



# ROSS

**Joe Ross**, an active professional trader, author, and educator, is president of Ross Trading International. He holds a degree in business administration from U.C.L.A, and is now in his 35th year of successful trading. He is best known as the inventor of the Ross hook. He has written *Trading by the Book*, *Trading by the Minute*, and *Trading Is a Business*. All three books have been widely acclaimed and honored as destined to become classics in the field of futures trading. His books have received rave reviews by CTCR, Traders Press, Traders Almanac, and Traders Library. Joe also authors *Traders Notebook*, an educational, teaching letter.

Joe holds regular monthly Trading the Truth seminars from which he has graduated many winning traders. His risk and money management techniques have been called "the best in the business".

Joe is fortunate to have been taught trading by his family, who have been successfully trading the futures markets since 1889.

**Topic:** Joe's workshop is entitled "Where Do You Place the Stop?" Joe raises the question, and then answers it in great detail. You will learn which specific items are important to consider for stop placement. You will learn several techniques for placing protective, objective, entry, and exit stops. You will learn to place stops based upon natural support and resistance and volatility. You will be taught about small profit objective stops and full profit objective stops. You will learn how to properly trail stops and how to increase the size of your protective stops using OPM. Joe shows you how to "curve fit" market volatility, and how and when to use Fibonacci expansions for objective stops. You will be shown more about stops than you might possibly imagine.

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# Stops

## Where Do You Place the Stop?

Stop placement appears to be a topic that is on every trader's mind. Where do you place the stop?

In this session, we will consider four situations for using stops:

1. Mechanical Stops: As dictated by mechanized trading systems.
2. Protective Stops: To protect against loss, or to protect profits.
3. Objective Stops: To cover costs.
4. Entry Stops: To initiate a trade.
5. Exit Stops: To terminate a trade.

### General Considerations

At various times you will hear or read material from someone who tells you where to place a protective stop.

Of course, if you are following an adviser and taking that advisers trades, you must utilize the adviser's stop placement. Why? Because when you follow an adviser, you are trading a mechanical system. The adviser is your system. You cannot possibly expect to achieve success until and unless you do exactly as the adviser dictates. In addition, you also need to do a lot of praying. Pray that the adviser will have a good year in the markets.

The same consideration is true if you follow a mechanical system. If you expect to get the results you paid for when you purchased the system, you must place your stops as the system dictates. At times, the draw down against your margin will be virtually intolerable. That's the price you have to pay for trading a mechanical system.



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There are few traders who can maintain the discipline needed to exactly follow a mechanical system, whether it be computer generated or derived from an advisory of some sort.

If you are following any other type of mechanical system, you will of course have to place stops where the system dictates. If you won't do that, you've thrown out the money you paid for the system.

Should you place a stop at a certain number of points distant from current price action? Should you place a stop at a certain percentage distant from current price action? Or, should you place a stop a fixed money amount distant from current price action? Any or all of these may be an incorrect way to place stops.

I am thoroughly convinced that no one on earth can tell **you** where to put **your** stop.

The truth is, only you can decide. Unless you are trading a mechanical system or following an adviser, the responsibility is yours. If you are calling your own trades, there is no way you can **pass** that responsibility to anyone else.

Since proper stop placement is such an important responsibility, let's take a few minutes to reflect on some of the items that must be taken into consideration when placing stops. We will return to these individually later on and view them in the context of whether we are using the stop to protect against loss, protecting profits, or seeking an objective.

### **Specific Considerations**

**1. The size of the margin account.** Certainly, the size of your margin account will affect where you are able to place stops. It will even affect the selection of markets in which you are able to trade.

**2. Margin requirements.** The margin requirements set out by the exchanges, and any additional requirements set by your broker, will affect which markets you can trade, as well as where you place your stop.



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**3. Your individual psychological and emotional tolerance for pain, that is, your individual comfort level, greatly affects stop placement.** Provided you can afford to trade in the market you have chosen, this is probably the most important factor in setting stops. You might have a \$100,000 account, but if taking a \$200 hit will devastate you psychologically, then you cannot set your stop that far away.

**4. Your economic tolerance for loss.** Your willingness to lose a certain amount of money and being able to afford it even though it makes no sense. If you are stopped out with a loss often enough, you will reach the point where you will no longer have money to lose. Therefore, you must have a rational approach to stop placement.

**5. The number of existing open positions already held.** If you are already positioned in other trades, you may not be able to set your stop properly in any new trades. In that case you may be forced to miss a good opportunity, or to set stops too close.

**6. Market volatility.** This is a market generated criteria for setting stops. The market may be too volatile causing you to need to set a stop beyond affordability or comfort level. Conversely, using a market generated criteria, volatility may be not sufficiently volatile for you to consider entering a market let alone place a stop. The stop would be too close to the price action and virtually certain to be hit.

**7. The rate of trading.** Whether you are in a fast or slow market affects stop placement. If a market is moving quite fast, you may have to set a stop further away than is affordable or comfortable.

**8. Tick size.** Usually, when a market is fast, or highly volatile, the tick size will also increase. That means your usual and normal stop will not suffice. An example would be if you limited your losses to \$250 on a five minute S&P chart, and suddenly the ticks moved away from the normal five to ten points per tick to twenty-five points per tick. In other words the market becomes fast. It would only take two of these super sized ticks moving against you to take you out of the market.



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**13. Your overall objectives and strategy for the trade.** For instance, if you expect to make a long term trade, you would place your stop a lot further back than if you were anticipating a short term trade.

In view of the preceding points, how can a trader expect someone else to tell him where to place a protective stop? You, and only you, are in a position to know all of these things. And while someone else may know some of these things, only you can know your comfort level.

Also in view of the considerations I've presented, isn't it a bit ludicrous to set loss protection stops at a fixed number of points, a set money amount, a previously determined percentage away from the price action, or based upon the dictates of a mechanical trading system?

None of these methods has anything to do with the reality of price action in the market, or the trader's economic, mental, or emotional condition, or any of the other conditions mentioned.

Stop placement is where you separate the knowledgeable mature trader from the amateur trader who still does not know how, when, or where to place stops in the market. Stop placement is where you separate the "men" from the "boys".

### **Placing a Loss Protection Stop**

Of the many stop-loss placement techniques I have seen, only two have proven continuously successful over the years. Only two have made any sense at all. One method uses natural support and resistance for placing stops. The other uses market volatility to dictate stop placement. In both cases, we allow the market to tell us where to put the stop. We then filter that knowledge through our financial, mental, and emotional condition.

If the market is telling us where to place a stop and that stop is too far away for comfort, then we do not take the trade. Or, if placing the stop where the market indicates would create too great a financial risk, we refrain from taking the trade.



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## Using Natural Support and Resistance

I'll now show you what I mean by "natural" support and resistance. Let's look at a nicely trending market in Crude Oil

CL G DAILY

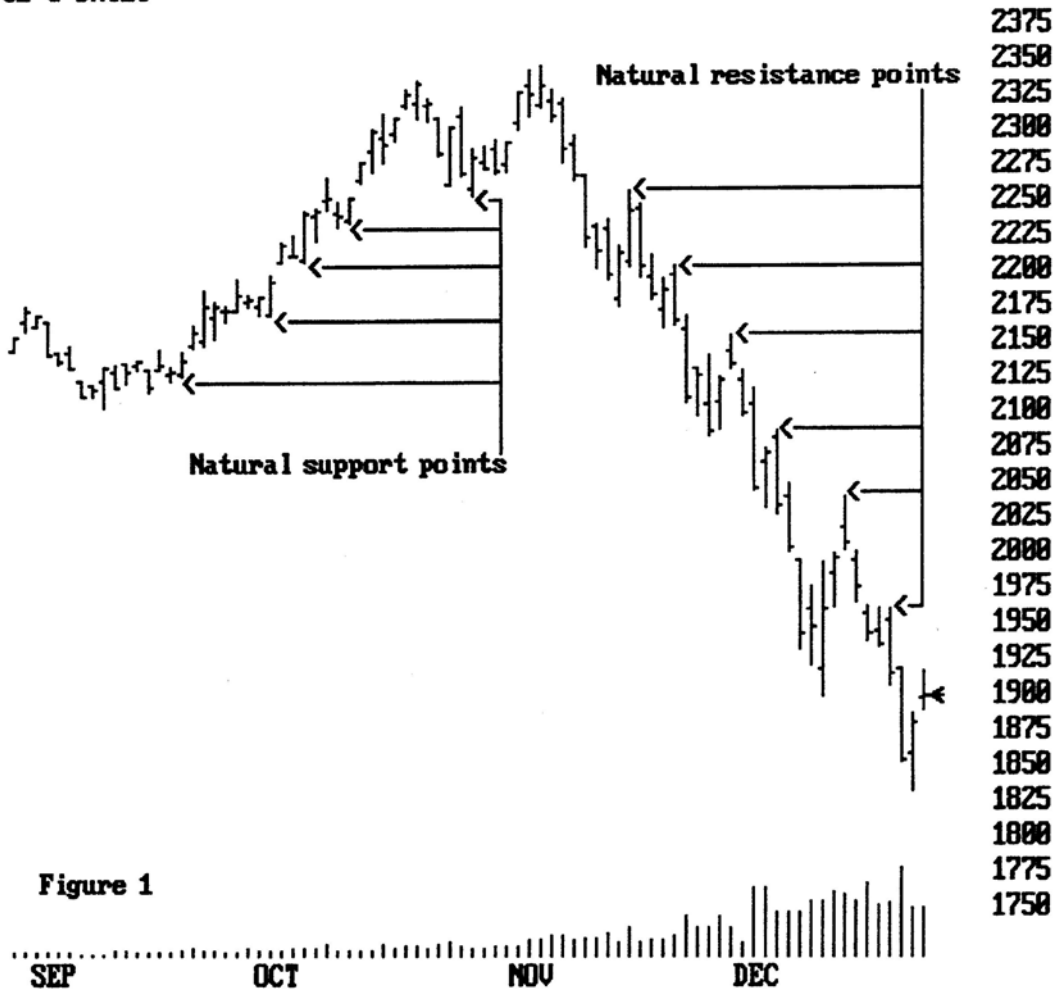


Figure 1

Natural support and resistance points are those places in a trend where prices either move sideways for a brief period or where prices make some sort of correction, by moving counter-trend for a few bars.

These stops usually work because price action in the market has previously held at that level. If recent price was too high or too low at that level, then price will probably be considered too high or too low at that level in the near future. These stops take advantage of the natural support and resistance in the market.

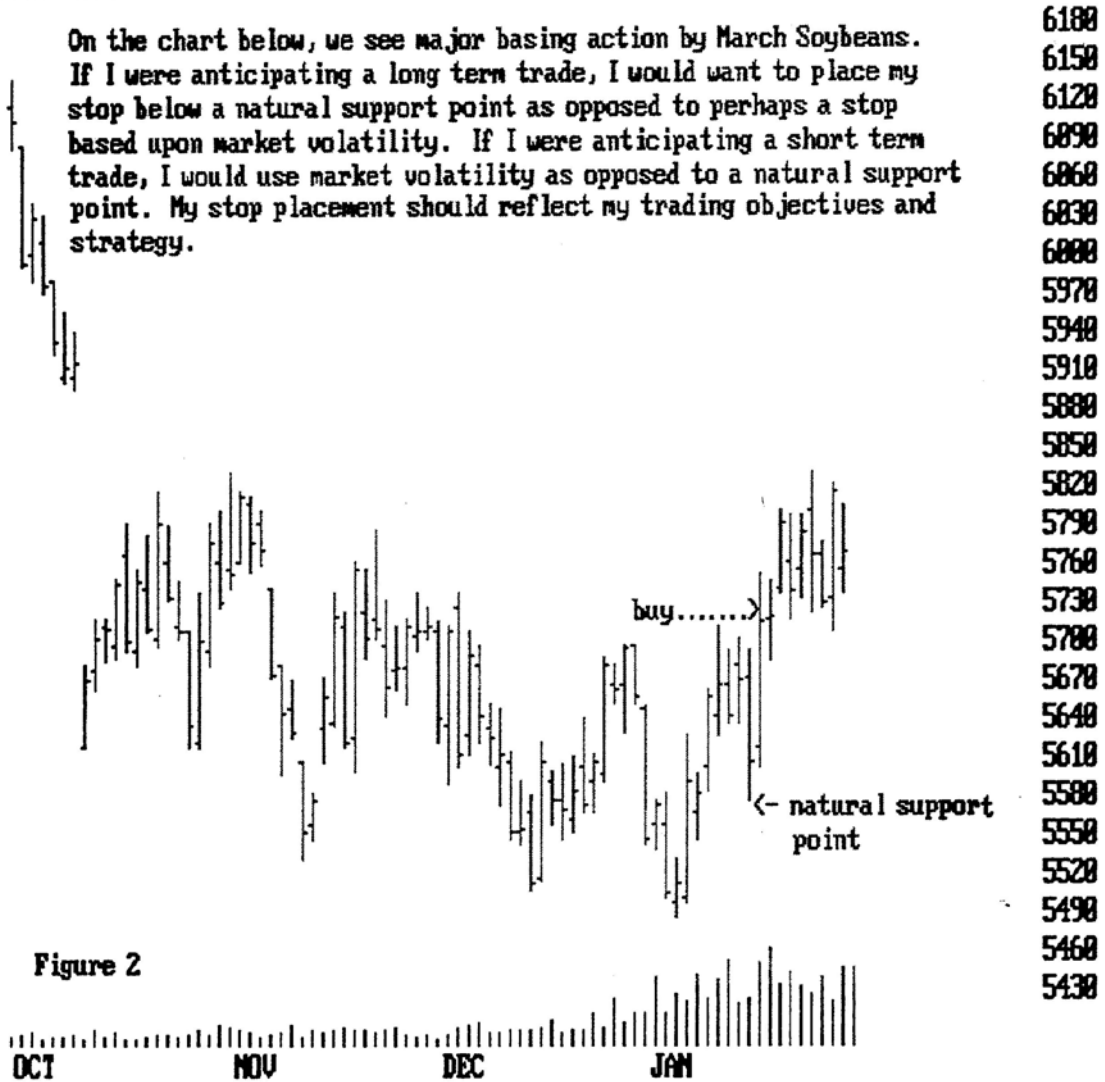


If prices at a natural point of resistance or support do not hold, then the probabilities are that we have been wrong in our estimation of market action, and we are better off being stopped out of the trade.

I have a tendency to use natural support and resistance points when planning a longer term trade for the time frame in which I'm trading. The next chart will illustrate this concept. The main thing is to set the stop in light of my objectives and strategy.

**S H DAILY**

On the chart below, we see major basing action by March Soybeans. If I were anticipating a long term trade, I would want to place my stop below a natural support point as opposed to perhaps a stop based upon market volatility. If I were anticipating a short term trade, I would use market volatility as opposed to a natural support point. My stop placement should reflect my trading objectives and strategy.



**Figure 2**



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## Advantages and Disadvantages of Natural Stops

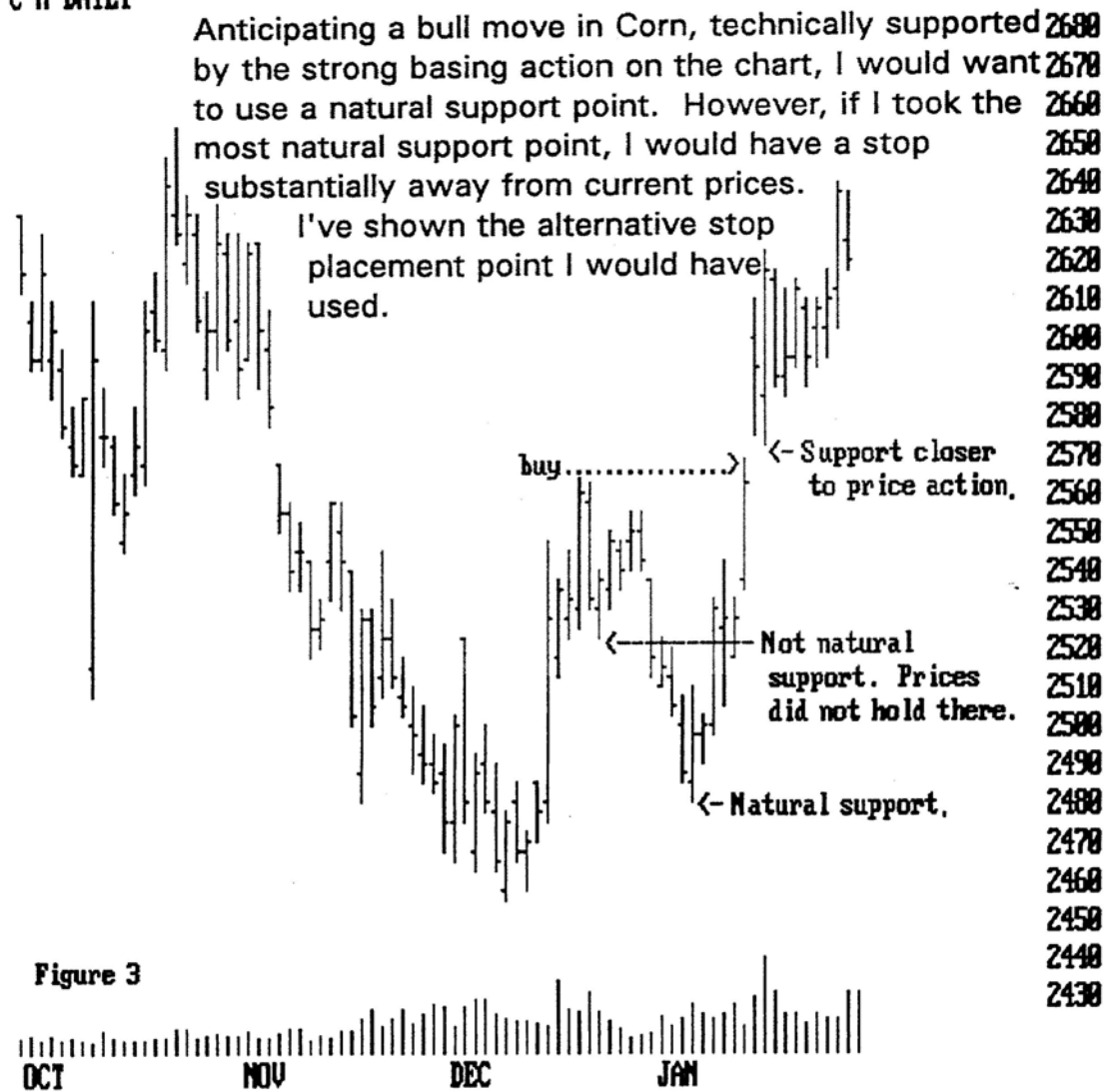
The single greatest disadvantage to using natural stops is at one and the same time its greatest advantage: Prices may be too far removed from the current price action.

Natural stops are easy to see on a chart once prices move away from them, and in a trending market prove to be remarkably safe. They tend to keep you in a trade for a long time.

A big disadvantage to using natural stops, is that at times, when you wait until they are hit, you may see a rather nice gain turn into a loss. Natural stops are of little, or no use in non-trending markets.

The next chart gives you an idea of what I mean when I say a natural support point may be too far removed from the current price action.

**C H DAILY**



## Volatility Stops

In my experience, other than natural support and resistance points, the market has only one other factor to aid in stop placement. That factor is volatility.

To understand how to use volatility you first need to understand the concept of volatility.

The difference between a bar's high and low price is that bar's trading range. You can use the high and low of a week to get a weekly range, or you can go intraday to look at hourly, 15 minute, or the trading range of any time period. You simply subtract the low from the high for that period. When you look at any bar chart, the length of each bar, from high to low, represents that bar's (or period's) range.

Once you have the range for one period, you can do the same calculation for any number of sequential periods, and then take an average. If you want to look at the range over a five bar period, you subtract the low from the high of each bar, and after five bars you add up all five individual bars' ranges, then divide by five to get the five bar average range. However, there's a complication.

Let's say that you have a gap up opening, and the low for the current bar ends up being higher than the previous bar's close. If we assume the range to be high minus low, then what happens to the gap, the distance that the market moved between the previous bar's close and the current low?

The true range must include the distance from the previous bar's close to the current bar's high. Conversely, when there is a down gap, and the current bar's high is lower than the previous bar's close, the true range is equal to the difference between the previous bar's close and the current bar's low.

There is yet another complicated consideration. What do you do about markets that trade elsewhere, or are affected by trading elsewhere, and the result is often a large gap opening due to the price action that has taken place overnight?



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You must decide for yourself whether or not to take that kind of gap into consideration in your calculation of volatility. The answer may be that you count gaps in some markets and not in others.

Once you learn how to calculate a bar's true range with or without gap considerations, you can take an average over any selected number of days to come up with the true average range.

The true average range is a direct measurement of the market's volatility. When daily ranges expand, we are seeing increased volatility come into the market. When ranges decrease, so does volatility.

If a market is very volatile, a stop based upon that same volatility will give a good indication of where to place the stop.

There are a number of ways to compute a volatility stop. In each case, we must first come up with a volatility figure.

In my own trading, I use average volatility for the last five price bars, provided they are reasonably the same in size relative to one another. If there is an abnormally large, or an abnormally small price bar, I will compute average volatility for the last ten days. As much as possible, I want to eliminate any aberrations in the market place.

I use ten or more days in market that have a lot of gaps.

To compute average volatility for any number of days —  $N$ , I take the sum of the differences between the high and the low for  $N$  days, and divide by  $N$ . I then have the average volatility for the last  $N$  days.

I'll give an example using the bonds. If you can figure average volatility for the bonds, you can do it for anything. When I compute anything that has to do with the bonds, I first convert them to decimal.

To accomplish that I multiply by 32 and then add the 32nd's:

| Day | High   | Low    | Conversion  | Difference |
|-----|--------|--------|-------------|------------|
| 1   | 103-20 | 103-08 | 3316 - 3304 | 12         |
| 2   | 103-16 | 103-02 | 3312 - 3298 | 14         |
| 3   | 103-14 | 102-19 | 3310 - 3283 | 27         |
| 4   | 102-27 | 101-29 | 3291 - 3261 | 30         |
| 5   | 101-29 | 100-28 | 3261 - 3228 | 33         |

$$\text{Total } 116 / 5 = 23.2 \text{ AV}$$

I then subtract the average volatility point from my entry price, to obtain a logical price at which to place my initial protective stop.

If I were to go long the bonds at 103-14, I would subtract 23/32 from my entry price and place the stop at 102-23.

In order to be consistent and also to show you how I convert back from decimal to 32nds, note the following steps.

$$103-14 = 3310 - 23 = 3287.$$

To convert back, you divide 3287 by 32. This gives a whole number and usually a fraction expressed as a decimal, NNN.xxx

You then subtract the whole number away. This will be the mantissa (whole number) to use for your order.

You then multiply the fraction by 32. This gives the remaining thirty-seconds if any for the remainder of your order.

$$\begin{aligned} 3287/32 &= 102.71875 - 102 = .71875. \\ .71875 \times 32 &= 23 \\ \text{Result} &= 102-23. \end{aligned}$$

It's important to notice that there is a flaw in this method of computing volatility. There's something missing. Can you guess what it might be?



Gaps are missing from this calculation. In the currencies, on the daily chart especially, this leaves a lot of the market missing from the calculation.

The truth is that on a gap day, prices have moved from where we see the close today to where we see the open the following day.

There are two sides to the argument. One says that regardless of the gaps, prices are only volatile to the extent that we see the market move each day during the hours we trade. The other side says that to compute true volatility, you must include the net amount of the gap. In an up market that would be the distance from today's close, to tomorrow's open. In a down market it would be the distance from today's close to tomorrow's open. On intraday charts it doesn't really matter.

You must try to calculate volatility both ways and see which method suits you best. For my own purposes, I have left out the gaps. But you need to be aware that they are there, and they may be more important in some markets than in others. That is the reason I compute a ten bar, or more, volatility on daily charts that contain many gaps.

I have set my stops both according to natural support and resistance points, and computing volatility as shown, over most of my trading career. It wasn't until I came across the Volatility Stop study that I began to consider another way to set stops.

### **The Volatility Stop Study**

One of the more interesting ways to set stops using volatility is to utilize the study called the Volatility Stop.

I have adjusted this study to my own liking by occasionally removing the multiplier that is normally a part of the study. However, the multiplier can be used effectively in a more volatile market to curve fit the study to the greater volatility occurring in that market.



To use the Volatility Stop study, simply compute average volatility and then add the figure to the lowest close in the last N days, and subtract it from the highest close in the last N days.

This will yield two prices, one for upper volatility and one for lower volatility. Typically, one of the figures will be a price that is within the range of prices you see on your chart for the last N days. The other figure will be either above or below the range of prices you see on your chart. You want to use the price that is furthest away from the range of prices for your stop.

Rather than try to explain further, I'll show you a picture of the Volatility Stop study. If you have such a study available simply set the multiplier to 1 to put it out of commission, or experiment with the multiplier until you get a plot that contains the move.

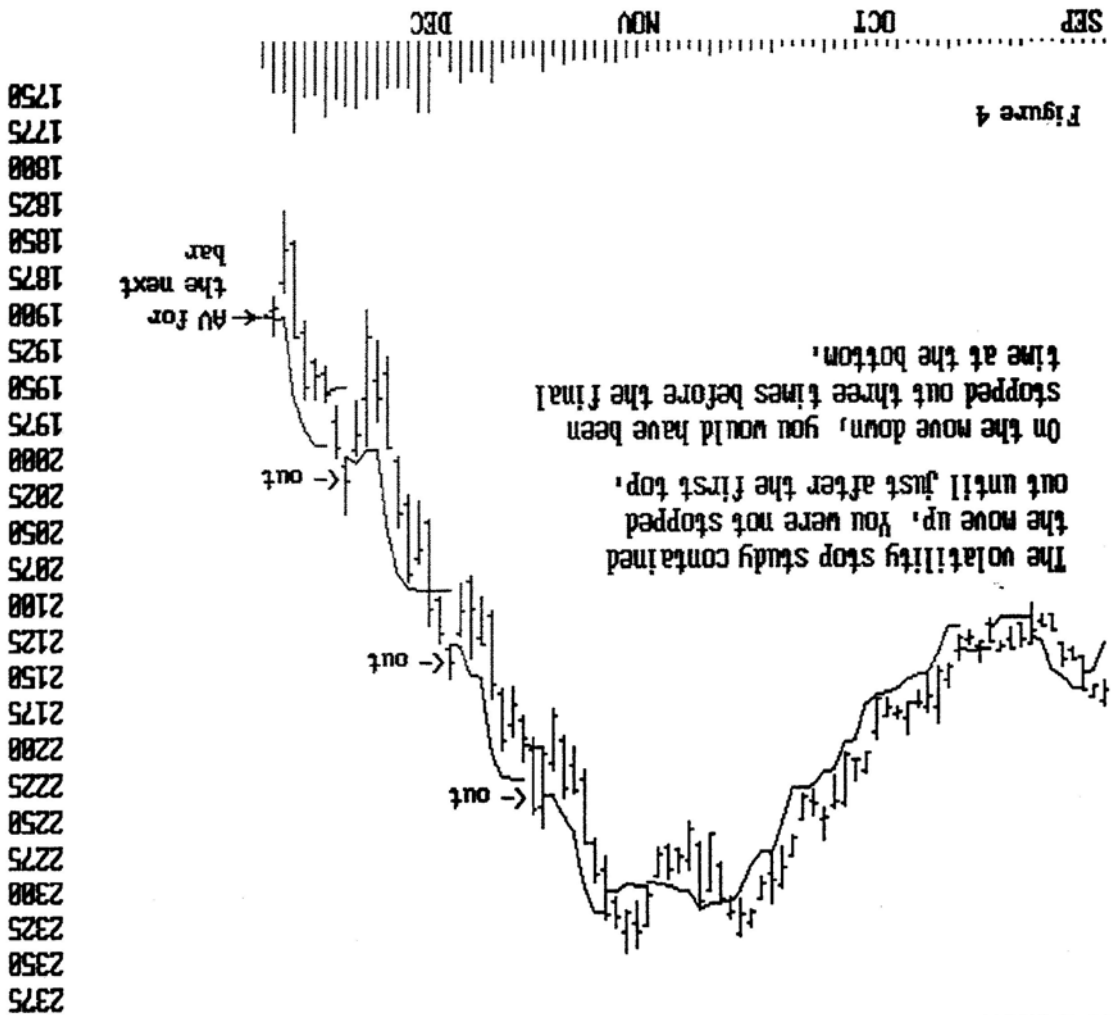




Here is an interesting way to use the Volatility Stop study.

When AV is running through the price range, it is a sign to avoid entry into the market, unless of course you want to trade in the congestion. An interesting thing about the Volatility Stop study is that it is computed and plotted at the completion of each bar so that you know where the stop is for the next bar. On the preceding chart, you see it sticking out by the arrow.

Volatility for the above study was set at 5, 1. The 1, takes away any multiplier.



CL 6 DAILY

Since a setting of 5,1 contained the upmove, You would leave that setting in place for the down move.

However, once the down move failed to be contained by the study, you could try setting the multiplier to a number greater than 1.

Here's how You would go about it.

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Suppose that when I saw the market take out the US plot at point a, and then take out the hook at point b, I then curve fitted the US plot so that it contained the move at the top of the bar at which point "a" occurred?

I'll show on the next chart what that would look like.



Figure 5



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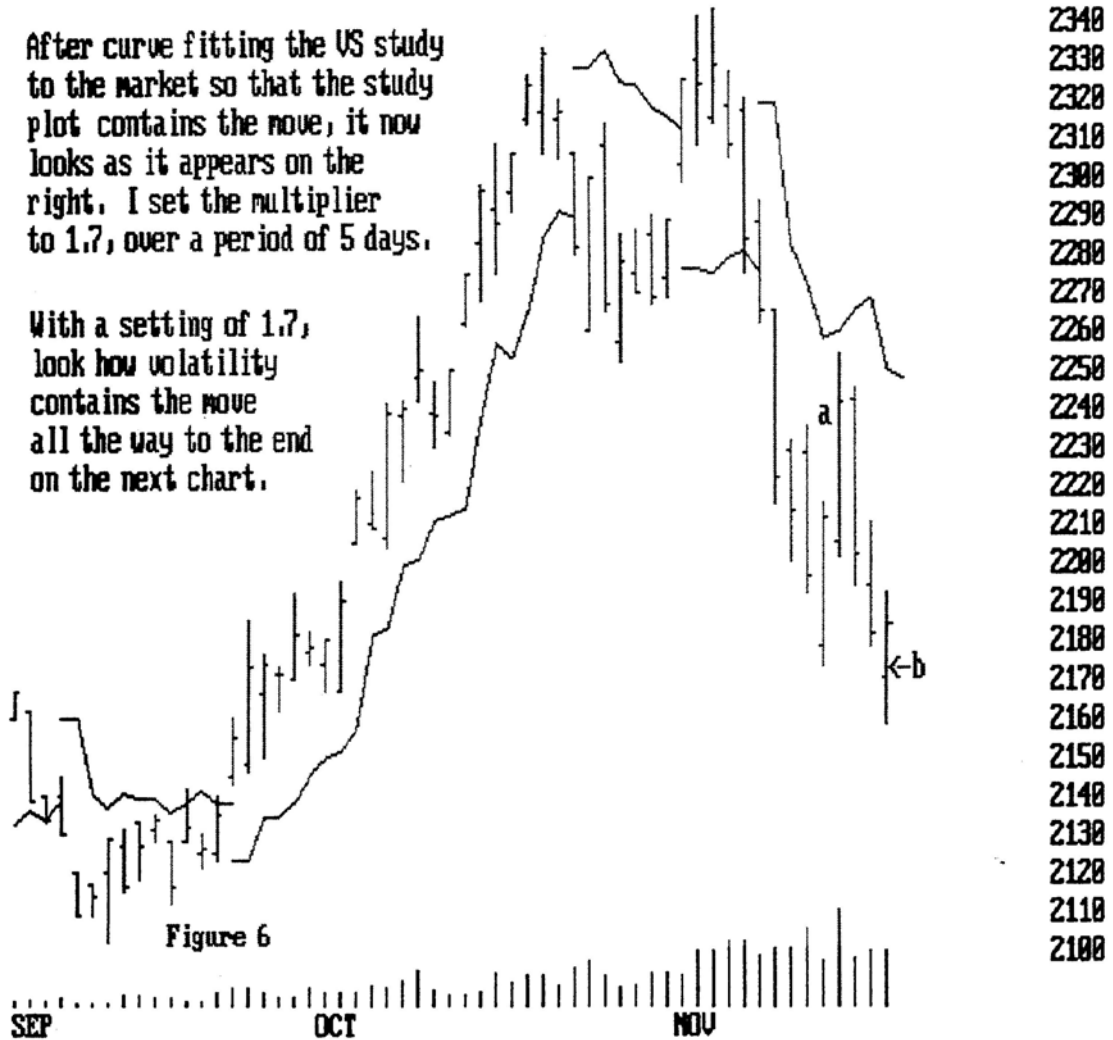
Is there anything wrong with curve fitting in this manner? I think not.

After all, we want to cooperate with the market. If the volatility is such that a 5,1 VS study is not able to contain price action, then set up a study that will contain it. The market is always right, the only one wrong is you! You must adjust to what the market is doing, not what you want to force it to do.

### CL G DAILY

After curve fitting the VS study to the market so that the study plot contains the move, it now looks as it appears on the right. I set the multiplier to 1.7, over a period of 5 days.

With a setting of 1.7, look how volatility contains the move all the way to the end on the next chart.



I like to see a little room between the high and the VS study.

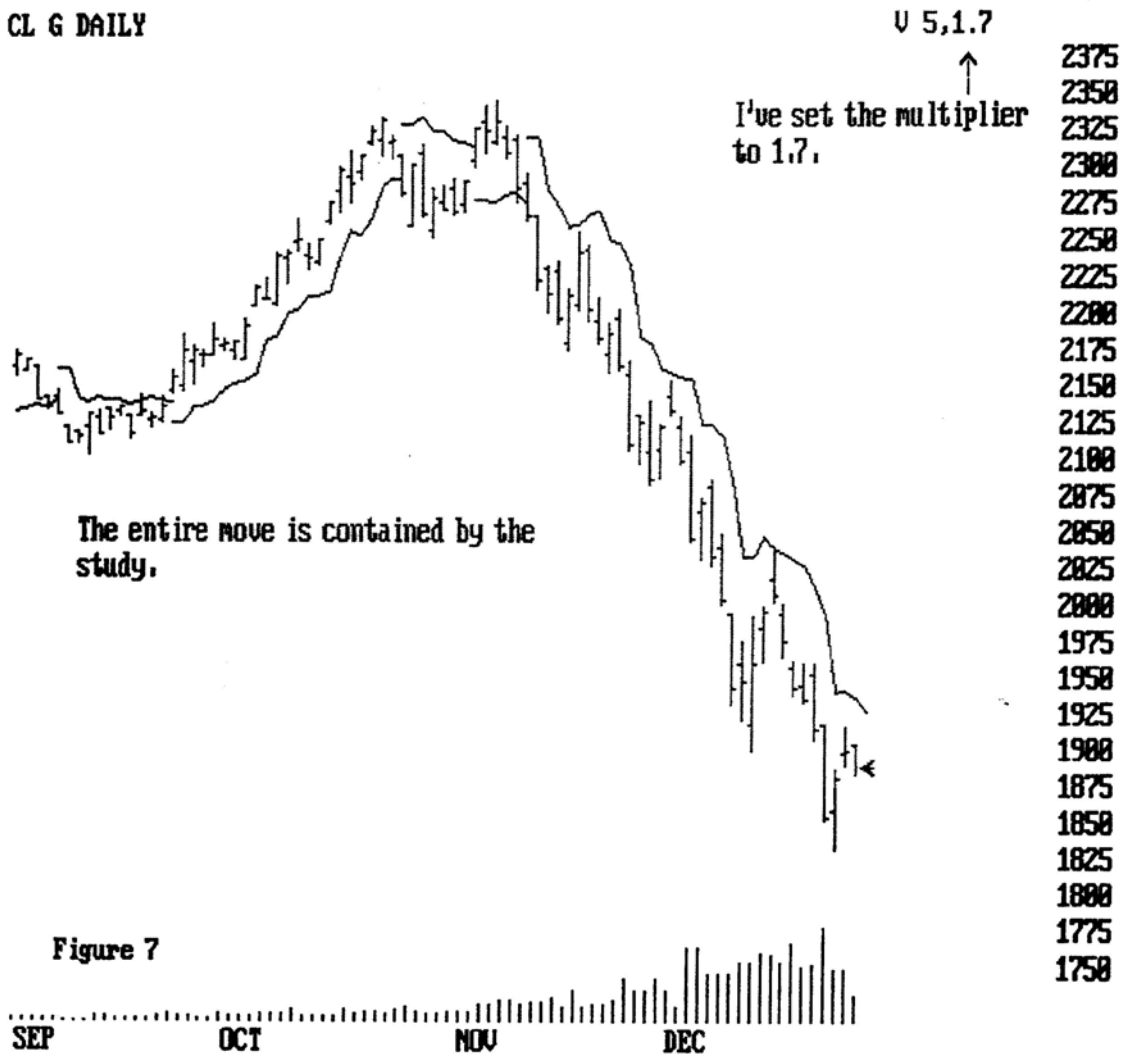
Remember, too, that if the stop is too far away, you don't have to trade. No one is twisting your arm to make you take the trade.

I prefer to fit the study to the market when I have made some profits and am ahead.

Then it's my decision whether or not I want to risk those profits.

A good rule of thumb is that if the VS study would cause you to lose more than you've made, then it might be better to chip away at the market until you do have enough to risk the amount dictated by the study.

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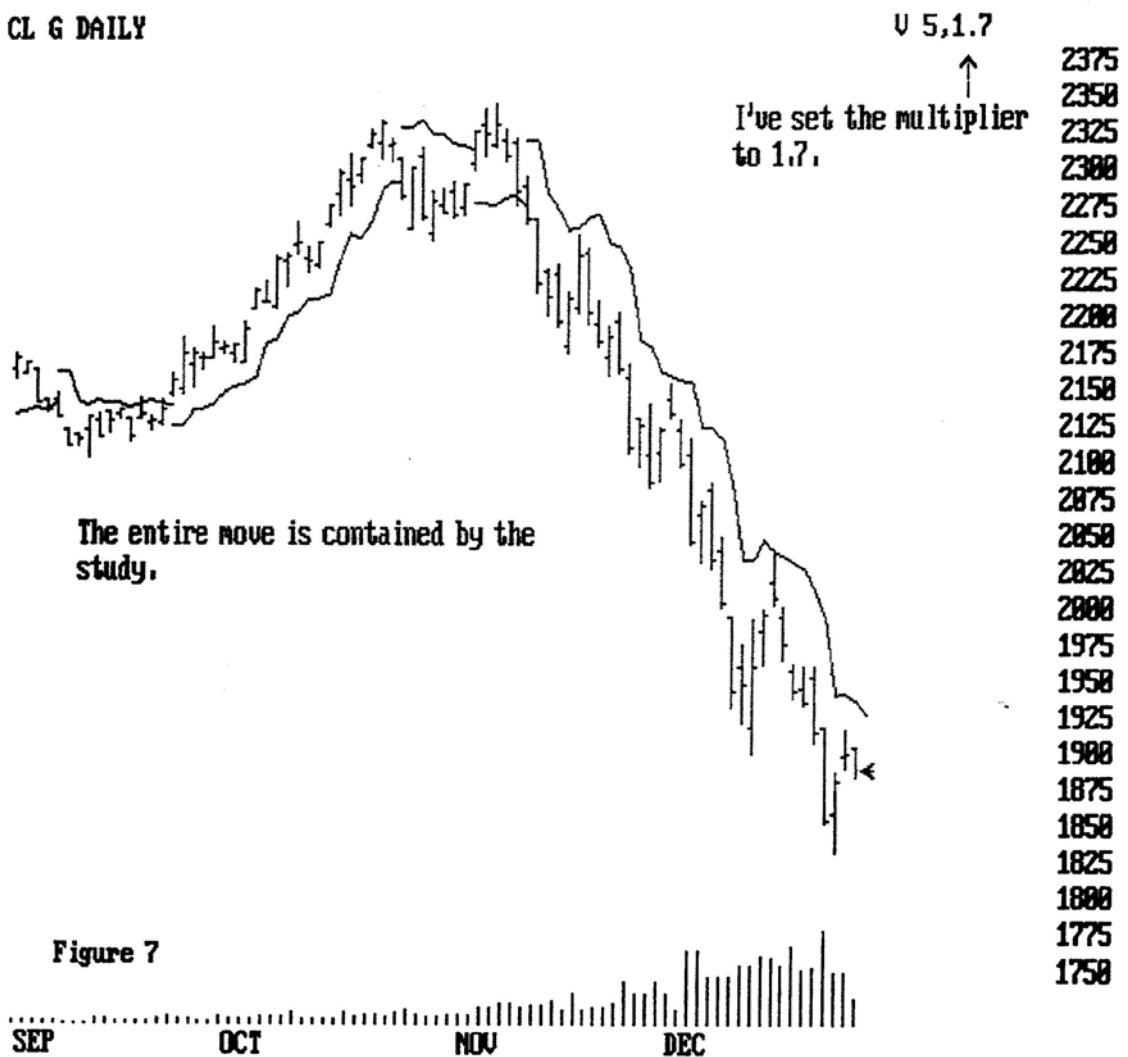


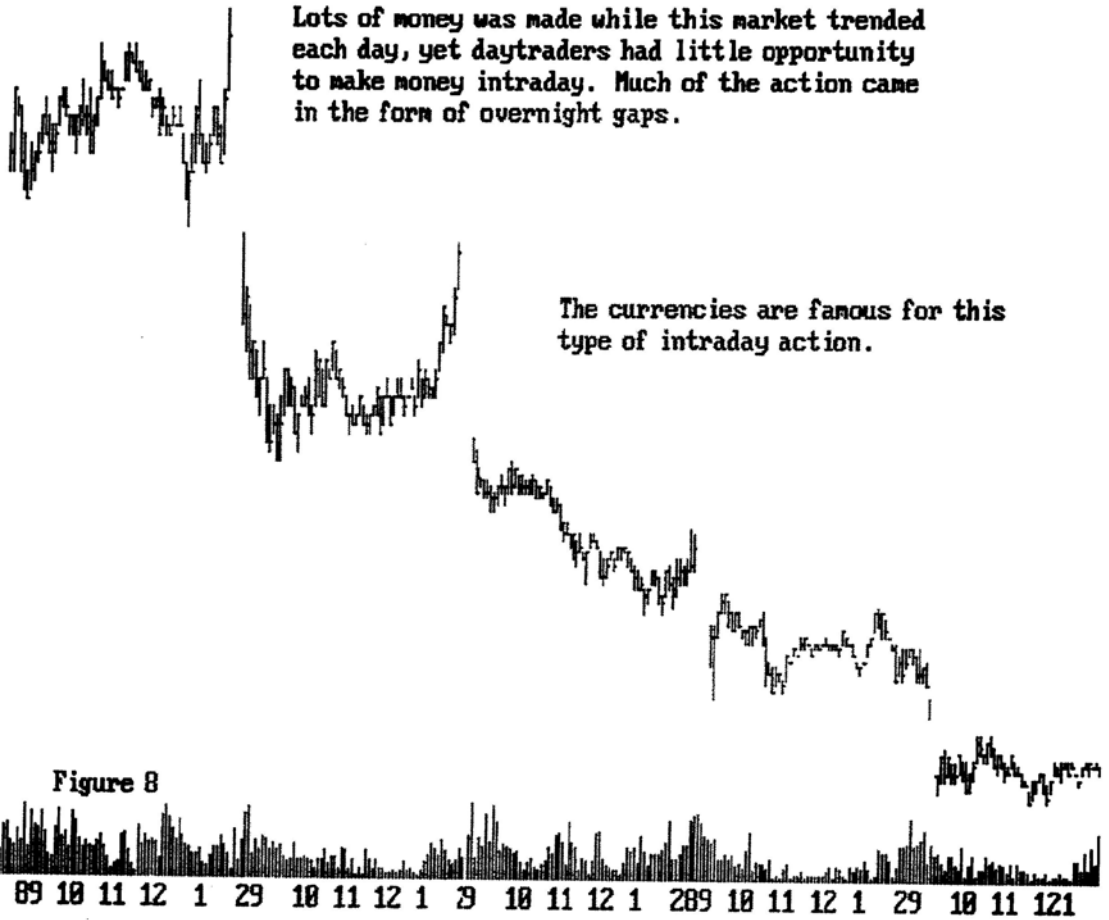
Figure 7



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I have repeatedly shown you a Crude Oil chart. While scads of money were being made by the daily position traders, there were plenty of days that looked like the chart below on an intraday basis.

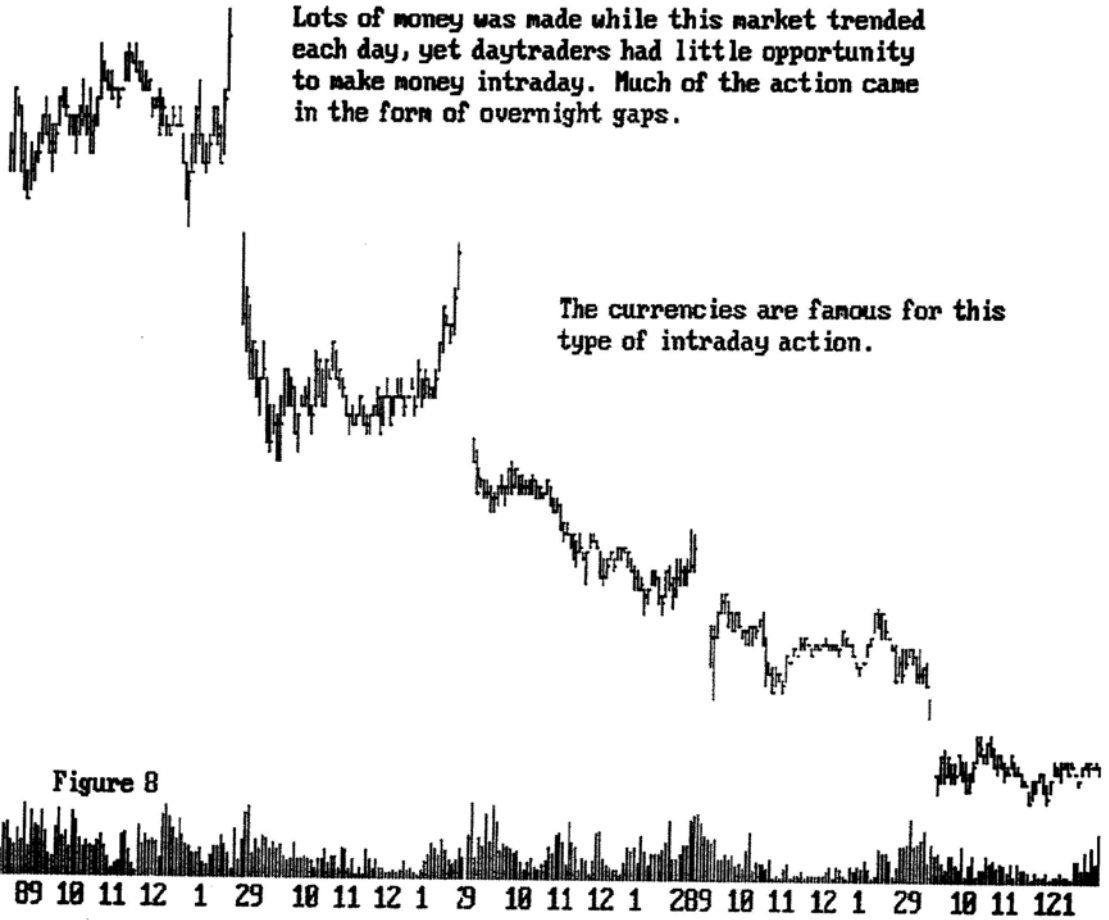
CL 6.5 MIN



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CL 6.5 MIN



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Here's a D-Mark intraday chart. It, too, shows that most of the movement came as a result of gaps. This happened during a strongly uptrending market on the daily chart.

DM H.5 MIN



The point I'm trying to make here is that a lot of traders end up stopping themselves out of a market when there is no need.

I believe in a balanced approach to trading. Every time you enter a trade, you are going into business. When you get stopped out, you are out of business. It's bad enough that we are put out of business more often than we care to be. Taking yourself out of a market that is making you money seems to me the height of foolishness.

This is the type of rigidity that has nothing to do with good trading. When you say to yourself "I'm a daytrader, therefore I must be out by the close," you are being rigid in a way that may be harmful to your success. If you don't get the big wins, how can you ever make up for the small losses?

Probably the oldest saying in the business is to let your winners run. If you stop yourself out of the market you are ignoring this most basic of principles.

Of course, there may be an overriding reason to be strictly a day trader. If you simply cannot stand the pressure of holding a trade overnight, then by all means you should restrict all trading so that you are out by the close. Comfort in trading is more important than money. If you have a problem with staying overnight, you will just have to leave that money there for me to pick up.

The only market I will purely daytrade is the S&P. I am not willing to put up so much money (\$22,000 as I write this) per contract for the privilege of staying overnight. Sufficient money can be made simply daytrading the S&P.

I'm not much for holding the Bonds overnight, but for a different reason — the Bonds simply don't trend sufficiently to warrant overnight positions most of the time.

### **Placing Objective Stops**

Good planning dictates that you should have some sort of objective for at least a part of your position. I use a three step approach to placing objective stops.

### **Cost Covering Stop**

#### **1. Cost covering objective stop.**

For me, it is important that I cover costs. This single, simple idea has been one of the most important concepts of my success in the markets.



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I never allow myself the luxury of counting profits until I have covered my costs. As long as I take care of that one detail, the profits seem to take care of themselves.

By covering costs, I mean taking care only of the immediate costs of the trade — commissions and fees.

I do this in conjunction with market volatility. Volatility must be equal to at least twice my immediate costs or I will not trade.

That means unless I have a chance to cover costs with no more than half my position, I will not trade. An exception to this rule would be if I were trading three contracts. Then I would want to be able to cover with one or two contracts.

Let's assume I want to get long a day trade in the S&P using a five minute chart, and that my costs are \$25 per contract, and that I am going to do a three lot.

I would need \$75 to cover costs. Since a single tick in the S&P is worth \$25, I would need six ticks of average volatility in order to meet my rule of the volatility being twice my immediate costs.

Why twice my costs rather than some other multiple? Or why any multiple at all.

The reason for a multiple of two, is the propensity for prices to overlap.

Take a look at what follows:



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If I were looking for a breakout of point A, it's clear that a part of the momentum of the price action will be used up just in getting to the breakout point.

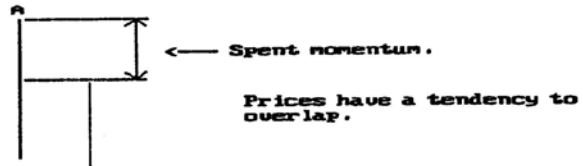


Figure 11

By using twice the volatility, as the least amount of volatility with which I'm willing to enter a trade, I increase my chances of reaching my objective of covering my costs.

These stops where possible are placed as "market if touched" orders.

### Small Profit Stop

#### 2. Small profit objective stop.

Once I have covered costs, I try to take some sort of profit. Depending upon observable market action, I may take that profit at the same price at which I cover costs. Whenever possible, I attempt to take the profit at a better price than costs, but that is not always possible. How do I tell?

If a market has been moving strongly prior to my entry into a trade, especially if it has been trending well in a time frame that is longer than the one in which I'm trading, I will have resting MIT orders for only that number of contracts that enable me to cover costs. My first profit stop will be set at an amount which is dictated by average market volatility. For example, if I need seven ticks to cover my costs, and average market volatility is thirteen ticks, then I will have a resting, cost covering MIT, at seven ticks and a resting, **small profit MIT**, six ticks beyond my cost covering MIT stop.



The point of all this is to avoid a situation where I have no profit to show for my having taken the risk of market entry.

### **Full Profit Stop**

**3. Full profit objective stop.** My third objective is to capture as much of the move as the market will allow. This is done with a trailing stop. In other words, my objective is to be stopped out. There are two considerations here.

A. Until I am satisfied in my own mind that the market is now trending, or is going to trend strongly, I will trail a 50% stop. When I am convinced I am in a strong trend, then I can do a number of things which I will describe just ahead under trailing stops.

B. When I am satisfied that I've made a nice profit, and feel there is no way I can be terribly hurt, I will lift my 50% trailing stop in favor of giving the market all the room I am comfortable in allowing.

### **Trailing Stops**

As stated previously, I trail a 50% stop until I feel as though I can take a chance on allowing the market a lot of room.

There are at least three ways I can do this, and use them as the mood suits me. A fourth way exists, but I reveal this only at my private seminars. However, these three ways are all excellent and I still use them according to my perception of the market action.

1. **Natural Support and Resistance.** I've already mentioned this but in a different context. Natural support and resistance points are superb stop placement points in steeply trending markets. The use of them is a judgment call — you have to look at the market anatomy and see if they have been working in this market, both in past trends and in the current trend. If they have been working well, use them. This is the simplest, least complicated way of trailing a stop. It requires that you know the market in which you are trading. You come to "know" it by studying its history.

2. Curve fitting a moving average to a trend. This is done in the same manner as I showed for curve fitting the Volatility Stop Study. Study the charts that follow, there are some important lessons to be learned.

Whenever you have a chart that contains a market aberration caused by some unusual event, political, climatic, etc., remove those bars from your chart so they don't skew your perception of the market or ruin the results of your studies.

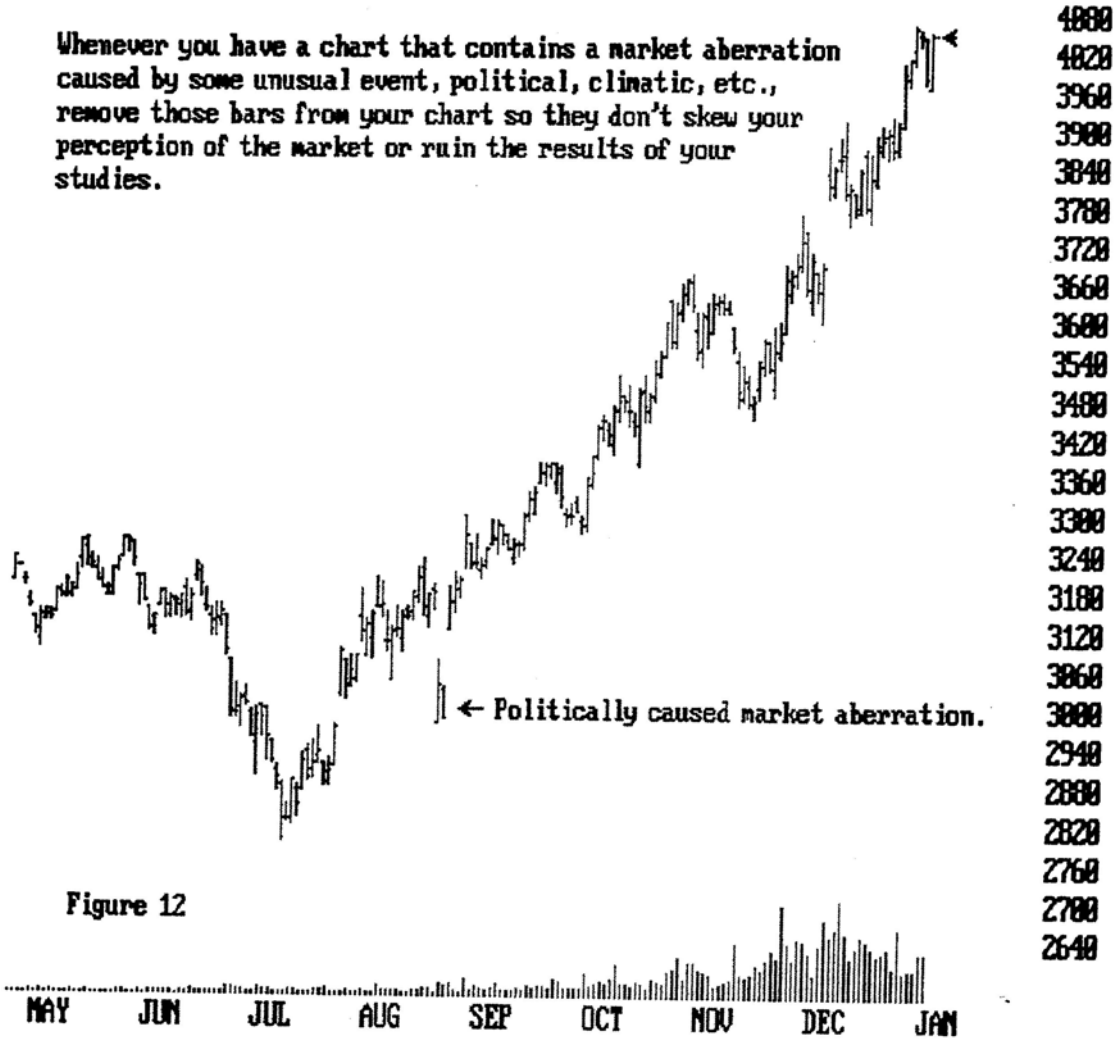


Figure 12

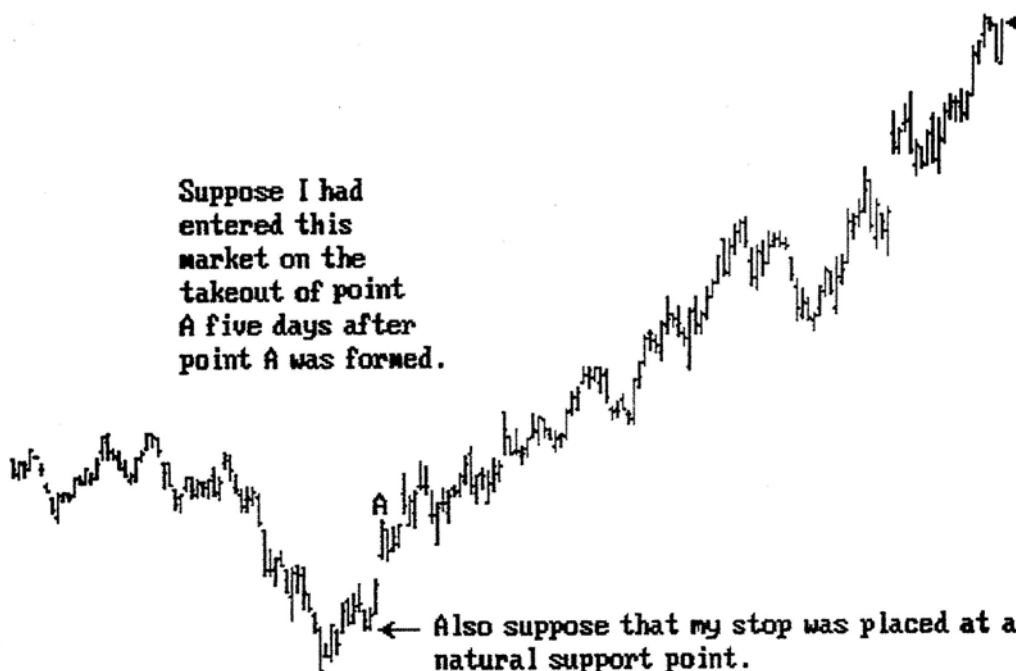
Simply remove the offending bars from your chart. They do not reflect the true, overall action in the market, but they will give false readings to any technical studies you may have on your chart.

In the charts that follow, you will see I have done what I said.



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4275  
 4200  
 4125  
 4050  
 3975  
 3900  
 3825  
 3750  
 3675  
 3600  
 3525  
 3450  
 3375  
 3300  
 3225  
 3150  
 3075  
 3000  
 2925  
 2850  
 2775  
 2700  
 2625  
 2550  
 2475



Suppose I had entered this market on the takeout of point A five days after point A was formed.

← Also suppose that my stop was placed at a natural support point.

Suppose, too, that as the market trended I was stopped out from time to time with small wins, by trailing a 50% stop.

Figure 13



In the above fictitious situation, the market is trending steadily but not steeply. Although I might have used an initial stop set at a natural support point, the market action, and the shallow angle of the trend, would dictate that a 50% trailing stop be used.

In other words, this market is not exactly running away. It is plodding along.



After awhile, I may have built up substantial profits. Then the market made a rather strong correction and began to move up once again, with the angle of ascent becoming somewhat steeper. If I were in this market, and if I were willing to risk some of the profits I've already made, I could curve fit a moving average to the major correction low and set a trailing stop just beyond the price level of the moving average.



Figure 14

Although I used a 54 bar moving average of the close, there are a number of other MAC's that would have given similar results. In addition, I could have used a moving average of the lows, since this is an uptrend. In a downtrend I could have used a moving average of the highs.

There's no magic in these moving averages. I use them only to show containment of a trend.



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Perhaps, you could have used a volatility stop with a large multiplier to show this containment. Offset Moving Averages could have been used. You might even have drawn an old fashioned trend line!

## **Other Considerations**

### **Profit Objectives Using Points**

If I am able to cover costs with one-third of my position, I will often take profits based on making a certain number of points. For instance, if I have made five points to cover costs on an intraday trade, I may take some profits by liquidating a part of my position when I see another five points. This, too, may be placed as an MIT order.

There are certain trades that are designed as short term scalps. I will very often have a profit objective based upon points for these trades.

Some markets lend themselves to the concept of setting point objectives. In the S&P, you can get fifty points on most breakout trades, involving intraday hooks on a five minute chart. AT fifty points in the S&P, I will take some profits, and then pull my protective stop to breakeven. If the market continues to move, I will make even more, but I almost always am able to take the fifty points.

Point objectives may be adjusted upward for time frames greater than five minutes, but keep in mind the volatility of the market and time frame you are dealing with. You wouldn't expect an objective of fifty points on a daily Bean oil chart. It may take Bean Oil two or more days to move that far.

### **Using Fibonacci Expansion Objectives**

The use of this type of objective has been pretty much hammered to death in recent years. It has been written up repeatedly. How to use these are described in Part I of my book entitled **Trading by the Book**.



I use Fibonacci objectives to project the expansion from a trading range. They can also be used in trending markets. Objective stops can be set at these objective points because they tend to be self-fulfilling when enough people use them in a market.

That in itself is a reason to know where they are. When enough people are using them, you will know where to expect reactions in certain markets.

For instance, Fibonacci traders abound in the U.S. Treasury Bond and S&P 500 markets. This is especially true intraday. You can pretty much tell where these traders will be looking for profits. If you see a market moving to Fibonacci expansion ratios, you can use these ratios to your own advantage. You will be able to forecast market moves with fairly good accuracy. Not only can you take profits there, but you can make good counter-trend, short-term scalps at those expansion levels.

Here's how to do it.

When you see a market making a leg up, a correction, and then a resumption of the trend by taking out the Rh, you can expect profit taking at one of three places.

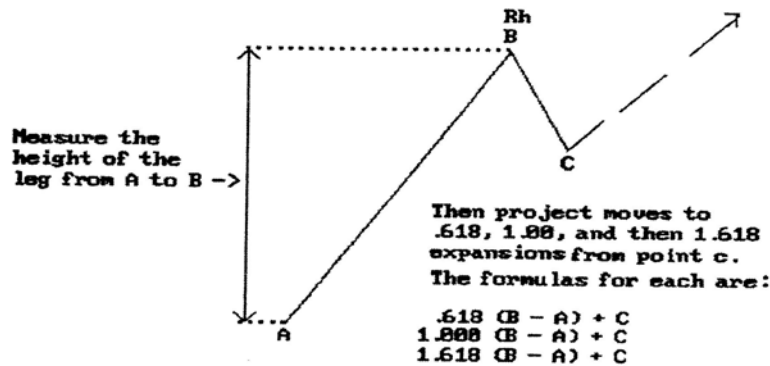


Figure 15

I do not use money objectives. I have trained myself to think of my trades in terms of points. When I do that, the money takes care of itself. I firmly believe that you do not count your money until the trade is over.



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I do not use percentage objectives. I think it's rather foolish to attempt to dictate to a market that it must move a certain percentage. However, if Fibonacci ratios can be deemed to be percentages, I will take advantage of those ratios by scalping into them in markets where I have determined that many other traders are using them.

### **Placing a Profit Protecting Stop**

Taking profits from a market while they are there to be had is a very important part of my money management when trading the Ross hook.

Any of the trailing stop methods can be used. The idea is to make sure you get out with a profit. By using a profit protecting stop, you will not fall into the trap of seeing the profit in a trade disappear and turn into a loss. By trailing a 50% stop in the early stages of a trade, you will make a decent profit on most of your trades.

There is a time to lift the 50% trailing stop. One is when you decide to let the market run, and place a stop far back using one of the trailing stop methods I've described. The other is when you decide to get out before your 50% stop is hit because of the price action you are seeing in the market.

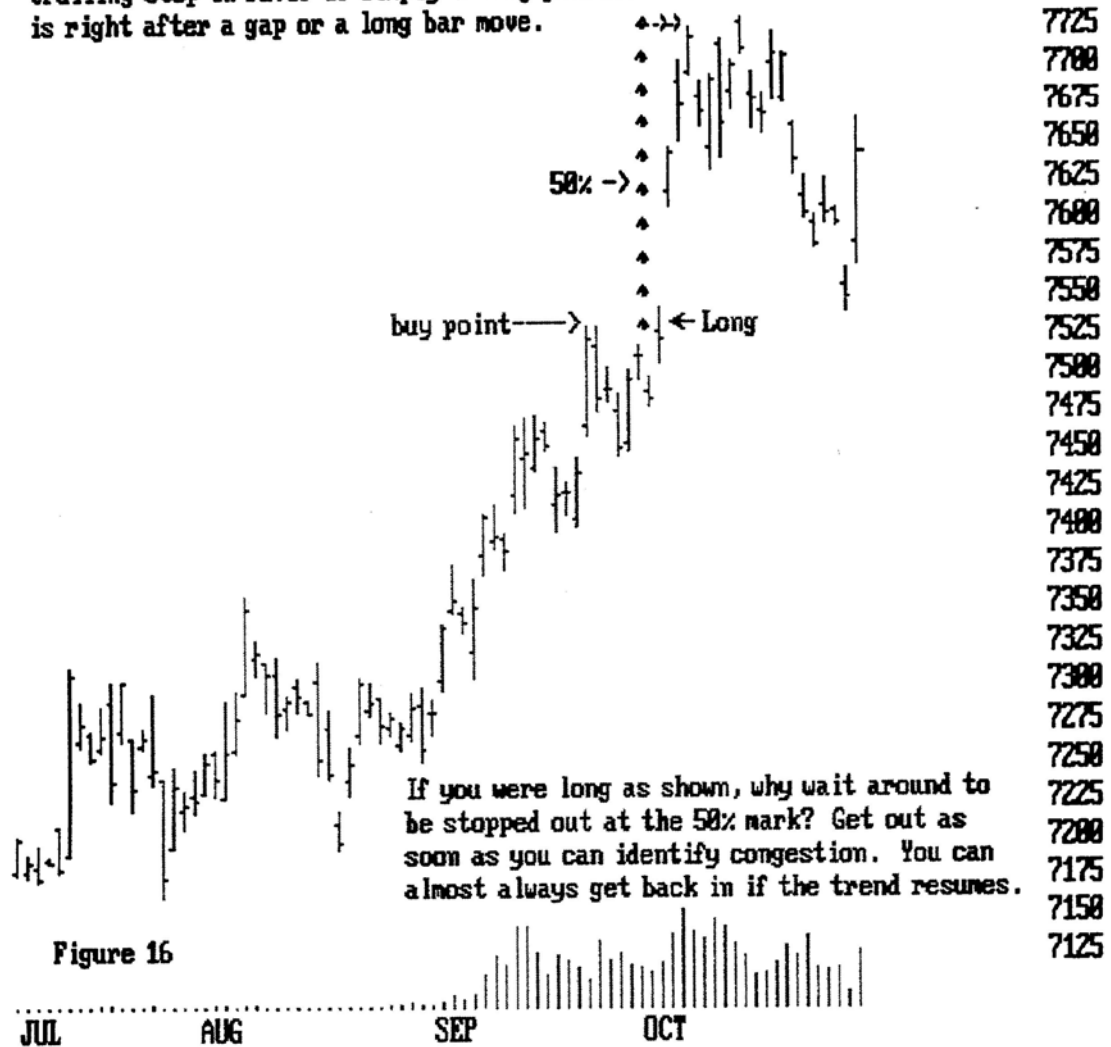
This decision is normally made at a short to intermediate term phase of the trade.



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A good place to consider abandoning the 50% trailing stop in favor of simply taking profits is right after a gap or a long bar move.



In other words, in the early or intermediate stages of a trade be aware of the market going into congestion. At the end of the congestion, or even at some point during the congestion, prices may move to your 50% stop, and you will have given up more than necessary.

Don't feel "honor bound", or in any way compelled to stay with a trailing stop if it doesn't seem to be making sense. Take profits!



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Here we see a reaction to a long bar move. Wisdom dictates getting out as soon as the congestion is detectable, if that happens before the 50% stop is hit.



Figure 17

Another important realization to consider when setting a 50% trailing stop is the concept that markets retrace to the  $\pm 50\%$  level fairly often. This is often a self-fulfilling prophecy because so many people believe in it. Be very aware of where the move started. The retracement will often be from the **inception** of the move to the point where the correction starts, not from where you **entered the market** to the point where the correction starts.

If your 50% trailing stop is in the pathway of a of a 50% correction, it is virtually sure to be hit. Therefore, try to wait until the market has made a correction from the current leg, before you begin to trail a 50% stop.



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