Twitter Thread by TraderLion

TraderLion
@TraderLion_

What to look for when the market gets volatile. (Thread)

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The first thing you should be on the lookout for is tight price action in leadership names. During corrective markets, liquidity is low as market participants take a step back due to uncertainty.

This leads to larger price ranges and therefore tight action is a sign that liquidity is returning to the markets.

As certainty returns, price action becomes tighter and more rational.

This type of action is much easier to operate in as a retail trader since it allows you to define risk which is always first and foremost in any trading strategy.

Another key thing to look for is multiple RS days within specific stocks and groups.

RS (Relative Strength) Days occur when a stock outperforms the market and other stocks during a corrective period.

If you need a refresher on Relative Strength techniques check out this blog post: https://t.co/zDX4FvqVLk

Watch for stocks that exhibit multiple Relative Strength Days over a span of weeks, not hours. Multiple Days of evidence (RS) will allow you to build conviction in the markets through observation, all the while preserving your hard-earned capital.

Relative Strength in and of itself is an institutional footprint. As retail traders, we must allow institutions to do the hard work while waiting and collecting evidence bit by bit, day by day, and allow the market to CONVINCE us for a span of a couple of days.

Institutions are the base builders, our goal is to ride the trends they create.

In addition to RS, you should be watching for decoupling action.

Decoupling action is when stocks start to ignore general market weakness and institutions begin to accumulate stocks they see as desirable.

Broad decoupling action in multiple groups is the key here, not a single name within a group, but multiple names within multiple groups. This adds to the evidence that the market may potentially be ready for an uptrend to resume.

During the days/weeks of corrective action you should continuously take notes. Just because the market is not favorable and you aren’t making a lot of $, it doesn’t mean you should turn the screens off and not do your homework.

Make consistent RS lists at the end of the day or every few hours when you have the time. These notes will keep you in tune with general market conditions and the stocks which consistently show up on your notes will be potential candidates to position in.

Homework is important, it cannot be skipped. Putting in the work now is what will prepare you for success when the uptrend resumes by having a ready list of actionable leaders that are showing relative strength.

As mentioned previously you should be taking special note of any groups that are outperforming together during turbulent markets. These are your PLGs (Potential Leadership Groups) during the next leg up.

Knowing your PLGs is important.

Remember that 50% of a stock's performance is tied to its Group. Knowing your PLGs is an important and a key component of outperforming the markets consistently.

During turbulent and uncertain markets, you should increase and decrease your exposure gradually in response to market conditions and how test trades have been performing. This is called practicing Progressive Exposure.

Exposure should NEVER be increased directly from 100% Cash to fully invested.

Such action will result in bad drawdowns and hurt your equity curve significantly.

If the market reverses its course from a downtrend/under pressure to an uptrend you will have PLENTY of opportunity and time to position in many names within the PLGs that are leading that trend.

If you are holding core positions, allow them to make progress first.

Let your existing cores have a few green sessions. That is added evidence that the market is potentially ready to resume an uptrend. If no progress is being made on your core positions then you are not in a position to be adding more exposure.

Progressively increasing exposure will allow you to get Market Feedback, and build your conviction over the course of weeks and not hours. The market is not going anywhere, so the focus should always be RISK first not money first.

Progress can only be made if you survive.

While making RS lists, it will become very clear what the next leadership crop may look like. You will have 3-4-5 groups/industries leading the rally.

The homework that is done when the market is turbulent is what will help you when it’s time to start increasing exposure from cash to your first position.

Progressive, Incremental exposure is key here.

You should not rush to be the first one in the pool.

You must progressively, incrementally, increase that exposure. Your first position should be in a name that has exhibited Relative Strength over a span of weeks, it should be from the PLGs that you’ve noted.

It should be a candidate that is LIQUID and considered a LEADERSHIP stock with CANSLIM fundamentals.

That first position is you testing the waters to gauge the temperature of the markets.

It must be the most textbook position you place so you can gauge the temperature well and be in tune with the markets.

If your first position to test the waters starts making progress, then you may go and add exposure progressively and allow the markets to CONVINCE you again and again, through tight, highly liquid, price action with WELL DEFINED risk.

In summary, you have to wait until trading conditions are right for your style before risking capital, both mental and financial.