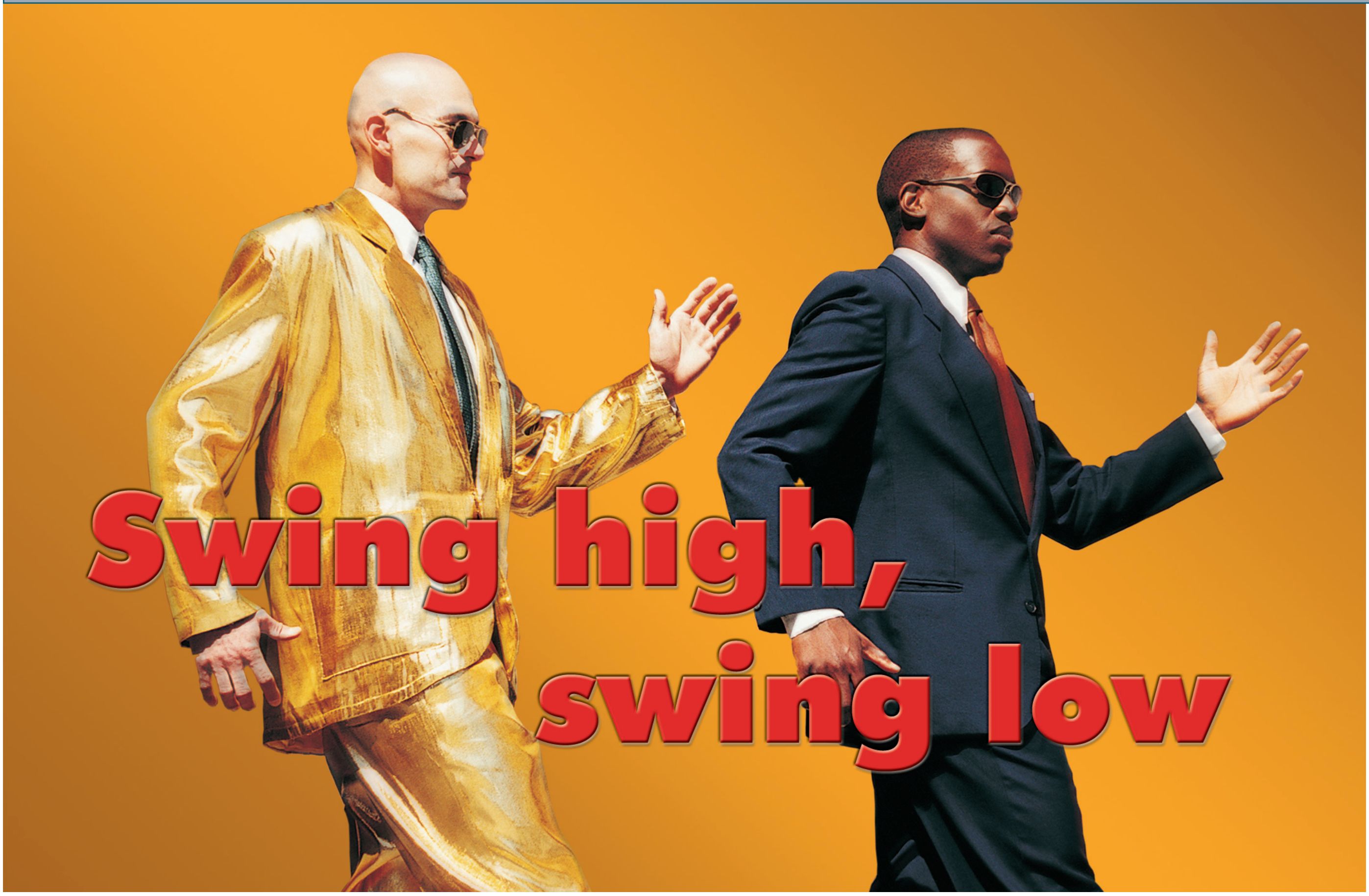

Swing high, swing low

Most traders would agree that it's easier to trade with the trend than against it. The issue though is how best to translate this into practice. Swing trading, a timing technique that seeks to profit from short-term upswings and downswings in the market, offers one solution. Nick Sudbury reports.

The standard three-day swing chart was invented by the legendary trader WD Gann. His trading methods coupled with a highly disciplined approach generated big profits for him back in the 1930s. In fact, despite his famous forecasting ability, Gann is reputed to have made most of his money through what he called his mechanical trading method, namely trading with swing charts.

The idea behind swing trading is to identify the major market trend and also the mini corrections to it. In an uptrend the principle is to buy on the dips as soon as the correction is over, and in a downtrend to sell the rallies as soon as the correction has finished. This ensures that both the major and minor trends are moving in the same direction as the trade.

This mirrors Gann's view that to make profits, traders have to follow the trend and change when the trend changes. The same idea is often expressed today through the expression: The trend is your friend. Swing charts were Gann's way of implementing this.

Robert Newgrosh, who runs the New Skills Training Courses, sees swing trading as a technique for capturing moves of anything from two days to two weeks. "I would look to use it to get an entry into a medium-term trend, for example, trying to catch the next upswing in a medium-term uptrend following a retracement," he says. Newgrosh explains that the idea is to enter the market at a point when the ongoing trend is about to resume. "If the market closes near its high then this is a good indication that the medium term trend will continue the next day. However, it's dangerous to enter the market just on the back of one day's data, instead I would always look at the bigger picture and check for support or resistance before deciding on a trade," he says.

Entry points

In going from a bull market to a bear market, Gann said that after a prolonged advance when the security reaches a final high, there is usually a short but severe decline lasting one, two or possibly three weeks or maybe even months. The market may then remain in a narrow trading range before experiencing a secondary bull rally.

The swing trading method identifies the trigger point for the short sell as coming after this rally when the stock breaks the swing low, namely when the stock breaks the bottom of the last reaction. At this point both the minor and major trends are falling.

Moving from a bear market to a bull market follows the same principles, albeit in reverse. After the bear market ends, Gann said that there is usually a rally lasting anything up to a couple of months and then a reaction back down again, making a higher bottom. The buy point follows when both the minor and major trends are rising.

The wave like appearance of the Dow (see the Dow Jones chart) reflects the whole ethos behind swing trading. For example, in early August the market rose from exactly 9,000 to 9,500, it then retraced half of the gains, falling back to 9,250. The market thrust that started on August 26 signified the end of this corrective phase and the resumption of the positive trend – a buy signal. In the next few days the market went on to add several hundred points.

The chart also shows a number of similar incidents, including

F1) The Dow Jones

From early to mid August the Dow Jones rose from exactly 9000 to 9500, establishing a major market up trend. The index then entered a corrective phase and retraced half of the gains, falling back to 9250. The subsequent recovery that started on August 26th signified the end of this phase and the resumption of the positive trend. This constituted a buy signal and in the next few days the market went on to add several hundred points.

Source: www.esignal.com

for example, the resumption of the positive trend on July 1 that saw the market add 400 points in just five days. Although in practice it wouldn't be possible to time a trade to capture the full extent of these moves, they nonetheless represent ideal entry points for swing trades.

The three-day swing chart reflects Gann's view that the first correction should last for at least three consecutive days. In an uptrend this means that each day of the correction should have a lower high and lower low than the previous day. In a downtrend it is the opposite – a day with a higher high and higher low than the previous day. It is the highs and lows that are important.

Tom Hougaard, chief market strategist at City Index, believes that it's possible to use Gann's three-day swing chart as a confirmation tool. "Every trader develops his own unique technique, but for those who don't want to watch the markets on a day-to-day basis, swing trading may be appropriate."

Andy Pancholi, who runs tailor made sessions in Gann Analysis through Cycles Analysis, agrees: "Swings act as a filter to show the main market moves. The clear entry and exit points mean that by using stops, traders do not have to watch the screen continuously.

Pancholi covers swing trading as part of his Master Timing course. This daylong session of one-to-one tuition costs £2,995 but includes ongoing support thereafter.

There are many different techniques for actually identifying trades. With Gann Analysis, the charts indicate buying and selling points based on whether a stock reaches a particular level at a certain time. Daily price movements will then determine whether the signal is actually used.

"From Gann's point of view, the trigger point for a trade comes from the daily price move on reaching a support or resistance level. The swing chart can also be used for looking at the medium- to long-term market move," explains Tony Zafar, MD at Gann Management.

"Take the example of a price falling to a support level. We would look for confirmation of the daily trend when the price reached this level; this can take a number of days. At this point one could look at the swing chart to see if the market was in a bullish or bearish phase," he adds.

The Zenith Service from Gann Management provides the data, software, training and support to apply Gann's theories. The company runs regular free introductory seminars in London and Cheshire.

Marc Rivalland, the well-known swing trader, has made some modifications of his own to Gann's three-day swing chart. "The main change is that rather than looking for three consecutive corrective days, I look for three that are closely bunched, which for an index means within eight trading days. You miss too many good opportunities if you wait rigidly for three consecutive corrective days," he says.

He uses his modified swing chart to help time his entry into the market. "I try to buy after a correction, which in an uptrend means buying as soon as the weakness is over. The swing chart dictates the timing of my entry into the market."

Rivalland says that his swing charts work better on indices than they do on individual equities. However, he adds that the technique works well for a handful of stocks like Vodafone, WPP, Hilton and Intel, possibly because these securities are often used as proxies for more general measures.

F2) FTSE 100

Using Rivalland's approach, the three down days on Thursday 16th (marked by the cross hairs), Wednesday 22nd and Thursday 23rd of October formed a correction. The high of 4249 on the 24th signalled that the correction was over. A buy signal was thus generated on Monday 27th when the market reached 4250.

Source: www.marketcenter.com

Exit strategies

A trader can define exactly the pattern that constitutes an entry point, but exiting is much harder. Newgrosh explains that there are basically three exit strategies: waiting for a specific signal – which incidentally may never happen; setting a target points profit; or using a trailing stop.

"Personally I prefer setting a profits target as it means that on a long position for example, the position would be closed by selling into strength. The problem with the other two options is that the market is moving against the trade when it is closed. Trades placed through the futures markets in these circumstances would suffer from a narrowing of the premium," he says.

Rivalland too adopts the same exit strategy of setting a target profit. He uses around 2.5%-4% on indices and 4%-9% on equities.

Risk management

Stop losses are essential for swing trades. In fact, as Hougaard explains, the very nature of the technique goes a long way to determining an appropriate level for the stops: "Minute by minute traders set tight stops, trend traders use wide stops and swing traders fall somewhere in between the two. This is because swing trading takes out a bigger chunk of the market and so has to have the space to breath, otherwise the position could be closed out prematurely by market noise."

Swing trading as a technique highlights two potential stops. For a long position this would be under the closing price of the