Independent Wealth Alliance

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No Bulls. No Bears. Just Profit.

Hubert Senters

John F. Carter

How to Ride August's Wild Bears and Bulls to Profit

By John F. Carter

In This Issue

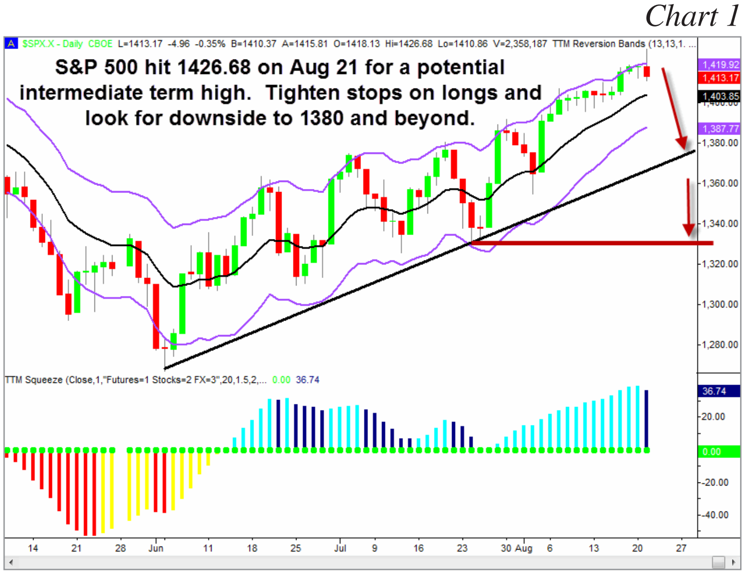
Hello IWA members,

Welcome to the August edition of the IWA. I hope you've had a relaxing summer vacation and are ready to get back at the markets with a vengeance! Believe it or not, there's a lot going on in the markets right now, so let's take a look, see what it all means, and how you can profit from it.

Many people don't realize just how important the month of August is in the markets. But August is a very interesting time for the markets because it sets the stage for September and October. Typically those are two very, very volatile months. And really, August sets the tone for the rest of the year.

This is especially true right now, with the market approaching some key 2012 support levels as well as some seasonality coming into play. It is no exaggeration to say that we are in a very critical time period right now. This is borne out by all the different set ups we're seeing in the charts that may well turn everything in a totally different direction very swiftly. Because of this, the most important thing is to preserve what you have and get ready for a complete reversal in the volatile months ahead.

Chart 1



A Complete Market Reversal

These are several markets that we would like to look at to take advantage of this occurrence, but we will focus on just a few of them here. First we're going to look at the broader stock market by looking at the **S&P Cash Index**, in **Chart 1**.

Now, for many months we've seen this kind of a symmetric move higher over time. And within these moves higher, we can see the equidistant little pops like this, at **Points A, B,** and **C** in **Chart 1**.

Can you see all those pull backs? See how they are all equidistant and all on an up trending slope? And see how, right now, we're in the next little pop, seen at **Point D**?

What does this mean? "Will we get another pull back and then just keep going higher? Or, pray tell, is this up trend coming to an end?"

It's very, very possible that on **Point E** on **Chart 1**, that we can actually set an intermediate term top. How should we read that?

One of the tools that I use, among a few others, is the **Elliott Wave**. The Elliot Wave is indicated by **two parallel lines** on **Chart 1**. Let's see where this goes…

Taking Out March Highs?

Now, in terms of technical analysis, what's happening here is that you can see **we had a five wave count high**. And now, we're in the middle of another one, indicated at **Point D**.

What's going to happen at our current point on this **Elliott Wave** essentially is that if by the end of August, we can't take out the March highs on a decisive basis indicated by **Point __**, then we're setting up the stage for a new fifth wave move, except this is going to be more like the one at **Point __**.

You can see that it's lower. That's what I think we'll see happening in the next two weeks or so. But the flip side is that if we *can't* take the March highs out, then look for a fifth wave to hit. That fifth wave will be a **lower hit**. So, *if we don't break through the March resistance highs, we could actually get a pretty nasty sell off.*

Which direction will the markets take?

It's a little tricky to call right now because we're right in the midst of this move, but at this point, my overall bias is to prepare for a nasty sell off. So, what should you do to prepare yourself for that?

First, we would be smart to tighten stops on all of your longs, because if break out does goes through the March highs and keep going, then you're fine. No harm, no foul.

But what happens that if I'm right, and it goes the other way? If the market rolls over and takes a big dive, then you will have protected your profits and you will be prepared for this move to the downside.

So the main thing I want you to understand is that we have a major move in the markets coming soon. There's a very decent probability at this point, that in August, we see an intermediate market top. So I'm preparing for that. Again the best way to prepare for that is tighten stops on longs, and then be ready for shorts. One more caveat to remember: these things don't happen on the turn of a dime, but they do happen relatively quickly.

Now, what can happen in the market if this does happen?

Dollar Wins in a Market Correction

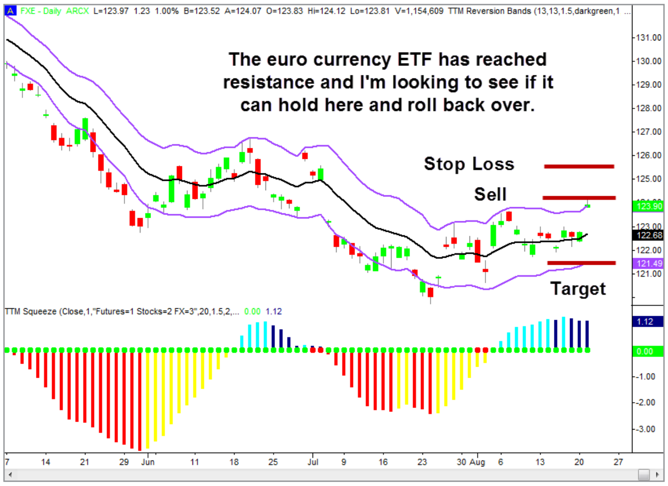
There are several things that can happen. First, let's look at what happens to the dollar. Typically, when the stock market is going to fall, you're going to see the dollar index push higher.

If the dollar index pushes higher, then that also has a lot of implications in the broader markets. For one thing, it means continued lower prices on the Euro. If nothing else, it means that it's going to get much cheaper to go to Europe. And that's important to know for planning and other financial positions. So, look for Euro to go lower.

How do you make money on this?

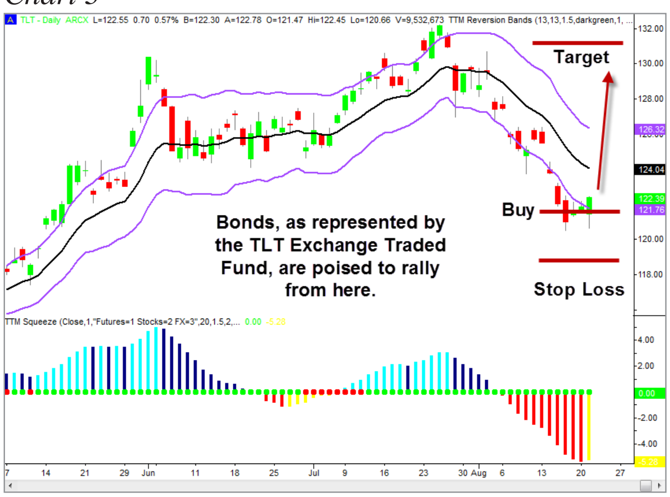
This play is best leveraged by the ETF **FXE**. See **Chart 2**. From there, look for bonds and notes--and again this is important too--to go higher. So there will be opportunity where we see *stocks and the Euro going lower.* But also, we'll see both *the dollar and bonds going higher.* Both of these developments could persist for a couple of months.

Chart 2



The next important piece of this puzzle is what happens to gold. Of course, if we get a situation here *where the U.S. dollar is going higher, we look for gold to go lower.* Gold, of course, is one of those things that is on everybody's mind, but you can see exactly what I mean at **Point__**, in **Chart 3**. The inverse relationship of the dollar and gold is clear.

Chart 3

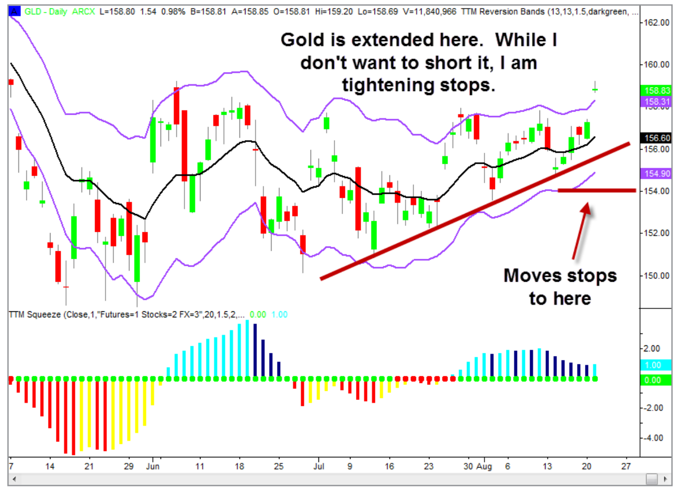


Remember how I said at the beginning of this article that August is a critical time?

GOING AGAINST THE GRAIN?

Well, *the biggest thing that's going on in the world right now is actually happening in the grain markets.* It is very important for countries around the world. Not only is there a historically important drought in the U.S., but more importantly, there's one at least as nasty in South America. How will these droughts affect the grain markets?

Chart 4



See **Chart 4**. On the one hand, at **Point A**, grain prices could shoot through the roof, as everyone would expect that they would. And why not? It makes perfect sense. But there is another hidden trap to look out for.

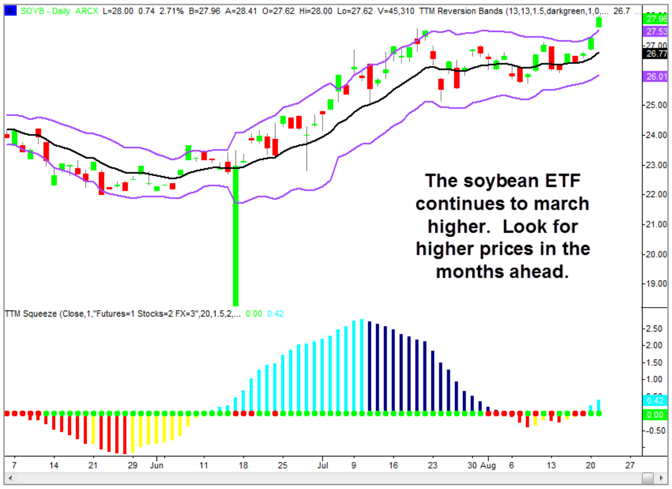
The danger is if the drought in South America becomes so bad, the U.S. may not ship as much grain outside the U.S. as it normally does or is expected to.

Think this won't happen?

Well, it happened in the '70's when Jimmy Carter, no relation to me, was President. The Carter Administration put a grain embargo in place and the price of grains collapsed. You can see that price collapse in **Chart 5.** They went limit down for at least five days.

For right now, I love grains for the long side. But you've got to be careful if what happened in the 1970's, happens again. A grain embargo is the kind of news that could kill a lot of trader accounts overnight.

Chart 5



So what are some ways around this risk?

Well, the easiest way is to not have exposure to futures contracts. **See Point A** on **Chart 6**. You could buy an ETF like **DBA**. DBA covers agricultural funds and seed markets.

Remember, if we're suddenly seeing all the grains get limited down, we're probably not talking about a huge move, maybe a couple of bucks. But *the upside potential is fantastic if that doesn't happen*. So to me, this is one of the more intriguing plays this month.

Of course, there is also an ETF XXX that's just soybeans, which we actually hold, and it's a good one as well because there's not much risk on that. You can see where we bought it at **Point A** on **Chart 7** and where the movement has gone from there.

That's the big picture for the month of August and several ways to make some very handsome profits. I next month's IWA, we'll look at what has happened in the market, what I think is about to happen, and as always, how to best profit from it.

John Frederick Carter

Sideline Play

A recommended trade that has nothing to do with what we've been talking about in this issue

For our Sideline Play, I like Toll Brothers (TOL)—a great way to invest in the Real Estate Market by proxy. Now I realize that the Real Estate market probably has about another year or two until it bottoms out, so this is a bit of a longer-term play. But I can also tell you that this trade has a lot of potential upside with it.

How do I want to play TOL? Your stops will be at the lows of $21.80. We have a potential Darvis Box break out forming and an elongated squeeze getting ready to push it to the high side. Our targets are going to be: T-1 $33.07 and T-2 $35.92

Sideline Play: Long Real Estate

Long TOL 30-32
Stop: 23.80
Target 1: 33.07
Target 2: 35.92

Trading Into Rising Volatility for Profit

Hubert Senters

Hello Everyone,

I don't want to put too fine of a point on my colleague John Carter's predictions for the market, but I think it best that you pay them close attention. Even a Kentucky country boy like me can see that volatility will be rising going forward for the rest of the year and into the Presidential Election. And by the way, it doesn't matter which side you might be on politically speaking, the key for you and me is making money in a dicey market when just about everybody else is losing theirs.

So let's just see how we can do this right now, okay?

For our first trade, we're looking at potential failure for QQQ on a Weekly Chart at the resistance level of around $67.

As QQQ rises, we're seeing a decline in volume. This is usually a sign of weakness going into the resistance level. That's why we want to short QQQ in the $67-$69 area.

Now, where should we put our stop? We'll use the Average True Range (ATR) for last 14 days, which is $2.25. If you want to use 2 ATRs for your stops, it's 2x14 days' ATR, or $4.50 for your targeted stops. So we have a $2.25 stop and a $4.50 stop range for the share price.

If you don't like decimal points, take them off. That would give us a $2 stop and a $4 stop range for the share price. So, we'll short QQQ anywhere from $67 all the way up to $69. From your entry, use either your 1x ATR 2.22 or 2xATR 4.50 for your stop.

What's our target?

We're looking for a retracement for our first target, T-1, (1/2 of investment) from 64 to 63, T-2 (1/4 of investment) at $60, and for the last position, an open target, looking for a bigger rollover at T-3 (1/4) at $50.50.

Short QQQ 67-69
Stop: 72
Target 1: 64
Target 2: 60
Target 3: 50

Or, to look at this trade in a different way…

What if you don't want to short QQQ? What if you don't like shorting? What if you think it's un-American? You can do the same trade but inversely.

Just trade SQQQ, which move inversely to the market. If the market falls, SQQQ will rise. The same logic applies. Go long SQQQ around $40 to about $38. Use a Stop Loss of $5 or $10 from your entry point, and T-1 will be the same math: 49.90 to 52.28, and T-2 around $87.72.

So we have two trades, the same dynamic, one long and one short, just coming at it from different directions. Remember QQQ and SQQQ are leveraged ETFs, ultra pro shares, short. Check Google for more information on both.

Long SQQQ 38-40
Stop: 33
Target 1: 49.90-52.28
Target 2: 87

For our second trade, I like FSLR. Looking at Weekly Chart for a slightly longer-term trade. We'll use the Value Chart System (VCS), a statistically over-bought and over sold-indicator, which shows us where FSLR will likely make its next move to the high or low side. The short signals look better than the long does right now. We'll be shorting at $20 or above, because the VCS tells us that it is overbought, over valued, and ripe for a sell off. We'll put stops at either 1 ATR $2.50 or 2 ATRs or $5.00. So our stop will be at $24.

What's our target? A good rule of thumb in high volatility markets is if a stock falls to $20, it's got a good shot to hit T-1, $15. If it goes to $15, it's likely to go to T-2, $10, and even T-3, $7. At this point, it can easily go to $5 and stay low from there for years, dying a slow death.

FSLR Short 20-23
Stop: 24
Target 1: 15
Target 2: 10
Target 3 : 7

Mail Bag

Welcome to the IWA members' mailbag. While we can't offer individual trading or investing advice, feel free to ask us your trading questions and we'll publish selected answers here. Write us at mailbag@independentwealthalliance.com.

Q. "Hubert, I don't like using stops. I've heard that my broker, the market makers and specialists hunt for stops and I'm afraid they're going to take me out of my trade. Should I worry about this?"

Back in the old days, that might have been true, but with computers handling 50%-70% of the order flow, it's not an issue any more. Now, another myth is that institutions, market makers and specialists care where your order is. But they really don't care where it is. If your order is two or three levels close to the order bucket, they'll try to fill them all at once. They won't hunt for you, stop you out, and then go in the opposite direction, even though it may feel like it sometimes.

But if you not using a protective stop loss order on all of your trades, or some other type of protection as a hedge, you will get hurt. My friend Mark was short Apple at $150. Did he stop out? No he did not. I told him to get out, but he had no idea that Apple would go to $200, then $200, then $400 and $500 and higher. Needless to say, Mark's account took heavy losses in margin calls. The message is, don't be like Mark! Use your stops.

Also always predetermine your maximum risk of loss for every trade. 2% is a common risk level among traders, or 25% from your entry, or even 1 or 2 Average True Ranges (ATRs) from your entry point. Whichever one you like, just be sure to use protective stops!

Q. "I think I've got a good trading strategy, but I'm not sure. How do I test it?"

There are several ways to test your trading plan or strategy, but two very good platforms to test it are *Trade Station* or *Multi-Charts*. You'll then put your trading program into either platforms, that will allow you to back test and forward test your trading strategy so you will be able to tell if you're strategy is profitable or a loser. You'll want to hire a programmer (or do it yourself if you're a techie) to input the program into the platform. You will also want to use good models like *Black Shoals* and other non-optimized stuff that takes unforeseen events into account.

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