ReadySetCrypto Futures Masterclass

Module Five: Defining Your Trading Strategy

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Defining Your Trading Strategy

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Introduction to Trading Strategies

What is a Trading Strategy? Investopedia defines it as: "*A trading strategy is method of buying and selling in markets that is based on predefined rules used to make trading decisions*."[1]

Let me add a little more color to their vanilla definition. Any trading strategy that you consider putting into play should contain:

Entry Rules

Entry Rules define WHEN and WHERE you would place an entry into the market. These will normally be keyed off of technical signals that your system provides. Depending on the timeframe that you trade, there can be a lot of inputs providing data at the same time. And some signals will be "filters" that prevent entries. Remember, it's not what you win, it's what you get to keep. And some entries will be identified ahead of time as "lower probability" ones.

Exit Rules

We'll get more into Risk Management in the next module, but we need to follow "Rule Number One" of risk management by identifying the exit BEFORE we enter the position. By doing this, we identify the reward AND the risk, so we can determine if the trade makes sense to initiate.

"Exits" refer to both a positive "take profit" exit, as well as a negative "stop loss."

Risk Management/Position Sizing

This is where your exit rules can dovetail into your risk management/position size settings, because you might identify a specific price level to set a "stop loss" at. Can you afford that stop loss with the position size that you are intending to use?

The rest of this text will be dedicated to showing a potential trading strategy using the Fractal Energy Trading methodology, specifically using the RSI Laguerre indicator available on TradingView. (Please see program Addendum for more detail on that study, and see the Fractal Energy Trading Masterclass for more specific detail

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1 https://www.investopedia.com/terms/t/trading-strategy.asp

A Fractal Energy Intraday System With the RSILg

This module will get right to the heart of the matter without much background at all. Again, for the background for this strategy, I will assume that you have gone through the entire Fractal Energy Masterclass, otherwise this one module alone would be 100 pages.

First of all, let's cover the main principles that we want to design into the strategy.

Choose Your Fractal Time Series Array

If you are new to trading more than one timeframe, you'll probably want to simplify things and go with a two-timeframe array, such as Figure 1

Figure 1

If you do the math, you'll see that the 5 hour chart is actually 25 times "larger" than a 12 minute chart. This "factor of five" relationship is part of Fractal Energy Trading.

Those that can handle a little more complexity will want to add a third timeframe, and include the 5x chart, like in Figure 2:

Figure 2

Do yourself a favor and start with the two-timeframe array first, before you add more complexity with the three-timeframe array. The three-timeframe array is technically more accurate, however can induce confusion because there are 50% more things to watch for the setup.

Trade In the Direction of the Anchor Chart Swing

We must pick an "anchor" timeframe and trade in the direction of the current price "swing," if not the overall anchor trend. Our goal is to just coast downstream without any effort, by identifying the direction of the "current" and putting in upstream of our destination. In Figures 1 and 2 the Anchor chart was the 25x 5-hour chart. Figure 3 shows a potential 5-hour timeframe anchor chart, with trends (larger arrow) built from smaller swings.

Figure 3

Note that during the large "red arrow" downtrend, the better "swings" to play inside were the bearish ones. We could play the bullish upswings, during the downtrend, but they tended to arrest themselves quickly. And during the larger "green arrow" uptrend, the better swings to trade inside were the bullish swings, not the pullbacks. You can improve your probability of success by trading not only with the Anchor chart swings, but also those swings that align with the larger TREND.

[Trade in the Direction of Anchor Momentum]

The RSI Laguerre study (light blue or cyan line) is meant to be used as the 1x Trigger Signal (which we'll cover in a minute) but is also used as a filter in the 25x and 5x Anchor charts by signifying the momentum of those anchor trends.

We want to be trading in the direction of the Anchor Momentum as well.

So not only in the direction of the Anchor Chart Swing….and Anchor Chart Trend….but also the MOMENTUM of the Anchor Chart.

Figure 4 below shows the 25x Anchor chart modified with the "LRSI: Coloring?" Option checked, which shows positive momentum=green and negative momentum=red.

Figure 4

If you are looking for a long trade entry, you would want both 25x and 5x momentum to be positive, either reflected by a positive slope on the cyan RSI line, or enabling the coloring to show it green.

An RSI that gets into the “overbought” zone above 80 can still support a long trade, just like an RSI value that goes into the oversold zone below 20 can still support a short entry. Keep in mind that you are likely not taking the very first possible entry, however, so the chances of reversal and/or failure are higher.

Do the Anchor Energy Levels Support the Entry?

Similar to the point raised above, a common error of newer traders is waiting too long to enter a new trend/swing, and instead waiting for the entry to “feel good.” This means that the energy available on that anchor swing has burned down somewhat, and you’re dealing with a limited resource. Trends cannot go forever, and typically reverse as they hit exhaustion on that timeframe.

We’ll talk more about this concept when we cover the “mindset” topics in module nine.

I will typically insist that an anchor chart have at least a value of “40” on the 25x anchor chart, and a minimum value of “45” on the 5x chart before I can consider an entry on the 1x chart. This is another example of a “filter.”

Use the 1x RSI Hook to Signal Entry

The most basic form of entry (once I verify that anchor charts are supporting the trade) is to look for a “hook” entry. This would be the RSI line “hooking” up (for a long) above the 20 level, and showing a hook alert, as in Figure 5 below.

Figure 5

The nature of the RSI Laguerre study itself will be very fast hooks that come flying out of the oversold zone, for example, for a long setup like this.

Entry Rules for the Fractal Array RSI Laguerre System

This is a very simplified list of entry rules, using the concepts outlined above.

Long Trade Entry Rules

- [ ] The 25x chart should be in an uptrend
- [ ] The 25x RSI should be showing positive momentum
- [ ] The 25x chart should be showing a price upswing
- [ ] The 25x chart should have a minimum energy level of 40
- [ ] The 5x chart should be showing positive momentum
- [ ] The 5x chart should have a minimum energy level of 45
- [ ] Enter the 1x chart positive RSI hook

Short Trade Entry Rules

- [ ] The 25x chart should be in a downtrend
- [ ] The 25x RSI should be showing negative momentum
- [ ] The 25x chart should be showing a negative downswing
- [ ] The 25x chart should have a minimum energy level of 40
- [ ] The 5x chart should be showing negative momentum
- [ ] The 5x chart should have a minimum energy level of 45
- [ ] Enter the 1x chart negative RSI hook

Again, these lists are just a skeleton to frame your own set of rules around.

Exit Rules for the RSI Laguerre Fractal Array System

Concerning our "exit" of the trade, we have to concern ourselves with the two directions that price could go.

The Stop Loss Exit

This exit produces a losing trade, however we should not think of this as necessarily a bad thing. It's your job as a Trade Manager to limit the risk to your account. Many an account has been blown because the trader pulled the stop loss at the last second, refusing to accept a loss ,and instead created a much bigger one. We will dive a little deeper into the "risk management" topic in the next module.

In all cases, however, the stop loss must be identified on the trade BEFORE the trade is entered. It cannot be determined "on the fly." (This is to say that it CAN be determined on the fly, but is a very bad practice that will almost certainly lead to capital destruction)

As far as where to place the stop loss on any trade? That's going to depend on several things, such as:

- Current daily range and volatility of the asset that you're trading
- Account size
- Position size
- Leverage amount
- Technical support or resistance levels

If you don't know where to begin, then a very simple way to start out is to determine the average daily range of the currency that you're trading, and divide that by 10. That will allow you to set a stop, as well as determine the position size to ensure that it does not exceed a 2% account risk.

Be careful of using actual "stop" entries with these instruments. The idea is that a "stop" order is there to protect your account in case of the price nearing that level, but be aware that a stop order is a "market" order as well, and the "market" price is whatever the broker says that it is for that millisecond of time. It might be very different from what the chart says it is. I use stop loss order without fear in highly liquid, actively-traded markets like the NASDAQ futures, but have had varied results using some of the synthetic futures products in the crypto space.

The “Take Profit” Exit

This is the “good” side of a trade result. We entered a trade, the price is going in the forecasted direction, and we need to determine when/where we will close the trade and book profits.

Like the stop loss, this level must be determined ahead of time.

Some will argue this point, saying that you should let winners run, and there is some truth to that, but I believe that it all depends on your strategy. If you are running a trend-trading strategy, then yes you need to let winners run as far as possible. But when you are day-trading futures and don’t want to get hit with an overnight hold fee, your entire goal is to get in, get your fair share, and get OUT while you can, with a profit.

There is no more devastating, demoralizing thing to occur in markets than to let a winning trade turn into a loser due to trade mis-management.

The general rule for “take profit” exits is that they should be at some multiple of what your Stop Loss is. A typical figure that you’ll hear is 3:1. This means that your stop loss would be set for a $50 loss, for example, yet your profit goal is $150.

Yet I believe that many beginning futures traders will have a really difficult time accomplishing that feat, due to the pullbacks inherent in a single price swing. Imagine entering a trade, watching it go towards your target, then pull all the way back to put your position underwater…..before finally rallying hard to get up and past your target.

Most newer traders would pull the plug right as the position goes back to break-even. Your result for the trade is zip, and you get to watch in frustration as the price goes back up without you on board.

This is why I believe that trading is a journey, and you need to build up the skill that requires you to set more and more aggressive profit targets as your experience grows.

And one thing that will help is multiple contracts. Being able to “peel off” parts of the position as intermediate goals are reached will have a huge impact, allowing you to get into a “risk-off” position where you cannot lose money, because some of the profits have already been booked, and the remaining stop loss has been moved to guard against loss.

So when you’re new, learning to trade, don’t be afraid of taking quick profits that might be less than your stop loss risk. After all, your goal is not necessarily to learn to make money at this point. Your goal is to begin the process of learning to trade, finding edge, and managing risk.

Summary - The Fractal Array Strategy with RSI Laguerre

Before I summarize let me make the obvious point that you do NOT necessarily need to be using a strategy based on the Fractal Array with the RSI Laguerre study; perhaps you are more comfortable with a single timeframe five minute study based on moving averages and oscillators and the MACD. Whatever you believe in is what you should use, as long as the numbers support your use of that system as based on your Module Three framework.

I have used the Fractal Framework for well over a decade and find it to be the most adaptive, accurate chart analysis possible for my needs; this is why I'm sharing it in this module. But as I've said so many times, it has to resonate with YOU before you can use it. Use a system that speaks to you.

We saw in this module that many of the entry rules were based on a combination of "triggers" as well as "filters." A trigger was like another green light, and a filter was a possible red light until cleared. In the end, you're just trying to float downstream on the current of the trend. A trend is usually fairly persistent and we want to utilize that characteristic until it reverses and starts to trend in the opposite direction. You might have heard the rhyme, "A trend is your friend" which is true, of course, "until it ends."

Experiment with your own version of this strategy. Use different combinations of timeframes that suit your eye; we talked about this in module four with your "niche." And don't forget that markets often change their stripes, meaning that the timeframe combination that works for you today might be too fast or too slow when conditions change.

Homework and Next Steps

Please complete the following tasks before moving to the next module:

- [ ] Watch the associated video for this module.
- [ ] Take the module quiz
- [ ] Determine your Fractal Array: 25x/1x or 25x/5x/1x
- [ ] Create your chart workspace and save it as a Chart Layout
- [ ] Write down all of your entry rules.
- [ ] Learn to start to walk through these trades by eye first until you know exactly what you are looking for, at which point you can start your first stage in your plan.