Trader profile – THE SCALPER
Scalping tools and techniques

Scalping consists of doing many trades. Each trade has a small profit objective. Because the profit consists of an accumulation of small profits, each loss must also be small. Scalpers tolerate a return/risk ratio as low as 1 (i.e. to win 1 they are willing to risk 1). The combination of such a low return/risk ratio and small profits per trade imply that a scalper's win rate (his % of profitable trades) must be substantially above 50% in order to generate a good profit.

Scalpers argue that scalping has limited risk. They only keep positions a very short time and a small market move is always more probable than a big one. Scalpers can usually trade at any moment in time. They do not have to wait for a signal given by a trading strategy.

Scalping is the trading style which comes closest to market making. A simple way to imagine a scalper at work is a trader who tries to buy at the bid and immediately tries to sell again at the ask. His profit is the spread.

	3558	684
	3557	621
	3556	523
	5 @ 3555	66
335	3554	
659	3553	
706	3552	
701	3551	

This **example** shows the order book of the EuroStoxx 50 future. The **bid price** is 3554 (the highest price buyers are willing to pay). In total they want to buy 335 lots at this price. The **ask price** is 3555 (the lowest price sellers are willing to sell at). In total sellers are willing to sell 66 lots at this price. A scalper may try to buy at the bid (3554) and immediately sell at the ask (3555). His profit in this case is 10€.

Scalpers tend to trade **futures**. Futures are traded on an exchange via an order book. This gives the scalper two main **advantage**s:

1. The scalper can see at each price level the number of futures traders are willing to buy and sell. When an order is executed the exchange shows the price and quantity in real-time. More about the important role of this **information** later in this e-book.
2. Futures are traded via an **order book** in which buyers and sellers place their orders. In the above example of the bid-ask in the order book is 3554–3555. A scalper entering a buy limit at 3554 could be executed (if a seller decides to sell at 3554) **without** the bid-ask moving. The same scalper entering a sell limit order at 3555 could get executed (if a buyer decides to buy at 3555) **without** the bid-ask moving. In the case of over-the-counter (OTC) instruments like CFDs and forex this is not possible. To be able to buy, the bid-ask needs to go down first to 3553-3554. Then, to be able to sell again, the bid-ask must go up to 3555-3556.

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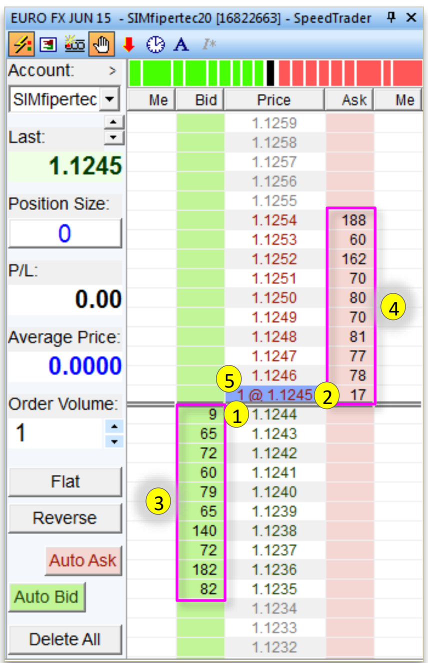
Tools: information

Given the particular nature of scalping (lots of orders, quick in and out, buying and selling within a narrow price range ...) scalpers **cannot succeed without** the right tools. Scalpers need:

1. **Information** (including a quality data feed).
2. **Order management tools** (to place orders quickly and precisely AND to change orders).
3. **Market analysis tools** (to find price levels around which scalper can be active).

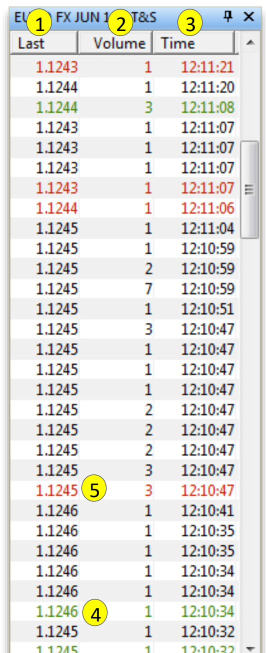
Scalpers need information

The scalper has to be right. He cannot afford many losing trades. His objective is a small profit. Hence he must close when he makes a small loss. In order to be right the first time he needs tools which give information about the possible price movement. Important information is provided by the **order book** and the **time&sales** screen. The order book covers **open** orders. Time&Sales covers **executed** orders.



Order book information:

1. **Bid price**: 1,1244. The highest price buyers are willing to pay.
2. **Ask price**: 1,1245. The lowest price sellers are willing to sell at.
3. **Bid volumes**. The number of futures contracts buyers are willing to buy at each price level.
4. **Ask volumes**. The number of futures contracts sellers are willing to sell at each price level.
5. **Last executed order's quantity and price**: 1 future @ 1,1245. Meaning ... one buyer was willing to pay the more expensive asking price instead of waiting for a seller to sell to him at 1,1244.



Time&Sales information:

1. **Execution price**: the price at which an order is executed.
2. **Volume**: the number of futures contracts traded at this price.
3. **Time**: the time the order is executed.
4. **Green**: the first order executed at the ask price.
5. **Red**: the first order executed at the bid price. Subsequent executed orders at the same price are **black**.

Notice that buyers are buying at the ask price (green). First at 1,1245 and then at 1,1246, pushing the market above the round number 1,1245. But sellers start selling at the bid (red). This puts pressure on the market and the ask price eventually goes down to 1,1243. A fine **scalper** can work around round numbers in the direction of the market's day trend.

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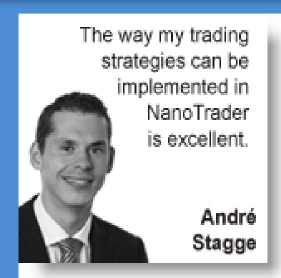
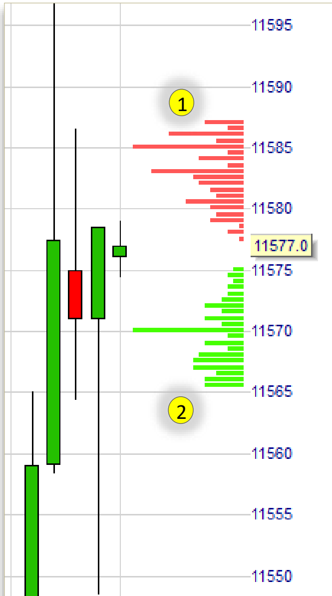


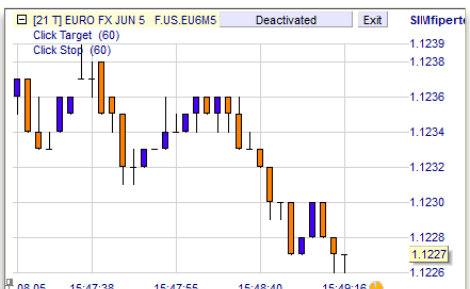
The information provided in the order book and the time&sales screens should also be available in a visual format in the charts.



This **histogram** represents the **order book**. The **red** horizontal bars (**1**) are the number of futures contracts the sellers are offering at each price level. The **green** horizontal bars (**2**) are the number of futures contracts the buyers are bidding for at each price level.

This **histogram** represents the **executed orders** at each price level. Orders executed at the ask price are yellow (**1**). Orders executed at the bid price are orange (**2**). The most volume was traded between 11.500 and 11.530. In this zone more trades were done at the bid price (passive buyers). Nevertheless the market went up. Currently, in the higher price range, we see predominantly trades at the ask price (active buyers). At the bottom, around 11.440 we only see trades at the bid price (passive buyers). Traders were not keen to buy at that level, as opposed to the current level.

This histogram shows what happened next. The market went up a little more but is now going sideways since 12 candles. The result is a more balanced distribution between trades at the bid and trades at the ask.



Tick charts are a popular scalper tool. They represent **time&sales as a chart**. Each bar represents a fixed number of trades. So the more trades, the more bars. This allows traders to see accelerations and slow-downs. Scalpers use anywhere from 5 to 144 ticks per bar depending on the speed of the market. 89 is often used during active markets and 21 during calm markets. Also important are **range bars** and **renko bars**.

<u>Attention futures traders</u>
Every information tool and chart relies on the **market data** your broker provides. Some brokers provide free ½ second snapshot quotes. For daytraders and scalpers ½ second snapshot quotes are worthless. Select a broker who provides CQG market data.

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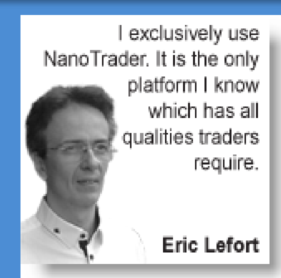
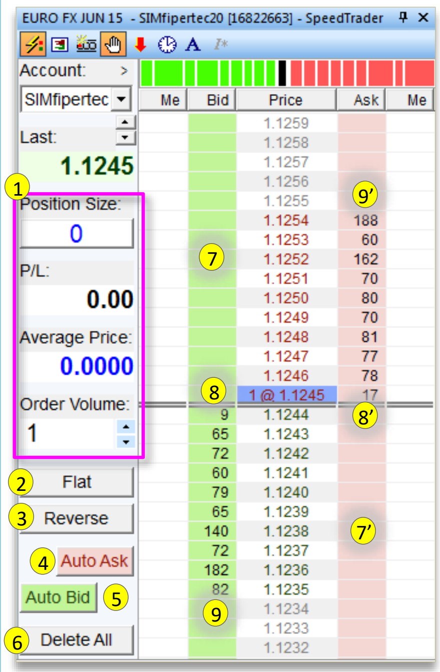


Tools: placing & managing orders

Scalpers need tools which allow them to place orders **quickly** and with great **precision**. The target is only a few points away. Their close order(s) need to placed automatically when the position is opened. They trade around the bid-ask and will get executed immediately if orders are not placed at the right level. Once a position is open its size, average price and the profit (loss) need to be visible in the order book and the chart.

Placing orders

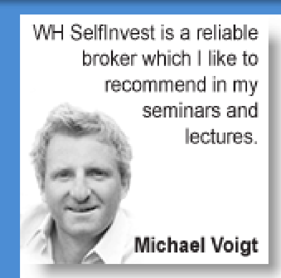
To place **new orders** quickly and with precision scalpers need tools such as these:



Orders via the order book:
1. Position information.
2. Flat: place a market order to close an open position.
3. Reverse: place a market order to turn a long position into a short position (or vice versa).
4. Auto Ask: place a sell limit order which follows the ask price!
5. Auto Bid: place a buy limit order which follows the bid price!
6. Delete all: cancel all working orders.
7. Right click to place a buy stop at 1,1252.
7'. Right click to place a sell stop order at 1,1238.
8. Left click to place a market buy order.
8'. Left click to place a market sell order.
9. Left click to place a buy limit order at 1,1234.
9'. Left click to place a sell limit order at 1,1255.

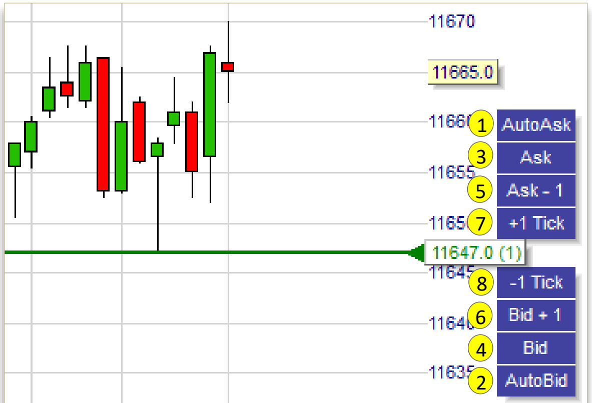
Orders via the chart:
Scalpers who prefer to only have a chart open can place orders in the same way as via the order book. The green column is to place all types of buy orders. The red column is to place all types of sell orders.

Automated bracket orders:
Once a scalper opens his position he needs a platform which **automatically** places his stop order and his target order. This platform needs to offer (a) the **greatest variety possible in stop and target calculation** (e.g. stops calculated automatically based on volatility or stops which close the position after a short time has elapsed) and (b) the possibility to close at **different price levels**.



Managing open orders

Once an order has been placed a scalper needs to be able to change his order quickly, efficiently and with **surgical precision**. Modifying an order must be done in **one step** with **one instruction**.



Tactic buttons to **manage an order which opens a position**. This scalper placed a buy limit order at the bottom of the range. Tactic buttons allow him to:

1. **AutoAsk**: change his order limit to a level always equal to the ask price (since he is a buyer he will be executed immediately).
2. **AutoBid**: change his order limit to a level always equal to the bid price (popular with scalpers as it is cheaper than buying at the ask).
3. **Ask**: change his order limit to the current ask price (since he is a buyer he is likely to executed immediately).
4. **Bid**: change his order limit to the current bid price.
5. **Ask - 1**: change his order limit to the ask price - 1 tick.
6. **Bid + 1**: change his order limit to the bid price + 1 tick.
7. **+1 Tick**: increase his order limit with 1 tick.
8. **-1 Tick**: decrease his order limit with 1 tick.

Tactic buttons to **manage an order which closes a position**. This scalper has an open position and a sell stop order to close it. Tactic buttons allow him to:

1. **BrkEven**: change his stop to his break-even price.
2. **AvgPrice**: change his stop to his average price (the average price if he bought positions at different prices).
3. **Bid - 1**: change his stop level to the bid price - 1 tick.
4. **+1 Tick**: increase his stop level with 1 tick.
5. **-1 Tick**: decrease his stop level with 1 tick.
6. **Trail**: change his fixed stop order into a trailing stop order.
7. **Linear**: change his fixed stop order into a linear stop order.
8. **Per HiLo**: change his fixed stop order into a periods high-low stop order.

Changing orders **via the chart**: once an order has been placed, the scalper must be able to click on the order in the chart and simply slide it to another price level.

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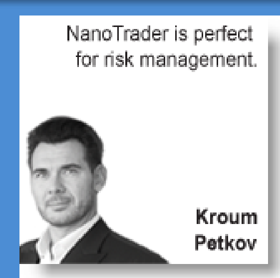
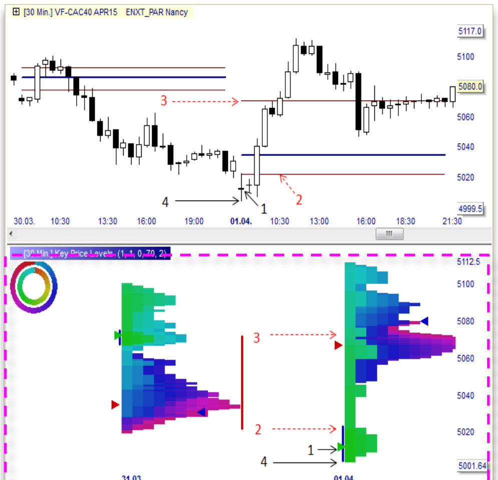


Tools: market analysis

Scalpers rely on information related to volumes and price levels. They want to know at which price levels many market participants buy (or sell). At a level where buyers buy the likelihood is highest that the market will move up a little so they can make their small profit. Two tools scalpers can use are **Key Price Levels** (KPL) and **LiveStatistics**. Note: daytraders and swing traders can also use these tools

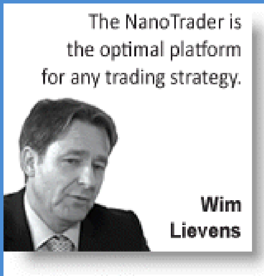


KPL contains a wealth of information related to executed orders. Yesterday's key price levels are projected in today's price chart.

LiveStatistics allows investors to define a market event based on different parameters. LiveStatistics will identify in real-time how often similar events occurred in the past. All these past events are analyzed in real-time. Based on the price developments of the past events, projections for the current market price are displayed in the chart. In short …

- The user defines an event based on a set of parameters (shape, trading range …).
- LiveStatistics identifies all similar events in the past.
- LiveStatistics displays projections for the current market price in the chart.

This **example** illustrates a classic trader question: will this gap close or not? The projections based on statistical data seem to have a bullish bias. The real evolution of the market price is shown next to the LiveStatistics projections. The gap did indeed close later that day.



Techniques for scalpers

A good scalping technique needs to be **precise** (there is no time to think), **simple** (preferably visual) and **fast** (small profits require many trades). The number of loss-making trades needs to be minimal. Many scalping techniques exist. Two examples are given in this e-book: **T-Line scalping** and **KPL scalping**.

T-Line scalping

This scalping technique can be mastered by most traders. It can be applied at **any time** and on **any instrument** (forex, indices, commodities ...).

1. Heikin-Ashi bars in time frame 8 ticks.
2. 8-period exponential moving average (EMA8).
3. 20-period moving average (MA20).
4. First Heikin-Ashi bar closed above the EMA8 in a green zone = buy 4 units (or 2, less risky).
5. Current position: long 4 EuroFX futures.
6. The 4 target orders based on the average true range (ATR).
7. The stop order, also based on the ATR, limits the risk to $ 150 in this case.

The first two targets have been reached. Half the position has been closed. Some traders will now drag their stop to their entry price.

T-Line scalping uses a Heikin-Ashi chart. You can put the chart in either 5, 8, 13 or 21 **ticks**. The technique incorporates a **filter** consisting of an 8-period exponential moving average and a 20-period moving average. When the EMA8 closes above the MA20 the chart background is **green**. When the EMA8 closes above the MA20 the chart background is **red**.

When to open a position? When the first Heikin-Ashi bar closes above the EMA8 in a green zone scalper buys a position of two or four (more risky) units (e.g. four EUR/USD futures). Reversely when the first Heikin-Ashi candle closes below the EMA8 in a new red zone, the scalper opens a short sell position of two or four units. The scalper can work in both directions or, preferably, in the direction of the day trend.

When to close a position? This strategy uses two (or four) different targets and one stop. These orders must be entered automatically (manually would be too slow). The targets and the stop are based on a measure of volatility called the average true range (ATR) calculated over 8 periods. This means that the targets and the stop change for every trade in function of the volatility. This is handled automatically by the platform. The targets are on 2x, 3x respectively (and also 5x and 8x ATRs for the trader who bought four units). The stop is on 3x ATR. Some traders with four units will put their stop to their entry level when the first two targets have been reached.

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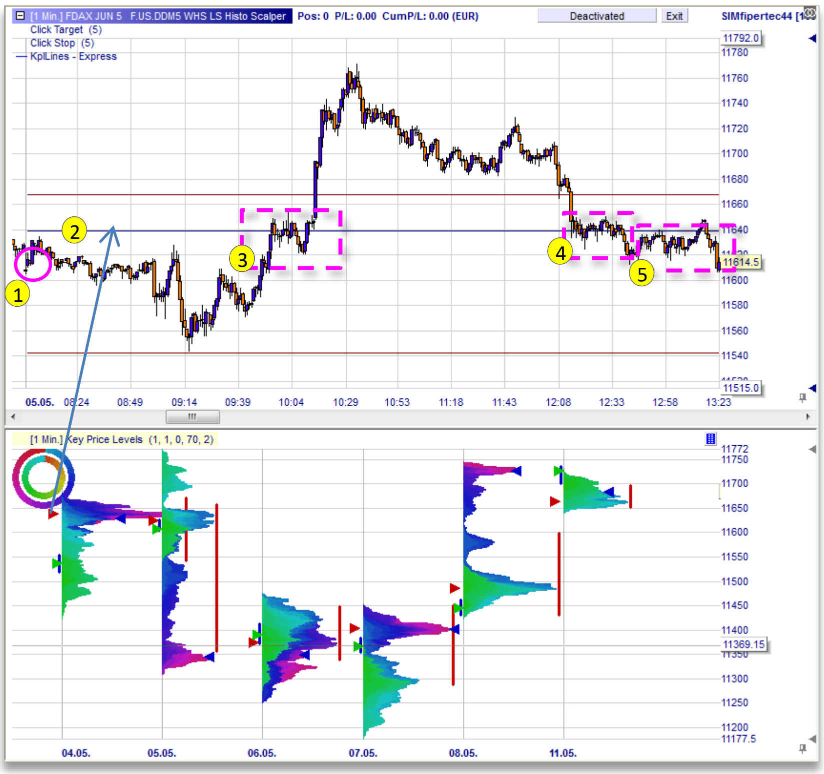
KPL scalping

Earlier in this document the importance of information related to orders was underlined. Information sources can be combined in a variety of ways allowing the scalper to gauge the ebb and flow of the market. KPL scalping uses the equilibrium line of the key price levels as its anchor. The technique uses in parallel other information sources such as time&sales, histograms and tick charts.



The market opens (1) beneath the previous day's market equilibrium level (2). Having opened below, the scalper uses the equilibrium as a **resistance** line. He will short sell when the market price bounces of the line and goes back down (3). The scalper must be careful as the market can break through the equilibrium line (like in this example).

Once the equilibrium line has been pierced conclusively, the scalper can use the line as a **support** line. He will buy when the market bounces up from the line (4). If the equilibrium line is pierced conclusively it can again be used as resistance (5).

1. Market open.
2. Yesterday's market equilibrium level projected today.
3. Resistance of the equilibrium line.
4. Support on the equilibrium line.
5. Resistance of the equilibrium line.

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