

9 Effective Forex

Trading Strategies

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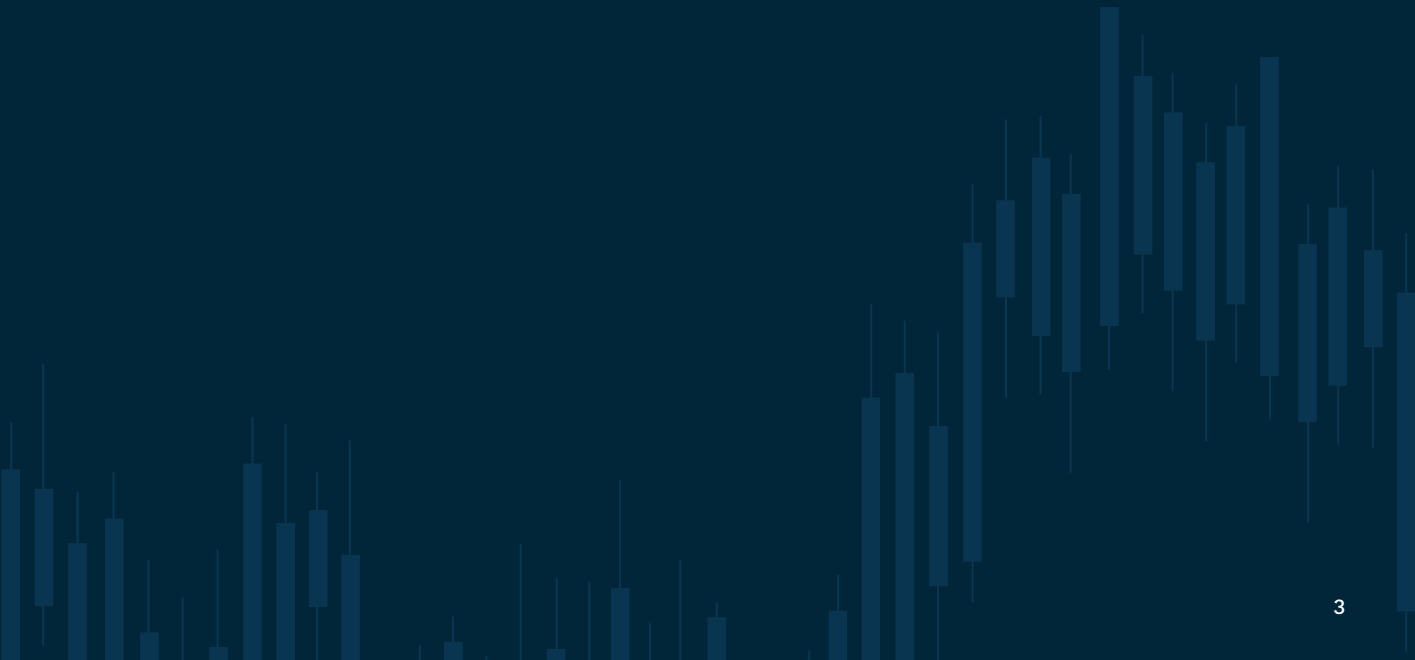
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Introduction

Why Having an Effective Trading Strategy is Important

Participating in forex trading presents an opportunity to take part in a global marketplace with significant potential. Due to its popularity with day traders, forex has even gained a reputation for turning quick profits. In truth, it's just as complex and competitive as any other world marketplace. To not only succeed but also succeed consistently, you need to understand the market and hone your trading strategy.

There are a variety of ways to trade forex, so it's important to choose an approach that is well-suited to your experience level, your goals, and the context in question. Below, we've outlined the basics, benefits, and drawbacks of nine popular forex trading strategies to help you find your ideal fit.



9 Effective Forex Trading Strategies

1. Trend Trading

Trend trading is one of the most reliable and simple forex trading strategies. As the name suggests, this type of strategy involves trading in the direction of the current price trend. In order to do so effectively, traders must first identify the overarching trend direction, duration, and strength. All of these factors will tell them how strong the current trend is and when the market may be primed for reversal. In a trend trading strategy, the trader doesn't need to know the exact direction or timing of the reversal; they simply need to know when to exit their current position to lock in profits and limit losses.

Even when a market is trending, there are bound to be small price fluctuations that go against the prevailing trend direction. For this reason, trend trading favors a long-term approach known as position trading. When investing in the direction of a strong trend, a trader should be prepared to withstand small losses with the knowledge that their profits will ultimately surpass losses as long as the overarching trend is sustained. For obvious reasons, trend traders favor trending markets or those that swing between overbought and oversold thresholds with relative predictability.

Tools Used

To determine the direction and strength of the current trend, traders often rely on simple moving averages and exponential moving averages such as the moving average convergence/divergence (MACD) and average directional index (ADX). All moving averages are lagging indicators that use past price movement to lend context to current market conditions. In addition to providing insight into the current trend direction and strength, moving averages can also be used to gauge support and resistance levels.

When price fails to reach anticipated support and resistance levels, or when a long-term moving average crosses over a short-term moving average, it's thought to signal a reversal. Rather than anticipating the direction of the reversal and entering into a new position, trend traders will use these signals to exit their current position. Once the new trend has manifested, the trader will once again trade in the direction of the current trend.

Price momentum will often change before a price change occurs, so momentum indicators, such as the [stochastic oscillator](#) and [relative strength index \(RSI\)](#), can also be used to help identify exit points. These indicators help traders identify when price is approaching overbought or oversold levels and provide insight into when a change will occur.

Pros and Cons

Trend trading doesn't require traders to know what will happen next—only to understand what is happening right now. As such, it tends to be a more reliable and consistent strategy. To trade effectively, however, it's important to confirm the direction and strength of a new trend before entering into a position. Although you may not be the first one to enter the trade, being patient will ultimately shield you from unnecessary risk.



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2. Position Trading

Position trading is a strategy in which traders hold their position over an extended time period—anywhere from a couple of weeks to a couple of years. As a long-term trading strategy, this approach requires traders to take a macro view of the market and sustain smaller market fluctuations that counter their position.

Tools Used

Position traders typically use a trend-following strategy. They rely on analytical data (typically slow moving averages) to identify trending markets and determine ideal entry and exit points therein. They also conduct a fundamental analysis to identify micro- and macroeconomic conditions that may influence the market and value of the asset in question.

Pros and Cons

The success or failure of position trading hinges on the trader's understanding of the market in question and their ability to manage risk. To lock in profits at regular intervals (and thereby mitigate potential losses), some position traders choose to use a [target trading strategy](#).

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3. Range Trading

Range trading is based on the concept of support and resistance.

On a price action graph, support and resistance levels can be identified as the highest and lowest point that price reaches before reversing in the opposite direction. Together, these support and resistance levels create a bracketed trading range.

In a trending market, price will continue to break previous resistance levels (forming higher highs in an uptrend, or lower lows in a downtrend), creating a stair-like support and resistance pattern. In a ranging market, however, price moves in a sideways pattern and remains bracketed between established support and resistance thresholds.

When price reaches the overbought (resistance) level, traders anticipate a reversal in the opposite direction and sell. Similarly, when price approaches the oversold (support) level, it's considered a buy signal. Finally, if price breaks through this established range, it may be a sign that a new trend is about to take shape. Range traders are less interested in anticipating breakouts (which typically occur in trending markets) and more interested in markets that oscillate between support and resistance levels without trending in one direction for an extended period.

Tools Used

Range traders use support and resistance levels to determine when to enter and exit trades and what positions to take. To do so, they'll often use banded momentum indicators such as the [stochastic oscillator](#) and [RSI](#) to [identify overbought and oversold conditions](#).

Pros and Cons

Trading the dips and surges of ranging markets can be a consistent and rewarding strategy. Because traders are looking to capitalize on the current trend rather than predicting it, there is also less inherent risk. That said, timing is exceptionally important. Oftentimes, an asset will remain overbought or oversold for an extended period before reversing to the opposite side. To shoulder less risk, traders should wait to enter into a new position until the price reversal can be confirmed.

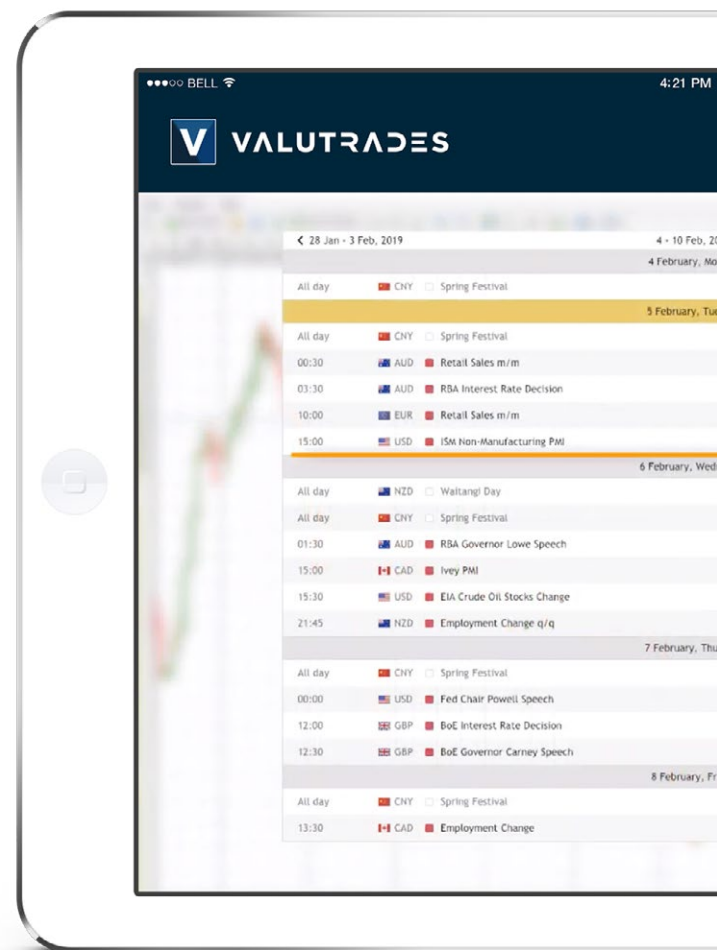
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4. News Trading

As a multinational marketplace, forex is influenced by global economic events. Understanding economic news events and their potential impact on currency pairs helps traders anticipate short-term (intraday or multiday) market movements, or breakouts.

Major (scheduled) news events include:

- Interest rate decisions
- Economic reports on national unemployment rates, inflation rates, gross domestic product (GDP), nonfarm payroll, and national trade balances
- Consumer and business confidence surveys



No one event is inherently more important than another. Instead of focusing on one variable, traders examine the relationship between them in tandem with current market conditions.

It's worth noting that forex, like any other global trade market, can be influenced by unscheduled, singular events such as natural disasters or political changes. These unexpected events, however, aren't reliable indicators to use in a news trading strategy.

Tools Used

News traders rely on [economic calendars](#) and indexes such as the [consumer confidence index \(CCI\)](#) to anticipate when a change will occur and in what direction price will move. With this in mind, they'll look for price action to consolidate, which typically signals that a breakout is imminent.

Pros and Cons

Trading small breakouts that occur over a short time period has high profit potential. Of course, it also carries greater risk. When price consolidates, volatility increases. If you enter a trade too soon, you risk being forced out of the trade (and experiencing a loss) if the breakout doesn't occur immediately or isn't sustained. Getting in early is part of the game, but getting in too early can be reckless. More experienced traders will often wait for confirmation of the breakout before acting on a hunch.

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5. Swing Trading

Swing trading is a trend-following strategy that aims to capitalize on short-term surges in price momentum. These smaller surges and dips may go against the prevailing trend direction, and thus require a more limited market outlook (examining 15-minute, hourly, daily, and weekly price charts as opposed to analyzing overall market trends).

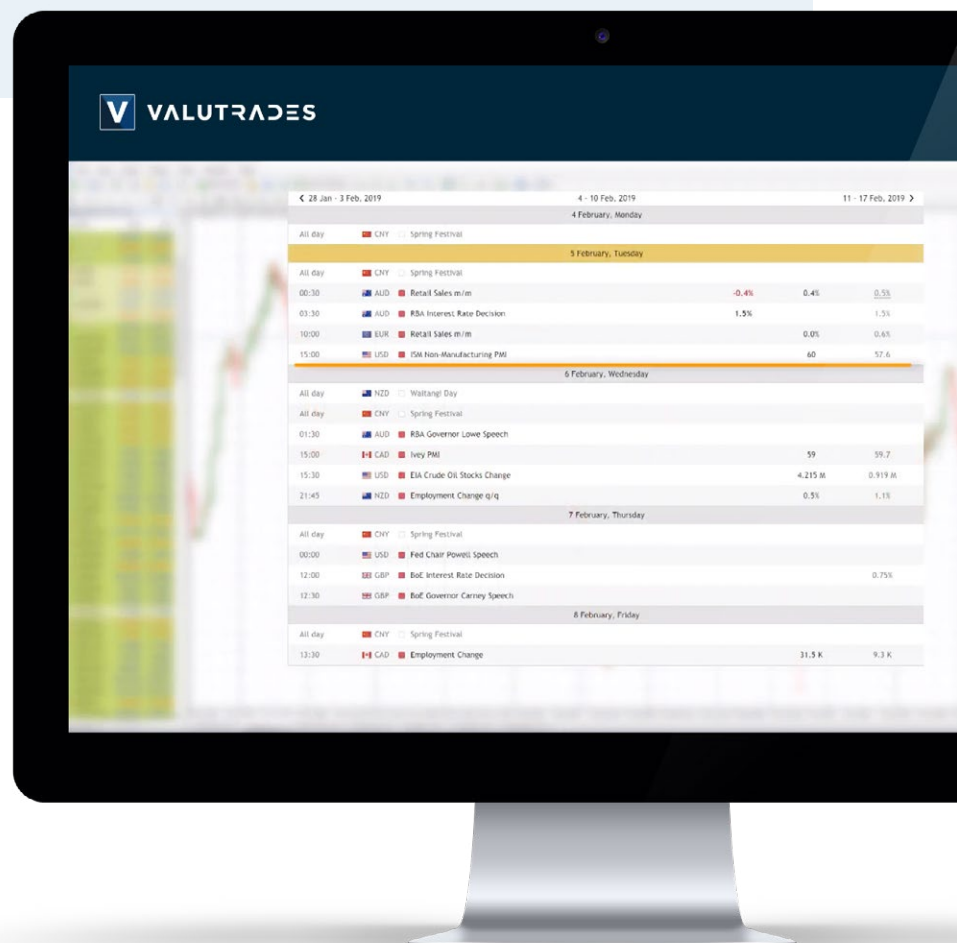
Because swing trading demands quick action and close market oversight, it's typically favored by day traders who are available to monitor changes in price momentum minute to minute. Despite being classified as a short-term trading strategy, this approach demands that traders hold their position overnight (unlike day trading) and may keep them in a trade for a few weeks at a time.

Tools Used

This strategy relies on both technical and fundamental forms of analysis. On the technical side, traders use momentum indicators and moving averages to analyze price movement over multiple days. From a fundamental standpoint, swing traders often use micro- and macroeconomic indicators to help determine the value of an asset.

Pros and Cons

Swing trading anticipates rapid price movement over a wide price range—two factors that suggest high profit potential. But greater potential profits naturally come with greater risk. Price momentum can change rapidly and without warning, so swing traders must be prepared to react immediately when momentum changes. To mitigate the risks of holding their position overnight, swing traders will often limit the size of their position. Although a smaller position size curbs their profit margin, it ultimately protects them from suffering substantial losses.



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6. Scalping

Scalping is an intraday trading strategy in which traders buy and sell currency with the goal of shaving small profits from each trade. In forex, scalping strategies are typically based on an ongoing analysis of price movement and a knowledge of the spread.

When a scalper buys a currency at the current ask price, they do so under the assumption that the price will rise enough to cover the spread and allow them to turn a small profit. In order for this strategy to be effective, however, they must wait for the bid price to rise above the initial ask price—and flip the currency before price fluctuates again.

Tools Used

Because scalpers are so reliant on the spread, it's important for them to have a good relationship with market makers who determine bid and ask prices for a given currency. Oftentimes, scalpers will hold professional trading accounts with brokers to access lower spreads. Their success also hinges on their use of a low-latency platform that is capable of executing multiple trades at a time with speed and precision.

To determine what position to take, scalpers use technical analysis and [pattern recognition software](#) to confirm trend direction and momentum, locate breakouts and divergences, and identify buy and sell signals in their target period. Like other day traders, they may also track economic events that are likely to impact short-term price movement.



Pros and Cons

If you're making a handful of trades per day, earning a few pips per trade can quickly add up to a substantial sum. But handling such a large volume of trades also comes with its own challenges. For any trader, managing more than one trade adds complexity to the process. In such a volatile, fast-moving market, the stakes are amplified. Succeeding as a day scalper demands unwavering concentration, steady nerves, and impeccable timing. If a trader hesitates to buy or sell, they can miss their (already limited) profit window and dwindle their resources.

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7. Day Trading

Day traders earn their title by focusing solely on intraday price movements and capitalizing on the volatility that occurs therein. These small market fluctuations are related to current supply and demand levels rather than fundamental market conditions.

Tools Used

Day traders use a variety of short-term trading strategies. Some trade the news (using economic calendars and indexes) and change their focus based on global economic events. Others may be scalpers who trade the same asset day over day and analyze intraday price movements using technical analysis (such as fast and slow moving averages). If they understand the general direction in which the market is trending on a given day, they can follow the trend and exit all their positions before the market closes.





Pros and Cons

When you analyze price movements over such a short time frame, more false signals are bound to appear due to the small sample size and limited context. Spotting a false signal and confirming the validity of your analysis can be tricky—especially when time is of the essence. For these reasons, day trading typically requires more experience and familiarity with the market. To be successful, day traders must also practice effective money management and be ready to respond swiftly if price moves against them.

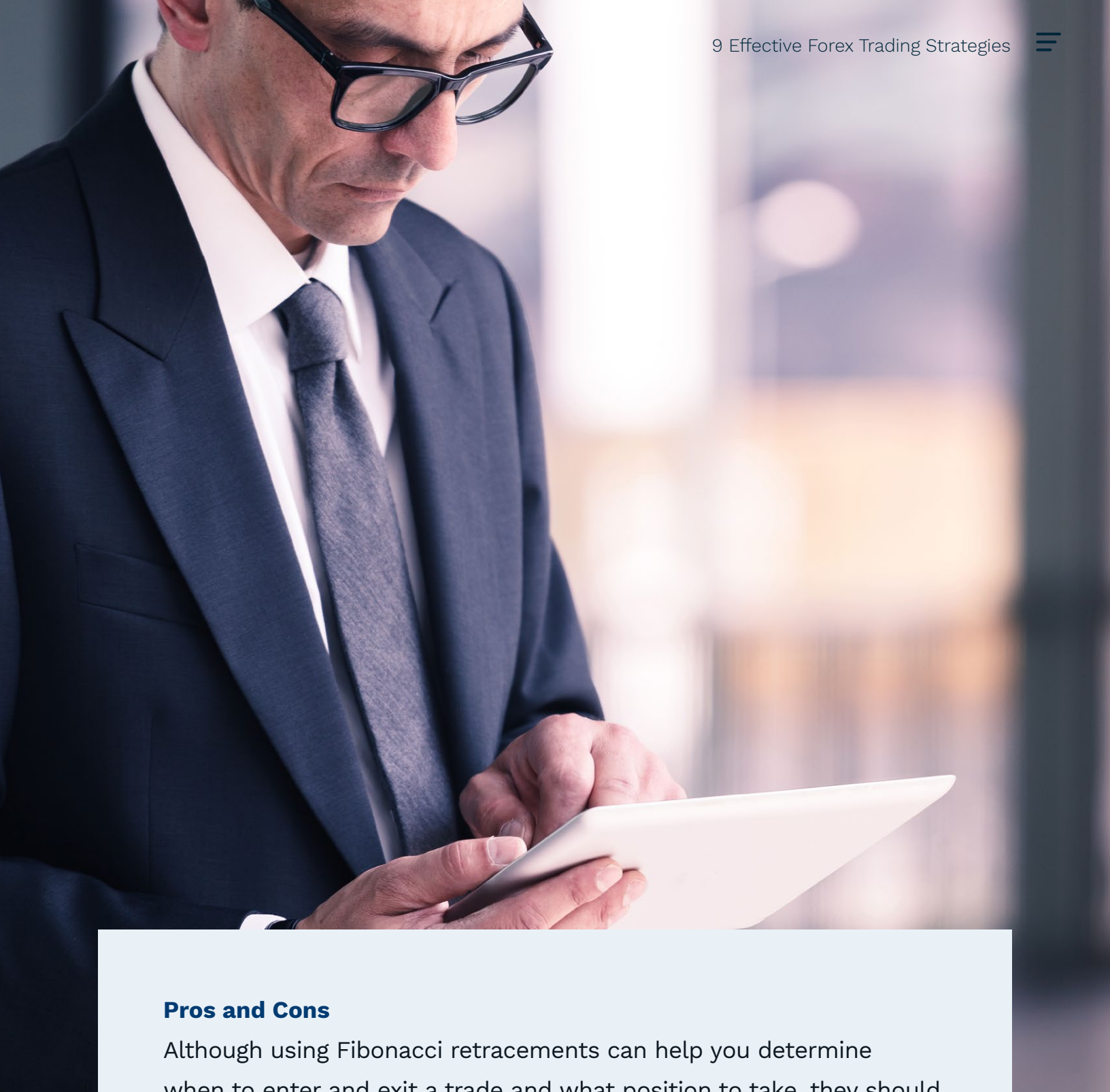
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8. Retracement Trading

A retracement refers to an instance when price reverses direction for a short time before continuing on in the direction of the dominant trend. Traders use technical analysis to identify potential retracements and distinguish them from reversals (instances when price changes direction but does not correct, forming a new trend). If the trader expects a temporary dip or surge in price to be a retracement, they may decide to hold their current position under the assumption that the prevailing trend will eventually continue. On the other hand, if they expect that the market fluctuation is an early sign of a reversal, they may choose to exit their current position and enter into a new one in accordance with the trend reversal.

Tools Used

To distinguish between retracements and reversals, many traders will use a form of technical analysis called Fibonacci retracements (based on the Fibonacci ratio). This principle dictates that a retracement will end once price reaches a maximum Fibonacci ratio of 61.8 percent. For this reason, many traders use this ratio of 61.8 percent to place profit-taking or stop-loss orders. Retracement traders who aim to profit on the break in the trend will also use the Fibonacci ratios of 38.2 percent and 50.0 percent as entry and/or profit-taking points.



Pros and Cons

Although using Fibonacci retracements can help you determine when to enter and exit a trade and what position to take, they should never be used in isolation. The most successful retracement traders confirm breakout and reversal signals using other technical indicators such as [moving averages](#), trend lines, [momentum oscillators](#), and [price candlestick patterns](#).

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9. Grid Trading

Grid trading is a breakout trading technique that attempts to capitalize on a new trend as it takes shape. Unlike other breakout trading strategies, however, grid trading eliminates the need to know what direction the trend will take.

In a grid trading strategy, traders create a web of stop orders above and below the current price. This “grid” of orders essentially ensures that, no matter what direction price moves, a corresponding order will be triggered.

Tools Used

Before placing buy and sell stop orders, traders will first identify support and resistance levels and [use this bracketed range as a guide for setting up orders at standard intervals](#). Support and resistance levels can be calculated using technical analysis or estimated by drawing trend lines onto a price graph to connect price peaks (resistance level) and valleys (support level). Because grid trading doesn't require insight into the direction of the breakout, orders can be placed ahead of time. Typically, grid traders will lay out their strategy after the market has closed and preemptively create orders for the following day.



Pros and Cons

The most obvious advantage of this strategy is that you don't need to know what direction the market will take—and you don't need to remain glued to your computer in order to profit.

Even though grid trading doesn't require immediate action, however, it still demands careful oversight. If your profit-taking values aren't immediately triggered after a position has been opened (i.e., the trend reverses or stagnates before continuing in the same direction), it can leave you vulnerable to losses. On top of that risk, traders must also manage the inherent costs of keeping multiple positions open. Once the trend manifests, it's important to close out pending orders in the opposite direction so as not to compile interest on positions that aren't profitable.

The Importance of Maintaining a Consistent Strategy

Each Strategy Detailed Above Has Unique Benefits and Pitfalls

As you choose which strategy to pursue, it's important to take experience and circumstance into account. If you're just starting out in forex, day-trading strategies that demand quick action and require you to manage multiple trades at a time may not be ideal learning environments. Instead, opt for a more straightforward, long-term strategy (such as trend trading) that will give you the time you need to learn technical analysis, practice smart money management, and reflect on your performance. Not every strategy is ideal for every trader.

In a similar vein, not every strategy is well-suited to every market. Some strategies work better in trending markets, while others are more effective in ranging or volatile conditions. Take some time to understand the market you're dealing with and determine what strategies are best suited to those conditions.

Finally, remember that all traders—no matter how knowledgeable—experience loss. When you lose money on a trade, it doesn't necessarily mean that you did something wrong or that your approach was flawed. Although technical analysis can help you manage risk and reward and inform your trading decisions, no analysis can predict the future with 100 percent certainty. Rather than scrapping your strategy each time the market moves against you, practice smart money management and be consistent.

The more time you take to learn and practice a certain strategy, the more adept you'll become at its execution. Being methodical in your approach will also give you a better understanding of what's working and what's not. If you change your strategy too often or add unnecessary complexity, it will become more difficult to pinpoint what factors are influencing your performance. When in doubt, stick to the basics and trade with the trend to keep the odds on your side.



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