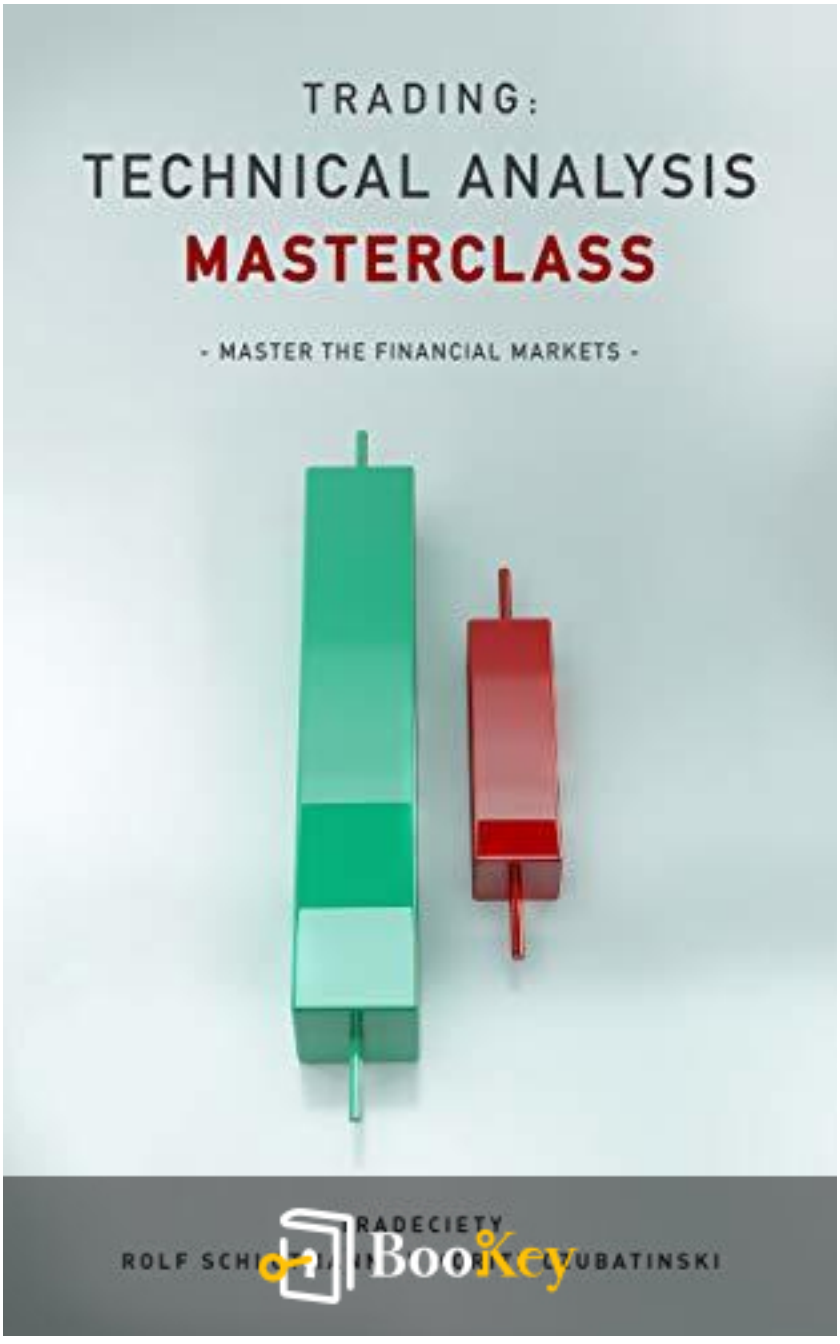
Trading PDF (Limited Copy)

Rolf Schlotmann



Trading Summary

"Mastering Markets with Strategic Precision and Insight."

Written by Books1

About the book

In "Trading" by Rolf Schlotmann, the often-perceived mystique surrounding the world of trading is demystified through robust strategies and lucid insights, designed to empower both novice and seasoned traders. This must-read book delves into the very DNA of trading by marrying technical acumen with a disciplined mindset, offering readers a blueprint for achieving market success. Schlotmann's profound knowledge is illuminated through real-world examples that unravel complex concepts into actionable steps. Whether you're looking to hone your skills or starting your journey in the financial markets, "Trading" is a compelling companion that encourages you to break away from trading myths and harness the tools to thrive confidently in the dynamic market landscape.

About the author

Rolf Schlotmann is a renowned name in the world of financial trading, known for his insightful and methodical approach to analyzing market dynamics. With a solid academic background in finance and extensive practical experience as a professional trader, Rolf has dedicated much of his career to demystifying the complexities of financial markets. Aside from being an active trader, he is a sought-after coach and mentor, guiding aspiring traders with his deeply analytical mind and disciplined methodologies. As the co-founder of Tradeciety, a popular online trading community, Rolf has nurtured a platform where traders can learn, share, and grow their expertise collectively. His dedication to elevating traders' experiences and outcomes is further evident through his literary contributions, where he distills years of wisdom and industry insights into accessible and actionable content. These efforts have firmly positioned him as a trusted figure in the trading world, combining educational prowess with practical expertise.

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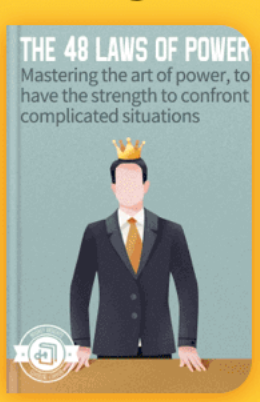

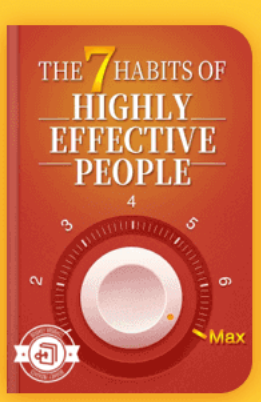

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Chapter 1 Summary: 1 . What is trading ?

Chapter 1: Understanding Trading

In this chapter, we delve into the essence of trading, focusing on key concepts that define a trader's role and actions. At its core, trading involves trying to make a profit by accurately predicting future price trends and strategically entering trades. Here, we break down the different elements of this definition for better insight into what trading entails.

1.1 Profit Potential

Trading offers opportunities to profit in diverse market scenarios. Traders can capitalize on both rising and falling prices. For instance, if a trader anticipates that Apple's stock or the EUR/USD exchange rate will increase, they can invest by buying shares or currency pairs. Selling them later at a higher price culminates in a profit. Conversely, when expecting a downturn, traders can employ a strategy known as short selling. This involves selling borrowed assets, anticipating price drops, and repurchasing at lower costs to take advantage of the depreciation. However, trading carries risks, as price movements may not align with predictions, potentially resulting in losses.

1.2 Decision-Making Processes

Successful trading relies on informed decision-making, achieved through analyzing price movements in charts and market data. Traders generally adopt one of two approaches: fundamental or technical analysis. Fundamental traders base their decisions on company-specific or economic data, assessing intrinsic values. Technical traders, which this book emphasizes, eschew economic data and focus solely on market price patterns and formations observable in charts. Each method has its merits, and it's crucial for traders to select the approach that aligns with their personal preferences and understanding.

1.3 Short-Term vs. Long-Term Trading

A trader's investment timeline significantly shapes their trading strategy. Two primary representations are day trading and swing trading. Day trading is short-term, involving quick trades completed within a day, ideal for those who can monitor markets continuously. This method suits traders who capitalize on minute-to-minute fluctuations but may be challenging for those with other daytime commitments, like jobs.

In contrast, swing trading is considered medium to long-term, with positions

held from several days to months. This method demands less day-to-day intervention, making it favorable for traders who balance trading with employment. A swing trader can engage in the market at a more relaxed pace, analyzing broader price trends without needing constant vigilance.

Day trading is less viable for many due to time constraints during active market hours, especially in Europe, where traders might instead focus on American or Asian markets outside their regular job schedule. Swing trading, offering more flexibility, often emerges as a better fit for working individuals who still want to engage in trading activities without dedicating critical hours continuously.

By examining these foundational elements of trading, we gain a clearer understanding of what it means to be a trader and the myriad strategies available to navigate the financial markets successfully.

Chapter 2 Summary: 2 . What is technical analysis ?

Chapter 2: Understanding Technical Analysis

Technical analysis is a method used to evaluate the price movements of financial instruments with the goal of identifying profitable trading opportunities. While its advantages are often highlighted, it is crucial to also consider the criticisms, notably those from proponents of the efficient market hypothesis who equate technical analysis with speculation. This skepticism is often underscored by references to the dart-throwing monkey experiment, which illustrates randomness in market predictions.

Conversely, some studies argue for the efficacy of technical analysis. Research by Neely and Weller suggests technical analysis might outperform fundamental analysis in the short term. Similarly, Zhu and Zhou identify the momentum effect as a potentially lucrative strategy based on past price patterns. Studies have also shown that technical tools can enhance analysis effectiveness, as demonstrated in the evaluation of over 2,000 Chinese stocks and Russian stock markets, where systems utilizing technical indicators outperformed simple "buy-and-hold" strategies.

Section 2.1: The Role of Crowd Psychology in Technical Analysis

Market prices fluctuate due to the daily interactions of countless individuals and institutions participating in global financial markets. Technical analysis is effective largely because it taps into human behavioral patterns. Traders often make collective decisions driven by emotions such as greed and fear, sentiments that have influenced market behavior over centuries. Historical and modern traders alike exhibit similar psychological traits, driving the same kinds of market movements observable across time and markets.

A key component of technical analysis is the concept of the self-fulfilling prophecy. Popular use of technical indicators by a vast number of investors can make these indicators appear valid, leading to widespread belief and utilization. Financial media's focus on technical concepts like price levels and moving averages further entrenches these patterns.

Exploring technical analysis involves more than just understanding graphs. By learning to interpret market sentiment and trader psychology through charts, traders can develop strategic insights. Yet, many traders practice technical analysis superficially, which critics argue undermines its potential. This superficiality does not do justice to the depth required for effective trading, a gap this book aims to fill by offering a deeper, more strategic exploration of technical analysis methods.

In summary, whether analyzing currency pairs, stock prices, indices, or

commodities, technical patterns are timeless and pervasive. This reinforces the enduring relevance and utility of technical analysis across different markets.

Critical Thinking

Key Point: Self-fulfilling Prophesy in Technical Analysis

Critical Interpretation: Picture trying to navigate the ever-changing sea of financial markets. It's daunting, yet thrilling, given its potential to transform your investments. One gem of wisdom from Rolf Schlotmann's Chapter 2, 'Understanding Technical Analysis,' stands out—the power of the self-fulfilling prophecy. By recognizing that traders around the world lean into specific patterns and indicators, you're privy to a kind of collective consciousness driving market moves. As more traders align their actions with widely accepted technical indicators, these patterns become deeply ingrained, sparking waves that ripple across the market. This communal behavior translates market patterns into vivid stories on charts.

Embracing this knowledge could revolutionize your approach not just to trading, but to life's broader landscape. Imagine harnessing the predictability ingrained in human nature, aligning your actions with templated success pathways, just as traders harmonize with market rhythms. Herein lies not just financial gain, but also a profound understanding of human behavior. This self-awareness empowers you to anticipate, adapt, and sail smoothly through life's tumultuous seas, following collective trends to elevate your pursuits.

Chapter 3 Summary: 4 . Chart anatomy

Chapter 4: Chart Anatomy

Understanding the anatomy of technical charts involves delving into various chart formations. Classical chart formations consist of multiple candlesticks, which contain substantial informational content. For instance, what appears as an engulfing candlestick formation on a daily chart may be part of a larger multi-candle Head-and-Shoulder formation on an hourly chart. This section aims to enhance the reader's ability to interpret charts practically, surpassing the analytical skill of many traders by considering the broader context and rich content that extensive chart patterns provide.

4.1 Chart Phases

Price movements on charts come in three fundamental directions: up, down, or sideways. By breaking down these movements, much like candlestick analysis, we gain deep insights into chart construction. Every chart can be divided into five distinct phases:

- **Trends**: Represent periods where prices consistently move in one direction. An upward trend, or rally, signifies a bull market, while a

downward trend signals a bear market.

- **Corrections**: These are short-term counter-movements against the prevailing trend. They demonstrate the ebb and flow within trend phases.

- **Consolidations**: Phases where prices move sideways within a defined range, indicating equilibrium between buyers and sellers.

- **Breakouts**: Occur when there's a shift in buyer-seller dynamics during consolidation, initiating a new trend.

- **Trend Reversals**: Long corrections may signal a trend reversal, leading to a new trend phase.

By understanding these phases, traders can accurately interpret price movements.

4.2 Application and Chart Analyses

Figures displaying different price phases illustrate how long-term trends are periodically punctuated by corrections and consolidations. When consolidations extend, they reflect a balance between buyers and sellers, with potential breakouts marking the start of a new trend. This dynamic

represents the ongoing contest between market participants and forms the foundation of price movement analysis. The concept of price waves—the oscillations creating upward, downward, and sideways trends—is timeless and underpins all price movement mechanics.

4.3 Chart Components

Just as candlestick analysis dissects patterns into individual elements, examining chart phases uncovers two primary features: price waves and swing points.

- **Price Waves**: The building blocks of any chart, price waves manifest as the repetitive upward and downward movements within trends.

- **Swing Points**: The endpoints of price waves, providing essential markers for chart analysis. Swing highs occur at the peak of upward waves, whereas swing lows mark downward wave troughs.

Technical analysis asserts that by identifying higher highs and higher lows, one can confirm an uptrend. This principle is foundational, dating back to Dow Theory, a cornerstone of modern analysis. By observing whether new swings surpass previous ones, traders can ascertain the health or reversal potential of trends.

4.4 Advanced Wave Analysis

This section delves deeper into four critical elements of wave analysis, equipping traders with tools to understand chart formations comprehensively:

- **Wave Length**: Long trend waves suggest strong buyer dominance, while shorter waves may signal a weakening trend.

- **Angle/Steepness**: The gradient of a price rise or fall can indicate trend sustainability, with moderate angles often being more durable.

- **Impulse vs. Correction**: The relationship between impulsive trend waves and corrective counter-waves reveals market balance; longer correction waves against a trend suggest equilibrium nearing.

- **Swing Structure**: The formation of highs and lows within trends helps determine trend sustainability. Failure to achieve new highs or lows suggests potential exhaustion.

These elements collectively provide a nuanced understanding of chart dynamics, allowing traders to analyze price movements predictively.

For additional resources, including cheat sheets, visit www.tradeciety.com/waves/. This chapter establishes foundational knowledge, paving the way for advanced chart pattern interpretation.

Chapter 4: 5 . The most important chart patterns

5. The Most Important Chart Patterns

In understanding technical analysis, rote memorization of chart patterns without considering the broader market context is ineffective. Traders relying solely on textbook patterns may find themselves unprepared for the complexities of real financial markets, which don't always conform to these conventional forms. This chapter emphasizes the need to comprehend classic chart patterns, utilizing analysis tools to apply concepts like price waves and trends to diverse chart scenarios.

5.1 The Head-and-Shoulders (HAS) Formation

The Head-and-Shoulders (HAS) pattern serves as an excellent introduction to chart patterns. It clearly reflects market dynamics and the tug-of-war between buyers and sellers. Typically appearing during a trend, the HAS formation indicates a potential reversal. During an uptrend, price waves form higher highs at the left shoulder and the head. However, the right shoulder forms a lower high, hinting at waning buyer strength. The formation's neckline—the line connecting correction wave lows—serves as a critical point; a break below the neckline signals trend reversal.

5.1.1 Variations of the HAS Formation

Understanding variations of the HAS formation is crucial for breaking away from rigid thinking:

- **Small Heads and Weak Shoulders:** When a deep correction wave follows the left shoulder, it indicates rising selling interest. A short impulse wave to the head and a weakly developed right shoulder suggest diminished buyer dominance.
- **Break of the Neckline and the Retest:** The neckline break is a common entry signal, denoting a trend change. A retest involves the price moving back to the neckline without surpassing it, offering a second entry opportunity amid persistent seller pressure.

5.1.2 Inverse HAS Formations

An inverse HAS formation is essentially a mirror image, appearing at the end of a downtrend and marking a shift to an upward trend. Similar to its regular counterpart, it signals a buyer resurgence and comes with retest possibilities.

5.2 Cup and Handle

The Cup and Handle (CAH) pattern effectively represents gradually

changing market sentiment. Emerging from a preceding uptrend, the CAH's cup signifies a slight bearish phase, while the handle introduces a brief correction before an upward breakout resumes the trend, classifying it as a trend continuation pattern.

5.3 Ascending Triangle

This pattern depicts temporary consolidation within an uptrend, characterized by consistent highs and ascending lows. It indicates that buyers dominate as the price makes higher lows, setting the stage for an upward breakout. The focus on trend line angles offers insights into the buyer-seller dynamic.

5.4 Wedges

Wedge patterns, often hinting at trend reversals, differ from consolidatory triangles:

5.4.1 Classical Wedge

A classical wedge denotes diminishing trend momentum within an uptrend, with price movements converging toward the formation's end. A downward breakout indicates a new downtrend.

5.4.2 The Wedge as a Trend Continuation

In contrast, wedges can appear as continuation patterns during a trend's corrective phase. A failure to establish new highs (or lows for falling wedges) indicates limited buyer interest, leading to a trend continuation

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Chapter 5 Summary: 6 . Additional charting concepts

Chapter 6: Advanced Charting Techniques

In previous sections, we've covered the essentials of chart analysis, equipping you with knowledge to interpret price movements. This chapter introduces additional technical analysis concepts to enhance trading opportunities and improve trade quality through a deeper understanding of charts.

6.1 Trend Lines

Trend lines, fundamental tools in technical analysis, delineate price movements by connecting specific highs or lows on a chart. Understanding their significance enhances trend and reversal trading strategies.

- **6.1.1 Drawing Trend Lines**: Typically drawn by connecting consecutive lows in an upward trend or highs in a downward trend, a valid trend line requires at least three price touchpoints for confirmation. Care must be taken to avoid cutting through candlestick bodies excessively; permissible intersections occur with candlestick shadows when justified by market conditions. Figure 47 illustrates how a trend line establishes a framework for

trend traders, while reversal traders focus on breakouts signaling potential trend changes.

- **6.1.2 Trend Line Angles**: The angle of a trend line depicts trend strength. In a bump-and-run formation, initially moderate angles intensify, indicating accelerated price movements. Such rapid ascensions resemble bubbles and precede a downward trend when the price breaks critical trend lines. Conversely, shallow trend line angles imply balanced market forces and potential trend reversals. Figure 49 highlights flattening trend lines indicating trend culmination.

- **Excursus: Confluence**: Combining various chart formations or signals increases the credibility of trading signals. Confluence occurs when multiple signals align, drawing attention from numerous traders and reinforcing trends through collective market actions.

- **6.1.3 Trend Line Breaks**: Breaking an established trend line often preempts trend reversals, marked by prior shifts in higher lows or lower highs. A confirmed trend line break signifies renewed market direction.

- **6.1.4 Subjectivity of Trend Lines**: Given the inherent subjectivity in drawing trend lines, combining them with horizontal breakouts offers a more objective trading approach. It enhances signal reliability by corroborating trading signals with additional patterns.

6.2 Support and Resistance

Key components in chart analysis, support and resistance levels are pivotal in identifying significant price points and enhancing strategic decisions.

- **6.2.1 Drawing Support and Resistance**: Defined by price points exhibiting reversal tendencies, resistance marks trend reversals from upward to downward, and support represents the opposite. Confirmed through repeated interactions, these levels, seen in Figure 51, reveal pivotal market dynamics.

- **6.2.2 The Concept**: Price reversals at support or resistance underscore significant market sentiment shifts. For instance, persistent resistance in an uptrend indicates a tipping point where sellers overpower buyers.

- **6.2.3 Support and Resistance as Trend Reversal**: Employ these levels to anticipate potential trend changes. Adding confluence through patterns like head-and-shoulders enhances the reliability of trading decisions, as shown in Figure 52.

- **6.2.4 Order Absorption in Support and Resistance**: Continuous interactions weaken support and resistance levels, facilitating breakouts.

This process is evident when price returns to these zones with diminishing resistance before breaking out, as depicted in Figure 53.

- **6.2.5 Levels vs. Zones**: Static lines may not reflect price dynamics; therefore, using zones mitigates premature signals and noise, offering clearer insights. This approach is beneficial for multi-time-frame analysis, as shown in Figure 56.

6.3 Supply and Demand Zones

Supply and demand zones, akin to support and resistance, provide insights into market dynamics through the balance of buying and selling pressures.

- **6.3.1 The Concept**: Identifiable where prices pause before explosive movement, these zones reflect significant supply and demand balances. Figure 57 depicts how demand zones generate upward movements when price revisits the area.

- **6.3.2 Identifying Zones**: Key factors include moderate volatility, timely breakouts, and strong breakout reactions. Figures 58 and 59 illustrate how timely, strong movements affirm supply zones, while corresponding demand zones are portrayed in Figure 60.

- **Order Absorption and Spring Formation**: Zones become less significant with frequent revisits. Early reactions signal significant imbalances, revitalizing trends, as shown in Figure 61 using spring formations for reinforcement.

6.4 Traps

Understanding and evading traps prevents premature market entries and resultant losses, crucial for enhancing trading success.

- **6.4.1 Buyer Traps**: Reflect shifts in market dynamics where initial price pullbacks invite traders into premature trades before reversing, demonstrated in Figure 62.

- **6.4.2 Avoiding Traps** Evade traps by refraining from late trend entries and waiting for confirmed breakouts. Understanding this reduces inadvertent losses.

- **6.4.3 Double Bottom Traps**: Frequently impacting hasty traders, traps often manifest around notable formations, such as double tops, explained with Figure 63.

- **6.4.4 Failed Breakouts**: Recognizing unsustainable movements,

especially with patterns like springs, aids in precluding traps. Figure 64 exemplifies the reactive nature following such failed breakouts.

Chapter 6 offers additional insights into technical analysis tools, reinforcing strategic trading through trend lines, support and resistance, supply and demand zones, and traps, thereby fostering informed decision-making based on comprehensive market assessments.

Chapter 6 Summary: 7 . School of indicators

Chapter 7 delves into the world of technical analysis, specifically focusing on the concept of indicators, which are essential tools for traders aiming to make informed decisions based on price data. These indicators, used alongside candlestick patterns and chart formations, offer visual insights into the market's movements and overall trends. However, some traders criticize indicators for being 'lagging', meaning they rely on past data, potentially leading to delayed signals. Nonetheless, this criticism overlooks the valuable interpretations they provide when used correctly.

The chapter categorizes indicators into three main types:

1. **Momentum Indicators**: Often referred to as oscillators, these indicators help assess who holds the majority—buyers or sellers—and gauge the strength of market movements. Examples include the Relative Strength Index (RSI) and the Commodity Channel Index (CCI).

2. **Trend Indicators**: These analyze ongoing market trends; they can be critical in trending markets but less effective in sideways markets. Common examples include the Average Directional Index (ADX) and Moving Averages like EMA and SMA.

3. **Volatility Indicators**: These assess the degree of price fluctuations,

assisting traders in setting stops, defining goals, and deciding position sizes. Bollinger Bands® and the Average True Range (ATR) are examples.

Moving Averages (MA) are highlighted as particularly popular, with EMA and SMA being the most common types. EMA adapts faster to price changes, while SMA offers a slower response, filtering out market 'noise'. Traders must select the appropriate setting based on their trading style—short-term (9-10 periods) for quick reactions or long-term (100-200 periods) for strategic planning. MAs can be used to indicate trend direction, as in the 'golden cross' strategy, or act as support and resistance markers due to widespread use, increasing the 'self-fulfilling prophecy' effect.

The **RSI Indicator** is emphasized for its versatility and effectiveness in momentum analysis by comparing 14-period candlestick data to assess trend strength. It quantifies movements on a scale from 0 to 100, with values over 70 or under 30 traditionally indicating ‘overbought’ or ‘oversold’ conditions, though these terms can be misleading as they actually signify strong momentum. RSI is also applicable for spotting divergences, indicating potential trend reversals.

Stochastic Indicator measures momentum similarly, focusing on how price patterns align with high and low points over defined periods. Overbought and oversold signals reflect strong trends rather than impending reversals, and like RSI, its divergences are reliable reversal indicators.

Bollinger Bands®, comprising a moving average and standard deviation bands, adjust according to market volatility. They are effective for signaling strong trends or potential market exhaustion, with breakouts beyond the outer bands often heralding trend continuations or reversals.

The **MACD (Moving Average Convergence Divergence)**indicator integrates trend and momentum analysis using EMA-based lines and a histogram to signal crossover points and trend strength. It assists in identifying trend changes and potential reversals through the separation and convergence of its lines.

The chapter concludes by emphasizing that no single indicator is superior; each serves distinct purposes depending on market conditions. Traders are urged to use indicators to complement their decision-making processes rather than sole justifications for action. An illustrative webinar is offered for further exploration into the integration and application of these indicators in trading.

Chapter 7 Summary: 8 . Your journey as a trader

Chapter 8: Your Journey as a Trader

This chapter of the book encapsulates a wealth of knowledge about trading, alongside practical tips and stimulating insights intended to aid readers in refining their trading skills. Drawing from personal experience, the author acknowledges that while reading extensively and experiencing numerous "aha" moments can be enlightening, the real challenge lies in applying this knowledge effectively. Often, traders encounter doubts and fears that can derail their progress.

In an effort to assist readers in taking the next step in their trading journey, the author introduces a supplementary resource: a website featuring a structured 10-step process. This is designed to provide even more practical and applicable trading strategies. The website, found at www.tradeciety.com/next, serves as the final step in reinforcing one's understanding of technical analysis while challenging preconceived notions about market behaviors.

Additionally, the chapter references several scholarly works that delve into different aspects of trading and technical analysis:

1. **Arnott R., Hsu J., Kalesnik V., and Tindall P. (2011):**This work examines unconventional strategies, highlighting how seemingly random choices might yield surprising market returns, as discussed in "The Surprising Alpha from Malkiel’s Monkey and Upside-Down Strategies" from The Journal of Portfolio Management.

2. **Neely C. and Weller P.:** Explores the application of technical analysis in the foreign exchange market, offering insights from the Federal Reserve Bank of St. Louis.

3. **Zhu Y., Zhou G. (2009):** The discussion centers on using moving averages from an asset allocation perspective, as explored in the Journal of Financial Economics.

4. **Li G. and Zhu J. (2014):** This research focuses on the effectiveness of technical indicators when combined with volume data, presenting findings at the International Conference on Education, Management and Computing Technology.

5. **Chsherbakov V.:** Evaluates the efficiency of technical analysis in the Russian stock market, contributing to the global discourse on market analysis strategies.

6. **G. Caginalp and H. Laurent (1998):** Their study in Applied

Mathematical Finance investigates the predictive power of price patterns, offering a mathematical approach to understanding market movements.

7. **George Lane:** Known for his contributions to technical analysis, particularly in the development of stochastic oscillators, his work is highlighted through a link to his Wikipedia page.

The chapter serves as a conclusive guide, encouraging readers to harness the acquired knowledge and resources to ensure a more structured and informed approach to trading. By integrating these strategies and insights, readers can better navigate the complexities of the trading world.