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Bond Index Trading

A Bond Trading Introduction Using the Wyckoff Method

There are times when the action of the stock market is dull providing only marginal opportunities to realize a profit. There are other times when the action of the stock market is confusing resulting in an unacceptable level of uncertainty making new positions too dangerous to consider and existing positions too dangerous to maintain.

During these periods, the Wyckoff trader has two options:
1. The trader can move to the side lines and take a vacation from market activity, or
2. Look to other markets for other opportunities.

The Pulse of the Market provides Wyckoff oriented data on one of these other markets. It is the interest rate market and the vehicle that provides the basis for finding trading opportunities in this market is the Bond Index.

The Bond Index was created in 1985 to assist Wyckoff traders in the business of trading treasury securities locate and manage positions for themselves and their customers.

The Bond Index is a composite picture of the long term, intermediate term and shorter term segments of the interest rate market. It is defined by the action of the thirty year bond future, the ten year note future and the five year note future.

These three futures contracts are monitored through out each trading session of the CBOT just as the Wyckoff Wave components are monitored throughout each session of the NYSE.

This monitoring allows for intra-day buying and selling waves to be determined and for an O.P., Technometer and Force to be calculated. With these tools, the Wyckoff trader can apply the five steps of the Wyckoff method and make intelligent decisions as to when to enter and exit positions.

There are a variety of ways that the Wyckoff trader can use the Bond Index to take and manage positions. The simplest way is to actually trade the index itself. This is accomplished by taking positions in all three components of the index at the same time making all positions of the same size.

The trader who buys or sells one contract of each of the components of the Bond Index will see his position change in value by $1000 every time the index moves one point. This approach allows for maximum participation in the movement of the index. Those who prefer a more cautious approach can leg into a position.

For example, if the index moves into a potential spring position, a trader might opt to begin building a position with one five year note contract. Later when the spring is successfully tested, the trader could consider adding one ten year note contract to his position to enhance his participation in the movement of the index. A third entry point might develop on a back up to the edge of a creek allowing the trader to add one thirty year bond contract and fully participate in the action of the index at a point where the certainty of correctness of the position is the greatest. In a similar manner, a Wyckoff trader might choose to leg out of a position reducing the odds of leaving a large portion of the potential profit on the table due to exiting too early or too late.

There are other trading techniques that can be used with the bond index to suit a Wyckoff traders tolerance for volatility. One possibility would be to establish a position only in the ten year note contract either all at once, or at three different points. This can be seen as being a middle of the road approach. It would reduce the volatility of the position somewhat by not taking a position in the bond contract. However, it would put some of that volatility back into the position by not taking a position in the five year note contract.

Other combinations of the three components of the index might also be considered. Doubling the size of the ten year note portion of the position and avoiding the short term or long term portion of the position would increase or decrease the volatility of the position and increase or decrease the participation of the position relative to the movement in the index depending upon which contract was not traded. Another option to consider would be to spread trade the bond contract and the ten year note contract. Other combinations could also be considered depending upon the tolerance for volatility of the trader and the degree to which he wishes to participate in the movement of the index.

Those who have never operated in a futures market should not do so without first engaging in a period of practice trading. Those who refuse to use the protection of a stop order should never operate in a futures market period. Futures trades are highly leveraged. They require only a small percentage of the value of the position to participate.

However, the trader who does not trade defensively could lose all or even more than all of his initial commitment of funds. These cautionary statements are not presented to scare the trader away from a trading vehicle that has the potential to be very rewarding. Rather, they are presented to help prevent the trader from focusing solely on the $1000 per point potential profit from the movement of the Bond Index and to encourage the use of defensive measures at all times.