Smart Money Forex

Phil's Smart Money Forex Trading Method

2nd Edition

by: Phil Gangluff

Disclaimer

I AM NOT...

- A licensed Financial Advisor
- An unlicensed Financial Advisor
- A psychic
- A guru
- Someone with a "Holy Grail" trading system

I CAN NOT...

- Foresee future world events
- Guarantee you will be profitable trading Forex

I CAN...

- Teach you the method that made me a profitable, full-time Forex trader
- Teach you a money management technique that will minimize your chances of loss and maximize your chances of gain

I make no guarantees as to the amount of money you may profit or lose by trading my method, but I can promise you that my method is sound. It's not a get-rich-quick scheme where you can make or lose a fortune overnight.

That being said, do not trade with money that you can't afford to lose. This method has made me a lot of money, but you are not me, so I cannot say who will or will not achieve profits similar to mine.

In other words, if you're an idiot and lose your food/rent/whatever money it's not my fault! Please use due diligence, follow the money management rules in Chapter 1, and just use some plain old' common sense.

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Introduction

So you're tired of losing money in the Forex Market and ending up like this guy…

Ready to make some money instead of losing it? My method, which I call the Smart Money Forex Trading Method, will teach you how to do just that!

Notice I didn't call it a Forex trading "system." There's a good reason for that… It's not just a system that tells you when to take a trade. This is an entire trading **method**, complete with a strategy for finding, entering and exiting trades, and a money management system to make sure you don't go broke in the process! The Smart Money Forex Trading Method will teach you everything you need to know to become a successful Forex trader, then you can look like this guy…

So what makes my method so great? Here are the main features that I believe make it stand out from all the others.

- **It's Adaptable** – My method works on any currency pair and under any market conditions. It is not a "system" that works now but will fail in the future.
- **It's Job Friendly** – You, like most people, probably have a full-time job. My method can be traded entirely with pending orders and only takes about 20 minutes per day to manage.
- **It's Time-Tested** – My method doesn't use some flashy new indicator or some weird new technique. It's based on the time-tested principles of support & resistance, trendlines, and candlesticks patterns.

- **It's Easy** – Yes, candlestick patterns can be confusing, but my method isn't. How's that possible? Keep reading and you'll see!

But before we get any further into the method I'd like to introduce myself and give you a quick overview of my trading philosophy, so you don't waste your time reading this 50 page eBook if it's not for you.

My name is Phil, and I went from a newbie to full-time trader in 6 months, but I had a luxury that most traders don't. I didn't have to work a job during those 6 months. I studied Forex 8-12 hours a day, 7 days a week with no other responsibilities. I had just graduated from college and my wife and I were accustomed to living on her salary alone, so I could devote that much time to Forex.

I learned about Forex from an eBook I found on the Internet. The book itself didn't contain much information. It was an advertisement for an automated Forex robot, and I knew better than to fall for that, but it did spark my interest in what Forex was all about. So I Googled "Forex" and started reading everything I could find about currency trading.

I started demo trading, and I failed miserably! It was mainly because I was trading randomly. I didn't yet understand why currency prices moved or how to predict their movements. I was just watching price go up and down and guessing where it would go next.

After some hunting I found a system I liked called the Cowabunga system, and I went to work demo trading it. It was important to me to trade a demo account just like it was real money, so I went the whole nine yards... Keeping a trading journal, setting alarms and getting up in the middle of the night to take trades, etc.

After a month or so of demoing I went live. Remember though that I was studying my charts for 50+ hours per week, if you can't devote that amount of time then it will take you longer to learn the ropes.

I opened an account at Oanda with $50, but I did my charting in MetaTrader 4 with an IBFX demo account (Oanda didn't offer MT4 back then, but they do now). After I had turned that $50 into $75 I added $1000 to the account, and after I increased that by a good amount I added the rest of my trading capital and grew my account from there.

I started trading over 6 years ago with a few thousand dollars and I now make a 6 figure income per year. I know most people think they'll get rich trading Forex faster than that, but remember that Forex is not a get-rich-quick scheme, it's get-rich-slow!

The most important lessons I've learned, many which form the basis of my trading method, are:

Demo Trading Is Worthless!

The only good use of a demo trading account is to learn how to use the trading software. Once you've mastered that, dump the demo account and get a small live account. Put in a dollar amount you can afford to lose, but that you don't want to lose. For me that was $50, but for you it might be $5000, or it might be $5. There are brokers out there (like Oanda) with no minimum deposit that let you trade a fraction of a penny per pip, so there's no excuse for not having a live account!

Of course whether you're trading live or demo you can still learn my method, but I would HIGHLY suggest a live account if you really want to learn how to trade. A demo account just doesn't bring up the emotions of trading like a small live account will.

Indicators Are Not All They're Cracked Up To Be!

As you'll learn in Chapter 2 of this eBook (titled "Indicators are Evil"), I don't like indicators and my method doesn't use them.

You're going to learn price action trading here! Price action and candlesticks are WAY more important than indicators. Indicators tell you what has happened in the past, price action and candles tell you what is happening NOW. I started with an indicator based system, and it worked, but it's very limiting in what it can do.

Dump the indicators now and never look back!

Money Management Is The Key To Success

I trade 2% of my account per trade, and doing so is ESSENTIAL to my trading method. If you're a gambler instead of a trader then this method isn't for you!

I read every day about people blowing their accounts. If you trade 2% per trade it should be impossible to blow an account. At 2% you need 35 losers in a row to cut your account in half, and over 100 to get it to the point of no return.

Trade Higher Time-Frames

I do almost all my trading on a 4-hour chart, although I will occasionally trade a daily chart. You can trade my method on any time-frame, but anything under 4H is off limits to me.

The higher time-frame you trade the more reliable price action will be. If you've been struggling trying to trade 5 or 15 minute charts you'll find 4-hour charts and above a breath of fresh air!

Are You Ready To Get Started?

If I haven't scared you away yet then let's get started! And remember, if you have any questions just ask! The best place to get in touch with me is at my website, SmartMoneyForex.com, but you can also find me on Babypips as “phil838,” and on ForexFactory as “Phil.”

The only thing I ask is that you don't email me with questions. I released the first version of this eBook in 2009 and included my email address in it so traders could ask me questions.

It's now 4 years later and I still get 25+ emails each day from traders asking the same questions over-and-over again.

I love answering your questions, but please do it on the forums. That way everyone can see my response and I don't have to answer the same questions via email mutliple times per day. The forums greatly reduce my workload and give me time to make more great trading videos and write more Forex eBooks and articles.

Also remember to watch my weekly analysis videos and follow my blog on my website. They both will help you tremendously when you're first learning and practicing my method.

Thanks,

Phil

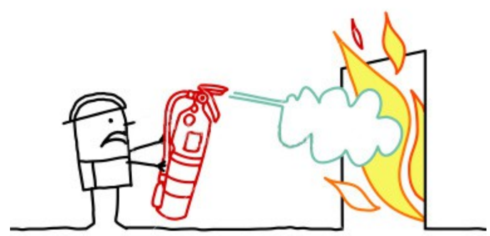
Chapter 1: Money Management

Do I have your attention? Good, because this is the most important chapter in the eBook! If there's a secret to Forex trading, money management is it.

What makes money management so special? The fact that it can guarantee that you won't lose all your money, that's what!

Read that carefully… I said you won't lose **ALL** your money. Forex is risky, and you could lose some money, but if you follow this money management plan and my trading method to the letter I can promise that no matter what type of disaster may befall you, you won't lose all your money (or even most of it).

So what exactly is a money management plan? Think of it as an insurance policy on your Forex account. Why do you have insurance on your car, or on your life, or on your house? In case a disaster happens! It's the same with trading, you need protection from the ultimate Forex disaster… the losing streak!



Losing streaks happen, but most new traders underestimate them because they don't understand how probability works. Just because you're trading a method that has an 80% win rate doesn't mean that you will win 4 trades and lose 1 over and over in a repeating pattern. Losing streaks of 4, 5, and even 6 trades will happen. It's not a matter of **if** it will happen, but a matter of **when** it will happen.

If you don't believe me, just start flipping a coin. I bet you can't get to 20 flips without hitting a streak of at least 4 heads or tails in a row. Your money management plan is an insurance policy against losing streaks like those. It keeps those streaks from wiping out your account.

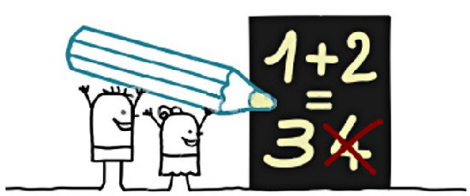
"But Phil," you say, "where do I get a solid money management plan?" Don't worry, I'm going to give you one right now! I call it the "2&2" money management plan…

Rule #1: *Never risk more than 2% of your account balance per trade.*
Rule #2: *Never have more than 2 trades open at a time.*

It really is that simple, so let's get started learning the 2&2 money management plan!

The 2&2 Money Management Plan

Rule 1: ***Never risk more than 2% of your account balance per trade***



The first rule of the plan is to only risk 2% of your account balance per trade. So how do you know how many lots to trade in order to risk 2%? With a little bit of math, that's how!

Yes, you will have to do some math before every trade, but it's just basic multiplication and division, so don't skip this section just because you hate math!

OK, let's get on with the lesson…

Step 1:
Account Balance x .02

Multiply your account balance by .02 to get the amount to risk on each trade.

Say we've opened a trading account with $1000 dollars and we want to place a trade on EUR/USD. We always want to risk 2% of our account on the trade, so we multiply our account balance by 2% ($1000 x .02) and get $20.

So the most we want to risk on this trade is $20. Now that we know the maximum amount that we can lose it's time figure out what lot size gives us that amount of risk. The formula for that is easy…

Step 2:
Amount to risk ÷ Stoploss

Divide the amount you want to risk by the stoploss (in pips) of your trade.

After we've planned our trade and know what our stoploss is going to be (we'll learn how to do that later) we simply divide our risk by our stoploss. So if we want to risk $20 and our trade has a stoploss of, say, 50 pips, then we divide $20 by 50 pips and get 0.40 dollars per pip.

Now we know that we want our trade to have a value of .40 dollars (40 cents) per pip, but how many lots do we need to trade to get a value of 40 cents per pip? To find that out we'll need to move on to step 3.

Step 3:
The Value Per Pip We Want Our Trade To Have ÷ The Value of 1 lot

Divide the value per pip you got in Step 2 by the value of 1 lot on your account type.

What is the value of 1 lot? That depends on the type of Forex account you have. The value per lot for all the different types of trading accounts are:

- $10 per lot for a Standard Account
- $1 per lot for a Mini Account
- $0.10 per lot for a Micro Account
- $0.01 per lot for a Nano Account

So if, for example, we have a micro account then 1 lot equals .10 dollars per pip. If we divide .40 dollars (the amount we want per pip) by .10 dollars (the value of 1 micro lot) we get 4, so we would need to trade 4 lots on this trade in order to risk 2% of our account.

Now I know there's some Forex/math guru out there reading this saying, "Hold on, that's wrong!! That formula depends on the pair you're trading!"

That person is technically right, since not every currency pair is based on USD, but there's no need to do the extra math to get "down to the penny" results. If you always use these three steps then, even with the margin of error, you'll always be trading between 1.5% and 2.5%. This is still a safe percentage of your account, even if it's not exactly 2%. The extra steps needed to get perfect results are more complicated, and will just confuse you and cause you to make mistakes.

OK, let's work through one more example, just to be sure you've got the process down…

If your account balance is $13000 and you have a mini account, how many lots should you trade if you need an 80 pip stoploss?

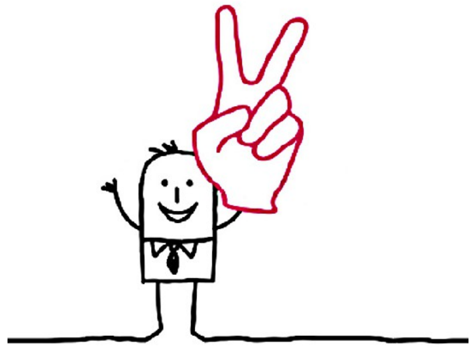
Step 1: $13000 x .02 = $260 to risk

Step 2: $260 / 80 = $3.25 per pip

Step 3: $3.25 / $1 = 3.25 lots

So you would trade 3.25 lots on this trade. See, wasn't that easy?

Rule 2: ***Never have more than 2 trades open at a time***



This rule confuses a lot of new traders. They say, "Why not trade as much as you can so you'll make more money?" It's because of a little thing called **correlation**.

If two currency pairs are "correlated" it means that they tend to move together over time. A picture is worth a 1000 words, so let's look at one now. The picture on the following page is of 5 different pairs over a 2 month period (Feb/March 2011). I have not altered them in any way, besides shrinking them so all 5 would fit on one page.


GBP/JPY


AUD/USD


NZD/USD


EUR/CHF


USD/JPY

They look pretty similar, don’t they? That’s because they are highly correlated and tend to move together.

But how does this have an effect on our money management?

See that downwards spike about 1/3rd of the way in on all 5 pairs? What if you were in a long trade on each of those 5 pairs when that spike hit? Your stoploss would have probably been hit and you would have lost all 5 trades. 5 trades lost at 2% risk each means that ONE price spike caused you to have a 10% account loss!

That's just unacceptable. Risking 2% each on 5 correlating pairs is the same as risking 10% on one trade. It’s just too dangerous, so we don’t do it.

Limit your trades to a maximum of 2 at a time and you’ll be safe. I usually limit mine to 1 trade at a time, but I will open 2 if I’m sure the trades aren’t correlated to closely.

That’s all there is to know about money management. All you have to do is risk 2% of your account on each trade, and never have more than 2 trades open at a time.

The real beauty of this money management plan is that you don’t have to worry about things like leverage, margin, drawdown, etc… Just follow the “2&2” rules, and you can safely ignore all those things!

How exactly does the "2&2" money management plan protect you? Let’s look at a table that shows us what 20 losing trades in a row would do to our account using this money management plan:

Number of losing trades	Account Balance
0	$1,000.00
1	$980.00
2	$960.40
3	$941.19
4	$922.37
5	$903.92
6	$885.84
7	$868.13
8	$850.76
9	$833.75
10	$817.07
11	$800.73
12	$784.72
13	$769.02
14	$753.64
15	$738.57
16	$723.80
17	$709.32
18	$695.14
19	$681.23
20	$667.61

Look at that! 20 losing trades in a row and we still haven’t even lost half our money. Of course the 35% we did lose is devastating, but I’ve never lost 20 trades in a row, and I doubt you will either. My record is 7 losses in a row, and that’s only happened once in all the years I’ve been trading.

If you follow proper money management techniques you’d have to be an absolute idiot to lose anywhere near all your money. After I lost 7 trades in a row I only lost about 15% of my account, which is fine, since I still came out with plenty of profit for that year.

Chapter 2: Indicators Are Evil

This entire chapter is pretty much just a rant against indicator-based trading, and indicators in general, so if you already know the joys of indicator-less trading feel free to skip it and move on to Chapter 3.

If, on the other hand, you think indicators are the greatest thing since sliced bread, or if you're not sure how to trade without them, then keep reading...

The nuts-and-bolts of Forex trading are easy to learn. Any Forex broker will teach you, right on their website, the definition of a pip, what phrases like "go long" mean, and how to use your trading platform. After these basic lessons most new traders are released out into the wild world of Forex, without a clue how to actually trade.

When people realize that they don't know what to do next they turn to people selling Forex trading systems, or they go through every single Forex trading forum on the Internet, hoping to stumble onto the perfect mechanical system that will make them rich. Or, even worse, they pay for an expensive trading robot or signal service, hoping that someone or something can do their trading for them.

They want easy money, so they cover their charts with one useless indicator on top of another thinking that these indicators will tell them when to buy and when to sell. They can then just sit back and watch the money come rolling in.

It's a great idea, but there's one slight problem… It doesn't work! But that's exactly what the majority of Forex traders do, and the majority of Forex traders (some say 95%) are losing money in the market.

I'm not telling you this to scare you, I'm giving you this information so you know that Forex trading is a serious business. I believe that one of the main reasons why the failure rate is so high is that many traders think they're in a casino. They have a chart full of pretty indicators, complete with flashing lights, bells and alarms that go off and make exciting noises! Even worse, they call their successful trades "winners" and their bad trades "losers" just like they would if they were betting at a casino in Las Vegas (I'm guilty of this as well). This mentality is not the kind of thinking you should be doing.

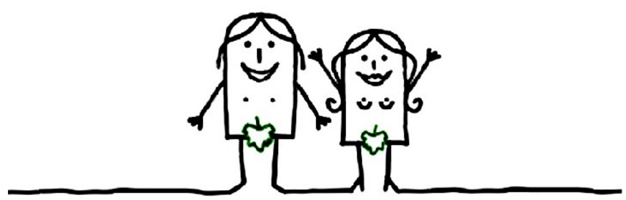
When it comes to Forex trading methods, there seem to be thousands of them available, both in print and on-line. When you look at them one thing becomes overwhelmingly clear: Most of them deal with indicators.

But what if you didn't use those indicators?

There is no indicator, Forex robot, or mechanical trading system that will make you money if you don't understand how and why the Forex market moves. Once you learn **why** prices move up and down you can start to predict **when** they will move up and down. All you need to do this is a simple candlestick chart and a little knowledge.

Depending on how long you have been trading with indicators this might sound scary, or even foolish! If you are one of those traders who only knows how to trade with indicators then it can be hard to fathom the idea of giving them up because of the false sense of security they provide. Indicators are like a crutch that make traders think they have an understanding of the Forex market, but they don't. In reality you're not really trading the Forex market, you're really just plugging numbers into a few mathematical formulas.

So what's so much better about the Smart Money Forex way of trading? The method is better because it's a form of naked trading, and just like when you see another person naked, you get to see the Forex market in all its glory!



Trading without indicators is just like eliminating the middle man. Instead of the indicators telling you what the market is doing, you can see it for yourself. This is, however, terrifying to a lot of traders. For some reason many people feel like an indicator has some sort of magical insight into the market that the human brain can't comprehend. That, in my opinion, is a load of crap.

Indicators have absolutely no flexibility. They are just a math equation that is used over and over again, regardless of market conditions. You, on the other hand, aren't limited to one way of perceiving your charts. You can understand the complexities of the market. If you're reading this then you probably don't yet know how to understand the market, but trust me… you can, and you will!

Indicators Lag, Price Action Leads

Stochastics, MACD, RSI, moving averages and a load of other indicators are presenting you with lagging information. They may look pretty on your chart, but they doesn't really help you predict where the price is going in the future.

What do I mean by the term “lagging indicator?” I mean that they are using a mathematical formula to show you what has happened in the past, and they have no bearing at all on what price is going to do in the future. This can be easily illustrated with one of the most popular indicators, the Stochastics oscillator.

The formula for Stochastics is really quite simple…

%K = 100[(C - L14)/(H14 - L14)]
%D = 3-period moving average of %K

Where:
C = The most recent closing price.
L14 = The low of the 14 previous candles.
H14 = The highest price traded during the same 14 candles.

I know most of you aren’t math geniuses, so I’ll translate for you. If the previous 14 candles (or whatever other number you plug into the indicator settings) tend to close near their high then the Stochastic indicator is rising, and if prices are tending to close near their low then Stochastics are falling. This is all the indicator does, and all the indicator knows.

We can just glance at our candlestick charts and see how quickly the price has been rising or falling. This indicator isn’t telling us what’s going to happen, and it isn’t telling us anything that we don’t already know!

So if indicators are so worthless, why do people use them? They use them out of habit and ignorance. Indicators used to be a powerful tool, but those days have passed. To see what I mean by this we have to take a look at the history of these indicators. Look at the decades these common indicator were invented and see if you can figure out why they were useful in their time…

- Stochastics: 1950’s
- MACD: 1960’s
- RSI: 1970’s

Do you see the connection? All of these lagging indicators were in use before modern computer systems took over the trading world! While there were certainly computers around during this 30 year period, they were limited to the trader that worked on the trading floors of billion-dollar companies. The computers were expensive, and therefore out of reach for the common trader.

If you, the little guy, wanted to see a financial chart in the 1950’s, other than the generic charts printed in the newspapers, you had to plot and draw them yourself! This took a tremendous amount of time and effort. In a situation such as this being able to use a few simple math formulas to see the data in a different way was a blessing. It was a great way to analyze data in its time, but now we have a better way. We have computer software that generates candlestick charts on demand!

The problem is that even though new tools like computers were invented, people never moved away from the old way of doing things. To make matters worse a new generation of traders came around, and knowing nothing of the olden days when lagging indicators had a purpose, they started using them the only way they knew how. They took their new computer generated charts, slapped the old indicators on them, and started using them as a way to predict the future. They never realized that they could just look at their charts and see (much more clearly) the same information the indicators were telling them.

OK, I'm finished ranting about indicators now. Let's move on and start learning about the underlying principle of Forex price movements... Supply and demand.

Chapter 3: What Moves The Forex Market

Supply and Demand

Have you ever wondered what actually makes the prices on a Forex chart go up and down? The big secret that all traders must realize is that a Forex chart is a chart of supply and demand. So before we can try to predict Forex movements, we need a short lesson in how supply and demand moves prices.

Think of the Forex market as an on-line auction site, like eBay. Say you wanted to buy something off eBay, let's call it a "widget." You go to eBay, type "widget" in the search box, and see that there are 100 widgets for sale, ranging in price from $1 all the way up to $100.

So which one do you buy? The cheapest of course! You place an order for a single $1 widget.

Since you bought the $1 widget when the next shopper comes along he finds the cheapest one is $2, but that's a fair price to him so he buys it. This pattern keeps repeating over and over until the cheapest widget is $50.

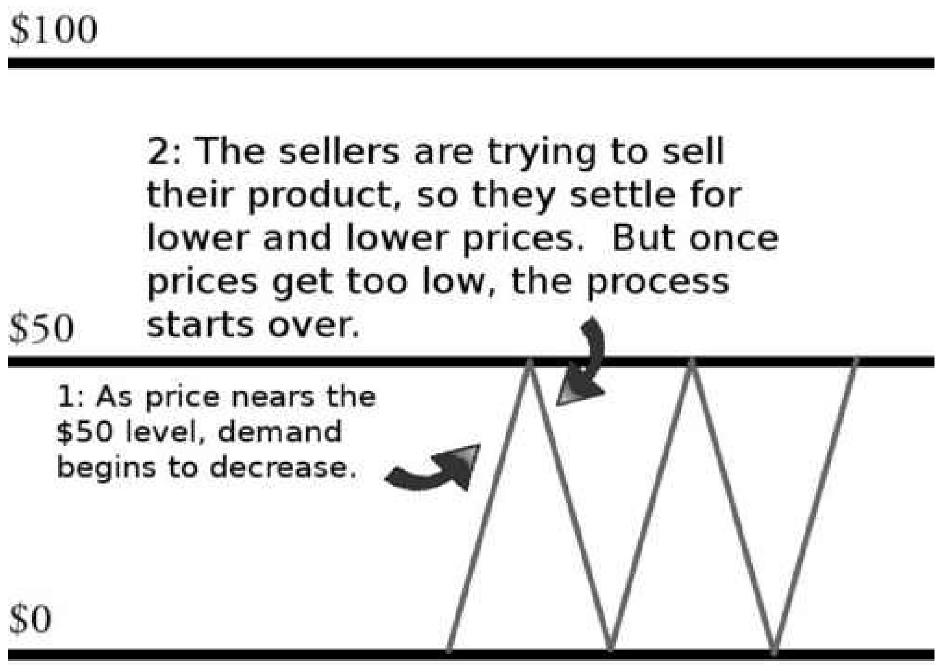
After the cheapest widget reaches $50 the buying seems to stop. Through demand the buyers drove the lowest price of widgets up to $50, but it turns out that people aren't willing to pay more than that, so the demand shrivels up and the widgets priced $50 to $100 just sit there.

What do you think all the widget sellers that really want to unload their merchandise are going to do now? Are they just going to close up shop because people won't pay $50 for a widget? No, they lower the price of their widgets until buying starts back up again, and the whole process repeats itself.

What has happened is that the demand for widgets drove the price up, then they became too expensive. Then an excess supply of widgets drove the price back down. This is, basically, what moves Forex prices.

Price Waves

This constant movement between excess supply and excess demand is what causes Forex charts to move. This movement happens in waves. In the following picture we can see a good example of a price wave. Realize, of course, that this is a simplified example. In the real world price doesn't bounce directly between two levels quite so cleanly.



So different levels of supply and demand are what cause the price of a currency pair to move, but what causes the supply and demand levels to fluctuate? The number of people wanting to buy or sell the currency, of course! If most people want to buy then the demand (and the price) is going to go up, but if a lot of people want to sell then the demand (and again, the price) is going to go down.

If this is still confusing to you then just remember, the Forex market is no different than an auction. If you have one extremely sought-after classic car up for auction, with an audience of dozens of buyers (excess demand), then as the auction progresses the price of the car is going to go up. People really want that car, so they will keep bidding against each other at higher and higher levels until the price starts getting too high for the buyers (demand is now diminishing).

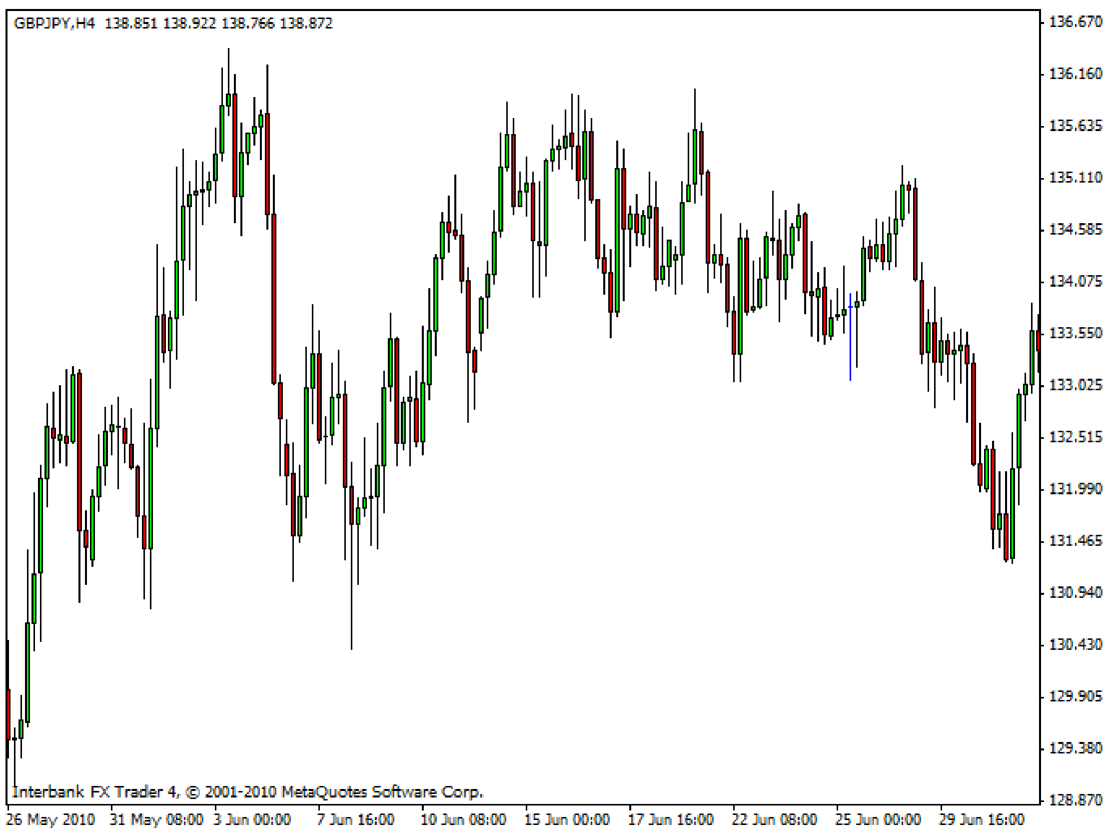
But what if the situation were reversed, what if you had the same car up for sale, but only one or two buyers came to the auction? Do you think your car would still fetch a high price? Probably not, since the demand is so low.

The fact that Forex prices move based on supply and demand makes our job as traders easy! All we have to do is figure out when a lot of people are going to want to either buy or sell a particular currency pair. This is easy to do because, as we've seen, prices move in waves, and waves are repeating patterns. It's also easy because human action is driving the market, and human beings are very predictable creatures!

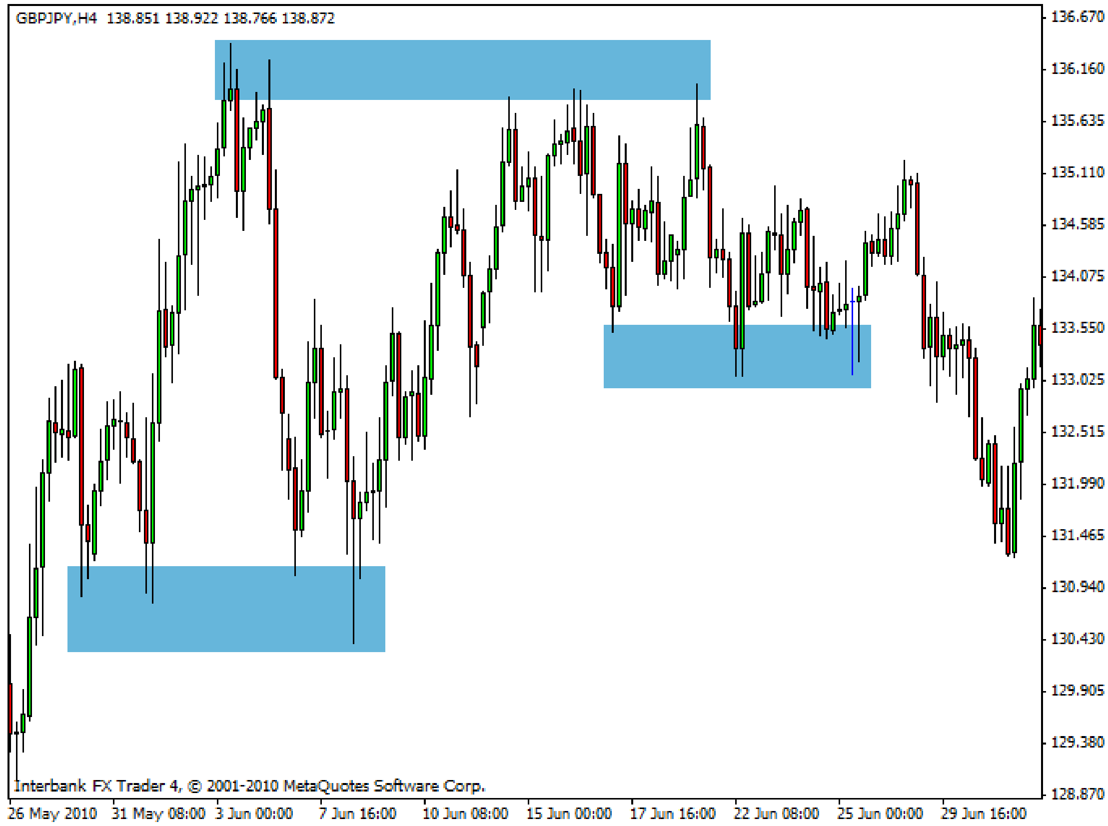
Is Forex Random, or Predictable?

People don't like chaos. We like for things to be neat, orderly, and predictable. So if humans are controlling the Forex markets through their buying and selling actions don't you think some kind of order and predictability would arise?

Take a look at this Forex chart, do you see randomness, or a predictable pattern?



If you only see random movements, it's because you are not looking at the chart with a repeatable pattern of supply and demand in mind. Let's color in a few areas of our chart to make the pattern easier to see.

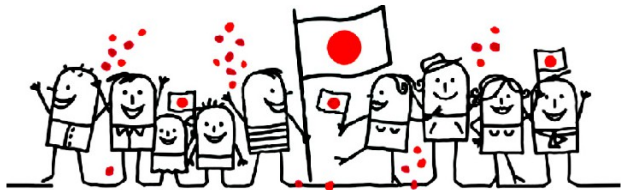


Twelve of the 26 price waves on the chart changed direction inside the blue shaded areas! This is a remarkable thing, and is the basis of the Smart Money Forex trading method. In fact, there are a total of 4 Smart Money trading signals on this chart, and all 4 were successful, profitable trades that I personally traded.

If Forex moves were random then we would only expect about 8% of the price waves to be in the blue boxes, since the boxes account for 8% of the chart's area (yes, I measured them). In reality, that small 8% area accounted for almost 50% of the price waves.

If you're familiar with Support and Resistance levels then you can probably tell that's what these blue areas on my chart actually are. These Support and Resistance (S&R) levels are the foundation of my trading method, but we need to cover a few more things before we continue on to exactly how to use them. Next we'll need to learn about candlesticks.

Chapter 4: Candlesticks Made Simple



God Bless the Japanese… They've given us some great inventions, like DVDs and the Nintendo. They've also given us some not-so-great ones like Karaoke… Thankfully somewhere in the middle of these is an invention that changed the financial markets forever: Japanese Candlestick Charts!

I know candlestick formations and patterns can be confusing, but don't worry. You don't need to memorize dozens of candle patterns with hard-to-pronounce Japanese names in order to trade. All we need are three basic candle concepts… Long Wicked Candles, Inside Bars, and Outside Bars.

Long Wicked Candles

Long Wicked Candles (LWC) are just what they sound like, candles with long wicks. I've circled some LWC's on the chart above. Notice that almost every time price changes direction we see a LWC? Long wicks pointing in the direction of a price movement can signal that the movement is coming to an end and price will be changing direction.

Now I know what you're thinking… "But Phil, there are long wicked candles all over that chart, and they aren't just in the places where price is reversing!"

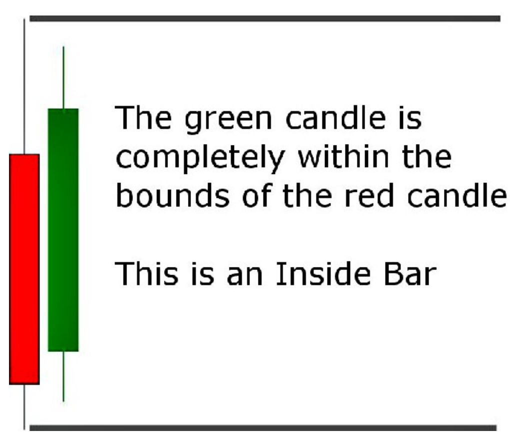
You're right, but remember we aren't basing trades off these LWC's by themselves. They are simply one tool among many to help us find price reversals. You should never take a trade based off a LWC by itself! We need to use them along with all the other tools we're going to learn later.

Speaking of those other tools, let's move on and learn about Inside & Outside Bars.

Inside Bars

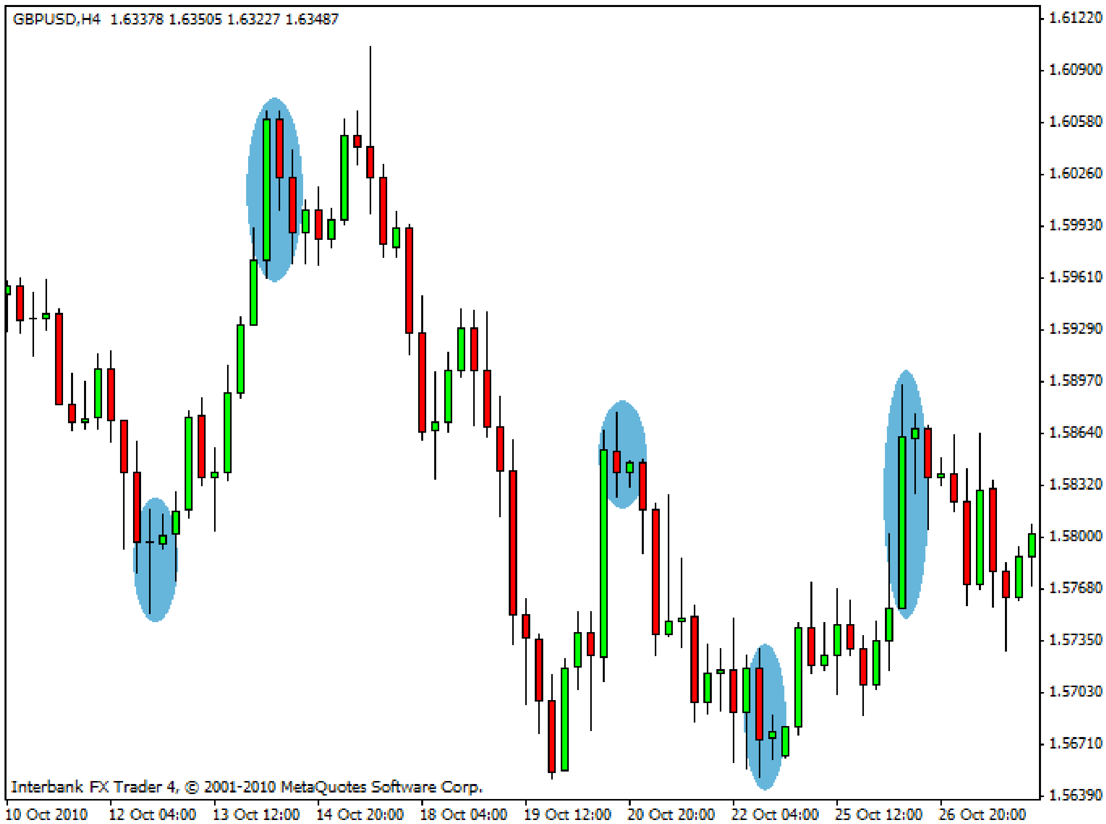
Another type of candlestick we're going to be using is the Inside Candle, also known as an Inside Bar, or IB. Even though the majority of people trading Forex today use candlesticks on their charts and not bars, the common name for this formation is still "Inside Bar," so that's the term I'm going to use.

An IB formation is one candle that is completely engulfed by the previous candle. Here is an example:



Notice how the top of the green candle is under the top of the red candle, and the bottom of the green candle is above the bottom of the red? This is an IB. An IB is the same type of signal as a Long Wicked Candle. In fact, the first candle of the IB formation will often be a LWC.

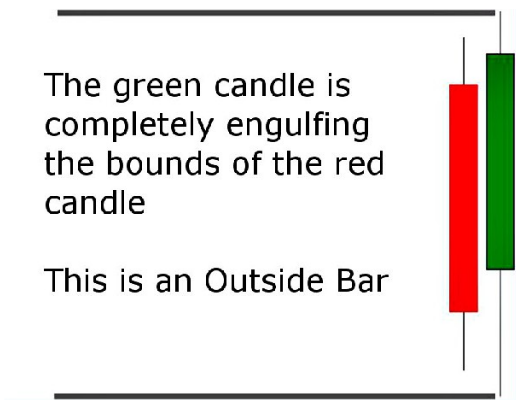
Just like LWC’s, IB’s can tell us that a possible reversal is coming. Here’s a chart with some IB’s circled. Notice how the IB’s are at the top of the price waves, just before price reverses and moves in the opposite direction.



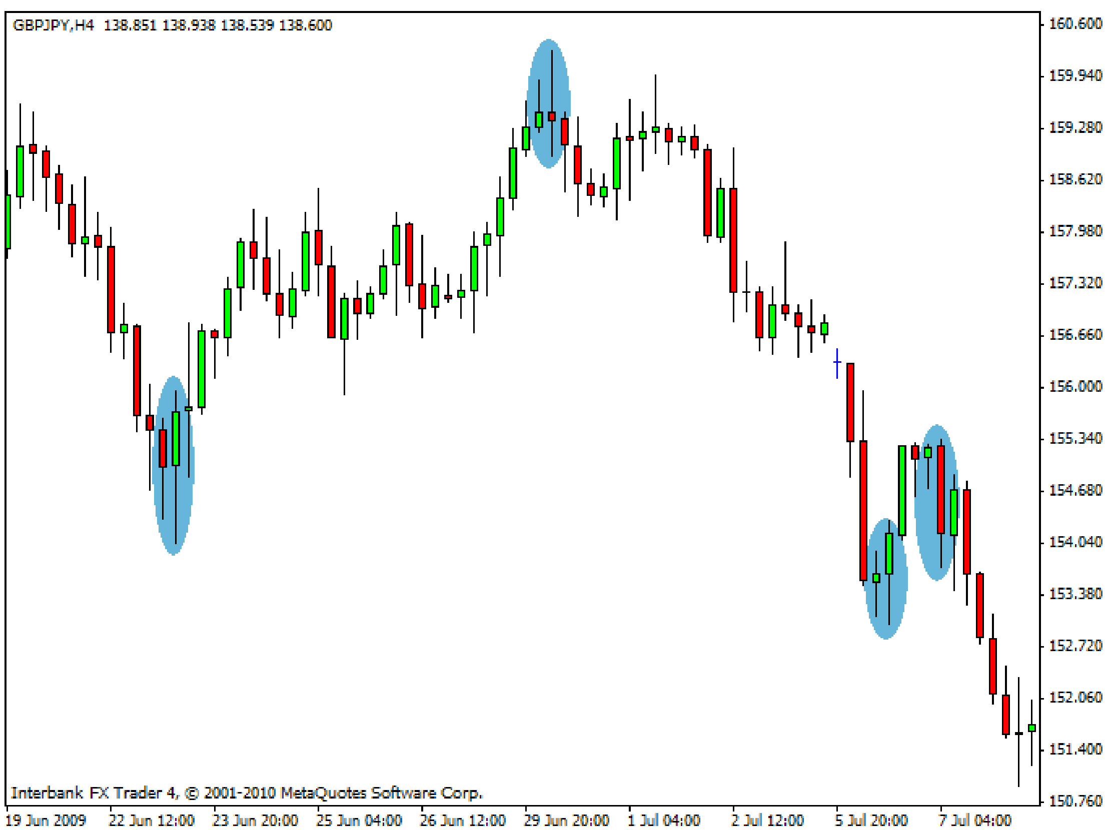
Remember, just like LWC’s we’re not taking any trades based off IB’s alone, they are used in conjunction with LWC's and the other signals we’re going to learn in later lessons.

Outside Bars

As you might have guessed, an Outside Bar (OB) is the exact opposite of an Inside Bar. In an OB formation the second candle has a top that is higher than the first candle, and a bottom that is lower than the first candle.



An OB is also a possible reversal signal, with a slight twist… It can also be a continuation signal, showing us that price will continue to move in the same direction! How do we know the difference? By the direction (color) of the candle. With OB's the price will ***usually*** continue moving in the same direction in which the OB closed.

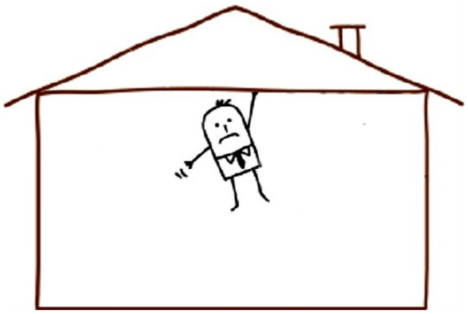


Remember, with OB's it is vital that you watch the color of the candlestick. If we are in a downwards trend of red, bearish candles then we are looking for a green, bullish OB to signal a reversal.

That's all we need to know about candlesticks! I told you it would be easy. Now we can move on to the foundation of my method, Support & Resistance.

Chapter 5: Support and Resistance

Understanding Support and Resistance is essential if you want to successfully interpret Forex charts, but before we even begin let’s define the terms Support and Resistance, just so we have a clear understanding of what they are.

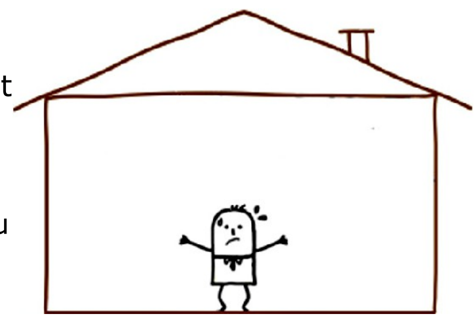


RESISTANCE levels exists above the current price, and act as a barrier to the price increasing above that level.

Imagine you were inside your house and tried to jump up through the roof. You would encounter resistance from your ceiling, and it would be very hard to break through that resistance.

SUPPORT levels exist below the current price, and act as a barrier to the price falling below that level.

When you fall back down from your previous jump you will encounter support from the floor when you hit it. You would have to do a lot of stomping to break through the support of your floor!



So why is it important that you know where the current support and resistance levels are? Because support and resistance levels are places where price direction can possibly bounce and reverse, or break through and take off like a rocket! So if you know ahead of time where they are you can use them to enter trades.

Now let's learn how to find these levels!

Plotting Support and Resistance

It's actually pretty easy to draw S&R on your charts, it just takes practice to get good at it. You just need to find and mark areas on your chart that price has had trouble breaking through in the past.

Let's look at an example. Here is a plain Forex chart…

Looks pretty boring, doesn't it? Now lets color in the area of resistance on the next page.

The blue area on the chart above marks a very strong area of resistance. I call these areas S&R zones.

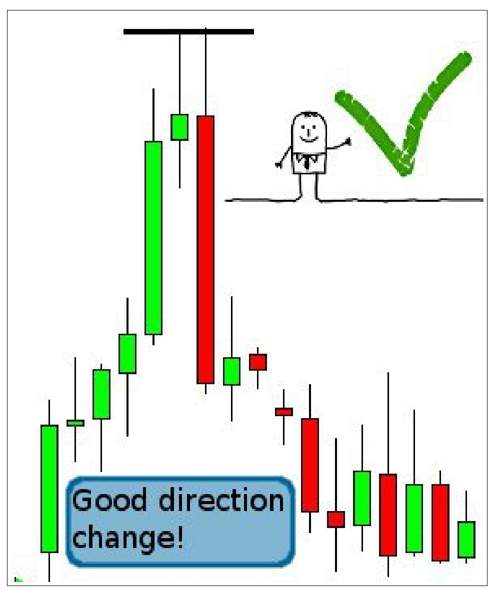
We have 5 major price swings that have highs inside this S&R zone. Every time price goes into this zone, it bounces back down!

Below is the same chart, zoomed out so you can see what happens later and with an area of support added. You can see that almost every time price gets down to this support level it stalls out and reverses, or breaks through and drops like a rock! On the next page you can also see that areas of support can later become areas of resistance.

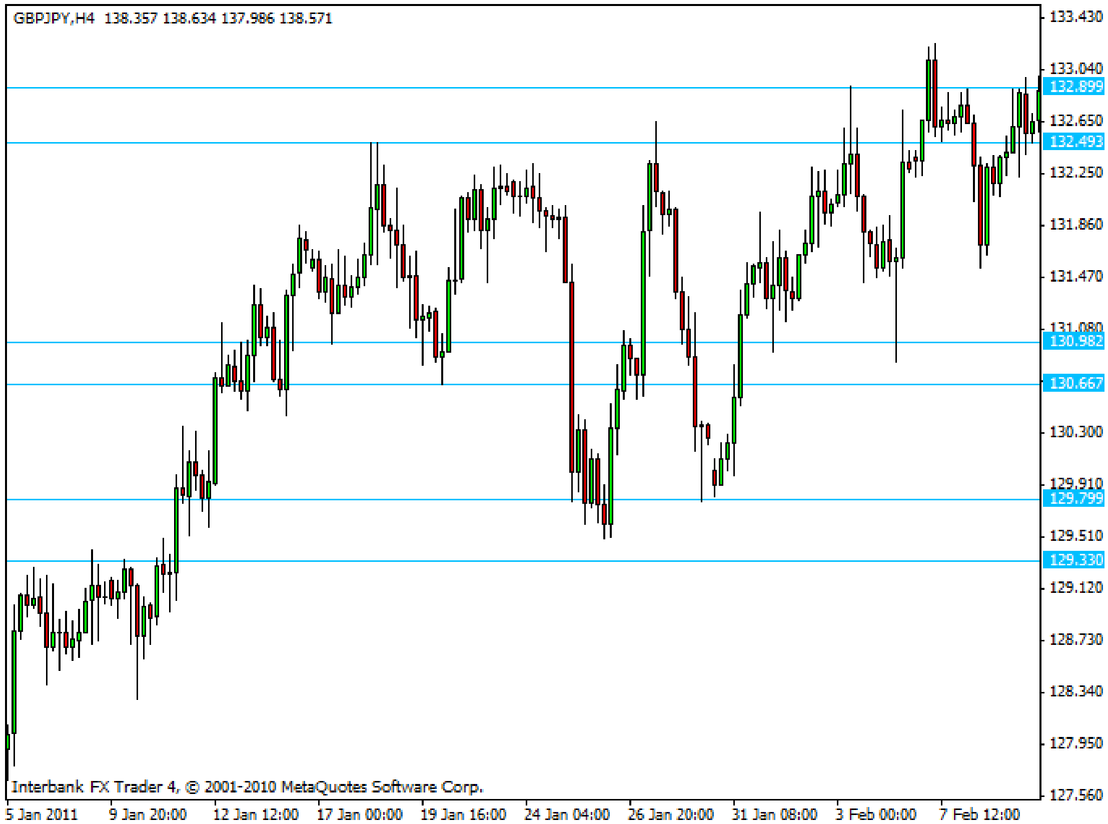
You may have noticed that I'm using what I call S&R zones, and not single S&R lines like a lot of other traders. Lines tend to be too rigid for me, because prices rarely bounce directly off a certain line. A zone is a much more realistic representation of S&R levels.

Now before we can take any trades we have to get our charts ready by drawing in our S&R zones. As a new Smart Money Forex Trader this is going to be the hardest part!

The thing to remember is that we are looking for areas where there has been a major price reversal, not just places that individual candles have touched.



Here is a GBP/JPY chart with S&R zones drawn by using lines in MetaTrader 4. This is exactly what the charts that I trade look like.



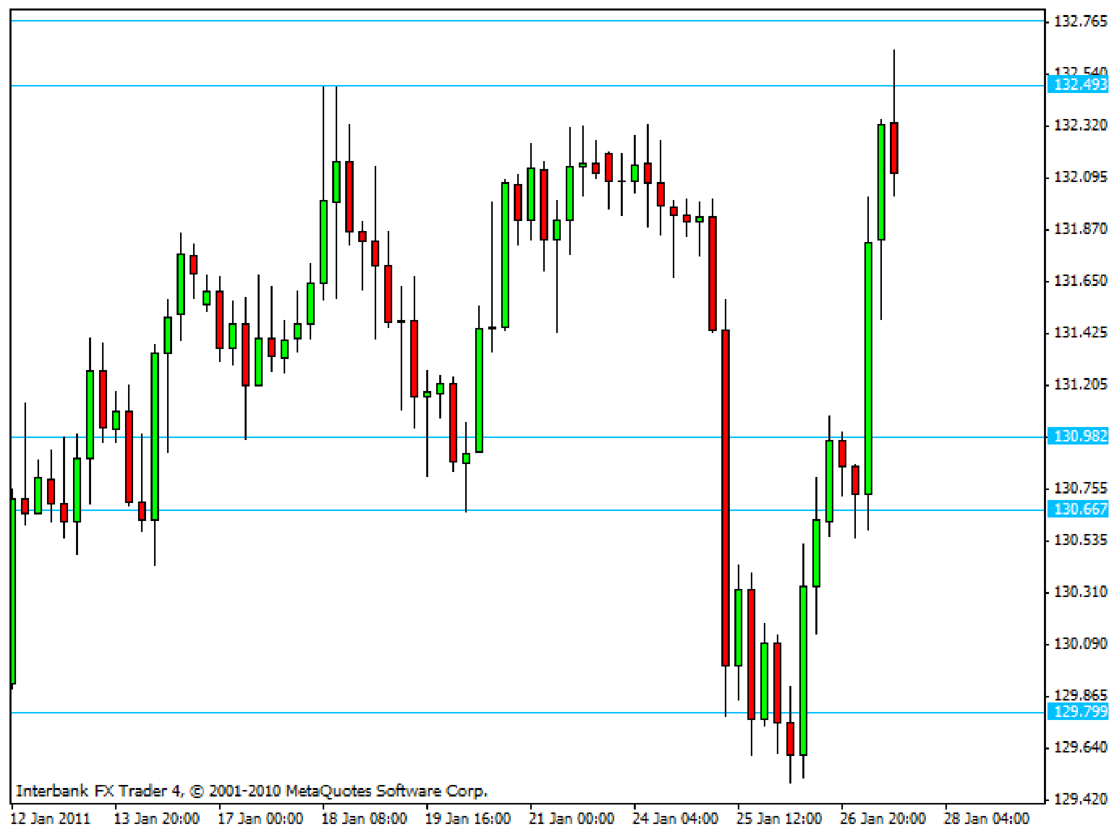
There are 3 S&R zones on this chart. You'll notice I don't color in the zones on my actual charts. Doing that makes the screen to cluttered for me, but you can do it if you wish.

After I get my lines drawn on my chart it's just a matter of waiting for price to enter an S&R zone and give us a reversal signal.

Next we'll see some examples of how we actually uses these S&R zones to trade.

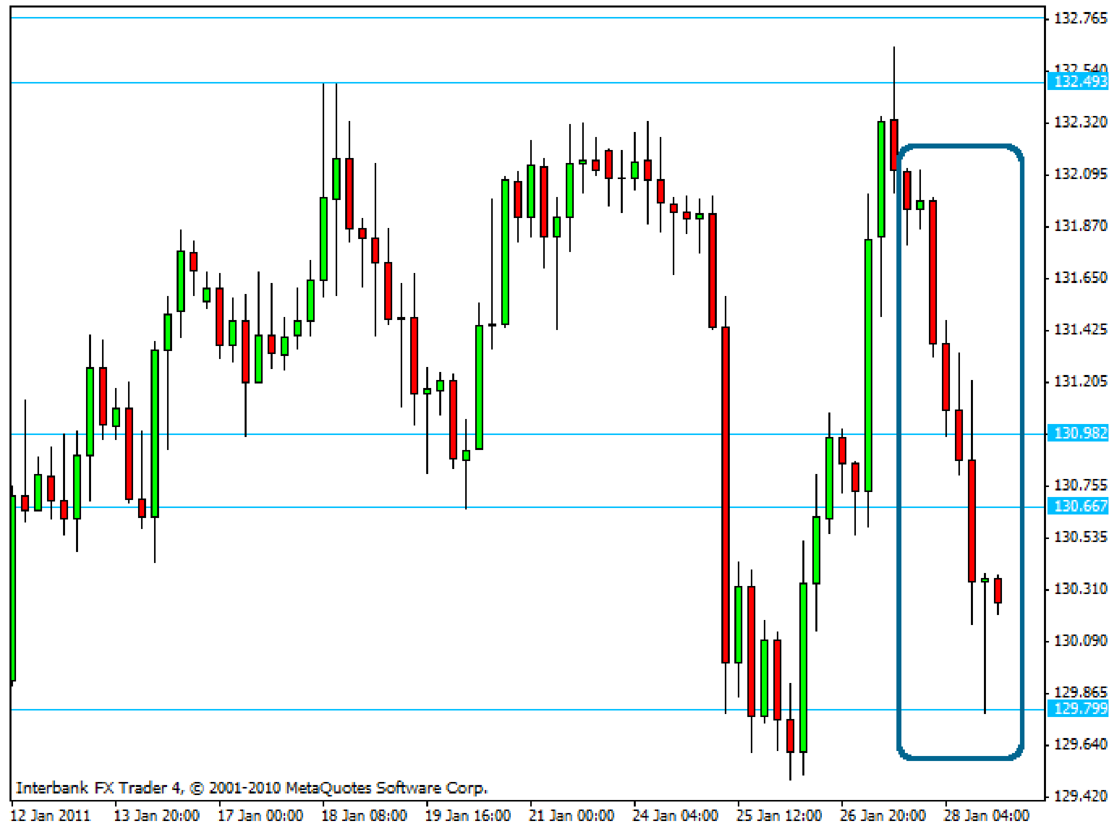
Support & Resistance Trade Examples

It's time to point out our first Smart Money Forex trade! Let's take a look at a new chart, this time with the last few candles erased so the chart looks like it would if we were watching it live. I've already marked the S&R zones for you.



Remember those candles we learned about earlier? Our knowledge of Long Wicked Candles, combined with this S&R zone, show us a trading opportunity.

Can you see it? We have a Long Wicked Candle that has bounced off a S&R zone. These two things tell us that price is probably going to reverse and start going down!



As you can see, we were right... Price immediately reversed and dropped like a rock!

We'll learn how figure profit targets later (and stoplosses), but for now what do you think we should do with this trade? Hold on to it in case it goes lower, or close it out? If you said close it out, you're right! We have a Long Wicked Candle, an Inside Bar, and the price has bounced off the lower S&R zone. All those things mean the price is likely to reverse again. We'd better close this trade and bank our profits!

Or better yet, since we are seeing signs of another reversal, bank our profits and take a new trade in the opposite direction.

Let's see what happened…

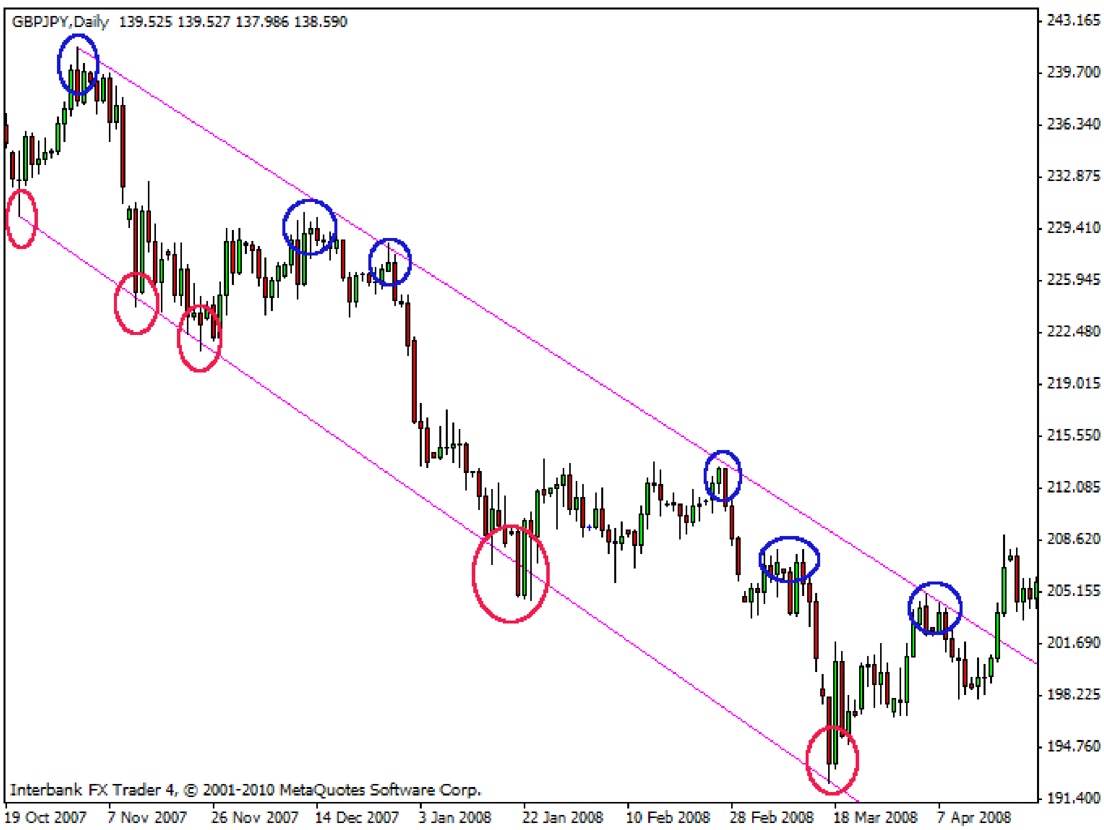
We were right again. The price reversed and moved back up to it's previous level.

So is that the whole Smart Money method, just trading bounces off S&R zones? Not at all! You need to have a lot more tools in your toolbox. Let's learn about another important one, the trend and the trendline.

Chapter 6: Trendlines

Anyone who's been trading for any time at all has heard the phrase "The trend is your friend," but what exactly is a trend, how do we find them and how do we use them?

A trend is nothing more than a series of higher highs and higher lows (or lower highs/lows for a downward trend). The following picture is a GBP/JPY daily chart. I've marked the trend with two purple lines, and I've circled the significant high/low points of the trend. Notice how the high points I've circled in blue keep getting lower and lower, and how the low points circled in red also keep getting lower?



This is also a good time to learn a little Forex terminology. In case you don't already know, those two purple lines are known individually as "trendlines," and together the two lines form what's known as a "trend channel." The circled highs and lows are called "swing highs" and "swing lows."

With your new-found knowledge of S&R zones how do you think we might use trendlines to trade? We use them just like S&R and trade reversals off of them. In fact, it would be very accurate to describe trendlines as diagonal S&R zones.

Trading With Trendlines

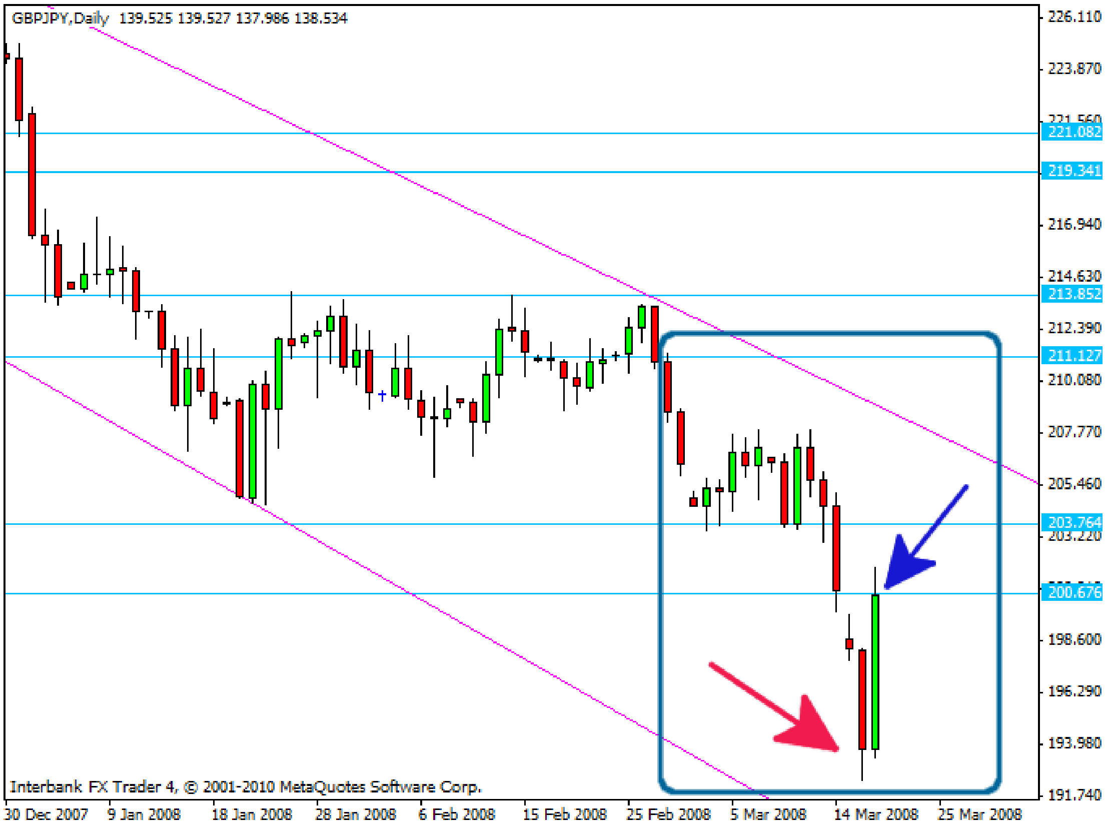
Let's erase some candles and look at that same chart as the last page, but as we would have seen it live. We'll also add in our S&R zones, which should be on our charts at all times.

You might notice a small change to the lower trendline on this chart. Since we're showing the chart as we would see it live the bottom trendline has moved up slightly from where it was in the previous page's chart. Trendlines, as well as S&R lines, will move slightly over time as we get new information. In the future this trendline will move up about 20 pips, but for now it is 100% accurate.

We don't have any Long Wicked Candles or an inside bar, and technically we don't have an outside bar either, but if you look closely this candle is literally 1 pip away from being an OB. We professional Forex traders call that "close enough" and treat it like an official OB (remember this is an art, not a science).

In addition to the candle being an OB we also have a trendline bounce that is inside an S&R zone. And even if we didn't have the OB and we were missing any candlestick reversal signals this would still be a great trade opportunity. We don't have to have every possible reversal signal, just enough to know the trade is very likely to be successful.

So the signals we have tell us that price is going to reverse and go down, so this is a good trade! Let’s see what happens.



Price did fall, just like we expected it to. The best place to exit this trade would have been on the red candle marked by the red arrow, but there’s no way we could have known that at the time. Price has not yet gotten close to the lower trendline, so we would have been expecting the trade to go even further.

But that didn't happen. Price moved back up and caught resistance at the S&R zone, so this trade would have been exited near the blue arrow. It was still an excellent trade, even though we lost a little profit at the end.

You can now see how we’ll be using trendlines in our trades. They are nothing more than diagonal S&R zones and are traded exactly the same way. Next we’ll take a look at predicting when a trend will end.

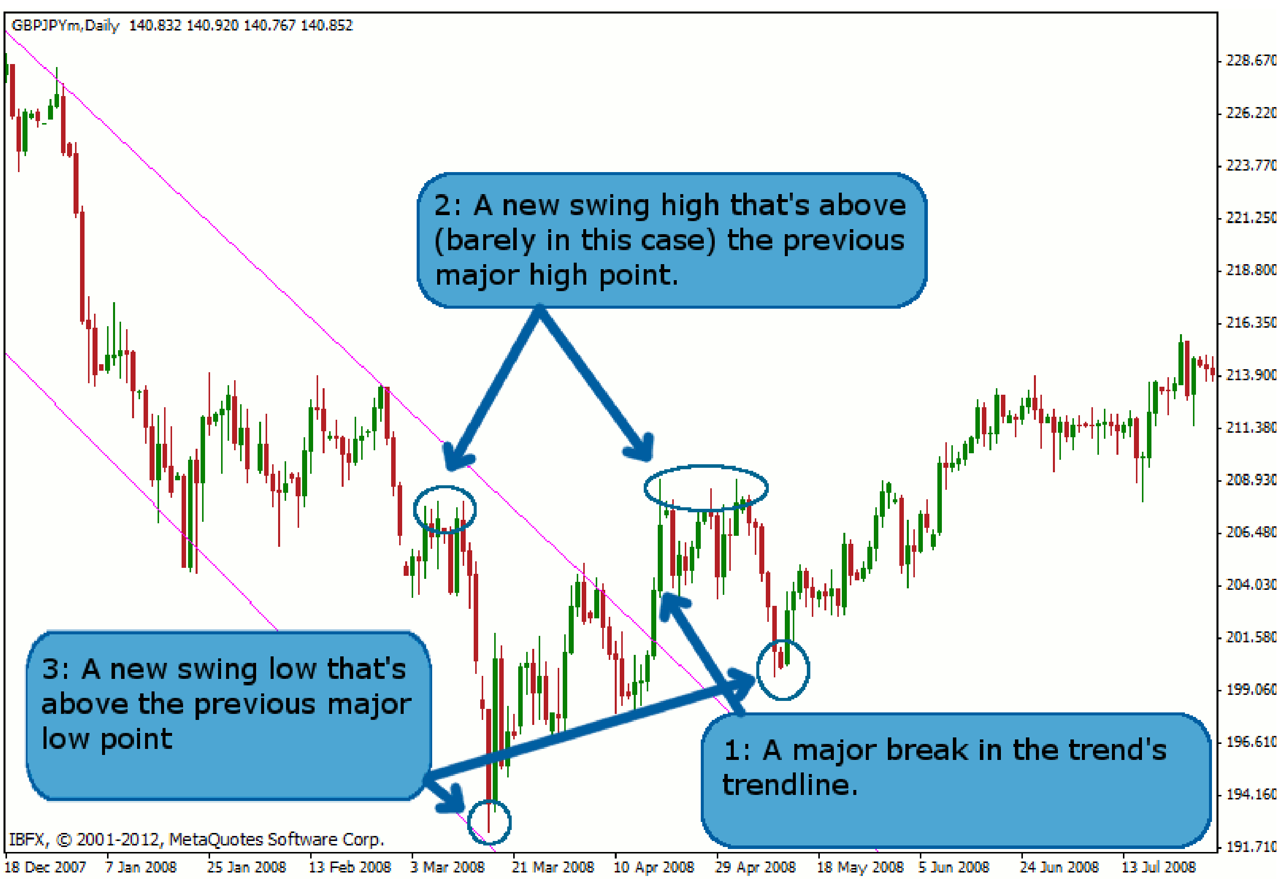
Predicting Trend Changes

When the pattern of lower highs and lower lows stops it means the trend is coming to an end, and that a new trend may be beginning. Here are the three things to look for that signal the death of a trend.

1: A major break in the trend's trendline.
2: A new swing high that's above the previous major high point.
3: A new swing low that's above the previous major low point.

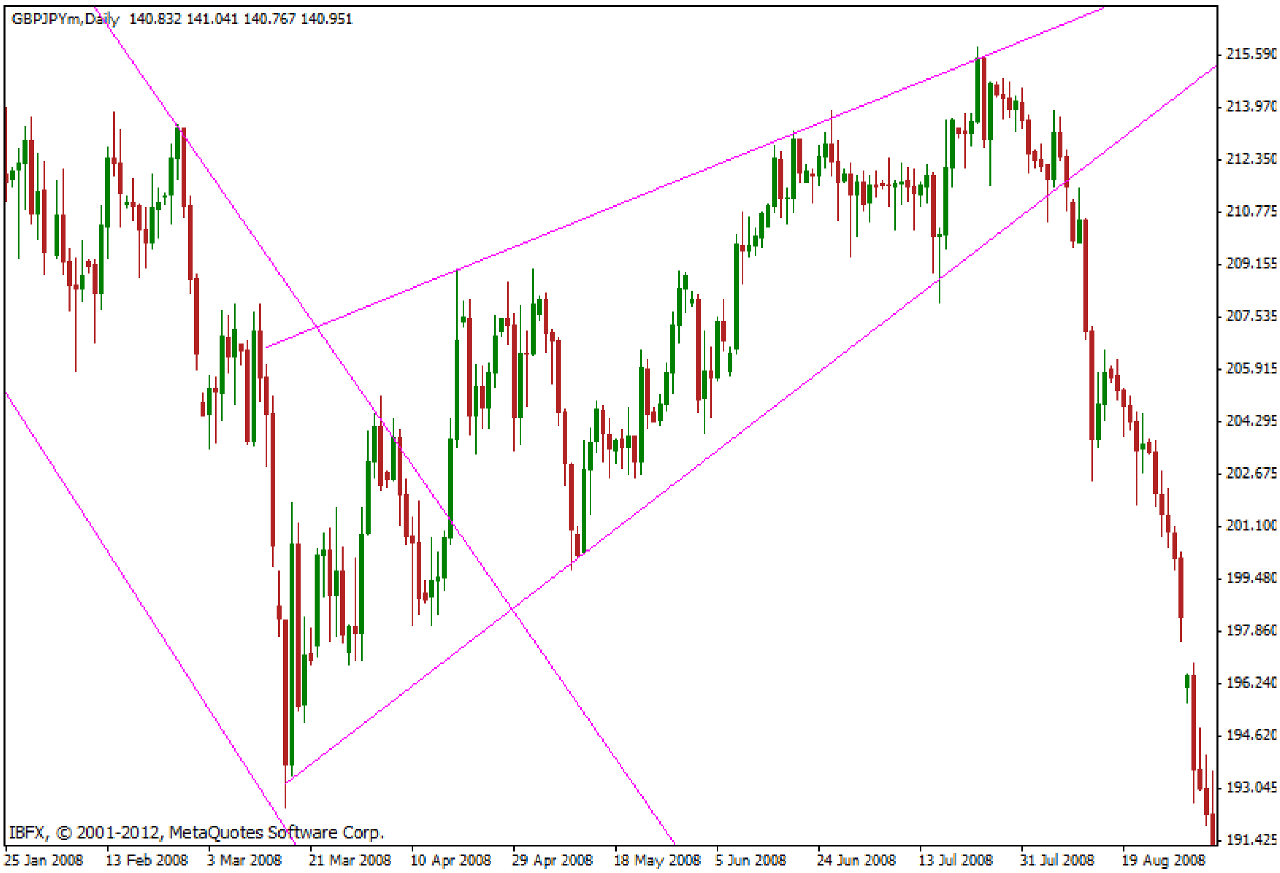
This example is for a downward trend, an upward trend would need to use the opposite of steps 2 and 3.

Here is a chart that zooms in on the end of our previous example trend and shows these 3 things.



All 3 criteria have been identified, so we can safely say this trend is probably coming to an end and a new trend is beginning.

In the chart below we can see that our signals were correct. The old downwards trend ended and a new upwards trend began. It did not last very long, however, and you can see the same 3 signs again at the point where the new trend ended. See if you can pick them out.

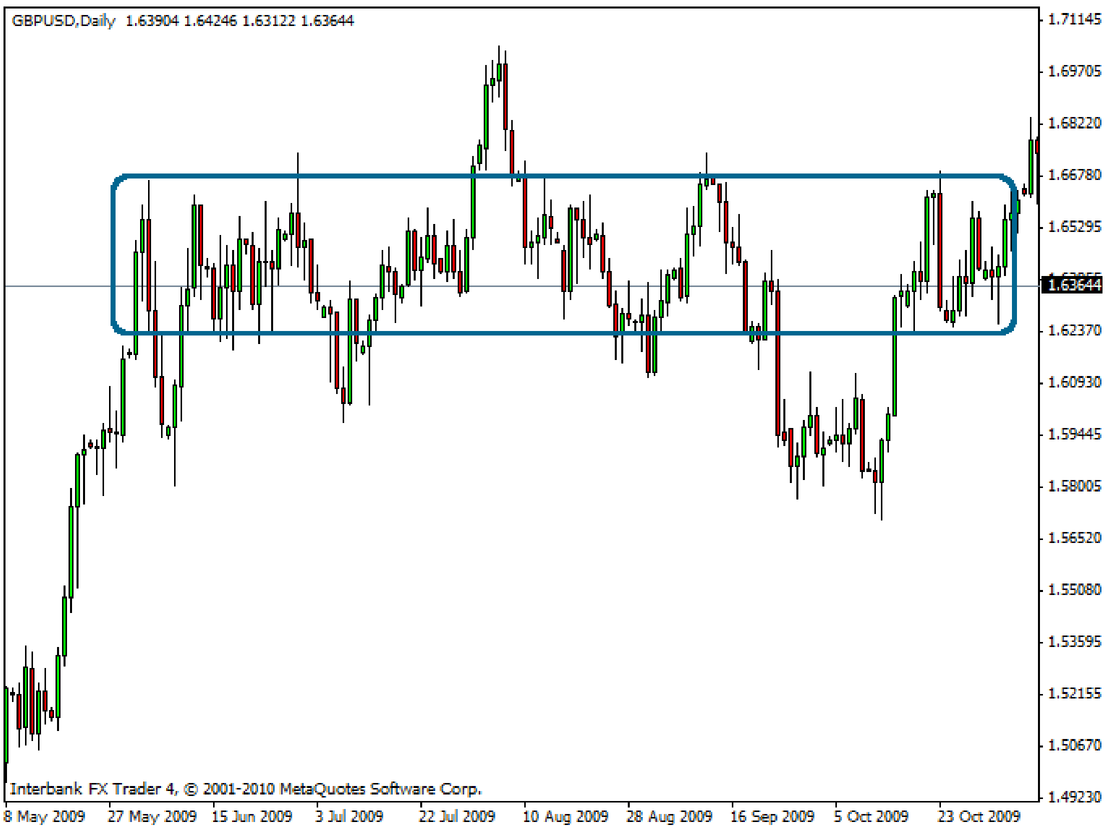


The idea is to know when trends are dying, so you don't take bad trades at the end of a trend. Even if all the other trading signals are there you don't want to get stuck in a trade when a trend is changing!

Ranges vs. Trends

It's important to realize that charts aren't always trending. A lot of times the Forex markets will be "ranging," which means that they are going sideways instead of in an up or down trending motion.

Let's look at an example…



For 5 months the price really didn't "go" anywhere. It just moved back and forth around the same level.

Ranging markets are good opportunities for trades based on S&R zones, but they are terrible for trendlines (since there are no clear, strong trendlines in a ranging market). If you try to force trendlines on your chart where none exist, you're 100% guaranteed to enter a losing trade.

Now let's take a look at a strong trending market.

So what's the point of all this? It's to illustrate the point that you should not look for trendlines in a ranging market. If you do, you're 100% guaranteed to enter a losing trade.

Now let's go over one more important thing before we learn how to put it all together and start trading. First we need to learn when NOT to trade.

Chapter 7: When Not To Trade

Forex markets are pretty predictable, but sometimes things throw a monkey-wrench into that predictability. Before we learn how to start taking trades let's learn when NOT to trade.

The News Can Kill You

One of biggest things that can mess with the Forex markets is a major news release.

There's only one thing you need to remember about major news releases, and that's not to trade when one is coming up!

Be careful here, because you’ll notice I said **major** news releases. There are low-impact news releases all the time, and I completely ignore them!

When I say major news releases I mean things like the U.S. Non-Farm Payroll (NFP) report, major economic announcements by the Fed or world leaders, and things like that. What I DON’T mean are all the little news events that happen every day. Yes, I know that a lot of the online Forex calendars mark them as important news events, but they really aren’t.

The only way they would have any significant effect on you is if you were trading really small timeframes, like 5M or 15M charts. If you never trade anything under 4H charts the 10 pip spikes from small news releases will have a minor effect on your trading, but it will even out over time. You might lose a trade because price suddenly dropped 10 pips based on some small news event, but you are just as likely to win a trade (or exceed your profit target) for the same reason!

Over time the light news will help you just as much as it hurts you, so why bother messing with it?

Holidays & Weekends

Holidays are usually a time for celebration, but not when it comes to Forex trading. Holidays are dangerous because of reduced trading volume. Big bank traders that work on huge trading floors make up over 80% of the Forex market, and when they stay home and aren't trading it can cause the market to do some weird, unpredictable stuff. Never trade on a major holiday!

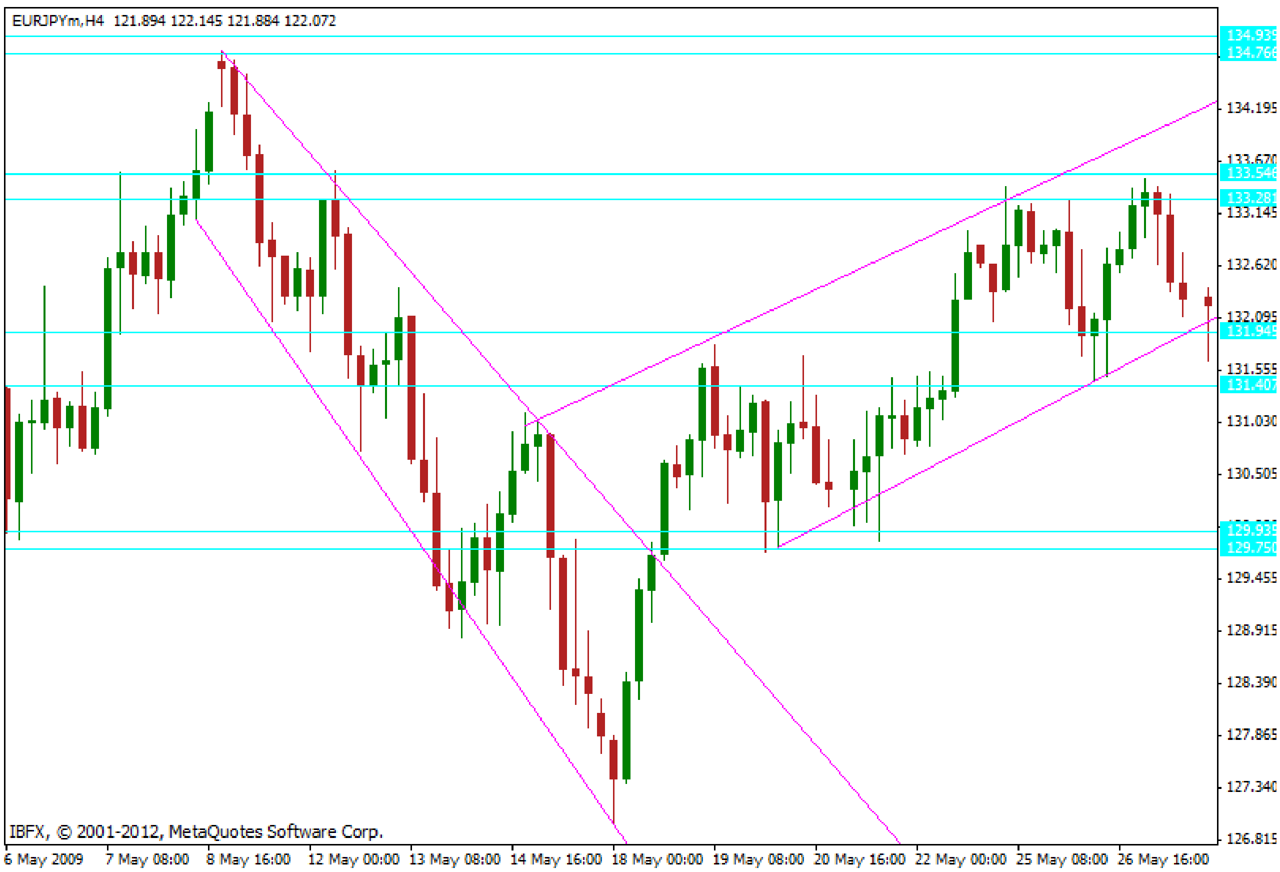
Other days that are off-limits are weekends and Friday after 12:00 GMT. Weekends are usually not a problem, since most online brokers won't even let you trade on weekends, but you should skip Friday afternoon as well. Those big bank traders like to close out their profitable trades on Friday afternoon, and that makes the market unpredictable since trades are being closed outside of the normal supply/demand cycle.

Now that you know when not to trade it's time to learn how to actually place trades, including planning your trades, setting stoplosses and profit targets.

Chapter 8: Entries, Exits & Stoplosses

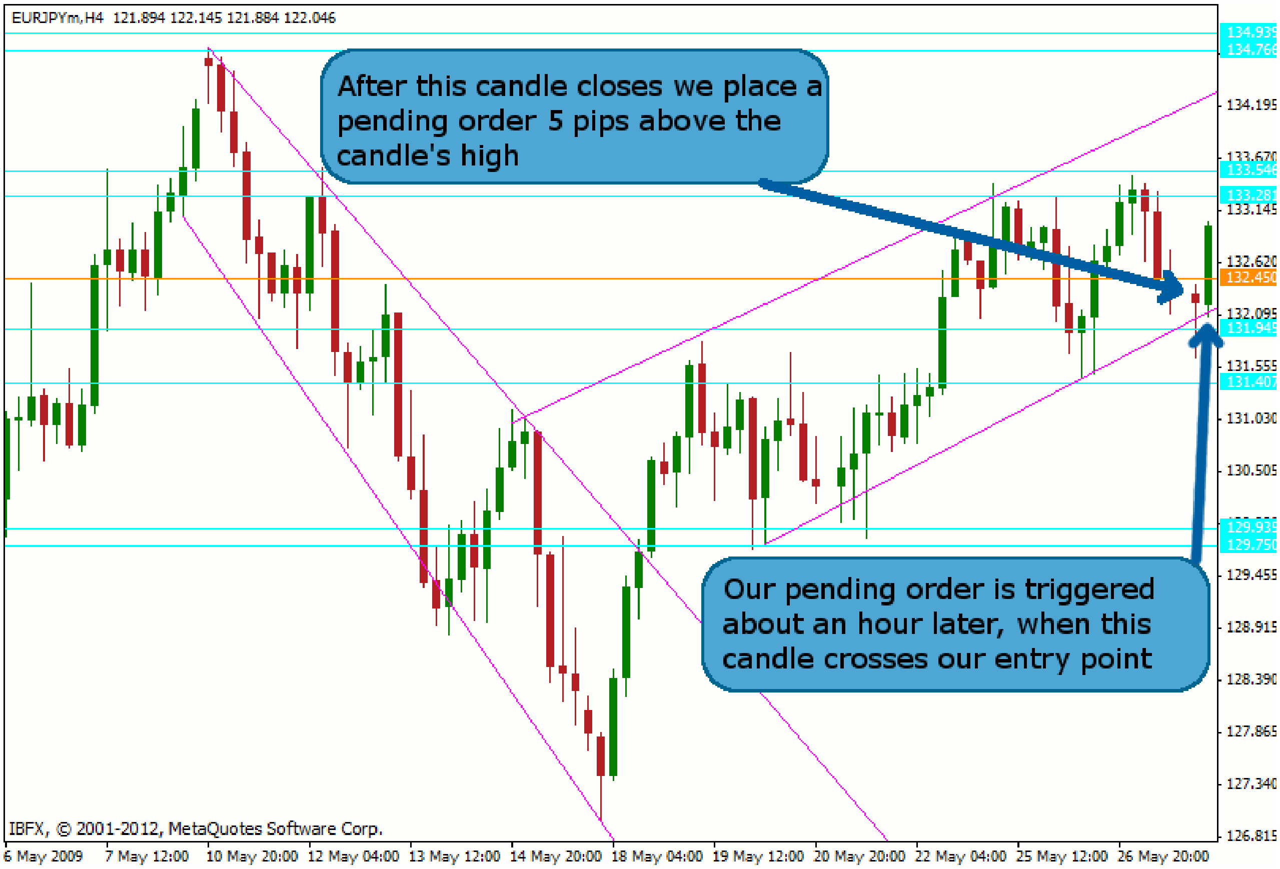
So you've found the perfect trade setup, now how do you actually trade it?

The first step is to plan your entry. Let's use the following chart to practice… It's a EUR/JPY 4H chart with trendlines and S&R zones already drawn. Can you see the trade opportunity?



As you can see, the last candle on the chart is a Long Wicked Candle, and it has bounced directly off both an S&R zone and off a trendline. This makes it an excellent trade opportunity!

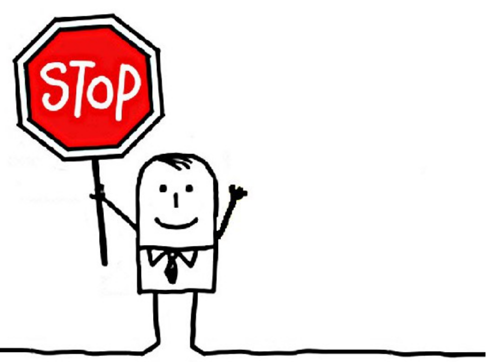
Before we enter we need to confirm that this is a valid price reversal. Even though all the signs of a reversal are there, we need to be safe and wait for the actual reversal to start. To confirm the price is reversing we want to set a pending order that will enter the trade automatically once the price moves a few pips above the red LWC that signaled the reversal. This pending order is represented by the orange 132.45 line on the chart below.



After the price breaks above that orange line our pending order will be triggered. That small 5 pip buffer above the previous candle is just enough to confirm that this is a good trade. Some people like to wait for the candle after the LWC to close, and you can do that if you want to be ultra-conservative, but if we wait for that we can miss out on too much profit!

Of course you won't be entering into any trades without knowing what your stoploss will be, so let's take a look at how we'd place our stop on this trade.

Placing & Protecting Your Stoploss

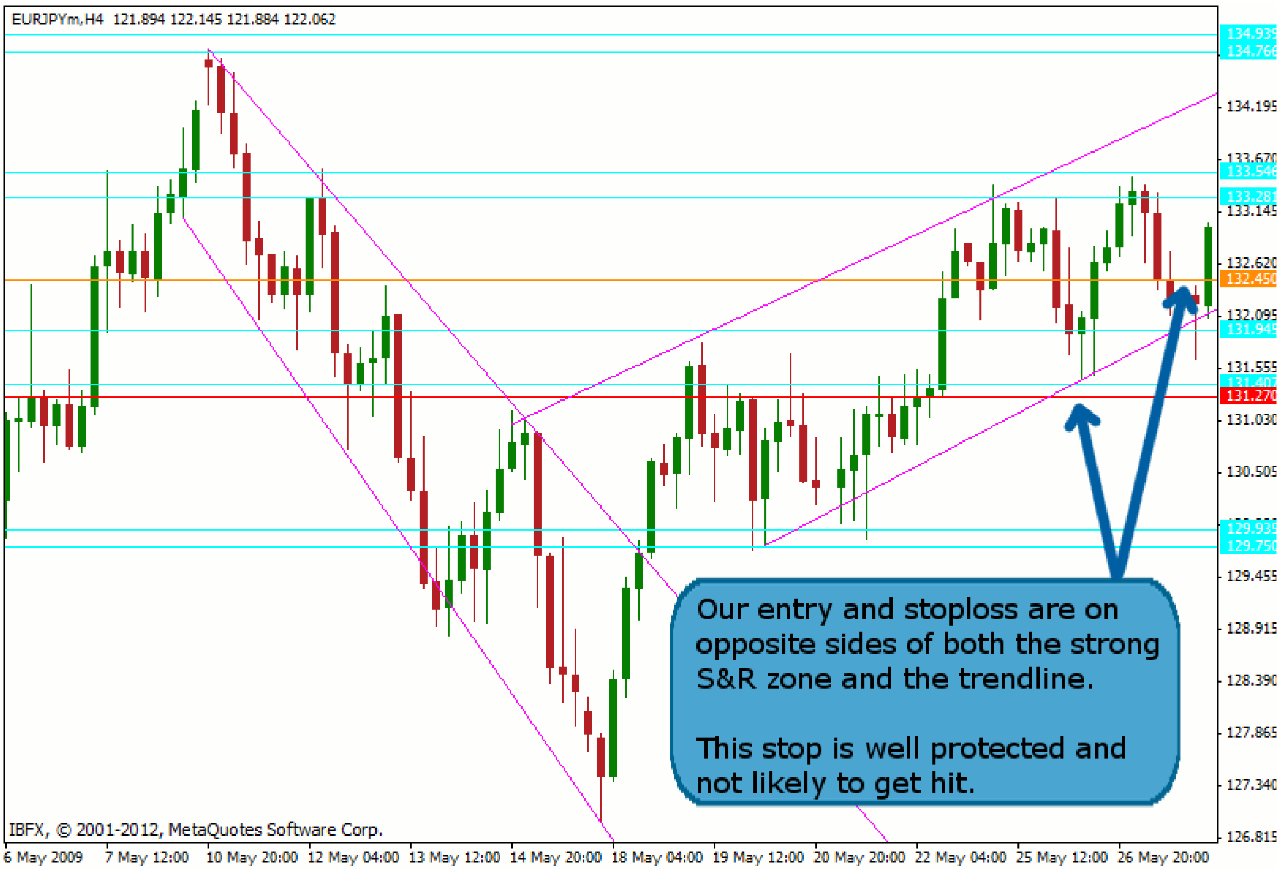


It's not enough just to place your stoploss a certain distance from your entry. We want our stop to be somewhere safe, in a place that is very unlikely to get hit. This is called "protecting your stop."

Fortunately, this is very easy to do!

On the trade above I would place my stop at

131.27. This price is on the opposite side of both the S&R zone and the trendline from our entry point (I've marked my stoploss with a red line on the chart below). You'll notice that if price did reach this stop level then we would have a lower low than the previous 131.46 low. This would mean our upwards trend was failing, and that the price is probably not going to go back up anyway, so it's a great place for a stoploss.



So we have our entry point and our stoploss, now let's move on to our profit target.

Selecting A Profit Target

Now for the most important part of the trade, selecting your takeprofit (yes, just like "stoploss" it's usually spelled as one word, and often abbreviated as TP).

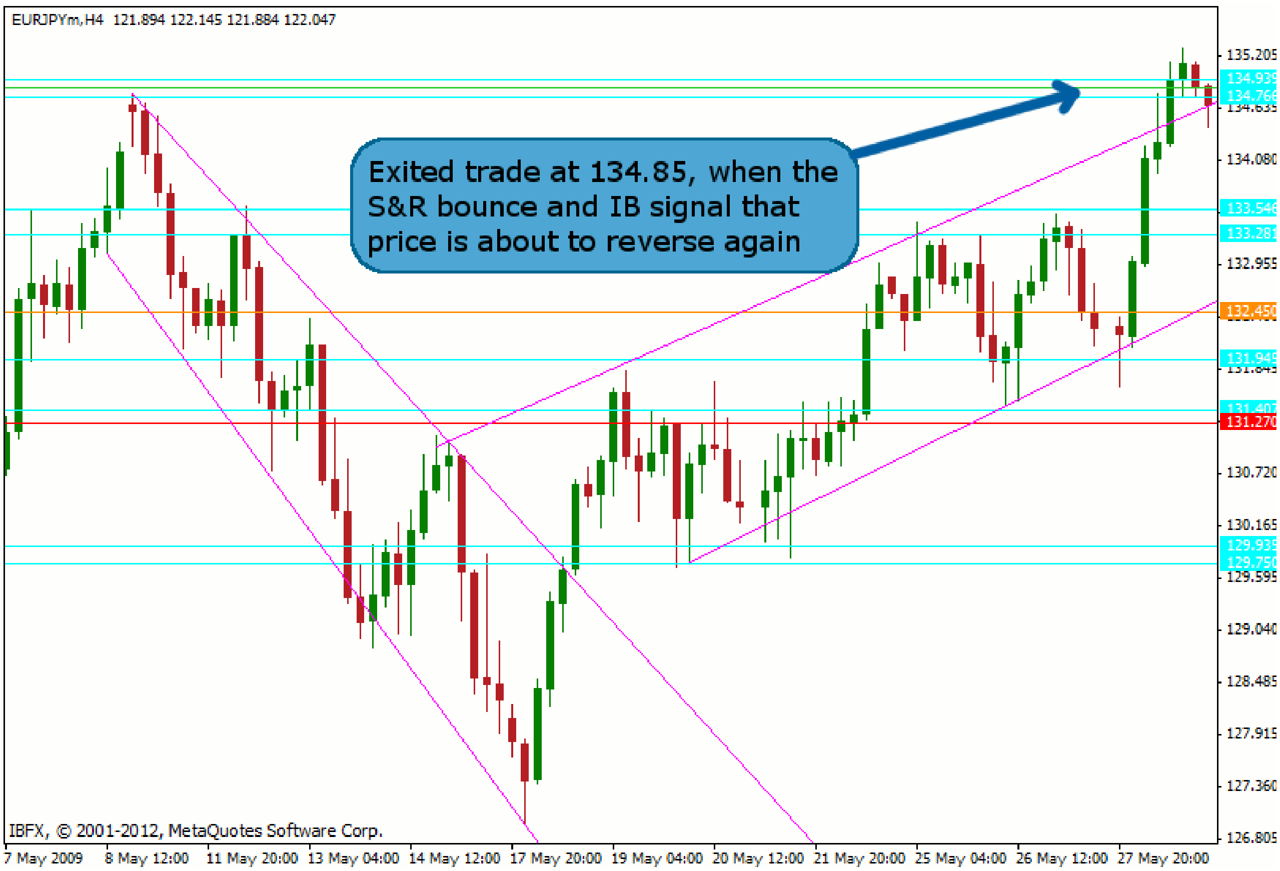
For a takeprofit level I would be watching three different areas, the first S&R zone (around 133.40), the area around the upper trendline, and the upper S&R zone (around 134.80). If the price started to reverse around either S&R zone or the trendline I would take my profit and be out of the trade, but if it moved through I would let it run!

If I had to exit this trade with an automatic TP (because of work, sleep, etc) then I'd set my TP level a little under the trendline. The lower S&R zone is too low to really consider it a profit target (if I had to get out here I would, but I'd consider that a failed trade, even though it made a little profit).

The upper S&R zone is too risky for an automatic TP. There's just too slim of a chance price will go that high, so if we're not around to watch our charts it's not a good TP level.

The safe bet for an automatic TP is a little below the trendline. You may lose some profit, but if you have a full-time job sometimes that can't be helped.

Let’s look at the chart after the trade is completed.



As you can see, the candle after our entry flew straight through the lower S&R zone, and the candle after that flew through our trendline. The IB that formed on the upper S&R zone is our signal to exit, since that's a reversal sign and shows the price is probably finished rising.

If you got out on the close of the IB formation you would have gotten 240 pips with a 120 pip risk, which means your account grew by 4%.

The End

Well, that's it! You're now a Forex trading machine... Or at least you will be after some practice.

Speaking of practice, remember to check out my website, SmartMoneyForex.com. You'll find a lot more information about my trading method there, including my weekly analysis videos, my blog where I post trade setups, and a forum to get all your questions answered.

Good luck in your trading,

Phil