ReadySetCrypto Futures Masterclass

Module Seven: Adjusting to Volatility

Module Seven
Adjusting to Volatility

By Doc Severson

• We Are Not Financial Advisors or a Broker/Dealer: Neither ReadySetCrypto® nor any of its officers, employees, representatives, agents, or independent contractors are, in such capacities, licensed financial advisors, registered investment advisers, or registered broker-dealers. ReadySetCrypto ® does not provide investment or financial advice or make investment recommendations, nor is it in the business of transacting trades, nor does it direct client commodity accounts or give commodity trading advice tailored to any particular client's situation. Nothing contained in this communication constitutes a solicitation, recommendation, promotion, endorsement, or offer by ReadySetCrypto ® of any particular security, transaction, or investment.

• Securities Used as Examples: The security used in this example is used for illustrative purposes only. ReadySetCrypto ® is not recommending that you buy or sell this security. Past performance shown in examples may not be indicative of future performance.

• All information provided are for educational purposes only and does not imply, express, or guarantee future returns. Past performance shown in examples may not be indicative of future performance.

• Investing Risk: Trading securities can involve high risk and the loss of any funds invested. Investment information provided may not be appropriate for all investors and is provided without respect to individual investor financial sophistication, financial situation, investing time horizon, or risk tolerance.

•Cryptocurrency Trading Risk: crypto trading is generally more complex than stock trading and may not be suitable for some investors. Margin strategies can result in the loss of more than the original amount invested.

Table of Contents

Introduction to Dynamic Volatility

It might surprise you to learn that any financial market sheds its skin and changes quite frequently, not only in the direction that it moves, but also the “character” of the price action as well as just the overall volatility and the manner in which price changes are made. Not only do we see this with the major coins in the market, such as Bitcoin…but by extension we see this behavior with nearly every asset in the crypto space.

It’s little wonder why so many investors are frustrated, as the strategies and analysis techniques that they just learned…no longer work just months later!

That’s the purpose of this module, to show you 1) how to “read between the lines” and understand when/how markets are changing, and 2) how we can adapt those changes to strategies that we might use. This is why I love using analysis techniques that are based on “price,” because they will never NOT work!

I see this “herd” cycle over and over again. The market adopts a certain “character” or style of movement, and smart traders adapt to it quickly, and pull profits from it over and over again as the investing “herd” is slow to adapt and wonders why the OLD system that they bought last year no longer works. Slowly, their consciousness becomes aware of these “smart guys” that are making money with a new system so they find someone that they can learn from, and invest the time to learn it. And pretty much as soon as they start to play live capital with this new system, the market shifts character again and the cycle repeats.

It’s not their fault, however no one really told them that things change all the time in markets. Most of us live our lives in stasis; traffic laws don’t change, a cheeseburger in 2019 will taste the same as one from 1972, there’s still 90 feet of distance between home plate and first base, and 60 minutes in an hour. We also assume that market price movement will remain the same next year as this year.

Well, I hate to be the one to break it to you but things will ALWAYS be changing with the crypto market, so I’m going to use this material to show you some things that you need to be aware of to spot these changes early on in the process….and then show you how we can alter our trading plan to make the best use of these changes.

The Trap of Current Performance

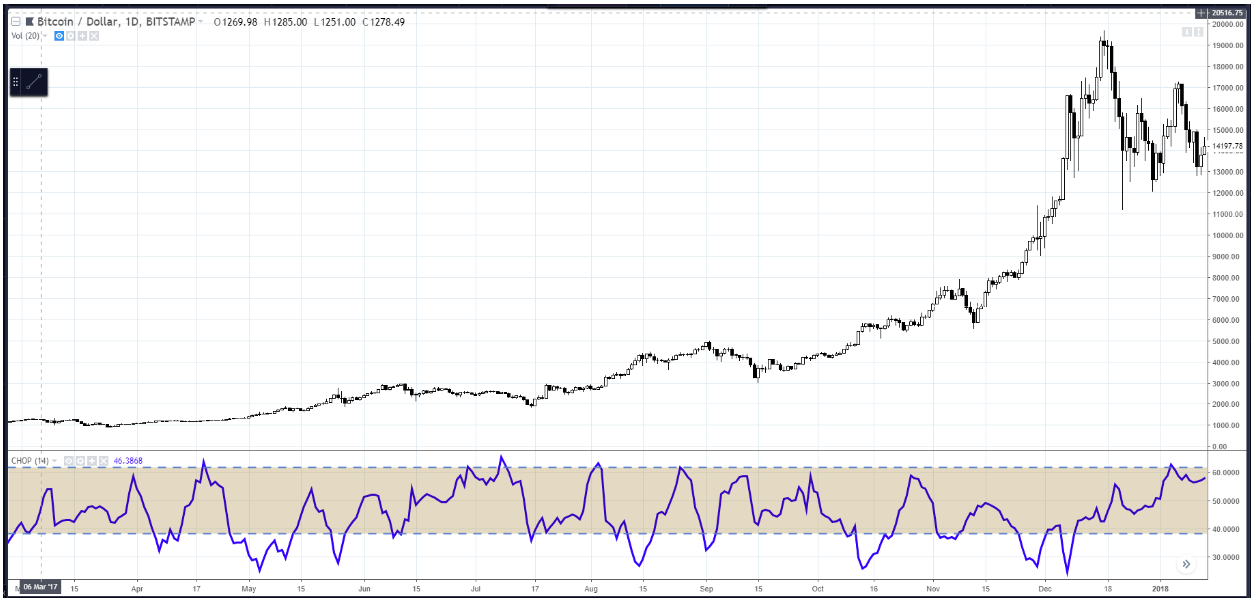
It's not uncommon to see month after month of profitable trading during a bull market. The dips keep being bought, there is a certain "rhythm" to the markets, and you get this feeling that you cannot lose. Sometimes, it almost looks too easy. And if I've been on a streak like this for over a year, I start getting cautious. ***Something's about to change***.

During the last Crypto bull run in 2017, we had a persistent anchor trend, the dips were bought, expansion led to contraction and then back to expansion again, as you can see in Figure 1:

Figure 1

Persistent price action like this normally will lead even the most seasoned investor to overconfidence, unless they are aware of how markets change their stripes when they "transition." And this started as the crypto market went completely parabolic in December of 2017, as we can see in Figure 2:

Figure 2



That last parabolic run where BTC hit about the 20k level was a classic example of "euphoria" where retail traders start throwing money at anything and everything, as there is no sense of "risk." And professionals start mumbling under their breath about the risk, but no one listens.

This is why I refer to this as the "Trap of Current Performance." As long as something is working, you should CONTINUE to use that strategy…..however the longer that it does work, the more aware that you should be that a change is coming around the corner. And learning to spot the signs of change will separate you from the rest of the Herd.

But what kind of change? How can we tell? Should we just tune into the TV and watch the professional pundits tell us what to do? Let's learn to read the market's "character," not only to understand what is happening ***now***, but also to anticipate what is likely to occur ***next***.

And the reason that this is pertinent to Futures contracts is because changes in underlying character will DRAMATICALLY change the size and velocity of the intraday swings; this will affect everything that we do, such as frequency of opportunity, profit targets and potential, as well as the reward/risk of the trade….and depth of stops. In short, EVERYTHING.

Defining Market “Character”

You might have heard me use this term before….talking about “market character,” and perhaps wondering what on earth I was talking about. That’s how I felt the first time that I heard about it, and it took me a while to absorb and process.

Mothers are EXPERTS in the field of noticing little changes in “character” with their children. The way that they interact, the way that they carry themselves, their tone of voice, their written communications…..all carry a huge amount of information to “Mom” that instantly puts them on DEFCON1 high alert when they see something changing.

And Men like me are typically tone-deaf to these changes, cranking the wheel of life day after day until we look up from the oar that we’ve been pulling for the past year, only to see that we’re rowing upstream. So guys, I’m not saying that we need to start wearing skirts, but there’s definitely something that we can learn from Women in that we need to start looking at the market in ways that we haven’t done before. Step back and detach. And for the Women that are reading this, you have that inherent skill that just needs to be tuned to read the same thing in markets that you do with children and people in general.

There is a “next level” of analysis that not only looks at what is happening today, but how things are actually changing in front of us. Let’s start out by defining the different types of price character that we’ll see in today’s market…

Defining Market Character - The Four Market Types

There might be an almost infinite display of the different "characters" that price movement can take on, but we'll confine our study to four major types of price movement that we'll see in the charts. These are the ones that I most frequently find in any market:

Quiet and Trending

This is the quintessential Bull Market character, where price movement is very linear and predictable. Plays against trendlines work, the Fractal Energies accurately depict where the price should "stall" or "explode," and the market can stay in this state for a year or more.

Figure 3

These "Quiet and Trending" markets are typically spawned from choppy and/or volatile price behavior; as we know, "range contraction" leads to "range expansion" and these "Quiet and Trending" states are excellent examples of Range Expansion.

A "Quiet and Trending" period is usually followed by a "Volatile and Sideways" period, which is where the market gets a chance to catch its breath and recharge, and it may or may not lead to a full change of polarity to a downtrend.

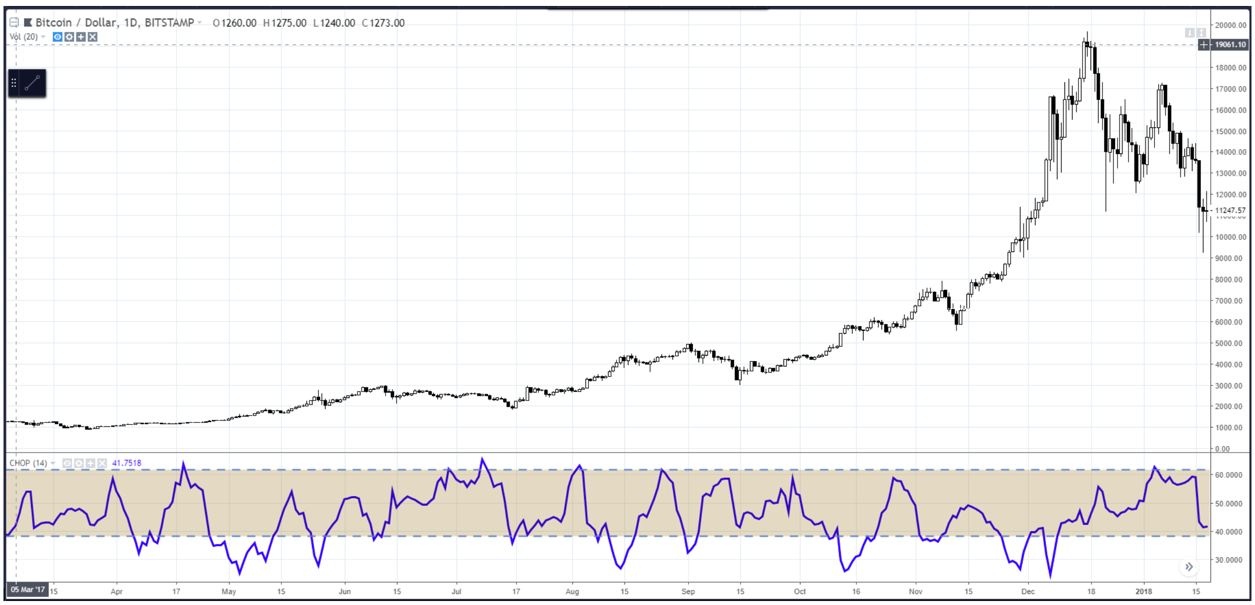
Note that we will almost NEVER see a "Quiet and Trending" market to the downside. Bear Markets are NEVER quiet and are always volatile.

Volatile and Sideways

This type of price action is most normally seen as the first act of a larger corrective pattern kicking in. Volatile and Sideways price behavior usually follows "Quiet and Trending" which is a rude shock to those that had become very comfortable with the quiet, predictable bull market.

Figure 4 shows an excellent example of a Volatile/Sideways market; note that you would not be able to determine this market character until the very end! This is what makes the shift of this character so hard to determine for bulls that hang on until the very end.

Figure 4



And notice that these "volatile and sideways" patterns are created from big, linear moves, regardless of whether they are bullish or bearish trends:

Those with sharp eyes will also see that these "volatile and sideways" movements usually start when a larger timeframe chart goes into technical exhaustion (Fractal Energy below 38.2) after a strong, persistent linear trend. And once the chart is charged up again at these larger timeframes, another linear trend will spawn from those conditions, but it could move in either direction from there. In Figure 4, we see this change to a trend to the downside. This is where this market changes to "Volatile and Trending."

Volatile and Trending

There's only two times that we see this type of price action: 1) right before a correction kicks in, or 2) during an actual correction or Bear market. Volatile price behavior like this is associated with uncertainty and this is where we get some giant tug-of-wars going on between the bulls and bears.

Figure 5

We will see this type of price action show up under two conditions: 1) when we've seen "quiet and trending" price action for a long time and the longer-timeframe charts are approaching exhaustion, or 2) when the market actually releases lower into a full bear market, featuring a "lower high" on the monthly chart.

Quiet and Sideways

I rarely ever see “Quiet & Sideways” on one of the major coins that has volume on it. There are occasional times that we’ll see a lengthy consolidation, such as this one on Bitcoin on the weekly chart, in Figure 6:

Figure 6

This is a classic case of “Range Contraction leading to Range Expansion.” We don’t see this character for any major length of time, and when we do, Range Expansion is almost assured after the energy at that timeframe has built up.

Identifying and Anticipating the Type of Market

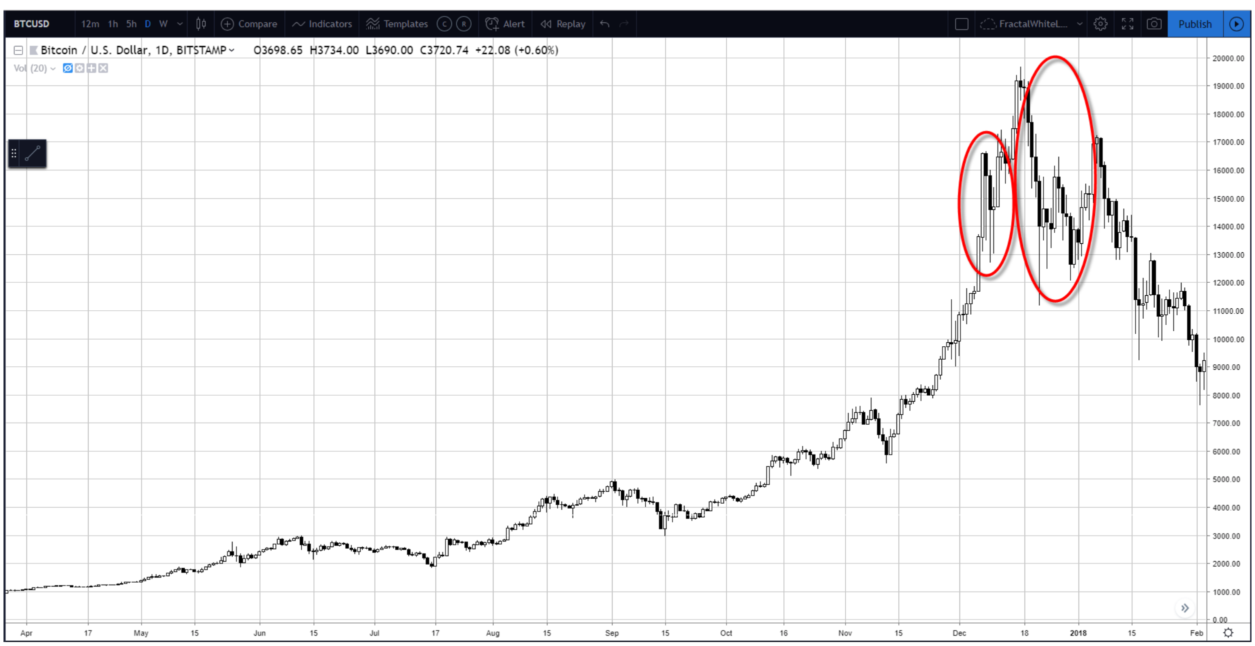
It's one thing to look at a chart in the rear view mirror and determine what the market "type" is; it's quite another thing to ANTICIPATE and then correctly READ what the market type is while it's in the process of changing.

What is nearly impossible to ignore is the fact that we're all human and therefore susceptible to the effects of bias, whatever the source. And one source that is very difficult to overcome is that of "Recency Bias." This is the tendency to weigh recent data more heavily than other data; this is extremely difficult to overcome near market bottoms and tops, where we have emotional extremes occurring in the market.

Quiet Transitioning to Noisy

Markets tend to spend most of their time in quiet, directional bull markets, especially if they are spawned from noisy, volatile conditions. And these quiet bull markets will continue until we see them start to "crack" and start to become unstable. We will typically see that begin with what I call a "shot over the bow"; this starts with an unexpected, negative event that drives the price quickly down, such as those shown in Figure 7:

Figure 7



The market was quiet and trending prior to these signals; it quickly became much more volatile after that…first “volatile and trending,” then “volatile and sideways” and then ultimately “volatile and trending” in a bear market.

The conclusion to a Quiet and Trending bull market is almost always a transition to a much more unstable, volatile market.

Noisy Transitioning to Quiet & Trending

The converse situation occurs when a market “coils up” all of that power from volatile price action until it finally chooses a direction to trend in. Most of the time, that energy will be transferred into a strong, quiet, linear bull market:

Figure 8

On rare occasions, we’ll see the energy from these “noisy” conditions actually transition into a volatile trending environment to the downside. As we discussed earlier, downside trends are ALWAYS volatile.

Trading Strategies for Different Market Characters

One of the biggest mistakes that investors/traders make is to trade all different market "characters" in the same manner. For example, those investors that have been indoctrinated into the "buy the dip" mentality from Twitter or Reddit will come into a Volatile/Trending bear market buying the dip left and right, and absolutely get their head handed to them by the larger overall downtrend. Let's break this down by Market Character type:

Quiet & Trending

This should be the character that you'll see the majority of the time. Trading traditional "buy & hold" as well as "swing" trades should be made during this time, biasing the long side. You will see lower overall volatility during this time, and see perhaps only one or two decent intraday moves per day.

Sideways & Volatile

You will see dramatic swings in both directions; this character can be tough to adapt to at first because of the Quiet/Trending character that led up to it lulled everyone to sleep. Experienced traders will quickly recognize and adapt their intraday systems to handle the new volatility. You will see multiple intraday swings that will be quite large, and you must adjust your stops and targets to accommodate.

Volatile & Trending

The only viable "long" trades during this time will be the short, strong swings back to the upside, known as "bear market rallies." For the most part, an intraday Futures trader will not notice the difference between "sideways & volatile" and a new "trending & volatile" character.

Sideways & Quiet

Not a character that we see very often. You will see few intraday moves during this time and it can be more of an exercise in patience more than anything else. You must drop down in timeframe to see recognizable patterns to trade.

Summary - Adjusting to Volatility

I see it happen all the time; someone will get into “trading” and just assume that the program that they bought off of someone that was optimized for a certain type of market character - usually bullish - will just instantly adapt to a different type of market character. Quite frankly, the most obvious application of this is with “bot” traders that do the trading for you. Their capabilities are only as good as those that program them, and most if not all of them are programmed to work best in a bull market.

But a newer trader hardly knows the differences between Bull and Bear markets, let alone the different types of market character that the transitions between them exhibit.

Learning to adapt your approach to the changing terrain of volatile markets is a skill that you will never outgrow. In fact, I would say that traders will not have much of a career without this ability to adapt and re-engineer.

Homework and Next Steps

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

- [ ] Watch the associated video for this module.
- [ ] Please take the module quiz.
- [ ] Can you spot some of these changes in volatility/character with any of the financial markets that you've traded in the past?