Tips for Traders | 10/27/2008 8:54:00 AM

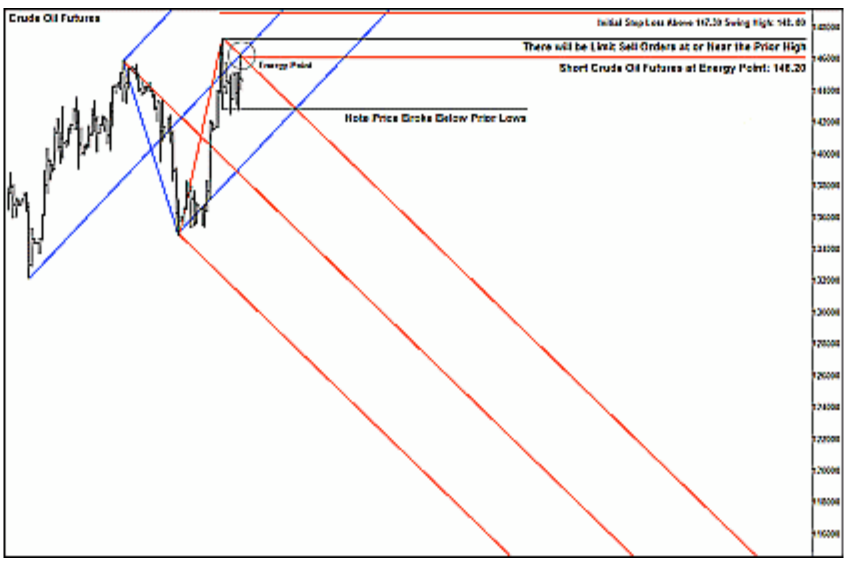
Supercharge Your Stop Orders!

Let's face it: most traders hate stops. They just know in the back of their mind that if they put a stop above (or below) their position, the market will find their stop-loss order, fill it, and then return to the trend, leaving them feeling they had the right idea but with no profit to show for it. This is such a prevalent belief, it must have some basis in fact. Or does it?

I have been a professional trader for more than 37 years. I am known for two things:

1. I am probably the world's authority on Median Lines [or pitchforks]
2. I am a master at using surgeon-like money management techniques when managing trades to "box in" and milk the most profit out of my trades. I want to show you some examples of how I use the market action and *your* orders sitting in the market to maximize *my* profits.

As we look at these images, I am not going to focus on the entry or profit target technique; instead, I want to show you how you can use market formations and *other traders'* orders to greatly improve your profitability. Let's look at a chart of crude oil futures:



Looking at the first chart, crude oil futures have come off their high of $147.30 a barrel. Once price began breaking through prior lows, I added in a down sloping red Median Line Set and its Parallel Lines. This left me with an up sloping and a down sloping set of lines-and an Energy Point, where two lines of opposing force meet, just below the high for the move. I know from my research that Energy Points act as price attractors and are also high-probability areas for changes in trends. Because oil prices seem to be showing some weakness and have come so far to the upside so fast, I put an order in the market to get short crude oil futures at the Energy Point with an initial stop loss order $2.50 a barrel above the prior high.

Since the majority of traders either use lagging indicators (MACD, oscillators, moving averages, CCI, etc.), at this point their indicators have yet to turn lower; the majority of the traders in this market are long or flat. And the few traders that use other methods are most likely working limit sell orders at or near the recent swing high, the all-time high for the move. I use Median Lines because very few traders use Median Lines as their main trading tool. Not only are they are a leading indicator, they also have a known statistical probability the moment they are drawn from three alternating pivots. The leading indicators I use, Median Lines, tell me there is a good probability that a major turn in oil futures has just occurred. I am short at the Energy Point, where an up sloping Median Line and a down sloping Median Line Parallel meet. But why put my stop loss order where I put it?

As I pointed out earlier, any traders willing to go short are most likely working limit sell entry orders at or near the prior high. These orders will act as a buffer if price approaches this level. If I am correct, either price will never make it high enough to test this level or the resting limit sell entry orders will slow or stop price's advance, protecting my stop-loss order hiding several dollars above these orders; if I am wrong, I'll be stopped out, and that is a normal part of trading.

Price consolidated a bit and then headed higher. It ran right into the limit sell entry orders in this case, and those orders slowed the advance of price, which failed to make a new high. Several bars later, when some of the traders that had left limit sell orders became frustrated at not being filled, sell orders began to flood the crude oil market. Once prior lows were taken out to the downside, the sell off became swift and steep as traders who were long scrambled to dump their position, and traders who had tried and failed to enter short crude positions at the prior high now looked for areas to get short.

At the close of this wide range bar lower, I canceled my initial stop-loss order and put in a break even stop-loss order. As soon as market structure gave me an opportunity, I would try to box in some profits.

After a huge $10 wide bar lower, price pulled back up about two and a half dollars a barrel and then consolidated in a trading range for four or five bars before starting to sell off again. Once price made a new low for the move, it confirmed a new swing high at the top of the consolidation. This new low in price is extremely important, because the aggressive sellers who had been working limit sell orders at the prior highs would now move their limit sell entry orders at or near the new swing high.

Because these traders have now lowered their limit sell entry orders, I am now able to move my own break even stop loss order to $2 ½ dollars above the just made swing high—because these new orders will be my new protection! Once again, these orders will act as a buffer if price approaches this level. If I am correct, either price will never make it high enough to test this level or the resting limit sell entry orders will slow or stop price's advance, protecting my stop-loss order hiding several dollars above these orders; if I am wrong, I'll be stopped out for a profit.

Once again, price plunges lower and then consolidates. This time, it spikes $2 dollars above the consolidation but then sells off hard again. Once price makes another new low for this move, a new swing high is confirmed. Again, this new low in price is extremely important, because the aggressive sellers that had been working limit sell orders at the prior highs would now move their limit sell entry orders at or near the new swing high.

Because these traders have now lowered their limit sell entry orders, I am now able to move my own break even stop-loss order to two-and-a-half dollars above the just made swing high-because these new orders will be my new protection! Once again, these orders will act as a buffer if price approaches this level. If I am correct, either price will never make it high enough to test this level or the resting limit sell entry orders will slow or stop price's advance, protecting my stop-loss order hiding several dollars above these orders; if I am wrong, I'll be stopped out for a profit.

You can see that this pattern continued over and over and I took my profits just above $120 a barrel. After staying away from the crude market for a few weeks, I was able to initiate another short position and rode it lower for more than another $45 a barrel using the same techniques.

The key lesson here is using *other* traders' orders as protection for *your own* orders. You can hide your orders above limit sell orders or below limit buy orders. These orders may be clustered at a certain area because of prior highs or lows, swing highs or swing lows, Geometric Ratio Levels (most of you call them Fib ratios), or even simple trend lines. But the most important thing is that you need to practice to anticipate where market orders are bunched-both limit entry orders and stop loss orders-and then learn how to use those orders to your advantage. I work with the few traders I mentor one-on-one with market context and anticipating where orders are likely clustered during a part of each session.

These orders are free protection-you need to learn how to use them to your advantage if you want to learn to improve your money management abilities. Money management topics are not as sexy as entry techniques or flashy new indicators, but quality money management can truly make the difference between being a winning trader or being in the majority of traders that open $10,000 accounts and lose all their money within three months.

Take the time to learn to supercharge your stops. It will make a tremendous difference in your trading. Once you begin using technique like these, you'll stop getting "washed and rinsed" at the tops and bottoms of moves by a tick or two; instead, price will get near your stop orders and the majority of the time, turn back towards the trend because the resting limit entry orders protected your stops.

I wish you good trading.

Timothy Morge

timmorge@gmail.com
www.medianline.com
www.marketgeometry.com

Timothy Morge
President
MarketGeometrics, and Blackthorne Capital, Inc.
Web sites: www.marketgeometry.com or www.medianline.com