you are comfortable with and go with that.

The Wall Street tunnel is probably the easiest bet but you may need to exit shortly after the news.

If you don't feel comfortable with any of the bets then I would suggest paper trading if you can. Choose a bet, check the price, write it down on a piece of paper and then see what happens. It's great practice."

So what happened next?

LTT - Thursday, 31 January 2008

Good Morning. My expectation of the Fed's announcement proved totally wrong but, on the upside, my tradewatch recommendations hit gold – which is, of course, what matters! Plus I believe I got it totally right when I said "So if they do cut rates I would expect a knee-jerk blip UP, then a sustained fall as the markets digest the implied hopelessness of the situation."

Yesterday the Fed cut rates by another 0.5%, the Dow briefly saw a high over 200 points ahead (sending the Dow tunnel and the "Hi" bet to a full profit – a return of over 600% on the cost of the "Hi" bet) and then promptly collapsed to end down on the day.

I think we saw the action of frightened men yesterday.

For many years now the governments of the

western world have been playing a high stakes game of pass the parcel and the trick is to pass the parcel to the next government, so that the financial time bomb inside the parcel doesn't explode all over your nice neat administration.

In the good old days, economies used to boom and bust and from the bust would arise, phoenix-like, a thrusting new economy.

But this could no longer be tolerated, especially as a succession of economists put into the inept hands of our politicians a variety of tools for prolonging the life of the old economy. Thus the old economy staggered on, limping and wheezing far beyond its normal productive life. Maybe it is unfair to blame anyone for this – if you can achieve short-term good then people will tend to go for that option and let the longer term take care of itself.

But whatever the reasons, the financial time bomb gets bigger and more potent every time it is passed on, and eventually it was bound to go off.

I believe this is happening now and as the economy continues to unwind we will hit various economic black holes on the way down which will lead to more crises and more bad news, which will turn into a vicious self-feeding frenzy.

Not a pleasant thought – I hope I'm wrong! But in the paper this morning that phrase, "economic black hole" was mentioned as a reason why the UK may need a 2% rise in income tax. It perfectly sums up the assumptions that seem valid in a time of boom but become disastrous in a time of bust. Anyway, enough of this conjecture...

As I have already said, the US bets I recommended did well and I even made some profit on the UK bets.

These being the two bets FTSE to finish up/down 150 points, which I bought both at a combined cost of 32.9 and got out at a combined price of 43.4 I sold the up bet at 19:24 last night and the down bet earlier this morning."

Explaining the strategy - The chart patterns

were not completely irrelevant in considering what strategy to adopt, but their input became irrelevant in the decision to back it both ways. Price is often a better guide than charts in this sort of situation. By price I mean the price of the bets.

The FTSE bets gave some profit advantage but not much and there is a clear logic why the Wall Street bets were better in any case and this is that the news was coming out when the Dow was open – this gave two clear benefits:

1 It is immediately after the news that the wild gyrations may come in and this is what we are looking to capitalise on.

2 The exotic bets which expire when hit are only available when a market is open and it is these bets that are tailor made for this sort of situation.

These two points go hand in hand. I have talked about exotics elsewhere in this book but a wise man once told me that a good teacher must repeat the key points at least four times. The key point with an exotic binary is that it can expire before its stated life. So a daily exotic may be expected to last until the end of the day (as any daily up/down bet would do) but all exotic binaries are bets on the underlying market reaching one or other pre-set levels – i.e. a one touch expires when that level is touched. When key news comes out, what often happens?

We often see wild action that touches lots of levels a fair way off the levels before the news was issued. If we can pick up some cheap exotics we may be getting excellent value for our money. (The concept of value is another topic I plan to repeat a few times in this book!) Compare this situation with our bets on FTSE where:

- We are unable to trade the exotics because these bets are only open when the underlying market is open.
- Because FTSE was closed when the news came out the wild gyrations might be long gone by the time it does open. Even if we do see a big opening gap it will be a distillation of the

action – and often a very faded version!

In fact FTSE did fall heavily at the open but then rallied and ended up 42 points on the session. That early fall would have been magic if we had been able to buy exotics; but we could not and so the modest close was not great news for the FTSE up/down >150 points bets we had in place – albeit I closed those earlier.

Conclusion - In this chapter I have set out one unique aspect of binaries that make them a gift from heaven if you want to trade the news. Doing this is something I have found to be highly profitable and it has become a staple of the service I offer to The Trade Maker clients. As an aside I would add that writing in this way is a great way to really understand your strategies in the market. If I don't write, but merely think about my strategies, I find all sorts of illogic creeps in. But write it down and you are forced to be logical – and you can learn a lot that way!

Summary - we have taken an in-depth look at how to trade the news with binaries.

- 1 Binaries allow us to trade without fear of either being stopped out or, alternatively, making a large loss.
- 2 The wild gyrations following an important news items is often a gift for exotic binary traders.
- 3 You will need to adapt your strategy to the situation in place ahead of the news.

Publishing Schedule

Now that we are doing one issue each month, plus weekly video clips, I plan to issue TTT either in the first or second week each month. Proposed dates are as follows...

Friday 2nd October 2009

Friday 7th November 2009

Friday 4th December 2009

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People of character do the right thing, not because they think it will change the world but because they refuse to be changed by the world”

Michael Josephson

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