QUINT TATRO

# TRADE THE TRADER

KNOW YOUR COMPETITION AND FIND YOUR EDGE FOR PROFITABLE TRADING

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chapter 1

# I'm Trading Against You

I sat in front of my six screens like a hawk high on a limb, watching the flickering symbols race across my level-two quote box. Market breadth had been horrible all day, notching 5 – 1 decliners over advancers, capping off a week that looked as if the indices would finish close to 5% in the red. I had been nailing the short side all week and was ready to book hefty gains against unsuspecting latecomers and amateur traders who actually believe they have a leg up with their basic technical analysis. I sifted through countless charts, and each one walked a very fine line, looking as if at any moment they would plunge to their deaths, cratering into the abyss. I imagined the number of traders cuing up these exact charts for shorts, and I shook my head again at what would surely be their misfortune. For a moment, I remembered what it felt like to be in their shoes. I recalled the days when I felt empowered by my basic chart knowledge. It would be a time such as this that I would believe the moons had aligned for a perfect trade, a trade that would correspond with all that I had learned from basic trading, netting me huge profits. Unfortunately, over the years it became clear that basic strategy no longer was enough. I had witnessed time and again how the basics would work for only a moment, at which point an immediate change of character would set in, robbing me of my hard-earned capital. This time was different. This time I sat with the hawks, not with the unsuspecting

squirrels gathering their charts like nuts, moments before those nuts were snatched up and taken away by a bigger, craftier prey. The same stage had been set this time, the players identical, and even though I already knew an incredible bounce was forthcoming, the exciting anticipation continued to build.

The market had been moving methodically lower all day. However, subtle signs told me to prepare for yet another play on those who equip themselves with sticks in a fight only won by bazookas and heavy tanks. I sat observing how the S&P 500 was bouncing back and forth, grasping for a bottom, when in reality it looked as if another breakdown was a foregone conclusion. Each rally attempt was met with selling, and each move back into the extremely short-term base seemed to be with more vigor and intensity than the one before.

I again pondered what most traders would be thinking as they observed the action and lined up the stocks they would short on yet another thrust lower. I could almost feel their passion through the tape as I watched the intensity build. I noted in my chat room how I had not yet seen the "towel trade" and until I did, I would believe new lows were pending, with a better opportunity to cover and book profits. Many in the room I had traded with for years and knew that the "towel trade" was merely my way of describing the move at which point most traders throw in the towel and, in this case, either give up on their longs or press their shorts. The congruent force sparking a breathtaking move, yet one that would only last a moment. Most in my chat room had been on a similar journey as I, and had finally arrived at the place where we were in a position to profit from the towel trade, instead of being the ones throwing in the towels.

The clock struck noon, and while a rumble in my stomach reminded me that I hadn't eaten anything since beginning my day around 4:45 a.m., I couldn't yet leave the screens until the trade had been executed with the money in the bank. I sifted through all my various charts, again noting that not one looked bullish, nor did any indicator I followed (such as breadth or sector leadership), yet I refused to be the greater fool. I had no intentions of playing the hero, throwing hard-earned capital at a declining market hoping for a bounce, but I knew very well that just when everyone moved to one side believing that a continued move into the abyss was a foregone conclusion, a change was imminent. This was the trade I was waiting for.

Even though I had seen the trade play out hundreds of times before, it never got dull. Finally, after observing the market for almost four hours, the drop began. At first it started in a slow and methodical fashion as the recent support gave way and traders realized what was happening. Within seconds, my alert box started to trigger stock after stock that was breaking below a predetermined level, of which I acted on not a single one. Rather than add new shorts, I watched closely as my existing inventory started to show even a greater profit, and one by one, stocks began a rapid and vicious decline. I was curious what was happening among the masses, so I took a quick glance at the StockTwits Twitter screen. As I suspected, trader after trader was adding short inventory almost as fast as their arrogance grew over what they believed to be certain riches. I covered half of my shorts and watched as the speed of the decline increased with the S&P losing a quick 5 points. I wondered whether a lull would set in, as traders

regrouped, but in a blink of an eye another 5 points had disappeared, and that was my cue to exit my shorts completely and go straight to cash. One by one, my stocks vanished off my screen while the realized profit column grew with my extracted funds. It was only 2:30 or so in the afternoon, but I was done for the day, with one month's worth of profits in the bank, and it was only the 5th of February.

The move was what I had been waiting for all week, and was my cue to take profits and start the weekend early. My timing wasn't exact, but within the hour on that Friday, the market started to reverse in a rapid fashion, repairing all of the almost 2% decline it had seen during the day, to close positive, squeezing the accounts of the unsuspecting traders yet again.

You would have to be living under a rock not to see the trading wave sweeping the nation as average investors move in mass toward the world of stock speculation. Not only are they fed up with the traditional Wall Street advisory practice, but they've been burned studying balance sheets and listening to management and are not interested in buying the next great American franchise at a deep discount, for a longer-term hold. No, these educated individuals are searching out and learning the core principals of technical analysis, behavioral economics, and even the likes of momentum investing. As they learn, they quickly see the real potential for riches. However, just as quickly as the number of people moving toward this field grows, the landscape shifts, with the greatest profit potential coming not from just trading the market, but from *trading the traders.*

You see, what most investors don't understand as they start to learn their basic technical patterns, such as cup and handle break-

outs, or as they study their MACD (Moving Average Convergence / Divergence) or RSI (Relative Strength Index) indicators, is they are the ones actually in play. Seasoned traders are no longer just cuing off of charts or indicators, they are also analyzing those same charts to determine what the amateurs are doing, and are seeking to profit from the ignorance of the newcomers. It's a chess game where the successful traders are thinking two and three moves ahead, playing off the basic strategy of the newcomers. Those simply pursuing a basic path of understanding technical analysis will find it is a road that ultimately leads to frustration, whereas those looking to trade the traders will be met with an endless world of opportunity.

It took me a long time to figure this out, and before I did, I was the trader licking my chops at the number of shorts setting up on a Friday afternoon whoosh, as I just described, only to lose my shirt on the reversal. You see, in that specific example, three levels of traders are present, with most occupying the first two areas:

- **Level one:** Although level one has dramatically thinned out after the 2008 bear market, there are still those who believe jumping in to catch a falling safe is the prudent way to go. In my example, this group would have been buying the market the entire way down, losing their shirts along the way, and were the ones throwing in stocks at any price during the towel trade mentioned earlier.
- **Level two:** The second level is the unsuspecting, semi-educated trader who realizes buying sunken ships is a loser's game and knows that shorting them is the way to profits. This trader stalks his prey, and relies on basic technical analysis or other advanced indicators to tell him

when it's time to move in. For our previous example, this is the trader who shorted on the towel trade believing the breaks would continue to plummet.

- **Level three:** Level three is not occupied by many investors. However, this is the group who more than likely has already moved through level one and level two, understanding that it isn't just economic forces or corporate profits that move stocks but that it is the traders acting in concert who create market movement. They thus understand what traders are thinking and doing, which gives them a greater edge toward capturing profits.

Traders are always in a state of flux when it comes to the way they approach the market. I believe this is so because it is real money and potential profits or losses that are involved, and therefore everyone is always attempting to glean a new edge. The market is quick to grade your approach in that it only takes seconds before you know whether or not your strategy was correct. Because of this rapid evaluation, traders are more inclined to move quickly to change, seeking out a better and more appropriate way to approach their investing. From my vantage point, the masses are moving to a strategy that involves some sort of technical analysis or indicators far away from the basic buy-and-hold approach of traditional Wall Street. As a result of the vast number of people shifting to this strategy, it is becoming saturated to the point that it rarely works as effectively as it once did. To truly succeed in trading, you need to seek out another level, not only possessing a basic foundation and proven edge, but also seeking to understand the movement of others and how to profit from this. If you do not grasp the theme of trading the trader, you will have a frustrating career in

stock speculation, regardless of how passively or methodically you approach the business. It's really quite simple: If you are following technical analysis, you are either stalking the movement of others, or your movements are being stalked. If you don't know on which side you fall, odds are you are someone's next meal.

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