Welcome to this SPECIAL issue of *The Profile Bulletin*, part of the broad range of educational materials produced by DLC Profiles. Our purpose in publishing this newsletter is to provide an additional educational learning medium for "Advancing the Power of Cumulative Experience".

As 2008 comes to a close, we are devoting this issue to (1) a few questions we received recently, (2) an educational segment from a past issue of our Index Insights, and (3) a copy of one of our CL/CES Cognitive Market Commentaries. We are publishing these so you can gain a deeper understanding of the value of our CL/CES process and how it supports our clients in "Advancing the Power of THEIR Cumulative Experience".

Reader Questions

Mr. Dalton, I have read both of your books and have had some success with using reference points as places to enter and exit the market. My biggest issue is in trying to evaluate if the market will continue through the reference point or reverse itself into the opposite direction. Can you please tell me what specifically you look at in deciding where to enter and exit a trade. Thanks, WR.

My suggestion is that you work on feeling the market's flow rather than looking for entry and exit points or levels. You may simply have the order backward. So many traditional approaches focus on entry and exit points so that what is actually occurring is missed. Without understanding the flow, entry and exits are meaningless. Once you are in the flow the entry and exit levels begin to fall out as do the levels where both the exit for a poor trade as well as a winning trade should occur. In my experience, when you focus on the entry and the exit, you are focusing on the money you will make or lose and simultaneously stacking the odds against you.

Recently I read that Dr. Debakey had passed away. Many years ago, one of his early associates, Doctor Don W. wanted to become a trader. One of the nicest people I've encountered; however, after several seminars he gave up on what I was trying to do and sought other teaching sources. About two years passed and I got a call and Don asked if we could meet in Chicago for dinner. At the dinner he told me that it all came together for him about three months back as he was taking flying lessons and making his first solo landing. He said he was trying to land by the numbers and outside conditions were changing rapidly and he couldn't get the plane down; his instructors on the ground said, Don, you are in trouble unless you can get into the flow with yourself, the plane and the weather. He made the landing and reported that something took over and he just landed the plane. He said that what we had been discussing for so long now also started to come together.

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I heard you make the following statement, "Don't risk capital but embrace risk, play with odds on your side" – please elaborate on it for me. MD

What I was trying to do was contrast less experienced traders against experienced seasoned traders. Younger traders focus on how much they can make on each trade and often commit two huge errors; first they don't think in terms of probabilities (risk/reward) but simply how much they can make, secondly, they are so afraid of loss that they place very tight stops in the belief that this action is loss limiting, when in fact it is financially life threatening.

More seasoned traders focus on protecting capital by not risking capital when they don't enjoy an edge. They are probability orientated, which is normally not the mind set of the less experienced trader. Seasoned traders embrace risk as that is where the opportunities are; however, they focus on attractive risk/reward opportunities.

In Markets in Profile you talk about context and the interrelationships of the different timeframes. In a recent copy of Index Insights you talk about the diffusion model from Gladwell's 'Tipping Point'. Am I correct in understanding that each of the timeframes could be further broken down into the classifications of the diffusion model?

Yes; within each timeframe there are innovators, early adopters, early majorities, late majorities as well as laggards. It is important to develop a keen sense of the behavior of each timeframe as well as an appreciation of the diffusion model.

What is market structure and how important is it to me since I am a short-term day-trader?

Market structure is a contextual, multidimensional view of the distribution of price and volume for any time period you choose. Price and volume are distributed via an ongoing, two-way auction process that represents the opinions of all timeframes. Market structure forms as this auction information is organized under the Market Profile distribution curve. The study and interpretation of market structure (via the Market Profile) enables traders to better understand which timeframe/s are controlling the market's auctions, as well as the aggressiveness being exhibited by the respective timeframes. Structure assists us in visualizing, internalizing, and understanding the many complex relationships that exist between all of the market's various timeframes. Finally, market structure represents the composite view of all market participants.

Why does it take a year to complete your CL/CES program?

It doesn't. When we originally structures our CL/CES, self-study process, we outlined a 'suggested' study process over 12 months. As clients enrolled and began working through it we found that some devoted inordinate amounts of time to it and finished the workbooks in less that 30 days. While we feel each module should be viewed as a springboard to increased understanding and internalization of the information presented, we also acknowledge that each individual has their own style of learning.

Therefore, based on client feedback, we now work with each new CL/CES client and help them design a study plan that fits their style and availability to gain the

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most from this process as possible be it a 3 month term or a 322 day term.

Our commitment is to support your learning process and the advancement of the power of your cumulative experience.

Caution: While you may actually complete the course in a relatively short period of time, few recognize or accept how many years it actually takes the brain to truly assimilated the knowledge necessary to become an expert trader. Completing the course too quickly is likely going to prove to be a determent.

I am interested in your CL/CES process, but, before making a decision, I would like to be able to read past issues of your Index Insights and Commentaries – is that possible? R. McK.

R. McK, Thank you for your inquiry and request. Based on your own and several other requests for 'samples' of our publications, please see the following excerpts from our Index Insights and a copy of one our *Cognitive Market Commentaries.*

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Educational excerpt from our August 24th and 31st, 2008, Index Insights issues

Sunday, August 24th, 2008

MYTH-A common day trading myth is that it is less risky than taking trades homes over night as you don't have to contend with the overnight risk; however, this fails to address a couple of other issues; first, some trades require more time to develop and achieve realization and secondly, day traders, especially those who get caught up emotionally, can accumulate sizable loses during a single session. The new Commentary will contrast two different day trading styles; the first style is employed by traders seeking only a couple of good opportunities each day, while the second style, which appears to be more common, is employed by more aggressive traders, who seek multiple opportunities often ranging between 6 and 10 each day. The same theory discussed above is behind these two contrasting day trading styles. Seeking a couple of day timeframe opportunities, once identified, allows these trades more time to reach fulfillment, while more active trading requires almost instant gratification. The more active trading has a higher propensity to stimulate emotional confusion, which can be very costly. Initially, you might think that this applies to traders who initially "get it wrong"; however, some of the biggest issues often arise with traders who "get it right" initially and become euphoric and feel invincible, which leads to giving back the initial profits, which are then compounded with significant additional losses.

RECENT LETTER-The following is a line from an email I received on Thursday of last week: "My results as a day timeframe trader have been less than 2-3 in 10 winning trades, have not had any success with fading extremes, balance breakouts, or gap open directional trades, and, of course, have lost multiple thousands of dollars one contract at a time." Upon calling the author of this email it was reveled that he was doing 6-9 trades per day often using money stops that were as close as two handles. Your instant response might be to laugh; however, I was there once early in my career as well as having seen very similar trading while I ran J. F. Dalton Associates, which was a futures discount trading firm in Chicago. Was the timeliness of this letter a simple coincidence.

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THE DAY TRADER-The following is taken from page 32 of *Markets in Profile*, with some updates:

> The day trader enters the market with no position and goes home the same way. Day traders process news announcements, reflect on technical analysis, and read order flow in order to make trading decisions. They also have to deal with numerous scheduled economic announcements along with many spontaneous events and announcements such as long and short-term program buying and selling, traditional technical analysis that may have short-term impact, brokerage firm margin calls (brokerage firms often will enter the market to buy or sell contracts for customers you have not met their margin calls-typically these orders are placed late in the morning), speeches by Federal Reserve governors, and "important pronouncements" by influential portfolios managers and political leaders. Additionally, out of the ordinary advances or declines in other markets will often influence other futures contracts, which in turn may influence additional contracts. Anyone who believes that markets are rational should spend a day trying to digest and react to the landside of conflicting data day traders must wade through to make a decision.

CONFLICTING TIMEFRAME INFORMATION-We have stated on numerous occasions, that no matter what longer timeframe information is telling you, markets have to deal with immediate information first. The example that I have traditionally used to illustrate this point is related to our markets. When I ran J. F. Dalton Associates no matter what I had planned for the following day if the market had moved substantially the day before or overnight the first thing I had to do in the morning was to issue and collect on margin calls; without taking care of immediate business first there might not be a business at the end of the day.

YOUR THOUGHTS-I'm just putting my finishing thought on paper for the CES/CL commentary on the two day trading styles. Your feed back on what you have just read would be extremely valuable in enriching this commentary for all. Fill free to disagree as your comments will provide additional insight for all of us. Please respond as quickly as possible-thanks.

Sunday, August 31st, 2008

A MESSAGE RESPONSE FROM BRIAN

In last week's *Index Insights* I stated that I spent the time contrasting two divergent day trading styles - one that trades a couple of times each day and another that trades far more frequently - in response to numerous statements of frustration among our day trading clients. Additionally, I asked for written feedback from our readers relative to the contrasting styles. The response that is reprinted below is the best I have ever received.

> Hi Terry & Jim,
>
> I thoroughly enjoyed this week's Index Insights as it not only followed up on topics discussed in last week's webinar but a topic I find very interesting. I consider myself a beginner trader, one notch from novice, but I guess if my ego would permit I am probably a novice. I found Jim's commentary on the amount of trades taken directly in proportion to a trader's success very informative. I can say without doubt that all my losses have, in the main, come from when I have overtraded, which was based largely on impatience, my inability to read the profile and deduce from it a clear understanding and trading strategy, which sometimes frustrates me. This I know is impatience. I realise that I am trying to force experience and there is no short cut for that, it's time and hard work. Trying to trade something without being able to define it leaves you chasing the market. When I have given myself time and created space amidst the pandemonium I see the game much clearer and hence place fewer trades but much more profitable ones. I know I need to stay on the sidelines more and create time and space around my decisions, so I have removed all short timeframe charts from my platform as this only adds to the euphoria. I now concentrate more on reading the profile, deducing the activity, and devising a plan to align myself with the flow of the market and being open enough to leave space for any new data that will help me in my decision making process during the day.
>
> Many thanks, BJ

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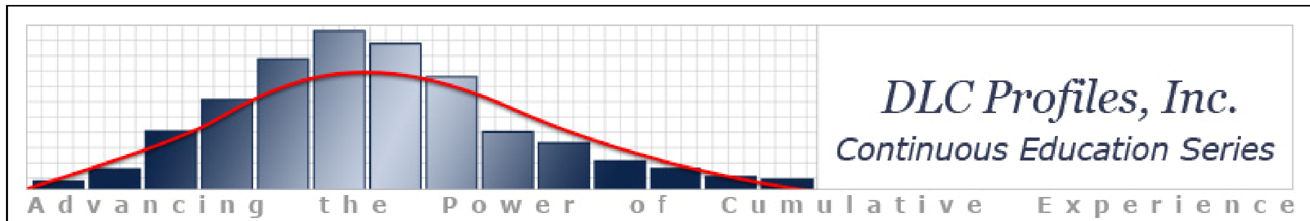
The following commentary is from our Cognitive Market Commentary Series, is published here to give you a first-hand look at another one of the key components of the Cognitive Learning / Continuous Education Series



DLC Profiles *Cognitive Learning / Continuous Education Series – Cognitive Market Commentaries*

Cognitive Market Commentaries **are twice monthly commentaries addressing DLC Profiles** ***Cognitive Trading Process*** **principles and concepts and the cognitive understanding of specialized market events. The focus of the commentary is then tied back into the appropriate elements of DLC Profiles educational offerings including** ***Mind over Markets*** **and** ***Markets in Profile*****.**

Cognitive Market Commentaries **are an integral part of DLC Profiles** ***Cognitive Learning / Continuous Education Series*** **– Part II which includes our weekly** ***Index Insights*** **and twice monthly** ***Cognitive Market Webinars*****.**

Sorting out the Timeframes: **The Continuing Quest for Control**

"Reality is a question of perspective."

—Salman Rushdie

Trading is an endlessly challenging endeavor, even for the experienced expert. Every day brings new variables and mental conditions that can result in skewed or misplaced focus. But even when all systems are running smoothly, it is extremely difficult to make money if you aren't able to recognize the actions of individual timeframes. Information that appears to be "conflicting"—because it contradicts your expectations—is often simply information coming from different timeframes with dissimilar motives conducting business (or waiting to conduct business) on the same day.

This article will first distinguish the various timeframes, and then provide a few examples that illustrate the importance of understanding their divergent behaviors. Make no mistake: this process is so complex that few ever truly grasp its significance. As we have said, and will continue to reiterate, there is no substitute for the power of dedicated study and accumulated experience.

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The right frame of mind

Markets trade quite differently, depending upon which timeframe is dominating activity. The shorter the timeframe that's in control, the more the market will conform to traditional technical and short-term market indicators. The longer-timeframe participants, in many cases, are not even *aware* of these indicators. As a result, when the longer timeframes are in control, traders that rely on technical input often get run over when they attempt to fade (go against) the market. The intermediate-term timeframe does pay attention to major technical information—such as 50- and 200-day moving averages—but tends to ignore shorter term indicators.

It is vital to know which timeframe is most influential in a market at any given time, but It is equally important to recognize which timeframes are *absent* from activity, as they may join the fray later with similar or opposite intentions. In order to assess the intentions of other time-frames, you must examine their recent action and its subsequent effect on market structure. These are difficult and subtle distinctions, so let's take a step back and review the behavioral characteristics of the various timeframes.

Scalpers—the shortest timeframe—live by the minute hand, constantly looking for ways to take advantage of fleeting discrepancies in order flow. Scalpers respond to the immediate needs of the market by buying and selling to all timeframes, but are seldom responsible for directional moves because they don't carry inventory for any meaningful length of time.

Day traders enter the market with no inventory and go home the same way. Day traders look to news announcements, technical analysis, and short-term reference points—such as previous daily highs and lows—in order to identify trading opportunities. They provide daily liquidity but have no impact on directional moves. Because they hold inventory throughout the day, however, they may initiate short-covering rallies or long-liquidation breaks (essentially the resolution of "old business") that, to the uninitiated, may appear to be new directional moves.

Short-term traders hold inventory overnight, although generally not for more than several days. Their focus is primarily on multiple days of overlapping prices, when they attempt to buy lows and sell highs, always watching for breakouts. They also rely on momentum indicators, trend lines, trading channels, and news announcements to identify trading opportunities. While they may pile on to directional trades, they have no risk appetite for leading the way, and thus are not responsible for new directional moves. Much like the day trader, their actions can result in short-covering rallies and long-liquidation breaks that occur when they have accumulated too much in-ventory. Mistaking such old-business auctions for new directional moves can be financially haz-ardous.

Intermediate-term traders/investors simply have a longer timeframe than that of short-term traders. Sometimes referred to as "swing traders," they often attempt to place trades that "swing" from the top to the bottom (or vice versa) of extended brackets, trading ranges, or con-solidation ranges (these are just different labels for the same market phenomenon). Swing trad-ers generally carry larger inventory positions and have a greater appetite for risk. They rely on fundamental and technical information in their decision-making process. Like the three time-frames discussed above, intermediate-term traders look for opportunistic trades, and don't as-sume responsibility for directional moves outside clearly identified trading ranges, although they may lead directional moves within the larger trading range. This is an important distinction, one that underscores the importance of understanding if the market you're trading is trending or in a long-term bracket (the subject of another article). This timeframe will quickly pile onto any break-out from an established trading range.

Long-term investors are far more attached to the securities they hold, often keeping inventory for months or years. While any successful investor or trader is likely to be opportunistic, this timeframe also takes responsibility for causing *new directional moves.* Their source of information is generally fundamental, with little technical information in the mix. Besides breaking new ground, this timeframe is also responsible for starting new trends, ending old trends, and upset-ting the status quo. While long-term investors/traders don't account for a large portion of market volume, the volume they are responsible usually represents substantial orders in one direction—this is volume that doesn't quickly return to the market. In other words, it's "stickier" volume.

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Understanding inventory conditions for the longest timeframe is complex; like any other timeframe, they can sometimes accumulate too much inventory, which can lead to sharp liquidating breaks that last for weeks or even months. Referring to long-term investors as being "short" usually represents a situation in which they are unallocated to the market, a market segment, or a particular position, rather than actually being "short." The effect is the same if they have to cover-buy in order to bring their allocation up to a market representation (this phenomenon is covered in detail in *Markets in Profile*).

Who's at the helm?

In real-time trading and investing, the timeframes are far more difficult to distinguish than the neat descriptions above might suggest. And although we've described them separately, it would be unusual to have only one timeframe active in any given marketplace. All timeframes coexist, interact, and merge together in a constantly changing tapestry.

Correctly assessing which timeframe or timeframes are most active in the market begins with a complete understanding of their *expected behavior.* For example, if the market is in a tight range centered within the previous day's range, the odds suggest that trading is mostly occurring among day-timeframe traders. What is of equal importance in this circumstance is recognizing the *absence* of the other timeframes.

To reiterate, it is unlikely that any single timeframe will not be participating in the market. However, what we're really discussing is the *level* of participation, aggressiveness, and dominance. For example, in the above "inside day" example, day-timeframe traders are dominant, and though other timeframes may be present, they are not aggressive enough to become dominant. If the market begins to make a directional move outside an initially constrained trading range, an understanding of the expected behavior of the day-timeframe trader (and their lack of responsibility for directional moves) will lead you to realize that a longer timeframe has either entered the market or become more aggressive.

This same phenomenon occurs when other timeframes are controlling the market. For example, if the market has moved to the top of a meaningful trading range, balanced, and then broke out to the upside, you can assume that—at least—the next longer timeframe has either entered the market or was in the market all along and has now become dominant.

> ***A change in timeframe dominance provides trading opportunities—as well as increased risk—for those positioned opposite the change.***

Once the dominance of a new timeframe becomes evident, it is important to reflect on the behavior of the multiple timeframes. For example, while shorter timeframes may not be responsible for *initiating* a directional move, it can be expected (by the savvy, experienced trader) that they will pile onto the move, causing the fresh auction to accelerate.

The ebb and flow of dominance

Timeframes are complex, interlocked, and ever-changing. To make matters more intricate, it is true that *everyone is a day trader on the day they enter or exit a market.* For most traders, including myself, keeping the timeframes distinct and making intelligent assessments about what each timeframe is doing can be overwhelming—but that's where the action is. The following example will hopefully help clarify what we've discussed thus far. (For those who would like to view this example on their own; the days used in the example represent May 2007 crude oil for March 13-22.)

Box 1 displays a market break. In this instance, it is illuminating to determine which timeframe is dominant through the use of deduction. In this example, if you understand general timeframe behaviors, then you can deduce that the late break in K period wasn't caused by the day or short-term trader, because these timeframes don't break new ground. The intermediate-term trader, however, can lead breakaway movement when it occurs within the bracket (or "consolidation

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range") in which they're operating. Therefore, I can conclude that the activity in Box 1 was the result of intermediate-term timeframe selling.

Box 2 shows that price is clearly accepted within and at the lowest end of the price break established by the intermediate-term timeframe. In other words, the intermediate-term timeframe is still dominant.

Box 3 displays another price break, and by continuing the same reasoning discussed above, we can conclude that the intermediate-term timeframe is still driving this directional activity.

Box 4 reveals a different picture. Here, while there is some price acceptance within the upper portion of the price break, there is never acceptance within the lower portion. We can therefore conclude that the intermediate-term timeframe has completed its selling, and has now become a buyer. This type of buying is often quiet, responsive, and patient, and you can see here that the lows from Box 3 were never seriously threatened. Shorter timeframes—which are not responsible for directional moves but follow momentum—continue to trade within this new lower range. However, they're getting no satisfaction from it, and in fact are probably trading more from the short side, which is *exactly opposite* what the intermediate-term timeframe is doing. Therein lies the risk of piling on and trading momentum: they won't recognize the shift in timeframes until the market reverses, which of course is probably too late.

Finally we see the upside breakout and clear dominance of the intermediate-term timeframe. This timeframe was initially patient (responsive), but has become aggressive (initiating). The shorter timeframes are now forced to cover, and once again go with the momentum initiated by the intermediate-term timeframe, piling on the developing trend.

See screenshot on the next page.

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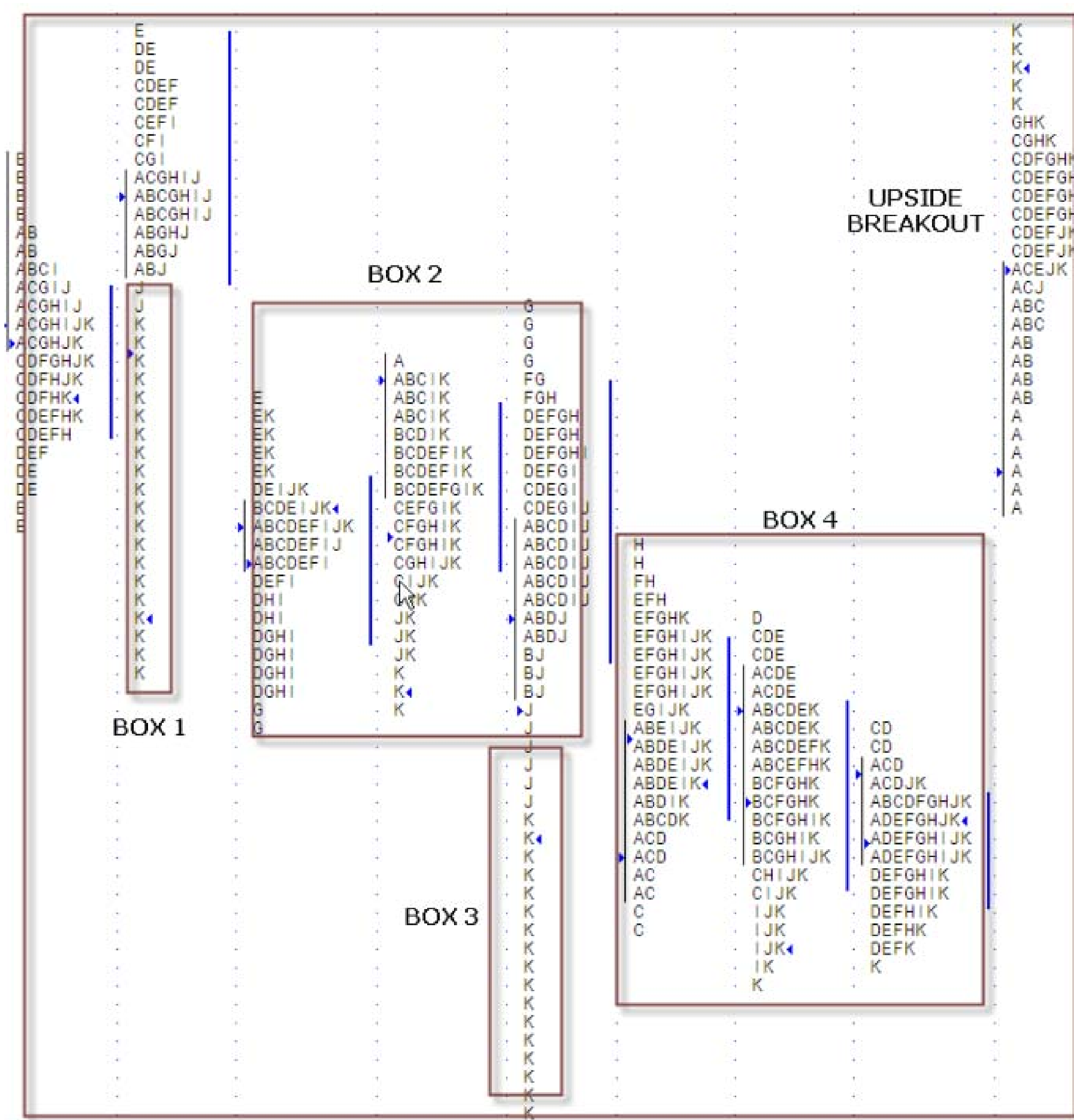

Over-sold and over-bought markets

If you understand the roles of various timeframes, you won't be misled when you hear market commentators state that the market is either "over sold" or "over bought." When the commentators start thumping that drum, the wise must ask: "Over bought or over sold for *which timeframe."* Most commentators (and traders) tend to lump all their comments into a single timeframe, which makes for easy simplifications, such as: "The market is over bought and we are expecting a correction." In such instances, without knowing which timeframe this information pertains to, you will most probably be late to all the rallies and breaks, especially if the market is not "over sold" or "over bought" for *your* timeframe.

When many traders hear "correction," they make an unconscious assumption that the term refers to a price *retreat* from recent market action. It is important to note that the definition of a correction is actually *counteraction*. The counteraction to buying is selling—but this activity won't necessarily result in lower prices. For example, intermediate-term selling that results from an over-

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bought condition could, in fact, be selling to new, aggressive long-term buyers. The correction could therefore take place *with no price decline,* and the security could actually auction higher. It cannot be emphasized enough: successful trading is highly dependent on creative, open-minded thinking.

We'll close this article with a few final examples that further illustrate the importance of time-frames and context. *Graph 2* shows the S&P daily bar chart and a clear excess low. The graph also reveals that once the market gets underway, the intermediate-term timeframe remains in control. *Graph 3* shows several individual days leading to the multiple highs shown in graph 2 prior to the upside breakout, which occurred following a Federal Reserve meeting. Judging from volume, shape, and conviction, each of the three days leading to the breakout would have received a poor grade for their efforts to auction higher. However, closer inspection reveals that the intermediate-term timeframe *remained in control.* If you were unable to keep the intermediate-term timeframe in perspective, you may have actually shorted this market. As a rule, the next longer timeframe always trumps the shorter timeframe. Probably the most complex portion of the previous discussion revolves around the days leading up to the breakout.

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In closing, if you would like additional information on our CL/CES process, please *click here*.

Or, if you would like to arrange a personal overview of our CL/CES process, please *click here*.

Wishing you an incredible 2009, Jim and Terry

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