

The background of the cover is a dark green color with a pattern of lighter green lines and shapes that resemble financial charts and data points. The lines are mostly diagonal, sloping downwards from left to right. There are some rectangular shapes that look like bars or segments of a chart. The overall effect is a sense of movement and data analysis.

**MARKET GEEKS**  
PROFESSIONAL TRADING EDUCATION

# SWING TRADING PROFITS

*BY ROGER SCOTT*

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*indicators will help the trader become profitable and profitability is really the ultimate goal.*



So instead of teaching you about the latest indicators or market timing tools, I'm going to share with you a solid approach, one that I've used close to 20 years and one that will give you a substantial edge in swing trading any type of Stock, ETF, Option or Currency, as long as there is liquidity and volatility.

*I want you to keep in mind as you read this E-book, that there is no correlation between the complexity of a trading methodology and the results you are going to achieve.*

Sometimes beginners believe that if a strategy is difficult or complex then the strategy must be more profitable and I'm going to tell you this is 100% false. Not only is there zero correlation between complexity and profitability, but in most cases, the simpler the strategy, the better it will perform in real market environment.

## My Story

I started trading in January of 1994, just a few short months before starting law school. One of my childhood friends was obsessed with the stock market and because we always visited each other, I started watching the markets over his shoulder and started picking up bits and pieces.



A few short months later I started law school and while I graduated 3 years later, I knew after a few short months that professional trading was my true passion in life.

I remember sitting in Law School classes during lectures while using a portable stock quote device called the Quote Track, which worked off traditional radio frequencies so you had to pull out a long antenna to get a signal. So while I was studying Civil Procedure, Evidence and Contracts, I was monitoring real time quotes and running downstairs during breaks to call the broker to place trades.

## Years Later

*Few short months after I graduated law school I got a job at a local brokerage firm and six months later I opened up my own brokerage firm, and a few short years later I was running two multimillion dollar hedge funds and doing in depth technical analysis computer back testing with two full time programmers by my side. By this time I was very heavily involved in trading options spreads, long term trends and several day trading and swing trading strategies as well.*

Life was great and I was doing very well financially, but I was working long hours and was spending very little time with my growing family, and I started feeling both mentally and physically that it was time for a change.



I always enjoyed teaching other traders, so when a few close business associates approached me with the idea of starting an online trading education site, I was absolutely thrilled and that's how Market Geeks began in 2007. Since that time we've grown to become one of the most visited active trading education sites on the net and we've had the privilege to teach thousands of students over the years.

## Technical Indicators



One of the major problems beginners make is relying too much on the wrong technical indicators or the wrong tools when first starting out. Most indicators such as the moving average as well as most oscillators are designed for position trading where

trades are held anywhere from one month to a few months and sometimes longer.

The typical period for swing trading is anywhere from two days to a few



weeks so relying on traditional indicators can be more harmful than beneficial the great majority of the time. The reason for this is simple; most indicators are created or derived from price.

Without feeding price into the indicator, the indicator cannot function properly and won't generate a signal and while this may seem very simple, many traders forget this basic fact.

But here is the important part: The signal is generated after price is already reflected and when your time frame is very short, relying on indicators instead of price, can seriously cause delay in your entry and exit signal, which is crucial when you are trying to squeeze every penny from the markets.

*So the clearest and the purest indicator, especially when you are swing trading, is price itself. As a matter of fact, one of the most profitable traders of our time once said that indicators are like different colored lenses, each one gives you a different view but the clearest view comes from using a clear lens.*



## Directional Movement



While picking tops and bottoms looks good in hindsight, it's not the easiest task to achieve in reality. Unfortunately, most stocks and other assets go through two distinct market cycles, the trending cycle and the range bound cycle and overtime most stocks shift from a trending cycle and then into a long range bound cycle before once again moving into a trending cycle once again.

so when a trader picks a market top there is a high likelihood that even if the trader was correct on the timing, the odds are overwhelming that instead of the stock moving lower, the stock is more than likely going to move sideways for long extended period of time.

*Over the years I found that instead of trying to find trading methods to pick the highest high or the lowest low, I ended up doing much better by trading in the direction of the major trend.*

First, if the market is currently trending, the odds are higher that a trend will continue, at least for some time. Moreover, the odds of a strong move in the direction of the trend are much higher in a trending market than in choppy range bound markets, so your profit potential compared to risk is going to be substantially higher over time if you simply follow the major trend.

## Trend Filter

One of the best ways to determine if a stock is trending is to find stocks that are trading above the highest high that was made over the last 40

**40  
DAYS**

trading days or stocks that are trading below the lowest price over the last 40 trading days. For position trading I like to use a longer time frame, but for swing trading I find that 40 day highs and lows provide a good trade time frame for

trends that are just beginning to pick up momentum and strength but not strong enough to where the trend may peak out any time soon.

In the example below you can see Citigroup trading several times over the year at the highest price reached during the last 40 trading days, I'm not including weekends or holiday's, only trading days, so to calculate the highest high, you can simply count back each day or each trading bar going back 40 bars and find the highest price that the stock reached during this time period. Once the stock surpasses that price, the stock is trading at a new 40 day high.

C - Citigroup Inc - Daily OHLC Chart

■ Op:49.97, Hi:51.22, Lo:49.80, Cl:51.07



Similarly, if you are looking for a 40 day low, you would simply count back the last 40 trading bars till you find the one that reached the lowest price during the last 40 trading days and once the stock trades below that price, the stock is trading below the 40 day low and is trending down.

SE - Spectra Energy Corp - Daily OHLC Chart



While you can use momentum indicators, like the moving average to find a trend, you will find that there is a short delay between the beginning of a trend and the time indicator lets you know the stock is trending, so you end up getting in when the trend is a bit mature and that can increase your risk of a reversal occurring closer to the time that you entered the trade.

Imagine surfing, the earlier you catch a wave the more time you will have time to ride it and at the same is true for short term trends; the quicker you catch the trend, the higher the odds that you will extract the most movement from that trend, especially when you're looking for quick short term moves that last a few short days.

When you start increasing your time frame, technical indicators can prove to be extremely valuable and effective, but when you decrease your time frame to a few days, you need immediate feedback and that's what you will get when you look at the assets price instead relying on indicators.

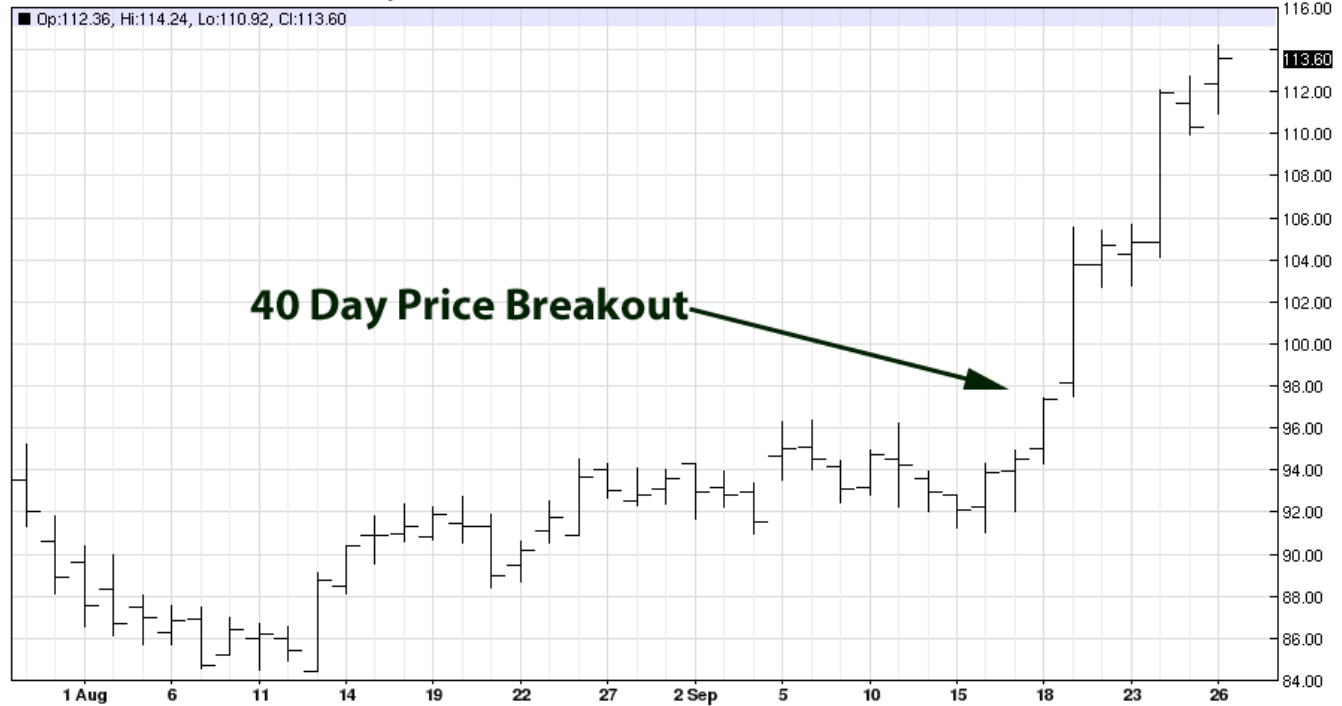
## Volatility and Risk



When you're trading in the direction of the trend, there are two primary trading methods that you can apply to the markets: One method is called the breakout method; this is one of the simplest forms of entering trades and the most popular entry method. You simply buy when the stock trades above a specified price level or sell when the stock trades below a specified price.

Below you can see a very simple example of VRTX stock trading above the highest high that was reached during the last 40 trading days, notice that the level of volatility or the difference between the highs and the lows tend to become wider apart during breakouts, this is very common, especially when the breakout occurs above a particular price level that took a long time to reach.

VRTX - Vertex Pharmaceuticals Inc - Daily OHLC Chart



In the example below, you can see how MINI stock trades below the 40 day price low; notice once again how the level of volatility increases during this time period. This is very typical to both the upside and the downside when you are trading breakouts or momentum style of trading.



*If you are wondering why I'm bringing up volatility, it's because volatility has some advantages, as well as some disadvantages. Like everything in trading it's a double edged sword.*



The upside to trading breakouts is the fact that momentum moves quickly and rapidly so you tend to stay in trades for a short period of time. In addition, because of the increase in volatility, when the trade goes in your direction, the profit potential tends to be on the higher side.

The disadvantage to trading breakouts is the fact that because volatility is higher, the risk per trade is on the higher side. And the biggest downside to trading breakouts is the fact that breakouts have an inherently low



percentage of profitability or to put in different words, breakouts tend to have a higher percentage of losing trades than winning trades and having a high percentage losing trades is the number one reason why traders lose confidence in their trading strategy or give up trading all together.

To put some numbers behind this, I back tested several thousand stocks as well as other assets over the years and on average, breakout methods are accurate only about 37% of the time; but the profit potential on breakouts can be on the higher side, therefore you don't need to be right frequently to profit from breakouts.

## Trade Off



So far we've covered two distinct entry methods: the reversal as well as the breakout and I explained that reversals are not really a method of trading that the active trader can rely on, because it's impossible to know with any degree of predictability when the current trend will end.

And breakouts can be very advantageous, but there is an inherently high risk of losing trades and the risk per trade can be on the high side due to the increase in volatility during periods when stocks are in the middle of a breakout.

Please keep in mind, that the reason why breakouts have both higher profit potential as well as higher risk is because of higher volatility, so understand that volatility can work both ways, it can help you achieve



bigger profit potential and at the same time it can increase your risk per trade and increase your percentage of losing trades, so it's a tradeoff between risk, reward and profitability.

## Trend Cycles



One of the most important principles in technical analysis is the study of trends and one of the first things that traders learn and often times forget is that there are different types of trends. For example there is a long term trend, this is a trend that can last several months or even years, and this is the type of trend you can easily identify on weekly charts and on daily charts that last several months.

You can see in the example below the long term trend of symbol SMH, an ETF that tracks several large semiconductor companies. The long term trend gives you the fundamental picture because of the extended time frame that you are viewing when you are using the longer timeframe.

SMH - Semiconductor ETF Market Vectors - Daily OHLC Chart



## Short Term Trend

The next type of trend is the short term trend and the short term trend is the trend that moves against or opposite of the primary trend. In the example below can see symbol AAPL stock, notice the primary trend is moving upwards and the short term trend moving against the direction of the long term trend.

AAPL - Apple Inc - Daily OHLC Chart



Notice in the example above, that the short term trend tends to resolve itself or ends up moving back in the direction of the primary trend, this has to happen for the primary trend to continue building momentum in the main direction, in this case upwards.

## Lowest Risk Opportunity

And here is what you need to know, this is very important and I truly hope that if you forget everything that you learned from reading this E-book, that you will remember what I'm about to share with you:

The lowest risk opportunity for short term trading or swing trading occurs at the point when the short term trend connects back to the long term trend.



*Look at the Apple graph above, and notice the areas that I highlighted, this is where the long term trend meets the short term trend and professional traders consider this to be a very low risk entry opportunity.*



The reason why this is the case is because volatility is typically lower during periods when the stock is in a counter trend. This is a period of time when the stock is pausing from a strong directional move and there is only so much momentum that the stock can achieve before needing time to pause, this is just a natural part of market's cycle.

So entering after a pause or a short correction in the trend gives you higher odds of success compared to entering at a new price breakout level, where prices are extremely vulnerable to volatile pullbacks that can

cause your stop loss to trigger prematurely, thereby causing you to get stopped out before the stock gets a chance to continue moving back in the direction of the primary trend.

I find that trading pullbacks or methods that trade against the short term trend and in the direction of the main trend or the primary trend to be the most effective methods of swing trading very short term price swings.

I'm going to show you a very simple method that will help you isolate the ideal pullbacks or low risk entry set up, against the short term trend and in the direction of the primary or the main trend.

I've used this method and many other similar methods for almost two decades and these counter trend set ups are just as effective today as they were when I first began using them almost 20 years ago.

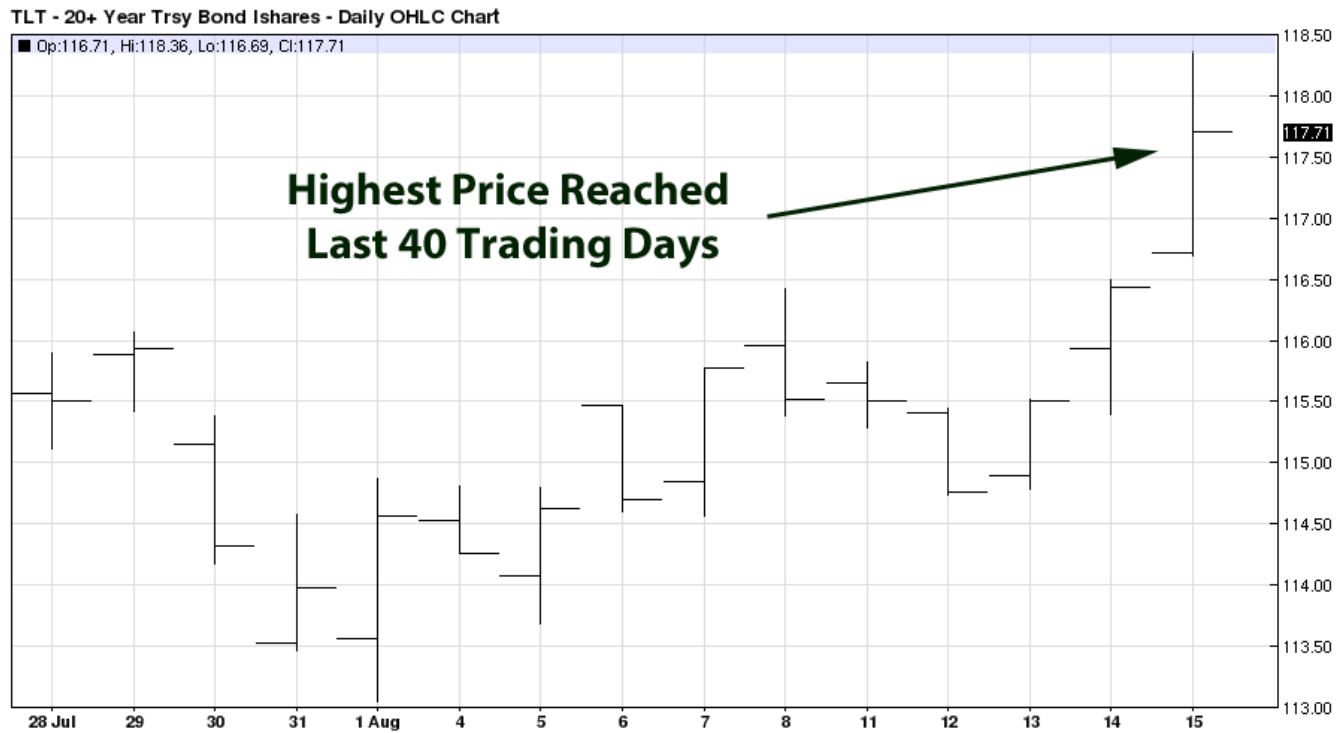
Lastly, don't underestimate the effectiveness of this set up because it appears so simple, remember what I mentioned earlier; there is no correlation between the difficulty and complexity of the strategy that you are contemplating using and the effectiveness or profit potential of that strategy.

## 40/3 Pullback Strategy

The strategy I'm going to share with you today is called the 40/3 pullback strategy, this is one of the best swing trading set ups for very short term swing trades, and it's very easy to identify on a chart without having to rely on complex indicators or fancy formulas.

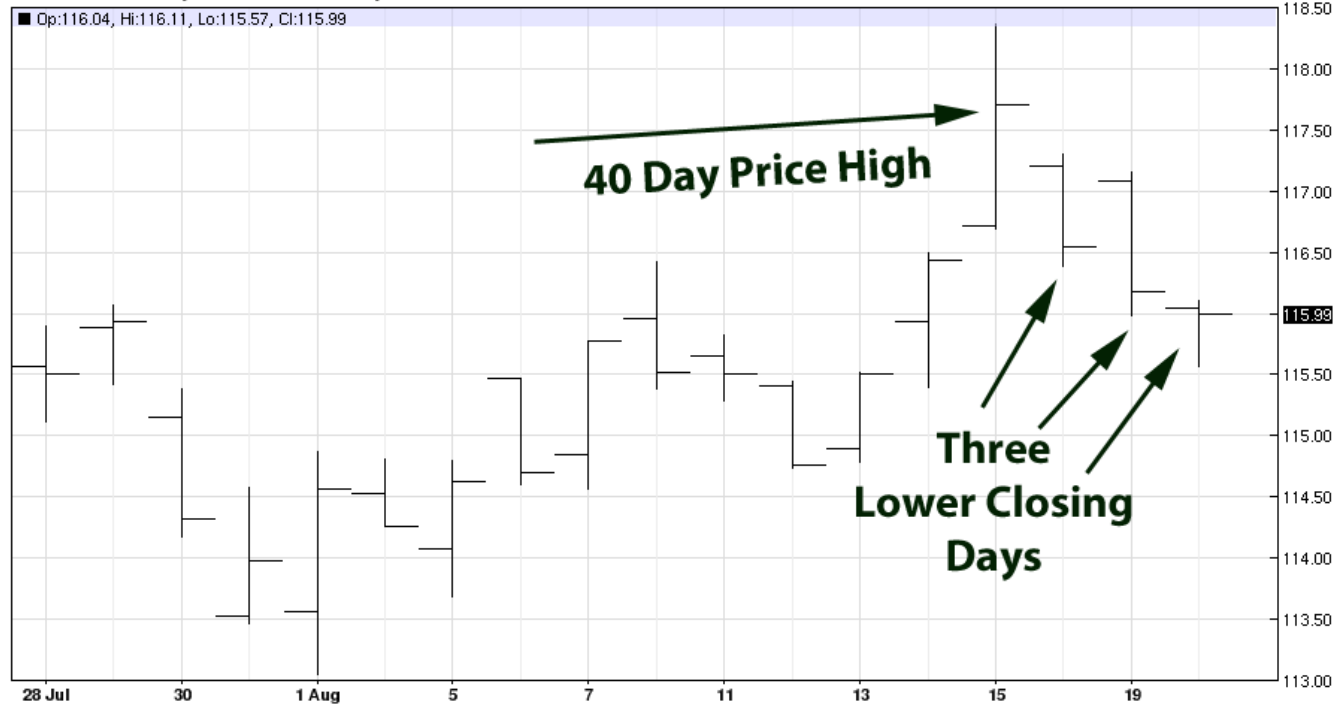
Let me give you the specific rules to trade the 40/3 strategy to the upside:

Find a stock that rallied to a new 40 day high, this is the first step in isolating this set up.



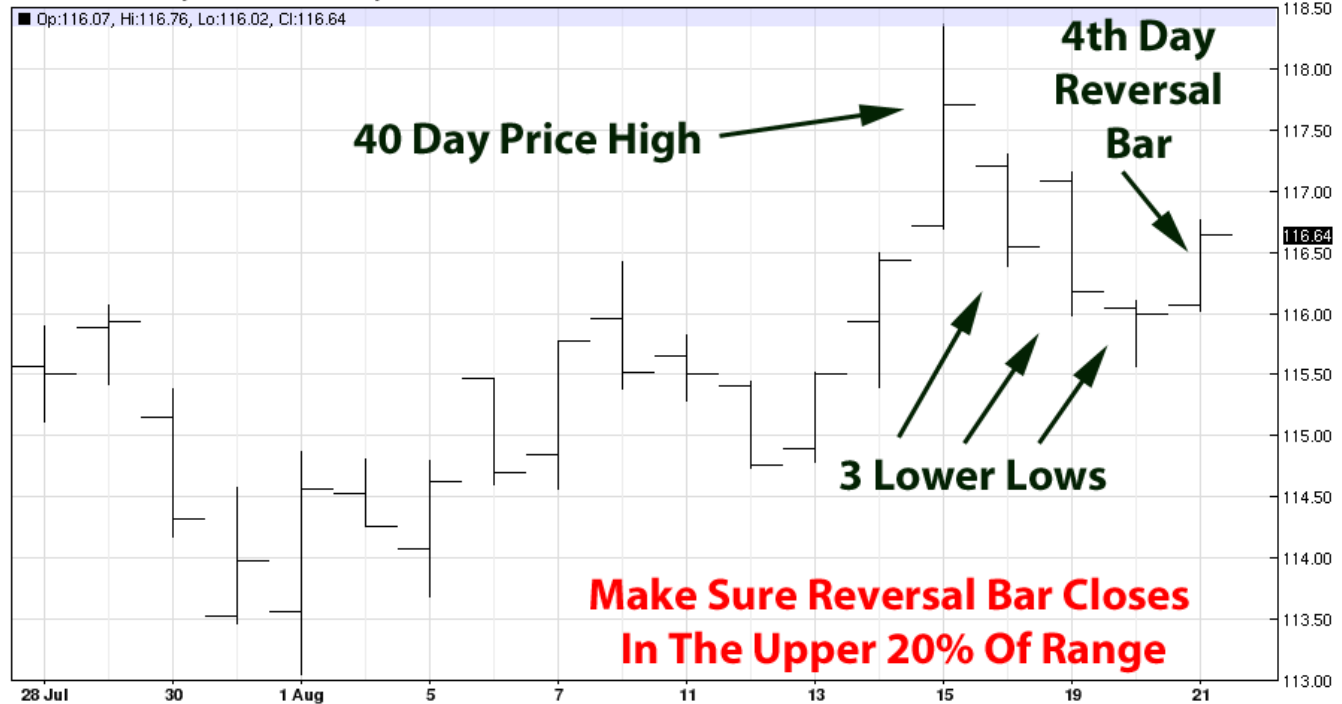
The next three consecutive days following the price breakout, must have lower closing prices, the lows may or may not get lower, but the closing price must get lower each day for three consecutive trading days.

TLT - 20+ Year Trsy Bond Ishares - Daily OHLC Chart



The fourth day the closing price much trade higher than the closing price that was reached the previous day, the third day. Furthermore, the stock price must close in the upper 20<sup>th</sup> percentile of the daily trading range.

TLT - 20+ Year Trsy Bond Ishares - Daily OHLC Chart



You place an order to go long on a buy stop that's placed \$.03 cents above the highest price that was reached on day four; the day the stock turned around and closed near the high that day. Assuming you are filled, you would place your stop loss order \$.03 cents below the low that was reached on day three, the day before the market turned around and closed higher.

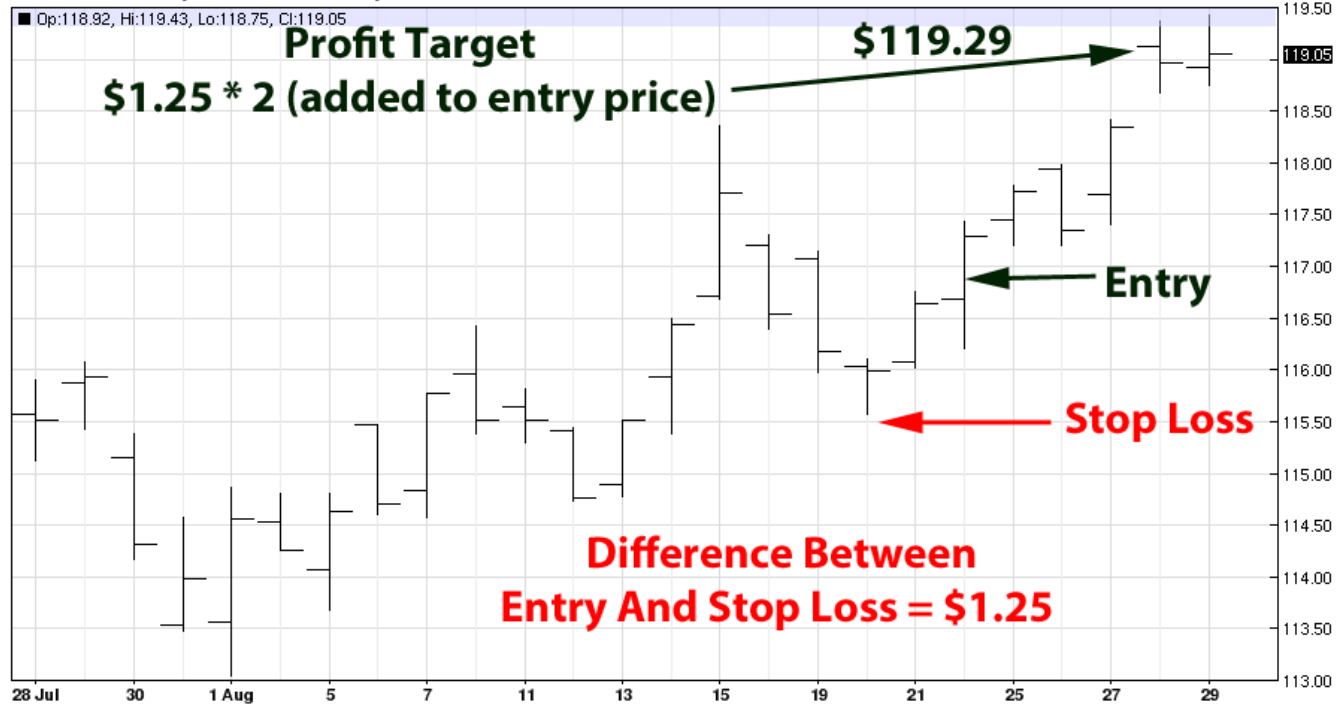


TLT - 20+ Year Trsy Bond Ishares - Daily OHLC Chart



Your profit target is the difference between your entry and your protective stop loss order, multiplied twice. So you would simply figure out the difference between your entry price and your stop loss order and multiply that number times two and then ADD it to your entry price.

TLT - 20+ Year Trsy Bond Ishares - Daily OHLC Chart



You can place a limit order at the profit target sell price so that you don't have to watch the market all day, but don't forget to cancel your order if your trade is stopped out or you change your exit strategy.

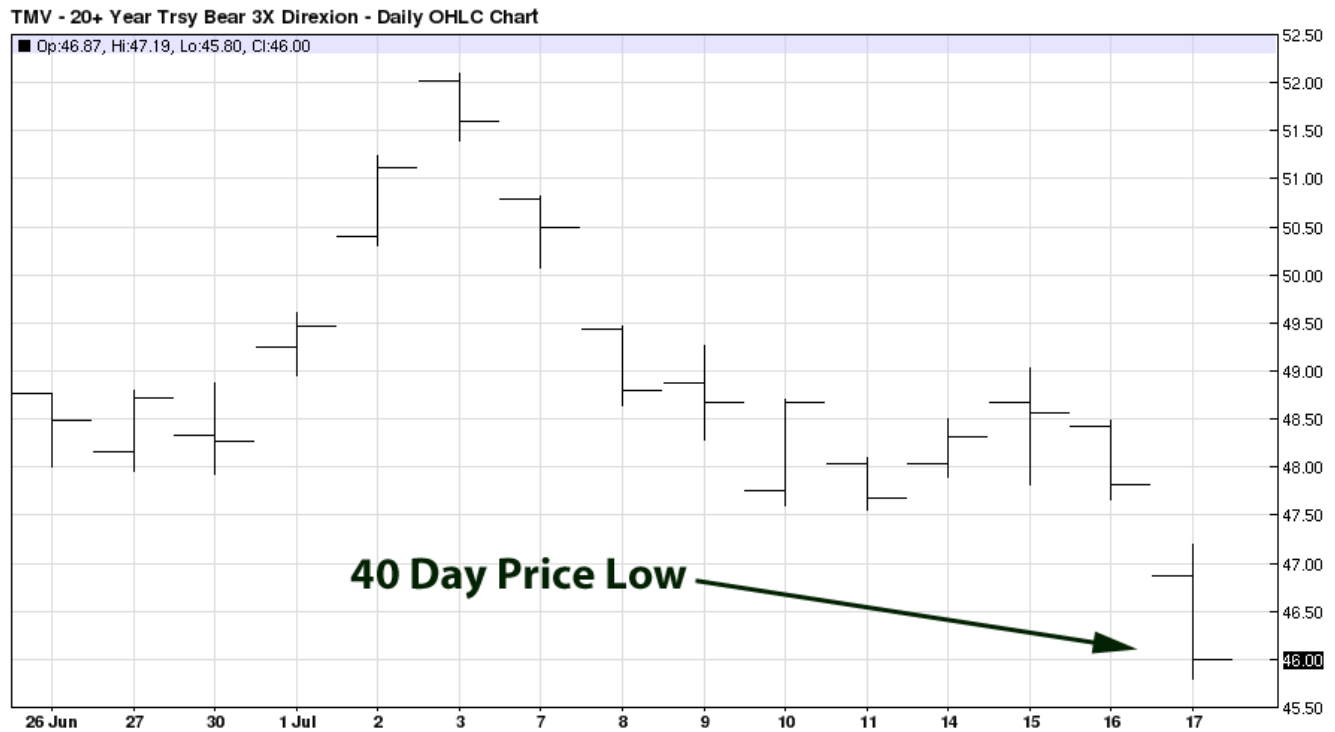
## Preventable Error



One of the biggest preventable errors traders make is forgetting to cancel their orders, don't make this mistake, it can be a very costly one. When I was a broker almost a decade ago, I remember times when traders would lose more by forgetting to cancel orders than they would make on winning trades, it's something preventable and you should make a conscious effort to always cancel your working or GTC (Good till Cancel Orders).

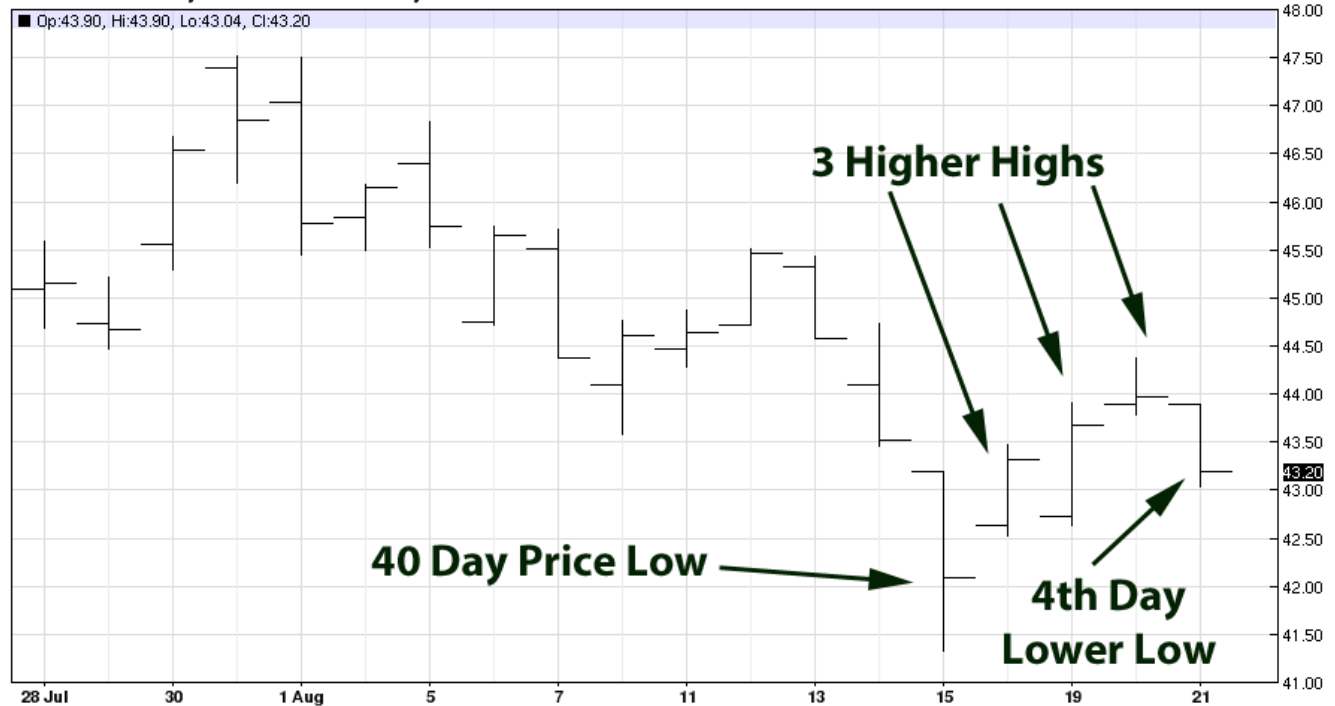
Below are the rules for the 40/3 pullback strategy for the short side:

The first thing we want to do is isolate the lowest low that was reached during the last 40 trading days.



Once we identify this price level, we want to see three consecutive days when prices close higher. On fourth day, the price must close below the closing price of the previous day, the third day.

TMV - 20+ Year Trsy Bear 3X Direxion - Daily OHLC Chart

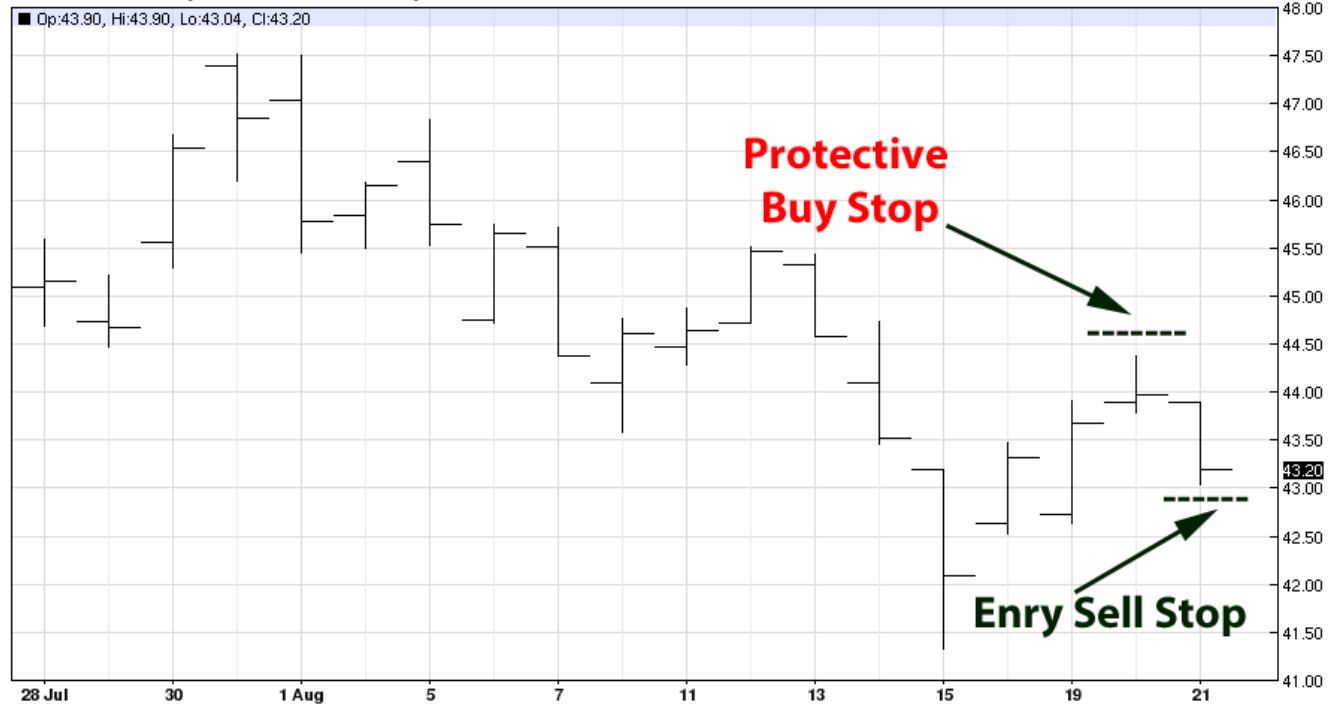


Make sure that the fourth day, the low of the day is near the lowest 20<sup>th</sup> percentile of the day's trading range.

Place an entry sell stop order .03 cents below the lowest price traded on day four, the day the stock turned back around and traded to the downside. If you are filled, place a protective buy stop .03 cents above the highest high reached on the third day, two days before your entry, the pivot high point.

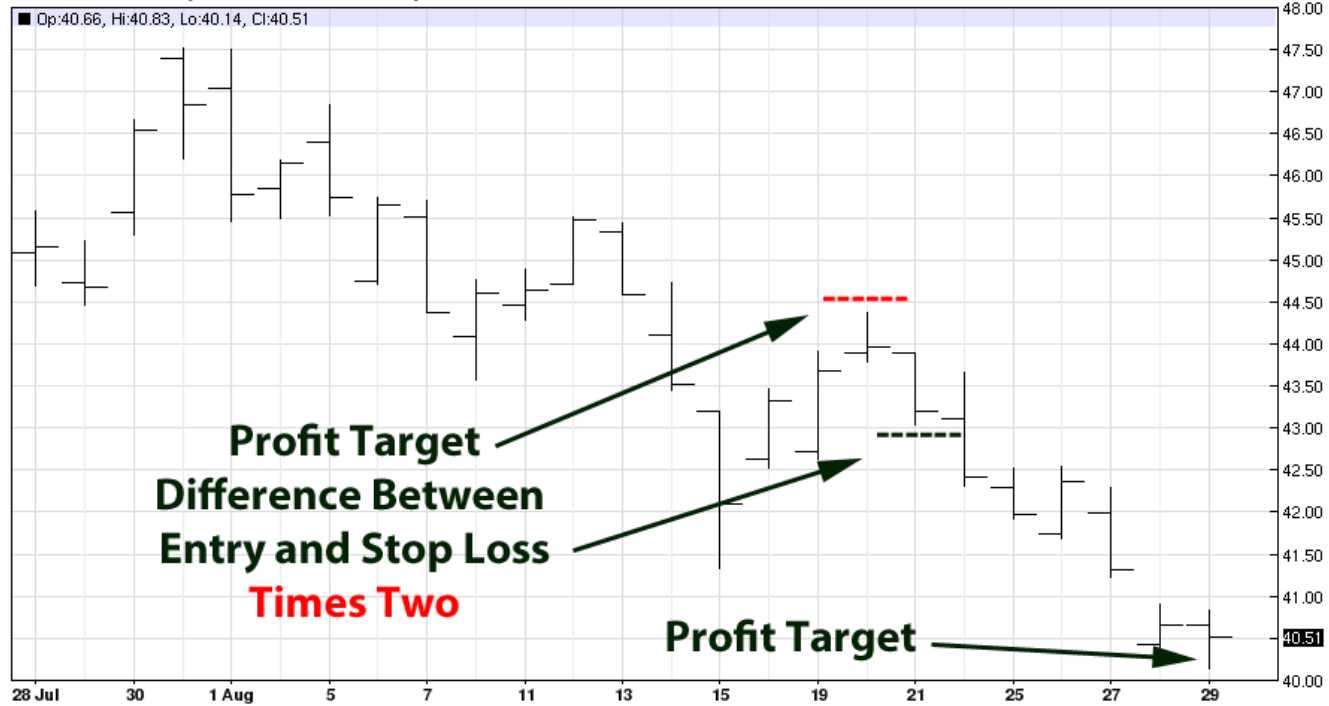
You can see the protective buy stop level in the chart below, notice it's a very strategic price level that gives you a low risk trade opportunity.

TMV - 20+ Year Trsy Bear 3X Direxion - Daily OHLC Chart



Your profit target is the difference between your entry price and your protective buy stop order, multiplied two times. This way, your profit factor over the long run is going to be close to two, which is more than reasonable for a very short term swing trading methodology.

TMV - 20+ Year Trsy Bear 3X Direxion - Daily OHLC Chart



And for traders, who are unfamiliar with the term profit factor, it's derived by dividing your average profit by your average loss and this is not based on one or two trades, this is based on a large sample of trades over time.

And while I'm on the topic of profit factor, you should know that the profit factor is the most frequently relied upon analysis indicator to determine the performance of a strategy. When investors look at stocks, they focus on PE ratio and technical traders focus on profit factor instead.

## Why It Works

One of the main reasons why the 40/3 Strategy works so well is because the 40 day high is a strategic point for a trend pause or a pullback. If the trend was further along, maybe near the 60 or 70 day high, it would be a bit riskier to enter the long position because the trend is a bit more mature

and the momentum may have already become a bit too strong. But at the 40 day high price, the trend is typically at the beginning stage of building momentum; and pulling back for 3 days tends to coincide with the ending phase of a very short term trend against the main trend.

*This type of a move against the main trend that only lasts a few days tends to be too difficult to isolate with technical analysis indicators, because of the extremely short term nature of the move we are trying to catch.*



Because we are relying on actual market price to isolate the short term trend as well as the reversal bar, which is what I call the fourth day reversal, we are able to take advantage of very quick short term price swings that tend to move in the direction of the main trend, which increases our odds of winning even further.

## Increasing Odds

There are a few things you can do to increase the odds in your favor when trading both the 40/3 pullback strategies.

The first thing I recommend is trading stocks that are priced at over \$20.00 per share. Lower priced stocks have less daily trading range and don't have enough volatility in most cases to give you enough profit potential, so *I highly recommend you stick to higher priced stocks that have a daily trading range of \$2.00 or more per day on average.*



The second and equally important factor to consider is to only trade in the direction of the main stock market index.

So if you are thinking about taking long trades in a particular stock, I recommend you make sure that the overall stock market, the SPY or if you are trading tech stocks, the QQQ is trading above the 50 day moving average and if you are considering short trades, I recommend you make sure the main index is below the 50 day average, this will increase the odds in your favor.

## Earnings

Lastly, don't initiate trades if earnings are coming out within three weeks of entering the position. The holding period for both strategies is usually anywhere from three day to ten days, so giving yourself three weeks is ample time to avoid being stuck in a trade during earnings.

## Sectors



One additional piece of advice I can offer you, is to perform routine sector analysis to make sure you buy the strongest sectors and sell the weakest sectors. You can find the different stock sectors at sites such as Barchart.com and numerous other financial sites. Stocks tend to move in groups or sectors with similar stocks, so when you buy stocks in sectors that are outperforming the market and sell stocks in sectors that are substantially weaker than the market, the odds of the stock moving in your desired



direction is increased, and when your swing trading, everything you can do to increase your edge is something worth considering, in my opinion.

## Psychology



I'm sure you've heard by now that psychology is the single most important part of successful trading and I couldn't agree with that more. What you need to know is that losing is a natural part of trading, it happens to everyone and it's not the loss but how you deal with the loss that's important.

Many times traders deal with losers by second guessing their strategy, every time they enter a losing period; and If you know that your trading strategy is based on solid trading principles, then the best way to get out of a losing trading period or a drawdown, is to continue trading the same method consistently, though both good times and bad. It's not uncommon to have a losing period that can last several weeks, keep this in perspective and try to understand that this is part of the game.

## Modular Approach

The 40/3 strategy that I demonstrated in this E-book is just the beginning of how you can approach pullback trading tactics.

There are other tools you can apply to help you make this strategy even more dynamic. For example, you can substitute the exit stop loss method I described with another stop loss method, which is based on volatility such as Average True Range, which is commonly called the ATR indicator.

You can also substitute the exit strategies with another more dynamic strategy such as allowing the stock to continue gaining momentum to the upside till the stock begins to move down against the uptrend, till it reaches a ten day low, long as the stock is moving upwards at a steady pace, this simple method will keep you in the trade, possibly for a very long time.

Similarly, if you are trading to the short side and you can use a ten day high against the downtrend as your exit signal. So if the stock continues moving lower with sufficient momentum, it will keep you in the trade for an extended period of time.

*You can learn more about trading pullbacks and the different indicators that you can apply to pullbacks at our website, [www.marketgeeks.com](http://www.marketgeeks.com)*

## Loose Ends

The strategy I explained to you in this E-book is based on very simple and yet effective trading principles that have withstood the test of time. I've personally used this method and similar methods in my trading over the years and taught them to thousands of traders over the years.

*And don't forget that the 40/3 strategy can be applied to any volatile asset, including ETF's, currencies and options.*

If you apply the methodology that I explained in this E-book, you will be on your way to developing a strong foundation for swing trading success.

I hope you enjoyed reading this E-book as much as I enjoyed writing it. You can email me at [rscott@marketgeeks.com](mailto:rscott@marketgeeks.com) if you have any questions.

Wishing you the best in your trading!

Roger Scott  
Senior Trainer  
Director of Education  
Market Geeks

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