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If You Can't Spot It, Don't Trade It

You will find that all successful traders share one thing in common. They all (without exception) have an edge based on low risk entries. Gabe Velazquez looks at why new traders need to learn to identify low risk entry points if they want to enjoy a successful trading career.

Of all the facets of trading, the first that a new trader must learn before he can engage the markets with any degree of confidence is the identification of low risk entries on a price chart. Notice that not just any entry will do, it must be those entries offering the biggest reward for the least amount of loss potential.

If you have ever read about or had the chance to chat with any successful trader, you will find one common thread. They all (without exception) have an edge based on low risk entries.

What defines a low risk entry? I define it as the following – the price level where a trader can expose the least amount of capital to prove whether his edge will work. I tell students to look for these areas by identi-

Figure 1

fying "the line in the sand" or "drop-dead level" where price has to hold. Generally, these are found at prior inflection points on the chart.

Specifically, inflection points can be spotted by looking for price levels on the chart where there was a clear change of direction. In other words, where was the dominance of either the buyers or sellers relinquished? Moreover, the more powerful the reversal, the more important that point becomes on the retest. The chart in Figure 1 shows some of these turning points in TF (Russell 2000 E-mini).

Also noteworthy is the fact that the first time these levels were "tested," not only did they provide low risk trade setup, but they also held and reversed a high percentage of the time.

I have used the next chart to illustrate this premise. If we use the 60-period exponential moving average as a dynamic trend line, coupled with the resistance level as the "line in the sand," we can determine that the breaching of these would signal a change of trend, and provide the entry and the buy stop (risk to be assessed).

Depending on how much risk one is comfortable in assuming, a limit order can be placed near or very close (within a few ticks) to that price.

In another example, the TF (E-mini Russell 2000) in the next chart has pierced through the lower Keltner band. This (in my work) is signaling an extended market in which the odds of a reversal are heightened. If we look to the right, we spot two previous inflection points (highlighted in yellow). These would be deemed support areas that should attract buyers. Again, these are the low risk areas to place orders. Since there are two levels, you are probably asking yourself, which one should I buy? Given that we know that one of them has a very high probability of holding, and our risk will be modest in either case, we have to try it at both price levels.

As the chart shows, the first level held and the trade worked very nicely.

In this final illustration, I am using a trade set up I used for the students in the last e-mini futures class I taught in Irvine. The rationale behind this trade was that the ES had been trending higher, albeit in a

Figure 2

Figure 3

Figure 4

choppy fashion. The price point highlighted was the last major low, which had to be sustained if the buyers were to preserve control. In the chart of the ES (e-mini S&P), Figure 4, the magenta-colored line is the last boundary; the entry was done a little above, with a snug stop just below that spot, and the trade was exited on the close of the regular session.

Suffice it to say, not all trades will work as well as these did, but the key here is when they do not pan out, the losses will be trifle compared to the profit potential.

Once a trader learns the skill of identifying these levels, the biggest challenge is putting on the trades. Why do I say this? All of these trades were being placed when price is either retracing or the market was moving strongly into one of these areas.

If you look closely at these charts, you will notice that you were buying into a series of red candles or shorting into a sequence of green candles (some of them very tall). Psychologically, this does not set well with most non-professional traders. Only by knowing probabilities and accepting risk can a trader place these trades with self-assurance.

The other issue is patience. These setups do not occur every minute, or five minutes for that matter – more like two or three times a day (maybe). This is where the phrase "if you can't spot it, don't trade it" becomes relevant.

Indeed, this style of trading is perhaps not for everyone, but regardless of your method, identifying and executing low risk entries are the hallmark of a consistently profitable trader.

Gabe Velazquez is a professional trader with 14 years of experience. His focus is intra-day and swing trading the TF (Russell 2000 E-Mini) using technical analysis as his primary tool. Gabe has managed stocks and futures accounts and has conducted educational seminars on technical analysis for the past ten years. He is a frequent guest on Biz radio, where he shares his market knowledge and utilization of technical indicators. Gabe also teaches the 5-day e-mini course for Online Trading Academy.