A Case Study in Success: John Bollinger

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More recently, he has also been building up a suite of websites (BollingerBands.com, BollingerOnBollingerBands.com, EquityTrader.com, GroupPower.com, PatternPower.com, MarketTechnician.com, and BBForex.com) to help bring useful information, education, and analytics to the individual investor.

Bollinger credits industry greats such as Art Merrill, Norman Fosback, Richard Wykoff and Sedge Coppock as inspirations whose work he greatly admired and tried to build upon. Bollinger is an avid historian of the craft of technical analysis and feels the current generation of investors under appreciates the body of work created during the "golden age" of technical analysis. Bollinger says that while the computer has been a boon to his business and to the industry in general, it "has created distance between the analyst and the indicator."

Bollinger also spoke of the need to thoroughly understand the behavior of any system or indicator, and how it responds under different market conditions. Said Bollinger, "If the market delivers an event that you know your indicator will not handle well, don't take the signal." It seems so simple and yet many traders get into trouble by ignoring this very advice.

Digital filters are one area where Bollinger has been doing a lot of research recently. The most commonly used digital filter in technical analysis is the moving average, but Bollinger's view that there are times when more sophisticated digital filters will produce a better result for the analyst.

When I asked Bollinger where he thought new entrants to the field should focus their efforts, he quickly responded that "they should read the old books!" He felt there was a tremendous amount of information that could be gleaned from these sources to help build a strong foundation in Technical Analysis. In fact, Bollinger recently donated half of his book collection to the MTA library to help members get access to old and out of print volumes on technical analysis.

However, Bollinger was equally emphatic of the need for people to try and do different things and be creative. He noted that most of the progress in an industry is achieved by the "non-believers" who simply do what they want to instead of following the hallowed traditions. He acknowledged that it's not an easy balance to achieve, but one that was worth striving for.

When asked what troubles him the most about current industry practices, Bollinger stated that it was the propagation of the belief that "if people just show up and 'follow the rules' that they will succeed as if the market owes them something." "The market doesn't owe anything to anyone, and people forget that this is a business like any other business. It requires hard work, discipline and skill." Bollinger feels that promotions that suggest otherwise are just not reasonable. Bollinger also believes that "every market crisis you go through builds up experience and knowledge. After you've been through a few iterations of the LTMC crisis, or 9/11 or 1987, you learn things that cannot be learned in a book or by looking at historical charts." Bollinger's view is that while reading history gives you "abstract knowledge", there is nothing like going through the experience in real time to create an indelible lesson.

One lesson that Bollinger is currently drawing upon is the contrary opinion thesis as described by Humphrey B. Neil. Neil suggested that in order to use contrary opinion, the following 3 conditions must exist. 1) There must be a widely held opinion 2) One must wait for that opinion to be wrong and 3) There must be a catalyst to signal the change.

Bollinger believes that the U.S. currency is showing signs of bottoming at a time when market psychology is still firmly negative on the "collapsing dollar." Bollinger notes that the dollar stopped going down in March, and is in the process of building a base and testing upside resistance. Foreign corporations are beginning to make cash bids for large U.S. corporations (Roche bid for Genentech and Inbev bid for Anheuser-Busch are two notable examples) and these events could be viewed as the catalysts to turn the flow of funds and psychology in favor of the USD. As a result of seeing market action that is in direct contrast to market positioning and psychology, Bollinger has reduced his overseas exposure "considerably" and thinks that U.S. markets have a good probability of outperforming going forward.

Bollinger strongly believes that psychology plays a roll in investment success, but also believes that "no one is born with the psychology for this business." However, Bollinger says he is "underwhelmed by the trading psychology industry." Bollinger believes that success is simply a matter of applying a proven (and well-tested) strategy in a disciplined and consistent manner. He states that the most important thing is to "see opportunities and seize them." Sometimes opportunities are made and sometimes they are found" but in the end, you have to take action. States Bollinger: "that's how I've done everything in my entire life."

Ajay Jani has been in the investment business since 1989, and is currently Managing Partner of Single A Capital, LLC, a hedge fund investing in Emerging Markets. He is an MTA affiliate and has completed levels I & II of the CMT.

John Bollinger has recently created MarketTechnician.com and several other web sites which provide valuable market timing tools that should prove to be valuable to the professional community. These sites provide long historical records of different signals along with obscure indicators such as those developed by James Alphier. A 30-day free trial is well worth the time.

Analytical Toolbox: Trade Psychology—Andrew Cardwell

By Clare White, CMT

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As a follow-up to last week's article discussing Andrew Cardwell's experience with the Relative Strength Index [RSI] and how he came to be a leading authority on this technical tool (see Analytical Toolbox: Speaking with Andrew Cardwell from 7/18/08, available at Optionetics.com), a natural next step is this week's discussion on the psychology of trading. Mr. Cardwell has traded different futures markets for thirty years and has definitely developed some insights into the importance of trading with a plan and the challenges the markets present traders. His longevity in leveraged markets suggests he's learned a thing or two along the way.

Andrew Cardwell, President of Cardwell Financial Group, Inc., began his trading career in 1978 as a broker with McCormick Commodities. In 1981, Andrew left the brokerage business to devote his time to the study of technical analysis and to develop a trading program and model around the Relative Strength Index. Today, he provides consultation and commentary for his RSI Course students and his Cardwell Private Client Group.

Andrew has taught his proprietary RSI Basic and RSI EDGE Courses to individual traders, brokers, money managers and technical analysts from around the globe. Over 70% of his course students have been referrals and he has course students in 27 countries. As a very respected and sought-after lecturer, he has presented at some of most prestigious worldwide financial conferences. From 1990 to 1993, he provided weekly market commentary for the Financial News Network and has also appeared on CNBC, providing opinions based on his RSI experience. His articles have been published in Futures magazine and by Knight-Ridder News Service. He was featured in the Commodity Traders Consumer Reports "Trader Profile" series where Bruce Babcock referred to him as ''the world's leading authority on the RSI''. Andrew Cardwell can be reached at cardwellRSI@hotmail.com.

Success in Trading

Q: What do you believe is needed to be successful trading any financial markets?

AC: When I started lecturing and teaching my courses, I said there were three things critical for success: 1) A methodology that works consistently and had proven itself to be reliable in uptrends and downtrends (good probability). The reliability should extend to all types of markets, using all

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different time frames, 2) Patience to wait for the signals and 3) Discipline to stay within the trading program and the rules you defined for it, but more importantly, the discipline for controlling yourself and your emotions.

While it's easy to teach someone chart patterns and a methodology the two hardest things to learn are patience and discipline. Having a good methodology (trade plan) gives you the opportunity to focus more time on discipline. Trading is like golf, 20% mechanical and 80% mental (same swing, different clubs).

The difference between a trader and an investor is that a trader buys and sells with the goal of making profits. An investor is someone who takes a position and when it goes against him holds on long enough to where he becomes an investor. They do this instead of using a stop loss and moving on like a trader. Take for example those who bought GM at $45, bought some more at 40 and at 30, and now that it's way down are asking, "What should I do?"

You have to have a plan, just like a football team. If you walk onto that field without a plan, you're doomed. You also have to be willing to change your plan, to adjust. Adjusting can sometimes mean admitting you're wrong and most people don't want to do that because they take it as a personal slap in the face. You were wrong and you lost money. Professional baseball players win batting titles batting 0.350 which means they're only getting 35 hits at 100 times at bat They're only right or in tune 35% of the time. You can do that in trading as well, if you maintain your discipline and are willing to admit when you're wrong.

People trade mostly on hope or fear; they buy something hoping it will go up and when it goes against them they experience fear. People take profits quickly for fear of losing it. They hope it will go up higher so they can make more money, but in the first correction they're out.

After 30 years I've seen just about almost everything that could take place. People have told me that I seem to have ice water in my veins. I don't equate the markets with money—it's a line moving up or down. When the markets drop I say, "don't be in such a hurry to buy" and when it starts running I say "don't be in such a hurry to sell". I tell people, "It's not the quantity of the decisions that make you money, it's the quality." Quantity means you're putting money at risk all the time. A lot of traders when they have a good position start thinking about how they will spend the profits before they have even off-set the trade.

Q: How have you been able to minimize emotions in regards to profits and losses?

AC: I always look at it as points; I don't look at it as dollars. I think about moving from Point A to Point B. if it goes above Point B, then I look to the next point. So I set targets along the way and bring my stop up to protect profits. This way I let the market show me what it wants to do. The market presents opportunities all day long, you just have to be sharp enough to know which ones are good markets and which ones are head fakes.

Mark Douglas in The Disciplined Trader wrote," Money is not a by-product of what you know, but what you act on what you know." You may know what a buy signal looks like, but you decide not to buy it because your friend tells you his broker says it's not a good time (it's like too many chefs in the kitchen).

Nobody knows what the market will do; traders work in probabilities. But when people start thinking about money it's where they can get very confused. A position can move 3 or 4 points in their favor and they're already thinking about how they'll spend the money. They may act aggressively thinking they can take profits and get back in on a pullback, but the pullback never happens. The markets take off without them. We can minimize risk, but more importantly we need to minimize emotion.

Trading is a very humbling way of making a living. You're either right or you're wrong, the bottom line is: did you make money or lose money. It's not until you learn the difference between "just trading" and making money that you start to really make money—there's a big difference. I've had people tell me they play my course CD, "Trading versus Making $" once a week so keep their head on straight.

In 1987 when I had first gotten out in the public I was working as a consultant for a friend of mine who was working for a broker. In July and August of that year I was suggesting that people get out of the stock market because conditions didn't look good and I felt we could have a real hard downturn. The president of the company ran me out, saying I was too negative.

Well a few months later we had the crash and the brokers working there lost about half of their client base. When I went back in to meet my friend for lunch the president of the company looked at me and said, "Well I hate to admit it, but you were right." I said it's not a question of right, it's a question of looking at markets and reading them for what they are, not what you want them to be.

Q: How does technical analysis help minimize emotions/decision-making?

AC: People have come out recently talking about being in a bear market, but I don't have to lose 20% of my capital to know a market is bearish. We've been there technically since May and really before that when you look at trading volume or the financials (XLF). Just watching how the economy was slowing down provided information, but you will still hear people say, "we're going to skirt the recession" or, "we're not really technically in a recession". We've been in a recession since last summer and the housing market's been in a recession since before that. (Note: Apply the Range Rule principles using the daily chart for XLY, XLF and GM—see article on 7/10/08 on Cardwell's Techniques with the RSI.)

When I was in school as an economics major I had a little debate with my professor about having to wait for two consecutive quarters of negative growth to classify the economy as a recession. Well, two quarters is six months and that's roughly last summer. At that point you did not have economic data signaling trouble ahead because it was still positive growth … GDP was still up 1%. The classic economist has to wait until the data confirms the slow down. That's why a lot of people are trading with uncertainty. Economists say, "It could be this or it could be that, but we have to wait for more data".

I see important data everyday based on where the market closes. That tells me what's going on. When using technical analysis if you start seeing a low that breaks the previous low from 3 days ago, 5 days ago, then 7 days ago, those lower lows are telling you something. Next when you notice week after week it's failing to make new highs, at that point at least it's time to tighten up your stops.

I focus on closing prices. If you want to see the importance of that price, draw a line on close—it's like drawing a one day moving average and can be used as an indicator by itself. Just draw a line and think of it as a one-period moving average. You can more easily see a lower low or higher bottoms and higher highs. I call it a Line on Close [LOC].

One of the charts I use in my basic course has a bar chart on top and a line connecting the closes [LOC] below it. If you look at the bar chart there's a lot of activity and a lot of noise. If you look at the LOC it's usually very smooth and will give you objective information about direction. The market can swing during the day, but it's the close that hits traders in the pocketbook. And why is this information is so important? The closing price will show whether your entry point is showing a profit or loss.

I really respect and admire the people who can use the 1-minute, 3-minute or 5-minute charts, but I don't ever want to be tied to a computer myself. While my work and analysis is applicable to all time frames, I prefer to take positions based on longer-term charts (hour and daily). Even if news hits the market during the trading session that sways it one way or the other for a little while, but at the end of the day most of the news is reflected in that closing price. The bigger position traders are making decisions on a closing basis – they're not sitting in front of their computer putting in small orders while watching 5-minute charts. They're scaling in and their scaling out of their positions.

Big position traders go in, place stops and when the position starts a favorable move they add to it. They raise the stop to help minimize their risk. Risk can never be eliminated, but it can be identified and managed, and used to protect profits. When something starts moving it goes from risking money in a trade to managing profits of a trade. This is where the LOC provides better information about the trend and the trader has a much better sense of

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where he is in reference to the close.

By the end of the day sometimes people say, "I've had enough" and get out before the close; they don't even want to see that close because they've been fighting with it enough. By watching the closing price—whether it's on a weekly chart, daily chart or an hourly chart—you can learn patience. You can remain more objective using closing prices and can then start using highs and lows when monitoring the trend.

I don't say a market has bottomed, I say "It looks like the market is bottoming because it's holding a certain level." Then I'll look at short-term charts to see if it's building a base. I'm a technician, but I also know the economic side. I understand that what you see technically is more information than what you'll get from fundamentals.

The technicals provide a sounder base for decision-making because you can look at statistics and probabilities too. Most people look at risk versus reward, but they look at reward first. They think "if it goes up from here I'll make this much." They're not willing to identify the risk right away or they'll use a money management stop of $500. I say identify where you're wrong first and the profits will take care of themselves. So I look at the risk first …I think, "I'm wrong if it does this." That way again I'm letting the market show me what it wants to do.

In lectures I've asked crowds how many would take a reward-to-risk of 2:1, 3:1, or 4:1. Then I discuss the probability of the outcome. Do you want to take a 3:1 trade that has a 50% chance of happening? Most people will. I consider probability first and then determine risk and rewards. When I go to play golf, if there's a 50% chance of rain I'm not going. If there's a 10 or 15% chance of rain, then I'm going to the golf course. People need to look at their trading the same way. If I risk $1 to make $3 and these patterns and statistics tend to be right 65% of the time, the trade is worth considering.

Q: What about system trading?

AC: When you're trading a black box system if something goes wrong you may not understand why. I encounter people who tell me they bought a software system that includes a bunch of algorithms. When I ask them what's in it, they can't tell me how it's calculated or what it means. All they say is that it hasn't taken more than 4 or 5 losses in a row. At that point I have to ask them why they don't use something where they know the inputs so they know when a market is behaving normally or abnormally.

Systems are what you take to Vegas, trading plans are what you take to the markets. If you learn the technical side of the market first, understanding an indicator backward and forward, you can then learn the personality of the market. At that point you know when it's behaving normally or abnormally. That was something I picked up from and discussed at length with George Lane—the importance of learning a market's personality (yes, different markets do have different personalities).

Q: What challenges do you feel people face in today's equity markets?

AC: Markets don't change, individuals do.

People start trading on the bended knee with hope and prayers saying, "I have to do something; the market has been down so long. This is a new low, maybe we're going to have a reversal and it's going to go up." Then you do get a reversal and it's only profit-taking, short covering rally and everybody gets all excited that the bottom is in. Or if they see a bullish divergence, they think the end is there. But in my course I explain bullish divergences come in downtrends. People take profits in bullish divergences, that is, the ones who understand trend. The market may rally, but new targets should probably be set to the downside.

People forget that bear market means downtrend and there's no rule that it has to stop and reverse after a decline of just 20%. A lot of traders think the market is always in an uptrend unless it's in a correction. It always comes back, until it doesn't. I tell them "There are such things as down trends". The technical approach is so much better than reading headlines, or listening to people on business channels because the media by nature is bullish. They're going to have more analysts that are bullish than those that are honest. I say honest rather than bearish. That's because everybody likes an uptrend. But when you look at RSI or simply price closes and moving averages, you see for yourself what's happening.

When looking at the situation back in 1987, I thought the stock market had trouble written all over it. But even after the initial decline in August and September, people kept asking me what to buy. The first order of business is to protect what you have. If that means taking a trade off, that means taking a trade off, even if you don't opt to take the reverse position. At least adjust things so if a position is not making money, at least you're losing not it.

I don't really care what I'm trading; I let the technicals and the market show me what to trade. I don't have favorites. If the market is in an uptrend I want to be long and if it's in a downtrend I want to be short and if it's in a gray area, I don't want to be in it at all. Either stay on the sidelines or move to a different market.

Honestly, I never know where the market is going. I have an opinion based on probability, risk, pattern recognition and everything in terms of trend and trade models. It's not until the market starts moving and confirms the move that I feel comfortable. I do not try to pick bottoms; I try to get in close to the bottom, but I don't try to pick it. A lot of people have been trying to pick a bottom for the last 6-8 weeks. As you start to get more confirmation and increased confidence, you can manage a position that is still working in your favor.

Once in a position you have to manage it based on the way it is moving. If it continues to build profits, raise your stop. That way you're minimizing your risk while also protecting your profits. But if the position is not moving or if it seems to be stalling out then tighten your stops more quickly. Once again, you're allowing the market show you what it wants to do. You're not making as many decisions because as I have tried to point out, it's not the quantity of the decisions that make money, it's the quality. Quantity means you're putting money at risk. Quality means you're determining and investing in good trades or positions, and for the most part you are in tune with the discernible underlying trend.

Q: What do you like best about trading?

AC: The fascination and challenge that the markets present. Every market is different everyday and seems to move sometimes without reason. The technical structure will help you determine the reason, but it may not show up or be known until later. But it's also about the ability to determine (and control) your own destiny and have the freedom and lifestyle everyone dreams of achieving.

Q: Will you ever completely walk away from the markets?

AC: I doubt I ever will completely walk away. I just love the markets, the challenges and enjoy working with, and helping, my students achieve their dreams and goals.

CW: Thank you again for getting together with these great insights for traders.

AC: Thank you for allowing me to share my insights and help people.

The Perfect Way to End this Article

A couple of weeks ago Mr. Cardwell told me about his initial contact with Welles Wilder. While visiting family in North Carolina Andrew Cardwell had the opportunity to meet with Welles Wilder and although he was not feeling 100% on that day, the two were able to get together to discuss each other's work.As the story goes, Mr. Cardwell expressed to Mr. Wilder that he really liked what he did with the RSI. Mr. Wilder returned the compliment letting Mr. Cardwell know that he really liked what he had done with the RSI.

Clare White, CMT, is a Contributing Writer and Options Strategist at Optionetics.com. She can be reached at cwhite@invelocity.com. Andrew Cardwell welcomes questions and comments about his work and can be reached at cardwellrsi@hotmail.com.