NEW TECHNIQUES

Any Secrets To Trading The Trend?

Three Trend Trading Techniques

The currency market is known to be one of the best trending markets in the world. Here are three strategies for entering and exiting trends to maximize profit and minimize risk.

Imagine that centuries ago, a pilgrim set out on a mission to discover the secret of trading. He passed through deserts, thirsty for truth more than water. He descended into valleys where he met despair and then rose again more determined than ever. Finally, he scaled the steep walls of a massive mountain and met a teacher whose wisdom was sought by even the mightiest of traders. And when asked the secret of trading, the master teacher spoke only these words:

"The trend is your friend. Never trade against it."

And thus a myth was created. Mountains of trading literature have been produced about this one statement. *But is it true?*

TREND TRADING AS YOUR WORST FRIEND

I have found that the truth about trend trading is more complicated. Trading is deeper than just a platitude, and the simple repetition of a falsehood doesn't make it true. The worst lie that we can tell is the one that we tell ourselves, and in this case, if you convince yourself that the trend is your friend and it must be trusted at all costs, then you run the risk of great disappointment and huge drawdowns.

For example, what if you bought the GBP/JPY at 252.00 in the summer of 2007? Let's take a look at Figure 1. That looks like a spectacular trend. Let's buy the pair! Let's see what happens next (Figure 2). Whoops! The trend wasn't too friendly. In summer 2007, I bought the GBP/JPY near the exact top and found that the trend was very unfriendly. To sum it up, the trend can be your friend, but when the trend gets angry, your friend knows you well enough to do terrible things to you.

TREND TRADING AS YOUR BEST FRIEND

I've decided over the years that I can use a few simple techniques to make trend trading as friendly as possible, while still remembering that no trend lasts forever.

First, I try to trade a trend early. Second, I jump out

by Rob Booker

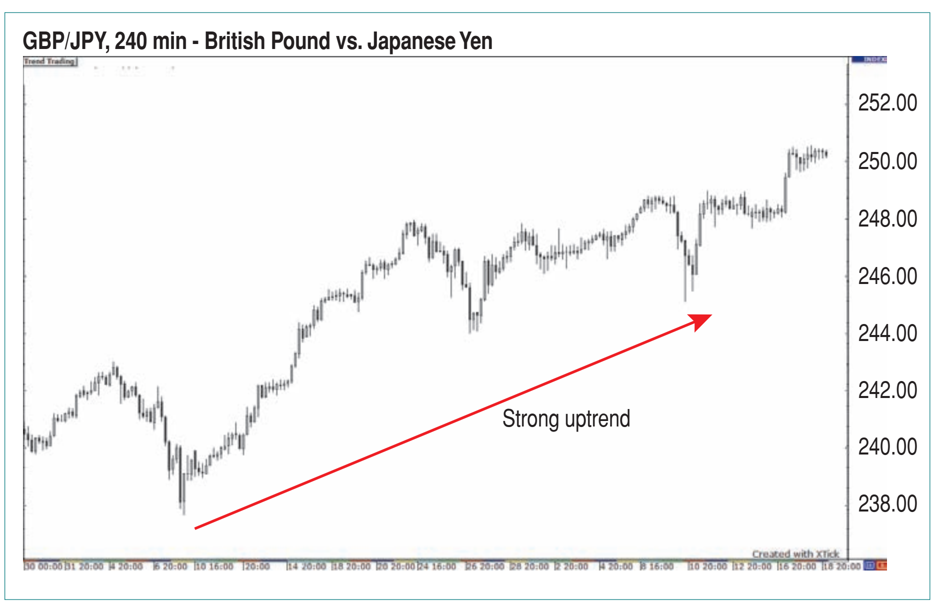

FIGURE 1: A HAPPY TREND. On this 240-minute chart of the GBP/JPY, the trend looks spectacular.

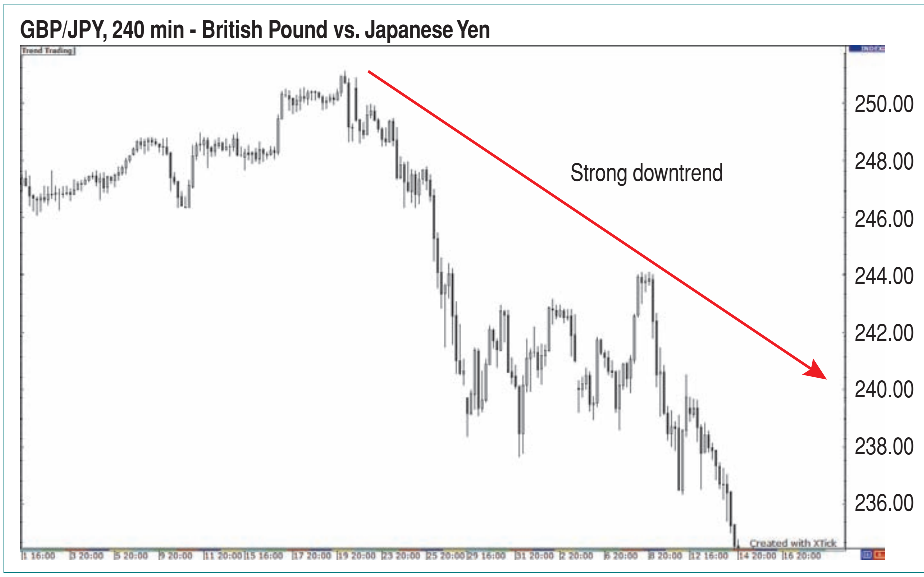

FIGURE 2: WHOOPS! The trend wasn't so friendly after all.

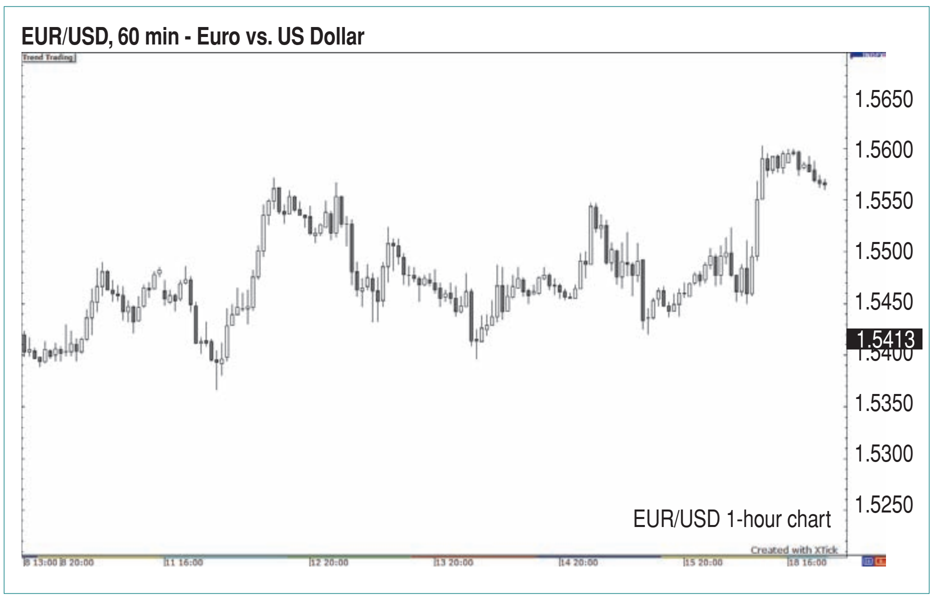

FIGURE 3: HOURLY CHART OF THE EUR/USD. Is this chart moving sideways?

of losing trades quickly (see Figure 2 again for a visual reminder as to why). Third, I add to my winning positions. Let's dive deeper into the details of these strategies.

Strategy 1: Trading the Trend Early

The first thing that I do in order to profitably trade a trend early is watch for a cycle of sideways serenity in the market, or a range. To find this range, I do these things:

1. I look back over the past 75 to 100 candles (or bars).
2. I ask myself, "Is the currency pair moving sideways over these last 100 candles?"
3. If the answer is yes, I draw a boundary around those 100 candles.

When I do this, I'm willing to watch any time frame chart. This technique is possible to practice on a short- or long-term chart. I've done this on a five-minute chart just as successfully as the one-hour or daily chart.

Now let's take a look at an example of the EUR/USD (Figure 3). In this one-hour chart, I looked back over the last four days, which was 96 candles (step 1), and asked myself: Is this pair moving sideways (step 2)? The answer was yes, so in the next chart (step 3), I drew horizontal levels along the top and bottom of this sideways movement (Figure 4).

Then, to take the trade, I simply wait for a candle to close above or below the top or bottom of the channel that I have drawn. My belief is that if the pair can break the barrier created over 100 candles, then the trading crowd has decided to rise up and revolt against the range. When the range is over, the pent-up pressure bursts and a trend is born. (We hope!) Once the candle closes above the top of the range, I buy the currency pair (Figure 5).

Strategy 2: Stopping Out Early

If the currency pair goes halfway back inside the channel, I close the trade. To do this, I calculate the midpoint of our channel and then set the stop in my trading platform. I risk no more than 1% of my account on this first position. This means that if the pair falls back down and stops me out, the most I can lose is 1% of my account balance.

In our EUR/USD example, the pair breaks free of the range and then drops back down almost immediately. Why does this happen? The range is powerful and the first set of trades that create the breakout are going to be the revolutionaries, the ones who are willing to go against the grain — the trendsetters!

In the example in Figure 6, the pair gets close to the midpoint — very close. But it doesn't hit the number, and then it shoots back up.

As I mentioned, this first position is what I call a "rubber glove" trade — if it fails, it's no big deal and a very small loss. It allows me to freely trade without putting too much emphasis on winning every trade, and more importance on giving myself a chance to ride the next trend.

Once the pair gets outside the channel we drew, we can then switch to using a trailing stop. One way I do this is to plot a 30-period simple moving average (Figure 7). If the pair closes below that moving average, in this case, we'll close the trade.

If you convince yourself the trend is your friend, then you run the risk of drawdowns.

Strategy 3: Adding to a winning position

One of the most powerful techniques for trend trading is that if you catch the trend and don't stop out on that first trade, you need to stack up positions and get the most out of the trade.

It's paradoxical that traders often scale out of positions even as the trade is doing exactly what we wanted it to do. In particular, when you are trend trading and you catch a trend early, you want to get the most out of the trade. You want to get everything that you can. Here's how you can do so: Add to the position when it breaks new highs or lows. I simply add a position equal in size to my first position at every momentum break.

Let's take a look at how we might add to the EUR/USD position. We stopped out when the pair closed below the 30-period simple moving average, at 1.5751. Let's take a look at all of our positions:

First, buy trade at 1.5619 (gains 132 pips)
Second, buy trade at 1.5672 (gains 79 pips)
Third, buy trade at 1.5687 (gains 64 pips)
Fourth, buy trade at 1.5777 (loses 26 pips)
Fifth, buy trade at 1.5803 (loses 52 pips)
For a total gain of 197 pips

When adding to the position, here are three other methods you might consider with the EUR/USD trade:

1. Drop to a lower time frame chart (divide the time frame you are on by four) and add to the position when an oscillator like relative strength index (RSI), commodity channel index (CCI), or stochastic becomes oversold.
2. Stay on the time frame you are on, and add to the position every time the pair drops and touches a shorter-term moving average like the five or 15.
3. Just add to your trend positions as often as you can before the pair closes below the 30-period simple moving average. Trust your own judgment and just add when you feel it's right, and close the whole thing out when the trailing stop catches up.

Add to a position when it feels right? *Really?* Read on.

The "closing eyes" technique

When I think about trend trading, I am reminded of the words of the 14th-century Rinzai Zen master Bassui Tokushi:

Put aside your rational intellect
Give up all techniques
Get rid of the notion of self

Over the years I have found that so many traders, when building, testing, or using a trading system, are looking for something that can't be found — certainty. We want to hold, in the palm of our hand, the plan that will bring us a certain percentage gain per week; we want to follow a strict map that leads us along the path of wealth. It is ironic that so many traders start out because we seek freedom, then later find ourselves desperate for rules that will bring predictability to the market chaos.

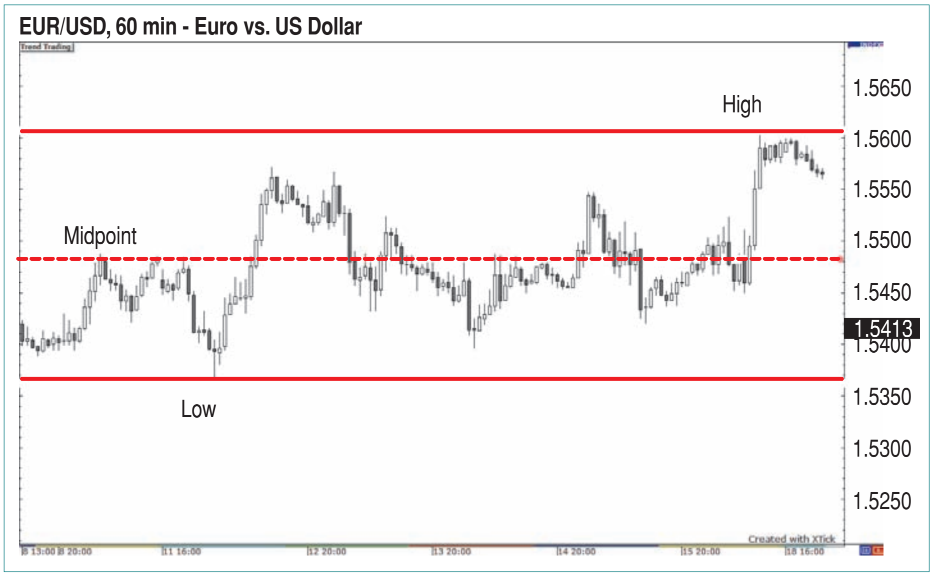

FIGURE 4: THE BOUNDARIES ABOVE AND BELOW. These boundaries are drawn to determine support and resistance levels of a sideways move.

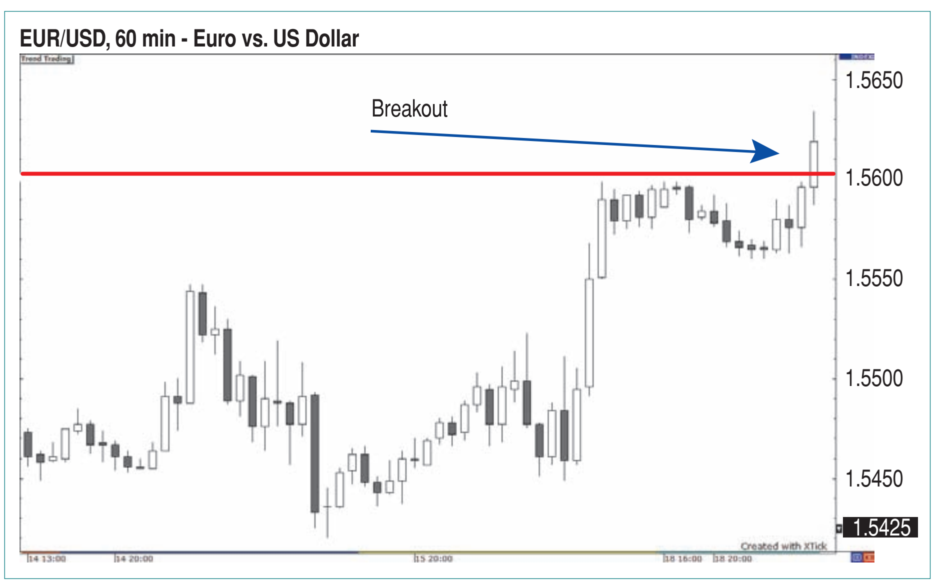

FIGURE 5: BREAKOUT! Once price breaks out above or below the boundary lines, hopefully a trend is born. Here, price broke out above the top boundary line, signaling a buy.

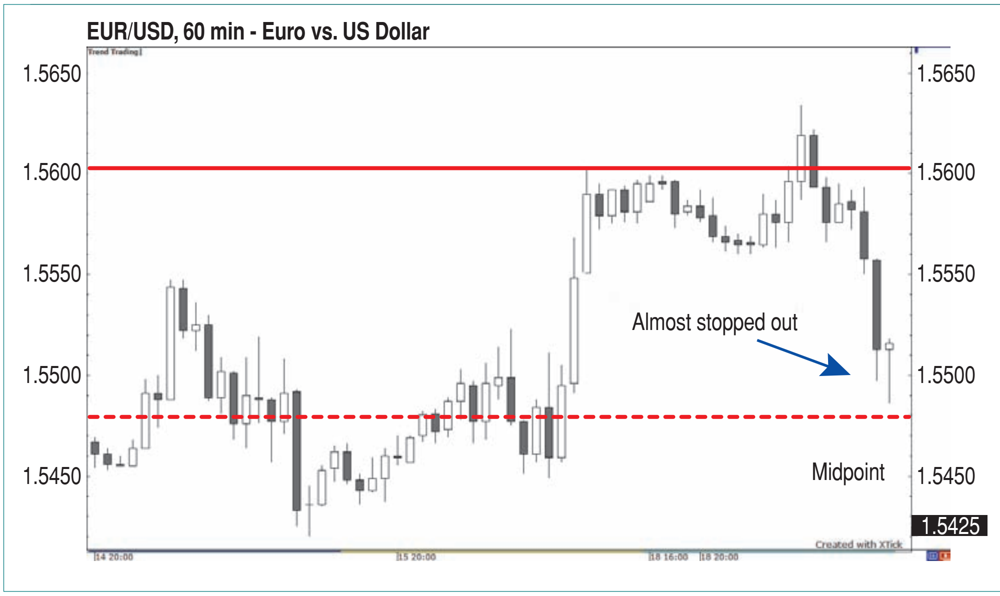

FIGURE 6: CLOSE CALL! The EUR/USD pair gets close to the midpoint — very close. But it doesn't hit the number, and then shoots back up.

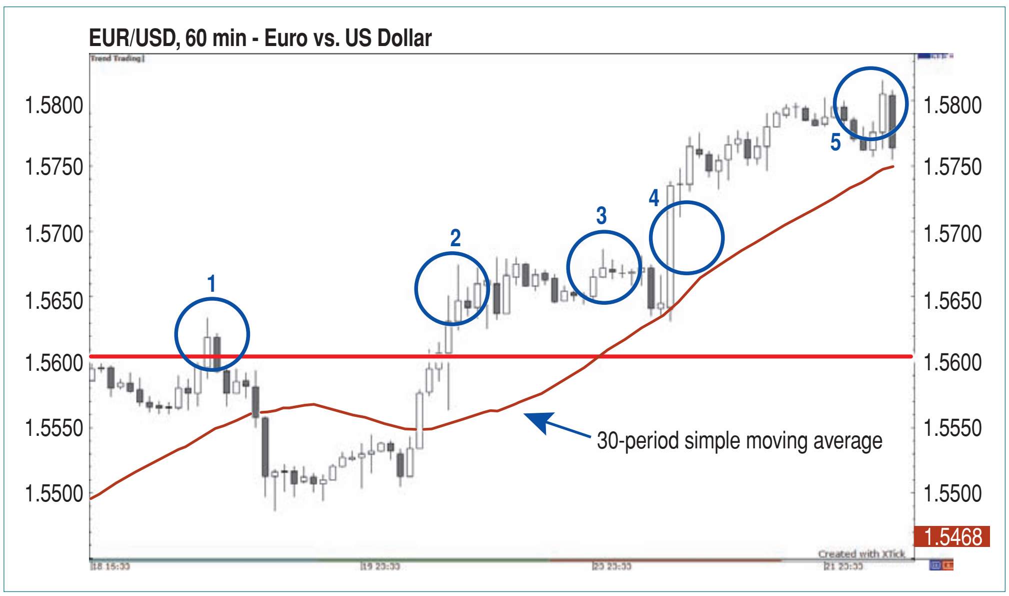

FIGURE 7: ADDING TO THE TREND TRADE. You can add to the position when it breaks new highs or lows.

The disappointment that comes from the uncertainty of the markets has created a huge volume of platitudes, stories, and outright myths about trading. These statements include sayings like "Always cut your losses short and ride your winners," as well as "No one ever went broke taking a profit," not to mention, "The trend is your friend." We repeat these phrases without considering how these supposed truths apply to our own lives. When we become entranced with these statements, we go astray. We start losing money not despite, but rather because of, our allegiance to the holy trading writ of unnamed persons who never knew us, our systems, our circumstances, or our experiences.

A possible truth in trading is that you can effectively face the uncertainty of the markets by never risking too much on a single trade.

In the end, only you can teach yourself. Only you can find out for yourself if any of the methods I've described today will work for you. The only way to do that is by testing, questioning, and trusting your own experience above all else. So when testing these methods for yourself, give it a try — trust your own judgment, never do anything to risk losing any substantial amount of money, and invest more heavily in your successful positions.

> **In the end, only you can teach yourself. Only you can find out for yourself if any of the methods described here will work for you.**

Rob Booker is a currency trader. His book, Adventures Of A Currency Trader, *was published by John Wiley in 2007.*

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