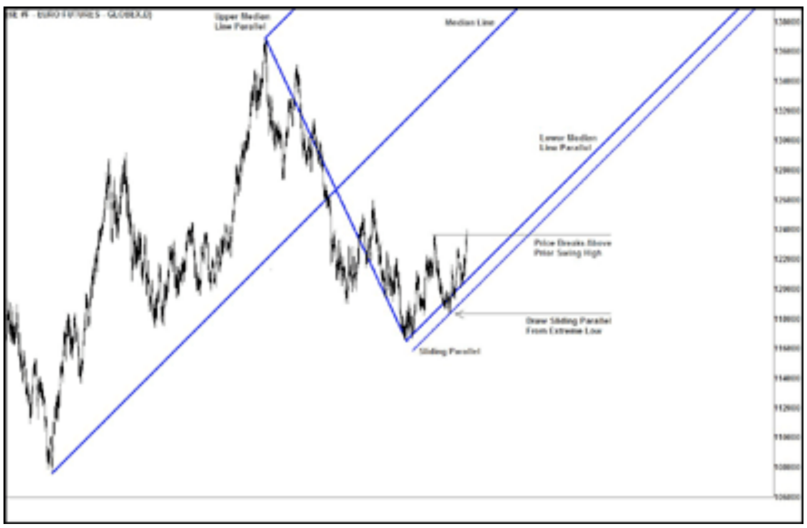
Tips for Traders | 5/12/2008

Riding the Waves: Managing Longer-Term Position Trades for Larger Profits

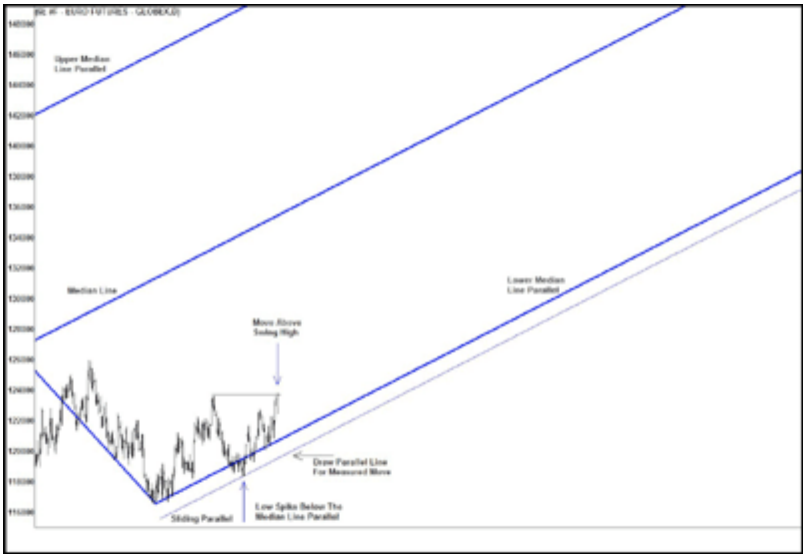
Many traders look at longer-term charts and see the large moves that can occur on these longer time frames. But not many traders catch these large moves. Is it impossible? The key to catching these large moves is using a low amount of leverage to limit your exposure, finding a high probability entry set up with an initial stop loss order that is tucked above or below a market formation and then using sound money management orders to 'box in' profits as they accrue.

Let's look at a daily chart of the euro FX futures from early April, 2006:

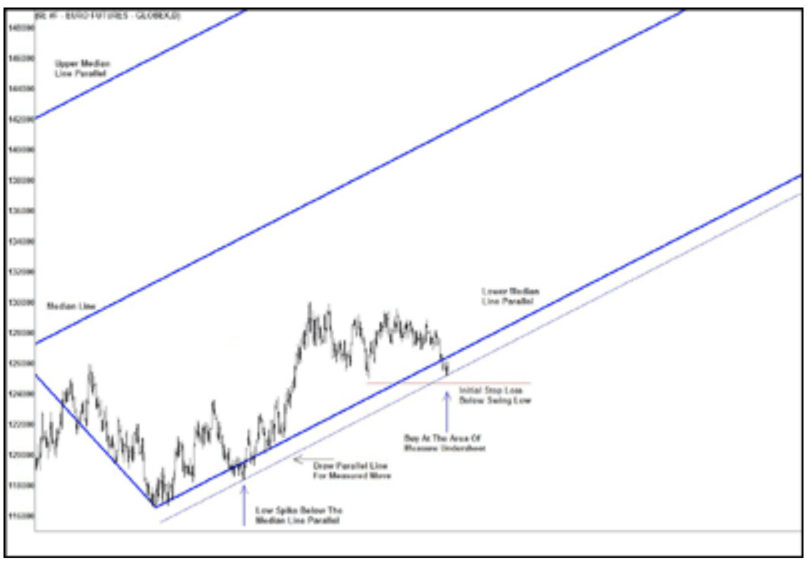


You can see that the euro had appreciated significantly against the US dollar after September 2003 and then began a fairly steep pullback. As always, the question is this: Has the longer-term trend changed to the down side or is this a pullback in a long-term up trend? Price does turn back higher and begins climbing above prior swing highs but it then trades lower and briefly moves below the lower median line parallel. When price closes back above the lower median line parallel, it is a sign of strength and that strength is further confirmed when price makes a new high for this move, breaking above the prior swing high.

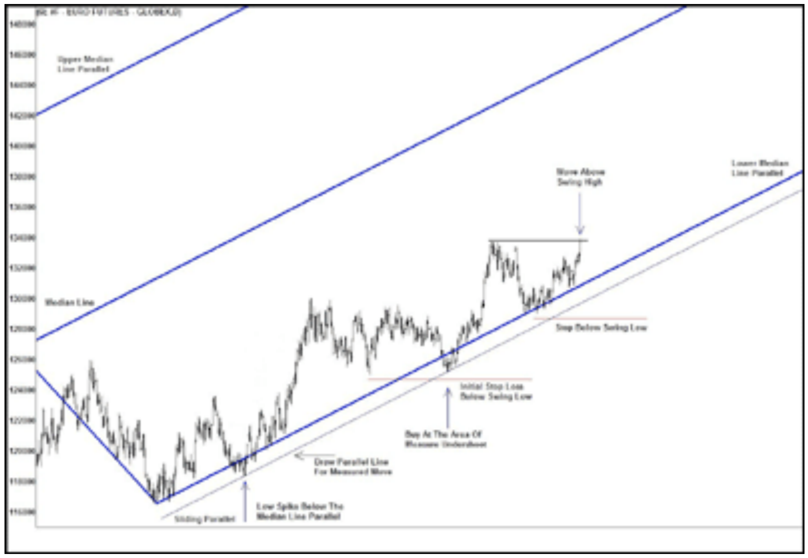
At that point, I draw in a sliding parallel, a line that carries the same slope as the lower median line but is drawn off the extreme low made below the lower median line parallel. This line should now contain any price pullbacks *if* price is now in an up trend.



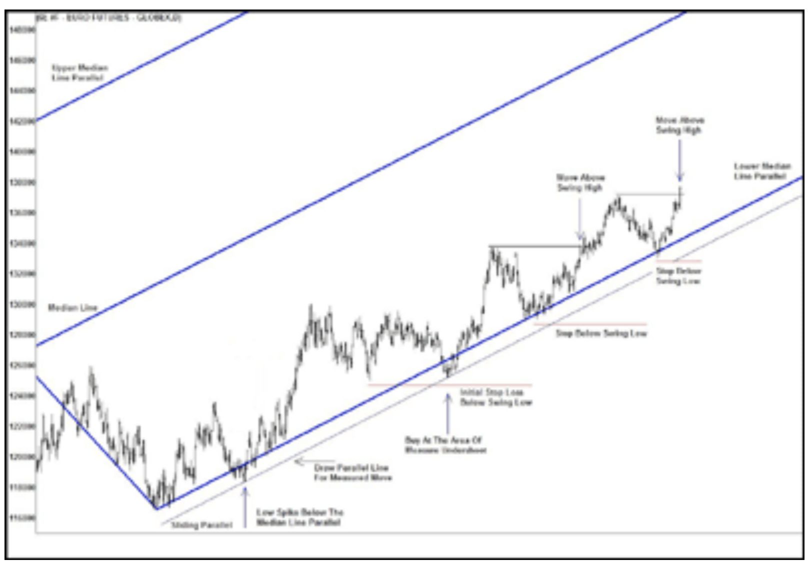
Here's a closer look at the same chart so you can clearly see the price action as it breaks below the lower median line parallel and then closes back above it. You can see that as price breaks above swing highs, I add in the sliding parallel.



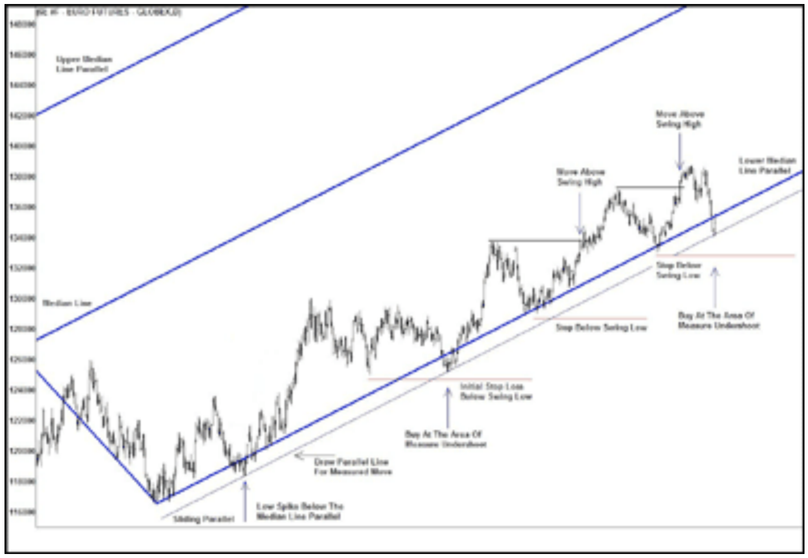
When price comes back down to test the sliding parallel below the lower median line parallel, I initiate a long euro FX position at 1.2538, with a stop 15-ticks below the prior swing low, at 1.2488. I believe this has all the makings of a long-term up trend that could take months to unfold. The key is to find an area that allows me to hide my initial stop loss order underneath a market formation, where buyers are likely to come into the market. These new buyers should act as a buffer, protecting my stop loss order from being filled unless I am truly wrong about the direction of this market.



Good things come to those that wait, or so I am told. About five months later, after an orderly climb, price climbs above a prior swing high just above 1.3450. When price makes takes out this swing high, I cancel my initial stop loss order and move it below the latest swing low, at 1.2888. I have a nice profit locked into this trade now [more than 300 ticks], but I think this is just the beginning of a major move higher. My goal on this trade will be to catch a ride to the median line, a move more than 800 points from the current price. To do this, I will have to strike a careful balance between protecting my 'boxed in' profits and not moving my stop profit orders too close to the current price action.



Longer-term trading takes patience and attention to detail. Several months later, price makes what appears to be a significant high and then sells off to test the up sloping lower median line. It then bounces out of the hole. When it makes a new high for the move, I move my stop profit order from 1.2888 to just below the swing low at 1.3306. Once again, it is a balancing act of protecting some of the potential profits I have in this longer-term trade while still leaving my stop profit orders far enough away from the current action to give the trade the freedom to mature and hopefully trade up to meet my profit target-the up sloping median line.



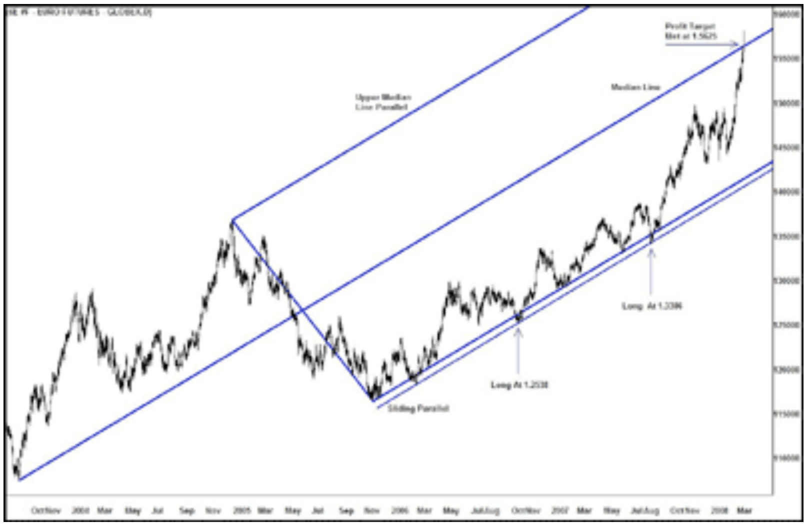
After making a new high, price again sells off, this time breaking through the lower median line parallel and tests the sliding parallel. Because I am less than 100 points from being profit stopped out of my original position as price tests the up sloping sliding parallel-and I still have almost 500 points in profits-I add a new long euro position at the test at 1.3386. I use the profit stop I am already using for the first long euro position at 1.3306 for this new position as well, since it is tucked below the prior swing low. I am now long one unit at 1.2538 and a second unit at 1.3386.

Once again, a little patience and careful planning goes a long way. Price climbs out of the hole and makes a new high for the move and when it breaks above the prior swing high, I move my stop order from 1.3306 to 1.3366, below the swing low that recently tested the sliding parallel and the area where I added my second position. I can continue to 'box in profits', as long as I don't get too close to the market's action.

How long can I ride this wave? I'll keep riding this wave higher until price either makes it to my profit target at the up sloping median line or price hits my trailing stop profit order. At this point, it doesn't matter which order gets hit—I stand to make a good amount of money per contract.

Patience generally does get rewarded and you can see price eventually begins to pull away from the lower median line parallel to the up side. I am eventually able to cancel my stop profit order at 1.3366 to 1.4013, just below the most recent swing low. I now have just under 1500 points of profit in the first long euro position and about 600 points of profit per contract in the second position.

I am still carefully balancing ‘boxing in profits’ without getting too close to the current price action, because the prices on this chart still look like they want to run higher and test the up sloping median line, and if possible, I want to protect some of my potential profits but still give this trade all the room it needs to mature.



Price finally makes it to the up sloping median line and I close out both positions at 1.5625. Though this was a very long-term trade, it paid off handsomely: I got long the first position in October of 2006 and netted just over $38,000 per contract; I entered the second position in August of 2007 and netted nearly $28,000 per contract. The wave was long and the ride demanded patience and a balancing act between protecting profits and letting the long-term trade mature. But by carefully hiding my stop orders below market structure, I was able to let this trade mature and stick with it for the long ride.

Catching these larger moves can be very profitable and extremely rewarding if you have the patience and perseverance to stay with the plan and ride the wave to its final destination.

I wish you all good trading!

Best,

Tim Morge
tmorge@sbcglobal.net
www.medianline.com
www.marketgeometry.com

Timothy Morge
President
MarketGeometrics, and Blackthorne Capital, Inc.