

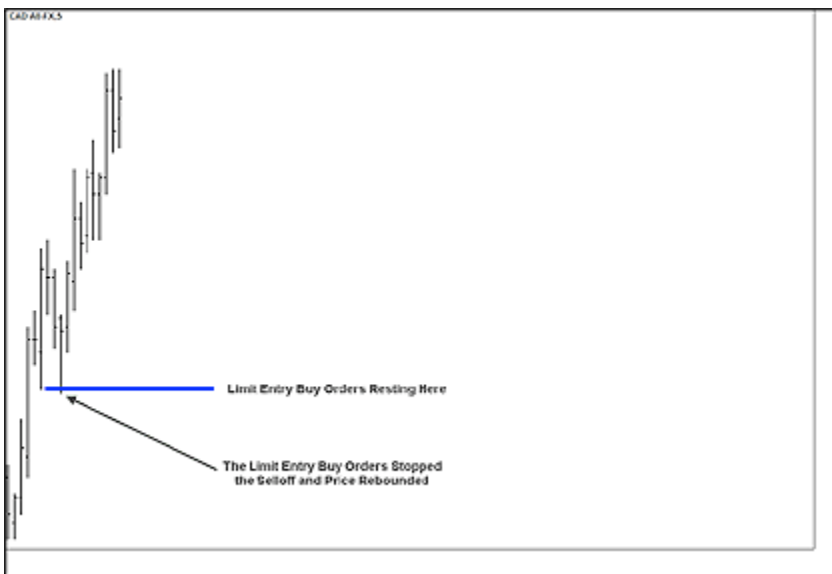
Tips for Traders | 3/30/2009 12:01:00 AM

## How to Tell Where Other Traders Have Placed Their Stop and Buy Orders

I find myself spending more and more time focusing on analyzing market structure, looking for the clues price has left right in front of me about its probable path. I still use my all of my normal tools: Median Lines, geometric or Fibonacci expansions and retracements, lines drawn from multiple tops and bottoms, and of course, solid money management and risk control.

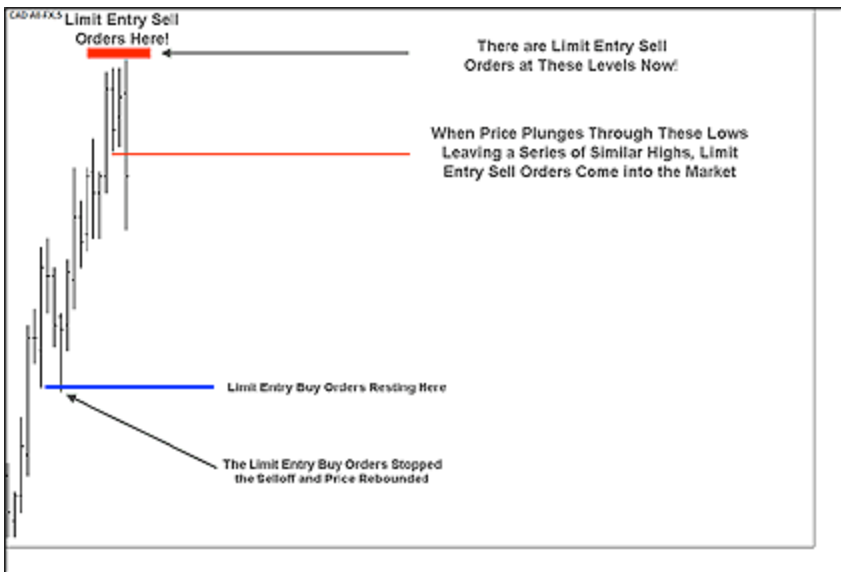
But the more I work with other traders trying to help them improve their trading, the more I realize just how much my successful trades rely on correctly reading market structure, identifying changes in the market's behavior, and knowing just where the majority of the market players are massing their buy and sell orders.

Let's look at a recent example in the Canadian dollar on a five-minute bar chart and see if I can show you what I mean:



On this first chart, I marked where I think there are limit entry buy orders with a thick blue line. This area is formed by the bottom of a wide range bar higher, and you can see that price pulled back to test this area and immediately found support here. If price comes back to this area, there are a large amount of limit buy orders left by traders that want to get long, but have not been able to get long on a pull back in price because price then rallied hard from this area of support.

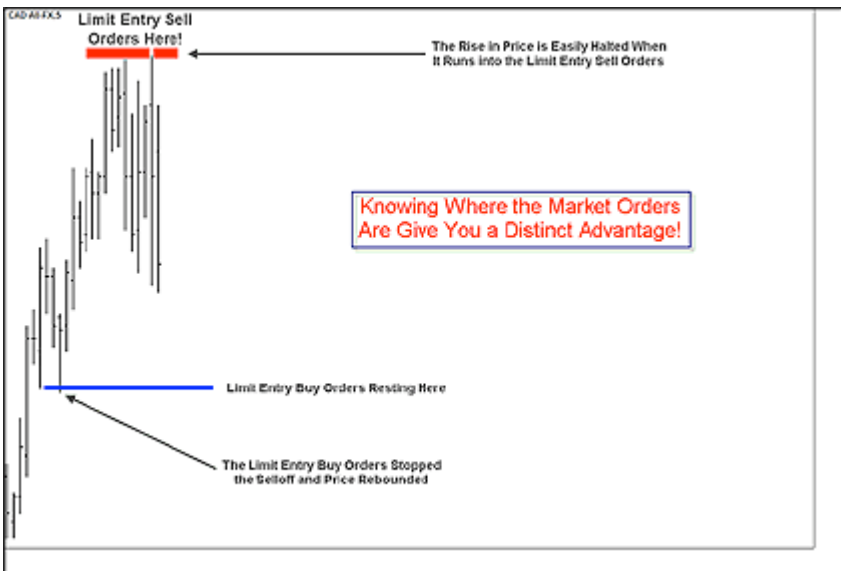
How do I know the market orders are where I marked them on this chart? I can tell by price's reaction when it tested the area.



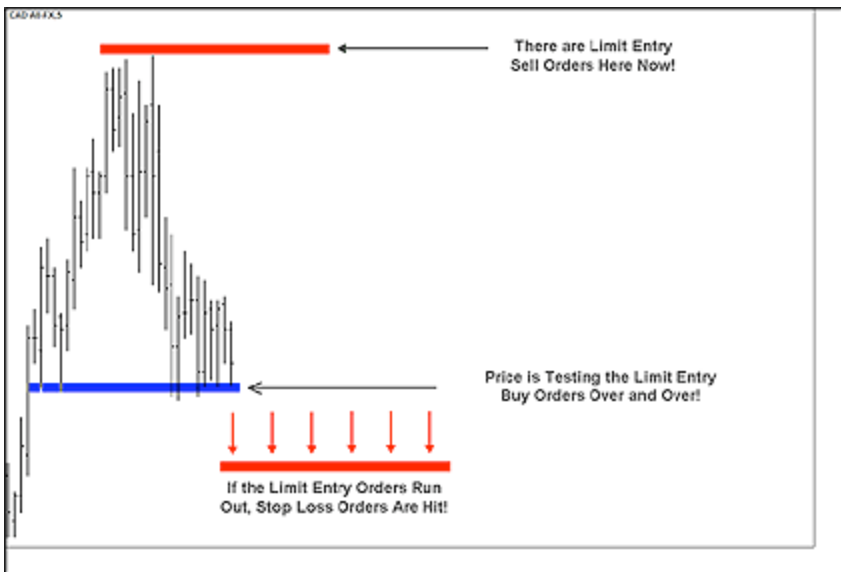
Now note that after price made three new highs—the last two had the same high, so they are called double tops—price made one last high and then plunged lower, easily breaking through the lows of the prior three bars.

This is a sign of weakness, so some traders are now willing to attempt to get short at the prior highs if the market rallies back there. They have left limit entry sell orders that will allow them to short this market at that level.

I have scouted out this chart, marking where I think market structure has left important areas of support and resistance. And I have also marked where I think the majority of traders will be leaving orders to try to exploit the short-term swings in this market. Let's see how these two areas come into play as the day goes forward.

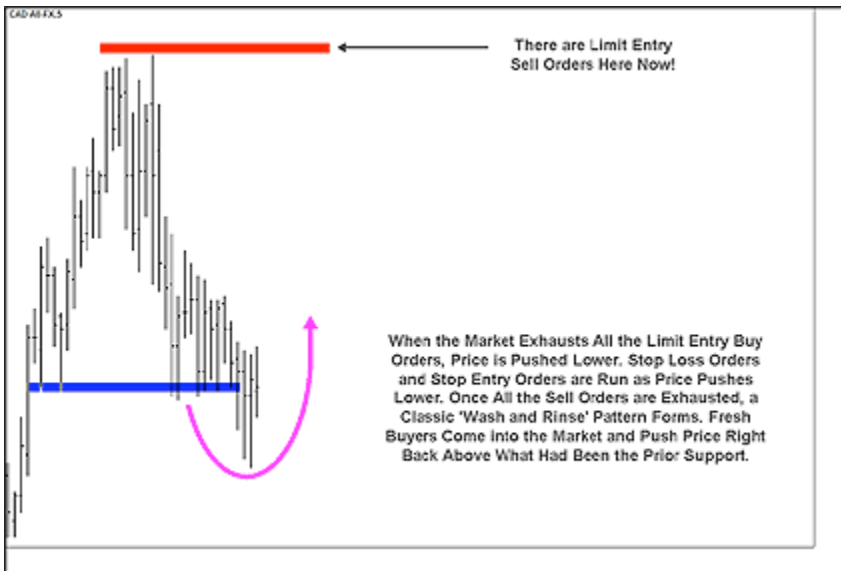


Price sells off a bit more before climbing back to re-test the prior highs. You can see that price had no ability to go higher once it got anywhere near the prior highs. The bar that tested that area was a wide range bar that closed well off its highs. This is a sign of weakness and it reinforces the view that there are a good amount of limit sell orders at that area.



After testing the highs and failing, price sold off and is now testing the area I marked where there should be a good amount of limit entry buy orders. Because price stopped here the last time price sold off and then rallied to new highs, many traders will initially be willing to attempt to go long at this area in an attempt to catch a bounce higher. It really is as simple as this: "It worked last time, I might as well try it this time."

If you look carefully, you'll see that while price is having a tough time breaking below and closing underneath this area, it is not bouncing back above it, either. You can see the highs of the bars are lower and lower and eventually, price is going to have to either rally hard out of this area or it will break below the set of limit buy orders and head lower.

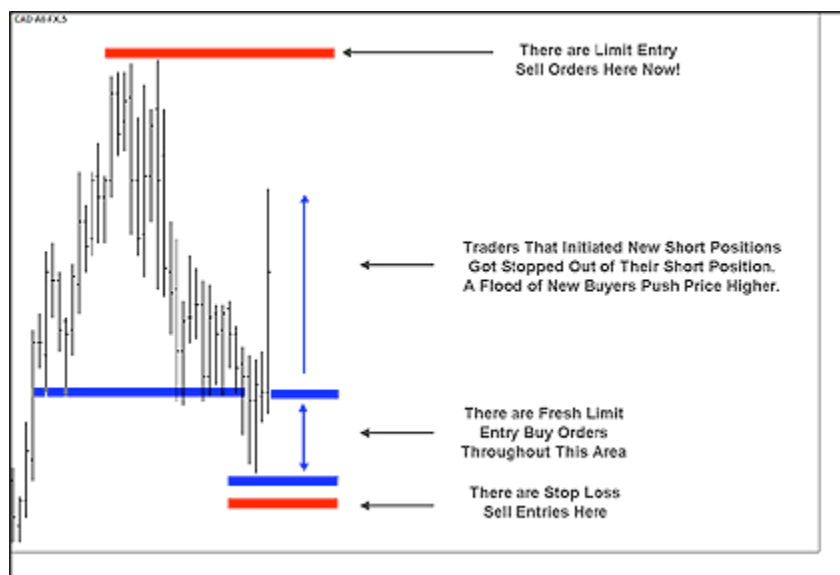


Either all the limit buy orders were filled, or more likely, the savvy traders pulled their limit orders and let the market plunge through the area where everyone thought the large set of limit buy orders were supporting the market. When price ran lower, the stop loss sell orders of traders that had just initiated new long positions at this perceived area of support began to be filled, and that helped push price even lower.

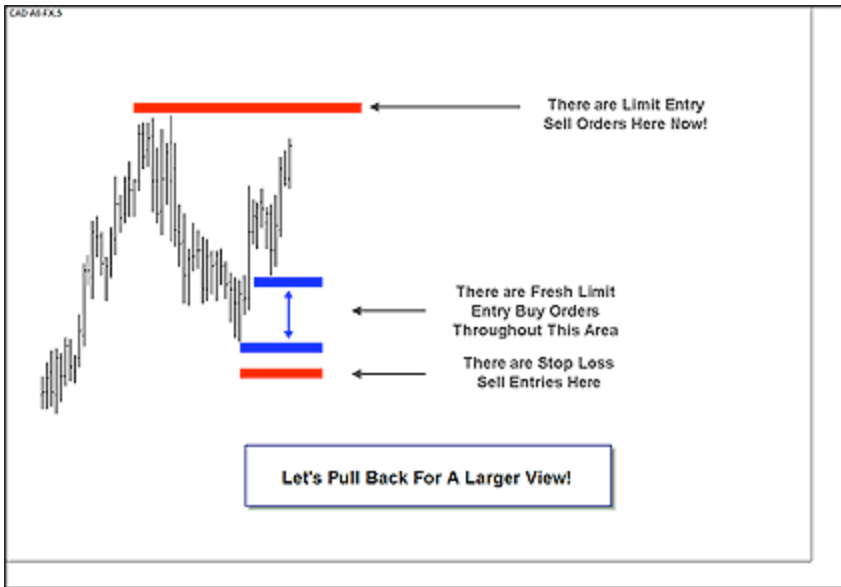
But you can see price didn't make a great deal of progress to the downside, and if you look at the closes of each of the last three bars, you'll see that they were closing at or above the original area of support.

The last bar says it all: Traders wanted to get long, because they thought they had a low-risk area protected by limit buy orders. But the savvy traders pulled their orders, letting price plunge. Once the weak long positions had been washed out of the market, the savvy traders were able to come back into the market and buy right where they originally wanted to get long. Except now, the rest of the market wasn't long as well! If the traders who had just gotten stopped out of their new long positions wanted to get long again, they would have to chase price higher. This is a classic "wash and rinse," and if you find yourself a victim of it, it can be quite maddening!

On the drive to new lows, some traders actually got short, and now they are being forced to liquidate their short positions. Price rallies hard on the combination of traders covering their short positions and traders who wanted to get long but ended up stopped out now getting long at the market.



Believe me, chasing the market is never a good idea! This chart updates the areas of support and resistance a bit, adjusted for the "wash and rinse" area. Let's see if we can identify an area for a high-probability trade set up.



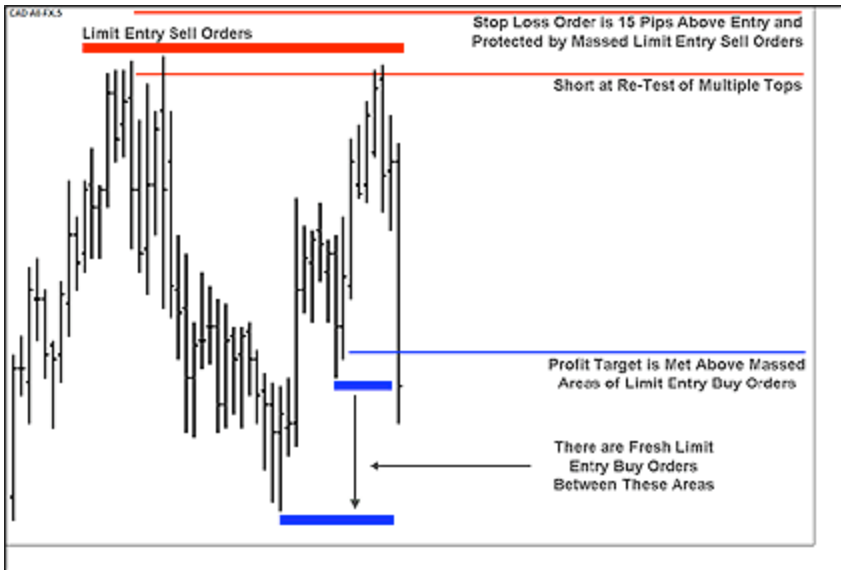
Price continues to climb higher. It's possible price will bounce around within this trading range, but in my mind, it's more likely price will interact again with the areas I have marked as structure hiding limit buy and sell areas. If it gets to one of these areas, we'll try to take advantage of this market map.

Now I see something that interests me: If price climbs just a little higher, I will sell the Canadian dollar just below where the original double tops formed. There should be a good amount of limit entry sell orders above this area, since it has been tested several times and acted as very good resistance.



If I am filled on my short entry, my initial stop loss will be 15 pips higher, which will be well above the area that should be holding the resting limit sell orders. To be honest, if price goes much higher than that, I no longer want to be short!

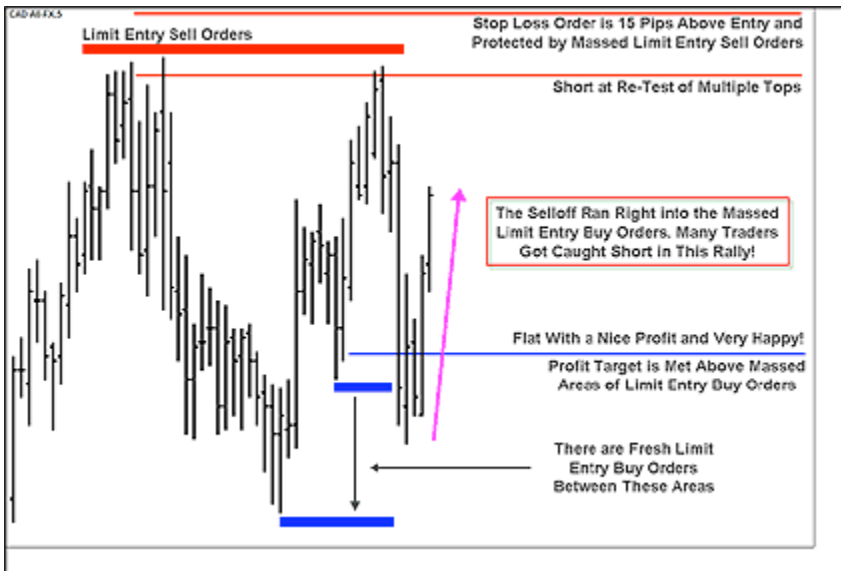
What can I use as my downside logical profit target? Price really did stop at its natural support. The "wash and rinse" move by the savvy traders extended the selloff a bit, but I still think the first area of support will be hard to get below. If I manage to get short, I'll take my profit as price approaches this first area of support, right above where I think the limit buy orders are hiding.



Price rallied a few bars higher, testing the earlier highs but not making a new high for the move. Because I chose a more aggressive entry in front of the limit sell orders, I managed to get short the Canadian dollar before it turned lower.

Several bars after I got short, price spiked lower with a wide range bar and my limit buy profit order was filled. You can see price did head even lower, so perhaps I was too conservative? Maybe price has begun a major push lower now!

Price could not stay below the natural area of support. There were indeed many limit buy orders in this area, and you can see by the price action that soon, traders were scrambling to buy the Canadian dollar.



I'm quite pleased with the results of the trade and even happier about the accuracy of my market map.

One of the most important things I teach the traders I mentor is "Plan your trade and trade your plan." You can see here that though there was a point in time where it would have been easy to question the plan, in the end, the plan was pretty darn good!

One last thought: When you sit down and do your pre-market analysis, always try to determine where the majority of the market is hiding their limit buy and sell orders. Update this market map as the day goes on. After you've practiced it for a while, you'll find it's an invaluable tool in your trading arsenal.

I wish you all good trading!

Best,

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