Introduction to the Leaf_West Trend Trading System

Back in May of this year, a trading friend of mine (Francisco) that I met a couple of years ago, emailed me to describe his frustration over his inability to get more consistent with his intra-day trading (he is a part-time trader as he still has a full-time gig in the technology business). He was experienced enough and disciplined enough to avoid blowing up his account, but he really was stuck in a rut of making a little money one day and then losing a little money the next day. The end result was that he was not consistent enough to make trading his sole source of earning a living, which I suspect is his long-term goal.

Francisco asked me if I had written strict rules that allowed me to make intra-day trading less discretionary and more rules-based. The short answer was "no" … I did not have a set of written rules for intra-day trading. I did, however, have mental rules of how my various chart indicators helped me when I was looking for trades and the entries/exits from those trades.

These "mental-rules" had worked well enough to allow me in making a reasonably good living as a full-time retail trader of my own account since 2001. Don't get me wrong, my trading career has been a process and my charting software and price indicators have come a long way since 2001, and so how I trade today is nothing like it was even 3-5 years ago.

So in trying to help my friend Francisco, I started drafting some PDFs illustrating how my chart indicators looked when the market was starting expansion phases over the past several months. It was a couple of weeks into this drafting process when a trader named Brett approached me about my chart indicators - he was wondering how he might be able to use them to help him become a more consistent trader – Brett is a full-time chiropractor and part-time avid positional/swing trader that has been on a multi-year journey to become a better/more consistent investor.

After corresponding with Brett, I began to think more about what I was trying to do for Francisco and how it would also apply to Brett. Even though these two had different time horizons over which they made their investments, as well as probably two totally different knowledge levels, I was actually convinced that what I was trying to write for Francisco would also apply to Brett (and by default other interested traders).

After thinking about it for a little while, I concluded that the way to give these two traders the structure that they were looking for was to go through in detail of how I use my chart indicators for trading – that would entail drilling down on each these indicators and teaching how to use each of them individually. And then finally, I would need to teach how all of the indicators could be used together with a set of written rules so that Francisco and Brett could have a similar trading edge to the one that I think I already have with my " trading system".

So here I go … with this Introduction PDF, I hope to briefly describe my indicators and how I use them. In the following months, I am hoping to flush out with written PDFs and videos, the in's and out's of my trading system ("the Leaf_West Trend Trading System").

In the end, I am confident that Francisco and Brett are going to be better traders – they are going to have the tools and knowledge that will then allow them to be more confident and with time and effort, more profitable and consistent traders.

Since you are interested enough to be reading this PDF, I invite you to join us on this journey … all that I ask is that you work hard and apply yourself. Everything I have achieved in life has come from hard work and the trust in my abilities. Let's get started!!

Price Waves & Structure

One of the big improvements in the consistency of my trading results came several years ago when I started a mentor-student relationship with a successful trader named Sean. He had not been trading longer than me, but I would come to learn that he was truly well skilled when it came to understanding how price moved in waves and the repetitive mathematic structure of those waves. I took to this way of looking at price very easily and over the past 6+ years, price has proven to me that it does indeed move in waves.

So obviously I would have to say that all traders should learn to look at price the same way and that their trading style/methodology should incorporate this knowledge – I'm not naïve enough to think this could ever happen. Francisco I think is headed down this path, but with Brett, I have no idea if he would ever pick up the concepts easily or readily. In the end, I don't think a deep understanding of price structure is necessary – I actually told Francisco that I was going to detail my "written-rules" without going into price structure because I didn't want less experienced traders to get bogged down and frustrated with price structure thoughts.

I told Francisco that I was going to just stick to my chart indicators when drafting the written rules … traders can "see" my chart indicators and how that relates to a new trade that is developing and therefore they won't have to be thinking too far ahead and concerning themselves of price structure.

I joked to Francisco that who knows, ignoring price structure and just focusing on what price is doing relative to my chart indicators may actually make traders more consistent and profitable. The old saying of "too much knowledge is sometimes a bad thing" does

often ring true, and I might end up proving that again here with the Leaf_West Trend Trading System.

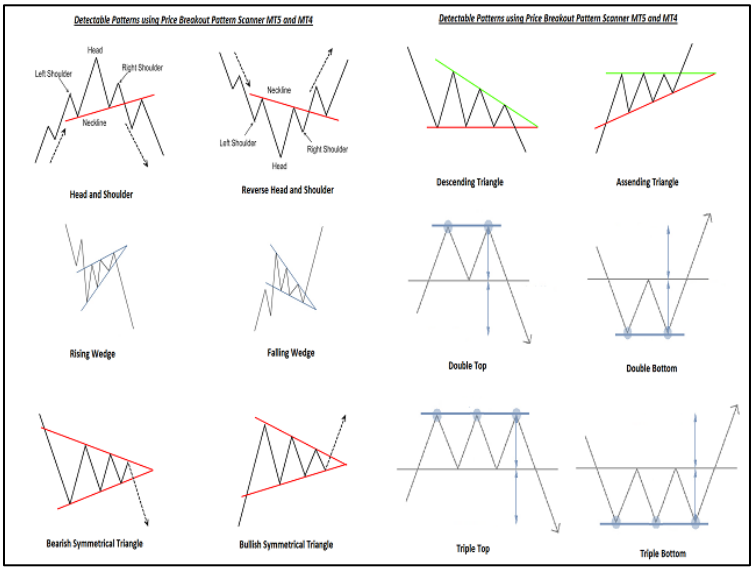
So there you have it, I'm going to try and ignore complex ideas in regards to price structure when writing these trading rules … I'm going to try and stick to the idea that "price is king", and that the chart indicators should do a good enough job in creating an edge for traders who are willing to work at understanding them.

Let's get started …

Chart Indicators

Again without going heavily into the concepts of price structure/waves, most traders with at least a couple of years under their belts should have a basic knowledge that price alternatively trends/expands and consolidates/contracts over time.

In fact, I would think that all traders with at least a couple of years' experience have all read some type of technical analysis book and/or a book describing classic chart patterns. They would likely have seen a picture of how price will repeatedly make moves like those depicted in the picture below:



These chart patterns are actually just created from the contraction and expansion phases that price continually undertakes.

With that stated, readers can probably understand why over the years I have paid programmers to help me create several customized software scripts for my stock charting software packages. Most of them were written with the intent of helping me monitor the expansion and contraction phases for the stocks/ETFs that I trade. It has been a series of experiments over time, but I have a core set of indicators that I think give me a trading edge, and with the rest of this Introduction, I am going to briefly describe the core of my indicators.

1. Average True Range ("ATR") Support & Resistance Indicator

When I thought about how best to describe the Leaf_West Trend Trading System to traders of all skill levels, it was clear that the most important chart indicator would be my ATR Indicator.

The idea for this indicator was to create a visual reminder on price charts that did two main things:

1. Reminded me which way price was currently trending; and,

2. Warn me when price had possibly changed trending directions or when price had possibly started a new trend out of a consolidation pattern.

How does it do that? The best way for me to explain this is to just show you …

ATR Support & Resistance Indicator

Note: all charts on my PDFs can be opened separately by "clicking" on them – this way you can follow along at the same time without having to go back and forth while reading the PDF.

The above chart is stripped down from all other indicators so I can isolate the ATR indicator … a green dash line is painted below price when the "trend" in price is upward and painted above price in red when the trend in price is downward.

All you really need to know about how it is drawn/calculated is that it is based on a "spread" above/below the moving average. The spread is calculated using the then current average true range ("ATR", and thus the name of the indicator). When price is trending in a given direction, the ATR indicator will follow price as the moving average that it is drawn from will also follow price. Please search google for "average true range" if you would like a more detailed description of the average true range of price.

The actual level that the ATR indicator is drawn from the moving average is a multiple of the current average true range … the idea of this was to create a level that historically

will allow price to make its normally occurring fluctuations without giving a "signal" that the trend has changed direction, or that a consolidation pattern was complete.

The ATR will stay in either support or resistance until price on a closing candle basis, breaks the ATR level. Once that happens, the ATR "flips" from support to resistance (or from resistance to support).

I marked some points on the above chart to illustrate some basic concepts. Point #1 shows price closing through the red dash ATR resistance level. The detailed PDFs on the ATR indicator will discuss in detail how I handle a break of an ATR level. For purposes of this introduction, suffice to say that the break at point #1 was a signal that price was starting an expansion phase higher, and that is obviously when you want to be trading long.

Point #2 was as it turned out a false break-out above the ATR resistance level (red dash line) … this highlights why I generally wait for price to "confirm" the ATR break (again all of this will be explained in the ATR PDFs).

Point #3 was the ATR support break that happened after a failed ATR break to the upside at Point #2 … that again is an important signal that I like to see for confirmation of an expansion phase. Look how price trended lower into the double bottom at Point #4 … see how the ATR resistance lines followed price lower but was never broken until price had actually made that double bottom (break at Point #5). This is what I mean when I say that the ATR support/resistance indicator is there in part to remind you of which way price is trending – for almost two months between Points # and #4, traders could look at this daily chart of the SPY and "know" that price was in a downtrend. They should have been holding/adding to their short positions during these two months.

The ATR break at Point #5 came after a double bottom and signaled a possible change in trend. Price did trend higher from that February 22nd break and held above the ATR support until the recent break on June 17th.

One of the key things that you will learn with the ATR indicator is how the higher time frames come into play. For instance, when the weekly and monthly time frame charts are both in positions of support, breaks higher above daily ATR resistance are more important and typically better to trade with. Breaks below the daily ATR support level when the weekly and monthly are in support are typically just part of a correction on the weekly chart – as such, you actually are looking for an area of support on the daily chart to trade in the direction of the weekly and monthly price trends.

I can't emphasize enough how important the ATRs are if you understand how multiple time frames work in concert. This is equally true for swing traders and for day-traders – the only difference is the time frames being studied/relied on.

2. Trend Strength Histogram and Colored Candles

I don't rely solely on the ATR indicators to signal to me when price is trending … one of the most important indicators I have is the scripts written to reflect a stock price's trend strength as calculated by J. Welles Wilder's Average Directional Index ("ADX") and its directional indicators (DI+ / DI-).

There are plenty of sources through Google that you can go to to learn more about the ADX indicator, so I'm not going to go into how it works or how it is calculated … let me just say that this software script was written to visually highlight the **direction and strength** of a given stock's price trend via a histogram and colored price candles.

The idea behind the simple histogram and the colored candle system was to create easy-to-understand visual guides that summarized the current condition or strength of a stock's price trend. Combining these visual guides with my other chart indicators helps me enter/manage/exit my trades on a more efficient basis.

Trend Strength Histogram and Colored Candles

Price Strength Histogram

The histogram that my software creates is a simple adaptation of Wilder's ADX indicator. Two things were changed … I wanted to have the ADX histogram to be colored – if the direction of the trend was upward (i.e., the DI+ indicator was > the DI- indicator) then the histogram's bars would be green in color. If the direction of the trend was downward, then the histogram's bars would be red in color.

I also wanted a simpler way to determine a trend's strength with what level that the histogram was at. To me the important levels for the ADX index are 55 and 15 – above 55, the trend strength as measured by the ADX was at what I called an "extreme" level that historically was difficult to sustain. When the index was at 15 or below, the ADX indicator was signaling a contraction in the price trend that was equally as extreme as when it was above 55 for expansion moves.

In my mind, it would be easier to have the extreme levels for expansions and contractions at simpler levels such as 100 and zero. Therefore I had the software script

written to adjust the ADX value based on that ratio ((ADX – 15) x 2.5 = "new" histogram value).

There is a whole art to interpreting the price strength histogram, especially if you are monitoring multiple time frames when trading – suffice to say that is beyond the intended scope of what I wanted to accomplish with this introduction PDF. Future posts and PDFs will give readers a better understanding of how I utilize the histogram in making my trading decisions.

I pointed out a couple of highlights on the above chart, but don't worry about the specific meanings until we get into a more detailed analysis of this indicator.

Colored Price Candles

I wanted my price candles to help me stay with an expansion move in price and to warn me when a contraction phase was underway … therefore I had the scripts written to have both the ADX value and the Directional Indicators reflected in the color of my price candles.

Here is a definition of what each candle color means …

Trend Strength and Direction

- Uptrend in the price trend & the histogram *increasing in strength* compared to the prior bar – **lime green**;
- Uptrend in the price trend & the histogram de*creasing in strength* compared to the prior bar – **dark green**;
- Downtrend in the price trend & the histogram *increasing in strength* compared to the prior bar – **bright red**; and,
- Downtrend in the price trend & the histogram de*creasing in strength* compared to the prior bar – **dark red**.

Trend Strength Warnings

- When the trend strength is contracting to the point where the histogram reading is at or below zero – **yellow;**
- When the trend strength is in the extreme warning zone (>= 100) – **dark blue.** In addition to the dark blue candles, the software will paint "pink divergence dots" above/below the blue candles when the strength of the histogram has weakened when compared to the prior histogram bar.

Price Warning

- When price has moved abnormally far away from its moving average, the software paints "warning" candles – **light blue.** When price has been range trading for a period of time, a candle painted light blue is what I refer to as a "kick-off" candle … i.e., it is warning me that an expansion phase has probably started or kicked-off. When the price warning candle is painted after an obvious expansion phase has been underway for a period of time, the warning is for a possible "exhaustion" move that typically is seen after a strong move or trend.

So again, a given chart's price trend strength is just one part of assessing the risk/reward of entering a trade … the examples I post in the detailed analysis PDFs will hopefully show how I use these candle colors with my other primary chart indicators to help me "pull the trigger" on trades.

The idea behind the trend strength charting script was to "assist" me in just focusing on the actual trend of price and worry less about the shape or direction of each individual candle. By focusing on the chart's trend more, I will hopefully increase my average profit per trade.

2. Price Momentum & Squeeze Indicator

When you combine a trend's strength histogram and candle colors with a good price momentum indicator, you can increase the odds of helping you find trade set-ups. I have found John Carter's Squeeze Indicator as a useful tool in this respect.

His tool or facsimiles thereof are available on many trading platforms (including Think or Swim) … the indicator combines a linear regression of price momentum with a "squeeze" feature which identifies when you are in a contraction phase based on the position of the chart's Bollinger Bands relative to its Keltner Channels.

Price Momentum & Squeeze Indicator

Bottom line is that you can often utilize the divergences in this indicator to better time pull-backs and contraction phases, which then allow you to enter the expansion phase with-trend trades.

3. Moving Averages

One of the simplest and often overlooked chart indicators is the moving averages of price. I will often look to the moving average of price when deciding when or where to enter a trade – all of the ways I utilize MA's will be evident in the PDFs to follow, but following below are a few points about moving averages to note.

I use the following moving averages on my charts … for less than daily time frames, I use a 20EMA with an 8SMA signal line (i.e., a 8 period SMA of the 20EMA indicator). For a daily chart I use a 20SMA with an 8SMA signal line; for the weekly I use a 10SMA with a 5SMA signal line and for the monthly time frame, I use a 5SMA with a 5SMA signal line. There is no right or wrong level or type of moving average … I use what I use because it has worked for me in the past.

I like to have the higher time frame's primary moving average on each chart as well for daily and under time frames. I do this because price will often pull into this bigger time frame moving average during pull-backs and because it can often act as a good filter to remind me which way price is trending.

One specific form of a moving average is the volume-weighted-average-price ("VWAP") found on most charting packages. For intra-day trading, monitoring price relative to VWAP is an important "filter" for traders when trying to determine which way to trade intra-day. The VWAP is also a very important level to trade against (i.e., a support and resistance level) – this is undoubtedly due in part to computer trading algorithms and also due to the fact that institutional traders completing large buy and sell orders are typically judged on the actual realized average price fill on their completed trades.

Institutional traders who are given large intra-day buy orders have as their goal to try and fill the buy order at or below the average price for that day. That is why when in a bullishly trending day, you will see price pulling back slowly to and then find quick buying support at or near the VWAP – more and more traders are buying as price gets closer to their daily average price goal.

The opposite works as well for when price is below the VWAP during the trading day … if a trader is trying to sell a stock, futures contract or ETF, he or she will try and sell more and more of their order as price gets closer and closer to the average price of the day. If you have a buy order in hand when price is trading below the VWAP all day, you will often use the last hour of trading to get those buy orders completed – that is why you see price squeeze right into the VWAP going into the close.

Computer programmers "know" this is how institutional traders are graded/judged, so they jump on board with a trading strategy that takes this natural bias into account. I tag along with this phenomenon as well, and will almost always set buy/sell orders at levels just in front of the VWAP.

Moving Average Spread Indicator

The third of my "big" three indicators that you will see on my typical chart set-up is the Moving Average Spread Indicator. I had a script written that depicted the spread or gap between the 20EMA and 50EMA of a given stock. The main indicator has an 8 SMA signal line that is important for me when monitoring a stock's trend strength.

Again the rules and how this all works will be explained in detail in PDFs and videos to follow.

Bottom Line – This introduction was meant to highlight the main tools I utilize in helping me trade the markets - that includes all types of trades and all time frames. I'm not sure if this looks straightforward or if your heads are spinning with concepts that are totally foreign to you. Trust me when I say, the detailed analysis to follow will make it all perfectly logical to all of you. Have faith and get prepared to become a Ninja level 9 Leaf_West Trend Trader.

Cheers … Leaf_West