TRUTH
OF
THE STOCK TAPE

A STUDY OF THE STOCK AND COMMODITY MARKETS
WITH CHARTS AND RULES FOR SUCCESSFUL
TRADING AND INVESTING

BY

WILLIAM D. GANN

IN FOUR BOOKS
EMBRACING
The Preparation and Knowledge
Required; Methods of Operating
And Determining Position of
Stocks and Commodities

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Underwood and Underwood

BOOK IV

COMMODITIES

"There is a principle which is a bar against all information, which is proof against all argument, and which can not fail to keep a man in everlasting ignorance! That principle is condemnation before investigation." -- SPENCER.

CHAPTER XXVII

HOW TO TRADE IN COTTON

The cotton market offers good opportunities every year for making profits both as an investment and as a speculative proposition. Trading in future options is just as legitimate as buying and selling stocks. It is not necessary to buy the spot cotton outright, carry it in the warehouses, pay insurance and storage, for if spot cotton is going up or down, future options will fluctuate more than the cash article, and there is no expense in carrying futures outside of the margin requirements.

The course of cotton prices is based on supply and demand, and it is much easier to form a correct judgment on the cotton market than it is on the stock market, on account of there being so many stocks and different groups of stocks which cause a mixed trend, some stocks declining while others advance. With cotton it is different. If one option goes up, they all go up. You might be right on a certain group of stocks and yet pick the laggard to buy, and not make any money; but with cotton you could not miss it; if you were right on the trend you would make money. A man who trades in cotton with the proper capital and uses stop loss orders to protect his capital and also to protect his profits will be able to make more money than he will trading in stocks, especially when the cotton market is active.

The great trouble with the people in the Southern states, where cotton is grown, is that they are always bulls. They never see but one side of the market and are always holding on and hoping for it to go higher, no matter how high the price advances. For this reason, 90 per cent of them lose money simply because they are unwilling to see both sides of the market. They ignore the bear side and refuse to sell short in a bear market. I have known many traders to buy cotton when it was high and lose anywhere from $1,000 to $2,000 on 100 bales by simply sitting and watching it decline day after day, and holding it for no other reason than that they hoped it would go up. Remember my rule -- *When you have nothing else to hold on for but hope, get out quick*. Never trade without a reason. The time to hold on is when the market is going in your favor and not against you.

When cotton is at extreme high levels and starts downward, it goes down fast and continues down for a long time, as past records will show. In the spring of 1920, cotton was selling around 38 to 37 cents per pound, and in December same year, it sold below 15 cents per pound. Now, what chance did a man have who was long of the market and held on and hoped for a rally? The decline continued, subject to rallies, until it got below the 11-cent level in June, 1921. Of course, the same rule applies to a man who sells short against the trend and holds on and hopes. Cotton was selling around 13 cents per pound in the middle of August, 1921. The advance started and in thirty days it advanced to around 21 1/2 cents per pound. Therefore, the only thing to do in trading is to limit losses and go with the trend. It is easy enough to make up a loss of 20 or 30 points, but it is hard to make back losses of 200 to 400 points. Let your rule be: *Cut short your losses and let your profits run*. But remember, profits must be followed up with a stop loss order, because it is just as foolish, after you have large profits, to let them get away from you, as it is to lose part of your capital by not protecting it.

REPORTS, NEWS, RUMORS AND VIEWS

Learn to discount reports which come from the farmers. They are honest, but they have cotton to sell and are always hoping for higher prices. They go to the extreme either way. If crops are bad, they exaggerate the damage. If crops are good, they are likely to become too hopeful and exaggerate the good condition. The man who produces the cotton to sell and the spinner who buys it are diametrically opposed to one another. Both are working for their own interests and you can not blame them, but you must discount their reports and opinions.

The tape tells you the consensus of opinion and reveals the predominance of the opposing forces and shows the trend according to supply and demand. Ignore the news, reports, opinions and views of everyone if it disagrees with what the chart and tape shows, for supply and demand must govern in the end, and if the selling power is greater than the buying, prices will decline, regardless of bad crop news or anything else. On the other hand, if the demand, or buying power, exceeds the selling, prices will advance regardless of good crop news. Of course, the general trend of the market does not continue for long contrary to natural conditions, but supply and demand govern the prices and the market discounts future events. Therefore, before you act too strongly on any good or bad news, be sure that your chart, which is but the reading of the tape and the correct interpretation of it, confirms the news and shows that it is yet to be discounted.

Do not try to trade too often. Jumping in and out of the market confuses you; the more trades you make the more chances you have for getting wrong, and increasing the percentage against you. You can always make profits if you wait for the opportunities. If you make two or three consecutive trades and they go against you, and you have to take losses, better quit for awhile and look on. Wait until your judgment gets clear, and the market shows a definite trend. You can always form a better judgment when you are out of the market than when you are in it, because you are not influenced by your hopes and fears.

It makes no difference whether you trade on the New Orleans Cotton Exchange, N. Y. Cotton Exchange or in Liverpool, the trend of the market is always the same, once it shows conclusively that a move has started. Liverpool may go contrary to New York for one day, but it seldom ever goes two. The same with New York or New Orleans. They always run on a very close parallel.

AMOUNT OF CAPITAL REQUIRED

One of the most important things that traders overlook is the amount of capital required to make a success trading in cotton. A lot of people think that when cotton is around the normal level, from 9 cents to 12 cents per pound, that $200 or $300 is enough capital to use in trading in 100 bales. This is financial suicide, because if a man loses 20 or 30 points on the first trade, his capital is crippled so that he cannot make a second trade. A man should go into the cotton market the same as he goes into any other business, -- to make a success and not a gambling proposition. If you make speculation or investment a business, you probably will be able to accumulate a fortune over a number of years, but if you go into it to gamble and expect to make it all on one deal, you will lose all your money and have nothing left but hope.

When cotton is at an abnormal high level, as it has been since 1915, selling between 15 cents and 40 cents per pound, it requires a larger amount of capital because stop loss orders will be caught more frequently and at the same time profits will be much greater. I consider $2,000 the amount of capital that should be used for trading in 100 bale lots. Nothing less is safe. This money is not to be used to put up on 100 bales and hold it if it starts going against you. It is for the purpose of paying several small losses and still have capital enough left to continue to trade until you hit it right and begin to make big profits.

HOW STOP LOSS ORDERS SHOULD BE USED

In normal markets, when fluctuations are narrow, you should use a stop loss order not more than 20 points away. In very wild active markets, where fluctuations are wide, you should use a stop loss order about 40 points away, but a risk of $200 should be the maximum on any one deal. If your capital is $2,000 and you make five trades and lose half of your capital and then make one trade which shows a profit of 200 points, you would be even. Most people trade the other way -- They take 20 to 40 points' profit and 200 to 300 points' losses. There is no chance of beating the cotton market that way. Of course, before you make a trade, you should try to determine the trend and be as near right as possible, but if you see that you are wrong, there is one sure way to play safe and that is get out at the market or place a stop loss order for your protection which will automatically put you out.

Once you make up your mind and place a stop loss order, do not cancel it, or change it to where you have a greater loss if it is caught. In 99 cases out of 100, you will be wrong when you place yourself in a position to take a greater loss than you first decided on. It may be well enough some times to cancel orders for taking profits if the market is going your way, but never cancel an order to stop a loss. The sooner a loss is stopped the better both for your capital and for your judgment. As long as you stay in the market and a trade goes against you, your judgment gets worse all the time; in fact, you have no judgment. It is simply a big hope that the market will turn and go your way.

HOW TO PYRAMID

In rapid markets successful pyramiding can be carried on. Of course, the condition of the market has to determine how close pyramids can be made safely. As a rule, after you buy 100 bales, you should not buy the second lot until the market has moved 60 points in your favor. Then place a stop loss order on your 200 bales so that if the stop is caught you will not lose as much money as your original risk on the first 100 bales.

We will assume that on the first 100 bales, you place a stop loss order 40 points away, which would be a loss of $200. Now, when you buy or sell the second 100 bales, place a stop loss order 40 points away on 200 bales. If the stop is caught, you will lose 40 points on the last 100 bales, but will make 20 on the first 100 bales, which places you in a better position than if the first trade had gone against you. If the market continues to move in your favor and your stop loss order is not caught, you can continue to buy or sell on the way up or down, but don't forget that the more the market moves in your favor, the nearer the end of the move is over, and buying must not be increased near the top after a long move, nor selling increased near the bottom after a long decline.

STRADDLES OR HEDGING ON COTTON

Many cotton traders get the idea that they can sell one option and buy another, thereby making a straddle which will work closer together and show them a profit. In nine cases out of ten, it works exactly opposite, and instead of a profit the result is a big loss. If you cannot form a judgment of the trend of the market, then do not try to play both sides at the same time. Something always happens to upset all calculations when traders figure out a dead sure cinch on a straddle. As a trader once said to me, "My broker recommended something safe and sure -- a good straddle -- and I got on for a joy ride and the straddle tore both my legs off." This is the way most straddles work out.

Another great mistake that traders make is that when they buy one option and it starts to go against them, they refuse to see that they are wrong and accept a loss, but sell another option to hedge. Then they are both long and short of the market, and they have to make two guesses as to where they will get out right. It can not be done. They invariably close the trade that shows a profit and hold the one that shows a loss. In this way, they undo the wrong side of the hedge. A man can not have a clear judgment trying to play two sides of the market at the same time. It is bad enough playing one side. Therefore, keep out of hedges and straddles; try to determine the trend and follow it.

CHAPTER XXVIII

PROPER WAY TO READ THE COTTON TAPE

The cotton market, as I stated before, is governed by Supply and Demand. The only difference in reading the tape on cotton and reading it on stocks is that the cotton tape does not show the number of bales traded in on each sale. This makes it a little difficult at times to determine the trend, but while we do not know the amount of trading that is going on, the fluctuations on the tape show very plainly whether the volume is extra heavy or very small. The market does not stand still on large buying or selling; it moves one way or the other. Therefore the activity tells us whether or not there is big business going on. When fluctuations are very narrow and the market is dull and inactive, it shows that the buying and selling is reduced to a small scale, and no big move is indicated. Therefore, the only thing to do is to watch and wait until you see activity start, and then go with it.

The best way to read the cotton tape is the same as stocks -- stay away from it; keep up a chart and read the tape quietly, away from the influence of the broker's office and the gossip which is always prevalent there, that will mix your judgment and invariably cause you to see things in the wrong light.

The cotton tape fools you just as often as the stock tape, because local weather condition, good or bad, will cause quick declines or advances which in no way change the major trend. Yet, while looking at the tape, it will appear extremely strong or weak and at the time you are convinced and act upon it. Afterwards you find that you have bought at the top or sold at the bottom, and then when the main trend is resumed, you are wrong, and of course, the tape whispers hope and you hold on. If you are away from it, you will make your trades according to your rule, place your stop loss orders, and will not be influenced by hope or fear. The same rule applies in narrow markets as in markets of wide fluctuations. Distribution has to take place before any important decline and time has to be allowed for accumulation before any big advance takes place.

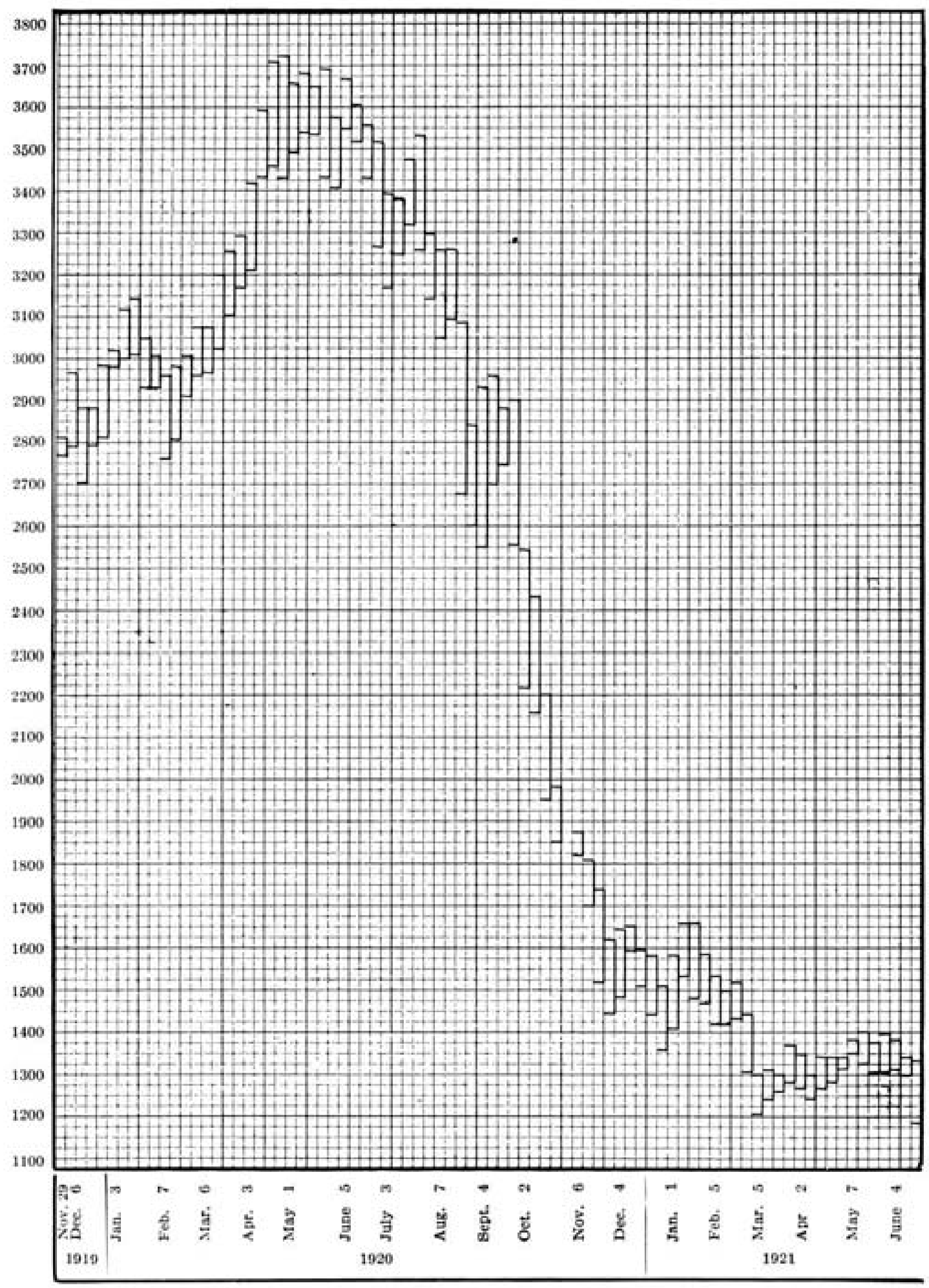
DISTRIBUTION OR TOP ZONE

Chart No. 13 on cotton shows the October option from November, 1919 to January, 1923, that is, all important tops and bottoms, accumulation and distribution. Notice that from December 6, 1919 to December 13, it declined from 2970 to 2700. Then followed an advance up to 3140 on January 17, 1920; then a decline to 2760 on February 7. The following week the market started to rally, after making a higher bottom than the one in December. After that note the progressive bottoms and tops. The advance continued, every week making higher, until the week of April 17 it advanced to 3715. The following week, ending April 24, it advanced to 3725, which was the final high. It declined quickly to 3430, but as distribution had not been completed, it required time. The market fluctuated up and down over a wide range, running up near the 37-cent level several times. On May 22, it advanced to 3690; then declined to 3410, and on June 5 made the last rally to 3670. After that it declined to 3170 on July 3; then rallied to 3530 on July 24, but the decline on July 3, as you will see, had broken under the distributing level, which indicated that the big trend had turned down and that cotton was a short sale on all rallies.

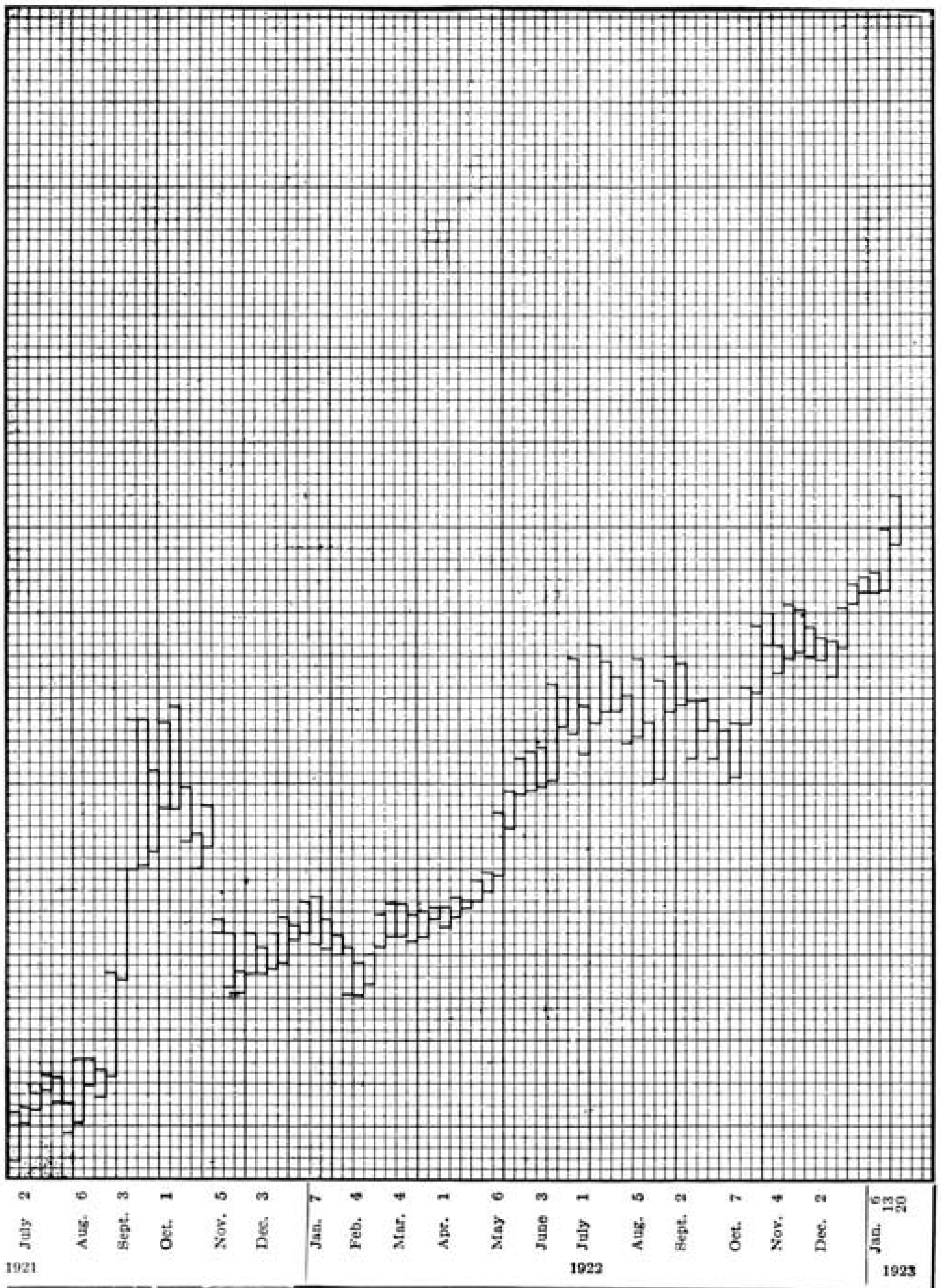
LIQUIDATION

A rapid decline followed, which carried prices down to 2550 on September 4, 1920, followed by a rally to 2960 on September 8. Note the following week was a narrow range. Then the decline started again, and drastic liquidation continued, carrying prices down to 1440 during the week ending November 27. After this the market rallied to 1650; declined to 1360 on January 1, 1921, rallied to 1640 Janu-

CHART NO. 13.—October Cotton, Weekly High



and Low. November, 1919 to January, 1923



ary 22, which was slightly above the top on December 18, 1920, where it again met selling. Notice that fluctuations were narrowing down, but bottoms were getting lower and tops also decreasing. The decline continued to March 5, and prices reached 1200. A slow rally followed, prices getting back, as you will see, to the 14-cent level during May and early June. Then followed another decline down to 1120, making final low on June 25.

ACCUMULATION

This was a sharp bottom and a quick rally followed, which carried prices to 1320 on July 16, 1921; then a reaction to 1190 on July 30; followed by a rally which carried prices up to 1350 on August 6, for the first time since prices broke under 30 cents per pound making a higher top after an important new low level. Here the market rested for a couple of weeks and then advanced above the August high. This was the cue that the trend had changed and that it was time to buy, because after several months of narrow fluctuations at a low level, prices became very active on the advance. Now when the 14-cent level was crossed, which was above all of the tops made in May and June, it was another sure indication that a big move was on, and this would be the place to pyramid. Prices advanced rapidly in September, and crossed the high levels around 1650 which were made in December, 1920, and January, 1921. The advance was rapid, and by September 10 had reached 2150. Then followed a sharp reaction to around 1810. This is where your stop loss order would have put you out when the reaction started.

You can not expect a big move upward or downward to start until after accumulation or distribution has taken place. The market halted for a few days above the 18-cent level, then rallied right back to 2150. This would have been the place to go short with a stop loss order 30 to 40 points above the old top. After this, prices again declined to around 1930 where they became dull and narrow. The advance started again and on October 8, 1921, rallied, making a slightly higher top at 2175. A decline started and continued downward till prices reached 1520 the week ending November 19. Then a slow rally for several weeks, carrying prices up to 1730 on January 7, 1922; followed by a decline to 1510, making a double bottom against the low of November 19, 1921. This would be your buying point with a stop loss order 30 to 40 points under the previous bottom.

SECOND STAGE OF BULL MARKET

After this, a slow advance started. On February 25, 1922, prices were up to 1720, just under the high price made in January. A reaction followed carrying prices to around 1640, where the market became very dull and narrow. In this position you should wait and see whether prices broke under the level made on the first reaction during the week of March 4, or whether they advanced above the high price made on January 7. During the week ending April 22, prices crossed the high level made in January and March. This showed that the trend had turned up, and as big accumulation had taken place over a long period of time, you could expect a big advance. The trend continued upward until June 24, when prices reached 2290. Then followed a sharp decline down to 2070; then a quick advance up to 2325. Here the market became narrow and dull around the top levels and you should have sold out and gone short.

RESISTANCE LEVEL

A decline followed to 2090 during the week of July 29, 1922; then an advance to 2290 the week of August 5, followed by a sharp decline down to 2000; then a rally to 2290 on August 26, prices again failing to get above the high levels made in the early part of July and August. This indicated distribution around the 23-cent level, and you should sell out and go short with stop 30 to 40 points above old tops. A decline followed, carrying prices down to 2000 again during the week ending September 30. 2000 was the level reached on August 12, and you should cover shorts and wait, or you could buy with a stop loss order 30 to 40 points under this level, which was not broken.

THIRD STAGE OF BULL MARKET

An advance started, the market moving up rapidly, carrying prices above the 23-cent level, and over all of the tops made in July and August. This was an indication that prices were going higher. They reached 2400 the week of October 28, 1922. Then they declined to 2260; rallied to a new high, 2415, but became narrow and dull and your stop loss order would have been caught on a reaction. The next point to watch was the last low level made on November 4. When prices reached this level the week of December 9, you should have bought with stop loss order 30 to 40 points lower and your stop would not have been caught. After this, the advance was resumed, the market continuing to make higher prices until the October option reached 2677 on January 24, 1923, the date of this writing. After distribution is completed at these high levels, a long decline will start which will carry prices back to the 15-cent level or lower.

This chart is all you need to learn about reading the tape on fluctuations in cotton, because the same principles are followed whether the market is a narrow normal market or an abnormal market selling at extremely high prices. I have simply used this chart to illustrate the principle of trading. You can apply it to any other option or any period in the past or future, and will find the market working out the same.

It always pays to trade in the active options, and not trade when they get too close to maturity. There is no use taking chances on wild fluctuations and bad executions when you get near delivery dates. Trade in the next option where you can get good executions.

CHAPTER XXIX

HOW TO DETERMINE A CHANGE IN TREND

When the market is fluctuating in a very narrow range, you should keep up a chart of every 10-point move made during the day. In this way you will be able to see whether accumulation or distribution is taking place, and discern where resistance levels are formed. When it breaks out into new territory you can then follow the trend. In very active markets, when prices are high and the range wide, fluctuations of 10 points mean very little, and you should keep a chart of every move of 30 to 40 points made during the day. In this way you will be able to locate the resistance levels and tell when it breaks out of the zone of accumulation or distribution.

You should always keep a monthly, weekly, and daily high and low chart on the active options you are trading in. It will only require fifteen to twenty minutes each day to do this and you will be well repaid for your trouble. The value of charts is to determine where support is given and where it is withdrawn; also where resistance is met on an advance and where it is overcome, thus enabling you to buy and sell and place a stop loss order as close as possible for your protection.

After violent fluctuations up or down, the market nearly always comes to a standstill before the next move starts. Buying and selling becomes about equal and the market narrows down, then activity starts one way or the other and you should go with it. Of course, there are bound to be false moves at times. After accumulation is shown some news may develop which will cause a sharp drive down, followed by a quick rebound. Then if prices go above the levels previously established, you can consider that the move has reversed and that prices will continue upward.

Often when the first top is made, a lot of profit taking will be encountered and a short interest will be built up. Something will occur of a favorable nature to scare the shorts and they will cover, forcing prices to a slightly higher level, which weakens the technical position. Then a quick decline will start, and if previous low levels are broken and the market is very active on the decline, it will be an indication that the trend has again turned down.

Do not try to trade every day. Watch and wait for opportunities and once you see you are in right and with the trend of the market, follow it up or down until you see a sign that the trend has reversed. Do not close your trade just because you have a profit, but always be convinced by the position of the chart and the general condition, that the trend has changed. Never buy after a lot of very bullish news comes out, nor sell after an extremely bearish report. Both good and bad news is nearly always discounted. Of course, consider whether the trend is up or down when good or bad news is made known.

Never try to start to pyramid after a long advance or decline. The chances are against you. Begin pyramiding when the trend first turns up or down after long moves. When prices reach top or bottom, as a rule, a series of rapid fluctuations take place; then the market gradually narrows down and lays the foundation for another important move.

If prices are high in the spring of the year, after a very short crop, be very careful about buying, as a decline may start which will discount a new crop six months later. The same applies to selling short in the spring following a very large crop. If prices are low, they have already discounted the old crop, but have yet to discount the future, which may be more favorable or unfavorable. After everybody knows about a large crop, or an extremely short one, it is too late to trade on it to advantage, except on rare occasions, and your chart will always show you when these changes are taking place at high or low levels.

Do not sell cotton short just because it may be at a very high price. Remember it can always go higher if conditions are right. Neither buy it just because it is at a low level, as it can always go lower. Never buck the trend, and do not try to guess the top or bottom. Wait until the chart shows you that the trend has turned. You can always make plenty of money buying or selling after the trend is well defined. The man who is in too big a hurry will lose money and miss opportunities just as often as the man who is too slow to act.

CHAPTER XXX

THE BOLL WEEVIL

This little pest began his ravages on cotton in Texas about twenty years ago. He has grown gradually worse, working further north every year until he finally crossed the Mississippi, doing great damage in the Southern cotton-growing states. Man has used all of his resources at hand to destroy this little monster and at the present writing everyone seems to think that the boll weevil is unconquerable. It reminds me of 1893, when cotton was selling at 4 cents per pound and people were disgusted and leaving their farms. Uncle Henry said "Things are so bad that something has to be done. You can't beat that old head of a man for figuring out things." Of course, after fields were abandoned and people went to the saw-mills to work, crops decreased and prices went up. When conditions go to the extreme one way or the other, something always happens and men get busy, start thinking, and figure out a way to bring about a change.

In 1917, when the English and French had their backs to the wall, and Germany was driving them rapidly back, the time had come when something must be done, and it was Uncle Sam's boys that turned the tide and saved the day. The American people, while extravagant, are resourceful in many ways, and every age produces its genius. Whenever we reach extremes and there is a great demand for brains, they are always forthcoming. Millions of dollars have been raised recently to solve the problem and exterminate the boll weevil and there is no doubt but that the man of the hour, some American genius, will appear with a new invention or destructive poison, which will spell doom to the little boll weevil. Then the bulls who were talking and hoping for 40 cents and 50 cents per pound on cotton, like the boll weevil, will pass away and the bears will again reign supreme with cotton back in the “teens.”

Cotton has held at high levels since 1915, when the advance started from 7 cents per pound. I remember well in the Fall of 1914 when the South was in deplorable condition, and they were urging everyone “to buy a bale.” Cotton could only be sold for about $30 per bale, but to save the South, people were urged to buy it at $50 per bale. I recall, one night I was in the McAlpin Hotel, and in the lobby there was a bale of cotton with a big sign on it: “Buy a bale and help save the South.” This was the extreme of over-production -- big supply and small demand; of course, helped by the outbreak of the war, which temporarily stopped European buying.

With cotton around 29 cents a pound, and having been higher for many years, people are convinced that the boll weevil is the “Kaiser” of the hour, and that cotton can never be grown again in sufficient quantities to supply the demand. But a change will come, and a supply in excess of the demand will be produced. Why? Because there is big money in growing cotton at 25 cents per pound. People will always go into a business where money can be made, and over-production is sure to come. It is the other extreme which must follow the present conditions of small supply and large demand. I have no hesitancy in predicting that a large crop will be grown in 1923 and that before the spring of 1924 cotton will sell at the 15-cent level and in a few years will again be below 10 cents per pound.

When extremes occur and everybody is radically bearish and can see no hope for prices ever advancing, or when prices are abnormally high and everybody believes that conditions are such that there is no hope for prices ever going down, that is the time to go against human judgment and follow the tape and charts, for they will point to the correct course of prices according to the natural law of supply and demand.

CHAPTER XXXI

WHEAT AND CORN TRADING

The Wheat and Corn markets, like Cotton, are easier to follow than stocks, as I have explained before, because they are less confusing. Once you determine the trend, all options move with it. If you buy or sell and are correct on the trend, you will make profits; while in trading in stocks, you might be correct on the trend of rails, for instance, but if you picked the laggard stocks to buy or sell, you would make very little money or might even have a loss, although you were right on the trend. This can never happen when trading in grain. Therefore, it is well to make a careful study of the commodity market, as it offers several opportunities every year for making substantial profits when the seasonal moves take place.

ABNORMAL MARKETS

Remember that abnormal markets, with wide fluctuations, only occur years apart. Therefore you must not expect unreasonable profits in normal times. During the past seven years, or since the war broke out, we have had abnormal markets, and Wheat and Corn have made a wide range of fluctuations, much greater than can ever be expected in normal times. Many traders miss opportunities for fair profits at the present time because they are looking and hoping for war profits. There is no reason or sound basis for it. They are simply gambling on hope.

The price of Wheat, Corn and Oats is to a great extent determined by the purchasing power of the dollar. The farmer could make more money in 1895 and 1896 growing Wheat and selling it at 60 cents per bushel, than he can selling it today at $1.00 per bushel, because the purchasing power of the dollar has decreased. Labor and land values have increased. When these conditions change and farm labor is again back to normal, Wheat and Corn, as a natural consequence, will seek lower levels. All of these factors which govern natural conditions must be considered in judging the trend of a market.

CAPITAL REQUIRED

The amount of capital depends upon whether Wheat is in a narrow range in a normal year or making wide fluctuations in an abnormal year. I consider that at least $2,000 should be used under any condition for trading in 5,000-bushel lots. Then, if you limit your losses to 2 cents to 3 cents per bushel, you can make enough trades on your capital to continue until your profits exceed your losses.

Suppose you use a stop loss order about 4 points away, which would mean a loss of $200 on each 5,000-bushel lot. This would enable you to make ten trades on your capital. If you made five trades and they all showed losses, you would still have plenty of margin to make another trade, and if you were successful in working with the trend, two trades that are right should wipe out five losses.

In a normal market you should use about $1,000 for each 5,000 bushels of Corn that you trade in. Losses should be limited to about 2 cents per bushel and stop loss orders should never be more than 3 cents per bushel away. It is not safe to risk more than 3 cents on any one trade. If you are wrong, you should get out and wait.

STOP LOSS ORDER FOR PROTECTION

In trading in Wheat or Corn, stop loss orders should always be used on every trade. The man who trades without a stop loss order will sooner or later lose all his money. As a rule, it never pays to risk more than 2 cents to 3 cents per bushel on any one trade, and even in abnormal wild markets not more than 5 cents per bushel. If you can not guess the top or bottom within 5 cents per bushel, you are wrong and should get out and wait for a change in trend.

Never buck the trend, because your stop loss orders will be caught more often. In a bull market, always buy on a reaction; in a bear market, sell on rallies. Do not try to guess when the market has reached top or bottom, but wait until the tape shows it. Give the market time, and supply and demand will tell you when the trend has definitely changed.

PYRAMIDING

In active markets, you can pyramid. The distance between your trades in pyramiding depends, of course, upon the market. In a narrow market, you should not buy or sell a second lot until after the first trade has moved 4 cents to 5 cents in your favor. In markets like we had during the war, you can pyramid about every 7 cents to 10 cents per bushel up or down. In normal markets, when Wheat moves 10 cents to 12 cents per bushel, you can always expect a reverse move of from 3 cents to 5 cents per bushel. Therefore, you have to be careful about buying or selling on the bottom or top of a 10-cent move.

Once the market gets away from the accumulation period and the trend is well defined up or down, reactions are very small. While accumulation or distribution is taking place, you should trade for small scalping profits, and never attempt to start to pyramid. Wait until the accumulation or the distribution zones are cleared before buying or selling a second lot.

CHAPTER XXXII

JUDGING ACCUMULATION AND DISTRIBUTION ZONES

The same rules that apply to stocks and cotton apply to grain. Before any move of great importance or of long duration takes place, time is required for accumulation or distribution. In an active option, you should keep up a daily high and low chart, a weekly, and a monthly chart. The daily chart will enable you to tell when the minor moves start, which only last for a few days; while the weekly and monthly charts will enable you to determine when there is a change in the major trend, and thus you can buy or sell in time to catch the big moves.

MONTHLY RANGE OF WHEAT PRICES

Supply and demand govern the course of commodity prices, but the tape, or a chart, which reveals the concentrated buying or selling power, will show which way the main trend is moving.

In 1894 and 1895 Wheat sold at 50 cents per bushel, which was the lowest since the Civil War. Prices did not advance rapidly but held at low levels for several years. Note Chart No. 14 from 1895 to 1898. The bottom on May Wheat was made at 56 cents in December, 1895; then rallied to 68 cents in February, March and April, 1896; declined to 56 cents in May, 1896, the same level made in December, 1895. After that, prices crossed the 68-cent level, which was above the distribution zone, and advanced to 85 cents, where you will notice they made the same level of tops for four months. Then followed a decline to 64 cents in April, 1897. After this, the advance started, which carried prices above 85 cents, the highest they had been for several years. Prices reached $1.00 per bushel in August,

Chart No. 14.—May Wheat, Monthly High and Low. 1895–1904

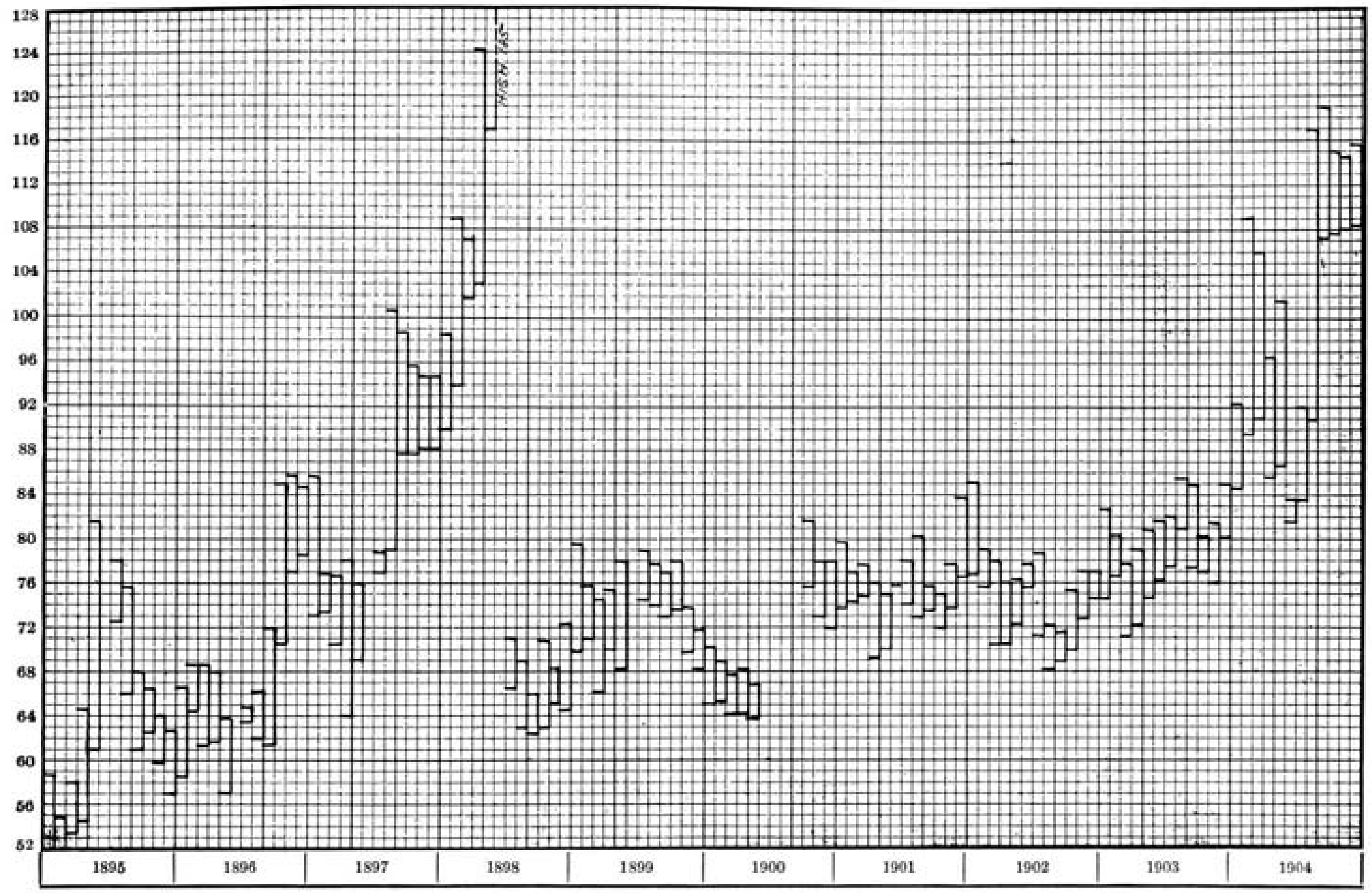


CHART NO. 14—May Wheat. Monthly High and Low. 1905–1914.

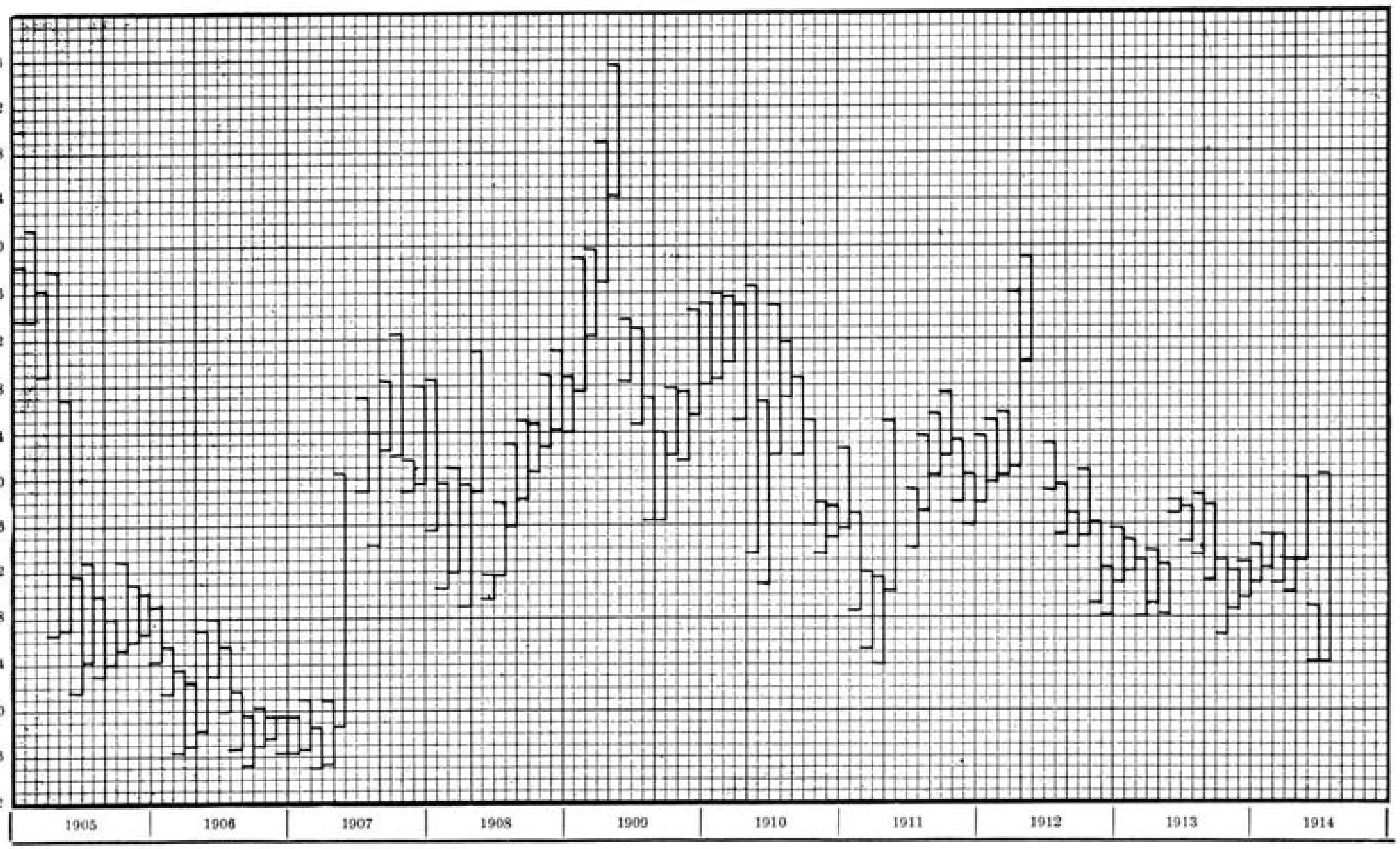
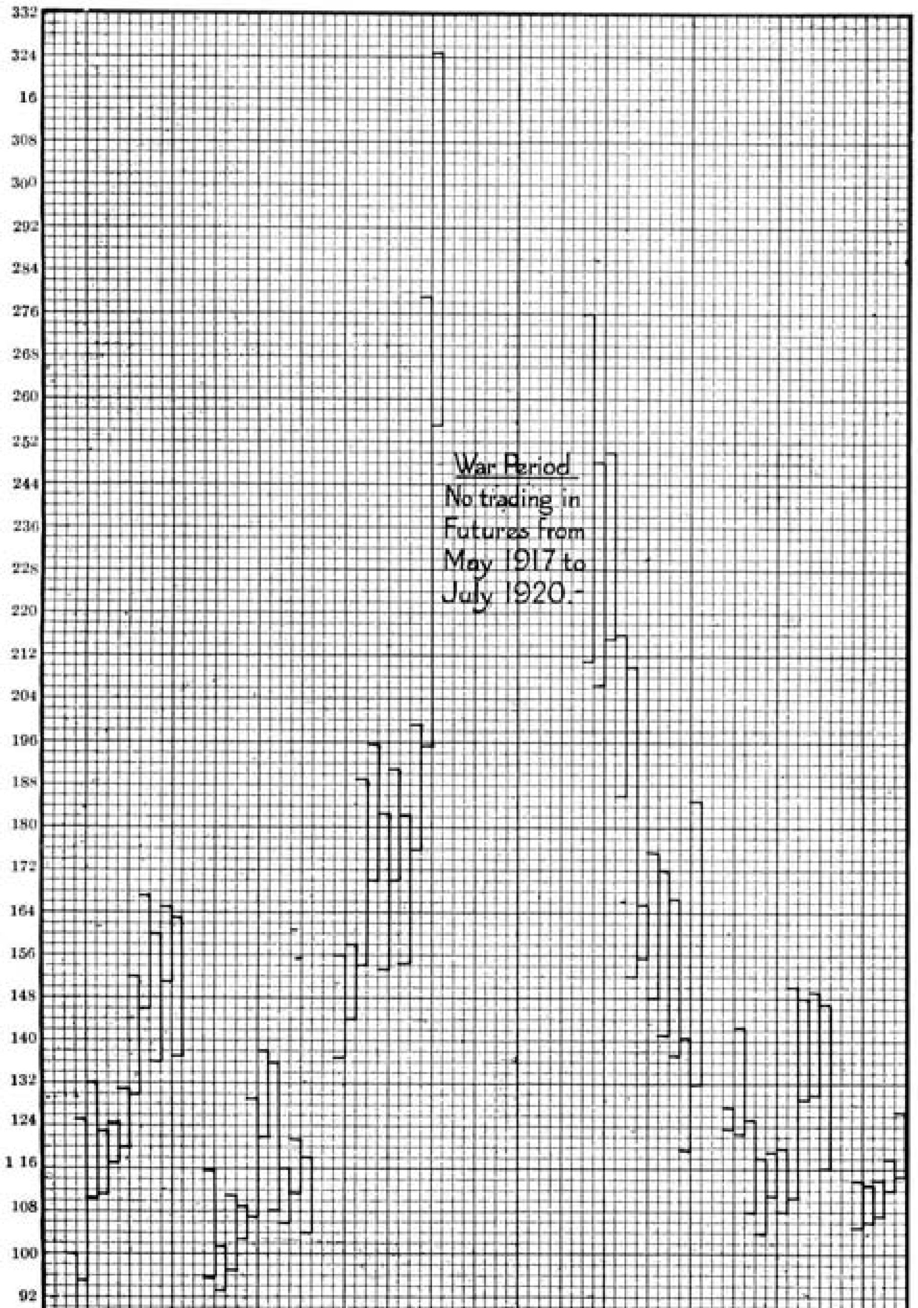


CHART NO. 14.—May Wheat, Monthly High and Low. 1914–1922



1897; then reacted to 88 cents, fluctuating in a narrow range between 88 cents and 95 cents for four months. In December, 1897, prices advanced to 98 cents which was above the high level for the past four months.

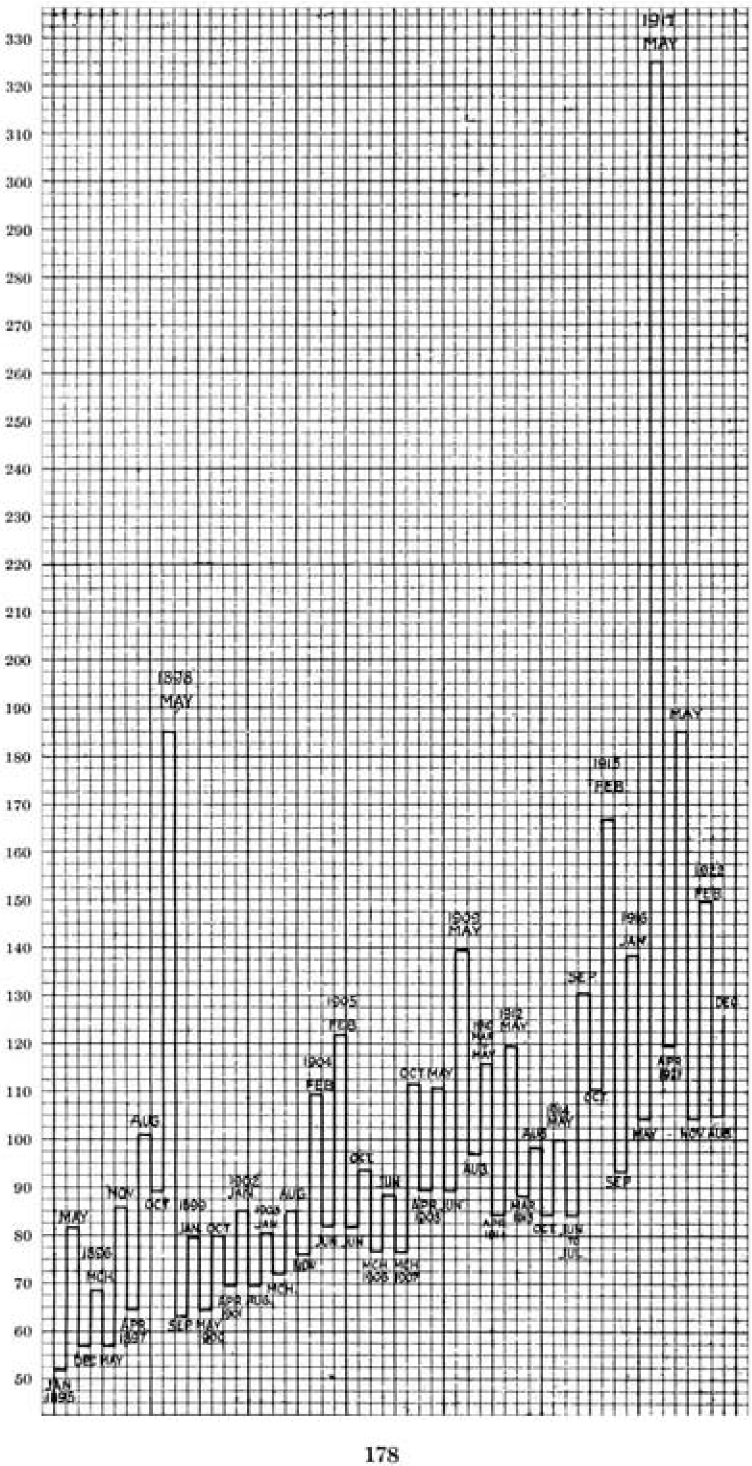
Remember we have stated that before any big advance or decline takes place, there must be a long period of time for accumulation or distribution before the move starts. From August, 1897, until February, 1898, accumulation had taken place at a level above the high prices for several years past. In other words, prices were maintained at a level which was really a new high level of values, for a period of seven months, and once the trend turned and advanced above $1.00, it continued up to 1.09, showing a big move was on. During the month of March, 1898, trading was in a narrow range between 1.07 and 1.02 for the May Option, but every indication showed that the trend was up. Then the big advance started which carried May Wheat to 1.85 in May, 1898. This was the Leiter Corner. Mr. Leiter had accumulated a large line of Wheat but was unable to sustain prices at a high level, with the result that the Corner collapsed and Wheat immediately broke back below $1.00 per bushel.

In September, 1898, notice that May Wheat again declined to around 62 cents per bushel. It held for three months around this level and in January, 1899, advanced to 79 cents. After that the market was a narrow, normal affair and prices again advanced to around 79 cents in July and September, 1899; then declined to 64 cents in March, April and May, 1900, where you can see that the fluctuations narrowed down to 3 or 4 cents per month.

SWING CHART

After that followed a long period of narrow fluctuations, but you will note from Chart No. 15, which shows only the big swings -- major tops and bottoms -- that from the early part of 1895 prices continued to work higher every year; that is, making a slightly higher bottom every time, until the war broke out in 1914, which again carried prices to abnormal high levels, reaching 3.25 in May, 1917.

CHART No. 15.—May Wheat, Swing Chart. 1895–1922



Notice the top in the fall of 1904 and the early part of 1905, when Wheat reached 1.20, which was the highest price since the Leiter Corner. Note that distribution took place between 1.08 and 1.20, and that when prices broke below this level, they rapidly declined, reaching 82 cents in June, 1905. This is what always follows a long period of accumulation or distribution. Once prices break out of the accumulation or distribution zone, a rapid move follows.

Note the bottom made between March, 1906, and April, 1907 -- a period of twelve months in a very narrow range. In September, 1906, prices declined to 75 cents and never rallied above 81 cents until May, 1907, a period of nine months of accumulation in a very narrow range. In May, 1907, when prices advanced to 82 cents they were out of the accumulation zone and immediately moved up rapidly to $1.00 in May, and on the Green Bug scare in October, 1907, Wheat sold at 1.12.

Note on Chart No. 15 that the low price on Wheat in April, 1911, was 84 cents and that it advanced to 1.19 in May, 1912. Then followed a long period of accumulation in 1913 and 1914. In June and July, 1914, prices were again down to 84 cents, the last low level of 1911. Here was a period from October, 1912, to July, 1914, when prices held in a range of 6 to 10 cents per bushel most of the time, which plainly showed another period of big accumulation the same as was shown in 1906 and 1907.

The war broke out the latter part of July and the advance started. When prices crossed the accumulation level of $1.00 it plainly indicated a big advance. Despite the fact that this country had a large crop and enormous surplus, prices advanced to 1.32 in September, 1914. Then reacted to 1.11 and after several months of accumulation, advanced to 1.67 in February, 1915, at which level, you can see, they held for about four months while distribution was taking place. Prices declined to 93 cents in September, 1915; advanced to 1.38 in January, 1916; declined to 1.04 in May, 1916.

After this, the scarcity of Wheat in Europe and the enormous buying by foreign countries, carried prices to 3.25 in May, 1917, when the Government stopped trading in Futures and fixed the price of Cash Wheat at $2.50 per bushel. Trading started again in July, 1920. The December option opened at 2.75. Prices continued downward until April, 1921, when the May option reached 1.20. Then followed a squeeze during May, 1921, which carried the May option up to 1.85. In November, 1921, the price again declined to 1.04, which was the last low level reached in May, 1916.

Then followed several months of accumulation in a narrow range, as you can see from the chart, and in February, 1922, May Wheat advanced to 1.49 7/8. You can see that during the months of February, March and April it advanced to around this same level, but failed to exceed the top made in February. During the early days of May, 1922, the May option was selling at 1.47, and everybody was bullish and hoping for $2.00 Wheat, but the chart, which is a record of the tape and shows the balance of supply and demand, plainly indicated that somebody had been supplying Wheat between 1.44 and 1.48 for nearly four months.

The decline in May, 1922, was rapid, carrying prices down to 1.16. Wheat continued to slowly work lower, and the May option declined to 1.05 in August, 1922. It remained between 1.12 and 1.06 during August, September, and October; then crossed this level and advanced to 1.26 3/4 in December, 1922. Note that the last low level, 1.04, was made in May, 1916, and again the same level in November, 1921, and in August, 1922, 1.05, which was practically the same level. The next time that Wheat declines to 1.04 for the May option, it will indicate lower prices and will probably continue down to around 93 cents to 90 cents per bushel. Should it cross the last level, 126 3/4, made in December, 1922, it will then be an indication for higher prices.

Make up a chart on any option of Wheat, Corn, Oats or Barley, and judge it in the same way that I have explained and you will be able to determine the zones of accumulation and distribution. When once prices break out of these zones, you should follow the trend until it changes again. Never trade without a reason. Do not sell because prices are high or buy because they are low. Wait until you see an indication that the trend is plainly indicated; then go with it.

WEEKLY CHART

Wheat and Corn make both sharp and flat tops and bottoms. Chart No. 16 a shows weekly high and low on May Wheat. Note on April 16, 1921, May Wheat declined to 1.19; rallied to around 1.32, holding two weeks in a narrow range; then made a rapid advance to 1.85 at the end of May. This was a straight run-up from a sharp bottom in which only two or three weeks were used for accumulation; then a rapid advance on short covering to a new high level.

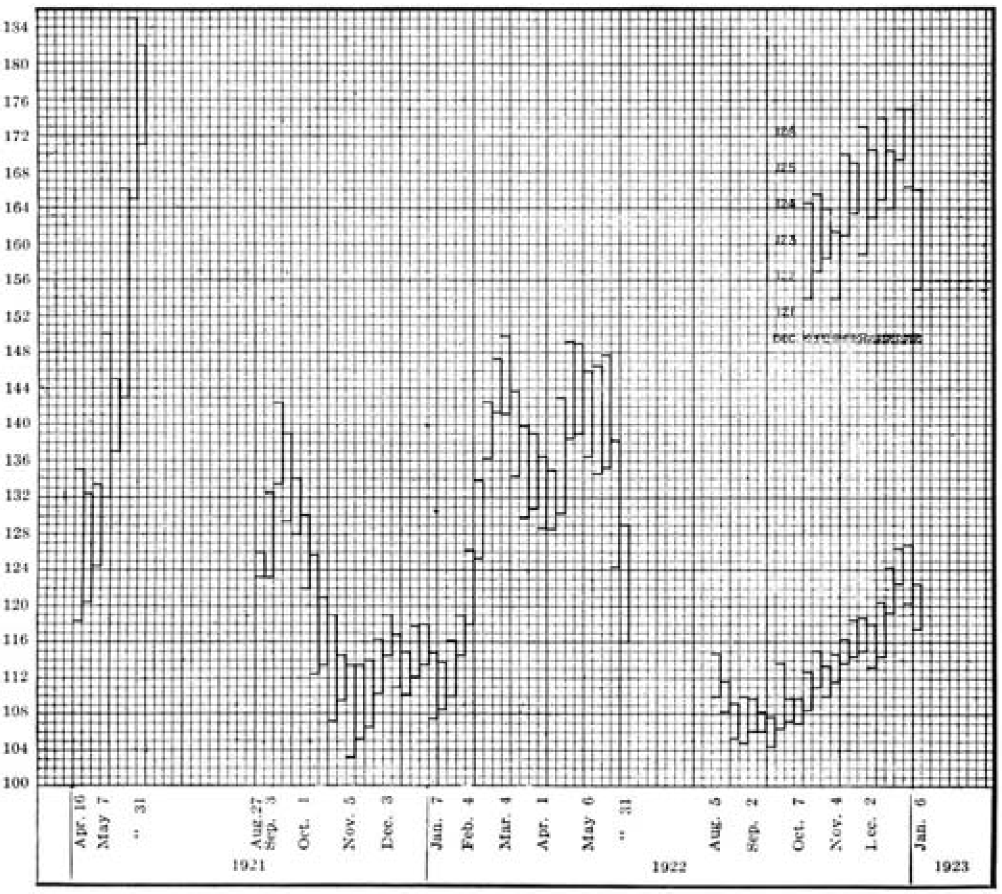
Note the weekly chart from October, 1921, to January, 1922. You will see that over 14 weeks of accumulation was plainly shown and that prices never got as low as 1.03 1/2, the level reached on November 5, 1921. The fact that they held for a long time without going lower showed accumulation, but if you waited until you had a plain indication, when prices reached 1.20, which was above the accumulation zone, you would have caught a fast advance which carried prices up 28 cents per bushel in four weeks.

After prices reached 1.49 7/8 on February 27, 1922, notice a sharp decline to 1.30 took place. Prices held for four or five weeks in a narrow range, reaching the lowest level, 128 1/2, around April 1 to 8; then advanced again to 1.49. Here they halted, failing to cross the high price of February and for five weeks distribution was going on, giving you plenty of time to sell out and go short with a stop loss order 2 to 3 cents above the high price made in February and the latter part of April.

After this, a rapid decline followed in May and prices worked slowly lower until the May option reached 1.04 1/2 in August and September, 1922. Here you find another level in a narrow range with five or six weeks of accumulation. During the week ended September 23, prices advanced above the accumulation level and showed that the trend had turned up. They reacted after that, but continued to work higher until they reached 1.26 3/4 in December, 1922, and here is where the daily chart helps us to get out near the top.

CHART NO. 16a.—May Wheat, Weekly High and Low, April 16, 1921 to January 6, 1923

16b.—May Wheat, Daily High and Low, Dec. 13 to 29, 1922.



DAILY CHART

I have shown on Chart No. 16*b* daily high and low from December 13 to 29, 1922. Note that on December 20 prices reached 126 1/4; on December 22, 1.26 1/2; on December 27, 1.26 3/4 and on December 28, the high was 1.26 1/2, from which the decline started. The high price on December 18 was 1.25 1/2 and for ten days prices failed to gain more than 1 cent per bushel, which showed that a level had been reached where supply was in excess of demand and after this period of time when prices broke back below 1.25, which was under the distribution zone on the daily chart, it was an indication to sell out and go short. Thus you see that the daily chart will help to give you a minor change and get you in or out close to tops and bottoms before the weekly and monthly charts show a change in the major trend. But the daily chart will often fool you, as the time period is short and many false moves occur which are the reverse of the main trend and do not in any way change it.

DETERMINING CHANGE IN TREND

By study and experience and by considering the activity of the market, you will often be able to determine very quickly an important change in trend. Of course, there is no way of knowing the exact amount of Wheat or Corn traded in daily; therefore the only way to judge when there is a large volume of business, is by the rapidity of the fluctuations. For instance:

Suppose May Wheat trades between 1.24 and 1.26 during the day, but fluctuates between the high and low price five or six times; that is, moving up or down over the same range. Then we would conclude that there was a large volume of business being transacted and that somebody was supplying large quantities of Wheat around 1.26 and buying around 1.24. Now, if it declines the next day below 1.24, it would be an indication that support had been withdrawn, or if it advances above 1.26, it would be an indication that the supply of Wheat at that level had been absorbed and that prices are going higher. But suppose the same day Wheat trades between 1.24 and 1.26, it simply opens at 1.24 and advances to 1.26 without making any reverse moves up or down. Then we would conclude that the volume of trading was not large enough to indicate that it was getting ready for any immediate change in trend.

SUPPLY AND DEMAND

When a market starts to advance, it continues upward until it reaches a level where supply and demand are about equal and prices come to a standstill. Then supply increases until it exceeds demand, and prices start to decline.

In a long decline or a long advance, a level is reached where the supply is absorbed and prices go on to the next level, where they meet another large supply and absorb it, and finally to a level where the supply is so much greater than the demand that distribution takes place and prices start on a long trend down. This is why many weeks and sometimes several months are required at bottom or top to complete accumulation or distribution before a big move starts.

People who buy or sell the first or second time that the market halts after the trend turns, invariably lose money because it is simply a halting period to absorb offerings or to supply a demand at that level, after which the main trend moves on to the next level. For this reason, it does not pay to buck the trend -- always go with it. If you trade against the trend for a quick turn and get a small profit, accept it; do not expect too much. At the same time, protect your trade with a stop loss order and do not let it run against you when you are bucking the trend.

SELECTING A BROKER

Last, but not least of all, selecting a reliable broker is most important. Millions and millions of dollars have been lost during the last few years through failures of unreliable brokers. Therefore, it is just as important to know that your money is safe and that you will get your capital and profits if you make them, as it is to know when to buy and sell.

Make the proper investigation and be sure your broker is safe, not only as to his financial standing, but also try to ascertain whether he or his firm speculates. I do not consider any broker safe who speculates or permits others to speculate on a credit with the firm or customers' money.

I do not advise trading at all with brokers who are not members of the New York Stock Exchange, New York Cotton Exchange, or Chicago Board of Trade. There are a few houses who are members of other exchanges that are honest and reliable. Therefore, investigate the house before you open an account.

I have written what I believe is required for your success. It is practical and based on the result of my years of labor and experience. Read this book over several times, for each time you will learn something new and get new ideas of your own which will benefit you. If you will follow the instructions carefully and trade conservatively, never buying or selling a stock without a reason nor being in too big a hurry to get in or out, I feel sure that you will make a success and after a few years will have cause to thank me for starting you on the right road to Successful Speculation and Investment.

W. D. GANN.

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