SIAW JUN KIT

BEHIND A TRUE TRADER

VICTORY OF 100 BATTLES IN THE FINANCIAL MARKET

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PUBLICATIONS

“Unleash the potential of self-trading.
Discover the secret behind a TRUE trader.”

- Siaw Jun Kit

DEDICATION

My parents did not give me an empire, but my dad taught me that it takes perseverance and courage to be a man; my mum gave me endless care and inspiration; and my only elder brother led me to the understanding of the importance of analytical thinking, which has shaped me to who I am today. I could not have asked for more. THANK YOU from the bottom of my heart.

– 7th April 2019

QUOTE

"Living up to an expectation is a crime. You must simply outperform it."

- Siaw Jun Kit

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INTRODUCTION

After 10 years of indulgence in the investment industry, I came to a decision to eliminate the so-called 'best' strategy of applying several tactics at a moment in time to enhance probabilities, such as by following the herd through an economist's professional point of view in trading. Why the Art of Price Reading? Support and Resistance are the most essential weapons for our trading system, and the fact is this: Players in the market use these tools to identify key levels to trade as prices. In short, the skill (including "depth" and "width") of applying Technical Analysis in most investment vehicles such as the stock market, foreign exchange market, futures market, commodity market, and energy market ensures accuracy and persistence in making a profit.

"The mind is the root from which all things grow if you can understand the mind, everything else is included." – Bodhidharma. Chronologically, this book will start with the history of technical analysis. By understanding that, everything will fall into place. The ACI format will only be applied in highly challenging topics, which often require skilful judgement in the live market such as instruments with its applications, followed by strategies to integrate the pieces of instruments to form different classifications of trading systems to suit several market places for long-term investment industry growth (stress on candlesticks, supports and resistance, trend line, breakout and reversal signal with the sensitive readings of volumes). In addition, perennial topics of all time, such as technical analysis vs fundamental analysis, will be explored in market cycles, types and levels of traders, charting basics, and emotional management.

Thus, the following contents do not solely result from research. Most importantly, they are the true essence of profound technical knowledge from experience, whereby studying them gives a person a ready "weapon" to go on-ground and start trading. This book comprises a few sophisticated methodologies in the art of Technical Analysis; hence, it is more suitable to the experienced trader.

This book should be interpreted this way:

I will first begin with contents similar to the Top-Down Approach in the field of the economy, encapsulating both macro and micro views – from the 'What', 'Who', 'How', and 'Why' of technical analysis into its roots (history). By killing the myths of trading and emotional management, we will be mentally prepared and therefore can move into market cycles as a big picture (just like the four seasons or business cycles in a year). Next, we will switch to 'smaller picture' strategies, by looking at trading instruments all the way down to even the very sensitive context. This means that after reading this, technicians should be able to decide what types of trades they should perform while knowing how to position themselves as the types of traders they want to be. From there onwards, the "little" component in the chart, also known as the candlestick, will be discussed in terms of how it can facilitate the decision process of a quality trade. But before that, you should first understand and identify the level and type of trader you want to be.

CHAPTER 1

WHAT IS TECHNICAL ANALYSIS?

- A Chart Speaks for Itself

There are two types of trading analyses – the Technical Analysis (Demand and Supply) and the Fundamental Analysis (in-depth analysis of the financial market news such as macroeconomics, financials, market outlooks, and qualitative and quantitative factors – computing the intrinsic values of a particular stock or foreign exchange rates is the topmost priority).

The essentials of technical analysis are shown even in the data charts of the financial market over the past few hundred years. They can be classified into two main data points: price and volume. This is a methodology of making judgments and projections of a particular vehicle's future prices based on projected historical data, therefore determining whether or not it is fit to enter the market. If yes, to Buy or to Sell; and if not, to plan for the right time to enter the market while preparing a sophisticated exit plan just in case the analysis is wrong. In a nutshell, the common belief that financial statements must be read is a myth. As stated in the chapter title above, a chart speaks for itself.

WHO is a Technical Analyst?

We often address a Technical Analyst as a Technician. He or she is a person who exploits past emotional responses of price movements – from price actions, trading volumes, price patterns, and charts relationships for future use. A mature technical analyst believes that price patterns will fail at times and result in losses, thus constantly seeking for and focusing on highly reliable patterns that traders all around the world are keeping an eye out for. With that said, a skilled or experienced technical analyst never seeks patterns that most retail traders all around the globe are looking for, but patterns that institutional traders are eyeing for instead.

HOW does Technical Analysis Work?

To perform a technical analysis, traders start with plain charts showing historical prices and volumes (shown in terms of trends and candlesticks) – the study of highs and lows, market opens and closes, and percentage changes of candlesticks. With the combination above showing the outcome of a trend – which can be divided into three types: uptrend (bullish), downtrend (bearish), and sideways (the bulls and bears are equally aggressive) – this gives us an idea of the market's future behaviour as a whole.

WHY does Technical Analysis Matter?

A technical analysis is based on the belief that past market cycles can forecast future trends of the market as a whole. Hence, if a trader correctly analyses the chart's "hint", there is a high possibility that he/she can make consistent positive returns from the market. Technical analysts are said to be risk-averse as they place heavy emphasis on the accuracy of entry points, the correct density of volumes, and evaluating the period of an exit plan.

Most traders tend to believe that in the early stages of trading, they should distinguish themselves to be either technical traders or fundamental traders. After moving on to the intermediate stages of trading, many believe that they are top-grade traders by combining both technical and fundamental analyses. However, there is no right or wrong in choosing to be a hybrid trader, or to be a technical or fundamental trader – which is to solely stand on one side of the aspect. But as far as precise entry points in the market are concerned, it can only be achieved through technical analysis.

Cons of Technical Analysis

Nothing is perfect. Every sharp and powerful weapon comes with disadvantages. Take a sniper rifle for example. It is able to shoot from extreme distances with 100% accuracy. But its downside is its heavy weight (inconvenient in terms of portability) and that it can be used only if the situation permits. Technical analysis too has its downsides but fortunately, the cons are clear and easy to read. As long as you know how to recognise them, technical analysis will give us a significant advantage in our journey ahead.

Lagging Signal

Some say trading requires nimble reactions. This concept is only partially correct as analyses can be done upfront while executions on trading can be made by setting pending orders (a pending order is an order that is waiting to be executed, thus it is still not considered an official trade. It can, for example, be an order that states that you do not want to buy before the price of a financial instrument reaches a certain point). However, the signals derived from technical analyses can be delayed. Putting aside the distance and time required for the information to reach your country, technical analysts require several signals formed together as a set, in order for them to decide whether or not to take the trade, often resulting in delayed entries. People often criticise the Dow's Theory too, which will be discussed further in the chapter below.

External Interference

Technical analysis is indeed quite a subjective field as different individuals see things differently. At a certain point, some traders may analyse a formation as a 'false breakout', while others may see it as a 'perfect breakout' (the topic 'breakout' will be further discussed later). Quick changes in schedules may have an adverse impact on trading results. For example, what is displayed on a chart may seem like a signal to enter the market. However, this information is something I would term ‘noise’, which is something that can only be cleared in a higher time frame. Thus, in a smaller time frame, this makes it difficult for traders to read signals with accuracy. Having said that, it is possible to increase its accuracy by upping the number of indicators used. However, it is not a panacea to improve accuracy because it reduces the number of entry signals to enter the market.

Signals Confusion

In some cases, one out of many technical analysis methods will indicate a buy signal while another shows a sell signal. These mixed signals will cause confusion and therefore affect decisions in trading. Most traders who fall under the second stage of trading (the stages of trading will be explained later) would start to become aware of this issue, thus applying a combination of technical indicators, chart patterns, trading volumes, moving averages, and even blend in fundamental analysis to better determine entry and exit points. As a matter of fact, as long as traders are able to identify when to deploy particular technical skills while foregoing others, the confusion can be cleared.

Controversial Conclusions

A glass half-filled with water may be seen as both half empty and half full. Using this as the baseline of perception, it accurately describes technical analysis as it is a static theory that can be used widely. However, some traders may have their own interpretation of an analysis, while others may interpret it the exact opposite way. What is interesting is that traders from both perceptions can argue their points of views with very logical explanations. With that said, this often causes traders with the initially right analysis to turn away from their actual motive and end up frustrating their own accounts. A technical analyst must understand that there is no analysis with 100% accuracy. Technical analysts' opinions may contradict one another's points of views, even if identical instruments are used for the analysis at the same time.

How to Integrate the Cons and Advance from there

The downside of technical analyses is that there is strong evidence suggesting that figures, data, information and postulates do not work accurately all the time. Indeed, all technical analysts see the same build of figures and the formation of chart patterns. But in the end, some may fail due to external factors such as the volume of trades, depth of the market, or institutional order flows that negate an accurate analysis. In a nutshell, theory often diverges from reality. Each and every tool has its own usage and characteristics, but does not work in every situation. As a mature technical analyst, our priority is to know which skills and tools are suitable to be used at particular times and places. With enough experience, investment in the in-depth study of the market, and continuous testing of different instruments, your optimal strategy can be born.

CHAPTER 2

HISTORY OF TECHNICAL ANALYSIS

Traditional Technical Analysis

Technical analysis is one of the oldest methods of analysing and forecasting charts with incomplete history records. Many historians believe that Japan is the place where these technical principles were founded, which is why the candlesticks we use today are commonly known as the "Japanese Candlesticks". Traders, as well as investors in the early days of Japan, applied technical analysis, particularly for the trading of silver.

Amsterdam-based merchant Joseph De La Vega's name appeared in the accounts of the Dutch financial markets in the 17th century. Apart from Japan, many other countries in the Asian region believed that technical analysis was developed by Homma Munehisa during the mid-18th century, as the people then started using technical charting tools. From the 1920s to 1930s, several books were published by Richard W. Schabacker, which carried on the efforts and legacy of William Peter Hamilton and Charles Dow. Then in 1948, Robert D. Edwards and John Magee published the ***Technical Analysis of Stock Trends (1948).*** The rules and knowledge from this book were widely applied in the stock market and were considered to be a seminal work of the industry. Technical traders all around the world have made it clear that classic trading methods, such as market trend analyses and chart patterns, are residues from this past.

Moreover, the industry bible, ***Technical Analysis,*** written by John Magee, noted that he was one of the very first people to make trades solely based on a chart's historical patterns. One thing I admire about him was his ability to achieve a state of congruence although he was applying everything from averages, trading volumes, market depth, to basically every other thing that could be graphed onto paper. He was able to identify possible patterns such as flags, triangles, heads, and shoulders that remain popular even today. Hats off to him for refusing to include fundamental news that could have possibly interfered or clashed with his trading signals. To me, he is the most disciplined technical analyst I know.

Modern Technical Analysis

Dow's Theory is said to be the most prominent advocate of technical analysis, reintroduced and recommended in the modern days of trading. Charles Dow (1851 – 1902) is considered by many to be the pillar of "modern" technical analysis. He also co-founded and acted as the editor of Dow Jones Industrial Index (stock index), and subsequently founded ***The Wall Street Journal***, a financial and business paper that is seen as the benchmark that all other financial papers are measured against. This all came after he published his book ***"Stock Market Theory and Practice and Technical Market Analysis".*** Other pioneers of technical analysis include Richard Wyckoff, Ralph Nelson Elliot and William Delbert Gann, who introduced their stipulated techniques for point-and-figure analysis after Charles Dow in the early 20th century.

I would like to give credit to Charles Dow who set the stage for technical analysis, as he recorded the importance of volumes (the highs and lows of the average daily trades) and how weekly and monthly candlesticks affect market movements, which also explain how some chart patterns could be used to predict future movements.

The fact that many historical characters explored markets of higher volatility using technical analysis proves the worth of the modern-era technical analysis. Today, this theory is like a concept or a core theory of applying movements in the past to project the future. For instance, on top of Dow's measurements, Hamilton added a few rules that he tailored to confirm railroad averages and the industrial average's direction. With that, he was able to predict the Great Depression in 1929, three days before it happened!

Overall, the advent of computers has contributed to the promotion of growth and advancement of technical tools, indicators, and exclusively designed software to aid market traders for better trading performances. This is unlike the early days, when traders were forced to plot prices and volumes on mahjong papers, deciding with that paper analysis whether to buy or sell, long or short.

Omissions in History

There is bound to be criticism in history like this. Ralph Nelson Elliot, William Delbert Gann, and Jesse Livermore were the few who first made technical analysis their top faith. But does anyone know how their stories end? (This is not criticism aimed at historical characters, but criticism towards human behaviour.)

Livermore died broke, Elliot was labelled a tweaking technical analyst whose theories were too difficult to apply and backtest, while Gann's theory was not conceptually useful. This begs the question – does a technical analyst's lack of success have any direct relationship with incompetence? The truth is that Livermore willingly spent his life studying technical analysis and achieved his life's highest self-realisation – trading.

"Your own self-realisation is the greatest service you can render the world."

– Ramana Maharshi

Is "tweaking" your analysis the correct thing to do? The right thing to consider should be rationalising the diversification of instruments to an easier and more understandable trading strategy. And what does it mean when we say that Gann's theory was not conceptually useful? What we should consider instead is the incompetency and inflexibility of traders to blend a "static" theory into a "constantly" changing market.

"There is no such thing as poor analysis, only inflexible traders."

– Siaw Jun Kit

The Bottom Line of History
Step into The Past, Back to The Future

Every time an investor (technical or fundamental) talks about getting into the market, exit plans, averages, and the concerns about yesterday's highs and lows, they are paying homage to the men mentioned above as they are the ones who laid the foundation and techniques we all use today.

CHAPTER 3

THE MYTHS OF TRADING

Just as Rome was not built in a day, trading is an art that cannot be mastered instantly. Beginners should be mindful that profits do not often come quickly, as even experienced traders fall into traps occasionally. In this chapter, I will discuss the 10 common traps that a trader might face, which I have termed the ***10 Myths of Trading.***

Ten Common Traps In Trading

1. ***Always look for the "better" or "best" strategy***

Let's start off with the first myth. It is not uncommon to see a trader **looking for the "better" or "best" strategy without mastering the basics.** Good traders do not look for shortcuts in their trading journey. While they know that being ambitious is a good thing, they recognise that mastering the basics is essential, as that will act as the foundation of even the best strategies. Without the basics, getting to the "best" trading strategy is just like asking a six-year-old to enrol in a university or a newborn to walk. It is simply not possible, not even for the geniuses of the world. Furthermore, as a trader becomes more experienced, he or she would know that there is no such thing as the "better" or "best" strategy, only capable and incapable trading.

2. ***Apply several systems at once***

The second myth is a trader's tendency to **apply several systems at once.** Traders would reach a bottleneck period where they have good knowledge of the field trading, but they are simply unable to see any returns (a further explanation on this type of trader will be discussed in the Chapter 7: 4 Stages/Levels of Traders). Out of desperation for profits, many traders would often try to apply several strategies in their trading plans, believing that this would increase the probability of a profitable trade.

This would usually turn out to be an ugly investment, as trades should always be kept simple by sticking to one or at most two systems at the same time in order to make a consistent profit.

3. ***Get-rich-quick scheme***

Apart from the first and second myths, it is common to see traders indulging in **get-rich-quick schemes without mastering the basics.** I do not wish to be overly harsh on people who believe in these schemes, but thinking that an investment is a means to make quick money is extremely unwise. Warren Buffet, one of the most celebrated investors and crowned the Sage of Omaha, only achieved his impressive returns after spending decades practising value investing.

4. ***Follow the herd***

The fourth myth is the tendency of traders to **follow the herd, without doing their own analyses.** Our investing community is made up of institutional investors (big banks, pension funds, etc.) and retail investors (the average Joes). It is unsurprising to see these retail investors act in herds and follow whatever the big guys are doing. This is something I do not enjoy seeing. Real traders do not copy what others are doing but instead, would attempt their best to conceive chart analyses on their own, honing their skills in the process. Always remember the saying, *"There is no free lunch in this world."* Following the herd will not make you a good trader.

5. ***Let the losers run, cut the winners***

The next myth I am going to discuss is something that even professional traders are sometimes guilty of – **staying too long, leaving too early.**

The Pareto Principle specifies that on many occasions, 80% of consequences come from 20% of the causes. In my opinion, only 5% of the trading community are outstanding, while the remaining 95% are just average Joes. Oftentimes, these average Joes overestimate themselves, leading to overconfidence in their judgment and precision in executing a trade. Consequently, they must pay the price of their overconfidence as they tend to hold on to losing positions, often leading to margin calls. Sometimes, knowing what you do not know is a blessing.

Furthermore, it is human nature to cut winners out and let losers run. Human greed prompts traders to hold on to their losses, with the hope that they would rise back up, leaving them exposed in the market for far too long. On the other hand, it is common to see traders close a winning trade too quickly for "peace of mind", freeing themselves from their fear of losing. In fact, once a trading plan is set and enough analyses are made up front, traders should stick to their stop loss level and take profit level, and let the market take care of everything else.

6. ***Over-diversification***

"Do not put all your eggs in one basket."

– *Warren Buffet*

I believe most of you have already come across this famous quote by the Sage of Omaha. I definitely acknowledge the importance of diversification to the success of a portfolio. But one must not overdo it.

Many traders frequently get too fixated on the above quote. They **consistently diversify their portfolio by trading in various instruments** in order to spread their risks. Many traders try too hard to trade in the Standard & Poor 500 Index (S&P500), gold, Brent Crude Oil, Australian Dollars (AUD), all at the same time! But in the event of a market crash, there is a high chance that this strategy will not work out.

The harsh reality is that naive diversifications do not always deliver the intended results, as diversification only works when a trader truly understands the correlations and inter-relationships between all instruments, and diversifies accordingly. Diversifying into another instrument with 100% positive correlation to the original instrument will not be much help unless you are using it for hedging purposes. Thus, it is imperative for novice traders to master one instrument before investing in another vehicle.

7. ***Frequent trading will translate to more profits***

Trading frequently means gaining more profit. Some traders might hold on to the belief that if they can get a hundred-dollar profit in one trade, they would be able to get a thousand-dollar profit if the same process is repeated 10 times. Although not entirely wrong, it is not correct either as more trades also mean more risks. Moreover, always remember that every time an order is placed, a trader must pay for commission, spread and brokerage charges. A trader certainly needs more profit to cover the initial costs sacrificed to the broker, bank or liquidity provider.

8. ***Over-reliance on the news, speculation can double up the account***

> *"If you start trading with very large positions, you will eventually be trading with no positions. But those who trade small can, through compounding, end up trading much larger positions than they imagine."*
>
> *– Danny Merkel*

Always remember that a trader and a speculator are totally different entities. Real traders can be risk-averse, risk neutral or risk takers, but they will never speculate on prices or heavily rely on the news. At most, they will just treat the news as references on whether or not to execute a trade, delay the execution, or exit the market earlier or later.

On the other hand, a speculator will **over-rely on the news and market sentiment, believing that their accounts would double up in no time.** From my experience, the survival rate of retail speculators is only a paltry 5%. The word “speculation” is specially created for institutional traders and retail traders who only speculate and will most likely receive a margin call.

9. ***Bias***

Many investment vehicles are highly volatile. However, no matter how volatile the vehicle is, traders must understand that an investment comes with risks and that there is no absolute guarantee that it will have a one-sided trend.

To be a successful trader, it is essential to get rid of any **bias** that you have, be it **for a particular instrument or for market sentiments as a whole** (for instance, the belief that the market will be on an indefinite uptrend). If a trader holds on to this kind of bias, they will only constantly seek Buy opportunities, even when there are fundamental data and analyses indicating that the trend will reverse.

Doing so would often cause a trader to miss out on a lot of opportunities, although with sheer luck, a lucrative positive gain could be in store if the trend is in favour of their predicted directions.

10. ***Trading without a system and a plan***

"We do not have to be smarter than the rest; we only have to be more disciplined than the rest."

– Warren Buffet

The quote above states that although trading is about hard work, it still would not pay without the presence of discipline. Discipline is the essence of a sophisticated trading plan and system that would prevent traders from going "wild" (this will be detailed later in the topic – Solutions to Overcome).

"Is it the right time to enter a trade? When is the right time to enter or exit? What is the best trading lot size? When should I hedge the account?" These all are important considerations to make before entering a trading position, which must be detailed in your trading plan.