Short-Term Traders Get More than they Bargain for with the Mini Indexes

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Well, it's been a long, bumpy and painful ride in the stock market, and a number of traders fell out of that vehicle back up the road. So, where are they? Did they switch to currencies or real estate? We can't speak for all of them but a lot of the smart ones did switch…to the E-mini Indexes. That's right, the E-mini Indexes. The Chicago Mercantile Exchange's (CME) S&P and NASDAQ E-minis are the hottest thing going and for good reason, and the Chicago Board of Trade's (CBT) newly hatched Dow E-mini is coming along nicely. Unmatched for consistent volatility and tops in liquidity, these incredible markets are "goldmines" for the trader looking for a real opportunity to trade profitably again.

For short-term or intra-day trading, finding the right market vehicle is one of the most important steps. E-mini stock index futures have become very popular trading vehicles in the past few years due to having certain prized characteristics that other markets just don't have — certainly not all together…at the same time…in the same market. Honestly, if you were to have total freedom to design the most ideal market for short-term trading, your "dream market" would probably fall short of what these E-mini indexes have to offer the day trader.

In September 1997, the S&P 500 E-mini contracts were introduced by the Chicago Mercantile Exchange, followed by their NASDAQ 100 and, finally, the E-mini Dow futures by CBOT in March 2002. To list all of the advantages of trading these markets would require lots of ink and a thick pad, but some of the highlights include the unique combination of high volatility, high liquidity, high leverage, and the ability to trade with 100 percent electronic order execution platforms, which negates the need for pit or floor broker involvement. Add to that minimal slippage, tight spreads, no uptick rule, ability to short as easily as going long, absolutely no market research to do, much less time consuming than other futures, very low commissions, great short-term tax advantages, hedging opportunities, and no accounting mine fields. That means these markets are, and always will be, totally fair. No corruption, no manipulation, no insider trading and no scandals to have to deal with. That alone is worth the switch from other futures contracts less worthy.

Methods and Systems – Do They Matter?

Any of the above elements can have a substantial impact on your bottom line. Your success is the direct result of your choice of trading market and your choice of trading method. The fact that the E-mini S&P has experienced explosive growth of more than 2000 percent in just the last few years is no accident. A lot of traders are making the right choice there.

But what about the method? Does it matter? You bet it does. A trading method must fit your style of trading as well as your individual personality. If you're a little short on patience and discipline, you need something with structure…something highly mechanical, but not 100 percent.

Before we discuss what the trader needs, let's take a minute to discuss what the trader *doesn't* need. In recent years, the trend has been toward brutal complexity or black box simplicity. From one extreme to the other, the truth is that neither trading method works very well. Complexity breeds fatigue. Fatigue is the father of frustration. Frustration is the mother of failure. With a complex approach you always find at least one element that is not lined up exactly the way it should, and you will end up guessing anyway. Most people aren't super-human computer heads, and complex methods involving multiple charts and multiple indicators don't work very well for them, but thousands of dollars are spent until the trader realizes the secret to success lies in simplicity.

Now they go the other way…in search of the Holy Grail…that magical black box that will turn their computer into a veritable money machine as it does the buy and sell decisions for them, because they no longer have the confidence to make those decisions for themselves. These are the same people who wouldn't think of risking their lives by letting a computer drive them to work, but they think nothing of risking their financial future to a computer that doesn't even know when Greenspan is about to speak. Investors who believe in the myth that they can just have a computer program to manage their money while they sit back and collect the never-ending checks are not realistic.

The long and short of software-based systems is the undeniable fact that success cannot be purchased. It must be earned, and it takes commitment and dedication. Think about it. If there really were a software-based system that made money in long-term, all the big financial institutions would own it and take all the money out of the market and leave nothing for the rest of us. If you owned one that was making money hand over fist, would you sell it for any price? Probably not. The reason that a black box software cannot be effective for long is because it has been programmed based on past market data. The fact is that market dynamics are always changing and a program is unable to recognize that. But when you know how to be flexible with the market dynamic changes, you can have a good control over your trades. So much for black boxes.

But what about trading methods? You've heard the expression "if you want something done right, do it yourself." That expression goes double for the trader. Trading success is nothing more than finding the market that offers the greatest consistent profit potential and then finding a good, reliable, accurate and simple trading method that works for you. Not just here or there, or now and then. You want it to work on a consistent and ongoing basis because, let's face it, you want to be able to make money for the long haul. Are we talking about a holy grail again? Not at all. Mastering a proven method means you're the star, not your computer. You're in total control of your trades and your financial destiny. Now we come to the really important question, "Is there a teachable methodology that works?"

By now, hopefully, you know that complexity doesn't exactly correlate to profitability, and the Holy Grail lies somewhere between the fountain of youth and the tooth fairy. If you're not already too jaded to believe that trading success does exist and is within your grasp, then let's talk about a simple approach. By combining this simple method with the high tech power of the E-mini indexes, the result should be a match made in heaven.

The average price movement of the S&P 500 E-mini market is about 25 points per day and each point is worth $50 per point per contract, and you can trade as many contracts as your margin account and financial temperament can handle. If you trade five contracts in a trade, for example, and gain just two points on that trade, you would gross $500/day. That's $10,000 a month or $120,000 per year, before commissions. The S&P E-mini index will typically move those two little points in about five minutes on average, which translates into an opportunity to make $500 in about five minutes. Wait! That's a five to ten-percent return on investment in practically a blink. Can that be? Why do you think this market is now being called "the most successful product ever launched in the financial industry?" Of course, to be fair, you can *lose* the same amount if the market goes against you. The question is how do we manage the risk and increase the potential all the time to experience more winners than losers?

Commissions are amazingly low for this type of trading as are the margin requirements, but they both vary among different brokerage firms. Achieving two points per day from a market that averages 25 points volatility a day should not be a difficult task — especially when you utilize a high probability trading strategy combined with sound money management techniques and a disciplined trading approach. Combine this with today's technology in advanced 100-percent electronic trading platforms, and you might begin to imagine the possibilities…like getting in and out of trades at will, in as little as one second, without relying on a pit broker.

Where is the Market Going?

Take a look at the one-minute chart of the S&P 500 ***(Figure 1)***, and you'll notice something. The vast majority of the time, the index moves up or down at least two points or more every five to 20 minutes. By setting the profit target at two points from your fill price, you have a very high-probability target to begin with based on price movement characteristic of the index. This type of price fluctuation provides excellent trading opportunities over and over again throughout the day and, thus, one could make a couple of points and call it quits for the day. Making two points a day as a goal is a very conservative approach.

FIGURE 1: One-Minute Chart of E-mini S&P 500

To increase the odds in your favor, avoid over-trading, and filter out price noise, you can adopt to a simple yet powerful trading methodology that seamlessly blends squeaky tight stops, highly accurate signals and sound money management approaches to achieve superb trading goals. The stop for such a method shouldn't be more than two points. The win/loss ratio is 50/50, but you should gain more winners than losers with this method. In order to determine the buy and sell signals, I use a stochastic and moving average with specific parameters in a one-minute chart. The parameters set up are very important to the accuracy of the signals when they confirm a certain price movement. (The entire set up is provided in training workshops that we conduct every week.) The two indicators are based on different formulas and looking at the market from two different angles. Whenever they *both* confirm a certain move, it implies a high-potential trade.

Most traditional methods of trading utilize multiple time frame charts. The 1, 5, 10, 15 and 30-minute charts are all supposed to somehow give us some magical power and accuracy when these charts confirm a certain price movement. The biggest disadvantage of those methods, in general, is missing a lot of opportunities. For instance, if we have a four-point move total on a one-minute chart, we can get in and out of that move and make a couple of points from it with ease. But if we want to wait for a five-minute chart to confirm a 10-minute chart to confirm a 15-minute chart, etc., by the time they show the confirmation, guess what? - the four-point move is over. Even if we use a single five-minute chart, 90 percent of our signals are never seen.

With multiple time frames, we miss a lot of opportunities to catch the small movements, such as a couple of points which could be a substantial gain depending on how many contracts are being traded. Notice the simplicity of the chart shown in this article. It's clean and uncluttered. A single one-minute candlestick chart and two tuned indicators combine forces to seek out even the slightest moves in the market and let you turn them into quick in-and-out trades.

The difference between this chart and the multiple time frame charts can be compared to two weathermen. One has to prepare the five-day forecast by trying to harness the number-crunching power of millions of dollars of computer equipment and pour over decades of charts and data. In the end, the public scolds him (or her) because something is usually wrong…especially that fourth and fifth day. The farther out the forecast, the worse it gets. The other weatherman, however, is praised daily because he's almost always right. You see, his job is to prepare the weather forecast for just the next five to ten minutes. Put a thermometer in your hand and you could do his job just as well! That's because, by predicting the weather for just the next few minutes, you don't have to deal with all the random variables that the other weatherman does.

It's the same with trading the indexes. When we use multiple time frame charts, we're trying to predict trends — trying to predict some price the market will be at somewhere off in the future. An hour, a day, a week into the future…the farther out you go, the worse it gets, because you're trying to predict all the thousands of big and little events that will shape the future direction of the market.

But how about predicting the market direction for the next five minutes or so? What if we used the tremendous power of modern technical analysis to tell us that direction, and we let the natural tendency of the market itself tell us how far it would go in that direction? It's starting to make a lot of sense now, isn't it? You bet it does.

Most traders pursue one school of thought in their trading. Some would approach the market using pattern recognition methods and wait for the high probability patterns to happen. Some other traders use technical analysis to predict the next market price movement. Some use astrology, news, and a number of other means to get "the answer."

We have found that combining the legendary "high-probability patterns" with simple, yet powerful, technical analysis is the single most accurate way to determine the highest possible probability for buy and sell points in certain time frames of the day. The best hours are the first and last two hours of the market. In ideal volatile and liquid markets such as the E-minis, this is an excellent approach to trade. Does this mean that we can only expect to achieve small two-point profits in our trades? In this model, it is possible to accurately detect those long, strong trends at their very earliest stage and trade in their direction. You can trade counter trend, or even in a sideways market, as long as it is not too choppy. Choppiness could be defined simply by the price range in a certain period of time.

Treading the Waters Lightly

Trading is like most other businesses. Based on statistics, 90 percent of new businesses fail in the first year or two. There are three basic reasons for this. First is under-capitalization, the second is lack of a reliable business planning, and third is lack of management. Any of the above factors can cause a business to fail, but still there are many people who try to fulfill their dreams of owning their own business. Interestingly, the same statistic and rules apply to the trading industry. A trader may fail for lacking one or more of the same elements such as being under-capitalized, not having a proven trading method and money management, and lack of discipline or management to implement the plan correctly.

With today's technology, it is easier than ever before to go through the proper steps and stages to develop and master a trading plan and to implement that plan with no initial capital risk exposure in order to make sure that the method and the plan works well. After mastering your method and adapting it to fit your personality and financial status, you can test it in simulated trading to find out how viable your trading method is without risking real money. This no-risk trial proves that your business plan is good and effective. I always urge every one to achieve a total of 15 consecutive days of trading success before they begin trading with real money. As most traders will attest, that's almost impossible without a very powerful and accurate trading method plus a very good personal mastery of that method. So, more is involved than just having a good plan to achieve the success that the trader desires.

The next step, assuming that the trader is not under-capitalized, is the correct management (or implementation) of that plan. This step will probably be the most challenging part because it involves putting actual risk capital in your trades. The training wheels are off. We have learned that the best way to make a smooth transition from simulation to the "real deal" stage is to begin trading with a small amount of money, perhaps as little as one contract. The least amount of money will bring the least amount of human factors (emotions) in the picture. There will be time for fear, greed and uncertainty later.

After proving that the method works in simulation, followed by small money trading, everything should become second nature to the trader as confidence grows and skills are honed. Patience, discipline and focus take control and the trader transforms into a fearless warrior with an unbeatable arsenal of trading weapons. Then by increasing the trading size by adding more contracts (based on what money management dictates), the trader enjoys the fruits of their learning labor, and the rewards go even beyond the financial. It takes work, dedication and commitment in the beginning to get to the positive working stage, but it is well worth the effort. This was the main philosophy behind the founding of Traders International as a trading school in 1998 — in order to share the most simple and powerful trading methods, as well as money management techniques for individuals of all different levels who are gearing up to trade the E-mini futures contracts.

It's been just five years since the E-mini "craze" began, and today it's no longer a craze, but a boon to a variety of traders who may not have the wherewithal to trade individual stock, but want to look at the broader market on a more limited basis. It will be interesting to see in future years how many more of these instruments are conceived, born and continue their lives based on the same brilliant concept.

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