

THREE LINES

Forecasting Forex Price Action



R. RANA

“The market does not know if you are long or short and could not care less. You are the only one emotionally involved with your position. The market is just reacting to supply and demand and if you are cheering it one way, there is always somebody else cheering it just as hard that it will go the other way”

- Marty Schwartz, Pit Bull

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“TO MY LOVELY WIFE AND TWO DAUGHTERS”

“Forex technical analysis using demand and supply strategy”

THREE LINES



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WORD/ABBREVIATION LIST

Australian Dollar (AUD)

Bank for International Settlements (and Triennial Central Bank Survey)

Bloomberg

Bretton Woods Agreement

British Pound (GBP)

Canadian Dollar (CAD)

Charles Collins

Charles Dow

CNBC

CNNMoney

Commodity Channel Index (CCI)

Dow Jones & Company

Dow Jones Industrial Average

Dow Jones Transportation Index

efficient market hypothesis

Elliott Wave Theory

Euro (EUR)

European Central Bank (ECB)

Federal Open Market Committee (FOMC)

Federal Reserve

Fibonacci

Financial Times

Forex

Fundamental analysis

FXCM

Japanese Yen (JPY)

Mario Draghi

Marketwatch

MetaQuotes Software

MetaTrader 4/5

Momentum Index

National Stock Exchange (India)

New York Stock Exchange (NYSE)

New Zealand Dollar (NZD) OK (computer button)

Online Trading Academy (OTA)

Purchasing Managers' Index (PMI)

Random walk hypothesis

R. N. Elliott

Relative Strength Index (RSI)

Smithsonian Agreement

Stochastic Momentum Index

Swiss Franc (CHF)

Swiss National Bank (SNB)

Theory of rational expectations

United States Dollar (USD)

Wall Street Journal

Yahoo Finance

INTRODUCTION

Just a few years ago, it was almost impossible for the average investor to trade in the foreign exchange market (Forex) online. It was the domain of corporations, large financial institutions, hedge funds, central banks, and very wealthy individuals. However, with the advent of Internet access to brokerage houses, it became easier to integrate financial trading platforms worldwide; thus today almost anyone can trade on foreign exchanges.

The Bank for International Settlements Triennial Central Bank Survey report on global foreign exchange market activity of 2013 showed that the daily turnover of Forex is about \$5.3 trillion. It is one of the largest financial markets in the world. Generally speaking, in Forex there are two actions, BUYING and SELLING, which lead people to either EARN money or to LOSE money. The end result a trader can expect is either financial success or financial loss.

Taking action to either buy or sell using a computer platform is very simple—almost everyone could do that. However, making money in Forex is not easy. The market does not move in a logical fashion. Emotions, greed, and wariness move the market. Therefore, you need to change your habits and have discipline to be consistently profitable over the long term. This book provides information in detail on how you can be successful in a Forex trading career. This book contains all the skills you will need to become a successful Forex trader.

This book will give you a clear idea of when to buy or sell, how protect yourself in case you make a bad decision, and to give you tips on when to get out. These parameters must be learned before you make your first trade. This book will help you to be a rule-based trader, not one overcome by greed or fear. I have tested this strategy on myself for almost five and a half years, and I am very happy with the result—and I have decided to share the approach in this book.

Before going into further details, I would like to mention that this book is for those “who like to trade using technical analysis.” Analysis of the foreign exchange market falls into two broad methods: technical and fundamental. Fundamental analysis looks at the price of a currency in respect to many factors that may affect it, including political stability, economic performance, interest rates, and a market development. On the other hand, in technical analysis, an investor studies the behavior of different indicators, such as momentum indicators, support and resistance levels, price indicators, statistical price, and oscillator indicators in order to predict a future price. These days, technical analysis is growing in popularity due to its accuracy and simplicity. I am not saying that a technical trader should ignore all fundamental analysis indicators, but any decision should be made based on a technical point of view rather than a fundamental one. In short, as a technical trader, a trader should be aware of fundamental factors, but act based on technical analysis.

WHY TRADE FOREX?

The objective of buying and selling currencies is to get profit in order to fulfill desires—whether they are personal or for social causes. I have met a fifty-three-year-old woman, for example, who was trading Forex to support a nonprofit company. Forex offers numerous of benefits, such as:

- The market is open twenty-four hours a day, five days a week. This means traders can make trades any time of the day or night.
- There are two ways of earning money—in many financial markets, going short may cause difficulties. In Forex there is no restriction on either buying or selling. Both ways, traders can earn money.
- Excellent liquidity. Liquidity makes it easier to get in and out of a trade at any time (if the market is not liquid, the trader may stock up to buy or sell instruments when they want). Forex is one of the most liquid financial markets in the world.
- High leverage. Leverage allows someone with a small amount of capital to control large amounts of money. Which means gains can be maximized.

- Low trading cost. Nothing is free in the financial market—every transaction costs money. Any person who decides to open a trade must pay fees to brokers as spread (you open an account with a broker for a Forex trading account). Spread is just the difference between the bid and ask (I will explain more about these terms in a later section).

Anyone who has Internet access, a personal computer or laptop, who knows how to use a computer, and who has this book can trade. In the beginning, you do not even need real money to get experience in trading. Large numbers of Forex brokers offer demo accounts. There is no difference between demo and real account platforms, except that you will trade without emotions! Real accounts can be opened for as little as twenty-five dollars (not recommended).

Forex trading can be done without leaving your current job, too; however, you need to develop a strategy that fits your lifestyle. In general, traders are categorized into four types: scalping, day, swing, and momentum. Scalping and day-trading styles consume more time, whereas swing and momentum trading requires very little time.

This book is divided into three broad sections:

- Enriching your knowledge about Forex trading
- Introducing a great strategy for buying and selling currency pairs
- A sample trading plan, journal, and money management tips

The method for trading on almost any Forex platform is similar, however, we will show a step-by-step process with clear pictures using the MetaTrader 4 platform (a free Forex trading platform for all) and most Forex brokers provide this platform for clients, too.

Chapter One

AN INTRODUCTION TO THE FOREIGN EXCHANGE (FOREX)

Worldwide, the importance of trading is increasing in the financial market. The basic concept of trading is an exchange of goods or services for other goods or services. When money emerged as a medium for commerce, trading became much simpler than traditional bartering. In financial markets, instruments such as stocks, bonds, currencies, and derivatives are exchanged or traded. A market where sellers and buyer exchange shares is called a stock market. Bonds are another kind of investment, and buyers and sellers engage in the exchange of debt securities—arrangements where one party promises to return the invested money with interest at fixed intervals. Usually, a contract is signed by both parties to formalize a trade. The predictive market is another type of exchange, where the exchange of goods or services is arranged to take place in the future. Foreign exchange (Forex) is a type of financial market where people exchange currencies to conduct business internationally.

Forex is an unregulated and decentralized network of currency trading between banks, public and private institutions, retailers, and speculators. It is one of the most liquid and the single largest financial market in the world. In the year 2013, Forex traded at an average volume of \$5.3 trillion per day—much more than the largest stock exchange. The New York Stock Exchange (NYSE) trades at an average of \$22.4 billion a day (EV 2014).

In 1944, with the aim of stabilizing the global economy after World War II, the

Bretton Woods Agreement was developed. This agreement fixed other nations' currencies against the price of gold, but eventually the US dollar was identified as a reserve currency linked to the price of gold. Gold was set at \$35 per ounce. In 1971, the modern foreign currency exchange was created and the Bretton Woods Agreement was discontinued (Viterbo 2012), and it was agreed that the US dollar would no longer be exchangeable for gold. In late 1971 and 1972, two more attempts were made to redefine how exchange rates related to the US dollar. These agreements were called the Smithsonian Agreement and The European Joint Float. By 1973, the price of a foreign currency was determined by supply and demand, which was mainly controlled by industrialized countries. The birth of computer and Internet technology encouraged currency trading to rise from \$70 billion a day in the 1980s to \$1.86 trillion a day twenty-five years later (Bailey 2006). In 1999, the European Union introduced the Euro (EUR), and it became the first single currency to be able to rival historic leader currencies such as the United States Dollar (USD), British Pound (GBP), and the Japanese Yen (JPY). Today, the Euro (EUR) is considered the second most important currency in the world (Martinez 2007).

In Forex, a transaction between traders occurs on the spot, using decentralized computer networks. Therefore it is called the **spot market**. Traditionally, foreign exchange trading has been a domain of large financial institutions, corporations, hedge funds, central banks, and very wealthy individuals. However, trading became much easier with the advent of modern Internet technology and other financial trading platforms; average individual investors can now speculate on the foreign exchange market. The attraction to Forex trading is also growing rapidly. This is mainly because it provides enormous opportunities to traders. It is open twenty-four hours a day, five and a half days a week; it has the highest leverage of any financial industry; liquidity around the clock; no commission; and it's relatively easy to open an account even with a small initial deposit.

FOREX TRADING ESSENTIALS

Forex is the abbreviation for foreign exchange. This is where one country's currency is traded with another country's currency (sometimes, a currency can represent the economies of multiple countries, as is the case with the Euro). Since a currency represents a country, its value depends on that country's economic health. The trading between currencies happens in real time, on the

spot, for whatever price it costs at any given moment, therefore, it is called the spot market, too (Martinez 2007). In Forex trading, there are only two possible actions: the buying or selling of currencies. Because of the nature of the exchange, currencies must always be bought or sold in pairs. For example: Euro vs. United States Dollar (EUR/USD), or British Pound vs. Japanese Yen (GBP/JPY). The first currency listed in an exchange, EUR and GBP in these two examples, are called **base currencies** and the second currency listed, the USD and JPY in these examples, are called **quote currencies**. The base currencies are the basis for any currency being bought or sold.

Let's look at an example of EUR/USD to discover how traders earn money by buying and selling a currency pair. Below, in [Table 1](#), we see the process of buying a base currency (EUR) in respect to a quote currency (USD). In [Table 2](#), we see the process of selling a base currency (EUR) in respect to a quote currency (USD).

Currencies are mainly divided into three categories: **major**, **minor**, and **exotic**. Major currencies include the United States Dollar (USD), Euro (EUR), Swiss Franc (CHF), Australian Dollar (AUD), British Pound (GBP), Japanese Yen (JPY), Canadian Dollar (CAD), and the New Zealand Dollar (NZD). When these currencies are traded with USD, they are called **major pairs**, for example, EUR/USD, GBP/USD, USD/JPY. When any of the major currencies are traded with each other, but not with USD, they are called a **minor currency pair**. For example, EUR/GBP, GBP/CAD. If there are no major currencies traded with another currency, it is called an **exotic currency pair**. for example, Omani Rial (OMR) vs. Egyptian Pound (EGP), so OMR/EGP. These currencies are less liquid, lack market depth, and trade at low volumes (Taylor 2003).

Description	EUR	USD
A trader purchases 10,000 Euros at exchange rate 1.1500 (EUR 10,000 x 1.15) = USD 11,500	+10,000	-11,500
After few days, the trader exchanges 10,000 Euro back for USD at an exchange rate of 1.2000 (EUR 10,000 x 1.2) = USD 12,000	-10,000	+12,000
Net profit		+500

Table 1: An example of EUR/USD buying

Description	EUR	USD
A trader sells 10,000 Euro at exchange rate 1.1500 (EUR 10,000 x 1.15) = USD 11,500	-10,000	+11,500
After a few days, the trader exchanges 10,000 Euro back for USD at exchange rate of 1.1000 (EUR 10,000 x 1.1) = USD 11,000	+10,000	-11,000
Net profit		+500

Table 2: An example of EUR/USD selling

In Forex trading, all currencies are quoted in two ways: with a **bid price** and an **ask price**. In general, the bid price will always be lower than the ask price. The bid is the price at which market is willing to buy the base currency in exchange for the quote currency (Arkolakis 2014). This is the price at which traders buy the base currency.

Below, in [Figure 1](#), we see a EUR/USD pair. The bid price is 1.1043, which means the trader can sell 1 EUR for 1.1043 USD. The ask is the price at which market sells the base currency in exchange for the quote currency. In this EUR/USD pair, the ask price is 1.1046, which means the trader can buy 1 EUR for 1.1046 USD. The difference between the bid and the ask price is called the **spread**, which is 0.0003 pips. Normally, the spread is what a trader would pay a

broker as a commission charge. A pip is short for a “price interest point,” or the amount of change in the exchange rate of a currency pair. A **pip** is the smallest unit of currency value. This is also the smallest measure of change in a given currency pair. All currency pairs are displayed to four decimal places, and one pip is equal to 0.0001. The only exception to this is Yen-based currency pairs; they are displayed in two decimal places (0.01). Some Forex brokers offer smaller denotations of pips, up to 1/10 of a pip.

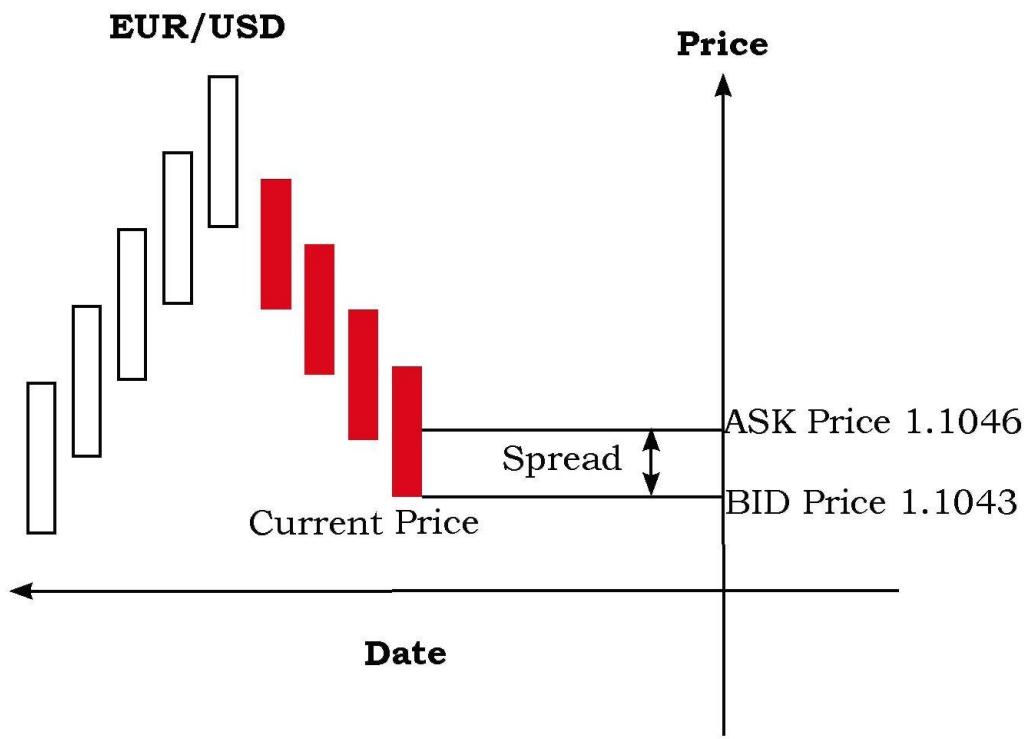


Figure 1: BID and ASK Prices



Figure 2: BID and ASK Prices. Meta Trader 4 Live Chart.

Traders have various nicknames for approaches to buying currencies, such as “going long,” “long,” or taking a “long position.” These are for when they think that the base currency will rise in value; then they buy it in order to sell it back later at a higher price. Similarly, if they think that the base currency will fall in value, they sell it in order to buy it back at a lower price. This is often called taking a “short position” or “short,” or “sell position.”

There are three types of lot size available in Forex trading: **standard lots, mini lots, and micro lots**. The standard lot is made of 100,000 units. The average pip size for a standard lot is approximately USD 10/pip. One pip changes the base currency value relative to the quote currency, with a result of USD 10 positive or negative value in a standard lot. A mini lot is a 10,000 unit lot, and the average pip size for a mini lot is approximately USD 1/pip. One pip changes the base currency value relative to quote currency, with a result USD 1 positive or negative. The micro lot the smallest lot, 1,000 units. The average pip size for micro lot is noted in cents (i.e., approximately USD 0.10/pip). That means one pip changes the base currency value relative to quote currency, with a result 10 cents positive or negative.

Traders (individual or institutional) must open an account with a Forex broker in order to trade Forex. Based on the broker's capabilities, traders can open an account in various currencies, such as USD, EUR, JPY, or others. A broker also provides the investor with a trading platform—software that allows traders to carry out online buying and selling activities. One of the most common trading platforms is MetaTrader; however, some brokers have developed their own platforms for clients. An open account comes with leverage, agreed between the client and the Forex broker. **Leverage** is expressed as a ratio and is based on the margin requirements imposed by your Forex broker. In order to hold an open position, a margin is required—it is collateral. The term “margin” is probably best explained with the word “bailout”. **Margin** is defined as the amount of money required in your account to maintain your market positions using leverage. For example, if you are in an open position for \$20,000 using a 100:1 margin, then your account balance should be no less than 1% of that amount. This is because you can usually trade up to 100 times the money you actually have. Similarly, if your broker require a 2% margin, you have a 50:1 leverage. The calculation for leverage is:

$$\text{Leverage} = 100 / \text{Margin Percentage}$$

Account balance and margin balance are different. The trader can have a balance in his or her account, but he or she can also have a shortage of margin, which may trigger the broker to close all open positions. Leverage allows a trader to trade without putting up the full amount, however, some margin amount is required to be in the trading account. For example, 100:1 leverage means \$1,000 of equity is required to purchase an order worth \$100,000. Traders need to keep a careful eye on margins. If there is not a sufficient marginal amount or the account falls below the liquidation margin level, trade will be immediately liquidated, which is called **margin closeout**. This mainly happens when open positions are in the negative.

Traders can conduct just two actions: buying and selling a base currency. An **entry** is when a trader decides to open a position, either to buy or sell. Traders have the option to close a position as well, either in a state of profit, loss, or no gain or loss. When a trader decides to close open positions for either a profit or a loss, or for no gain or loss, it's is called an **exit**. A **stop loss** is the amount or value a trader is willing to lose in case of a bad decision. Stop loss can also be

used to secure profit, if the trade is already profitable. The distance between entry and stop is called **risk**, whereas the distance between target and entry is called a **reward** (Seiden 2011). **Target** is a price that, if accomplished, would result in a trader recognizing the best possible outcome. This is the price at which the trader would like to exit his or her existing position.

Liquidity in the Forex market is due to the presence of many participants. This enables traders to get in and out anytime, and at a variety of prices. This level of activity and interest reduces trading risk to traders. The seven major currencies—EUR, CHF, GBP, CAD, AUD, JPY and NZD—are the most liquid currencies in the Forex market when traded against the USD (Karnaukh, Ranaldo, & Söderlind 2013). Major international banks play an important role in providing liquidity in the Forex market (BIS 2014).

CHAPTER SUMMARY

Now we have had a general introduction to Forex and we have learned the basic terms associated with Forex trading. The next thing we will look at is how to analyze the Forex market.

Chapter Two

AN ANALYSIS OF THE FOREX MARKET

In Forex, traders use mainly two kinds of analysis to predict future price movements. They are **fundamental** and **technical analysis**. Fundamental analysis is most similar to the way traders in the stock market evaluate a company; they look at the company's earnings, expenses, assets, liabilities, and statements by operating officers and the board to determine its health. People buy stock in anticipation that it will rise in value in the future. In Forex, it is very important to do research on individual countries, just as if they were companies. On the other hand, technical analysis involves pattern recognition on a price chart in order to predict future prices. In the share market, traders analyze the prices of the volume of the shares traded on the stock exchange. If prices are moving higher on increasing volume, traders will see the demand for shares of that company's stock rise. Forex traders use also a similar kind of technical analysis, and they apply the same kind of technical tools, too. A technical trader in Forex will look at price action, trends, and other empirical factors to make decisions about buying and selling a particular currency pair.

Fundamental analysis suggests that in order to invest intelligently, it is very important to do research on countries themselves. This theory holds that if a country is fundamentally strong, it will be worth investing in (McDonald 2007). Several theories have been developed to explain this in relation to financial markets. Efficient market hypothesis is a theory that says instruments trade at fair value. Random walk hypothesis says a past price cannot be used to predict future price and the theory of rational expectations suggests that past experience can help to predict the future. These theories are either biased toward fundamental or toward technical analysis. In general, fundamental analysis is

based on the overall financial condition of the economy, whereas technical analysis is based on price action and human emotions, as revealed by the charts.

FUNDAMENTAL ANALYSIS

In the equities market, fundamental analysis measures everything that could affect a security's value. This includes financial stability, management, the economy, and the condition of an industry. To some extent, fundamental analysis also involves studying the economic situation of countries in order to trade currencies more effectively. Fundamental analysis is therefore the study of geopolitical and socioeconomic factors that influence a country's currency. Currencies react to fundamental factors such as interest rates, economic growth, and speeches made by the directors of central banks. Looking at an economic calendar is another way to speculate on forecast verses actual values to predict currency movements upward or downward. Free sites such as [forexfactory.com](#), screenshot shown in [Figure 3](#), and [fxstreet.com](#) provide information about forecast verses actual values in real time. Other sources are available too, such as television stations Bloomberg, CNBC, and CNNMoney; financial magazines and newspapers like the *Wall Street Journal* and *Financial Times*; and Internet sites Marketwatch, CNNMoney, and Yahoo Finance. Other lists of fundamental indicators include oil prices, gold prices, US dollar sentiments, gross domestic products (GDP), consumer sentiments, imports, and exports.

Date	9:52pm	Currency	Impact	Detail	Actual	Forecast	Previous
Tue Dec 22	1:05am	GBP	🟡 GfK Consumer Confidence	📅	2	1	1
	3:00am	CNY	🟡 CB Leading Index m/m	📅	0.6%	0.3% 🟠	
	8:00am	CHF	🟡 Trade Balance	📅	3.14B	3.82B	4.09B 🟠
		EUR	🟡 German Import Prices m/m	📅	-0.2%	0.2%	-0.3%
		EUR	🟡 GfK German Consumer Climate	📅	9.4	9.3	9.3
	10:30am	GBP	🟠 Public Sector Net Borrowing	📅	13.6B	11.9B	6.7B 🟠
	2:30pm	USD	🔴 Final GDP q/q	📅	2.0%	1.9%	2.1%
		USD	🟡 Final GDP Price Index q/q	📅	1.3%	1.3%	1.3%
	2:55pm	EUR	🟡 Belgian NBB Business Climate	⭐	-1.4	-4.0	-3.9
	3:00pm	USD	🟡 HPI m/m	📅	0.5%	0.4%	0.7% 🟠
	4:00pm	USD	🟠 Existing Home Sales	📅	4.76M	5.32M	5.32M 🟠
		USD	🟡 Richmond Manufacturing Index	📅	6	-1	-3
	10:45pm	NZD	🔴 Trade Balance	📅	-779M	-812M	-905M 🟠

Figure 3: Actual vs. Forecast Data (source: Forex Factory)

Intermarket analysis is also a part of fundamental analysis. A good trader is always aware of stocks, bond yields, commodities, and US dollar sentiments. The dollar is the leading currency in the world not only because the United States is an economic powerhouse, but because it is the preferred reserve currency in the world. Asia alone holds \$4.96 trillion in reserve (Arunachalam 2010). Global commodities such as oil, copper, and gold also play a large role in the flow of global capital and international trade. The changes in demand and supply for commodities impact currencies. For example, if we look at gold prices we'll see that a falling price results in the weakening of currencies from countries that are correlated with gold, like Switzerland. The Canadian and Australian dollars are also closely related to commodity price movements. New currencies emerging in the global market must also be taken into account. China has become second-largest economy in the world, for example, but its currency has lagged behind in international stakes (Zhou 2015). Between 1989 and 2015, the annual growth rate (AGR) in China averaged 9.06% (Trading Economics, n.d.). Such strong growth requires consumption of global resources such as copper, wheat, cement, etc. Hence, a stronger Chinese currency benefits its commodities trading partners, such as Australia.

Many additional, smaller or more unpredictable factors also influence currency movements. These include inflation, rate of interest, account balances, political stability, employment data, microeconomics, geopolitical events, and economic performance. (P. Patel 2014; N. Patel 2014; & S. Patel 2014). These can be more generally categorized into two categories, however: economic and political. Economic factors are composed of general macroeconomic policies and general economic conditions as revealed in market surveys and other reports. They are also based on economic indicators and economic policies including fiscal and the monetary policies. Fiscal policy is related to budget and government spending, whereas monetary policy is related to central bank activities—these influence money supplies and interest rates.

Political events profoundly impact how currencies behave. These impacts can either be from internal, regional, or international political conditions. Exchange rate markets as well as Forex market trading are deeply impacted by political conditions as well as the policies of parties in power. For example, political incidents between radical Islamic groups and the Egyptian state led to fewer domestic assets being in demand and replacement of foreign currency deposits. Various measures were taken in response to political instability, including

economic policy interventions (Fielding & Shortland, n.d.), but ultimately any political upheaval will generally cause investors to withdraw money from a country. The currency market, like any other, has long-term trends. Currencies do not grow, nor can they be mined like physical commodities, so business cycles do have a measurable impact on currency values. Cycle analysis helps an investor look at a long-term price trend that may arise from an economic or political trend. It's not surprising that economic numbers certainly reflect economic policies, but some numbers create what seem to be a strangely disproportionate effect where a number itself becomes important and has an immediate effect on short-term market moves.

Governments also affect Forex trading in various ways. They can do so directly, by instituting policies that have effects on portfolio investments as well as money supply. Regulations, taxation, and subsidies will all impact macroeconomics and will thus have a spillover impact on the performance of Forex market trading. Governments now often have to choose between traditional methods of intervention and market-based approaches. A central bank's policy on interest rates, for example, will also impact the economy and hence the Forex. Many investors and analysts argue that the market is efficient, but fundamental analysis says that publicly available information alone cannot be used consistently to earn an enhanced return on investment (Kevin 2006).

TECHNICAL ANALYSIS

The credibility of technical analysis goes to Charles Dow [journalist and coinventor of stock market index Dow Jones & Company in 1884). His series of articles for his fledgling *Wall Street Journal* popularized Dow Theory, which evolved into what we now call technical analysis. Technical analysis is basically the recognition of price action in combination with volume. It seeks to find patterns of support and resistance that indicate whether a price is likely to go up or down. The technical analysis approach has not gained significant credibility in academic circles, interestingly. This might be one of the reasons why the efficient market hypothesis has become so popular. Explained and surveyed by fame, it claims that price cannot be predicted based on behavior, that it follows random directions (Loganathanraj 2000). However, the supporters of the technical analysis technique argue that past performance shows a trend that can easily point to the future price of a security. Significant academic research

reports show that you can indeed predict future market prices based on historical data. A considerable body of work exists in academic literature concerning the validation and verification of expert systems (surveyed in Weiss and Kulikowski) (Loganantharaj 2000). A survey reported in a research paper by Menkhoff and Taylor (2006), from the University of Warwick, mentioned that when asked about the statement “almost all foreign exchange professionals use technical analysis as a tool in decision making at least some degree,” almost 90 percent of those surveyed responded positively.

Neely and Weller (2011) define technical analysis as the use of price behavior in the past to help make decisions about future plans. Historical data is used to make future decisions by overlaying rules on the data. Technical analysis is simply the study of price movements, activity, and price relationships for market analysis. According to Plummer (1993), price patterns of a historical nature can be used for current trading. According to Murphy (1999), practitioners extensively use technical analysis. Technical analysis is used to find a sort of geometry in prices, such as support and resistance and other basic patterns. Sentiments such as trends, surprise events, and emotions such as momentum and exhaustion all influence pricing. Technical analysis relies on charting price activity. Chart patterns are the result of reactions to other people’s actions. Graphs that show trends of previous prices are studied so that positive movements can be predicted by the observation of key variables. According to surveys by Menkhoff (2010), Allen and Taylor (1992), and Cheung & Chinn (1999), the use of technical analysis has grown (Menkhoff & Taylor 2006).

In conclusion, there are two common types of analysis: fundamental and technical. Many traders use a combination of both when making their trading decisions about what currency to trade, when to enter, and when to exit.

TRADING STYLES

Trade styles are defined by how a trader enters a trade and how he or she manages that trade. There are basically four types of trading styles: **scalping**, **day-trading**, **swing**, and **position trading**. However, a trader can of course switch from one style to another depending on need or circumstances.

Scalpers use the shortest time frame in trading; these are individuals who are satisfied to come away with small gains and who may enter and exit many times in a continued trend. Scalpers think quickly and have excellent eye-hand coordination for the quickest trade execution. Since scalpers use short turnarounds—seconds to minutes—they look for few pips from the trade. To be a scalper, you must not mind being attached to trading charts for several hours at a time, you must like to analyze, you must be impatient, and you need to be able to change your mind frequently in regards to trends or directions. If you get stressed easily, do not like taking longer periods to analyze charts, or you want to make fewer trades and bigger long-term profits, scalping is not a good fit for your personality (Cheng 2007).

The name itself tells us that a day trader enters and exits a position within a day. This is one of the more popular trading strategies in Forex trading. Day traders do not like to hold a position overnight because of added risk, and of not knowing whether prices will change significantly while they're away from the trading screen. Day-trading is best for traders who have sufficient time to analyze, execute, and monitor trades. Typically, a day trader takes less than an hour to analyze a chart about whether to enter and exit a trade. Once the overall trend is identified, the trader moves from bigger time frames to smaller in order to look for trading opportunities. If a trader decides to follow a trend, it is known as **trend-trading**. If a trader identifies that a trend is going to end, he or she might make a trade in the opposite direction, which is called **counter trend-trading**. Breakout traders look for opportunity by waiting to see if a price moves outside a defined resistance or support level—with increased volume. Day traders tend to wait for good opportunities to enter the trade for long periods, in contrast to scalpers (Cheng 2007).

Swing trading attempts to capture gains by holding positions for several days; hence it is a longer-term trading strategy. Early identification of trends is one of the main objectives of swing trading. This type of trader looks for fundamental indicators as well as for price action, trends, and patterns. They will not buy into highs or short into the lows. This kind of trading suits people who are willing to make fewer trades, are patient enough to look for distinct trends and stick with them until reversal, and who are capable of making measured pullbacks in an uptrend and bounces in downturns. Mostly they set profit goals by using support and resistance or trend lines. This strategy will not be attractive to the trader who likes to jump in and out frequently, who is impatient, or who cannot spend time

analyzing charts (Cheng 2007).

Position trading is a longer-term approach, and is based on overall trends, sentiments, and technical analysis. Positions can last from several months to years. They set high profit targets, and need to be alert to major, fundamental changes in the market. Such a strategy will be suitable for the trader who can effectively incorporate fundamental foresight into predictions about how it might affect particular instruments over the long run (Cheng 2007). However, if the traders get easily influenced by market news, do not understand how the fundamentals affect the market over the long term, are impatient, do not have sufficient starting capital, or who are looking for quick results, the trader does not fit with the position trading strategy. Usually, portfolio managers and hedge fund managers engage in position trading.

CHAPTER SUMMARY

We have learned that there are two basic types of analysis: fundamental and technical. Traders incorporate the principles of one or both into their decision-making routines. These also help them decide whether to enter, hold, or exit a trade. The next thing we will look at is the basis of all technical analysis—charts. Traders mainly use three kinds of charts in order to predict future prices in technical analysis. They are A-line, bar, and candlestick charts. We will look at all three in detail in the [third chapter](#).

Chapter Three

THE BASIS OF TECHNICAL ANALYSIS

Technical analysis is all about forecasting future financial price movements based on an examination of past price movements. Past data is usually examined in the form of a chart. Technical analysis works mainly on the following principles, founded by Charles Dow:

- Price discounts everything
- Price movements are not random
- Price is set by ongoing demand and supply phenomena

Let's look in more detail at the first point: price discounts everything. Technical analysts believe that all influences on price are reflected in the price. At any moment, thousands of events of different types could have occurred—announcements by the Federal Reserve, employment news, crises, terrorist attacks—and all of these lead traders' thoughts and perceptions to two actions: buy or sell. Because all circumstantial information is already reflected in the price, the price represents the fair value of a currency, and should form the basis for analysis of its performance. Therefore, technical analysis utilizes the information inherent in the price to understand what the market is saying with the purpose of forming a view to the future. The second principle is that price movements are not random. This simply means it is possible to identify patterns of trade based on a trend. There are various kinds of trends, including upward, downward, and sideways. The third principle explains how technical analysis provides a direct approach to data. It says that a price is set by the ongoing

forces of demand and supply. Demand for a currency gets higher when there are fewer sellers, and demand for a currency gets lower when there are more sellers. This is a simple principle of economics!

Charts are at the core of technical analysis, and a technical analysis is virtually impossible to perform without charts. Technical analysts study price actions, patterns, and volume. They believe that influences from factors such as economics, political forces, geopolitical forces, crises, bank announcements, etc. are either positives or negatives for an instrument—in our case, a currency. This leads to different approaches and perceptions among traders, who take action based on their analysis of these forces' influence on price to either buy or sell currencies. Historic buy and sell actions are clearly documented and available in a chart form. Hence, as a technical trader, the decision to enter or exit should be based on technical analysis rather than fundamental analysis!

CHART TYPES

There are three main types of charts used in technical analysis:

- Line charts
- Bar charts
- Candlestick charts

Line charts: The most basic type of chart is a line chart.

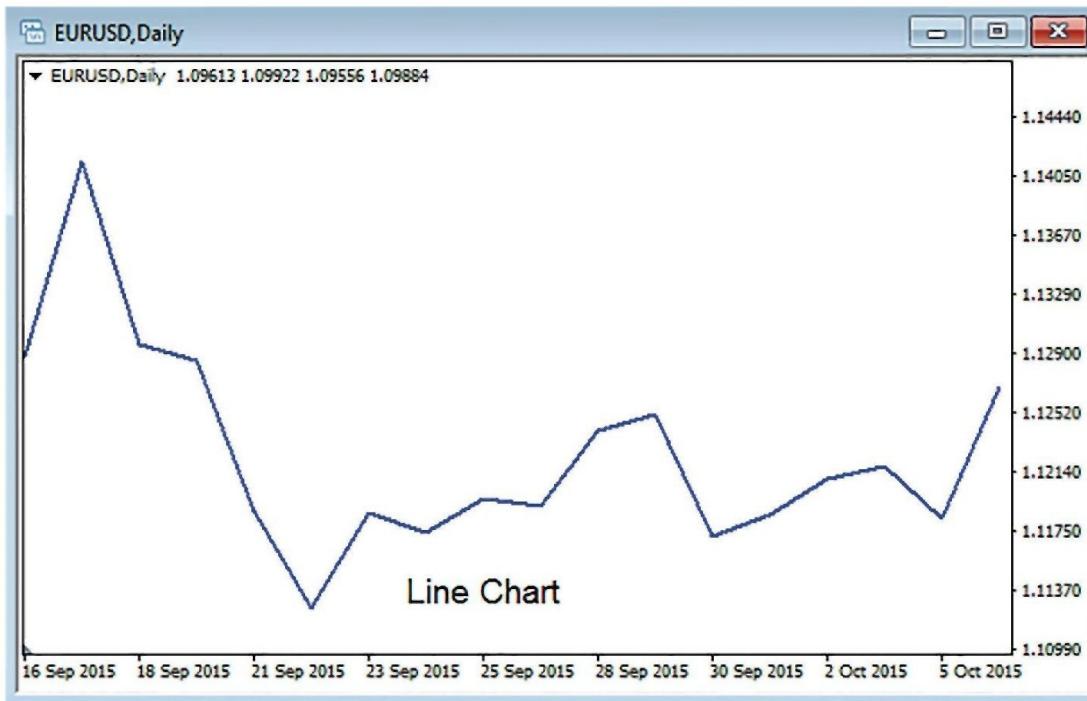


Figure 4: EUR/USD Line Chart

This chart also displays the least amount of data. It is very simple—it just plots closing prices and connects them. This is for traders do not need to know the price movements of an instrument such as the opening, high, and low prices. [Figure 4](#) shows a line chart of EUR/USD over the time frame of one day. The x-axis represents date and time; the y-axis represents the price.

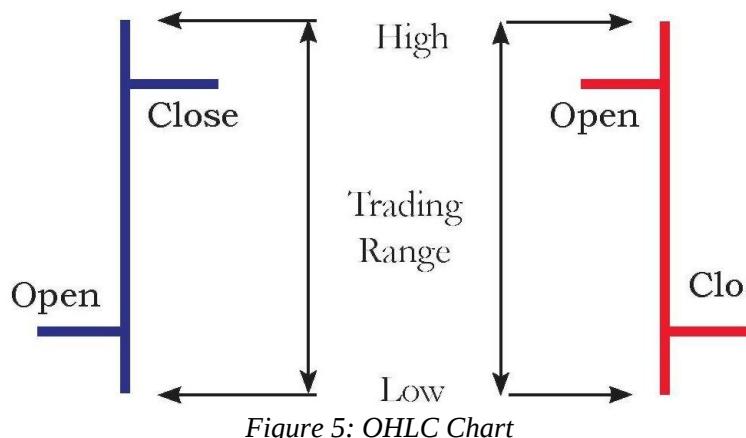


Figure 5: OHLC Chart

Bar charts: These are more complex than line charts. In addition to closing price, they shows high, low, and opening prices, too. [Figure 6](#) shows a bar chart of EUR/USD over a one-day time frame. That means each individual bar was created over a one-day time frame. The vertical lines show trading range, and the two horizontal bars connected to each vertical line show the opening and closing prices of currency pairs; the opening price is on the left, and the closing price is on the right. These charts are sometimes called “OHLC” charts, for “open-high-

horizontal bars connected to each vertical line show the opening and closing prices of currency pairs; the opening price is on the left, and the closing price is on the right. These charts are sometimes called “OHLC” charts, for “open-high-

low-close.” They provide a more detailed picture of the price movements of a particular currency pair than a line chart can. A closer look at a bar chart that indicates both a bull OHLC and a bear OHLC is given above, in [Figure 5](#).

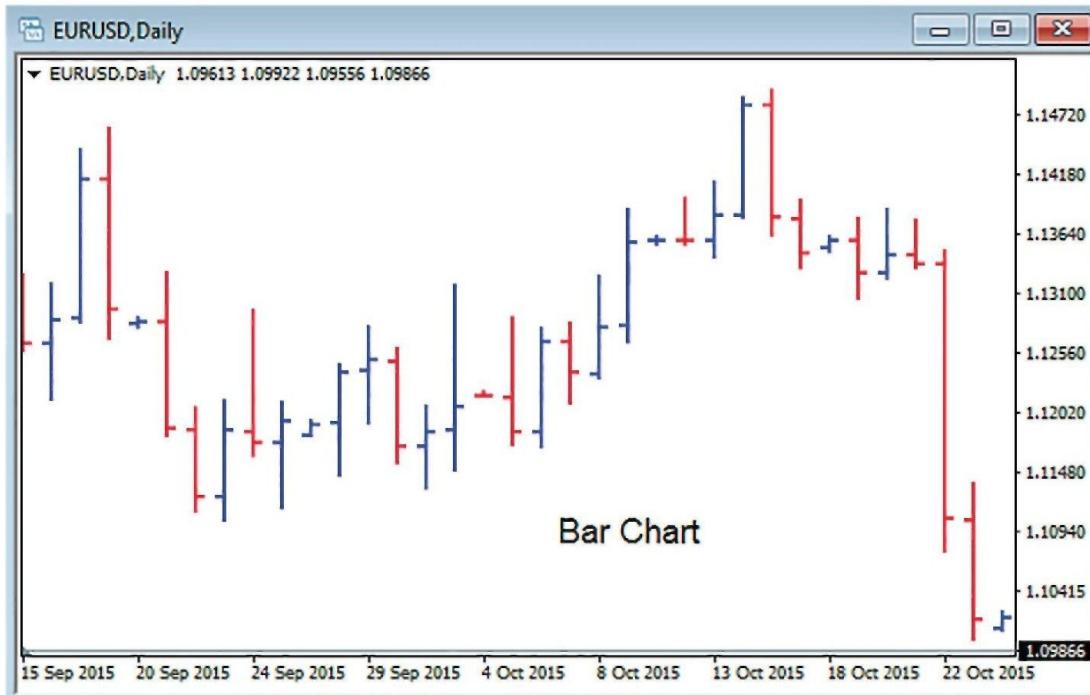


Figure 6: EUR/USD Bar Chart

Candlestick charts: These are the preferred chart type for technical analysis. Candlestick charts (originally developed in Japan) display the greatest amount of detail about the price movement of a currency pair. The construction of a candlestick chart is shown below, in [Figure 7](#). Different colors represent when the opening is higher than the closing, and vice versa, in addition to bars displaying the open, high, low, and close prices.

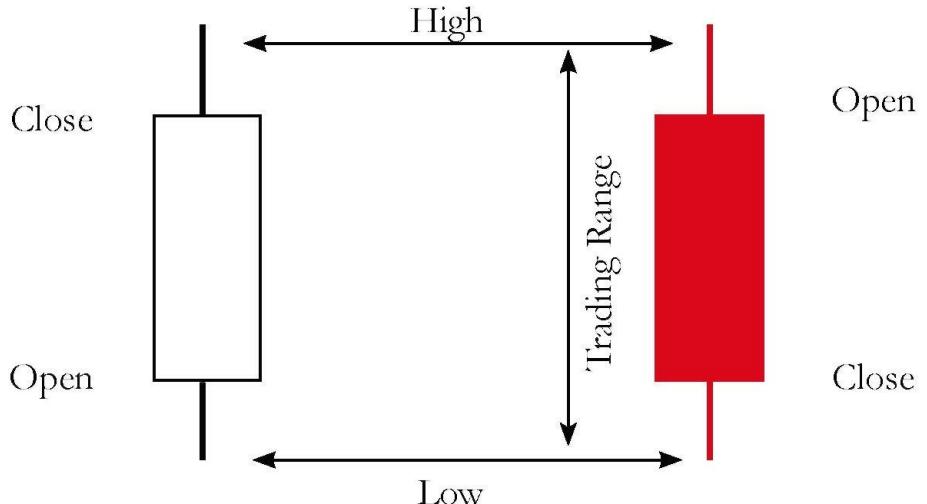


Figure 7: Bull Candle (Left), Bear Candle (Right)



Figure 8: Candlestick Chart (Source: Meta Trader 4)

The wide area on each vertical line is called the “real body,” and the thin area on each vertical lines above and below the body are called “shadows” or “wicks.” The shadow represents the highest and lowest price that occurred during a trading session (of a specific time frame). The upper wick represents the difference between the highest price and top of the real body of that period, and the lower wick represents the difference between the real body and the lowest price of that period.

Bullish candle forms—indicating when the price closes higher than it opened—are shown with blue, and bearish candle forms—when a price closes lower than it opened—are shown in red color. The top and bottom of the candle is called the “range” of the candle.

A closer look at a candlestick chart, with bull and bear periods labeled, is given above in [Figure 8](#). Please note that different colors can be used for bull and bear candles based on customer preferences, however the market standard is blue for bull and red for bear.

Candlestick charts allow for a quicker analysis and a more efficient analysis than the previous two types of charts. Bearish and bullish candles can be identified easily, since the areas between the opening and closing prices are colored and boxed. Also, various formations of candlesticks can act as a signal to traders to take quick action, as we'll see below. The limitation of candlestick charts is they are not perfect—like any other technical analysis tool. They also take up a lot of space on screen once you enlarge them enough to get useful detail. Since they create different kinds of forms, with colorful names like hanging man, doji, shooting star, and hammer, each of which point different types of reversal or continuation patterns, it can be time-consuming and hard to analyze authentic charts.

CONCEPTS OF CANDLESTICK FORMATION

The Forex market is driven by a supply and demand principle. Candlestick charts simply show supply and demand for specific currency pairs. The demand for a particular currency increases when it is considered more valuable as compared to the second currency in a pair; similarly, the demand of particular currency decreases when it is considered less valuable as compared to the second currency in a pair.

Buyers (Units)	Sellers (Units)
100	50
100	50
200	300
100	50
50	50
250	
200	
Total: 1000	Total: 500

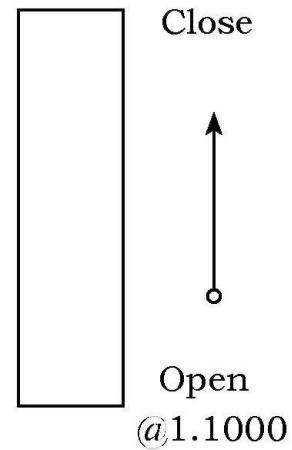


Figure 9: Bull Candlestick Formation

Buyers (Units)	Sellers (Units)
50	100
50	100
300	200
50	100
50	50
	250
	200
Total: 500	Total: 1000

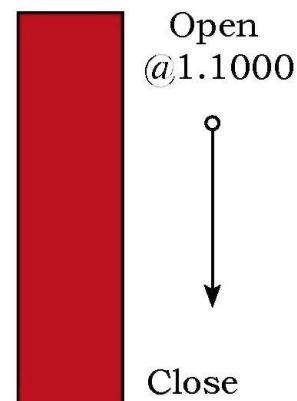


Figure 10: Bear Candlestick Formation

Another way of looking at it is that a base currency will be more valuable than a quote currency when the demand for the base currency increases, and less

valuable when demand for the base currency decreases. The magic behind being a successful currency trader lies in being able to identify supply and demand trends in the market. If traders can determine these, they will be well on the way to making significant income in the Forex trading market (Hansen 2006).

Candlestick charts show supply and demand imbalance in a colorful way. Traders can take advantage of candlestick formation to identify supply and demand on a chart. When buyers take control over suppliers in a particular time frame a candle is represented in blue, and similarly, when sellers take control over buyers, it is represented in red, as shown in [Figure 9](#) and [10](#).

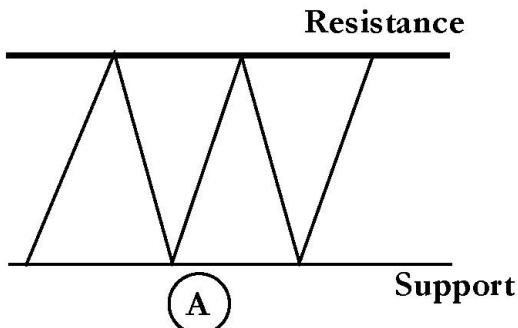
Looking again at [Figure 9](#), suppose the EUR/USD is currently trading at 1.1000. If there are no willing buyers or sellers available, the price will be constant. Candlestick formation would look like a dot. Since Forex represents one of the most liquid markets in financial trading, therefore, buyers and sellers are present at all times. Assume at the price of 1.1000 there are 1,000 buyers available to buy EUR and 500 willing sellers, thus, the demand of 500 buyers will be fulfilled by the existing 500 sellers. However, there are still more willing buyers, but the sellers have run out. In this scenario, the price starts to move up. When buyers take control over sellers, the candlestick formation will be blue/bull candle. When the demand is very strong, the formation of the blue candle will be longer. Therefore, the size of the candlestick represents the strength of a buyer-seller imbalance at any given point. In the opposite scenario, where at the price of 1.1000 there are 500 buyers available to buy EUR and 1,000 willing sellers, all sellers cannot offload their currency. In this scenario, the price starts to move down. When sellers take control over buyers, the candlestick formation will be red/bear candle, indicating a bear market. Strong supply is denoted by larger red candles.

CONCEPTS OF SUPPLY AND DEMAND IN FX

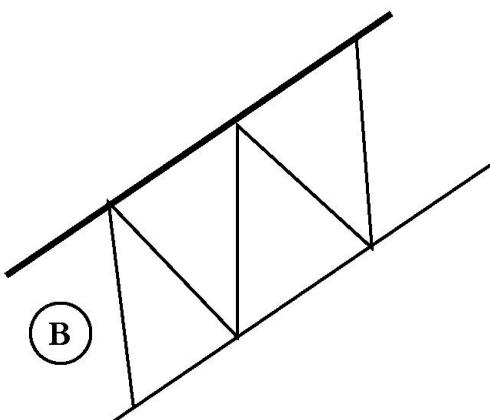
Traders use various kinds of strategies to govern when to enter and exit trades. Some traders are happy to trade in a sideways market or a ranging market, whereas some like to trade in a trending market. When the pair has been frequently trading between the same level of resistance and the same level of support for a period of time, the market is said to be moving “sideways” whereas

trending market is one in which price is generally moving in one direction. It establishes new highs or lows. The demand and supply strategy tends to identify moves in advance, in order for a trader to be a trend setter. Early entry can provide great profit potential, but it could be risky because you will be going against a previous trend.

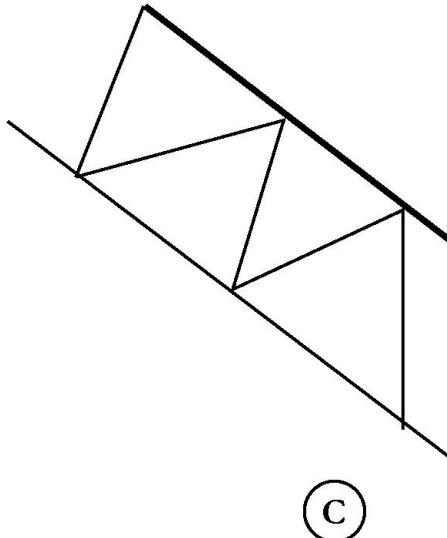
Technical analysis is all about using historical prices overlaid with a set of rules to predict future prices. They use technical indicators as a weapon for decision making. Studies show that **support and resistance strategy** is one of the most widely used methods in the financial industry. Research done by Osler (2000) and major exchange firms shows what provided some technical assistance to clients in order to help predict future price movements, and most of the useful data provided support and resistance levels. **Support** is a price when demand is greater than supply; buyers have control over supply in this scenario, so prices stop falling. **Resistance** is a price when demand is less than the supply; buyers cannot take control over supply, hence the price stops rising (Osier 2000).



A: Such kind of formation appears when market can not make new highs or lows (Sideways)



B: Price makes new highs and new higher lows during the uptrend.



C: Price makes new lows and new lower highs during the downtrend

— Resistance

— Support

Figure 11: Support and Resistance Formation

There are many ways to identify support and resistance trends. [Figure 11 \(A\)](#) shows support and resistance indicators as lines during a sideways market.

[Figure 11 \(B\)](#) and [\(C\)](#) show support and resistance in a channel format. The most common ways to show support and resistance levels are these two. In [Figure 11 \(A\)](#), lines indicate where a price touched a high and low point multiple times. In [Figure 11 \(B\)](#) and [\(C\)](#), recent highs are connected by one line and recent lows are connected by another to form a channel (Osler 2000). When a price touches a resistance or support line without breaking it, that data indicates the strength of that level, or price. However, the more time a line is touched, the weaker that price becomes (Wagner 2011). It is easiest to identify support and resistance trending in a sideways market. Many traders use support and resistance to enter a trade or to create profit targets. In a sideways market, neither the bears nor the bulls take control of prices, so neither an uptrend nor a downtrend happens. In sideways markets, price activity oscillates between narrow ranges without forming any distinct trends (Waring 2007).

Each pip movement in foreign exchange data shows the game between buyers and sellers. They create two opposing forces, which results in price movements.

Sellers are looking to sell high, whereas buyers like to buy at a cheap price. This tension is recorded by candlestick charts. At support and resistance areas, traders consider their positions in order to buy or sell particular instruments at a higher volume. These levels are not the result of market participants agreeing to buy and sell an instrument at a given price; support and resistance levels simply indicate that traders think that the exchange rate is either too high or low. This is also due to memory of market phenomena, which tell when certain price levels have been important in the past, indicating that they may have some impact on price movements in the future (Seiden 2009).

When the price reaches a new high and then falls considerably, both the sellers who bought at that high and the ones who lost the opportunity to sell will be willing to enter short when the price reaches that level again. The same thing will happen when the price reaches a new low and then rises considerably; both the sellers who sold at that high and the ones who lost the chance to buy will be willing to go long when the price arrives at that level again. This dance happens until there is balance between buyers and sellers. But many other variables affect the market in the meantime; therefore, a new variable can change the general actions of traders, resulting in weakening support or resistance and breakdowns (Frankel, n.d.).



Figure 12: Imbalance Points (Support Broken)

In Figure 12, at point A, indicating support, have been broken at a certain point (shown by the black price). The reason is either that there were no more buyers left, or that the point was not attractive enough for buyers to buy again, therefore, the support lines could not hold. Similarly, in Figure 13, at point A, which indicate resistance, have also been broken at a certain point (shown by the black price). The reason is either that there were no more sellers left or that the point was not attractive enough for sellers to sell again, therefore, the line could not hold (fxstreet, n.d.).



Figure 13: Imbalance Points (Resistance Broken)

In Forex, there are no defined rules about whether trade can be categorized by buyer or seller. Buyers can turn to sellers and sellers can turn to buyers. For example, when you have a long position, you are considered a buyer. At some point, though, you need to close the position for profit. Your action in seeking profit turns you into a seller; hence, Forex is a double-direction market (fxstreet, n.d.).

Traders/investors use support and resistance levels in conjunction with demand and supply as the basic function of economics to make decisions. Like other markets, the Forex market is driven by the supply and demand principle. The demand for a particular currency increases when it is considered more valuable compared to the other currency in a pair; similarly, demand for a particular currency decreases when it is considered less valuable compared to the other currency in a pair. Another way to say this is that a base currency will be more valuable than a quote currency when the demand of the base currency is increased and less valuable when demand of the base currency is decreased. The magic of being a successful currency trader lies in being able to find supply and demand trends in the market. If traders can determine that, they are well on the

way to making significant income in the Forex trading market (Hansen 2006).

In the financial marketplace, the price of an instrument has significant impact on demand and supply. The supply and demand principle tends to work best when market conditions stay steady. The effect of minor fundamental influences are minimal, thus the market does not behave drastically by showing changes in price. However, major fundamental news could affect things such as interest rates, which could cause formerly stable support and resistance lines to break (Stanley 2012). Volume also plays a significant role in demand and supply. The demand and supply level becomes valid only when there is sufficient volume (Evens 2009).

In Forex, people are essentially trading the economies of one country against another. Strong economies tend to have strong currency, and weaker economics tend to have weaker currencies. Thus, demand and supply of a particular currency depends on the economy today as well as in the future. This of course involves making an emotional decision. However, trading is all about making rule-based decisions rather than relying on emotions or luck. The market operates on three principles: in a free market, supply and demand is an ongoing process of price actions; all price influence factors are already reflected in price; and changes in price movements happen when one of the sides (supply or demand) approaches null (Seiden 2011).

Let's look at the first principle: in a free market, supply and demand is an ongoing process of price actions. In the Forex market, the price is determined by ongoing actions between sellers and buyers of particular instruments. If there is greater demand, it pushes prices higher and creates a **pivot high**. Similarly, when there is greater supply, it creates higher lows and creates a **pivot low**. All these are reported on the charts we have seen above. However, in equilibrium states, buyers and sellers are almost equal (indicated on the chart by where the majority of candles are) and the price movement cannot be driven in one direction or another. The market cannot stay forever in a state of equilibrium—various factors will eventually move the price. However, the market will eventually again move toward equilibrium (Seiden 2011).

To examine the second principle: all price influence factors are already reflected in the price. This means that at any given moment, thousands of pieces of

information, such as economic reports, speeches by key figures, political issues, etc. can emerge and fade away. This information is translated into thoughts and beliefs by traders. Thoughts can be translated into action—either selling or buying an instrument at a specific price. Therefore, only price matters.

The last principle: changes in price movements happens when one of the sides (supply or demand) approaches null. This can be illustrated using a simple example. Say there are 100 buyers and 50 sellers at the price of 1.1000. The price will be in equilibrium until all 50 sellers have sold. After that, the price will start to move upward because no sellers are available but demand is present. The price will move upward until it finds another equilibrium point. In this example, the movement started when the sellers approached null (Seiden 2011).

So, as a trader, opportunities arise by seeking out these imbalance points of supply and demand. Doing so not only helps to maximize profit potential, but creates better chances for trading success while limiting risk.

CHAPTER SUMMARY

In this chapter, we learned about the three types of chart: line, bar, and candlestick. The most preferred among these three is the candlestick, which provides a huge amount of information to traders and allows them to make better decisions during a trade. It can be a very powerful tool for learning to understand quickly what has happened in the battle between buyers and sellers during a particular time period. In addition, we've learned how the demand and supply concept applies to Forex trading. In the [next chapter](#), we are going to look about some theories about trends, and examine the most popular chart patters to find out about trends and multiple time frame analysis.

Chapter Four

TRENDS IN FOREX MARKETS

Market trends in Forex trading show the direction of a price for a particular currency pair. When identified early, a trader can be profitable in the market by positioning his trades in advance (Chande 2001). Equally, a trader can avoid huge losses from aborting unfavorable existing trades. Forecasting the market is important for all sizes of companies, individual investors, and financial institutions. Effective technical forecasting methods will help keep investors from losing capital easily in the market, and will help them residing for longer periods of time in the market and to be profitable as well.

DOW THEORY

Charles Dow is considered the inventor of technical analysis. He founded Dow Jones & Company, which created the *Wall Street Journal*. Around 1900, after analyzing how the Dow Jones Industrial Average and the Dow Jones Transportation Index moved, he concluded that markets tend to move in similar fashion over time. Later, this basic statement evolved into Dow Theory. The theory is quite old now, but interestingly still relevant for many financial instruments (Waring 2007).

There are six assumptions that must hold for the theory to function. 1. Price discounts everything. 2. New information is disseminated immediately; when it arrives in investors' hands, prices are adjusted accordingly. 3. There are three trends in the market (**uptrend**, **downtrend**, and **correction**) and each trend has

three phases (accumulation, public participation, and excess). These forces include primary, secondary, and minor trends. The primary trend is likely to last for a long time (more than one year). Intermediate trends last for a few months. Minor trends last for a very short time (between three and twenty-one days) (Spaulding 2014). 4. Averages must conform to each other. 5. Volume confirms the trend. 6. A trend is considered to remain intact until it gives a definite reversal signal.

Let's look for a moment at Dow's third condition, regarding trends. An uptrend is defined as a movement when the price makes higher highs (HH) and higher lows (HL) than the previous highs and lows in a given period of time (shown in [Figure 14](#)). Down trends are when the price makes lower lows (LL) and lower highs (LH) (shown in [Figure 15](#)). When the market moves sharply in one direction, a correction is required in order to get it to move in the same direction again (shown in [Figure 16](#)).

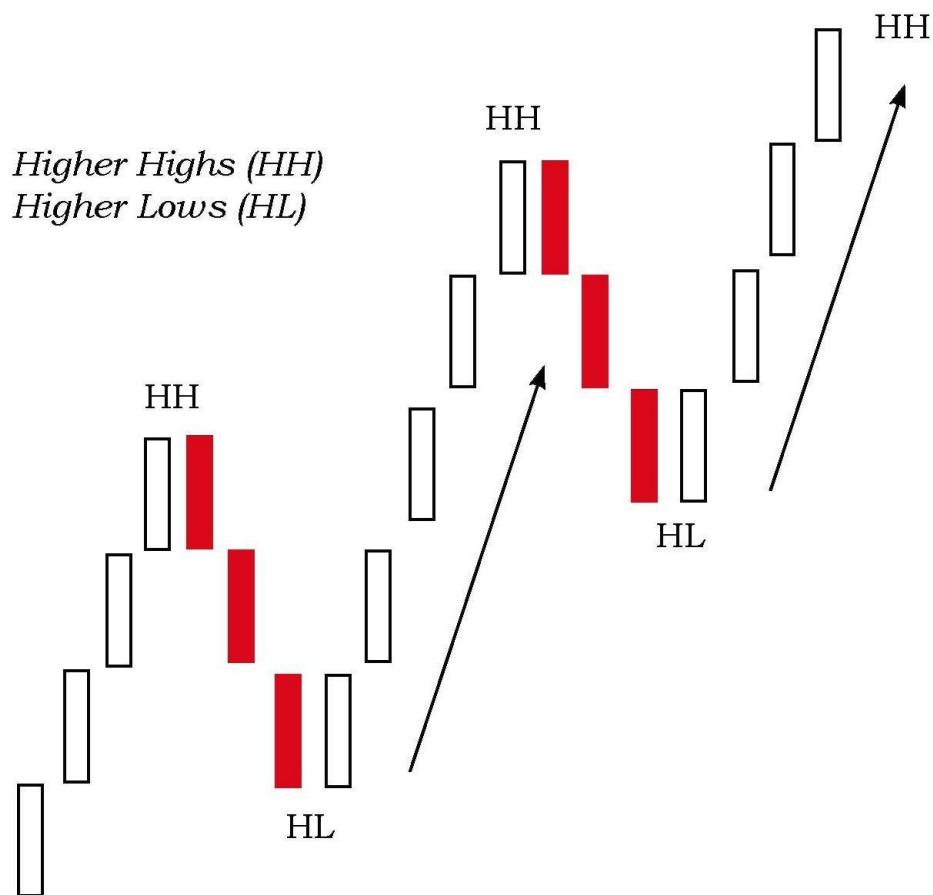


Figure 14: Uptrend

Let's look for a moment at Dow's third assumption—that a primary trend has three phases. During the first phase (accumulation), investors buy in plenty as they begin to enter the market. When conditions improve in the second phase (participation), investors accumulate the instrument due to improved market conditions. During the third phase (excess phase), more instrument is bought, but smart investors start to exit their positions in order to gain profit (Waring 2007).



Figure 15: Downtrend



Figure 16: Correction

An instrument's movement will be upward if there is an upswing in the market and downward if the market is on the downward swing. Two indexes developed for measuring overall market movement are the Dow Jones Industrial Average and the Dow Jones Transportation Average (only industrial and transportation instruments are included in Dow Theory) (Siegel, Shim, Qureshi, & Brauchler 2000). Investors in the market use this theory in determining whether there is a trend emerging and, if so, what its direction is likely to be. The theory is criticized for failing to give a maximum length and magnitude to the primary, minor, or secondary trends. It is also viewed as indicating the beginnings or endings of market movement very late. At times, it may also give inaccurate results. People are generally advised to buy if the market moves high and sell if it moves low (Siegel, Shim, Qureshi, & Brauchler 2000).

A trend is used to represent a consistent change in prices. The market for an instrument cannot move in a straight line. Decisions in trading can be made through support (traders may buy the instruments, causing sellers to be overpowered by the buyers) and resistance (traders may sell the instruments, causing prices to be pushed up and sellers to overpower the buyers) analysis. In

support mode, a price tries to find support as it goes down. A resistance level indicates that the price goes up until it finds resistance. There is a shift in supply and demand once the trend lines (used for connecting points that are significant to resistance, as we saw above) are broken. Support may turn into resistance, or resistance may turn into support. Analysis of support and resistance is very crucial, as it helps in the process of making trade decisions and in identifying trends that may be reversing. Through the use of Dow Theory, price patterns can be determined. The operation of support and resistance can be well understood if there is an understanding of how Dow Theory can be applied to trading instruments (Thomsett 2003).

ELLIOTT WAVE THEORY

R. N. Elliott first developed Elliott Theory in the early 1930s, but it was published by Charles Collins in 1938. Waves in this theory refer to patterns of movement of prices in the financial markets (Ginneken, n.d.). The price moves in five steps, and support or resistance is found after every step. When this specific repeating pattern of waves is observed and identified, prediction of market movement can be made. Fibonacci ratios are mainly used to find support and resistance levels, and mathematical foundations for this theory are provided by Fibonacci numbers. The time and magnitude of future market movements can be predicted by using Fibonacci numbers and counting waves. For the theory to make correct predictions, however, wave count must be accurate. It can be challenging to determine the starting or ending points of a wave.

A study by Dash and Patil (2009) was conducted in the stock market in India to find support for Elliott Wave Theory. Statistical data on the closing prices between the 2001 and 2008 indexes were used. The National Stock Exchange website served as a source of secondary data. Twenty-five companies were sampled in the study, drawn from the telecommunication, banking, information technology, energy, and automobile industries. The method used to identify the wave was careful observation. In their sample, the researchers selected scripts that were used in trading for the whole period under study. The study used two patterns (Pattern 1 and Pattern 2). Pattern 1 (a four-day pattern) had alternating signs that signified either gains (+) or losses (-). Pattern 2 (a seven-day pattern) was also used. The results of the study showed that the market does exhibit significant patterns. Pattern 1 was found to be missing in some scripts, but

Pattern 2 was found to be present in all the scripts. Trends were found to be of short length in several scripts. An Elliott Wave was present in various scripts. The Elliott Wave Theory is hence supported by this study (Dash and Patil 2009).

The Elliott Wave principle states that the psychology of investors and the momentum of the prices changes results in the movement of markets. There is movement from positivity to negativity in crowd psychology, hence the progress of some market trends in being forecasted. This principle is mainly applied in stock markets (Talreja 2007). There are five waves (impulse) that exist on the upside and three (corrective waves) on the downside of an Elliott wave. Major waves determine major trends and minor waves determine minor trends in the financial market. Impulse waves must be analyzed before a trader can predict or act on a prediction. In [Figure 17](#), Wave 1 is caused by a small number of various reasons—that instrument is cheap and there is time to buy it. Wave 2 is where profit-taking happens, but the price does not make it to a lower low than when the move started. Wave 3 occurs when an instrument gets the attention of traders and it creates a higher high. Profit-taking happens again in Wave 4, but again the price does not make a lower low than the original price from Wave 3. When it reaches Wave 5, people believe that the instrument is extremely overbought (Babypips 2011).

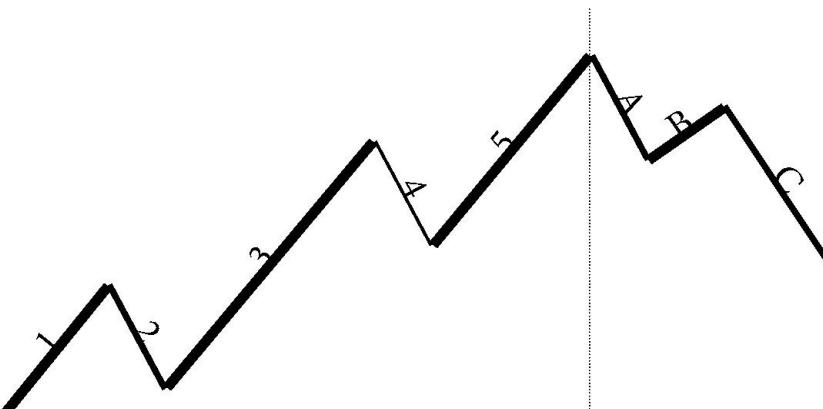


Figure 17: Impulse and Corrective Waves

In summary, understanding trends is one of the vital factors in Forex trading. When you look at charts, you can figure out the general direction a currency pair is headed. In some cases, the trend is easily identified; however, there are some cases where the trend is much more difficult to identify. There are commonly used rules for identifying trends. The first is that trends tend to move in a series

of gradually moving highs and lows. Thus, an uptrend is a series of ascending highs and lows, while a downtrend is a series of descending lows and highs. It takes at least two higher highs and higher lows to establish the uptrend and two lower lows and lower highs to establish a downtrend. Besides uptrends and downtrends, though, many instruments experience sideways trends too, which are created by roughly equal highs and equal lows.

The main purpose of this book is to teach investors to trade using demand and support strategies, not by relying on chart patterns. However, these chart patters can provide additional confirmation to the likely success of a trade. Therefore, we should investigate some details about four often-encountered chart patterns.

DOUBLE TOP AND DOUBLE BOTTOM

Double top is a powerful reversal chart pattern. Shown in [Figure 18](#), this kind of pattern forms two consecutive peaks. Double top appears during an uptrend where price creates a new high to the resistance level. It falls quickly, though, because sellers take control over buyers. Since the overall trend is still on the upswing however, buyers make another attempt to purchase, and this pushes prices higher. Buyers fail to make a higher high, however, due to selling pressure. Finally, the price starts to fall back to the support level (called the **neckline**). Once the support level is broken more sellers step in, which marks the beginning of a downtrend.

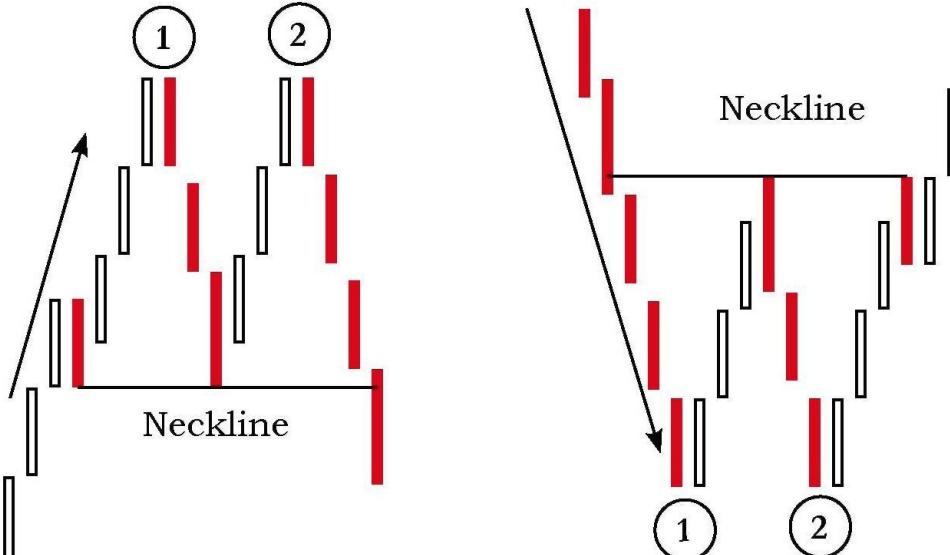


Figure 18: Double Top (Left), Double Bottom (Right)

Another way to say this is that, at the resistance level, supply surpasses the demand, which results in falling prices. It is quite difficult to see volume in Forex due to the fact that it is a decentralized market, so in the normal trading process, traders watch closely for declining volume in the second peak of a double top.

Another common chart pattern is a **double bottom**. This is also a reversal pattern, and is the mirror image of a double top. Double bottoms appear during a downtrend, where price creates a new low at the support level. It rises quickly up because buyers take control over sellers. Since the overall trend is still downward, however, sellers make another attempt to push price lower, and this causes the second low. However, sellers fail to make a lower low due to buying pressure from bulls. Finally, the price starts rising back to the resistance level. Once the resistance level (neckline) is broken, more buyers step in, which makes the beginning of an uptrend again.

Simply put, at the support level, demand surpasses supply, which results in rising prices. It is quite difficult to see volume in Forex due to the decentralized market, so in the normal process, traders watch closely for declining volume in the second peak of a double bottom.

HEAD-AND-SHOULDERS AND INVERSE H&S

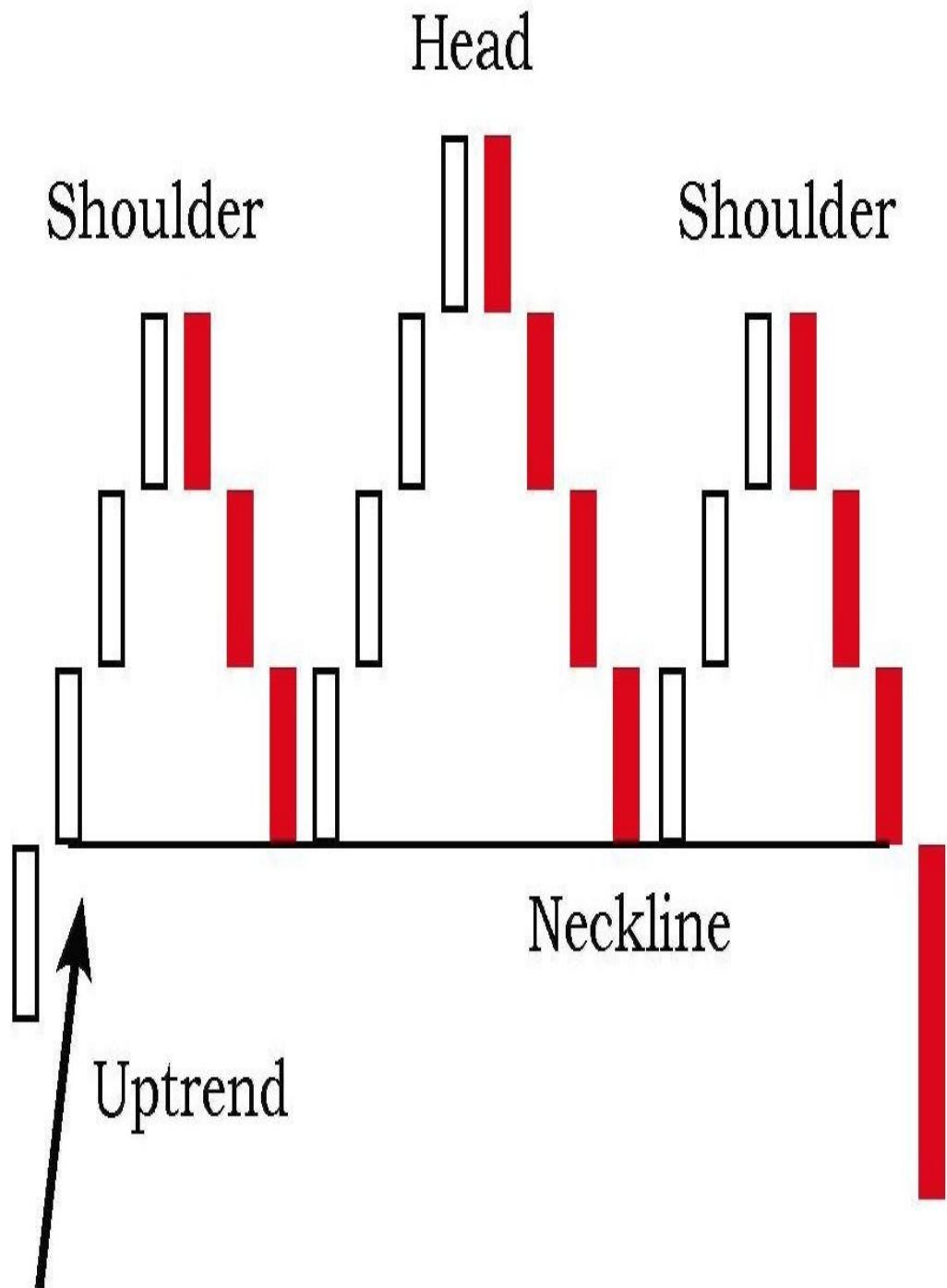


Figure 19: Head-and-shoulders

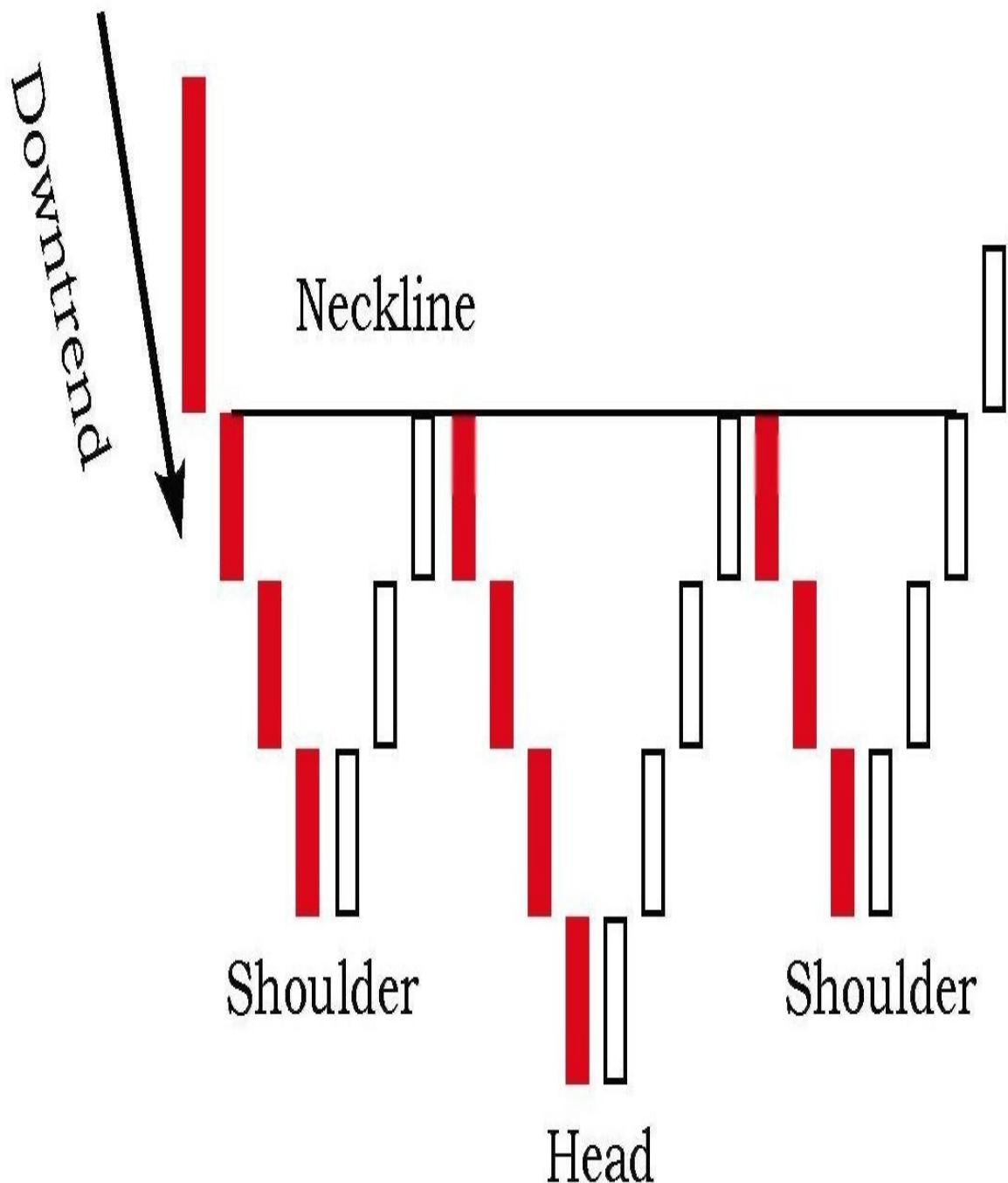


Figure 20: Inverse head-and-shoulders

The **head-and-shoulders** (H&S) pattern is another common chart pattern to encounter. This is trend-reversal pattern and occurs during an uptrend. The formation structure follows the name itself, and it looks like a head with two shoulders (shown in [Figure 19](#)). A head-and-shoulders pattern forms when the price makes one peak (the left shoulder), followed by a higher peak (the head), which is then followed by a lower peak (the right shoulder), and finally breaks below the support level (neckline). As we can see from Figure 19, buyers pushed the price higher three separate times before the sellers finally took control. The chart pattern gets validation when the neckline is broken. Traders pay special attention to this, but the neckline is synonymous with the support line.

An **inverse head-and-shoulders** pattern is mirror image of a head-and-shoulders pattern. This is also trend-reversal pattern, but it occurs during a downtrend. An inverse head-and-shoulders pattern forms when the price makes a new low (the left shoulder), followed by a lower low (the head), which is then followed by a higher low (the right shoulder), and finally the price breaks below the resistance level.

As we can see from [Figure 20](#), sellers pushed the price lower three times before buyers took control. The chart pattern gets validation when the neckline is broken, and traders pay special attention to it. The neckline is synonymous with the resistance line.

MULTIPLE TIME FRAME

A **multiple time frame** chart is one of the tools we can use to analyze the same instrument over several different time frames, for trend analysis. This enables the trader to find out whether an instrument is experiencing an overall trend. If there is a trending market, smaller trends occur before larger trends, which means trends exist within trends (Money 2012). For example, if we look at a weekly chart of AUD/USD, the trend may seem to be toward a downturn; however, on a four-hours chart, the trend may be up. A sixty-minute chart of the same pair may appear to be no trend (see [Figure 21](#))

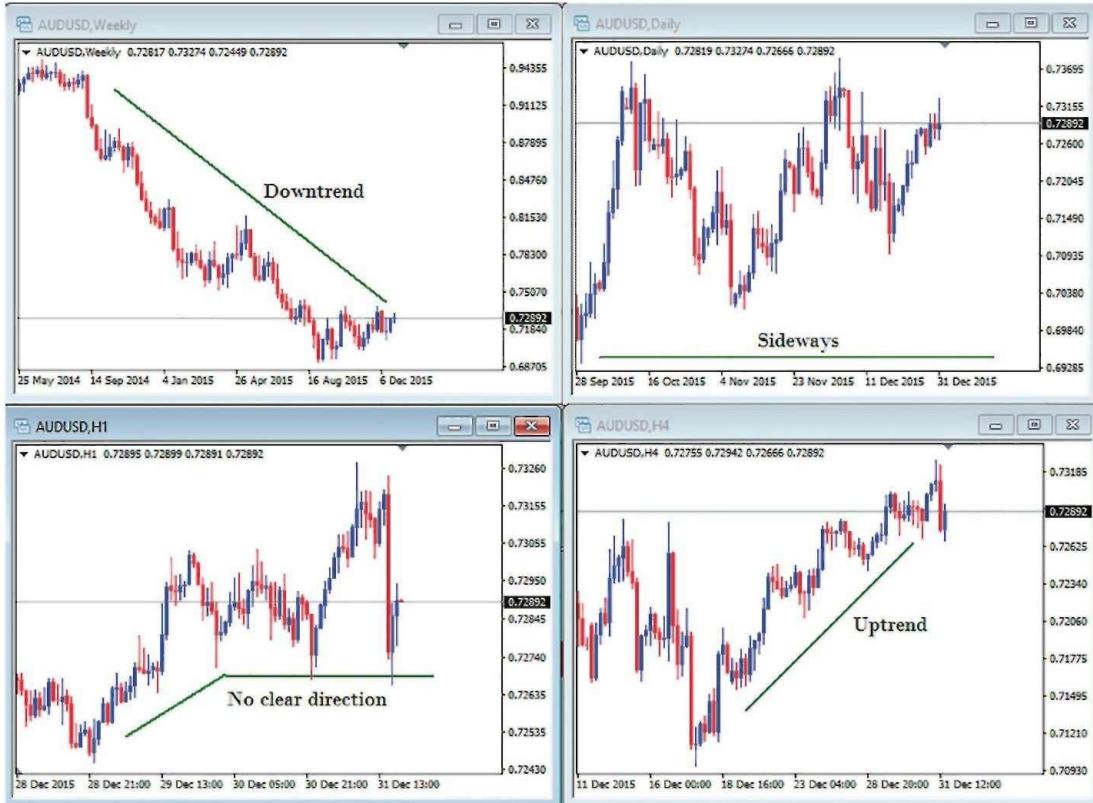


Figure 21: Multiple Time Frame

Most traders use three time frame analyses, but this depends on an individual's trading style. For example, swing traders may look at a weekly chart for bigger-picture analysis, trend identification in a daily chart, and a 240-minute chart to determine entry. Traders such as day traders—who want to get in and out of a trade on the same day—might look at 240 minutes as their “big picture” chart, a sixty-minute chart for intermediate analysis, and a fifteen-minute chart to determine entry. As described earlier in the Dow and Elliott theories discussion, in case of an uptrend, a price reaches new higher highs and new higher lows, and in a downtrend, a price creates new lower lows and new higher lows. Traders see opportunity once the smallest time frames have completed a retracement and a price starts to travel in the direction of the longest time frame’s chart trend. If we take the example of three-time-frame analysis for swing trading, the best entry point would be when the 240-minute trend chart begins to align with the daily chart and daily chart begins to align with the weekly chart (Money 2012).

CHAPTER SUMMARY

Many traders use Dow and Elliott wave theory to identify trends, in combination with other tools. Double top, double bottom, head-and-shoulders and inverse head-and-shoulders are often-seen reversal patterns. It is very important to be able to understand and identify trends in order to trade with a trend for profit maximization. Trend identification also helps traders to avoid losing money by acting counter to trends. Demand and supply directs trends or trend reversal strategy, which will be explained in greater detail in [Chapter Five](#).

Chapter Five

DEMAND AND SUPPLY ZONES

The concept of technical analysis is similar to weather forecasting. In Forex, two major assumptions take place that reinforce the validity of using charts and chart patterns. They are: prices operate in trends (uptrend, downtrend, and sideways), and that history repeats itself. Technical analysis is one of the forecasting methods that uses historical data of price movements in order to predict future price movements. Pring (2002, p.2) defines investment using a technical approach as basically a reflection of the idea that prices follows trends, and that these are calculated by the changing attitudes of investors toward various forces such as monetary policy, economics, crowd psychology, and politics. The aim of technical analysis is to find out about the likely reversal of a trend from quite an early stage and to travel with it until it shows some sign of trend reversal (Park & Irwin 2004).

The primary goal of this book is to teach how to trade using demand and supply strategy, in order to forecast future price movements. Technical analyses can help identify supply and demand imbalance patterns for trend or trend reversal. A trend reversal pattern indicates the possible reversal of a trend, and trend continuation patterns inform investors that temporary pauses have occurred in an existing trend. Continuation patterns take less time to form than reversal patterns, and usually result in an eventual resumption of the original trend (Murphy 2000).

IDENTIFYING MARKET REVERSAL POINTS

Technical analysts believe that trends and patterns on candlestick charts can be used to identify reversal points in the market. They assume that history repeats, that humans behave in similar fashions in similar circumstances. However, finding good entry, stop, and exit points have been always challenging for traders. This book will give guidelines about effective ways of finding entry and exit criteria using demand and supply imbalance patterns for trend reversal and trend continuation. An entry point is considered to be good when there is a higher probability of success, low risk, and the potential for achieving profit targets. Similarly, a stop is considered good when predefined losses are known —this includes the cost of opening a position in case the trade does not go in a trader's favor. A target is considered good when predefined gains are known (Seiden 2009). The general rule of trading is that, for every dollar you are risking, you should get a return of equal or more (Bernard 2011). The distance between entry and stop is called risk, and the distance between target and entry is called reward. Therefore, the demand and supply imbalance points often called **market turning points** provide the lowest risk, the highest reward, and often make the most sense as probable entry points (Seiden 2011).

A demand and supply imbalance occurs when demand exceeds supply or supply exceeds demand. This creates a series of same-color candles in one direction if there is great imbalance, as shown in [Figure 22](#). When a majority of different-color candles occur together, that zone is called an **equilibrium zone**. When a price moves quickly up from that zone, one thing is confirmed: there were no available sellers. This is because if there had been sellers at that point, price would not have moved up. At that point, all the sellers were absorbed. Therefore, the price started to go up.



Figure 22: Equilibrium and Imbalance Area

This move was created by an institution trading at high volume. Then individuals or speculators started to join the move, which created a series of bull candles. This imbalance point can be used as a market turning point for high possible reward and low-risk entry points. Similarly, when price moves quickly down from the equilibrium, one thing is confirmed: there were no available buyers. This is because if there had been buyers at that point, the price would not have moved up. At that point, all the buyers were absorbed; therefore, the price started to fall. This imbalance point can be used as a market turning points for high possible reward and low-risk entry points (Seiden 2009).

IDENTIFYING DEMAND AND SUPPLY ZONES

The first step in developing a demand and supply strategy is to identify demand and supply imbalance points where a great imbalance occurred. This can be identified by looking at a candlestick chart, and watching for a place where a series of same-color candles occur in one direction. Of course, in Forex we only

have two actions: buy and sell. Let's look at both scenarios below.

Buying scenario:

[Figure 23](#) shows the chart of GBP/USD, in 240-minute time frames. The current price is point A. We need to look left from the current price. The main target is to look for the demand and supply imbalance area—without cutting through candles. The current price will always be located above the demand zone. Point B shows the origin of this demand and supply imbalance, as indicated by many blue candles in one direction. At that moment, willing demand exceeds willing supply, therefore, the price moved higher. When price moves quickly up from the equilibrium zone, one thing is confirmed: there were no available sellers. This is because if there had been sellers at that point, the price would not have moved up. Hence, point B is considered a potential buying point. Institutions and professional traders do not chase prices—they wait. Certainly, they know that the price does not move only in one direction. People who entered at point B will sell at a certain point in order to make a profit, especially where the next supply is available. When price is moving quickly upward, creating a series of blue candles, two things can be anticipated: a) the market moved quickly away from the equilibrium because there were no supplies available, and b) not all buyers positions were triggered at that area, some were left behind (Seiden 2009). It is advisable to wait until the price comes back into the buying area, shown at point C, in order to buy the pair so that we can participate with existing buy pending orders. [Figure 24](#) shows a scenario of what happens when the price comes back into the buying zone. Most traders will get nervous about making a buy decision because of the first red candle, which is quite bearish.

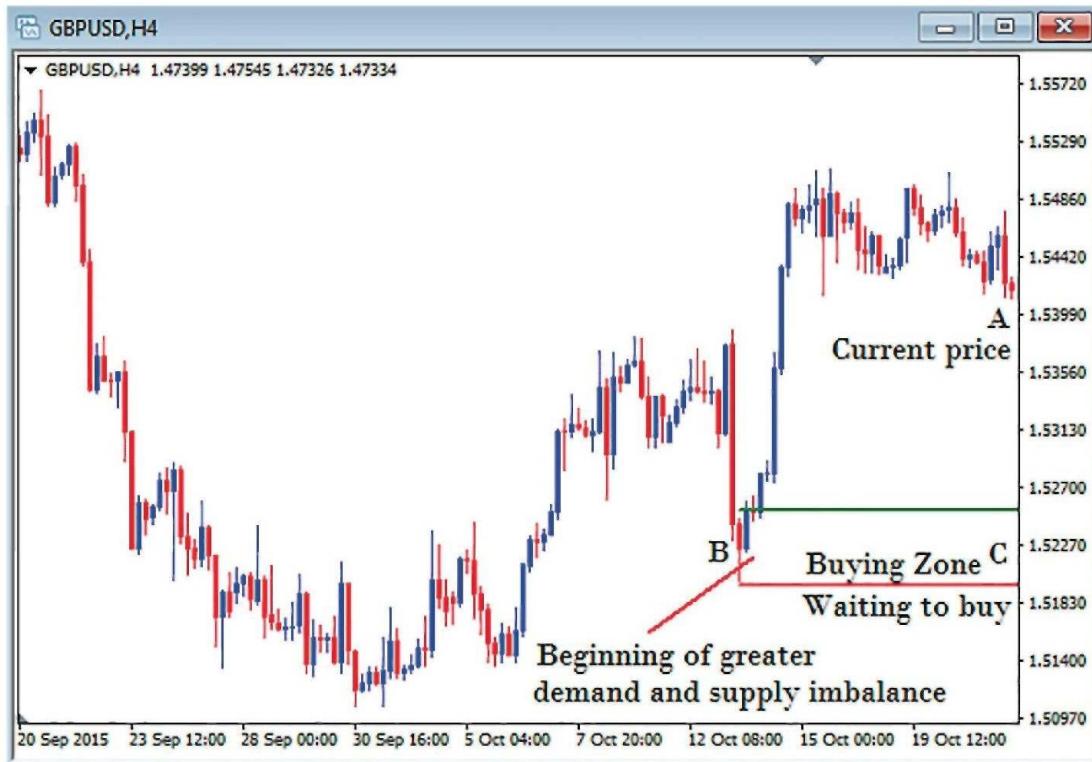


Figure 23: GBP/USD Buying Zone



Figure 24: GBP/USD Buying Scenario - Result

Selling scenario:

To examine selling points, let's look at [Figure 25](#). This shows the EUR/USD pair from a live MetaTrader 4 chart.



Figure 25: EUR/USD Selling zone

The current price is point A, and we need to look left from there to determine a trend. The main target is to look for the demand and supply imbalance area—without cutting through candles. The current price will always be located below the supply zone. Point B shows the origin of this demand and supply imbalance (many red candles in one direction).

At that moment, willing supply exceeds willing demand, therefore, the price moved lower. When price moves quickly down from the zone, one thing is confirmed: there were no available buyers. This is because, if there had been buyers at that point, the price would not have moved down. Hence, point B is considered a potential selling point. Institutions and professional traders do not chase prices—they wait. Certainly, they know the price does not move only one

direction. People who entered at the point B will need to make a profit at a certain point, especially where the next demand is available. When a price is moving quickly downward, creating series of red candles, two things can be anticipated: a) the market moved quickly away from equilibrium because there were no buyers available, and b) not all the sellers' positions were triggered in that area, some were left behind (Seiden 2009). It is advisable to wait until the price comes back up into selling area, shown in point C, in order to sell the pair, so that we can participate with existing sell pending orders.

[Figure 26](#) shows a scenario of what happens when the price came back into the selling zone. Most traders will get nervous about making a sell decision because of the first blue candle, which is quite bullish.



Figure 26: Sell zone result

THE STRUCTURE OF MARKET REVERSAL

In the above section, we learned how we can find market reversal points and discussed the logic behind why these points play a significant role in trading

success. These points can be identified by looking left from the current price until we find the origin of the imbalance. In the case of buying, we will look for strong price movement upward from the origin price and, similarly, for the selling opportunities, we look for strong price movements downward.

Once the location of a market imbalance point is identified, the structure the price takes on at the origin of the move also plays a significant role. Therefore, not every imbalance point will be valid for buying or selling a currency pair. In general, valid buy and sell zones/location falls into four categories: **Rally-Base-Drop (RBD)**, **Drop-Base-Rally (DBR)**, **Rally-Base-Rally (RBR)**, and **Drop-Base-Drop (DBD)** (Seiden 2013). Rally-Base-Drop and Drop-Base-Rally are the reversal patterns, whereas Drop-Base-Drop and Rally-Base-Rally are continuation patterns.

Rally-Base-Drop

[Figure 27](#) shows how low supply and high demand results in a price rising from the equilibrium zone or point; however, after finding the supply higher than the current price, it falls again. We will be looking the area denoted as “base: in order to draw lines on a chart to determine when to sell the pair.

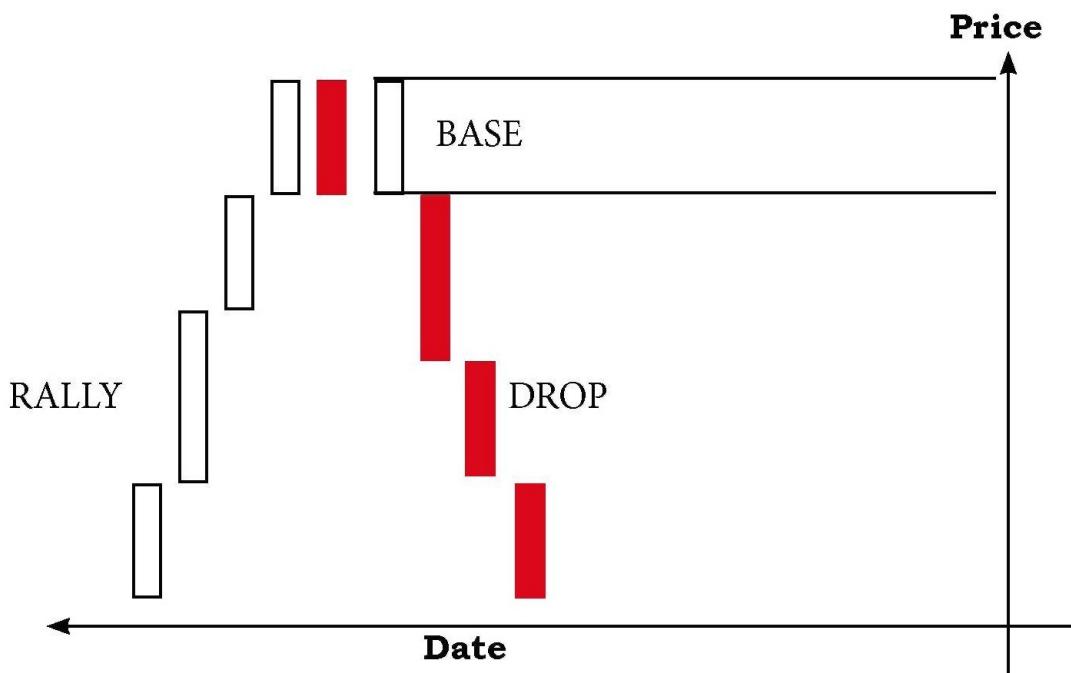


Figure 27: Rally-Base-Drop (RBD)

Drop-Base-Rally

The opposite pattern of rally-base-drop is drop-base-rally (see [Figure 28](#)). Low demand and high supply results in a price drop from the equilibrium zone/point; however, after finding demand lower than the current price, it rises again. We will be looking the area denoted as “base” in order to draw lines on a chart to determine a buy opportunity.

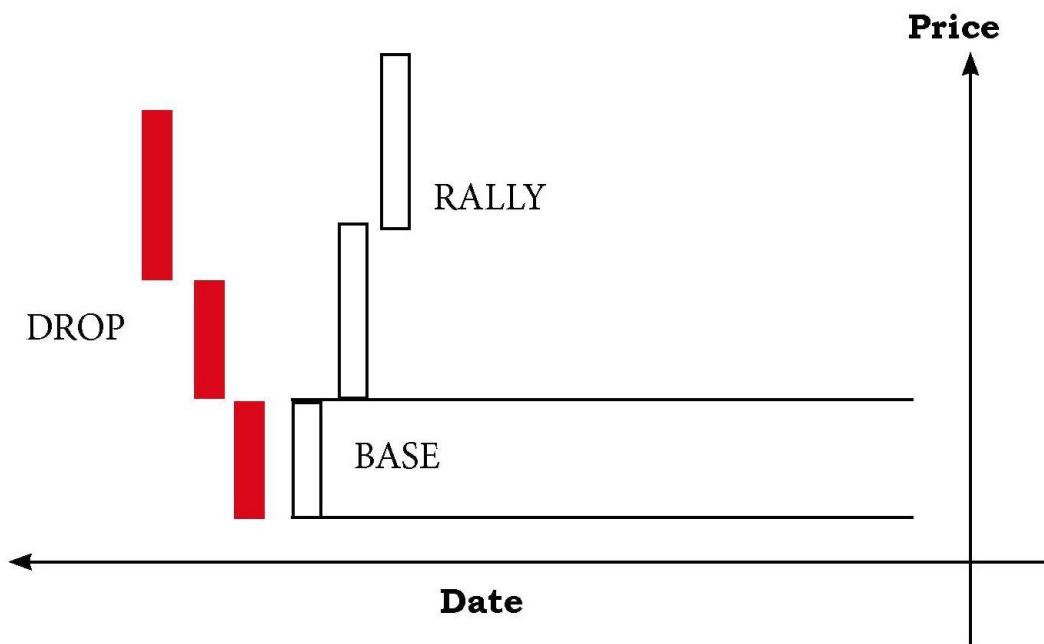


Figure 28: Drop-Base-Rally (DBR)

Drop-Base-Drop

[Figure 29](#), shows a drop-base-drop, which occurs when a price is pushed down from the equilibrium point due to high supply and low demand. Buyers tried to take control at the base, but sellers failed to push the price higher, resulting in a further sell of the instrument.

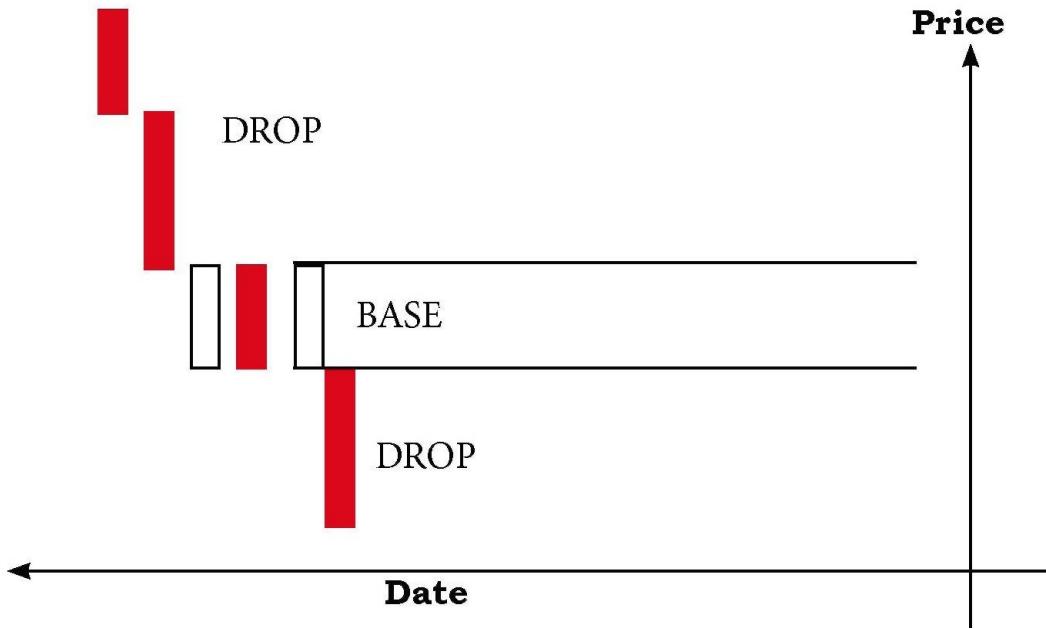


Figure 29: Drop-Base-Drop (DBD)

Rally-Base-Rally

Rally-base-rally is the opposite of drop-base-drop (see [Figure 30](#)). Here, low supply and high demand push the price upward, sellers try to take control over buyers at the base, but buyers fail to push the price low, resulting further imbalance of the instrument, and the price rises higher.

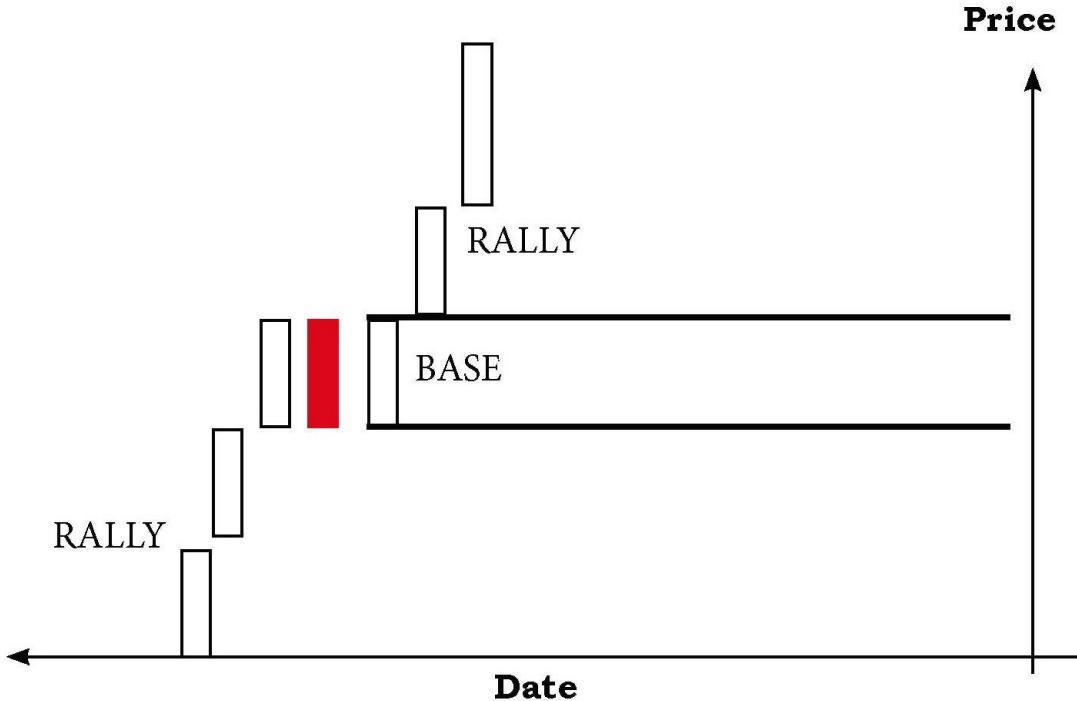


Figure 30: Rally-Base-Rally (RBR)

Traders may experience any and all of these four scenarios in many places on a candlestick chart. However, not all of them are indicative of the quality of the entry and exit opportunity for a trade. Quality levels are only valid if certain parameters are fulfilled.

Parameters for Validating RBD, DBR, RBR, and DBD Opportunities

The below parameters must be fulfilled before the quality level for a trade opportunity at the origin of the move/imbalance point can be determined. They are:

- Reward-to-risk ratio
- The distance from the zone
- Time spent on the level/zones
- The freshness of the zone

Reward-to-risk ratio: a level only becomes a quality opportunity if the initial

rally from the level is at least three times the reward-to-risk ratio (Seiden 2012).

In simple terms this means the distance from the origin of the imbalance point to the next equilibrium point needs to be at least a 3:1 reward-to-risk ratio—in the case of swing trade. However, with smaller a time frame such as five minutes or fifteen minutes, at least 2:1 reward-to-risk ratio is needed. The quality level will not be valid if this criteria is not met.

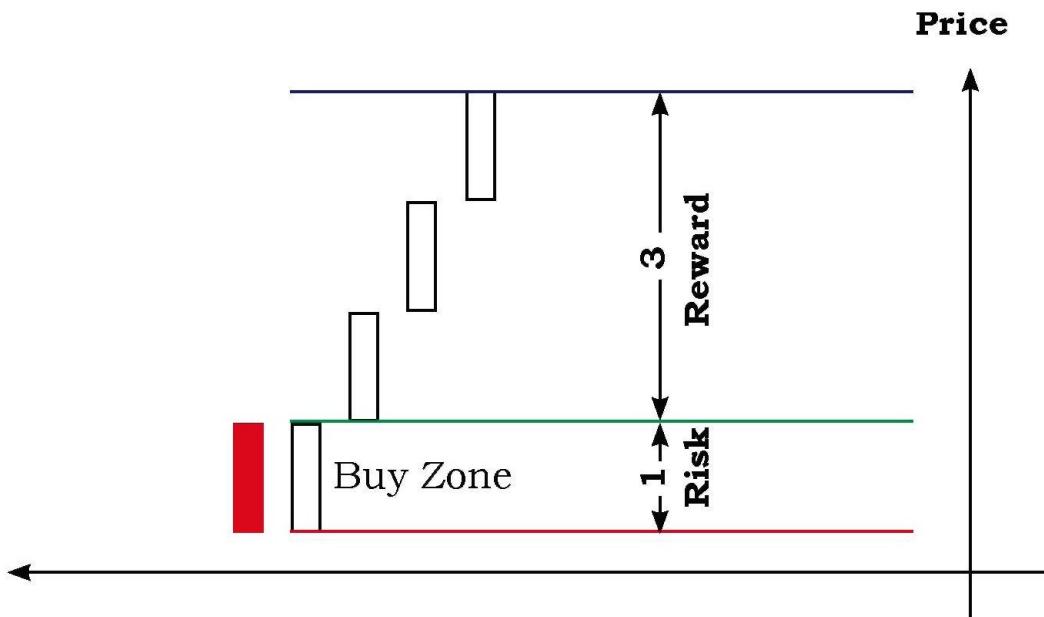


Figure 31: Reward-to-Risk Ratio

The distance from the zone: A stronger imbalance is implied if there are comparatively longer and bigger consecutive candles in one direction.

In the case of an uptrend, there should at least three bull candles combined with at least one or more extended candles; in the case of a downtrend, there should be at least three bear candles combined with at least one or more extended candles from the origin of the imbalance point/zone. The quality level will not be valid if there are mixed candles of bears and bulls.

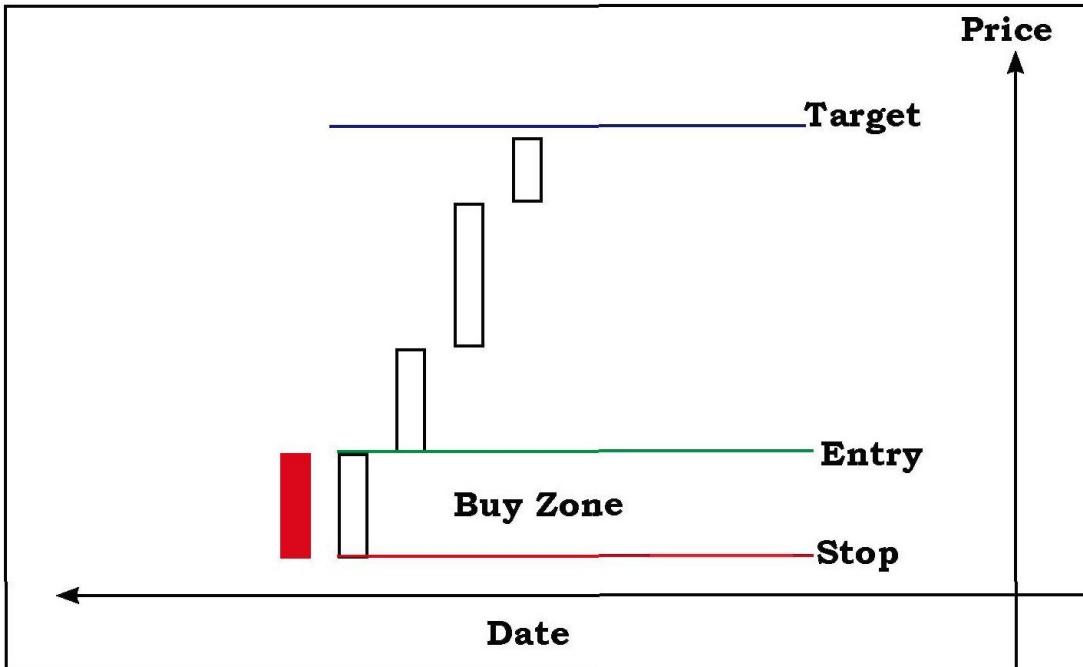


Figure 32: Distance from the Zone

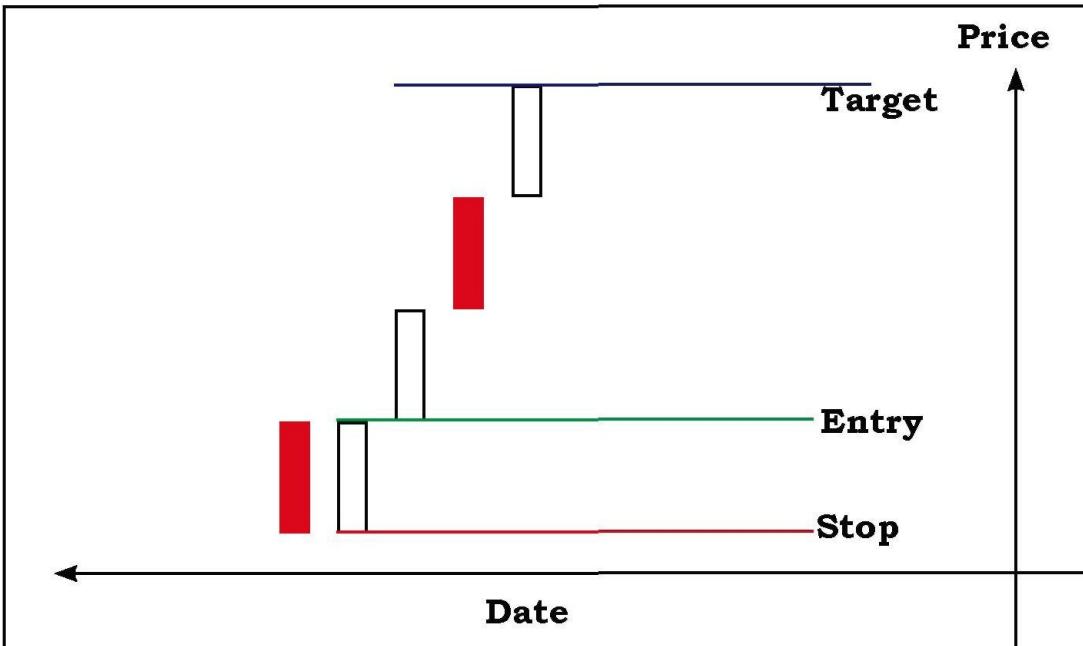


Figure 33: Distance from the Zone (Invalid Zone)

Time spent on the level/zone: Zones are categorized as long and short. If there are several candles—usually more than four—it is called a **long zone**, and if there are fewer than four candles at the origin of imbalance, it is called a **short zone**. A short zone is considered more effective than a large zone, and should

therefore draw our attention.

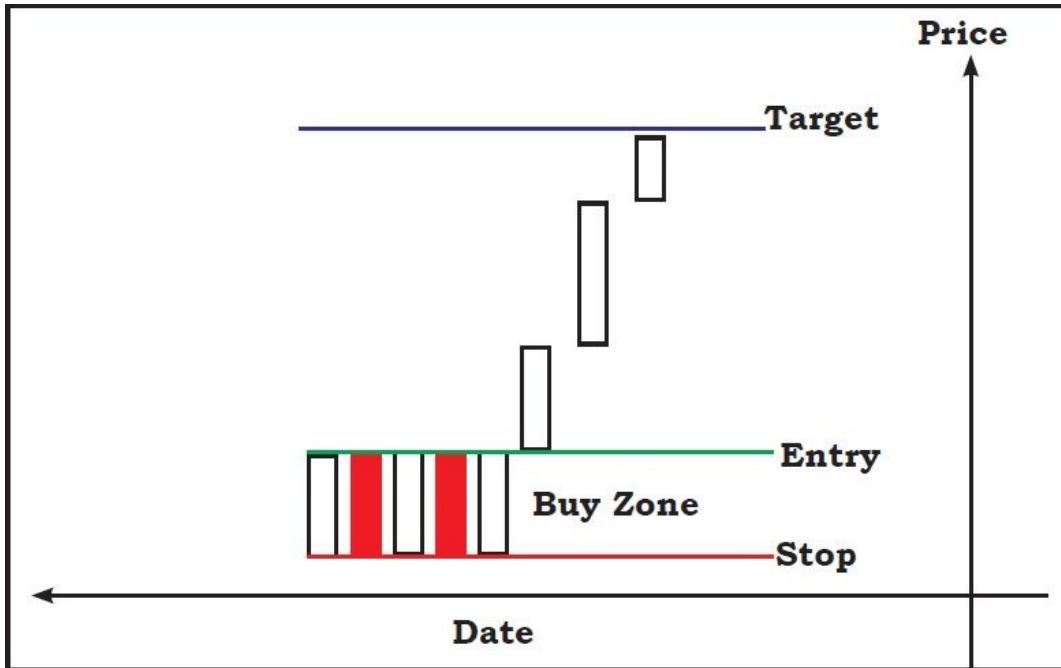


Figure 34: Time Spend on the Level

The freshness of the zone: Freshness can be identified by looking to the left from the current price, to see whether the price has hit a plateau or not. Normally, the quality level will be less valid if the price touches a buy zone more than one time. We consider a quality level valid if it is fresh. In [Figure 35](#), point 1 is fresh, where as point 2 is not fresh.

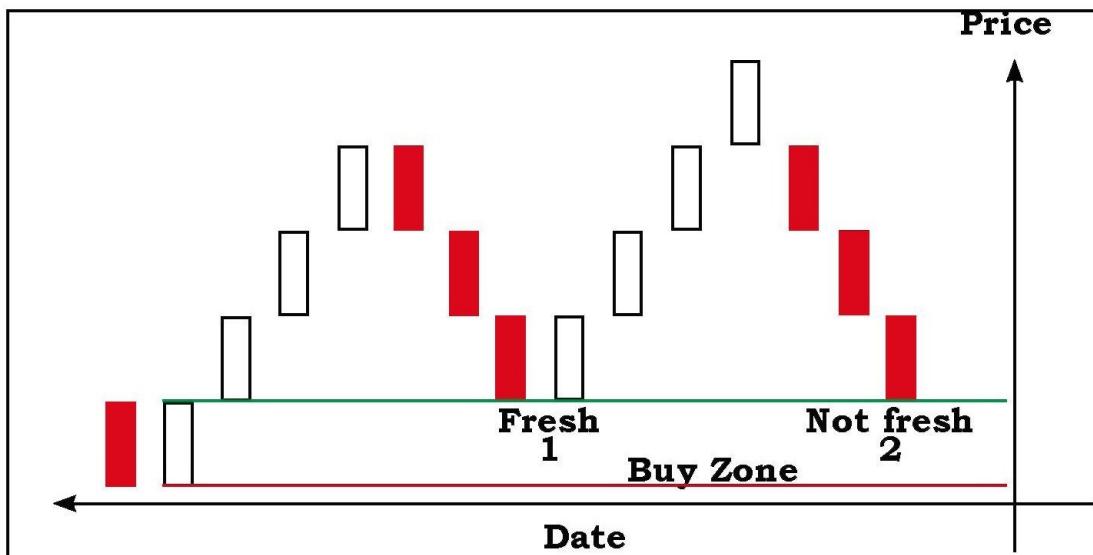


Figure 35: Fresh and not fresh zone

CHAPTER SUMMARY

The chapter summary is expressed in the table below.

Parameters	Description
Name of the zone	Supply or demand
Type of zone	Drop-Base-Rally, Rally-Base-Drop, Drop-Base-Drop, Rally-Base-Rally
Reward-to-risk ratio	At least 3:1 for swing trade and 2:1 for day-trading
Distance of the zone	Long or short
Time spend at the level/zone	Long time or Short time
Freshness of the zone	Fresh or not fresh (touching)

In the [next chapter](#), we are going to look at how a confluence of factors support supply and demand zones. Confluence factors provide more confidence to traders, and can be indicators for trade success.

Chapter Six

CONFLUENCE FACTORS FOR DEMAND AND SUPPLY ZONES

Traders incorporate technical indicators along with a main strategy to get additional confirmation about whether to buy or sell currency pairs. Technical indicators are a series of data points—including the prices at opening or closing, the low and high prices in a given period, or a combination of these over a period of time—and apply formulas to them to derive certain outputs. One good example is the simple moving average of four high prices, say $20+20+10+30=20$. This would create one data point. Technical indicators are a series of data points that provide meaningful information to traders. For example, a ten-day moving average and a fifty-day moving average crossover might reveal a changing trend. Traders may decide to “go short” instead of taking a “going long” position on a given currency pair based on these indicators.

The main concept is that, at the support level, supply is overtaken by demand and, conversely, at the resistance level, demand is overtaken by supply. The entire calculation derived using price is called **proactive technical analysis**, which can be used to find support and resistance lines. For example: Fibonacci number and trend lines. Trade may use these to determine potential profitable entry and exit points. Another method is **reactive technical analysis**, which can be derived from price actions, such as highs and lows, gaps, or volume. Traders tend to respect past levels.

All available technical indicators are broadly categorized into two groups: leading and lagging indicators. **Leading indicators** are considered to lead price movements, meaning they herald future events. Fundamental leading indicators are such things as consumer sentiment indexes and the Purchasing Managers' Index (PMI). The Commodity Channel Index (CCI), Momentum Index, Relative Strength Index (RSI), Stochastic Momentum Index, and Fibonacci numbers are leading technical indicators. Leading indicators are great to know as an early signal for entry and exit criteria in a trending market. However, no technical indicators predict 100 percent correctly—early signals can be a major forewarning factor, too. These leading technical indicators tend to produce false signals in nontrending and range-bound markets.

Lagging indicators follow an event/price action. Some of most popular lagging indicators for trending markets are moving averages (simple and exponential) and moving average convergences/divergences (MACD). They do not predict the future, but they are good for confirmation of a move. Some traders use these indicators to catch a trend or to determine whether to remain in the trade. Since these indicators provide signals after an initial event, however, a trader using them may enter into a position quite late, and a significant move may have already passed. For example, waiting until a moving average crossover happens could reduce the risk-to-reward ratio or the profit margin, which could result in late entry or late exit.

Many technical indicators have been developed to guide investors. Their efficiency, however, varies from indicator to indicator and depending on market conditions. By combining multiple indicators, a trader can gain additional confidence in decision making (Hussain, n.d.). Some traders argue that incorporating too many indicators may cloud the decision-making process, or could provide false signals. Here is an example. When we analyze a EUR/USD chart, we find out that there is an imbalance zone ranging from 1.1100 to 1.1125, and we'd like to place a sell position. We also found a 50% Fibonacci retracement at 1.1110 and 100 periods moving at 1.1115. The level is supported by factors we will discuss later, including round numbers, moving averages, and Fibonacci retracement, therefore, the quality level is affirmed by a confluence of many indicators. Hence, the trade can be considered viable.

Below are few additional confluence indicators that may be useful to incorporate

with demand and supply strategy.

SMA AND EMA

Simple moving average (SMA) in conjunction with supply and demand strategies provides an extra level of assurance that a trade may work in favor of the trader. A simple moving average is calculated by calculating the average price of an instrument over a specified number of periods. For example: a ten-day simple moving average is the sum of ten days' closing prices divided by ten. Popular SMAs in Forex are periods of 50, 100, and 200 days. An **exponential moving average (EMA)** gives more priority to recent closing prices. There are three steps to calculating EMA. First, calculate the SMA over a specified period of time; second, calculate the weighting multiplier; last, calculate EMA using the formula given below.

The formula for a ten-day EMA:

- SMA: 10-period sum/10,
- Multiplier: $(2/(Time\ periods + 1)) = (2/(10 + 1)) = 0.1818\ (18.18\%)$,
- EMA: $[Close - EMA\ (previous\ day)] \times \text{multiplier} + EMA\ (previous\ day)$.

A ten-day EMA applies an 18.18% weighting to the most recent price. The most popular EMAs for Forex trading are periods of 10, 20, 30, and 50.

Traders use SMA and EMA in order to identify trends, using different period moving average crossovers. For example, a 10-period moving average, which is called short, and a 100-period moving average, which is called long crossover. These indicate trend reversal. An EMA reacts faster than an SMA. The reason is that it gives more weight to recent prices, whereas an SMA provides a currency's true value. There are also bullish and bearish crossovers. Bullish crossover means shorter moving average crosses above the longer period's moving average. When it crosses below the moving average, it's called a bearish crossover. All kinds of moving averages are lagging indicators, because they

provide late signals about value. Traders use moving averages in combination with support and resistance indicators to create confluence factors.



Figure 36: Buy Zone Confluenced by SMA

[Figure 36](#), shows the combination of a 100-period SMA at the demand level (240-minutes EUR/USD chart). SMAs and EMAs do not need to be calculated manually. Almost all trading platforms can provide the automatic result and indicate it with a line on a graph in a second. Traders need to base their analysis for investing in on a combination of charts and their main strategy.

ROUND NUMBERS

When a person purchases a piece of equipment such as an iPad, he tells family or friends, he paid \$500 or \$600 for it when they ask, rather than the actual amount of \$499.95 or \$599. Humans have a tendency to simplify. Similarly, in Forex trading, traders have many strategies that utilize round numbers. Research done by Oslar (2001) shows that traders also have a tendency to use round numbers for buy stops and stop-losses. He noticed that **buy stops** were clustered just

above round numbers, for example: at 1.2005 rather than 1.2000. Similarly, stop-losses were clustered just below round numbers, for example at 1.1995 instead of 1.2000. Therefore, support and resistance strategy in combination with round numbers could be useful in a trader's decision-making processes.



Figure 37: Buy level at Round Number 1.5200

FIBONACCI RATIOS AND RETRACEMENTS

Leonardo of Pisa, originally named Leonardo Fibonacci, was born in c. 1170 in Italy. His number theories relating to sequence were discovered by later mathematicians to be reflected in nature. These numbers are often used in the financial markets as **retracements** and **extension numbers**. The most popular retracement numbers are, .382, .50, .618, and .786, and the most popular extension numbers are 1.618 and 1.27 (Martinez 2007). During an uptrend, the market makes higher highs and higher lows, whereas in a downtrend, it makes lower lows and lower highs. Fibonacci retracement levels can be used as future calculations of support and resistance. If it is a strong trend, the minimum retracement the trader looks for is 38.2%, whereas in a weaker trend, it can go up

to 61.8% or 78.6%. If market retracement happens completely, 100% of the previous move, it cancels the current move (Yell 2013).

Fibonacci factors can be useful in determining support and resistance zones. A resistance zone can be defined as a zone where sellers appear to be stopping the price from rising further, and which can be used to indicate a market turning point of a trend. Similarly, a support zone can be defined as a zone where buyers appear to be stopping the price from falling further, and which can be used to indicate a market turning point of a trend (Giryn & Kozubski, n.d.).



Figure 38: Demand Level and Fibonacci 38.2% Retracements

Figure 38, shows EUR/USD, on a sixty-minute chart. If we take the move created by the European Central Bank (ECB) press conference on March 12, 2015, to draw a Fibonacci retracement (at the bottom and top of the move), the demand level shown as point A is supported by Fibonacci 38.2%. This gives additional confidence to the trader as to why buying Euros at that level would be recommended.

CANDLESTICK FORMATION PATTERNS

Candlestick charts form many different patterns. Since our main strategy is to identify demand and supply imbalance points for entry into the Forex market, the formation of candlestick patterns are taken into account as a confirmation of a strategy only. We will be discussing four major candlestick formation patterns that may provide buy and sell signals. Other patterns also follow similar principles.

Bullish patterns that indicate buy signals:

- Morning star
- Bullish engulfing pattern

There are other common bullish reversal pattern formations in candlestick charts, including: hammer, inverted hammer, doji, piercing patterns, and bullish harami. These patterns will not be discussed in this book. It suffices to note that bullish reversal candlesticks appear after a downward move (a strong downward move creates a reliable pattern more than a weak move will). Candlestick formations at the base of the move where prices are traded in near equilibrium are not valid.

Morning Star BUY Signal

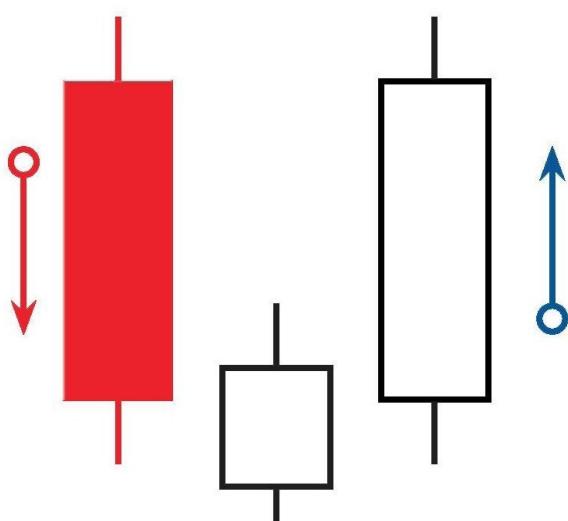


Figure 39: Morning Start for Buy Signal

The ideal morning star candlestick pattern forms from three candles after a sharp drop in price. The pattern appears at the bottom of the chart (near the support level), with one “large” bearish candle followed by one indecision candle (or sometimes more, however, more candles mean the pattern has less validity), followed by another “large” bullish candle. The bullish candle must be at least 60% of the length of the previous “large” bearish candle. A bullish candle less than 60% of a bearish candle’s length

does not validate the morning star formation.

This formation happens when there are a great number of buy pending orders sitting at a certain level, where demand of that currency pair exceeds the supply. Many traders see the formation of a morning star leading to profit-taking among the majority of sellers. New bulls quickly emerge to buy the currency pair, which results in a quickly rising price.

Bullish Engulfing BUY Signal

Bullish engulfing patterns form after a sharp drop in price at the support level. This can appear at the price turning point, or at the end of retracement in an uptrend. The ideal formation of such patterns is as follows: a first candle with a bearish “real body,” followed by a second candle opening lower than the first candle’s close and that completely engulfs first candle’s “real body.”

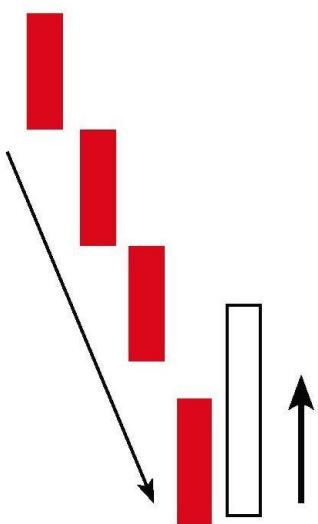


Figure 40: Bullish Engulfing

These formations appear when there are a great number of buy pending orders sitting at a certain level, where demand of that currency pair exceeds the supply. Many traders see the formation of bullish engulfing formations as leading to profit-taking among the majority of sellers. New bulls quickly emerge to buy the currency pairs, which results in the price rising quickly.

Bearish patterns that create sell signals:

- Evening star
- Bearish engulfing pattern

There are additional common bearish reversal pattern formations of candlestick charts as well, including: hanging man, shooting star, doji, dark cloud cover, and bearish harami. These patterns will not be discussed in this book. Note that bearish reversal candlestick formations appear after an upward move (a strong

upward move creates a more reliable pattern than a weak move). Candlestick formations at the base of the move, where prices are traded in near equilibrium are not valid.

Evening Star SELL Signal

The ideal evening star candlestick pattern forms with three candles after a sharp rise in price. The pattern appears at the top of the chart, near the resistance level, with one “large” bullish candle, followed by one indecision candle (sometimes more, however, more candles means the pattern has less validity), followed by a “large” bearish candle. The bearish candle must be at least 60% of the previous “large” bullish candle’s length. A bearish candle less than 60% of the previous bullish candle does not validate the evening star formation.

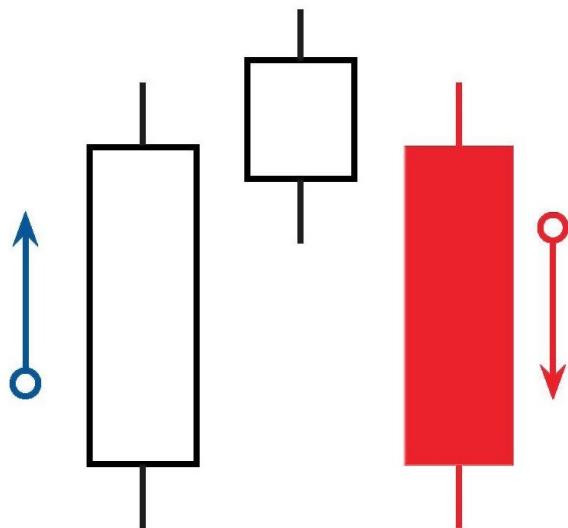


Figure 41: Evening Star

This kind of formation happens when there are a great number of sell pending orders sitting at a certain level, where the supply of that currency pair overtakes the demand. Many traders see the formation of an evening star as leading to profit-taking among the majority of buyers. New bears quickly emerge to sell the currency pair, which results in the price falling quickly.

Bearish Engulfing SELL Signal

A bearish engulfing pattern forms after a sharp rise in price near the resistance level. This can appear at the price turning point, or at the end of a retracement in a downtrend. The ideal formation of such a pattern would be: a first candle with a bullish “real body,” followed by a second candle opening higher than first candle’s close and completely engulfing first candle’s “real body.”

This kind of formation happens when there are a great number of sell pending orders sitting at a certain level, and where supply of that currency pair overtakes

the demand. Many traders see the formation of bearish engulfing patterns as leading to profit-taking among the majority of buyers. New bears quickly emerge to sell the currency pair, which results in the price falling quickly.

GAPS

Gaps refer to a spot on a candlestick chart where the price of a currency pair moves sharply down or up with no trading in between—an empty space. Two things create gaps: when a price opens higher than the current price, which is called **gap up**, or when a price opens lower than the current price, which is called **gap down**. If the price opens at the same level as the current price, there would not be any gap. In Forex trading, gaps usually appear between Friday's closing and Sunday's opening. There can be large gaps, often called **full gaps** in price, or small gaps, called **partial gaps**.

Gaps are formed when there is an extreme sentiment in the market due to fundamental (usually) or technical factors.

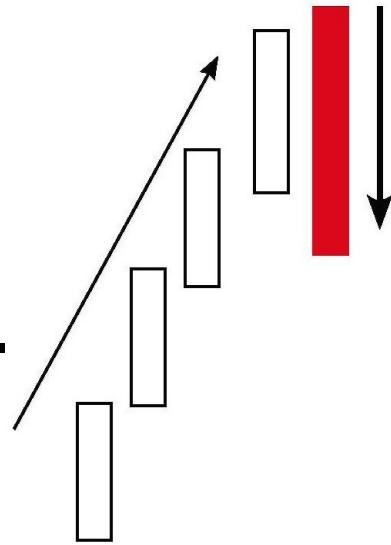


Figure 42: Bearish Engulfing



Figure 43: GAP on EUR(USD)

For example, during the financial crisis in Greece, if there was a major events such as a meeting of finance ministers or a speech by the ECB president, it usually caused Euro pairs to either gap up or gap down on the opening of Forex on Sunday. In the Forex market, unlike the stock market, reports do not create much gap during the open trading period, unless they widen the ask and bid spread to a point where a significant gap can be seen.

Traders use the terms **gap filled** or **gap not filled**. Gap filled means that the price has come back to where it originated. Similarly, gap not filled means that the price has not come back to where it originated. Applying demand and supply concept to gaps means viewing them as the result of an imbalance between buyers and sellers. In the case of gap up, there were no sells (or only a very small number) available at the closing price and demand for that instrument was high—this looks similar to a bullish candle. Similarly, in the case of gap down, there were no buyers available (or a very small number) at the closing price and supply of that instrument was high—this looks similar to a bearish candle.

Demand and supply traders watch for gaps created near the supply zone, and once the price comes up to that level, they look for a sell opportunity. If the gap was created near the demand zone, once the price comes down to a certain level, traders will look for a buy opportunity.

CHAPTER SUMMARY

In this chapter, we looked at various confluence factors and how they can be incorporated into our main strategy of demand and supply. Confluence factors indicate a higher possibility that a trade may move in the favor of the trader. Confluence factors such as moving averages, round numbers, Fibonacci ratios, candlestick formation patterns, and gaps should ONLY be used, however, as secondary decision-making tools.

Chapter Seven

CANDLESTICK AS DEMAND AND SUPPLY

Now that we have pretty good idea about demand and supply strategy and how confluence factors may help in providing additional confirmations about trades, let's take an in-depth look at how a candlestick chart could be used to identify demand and supply imbalances that yield high-reward and low-risk trades. We can actually draw demand and supply zones in Forex trading.

Demand and supply strategy falls under technical analysis in Forex trading. Technical analysis is the study of past price action in order to predict the future. Candlestick charts not only show the price of an instrument, but they reflect all items that have influenced a price, such as economic reports, geopolitical issues, technical indicators, emotions, thoughts, and so on. This information can be plotted as "time" on the horizontal axis and "price" on the vertical axis. Candles are the results of the battles between sellers and buyers. If the buyers win a battle, it's represented by a bull candle (most trading platforms represent these in blue or green colors). If sellers win a battle, it's represented by a bear candle (most trading platforms represent these in red or black colors). They form different shapes. A no win/no lose situation can be represented as a doji. Traders use technical indicators as tools to analyze charts. These tools are nothing more than the mathematical calculation of price, for example: a simple moving average (SMA) or a relative strength index (RSI).

Good businesses always have a plan regarding return on investment. Fast-food

restaurants such as McDonald's introduce many new products each and every year, but also keep products on the menu that have proven to be profitable in the past. Some products they inevitably discontinue at a loss. Similarly, traders need to analyze past information ahead of making investments in order to take advantage of the future. Finding demand and supply is the processes of predicting what looks likely to happen in the future. There are three elements to every trade: entry, stop, and target. Low-risk and high-profit targets should be the focus of all trades. There are as many kinds of strategies available in the market as there are traders. Some enjoy riding out trends. However, calculating demand and supply is a strategy for entering a market before a trend starts. It scans the places where trades have the highest probability of success. It is a trend-setting or a trend-reversal strategy. Stops are used to minimize cost. Like in the above example, McDonald's discontinues products that are not performing well. In trading, the decision of where to place stop losses is important. One of the reason amateurs start to lose significant amounts of money is often because they do not know where to place stop losses. Letting profit run is a good idea, but how far is the critical question to answer. Professional traders know where to exit, because they keep in mind that the price of any given instrument cannot continue to go in one direction forever.

Traders can open long or short positions in the Forex market. Long positions are opened at low prices, with the intention to sell at higher prices. Short positions are opened at higher prices, with the intention to close at low prices. As soon as a trader takes an action to buy or sell, only one of two things can happen: profit or loss. Occasionally a situation arises where there is no profit or loss, but that is not the purpose of trading. The reward is a measure of what happens between entry and target, and risk is a measurement of what happens between entry and stop loss.

In [Chapter 3](#), we saw how candlestick charts can be used to identify demand and supply imbalances for high reward and low risk trades. A demand and supply imbalance occurs when demand exceeds supply or supply exceeds demand. A series of same-color candles in one direction indicates a significant imbalance. When the price moves quickly up from the equilibrium zone, one thing is confirmed: there were no available sellers at that moment in time. If there had been sellers at that point, the price would not have moved up. All the supplies were absorbed, therefore the price started to go up. This type of move is created by an institution trading at high volume. Individuals or speculators then started

to join in the move, which created a series of bull (blue) candles. This imbalance point can be taken as a market turning point for high possible reward and low-risk entry points. Similarly, when price moves quickly down from the equilibrium zone, one thing is confirmed: there were no available buyers. Had there been buyers at that moment, the price would not have moved down. At that moment in time, all the buyers were absorbed, therefore the price started to fall. This imbalance point can also be taken as a market turning points for high possible reward and low-risk entry points (Seiden 2011).

In Figure 44, the price quickly dropped after point A, creating a series of red candles. Two things can be derived from this data: a) the market moved quickly from the equilibrium because there were no demands available, and b) not all the sellers' positions were triggered at that moment, and some were left behind (Seiden 2009).

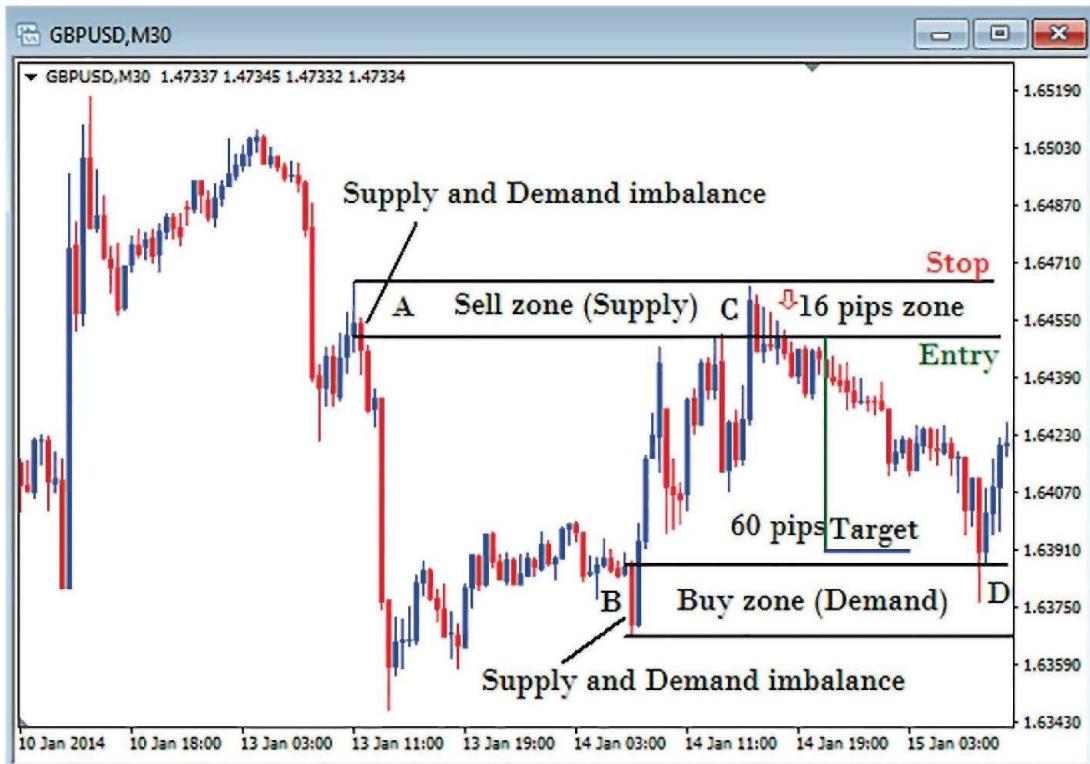


Figure 44: Demand and Supply Imbalance

Institutional and professional traders do not chase prices—they wait. They know for certain that a price does not move in only one direction. People who entered at point A will need to take their profit at a certain point, and should do so when

the next demand is available—before point B. We will be targeting the location where imbalance occurred (point A), and try to anticipate when the price will approach that level again, so we can sell the position along with leftover sellers. To do this, we draw two horizontal lines at the origin of the imbalance. The lower line (blue) in [Figure 42](#) near point A indicates trade “entry” (this line can be moved up or down based on a trader’s own risk-taking criteria) and upper line (red) is the “stop loss” in case we guess wrong. The red line is static, and cannot be moved. The bigger the yellow zone between these two lines, the more chance we have to get the trade filled, but it correlates with a higher amount of risk. A small zone has less risk, but also a lower chance that the trade will be triggered.

As shown in [Figure 44](#), while prices travel from point A to B, we do nothing. We wait for the price come to point C before we sell. There are three types of possible entry at point C: **market entry**, **limit entry order**, and **stop entry order**. Limit entry order and stop entry orders are often called pending orders. Stop losses will be placed a few pips up from the stop line. Profit targets will be a few pips above the next demand level (or opposing area), just above point D. While prices travel from point A to B, we also watch to see whether there will be any demand created for future buying opportunities. If B is a buying opportunity, when the price reaches D we will buy the instrument. At point A, the difference between the entry to and the stop loss is called risk, which is 16 pips. Reward (entry to target, i.e., point A to point B) is the distance between the opposing areas where demand was created, which is 60 pips. In this case, the ratio of reward to risk is 3.75:1.

As discussed in [previous chapters](#), there are four types of zone: drop-base-drop, rally-base-drop, rally-base-rally, and rally-base-drop. A zone is simply the place where supply and demand fell out of balance. There are two types of zones: demand zones and supply zones. These zones provide a) low-risk trades, which are an important factor for minimizing loss, b) high profit potential, and c) most important, rule-based trading, which is an important aspect of professional trading. Rule-based trading not only helps a trader to be systematic, but helps to overcome any impulse a person may have to act emotionally.

Based on the quality of the zone, traders can decide whether to place an entry or not, and should establish predefined stop losses and targets. Supply zones are always located above the current price and demand zones are always located

below the current price.

There are three steps to finding supply zones:

- Start with the current price,
- Without cutting through any candles, look left on the chart until you find a strong drop due to an imbalance (it will be higher than the current price),
- Mark two horizontal lines at the origin of the imbalance.

Similarly, there are three steps to finding out demand zones:

- Start from the current price,
- Without cutting through any candles, look left on the chart until you find a strong drop due to an imbalance (it will be lower than the current price),
- Mark two horizontal lines at the origin of the imbalance.

To identify the quality of these zones, we should take into account the reward-to-risk ratio. Additional factors, such as the distance to the zone, the freshness of the zone, and time spent at a given level are vital, too.

TRADE ENTRY TYPES

There are three types of entry available on the MetaTrader 4 platform. These are: market order, limit entry order, and stop entry order.

A market order is an order to sell or buy at the best available price. For example, for the EUR/USD pair, say the bid price is currently at 1.1110 and the ask price is at 1.1112. If trader decides to go long, the long position will be executed instantly at the ask price, which is 1.1112. The main drawback is that you will pay a little more, but this may be acceptable when trading volume is thin or there

has been high volatility due to a news announcement, etc.



Figure 45: Limit entries

A limit entry order is placed to either buy below the current market price or to sell above the current market price. For example, see [Figure 45](#), say at the moment, EUR/USD is trading at 1.0863. We traders want to take a short position when the price reaches 1.0940. There are two possibilities: we can either watch until the price reaches 1.0940, or we can place a sell limit order at 1.0940. When price reaches 1.0940, it will be automatically executed. The disadvantages of this method is that order filling takes some time, and there is the possibility that the higher price may never be reached and therefore entire order may not be filled.

Stop entry orders are orders placed to sell below the current price or to buy above the market price, where a specified price is arranged (OTA 2010). For example, see [Figure 46](#), say the current trading price of EUR/USD is 1.0863, and we traders would like to take a buy position when the price reaches 1.0940. There are two possibilities: we can either watch until price reaches 1.0940, or we can place a buy stop entry at 1.0940. When price reaches 1.0940, it will be

automatically executed. The disadvantage of this method is that order filling takes some time, and there is the possibility that the price may never reach that level and therefore the entire order may not be filled.

Buy and sell stops and buy and sell limits are called **pending orders**.



Figure 46: Buy and Sell stop entries

CHAPTER SUMMARY

When a price moves quickly upward or downward, creating a series of similar-colored candles, the origin of the move can be considered an imbalance between demand and supply. That imbalance point is a potential entry point for buy and sell instruments. Traders can choose to place an order with different entry styles for pending entries. In the [next chapter](#), we will look at money management and its importance.

Chapter Eight

MONEY MANAGEMENT AND TRADING PSYCHOLOGY

Many novice traders do not like the idea of losing any money. The main aim for all traders is of course to earn money in every entered position. Novices, however, do not have a clear plan about where to buy and exit, do not hold position for a long time, or conversely they hold it until the account is empty or exit a position when it is only a few pips up. These ways of trading are not compatible with the methods used by professional traders. So, you might ask whether winning trades in Forex 100 percent of the time generates the maximum return on investment.

Let's look at an example that will illustrate the importance of money management. [Figure 45](#) shows the GBP/JPY pair on a weekly candlestick chart, taken from the MetaTrader 4 platform. We'll look at it from three perspectives:

- Profit vs. loss
- Reward vs. risk
- Duration

We know now that traders can take only two actions in Forex trading: buying and selling. Let us suppose a trader has decided to take a long position at the price of 195.00 on September 29, 2008, without money management in mind and with one standard lot ([Figure 47](#)). The primary goal of traders is to win

trades, which means a trader does not consider losing money an option. Unfortunately, after he/she took buy action, the price continued to drop ([Figure 48](#)). This definitely creates fear with the trader. On September 23, 2011, the price reached its lowest level, 116.86. Measuring the distance between open position and the lowest level, we register a loss of 7,814 pips. This shows that the trader needed to have more than \$78,140.00 in his/her account to keep the position alive (ignoring all conditions such as different leverage, interest/overnight charges etc.). Failure to have equity of \$78,140.00 in his/her trading account would have resulted in the position being liquidated immediately.



Figure 47: GBP/JPY Long position



Figure 48: Negative Movements

On June 18, 2015, however, the price came back up to the break even level, and the trader decided to close the position at a price of 195.50—up 50 pips (i.e., \$500) in his/her favor ([Figure 49](#)). The position was closed with a gain. However, the trader/investor needed to hold that open position for 6.72 years in order to make a profitable trade! Besides that, it required tying up more than \$78,140.00 in equity, and for all that the trader only made \$500 in profit.



Figure 49: GBP/JPY Trade Closed

September 29, 2008—Trade opened based on long bull candle (as seen on a daily chart, [Figure 47](#))

The above case shows the importance of paying attention to money/risk management in Forex trading. A good trading strategy should have proper risk management in place and a trader should know how to manage risk effectively. Trading without risk management is like driving a car recklessly. Risk management not only protects against losing capital, but also gives a trader the opportunity to be profitable in the long run. As an example, say a trader started trading with \$10,000.00 in capital. Due to a first bad trade, he loses \$5,000.00, or 50% of his investment. In order to recover the initial capital, he needs to make 100% in returns, which means he needs to be twice as successful next time.

[Table 3](#) and [Table 4](#) show the importance of money management. [Table 3](#) shows how with an initial investment of \$20,000 and allowing for risk of 2% of that capital, a trader can still wind up with over \$13,000 even if he/she makes bad trades 20 times. Risking 10% capital per trade, however, will leave the trader with less than \$3,000 of the original capital after 20 bad trades. [Table 5](#)

illustrates this loss of capital and the required percentages for breaking even again.

Trade No	Total amount	2% risk per trade	10% risk per trade	Total account
1	20000	400	2000	20000
2	19600	392	1800	18000
3	19208	384	1620	16200
4	18824	376	1458	14580
5	18447	369	1312	13122
6	18078	362	1181	11810
7	17717	354	1063	10629
8	17363	347	957	9566
9	15015	340	861	8609
10	16675	333	775	7748
11	16341	327	697	6974
12	16015	320	628	6276
13	15694	314	565	5649
14	15380	308	508	5084
15	15073	301	458	4575
16	14771	295	412	4118
17	14476	290	371	3706
18	14186	284	334	3335
19	13903	278	300	3002

Table 3: Trades with Different Risk Amounts

SN	Capital loss	Percentage required for break even
1	10%	11%
2	20%	25%
3	30%	43%
4	40%	67%
5	50%	100%
6	60%	150%
7	70%	233%
8	80%	400%
9	90%	900%

Table 4: : Percentage Required for break even

Traders use different kind of mechanisms to prevent capital losses in case of bad trades. Stop loss allows a trader to exiting a position with precalculated loss. These are designed to control the risk in trading—think of them as a seat belt. It is recommended that a trader never risk more than 1% of his or her total equity. By following that simple rule, a person can be different from many other traders. Besides that, traders who make bad trades 20 times can still retain 80% of their capital. Generally, there are two types of stop loss in Forex trading: equity stop, and technical stop loss. In an equity stop, traders risk only a specified amount for a single trade, such as 1% of the total capital. Some traders argue that this kind of stop loss is not a logical response to market conditions. Technical stop loss is designed in combination with another technical indicator such as moving averages, or demand and supply imbalance points (Singh 2008).

Traders use the rewards-to-risk ratio to maximize profit and minimize losses. Considering even a 3:1 reward to risk ratio, traders have higher chance of being profitable in the long term. [Table 5](#) demonstrates how even losing trades 50 percent of the time can still be profitable if we follow the trading rules above. There is no hard rule for setting a reward-to-risk ratio. It can be adjusted as per the individual trading plan. In real trading, position traders look for a reward-to-risk ratio as high as 10:1, while scalpers go for as little as 0.7:1 (Babypips 2010).

It's imperative that traders know the importance of money management in Forex trading. Even assuming that you can obtain all winning positions does not mean

that Forex will automatically generate an impressive return on investment.

SN	WIN	LOSS
1	3000	
2		1000
3	3000	
4		1000
5	3000	
6		1000
7	3000	
8		1000
9	3000	
10		1000
Total	15000	5000

Table 5: Win-Loss Scenario / 3:1 Reward to Risk

TRADING PSYCHOLOGY

In order to be successful in the financial markets, many skills and characteristics are required on the part of the trader. An ability to analyze technical data and to understand fundamental influences are one part, but another important part is the ability to manage emotions and to be disciplined. At some level, it does not matter how much you have studied or how much knowledge you have when it comes to trading. Only one thing matters: psychology (Cabot Heritage Corporation 2012). The Traders Laboratory defines trading psychology as “the mental attitude that a trader adopts before, during, and after a trade and his emotional response to the market events that occur.” When the market moves against you, you feel fear, and you may make an ill-advised decision, such as to liquidate, minimizing your profit by exiting a position too soon. Or you may try to hold on for a longer period than you should in the hopes the market will move in your direction. Successful traders are aware of when they veer toward one of these two polarities.

One simple experiment reveals much about how the human mind operates. Participants were presented with two options: to just be handed \$10, or to try for

either \$30 or nothing over two handouts. Logically, the second option is viable because the person can expect \$15 in return, and the first option yields only \$10. But the human mind tries to avoid uncertainty hence, it looks for maximum winning chance rather than to maximize profits. The majority of people chose to take the \$10 (Cabot Heritage Corporation 2012).

A quote from Online Trading Academy (OTA), goes something like “profitable trading is an old game, played in an organized arena, governed by some golden rules.” Failure or success in a trading can bring the worst and best of emotions. Greed is an excessive desire for wealth, and urges us to stay longer in trade. Fear causes traders to close out positions prematurely or to refrain from taking on risk at all because of concern about large losses. Successful traders do not gamble. Successful traders have common psychological traits that contribute to their success. They know their limits and do not overtrade, they maintain discipline, and they trade based on what they see rather than what they envision happening.

It is not easy to overcome fear and greed. A trader should recognize that those are factors of human nature, and then develop a trading plan based upon making rational decisions. A trading plan is simply a set of written rules or guidelines, a structure if you will, that tells when and how you will enter into a trade, manage, and exit it (Curtis 2003). From time to time, traders should review and assess their own performance, and think logically—not emotionally—about their education levels and whether they have up-to-date market knowledge since both of these will help to improve overall returns. It may also help them to develop a right, emotionally detached mindset and prepare them psychologically for trading. Without certain checks and balances in place, a trading plan will not have any value if the person cannot follow his or her own advice and implement it in a proper manner (Mitchell 2012).

CHAPTER SUMMARY

In this chapter, we looked at how money management and trading psychology are key components to consider in making a successful trading career. Small losses of money in trading are perfectly fine and anticipated, however bigger losses can place an entire trading career in jeopardy. People tend to be the victims of greed and fear, but rule-based approaches can keep us successful in

the long run in trading. In the [next chapter](#), we will look at how to structure trading plans, which can act as safeguards against money-management and trading-psychology problems.

Chapter Nine

TRADING PLANS

Identifying supply and demand imbalance points as possible entry points is a method of predicting market behavior before it happens. These imbalance points are considered market turning points. The sell zones are always located above the current market price, and buy zones are located below the market price. The beauties of this trading strategy include the following benefits:

- The entry, exit, and targets are predetermined before a trade is initiated. Traders can identify reward-to-risk ratios in advance. That includes predicting how much money a trader will make in the case of a successful trade. Similarly, how much money a trader stands to lose in the case of an unsuccessful trade. This is helpful to the traders in making decisions, such as whether to take a trade or not. Does the risk level satisfy the trader's trading plan criteria, or not?
- Second, the trader has a clear plan of why he wants to take trades on at demand and supply imbalance points. This gives confidence to the trader.
- Consistency is key to being a successful trader. Trading plans also help develop good habits—essential to any trading career. With demand and supply strategy, it helps to be consistent in the way a trader approaches the actions of buying and selling currencies.
- Trades must follow a rule-based trading approach to be successful. It is one of the vital ingredients for a trading career. Opening positions

randomly or applying multiple strategies may lead to confusion and frustration. Rule-based trading helps traders to overcome fear and greed (Curtis 2003). Besides that, keeping journals and logs of transactions based on a rule-based approach could help to modify strategies, and by extension, to help traders mature for better performance.

- This strategy is based on a straightforward approach; it is quite simple, and has only a few rules to remember.

WHAT IS A TRADING PLAN?

The Forex dictionary defines a trading plan as “a formal document that summarizes a Forex strategy of the trader, including a trading system, money and risk management, trading rules, and other details.” It is a primary document that helps traders track feedback. A written plan also helps traders to compare his/her different actions, which could lead to performance improvement in the near future. A plan also helps during a trade itself, when emotions threaten to lead traders into making to bad trades or poor decisions.

Most professional traders undoubtedly emphasize trading plans heavily. They consider them must-have documents. Trading plans are to traders what business plans are to entrepreneurs. It is a roadmap for a trading business that outlines a goal. Business dictionaries define business plans as a written document prepared by a company to summarize its operational and financial objectives for the near future, and details how it plans to achieve those goals. The business plan can be continually modified as conditions change and new opportunities and/or threats emerge. The same basic principles apply for trading plans, too.

A trading plan is a written set of rules that defines why, how, and when a trader will place trades, and how a trader will manage them. Although there are some differences between business plans and trading plans, the end goal is almost same: to earn profit in the long term (ignoring charitable or special-purpose businesses!).

The main aim of a trading plan is to eliminate ill-advised or emotional decisions,

to help a trader stick to the rules, and to overcome the pull of greed and fear. Sticking with a trading plan will also give a trader the opportunity to learn from past mistakes, and to modify the plan based on new opportunities and threats as the market conditions change and/or as a trader updates him or herself on the market changes.

TRADING TIME AND DAY

While developing trading plan, it is important to consider days and timing. This will help to plan better in your daily life, too. Although technically there is always round-the-clock liquidity in Forex, not all periods are exciting to trade in. There are some periods where the market does not move much, called muted time. Therefore, the trader should always look to trade during the time when the market is most active.

Stock market opening and closing hours of the three major world markets—New York, Tokyo, and London—drive Forex movements significantly. Until recently, London was known as the trading capital of the world. The opening of the stock market in London always creates significant movements in currency trading. New York plays an important role as well, since the USD is the king of currencies. Movements in the New York Stock Exchange can have an immediate and powerful effect on the US dollar. Actions taken by the American Federal Reserve are therefore also key, because they result in stock market movements, and these movements are directly and instantly correlated with the value of dollar's gain or loss. Similarly, Tokyo is considered the main trading hub for all Asia.

The geography of the earth is so beautiful. As it rotates to create twenty-four hours a day, one or more of these stock market's trading hours always overlap. This creates a much higher volume of trading than if just one were open at a time. This means more trading opportunities. The best trading hours are considered to be when volume and volatility levels are high. London and New York alone have the capacity to move currency pairs significantly. The time when they overlap is the most important time for many traders.

The movements of currency are expected to be lower when one or more

important industrialized countries has a holiday or weekend. Mostly, liquidity reaches its lowest levels on Friday after the NYSE has closed, and on Sunday as well. Traders consider Tuesday, Wednesday, and Thursday to be the best trading days because of liquidity and volatility. Similarly, liquidity drops sharply between mid-December and mid-January.

Considering all these different sources of information helps traders to plan daily, weekly, and monthly targets.

TRADER TYPES

Another aspect you should consider while developing a trading plan is simply what kind of trader you are. Generally, traders fall into four categories: scalping, day, swing, and position. These groups define how a trader enters a trade and how he or she manages it. The scalper uses shortest time frame in trading, is an individual who looks for small gains, and may enter and exit many times in one continued trend. Day traders enter and exit a position within a day. Swing traders attempt to capture gains by holding positions for several days or weeks. Position traders are the longest-term traders, they base their entry on overall trends, sentiment, and technical analysis. Therefore, it is important to know what kind of trader you are. Do you like to trade many positions in a day, or just once a week?

TRADING GOALS

Every trader who likes to trade must have a goal. The more specific and focused a goal, the better the chance you have of encouraging yourself to achieve it. A trading plan without cannot be imagined or put into action without a goal. Earning money is the most common goal—but not the only one. Goal setting provides you a reason to work hard, motivates you to achieve the goal, and gives you a sense of confidence and accomplishment once you achieve it. Trading goals can be formulated by answering questions such as: What do I expect to achieve from trading? Where I want to be in five years? What do I want to achieve for my wife and kids? And so on.

Goals should be realistic and achievable. Depositing \$100 in a Forex trading account and setting a goal to be a millionaire in a year is not a realistic goal. If you are a novice trader, trying not to lose your initial capital during your first six months in the market might be a better goal. If you achieve your first goal, you will be much more confident about trying to achieve the next one. Once your goals are identified, it will help you to budget, to set monetary targets, perhaps even on a daily, weekly, monthly, or yearly basis.

TRADE RISK MANAGEMENT

A trading plan should include a clear trade risk management plan. This is a plan about how to manage an individual trade. There is no doubt that risk management is one of the most important aspects of becoming a successful trader. It focuses on the risk of each trade, the risk-reward ratio, the winning probability, and position sizing. Depending on your account, the pair of currency, and the risk you will accept per trade, you should be able to calculate the exact size of the position you should use for the trade.

MONEY MANAGEMENT

Money management is a crucial element in trading, particularly in times of high volatility. It is a defensive concept that protects your capital. Not all days are the same, and some days traders make bad decisions due to various factors. There will always be another day to trade. No one in the world makes a good trade every time. Money management helps you to have more staying power in the market. Besides that, you'll always know that there is a sufficient amount in your trading account to achieve your goals. Money management focuses on initial lot sizing in relation to account size, and how it increases and decreases as the account grows or falls.

TRADING STRATEGY

This book is all about how to develop the most effective and powerful demand and supply trading strategy. The core of the plan is a trading strategy, which

consists of trade entry, stop, and exit rules. Once the predefined conditions are met, trades take action. Trading strategies also include aspects of money management, order types, etc. A trading strategy must be quantifiable. Most strategies fall into three groups: trends, retracements, and reversals.

JOURNALS/TRADE REVIEWS

There are various benefits to keeping a trading journal. As a trader, you should be consistent about continuing to improve. If you consistently apply your entry and exit rules for trades, journals will help you detect errors made on your previous trades—this way, you're less likely to make the same mistake again. Besides that, it will help to fine-tune your strategy. For example, you might ask yourself whether you need to increase or decrease your risk-to-reward ratio in sixty-minute time frames. Do you need to slightly increase or decrease GBP/JPY allowance for better result? Journals and logs help you to keep track of your past behaviors in order to recognize mistakes and avoid them in the future.

CHAPTER SUMMARY

Trading is one of the most competitive businesses in the world. Being an owner or employee of a trading company requires a proper plan, discipline, and an effective rule-based approach. Every action taken by the owner directly affects the employees, and vice versa. In the case of accountability—it is ONLY you. Developing a trading plan and following it, is necessary if you want to be a professional trader. In the [next chapter](#), we will discussing about features of the popular MetaTrader 4 platform in order to show how demand and supply strategy can be applied with it.

Chapter Ten

TRADING USING METATRADER 4/5

The MetaTrader 4/5 (MT4) trading platform was developed by MetaQuotes Software for online Forex trading (although some brokers use it to trade other instruments such as stock, commodities, etc. as well). It is a free Forex trading platform. Traders can download the program directly from the MetaQuotes website at metaquotes.net, or through a Forex brokers for free. The platform can be used to trade in live or demo accounts. It provides many tools for analyzing charts, making automated trades, and various kinds of entry and exit methods for risk management. It is considered one of the most powerful Forex trading platforms.

INSTALLATION PROCESS

MT4 can be downloaded from most Forex brokers. It takes only a couple of minutes to install. Read the licensing agreement, then click “Next” to begin the installation. A new window will appear, giving you the option to create a new folder for the program or to allow the program to default install where it chooses. Click “Next” and “Next” without changing anything for default setting. This will create a shortcut on your desktop.

OPENING A DEMO ACCOUNT

Open an Account ? X

Personal details
To open an account, please fill out all the following fields:

Name:	min 6 chars				
Country:	▼	State:	min 2 chars		
City:	min 2 chars		Zip code:	▼	
Address:	min 6 chars				
Phone:	min 6 chars		Email:	name@company.com	
Account Type:	ECNPremiUSD		Currency:	USD	
Leverage:	1:200	▼	Deposit:	10000	▼
<input type="checkbox"/> I agree to subscribe to your newsletters					
			< Back	Next >	Cancel

Figure 50: MT4 Demo Account Registration Form

Once the MT4 installation is completed, open the program by clicking the desktop shortcut. Some brokers give the option of opening a demo account right away, as shown in [Figure 50](#). Fill in the required fields for name, country, state, city, zip code, address, phone, and e-mail. Select the account type, currency, desired leverage, and hypothetical deposit from the drop-down menus.

Click “Next” and the demo account will be opened. Your user-name and password may appear on the terminal, and some brokers send these to your e-mail address, too.

If there is no option to open a demo account right away, you should be able to as shown in [Figure 51](#), by navigating to “Open an Account” under the “File” menu. This process can also be undertaken even if you already have live account and would like to open a demo account.

In the demo account, traders can practice Forex trading without risking real money. Once you log in to your demo or live MT4 account the first time, the

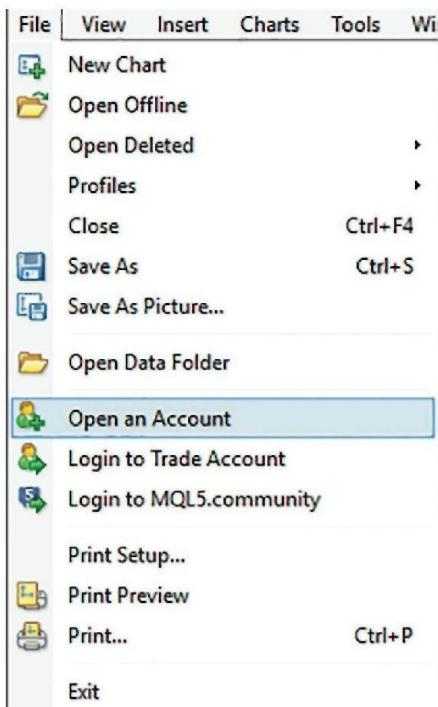


Figure 51: MT4 demo account opening



Figure 52: MT4 Terminal at First Time

terminal screen will look like [Figure 52](#).

This is not a great appearance for technical analysis. The good news is that it can be formatted with custom colors. You can change the colors of candlesticks or the background, and windows/terminals can be removed or added.

OPTIMIZING MT4 FOR DEMAND AND SUPPLY

In general, all MT4 platforms are similar, across brokers. However, some brokers offer a few features more than others. For example: some brokers do not offer the “partial close” feature. **Partial close** means, for example, that a trader might have opened one position of 0.5 mini lot of EUR/USD, and after making a profit or loss he/she would like to close 0.3 of the mini lot and to keep 0.2 mini lot open in the market. However, tools and indicators are almost the same across all Forex brokers who offer an MT4 trading platform to their clients.

Clean screens with white backgrounds, like [Figure 53](#), are the most helpful for interpreting demand and supply zones and for drawing lines. In a later section, we will be discussing in more detail how to make clean screens with red and blue candles and how to draw demand and support lines after analyzing charts for trade entry viability.



Figure 53: Clean MT4 Chart

STEP 1: Remove All Windows

If you like to work with a clear screen like [Figure 53](#), just close all windows by clicking “X” on the right top of each of them. Windows can be removed and

brought back by clicking icons on the toolbar, too. For example, if you would like to close a market watch window, just click one time on the market watch icon. If you would like to bring it back, click the market watch icon again. Other windows can be removed from the main screen by clicking the icons. These include the data window, the navigator, a terminal, and a strategy tester icon.

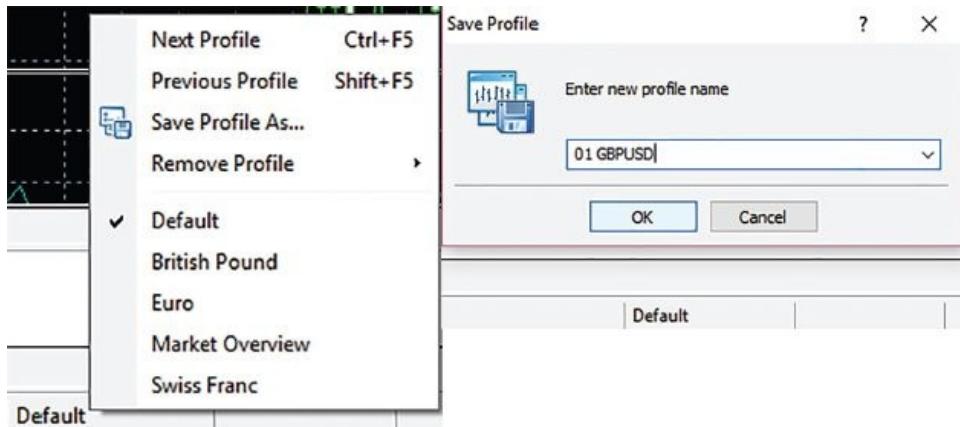


Figure 54: Creating Multiple Profiles

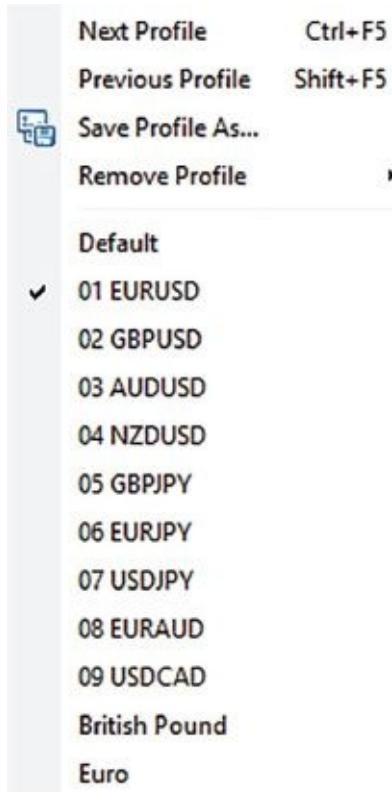


Figure 55: Profiles

STEP 2: Create Multiple Profiles

Creating multiple profiles will help you switch to a particular currency pair with one click. Within each profile, traders can create multiple windows of the same currencies, or different instruments. For example, you can create a dollar index chart and four EUR/USD charts, or a gold chart and three USD/CHF charts, etc.

In the MT4 terminal, click “Default” (located on the center-bottom of terminal, on the terminal window). A screen will appear. Click “Save Profile As,” type GBPUSD (as shown in [Figure 54](#)) and click “OK.” Now GBP/USD will appear instead of the default currency.

You can create any currency pairs you like, for example EUR/USD, AUD/USD or USD/JPY by repeating above process. Once you have created a profile for each currency pair you’re interesting in trading, it is very convenient to switch between profiles. [Figure 55](#) shows an example of how it looks like once several currency pairs have been created.

STEP 3: Create Multiple Windows for a Particular Currency Pair

Creating multiple windows helps to ease analyzing multiple time frames of a particular currency pair. Not only that, traders can draw different lines, or write comments on each screen after analyzing a chart. This will certainly help to save time, and will keep you organized as well. Here we show how to create four multiple windows of different time frames: daily, sixty minutes, thirty minutes, and fifteen minutes for a GBP/USD pair. The process can be repeated to create any other pairs you like.

Click the “Market Watch” window. This will show multiple currency pairs. Select the GBP/USD, right click, and new pop-up window will appear. Select “Chart Window.” Repeat this process four times to get four windows of GBP/USD. Click “Window” from the menu bar, then click “Tile Windows” or push “ALT+R” to arrange windows in a configuration you find comfortable. You can manually arrange these windows as per your choice and size too, if you like to have some windows bigger and some smaller.

Figure 56 shows the how a single currency pair, GBP/USD, can be displayed in multiple time frames for analysis. Note that your chart color could be different than what is shown here. We will discuss how to change the color of candlesticks next.



Figure 56: Multiple Chart Windows

STEP 4: Chart Settings

We will be customizing charts to make bull candles blue and bear candles red. However, price charts can be customized based on customer choice and preferences. In order to do so, right click on any price chart window and select “Properties.” The default color scheme will appear, but you may change the color as shown below in [Figure 57](#).

If there are still unnecessary vertical and horizontal lines on your chart, you can remove by right clicking, and then selecting “Grid.”



Figure 57: Chart Properties - Blue and Red Candles

In order to save time and make all the charts consistent, right click on a formatted chart, click “Template” and then “Save template.” Give it whatever name you like. For example: “01 Clean chart.”

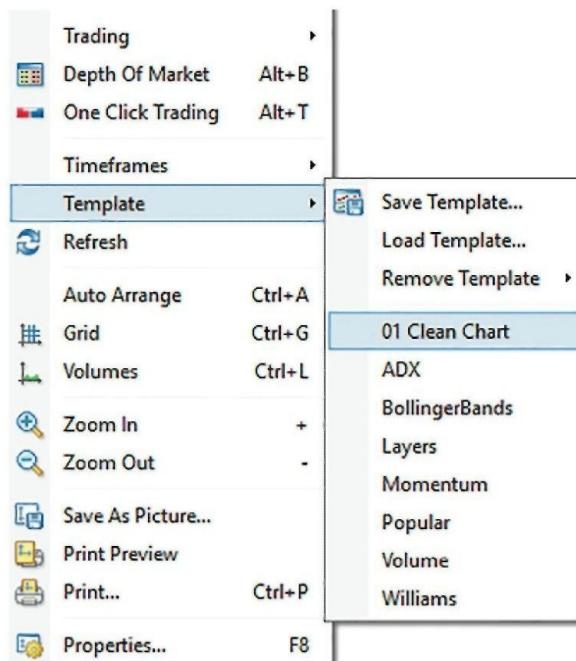


Figure 58: Template to apply

To apply this template across other charts, just right click on the window you would like to change, click “Template,” and then select the name you entered. [Figure 58](#) shows another way to change this.

STEP 5: Drawing Demand & Supply Zones

In order to draw horizontal lines, first click on the chart window where you would like to draw demand and supply zones. Click the “Trendline button”. Click at the desired location on the chart, hold the starting point, and then move the mouse cursor slowly to the right. You will see the line emerge, although it may not be a flat horizontal line.

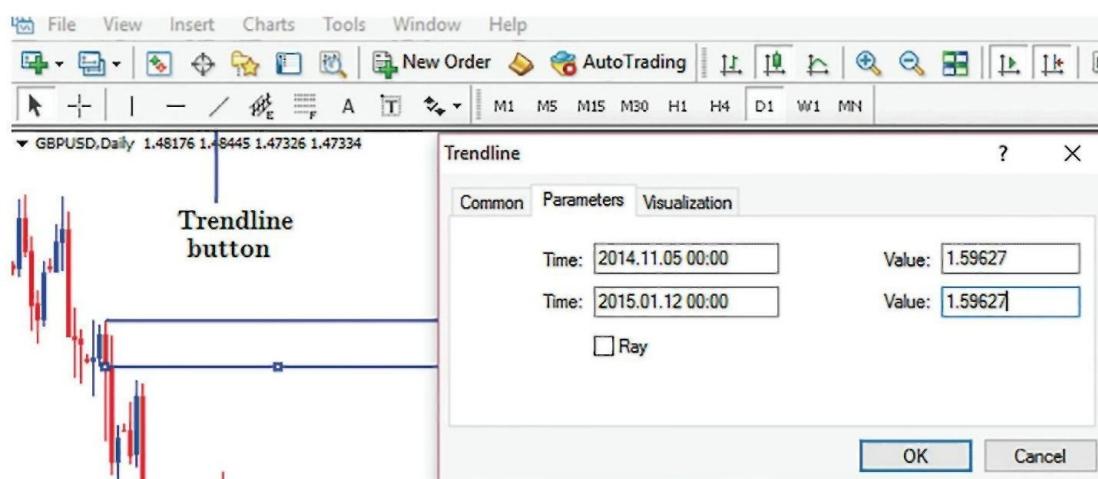


Figure 59: Trendline setting

In order to make a flat horizontal line, double click to select the line. Three dots will appear, as shown in [Figure 59](#). Right click, click “Trendline Properties,” then “Parameters.” Both values should be equal. Normally, you can copy (CTRL+C) the upper value and paste to a lower value (CTRL+V), then click “OK.” In order to deselect a line, click on the line and then double click; the three dots will disappear. If you want a short trendline, just uncheck the bottom of the “ray.”

The color and thickness of the line can also be changed by clicking “Trendline Properties > Common > Style.”

STEP 6: Pending Orders

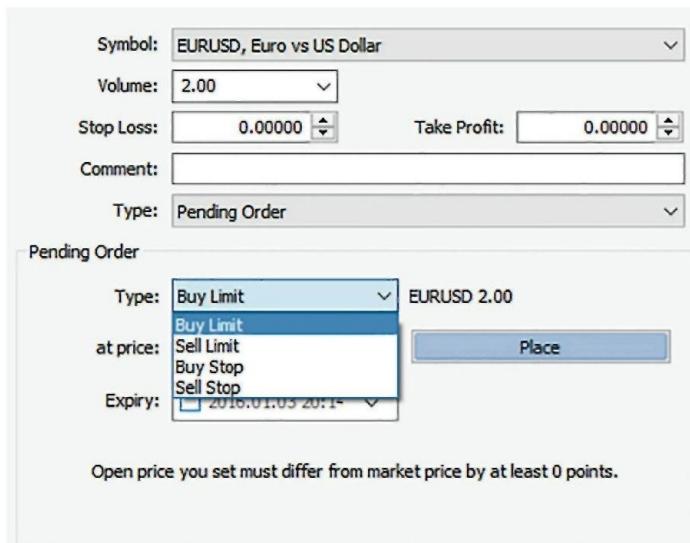


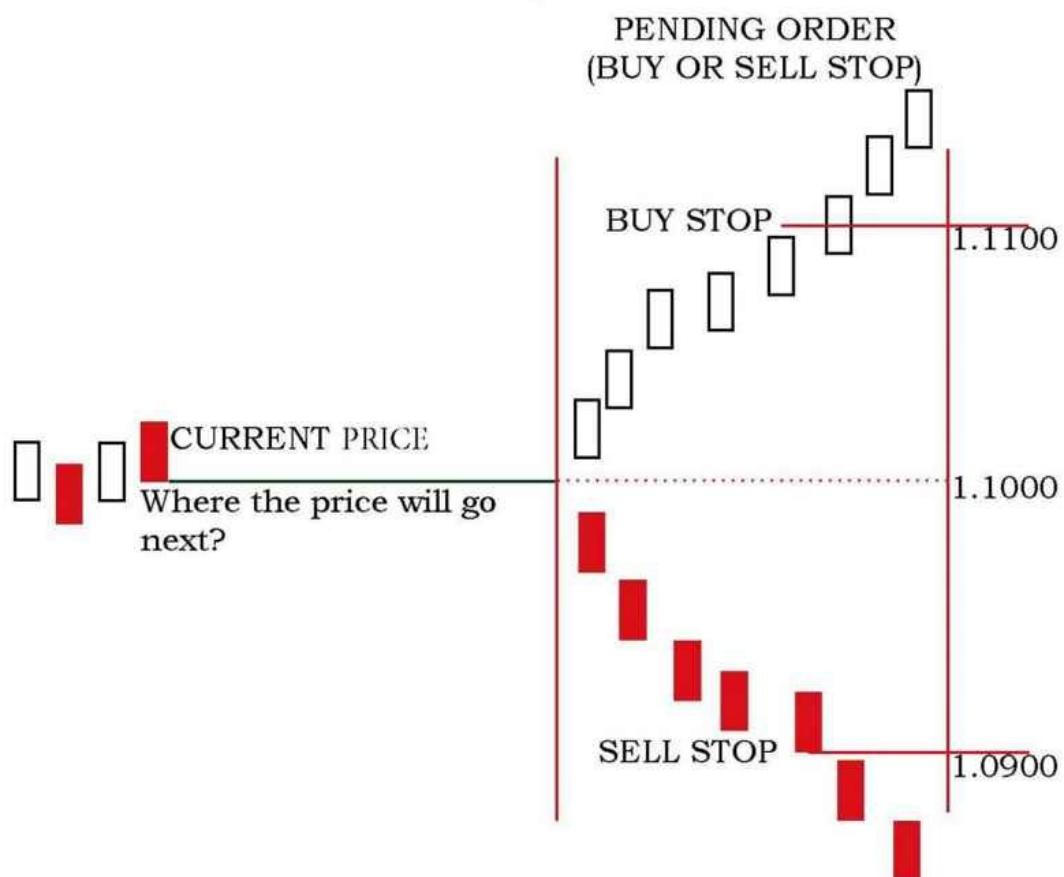
Figure 60: Placing Pending Order

Our main goal for this section is describing how to use the MT4 trading platform with a demand and supply strategy, for the manual trader. Other basic and advanced functions are described in the MetaTrader 4 User Guide and on the MQL4 community web. It requires time and effort to learn and master.

CHAPTER SUMMARY

MetaTrader 4 and 5 are powerful trading platforms for analyzing charts. They provide almost all the features a trader requires to place trades using a demand and supply strategy. It requires a few days to become proficient in using MT4 trading platforms, so be sure to learn on a demo account.

One of the most important features that makes demand and supply strategy worthwhile is the ability to place a pending order. It is quite simple. Select the chart of a currency pair, right click anywhere on the chart, click “Trading” and then “New Order.” A new window will appear, like in [Figure 60](#). Select “Pending Order.”



Chapter Eleven

SUMMARY

Experience life in all possible ways—good/bad, bitter/sweet, dark/light, summer/winter. Experience all the dualities. “Don’t be afraid of experience, because the more experience you have, the more mature you become.” This is an extraordinary quote by Osho. When it comes to trading, the same is true for monetary transactions. We work really hard to earn money, so it’s no surprise that emotions are involved when we put our hard-earned money at risk. We know going in that trading is also considered one of the most risky businesses, which doubles our anxiety. The most important rule of trading to remember is that as long as emotions are involved during trading, it is almost impossible to be a successful trader. Emotions lead to us to make irrational decisions.

Sound decision-making is important for every business—and for our personal lives, too. In Forex trading, where trading style is based on personality type, a trader/investor may use different methods of making decisions such as fundamental, technical, or a combination. However, a technical trader should make every decision based on technical analysis. This is not to say that a technical trader should not be fully aware of fundamental influences.

Trading is all about implementing a rule-based approach. As long as you stick to your rules, there is a certainty for success in the long run. Great strategies are worthless when traders do not stick to them. Remember, when it comes to trading you are both a boss and an employee. You set the rules and you must follow them exactly.

Any strategy developed by a trader needs to make that trader feel confident, and the same principle applies to the demand and supply strategy. I have given several training seminars, and when I was giving one in Frankfurt, Germany, one of the students had been tasked with earning a lot of money by going short on December 3 and 16, 2015, following ECB and Federal Open Market Committee (FOMC) meetings, respectively. The logic was that ECB president Mario Draghi would want a weaker Euro. Fundamental analysis showed that the USD was doing pretty well. I asked the question of who wanted to buy EUR at 1.0570 levels, because that was the day's demand line. Only one person raised a hand—out of fifteen people. The student's reasons were almost the same as first student's. I told them that my own buy orders were sitting at that level, with 70 pips of stop loss. Everyone looked at me like I was crazy!



Figure 61: EUR/USD trade

We were still in the class on December 3, 2015 (at 2:30 EST). On that day, just after the press conference by the ECB, EUR went up almost 450 pips. A snapshot of this real-time activity is shown in [Figure 61](#). One of the students asked me that how I knew that the Euro would go up. I replied: "I do not know."

“So it was your guess?” he asked.

I replied, “I know one thing: buy in demand level and sell at supply level. The Euro was in the daily demand level, where my rule says to buy. In case my decision was wrong, I decided I would be willing to lose a small amount of money. That is part of trading. That is the cost of doing business!”

Of course, there are various factors that affect the volatility of the currency market, such as geopolitical issues, economic news, and speeches by political figures. These factors not only make it hard to predict future prices, but make the currency market a risky place for speculators and investors. As a technical trader, you must be confident about using technical indicators, your rules, and yourself. Continuing to change your strategy based on fundamentals (your views) or from listening to the news (I am not saying that news agencies always wrong, but many times the news they report has only been analyzed from one perspective) could be destructive behavior.

Throughout this book, we have emphasized how to identify demand and supply imbalances by using candlestick charts. This is one of the methods that can be used to predict future price movements through an analysis of historical information. It assumes that history repeats itself, price imbalances will continue to occur, and that the market discounts the whole thing (Seiden 2011). Many people may agree that charts provide a huge amount of information. This information can be translated in various forms—trends, patterns, and support and resistance—in a relatively small amount of time.

I’ll repeat again that great trading strategies are worthless if a trader does not control risk or allocate proper money-management rules. No one makes the market follow in his/her direction, but traders can control losses. Demand and supply imbalance points are an effective tool for proper money management when combined with predefined entry points, stop losses, and targets. Effective risk management certainly compensates for fear, greed, hope, and ignorance (OTA 2010). However, the downside of this strategy is that if the trade goes in favor of the trader, the trader cannot capture maximum profit because he or she has limited profit target. Demand and supply strategies, in combination with risk management, have proved to be very effective tools for Forex, however, whether they produce returns on investments that will satisfy an investor’s/trader’s

expectations depends on personal interpretations of success.

Analyzing historical information is one of the ways to predict future price movements, but no amount of historical data can tell us exactly what the future price will be. Prices are based on what has happened in the market. Supply and demand strategy is reactive, not predictive of what will happen. Neither technical nor fundamental forecasting methods are completely accurate, which means that technical indicators do not produce 100 percent accurate results. They suggest plausible entry, stop, and exit points for a trade. For example, when the technical indicator indicates that it might be possible to go long for the EUR/USD, it does not guarantee success of the trade. The price may fall after entry (Kristopher 2014).

Interpreting charts and timing is an art. Although we have discussed four entry levels in order to find the best possible entry, however, the interpretation of the same chart may vary person to person. One person could find the perfect drop-base-drop, but others may not agree on that level. Another factor is broker timing. Forex is open twenty-four hours a day, but brokers may be located in different parts of the globe from the trader. When the day starts in Australia, US traders will still need to wait a couple of hours to be in the same calendar day, which means a candlestick formation may already have changed depending on where the broker is located. Daily highs, lows, and closing prices could all have been affected already.

Personal views also make certain levels attractive—one of the problems in technical analysis is personal emotion, which leads to different assessments of the same data. We tend to be biased based on circumstances. For example, if a person likes to buy EUR/USD, even when the level is not attractive, he/she may make some assumptions that make the level seem more attractive to himself or herself. However, by sticking with the trading plan, a trader can slowly improve these habits. Trading is all about psychology—yours and theirs. In the Forex market, there are only two options: buy and sell. It is same as tossing a coin, and the law of chance suggests that winning chances are 50 percent. If you combine this probability with more parameters or factors such as stop loss settings, profit targets, marginal calls, etc., the chance of winning goes down significantly. Good technical analysis keeps the balance between fear and greed in the market (OTA 2010).

Although, stop loss settings are designed to protect an investor's capital, they do not always work. Forex is one of the most volatile markets in the financial industry. Every fundamental news story, central bank action, geopolitical issue, natural resource issue, natural disaster, action by another country, etc. can affect the buying and selling price of currencies (Pettinger, n.d.). While trading a EUR/USD pair, traders might be directly or indirectly affected by actions taken by the Bank of Japan, or unexpected news out of Australia. On January 15, 2015, the Swiss National Bank (SNB) suddenly decided to stop holding the Euro to a fixed exchange rate, which created enormous losses for many investors, Forex brokers, and banks. Just the day before, 1 EUR was traded to 1.2 CHF, and the very next day the value had fallen to 0.80 CHF (Bishop 2015). FXCM, one of the biggest Forex brokers, lost \$225 million, and the New Zealand Foreign Exchange Trading House went bankrupt (Smith 2015). This was mainly because there was no liquidity in the market, and it caused a significant gap. This resulted in not only losing the entire investment, but it went into the negative (Elam 2015).

To create continuous improvement, every winning and losing trade needs to be recorded for later review. Successful and unsuccessful trades need to be examined. The market keeps on changing, therefore trading plans needs to be changed based on independent assessments. A plan requires continuous updates, modifications, and improvements.

In summary, many pieces of evidence suggest that technical trading, when performed within a set of rules created by analyzing past data, can generate persistent profits in the foreign exchange market (International Economics, n.d.). A good plan is required to be successful in business, but even the best plan is worthless when it is not followed. A rules-based approach is essential to be successful. Guessing in the market is a destructive approach to investing. Discipline plays an important factor in every successful trading career.

Thank you for your time. I hope that this book was worth it to read—and that it gives you a good value for your money! I wish you all the best in your trading career.

Appendix

SAMPLE TRADING PLAN

A trading plan is a written set of rules that defines how and when to place trades. It can be simple and short, or long and complex; this is based on personal preferences, personality, and style. The purpose of a trading plan is to keep you relaxed, to remove emotions, and to make you to follow a rule-based approach. If the strategy/plan is working fine, there is no need to modify it; however, it can be modified based on assessment (from journals, logs, etc.) every three months, six months, or annually. A trading plan should not be modified as regularly as on a daily or weekly basis.

POSSIBLE OBJECTIVES

- Not to lose more than 50% of initial capital after six months (novice traders)
- To make a 60% return on investment in one year (experienced traders)
- To generate the same income from trading as from a salary (\$10,000/month) so you can leave your current job in three years
- Contribute to social causes or not-for-profits
- To pay for a family trip to Paris

PERSONAL STRENGTHS

- “I worked as an office manager for a very organized company; this helped me to be extremely organized at work and home. I am confident that this will help me to keep journals, logs, and be organized in my new work—Forex trading.”
- “I worked as crime controller, which helped me develop powerful skills for looking at evidence from different angles. This skill will help me to analyze charts from various angles as well—essential for Forex trading.”

PERSONAL WEAKNESSES

- “I am a very impatient person, and I cannot wait long for anything. I know this could be destructive if I cannot wait to enter and exit a trade. Therefore, I will set up only trades that use pending orders, with a set-and-forget strategy.”
- “Most of the decisions in my life that I have made based solely on emotions resulted in negative effects. In trading, if I make decisions based on emotion, it could lead to failure in a trading career. Trading is ultimate thing I would like to do. In order to overcome this problem, I will use only set-and-forget strategies.”

TRADING SCHEDULES

- Best trading days: Tuesday to Thursday.
- Fundamental analysis time (GMT): 8:00 a.m. to 9:00 a.m., to look over news and economic calendars.
- Technical analysis time (GMT): 9:00 a.m. to 11:00 a.m., to analyze charts, find demand and supply levels, select trades, and place pending orders.

- Trading times for day trades (GMT): 2:00 p.m. to 5:30 p.m.
- Meditation/break time (GMT): 3:30 p.m. to 4:00 p.m.
- Documentation time (GMT): 5:30 p.m. to 6:00 p.m., to record journal logs, etc.

TRADING STYLE: DAY TRADER

ITEM	DESCRIPTION
Chart types	Daily: to discover daily demand and supply and daily highs and lows; 60 min: for trend analysis and profit targets; and 5 min/15 min: for trade entry
Currency pairs	EUR/USD, GBP/USD, AUD/USD (only one pair at a time, since all are trading against USD) USD/JPY, EUR/JPY and GBP/JPY (one pair at a time, since all pairs are trading against JPY)
Main Strategy	Buy in demand zones and sell in supply zones based on 5-to-15-minute candle charts. Zones will be valid ONLY if less than 40 pips
Entry Type	<ol style="list-style-type: none"> 1. Pending order with set-and-forget strategy, if daily demand and hourly demand are in the same zone. 2. Buy/Sell: STOP entry if the demand and supply zones are in only hourly zones. 3. Confirm entry if the zone exists only in 5-min chart. 4. No market execution!
News trading	No trading during the news, however, pending orders (if any) will not be removed even if price is very close to my level. After 15 min, trading opportunities will be looked at for trends
Number	The level will be increased or decreased toward 00 and 50; however, in any case there must be less than 40 pips at risk.
Min lot to open	2
Max lot to open	2
Maximum stop loss	50 pips (Maximum stop loss with allowance)
Minimum Stop loss	20 pips
Maximum pending order	5 positions
Removing pending order	After 10 days, when pending order is placed, or if the price has moved away 300 pips from the level
Risk amount	3% of capital per trade. If there are open positions also, 3% of the balance will be used for new positions
Reward to risk ratio	1:1 for first target 3:1 for second target
Technical stop loss	No
Money management	Once first target is achieved, stop loss will be moved to entry; however,

	for the first target, hit-or-kill method
Trading Log	Before placing a trade, all the entry and exit criteria must be written into log file. Trades will be ignored if the price comes into zone while writing it. Trading log will be analyzed on a weekly basis and monthly basis. The strategy will be modified on a quarterly basis if required.

LOG SAMPLE

Traders can make their own log files based on their own preferences and personalities. However, maintaining at least these parameters, could help to analyze trades on a monthly basis. Traders can add more parameters such as date of chart analysis, pending order selection date, date when a pending order was actually placed on terminal, etc.

TRADING LOG (SAMPLE)

I

Date	Pair	Direction	Entry Time Frame	Quality	Entry Type	Imbalance on	Trade Entered On	Entry	Stop	Stop Allowance	Actual Stop

II

Stop Loss in Pips	Risj %tage	Total Lot Size	Target 1	Target 2	Target 3	Target 1 or Stop Hit Date	Stop (\$)	Target 1 (\$)	Target 2 (\$)	Target 3 (\$)	Profit & Loss

III

Trade Status	Positive Points	Negative Points	Lesson Lernt/Remarks

See [next page](#) for description details

- Date: the date when the “Pending Order” placed - either buy or sell limit order or buy or sell stop order
- Pair: currency pair
- Direction: long or Short
- Entry time frame: In which time frame trader decide to take entry (For example: if three time frames are used to analysis the trade 240-min,

60-min and 15-min, entry time frame will be 15-min)

- Quality: quality of the location based on your parameters , for example: high quality level or low quality level
- Entry type: pending order - buy or sell limit, buy or sell stop or market execution
- Imbalance on: the date when the imbalance occurred or the level located. This will be always before the current price.
- Trade entered on: when the pending order executed or market order executed date
- Entry: entry price of the instrument
- Stop: suggested stop loss from the chart
- Stop allowance: based on spread or other parameters, some allowance is required on top of suggested chat stop loss, for example: EUR/USD pair has low spread therefore it could require low allowance e.g. 5 pips where as AUD/JPY may require more e.g.: 15 pips.
- Actual Stop: (Stop - stop allowance) for BUY order and Stop + Stop allowance)for SELL orders
- Stop Loss in Pips: (Entry-Actual Stop) in pips
- Risk %tage: risk percentage of the capital for individual trade
- Total Lot Size:
- Lot 1: For example: 60% of total lot size for first target
- Lot 2: For example: 20% of total lot size for second target
- Lot 3: For example: 20% of total lot size for third target
- Target 1 or Stop loss Hit date: the date when the Lot 1 hit the first target or Lot 1, 2 and 3 hit the stop loss.

- Trade status: the trade can pass multiple stage for example: selection of trade, pending order, position open, trade closed or even trade closed with out entry.
- Positive points: what are positive points about the trade, for example: round number
- Negative points: what are negative points about the trade, for example: zone is not a fresh.
- Lesson learned / remarks: what have you learned from the trade or any remarks for success or failure of the trade.

AUTHOR BIOGRAPHY

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