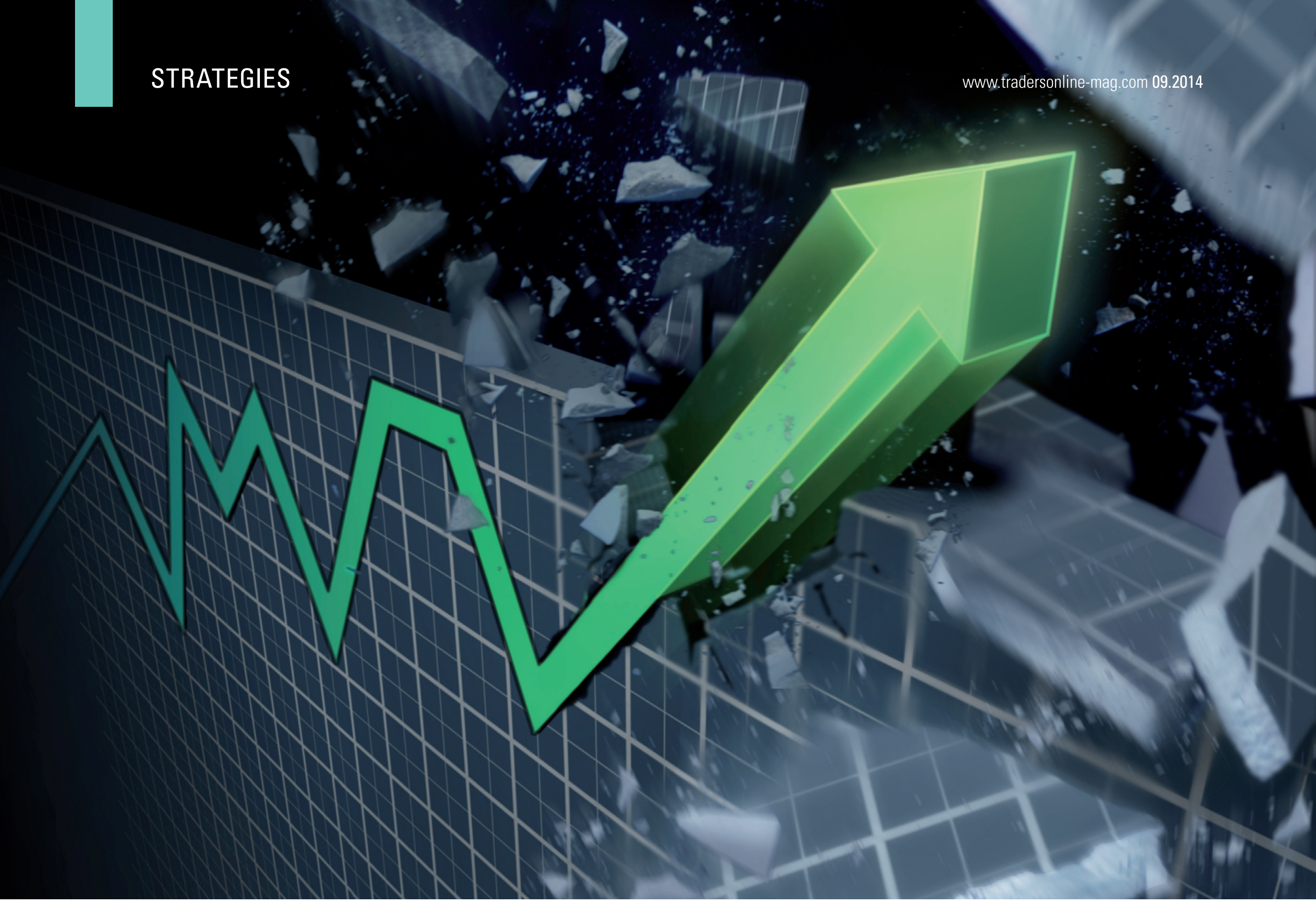

Inventory Retracement Bar

An Award-Winning Approach to Finding the Great Trades

Developed and used to win trading competitions around the world, the Hoffman Inventory Retracement Trade is quickly becoming one of the most popular ways to identify where short-term countertrend institutional inventory has subsided and when it's time to re-enter into a trade's original trend direction. What you will learn here is how to identify when the conditions arise to make the trade, the entry points, and exit strategy.

Rob Hoffman

Rob Hoffman is two-time International Trading Champion and a trader who has won numerous live, real-money only, domestic and international trading competitions. Rob is also a frequent speaker for top brokerage firms and financial exchanges, skilled educator and passionate mentor.

rob@becomeabettertrader.com

» What Is the Hoffman Inventory Retracement Trade?

The Hoffman Inventory Retracement Trade is a strategy that is used to identify specific types of institutional trading activity that is counter to the prevailing trend at hand, and then identify entries when the short-term countertrend inventory activity has come to an end and the market is likely ready to resume its original trend.

> In an uptrend you're looking for the market to break one tick/cent above the high of the Inventory Retracement Bar.

While it is common folklore in the investment industry that institutions, like wolves, travel in packs, the reality is that institutions are not all sitting around at a table conspiring as a group about how to part retail traders with their money. The institutional investment business is extremely competitive and these firms are very much out for themselves and have their own objectives and performance metrics to achieve to appear most attractive to prospective investors at any given time.

Therefore, this strategy is designed to identify when one or a handful of institutions are moving inventory in and out of the market and are straying away from the markets current path causing a short-term retracement against the trend. We are subsequently looking for the market in question to resume its preexisting trend when those short-term countertrend institutional activities and inventories have dried up.

IRB Bar Characteristics

In an uptrend, look for candlestick bars that open and close 45 per cent or more off their high.

In a downtrend, look for candlestick bars that open and close 45 per cent or more off their low.

Trend Identification

In the absence of advanced trend identification systems, a simple approach to trend identification is looking at the 20 EMA (Exponential Moving Average) and asking yourself if it appears to be in approximately a 45 degree angle based on the timeframe you're looking to trade. The next higher timeframe above the one you're looking to trade should also be flowing in the same direction. For instance, if you're trading off of a 5-minute chart and it's in an uptrend, you would like to see that your 15-minute chart also is in an uptrend. If it's sideways, or worse yet, trending in the opposite direction, your trade is much more likely to fail.

The Entry Strategy

Once an IRB and proper trend is identified, the next step is to allow the market to move along and wait for the price action to break one tick/cent below the low of the IRB in a downtrend. In an uptrend you're looking for the market to break one tick/cent above the high of the IRB. While it is not an absolute, it is preferred that the price breaks beyond the IRB within the next 20 bars based on the time period you're trading. For example, if you're trading off of a 2-minute chart, you would ideally like to see the break in the next 40 minutes.

The Trailing Stop Exit Strategy

While many traders are specific dollar target traders, the preferred method is more of a support and resistance target based methodology backed up by a trailing stop to ensure you are not giving back those profits during any snapbacks against your position. Typically, a 50% trailing of profit achieved until you approach a major support or resistance level is desirable, then move the stop to 90%+ of profit achieved as the major support or resistance level is hit. Common major levels include key Fibonacci levels, previous day's highs and lows, daily, weekly and monthly

F1) Inventory Retracement Bars (IRBs)

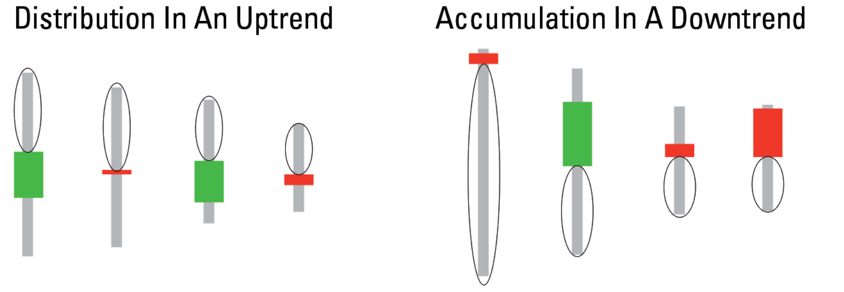

Figure 1 shows four individual examples of the IRBs in an uptrend and four more individual examples in a downtrend for illustrative purposes.

Source: www.tradestation.com

F2) Used During International Trading Competitions

Figure 2 shows one of the seven trades taken using this strategy during the International Trading Competition held in Paris, France. The black vertical arrow highlights the IRB and the black horizontal arrow shows the intended area of entry for trades using this strategy.

Source: www.tradestation.com

pivot points, etc. For maximum comfort with the strategy, it is preferred that you use this with your own favourite support and resistance levels.

Stop Management

Based on the premise of this trading strategy, the expectation upon the entry is that the market will continue into the original direction it was heading after its brief institutionally driven pullback against the trend. Very frequently, after breaking through IRBs, the market will actually rapidly accelerate with fast action and wide ranges as everyone starts to realise that the brief pullback was merely a pause against the intended direction and the market plays catch up with itself.

With that said, once a trade is entered, the price should not retrace back beyond the opposite side of the IRB. For instance, if the trade is entered one tick/cent below the low of the IRB in a downtrend, it should not stop and reverse to one tick/cent above the high of that IRB. If it does, that market may be forming more of a reversal pattern and thus the need to exit the position and move on to the next opportunity.

When Not to Use the Strategy

This strategy was primarily designed to identify and take advantage of trend continuations after counter trend inventory exhaustion. Therefore, this trade is not to be used in sideways market conditions as continuation failure will frequently occur.

Why This Strategy Works

In general, the market tends to trade directionally with as few retail traders on board the correct direction as possible.

This strategy is so effective due to its ability to find high probability areas where three things are happening to retail traders in an uptrend:

1. Buyers are being distracted from taking long side trades when they see the pullbacks off the highs, scaring them into believing the move is over.
2. During pullbacks, sellers are being given false hope that any shorts taken earlier in the uptrend may finally start to work.

3. Buyers who bought the high during rapid wide range ascents hoping it will go higher get stopped out on the pullback.

After all of these events above, once a new IRB to the upside appears and is pierced, the market is much more likely to move without all of those traders above on the right side of the market.

In a downtrend these three things are happening to retail traders:

1. Sellers are being distracted from taking short side trades when they see the pullbacks off the lows, scaring them into believing the move is over.
2. During pullbacks, buyers are being given false hope that any buy side trades taken earlier in the downtrend may finally start to work.
3. Sellers who sold the low during rapid wide range descent hoping it will go lower get stopped out on the pullback.

After all of these events above, once a new IRB to the downside appears and is pierced, the market is much more likely to move without all of those traders above on the right side of the market.

Key Points to Remember

No more weight is given to any IRB based on whether its close is above or below the open (i.e. green or red candle).

In addition, think about the concept of over-extension. If the IRB has an extraordinary range as compared to the Average True Range of the last 10+ bars before it then the break back through the IRB is far more likely to fail. This will more likely result in an entry that has a higher likelihood of reversion to the mean as much of the energy and profit opportunity has potentially dissipated leaving the trader with a much smaller profit or perhaps a stop-loss.

Trail your entries to reduce the risks of reversion to the mean while still giving a trade a chance to push into your intended direction.

Use a proven trend qualification tool. In the absence of a well-tested tool of your own, trade in the direction of an approximately 45 degree angled 20 EMA.

This strategy has very diverse applications across many markets and asset classes. For instance, in addition to trading conventional equities, futures and Forex instruments, traders can consider using this strategy to analyse underlying equities and then trade high delta, in the money options plays as an example for active options day traders.

The Conclusion

What we have shown you here is a simple, award-winning strategy that you can take away and explore. It is an excellent tool used for identifying where retail traders are misjudging the markets movement. It shows where institutions are temporarily breaking away from the trend due to short-term inventory acquisition or liquidation. Once that inventory need is exhausted the overall market is free to resume the existing trend offering new opportunities for retail traders to trade back in the direction with the overall trend. «

Strategy Snapshot

Strategy Name	Hoffman Inventory Retracement Trade
Strategy Type	Trend Continuation
Time Frame	Intraday as well as daily and weekly signals
Setup	IRBs are created where the open and close of the bar are 45% or more off the low in a downtrend and 45% or more off the high in an uptrend
Entry	One tick/cent below the low of the IRB in a downtrend and one tick/cent above the high of the IRB in an uptrend
Stop-Loss	One tick/cent above the high of the IRB in a downtrend and one tick/cent below the low of the IRB in an uptrend
Trailing Stop Exit Strategy	50% of profit achieved until you approach a major support or resistance level, then move the stop to 90%+ of profit achieved as the major support or resistance level is hit
Risk and Money Management	< 1% per trade
Average Number of Signals	Every instrument and time duration will be different based on its frequency of trending; however for active traders as an example, in general, it is possible to see as many as 25+ IRBs on a 2-minute chart over a 24 hour period