

# **Working Money**<sup>™</sup>

## **Those Money-Making E-Minis**

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*by David Penn*

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*Daytrading e-mini futures offer another way for stock market daytraders to play.*

One of the biggest changes since the market top of 2000 happened in the world of stock market daytraders. Very much the symbol of everything that was both right and wrong about the bull market of the late 1990s, traders trading the stock market intraday benefited from a perfect storm of low commissions, high volatility, and relatively low margin requirements.

While the low commissions remain years after the bubble burst, and volatility has served mostly to bring pain to the houses of short-sellers, one thing that has definitely changed is the margin requirement for intraday stock market traders. Back in the spring of 2001, the Securities and Exchange Commission (SEC) approved new rules that, among other things, dramatically increased the margin requirements for what they called "pattern daytraders."

This was a classic "closing the barn door after the horse has bolted" maneuver. From the mere fact that whatever damage daytraders had done to themselves or the market was already on the wane by the time the amendments to Rule 431 came round, to the fact that the phrase "pattern daytrader" seemed to suggest something insidious about the behavior of daytraders, the new rules meant that daytraders would be operating in a vastly different -- and more expensive -- environment going forward.

What might have been a bane to the world of daytrading stocks, however, might have proved to be a boon to the world of e-mini futures index trading. For while the SEC has made it more difficult for the average retail trader to participate in the stock market intraday, the futures exchanges have actually lowered the barriers to entry for retail traders who are interested in trading intraday but cannot afford the new \$25,000 minimum margin required to trade stocks in this way. Many brokerages now offer dramatically reduced margin requirements for traders interested in trading e-mini futures -- as long as they close out their trades by the end of the trading day.

So while the government is providing disincentives to daytrade stocks, the futures industry is providing incentives to daytrade e-mini futures.

## **E-MINI MERRY-GO-ROUND**

What are e-minis? E-minis are miniature versions of full-sized futures contracts traded on exchanges such as the Chicago Mercantile Exchange (CME) and the Chicago Board of Trade (CBOT). The number of electronic "miniature" versions, or e-minis, has grown significantly in the past few years. The first e-minis were versions of the Standard & Poor's 500, launched by the CME in 1997, but others soon followed. Today, traders can choose e-mini index products based on not only the S&P 500, but also the Dow Jones industrials, the NASDAQ 100, the Russell 2000, and the EAFE.

There are also e-mini products available for some of the more widely traded commodities, including many in the energy complex (as in crude oil, unleaded gasoline, heating oil, and natural gas) as well as in agriculture (such as corn, soybeans, and wheat), international currencies (the Japanese yen and the euro, for example), and precious metals (that is, gold and silver).

But the belles of the e-mini ball are still the e-mini index products -- particularly the e-mini S&P 500. While many traders insist that the e-mini Russell 2000 is a superior trading vehicle, the familiarity most traders feel they have with the movement of the S&P 500 keeps the e-minis based on it quite liquid and quite tradable -- especially for those interested in intraday price movement.

The popularity of the e-mini S&P 500 is such that there is no shortage of strategies and methods that traders have devised to profit from them. From methods looking at five-minute bars to strategies that focus on 15-minute blocks, and from volatility to momentum trading, traders have proved that there is money to be made intraday by working exclusively with a single trading vehicle (rather than trying to track the universe of stocks as many stock daytraders continue to do).

Add to this the lowered margin requirements (as low as 50% of the typical margin) for trades entered and closed on the same day, which actually helps provide liquidity to the e-mini market for those trading over longer terms, and you have a situation worth investigating for traders who like the idea of going to sleep each night with nary a single open position.

## **E-MINIS IN THE MARKET**

Many of the same strategies effective in trading stocks in the daily time frame are also effective in trading the e-mini S&P 500 intraday. Even a cursory review of intraday movement in the S&P 500 shows trends, consolidations, evidence of support and resistance, breakouts, and reversals.

That said, there are a few differences worth underscoring. For one, the clock is "on the field" when it comes to intraday trading the e-mini S&P 500 -- that is, setups late in the day may have to be avoided because there may not be enough time for the price target to be reached before the close when the e-mini daytrader needs to liquidate his or her position.

A second difference is that intraday markets are more vulnerable to sudden price swings

that can easily shake a trader out of an otherwise profitable trade. While the liquidity of the e-mini S&P, for example, is such that these sudden spikes in volatility shouldn't be overstated, they do exist and intraday e-mini S&P 500 traders need to factor this into both their trading and their money management.

Here's an example of an e-mini S&P 500 daytrading method I monitored during 2006 (Figure 1). I used the TRIX, a momentum indicator developed by Jack Hutson, trader and founder of *Technical Analysis of STOCKS & COMMODITIES* magazine, and 15-minute candlesticks. The particular implementation of TRIX that I used is the one from Prophet.net, which uses crosses between the TRIX and a shorter-term signal line to determine entries and exits. This implementation also had the visual advantage of displaying green and red arrows to indicate when four different types of technical events were occurring:

- **Golden cross:** TRIX crosses above signal line
- **Dead cross:** TRIX crosses below signal line
- **Bounce:** TRIX hooks from down to up
- **Fall:** TRIX hooks from up to down.



**FIGURE 1: EMINI S&P 500, JUNE FUTURES, 15-MINUTE.** This implementation of TRIX uses a signal line to create patterns such as golden and dead crosses, bounces, and falls. The highlighted candlesticks correspond to the three, intraday buy signals on Wednesday, May 30.

Trading the TRIX this way at its most basic would have traders buying golden crosses

and selling "falls."

I added a few rules for entries: no longs below the 50-period EMA, and no shorting below it. I also required follow-through by at least 50 cents after a confirmed golden cross buy signal. In other words, if a 15-minute session closed at 1400.25 and created a golden cross in doing so, then I would look to get long the market if and when it reached 1400.75.

There were a number of other wrinkles, many of which had to do with trade and money management. The goal with each trade was to exit half the position with the first, +2-point, 15-minute close (remember, this was based on 15-minute charts), and move the stop on the remaining position to breakeven. Exit the balance of the position on any subsequent close that is also +2 points or better. This sometimes means closing one position at 11:15 and the balance only 15 minutes later. But I found that making the +2 profit taking contingent upon the 15-minute close often allowed for an extra point or two (or much more) than exiting as soon as the +2 point were touched.

With regard to a stop, I used a simple three-point per contract maximum loss rule that was not based on the close. While I was content to wait for the close to exit a profitable position, I was not interested in waiting in a position that was already losing money. Unlike trend trading, intraday and momentum trading is about exploiting the opportunity and moving on. Rather than attempting to ride out corrections, the intraday trader needs to limit their damage when he or she cannot avoid that damage altogether.

My results were not earth-shattering, but they were profitable and worth further exploration. More important for present purposes, those results were enough to prove to me that even basic trading methods -- and conservative money management -- can effectively be used to trade the e-mini intraday.

### **E-MINIS AND MARKETVOLUME**

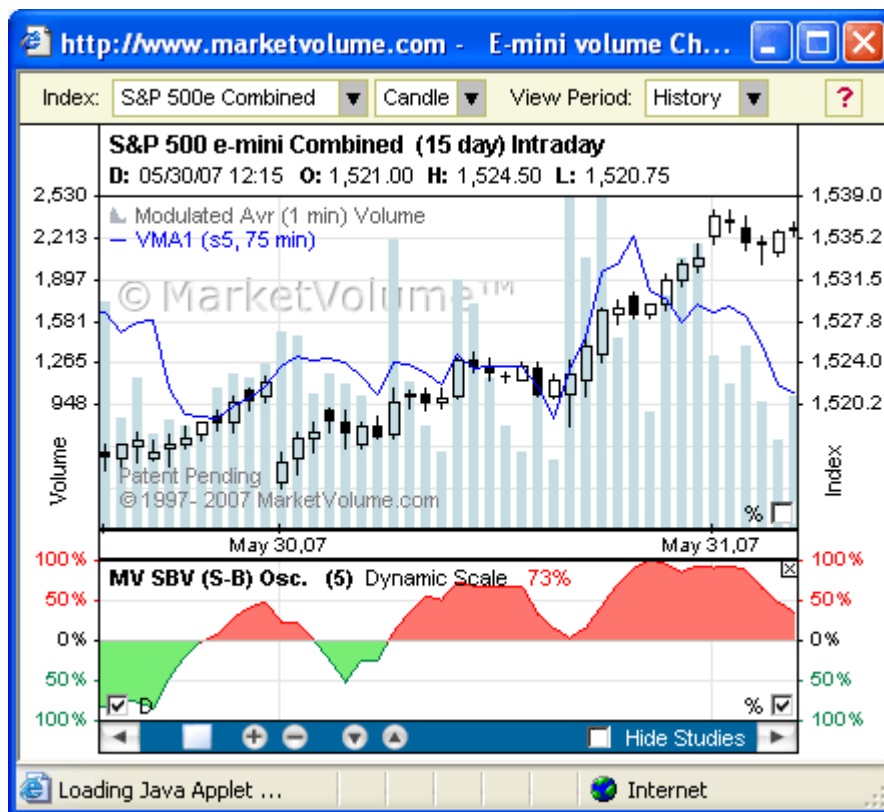
The method described is completely volume-agnostic. Instead, the TRIX with a signal line method relied on price momentum and relatively modest price goals in order to determine entries and exits. As you might imagine, there are other ways to trade the e-mini S&P 500, ways that, far from being volume-agnostic, more represent an attitude toward volume that is closer to a deep and abiding faith.

Marketvolume, which has brought their innovative modulated volume technique to the world of stock indexes, has now made that same discriminating volume analysis available to the world of e-mini index futures. In the case of stock indexes like the \$SPX, the problem was compiling accurate volume data in the first place. With regard to their volume analysis and the e-mini S&P 500 market, Marketvolume sought to solve the problem of distinguishing worthwhile volume information from potentially misleading volume information. As they wrote in an introduction to their volume analysis for futures daytrading:

... [I]t was difficult to separate volume fluctuations generated by market sentiment (i.e., panic selling/euphoric buying) from the typical

diurnal volume patterns caused by the time of day or approaching expiration.

For daytrading the e-mini S&P 500, the solution was something they called "combined modulated futures volume." "Combined" refers to Marketvolume's practice of including "futures volume from all available expiration series" -- which, in practice, tends to be the current contract and the next forward two (for the e-mini S&P 500 as of this writing, that would include June, September, and December). "Modulated" refers to the practice of blending and adjusting volume data based on what Marketvolume observes to be "historically defined, normal volume fluctuations known to occur during typical trading sessions..." (See Figure 2.)



**FIGURE 2: S&P 500 EMINI COMBINED, 15-MINUTE.** A look at the same market period shown in Figure 1 as seen through the lens of combined modulated volume. Buy & sell signals are derived by the SBV histograms movement vis-a-vis the +33% and -33% levels.

The result, "combined modulated volume," according to Marketvolume, provides the clearest and most helpful analysis of the selling and buying volume that often leads prices and can tip off perceptive traders to both reversal and breakout opportunities during a single trading session or over the course of several. I have written about Marketvolume for Working-Money.com in the past. But for those unfamiliar with the most basic aspects of the company's market/volume analysis method, let me provide a brief reminder. For Marketvolume, the key to trading opportunities in the market comes from climatic or exhaustive volume patterns, patterns that indicate a "last best effort" on the part of the

bulls or bears to push the market in a given direction.

As such, and contrary to much conventional volume analysis, Marketvolume sees spikes in volume to the upside as bearish and spikes in volume to the downside as bullish. Marketvolume calls this "selling volume" and "buying volume" and, further, has constructed an indicator -- the SBV indicator -- that measures the divergence between selling and buying volume. This allows peaks in troughs in the selling and buying volume that can help traders anticipate counterattacks by bulls and bears that often take other market participants by surprise.

What can traders expect when trading the e-mini S&P 500 as Marketvolume suggests? Vlad Korzinin, the CEO of Highland Investments (which runs Marketvolume.com), noted that gains from Marketvolume's e-mini S&P trading system were dependent upon the "magnitude and duration of the volume surge" that produced the signal. Obviously larger surges beget more powerful signals and more enduring moves.

Typically, Korzinin said by way of example, the sort of volume surges that appears in the one-day view in a Marketvolume chart produce between one and three e-mini S&P points per contract, while surges in the five-day view tend to generate between five and seven points on average. For the most part, he said, longer views lead to fewer trades but larger potential point gains. Another "cookie" for intraday e-mini S&P 500 traders, Korzinin added, was the fact that combined volume seemed to be particularly effective in anticipating price movement during the two weeks leading into contract expiration.

Marketvolume actually provides a complete e-mini S&P 500 trading system based on its combined modulated volume analysis and its SBV indicator. The rules of the system are few and straightforward, and all positions -- befitting an intraday trading system -- are exited at the close of the session, profit or loss, unless stopped out by a retreating SBV (for longs) or a rising SBV (for shorts). Marketvolume also continues to offer a 30-day free trial for traders interested in trying out or even simply learning more about their unique brand of volume analysis and how it relates to trading the e-mini S&P 500.

### **MAKE MINE A MINI!**

Writing about daytrading S&P futures in their book, *The Ultimate Trading Guide*, authors John Hill, George Pruitt, and Lundy Hill note that:

The S&P day trade system is by far the most popular system out there ... People are constantly drawn to the idea of day trading. They like the idea of closing out all positions at the end of the day and not exposing themselves to overnight risk. By the end of the day, day traders know exactly how much they made or lost and can go home and not worry about any adverse news that may affect the markets.

Hill, Pruitt, and Hill acknowledge that this "utopian" notion of daytrading is not without its obstacles; perhaps the most major among them is the requirement of a large-enough intraday range for traders to be able to make a decent-sized profit on a consistent basis. The system they present involves calculations to assure sufficient range, as well as

techniques to both exploit breakouts as well as reenter markets in the event of failed breakouts.

Their system produced nearly 41% winning trades, but with winners winning more than losers lost by almost 2 to 1. The system, over the period from January 1990 through February 2000, averaged 125 trades a year.

This underscores the point that there are profits to be made intraday trading e-mini index futures and techniques for doing so. This is true whether they are as complex as the system of Hill, Pruitt, and Hill, or reversal and volume based such as the Marketvolume system, or something else entirely, like the TRIX-based momentum method, are readily available to traders fed up with the high-margin requirements for daytrading stocks, but eager to remain, at least nominally, in the stock-focused world.

For these traders, daytrading the e-mini S&P 500 provides enough of the same sort of market familiarity as daytrading stocks (as opposed to, say, daytrading copper futures or the euro/yen currency cross), while also providing the sort of leverage that can find daytrading the index futures to have, in the words of Hill, Pruitt, and Hill, "the most profit potential when compared to the other markets."

#### **SUGGESTED READING**

Hill, John R., George Pruitt, and Lundy Hill [2000]. *The Ultimate Trading Guide*, John Wiley & Sons.

Penn, David [2005]. "V Is For Volume," Working-Money.com, December 28.

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