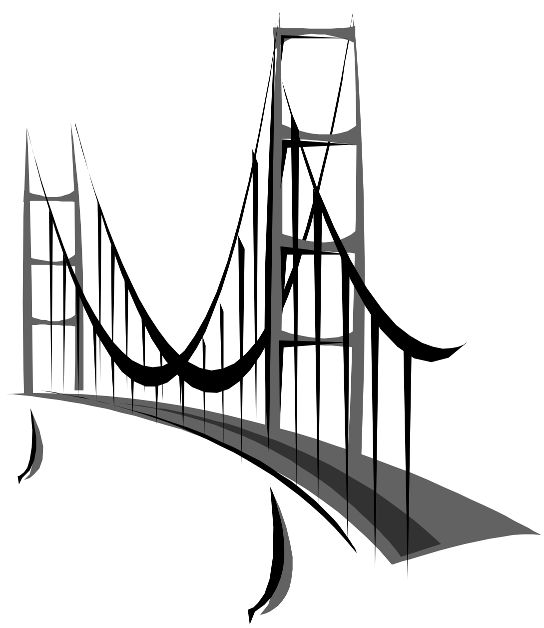
The Slingshot Trading Method



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The Slingshot Trading Method

By

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The charts used in this book were created with AIQ Systems Trading Expert Pro 5.0 software.

Disclaimer

The methods described in this book are for educational purposes only. Past results are not necessarily indicative of future results. The author and the publisher assume no responsibility for your trading results. Trading involves a high degree of risk.

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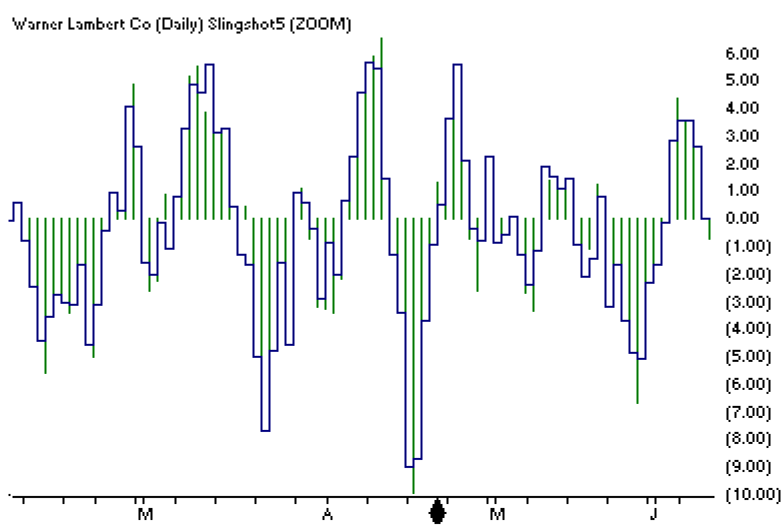
Introduction

The purpose of this book is to give the reader an effective tool to be used in short term trading. The trading strategies and indicators discussed in this book are being used by this author and others on a regular basis and have been used and tested for over eight years. While learning this system you will learn techniques for trading intra-day, one to three days and for trading on a longer-term basis all with a high degree of accuracy. The techniques that I will be discussing may go against traditional trading systems and may not be for everyone. They are in fact though a profitable way to trade.

I have used many different trading systems and have found that all systems will work at different times and in different types of markets. I find it most effective to focus on just a few different trading systems and get very good at them. The more focused one becomes at what he is doing the more likely he will become good at it. It is hard to focus on too many different ideas at once when it comes to trading because many contradict each other, therefore it is best to stick with what works effectively. Even concentrating on a limited number of stocks will often increase your trading performance immediately. The more you learn about how a particular stock moves the better your trading will become. It is a good idea to select a few stocks, which you know and follow, and learn how they trade. One of the most common practices I have seen in trading is for a trader to make a trade in a particular stock and after profiting or losing his or her money, forgetting about the stock and moving on to the next one. I don't think this is necessary. Many professional traders make a living just focusing on one or two stocks. The flip side of this and one of the biggest mistakes a trader can make is "falling in love with a stock." Many traders will trade a stock over and over, often in the same direction, then one day the stock turns against them. They will continue to hold it thinking it will turn around because it has so many times before. After the stock continues to go against them and they lose their money and their "love," they feel betrayed and will try to forget about the stock. This can often be avoided by learning how a stock trades and by trading it in both directions. It can also be avoided by using strict money management with stops.

The trading system that I will talk about in this book will help you both focus on the best stocks for trading as well as teach you to trade them both long and short and by using options. I call this system "Slingshot" due to its ability to indicate stocks that have been stretched to extreme points where they need to rebound from. Using a momentum indicator I have developed a system that shows key short term turning points in stocks and stock indexes as well as daily trading opportunities in each. The momentum indicator that I use shows points of extreme overbought and oversold conditions. Using the trading signals often results in remarkable short-term moves that can reward you with great profits on stocks or equity options. It also signals daily stock trades that let you buy a stock before the close and sell the next morning for a quick gain. It can also be used as a highly effective day-trading system. I will show you how to use this system in all of these different settings and hopefully in the process give you a greater understanding of how to make a good living trading. I will begin by giving you a background of how this indicator was developed then how to construct it. We will then go over what the best trading signals are and how to trade them. From there I will show you chart examples of sample trades. I feel this is the best way to learn what the trading signals look like and how the system works. Now let us begin…



Trading Rules:

When beginning to use this system, as with any other trading system, it is very important to understand what exactly you are attempting to accomplish with its use. When using the standard Momentum indicator found in most trading software, a trader is attempting to follow a current trend until it ends then either jump off or ride the new trend. The Slingshot method attempts to find short-term turning points in the overall trend. Using a histogram of the normal Momentum indicator and using the momentum of the lows (LowMom) as a line over the histogram we can find instances where the histogram will spike above or below the Lowmom line. It is at these points where exhaustion in a trend takes place. The momentum is unable to push the momentum of the lows any lower or higher. It often happens at resistance points or within other more common patterns. This will start to make sense to you when you see the examples.

In order to select stocks that are triggered by this indicator you will need a software package that will allow you to program your own indicators and graph those indicators. Tradestation, AIQ, and Metastock are just a few that I know allow this. TC2000 while allowing you to program the code and scan for the signal will not let you graph the indicator. Another way to accomplish the screening without the use of a specialized software package is to use a spreadsheet program such as Microsoft Excel or Lotus 123. These spreadsheet allow you to both program the indicators and to chart them. (For more information on setting up a spreadsheet for use with the Slingshot Method, see the section titled Using Spreadsheets).

The first process is to weed out stocks that do not have a high average daily range. Filtering out stocks that do not have an average daily range of at least 2 points does this. A stock that moves any less than this is not very useful to this indicator since the idea is to be in and out of stocks in one day generally. It is important to decide how much capital you are going to have to trade with. If you are just starting off and do not have the advantage of a large capital base you will want to focus on stock that are lower in price. It is a good idea to be able to buy or sell short at least 100 shares of the stocks you are trading. It is not required nor does it have any effect on the trading system. The only thing that is effected by the size of your position is your profit or loss. Finding stocks that have a high daily range is more difficult as you go lower in price. NASDAQ stocks can fit this profile better than Dow stocks. The other alternative is to trade options on the stocks that are signaled by the indicator.

Creating the Indicator

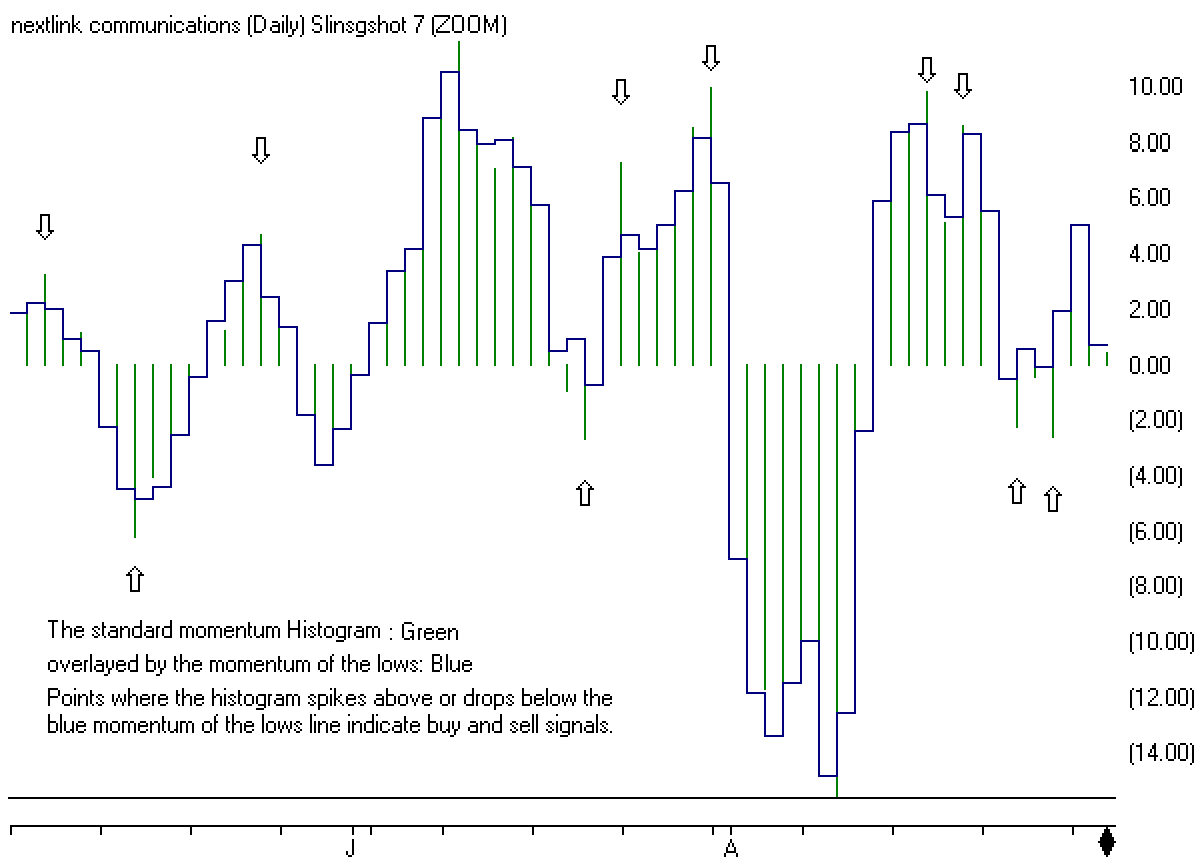
Once you have decided how much capital you intend to invest with and have found a selection of stocks that you want to trade, you need to program the indicator into your software and test the stocks to make sure they are effective with the indicator. Some stocks do not give good signals. If a stock is in a trading range it should be a large range with visible ups and downs. Otherwise the indicator will not likely be signaled. The indicator, while it could be calculated by hand, is best used when programmed into your trading software. The formula for calculating the indicator is as follows:

-Momentum = close today – close *n* days ago. For my system I use the 13-day, 7-day, 5-day, and 3 day momentum.

Next calculate the momentum of the lows for the corresponding days:

-Momlow = low today – low *n* days ago. Calculate for 7 day, 5 day, and 3 day.

After you have calculated these indicators you want to be able to see them. You insert these indicators as a standard feature of your charts. Most programs will allow you to do this. I currently use AIQ Trading Expert Pro software and all of the charts in this book were created using AIQ Trading Expert Pro Charts. I like AIQ for its value and ease of use, as well as its advanced functions. The way to view the indicator is by making the Momentum indicators into histograms for each period and fixing the LowMom indicator on top of it as a line (See chart). The combined indicators should be used with a support line of "0." You need to create a separate indicator for each time period. I label mine as Slingshot3, Slingshot5, and Slingshot7. You can label them however you wish.



As you can see from your first look at the indicator, it gives clearly visible buy and sell signals. Buys occur when the histogram drops below the signal line. Sells occur when the histogram spikes above the signal line. Upon looking at this indicator chart for Nextlink Communications you can see that we had quite a few trading signals over the three-month period covered. In fact there were over 10 for just this one security with an impressive profit record. The most reliable and timely signals occur at points high above and below the support line. You will have the opportunity to view the indicator with a price chart soon. First let us discuss how to enter a trade.

Review:

- Decide upon how much capital you are going to trade with.
- Program the Slingshot Indicators into your software program or spreadsheet.
- Filter all stocks that do not have a daily range of at least $2.
- Run a scan on your stocks to identify trading signals.
- When the histogram spikes above or drops below the LowMom line it triggers trading signals.

Entry Points:

For long positions, trades are entered only after the Slingshot indicator drops below the LowMom indicator. There are several options for entering a trade and it will depend on your risk tolerance to decide which is best for you.

Short position trades are entered only after the Slingshot indicator spikes above the LowMom signal line. When I make reference to a stock's moving average I am referring to its significant moving average. This may be the 13-day, 21-day, 9-day or whichever it tends to follow and use as support. I usually use the 9-day and 13-day exponential moving averages for short-term support and the 10-week and 13-week for weekly charts.

The riskiest and often most accurate trade to enter is to run a test for the indicator before the close and entering the trade prior to the close. This is very risky for obvious reasons. The market could turn worse over night, there could be news that effects the stock causing it to gap down further, or any number of unfavorable things could happen. This does not happen most of the time. The idea is that you are entering the trade after a major down run and most of the selling pressure has run its course. You are entering this trade to capitalize on the profit taking of short sellers. The thing to remember is that you want to enter this trade at extreme points. Use your trading software to create trading bands that enclose 90% of the stock price action. AIQ software does this for you with its AIQ Upper/Lower Bands. Bollinger Bands and Envelope Channels also work well. You want to look for entry points when the stock is trading at or below these support levels. When stock prices fall outside of these levels it indicates oversold levels. The stock will often come back into the trading bands soon after falling below. The slingshot indicator often signals the exact turning point and a safe entry point for long positions. Stocks that are trading near a significant moving average such as the 9 or 13 day moving averages also will often show great entry points. When entering a trade before the close your goal is to get an early bounce the next day from profit takers in short positions and from position traders increasing their position size at lower prices. If you are a short-term trader this style is highly consistent for 1-3 points. This is the riskiest method and is not suitable for all people. Using risk capital to purchase options on the underlying stocks can reduce the risk factor some. The examples will show you just how accurate this system is.

Short positions using this overnight method should be entered when stocks close above their upper trading bands and signal a Slingshot sell signal. These trades are quick and you need to be alert to make sure you get out before the continuation of the trend. It is often a good idea to wait until the second or third day of a stock closing outside the upper band. What you are looking for is a sign of weakness or profit taking. Many times a stock will close above the upper band then gap up the next day only to close lower for the day. This would be the best time to enter this trade. Most of the time a strongly trending stock will come back to its moving average after rising above the upper band. The other time to enter a short position is when a down trending stock rises up to its moving average and Slingshot sell signal is given.

For day traders, long positions should be taken on upward trending stocks following a sell signal in the Slingshot indicator. This method is less risky due to the fact that you are not holding positions over night. You will be looking to get in on the continuation of the trend after profit taking early in the day. The trend may not continue until later in the day or during the following day. It is important to wait for buyers to come back in. If the overall market or sector is strong these trades will often continue rather quickly and can result in great gains. Long positions should be avoided when the stock is above its upper trading band. These stocks are often over bought and will pull back to their moving averages before continuing the trend. You will be disappointed by the missed gains when a few stocks will rocket even further out of their trading bands but it is impossible to guess which of these will keep rising. You will find that most will retreat once out of the trading bands. For the ones that got away keep in mind you will still have an opportunity to trade them on the short side when they do finally fall.

Trades can also be entered late in the day based on a buy signal on the Slingshot indicator. You will want to look for stocks that are down heavy on the day and are subject to profit taking before the close. This method is more difficult and should be used in conjunction with intra-day charts and trend following indicators on those charts. Stocks that work best with this method often bottom out on the day after 2:30 then profit taking and long positions are entered around 3:15.

Short trades are entered in the exact opposite manner. You want to enter short positions after a buy signal occurs and the expected profit taking takes place. You are selling into the relief rally with the idea that the stock will go lower. When the stock is outside of its lower band the probability of this trade being profitable goes down. The best intra-day shorting trades are when a recently upward trending stock has a major drop that puts it below its moving averages but above of the lower trading band. If there is a Slingshot buy signal, there will usually be a quick bounce the next morning while profit takers, dead cat bounce players and bargain hunters jump in. Use intra-day charts to look for weakness and time your entry. Once the downtrend resumes it usually will do so for the remainder of the session.

As a final note on this method, both the long and short methods of day trading with this indicator are designed for very short-term day trading. Day trading is a risky business and requires substantial capital and discipline. I recommend using tight stops to protect your capital. Attempts have been made to program the indicator into our system and use it as a day trading indicator with varied results. Based upon the same entry and exit rules the strategy proves ineffective. It does not call the exact turning points as it often does with daily data. However, used as a general intra-day timing tool it can be useful. It gives several signals in trending stocks before the change in trend will take place so it requires close attention and confirmation from another indicator.

For the longer term trader the Slingshot method works well on weekly charts. When signaled near support the indicator is highly accurate at delivering good buy signals for one to five weeks. The best buy signals are given when the nine-week or thirteen-week moving averages are trending upward and the stock price is near these levels. Buy signals are also signaled in the same manner as the short-term trading strategies. If the stock closes below its lower trading band and signals a Slingshot buy signal, the trade is usually good for a gain the next week. The one important thing to keep in mind and a good habit to get into is that when the weekly trend is down you should only cautiously enter long positions. Even when there is a buy signal on the weekly slingshot indicator, the overall weekly trend will likely continue. Profitable trades can still be made but they need to be watched closely and you may be subject to further downside before the stock will turn in your direction. The best way to avoid this is to use a daily confirmation signal to enter a trade after a weekly Slingshot signal.

Short trades using the weekly charts should be taken when stocks rise above the upper trading band or have risen sharply above the moving average. These stocks will often come back to their moving averages. I prefer to wait until the stock is well above the upper trading band to trade stocks on the short side based on weekly data. I feel they offer less risk and higher rewards.

Another method for the longer-term trader is to enter a trade using the signals triggered on the daily charts and stay in the trade until a reverse signal is given. Profitable trades occur this way and for the trader that wishes to hold positions for 2 to 7 days this is a remarkable system. The risks associated with this method are that the signal could be wrong on either its timing or accuracy and the stock could reverse direction before giving an exit signal.

If you use the Slingshot signal as a mechanical system entering when it gives a buy or sell short signal and exiting when it gives an opposite signal, you run the risk of the signal being wrong or reversing quickly. The safeguards for these risks are to limit your trades to signals that are given when the stock is at extreme levels when the histogram is far above or below the support line. Limiting your trading to a few companies will allow you to learn the trading pattern of each stock and increase your ability to time your trades using the Slingshot signals. A good way to do this is to run a scan for Slingshot signals, go through the list and try to observe stocks that give good entry and exit signals. Studying charts is the only way to learn how a particular stock trades over time. Compare them to the major market averages and related industry averages. Are they leaders of the group? How is the volume? Is it near a high or low? What is the weekly trend? These are the types of things to look for. Notice all of these things in order to learn how they trade. This method works well in flat, downward and upward trending markets

Another tool that lends itself well to the Slingshot method is the Williams%R or Stochastics. These indicators help identify where a stock may be oversold or overbought. Sell signals given in overbought areas are higher probability trades. As are buy signals given in oversold areas. The thing to remember is that William%R and Stochastics can remain in oversold and overbought territory for a long time. After programming the indicators into your system you will see that the Slingshot method will give different signals depending upon which day settings you use when you program your indicators. Slingshot/3 will give more signals than Slingshot/13. The shorter the period the more signals you will get. This is not always good. I usually use both Slingshot/5 and Slingshot/7 on the same chart. A buy signal given with Slingshot/7 far below the support line may not be a signal for a Slingshot/5. Different stocks give different signals for each day. GE trades well using the five-day settings where Mindspring trades better using the seven-day settings. You will be able to see right away which setting works best by looking at the chart and counting the number of correct and false signals given by each setting.

Review:

- Long positions are entered when the momentum histogram drops below the LowMom signal line.
- Short Positions are entered when the histogram rises above the signal line.
- Trades can be entered three different ways;
    1. At closing the day of the Slingshot signal.
    2. Intra-day the day following a slingshot signal.
    3. At the end of or beginning of the week following a Slingshot signal on a weekly chart.
- All three trading methods are designed to find high probability trades for short-term traders.

Reversing Your Trade

As I a mentioned earlier a costly mistake that a trader can make is to only trade a stock in one direction. Doing this will cause you to miss out on half of the trades. I am not implying that half the time a stock is going up and the other half it is going down. What I mean, and you will find it true if you study the charts, is that there are always opportunities to trade in either direction. If you follow only a few stocks you will have the opportunity to trade them in both directions all while the stock is going through its longer-term trend.

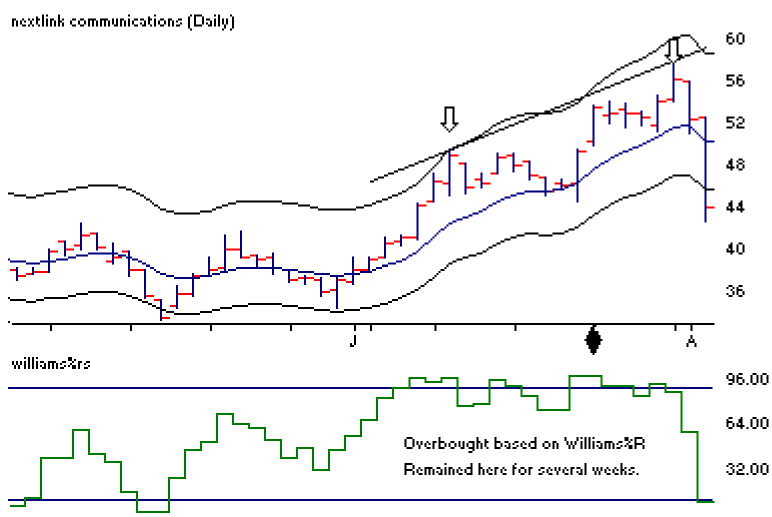
A stock will rise strongly for a while then pause or return to support or it will fall for a while then pause or return to resistance. This is the standard pattern of trends. Money can be made at these points. These points where the stock will pause are the points where the Slingshot signal will most often occur. After entering a trade you should start to watch for where the stock will find support. The 10-day or 20-day moving averages for example. In an upward trending stock you will want to reverse your trade or take profits when the stock falls to its support levels. In a downward trending stock you will want to look for a Slingshot signal to reverse your trade or take profits near the stocks resistance levels. In flat markets Slingshot signals might be more common and you can switch positions and direction every 1 to 5 days. The point of this section is to remind you that you can always switch direction with the stock you are trading. You don't have to wait until the next signal in the current direction. The way to prepare for this is to plan ahead. Always make your entry, exit, stop-loss, and reversing trade forecast before you actually make you trade. Sometimes the market is too fast to wing it and frankly that is an irresponsible way to run your business. If you were a storeowner and sold shoes for instance, you would not go out and buy 100 pair of shoes to sell without having a projection for how long you will have to hold onto the inventory. You would also likely know how much it would earn you if you sold them all, half, or none. You would also have a projected date for when you will have to restock the shoes if all goes well. On top of that you would likely have a plan of what you will do if nothing works as planned. This is also how you should plan your trades in the stock or options market. There is no set formula for determining these factors.

Each of us will have a different risk tolerance. A stop-loss method of protecting your trading capital using the Slingshot Trading Method is tricky because many trades go against you before they go your way. One way to protect yourself if you are uncomfortable with a trade turning into a loss before it moves in your favor is to not use the system to hold overnight positions. Set entry points for the next day based on the prior day's signal. Subscribers to our daily stock and option picking service receive daily picks that are designed to be entered during the day following a Slingshot signal. The holding periods for these trades are usually 1 to 3 days.

The idea behind this method is to reduce risk by not initially holding positions overnight and using the market direction to confirm the entry of trades the day after a signal is triggered. You can do this on your own by planning your trades and using limit orders to enter your positions at your selected entry point. It is often possible to get in the trade at a better price this way and you can sleep easy at night.

Finding the Best Trades

The most reliable and profitable trades using the Slingshot Trading Method are trades that are confirmed by other indicators. The examples help to make this clear. Oversold and over bought indicators like Williams%R or Stochastic are good gauges of the validity of a trade. If your trading program does not include the Williams%R indicator, it is very close in behavior to the 14-day Stochastic, which is more common in charting software. Williams%R is the best indicator for use with the Slingshot methods I have taught in this book. When a Slingshot signal is given to go short it is a safer bet if the Williams%R has entered overbought territory. If there is a signal given and Williams%R has not reached the overbought area there is a good chance the stock will climb until it does before pausing. Williams%R usually will go from oversold to overbought without switching directions. When it does it is a negative sign for the current trend. As a Slingshot trader looking to capitalize on the profit taking of momentum players you should watch for when Williams%R changes directions or enters overbought or oversold areas. Keep in



mind that these indicators can remain in these oversold or overbought areas for some time. (See chart)

Other indicators work well as confirmation for Slingshot Method as well. For those of you who intend to use this system for the very short-term methods I have described, the signals themselves and the Williams%R indicator are suffice and the best way to trade in this fast paced manner. For those of you who intend to use the Slingshot indicator in order to time longer term trades, or to time the overall market, indicators like the MACD Oscillator and exponential moving averages are good tools to confirm trades.

Divergences

When a stock advances or falls to new levels, whether they are highs or lows, it needs confirmation of those highs or lows to validate the moves. Technicians use indicators to validate the action of stocks or stock indexes. An example of this is the way stock market analysts and the financial media often report on the Advance/Decline Line when they report on the major market indexes. Recently the Advance/Decline Line has been falling while the overall market is making new highs. This is a divergence. This pattern can occur with most indicators that follow a stock or index. MACD, Stochastics, and even the Slingshot indicator are examples of some.

When a divergence occurs between a stock or index and the Slingshot indicator it signifies a potential lack of follow through in the current trend. When a Slingshot signal is triggered while a divergence has been formed, it is a strong trading signal. These set-ups are some of the most reliable and profitable trades. They usually are turning points that last for several days to weeks. They are the best trades for those of you who wish to be in a position for periods over the usual 1 to 3 days. This makes them some of the best trades for options traders. The reason is that the odds are stacked against the trend continuing much further and because of the “apparent” strength of that trend, options premiums are often priced low for the opposite direction.

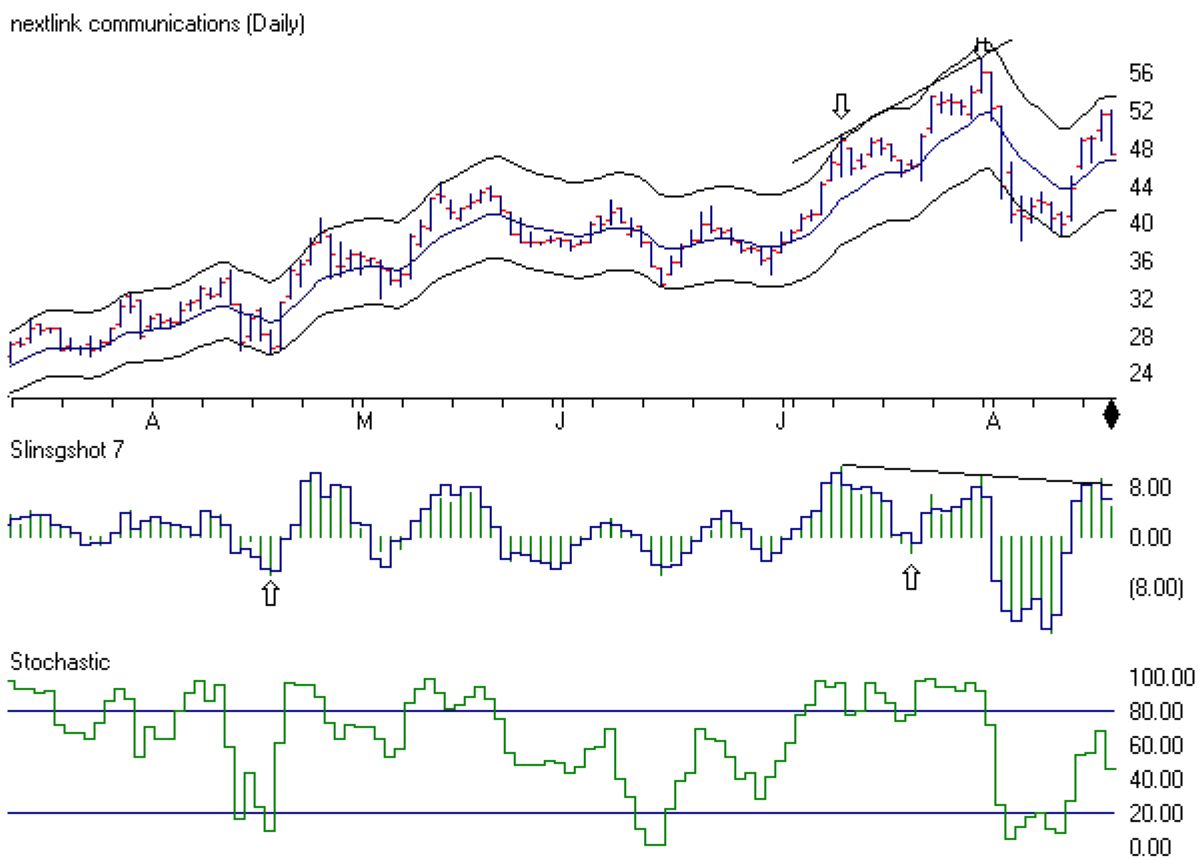
If a divergence in the Slingshot indicator is accompanied by a divergence in other indicators such as MACD, Stochastic, Williams%R, or Volume, so much the better. This is not a sure thing but in this business nothing is. It however does increase your odds and allow for some great trading opportunities.

Review:

- Trading stocks in both directions greatly improves your trading profits.
- The best trades are those that are confirmed by other indicators.
- Divergences offer the best trading opportunities for longer-term stock and option traders.

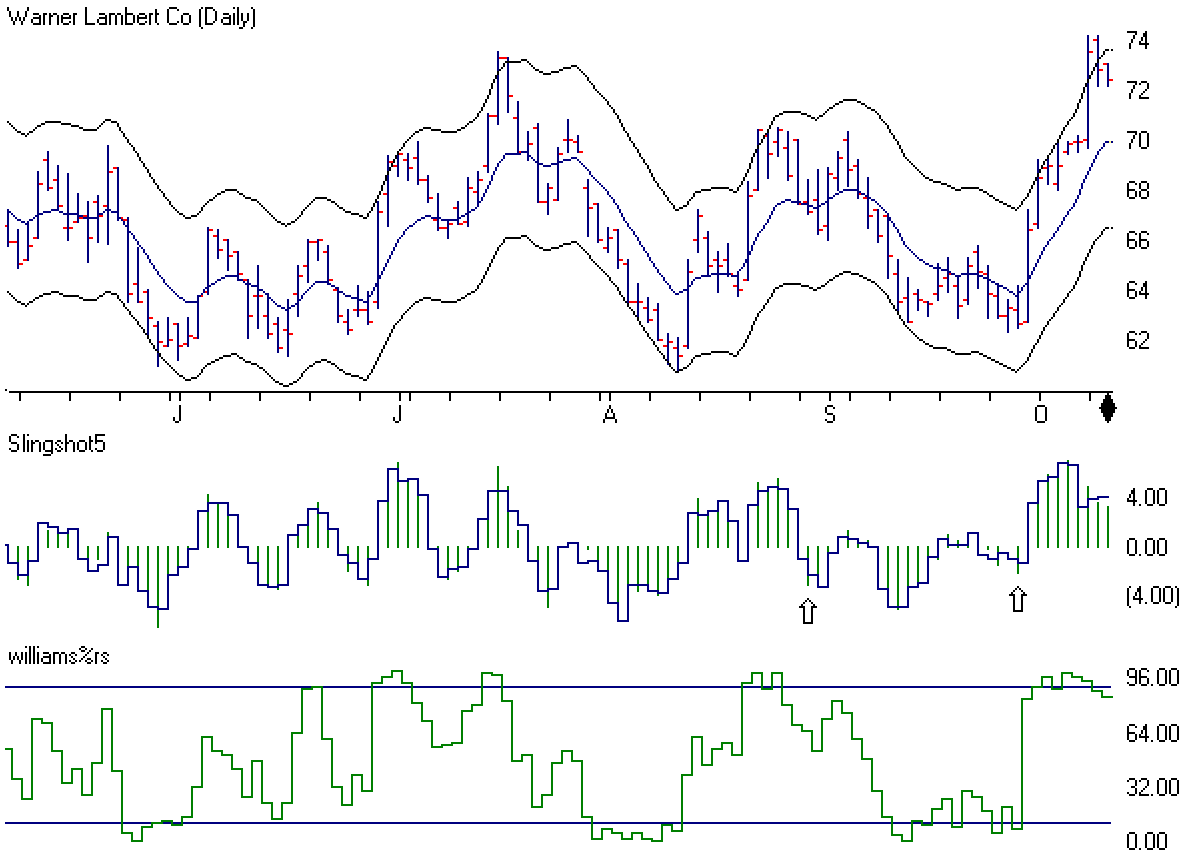
Examples

In this section you will see several examples of trades made using the Slingshot Method. Refer to this part to enhance your learning of what the indicator looks like and how to trade with it. I have made an effort to include trades from several different market environments and both winning and losing trades.



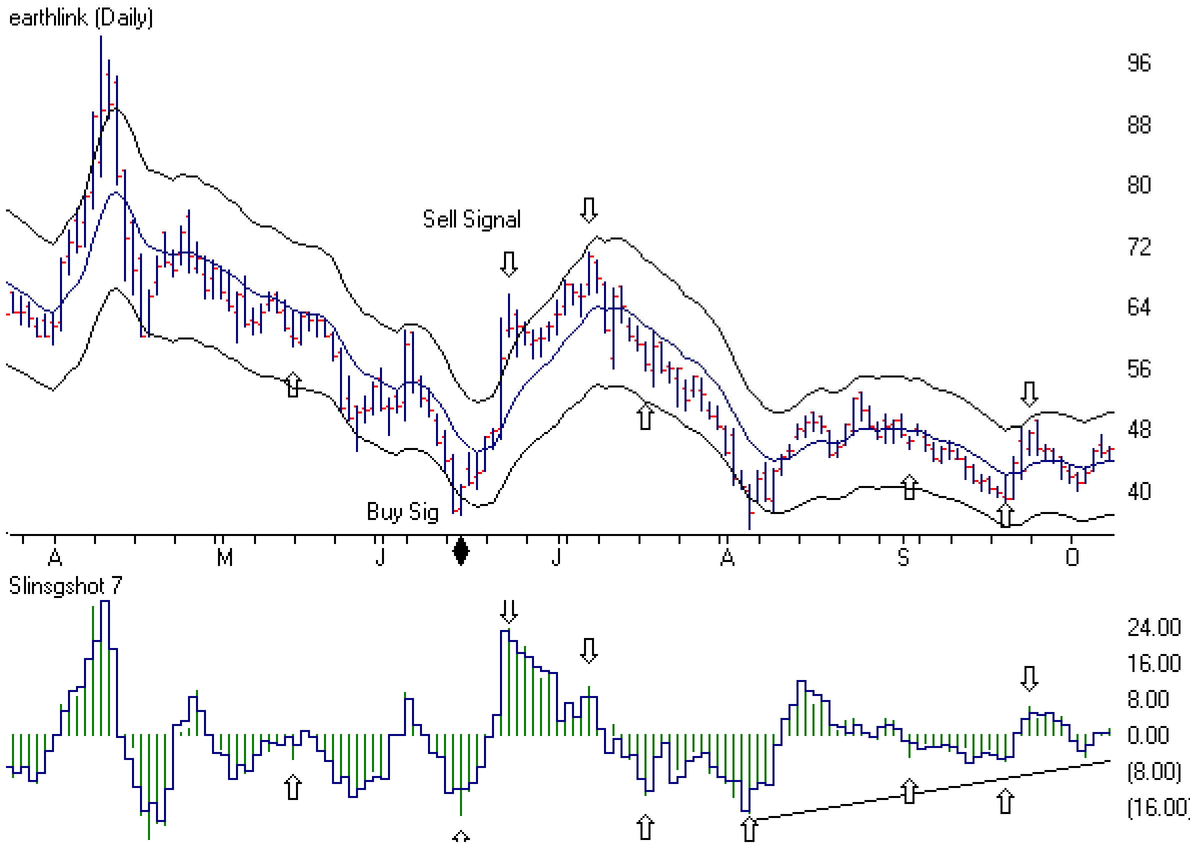
NXLK Apr – Aug

Notice the Slingshot sell signals given as NXLK approached the upper trading band in July. During this advance a divergence was formed between the Slingshot indicator and the price chart. Stochastics was also in overbought territory, which confirmed the sell signals. NXLK experienced a major drop after a Slingshot sell signal at the end of July. These are some of the high probability trades you should be watching for. Take notice of the buy signal given in mid July when stochastics was in overbought territory. This was a valid trade because the stock was at key support at the time.



In this chart notice how WLA has several clear signals from May to October. We have been focusing on this stock for much of 1999 due to the nice movement it has shown in its trading range. The Slingshot signals have been great with this stock. Using the Williams%R to help confirm trading signals we can increase the probability of a successful trade. Looking at this chart you should see that some of the best signals came while the Williams%R indicator was in overbought or oversold areas. Also note the arrows in late August and late September. These were Slingshot signals that were low probability trades due to the fact that they were located so close to the support line. The one in late August should have been avoided for sure since the Williams%R indicator was closer to overbought territory and headed downward. The Late September signal was a reasonable trade to make since the confirming Williams%R indicator was in oversold territory, it had been there for several weeks and the Slingshot momentum indicator had formed a positive divergence. On the right side of the chart the stock is showing signs of weakness ahead. The stock has moved above the upper trading band and momentum is decreasing. Much money could have been made trading this stock by buying when a buy signal was given then holding it until a reversing signal was given. This method is most effective with range bound stocks.

When trading in this manner do not throw caution into the wind. Not every trade will have a reversing signal. Do not let your profits slip away from you. In the instance that the momentum indicator starts to change directions without giving a Slingshot sell signal, you should get out and look for a new position. It is much better to be in cash and shopping than in a stock and wishing!

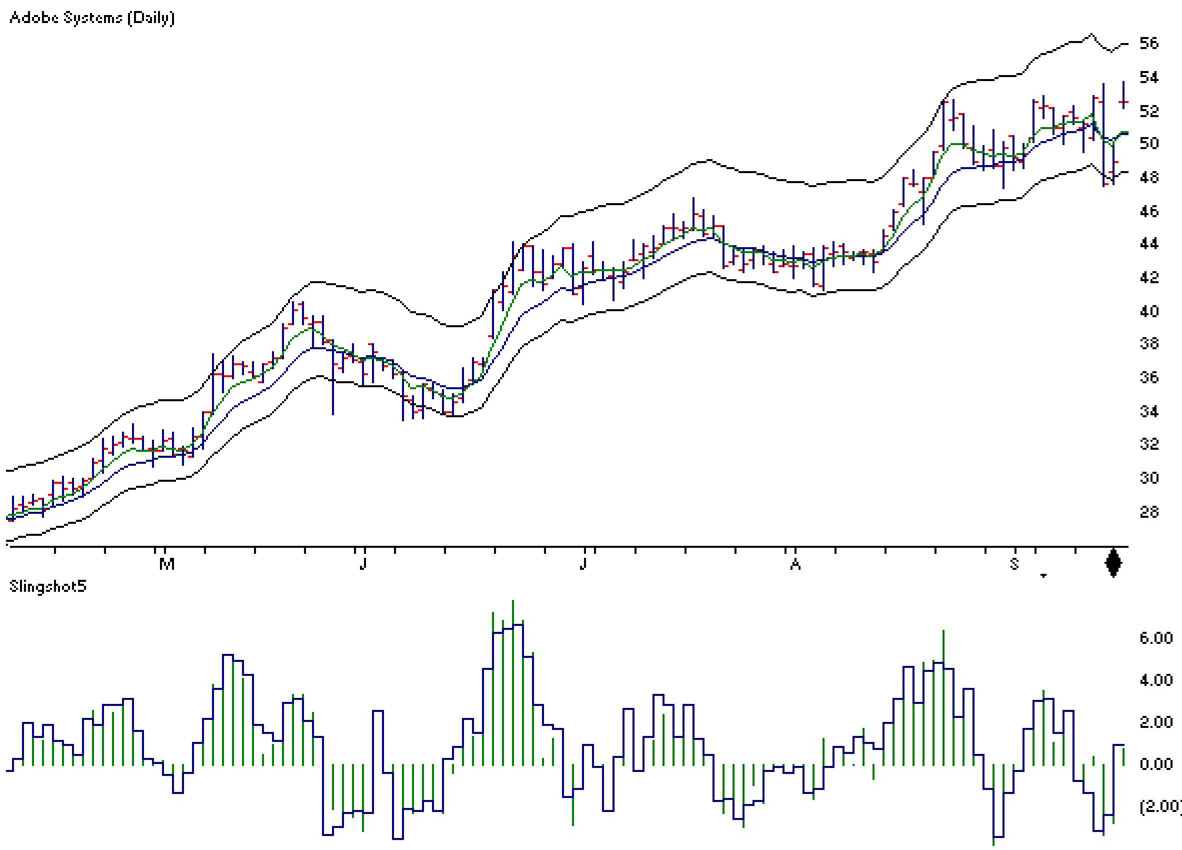


ELNK- May – Oct

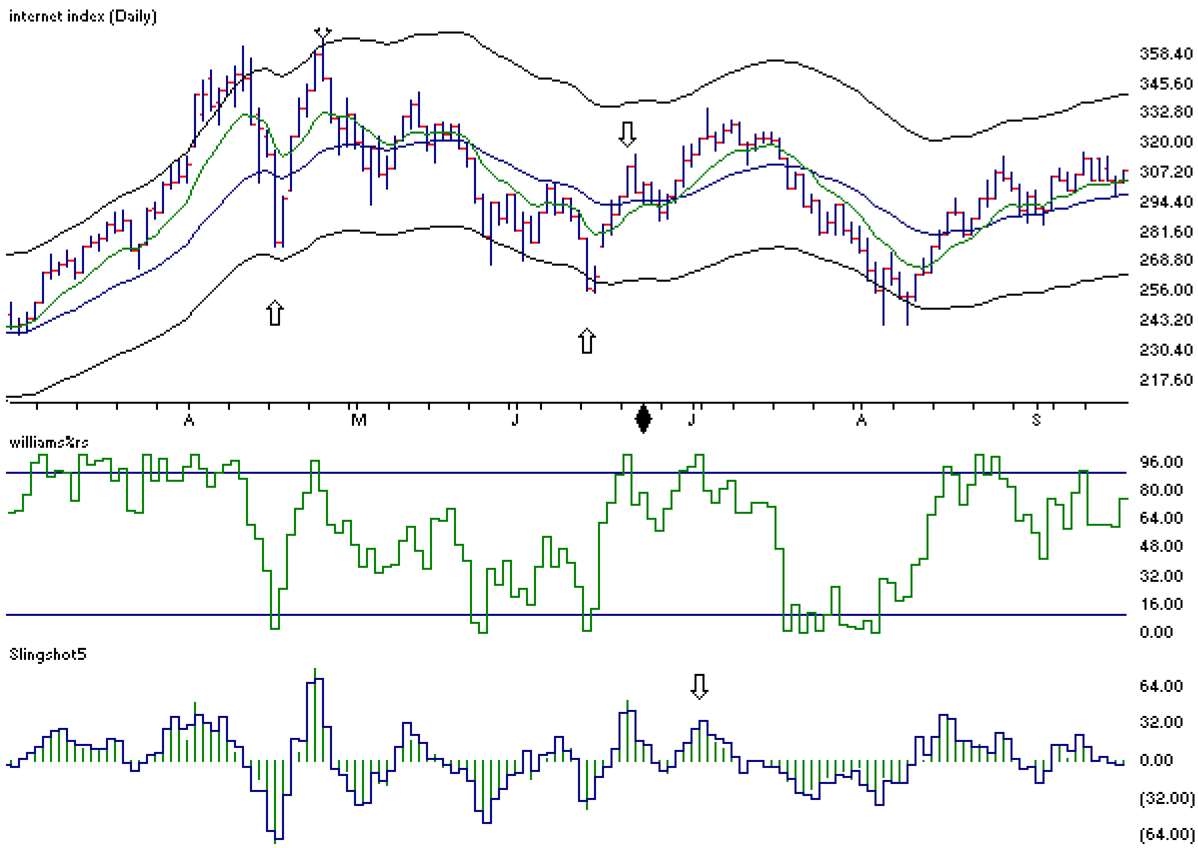
Notice how in mid June ELNK was at a low. All of the Internet stocks were performing poorly at that time. On 6/14 ELNK fell below its lower trading band. A Slingshot buy signal was given on 06/15. On 06/16 ELNK traded as high as 44 7/8. Five days after the buy signal was first given ELNK traded as high as 62 and broke above the upper trading band. It also signaled a Slingshot sell signal. Since this was the first day above the upper band and the momentum indicator had only crossed above the support line one day before we waited for confirmation. It came the next day with another signal and a tail on the stock. The stock closed the day at 61 ¼ and we went short at the close. The next day the stock traded as low as 57 ½.

One thing to notice about this chart is that the longer-term trend of the momentum indicator itself is a confirmation for the individual trades. Note the divergence between price and indicator from late June to early July. And also the upward trend on the indicator from Aug to Oct.

Also take note that the first Slingshot sell signal (6/20) given when ELNK traded above the upper band for the first time is now not visible. This is because the much higher low the next day forced the LowMom upward and it covered the signal. This is important to remember.

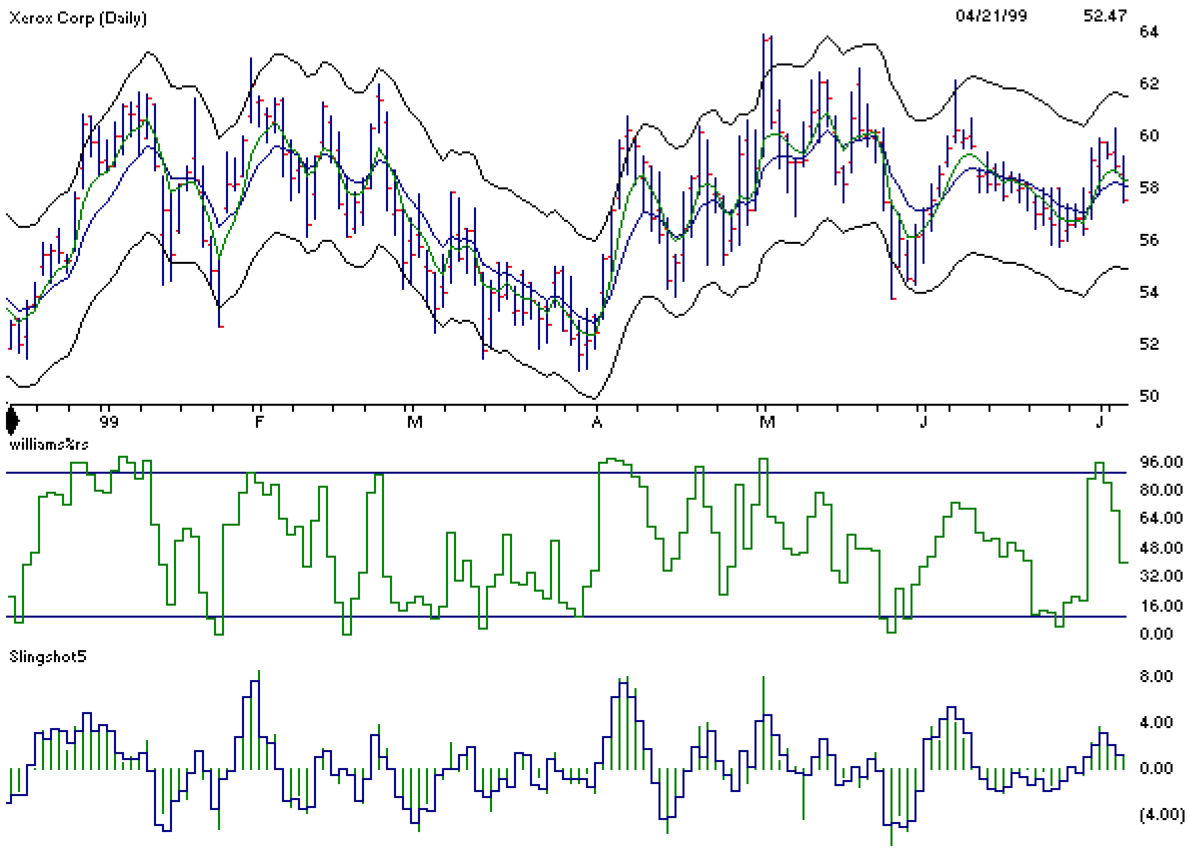


Note the strong trend in Adobe Systems stock over the six-month period. Any trader would have done well to just buy and hold this one. Hind-site is 20/20 though and there was no way to know this at the time. Also note the many Slingshot signals in both directions over the period. The first sell-signal in late June is an example of a signal that came too early. It was a profitable trade none the less but it was not advisable since it was the first day above the upper trading band and the Slingshot indicator confirmed the new high with a new high itself. Notice again how the stock will rise and rest in steady fashion using its moving averages as support.

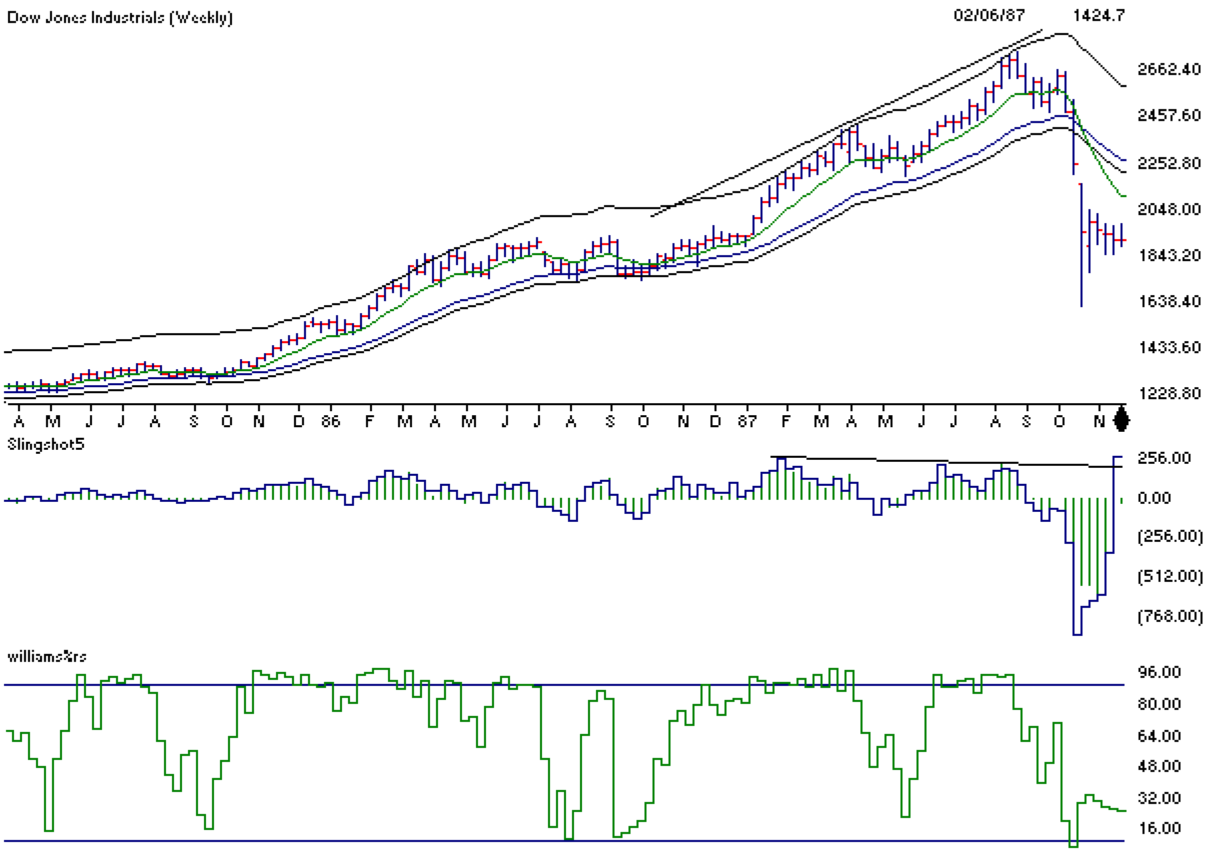


IIX- Internet Index March to September.

This is an example of how the Slingshot Method works with index's as well. Options can be traded on stock indexes and can prove to be very profitable as you can see. The IIX was beginning a downtrend in April following a rise run from the Oct '98 lows. A Slingshot buy signal was triggered after a steep drop that brought the price close to the lower trading band. The index rose 90 points in the following five days before giving us an exit signal. We took that as a sell-short signal and again the index fell. We exited the position as it approached its moving average two days later. The index continued its downward trend over the next several months with a lot of volatility. There were several signal over this period the best of which occurred near the lower or upper trading bands. On volatile indexes like this one options can be very profitable since the index moves in such large swings.

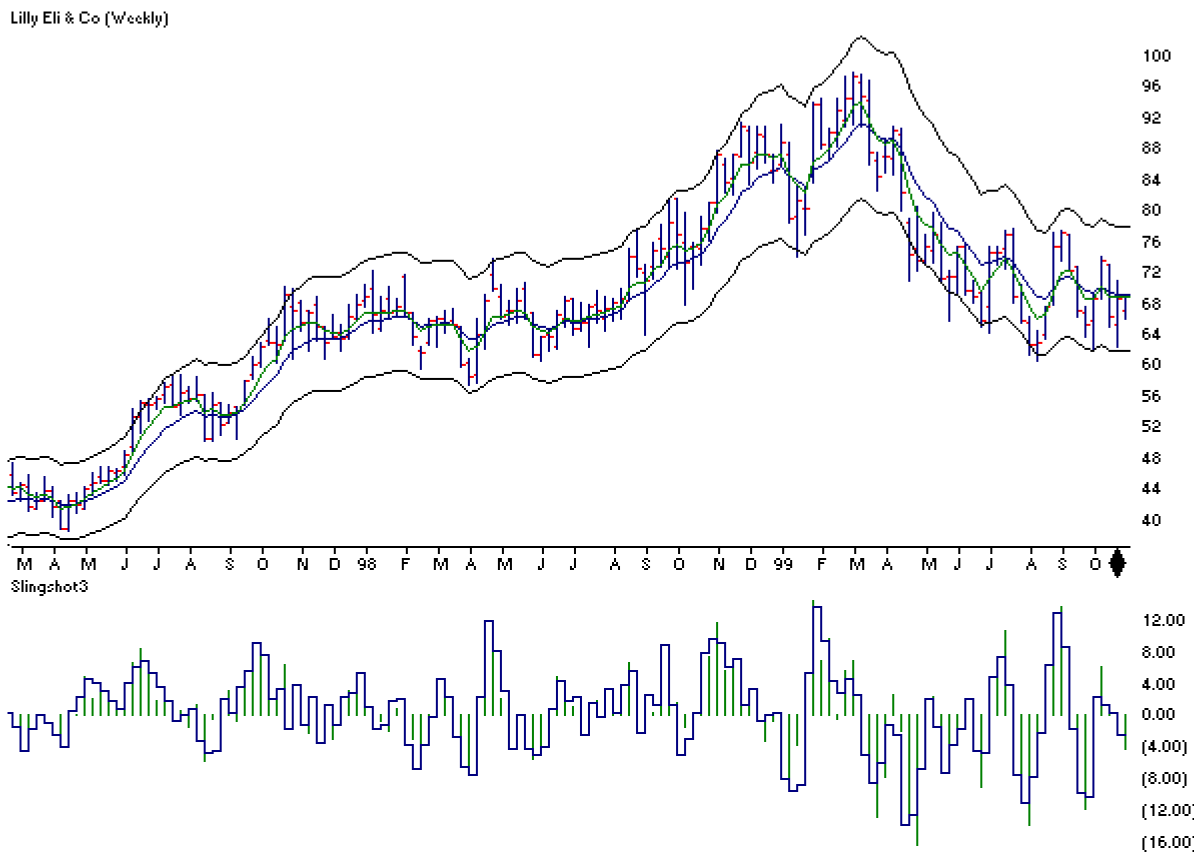


Another example of a choppy market and the many Slingshot signal that accompany it. An investor could have bought XRX at the beginning of the year near $60 and sold it in July for the same price. A Slingshot trader would have been able to make at least 13 profitable trades using only the 5-day Slingshot indicator over this period. The 3-day indicator might have allowed more since it is better suited for highly volatile stocks. Can you see the way that the trading bands act as support and resistance for this stock? A few of the best trades occurred when the stock closed outside of the bands.



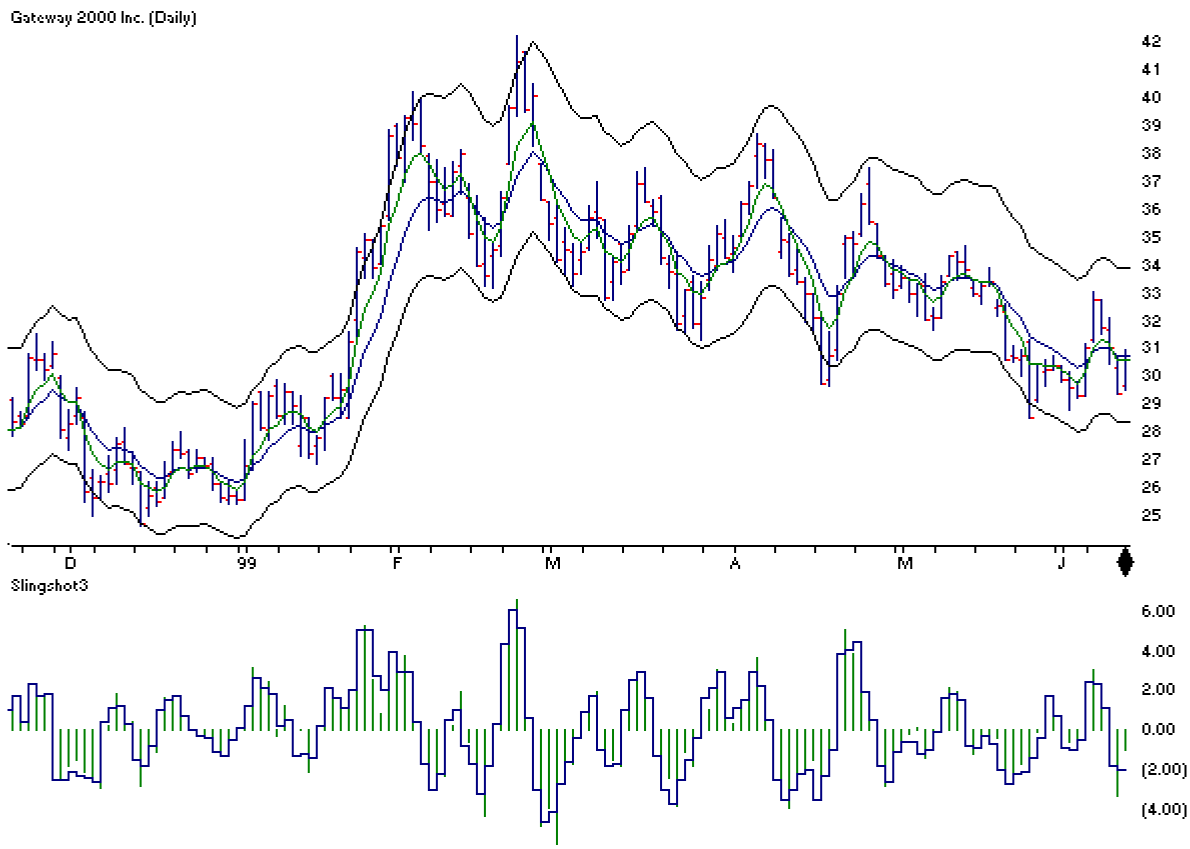
Dow Jones Industrial Average 1987.

This is a good example of how powerful a sign that a negative divergence can be. The Dow was making a new high in August while the Slingshot indicator gave a sell signal at a lower high. This is on the weekly chart. This was a sign of things to come. The Dow fell 10% over the next few weeks and the famous crash of ’87 occurred seven weeks later. The signal itself was not a very strong signal but because of the divergence it was valid.



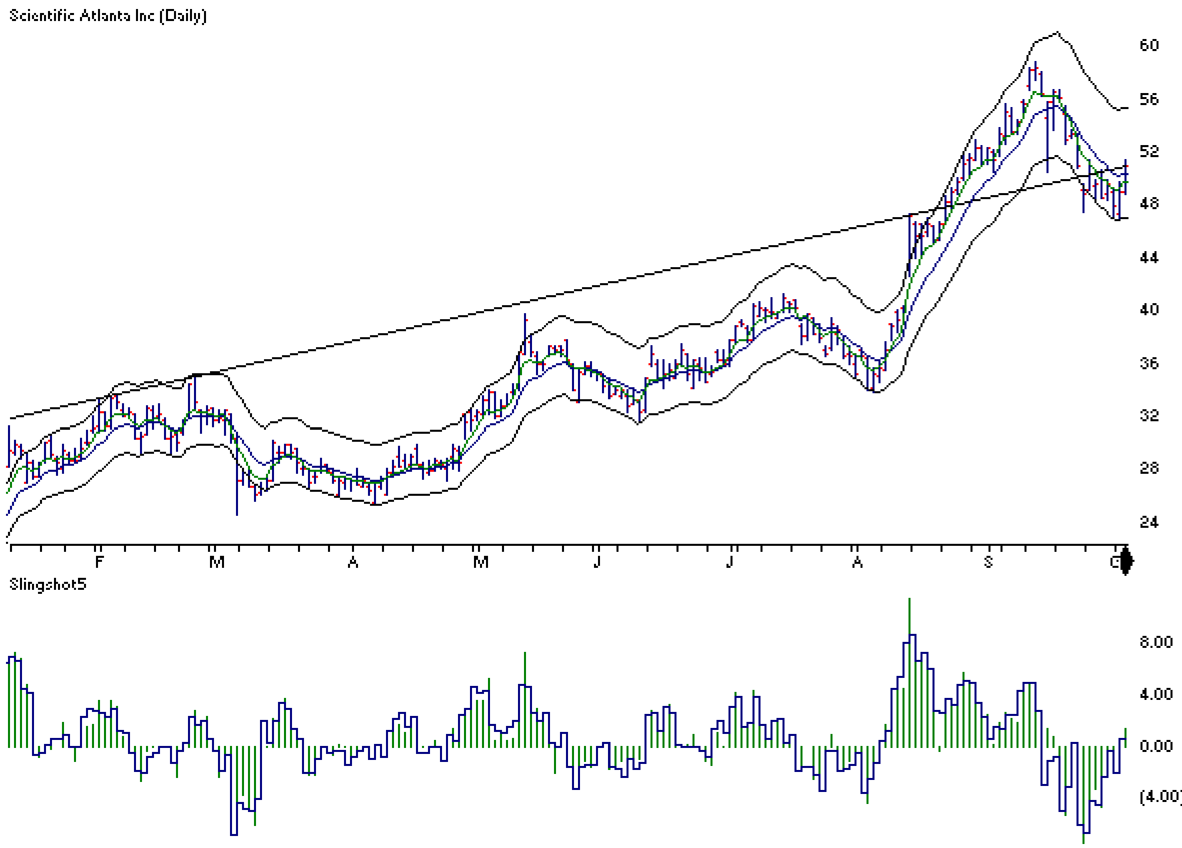
LLY Weekly 1997-1999

Using the 3-week Slingshot indicator trading Eli Lilly we were able to enter quite a few trades that were profitable. Using the indicator this way allows traders to enter a trade on a Friday and capture a short-term move the next week. Signals based on weekly data are very reliable. The shorter the period used the more signals that will occur. Notice the spikes above and below the LowMom line by the histogram. These are common for the 3-week or 3-day indicator. The further below the line the stronger the signal.



GTW

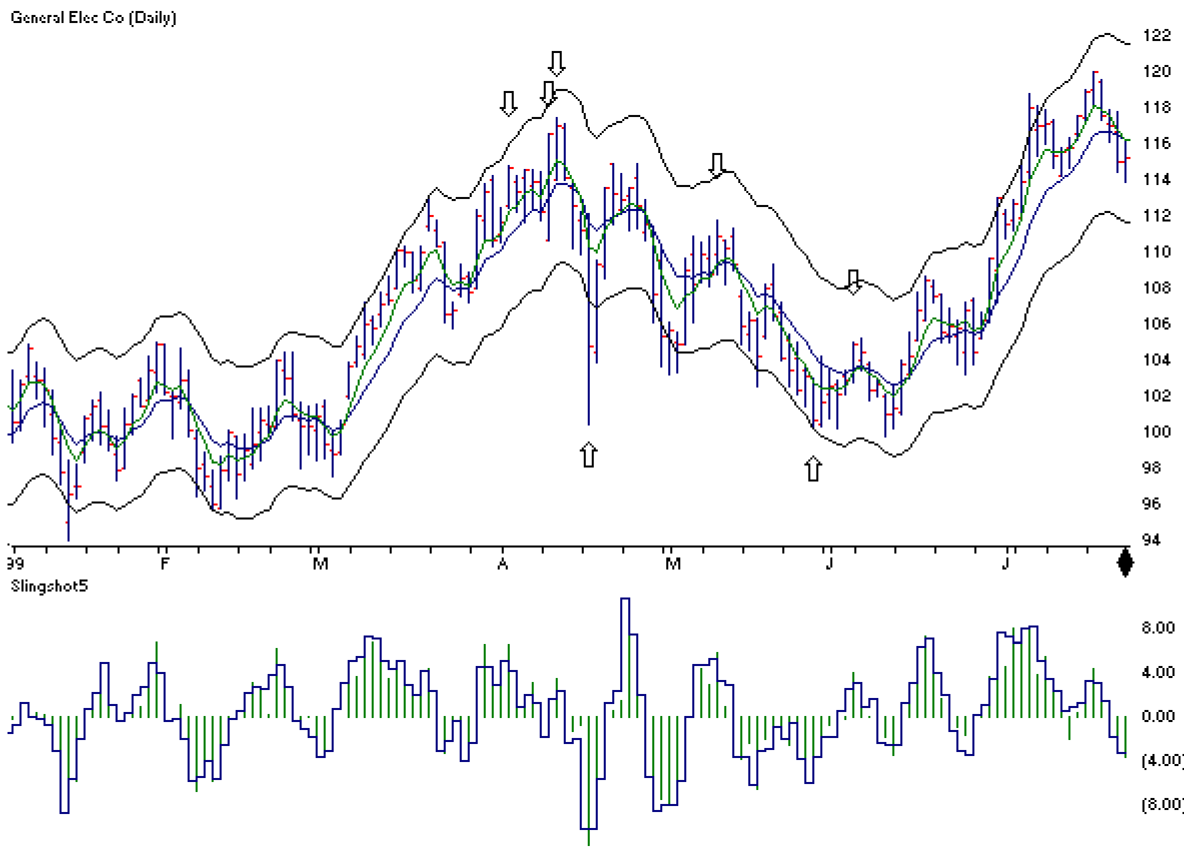
The 3-day indicator again used on GTW. The overall trend was down and the stock was making volatile moves between its upper and lower band. Again the best trades occurred when the stock was approaching these levels and the signals had substantial spikes above and below the line. There were several signals that occurred just below the zero line like the one in early May. These are signals that I usually avoid even though they are often profitable. I would rather miss out on the gains of those trades than get stuck with the losses that often occur when the stock continues lower from those levels.



SFA

Use the Slingshot method for short-term trading and stick to your plans, but be flexible. This is an example of what would happen if you don't get out quickly on a planned trade. SFA was showing strength then shot up outside of the upper trading band where it reached a long-term rising trend-line set above the price data. It triggered a Slingshot sell signal on all of the days settings. It looked like a solid trade. After studying similar patterns for SFA we concluded that it should drop over the next couple of days to its 10-day moving average and back inside the band so we sold short before the close @ 47 1/16. The stock opened the next day at 46 ½ then fell to 44 before closing at 45 11/16. A nice trade had we exited. We wanted more. The plan was to sell at the 10-day moving average. We never got that opportunity. After a couple of days the stock was off to the races. We got out with a ¼ point loss. Had we been more flexible we might have had a better week. This is a good example of when it pays to look at the fundamentals. SFA was hyped up in the news due to the excitement in their industry where they were the leader. They had strong earnings and a low P/E, which is what the institutions were looking for.

Lesson: Be careful. Be flexible. Be ready to switch directions.



GE

GE, one of the benchmarks of the overall economy, gives good signals. The stock trades best with the 5-day indicator. Here we see several signals in both directions Signals given on this stock usually run for several days. When there is a signal given on the Dow or on the S&P500, GE is a good individual stock to play in that direction.

Trading Options Using The Slingshot Method

If you are not familiar with options, you should not trade them. However, contrary to popular opinion they can be a very useful in many trading systems. With options you are essentially "betting" on the direction of stock. I will not go into a big lesson on options, if you want to trade them it is important to learn how they trade and paper trade them prior to investing actual money. I will list these key points to remember.

1. Options are risky
2. Options are a less expensive way to play a stock.
3. An option is either a "call"; the right to but not the obligation to buy a stock at a specific "strike" price before "expiration", or a "put"; the right to but not the obligation to sell a stock at a specific "strike" price before "expiration."
4. Options are sold in terms of "contracts". Each " contract" represents 100 shares of the underlying stock.
5. While they are directly related to the stock, options have no shareholder value unless they are exercised.
6. Options are traded on their own exchanges and can be bought and sold as a trading instrument.
7. Options have specific strike prices. A stock that is trading at $75 might have "strike" prices of $65, $67 ½, $70, $72 ½, $75, $77 ½, $80, $82 ½, $85, etc….There will be strike prices both for puts and calls.
8. With "calls", if the stock price is below the "strike" price it is "out of the money". If it is the same as its "strike" price it is "at the money". If it is above the 'strike" price it is "in the money." The opposite is true of "puts." The more in the money an option is the more expensive it will be.
9. Options have specific expiration dates where if they are not traded before that date they expire worthless. Expiration refers to the month in which the option will expire. All stocks

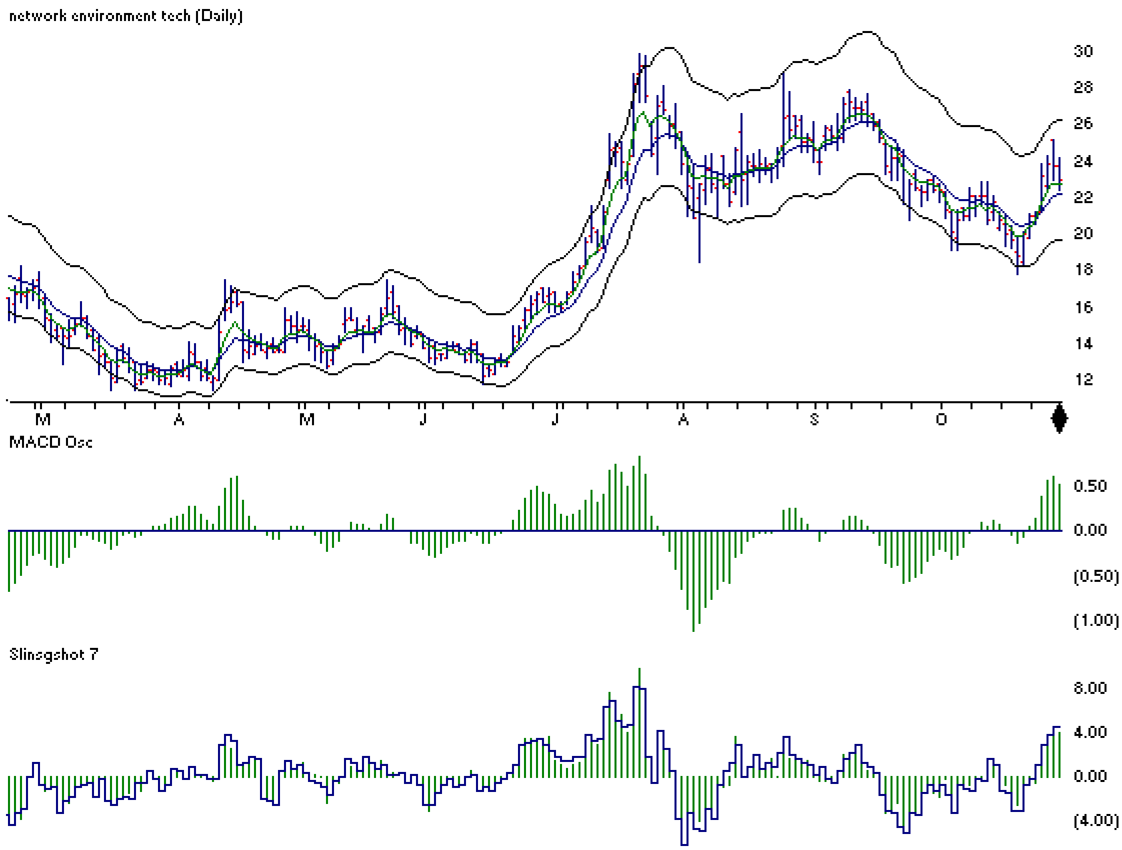
have different option cycles for their expirations. Equity options technically expire on the third Saturday of the month. Since trading ends on Friday they are effectively expire on the third Friday of the month.

10. Option prices are based on the stock price, its volatility, and the time remaining until expiration.
11. Options have a wider spread between the bid and ask prices than stocks do usually.
12. It is important to focus on the underlying stock when it comes to trading its options. If you pick the direction and the timing correctly on the stock you can profit well with its options.

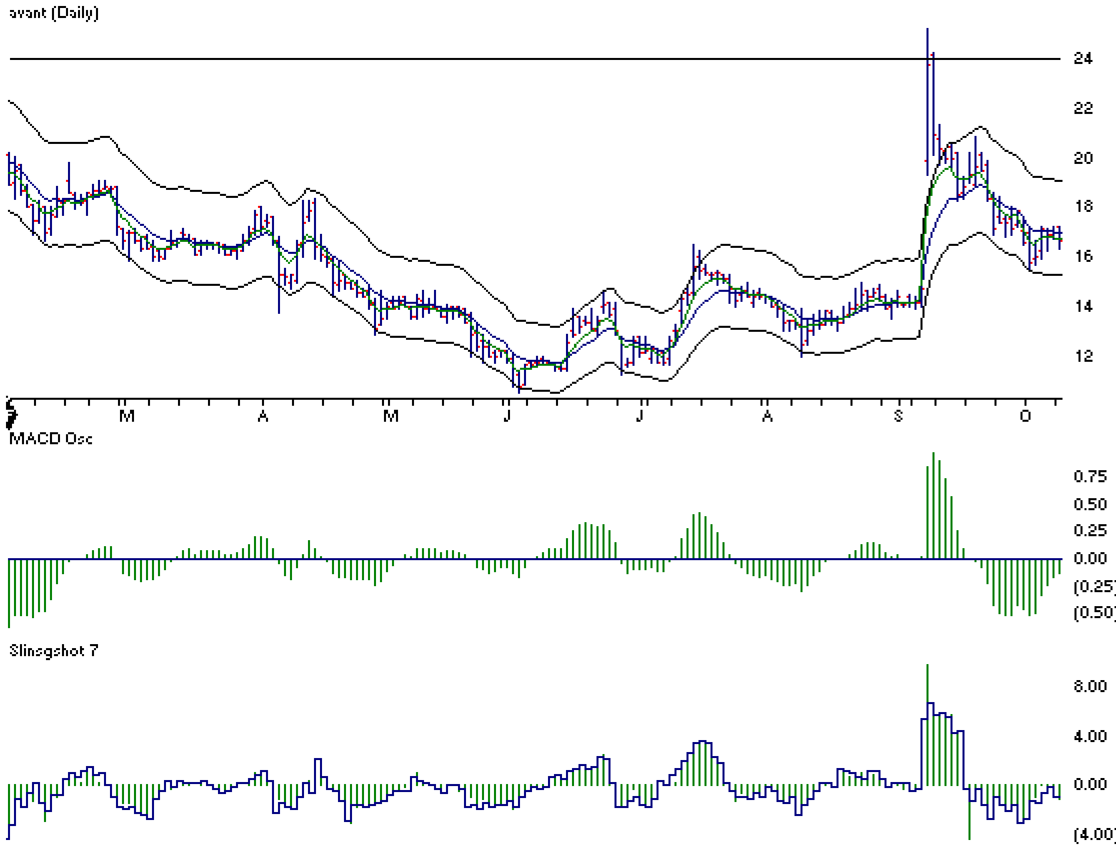
An example of an option trade: you are betting that the price of Intel is going to go up from its current price of $72 and you want to make a play on the stock without the major outlay of capital. You can buy a “call” option on Intel at a particular “strike” price, lets say $70, which will allow you to buy Intel stock at $70 before expiration. Lets say it is now July 15th and we purchase the “August 70 calls” for Intel. The stock is at $72 now. The option might cost $5 ½. If the stock goes up from $72 the option will likely go up too. After one week the stock is trading at 77 ½. The option might be trading at $10 ¾. We could sell the option now for a $5 ¼ gain or we can continue to hold on to the option until expiration. The option will experience “time decay” as it gets closer to expiration. This means that the value of the option will start to decrease each day as it gets closer to expiration. This is especially true over weekends. So, if we did not sell the option in July after the stock ran up to $77 ½ and the stock stayed at this level until the third Friday of August, it would not be valued at the $10 ¾ we could have sold it at in July. It would likely be valued at near $7 ½. This is why I believe it is best to have set entry and exit goals that you trade by. When trading with the Slingshot Method using options your goal is essentially the same as with that of stocks alone. You want to use the leverage power of options to position yourself for small moves in the stock. The entry rules for trading options are similar for those of stocks as well. When a Slingshot signal is triggered you want to plan your trade by finding the most attractive options on the highest probability stocks triggered. Since options can expire worthless as I mentioned before special care is needed in picking options. The Slingshot Method is excellent at picking safe trades for stocks, and the primary goal as I have mentioned is consistent profits. The method works well for 1 to 5 point moves in stocks in one to three days. When using options however, consideration must be given to the volatility of the stock. The more volatile the stock – the more the option will cost and the less it will move compared to the stock. A one-point move in the stock will equate to a $100 gain on every 100 shares of stock held (not counting commissions). A one-point move in the stock will not likely equate to a one-point move in the option price however. Unless the option is “in” or “at” the money on a low volatility stock, the option price will move at some percentage less than the move in the stock. The way to deal with this is to make sure that you are in the highest probability trades and by giving yourself the best opportunity by purchasing “at” or “in” the money options. Taking advantage of the lower prices of options compared to the underlying stock by purchasing several contracts will allow you to profit on smaller moves in both the stock and the option. Remember your goal is to consistently profit not to hit grand-slam plays.

The benefit of options is that they allow traders to leverage themselves by controlling the much higher priced stock with a smaller investment. If you are using risk capital for trading, which you are always doing whether you know it or not, then using options on more volatile stocks and entering trades on a Slingshot signal and exiting on an opposite signal can be very profitable. This allows positions to run for several days and often results in the grand-slam trades. Some of the riskier Internet and technology stocks can move 20-points in between signals. The Slingshot indicator often signals the exact turning points in these trades. Options allow the traders with less capital a chance to really get ahead with these moves.

More Examples

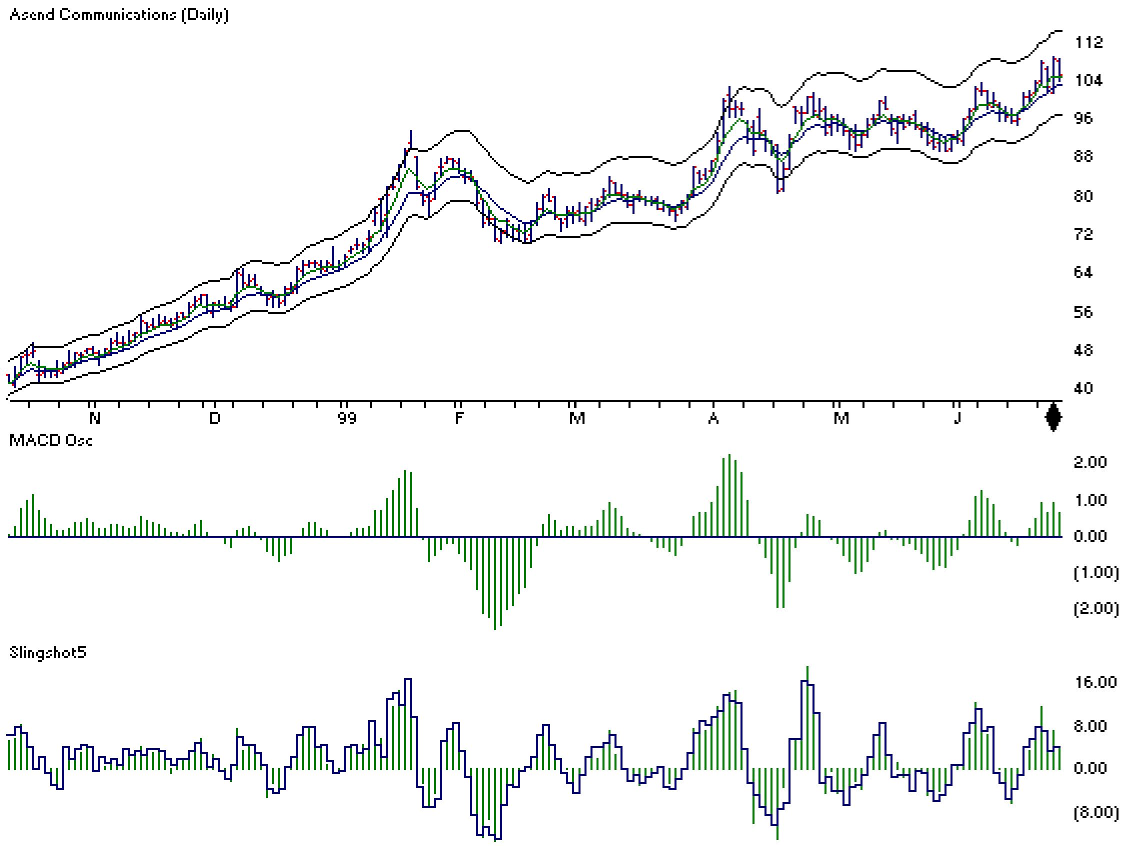


This past summer we were experimenting with trading options on lessor known lower priced stocks. Network Environment Inc, an Internet company appeared to be a good specimen. The option premiums on the stock were very low compared to the better know Internet stocks, therefore we could purchase a lot more contracts for what we would pay for another stock. By loading up on these contracts at premiums between $1 ½ - $3 for at or in the money options, we were able to profit with very small moves in the stock. Many option-picking services subscribe to this concept and we agree that it can be a very profitable way to trade as long as you are correct in your stock picking. The Slingshot indicator helps us to find high probability trades when using this method. If you are going to use this method of trading options I suggest that you stick with at or near the money options. Taking a low priced option with a far out of the money strike price is not a high percentage trade and usually will prove to be a loss. The trades we made in NETS were done in July and August when the stock approached the upper trading bands. We bought 10 contracts of Aug 25 puts on the first Slingshot signal and 7 contracts of Aug 30 puts on the second signal. Both of these trades were profitable because we had the odds in our favor and the options were either in or at the money.



AVNT

This is an example of the perfect Slingshot sell signal to use with options. This stock rocketed out of the trading band and gave a nice Slingshot signal to sell. At the time there were no put contacts over 20. The next day there were contract out at 22.5 and 25 strike prices. We took the signal and bought 10 Sept 22.5 contacts at 3 3/4. Over the next 3 days we doubled our money. With these type of signal where the stock closes far outside the band it is usually safe to let it run for a couple of days unless there is just incredible news or a stock-split. We could have gotten out of the trade the same day with $1000 profit had conditions changed. That is a good day by any standard.



ASND

Stocks like ASND are good for trading options. This chart shows the overall upward trend from Nov '98 to June '99 along with quite a few Slingshot signals. Each time the stock advanced to the upper band it had a brief fall shortly afterwards. On the occasions where the visit to the upper band was accompanied by the Slingshot signal it experienced more rapid drops. When trading options you want to study these patterns and take positions when the odds are in your favor. It will be more difficult that it looks because it is easy to look back over charts and pick out what you would have done, but you don't trade in the past. Today's chart is what matters but the only way to have an idea of what to expect is by studying the past and learning from it.

<u>Using Spreadsheets to Create the Slingshot Indicator</u>

If you do not have a specialized trading software program such as AIQ or Tradestation, you can use a spreadsheet program such as Excel or Lotus to use this system. They are easy to program as well. To create the indicator in a spreadsheet you need a column for the date, close, high, and low. You then create columns for momentum and for the momentum of the lows. Again the formulas are *today's close- the close x days ago* for momentum and *today's low – the low x days ago* for the momentum of the lows.

In the next column you will find out if a Slingshot buy signal was triggered by subtracting the momentum column from the momentum of the lows column. Next find out if there is a Slingshot sell signal by subtracting the momentum of the lows from the momentum indicator. If there is a Slingshot buy signal there will be a negative number in that column. If there is a sell signal the number will be positive in the Slingshot sell column. Another method for those of you who have an intermediate skill level in spreadsheets is to create a column using the logical function "*if*" to identify buy and sell signals. Then to use the answer from that function to signal another column with a simply "*y*" for yes and "*n*" for no. This will clean up your sheet some and eliminate excess numbers and copy these initial formulas to the whole column. You will repeat the steps above for each of the different day settings that you use. I use 3-day, 5-day, and 7-day primarily.

The next step is to input the price data. This can be done manually or by downloading the data into the spreadsheet. You need to check with your data vendor for instructions on how to do this. You could also clip the data from another source and paste it into the sheet. Whichever method you choose it will be more time consuming than using a specialized trading software package. Due to the extra time that is needed by using a spreadsheet you should most certainly focus on only a few stocks at once. You will have to have access to old price data or begin from today's date forward. America Online allows you to download historical data from their stock charting area. I do not know if you need to be a member of AOL to access this area. After you have input some price data you will want to graph the indicators. Use your software charting features to create a histogram of the momentum indicator and a line graph of the momentum of the lows. You will also need to graph the price data in order to get an accurate representation and study historical action.

Using your newly set up spreadsheet you should test the system by studying old signals and by using new signals to practice and learn how it works. There are many stock and option trading contests available to traders online now. These are excellent places to learn and implement new systems. These contest also offer nice prizes to the traders who increase their trading accounts the most in the given time. It is a good place to gauge the potential of a system before using real money. Be sure to send us an email at tradesmarthelp@yahoo.com for our latest Excel version of the indicator for free.

While it is possible to use a spreadsheet program with this system, I recommend that you get an alternative software package like AIQ. The cost is small in comparison to the increase in the overall convenience and learning you will experience. At this time AIQ offers their software for free and they have end of day delayed quotes for around $59 a month. With this you get access to AIQ's advanced features including the ability to program your own indicators and back-test them to see how they performed over time. It also comes with a good selection of pre-programmed indicators and systems already loaded.

Recommendations and Cautions for The Slingshot Method

This section is provided in order to give you our thoughts on special situations that may occur with the Slingshot Trading Method. You may not agree with our findings and in fact they are designed to further increase the safety of the system and therefore may not be applicable to gamblers or high risk taking traders. Following these tips will often keep you out of winning trades but it will also help to create more concrete trading rules to follow. This will benefit those of you who are compelled to act on emotion.

1. Do not take a Slingshot signal on the first day above or below the zero line unless it is significantly above the line and you plan to allow time for the trade to develop.

2. Do not take a Slingshot signal on a day where the stock rose above or below the upper or lower trading bands but then closed inside of the bands.
3. Do not take a buy signal or sell signal prior to earnings announcements.
4. Do not play against stock-split announcements on the day of the news.
5. Cut losses early.
6. Set entry targets and stick to them. Don't chase stocks down or up. Have alternate plans instead. If none of your plans work out reevaluate your market direction forecasting techniques.
7. Sometimes signals don't work out as fast as we like. Wait for confirmation. If a stock breaks out on great news and good volume it can trigger a signal. Wait until the signal is confirmed by weakness. Its better to be a little late than completely wrong.
8. Protect your profits. Keep a very technical attitude about your trading. Trading is a war. And in this war you are the General. Make your battle plans and be aware of your enemy's plans and goals. He wants your money. His plan is to lure in the emotional beach storming warriors then to pull out and relocate, leaving the warriors standing there on a useless sinking island. The warriors may eventually conquer the enemy in this manner but it is at a high cost. You and the other Generals will more likely win if you anticipate the enemy and lie waiting for him at the next island. Do not surrender, instead use your assets and abilities to defend and attack. If you lose all of your assets, in this war you have essentially been defeated. The sad fact is that you would have defeated yourself by not following simple rules. Keep in mind that the institutions and successful day-traders have a lot more experience than you likely do. They are counting on you to act emotionally rather than logically. Prove them wrong. Stay focused and use them to your advantage.
9. Takeover stocks that give signals on the day of the announcement should be avoided. Most of the time these stocks will rise due to a premium that will be paid by the acquiring company. There is too much buying power here to sell short. These stocks will often open higher after the announcement and stay flat for a long period while the stock is being accumulated.
10. In case I have not said this enough time already, narrow your focus to a few select stocks. Update your watch list as certain stocks become non-performers. Use *Investors Business*

Daily's Friday edition weekend review section to pick the best stocks for growth. These stock will also provide you with sell-short trades as well. These are the strongest stocks and will rise and rest in the usual fashion. Many are technology stocks and have large range days. Remember the hierarchy of the markets:

- Market- long-term growing machine that feeds upon itself.
- Sectors- Components of the market that take turns in the feedings.
- Stock- the core of the market.

Understanding this hierarchy will assist you to remain focused.

11. Do not take a Slingshot signal at face value. It is possible to be correct most of the time, but not all of the time. Taking the extra time to investigate every signal will push you closer to 100%.

Last Words

For both long and short positions you need to be aware of the earnings date and other news related to the stock you are playing. With all of the information easily available it is unwise to ignore these factors that could have an effect on the stock. If a stock has earnings coming out after the close you do not want to buy the stock just prior to the close. If a stock is near old split-levels and has a board meeting after the close, you don't want to go short on this stock today. If a stock in the same sector has news out that is significant you don't want to trade against the direction of the sector. The whole idea for this system is to give the alert active trader safe entry points into trades. It pays to know the overall market environment and to trade in the direction of the overall market. The slingshot method works well on both stocks and indexes. If there is a signal on a major index it pays to look for candidates in the direction of the signal. You could also trade options on the index itself.

My daily routine for using this system starts with checking the overall market for its direction followed by running the test on stocks and finding the best stocks for the direction I think the market will go the next day. I do this by finding the stocks that have had the momentum drop the furthest below the LowMom signal line for long positions or spiked the highest above it for short positions. I do this for the current day and the prior day. I check both days because yesterdays trades that did not act as expected often are the best trades for the today. If a stock takes a hard fall it can take a couple of days for it to correct itself. I also check the long-term trend of the stocks using the weekly charts. I then check the news related to the stock followed by the earnings date and option prices. I then set my target profit and maximum allowable loss. I then record all of this information into a trading journal. Only after checking all of these items and feeling good about all the information will I enter a trade. Your goal as a trader should be to become as knowledgeable about what you are doing as possible and trade profitably as consistent as possible. This is done by thorough preparation and having the patience to wait for the highest probability trades. Some of the best trades form over several days and require almost a stalking attitude and the patience to move in when the stock moves your way. This is why I believe it is best to learn a few stocks in different industries with different cycles and trade them as much as possible. You will miss out on some of the highest flyers and fastest falling stocks, but you will become more consistent and profitable in the long term. I wish you luck in your trading.

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