

Weekly Trading Education Article

A Nuts-and-Bolts Approach

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Most of the time, the novice traders have difficulties to apply the most efficient trading techniques due to misunderstanding of the so-called assimilated educational material, or to their greed race. In teaching this topic, through the use of progressive modules, the author emphasizes the use of applied principles of epistemology, based on repetitive examples of trading choice parameters, thus enhancing the probability of getting consistent profits.

Trading the Futures, especially the German Dax, is a real challenge, due to its specific characteristics, money & risk management techniques and finally the last, but not the least the psychological aspects applied to every day practice. In this paper we will refrain ourselves, because of the space, and will only treat the advantages of trading German Dax Futures, with regard to E-mini S&P 500 Futures and E-mini Russell 2000 Futures.

Part I of this article will describe the German Dax choice principles, and Part II will treat a real-time trading example.

Why Trading the German Dax Futures and not S&P 500 nor Russell 2000 Futures?

The choice of trading intra-day financial securities is based on several primordial factors, whose influences were observed by the author, along with his 25 years of experience:

Volatility

Volatility is the first of the three parameters, analyzed by the author.

The measuring instrument could be the Average True Range [ATR (14)] or the Bollinger Bands, once we have calibrated the settings to (21, 2.618). In order to keep it simple, but efficient, we will remain on the ATR (14).

As of March 15th, the intra-day maximal volatility on a daily time frame chart, measured only by the ATR (14), was:

97.28 points on German Dax June Futures, each point having a 25 euro value, for a total of 2 432 euro, or 3 162 USD. The Euro/USD average conversion rate, as of the same date was 1.30.

13.82 points on E-mini S&P 500 Perpetual Futures, each point having a 50 USD value, for a total of 691 USD.

10.04 points on E-mini Russell 2000 Perpetual Futures, each point having a 100 USD value, for a total of 1 004 USD.

If we go even further on and compare the USD values among these three securities we will obtain the following:

4.57 ratio between German Dax and E-mini S&P 500 Futures

3.14 ratio between German Dax and E-mini Russell 2000 Futures

1.45 ratio between E-mini Russell 2000 and E-mini S&P 500 Futures

Conclusion:

We can observe that the best ratio is 4.57, meaning that trading the German Dax Futures is far more profitable than trading the E-mini S&P 500 Futures or E-mini Russell 2000 Futures. However, we must be aware that this ratio is dependent on the Eur/USD conversion rate and also on the individual peculiarities of each market. In order to be on the safe side, and avoid the high fluctuations of ratios, the trader should verify, at least once a month, the reliability of this logical process.

Liquidity



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Liquidity is the second of the three parameters, analyzed by the author.

The liquidity of the three securities was observed and it was revealed the following:

Monitoring the Volume and its average [Volume MA (5)] of the German Dax June Futures, we found out that on March 15, 2013 were traded 105 918 contracts. The Volume MA (5) was that day 91 986 contracts.

Monitoring the Volume and its average [Volume MA (5)] of the E-mini S&P 500 Perpetual Futures, we found out that on March 15, 2013 were traded 1 528 900 contracts. The Volume MA (5) was that day 1 757 900 contracts.

Monitoring the Volume and its average [Volume MA (5)] of the E-mini Russell 2000 Perpetual Futures, we found out that on March 15, 2013 were traded 93 800 contracts. The Volume MA (5) was that day 117 240 contracts.

Conclusion:

We can observe on the above analysis that the best liquidity illustrated by the Volume and also the Volume Average [Volume MA(5)] belonged to E-mini S&P 500 Futures with a record volume of 1 528 900 contracts traded on March 15, 2013.

German Dax Futures, came out the second, with a smaller volume of 105 918 contracts traded on the same day. The third liquidity pertained to E-mini Russell 2000 Futures and came out with only 93 800 contracts.

We may conclude that Dax and Russell 2000 have almost the same liquidity (a slight difference of 8.8% occurs in favour of Dax), and that E-mini S&P 500 Futures has a ten times bigger liquidity value. German Dax Futures takes here the second place. In spite of this 10 times smaller liquidity, with regard to E-mini S&P 500 Futures, we will ask ourselves... Should we renounce to Dax trading and take up only the S&P 500?

Intra-Day Behavior

Intra-day behavior has multiple important traits, and is the last of the three parameters, analyzed by the author.

First, we noticed the influence on the profits of the "time-of-the-day" parameter. We observed that in most days 10:00 AM CET is the optimal entry trading time on the intra-day German Dax trades. It can also represent the optimal time for an exit of a multiple day trade. Both of these will certainly improve the trader's P/L statement. This trait also occurs on E-mini S&P 500 and E-mini Russell 2000 Futures, but with a lesser degree and also a lower frequency associated with a lesser accuracy.

Second impressive trait is the "morning and the after-noon typical behaviour", which splits the day in two, each part behaving differently, as if they were two separate days. The market complies fully here, following the "return to the opening range" principle, described by Larry Pesavento in his excellent book "Opening Price Principle" (2000).

This characteristic also occurs on E-mini S&P 500 and E-mini Russell 2000 Futures, but with a lesser degree and also a lower frequency.

The third efficient and very profitable trait would be the occurrence of "morning and after-noon trending swings" that will make trader's "bread-and-butter", for the day.

This trait occurs at least three times a week, like a Swiss clock-work, when trading the German Dax. The morning would be "blessed" with a 50 to 80 Dax points swing, worth between 1625 USD and 2600 USD per contract. This represents, as of March 15, 2013, 51.9% to 82.23% of the daily ATRA (14). For an average trade of 3 contracts, the trader's "bread-and-butter" will swiftly climb to a maximal 7800 USD, and all this, within the 2 to 3 morning hours. It is not seldom that the same behaviour occurs in the after-noon, but in the opposite direction, especially when the Nikkei 225 had an earlier day climbing or falling of more than 1.5%.

If we compare this profit performance with that of the E-mini S&P 500 or the E-mini Russell 2000 Futures, we can readily observe that even if their moves would cover the 100% daily ATR (14) (even if this happens, but very seldom), they are well behind the German Dax, with only 691 USD and 1 004 USD, respectively.

The fourth and the last trait, is trading intra-day with a set of two German economic indicators (IFO and ZEW), which brings consistent monthly profits to the practising trader.

IFO news reports (DE IFO Geschäftsklimaindex), on the climate of the German economy is published once-a-month at 10:00 hours CET. For a detailed description please go to: www.finanzen.net/ifo/ or to http://en.wikipedia.org/wiki/Ifo_Business_Climate_Index

ZEW news publication (DE ZEW Konjunkturerwartung) is released once-a-month at 11:00 hours CET (barometer for economic conjuncture) - see the link www.finanzen.net/zew/. It represents the

economic expectations for Germany. For a detailed description please go to:
<http://www.zew.de/en/>

For the exact date of both publications refer every week-end or daily, early in the morning, to the following link: <http://www.derivatecheck.de/termine/>

The particularities of these two news indicators are different from those of the main US economic news indicators. We found them less erratic, especially after the first 5 minutes of evolution. Their intra-day span life period usually lasts an average of 30 minutes until it reaches the reversal pivot. We call it the "forth" impulsive movement. Once the reversal occurred, it means that the effect of the news has waned and the market flow will return to the initial starting level or at least close to it. We call this contrary move, the "back" or "backward" impulsive movement. Due to a smaller risk, we trade most of the time, only the "back" impulsive movement of the German Dax Futures, which has usually a 20-40 minutes span life. The "forth" movement can also be traded, but it demands more trading experience. It takes more risk & money management and also a greater involvement of the trader, within the trade management procedures.

The problem is the exact detection of the final target, which represents the reversal landmark. The trading technique is identical for "forth" and "backward" moves and we concomitantly use three time frames:

It is well known that the charts instantly discount everything, including reports or events. Thus, it is only natural to study the trader's reactions on different charts, along the various time frames, starting with the smallest and ending with the largest. However, one task is essential... They should be performed in a synchronized manner, in such a way that the information of the lowest time frame (for instance, a 1-min) will have a predictive bias for the upper time frames (5-min or 15-min).

The 1-min chart is the closest to the market flow evolution and is used for revealing the economic indicator's nature in three development phases: the beginning, the mid-period through its continuation pullbacks (or rallies) and of course, the reversal time, illustrated with a high precision by the reversing one-, two- or three-bar pattern. Besides the trending tools, the Volume and OBV indicators are associated with floor pivots in the process of decision taking. The 10:00 AM IFO release is in the vicinity of the opening gap, meaning that its influence on IFO development is more than essential. This is effectively performed through the use of high, low and mid-level of the gap, especially when its size is bigger than 20% of the daily ATR (14). This time frame is of a great assistance in the process of implementation of additional contracts to the initial entry. We should not forget that the "add-ons" contribute more than 50% to the trader's profitability!

Moreover, the entries and the implementation of the stop losses (initial and/or trailing) are highly dependent in their precision, especially on fine tuning, on this time frame.



Figure 1 – The above 1-min chart illustrates the magnified view revealed by the 1-min time frame, and guides the trader in interpretations of the pullbacks with the specific "add-ons" locations, market momentum and localisation of the reversal zone.

The trending tools illustrated on the above chart – the channelling and the ascending pitchfork – unveil, not

only the dominant trend on this time frame, but also the final waning of IFO's initial ascending momentum. Floor pivots, Volume and OBV indicator were not shown here, due to a better chart visualisation.

The 5-min chart is the operational time frame, for this type of trading, in order to optimally monitor the market flow evolution and is also used for entering and exiting the trade. It may also reveal the economic indicator's nature in three development phases: the beginning, the mid-period through its continuation pullbacks (or rallies), which are eventually used for "add-on" contracts and of course, the reversal timing. Once again, the floor pivots, the Volume and the OBV indicators are here associated for trading decisions.



Figure 2 – The above 5-min chart illustrates the operational time frame and guides the trader in decision taking process of trade management.

The trending tool illustrated here – the ascending pitchfork – unveils, not only the dominant trend on this time frame, but also the final waning of IFO's initial ascending momentum. Floor pivots, Volume and OBV indicator were not shown here, due to a better chart visualisation.

The 15-min chart is the common operational time frame for intra-day trading, outside the IFO amp; ZEW trading periods. However, in this case it will have a passive function. It will superbly illustrate the behaviour of the two news indicators, which the trader will be astonished to find out, how disciplined they are, from the inception to the termination of the IFO news. The illustration on this time frame of the IFO news trade has also an informative role concerning the post-news period.



Figure 3 – The above 15-min chart illustrates the passive function of this time frame and guides the trader in the decisional process of trade management in the post-IFO period. Its life span will be "grafted" on the "ongoing pattern" of the daily market flow.

The indicators' trading period (20-40 minutes 'forth' and 20-40 minutes 'backward'), will look like a "grafted" portion on the contextual ongoing market flow. One can easily observe where and when the news indicators occurred and also, at what time their entire influence on the market, has waned. The use of the interconnected markets will certainly help you out. The most efficient one, in this case, will probably be the German Bund Futures.

We conclude Part I of this article by believing that we have convinced the young traders, at least partially, to trade the German Dax Futures. For further practical trading details please go to our website and consult the excerpts of our trilogy of professional trading manuals, a 1200 page work.

The only apparent caveat would be the lesser German Dax's liquidity compared with that of the S&P 500. In spite of this 1 to 10 ratio, where S&P 500 is favoured, we consider it insignificant, due to the rapid execution of all our Dax trades that we have experienced for more than two decades. From the moment of clicking on the 'buy stop' button until the occurrence of the familiar message 'trade in progress', it takes only a blink-of-an-eye.

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