Scalp Trading Methods

Kevin Ho, floor trader, reveals his six favourite high probability scalping setups with tight risk rules.

After working a trading business plan, the prospective trader by now has a very strong justification for trading, and should be looking to formulate strategies to extract consistent profits from the market. As promised, this issue looks to demonstrate an array of pit-like scalping methods with high accuracy.

Trading is a Wishing Well

How would you describe trading? In the words of motivational guru Tony Robbins, what metaphors you use to describe your Life affects the quality of your perceptions, and ultimately your Life. So it goes with trading. Some people say it's like a dangerous animal, waiting to pounce; others think of it as rough seas, waiting to be sailed. I like to think of trading as a walk in a knee-deep wishing well full of coins – be content to consistently pick up coins here and there, and avoid the temptation to go for a chestful of coins, lest you fall and wet yourself. (Or worse, drown in knee-deep water)

Definition of Pit scalping

By the very nature of trading in the pits, scalping is best defined by trades that are very short term in nature. This presupposes small consistent profits from trades that last no more than a few minutes.

These methods presented here are exactly that - high probability trades with extremely small risk stops and predefined profit objectives. In the adage of the successful pit trader, it all about taking a million trades to make a million dollars.

Risk Management

Whilst entry techniques here are self explanatory, the risk management aspect of these trades are such that they must be followed without question, or when the position doesn't perform as expected. Being relatively tight stops the trader must either be very fast in exiting, or already have orders placed in the market after entry. The methods here depend very much on taking these losses as and when they come - taking larger than normal losses when they should have been taken earlier will undermine week-to-week profits significantly

3 categories of scalp trades

These timing methods come under 3 classifications:

1) **Time-sensitive trades**

This comes in 2 forms:

- In opening range breakouts, where a quick scalp is taken minutes after the open, in the direction of any market thrust.
- Trading to capitalise on the regular market turnaround times like 10am & 3 pm NewYork time.

2) **Countertrend trades**
Where trades are taken in known periods of trendlessness during the trading day.

3) **Trend continuation trades**
These methods focus on entering the market in the direction of a trend AFTER the trend has gone underway. They are also classified as retracement trades.

The Ultimate market for these scalping methods

As the S&P500 futures is, in my opinion, one of the most liquid, most active and most electronically accessible market, these methods represent the best known chances for picking consistent profits as a trader-scalper.

TIME SENSITIVE TRADES:

My bread and butter

Pattern 1: The 15-minute Opening Range Scalp (15ORS pattern)

This is my all-time favorite method- it's easy to do, need no more than telephone or Internet access to a broker, and is very reliable. It differs from the usual notions of opening range breakouts in that profits are taken so quickly that the trade lasts no more than 1 minute.

Setup: Wait for the first 15miute range to form from the open.
Entry: Enter on a buy stop 2 tics above the high of the first 15 min range or Enter on a sell stop 2 ticks below the low of the first 15 min range
Profit exit: Close out positions on an immediate 1-point profit
Stop Loss: Exit for loss on a 1 point loss from entry or,
Exit if trade is open for more then one minute.

Re-entry: On being stopped out, look for the usual breakout in the opposite end of the opening range. In this case I normally double my stop entry size and wait. Same exit rules apply.

Chart 1: S&P 500 -15 Minute Open Range Scalp

Notice relatively clean breakouts from the first 15-minute bars of each day. All 9 trades for the 9 trading days were winners.

Note: All charts in this article depict market action in the S&P500 futures for the same week of August 2003. Blue words and entry circles denote profitable trades. Red denotes losing trades. Time Scale in Chicago Time, which is 1 hour behind New York.

Pattern 2: The 10 o'clock jiggle (10OJ pattern)

As mentioned in the last few issues, 10 o'clock New York time provides ample opportunity for the market to reverse its current intraday trend from the open.

Setup: Wait for the market to make to 15-minute bar closes from the open. If the market is near the intraday high for the 1st 30 minutes of trading, be prepared to go short. If the market is near an intraday low for the same time period, then be prepared to go long.

Entry: For sell setups: Enter on sell stop 1 tick from low of the last 15 min bar.
For buy setups: Enter in buy stop 1 tick from high of the last 15-minute bars
Profit exit: Close out positions on 1.5 point profit
Stop Loss: Close out on 1 point loss or if trade takes more than 1 minute.
Cancel all stop entry orders (if not hit) after 10.30 has passed. No re-entry rules here.

Pattern 3: The 3 o'clock jiggle (3OJ pattern)

Due to the US bond market close around 3 pm New York, there is a reversal tendency similar to the 10 o'clock jiggle.

Buy setups:	Place entry buy stops if the move 30 minutes prior to 3 pm has been down
Sell Setups:	Place entry sell stops if the move 30 minutes prior to3pm has been up
Entry, Exit & stop losses:	same as the 10 o'clock jiggle Cancel all entry stop orders (if not hit) after 3.30 has passed. No re-entry rules here

Chart 2: S&P500 – 10& 3 O'Clock Trades

Horizontal blue lines denote entry levels. All trades for the week were winners. Note the 'downtime' period on Tuesday and early Wednesday- no signals here.

Scalp Patterns:

With the idea of extracting scalping profits from short market thrusts, I re-introduce my 10minute 'coin-collector' in 'penny' form.

Pattern 4: The Penny Pincher (10PP pattern)

Setup: On 10 minute candlestick bars, look out for bullish or bearish engulfments.

I reproduce the classic engulfment patterns in Figure 1.

Figure 1: Engulfment Patterns

Entry:	Timing window: only take trades within first hour and last hour of the trading day. For bullish engulfments: buy at market price when the white body of the current bar exceeds the high of the last dark-bodied bar (see above) For bearish engulfments: sell at market price when the current dark body of the current bar goes lower then low of the last white-bodied bar. (see above)
Profit Exit:	Close out position for a 1-point profit.
Stop Loss:	Exit for a 1-point loss or if the trade lasts more than 30 seconds.

Chart 3: S&P500 – Penny Pincher (during first and last hour of trading)

This week there were 14 out of 15 successful trades.

Trend-Continuation Trades

I like them because they only enter trends after the market has tipped its hand.

Pattern 5: The 5-Minute Standard Deviation Scalp

Ok, it's a fancy name for re-entering the market on a pullback. The strategy is simple to understand. You only enter the market on meaningful retracements.

Setup: On 5-minute bar chart, impose a 10-bar moving average. From this moving average, expand an upper and lower band exactly 1 standard deviation from it.

Entry: In an up trend, we are looking only to buy the dip that penetrates the LOWER band, provided the slope of the bands are still up.

In downtrends, we look to sell the rally that penetrates the UPPER band, provided the bands are sloping downwards.

Profit Exit: Close out for profit on a 2-point gain or it the price touches the other band, whichever is sooner.

Stop Loss: Take a 1.25-point stop loss or exit at market if the slope of the bands changes after entry.

Chart 4: S&P 500 - Showing 10 out of 14 profitable trades in 3 trading days for the 5-minute standard deviation retracement pattern.

Pattern 6: The 'ANTI'

This one's a Linda Bradford Raschke original. She's the only woman to be featured in Jack Schwager's 'New Market Wizards'. Go figure why she calls it the 'ANTI'.

Setup: On 5 minute bars, we use a 7 period slow stochastic indicator, with a 10-period moving average of it to act as a trend filter.

Entry: For Buys: Buy at market when the 7-bar stochastic indicator crosses above its own upward sloping 10- bar period moving average line on the close of any 5 minute time-period

For Sells: Sell at market when the indicator crosses beneath its own downward sloping 10-bar moving average line on the close of any 5-minute time-period.

Profit Exit: Close out for profit at a 2-point gain.

Stop Loss: Exit with a 1.5-point loss or if the trade goes nowhere after 3 minutes.

No re-entry rules here.

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Chart 5: S&P 500 - 5 winning trades in 3 trading days using the 'ANTI'.

Conclusion and Caveat:

There you have it - 6 high probability scalping setups with tight risk rules. Be sure to take those losses when they invariably come by, and avoid the temptation to gun for more profits by staying too long in a trade.

It's easy to dismiss these patterns as unexciting, since they do not lead to large windfalls, but are happy to chug along with small consistent profits.

Imagine using all 6 setups each trading day. The first 3 occur without fail, with the rest having very high chances of appearing during the trading day. By experience they usually have a decent 75 percent accuracy rate (sometimes higher!), which roughly equates to about close to an average of US$200 per day profits in a single lot of the e-mini S&P500. Don't scoff at the apparently small monthly returns of about US$2000 (give and take for losses etc).

Trading is scalable and very profitable if consistent. Try 10 lots for size. It's going to be real serious money if you know what you're doing. Just remember to cut loss at the slightest discomfort. And remember: *"A million dollars on a million trades".*

Kevin Ho is a member of the Singapore Exchange (Derivatives Trading Division), and comes from a money-center bank treasury background. He is in the midst of migrating all his trades to screen-based off-shore capital management, and can be contacted at his website:
kevinho@market-kinetics.com

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