



Volume 2 No. 3 January 2008

Futures, Forex, & Stocks

Magazine

Trading the February Break in CBOT Wheat: Developing a Trading Plan

By: Scott Barrie *p.17*

Lan Turner's Hierarchy of Trades

Part 5 of 6 *p.13*

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In this issue...



Off The Wall

By: Lan H. Turner

This Month's *Off the Wall* chart comes from James: *Here is my two cents. Cotton is challenging a major downward trendline on the monthly chart. A close above 70.00 would be significantly bullish. I am long two contracts from 67.95. Overnight trading is steady*



January 2008 Commodity Trader's Almanac

By: Scott Barrie

Last month we discussed how holiday demand and possible transportation problems tend to push Livestock prices higher in December and into early



Lan Turner's Hierarchy of Trades: Part 5 of 6

By: Lan H. Turner

After having been directly involved in the financial world for over fifteen years as a market software developer and trading trainer, I've



Developing a Trading Plan

By: Scott Barrie

In the book *Market Wizards* by Jack Schwager, the top traders interviewed agreed that having a definite trading plan and sticking to that plan was an important part of their success. The basic building blocks for developing a Trading Plan can be

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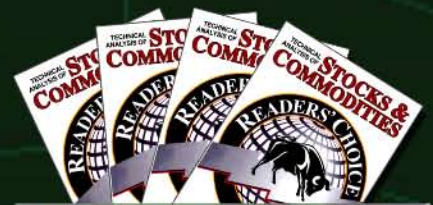
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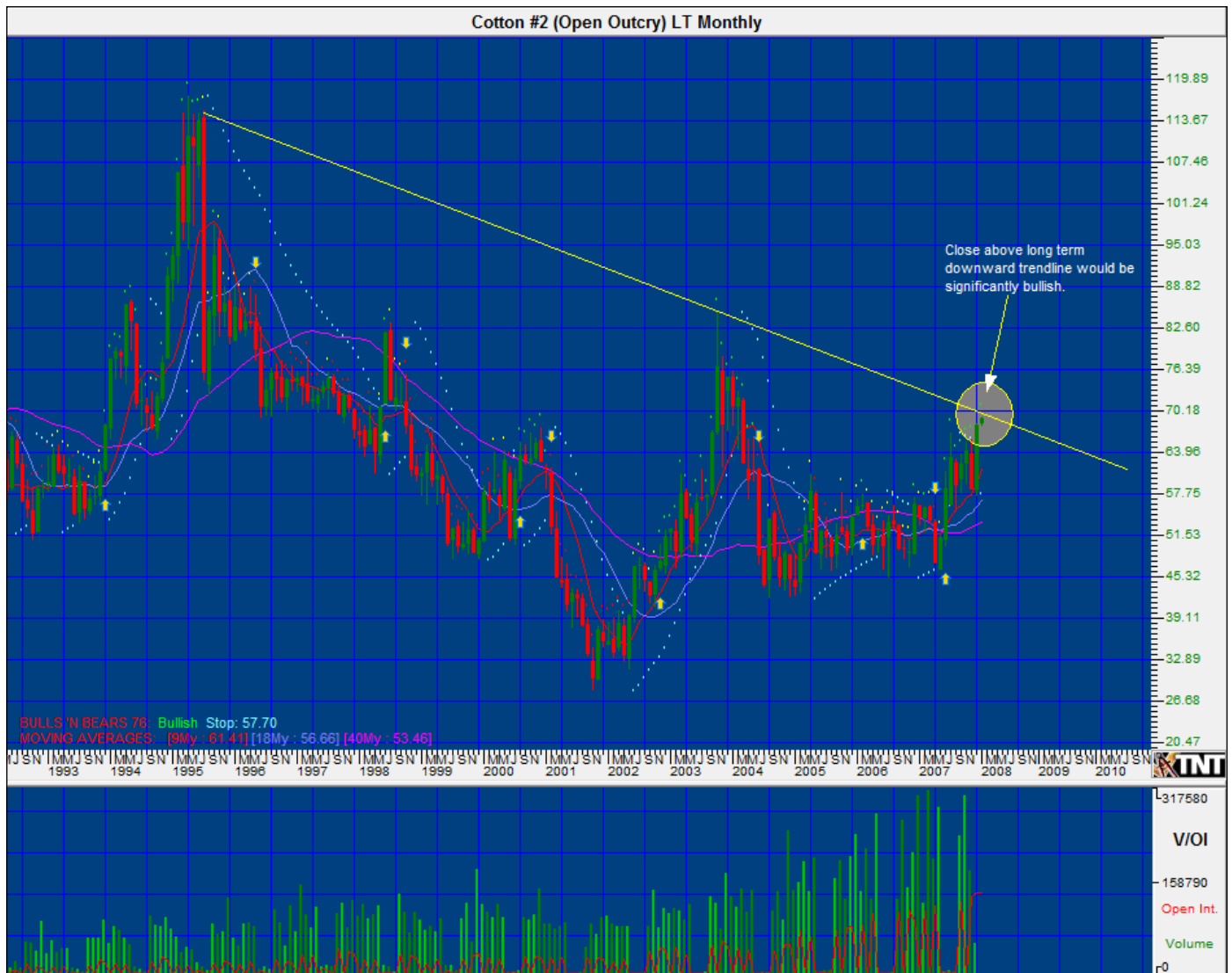
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OFF THE

By: Lan H. Turner
Editor in Chief
PitNews.com Magazine

WALL

The Wall is PitNews.com's trading forum, found on the web at <http://thewall.pitnews.com> or from the tab link on the front page of PitNews.com. Each month, we highlight a chart submitted by one of our users.



This Month's *Off the Wall* chart comes from James:

Happy Trading! :-) James

Here is my two cents. Cotton is challenging a major downward trendline on the monthly chart. A close above 70.00 would be significantly bullish. I am long two contracts from 67.95. Overnight trading is steady this morning with a high of 68.95.

Get into the action! Start posting charts on The Wall, and maybe you'll see your chart highlighted here in our next PitNews.com Magazine issue.

January 2008

COMMODITY TRADER'S ALMANAC

By: Scott Barrie

GRAIN MARKET FEBRUARY BREAK FOCUS

Last month we discussed how holiday demand and possible transportation problems tend to push Livestock prices higher in December and into early January. However, by mid-January this trend tends to be reversed, at least temporarily, as slaughter rates increase in the New Year and transportation problems tend to cause build-ups of supplies near production facilities.

This is the premise behind probably the best known of all seasonal tendencies—the February Break. This month we will



examine the February Break, which has shifted in recent years, and look at how it affects the Soybean Complex as well as the Wheat market.

Look For the February Break in January in the Soybean Complex

The most famous of all seasonal tendencies in the futures market is most likely the “February Break.” However, like many well known tendencies, the February Break in the Grains—especially the Soy market—has shifted. In the last decade and a half, the February Break has shifted to January in the Soybean market.

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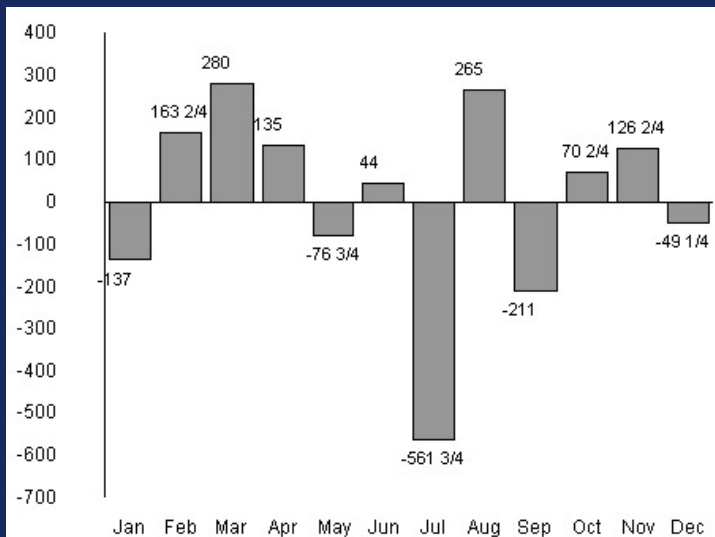
The February Break is usually blamed on increased marketings (sales) in the New Year. Producers raise money for upcoming lease and tax payments, as well as prepare for spring planting. Farmers tend to increase their marketings at the beginning of the year, as opposed to the end of the year, to defer tax liabilities into the following year (for example, sales made in 2007 create tax liabilities in 2008 while January 2008 sales have 2009 tax consequences).

Transportation also plays a key role in this as well. During the winter it is difficult to move soybeans—and its products (soymeal and soyoil)—from production areas to consumption areas. As such, supplies build up in production centers, causing grain elevators and processors to limit their purchases and prices tend to come under pressure.

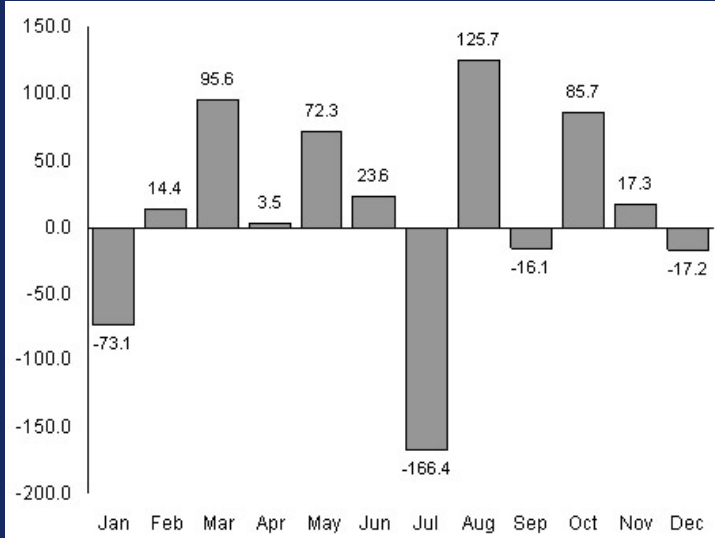
In the past, increased grain marketing usually occurred in February as producers began preparing for spring planting. To pay for their seed and fertilizer, as well as make land/lease payments plus taxes, they sold grain in February. However, in recent

Month Performance 1982-2007

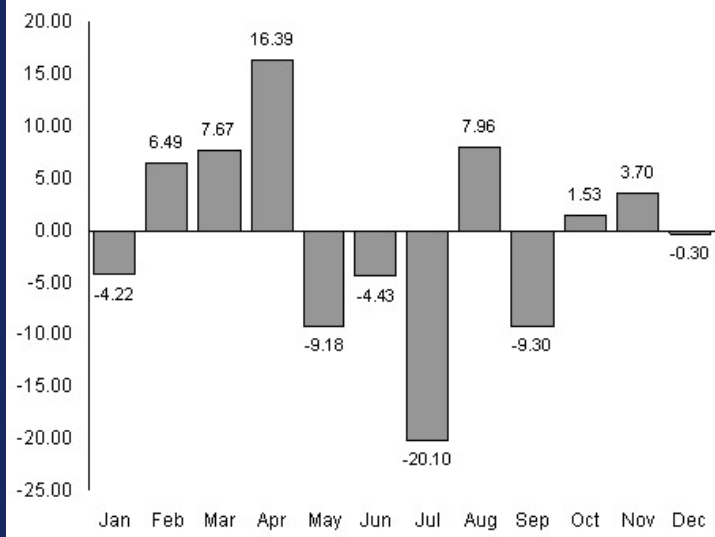
Nearby Soybean Futures In Cents/bushel



Nearby Soymeal Futures In \$'s/metric Ton



Nearby Soyoil Futures In Cents/pound



Charts courtesy of Track 'n Trade 5.0 Futures. Visit www.TracknTrade.com for a FREE Trial!

HYPOTHETICAL PERFORMANCE RESULTS
March Soymeal Futures Dollar/Metric Ton
Enter Approximately January 24th / Exit Roughly February 7th

Entry	Entry	Exit	Exit	Closed	Closed	High	High	Low	Low
Date	Price	Date	Price	P&L (pts)	P&L (\$)	Price	Date	Price	Date
1/24/2007	208.4	2/7/2007	213.7	-5.3	(\$530.00)	216.0	2/7/2007	204.2	1/29/2007
1/24/2006	179.9	2/7/2006	176.7	3.2	\$320.00	191.5	1/30/2006	175.8	2/7/2006
1/24/2005	155.9	2/7/2005	149.7	6.2	\$620.00	159.5	1/26/2005	145.0	2/7/2005
1/23/2004	264.3	2/6/2004	256.8	7.5	\$750.00	268.8	1/27/2004	243.6	2/3/2004
1/24/2003	169.1	2/7/2003	167.1	2.0	\$200.00	173.6	1/31/2003	166.5	2/7/2003
1/24/2002	152.7	2/7/2002	149.8	2.9	\$290.00	153.5	1/25/2002	147.5	2/6/2002
1/24/2001	172.2	2/7/2001	165.4	6.8	\$680.00	174.9	1/25/2001	162.1	2/6/2001
1/24/2000	164.1	2/7/2000	162.1	2.0	\$200.00	167.9	1/28/2000	158.0	2/4/2000
1/22/1999	133.1	2/5/1999	135.4	-2.3	(\$230.00)	137.9	2/3/1999	129.5	2/1/1999
1/23/1998	193.4	2/6/1998	196.1	-2.7	(\$270.00)	201.5	1/29/1998	193.0	1/26/1998
1/24/1997	238.1	2/7/1997	235.3	2.8	\$280.00	241.1	1/29/1997	232.1	2/6/1997
1/24/1996	235.2	2/7/1996	227.7	7.5	\$750.00	236.8	1/29/1996	226.8	2/7/1996
1/24/1995	159.9	2/7/1995	154.8	5.1	\$510.00	161.2	1/27/1995	153.5	2/1/1995
1/24/1994	195.2	2/7/1994	194.9	0.3	\$30.00	198.0	1/27/1994	192.2	2/2/1994
1/22/1993	183.6	2/5/1993	177.6	6.0	\$600.00	184.1	1/27/1993	177.1	2/5/1993

			In points	In \$'s		In points	In \$'s
# Trades	15	Total P&L	42.0	\$ 4,200.00	Max Draw	-11.6	(\$1,160.00)
# Win	12	Avg. P&L	2.8	\$ 280.00	Avg. Draw	-4.1	(\$408.00)
# Loss	3	Avg. Win	4.4	\$ 435.83	Min. Draw on Win		
% Win	80%	Avg. Loss	-3.4	\$ (343.33)		-11.6	(\$1,160.00)

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years, more grain is produced by large scale producers who can manage their cash flow more efficiently, and hence they do not need to rush grain to market to pay for future production.

The February Break is a myth now and can be seen as such in the monthly performance charts. For Soybeans, February is actually the 3rd strongest month on record. January now takes the spot of the New Year break, with January's performance being the 3rd weakest for Soybeans, 5th weakest for Soyoil, and the 2nd weakest for Soybean Meal. As such, the member of the Soybean Complex we will concentrate on for January Break opportunities is Soymeal.

In the last 15 years, March Soymeal futures have declined 12 times from late January through early February (January 24th to February 7th).

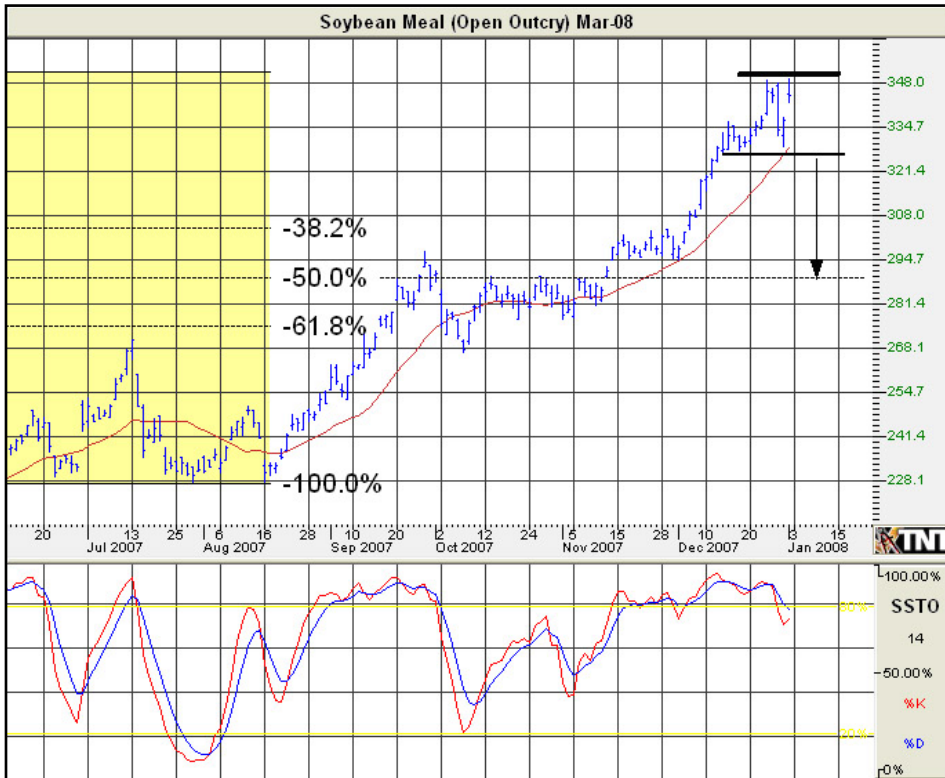
From a fundamental perspective, the January Break in Soymeal may happen this year. First, Southern Hemisphere planting went well, and the Brazilian Crop is expected to be large. Secondly, despite fewer acres planted in the U.S. this past

spring, U.S. Soymeal supplies actually increased this marketing year, due to a large "carry over" from the previous year. Ending Soymeal Stocks (Total Supply – Total Usage) are expected to be at their 3rd highest level in the past decade.

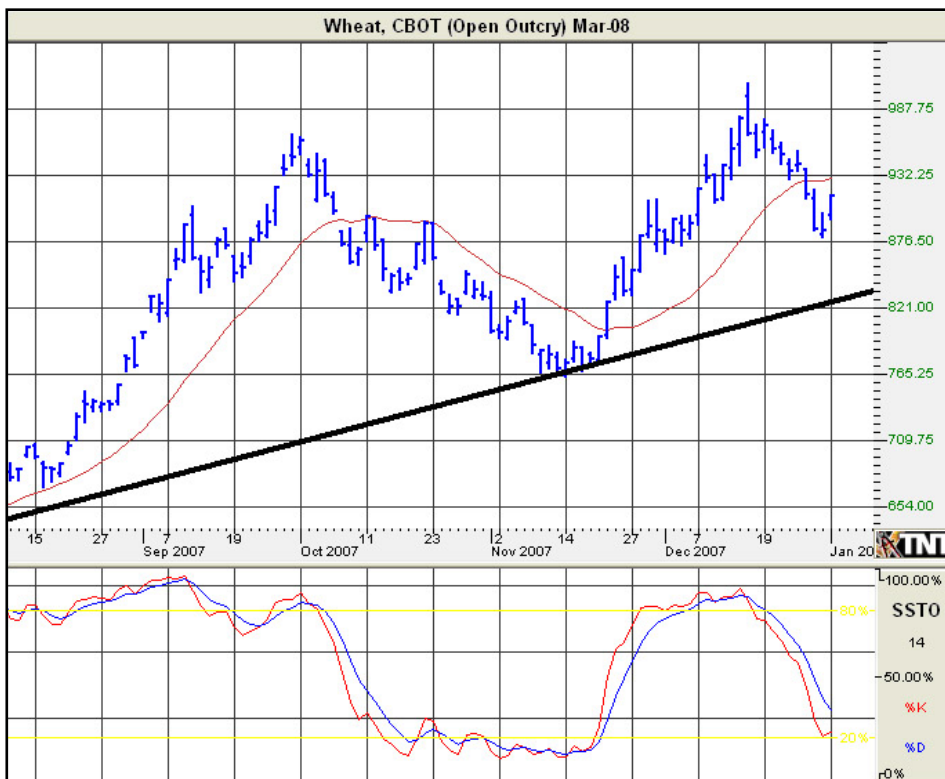
In the last 15 years, March Soymeal futures have declined 12 times from late January through early February.

From a technical perspective, the trend in Soymeal is bullish—obviously, with prices reaching their highest levels since 2004 and 1988, respectively. However, caution should be the name of the game. The market looks extremely over-bought.

Currently, March Soymeal is making a small sideways channel formation, bounded by minor resistance between 348.7 and



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349.1 to the upside and support between 327.0 and 328.5. Given the strong trend in Soymeal, traders should assume the trend will continue. However, if prices break support below 327.0 then traders may wish to assume that the market will continue lower, possibly retracing the latest leg up of this bull market.

The February Break Exists In CBOT Wheat

The Wheat market—at least CBOT Wheat—still experiences a February Break. In 20 of the last 26 years, March CBOT Wheat futures have declined during the month of February. Traders can get a jump start on this break, by establishing short positions in late January. In the last 15 years, March CBOT Wheat futures have declined 12 times from mid January through mid February (January 16th to February 16th).

This last rally, associated with the planting effort of winter wheat, may be the last hurrah for the wheat market.

Fundamentally, the supply/demand relationship in Wheat is extremely tight. This can readily be seen by simply looking at pricing. CBOT Wheat prices are trading near \$10/bushel, a price level never before seen and usually associated with Soybeans.

The high price of Wheat has caused a lot of acreage to be planted to Winter Wheat. This may pressure prices later in the season, once the crop emerges and this supply can be counted on. Perhaps by February the market will start factoring in new crop supplies, as wheat usage has been fairly static.

Though record-high prices are worrisome, the recent correction in Wheat has moved this market almost to

HYPOTHETICAL PERFORMANCE RESULTS
March CBOT Wheat Futures Cents/Bushel
Enter Approximately January 16th / Exit Roughly February 16th

Entry	Entry	Exit	Exit	Closed	Closed	High	High	Low	Low
Date	Price	Date	Price	P&L (pts)	P&L (\$)	Price	Date	Price	Date
1/17/2007	477	2/16/2007	468	9	\$450.00	485	1/18/2007	447 3/4	2/15/2007
1/17/2006	328 3/4	2/16/2006	359	-30 1/4	(\$1,512.50)	365	2/9/2006	321 1/2	1/18/2006
1/14/2005	297 1/2	2/16/2005	292 1/2	5	\$250.00	307 1/2	2/9/2005	287	2/4/2005
1/15/2004	386 1/4	2/18/2004	364 1/2	21 3/4	\$1,087.50	404	1/20/2004	364	2/18/2004
1/15/2003	312 3/4	2/19/2003	327 3/4	-15	(\$750.00)	338	2/18/2003	307 1/2	1/17/2003
1/15/2002	302	2/19/2002	277 3/4	24 1/4	\$1,212.50	306 1/2	2/15/2002	274 1/2	2/15/2002
1/16/2001	285 1/4	2/16/2001	264 1/4	21	\$1,050.00	287 1/2	2/15/2001	260 1/2	2/13/2001
1/14/2000	265	2/17/2000	262 1/2	2 1/2	\$125.00	273 1/2	2/11/2000	249	2/4/2000
1/15/1999	277	2/17/1999	254 3/4	22 1/4	\$1,112.50	278 1/2	2/11/1999	247	2/17/1999
1/15/1998	333 3/4	2/18/1998	322	11 3/4	\$587.50	348	1/27/1998	321	2/17/1998
1/14/1997	388	2/19/1997	359 1/2	28 1/2	\$1,425.00	392	1/28/1997	351	2/11/1997
1/15/1996	496	2/20/1996	513	-17	(\$850.00)	533	2/14/1996	473	1/17/1996
1/16/1995	381 3/4	2/16/1995	366 3/4	15	\$750.00	386	1/17/1995	363 1/4	1/30/1995
1/14/1994	388	2/16/1994	368 1/4	19 3/4	\$987.50	390 1/2	1/17/1994	361	1/28/1994
1/14/1993	379 1/4	2/17/1993	368 3/4	10 1/2	\$525.00	393	1/20/1993	356 1/4	2/8/1993

			In points	In \$'s		In points	In \$'s
# Trades	15	Total P&L	129	\$ 6,450.00	Max Draw	-37	(\$1,850.00)
# Win	12	Avg. P&L	8 1/2	\$ 430.00	Avg. Draw	-12 3/4	(\$632.50)
# Loss	3	Avg. Win	16	\$ 796.88	Min. Draw on Win		
% Win	80%	Avg. Loss	-20 3/4	\$ (1,037.50)		-17 3/4	(\$887.50)

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an over-sold basis. However, the most recent rally in December, which pushed March CBOT Wheat prices to 1009 ½, just barely surpassed the old high made in September. As such, this last rally, associated with the planting effort of winter wheat, may be the last hurrah for the wheat market.

In the last 15 years, March CBOT Wheat futures have declined 12 times from mid January through mid February.

Traders may wish to respect this bullish trend—after all the “trend is your friend.” However, the trend may be drawn into question if the market fails to make new highs on this swing or violates minor support at 879. As an added bit of evidence of a

trend change, traders may wish to look for the bullish trend line in place since July is violated to the downside.

Another, more reliable, way to play the February Break in CBOT Wheat is to establish bear spreads, or sell the nearby futures (like the March) and buy the deferred contract (like the July). This type of spread is usually called a bear spread because when grain prices fall, usually the nearby contract declines at a faster pace than the deferred contract.

In 14 of the last 15 years, July CBOT Wheat futures have increased relative to March CBOT Wheat futures from the middle of January through the middle of February (January 10th and February 13th, respectively). The one year that did not see July gain relative to March (1999) saw no change in the spread between these two contracts.

Like the CBOT Wheat market itself, the July/March CBOT Wheat spread is at unheard of price levels. July 2008 CBOT Wheat is trading -124 ¼ cents under March 2008 CBOT Wheat. In other words, the crop in storage (March) is trading at a +124

HYPOTHETICAL PERFORMANCE RESULTS
Long April Hogs: Short February Hogs
Enter Approximately December 2nd / Exit Roughly January 8th

Entry Date	Entry Price	Exit Date	Exit Price	Closed P&L (pts)	Closed P&L (\$)	High Price	Low Price
1/10/2007	13 2/4	2/11/2007	23 2/4	10	\$ 500.00	10	13 2/4
1/10/2006	19	2/11/2006	20 3/4	2 2/4	\$ 125.00	2 2/4	19
1/11/2005	13 2/4	2/11/2005	14 2/4	2	\$ 100.00	2	13 2/4
1/9/2004	-15 1/4	2/12/2004	-12 2/4	2 3/4	\$ 137.50	-9 3/4	-17
1/9/2003	-10	2/13/2003	-7 2/4	2 2/4	\$ 125.00	- 2/4	-10
1/9/2002	-8 1/4	2/13/2002	9 3/4	18	\$ 900.00	10 1/4	-8 1/4
1/9/2001	21 2/4	2/13/2001	23 1/4	1 3/4	\$ 87.50	23 2/4	20 3/4
1/10/2000	21 1/4	2/11/2000	22	3/4	\$ 37.50	22 2/4	20 3/4
1/11/1999	20 2/4	2/11/1999	20 2/4	0	\$ -	21	19 2/4
1/9/1998	15 1/4	2/12/1998	19 1/4	4	\$ 200.00	19 1/4	14 2/4
1/8/1997	-45 2/4	2/12/1997	-15 1/4	30 1/4	\$ 1,512.50	-13	-45 2/4
1/9/1996	-63 3/4	2/12/1996	-57	6 3/4	\$ 337.50	-57	-77 3/4
1/10/1995	-44 3/4	2/13/1995	-33 2/4	11 1/4	\$ 562.50	-27 1/4	-44 3/4
1/10/1994	-44 2/4	2/11/1994	-26 3/4	17 3/4	\$ 887.50	-23	-44 2/4
1/8/1993	-48 2/4	2/11/1993	-44	4 2/4	\$ 225.00	-41 3/4	-56

			In points	In \$'s		In points	In \$'s
# Trades	15	Total P&L	114 3/4	\$ 5,737.50	Max Draw	-14	\$ (700.00)
# Win	14	Avg. P&L	7 3/4	\$ 382.50	Avg. Draw	-1 3/4	\$ (87.50)
# Loss	1	Avg. Win	8 1/4	\$ 409.82	Min. Draw on Win		
% Win	93%	Avg. Loss	0	\$ -		-14	\$ (700.00)

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¼ cent premium to the crop in the ground (July), which is still at the mercy of weather and susceptible to disease.

***Like the CBOT Wheat market itself,
the July/March CBOT Wheat spread
is at unheard of price levels.***

Technically, this spread has changed to a bullish trend, but it is now undergoing a correction. A break-out above -107 would signal the end of the correction and the resumption of the uptrend which began in mid-September. Traders should look for a move to at least -80, should -107 be violated to the upside.

Conclusion

The true power of a chart is to understand the past. Trading is

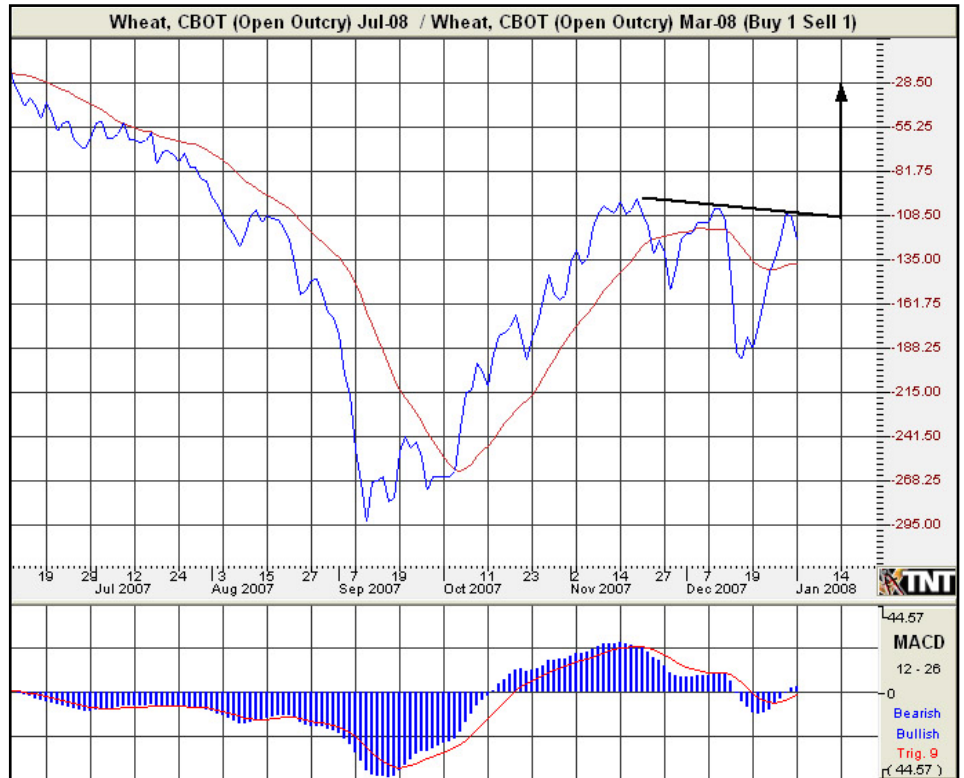
full of myth and lore. But, a trader armed with a chart—or even better, an excellent charting program like Track 'n Trade—can examine the markets' history and find out for themselves which myths are actually true and which can be disproved or ignored.

The February Break is probably the best known of all the seasonal tendencies in the grain markets. W.D. Gann and Wyckoff both mention this seasonal phenomenon in their popular works. However, it is only the Wheat market that falls subject to it today. As we showed by examining the charts (and past price data), February is actually a strong month for Soybean Complex futures (S, SM, and BO). By looking at history, we are able to separate the myth from the reality.

Of course, just because something has (or hasn't) worked in the past does not mean it is guaranteed to work in the future. However, it is the opinion of technical traders everywhere that past patterns and cycles can be useful tools for predicting the future. Hopefully the seasonal tendencies presented in this article are instructive and will help PitNews Magazine readers

make more informed decisions in the coming months.

Scott Barrie is a former Chicago Exchange Member and Private Hedge Fund Operator. He is also a well respected speaker, author as well as the editor of Pitnews Magazine and a major contributing author. His firm, Commodity Futures and Equity Analytics (CFEA) offers newsletters, as well as consulting services for Individuals, Funds, and Brokerages involved in both Speculation as well as Hedging. For current research and products available from Scott Barrie and CFEA visit www.COMMODITYALMANAC.com

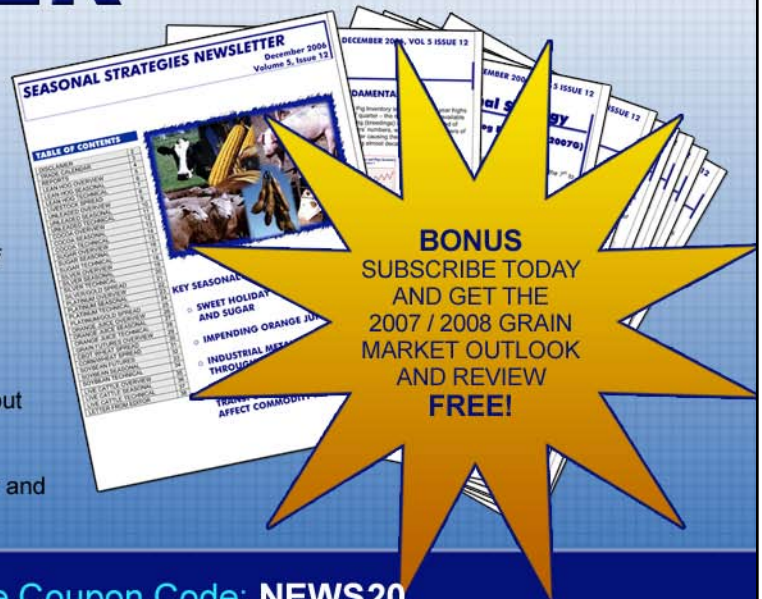


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Lan Turner's Hierarchy of Trades

Part 5 of 6 "Count, Measure, Setup, Trigger, and Follow Through"

By: **Lan Turner**
President & CEO
Gecko Software, Inc.

This is the fifth part of a six part series on Lan Turner's Hierarchy of Trades. If you missed the first four sections, go back to the previous versions of the PitNews.com Magazine to get caught up on our discussion.

After having been directly involved in the financial world for over fifteen years as a market software developer and trading trainer, I've compiled what I believe to be equivalent to Maslow's Hierarchy of Needs for the "would-be-trader."

Lan Turner's Hierarchy of Trades:

- **Fundamentals**—such as the seasonal nature of a commodity
- **Cycles**—such as the psychological buying and selling habits of traders
- **Technical Analysis**—such as Fibonacci, Gann, and recurring price patterns
- **Oscillating Indicators**—such as MACD, Stochastics, and CCI
- **Entry & Exit**—such as proper follow through, the skill of entering and exiting the trade

I've encapsulated this hierarchy of needs in a simple, easy mnemonic to help us remember to stay on the right path:

"Count, Measure, Setup, Trigger & Follow Through."

If we remember to follow these five simple steps, it will help us stay on the straight and narrow path to financial success.

During the previous sections, we've established the foundation of our Hierarchy of Trades. In this article we're going to discuss Oscillating Indicators as part of the Trigger discussion of our mnemonic.

Oscillating Indicators

As with traditional technical analysis, "oscillating indicators" is a wide and varied segment in itself of technical analysis, and I couldn't begin to touch on all the different aspects of this particular market segment. I want to only give you an insight



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as it pertains to our particular needs within the scope of this article.

Oscillating indicators are often times hailed as the life focus of technical analysis, and the pursuit of the perfect indicator has been the life long work of many a technical trader. It seems that through the use of mathematics, we attempt to do our best at predicting a very non-mathematical event—human nature. The markets are a perfect reflection of human nature: as markets advance, it is a representation of greed and good fortune; as they retrace, it is a representation of fear and a psychological negative. The human experience is wide and varied, and as each individual trader contributes their personal experience to the whole, known as the financial market, they in some small way manipulate the market trend.

Oscillating indicators are each individually designed to handle a different and unique human interpretation of the markets. As the human psychology causes the market to rally for one reason or another, different indicators will attempt to tell you at what point the overall group of humans now believes the market is ready to continue the advance, and that oscillator will throw a buy signal. Once the overall psychology of the

market has changed, the oscillator will once again attempt to identify this turning point, and throw a sell signal. But because the market is so varied and so dynamic in the way it responds to each fundamental event in a different way, due to the varied experiences of all participants involved, the market is dynamic and ever changing, and therefore no indicator has ever been created that is able to predict with any great accuracy what the market is going to do next.

Through the use of mathematics, we attempt to do our best at predicting a very non-mathematical event—human nature.

It is for this reason that using any single oscillating indicator as your sole source of information for buying and selling is a losing proposition. One tool may be optimized to work perfectly in one situation, but fails miserably in another.

Therefore, it is highly recommended that you, as a trader, use oscillating indicators as a tool to confirm your other thought processes, and recognize them for what they are: “simple mathematical formulas.” When the market is doing exactly as the formula was designed and intended to chart, it works great. But when the market is in any other state, the indicator is going to fail to perform up to our expectations.

Bulls ‘n Bears will indicate to you, as the trader, every single market reversal from bullish to neutral to bearish, based on the rules identified.

I believe it goes without saying that all oscillating indicators are not created equally. Because the focus of this article is to help a new trader identify valleys and rallies within the overall trend, I want to focus our attention on several indicators that seem, for me, to do the best job at helping us along that pathway.

The Bulls ‘n Bears Indicator (Created by Gecko Software in 2005) is my overall favorite indicator. Markets can only do three things: go up (bullish), go down (bearish), and go sideways (neutral). This proprietary oscillating indicator was designed using four hyperbolically linked mathematical formulas that analyze the historical market to give an overall forward

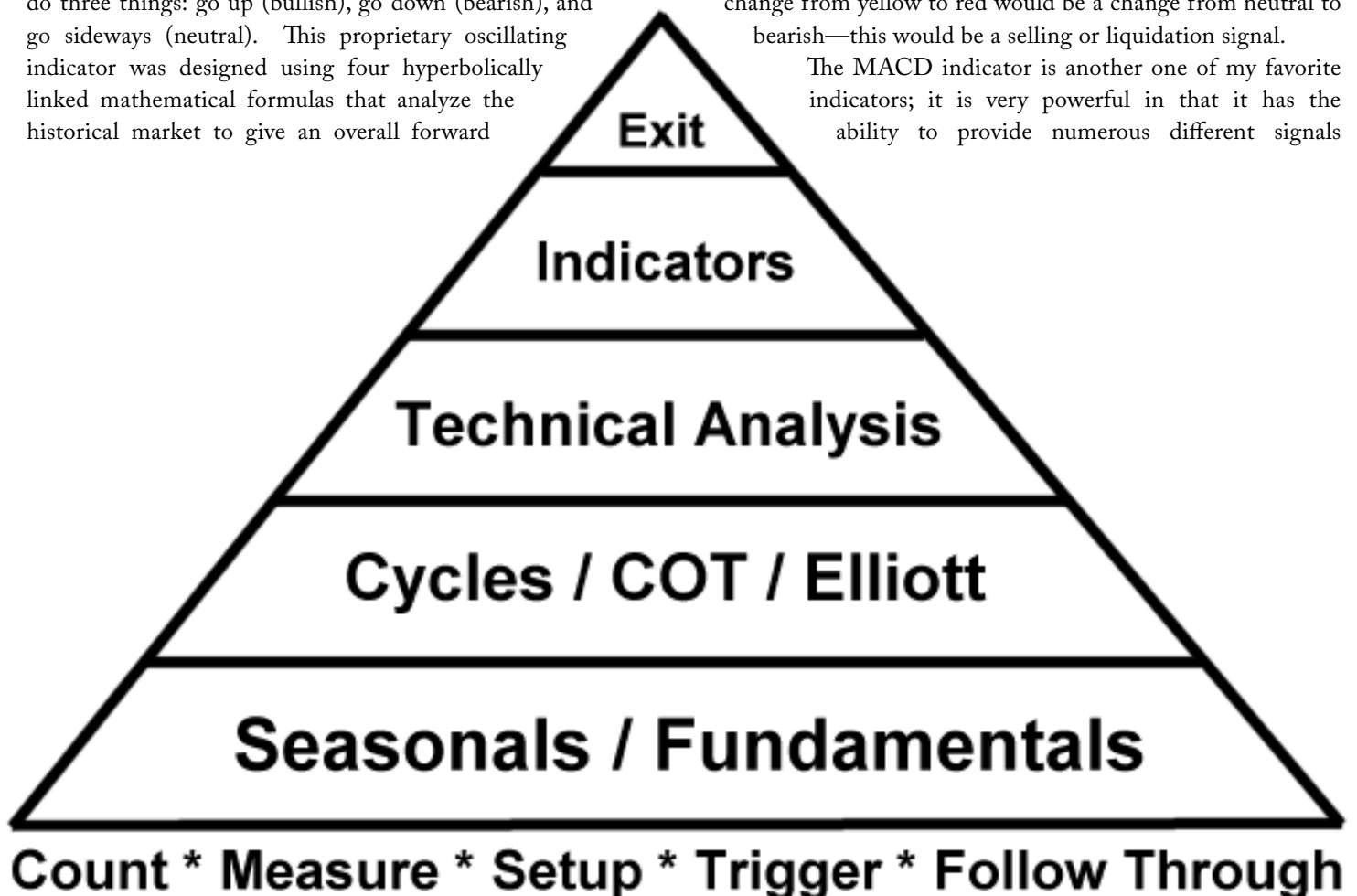
looking trend change. This indicator is perfect; it never fails. It will indicate to you, as the trader, every single market reversal from bullish to neutral to bearish, based on the rules identified. The one thing it cannot do, is tell you how long that trend is going to last. It may last one day or six months; the mathematical model cannot predict the future, it can only identify the here and now, based on market history.

“Where systems fail, methods prevail.” The Bulls ‘n Bears is not a trading system, but we like to call it a trading method, since we still use human intervention and experience to make our trading decisions based on the other factors of the Trading Hierarchy.

A trading system, on the other hand, is completely hands off—often times referred to as “black box.” The “system” or “black box” generally gives mathematically calculated entry and exit points with no regard to any other market factors, other than the math formula designed by the mathematician.

The unique feature of the Bulls ‘n Bears trading method is that it actually color codes the market to represent the trends being experienced. Red represents a downtrend, green an uptrend, and yellow is a neutral market. Following a simple change from yellow to green is an indication that the market has just changed from neutral to bullish—this would be a buying opportunity. A change from yellow to red would be a change from neutral to bearish—this would be a selling or liquidation signal.

The MACD indicator is another one of my favorite indicators; it is very powerful in that it has the ability to provide numerous different signals



and indications of market movement and direction. One of the features derived from the MACD indicator are areas of convergence and divergence—where market direction and momentum are either in agreement with the indicator or out of sync with the indicator, which is also a very powerful feature of many oscillating indicators. The MACD also has the ability of identifying smaller reversals through the use of color bar changes within the over all long-term trend.

The MACD indicator is a variable scale indicator, which changes and automatically rescales its high and low values based on the overall market movement and value, unlike the Stochastics

Indicator, another one of my favorite indicators, which is based on a fixed scale between 0-100.

The MACD indicator is another one of my favorite indicators . . . it has the ability to provide numerous different signals and indications of market movement and direction.



The Stochastics indicator, therefore, has what we call an “overbought” region and an “oversold” region. When this indicator’s two moving averages cross above a fixed threshold, in this example 80% of the overall fixed scale, we consider the market to be in the “overbought” region, meaning that we are looking for the market to make a reversal and anticipate a drop in price. When the two moving averages dip below the 20% lower threshold, we consider the market to be “oversold,” and we begin to anticipate a change in price and a rally to ensue.

The main point to always remember when using oscillating indicators is that no indicator is perfect in every situation. They were programmed to take into account specific market actions, and when the market is not performing to the formula’s overall design, the indicator will not perform as anticipated. This is the reason that it is key to your trading strategy to consider multiple indicators: indicators that were designed to complement each other in their intended market perspectives.



Lan H. Turner is the president of Gecko Software, Inc., developers of the award winning Track 'n Trade, Stocks, Futures & Forex software applications. You can find them on the web at www.GeckoSoftware.com

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TRADING THE FEBRUARY BREAK IN CBOT WHEAT:

Developing a Trading Plan

By: Scott Barrie

In the book *Market Wizards* by Jack Schwager, the top traders interviewed agreed that having a definite trading plan and sticking to that plan was an important part of their success. The basic building blocks for developing a Trading Plan can be stated as follows:

1. Trade Set-Up
2. Exit Plan for a Loss
3. Exit Plan for a Win
4. Time Based Exit Plan

The Trade Set-Up is the trigger for the trade. This is the pattern, cycle, indicator, or combination that must be present for the trade to be initiated. Simply put, the Set-Up is reason for

the trade. In other words, if the following is present, then the trader should buy/sell.

Once the trade is initiated by having the set-up criteria met, the trader must decide how much is going to be risked. This can be as simple as an amount of money that will be risked, a price level, or a combination. All traders should plan for a loss, and know when the market has proven their trade to be wrong. This is accomplished with a pre-set Exit Plan for a Loss.

Many traders also like to have a plan for when to take profits. The old market adage of “let your profits run and cut your losses short” sounds great, but it is difficult to implement. And sometimes, it may well be better to take profits and reduce ones

risk, than to continue in the position. As Baron Rothchild once quipped, "I am rich because I always sold too soon."

The last, and least important, criteria is to plan for a stalled trade, or one which really does nothing. Though the futures markets can be quite volatile, sometimes positions can be put on and simply linger. As most experienced traders know, this can be frustrating. As such, many traders make a plan for exiting such positions using time. After all, trading is frustrating by itself, and the purpose of the plan is instill discipline into your trading. By avoiding excess frustration, one may be more likely to follow their plan.

In this article we will examine how one could set-up a trading plan for Trading the February Break.

Developing a Set-Up

The most well known seasonal tendency in the grain markets

is the fabled February Break. From 1982 to 2000, March CBOT Wheat futures declined in February 16 times (84.2%). As such, we will begin our analysis by trying to capture this move.

The development period is 1982 to 2000, so we can develop all of the elements of the Plan during this time-frame, and then test it on new data (2001 to 2007). This makes the testing a little less likely to be curve fitted, or adopted to the data studied.

During the same 1928 to 2000 period, March CBOT Wheat increased in January 11 times, and declined in 8 years. All 3 of the February increases were preceded by a January Break. As such, the first part of our entry is to only look at years when CBOT Wheat futures rallied in January.

A January rally can be defined as the distance traveled from the December close to the January High (or January High - December Close). In 17 of the 19 years, March CBOT Wheat experienced a January Rally, averaging +17 cents and ranged

Figure 1
March CBOT Wheat Prices in Cents/Bu

	DEC	JAN	JAN	JAN	JAN	FEB	FEB	FEB	FEB
YEAR	CLOSE	CLOSE	CHANGE	RALLY	BREAK	CLOSE	CHANGE	RALLY	BREAK
1982	391 2/4	377	-14 2/4	13 2/4	-22 3/4	356	-21	8	-30
1983	330 3/4	343 2/4	12 3/4	17 3/4	-8 1/4	306 1/4	-37 1/4	9	-38 2/4
1984	363 2/4	328 3/4	-34 3/4	- 3/4	-39	326 1/4	-2 2/4	8 2/4	-9 1/4
1985	347 3/4	350 3/4	3	7 2/4	-10	346 1/4	-4 2/4	9	-7 3/4
1986	343 1/4	327 1/4	-16	- 3/4	-28 1/4	337	9 3/4	12 1/4	-7 1/4
1987	274 2/4	288 1/4	13 3/4	19 1/4	-7	282 3/4	-5 2/4	2	-16 1/4
1988	310 3/4	326	15 1/4	25 3/4	2/4	315 2/4	-10 2/4	13	-16 2/4
1989	440	440 2/4	2/4	9	-11 2/4	436 1/4	-4 1/4	-1	-21
1990	409 1/4	375 3/4	-33 2/4	2 3/4	-37 3/4	393 1/4	17 2/4	22 2/4	-2 2/4
1991	260 2/4	263	2 2/4	3 2/4	-16	259 3/4	-3 1/4	2/4	-15
1992	404 3/4	440 1/4	35 2/4	38	-12 1/4	401 2/4	-38 3/4	23	-39 1/4
1993	353 3/4	380	26 1/4	39 1/4	- 3/4	372 1/4	-7 3/4	2/4	-23 3/4
1994	378 1/4	371 3/4	-6 2/4	16 1/4	-17 1/4	342 2/4	-29 1/4	6 3/4	-31 3/4
1995	401 2/4	373 2/4	-28	1 1/4	-38 1/4	349 3/4	-23 3/4	4 2/4	-24 2/4
1996	512 1/4	519 2/4	7 1/4	15 1/4	-39 1/4	512 2/4	-7	13 2/4	-24 2/4
1997	381 1/4	359 3/4	-21 2/4	18 2/4	-24 1/4	373	13 1/4	20 1/4	-8 3/4
1998	325 3/4	337 1/4	11 2/4	22 1/4	-6 2/4	327 2/4	-9 3/4	9 3/4	-21 1/4
1999	276 1/4	275 2/4	- 3/4	17 3/4	-13 1/4	237 1/4	-38 1/4	-1	-39
2000	248 2/4	256 1/4	7 3/4	20 2/4	-7 2/4	247	-9 1/4	17 1/4	-12 1/4
	AVERAGE	-1	17	-17 3/4		-11 1/4	9 2/4	-20 2/4	
	#UP		11	17	1		3	17	0
	#DOWN		8	2	18		16	2	19

Jan Rally = Jan High - Dec Close, Jan Break=Jan Low-Dec Close, Jan Change=Jan Close-Dec Close
Feb Rally = Feb High - Jan Close, Feb Break=Feb Low-Jan Close, Feb Change=Feb Close-Jan Close

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from as little as +1 ¼ cents in 1995 to as large as +39 ¼ cents in 1993. Out of the 17 January Rallies, 12 exceeded +10 cents.

As such, our Entry Criteria will be to sell March CBOT Wheat +10 cents above the December monthly settlement price. This can be accomplished by placing a sell limit +10 cents above the closing price on the last trading day of December. The Entry Criteria can be stated very simply...

“If March CBOT Wheat gains +10 cents, sell March CBOT Wheat.”

Using the data from Figure 1, the Entry Criteria was met in 12 years: 1982, 1983, 1987, 1988, 1992, 1993, 1994, 1996, 1997, 1998, 1999, and 2000.

Developing an Exit Strategy

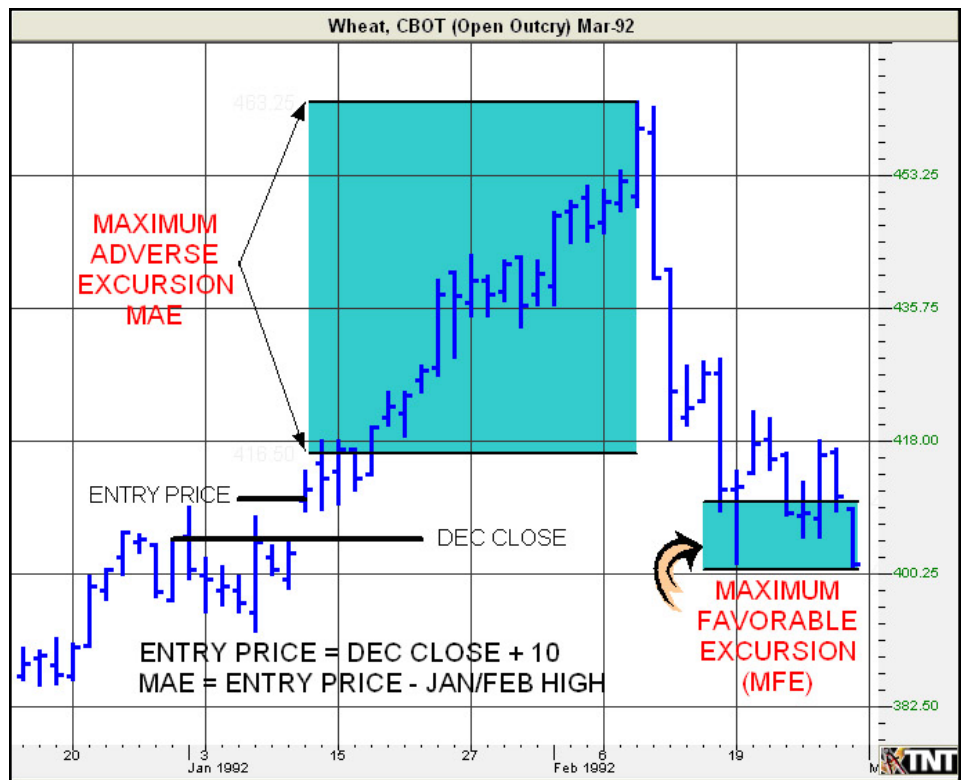
Once we have determined our plan for entry, now we have to develop a plan to exit the trade. Since we are trading March CBOT Wheat, obviously we have to exit the trade by the end of February as this is First Notice Day for the March contract. As such, our time-based exit plan is already made for us.

Dealing with a loss is probably the hardest part of developing a trading plan. If the initial amount risked is too small, the trader will be stopped out of many positions which could be profitable. On the other hand, if the risk is too large, the trader will suffer too large of losses and severely influence the performance of the pattern. As such, we need to decide upon on a happy median.

All traders should plan for a loss, and know when the market has proven their trade to be wrong. This is accomplished with a pre-set Exit Plan for a Loss.

Examining the data (Figure 1), we can see that in the 12 years which had a trade entry, we saw a maximum loss of -51 cents. The maximum loss per year—referred to as the Maximum Adverse Excursion (MAE)—is measured by the distance between the higher of the January/February high and the entry price (or December Close +10 cents). The opposite of the Maximum Adverse Excursion (MAE) is the Maximum Favorable Excursion (MFE), which is the Entry Price (Dec Close + 10) minus the February Low. The MAE is a measure of the worst point in the trade, while the MFE is a measure of the best point in the trade.

Figure 2: MAE and MFE Graphically



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(MFE), which is the Entry Price (Dec Close + 10) minus the February Low. The MAE is a measure of the worst point in the trade, while the MFE is a measure of the best point in the trade.

MAE's have ranged from -1 ½ cents to -51 cents, with an average of -16 ¼ cents. Using this sampling as a basis, we will set our initial stop loss at -15 cents, as only 4 of the 12 years which saw a trade entry experienced an MAE greater than or equal to this amount.

As such, our Exit Plan with a Loss can simply be stated as risk +15 cents above the entry price. In other words, once the trade is initiated, place a “good till canceled Buy Stop +15 cents above the entry price.”

If they had used the +15 cent stop loss between 1982 and 2000, traders would have initiated 12 trades and been stopped out 4 times (1988, 1992, 1993, and 2000). Eight of the 12 trades would have been profitable, yielding an average trade profit of +12 ¾ cents.

The +15 cent stop loss rule seems reasonable. Fifteen cents in the Wheat market for this time of the year is far enough away from the market to give the trade some room, but still close enough that a small to medium capitalization trader can implement the strategy. As a side note, testing all variations of

stop losses from +5 cents to +50 cents yielded a maximum profit at -35 cents, with an average trade profit of +15 1/2 cents and only 1 occurrence of being stopped out at such a loss. All stop losses below -15 cents resulted in net losses. But, a +35 cent stop loss seems too large, and the difference in trade performance is not substantial. Remember, we want to “Cut Losses Short.”

Using a +15 cent stop loss works well in combination with no profit objective. However, a slightly higher average profit per trade can be achieved by using a -50 cent profit objective. Using a -50 cent profit objective, traders would have achieved an average profit of +16 cents. Also, this large profit objective—achieved only in 1982 as prices broke from an entry price of 401 1/2 down to a February Low of 347 before finishing February at 356—allows traders to take a very rare large profit, and does not impede the systems performance.

The Exit Rule with a Profit can be achieved simply by placing a “good till canceled buy limit -50 cents below the entry price” after the trade is initiated. This better than 3 to 1 profit to loss objective also appears to fit the old trading of “letting profits run and cutting losses short.”

Walking Forward

We developed this trading strategy between 1982 and 2000 (19 years) so we have a few years to test it on new data. This way, before we begin trading it in real time, we can see how it did in a time frame outside the original test. The Trade Plan we just used can be condensed as follows:

1. ENTRY RULE: Sell March CBOT +10 cents above December Close
2. EXIT WITH LOSS STRATEGY: If trade is initiated, risk +15 cents by placing stop loss +15 cents above entry price

3. PROFITABLE EXIT STRATEGY: After trade initiation, exit trade if prices decline -50 cents below the entry price, by placing a buy limit -50 cents below the entry price.
4. TIME BASED EXIT: If the trade is initiated and neither stop loss (+15 cents) nor the profit objective (-50 cents) is achieved by the last trading day in February, exit market on close.

Using the above rules, between January 2001 and the end of February 2007, 5 trades were made. In 2001, a +24 1/2 cent profit was achieved, a +31 3/4 cent profit was achieved in 2002, and a +22 1/2 cent profit was made in 2003. However, the final two trades—2004 and 2006—both incurred losses of -15 cents, being stopped out, as both years saw above average rallies.

We developed this trading strategy between 1982 and 2000 (19 years) so we have a few years to test it on new data.

In total, the system performance is not half bad. 3 out of 5 profitable trades (60.0%) made an average profit of +9 3/4 cents. However, these results are below the past expectations.

The divergence may be due to the last two years of trades, when prices were substantially higher. During the initial test period, prices ranged from 236 1/2 to 527 1/2 and averaged 355. As such, a +10 cent rally in January would equate to about a +3% rally. A +15 cent move would equal about a +4.5% move, and a

Figure 3
2001 through 2007 March CBOT Wheat Trade Results

	DEC	JAN	JAN	JAN	JAN	FEB	FEB
YEAR	CLOSE	CLOSE	CHANGE	RALLY	BREAK	CLOSE	CHANGE
2001	279 2/4	294 2/4	289 2/4	-5	33 1/4	265	24 2/4
2002	289	313 1/4	299	-14 1/4	32 3/4	267 1/4	31 3/4
2003	325	339	335	-4	26 2/4	312 2/4	22 2/4
2004	377	407	387	-20	23	402	-15
2005	307 2/4	312	NO TRADE INITIATED, JAN RALLY <+10				
2006	339 1/4	350	349 1/4	-28 3/4	11 3/4	364 1/4	-15
			AVERAGE	-14 2/4	25 2/4		9 3/4
			#UP	0	5		3
			#DOWN	5	0		2

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-50 cent move would equal roughly a -15% move. However, in both 2004 and 2006, prices were above average. If a +4.5% stop loss would have been used, and the 2004 loss of -15 cents would have been replaced with a profit of +49 ³/₄ cents, changing the average profit to +22 ³/₄ cents and a batting average 4 out of 5 trades, the results would have changed from “not bad” to pretty darn good.

As we enter January 2008, traders may wish to use percentage based rules.

As we enter January 2008, traders may wish to use percentage based rules. This is a modification of the tested system; however, it is necessary with March CBOT Wheat ending December at 885, the highest price in history. As such, going into 2008, the trading plan could be modified as follows:

1. ENTRY RULE: Sell March CBOT +27 cents above December Close, by using a sell limit at +27 cents above the December settlement (912)
2. EXIT WITH LOSS STRATEGY: If trade is initiated,

risk +40 cents by placing stop loss +40 cents above entry price (952)

3. PROFITABLE EXIT STRATEGY: After trade initiation, exit trade if prices decline -133 cents below the entry price, by placing a buy limit -133 cents below the entry price (819)
4. TIME BASED EXIT: If the trade is initiated and neither stop loss (+27 cents) nor the profit objective (-133 cents) is achieved by the last trading day in February, exit market on close.

Conclusion

Hopefully this article gave traders an idea of developing a trading plan. This plan is obviously missing a money management segment—or how much of an account should be risked on any one trade—but it did show how to actually pick logical reasons and places for entries, stop losses, and profit objectives.

Given the current high price of Wheat, traders may wish to switch to percentage based moves and rules—as shown above. Though this is a difference from the testing, it does make sense as +15 cent is fairly large when Wheat is trading at 350. However, when Wheat is trading near 900, it is substantially smaller. Ideally, before initiating this trade, traders should go back and test a percentage based stop loss and profit objective as well as a entry rule... as it is always better to look before you leap, especially when trading and financial risk is involved.

The purpose of this article was not to present readers with a trading idea, but to show them how to develop their own. With the power of the PC and excellent software (like Track 'n Trade Pro), traders can test various ideas and make more informed decisions in the markets.

Scott Barrie is a well respected speaker, author, and editor of PitNews Magazine. His firm, Commodity Futures and Equity Analytics, offers newsletters and consulting services for Individuals, Funds, and Brokerages involved in both Speculation and Hedging. For current research and products available from Scott Barrie and CFEA visit www.CommodityAlmanac.com

Figure 4: 2008 Potential Trade Graphically



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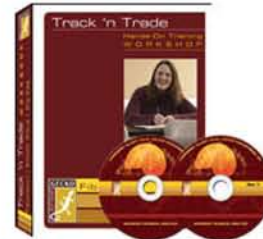
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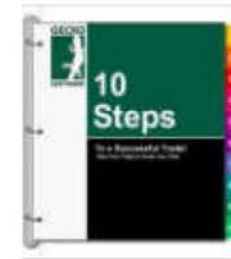


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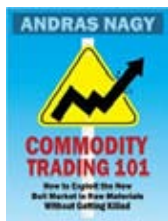
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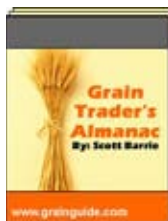


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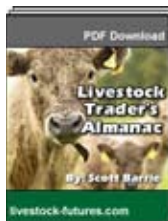


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