MONDAY MORNING
PAYDAY$

10 *Real* Rules
Of Technical Analysis

Rule 1

Data shows that traders who rely on technical analysis should never look at a chart for more than a few seconds before finding the pattern or trend that is there. The reason for this is simple: The mind will try to find patterns and make some type of order out of pure random lines. What most beginners do is stare at charts till they see an obvious pattern, you should avoid doing this. Also, try to focus on patterns that have some objectivity, this makes it much easier to stay consistent. Objectivity could be gaps, 123 patterns, support and resistance levels, etc.

Rule 2

Never apply more than 2 directional indicators to a chart. I tend to trade assets that have a clear trend, if I'm considering a directional trade. If you have to place several indicators to determine if a market or stock is moving up or down, then the market or asset you are trading does not have clear direction and you should avoid taking directional trades using that asset.

Rule 3

Don't impose indicators to give you the result you want. This happens when you are looking at a chart and you want the market to go a certain direction and then you apply dozens of indicators and rely on the ones that agree with you. I've had this happen more than once, especially with all the different technical analysis available to us and I've even learned how to use a few indicators this way. But the point here is this: Use indicators in a consistent way, notice I said nothing about using indicators the way they were intended to be used, I use traditional indicators in very untraditional ways from time to time, but I use them consistently. So if you use oscillators to determine overbought and oversold levels, don't switch to other indicators because the oscillator doesn't agree with your current position.

Rule 4

You should always consider different time frames when initiating positions. This is one that beginners overlook and one that I force you to focus on in this program. Notice we always use the 50 day average and the 90 day average on the daily charts. Notice I discuss the daily analysis and bonds and other sectors? This is because the macro view has everything to do with the micro view, so don't forget to always analyze big picture. In financial markets, especially the way the world is becoming one big global economy; everything that happens in one market to a degree has an impact on the U.S stock market.

Rule 5

The pattern must fit within the trend. This is something extremely important and something I never hear anyone ever talking about. For example, say you're trading pullbacks and using weekly chart to determine the length of the trend, I would not use a 4 day retracement to determine a pullback. The reason is because 4 days against a 1 year trend is not really a pullback. If you're going to use weekly charts, then use weekly pullbacks. Another good example comes to mind is reversals patterns: 123 tops and bottoms are great reversal patterns, but real reversals don't occur every few days, so to get the most benefit out of these patterns you should see the pattern set up over a month or two, but relying on market reversals over a few days time is not realistic, unless you are looking for intraday reversals and if that's the case then you should use intraday charts and not daily charts. So remember to always match the pattern to the underlying trend you are trading.

Rule 6

The best indicator is market price. I've used different analogies before but to make you really understand imagine looking at the same thing through different colored lenses, no matter how many different colors you try, the clearest picture will always be the lens that doesn't use color. Technical indicators are different colored lenses and you are using them get a better indication of price. But the best indication of price will come from actually looking at price itself. Just look at the Hybrid strategies for example.
Try to find an indicator that will get you into the bottom 20% of the daily range 80% of the time. This is very important to remember

Rule 7

Do not undervalue the importance of divergence analysis. In my experience only about 15 percent of traders use divergence analysis in their trading. I use divergence analysis at least weekly when analyzing the broad market and I do the same when I analyze indexes and commodities as well. What divergence analysis gives you that you cannot get anywhere else except maybe the MACD indicator is a good idea of the momentum behind the actual change in asset price. When our eyes look at price, we can see where it's going, but we cannot see the power behind that move.
Divergence analysis allows us to get an approximation of the power or lack

of power behind moves. For example, we using the RSI and the broad market divergence analysis, this showed us that there is very little commitment or real buying behind the move we are having right now in the broad market.

Rule 8

Volume analysis is very tricky and is not recommended for beginners. I'm not sure if you've noticed that I don't focus too much on volume and how volume analysis can help improve your trading results. The truth of the matter is volume analysis is very difficult to interpret accurately and most beginners pay too much attention to volume when it's purely random and meaningless. I wrote a tutorial on one way to use volume and there are others, but volume analysis is not something you should focus on till you are a consistently profitable trader. Trading Volume Spikes Article and Trading Volume Spikes Video.

Rule 9

Aside from diversification, relative strength analysis is the only other free lunch Wall Street offers traders. Most traders undervalue the importance relative strength analysis. Relative strength analysis is a form of technical analysis and comparing the strength or weakness of one asset over the other is one very accurate way to determine strength and/or weakness. I know several traders who only trade one asset against the other and they are very profitable. There are many ways to use relative strength analysis and I will start showing you some of those ways next week. While these methods perform best using daily time frame, I will show you how to utilize this for intraday trading as well. What amazes me is the level of interest traders take in advanced indicators that are 3 times derived from actual price, but ignore simple techniques such as comparing one company to its competitor and trading them against each other.(I.E. Coke vs. Pepsi or Ford vs. GM)

Rule 10

Know the current market cycle. This is another very important and much overlooked analysis technique that for some unknown reason many traders completely ignore. Market, just like anything else in life goes through cycles. Right now the U.S. stock market is in the End of one a very strong bull run (why it's there is another story and one I've mentioned at least 50 times) but that's where we are right now. So applying stochastic oscillators and RSI

indictors (traditional ways, not divergence analysis) is not going to give you a good picture of the current market environment.
If the market was very choppy and going through a consolidation stage (which is the next stage of this market) then RSI and other Oscillators will be extremely useful and beneficial to our analysis, but while we are still in a bull run, it's hard to get any benefit from these indicators in a traditional sense. In this type of market environment (using daily charts) pullbacks away from the moving average is a great way to trade this market as are other methods that rely on trend pullbacks or any other method that involves using the trend. So remember, always know the current market cycle before
you create a trading plan for that market.

Wishing you nothing but the best,
Rob

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