# ReadySetCrypto Trading Edge Masterclass


**Module Four:** Creating Trading Edge

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# Creating Trading Edge

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# Table of Contents

# What is “Trading Edge?”

If I ask any sample of Retail traders what “Trading Edge” means, I’m constantly surprised by the answers that I hear. Here are some typical answers:

- “Using Technical Analysis”
- “Following analysts’ recommendations”
- “Using a better trading platform”

I really don’t think that most Retail traders understand the battleground that we’re fighting on. Let’s start with the basics; if I were trading a strategy based on a coin flip, where “heads” was a winner and “tails” was an equal loser, what is the probability that I have a positive-expectancy, money-winning system?

That probability would be a big ZERO. My probability of success for any coin flip would be 50%, so over a huge sample I will lose just as many flips as I will win, but it would be a mistake to assume that this is a “break-even” system. Commissions and transactional costs will be a constant drag that I must overcome, and will ensure that I will lose money over time to “trade” this strategy. And the opportunity cost of not having my capital in a positive-return system would be a secondary issue.

I have NO EDGE to my system.

Let’s go to Investopedia for their technical definition of trading edge:

> **A trading edge is a technique, observation or approach that creates a cash advantage over other market players. It doesn’t have to be elaborate to fulfill its purpose; anything that adds a few points to the winning side of an equation builds an edge that lasts a lifetime.**

So in our “coin flip” strategy, how can we have any *edge*? Perhaps if we slightly weighted the “tails” side of the coin in advance, then we’d see a higher probability of the coin landing heads-up. This is similar to “loaded dice” that are weight-biased to show 6’s or 1’s.

But those edges are cheating and no such edge exists in financial markets like that, if you discount insider trading. Now that we have a baseline for what “edge” is, let’s examine some of the typical edges seen in the financial marketplace that we can use…

# Edges in Financial Markets

There are some fairly simples edges in financial markets available to all; the great thing about Trading vs. Gambling is that we are ALLOWED and ENCOURAGED to create edge with our trading systems, but in almost every case our inherent human nature makes these edges impossible to follow through on because of the way that our “dinosaur brain” processes risk. We’ll cover a few of these edges and I think you’ll see the pattern…

**Pullbacks In a Trend**

One of the oldest edges in the financial markets is also one of the hardest to accept as a newer trader. Notice how the chart below is ultimately heading higher, however shows a couple of deep pullbacks along the way:


This is very normal, and is how markets move in a Fractal manner; the larger, or “parent” timeframe is moving higher, however the smaller or “child” timeframe will move up and down within the context of that larger timeframe trend.


Now imagine that you were a newer trader just focused on one timeframe, and you saw the following price movement show up in the short term:

Chances are pretty good you'd panic and either sell out of your long position, convinced that the End of Days was here, or perhaps you'd even flip to a short position.

This is the "emotional" reaction that is programmed into all of us, and creates frustrating reactions that we see in the markets all the time, such as when those pullbacks bounce higher:


In practice, it's not quite this simple, because most traders finally get the pattern, and vow to "buy the NEXT dip!" (Remember the "Hot Pot" stage from the Trader Progression?) Average retail traders buy the LAST pullback in a larger trend (because buying that pullback signal FEELS GOOD by then!) and unfortunately the pullback keeps dropping and dropping…more than likely this is a larger-timeframe pullback playing out, because they waited too long!

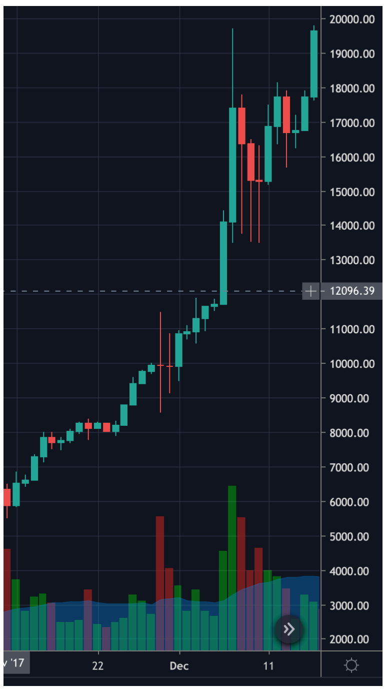
The "pullback within the context of a larger trend" still works with trending markets, but care must be taken that you're entering these pullbacks as soon as the main "parent" timeframe is recognized, and you're not going after the last pullback in the major trend.

There are many tools available for traders to evaluate pullbacks, such as understanding the major trend, using trendlines as support levels, fibonacci retracements to identify common "landing zones," plus many different oscillators to determine when the price has "turned."

## Trading Against Excessive Crowd Emotion

There is a huge edge in going against the “herd” and being independent, especially during times of massive crowd emotion. When EVERYONE sees the same thing and the “conventional wisdom” is unanimous, the opposite is likely to occur.

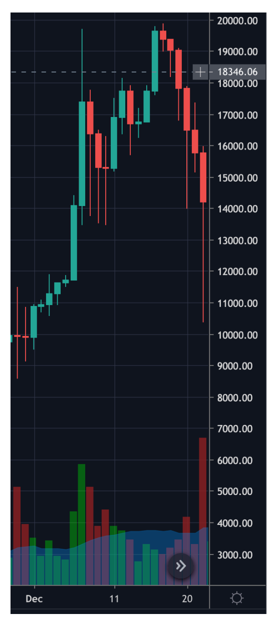
Before I dig into this with you, let me also relate that this edge, while massive at times, ***can be incredibly difficult to execute***. Not only is the timing of such a trade going to be nearly impossible to hit with any precision, but every nerve and fiber in your body will be screaming out that you’re doing the wrong thing. Humans are herd animals and find the most comfort in the company of other like-minded beings, but in this case you’re going to be all by yourself out on a limb.




For example, in late 2017 Bitcoin was undergoing a historic run to the upside, with the price gaining hundreds of points a day, and near the top it saw gains in excess of 1000 points/day.

Public sentiment was amazing; cryptocurrencies were just starting to dawn on the public consciousness, and the sense was that something historic was happening.

Every financial news media source was talking about cryptocurrency and specifically Bitcoin in December of 2017 as it rallied near $20,000 twice within a couple of weeks. Based on this chart, would you be bearish and looking for a move to the downside? You would definitely be in the minority.



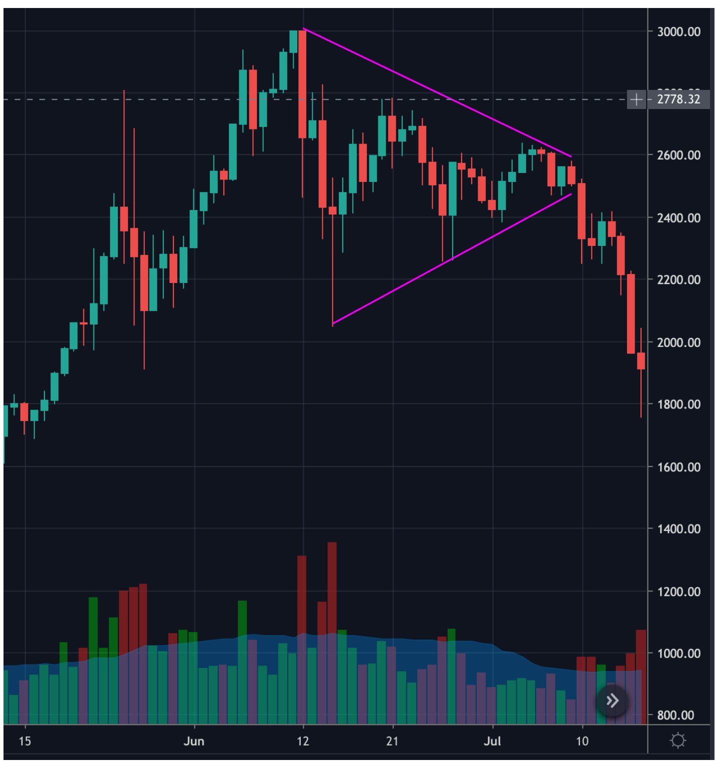

It was a surprise for the vast majority of all crypto investors, therefore, when the price dropped in half over the course of six days, right off of the all-time highs! $20,000 to $10,000 in six days, do the math on the amount of pain that produced every day. Note how the speed of the move to the downside was even faster than the rally that got the price to $20,000 in the first place.

Were there traders that rode the price down over those six days? Yes, but all but a very tiny portion of them sold short at the very top. More than likely most of the bears had started to accumulate positions as the price shot above $10,000…and then suffered in silence for two weeks as the price doubled before it cratered, and spent the majority of the next year in a nasty bear. Selling the “top” by going against the crowd can be very lucrative, however it's nearly impossible to "catch the rising knife" since most of the gains in a runaway market come at the very end.

And for the new bulls, those last $10,000 in gains were fun, but very short-lived. Since they don't trade with any edge, all of those paper gains evaporated over the next two weeks.

The conclusion to "gaining edge by selling against an over-enthusiastic crowd" is that it can be done, but the timing is impossible to nail, and you'll likely have to endure a lot of short "pain" before the price finally yields lower. They call this concept "duration over direction" since you have to be "in it to win it" with these kinds of trades.

Fortunately, there is a somewhat easier trade against the public's emotions to gain edge, and that is with the "scary pullback" that is similar to the earlier "pullback" trade, but this might be one that's deeper and "scarier" than others.




In the middle of a primary bull market, you'll see occasional pullbacks against the major trend, as we already established. But there will be times that the "anchor" trend (for example, the weekly chart if you're trading with the daily as a "signal") will go into a pullback itself.

Think of it this way…when you were a child, you'd get sick from time to time or hurt, but you'd view your parents as the Rock of Gibraltar because they never got sick or hurt. If/when they DID get sick or hurt, it rocked your world because it affected the security in your world.

When the Anchor chart undergoes a pullback, all hell breaks loose in the market that you're following, even though this is completely normal. All of the media is negative, pundits are bearish, and everyone generally agrees that this market is "toast" and prices will be going lower. Those that can ignore their emotions and look for opportunities are about to have a giant edge against the rest of the market.


It looks so….OBVIOUS in the rear-view mirror, doesn't it? And this is what every one will say….afterwards! But those that can trade in the face of the public fear to catch the capitulation bottom in the middle of a longer-timeframe uptrend will have a huge edge over the rest of the market.

To catch these larger timeframe "panic" pullbacks, it really helps to understand the market context at a larger timeframe so that you can "put the puzzle pieces together" and see through the fog that the rest of the market cannot see. This type of setup is usually much less about using specific "tools" and much more about understanding how to evaluate short-term moves within a larger context…in other words, understanding price action.

Both of these were examples of trading against excess crowd emotion, but these major tops and bottoms show themselves infrequently. When they do show, they can be incredible sources of opportunity that few will be able to seize upon.

**Options Time Value Decay**

If you've taken our "Income With Options" class, you'll know that an option contains Intrinsic or "real" value, plus "extrinsic" or "time" value, which is the premium that's priced into an option that trends to zero by expiration.

Therefore, those that BUY options are at a natural disadvantage to those that SELL options to open the trade. Option sellers have a natural edge/advantage by selling a wasting asset.

If you've sold an option to open a trade before, sometimes that edge isn't apparent at first; you are essentially "sitting on an egg" for some time waiting on expiration, so any price movement towards your position feels like an attack.

During times of extremely complacent volatility, it might provide more edge to be an option buyer, as the reward-to-risk might outweigh the friction of buying an eroding asset.

**Options Volatility Crush**

As with everything options-related, there are many dimensions in play. We typically want to be selling options during times of "relatively high" implied volatility, which are likely to contract. We call this "volatility crush." Newer option traders tend to buy options regardless of what's happening with price/time/volatility, so an experienced trader can find edge by selling options (instead of buying) during times of relative peaks in implied volatility.

**Just a Few Examples…Your One Thing?**

These are but a few examples of "edge" that one can harvest in financial markets. Notice that the common thread is that you're on the other side of the trade from the newer trader. Yep, you can become one of those hated "market maker" types that is happy to take the other side of the trade that feels so good for you to enter.

And tie this with the last module on Your One Thing; can you see how narrowing your field of focus to one asset/one strategy/one timeframe can help you spot more opportunities for trading edge? You'll be able to much more clearly see situations where the majority will get "trapped" on the wrong side of the price action and give you an easy trade.

## Stacking Edges

Stacking edges is something that everyone should look to do. Let's use one of the previous charts to show an example:


I love to sell cash-secured put options at levels well below the current price, which would essentially obligate me to purchase the asset at the strike price sold. Let's say that I would be a willing buyer of BTC/USD at $1400. During the mid-July pullback I would sell the $1400 put option at some forward expiration date and I would seek to make at least 3-5% return on my margin capital. I *would* accept assignment if the price did dip to $1400 by expiration, however I'm just as happy to watch the put evaporate to zero, and then do it again the next month or next cycle.

What are the edges that I'm stacking with this trade setup?

- I'm selling a put option during a relative spike in implied volatility.
- I'm selling a wasting asset.
- I'm taking a bullish trade on a daily pullback against a longer-timeframe uptrend.
- The time value decay will continue to erode the option in exponential fashion until the expiration date, making it cheaper and cheaper to buy back.
- With any kind of bounce in price, the implied volatility will "crush" the time value component of that option, making it cheaper for me to buy back.

This is one of the advantages of options; you can add many more dimensions of "edge" than a standard directional trade using spot or futures. With one of the standard directional instruments, the exercise of stacking edge really comes down to identifying setups that get the majority of traders on the "wrong side" of the movement, forcing them to punch out at great cost.

When directional traders eject from a trade, it's typically with a market order. When you combine thousands of people being on the wrong side of price movement all punching out with Market orders, it tends to push the price very quickly since the supply/demand equilibrium is a moving target.

## Summary - Creating Trading Edge

As you build your "one thing" strategy, you should consider what your "edge" is with your strategy. Remember, with a directional trade, you have a probability of success at the onset of the trade of 33%. Price can go up, down, or sideways….and only one of those directions is going to create a positive return for you.

The very best setups for a directional trade will feature:

- Violent directional movement in your expected direction. This is caused by too many people on the other side of the trade being very wrong, and having to to stop out using market orders.
- Maximum reward-to-risk on the trade setup. The potential for huge movement is very high.
- Quick profits and very easy to reduce risk.
- Very difficult entry "feelings." The trade will not make sense to those that are trading with the crowd.

The best setups for non-directional trades will feature different criteria:

- A strong trend leading into the entry of your non-directional trade, because range expansion leads to "contraction."
- Depending on whether you're entering at the top of a rally or at the bottom of a sell-off, the news will be almost universally bullish or bearish depending on the move.
- It will feel very unnerving to enter a non-directional trade in the face of the existing move.

Remember, to gain the maximum "edge" on any trade setup, you'll be going directly against the "crowd." You'll have to think independently and it might take some time before you summon the courage to enter your first few. If you keep at it, your subconscious mind will start to associate the entries for this strategy with the joy of winning, and things get much easier for you. This is why it's important to stick with one strategy and master it, because you have to train yourself to trust it!

## Homework and Next Steps

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

- [ ] Watch the associated video for this module.
- [ ] As you build your “one thing” strategy, can you think of some edges that you can build into yours?
- [ ] Have you ever been part of a trade that was almost instantly profitable and moved a great distance in price in a short period of time? Can you determine what edge existed in that trade, and how it felt to enter that trade?