

APPENDIX B

ART Basics

Here you will find the ART software basics so you can get started and determine whether the ART software matches your personality and trading style in order to give you an edge in the markets. In addition to this appendix, another essential resource complete with videos, free ART software trial information, current ART charts, and commentary can be found at the following link:

www.traderscoach.com/survivalguide.php

If you would like to take your understanding of ART to an even higher level, it's recommended that you purchase and study *The ART of Trading*, by Bennett McDowell (John Wiley & Sons, 2008). This manual has much more in-depth information on how to customize the ART software for your needs and has an extensive "Advanced Techniques" section of nine chapters, which in itself can advance your ART skills immensely.

THERE ARE FOUR ART SIGNALS

The ART signals can be used to create an infinite number of strategies and these signals can be combined for powerful entry, exit, and risk control approaches. No two traders use the ART system in exactly the same way. This is because the open architecture and flexibility of the system allows each trader to customize it to their own unique trading personality and style. The four ART signals are as follows:

Primary Pyramid Trading Point—P

The Primary Pyramid Trading Point is a trend identifier that keeps you in a trend long enough to maximize profits. Pyramid Trading Points look like triangles and indicate trend direction. Bullish entries are confirmed once prices meet trend definitions such as higher highs (key resistance) and higher lows (key support). Bearish entries are confirmed on lower lows (key resistance) and lower highs (key support). Volatility is determined by the velocity of the left-hand side of the triangle as compared to the velocity of the right-hand side of the triangle.

The point or *apex* of the triangle always shows you the direction of the trend and represents *resistance*. The *base leg*, or flat part of the triangle, always represents *support*. See Figure B1 and Figure B2.

Minor Pyramid Trading Point—MP

The Minor Pyramid Trading Point signal indicates only a correction in the primary trend (the primary trend is always identified by a Primary Pyramid Trading Point). So the Minor Pyramid Trading Point is used as a signal to scale into or scale out of a trend. It may also be used to scalp the market or to indicate the beginning of a change in trend.

ART One-Bar Reversal—1B

The One-Bar Reversal signal indicates market pivot points representing significant short-term tops and bottoms of market swings. ART Reversals are high-probability signals used for scalping, scaling out of trends, and scaling into trades, as well as for countertrend trading. You can use ART Reversals in a variety of ways to complement your trading style.

ART Two-Bar Reversal—2B

This signal is similar in meaning to the ART One-Bar Reversal but requires two price bars in the pattern to identify market swing pivot points.

ART SIGNALS HAVE LABELS AND ICONS

You will note that each ART signal has a unique label and icon to identify it on your chart (see Table B.1). The variations on how and when to use these four ART trading signals are unlimited. Your experience and beliefs will determine how you decide to mix and match these signals to create your own custom ART trading system. By studying the ART methodology you

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TABLE B.1 The ART Trading Signals

Signal Description	Label	Icon
Primary Pyramid Trading Point	P	Triangle ▲ or ▼
Minor Pyramid Trading Point	MP	Triangle ▲ or ▼
ART One-Bar Reversal	1B	Diamond ◆
ART Two-Bar Reversal	2B	Square ■

TABLE B.2 The ART Trading Signals (and Icons for TradeStation Users)

Signal Description	Label	Icon
Primary Pyramid Trading Point	P	Triangle ▲ or ▼
Minor Pyramid Trading Point	MP	Triangle ▲ or ▼
ART One-Bar Reversal	1B	Circle ●
ART Two-Bar Reversal	2B	Circle ●

will develop your own unique approach. Through paper trading, you will test your trading approach and discover what works best for you.

Note to TradeStation Users

The charts in this appendix were created using the eSignal platform and have slightly different icons than the TradeStation platform (the labels are the same). The only difference is that the ART Reversals have circle icons on the TradeStation chart instead of squares and diamonds. (See Table B.2.)

ART COLOR MEANINGS

The colors of each of the three ART studies enable you to quickly identify what the market is doing with each and every new price bar or candlestick. The three ART studies are: (1) Pyramid Trading Points; (2) ART color bars; and (3) ART reversals. There are default color meanings for the ART studies, but these defaults can be changed to suit your personal preference. The default color meanings of each of the three ART studies are as follows:

Color Meanings for Pyramid Trading Points

▲ = **Yellow up triangle** indicates a potential bullish Pyramid Trading Point (when voided it will disappear).

- ▼ = **Yellow down triangle** indicates a potential bearish Pyramid Trading Point (when voided it will disappear).
- ▲ = **Green up triangle** indicates a confirmed bullish Pyramid Trading Point.
- ▼ = **Red down triangle** indicates a confirmed bearish Pyramid Trading Point.

Color Meanings for ART Reversals

- ◆ = **Green diamond** indicates a bullish ART One-Bar Reversal.
- ◆ = **Red diamond** indicates a bearish ART One-Bar Reversal.
- ◆ = **Gray diamond** indicates a voided bullish or bearish ART One-Bar Reversal.
- = **Green square** indicates a bullish ART Two-Bar Reversal.
- = **Red square** indicates a bearish ART Two-Bar Reversal.
- = **Gray square** indicates a voided bullish or bearish ART Two-Bar Reversal.

Color Meanings for ART Charts

- **Yellow** indicates a preconfirmed or prevoided potential Pyramid Trading Point.
- **Green** indicates a bullish ART trading signal.
- **Red** indicates a bearish ART trading signal.
- **Gray** indicates a voided ART Reversal.
- **Black** indicates a neutral price bar.

Note: These are the default colors for the ART software system. You can change the defaults by referring to your *ART Trading Software User's Manual* and following the "User Input" instructions.

EXACT ENTRIES AND EXITS GIVE YOU STRUCTURE AND DISCIPLINE

Because Applied Reality Trading indicates exact entries and exits that are easily seen on your chart, you know at all times whether you should be in the market or out of the market. The ART signals enable you to avoid random trades and investments and help eliminate emotional trading and investing. You want to avoid emotional behavior since it leads to poor results.

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The ART signals allow you to trade and invest confidently. They lower your stress and anxiety, which allows you to remain calm and to make rational, objective, and sound decisions. We call this adding structure to your finances.

By adding structure, you can overcome psychological barriers that may be keeping you from attaining financial success. For example, those experiencing fear and emotional discomfort while trading and investing usually lack structure and/or confidence in their actions. ART not only deals with these issues but also enables you to reach higher levels of financial mastery.

Today, more than ever before, traders have an overwhelming amount of information available to absorb, analyze, and process. Too much market information can cause you unnecessary stress and can impair your judgment. By the time you absorb and process this excessive information, you may miss some fantastic opportunities. Keeping easily visible on your chart the signals that depict exact entries and exits, ART eliminates this information analysis paralysis.

PYRAMID TRADING POINT

A significant change in the market, represented by price action, is defined as a Pyramid Trading Point (PTP), which looks like a triangular Egyptian pyramid, hence the name. ART Reversal bars are commonly found at the apex (pointed peak) of a Pyramid Trading Point.

P = Primary Pyramid Trading Point

The Primary Pyramid Trading Point identifies the *primary* trend direction. It will appear on your chart with a P symbol near the base leg (flat base) of the triangle. A *confirmed* Primary PTP is formed when prices exceed the apex (pointed peak) of the triangle. When it is confirmed, it will appear as either red (for a downtrend) or green (for an uptrend). A potential Primary PTP will appear as the color yellow until it is confirmed.

This signal is important and can tell you trend direction, trend entry points, trend exit points, trend exhaustion, and how to behave in a bracketed market to avoid whipsaw drawdowns.

MP = Minor Pyramid Trading Point

The Minor Pyramid Trading Point is used to identify a trend *correction* or *reversal*. It does not identify a primary trend. It is often the first PTP that

forms in the opposite direction of the primary trend. It will appear on your chart with an MP symbol near the base leg (flat base) of the triangle. When it is confirmed, it will appear as either red (for a downtrend) or green (for an uptrend). A potential Minor PTP will appear as the color yellow until it is confirmed.

Important Note: A Minor PTP occurs only when prices have still not exceeded the base leg of the most recent Pyramid Trading Point of the primary trend. Its position in relation to *the most recent PTP of the primary trend* is what distinguishes it as minor instead of primary.

PTP = Pyramid Trading Point

We use the abbreviation PTP to refer to a Pyramid Trading Point in an effort to streamline the text.

Five Ways the Primary PTP Can Help You

1. Identify trend direction.
2. Select trend entry points.
3. Select trend exit points.
4. Determine trend exhaustion or key trend reversals.
5. Identify a bracketed market.

Five Ways the Minor PTP Can Help You

1. Identify market corrections and consolidations in primary trends.
2. Scale out of trends.
3. Countertrend trade.
4. Scalp trade.
5. Identify possible trend reversals.

POTENTIAL VERSUS CONFIRMED PYRAMID TRADING POINT

It's important to understand the difference between a *potential* and a *confirmed* PTP. A potential PTP will appear yellow on your chart and will not change color until it has been confirmed. Once the PTP has been confirmed, it will change color to either red for a bearish downtrend or green for a bullish uptrend. The definitions of potential PTP and confirmed PTP follow.

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- **Potential Pyramid Trading Point.** A potential PTP may occur when prices have not yet exceeded the pointed peak or apex of the triangle. A number of charts in this appendix show potential pyramids in a row; they will appear *yellow* on a live color chart generated by the software. The reason a pyramid is considered potential is because price activity has not yet broken beyond the apex of the triangle.
- **Confirmed Pyramid Trading Point.** When prices exceed the pointed peak or apex of the triangle, the pyramid will become confirmed and will appear *red* or *green* on a live color chart generated by the software.

The ART software will give you a voice alert (if you select this feature) only when the PTP has been confirmed. The value of watching your monitor to check for yellow potential PTP signals is that you will have a heads-up that a signal may be forming and you will have time to calculate your trade size prior to the signal confirmation.

Important Note: If the yellow PTP signal is voided (not confirmed), it will disappear from your chart. Another note is that sometimes in fast-moving markets a confirmed PTP signal will appear without warning (no yellow potential PTP). Once you have been using the software and are comfortable with it, this information will become second nature and you will respond automatically to the various changing signals.

PYRAMID TRADING POINT RULES FOR TREND ENTRIES AND EXITS

The ART software uses sophisticated algorithms to identify high-probability entries into and exits out of the market based on current price and volume activity. By using the Pyramid Trading Point signals, you can clearly identify entries and exits using the following information and the rules in Figure B.1 and Figure B.2. In Figure B.3 you can see how the ART software places bullish and bearish PTP signals on your chart so you can easily see the changing trend direction at all times.

Trend Entries

When drawn, a Pyramid Trading Point becomes confirmed only when prices exceed the apex of the Pyramid Trading Point, triggering the trade entry. Until the apex is exceeded, the Pyramid Trading Point is considered to be a potential Pyramid Trading Point and will remain yellow in color.

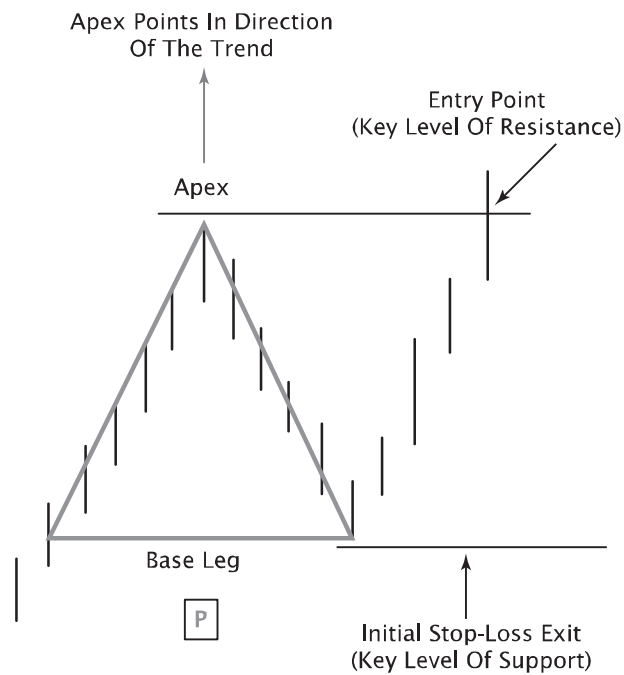


FIGURE B.1 Bullish Pyramid Trading Point Diagram
 Entry and exit rules: The apex always points in the direction of the trend; enter one tick above the apex; initial stop-loss exit is one tick below the base leg if the market goes against you.

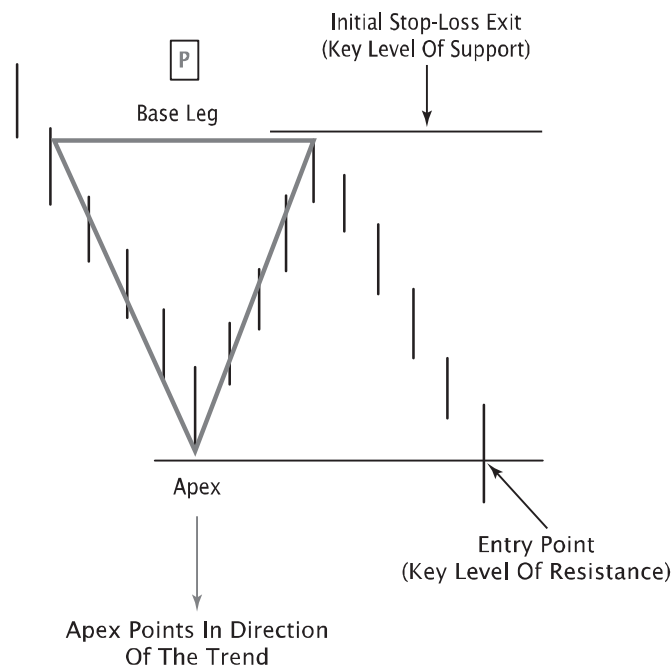


FIGURE B.2 Bearish Pyramid Trading Point Diagram
 Entry and exit rules: The apex always points in the direction of the trend; enter one tick below the apex; initial stop-loss exit is one tick above the base leg if the market goes against you.

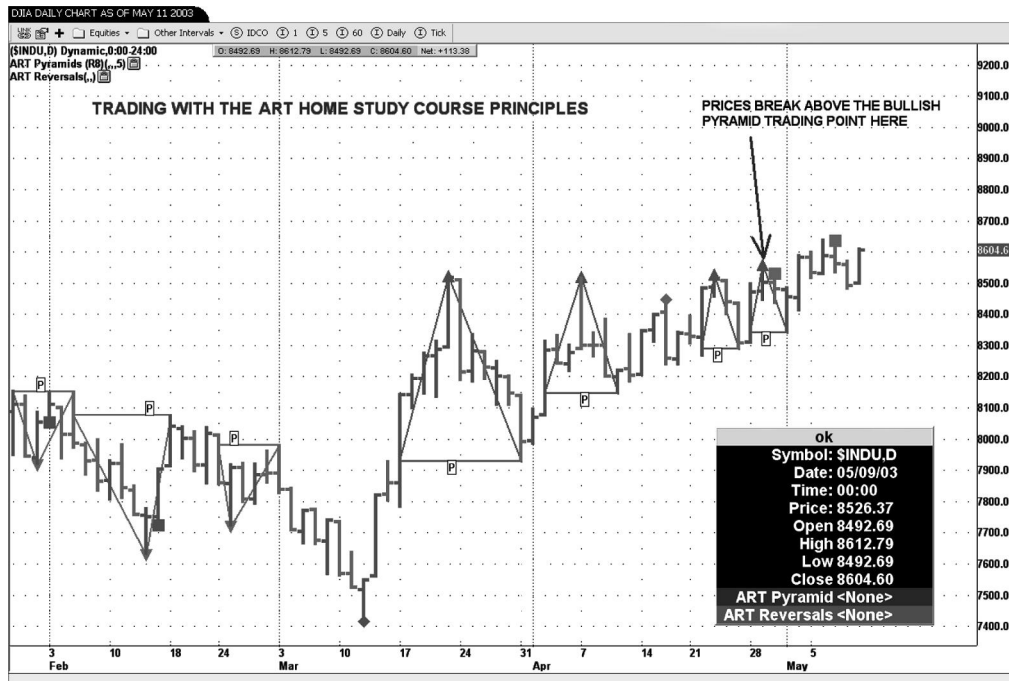


FIGURE B.3 Bullish and Bearish Pyramid Trading Points

This chart illustrates bullish (triangles pointing upward) and bearish (triangles pointing downward) Pyramid Trading Points. On a color chart the bullish PTP signals would be colored green and the bearish PTP signals would be colored red.

Source: eSignal (www.esignal.com).

When the apex of a primary Pyramid Trading Point is exceeded, this signals that a primary trend is in place. An entry signal is triggered when prices exceed the apex by one or two ticks. The logic behind this signal is that some new information has come into the market, causing prices to end their correction. This establishes the base leg of a Pyramid Trading Point. When prices move past the apex of the Pyramid Trading Point, this triggers your entry signal.

With a bullish Pyramid Trading Point (see Figure B.1), positive information has come into the market, causing prices to go higher and exceed the apex. With a bearish Pyramid Trading Point (see Figure B.2), negative information has come into the market, causing prices to go lower and below the apex. You do not care what the information is, because you know price action is a real truth and that is what triggers the ART entry signal.

Initial-Stop Trend Exits

Most trading systems use a moving average to determine an exit signal. Moving averages are usually derivatives of price and therefore do not

represent the true realities of the market. Furthermore, moving averages can be adjusted with variables such as simple versus compounded moving averages.

In contrast to the moving average approach, with Pyramid Trading Points you are trading with market realities. You will set your stop-loss exit at the base leg of the pyramid. An exit signal is generated if and when prices reverse one tick past the base leg.

If prices reverse and go against you by passing the Pyramid Trading Point base leg, then some new information has come into the market causing the reversal (see Figure B.1 and Figure B.2). We exit the trade based on price activity, which is a truth of the market.

Trailing-Stop Trend Exits

When a trend is going in your favor, you will want to lock in profits by moving your stop accordingly (see Figure B.4). This means that when you have a second PTP appear in the same direction as the trend you are currently in, you will want to move your stop from the base leg of the first PTP in

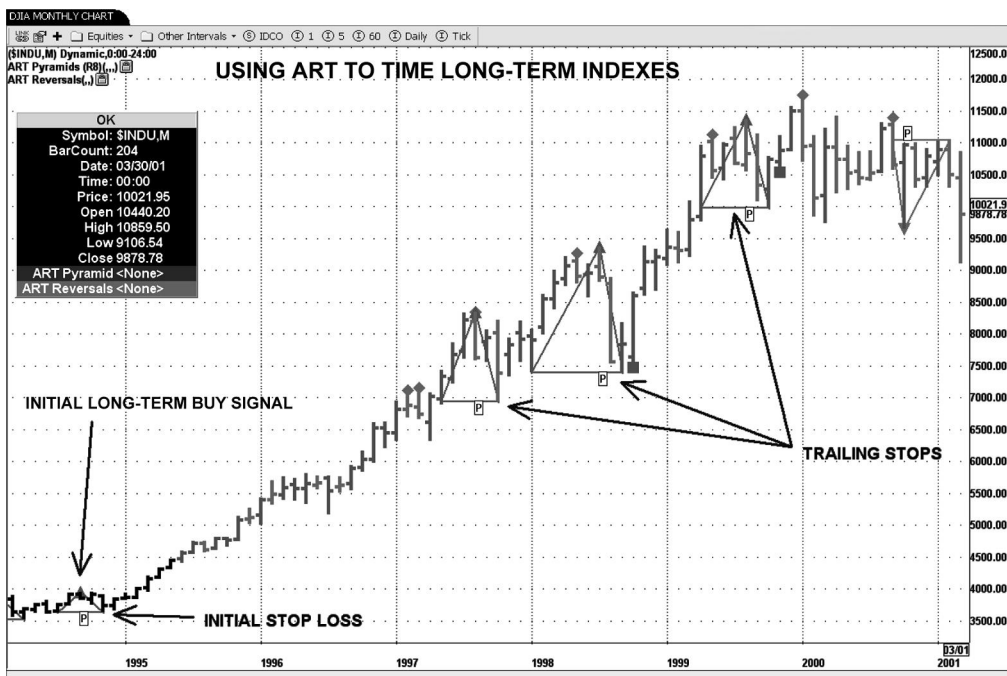


FIGURE B.4 Trailing Stops

The bullish Pyramid Trading Points clearly identify the uptrend and the levels at which to place specific trailing stops to lock in profits as the trend moves in your favor.

Source: eSignal (www.esignal.com).

the trend to the base leg of the second PTP in the trend. As additional PTP signals appear, you will want to repeat this trailing-stop method until the trend is exhausted or reverses.

Scaling-Out Trend Exits

A favorite technique of mine is scaling out of positions (see Figure B.5). When there is a sharp, fast, hyperbolic move in the direction of your trend, it is useful to lock in profit by taking a portion of your position off the table. This technique also reduces anxiety and any fears related to the possibility of the position turning against you. This approach makes it easier emotionally to leave the rest of your position on the table until you get stopped out.

You will need to lay out your personal rules for scaling out prior to initiating a live position to be sure that you do not emotionally bail out of your trend prematurely. One of the most common causes for low payoff

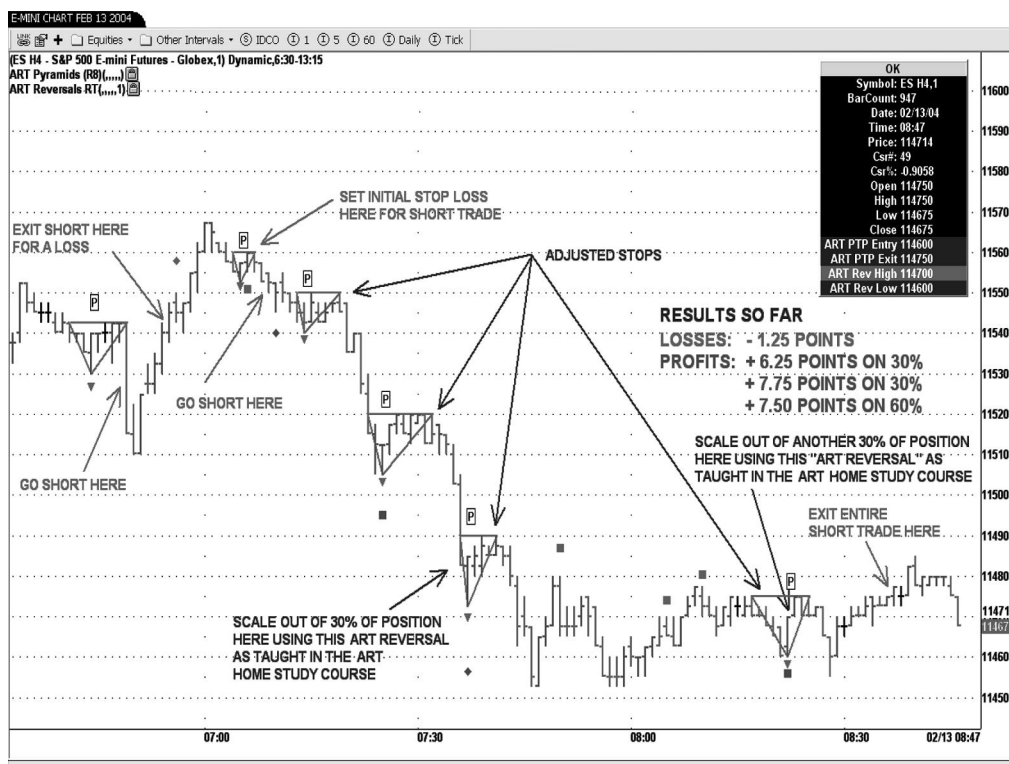


FIGURE B.5 Scaling Out of Positions with ART

Scaling out of a position locks in profit when the ART system tells you there is a high probability that the trend is nearing exhaustion. Generally a trend will reverse after four or five Primary PTP signals in the same direction.

Source: eSignal (www.esignal.com).

ratios is that the trader abandons trend positions before they reach their full profit potential.

With the ART software, some traders will use a signal like an ART Reversal bar or a Minor PTP combined with a significant move in their favor to signal scaling out of a position. For this method to be effective, you must have a large-enough position in play to make it work. For example, if you have three contracts on, you could scale out one contract easily and leave the remaining two contracts in play. If you have only one contract in play, you cannot effectively scale out.

MOMENTUM AND NEW INFORMATION

When a Pyramid Trading Point forms on your chart, momentum has changed, which causes the Pyramid Trading Point. Maybe a news-related item came out, or momentum in the existing trend just dried up. The next thing to realize about the Pyramid Trading Point is that if prices exceed a pivot, whether to the upside or the downside, some new information came into the market for traders and investors to feel differently. Maybe momentum has returned, or the smart money knows something we don't.

Whatever the reason, all we know is that the market is pushing prices beyond the old behavior that stopped it before. When this happens, we need to recognize that something is going on. This alone may be a reason to enter a position. Your reasons for entry into the market will be further strengthened with high volume.

PYRAMID TRADING POINT REQUIREMENTS

The minimum requirements for a bullish Pyramid Trading Point are two previous bars with higher highs and higher lows, and the following two bars of lower highs and lower lows. The minimum requirements for a bearish Pyramid Trading Point are two previous bars with lower highs and lower lows, and the following two bars of higher highs and higher lows. When prices pull back more than the minimum requirements, you can draw the base leg of the Pyramid Trading Point.

The ART trading software takes into consideration minimum Pyramid Trading Point requirements along with other momentum characteristics when identifying a Pyramid Trading Point. The ART software looks for the highest-probability Pyramid Trading Point and may pass on some even though they meet the minimum requirements.

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In most cases the ART charting software will draw a *yellow*-colored Pyramid Trading Point icon before the signal is confirmed so that you know its strength and have time to calculate your correct trade size.

IDENTIFYING TREND DIRECTION

The Pyramid Trading Point looks like a triangle when drawn on a chart. The apex of the triangle always points in the direction of the trend (either bullish or bearish). Using the Pyramid Trading Point makes trend trading easier. It is hard to miss the trend if you know how to properly use the Pyramid Trading Point. Figure B.6 shows you how the Pyramid Trading Point triangles point in the direction of the trend. The bearish Pyramid Trading Point points downward in the direction of the downtrend, and the bullish Pyramid Trading Point points upward in the direction of the uptrend.

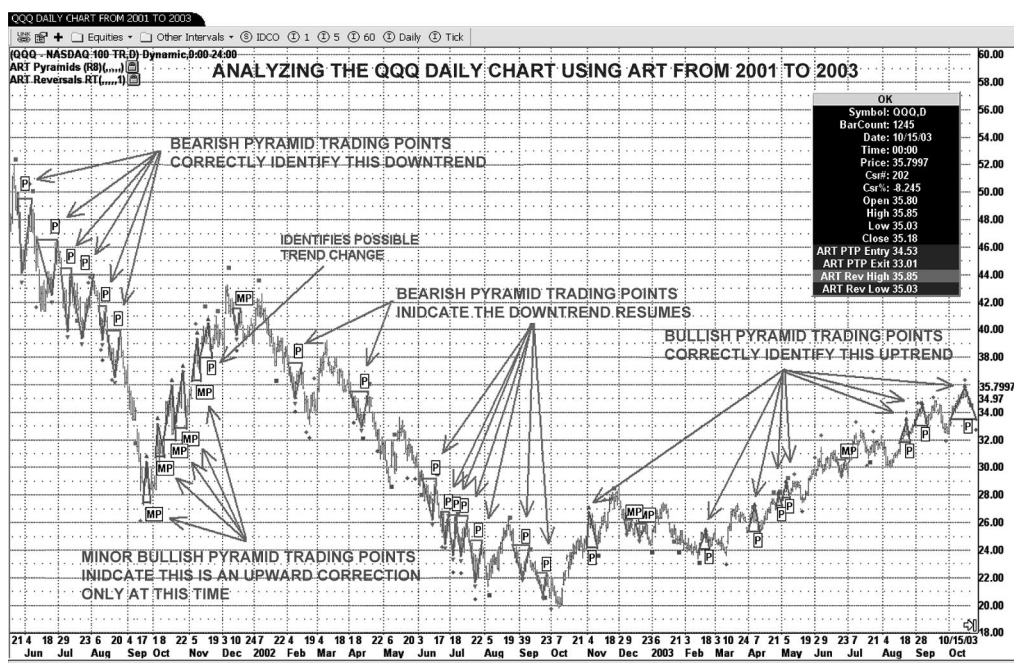


FIGURE B.6 Pyramid Trading Points Identify Trend Direction
 Note that the Primary PTP (P) signals identify primary trends, and the Minor PTP (MP) signals identify corrections in the trend or reversals in the trend.
 Source: eSignal (www.esignal.com).

IDENTIFYING TREND EXHAUSTION AND TREND REVERSALS

The Pyramid Trading Point can be used to gauge when a trend may exhaust itself. Most trends end after four, five, or six consecutive primary Pyramid Trading Points in the same direction, which indicate a mature trend nearing its end. On rare occasions, significant and exceptional trends may have eight or more consecutive Pyramid Trading Points in the same direction before the trend changes. The most significant trends occur when traders on other time frames are participating in the trend as well.

IDENTIFYING TREND CORRECTIONS USING THE MINOR PYRAMID TRADING POINT

Using the rules and definitions of a Minor Pyramid Trading Point, we can quickly distinguish between the primary trend and a minor trend correction. The Minor PTP is often the first Pyramid Trading Point that forms in the opposite direction of the primary trend.

Important Note: A Minor Pyramid Trading Point occurs when prices have still not exceeded the base leg of the most recent Pyramid Trading Point of the primary trend.

When looking at Figure B.7, we can see that there are two bullish MP Minor PTP signals. Neither of these signals is telling us that the trend has completely reversed; so far they are merely corrections of the trend. When we look at other factors on the chart, such as how mature the trend is, we can determine if it makes sense to scale out or exit the trend based on our personal rules.

When prices exceed the base leg of the most recent dominant-trend Pyramid Trading Point, then the next Pyramid Trading Point that occurs in the direction of the existing Minor Pyramid Trading Point will be considered a Primary Pyramid Trading Point.

IDENTIFYING BRACKETED MARKETS

There are times when a market will remain bracketed for an extended period of time and meander along sideways with no real direction. Significant trends occur when a market breaks out from a channel or bracket like this. That can be a terrific opportunity, and the Pyramid Trading Point can help you catch these significant trends emerging from bracketed markets. Figure B.8 illustrates a classic bracketed market with multiple yellow Pyramid Trading Points appearing in bullish and bearish positions side by side.

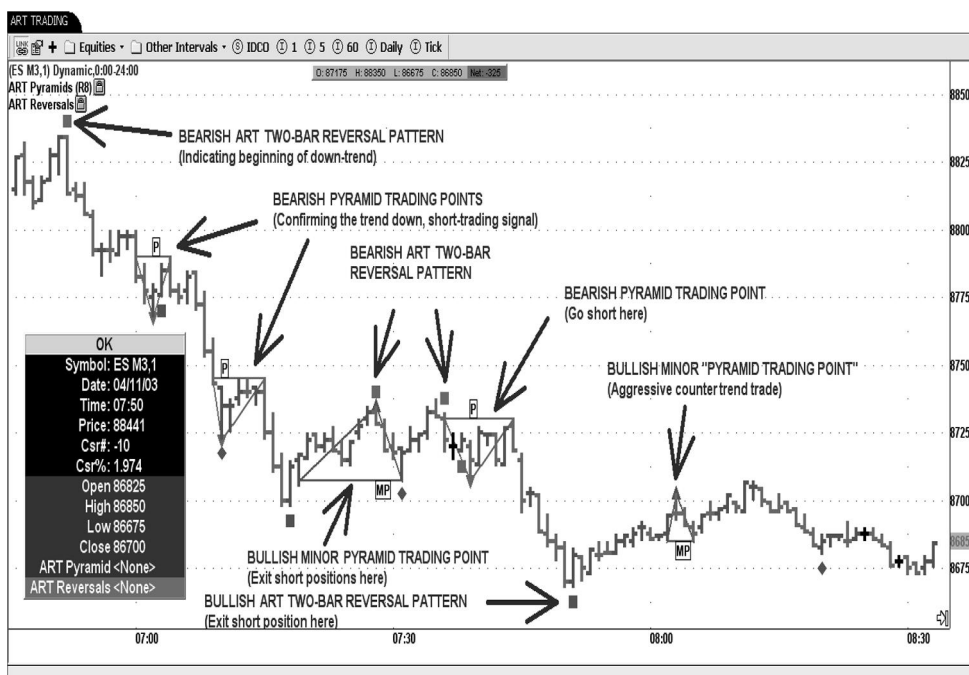


Figure B.7 Minor Pyramid Trading Points (MP) Identify Trend Corrections
 Source: eSignal (www.esignal.com).

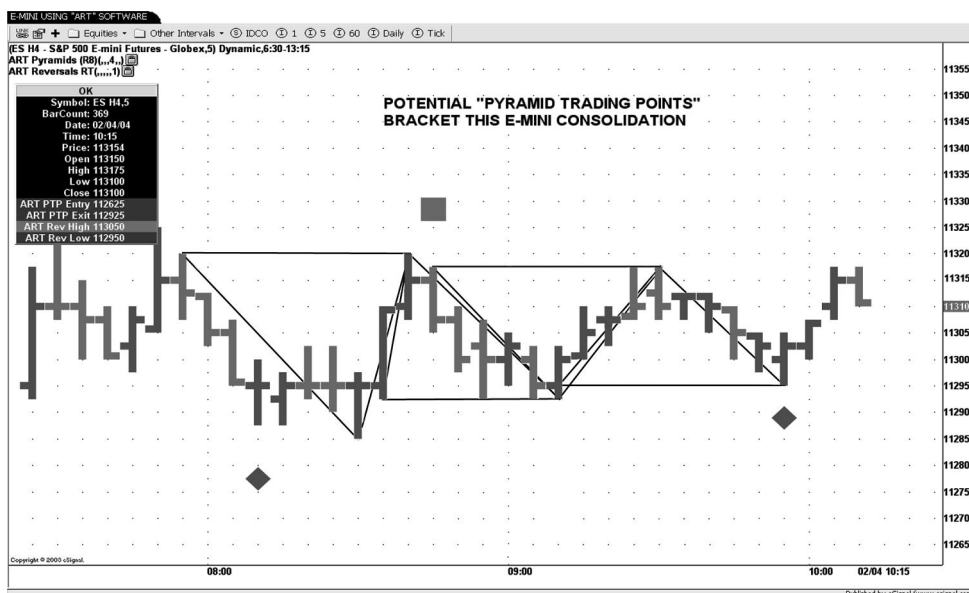


FIGURE B.8 ART Software Bracketing the E-Mini
 This chart shows multiple yellow potential Pyramid Trading Points side by side in a classic bracketed market being identified by the ART software.
 Source: eSignal (www.esignal.com).

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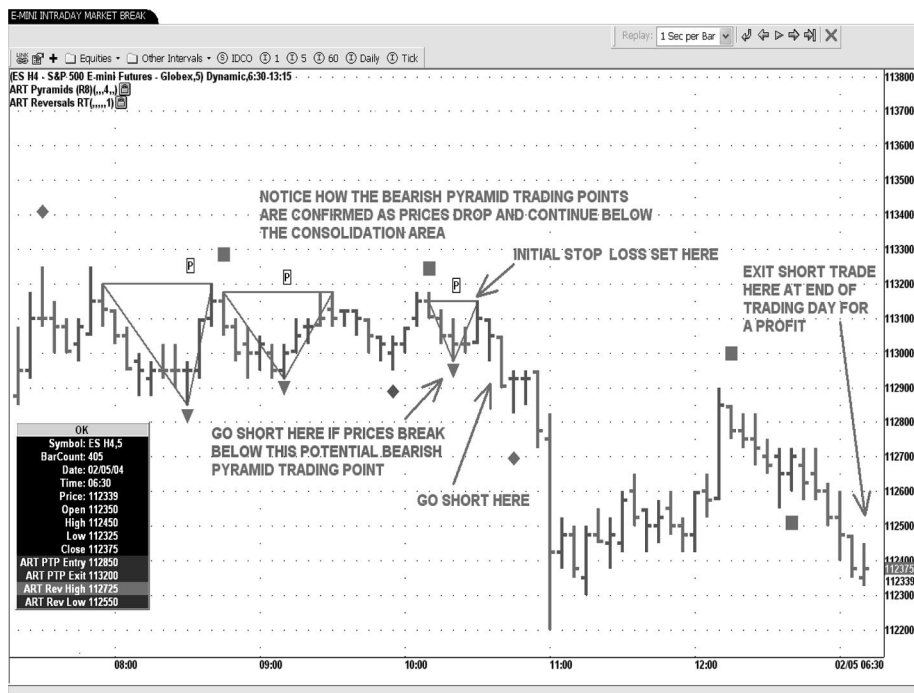


FIGURE B.9 ART Software Confirming Bearish Pyramids
When the bracketed market from Figure B.8 breaks to the downside, the bearish triangles are confirmed and turn red; the yellow bullish triangles disappear.
Source: eSignal (www.esignal.com).

When the market for Figure B.8 does break to the downside (see Figure B.9), the bullish yellow pyramids disappear and the bearish pyramids are confirmed (they turn red). This classic bracketed PTP pattern effectively prevents you from getting whipsawed by consolidating markets.

It is said that markets trend approximately 35 percent of the time, meaning that 65 percent of the time they are bracketed or trendless. It is common for inexperienced traders and investors to get whipsawed during these trendless periods, causing significant drawdowns. When you see this classic yellow pyramid pattern, it is important to recognize it as both a time to stay out of the market and also a time to be ready to jump in when the market does break in one direction or the other.

CUSTOMIZING THE ART SOFTWARE TO TAILOR IT TO YOUR TRADING NEEDS

The ART trading software has many features that can be adjusted to suit your needs and to suit changing market conditions such as market volatility.

You will want to refer to the *ART Trading Software User's Manual* that you download from the TradersCoach.com website to give you the step-by-step instructions on how to change the default settings that are set up in the software when you first receive it. Two of the most popular features are the MinScore and the Audio Technology.

Adjusting the MinScore for a Pyramid Trading Point

The MinScore is used to calculate the score of the conditions that make up the peaks and valleys used to identify the Pyramid Trading Point patterns. This is a numeric setting with a range of values from 1 to 8 (the default value is 5). This setting controls how well-formed the pyramids must be before they are selected as Pyramid Trading Points.

Increasing the MinScore value will cause the ART software to identify only the higher-scoring peaks and valleys. Under perfect conditions, with a MinScore value of 8 (the highest setting), the highs and lows of these bars would ascend smoothly up and down, as shown in Figure B.10.

Lowering this value will cause the ART Pyramid Trading Point system to identify lesser-scoring peaks and valleys (see Figure B.11). For example,

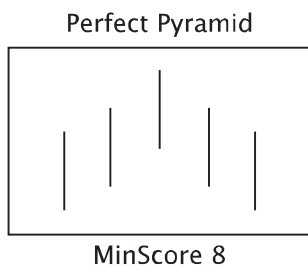


FIGURE B.10 Perfect Pyramid with a MinScore Setting of 8
This setting allows for the most selective pyramids with a higher probability for success than others with lower MinScores.

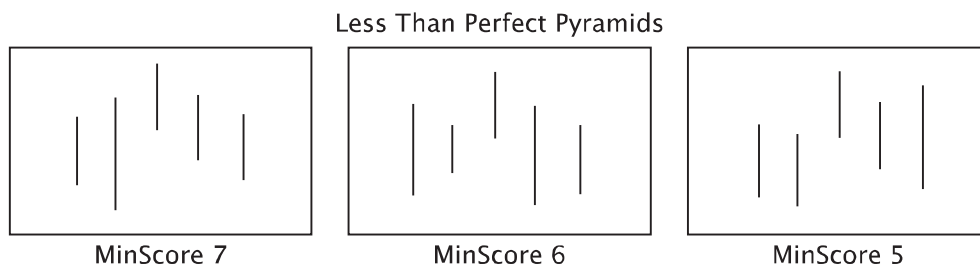


Figure B.11 Less Perfect Pyramids with MinScores of 7, 6, and 5
Notice how the shape of the pyramid gets progressively more ragged as the highs and lows fall out of line. These settings allow for less selective pyramids than a MinScore of 8 does.

setting the MinScore to 1 (the lowest setting) will result in Pyramid Trading Points being identified that are less constrictive in nature. Because these are lesser-scoring PTP signals, there will be more of them and they will have a lower probability of success than the higher-scoring MinScore PTP signals.

The MinScore setting controls the minimum score and therefore how well-formed a Pyramid Trading Point must be before it is selected by the software. A MinScore value of 1 is very tolerant and will allow many small pyramids to form with lower probabilities of success. MinScore values of 4, 5, or 6 seem to work best. Values of 7 and 8 are very selective. These lead to fewer pyramids but with higher probabilities of success.

Adjusting the Audio Technology for Your Pyramid Trading Point

One of the most popular features of the ART trading software is that you can set specific voices and tones to signal to you that there is a “Pyramid Trading Point entry now” or a “Pyramid Trading Point exit now.” You will actually hear either a man’s voice, a woman’s voice, or a tone that tells you when to enter and exit a trade.

The value of this feature is that you can multitask yet avoid missing important entries and exits, and you don’t need to constantly keep your eyes on the computer screen. This will reduce fatigue and stress for you. Refer to your *ART Trading Software User’s Manual* that you will download when you register your ART trial for instructions on how to adjust the audio features.

*****PRICE BARS AND VOLUME*****

In the pages that follow, you will learn that ART has a different definition of a bullish and bearish price bar than most systems do, and you’ll see how volume can have great meaning, depending on its intensity. These two truths combined give you the ultimate undistorted reality of the markets.

The First Market Truth Is Price

ART uses an open, high, low, close price bar. A price bar tells us what is going on between buyers and sellers. The current price bar tells us what the reality is now—not tomorrow, not yesterday, nor one minute ago.

Price bars not only tell us the price of the market we are looking at, but also tell more about who is in control in the market. An individual price bar can also indicate the possibility of a reversal in the trend. Comparing the current price bar with the previous one tells us how the market is doing now compared to one price bar ago.

New information coming into the market will cause traders to either buy or sell. This will cause the price to change. The outcome of that action is represented in the price bar. By comparing the current price bar to the previous price bar, we can see that this new information has had either a positive effect or a negative effect on price.

Either way, you are looking at how the market is responding to new information such as a news event. In the ART approach to price bar meaning, it is important to realize that ART determines whether a price bar is bullish or bearish by *where prices close* in relation to where prices have traveled on the price bar itself. Notice I did not say where prices open.

Color Meaning for ART Price Bars

- Bullish price bar = green.
- Neutral price bar = black.
- Bearish price bar = red.

Note: These are the default colors. You can change the defaults by referring to your *ART Trading Software User's Manual* and following the "User Input" instructions.

OHLC: Open, High, Low, and Close

Technical analysis is based on charts, and very often price bars are used on bar charts to indicate the current price action in the market. The anatomy of a price bar includes four important items, which are the:

1. Open.
2. High.
3. Low.
4. Close.

In just one simple price bar you can read all of this information at once. An acronym to describe this price bar information is OHLC. Look at Figure B.12 to see an example of how this information looks on a price bar.

ART Defines Price Bars Differently, It's All about the Close

These price bar rules are all programmed into the software, so you will not need to implement them manually. But we want to show you how the ART

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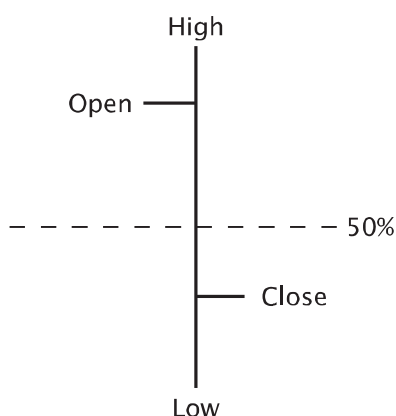


FIGURE B.12 OHLC Price Bar

This illustration of a typical price bar shows the open, high, low, and close of the time interval of the price bar. The acronym to describe this is OHLC.

software is interpreting market data in a unique way so you will have a better understanding of how ART is based on reality even on the price bar level.

- An **ART bullish price bar** is one *where prices close* on the upper half of the price bar.
- An **ART bearish price bar** is one *where prices close* on the lower half of the price bar.

Given that the definition of an ART price bar is different than other systems' price bar definitions, here are a few possibilities you should be aware of:

- It is possible to have a bearish price bar (by the ART definition) even though prices go higher than the previous price bar's close.
- It is possible to have a bearish price bar (by the ART definition) when the close is higher than the open on the same price bar.
- It is possible to have a bullish price bar (by the ART definition) even though prices go lower than the previous price bar's close.
- It is possible to have a bullish price bar (by the ART definition) when the close is lower than the open on the same price bar.

Remember: With ART a bullish or bearish price bar is determined based on where the *close* is in relation to the price bar interval (the distance between the price bar's high and low prices). If the open and close are both exactly at the 50 percent mark on the price bar, then the bar is neutral with little meaning except that the bulls and bears are in stalemate.

By evaluating the market's response to new information (by concentrating on the *close*) instead of evaluating the new information itself, you are tuned in to the reality of the marketplace. Don't look at the content of any news event—because the content is more information than you need.

ART Price Bar Definitions

How a price bar closes is an important truth we must be aware of. Here are seven examples of ART price bar definitions:

1. **Bullish—closing price at the very top of the price bar.** This means buyers are in control. (See Figure B.13.)



FIGURE B.13 Very Bullish Price Bars

2. **Bullish—closing price on the upper half of the price bar.** Buyers are in control, but not as much as when prices close at the very top of the price bar (the higher the closing price is the more bullish the bar is). (See Figure B.14.)

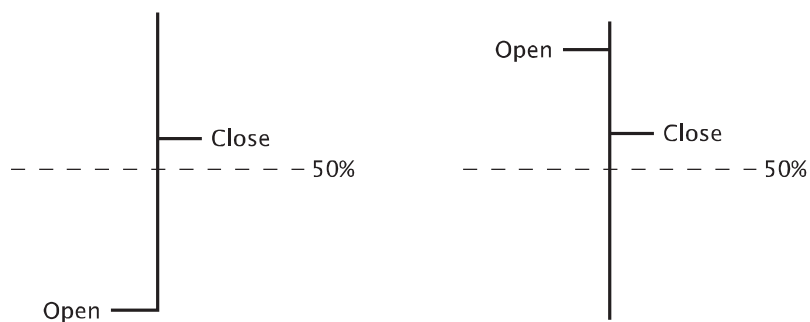


FIGURE B.14 Bullish Price Bars

3. **Bearish—closing price at the very low of the price bar.** This means sellers are in control. (See Figure B.15.)

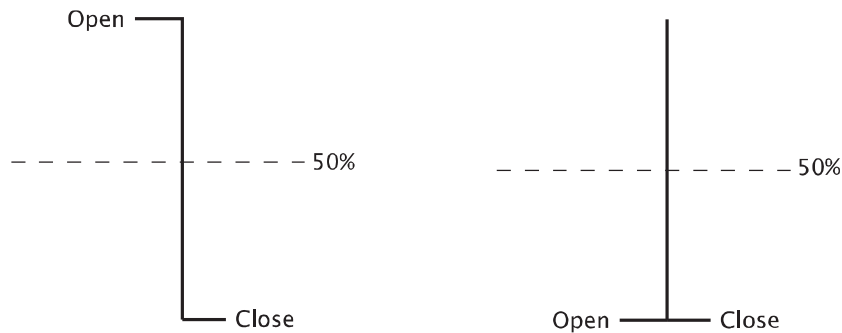


FIGURE B.15 Very Bearish Price Bars

4. **Bearish—closing price on the lower half of the price bar.** Sellers are in control, but not as much as when prices close at the very low of the price bar (the lower the closing price is the more bearish the bar is). (See Figure B.16.)

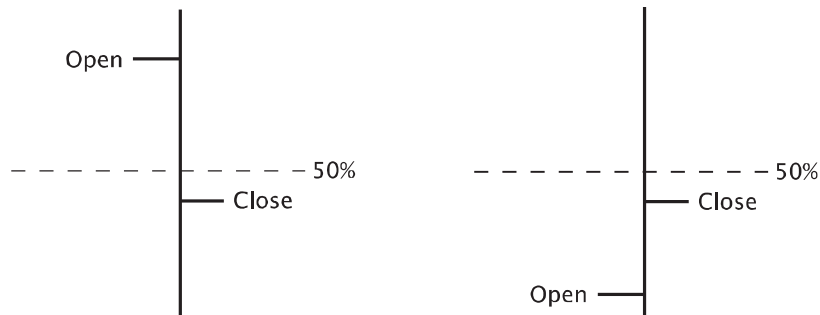


FIGURE B.16 Bearish Price Bars

5. **Bullish—closing price above the open of the price bar and at exactly the 50 percent mark on the price bar.** This means buyers are in control. (See Figure B.17.)

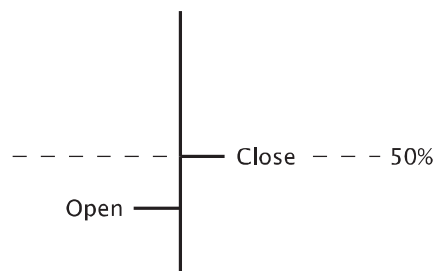


FIGURE B.17 Bullish Price Bar

- 6. Bearish**—closing price below the open of the price bar and at exactly the 50 percent mark on the price bar. This means sellers are in control. (See Figure B.18.)

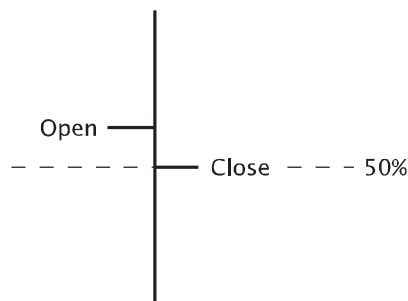


FIGURE B.18 Bearish Price Bar

- 7. Neutral**—closing price equal to the opening price and at exactly the 50 percent mark on the price bar. This means buyers and sellers are in a stalemate. (See Figure B.19.)

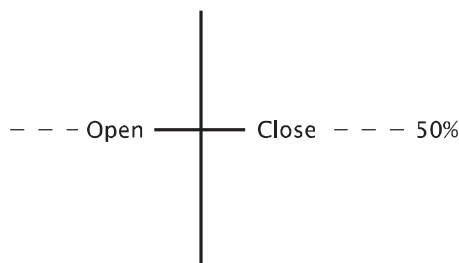


FIGURE B.19 Neutral Price Bar

Elongated Price Bars Represent High Emotion in the Market

A large price range, called an elongated price bar, has significant meaning (see Figure B.20). This type of price bar is *at least one-third longer* than the previous two to five price bars. These bars can signal the beginning or end of a trend. When you see an ART One-Bar Reversal that is elongated, it represents high emotions in the market between buyers and sellers and is one of the highest-probability ART One-Bar Reversal signals.

The Second Market Truth Is Volume

Volume is a market truth because it represents the number of trades (activity) in the current price bar. Like price, volume is not distorted; it is actual activity, a truth. Using volume along with price allows us to see what the



FIGURE B.20 Elongated Bullish ART One-Bar Reversal Forms on May 23, Signaling Beginning of Uptrend

Source: eSignal (www.eSignal.com).

market is saying. It is a powerful combination. Most indicators are derived from either volume or price. The problem is that indicators can be tweaked. And guess who does the tweaking? That's right, humans!

When a trader tries to tweak the variables of an indicator, the truth can be distorted. You may ask: Then why do they do it? One answer is that they are looking for the holy grail—the magic indicator that will solve all their trading problems and make trading a sure thing. The other reason is that the media have brainwashed traders into believing they must have these indicators to be successful.

One positive note about indicators is that once you realize that they are not the truth of the market and they can cause destructive opinions, they can be useful. Using indicators is an advanced technique, and if you would like to know more about how to use them in conjunction with the ART software, refer to the “Advanced Techniques” chapters in my book *The ART of Trading* (John Wiley & Sons, 2008). Remember, indicators are useful only if you are mentally tough enough to resist forming destructive opinions. Use indicators only as a confirmation and filtering tool. ART does not use indicators to forecast the market.

The Meaning of Volume

The meaning of volume is determined by its intensity. Here are two ways volume can have meaning.

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First, when volume is higher than the previous price bar, more traders are trading. This may be either bullish or bearish, depending on how the price is moving. The more volume a price bar has, the more significant it is. The more volume present, the less likely it is to have price manipulation from locals on the floor or market makers. An increase in volume usually means trades are coming in from outside the community of locals and market makers. This means that new information has entered the market, causing traders to increase volume.

Second, when volume is higher than the previous 20 price bars, this has great significance and means many traders are trading. New information has come into the market, causing traders to trade with increased activity. Prices have reached an emotional point, and traders are either panicking out of the market or trying to get into the market. It can also be a combination of fear and greed; the two groups of buyers and sellers cause high volume. This type of activity usually occurs around market tops or market bottoms. It can also occur during breakouts when buyers want to buy the market.

ART REVERSAL BARS

Now we're going to work on combining price bar information with volume information. By combining these two market truths, we can benefit from significant trading signals called ART Reversal bars.

The ART One-Bar Reversal (1B) and the ART Two-Bar Reversal (2B) can help you:

- Scale out of trends.
- Scale into trends.
- Scalp.
- Countertrend trade.

The ART One-Bar Reversal occurs at market tops and bottoms. It is often seen as an elongated price bar at the end of a runaway market trend. This is a strong signal with relatively low risk. Within five bars after entering the position, you will know whether it will be successful.

The ART software identifies all ART Reversal bars (both one-bar and two-bar patterns) and is designed to be flexible enough to accommodate your personal style. This flexibility allows you to set the ART Reversals to occur aggressively or conservatively. (See the *ART Trading Software User's Manual* that you downloaded from the TradersCoach.com website to learn how to optimize this software to your needs).

On-Screen Icons for ART Reversals

- ◆ = **Green diamond** indicates a bullish ART One-Bar Reversal.
- ◆ = **Red diamond** indicates a bearish ART One-Bar Reversal.
- ◆ = **Gray diamond** indicates a voided bullish or bearish ART One-Bar Reversal.
- = **Green square** indicates a bullish ART Two-Bar Reversal.
- = **Red square** indicates a bearish ART Two-Bar Reversal.
- = **Gray square** indicates a voided bullish or bearish ART Two-Bar Reversal.

Note: These are the default colors. You can change the defaults by referring to your *ART Trading Software User's Manual* and following the "User Input" instructions.

ART One-Bar Reversal Rules

Bullish ART 1B Rules

- The signal price bar is identified by a *green* icon on the chart.
- Go long on the next bar if prices go one tick above this ART One-Bar Reversal signal price bar.
- Set your initial stop-loss exit one tick below the low of the bullish ART One-Bar Reversal signal price bar.
- The signal is voided if prices on the next bars go below the ART One-Bar Reversal signal bar before going above it.

See Figure B.21.

Bearish ART 1B Rules

- The signal price bar is identified by a *red* icon on the chart.
- Go short on the next bar if prices go one tick below this ART One-Bar Reversal signal price bar.
- Set your initial stop-loss exit one tick above the high of the bearish ART One-Bar Reversal signal price bar.
- The signal is voided if prices on the next bars go above the ART One-Bar Reversal signal bar before going below it.

See Figure B.22.

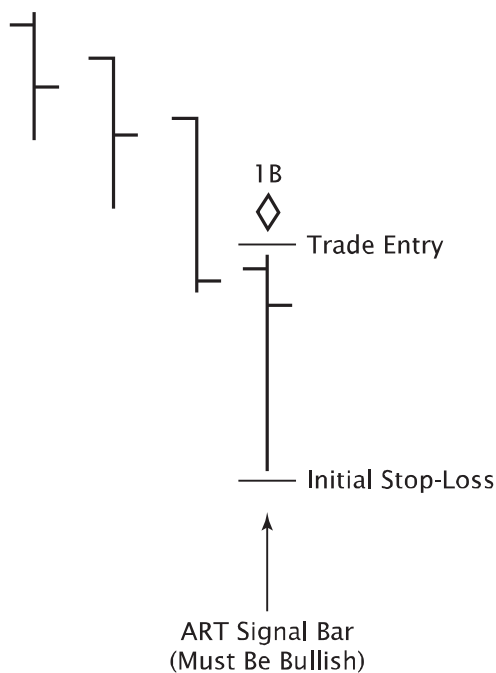


FIGURE B.21 Bullish ART One-Bar Reversal Diagram

Entry and exit rules: The bullish ART One-Bar Reversal signal price bar is identified by a green icon on the chart; go long on the next bar if prices go one tick above this ART One-Bar Reversal signal price bar; set your initial stop-loss exit one tick below the low of the bullish ART One-Bar Reversal signal price bar; the signal is voided if prices on the next bars go below the ART One-Bar Reversal signal bar before going above it.

Highest-Probability ART One-Bar Reversal

An elongated price bar and increasingly high volume combine for the highest-probability ART One-Bar Reversal.

An elongated price bar will be at least one-third longer than the previous three to five bars. Some reversals do occur on nonelongated price bars as long as the volume is high and the trend has been sharply in place. When you see an ART One-Bar Reversal that is elongated, it represents high emotions in the market between buyers and sellers. It is the highest-probability ART One-Bar Reversal signal, especially when combined with high volume.

If there is higher volume than the previous price bar's volume, that is a high-probability signal. Better yet, if there is higher volume than the previous two price bars, the signal is strengthened even more.

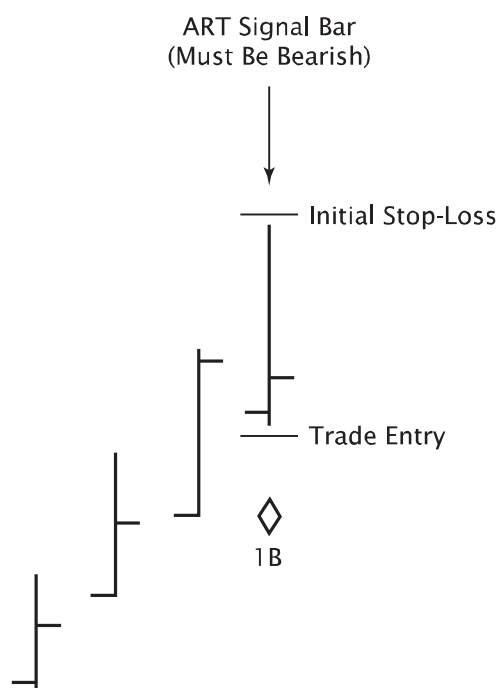


FIGURE B.22 Bearish ART One-Bar Reversal Diagram

Entry and exit rules: The bearish ART One-Bar Reversal signal price bar is identified by a red icon on the chart; go short on the next bar if prices go one tick below this ART One-Bar Reversal signal price bar; set your initial stop-loss exit one tick above the high of the bearish ART One-Bar Reversal signal price bar; the signal is voided if prices on the next bars go above the ART One-Bar Reversal signal bar before going below it.

Once you see an elongated price bar combined with increasingly high volume, you have a very high-probability ART One-Bar Reversal. Not all ART One-Bar Reversals are elongated, but when you see one that is, it is a high-probability trade signal.

The ART One-Bar Reversal signal becomes void if prices go one tick beyond the opposite side of the reversal bar before triggering the expected trade. If this happens, it indicates a possible trade in the other direction. Also, a new ART One-Bar Reversal cancels the previous ART Reversal price bar signal. As long as prices stay inside the highs and lows of the reversal bar, the signal(s) remain(s) valid.

What we will not know when trading this technique is whether the reversal will be a major change in trend or just a normal correction in the ongoing trend. You must accept this. Your personality will determine if and how you use this technique.

Three Methods of Monitoring an ART One-Bar Reversal Position

1. Trading as a possible beginning of a new trend in the opposite direction: Keep your stop in place until you have your first correction in the new trend. Once this new trend resumes and forms a new high, move your initial stop loss up one tick under the first pullback. Keep doing this until either you get stopped out or you see a sharp increase in the current trend. Then look for a reversal bar to get out, or get out and do a stop and reverse.

Figure B.23 illustrates examples of ART One- and Two-Bar Reversal signals on increasing volume along with adjusted stops. ART One- and Two-Bar Reversals are shown with square and diamond icons.

2. Trading as if this is a correction in the current trend and not a change in trend direction: Once you initiate a trade against the trend, keep your initial stop loss in place. Then look for an ART Reversal indicating that the correction is possibly over. If you are trading this as a correction, the best you should expect from the trade is that the correction will retrace the trend by 50 percent. So the idea is to take a quick profit.

Figure B.24 shows a bearish trend trade on an intraday chart with an exit at the end of the trading day. However, there is also a countertrend



FIGURE B.23 Using ART One- and Two-Bar Reversal Signals on Increasing Volume to Take Advantage of a Possible Change in Trend Direction

Source: eSignal (www.esignal.com).

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FIGURE B.24 Using ART Reversal Signals to Take Advantage of Countertrend Opportunities

Source: eSignal (www.esignal.com).

trade opportunity: the pullback in the downtrend as indicated by the bullish ART One-Bar Reversal occurring at approximately 12:30 P.M. on this one-minute E-mini S&P 500 chart.

This countertrend trade off that bullish ART One-Bar Reversal would have been at an approximate price of \$1,130.50. As prices rebound, you would not know whether the downtrend would continue, but the bearish Primary Pyramid Trading Point indicates the trend is still down. However, this rebound or countertrend movement of prices provides an excellent opportunity to countertrend trade using the bullish ART One-Bar Reversal. You could exit this countertrend trade when prices retrace 50 percent of the downtrend or wait until the next bearish ART signal indicating a possible resumption of the downtrend.

3. Trading as if this is a new trend in the opposite direction, but getting out if it appears to be just a correction in the current trend:

Once you initiate a trade against the trend, keep your initial stop loss in place. When prices move 50 percent against the trend, use a trailing stop on half your positions. If your stop is triggered, you then are long half your original size. Keep the stop for your remaining position



FIGURE B.25 Using the ART Trading Software to Take Advantage of a Change in Trend or a Correction
 Source: eSignal (www.esignal.com).

at the original stop-loss location. Either you now will get stopped out or a new trend will emerge. Then you can revert to placing stops in accordance with the trend.

Figure B.25 illustrates a change in trend using the ART charting software. Note the elongated bullish ART Reversal bar at the bottom of the trend. A bullish One-Bar Reversal signals a new uptrend on March 12.

ART Two-Bar Reversal Rules

Bullish ART 2B Rules

- The signal price bar is identified by a *green* icon.
- Go long on the next price bar if prices go one tick above the signal bar.
- Set your initial stop-loss exit one tick under the low of the first price bar in the bullish ART Two-Bar Reversal pattern.
- The signal is voided if prices on the next price bars go below the signal bar before going above it.

See Figure B.26.

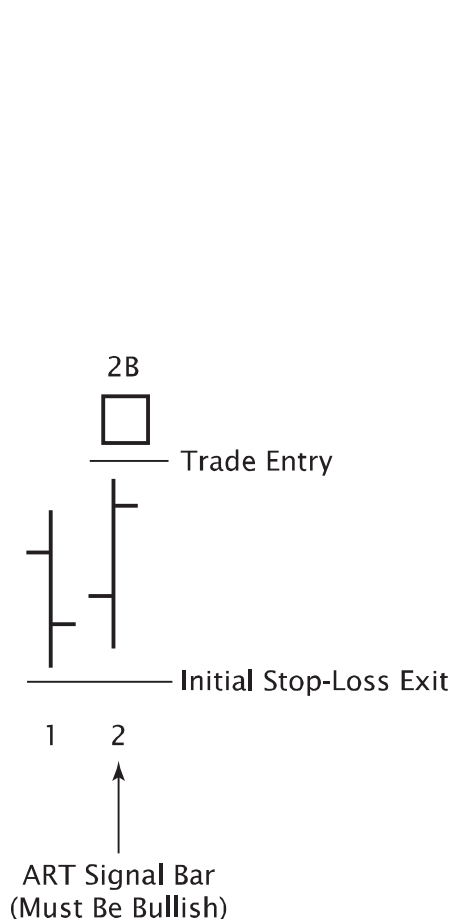


FIGURE B.26 Bullish ART Two-Bar Reversal Diagram

Entry and exit rules: The bullish ART Two-Bar Reversal signal bar is identified by a green icon; go long on the next price bar if prices go one tick above the signal bar; set your initial stop-loss exit one tick under the low of the first price bar in the bullish ART Two-Bar Reversal pattern; the signal is voided if prices on the next price bars go below the signal bar before going above it.

Bearish ART 2B Rules

- The signal price bar is identified by a *red* icon on the chart.
- Go short on the next price bar if prices go one tick below the signal bar.
- Set your initial stop-loss exit one tick above the high of the first price bar in the bearish ART Two-Bar Reversal pattern.
- The signal is voided if prices on the next price bars go above the signal bar before going below it.

See Figure B.27.

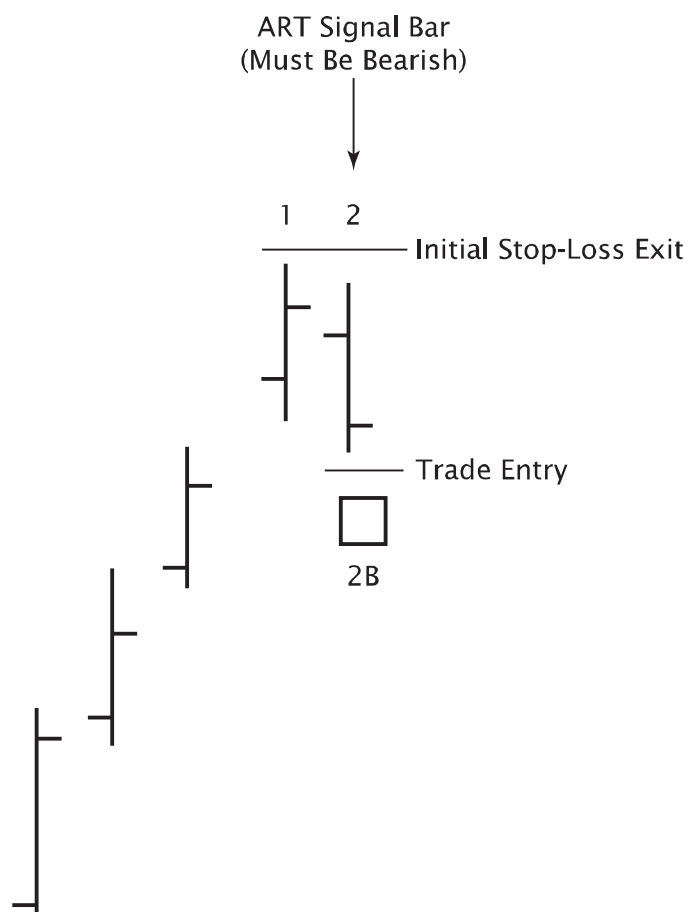


FIGURE B.27 Bearish ART Two-Bar Reversal Diagram

Entry and exit rules: The bearish ART Two-Bar Reversal signal bar is identified by a red icon; go short on the next price bar if prices go one tick below the signal bar; set your initial stop-loss one tick above the high of the first price bar in the bearish ART Two-Bar Reversal pattern; the signal is voided if prices on the next price bar go above the signal bar before going below it.

ART REVERSALS TELL YOU WHEN THE TREND ENDS

If trends don't end on an ART One-Bar Reversal bar, then they will usually end on an ART Two-Bar Reversal pattern. So, one way or another, we are going to have a high probability of spotting a potential change in trend from the ART Reversal signals. Because with the ART Two-Bar Reversal we are using two bars instead of one, volume may not be as high as the volume on other bars. This is why there is no volume minimum required

on this setup. If high volume is present, the ART Two-Bar Reversal patterns will have a significantly higher probability of success.

When intraday trading below the five-minute time frame, the ART Two-Bar Reversal pattern is more common than the ART One-Bar Reversal. In fast time frames like a one-minute chart, traders' reaction to new information coming into the market may take two price bars to represent itself. The ART Two-Bar Reversal catches this phenomenon.