CAMARILLA TRADING AND PIVOTS

You have probably heard about the 'Camarilla Equation' by now, and how Day Trading is made easier by it - allegedly a secret day trading formula that will help your day trading reach new heights of accomplishment, with the bare minimum of risk. Or so the story goes. But what about the reality? We have investigated the Camarilla Equation thoroughly, and can now report on the truth behind this amazing phenomenon.The first thing you should realise is that there are a number of different versions out there all confusingly called 'Camarilla'. Most are attempts by amateur traders on notice boards and such like to 'crack the secret' of the Equation, which are obviously worth what you pay for them (nothing!) and there are a few commercial websites offering a 'Camarilla Equation' all appearing to be based on different ideas and mathematics. The version we have had success with is the 'SureFireThing Camarilla Equation', discovered in 1989 by a semi-legendary bond trader called Nick Stott which is the only offering that has convinced us that the Equation works, and the only site that can offer any kind of explanation behind the phenomenon.

Origins of the Camarilla Equation

camarilla. cam·a·ril·la. A group of confidential, often scheming advisers; a cabal.[Spanish, diminutive of cámara, room, from Late Latin camera. See chamber.]

Discovered while day trading in 1989 by Nick Stott, a successful bond trader in the financial markets, the SureFireThing 'Camarilla' equation uses a truism of nature to define market action - namely that *most time series have a tendency to revert to the mean*. In other words, when markets have a wide spread between the high and low the day before, they tend to reverse and retreat back towards the previous day's close. These levels are, frankly, astounding in their accuracy as regards day trading, even to seasoned traders, who know all about support and resistance, pivot points and so on.

SFT Camarilla Equation Levels

The SFT Camarilla Equation produces 8 levels from yesterday's open, high, low and close. These levels are split into two groups, numbered 1 to 4. The pattern formed by the 8 levels is broadly symmetrical, and the most important levels are the 'L3', 'L4' and 'H3', 'H4' levels. While day trading, traders look for the market to reverse if it hits an 'L3' or 'H3' level. They would then open a position AGAINST the trend, using a stop loss somewhere before the associated 'L4' or 'H4' level. The SFT theory suggests setting stoplosses that appear to you the trader to be prudent, and to not even open the trade until it has penetrated the level in the 'right' direction, i.e. demonstrated that it has found resistance (or support). In the case of the higher H3 level, this would mean that price had already reversed and pushed back down thru the level, heading south.

The second way to try day trading with the Camarilla Equation is to regard the 'H4' and 'L4' levels as 'breakout' levels - in other words to go WITH the trend if prices push thru either the H4 or L4 level. This essentially covers all the bases - Day Trading within the H3 and L3 levels enables you to capture all the wrinkles that intraday market movement throws up, and the H4 - L4 breakout plays allow the less experienced trader to capitalise on relatively low risk sharp powerful movements. Here's what it looks like

i   n
action:-

Trading with the Camarilla Equation is discretionary - although the main 'philosophy' of the system seems mechanical, a reasonable amount of experience and knowledge is needed to trade the equation well. Basically, you give the Equation yesterday's open, high, low and close. The Camarilla Equation will then give you 8 levels of intraday support and resistance. There are 4 of these 'L' levels above yesterday's close, and 4 below. Below the close they are numbered L1, L2, L3 and L4, and above the close H1, H2, H3 and H4. The important levels to note are the 'H3' and 'L3' levels, points where significant reversals are likely, and the 'H4' and 'L4' levels which are where breakouts have a tendency to start. How you specifically enter a trade depends to some extent where the market opens.

Market Open BETWEEN 'H3' and 'L3'

If the market opens BETWEEN the H3 and L3 levels, you must wait for price to approach either of these two levels. Whichever level it hits first gives you your first trade.
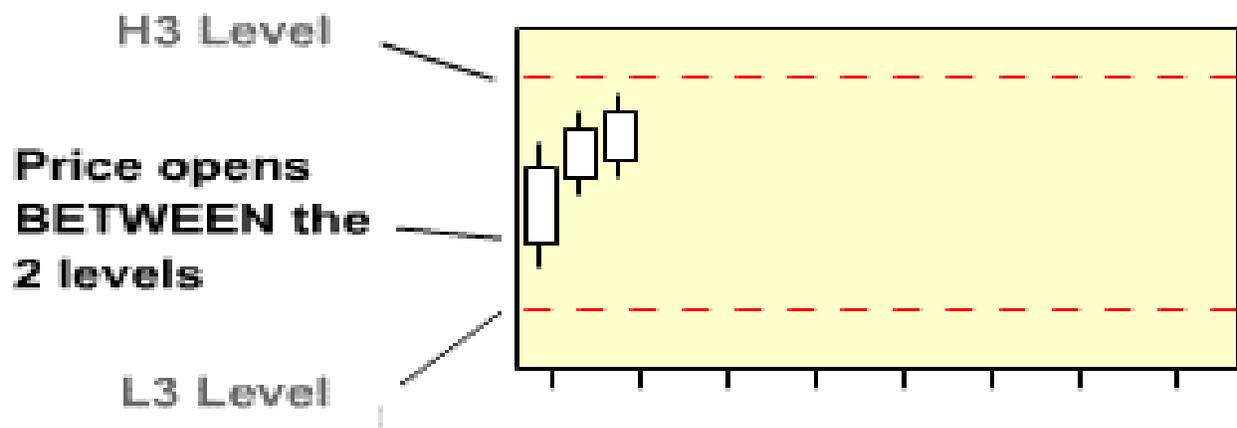

If the H3 level is hit, the idea is that you go SHORT (against the previous trend) in the expectation that the market is about to reverse,

with a stoploss point somewhere between the H3 and H4 levels (if it his H4, chances are it's going to breakout bigtime upwards, so you want your stop to be before that!).

H4 Level shows where the market may breakout upwards

H3 Level

Market should reverse here
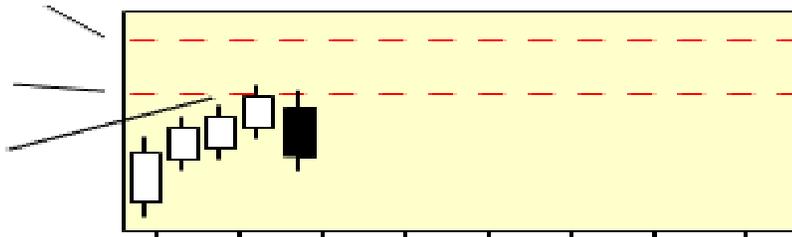
SureFireThing, suggest that you wait for price to bounce back down into the H3 level again before entering the trade, as you will therefore be technically trading WITH the short term trend. You need afair amount of experience for this style of trading. The opposite, of course applies if the LOWER L3 level is hit first - wait for it to come back up, then go LONG.
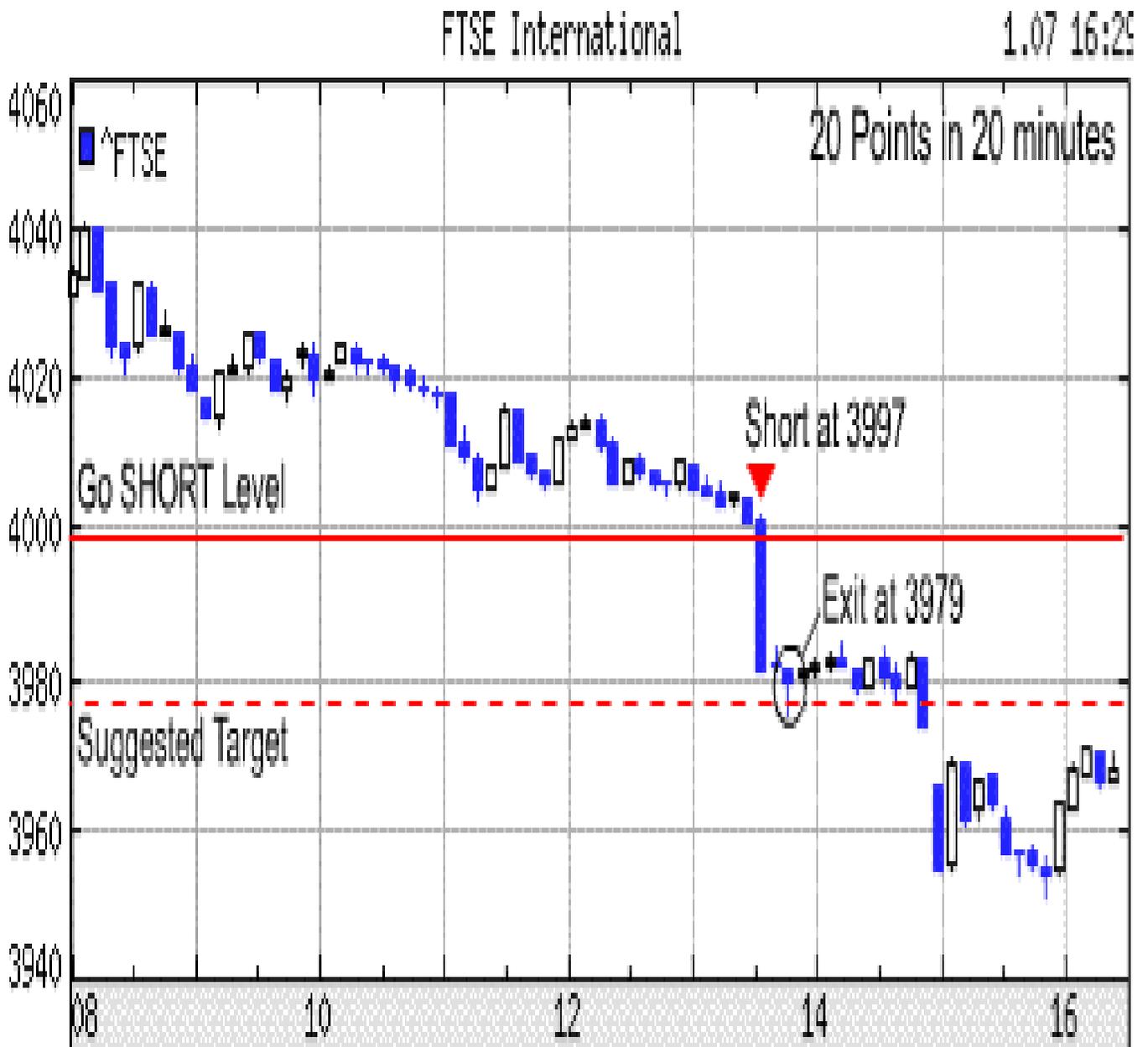
Market Open OUTSIDE 'L3' and 'H3'

In this case, you wait for the market to retreat back thru the L3 or H3 level - you will then be trading WITH the trend, and once again, put a stop loss somewhere before the matching H4 or L4 level. Taking profits is down to you - trailing stops seem popular. You need to be aware that you WILL want to take profits at some time during the day, because the market is unlikely to 'behave' and stay right-sided for your trade. These reversals from H3 and L3 appear to happen fairly frequently during intraday trading.

The L4 and H4 levels are actually phenomenally good 'breakout' levels themselves. If price pushes up thru the higher H4 level, the chances are it is going to keep on running that way. Our own research indicates that in such a breakout on the S&P, a move of up to 7 points can be expected, which is, as you will understand, a VERY significant proportion of a typical day's volatility.

Running with the breakout

As the original equation specified no levels outside L4, knowing when to exit the trade becomes highly subjective. This is where SureFireThing's '{b}' version of the Equation becomes useful, as the 'profit target' of the {b} version seems, in our experience, to be quite a good level to watch for the move to falter. Taking profits here might often be a prudent course of action, as once your money is off the table, the worst that can happen is that you earn some interest on it!

FTSE International   1.07 16:29

^FTSE

20 Points in 20 minutes

Short at 3997

Go SHORT Level

Exit at 3979

Suggested Target

Putting it all together

They say a picture is worth a 1000 words - below is a chart from 21st May 2003, showing what levels the Equation predicted (thanks to SureFireThing.com for permission to reprint this image) and what actually happened on that day.
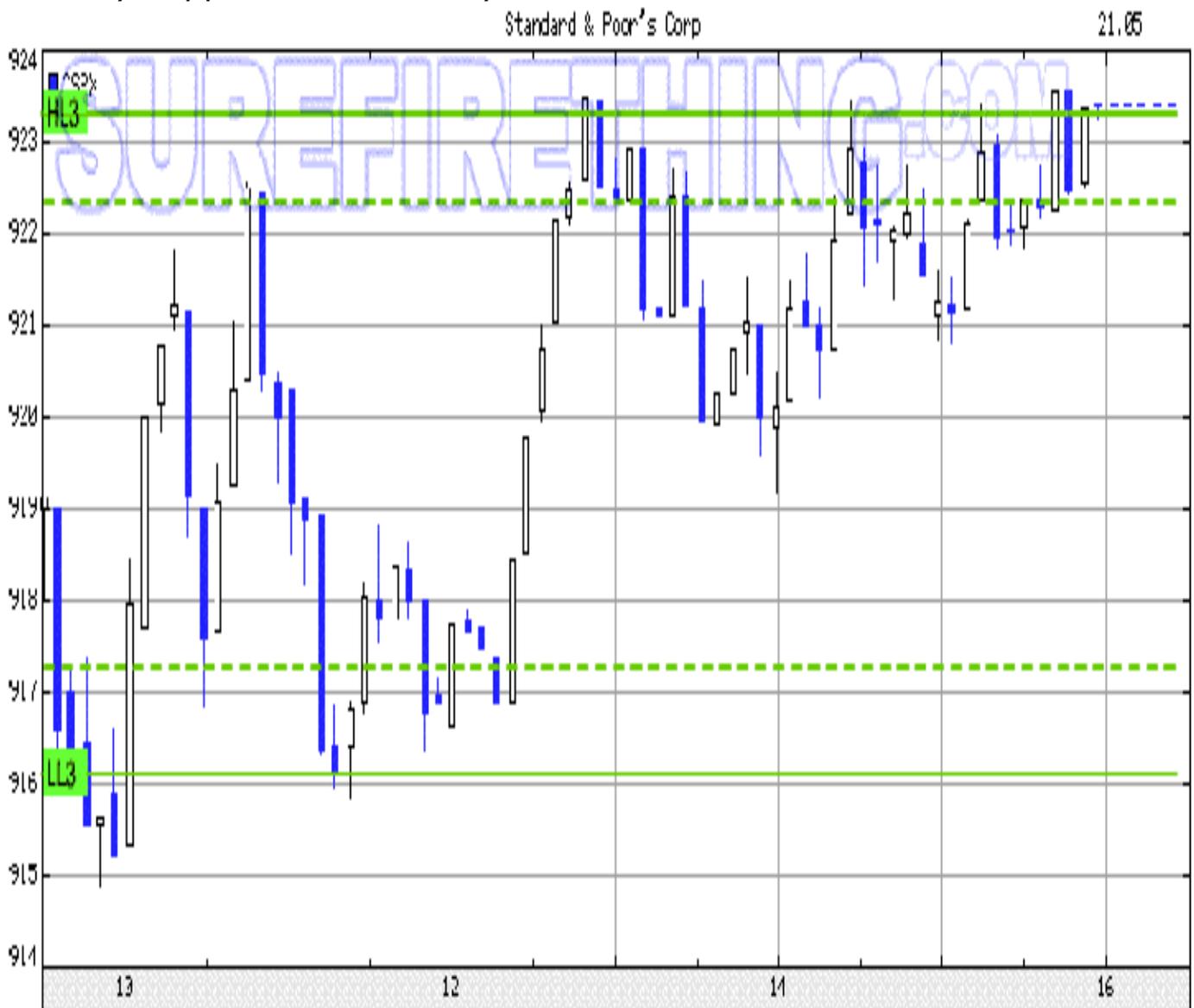
A Classic Day.

As you can see, the market respected the H3 and L3 levels very well, and gave an opportunity to make a double digit profit on the day. Our research leads us to beleive that such opportunities are not, in fact, rare, but rather the usual state of affairs. Once again, thanks to SureFireThing for permission to reprint this image.