

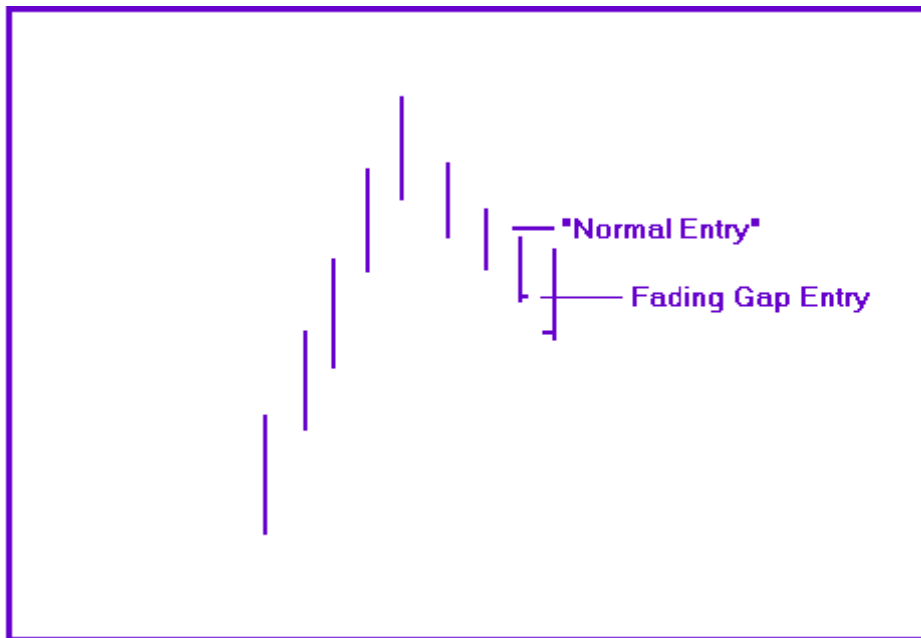
## How To Add A Layer Of Discretion To Your Swing Trading

By Dave Landry  
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**In my articles and books on trading, I strive to make the rules as specific as possible.** However, the market doesn't always conform to specific rules. Therefore, you occasionally have to add a layer of discretion. Below I discuss a few ways in which discretion can be used to help improve your trading.

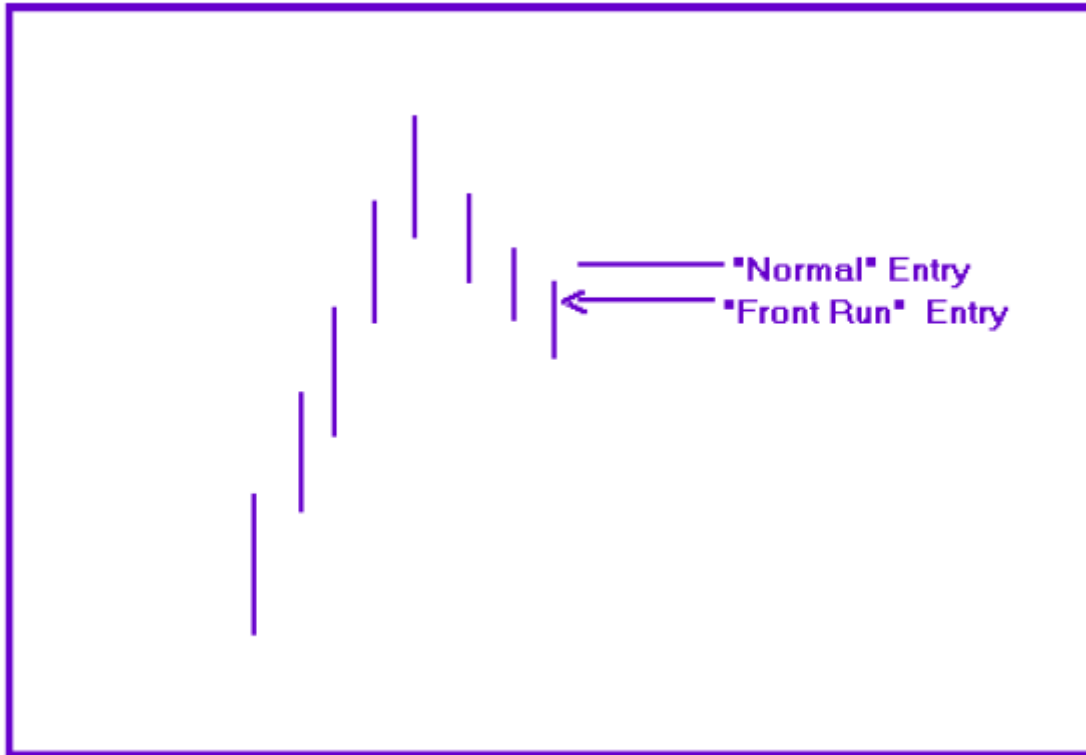
### Fading Gaps

Stocks that close poorly (for potential longs), often gap lower on the following day, as existing longs "throw in the towel" and new shorts are attracted to the market. The gap down can often represent a panic low or near low for the day. In the case of a pullback (or any setup for that matter), you might look to enter in the direction of setup and against the direction of the opening gap, provided it shows some sign of reversing back into the direction of the underlying trend. Often, this allows you to get a head start on those that won't be triggered until the prior day's high is taken out. This is illustrated below and discussed in further detail in my article "Opening Gaps: Trade 'em, Fade 'em or Ignore 'em".



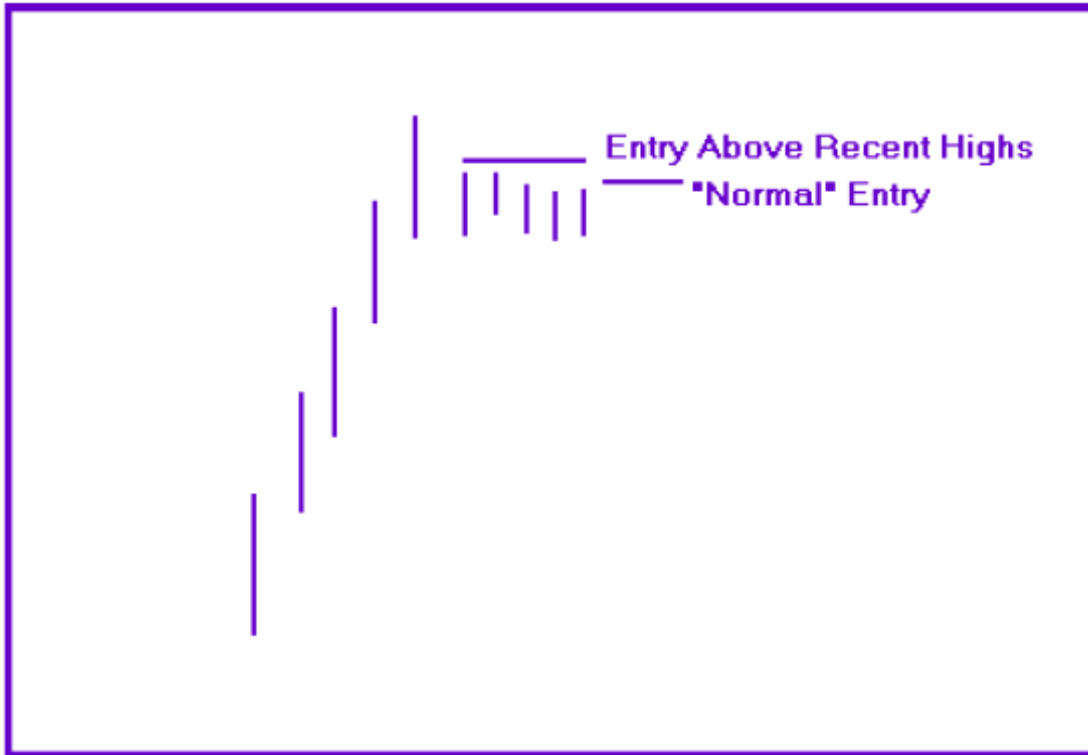
### Early Entries

In addition to fading gaps (mentioned above), there are occasions where you might look to enter a setup before the actual trigger is hit. I've dubbed this "front running" a setup. This usually works best when the setup is very obvious -- possibly "textbook" in nature. In these cases, you enter before the "official" entry is triggered—getting a head start on those who are waiting for the entry. Front running a setup works best when the overall market and sectors are in gear or showing signs of reversing intra-day. You look to enter just below the obvious entry (usually above the prior high for longs).



### Higher Entries

In general, unless the setup dictates otherwise, the entry (for longs) is normally just above the prior bar's high. However, there are instances where you might want to enter above the prior 2-3 (or more) bar highs. The best case for a higher entry is when the recent highs are fairly close to the prior bar's high. The advantage is that the stock might not make it through this resistance level and you will avoid a potentially losing trade. And, because the entry is only slightly further away from a "normal" entry, you don't give up too much of the stock's move.

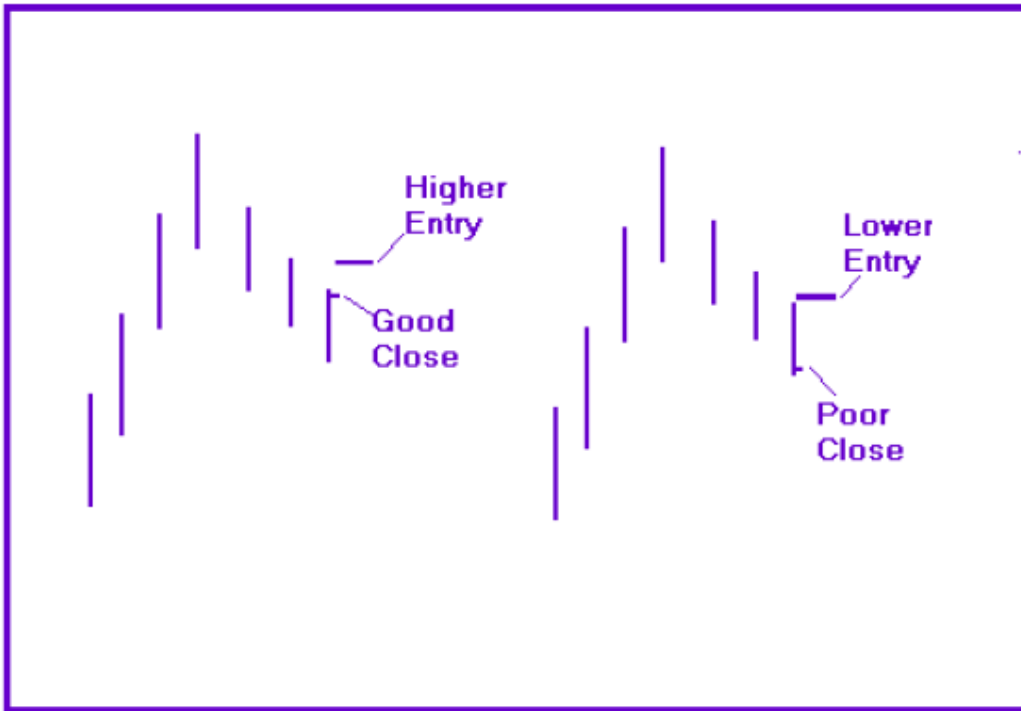


Higher entries should also be considered in choppy markets. This way, you don't get triggered on noise alone.

### 5, 10, 15, 20, 25?

When the exchanges implemented decimalization, I quickly realized that professionals were often able to push stocks at least 1 cent above/below the prior day's high/low in order to trigger stops or entries. This created more false moves as they took out traders who took a "textbook" approach to placing entries and stops.

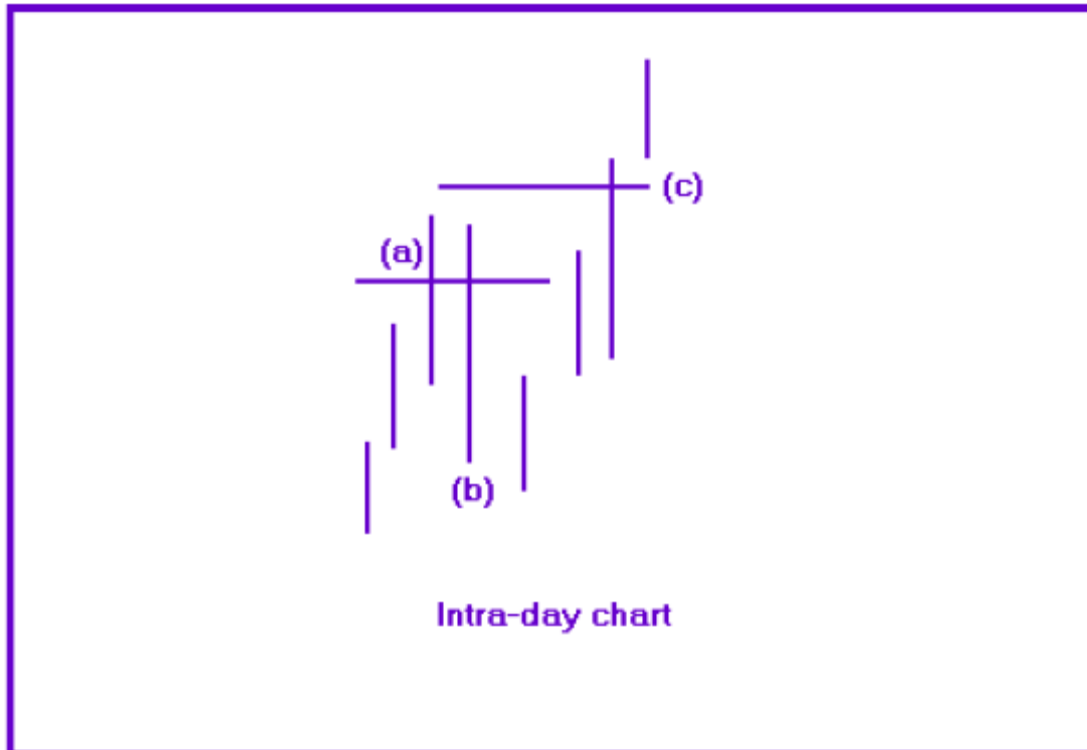
I also discovered that if a stock closed well (for longs), I wanted my entry even further away to help ensure that I would not get caught in a false move. Why? Because stocks that close well have a very good chance of showing some *initial* follow through but after that, there's no guarantee the stock will continue higher. Therefore, by placing an entry well above the prior high, usually 25 cents or more, depending on the close, I was able to avoid (some of) these false moves. On the other hand, on a poor close, the stock is less likely to trigger on the following day. And, if it does trigger, it shows that the stock has very strong intra-day strength. Therefore, when a stock closes poorly, I usually place an entry stop very close to the prior day's high. In fact, on a very poor close, I might put the entry at the high or even look to enter early (before the trigger—i.e. "front run" the setup). This is illustrated below.



One more point about poor closes: Stocks that close poorly often make good candidates for a “fading with the trend” opening gap reversal strategy. See my article “Opening Gaps: Fade ‘em, Trade ‘em, or Ignore ‘em for more on this.”

### **Second Entries**

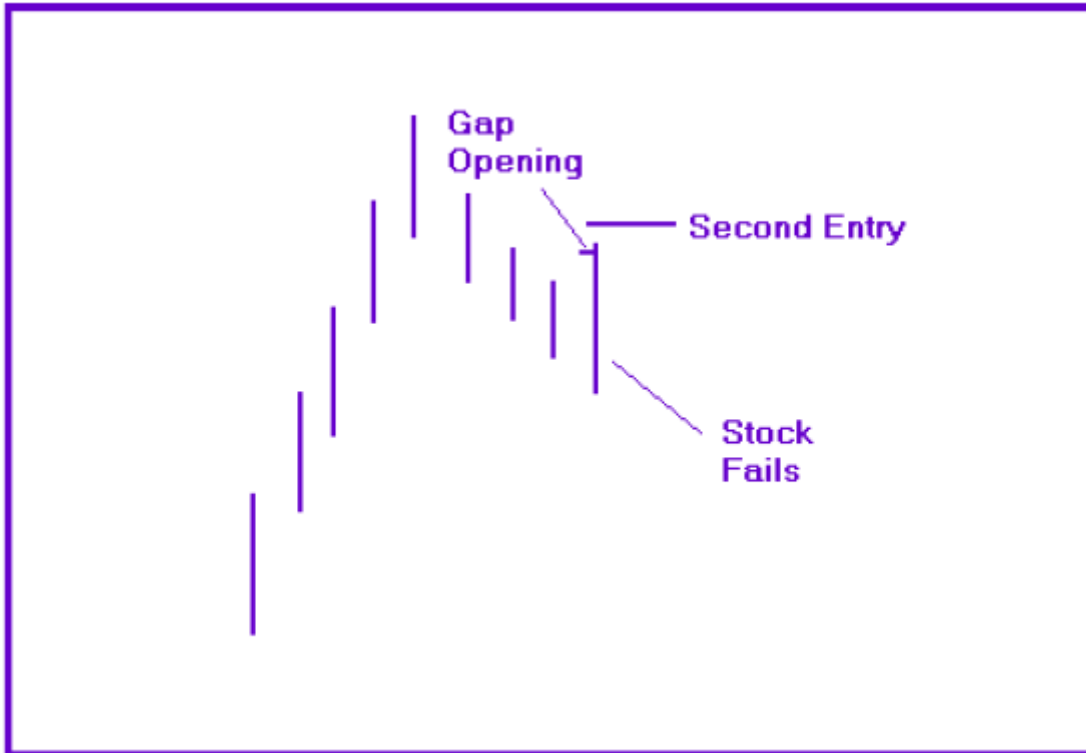
In choppy markets, the first move a stock makes will often be a false move. Therefore, in these instances, you might want to allow a stock to trigger and observe its behavior before taking a position. By avoiding the first push, you can then look to position yourself if *and only if* the trend resumes. The advantage is that you will often avoid a losing trade, should the stock reverse and never "re-trigger." Obviously, the trade-off is that you risk missing a winning trade should the stock trigger and keep on going.



Notice above that the stock pushed above the entry (a) but immediately reversed (b). In choppy markets, the original trigger can often be the high or near high of the day. Waiting for a second entry (c) (possibly slightly *above* the original entry/intraday high) helps to ensure that the stock will keep going in the intended direction.

### **Second Entries On Gaps---Avoiding OGeR Entries**

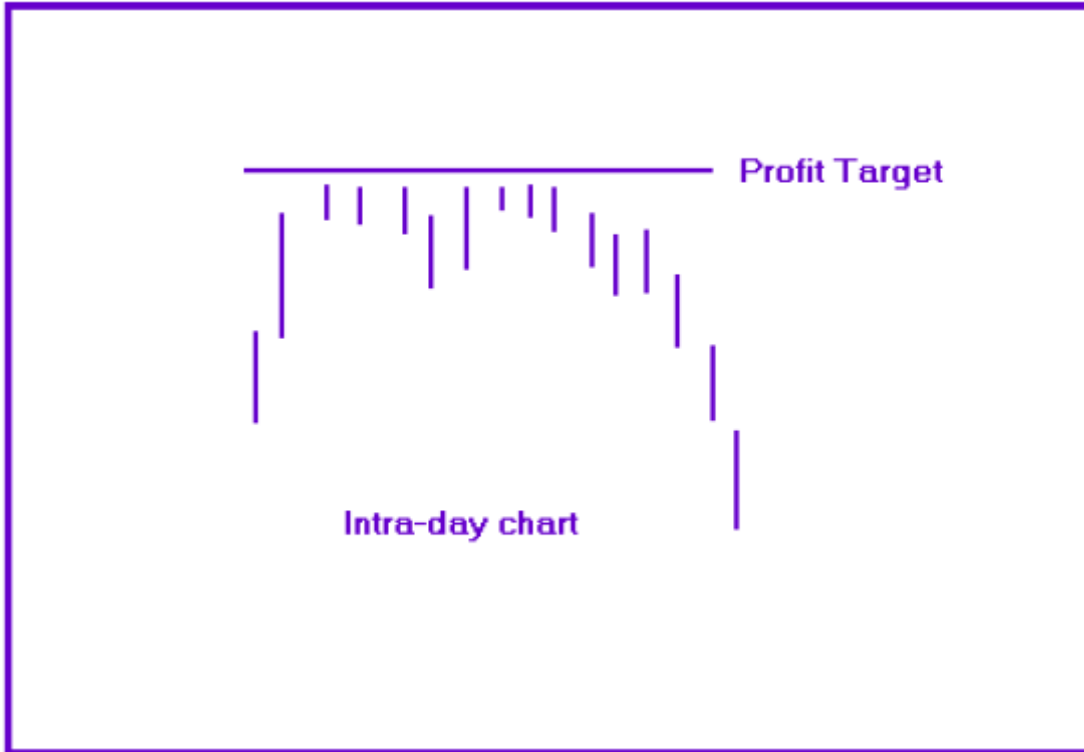
Stocks that gap open often gap open to their high (or near high) for the day. This Opening Gap Reversal (OGeR) occurs when there is some initial euphoria about a stock that quickly wanes. Therefore, by waiting a few minutes to see if the gap "sticks," and then looking to enter above the morning range, a losing trade can often be avoided. I have illustrated this common pattern below.



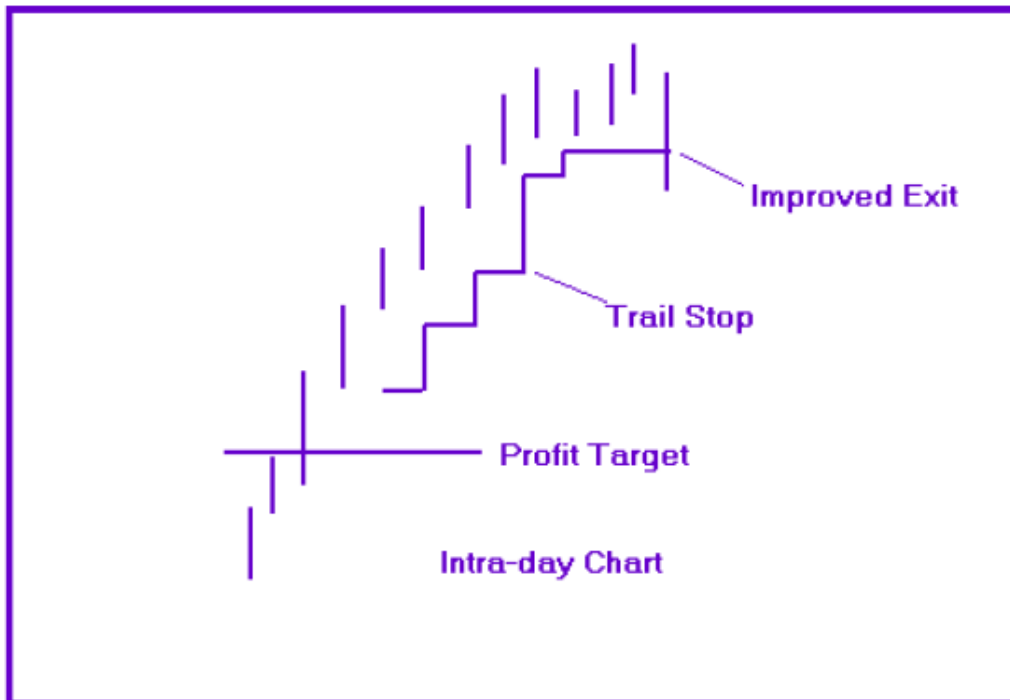
### **Taking Partial Profits**

Ideally, when taking partial profits, you should make at least the amount you risked on half of your initial trade. Otherwise, the winners won't be enough to cover the losers. However, sometimes, during choppy market conditions, the market will tempt you by coming within cents of your intended profit goal before backing off. During these times, you are often better off taking the less-than-ideal partial profit.

This is illustrated below.



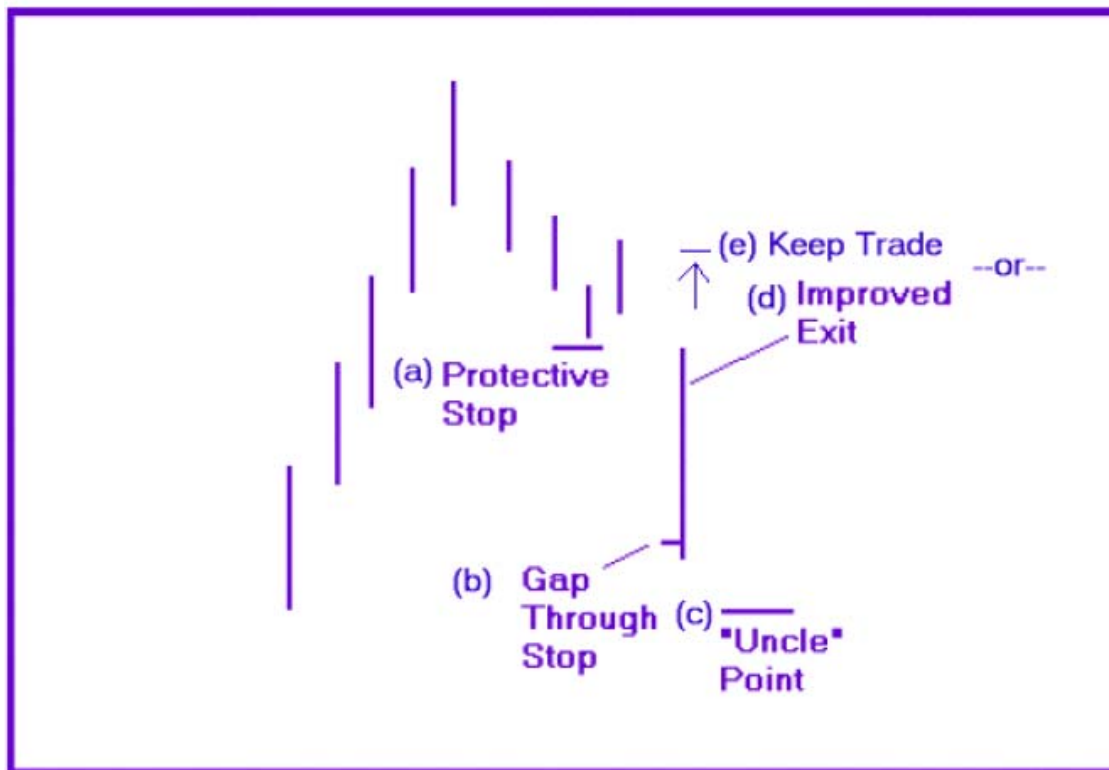
On the other hand, if a market is really flying, you might want to trail a stop intra-day to capture a greater-than-intended partial profit. This is illustrated below.



See my webcasts at [www.davelandry.com](http://www.davelandry.com) for more techniques for letting profits ride intra-day.

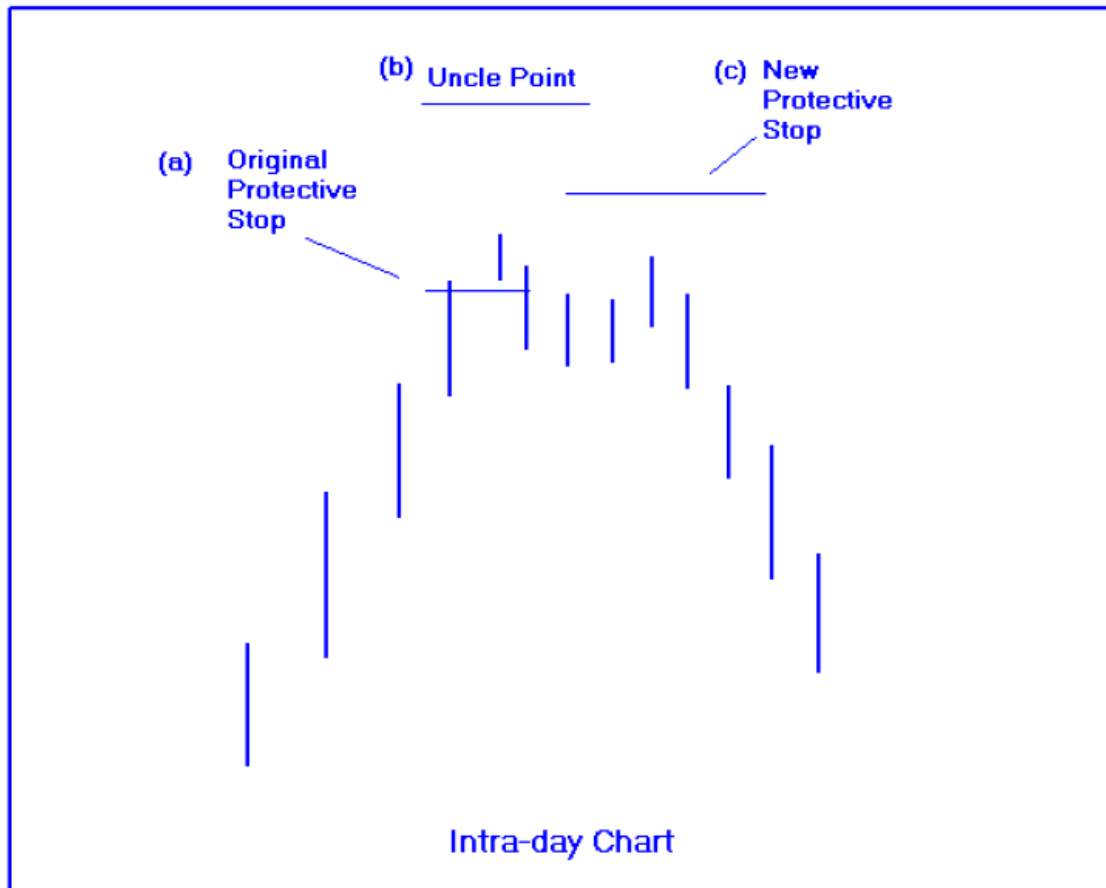
## A Cardinal Sin?

As you know, I always preach the use of protective stops. However, there are *some* cases where a stop could (and should!) be pulled and then replaced. The most common argument for "pulling a stop" is when a stock is called to open sharply against your position. This is often caused by some sort of bad news, or events that transpire overnight. The next opening represents a potential panic situation as traders look to exit at the first possible chance. Often, these panic opens become the low or near low of the day. Therefore, in these situations, you might want to pull your stop and see if the stock will bounce within the first few minutes of trading. Keep in mind that this requires the utmost discipline and you *must* have an "uncle point" (i.e., where you will exit no matter what) just in case the stock gaps lower and keeps on going. This is illustrated below.



A very similar situation to a gap open is a "fast open." A fast open is when a stock makes a big move in early trading. Often though, these moves quickly exhaust themselves as the euphoria (or panic) quickly wanes. This creates a situation similar to an opening gap reversal. When this occurs, especially if the stock market (basis the stock futures) has made a large move overnight, pull the stop and give the stock some "wiggle room." Like the damage control on a potential opening gap reversal, the amount of wiggle room to give the stock above/below the original stop is arbitrary and depends on the volatility and price of the stock. Market conditions such as the magnitude of the overnight move and "recent behavior" (e.g. has the market been choppy lately and prone to reversals?) must also be considered. As *general* rule, the stock must trade at least  $\frac{1}{2}$  point to 1 point above the stop for shorts or  $\frac{1}{2}$  to 1 point below the stop for longs. Risks must be kept in line and this "uncle point" must be honored if hit. If the stock reverses (in earnest) before hitting

the “uncle point” (b), the stop can be tightened to above the opening range (c) for shorts (or below the opening range for longs). This is illustrated below.



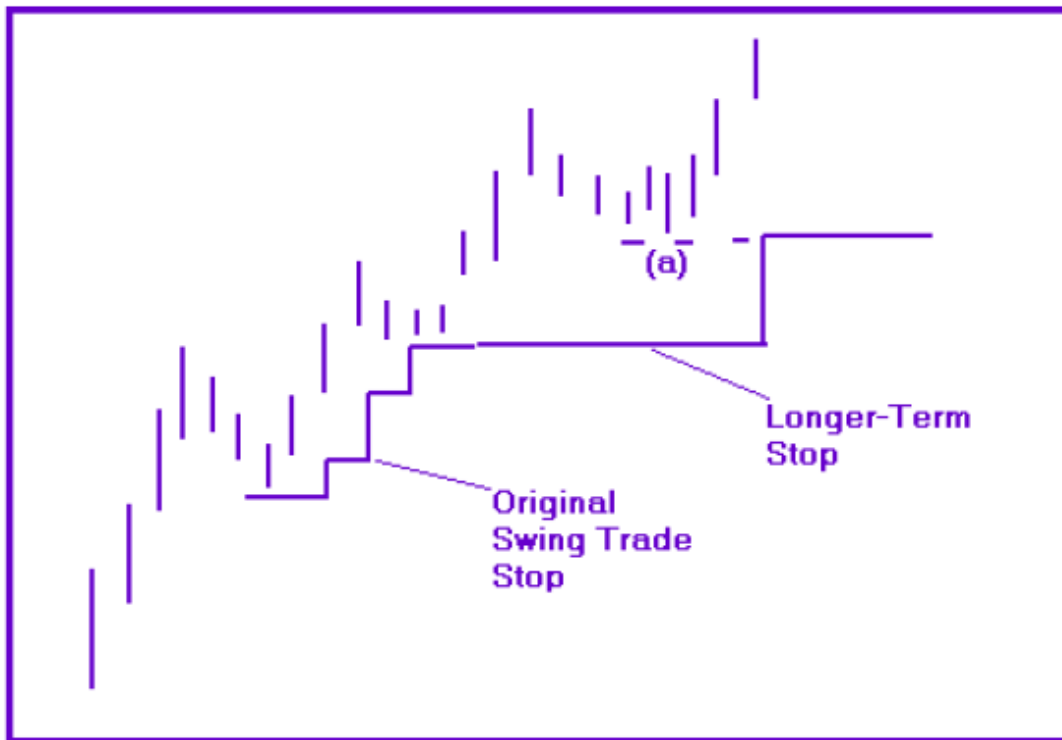
For more detailed information on trading fast opens, see my webcast: “Dave Landry’s The Week In Charts” for 02/14/08:

<http://videos.worden.com/videos/swf/dlcs021408/dlcs021408.html>

### Let It Ride—The Best Of Both Worlds

Swing trading (i.e. “shorter-term”) has the advantage of keeping risks within line because you’re only in the market for several days. The disadvantage is that the amount of gains are limited by the limited amount of time in the market. Intermediate-term trading has the potential of capturing big picture moves but the risk are increased because these positions need room (i.e. looser stops) to work.

I like to see myself as an intermediate-term trader with better entries. If I play my cards right, I enter a swing trade and take a short-term profit but then keep a portion of the position for a longer-term move. In these cases, I have already taken half of my profits when they exceeded my initial risk and have moved my stop to breakeven (see my money management lessons for details). Therefore, I essentially have a “free” position on the remaining shares (barring overnight adverse gaps). I’m now in a situation where I can give the stock more room to breathe. If the position continues to move in my favor, I begin to trail my stop more loosely, giving the stock room to “breathe.” Ideally, the stock continues to “stair step” higher. The stop can then be trailed more loosely, possibly below the last “step” (i.e. pullback or base)—(a).



### To The Letter?

When I define a setup, I usually try to be as specific as possible. This helps to weed out lesser setups. However, many times the pattern doesn't fit the setup to a "T" but still may be worthwhile. In these cases, as long as I can justify the pattern from a conceptual standpoint, I might still be interested. For example, with pullbacks, I normally like to see at least three but no more than seven days from the high (for longs). However, there are instances where I might find a stock that has only pulled back 2 bars interesting. By the same token, I might also consider stocks that have pulled back for more than 7 bars. On occasion, stocks that are in the spirit of the setup can actually be better than those that fit the pattern "mechanically."

### The Ultimate Discretion -- Not Trading

Your own equity is the best measure of your performance and/or the performance of your methodology for the present market conditions. Therefore, if your equity curve has been heading down of late, it may reflect either personal problems or poor market conditions for your methodology. It is at these times you might want to avoid trading altogether and then *slowly* ease back in when new opportunities present themselves. See "My Most Valuable Trading Lesson" for more on this subject.

Many new to my Trading Service ([www.davelandry.com/shop](http://www.davelandry.com/shop)) are surprised to see that often recommend taking NO action in less-than-ideal conditions. For my momentum based method, this is usually in choppy markets and/or when there are very few meaningful setups.

### Taking It Further

In this lesson, I have barely scratched the surface on how discretion can, and probably should, be used in swing (to intermediate) trading. I urge you to study these and, more importantly, develop your own layers of discretion through market observation and experience.