

# How to Create Your Own Forex Trading System



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The beginner's guide to forex trading

# Creating Your Own Forex Trading System

## Forex Trading Systems

Let's get into our favorite part of trading...creating your own trading system!

If you do a simple search in Google for "Forex trading systems" you'll find many many many people out there who claim to have the "Holy Grail" system that you can purchase for "only" a few thousand dollars.

These systems supposedly make thousands of pips a week and never lose. They will show you supposed "results" of their perfect system and it will make your eyeballs turn into dollar signs as you sit there and say to yourself, "Wow I can make all this money if I just give this guy \$3,000. Besides, if his system making thousands of pips a week, I'll be able to make my money back in no time."

Slowww down cowboy. There are some things you should know before you give them your credit card number and make that impulse buy.

The truth is that many of these systems DO in fact work. The problem is that traders lack the discipline to follow the rules that go along with the system.

The second truth (there's such thing as a second truth?) is that instead of paying thousands of dollars to buy a system, you can spend your time developing your own system for free, and use that money you were going to spend as capital for your trading account.

The third truth is that creating systems is not even that difficult. What is difficult is following the rules that you set when you do develop your system.

There are many articles that sell systems, but we haven't seen any that teach you how to create your own system. This lesson will guide you through the steps you need to take to develop a system that is right for you. At the end of the lesson, we will give you an example of a system that we trade just so we can show you how awesome we are! (Insert evil laugh here.)

# Creating Your Own Forex Trading System

## Goals of your trading system

I know you're saying, "DUH, my goal of my trading system is to make a billion dollars!" While that is a wonderful goal, it's not exactly the kind of goal that will make you a successful trader.

When developing your system, you want to achieve 2 very important goals:

1. Your system should be able to identify trends as early as possible.
2. Your system should be able to avoid you from whipsaws.

If you can accomplish those two things with your trading system, we GUARANTEE you will be successful. The hard part about those goals is that they contradict each other. If you have a system in which its sole purpose is to catch trends early, then you will probably get faked out many times.

On the other hand, if you have a system in which its sole purpose is to avoid whipsaws, then you will be late on many trades and will also probably miss out on a lot of trades.

Your task, when developing your system, is to find a compromise between the two goals. Find a way to identify trends early, but also find ways that will help you distinguish the fake signals from the real ones.

Always remember these two goals when you create your system. They will make you a lot of money!

# Six Steps to Setting Up Your System

The main focus of this article is to guide you through the process of developing your system. While it doesn't take long to come up with a system, it does take some time to extensively test it. So be patient; in the long run, a good system can potentially make you a lot of money.

## Step 1: Time Frame

The first thing you need to decide when creating your system is what kind of trader you are. Are you a day trader or a swing trader? Do you like looking at charts every day, every week, every month, or even every year? How long do you want to hold on to your positions?

This will help determine which time frame you will use to trade. Even though you will still look at multiple time frames (go back to 7th grade if you forgot), this will be the main time frame you will use when looking for a trade signal.

## Step 2: Find indicators that help identify a new trend.

Since one of our goals is to identify trends as early as possible, we should use indicators that can accomplish this. Moving averages are one of the most popular indicators that traders use to help them identify a trend. Specifically, they will use 2 moving averages (one slow and one fast) and wait until the fast one crosses over or under the slow one. This is the basis for what's known as a "moving average crossover" system.

In its simplest form, moving average crossovers are the fastest ways to identify new trends. It is also the easiest way to spot a new trend.

Of course there are many other ways traders' spot trends, but moving averages are one of the easiest to use.

# Six Steps to Setting Up Your System

## Step 3: Find indicators that help CONFIRM the trend.

Our second goal for our system is to have the ability to avoid whipsaws, meaning that we don't want to be caught in a "false" trend. The way we do this is by making sure that when we see a signal for a new trend, we can confirm it by using other indicators.

There are many good indicators for confirming trends, but I really like [MACD](#), [Stochastics](#), and [RSI](#). As you become more familiar with various indicators, you will find ones that you prefer over others, and can incorporate those into your system.

## Step 4: Define Your Risk

When developing your system, it is very important that you define how much you are willing to lose on each trade. Not many people like to talk about losing, but in actuality, a good trader thinks about what they could potentially lose BEFORE thinking about how much they can win.

The amount you are willing to lose will be different than everyone else. You have to decide how much room is enough to give your trade some breathing space, but at the same time, not risk too much on one trade. You'll learn more about money management in a later lesson. Money management plays a big role in how much you should risk in a single trade.

## Step 5: Define Entries & Exits

Once you define how much you are willing to lose on a trade, your next step is to find out where you will enter and exit a trade in order to get the most profit.

Some people like to enter as soon as all of their indicators match up and give a good signal, even if the [candle](#) hasn't closed. Others like to wait until the close of the candle.

# Six Steps to Setting Up Your System

In my experience, I have found that it is best to wait until a candle closes before entering. I have been in many situations where I will be in the middle of a candle and all my indicators match up, only to find that by the close of the candle, the trade has totally reversed on me!

It's all really just a matter of trading style. Some people are more aggressive than others and you will eventually find out what kind of trader you are.

For exits, you have a few different options. One way is to trail your stop, meaning that if the price moves in your favor by 'X' amount, you move your stop by 'X' amount.

Another way to exit is to have a set target, and exit when the price hits that target. How you calculate your target is up to you. Some people choose support and resistance levels as their targets. Others just choose to go for the same amount of pips on every trade. However you decide to calculate your target, just make sure you stick with it. Never exit early no matter what happens. Stick to your system! After all, YOU developed it!

One more way you can exit is to have a set of criteria that, when met, would signal you to exit. For example, you could make it a rule that if your indicators happen to reverse to a certain level, you would then exit out of the trade.

## **Step 6: Write down your system rules and FOLLOW IT!**

This is the most important step of creating your trading system. You **MUST** write your trading system rules down and **ALWAYS** follow it. Discipline is one of the most important characteristics a trader must have, so you must always remember to stick to your system! No system will ever work for you if you don't stick to the rules, so remember to be disciplined. Oh yea, did I mention you should **ALWAYS** stick to your rules?

# Six Steps to Setting Up Your System

## How to Test Your System

The fastest way to test your system is to find a [charting software package](#) where you can go back in time and move the chart forward one candle at a time. When you move your chart forward one candle at a time, you can follow your trading system rules and take your trades accordingly. Record your trading record, and BE HONEST with yourself! Record your wins, losses, average win, and average loss. If you are happy with your results then you can go on to the next stage of testing: trading live on a demo account.

Trade your new system live on a demo account for at least two months. This will give you a feel for how you can trade your system when the market is moving. Trust me, it is a lot different trading live than when you're backtesting.

After two months of trading live on a demo account, you will see if your system can truly stand its ground in the market. If you are still getting good results, then you can choose to trade your system live on a REAL account. At this point, you should feel very confident with your system and feel comfortable taking trades with no hesitation. At this point, YOU'VE MADE IT!

# Setup Your System in Six Steps

## My “It’s So Easy It’s Ridiculous!” System

In this section I will give you an idea of what a [trading system](#) should look like. This should give you an idea of what you should be looking for when you develop your system.

### Trading Setup

- Trade on daily chart (swing trading)
- 5 EMA applied to the close
- 10 EMA applied to the close
- Stochastic (10,3,3)
- RSI (14)

### Trading Rules

- **Stop Loss = 30 pips**
- **Entry Rules**

1. Enter **LONG** if:

- The 5 EMA crosses *above* the 10 EMA and both stochastic lines are heading up (do not enter if the stochastic lines are already in the overbought territory)
- RSI is *greater* than 50

2. Enter **SHORT** if:

- The 5 EMA crosses *below* the 10 EMA and both stochastic lines are heading down AND (do not enter if the stochastic lines are already in oversold territory)
- RSI is *less* than 50

- **Exit Rules**

- Exit when the 5 EMA crosses the 10 EMA in the opposite direction of your trade OR if RSI crosses back to 50



# My “It’s So Easy It’s Ridiculous!” System

Okay, let's take a look at some charts and see this baby in action...

As you can see, we have all the components of a good [trading system](#). First, we've decided that this is a swing trading system, and that we will trade on a daily chart. Next, we use [moving averages](#) to help us identify a new trend as early as possible.

The [Stochastics](#) help us determine if it's still ok for us to enter a trade after a moving average crossover, and it also helps us avoid oversold and overbought areas. The [RSI](#) is an extra confirmation tool that helps us determine the strength of our trend.

After figuring out our trade setup, we then determined our risk for each trade. For this system, we are willing to risk 30 pips on each trade. Usually, the higher the [time frame](#), the more pips you should be willing to risk because your gains will typically be larger than if you were to trade on a smaller time frame.

Next, we clearly defined our entry and exit rules. At this point, we would begin the testing phase by starting with manual back tests.

# My “It’s So Easy It’s Ridiculous!” System

Here are a couple of examples:



If we went back in time and looked at this chart, we would see that according to our system rules, this would be a good time to go long. To backtest, you would write down at what price you would’ve entered, your stop loss, and your exit strategy. Then you would move the chart one candle at a time to see how the trade unfolds.

# My “It’s So Easy It’s Ridiculous!” System



In this particular case, you would’ve made a massive pip gain. You could’ve bought yourself something nice after this trade! You can see that when the moving averages cross in the opposite direction, it was a good time for us to exit. Of course, not all your trades will look this sexy. Some will look like ugly heifers, but you should always remember to stay disciplined and stick to your [trading system rules](#).

# My “It’s So Easy It’s Ridiculous!” System



In this example, we can see that our criteria is met and at this point we would enter short. Now we would record our entry price, our stop loss and exit strategy, and then move the chart forward one candle at a time to see what happens. I'll bet you a \$1000 that I'm right on this trade.

# My “It’s So Easy It’s Ridiculous!” System



Well, isn't that amazing?! It just so happens that I'm right again! You can see that we would've stayed in this trade until the moving averages crossed again and RSI went back to 50.

We know you're probably thinking that this system is too simple to be profitable. Well the truth is that it is simple. You shouldn't be scared of something that's simple. In fact, there is an acronym that you will often see in the trading world called KISS. It stands for Keep It Simple Stupid!

It basically means that trading systems don't have to be complicated. You don't have to have a zillion indicators on your chart. In fact, keeping it simple will give you less of a headache.

# My “It’s So Easy It’s Ridiculous!” System

The most important thing is discipline. We can’t stress it enough. Well, yes we can.

## **YOU MUST ALWAYS STICK TO YOUR TRADING SYSTEM RULES!**

If you have tested your system thoroughly through back testing and by trading it live on a demo for at least 2 months, then you should feel confident enough to know that as long as you follow your rules, you will end up profitable in the long run.

Trust your system and trust yourself!

# Summary of Trading Systems

**There are many systems out there that work, but many traders lack the discipline to follow the rules and as a result, still end up losing money.**

**Your trading system should attempt to accomplish 2 goals:**

1. Be able to identify a trend as early as possible
2. Be able to find ways to avoid whipsaws (confirm your trend)

If it is profitable, then you trade your system live on a demo account for at least 2 months. This will help you get an idea of how you would trade your system when the market is moving. It is a lot different trading live than manually backtesting.

Once you've demo traded your system for at least 2 months and you are still profitable, you are then ready to trade your system live with real money. However, you must always remember to stick to your rules no matter what!

**There are 6 steps to developing your system:**

1. Find your time frame
2. Find indicators to help you identify trends early
3. Find indicators to help you avoid whipsaws and confirm your trend
4. Define your risk
5. Define your entry and exit
6. Write your trading system rules down and ALWAYS stick to those rules!

# Summary of Trading Systems

**There are 3 phases to testing your system:**

1. Back test- go back and time and move your chart forward one candle at a time. Trade your system according to its rules and record your trades to see if it ends up being profitable.
2. If it is profitable, then you trade your system live on a demo account for at least 2 months. This will help you get an idea of how you would trade your system when the market is moving. It is a lot different trading live than manually back testing.
3. Once you've demo traded your system for at least 2 months and you are still profitable, you are then ready to trade your system live with real money. However, you must always remember to stick to your rules no matter what!



# Summary of Trading Systems

Okay now legal stuff our lawyers asked us to add:

*HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS. IF YOU ACTUALLY READ THIS ENTIRE MASSIVE BLOCK OF TEXT, YOU ARE RIDICULOUSLY AWESOME!*