

Scalping

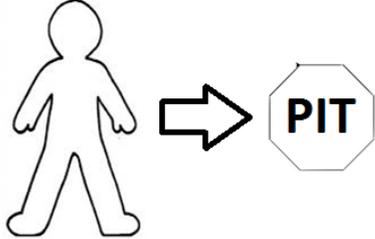
The Basics of Scalping Stock Indices

What is Scalping?



TRADE	ORDER
Germany 30 ⚙️ ✕	
Amount	
Sell	100 Buy
12726	12727
<input checked="" type="checkbox"/> Hedging	Stop / Limit »
SUBMIT	Est. Margin: EUR 6,364 Notional Value: EUR 1,272,740 Comm. Cost: EUR 0.00

BROKER



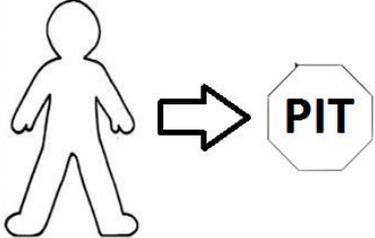
A floor broker walks into a trading pit.

He has an order to execute for a client.

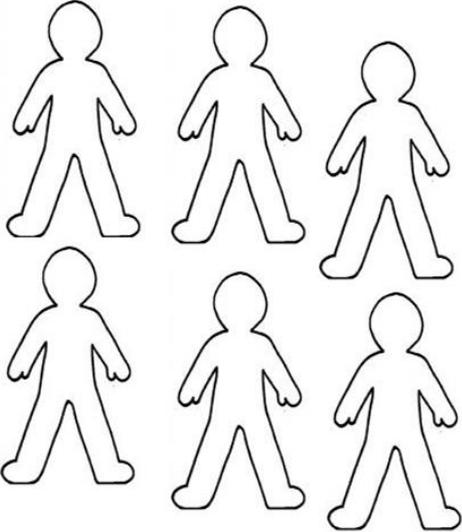
He begins to announce that he has an order to fill. The floor traders begin to shout prices to him.



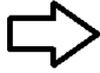
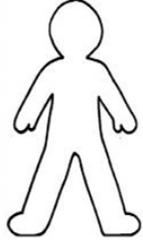
BROKER



Floor Traders - "locals"



BROKER

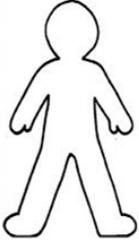


\$1.10 - \$1.11

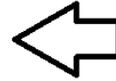
FLOOR TRADER



BROKER



\$1.10 - \$1.11



FLOOR TRADER

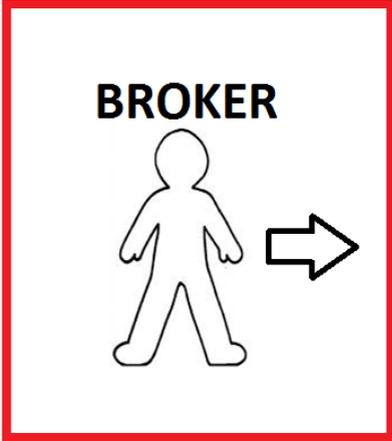


BID

SELL PRICE

OFFER

BUY PRICE



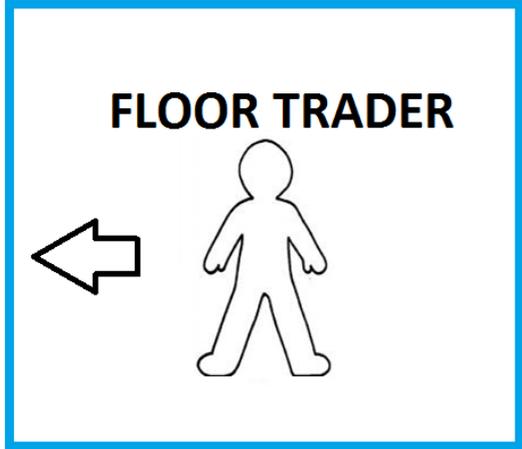
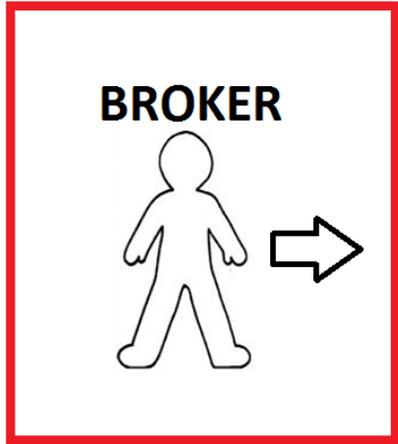
FLOOR TRADER



\$1.10 - \$1.11

**BID
SELL PRICE**

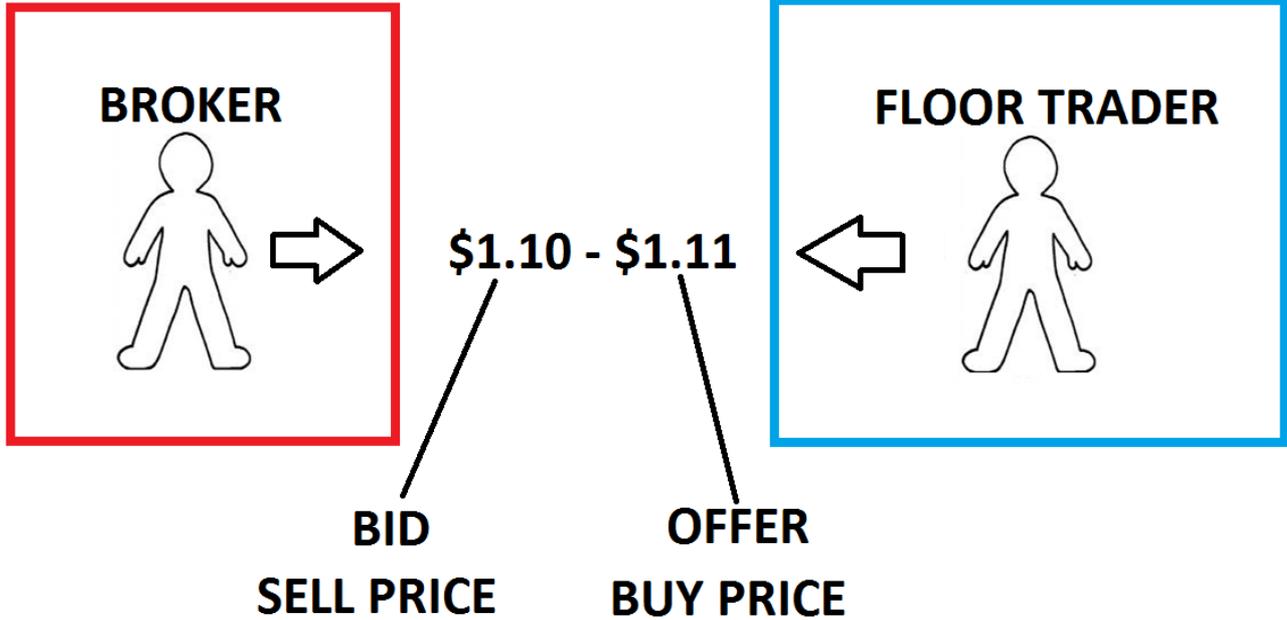
**OFFER
BUY PRICE**



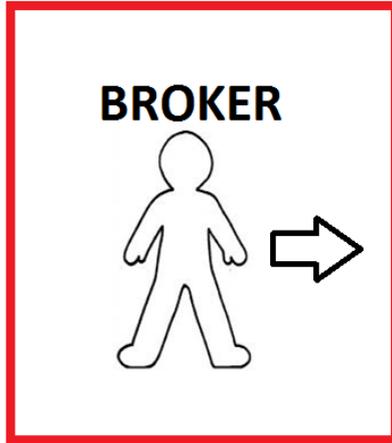
\$1.10 - \$1.11

**BID
SELL PRICE**

**OFFER
BUY PRICE**



DEAL CONCLUDED AT \$1.11



The broker/the client have now done what they wanted to do. They bought at \$1.11.

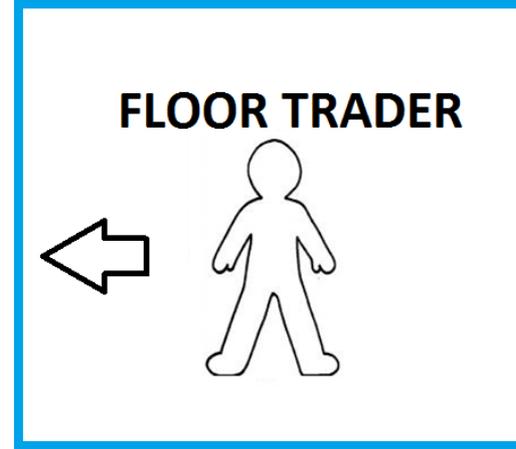
If the price is unchanged, they are immediately 1 cent out of pocket.

The broker/the client gave up a 1 point cent to get into the market. If they sell their position now, they will lose 1 cent, because they can only sell at \$1.10.

The floor trader - the local - is now holding a position.

He is SHORT the market at \$1.11. He went short at that price the moment he let the broker buy off him at \$1.11.

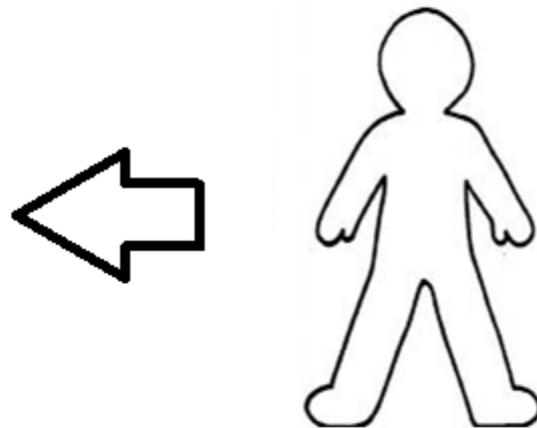
He can immediately close that position by buying back his short position at the prevailing market price.



1. The broker gives up edge to get business done. He pays the bid-ask. Broker/client is now long.
2. The “local” sells to the broker. The local is now short. However, he has an edge.
3. The broker is immediately out of pocket by the size of the bid-ask spread.
4. The local is at breakeven. The local has a very small amount of transaction cost.
5. Now the work of the local starts in earnest!



FLOOR TRADER



The floor trader now has to get rid of his short position. He will now begin to communicate with the pit in the hope of finding another trader or a broker, who wants to go short at \$1.10. If he can find someone who wants to short at \$1.10, then our local can take the other side, i.e. be long at \$1.10. Then his position is closed. He shorted at \$1.11, and he closed at \$1.10. “Facilitate – offload – repeat”. As I understand it, this was known as **scalping** (for a cent).

1. The local takes on the risk in return for a neutral position. The local's role is to facilitate liquidity.
2. At worst the market begins to move against him.
3. At best the market begins to move in his favour.
4. From a status quo perspective, he should be able to get out at breakeven – minus t-cost.
5. If a local could do this many times a day, he or she should theoretically over time – statistically speaking – make a near risk free living. However, when you factor in the cost of owning/renting/leasing a “seat” on the exchange, and include transaction costs, however small, the prospect for the “local” scalper was perhaps not as rosy as you imagined. It was noisy, dirty, smelly, even dangerous, but some made it big: Tom Baldwin, Charlie D.
6. **How is that different to what we do today as “off floor – screen based” traders.**



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The typical CFD broker has 3 distinct advantages:

1. He is always at breakeven on entry.
2. He has two way flow.
3. He controls the size of the bid – ask spread.

The screenshot shows a trading interface for 'Germany 30'. At the top, there are two buttons: 'TRADE' (blue) and 'ORDER' (black). Below these, the instrument name 'Germany 30' is displayed with a settings gear icon and a close 'X' icon. A horizontal line separates this from the order entry section. Underneath, the word 'Amount' is centered above a text input field containing '100'. To the left of the input is a red 'Sell' button, and to the right is a blue 'Buy' button. Below the input field, there are two large price boxes: a red box on the left showing '12726' and a blue box on the right showing '12727'. Below the price boxes, there is a 'Hedging' checkbox (checked) and a 'Stop / Limit' dropdown menu. At the bottom left is a 'SUBMIT' button. On the bottom right, there are three lines of text: 'Est. Margin: EUR 6,364', 'Notional Value: EUR 1,272,740', and 'Comm. Cost: EUR 0.00'.

The typical CFD broker has 3 distinct dis-advantages:

1. If his spreads are not competitive, he will lose business.
2. Flow may be one-sided during strong trends.
3. He has his own risk parameters to adhere to.

The screenshot shows a trading interface for 'Germany 30'. At the top, there are two buttons: 'TRADE' (blue) and 'ORDER' (black). Below these, the instrument name 'Germany 30' is displayed with a settings gear icon and a close 'X' icon. A horizontal line separates this from the main trading area. In the center, there is a 'Sell' button (red) on the left and a 'Buy' button (blue) on the right. Between them is an input field labeled 'Amount' containing the number '100'. Below the 'Sell' button, the price '12726' is shown in white on a red background. Below the 'Buy' button, the price '12727' is shown in white on a blue background. At the bottom of the interface, there is a 'SUBMIT' button (black) on the left. To its right, there are three lines of text: 'Est. Margin: EUR 6,364', 'Notional Value: EUR 1,272,740', and 'Comm. Cost: EUR 0.00'. Above the 'SUBMIT' button, there is a 'Hedging' checkbox (blue) and a 'Stop / Limit »' button (white).

The typical CFD scalper has 4 distinct dis-advantages:

1. If spread is not tight, or if it is a variable spread, he is immediately at a disadvantage.
2. He will always be behind by the amount of the bid-ask.
3. He has no sense of “flow” like a floor trader, and he has no visible or auditory feeling of the market whereas a floor trader can sense the mood in the market by the noise level, and he can perhaps see brokers coming into the pit and can second guess their bias.
4. It is often impractical to enter quickly using limit orders. I will never be able to “buy the bid” or “short the offer”.

TRADE ORDER

Germany 30

Amount

Sell 100 Buy

127.26 127.27

Hedging Stop / Limit »

SUBMIT

Est. Margin: EUR 6,364
Notional Value: EUR 1,272,740
Comm. Cost: EUR 0.00

The typical CFD scalper has 4 distinct advantages:

1. He will have no problem with getting a fill. Even when I trade £100/£200/£300 a point, I rarely encounter issues with my fills.
2. I may not have noise or brokers to guide me, but I have charts to aide me.
3. I have a calm work environment, with clear focus, I am guaranteed a fill, I don't have to worry about latency.
4. I often don't have any commissions or fees to pay.

The screenshot shows a trading interface for 'Germany 30'. At the top, there are two buttons: 'TRADE' (blue) and 'ORDER' (black). Below these, the instrument name 'Germany 30' is displayed with a settings gear icon and a close 'X' icon. The main area features a 'Sell' button (red) on the left and a 'Buy' button (blue) on the right, with a text input field in between containing the number '100'. Below the buttons, the current price is shown as '12726' in red on the left and '12727' in blue on the right. At the bottom, there is a 'SUBMIT' button (grey) and a 'Hedging' checkbox (blue). To the right of the 'SUBMIT' button, there is a 'Stop / Limit' dropdown menu. Below the 'SUBMIT' button, the following information is displayed: Est. Margin: EUR 6,364; Notional Value: EUR 1,272,740; and Comm. Cost: EUR 0.00.

All trading involves risk – scalping is no different

- The risk to a CFD scalper is that, once he is filled, the market goes against his position to such an extent that he is obliged to trigger his stop loss.
- If he sets his stop loss too tight, he may be forced to exit positions that are initially unprofitable, but which would have recovered and shown a profit, had he not exited the position.
- Conversely, if he sets the stop loss too close to his entry, the risk reward ratio is very low. A single loss-making trade could wipe out the profit from a large number of smaller, profitable trades.

“One inch is too soon – one inch is too late” . . . Al Pacino in *Any Given Sunday*

- If you are too ambitious in your profit target, you may never get to realize the gains the position is showing. The market could reverse, leaving you with a loss on a position that was, initially, profitable.
- The flip side is you set too tight a target, you may give up too much potential in a winning trade to overcome the effects of the occasional, large loss.

“Everyone worries about entry – and not exit” . . Dr David Paul

- The obstacles that are facing a scalper are compounded by the fact that time is rarely on their side. There is not the luxury of waiting.
- It stands to reason that the exit is just as important as the entry, if not more so.



Hit rate is a misunderstood concept amongst retail traders, at least amongst newcomers. A high hit-rate does not equate a profitable strategy.

Scenario 1: Scalping Dow with “R10P30” = Risk 10 Profit 30

I have set a stretched profit target. My win rate will be low.

Scenario 2: Scalping Dow with “R5P50” = Risk 50 Profit 5

I have set a small profit target. My win rate will be high.

We assume that

P = profit

R = risk

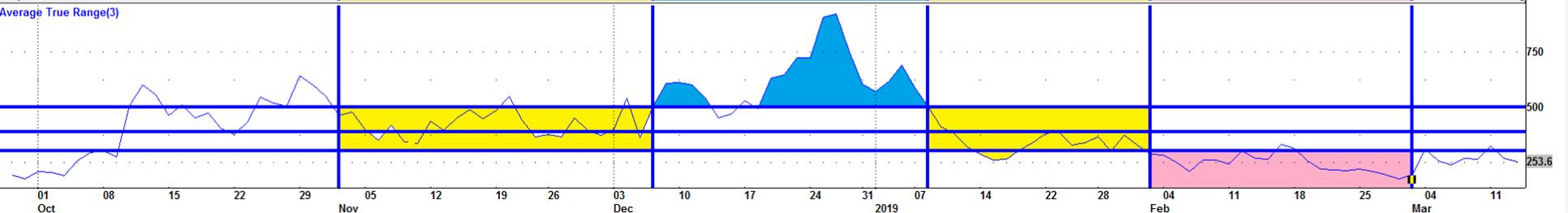
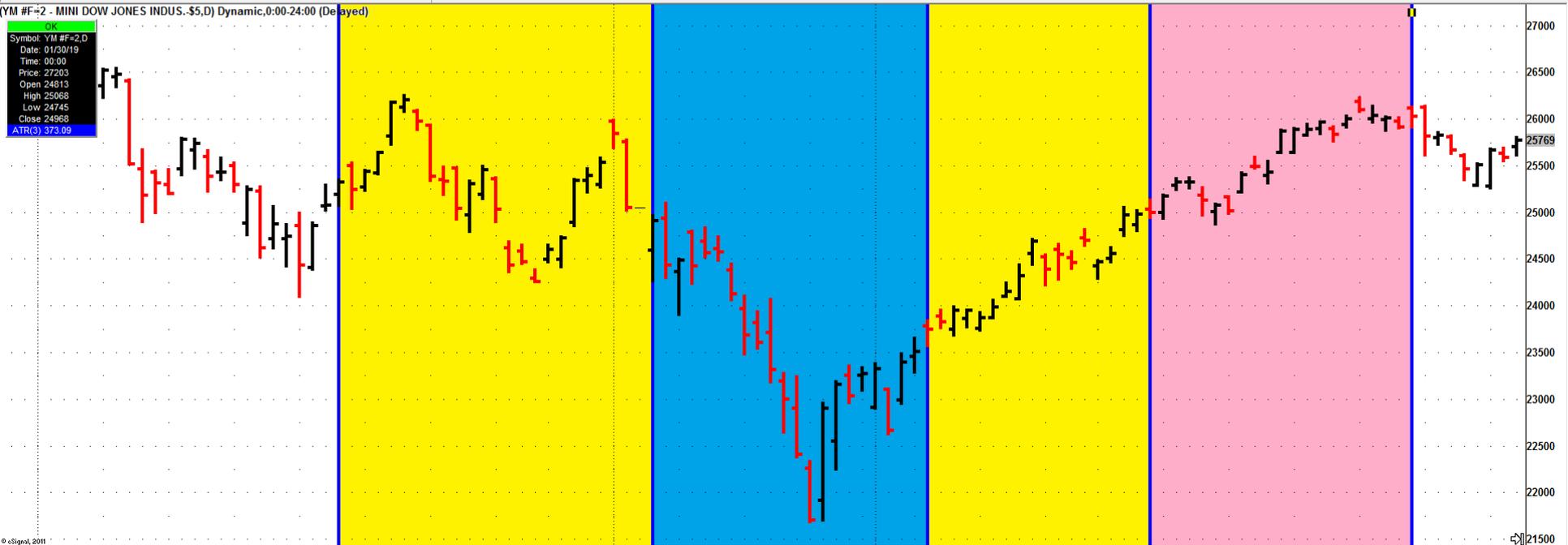
P is our profit target and R is the risk we undertake. How do we optimise our P and our R? Does it matter? What market factors if any do we have to factor into our decision process?

After all, there is a big difference between scalping in the following 4 scenarios:

- Highly volatile trading range
- Docile summer afternoon trading range
- Highly volatile trending market
- Docile trending market

YM #F=2 - MINI DOW JONES INDUS.-\$5,D) Dynamic,0:00-24:00 (Delayed)

OK
 Symbol YM #F=2,D
 Date 01/30/19
 Time 00:00
 Price 27203
 Open 24813
 High 25098
 Low 24745
 Close 24968
 ATR(3) 373.09



1. **YELLOW is for the “Daily High Low” between 300 and 500 Dow points.**
2. **BLUE is for the “Daily High Low” readings above 500.**
3. **PINK is for the “Daily High Low” readings below 300**

1. My job in simplistic terms is to risk as little as possible to make as much as possible.
2. The problem is volatility.
3. When the Dow is trading in a “very low volatility” environment, I do well by using a larger stop loss than my profit target. I will have an exceptionally high hit rate, but I will have the occasional larger loss. The hit rate is around 90%, and the purpose is to make a large number of small gains.

Profit target 5 points

$90 * 5 = 450$ made

Stop loss 20 points

$10 * 20 = 200$ lost

1. As volatility grows, my approach to scalping has to change too. This is a dynamic approach rather than a static approach. I can't simply declare *"I use a 25 point stop loss"*.
2. **As volatility grows to between 300 and 500 Dow points** using True Range as measure, it becomes evident that making 20 points is akin to being given a basket full of apples, and then you only take one. The stop loss approach can now take one of two paths:

Increase profit target as well as the stop loss = 25P / 75L

Increase profit target but decrease the stop loss = 25p / 5L

3. The win rate naturally decline, depending on selected option, and it is far from 90%. As volatility grows, I am aiming to make occasional larger gains, but I am willing to pay the price of sustaining repeated small losses.

1. **If the markets are very volatile,** when Dow readings on True Range exceeds 500 points, the whole dynamics of scalping changes dramatically. I am essentially doing a 180 degree U-turn from how I scalp in a low volatility environment.
2. If you trade with large stops in a raging volatile market, you are likely going to suffer an increase in larger losses. Therefor I have gone in the opposite direction, and I have opted to trade with very small stop losses, but I am targeting occasional large gains.
3. The win-rate can be as low as 25%. The math though is compelling.

Profit target 50 points

$25 * 50 = 1,250$ made

Stop loss 10 points

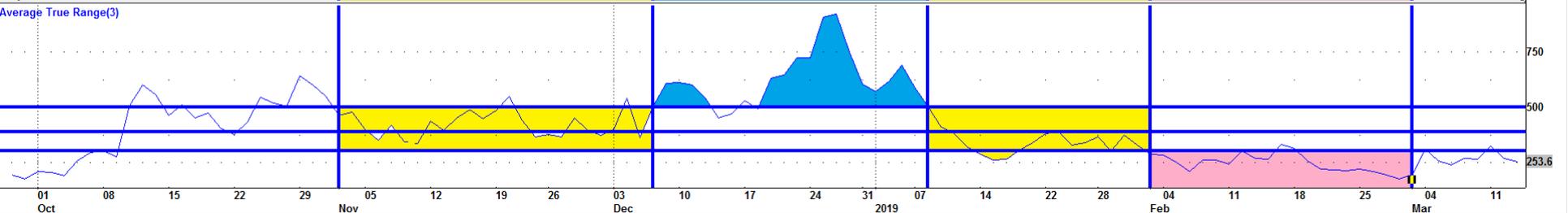
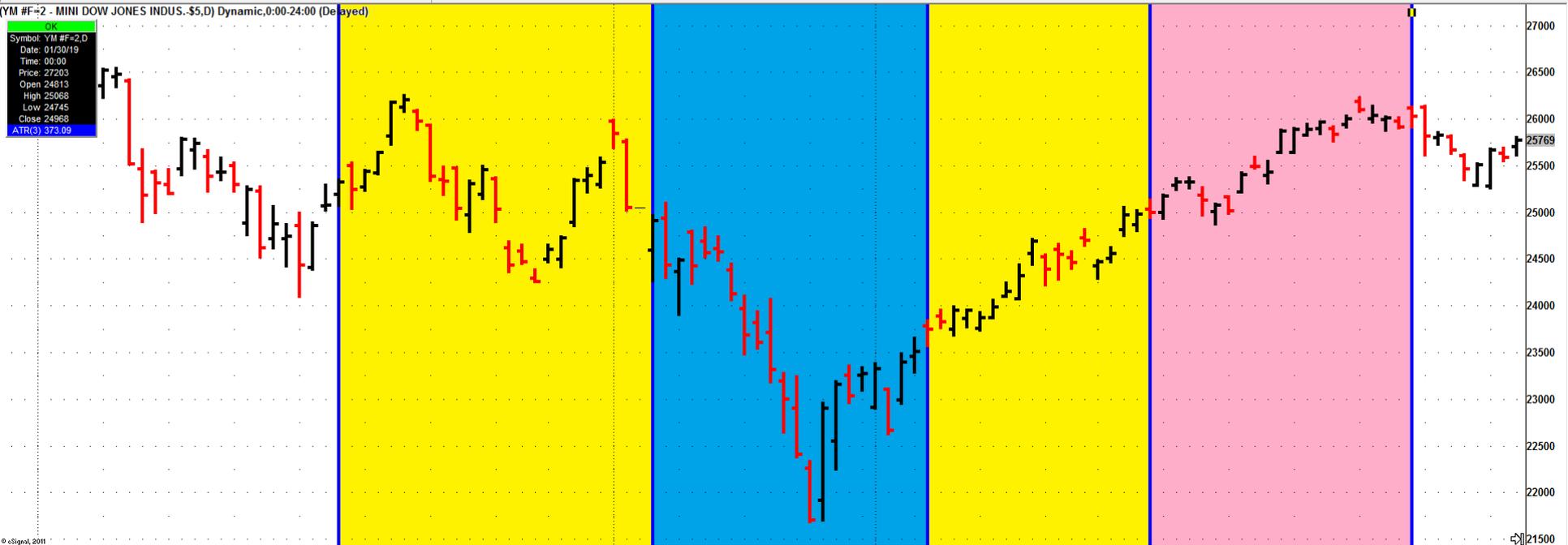
$75 * 10 = 750$ lost

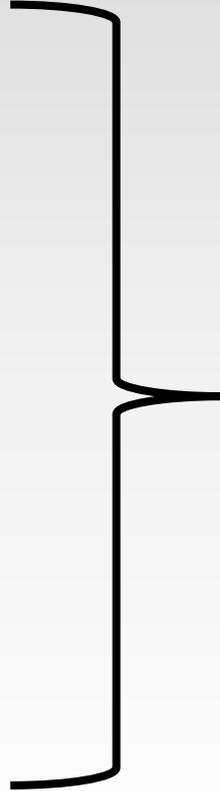
4. I have deliberately been overtly negative on the win-rate to portray a bleak scenario. I think perhaps having stated that I am right 3 times out of 10 in volatile situations was more realistic.

What is Intra-Day Volatility?

YM #F=2 - MINI DOW JONES INDUS.-\$5,D) Dynamic,0:00-24:00 (Delayed)

OK
 Symbol YM #F=2,D
 Date 01/30/19
 Time 00:00
 Price 27203
 Open 24813
 High 25098
 Low 24745
 Close 24968
 ATR(3) 373.09





What is the volatility on the 10-min chart over various time segments during the trading day?

Next I will go through 3 volatility environments which will highlight the extent of the volatility under each time segment.

Above 500 True Range – UK times – 10min chart

14:30 – 15:00	120 points
15:00 – 15:30	103 points
15:30 – 16:00	96 points
16:00 – 17:00	86 points
17:00 – 18:00	73 points
18:00 – 19:00	67 points
19:00 – 20:00	80 points
20:00 – 20:30	90 points
20:30 – 21:00	94 points

300 – 500 True Range – UK times – 10min chart

14:30 – 15:00	81 points
15:00 – 15:30	64 points
15:30 – 16:00	61 points
16:00 – 17:00	54 points
17:00 – 18:00	53 points
18:00 – 19:00	50 points
19:00 – 20:00	55 points
20:00 – 20:30	59 points
20:30 – 21:00	59 points

Below 300 True Range – UK times – 10min chart

14:30 – 15:00	53 points
15:00 – 15:30	45 points
15:30 – 16:00	40 points
16:00 – 17:00	37 points
17:00 – 18:00	30 points
18:00 – 19:00	24 points
19:00 – 20:00	25 points
20:00 – 20:30	25 points
20:30 – 21:00	30 points

- Scalping – manually as opposed to via an algorithm – is a serious endeavour which requires an immense amount of concentration and focus.
- The scalping method is highly sensitive to the underlying volatility.
- The setting of the optimal profit targets and the stop loss limit is a dynamic process and is dependent on the current levels
- At low levels of volatility I use large stops, and small profit targets. The chance of being stopped out is small, and the profit target usually gets hit. The win rate is 90%, which will compensate for the occasional larger loss.
- At the opposite end of the volatility scale, it seems more prudent to reverse the strategy, by using large targets but small stops. This is irrespective of whether being LONG or SHORT.

Scalping Entry Techniques

- Before I engage in the “main course” of the lecture, I would like to make an opinion known.
- Whether the volatility is high or low, we still have to figure out whether to buy or whether to sell short.
- How do we do that? We can use a trend estimator for example.
- The problem with “trend” within a highly volatile environment is that trend tends to get washed out or drowned out on short time frames like a 1min chart.
- Fortunately not all scalping techniques are trend dependent.

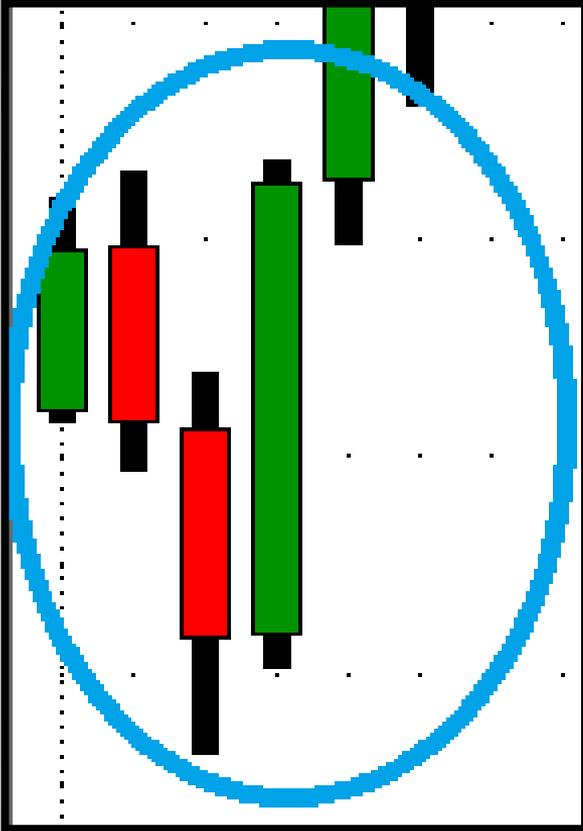
- If I gave this talk in the US, I would have to consider topics such as slippage and fill rates.
- I would also have to factor in commissions and exchange fees.
- Outside of the US, we have CFDs at our disposal, which means that when we trade stock indices, we rarely if ever pay commissions, and we certainly don't pay stamp duty or exchange fees.
- We also have the advantage of being able to trade odd lot size as opposed to exchange set contract sizes.
- Finally because we trade through a financial middle man (the broker) we tend to always get the price that we have requested.

Buy On Close

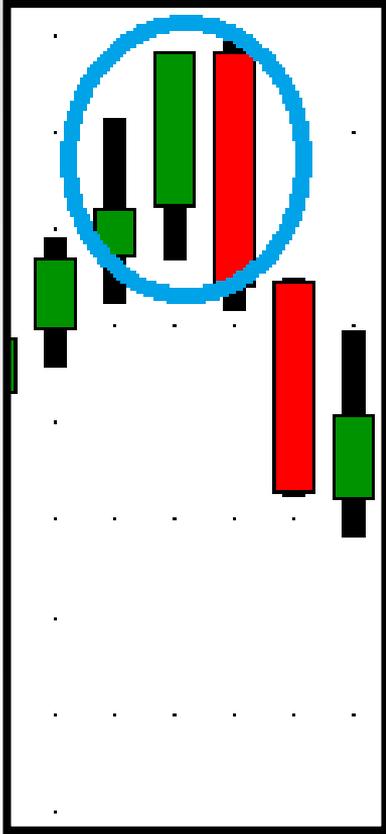
- Buy On Close is an entry technique in its own right – scalp or position trading.
- The close is important. Is there a tail or no tail?
- Length of the bar is also a consideration. Is the market expanding or contracting?
- Example will show DAX on a 5min chart.
- I will show the chart and then break down the individual trades.





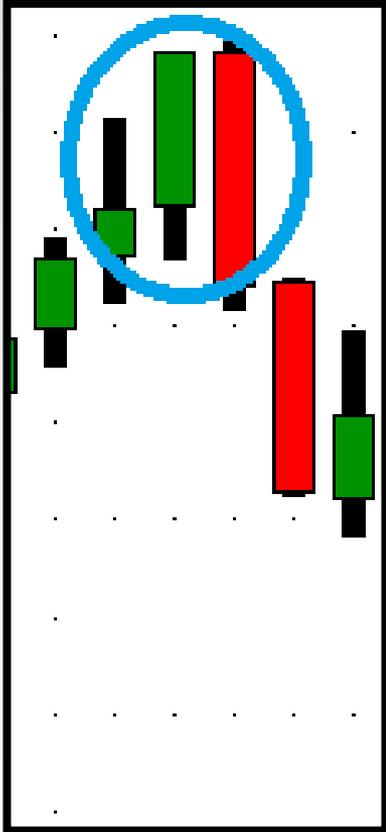


- The vital criteria for Buy On Close is a strong close.
- The close is important. Is there a tail or no tail?
- Length of the bar is also a consideration. Is the bar expanding or contracting compared to previous bars?
- The 3rd bar is the bar in focus. It is a bullish bar, longer in length than previous 2-3 bars, and a decisive bullish close with nearly no “tail” at all.
- This makes it a good candidate for a “Buy on Close” scalp. The stop loss is a function of volatility, but here are three suggestions:
 - 1/ Opposite side of entry bar (preferred)
 - 2/ Halfway down bar (less risk – but high chance of stop triggered)
 - 3/ Below day low (more risk – but less chance of stop trigger)



- The bar itself – the third one in – is fine. It has the qualities I need.
- Context however, is a problem.
- Let us look at the big chart again:





- The bar itself – the third one in – is fine. It has the qualities I need.
- Context however, is a problem.
- Let us look at the big chart again:
- I will be buying exactly where resistance sellers will be selling short.
- My stop is either below the low of last swing, or volatility based or simply below the low of the signal bar.

Trader Tom



- **Circle 1:** happier to buy it – cleared sideways congestion resistance. The bar itself is perfect. Stop loss is very manageable.
- **Circle 2:** The bar itself is perfect, but the context is a problem. I am bang up against the trading range roof. A big stop and a small target would alleviate the problem.
- **Circle 3:** The bar itself is fine, because it signifies strength in the market. However, one of the very important features of Buy On Close is missing. It is a very small bar. Instead of range expansion, I see range contraction.



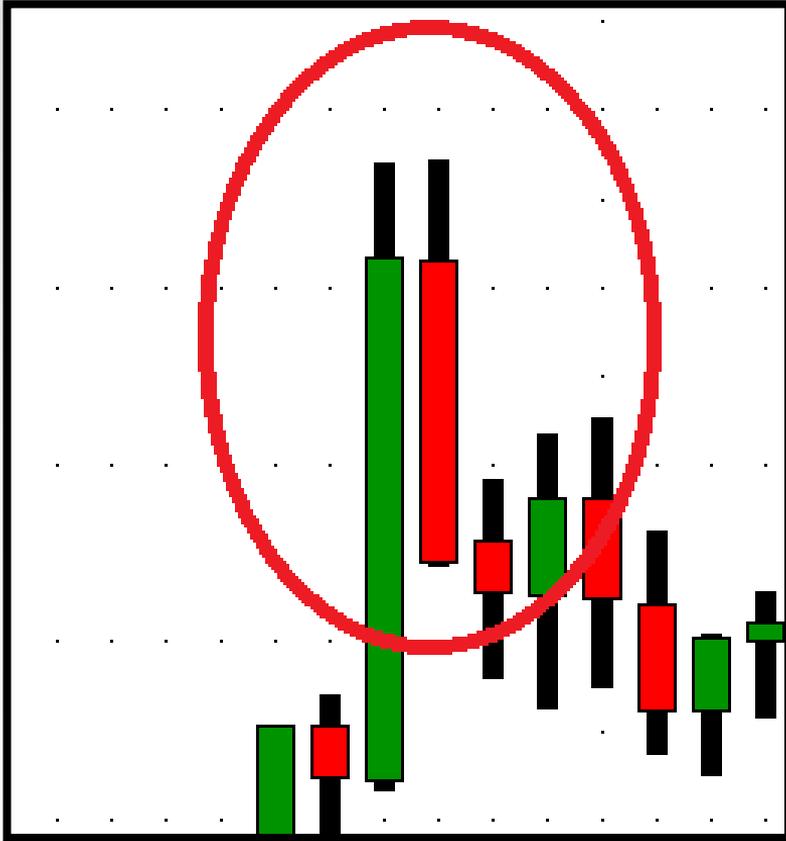
- Circle 1 and the bar not circled immediately after are good candidates for a Buy On Close Strategy.
- They are both significantly longer in length than the bars immediately prior (there are 6 very tiny bars before the first circled bar).
- The 2nd circle has a near identical setup to the first circled bar.

Sell On Close

- Sell On Close is an entry technique in its own right – scalp or position trading.
- Like the Buy On Close, the close is important. Is there a tail or no tail?
- Length of the bar is also a consideration. Is the market expanding or contracting?
- Example will show DAX on a 5min chart.
- I will show the chart and then break down the individual trades.

\$DAX-XET - XETRA INDICES,5) Dynamic,0:00-24:00 (Delayed)





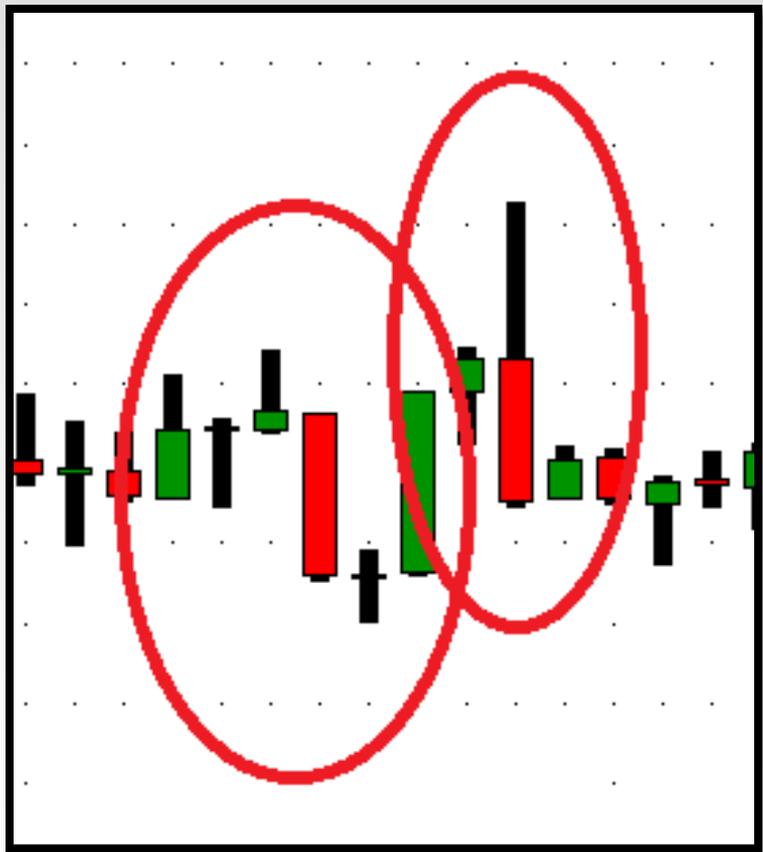
- The parabolic move higher has been met with selling. A long bullish bar which comes after a market has already pushed higher for 5-8 bars suggest that the buyers are saturated.
- The red bearish bar closes at its absolute most negative and there is no tail whatsoever to the downside.
- This suggest that there is more selling to come. As a scalp trade, the odds are high that we will see more down side.
- The risk is fairly easily defined. The stop loss is above the most recent high, or potentially lower, depending on how sure you want to be to not get stopped out.



- These Sell On Close bars come within a trading range retracement. The index is retracing the morning move but over the last 16 bars, there is a lot of “overlap” between bars.
- Context is always a consideration to be factored in when you are scalping.
- The first circle shows a bearish Sell On Close type of bar, but the problem is how close you are to support.
- The second circle is much better to sell because you have at least some distance to travel to the low of the range.

\$DAX-XET - XETRA INDICES,5) Dynamic,0:00-24:00 (Delayed)





- The first circle Sell On Close bar I considered to be a really good setup. I was rewarded with a sweet “thank you very much – but not this time amigo!”
- The second circle is a little different than the other bars I have shown you. You actually a fair amount of “tail”, but it is at the opposite end of the part of the bar that I care about.
- I care about getting a negative close, one where there is little or no tail at the close.
- The second circle is also a good sell. Neither scalps are profitable, but the point is not to find pretty setups, but to illustrate the setup.



- I regret taking the first circle with me as an example, because I would be sceptical to sell is as a “Sell on Close”.
- It is an inside bar, and it is smaller than bar prior.
- It also doesn’t close at its low. It is not by a lot, but as a setup bar, this is not a good example.
- That it didn’t turn into a winner is inconsequential.
- The second circle has a lot of “tail”, but close at the DEAD LOW.

Limit Scalps



This is in the context of very short-term trading. If we work under the assumption that more than 60% of all trading executed in America is the result of algorithmic trading, and on very volatile days, they can account for as much as 90% of trading, then it becomes a question of figuring out what THEY are doing.

Again, I stress this is not for position trading. This is for ultra-short term trading. The average holding time for a stock in America is now 22 seconds. It is unfortunately not within the remit of a human mind to Observe, Evaluate, Execute, Evaluate, Close - all within 22 seconds, all day long.

However, an active scalper can look to execute some 40 trades a day, or one about every 10 minutes. There are 78 5-min bars in the active Dow Jones session.

You always hear me talking about: “Are stop entry bears making money, are limit entry bears making money? Are stop order bulls, are limit order bulls making money?” In a situation like this, where the only way to make money is buying the market – right? – that to me is a market that is going to go higher. Probably some kind of a measured move up.

“Who is making money?” is a question geared towards understanding what is going on in an index on a very short-term basis, in this case using a 5-min chart.

Are stop entry bears making money?

Are limit entry bears making money?

Are stop order bulls making money?

Are limit order bulls making money?”

This will probably require some explanation, I imagine.

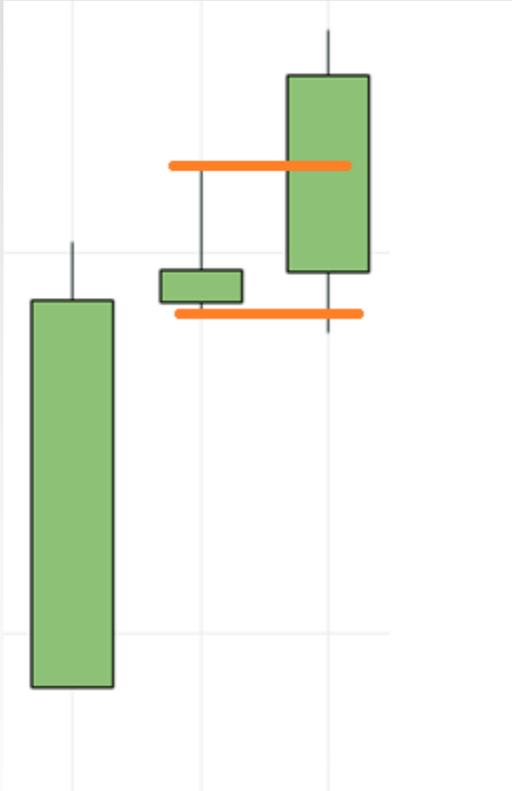
PRICE 12863.5 OPEN 12853.3 CLOSE 12863.5
HIGH 12865.5 LOW 12851.0 DATE: 10-24 09:45

Germany 30



Share Prices shown on charts are MID prices. Historical data is indicative only.

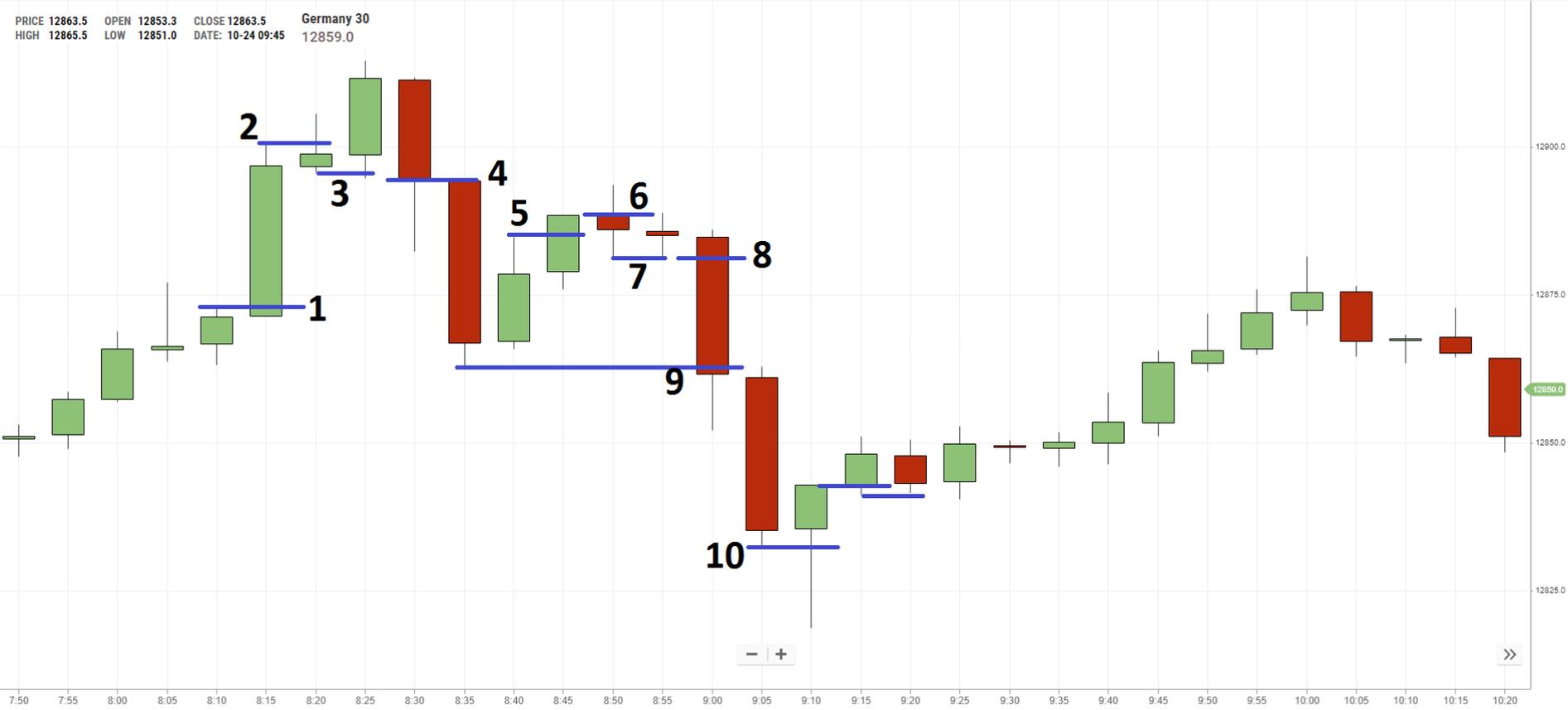
Tick 1 Min 2 Min 3 Min 5 Min 10 Min 15 Min 30 Min 1 Hour 4 Hour 1 Day Week Month

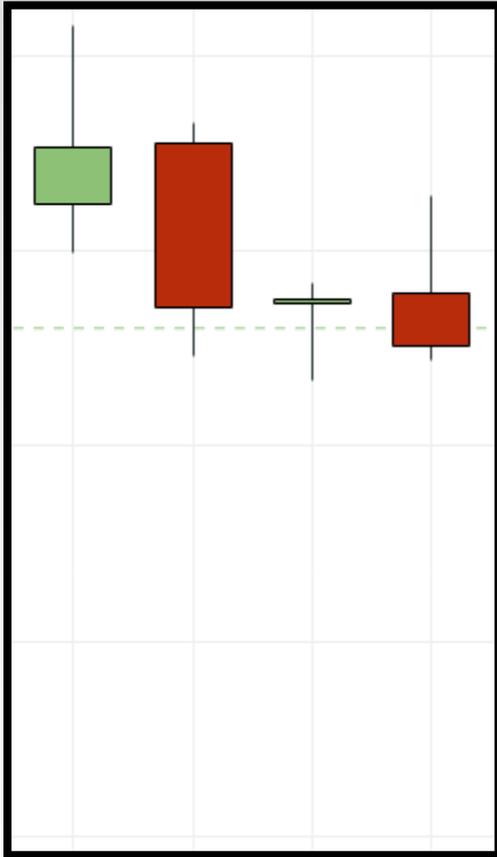


The points below are used to describe the price action of the third bar, which is the last bar you see.

1. Limit Order buyers BOUGHT at, or below, the price of the 2nd bar low. They are now making money.
2. Stop Order sellers SHORTED at, or below, the price of the 2nd bar low. They are now losing money.
3. Limit Order sellers SHORTED the top of the 2nd bar or higher. They are now losing money.
4. Stop Order buyers BOUGHT the top of the 2nd bar or higher. They are now making money.

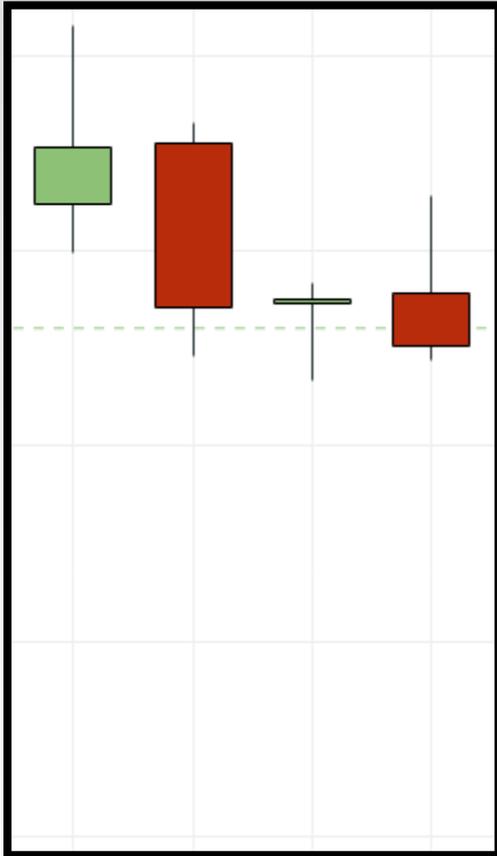
PRICE 12863.5 OPEN 12853.3 CLOSE 12863.5 Germany 30
HIGH 12865.5 LOW 12851.0 DATE: 10-24 09:45 12859.0





I will call the extreme left green bar Bar 1, and then the following bars Bar 2, Bar 3 and Bar 4.

- Bar 1 is positive. It closes halfway down the length of bar.
- Bar 2 is negative. It pushes below the low of bar 1. It also closes below the low of bar 1. It is not a full blown negative bar. Limit buyers are losing, and stop sellers are winning.
- Bar 3 is meeting buyers below low of bar 2.
- Bar 4 pushes above the high of bar 3, but it loses momentum as “limit sellers” overcome buyer strength.
- Bar 4 is the signal bar for my scalping approach using this method. There is an “**aggressive**” approach and a “**Closed Bar**” approach. I am showing you the Closed Bar approach.



What makes me bearish at the completion of Bar 4?

- Buyers pushed the market above the high of Bar 3.
- Sellers pushed the buyers back. There must have been more Limit Sellers above the high of Bar 3 than there was Stop Order buyers.
- Bar 4 closes at its lows.
- Bar 4 closes well into the range of Bar 3. This and the above trigger a “sell short” alarm and a stop above the high of the bar.
- The “aggressive” approach will be discussed at another lecture. Safety first, and then sophistication later.

PRICE 26826.5 OPEN 26844.5 CLOSE 26826.5 Wall Street 30
HIGH 26857.5 LOW 26821.5 DATE: 10-23 15:05 26858

Sell:

26857

Amount

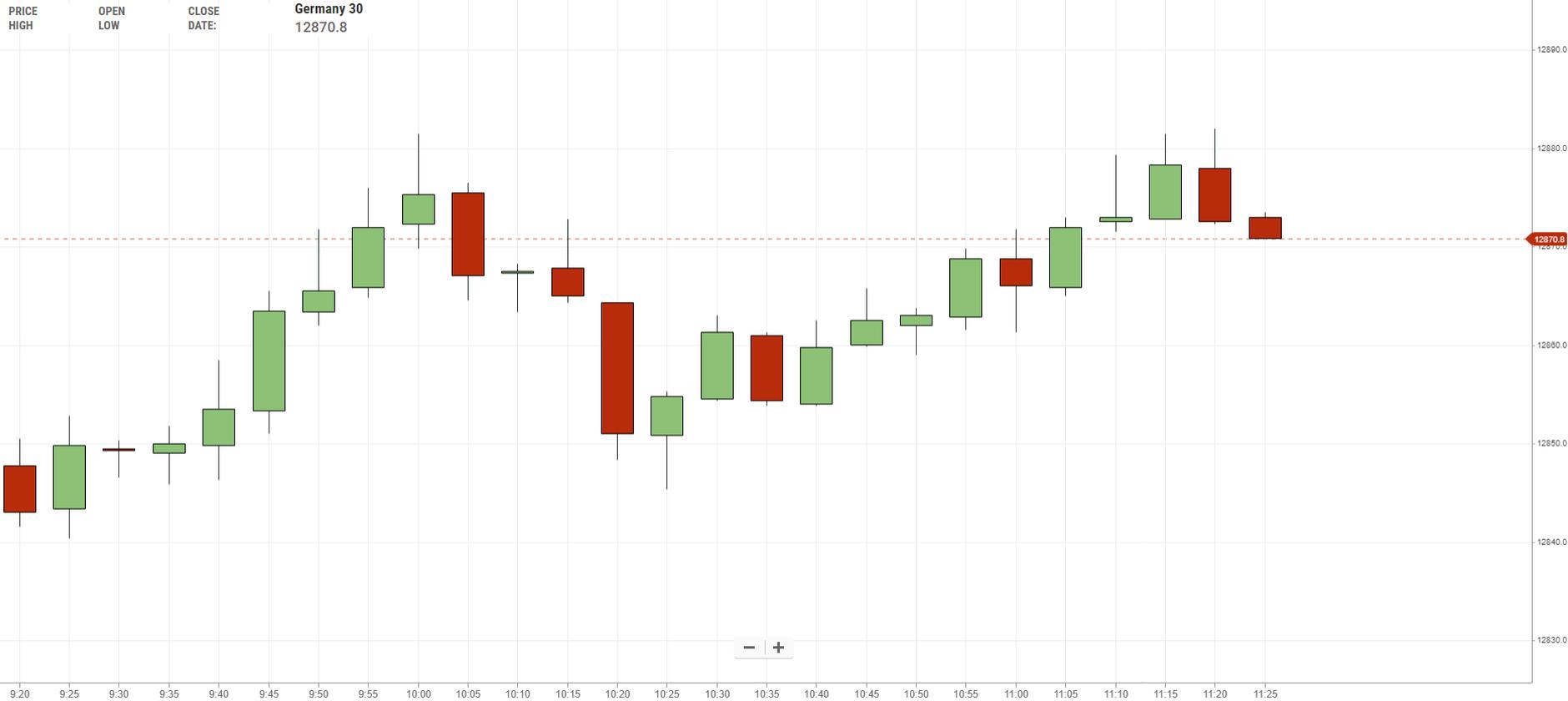
Order Level

Hedging

Buy:

26859





Thank you

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