

Short Term Trading Strategies That Work

A Quantified Guide to Trading Stocks
and ETF's

By Larry Connors and Cesar Alvarez

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Larry Connors was a broker for Merrill Lynch in 1982. In 1987 he was earning 3 to 5 times more than almost everyone with whom he attended college. In 1987 he went to work for Donaldson, Lufkin and Jenrette. His goal was to learn how to become a professional trader. On March 4, 1994 he quit his job and became a professional trader. In the early days of trading, there were many inside methods to scalp money from the market. As computers and instant news grew, this became more difficult. This book describes the techniques that worked then and can still work today.

The strategies in this book have been backtested using data from 1995 to 2007.

Quotes from the book

“The one thing [professional traders] have in common is that they know what it’s like to trade from a position of strength. Each has the institutional and floor experience to fully understand that in order to consistently make money from the market, they want to buy into the selling and sell into the buying.”

“They followed their dream and have become successful because of their brains and most importantly their tenacity.”

“...the never ending challenge of figuring out a game that may be the most complex and fascinating game in the world. It’s a game with a fixed set of rules, but with the pieces always moving.”

“Philosophically, I live in a world of reversion to the mean when it comes to trading. What that simply means is that something stretched too far will snap back.”

“First we’ll look at certain behavior which is inherent in the marketplace. ... You will learn that what seems to be logical and obvious is often wrong when it comes to trading.

“It’s one thing for someone to give you a handful of rules and say “trust me, this works.”” It’s another thing to have it backed up by statistical evidence”

The Chapters

Think Differently

Rule 1 – Buy Pullbacks Not Breakouts

After the market has dropped three days in a row, it has risen more than 4 times it's average weekly gain over the next five trading days.

After the market has risen three days in a row, it has on average lost money over the next five trading days.

Rule 2 – Buy The Market After It's Dropped; Not After It's Risen

After the market has dropped three days in a row, it has risen more than 4 times it's average weekly gain over the next five trading days.

After the market has risen three days in a row, it has on average lost money over the next five trading days.

Rule 3 – Buy Stocks Above Their 200-Day Moving Average, Not Below

This rule is not fool-proof.

Many good stocks represent real value below the 200-day MA but it's easier and less stressful to follow this rule.

Large losses can be prevented by following this rule.

Rule 4 – Use The VIX To Your Advantage...Buy The Fear, Sell The Greed

If SPY (or SPX) is above its 200-day moving average, the higher the VIX is above its 10-day simple moving average it's more likely oversold and a rally is near.

The VIX 5% rule

- If 5% above its 10-day SMA, buy the market.
- If 5% below its 10-day SMA, lock in gains (and don't buy).

Rule 5 – Stops Hurt

The tighter your stops, the less money you will make. The wider your stops, the better.

You can control losses with position size and money management

Rule 6 – It Pays To Hold Positions Overnight

During the test period, buying the SPY on the open and selling the same day's close lost -70.88 points.

Buying the SPY on the close and selling on the open gained 171.40 points.

Trading With Intra-Day Drops Making Edges Even Bigger

The greater the intra-day momentum to the upside, the worse the performance has been over the next five days.

The greater the intra-day selloff, the better the performance over the next five days.

The 2 Period RSI

The Traders Holy Grail of Indicators

For stocks above their 200-day moving average, a 2-period RSI above 90 should not be bought. Aggressive traders might prepare to short them. Readings below 10 are oversold. Readings beyond these are even better. These were tested up to one week. Trades held one week did better than less time.

Double 7's Strategy

If the SPY is above its 200-day moving average and it closes at a 7-day low, buy.

If it closes at a 7-day high, sell your long position.

The End Of The Month Strategy

For stocks above their 200-day moving average, gains are higher on the following days of the month, in order from highest to lowest, 25, 24, 1, 27, 26, 29, 28, 30, and are lowest on 3 through 8.

If stock dropped the previous day, the best days are 25, 30, 27, 26, 24, 28, 29, 22, 1, 31.

If stock dropped two or more consecutive previous days, the best days are 25, 26, 24, 27, 30, 28, 29, 23, 1, 22, 19, 31, 18.

Five Strategies To Time The Market

VIX Stretches

SPY above 200-day SMA

VIX 5% or more above 10-day MA for 3 or more days

Buy the market on the close

Exit when SPY closes above a 2-period RSI reading of 65 or more.

VIX RSI

SPY above 200-day SMA

2-period RSI of VIX above 90

Today's VIX open is greater than yesterday's close

2-period RSI of SPY is below 30

Buy the market on the close

Exit when 2-period RSI of SPY closes above 65.

TRIN

SPY above 200-day SMA and 2-period RSI is below 50

TRIN closes above 1.00 for three consecutive days

Buy on close

Exit on close when 2-period RSI above 65.

Cumulative RSI

SPY above 200-day SMA

Sum of last 2 days RSI is below 45

Buy on close

Exit when 2-period RSI closes above 65.

S&P Short

SPY below 200-day SMA

Market closes up 4 or more consecutive days

Sell on close

Cover short when SPY closes under its 5-period MA.

Exit Strategies

Fixed Time

Does not like. Should sell into strength.

First Up Close From Previous Day

By Larry Williams, excellent strategy

Close Above A New High

A valid choice

Close Above Moving Average

5-day is first choice, then 10-day MA.

2-Period RSI

Closes above 65, 70 or 75.

Trailing Stops

The tighter the stop, the worse the performance.

Few stop strategies showed consistent results.

Choose on exit strategy

Stay with it

Remember - the stronger the move the more likely you want to lock in gains.

The Mind

You must be prepared for any situation.

You need to know how you will react before it happens.

Know the appropriate action to take.

Have the discipline to do it.

What would you do if:

You start trading a new strategy that tested well but immediately starts losing money?

What would you do if:

You start trading a new strategy that tested well and immediately starts making big money?

What would you do if:

You have lost money eight consecutive days, you are long many positions and the market is tanking?

What would you do if:

The market has one of it's worst months in years and so do you?

What would you do if:

You are long 1000 shares, you place an order to sell at \$48, at the end of the day you realize you bought instead of sold, you are now long 2000 shares at \$43?

Interview with Richard J. Machowicz

Martial arts specialist, Navy SEAL instructor.

Author of “Unleash the Warrior Within: Develop the Focus, Discipline, Confidence and Courage You Need to Achieve Unlimited Goals.”

Why people achieve great success in trading and all walks of life.

<http://www.tradingmarkets.com/.site/stocks/tradinglessons/interviews/Not-Dead-Cant-Quit-No-Limit-Thinking-with-Navy-Seal-77443.cfm>

The Finale – a summary

16 Short Term Trading Strategies That Work

Strategy 1

Buy pullbacks, not breakouts.

The statistics overwhelmingly prove that.

Strategy 2

Buy the stock market after it has dropped multiple days in a row, not after it has risen.

Strategy 3

Buy stocks above their 200-day moving average.

Strategy 4

Buy stocks when the VIX is 5% or more above its 10-period moving average.

Lock in gains (or short stocks) when the VIX is 5% or more below its 10-period moving average.

Strategy 5

Stops are potentially an expensive form of insurance.

Strategy 6

Hold positions overnight in times of concern.

Strategy 7

Buy stocks on intra-day pullbacks in order to increase the edges even more.

Strategy 8

Apply the 2-period RSI to all of your trading. It's almost the holy grail of indicators.

Strategy 9

Buy the market and stocks
when the 2-period RSI is below 5.

Strategy 10

Trade with Cumulative RSI's.

The lower the Cumulative RSI, the better.

Strategy 11

Trade Double 7's on U.S. and World Indices, and
ETF's.

Strategy 12

Time the market using TRIN, the VIX, the 2-period RSI and price as described in the Market Timing chapter.

Strategy 13

Buy stocks at the end of the month, especially those that have dropped 1 to 2 days in a row.

Strategy 14

There are many good exit strategies. The key is to make sure the ones you choose are dynamic. The best are the close above the 5-period moving average and the RSI exits.

Strategy 15

Have a plan in place to deal with the many realities of daily trading.

Professional trading requires professional preparation.

Strategy 16

The most important strategy begins with your mind.

Your mind will dictate your success.

The more focused you are on your targets, the more successful and profitable you will become.

The End