

Trading Pullbacks:

The Quintessential Trend Trading Pattern

Outline

- Why trade pullbacks?
- What is a pullback?
 - What are some common variations of pullbacks?
- How to use pullbacks to read trend strength.
- A sample trading plan



Two Styles of Trading

- With-Trend
 - Seeks to enter a position in alignment with the preexisting trend, or at the beginning of a new trend.
 - Common structures are pullbacks and breakouts.
 - Ideal entries are often around “centers”.
- Counter Trend
 - Looks to take positions against the current dominant trend on the trading timeframe.
 - Is there any true countertrend trading?
 - Hope is to be able to capitalize on a shorter trend against the main trend.
 - Trades often center around extremes.



Differences Between the Two Styles

- With-Trend
 - Trades can often be held a long time as trends run—“Ride your winners”.
 - Winners tend to be larger than losers.
 - May reward a more passive mindset.
- Counter Trend
 - Trades tend to have limited expectation. Important to take profits proactively.
 - Losers are often bigger than winners.
 - Often require aggressive (decisive) psychology.



The Pullback

- Trends tend to move in alternating patterns of with-trend strength and retracement.
- The pullback tries to capitalize on this fundamental element of price behavior.
- Uses market structure to limit and define risk.



Many names...

wedge
triangle
stairsteps
pennant
range
rising-wedge
box
pullback
flag
retracement



Simplify. Simplify. Simplify...

- All pullback variations are the same and can be traded the same.
- The market is so random that small variations are not significant.
- The concept is more important than the details.
- You are **trading pauses in established trends.**
- Simplify as much as possible, but not one bit further.

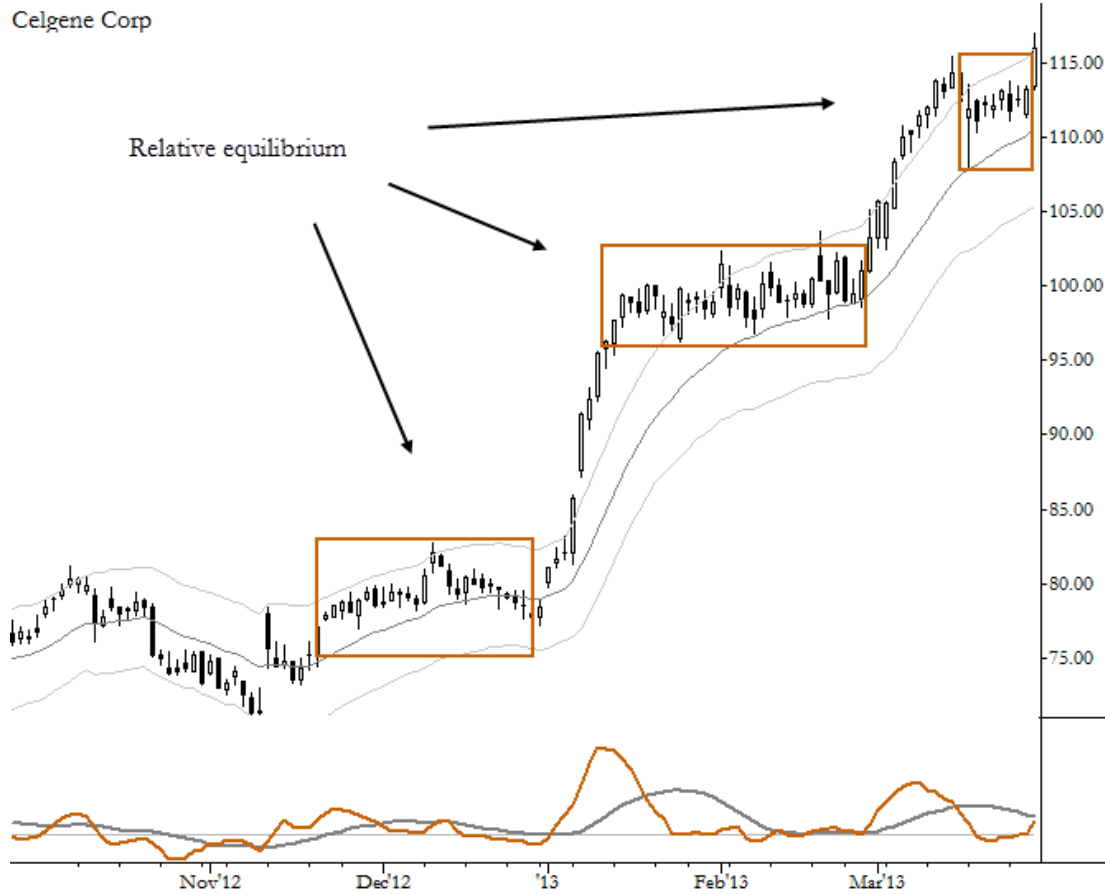


The Key to Technical Trading

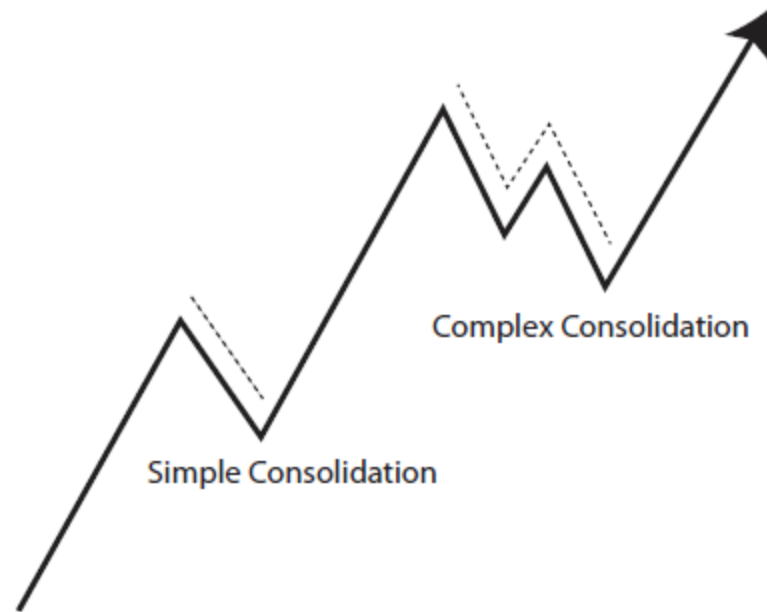
**Every edge we have comes from
an imbalance of buying and
selling pressure.**



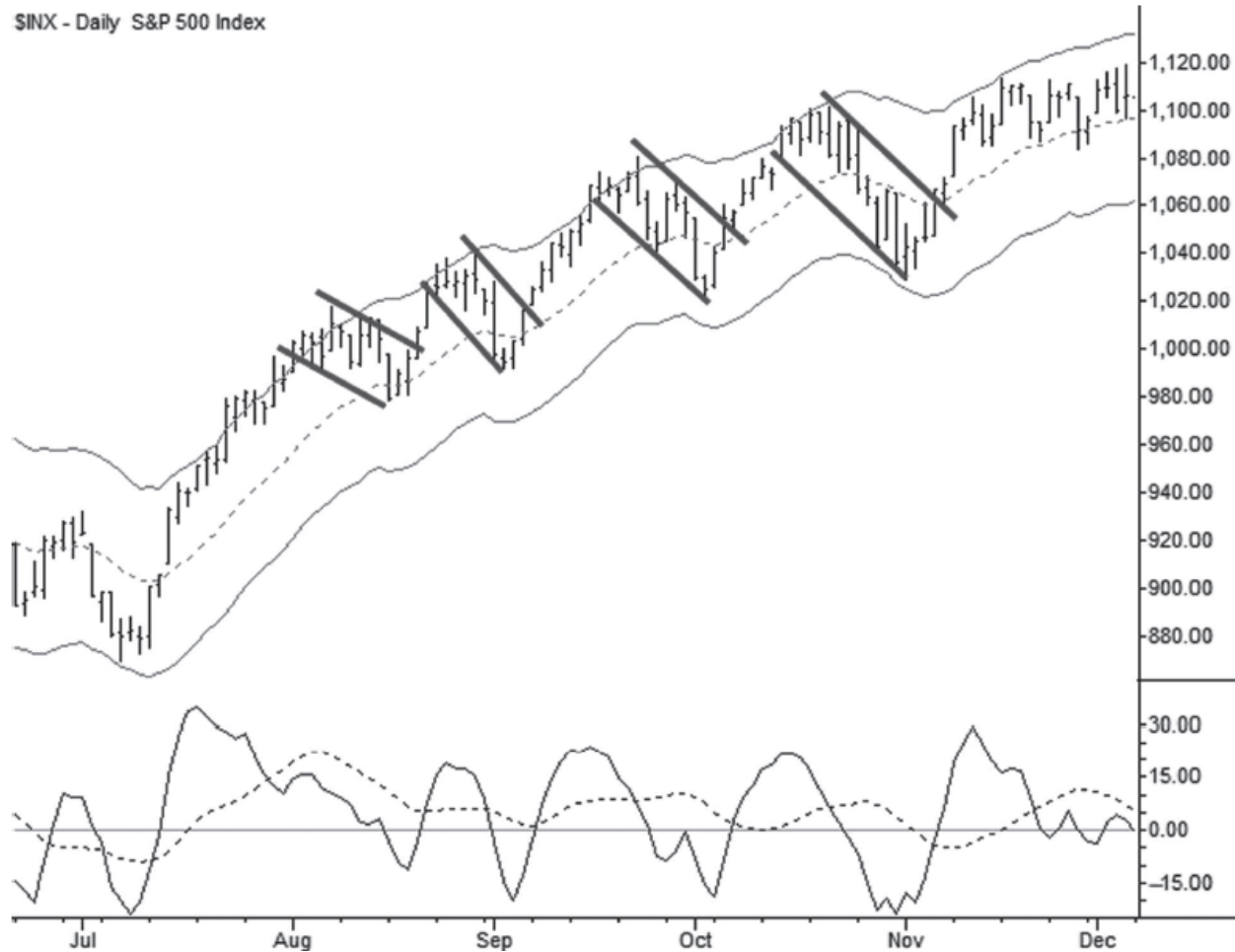
Alternation of balance/imbalance



Two Basic Pullback Variations



Pullbacks



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Understanding Trend Strength

- Define swings.
 - Can use pivots and market structure. (See *TAAS pp. 15-19*)
 - Can also use algorithmic tools. (Pivots, volatility, etc.)
- Consider each swing in context of previous swings.
- This price-based approach will lead many indicators.
- This is only context. Probably not possible to trade market structure like this on a stop-and-reverse basis.

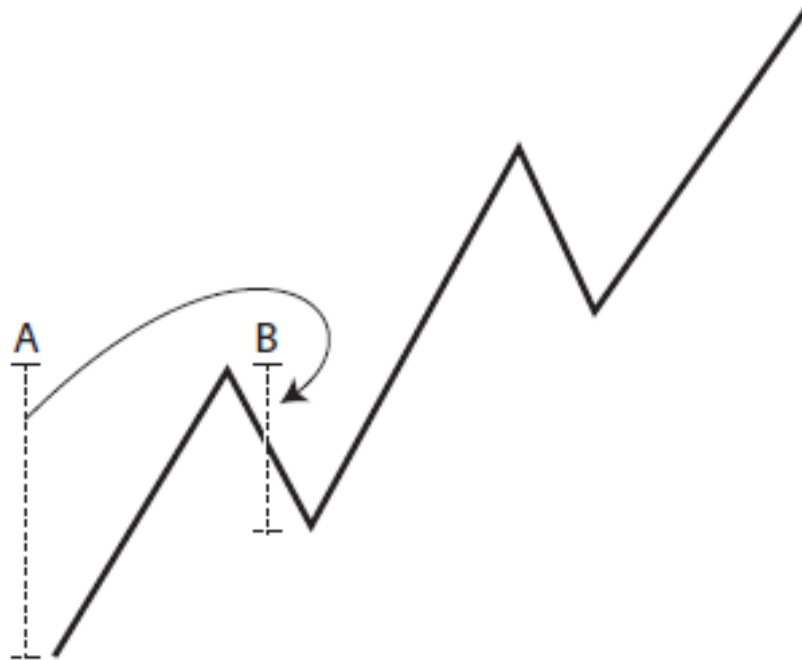


Understanding Trend Strength

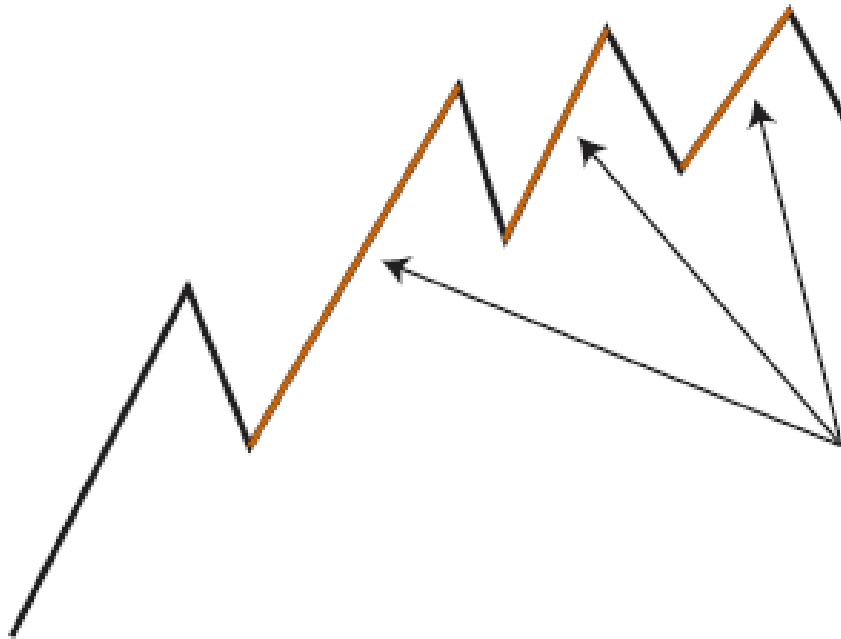
- Uptrend:
 - Upswings are larger than downswings, both in price and time.
- Downtrend:
 - Downswings are larger than upswings, both in price and time.
- Pay attention when the pattern changes.
- Markets in equilibrium do not present clear patterns.



Trend Analysis (1 / 3)



Trend Analysis (2/3)

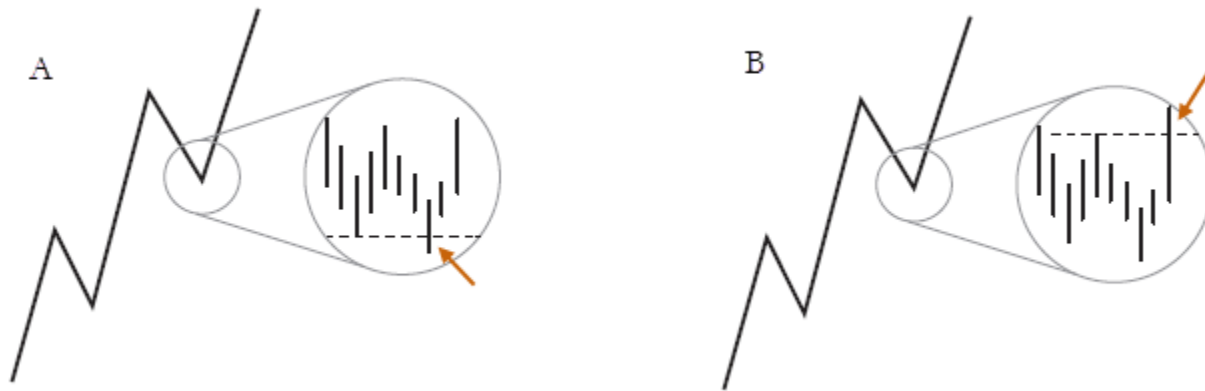


Trend Analysis (3/3)



Pullbacks: How to Enter Trades

- Broadly speaking, two plans (for long trades):
 - A. Buy failure tests near the bottom of pullbacks
 - B. Buy breakouts after a pullback
- These two plans offer a tradeoff between trade location and confirmation.



Pullbacks: Stop Placement

- With any technical trade, the most important thing is knowing where you are getting out if you are wrong.
- Cannot use extremely tight stops (in most cases).
 - Why?
- In a proper position-sizing plan, there are no low risk trades, but closer stops allow larger positions and closer profit targets.
- Using support and resistance for stops is problematic because S&R slope in pullbacks.



Stop Placement: Near and Far

@SB - Daily Sugar No. 11 Continuous Contract [Jul11]



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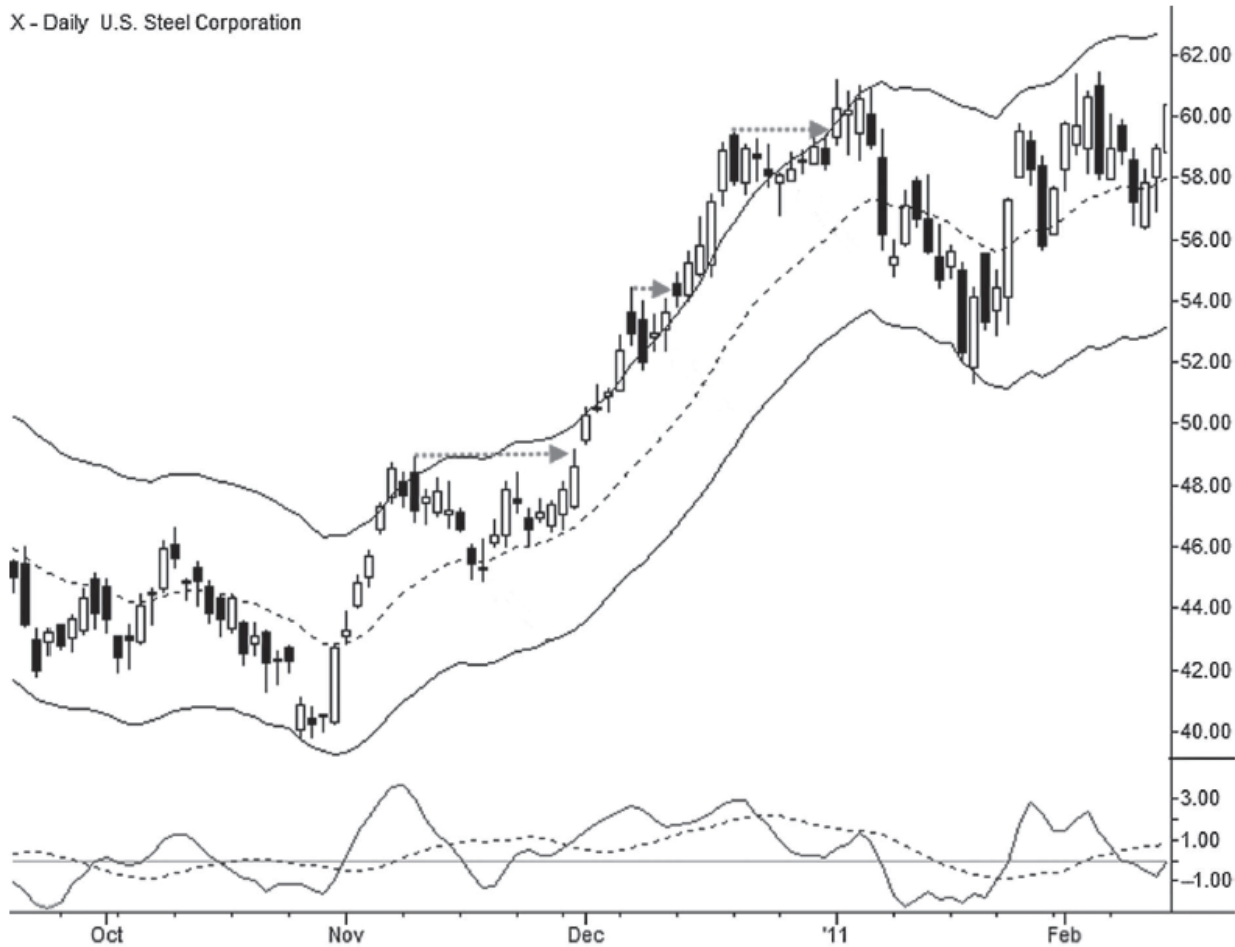
Pullbacks: Profit Targets

- To use or not to use?
 - “Trend following” plan might be to simply buy every pullback until the trend decisively fails.
 - What is wrong with this plan?
 - Using profit targets will lead to more consistency in the bottom line.
- If using profit targets, two broad categories:
 - Based on risk ratios.
 - E.g., profits at $1\times$, $2\times$ initial risk
 - Based on market structure



Conservative Profit Targets

X - Daily U.S. Steel Corporation



Pullbacks: Managing Trades

- One of the most important things to understand about any trading pattern is how they fail.
- Failed trades can sometimes offer good trades in the other direction. (Less so in the case of pullbacks.)
- Understanding how patterns fail can let you see pattern failure as it happens, sometimes limiting losses on losing trades.
- Common failures:
 - Flat pullbacks
 - Sharp momentum against
 - Failure at first target



Pullbacks: Finding the best trades

- First, be sure the market is actually trending on the relevant timeframe.
- The best pullbacks:
 - Follow sharp with-trend momentum
 - Do not come after climaxes
 - Come earlier in trends
 - Stop at “about” half the previous swing



A Sample Trading Plan (1 / 2)

- Using Keltner Channels and Modified Moving Average Convergence-Divergence (MACD):
- A long **setup** occurs after sharp momentum:
 - Price goes through the upper Keltner Channel
 - MACD makes a significant new low
- A long entry occurs:
 - After price pulls back near the EMA
 - On the bar that “hooks” the fast line of the MACD in the direction of the trend.



A Sample Trading Plan (2/2)

- Do not trade after a climax.
- Initial stop placement:
 - At the point at which the pullback is violated
 - Never moved in the direction of risk
- Profit targets
 - Take $\frac{1}{3}$ of the position off at 1X and 2X risk.
 - Watch for failure around previous trend extreme.
- (Examples show 10 minute S&P 500 E-mini futures, 24 hour data.)



Sample Trades

- 10 Minute S&P 500 Futures, 24 hour data
- Only take trades in the regular U. S. Session (9:30 – 16:00 EDT)
- Only entries marked
- (Another consideration with intraday index futures is to understand the alternation of trend and range days.)

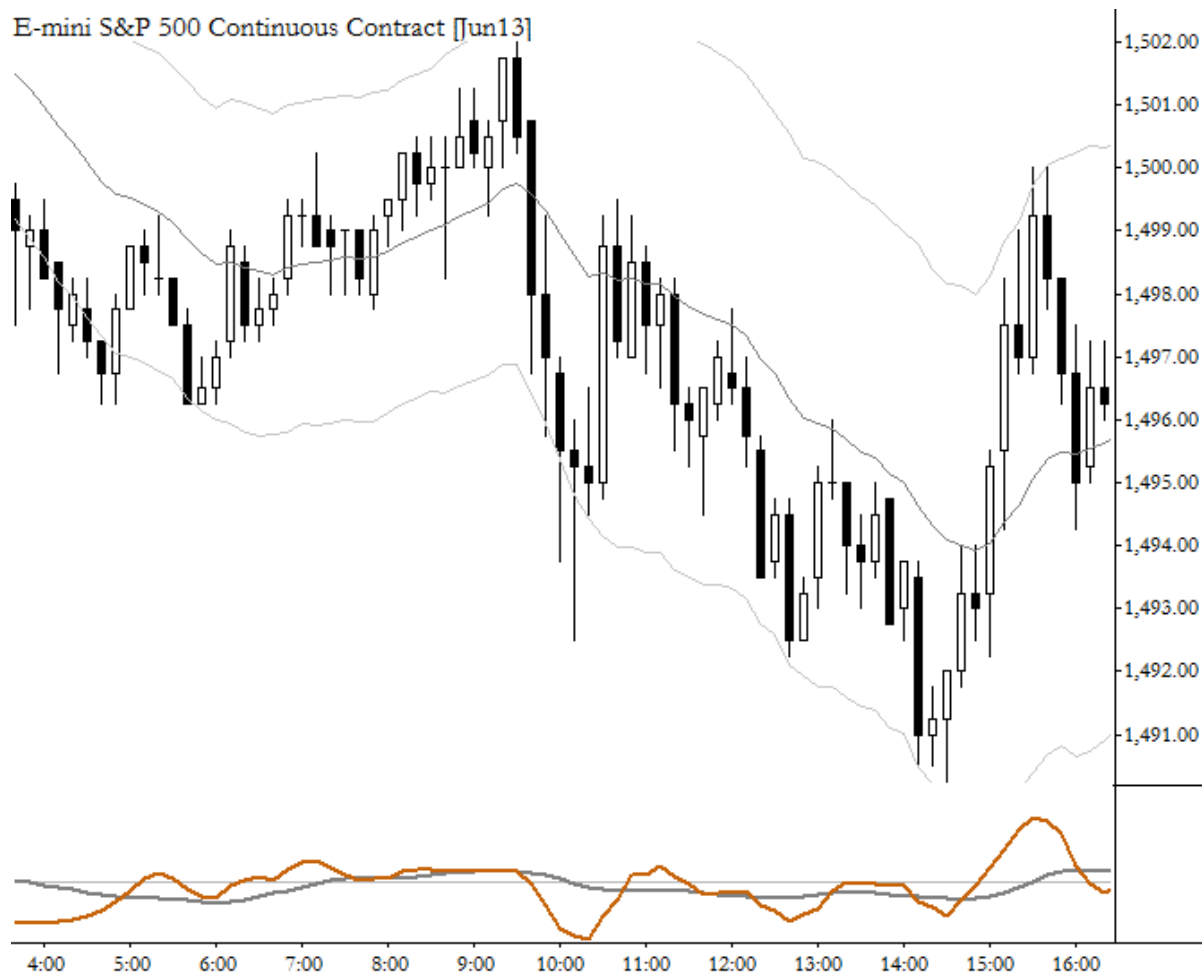


Sample Pullback Trades (2/20/13)



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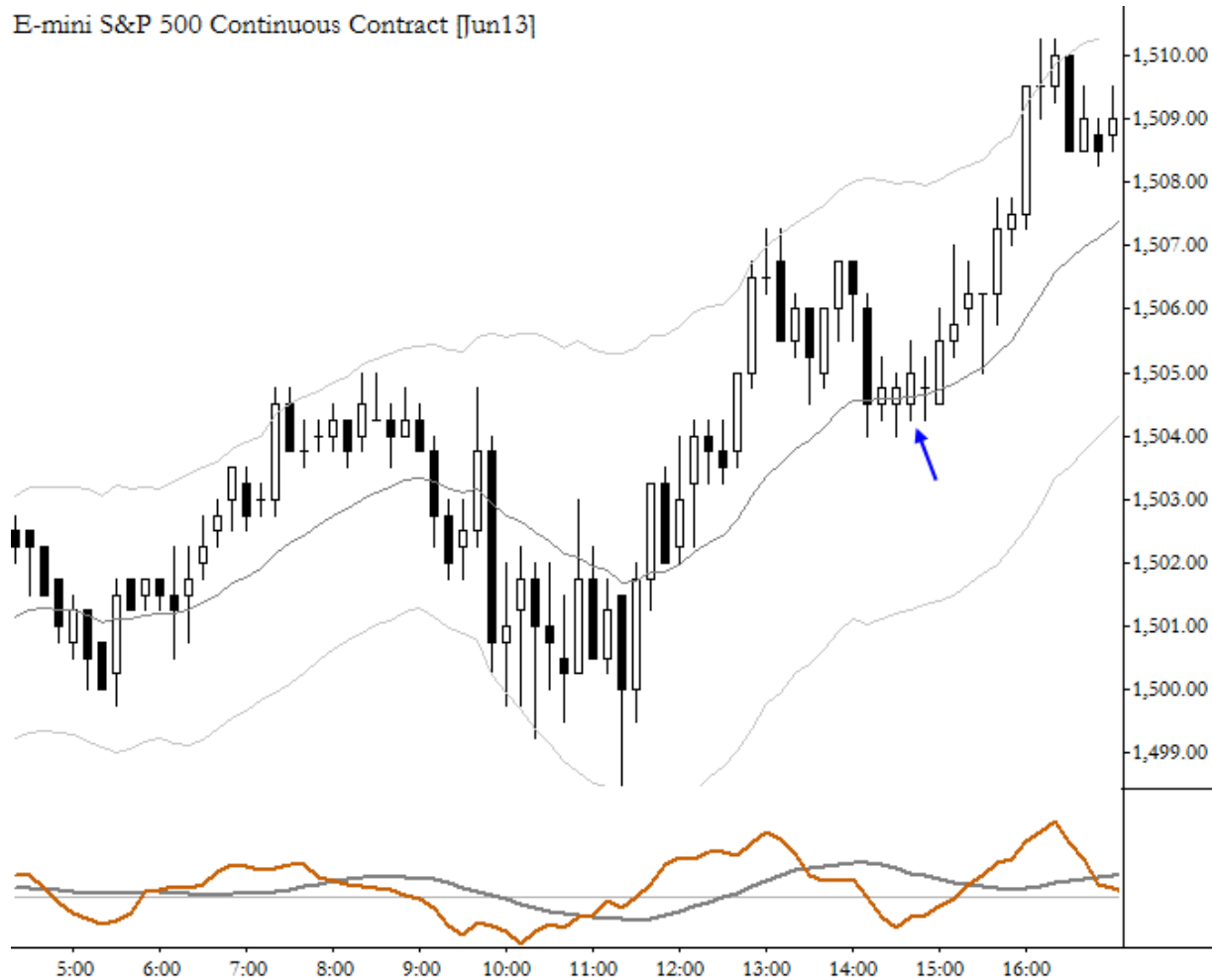
Sample Pullback Trades (2/21/13)



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Sample Pullback Trades (2/22/13)

E-mini S&P 500 Continuous Contract [Jun13]



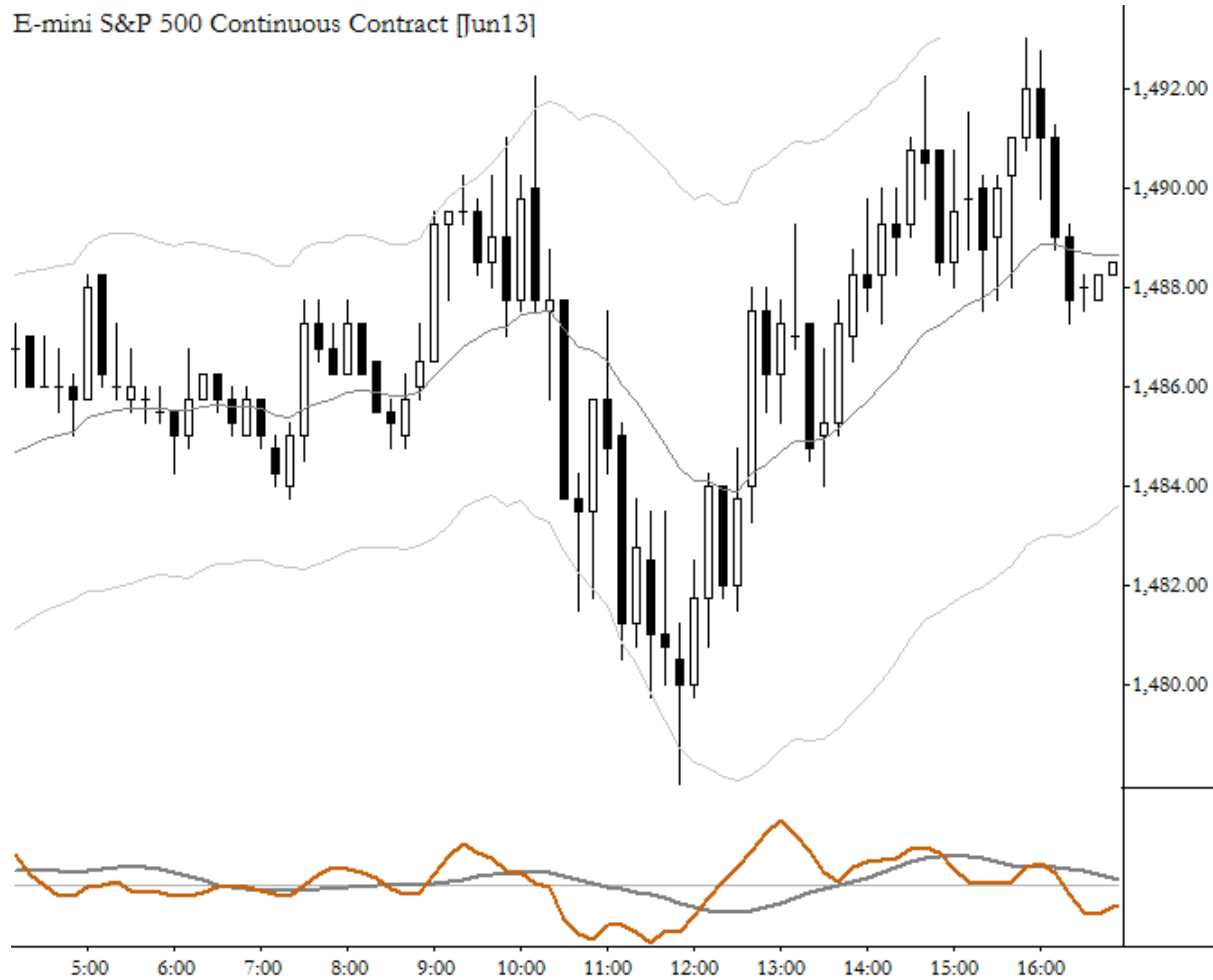
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Sample Pullback Trades (2/25/13)



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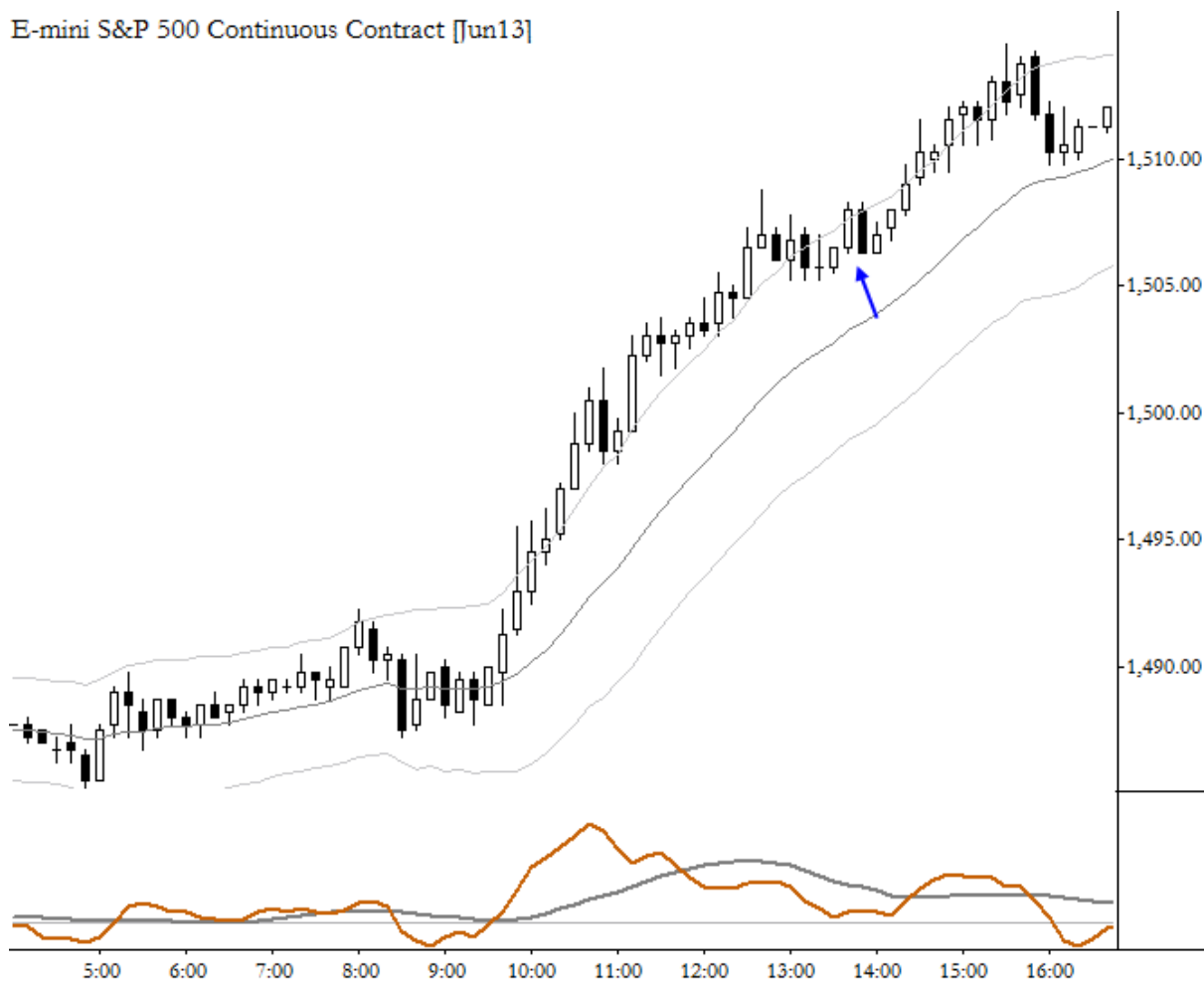
Sample Pullback Trades (2/26/13)




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Sample Pullback Trades (2/27/13)

E-mini S&P 500 Continuous Contract [Jun13]



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 WILEY Trading

MARKET STRUCTURE,
PRICE ACTION, AND
TRADING STRATEGIES

THE
ART AND SCIENCE OF
TECHNICAL
ANALYSIS

ADAM GRIMES



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Tactical Playbook – **Available on Interactive Brokers - IBIS**

- In-depth Monday report
 - Technical setups for all major asset classes
 - Exact trade recommendations
 - Macro perspective on major events and risk factors
- Daily update
 - Updates to positions, stops, and trade management decisions

Options Market Outlook – Contact Waverly Directly

- Quantitative analysis of options market
- Macro risk factors and analysis of market environment



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- Our investment process is built upon our disciplined research process and risk management acumen
- We provide world class research as well as bespoke advisory and derivative services and count some of the largest asset managers in the US and Canada among our clients



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