

Wiley Trading Advantage

THE
**UNIVERSAL
TACTICS**
OF
**SUCCESSFUL
TREND TRADING**

**FINDING OPPORTUNITY
IN UNCERTAINTY**

COMPANION TO THE UNIVERSAL PRINCIPLES OF SUCCESSFUL TRADING

BRENT PENFOLD

WILEY

The Universal Tactics of Successful Trend Trading

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**Finding Opportunity
in Uncertainty**

By

BRENT PENFOLD

WILEY

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*To my beautiful family,
Katia, Beau and Boston,
the three best trades I've ever made.*

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If that is you, then a big, big thank you.

If it's not you, then a big thank you anyway for picking up this book!

This book has come about only because of the success of *UPST*.

Since its publication in 2010 *UPST* has become an international best seller having been translated into Polish, German, Korean, Japanese and simplified and orthodox Chinese.

If it wasn't for its success this companion book would never have been written.

So, a big thank you to all the traders out there who helped *UPST* become the success it is today.

PREFACE

BUCKLE UP

This book is about practical trend trading.

But wait. Before you decide to attempt trend trading, or continue trend trading, you will first need to do a little ‘speed’ review and ‘speed’ self-analysis to determine whether you’re suitable for it. It would really be pointless continuing with this book if deep down you weren’t suited to trading with the trend. Hence this little ‘heads up’ before you start.

Now, if after your speed review you decide trend trading is not for you then no worries. Well done on being truthful to yourself, your risk capital and your family.

If you do decide you’re up for it, and if you persist, then well done—you will be rewarded. However, the key word is ‘persist’. Although simple, trading is not easy, particularly trend trading. You will need to learn to endure its unpleasanties. It won’t be a smooth ride without its bumps. But if you persist and are sensible, you will be rewarded. So why not buckle up and let me give you a little speed introduction to the world of professional trend trading.

THE FIRST AND MOST IMPORTANT FACT ABOUT TREND TRADING

Let me start with the unpleasanties. Trend trading is undeniably miserable. Yep, I said it. Miserable. Miserable with a capital ‘M’.

It’s a miserable existence where you can expect to suffer 67% losses on all your trades. You’ll be spending more time losing than

winning. A lot more time losing. If you're still with me then you'll need to be aware of the following:

- You won't be trading to make immediate profit. No.
- You won't be trading to prove your market analysis correct. No.
- You won't be trading for the action, or thrill of being in the market. Don't be stupid.
- You'll only be trading in what you believe is the general direction of the market's trend, which quite often will be wrong. Get used to it.
- You'll only be trading for the opportunity to earn expectancy, not profit. That's right.
- Expectancy comes from both your winning and losing trades. Yes, it does.
- Expectancy can only accrue over a long period of time covering many losses and a few wins. Did I say it was miserable?

Know and accept this and you'll be prepared.

I'm not saying this to be a kill joy. I'm saying it to be realistic and to tell you how it is. I don't want you to develop a satisfactory trend-trading methodology only to see you throw it away following a dreadful losing streak of 10, 20 or 30 losing trades. It will happen. Don't think it won't. The market's Mr Maximum Adversity will ensure it does.

Remember, life as a trend trader is miserable. You'll always be losing. It's repetitive and boring. You'll be placing the same orders and entering the same trades over the same portfolio of markets time and again. It's a constant wash cycle of rinse and repeat. It's repetitive, it's boring and it's painful. You'll constantly suffer drawdowns. Some quite deeply. It's more mind numbing than mind stimulating.

However, despite its challenges, it is also profitable, and at times, very profitable.

But only if you stick with it during the turbulent times. Survive the turbulent times and you'll be around to enjoy the good times.

You will need to employ appropriate money management. You'll need to trade small relative to your risk capital. You will need to ensure your risk-of-ruin (ROR) is at 0%. You will need to ensure you're a good loser, both in never moving your stops and never letting the losses get you angry. You will need to suffer the bad times. You will need to learn to endure the darkness that will inhibit your world from time to time. Do all that and you will come out the other end with a surprising result.

I hope that if you embark on this trend-trading journey that you will remember these few words.

I hope you will remember them when you're in a deep dark place that all trend traders inhabit. When it appears to be the darkest, I hope you will remember that successful trend trading is all about survival, avoiding risk of ruin, being a good loser and following a good trade plan. I hope you'll remember you're only trading for the opportunity to earn expectancy, not immediate profit. That expectancy can only accrue over a long period of time executing many, many trades. It may take a whole year. It may take a couple of years. This is because you don't know which market or markets will decide to trend or when they'll decide to trend. But if you can learn to ride and stay on the bumpy equity curve you will be rewarded when a new equity high is reached.

Are you still up for trend trading?

No? No worries and well done on being decisive, and honest.

Yes? Well done and welcome to my painful world of trend trading. I hope you enjoy the ideas I'm going to share with you.

HOW TO MAKE MONEY TRADING

Now that I've got you quickly briefed and soberly onboard (and remember to keep that buckle tight), let's cut to the chase. You're reading this book for one reason only, and it's the same reason why I'm writing this book. You want to know how to make money trend trading.

Well I'm going to show you how.

But you'll need to stick with me as I progress through the book. When you finish, you'll need to independently verify and validate everything I say. It's no good me telling you what works and what doesn't. It's up to you to tell yourself by doing the work. Defy human nature and put the effort in. Do that, execute correctly and you'll be rewarded.

Good luck.

Brent Penfold
Sydney, Australia

INTRODUCTION

This book has a dual objective.

A REALIST BOOK

Firstly, I hope it will become a popular book based on its own merits. I hope in time it will become seen as a realistic and honest voice on trend trading. And just like trend trading, one that will stand the test of time.

A COMPANION BOOK

Secondly, I also hope this book will be seen as a necessary and deserving companion to my previous book, *UPST*. A natural extension and compliment to the universal principles of successful trading that I extensively wrote about in *UPST*.

THE MISSING CHAPTER

With *UPST* I took a holistic approach to discussing the process of trading that follows a number of immutable core principles. Principles that are applicable to all traders regardless of the market, instrument and timeframe, technique or analysis they follow. Following a good process of trading is primary to the secondary issues of markets, instruments, timeframes, techniques and analysis.

Being a holistic-type book I spent little time on the most interesting part of trading—the analysis and development of trading strategies. I spent little to no time on dissecting market structure, identifying appropriate setups and applying sensible trading plans.

As a side-bar it still amazes me that *UPST*, a trading book that basically doesn't discuss in detail market structure, analysis, setup criterion, entry, stop and exit techniques was so popular. In a nut shell, it doesn't dwell on the interesting side of trading—the analysis, investigation, development, reviewing and finalization of trading strategies. No. The book concentrates on the dry aspects of trading, the universal principles of successful trading. Material that I personally cherish above all else, but material nevertheless I know not to be particularly exciting. From a material perspective, this book will be far more interesting, not more important, but far more interesting compared to *UPST*.

Now back to point.

UPST is a more holistic, theoretical type book. This book will be a more practical, how-to guidebook on trend trading. It will be a natural extension and complement to *UPST*, where I will attempt to take the principles I shared regarding methodology and apply them in a practical manner to investigate, review and develop a robust trend-trading methodology.

Although I wrote extensively about 'methodology' in *UPST*, I did not provide a practical turn-key strategy example to demonstrate my ideas. This book will provide the practical turn-key strategy example to do just that, to demonstrate what I was saying. To give you an example of what I discussed in *UPST*.

I suppose you could view this book as the missing 'practical' chapter of *UPST* that will provide an example of an objective and independent trading methodology.

MY OBJECTIVE

As I've mentioned, my objective is to make this book:

1. An important, honest, informative, practical and helpful book for the serious trend trader, which can stand on its own merit and be robust enough to last the test of time.
2. An important and complementary companion book to *UPST*, its missing chapter so to speak.

Accordingly, it will have a singular, narrow focus on the ‘methodology’ side of trading. It will not touch upon the other universal principles of successful trading—those are comprehensively covered in *UPST*.

Wish me luck.

NOT ENOUGH TO BE SUCCESSFUL

Please understand that this book is not a silver bullet. By itself it will not be enough to make you a successful long-term sustainable trader. Although I believe this is a good book, it will not be enough on its own to help you learn how to become a successful and sustainable trader. A trader who can survive despite the inevitable losses, inevitable drawdowns, inevitable doubt and inevitable pain that all traders are intimate with. No, this book will not be enough. However, in combination with my previous book *UPST*, I believe it has the potential to transform a losing trader into a long-term sustainable winning one. If you haven’t already done so please read *UPST*.

This book only covers one component of the universal principles of successful trading, ‘methodology’, you’ll need all the others to hope to achieve sustainable trading success.

THERE WILL BE DUPLICATION

Let me apologize now as there will be some duplication with *UPST*.

Although this book has a narrow focus, there will be times where I’ll need to touch upon other areas that are detailed in *UPST*. So, there will be some duplication. My apologies now for the duplication you will come across here and there. However, please understand that the duplication is necessary to help explain, emphasise and resonate a point I’m trying to make. It will not be duplication for the sake of ‘padding’. In actual fact I want this traders’ ‘hand book’ to be relatively small, as it’s designed to complement *UPST*.

READERS OF DIFFERENT EXPERIENCE

I hope this book will have something for everyone.

For those readers relatively new to trading there is some good news and some bad news. The bad news is that I will be covering a lot


The Universal Principles of Successful Trading					
1. Preparation	2. Enlightenment	3. Developing a Trading Style	4. Selecting Markets	5. The Three Pillars	6. Trading
Maximum Adversity Emotional Control Living Daily Money Management Hedge Money Personal Boundaries Risk Cover Risk Risk Management Trading Partner	Avoid Risk of Ruin Build Core Skills Money Management Hedge (1:1 & 1:2) Single-Op Support/Resistance Trade where liquidity is Validation - 1:1, 2:1	Style - Trend Trading - Swing Trading - Day Trading - Arbitrage - Short term - Medium term - Long term	Characteristics Single markets Multiple markets	Discipline, Trade Ethics 1. Money Management 2. Methodology 3. Psychology 1. Money Management - Fixed Risk - Fixed Capital - Fixed Op - Fixed Size - Fixed Units - Volume Fixed Risk - Fixed Percentage - Fixed Volatility 2. Methodology Approach - Discovery - Mechanical Method - Top-Down - Trade Plan - Validation Set-up Analysis - which market theory? Trading? Fractal? Risk - volatility - Cycle - Day Trade - Elliott Wave - Fibonacci - Fractal - Geometry - Indicators - Market Profile - Patterns - Seasonality - Central - WD Gain Trade Plan Order - Size - Fill Validation - 1:1, 2:1 1:1 & 2:1 Entry (Entered Simulated Trades) 3. Psychology Managing Stress, Greed, Fear and Pain.	Pulling It All Together Market Performance Position Size Enforcement Equity Withdrawal
 <p>Yep, just like School it's a lot of hard work!</p>				<p>This book only covers one component of the universal principles of successful trading.</p>	

FIGURE 1.1 This book alone is not enough to make you successful; you will also need to know the universal principles of successful trading, which I extensively wrote about in *UPST*.

of information. And I say a lot. So, you'll need to concentrate. That's the bad news. The good news is that it's all good information!

For the more experienced reader, I hope the ideas I share here will resonate with you and either reinforce what you already know to be true or encourage you to revisit and reinvestigate and then reconsider the ideas I share here.

EVIDENCE, NOT OPINION OR MYTH

It's my preference here to deal only with evidence. Not opinions. Not myths. Much of what is written, spoken or animated about trading is based on the author's, presenter's or editor's opinion with a few well-chosen chart examples thrown in. Unfortunately, these opinions wilt under scrutiny.

In this book it's my preference to discuss only those ideas that can be distilled down into clear and unambiguous objective rules. Rules that can be hard coded in appropriate software to determine their historical significance. It's my preference to demonstrate the historical profitability (or loss) of all ideas I share that I believe are worth discussing.

Too often the most enthusiastic talking heads, engaging writers or charismatic presenters capture traders' attentions. Many confuse the 'confidence' displayed as valuable and actionable knowledge. However, it's usually impossible to make money from these sweeping opinionated views. Unfortunately, it's the lack of granularity that allows these repeaters and amplifiers to continue to express their views. Lack of detail avoids accountability, which is good for them. Sadly, the lack of detail is usually ignored by less experienced traders, who generally pay for their ignorance in trading losses. They usually decide to buy the 'hot' share the next day without any consideration for where to place a 'stop' or what expectancy they're trading for?

In this book I will attempt to code my ideas, whether good or bad, to illustrate their historical profitability (or loss). And while I'm here, I should also add an important warning that historical performance of any idea is no guarantee that the same performance will continue into the future.

NOTHING NEW AND SHINY

If you've picked up my book looking for a new trading idea then I'm sorry to disappoint you, because I don't have one. What I'm going to share with you is not new. What I'm going to share with you can be referenced in other books. I have nothing new to show you. I'm simply standing on the shoulders of others who have gone before me. However, what I will say is that I'll be standing on the strong shoulders, not the weak ones.

So unfortunately, if you are looking for a new trading idea, then this book might not be for you.

However, if you're looking for good ideas, then I may be able to help you. I will be sharing a number of them. But remember they won't be new. Some, one in particular, is old and simple. Actually, it's very old and very simple. An idea that is so old and obvious that most traders discount its usefulness. To most 'old' and 'simple' means 'unfashionable' and 'not profitable' and therefore 'not' useful.

But let me tell you, 'old' and 'simple' is the new 'good' and 'robust'. By the end of this book (if you're still with me) I hope to convince you that 'old' and 'simple' will become the new 'fashionable' and the new 'useful' and the new 'essential' in trading.

I wish I could entice you with a new idea. A shiny and mysterious new idea that would lift your hopes for a better and more profitable future that would activate your feel-good neurotransmitters. But I can't. There would be nothing better for this book's success than a new idea wrapped in mystery. But unfortunately, I don't have one.

I like old and I like simple trading ideas.

SIMPLE IS BEST

I like 'simple' ideas for the obvious reason that they are 'simple'. Now, there are many reasons why traders lose. But one reason they lose is that the majority of traders mistrust the obvious, they mistrust simple trading solutions. They can't believe trading can be simple, so they seek clues and advantages in the new and the complex.

Believe me when I say simplicity works. Simple means you have avoided the trap of excessive curve fitting. You have avoided the miss-step many make of either intentionally or unintentionally curve fitting their strategy to historical data. Simple means fewer moving

parts, which means less can go wrong moving forward. To me, simple does not mean less but ‘more’ in trading. And by ‘more’ I mean more ‘robustness’—the single most important attribute of any trading strategy. Robustness to last the test of time. Robustness to not only make money today, but tomorrow and into the future. So, what I will be sharing is simple. Therefore, please do not mistrust what you’re about to learn but embrace it for one of its greatest strengths—simplicity.

So, if you’re not necessarily looking for a new idea, but seeking help to be introduced to or reminded about what works, then this book may quietly surprise you.

NOT PERFECT

In addition, the ideas I will be sharing with you are not perfect. They do lose. They do experience drawdowns. They will hurt you. They will leave you uncertain, disappointed, frustrated and, at times, furious. But they have an edge, a positive expectancy. Good traders can make money from an edge.

KEEPING IT REAL

I’m writing this book for the serious trader. Not for the rainbow chasers. This book is about how to chip away to get ahead. It’s not about revealing trading secrets. It’s not about selling false hopes and it’s not about publishing nonsense. It’s not about showing you how to ‘hit’ a mythical ‘home run’ in trading. No. It’s about keeping it real for the serious trader. Yes, what I will share with you is not shiny and new. Yes, what I share with you will at times leave you battered and bruised. But that is part and parcel of trading. It’s not all sunshine and high fives. Trading successfully for long periods of time will have its dark and uncertain times. I can promise you that what I will be sharing with you between these pages will leave you shaken and doubtful at times, but at least what I will be sharing is real and has an edge.

SUCCESS WILL COME

If you understand, respect and embrace the importance of money management and its significance in being one of the chief weapons

against ROR, then what I will share with you in this book will help you navigate the volatile world of global markets. But first you will need to understand, respect, embrace and execute the universal principles of successful trading that I have extensively written about in *UPST*. If you can, and if you can combine them with what I'll be sharing with you in the following chapters, then you may pleasantly surprise yourself with where you arrive. At a destination that I hope will be safe, and one that will be called sustainable trading.

MY BACKGROUND

I've been involved with the markets for over 35 years, since I joined Bank America as a trainee dealer in 1983. Since my first trade I've probably tried just about every technique there is to trading. If there was a book, a seminar, a workshop or a software program that could help my trading, I either bought it, attended it or installed it. During the 1990s in my quest to find an edge, I felt like I was walking through a revolving seminar door. I attended many well-regarded seminars. I attended the Turtles seminar with Russell Sands, learnt PPS with Curtis Arnold, studied geometry with Bryce Gilmore and attended Larry William's Million Dollar Challenge (MDC) seminar. I picked up useful bits here and there and it was Larry William's MDC seminar that reinforced my work with short-term mechanical price patterns.

As a trader I trade a portfolio of uncorrelated systematic (or algorithmic) trend and counter-trend strategies across multiple time frames (short term, medium term and long term) over a portfolio of global index, currency and commodity futures. My portfolio contains over 30 markets. For index futures I trade the SPI, Nikkei, Taiwan, Hang Seng, Dax, Stoxx50, FTSE, E-Mini Nasdaq and E-Mini S&P 500 index futures contracts. For currency futures I trade the main currency pairs against the US dollar, which include the Euro Currency, British Pound, Japanese Yen and Swiss Franc. For commodity futures I trade the three most liquid futures contracts in the US within the interest rates, energies, grains, meats, metals and softs market segments.

I trade my portfolio on an almost 24/7 basis, where a day doesn't go by without one of my many futures orders being triggered somewhere around the world.

I'm principally a pattern trader. Apart from using the average true range and a 200-day moving average, I focus purely on price. And

please do not read too much into my use of a 200-day moving average. There is nothing magical about me using 200-days. It's just a length I have always used. I don't even know whether it is the optimal length to determine the dominant trend, and nor do I care. The last thing I would want to do in my trading is start using 'optimized' variables, as its one of the quickest routes to the poor house. And please understand that those strategies of mine that use the 200-day moving average don't use it to find trade setups. They don't use it to find entry, stop or exit levels. They just use it to determine the dominant trend.

THIS BOOK IS NOT ABOUT FUTURES TRADING

Despite myself being a futures trader, please do not think this book is about futures trading. Yes, many of the examples and portfolios used to share and illustrate ideas will involve futures, but only because they are a device of convenience for myself. What I will be sharing in this book, similarly to what I did with *UPST*, is a focus primarily on the process of good trading. Not on secondary issues such as individual markets and instruments. This book is not about trying to convert you to futures. Futures is just my preferred instrument to trade. You will have your own preferred markets and instruments to trade. So, please don't think this book is designed to attempt to convert you to the markets and instruments I trade. No. I'm writing this book to encourage you to focus first on the process of good trading rather on any individual market, instrument, technique or timeframe. It's just that the majority of examples involve futures, and I use futures because it's convenient for me.

So, please understand that this book will be focused on the correct process of good trading, regardless of market, instrument or timeframe. The markets and instruments shown within these pages are for illustrative purposes only, and in their turn become secondary in importance to following good trading principals.

PATHWAY TO SUSTAINABLE TRADING

I hope this book can become a sensible stepping stone on your pathway to sustainable trading. I certainly believe it's possible to reach

your destination if this book is used in combination with my previous book, *UPST*.

I have a lot to share with you over the following pages. Let me give you a brief outline of what I'll be discussing.

In Chapter 1 I begin by outlining how difficult it is for you and I to succeed as traders.

In Chapter 2 I offer a number of key messages covering knowledge, risks, application and execution.

In Chapter 3 I share with you the appeal of trend trading and why you should seriously consider it as a trading technique.

In Chapter 4 I give a brief outline of why trends exist.

In Chapter 5 I share my thoughts on why so many fail at trend trading.

In Chapter 6 I review a number of different trend trading strategies to demonstrate the various techniques that exist.

In Chapter 7 I discuss the importance of measuring strategy performance on a risk-adjusted basis.

In Chapter 8 I share a toolkit that traders can use to help them review, develop and select strategies to trade.

In Chapter 9 I finish the book with an example of using the toolkit to develop, what I believe is, a sensible and sustain trading strategy.

JUST MY OPINION

As you read through my book please always remember and understand that what I write is only one person's opinion. Mine. I only represent one trader's view and please don't accept, just because I write something, that it's necessarily true. I'm certainly no guru and nor do I believe anyone can claim that mantle in trading. I'm just writing what I believe to be true. So, please don't take offence to anything I write, it's just what I think and it's ok for you to disagree. I won't be offended, I promise. The only caution I'll make is that you will need to produce the necessary substantiation to counter my position as my ideas/position will be supported by historical evidence and actual trading experience. So, if you do find yourself disagreeing with my ideas, then you will need to produce the necessary verification to support your view. It won't be enough for you to rely purely on gut feel or personal opinion. Remember, our gut feelings and our personal opinions are generally held captive by our cognitive biases, which can and do play havoc with our trading decisions. So be warned!