Introducing Neely River Trading Technology: A Paradigm Shift in Market Trading

An interview series with Glenn Neely, Part 2 of 3

Interviewer: Hello, traders. This is Bud Fox from GreedandMoney.com. Today, again I have the privilege to have the well-respected expert Glenn Neely on NEoWave and Neely River theory here with me. This is the second part of our interview regarding Neely River Trading Technology. In our last discussion, we covered the focus. Neely River theory has three different types of traders, and how to trade the market depends on whichever trader is dominating the market at the time. Today we are going deeper into exactly how Neely River theory works.

Glenn Neely: Iôll go into some different aspects of it and make some interesting comparisons to Wave theory, which will probably be very intriguing to most people. I would like to pick up a little bit about where we left off from the last interview to bring people up to speed. Then we can move on a little bit.

Interviewer: Sure. Please go ahead.

Glenn Neely: Last time, we talked about the comparison of water flowing through a river with gravity being the primary force ï and prices moving through a market with money being the primary force. I had shown two different charts, one showing fluid dynamics in a river.

Then I compared that to the three zones that this creates in a river. We have a wave of turbulence near the north bank, a wave of turbulence near the south bank and more directional action near the middle of a river.

We had taken that information and compared it to the idea of money flowing through a market, producing up and down price action, and how you also have similar turbulent price action near the top of the market's channel and the bottom of a channel and more directional price action toward the middle of the channel.

Just about anybody can see this kind of behavior on a chart just by looking over it for a short period of time. It's very common for markets to chop around and oscillate a lot near major tops and bottoms and trend much better toward the middle of the movement. It's very similar to the way water moves through a river.

It's a similar idea. Over time, this idea started to make me realize that the way price action behaves is dependent not only on where you are in a river but who is in charge of the trend.

The different controlling elements on the market are trend traders, those who buy in the strength and sell in the weakness and top and bottom pickers, those who sell near the high or buy near the low, just the opposite are the trend followers.

Then there are bargain hunters who really don't try to get in at the top or the bottom. They let the high or the low happen and let the market react. Then they pull back toward the high or the low and get in with a clearly defined stop and hopefully ride it into the early start of a new trend.

The bargain hunters are generally long-term accumulators and distributors. I would put Warren Buffett as a bargain hunter. He waits for all hell to break loose and everybody to be dying to sell. There are bargains everywhere. It's almost like going to shop on a sale day after Thanksgiving and waiting for a great bargain.

Those are the three different types of traders: top and bottom pickers, trend followers and bargain hunters. Neely River theory recognizes all three as an important part of the market.

Most systems just pick one and say, ñWeøre a trend follower or a trend-following system.ò Itøs only dealing with one third of the reality of a market, which means by definition that it only can make great money about a third of the time.

The rest of the time itøs either going to struggle or lose money, because the market doesnøt always behave in the trend-following fashion. It isnøt always trending. Sometimes it goes sideways for long periods of time, which is when bargain hunting works better.

Sometimes markets have major-defined tops. Elliott Wave theory works really great for picking tops and bottoms. Catching the high or the low is the best time to get in for environments like that.

Each environment has its special place and time. Every dog has its day. If you only trade in one particular fashion, then youøre automatically going to be limiting yourself to only about one third of the time that a market is behaving in that way.

Thatøs why most systems are designed around the idea that youøre going to lose money for a while but you just have to control your risk so that when things get good, youøll start making money.

Neely River theory takes a whole different approach. It tries to figure out whoøs in charge: trend followers, bargain hunters or top and bottom pickers? It tries to figure out which group is in charge based on a very objective process, not a subjective or mathematical formula or anything like that. It allows you to automatically and immediately adjust the way youøre trading to fit that style of trader, so youøre doing what that one out of three is doing the right way instead of what the two-thirds are doing the wrong way for every little change in the environment.

The Neely River trader is constantly changing the way they trade. Right now on the S&P, weôre currently trend followers. We went short into weakness just a week or so ago. So far itôs working out great, but sometimes Iôll wait for the market to bounce off a low and go short on a balance. Sometimes Iôll look to pick a top or a bottom.

Iôm constantly changing the way I trade, which is one reason why I think my service does pretty well most of the time. Iôm not trying to force the market to fit a particular style of trading, which virtually all other computer systems, newsletters and whatever else do. They almost always stick to one style of trading. Thatôs the downfall.

If we move on to the chart where it shows three trading zones, the three trading zones reflect what Iôm talking about. If the market trend is up, Zone 1 up at the top would be the trend followers where theyôre buying into strength. Zone 2 would be where bargain hunters are buying into retracements. Zone 3 would be the wholesale buyers are buying near the low, trying to pick the bottom. If you have a downtrend, you have three more zones exactly the same concept but all in reverse.

When it comes to markets, you actually have six different realities. Letôs say in a regular retail environment, you only have at most about three realities. You have the wholesaler who then might sell to a middleman who then might warehouse these products locally. Then you have the retail location, like a store or grocery store where youôre buying these final products. They hope you take it home and never come back. Itôs a one-directional phenomenon from the wholesaler to the middleman to the retailer.

When it comes to markets, there is no absolute defined best or worst price. Nobody really knows what the best price is, so you can have people buying and selling in both directions. You have wholesalers trying to pick the bottom if they think the trend is up. Then you might have wholesalers trying to pick the top if they think the trend is down. You have a deepening and doubling of complexity of the market. This creates six different participants in the market. There are those who are bullish, and thatôs your three that I mentioned earlier. Itôs your trend followers, bargain hunters and top and bottom pickers.

Then you have the same thing occurring on the bear side. You have the same three people looking at things in the exact opposite way. You have six primary participants. If you have six participants in a market and you divide that by 100, that means youôre only getting a probability of being right about 12.5% of the time because youôre trying to be that one out of six whoôs doing the exact right thing at the exact right time. Thatôs the reason why itôs so hard for most people to make money trading. The chances of always being that one out of six arenôt very good.

Neely River theoryôs goal ï without any kind of formula or mathematical formulas but pure observational analysis thatôs based on current information not forecasts of the future ï is to give you an idea what the actual trend is just by observing.

If youôre standing in front of a river, it doesnôt take a lot of time, analysis or instruments to figure out which way the water is going. You just look and can tell. Neely River theory is the same way. You can just look at a chart and tell what the likely trend is.

Once you know what the trend is, then you have to decide: Am I going to be a trend trader, buy at the strength, wait for a 50% reaction and buy on a pullback, or am I going to try to pick the bottom?

Neely River theory also makes a process of determining who is in charge of the trend relatively easy. You know what style of trading you're going to implement. Bud, do you have any questions before I go on?

Interviewer: How does Neely River theory help us define if one of those three traders is dominating the market?

Glenn Neely: It all has to do with just looking at price action. Of course, that's the secret part that I don't reveal to the public. It's something I've been working out for 30 years. It's taken a lifetime to understand all this. It's not something I just hand out free to the public, but I make it a very objective process.

When I start the class with students, I explained that when most people approach the markets, they come in with this thought process – that predicting the future is the way you make money trading. I think we covered that in Part 1 when I talked about a trading paradigm and a forecasting paradigm. Have we gone through that yet?

Interviewer: Yes. We did.

Glenn Neely: They come into a market with the belief, and strictly just a human belief and decision, that markets have to be predicted first, before you can benefit from them.

Neely River theory turns that whole thing upside down. It's related to the way rivers work. You don't look at a river and decide which direction the ocean is.

When you're trading, it isn't about figuring out where the market is ultimately going to go, so you can make money. The goal is to survive. Your position has to survive until the market goes wherever it happens to end up going. It doesn't deal at all with trying to predict what's going to happen. It only deals with how you get in safely using the right kind of entry strategy, stop placement and stop movement until the market takes you out or reaches a point where you can get more aggressive with your stops. Eventually, you let the market stop you out.

Youâre never anticipating where itâs going to go or worrying about where itâs going to go. Itâs worrying about where youâre going to get in, where your stop is going to go and getting this to you as quickly as possible. Thatâs the whole focus of Neely River theory.

Like I say, itâs extremely different from anything Iâve seen in my career. It does take time getting used to this, because most people always feel like theyâre somehow in control of the human characteristic. They want to control things, especially when it comes to finances.

They donât want to just leave things to hope and faith, but if you compare it to a river, your thoughts have zero to do with where the river is going to go and how long itâs going to take to get to the ocean. What you think about it is completely irrelevant.

Itâs the same with markets. What you believe is going to happen is irrelevant. Whatâs important is what you do right now to survive until whatever is going to happen happens and you maneuver in a way that youâre avoiding the rocks, sandbars, waterfalls, the edge of the river and all of that. Youâre just avoiding the problems until it takes you wherever itâs going to go. Thatâs the way good trading is done. Itâs taken me a lifetime to figure that out.

Interviewer: Iâm going to ask a few more questions. You can always kindly decline if I get into too much detail, because Iâm not sure if the level of question I ask is going to be too detailed for this conversation. I suspect that the Neely River theory focuses a lot on horizontal supports and resistance, especially considering when you deal with the trend-following trader, who is more of a breakout trader, and something with retracement, which you consider the bargain hunter. I would call that more the retracement trader where they come and buy 50% retracements and 60.8% retracements. Itøs a Fibonacci type of deal.

My first question would be, are horizontal supporters one of the key factors that you focus on? The second thing is, for picking the top and the bottom, that seems to be fairly difficult, because you really donøt have a horizontal support and resistance most of the time.

Glenn Neely: The way youøre talking automatically implies thereøs prediction involved with the process. If youøre talking about support and resistance, youøre automatically trying to predict something. Neely River theory is not about prediction of future market action, where it might top or where it might bottom. Itøs about how you trade, how you enter, how you exit and how you place stops, not what you think is going to happen.

With most of the students I teach, it takes at least a month before they get out of this forecasting paradigm and into what I call a trading paradigm ï where you forget about what you believe, what you think, whatøs supposed to happen and how markets feel. Itøs not about any of that stuff, because those are all human judgment, forecasting, prediction and control issues.

Interviewer: Itøs very hard because the majority of traders obviously have to believe something before they enter a trade. Youøre saying that with the technology youøve discovered and implemented, itøs not to think like that. It definitely requires a paradigm shift to get into your level of thinking.

Glenn Neely: Yes. There is a paradigm shift in thinking that is required. I think thatøs the only thing that will hold Neely River theory back from eventually being really popular or famous, because it is completely contrary to the initial belief system of anybody who is involved in markets.

When you come into the markets initially, you hear television talking about every hot forecast or trade recently and what they think the markets are going to do. If you look at the newspapers, theyôre always predicting what the economy is going to do. When you get computer programs, theyôre always trying to predict whatôs going to happen. Thereôs psychoanalysis. Everything you see, hear and read is all about belief systems regarding forecasting and that thatôs the secret and ultimate best answer to making money in the future.

Neely River theory flies in the face of all of that. The problem with Elliott Wave analysis is that itôs too complicated to do well, so most people will never go to the trouble to learn it, whereas Neely River theory is not a learning-curve issue as much as a personal psychological paradigm shift in the way you think about markets. Itôs difficult for most people.

It took me probably 20 years to realize that something was wrong with what I was doing, because I got better and better at Wave analysis to the point where it was almost ridiculous how good my Wave analysis is sometimes. My trading wasnôt getting equally better. It was falling way behind and increasing at an arithmetic pace, whereas my forecasting was increasing at a logarithmic pace.

The further apart they got, the more I started to question, ñWhat in the world is going on here? How is this possible? If I can predict well, why canôt I trade well?ò Thatôs when it dawned on me that prediction was not the answer to making money. Thatôs a very bizarre thing to realize.

Interviewer: Sure. You mention a lot about stop placement and profit target, so I would suspect that it depends on what kind of trader you think is dominating, and when you enter a trade you already know where youôre going to place your stop.

Glenn Neely: Itôs the way you enter, how you place your stops, how you move your stop, what your target is and if there even is a target. Even weirder, all of that stuff changes almost every single bar. You have targets constantly moving up or down, stops constantly moving up or sideways and strategy constantly changing, just like if youĝre in a river.

You donĝt just sit there in your boat and say a prayer. You have to put the oars out, turn the engine on or do something. You have to steer through the river. Real trading is just like that. It requires constant reevaluation and constant maneuvering to stay alive.

Interviewer: I guess that goes the next slide where I imagine you actually have a buy or sell stop limit, or do you do something else?

Glenn Neely: It depends. Generally speaking, with trend followers, youĝre using buy stops with sell stops. With top and bottom picking, youĝre just immediately jumping in at the market when you think the top and bottom is occurring based on behavior. Itĝs not based on future expectations but current behavior. With bargain hunting, youĝre usually using a limit order on a pullback.

Each one of them is different, which makes sense because each trade is made in a different kind of way.

Letĝs move to the next page, because I donĝt want to get too bogged down in that stuff. Letĝs go into the page that says, ñTracing fish in a river.ò Instead of it being a fish, letĝs just pretend itĝs a slightly weighted Ping-Pong ball that may have a little ball bearing or something heavy inside of it to give it some momentum, so itĝs not just being pushed around by the air.

Letĝs say youĝre at the edge of a river and you place this weighted Ping-Pong ball right at the edge of the river. The river is flowing, of course. If you let go, that Ping-Pong ball is not going to go perfectly horizontal along the north bank of the river. Itĝs going to get caught in turbulence, move around and jump around in different kinds of ways until it might pass what I call the event horizon, which is generally around 25% of the range of a river. When it passes that point, thatøs when it gets into the acceleration range of a river.

Then that Ping-Pong ball will start to move a lot quicker. As it gets to the other event horizon on the other side, it potentially will get caught in the fluid dynamics and turbulence on that side. It will go back and forth until eventually it may hit the other side of the river.

The interesting part is that when I drew this out and realized what kind of behavior you might get from a Ping-Pong ball or any kind of object in the river, it actually starts to create a logical explanation for why Wave theory exists.

On the next chart, which I think is the final chart, it actually shows Wave count superimposed on the behavior of what you might see of a Ping-Pong ball or some kind of object in a river being affected by the turbulence near the perimeter, and then getting affected by the momentum in the middle, and then getting affected by the turbulence toward the end.

This was a real eureka moment for me. I thought, ñWow, this is actually a potentially higher level than Wave analysis, because it actually gives us an explanation of how Wave phenomenon works and why it actually happens.ò

I do feel like Elliott Wave theory is generally one part of a three-pronged equation. Wave theory primarily is a top and bottom picking technology. Even though you can sometimes predict direction and trend, it gets very hard toward the middle. It gets very hard during corrections to know whatøs going to happen. In the very beginning and the end, thatøs when it becomes very clear. For the most part, Wave theory is a top and bottom picking system. There are two other things. There is trend following and bargain hunting, which Wave theory doesnøt deal with as well.

I still think Wave theory is the most sophisticated form of technical analysis ever devised, but it does have its flaws and problems. You need to know when itøs useful and when itøs not and when itøs dangerous to use and when itøs very advantageous.

I think this is a really cool graphic to show that thereøs a logical way to represent behavior connected to River theory, the behavior of water in the river, and price action in the market. That then directly connects it to Wave theory action and that price action.

Interviewer: You mentioned that Wave theory is an excellent tool to utilize picking top and bottom. Do you incorporate that into your Neely River theory technology, or is the Neely River theory technology a standalone technology that does not use Wave theory for top and bottom picking?

Glenn Neely: River theory can stand alone, but in any market, itøs always nicer if you know which direction not to trade. Just know that the trend is up when you avoid any signals that might be to go short, and if you know the trend is down you avoid any buy signals. Wave theory can be handy when helping to determine the general trend or when big changes are occurring, like in the S&P just recently.

The market all of a sudden dropped on Friday quite substantially and sort of unexpectedly. I immediately realized that this may indicate that the bull market is over that weøve been into since 2009 ï and that itøs the first time in probably two years or more where it was even possible, so that was a critical event.

For that reason, Iøm primarily only going to focus on trade in some areas that look to go short until Wave structure tells me otherwise. I tend to integrate, because I do know Wave theory very well, but Neely River theory can be used totally independently. It can do well on its own.

You just automatically eliminate 50% of any possible signals alongside of the market if the trending is really up or really down and you know it.

Thatôs my overview for today. The primary understanding today is that Neely River theory does have a connection to Wave theory. It helps to explain why Wave theory actually works and where the phenomenon actually comes from, which makes it, to me, an even more interesting and compelling concept. Itôs helping you trade without worrying about prediction.

Hereôs something we may not have covered yet. When youôre predicting a market, the real problem with prediction is that it gets your ego involved in the trade. The minute your ego is involved, you donôt want to lose. You donôt want to be wrong. Thatôs really the reason that forecasting is so dangerous. If you donôt have anything to lose, itôs much easier to be objective and do the right thing.

Letôs say you get $400 in some market. You think the trend is up and it drops to $390. Youôre going to look for some rationalization. ñItôs still okay. Iôm going to wait a little bit longer.ò Then it goes to $380. ñItôs probably still going to go up.ò You keep waiting, lowering stops or adjusting things, and you keep losing more money.

Thatôs typically what happens to people who are in the forecasting paradigm. Neely River theory completely avoids that. All stops are purely objective. You canôt move them. You canôt change them. They never go against the trend. They only go with the trend or stay where they are, so you can never increase risk or move them below certain points. It makes trading a lot easier for that reason.

You know theyôre objectively designed and based on an idea of whoôs in charge, so you know youôre moving and placing them in the right kind of way for the environment youôre currently dealing with, so you have the best chance of making money of any of the six people who are attempting to make money from a trend.

Interviewer: This is my last question before we end this second interview. We have one more interview coming up. Can you actually program Neely River theory to be automated trading or is it still a fairly discretionary trading?

Glenn Neely: Iőve been working on automating Neely River trading for about 10 years, maybe a little bit longer. Iőve been paying a programmer in Germany to program it into TradeStation. For the most part, itős done to where it presents information.

River theory is more of an observational phenomenon just like Wave theory is. Thereős nobody who can come in and tell you with a mathematical formula that this is the top or this is the bottom with Wave theory.

River Theory is the same. Itős not a mathematical formula. Itős an observational, real-time phenomenon that does not attempt to predict the future. It just deals with what you know and whatős happened in the past. It has nothing to do with what you think is going to happen in the future. It can be programmed, but automation of it gets a little more difficult.

Iőve been working on automating it, but I always tend to find that just having the information helps. Having the Wave theory structure in front of you makes it easier to make the decision on how to approach the market than to have a computer do it for you.

The computer canőt think in dynamic, deductive and inductive reasoning and things that are just a little outside the realm of computers. Computers want everything to be absolutely perfect where the human brain can kind of think in fuzzy kinds of ways. Neely River theory, I think, is slightly fuzzy. For that reason, Iőd rather personally just look at the information and make a decision on the best way to approach a market than to try and get it down to an absolute formula.

Interviewer: That was great, Glenn. I really appreciate your time, and weǒll look forward to our next interview to dig even deeper into Neely River technology. The first two interviews have been really exciting and informative, and I appreciate speaking with you again.

Glenn Neely: Thanks a lot.