The First

Trading Manual

Foundation Course and Strategies

Thank you for downloading this eBook

My name is Tom Hougaard. I am a trader by profession, and this eBook is written for people who want to trade for a living.

By trading for a living, I mean people who want to make the financial markets their workplace. I mean people who take their monthly wages from the profits of their brokerage accounts.

It is probably not where you are right now. Otherwise, why would you read this book? Even if you have some trading experience, the odds are high that you are not profitable, or you are not as profitable as you know you can be. If this is the case, then this book will not let you down.

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I know it is a free book, and as the saying goes: “You get what you pay for”. I give you my word that this book is not a sales pitch for something I sell. I stake my name on it.

The question you may ask yourself is why you should learn from me? I think that is a fair question.

Well, for starters, I make money trading. This instantly puts me in the top 20%, according to the brokerages themselves.

You see, these days the brokers have to reveal how many of their clients are making money and how many are losing money. They even have to do it on their adverts.

This brokerage states that 76% of their clients are unprofitable.

> CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage. **76% of retail investor accounts lose money when trading CFDs with this provider.** You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money.

One brokerage I know of is owned by the biggest educational provider for trading seminars. I could not help but smile to myself when I read that 79% of their clients are unprofitable. Their clients are people who have attended their seminars. You have to wonder if their seminars are any good? Would you not expect a higher win percentage if you spent £3,000 on your education?

Of course, these percentages won’t make a blind bit of difference to people who want to trade, anymore than the horrible images you see on the cigarette packages nowadays will stop people from smoking.

Why am I Different?

I can offer you several reasons.

1. I have traded in an annual competition since 2014 and my results are audited. One year I took an account from £25,000 to nearly £1m. Other years were less spectacular, but no year had less than a 100% return. There were no losing years.

2. Two journalists have written a book about day-traders, where I was interviewed. The pair had access to my trading statements for the year, verifying it was real money I was trading.

3. I have run live trading rooms where my trading was under scrutiny every day for years. These days I run a free group in an App called Telegram. I trade live here almost every day. It is an invitation-only group, and in there I keep myself accountable by posting some of my trades, in real-time.

4. I have not only traded for myself for years. I have also worked at a brokerage for many years. I have seen how people trade. I have seen what mistakes they are making – over and over.

I am very good at what I do, but if you compare me to the rest, it doesn't mean a lot, does it? If 80% lose, then the competition isn't very hard to beat. I could stop trading and still beat 80% of people.So I am in the 20% group, but that by itself means very little. Don't be fooled, my friend. There is a big leap from making occasional money trading to making a living from trading. Even if you belong to the group of people who are making money or are breaking even, the people who truly make a living from trading is not the 20%. It is the 1%.

Talent or Ability?

Are you good at something? How did you get good at it?
Did it just miraculously happen, or did you have to work at it?

Here is what I believe is true about my trading abilities:

1. I am a great trader because I have worked focused and intensely to become one. I have always been good with numbers, but what does that have to do with good trading? Buy a calculator, if you are not good with numbers. It isn't my arithmatic abilities that makes me a good trader.

2. I never found the "holy grail", although I admit I did look for it. I stopped looking when I finally realised it didn't exist. I declare I am not profitable because I have found some amazing secret to trading.

3. I am able to talk about technical analysis for days on end, even weeks if I want to, but that is not what makes me profitable. Yes, my knowledge on technical trading helps, but I know for certain that it doesn't make me or anyone else profitable.

So to conclude, I am not talented. I am trained. I work from a structure. So once, again, what is this e-book all about? The answer is that it is a PLAYBOOK. It is designed to give you a plan and a structure to work from.

What is a Playbook?

A framework to guide you to a successful outcome.

You will need to start somewhere, and you can consider this book a great place to start. What you will learn is better than the material you will be presented with at those expensive weekend courses, you have probably seen and heard about. There you pay £3000 to be taught the basics of trading. You are much better off reading this book, and put £3000 into a trading account and begin trading. You will learn a lot more from your own experiences than from a weekend course.

playbook

noun [C] • UK /ˈpleɪbʊk/ US

a set of rules or suggestions that are considered to be suitable for a particular activity, industry, or job:

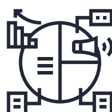
Typically, outsiders are brought in to execute a specific playbook, i.e. to solve a particular problem in a particular way.

What Will You Learn in My Playbook?

Market Knowledge

Instrument Knowledge

Technical Knowledge



Strategy Knowledge

Psychology

Market Knowledge

I will take you through the markets and what they each mean. You will be surprised to learn how many different markets you can trade. You don't have to worry about which one you want to trade yet. We will cover that later.

Instrument Knowledge

You need to execute your trades somehow. There are several ways you can execute trades in the market. You need to know your options to discover what suits you.

Technical Knowledge

Once you know what markets you want to trade, and how you are going to execute the trades, you need to learn about how to decide if you want to buy or sell short the market. I call this technical knowledge. You need to build a foundation of technical knowledge for you to progress to the next step.

Psychology

Once you start placing trades, you will quickly realise that trading is much more than just studying charts and knowing about technical analysis. I argue, and many experienced traders will agree with me, that trading is 10% technique and 90% psychology. I have concluded this book with material from another book I am writing. The topic of the book is trading psychology. Here I draw from my experiences as a broker, an educator and above all a trader. It should be published by October 2018.

Strategy Knowledge

Building a technical knowledge will enable you to devise your own trading strategies. This e-book contains plenty of strategies. You may want to adopt them, or you may want to use them to build your own strategies.

You also need to practice. The practice segment comes in two parts. Trading is simple. You buy, you sell, or you do nothing. The practice part can simply mean you start off on a demo account for a few days just to learn the ins and outs of the trading platform you have decided to trade on. You learn how to place trades, how to place orders, and how to navigate the platform.

The second part of practice is in the form of REAL trading. There you will start to trade with real money, and you will begin to develop your skillset. It will take time, but the Playbook will guide you.

Knowing the Truth

I have to warn you.

This is not an easy profession. The money is good, but the path to success is going to challenge you in ways you never imagined. The pursuit of wealth and financial freedom through speculation can be costly, both financially and spiritually.

Unlike what the glossy adverts in the newspapers, and the financial magazines and the unsolicited emails suggest, it takes time and effort to get to the point where you can call yourself a profitable trader.

It is a worthwhile pursuit, but many fall by the wayside. They give up too soon, or they put their faith in an educational guru, who overcharge and deliver under.

I wrote this book for you. It doesn't reveal all that I know about trading, but it reveals all you need to know to get off to a good start.

I have studied thousands of hours, and my research has taken many paths. Some of it has been useful. Some of it has been worthless. This book is designed to get you started on the right path.

The course spans many lessons. It is designed to rival and surpass the £3000 weekend courses offered by the training companies around the globe, and it does. I have chosen to pass this information to you for free. If you can read through this manual, and still think this is a great profession, then you are already halfway there.

I do run courses, so I could be accused of being a hypocrite. After all, those who can, they do, and those who can't, they teach. It is not that simple. You see, whatever you think about trading right now, is unlikely to be what you will think about trading in a year from now or 10 years from now.

Many years ago it sent shivers down my spine just hearing the word “trader”. Then I got hired to trade, and a new reality emerged. Beneath the glamour of a great sounding work title lies thousands of hours of merciless beatings by a market that just doesn’t care about you or how you feel or think or what you want. So for me to be able to pass on my wisdom to you and people like you gives me a sense of purpose beyond just trading the markets. I realised a long time ago that aside from my love for trading I also love to teach. I hope this love shines through in the pages to follow.

I run courses on trading, but I just don’t want to teach the basic technical analysis stuff. No one should charge for that. This book will get you to a point where you are ready to trade, and where you can expect to begin to make money from trading.

It might not be a lot to begin with, but it is not about making money at first. It is about getting the techniques and, more importantly, the process down to a fine art. After that the money will just come. I hope your path will be a profitable one, and enable you to live the life you dream of.

If you have questions for me, then please email me at

hello@tradertom.com

Many thanks,

Tom

London 18-08-2018

DISCLAIMER

The trading of stocks, futures, options, spread betting, spread trading and CFD trading and any other leveraged trading activity involves risk.

It should not be assumed that the methods in this trading book, the techniques explained within or the technical settings presented here will be profitable. Trading is a risky proposition, one which has the ability to elevate lives financially as well as destroy a sound economic foundation. Please be as prepared and as cautious as you would be, if you were planning a trip into an unknown landscape.

I wrote this book with the intention of guiding both the absolute beginner and the more experienced trader and investor through the financial markets.

However, I do not guarantee that the results of the past imply or forecast the results of future endeavours. You should not trade with money you can't afford to lose.

The 24-Hour Trading Cycle

I want to kick off this book by explaining to you what the 24-hour trading cycle is. In fact, I think we should go through a full week, so you get an idea of what is what. We will focus on 4 markets and their place in the market rhythm over the course of a trading week.

1. **Individual Stocks**
2. **Stock Indices**
3. **Currencies**
4. **Commodities**

The markets are not linear. It is often a question of “two steps forward – one step back”. Other times it is 4 steps forward and no step back. The markets are forever changing, yet it is always the same.

I know that sounds confusing, but what it really means is that although you never know what will happen, you can be certain that whatever happens has happened before. There is nothing new under the sun, when it comes to the markets. The trading day is not linear either. There are times when we want to be at our screens, and there are times when we can expect little activity in the market.

Here is how I see the markets from Sunday night to Friday night. All times are London GMT.

Sunday Night

At 10pm Sunday night many markets open. The currency market opens because in New Zealand and Australia the time is now Monday morning for them. They have business to do. They are the ones who kick off the trading week. An hour later many stock index futures open as well. This is an instrument which mirrors the actual stock market index, but it is open to trading almost 24 hours a day, even when the real stock market is closed.

Monday to Friday

06:00

Although most traders in London don't arrive at work until around 07:00 the European traders in the financial centres such as Frankfurt, Paris and Geneva arrive at their respective desk at 07:00. 7am in Europe is 6am in London. Almost every day you see an increase in the volatility in the Forex market after 06:00.

07:00

The German DAX futures index opens for trading on the EUREX exchange. This is a particular important time because the DAX index is the biggest stock market index Europe, and it will often give traders a clue as to what lies ahead in the world of stock market trading on that day.

08:00

All European stock markets open at 08:00am. The trading day has officially started. By now the Foreign Exchange traders in Europe and London are running at full speed. Equity markets are up and running as well, and the next 2-3 hours marks the first busy period of the trading day.

From a trader's perspective this is where you will find good trading setups. Of course, you can trade at any time during the day and night, but I prefer to trade when there are movements in the markets.Does it matter to the stock market what the currency market is doing? Does it matter to the currency market what the stock market is doing?

I would generally say NO.

I say no because I don't need to know what is going on in the currency market to trade the stock market. However, I also do know that the two at times affect each other, but it is often not obvious until after the fact.

Sometimes you will see what appears to be a correlation between the stock market and its underlying currency. I am from Denmark, so I naturally keep an eye on the Danish currency. I have witnessed the Danish currency being sold off, or bought up, and it had no impact on the Danish stock market.

My own mentor taught me to focus on what is happening – not what I think is happening. Let me give you a specific example of that. Let's say the German DAX index, which is home to the 30 biggest stocks in Germany, is strong. It is moving higher. Let's at the same time assume that the Dow index in America is weak. It is not moving higher. Just because both are stock indices doesn't mean that one can't be weak, while the other is strong.

This means you should not sell short the DAX index just because you think it will follow the American Dow index. Nor should you buy the Dow index, just because the DAX is strong, and you think the Dow will follow the DAX.

09:30 News items are released during the trading day. Most of them are released at specific hours. As part of your preparation for the trading day and the trading week, it is a good idea to investigate what news is being released and when it is being released.

There are many places you can receive this information. I have become quite accustomed to the Forex Factory calendar:

http://www.forexfactory.com/calendar.php

Make sure you adjust your "time" on the calendar of Forex Factory to your time zone, otherwise the site usually defaults to US Eastern time. There will be a lot of news released every day. I only pay attention to the ones that are "red flagged". You can safely ignore everything else.

10:00 Some European news is released at 10:00, while other countries release their economic data ranging from 07:00 to 09:00. It is a good idea to make it your priority in the morning to check what news is released during the trading day and when it is released.

The German DAX index - in black - overlaid with the Euro Dollar. It is tempting to think that a currency and its stock market may be correlated, but that isn't the case. On the chart you see the two following each other at times, while at other times they don't. At 10:00 the first 2 hours of trading in the stock market is over and by now you often see the market volatility die down. That doesn't mean there aren't tradable moves. It just means that these moves don't tend to happen so quickly.

RED = EURO DOLLAR

BLACK = DAX INDEX

11:00 By 11:00 most equity traders, and to some extent Forex traders in London and Europe, are winding down their activities of the morning. European traders will be more focused on what to have for lunch than what is happening in the market.

Everyone will now wait for the US traders to arrive at their desks. This often means that the markets, both stock indices and Forex markets, will settle into a consolidation range or continue the trend that was established in the first couple of hours of trading.

Of course, this is just a rough guide. I have also seen spectacular reversals in both stock indices and the Forex market between 11:00 and 13:00, but it is less frequent. In my experience it is relatively safe to go to lunch after 11:00 and not expect to miss too much. What you should be aware of is this. For you it is 11:00, but American East Coast traders, it is now 06:00, and they are beginning to come to work now.

The first thing they will do, while drinking their coffees and orange juice is to look at what has happened in Europe while they were sleeping.

The currency traders in America will look at what the European currency traders have bought up or sold down during the night.

The American stock traders will do the same for stocks, and their opinions will broadly fall into 3 categories:

1. They agree with what is going on in Europe and they want to carry on with that trend (up or down).
2. They disagree with that trend and they will begin to do the opposite.
3. They don’t care one way or the other.

Noon - 14:30

Between noon and 14:30 the stock market is in a waiting game. The US stock market opens at 14:30, but the reality is that the big stocks in the Dow Index and the SP500 Index have been traded on other exchanges around the world, especially in Frankfurt. Therefore, traders will have an idea of where the market will open.

Traders are aware of where stocks are due to open once the official market opens at 14:30. A stock does not have to open at the same price it closed at the night before.

News

13:30

There are 2 major times when news is released in the US. At 13:30 most government-official economic news is released from the US. Not a week goes by where some important piece of economic information isn't released. Two of the major news items is the monthly labour report (Non-Farm Payrolls) and the monthly GDP.

15:00

Other less important news is released at 15:00. It is often business surveys that are released at 15:00, such as ISM numbers. You should have a quick look in the morning on Forex Factory to see if anything is released today.

14:30

The "bell" rings to open the floor for official trading across America at 14:30. The first few minutes are often whippy and full of confusing moves. This is the first opportunity that traders and investors have to react to earnings results, news releases, economic data and rumours in general.

16:30

The FTSE 100, the DAX, and the rest of the European stock indices close for trading. Now America is alone until 21:00.

Note to the Forex Markets
London is considered the Global Forex Centre. I am not so sure that is true as much today as it once was, especially since so much trading is now done electronically.

At 16:30 things tend to change a little in the FX market. The UK traders and the European traders have left their trading desks. This means that some of the market liquidity has left. Once the US traders leave their desks at around 22:00 the Forex market tends to go very quiet, until the Asian traders come to work around midnight.

19:00 If the FOMC (the FED) meets to discuss their interest rate policy in the US, they will release their statement at this time.

21:00 The US stock markets close for official business. The US futures carry on trading for another 15 minutes, then close to settle, and reopen at 21:30 and close at 22:00 and re-open at 23:00 and stays open until 21:15 the next day.

22:00 While there is no official close in the currency market, it is thought that the US trading desks hand over their book to their Asian counter-parts at this time.

Summary

This is what a typical 24-hour cycle looks like in the markets. I know I haven't discussed commodities, but they follow this cycle too. In the oil market for example, we tend to see much more activity during the US market hours than during the European market hours.

Check Asia

I always check what has happened in Asia when I sit down to trade in the morning. Why do I put emphasis on knowing what is going on in Asia? I can think of two immediate reasons.

If I am expecting a negative open in European indices after a negative close on Wall Street the night before, but I find that Asia is in positive territory, then I will be looking for opportunities to buy instead.

I also want to know what the mining companies in Australia have done during the night, as this will most likely carry over into the FTSE 100 index, which is also rich in commodity stocks.

I check this information on CNBC. It looks like this:

It would be wrong to say that nothing goes on during the night. As I stated earlier, even stocks that only trade officially between 14:30 and 21:00 in the US can be traded on other exchanges around the world.

In the earnings season, where companies release their quarterly earnings results, you often see the futures market trade in big swings, as traders position themselves ahead of the next trading day.The Dow index consists of 30 stocks. However, each stock does not have the same weight in the Dow index. For example, Boeing and Goldman Sachs account for 16% of the Dow alone!

When these stocks make big moves, it will have a big impact on the Dow Jones Index. When these companies announce their earnings results, the Dow can be called up or down by hundreds of points, simply on the back of where traders think these stocks will open. The earnings season in the US occurs in the month following the end of each quarter, i.e. January, April, July and October. This is often a volatile period in the stock market where the market moves significantly both “in hours” and “outside hours”.

Basic Technical Analysis

Did you know that the foundation for technical analysis was laid more than one hundred years ago? In fact there are those who say that analysing charts dates back to the 16th century and it was done by the Japanese.

Analysing a chart is called chart analysis or more commonly known as techncial analysis. It is only natural that the next step in this book is a chapter about the most basic concepts of technical analysis.

The basic premise for technical analysis is known as Dow Theory and it was developed by Charles Dow more than a hundred years ago. What we have taken away from those newspaper articles he posted back then forms the foundation of what we know as technical analysis.

Trend Analysis

Take a look at this chart! It is easy to see that the stock is trending down. It is in a “down-trend”.

The question we have to answer is this:
How do we quickly and precisely define a “trend” so we can jump onboard and make money from it?

Definitions

The definitions for a trending market is not overly complicated.

Up Trend

For the market to be in an up-trend, the market has to make higher highs and higher lows.

Down Trend

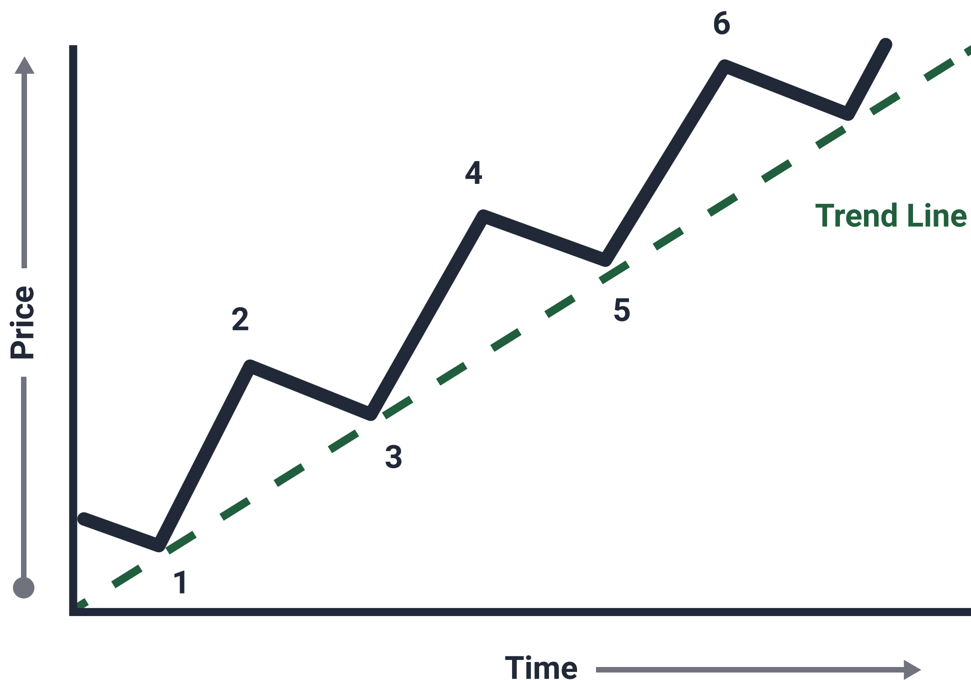
For the market to be in a down-trend, the market has to make lower highs and lower lows.

Example

DOW Theory

Bull Trend

Rising Tops & Rising Bottoms



On the chart previous, the market is making a series of “higher lows”. What that means is that the lows you see at point 1, point 3 and point 5, are each higher than the previous low. Point 3 low is higher than point 1 low. Point 5 low is higher than point 3 low. This is what you see when the market is in an up-trend.

You also see that point 4 is higher than point 2 and point 6 is higher than point 4. This is another sign of an up-trend. Rising highs and rising lows means this market is in an up-trend. Of course, the opposite holds true for a down-trend. A down-trend consists of a series of lower highs and lower lows. One of the challenges that new traders have is the idea of selling short the market.

If the market is trending down, it would be nice to be able to make a profit from it. Well, you can, if you know how to sell short the market. Selling short means you are selling something now, and you will buy it back at some point later, hopefully at a cheaper price. You pocket the difference between where you sold it, and where you bought it back.

Example of Trend Analysis

On the chart on the next page you see a stock over many years. You should be able to see it going through “phases” where it is in an up-trend, and “phases” where it is in a down-trend. Can you spot the up-trend and the down-trend?

I have made it easier to see by labelling the up-trends with blue lines and down-trends with red lines.

First the market moves up, and the peaks are higher than the previous peaks. Then it changes, and the market fails to make a new high. It also makes a low, which is lower than the previous low.

The market has moved from an up-trend to a down-trend.

Example of an up-trend turning into a down-trend

This stock was in a long-term up-trend until year 2001. In late 2001 it makes a double-top, and a down-trend begins. This down-trend is visible to the trained eye because of several clues: the red line you see on the chart is a moving average, and it begins to slope downwards and the price of the stock is below the moving average. You should also see that the market continues to make lower tops and lower lows.

In 2005 the market makes an attempt to move higher, and it succeeds temporarily. Then the market fails, rolls over, and the down-trend resumes. Don't for one second think that the market is always easy to understand – just because you know how to read a chart and understand technical analysis. That is why we use money management when we trade. We will cover that later. Some markets are very easy to analyse.

The chart on the following page is easy to analyse. I am preparing a trade in the Australian Dollar. The first thing I need to figure out is what the big trend is. It is easy to see that the Australian Dollar against the US Dollar was trending up to begin with. Then it changed.

The change is also easy to see. The chart is making two tops close to each other in the middle of the chart. Then the market makes a big move lower, which goes below the last low (the last low before the highest high point you can see on the chart).

Then the market begins to trade sideways, but it never makes it up to the old high. The market slowly but surely begins to trend lower. A market has moved from being in an up-trend into a down-trend.

Definition of Trend Change

How do you decide that an up-trend is no longer in place? How do you decide that we have moved from an up-trend to a down-trend?

I was taught this definition: **To reverse an up-trend to a down-trend, the market must make a lower low, and a lower high, and then turn down from there.**

Example

The chart of Gold on the following page is moving up, but at point 1, the market makes a high, which is not a higher high. It is a lower high. The high at number 1 is lower than the high you see at the top of the chart. At point 2 it has made a low, which is lower than the previous low. By point 3 the downtrend has been confirmed. The moment the market begins to trade below the low at point 2, you could argue that a trend change has taken place.

Some markets are much more difficult to analyse, such as the next one. It is difficult to tell if this market is in an up-trend or a down-trend, or perhaps in no trend at all. Can you tell me what the chart trend is?

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No, you can’t. Neither can I. We can’t say that the trend is up. We can’t say the trend is down either. In fact it makes most sense to say that there isnt really a trend in place.

This market is called RANGE-BOUND, or a RANGING MARKET.

Some traders love range-bound markets. Some traders love trending markets. Some traders are good at trading both kinds of markets. Both trading disciplines have their merits. It is just a question of training and strategy and risk management.

Principles of Technical Analysis

What is technical analysis for me?

It is a way to read the mood of the market. It gives me trade entries. It tells me where to place my stop loss. I argue that chart patterns repeat over and over. This is the reason why I am able to make money trading.

Price Action & Price Behaviour

I remember the first time I read Arthur Merrill's work on price and price action. Arthur is a Wall Street veteran, and his focus was on price, and price patterns. Before I read his work, I wasn't really sure what people meant when they spoke about price and price behaviour. The fact is that price is driven by demand and supply, which is driven by people. I have distilled my beliefs of price below. I call this part the Principles of Price Behaviour.

1. Price is the only real TRUTH in the market. Price never lies. It can't.
2. Trending markets have higher odds of continuing the trend than of reversing the trend.
3. Ending of trends fall into only two categories. I will discuss these two later.
4. Price alternates between ranging markets and trending markets.

In 2010 I did a seminar at Soho House in London for traders from all walks of life. There were hedge fund traders and there were private retail traders. The topic of the talk was “price” and “price action”.

I showed the audience every conceivable method for pin-pointing where the market could change – from an analytical point of view. There were charts of Fibonacci ratios, both in time and in price. There were charts of volume analysis, highlighting the theory that trends end in a climax, be it an emotional price spike or in a volume spike.

I even showed them the correlation between the stock market and the ebb and flow of the tide, as governed by the moon. Most people had a good laugh about that one. Finally I showed them a chart of the Dow Jones Index since 1960, with a simple 200-day moving average. The moving average is a lagging indicator. It doesn’t catch the high or the low. It simply shows the average price of an asset over a period of time – in this case over the last 200 days.

The moving average – especially on long-term charts - is considered a good trend indicator and as such it is far superior in terms of returns than any other tool. The audience could appreciate that trends tend to persist and tend to run a lot longer than most people dare to believe.

Price Behaviour

Principle 1

“Value doesn’t exist”

The biggest lesson for many traders and investors to unlearn about the markets is the idea of value. If you walk into a supermarket to buy a bag of rice, and it cost £1, you may think it is a fair price. If it cost £1.50, you may think it is expensive (because it cost £1 the day before), and you may decide to not buy the bag of rice. If it cost 50 pence, then you may think it is cheap and you will buy more rice than if it had cost £1.

The ”rice” story makes perfect sense in the world of consumerism. It is logical. But the financial markets DO NOT fall into this category. The markets are NOT logical how you and I want it to be logical.

If a stock cost £1, you may think it is expensive. You may think it is fairly priced or you may think it is cheap. Nevertheless, the price is determined by the market at £1. If you think it is cheap, and you decide to buy it, you will need someone else to think like you do, BUT AFTER you thought about it.

Say for the sake of this argument that the stock which cost £1 yesterday now cost 50 pence today. Does that make it cheap? Some would say yes. However, you have to seriously question why a stock you think is attractive has fallen 50% in price. I have had this argument with many people. Some agree with me. Others don’t see it as I see it. Fair enough. Let me tell you a story. It happened in 2008. I received a phone call from an investor. He asked me what I thought of a stock, one he had bought into, and one that was falling rapidly. The stock in question was Northern Rock (NR). NR was a UK banking stock. It had peaked at 1200 pence the year before, and since then it had fallen and fallen.

At the point of the phone call, the stock was now trading around 400-500 pence. The man argued that it was cheap, and he had already bought it. Now he wanted my assurance that I also thought it was cheap.

The chart of the stock at that point in time looked horrible to me.

Northern Rock had been a stable stock on the UK stock market. Some would say it was a boring stock. Then they changed their business strategy and the bank became involved with the same products that brought down Lehman Brothers in America. At first the stock rose rapidly, but then it fell, and fell. Would you buy this stock on this chart here? Is it “cheap”? Is it "good value"?

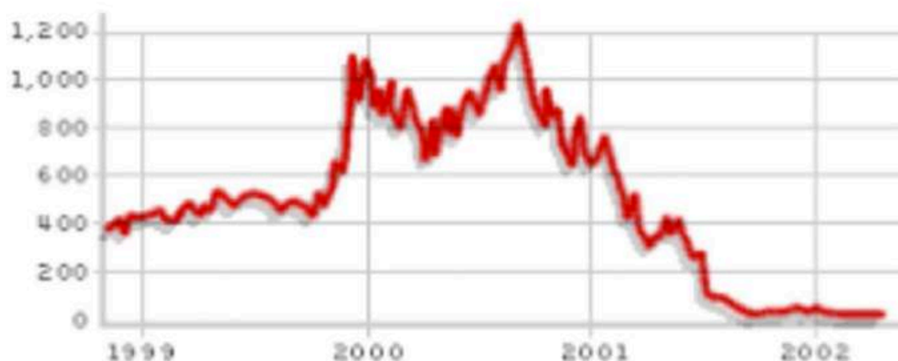
I asked him: Why do you want to buy it now?

He said he thought it was cheap. He said it was one of England’s oldest banks and he was certain it was not going to fail. He said that it had a solid reputation in the industry and that he was very happy to buy more. He felt it was rare that a blue chip stock like NR was this cheap.

At this point he invited me to comment on his argument.

I asked him what the age of the bank had to do with the quality of the stock? I asked him if he had considered who was selling, and why it was falling as rapidly as it was? It must mean someone is keen to get out of the stock.

I asked him if he remembered the story of Marconi?



Marconi was an old company in England. It was a leader in its field. Then it changed its business strategy. At first it went well, but then it hugely backfired. The stock eventually went to ZERO.

I was working in my first trading analyst job when this happened. I went on TV during 2001 and stated that I had no idea where the low in Marconi would be, but I thought that zero could be the place where it stopped. Danish humour at its best, but my boss disagreed, and I was asked to apologise and retract my statement.

I was young and naive, and I didn't know that many of our best clients were heavily invested in Marconi. They eventually lost fortunes. It wasn't long after that I was mysteriously made unemployed, but fortunately for me there were plenty of other companies who did value someone speaking his mind.

Back to our friend who wanted to buy Northern Rock: He said he did remember Marconi, but he argued that Northern Rock was nothing like Marconi.

I said to him: "Maybe you are right. Maybe Northern Rock is different to Marconi, but right now there are major institutions unloading their Northern Rock stocks.

I don't know why they are doing it, but they are. If you think these institutions are wrong, then by all means go ahead and buy more. However, in my experience, it never pays off to bet on finding the lowest point in a stock. It has a tendency to go a lot lower than you think." I never heard from the man again. I don't know what happened to him. I do know what happened to Northern Rock. It went bust. The shareprice went to ZERO.

Equities Other Intervals IDC 1 5 60 Daily Tick

(NRK-LON - NTHN.ROCK ORD 25P,W) Dynamic,0:00-24:00

1300.00
1200.00
1100.00
1000.00
900.00
800.00
700.00
600.00
500.00
400.00
300.00
200.00
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0.00

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So here is my answer to the question: are the markets ever cheap or expensive?

No. There is no such thing as cheap. There is no such thing as expensive either. There is just “the price”. In this case the price has gone down. It makes no sense in the financial markets to buy a stock, which is going down. At least wait until you see other buyers stepping in.

Lesson

The financial markets are driven by economics, by technicals, and by emotions. It is people who push markets higher or lower. You may think it is economics that push the markets higher or lower, but the reality is that it is people and their interpretation of the economic realities and the economical prospects and potential that is pushing a market higher or lower.

Trends persist because when things go well for a company, it tends to carry on going well for a company. Trends persist in a currency pair because when things go poorly for one country, it tends to continue to go poorly for that country.

As such, being an investor or a trader can require you do things that don’t seem logical. I often use a supermarket metaphor to illustrate what I mean.

If you visit a supermarket and you see that butter is half price, you are inclined to buy more butter than you need right now. You will stick it in the freezer until you need it.

It could be virtually any product for that matter. If it is cheaper than before, you will at least consider buying it – and the cheaper it is as compared to before – the more tempted you are to buy it.

The financial markets traders are completely opposite in their behaviour than a supermarket shopper. They know that if something becomes cheaper and cheaper every day, there is a reason for it. To use the “butter metaphor” from the supermarket example, a falling price in the financial markets will make an experienced trader think there is something rotten about the butter.

When I see a market falling, I often have to accept to myself that I don't understand why. However, if I don't accept it, and I start buying, I am actually ignoring what the market is telling me.

If the market is rising, and I don't understand why, it makes no sense to ignore the fact it is rising. The market is bigger than me. It is bigger than all of us. I am better off simply accepting that the market is rising, and I need to find a place to jump in.

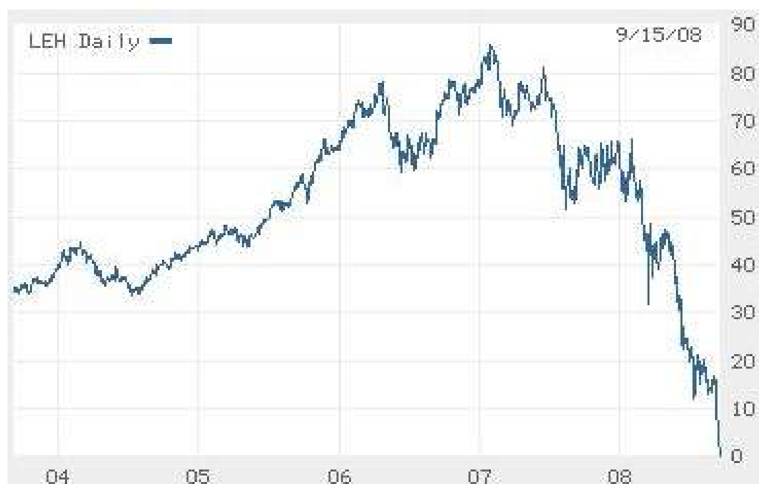
I tell my students that the markets are irrational to a rational human being. The rational person who comes into this arena called the financial markets would not want to "buy butter" today, just because it is more expensive today than yesterday and the day before.

Butter is trending higher, and it is getting more and more expensive each day.
You might not want to buy butter in the supermarket if that happened, but if it is a stock we are talking about, then you need to train yourself to accept that it makes more sense to buy something today, simply because it has increased in price from yesterday.

This is why I argue that the markets are an illogical place. Where else does it make sense to buy something just because it has already increased in price? You wouldn't do it in a supermarket, but you need to in the financial markets, because trends persist.

Lehman Brothers 2004-2009

Lehman Brothers stock got cheaper and cheaper every single day until the day it was worth NOTHING.



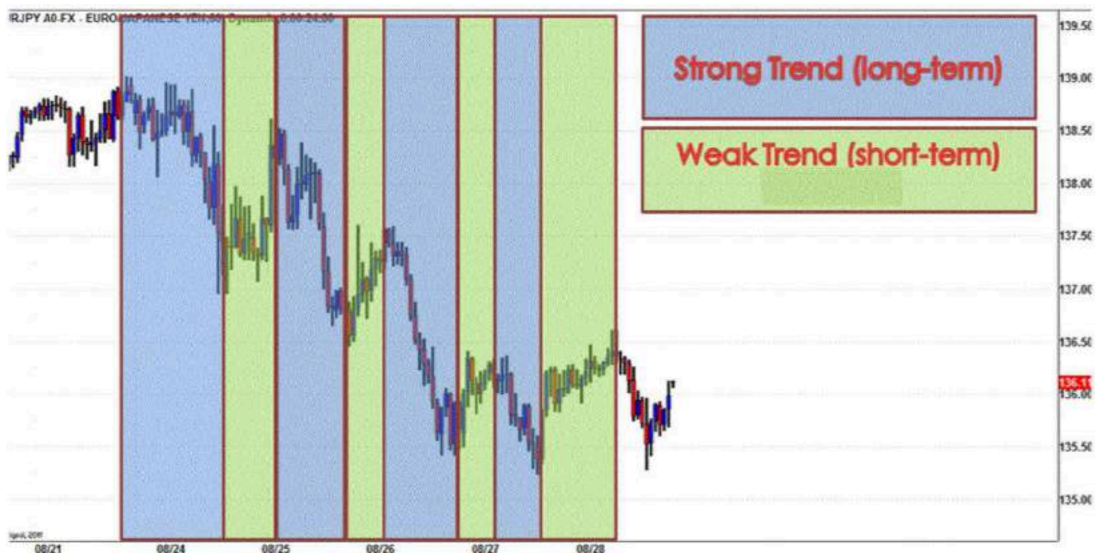
Price Behaviour

Principle 2

"Follow the herd – follow the trend"

Following the trend is another way of saying "follow the majority". I am not so sure that statement is technically correct, but it is not so important at this point in time.

It is a simple piece of advice, and although there are MANY nuances to this simple statement, it does make your trading and investment life a whole lot easier. I have a saying for my students. As you are now also my student, you need to know it too. I like to "fade" the short-term trend in favour of the long-term trend. I will talk a lot more about that later in the book, but here is a simple example. If the trend on the Daily chart is up, and the trend on the hourly chart is down, then I will consider going against the trend on the 60-min chart, because the trend on the Daily chart is up. I call this action "fading the 60-min trend in the direction of the Daily trend".



Let me give you a simple example of what I mean by that. On the chart previous – of Euro Yen – you see a down-trend in progress. The market is trending lower. However, you will also notice that although the market is trending down, there are times when the market is moving up. Those up-moves do not last long, but they are nevertheless a part of a normal trend.

I have coloured this chart, to show you what I mean by “strong trend” and “weak trend”. The blue colour is the strong trend. The green is the weak trend.

My trading philosophy is that when a trend is in place, I will use the counter-moves against the "strong" trend as an opportunity to get into the market.
I call the counter-moves the “weak” trend, or the “short-term” trend.

I teach my students to fade (go against) the short-term trend in the direction of the long-term trend. How do I know what the strong trend is? I look for the signs of a trend, which is higher highs and higher lows for an up-trend, or lower highs and lower lows for a down-trend.

I will give you a practical example to study on the next page. Over the last 4 months the Euro Dollar currency has trended lower. You are seeing a DAILY chart below. I have marked the downtrend with an orange colour.

It should be easy for you to see that Euro Dollar is trending lower. However, this is a daily chart you are looking at. What happens if you look at a smaller time frame?

What I will show you next is a much smaller picture of the Euro Dollar from April 2018 until July 2018. It is not a daily chart I will show you. Instead I will show you Euro Dollar on a 30-min chart. By doing so, I hope you will be able to learn to differentiate between the “strong” trend, which you are seeing on the Daily chart, and the weaker trend, which you are seeing on the 30-min chart.

The logic here is that if the bigger time frame trend is down, then the trend on the bigger time frame is more important than the trend on the smaller time frame.

Above you see Euro Dollar on a 30min chart. As you would expect, the trend is pointing lower. What I want you to pay attention to is what the good traders are doing, whenever they have an opportunity to do so:

Everytime the market rallies higher, they take advantage of it, and they sell short.

What are they doing? They are fading the short-term rallies on the 30min chart in the direction of the long-term trend on Daily chart, which is down.

The chart on the following page shows some more trading days from Euro Dollar. This is how good traders trade a trending market. It is not difficult at all, but it does require patience.

Every time the market has rallied for a while, the sellers come into the market, and they push the market back down again. That is how a down-trend works. Sure, the down-trend won't last forever, but do you know when it ends? I don't.

There is a good saying about trends, which goes back to the last century. It goes something like this: Top pickers and bottom pickers soon become cotton pickers. I guess the saying stems from a time where manual labour would pick cotton in the fields, and if you wanted to avoid that, you should not try to pick the point where a trend is ending. You should simply follow the market in its current direction and trade in that direction.

The Japanese have a slightly different saying, which is a little more humouristic: Those who insist on peeing against the wind (trading against the trend), will have to accept a bigger cleaning bill.

I am not stating you have to be an expert on the Euro Dollar currency pair to make money trading it. You need to understand trends, and how trends work. If you can do that, then you can make money trading.

Charles Dow writes about the strong trend in his work, we today call Dow Theory. The odds of the trend continuing is higher than the odds of it reversing. When the market is trending, it displays many familiar characteristics, some of which I will teach you in this book.

It is important to remember that as a technical trader, i.e. a trader who uses charts and price data to gauge when to enter the market, and when to exit the market, we are constantly looking for places to buy or sell the market with as little risk to our money as possible.

Below I have summed up in short sentences what I have come to believe about price action:

1. Once the trend is established, it is better to bet it will continue than it will reverse.

2. A big trend rarely stops withouth major warning signs, such as price spikes, volume spikes, emotional market (when the financial press declares that this trend will never end), or the market simply goes into a sideways range.

3. The largest part of the price move comes towards the end of the trend. This statement will take some explaining. My own mentor used to say that “90% of the move comes in the last 10% of the trend (time wise)”.

Price Behaviour

Principle 3

"The End of Trend"

1. The market reaches a price level which has significance to investors. It could be a previous high or low from the past. It could be a round number. It could be a price where investors think this is too good to be true, and they take advantage of this price.

2. Volume Spike. Increased volume at a price level is often indicative of an imminent trend change.

3. Emotional High/Low. You will often need to refer to the media to catch these kinds of highs or low. I can right now think of a good example almost everyone in the world will remember: BITCOIN. Everyone was talking about Bitcoin and there was no end to how high it would go. This was just around Xmas 2017. 6 months later, Bitcoin was trading 70% lower.

A trend will continue until it reaches a price level associated with an emotional response by the market. It can be a SELLING SPIKE, where the market is so fearful that investors just want to get out at any price. This is what you see in stock market crashes. Fear is dominating the market in those cases.

Then there is the euphoria spikes when the market reaches dizzying heights on the perception that it will go much higher. We call this the "frenzy and hype" phase.

It can simply also be a case of the market hitting a significant price level, and it begins a process of 2 steps forward – 2 steps back.

We call this a range-bound market. The market moves from a trending market to a range-bound market.

When the market is range-bound, the traders have to mentally prepare themselves for the possibility that the market will continue in the direction it had BEFORE it went into the range-bound market, or that it will reverse and begin a new trend in the opposite direction.

Price Behaviour

Principle 4

“Ranging to Trending to Ranging”

The stocks and currencies and bonds and indices and anything else in the financial markets moves from trading within a range, to trending higher
or lower.

The chart on the next page is a good example of how a market moves from being in a trading range to being in a trending market.

It is the price of Gold. Those traders who trade according to trend jump on board by selling short Gold. Those who were long have to sell out and close their positions at lower and lower prices. A new trend is born.

Gold is trading in a range. Normal trend analysis doesn't apply here. The market is making both higher lows and lower highs. Around the middle of the chart Gold breaks down sharply. This is the beginning of a trending market. The market has moved from a ranging market to a trending market.

How do we make money from this?

The market moves up and down in mini-trends, within a bigger trend, which is up or down (or sideways). We call these moves "swings". What we want to do is to trade those swings using the tools taught in this manual.

If you are new to trading, then do your best to follow the instructions the best you can. Your job starting out is not to make money, but to avoid losing money whilst staying in the game, learning and getting valuable experience.

As I have said before, an up-trend, a swing higher, is made up of a pattern of higher highs and higher lows. When the market goes from an up-trend to a down-trend, it must first make a lower high, then a lower low, and then surpass the low of the lower low. If it takes out the lower low, we have a confirmation of a trend change. However, here is a VERY important lesson.

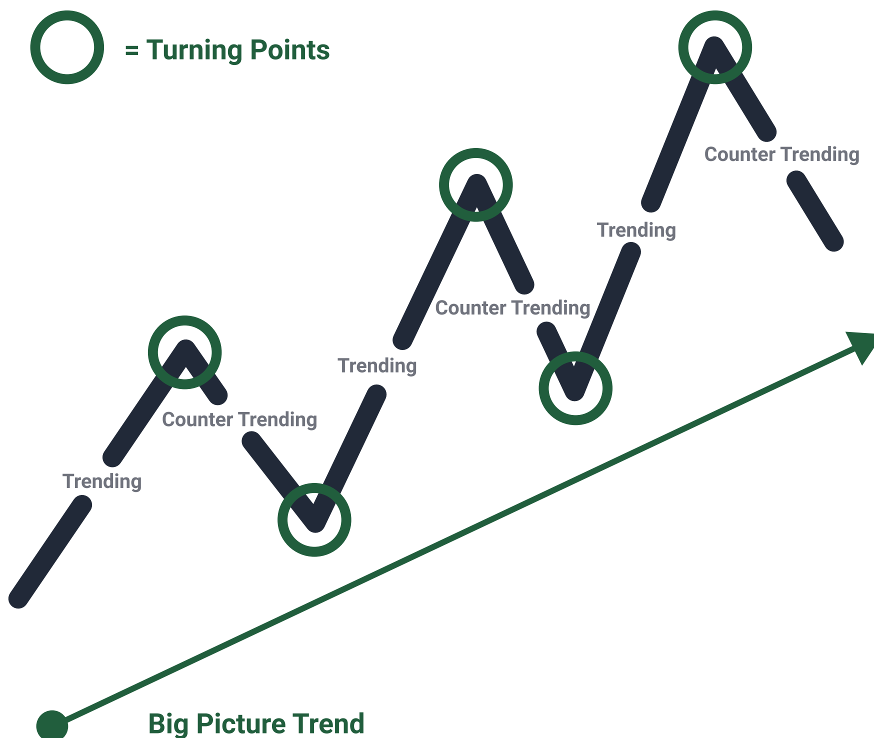
If you look at a 5-min chart, you can easily see the market change trend from up to down. This doesn't mean that the trend has changed on the higher time frame such as the 60-min chart.

Next I am going to take you through the principles of price action and trend analysis. It will help you in your education to see the patterns visually rather than just having them described to you in words.

Illustration of Trend Trade Concept

Before I move to the next topic though, I want to show you a graphical illustration of what we are trying to do. We want to trade in the direction of the long-term trend.

When the market moves against the long-term trend, it is our job to identify an area where we want to enter the market.



We want to trade the trend, not the counter-trend. The traders I know who trade professionally for firms or funds are constantly looking to identify areas where they can enter the market in the direction of the strong trend.

When the “big picture” trend is down, and the market is bouncing, they are looking for a place to sell short the market.

When the market is trending higher, they are looking for places where they can buy the market. The difference between the professional and the individual starting out is simply experience. Now, let's move on to the principles of Price Action and Trend.

Principles of Price Action & Trend

Within this chapter you will find a series of charts. Each chart will have its own annotation. It will describe the theory of trend and price action.

Lower High and Lower Low = *WARNING*

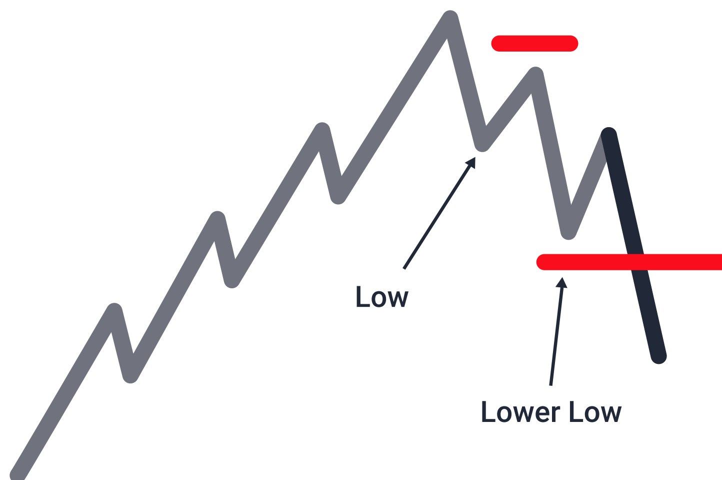
But it does not mean the trend has changed

The up-trend is not broken, but the market is so far showing a lower high (see red markings) and lower low. If the market turns down from here, the downtrend is confirmed. Otherwise this is just a 2-legged retracement, sometimes known as an ABCD.

It is important that you know that the odds of a trend reversal is not as high as the odds of the trend continuing higher. You will often see the market correct lower in an up-trend. The ABCD pattern is essentially a 2-moves down correction. It has 2 legs down. You will see this a lot.

Lower High and Lower Low = *WARNING*

Downtrend is confirmed when lower low is exceeded



The up-trend is broken if the market moves below the “lower low”. If the market has made a lower high, a lower low, and the market has traded below this lower low, then you can argue that a trend change has taken place.

However, please make sure you pay attention to this lesson: Just because you have a trend change confirmation on a lower time frame, does NOT mean you have a confirmed trend change on a higher time frame.

On the example above, the trend has not changed yet. All we can see is a sequence of a top, a low, a lower top, a lower low, but we have not seen the market move below the “lower low”. Until that happens, the market is still in an up-trend.

I have a live trading room, where I post my trades in real-time, as they happen. At times I receive complaints from people, who claim I am trading against the trend.

Well, maybe I am, but I will tell you this: The whole debate about trend is very clouded. Why do I say that? I say that because hypothetically speaking, I can look at a 5-min chart and clearly see the market is trending higher.

The 5-min time frame is my focus for this particular trade, so why do I care what the daily or weekly chart is saying? I am not planning on being in the trade for more than 5-10 minutes anyway.

Do you follow my idea here? I accept that the trend is down on the weekly chart or the daily chart, but I don't care, because I am looking at a much shorter time frame, and the daily and weekly trend will have no real impact on the trend over the next 10-20 minutes, which is how long I plan to be in the trade.

I don't want to confuse you too much. The markets are confusing enough as it is. I just want you to be conscious of one thing: Part of your education will be to decide what time frame you prefer to trade. When you do, you will almost certainly also be faced with the prospect of trading against the trend at times, even though that trend will have no impact on your trade.

Let's move on.

Lower Low = *WARNING*

The up-trend is not broken, but the market is correcting by going below the previous low, which sends a warning signal that the trend could be about to change. The trend hasn't changed yet.

Lower Low = *WARNING*

Downtrend confirmed when lower low is exceeded

The up-trend is broken if the market trades below the lower low. The market has made a lower high, a lower low, but the market has not traded below this lower low.

The Euro Dollar chart on the next page is a perfect example of how theory and reality can be two very different things. Point 1 to 4 is a perfect real-life example of an up-trend. But then things get tricky. Is “5” a low, or is “5” a lower low? Is it “5a” that if the first low and then “5” which is the lower low? I argue that “5a” is not an important low. It is “5” that is the important low.

That makes the “4 to 5” and the “6 to 7” what we call an AB-CD, and the trend can continue higher.

Definition of Trend Change - Again

When the market goes from an up-trend to a down-trend, it must make the following sequence of events:

1. **First it must make a lower high.**
2. **Then it must make a lower low.**
3. **Then it must surpass the low of the lower low.**
4. **If it takes out the lower low, we have a confirmation of a trend change.**

I want you to read this next sentence a few times. I am not interested in being academically right about some technical analysis definition – I want to make money.

If I had taken a trade based on the market moving below point 6, and I had believed the market had changed trend, and I was now betting on the market falling further, then so let that be it.

I would have been wrong, because the market moved higher. However, it would not have been the end of the world. It would not have been the end of my career. It would not have been the end of anything. It would just have meant that I was proven wrong by the market. I would have taken my loss quickly, and I would have moved on to the next trade.

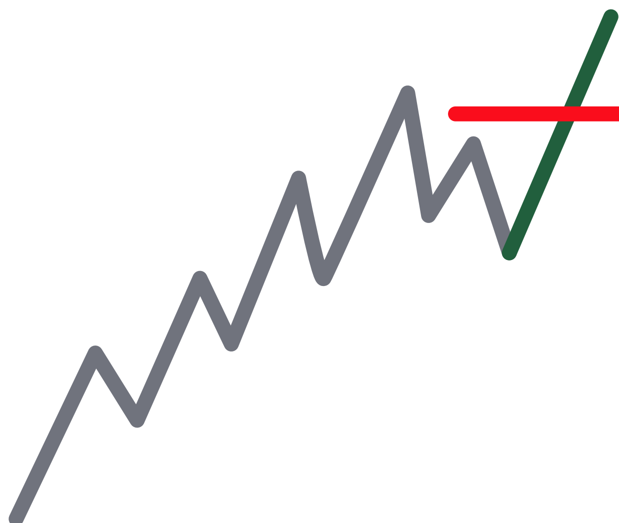
I want you to get it into your head quickly that no matter how good you think a trader is, he or she will have losing trades. I want you to read the next sentence carefully, because it may just mean the difference between you having a successful career as a trader or not having one at all:

The way you handle your losses will tell you more about your potential to become a profitable trader than any other indicator.

Your "hit-rate" won't tell you how good you are or how good you could be.
I know of traders who I have coached who have a hit-rate of 85%, yet the 15% of their trades, the losing trades, ran out of control, and they lost 20 times as much as they made on their 85%. Is that who you want to become? You want a high hit-rate because it feels good to have a lot of winning trades? Or is it more important to make money? What weighs heaviest to you? Being right
or making money?

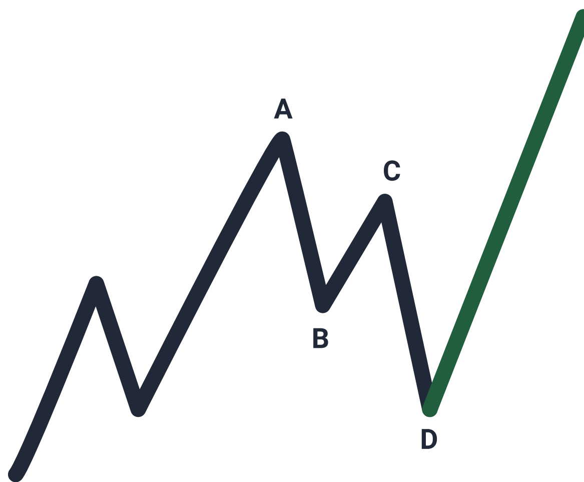
The Euro Dollar chart with the benefit of hindsight looks more like the chart below. The market didn't change trend. The warning didn't result in a trend change. It sets up a **"Continuation Buy"** signal as the market passes the old swing high.

Warning didn't result in a trend change and sets up new "Continuation Buy" signal as market passes the old swing high.



In fact, it looks very much like a pattern called an AB CD. You should familiarize yourself with this pattern. It happens a LOT – I mean A LOT!!!

Classic *ABCD* Correction



Is the Market Always Right?

“The market is always right” is one of the axioms of the traders who have been around the block once or twice in their career. They believe that you should not argue with the market. If a stock is trading at $100 and it used to trade at $200, it is NOT worth $200 anymore, no matter what you say or think. The market has spoken.

I will agree with the statement. The market is always right, but it doesn’t mean I agree with it. I accept the current price as the truth, but I also know that price will fluctuate every single day. Therefore I have to come to live with the truth being ever changing.

Take a statistical measure such as ATR (Average True Range): it measures the lowest low and the highest high over a period of time, and then gives you the average number over the period.

For example in Euro Dollar right at this point in time, the price is 1.3100, and the 14-day ATR is 120. That means that over the last 14 days the average movement from high to low during the day has been 120 points.In other words the price of Euro Dollar swings nearly 1% a day, and has done so every day for the last 14 days.

You can say that Euro Dollar is worth 1.3100 right now. That fact is indisputable. You just need to make sure you are ready to move with the market, up or down, because over the last 14 days, the market has on average moved in 120 point ranges, every day.

Markets are driven by demand and supply. Markets oscillate between “overbought” and “oversold”. When buyers are more aggressive than sellers, prices will rise, and if the sellers are more aggressive than buyers, then prices will fall. I know I am stating the obvious, but my point is this: The flow of the market makes it a measure or barometer of demand and supply, but not a valuation tool.

So I argue that if prices are moving higher, and you have a short position in that market, you are "wrong" and the market is "right". If you argue against the market, you are missing a point. You can’t control the market. You can only control your response to the market.

Before you can become a professional technical trader you need to understand a few things about the markets.The famous analyst W.D. Gann once wrote that "there is no price too high to buy and there is no price too low to sell". Anyone who believes that the market will unfold within the parameters of reason is bound to lose money. I remember some years ago, in 1992, when George Soros made over a billion dollars by continually shorting the British Pound. He believed it was vastly overvalued due to the European Exchange Rate Mechanism, which prevented it from floating freely – as a result of demand and supply. Instead it was held artificially in a narrow band against other currencies. I recall this story because at the time I was a young man, preparing to go to England to study. I had saved for 2 years to finance my studies in England, and when the time came to convert my Danish Kroners to British Pounds, I made an extra 25% because of George Soros and other traders shorting Sterling.

What most people don't know is that George Soros was underwater on this position for over half a billion before it turned in his favor. Here is a case of a world-famous speculator who believes in fundamental analysis. He is not afraid to let the market move against him as long as he believes in his analysis.

Every now and then a market goes for a run (up or down), caused by the perception of the future, or because of rumours, maybe even market manipulation, or just because a majority of traders select a preference to buy or sell short a market.

Once a move gets in motion it tends to create ripples in the market. For example, if a stock begins to move higher, those who have shorted the stock will be in trouble. They may throw in the towel, which will only push the market even higher.

Let me tell you a little story from the real world. It took place more than a century ago, but it is a good tale to tell. I read about this story when I came across a famous investor called Bernard Baruch. The Panic of 1907 – also known as the 1907 Bankers' Panic or the Rich Man’s Panic – was a United States financial crisis that took place over a three-week period starting in mid-October, when the New York Stock Exchange fell almost 50% from its peak the previous year.

The primary causes of the run on banks and brokers included a retraction of market liquidity by a number of New York City banks and a loss of confidence among depositors, exacerbated by unregulated side bets at bucket shops. What I need you to pay attention to here are the words **“loss of confidence”**. When a man loses faith in his bank, he is not inclined to think rationally. You think this could not happen today? I am afraid it already has. I worked at Moorgate in London in 2009. I sat on the third floor of an office building where the ground floor was occupied by a branch of Northern Rock, the stock I told you about earlier.

Northern Rock was in trouble. This was public knowledge. What was also public knowledge was that the Bank of England together with the British Government had guaranteed for the bank. People had been told they would not lose their money. It was guaranteed by the Government itself.

Do you think that calmed people down? Take a look at the photo below. This was taken outside the branch in Moorgate and it was taken the day after the Government had guaranteed everyone's deposits. That is a long queue, isn't it?

Back to the Rich Man's Panic, which was triggered by the failed attempt in October 1907 to corner the market on a stock called United Copper Company. When this bid failed, banks that had lent money to the speculators involved in the cornering scheme, became insolvent.

What I learned from studying the Rich Man's Panic was that one stock can affect an entire market. In this case investors liquidated their positions in other unrelated stocks, simply because they needed money to cover their margin calls in United Copper Company. There was nothing wrong with the stocks they sold.

They just had to get their hands on anything to sell to raise money. Do you now see that there can be a million reasons why a market is trending higher or lower, and you may not necessarily know why. Just because you don't know why it is rising, doesn't mean you should ignore what you are seeing. Never lose site of this fact if you are a trader.

Trend Indicators

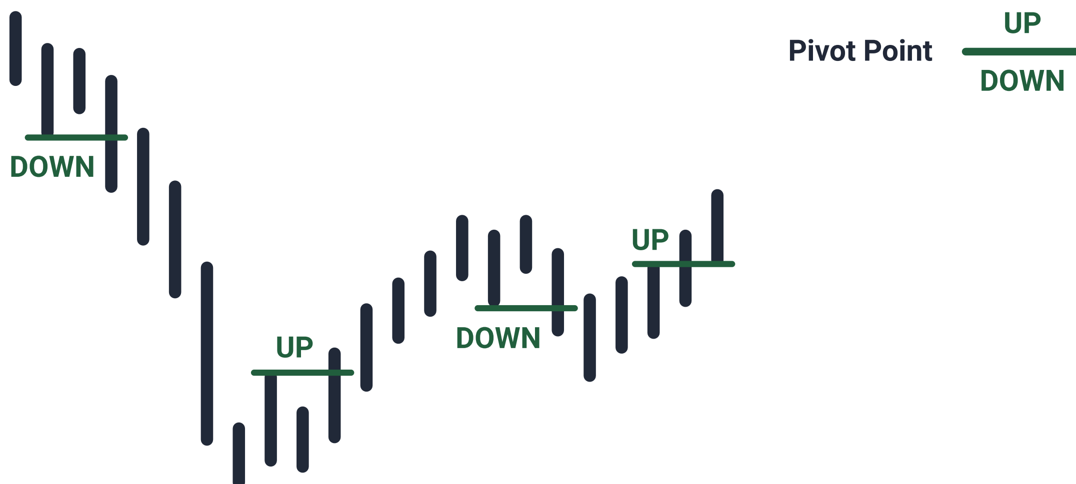
The last 2 chapters have dealt with trend and how to read charts. Now I want to teach you a simple trend indicator. I call it the Three Bar Swing. I was taught this technique by Bryce Gilmore.

There are all sorts of indicators showing you the trend. I think one of the simplest and quickest is the 3 BAR PRICE SWING CHART.

If markets that were previously moving higher are breaking back below the previous 3-bar low, then there is a real possible chance of a change in trend. For markets moving lower, the opposite is true.

I use a simple tool called the 3-day swing:

The three-day swing chart is the best indicator of trend I know of from a purely mechanical point of view.



This chart is an example of the 3-day (3 bar rule).

Before I venture into the days trading I look at what the highest high and the lowest low is for the last 3 days. Starting from the left, the first 3 bars set the tone. The second bar is the lowest of the three. Therefore the rule states that if this low is exceeded, then the trend is down.

Let's take a look at a real-life example, this time Euro Dollar:

Starting from the left, you quickly get an idea of how the 3-day swing chart works. The long line starting 11 bars into the chart is the lowest low at that point, and the market keeps trading near it, but above it. I simply kept this level as my dividing line between the market being in an up-trend and a down-trend. It is that simple. Towards the right of the chart the market begins to trade lower. On two occasions it looks as though the market is about to break above the three day high, but it doesn't. The market stays in a down-trend.

The 3-day swing chart is constructed using the highs and lows of the last 4 trading days. For instance if today the current price trades below the lowest low of the last 3 days, then the trend is down.

It is an incredibly simple and powerful tool to make sure you understand what forces are at play. Is the market bullish or is it bearish?

Can you use the 3-bar method for anything less than the daily chart?

Yes, you can, but you need to be aware of the possiblity that the signals become more frequent and possibly less reliable.

The final trend tool I want to show is the basic trendline. It is so basic that it is hardly worth spending much time on.

I have shown a Euro Dollar chart which has a couple of trendline break signals on them. The idea behind a trendline is to connect a low with a higher low, and project this line outwards. This gives you an idea of where support is in the market.

If the line at some point is broken, then it constitutes a trendline break and the market is, in theory, setting up a sell signal.

The same applies to connecting a high and a lower high. If the market is trending lower, but a trendline connecting a high and a lower high is broken, then the market may be ripe for a long position.

I don’t wish to spend too much time on trendlines. They are the simplest trick in the book and quite self explanatory. However, there is something I like to give away, a little secret, if you like:

The chart on the next page shows two trendlines. I actually only drew one of them, and then copied it onto the other low. The slope is 100% identical.

I have found in my research that very often you can draw one trendline and copy it onto other highs or lows, and you get a good idea of support and resistance in the market, and where you potentially can buy or sell short.

(EUR A0-FX - EURO,60) Dynamic,0:00-24:00
Symbol: EUR A0-FX,60
Date: 02/04/13
Time: 07:00
Price: 1.3207272
Open 1.36262
High 1.36362
Low 1.36190
Close 1.36260
1.370014
1.365014
1.360014
1.355014
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1.315013
01/24 01/25 01/28 01/29 01/30 01/31 02/01 02/04 02/05 02/06 02/07 02/08 02/11 02/12 02/13 02/14 02/15 02/18 02/19 02/20 02/21 02/22
Published by eSignal (www.esignal.com)

Daily Work Routine

The daily work routine is the process that I go through in preparation of the trading day. It may seem lengthy to you to begin with. It isn't. It will quickly become second nature, and it should not take you much more than a couple of minutes per currency.

Although there are many currencies to choose from, I only look at the following currencies for my swing trading: Euro Dollar, Sterling Dollar, Dollar Swiss, Dollar Yen, Euro Yen, and Sterling Yen.

For my day-trading I only engage in 3 currency pairs: Sterling Dollar and Euro Dollar, and from time to time the rather volatile Euro Yen.

By only focusing on a few currency pairs, I gain a better understanding of the nature of these instruments. Each currency has their own little quirks, which you get to know by observing them.

Weekly Chart

I use two different methods for deciding the trend on the weekly chart. They are important because they create my bias for the week. Having a bias means that I am looking for confirmation for the market to move in a certain direction.

For example, if my bias is “long”, i.e. to buy the market, then I am looking for patterns that conform with this viewpoint. It is not always an advantage to have a bias because it potentially leaves you without the flexibility needed to address changes in market sentiment.

I use the simple method called the 3-bar break that I described in the last chapter. I look at the previous 3 bars, the previous 3 weeks, or days, and I determine what the highest high and the lowest low is for those 3 bars.

If the market during the week breaks one of these two levels, either the high of the last 3 bars, or the low of the last bars, then I consider that a trend change.

Incidentally I do the same on the daily chart. The technique I use on the weekly chart applies to the daily chart as well. It sometimes gives me an early confirmation of a trend change.

The Euro Dollar weekly chart on the following page gives me a bias. On Sunday night, as preparation for the trading week ahead, I look at the most recent 3 weekly bars.

What is the high of the last 3 bars?

What is the low of the last 3 bars?

It is simple, but it really works well.

Candlestick Charting

I have studied Candlestick charts intensely for many years.

This chapter contains the essence of Candlecharts. This is what I believe you need to know to start trading. This chapter is by no means a fully comprehensive chapter on candlestick charting. If you want to read a good book on Candlecharting, then I recommend the following book:

Candlestick Charts by Clive Lambert

However, I do have a significant amount of trading experience, and as I said earlier, I believe that the following pages on Candles are all you need to know, unless you intend to become an expert. For trading purposes though, this covers what you need to know.

A Candlechart bar uses 4 pieces of data:

If the time frame you are looking at is a 5-min chart, then the candle will show you the open of the 5-min time period, the high of the 5-min period, the low of the 5-min time period, and the close of the 5-min time period.

If you look at an hourly chart, well then it is going to give you the data of what happened during those 60 minutes.

A bar chart gives you the same information. It too uses the open, the high, the low and the close for its construction. The difference between the familiar bar chart and the candle chart is that the candle chart makes use of a colour coding (usually red for a candle where the close is below the open, and green (or blue) for a candle where the close is higher than the open), which makes it easy to see which “force” is in charge.

I use the word "force" to describe if the bulls are in charge or if the bears are in charge. Bulls want the market to move higher while the bears want the market to move lower.

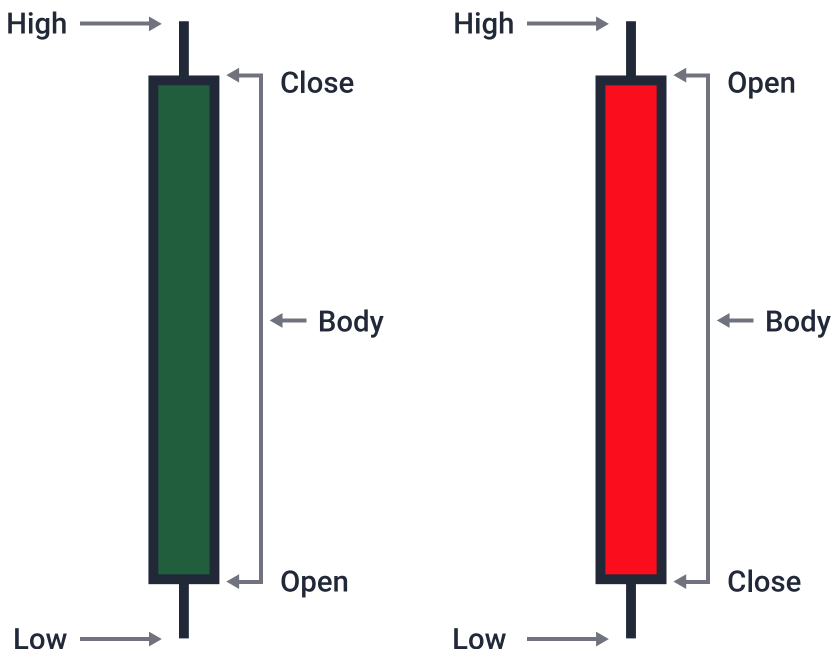
The Candlechart Construction

The body of a Candlechart is the difference between the open and the close. In Japanese Candlecharts the body takes on a significant role.

The reason is that the Candlestick charting is essentially a PATTERN RECOGNITION SYSTEM.

Let's take a closer look at how a Candlechart is put together.

To the left you have a positive candle. It means that the close is higher than the open. To the right you have a negative candle. It means that the close is lower than the open.



The Body

The Candle is made up of two components:

The tail is also more popularly known as the shadow of the candle. The body is the point between the open of the candle and the close of the candle. On top of the body sits the tail, and the same applies to the point below the body.

Both components are as important as each other in the understanding of the unfolding pattern.

What you need to know about Candlecharting is that it has been portrayed as the Holy Grail to trading. There is a lot of marketing hype surrounding candle chart patterns, designed to get you to buy the “new secret pattern”.

I happen to know the man personally who brought candles to the west, Steve Nison, so I know what a trader needs to know to make money from candles, and I can tell you that you don’t need any “secret” pattern, because it is just hype.

I admit that for the newcomer candles can seem a handful due to the huge amount of signals. The truth (at least this holds true for me) is that Candlecharts are exceptionally easy to handle, even if you do have to filter out the quantity of signals that are presented during trading.

Ask yourself over the course of this section:
What is it we are trying to accomplish?

The answer of course is simple:
We want to know who is winning the constant battle between buying pressure and selling pressure.

More importantly we want to be the first to know when the balance of power is shifting from one camp to the other, so we can make money from it. We don't trade to satisfy a need for gratification or glory. We trade to make money.

Candlecharts provide us with early clues when the balance of power is shifting from one camp to the other. There are false signals, which is why Candlecharts on its own will never be the Holy Grail, but without the understanding of Candlecharts you are often left in the dark at crucial turning points in the market.

The Shadow - The Tail

In some textbooks it is said that the open is governed by the amateurs and the close is ruled by the professionals. I think it is false statement, which should be taken with a pinch of salt. The market is what it is, a constant reflection of equilibrium of demand and supply. I am not concerned with if one camp appears more sophisticated than another. I trade what I see, not what I think.

Nevertheless when it comes to the shadow, we are talking about the demand and supply that takes place after the open but before the close. We are talking about the price action that pushes the market from one extreme to the other.

The shadow – also known as the tail - shows the extreme for the time period, the high and the low. By bearing this in mind we can derive some facts about the Shadow:

1. The shadow shows where the power shifts from one camp to another. At the extreme high or low for the Candle, the force shifts from one camp to the other.

2. The shadow indicates a degree of uncertainty about the future direction of the trend. There has been a shift of power from one camp to the other, and traders, speculators and investors all over the world now have to decide if the "failure" of one camp to carry market further in their favoured direction is a permanent failure or a temporary failure.

In an uptrend the upper shadows can be viewed as failure on the parts of the bulls to dominate the time frame that is being charted.

Furthermore in an uptrend long bearish shadows may be a pre-curser of things to come, although for now the supply that came into the market was absorbed by those who are still bullish.

In a downtrend the opposite holds true. Upper shadows could warn that the bulls are trying to gather strength, while lower shadows could mean that while the market was bearish during the Candlechart timeframe, the bears failed to hold on to their advantage.

We pay attention to these subtleties in the market, so we can assess who is winning the constant battle between buying pressure and selling pressure.

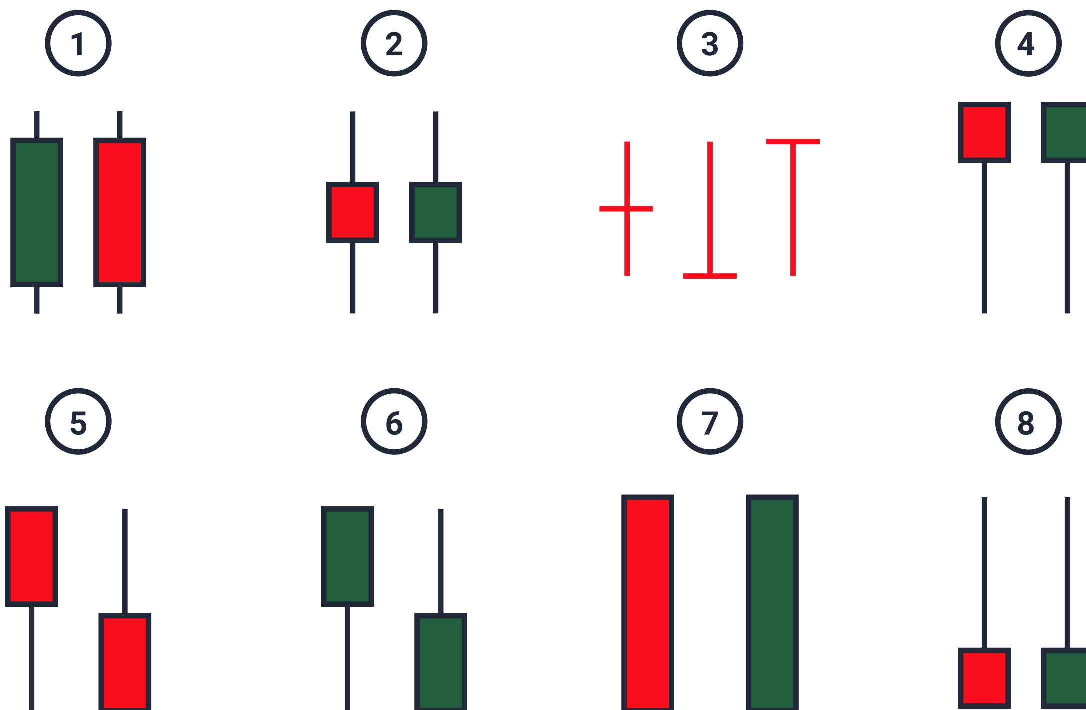
We want to be the first to know when the balance of power is shifting from one camp to the other.

The Essential 8 Candle Patterns

I actually called this chapter “The Only 8 patterns you need to know.” During the editing I realised that we can always learn more, and although I think we only need these 8 patterns, I decided to rename it to the “Essential 8”. I am grateful for Trevor Niel and his assistance on this topic.

The Essential 8 Candle Patterns are an attempt to simplify the hundreds of candlechart patterns that you see written about on the internet. It is just foolish to even think you need to learn so many patterns to trade well.

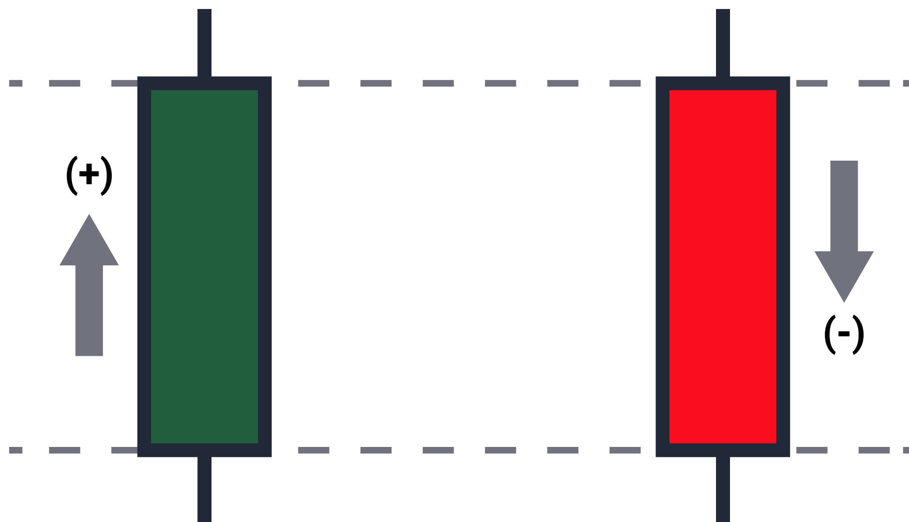
I believe a market can make one of these 8 moves.



Pattern Number 1

Standard Pattern

I call pattern number 1 a Standard Pattern.



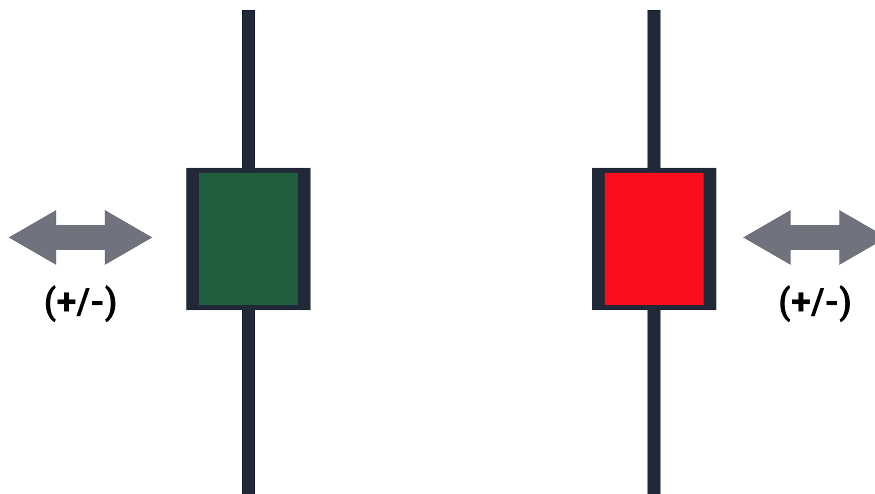
The Standard Pattern is generally considerd to be a continuation type pattern. It means that if the market has printed a bullish candle, then I will tend to expect the market to continue higher. The market continues to do what it has already done. The Standard Pattern has a strong close with a small tail on either side. It can be a strong positive close, or it can be a strong negative close.

If the bar is red, I expect the market to continue lower. It is a weak close (I describe it as a strong negative close – which of course I mean is a weak close), with a little tail either side. It tends to forecast more weakness. The Standard Pattern will not give you a clue about any potential trend change. This is important to remember. The Standard Pattern is a pattern where you expect the market to continue higher/lower depending on the colour of candle.

Pattern Number 2

Spinning Top

I call pattern number 2 the Spinning Top pattern.



The Spinning Top is a neutral pattern and is distinguishable by its small real-body and long shadows either side of the real-body.

Generally the market is considered to be consolidating when this pattern is formed. The market has very little directional conviction.

If the market has been trending higher or lower, the Spinning Top pattern might warn that the trend is about to pause or has already paused.

Let me show you an example of how I have traded a Spinning Top pattern. The market had been trending lower for the last 40-50 candle bars – not shown on the chart – and then the last 8-10 bars had been trending higher.

I still believed that the market was primed to continue lower, so I was waiting for the bullish force to run out of steam. On the chart I have indicated with an arrow the moment I suspected that this had happened.

The market makes a spinning top, and a few bars later, the low of the spinning top is broken. This sets in motion a move lower. By then I was short the market.

The market had been trending lower - not shown on the chart - and was now retracing a little.

I wanted to short the market, and I was waiting for a sign of weakness.

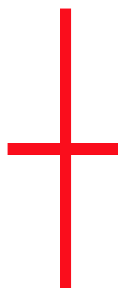
The Spinning Top was that sign of weakness, but I still had to wait for the market to trade below the low of the spinning top for real confirmation.

Pattern Number 3

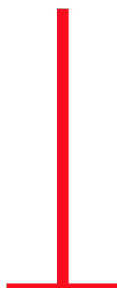
Doji Pattern

I call pattern number 3 the Doji pattern. It consists of 3 possibilities.

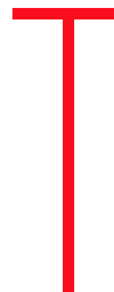
1. There is the **Long Legged Doji**, which is like the Spinning Top, but there is no body. I also called it the **Doji Star**.
2. Then there is the **Gravestone Doji**, where the market closes at its low, after it has attempted to move higher.
3. Finally there is the **Dragonfly Doji**, which is the opposite of the Gravestone Doji. The market closes at its high, after it has attempted to move lower.



Long Legged / Doji Star



Gravestone Doji



Dragonfly Doji

The Doji is a very important pattern. It is considered to be a reversal line. The Doji represents the area where the bulls and the bears meet.

Let me give you a practical example.

I am long the market and everything about the chart looks good. Suddenly, I see a Gravestone Doji. I interpret it as follows:

The market was in fine form and it was moving higher, but suddenly the market reversed and closed right where it has opened.

One of 3 things can happen.

1. It was just a short-term set-back and the bulls will come back to push the market higher. This is not so likely.
2. We are headed into a trading range. This is more likely.
3. We have just witnessed a top in the market, maybe just a temporary one, but nevertheless a top. This is more likely.

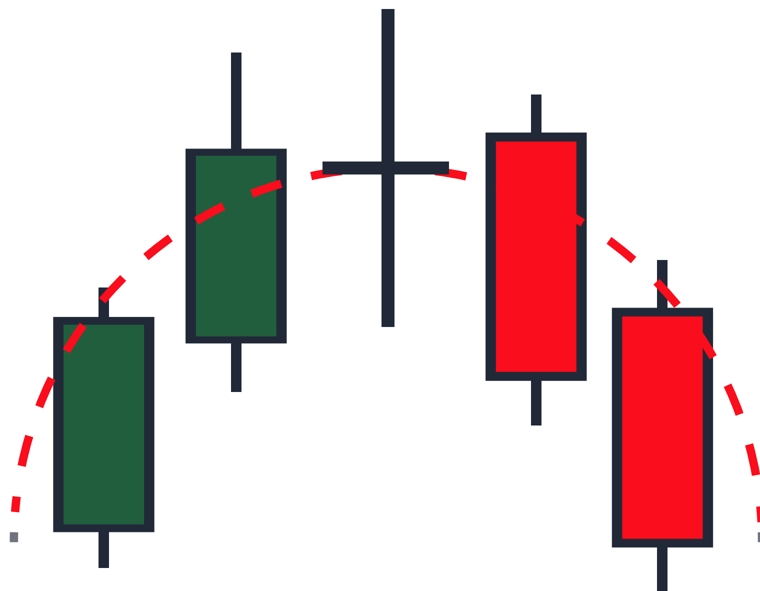
Which one of the 3 options is most likely?

You can’t answer that without **context**. Did the market digest bad news? Did it hit an old top, which is why traders are taking profits?

There can be many reasons for the Gravestone Doji, but if you are bullish the market, it is rarely a good pattern for you in the near-term. I am not suggesting that the Gravestone Doji will end the bullish forces forever, but more often than not, it means we will see sideways or lower prices for a while.

Long Legged Dogi

Let's go through each pattern in more detail.
We will start with the **Long Legged Doji**.



Here is a good example of the warning sign that the Doji can serve you.
The market is trending higher, but the Long Legged Doji acts as a warning sign. As a trader you have to consider what the market is telling you.

In this example I would consider moving my stop-loss up on an open long position to just underneath the low of the Long Legged Doji. That is one possibility. Another is simply to take profits, if you have been long the market. A third option is to await more data.

Would I sell short if I have witnessed a Long Legged Doji after an up trend? No – not immediately. I would like to consider the bigger picture, but I would certainly consider it if the bigger picture suggested it. I would prefer to see a Gravestone Doji if I was to sell short the market. Let's move on to the Gravestone Doji.

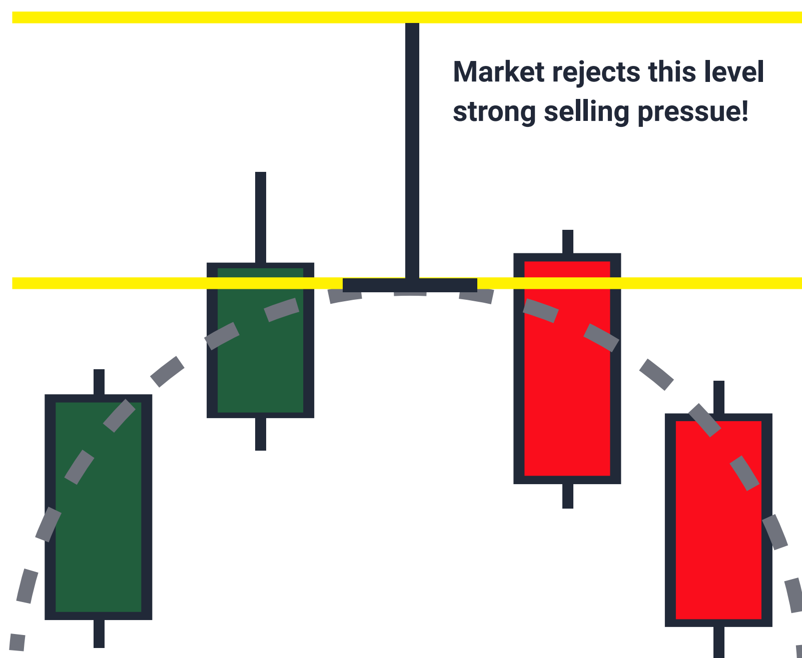
Gravestone Doji

The chart below shows the same pattern as on the previous chart, but now we have a Gravestone Doji rather than the Long Legged Doji.

I would be more inclined to initiate a short signal if I saw this kind of pattern. Again, context is very important, and I would need to see more information than what I am seeing here. In particular I would like to see if the market has enough weakness to move below the low of the Gravestone Doji.

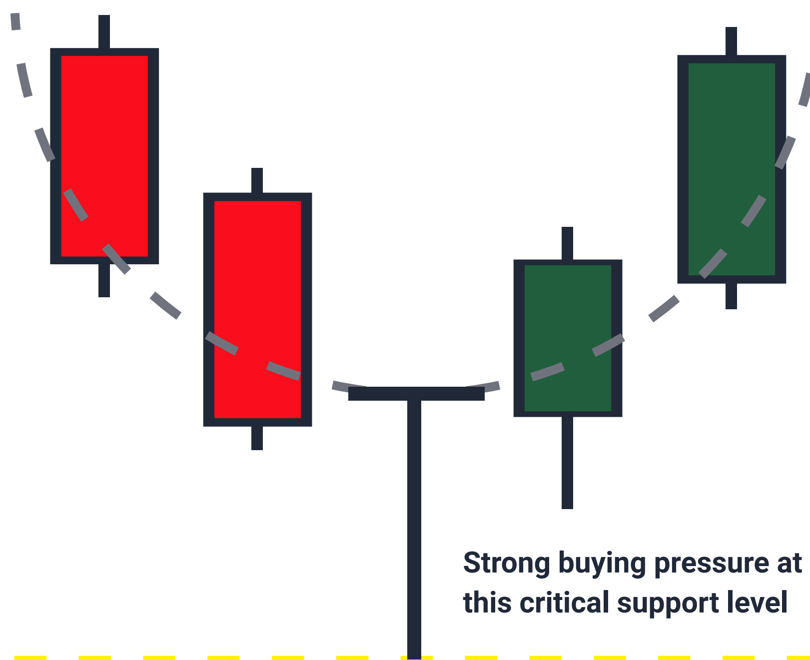
It is called the Gravestone because of its shape. The original thinking behind this pattern was that this was a sign of the end of a bullish move. It was the gravestone for the bulls.

You should notice how the market is rejecting the price signified by the yellow line. The selling pressure forces the market back down again.



The Dragonfly Pattern

This is the exact opposite of the Gravestone Doji and it is often found at market bottoms. Here you should notice how the strong buying pressure is moving the market away from the yellow line, which marks the low of the bar.



I will give you a little hint, which I use in my trading. It will need some explaining, but here goes. You see the Dragonfly Doji? Well, imagine you were
short the market, and you saw the market make this pattern. You would be thinking that this is bad news for your position.

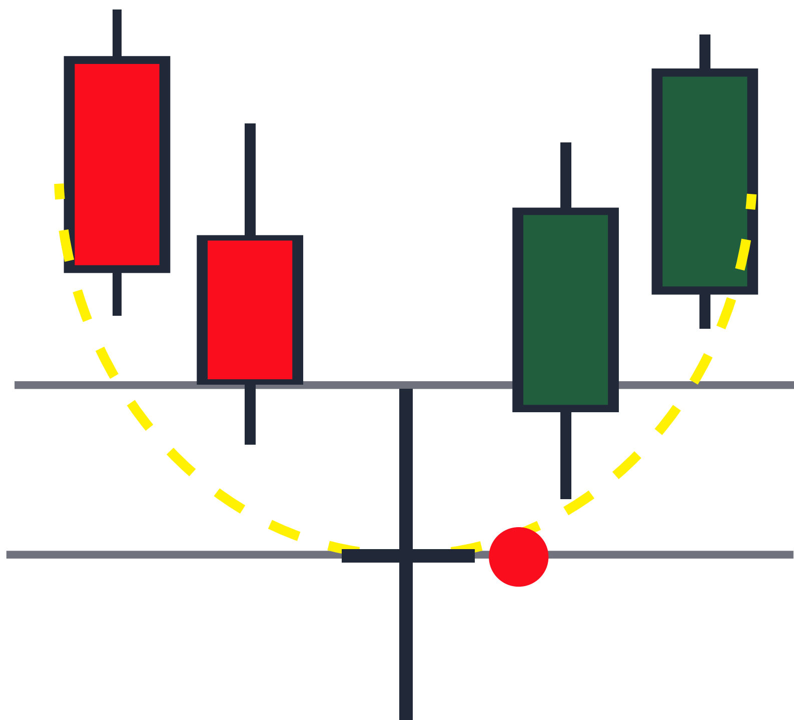
You may even consider moving your exit order, your stop-loss, down to just above the top of the high of the Dragonfly candle pattern.

Well, if you are thinking that, then so will a lot of other traders. My tip is to place a Buy order where everyone else is placing their stop-loss order.

The Doji Star

The Doji Star is one of the stronger reversal patterns. It can be found at tops and bottoms. Here I have shown it in the context of a “pattern of three”. This means that you should not just look at the Doji bar. You should also look at the bar before, and the bar after.

Can you see how the bar after the Doji closes above the high of the bar before the Doji? This is significant, and it is the reason why it is called the pattern of 3. It is essentially a rounded pattern, one that in this case suggests higher prices.

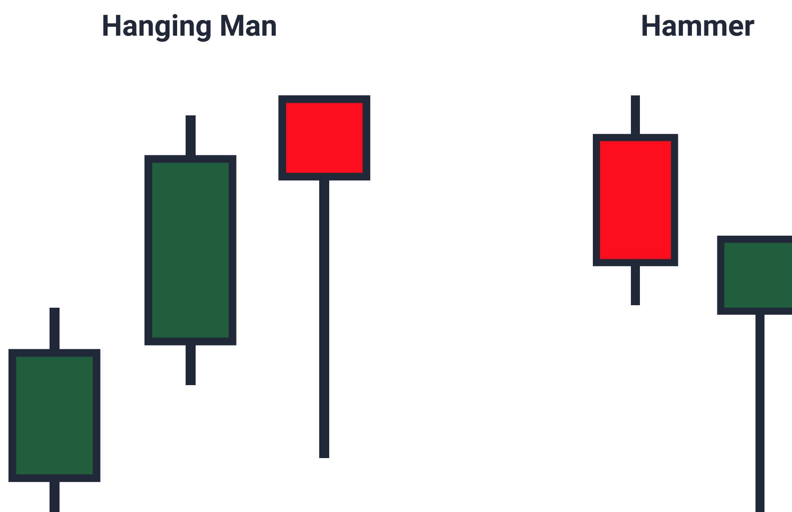


Pattern Number 4

The Umbrella Pattern

At the top of the market this pattern is called a Hanging Man, but at the bottom of the market it is known as a Hammer. There are two distinctive variations of the umbrella pattern.

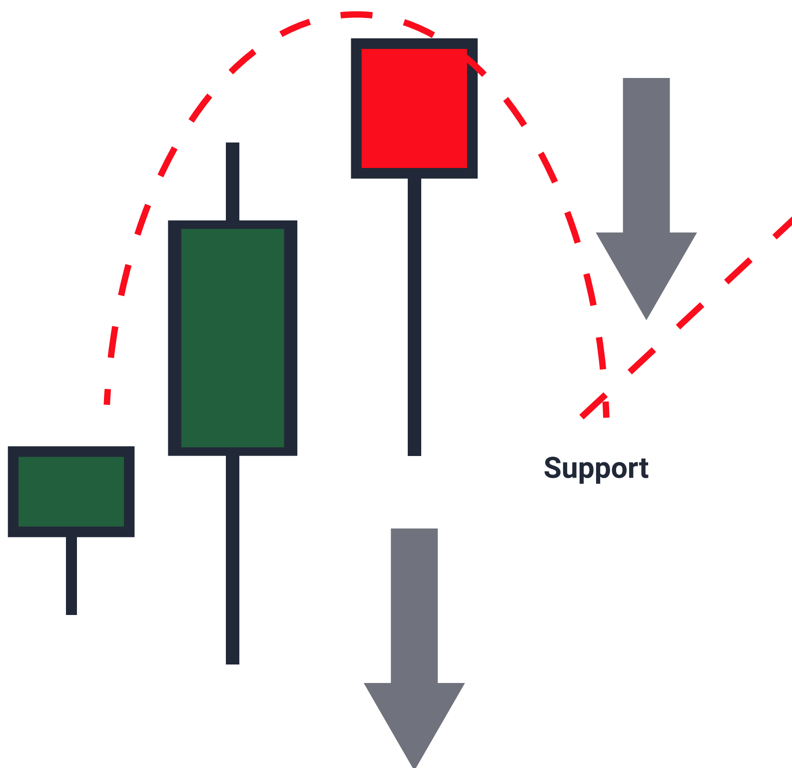
The Hanging Man at a market top and The Hammer at a market bottom.



An umbrella should have a small real body with little or no upper shadow. The lower shadow should be 2/3 times the length of the real body. The umbrella is widely regarded as a reversal line but confirmation of reversal is required. The colour of the real-body is usually not considered to be important but I would recommend that you do pay attention to the direction of the closing as this gives additional weight to the pattern.

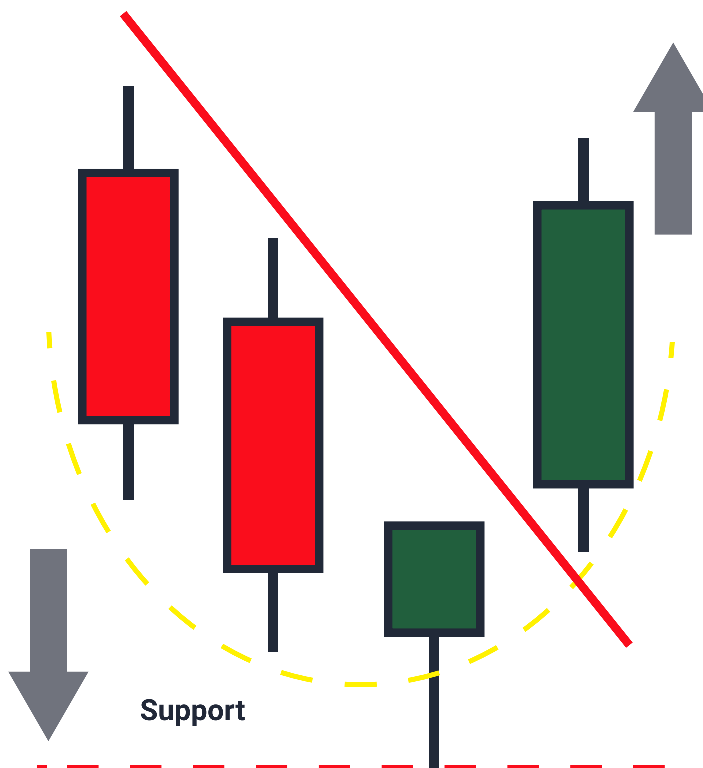
Let's take a look at a few examples. On the chart below the market is in a clearly defined up-trend. We see two strong bullish candles. Then we see a **Hanging Man**. The market shows signs of weakness and aggressively tests the downside. The session however closes much higher than the recorded low.

A close below the support in the **next three periods** is required for a confirmation that the market has reversed. A break of a trend line could also act as a valid confirmation.



The next chart shows the **Hammer**. The Hammer is a very important bottom reversal pattern. The colour of the real body is less important than for the Hanging Man as the market has bounced off a low in a downtrend.

The chart shows us that strong buying has occurred, and it indicates a good level of support. The long shadow is indicative of the strong buying pressure.



Pattern Number 5 & 6

Shaven Top or Bottom Pattern

Pattern number 5 and 6 are significant because they either have no tail on top or no tail on the bottom. That is why it is called “shaved”. It is a continuation pattern and as such I don’t put too much focus on them, but they can show weakness in a trend.

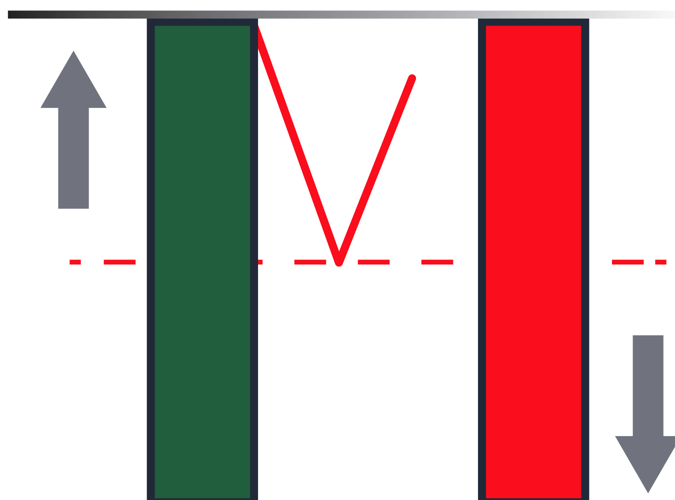
Pattern Number 7

The Marabozu Pattern

The Marabozu Pattern is a candle line with no upper and lower shadow. The period opens and closes on the low and high.

The Marabozu is very common in short term charts, especially after the release of economic data.

50% Level Critical



Let me show you an example of a Marabozu pattern, which I am keen to trade.

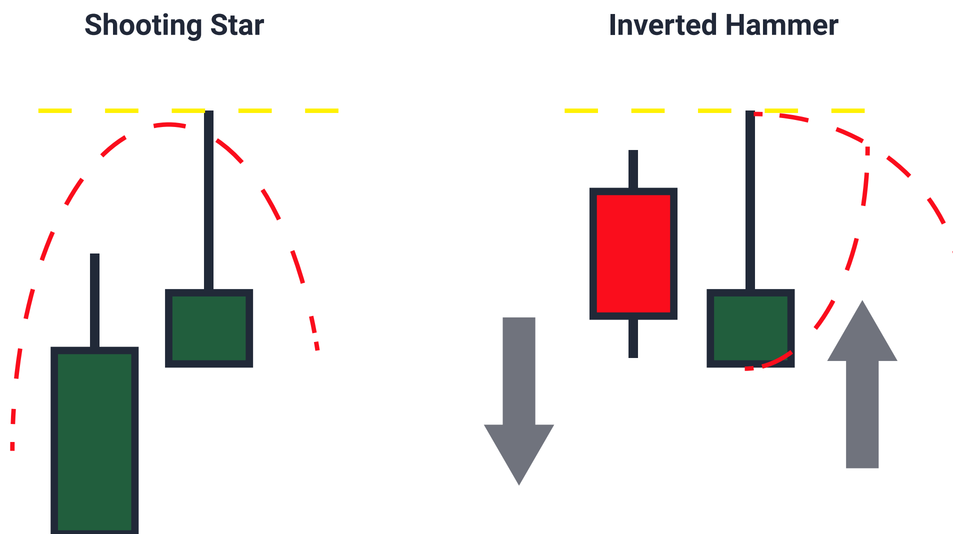
The market is trending lower. It makes an attempt to push higher, but it fails. Where I see it fail is when the market prints that beautiful Marabozu bar. There is nothing but selling pressure on that bar, and I consider it a strong sell-short signal.

Pattern Number 8

The Inverted Hammer / Shooting Star Pattern

This pattern is the direct opposite of the Umbrella Pattern. The Shooting star can be a powerful reversal signal in an up-trend (but only on a new high).

An inverted hammer is indicative of a strong area of support and confirmation is sought prior to entering any new long positions.



Putting it Together

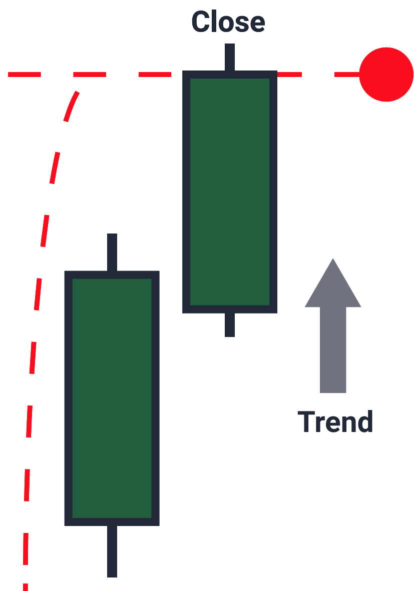
Now that we have identified the individual classification of the various candle lines, we will now look at the 2-bar (session) reversal patterns. This means that we are looking at the context of the market, rather than just looking at one individual candle bar.

In this section it is essential to understand the impact of the opening versus the previous session closing value as this is always a good pointer to the state of the market.

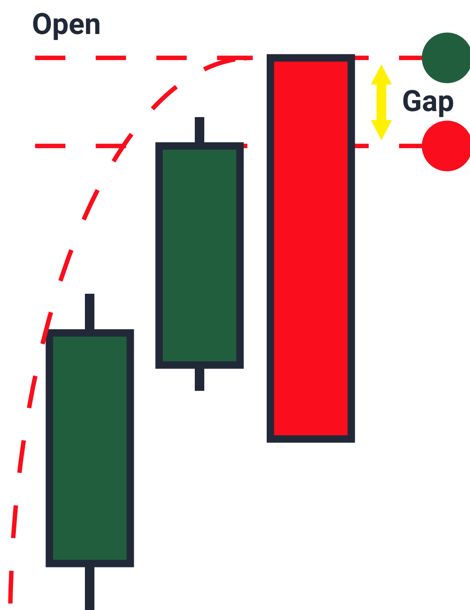
If you are trading a 5-min bar, this is not relevant, but if you are looking at a daily chart, where each bar is 24 hours, then it does have significance.

We also look at a little known confirmation technique which is derived from combining the 2 individual candles to view the candle formation as a single line. This enables greater understanding of changes in market sentiment.

The **Engulfing** Line is one of the strongest of all the reversal patterns and it is a quick and effective method of spotting a change in market sentiment.



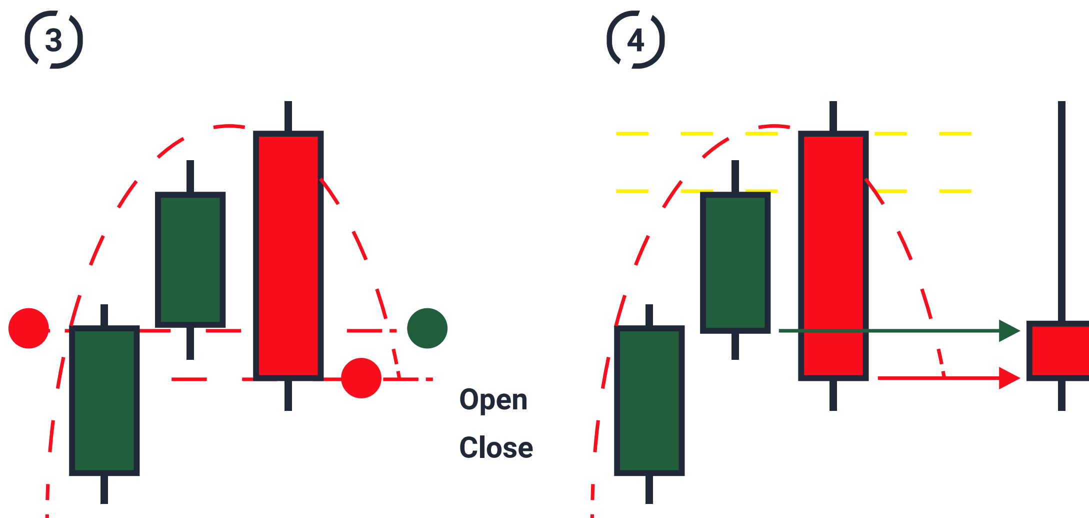
On **Part 1** of the chart below, we assume the market is in a reasonable trend. That is essential for this pattern to be validated. On the chart below we assume the market is in an up-trend.



On **Part 2** of the chart below (to the right), we observe that when the next period opens, it opens higher than the previous close, creating a gap in the market. The real-bodies are obviously of opposite colours.

On **Part 3** and **Part 4** of the chart you witness the effect of this 2-bar pattern. The Engulfing bar alone is bearish as it is. On Part 3 of the chart you see how the body of the current bar engulfs the previous bar. The close of the current candle line is lower than the previous session open. It engulfes the whole of the last real-body.

The shadows are not taken into consideration at this stage.

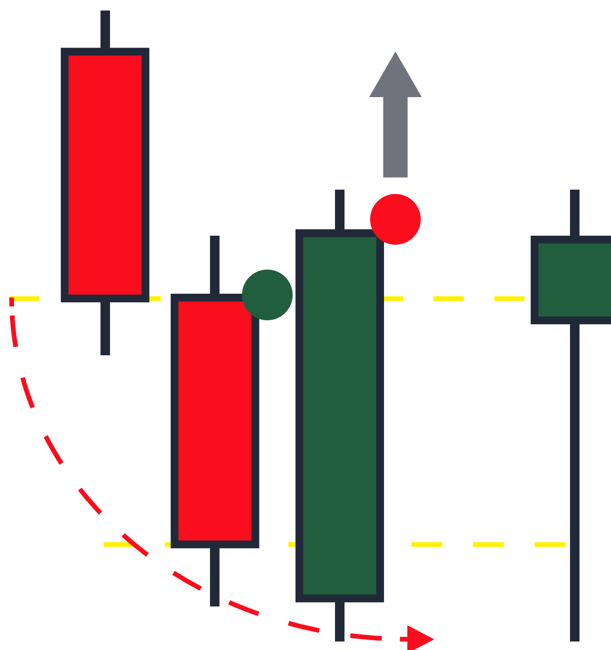


Combining the 2 candles together would result in the entire session resembling a Shooting Star. This is what I have pointed out to you on Part 4 of the chart above.

This technique gives additional understanding to the analysis and it suggests that this pattern does not require confirmation…

Bullish Engulfing Pattern

The reverse of the bearish Engulfing pattern is shown next and it is a very strong pattern, when you look at the 2 bars as 1. It forms a hammer. There must be a reasonable trend in place for this pattern to work. I like to make sure my stops on open positions are tight and I will be ready to reverse my position to the other direction.



Like the Bearish Engulfing pattern, the Bullish Engulfing pattern can be used on its own, or it can be used as a 2-part candle formation.

The latter is what I am showing you here. The current bar engulfes the previous bar, but combined with the bar before, it actually shows another pattern: The Hammer. These patterns are exceptionally powerful, and although I don't advocate always looking for tops and bottoms in the market, part of your education has to involve spotting turns in trend as soon as possible.

On the chart here you see a classical Bearish Engulfing Pattern, where the market has pushed above an old high, and the bullish trend looks solid. Then we see an Engulfing candle, and it sets the tone for a new bear trend.

The Evolution of a Trader

What timeframe do you want to trade?

Do you want to trade a Tick chart, where your focus is on the smallest minute changes in the market. Maybe you want to be a traditional 5-min chart trader, or maybe you want to look at longer timeframes, such as the hourly or daily chart.

Your evolution as a trader is partly to discover what time frame you want to trade, and trade the trend of your time frame accordingly.

The reason I am bringing this up at this stage is to let you know that whatever timeframe you want to trade, you can use Candlecharts for it. It is as simple as that. I always intended for this book to be as practical as possible. Therefore I want to give you some practical trading tips and strategies that I use or have used with great success.

The Fake Moves

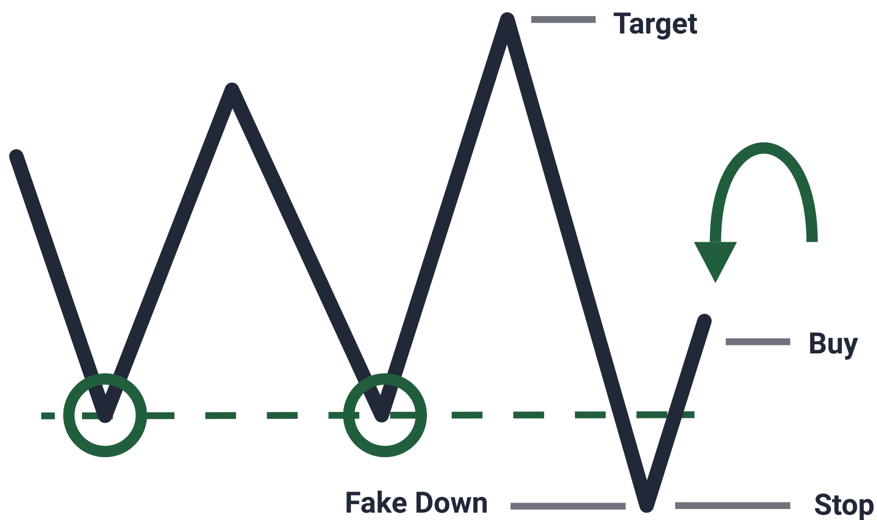
When I started out trading I was keen to sell break-outs and buy break-outs. It took me a while to realise that more often than not the market would pull me into a trade, by breaking above the previous high or below the previous low, only to reverse in the other direction.

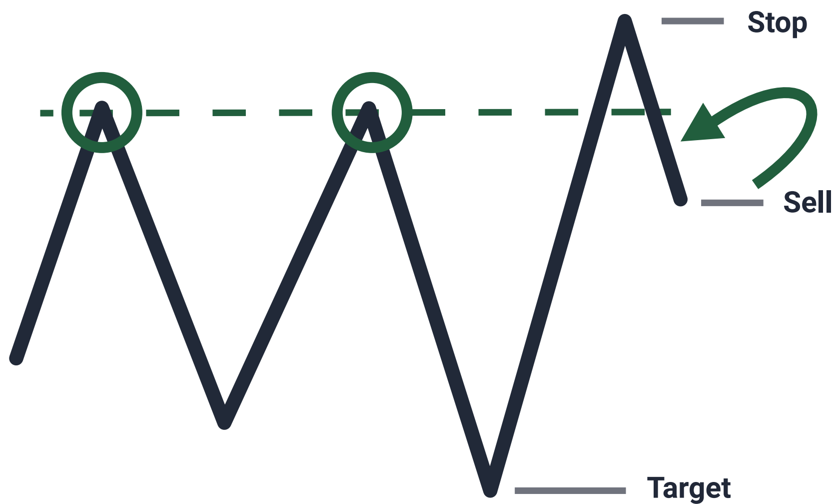
The realisation came when I sat in a seminar myself some time back. I was staring at a chart image on a very large screen, which probably helped accentuate the visualisation of the chart.

It was a trading epiphany when I realised how often the market tends to test previous highs or lows, only to reverse back into the range.

I went through thousands of past charts to enhance my understanding of this pattern, which I call Fake-Out and Fake-Down. It works very well in so many time frames.

Fake-Out & Fake-Down





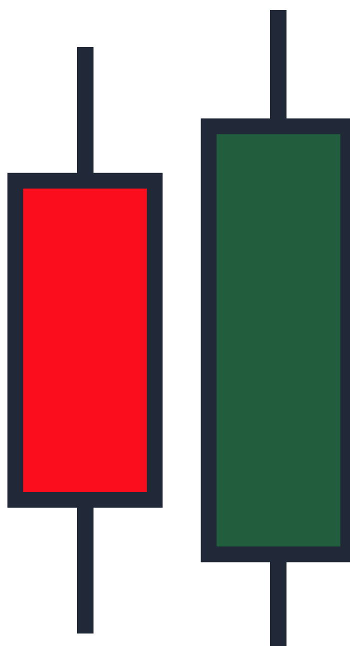
Engulfing Patterns for Day-Trading

The Engulfing pattern is a candle bar where the price action measured by the BODY of the current bar engulfs the body of the previous bar. I like using them on a 10-min time frame or higher on indices such as the FTSE, the DAX (although the two are highly correlated), as well as the SP500 and the Dow.

They work great as a reversal signal or continuation signal. They tell us exactly where to enter. They tell us how much to risk on the trade.

What does the **Engulfing Pattern** look like?

I have displayed a Bullish Engulfing Pattern below. What you should notice is that the green bar's length engulfes the entire previous candle.



There are 3 potential entry criteria, which depends on how much certainty the traders wants in the set-up.

1. Aggressively enter the market on the assumption an Engulfing pattern is being formed. If the trader enters the market on the assumption that an Engulfing bar will print, and it fails to do so, the trader should exit the trade.
2. Normal entry method – waiting for the Engulfing pattern to complete.
3. Cautious method – waiting for next bar to trade through the high/low of the Engulfing bar.

The above example is not perfect, but it serves to show the concept quite well. A move above the Engulfing Bar triggers a buy signal.

You can either time your entry with an order just above the high of the Engulfing Bar, or you can simply execute the trade yourself manually, the moment you see the market push above the high of the Engulfing bar.

I like the example above because when you are trading a 10-min chart, you are not in a big rush. This trade takes a while to work out, but it works well.

I like the example previous because I realise I made a mistake. I meant to highlight another part of the chart with a square. The area I have highlighted is a valid Engulfing Bar, but I meant to highlight another one as well.

Can you see it? It sets up a buy-signal. It comes 8 bars after the two I put a box around, and it shows a set-up, which ends the correction against the trend.

The chart above shows an Engulfing bar. The market has already moved down a bit.

Many traders would be scared to sell short a market that has already fallen significantly. I call these long bars Road Map bars. If you are concerned about the size of your stop-loss, then trade it in smaller size.

Now the next chart is important. It is important because I don't want you to think that all set-ups are winners. One of the most important components of trading is how you handle your losses. Do you let them run out of control, or are you in control of them?

On the chart above, the market is trending lower. If we call the lowest bar on the chart, bar number 1, then you can follow my thoughts.

Bar no 1 is red, and it is the lowest bar.

Bar no 2 is green. It is a very positive bar. There is no tail on either side of the body. It closes very strongly. **Bar no 3** is red. **Bar no 4** is green.

Bar no 5 is red, and the body of bar no 5 engulfs the body of bar no 4. This is an Engulfing Bar setup, and I short the market. As the trend is down, this makes good sense. As you can see, I am stopped out very quickly.

I was wrong.

Exit Criteria for Engulfing Pattern

The exit can be done in one of several ways, but remember that the aim is to be on board a "runner", so taking a profit should not be because some monetary criteria has been met.

If the market immediately runs in the anticipated direction, the trader should move the stop-loss to break even.

If a trending move develops, the trader can move the stop loss progressively in the direction of the trend.

If another candle pattern forms, such as a doji, signifying a potential trend reversal, the trader should tighten the stop loss.

If volume spikes into previous support or resistance, it would be wise to keep the stop tight or take profit.

Otherwise, try keeping the position open, and above all, have patience. A good Engulfing set-up on a 10-min chart can easily last a full hour or more.

Understanding Chart Time Frames

I use two charting packages. One is a paid-for service, which I use for research. I don’t recommend you invest in a charting package. These days the brokers you trade with have excellent charting tools, and they cost nothing.

The other is the free charting application provided by my broker. As I said, it "costs nothing", and it is perfect for my daily trading needs. Please do not use money on subscribing to a charting package.

The Time Scale on a Chart

Each bar or candle on the chart tells you the open, the high, the low and the close for the time frame you have chosen. So, if you have chosen a 10-min time frame, you get the open, high, low and close for that 10-min segment.

When I go through my morning routine (discussed in the chapter “Daily Work Routine”), I go through the several timeframes of the currency pair.

The Time Frames

Weekly Chart

It is superb for the “great overview”. I put a charting tool called a moving average on to make it easier on my eyes to find the trend.

When I use a moving average for trend detection, I use the 89-period moving average. If the market is trading above 89MA, I deem the trend to be up on that time frame.

If it is not possible to say if the market is trending above or below the 89MA on say the weekly chart, then I must accept that the market is not trending.

Daily Chart

The daily chart is a vital part of the daily work process because I use it for my 3-day rule. It is great for trend identification. I will teach you the 3-day rule next.

1-hour & 4-hour

These two timeframes are great for swing trading, and for identifying patterns over longer time periods. It is also great for identifying support and resistance.

15 min

It is a good timeframe to trade from, which can cover both the short-term and the longer-term. I use the 10-min and the 15-min after I have done all my preparation for the day.

Lower Time Frames

I frequently go down to a 5-min or a 1-min if I am looking for an entry. It means I already know I want to execute a trade, but I am attempting to gauge the market for obvious strength or weakness.

A Special Note on Scalping

When I go about my day-to-day business, scalping and short-term trading stock indices, I always do it on a 5-min chart. Let me give you an example of a worksheet from earlier today.

The red bar marked with black lines was a place I sold short. It was an Engulfing bar. I was stopped out soon after. When an Engulfing bar fails, you often get a move in the other direction. I went long. It paid off.

Trade Entry Technique

4 Bar Fractal

The 4-bar fractal is a simple measure of a turning point. It is mechanical, so it is easy to explain and easy to implement. It is reliable, but don't expect miracles. It will catch some sustained trend moves, but you will also have your fair share of small losses and small wins, because you get stopped out.

As the name implies, it is composed of 4 candles (or bars). It works in any time frame. The longer the time frame you are viewing it on, the more of an impact the signal is likely to have.

The 4-bar fractal is one of the most solid trend change indicators I know of. I owe it to Dr David Paul for introducing this to me.

There are 2 conditions to the technique.

Buy Signal

1. The CLOSE of the current bar (1) must be higher than the HIGH of the previous bar (2).
2. The CLOSE on this bar (1) must be higher than the HIGH of the bar three bars back (4).
3. If those conditions are met, we have a BUY SIGNAL.

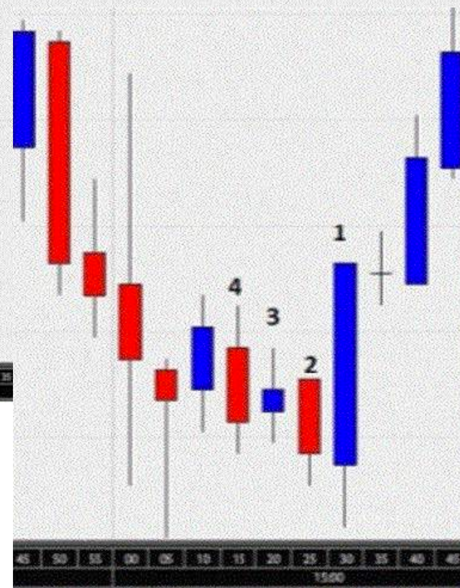
Sell Signal

1. The CLOSE of the current bar (1) must be lower than the LOW of the previous bar (2).
2. The CLOSE on this bar (1) must be lower than the LOW of the bar three bars back (4).
3. If those conditions are met, we have a SELL SIGNAL.

You should be able to see from the chart below how the fractal works. It is simple, but who said that it had to be complicated for it to make money?

You should be able to see that bar 1 closed above bar 2. Bar 1 also closed above bar 4.

The moment bar 1 is complete, and has fulfilled the criteria, I have a buy signal.

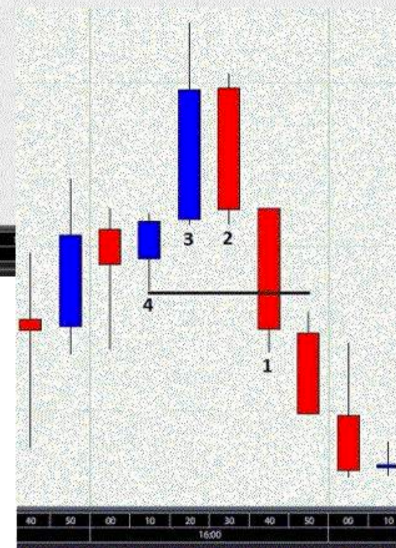


Let me show you a close-up of the chart above, in case you don't see it so clearly:

How does it work if it is a reversal from an up-trend to a downtrend?

This is explained on this graph. Here we have a **sell signal**.

Again, let me show you a close-up of the sell signal:



Divergence Strategies

The 4-bar fractal is an excellent tool used in conjunction with other techniques. One such technique is a **“Divergence Strategy”**.

The Divergence Strategy was actually invented by a trader from J.P Morgan. Sadly, I don’t remember his name. I apologise to the man.

In order to explain what a Divergence Strategy is, I want to show you what it is not.

I have taken a chart of the Dow Jones Index on a 5-min chart. I have put a tool called an Oscillator on the chart. I have chosen the Stocastics Oscillator.

As the market moves up and down, so too does the Oscillator. What you should be able to see on the chart below is that when the market makes a new high, so too does the Oscillator, or at least it makes it up to its last high. **This is normal.**

Now, let me show you an example, where you see something which is not normal. We call that “Divergence”.

The Dow is trending lower, and we see a **lower high** on the price chart.
On the Oscillator we see that the corresponding lines are making a **higher high**. This is called a Divergence, and when we see that, we have a pretty good idea what will happen next. The market is ready to continue in the direction of the trend.

This is where the 4-bar fractal can come handy. We have had a warning from the Divergence and now we are waiting for the market to confirm it. This could be in the form of a 4-bar fractal sell signal.

On this page there are two SELL SHORT signals, that I haven't identified for you. **Can you find them yourself?**

I see 3 signals on this chart using the 4-bar tractal technique, using a 4-hour chart. I have marked the 2nd one. Can you see the first one and the third one?

Divergence studies are a fine way to time the market. Here I have used a 4-bar fractal to time my entry, while having a Divergence between the stochastics indicator and price confirming the entry.

Sterling Dollar in an up-trend on the 4-hour chart and the Divergence sets up a buy-signal, which is confirmed by the 4-bar fractal.

The 4-hour trend is pointing lower. The Sterling Dollar chart sets up a sell-short signal using the Divergence and the 4-bar fractal takes care of the entry.

Sterling Dollar sets up a sell using the Divergence and the 4-bar fractal takes care of the entry signal.

Managing your Risk

Risk management means how you allocate your trading capital. I suspect quite a few people's eyes glaze over with boredom, when they hear about risk management.

However, it would not be professional of me to write a trading manual and not discuss it. I will keep it short and sweet.

Trade Preparation

You can make your life as a trader easy by following some simple rules.
Don't ever trade without a stop loss.

There you have it. It is simple, and it is most likely the most important rule of all. It is also the rule that most people break.

You need to consider these 5 points when you want to place a trade:

1. What is your proposed entry price?
2. What is your proposed stop-loss?
3. How much do you want to risk per point?
4. How big is your account?
5. What percentage are you risking?

Example

My account is £1,000.

I want to risk 5% of my account per trade = £50
I want to buy DAX at 7920. My stop loss is 7910.

Therefore, I will buy £5 per point.

Example

My account is £1,000

I want to risk 1% of my account per trade = £10
I want to buy Sterling Dollar at 1.5525.
My stop loss is 1.5515. My risk is 10 points.

Therefore, I will buy £1 per point.

It is as simple as that. No one can decide for you how much to risk on a trade. I can tell you that the more you risk, the more you will make when you win, but you will also statistically blow up your account.

I recommend that you start your trading risk at 1% or 2%. That is a good place to start to learn from. Part of the trading journey is to decide for yourself what kind of trader you are. Do you like high risk trading? Are you prudent? Are you aggressive? Do you add to winning positions?

So many questions to think of and many you can't answer until you have some experience under your belt. We need to get you started, and then many of those questions will answer themselves.

Managing the Trade

There are three main ways of managing the trade and traders argue about the virtues of each at every occasion. I will discuss these in turn and let you make up your mind. Managing the trade is a personal philosophy rather than any form of mathematically defined concept.

Scaling Out

In this the trader exits part of the position as the position gets into profit. The concept gets support from Mark Douglas in his book “Trading in the Zone”. Douglas and many others reckon that the trader should exit a third of the position after a few points have been made.

In the context of the four-hour chart in forex about 20 points. Douglas then instructs to exit the next third at the next significant high and at that point, get the stop up to entry. Douglas then instructs that the third and remaining third can be let run to the target.

The scaling out system is used by most traders in some form or other. Many would exit the second third well before the old high was encountered and would have got their stop to entry after a move of 40 points in their direction.

Many would exit the first third at plus 20 points, exit the second third at plus 40 points, get the stop to entry and let the remaining run.

This is emotionally quite easy to do as most of these trades on the four-hour chart using my rules will go at least 40 points.

The problem with the scaling out method is that when you are wrong, the big hit is taken with the whole position, while the big win is taken with only a third of the position. Nevertheless, this is how I believe that you should start with this methodology.

I will for clarity and honesty tell you that this is not how I trade. My philosophy is that either you want to be in the market, or you don’t want to be in the market. The idea of taking half off your position or a third off a position is in my mind a psychological limitation rather than a trading strategy. I will discuss this more under the psychology section.

Scaling In

Here the trader starts with a small position and adds as the position goes his or her way. This has the advantage that the loss, if the trade is not a success, is taken with only a small position while the profitable big winner is taken with a much bigger position.

The downside is that a sudden reversal can turn a 100-point profit into a loss. This is hard to take emotionally. I believe that to add successfully the first add must be a place on the chart where the stop can be brought up to entry on the first position. This is also the stop on the second position. This means that the initial small risk does not increase.

It's important to note that most of the very successful traders that I know who hold positions overnight to a week all believe strongly in adding to winners. It brings the success rate down markedly and frequently 75-point winners turn into losers.

These traders have got to a point emotionally where that does not matter, as the gigantic profits that they make on the 40% of trades that go a long way more than make up for this.

I am positive that the longer the timeframe that is traded the more important adding to a position becomes. In the four-hour chart consider adding at a profit of 75 points.

This means we double the position here and get the stop to entry. If profits are taken at 150 points than we have made 225 points in total for a risk of 75 points.

This means the risk to reward has gone up to 3 from the norm of 2 from a 150-point profit. This makes a vast difference to your bottom line over a year's trading.

Demo Accounts

I am not a fan of demo accounts except for when I need to learn a new platform. Then I practice how to execute trades. I also practice the use of the stop-loss function and how to use the limit order system. Beyond that there is no use for a demo platform for me. For you however, there are some obvious advantages and some not so obvious disadvantages.

Advantages of a demo account:

1. You get to know the trading platform and can practice executing trades and orders without being concerned about making mistakes.
2. You are trading fictitious money.
3. It is a great place to practice a trading technique.
4. It is a great place to learn about charting.

Disadvantage of demo account:

1. The purpose of trading is to make money. Using a demo account is not the real thing, which means you won't know how you will handle the pressure of real trading with real money on the line, until you make the switch.
2. It is easy to get lulled into a fall sense of satisfaction by using demo accounts, and then think it will be easy to replicate the success once you start the real thing.

At a trading conference I was asked the following question by a delegate. “Do you recommend the use of demo accounts?”

I answered that demo accounts are great for several reasons, including getting used to a new trading platform and its functionalities, trying out new strategies and maybe just getting the taste for trading in the first place.

I went on to say that I wasn’t a fan of demo accounts beyond the reasons mentioned above. I stated that demo accounts take out the emotional sting of trading, which gives a false psychological profile of successful trading.

I argued that it is a good idea to start with a demo account, but as soon as you are comfortable with the platform, you should begin to think about opening a real account. You can start off with a small account, work your way up by increasing your stake size as your experience grows.

I told the delegates a story about a client of mine, a 20-year old medical student from Copenhagen University, who had spent a month trading Euro Dollar intra-day for 5-6 hours a day.

By the time he started with a real account, he already felt fairly confident with his way of trading, and he did very well for himself, because he kept doing on his real account what he had done on his demo account. I think he made 180,000 Danish Kroners on a 25,000 kroner account over 4 months.

If this is your intention, to train yourself to execute trades, one after another, using a specific system, then you have my blessing. It takes a tremendous amount of discipline to treat a demo account as if it was the real deal. He could do it, but I am not sure many can.

Forex Markets & Forex Trading

Introduction to Forex Markets

The Forex market, also called the currency market, is the most actively traded asset class in the world, with trillions of dollars exchanged every day. It trades 24 hours a day, from Sunday afternoon London time, to Friday night.

It opens in New Zealand when currency traders come to work Monday morning their time (Sunday night in London) and it closes Friday evening when the traders in New York and the rest of the US heads off for the weekend.

In those 5 days it doesn't stop trading!

There is no central exchange where you trade Forex. It is not like the stock market, where the US has their NASDAQ exchange and their New York Stock Exchange, and Britain has its London Stock Exchange. Instead the Forex market is traded electronically, and it is truly global.

Major banks and brokerages all over the world make a market in currencies, providing a buy price and a sell price for their customers. They are called liquidity providers. They tend to have operations all over the world, so when members of staff go home in London, the staff in New York take over.

It is very easy to trade Forex, and there are so many different currency pairs you can choose from. Most traders tend to focus their efforts on following just a handful of currencies, and it is usually the major currency pairs they trade, like Euro Dollar.

How to Get Started

You will need a trading account. Contact me if you want a name of a good broker, who you can trust.

When I say it is easy to trade Forex, I don't want you to misunderstand me. "Easy" does not equal "easy to make money". What I mean by easy is that the mechanical process for placing trades is easy. However, making money from trading is not easy, but you are in the right hands. I will guide you to a place of competence so that the chance of fulfilling your goal of making money has been significantly improved.

You can trade VERY small size while you are learning how to trade. That means you don't have to be concerned so much about your profits or your losses to begin with. The importance is on learning. You can even open a demo account to begin with to get the hang of the platform.

Forex Trading Action Plan

You will need an action plan to guide you through the first months of trading. It will reduce your learning curve and it will provide you with structure in a rather unstructured environment.

What do I mean when I say it is unstructured? Well, look at the facts: there is no opening time, there is no closing time, and you can trade as often as you want with as much money as you can personally afford, with unlimited risk to yourself and operating in an environment where you eat what you kill.

There is no regulation (although your broker is of course regulated), and the rules of the game changes every day, sometimes many times during the day.
I am going to provide you with some structure to your trading and train you to slowly navigate your way around the market. Easy does it, to begin with.

Trading is simple, but it is not easy. To put it differently, it is easy to open a trading account and begin buying and selling currencies, but if you don't know what you are doing, then the odds are high that you will not last very long and that you will lose your money. We don't want that to happen.

The action plan is a guide to your first steps in the markets. The best thing you can do for yourself is to read this manual from cover to cover, and then go back to the individual points and action them, as and when you are ready.

I have covered everything you need to get off to a brilliant start. I have given away the secrets of how I trade myself. This is a not a beginner's manual or an advanced manual. It is simply a manual for profitable trading.

Details of Action Plan

1. Read the manual from cover to cover.
2. Open a trading account with a broker. I will send you some suggestions, if you haven't already received it in your email inbox.
3. Begin applying the techniques.
4. Start trading small.

Basic Facts of the Forex Market

Here are some of the facts about currencies that are useful to know.

1. A currency is a country's means of exchanging goods and services within its own borders and abroad. The money exchanged is called their currency. In Denmark for example it is called Danish Kroners. In England it is British Pounds.

2. The exchange rate is the price for which you can exchange money in one currency into the money from another country.

The major currencies of the world are:

Code	Name
USD	American Dollars
GBP	British Pounds
JPY	Japanese Yen
EUR	The Euro for members of the European Union
CHF	Swiss Franc
NZD	New Zealand Dollars
AUD	Australian Dollars
CAD	Canadian Dollars

Some currencies are traded more than others. The major currency pairs are called The Majors.

They are as follows:

Name	Code	Symbol
Sterling Dollar	**GBPUSD**	**£ $**
Dollar Swiss	**USDCHF**	**$ CHF**
Dollar Yen	**USDJPY**	**$ ¥**
Euro Dollar	**EURUSD**	**€ $**

The minor currency pairs are numerous.

Here are a few examples:

Name	Code
Sterling Yen	**GBPJPY**
Euro Swiss	**EURCHF**
Sterling Swiss	**GBPCHF**

The Way Forex is Quoted

How is a currency pair quoted? What does it mean if you are seeing Euro Dollar traded at 1.3345? How does the Forex market set the prices? These are some of the questions we will look at now.

Let's look at the way a currency is quoted.

If we stay with Euro Dollar, then it is made up of two currencies, namely the Euro and the US Dollar. In the Forex market it would be described as EURUSD.

The Forex market operates with two rates. There is the Base rate and the Quote rate.

Example 1 - *EURUSD*

EUR is the base rate **USD is the quoted rate**

The price will describe how much ONE unit of the base rate will buy you of the quoted rate

EUR USD = 1.3350

This means that it will cost you *$1.3350* to buy *1 Euro*

Example 2 - *GBPUSD*

GBPUSD trades at 1.5535

Base rate is GBP **Quote rate is USD**

For ONE unit of Pound, you get 1.5535 US Dollars.

So, if you spend £10 (ten British Pounds) on buying US Dollars,
you will receive £10 x 1.5535 = $15.53.

Example 3 - *GBPEUR*

GBPEUR trades at 1.15

Therefore, One British Pound will buy you €1.15

Advanced Exchange Rate Example

In the last example we used the exchange rate between the British Pound and the Euro. What if you have one Euro, and you want to exchange it to GBP, how much will you receive?

Reciprocal rate =
Inverting the exchange rate, so Base rate becomes
Quote rate, and Quote rate becomes the Base rate.

Answer: one divided by exchange rate = reciprocal rate

1/1.15 = 0.8695

The answer is that one Euro (€1) = **£0.8695**

If this reminds you a little too much of the math classes you are trying hard to forget from school days gone by, then please don't despair. You do NOT need to know this to trade Forex. I am just telling you how the Forex market is put together.

Practical Forex Trading Terminology

How are your Profits or Losses Calculated?

Currencies are traded as “pips”. A pip is the smallest fluctuation you can see in the exchange rate.

For example,

GBPUSD = 1.5546

One pip increase = 1.5547

One pip decrease = 1.5545

As a currency trader you want to make as many pips as possible. The value of the pip depends on how much you have risked. We will look at “pip”
size now.

Value of the Pip

The value of the pip is decided by you. You decide how much you want to risk per pip. The more you want to risk, the bigger the account you need. It all depends on your appetite for risk and the size of your account.

In the example below, you risk £1 per pip. If you read this manual, and you are based in another country, say Portugal or Singapore or Norway, you simply take one unit of your local currency, rather than what I have done in this example, which is to use Sterling Pounds.

Risk: **£1 per pip**

Price of GBPUSD: **1.5546**

Action: You buy GBPUSD at 1.5546

Later the price is: ***1.5596***

Action: you sell GBPUSD at 1.5596

You made 50 pips. Your profit is calculated as follows

Closing Price minus Open Price = pips made (or lost)

Profit or loss = pips made (or lost) * risk per pip

Your trade looks as follows:

1.5596 minus 1.5546 = 50 pips

50 pips x £1 = **you made £50**

Quick Guide to Spread Betting / Trading

Spread betting / spread trading is an easy and cost-efficient way to enter and exit the financial markets. I have traded with many different companies. It is suitable for all levels, from the absolute beginner to the hardened professional.

Uniqueness of Spread Betting / Trading

Spread betting is unique in the sense that you are not trading with contracts or lots. You nominate your own trading size whenever you trade, and you ALWAYS trade in your own currency.

If you live in England you trade in Sterling, and if you live in Denmark you trade in Danish Kroners. If you live in the European Union, you will place your trades in Euros.

Let’s take an example from a trading platform I use. You trade the Euro Yen, i.e. the Euro against the Japanese Yen. Here I am trading £1 per point, which means I will risk £1 for every point the market moves up or down. I have set a stop loss at 35 points, meaning I am risking £35.

You can trade much more than just currencies. You can trade individual stocks, stock indices (my favourite), commodities like gold and oil and even government bonds.

Whether you trade currencies or stock indices or commodities, it works exactly in the same way. You nominate how much you want to risk per pip movement, and that is all you have to worry about.

I am going to go through some examples on how to place trades. I have sneaked in some examples from stock indices as well, just so you can see that the principle of spread betting/spread trading is the same, irrespectively if you are trading currencies, or individual stocks or commodities or bonds or stock indices.

You nominate your risk per point, and then you simply buy or sell.

Example of a Trade on a Stock Index

DAX (called Germany 30) is trading at 7921-7922

7921 The price to sell short or to close a buy trade.

7922 The price to buy or to close a sell short trade.

You think DAX will move higher. You bring up the DAX trading ticket, and in the "stake size" you put £10. You then click "BUY" at the price of 7922.

Later the price is 7932-7933

You close the trade at 7932.

You have made 7932 minus 7922 = 10 points

You risked £10 per point.

Your profit is £100.

If you live in say Norway, you may have put your stake size as NOK 100 per point.

Your profit would have been 10 points times your stake size of NOK100 = **NOK1.000**

What If You Had Done The Opposite?

You sold short DAX at 7921.
You had to buy it back at 7933.

Your loss is 7921 – 7933 = 12 points

12 points * £10 = £120 loss

Notes:

The examples shown illustrate perfectly the merit of trading with any spread betting broker or any CFD trading platform. The process is 100% identical, whatever product you are trading. Forgive me for the banality of the example but imagine the price of 7921 – 7922 is the price for an orange.

If I think the price of an orange will rise from 7922, I can place a trade on the orange, betting on the direction of the price of the orange.

The point I am trying to make is that the principle is universal. Once you understand one trading ticket, where you execute your trade, you understand them all.

What Makes Markets Move?

As a trader we are looking for markets that move. What makes the currency markets move? What makes the commodity markets move?

Who buys and sells in the currency markets? While you don't need to know who is in the market to make money from the markets, a little background into, for example, the currency markets won't go amiss.

Global corporations operate in the market. Ford Motor sells cars all over the world. They receive money in many different currencies, which they then convert into US Dollars on the currency market.

Hedge funds speculate on the direction of currencies to generate profits. Central banks operate too in the currency market for various reasons, such as supporting their own currency.

All these corporations and banks and hedge funds meet in the markets to conduct their business. Some are there to speculate. Some are there to convert profits from car sales overseas. Some are there to support their country's currency. This is what makes a market.

Advanced Concepts of Currency Trading

A currency represents a way of conducting transactions in a country. The British Pound will allow you to buy goods and services when you are in the UK. If you live in the UK, and you want to travel to the US, you will exchange your British Pounds to US Dollars. You do so using the exchange rate between GBP and USD.

What determines the price of a currency pair, like GBP USD?

The answer is: Demand and supply.

There is no other factor. It is simply the flow of buying and selling which determines the price of a currency pair.

There are several things which can make currency speculators sit up and pay close attention. Before I can go into that, I need to explain a concept to you. It is called the “Carry Trade”.

When you put money into your bank account, you will earn interest on your money. When you borrow money from a bank, you must pay the bank interest. This is the same all over the world.

Whether you live in New York or in Copenhagen or Paris or anywhere else we all must pay interest on money we borrow, and we receive interest on money we lend to the bank (our bank deposits).

However, interest rates are not the same all over the world. Some countries have very low interest rates. In those countries it is cheap to borrow money. In some countries it is expensive to borrow money, and correspondingly you receive much more interest on your bank deposit than you do in the countries with low interest rates. Imagine you can borrow money in one country very cheaply, and then convert them to another currency, and put them in a bank account in that country. Then you would make money, due to the interest rate differential.

For example, back in 2004 you could borrow money in Japan at 0.50% interest a year. You could then convert the money to New Zealand Dollars and put them into a bank account in New Zealand and earn 8% in interest a year. Your net profit would be 7.5% a year. Not bad for doing very little. That is called a “Carry Trade”. However, it is not risk free! It would be risk free if the interest rate stayed the same in both countries forever, and if the exchange rate between Japan and New Zealand stayed the same. But things change. The markets don’t stand still.

Market Movers in the Forex Market

A central bank of a country will always keep an eye on its own currency vis-à-vis its trading partners. If its currency becomes too expensive, then the goods and services offered of the country becomes unaffordable for foreign trading partners, and subsequently demand falls, leading to unemployment and loss of ability to compete in the international market.

Currency traders are found to pay close attention to what central banks are saying. When a central bank spokesperson makes comments on the country’s interest rate, it can have a profound effect on the Forex market. Every week there is economic news released by government agencies all over the world. This can often have a huge impact on the flow of the Forex Market. This is because the news will be interpreted as being good or bad for the country’s ability to compete in the world of commerce, and Forex traders attempt to capitalise on the new information.

Example

On the 25th April at 09:30 we were expecting the quarterly preliminary GDP figures from the UK. The market was expecting 0.1%, but instead the number was 0.3%.

Date	Time	Currency	Impact	Event		Actual	Forecast	Previous	
Thu Apr 25	All Day	EUR		Italian Bank Holiday					
	9:00am	EUR		Spanish Unemployment Rate		27.2%	26.5%	26.0%	
	9:30am	GBP		Prelim GDP q/q		0.3%	0.1%	-0.3%	
		GBP		Index of Services 3m/3m		0.1%	0.0%	-0.3%	
	1:30pm	USD		Unemployment Claims		339K	352K	355K	
	3:00pm	USD		Treasury Sec Lew Speaks					
	3:30pm	USD		Natural Gas Storage		30B	33B	31B	
	11:45pm	NZD		Trade Balance		718M	472M	441M	

The result of the economic news release affected the exchange rate between the UK and the US profoundly. The next chart shows what happened to the GBPUSD rate immediately after the news release.

Chart of Sterling Dollar, with the effect of the economic number released at 09:30am on the 25th April circled in RED. The market was surprised by the strength of the UK economy and immediately began buying Pounds and selling US Dollar. The chart is moving up, indicating that you get more US Dollars for your one unit of British Pound.

Other things that are watched by Forex traders are when Central Banks set interest rates. The interest rates in a country has an impact on its currency and is rated against other currencies.

What Drives Intra-Day Movements in the Forex Market?

1. **Commercial firms buying or selling.**
2. **Day traders and trend traders speculating on the direction of the market.**
3. **Hedge funds taking positions.**
4. **Pension funds taking positions.**

Summary: Currency Movements

1. Interest rates and news have a big impact on currency trends.
2. Often currency trading is driven by what traders expect will happen in the future.
3. Currency traders will listen very carefully to central bank announcements.

Case Stories & New Entry Techniques

David the Swing Trader

David doesn't want to sit and watch the screen all day. He has other things to do with his time, so he carefully chooses the times when he watches the charts. He prefers to watch the currency market in the morning and again in the evening.

He uses a 4-hour chart and a 1-hour chart. There he is looking for currencies that are likely to continue the trend. If they aren't trending (range bound) he leaves them alone.

When he spots areas where he would like to buy or sell, he inputs orders into the trading platform. He places an entry order, a stop-loss order and sometimes even a limit order. He then checks his position again in the evening.

David makes use of the 4-hour chart to spot Confluences. He analyses the charts to identify places where the odds of a successful trade are high.

Example on the following page

David views the Euro Sterling 15-min chart and sees that there was a retracement in the most recent rally at point 1. He copies the line from point 1 and places it on the top of the most recent rally. This is point 2.

Now he sees that if Euro retraces by the same amount as at point 1, then Euro EUR should hit the price of 0.8945. This technique is called a Harmonic Retracement technique.

David now places a buy order at 0.8945.

All David can now do is wait. He reviews the chart a couple of times a day. He repeats this process with the handful of currencies he is following.

David's story is an example of how you can make trading work for you even though you have other commitments.

There are those who would say that David gets the best of both worlds, because he is not there to watch the market move up and down during the day, so he doesn't get emotionally invested in the charts, like so many traders do, leading to over-trading.

EURGBP A0-FX - EURO/BRITISH POUND,15) Dynamic,0:00-24:00 (Delayed)

OK
Symbol: EURGBP A0-FX,15
Date: 08/08/18
Time: 01:00
Price: 0.894773997
Csr#: -72
Csr%: 0.3398
Open 0.89501
High 0.89516
Low 0.89450
Close 0.89472

2

1

0.899009
0.898509
0.898009
0.897509
0.897009
0.896509
0.896009
0.895509
0.895009
0.89472
0.894509
0.894009
0.893509
0.893009
0.892509
0.892009
0.891509
0.891009
0.890509
0.890009
0.889509
0.889009
0.888509

eSignal, 2011

01:00 04:00 07:00 10:00 13:00 16:00 19:00 22:00 22:00 01:00 04:00 07:00 10:00 13:00 16:00 19:00 22:00 01:00 04:00 07:00 10:00 13:00 16:00
08/03/18 08/05/18 08/06/18 08/07/18

hu Aug 30 13:59:51 2018

OK

Case Story:
Stanley the Intraday Trader

Stanley sits and watches the markets for large parts of the day. He is a day-trader. Although the term day-trader means something different, depending on who you ask, for Stanley it means that he attempts to profit from shorter-term price movements during the day.It also means that Stanley rarely holds a position overnight. It is not unlikely, especially if he is sat on a good profit, but he likes to close all his positions before he finishes for the day. Stanley has many different tools he makes use of. One of those is the trendline break after a fake-out. It usually trades' a handful of times during the day. He trades it on some of the more volatile currencies such as the Euro Yen, the Sterling Dollar and the Euro Dollar.

He uses a 1-min chart to identify the pattern. He is looking for 3 or 4 tops, where he can easily draw a connecting line, touching all tops. He is also looking for the market to go below an old low (for buys), and then reverse back up again, and break the trend line. Once he is in a position, he places a stop below the last low. If this low is further away than he likes, he reduces his stake size. Because Stanley trades quite frequently, he doesn't like to risk more than 1% of his account. Otherwise he exposes himself too much to wild swings in his account. Stanley uses several screens, so he can follow more than one currency pair at a time. Although the technique is simple, it is very efficient.

However, if he gets a sense that the market is range-bound, and not likely to trend, he attempts to spot it early and stays clear of the market. He also stays clear taking positions before important economic news is released in the market. You can find an example on this simple intra-day technique on the next page.

Trading is about finding what works for you. It takes time, but the longer you can stay in this game without blowing up your account, the more likely you are to find what works for you. Take your time. A masterpiece is not made in a hurry. It takes time. There will be set-backs. Expect it and persevere.

This chart shows a simple trendline entry technique coupled with a fake-out to the downside. This is a one-minute chart of Euro Yen.

Trading Psychology

If you are new to trading, you will learn soon enough that it can be a demanding business. I have written a book on trading psychology.
I will show you some extracts from it here.

When you write a blog about a subject, or a book for that matter, you inevitably write from the heart. You write about a topic as you see the topic. You don't write how other people see the world.

This presents a problem when you are writing about the inner workings of your psyche. Your inner composition is so unique and so intimate to you. Sure there are probably people who think like you, act like you, behave like you, and respond like you, in broad strokes, but you as an individual are unique, one in 7 billion (or however many people living on planet Earth).

Many people before me have written about trading psychology. Some are traders, and some are not. Just because you are not a trader doesn't mean you can't contribute to a trader's development. The flipside is that being a trader doesn't necessarily qualify you to talk about the trader's mind.

I put the word trader in quote mode, because I want to emphasise the notion that I have of a trader. He or she is bright and alert, and knows himself and trusts his instincts and his abilties.

I have read all I could get my hands on in the world of trading psychology. The first book I read was by a Danish investor, who I subsequently got to know well. He didn't strike me as a "trader", but more as an investor.

The second book I read was not so much a book on trading psychology, but it certainly was written by a “trader”. Marty Schwartz wrote Pit Bull, which is an entertaining read. I don’t think I learnt much from it and apart from the entertainment value of it, I would not necessarily recommend it as a must-read.

My favourite trading book is written by a journalist called William Fallon. It is the story of the legendary bond trader Charlie D. Now there is a trader I aspire to be like. The problem is that Fallon doesn’t talk much about what Charlie struggled with and how he overcame his struggles. So we are left guessing how to become the greatest bond trader ever.

Of course, you can always turn to Reminiscences of a Stock Operator, written by Lefevre about Jesse Livermore. I recommend the book, and it certainly has plenty of pearls of wisdom to keep you reading from cover to cover.

There is just one problem. Jesse Livermore was a blow-up artist. He always went ALL IN, and he lived through plenty of personal booms and busts, the last bust culminating with him blowing his brains out at a hotel in New York.

Still, just because the man killed himself, supposedly because he was bust again (but that is being disputed), doesn’t mean you can’t learn from his words and actions. I mean, we don’t stop reading Hemmingway or listen to Nirvana just because they killed themselves.

This brings me to the more hardcore literature of trading psychology. My friend and at one-point my trading coach Steve Ward is a hard working man. His skill doesn’t necessarily lie in the academic or clinical approach to trading psychology. Rather, Steve writes about and teaches practical tools to combat your inner obstacles.

I like Steve’s books. They are easy to read, which is most certainly an advantage. Can you imagine a book about how the brain works, and you have to sit with a medical dictionary just to try to understand what the author was saying.

Another coach I value is Brett Steenbarger. He is as hard working as Steve Ward, but he does have the geographical advantage that he is from USA. There they

have many more trading floor operations and prop trading houses than they have in England where Steve is from. What you get from Brett isn't necessarily more academic knowledge but you sure get many more anecdotes from his time on trading floors.

This brings me neatly to where I fit in.

My background is academic. I have 2 college degrees and 2 university degrees to my name. For someone who wasn't keen on school, I certainly knew how to punish myself. Apart from working a few years in a semi-relevant market role, I have spent my entire working life on the front row of the markets. I worked as an analyst for many years, trading the firm's money as well. I was fortunate to be a regular guest on esteemed TV channels like Bloomberg and CNBC. I met some towering giants in the world of trading through these interviews.

However, I was also a grinder, who would start early AM and finish late PM. I traded most evenings for myself and would often sit and listen to the brokers take orders and manage the firm's risk.

I learned more from those evenings than from any other source of trading wisdom. I tell this story often in my courses. I have observed thousands of retail traders execute millions of trades. Much of my work has been based on the obervations I made.

I am aware this sounds a little cynical, so forgive me. However, when you are observing a group of people, who trade as if their heads are buried in the sand, you soon realise what to do and what not to do.

I worked for a broker for 10 years. There weren't many clients there who I wanted to be like. Sure there were some, but they belonged to the minority.
I mean the MINORITY!

I coined a saying, which I think sums up what I saw over that decade so well.

Untrained traders become scared when they should be hopeful, and they become hopeful when they should be scared.

Ask traders about their reasons for trading, and most will tell you, "I want to make huge profits." Although most traders get into the business to make a significant return on their money, the vast majority blow up their accounts.

Why do so many traders fail?

The obvious reason for many is that they just don't know how to trade. They don't use proper risk controls. They don't have enough financial resources. They don't have proper instruction. They don't have solid, reliable trading strategies. And for many, they don't have good reference points; they don't have a clear understanding of how the markets work.

Any or all of these factors can spell disaster for the novice trader. One doesn't need to explore the depths of one's psyche to find other reasons for failure. That said, there's an interest among many would-be traders as to the extent unconscious processes thwart their trading efforts.

Years ago, Freud wrote about people who fail after achieving great success in "Those Wrecked by Success." According to Freud, some people feel guilty and physically ill upon attaining a lifelong dream. Upon experiencing success, they aren't comfortable with it, and unconsciously take steps to punish themselves for being successful.

Does that apply to the traders I saw? No, it did not. They had no success at all. In other words, traders don't repeatedly fail because they have an unconscious wish to spoil their efforts, but trading is just plain hard.

Traders repeatedly fail because they don't have proper financial resources, solid trading strategies, or the proper mind-set.

What is Trading Success?

A Trading Strategy With An Edge (positive expectancy)

+

The Ability To Be Able To Consistently Apply The Strategy

That is just two components. That doesn't sound very difficult.
What could possibly go wrong?

Well, none of us are 100% immune to the pressure of trading.
I have identified 4 trading fears that can affect our performance:

1. Fear of being wrong.
2. Fear of losing money.
3. Fear of missing out.
4. Fear of leaving money on the table.

In my experience the newcomer wants to be right about the market, while the professional traders want to make money. When I travel around the world, for whatever reason, and I am recognised as “the guy from CNBC/BLOOMBERG/CNN” I quite often have to listen to people giving me their opinon on the market, or a specific stock.

Many of these comments are born out of a need to be right. People are already invested in the stock or the market, and they are now looking for validation for their arguments.

I don’t have a problem with that, and I do love to talk about the markets. However, the problems arise when people are losing money. I am convinced that they don’t have an exit strategy. The thought that they may have read the market wrong just never even enters their mind.

It is not what you don’t know, that gets you into trouble. It’s what you think you know for sure, that just isn’t so, that gets you into trouble.

The Need to Be Right

Most traders focus too much on their need to be right. This can be detrimental and needs to be addressed. The truth of it is, we are dealing in the financial markets.

There is not a system, method or pattern that can produce accurate results all the time. If there were, it would be known to all. All would be using it. Ironically, if this was the case, when all started using the system, it could no longer work. A 'catch 22' of sorts, but just goes to show that it is obvious that there will never be a perfect system or indicator.

The best we can do is to study each situation, collect the evidence, and make a high probability decision at the proper moment. What is of primary importance is how the situation is handled when the trader is right, how the situation is handled when the trader is wrong. What is the most common reason traders fail?

The answer is not following stops. What is another top reason traders fail? The answer is not letting winners run.

Not following a stop is an example of handling the situation improperly when a trader is wrong about the trade. Not letting a trade hit a target is an example of handling the situation improperly when a trader is right about the trade.

What good is being 'right' if you are not paid for it?

Good traders assume from the beginning that the trade may go bust. They know how much money they have risked. They know when they will get out, and they will analyse other options, such as profiting from the stock, which is now moving 'against the odds'.

Yes, we need to be 'right' a fair amount when we trade. However, if your average winner is three times your average loser, you only need to be right 25% of the time to be breaking even gross.

Accept that this is not an exact science, and never will be. We are reading peoples emotions. Accept that you will be wrong a certain amount of the time and accept that graciously.

Done properly, this is a very profitable business. Focus on how you handle your winners and losers. Make timely, high probability decisions when you have sufficient evidence, and do so consistently and objectively.

Notes on High Standards

A hallmark of success is the dedication to high personal standards. This can be said about individuals as well as organisations. Unless one is striving to move forward, to move beyond one’s comfort zone, he or she will never achieve true greatness.

When it comes to trading, it is my experience that you are not going to make huge profits unless you set your sights high. However, high standards can also work against you. So in order to set yourself on the right track, working in your own best self-interest, it is worth considering what is meant by high personal standards.

It's not as obvious as it seems, especially for trading aspirations. Depending on the context, setting extremely high personal standards, and meeting them, is vital. When you have a demanding job where even the best effort may not be quite good enough, it is necessary to comply with extremely high standards. Let’s face it: not every trade will be a winner, despite your best effort.

There are many examples in life of professions where high standards are expected, and where it is difficult to hide: teachers must ensure their students reach a prescribed level of mastery, a heart surgeon must act flawlessly to save a patient's life, the pilot must fly the plane safely to its destination to ensure passenger safety.

But there are times when one may set standards inappropriately, a little too high for a particular context, and this holds true in trading too.

DON’T INSIST ON PERFECTION IN TRADING

Some people are extreme perfectionists. They set standards higher than they can possibly achieve. A pathological example of this is found in some people who experience frequent bouts of depression.

These individuals set high standards they can't meet, and feel like failures when they can't reach them. This can happen to traders who set profit objectives beyond their skill level. They may feel disappointed and helpless because they never meet their expectations. But usually, traders set unrealistically high standards in other ways. A common ailment is “analysis-paralysis”.

Some traders have such high standards that they overthink and overanalyse market data before entering or exiting a trade. This often leads to hesitation and self-

reproach, and tends to undermine one's trading strategy. Timing is everything and if you cannot enter and exit trades at the right time, your trading account will take big hits.

Another common example of overly high standards is illustrated in the belief that one must not miss an important trading opportunity. Some traders think they must find every opportunity to make money in the markets, and they fear they may miss even one trading opportunity.

They find this possibility hard to accept. But seasoned traders will warn you that setting your sights on finding every opportunity will produce undue stress. You'll be much more successful if you remind yourself that you just
can't expect to trade every possible opportunity.

So how does a trader set appropriately high personal standards for trading? One way is to maintain a high level of discipline. For example, outline and follow a very detailed trading plan.

Define specific entry and exit strategies, and use appropriate risk management. Once you outline your plan, it is important to follow it. Don't let yourself stray from your plan. And don't focus your immediate attention on how much profit you are making on each trade. Instead, concentrate on whether or not your profits are "justified" in that they are a direct result of following your trading plan.

Remember, it's better to have a "justified loss," which results from showing proper discipline and following your plan, than an "unjustified win," which happened because you abandoned your plan. Setting high personal standards is a key prerequisite to success, but there is a right way and a wrong way to set these standards. Don't be an extreme perfectionist.

Execute your trading plan effortlessly, and make sure you stick with it. High levels of discipline are one of the best ways to set high standards for your trading, and they will help ensure you trade profitably and consistently.

Your Mind and Your Reality

On my office wall I have a picture. It is a picture of a little fir tree. It is probably not even 10 inches high. Yet.

Behind the little tree there is a fully mature tree. It towers over the little tree. Underneath there is caption which states that “It is the size of one’s will which determines success”. It is a nice picture and I keep it because a dear one gave it to me. But it is not my favourite quote. My favourite quote is one I made up for myself. It is personal to me.

You see, I have NEVER had any problems with motivation or will. My weakness is my mind. It sends me messages from time to time, creating doubt and fear. I am CERTAIN this applies to EVERYONE. At times we are not thinking in our best interest.

So, to counter the doubt and the fear, I have written on a post-it note a few words which apply to me. I don’t mind sharing it, as long as you know that this is what applies to me.

Control Your Mind – Control Your Future.

To control your mind means to discipline it. Your mind can be your best friend, if you train it and manage it daily. It can also be your worst enemy.

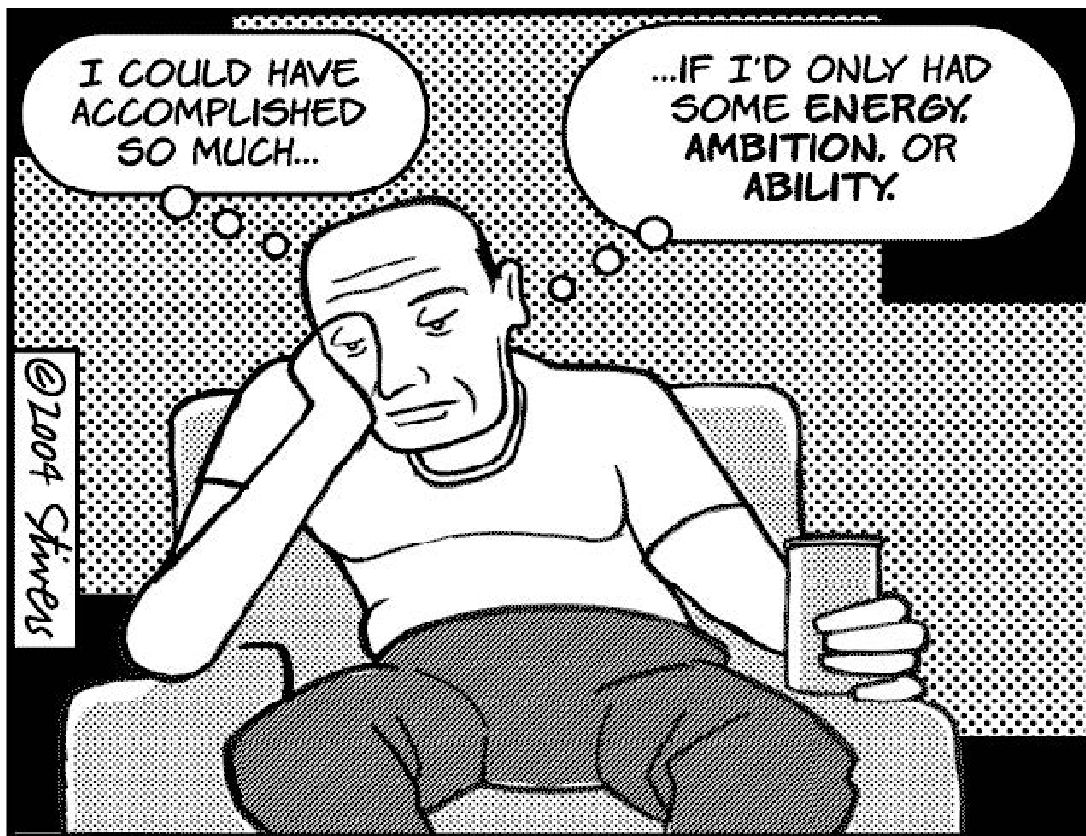
If you are anything like me, you will have your ups and downs in life. The question isn't, can you handle the situation? The question is, can you handle your mind? Can you manage the thoughts and the emotions that are trying to poison your progress? Forget managing the situation. Manage your mind.

To get something you never had, you must do something you never did. If that means that you must spend time working on your mind as you would spend time working on your fitness, then I promise you, it will be time well spent.

Your life is going to follow your thoughts. If you think thoughts of mediocrity you're going to go right down that path of mediocrity. It is inevitable. If you think that your problems are insurmountable and there's just no hope, then you are going down that path of hopelessness.

I don’t care if your dreams are to become a profitable day-trader or some other endeavour that requires that you free yourself from the shackles of mediocrity. There is a price to be paid to be the best that you can be.

You have got to change your thinking before you can change your life. You have to choose to dwell on the positive, choose to dwell on the good because, and trust me on this, the negative is always going to be around us.



You have to choose to dwell on what's right and not what's wrong. You have to choose to dwell on what you have, not on what you don't have. You have got to choose to stay in an attitude of faith and victory, choose to think the right thoughts. You have to choose to BELIEVE.

There's tremendous power in our thoughts. Our thoughts determine our actions. Our thoughts determine our moods. Our thoughts determine our self-image. Our thoughts determine the words that we speak. Our thoughts determine our destiny.

Be clear in your mind in what you intend to achieve. I may not have lived a long life yet, but I am getting there – whether I like it or not. Time keeps ticking. It never stops. When I look back at the life lived so far, and I tally up the wins and the losses, I see clearly where I failed, and why I failed.

I didn’t fail for any other reason than I didn’t work hard enough at it. The guy who beat me worked harder at it. He wanted it more. It is that simple. I thought I had time back then. There is always tomorrow.

Now I live a life which respects time. It wasn’t a single cataclysmic event which changed my attitude. It took time. The mind is like a muscle. You can work on that muscle every now and then, and you are going to get the results according to your effort.

But if you want what you don’t have, then be sure to know that it will require something out of the ordinary. Extraordinary effort leads to extraordinary results.

Whether you are young or old, make sure you keep your perspective. I love the cartoon on the right. You will never see a U-haul after a hearse.

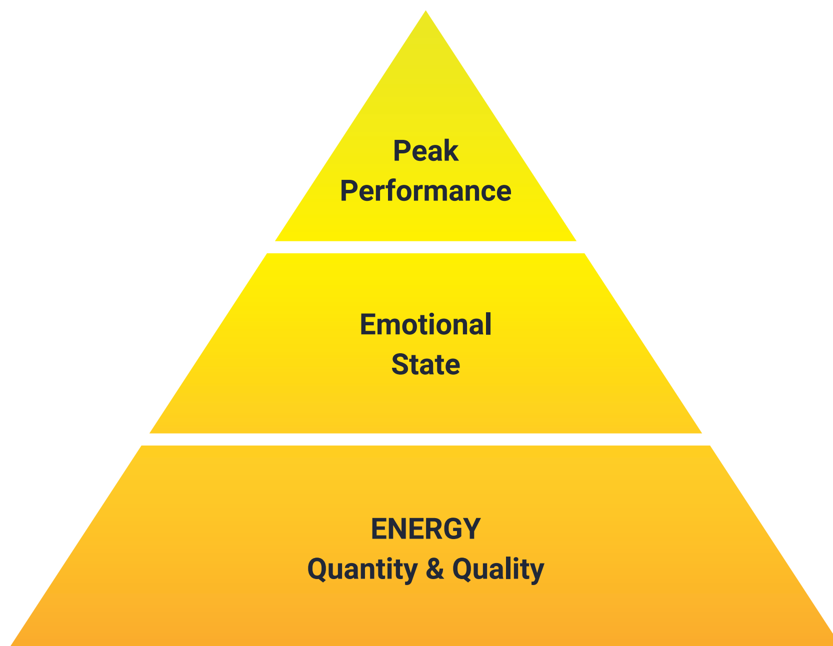
I can't take my money with me. Neither can you. What that means to me is that the money is secondary. The joy of pursuing my dreams and my imagination is what makes me sit in a quiet house long after everyone else has gone to sleep, right now working on this book, and at other times working on becoming a better trader.

If you can find this kind of enthusiasm, you will be a great trader, a force to be reckoned with. I don't need to promise you that it will happen. It is inevitable.

High Energy Life

I have found that I trade the best when I am on holiday. I realised that when I am on holiday, I usually sleep more. I am rested and well fed. I am happy. I am full of energy.

To enable a trader to perform at peak levels consistently there is one vital commodity that is required - energy! When we have high energy levels we are able to focus for longer, deal with stress and setbacks more effectively and achieve more. With low energy our motivation, resilience and focus are all reduced.



Energy is a foundation of emotional states, and is critical to sustaining positive states, and therefore peak performance.

In his work with traders Steve Ward always tries to make people aware of the importance of energy and its role in peak trading performance.

Can you think of times when you have had been experiencing low energy and how that felt? How was your trading? And what about a time when you had high energy? How did you feel? What was the impact on your trading?

Why don’t you take a snapshot of your current energy levels? When you wake up in the mornings how do you feel?

Eager to get going or eager to hit snooze?

Many factors can impact on your energy levels such as levels of stress, sleep quality and quantity, lifestyle factors such as exercise and nutrition, your age and your health etc. Part of sustaining a high level of trading performance is being able to sustain high levels of energy, and this means being able to manage energy levels, and being aware of the demands on energy and how to generate energy.

Deliberate Practice

I once had the pleasure of listening to a speech given by the only female “Market Wizard” (book by Jack Schwager called Market Wizards), Linda B Raschke. She was asked how one could acquire the art of interpreting price action.

Her reply was to watch a 5-min chart for a full week of your favourite instrument, for example Euro Dollar. She recommended making a note of every single major high or low during the day, and writing it down. She claimed by Friday you would have a much better understanding of price action and of the ebb and flow of the markets.

When I get asked what one should do if one is new to trading, I recommend following and trading just one instrument. While “a chart is a chart” every instrument (asset) has its own idiosyncrasies and its own rhythm. By applying your focus on just one instrument you learn to trade it well.

Many traders will only trade one or two products and they know these products inside out. Often new traders will focus on too many instruments at the same time. On paper it makes sense to search for a particular setup across many assets, but in practice it usually means that the trader misses many opportunities because they are not focused on one instrument.

Ericson, a Swedish researcher, conducted a study which looked at the role of deliberate practice in the acquisition of expert performance.

The study looked at whether "great" musicians, chess players, and athletes were genetically predisposed to achieve greatness (physiological) or whether greatness came as a result of external factors such as practice.

The study's findings overwhelmingly showed that there was absolutely no basis to the argument that genetics is the sole determinant in predicting success. In fact, genetics played at best a very minor role in differentiating between those who were "great" in their field versus those who were merely "good". The number one factor in determining whether or not one reached the highest levels in their field was the amount of time these individuals spend on "deliberate practice."

Deliberate practice is defined as the amount of time one spends in attempting to improve their performance. Simply performing the act is not deliberate practice; deliberate attempting to push oneself further is.

The researchers found that those who achieved greatness in their fields spent anywhere from 30 minutes to two hours MORE per day on deliberate practice than those who were only "good" in their field. The authors go on to say that 30 to 120 minutes of extra practice does not seem like much until one begins adding up the difference over a period of time.

For example, they cite numerous studies that show that it is virtually impossible to reach the pinnacle in one's field without at least 10 years of concentrated effort. Therefore, the 30 to 120 minutes each day the future greats spend on improving themselves works out to be many thousands of hours of extra practice over a 10-year period!

Frustration is an emotion which is never far away in the world of trading. We all have days where we just don't get the market. It acts strange or it doesn't do what it normally does. Many traders make the classical mistake of constantly searching for new things to try, rather than to focus on one thing.

Most "expert" traders use just a couple of simple techniques to extract money from the market and nothing else. Some days are better than others, but that is true for any strategy. By knowing an instrument well we also develop a good intuitive sense for when to use one set of rules and when to use another set of rules.

If you are new to trading, then please take these words to heart: Don't insist on perfection in trading. Despite your best intentions and your best effort, sometimes things just don't work out the way you had hoped. It is important you remember that your trading career is NOT judged by the outcome of one single trade.

Recent Trade Examples

I have come to the end of the road with this manual. Before I leave you,
I want to show you two trades I have conducted. Your examples are that you're unhappy with Trade number 1, but are happy with trade number 2.

I hope a couple of practical examples from a professional trader can inspire you to find your own rhythm and path to follow.

Trade Number 1

I was certain today that the Dow Jones sell-off had been overdone. I counted 3 pushes down. I executed a long position by point 1. I patiently waited. At point 2 I got stopped out. The loss wasn't big. I lost 25 points.

What hurts is that I missed the move higher. As it stands right now, I not only lost 25 points. I also lost the opportunity to make 100 points. That is how much higher the Dow is right now.

I can find many things I did wrong here. I am sure you can too. It is not so much the trade I want to focus on by telling you this. It is the process. I make mistakes. You will most likely make mistakes too.

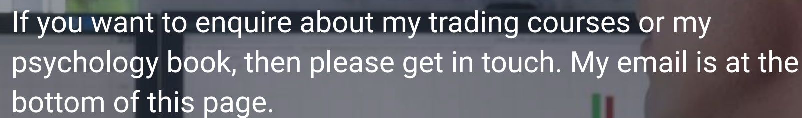
Mistakes are inevitable. It is what you do with the mistakes that matters. Mistakes are the most important lessons you can receive. How do you think I got to where I am? I observed tens of thousands of traders make millions of mistakes. I watched them for nearly a decade.

When I do my review of my trading day or trading week, I will make notes. This trade will come under the section of "good call, a bit impatient, a bit unlucky and maybe a too tight stop loss". It was just one trade of many.

Trade Number 2

Trade number 2 was perfectly executed, but what I am more pleased with is the patience I exhibited. I sold short the Dow at point 1. I then had to wait for 5 hours before I took profits. I was a little unlucky with my exit. The market went higher for a little while and then fell 60 points more.

Still I got 80 points and it was in double trading size. When I am in a winning trade, I add to my winning position. It takes time to learn this skill, but it is something you should work towards. It makes your profits so much bigger – when you win.



If you want to enquire about my trading courses or my psychology book, then please get in touch. My email is at the bottom of this page.

I want to thank you for reading my book. You have gotten off to a great start. Just remember that success is not what we do every now and then. Success is what we do every single day. Remember that, when times are tough.
Stay in touch. I may not know you by name and face yet, but I sure would like to hear how you progress.

Take care of yourself.

Tom Hougaard

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TraderTom