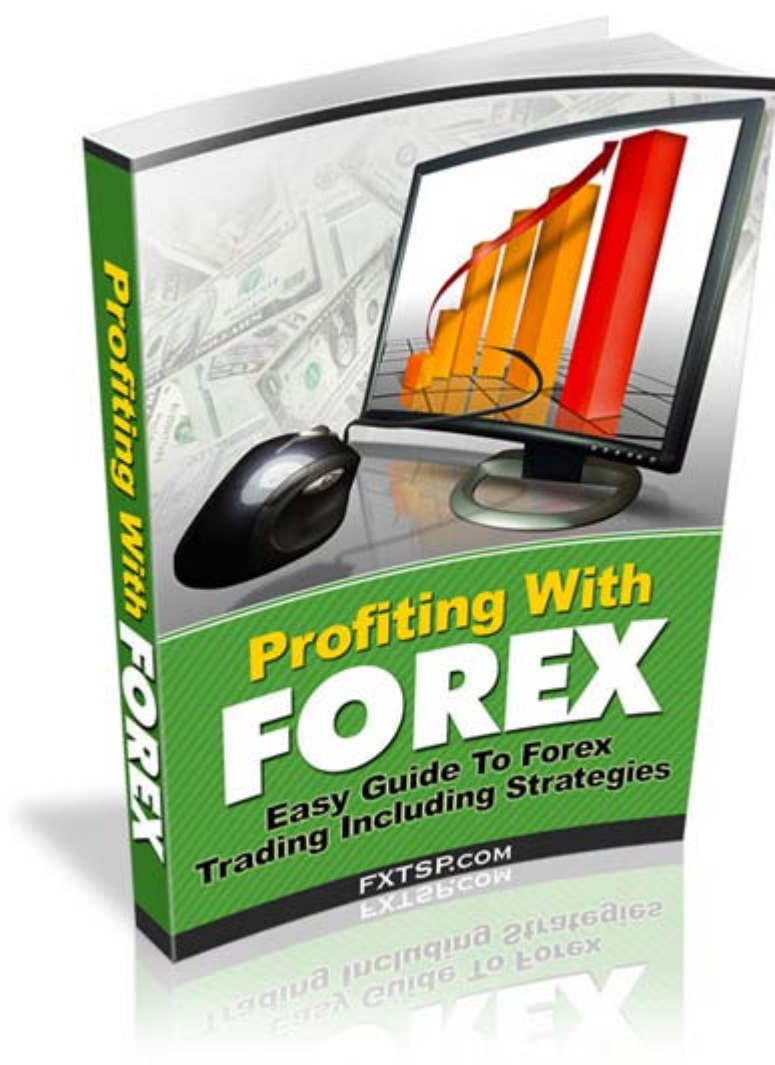


Profiting With **FOREX**



Electronic Book Edition
By FXTSP.COM



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Chapter 1: Forex Basics

What is Foreign Exchange?

Foreign Exchange or **FOREX** is the financial market where a nation's currency is exchanged for that of another. The foreign exchange market is the largest financial market in the world, with the equivalent of over \$4.0 trillion changing hands daily (according to Bank for international Settlements); more than three times the aggregate amount of the US equity and bond and commodity markets combined.

Unlike the other financial markets mentioned, the Forex market has no physical location and no central exchange; this makes the Forex market an OTC or over-the-counter market. It operates through a global network of banks, corporations and market makers trading one currency for another.

The lack of a physical exchange enables the Forex market to operate on a 24-hour basis, spanning from one time zone to another in all the major financial centres of the world.

Traditionally, private traders only means of gaining access to the foreign exchange market was through banks that transacted large amounts of currencies for commercial and investment purposes. Trading volume has increased rapidly over time, especially after exchange rates were allowed to float freely in 1971.

Over recent years the way the interbank currency market operates has changed dramatically. The Forex market has become accessible to private traders. The market makers have achieved this through a combination of low margin and high leverage and providing the professional tools and services needed to trade effectively in an independent atmosphere.

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For the active trader, foreign exchange should be no different than other investments or financial instruments such as equities, commodities, bonds, notes, bills, etc.

In fact because of the globalisation of the economic world and the consolidation of whole economic regions such as the European Union, having currencies as part of a diversified portfolio simply makes sound portfolio and investment sense.

Just like these other investment alternatives mentioned, foreign exchange offers private traders and investors a market where they can buy and sell an investment product. In this case it is a specific currency pairs.

The currency pair may be the Euro versus the US Dollar, the US Dollar versus the Japanese Yen, the British Pound versus the US Dollar, the Euro versus British Pound, or a number of other currency combinations.

The different currency combinations represent nothing more than the value of one currency versus the value of another. That relationship is represented by a single price.

In foreign exchange, the price of a currency pair is the markets expectations at that time of the value of that currency vis-à-vis another currency given the current and expected economic and political situation of the two countries. In equity terms, it would be the price of the stock.

If for example, a country's inflation and interest rates are low and stable. If it's economy is strong and politics are stable and the expectations are for more of the same, then one can expect "in general" for that country's currency to remain strong versus a less fundamentally favourable currency. Keeping in mind that all comparisons are relative to that of other economic regions.

Contrasting that with equity, if the domestic and global economy is strong and inflation is not running away. If competition is not taking away market share or eating into margins as well product demand and growth are strong.



If the companies internal "politics" are such that the workers are happy and productive, and expectations are for more of the same, then you can expect that companies stock to remain strong versus a company with less favourable fundamentals within the same sector.

Like equities there are other factors that determine the short-term value of a product including technical analysis, short-term supply and demand, seasonal capital flow patterns, the current price of the instrument, etc.

By analysing the pricing dynamics and combining that with sound money management discipline like stop loss orders, the trader can insure greater success in his foreign exchange trading.

A Brief History of the Forex Market

Foreign exchange dates back to ancient times, when traders first began exchanging coins from different countries. However, the foreign exchange itself is the newest of the financial markets.

In the last hundred years, the foreign exchange has undergone some dramatic transformations. The Bretton Woods Agreement, set up in 1944, remained intact until the early 1970s.

At this conference, representatives from 45 nations came together to discuss the future exchange system. The conference result in the formation of the International Monetary Fund.

It produced an agreement that fixed currencies in an exchange rate system that tolerated 10% currency fluctuations to gold values, or to the dollar that was established as the Gold Standard.

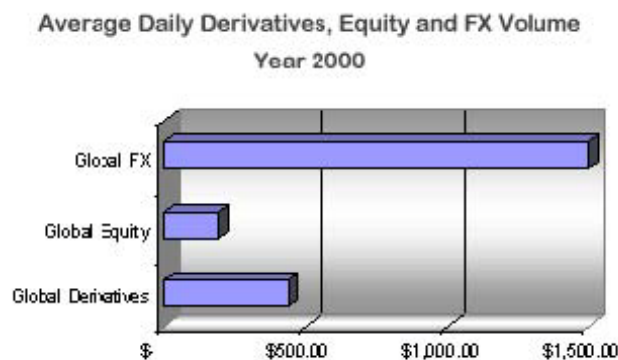
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In 1971, the Bretton Woods Agreement was first tested because of uncontrollable currency rate fluctuations, by 1973 the gold standard was abandoned by president Richard Nixon, currencies were finally allowed to float freely.

Thereafter, the foreign exchange quickly established itself as the financial market. Open 24 hours a day, 6 days a week, transactions in foreign exchange gained from about \$70 billion a day in the 1980s, to more than \$1.7 trillion a day in the year 2004.

The Forex Market Compared to other Markets



Forex Market Players

The FOREX refers to the Foreign Currency Exchange Market in which over 4,600 International Banks and millions of small and large speculators participate worldwide.

Every day this worldwide market exchanges more than \$4.0 trillion in dozens of different currencies. With the current growth rate the market is projected to grow to more than \$4.3 trillion per day by the year 2014.



Forex Investment Myths

The foreign exchange market is one of most popular markets for speculation, due to its enormous size, liquidity and tendency for currencies to move in strong trends. Presumably, these characteristics would enable traders to have tremendous success.

However, success has been limited mainly for the following reasons: Many traders come with false expectations of the profit potential and lack the discipline required for trading. Short term trading is not an amateur's game and is usually not the path for quick riches.

Because currencies may seem exotic or less familiar than traditional markets (i.e. equities, futures, etc.), it does not mean that the rules of finance and simple logic are suspended.

One cannot hope to make extraordinary gains without taking extraordinary risks.

A trading strategy that involves taking a high degree of risk means suffering inconsistent trading performance and often suffering large losses.

Trading currencies is not easy (if it was, everyone would already be a millionaire), and many traders with years of experience still incur periodic losses. One must realize that trading takes time to master and there are absolutely no short cuts to this process.

The most enticing aspect of trading currencies is the high degree of leverage used. Leverage seems very attractive to those who are expecting to turn small amounts of money into large amounts in a short period of time.

However, leverage is a double-edged sword. Just because one standard lot (\$100,000) of currency only requires \$1000/\$2000 as a minimum margin deposit, it does not mean that a trader with \$10,000 in his account should easily be able to trade 10 lots or even 5 lots.



One lot is \$100,000 and should be treated as a \$100,000 investment and not the \$1000 put up as margin. Most traders analyze the charts correctly and place sensible trades, yet they tend to over leverage themselves (take a position that is too big for their portfolio), and as a consequence, often end up forced to exit a position at the wrong time.

If an account value is \$10,000 and the trader places a trade for 1 lot, he is in effect, leveraging himself 10 to 1, which is a very significant level of leverage. Most professional money managers are not allowed to leverage even this high.

Trading in small increments on the account will allow the trader to endure many losing trades without experiencing large monetary losses.

Online Currency Trading: A Growing Trend

Online currency trading is the fastest growing market. The FOREX Market never sleeps. A currency trader may take advantage of all profitable market conditions at any time.

There is no waiting for an opening bell as in the case of trading stocks. It is a 24-hour, continuous currency exchange that never closes (normal hours of operation are Sunday 1pm through Friday 2pm Pacific standard time).

This is very desirable for those who want to trade on a part-time basis, because you can choose when you want to trade: morning, noon or night.

Traditionally the foreign exchange market was only available to larger entities trading currencies for commercial and investment purposes through banks. Now online currency trading platforms, such as the **AVAFX Metatrader 4 platform**, allow smaller financial institutions and retail investors access a similar level of liquidity as the major foreign exchange banks, by offering a gateway to the primary (Interbank) market.



Forex Time Zones Activity Table & Activity Level

Time Zone	GMT						EST	PST
Market	Sydney	Tokyo	Hong Kong	Moscow	Frankfurt	London	New York	Vancouver
Aussie Start	9:00	7:00	6:00	1:00	23:00 prev.day	22:00	17:00	14:00
Asian Open	12:00	10:00	9:00	4:00	2:00	1:00	20:00 prev.day	17:00
Euro Open	18:00	16:00	15:00	10:00	8:00	7:00	2:00	23:00 prev.day
London Activity	19:00	17:00	16:00	11:00	9:00	8:00	3:00	0:00
US - NY Open	0:00 next day	22:00	21:00	16:00	14:00	13:00	8:00	5:00
European Close	4:00	2:00 next day	1:00 next day	20:00	18:00	17:00	12:00	9:00
US Close	8:00	6:00	5:00	24:00:00 next day	22:00	21:00	16:00	13:00

Market is Usually Very Active

Market is Usually Less Active

Market has Medium level of Activity



Forex: Another Perspective

Importers and exporters, and multi-national corporations are particularly concerned about the strength and weakness of specific currencies.

If you are Coca-Cola, McDonalds, BMW or simply a wine importer of French wines to South Africa, having the right currency position can provide a tremendous amount of value to the bottom line profits.

Taking the example of the regional wine importer, generally speaking that importer knows the level he could sell his product to wholesale suppliers. He may also know the price in EUR that he will have to pay for the wine. If the value of the USD weakens or gets stronger versus the EUR, the price of importing the wine will change.

The change given a constant EUR purchase price and constant Rand sale price goes directly to or from the importers bottom line profits.



Transacting Foreign Exchange Fundamentals

Foreign Currency Symbols

Foreign Currencies like equities have their own symbols that distinguish one from another. Since foreign currencies are quoted in terms of the value of one currency against the value of another, a currency pair includes the "name" for both currencies, separated by a "/".

The "name" is a three-letter acronym. The first two letters are in most cases reserved for identification of the country. The last letter is the first letter of the unit of currency for that country.

Examples

- ★ USD = United States Dollar
- ★ GBP = Great British Pound
- ★ JPY = Japanese Yen
- ★ CAD = Canadian Dollar
- ★ CHF = Swiss Franc
- ★ NZD = New Zealand Dollar
- ★ AUD = Australian Dollar

Since the new European Euro has no specific country attached to it, it goes simply by the acronym EUR. By combining one currency, EUR, with another USD, you create a currency pair EUR/USD.



The Liquid Currency Pairs

Currencies, like equities and bonds, have pairs that are very liquid and those that are not so liquid. The liquid currencies can be characterised as those that are the most stable economically, and politically.

They include the countries that form the Group of 7 or G7 - the United States, Japan, Great Britain, France, Germany, Italy, and Canada.

Since the unification of the European currencies into the Euro, the currencies that are most liquid now include the US Dollar, the Japanese Yen, the British Pound, and the Euro, known as the “major pairs”.

It is estimated that activity in these currencies comprises of more that 85% of the daily foreign exchange volume.

Liquidity is essential when trading foreign currencies. Currencies that are illiquid generally will have wider bid ask spreads, have a much greater chance to have "fast market" conditions where liquidity can be non-existent and volatility greatly increased, and are also often more susceptible to short term market manipulation or deception, like false technical breakouts.

Liquid currency pairs like the *EUR/USD*, *USD/JPY*, *GBP/USD* and *USD/CHF* will enjoy a level of liquidity that will in most cases protect the trader from unfavourable market spreads and market conditions where liquidity dries up.

The following are examples of situations that might lead you to choose a particular currency pair to trade:

EUR/USD

Dollar weakness drives EUR/USD higher • US recovery and strong influx of foreign demand will send EUR/USD lower

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If, for example, you think the US economy will continue to worsen and that will hurt the USD, you click on BUY, which means that you are buying euros and expecting them to go up against the USD.

If, for example, you think that there will be increased foreign demand for US assets such as equities and treasuries and that will benefit the USD, you click on SELL, which means that you are buying US dollars and expecting them to climb in value against the euro.

USD/JPY

- ➔ Japanese government intervention to weaken their currency sends USD/JPY higher
- ➔ Gains in Nikkei and demand for Japanese assets drive USD/JPY down.

If, for example, you think that the Japanese government will continue to weaken the yen in order to help its export industry, you would click on BUY, expecting the US dollar to increase in value against the yen.

If you think that Japanese investors are pulling money out of US financial markets and repatriating funds back into the Japanese asset markets, such as the Nikkei, you would click on SELL.

This means that you expect the yen to strengthen against the US dollar as Japanese investors sell their assets and convert their dollars back into yen.

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GBP/USD

- ➔ High yield and attractive growth in the UK drives GBP/USD higher • Speculation about UK adopting the euro will send the GBP/USD lower.

If, for example, you think the British economy will continue to benefit from its high yield and attractive growth, thus buoying the pound, you would click BUY, which means that you expect the British pound to strengthen against the US dollar.

If you believe the British are about to commit themselves to adopting the euro, you would click SELL, expecting the pound to weaken against the dollar as the British devalue their currency in anticipation of merging with the euro.

USD/CHF

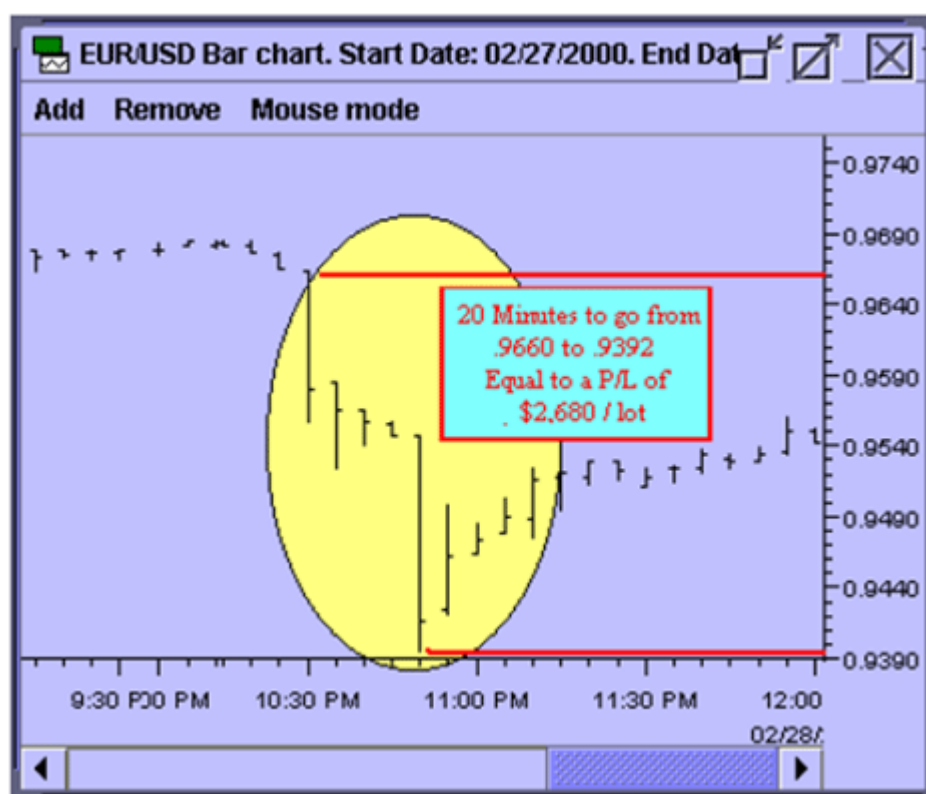
- ➔ Global stability and global recovery will send USD/CHF higher • USD/CHF rallies on geopolitical instability.

If, for example, you think that the market is headed towards a period of global stability and economic recovery, meaning that investors no longer need to park their money in the safe haven currency, or Swiss franc, you would click BUY, expecting the US dollar to strengthen against the Swiss franc.

If you believe that due to instability in the Middle East and in US financial markets, the dollar will continue to weaken, you would click SELL, expecting the Swiss franc to strengthen against the dollar.

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Nevertheless, there are instances when even the most liquid, become illiquid. The chart below outlines a 25-minute period where the EUR/USD went from a high of 0.9660 to a low of 0.9392 (268 pips).



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Also, remember that Sunday morning when news reports emerged that Saddam Hussein has been captured?



The currency markets were closed for the weekend but set to open on Sunday evening “ET”.

On that occasion the EUR/USD currency pair opened that evening with a 130-pip down gap.

The illustrations above are meant as a visual reminder that no matter what the market or the level of market understanding, although few and far between, there are pockets of extraordinary volatility where traders get off sides.



That, combined with a market shock, can lead to short term periods of scarcity of liquidity and a sharp price movement that is outside what normal statistical modelling can predict.

The “Major” Currencies

Often you will hear on CNBC or read in the financial press that the "dollar was stronger today". When that is said, it usually implies that the dollar got stronger vs. the major currencies or what is often referred to as the “*Majors*”.

Some days you will hear that the USD was mixed. This implies that against some currencies it got stronger and against some currencies it got weaker.

The majors generally refer to those currencies that represent the countries that make up the Group of 7 or G7, as mentioned above these are the most liquid of all currencies traded. That group includes the British Pound, the US Dollar, the Euro, and the Japanese Yen.

Since the Euro replaced the Deutsche Mark, Italian Lira and the French Franc, the Major Currencies are really only five in number. However, many also consider the Swiss Franc and the Australian Dollar worthy of inclusion as these currencies are well traded and have favourable liquidity.

Question:

When the USD is said to have gotten stronger, what happens to the other currencies in the Currency Pairs i.e. USD/CHF, USD/JPY, GBP/USD, USD/CAN, EUR/USD?

Answer:

When the USD gets stronger, the other currencies all get weaker.



The Base Currency

One currency in a currency pair is always dominant, “only in the way it is quoted”. It is called the Base Currency. The base currency is identified as the first currency in a currency pair. It also is the currency that remains constant when determining a currency pair's price.

The Euro is the dominant base currency against all other global currencies. As a result, currency pairs against the EUR will be identified as EUR/USD, EUR/GBP, EUR/CHF, EUR/JPY, EUR/CAD, etc. All have the EUR acronym as the first in the sequence.

The British Pound is next in the hierarchy of currency name domination.

The major currency pairs versus the GBP would, therefore be identified as GBP/USD, GBP/CHF, GBP/JPY, GBP/CAD. Apart from the EUR/GBP, expect to see GBP as the first currency in a currency pair.

The USD is the next dominant base currency. USD/CAD, USD/JPY, USD/CHF would be the normal currency pair convention for the major currencies. Since the EUR and the GBP are more dominant in terms of base currencies, the dollar is quoted as EUR/USD and GBP/USD.

Knowing the base currency is important as it determines the values of currencies “notional or real” exchanged when a foreign exchange deal is transacted.



The Counter Currency

The Counter Currency is the second currency in a Currency Pair notation.

For example, the JPY is the Counter Currency in the USD/JPY pair. The USD becomes the counter currency in the EUR/USD pair.

The Value of Currencies

The base currency is always equal to one of the currency's monetary unit of exchange i.e., 1 Euro, 1 Pound, 1 Dollar etc.

When a trader buys 100,000 EUR/USD, he is said to be buying or receiving the EURO or the Base Currency and selling or paying for the USD or Counter Currency. The amount of the Base Currency he is buying is equal to 100,000 Euros.

Note that this is true no matter the current exchange rate at the time. The base currency amount remains constant.

The Counter Currency equivalent amount that the investor is selling (or paying), on the other hand, will fluctuate with the exchange rate for the Currency Pair.

It is equal to:

(Amount of Base Currency x Market Foreign Exchange Rate)

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Since the Counter Currency is the part of the currency pair that fluctuates higher or lower, it indicates the relative strength or weakness of both currencies in a currency pair. As one currency goes up, the other must go down in relation to one another.

Question 1:

Given a Foreign Exchange rate for the EUR/USD Currency Pair of 1.2049, a trader who buys (or receives) 100,000 Euros would be selling (or paying) what equivalent amount of US dollars?

Question 2:

If a trader buys the EUR/USD at 1.2051 because he has identified a trading opportunity, and the value of the EUR/USD Currency Pair goes to 1.2095, did the trader make a profit or loss on the trade?

Question 1 - Answer:

Base Currency Amount = 100,000 Euros Foreign Exchange Rate = 1.2049
 $100,000 \times 1.2049 = \$120,490.00$

The trader would be buying or receiving, 100,000 Euros and selling or paying, 120,490 US Dollars.

Question 2 - Answer:

The trader made a profit.



By buying the EUR/USD at 1.2051, the trader bought or received 100,000 Euros and sold or paid US\$120,510. When the exchange rate rose to 1.2095, the trader could now sell the 100,000 Euros for US\$120,950.

Since the trader initially paid or sold \$120,510 for the Euros, the total profit on the transaction is equal to \$120,950 (the amount now received or bought from selling the Euros at 1.2095) minus \$120,510 (the price originally paid or sold).

Total Profit = \$440

Buying and Selling Foreign Exchange

What exactly do you buy or sell when you make a foreign currency transaction?

In reality, you are doing both actions, buying and selling. A transaction of buying the EUR/USD at 0.8800 is actually buying the Euro and selling the Dollar at 0.8800 cent. If the Euro increases in value in relation to the dollar, the price would increase and the trader will make money.

If for whatever reason, a trader could not execute an order using his trading or dealing platform, a verbal order to a broker could be the following:

"I buy 100,000 Euros and sell the dollar at the Market", one lot traded

or

"I buy 500,000 EUR/USD on a .8800 stop", five lots traded

or

"I buy 100,000 Euros vs. the Dollar at the market", one lot traded



What are required on all verbal orders are the amount, the currency pair, the rate and the type of order. Simply saying "I buy the Euro at the Market" is not good enough, as it does not say what counter currency the trader wants to sell.

Understanding the Concept

Since exchange rates represent what a fixed amount of currency is equal to in terms of another currency, we have seen there is just one price for the currency pair.

The movement of that price determines whether a currency is getting stronger or weaker.

If the EUR/USD exchange rate goes from 1.2097 to 1.2124, we have concluded that the EUR got stronger, the USD weaker.

Why?

When looking at foreign exchange rates or prices an action to buy the currency pair implies buying the base currency, or EUR, and selling the counter currency, or USD.

If the EUR/USD exchange rate moves higher, as expected, the trader can now sell the EUR/USD at a higher price. The difference represents a profit to the trader that was long, or who bought the EUR/USD pair.

Another way of looking at it is, if at the rate 1.2097, a trader could exchange 1 EUR for \$1.2097. At 1.2124, however, the same single EUR can now be exchanged for a higher amount of USD, in this case \$1.2124 USD.

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The EUR has strengthened or gotten stronger versus the dollar.

In the following examples, what has happened to the respective currencies in the Currency Pairs?

EUR/USD goes from 1.2096 to 1.2134

USD/CHF goes from 1.2450 to 1.2430

USD/JPY goes from 108.90 to 113.00

Answer:

When the EUR/USD exchange rate goes from 1.2096 to 1.2134, the EUR gets stronger and the USD gets weaker. Remember, when one currency gets stronger, the other gets weaker.

Answer:

When the USD/CHF exchange rate goes from 1.2450 to 1.2430, the USD gets weaker and the Swiss Franc gets stronger.

Answer:

When the USD/JPY exchange rate goes from 108.90 to 113.00, the USD gets stronger and the Japanese Yen gets weaker.



Lessons Learnt:

- ★ The exchange rate of a currency pair reflects how much of the counter currency is been paid for the base currency at any point in time.
- ★ If you buy one currency, you are selling another currency to obtain the currency you are buying.
- ★ If you are LONG EUR/USD you have bought “long” Euro or the base currency and sold “short” the US Dollar or the counter currency.
- ★ If you are SHORT EUR/USD you have sold “short” Euro or the base currency and bought “long” the US Dollar or the counter currency.
- ★ When a currency pair or exchange rate goes from a low price to a higher price, the Base Currency is said to have strengthened or gotten stronger.

The converse is true for the Counter Currency. That is, it has weakened or gotten weaker as the Base Currency has gotten stronger.



Price Interest Point (PIP)

Currencies trade in “fractions” of a cent: these are the smallest movement in price an exchange rate can make during forex trading.

This fraction is called a "pip" or Price Interest Point.

Currencies trade in pips because exchanges of currencies for speculative and other reasons are generally for large amounts and this makes representation in one currency more accurate in another. A pip represents 1/100 of 1 cent.

Therefore the following currency pairs correspond to 1 pip or the smallest price increment that the rate can make.

- ★ EUR/USD = 0.0001 or a move from 1.2104 to 1.2105 or to 1.2103
- ★ GBP/USD = 0.0001 or a move from 1.8210 to 1.8211 or to 1.8209
- ★ USD/CHF= 0.0001 or a move from 1.2546 to 1.2547 or to 1.2545
- ★ USD/JPY = 0.01 or a move from 110.38 to 110.39 or to 110.37



Calculating Pip Size

To determine the value of a pip for the deal above the following calculation would be made:

★ $\text{US\$} = 1.2097 \times \text{Par Amount of Base Currency} = \$120,970$

★ $\text{US\$} + \text{a pip} = (1.2097 + .0001) \times \text{Par Amount of Base Currency} = \$120,980$

The value of a pip in dollars is equal to $\$120,970 - \$120,980$ or \$10.

Question:

What is the Dollar value of a pip on a \$100,000 position in USD/JPY at an exchange rate of 108.33?

Answer to Question:

An exchange rate of 108.33 means, that for every US\$1 (The Base currency), you can buy or sell 108.33 yen.

Therefore, US\$100,000 would be the equivalent of $\$100,000 \times 108.33$ or 10,833,000 yen.



A pip move in the exchange rate from 108.33 to 108.34 would create a yen amount of 10,834,000 yen, an increase of 1,000 yen.

Converting the 1,000 yen gain to dollars requires dividing by the 108.34 exchange rate. The 1,000 yen gain divided by 108.34 exchange rate yields a dollar pip value of \$9.23

$$1,000/108.34 = \$9.23$$

The Bid/Ask Price

Like equities, foreign exchange has a bid price and an ask price. The bid price is where the market maker will buy. The ask price, is where the market maker will sell.

For traders, the reverse is true. The bid price is where a trader can sell, while the ask price is where a trader can buy. The bid price is always less than the ask price. This makes logical sense, as a market maker, like any investor, wants to buy low and sell high.

The spread between the bid and the ask price is called the bid/ask spread or dealing spread. The bid/ask spread is the premium that forex brokers charge to provide constant liquidity to their client base. Typical spreads: EUR/USD: 1.5 pips, GBP/USD: 3 pips, USD/JPY: 2 pips,...

In general, dealing spreads for the major currency pairs are between 1-4 pips wide and less liquid currencies, will be a bit wider. This reflects the relative liquidity and risk in the professional market for that particular currency pair.

Obviously, if the volatility and risk of making a market increase because the markets become less liquid, it stands to reason that spreads may increase as well. These are universal realities of market makers however this dealing spread is much more stable with large and reputable brokers such as AVAFX.



Types Of Orders

The placement of orders in the market saves the trader the time and tedious job of monitoring market price for levels and also ensures that he does or implements what he intends to do.

When placing an order with the market maker, it is very important to make sure you are placing your order properly to avoid easily made costly errors.

The main types of orders are:

Market Order

This is an order to buy or sell a given currency at the current market price. This means that the trader will be buying at the “current” ask or selling at the “current” bid that is quoted. The market order can be used to enter or exit trades.

When placing a market order, the currency trader specifies the currency pair that he wants to buy or sell and the number of lots or contracts he wants to trade.

With most currency trading platforms, this order is placed with a single click and is executed instantly at the current rate quoted.

Often small market makers are unable to fill market orders instantly and usually re-quote traders. This can be a major source of problems as unnecessary costs of trading are incurred that can affect performance over time and the profitability of each trade.

However, this type of order is very popular with certain trading strategies i.e. strategies which react to market conditions and require instantaneous execution of a trading position, ether to enter or exit.

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Therefore it is important to make certain you are trading through a firm that have the necessary credit lines within the Interbank market to attract large hedge funds and money managers as clients.

This will ensure you can obtain the necessary liquidity required to execute market orders regardless the size, with no hassle.

Limit Order

This is an order to buy or sell a given currency at a pre specified exchange rate or better, and can be used to enter or exit trades. It “limits” the price at which you are willing to trade at.

When a Buy Limit order is placed, the trade cannot be executed at a price that is higher than the specified limit price. Therefore the buy limit is placed below the current market price.

It can be used to obtain a better entry price when looking to go long, or used to close out or exit an existing short position at a profit.

When a Sell Limit order is placed, the trade cannot be executed at a price that is lower than the specified limit price. Therefore the sell limit is placed above the current market price.

It can be used to obtain a better entry price when looking to go short, or used to close out or exit an existing long position at a profit.

When using limit orders to exit existing trading positions, long or short, it is usually associated with pre-determined trading targets.



Stop Order

This is also an order to buy or sell a given currency at a pre specified exchange rate and can also be used to enter or exit trades. It is activated when the specified exchange rate, in this case the stop price, is reached.

This is a very useful order, in that it is placed on the opposite side of the current market price than the limit order.

When a Buy Stop order is placed, the order cannot be placed at a specified price that is lower than the current market price. Therefore the buy stop is placed above the current market price.

In this way it can be used to enter a new long position when the price of a given currency breaks above, “a price break-out”, a certain rate or it can be used to limit a loss in an existing short position.

When a Sell Stop order is placed, the order cannot be placed at a specified price that is higher than the current market price. Therefore the sell stop is placed below the current market price.

In this way it can be used to enter a new short position when the price of a given currency breaks below, “a price break-down”, a certain rate or it can be used to limit a loss in an existing long position.

As briefly mentioned above the stop order can also be used to stop a loss or protect profits, when the price of a currency moves against a trading position. This is why it is also referred to as a "Stop Loss" or “Protective Stop” order.

If a trader that is looking to go long an exchange rate, wanted to protect against the possibility of a large loss, he would, after careful evaluation place a sell stop order at a strategic “safe” spot below his entry price as soon as he entered the long position.

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This would then act as a “protective” stop loss and guard the trading account against an unprotected adverse movement in the exchange rate.

In the same way, if a trader who is already holding a short position in an exchange rate and is making money in the trade or what is referred to as been “in the money”, wanted to protect some of the profits already showing but still have the opportunity to benefit from a further fall in the rate, would, after careful evaluation place a buy stop order at a strategic “safe” spot, above the current price but below his short entry level, thereby “locking in” profit if stopped out.

This trading technique is referred to as a trailing stop and is incorporated into the strategies of many successful traders.

At all times remember, “Always trade with the probability and protect against any possibility”

Margin

Margin is the aggregate amount of customer cash pledged against the aggregate open position or positions. The margin pledged is a function of Maximum Trading Leverage Ratio. The higher the leverage the lower the pledged margin needed to carry the position. The lower the leverage, the higher the margin needed to carry the position.

By trading on margin traders have the ability to control trading positions much larger than the amount of cash pledged. Leverage is a very nice tool to enhance the performance of a trading account but without the correct controls in place can very easily be used incorrectly and the trader can run the risk of ruin.



The amount of leverage or gearing used during trading is a matter of risk management and needs to be addressed accurately by each trader to have optimal market exposure.

The margin pledged for leverage is not a down payment on a purchase of equity as in the stock market but rather a performance bond to insure against trading losses.

Most brokers provide a Minimum Trading Leverage Ratio of 50:1, which can also be represented by 2%. At that ratio, a 100,000 EUR position would require \$2,419 of Margin at an exchange rate of 1.2097.

This is calculated by taking the US\$ equivalent of 100,000 EUR or US\$120,970 and dividing by the 50:1 leverage ratio or calculating 2% of the value.

★ Margin required = $\$120,970 / 50 = \$2,419$ or

★ Margin required = $\$120,970 \times 2\% = \$2,419$

Interest Rollover

When a trading position is still open at 5 pm EST, traders pay/earn a daily rollover interest on that open position.

If you don't want to pay/earn daily rollover interest, be sure the position is closed before 5pm EST. On Wednesdays, the amount added or subtracted to an account as a result of rolling over a position tends to be around three times the usual amount.

This "3-Day" rollover accounts for settlement of trades through the weekend period.



Forex Basics Frequently Asked Questions

How do I know which currency I am buying and which I am selling?

In the FX market currencies are always priced in pairs; therefore all trades result in the simultaneous buying of one currency and the selling of another.

The objective of currency trading is to exchange one currency for another in the expectation that the market rate or price will change so that the currency you bought has increased its value relative to the one you sold.

Consider the following example:

The current bid/ask price for USD/JPY is 110.02/110.07, meaning you can SELL \$1 US for 110.02 Yen or BUY \$1 US for 110.07 yen.

Suppose you decide that the US Dollar (USD) is undervalued against the Japanese Yen (JPY).

Since the US dollar is the base currency, to execute this strategy you would BUY the pair i.e. buy dollars (simultaneously selling yen), and then wait for the exchange rate to rise.



How can I enter a short (sell) order to sell a currency pair that I don't own?

In every currency trade, you are borrowing one currency to buy another. For example, if you buy the USD/JPY, you are simply borrowing yen to buy US dollars; if the US dollar rises in value, you will be able to sell them for more yen than you borrowed, and thus profit accordingly.

If on the other hand you enter a short, or sell, order on the USD/JPY, you are simply borrowing US dollars to buy Japanese yen. If the yen rises in value, then you will be able to sell them back for more dollars than you initially borrowed – and will reap a profit in doing so.

In every trade, regardless of whether you are buying or selling the currency pair, you are buying and borrowing a currency.

What is leverage?

Leverage is a means of enhancing returns or value without increasing the investment size. Leverage allows you to magnify your potential returns by trading more than you actually deposit.

For instance, forex traders can utilize 50:1 up to 1000:1 of trading leverage (depends on the broker) -- meaning they can trade at least 50 times the amount they deposit -- without being liable for more than their deposit.

This means with a \$100 margin deposit you can place a 5,000 base currency position in the market. In the event the total value of the account falls below margin requirements, the trading platform automatically closes all open positions.

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This prevents clients' accounts from falling below the actual available equity particularly in a highly volatile, fast moving market.

Bear in mind, though, that leverage is a double-edged sword. Without proper risk management, the high degree of leverage can lead to large losses as well as gains. Use it wisely!

What is a margin call?

Most forex accounts are set-up on a default margin on 1% (approximately 100:1 leverage). Meaning, clients must maintain in excess of \$1000 in the account for every lot (100,000 position) that is open on the trading account. (\$1000 is 1% of 100,000).

The following is an example of a margin call situation:

Assuming account balance is \$8000:

If the client buys 6 lots of EUR/USD (\$600,000) at a rate of 1.3000, which uses up \$6000 (\$1000 x 6) of the account's usable margin, leaving an available margin of \$2000.

If the position were to go against the client by only 34 pips to 1.2966, the floating trading loss would be \$2040 and open positions will be closed on a margin call.

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Where is the Central Location of the FX Market?

Currency trading is not centralized or an exchange, as with the stock and futures markets. The FX market is considered an Over the Counter (OTC) or 'Interbank' market, due to the fact that transactions are conducted between two counterparts over the telephone or via an electronic network.



Chapter 2: Setting Up Your Workstation

Introduction

Before we get too far into the nuts and bolts of analyzing market data and trading, we first must consider a very important factor in profitable trading. At first glance, it may not appear that important, but you will come to appreciate the wisdom of ensuring you have all of the tools necessary to make your trading experience a positive one.

Work Station Location

Choosing the right place for trading is your first step. Be sure not to rush into making this decision too quickly. Do you have a spare room? How about an office? The place you choose should be a place where you can concentrate and feel comfortable.

Trading at times can be very stressful, so your trading area should be a place where you can relax. Avoid setting up your trading setup in your bedroom, as this could disrupt your sleep cycle. Having the right amount of rest and sleep is as important as trading forex itself. Keep this in mind.



Trading Computer and Accessories

One of the most frustrating events for a new trader is attempting with outdated computer equipment.



The following list must not be ignored in acquiring adequate computer equipment:

Preferred Hardware Requirements:

- ★ PC or MAC
- ★ 4096 Mb Ram
- ★ 1 TB HD
- ★ 23" Monitor

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- ★ Fast Internet Connection
- ★ Antivirus and Firewall Protection

Whether you choose a PC desktop, MAC or laptop , be sure it meets the minimum requirements for the best operating results. You'll also want to have a comfortable chair with adequate lower-back support.

Other useful accessories include: a small calculator, a telephone to call dealing desk if needed and a notebook to be used as a trading log.

Internet Connection

When you are a day trader, you will need a stable fast internet connection, avoid internet services where frequent disconnections are the norm, for longer term traders (such as on a daily chart), you can still use a dial up connection but preferred is a fast stable connection to the internet such.

Firewall and Antivirus Protection

Why use it?

Connecting to the Internet without a firewall is like leaving the keys in your car with the engine running and the doors unlocked while you run into the store. On the Internet, hackers use malicious code—such as viruses, worms, and Trojan horses—to try to find unprotected computers.

A firewall can help protect your computer against these and other security attacks.

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So what can a hacker do? It depends on the nature of the attack.

While some attacks are just nuisances that may play simple pranks, others are created with malicious intent. These more severe strains may attempt to delete information from your computer, crash it, or even steal personal information, such as passwords or credit card numbers.

Some hackers enjoy nothing better than breaking into vulnerable computers. viruses, worms, and trojan horses are scary. Fortunately, you can reduce your risk of infection by using a firewall and antivirus software.



Chapter 3: Essentials of Technical Analysis

Introduction to TA

Before we start an in-depth study of our FXTSP Trading Method, we must first define what technical analysis is for our purposes. We will not discuss each and every technical indicator because there are over 1000.

Often, forex traders spend so much time trying to understand a system that is mathematically so complex that they never get to make any money, for that reason, we prefer to keep it as simple as possible for you.

What is Technical Analysis ?

Technical analysis is the study and analysis of market price movement in order to forecast future market price movement. Technical analysis does not concern itself with a currency's basics or fundamentals.

Rather, technical analysis involves the study of a currency trading patterns through the use of charts, trend lines, support and resistance levels, and many other mathematical analysis tools, in order to predict future movements in a currency's price, and to help identify trading opportunities.

TA has become popular over the past several years, as more and more people believe that the historical performance of a currency is a strong indication of future performance.



Why does Technical Analysis Work?

Certain patterns tend to be repeated year after year in all publicly traded financial instruments, such as head and shoulders tops, or double tops, or rounding bottoms, or triangles.

The recognition of these patterns, trends and support and resistance is a qualitative or judgmental process, but the existence of trends is undisputable.

Technical Indicators

A technical indicator is a mathematical calculation using price (and volume) history. Technical analysis is based on the premise that it is possible to predict market moves by quantifying previous market moves.

Types of Technical Indicators

- ★ Leading Indicator
- ★ Lagging Indicator
- ★ Overbought Indicators
- ★ Oversold Indicators

Leading Indicator

Leading indicators attempt to predict the move of a market/commodity/security. Leading indicators tend to give the signal of a change in the price of a market/commodity/security before the change begins.

Most technical analysts advise waiting for the change in price to manifest,



confirming the indicator's signal, before making a trading move.

Lagging Indicator

Lagging indicators attempt to confirm that the move of a market/commodity/security is the beginning of a short or long term trend. Lagging indicators tend to give signal of a change in price of market/commodity/security after the change begins. Lagging indicators work better in trending markets.

Overbought Indicators

A market/commodity/security which has had an unexpected price rise or is trading near or above the top of a normal trading range is referred to as overbought. Often when an issue is overbought there are fewer buyers available to sustain its price. Overbought indicators attempt to identify the vulnerability of a market/commodity/security to a correction based on these conditions.

Oversold Indicators

A market/commodity/security which has had an unexpected fall in price or is trading near or below the bottom of a normal trading range is referred to as oversold. When an issue is oversold those looking to sell have already sold. Oversold indicators attempt to identify the possibility of a bounce based on these conditions.



Technical Analysis Assumptions

A repeat of the philosophical assumptions on which technical analysis is based is appropriate here, before we begin the study of analyzing market patterns.

All available information and its impact on traders and the market is already reflected in a currency's price.

★ *Prices move in trends or patterns.*

★ *History repeats itself.*

Technical analysis allows for an indirect study of all market data, including fundamentals. Most technical traders would agree that uptrends and downtrends are caused by the underlying forces of supply and demand and the economic fundamentals of the market.

As a general rule, we are not going to concern ourselves so much with the reasons why market prices move up or down. Instead, we are going to discount the reasons why and are going to trade in agreement with the supporting technical indicators.

The next concept that we must understand to become a technician: prices move in trends. If one cannot accept this premise, there is no point in studying technical analysis.

The FXTSP Trading Method is written to help identify trends and their early stages of development for the purpose of trading in agreement with the direction of those trends. We follow trends because trends have shown that once they are in motion, they are most likely to continue rather than reverse.



Learning the Basics of Technical Analysis

- ★ Price Charts
- ★ Market Trends
- ★ Patterns & Indicators
- ★ Moving Averages
- ★ Support & Resistance

Price Charts

There are 3 types of price charts which can be used in FX Trading

- ★ **the line chart** – less used
- ★ **the bar chart** – frequently used
- ★ **the candlestick chart** – most used



A Line Chart



The basic price chart is a simple two-axis (x-y) plotted graph of price data over price and time.

Using price data that can be captured and processed, each individual foreign exchange rate or stock, bond and index, listed on a public exchange can be charted in this way to illustrate movement of price over time.

Individual data plots for a graph can be made using the OPEN, HIGH, LOW or CLOSE, price for any defined time period. The plots are connected together in a single line, creating the graph.

This first basic type of price chart is called a LINE CHART as shown at the above picture.



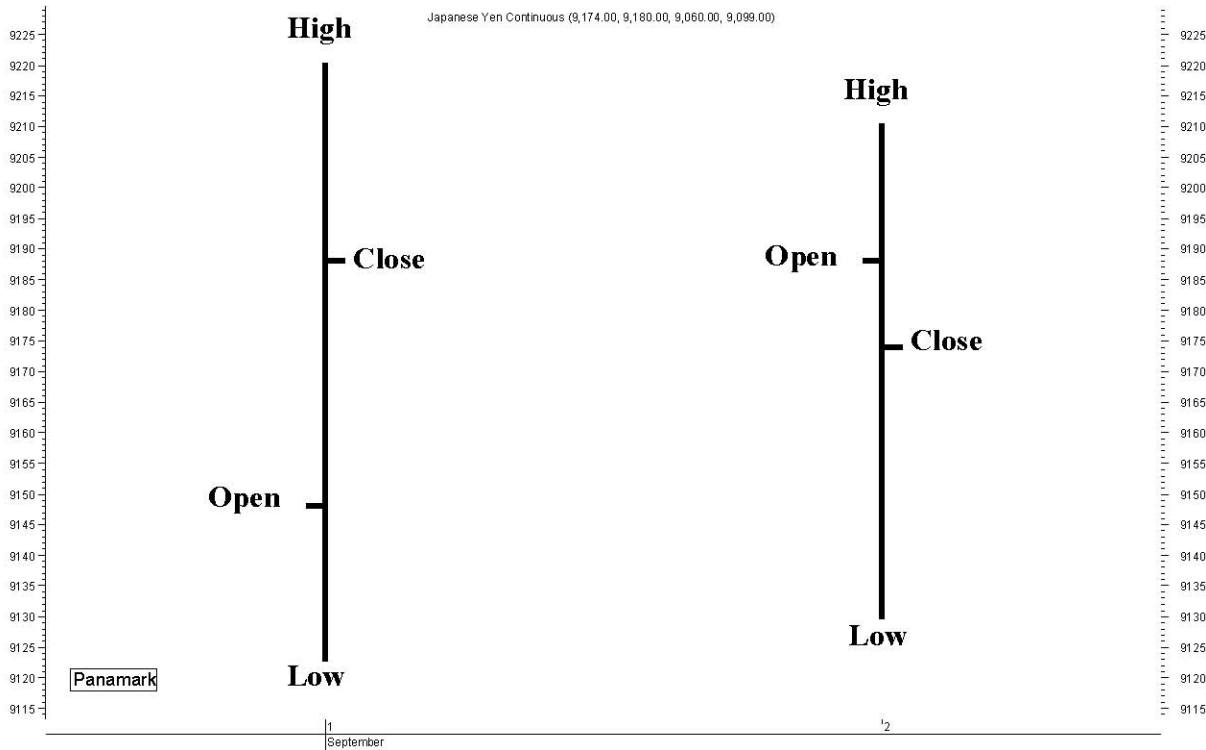
Also, a combination of the OPEN, HIGH, LOW and CLOSING prices for a defined time period can be used for these data plots. This type of price structure over a selected time period is an individual PRICE BAR.

The price fields mentioned above define a price bar and are explained below.

- ➔ **OPEN** - This is the price of the first trade executed in the market for the defined time period e.g., the first trade of the week, day, hour or minute.
- ➔ **HIGH** - This is the highest price traded during the period defined. It is the price level at which there were more sellers than buyers or **supply exceed demand**. As there are always sellers willing to sell at higher prices, the high represents the highest price buyers were willing to pay within that defined time period.
- ➔ **LOW** - This is the lowest price traded during the period defined. It is the price level at which there were more buyers than sellers or **demand exceed supply**. As there are always buyers willing to buy at lower prices, the low represents the lowest price sellers were willing to accept within that defined time period.
- ➔ **CLOSE** - This is the last price level that was traded during the period defined. The close is the most often used price for analysis. The relationship between the open and the close are considered significant by most technicians.



The Structure of a Price Bar



In the above figure the open, high, low and close of each PRICE BAR can clearly be seen. This is obviously an advantage in that the price bar displays clearly the range for each time period within the graph.

Once adequate price data is collected each price bar is overlaid onto the graph and this creates a dense visual display of price movement over each time period in the price bar in addition to the longer time frame that makes up the graph.

This second type of price chart is called a BAR CHART.

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Bar Chart



Price charts can be created in many different time frames, be it minutes, hours, days, weeks, months or even years. Long-term Unit Trust holders may use monthly bar charts in which each individual data plot consists of a single month of activity.

Day traders may use 15, 30 and 60-minute price charts to find trading opportunities. Scalpers may use 1, 3 and 10-minute price charts to make quick buy and sell decisions. The most common type of price chart used by a position trader or swing trader is the daily “Bar Chart” as shown above.

It illustrates a single complete market session for each day of trading or what is known as a Trading Session.



There are many more methods other than the line and bar chart in which to display the price data of an underlying financial instrument and all these methods will be studied in the module concerning Trading Methods.

In the “west” price charts gained popularity in the late 19th Century from the writings of Charles H. Dow in the Wall Street Journal.

His comments, later became known as "Dow Theory", and alleged that markets move in all kinds of measurable trends and that these trends could be deciphered and defined in the price movement seen on all price charts.

The study of price charts, known as *technical analysis*, believes that the past action of the market itself can determine the future course of prices and that all fundamental market information will be discounted into price action already.

Whereas *fundamental analysis* seeks to determine future price by understanding and measuring the objective "value" of the underlying financial instrument through the study of economic indicators.

Price charts can be drawn in two different charting scales. These are known as ARITHMETIC and LOGARITHMIC charting scales. An arithmetic chart has equal vertical distances between each unit of price. A logarithmic chart is a percentage growth chart. It has equal vertical distances between the same percentages of price growth.

For example, a price movement from 10 to 20 is a 100% move. A move from 20 to 40 is also a 100% move. For this reason, the vertical distance from 10 to 20 and the vertical distance from 20 to 40 will be identical on a logarithmic chart although the first movement represents 10 and the second 20.

Price chart analysis can be applied equally to any market, be it Foreign Exchange, individual equities, major indices or bonds. Technical analysts can use their skill on any market to determine the same thing, whether the current market is a BULL MARKET or a BEAR MARKET and time their entries accordingly.



One over whelming factor that assists in the affective use of technical analysis for every trader to consider is market liquidity.

Financial instruments that do not have market liquidity are subject to manipulation and therefore do not reflect true market psychology.

As mentioned earlier the Foreign Exchange markets are by far the most liquid and hence, ideal to trade “Technically”.

The Candlestick Chart

The third type of chart is called the candlestick chart and is the most popular of all 3 types of charts.

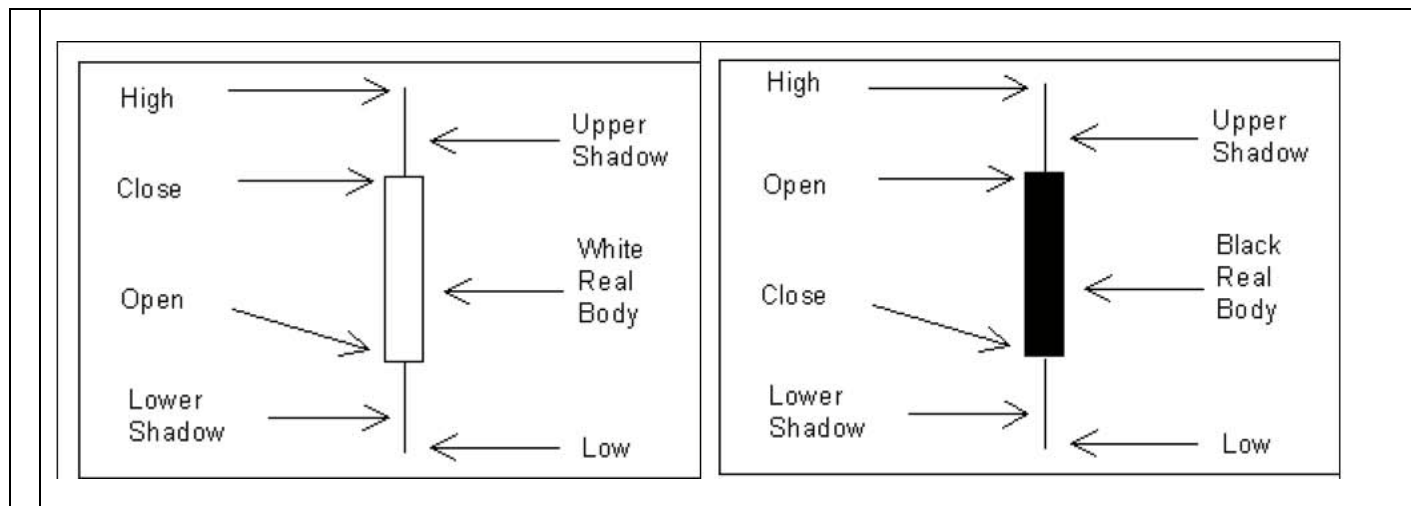
Where do Candlesticks Come From?

In the 1600s, the Japanese developed a method of technical analysis to analyze the price of rice contracts. This technique is called ***candlestick charting***. Candlestick charts are simply a new way of looking at price; they don't involve any calculations.

What do Candlesticks Look Like?

Candlestick charts are much more visually appealing than a standard two-dimensional bar chart. As in a standard bar chart, there are four elements necessary to construct a candlestick chart, the OPEN, HIGH, LOW and CLOSING price for a given time period. Below are examples of candlesticks and a definition for each candlestick component:

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The body of the candlestick is called the real body, and represents the range between the open and closing prices.

A black or filled-in body represents that the close during that time period was lower than the open, (normally considered bearish) and when the body is open or white, that means the close was higher than the open (normally bullish).

The thin vertical line above and/or below the real body is called the upper/lower shadow, representing the high/low price extremes for the period (one period of time measures the duration of selling or buying within the market).

As a trader, you can use any time period you want, time intervals may be a tick chart, 1 min, 5min, 10 min, 1 hour, 4 hour, 1 day,...

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Example of a Candlestick Chart:



Candlestick Patterns Formations

When recognized and applied correctly, they can be a very powerful tool in your trading decisions; we refer to the forex resources section in this manual to view the different types of candlestick pattern formations.



Market Trends



Price charts illustrate and identify the current trend in any defined time frame.

What is a trend?

A trend reflects the average rate of change in price over time. Trends exist in all time frames and all markets. Day traders may attempt to establish and take action in the short-term trends to within minutes.

Position and swing traders may attempt to establish and take action in the intermediate trends of days or weeks and the long-term investors watch trends that persist for many months or even years.

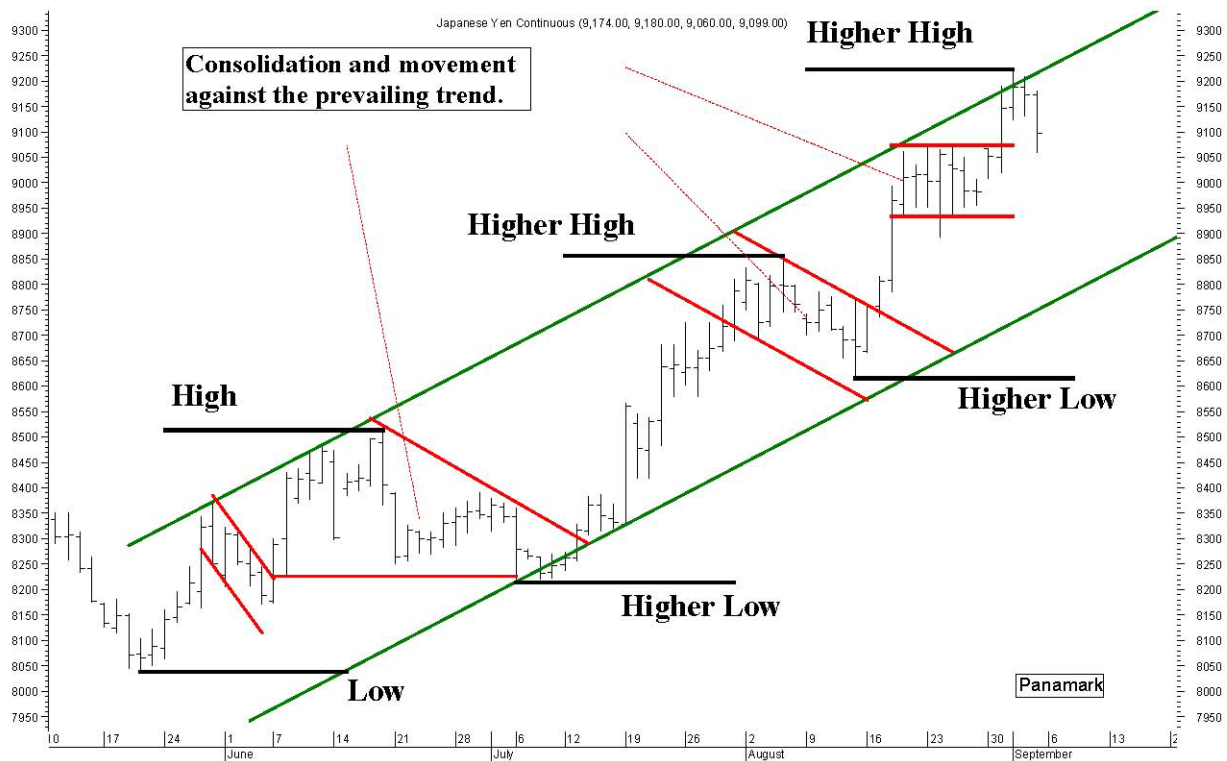
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Trends can be classified in three ways: UP, DOWN or RANGE-BOUND and as mentioned are found in all time scales.

Up-trend

The price rallies often with intermediate periods of consolidation or movement against the prevailing trend. In doing so, it draws a series of higher highs and higher lows on the price chart. In an up-trend, there will be a POSITIVE rate of price change over time.



Trends tend to persist over time, therefore a price graph in an up-trend has a high probability of continuing to rise until some change in value or conditions occur and fulfil the possibility of a change in the trend.

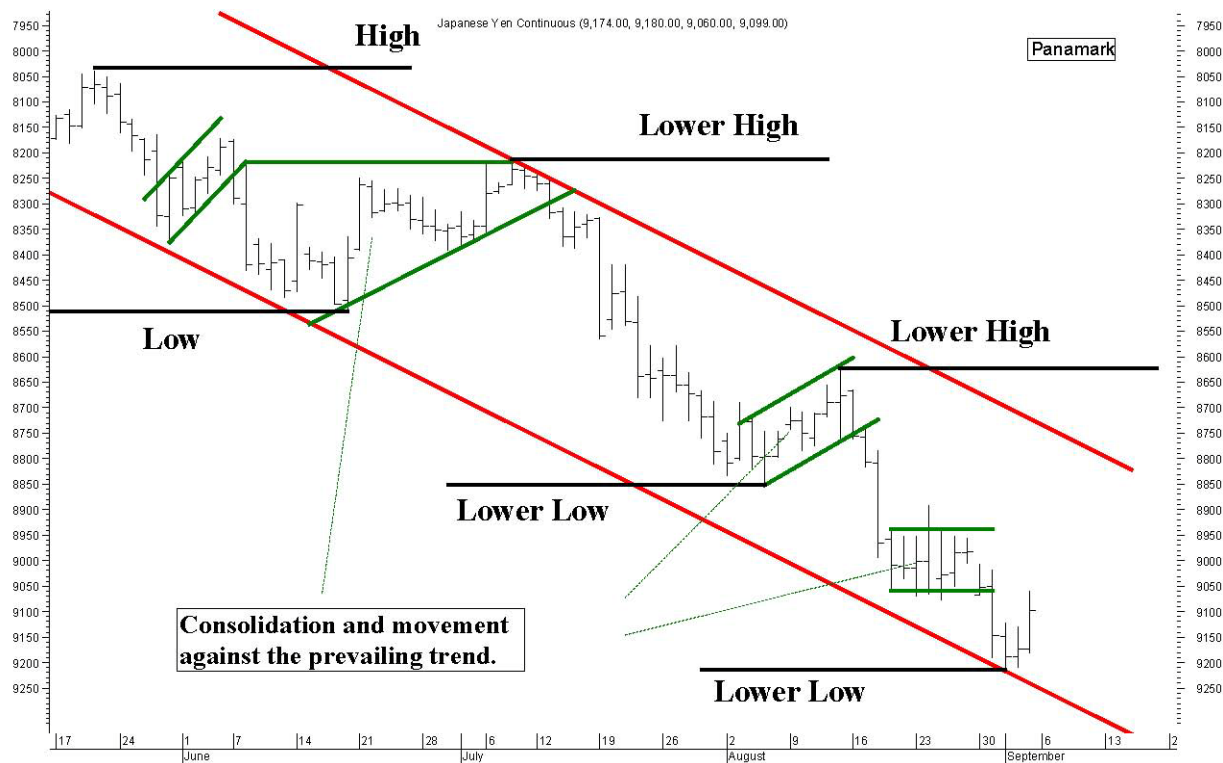
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In the same way, a declining price graph has a high probability in continuing to fall until some change in value or conditions occur and fulfil the possibility of a change in the trend.

Down-trend

The price declines often with intermediate periods of consolidation or movement against the prevailing trend. In doing so, it draws a series of lower highs and lower lows on the price chart. In a down-trend, there will be a **NEGATIVE** rate of price change over time.



Study the above down-trend chart carefully and try and see what it has in common with the up-trend chart previously shown, other than the obvious we have already discussed.

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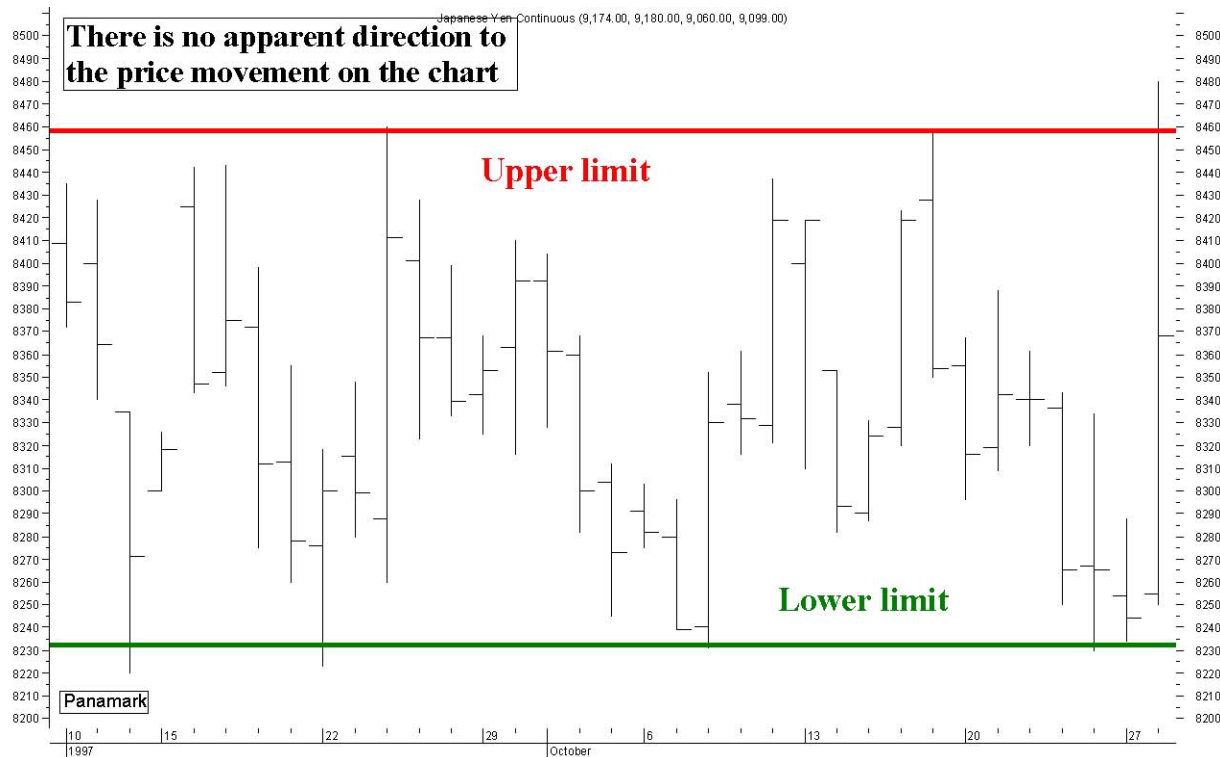
Some technical strategies try to locate TOPS and BOTTOMS, which are those points where a trend, rally or a decline, ends. Locating a top or a bottom can be especially difficult though a successful trade is often very profitable due to the high level of reward to risk.

However a well-known quote about trends advises, "*The trend is your friend*". For traders, this wisdom teaches that you will have more success taking trading positions in the direction of the prevailing trend within chosen time scales than against it.

Range-bound

The Price swings back and forth for a prolonged period between easily seen upper and lower limits. There is no apparent direction to the price movement on the chart and there will be LITTLE or NO rate of price change.

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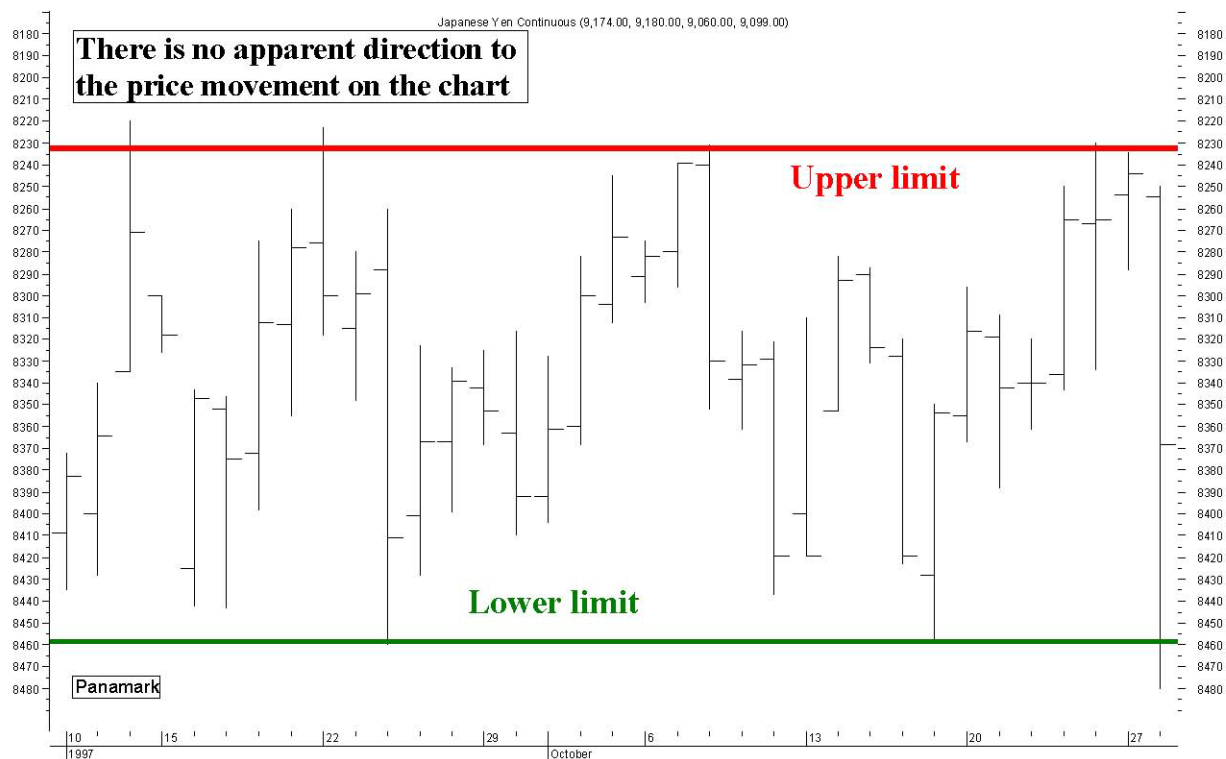
Did you study the down-trend chart carefully and did you find anything significant in common with the up-trend chart. If you were sharp enough you may have seen they are one in the same.

One chart is just the inverse scale of the other. Hard to see that they are the same chart unless you already knew. The point we are making is that, if you are not sure the market is trending or range-bound then turn the chart upside down and if it looks the same stay away and consider another time scale.

Compare the inverse scale of the range-bound chart and you will think you are looking at the same graph. It may sound silly but if it helps to avoid trading at the wrong time or using the incorrect strategy for prevailing market conditions than it is truly worth its weight in gold.



Inverse range-bound chart



Patterns & Indicators

How does the professional trader organise the endless stream of price data into a logical format that doesn't require rocket science to interpret?

Technical analysis is an extremely visual medium and this one fact alone sets it apart from the colder method of fundamental “value-based” analysis. Price charts allow traders to look at past and present price action in order to make reasonable decisions and intelligent choices.

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To assess or analyse a price chart both left-brain and right-brain functions of logic and creativity are active. So it's no revelation that over the last century two major forms of technical analysis methods have developed that focus along these lines of significant examination.

Pattern Analysis

The oldest form of interpreting price charts is PATTERN ANALYSIS. This method gained popularity through both the writings of Charles Dow as mentioned earlier and *Technical Analysis of Stock Trends*, a classic book written on the subject just after World War II.

Basic pattern analysis



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Pattern analysis gains its power from the tendency of charts to repeat the same formations over and over again. These patterns have been categorised over the years as having a bullish or bearish bias. Some well-known ones include HEAD & SHOULDERS, TRIANGLES, RECTANGLES, WEDGES, DOUBLE & TRIPLE TOPS, DOUBLE & TRIPLE BOTTOMS, FLAGS and PENNANTS. Also, basic SUPPORT & RESISTANCE and TREND-LINES have great importance on price action.

Indicator Analysis

The newest form of interpreting price charts is INDICATOR ANALYSIS, a maths oriented examination of the basic elements of price, time and volume.

These elements are run through a series of different calculations in order to evaluate and identify various types of opportunities in market price statistics and data.

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Basic indicator analysis



Indicator analysis uses a diverse range of maths calculations, some simple, others more complicated, these calculations are then used to measure the relationship of current price to past price action and thereby assess the probabilities associated with price moving in one of three directions up, down or sideways.

In total there are six categories of technical indicators as well as two groupings namely LEADING indicators and LAGGING indicators, all of these will be covered in Module 5. Although there are six categories almost all indicators can be categorised as TREND-FOLLOWING or OSCILLATORS.

Popular trend-following indicators include MOVING AVERAGES, ON BALANCE VOLUME and MACD.

Common oscillators include STOCHASTICS, RSI and RATE OF CHANGE.



A combination of the MACD and RSI are illustrated in the above price chart.

Trend-following indicators react much more smoothly to price action than oscillators. They look deeply into past price data and often have internal smoothing to filter out market noise and minor volatility to evaluate the overall direction of the “time frame” been studied.

Oscillators react very quickly to short-term changes in price, flipping back and forth between OVERBOUGHT and OVERSOLD levels.

Prices rise and fall moving markets from extreme to extreme within all timeframes. The core of investors and traders that make up the market tend to act with a group or crowd mentality. This "crowd" tends to develop known characteristics that repeat its self within all of these time frames.

Markets are a manifestation of human psychology and chart interpretation using patterns and indicators as a measure of that market psychology attempts to uncover growing pressure within the market that has a high probability of ultimately developing into price change.

Moving Averages

The original and probably the most accepted technical indicator for studying price charts is the MOVING AVERAGE. This basic but versatile tool has many important uses for traders and investors alike.

You have 3 types of them: Simple MA, Exponential MA and the Weighted MA.

The most powerful point of the moving averages is that they show the trends of market movements in an early stage which gives the trader serious advantages.



Moving Averages Explained:

A moving average is a statistical calculation that is used to smooth the effects of volatile fluctuations in time series data, which within this application are financial price values.

Moving averages are trend-following in nature and their purpose is to anticipate the beginning of new trends, or to identify new trends as soon as possible after their inception.

In mathematical terms, a normal moving average can be expressed as the arithmetic mean of n observations for every n samples in a set of time series data.

In its simplest form, a simple, or Normal Moving Average, is calculated by adding a constant number of price data values, where the value of the constant is known as the smoothing constant of the moving average, and dividing the result by the same value of the constant.

This is repeated for all available data points on the chart, giving a series of values that can be plotted as the moving average.

In a market that has a rising trend, the moving averages will be less than the rising price values, but for a market that has a falling trend, the moving averages will be higher.

In such trending markets, the intersection of a price chart with its moving average can be used as a decision making point within a disciplined trading strategy.



How to calculate a Moving Average?

A normal moving average study for a historic data chart is calculated by adding a constant number of the price data values, where the value of the constant is known as the smoothing constant of the moving average, and dividing the result by the same value of the constant.

This is repeated for all data points of the drawn chart to give a series of moving average points.

The formula for a normal moving average applied with n points as the smoothing constant is:

$$\text{NRM (mva - n)} = (\text{Sum (Pi) for } i = 1 \text{ to } n) / n$$

Where P = the price value of data point, which can be selected to be high, low, close or open (default is close)

How to calculate a Weighted Moving Average?

The calculation of a weighted moving average is similar to that of a normal moving average except that every price point is linearly weighted according to its age. The emphasis therefore is placed on the most recent price values.

This type of moving average will respond to a changing price trend more rapidly than will a normal moving average, and will be seen to cross the price chart sooner than would a normal one. The weighted moving average is therefore said to be “fast”.

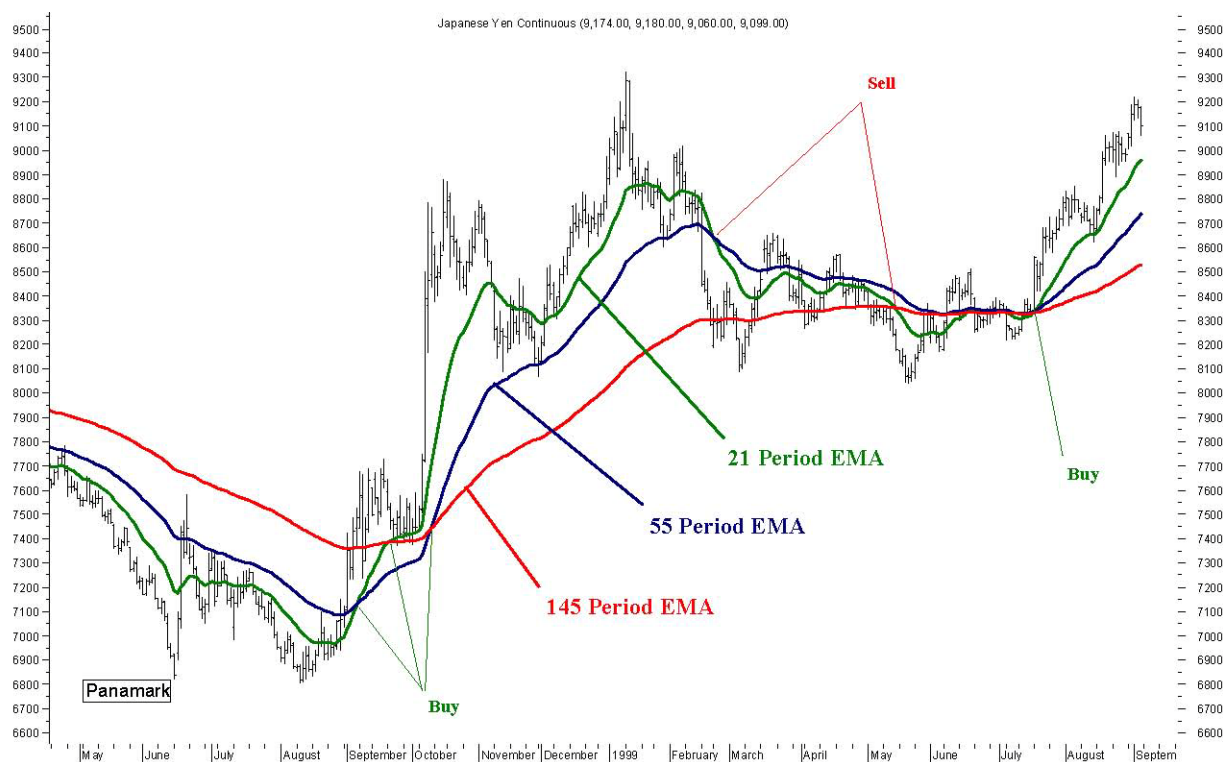
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How to calculate an Exponential Moving Average (EMA)?

An exponential moving average is similar to a Weighted Moving Average in that a weighting factor is applied to the data points, but here the weighting factor increases exponentially. This also results in a greater emphasis being placed on the most recent data point.

Multiple moving average chart



Moving averages LAG price, in other words, if price starts to move sharply upward or downward, it will take some time for the new data to filter into the moving average calculation and for it to react or "catch up".

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The power of the moving average comes from its direct interaction with the price it is plotting. Current price will always be above or below any moving average calculation.

The basic concept is, that when it is above, conditions are "bullish" and when below, conditions are "bearish". Additionally, moving averages will slope upward or downward over time. This adds another visual dimension to the analysis.

Moving averages can be used to define TRENDS. They can be computed for any period of time. Traders find them most useful when they provide input about the SHORT-TERM, INTERMEDIATE and LONG-TERM trends. For this reason, using multiple moving averages that reflect these characteristics can assist important decision-making. Common moving average settings for daily price charts are 21 period for short-term, 55 period for intermediate and 145 period for long-term as can be seen in the chart above.

One of the most common buy or sell signals in all chart analysis is the MOVING AVERAGE CROSSOVER. These occur when two moving averages representing different trends criss-cross.

For example, when a short-term average crosses BELOW a long-term one, a SELL signal is generated. Conversely, when a short-term crosses ABOVE the long-term, a BUY signal is generated.

Moving averages can be "speeded up" through the application of further math calculations. Common averages are known as SIMPLE moving average or SMA.

These tend to be very slow. Giving more weight to the current changes in price rather than those many bars ago, a faster EXPONENTIAL moving average or EMA can be created.



Many technicians favour the EMA over the SMA. Fortunately all basic price charting software programs do the calculations for you and plot price perfectly.

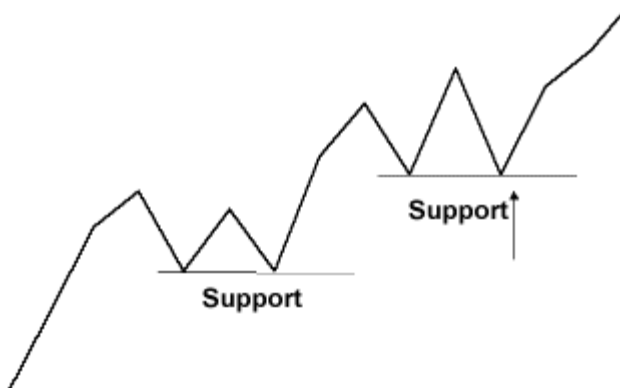
Support & Resistance

The concept of SUPPORT and RESISTANCE is essential to understanding and interpreting price charts affectively.

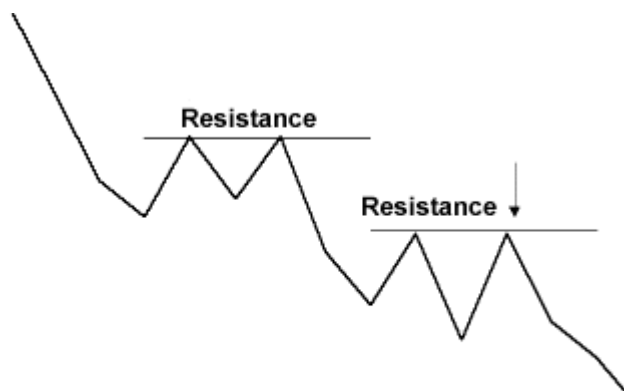
Think of price charts as the result of SUPPLY and DEMAND of BUYERS, the “BULLS” and SELLERS, the “BEARS”. The bulls push prices higher and the bears push prices lower.

The direction prices actually move reveals what is the stronger factor, supply or demand in relation to each other. In order to be successful at trading you need to supply or demand at the correct times.

Support Levels



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Resistance Levels

Using this analogy, consider the price action of the price chart below. During the period shown, note how each time prices fell to the 8000 / 8100 level, the bulls i.e., the buyers took control and prevented prices from falling further.



Japanese Yen Continues



This price action should inform traders that at these levels, bulls currently consider that going long is worthwhile and sellers are not willing to go short at lower levels. This type of price action is referred to as support, because buyers or the bulls are supporting the level.

Therefore support defines that level where buyers are strong enough to keep price from falling further or simply sellers may be unwilling to sell any lower and demand inevitably exceeds supply.

In the same way, resistance defines that level where sellers are too strong to allow price to rise further and buyers may not be willing to pay a higher price, supply inevitably exceeds demand.



Support and resistance play different roles in up-trends and downtrends. In an up-trend, support is where a pullback from a rally should end. In a downtrend, resistance is where a pullback from a decline should end.

The last price at which a trade takes place is the last price at which a bull and bear agreed to do business and this price represents the consensus of their EXPECTATIONS. The bulls think prices will move higher and the bears think prices will move lower.

Support and resistance are created because traders have a memory and expectation not “the market”. Those prices where major buyers or sellers entered the market in the past will tend to have the same expectations and this generates a similar mix of participants when price again returns to that level.

Nevertheless traders EXPECTATIONS CHANGE over time and in some cases very abruptly. Underlying fundamental changes that are above or below market expectations brings about these changes. The cause of these changes in expectations is not as significant as the effect as NEW EXPECTATIONS LEAD TO NEW PRICE LEVELS.

Support and resistance come in all varieties and strengths. They most often manifest as horizontal price levels. But TREND-LINES at various angles represents support and resistance as well.

Support and resistance exist in all TIME FRAMES and all MARKETS. The length of time that a support or resistance level exists determines the strength or weakness of that level.

Therefore naturally levels in longer time frames are stronger than those in shorter time frames. Also, the greater volume traded at any level, the stronger that level will be. This strength or weakness determines how much buying or selling pressure will be required to break the level. Therefore a greater change in expectation is needed to break stronger supports or resistances.



Among various other tools, as mentioned trends as well as support and resistance can be measured using trend-lines. Very often a straight line can be drawn UNDER two, three or more pullbacks from rallies in an up-trend or OVER pullbacks from declines in down-trends.

When price then returns to that trend-line, it tends to find SUPPORT or RESISTANCE and bounce off the line in the direction of the trend.

However, once breached the trend-line acts as an apposing force.

In other words what once may have been *support now becomes resistance* and visa versa.

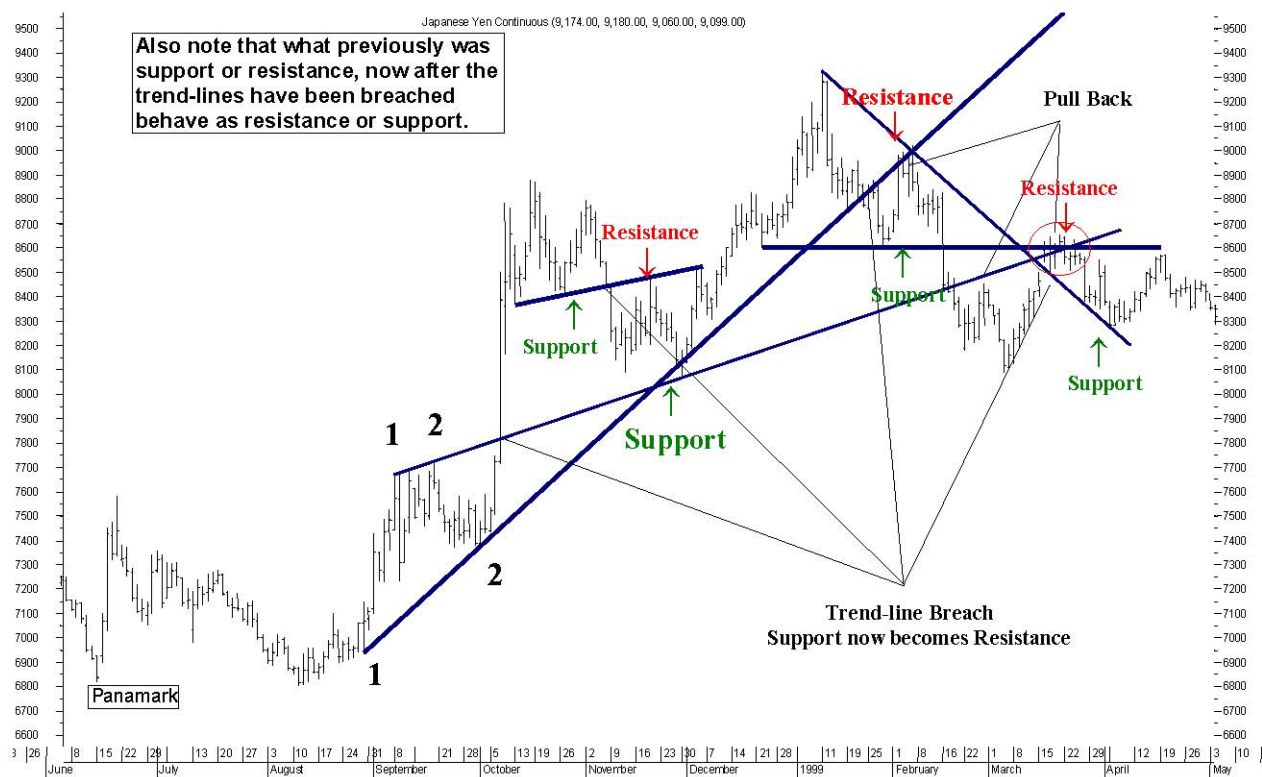
Interesting points to note about Support and Resistance:

- ★ When the market passes through resistance, that resistance now becomes support.
- ★ When the market passes through support, that support now becomes resistance.
- ★ The more often price tests a level of support or resistance without breaking it, the stronger that level becomes. When price breaks such a strong level of support or resistance, the stronger the break out will be.
- ★ Such strong levels of resistance or support are called double tops, double bottoms, triple tops and triple bottoms. Of course, these patterns are interesting to be successful in our trading as they can create great opportunities in the FX market. If a currency pair is approaching an important support level, it can serve as an alert to be extra vigilant in looking for signs of increased buying pressure and a potential reversal.

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- ★ If a currency pair is approaching a resistance level, it can act as an alert to look for signs of increased selling pressure and potential reversal. If a support or resistance level is broken, it signals that the relationship between supply and demand has changed. A resistance breakout signals that demand (bulls) has gained the upper hand and a support break signals that supply (bears) has won the battle.

Trend Lines



As can be seen when price pushes above resistance, it becomes a new support level because of the change in expectation related to the previous resistance. When price falls below support, that level becomes resistance.

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When a level of support or resistance is penetrated, price tends to thrust forward sharply as the crowd notices the **BREAKOUT** and jumps in to buy or sell.

When a level is penetrated but does not attract a crowd of buyers or sellers, it often falls back below the old support or resistance. This failure is known as a **FALSE BREAKOUT**.



Chapter 4: FXTSP Trading Strategy

Introduction

Do you really need a very complex trading system or strategy to make money at the forex? The answer is absolutely no. It is our firm belief that traders, in a desperate search for the “holy grail” will unnecessarily grasp at anything that suggests, “super complexity”.

Most traders think that basics such as moving averages, chart patterns and support and resistance levels won’t work because their mind tells them that if a system is not complex enough, it isn’t profitable. Our view is closer to the exact reverse of this misconception, keep it simple and you will succeed.

Simple trade setups often outperform complex systems!

There is absolutely no need to provide you with explanations on how each technical indicator work and how to apply them, this will only confuse you in your trading decisions and will often lead to bad trading results!



Components of the FXTSP Trading System

Our trading strategy is based on exponential moving averages (EMA) and support & resistance levels (R&S), our system can be applied on every timeframe in between the 5 min chart up to a monthly chart, we do recommend not to use timeframe's less than the 5-min, this to avoid too many false signals.

This system will be used to identify a trend and once identified, stay with it as long as possible.

System Components:

- ➔ 5 exponential moving average (5EMA)
- ➔ 62 exponential moving average (62EMA)
- ➔ 89 exponential moving average (89EMA)
- ➔ support and resistance levels

Preferred Currency Pairs to Trade our trending system:

Major currency pairs and the most popular crosses.

Try to focus on only 1-2 currency pairs of your choice, often, this will lead to better trading results.

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Preferred Timeframe(s) to Trade our trending system:

This depends on your trading style and skills.

Do you like to trade several times a day or do you prefer to stick with a trade for several days or weeks?

Do you like to keep stops small/take small profits or do you prefer to wide up your stop and go for more profit?

- ★ If you prefer to trade several times a day or daily, then you should use a 5 min up to 1 hour charts.
- ★ If you prefer to take few trades a week or a month, then you should use a 1 hour up to the daily charts.



Trading System Basics Overview

We will divide the trading method in to 3 parts for your best understanding:

- ★ Entry Levels
- ★ Stop Losses
- ★ Limit Levels - When to Close a Trade

Part 1a: Entry Levels- Conditions and rules

(1) When to open a trade?

Open a long or short trading position when EMA5 has Crossed EMA62 and when the difference in pip value between EMA5 and EMA62 is ≥ 3 pips

(2) When to open a long trade?

Open a buy order when EMA5 has Crossed EMA62 from below and when the difference in pip value between EMA5 and EMA62 is ≥ 3 pips (*valid “go” long signal*)



(3) When to open a short trade?

Open a sell order when EMA5 has crossed EMA62 from above and when the difference between EMA62 and EMA5 ≥ 3 pips (*valid “go” short signal*)

(4) Where exactly do you have to open a position (same conditions are applied for long and short trade setups)?

Looking at the below picture, you have to open a long position at the OPEN of candlestick 2.

Why?

At the OPEN of candlestick 2, you have to look at candlestick 1 for valid entry conditions (EMA5 has Crossed EMA62 from below and $\text{EMA5} - \text{EMA62} \geq 3$ pips for candlestick 1).

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Always look to the previous candlestick because that candle has been completed and STATIC. NEVER look at the current candlestick for valid entry conditions because that candle is still updating tick by tick (DYNAMIC). Very important to understand and don't violate this rule!

(5) When is an entry signal defined as not valid yet?

For a long position setup:

A long entry signal is not valid (yet) when the EMA5 has crossed EMA62 from below AND the difference in pip value between EMA5 and EMA62 < 3 pips, we will NOT take a long signal until the difference in pip value between EMA5 and EMA62 becomes greater or equal to 3 **AND** EMA5 remain above EMA62.

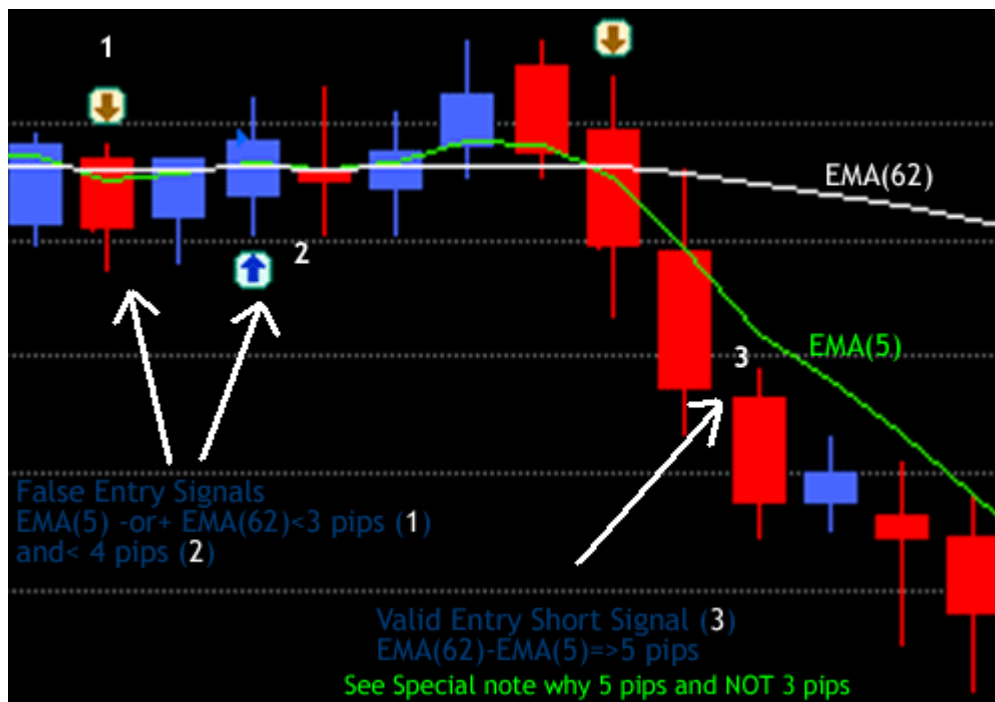
For a short position setup:

A short entry signal is not valid (yet) when the EMA5 has crossed EMA62 from above AND the difference in pip value between EMA62 and EMA5 < 3 pips, we will NOT take this signal until the difference in pip value between EMA62 and EMA5 becomes greater or equal to 3 pip **AND** EMA5 remain below EMA62.



(6) What are false signals and how to filter out most of them?

We will explain this with below example.



In ranging markets, it can happen that EMA5 crosses EMA62 from below/above and reverse after one or couple of candles *without* becoming a valid signal, now EMA5 will cross EMA62 from above/below and the same scenario can happen again, this will generate *false entry signals*.

Take a look at the above picture, at point 1:

We have a sell signal but NOT valid because $\text{EMA62} - \text{EMA5} < 3\text{pips}$ **AND**

the difference between EMA5 and EMA62 **remain** below 3 pips for a valid sell signal during this down cycle.

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Now we got a reverse to a long signal at point 2, same scenario:

We have a buy signal but NOT valid because $EMA5 - EMA62 < 3\text{ pips}$ **AND**

the difference between EMA5 and EMA62 **remain** below 3 pips for a valid long entry signal during this up cycle.

After few candles, the market reverses again to a sell signal, at point 3

We will take the short signal. *Why do we take the short signal at point 3?*

Here comes our entry trick in play to wipe out most false signals:

For each false signal, we will wide up the difference in pip value between EMA5 and EMA62 by 1 pip needed to generate a valid entry signal!

Look again to the above picture:

- ➡ At point 1, the difference between EMA62 and EMA5 must be $\geq 3\text{ pips}$.
- ➡ Now, this is a false signal as explained above. So following our rule, at point 2, the difference between EMA5 and EMA62 must be $\geq 4\text{ pips}$ to generate a valid signal which is false too.

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- ➔ The market reverse again to a sell and now, the difference between EMA62 and EMA5 must be ≥ 5 pips which is valid at **point 3**, finally, now we can enter the market with a valid short entry!!

This special entry trick method can save you thousands of dollars in ranging markets, so always keep it in mind and use our entry trick whenever you need to.

Part 1b: Entry Levels- Long Entry Example

Looking at the below example, a long term entry signal has been issued at the open of candlestick 3.



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Explanation:

- ➔ At the open of candlestick 2 and looking to candlestick 1 for valid entry conditions, we notice that: EMA5 has Crossed EMA62 from below but the signal is not valid yet because EMA5 and EMA62 is <3 pips, so wait for the next candle to look for valid entry conditions.
- ➔ At the open of candlestick 3 and looking to candlestick 2, we have valid entry conditions, EMA5 still **remain** above EMA62 **AND** the difference between EMA5(1.2206) and EMA62(1.2199) is ≥ 3 pips

Now we can enter our long position at the open of candlestick 3.



Part 1c: Entry Levels- Short Entry Example

Looking at the below example, a short term entry signal has been issued at the open of candlestick 3.



Explanation:

- ➔ At the open of candlestick 2 and looking to candlestick 1 for valid entry conditions, ***we notice that:*** EMA5 has Crossed EMA62 from above but the signal is not valid yet because the difference between EMA62 and EMA5 is <3 pips, so we must have patience and wait for the next candle.



- ➔ At the open of candlestick 3 and looking to candlestick 2, now we have valid conditions: the EMA5 still **remain** below EMA62 from above **AND** the difference between EMA62(1.2281) and EMA5(1.2274) is ≥ 3 pips

Now we can enter our short position at the open of candlestick 3.

Part 1d: Entry Levels- Special 5 min Entry Setup

When to open a trade?

Open a long or short trading position when *EMA5 has Crossed EMA62 and EMA89* and when the difference between *EMA5 and EMA62* is ≥ 3 pips

When to open a long trade?

Open a buy order when *EMA5 has Crossed EMA62 and EMA89 from below* and when the difference between *EMA5 and EMA62* is ≥ 3 pips (valid “go” long signal)

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When to open a short trade?

Open a sell order when *EMA5 has crossed EMA62 and EMA89 from above* and when the difference between *EMA62 and EMA5* ≥ 3 pips (valid “go” short signal)

When is an entry signal defined as not valid yet for the 5 min chart?

For a long position setup:

A not valid yet long entry signal occurs when the EMA5 has crossed EMA62 and EMA89 from below BUT the difference between EMA5 and EMA62 < 3 pips, we will NOT take this signal until the difference between EMA5 and EMA62 becomes greater or equal to 3 pips.

For a short position setup:

A not valid yet short entry signal occurs when the EMA5 has crossed EMA62 and EMA89 from above BUT the difference between EMA62 and EMA5 < 3 pips, we will NOT take this signal until the difference between EMA62 and EMA5 becomes greater or equal to 3 pips.

5 min chart false signals:

For each false signal at the 5 min chart, we will wide up the difference in pip value between EMA5 and EMA62 by 1 pip needed to generate a valid entry signal!



For more explanation about false signals, we refer to page 68 and 69.

Part 1e: Entry Levels- Special 5 min Entry Setup Examples

Looking at the below picture, a short term entry signal has been generated at the open of candlestick 2.



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Explanation:

At the open of candlestick 2 and looking to candlestick 1 for valid entry conditions, we notice that: EMA5 has Crossed EMA62 AND EMA89 from above AND the difference between EMA62(1.2325) and EMA5(1.2318) is ≥ 3 pips

Now we can enter our short position at the open of candlestick 2.

Next Example: Looking at the below picture, a long term entry signal has been generated at the open of candlestick 2.





Explanation:

At the open of candlestick 2 and looking to candlestick 1 for valid conditions, we notice that: *EMA5 has Crossed EMA62 AND EMA89* from below **AND** the difference between EMA5(1.2292) and EMA62(1.2288) is ≥ 3 pips

Now we can enter our long position at the open of candlestick 2

Part 2: System Stops Losses

Why use a Stop Loss?

Stop Loss orders allow traders to set an exit point for a losing trade. If you are short a currency pair, the Stop Loss order should be placed above the current market price. If you are long the currency pair, the stop loss order should be placed below the current market price.

Stop Loss orders help traders control risk by capping losses. Stop Loss orders are counter-intuitive because you do not want them to be hit, however, you will be happy that you placed them! When logic dictates, you can control greed.

Where to place a Stop Loss?

The most logical is to place a Stop Loss **1 pip below a previous support level** when we enter a long position or **1 pip above a previous resistance level** when we enter a short position.

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Attention:

It is very important that you fully understand what support and resistance is and how to recognize these levels, if you don't know yet, we refer to the support and resistance section in this course (see page 59).

Below examples will show where to place logical Stop Losses for your trades.

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Example 1: Where to place your stop-loss when going short?



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Explanation:

At the entry section, you have learned what a valid entry is, so looking to the above picture, a valid short entry has been issued at 1.2342(EUR/USD). Where to place your stop? You have to place your stop at the most logical level what means a previous resistance level because you are short. Price went as high as **1.2369** in a previous uptrend and formed a resistance level, your stop will be located 1 pip above this resistance level at **1.2370**.

How many pips do you have at risk? You have 31 pips at risk (3 pip spread included)

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Example 2: Where to place your stop-loss when going long?



Explanation:

A valid long entry has been issued at 1.2417(EUR/USD).

Where to place your stop? You have to place your stop at the most logical level what means a previous support level because you are long. Price went has low as **1.2399** in a previous downtrend and formed a level of support, so this is a support level and the most logical place to set your stop. Your stop will be located 1 pip below this support level at **1.2398**.

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How many pips do you have at risk? You have 22 pips at risk (3 pip spread included)

Use of Stops Summary:

(1) Always place a stop below/above logical levels (support & resistance), it will keep you more in the game if you compare to stops which are placed at levels in between support and resistance levels (as most traders do).

(2) It seems logical that how bigger the timeframe is you are trading at, the bigger your stops you will be because normally, S&R levels will be farther away from your entry levels.

For example, below you will find some typical stops for the EUR/USD pair for use in different timeframes.

Used Timeframe	Typical Stops in Pips
5 Min	7-30
15 Min	15-50
1 Hour	40-75
4 Hour	60-110
Daily	110-300



Part 3a: System Limit Levels and When to Close a Trade

In previous 2 parts, you have learned when to open a trade and how to set a logical stop for your position. In part 3, you will learn with a simple basic rule where to take profits and when you need to close a trade.

As a general rule, you have to take profits only when your Risk-to-Reward Ratio is at 1.5 or better

For example: When you have 50 pips at risk on a trade, the reward (taking profit on the trade) should be at least 75 pips.

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Let's consider following example:



Explanation:

- ➔ We have entered a valid short trade at **1.2340** and our stop will be located 1 pip above a previous resistance at **1.2370**.
- ➔ How much risk do we take on this trade? We risk 30 pips + 3 pips (spread) = **33 pips**.

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- ➔ Where to take profits on this trade? Following our rule, we do risk 33 pips on this trade, so we need to take profit, at least at $1.5 \times 33 \text{ pips} = 50 \text{ pips or better}$.
- ➔ In our case, the profit taking level will be located at **1.2290** or better.

Use of Limits Summary:

(1) The more pips you take at risk, the more pips you have to gain on the trade.

For example, if you risk 100 pips, you should gain 150 pips.

(2) The better your system's performance is, the less your risk reward ratio has to be in order to make profits.

Practical Example for a 70% winning system:

For each 10 trades done using a 70% winning system, 7 trades will reach our profit taking level and 3 will stop you out at your stop loss level. We can use a Risk-to-Reward ratio 1 (our profit taking level will be equal to our risk level) for this system and we will still have some nice profits.

Profit taking level (pips): 40
Stop used or pips at risk: 40

Winning pips: $7 \times 40 \text{ pips} = 280 \text{ pips}$
Losing pips: $3 \times 40 \text{ pips} = 120 \text{ pips}$

Total gain: **160 pips**

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(3) Never risk more pips on a trade then you plan to make. It doesn't make sense to risk 100 pips in order to make only 10 pips.

Why?

Profit taking level (pips): 10
Stop used or pips at risk: 100

You win 10 times which makes 100 winning pips.
You ONLY lose once and have to give back all profits!!!

This type of trading makes no sense and you will lose money on the long term guaranteed!!!

Part 3b: When to close a Trade?

- ★ When your profit taking level has been reached (see part 3a).
- ★ When your Stop Loss has been hit.
- ★ When a valid reversal signal has been generated by the system.



Maximizing Your Currency Profits

How to maximize your currency profits?

Stay as long as possible with the current trend and let your profits run. When the current trend has come to an end, you will get stopped out at a pre-defined level.

Advantages

Some trades you will make can generate a lot more profits compared to those when you use a risk-to-reward ratio.

For example, you have taken a trade on the 5min chart using a Risk-to-Reward ratio 1.5 and your pre-defined target level is 32 pips, now sometimes, the same trade can generate a lot more profit when you stick with the current trend and let your profits run as long as possible.

Which trades are likely to give you more profits?

When important S&P levels are broken, very often, price will move a lot higher (when resistance is broken) or lower (when support is broken), if you are in such a trade, it is always interesting to try to maximize your profits because often, even when you use the 5-min chart, it can generate 100+ pips for you.

For example, important S&R levels can be broken by Economic News releases.



Using Support & Resistance Levels

- ➔ ***In an uptrend***, you will move your stop always 1 pip below the most recent important support level and let the trade further develop until you get stopped out at your pre-defined stop level.
- ➔ ***In a downtrend***, you will move your stop always 1 pip above the most recent important resistance level and let the trade further develop until you get stopped at your pre-defined stop level.

PLEASE NOTE:

The importance of an S or R level depends on the used timeframe, longer time frames will have more important S&R levels if you compare to smaller time frames.

For example:

A support level at the 5 min chart will be broken much easier than a support level at a daily chart because traders will pay more attention to those S&R levels (more stops are placed at the daily charts below/above the S&R levels).

A Support or Resistance level at the daily chart is more likely to hold compared to a Support or Resistance level at the 5-min chart.

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Consider the following example (see picture):



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Explanation:

- ➔ We have entered a long position for the EUR/USD pair at 1.2469 with our entry method, our original stop is located at 1.2445 (1 pip below support).
- ➔ The price makes a high at **point 1** and thereafter, it retraces back to the 1.2471 level and forms a bottom at **point 2** (support 1).
- ➔ From **point 2**, price bounces and as soon as it breaks thru the top at **point 1**, we will move our original stop to 1 pip below **point 2**.
- ➔ From **point 3**, price retraces back to **point 4** and forms a bottom (support 2).
- ➔ Now, we will move our stop from **point 2** up to 1 pip below **point 4** once the price breaks again the **point 3** level from below (most recent market high).
- ➔ This way, we will keep moving up our stop to 1 pip below the most recent support level which in our case is 1 pip below **point 6**.
- ➔ The pair now makes a high at **point 7** and retraces back from there to get us stopped out at 1 pip below **point 6** at **1.2513**.

In summary, every time a market high is broken, we will move up our stop 1 pip below the most recent support level when we are long at the market.

PLEASE NOTE:

You can apply the same rules for short trades. Now move your stop 1 pip above resistance.



Trading Important “Economic News” Items

Trading economic news can be very profitable but can also lead to a disaster when you don't know how to trade this. Very often, when important news data has been released, price can spike up or down 50 pips in matter of seconds in order to come back with speed of light and even make a reverse.

If you had entered a long or short position after the news release at the spike's top or bottom, you would have lost 50 pips in matter of seconds or even more.

Trading important news is only for experienced traders, we do not recommend the novice to trade them (practice first on a demo account).

We do recommend to download the Weekly Economic Data Release Calendar at www.dailyfx.com and mark the most important releases for that week.

Economic Numbers to keep an eye on

The rankings for US economic data as seen in below table are based on an analysis of 20-minute and daily ranges. As seen in below table for example, the Non-farm Payroll release days can cause a big shake up in the forex market.

They have the potential to move the EUR/USD (on average) 124 pips in 20 min and 193 pips in a day on average.

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Biggest FX market “shakers” table

For 2004	Avg. Range (pips)	Total Daily	Avg. Range (pips)
For 20 min		Range	
Non-Farm Payrolls	124	Non-Farm Payrolls	193
FOMC Decision	74	FOMC Decision	140
Trade Balance	64	TICS	132
Inflation - CPI	44	Trade Balance	129
Retail Sales	43	Current Account	127
GDP	43	Durable Goods	126
Current Account	43	Retail Sales	125
Durable Goods	39	Inflation - CPI	123
TICS	33	GDP	110



FXTSP Trading System Summary

Always enter the market with a valid entry signal, be patience and have the discipline to wait for it, take only profits when you have reached your profit target level or try to maximize your profits if given a chance, close a trade when you need to and last but not least, use logical stops!



Chapter 5: High Probability Chart Patterns

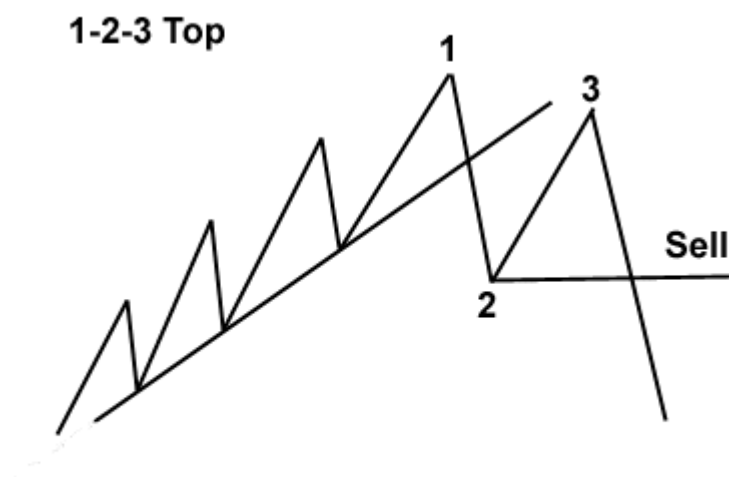
We have selected 3 chart patterns which have a high rate of success, these chart patterns are:

- ★ 1-2-3 Reversal Chart Pattern
- ★ Double Tops and Bottoms Pattern
- ★ Head & Shoulders Pattern

1-2-3 Reversal Chart Pattern

What is it? A 1-2-3 reversal chart pattern is build up of 3 definable points, known as point 1, 2 and 3. A typical 1-2-3 chart pattern is best traded after a strong up - or downtrend and can be accurately defined by an easy set of rules.

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Point (1): The high in an up trending market is created when a previous move up has come to an end and price starts back moving down.

Point (2): A downward correction in the uptrend, the lowest bar in the correction before the price move back up to point (3).

Point (3): The high in the move up from Point (2) but a failure to make a new higher high.

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Let's take a look at the following example (4 Hour Chart GBP/USD):



How to trade the 1-2-3 reversal chart pattern:

- ➡ Mark the low of Point (2) and sell a breakout when price penetrates this level by 1 pip.

In our example, you should go short at 1.8115 because the low of point (2) is 1.8116.



- ➔ Place a protective stop above point (3).

In our example 1 pip above the bar high of point (3)@1.8305.

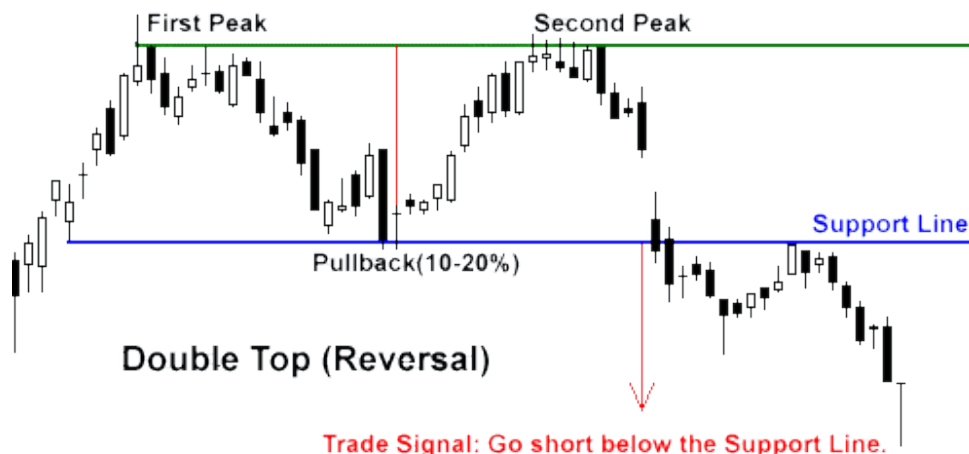
- ➔ Target: We do recommend to use a Risk-to-Reward Ratio 1.5 or better. For example, if you use a 30 pip stop, go for a 45 pip profit target or better.

Double Tops & Bottoms Chart Pattern

Double Tops are identified by two consecutive peaks of similar (or almost) height with a moderate pullback in between. The double top is a major reversal pattern that can be formed after an extended uptrend.

A double top formation is a distinct chart pattern characterized by a rally to a new high (first peak) followed by a moderate pullback (10 -20%) and a second rally to test the new high (second peak) again.

As the currency pair rallies to make the second peak (top) sellers overwhelm buyers and the currency price goes down to test prior support levels.





How to trade a Double Top:

- a) Trade Signal: Go short below the Support Line.
- b) Price Target: The distance from support break to peak can be subtracted from the support break for a price target. This would infer that the bigger the formation is, the larger the potential decline.
- c) Stop-loss: Place your stop-loss just above the last peak.

Double Bottoms

Similar to double tops but the reverse scenario.

IMPORTANT NOTE:

When a double top/double bottom is broken from below/above, the price is likely to move higher/lower in that direction. When it breaks, enter a long (double top) / short (double bottom) position and place your stop 1 pip below / above the support line, use a risk reward ratio 1.5 or better.

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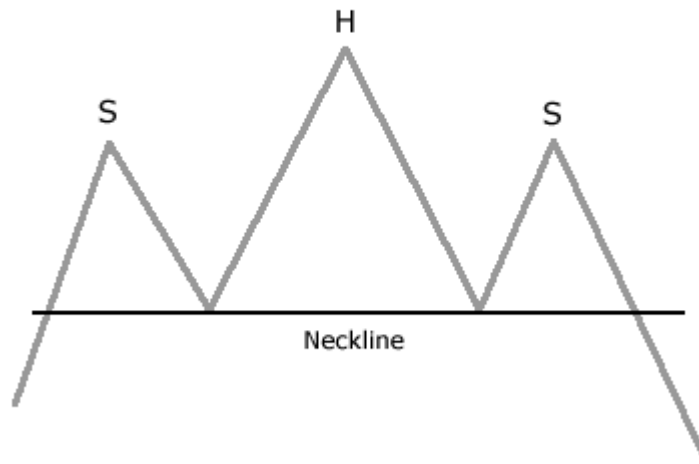
Trading Example





Head & Shoulders Chart Pattern

Head & Shoulders Top



The head and shoulders top is an extremely popular pattern among investors because it's one of the most reliable of all formations. The head and shoulders top is a "reversal" pattern. The formation marks a reversal in an upward trend of the currency pair's price - an uptrend is in the process of becoming a downtrend.

What does a classic head and shoulders top look like?

The first point - the left shoulder - occurs as the price of the currency pair in a rising market hits a high and then falls back.

The second point - the head - happens when prices rise to an even higher high and then fall back again.

The third point - the right shoulder - occurs when prices rise again but don't hit the high of the head.



Prices then fall back again once they have hit the high of the right shoulder. The shoulders are definitely lower than the head and, in a classic formation, are often roughly equal to one another.

A key element of the pattern is the neckline. The neckline is formed by drawing a line connecting two low price points of the formation. The first low point occurs at the end of the left shoulder and the beginning of the uptrend to the head.

The second marks the end of the head and the beginning of the upturn to the right shoulder. The neckline can be horizontal or it can slope up or down.

The pattern is complete when the support provided by the neckline is "broken." This occurs when the price of the currency pair, falling from the high point of the right shoulder, moves below the neckline.

Technical analysts will often say that the pattern is not confirmed until the price closes below the neckline - it is not enough for it to trade below the neckline.

Trading Signals

How to trade a Head & Shoulders Chart Pattern:

Go short at breakout below the neckline and place a stop-loss just 1 pip above the last peak, use a risk reward ratio 1.5 or better to calculate your profit target.

Head & Shoulders Bottom

Same as head & Shoulders top but the reverse scenario.



Chapter 6: Trading Psychology

Introduction

The goal of any trader is to make profit on a regular basis, yet so few people ever really make consistent money as traders. Why?

If you do not have the correct mind set, you are doomed to failure. Most traders we come across are seeking a get rich quick scheme or wish to make money in the FX with no effort.

Then they wonder why their account balance is going down with speed of light.

Those kind of traders jump into the FX Market with little or no education but expect to make lots of cash.

Get this, if you enter the FX with no education then you are treating it as a gamble. If you gain an education and adopt a more professional stance, then you are treating it as a business.

Who makes money? Gamblers or business people? Well it is no different in the FX market.

Trading really is a great business but only when you remove the stress or trading from emotion, getting excited about winners and down about losses.



The Holy Grail

Does the Holy Grail exist?

The answer is NO, it does not exist for currency trading, neither for any other financial market. There are no secret tools or trading systems which are correct 100% of time.

For example a trending system will not work in ranging markets and reverse, a ranging system will not work in trending markets.

So, a trader will have to deal with losses as well in his trading. Over the internet, some "company's" do you want to believe the Holy Grail exist, well avoid there hypes because there's nothing to hype.

In your own interest, avoid following Currency Marketing Hypes:

- ➡ Do not trust a company who promise you 1000 pips each week.
- ➡ Do not trust a company who makes 2000% profit / year.
- ➡ Do not trust a company who tells you to become rich quickly without any education.

Conclusion

You need proper education to make money currency trading, don't believe in Marketing Hypes and Holy Grails because they don't exist. There's no easy money, Currency Trading is a serious business.



An Introduction to Trading

When trading goes well, it can be a fantastic experience but when it goes bad it can be a terrifying one. It is true that fortunes have been made and will still be made in the markets but it is just as important to realise that without the correct understanding, knowledge and controls in place, fortunes have been lost and will still be lost.

We believe this is simply because people keep doing the same things expecting a different result. This pattern repeats itself for just about every new trader that comes onto the market.

Obviously, for an individual to become a successful trader he must recognise these patterns of wrong beliefs and errors and then by rational observation and logical conclusion break the pattern. We are here to help you do just that.

The main reason it is so difficult for most to achieve this goal of recognising their errors or mistakes is because of the nature of the market and the way in which it has what can be described as “random reinforcements”.

What we mean by “random reinforcement” is that the market sometimes rewards “bad market practice” and punishes “good market practice”.

Most traders do not understand that they can have a profitable trade for the wrong reasons or a non-profitable trade for the right reasons.

This simply leaves most traders confused and totally unsure of what it is they are doing wrong or for that matter, even what it is they are doing right.



This is the very reason that it is so hard for most to recognise what expertise are needed to develop into a profitable and successful trader. We feel that with the correct guidance and the right attitude just about anyone can be brought to a level of a competent trader.

We would first like to point out that in our own observations as traders, we came to realise that almost every successful trader used what can be described as “***A Complete Trading Methodology***”. This is by no means a coincidence, as a good complete trading methodology automates the entire process of trading.

What do we mean by “A Complete Trading Methodology”?

A complete trading methodology automates most of and sometimes the entire process of trading. The methodology provides answers for each of the decisions a trader must make while trading.

A complete methodology makes it easier for a trader to trade consistently because there is a set of clearly laid out rules, which specifically define exactly what can or should be done at any point in time during the trading process.

Most of the mechanics of trading and in some cases all are not left up to the judgement of the trader. This does not necessarily mean that a complete trading methodology disregards the discretion of the trader altogether but rather insures each decision that can be made at any point in time are clearly defined by predetermined parameters.

Therefore what we define as “a complete trading methodology” does identify trading strategies from both discretion and non-discretion approaches as valid provided they meet the required workings of what a complete methodology must encompass.

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The “Complete Trading Methodology” insures that the mechanics of trading and all decisions associated with trading are not left up to the “SUBJECTIVE and EMOTIONAL” whims of the trader.

The fact is that a disciplined trader who can consistently and systematically implement a rational and clearly defined complete trading methodology and at the same time apply strict rules governing the principles of risk control and money management within that complete method with the same consistency will achieve long term profitable results.

The Complete Trading Methodology

The Components

Profitable trading and a complete trading methodology are based on three things and these are: Trading Psychology, Risk Management and Trading Strategy or what is sometimes referred to as the three M’s.

★ “MIND”

★ “MONEY”

★ “METHOD”

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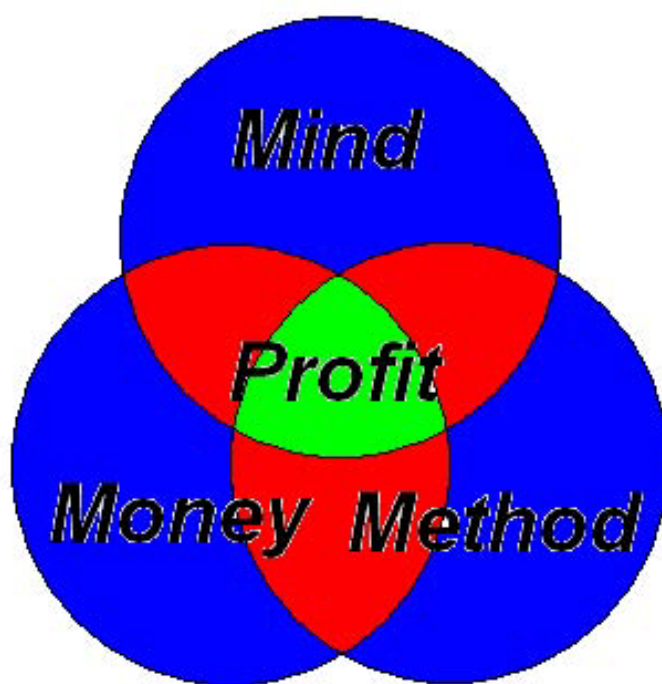


“Mind” refers to trading psychology. A profitable trader always has a sound mindset and belief structure that assists him in the market to trade with consistency and discipline. It helps keep emotions in check and the trader in control.

“Money” refers to risk management and how it can affect your capital. A trader may have an otherwise technically sound trading strategy or method but if he risks too much capital on every trade sooner rather than later he will go broke.

“Method” refers to trading strategy or trading method a trader uses to find his trades. How the trader studies the market and finds his entries, exits etc.

Each component of a **“Complete Trading Methodology”** should work collectively to reinforce the overall performance of the Methodology. To insure efficiency the trader must be completely comfortable with every aspect of the methodology to insure discipline and consistency are adhered to at all times.





Which component is more important?

The few traders that eventually arrive at the realisation that there is more to trading than simply buying or selling and having a few basic rules in place, if any, often ask this very question.

The answer is simple, each component is as important as the next. The truth is, the sum of the total is what makes a good trader and if there is lack in one area the sum does not add up.

Think of a three-legged stool, if all the legs are present and equal in length then it is very stable and reliable to use with confidence. Now imagine sitting on the same stool but now with one leg not been equal in length you will not be so confident when using it, now imagine one of the legs are missing all together. You will not be sitting for very long!

The Phases of the Lonely Trader

Looking at traders in general, those that start trading with no help of any reliable kind, tend to go through three phases of development and at each phase more and more of them drop out, never realising their true potential in the markets.

The main reason for this is that they have no one to support and guide them along the way. The importance and benefits of assistants provided by more knowledgeable traders to insure the novice trader does not end up like most who go it alone is often overlooked through ego, pride and arrogance or simply ignorance.

Most traders we come across are looking for some sort of get rich quick scheme and hope to make money in the markets with no effort. The problem is they jump into trading with little or no understanding and education and expect to achieve the same results as the large, experienced and market educated traders.



Most do not understand if they enter the markets with little or no trading education and even less understanding of the trading process and all the aspects that can affect performance, perhaps having no systematic well thought out trading method at all.

Then they are treating trading as a gamble and are doomed to fail with the majority of people that enter the markets that way.

If they gain an education, test and adopt a more professional stance and come to understand what must be done in order to succeed, they are then treating trading as a business.

Successful traders take joy in trading but at the same time they are incredibly passionate and take trading very seriously, they consider it a business.

In our experience, we have found that most every successful trader we have the privilege to know, are confident in their own abilities but at the same time also humble, teachable and passionate individuals.

The First Phase, “Method”

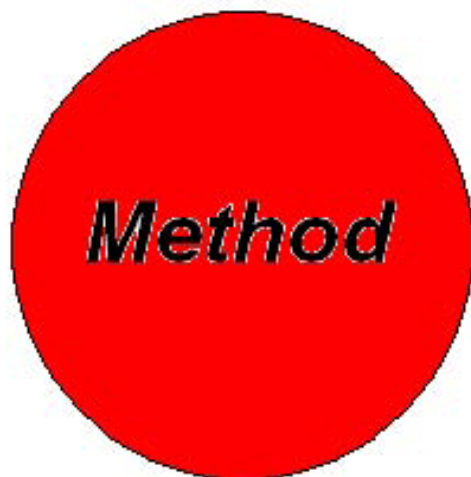
The first phase in development is the “Method” phase. Most people that first start trading with no guiding assistance tend to focus all their attention on the method or trading strategy.

Most traders do not survive this phase as the effects from the absents of Trading management “Money” and Trading psychology “Mind” is to severe on the overall performance. In this phase no matter what trading method they think they are using, the ultimate decision is more usually an emotional one.

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They simply have too little experience and end up losing in a destructive and aggressive manner. No trading method no matter how sound will help see them through without progressing very slowly all the way in a process of very expensive trial and error analysis.



The traders that do survive this first stage of development are those traders that are of course most determined to succeed but these traders also have an open mind and are willing to admit that there is something very wrong and start asking questions.

Through the process of rational observation and logical conclusions the trader comes to the realisation that a trading method alone is not sufficient to, not only prosper in the market but also it is not even sufficient to survive.

The thing is, in this phase they have developed systems and strategies that can help them take sound action in the market and have even become quite proficient at technical analysis; this experience makes the trader more confident and determined to find the answers.



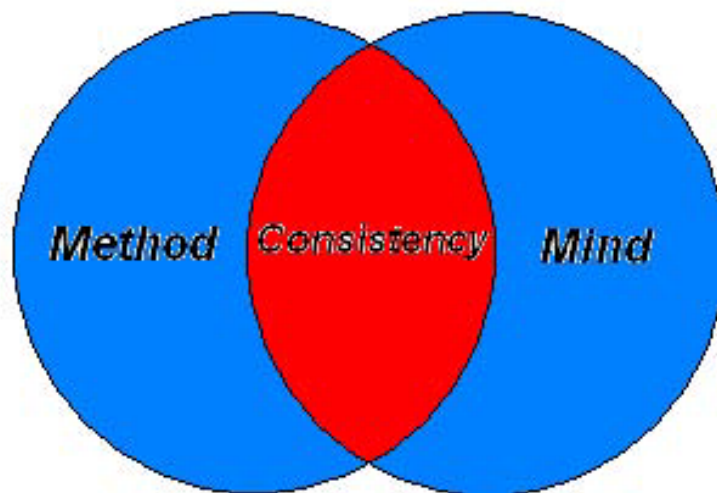
The Second Phase, “Mind”

One month their account is up 15% and the next down 15% or worse. They now enter the second phase “Mind” and start to look within for an answer to their problems.

As their trading method is adequate to produce profit but they are still not profitable, they realise that their biggest obstacle to consistent profitability is the person they see in the mirror.

The understanding that just as much as the computer they use is a tool to trade, they themselves are just as important to the overall performance.

They realise that impulsive and undisciplined trades with no protective stops lead to their losing strikes, soon they start to develop the correct mind set and mental strategies that can support them in trading the markets in a consistent and disciplined manner.

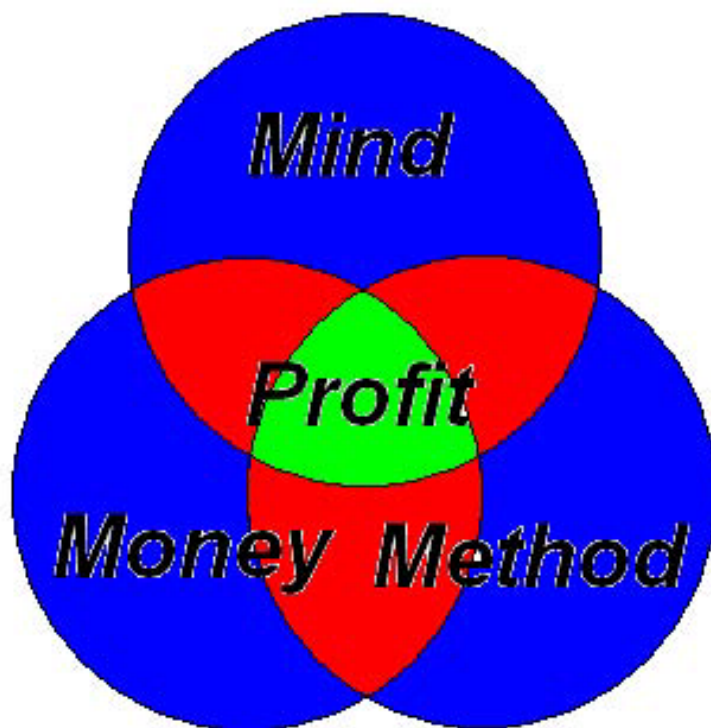




The traders that survive the second phase come to recognise that their character, with all its complexities is just as much a trading tool. Of course most traders do not get this far but for those that do, they become more relaxed and confident and less anxious in the market.

The Third Phase, “Money”

These traders are now in the third phase and start focusing more on risk management. The trading “method” is in place, they are now also at peace with themselves, and they spend more and more time assessing how to allocate trading capital in order to reduce overall risks associated with trading.



A sound “Complete Trading Methodology” = PROFIT



Summery

A very significant thing most new traders do not understand is that it is not merely sufficient to start using the first trading strategy “Method” they come across, as there are very important considerations to make before choosing a trading method.

For one it is imperative that the method itself matches the traders makeup and beliefs as an individual, also the time available to the trader needs to be considered as well as the risk profile of the method and a great deal more.

It is more important for a trader to be comfortable with the parameters of the Trading Methodology than simply asking what strategy is profitable.

It is one thing to have a profitable strategy but it is another thing all together to implement that strategy if it simply dose not agree with ones risk tolerance for instance.

It is far more easier to correctly implement a Trading Methodology successfully if the trader is comfortable with it's parameters.

It is also tremendously important to understand every aspect of the Trading Methodology, it's mathematical or fundamental construction and it's characteristics in the market, so that one is familiar with it's every process as it is been implemented in real time trading.

The confidence, consistency and discipline afforded by a thoroughly tested complete Trading Methodology is often the means to been a profitable and successful trader.

Most often for someone starting out as a trader it is usually best to adopt a non-discretionary approach to trading at first and over time increase on his or her knowledge and trading skills that will be needed to develop and trade profitably from a discretionary based method.



This is not to say that we believe discretionary strategies are by any means superior to non-discretionary strategies.

The truth is, it is simply much more easier for someone starting out as a trader to have less discretionary freedom while implementing a trading strategy until their trading skills and confidence levels are properly developed to support the added emotional pressures associated with discretionary trading methods.

In our experience we have seen traders in both instances consistently take profit out of the market using both, self developed or adopted, non-discretion and discretionary strategies.

As a trader develops his skills and becomes more aware of self, he will also become more aware of what trading strategies line up with his personality.

Once a trader aligns his “Trading Strategies” METHOD and “Risk Management” MONEY with his “Trading Psychology” MIND, he will know where he belongs in order to perform at his best.

Rational Observations

What follows are some of these observations and conclusions that we have used in our own trading over the years to help develop improved behaviour and keep us on the right path, you can use them as a guide to determine the probability of being a successful trader and where you would need to make adjustments to insure an easier learning curb.



Observation one

The greatest number of losing traders is found in the short-term and intra-day time horizons. This has less to do with the time frame and more to do with the fact that many of these traders lack proper preparation and a well thought-out trading plan that only comes with experience.

By trading in the time frame most unforgiving of even minute error and also most vulnerable to “temporary manipulation” and general costs of trading, losses due to lack of knowledge and lack of preparedness can be exponential.

Winning traders most often start out their trading careers in the mid-term to long-term time frames and gain the adequate experience over time before considering whether or not entering the short-term and intra-day arena is something that is viable or even of interest to them. Most traders find themselves gravitating to the shorter time frames, but for the wrong reasons, lack of capital and lack of patience.

Conclusion

From a statistical point of view trading and gaining experience in the mid-term and long-term time frames offers greater probability of success for the novice trader.

There is a great deal of reason for this but for the most part it has to do with ones mental stance and ones ability to shift perception of what the market is doing and been able to take action on that understanding.

It is just far more complex and difficult to do this in the short-term and intra-day time horizons. The mid-term and long-term time frames offer a far more forgiving environment to learn the dynamics of successful trading.



Observation Two

Losing traders often use complex systems or methodologies that they do not understand or rely entirely on outside recommendations from gurus or black box systems as well as tips and sometimes they even have no systematic well thought out trading plan at all.

Winning traders often use very simple techniques as described in our FXTSP trading method. Invariably they use either a highly modified version of an existing strategy or else they have designed and developed their own. They also are disciplined and consistent in the implementation of their preferred approach.

Conclusion

This seems to fit in with the mistaken belief that "complex" is synonymous with "better". This is not necessarily the case. Logically one could argue that simplistic market approaches tend to be more practical and less prone to false interpretation. In truth, even the terms "simple" or "complex" have no real relevance.

All that really matters is what makes money and what doesn't. From this observation, we might also conclude that maintaining a real stake in the trading process via your own trading ideas and analyses through study is very important to being successful as a trader, instead of simply relying on the methods of outside sources that you do not understand.

This may also explain why a trader who possesses no other qualities other than patience and persistence often outperforms those with advanced education or superior intellect.

Always remember, ***“Making money is more important than been right or bright”***



Observation Three

Losing traders often depend heavily on systems and methods from outside sources because they do not take the time to understand first before making use of them.

They do not take the time to study the mathematical construction of such tools nor do they consider variable usage other than the most popular interpretations and more importantly, they do not take the time to test a trading method first to gain understanding of it's characteristics in the market.

This builds and develops confidence in the trading methods ability to profit in the market before applying it to real capital.

This results in the inevitable lack of conviction in any market approach. This type of trader will always have a weak stance in the market second-guessing every decision made rendering an otherwise sound approach or trading recommendation useless.

Winning traders often take advantage of the use of computers because of their speed in analysing large amounts of data and many markets and even the use of systems and indicators or recommendations from outside sources but first they test and understand these systems completely.

However, they also tend to be accomplished chartists who are quite happy to sit down with a paper chart, a pencil, protractor and calculator.

Very often you will find that they have taken the time to learn the actual mathematical construction of averages and oscillators and have completely evaluated the trading systems they use and can construct them manually if need be.

They have taken the time to understand the mechanics of the markets and the tools they use, right down to the last nut and bolt before applying any method to real capital.

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It is inevitable that this type of trader will have the adequate conviction and trust in his approach and trading methods to insure consistency and discipline in it's implementation to real capital.

Conclusion

Trading is not and should not be seen as a complicated task but nothing comes easy. If you want to be successful at anything, you need to have a strong understanding of the tools involved. Using a hammer to drive a bolt into a threaded hole might work, but it isn't pretty or practical.

“Always keep a detailed trade-log / journal and study it every week”

Observation Four

Losing traders spend a great deal of time trying to forecast where the market will be tomorrow, next week or month and then hang onto that view long after the market is doing something new.

This is not rational if one hopes to make money in the market. Subconsciously they are essentially saying it is more important to be right than it is to make money. Sooner or later the market will prove them “very wrong indeed” for subconsciously believing this.

Winning traders spend most of their time thinking about how traders will react to what the market is doing now, and they plan their strategies and systems accordingly.

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They are able to make very fast paradigm shifts in their view of the market.

Conclusion

Price forecasting is important and it has its place. There are also very accurate forecasting techniques that can produce very profitable trades but often these techniques are based on highly sophisticated mathematics or require a great deal of subjective interpretation by the trader, therefore it can take years of study and practice to perfect.

The success of a trade is much more likely to occur if a trader can understand what type of crowd reaction (fear or greed) a particular market event or move will invoke and then construct their strategies and systems to seize advantage of these events.

Being able to respond to irrational buying or selling by market participants with a rational and well thought out trading plan will always increase your probability of success.

It can also be concluded that being a successful trader is easier than being a successful analyst since analysts must in effect forecast ultimate outcome and project ultimate price movement.

If you were to ask a successful trader where he thought a particular market was going to be tomorrow, the most likely response would be a shrug of the shoulders and a simple comment that he would follow the market wherever it wanted to go.

By the time you have reached the end of this coaching program, what may seem like a rather silly response may be reconsidered as a very prophetic view of the market.



“Never think in terms of boundaries that limit what the market can do because simply the market can do absolutely anything”

Observation Five

Losing traders focus on winning trades and high percentages of winners.

Winning traders focus on controlling risk, money management, solid returns, hit rate and good risk to reward ratios that produce an acceptable Positive Expectancy.

Conclusion

This observation implies that it is much more important to focus on overall risk versus overall profit, rather than merely "wins" versus "losses".

The successful trader focuses on possible money gained versus possible money lost or what is known as a positive expectancy, he cares little about the mental highs and lows associated with being "right" or "wrong" whereas losing traders seem to always have their ego's on the line and this keeps them thinking irrationally.

Some of the best traders we know are right only 40% of the time yet still make enormous profits through proper risk controls and money management. Often these very successful traders never risk more than 3% on any single trade, still other even less.

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A good friend of mine always says “If a trader is profitable 99% of the time but risks his wallet on every trade sooner or latter he will lose everything”. This is obviously true and therefore risk controls and money management plays an enormous roll in the success of a trading methodology.

“Always think of risk, reward and points in terms of percentage never money”

Observation Six

Losing traders often fail to acknowledge and control their emotional processes during trading. Doubt fear and greed through lack of preparedness control their decisions and sooner or later they always find themselves in a spiral of panic losing all rational thinking.

Winning traders acknowledge and control their emotions, examining the market based on their complete trading methodology, which they have taken the time to “know”, leaving no assessment of the market to an emotional impulse, particularly if the state of the market has not changed or the trade is still within it’s original trading plan.

Conclusion

If a trader enters or exits a trade based purely on emotion having no real trading plan, then his market approach is neither practical nor rational.



Even trading through reliable outside recommendations or from black box systems that the trader has not tested to gain understanding of their characteristics, again his market approach is neither practical nor rational.

For this trader there is no conviction in anything he is doing leaving the door open for doubt, fear and greed to stamp its ugly mark.

Strangely, much damage can also be done if the trader totally ignores his emotions. In extreme cases this can cause physical illness due to psychological stress.

In addition, valuable subconscious trading skills that the trader may possess but has no conscious awareness of may be lost. It is best to acknowledge each emotion as it is experienced and to view the market at these points based on your trading plan to see if the original reasons you took the trade are still present.

“Always be disciplined and consistent, plan your trades and trade your plan”

Observation Seven

Losing traders care a great deal about being right. They love the adrenaline rushes and emotional highs that trading can produce. They become obsessed and must be in touch with the markets almost twenty-four hours a day.

Winning traders recognise the emotions but do not let it become a governing factor in the trading process. They may go days without looking at the markets. To them, trading is a business. They don't care about being right or wrong for that matter. They focus on what makes money and what doesn't.

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They enjoy the intellectual challenge of finding the best odds in the markets. If those odds aren't present they simply do not trade.

Conclusion

It is important to stay in synch with the markets, but it is also important to have a life outside of trading. It is a rare individual who can do anything to excess without suffering some form of psychological or physical breakdown.

Successful traders keep active enough in the markets to stay sharp but also they realise that it is a business not an addiction. Any other way to view the market seems impractical, inefficient and counter productive as it can stir up all kinds of harmful emotions.



Chapter 7: Money Management Principles

Trade With Sufficient Capital

One of the worst blunders that traders can make is attempting to trade without sufficient capital.

The trader with limited capital not only will be a worried trader, always looking to minimize losses beyond the point of realistic trading, but he will also frequently be taken out of the trading game before he can realize any sense of success trading the method(s) or patterns.

The minimum recommended amount to open your FOREX MICRO trading account is \$/€250. For a FOREX STANDARD, we do recommend a minimum of \$/€15000.

Exercise Discipline

Discipline is probably one of the most overused words in trading education. However, despite the cliché, discipline continues to be the most important behaviour one can master to become a profitable trader. Discipline is the ability to plan your work and work your plan.



It's the ability to give your trade the time to develop without hastily taking yourself out of the market simply because you are uncomfortable with risk. Discipline is also the ability to continue to trade the methods and patterns even after you've suffered losses. Do your best to cultivate the degree of discipline required to be a world-class trader.

Employ Risk-to-Reward Ratios

There are three basic questions that every trader should answer BEFORE entering a trade.

How much do I believe the market will move and where do I want to take my profit?

Limit Orders allow traders to exit the market at profit targets. If you are short (sold) a currency pair the system will only allow you to place a limit order below the current market price because this is the profit zone.

Similarly if you are long (bought) the currency pair the system will only allow you to place a limit order above the current market price. Limit orders help create a disciplined trading methodology and enable traders to walk away from the computer without constantly monitoring the market.

Where should I place my stop and limit orders?

Place them as described in our trading method(s), a common mistake of many traders is that they take profits too early, so try to avoid that, remove your emotional thinking from trading.

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The following table shows possible risk-to reward ratios, and the win ratios required to break even in a trading system.

Risk-to-Reward Ratio (in pips)	Win Ratio Required to Break Even
40/20 (2 to 1)	67%
40/40 (1 to 1)	50%
40/60 (1 to 1.5)	40%
40/80 (1 to 2)	33.5%
60/20 (3 to 1)	75%
60/60 (1 to 1)	50%
60 /90 (1 to 1.5)	40%
60/120 (1 to 2)	33.5%



Chapter 8: Forex Resources

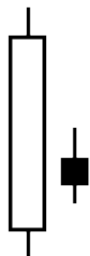
Candlestick Pattern Formations



Bearish 3:

Pattern: A long black body followed by several small bodys and ending in another long black body. The small bodys are usually contained within the first black body's range.

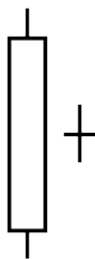
Interpretation: A bearish continuation pattern.



Bearish Harami:

Pattern: A very large white body followed by a small black body that is contained within the previous bar.

Interpretation: A bearish pattern when preceded by an uptrend.



Bearish Harami Cross:

Pattern: A Doji contained within a large white body.

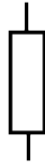
Interpretation: A top reversal signal



Big Black Candle:

Pattern: An unusually long black body with a wide range. Prices open near the high and close near the low.

Interpretation: A bearish pattern.



Big White Candle:

Pattern: A very long white body with a wide range between high and low. Prices open near the low and close near the high.

Interpretation: A bullish pattern.

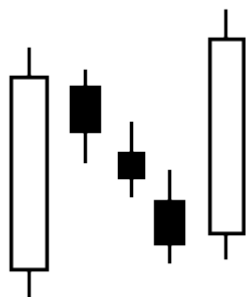


Black Body:

Pattern: This candlestick is formed when the closing price is lower than the opening price.

Interpretation: A bearish signal. More important when part of a pattern.

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Bullish 3:

Pattern: A long white body followed by three small bodies, ending in another long white body. The three small bodies are contained within the first white body.

Interpretation: A bullish continuation pattern.



Bullish Harami:

Pattern: A very large black body is followed by a small white body and is contained within the black body.

Interpretation: A bullish pattern when preceded by a downtrend.



Bullish Harami Cross:

Pattern: A Doji contained within a large black body.

Interpretation: A bottom reversal pattern.



Dark Cloud Cover:

Pattern: A long white body followed by a black body. The following black candlestick opens higher than the white candlestick's high and closes at least 50% into the white candlestick's body.

Interpretation: A bearish reversal signal during an uptrend.


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Doji: 

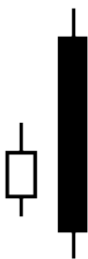
Pattern: The open and close are the same.

Interpretation: Dojis are usually components of many candlestick patterns. This candlestick assumes more importance the longer the vertical line.

Doji Star: 

Pattern: A Doji which gaps above or below a white or black candlestick.

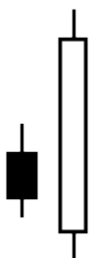
Interpretation: A reversal signal confirmed by the next candlestick (eg. a long white candlestick would confirm a reversal up).



Engulfing Bearish Line:

Pattern: A small white body followed by and contained within a large black body.

Interpretation: A top reversal signal.



Engulfing Bullish Line:

Pattern: A small black body followed by and contained within a large white body.

Interpretation: A bottom reversal signal.



Evening Doji Star:

Pattern: A large white body followed by a Doji that gaps above the white body. The third candlestick is a black body that closes 50% or more into the white body.

Interpretation: A top reversal signal, more bearish than the regular evening star pattern.



Evening Star:

Pattern: A large white body followed by a small body that gaps above the white body. The third candlestick is a black body that closes 50% or more into the white body.

Interpretation: A top reversal signal.

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Falling Window:

Pattern: A gap or "window" between the low of the first candlestick and the high of the second candlestick.

Interpretation: A rally to the gap is highly probable. The gap should provide resistance.



Gravestone Doji:

Pattern: The open and close are at the low of the bar.

Interpretation: A top reversal signal. The longer the upper wick, the more bearish the signal.



Hammer:

Pattern: A small body near the high with a long lower wick with little or no upper wick.

Interpretation: A bullish pattern during a downtrend.



Hanging Man:

Pattern: A small body near the high with a long lower wick with little or no upper wick. The lower wick should be several times the height of the body.

Interpretation: A bearish pattern during an uptrend.



Inverted Black Hammer:

Pattern: An upside-down hammer with a black body.

Interpretation: A bottom reversal signal with confirmation the next trading bar.



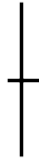
Inverted Hammer:



Pattern: An upside-down hammer with a white or black body.

Interpretation: A bottom reversal signal with confirmation the next trading bar.

Long Legged Doji:



Pattern: A Doji pattern with long upper and lower wicks.

Interpretation: A top reversal signal.

Long Lower Shadow:



Pattern: A candlestick with a long lower wick with a length equal to or longer than the range of the candlestick.

Interpretation: A bullish signal.

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Long Upper Shadow:

Pattern: A candlestick with an upper wick that has a length equal to or greater than the range of the candlestick.

Interpretation: A bearish signal.



Morning Doji Star:

Pattern: A large black body followed by a Doji that gaps below the black body. The next candlestick is a white body that closes 50% or more into the black body.

Interpretation: A bottom reversal signal.



Morning Star:

Pattern: A large black body followed by a small body that gaps below the black body. The following candlestick is a white body that closes 50% or more into the black body.

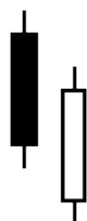
Interpretation: A bottom reversal signal.



On Neck-Line:

Pattern: In a downtrend, a black candlestick is followed by a small white candlestick with its close near the low of the black candlestick.

Interpretation: A bearish pattern where the market should move lower when the white candlestick's low is penetrated by the next bar.



Piercing Line:

Pattern: A black candlestick followed by a white candlestick that opens lower than the black candlestick's low, but closes 50% or more into the black body.

Interpretation: A bottom reversal signal.



Rising Window:

Pattern: A gap or "window" between the high of the first candlestick and the low of the second candlestick.

Interpretation: A sell off to the gap is highly likely. The gap should provide support.



Separating Lines:

Pattern: In an uptrend, a black candlestick is followed by a white candlestick with the same opening price.

Interpretation: A continuation pattern. The prior trend should resume.



Shaven Bottom:

Pattern: A candlestick with no lower wick.

Interpretation: A bottom reversal signal with confirmation the next trading bar.



Shaven Head:

Pattern: A candlestick with no upper wick.

Interpretation: A bullish pattern during a downtrend and a bearish pattern during an uptrend.



Shooting Star:

Pattern: A candlestick with a small body, long upper wick, and little or no lower wick.

Interpretation: A bearish pattern during an uptrend.

Spinning Top:

Pattern: A candlestick with a small body. The size of the wicks is not critical.

Interpretation: A neutral pattern usually associated with other formations.



Three Black Crows:

Pattern: Three long black candlesticks with consecutively lower closes that close near their lows.

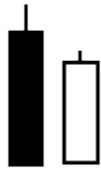
Interpretation: A top reversal signal.



Three White Soldiers:

Pattern: Three white candlesticks with consecutively higher closes that close near their highs.

Interpretation: A bottom reversal signal.



Tweezer Bottoms:

Pattern: Two or more candlesticks with matching bottoms. The size or color of the candlestick does not matter.

Interpretation: Minor reversal signal.

Tweezer Tops

Pattern: Two or more candlesticks with similar tops.

Interpretation: A reversal signal.



White Body:

Pattern: A candlestick formed when the closing price is higher than the opening price.

Interpretation: A bullish signal.

Economic Indicators Explained

Balance of Payments:

The balance of payments is separated into two main accounts: the current account and the capital account. It's a complete summary of a nation's economic transactions and the rest of the world including merchandise, services, financial assets and tourism.

Beige Book Fed Survey:

The Beige Book, is published eight times a year by the Federal Reserve Bank. It highlights the activity information by District and sector. The survey normally covers a period of about 4-weeks in duration.



Business Inventories and Sales:

Inventories are an important component of the GDP report. Business inventories and sales figures consist of data from other reports such as durable goods orders, factory orders, retail sales, and sales data.

Construction Spending:

Spending Measures the value of construction during the course of a particular month.

Consumer Price Spending (CPI):

CPI measures the change in prices at the consumer level for a fixed basket of goods and services paid for by a typical consumer. Items included in the CPI reflect all goods and services that people buy for day-to-day living.

Durable Goods Orders:

Durable Goods include large ticket items such as capital goods, transportation and defence orders. They are extremely important because they anticipate changes in production and thus, signal turns in the economic cycle.



Employment Report:

In the US, the employment report is regarded as the most important among all economic indicators. The Employment Report contains 3 components: Payroll Employment: Measures the change in number of workers in a given month.

Unemployment Rate:

The percentage of the civilian labor force actively looking for employment but unable to find jobs. Average Hourly Earnings Growth: The growth rate between one month's average hourly rate and another.

Factory Orders:

The factory orders report contains data on orders and shipments of non durable goods, manufacturing inventories, and the inventory/sales ratio.

Gross Domestic Product (GDP):

There are four major components of the GDP are: consumption, investment, government purchases, and net exports. GDP measures the market value of goods and services produced in a country.



Housing Starts/Building Permits Starts:

Are divided into single-family and multi-family categories. In both cases, a housing unit is considered “started” when excavation actually begins.

IFO:

Germany’s leading survey of business conditions. The index surveys over 7,000 enterprises on their assessment of the current business situation and their resulting plans for the short-term.

Industrial Production and Capacity Utilization:

Industrial production measures the monthly percentage change in volume of output of the nation’s factories, mines, and utilities. Capacity utilization measures the extent to which the capital stock is employed in production.

National Association of Purchasing Managers (NAPM):

This is leading survey on US manufacturing activity, arranged by the National Association of Purchasing Management (NAPM).



New Home Sales:

Monthly data new home sales data contains information on home prices, and number of houses for sale.

Personal Income:

Personal Spending, also known as PCE, represents the change in the market value of all goods and services purchased by individuals. It is the GDP's largest component.

Producer Price Index (PPI):

PPI measures the monthly change in wholesale prices and is broken down by commodity, industry and stage of production.

Purchasing Managers' Index (PMI):

PMI is widely used by industrialized economies to assess business confidence. Germany, Japan and the UK use PMI surveys for both manufacturing and services industries.



Retail Sales:

Retail sales is the first real indication of the strength of consumer expenditure .Measures the percentage monthly change in total receipts of retail stores, and includes both durable and non-durable goods.

Tankan Survey:

Japan's chief business survey, compiled quarterly by the Bank of Japan. The survey consists of two major parts; the "judgment survey," asking businesses about their situation in the previous, current and following quarters on macro-economic variables, business conditions, inventory levels, capacity utilization levels and employment level. The other main part is related to "current management issues" confronting companies.



Forex Glossary of Terms from A to Z

A

Ask

The price at which traders can buy currency pairs.

B

Bar

A vertical line representing price action during a given time interval. The bar connects the high and low prices. Horizontal ticks to the left of the bar represent opening prices, ticks to the right represent closing prices.

Bear

Someone who believes the prices/market will decline.

Bear Market

A market in which prices decline sharply against a background of widespread pessimism (opposite of Bull Market).

Bid

The price that a buyer is prepared to purchase at; the price offered for a currency.

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Bretton Woods Accord of 1944

An agreement that established fixed foreign exchange rates for major currencies, provided for central bank intervention in the currency markets, and set the price of gold at US \$35 per ounce. The agreement lasted until 1971. See More on Bretton Woods.

Bull

Someone who believes the prices/market will rise.

Bull Market

A market characterised by rising prices. Price increase at the market over a longer period.

Bottom

A low for the market.

Broker

An agent who handles investors' orders to buy and sell currency. For this service, a commission is charged which, depending upon the broker and the amount of the transaction, may or may not be negotiated.



C

Cable

Dealers slang for the Sterling/US Dollar exchange rate.

Call Rate

The overnight interbank interest rate.

Candlestick

Most popular by forex traders, candlesticks have bodies that denote bearish or bullish movement.

Cash Market

The market for the purchase and sale of physical currencies.

Commission

A fee charged by the broker for executing your trade, this is a one time fee per trade. Fees depends on what currency pair you opened the trade.

Consolidation

A trading range in which prices will move until a new trend is developed.



Convertible Currency

Currency which can be freely exchanged for other currencies or gold without special authorisation from the appropriate central bank.

Counter party

The customer or bank with whom a foreign deal is made. The term is also used in interest and currency swaps markets to refer to a participant in a swap exchange.

Crossover

Two lines that crosses each other, used by traders as a trigger to enter the market.

Cross Rate

An exchange rate between two currencies, usually constructed from the individual exchange rates of the two currencies, measured against the United States dollar.

Currency Risk

The risk of incurring losses resulting from an adverse change in exchange rates.

Currency Swap

Contract which commits two counter-parties to exchange streams of interest payments in different currencies for an agreed period of time and to exchange principal amounts in different currencies at a pre-agreed exchange rate at maturity.

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Currency Option

Option contract which gives the right to buy or sell a currency with another currency at a specified exchange rate during a specified period.

Currency Swaption

OTC Option to enter into a currency swap contract.

Currency Warrant

OTC Option; long-dated (more than one year) currency option.

D

Day Trading

Refers to opening and closing the same position or positions within one day's trading.

Dip

Period of declining prices in a bull market.

Direction

Immediate price movement.

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Dollar Rate

When a variable amount of a foreign currency is quoted against one US Dollar, regardless of where the dealer is located or in what currency he is requesting a quote. The exception is the Sterling/US Dollar rate (cable) which is quoted as variable amount of US Dollars to one Sterling.

Downtrend

When overall prices are declining.

E

EMS

Abbreviation for European Monetary System, an agreement between member nations of the European Union to maintain an alignment between the exchange rates of their respective currencies.

European Monetary Union

The principal goal of the EMU is to establish a single European currency called the Euro, which will officially replace the national currencies of the member EU countries in 2002. Currently, the Euro exists only as a banking currency and for paper financial transactions and foreign exchange. The current members of the EMU are Germany, France, Belgium, Luxembourg, Austria, Finland, Ireland, the Netherlands, Italy, Spain and Portugal.



F

Federal Reserve (Fed)

The Central Bank of the United States.

Fibonacci numbers

Leonardo Fibonnaci discovered the relationship of what now are referred to as Fibonacci numbers: a sequence of numbers in witch each successive number is the sum of the two previous numbers.

Fibonacci projections

Used to identify support and resistance levels witch means in an up market the level where the price is likely going down and in a down market price is likely going up.

Fibonacci Retracements

Used to identify likely retracement levels after a significant move, the most common are 0.382, 0.50 and 0.618.

Fixed Exchange Rate

Official rate set by monetary authorities for one or more currencies. In practice, even fixed exchange rates are allowed to fluctuate between definite upper and lower bands, leading to intervention.



Flat / Square

To be neither long nor short is the same as to be flat or square. One would have a flat book if he has no positions or if all the positions cancel each other out.

Floating Rate Interest

As opposed to a fixed rate, the interest rate on this type of deal will fluctuate with market rates or benchmark rates. One example of a floating rate interest is a standard mortgage.

Foreign Exchange Swap

Transaction which involves the actual exchange of two currencies (principal amount only) on a specific date at a rate agreed at the time of the conclusion of the contract (short leg), at a date further in the future at a rate agreed at the time of the contract (the long leg).

Foreign Exchange (Forex or FX)

The simultaneous buying of one currency and selling of another in an over-the-counter market. Most major FX is quoted against the US Dollar.

Forward

A deal that will commence at an agreed date in the future. Forward trades in FX are usually expressed as a margin above (premium) or below (discount) the spot rate. To obtain the actual forward FX price, one adds the margin to the spot rate.

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The rate will reflect what the FX rate has to be at the forward date so that if funds were re-exchanged at that rate there would be no profit or loss (i.e. a neutral trade).

The rate is calculated from the relevant deposit rates in the 2 underlying currencies and the spot FX rate. Unlike in the futures market, forward trading can be customized according to the needs of the two parties and involves more flexibility. Also, there is no centralized exchange.

Fundamental Analysis

Thorough analysis of economic and political data with the goal of determining future movements in a financial market.

G

Gap

Represents a price range on a chart at which no trading took place.

GTC

" Good Till Cancelled". An order left with a Dealer to buy or sell at a fixed price. The order remains in place until it is cancelled by the client.



H

Hedging

The practice of undertaking one investment activity in order to protect against loss in another, e.g. selling short to nullify a previous purchase, or buying long to offset a previous short sale. While hedges reduce potential losses, they also tend to reduce potential profits.

High/Low

Usually the highest traded price and the lowest traded price for the underlying instrument for the current trading day.

I

Initial Margin

The required initial deposit of collateral to enter into a position as a guarantee on future performance.

Interbank Rates

The Foreign Exchange rates at which large international banks quote other large international banks.



L

Limit Order

An order to buy at or below a specified price or to sell at or above a specified price.

Long Position

A market position where the Client has bought a currency he previously did not hold own. Normally expressed in base currency terms, e.g., long Dollars (short D.Marks). A buy position taken in the market when the trader believe that the currency pair will move up.

M

Margin

Customers must deposit funds as collateral to cover any potential losses from adverse movements in prices.

Margin Call

A demand for additional funds. A requirement by a clearing house that a clearing member (or by a brokerage firm that a client) brings margin deposits up to a required minimum level to cover an adverse movement in price in the market.

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Market Maker

A dealer who supplies prices and is prepared to buy or sell at those stated bid and ask prices. A market maker runs a trading book.

Momentum

The rate of expansion of price or volume.

Moving average

Tool used by traders to smooth the fluctuations of price movements, allowing the trader to better determine trends in the market. The MA is the average of prices taken from n periods of time.

O

Offer

The price, or rate, that a willing seller is prepared to sell at.

One Cancels Other Order (O.C.O. Order)

A contingent order where the execution of one part of the order automatically cancels the other part.

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Open Position

Any deal which has not been settled by physical payment or reversed by an equal and opposite deal for the same value date.

Over The Counter (OTC)

Used to describe any transaction that is not conducted over an exchange.

Overnight Trading

Refers to a purchase or sale between the hours of 9.00 pm and 8.00 am. On the following day.

P

Pip (or Points)

The term used in currency market to represent the smallest incremental move an exchange rate can make. Depending on context, normally one basis point (0.0001 in the case of EUR/USD, GBD/USD, USD/CHF and .01 in the case of USD/JPY).

Political Risk

The uncertainty in return on an investment due to the possibility that a government might take actions which are detrimental to the investor's interests.

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Primary trend

It's called as the predominant movement of the market. When it is up, it is know as a bull market, when it goes down; it is called a bear market.

Pullback

A brief period of declining prices in a bull market.

R

Resistance

An area where of witch selling pressure>buying pressure.

Retracement

Any movement contrary to the previous significant move. Retracements are usually measured in percentages of 38.2%, 50%, 61.8% up to 100% (full retracement) of the previous significant move.

Risk Capital

The amount of money that an individual can afford to invest, which, if lost would not affect their lifestyle.

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Rollover

Where the settlement of a deal is rolled forward to another value date based on the interest rate differential of the two currencies.

S

Settlement

Actual physical exchange of one currency for another.

Short

To go `short` is to have sold an instrument without actually owning it, and to hold a short position with expectations that the price will decline so it can be bought back in the future at a profit.

Spot

A transaction that occurs immediately, but the funds will usually change hands within two days after deal is struck.

Spread

The difference between the bid and offer (ask) prices; used to measure market liquidity. Narrower spreads usually signify high liquidity.



Stop Loss Order

An order to buy or sell at the market when a particular price is reached, either above or below the price that prevailed when the order was given.

Support Levels

A price level at which you would expect buying to take place. An area where of witch buying pressure>selling pressure.

T

Technical Analysis

An effort to forecast future market activity by analyzing market data such as charts, price trends, and volume.

Tomorrow to Next

Simultaneous buying and selling of a currency for delivery the following day and selling for the next day or vice versa.

Two-Way Price

Rates for which both a bid and offer are quoted.



U

Uptrend

When overall prices rises.

US Prime Rate

The rate at which US banks will lend to their prime corporate customers.

V

Value Date

Settlement date of a spot or forward deal.

Variation Margin

An additional margin requirement that a broker will need from a client due to market fluctuation.

Volatility

A statistical measure of a market or a security's price movements over time and is calculated by using standard deviation. Associated with high volatility is a high degree of risk.

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W

Whipsaw

A condition in a highly volatile market where a sharp price movement is quickly followed by a sharp reversal .