TSR TRADING SETUPS REVIEW

DAY TRADING WITH THE ANTI-CLIMAX PATTERN

GALEN WOODS

Day Trading with the Anti-Climax Price Pattern

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Trading Setups Review

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Chapter 1 - Introduction

Thank you for being part of Trading Setups Review. This eBook contains a chapter from my "Day Trading with Price Action" series.

This chapter is selected from Volume III which talks about 7 price patterns and how to use them as trade setups. Specifically, this chapter covers the Anti-climax price pattern which is a very powerful pattern within the right market context.

To help you understand the context of this chapter, I will explain my trading framework briefly.

Our trading framework is essentially a trend trading approach. It covers the following aspects.

1. Identify the market bias
2. Find stop-loss levels
3. Find target levels
4. Find trading opportunities that offer positive expectancy

1.1 - Identify the Market Bias

Market bias refers to the general tendency of market movements. If the market is more likely to move up than down, the market bias is bullish. If the market is more likely to move down than up, the market bias is bearish.

Market bias is a critical concept for trading. Following the market bias place the odds in our favour. It gives us the chance to be the casino rather than the gambler. If we ignore market bias, we are better off in casinos. As market traders, we make money only if we go along with the market bias and not against it.

Market bias is the subject of Volume II. I will show you how to determine the market bias for day trading with two simple tools - market swings and trend lines. It is amazing how much insights we can get out of these seemingly basic trading tools.

In addition, we will discuss which time-frames are amenable to price action analysis and how to determine your trading time-frame with a simple concept.

1.2 - Establish Stop-Losses

The market bias places the odds in our favour and helps us make money from the market. Then, what does a price pattern do?

A price pattern controls our risk. Contrary to what many traders perceive, a price pattern does not help us to pinpoint an entry. It helps us limit our losses when we are wrong.

Our price patterns are tipping points. Bullish price patterns find the point where the bears will give up and the market goes up. Bearish price patterns pinpoint where the bulls are exhausted and the market falls.

Tipping points are useful because we can place stop-loss orders near them. When the market tips over to the bullish side, we can safely place our stop-loss order below the tipping point. If price crosses back below the tipping point and hits our stop-loss order, we know that our timing is wrong and we should exit.

Price patterns form the subject of Volume III. We will cover seven price patterns that will guide our trade entries and limit our trade risk.

In the same volume, you will also find advanced trading techniques for finding high-probability trades. More importantly, there will be an extensive discussion on exercising discretion while trading. You will realise that, ultimately, your trading success comes from your trading decisions and not my price patterns.

1.3 - Find Targets

If we are wrong in terms of timing or market bias, our price pattern stop will protect us. If we are right in both timing and market bias, the market will reward us and place some money on the table.

Having a target (exit strategy) helps us to grab the money from the table and place them into our pockets.

Taking your profits in a disciplined manner is more important in day trading than in other styles of trading. For most trading sessions, the market movement is limited. Day traders do not get very far with "letting your profits run". We must take profits when we can.

In Volume IV, we devoted a chapter to setting targets. The main techniques rely on support/resistance and measured moves.

1.4 - Find Trades with Positive Expectancy

The three aspects discussed above are not distinct and separate from one another. In fact, to trade successfully, we must integrate them and understand how they work together in a trading plan. And the objective of the plan is to find trades that offer positive expectancy.

In Volume IV, you will learn to:

- Integrate the price action techniques explained earlier in the series to find trades with positive expectancy
- Transit successfully from studying historical charts to trading in real-time
- Analyse your trading performance with a robust framework
- Manage financial, operational, and psychological risks face by a professional trader

Volume IV is closely tied to the Toolkit included with the book series. The Toolkit is a set of Excel worksheets to help you implement the trading framework.

The Toolkit contains the following:

- Checklist for Day Trading
- Trading Rules and Guidelines
- Price Analysis Matrix
- Trade Records Template
- Monte Carlo Simulator
- Trading Emotion Journal Template
- Risk Management Card Template
- Recommendations for Trading Resources

These tools will guide you to build your personal trading plan.

1.5 - Scope of the "Day Trading with Price Action" series

Over the next few pages, you will find the table of contents of the four volumes in the series. (Tables of contents are subject to change as I improve on the series continually.)

Volume I: Market Perspectives

Volume II: Market Bias

Volume III: Price Patterns

Volume IV – Positive Expectancy

Chapter 2 - Anti-Climax Price Pattern

> *"A disappointing end to an exciting or impressive series of events"*
>
> Anti-climax, as defined in Oxford Dictionaries

2.1 - The Psychology Behind

When the market rises with strong momentum and speed, traders fear that they get left behind by this exciting and impressive price action.

The instinctive (and wrong) response of these traders is to chase the market, hopping onto the bandwagon at market prices. Such responses cause the market to rise even more.

Eventually, the market runs out of buyers as traders finally pause to ponder over what the hell just happened. At that point, the market is left with a bunch of traders who have no idea why they are holding onto long positions.

Reluctantly, they take a step back and realise that they just bought into a resistance. Or, despite the seemingly strong upwards thrust, the market has not even breached the nearest resistance. The fact that they ignored the bearish market bias starts to sink in.

This is the beginning of the disappointing end. This is the Anti-climax.

As these disappointed traders sell off their long positions, we are already poised to take advantage of the selling pressure they are creating.

2.2 - Identifying the Anti-Climax

2.2.1 - Anti-Climax Pattern

The exact requirement of an Anti-climax pattern is shown in Figure 2-1. Each bar in the pattern rises above the previous bar high by an increasing distance. The bulls are buying frantically. Like the Deceleration pattern, the Anti-climax also has a limit line, beyond which the pattern becomes ineffective.

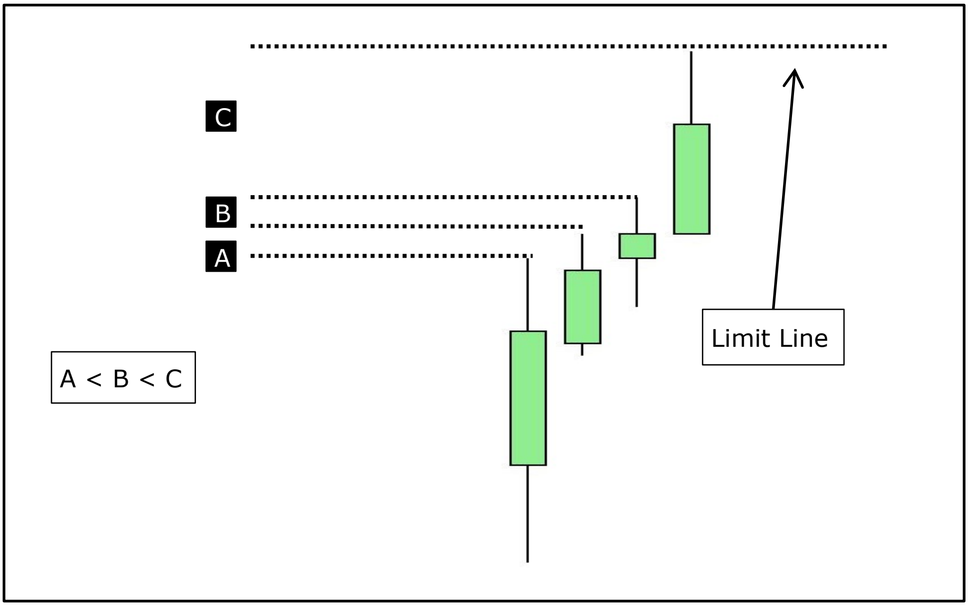

Figure 2-1 Structure of an Anti-climax pattern

You can also think of the Anti-climax pattern as the price action equivalent of price oscillators like the Stochastic and RSI. A defining feature of these oscillator type indicators is the overbought/oversold signal. A bullish Anti-climax pattern is an oversold signal and a bearish Anti-climax pattern is an overbought signal. However, instead of using complex calculations and arbitrary overbought/oversold levels, the Anti-climax uses price action and tends to occur before oscillator signals.

2.2.2 - Anti-Climax versus Deceleration

Visually, the Anti-climax is the exact opposite of the Deceleration.

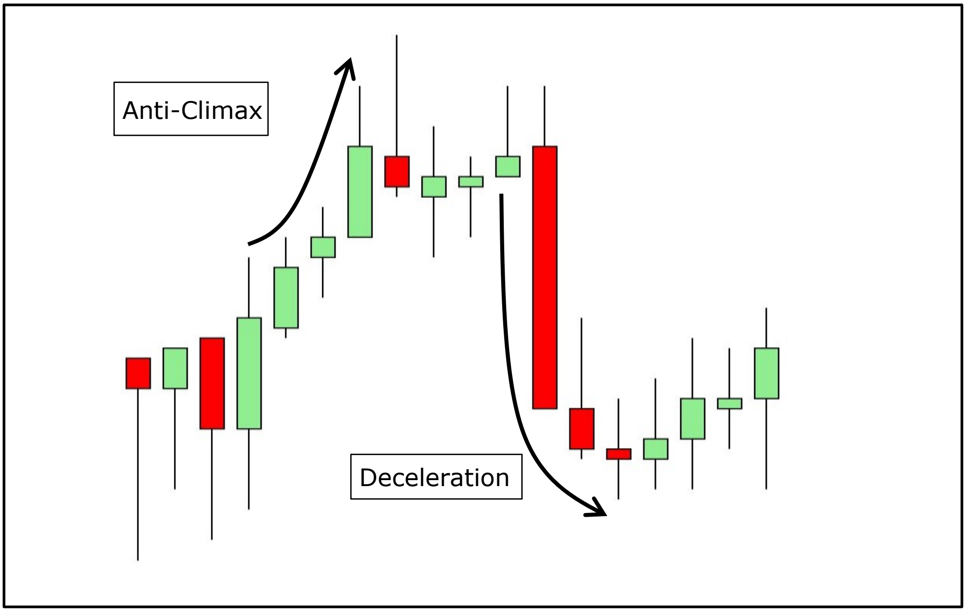

Figure 2-2 Anti-climax versus Deceleration

Although the Anti-climax and the Deceleration are complete opposites in their appearance, the trading rules we employ for both are similar. For a short Anti-climax pattern like the one in Figure 2-2, we sell a tick below the next bearish bar.

But these two patterns are the exact opposite of each other. How can we trade them similarly?

Doesn't it make more sense to interpret one as showing strength (Anti-climax) and one is showing weakness

(Deceleration)? Why are we fading both strength and weakness? Are we being inconsistent?

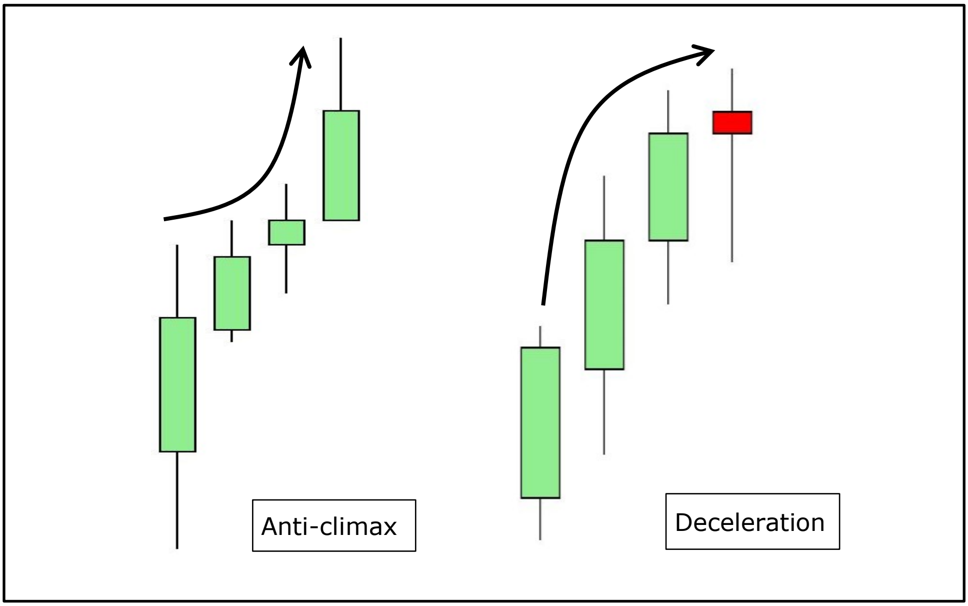

Figure 2-3 Both are bearish patterns; does it make sense?

Look at the two patterns in Figure 2-3. Within a bearish market context, both patterns are potential short setups. Why?

Three consecutive bars with higher bar highs could take on a variety of appearances. Within the spectrum of such three-bar patterns, the Anti-climax and Deceleration are on the extreme opposite ends. Anti-climax is the most powerful kind of upswing, while Deceleration is the most ominous type.

Understanding that both Anti-climax and Deceleration are on the extreme ends of the spectrum is the key to reconciling the seeming inconsistency.

This is because extreme market behaviours are unsustainable. Many trading strategies look out for market extremities in order to find trading opportunities. Some examples are:

- Extreme oscillator values (RSI, Stochastics)
- Prolonged period of low volatility (Bollinger Squeeze, NR7)
- Extremely high volume
- Extreme ends of a trading channel

Since the Anti-climax and Deceleration patterns represent the extremes of what a directional price swing could be, it is reasonable for us to expect both patterns to be unsustainable.

Of course, we tread prudently. We must have the support of the market bias, and we always wait for an appropriate setup bar to be triggered to confirm our analysis. Moreover, we have a limit line to help us distinguish patterns that do not conform to the market psychology we expected.

Remember how we interpret both patterns. The Deceleration is a counter-bias thrust that exudes weakness, while the Anti-climax is an impressive thrust that causes traders to ignore the market bias. The similarity is obvious. Both patterns go against the market bias.

Hence, if a bearish Anti-climax pattern punches above several key resistance areas, then perhaps, the traders have not ignored the market bias, but are instead part of a new bull trend. Similarly, if a Deceleration takes place when the market bias is unclear, is it really the counter-bias thrust we are looking out for? Bearing in mind the underlying concepts of each pattern is how we distinguish the quality of each setup.

Essentially, the Anti-climax and Deceleration form a pair of visually opposite patterns with similar implications, albeit due to different underlying psychology. Such pattern pairs are not unique in price action trading. Another notable pair is the Hammer and Inverted Hammer candlestick pattern. As shown in

Figure 2-4, the Hammer and Inverted Hammer patterns are visually opposite. Yet, both patterns have bullish implications. The same characteristic applies to their bearish counterparts: Hanging Man and Shooting Star. Opposite in appearance but similar in their bearish implications.[1]

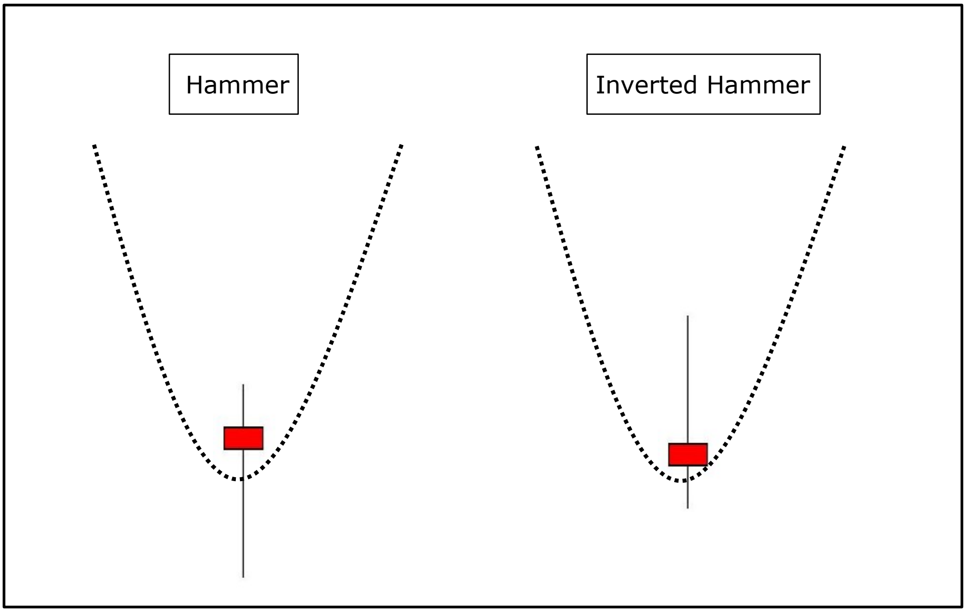

Figure 2-4 Hammer and Inverted Hammer

Again, it is the market context that reconciles this pair of seemingly contradictory candlestick pattern. Both the Hammer and the Inverted Hammer patterns are bullish reversal patterns. It is only within this context of a market decent that this pair of patterns becomes valid and meaningful as a bullish reversal signal.

2.2.3 - Long Anti-Climax Setup

Figure 2-5 explains the trading rules of a long Anti-climax setup step-by-step.

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[1] Refer to Steve Nison's Japanese Candlestick Charting Techniques to learn more about Hammer, Inverted Hammer, Hanging Man, and Shooting Star

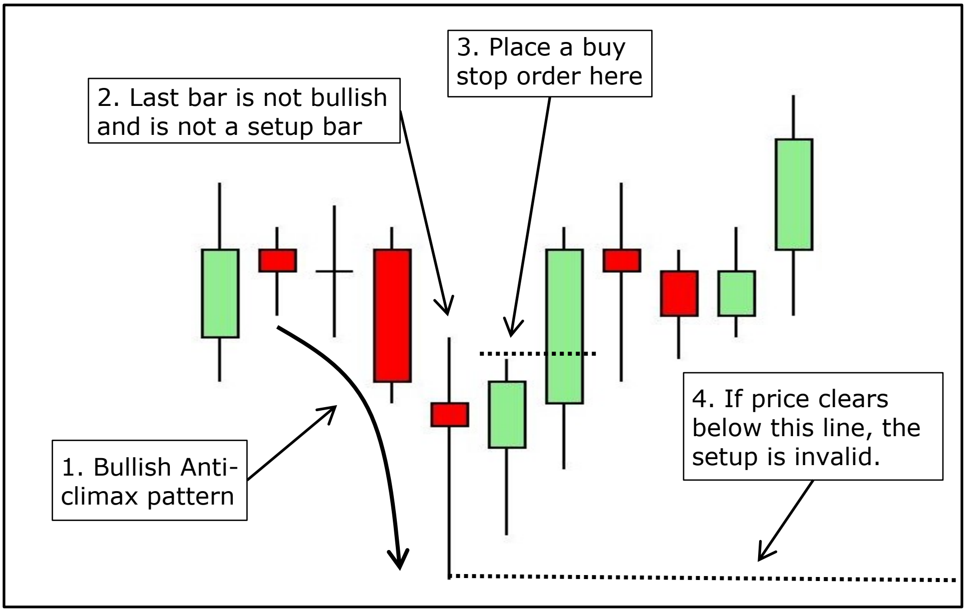

Figure 2-5 Long Anti-climax setup

1. Bullish Anti-climax pattern
2. If the last bar of the pattern is bullish, buy one tick above its high.
3. If not, buy one tick above the next bullish bar.
4. If price clears below the limit line (any bar high below the limit line), the setup becomes invalid.

2.2.4 - Short Anti-Climax Setup

Refer to Figure 2-6.

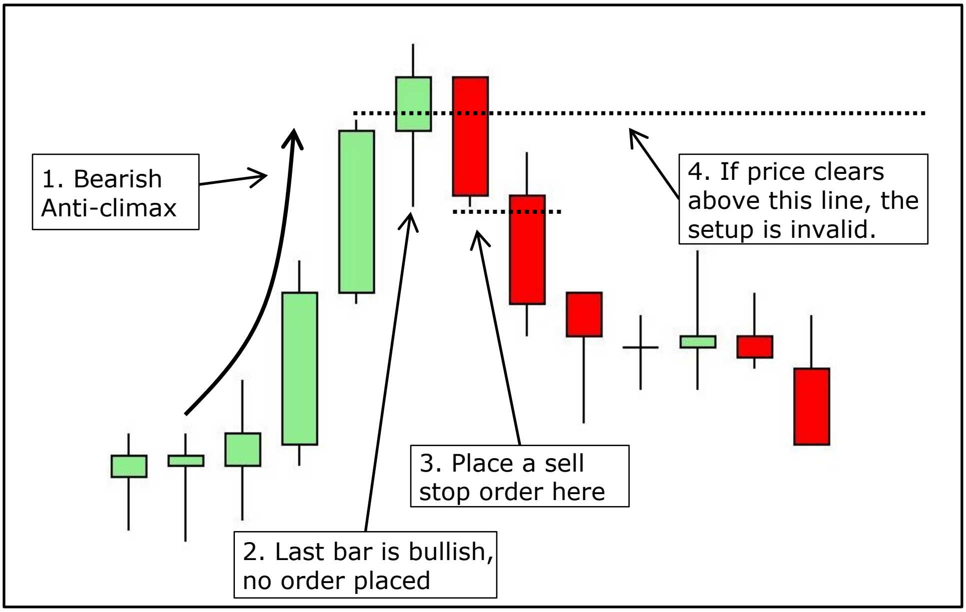

Figure 2-6 Short Anti-climax setup

1. Bearish Anti-climax pattern
2. If the last bar of the pattern is bearish, sell one tick below its low.
3. If not, sell one tick below the next bearish bar.
4. If price clears above the limit line (any bar low above the limit line), the setup becomes invalid.

2.3 - Trading the Anti-Climax

2.3.1 - CL 4-minute Example

Figure 2-7 shows an example of an excellent bullish Anti-climax pattern in the CL futures market.

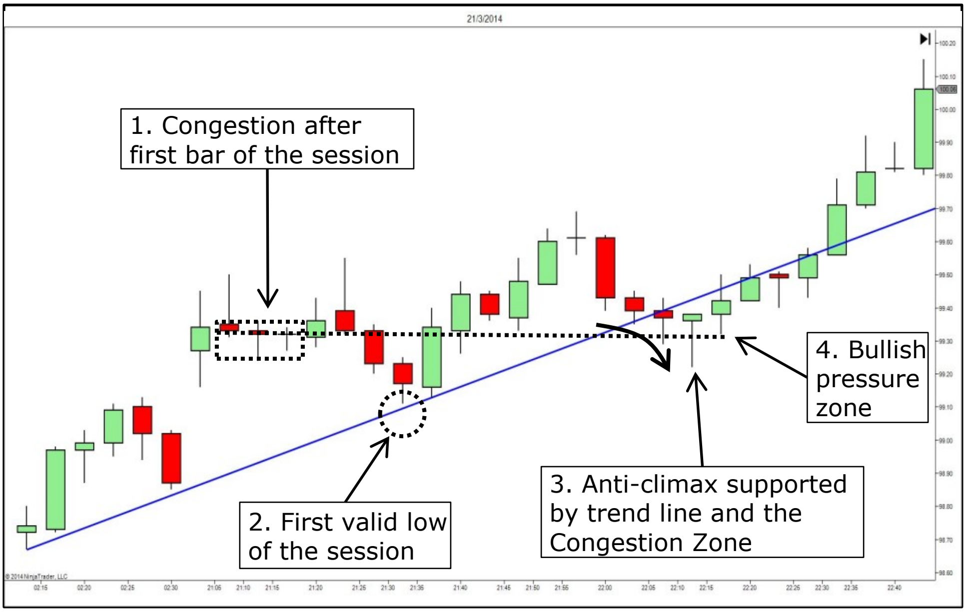

Figure 2-7 An excellent bullish Anti-climax setup

1. After the first bar of the session, a congestion pattern formed. It presented a short Congestion Break-out Failure trade which we were not interested in as it went against our bullish market bias.

2. The market resumed its way up and formed a valid low. We adjusted the bull trend line to keep up with it. The resulting trend line is shown in blue.

3. Price fell and formed an Anti-climax setup as it tested the Congestion Zone and the bull trend line. With this overlapping support, this Anti-climax setup looked especially promising. Moreover, the last bar of the pattern was a bullish reversal bar with a long lower shadow. We bought a tick above the high of this reversal bar.

4. The entry bar (the bar that triggered our buy stop order) also completed a bullish Pressure Zone which confirmed the buying pressure at the support area. It boded well for the Anti-climax

trade. In fact, aggressive traders could add to their long positions based on the Pressure Zone.

2.3.2 - 6A 30-Minute Example

In this example, the Anti-climax pattern represented the last-ditch effort of the bulls after a bearish break of a trend line.

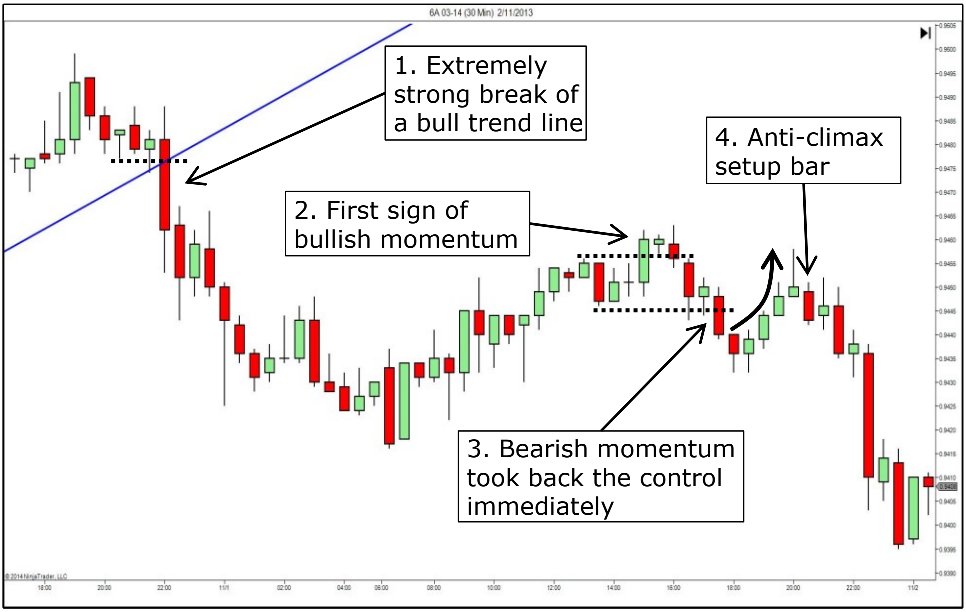

Figure 2-8 A matter of momentum

1. The market broke the last bull trend line with extremely strong momentum. After this trend line break, no more valid pivots developed, not until after the Anti-climax pattern. Thus, we were unable to add any bear trend line to aid our analysis. In cases like this, momentum analysis plays a key role in determining the market bias.

2. Despite a protracted upwards movement, the market did not show any bullish momentum until now.

3. Just as we might consider the possibility of the bulls returning, the market swung down with clear bearish strength. This turn of events led us to affirm our bearish market bias.

4. The bulls did not give up straightaway and tried to bring the market up. However, the upswing formed a bearish Anti-climax pattern that caught our eye. This last-ditch attempt did not even reach the last swing high, confirming the bearish tone of the market. Shorting below the setup bar was a reliable trade.

2.3.3 - ES 10-Minute Example

This example contains a bearish Anti-climax pattern that tested a previous pivot high.

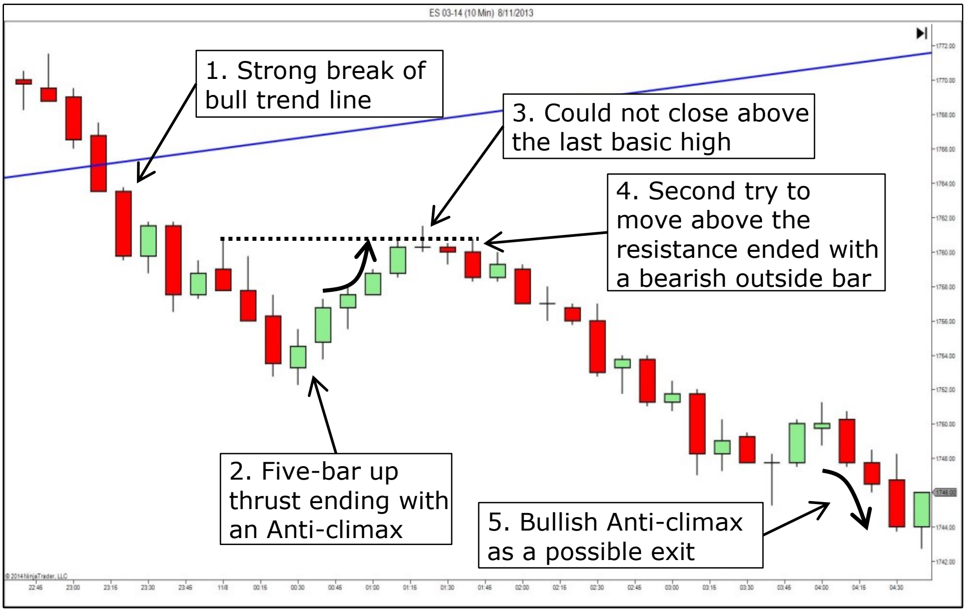

Figure 2-9 Clear rejection by basic swing high

1. We started the session with a bullish bias, which quickly turned bearish as the market broke below the bull trend line with strong momentum.

2. These five consecutive bullish bars were impressive. However, the last three bars formed an Anti-climax pattern, which warned us that this seemingly strong rise might be unsustainable.

3. We looked at what this five-bar thrust has achieved. It did not move above the last basic high. The bar right after the Anti-climax pattern tried but ended as a doji that closed below the resistance. This magnified the fear in the traders who bought during the up thrust. The following bar was a weak bearish bar which showed some buying pressure (lower shadow). Technically, this was our first setup bar. However, in view of the five-bar thrust earlier, we might want to wait for confirmation.

4. The market tried to rise above the resistance again. It failed and ended with a bearish outside bar, which provided the confirmation we needed to take this short Anti-climax setup. A sell stop order could be placed below the outside bar.

5. Anti-climax patterns are excellent signals for exits. In this case, the bullish Anti-climax pattern offered a great exit. To appreciate its effectiveness as an exit in this example, look at Figure 2-10. (We will discuss more about exits in the next volume.)

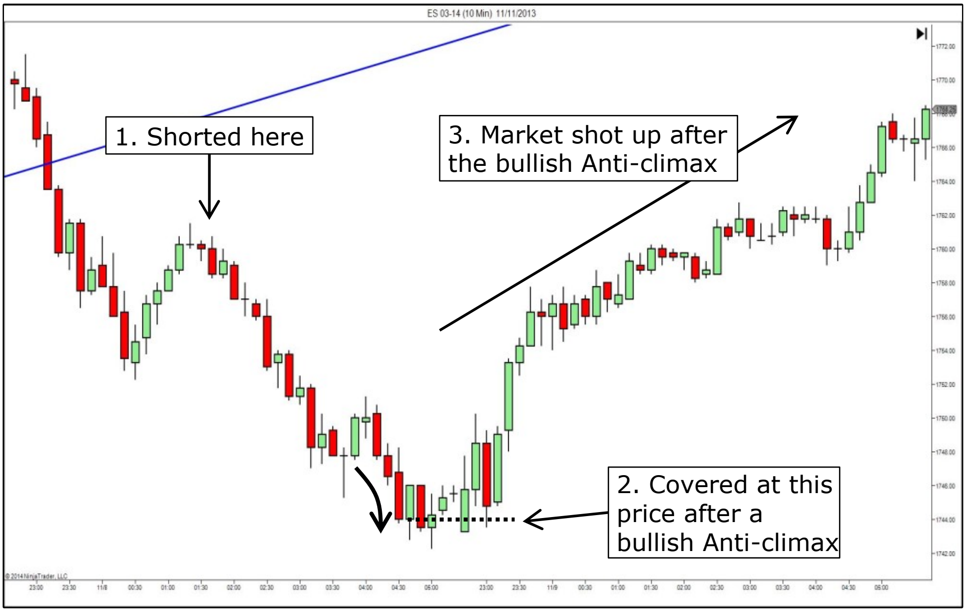

Figure 2-10 Effectiveness of Anti-climax for trade exits

As shown in Figure 2-10, the market shot up soon after a bullish Anti-climax pattern. This means that by exiting with the Anti-climax pattern, we have exited at the optimal point, capturing most of the maximum potential profit of our setup.

When we say that a pattern is effective for exiting our trend entries, we are also saying that it is an effective trend reversal pattern. This is the case for Anti-climax patterns. They occur commonly at the extremes of ongoing trend, threatening to reverse the trend. And on many occasions, they perform very well and often pinpoint the exact end of the trend. Another example is shown in Figure 2-11.

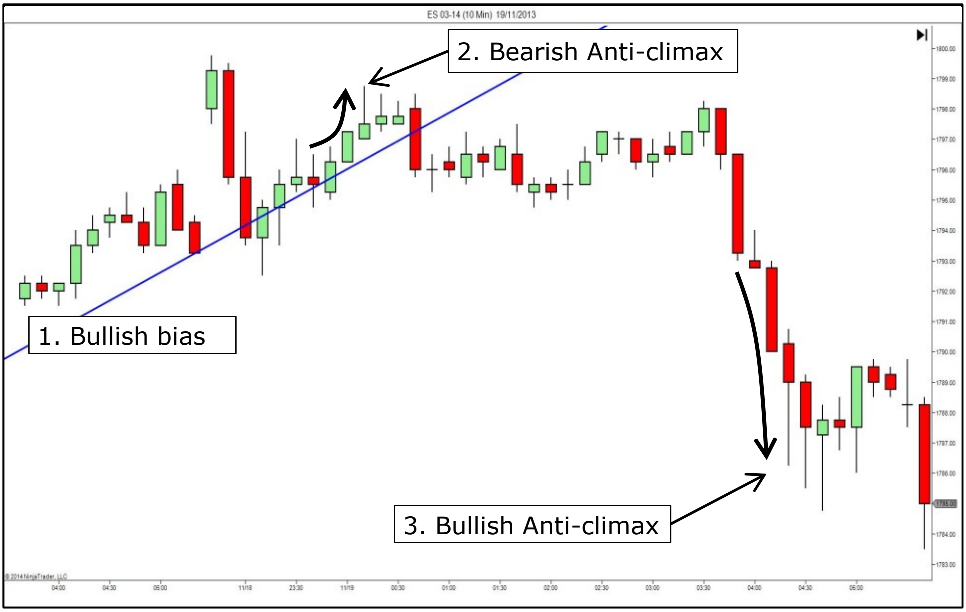

Figure 2-11 Using Anti-climax patterns to catch tops and bottoms

Hence, it is viable to employ the Anti-climax pattern in reversal trading strategy. However, as our trading framework focuses on taking trades along with the market bias, we will not elaborate on using Anti-climaxes for trading reversals. However, if you have an existing reversal trading strategy, you would want to consider adding the Anti-climax pattern to your trading arsenal.

2.3.4 - FDAX 10-Minute Example

The Anti-climax pattern, like all the other setups, works best when the market bias is clear and in conjunction with other setups.

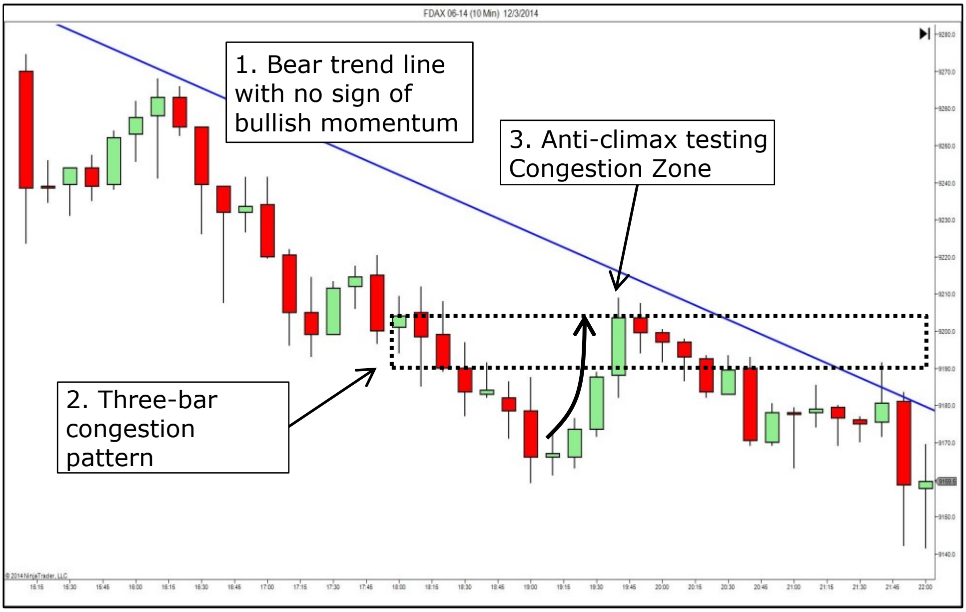

Figure 2-12 Anti-climax in a clear bearish market

1. The bear trend line was extended from the price action of the last trading session. The price bars in this session were entirely below the trend line. Moreover, there was no sign of bullish momentum. Hence, it was a firmly bearish market.

2. We extended a Congestion Zone from the three-bar congestion pattern.

3. After breaking out below the congestion pattern, price retraced upwards to test the Congestion Zone. The upswing presented a bearish Anti-Climax pattern. The following bearish bar was not only an Anti-climax short setup, but also a Congestion Zone setup. Given the confluence of two short signals, it was a clear and reliable trade.

2.3.5 - NQ 3-Minute Example

Figure 2-13 shows another example of an Anti-climax setup with the support of a Congestion Zone.

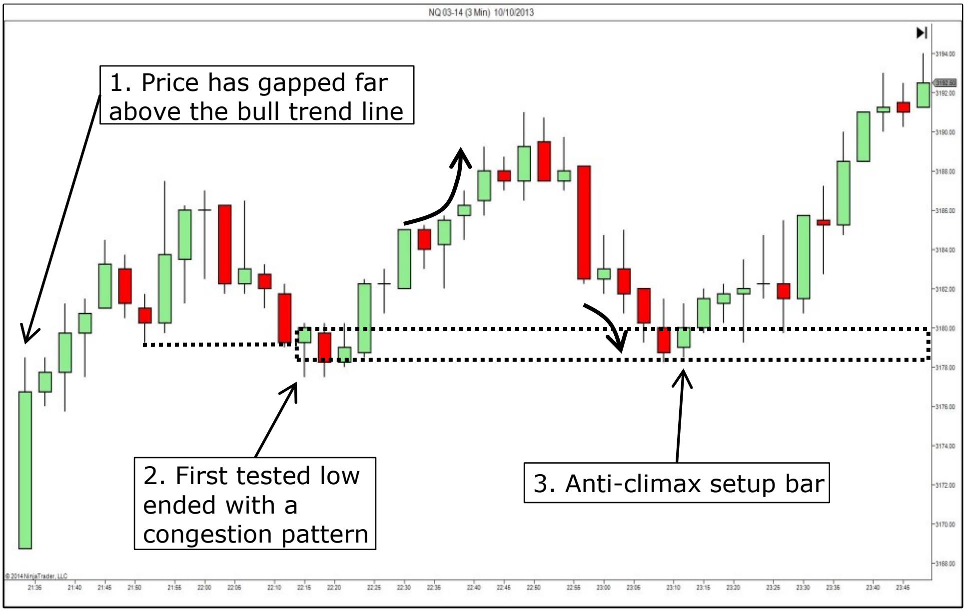

Figure 2-13 A well-supported Anti-climax trade

1. The effective trend line (not shown) was bullish. However, this session gapped a long way above the trend line. As usual, we were on high alert for any bearish signs that might reverse the bullish bias.

2. The first tested low of the day ended with a congestion pattern. It only managed to close below the previous swing low for one bar and did not clear below it at all. Thus, we concluded that it did not exhibit much bearish momentum. Accordingly, we maintained a bullish bias.

3. The bullish Anti-climax pattern ended right inside the Congestion Zone. The setup bar was a narrow range bar that offered a low risk long trading setup.

Even though this trade turned out to be profitable, there was a minor cause for concern. Look at the bearish Anti-climax pattern at the top of the chart before the market fell to test the Congestion Zone. That bearish pattern led to swift profits for traders who shorted it. The success of bearish setups is an indicator of the potential bearish market bias in the near future. In strong bullish markets, bearish setups should not be too successful or profitable. (This is a concept we will elaborate on in Volume III of the "Day Trading with Price Action" series.) As we were on high alert for any possible change in market bias from bullish to bearish, we must factor that into our trading decision.

I must emphasise that this was not a deal-breaker. It was, however, the difference between a good trade and an excellent trade. After all, the support provided by the Congestion Zone and two previous pivot lows was solid. Hence, the long Anti-climax setup in this case was still an acceptable trading opportunity.

2.4 - Conclusion

The Anti-climax is a tricky pattern to trade.

First, it often ends with increasing volatility, which means larger bar range (trade risk) and more whipsaws around our entries.

Another problem is that in isolation, an Anti-climax looks the same as a strong impulse thrust that starts a new sustained movement in its direction. Hence, we must take care in selecting Anti-climax trading setups.

Fortunately, doing so is not rocket science. Look at all the examples we went through. They share a similarity. None of the bearish patterns closed above the last pivot high, and none of the bullish patterns closed below the last pivot low. Hence, they exemplify the market behaviour we desired, which is a climatic counter-bias thrust that in fact could not even affect the structure of the existing market bias. Be careful and avoid Anti-climax patterns that manage to shatter the current market structure.

Notwithstanding these difficulties, when used correctly, the Anti-climax pattern offers reliable trading setups where most traders perceive danger.

In addition, as shown in Figure 2-10 and Figure 2-11, the Anti-climax is not only effective as exit signals. It is also a great pattern for nailing market tops and bottoms. If you recall, the Deceleration is good at locating trend reversals as well. However, comparing both patterns, the Anti-climax is more potent as a reversal pattern.

Thus, you might find it tempting to trade reversals with the Anti-climax pattern. If you are a beginner, resist the temptation at all costs. If you are a seasoned trader comfortable with trading reversals, feel free to incorporate the Anti-climax pattern into your reversal trading strategy.
