# CHAPTER 6

# 80-20's

The 80-20's is a strategy we use for day trading. Many of our readers may. already be familiar with The Taylor Trading Technique which is a reference manual for swing trading. Simply stated, Taylor's method implies that markets move with a natural rhythm that is made up of a buy day, sell day, and sell short day This pattern is further evidenced by the research done at the Moore Research Canter by Steve Moore.

Steve profiled days that closed in the top 10 percent of their range for the day. He then tested for the percentage of times the market exceeded the profiled day's high the following day and the percentage of times it actually closed higher. His research showed that when a market closed in the top/bottom 10 percent of its range, it had a 80-90 percent chance of follow-through the next morning but actually closed higher/lower only 50 percent of the time. This implies that there is a good chance of a midday reversal.

How could a methodology be created that would profit from this reversal phenomenon? Derek Gipson, a fellow trader, noticed that the market has an even higher likelihood of reversing if the setup bar opened in the opposite end of the daily range, so we added a pre qualification that the I The Taylor Trading Technique, Gears Douglass Taylor.

Market must open in the lower 20 percent of its daily range. Then to create more trading opportunities, we dropped the closing range function down from 90 percent to 80 percent. This did not affect the overall profitability. If the market opened in the lower 20 percent of its daily range and closed in the upper 80 percent of its daily range, a sell setup would be indicated for the next day (and vice versa for buys).

Finally, as with all of the strategies presented, night data are ignored. The range should be created from day-session data only.

Here are the rules:

FOR BUYS (SELLS ARE REVERSED)

1. Yesterday the market opened in the top 20 percent of its daily range and closed in the lower 20 percent of its daily range.

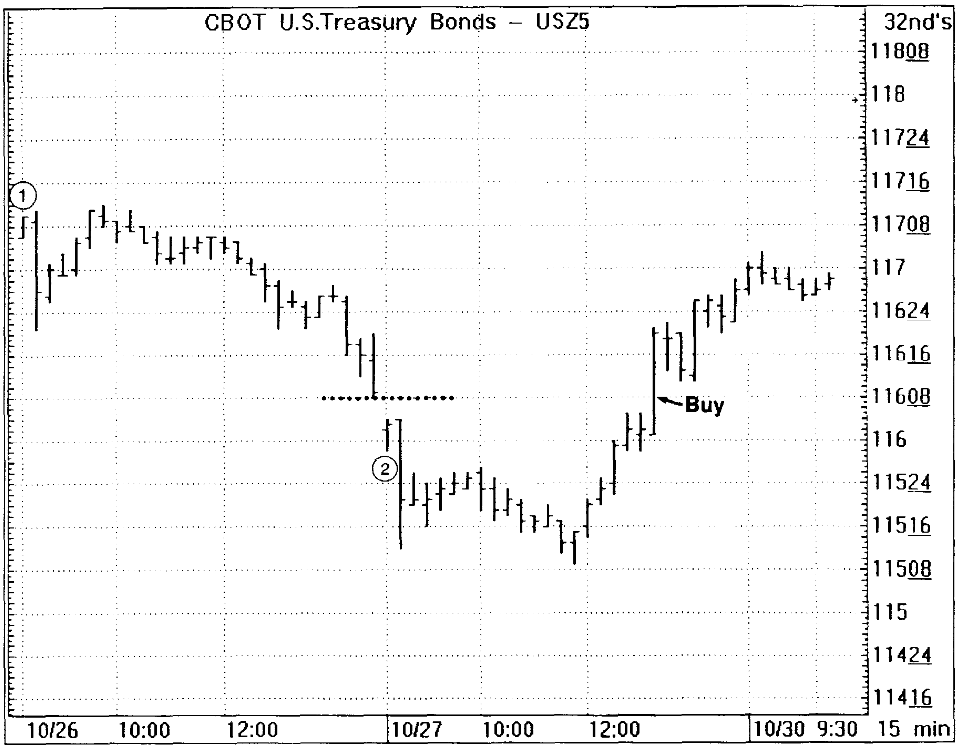
2. Today the market must trade at least 5-15 ticks below yesterday's low This is a guideline. The exact amount is left to your discretion.

3. An entry buy stop is then placed at yesterday's low. Upon being filled, place an initial protective stop near the low extreme of today.

Move the stop up to lock in accrued profits. This trade is a day trade only.

To give you a better feel for this strategy, let's look at a few examples.

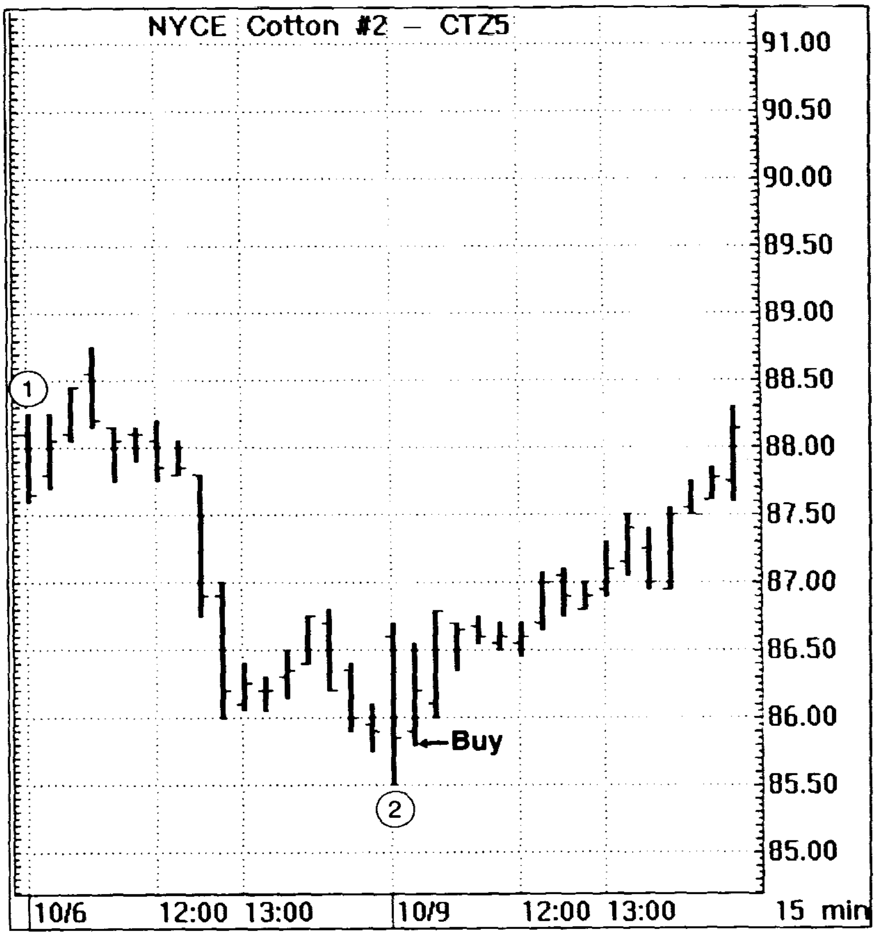
EXHIBIT 6.1 Bonds-December 1995-15-Minute




1. October 26, 1995, bonds opened in the upper 20 percent of their range and closed in the bottom 20 percent of their range.

2. Today's bonds trade at least five ticks below yesterday's low and reverse. We go long at 11608 and the market rallies 3/4 point.

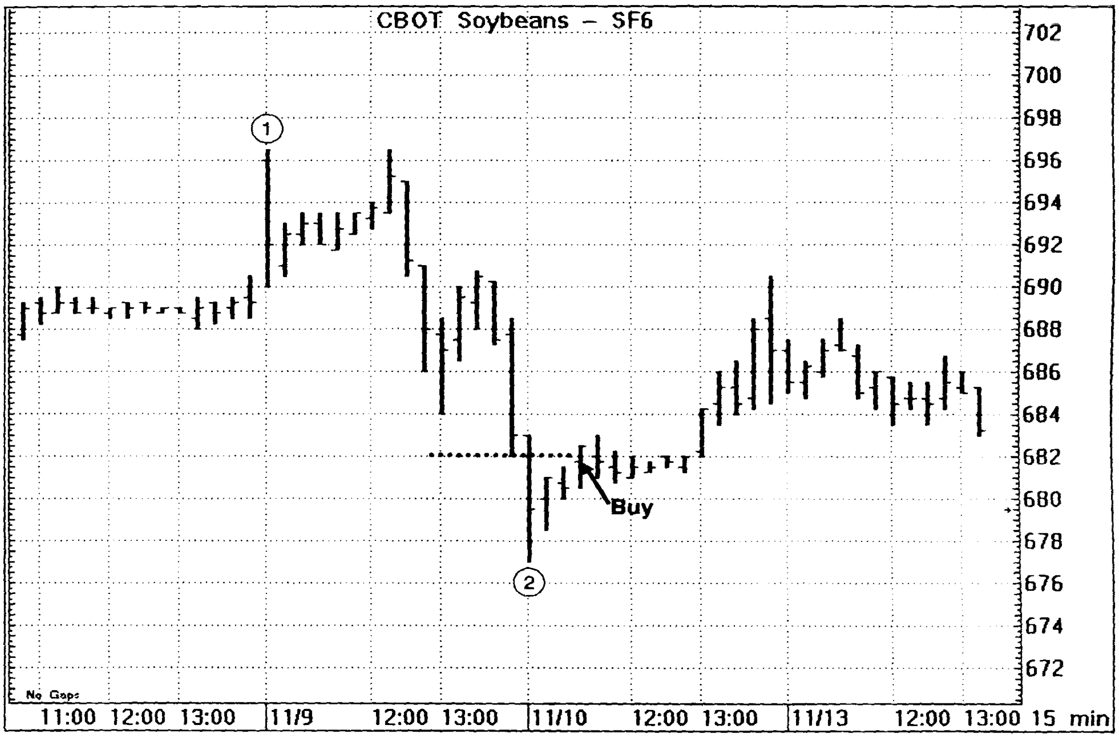
EXHIBIT 6.2 Cotton-December 1995-15-Minute




1. October 6, 1995, cotton opens in the top part of its range and closes the bottom 20 percent.

2. The next day cotton trades at least five ticks below the previous da low and reverses. We go long at 85.80 with our stop in the 85.50 ran The market proceeds to rise over 200 points by the dose. (Remember this is a scalping strategy that exploits the daily reversal tendency of the previous day's pattern. Large profits from 80-20's are the exception, not the rule.)

EXHIBIT 6.3 Soybeans-January 1996-15-Minute




1. On November 9, soybeans open in the top of their range and close near the bottom.

2. The next morning they trade at least five ticks under the previous day's low and reverse. Our buy stop at the previous day's low of 682 is filled. A protective sell stop is placed in the 677 area. Beans trade sideways and then move nearly nine cents higher. A stop is trailed appropriately to capture the gains.

LARRY.

80-20's are low-risk setups for day traders. When the bar following an 80-20 bar takes out the previous day's high/low and then reverses, it represents a failure test of the high or low. This is always one of the strongest places to put a stop. The buying from the previous day has exhausted itself, and the latecomers (weak hands) cannot sustain the move.

LINDA:

This pattern does not necessarily have any long-term implications. It will, though, capture Taylor's market rhythm of one to two day setbacks. It represents a classic short-term swing trade.

LARRY.

Again, this is not a mechanical system. We just want to take advantage of the times the market loses steam and reverses. Another filter one may wish to look at is the size of the setup bar.

LINDA:

That's right. I especially like to look for reversals after bars that have a larger than normal daily range.

LARRY.

With correct money management and stop placement, you can make this a profitable part of your day-trading methodology.

Tables are given in the Appendix that show all of Steve Moore's original research. As you can see, 80-20's capitalize on the market's high tendency for reversal, and this sets up a high probability short-term trade.