Tutorial 36 – Swing Trading

This week, our tutorial covers **Swing Trading** which is available in ShareScope Plus and Pro, using both the original methodology of WD Gann and Marc Rivalland's more practical approach.

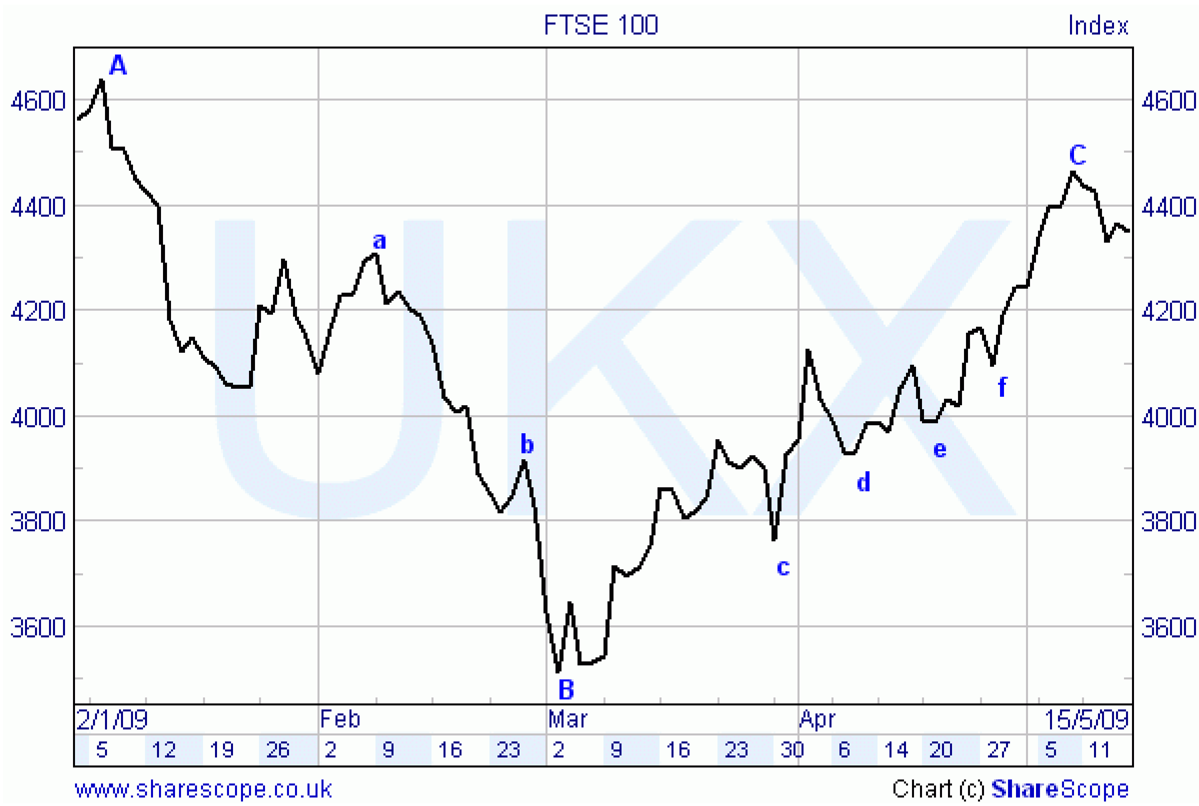
Swing Trading

The ethos of Swing Trading is to look for short-term corrections to an underlying trend and to bet that the underlying trend will resume. It enables traders to profit from both bull and bear markets.

Swing charts were invented by Gann in the early 1900s. Marc Rivalland is the modern proponent of swing trading and he is also a charting columnist for the Investors Chronicle.

Rivalland has adapted Gann's technique in order to increase the number of trading opportunities and to improve the risk/reward ratio (i.e. maximise potential profits and minimise potential losses). Even Gann acknowledged that the rigidity of his system could be limiting.

Look at the price chart for the FTSE 100 below. You will notice that the broad trends are from points *A* to *B* (downtrend) and *B* to *C* (uptrend). An aggressive swing trader may also have gone short at points *a* and *b*; and gone long at points *c*, *d*, *e* and *f.*



Swing trading is likely to be of interest to short-term traders who like to take profits when they can. Furthermore, the leverage afforded by spread bets and contracts for difference (CFDs) enables you to make substantial profits on margin (i.e. without having to put up the full stake). [Disclaimer]

Basics of Swing Trading

Let's first look at how the swing chart can be used to identify mini-corrections to the broad trend and the differences between the Rivalland and Gann approaches. We'll look at entry/exit positions later.

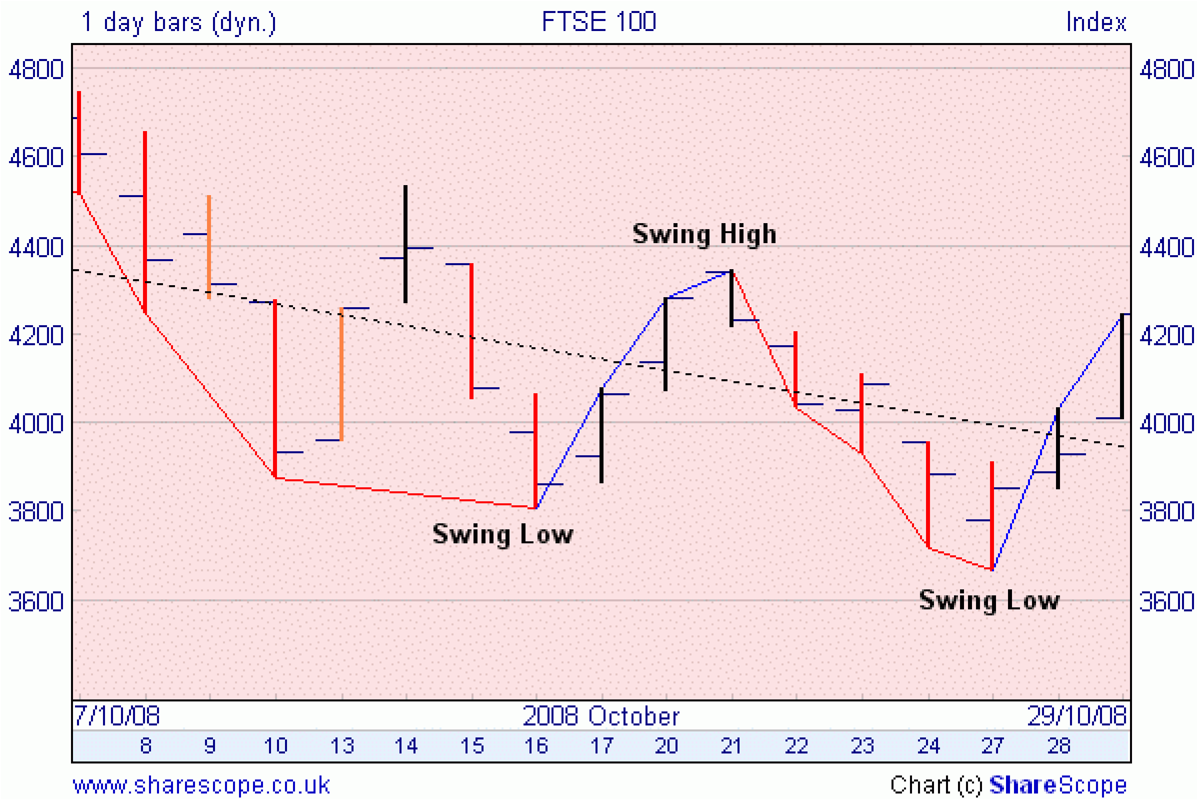
Swing charts are best understood using daily OHLC bars. Each day is compared to the previous day to determine if it is an *Up*, *Down*, *Inside*, *Outside* or *Neutral* day.

Up day	Higher high and higher low than the previous day Higher high and equal low to the previous day (relaxed) Equal high and higher low than the previous day (relaxed)
Down day	Lower high and lower low than the previous day Lower low and equal high to the previous day (relaxed) Equal low and lower high than the previous day (relaxed)
Inside day	Lower high and higher low than the previous day
Outside day	Higher high and lower low than the previous day
Neutral day	High and low equal to the previous day's high and low

Let's assume the share or index is in a downtrend: the next event we are interested in will be a mini-correction upwards. The mini-correction must last for at least 3 trading days, often lasts for 4-7 days, and occasionally lasts for more than 12 days.

In a downtrend, the standard Gann swing chart turns up and registers a mini-correction (a swing high) only when there are three consecutive days of higher highs. Furthermore, the resumption of the downtrend is only confirmed after three consecutive down days. Gann's rationale for this was to try and avoid false signals but, in doing so, he reduced the potential yield of the swing trade.

Look at the FTSE 100 chart for October 2008 below. The dashed line indicates that the underlying trend is downwards:



This chart is configured to use strict Gann rules. After the swing low on the 16th October, three consecutive up days satisfy Gann's requirements for a mini-correction. There then follows three consecutive down days (22nd, 23rd and 24th) signalling that the downtrend has resumed and, indeed, continues until the 27th. Note that the downtrend breaches the previous swing low on the 3rd day of the downswing.

It is the resumption of the underlying trend from the 22nd that the swing trader will trade on. We'll discuss entry and exit points later.

Relaxing the three day rule

Of course, charts are rarely so simple. Rivalland's modifications relate to the realities of swing trading: you may wait some time for a classic three day counter-trend.

Rivalland also looks for three or more days movement to establish a mini-correction but these do not have to be consecutive. In fact, so called "complex" swing highs and lows can include a number of inside, outside, up or down days.

Look at the chart for the FTSE 100 in October/November 2009. On 23rd October, a temporary high is made at 5300 in the middle of an uptrend. This is followed by a Down day, which is then ignored due to the following Inside day on the 27th. A further two Down days are also cancelled out by the Outside day on the 30th. A further two Down days brings the price down to 4985. As there are not three consecutive Down days over this period, no signal is generated by Gann's method. The Rivalland method identifies this 315 point movement as a relevant mini-correction, and would also have identified the correction back up to the high of 5397 on the 16th November – another 412 point movement.

Generally, if the swing isn't clear - move on to the next chart and find one that is.

Improving the Risk/Reward Ratio

Rivalland's method also increases the potential profit per trade.

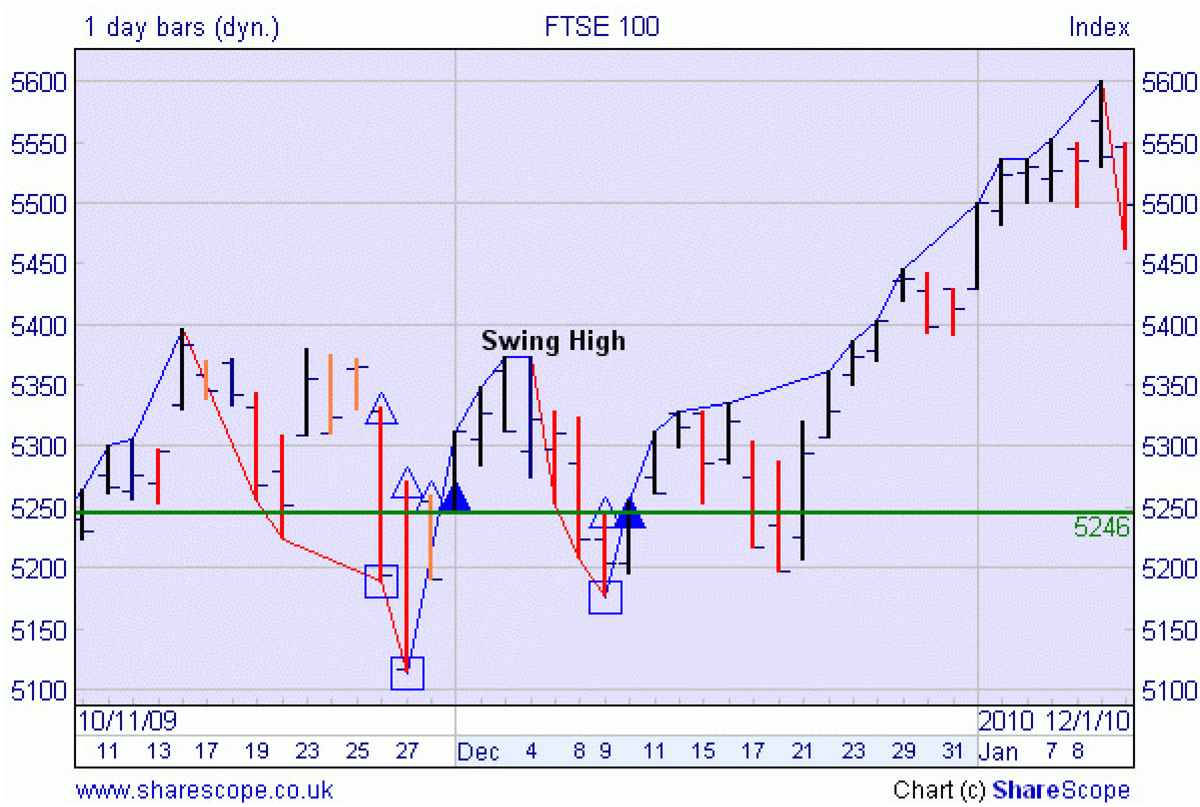
As mentioned above, Gann also requires three consecutive days price movement to confirm the resumption of a trend. Rivalland, however, will trade on the first day that the counter-trend appears to end. That is, he uses a 3 day swing chart to set up the trade and a 1 day swing to activate the trade.

Look at the chart of the FTSE 100 for November/December 2009.

On 9th December, the FTSE 100 completes a swing low both in terms of Gann's method and the Rivalland method. However, the Gann method (above) puts the swing trader long only on the third consecutive up day, namely on 14th December at 5329. On the chart, ShareScope indicates the buy order (outline triangle), the stop loss (square) and the buy trigger (solid triangle). Strict Gann would have waited until the 24th when, at 5397, the previous swing high was breached.

The Rivalland method (below) puts the swing trader long on 10th December at 5246. You will notice that the buy trigger is generated, in this instance, at 5246 (the high of the 9th).

As you can see, the trade is profitable under both methods but it is 151 points more profitable under the Rivalland method.



Crucially, it is not just the reward that is enhanced under the Rivalland method. The amount risked is much lower. Both systems would place a stop loss order at 5175 under the swing low of 9th December. The Gann method risks 5329-5175 = 154 points whereas the Rivalland method just 71 points. Since some losing trades are inevitable, the number of points risked on each trade should be at the forefront of every trader's mind.

Here then is the crux of Rivalland's modifications to Gann: get in early to maximise your potential yield and to minimise your stop loss exposure.

Exit Strategies

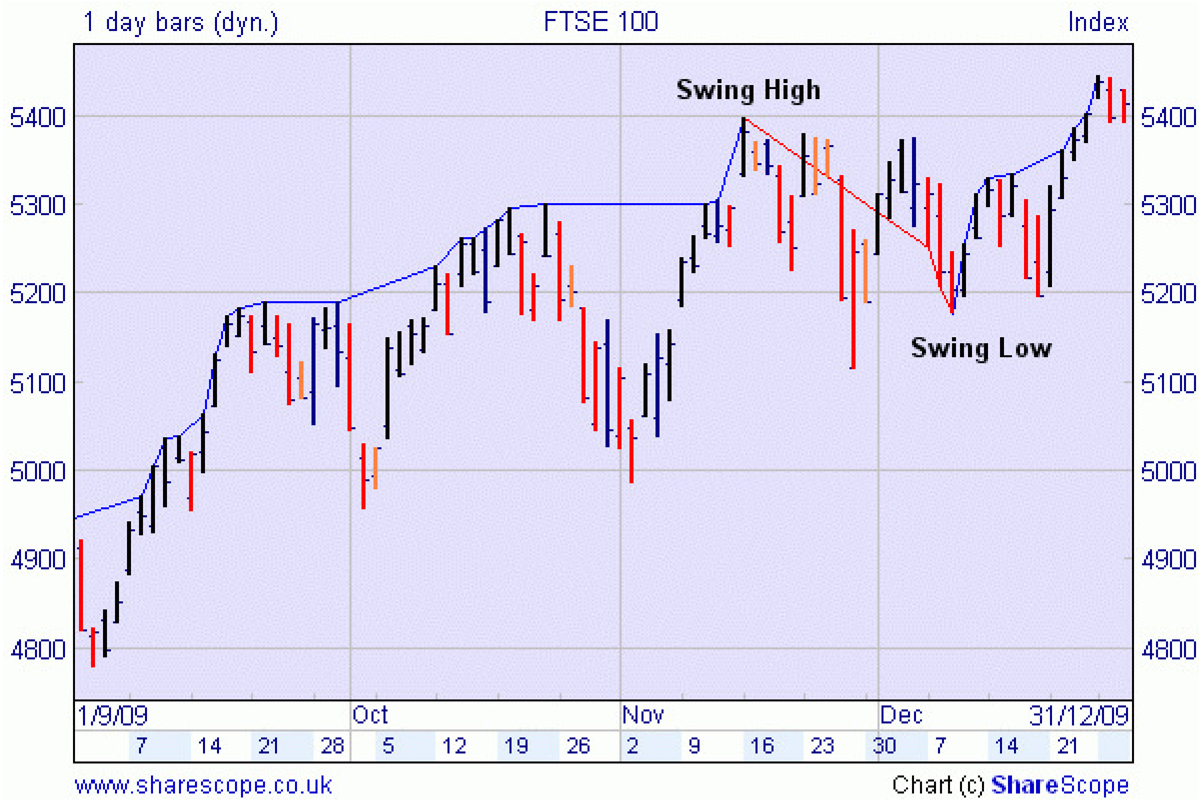
Marc Rivalland and other investment gurus are not prescriptive but they all recommend that you should have a clear exit strategy. They say that the point of swing trading is to exploit the swing. Take your profits at a point which fits your risk/reward ratio, rather than running a position until the short-term trend changes. Your exit strategy might include:

- Trailing stop
- % gain target (say exit after a 1.5%-4% profit)
- Mixed % gain target (remove half the stake at 1% and the rest at 3%)
- Or a combination of the above.

Increasing the number of trading opportunities

One further advantage of this relaxing of the rules is that Rivalland swing charts identify more trading opportunities than Gann, and therefore greater profits.

Look at the two charts below showing the same time period but with swing charts according to Rivalland and Gann respectively.



Rivalland's method presents four swings to trade during the broader uptrend whereas Gann finds only one. The potential for profit taking is significantly increased.

Of course, swing trading can also lead to more trading costs and more chances to get stopped out.

Further information on Swing Trading

There is far more to swing trading and Marc Rivalland's techniques than is described here. In particular, Rivalland makes extensive use of Point & Figure charts to support his swing charts and decision-making.

We recommend the book "Marc Rivalland on Swing Trading" which is very accessible. You should note that his ideas, and thus those embodied in ShareScope Swing Trading, have evolved since the book was published. However, the book will give you Rivalland's take on trading indices versus stocks, exit strategies and point & figure buy/sell signals.

There are several books by Gann, but it is generally agreed that although his ideas are stimulating, it is very hard to extract a clear and definitive trading strategy from them. We recommend that you compare Gann and Rivalland swing charts on ShareScope, as well as the various relaxation options, and see which work best for you.

To purchase "Marc Rivalland on Swing Trading" please visit the ShareScope Bookstore.

Alternatively, please visit Marc Rivalland's own website at www.marcrivalland.com.

Customers unfamiliar with the theory of chart trends and patterns may also be interested in an audio-visual CD called "An Introduction to Technical Analysis" available from the ShareScope website.

Remember if you have any trouble finding or using any of these features, please don't hesitate to call our Customer Support team on **020 7749 8504**. They will be delighted to help.

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