TRANSCRIPT

Trading the dips and downtrends

Presenters: James Savage & Chase Cotnoir

JAMES SAVAGE: Welcome, everyone, to our session today regarding Trading Dips and Downtrends. Probably could not have come at a better time, right? I must say it's, Chase, always a pleasure to be doing these webinars with you. As we are both from Fidelity's Trading Strategy Desk. For those of you who don't already know, we're a small group of traders that are here to assist clients like yourself with their trading strategies. We host a number of sessions. These are going to be Monday through Friday. Topics regarding options, technical analysis, Fidelity trading tools. Both on Fidelity.com and within Active Trader Pro. And we even do morning and aftermarket briefings where we talk about the day and take a look at stocks provided by folks like yourself in the audience. We're live just as we are here. We turn our cameras on and we stop throughout the session to answer questions and comments. And because of the smaller size we can be far more interactive with the audience than in most webinars. So if any of those topics sound interesting to you I absolutely want to invite you to join us sometime. And better yet after this go ahead and sign up for the Q&A follow-up session for this webinar tomorrow. It's going to be at 1:30 Eastern time. I'll be back with another one of my colleagues on the desk. But of course without further ado, let's get into some of the material that we have for today. Now today we're going to be talking about two different market scenarios. A dip and a downtrend. We're going to spend some time defining them. What is a dip and what is a downtrend? Just so we're on the same page in some of the terminology that we'll be using. And we're going to be going over a couple of ways to both measure and define them with technical analysis.

Now this is an intermediate webinar. And I would say it's in the realm of beginner to intermediate, which we don't too often in the webinars. We typically save the intermediate and advanced topics for the coaching sessions. And because of the slightly higher level than typical, when Chase and I begin to talk about some of the strategies we won't stop at the very basic ones. We got a few strategies in mind that can help you with both of these market scenarios. And I want you all to keep in mind since the nature of trading a downtrend for example involves oftentimes trading against the herd, we're going to be including some options trades in this discussion. So this will be related to both something such as a stock or an ETF as well as options trading. But we're going to keep it fairly on the higher level. So even if you're not an options trader out there, I think you'll still be able to engage with some of the discussions and strategies that we're going to be talking about.

Now finally, because of some of the strategies that we're going to be going over, especially using options, we're going to be choosing some theoretical contracts and running them through some hypothetical scenarios. So keep in mind, everyone, these are going to be for illustrative and educational purposes only. We're not trying to endorse or recommend you trading any of these specific strategies as they are described. But they will convey the risk and reward dynamic that you could put towards your own possible future trades. So we've definitely got a lot in store for you today. Both from charting perspective as well as a trading strategy perspective. So Chase, I think I've hopefully maybe set the stage for us today. Might be time to really start looking at some charts and really getting involved. So let me pass over the mike to you, sir. And take us away with what we're looking at.

CHASE COTNOIR: Thanks, James, I appreciate it. Good to be here with everybody. Another member of the Trading Strategy Desk. I'm going to share for really the majority or the remaining time of today's webinar Active Trader Pro. We're going to be using this platform to demonstrate some of the technical analysis that James had mentioned as well as some of the tools and capabilities to monitor and evaluate some of these potential or typical option strategies that you might use in trying to trade a dip or a downtrend. This tool we use all the time in our coaching sessions. We've spent years teaching clients about this. And we hope that some of that experience and knowledge comes over to you as well, and transfers into something that's confidence-inspiring and gives you the ability to take some actionable steps after today's presentation. So what I want to do is set the stage on what we're looking at first, how we get there, because I think it's important for everybody to follow along at home if you want to or if you have the capability.

So first thing is if you don't have Active Trader Pro, it's free. So you definitely should be using it if you want to. If you're someone who wants to do more in-depth technical analysis, or you want real-time quotes or customizability that maybe the website doesn't have. The way that you access this is you go to Fidelity.com/ATP which stands for Active Trader Pro. It's going to prompt a website with a big blue button for you to click on to download the platform. It's free, there's no catches there. And what you do is you can customize the platform and make it your own so that you might end up with something that looks like my chart today, the one that James and I use every single day.

So, looking here at my screen, this Active Trader Pro, we've got a chart pulled up. And we're using the S&P 500 as really the staple for the examples we're going to be using here today. I have a maximum timeframe chart with a monthly frequency. So, for anyone here who's not the most familiar with charting or technical analysis, this is a candlestick chart. So, every little green and red candle represents in this case as I have the chart constructed a month worth of time.

We're seeing over an entire multiple decades here since it's a maximum type chart. So what we're going to do here is add some things to the chart, some technical indicators, some additions that might give us some insights when it comes to defining a dip and a downtrend. Now I'm not going to hop right into the dips and downtrends just yet because I want to give us some context as to how that comes into play. What I'd like to do to start is really talk about the trend of whatever we're evaluating. In this case it's going to be the S&P 500. Once we understand the trend, we're going to take a look at the volatility and some of the movements occurring in price action. And from there we'll be able to better understand what exactly a dip is historically looking backwards in time and what isn't a dip and may be actually a downtrend.

So, the first thing I'm going to do here is add a technical indicator. So, I'm going to go up to the indicators button on the chart. And from here I'm going to type to search for the specific one because I already know what I'm looking for in this case. It's going to be the simple moving average, which you can search for by clicking, typing in, excuse me, SMA. We'll go ahead and add this to the chart. Now once this comes on there's a few manipulations we're going to make for today's discussion.

First thing here is I'm going to click on this bubble. Modify it so we'll make it a little bit easier for everybody at home to see first of all. And most importantly we're going to change the period or the number of instances it's going to include in this indicator. We're going to change it from 20 to 10. Now again if I'm going too quickly, if you don't know what a simple moving average is, it's essentially looking at historical prices over some period of time. In this case it's going to be 10 months' worth of time. It's then going to average the price from those 10 instances and through time it's going to get rid of the old data, include the new data, and it's going to do that through time on the chart. So, this is what we're left with. We have price, which are those green and red candlesticks, and we've got this black simple moving average line. Giving us an idea of the trend of in this case the S&P 500.

Now you might be asking yourself, "Well, Chase, why are you using a 10-period simple moving average?" And here's why. We're on a monthly longer-term chart and every month there's approximately 20 business days or 20 trading days. So, if we think about 20 trading days and we've got 10 months' worth of that, 10 instances, that's approximately 200 trading days in the average. So, for James and myself we're going to be using this 10-period monthly moving average as a proxy so to speak, a loose approximation of a 200-day simple moving average.

And the reason we're doing that is we're going to be looking at longer-term trends in the conversation today when it comes to dips versus downtrends. All right. So, the next thing we want to do in this example for today is we're going to zoom into a specific area. Now I'm clicking on the magnification icon, left clicking, holding, and dragging, and we have our chart right here. I'm going to focus in on this timeframe for most of today's presentation. I think James will do the same on the second or back half as well.

Let's look first at the price action. What direction is this price going in? It's going up. We're in the bottom left corner, and we go up to the top right. But if we wanted some type of level playing field to measure this trend, that's where the simple moving average comes into play. We can see that the average or the trend overall is also going up.

Now why is this important? Because when we think about what a dip is, and here's how I define a dip, it's a short-term countertrend movement within some kind of longer-term uptrend. But if you haven't defined your uptrend then it might be difficult to define what that countertrend movement is against it. So, starting your analysis, especially when you're someone who subscribes to technical analysis, you typically start with the trend first. What trend is it? Is it in an uptrend? Is it in a downtrend? Or sometimes there could be sideways or no trends. In this case we clearly have an uptrend historically speaking with the S&P 500.

Now I'm going to come back to that dip definition in just a moment here. So what do we notice here? S&P 500 goes up. There's a couple of red candles but for the most part they're green. So, a strong uptrend. We see the simple moving average curling up with it as well.

Then within a month we trade down. We do trade through the moving average within the month. But we ultimately close above it. The next candle, again we trade down to it, but it bounces off, closes higher, and then from there we launch a little bit higher. All right, so we're going to call this for demonstrative purposes dip number one. Again, a little bit easier looking in hindsight. But that's what we're going to call this. Dip number one. Right here.

Dip number two I'm going to call right here. And now why might I do that? Because intramonth the candle wicked down. These are candlesticks so this is referred to as the candlewick so to speak. It traded down within the month. But once again the bull stepped in. There was enough buyers, enough buying pressure, that it went back up. This is going to be number two for a dip. A short-term pullback. But then ultimately move upwards within a greater broader bullish uptrend.

We have dip number three right here. Again, another intramonth sell-off that was able to be bought back up by the bulls. Essentially putting it back to where it was. Went higher. Dip number four right here. Again, similar type of situation where within the month it traded down but once again that simple moving average was able to act as some form of support. The bulls were confident enough to step in. And they bought it up.

We're going to get to this section in just a moment. But let's come back to my definition. What is a dip? Again, what I had mentioned before. It's a shorter term. And if I pause for a moment. What is shorter-term? This is a monthly candlestick chart. So, for most people they might be looking at daily charts. Or if you're a shorter-term trader you might be looking at intraday charts. But what I mean is relative to whatever frequency chart it is you're typically only looking at a few candles within that type of short-term reversal. So even though these are month candles and I get that for most people that could be seen as longer-term, what we mean to say, there's only a couple candles within this short-lived reversal.

So, it's a short-term countertrend reversal that then resolves upwards in an overarching broader bullish uptrend. And if we apply that definition, we've got one, we've got two, three, and four.

So why is it important to define what a dip might be? Because if you're expecting a dip to occur because prior ones have occurred and you're thinking the market is going to respect a particular simple moving average in the future as it has in the past, well, having a good definition of what you're looking for is going to be helpful because if you don't see what you want to see, if you get something else, then you know that your thesis was incorrect. So, let's use an example right here. If we assume for a moment we're right about this time, if we look backwards, we've got about four instances where the market has proven to us that this simple moving average is some form of support. It respects it. Each time it trades down the bulls come in, they buy it back up.

So, some technical trader might say, "You know what, on the next time it sells down I would actually expect it to come down to this line and bounce right off of it." And the reason why you might make that thesis or assumption or that game plan is because that's exactly what the market has done the past four times. One of the key principles of technical analysis is we're going to assume trends will persist through time until they're violated. At some point they'll come to an end.

So as this dips down, there might have been traders out there who within the candle, within the month, said, "Hey, once we're about here I'm going to start buying, whether it's some type of shares on an individual stock or ETF, maybe it's some options." We'll get to that in just a little bit. In any case they'd be expecting a bounce.

Unfortunately, in this case what do we get, James? Well, we didn't really get a very short-lived bounce off of the moving average. This is one of those common pitfalls that can happen when you have a very rigid expectation of the trading plan or situation moving forward, is that it broke through, then got stuck underneath it, only to then reverse later on. So when someone asks me or you in these one-on-one sessions that we have or during the coaching sessions or even a webinar like this, "Hey, what's a common pitfall?," well, it can be that trends might be violated or end very quickly only to then be resumed. And that's exactly what happened.

If you were managing your risk appropriately and your thesis was that if it was going to bounce off that would be enough for me to buy, so it comes here, you start buying maybe a little bit early, maybe you don't wait for additional confirmation, once it starts crossing down through and there's no real sign of immediate reversal you might end up closing that position for a loss. And that's happening. That happens to traders. That's part of trading. You make a thesis based upon what we can observe in the marketplace and you hope that you're right. But if hope doesn't carry you through and the plan isn't right, you need to react appropriately. That's the second reason why I think defining a trend and then defining a dip is so important. Because when you see something that isn't clearly a dip, maybe it's a little bit more ambiguous, you have the control as the trader to then exit that position and wait for additional confirmation to maybe get back in or stay out of the trade and move that capital to something that might be a more promising prospect to you and what you trade.

Now certainly there's a mechanism of market timing in this environment. We can see that. You might have closed out at a loss only for it to resume back in this uptrend. So maybe you reentered it along the way.

What I want to talk about here real quickly is something that we typically talk about in a technical analysis realm of a confirmation filter. You need maybe some extra data to give you an additional level of confidence to either place the opening trade to get into the position or you need enough to say, "Hey, you know what, enough is enough, I'm not getting that reversal, at this point I'm just going to have to end the trade."

And there's many different types of confirmation filters. We won't have time to cover all of them here today. But a very simple way is simply the number of instances after an initial signal. So, what do I mean by that? What I mean is to say if it crosses through you might wait for one, two, three, five candles beneath that moving average for you to feel justified in closing a position if you had opened it right as it was near the line expecting some kind of bounce back. And there's some pros and cons. The shorter your confirmation filter is, well, the likely that you're going to get maybe zigzagged out of these trades, stopped out a little bit sooner. But you also might be managing risk a little bit tighter. However, you might also miss an instance where it just reverses a couple days after. If you wait for let's say two or three candlesticks for confirmation, then there's a chance that it actually might bounce back. You never really closed out your position, you held through it, and the dip did eventually realize, and you were rewarded for it. But James, there's definitely times, we see them in the marketplace, where even after waiting those three, four, five candles -- please, everybody, keep in mind, this is a monthly chart, so that's going to be a couple months of time. There's instances where it doesn't reverse. That dip is really, well, no longer a dip, it turns into a downtrend, which is why that's going to be the second half of our conversation here today. So I really want to stress to everybody why looking at the moving average can be important because it's a proxy for trend. Once we know the direction of the trend looking at it we can make a judgment. Is it in an uptrend? If it's in an uptrend like we see here historically, are there historical dips that prove to us that the market is respecting this trend? If it is, you make some tentative thesis about what you would expect in the future. So, if you get what you want you know what you're looking for, the trade works out. But if it doesn't show you what you want then you also know that the thesis was incorrect, and you can now manage your risk and capital appropriately. So, I hope that makes sense.

Another way that we can take a look at this in terms of defining dips or the direction of a trend is a different indicator. I'm going to go back up to our indicators and type in BB Bravo Bravo, which stands for Bollinger Bands. This is going to be a volatility indicator. And with these volatility indicators, specifically for the Bollinger Band, what we're looking for, it's basing it off of a 20-period simple moving average in this case, and we're looking at two standard deviations around that. That gives us this, as the name would imply, a band. These envelopes. What you'll commonly see in an uptrend, especially for someone who's looking for dip opportunities, is as it trades up the top end of the Bollinger Band may act as resistance but not an immediate reversal point. It might ride the band on the way up. That might be something you're looking for in these dip opportunities where it quickly reverses down, gets right back up to the band. When it pulls down gets right back up to the bands. That would be an indication of strong bullish strength within the trend. That might be something that you're looking for if you're a dip trader on the bull side.

But James, on the bearish side, and I know that you'll talk about this a little bit later, we'll see that that relationship almost reverses, where before the stock or ETF might be trapped in between the top end of the envelope or the Bollinger Band and the moving average and the bullish uptrend, then it flip-flops so that it's stuck underneath the moving average and bouncing off the Bollinger Band. So certainly this can help us to further visualize the direction of the trend and also what's the relationship to respecting that trend, is it in the top half of the Bollinger Band or is it stuck to the bottom half.

The very last thing we can think about here just for today's conversation about the movements is the size of the dips themselves historically. For example, approximately at the top of this candle to the bottom is about 20 percent. It's about a 20 percent pullback. There's traders out there who they might define dips by some percentage. And you could make an argument that might be arbitrary. But you can also use that, what might have been an arbitrary picked number, in a systematic fashion to be consistent. So, what do I mean by that? There's traders out there who say, "Hey, if there's a 5 percent pullback, that to me is a dip. That's a buying opportunity. I'm going to go ahead and allocate additional capital to this trade." And so on each 5 percent dip along the way, 5 percent, they're going to go ahead and add more, add more, hoping that the trend continues. Those are just short-term buying opportunities.

Others say, "Hey, 5 percent is not the right number. Maybe it's 10 percent, 20 percent." Where you choose your percentage, or your number is up to you as the trader. There's not really a right or wrong, a better or worse. But the reason why someone might use that, the advantage or the benefit, would be that if you see something that's rather anomalous relative to what you would consider a dip then you might second-guess whether you really want to put additional capital to that trade. So, if you had a 5 percent pullback, 5, 10 percent pullback, a 5 percent pullback, but then you get a 20 percent, hmm, something's a little bit different in this instance. Maybe I want to wait a little bit longer for that additional confirmation before I feel comfortable. Maybe it gets down to 20, I'm going to wait for it to come back up to only being a 5 percent pullback from that pivot swing high point and then allocate my capital. So there's a few different ways we can look at these dips. I hope this is helpful in terms of defining what they could be, what the importance is of a trend, and using the analysis of is this a dip or not a dip, should I make this trade or not, and if I'm wrong what does wrong being look like, how can I manage my risk.

And James, I think this is really important here when we talk about this conversation is risk. I want to turn it over to you to look at the second half of this chart. We'll notice that things take a turn. What was once an uptrend becomes a downtrend. I know today we're talking about trading in dips but also downtrends. So, I'll turn it back to you to talk about why this is different and what we can be thinking about as traders here.

SAVAGE: And this chart should really show why it's important to sometimes have a method of confirming the trend that you're in. The left side of this chart looks very different from the right side of the chart. And we spent a lot of time focusing on defining that trend, that direction of trend, because that's going to be crucial in formulating your plan, what strategy is going to be appropriate for the specific situation that you're in.

As we can see on the left side, what direction is our moving average facing? It is moving up from left to right. And as we get to the right side of this chart, it's not rocket science here, it is now moving on the downward side. And this is our -- for the examples that we're using today we've chosen this indicator. But there are multiple indicators out there that can assist you with determining trend direction and trend duration. Just for this example we've chosen our simple moving average, that commonly used close proximity to the 200-day simple moving average, to assist us with determining our trend direction, which will then allow us to choose the appropriate tool strategy for the situation that we're in.

So, as we move over on the right side, as Chase was outlining, what do we notice price, and where is it in relation to that moving average? It is now underneath that moving average. And as before the average was acting as a bit of support to price, now it is resisting price on the upside and the Bollinger Band is now acting as our level of support. One of the other uses of the

Bollinger Bands that John Bollinger had actually mentioned in creating this is that it can even sometimes help us with trend analysis because price can and oftentimes will ride those outer envelopes. The upper one in an uptrend and the lower one in a downtrend. So, in addition to measuring volatility Bollinger Bands can even assist us with our trend analysis.

Now as I get to explaining the downtrend, let's try to break that word down into two parts. Again, it should be fairly simple here. First part is down. That's easy, right? Price is moving down. Now the second part is going to be trend. And if I were to use some of the simplest words that I can, trend is just the direction of price or an index in our example today. Trend can be up. Trend can be down. Trend can be sideways. And some may view that as no trend when it's sideways and that's all right.

Now a downtrend is generally defined as price or an index value exhibiting lower troughs and lower peaks. So, in other words lower lows and lower highs over time. And we're noticing that. As our moving average is pointing downward what is price doing? Those lows continue to get lower. And those highs continue to get lower. So that is also assisting us to confirm that we are in a downtrend.

Now with a description as loose as that you might be wondering next well, how long does the price have to go down for it to be in a downtrend, how does this distinguish itself from a dip. Well, other than our moving average being there to assist us, pointing downward, we can sometimes use some of these other technical analysis beliefs in assisting us with determining the duration of our downtrend. Now when I'm referring to trends I always like to talk about well, this idea oftentimes of trends comes from the teachings of Charles Dow. And yes, that is the Dow from the Dow Industrial Average back when it was developed in the late nineteenth century. So one of these components of Dow theory is that there are three primary kinds of trends. There are minor trends which are lasting a few weeks. Secondary trends which are lasting for a few months, being fairly broad here. And then a primary trend that can last for a year or more. All are trends. So, as we can see that there are shorter-term, intermediate-, and longer-term. We can view many different trends even within a single chart sometimes if we break them down into their own specific periods. However, for today and the strategies that we're going to be showing in some of the examples we're going to get to in a few moments here, we're going to be focusing more on the secondary and the primary trend. So something that could be three months, six months, or greater. And again before we get into the strategies, I want to again state why this was viewed as an intermediate type of session. Because trading in a down market as I mentioned earlier is trading against the herd. It is not typical. The world as a whole is generally trading from the long perspective. It might be long in your 401(k) or possibly your IRA. That is oftentimes considered the default way to trade and invest. When you're choosing to go contrary to the overall market, you're going to need to oftentimes add additional features on your account, such as adding margin for example if you want to short stocks or ETFs, or even adding the options feature on the account. Because options do have the ability to allow us to trade bearish strategies.

Now some of these bearish strategies do carry this theoretical unlimited amount of risk. So, I want you to keep that in mind. When you're trading a downtrend, it can sometimes feel like the whole world is rooting against you, because to some degree they are. They want the market to continue to rise. So this is why risk management is so important and why we need to focus on that, because well, as we talked about, the rest of the world is really trading bull and some of these bearish strategies that we're going to talk about do carry unlimited amounts of risk. So let's keep that in mind.

So, I think it's time to now jump into one of the greatest tools that we have in Fidelity Active Trader Pro. And this is going to be the profit loss calculator. Now for the examples I'm going to go ahead and choose a stock just so we can mix it up a little bit here. We'll go back to the S&P, but we'll go ahead and choose a stock, Apple. It's one of the largest companies in the world by market cap. It's in quite a few of the common indices like the Nasdaq 100 and the S&P and I'm sure many of you are familiar with this.

Now if you're not familiar with the profit loss calculator, I just want to spend maybe a minute or two just describing what we're looking at right now. So we can break this up into what I like to view as four parts. We've got some of our inputs up at the very top. You'll see a box for price, a box for date, and a box for IV percent change. This is where we are going to put our forecast, our simulated we can say future that we want to create. Whether that be a price of in this case the stock where Apple is, we can put it where it's currently, if it goes higher or if it goes lower. We can then choose a date. So if Apple is a certain price on a specific date, what will that look like from a profit loss standpoint? And then finally, we can change the implied volatility. Now this is going to be related to options. Now because this isn't an options-focused type of webinar I'm going to be leaving this one blank because I think the majority of you, even if you're just trading stocks, can conceptualize well, if we change price and we change what time we're in, what day we are, well, that's going to impact how some of these option strategies could change. I'm going to keep implied volatility blank. But this is absolutely a part that you want to add when you're trying to formulate this hypothetical future that we're trying to trade.

So, moving below that to the second part of our profit loss diagram is our P&L table, our P&L graph. Now on a stock it's fairly straightforward. On the x-axis down below, we've got price. So, as we move from left to right price is increasing. As we can see 151 at the current levels is a higher price we are in. Under 30 is at the current levels a lower price than where we are. Over on the y-axis this is our profit and loss. Profits are up in the green, loss is down in the red. Now this same information is going to be given in what I like to view as the third section, which is down below, this is the same profit loss data, just in a tabular form, so a table. So, if you'll notice, if we're on a higher price, again maybe 150, we're going to be showing a loss, and you'll see why soon. And the lower price, we're showing now a positive figure, a gain. And then finally on the bottom section, that lower fourth area is where our strategies are going to be located. And we've got four of them that we're going to be talking about. Now just as a reminder, we do have slides accompanying this webinar today. The same four strategies that we're listing down below are going to be what was used on the slides. If you want to take a look at what those strategies are for reference after the webinar you can go ahead and download those slides and view them there.

So, let's break it down now and go into well, how these strategies start to interact with each other, starting with shorting stock. Now how do we know we're short stock? Some of you may not be familiar with this, especially if you don't have a margin account or never added this feature. Look at our quantity. It's a negative 100. That stands for negative 100 shares. So yes, if you're shorting your account, instead of seeing a positive number which I'm sure many of you are familiar with, you will actually show a negative number. Because you have sold first. I don't want to get too much into the mechanics of what goes on behind the scenes. But it's still going from the same premise that we all know. That phrase buy low sell high. When shorting you're doing the inverse. You're selling high and then buying low. You've just swapped the order a bit. So, let's bring our attention back to the profit loss table or graph, whatever you might find is easier. And you'll notice that why the value of our profits were increasing as we go down is because we've sold the stock. So ideally, we would have wanted to have sold it high maybe at the current price now and then buy those shares back at a lower. So, let's start to adjust our P&L graph for a little bit here.

What if the stock went down to 130? So, by typing in that theoretical price -- and we'll keep our date as today. What if it went down to 130 today? Go ahead and click on enter. And what we'll notice is that our P&L graph has now slid. That we are now focusing, and it is highlighted in that column. See it in the third part. That we would have a gain of about $1,300. It's just based on the theoretical price of when we opened up our trade that we inputted earlier. So, I think this is going to be fairly straightforward for the majority of you, if you're looking to trade in a downtrend, well, if your forecast is that the market would go down, you'd be choosing to sell first, sell high, and then buy it back later at a lower price.

Let's get some of these option strategies involved. So, I'm going to start with one of the ones at the very bottom here that we had. You're going to see it's listed as a spread. Now you can see that there are a few more figures down below. We've got what's referred to as a bear put spread. Why? This will make money as the value of the underlying goes down. Or some may view this as a debit put spread because we are paying money to open up the strategy.

So, let's take a look now at our P&L table. I'm going to make a few adjustments. So, going back up to the first section here, what if our forecast in our downtrend -- so let's go back to the S&P chart. Remember we were looking at price going down with that simple moving average. And maybe we had a specific target in mind that well, we think this price trend is going to continue but we want to get out once maybe Apple gets to $115. So, we could go ahead and put in a price. And you would put whatever price you were looking to target as your profit zone. And again, as I talked about the idea of maybe a longer term, that type of primary or secondary trend area, I've used contracts that went out for a year again just for this hypothetical example. But let's say it happened after six months. So, using our P&L tool we can move the date. And let's bring us to March. Any day really in March. We'll go ahead and choose maybe this March 18th point in time.

Now I like to focus, and I think this is going to be easier, especially for some of you out there that are not options traders or maybe thinking about getting into options trading. I'm going to mostly focus on the table. I think it's a little simpler. So, you're not worrying about what are these three lines on the table above. Let's just focus on just this table. So you'll notice there's three rows. There's only one with the stock. Because we're selecting an option we're given three. One is showing us the profit loss at today's date. One is showing us our profit loss at the date that we chose. That was that March date. And then finally one will show us, the final bottom row will show us our profit loss at the date of expiration of the contracts. Because we are modeling this date six months roughly from now, we're going to choose and focus on that middle row. So, keep your eye on those middle rows as we go through the option strategies.

So, in our example if everything went right on the trade, how much money would we be making from our strategy? We'd be making about $1,000. We can see it's $1,045. So roughly $1,000 just to round that number. So, it's doing what we intend. We're trying to trade a down market, a downtrend, and we've put a strategy where if in this case Apple were to go lower than where it's currently trading, we're going to see a profit of $1,000.

Now let's see how this compares to some of those other strategies that we gave. So next up as we move up on this list is the long put. So, you are just in this case buying that put. How do we know we're buying it? Because the quantity is a positive value of one. So, let's see what would have happened had we chosen this strategy as opposed to our bear put spread. Well, again let's focus on that middle row. The column at that price target that we've chosen. And we're showing a profit of 1,383, so about $1,400, again just to make those numbers nice and use your rounding. So, we got a larger profit than the other strategy, don't we? It was $1,000 with the spread as opposed to $1,400. Okay. So, you could make a higher profit with this trade should this scenario play out.

Now of course that's not the end of the story. But let's introduce that final option strategy that we have in mind, and this is now trading call. And you'll notice that quantity is a negative one. So, we have shorted this call all on its own. And now what do we notice with our profit and loss? It is higher. We went from around $1,400 for the long put and about $1,000 on the put spread, and we've made even greater. Of those three option strategies we're now making about $1,600. We're making even a larger amount of money.

And let's go back to the stock one more moment. Just again put this in comparison. Remember how much the stock would be if we went down to $115. We'd be making close to $2,800 profit. So, what's the relationship here so far? As we can see, all of these strategies have yielded us different profits. Stock being the greatest, and the short call, the long put, and then the put spread. Now that won't always be the scenario. This won't always be the case with these strategies. But in the scenario that we've outlined and modeled, this is how it would work.

But why we want to focus on risk is because we're not always going to be right. I don't know about you but I'm not right every single time. Every time I place a trade there's an equal sometimes chance, I'm going to be right or wrong. So we need to always plan as if we were wrong in the trade. That is our primary duty as a retail trader, is to manage our risk and preserve our capital. So we would always want to run a inverse scenario to what we expect so the scenario if we're wrong. So, since I used $30, let's say $30 above. Instead of 115 let's use 175. And let's take a look at the stock. How much money would we be losing now? Three thousand two hundred dollars on the stock. So that's our baseline if we were just shorting.

Now let's do the same thing that we did for those strategies. So, what if we did the spread? The bear put spread. And we were wrong. The market were to go up six months from now instead of down. Maybe we incorrectly called that downtrend and possibly it was just a dip. So, we tried to trade a downtrend but the price dipped instead and continued on an upward movement. We'd be losing about $772, around $800 with the spread.

Again, let's run through the comparison. With the short put we'd be losing about 1,100. Sorry. The long put. We'd be losing about $1,100. From 800 to 1,100. So, we're losing a little bit more. How about that short call? Again, focus on that middle row in the table. We are losing now $1,900. So, what's the relationship between all the four strategies from the gains, from the profit side, and the loss side? If we were to think of maybe some type of risk-reward balance. The strategies that yielded us the highest profit in this scenario, the short stock and the short call, had the higher losses, the greater risk should we be wrong. As opposed to the long put and the bear put spread, the debit put spread, well, they had a lower threshold of losses. So, this is why we always like to focus on is that there's never going to be a best strategy, the perfect strategy. Only know what the best strategy was or what the perfect strategy was in hindsight. And that's not going to help us make profits now.

So, what you want to think about as a trader. When I've identified a downtrend, well, think about how do you want to balance your risk and reward. Because each of these four strategies have a different degree of risk to reward. While in one strategy you've got higher risk, you've got higher reward. So, you're going to want to tailor the strategy possibly to your level of risk and reward. Now there are some other factors at play there. But I think this is coming at it just in the limited time we have and focusing on the risk and reward perspective is going to be extremely important, because ultimately our goal is to put dollars in our pocket and protect the dollars that we have as much as possible which is why we're focusing on the risk-reward, the profit loss standpoint.

But one more thing I want to focus on. One final example I want to show here. And that is balancing as I mentioned what's our primary duty as a retail trader, to manage our risk. There's also another risk out there other than loss. And that is the risk of ruin. We do not want to have any of these trades ruin our trading career, especially if we're just getting started. So, let's use an example of a catastrophe. What if Apple doubled in price? Let's say it went to $280. You might think well, no, they're not going to double in price. Well, there were quite a few stocks that have doubled in price over the past year. So, let's never rule that out as a possibility. Remember we need to be focusing on a risk first approach, weighing all the types of risk that are out there. Because it can just take one bad trade to ruin our trading account and have a severe setback. So let's focus on some of these strategies now if it were to go significantly against us and we did not manage our risk. We held on to the trade with the hope that it was going to reverse, and we held on to a losing trade without an exit plan.

Well, look at our stock loss. A loss of $13,700. Let's take a look at that put spread. What is our loss? We'll move over. As you can see, we've got to slide this over quite a bit here, $1,000. It is less than 10 percent of the loss. How about our long put? Fourteen hundred dollars roughly. Again, significantly less, about 10 percent of the loss of the stock. And our short call. Twelve thousand dollars. It's significantly greater than the other two options trades. And this is what I was referring to. When you're trading some of these more advanced type of strategies, especially these uncovered short positions, the short stock and the short call, you're dealing with risk that could be significantly higher than what you're used to. These are two examples of those theoretically unlimited risk trades. So, this should also factor into your consideration when choosing the optimal strategy, is that risk of ruin possibility.

So, as you can see, yes, those two strategies had the higher potential profit should you be right. And should you be incorrect, well, they could have a higher degree of losses. But without a plan some of these strategies carry a significant amount more risk or potential for losses than some of the other ones. So, you absolutely want to weigh some of these considerations when choosing what strategy is appropriate to your level of risk and reward. You might find that well, the rewards are close enough for you in the scenarios that you don't want to open yourself to that higher degree of risk. So, it's something that every trader should keep that in mind and hence why this tool can help alert you to some of the potential profits that you could have as well as some of the potential risks that you need to be on the lookout for.

I really wanted to spend a good amount of time focusing on the profit loss calculator and how we can model some of these trades and just showing the four that we gave in the slides in a bit of a hypothetical scenario.

But of course, let's focus a little bit on the dip strategies that we mentioned as well. Not to exclude those. So, Chase, I know you had been walking us through the S&P chart. So maybe for the example we can jump back over to the S&P and show a little bit of some of the dip strategies that we had in mind.

COTNOIR: The one thing I want to add here, James, really crucial to that though process of risk and reward, that balancing act that can be so difficult for traders, is your confidence level in the trade. That's the other word I would add to that statement, is what is your confidence, or how confident are you that you're right, and that someone else on the other side of the trade is wrong. There might be setups both technical or fundamental in nature where you might feel very very strongly with. And others you might like the risk-to-reward ratio, but you might also not be as convinced. And so, you need to think about how confident am I in this trade. If you're more confident and you absolutely know that you're right, there's no way that you could be wrong, who hasn't been there before, then you might be more inclined to look at one of those higher risk potential but also higher reward. Why? Because you think that you're right, you know that you're right in your own mind.

But if you're a little bit more tentative, you're trying to be more pragmatic, you might be waiting for that additional confirmation that we talked about before, you might at first take a more tentative strategy choice or selection as opposed to going all in in the higher risk, higher potential reward type strategy.

So, we look at this S&P 500 chart. There's a few times we've had a dip that quickly bounces back, quickly reverses. Here's another dip, quickly reverses. So, by the third or fourth one you might be feeling very confident and say, "Hey, this market is clearly respecting some uptrend in this case as we've defined it." It's the 10-period monthly proxy for the 200-day simple moving average.

But what about when you get up here? The moving average is not at the same level of ascension or the angle or ascension. The degree is just not the same. It's starting to wane in how strong it is or the level of bullishness. So at this point maybe you're not doing those full-on trades. Maybe your position sizing is a little bit smaller. Or if you are taking on those higher risk and potential reward trades, you have an even more stringent risk management plan.

So, it's always important to keep in mind what is the condition of price and what is the confidence that you feel given what you're witnessing out in the marketplace. So, what would be some of those potential strategies you could employ? I'm going to stick with the S&P 500, in this case actually SPX, the index, for some of the potential choices we have available to us. I won't spend too much time going through all the intricacies only because the conversation is going to read quite similar to what you just talked about, James, except these aren't bearish trades, these are going to be bullish trades.

So, first thing we have here is the October 15th call. Now what people might notice is I've gone a little bit shorter here in the expiration selection for the option. Now why might that be? Again, think back to what that definition of a dip might be. It's a shorter-term countertrend movement within an overarching longer-term uptrend. So even on those monthly charts or those monthly candlesticks your expectation may be that you only need one or two candles or one or two months for reversal. So, could you choose a longer-dated option but then just trade it in a couple months? Yeah, of course you can. That certainly is a choice. But for demonstrative purposes we're sticking to a little bit shorter of an option expiration here.

So, James, just like you had done, we can start running some evaluations on what we might expect both for the good and for the worse. In this case I'm going to focus on the worse just because we're coming to time. I want to make sure that we're really driving this risk management point home. Let's say we have this call option and the S&P falls drastically. We'll put it down let's just say in this case to 4,200 points. And we'll fast-forward some time just a little bit here. Again, this isn't the longest expiration that we have available to us. So, what if it does it, we'll call it by the 6th? So we have a little bit of time left to expiration but not a ton. What would this look like for our trade?

Well, you can go trade by trade, strategy by strategy, look at all the details. But we also do offer this theoretical profit loss column as well. That might give you a more consolidated look. And we can see across the strategies how this would have played out. For the long call we would have lost approximately 6,100 bucks. Why would that be? Well, we think about what we paid for, almost $6,400, most of that is going to be lost, not only to the passage of time, but because this moves in the opposite direction that we were looking for. So, it's exactly what we didn't want to have happen. The market knows that. They're pricing that into the option.

What about a put spread? In this case we can see that we are short the higher strike. And we are long the lower strike. So, this might be referred to as a credit put spread or a bull put spread. Not necessarily as bullish of a strategy as the long call. Sometimes referred to as bullish neutral. How would that fare? Well, in this scenario we lost less. About half or so. But we still lost money. Approximately 3,000 bucks on this trade.

If we did just a short put alone, so there was no hedging effect with the spread that we might have gotten before, how would this have played out? Well, significantly worse. We'd have lost about $14,000 give or take.

So, what's important here, especially with these bullish trades, as James was mentioning, the world is trying to at some point in time acquire a long position whether it's through your 401(k) or savings. So, you want to think to yourself if I'm going to be wrong, if I'm going to be wrong in a big way, are all the world's bulls going to let me down, if they do what will that look like, how will I position myself, how confident would I be, and can I really afford to take the risks that I'm positioning myself with here.

Of course, we can run the same analysis to the upside. Which is what you would expect for a dip type trade. You're looking for that short-term reversal to the upside in continuation with your bullish trend. We can see again if we compare all these side by side, the put spread is not going to make as much relative to the two other choices. It's going to make about $900. The short put in this case just by itself is about $4,700. And the long call is about 4,900, almost 5,000 bucks.

So, what I want people to take away, whether it's the dip or the downtrend, is starting first with looking at what is the condition of price, what is the market showing me. You can use some type of technical indicator like a simple moving average or any other trend indicator to maybe more definitively define what that trend is. Is it an uptrend? Is it sideways? Or is it a downtrend?

And from there you can start to formulate okay, if it's in an uptrend, is there any kind of respect for this trend line, are these dips actually being bought up through time, and if so do I feel confident that that will continue to be the case, and if and/or when I'm wrong what kind of risk management do I have in place.

Versus hey, this is a downtrend, if I'm buying on the dips but they keep dipping, that's an entirely different trade, that's no longer buying in an uptrend, I'm buying in a downtrend. We want to be mindful of the trades and the risks that we're taking. So I hope that's coming across for everybody today. James, I'll pass it back to you just for final thoughts, what people should be doing in terms of next steps if any to take away some of these lessons and learn more about trading.

SAVAGE: Chase, I really liked what you said there. You need to have a plan where if you're trading the dips, but the dips keep dipping you need to be ready to get out. Because you're going to be ultimately in a bullish trend, a trade that requires a bullish trend, and you don't want to find yourself in the downtrend with a bullish trade. Likewise, if you are in a bearish trade and you're now in a bull trend, well, you don't want to find yourself in a bearish trade in a bull trend. So, it's very important to make sure that your strategy is going to align with not only your outlook but what the market is telling you. Hence why we really wanted to cover just a few technical indicators to just remind everyone to possibly use some either indicators or what price is telling you to assist with your analysis on your entry, your exit, and your risk management. But I know we are, Chase, right at time. So, I don't want to go over too much here. I definitely want to respect everyone's time. I absolutely had a great time talking about this topic today.

END OF AUDIO FILE

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