IS SWING TRADING THE PERFECT TIMEFRAME?

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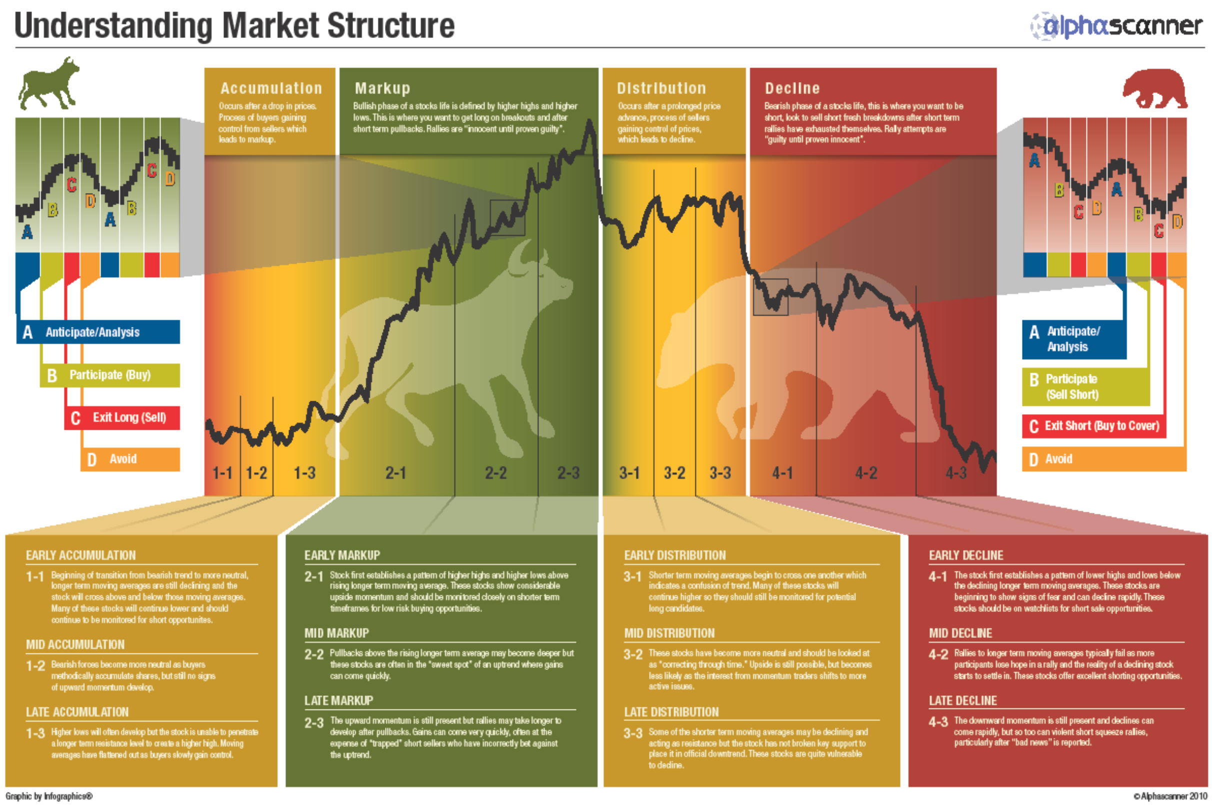
Do you categorize yourself as a long term investor, a day trader or maybe something in between? If you are like many people, you do not have the patience of Warren Buffet or maybe don't trust the market as a place to keep your money at risk for long periods of time. You also may not have the time, experience or interest in being tied to your trading computer all day long to beat the odds as a successful day trader. **For many people, the perfect timeframe to engage the market is anywhere from one to five days, this holding timeframe is known as swing trading.**

Swing traders attempt to have their money in stocks when they are moving, lock in profits as momentum wanes and then patiently wait for new low risk opportunities to reveal themselves before getting back into the same stock or a different one. The goal is to leverage time and capital by avoiding the natural pullbacks within a trend. If done properly it allows for a steady and consistent growth of capital while avoiding large losses.

Whether the trend is up or down, the low risk strategy to capture trading profits is to trade in the direction of the primary trend. Swing trading is synonymous with trend trading and for this article we will refer to trading long, but realize that the same principles apply to short sales, except we would start with a stock in a down trend.

Any trading strategy should be based on a solid understanding of market structure. There is a definite cyclical flow of money in and out of assets and this rhythm can be observed on charts of almost all timeframes. The graphic below is a reference to the various stages of a stocks life cycle, print it out as a handy reference tool for understanding market structure better.



While in a trend, stocks tend to thrust and correct it is the "thrust" that we look to capture as swing traders while avoiding the corrections. By the way, corrections don't always mean a price pullback, stocks can correct by price or through time. Time corrections are typically considered stronger candidates for trend continuation than a price correction because it shows an underlying bid (demand) for the stock at current prices.

Notice in the chart below that regardless of the timeframe (from years on the weekly chart down to just one day using one minute increments of time) the behavior of a trending stock is generally the same. An uptrend is defined as "higher highs and higher lows" and all of the stocks below show that pattern. The up trending action looks like a staircase the stock is ascending, with prior levels of resistance (red horizontal line) often acting as support (green) for price. Our objective is to purchase the stock *after* a period of consolidation or a price pullback has run its course. We do not want to buy as the stock is pulling back because we can never be sure if it will turn into a reversal. As we will cover below , we want to avoid the pullbacks and then anticipate the resumption of price momentum before we put our money at risk.

Avoiding corrections is the goal when your money is sidelined, but the flipside of being in cash is the risk of opportunity. Like it or not, you will miss many good trades as you wait for the right moment to buy a stock you have been watching but the stock doesn't give you the opportunity for a low risk purchase. It is frustrating to patiently wait for a stock to setup properly and then pass on buying it because the risk/reward changes. Missing a trade is much better than chasing a move which is underway and exposing equity to a larger price pullback. As it is said, "it is better to be on the sidelines in cash wishing you were in, than it is to be in the market and wishing you were on the sidelines." For most people the emotional discomfort from losing money is greater than the sense of pride or happiness from winning. This is a good response because it creates a natural aversion to large risks which can wipe us out, it is a built in survival mechanism.

At first glance, trend trading seems easy but what many participants fail to understand is that a stock can have conflicting trends in existence at the same time if they are look at more than one timeframe. A stock in a longer term uptrend over the last year may be in a downtrend over the last 2 weeks and just beginning to turn higher on a shorter term timeframe. These conflicting trends can create confusion about when to make a low risk (with decent upside potential) purchase of a stock.

The best strategy is one which not only protects us from immediate losses (or mitigates the inevitable losses when the market disagrees with our purchase) but we also want to make sure we are not one of the people who end up chasing short term strength and buying near the end of a move. Put differently, consistent success in the markets is obtained by implementing an approach which controls risk in the trade from the onset and has the potential for large rewards. Trend alignment is the strategy which can deliver on both of those goals. We want to be involved in the stock as the short term trend comes "into alignment" with the longer, more powerful trend.

If you fail to plan, you plan to fail ~ Ben Franklin

We need to have a plan that is based on a reasonable expectation of success relative to the perceived risk. Perhaps the strongest reasons to utilize technical analysis is that it allows us to determine our risk/reward prior to entering a trade, thereby putting our money at work in the positions where the opportunities for profit appear greatest. As I often point out, coming up with a risk/reward ratio is what programmers would call "garbage in, garbage out" meaning that if we are not objective about our analysis, or if our interpretation of the action is flawed, the theoretical risk reward ratio we determined is useless. The best way to come up with a risk reward ratio is to "listen to the message of the market."

ASK THESE TWO QUESTIONS

Before any money is put at risk in the market these two questions should be answered after we objectively analyze at least two timeframes

1- Where has the stock come from? RISK

If the stock has experienced a period of consolidation after a pullback in an uptrend I consider it to be less risky than a stock which has just "broken out" after a recent spurt of strength. In other words, a stock which has experienced a large move recently may have expended most of its energy getting to its current price compared to a stock which has paused and rebuilt energy. Look again at the action of the stocks on the various timeframes in the first chart. Our goal here is to identify a solid level of recent support under which we can place our stop, that way if the stock meets our entry parameters we will have our risk defined in advance. The closer our entry is to this support level, the less theoretical risk we have.

2-Where does the stock have the potential to go before it is likely to encounter a source of supply (resistance) which will halt the advance? REWARD

With this question, our objective is to determine whether the stock has expended most of its energy getting to where it is or if it is reasonable to expect further movement in the near term. For upside price targets we will look for prior levels of support that have the potential to become resistance, measured move targets and other techniques discussed in Alphatrends videos, in an attempt to identify if there is sufficient profit potential relative to the perceived risk we have already observed. It is important not to get stuck on these price targets, they are merely guides which help us to determine whether or not to enter the stock. Once we are in the stock our job is to manage risk, not to be starry eyed and expect the market to comply with our outlook. Risk management is always job #1!

To answer these questions and identify the best swing trade candidates we should begin with a chart which shows the trends of the last year or so (I usually look at 150-200 days) to make sure our trade candidate is in a primary uptrend and there aren't any large potential levels of resistance to slow the upward advance. A quick reference point to measure the primary trend is the 50 day moving average. We want to be aware of the slope of the moving average and we generally consider a stock with an ascending 50 DMA as "innocent until proven guilty." This is a simple way to be sure we have a stock where the path of least resistance is higher and warrants closer study on a shorter term timeframe.

As noted earlier, a stock with a primary uptrend may be in a shorter term downtrend and swing traders who are looking to participate in the primary trend we would want to avoid it during the pullbacks. The bullet points below outline how we want to analyze the shorter term trends to find the ideal point of entry, set our initial stop loss and then to manage our winners. A minimum of at least one other shorter term trend should be consulted to plan the trade properly, I prefer to use a 30 minute timeframe (approximately 25-45 days) with a 5 day moving average as a trend reference point.

COMBINING TIMEFRAMES

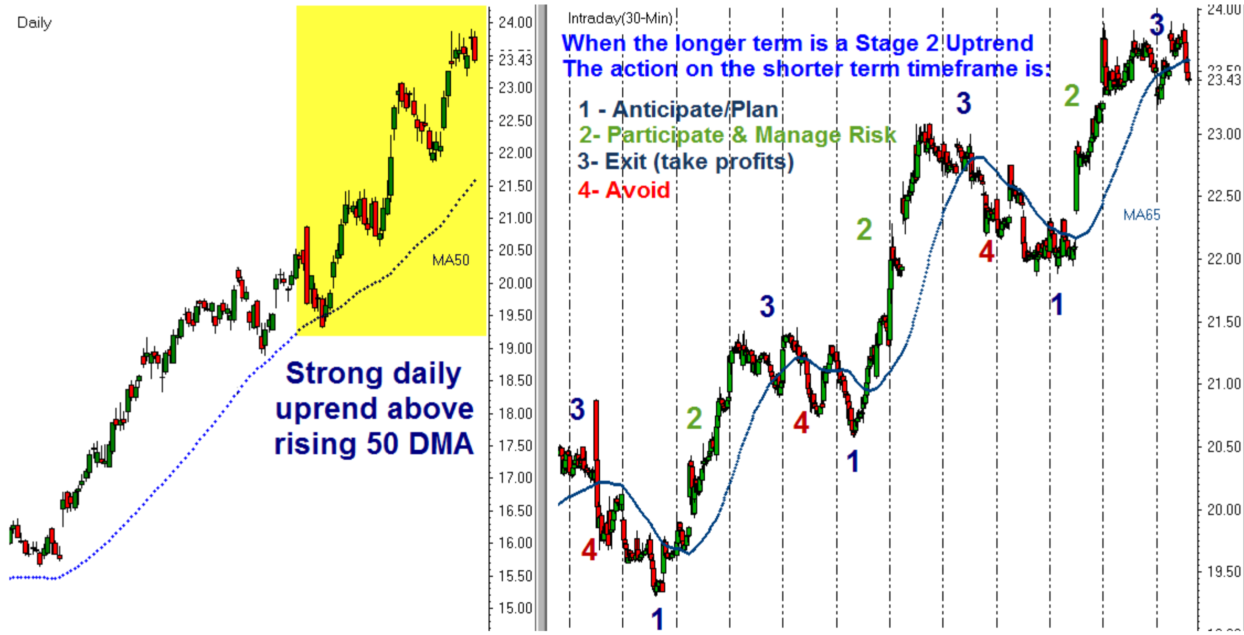
When the stock is in a longer term Stage 2 MARKUP and when the shorter term trend is:

Stage 1 Accumulation- This is where we do our planning. We observe, analyze and ANTICIAPTE the point where buyers will take control. This is the time assess our price objectives and stop levels to determine or plan of action when the stock gives us a reason to get involved.

Stage 2 Markup- As the stock makes a short term higher high, which is in alignment with the longer term trend, we want to purchase the stock. This is when we PARTICIPATE in what appears to be a reassertion of the uptrend on the longer term timeframe. Stage 2 is also where we manage our winners by raising the stop just below under higher lows as the stock rallies, this is the fun part!

Stage 3 Distribution- This is when the stock begins to show signs of fatigue and may precede a price pullback or be in need of a "correction through time." This is a good point to EXIT the position or at least lock in partial profits, rather than continue to expose our capital to risk. Once the definition of trend no longer exists "higher high and higher lows" there is no reason for a swing trader to continue to hold.

Stage 4 Decline- When the primary trend (longer timeframe) is higher it is likely that it is just the beginning of a pullback rather than a longer term reversal so the odds do not favor profitable short sales. It is better to AVOID these stocks and look for better setups where trends are coming into alignment.



The image above shows the daily chart on the left and the yellow highlighted section is magnified in the chart on the right. It should be easy to see why using more than one timeframe allows us much greater accuracy in our determination of where the trend of the daily and intraday timeframes become aligned. The numbers on the chart on the right are the shorter term trend.

Simplicity is the ultimate sophistication ~ Leonardo da Vinci

The stock market is not an easy place to make money but if you have a method which is based upon market structure, you size your trades well and implement your strategy with discipline YOU CAN be a success. When armed with a solid understanding of how the markets truly work you approach the market with confidence and achieve more consistent results. . I have been trading and teaching others to trade for nearly 20 years, I love the intellectual challenge, learning, teaching and helping others. Please consider a subscription to Alphatrends where we discuss these concepts with actionable ideas in detail every day.

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