The Search for the ‘Holly’ Grail

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Man vs Machine?

or

Man AND Machine!

No man is better than a machine, and no machine is better than a man with a machine.

~Paul Tudor Jones
WHAT WE WILL COVER

1 - Who is Holly?

2 - Market Structure Review

3 - Short Sales – Why, How and When

4 - Short Squeeze
   • Why they occur
   • Short Interest
   • Days to cover
   • How Accurate is the short information?

5 - Two Types of Short Squeezes
   • Knee Jerk
   • Structural
1 - Who Is Holly?

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2 – Market Structure Review

ALPHATRENDS - Understanding Market Structure

Segment of Uptrend

Stage 1 Accumulation
Occurs after a drop in prices. Process of buyers gaining control over sellers, which leads to markup.

Stage 2 Markup
Bullish phase of a stocks life is defined by higher highs and higher lows. This is where you want to get long on breakthroughs after short term pullbacks. Railes are “innocent until proven guilty”.

Stage 3 Distribution
Occurs after a prolonged price advance, process of sellers gaining control of prices, which leads to decline.

Stage 4 Decline
Bearsish phase of a stocks life, this is where you want to be short, look to sell short from breakthroughs after short term rallies have exhausted themselves. Rally attempts are “guilty until proven innocent”.

Segment of Downtrend

EARLY ACCUMULATION
1-1 Beginning of transition from bearish trend to more neutral, longer term moving averages are still declining and the stock will cross above and below these moving averages. Many of these stocks will continue lower and should continue to be monitored for short opportunities.

MID ACCUMULATION
1-2 Bearish forces become more neutral as buyers methodically accumulate shares, but still no signs of upward momentum develop.

LATE ACCUMULATION
1-3 Higher lows will often develop but the stock is unable to penetrate a longer term resistance level to create a higher high. Moving averages have flattened out as buyers slowly gain control.

EARLY MARKUP
2-1 Stock first establishes a pattern of higher highs and higher lows above rising longer term moving average. These stocks show considerable upside momentum and should be monitored closely on shorter term timeframes for low risk buying opportunities.

MID MARKUP
2-2 Pullbacks above the rising longer term average may become deeper but these stocks are often in the “sweet spot” of an uptrend where gains can come quickly.

LATE MARKUP
2-3 The upward momentum is still present but rallies may take longer to develop after pullbacks. Gains can come very quickly, often at the expense of “trapped” short sellers who have incorrectly bet against the uptrend.

EARLY DISTRIBUTION
3-1 Shorter term moving averages begin to cross over another which indicates a confusion of trend. Many of these stocks will continue higher so they should still be monitored for potential long candidates.

MID DISTRIBUTION
3-2 These stocks have become more neutral and should be looked at as “conforming through time.” Upside is still possible, but becomes less likely as the interest from momentum traders shifts to more active losers.

LATE DISTRIBUTION
3-3 Some of the shorter term moving averages may be declining and acting as resistance but the stock has not broken key support to place it in official downtrend. These stocks are quite vulnerable to decline.

EARLY DECLINE
4-1 The stock first establishes a pattern of lower highs and lows below the declining longer term moving averages. These stocks are beginning to show signs of fear and can decline rapidly. These stocks should be on watchlists for short sale opportunities.

MID DECLINE
4-2 Railes to longer term moving averages typically fail as more participants lose hope in a rally and the reality of a declining stock starts to settle in. These stocks offer excellent shorting opportunities.

LATE DECLINE
4-3 The downward momentum is still present and declines can come rapidly, but no box can violent short squeeze rallies, particularly after “bad news” is reported.

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Understanding Market Structure - The Four Stages Graphic

Plan of Action:

STAGE 1 - ACCUMULATION
Anticipate Long/Cover Short

STAGE 2 - MARKUP
Participate Long/ Avoid Short

STAGE 3 - DISTRIBUTION
Exit Long/ Anticipate Short

STAGE 4- DECLINE
Participate Short/ Avoid Long

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3 – Short Sales

• Borrow stock from broker to sell (short) and buy back at a lower price to profit

• Always use a buy stop

• Stocks typically decline much faster than they rise (fear vs greed)

• Stick to stocks in a Stage 4 Decline, Stocks in a downtrend are “guilty until proven innocent”

• It is a bonus if there are “bad fundamentals” in the underlying company, but not essential to make a good short (news follows trend)

• Seriously consider buying some back on “bad news” (who is left to sell)
Selling Short

• Be skeptical of takeover rumors in down trending stocks

• Do not chase lower, ask “where has it come from & potential to go?”

• Consider options strategies to implement bearish ideas, limit losses if market moves against you

• Timing even more important than with longs when primary market trend is higher

• Try not to be influenced by “obvious” reasons (market is only up because of Fed) There is ALWAYS something to worry about.

• If sector and market do not agree with the setup in the individual stock, adjust position size to compensate
Selling Short
Don’t get caught in the emotional cycle

Same emotions for short sellers but at opposite times than longs

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Selling Short
Short Sales The Right Way

Plan of Action for Trend Participation:

**Primary Trend**
- DAY
- Identify Trade Candidate

**Intermediate Trend**
- 65/30/10 Minute
- Plan your Trade

**Short Term Trend**
- 10/5/2 Minute
- Trade your Plan

- **Stage 4 Decline**
  - *guilty until proven innocent*

- **Stage 1 Accumulation** — Exit
- **Stage 2 Uptrend** — Avoid
- **Stage 3 Distribution** — ANTICIPATE
- **Stage 4 Decline** — PARTICIPATE

Fine tune your timing

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Selling Short

Identify the trade candidate on a larger timeframe
Establish a **RISK / REWARD** Scenario

Before Entry, Answer 2 Important Questions:

1- Where has stock come from?

   **RISK**

   Has it expended a lot of energy, is it extended, what is volume pattern, where does stop go? **DO NOT CHASE!!**

2- Where does it have the potential to go before likely resistance (long) or support (short) is found?

   **REWARD**

   There must be enough profit potential relative to *perceived* risk

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Selling Short
Plan and execute the trade on an intraday timeframe

Buy stop above the most recent and relevant lower high for YOUR timeframe

Short below the lower low when stock is below the flat/declining 5 DMA
Short Selling
The two timeframes together

**PLAN** on the longer timeframe

**Execute & manage risk** on shorter timeframe

- **Buy stop** above the most recent and relevant lower high for YOUR timeframe
- **Short below the lower low** when stock is below the flat/declining 5 DMA

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Short Selling - Risks

- Short sales are more difficult than going long
- Only short stocks in a downtrend (downtrend definition)
- “Unlimited” potential for loss
- Some of the sharpest rallies occur in downtrends (don’t fall for them long)
- Do not short after a 2-3 days of decline
- Be quicker to take partial profits than when long
- Do not short “obvious” ideas, especially if they are still in an uptrend

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Risk Management is Job #1!!

My job is that of risk manager for the economy.
~Alan Greenspan
Selling Short

We manage risk by lowering stops to just above the most recent & relevant lower high.
4 – Short Squeeze

• A rapid run-up in price within a heavily shorted stock which is exaggerated by short sellers covering their bearish positions

• FEAR of unlimited upside

• Stocks in an uptrend are “innocent until proven guilty”

• Double demand – “natural” longs and shorts trying to cover

• Lack of supply- stocks near all time highs do not have “trapped longs” looking to get out at breakeven

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Short Squeeze Dynamics - Short Interest

- Total number of shares sold short and not covered (representing future demand)
- Updated by the exchanges 2x per month

Significant lag time between settle date of trade and when numbers are publicly reported
## Short Squeezes

**TERMINIOLOGY-** Short Interest Ratio (SIR) aka Days to Cover

**Short Interest / Average Daily Volume = SIR**

<table>
<thead>
<tr>
<th>Short Position</th>
<th>Daily Volume</th>
<th>S.I.R*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Million Shares</td>
<td>2 Million Shares</td>
<td>1</td>
</tr>
<tr>
<td>2 Million Shares</td>
<td>500,000 Shares</td>
<td>4</td>
</tr>
<tr>
<td>2 Million Shares</td>
<td>250,000 Shares</td>
<td>8*</td>
</tr>
</tbody>
</table>

Short Interest Ratio (SIR) is the amount of days it would take shorts to cover their bearish bets based on the most recent average daily volume.

Days To Cover (SIR) Numbers may vary on different sites, depends on # days used in average volume calculation

*over 5 Days to Cover is generally significant
Short interest ratio can change without a change in number of shares sold short because the average volume may change

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How accurate is the short information as reported by regulatory agencies?

“Markets can remain irrational longer than you can remain solvent.”
~John Maynard Keynes

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Short Squeeze Stock Characteristics

- Up trending stock or one near a breakout (double demand and less supply)
- Often strong fundamentals (revenues & earnings)
- Often a “fad” stock
- Know approximate level where short position was initiated
- High (over 5) Short Interest Ratio (SIR aka Days to Cover)
- High percentage of floating shares short (more than 5-10% gets my attention)
5 – Two Types of Short Squeezes

1 - Knee Jerk Short Squeeze

Characteristics:
• Stock in Stage 4 Decline
• Longer term sellers in control
• Declining moving averages
• Rumor motivated, takeover, upgrade
• Violent upside brings in emotional participants
• High likelihood of failure
• Guilty until proven innocent
• Rallies in Downtrends Can Come Quickly But Typically Fail

• Stocks in Downtrends are “Guilty Until Proven Innocent”

• Always be aware of the next bigger timeframe
Knee Jerk Short Squeeze? SHAK
Knee Jerk Short Squeeze

Rallies in downtrends can be violent but most of them get “snow packed” quickly.

Stocks in Downtrends are considered Guilty until Proven Innocent!

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2 – Structural Short Squeeze

Characteristics:
• Longer term transition from Stage 1 Accumulation to Stage 2 Uptrend
• Above rising moving averages
• Shorts in real trouble as buyers gain control of long term trends
• Fear of unlimited losses
• Stock is “Innocent until proven guilty”
Begin of fresh stage 2 uptrend on weekly (Structural Shift)

Shorts began covering before uptrend but still 23M
Reenergized uptrend after 18 months of choppy action (Structural Shift)

Shorts piled in during "time correction"

Fresh uptrend, time to cover!
Structural Squeeze Potential - FEYE

Fresh Stage 2 Uptrend in $FEYE

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Structural Squeeze Potential - CARS

I would be nervous if I was short.

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Risks In Short Squeeze Candidates

• Short sellers aren’t stupid (especially in biotech stocks)

• A lot of assumptions in data due to staleness

• We don’t know if the position is hedged or part of a more complex position

• Mitigate Risks with options strategies, position size, etc.

• Job number one is always to manage risk!

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Thank You for Attending

Thank you to Trade Ideas

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Risk Management is Job #1

Technical Analysis Using Multiple Timeframes
by Brian Shannon is available exclusively on Amazon.com