

The Stair Step Trade

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The Waterfall Introduction:

Let me first say thank you for taking the time to read this amazing Book. I believe this Book will change the way you trade Stocks, Options, Futures and Forex markets. I have been a trader and teacher of the markets for over 15 years and run the website www.DayTradingfearless.com In my first few years, I was really struggling to understand how to make money in the stock market and devised a system. I have created 2 names for this trading strategy which are “The Stair Step Trade” but in this book we will call it the “The Waterfall Trade” which you will see later on why it was named as such. I am a chart trader technician and I use candlesticks for my trading. By using candlesticks, I feel I have an edge with the Waterfall system.

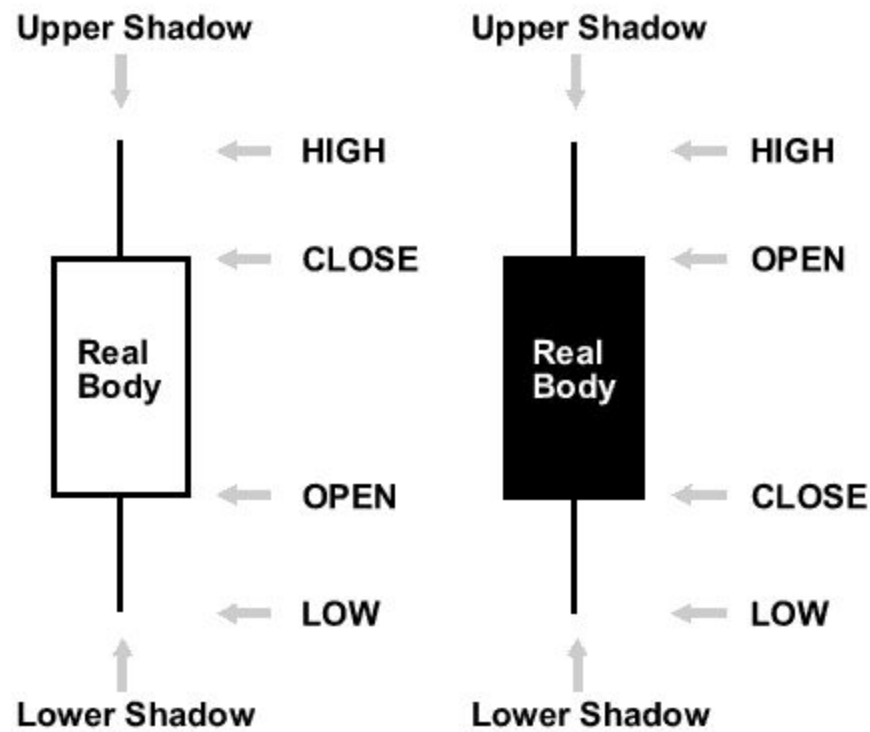
You probably have seen other trader's screens with Bollinger bands, 20, 50, 200 moving day averages, pivot points, MACD, stochastic, volume, etc, and while you stand there looking at the screen I bet you are getting cross eyed because there is so much going on with the chart.

This Book will show you a system where you have only candlesticks and volume, a very clean & simple chart. In those other charts you see with all the indicators, there is just way too much going on and I believe in one thing and that is Price Action. Price Action is where price has been and where the price is right now. All those other indicators are lagging and yes they look great at the end of the day on the chart and you think to yourself “See, that was the perfect entry because it touched the lower Bollinger band and bounced off it, etc”.

Well, I am here to tell you that you must to be true to yourself and say while the price was touching the lower Bollinger band, did you really know that price would bounce higher there and be a perfect trade. I don't think you did, because in real time the bollinger bands were more than likely pointing lower and you thought there would be more downside. Now with price action all we really care about is price, so I don't need all of these pretty indicators. The main indicators I use for this trade is the candlesticks and sometimes volume bars.

The Waterfall / Stair Step Trade System:

Okay, so let's get right down to the Waterfall trade system. First thing is you must know and understand what candlesticks are and how they function. Below is an example of how a candlestick works.

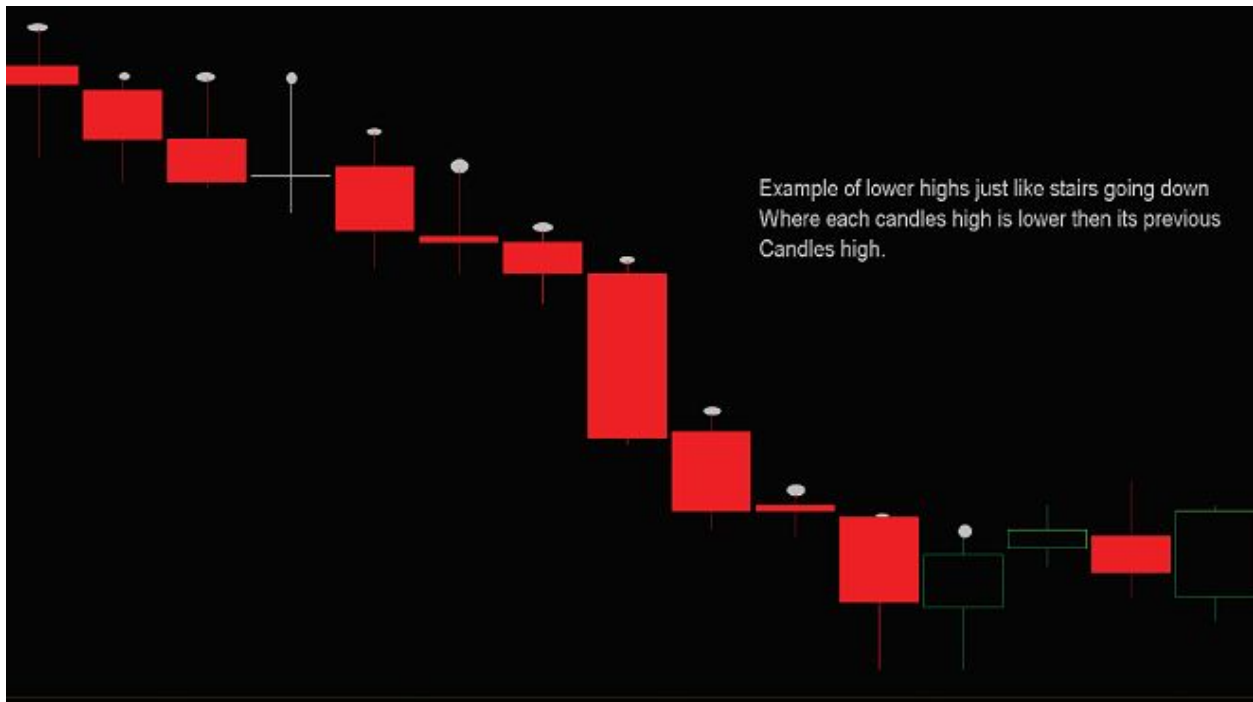


The upper and lower shadows represent the high and low of that time period and the full bodies are where price opened and closed. If the candle is white or green, that is telling you that price opened lower and closed higher, and if it's a black or red candle the price opened higher and closed lower. That is Price action, telling you where price has been and where it currently is.

The way we use this in the Waterfall trade system is we look for a series of lower highs on each candle to its previous candle. What this is telling us is that during that time period (and we will use 5 min candles for all of the illustrations) is that price was not able to make a higher high above the previous candle. (Just a side note, the Waterfall trade system can be used on all timeframes)

Think about this for a second, you have a flight of stairs going down and the top of each stair is lower than the previous stair then you are moving lower. We use this same method just with the highs of the candlesticks. See the chart below for an example.

Waterfall - Every candlesticks high price is the same or lower than the previous candlestick high.



We will want to look for a trend on a minimum of 3 candlesticks that are making lower highs. When we find this trend we will want to start watching the current stocks candlestick to now make a new higher high over the previous candlestick's high, also know as a trend reversal.

Now just a note that you may go 30 minutes to over an hour or two watching a stock's candlestick make lower highs but the longer it goes the better your chances of success are.

The entry for this trade is when the current candle makes a higher high by just 1 penny above its previous candlestick's high.

Here is an example, let's say there is a trend of 5 candles with a lower high from its previous candle and the last candles high was \$48.93 but closed that time period at \$48.85 we will want to place a buy stop market order at \$48.94 because that will be 1 penny above the previous high and will signal a possible trend reversal to the upside.

Let's break this down a little more, we will say the first candle makes a high of \$50.20 then the 2nd candle makes a high of \$49.75. Then the 3rd candle makes a high of \$49.35 and the 4th candle makes a high of \$49.05 and the 5th candle makes a high of \$48.93. Below is a charts with this exact scenario and look at how price & candle react once the current candle breaks its previous high.

Waterfall Reversal:

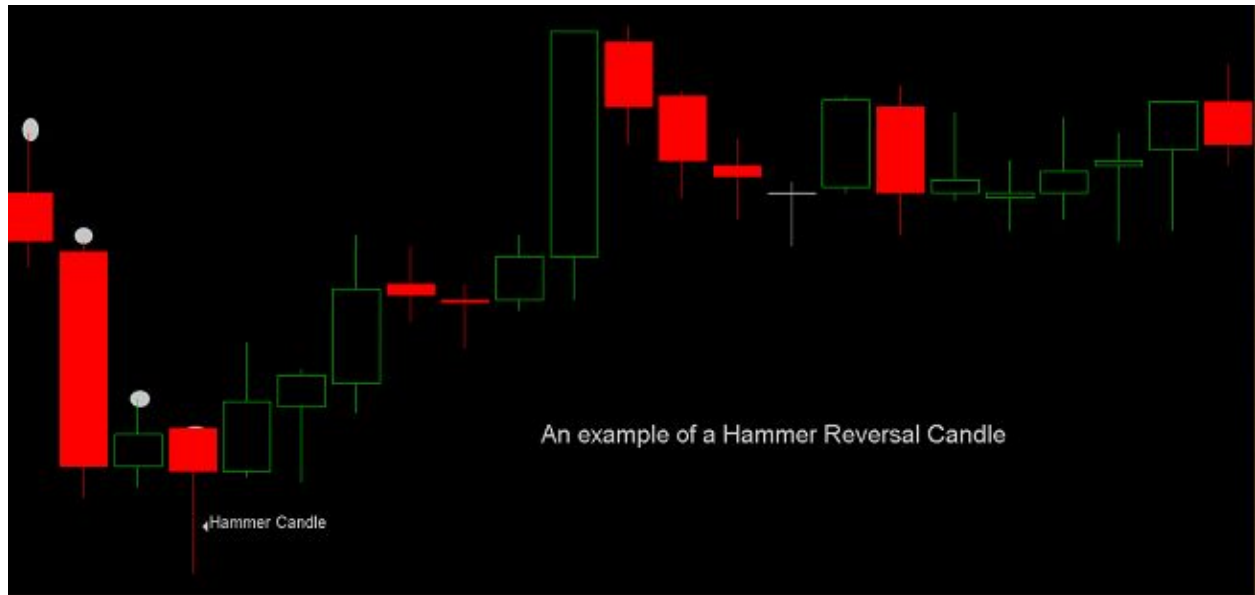


What is happening here behind the scenes is that traders are short the stock and have caught a trend to the downside, their thinking is that they will ride the price lower until the trend reverses. With a candle making a new higher high than its previous candle it is telling the shorts that the trend may be over and they will need to cover their short positions which means they need to buy back the stock and create a short cover rally.

Now there are a few things to know about this trading system that will increase your odds of success and tricks that you will want to look for. You will want to look for hammers, doji's or

bullish engulfing candlestick patterns during the sell off. I have found that the hammer candlestick is the most reliable and high probability of success to trade this system with. The hammer can potentially give about a 90% win rate. Below is a chart of each different candle trade reversal type.

Hammer Pattern:



Bullish Engulfing Pattern:



Doji Long Pattern:



Doji Short Pattern:



With these candlestick patterns you will want to look for small range candlestick bars for a better risk vs reward entry but it is not mandatory.

The reason for this is because we want to limit our risk as much as we possibly can. In the next section we will discuss how to manage our risk and where to place our stop loss.

Risk Management:

I am a firm believer in risk management because being in this business for 10 plus years and seeing all I have seen the main reason most people fail is they have no risk management and no trade plan.

What is risk management?

It is being able to take a loss and protect your capital. I am not going to lie to you and say you will never have losing trades because you will, there is no perfect system out there. But the Waterfall trade system could produce about a 80% to 90% win rate if it is traded correctly. You must have a good risk management system in place to keep your profits and I often tell my clients “It’s ok to be wrong, just don’t stay wrong”.

The beauty of this system is that price action tells you where to place your stop loss and you will always know how much you are risking on every trade and here is how.

You are watching a nice waterfall and the candles are making lower highs, now the current candle has broke above its previous candles high by 1 penny and you have entered into the trade to the long side. The next step is to place your stop loss order 1 -2 pennies below the previous candlestick's low.

Here is a candlestick pattern of a doji long entry where price broke above its previous candles high and the stop loss is placed below the previous candles low. (The entry is when the long green candle breaks above the green doji candle and the stop loss is 1-2 pennies below the green doji candle).

Doji Long Pattern:



The main reason we go 1-2 pennies below the low is because stocks tend to do 3 things on pullbacks. The stock will either make a higher low, a double bottom where price will retest the low of the previous candle or thirdly will break down and make new lows and can keep going lower.

All three of these are part of the cat and mouse game of the stock markets.

Below is an example a waterfall trade where you had a low risk entry then the stock rallied and pulled back but never made a new low, as you can see if you stuck with the trade you would have made a nice profit.

The Entry Then Pull Back Trade:



By placing your stop loss order this will protect your trading capital and make you a more disciplined trader. There are many techniques you can use when figuring out how many shares to trade and your profit targets, But the Stop Loss will always be the same below the previous candles low.

Risk vs Reward Techniques:

One technique that I use is to buy 1000 shares and will look for at least a one-to-one risk vs reward. Once you have a one-to-one reward you can take half the position off and move your stop loss to breakeven. By doing this you now have done two things, first is you have made this a guaranteed winning trade and second is you can let the remaining 500 shares run for a potential home run.

Another technique is you can always look for a one-to-two risk vs reward which means that you can win only 50% of your trades and still be a profitable trader.

There are many other techniques you can use with exiting the trade with profits. Below is a chart of a short trade and how both of the techniques I mentioned above would have made you money. You could have done a plain one-to-two risk vs reward trade, or take half of the position off to lock in profits, move your stop to breakeven and then let your winning trade run.

1-To-2 Risk/Reward & Let The Trade Run Trade:



How To Use Volume With the Waterfall Trade:

Lets now look at how we can use volume to help us on our entry of the Waterfall trade system. Volume can be the key to knowing that our entry point is very near. Below are 2 examples of the Waterfall trade with volume as our guide.

Reversal Candlestick With Volume Spike:



Low Risk Entry With Volume Spike:



Here is how we use volume to help us enter the trade, As the stock is selling off there is increasing volume but then there is a large volume spike that over shadows all the other volume bars. When we see a candle with large volume we will want to be watching closely for our entry on the stock. In the charts above you can see the stock had a nice hammer candle and a large volume spike at the same time. What the volume spike is telling you is that the stock is capitulating and that all the sellers may have sold and this is when the buyers may step in to buy the stock.

Most people have been taught that when they see a stock is moving lower and also has large volume there will be more downside to the stock, but the professional trader looks at it as this is the time to be a buyer.

The Reverse Waterfall – A Short Trade:

Let's take a look at another type of Waterfall Trade that you can trade, but this is going to be a trade to the downside. This trade is called shorting a stock, a lot of traders either do not know they can take a trade for the stock to go lower or are scared to short a stock. Let's look at this type of trade.

The reverse waterfall trade is when a stock is in an uptrend and you want to short the stock and looking for the price of the stock to move lower.

The rules are the same as for the entry and stop loss but instead of looking for lower highs and the reversal to the upside you will want to look at the lows of the candlesticks and look for the reversal at the highs of the uptrend. As the candlesticks are making higher lows from its previous candlestick you will want to take a short position when the current candle breaks below the previous candlestick's low.

You will want to look for shooting stars (upside down hammer), bearish engulfing and doji candlestick patterns. You also will want to still watch the volume bars for the spike to the upside.

Below are 3 chart examples of the reverse Waterfall Trade.

A Doji Reversal Candlestick Pattern:



A Shooting Star Reversal Candlestick Pattern:



Reverse Waterfall Short Trade W/ Volume Spike:



The Failed Waterfall Trade:

I saved this one for last, As I have show you the waterfall trades all have worked out perfect and we're all winning trades. Now I also said at the beginning of this book you will have some losing trades and to protect our trading capital we MUST always use stop losses. This type of Waterfall trade has a lot higher probability of success then all of the other Waterfall trades I have shown you. What is it you ask, well let's look at it.

The failed Waterfall trade is when there is a Waterfall, let's say to the downside, and the current candle breaks the previous candles high but then the stock has no follow through to the upside and then fails and make new lows. There are 2 things that can be done here.

You can reverse the trade and go short the stock or you can wait and look for a secondary waterfall and look for an entry to the long side again using the same rules as with the original Waterfall trade. The secondary long waterfall trigger has a much better success record.

Below is a chart of how a secondary Waterfall trade works, also see how once you have a secondary Waterfall trigger to the long side the stock starts to make higher swing highs and higher swing lows.

Failed Waterfall Trade:

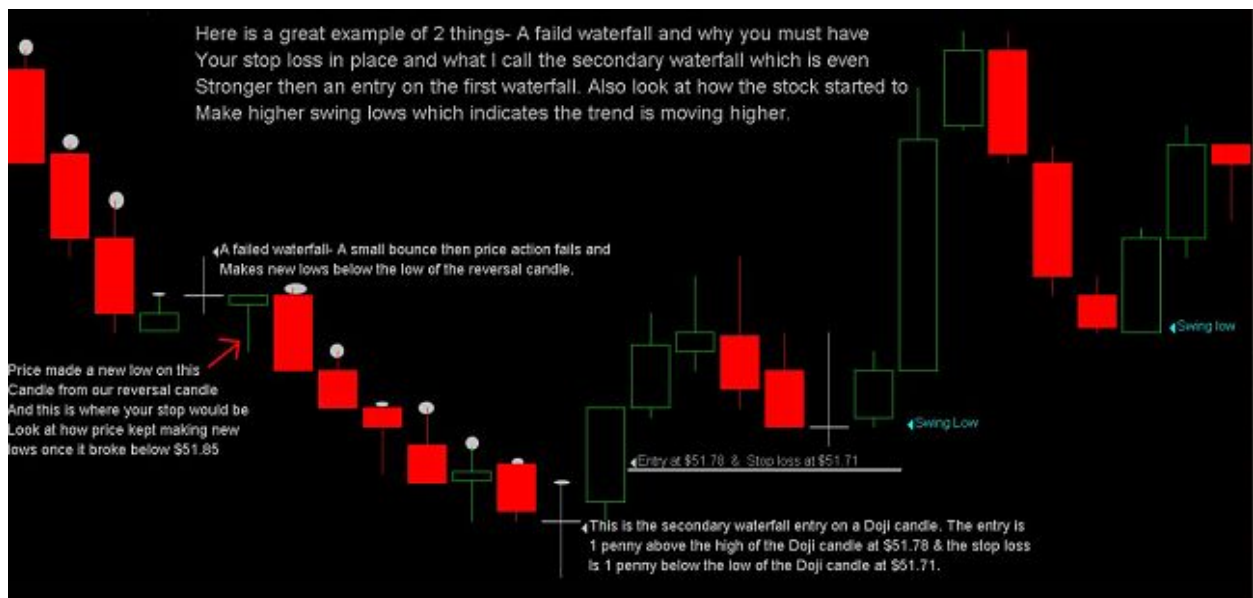
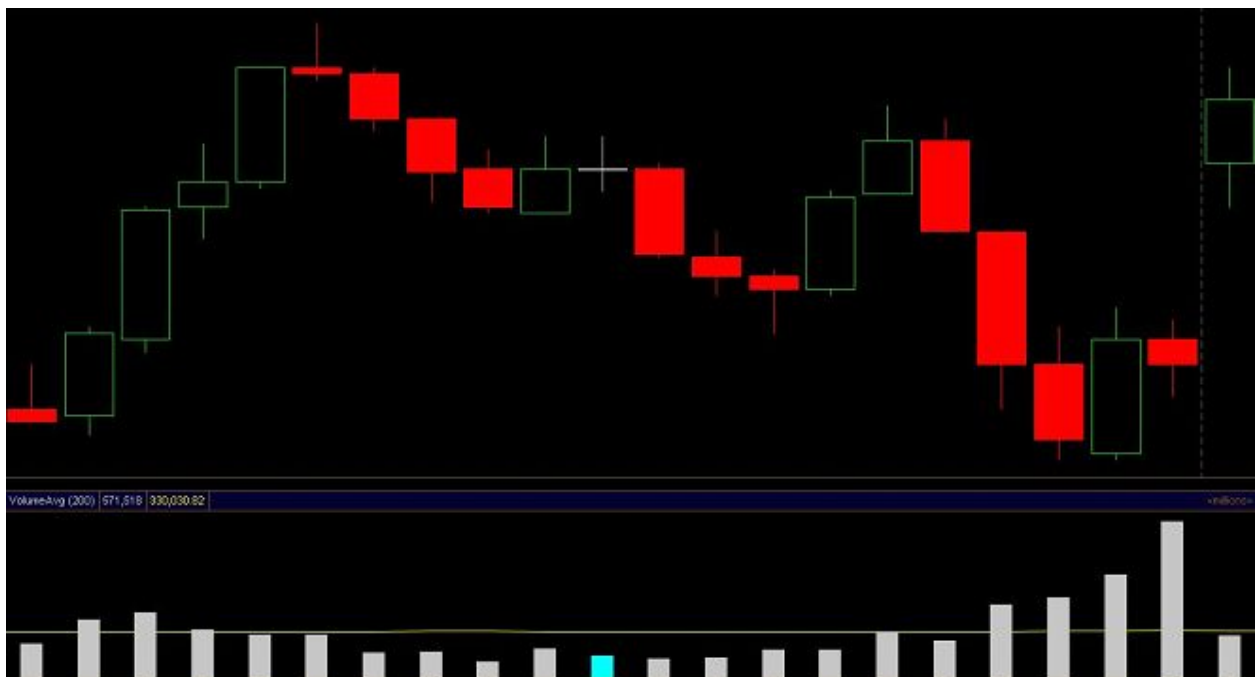


Chart Time to Train Your Eyes:

Below are a few charts of waterfalls, reverse waterfalls and failed waterfalls all with volume. You will see how volume may give a signal and may not give a signal. The main point of this is to get your eyes trained of what to look for when looking at charts by focusing on how the candles will create a waterfall and how volume may work with the trade. I have purposely not shown you the entry's on the charts. This section is also to show how this trade works over and over to be a profitable trading system. I also recommend to look at past charts of your own.









Did you find the Waterfall & Reverse Waterfall Trades? I know some were hard to find but that is the way it works in live trading. Not all waterfalls will be clean and easy to see, but I am pretty sure you found the waterfalls because if you read and studied this book then you now have the tools to start trading and making money with low risk trades in the stock market.

I want you to now turn on your trading platform, pull up your charts and create a watch list. Select the 15 minute time frame and start going through the charts looking for Waterfalls. The more you look at the charts for the Waterfalls the easier they get to spot. Don't forget to also look at volume and look for swing highs and low to spot trends to keep you in the trade longer.

I hope this book opens a new style of trading to you and you become a very profitable trader from this system and as you can see all we care about is Price Action and Volume and not getting confused by 10 different indicators that are telling us 10 different things, also look at how clean the charts look and by the end of the day you will not be crossed eyed.

One last thing is I think the 15 minute time frame is the best time frame to trade for Intra-day trading.

Thank you and please visit my website www.DayTradingFearless.com for more trading information.

I wish you the best success to your trading!

- Jason Ramus

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