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Renato Di Lorenzo

How to Make Money by Fast Trading

A Guide to Success

 Springer

to Annie

Preface

It may have been the crisis or a natural evolution, but all over the world a growing number of people look at trading the markets as a second job in addition to their first one, or even as a full-time job if they should have lost the first one. They perhaps may have no other alternative, due to their age, or they may have been attracted to this activity by the circumstance that trading the markets implies *freedom*, in particular it does not involve commuting every morning and night, or having a boss that one not always esteems but whose orders have to be fulfilled and so on.

Thus a growing number of people spend part of their time—not necessarily the most part—in front of a PC, connecting to the platform of their broker online, and they buy and sell in the world markets assets of the most different kinds: gold, oil, shares, bonds, and so forth.

Once upon a time, when the markets crashed, this was a reason to stay awake in the night because the common Joe knew only how to long the markets; the short positions were badly understood and in some cases it was difficult to realize them in practice. Today there is no problem to short almost any class of assets; therefore half of the main reasons why people once lost money—i.e., the necessity of markets going up and not down—has disappeared.

Being long or short is indifferent to the trader today; he has only one problem (clearly not at all trivial): being on the *right* side of the market.

Another reason why not many years ago it was difficult to trade the markets for a person that had a regular job was that when he had time to do that—i.e., after the regular job—the markets were closed. Today also this obstacle has been removed: many markets—albeit in some cases foreign markets¹—are open until late in the night, not to mention the Forex, which practically is always open.

¹But where at least the most popular of the domestic securities are normally traded.

The third reason why not much time ago it was difficult to trade the markets for the common Joe was that in many cases one had to use a substantial amount of money, but also this obstacle has been removed, as today almost any asset can be traded using the leverage effect, i.e., owning only part (the margin) of the total sum, and having financed by the broker the remaining part.

Is it that simple?

Not at all.

If one does not study thoroughly the matter, if he does not make much paper trading before using real money, and if he does not accumulate knowledge and experience, the capital employed may be small, but it will be lost with 100% probability.

The reason is that, in trading the markets, the probabilities are against you, and not the converse.

This is the situation:

We are:	The market:		
	Goes up	Moves sideways	Goes down
Long	⊕	–	–
Stay by the sidelines	–	–	–
Short	–	–	⊕

As you can see, if you do not have a method, the favorable cases are only 2 out of 9 with a probability of success of only $2/9=22\%$, which is very low.

This is the reason why most of the newcomers lose money: because they do not have a method and therefore are a prey of the probabilities.

Having a method means to possess a *protocol*, i.e., a consistent investment procedure that specifies:

- When and how to enter a position, and this is an answer that a so-called *trading system* must provide, formal (i.e., mathematically formalized) or informal
- The maximum loss that one may accept to suffer, both from a psychological and a patrimonial point of view
- The dollar dimension of the position that one may allow to take
- When and how to exit a position, and this again is an information that is expected to be obtained from a trading system

It is to guide you through the process of building this setup that this book has been written: to make you trade professionally, as today, in the markets as everywhere else, there is no more room left for the improvisation.

Many maintain that scalping, or fast trading anyhow, is pure talent and intuition. Not true.

Any trading activity is 90% pure technique.

The process is as follows:

- One builds and tests—on the many free platforms that are available on the internet²—a trading system, i.e., a protocol that tells him when to be long or short or stay by the sidelines, based on a series of rules that the trader chooses according to his beliefs
- When the trader is confident that the indications given by the trading system are reliable, its advices have to be followed blindly
- Therefore the true brain effort resides in the design and in the test of the trading system; the rest follows slavishly

Following the advices given in this book, it will be seen that there is no need for the trader to stay in front of the PC all the time, as the position he takes on the market is in a certain sense encapsulated, with a stop loss and a series of take profits that act automatically according to the rules dictated by the trading system and, most important of all, that protect the trader from himself, preventing him from the temptation not to follow the rules that he himself has proved to be consistent and successful.

By now, part-time (and full-time) scalpers and day traders are countless on both the sides of the oceans. Their activity has even gained a nickname: *T/S*, traders for a salary.

Good luck then to the TfS newcomers and the veterans!

Renato Di Lorenzo

²*ProRealTime* is, in our opinion, the best one at the moment of writing and we will use mostly it.

Acknowledgments

Stefano Caroti Ghelli has been of support in writing different scripts.

Riccardo Grasselli developed some time ago, in a common effort,³ the description of numerous oscillators partly reproduced here.

Many charts have been reproduced by kind permission of Saxo Bank and ProRealTime; the responsibility of their interpretation however stays with the author.

Many thanks to the editor, Marina Forlizzi.

Disclaimer

Markets may go up or down and in our knowledge there is no way to forecast their movements exactly; therefore, the author cannot be deemed responsible for eventual losses that may arise from the application of the instruments and procedures described herein.

³Di Lorenzo R, Grasselli R (2006) Individuare i trend per guadagnare in Borsa. Il Sole 24 ORE, Milano.

Warnings

In the development of the text many spreadsheets have been designed and used, and it may even be said that in a certain sense this is a multimedia book because such spreadsheets will be sent via e-mail, free of charge, to all those that will ask the author (renato.dilorenzo1@gmail.com); in the request they shall enclose any proof of the purchase of this book: a snapshot of the receipt taken with the cellular phone, or whatever.

The reader himself can use the spreadsheets by entering the yellow boxes with the data of the assets he is interested in and then reading the result of the calculations in the other boxes.

In addition to the spreadsheets, in this book also scripts (or *codes*) have been used that, if copied in the apposite space of a trading platform (in particular ProRealTime), will give the reader the possibility of using immediately the trading systems, the indicators, the screening system, and so forth. Also these scripts will be sent free of charge with the same e-mail as before, written on a Word page, so that one will be able to copy and paste them and so start trading immediately. Such scripts at the time of writing do work perfectly with ProRealTime platform version *v8.1*, but in the future some eventual changes in the platform may negatively impinge on their performance; in this case it is advisable to contact directly the *Client Service* at ProRealTime to get a solution.

The number of instruments that are available today on the financial markets is very large and growing: shares, bonds, futures, options, and so forth. But technical analysis may be applied to a large extent to the time series of the market prices of anyone of them. So we need a unified name for all those instruments and we have chosen the words *asset* or *security*. If not otherwise stated, when using such words we will intend that the algorithms and the protocols we are illustrating can be applied identically to the time series of the market prices of all those instruments. Likewise the terms *share* or *contract* and the like will be used interchangeably without much rigor, being clear from the context what is intended.

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Part I

Chapter 1

What We Are Talking About

He who trades the markets usually does it for two different reasons:

- Building his asset wealth
- Earning a stable income (maybe an extra income)

In the first case, one operates mostly in a daily perspective, i.e., making decisions by considering charts that are updated once a day (or maybe once a week, or more) usually using the closing price of the session. In this case, we say he is an adept of *swing trading* if his positions remain open for a few days or of *position trading* if his positions remain open for a longer period.

In the second case, it is more likely that the trader's positions remain open for a period shorter than one single day, maybe a few minutes, and in this case we say he is a *scalper* (in the few minutes case) or a *day trader* (in other cases).

Scalpers and day traders usually do not want that their positions remain open overnight because during the night nobody is in control: the opening of the next session may be substantially different from the closure of the previous session, and even stops may be of no use as the opening price may be far lower (in the long case, or higher in the short case) than the stops themselves, making the loss much higher than expected.

It must be said that the difference between a scalper and a day trader is only in attitude: a scalper is content of a very small profit but repeated many times a day, while the day trader tries to make substantially higher profits-per-trade. Obviously both of them will suffer also losses, larger losses-per-trade for the day trader and smaller losses-per-trade for the scalper, but to be successful both of them will obviously have to earn cumulated profits that are larger than the cumulated losses.

Let's now stop for a minute and give another information: the meaning of the word *sampling*.

Almost everybody today knows that the majority of the graphs on which technical analysis is based are of the *candles* type, as shown in Fig. 1.1.

It is composed of figures (candles or Japanese candlesticks) as shown in Fig. 1.2.

The large central part of the candle is named *body* and the two thin remaining parts are called *shadows*. When the body is white or void, the close is higher than

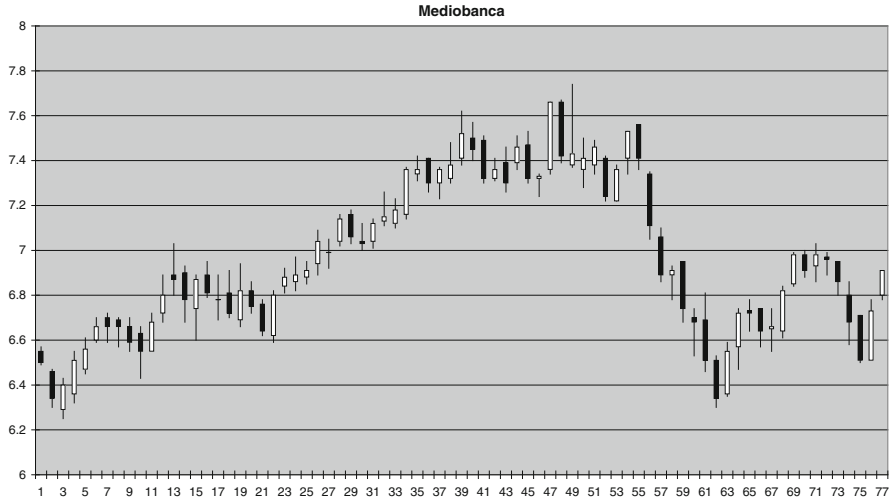


Fig. 1.1 Japanese candlesticks

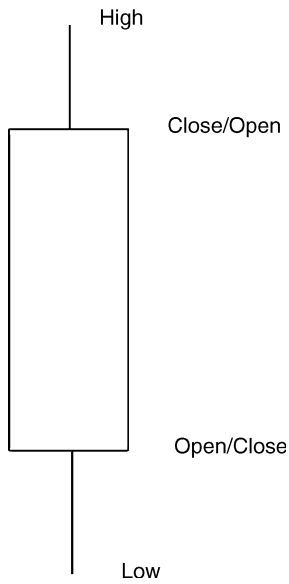


Fig. 1.2 Candle