HIGH PROBABILITY PLAYS IN A DIRECTIONAL MARKET:
Stick with Five Star Setups

Written Danielle Shay with Simpler Trading®
FINDING A FIVE STAR TRADE

What is a Five Star trade? It's a trading system in which five pieces of criteria are all true. Those five pieces, in and of themselves, are standalone trading setups with an edge. So what happens when you combine multiple high probability setups? You have the master setup - my highest probability bet - The Five Star.

High probability directional bets are my bread and butter. The key to identifying these, is to use technical analysis to first identify the direction of the overall tide, match this with underlying fundamental analysis, and then identify directional moves on a specific index, sector, industry, or stock - before they take off.

Identifying High Probability Directional Bets

To do this, I start by identifying the strongest and weakest sectors through a top-down analysis process. This is done through a combination of:

1. Fibonacci analysis and technical analysis on the primary sector charts
2. Analysis of the four indexes
3. Analysis of additional industries such as Chinese internet stocks, housing sector, etc.

Once I notice a trend, I look for fundamental backing to hold up the technical picture.

This method of analysis is applied to identify the strongest and weakest stocks. Therefore, allowing traders to focus in on those areas for their long and short positions. For example, I look for strong stocks within strong sectors, and weak stocks within weak sectors.

Once I've found my marks, I jump on them - primarily through the options market, but I also employ this strategy for my long-term stock accounts as well.

This method, the Five Star Setup, is the core of my analysis. It leads me to the gold at the end of the rainbow, the trades I call my “Five Star Trades.”

Shifting Sectors Throughout Time

In 2017, the financials, industrials, and technology stocks were my favorite. Throughout the beginning of 2018, I shifted my strategy to trade more consumer discretionary, consumer staples, and still - technology. Why? When the tide shifts, I change the area I'm looking at. I want to focus on the area that is trending and outperforming the overall market. In the options market, the best place to focus is the area that’s making greater than expected moves. By starting with top down, sector analysis, you’ll know where to focus.
TRADING WITH OPTIONS

In this market, opportunities are all around us, and it's up to the individual trader to decide which space they want to partake in. You can select buy and hold moves in the stock market, make plays in various sectors through ETFs, trade short or longer term options on stocks you favor, or trade futures. Either way, learning how to make directional bets through expert technical analysis, starting with the overall tide, will allow you to profit in the market.

Overall, I like making my bets through the options market. Why options?

Leverage

Options provide me with adequate leverage that allows me to make substantial gains on directional plays - gains that far outpace gains I could receive if I just traded stock alone. When trading stock, you really need a substantial amount of money invested in a certain name before you can see returns, and those trades can take quite a while to generate returns. The same isn't true with me for options. I particularly favor lower priced names, where I can make an investment as low as $150 per contract. My typical trades generally cost me about $300-500 per contract. The low price barrier to entry point with options trading takes away the giant barrier to entry that comes with trading stocks.

Time Table

Like I mentioned before, investors wanting to build a stock portfolio should expect that it'll take time to see solid gains. With options, we're able to place trades that work on our personal time frames. If you want to day trade, you can! If you want to select trades that'll last about a week, you can. More conservative options traders might place their bets lasting about a month. I for one focus on trades that mature within about a week. I enjoy being an active trader, and focusing in this manner helps me grow my account. The best thing about the Five Star Strategy, though, is that you can use it for trading stocks and ETFs as well on a higher time frame.

Strategy

The price of a stock cannot be changed. Investors can't decide to buy Amazon (AMZN) at a cheaper price. However, with options trading, even traders with smaller accounts like me can get a piece of moves in AMZN due to the variety of options strategies available to us. We're able to utilize both conservative and aggressive strategies, as well as adjusting contract size and selecting varying strategies to find a risk situation appropriate for varying account sizes. For example, an aggressive trader with a large account may not
have any issues with buying long calls in AMZN that can cost you around $1200 per contract. However, more conservative traders with smaller accounts can formulate spreads or butterflies, bringing the cost down to around a forth of the cost of a single call.

Sea of Opportunity

By using your own research and scans, you can work to identify tickers that you enjoy trading via the options market. I have my favorites, and most of them I've identified using various scans and market research. I can tell you which ones I like - but they may not be your favorites. That's completely fine! The most important part is that there's something out there for everyone. I personally love trading whichever S&P sectors are currently trending, and swapping them out for different sectors as the trends shift.

Trading options gives you the opportunity to mold the market to your liking (within reason). It gives you the ability to find things that work for you, instead of being tied to certain constraints presented by stocks.

KEY COMPONENTS OF THE FIVE STAR

Trading it Simpler - The Trend is Your Friend

Identifying high probability directional plays is all about identifying where the market is seeing its strength, and identifying high probability moments in time in line with that trend. There is no reason to make trading difficult on yourself.

How can you make it easier?

Just think about going for a swim in the ocean and think about swimming against the tide. Maybe it gives you an initial thrill, and you feel good getting in some exercise. However, it doesn’t take long before you start getting winded. Swimming against the tide is exhausting. It can be especially dangerous in treacherous waters. Conversely, imagine yourself swimming out past the tide, waiting for a nice wave to come along, and then riding the wave back to shore?

Trading in and of itself is an extremely difficult skill to master - so why make it harder on yourself? In trading, we want to select setups where we can ride the wave, especially in these strong, directional markets. We don’t want to swim against the tide, especially when we’re trying to make money.
It sounds simple, right? Selecting high probability directional setups instead of messing with tickers that’ll stress you out. But where do you start? That is what I’m here to teach you.

First, we must identify key, trending markets, then we have to look for moments in time where they’re about to explode. This is how we look to capitalize in this market and create exponential gains for ourselves. This is the name of the game.

**Identifying Explosive Moves - Before They Happen**

If you want to make aggressive profits in this market, you have to know how to identify when a stock is setting up for a greater than expected move. Selecting charts that are trending higher isn’t enough. Options are specifically priced so that traders won’t make money if the stock moves within its ‘normal’ range. The way to profit in the options game is to identify high probability tickers, and then, combine that with tickers that are setting up with a chance for a greater than expected move.

So, how do you know when a greater than expected move is setting up? It’s all about ‘the Squeeze.’
The Squeeze

The Squeeze indicator attempts to identify periods of consolidation in a market. In general, the market is either in a period of quiet consolidation or moving. By identifying these calm periods, we have a better opportunity of getting into trades with the potential for larger moves. Once a market enters into a “squeeze”, we watch the overall market momentum to help forecast the market direction and await a release of market energy.

In the chart above, the red dots in the indicator, the squeeze, help us identify moments in time where energy is building up - and will be released. Using this signal, we’re able to capitalize on greater than expected moves in the market.

BULLISH FIVE STAR TRADES - 2017

Below are a few examples of recent trades made in the Simpler Options Live Trading Room from 2017. At the time, these were Five Star Setups. A critical part of the strategy is knowing when to identify ‘the shift,’ and knowing when a setup no longer qualifies as Five Star.

Here are bullish entries, exits, daily analysis, and updates that were all provided to members. Check out the examples below.
JPM

JPMorgan Chase & Co. is a long trade that I entered shortly before the new year. I noticed that the Financial Select Sector SPDR Fund (XLF), was setting up for what looked like another leg higher into the new year, which led me to look for setups among its top weighted holdings. Setups in Morgan Stanley (MS) and American Express (AXP) also fit my criteria.

Looking at the chart, you can see the signal outlined in red — the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It's appearing on a chart that has a strong, bullish trend.
3. This stock is in a particularly strong sector.
4. Additional stocks in the financial sector, as well as the sector itself, were also setting up with buy signals.
5. It's a bullish stock, and as such, we can anticipate a bullish run into earnings.
6. When entering the trade, it was very close to making new all-time highs.

As you can see, an entry on December 29th, 2017 led to a 127.2% extension target within less than a week, as this stock grinded higher on it's way to its earnings report. JPM ended up meeting the 161.8% extension target on the afternoon before they reported earnings.
CBRE Group (CBG)

I found this stock on the Investor’s Business Daily Top 50 list. This is a list produced each week by Investor’s Business Daily, that screens the leading growth stocks and gives you 50 companies showing strong relative price strength and top-notch fundamentals. These are new and innovative stocks that historically far outperform the S&P 500. Upon further investigation of this particular chart pattern, I determined it had a favorable pattern, and I liked the squeeze setting up on the daily chart.

Looking at the chart, you can see the signal outlined in red - the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It’s appearing on a chart that has a strong, bullish trend.
3. This stock is on the IBD50 list of innovative stocks that are outperforming the S&P 500.
4. Multiple stocks within this list were also setting up with buy signals.
5. When entering the trade, it was just breaching to new, all-time highs.

The setup in CBG took a little more time to play out than I anticipated. Entering this trade shortly before the holiday season, meant low volume in the stock market - particularly for IBD50 stocks, which are already typically low volume. I entered this trade on December 18th,
2017, just as it was making new, all-time highs. On IBD50 stocks that typically outperform the market anyways, I was looking for extended targets, versus just a 127.2% extension target. Finally coming through on January 9th, 2017, CBG made a 161.8% extension target which allowed me to take profits, before pulling back to the 8 EMA.

**Honeywell International Inc. (HON)**

Here's a ticker I've had the pleasure of trading a few times in the last couple months. Its sector, Industrial Select Sector SPDR Fund (XLI), was extremely strong into the end of 2017, making and exceeding even 261.8% extension targets (the third target). As such, I've been on the lookout for a renewed setup in HON. On January 4th, I took a new entry with the daily squeeze.

Looking at the chart, you can see the signal outlined in red - the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It’s appearing on a chart that has a strong, bullish trend.
3. This stock is in the industrials sector of the S&Ps, which has been incredibly strong.
4. Multiple stocks within this sector were also exhibiting buy signals (MMM, BA).
5. *Earnings was about 2.5 weeks ahead when entering the trade.*

6. *When entering the trade, it was very close to making another new all-time high.*

*As of this writing, this trade isn’t complete, but I’ve doubled my in the money calls and taken half of my profits at the 161.8% extension target. I have a price target of $163 in this stock, before earnings on January 26th, 2017.*

**2017 & 2018 Shifts**

Throughout 2017, I traded a lot of industrial stocks, financials, and big Nasdaq names like AMZN, FB, NFLX, MSFT, and GOOGL.

However, as we got into the beginning of 2018 and saw the first correction at the end of January, I had to update my favorite sectors. The sectors that stood out to me were consumer discretionary (Amazon and Nike being my favorites), along with technology, and healthcare. These remained my primary focus until about September of 2018. At this point, the shift happened again.

**Fall 2018**

As 2018 went on, many traders wanted to know if they could use the Five Star strategy to short stocks, just as I use it to identify moments in time to go long.

Well, beginning in the fall of 2018, we got that chance.

Two of my favorite short candidates (as far as sectors and industries are concerned) have been in the Kraneshares CSI China Internet Trust (KWEB) and the Sector SPDR Communications sector (XLC). After I identify the sectors, I focus on specific stocks within them.
Kraneshares CSI China Internet Trust (KWEB) - Daily Chart

This sector became favorable to the bears around the time that tariff wars with China really started being publicized in the news. While the macro background is great, I have to root my trading decisions in technicals. The technicals confirmed a downside perspective in July 2018.

While trading the KWEB alone is definitely possible, and also comes with less volatility, I also enjoy trading options on stocks such as Baidu Inc (BIDU) and Alibaba Group (BABA).
Communications Sector Short Candidates

The sector itself has 25 stocks within it. A main part of my strategy is narrowing down which stocks I want to trade, after I’ve decided on the sector. This is primarily a technical process.

Two of my favorites in this sector are TTWO and NFLX. Why pick these?

Looking at the chart, you can see the signal outlined in red - the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It's appearing on a chart that has a weak, bearish trend.
3. This sector has suffered significantly in the news, with repeated negative news stories surrounding privacy issues, etc in stocks such as GOOGL and FB. This speaks to a negative macro view on the stocks.
4. Multiple stocks within this sector are showing the same downtrending pattern.
5. It's rallied into my Fibonacci clusters multiple times, only to fail again.
Looking at the chart, you can see the signal outlined in red - the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It’s appearing on a chart that has a weak, bearish trend.
3. This stock is in the communications sector of the S&Ps, which has been incredibly weak.
4. Multiple stocks within this sector were also exhibiting sell signals (TTWO, FB, GOOGL).
5. It rallied directly into Fibonacci resistance, giving us an edge on the short side.
Looking at the chart, you can see the signal outlined in red - the daily squeeze. You have to keep in mind, that all squeezes are not created equal. This one however, was a high probability setup, due to the fact that:

1. A squeeze in and of itself is high probability.
2. It's appearing on a chart that has a weak, bearish trend.
3. This stock is in the communications sector of the S&Ps, which has been incredibly weak.
4. Multiple stocks within this sector were also exhibiting sell signals at the same time (NFLX, FB, GOOGL).
5. It ran directly into resistance at my Fibonacci cluster.
COME TRADE WITH ME!

When trying to identify which stock I select, I go through a rigorous process. Want to join me? Read my “About Danielle” section for a few places where you can find me.

About Danielle:
Danielle Shay is the Director of Options and the face of Foundation at Simpler Trading. Danielle is a strict technical analyst, with a strong emphasis in Fibonacci Analysis. Her primary focus is on trend-following, directional strategies via options trading, though she covers stocks and ETFs as well.

Her goal in Foundation is to help traders grasp the basics of options and trend following - no matter their skill level. You can also find her in the Live Trading Chatroom five days a week, hosting her session called ‘Cash in on the Close’ where she focuses on directional swing trading opportunities in the options market.

Since she rose from beginner to expert, her strategies are ideal for smaller accounts because she knows what it’s like to be at the starting line. As a former teacher, she has the keen ability to relay trading information in small tangible bits where even the ‘best’ of traders will find her insights useful and easy to understand.

WANT MORE ANALYSIS BY DANIELLE?
Danielle is an author and contributor in John Carter’s 3rd Edition of Mastering the Trade. She's also an expert commentator seen regularly on RT America, as well as Fox News. She's been a guest speaker on Real Vision TV, Trader's Nation, Stockcharts.com, and Benzinga. You can find her written commentary at www.FiveStarTrader.com, and find her in the chatroom at www.SimplerTrading.com. To get weekly analysis, check out www.SimplerFoundation.com.

You can also find her on Twitter, @traderDanielle, and on Youtube.