

The ART
and SCIENCE
of TRADING

Course Workbook

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Module 1: Chartreading 101

This module, the first of the course, focuses on some important foundational concepts that are often overlooked. We begin with an investigation of what it means to have trading edge and why it matters. Our goal in all of this work is to focus on practical application, but to also supply enough theory to support the work and to make sure that the trader understands the “whys” as much as the “hows”.

This module also includes a solid look into price charts. Too often, traders begin their work without truly understanding what the chart represents. Chart display choices are made based on vague visual appeal, similarity to something seen elsewhere, or a recommendation from a friend (who may or may not know what he is doing!) Thinking deeply about the chart also leads us to our next area of focus: chart stories.

I came up with the term “chart story” when I was working with beginning traders. When we think in these terms, we imagine that every aspect of every bar is important, and we try to understand the part every tiny detail plays in the developing story of the market. (We must acknowledge right away that this line of thinking is misleading because it does not respect the random variation in the market. Its value is only as a training tool to help build solid habits in chartreading.) This is one way to look at and to think about price charts, and it lays a solid foundation for developing market feel down the road.

The supplementary readings for this section also cover some thoughts on the process of learning to trade and why it can be so difficult. Simply put, we do not learn to trade at all—rather, we become traders. And that journey, richly rewarding as it may be, is long, challenging, and fraught with danger. The trader who understands this from the first steps is much better equipped to succeed.

Section 1: Chart Setup

You should begin to set up your charts, or, if you are an experienced trader, to rethink your existing chart set-up. While there's no right or wrong, it's probably a good idea to move toward simplicity and a focus on the chart itself (rather than on indicators.)

A common question is what my chart settings are. There's no need to duplicate exactly, but the charts in this section use:

- Modified Keltner Channels set 2.25 average true ranges around a 20 period exponential moving average.
- A modified MACD that uses simple instead of exponential moving averages, and the settings of 3-10-16 (with no histogram) for inputs.

For the developing trader, it's probably a good idea to use the same chart setup for all markets and timeframes. Of course, there may be reasons you want to use different indicators or setups on, say, monthly vs. 5 minute charts, but the purpose of these exercises is to train your eye to see the data in a consistent way.

Experiment and play with the options your charting package presents. Sometimes different color settings can be more pleasing to your eye, and it's also worth taking some time to look at candles and bars, spending more time on whichever you are less comfortable with.

Section 2: Chart Stories

This is an exercise that is designed to do a few specific things:

- To force you to slow down and to look at the details of the charts
- To get you to start thinking about the forces that might be behind the price formations
- To start thinking about emotional context in extreme situations
- To show you a handful of important historic moments in financial markets. (Not every chart in this sector is designed to that end; some are simply illustrations of interesting patterns.)
- To begin to awaken some sense of intuition and inductive learning.

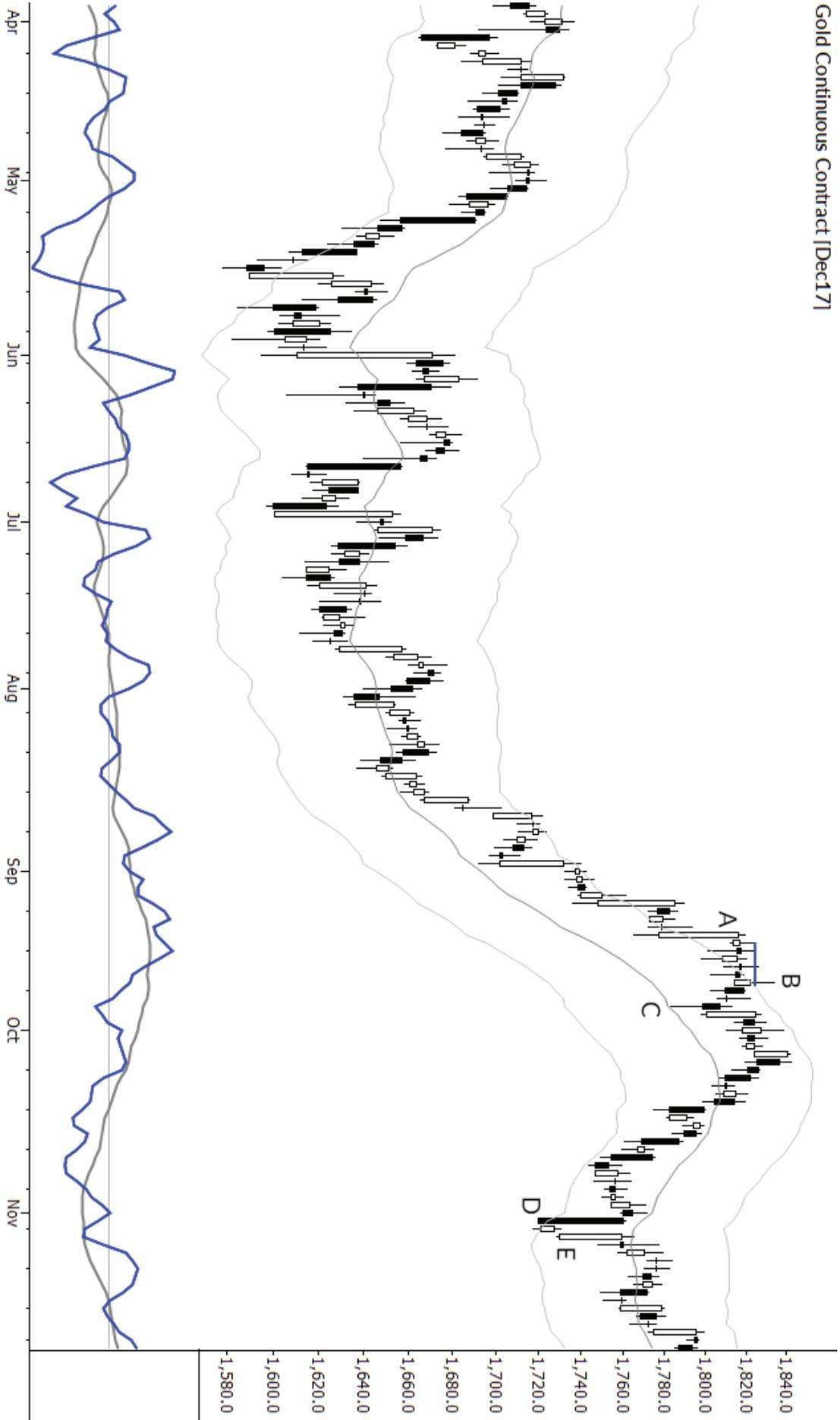
For the purpose of this exercise, assume that every bar has a story; your job is to tell that story. Rather than worrying about being right or wrong, focus on the thought process and inductive nature of this analysis. There really are no wrong answers here, and you may even find value in doing these exercises more than once. Finding interesting examples on your own would be another way to extend the analysis.

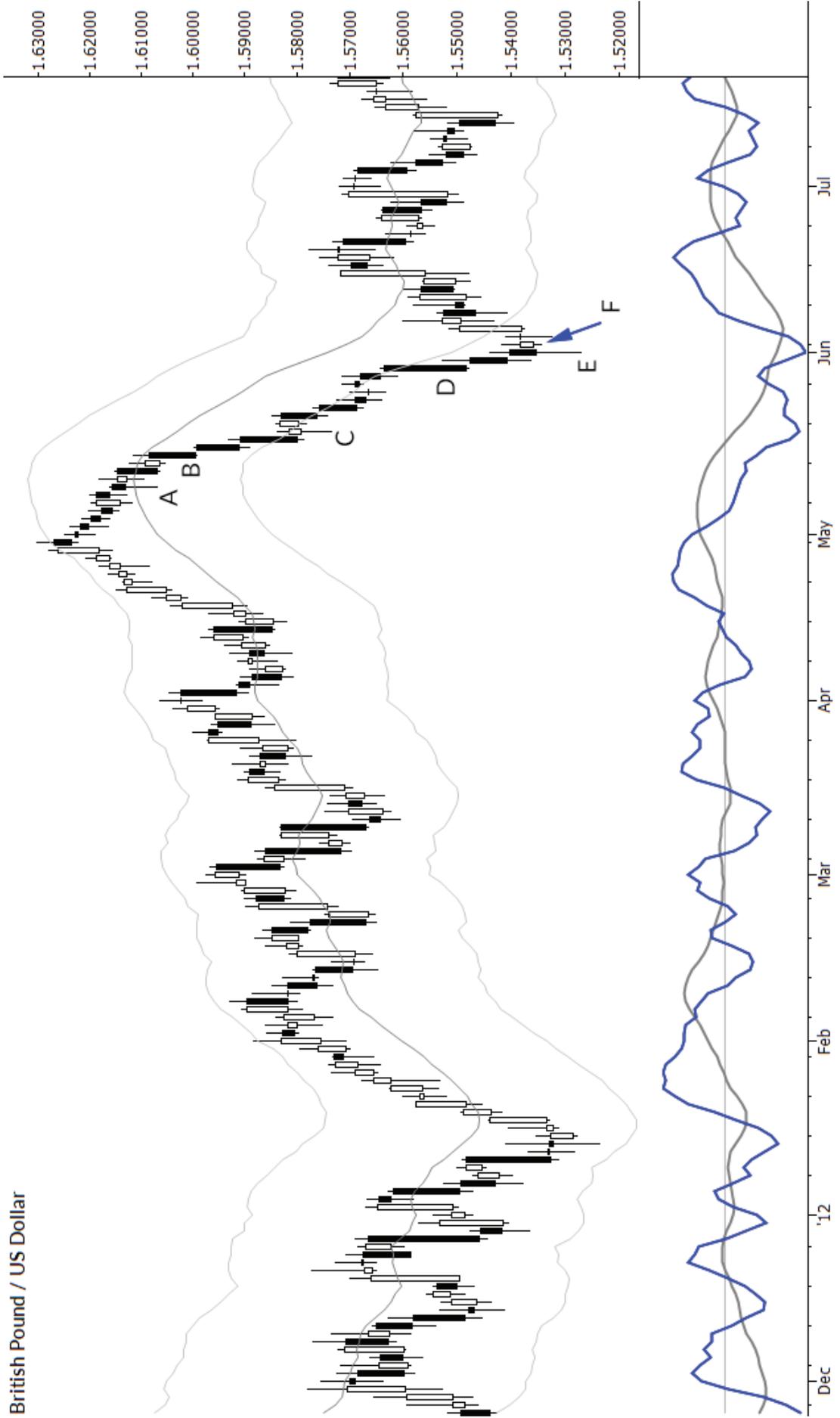
If the chart has text, answer the question or do the specific analysis on the chart. If there is no text, then write a separate explanation for each labeled bar—in all cases, make sure that each bar designated with a label receives your attention and a text explanation.

Adequate explanations will usually be 2-6 sentences long and will focus on concepts such as:

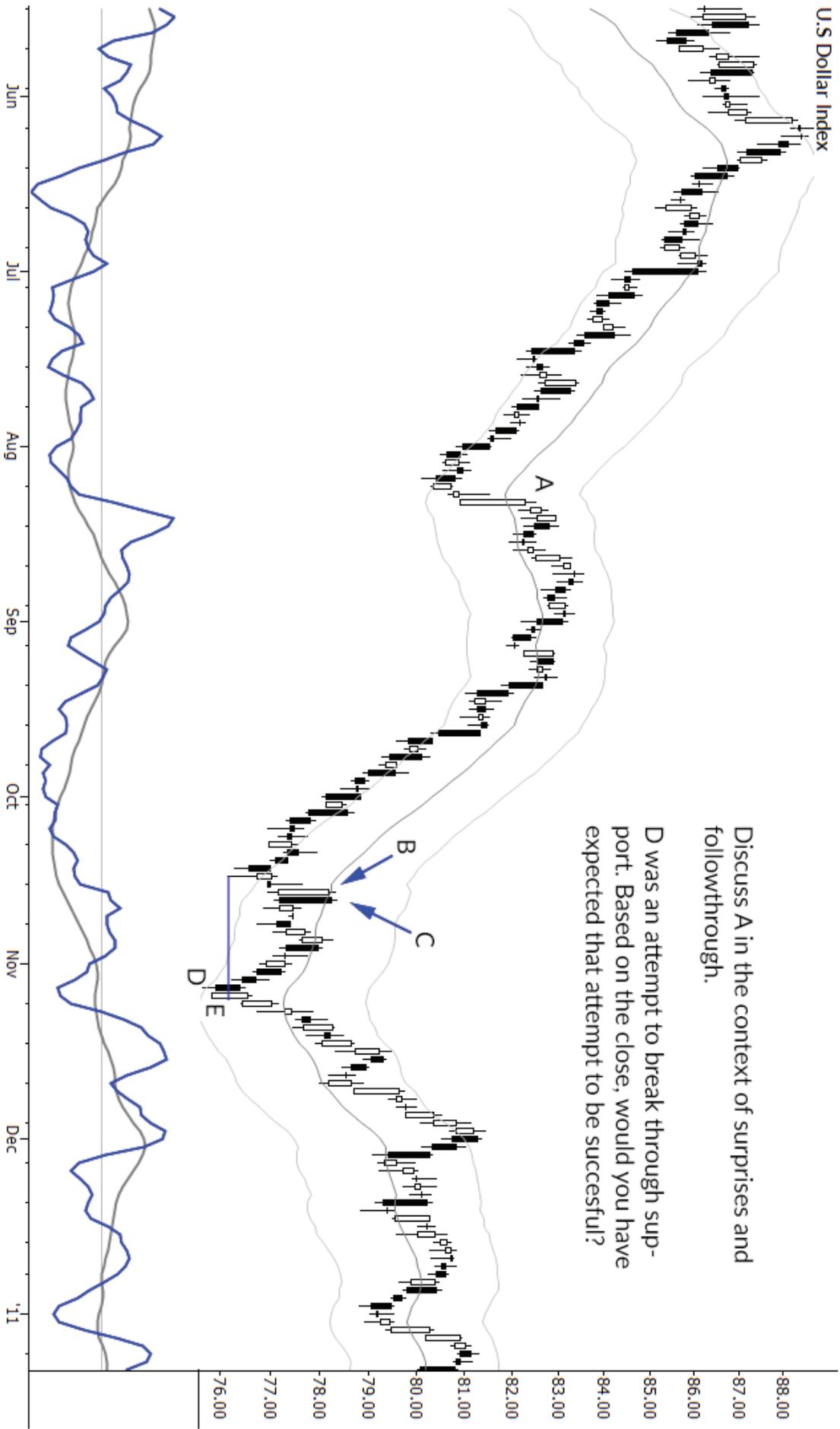
- The position of the open and close within the day's range
- The position of the open and close relative to each other
- The range of the bar relative to previous bars
- Consider each bar both alone and in relation to previous bars
- Any "surprises" (This is a deliberately large category.)
- Action around any obvious support and resistance levels. (This is not an exercise in support and resistance, so do not focus on this aspect.)
- It may be useful to think it terms of large groups of buyers and sellers driving the market, and the battle between those groups.

Gold Continuous Contract (Dec17)

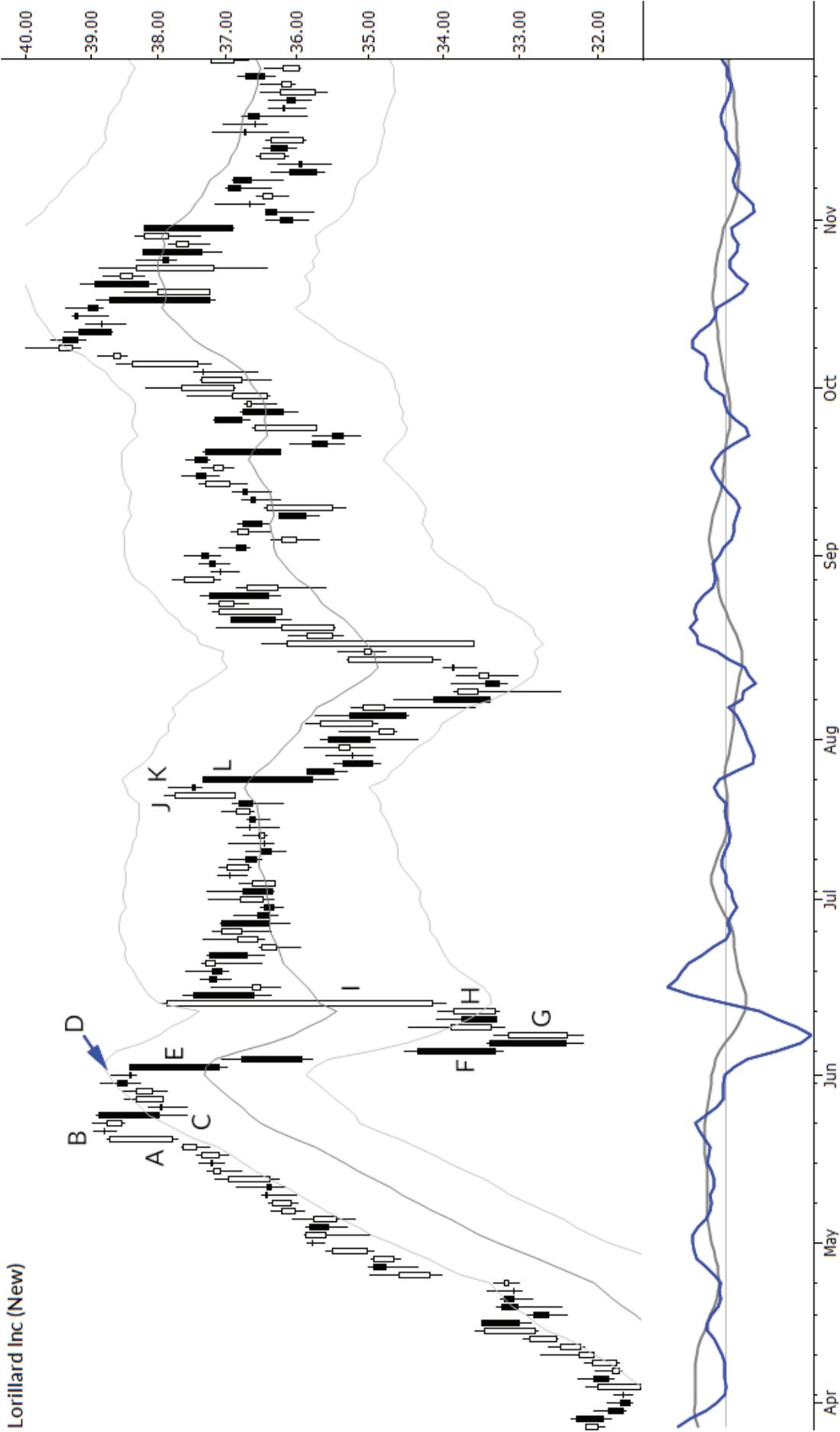




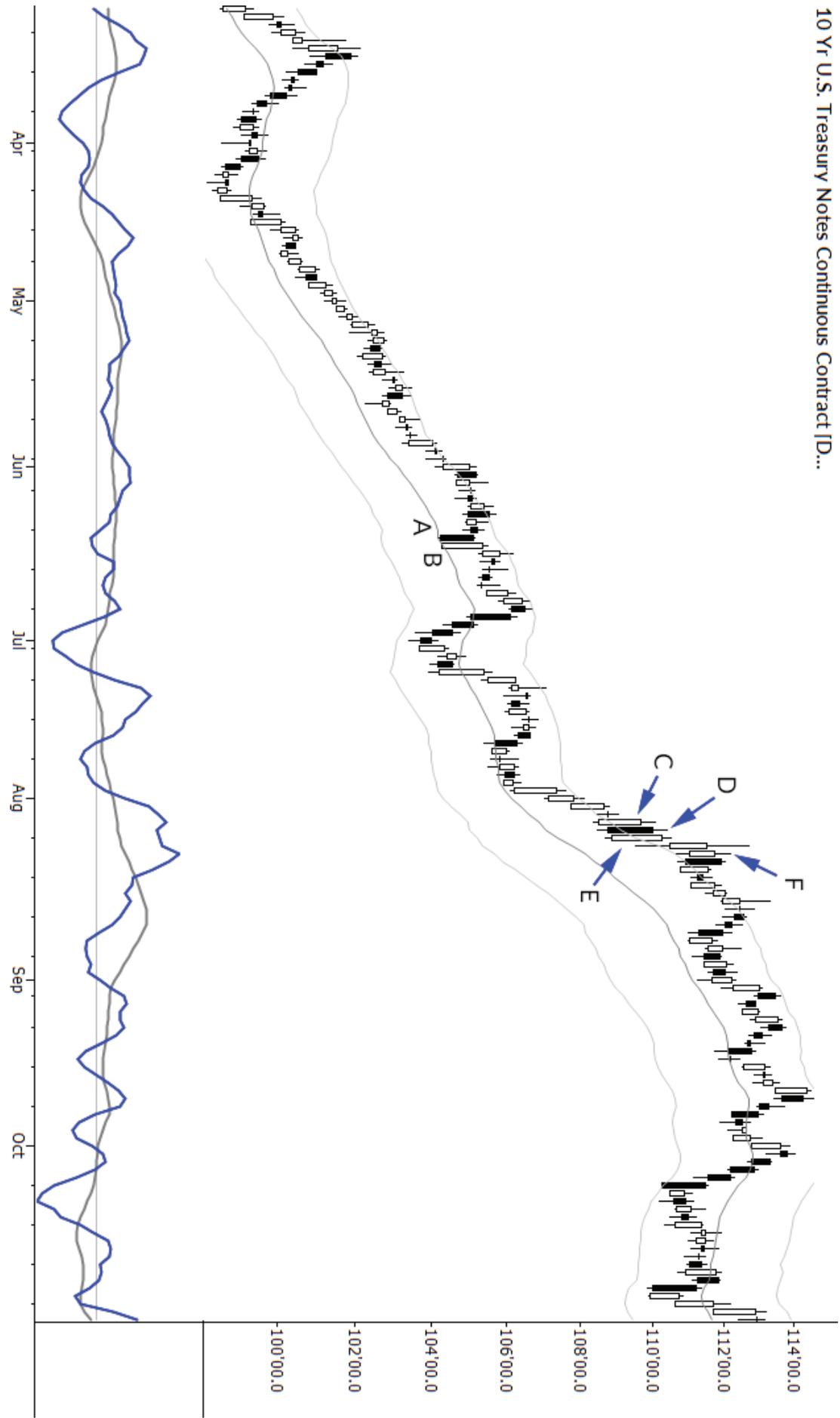
British Pound / US Dollar

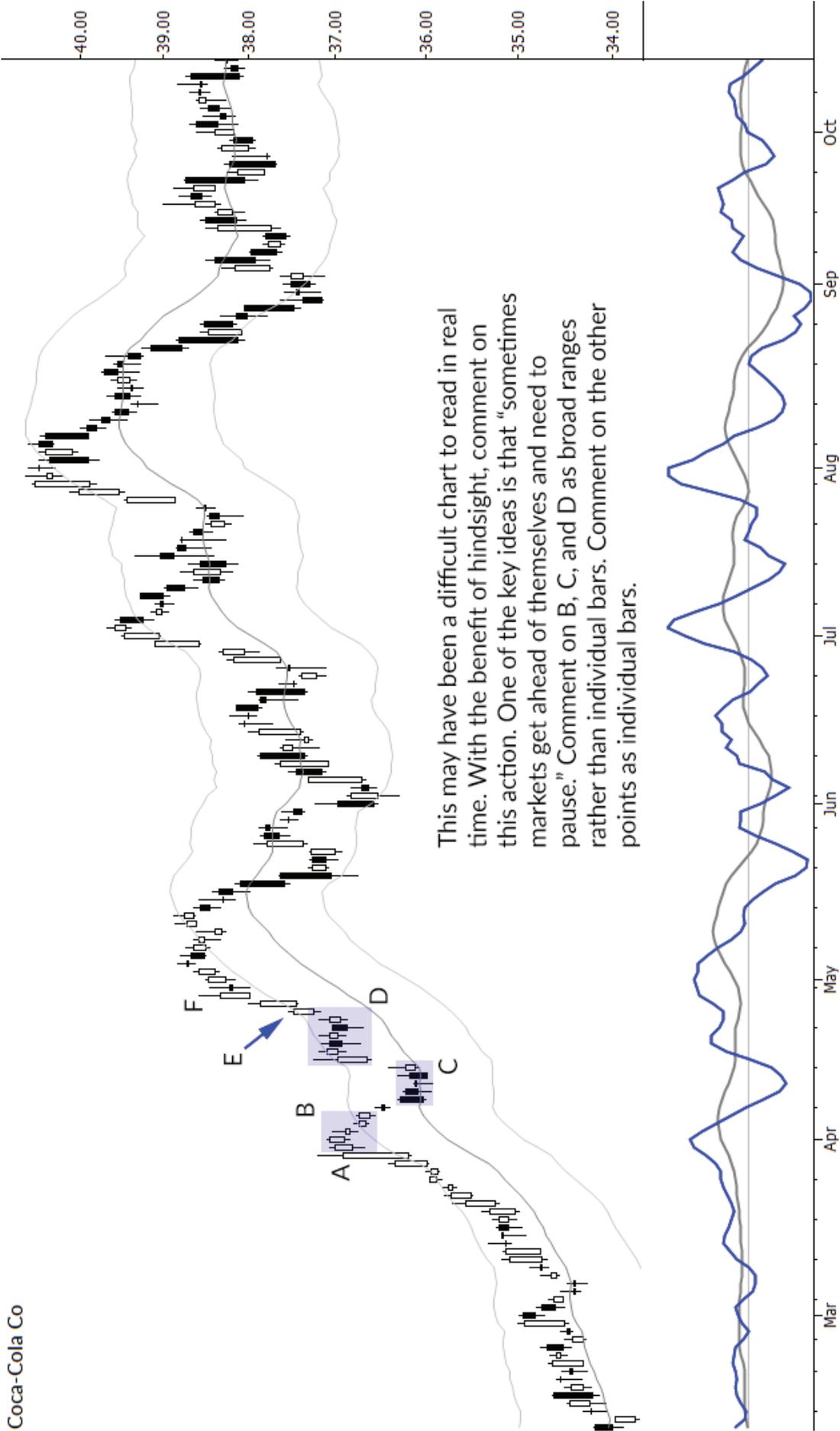


Discuss A in the context of surprises and followthrough.
D was an attempt to break through support. Based on the close, would you have expected that attempt to be successful?



10 Yr. U.S. Treasury Notes Continuous Contract ID...





This may have been a difficult chart to read in real time. With the benefit of hindsight, comment on this action. One of the key ideas is that "sometimes markets get ahead of themselves and need to pause." Comment on B, C, and D as broad ranges rather than individual bars. Comment on the other points as individual bars.

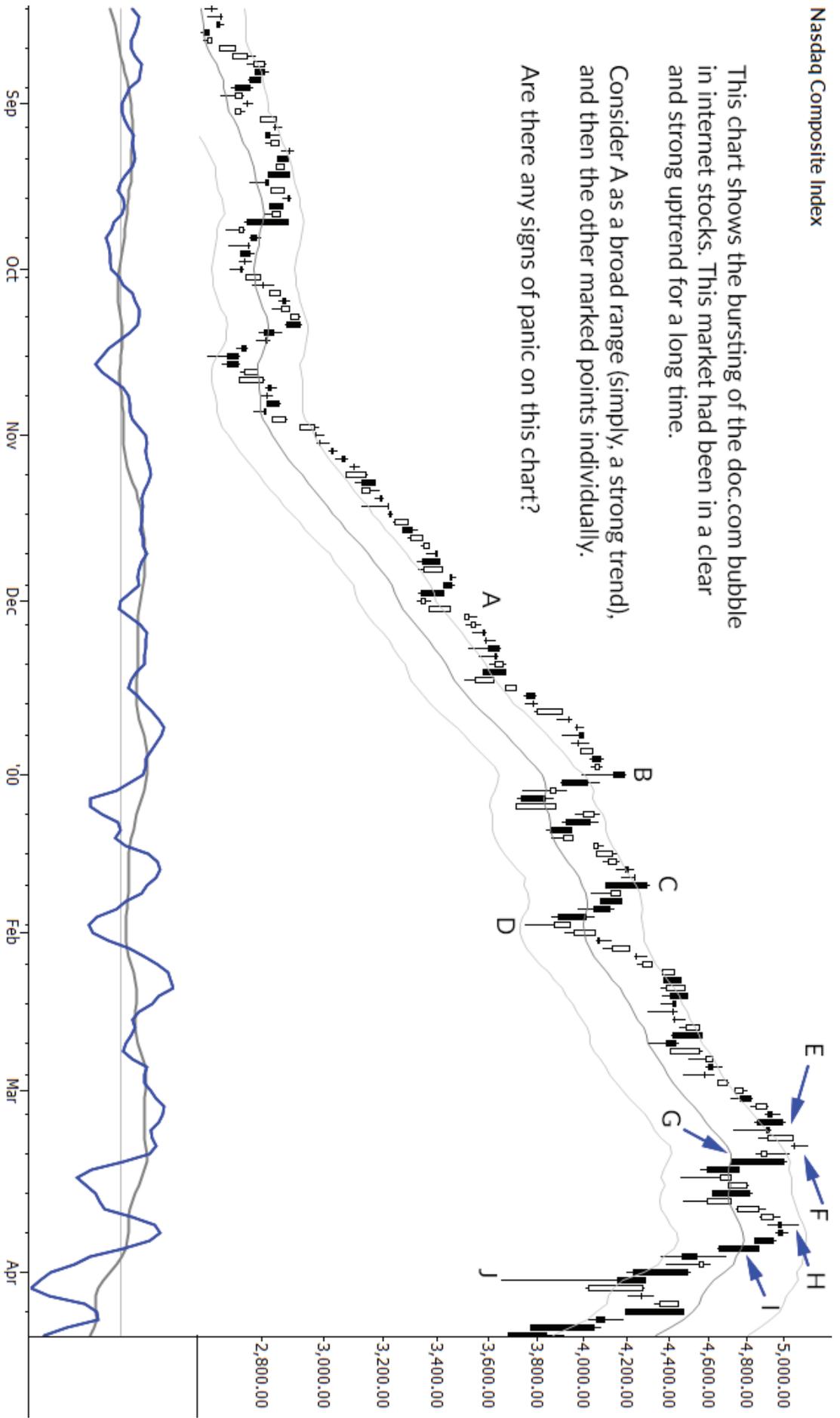
Coca-Cola Co

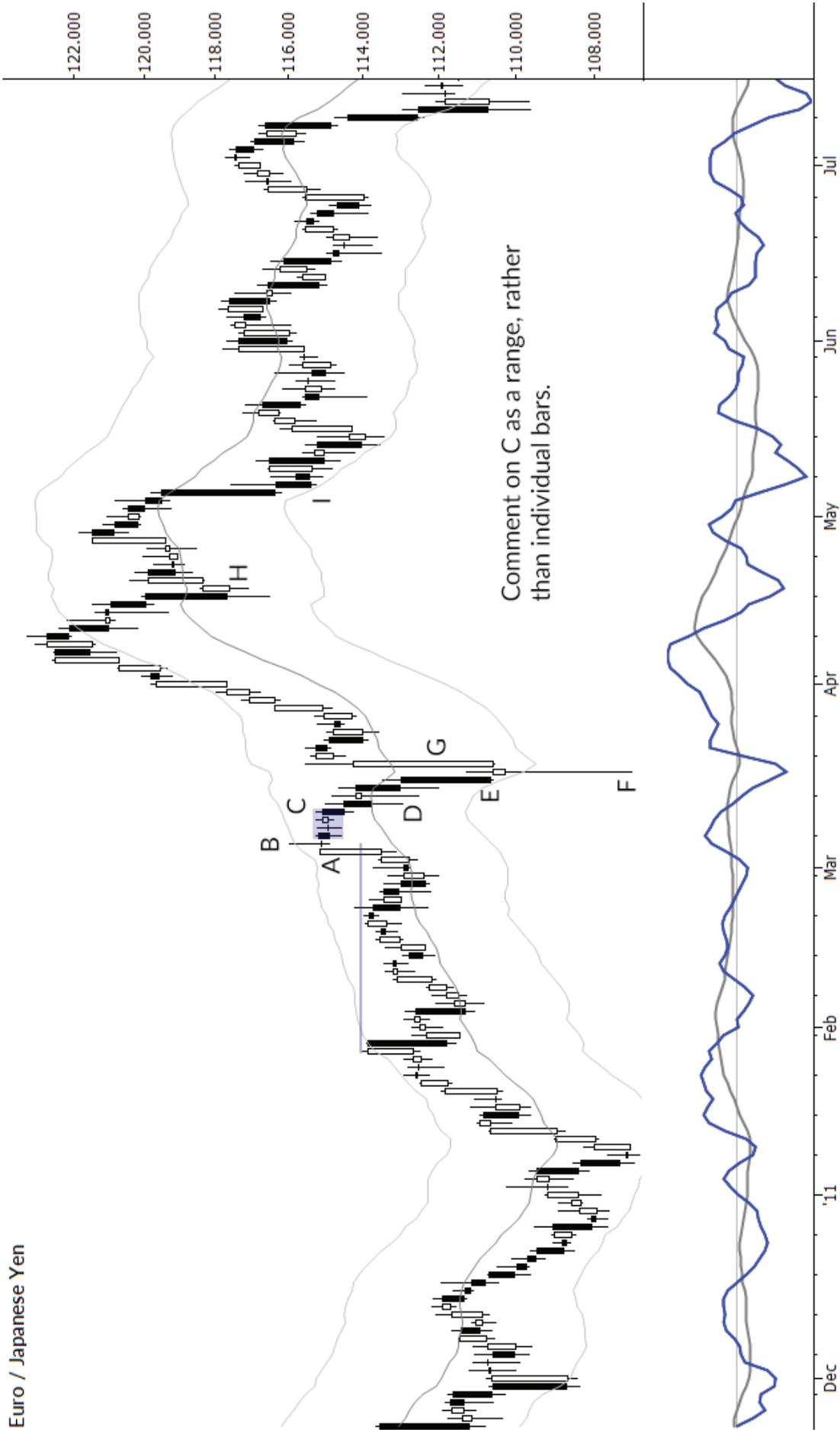
Nasdaq Composite Index

This chart shows the bursting of the dot.com bubble in internet stocks. This market had been in a clear and strong uptrend for a long time.

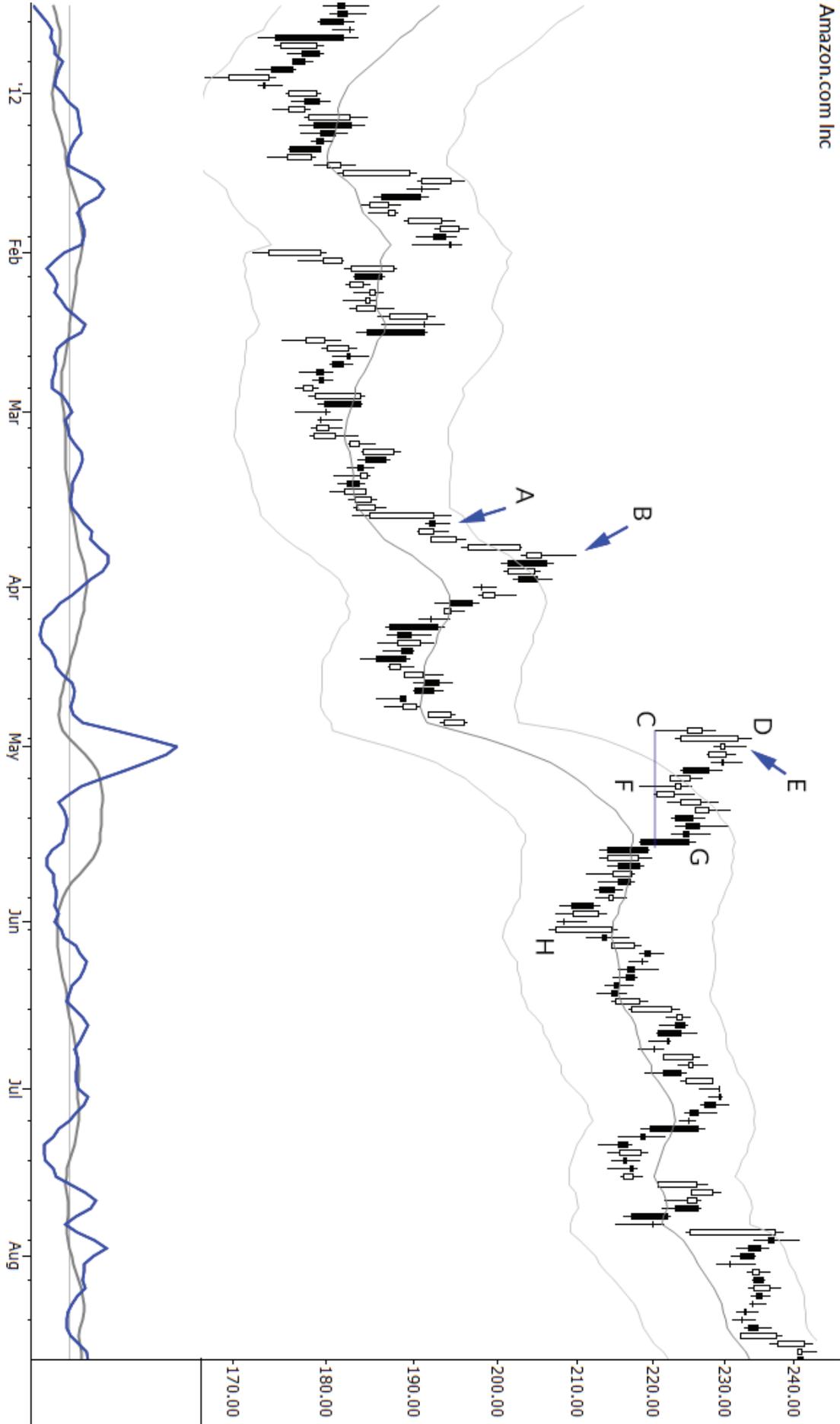
Consider A as a broad range (simply, a strong trend), and then the other marked points individually.

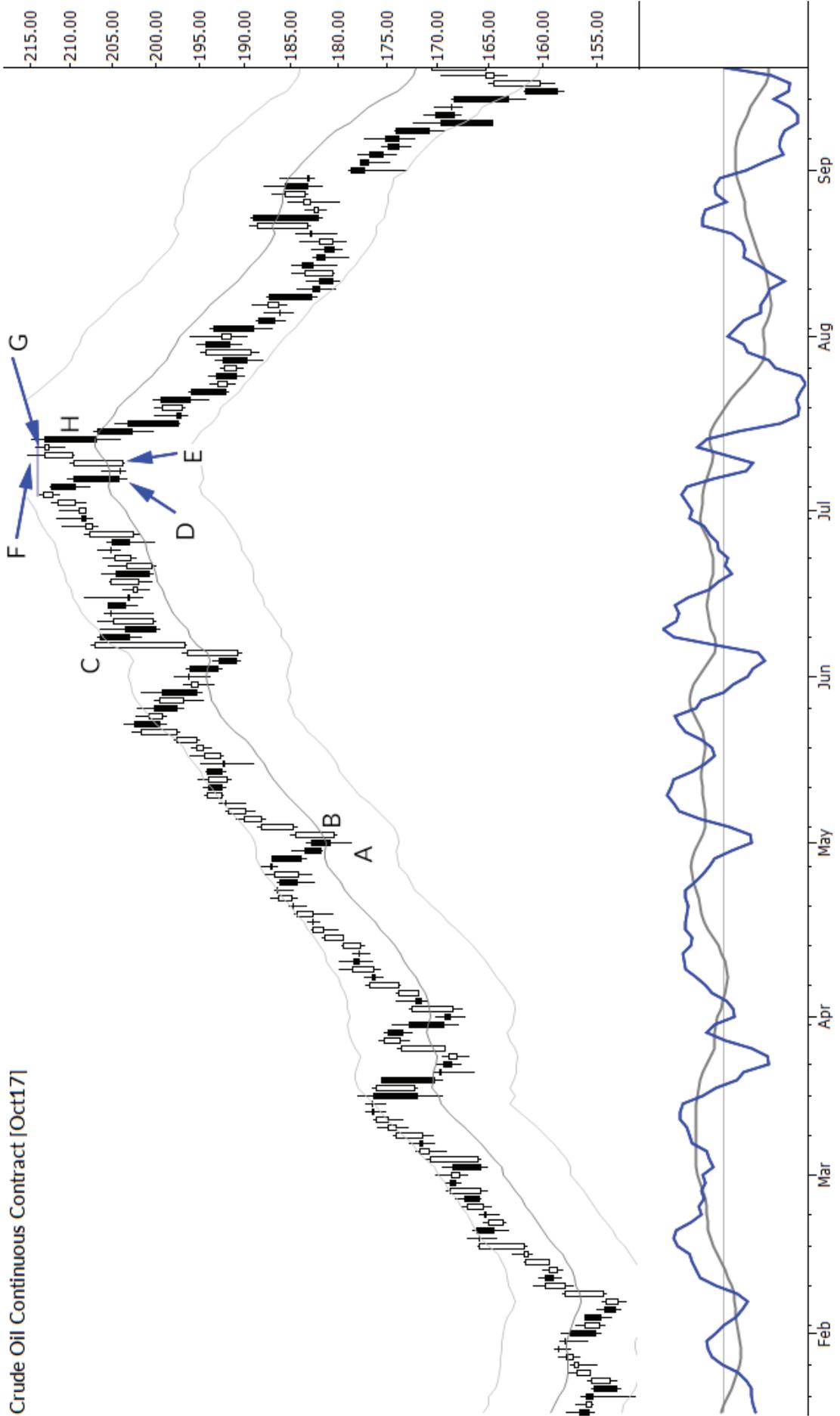
Are there any signs of panic on this chart?





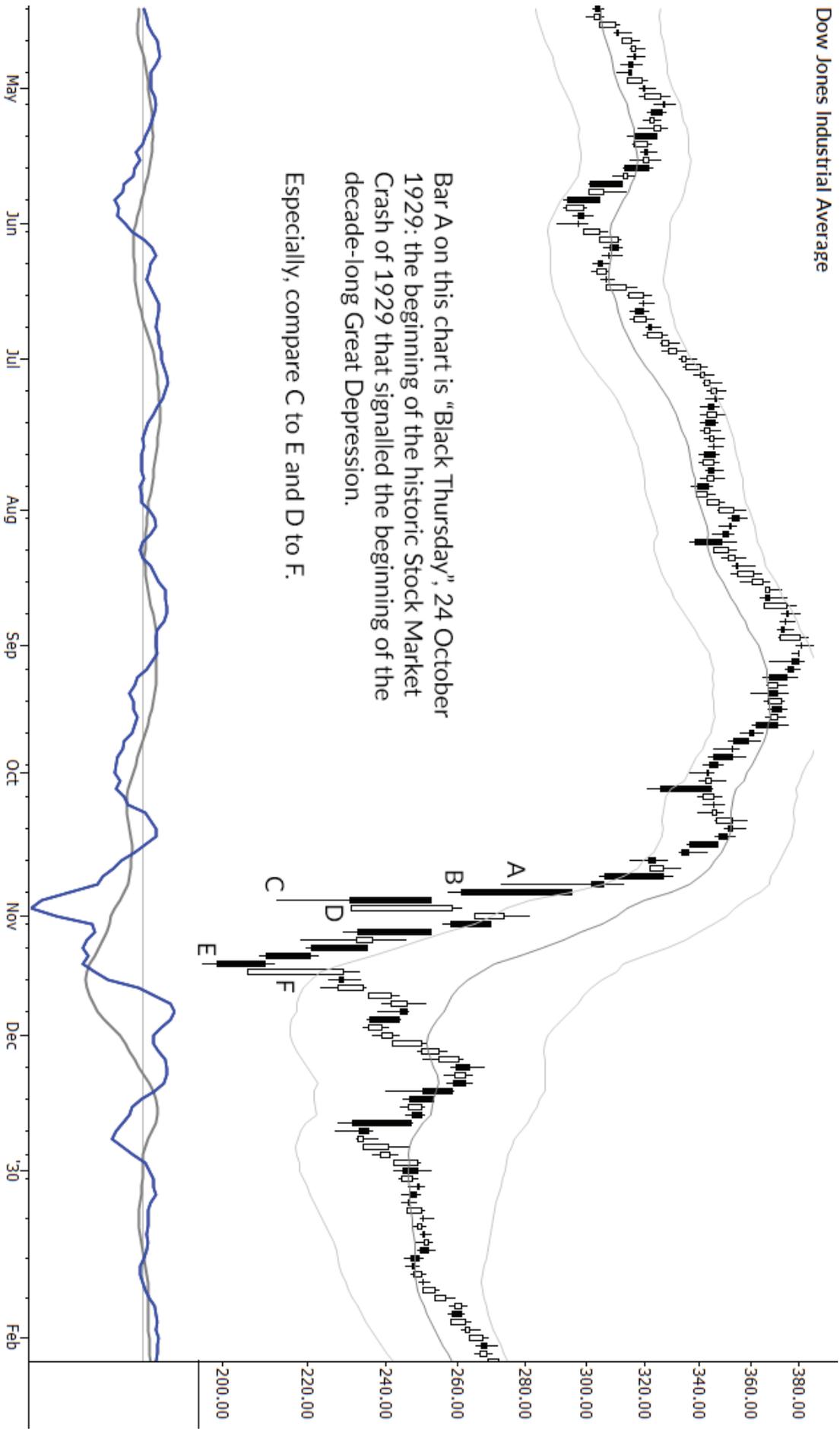
Amazon.com Inc



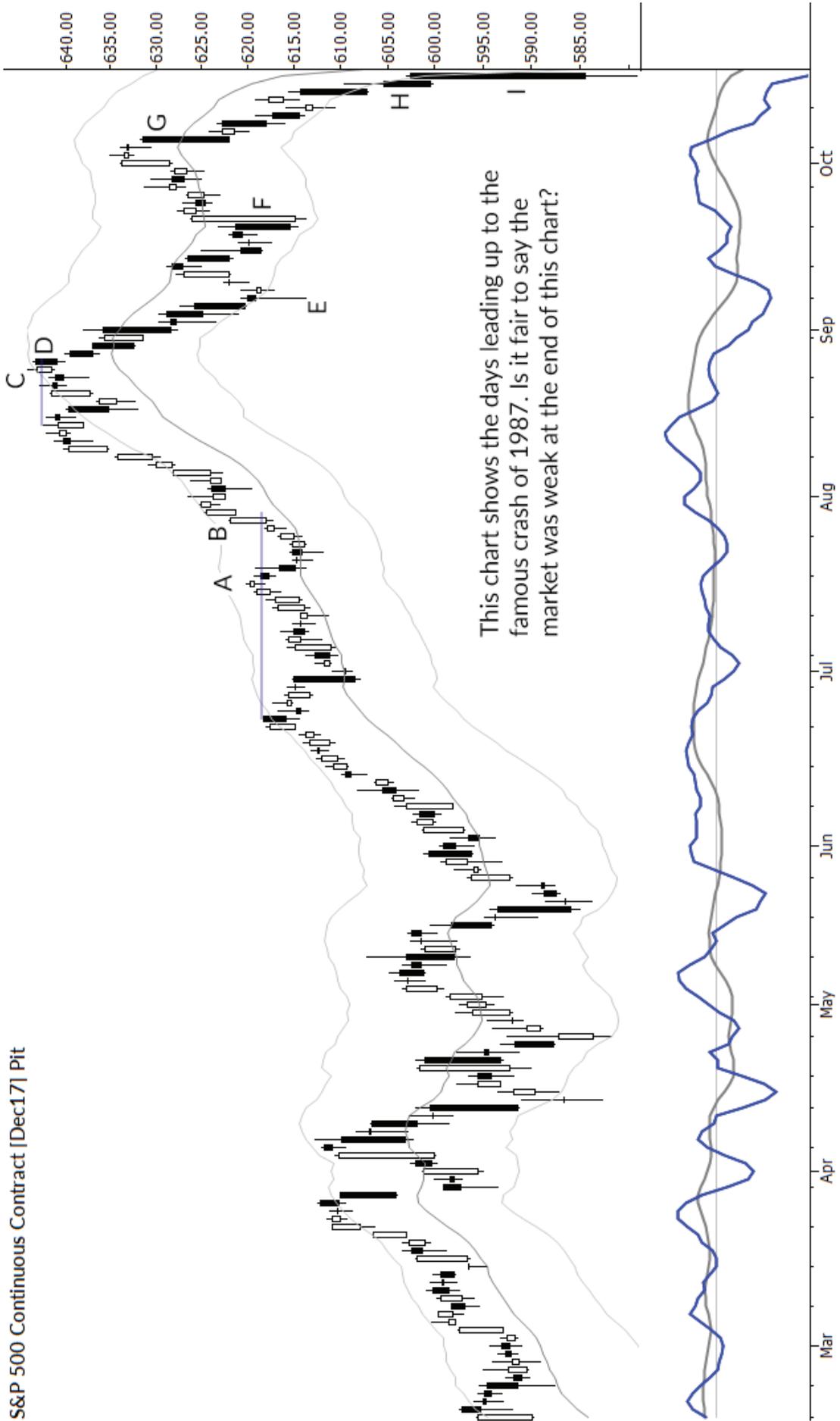


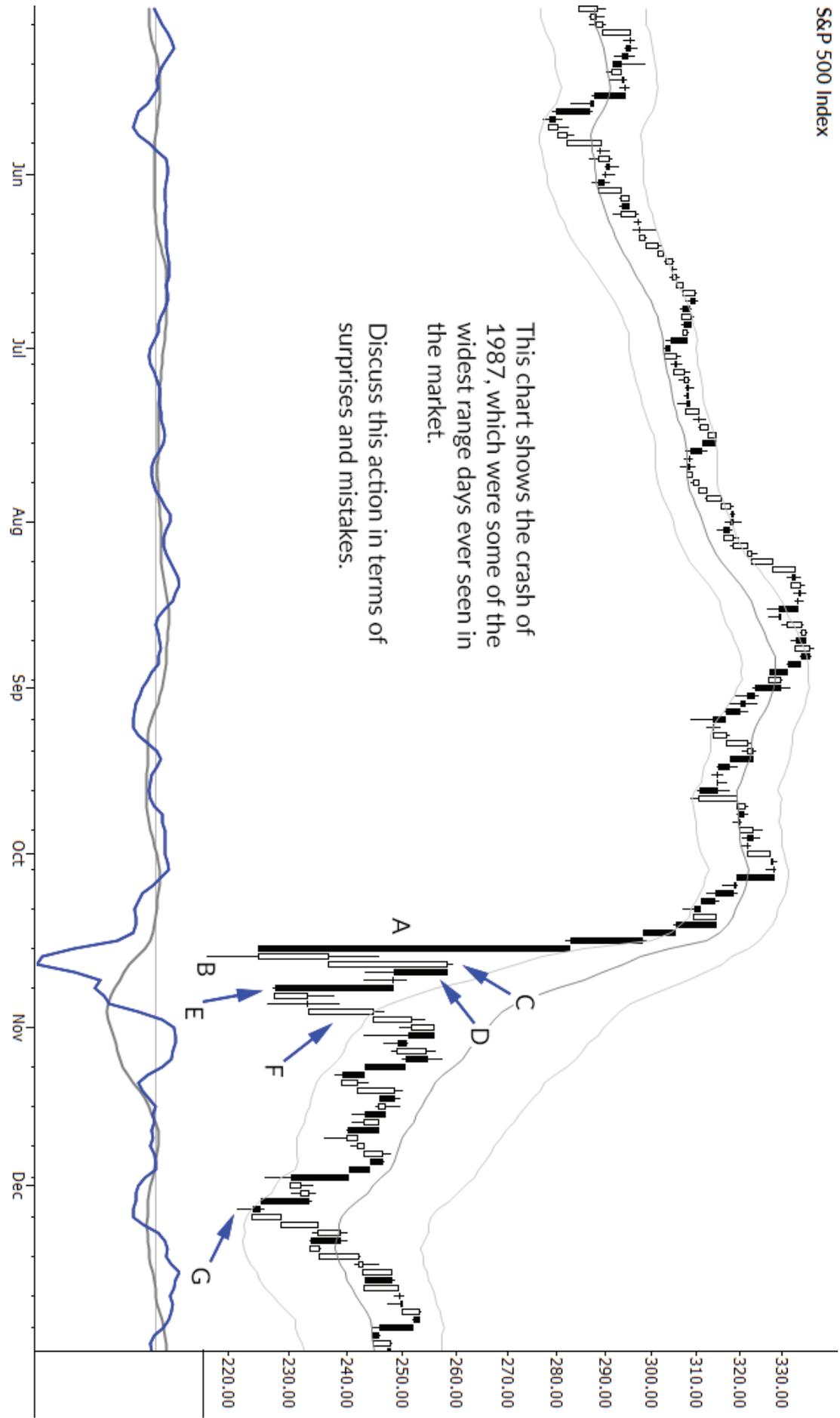
Crude Oil Continuous Contract [Oct17]

Dow Jones Industrial Average



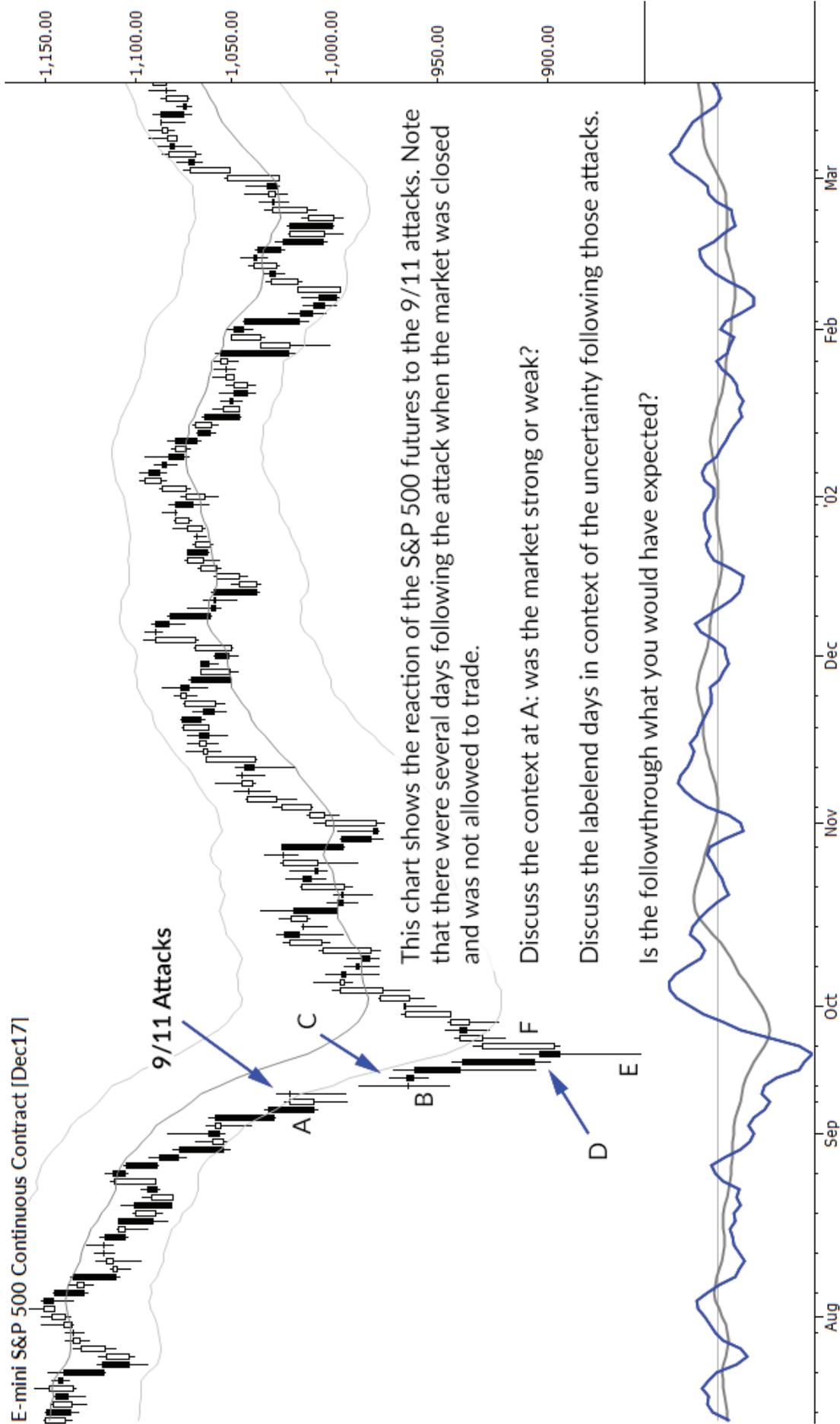
Bar A on this chart is "Black Thursday", 24 October 1929: the beginning of the historic Stock Market Crash of 1929 that signalled the beginning of the decade-long Great Depression. Especially, compare C to E and D to F.





S&P 500 Index

This chart shows the crash of 1987, which were some of the widest range days ever seen in the market.
Discuss this action in terms of surprises and mistakes.



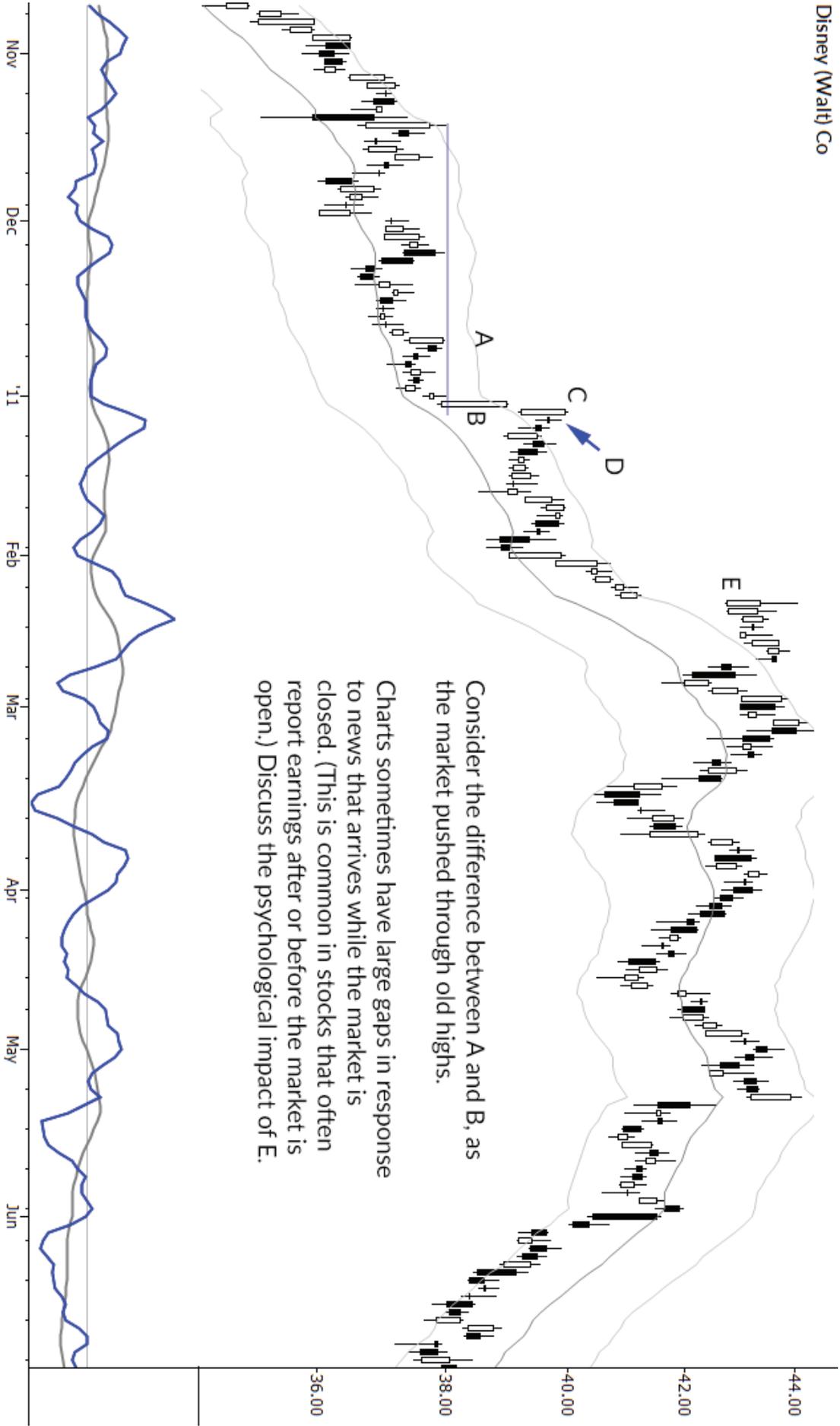
This chart shows the reaction of the S&P 500 futures to the 9/11 attacks. Note that there were several days following the attack when the market was closed and was not allowed to trade.

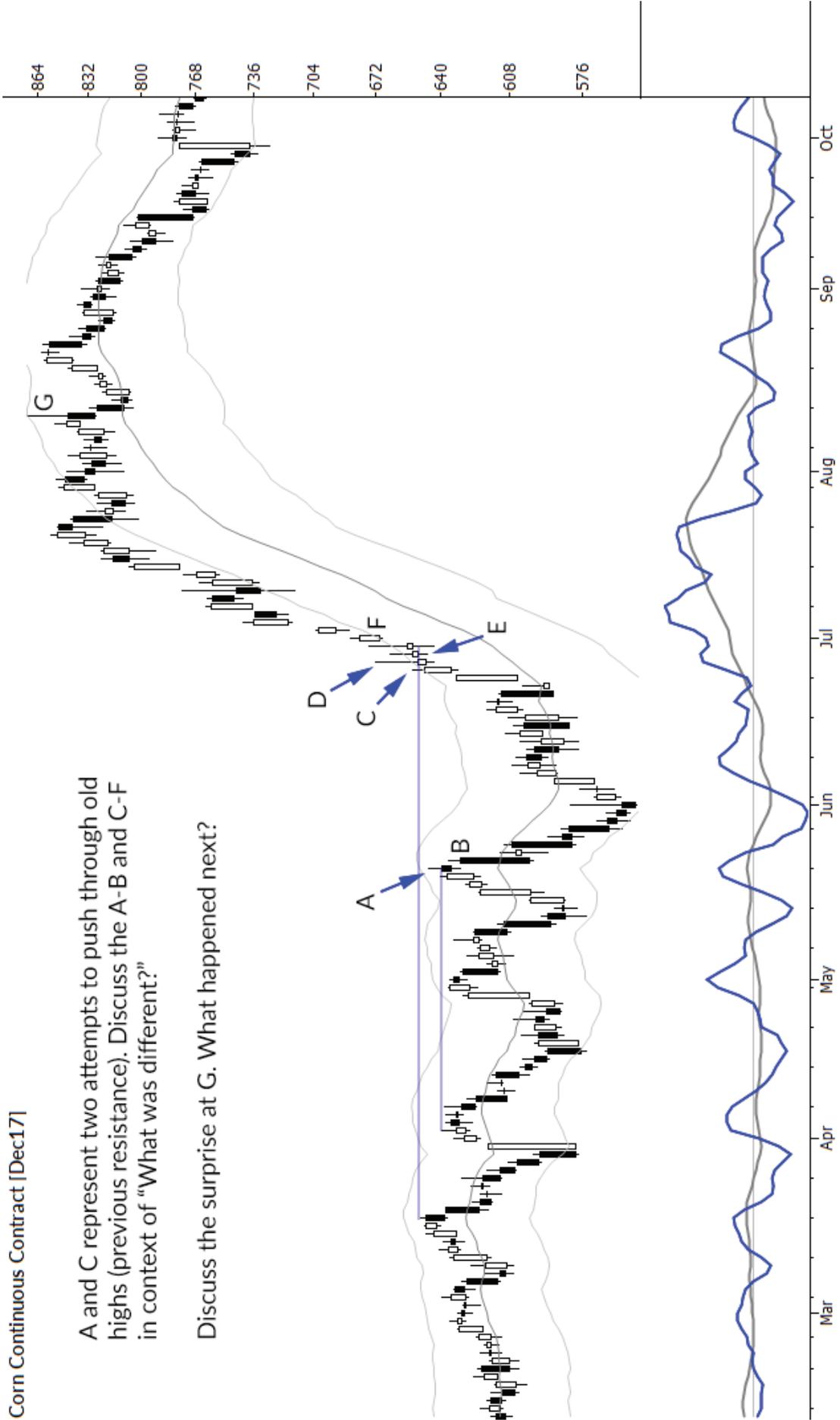
Discuss the context at A: was the market strong or weak?

Discuss the labeled days in context of the uncertainty following those attacks.

Is the followthrough what you would have expected?

Disney (Walt) Co



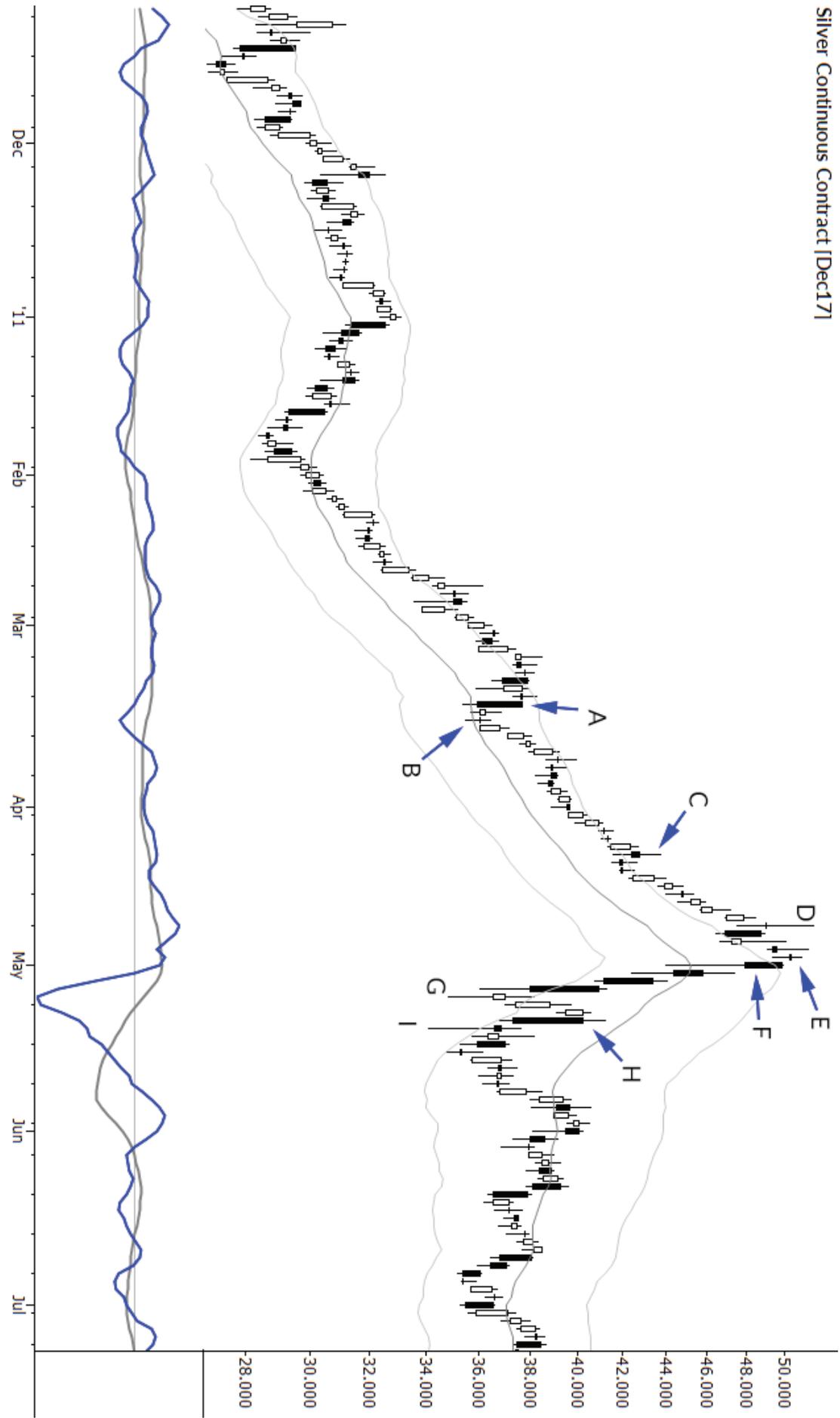


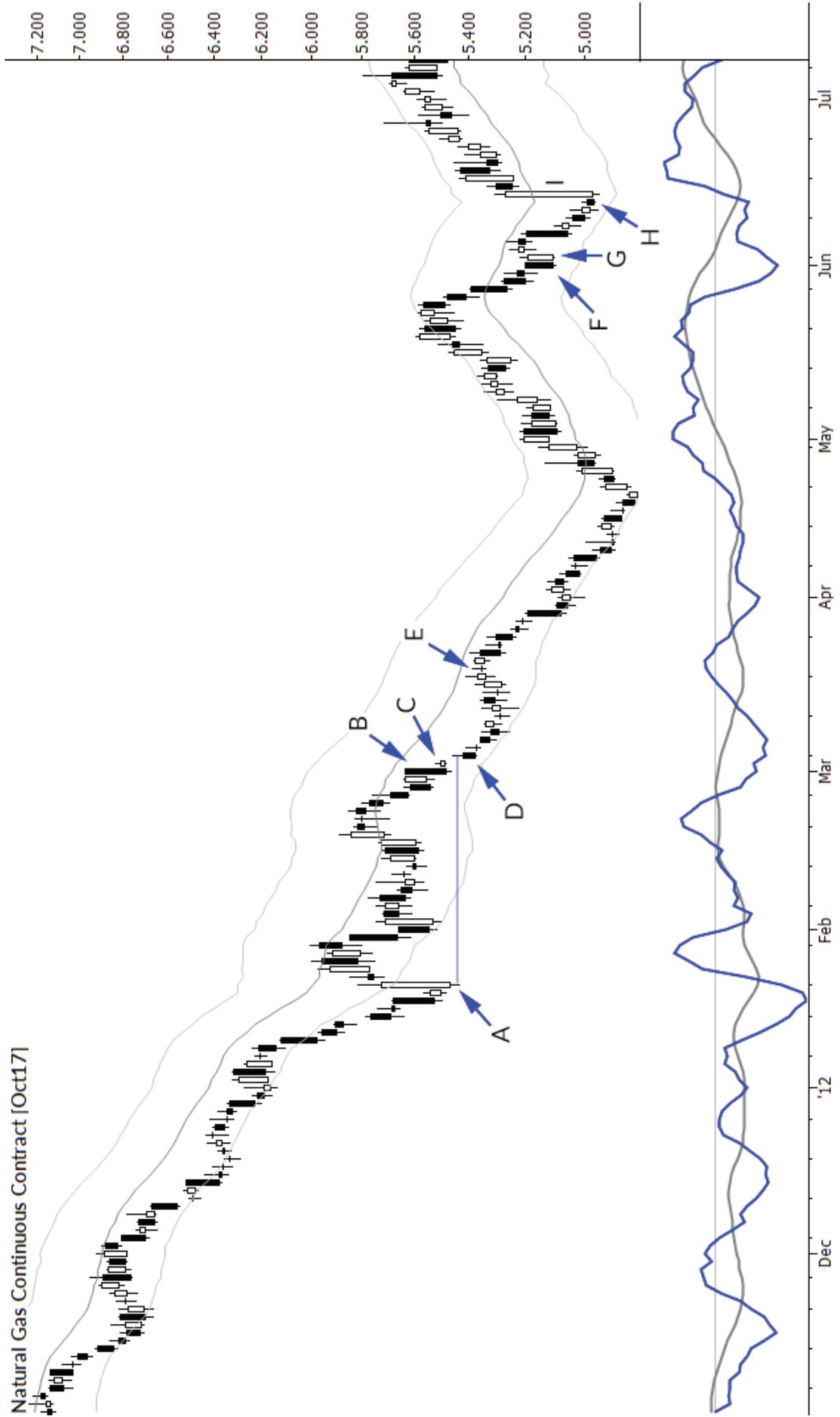
Corn Continuous Contract [Dec17]

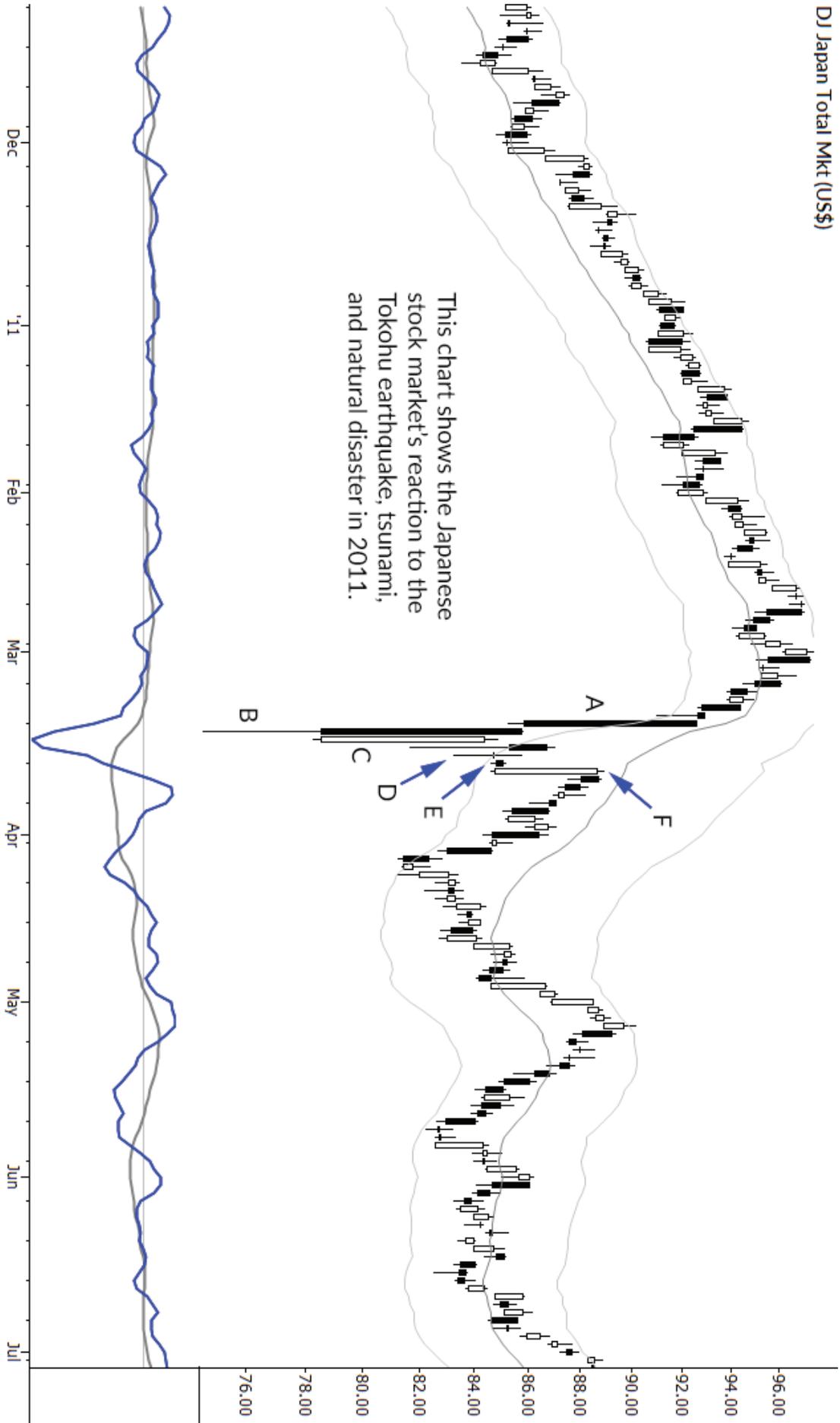
A and C represent two attempts to push through old highs (previous resistance). Discuss the A-B and C-F in context of “What was different?”

Discuss the surprise at G. What happened next?

Silver Continuous Contract [Dec17]







Section 3: Charting by Hand

There are several ways to do this exercise, and a few major benefits. The simplest is to simply write down closing prices for 3-5 markets you follow at the end of the day. If you are an intraday trader, you could record prices at regular intervals (e.g., every hour) throughout the day.

The next step up in complexity is to draw price charts. There are several ways to do this, depending on your time and artistic inclinations. Keeping bar charts is not too difficult, and candles also could be drawn by hand.

A swing chart (Kagi chart) or point and figure is an even better solution for many traders. In this style of charting, the X axis is not time. Rather, you draw a line up until some reversal signal occurs, at which point you move forward one stop on the X axis and then start drawing a line down. You continue the line down until you get another reversal signal.

Here are some possibilities for reversal signals:

- A simple price movement. This is what point and figure charting uses, and you will have to figure out some appropriate value for the markets you follow. (For instance, if your reversal criteria is “the stock reverses \$1 off a high or low”, that’s probably going to give you a very different number of flips for a \$1 stock and a \$500 stock.)
- Crossing a short-term moving average
- Some trend system like Parabolic Stop and Reverse
- Reversing a certain number of ATRs off a high or low (effectively the same as the Parabolic.)
- Market makes an N bar high or low

Don’t get too caught up in the exact choice of flipping criteria, and don’t make it too sophisticated or hard to calculate. Ideally, you want to see the reversals very easily, or have them marked somehow in your software (or in a spreadsheet.)

This should not be an extremely difficult task; a few minutes each day is enough, but much of the value comes from actually putting pencil (or pen) to paper.

Section 4: Readings

From the *Art and Science of Technical Analysis*:

Preface

1-8 (having an edge)

9-12 (basic chart setup)

22-30 (reading inside bars, charting by hand)

375-385 (becoming a trader)

399-408 (trading primer)

375-384 (becoming a trader)

The readings are not essential, but will help you get some deeper perspective on many of the issues discussed in this course.

Section 5: Blog Readings

On charting

<https://adamhgrimes.com/charting-by-hand/>

<https://adamhgrimes.com/trust-gut-power-subjective-chartreading/>

On Learning

<https://adamhgrimes.com/no-10000-hour-rule/>

<https://adamhgrimes.com/building-expertise-beyond-the-10000-hours/>

<https://adamhgrimes.com/1000-hours-what-really-matters/>

<https://adamhgrimes.com/learning-deeply-well/>

<https://adamhgrimes.com/maintaining-motivation/>

<https://adamhgrimes.com/the-importance-of-ritual/>

<https://adamhgrimes.com/the-homework-rule/>

On Becoming a Trader

<https://adamhgrimes.com/traders-journey-heros-journey/>

<https://adamhgrimes.com/rage-master/>