

Chapter 1 - INTRODUCTION

This book is written for the trader who wants to learn to trade shares actively.

One of the things that we have learnt about trading is that there is no short cut to making money from share trading. And there is certainly no hidden secret method out there wrapped into an expensive trading platform or training course.

The most important principle to trading successfully is to learn to apply your trading techniques with discipline and with an awareness that you cannot force the market to deliver anything.

Good trading results come from consistency and discipline.

In this book you will be provided with trading rules but your success in the market is as much dependant upon your own discipline in following the trading rules as it is with the edge that the rules give you.

You will find a compilation of trading techniques that have served the authors well for over 15 years trading in equity (ordinary share) markets. The trading techniques are conceptually straight forward and have been successfully used by thousands of traders.

Although we present multiple trading techniques, you need only become the master of one technique to be successful. Often times the most successful share traders are the ones who keep things simple and who master a very small number of trading techniques that they know inside out.

This is a book based on the premise of trading well defined trends in individual equities. The book is written in the form of a Trend Trading manual complete with many real trading examples.

This manual will teach you what the authors have learnt about trend trading over the last 15 years.

By trend trading we mean trading with the underlying direction of the individual share price movement. In this manual we focus entirely on trading upward trending shares. For those interested in trading downwards moving shares, simply reverse the logic in each of the techniques.

To answer one of the most common questions we get asked: "*YES you can make a living from trading.*" But be realistic. If you are just starting out you need to learn how to trade and then practice, practice, practice before you will become proficient. Also be aware that "making a living" is different for each person and how long it takes you to reach this point will depend on the trading capital that you start with, the discipline with which you apply the trading rules, your personal success in applying the techniques and your determination to protect your trading capital.

In order for you to get the most out of the trend trading techniques presented in this book, a few points need to be made:

- It is important to initially practice any new trading technique on paper. Only by seeing a technique applied over and over again under your own control will you truly feel comfortable with it.
- If a trading technique does not make sense to you, don't trade it.
- All you need is one successful trading technique to make a living from trading. Learn to specialise in doing one thing exceptionally well. Then if you feel that you need to or want to add further techniques to your repertoire.
- Be aware that trading techniques are never mechanical. This means that you need to apply your own discretion and judgement to each possible trade. In turn this means that you need to manage each and every trade that you execute.
- **And the most important point. Stop loss orders are essential. Always.** Stops are your protection against a trade going against you. All it takes, as you will see later, is getting sloppy once or "frozen rabbit syndrome" to undo all the good results from a string of winning trades. **Placing protective stop loss orders must become a never to be broken habit if you are to make money from trading.**

Before we get into the trading techniques we want to start by being very clear on what you will **not** read about in this book.

Firstly, you will **not** read any exaggerated claims of how you can make lots and lots of money for no or very little risk. The reason for this is because we simply do not believe it is possible. As the well founded saying goes "if it sounds too good to be true it probably is."

The fact is that every single time that you buy even a single share there is risk involved. And one of the critical things that you will learn in this book is how to manage this risk when you are trading shares.

Understanding the risk and knowing how to manage the risk, or to put it another way, knowing how to protect your money, is where, in a few pages, we will start our share trading journey. Nothing is more important in share trading than knowing how to protect your money.

Secondly, you will **not** read anything about why you will have to buy really expensive computer programs or attend very expensive training courses that cost thousands and thousands of dollars in order to make money trading shares.

We firmly believe that share trading is a relatively straight forward activity. Because it is straight forward and not complex there is no need to buy complex, and consequently expensive, computer programs.

We certainly agree that you can spend a few hundred dollars to buy a computer program that will improve your productivity when you trade shares; but you certainly should not be spending thousands and thousands of dollars on a computer program.

The third thing that you will ***not*** read, is that you will be able to give up your day job tomorrow or next week or even the month after that and start living by the poolside with your laptop computer.

The reality of share trading is that those people who make a reasonable income from it, including professional share traders, will have taken years to get to that position. So it is unrealistic to expect that you'll be able to make a full-time income from share trading in a short period of time.

You definitely can make money from trading shares and we will teach how to.

After that you will need time to practice and gain experience and then you will need time to grow your trading capital. You can then decide for yourself based upon your own trading performance and your level of trading capital at what point in time you might be able to make enough trading profits to live off.

Chapter 2, Page 1 - TREND TRADING

Let's start by looking at what share trading is. Share trading has been around for a very long time. The word trading dates back to the 13th century. And people have traded all kinds of things including camels, oil, rice and of course more recently shares.

At its core, share trading is simply buying a share for one price today because we believe that at some point in the future we'll be able to sell the share at a higher price. For example, we buy a share today for five dollars because we believe that at some point in the not too distant future we'll be able to sell that same share for five dollars 50.

Share trading is that simple. Anytime anyone tries to convince you that share trading is complex and difficult then you should always bring it back to this very simple concept.

Share trading is about buying a share today for one price in order to sell it in the future for a higher price. Remember keep it simple and keep it straightforward.

Let's briefly examine the difference between trading shares and investing in shares. Investors buy assets, and in this case specifically shares, primarily for two reasons. Firstly, for the income-producing capacity of the share. Secondly, for the potential long-term capital growth of the share.

With shares the income comes from the regular dividends that the company will hopefully be paying. If a company makes a profit they normally payout some of this profit to shareholders in the form of dividends.

The share's capital appreciation comes from the so called long-term effect of the share market.

What the typical share market investor does is to buy some shares, normally in one of the large well-known companies. They then put those shares in the bottom drawer. Then they sit back and watch the regular dividend cheques roll in. And at some point further down the track, maybe in five or ten or fifteen years time they pull the shares out of the bottom drawer and sell them. When they sell the shares they expect the shares to be worth considerably more than when they bought them. This is what the typical mom and pop investor in the share market does.

As we've already said, share traders buy shares today with the intention of selling them at a higher price in the future. The future for a share trader could be as short as a few minutes time but it could also be in a few days time, or a few weeks time, or a few months time. The trading techniques in this book will cover a time span of between about 12 days and up to about 12 months.

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Chapter 3, Page 1 - MONEY MANAGEMENT

Every trading technique in this book, and in fact every trading technique that you can find, is useless without proper money management. Many novice traders find this difficult to believe but we can tell you story after story of traders who have gone broke because of one or two bad trades that they let turn into big losses.

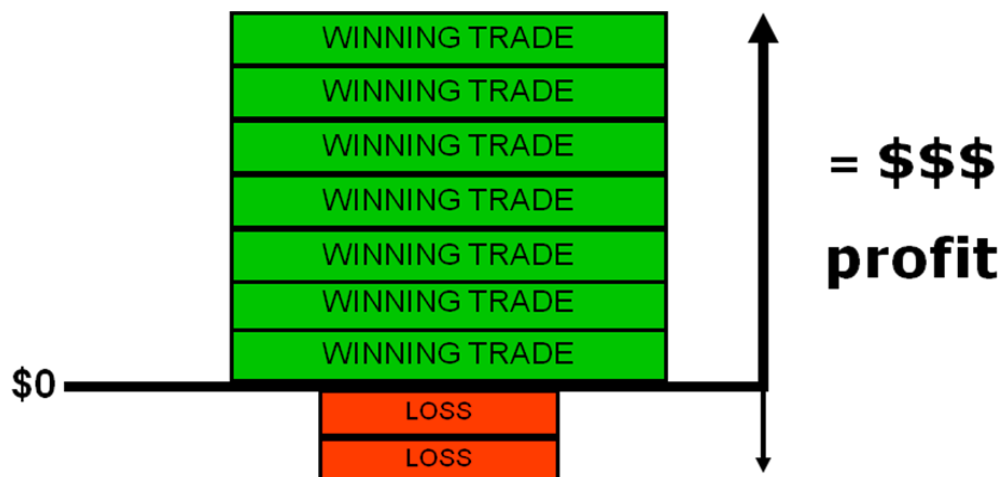
By money management we simply mean keeping any losses really small whilst making the most of opportunities for profit.

Money management in trend trading is all about the first golden rule of share trading. In fact this is the professional trader's golden rule of share trading. This rule is often the difference between making money and losing money when trading shares.

You make money from trading shares by accumulating many moderate winning trades whilst accepting a smaller number of smaller losing trades.

Let's say that again because it's a big concept to take in. You make money from trading shares by accumulating many moderate winning trades whilst accepting a smaller number of smaller losing trades.

This is such an important concept that we want to take the times to explain it in more detail.



The \$0 line that you can see above represents break even or zero dollars.

In any period of time we expect to build up a number of winning trades(green) and in turn build up our profits.

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Chapter 4, Page 1 - GOLDEN RULE OF SHARE TRADING

“Making money from share trading is dependant upon keeping any losing trades really, really small.”

In order to present the golden rule to you in a way that you can understand the significance of this rule, we will start by looking at an example.

This example involves two traders who are going to buy the same shares at the same time.

The scenario here is that we give both traders \$10,000 to trade with. It is possible to trade with a lot more than \$10,000. It is also possible to trade with a lot less than \$10,000. We have chosen the round figure of \$10,000 just to keep the math easy.

We will assume that each trade that they enter into has a 50% chance of being a winning trade and a 50% chance of being a losing trade (in real trading we are aiming for a higher winning percentage than 50%). For this example, we will simply alternate between a winning trade and a losing trade to achieve this outcome.

We will assume that each winning trade will return a profit of \$1,000.

We will assume that each losing trade will result in a loss of \$1,000 unless the trader takes some action to manage the loss.

We will now have a look at each of the trader's performance over ten individual trades.

In this example each trade will happen one at a time. That is, the first trade will be complete before the second one starts. And the second trade will be complete before the third one starts. And so on. The trades are done one at a time not all ten at once.

We will start with the first trader. The first trade is a successful one.

So we add \$1,000 profit to the initial balance of \$10,000. Trader one now has a trading balance of \$11,000.

As we said we are simply going to alternate between losing trades and winning trades to achieve a success rate of 50%.

So the second trade will be a losing one.

So we subtract the \$1,000 loss from the trading balance of \$11,000. Trader one now has a trading balance of \$10,000

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Chapter 5, Page 1 - WHY TRADE TRENDS?

We have a 2% stop loss rule in place to protect ourselves from large losses.

The next question is, which shares should we trade?

Let's look at the problem. On the major US share markets there are over 7,000 securities trading, in the UK on the London Stock Exchange there are over 3,000 companies listed and even in Australia there are more than two thousand shares trading on the Australian Stock Exchange.

We want to narrow this huge number of potential shares to trade down to a small number of shares that have a reasonable probability of making money for us when we trade them.

We also want to select shares to trade where the trade will be straight forward to manage as time goes on.

We want these shares that we trade to have greater than a 50% probability of moving up in price. And remember, our aim is a significant number of moderate wins whilst accepting a smaller number of smaller losses.

A share price can move up and down right? Absolutely!

Therefore there is a 50% chance that a share's price will go up or down.

Right?

No - not so.

In reality a share price can do three things – it can, generally speaking, go up, or it can go down, or it can move sideways. By moving sideways we mean that it is neither moving up nor down but is drifting along at around the same price. It may vary up or down a bit but the general direction is sideways.

The analysis that we are about to show you is based upon the historical analysis of many, many share price histories. The analysis has been done by many different people in different countries. The outcomes, no matter who does the analysis are always similar. Sometimes the numbers vary slightly but the outcomes are always the same.

Chapter 6, Page 1 - Straight Line Trend Trading

The straight edge trend line is used to help us to select easy to manage trades and provides a clear trade exit signal. We can also use this trading technique to provide us with a relatively low risk trade entry.

It is important to note that there is a difference between the trend and any trend line we may plot on a price chart.

The trend is the general direction of share price movement. The trend line is a way of defining the boundary conditions of the trend.

A trend is a discernible bias in the direction of the price movements – upwards or downwards. If there is no discernible upwards or downwards bias then the price is moving sideways.

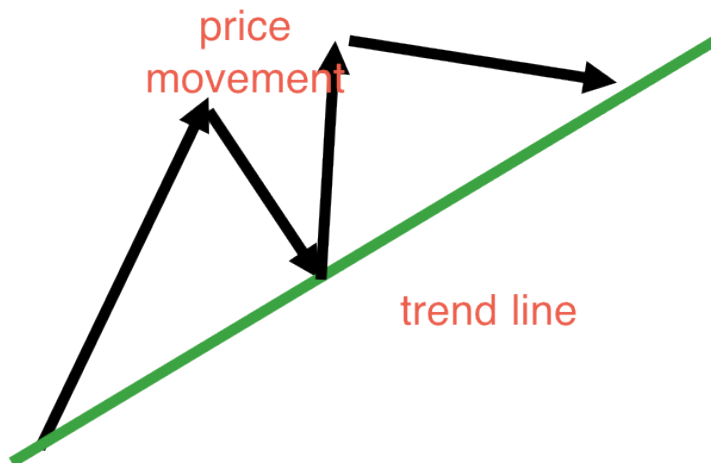
A trend line is a line that we draw on a price chart to define the trend.

The trend itself and the trend line we draw are two different things. **The trend is real while the trend line is an artificial construct that we have created.**

The share market has no obligation to follow any trend line that we have drawn – in fact it doesn't know that the line exists.

We use the straight edge trend line to take a profitable chunk out of a trend, up to a maximum of around six months. Remember we are not attempting the impossible – picking the bottoms and tops in the trend. We will always be leaving some money on the table at the start and end of the trend.

What does a straight edge trend line look like? The straight edge trend line is plotted beneath a rising trend. It is defined by the low points of price bars



Chapter 7, Page 1 - **Van Tharp's 55/21 Trading Breakout Technique**

This very straight forward trading technique was used by Dr Van K Tharp, Ph.D. to prove the importance of position sizing.

In doing so he carried out multiple historical simulations showing that this technique combined with solid stop loss discipline and correct position sizing could deliver profits of up to 3,000% over ten years.

Note that without stop loss management and no position sizing he also showed that the technique could deliver a loss of up to 100% over ten years.

This technique is documented by Van Tharp in his very detailed book "Trade Your Way To Financial Freedom". Note that this book is a dense and complex read and its focus is most definitely not on giving you the "secret" trading technique that will make you a fortune. Rather it is about all the other factors that influence the outcome of your trading in spite of which technique or techniques you use.

Van Tharp's 55/21 Day Channel Breakout Technique works only when combined with stop loss management and position sizing.

The trading technique itself is straight forward.

You buy a share when it hits a new 55 day high.

You use a trailing 21 day low as a stop loss and a close below the 21 day low as your exit signal. The level of the 21 day low is evaluated each day and only ever moved upwards.

Position sizing is absolutely critical to the success of this technique as at times there can be a large separation between the 55 day high and the 21 day low.

NOTE that it is critical to apply position sizing with this technique.

For example if your total trading capital is \$40,000 and you allow for a maximum of four trades at once with a preferred trade size of \$10,000: