



retailtrader.net

Top-Down Trend Analysis For
Beginning Traders

A Free Report

Copyright 2009, Retailtrader.Net, LLC All Rights Reserved

You may distribute this e-book as a promotional item for your website or as a bonus gift - we only ask that the content and links to RetailTrader.Net remain in tact and that the e-book remain FREE.

A journey of a thousand miles begins with the first step.

Confucius

Hello Fellow Retail Traders,

And welcome to **your** journey. Today, I thought I'd put together a quick report to explain a little bit about how we at RetailTrader.Net view the market and the style of trading we engage in. With so many different ways to approach the markets and so many unique styles of trading, it's important that you become intimately aware of how any advisor or instructor approaches his or her trades before heeding their advice. Because so much market activity is based in psychology, it's imperative that you find a style of trading that matches YOUR personality.

With that said, let's move onto the topic at hand: how **we** trade the market, and how someone could learn to trade like we do if they so desired.

Through **RetailTrader.Net** I have been working on the idea of simplifying the concept of trading for a newbie trader for the better part of 2 years. Visiting forums. Answering newbie questions. And looking at the questions they ask.

Picasso said that it took him a lifetime to paint with the simplicity and innocence of a 5 year old and I believe that traders are after the same thing -- striving to return to the simplicity of that first buy or sell decision.

Mark Douglas of **Trading in the Zone** says that before we enter the trading arena we have no pain at all associated with the buying and selling of stocks. Then we place that first trade and begin to understand the difficulties associated with it.

If our first trades are losers, we cram our brains with technical knowledge sure that "education" is the answer. If our first trades are winners, we will inevitably escalate our position size until we blow up from over confidence. At this point we will either wash out and never return to the market or we will join the traders whose first trades were losers, and we will try and get that "education" we feel will prevent future losing trades and the psychological pains associated with it.

With that being said, is it possible to learn how to trade before actually trading? I'm not so sure. It's my belief that many traders mistake "trading" and "analysis" for the same thing.

The act of looking at the market, marking indicator values, support/resistance levels and the like is not the same thing as placing and managing a trade.

When I was a kid, I wanted to learn how to surf. I lived by the beach, saw people surfing every day, and knew I wanted to be a part of that lifestyle. What they were doing seemed simple enough. They hopped on their boards, paddled out, and caught wave after wave.

So I saved up my allowance, bought a board and proceeded to flail around for the better part of two summers before I began to get the hang of it.

Sure, other surfers offered advice (or snickers). You're getting up too early, some said. You're getting up too late others said. Your board's too big, some said. Your board's too small, others said.

And no matter what I did I couldn't stand up. Until the day that I did.

It wasn't a magical day. Or a different day. I was on the same board, doing the same things in the same way. But on this wave, it all clicked -- I was standing up and riding that wave.

From there it took me another couple years to understand the nuances of surfing and to really excel, and after that I was out in overhead surf, catching tubes and hitting lips.

Now, was there something I could have been told during that period to help my learning curve? I doubt it. The real secret came from perseverance, passion and experience.

The same is true for the markets. You know where they are. (all over the world) You know how to get to them. (through your

computer) You know how to hit the buy button, and you know how to hit the sell button. You should be aware of the different types of orders (market, limit, stop-loss) and what they mean.

Once you have that knowledge down you should start small. Don't paddle out on a double overhead day. Start on the small days. And take on more as you're comfortable.

Thinking back to surfing, I remember my first objective was just to stand up. After that I wanted to make it to the bottom of the wave. After that I wanted a good ride. Then I wanted to rip!

As a trader, I guess standing up would be that first profitable trade that just felt right.

The bottom of that first wave might be a profitable week/month/year.

And ripping might be getting in and out of trades with ease, targeting and isolating potentially profitable trades and executing them as they come up.

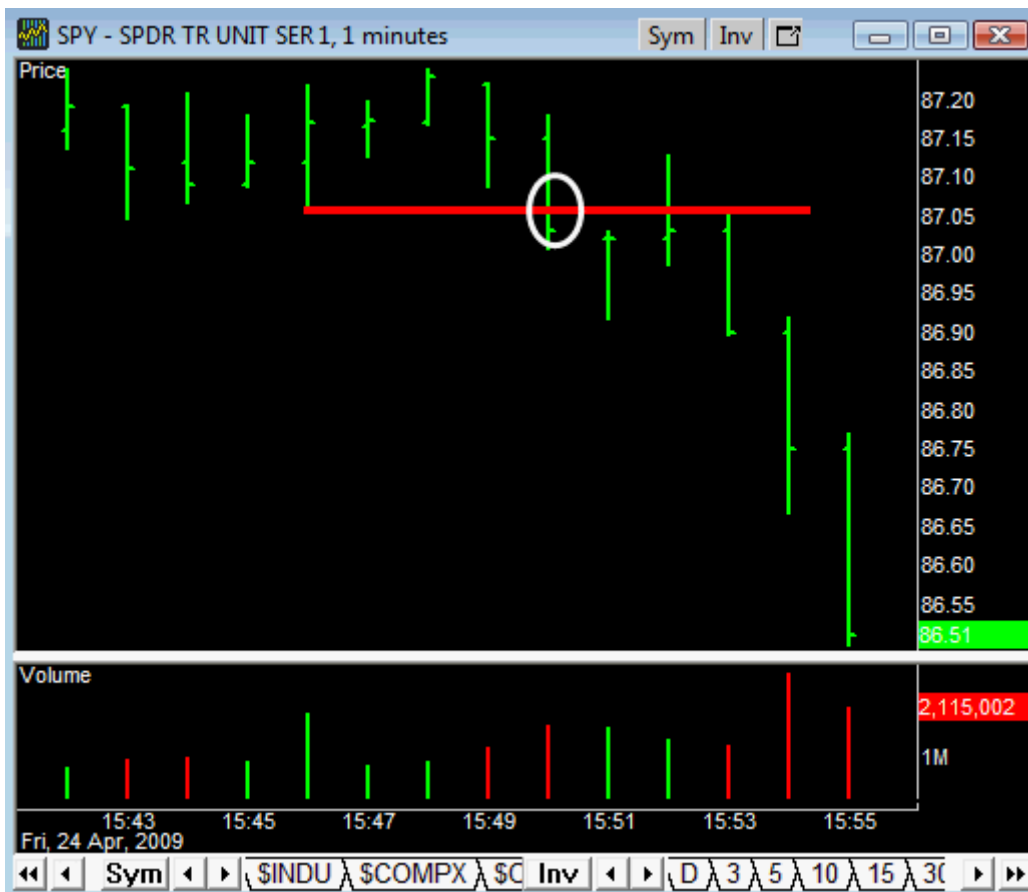
Now, when it comes to our analysis we use a method called "Top-Down Trading". What this means is that we start our analysis at the Index level and move down to the individual stock level. To do this you have to be aware of 4 important steps:

1. Market direction

Which way is the market going NOW -- on your time frame.

Obviously "now" doesn't mean right this second, it means what is the most recent trend of the market.

To highlight the difference, here are two charts. A one minute chart and a daily chart. First, the one minute intraday chart:



This is what is called an intraday chart, meaning all of the price action

takes place inside of a single day and the time frame is minutes to hours.

If you were taking trades based on information from this particular chart, your trades could be as short as 1 minute or as long 15 minutes and looking at what it is saying about price action "now" you would want to be "short" because the trend on your time frame would be down.

Now, take a look at this daily chart of the SPY which includes the price action highlighted in the one minute chart above:



Now, the trend is up. And as such I would want to be long. I might even want to be in cash if I'm not sure about the consolidating/muddled price action lately -- especially with that wide range down bar a few days back.

So there is step one. What is the market doing on your time frame -- going up (long) down (short) or sideways/who knows (cash).

Why is it important that you trade in line with the general direction of the market? One word: **probabilities**. As an example, Here is a chart of the S&P 500 from 2007.



If you take a look at the chart of the S&P 500 from November of 2007 you'll see that over a span of three and a half months the S&P 500 experienced 2 nearly identical moves. One up and one down. They're nearly the same distance and took nearly the same amount of time. Now, during the up move we had the following statistics from stocks composing the S&P 500.:

DURING UP MOVE (August 16, 2007 thru October 11, 2007)

Biggest Gain: 55.28%

Stocks that gained greater than 5%: 333 stocks

Stocks that gained greater than 0%: 421 stocks

Biggest Loss: -28.19%

DURING DOWN MOVE (October 12, 2007 thru November 26, 2007)

Biggest Gain: 34.37%

Stocks that gained greater than 5%: 44 stocks

Stocks that gained greater than 0%: 114 stocks

Biggest Loss: -63.79%

This is why we like to focus our attention on the indexes and stay involved on the side of the trend only. Yes, there is money to be made trading the bounces along the way, but that's best left to the pros. As Retail Traders you stand a better shot at success if you can identify the trend and stay with it.

2. Which are the strongest/weakest sectors?

Money flows in and out of the market's favorite and least favorite sectors. In a weak market, weak sectors make excellent shorting opportunities, and in a strong market, leading sectors make excellent long opportunities.

You can get a quick glimpse of market sectors by checking out the candle glance sector charts at StockCharts.com. Here's the link:

<http://stockcharts.com/scripts/php/candleglance.php?XLF,XLK,XLI,XLB,XLE,XLP,XLV,XLU,XLY>

In strong markets, look for sectors making new highs. In weak sectors, look for markets making new lows. Or read our RetailTrader.Net Weekly Commentary for the sectors that we like.

3. Which stocks are the market leaders?

Once you have isolated the market direction, the strongest/weakest sectors, you will usually find the leaders in those same sectors. Not always -- but for now -- at this stage -- it's probably best for you to stay with sector correlation. Meaning, you will look for your long ideas in strong sectors and your short ideas in weak sectors.

4. Indicator Entry -- Chart Pattern

Once you have decided on market direction, isolated a sector, found a stock you will need an entry. THIS is where indicators play a part. Unfortunately, this is where most newbie traders start! They think if they find the right indicator (or Holy Grail) they can trade any market at any time and get rich overnight. That's just not true. The only time where indicators should be used (if at all) is for the market entry/exit. Then, as far as I am concerned, if you have the market direction right, you have the sector right and you have the stock right, ANY indicator will do. I myself use mostly chart patterns.

Two excellent books for this area of trading (entries/exits) are: **Technical Analysis Explained by Martin Pring** or **Technical Analysis of Stock Trends by Edward and McGee**. The latter was written in the 40's and as far as I am concerned hasn't been matched yet.

Well, now you know how we trade the markets. We use what is called a Top Down Trading Method which means we start with the index and work our way down. To recap, here is this order in which we look at the market.

1. **General Market Direction**
2. **Sector strength/weakness**
3. **Strong or weak stocks in leading or lagging sectors**
4. **Entry based on indicator or pattern**

Good luck out there everyone. Don't be discouraged if the learning curves take awhile. Some of the greatest traders of our time have blown up many accounts and taken YEARS to get this down.

The best thing you can do for yourself during this learning phase is to be patient, start small and give yourself lots of room for error.

Until next time....

David John Hall
Founder/CEO
Retailtrader.Net, LLC