Chapter 21

BABY STEPS – GIANT STEPS

What we call "baby steps" and "giant steps," will explain to you one of the most fascinating defensive techniques any trader can use. Baby steps and giant steps represents a detailed explanation of the rationale behind the Trader's Trick, which has been mentioned in virtually everything about which we have written, and is available as a free resource on our website. To see the deployment of Trader's Trick, we refer you to Appendix B at the end of this course. What follows is a complete explanation of the "wherefore" of the Trader's Trick.

STEPS

It has been said that the best offense is a good defense. Since most traders and aspiring traders are hardly in a position to move a market, or materially affect the movement of prices in any great way, it is incumbent upon such traders to learn to trade defensively. By trading defensively we don't mean cowardly, or non-assertively. What we are saying here is that the individual trader, not having the wherewithal to move prices, must avoid being trampled by those traders who are able to manipulate and engineer price moves. The average trader reading this course must defend himself from becoming the victim of engineered market moves, whether they be small (baby steps) or large (giant steps).

When prices begin to move, it is virtually impossible for the trader to know if the move is genuine, or merely a fake out. We suppose that every move in prices is genuine for someone, but whereas the insiders in the market, paying little or no commissions, can be profitable on a move of a fraction of a point, the "outsider" trader, i.e., the public, usually needs much more than that to be profitable.

No one, other than the originator of a manipulated move, knows whether or not such a move is capable of being profitable. No one other than the originator of a manipulated move knows the true intentions behind the move. Is the originator taking the market up because he wants to end up with higher prices? Or is the market being taken up because the originator actually wants to begin a sales campaign from a much higher price?

Does the originator move prices down because he is a true short seller in the market, or are prices being driven down only so that a huge long position can be put on at significantly lower prices?

The problem is even more acute than the lack of knowing the intentions of the originator. We are also unaware of the true size of the originator. If we see a series of bids that drive the market up, is the size of what we are seeing really the true size of what the originator is trying to buy, or is a massive position being put on that is far beyond the size we are now seeing in the market?

Consider: We see the prices at 272.25. The next bid is 272.50 for 50 contracts. The very next bid is 272.75 for another 50 contracts. Does that truly mean that someone very much wants to own the underlying? Or is it a large short seller who wants to bring in a bunch of buying so that he can begin to sell from perhaps 274.50 ?

Consider: We see prices at 339.50 the next offer is 50 contracts 339.25, quickly followed by 100 contracts at 339 even. Does this mean someone is dumping the underlying? Does it mean a short seller is trying to drive the market down? Or does it mean that a buyer, trying to put on a very large position, is now flooding the market with sell orders so that he can actually buy at much lower prices?

Since we are unable to ascertain the true size or intention of any move, and especially engineered moves, we must find a way to defend ourselves against such moves, and to actually "go with the flow" so to speak.

But before we do so, let's continue to explore the problem faced by the average individual trader.

Human nature being what it is, traders are always and forever trying to outwit the market. There seems to be no end of fools who enter the markets with some theory, system, or method that is going to make him/her wealthy overnight. It is the same type of fool who regularly appears at the casinos of this world to serve up as cannon fodder for the owners of these gambling houses who are more than happy to take their money from them in return for allowing them to wallow in their foolishness for the period of time between their arrival and the time they leave, having lost all of their money and perhaps that of their friends, neighbors, and relatives. P.T. Barnum had it right when he said that there is a sucker born every minute. Eventually, some of these suckers find their way into the markets to serve as lambs for the slaughter. They are the proverbial patsies, there to have their feathers plucked so they can go home naked and ashamed, but seldom none the wiser. Invariably, they come back with a new twist, a novel change, or some adjustment, only to be taken to the cleaners once again.

Be that as it may, these would-be winners, by their sheer numbers, have an effect on the markets. They do such foolish things as trading Fibonacci* retracements, buy or sell at the "golden ratio," trade breakout systems, trade mathematical systems, blindly use indicators instead of their brains, etc. None of these ways of trading make any sense, yet they do make "noise" in the markets, especially when it comes to day trading markets. The more of these fools there are in a market, the louder the noise. Insiders have learned to welcome this noise in the same way as the casinos have learned to welcome system playing gamblers. It is just a matter of time until they have lost all of their stake and have to make room for the next sucker.

The problem for us traders is that when we see buying at a retracement, we cannot be sure that the buying is such that we are able to make a profit from it, or that such buying is that from which only an insider can make a profit. Conversely, when we see selling at a retracement, we are not sure that such selling is real and can be profitable for us, or that the selling is such that only the insiders will be able to profit from the move.

A further problem comes when we see buying or selling at breakout points in the market. Is the buying at a breakout real, or is it merely stop running? Similarly, is the selling at a breakout point real, or is it simply stop running?

**FIBONACCI TRADERS BUY/SELL AT .382, .50, AND .619 RETRACEMENTS. THE INSIDERS USE THEIR BUYING/SELLING AS PART OF THE MOMENTUM THEY NEED TO MOVE PRICES TO THEIR OWN OBJECTIVES.*

By now you might be thoroughly discouraged and ready to throw your hands up in the air and give up. Don't do it. Hang on a bit longer while we show you how the Trader's Trick solves most of those problems most of the time.

Since there is no way to know who is doing what, their size, their intentions, or anything else, all we can do is to trade defensively and attempt to catch the moves that occur in the market in some manner that will minimize our losses while we let our profits run.

Since the public are the constant and steady losers in the market, we must learn to trade along with those who are able to move the market. Believe it or not, we can win while a market mover is winning, and even when he is losing!! How about that?

We'll explain the various players and how it all works, and then we will provide some examples and charts to help you get a lock on the rationale of the Trader's Trick.

BABY STEPS

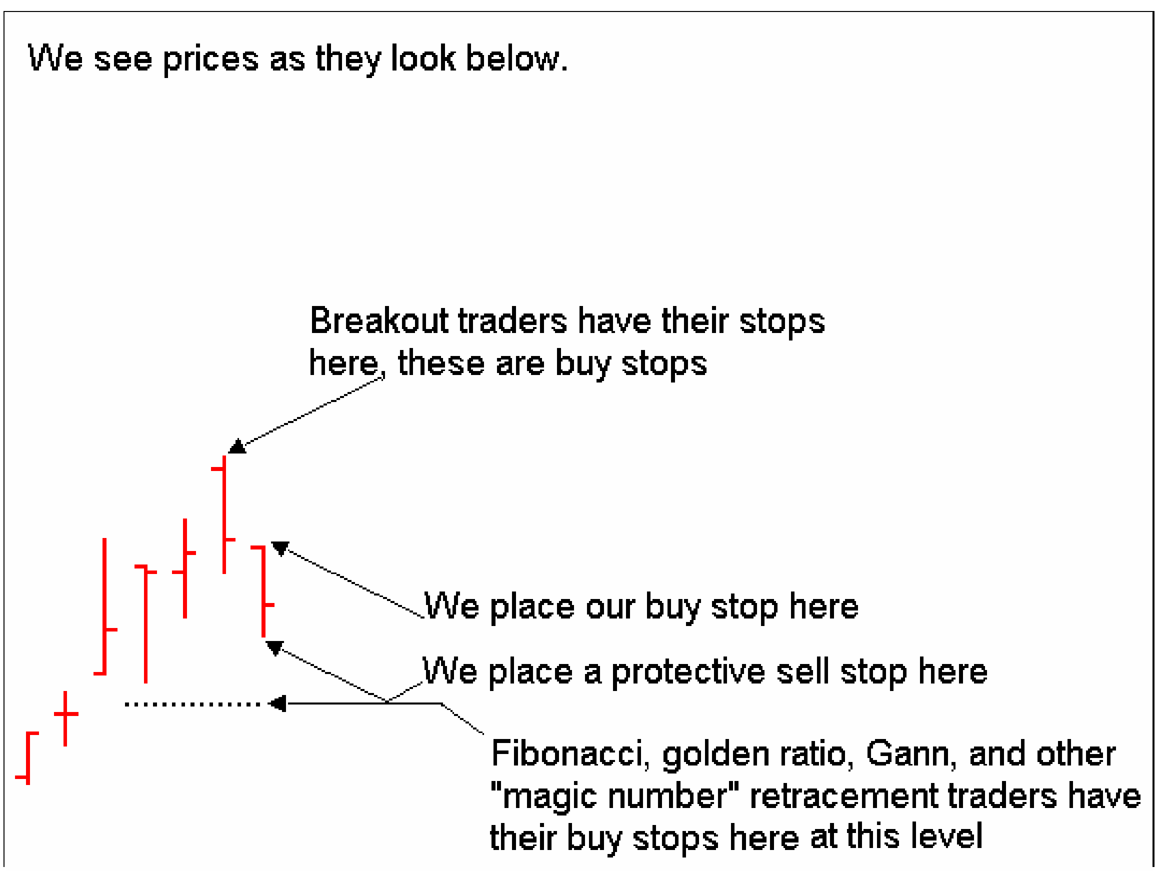
Baby steps are those created by the lesser market movers, and for the most part, they affect only day traders. These moves are basically small market manipulations good for picking up a few ticks or fractions of a point. When a market is dull, with little order flow, and insiders are bored, they will bump prices around trying to pick up a bit here and there. This is nothing more than spread trading where the market makers are "picking each others pockets," and those of any outsiders foolish enough to trade when there is nothing really there worth trading.

Somewhat larger baby steps, or intermediate steps, take place when the market is moved a short distance in order to pick off the stops that may have entered the market via the buy and sell orders of breakout and retracement traders, as well as those traders who are haphazardly following various indicators and moving average crossovers. Sometimes this takes place as a slow sneaking-up on those stops, and such a situation is very difficult for us to trade. However, when a market is trading in baby steps, it will generally move sideways, and often look like a spider or centipede, with legs sticking out all over the place. We can rarely make money when a market is making a spider or centipede. The reward will rarely be worthy of the risk. However, the price action on the chart may look like a slow climbing caterpillar sort of inching its way upward or downward. We can make money in such a market, and very often need to make the attempt. However, the attempt must be made using the Trader's Trick.

GIANT STEPS

Giant steps are large strong moves during intraday trading, seen on the daily charts in much the same way as they occur on intraday charts. For the most part, giant steps are manipulations by very large traders who run the stops on the daily charts in much the same way that baby-steppers run them on the intraday charts. Once again, we want to stay away from sideways spidery-looking price action.

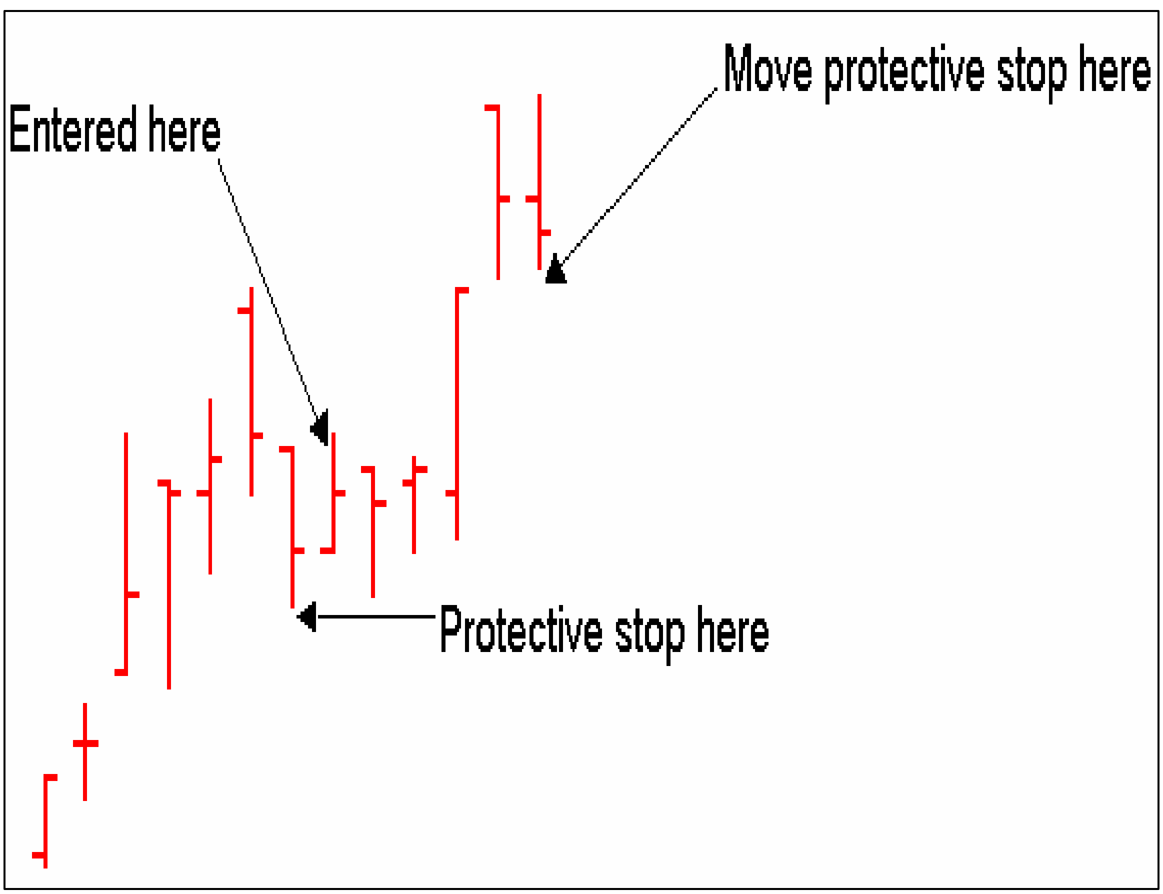
We're ready now to implement the Trader's Trick in order to demonstrate how it solves the various problems we have presented.



As long as there is room for us to make a profit between where we anticipate entering the market and the point of the breakout, we can take a ride along with the market movers when they go for the buy stops place there by the breakout traders.

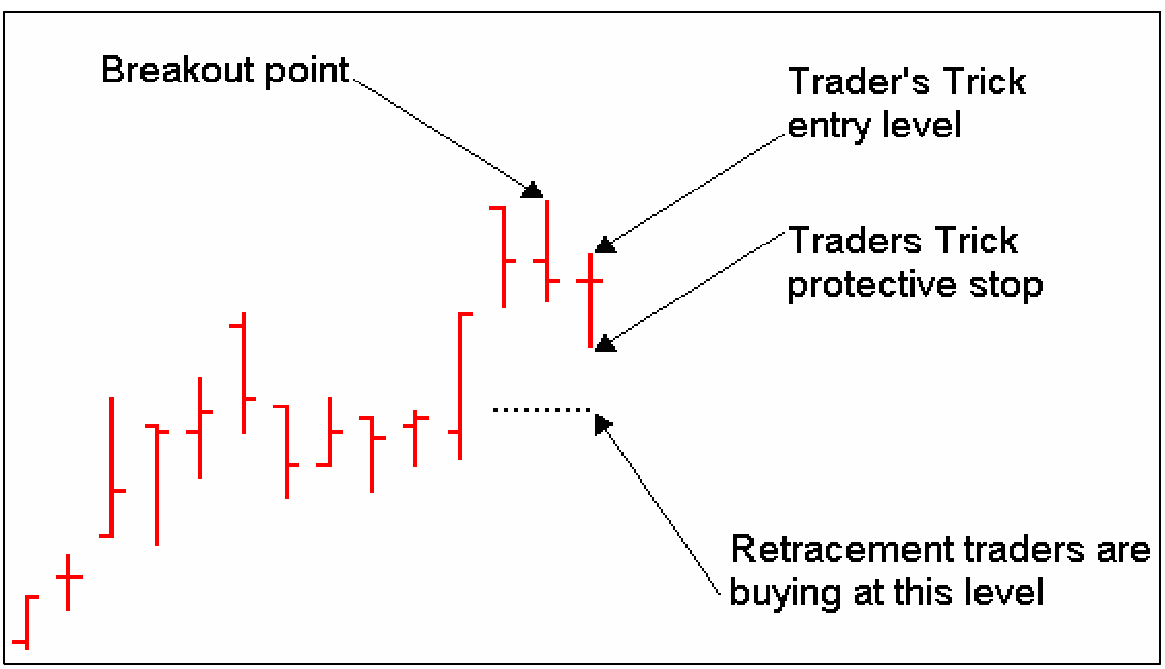
If prices were to dip (correct) to the point where the magic number retracement traders have their buy stops, and then prices began to move upward in order to fill the breakout traders, we would then catch the momentum of not only the market movers going for the breakout-trader orders, but also the momentum of buying pressure created by the retracement traders. Where we placed our buy stop is the location of the Trader's Trick.

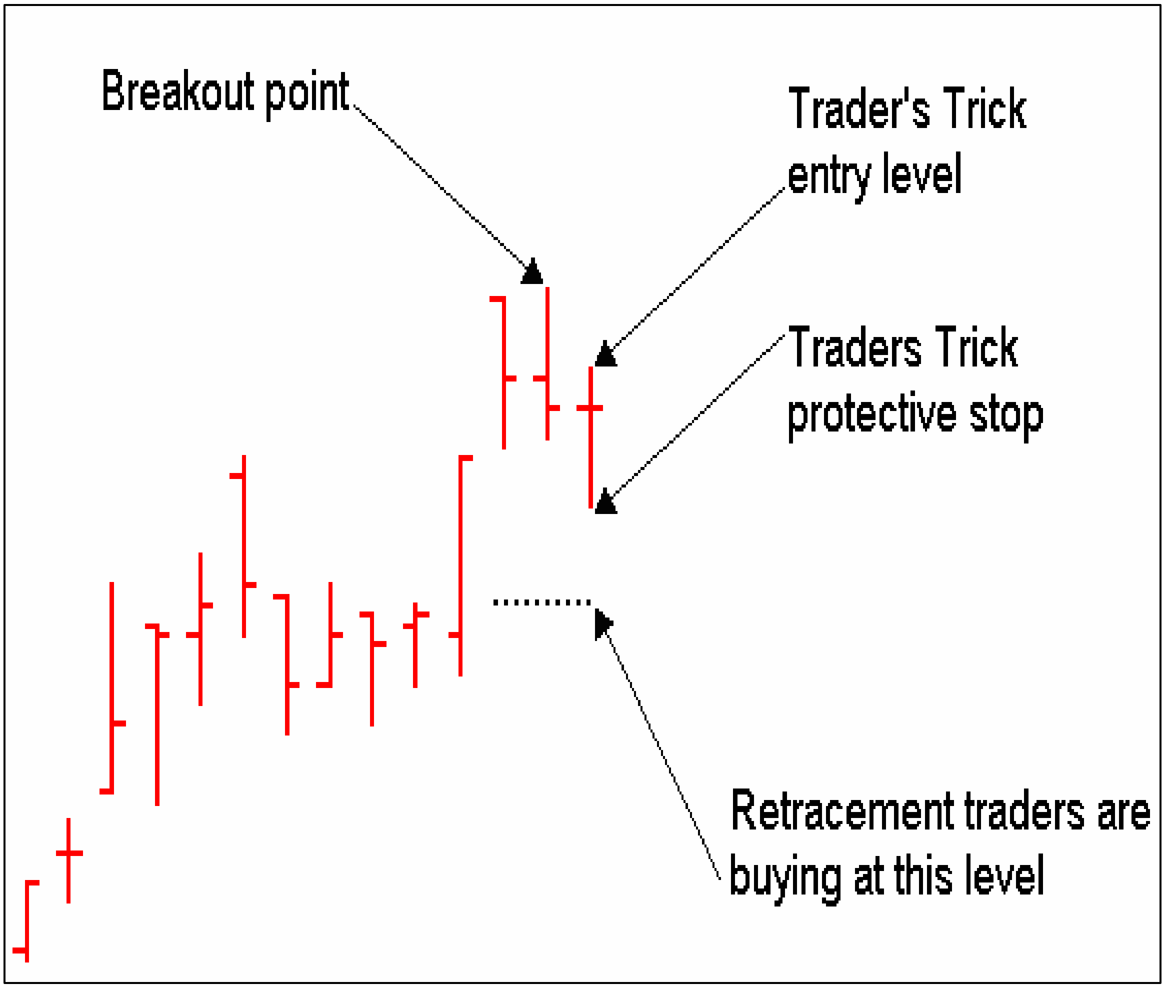
Now let's see how the trading evolved. But note: The only difference between an intraday move and the same move on a daily chart is that of magnitude. Obviously, if the chart were a daily chart, the anticipated move would be greater than if the chart was a 15 minute chart. A chart is a chart, is a chart!!



As you can see, in this particular instance, retracement traders would not have been filled at all. “Trader’s Tricksters” are filled and have to sweat out the next price bar after the fill. We took the liberty of moving our protective stop after the first reversal bar (close lower than the open) took place. Why? Two reasons: 1. Seventy-five percent of the time when a reversal bar takes place, the next bar sees prices move lower (higher) in the direction of the reversal bar. 2. For all we know, the only thing taking place here was stop running at the breakout point. Since good traders take profits while they are on the table for the grabbing, we want to lock in as much of the available profit as we can while still leaving ourselves open for a more substantial upward move if it is to take place. We are playing the percentages, pretty much in the same way the casinos do. If prices continue up strongly, we will be there. If all that was happening was stop running, then we will give back a modicum of the profits that were on the table, take the rest of our money, and wait to see what the market does next. We are trading what we see, not what we think, and that is the only way we know of to consistently win money as a trader.

Let’s see what happened next. By the way, the price action we are showing you is taken exactly the way it happened on the very first chart we grabbed literally at random from our computer screen.

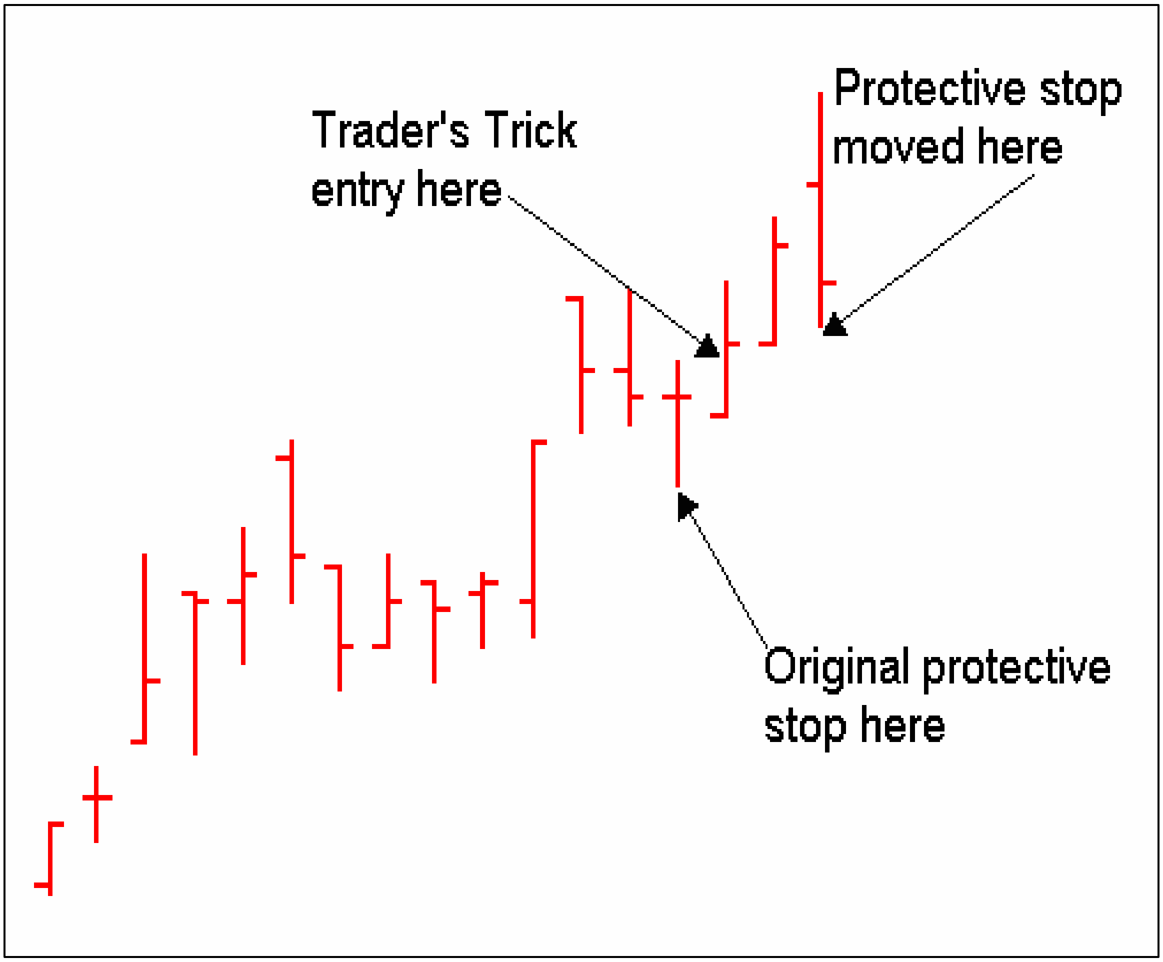




Here we see the pattern repeating itself. If there is room between the Trader's Trick entry level and the breakout point to make a profit, then an entry attempt is justified. As usual, we maintain a tight protective stop, whether mental or physical.

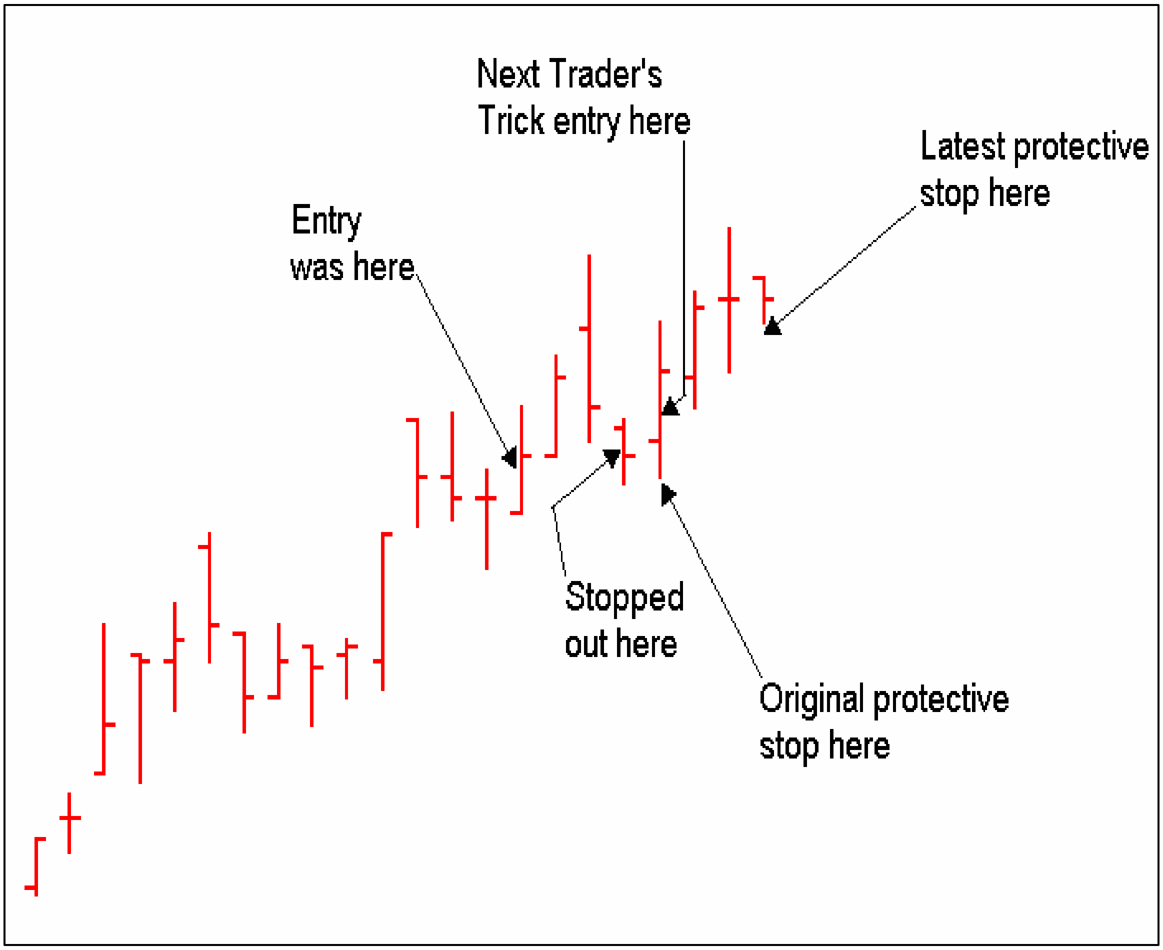
The retracement trader's entry point is anywhere from 38.2% of the last move down to 61.8% of the last move, with 50%, the "golden ratio" being the most common. These are Fibonacci ratio numbers. Gann traders also use the 50% ratio for retracements, but they seek lesser retracements at 1/3rd and greater retracements at 2/3^{rds} of the last upward move. All of this foolishness makes about as much sense as awarding a doctorate degree to a dog who has learned to shake hands. However, the insiders are very much aware of the mind set of retracement and breakout traders, and they gain much of their momentum by feeding on the orders they place in the markets.

Those orders are simply grist for the mill to be ground into profits for the insiders. Actually, professional traders are very grateful for the neophyte traders and their foolishness. After all, in they have been supporting our respective life-styles for many years. Now let's continue with our chart.



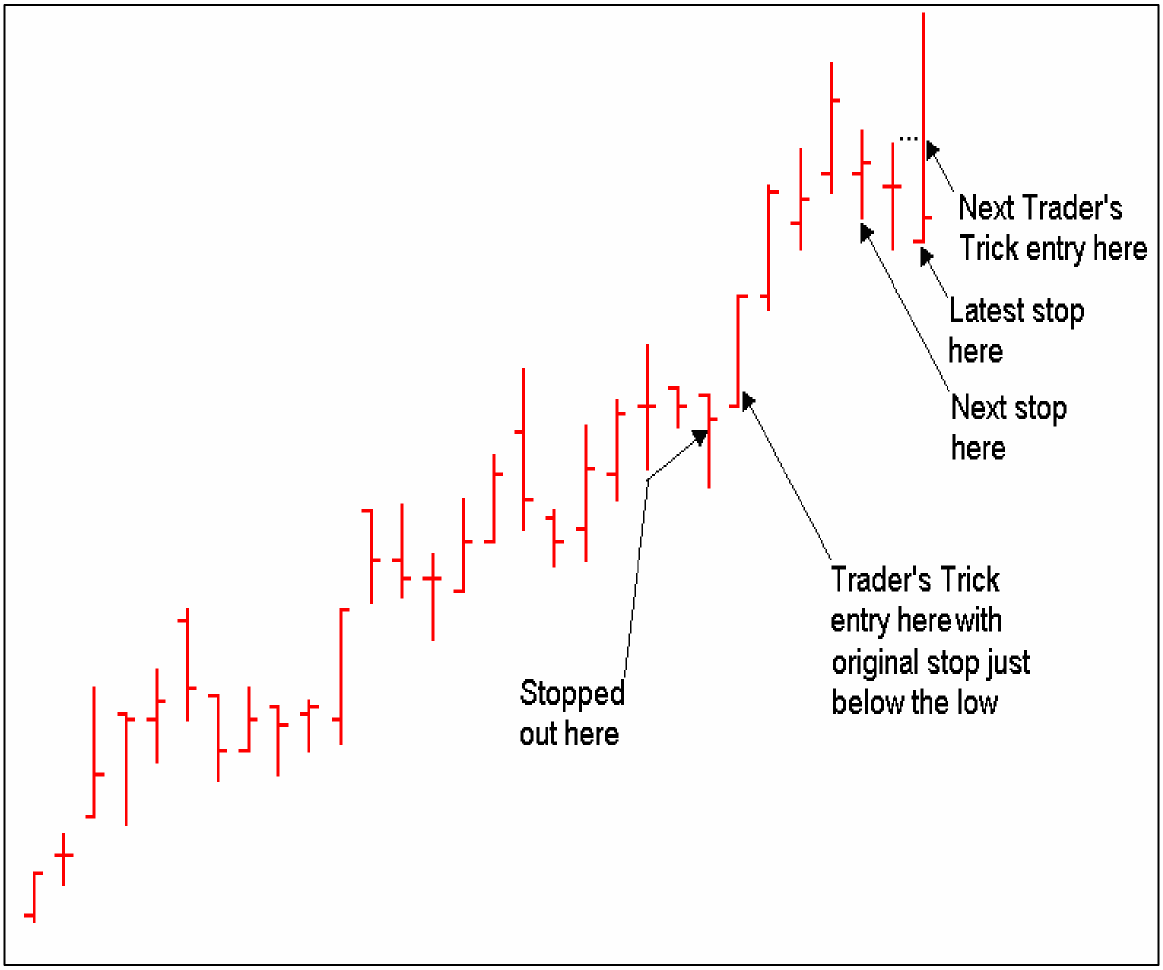
As we did previously, we moved our protective stop just underneath the last bar shown because it reversed by closing lower than it had opened.

And once again, it appears that the retracement traders were left out of this move. We may get stopped out with little or no profit here, but at least we had our low risk shot at the move. Let's see!



The first protective stop is placed below the low of the bar that is the Trader's Trick bar. The stop is moved to just below the low of the first bar to make a reversal by closing lower than it opens at a time that prices are rising. In this case, if we are stopped out, we will make more than the couple of ticks that were made on the previous trade. Once again, retracement traders are not getting in on the trade. When prices move at a 45 degree or steeper angle, retracement traders seldom get very much of the available price action. If you have noticed, breakout traders, unless they are using large stops and taking more risk, are the ones being hammered repeatedly in this series of price moves.

Let's continue with the trading.



The Trader's Trick is good for up to three bars of correction. Beyond three bars, the percentages are against success. Yes, you will miss some good trades where the correction last for more than three bars. The most we have seen is two bars of correction in this entire series.

Does it matter whether or not anyone was deliberately moving this market? No! Does it matter whether or not we know the intent of the market mover? No! Does it matter whether or not the moves were genuine? No! Does it matter about the number of contracts (size) that hit the market? No! Do we care that the breakout traders put dinner on our table? No! Do we care that the retracement traders had no dinner at all? No! Did we have to use an indicator? No! Did we use any sort of "magic" number series? No! Do we stand to lose something on that very last trade? Yes! Did we control the possible loss with that last stop? Yes! Enough said? We hope so!

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