FOCUS FOREX

24/7 Trading in Foreign Currency
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CHAPTER 1

GETTING STARTED IN FOREX
Chapter One: Getting Started In FOREX

“Early to bed and early to rise makes a man healthy, wealthy, and wise.” Benjamin Franklin

Congratulations on your decision to educate and prepare yourself to participate in what is perhaps the most exciting and cutting-edge financial market on earth. The foreign exchange market, commonly referred to as FOREX, deals exclusively with the constant movement of the world’s money supplies. Money, as you know, is the life blood of the world’s economies. It does not require an advanced degree in economics to understand that at the very heart of international commerce is the basic evaluation of the world’s various currencies and what determine a fair and equitable rate of exchange. Learning to keep your finger on the pulse of the global money flow can help you to diagnose and identify market conditions that present money-making opportunities.
The Focus FOREX program is designed to not only help you learn the skills you need to successfully trade FOREX (FX), but to also help you develop a daily routine and disciplined regimen that will aid you in your pursuits. Focus FX and MetaTrader Software, are just what the doctor ordered to help you grow “healthy, wealthy, and wise.”

**Focus FX Key To Success** will help alert you to key concepts, test and apply your newly acquired knowledge, as well as encourage you to put into practice what you are learning.

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**LEARN AS YOU GROW**

The “Focus FX Key to Success” above, will help you throughout your study of this manual. **Key Concepts** are vital pieces of the puzzle that you absolutely must know. As you progress through the course make sure you **Test Your Knowledge** to help you ensure both comprehension and retention. Make sure you internalize this valuable information by applying what you learn inside the MetaTrader virtual platform whenever you see the **Practical Application** Icon. The **Playbook & Notes** icon will appear whenever there is a specific strategy that should be practiced until mastered. Then come game day in live-market action you can trade these high-probability strategies with confidence.

Unfortunately, most of us do not learn through osmosis, so it is important that you remember to apply your own personal study methods, and make sure to utilize your skills and talents in addition to the tools provided here. The information, strategies, and techniques developed for the Focus FX program, are designed to be replicated by you, the individual trader and investor. The secret to successful replication of these tried and true techniques is for you to personalize and fine tune the information contained here to match your own unique personality. A feverish work ethic and disciplined application of your individually tailored game plan can help you attain your goals.
The fast paced and exciting world of FOREX can provide unlimited wealth-building opportunities, and your enthusiasm and dedication are vitally important ingredients to remember. Enjoy the learning process, and don’t forget that trading should be fun. Hard work and lots of practice can help you achieve that which you dream, and when it comes to FOREX the sky is truly the limit.

GOAL SETTING AND GAME PLANNING

“A goal without a plan is just a wish.” Antoine de Saint-Exupery

It is probably safe to assume that if you own a T.V. you’ve seen a few reporters perform post-game interviews with the MVP of the “big game” and almost invariably, the exhausted and elated athlete provides a cliché and pre-packaged answer that explains how it was that they once again claimed victory. These types of interviews always tend to resonate the same tone. A hard week of practice, some team goals, and a well-prepared – well-executed game plan. In addition to a good game plan and solid execution, the appropriate game-time adjustments helped them conquer their worthy opponent. Success in the real world is based on the same elements that exist in the sports world. This would help explain why there are so many team and sports analogies used in the business world. Proper planning, preparation, execution, and game-time adjustments are what successful players in both athletics and business have in common. Lady luck tends to smile on those who plan and prepare.

Taking control of your financial future requires setting goals. Careful planning and plotting can help you chart a course that leads to your desired destination. All journeys begin with a single step. Great journeys also begin with a destination in mind. This is why we set goals. When it comes to financial independence there are two classifications of goals that need to be understood and differentiated. There are primary goals used for motivation, and secondary goals to help you reach your primary goals.
GOALS EXERCISE

- Primary Goals
- Secondary or Financial Goals

Your primary goals should be based on the dreams and aspirations of your heart. Primary goals are used to motivate you to get up in the morning, or burn the midnight oil… Once sufficiently motivated, a pragmatic approach to goal setting will quickly lead you to the fact that there is usually a specific or measurable amount of money required to help you live that dream. For most of us, money is only a means to an end. Our true currency is usually something deeply ingrained in our personalities. Take a moment to think about what your true currency is, and then write it down in the space provided below. Some examples have been provided to help you think this through clearly.

Example

Free time is my currency. I would like more free time to spend with my family and friends, and to be able to enjoy life, and pursue my passions and hobbies.

I would enjoy life more if I felt financial security… I’m tired of the stress and uncertainty I feel when I think about the future.

I’ve always wanted a sailboat…

What is your currency?

My Currency

_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
_____________________________________________________________
Now that you’ve established what is important to you, take some time to identify and set some **Primary Goals** to help you in your own pursuit of happiness.

**Primary Goals**

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It does not matter how lofty the goal, what matters is developing a realistic game plan with attainable benchmarks that can help one measure progress. Take some time to sit down and do some arithmetic. The mathematical skills you need to develop a game plan to grow wealth, you learned way back in elementary school. All you need to do is estimate what it will cost to reach your goal. Then you need to determine and specify a time frame in which you would like to obtain your goal. Then break it down into incremental and obtainable short-term goals that will lead you to reach your longer-term primary goals. The formula is simple really. How do you eat an elephant? “One bite at a time…”

**Secondary Financial Goals**

- Long-Term Goals ________________________________________________
  ______________________________________________________________
  ______________________________________________________________
  ______________________________________________________________
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  ______________________________________________________________
  ______________________________________________________________
  ______________________________________________________________
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• Short-Term Goals ______________________________________
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Do The Math

Here are some basic numbers to help you think through the process. There is an average of FIVE TRADING DAYS EACH WEEK and 50 WEEKS OF TRADING IN A YEAR. That gives us approximately 250-TRADING DAYS ANNUALLY. It is important to remember that FOREX trades around the clock 24-HOURS IN A TRADING DAY.

EXAMPLE: Trading a single full-size lot worth $10 per PIP would yield $50k annually if a trader was able to lock in 20 PIPS each trading day.
**THE DISCIPLINED TRADER**

*Show me a successful trader, and I’ll show you a disciplined trader.* Regardless of the type of trader, or the tradable instrument being used, a disciplined approach is critical. In a fast-paced environment such as the foreign exchange market, emotions can run rampant. The basic human emotions that conflict traders are fear and greed. Without trading rules, and a concise-game plan, traders can become their own worst enemies. Basing decisions on impulse, and market-induced manic depressive episodes, rather than a pre-planned and well-thought out plan, can be a recipe for disaster. Trading on emotion, rather than rules, can not only have financial ramifications, it can damage the fragile psyche of a new or inexperienced trader. When a trader falls into the trap of basing decisions on knee-jerk reactions, confidence can be lost, and Analysis Paralysis can rear its ugly head.

Analysis Paralysis is a syndrome that is common among traders. Symptoms of Analysis Paralysis include: anxiety, fear, uncertainly, confusion, and indecision. This condition can be serious, but, *fortunately for us, this disorder is both preventable and curable.*

The old adage “an ounce of prevention is worth a pound of cure,” specifically holds true when it comes to trading. It is easier to start your trading career with structure and discipline than it is to correct bad habits, but even if bad habits have been formed, correcting them is a simple process. So whether you are a neophyte, or a seasoned trader simply guilty of shooting from the hip, you have the opportunity to decide, right here and now that you are going to be a disciplined trader.

The decision to be a disciplined trader, and the subsequent effort to develop and maintain a healthy-trading regiment, is without a doubt the most important decision that a trader will ever make. Discipline is more important than technique or skill. Too often, traders only focus on learning new techniques, or get caught up in trying to find the Holy Grail, rather than practicing and mastering simple techniques that they have already learned. The fact of the matter is that even the simplest of techniques executed with discipline and consistency can be every bit as valuable and effective as the most sophisticated tactics. "Keeping it simple" is advice that many traders embrace, and is in fact, why many traders are drawn toward the FOREX market, because it lets them keep it simple.
Let’s take a moment to discuss Tradable Instruments. Stock, Options, Futures, and FOREX are the most commonly used vehicles for trading... and let’s face it, trading baseball cards, or comic books is not a viable path to wealth. Trading, like many professions, requires areas of expertise and specialization. Practitioners of medicine and law will specialize in one area or discipline, and by doing so can offer their patrons better service and care. At this stage in your trading career, you may not be certain which facet of the market you should specialize in, or quite the opposite may be true. You may be taking this course because you are very clear on the path you wish to take. Keep in mind, that it is certainly possible for you to become a “jack of all trades” and many traders do participate in all of the various markets, and enjoy the variety of instruments that the markets offer; but typically traders tend to stick with the instruments they know and like the best. What instruments you choose to trade and the area of the market you decide to specialize in are entirely up to you. There is no right answer, or best choice, because all of the tradable instruments have express advantages. Thankfully, the majority of the knowledge, skills, and techniques you’ve invested in learning can be universally applied with some fine tuning and minor adjustment.

At the end of the day, a disciplined trader knows the instruments they choose to trade inside and out. Disciplined traders do not take unknown or indefinable risks. They don’t trade instruments that they don’t clearly understand. They practice with instruments incessantly to gain not just proficiency, but mastery. A disciplined trader is always working at perfecting his game in the same way that a professional golfer is always looking for ways to take strokes off of their game. The habitual pursuit of knowledge is a trait that successful investors and traders share alike, and the acknowledgment that there is always something more to learn is always a given. Rich Dad Education offers complete training for all of the market’s tradable instruments and through access to talented trainers, mentors, and coaches, a wealth of information is within your grasp. You can become fluent in all of the market’s various facets, and develop yourself into a well-rounded trader, as well as specialize in your favorite discipline. Let’s take a moment to define and familiarize ourselves with each of the tradable instruments, and of course the FOREX market specifically.

Traders typically start out in the stock market because of the familiarity with the market. The benefits of stocks are many, but a few simple drawbacks become apparent to traders. There are over 65,000 publicly traded companies, and as many as 15,000 heavily traded stocks. This can pose a problem to traders based on the sheer quantity from which to choose. Stock trading can be capital intensive
due to the high cost per share of many quality stocks. Solid market scanning and filtering software such as MachTrader can help a trader cut to the chase, and more effectively select stocks.

**OPTIONS**, because of the leverage they offer and the greatly reduced amount of capital required to trade them, attract traders like moths to a street lamp. There are approximately 3,500 optionable stocks, and the reduced number of tradable instruments can simplify searching and scanning for traders. The percent return on options trading is very appealing to traders, but options trading is learning intensive, and many strategies are difficult for traders to bend their minds around. Options have some inherent problems that traders need to be aware of. Options have a funny habit of expiring, which means you not only have to be correct about the direction of a stock’s movement, you need to be correct about the amount of time it takes to move. Another frequently overlooked personality quirk options have, is that even though they require less capital to trade, they actually are a more expensive instrument to trade when it comes to trading costs. For example, the bid Ask spread on a stock may be only 2 to 3 pennies, but the bid Ask spread on an option can be in excess of 20 or 30 cents. That added cost needs to be accounted for by additional movement in the underlying stocks price to get to the breakeven point, where the initial cost of trading is covered (i.e. the cost of the bid Ask spread, and brokers’ commissions). The benefits of options trading are many, but traders in search of better and more efficient ways to make money, often move on to futures.

**FUTURES** are an incredibly popular tradable instrument among seasoned traders because of the leverage they offer and the lower cost of trading associated with them. Futures can be day traded without the $25,000 margin requirement that stock exchange rules require. There are various futures vehicles, but the number of instruments is much easier to choose from because there are really only a few dozen futures contracts that are popular among traders. With a modest trading account, a skilled trader can make a decent living. Trading futures is not rocket science, but it does require an advanced skill set, and a complete understanding of the life cycle of trends, and a solid repertoire of trade identification. Once again, discipline is the key to successful futures trading. Trading futures is a fantastic way for a trader, with limited resources, to use the leverage that futures trading offers. The one consideration to make, when deciding whether or not to trade futures, is if you will have the time and attention to pay to the futures market during regular business hours, when futures trading is heaviest. For those of you who have no intentions of “quitting your day job,” futures trading can be a little more challenging if your focus
is turned elsewhere. **FOREX on the other hand, trades round the clock 24 hours a day,** and regardless of your busy schedule, there are opportune times for trading that anybody can take advantage of.

**The FOREX Market is wildly growing in popularity.** There are many reasons why the FOREX market is bustling. Since the advent of high-speed internet access, the growth of online trading has been absolutely amazing. Average people can now participate in trading and investment opportunities that, prior to this explosion of technology, were unavailable. Access to data and information is practically unfettered, and anybody with a personal computer and some gumption can make a go of it. The FOREX market is like no other market in the world. FOREX is hands down the largest and most liquid market in the world. Trillions of dollars are transacted each day. Even though this market is massive, the number of heavily traded pairs is very few. There are only about 22 pairs of currency, or currency crosses. When we trade FOREX, we are literally exchanging one currency for another. Therefore, FOREX involves the “pairing” of currencies that are commonly called “crosses” of these 22 crosses or pairs; there are only six major currencies that make up the majority, or highest percentage of trading activities. You are probably already familiar with the major currencies because they are naturally from the largest economic powers. We will introduce you to the different pairs in the next section, but for now the important thing to note is the fact that the small number of currency crosses to choose from is an incredible feature of the FOREX market. The benefit of fewer things to trade is easy to understand... You have less to worry about, and it is easier to keep tabs on the market. Figure 1.1 illustrates one of the

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**FIGURE 1.1** There are over 65,000 publicly-traded companies, and as many as 15,000 stocks traded on the major exchanges. Optionable stocks numbering approximately 3,500 is a much more manageable number of stocks to scan and filter for trades. The number of popular futures contracts traded drops off sharply and traders can make a good living by specializing in trading a more cost-effective and leveraged futures contract... FOREX boils trading down to its simplest form with just six major pairs that allow traders to customize leverage and zero commissions. FX keeps it simple and easy to discipline oneself.
major factors in the general migration of traders into FOREX; the overall simplicity of the market, and limited number of charts to track and watch is very appealing to traders. You can spend less time searching, and more time trading. The amount of capital required to trade FOREX is dramatically less, and perhaps the most appealing aspect of trading FOREX is... NO COMMISSIONS!

**DISCIPLINED RISK MANAGEMENT**

Regardless of the tradable instrument you choose, your trading plan needs to make sense… dollars and sense. Proper and disciplined money management is another key ingredient to a profitable trading plan. This might seem like good old fashioned common sense, but good money/risk management is frequently neglected by traders until it becomes an obvious problem. No doubt by now, you’ve heard that trading is a “risky business” and unfortunately too many people equate trading to gambling. The serious trader finds this line of thinking not only flawed, but offensive. The business of trading is not that different than any other business out there that takes calculated risks. All types of businesses in all kinds of industries take calculated risks every day, yet for some reason they don’t bear the same stigma that trading regrettably has for some people. The word risk alone has such a negative connotation it is no wonder that people are afraid of it. Fear of risk is the problem, and at the root of this problem is the fear of the unknown. People are typically not frightened by the familiar, but the unknown can terrify us.
Franklin D Roosevelt’s inaugural speech is most notably remembered for a timeless statement “the only thing we have to fear is fear itself.” The wisdom of these words can be directly applied to your own trading. Risk is not something to worry about; Risk is to be understood, defined, controlled, and embraced. **Because without risk, there can be no reward.** Calculated risks are an integral part of a trading business, and a trader in the proper frame of mind perceives risk as nothing more than the cost of doing business. The business of trading is based entirely on taking calculated risks. The secret is to only take on risk that makes good business sense, risk that is clearly outweighed by the potential for reward. It is important to note that there is no one magical formula for reward to risk ratios, because there can be so many intelligent variables. That being said, your job as a trader, is to first determine what amount of risk is appropriate for you. The next step is for you to establish a trading rule that limits the amount of risk that you expose yourself to on each and every trade. By pre-determining your risk tolerance, and strictly adhering to your trading rules, the emotion and impulse will be effectively curtailed.

There is a popular saying among traders: “There are bold traders, and old traders, but there are no old, bold traders.” Fortunes may be won and lost, but sustainable wealth is generated through consistency. Taking large risks may yield large rewards, but it is of course a double-edged sword that cuts both ways. A disciplined trader keeps position sizes and risk exposure consistent and palatable. **FOREX can be a highly-leveraged instrument, and it is very easy to over-expose yourself to risk.** Many FOREX brokers offer up to 200 to 1 leverage, and that kind of leverage is extremely powerful. The problem is that 200 to 1 leverage gives you enough rope to hang yourself. The discussion of risk in this section is not intended to scare or intimidate you, but inform you of the potential hazards of trading. At this stage in the game, a frank and open discussion of the risks of trading FOREX is intended to ground you, and its purpose is that of an “an ounce of prevention.” Before you place a single buy or sell order it is important to consider the risk. Considering and calculating the exposure to risk is requisite for a disciplined trader. A disciplined trader puts an emphasis on consistent and proper position sizing that is based on exposure to risk.

Your own risk-tolerance level is up to you; however, the general consensus among market “gurus” is that risk-management rules should place your personal threshold somewhere between 1% and 5% of your total account balance.
KEY CONCEPT

THE KEY TO GOOD MONEY MANAGEMENT IS A PREDETERMINED MAXIMUM THRESHOLD FOR RISK EXPOSURE.

In good conscience, we cannot dictate this number for you because it’s something that has be determined by you and you alone. Conceptually, the exposure to risk based on the trade setup and time frame being traded, should be measured and accounted for and then position sizing should be based on a predetermined set of rules. This will prevent you from over-exposing yourself to risk due to greed, or under positioning yourself because of fear. Keep your emotions out of the equation.

A BRIEF AND INCOMPLETE HISTORY OF MONEY

The earliest economies in human history were based on very simple and crass bartering systems wherein one valuable commodity or good was traded directly for another. Live stock and crops were most likely the earliest currency believed to be established between 6,000 and 9,000 years ago. The basic bartering system; however, is very limited and problematic by nature due to terrible inconsistency and general difficulty in establishing and maintaining fair and equitable trade. Necessity being the mother of invention, more efficient systems would be established very early in our history using anything from pretty rocks to seashells as currency. There is strong evidence that around 3100 years BC, around the same time the dating of the earliest human writing systems were discovered in ancient Mesopotamia, the banking industry was established. Valuable goods such as grains, livestock, and precious metals are deposited for safe keeping around temples and palaces. Around 2200 BC, Cappodcean rulers guaranteed the quality of the weight and purity of silver ingots. Around 1750 BC, during the reign of Hammurabi in ancient Babylon, the written code of Hammurabi literally documents in stone first known laws that govern money and banking operations. During the ensuing millennium, various models and methods of currency are adopted
Throughout the world, until according to Herodotus around 687 BC, the first crude “coins” are invented in Lydia and the first retail shops are established. By the close of the 6th century BC, the first true coins are minted in Lydia which is located in Asia Minor. The coins were made of electrum, a naturally occurring blend of gold and silver. The Chinese, at some point during this same era also developed coins made of low-value base metals. In the 5th century BC, the use of coins spreads from Lydia to Greece.

During the next several hundred years, the Persians and Greeks use this newly established and highly portable form of currency to wage war on each other. Romans show up to the party a little late and are still using heavy and cumbersome bars or bricks of bronze and other precious metals until midway through the 3rd century BC. The use of coins was adopted by Rome by the second Punic War between Rome and Carthage from 218 to 201 BC; the demand for coins to pay for troops was so high, rulers decided to debase the purity and weight of the coins in order to stretch the available supply. As a result, inflation is born. Then during the 1st century BC, Julius Caesar invades Britain and Celtic tribes also adopt the minting of coins. In fact, the expansion of the Roman Empire helps proliferate the use of minted coins all throughout Europe. Sometime shortly after Julius Caesar uttered the phrase “et tu bute,” Caesar August reformed the struggling roman monetary and tax systems and issued the first known coins of differing monetary value. Precious metals were used including pure gold, silver, bronze, and copper. Caesar Augustus also invented new and innovative taxes including general taxes, sales tax, and poll taxes… All hail Caesar!

For the next 300 years, the Romans continued to tinker with money by altering and manipulating the weight and purity of the coin. Increasing and decreasing the amount of precious metals used to mint the coins could alter perceived value of the coin. Diluting the amount of precious metals used debased the value of the coin in two different ways: increasing inventory, and reducing the quality. Because of this manipulation, inflation levels fluctuated and at times soared, leading to rebellions and revolutions. In the year 306, Constantine secured control of the Roman Empire and removed the old currency from circulation and replaced it...
with the Solidus whose weight and purity remained unchanged for the next 700 years. In 313, Constantine adopted Christianity, and following his conversion, proceeds to confiscate the enormous treasures amassed in the pagan temples within the borders of the Roman Empire. As a result, Rome and the Catholic Church accumulated massive amounts of gold bullion. Even though Constantine stabilized the Solidus he continued to produce coins from debased silver and copper called Denarii, despite having plenty of gold bullion to produce higher quality and more valuable coins. As a result, over the next 20 years, inflation for the Denarii rose 300% and created huge disparity between the rich and the poor. Finally in 410, Rome fell to the Visigoths, and the Roman banking system failed. Roman banks and coinage were abandoned until the crusades began nearly 600 years later and stimulated the re-emergence of banking in Western Europe.

The Chinese introduced the first paper currency by 1000 AD and experienced many fluctuations ranging from stability, all the way to hyperinflationary phases where the currency was not even worth the paper it was written on. Marco Polo traveled to China during the 13th century, and upon his return, Europe was introduced to the concept of paper money. In the meantime, Europe experimented with many different types of currencies including wooden chips. Italians introduced the florin, and the British discovered that re-circulating or issuing money every six years could control purity, and yield a profit through the melting down and re-minting process.

England, at the beginning of the 14th century, placed restrictions on the import of bad money, and export of good money with the Statute of Stepney. Shortly thereafter, Nicole Oresme, one of the greatest minds of the Middle Ages, asserted that the quantity of precious metal in circulation determined the value of the currency. Oresme made significant contributions to modern day monetary theory. *A Treatise On The Origin, Nature, Law, And Alterations Of Money*, written by Oresme, is the foundation for many studies on economics, banking, and the science of money. His theories are based on the observation that an increase in the supply decreases the value of the currency. Oresme’s Law is confirmed when a century and a half later Spain experienced hyperinflation with the influx of Aztec, Mayan and Incan gold upon the return of the conquistadors from the new world. The abundance of money caused a significant rise in the cost of sellable goods and labor.

*COPERNICAN THEORY ON DEBASEMENT* For Millennia, people
believed that the planets rotated around the earth, until the great astronomer Nicholas Copernicus published his theory that heavenly bodies rotated around the sun and not the earth. This absolutely turned conventional thinking on its head. In a similar fashion, Copernicus challenged conventional thinking in economics. Copernicus asserted the value of money did not revolve around the weight and purity of precious metal used to mint the coin, rather Copernicus argued that the number of coins in circulation, and not the weight of metal they contain determined the level of prices and the buying power of the currency.

SIR THOMAS GRESHAM, a leading advisor to Queen

Above Nicole Oresme 1323 to 1382 A.D. Counselor to Charles V of France was an economist, mathematician, physicist, astronomer, philosopher, psychologist, and theologian.

Bottom Right Nicolas Copernicus 1473 to 1543
Elizabeth I, is accredited with an economic law of his own. **Gresham’s Law**, when simplified into layman’s terms, states that “**Bad money drives out good money.**” This simple statement, when elaborated on in detail, is perhaps one of the most powerful statements in regards to the value of currency exchange rates and economic value of all time. It is a little bit more complicated to explain than the simplified statement above reads. But when we break it down, it becomes abundantly clear.

**“GOOD MONEY”** is money that shows little difference between its exchange value and its commoditized value. Good money is desired by people. And they want to keep it.

**“BAD MONEY”** is money that has been debased and has substantial difference between its exchange value and its commoditized value. Gresham’s law states that any circulating currency consisting of both “good” and “bad” money (both forms must be present, and required by tender law to be accepted at equal value) the “bad” money quickly becomes dominant. This is because people, when spending money, will get rid of the “bad” and keep the “good” money for themselves. In time, the good money disappears from circulation because people hoard it, and it has a tendency to migrate out of the local economy into foreign economies because of the perception of higher value. Gresham’s law was particularly applicable to coins made of precious metals, but the concept has valid application with paper money, and the value of one currency crosses, or foreign exchange.

To better understand Gresham’s Law, take a look at how you treat
the cash in your pocket... If you have the choice of spending the crisp dollar bill, and the crumply torn dollar bill, which one do you liquidate first? Another example of how Gresham’s Law is applicable in modern day currency trading. If you have the choice between two currencies, where one is stronger than the other, the European EURO in contrast to the US Dollar, the EURO having about 44 percent more value than the US Dollar at the time this manual was created, people gladly spend the dollars and keep the EURO, reducing the supply of EURO’s circulating in the global economy, thereby increasing the value of the EURO and potentially decreasing the value of the US Dollar. Although the valuation of the USD vs. The EURO is more complex than that, Gresham’s law is a contributing factor to the current supply/demand and currency valuation. We will take a closer look at all the things that affect the value of a currency in the next section.

HOLLAND’S LOVE AFFAIR WITH TULIPS lasted for three years from 1634 to 1637. The sudden increase in prices for tulips, particularly those with interesting characteristics and patterns, lead to a frenzy of tulip speculation by the general public. Tulip contracts sold for more than 20 times the annual income of a skilled craftsman. This is a classic example of an unsustainable trend. “Tulip Mania” is generally considered the first-recorded speculative bubble, and when the bubble burst, the speculative value of tulips burst and dropped nearly 85% to 95% in a matter of days. Some believe that many investors were crushed, and the Dutch economy fell into a recession. “Tulip Mania” is a good example of what greed and fear can do to the speculative value of any commodity or currency.

AMERICA THE BEAUTIFUL One of the first currencies used by early colonists was tobacco. The use of tobacco as tender lasted for approximately 200 years. The first public note-issuing bank was founded in Massachusetts in 1681, and in 1690 The Massachusetts bay colony issued the first official paper money. By 1715, North Carolina had developed 17 different forms of tender. In 1766, Benjamin Franklin’s request to issue paper money for general use in the American Colonies is declined by British Parliament. In 1776, Declaration of Independence is signed, and Adam Smith, the father of modern economics published Wealth Of Nations. His invisible hand metaphor gains widespread popularity, and is used in
the discussion of free markets. Adam Smith’s work helped create the modern academic discipline of economics, the most famous rationales for free market capitalism. Then in **1789, the US Constitution Article 1 clause 8 gives congress exclusive rights to mint money.** States are no longer allowed to issue their own currency and in 1794, the US mint starts operation. It was not until 1837 that the US states can issue paper money. **From 1840-1846, the United States Treasury is established.** 1900 saw the passing of the US Gold Standard Act and in 1929, the U.S. stock market crashed and wide-spread bank failures lead the US into the great depression. World War II started and the US national debt increased 16 fold. **It was not until 1973 that the United States abandoned the gold standard.** In 2002, The Europeans consolidated currencies and established a common currency called the EURO.

**AS THE MODERN FOREX MARKET EMERGES and explodes in popularity.**

**MODERN THEORIES ON THE VALUE OF CURRENCY**

Prior to WWI, most countries and economies utilized a central bank and supported their paper currencies with convertibility to gold. And although conceptually paper money could be exchanged for gold at anytime, it did not occur very often. This fostered the idea that there was not a need for full cover in the central reserves of the government. The issue of paper money had a tendency to balloon out of control frequently leading to monstrous inflationary levels which would frequently lead to significant political instability and eventually wars. WWI and WWII created significant government expenditures on both sides of the conflicts. The emerging victors of WWII (both US and European interests) searched for a way to avoid the destabilizing monetary policies which led to the great wars. The Bretton Woods agreement resulted in a system that intended to return to the gold standard, by fixing the US dollar at 35 ounces of gold, and in turn fixing other currencies to the now dominant US Dollar. This policy eventually collapsed under the pressure of divergent world economies during the 1960’s. During the Nixon administration the suspension of gold convertibility made the US dollar no longer suitable as the primary international currency due to the increasing US budget and trade deficits. By the beginning of 1974 the US abandoned the gold standard in favor of a flexible monetary policy that is directed by the Central Bank and the Federal Reserve.

Modern monetary policies are based on theories that control of the
supply of money, through the general availability of money, or the cost of money through interest rates through centralized controls, can be directed and influenced with the goal of crafting optimal monetary function, and economic stability. The tone of monetary policy is either considered dovish or hawkish. What does this mean? Monetary policy is typically referred to as either being an expansionary policy or contractionary policy. An expansionary policy works to increase the total supply of money in the economy, and a contractionary policy works to decrease the total money supply. Expansionary policy is traditionally used to combat unemployment and recession by lowering interest rates, while contractionary policy involves raising interest rates to combat inflation or debasement of the currency. Monetary policy is not to be confused with fiscal policy which refers to government policy on borrowing, spending and taxation.

**WHAT INFLUENCES THE VALUATION OF A CURRENCY?**

**FREE FLOATING CURRENCY** is currently the status quo in an increasingly global economy. Currencies are no longer pegged to precious metals, rather they are backed by central banks and treasuries supported by the government’s ability to tax the populous. Currency values can fluctuate depending on various economic influences and conditions. Let’s take a look at a few of the more significant influences on the evaluation of a currency. They range from the rational to the irrational, and it is essential to understand them.

**WHAT TO WATCH:**

1. **ECONOMICS.** Here are a few economic factors that are critical to monitor:

   a. **Interest rates**
      
      i. What is the current policy and perceived ramifications?
      
      ii. Changes in interest rates move currency.
b. Government budget and spending
   i. Size of budget
   ii. Is the government operating on a balanced budget or deficit spending?

c. Trade Balance
   i. Imports vs. exports

d. GDP (gross domestic product)
   i. Economic growth and expansion
   ii. Economic recession and contraction

e. Inflation
   i. Money Supply
   ii. General level of prices, goods and services
   iii. CPI (consumer price index)

2. PSYCHOLOGICAL
   a. Flight to quality
   b. Reactions to news
   c. Reactions and subsequent reactions to trade action

3. POLITICAL
   a. Internal, regional international
   b. Fiscal policy
   c. Taxation
   d. Political elections
SUMMARY

FOREX market transacts trillions of dollars each day. There are six major currency crosses, and just 22 mainstream pairs. The value of any given currency is based on many factors and theories, but the day-to-day fluctuation are based on perception, interpretation of information, and psychology. The financial opportunities that FOREX present to you, the individual trader, are limitless. The benefits of trading currencies are many: 24-hour trading, commission-free transactions, customizable leverage and position sizing, the ability to profit from up and downward movement of any currency cross. The keys to your success are to set realistic goals and to create a disciplined structure from which to work. Base trades on rules, not emotional reaction.
Chapter Two: FOREX Primer

“Knowledge must come through action; you can have no test which is not fanciful, save by trial.”
Sophocles

Now that we understand the importance of goal setting and discipline, and we have a little history and theoretical knowledge under our belts, we can lace up our boot straps and start our journey to becoming proficient FOREX (FX) traders. Understanding the function and inner workings of the foreign exchange market should be a pre-requisite to trading the market. Granted you don’t need to know how a car works to be able to drive one, but understanding the inner workings of the automobile, proper maintenance, the operations from the driver’s seat, rules and regulations of the road etc… will really improve the driving experience.
This chapter is going to break down for you and spell out the features and benefits of the FOREX market. The purpose of this section is to help us understand the market’s structure and inner workings. To help you gain clarity and insight into the FOREX market, we are going to start out with a primer for the market, and then we will break down that information into the elemental aspects and important definitions and explanations of the different terms you’ll encounter and individual components that make up the FOREX market. Before we get into the FOREX Market Primer let’s generate some excitement. There is a reason traders are flocking to FOREX, because there are many advantages and benefits that trading FOREX offers. The simplicity and efficiency of the market, and the commission-free trading are just two of the many reasons traders are infatuated with FOREX. Trading FOREX can be as simple as a click of the mouse on the buy or sell button which can trigger lightening fast executions giving you, the individual trader, some financial agility. So without much further ado, let’s take a look at why we are here.

**BENEFITS OF TRADING FOREX (FX)**

- **PROFIT IN AN UP, OR DOWN, MARKET**
  - It is possible to be long or short in order to profit in any market direction
  - It is as simple as selecting buy or sell order types

- **24-HOUR TRADING**
  - Allows you to trade more or around your regular schedule
  - The FX market is open for trading 24-hours a day, five days a week

- **SUNDAY EVENING (20:00 GMT) TO FRIDAY EVENING (22:00 GMT)**
• LEVERAGE, LEVERAGE, LEVERAGE
  – Broker requires a small amount of money, known as “margin,” to control a much larger position
  – It is common for a FX broker to give 100:1 leverage or more
• THIS MEANS ONLY $1000.00 COULD CONTROL $100,000.00
  – Allows for profit on small fluctuations in the currency
• NO COMMISSIONS
  – Broker typically does not charge a commission on the opening or closing transaction
  – Broker does, however, capture a small profit on the bid/Ask spread
• MASSIVE LIQUIDITY
  – Allows for easy entry and exit, regardless of position size
  – Lightening fast executions often guaranteed by brokers
  – Anonymity for our trades

There is a lot of sizzle and aroma coming out of the FOREX kitchen. Enough to make any trader salivate uncontrollably… Now let’s take a closer look at this juicy steak.

LIQUIDITY OF FOREX

• One of the attractive features of trading is liquidity
  – Average daily turnover in FX transactions – 2.7 trillion USD in April 2006 (ISFL estimates)
  – 10 times the size of the combined daily turnover of the entire world’s equity markets
FOCUS FOREX 24/7 Trading in Foreign Currency

Notes

- FX trading increased by 38% between April 2005 and April 2006
- FX trading has more than doubled since 2001
- According to ISFL 2006, 32.4% of global turnover went through London

As of 2008, the amount of liquidity has increased even more and is estimated to exceed three, count them, $3 trillion of daily turnover according to ISFL estimates. That is an amazing amount of zeros to count. With the growing world economy and addition of rapidly emerging markets, this trend in growth is likely to persist.

**FOREX trading is more accessible than ever** due to the explosion of electronic trading networks. Up until now, the currency markets were the province of big money. The world’s governments, central banks, investment/commercial banks, global/ international corporations, and hedge funds have been trading currencies for a long time. At first, the big-time players in the foreign exchange market may be intimidating, to say the least. The mere presence of these big players can make an individual trader feel like a minnow swimming among sharks. But it is precisely the size, speed, and agility that individual traders possess that turns disadvantage into express advantage. The sheer volume of daily transactions is estimated in excess of $3 trillion. Because of high volume and liquidity, an individual trader can dart in and out like a speedy minnow and go unnoticed by the shark that is only after bigger fish.

FIGURE 2.1
Opportunities abound in FOREX. The volume and volatility that exists in FOREX on a daily basis, and the number of currency pairs being traded, means that there is almost always something to trade somewhere in the market. The MetaTrader software can help you scan the market on various time frames to spot trading opportunities. These opportunities will be both bullish and bearish, allowing you to potentially profit in both rising and falling markets. The brokers profit when people trade, so they work hard to give you the tools and information you need to help you trade often. The minimal margin requirements, and highly leveraged trading and zero commissions are enough to make the other equity markets mad with jealousy. There are many instruments utilized in FOREX markets such as FX options, Futures, Forwards and spot markets. Since the vehicles for trading currencies usually have minimum trade sizes for the base currencies, the use of margin is almost universal. Here is an example of what we are talking about. A typical trade size for the Spot Market would be $100,000 and your broker would typically require just $1000 of margin to control the $100k in currency. Many brokers offer varied amounts of leverage allowing you to use as little as $100 margin to trade micro mini lots.

Crosses and Pairs are the vehicles or instruments we primarily use to trade FOREX. In essence, we are buying and selling currencies. A trade consists of the simultaneous purchase of one currency and the sale of another currency. To bend your mind around this concept requires a little bit of explanation. A trade should be placed when the currency being purchased is expected to increase in value in comparison to the other side of the currency pair which you are effectively selling. If the currency you are buying does increase in value, a profit is locked in by selling back the other side of the currency pair. To effectively understand what happens when you place a trade, we need to explain the actions taken a few times to help it sink in and register for you.
When you pull the trigger and are in an open trade or position, you have either bought or sold a particular cross or pair, the transaction is brought to a close by buying or selling back an equivalent amount of the currency pair. Let’s use the European EURO and the US dollar cross to help you understand the mechanics. The pair is referred to as the EUR/USD and if the chart goes up, the EURO is gaining value against the dollar, buying the EUR/USD means you are buying Euros, and selling Dollars. If the chart goes down, the Dollar is gaining in value against the Euro, and to profit you would sell the pair EUR/USD which in turn is effectively selling EURO’s and buying Dollars. Each pair consists of two currencies: the base currency and the counter currency.

![Chart of the EURO vs. the US Dollar.](image)

Currency quotes tell us how many counter currencies it takes to purchase the base currency. Each currency has a symbol that is used to identify it. Here is a partial list of world currencies to illustrate this concept below.

<table>
<thead>
<tr>
<th>ISO 4217 - THREE LETTER CODE FOR CURRENCY</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States Dollar USD</td>
</tr>
<tr>
<td>Euro Zone Euro EURO</td>
</tr>
<tr>
<td>Japanese Yen YEN</td>
</tr>
<tr>
<td>British Pound Sterling GBP</td>
</tr>
<tr>
<td>Swiss Franc CHF</td>
</tr>
<tr>
<td>Australian Dollar AUD</td>
</tr>
<tr>
<td>Canadian Dollar CAD</td>
</tr>
<tr>
<td>Swedish Krona SEK</td>
</tr>
</tbody>
</table>

Partial list of currency symbology.
EVALUATING A CROSS OR PAIR

Now that we’ve established that each currency has its own symbol, let’s take a look at how currency crosses are valued. Below in figure 2.3 is a table cross-referencing currencies against each other.

![Currency Crosses](image)

FIGURE 2.3 Currency Crosses are based on the value of one currency against another.

Rather than look at a spreadsheet, and have to locate the row and column where the currencies will cross, FOREX quotes are given for each pair specifically. The base currency is listed first in the pair, and the counter currency is listed second. If you take a glance at figure 2.4 you can quickly identify which two currencies make up the pair, and you can also determine which of the two currencies is the base currency by which symbol appears first in the pair. (e.g. first on the list is the EURUSD. The Euro is the first currency in the pair, and is therefore the base currency. The USDJPY is the second pair on this quote sheet, and as you can easily see, the US dollar comes first in the pair, and therefore is the base currency).

![Quote Sheet](image)

FIGURE 2.4 MetaTrader quote sheet showing several pairs. The information contained here tells us which currencies are involved in each pair. The base currency is always listed first, and the current Bid and Ask price are shown here.
THE MAJOR PAIRS

The most liquid and popular of the FX crosses are called the “majors.”

- EUR/USD
- USD/JPY
- USD/CHF
- GBP/USD
- EUR/USD = we are buying EUR, or we are selling EUR in USD
- GBP/CHF = we are buying GBP, or we are selling GBP in CHF
- The 1st currency in the cross is the base currency
- The 2nd currency in the cross is the secondary currency
- All gains and losses are expressed in terms of the secondary currency
FOREX Quotes always include a Bid and an Ask price as you can see in figure 2.5, the Bid price is the current price at which the market maker is willing to buy the base currency in exchange for the counter currency. As you can see there is a difference between the Bid and the Ask price. This difference is known as the spread. Price Quotes are always quoted using five numbers, four of which come after the decimal point. The final digit of the quote is the smallest incremental value for the currency which is referred to as a point, or a PIP. A PIP is the smallest price change that a given exchange rate can make. Since most major currency pairs are priced to four decimal places, the smallest change is that of the last decimal point - for most pairs this is the equivalent of 1/100th of one percent, or one basis. For example, the smallest move the USD/CAD currency pair can make is $0.0001, or one basis point. The smallest move in a currency does not always need to be equal to one basis point, but this is generally the case with most currency pairs.

The cost of establishing a position is determined by the size of the spread. Therefore, from the very start of a trade, the trader must recover the cost of the spread in order to break even. The example below in figure 2.6, the EUR/USD Bid is 1.4671 and the Asking price is 1.4673. In this example, there is only a 2-PIP spread between the Bid and the Ask. This is the only cost that a trader incurs when trading the EURUSD pair.

The EURUSD is perhaps the most popular pair because of the narrow spread which is typically 2-to-3-PIPs. The price chart does not need to move too much in order for the trader to cover the cost of the trade, and get in. Here are a few bullet points to summarize the bid Ask spread.

- With every FX cross, there is a corresponding Bid/Ask spread
- The spread is the difference between the prices at which the currency can be bought or sold
- Typically, the Bid/Ask spread is 3-PIPs, but can vary broker to broker from pair to pair, and can potentially fluctuate in certain market conditions.
Notes

- News events
- Fast market

• Depending on the size and number of lots traded, the PIP spread slippage will correlate accordingly. (e.g. one standard lot .0003 PIP spread = 30)

**PIPs**

The minimum price movement possible is 1/100th of one percent. These tiny moves are called “PIPs.” The term PIPS comes from the calculation of this increment in percentages (percentage in points = P.I.P.) Depending on the broker, the capital required to trade full-size lots is approximately $5,000, some brokers for as little as $2,000. There is an old proverb that states “only a fool tests the water with both feet.” This is good advice when it comes to learning to trade a new instrument such as FOREX. It is not wise to run out and start trading full-size lots...not without some practice. We suggest you start out virtually first, and then move to micro/nano size lots, then to mini. Try starting out trading one lot then two lots etc… before you graduate yourself to trading multiple-full-size lots. The example below shows us the same number of PIPs but calculated using the various lot sizes.

![Graph showing PIP movements](image)
When it comes to PIPs there are a few variations you need to be aware of. Normally, 1 PIP = 0.0001 of the currency we are trading which is 1/100th of a percent and on a full-size lot = $10.00. But there are some variables or exceptions that you need to be made aware of to avoid confusion. Currencies Paired with the Japanese Yen are different.

FIGURE 2.8 Understanding the value of each PIP as it relates to your profits and losses is critical when you trade FOREX. As you can see, there is a considerable amount of money to be made or lost from typical movements.

VARIABLES ON PIP VALUES
HOW TO CHANGE LOT SIZE AND QUANTITY

Now that we have introduced you to the different lot sizes available for trading it will be important for you to know how to select the size of the lot inside the MetaTrader platform. It is also important to know how to select the number of lots you wish to trade. It is a relatively simple task to change these settings, and the setting may be saved once you have established yourself and know what you are doing.

There are three ways to open up an order ticket inside the MetaTrader Platform. Start by double clicking on the pair you wish to trade. From the symbols list, this will automatically pop open the ticket. You may also open up the order ticket by right clicking on the chart, and selecting “Trading” from the quick list, and clicking on “New Order” or you can simply press F9 on the keyboard.

FIGURE 2.10 The symbol list is found on the left hand side of the screen in MetaTrader. Click on the volume drop down menu from inside the order ticket. This will then allow you to choose your position size.

FIGURE 2.11 The volume drop-down menu allows you to choose your position size.
FOREX MARKET STRUCTURE

There are various tiers of pricing in the FOREX market. Typically, FX trading is considered “over the counter” which is commonly abbreviated as simply “OTC.” Pricing is set by multiple markets, and brokers receive price quotes and data from multiple banks. There are variations in quote prices, but for the most part, prices must remain consistent to avoid problems with arbitrage.

- Bank vs. broker vs. retail
- Size of account and activity

- Structure
  - Inter-bank market (bank to bank)
  - Smaller investment banks
  - Multinational corporations
  - Funds
  - Retail Market-Maker (brokers)
  - Individuals
The further down the chain from inter-bank to individuals, the less competitive pricing becomes (larger Bid/Ask spreads).

Try going to a currency exchange kiosk in an airport and see how good of a deal you get at that bottom tier.

The Rollover is another aspect of FOREX that must be understood. Trades must be settled within two business days in the spot FOREX market. If a trader sells two lots of a currency unit on Tuesday, he or she must deliver an equivalent number of units on Thursday. This might seem like a restriction or limitation, but currency trading systems allow for “rollover” in which open positions can be swapped forward to the next settlement date; in essence giving the position an extension of two additional business days. In order to rollover there is an interest rate associated with the forward swap of any given pair. This interest rate, commonly called the swap, but technically named the forward outrights, is actually a financial instrument that can also be traded on the currency market.

The difference between the interest rates of the base and counter currencies in any spot rollover transaction is considered an overnight loan. If a trader holds a position through rollover, the difference between the current interest rates for each side of the pair is calculated, and depending on which side of the pair is favored, and which side of the pair is held, a gain or expense will occur. The amount of the gain or expense will fluctuate from day-to-day depending on the calculated difference between the base and the counter currency. The rollover rates are quoted in dollars and are displayed in the interest rate column of the MetaTrader Terminal. If the trade is not held through the rollover, the position will be unaffected. In order to be affected by the swap, a position must be carried overnight.

FX forward outrights fluctuate from day-to-day. Figure 2.13 below shows examples of individual currencies interest rates.

The swap is based on the difference between each individual currencies’ interest rates and is automatically calculated for you inside the MetaTrader Terminal.

Here are some quick bullet points to help you digest this information more efficiently:

- Each currency that we hold has an interest rate. The swap is the calculated difference in interest rates between each side of the pair.
• The length of time you hold the position determines what effect the Swap will have on the position. Trades that are carried overnight have zero effect.
  – Short-term trades will have nominal effects
  – In longer-term trades, the difference in interest rates can culminate in larger positive or negative effects.

• Example: Using the GBP/JPY currency pair
  – The interest rate on GBP is 4.3% APY, and the interest rate on JPY is 0.25% APY

![Benchmark Rates as of 20080131](image1)

**FIGURE 2.13** Forward outright benchmark rates (rates in this example are from 01/21/2008).

![MetaTrader Terminal](image2)

**FIGURE 2.14** The MetaTrader Terminal automatically calculates the swap upon rollover. The swap is easy to locate.
Notes

- We buy GBP, thereby selling JPY, in other words we are financing our purchase of GBP with JPY
- We earn 4.3% APY on GBP and pay 0.25% APY
- Net positive interest = 4.3% - 0.25% = 4.05% × leverage (100:1) = 405% APY

When applied to trading the swap needs to be considered.

WORKBOOK EXERCISE

The following chart is an example of a long trade on the AUDJPY cross. (Figure 2.15)

- Assuming that we bought one lot of the cross at $85.97 and then sold the position 42 days later at $105.17, what would the profit be?

- Considering the duration of the trade, what is the effect of the swap?

FIGURE 2.15 A chart of AUDJPY with a long position held over 42 days.
The following chart is an example of a short trade on the AUDJPY cross. (Figure 2.17)

- Assuming that we sold short one lot of the cross at $107.30 and then bought to cover position 25 days later at $87.05, what would the profit be?

- Considering the duration of the trade, what is the effect of the trade?
FIGURE 2.17 A chart of AUDJPY with a short position held over 42 days.

FIGURE 2.18 See if you can follow through with the math that goes into calculating the profit/loss of a trade including the swap. Thankfully MetaTrader automates this process.
Trading on margin in other equity markets is considered by many to be aggressive and is frowned upon by many “gurus.” And despite being a powerful tool, oftentimes the word margin has a negative connotation associated with it for many traders. Trading the currency markets requires a different train of thought. Margin on the FOREX is not a down payment on a future purchase like it is in stock trading; rather it is a deposit to the trader’s account that is intended to cover against any currency trading losses in the future. Essentially, Margin is risk capital. When you open a position, you assume all of the reward and risk of the movement of the procured block of money. Your broker’s trading system software will automatically calculate the funds necessary for the current position, and will check to make sure that you have the proper amount of free margin available in your account before executing any trade. A typical trading system will allow you to customize the level of leverage by selecting a simple setting inside the trading account that can be set as a default. Once selected, trades can be executed quickly without having to re-select the desired amount of leverage.

Use the MetaTrader “Trade” tab to select your trading defaults. This can benefit you by giving you some consistency in your trade discipline. If your trading plan calls for the use of a specific position

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**FIGURE 2.19** Inside the options screen is the ability for you to select trading defaults. This feature can be used to give your position sizing consistency.
size, use the default settings to help you save time and maintain your discipline. To access this feature, click on “Tools” in the main toolbar at the top of the screen. Click on “Options” and the options window will appear on your desktop. For practice trading, you might want to select the mini size lots while you are getting your feet wet.

CONCLUSION AND REVIEW

As you have probably surmised, trading the FOREX Market requires a slightly different mindset and train of thought when compared to other equity markets you might be familiar with. Upon introduction to the FOREX Market, it may seem a little daunting. You’ve been introduced to a lot of new information in a very short period of time. With practice and repetition, this information will become familiar and second nature to you. If you have experience in trading other equity markets, you might be set to take to FOREX like a duck takes to water. If you are a complete neophyte with little to no experience, don’t worry. Learning to trade FOREX is about as hard as learning to ride a bicycle; once you get a feel for it, and learn the basic skills, you’re not too far off from being ready to hit the open road. The keys to successfully trading FOREX are not a mystery. Hard work and study will properly prepare you, but FOREX trading, like other types of trading, is something you learn by doing. All the book smarts in the world will not help you if you do not apply the information, and practice, practice, practice. Repetition is the key.

The amount of liquidity, plentiful opportunities for large profits, and availability of personalized leverage make the FOREX Markets a magnet for traders. To put it plainly, the FOREX Market is smoking hot. It is wise to remember that the great potential to make money is also accompanied with potential exposure to significant risk, and just because the execution of trades is clean and relatively simple, does not mean that one does not need to understand what they are doing. We need to know what is going on behind the great curtain. We need to be familiar with what is under the hood, and then establish an absolute and intimate familiarity with our methods and discipline. Understanding the mechanics will give us clarity and help us become better traders. Planning and discipline will keep us out of trouble. Establishing a risk tolerance and being committed to sticking with it will help you to trade for a long time. Remember there are old traders, and bold traders, but no old bold traders.
The FOREX Markets are like no other, and trading them is exciting and fun. The sky is truly the limit when it comes to earning potential, but we must learn to crawl before we can walk, and we must walk before we can run... and then when we learn to run, we need to pace ourselves. Start out by sticking your toe in the water. Get familiar with the MetaTrader Software, and learn to harness its power. Start out by trading in the virtual platform with zero risk. Don’t be afraid to make mistakes. Children are such prolific learners because they have no fear of being wrong. Adults on the other hand, are afraid to make mistakes which can keep them from learning from those mistakes. Mistakes are some of the best teachers of all, as is experience. A year’s worth of live trading experience is worth far more than just hitting the books. If you do both, you are more likely to succeed period.

The next part of the course is designed to teach you the software and demonstrate the power it has to offer. Have fun with it. Enjoy the process of learning, take notes, keep a journal of your trading as well as your progress. And above all... PRACTICE, PRACTICE, PRACTICE.

TEST YOUR KNOWLEDGE

?
MASTERING
MetaTrader/RedFish
“He that would perfect his work must first sharpen his tools.”
Kung Fu-tzu Confucius

Tools to get the job done right are what every professional and craftsmen need to be both proficient and precise. We’re not talking about WD-40 / Duct-Tape and a big ol’ hammer. We are talking about powerful software tools, designed to expand on your mind and intellects capabilities. MetaTrader is a professional online trading terminal for the FOREX Market. It is a convenient and adjustable tool for the active trader. The different functions and options of this system will offer you great flexibility in your trading. MetaTrader provides the tools to help you expand and grow your FX trading business. It has been designed for active traders looking for an edge and because of this, it provides a rich user interface that is highly customizable.
MetaTrader software is cutting edge technology designed for maximum performance in a live-trading environment. The enhanced charting functionality and sophisticated order management tools will help you to manage your positions quickly and efficiently. There is no need to be chained to your computer because with proper application of these tools, constant monitoring of the market is not required thanks to the Focus FX companion’s ability to run sophisticated scans and apply expert advisors.

MetaTrader is a robust and well-rounded technical tool box. It also happens to be programmable, if you wish to delve into that aspect of trading. But for those of us who want out of the box solutions, and instructions, this chapter is designed to walk you through the functions of the software pertaining to the practical application of trading. We will discuss how to place orders using the appropriate order types. We will then show you how to use some of the advanced features that will save you time, and help you be in the right place at the right time to place that next trade with confidence and skill.

**METATRADER 101**

MetaTrader might not be able to turn your CPU into an ATM, but that is not too far off from our goals to grow and generate wealth trading FOREX.
The focus of this chapter is to teach you how to use the software as it pertains to trading. This section is not intended to be an instruction manual for the software because that already exists under the help tab of the software. There are even online tutorials available to help you with the general operation of the program. That being said, this chapter is going to show you how to use the software to actually place buy and sell orders either virtually for practice, or for real once you are ready to test the water. The application of the virtual program is identical to a live trading environment, so the transition should be relatively simple. We will start off by locating and identifying the different areas inside the command center’s layout. MetaTrader is such a massive program, that we will only be able to scratch the surface, but that is all you need to get started. You’ll quickly discover the ease of use, and simplicity of executing a trade.

You need to get comfortable at the controls. Not knowing exactly where to point, and click, and proper set up and layout orders to execute according to plan will only hold you back. The virtual environment allows you to practice without fear of accidentally clicking on the wrong button, or entering the wrong order type. The whole idea of the virtual platform is for you to be able to practice in a safe environment. With zero dollar risk. In fact, for all intensive purposes, everything you learn through this course should be practiced to perfection before you put your hard-earned dollars at risk on experimental trading. Professional traders know, based on experience, that we should only experiment with new strategies in a place that is free of risk.

THE MAIN DISPLAY SCREEN

The MetaTrader main screen is shown in figure 3.1; as you can see, it is a lot of information to squeeze into a small picture that fits on one page of a manual. Take a moment to actually open up the software and look at this screen for yourself so that you can orient yourself and get comfortable at the controls.
Symbol quick list/market watch is found in the top left quadrant of your screen. The number of symbols that you choose to display is up to you and customizable by simply right clicking, and selecting or deselecting the desired pairs. Red or green arrows with color-coded price quotes indicate the direction of the last price change. To initiate a trade, simply double click on the desired pair.

Navigator is found in the middle, on the left hand side of the screen. This is where you can switch between the different accounts you establish. You can change back and forth between your real money account, and your virtual account. You can access indicators, or even program your own from this section. Besides changing from account to account, this section is what we will
use to apply FocusFX expert Advisors on our charts, and run FocusFX technical pattern scans on the entire FOREX Market, or just the pairs you would like to focus your trading on. If you click on the expert advisors tab, and open up its contents, you will find all of the custom experts and scans that have been designed specifically for this course. The use of this application, found inside the navigator control tab, will empower you to find incredible trade setups. With ideal conditions for entering trades with managed risk profiles, and quantifiable trading ranges that can yield profits, the FocusFX experts and scans are without a doubt going to give you an express advantage in your trading business.

FIGURE 3.4 A screen-shot of the toolbar.

**Toolbar** is found along the top of your screen, where it is located in most Windows-based applications. The toolbar is entirely customizable, allowing you to display only the tools you want to use. This is where you go to adjust your chart settings, apply indicators and even expert advisors. You can select the time frame setting on the chart you have selected by clicking on the desired time frame as seen above. In this example, on the bottom center, H4 is selected which changes the time frame to four hours. In the bottom left of this picture you can see the drawing tools and line studies that technicians love to decorate their charts with while studying price action. There are some quick shortcuts available here, and you’ll notice an important shortcut just left of center, labeled the “New Order” button. This is another way for you to open up an order ticket and initiate a trade. The best way to learn what everything on this tab does is to go ahead and click on it... You can’t break it. So by all means click away, and see what each button does. At first you might not know what to do with it, but in no time flat you’ll be flying around the screen like a seasoned pro. You can also create and save your charts and favorite setting into a layout that can be applied at the click of a button. There is no magical or correct way to use these awesome tools. Just as long as it makes sense to you, the end user. That is all that matters.

**Terminal or the Trade Terminal** is located at the bottom of your screen. This area will automatically log your trades for you, continuously calculating gains and losses. From the time you open a trade till it is closed, all open positions will be displayed there.
The terminal is the most important part of the software because it is where the money is. This is where the rubber meets the pavement. The Terminal is where a trader can really set him or herself apart through diligent trade management. If you double click on any of the open orders, it will open up a ticket for that specific order number. The order numbers are found in the left column followed by a time and date stamp. Be careful to click on the correct order. Keep a close eye on the profit column at the far right. Don’t be afraid to lock in a profit when you see one, and make sure you stick to your game plan, and close out any trades that exceed your risk threshold. Through this course you will learn how to manage trades so that you don’t become a reactive trader; but rather, stay in control of your trading business through proper trade management.

Right click on the line item or open position order number and the menu displayed here on the left will appear, giving you the ability to close the trade, create a new order, or to modify the existing order. You can adjust profit targets and even apply a trailing stop to a profitable position to ensure that you lock in a profit. Learning to quickly access this window is going to help you more effectively manage your trades and thereby your trading business. Making appropriate adjustments to open trades is critical in a fast moving market.

This is also where you can set your bracket orders giving you exit orders on both sides of an open position in the form a targets using limit orders, and stop orders for exits. When a trade is effectively managed with an exit order on both sides of the trade, you can do amazing things... like leave the computer, go grab a bite to eat, or in a 24-hour market environment, get some much needed shut eye. Leaving open trades unmanaged can have disastrous effects. Please don’t learn the hard way. Always manage your open trades, even if you just need to run to the restroom. Never leave an open trade unmanaged.
The Order Ticket

You must be absolutely fluent with the use of the order ticket in figure 3.7 above. None of us can afford to make mistakes here. The key to good trading is trade management. The key to good trading management is knowledge, discipline, and execution. The order ticket is where you execute your orders, entries, exits, adjustments, and more. On the left side you can see an up-to-the-second price quote with the Bid and the Ask price displayed in red and blue, respectively. Those colors match the colors of the Sell and the Buy button. You always sell the Bid, and buy the Ask, therefore you are always subject to the spread. The spread is displayed prominently above the buy and sell buttons in heavy black lettering, as well as highlighted in the price column in the chart at the left. You must pay attention to detail here, because it is too easy just to hit the buy or the sell button without making sure that you’ve crossed your T’s and dotted your I’s. Make sure that you’ve got the correct pair selected in the symbol box at the top right hand side of the window. If it is incorrect you can select the drop down arrow at the right and chose the correct symbol from the drop down menu. The Volume window shows you what leverage you are selecting. Make sure that you calculate the risk and reward
first, and make sure that your position size stays true to your personal rules and risk tolerances. Upon opening the order, you can establish a bracket order by filling out a stop loss and take profit price level. The stop loss is displayed in dark red at the bottom of the price chart and corresponds to the price selected in the stop loss order window. The take profit is displayed in dark blue at the top of the chart, and corresponds to the value in the take profit order window.

Setting your stop loss and target at the time of order is a discipline that many traders swear by, and in general it is great advice. In the center of the window you can see a comment window in which is typed the words “Focus FX ROCKS!” for two reasons, first because it is true, and second to demonstrate the ability to attach a brief comment to the order prior to executing the order. Directly below the comment window is a drop down menu that allows you to send the order directly to market, or to select pending order status which will change the order ticket to the view you see highlighted below in figure 3.9. In the upcoming sections we will discuss in depth these order types in detail. This is where you select them. Buy and Sell Stops, as well as Buy and Sell Limits. Knowing when, where, and how to properly use these order types is critical to the FocusFX trading Methods. The key to using them properly is to clearly understanding what each order type implicates.

FIGURE 3.8  When pending order is selected, new order types appear. Buy and Sell Stops as well as Buy and Sell Limits.
In figure 3.9 below, you see the highlighted area from above changes to allow you to input the price data after the order type has been selected. You must also put in the corresponding “time in force” letting MetaTrader know how long the order should be good for.

![Figure 3.9](image)

**FIGURE 3.9** Once you’ve selected the order type, the price criteria must be input.

**KEY CONCEPT**

**YOU NEED TO KNOW YOUR ORDER TYPES LIKE THE BACK OF YOUR HAND.**

- Order entry area of MetaTrader
  - User-friendly interface, and easy to understand ticket order
  - Instant Execution
- Buy Market
- Sell Market
  - Pending Execution

![Figure 3.10](image)

**FIGURE 3.10** The instant execution portion is the default setting on the order tickets.
Notes

- Buy/Sell Stop
- Buy/Sell Limits
- Time In Force/set expiration

MetaTrader Market Orders are instant execution orders inside the MetaTrader Platform. A market order sends an order to buy or sell a pair straight to market and will immediately take the next available price. The reason we would use a market order is to get exactly what the order ticket says...“Instant Execution.” Below are some benefits of and reasons to use market orders. As well as another example of the order ticket in figure 3.12.

- Fast market
- Speed of execution
- Price is not the emphasis
- Execution is the emphasis
- Market buy @ Ask
- Market sell @ Bid
- Market orders “step in front” of limit orders

FIGURE 3.11 Pending execution portion of the order ticket must be selected to activate pending order types.
The use of market orders can get you into trades lighting fast, the orders fill, in what seems like a split second. Fast executions can be important but there are also potential problems with the use of market orders that we must be aware of.

**Potential problems with market orders** are not to be feared, but they do need to be discussed. Placing market orders is extremely easy. There are problems that may arise, and potential dangers that can be avoided.

- The danger of market orders
  - We are at the mercy of the market
  - Market Bid/Ask can change unexpectedly
  - Transaction price is uncertain
  - Itchy Trading Finger
Due to the simple order execution process, and relative ease of placing orders, take special care not to develop an itchy trading finger when trading FOREX. It is all too easy to fall into the bad habit of trading on impulse rather than sticking to your game plan. Entering a trade without a clear and concise plan is the most common mistake new traders to FOREX make. Click and hope isn’t an effective strategy. When we approach trades they will be based on the Focus FOREX Five T’s of trading that will account for Trade Identification, Triggers, Targets, Trade Management and the Tradable Instrument of Spot FOREX. Using this approach will keep your trading disciplined and consistent.

The quickest and easiest way to get into trouble is with the undisciplined use of Market Orders. Plain and simple...

“Plan the trade—then trade the plan.”

Proper example of instant execution market order:

- Attention paid to detail
- Entered with a predetermined plan
Pay special attention to detail when placing a market order. Don’t be too hasty with the execution. Your speed will improve with time. The most important part of this process is making sure that you are selecting the correct Instrument and that a trading signal or confirmation is the reason you’re pulling the trigger, not impulse. Make sure that the position size is appropriate. Before you pull the trigger, make sure to set up your trade management. At a minimum, you should be using a stop loss on every order placed at the time of purchase. Mental stop losses don’t work. Promising yourself that you’ll stop doesn’t work either. If you kept every promise to yourself, you wouldn’t have eaten half a gallon of ice-cream last weekend. Setting the stop loss at the time of purchase is the way disciplined traders play the game. A take profit order can be used to bracket the trade, or a trade adjustment can be made once in profit. Now that you’ve got your ducks in a row, go ahead and click on the Buy or Sell Button.

**MetaTrader Limit orders** demand that the broker execute the trade at the limit price or better. What this typically means, is that you are trying to control the price of entry. A buy limit requires the broker to fill a buy order at or below the price you specify. A sell limit instructs the broker to sell at or above the price you specify.

- **Buy Limit Example on the EURUSD:**
  - Bid 1.4702 Ask 1.4704
  - We want to buy EUR, but @ 1.4693
Notes

- Place a buy limit order for one contract of EUR @ 1.4693
- Broker must fill order at, or below, 1.4693 to satisfy the limit order

The Benefits of limit orders are in the price control aspect. Getting the price you want for the pair. By demanding a better price than the current market price, you are effectively negotiating with your broker to fill you only at your price, and not to fill the trade unless your price is met. This would be the equivalent of walking into a car dealership, and offering to buy a car $3000 below MSRP and standing firm on your offer. The only way you will be driving home in that new car is if the automobile broker lowers the price down to your demand. If the dealer refuses to lower the price, you are likely to leave the car lot without a car. If you get the car great… you’re happy because you got the price you wanted. But if you didn’t get the car, you’re a little disappointed, leave empty handed, but proud of yourself for sticking to your price, and not paying too much for the automobile in your opinion. To reiterate the point, the advantages of buy limits are getting the price you want.

FIGURE 3.15 A buy limit order requires the price to drop down to or below the specified price.
- Benefits of limit orders
  - Demand a better price than the market price
  - Used to negotiate the order
  - Order is posted to queue if not filled immediately

Limit orders place more control over the entry.

**Notes**

FIGURE 3.16 *A buy limit order as it is displayed on MetaTrader charts.*

**Potential Problems with limit orders** need to be discussed as well. There are some distinct disadvantages to buying with this type of order. For starters, just like in the car buying analogy, we low ball the market, and run the risk of not getting filled on the order. We also run the risk of slowing down the order, because market orders will get filled before limit orders do. This means that the execution of the trade might not be as timely as we had hoped. Both of these problems could cause us to miss the boat on the trade, and that can make a trader a little grumpy. Imagine picking the winning horse for the Kentucky Derby, and not placing a bet in time. The number one problem with placing a buy limit order is that the instrument is moving the wrong way when you get filled. If you stop and think about it, when placing a buy limit order we have instructed the broker to buy at a lower price than the current
market. This requires the price to come down to meet our entry criteria. It can feel a little bit like stepping in front of an oncoming bus. Take a look at the example below in Figure 3.17.

![Figure 3.17](image)

**FIGURE 3.17** A buy limit designed to buy the instrument at a lower price to enter a position. The price will need to head in a downward direction to hit this pending buy limit order. A little like stepping in front of an oncoming bus.

In other types of trading such as stock trading, buying with a limit order is considered to be a bad habit. FOREX instruments behave a little differently than other, more traditional instruments such as stocks. We will teach you how to use limit orders correctly.

- The dangers of using limit orders
  - Slows execution of trade
  - Market orders are filled before limit orders
  - Could “miss the boat”
  - Price is moving in the wrong direction.

**When is it appropriate to buy using limits?** Under certain conditions, the use of a limit is 100 percent appropriate every time and can be used without reserve or hesitation of any kind. These occasions that we speak of are not only an appropriate time to use a buy limit, but the very strategy itself dictates the use of a buy limit. Buying to exit a short position limit can be used as a target order to cover the position when the anticipated goals are reached. The use of buy limit orders as targets is a commonly used technique among savvy traders. In this case, a
Buy limits can be appropriate when properly implemented to enter a trade when prices are considered low, and trading within a range where a short-term reversal in price is highly probable. We will discuss this technique in great detail in the trade identification section. But in essence, the idea is to buy using a limit when the trading instrument
is either extremely over extended and trading at a statistically unlikely range, when coupled with slowing momentum of price movement in the instrument. Buy limits can also be used when price is trading at probable and or forming support zones that can be identified through some good solid technical analysis.

**Sell Limit Orders** are a good use of limit type orders. A sell limit order can be used to exit a long position, or enter a short position. Our primary use will be to exit long positions at our targets using a sell limit. A sell limit order as a target is an order that instructs the broker to sell once our goal has been met, and the instrument is trading at or above the specified price. Remember the car analogy... let’s look at it from the perspective of seller and not the buyer. The seller or car dealer would like to sell the car at a specified price that would bring in more money than they bought it for. They probably have a price in mind and if that price is met, will gladly sell to a prospective buyer. They would refuse any low ball offers because they did not meet the conditions of the sell that the dealer had in mind. In a similar fashion when we buy an instrument low, we can sell high, and we can pre-determine a high price at which we would be willing to sell if and when the instrument reaches that price or even higher, the sell order would be executed. Take a look at a sell limit target in figure 3.20.

![Sell Limit Exit Target](image-url)

**FIGURE 3.20** A sell limit order is pending and is shown as displayed in the MetaTrader software.
**Sell short using a limit** can be appropriate if the conditions are right. It is similar to buying with a limit in the types of conditions that we are looking for, but upside down and backwards. We want to find stocks that are overpriced and slowing down, when there is a high probability that a selloff reversal will drive the price back to the mean. We anticipate the price to drop, and we can use the sell limit to enter the trade when prices are overstretched up and resistance is forming. An example of this is given in figure 3.21.

**Limit Order Summary and Review**

- Please review the limit order examples
- Buy limit at a lower price than market asking price
  - Buy at support
  - Profit target on a short position

**FIGURE 3.21** Selling with a limit as resistance forms in anticipation of price dropping back across the trading range.
Notes

- Sell limit at a higher price than market asking price
  - Short at resistance
  - Profit target on a long position

**FIGURE 3.22** Remember that limit orders are found once you've selected pending order.

Limit orders are powerful tools for traders when used properly. It is critically important that you understand all order types, and when it is appropriate to use them. Review these order types with your trading coach to make sure that you’ve got them down pat. Remember practice makes perfect.

**Stop orders** are quintessential order for traders. Understanding stop orders is critical. Stop orders often confuse traders because the term stop is frequently used with the trade management technique of stop loss, also known as the protective stop. The word stop as you have hopefully learned by now, is equivalent to the word trigger. Stop = Trigger, and stop orders are used for both buying and selling tradable instruments. They are used as orders to trigger a trade above the current price of the market. A buy stop order is used to trigger a trade when confirmation of price action is received. It is typical for a trader to place a buy stop above a candlestick high, or above a resistance point to enter a trade when prices are going up as seen in Figure 3.23.

Stop orders are used for both buying and selling.
Sell stops are also used to protect us if prices drop below a predetermined price threshold, at which point, an open position will be liquidated to prevent additional drawdown on the account. The stop order will execute the trade, and sell the instrument at market once the stop criteria has been met, as shown in figure 3.24.

![Buy Stop Entry](image)

**FIGURE 3.23** Buy stop above resistance.

As you can clearly see in this example, the sell stop is shown here as displayed on MetaTrader charts. When placing the order for a sell stop, click on pending order, and then choose the order type Sell Stop and input the data.

![Sell Stop Exit](image)

**FIGURE 3.24** A protective sell stop loss used to prevent losses, or lock in profits.
Stop orders are also used to enter and exit short sell orders. Entering a short sell using a stop loss order is typical behavior for a trader. Placing a sell stop order to trigger into a short position at a desired technical price point is a great way to get into a short trade when the market is moving in the right direction. This will allow you to set up an order that will not fill unless the market moves in the direction you anticipate. We could take a look at those exact same charts that we just used to put in the buy stop to enter and protective stop to exit, and we could twist the perspective and order type to give us a completely different story. Let’s first look at entering a short order using a sell stop to enter the trade. In Figure 3.26, you will see a pending sell stop order below support. In this scenario, it is a sell stop order designed to enter
the trade short when support is broken. The order will not fill until the trigger is hit; once hit, the stop order is sent to market, and will sell at the next available price.

Once triggered into the trade, a protective stop loss should be in place to buy to cover the position, in case it runs up against us. The Buy Stop order in this example figure 3.27 is set to cover the position above resistance, and at a pre-determined threshold.

![Buy Stop Exit]

**FIGURE 3.27** Buy stops are used to protect against loss, or lock in a profit if the instrument turns and runs up.

**STOP ORDERS SUMMARY, REVIEW AND ADDITIONAL POINTS**

Stop orders, once triggered, are sent to market as market orders, once the stop condition has been met. This means that the actual fill price is subject to what the market has available in that neighbourhood. The buy stop order is triggered based on the Bid price, and sell stop orders are triggered based on the Ask price, which makes sense, since we always buy the Ask and sell the Bid. This is easy to remember because of the two prices, the Bid and the Ask, it is always the one you don’t want. On every trade, the market
maker and the broker will get paid. An example of the sell stop order ticket below in figure 3.28 shows a pending short sell order in the chart to the left.

- Buy stop order triggers off of Bid
- Sell stop order triggers off of Ask
- Example:
  - GBP/JPY
  - Sell stop order @ 211.82

FIGURE 3.28 This order will trigger when or if the Ask price dips to or below the entry stop.

There are some drawbacks to using stop orders. Stop orders are excellent for triggering into positions both long and short, and protecting us against draw downs or locking in profits if price direction changes. Stop orders, like all order types, have some inherent problems that exist due to real life market conditions. Stop orders do not account for gaps, and once the condition is met, or the stop is triggered, the order is sent to market. In fast moving, or gapping markets, the market may fill you at an undesirable price.
• Drawbacks of Stop orders
  – Gaps
  – Triggers into a market order

**Mechanical Trailing Pip Stops** is one of the most powerful features offered in MetaTrader. Trailing stops, once implemented, will actually chase the instrument for you by a specified amount. Placing a trailing stop on a profitable order is a great way to let your winners run, and ensure a profit. It is important to note that we do not use trailing stops until a trade is in profit, but once in profit, all we need to worry about is not letting a winning trade turn into a losing trade. Many traders will adjust a hard stop up to the breakeven point as soon as a trade has covered the initial cost of the Bid Ask spread, and moved far enough beyond that point to adjust the stop up. Other Traders will use a trailing stop which will chase the stock like a greyhound chases the mechanical rabbit. To place a mechanical trailing stop on the winning trade, we need to follow a few simple steps. We start off by right clicking on the open position tracking our gain down in the trade

**FIGURE 3.29**  Gaps and fast-moving markets can potentially cause undesirable fills with stop order due to the fact that stop orders once hit are sent directly to market as market orders.
terminal. Select the position you wish to adjust the trade management on, and then right click on the position selected and chose the trailing stop. You may also chose to place a trailing stop with a profit target if so desired, and this will allow you to place a target as well. Take a look at the example in below Figure 3.30.

- Right click on open position in terminal window
- Trailing stop alone

There is a minimum requirement of 15 PIPs that the broker will not allow you to encroach any tighter than that. This is probably a good thing, due to the volatility of FOREX; anything less than a 15 PIP trailing stop would probably just be too tight. Trailing stops are a powerful tool that you can incorporate into your trading techniques, and can be a consistent part of your game plan and strategy. To become proficient with the use of trailing stops, practice with them feverishly inside the virtual trader. Play around with different settings, and see how they behave. There is a lot to be taken into consideration, such as when and how far off to place the trailing stop. Ultimately, what we are after is a “baby bear” trailing stop: not to tight, not too loose, but just right.
The Bracket order or the OCO (one cancels other) is something that we will frequently use when trading FOREX. We have already alluded to it, and even given some examples of how to set up a trade with both a stop loss, and a take profit. What a bracket or OCO order consists of is a set of orders that bracket the price on top and bottom. It is designed to stop out if the instrument turns and runs against you and to target out, or close the order with when the instrument reaches its limit. You can place a bracket on an existing order by right clicking on the position and selecting modify order. You can then input the Stop, and the Limit order, which are referred to as Stop Loss and Take Profit, inside the order ticket window and will show up on the chart as well.

MetaTrader OCO – Stops/Target

- Right click on open order in terminal window
- Modify
- Use the buttons to set stop loss and take profit

FIGURE 3.31 Allowing you to set a bracket order also known as an OCO (One Cancels Other).
KEY CONCEPT

BRACKET ORDERS ARE EXTREMELY EFFECTIVE METHODS OF TRADE MANAGEMENT.

Learning to use them properly will help you manage trades effectively, giving you initial reward to risk profiles that make sense. Once in profit, the bracket can be adjusted to ensure that you make money. It can become a question of not if you make money, but a question of how much.

CONTROL

In life, we often seek to exert control on things. In fact, many of us are admittedly “control freaks.” In order to trade successfully, we must recognize quickly that we cannot control the market. We cannot will the market to move in our direction. The truth of the matter is, the market is going to do whatever it does, and there is nothing we can do about it. No amount of hope, prayer, fretting, sweating, cursing, dancing, or burnt offerings will bend the market to our will. If only we could concentrate really hard and control the market.

Just because we cannot control the market does not mean that we lack control. We have all kinds of control at our disposal, in the form of being selective on our trade identification and patient with our triggers. We can control our entry price within reason, and we can select appropriate stop losses and position sizing, based on a well thought out plan. We can adjust our trades to lock in profits, and learn to manage our trades effectively. We need the wisdom to know what we can control, and what we cannot.
I once met a trader who had the well-known and famous serenity prayer by Reinhold Niebuhr framed and hung on his wall.

Only his version read a little different. I chuckled a little when I read it, but was not surprised when he told me it helped him be a better trader.

**THE “TRADERS” SERENITY PRAYER**

*God grant me the serenity*

*To accept the things I cannot change—*

*about the market;*

*Courage to change the things I can—*

*on my open orders;*

*And wisdom to know the difference—*

*between discipline and emotion.*
WHAT IS A GRAY BOX?

With the advent of computers and the internet, the financial markets have longed for the days of efficiency, transparency, and timeliness. In 1971, the NASDAQ was the world’s first electronic stock exchange. Its aim was to increase the volume for the OTC (Pink Sheet) stocks that were ignored by the larger exchanges. Over the past thirty plus years, we have seen the entire world’s markets fall in line.

Initiated by the NASDAQ, the electronic markets trading arena has rapidly given rise to algorithmic (algo) and automated (auto) trading. One example of the complexity and speed of such systems would be the “flash crash” of May 6th 2010; in which the Dow Jones Index dropped over 700 points in less than fifteen minutes, only to gain it all back seventy five minutes later. This illustrates a special class of algo systems known as “high-frequency trading”. Making thousands of decisions per second based on electronic market information, this program can initiate just as many orders before its human trading counterparts can process and react to the same data. The financial institutions often refer to this as “black box” or “robot” trading. It’s easy to see why. The user defines the inputs for the trading algorithm, and the computer, free of human intervention, executes all aspects of the order placement. A growing number of stock’s market makers must rely heavily on these means in order to keep pace with providing timely liquidity by automatically generating outbound and executing inbound orders.

Would you feel safe flying in a plane that had no pilots in the cockpit?

A “gray box” trading system in the financial markets is analogous to the aviation industry’s “auto-pilot”. Both were created to reduce human fatigue by analyzing user defined algorithms, based on a set of variable conditions. In some ways, both are just one step below being fully automated. The auto-pilot uses a person for the correct take off and landing, just the same way the gray box uses a trader
to determine entry and exit points. The one thing that we did not mention above was that the black box system will implement and execute any trade based on the algorithm, be they right or wrong. The gray box will do the same, but will ask you first for approval to execute the trade. The gray box uses your gray matter in the decision making process. After that, the process becomes automated unless you feel inclined to take back over the controls or just help guide the program with your personal trading touch.

**IMPORTANT SECTION ABOUT GRAY BOXES, REDFISH, AND YOU**

“One day Alice came to a fork in the road and saw a Cheshire cat in a tree. Which road do I take? She asked. Where do you want to go? The cat responded. I don’t know, Alice answered. Then, said the cat, it doesn’t matter, one is as good as the other.” – Alice in Wonderland, Lewis Carroll

Some believe that Black and Gray Boxes have a winning record of 100% without a losing trade. This would be mathematically impossible! In the realm of Gray Boxes, they were designed to alert the user of a potential combination of conditions that could lead to certain trade strategies being employed. After a trade is initiated, the conditions could change such that there is not a high probability of being successful. An analogy would be a jet liner taking off from New York in route to Los Angeles. At cruising altitude, the pilot engages the ‘auto pilot’ and takes a nap. Somewhere in the Midwest, the plane encounters a turbulent storm. The auto pilot is going to fly right into the storm and keep on going. If you were the pilot would you allow this? Or would you disengage the auto pilot, and fly it yourself because the original weather conditions have changed?

Artificial Intelligence (AI) is a theory that some day, we will be able to program computers to replicate all functions of the human brain. The step that keeps this from existing is human reasoning. Reasoning is an innately human learned process that weighs variables from past experiences through relation thinking. This is your interface into
the RedFish Gray Box system. Your reasoning skills will be based on your knowledge of the FX market and the concepts you are about to be taught. They are not hard, and will probably be a review in some instances.

When RedFish presents you with a trade opportunity, you will be just like Alice. Do you understand whether RedFish has selected the right path for you? If ‘yes’, continue down that path. If not, it may be a wise Cheshire cat decision to click ‘no,’ and wait for the next path’s opportunity. Not all paths will lead you to success; it is up to you to understand that path less travelled.

Out of ten trading opportunities presented by RedFish in trading cycle, how many of them do you believe will be correct from inception to finish?

THE META TRADER EXPERT ADVISOR

An Expert Advisor (EA) is a computer program based on a set of Forex trading signals generated by customized functions and indicators that help to determine possible high probability buy and sell opportunities for currency pairs.

The currency market is a vast ocean of interworking relationships and possibilities, too many for just one person to follow. The RedFish EA simplifies your daily Forex workload, saving you time. Its main purpose is to speed up the execution of your trading operations on all levels, such as scanning and analysis. Critical decision making systems have also been included in the areas of money and trade management.

Before utilizing an EA, each trader should know and understand mechanisms and basic features of Forex trading. Always remember that RedFish is only a tool that can aid you in making better trading decisions. The main element of Forex trading is you. Successful trading fully depends on timing and the setting of RedFish, made by you.
APPLYING THE REDFISH EXPERT ADVISOR (EA)

The RedFish EA can be found under the Expert Advisors section of the Navigator. It’s critical that when downloading MT4, the correct version of the RedFish executable file, .exe, be matched with your computer’s Windows operating system. The Windows 32 bit OES will require RedFish32.exe and the 64 bit version will need RedFish64.exe. Any mixture of these two entities will cause RedFish to work improperly, or not work at all, depending up your dealing desk’s charting package. Mac users will want to match the same files to the Windows operating systems run in parallels or boot camp.

Once downloading has been accomplished and your SIM account has been created and approved, it’s time to ensure your RedFish system functions are properly enabling the DLL imports. This can be easily done by selecting the word ‘TOOLS’ and then ‘OPTIONS’ on your MT4 main menu bar.

The Options menu should now appear. Left click to check all the outer boxes, circled in red, and uncheck the inner boxes. This will now enable all the communications between your broker’s data server, MT 4, and RedFish.
TURNING REDFISH ON INSIDE OF MT 4

In order for the RedFish EA to work, it must be installed within at least one chart. Installation can be accomplished in one of two manners:

- Left click on the RedFish EA, without releasing, and drag it over to the appropriate chart and release.

- Select the appropriate chart first by left clicking on the chart. Right click on the RedFish EA. A drop down menu will appear. Select ‘attach to a chart’. After the appropriate EA inputs are made and verified, the RedFish EA icon should appear in the chart’s upper right corner.

To Uninstall the RedFish EA or make revisions to its properties, simply right click on the RedFish EA icon within the appropriate chart. A drop down menu will appear. Select the appropriate action.
Note: When first starting, it is recommended to only use (1) RedFish EA running on (1) chart at any given time. Multiple versions of the RedFish EA on multiple charts with different Pre-Sets can cause confusion and conflicting alerts.

REDFISH EA PROPERTIES

When the RedFish EA is being applied to a chart, certain developer parameters must be selected for proper functionality. There are two tabs at the top of the EA menu box that must be reviewed before enabling RedFish: Common and Inputs.

COMMON TAB

It is imperative that the Common Tab look exactly like the picture with the appropriate (4) boxes checked.
Notes

Depending upon the trader's market bias, style, or outlook, the EA can be set to only consider Long (Bullish), Short (Bearish) or Long & Short positions.

INPUTS TAB

This section would be considered the most important part of the EA to understand. RedFish has the ability to assist you in countless combinations of pattern identification, trading strategies, money management, momentum indicator recognition, trade management, market cycle opportunities, and many more, but you, the user, must tell it the most important information pertinent to your trading plans and how you would like to make decisions. The RedFish EA enables you to create predefined EA Pre-Sets for different trading scenarios that can be recalled instantly. An example would be using different money management techniques and decision making criteria for break out buys versus retracement sell strategies, or indicator recognition routines better suited for quite time (banks closed) compared to news events (maximum volatility).
Max Trades – The number of trades that you will have simultaneously working in your account at one time.

Percent Risk – The percentage of capital risk for a trade based on the available account balance, i.e. account balance is $10,000 and percent risk is 1.0, meaning 1%, the position would be sized to no more than a $100 loss. The maximum input is 5.0 or 5% for a single position. See Money Management, page 59.

Profit Range – This is a proprietary feature unique to RedFish only. You will find in-depth discussions on pages in the following sections. RedFish calculates a Minimum, Average, and Maximum profit zone that a pattern/strategy has produced every time it has occurred. The inputs are customizeable but the basics are: (0) for Minimum Profit Range, (100) for Average, (200) for Maximum. Some presets will use (161.8) for reasons referred to in the RS Bands Section, page 59.

Stop Loss Range – Same as Profit Range used for Protective Stops. References can be found on pages 61 and 75, RS Bands and Money Management sections.

Max Spread Filter – The number of pips between the Bid and Ask spread on the currency pair. This is your trading commission. It also affects your entries and exits. Most pre-set inputs are 10. An example of the lower spread is the EUR/USD mostly at (3) pips. One of the
greater would be the GBP/AUD approximately at (18) pips. More information is available in the Money Management Section, page 59.

Came Next Filter – The RedFish order pop up box advises the trader not only of a potential entry but the likelihood of whether support or resistance should occur next, expressed as a percentage. This number is based on the total statistical sampling for the specific pattern. The input filters out trades with lower probabilities of this event. A typical input might be 50 or 60. More information can be found on page 55, RS Bands section.

Risk Reward Filter – This input is only relevant to the Pullback or Retracement strategies. RedFish will use this input, typically 2.0, to filter out trades and size your position. This input is directly affected by Profit Range and Stop Loss Range.

Number of Events – The number of times a patterns or strategy has previously occurred for a specific time frame. This is very important due to various inputs drawing on the data collected over the number of something happens. Would it be better to understand your protective stop loss placement on a pattern that has occurred (8) times or (100)? Typical input is (10). The basis for this concept is statistical total sampling referenced on page 55, RS Bands section.

SECTION 2

Enables only trade strategies based on trend when Trend Direction is ‘true’. In this scenario, the trend is defined as whether price is above or below the 50 simple moving average. The length of the average is customizeable but only if considered simple. No exponential or weighted averages are allowed.
SECTION 3

Unique to RedFish is the automated Money and Trade Management inputs. These functions will work for all enabled strategies and time frames. They take your trading plan methodologies and incorporate them into real time executable instructions.

Note: Due to the RedFish specific concepts related to Volatility, this section should remain turned off and will be discussed in Module 2, Money Management section, page 65.

SECTION 4

This section helps you concentrate on bullish or bearish directional strategies. Each of the patterns and strategies can be categorized into one of these two groups. As in the illustration above, both are turned to ‘false’. This allows the RedFish EA to scan for both types of directional plays. If bull was turned to ‘true’, the EA would ignore all bearish patterns. Even if the bearish scans were turned ‘on’ in sections 7 through 10, they would be overridden by this input.

In order to understand when to turn one ‘off’ and the other ‘on’, would be a function of following trend on a least two different timeframes and the cycle of the market day.
FIGURE 3.42

FIGURE 3.43
The chart on the left is the EUR/USD M5 (5 Minutes) on the right is the EUR/USD H1 (1 Hour). The red line arrow represents the same exact downtrend on both timeframes. It is obvious where the downtrend actually began. You may be questioning some of the violent spikes in price during the trend; those would correspond to critical news releases.

Note: Never turn both bull and bear to ‘true’. This tells the EA to ignore all bullish and bearish strategies, even if they are turned on in sections 7 through 10. This would result in no scans or pop up boxes.

SECTION 5

<table>
<thead>
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<tr>
<td>USDJPY</td>
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<td>GBPUSD</td>
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<td>USDCHF</td>
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<td>AUDCAD</td>
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<td>AUDJPY</td>
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<tr>
<td>EURUSD</td>
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</table>

In the beginning, it’s probably a good idea to stay with the Major currency pairs. The spread as mentioned in Section 1, Max Spread Filter, will also be apart of this consideration. The liquidity of some Exotic Crosses may be the last determinant. We can categorize the pairs in section 5 as:

Majors: EURUSD, GBPUSD, USDJPY, USDCHF
FOCUS FOREX 24/7 Trading in Foreign Currency

Notes

Majors (Commodities): AUDUSD, USDCAD, NZDUSD

Working Crosses (Share Borders): NZDJPY, EURGBP, GBPCHF, AUDJPY

Exotic Crosses (Separated by Ocean): EURJPY, GBPJPY, CHFJPY, EURAUD, EURCAD, AUDCAD

SECTION 6

The timeframes chosen will be a reflection of your account size and risk tolerance percentage. The higher the timeframe, the more inherent risk based off of increasing historical volatility ranges. A good suggestion might be to start off with the five minute (M5), fifteen minute (M15), thirty minute (M30), and possibly one hour (H1) ranges.

Note: Turning off the time frame and setting the input to ‘false’ only tells RedFish to ignore telling you about trading opportunities based on that TF. The EA will still allow the following for that time frame: display an MT4 chart, record information for your computers data file, and provide critical data to other scans, i.e. Slowing Momentum into Resistance.

SECTION 7

This section introduces you to the heartbeat of RedFish’s core technology. The EA has the ability to recognize and analyze thirty two different strategies based on patterns, conditions, and indicators. Section 7 contains the broadest inputs for trade identifications during

FIGURE 3.45
the Banking and Quiet Time phases of the Forex market. RedFish will search for these opportunities on eight different time frames. The content of this manual and class will not cover all thirty two strategies. Instead, the time will be spent focusing on pertinent trade setups relevant to the different phases of the market day as discussed in modules 1 – 4.

Note: All the input values for Sections 7 – 10 have been turned “off” (false). This had been done in an effort to start you off in the correct manner. If this had not been done, once the RedFish EA was activated, it would have instantly searched for (32) strategies on (8) timeframes for a total of (256) possible combinations at one time.

**SECTION 8**

The scheduled event strategies not only deal with daily economic news releases, but also look for opportunities based on changing trend momentum created by major world banks closing. This is mainly used for currency pairs pre-market and market opens, plus one hour prior to the close.
SECTION 9

Finally, sections 9 – 10 are overnight (Quiet Time) indicator based strategies. Since the greater part of the Major currency pairings (EUR/USD, GBP/USD, USD/CHF, and USD/CAD) occur in Western Europe and North America, we will mainly focus on a daily period from 5 PM New York to 5 AM London.

SECTION 10

SAVING PRE-SETS

After selecting your appropriate inputs, we can now save our settings to be recalled anytime by selecting the save button. First, a ‘Save As’ drop down menu will appear. Second, make sure the ‘presets’ folder appears inside the ‘Save in’ window. If not, you will have to click on the drop down arrow to the right of the ‘Save in’ window and browse.
for the ‘presets’ folder. Third, it's now time to name our pre-sets file. In the example below, we entitled our inputs “My Favorite Set for Slow Time.” Notice the file type extension is ‘.set’. If we do not add this to the ‘File name’, you must make sure that the ‘Save as type’ is ‘Expert Set (*.set). Finally, left click the ‘Save’ button.

**LOADING PREVIOUSLY CONSTRUCTED SET FILES**

You can load your RedFish EA with previously built ‘presets’ files simply by right clicking the RedFish icon in the upper right corner of your chart. A drop down menu will appear select ‘Expert Advisors’ then ‘Properties’. Use the menu, similar to the one below, to browse for your file. Once found either double click the file name or left click the ‘Open’ button.
For your convenience, the developers have already built and loaded three .set files for your discretionary use. These files correspond to settings based on the Western European, London, and US currency pairs. They are entitled RedFish 6 to 3, RedFish 3 to 5, and RedFish 5 to 5.

Note 1: You will want to review the inputs for these files, especially Sections 1 & 3, which deal with risk percentages and money management, respectively. For a better understanding of Section 3, please refer to page 65.

Note 2: As previously addressed, you should start out with only (1) RedFish EA on (1) chart at any given time in order to avoid confusion and duplication of alerts.
INSTALLING REDFISH INDICATORS

Your Meta Trader 4 (MT4) comes with a set of standard chart indicators located in the Navigator window under the Indicators sub menu. RedFish supplies its own proprietary chart overlay and underlay studies. They can be located in the same Navigator window under the Custom Indicators section. If you do not see a Navigator window, go to the main menu and select view. Then select Navigator, the Custom Indicator list will appear beneath the Expert Advisors section.

To use an indicator, simply locate it under the Custom Indicators list in the Navigator window. Left mouse click to select the indicator and drag it to the appropriate chart. For this example, we will choose the RedFish – Pivots. After dropping the indicator on the appropriate chart, a popup menu will appear, allowing you to customize inputs. Note: If any indicator has an input for ‘Shift’, please change the number from (1) to (0).

![Custom Indicator - RedFish R1 S1 Labber](image)

FIGURE 3.52

To remove or modify an indicator, left click anywhere on the appropriate chart. A popup menu will appear, displaying the active indicators for that chart. Select the appropriate indicator, and choose Delete or Edit.
FIGURE 3.53

DATA PREP

FIGURE 3.54
When first beginning with RedFish, it’s a good idea to build data files on your computer’s hard drive for all the different currency pairs and their respective timeframes. This will insure a clean install, and a good first start to your RedFish experience.

To accomplish this, simply load the RedFish – Data Prep indicator on any currency pair’s chart using a five minute (M5) time frame. When the data download is complete, you should see results similar to those in the above illustrated chart.

The indicator only needs to run once. Once used, it should be deleted from the chart.

Will I ever need to run this process again? Answer: If your charts appear to be out of sync with the market, simply follow the above steps again. This will rebuild your files with good data from the dealing desks servers. Once completed, delete the indicator from the chart, and restart MT4. Most dealing desks keep a minimum of six months worth of currency pair’s data on their servers; there are a few that keep data all the way from 1999!
CHAPTER 4

INTRODUCTION AND REVIEW OF TECHNICAL ANALYSIS
"Technical analysis works precisely because people look at it. And if people care, I care.”  John Bollinger of Bollinger Capital

Technical analysis of the financial markets has been around for the better part of a century, if not more. It is the study of price action over time. Practitioners of technical analysis will tell you that they can learn more from looking at a chart in just a few brief moments than they can from reading all of the financial analytics and news available on the worldwide web.
Technical analysis is the study of price action which is based on transactions made between buyers and sellers. Tracking the transactions that have been made, and paying attention to pivotal points on the charts, gives us insight into the mindsets of the traders who made them. Through the study of charts, we can read into the psychology of the market. This is a logical assertion, given the fact that monitoring people's buying and selling behavior tells what market participants are actually doing. Their actions in theory are based on preceding thoughts.

Therefore, we can make reasonable assumptions about their psychology, depending on what we see in the charts. Markets move in repeatable patterns that are based on deeply rooted human behavioral patterns. Because human behavior is somewhat anticipatable, when we see certain patterns emerging in the price movement of a chart, we can interpret the information and potentially anticipate what the market is likely to do next. Unfortunately, many people think that technical analysis can somehow magically be used to predict the future, when, in reality, we would need a crystal ball that actually worked (unlike the one Uncle Bob purchased on eBay). The Anti-Technical analysis camp (the non-believers) will go so far as to assert that technical analysis is a bunch of mumbo jumbo, and that there is no way to consistently predict market actions. They subscribe to the “random walk” theory, and insist that market investment must be long-term and fundamental in nature to be profitable. It is impossible to outperform the market or its sectors. A few years back, there was an article in a highly circulated financial newspaper which shall remain nameless. A
financial columnist wrote a nine-page diatribe insisting that technical analysis was garbage, and about as reliable as an old jalopy. The author of this article proceeded to pontificate and extol the virtues of the random walk theory. The original random walk thesis couldn’t have possibly been as long as this article was, or as passionate about its defense. The next day, there was an editorial response, that in one tiny paragraph, deflated the entire nine-page diatribe. The editorial simply read: Dear Mr. Author, Your assertion that technical analysis is nothing but voodoo is both uneducated and uninformed. If you would like to learn more about technical analysis from a serious practitioner, come visit me at my Michigan lake house, which technical analysis paid for.

No, technical analysis cannot help us predict the future, but it can give us insight, and help us make reasonable forecasts. In the short-term world of trading, technical analysis is much more effective than it is in the longer-term investor’s perspective. One of the core axioms that this course is based on, is that technical analysis is more accurate in the short-term time frame, and therefore most of our trading strategies will be very short-term.

Technical analysis is the foundation of the FocusFX methodology, and we are big fans and believers in the ability to properly analyze a chart. We believe that fluency in various forms of technical analysis can give a trader an express edge, and when coupled with good trade management can be an extremely powerful one, two punch. It is chart literacy that gives us the ability to identify opportunity, time the markets, analyze proper exposure to risk, etc., and ultimately take profits.
Most courses in FOREX discuss magic indicators and red and green lights systems. These types of “magic” systems are what are called black box systems. They are called black box systems because you don’t necessarily know what goes into them. Many of these “magic black box systems” claim to be the “Holy Grail,” when, in reality, these type of black box systems are typically flawed in some way or another, and can be absolutely financially devastating when used without knowledge and discipline. The FocusFX approach to technical analysis and trading is not like other forex companies that are out there (and we do mean out there).

The FocusFX approach is to:

1. Equip you with knowledge, and prepare you mentally
2. Give you methods and techniques that you can apply in real market conditions
3. Help you develop risk management skills

Before we can run out and teach you trading techniques, we need to establish some knowledge of technical analysis. Then, we’ll teach you some brilliant trading techniques which will need to be coupled with good risk management. The FocusFX system isn’t “magic;” rather, it is brilliant. So, let’s get started. Let’s talk technicals.

**FOUNDATION FOR TECHNICAL ANALYSIS**

The first thing we need to establish is how to read a basic price chart. Price charts track a tradable instruments price action over time. So the two ingredients we have so far are price and time. Price charts are based on a Cartesian graphing system. The Cartesian graphing system is named after the French mathematician René Descartes. You’ve probably already been introduced to Cartesian graphs when you took algebra, geometry or trigonometry back in junior high and high school. Don’t worry, the math does not get that complicated. We simply need to construct an X, Y axis graph. When it comes to tracking price overtime, the X axis is used to track time, and the Y axis is used to track price. in figure 4.1, you will immediately recognize the Cartesian graph, that is used to track price over time.
The Y axis can be set to track any increment of price, and the X axis can be set to track any increment of time. The fast-paced FOREX market price action could be tracked over one minute, five minutes, 15 minutes, hourly, daily, weekly, monthly, etc. Literally any time frame can be used. Our FOREX charts will automatically adjust the Y axis for price to match the typical ranges of the time frame we are looking at. What does this mean? Well, if you are looking at a five-minute chart, the Y axis will be in smaller increments of price than if you were looking at, say, an hourly chart. It is extremely important to pay attention to what time frame you are looking at, and what type of increments that price is moving in over that time frame. In FOREX trading, we will be studying multiple time frames in order to properly assess a chart. We will be frequently switching back and forth between time frames, so pay attention to the time frame you are on.

In figure 4.2, you will see the MetaTader price chart with the data.
sets labeled to help you orient yourself, and familiarize yourself with the format and layout of the charts. One thing that you will notice is that this graph is only tracking the closing price, but the software is also tracking the opening price, the high price, and the closing price, or the last traded price. If we are only tracking the close, we are only getting part of the story. Market technicians have devised many ways to track the data, but the most common and popular are the basic line chart (close only). To track the full set of data, we will use either bar charts or candle charts. In figure 4.3 below, we compare and contrast a Western Bar chart on the top, and a Japanese Candle chart on the bottom. These charts are identical GBPUSD charts, measuring a one-hour time frame. A seasoned technician can easily read both charts.

FIGURE 4.3 Two different style charts reporting the same set of data. The top graph is a western chart. The bottom graph is a Japanese candlestick chart. One bar or candle equals one of the the prescribed time frame setting. Each candle and bar equals one-hour of time on this chart. Note the OPEN, HIGH, LOW, CLOSE labels that assist you in reading the candle charts.

In fact, most technicians use the terms candles and bars interchangeably as a measure of a single-time frame. The FocusFX method will favor candles over bars for the simple fact that they pop, and clearly show us the direction of the chart up or down, without having to squint your eyes to see the open and close. If you are new to
candlestick charts, white hollow candles are upward movement in price where the close is higher than the open, and filled-in solid candles are downward movement in price where the close is lower than the open. The use of bars, candles, or other styles of charting is just a matter of preference. What is most important is that you know how to read it. That means if you don’t already know candles, you’ve got some studying to do…

**CANDLES ENLIGHTEN US**

A rock-solid understanding of candlesticks and candle patterns will enlighten you as a trader, and help you make more intelligent and well-informed decisions. This Manual will not give a full treatment on candles, but we will briefly review them, and remind you to make sure that you familiarize yourself on candlesticks and candle patterns. We assume that prior to your coaching sessions, you have some experience and background already with technical analysis, and candle charting specifically. If this is new information to you, ask your coach to point you towards some supplemental materials.
TYPES OF CANDLESTICK/PATTERNS

QUICK CANDLE STICK PATTERN REVIEW

The Bullish Engulfing Candle entirely engulfs the preceding day’s candle’s range or real body. The candle usually opens at or near the day’s low, and closes at or near the day’s high. As the name insinuates, this pattern suggests that the bulls have taken control of the action, and are now driving up the price. As discussed in the long candlestick section, a non-shaded long candlestick is evidence of increased buying pressure. Since this non-shaded candlestick’s move up is so much more dramatic than the preceding smaller, shaded candle, it is taken as a possible end to a previous downward trend.

The Bearish Engulfing Candle entirely engulfs the preceding day’s candle’s range or real body. The candle usually opens at or near the day’s high and closes at or near the day’s low. Again, as the name implies, this is a bearish pattern which suggests that the bulls have lost control to the bears, and that the bears are now pushing the price of the stock downward. Holding true to the engulfing pattern, the move of the shaded candlestick is much larger than the preceding smaller non-shaded candlestick, indicating increased selling pressure and giving further strength to sellers.

The Many Faces of Doji (Doji, pronounced do’-je, is the same for both singular and plural usage) is one of the most commonly recognized patterns in candlestick charting, and looks similar to a plus sign or a cross. The doji is considered the single best candlestick for power and reliability. The doji is formed where the opening and closing prices are equal, or almost equal, leaving no real body. The upper and lower shadows are equal in length. The doji is a signal of indecisiveness and the trader, after watching the doji appear, then confirms the direction of the doji by looking at the candle the next trading day. For example, if the trend was bullish, but the doji
appeared, then the trader would wait and confirm the doji the next day. If the candle was bearish, then the doji has, with high probabilities, predicted a change in direction, or bearish, for the next trading day or days. Doji convey a sense of indecision or a standoff between the bulls and the bears. As the price moves above and/or below the opening price, then closes at or near that same price, this shows us that there was a tug-of-war and that neither the bulls nor the bears were able to gain control during that session. This is often an indication of upcoming reversals in the near future, when either the bulls or the bears finally wrestle control away from the other. Similar to determining a long candle, the Doji do not have absolute rules for determination; however, the presence of a Doji will help determine the next short term move, depending on the candlesticks that come before the Doji. For example, a Doji present in a sideways move of the security is generally not very helpful. Similarly, a Doji at the end of a previous run of other Doji is not very revealing. Ideally, a Doji by itself, without the presence of preceding Doji sessions, gives a better indication of what is likely to happen. For example, a Doji at the end of a run up preceded in particular by longer candles is a strong indication that there is significant indecision, and it could result in a change in direction—at least for the short-term.

**Long-legged Doji** have long upper shadows and long lower shadows. These shadows are very similar in length, which give hints of tremendous indecision with the security coupled with high price volatility. These candlestick patterns tell us that even though the security showed a drastic difference between the high and the low during the session, it still closed at virtually the same price as where it opened.

**The Dragon Fly Doji** forms when the open, high, and close are equal, with a significant low represented by a long lower shadow. This lower shadow tells us that the sellers controlled a good portion of the session, but the buyers re-emerged and pushed the price back up to the opening price, which was also the high.
This formation can be a strong indication of bullish sentiment in the immediate future in the midst of a downward run. It can also be a bearish indication of an exhaustion point at the end of an upward run, as bullish trader’s attempt a “last gasp” rally before the price reverses to the down side.

**The Gravestone Doji** is the exact opposite of the Dragon Fly Doji, with the opening, closing, and high prices occurring at or very near the low of the day. This upper shadow tells us that the buyers controlled the majority of the action during the session, but that the sellers mustered up one more push downward, leaving a long shadow on top, abating the rally earlier on. This formation is typically a bearish indication for the immediate future. During a downward run, stocks typically find a support level at which they tend to hold their value, and even attempt to rally back to the upside. The appearance of a Gravestone Doji in this case can be a strong indication of a continuation of the current downtrend, while at the high end of an upward rally… it usually indicates a significant change in the prevailing market attitude about the stock to the down side.

**Long Candle or Expanded Range Candles** refer to the length of the candlestick body—the difference between the open and the close. Candlesticks of this nature indicate that there was a relatively large range of price movement in the stock, and that the difference between the open and the close was considerably different. Now, you may be asking yourself, “What is relatively large?” The answer to that question is, “It’s all relative.” Since the use of Japanese candlestick analysis is applied almost solely to short-term time periods, a long candlestick can be compared only to previous candlesticks during this short-term. Generally, one to two weeks is appropriate and will give you a good perspective, thus allowing you to judge accordingly. In general, the longer the body, the more buying or selling pressure is evident.
Narrow Range or Short Candles as shown can also be analyzed under the same relative time frame discussed in the long candles section. They represent a less significant variance between the open and the close during the day, resulting in a smaller real body. The smaller body gives evidence to less buying or selling pressure, and often points to consolidation periods. You will also hear these shorter candlesticks referred to as narrow range candlesticks.

Marubozu Candle is a long candlestick body without any upper or lower shadows (sometimes known as a bald or shaven candle). This shows us that the open and the close are also the low and the high for the day, respectively. These candlesticks typically give equally strong indications.

A White Marubozu is formed when the open and the low are equal, and the close and the high are equal. This is an indication that the buyers (or the bulls) were in charge of the session from start to finish. This candle will often indicate the first phase of a bullish continuation or a bearish reversal candle pattern.

A Black Marubozu is formed when the open and the high are equal, and the close and the low are equal. This is an indication that the sellers (or the bears) were in charge of the session from start to finish. This candle, as opposed to the white Marubozu, indicates the first phase of bearish continuation or a bullish reversal candle pattern.

A Spinning Top is similar to a Doji in nature, representing a potential change or interruption in the current trend. The small real body (shaded or non-shaded) shows little variance between the opening and closing prices. Like the Doji, this tug-of-war between the bulls and the bears as represented by upper and lower shadows shows indecision and suggests that the current trend could change. Although we have more individual candlestick formations to examine, let’s pause for a moment and discuss candlestick shadows, or wicks, in a little more depth. Shadows have significant relevance to the candlestick formations we still need to consider.
The Shadow Knows  Shadows on both the upper and the lower side of the real body can be helpful in deciphering what occurred during the session. Candlesticks with short shadows usually mean that the majority of the trading action occurred near the open and the close. Candlesticks with long shadows typically infer that the trading action took place well beyond the open and the close.

**Candlesticks with short upper shadows and long lower shadows** indicate that the bulls had control during the majority of the day, and drove the price higher on the security. However, this long shadow on top tells us that selling pressure later in the session drove prices back down from their highs, indicating that the bulls lost control.

**Candlesticks with long upper shadows and short lower shadows** indicate that the bears had control during the majority of the day, and drove the price lower on the security. However, this long shadow on the bottom tells us that buying pressure later in the session drove prices back up from their lows, indicating that the bears lost control.

In other words, longer shadows on the bottom reveal a potential turn-around from a current move downward, giving signals that the security could go to the upside. A longer shadow on the top indicates some potential weakness, and thus we would look for a possible move to the downside. These longer shadow lines are also referred to as umbrella lines.

So far we have introduced various single-candlestick patterns. Although these patterns will often give us hints as to what could possibly happen, we need to take the context into consideration. None of these individual candles, taken by themselves, give a decisive indication to the likely future price action. For candlesticks to be of pertinence to forecasting the future direction of a stock’s price, you need to look at what has previously happened to its formation. We have alluded to looking at the broader picture, but let’s take it a step further with these next formations.
**The Hammer Candlestick** has a smaller real body with little or no upper shadow and a longer lower shadow. Generally, the best indications from this formation come when the length of the lower shadow is at least twice that of the real body. This formation occurs in both uptrends and downtrends, but is referred to as a Hammer only in a downtrend. It is named as such because it looks like a hammer, and oftentimes is “hammering out” some level of support. When a hammer develops at the end of a run down, this is usually taken as a signal that the bulls have revitalized and are back on the scene. The lower shadow, as discussed in the section, indicates that the sellers drove the price down during the session and were in control for a time. However, as the close forms relatively near the opening price, creating a smaller real body, you can assume that buyers have pushed the price up a significant level from the low of the session, ending on a strong move. This reduces the bearish sentiment and signals that a potential move to the upside may be near.

**The Hanging Man** is just like the Hammer in that it is found at the end of a run and has an identical shape. However, where the Hammer is at the end of a run down, the Hanging Man is found at the top of a run up. In a bullish environment, a Hanging Man will form at or near the end of the ascent, with the lower shadow of the Hanging Man giving a hint of potential weakness and increased selling pressure. Although buyers forced the stock back up from the low of the day, this longer shadow should be taken as a potentially changing market condition for the short-term. Also notice that a long upper shadow is present on the candlestick preceding the Hammer on the first and third chart, giving us an additional preview of the weakness of the bullish move in each example. It is worth noting that the shading of the real body in a Hammer or Hanging Man formation isn’t considered as important as the overall formation and the pattern of previous Doji it occurs in. In either case, this candle is taken as a signal of a likely reversal in the near future.
Notes

**The Inverted Hammer** is a bullish reversal pattern that forms after a decline. It is similar to the Hammer, but as its name suggests, it is upside down. There is little or no lower shadow, and the upper shadow is about twice as long as the real body. After a move down, the long upper shadow alerts us that the buyers were in the game, but that the elevated level was not able to be sustained, and the security dropped back down significantly from the high of the session. Although this higher price level did not hold, it does indicate that sellers are losing momentum and that buying pressure may be just around the corner.

**The Shooting Star** looks exactly like the Inverted Hammer, but it forms after an advance, indicating a possible reversal of the trend. Think of this pattern in similar fashion to its name. If you happen to catch sight of a shooting star in the night sky, how long does it last? Not long, of course, because they only show up as they burn out! A stock with this formation at the high end of an upward run will usually “flame out” just as happens in the meteorological sense. Generally, this pattern also has a smaller real body, while the upper shadow is at least two to three times longer than the body. Also, unique to the Shooting Star is the gap up from the previous day. As buyers try to force the stock higher, the rally struggles to continue, as noted by the longer shadow up top, and the security closes near the low of the day. Thus, this pattern hints at a potential turnaround.
CANDLES SUMMARY

Candles tell a story of price action over time. Think of them like the sports re-caps on the news. They give you a couple of highlights and the final score of the game. The size and shapes of candles and shadows can shed some light on the psychology of traders. Candles are powerful technical tools that will serve you well throughout your trading career.

PIVOTS

If we were to look at a counter-balance scale with little weights that represented demand on one side, and little weights that represented supply on the other, and we had more demand than supply, the scale would not tip until the supply started to outweigh the demand.

When we see that shift from demand to supply, or from supply to demand, the emotions and decisions of traders and investors can shift from greed to fear, and fear to greed very quickly. As the shift in the direction of price movement occurs, traders act and RE-ACT to each other. Whenever we see this shift in price direction from demand to supply, or from supply to demand, a Pivot point is formed on the
chart, and it leaves a “footprint” on the chart that can provide “clues” for us as traders and investors, from which we can extrapolate valuable insight into the thoughts and actions of the people actively trading any particular stock. Understanding pivots, how and why they form, as well as when and where they are likely to form is the foundation on which we are going to build the majority of our trading techniques. Understanding pivots will empower you as a trader.

**PIVOTS ARE RANKABLE**

Pivots define support and resistance, denote a change in market sentiment, and potentially can be the starting point for new trends. Pivots start with small changes in direction, and are easily recognized on a price chart. They are the peaks and valleys on the price chart. Pivots are commonly referred to as swing highs or swing lows. Pivots mark shifts in supply and demand, and have the potential to mark the beginning of significant trends. All pivot points start out with small movements in price; they denote a change in trend on a smaller time frame. Pivots are like tornados or hurricanes, in that when they first register on the meteorologist radar, they are small, but because they have the potential to grow, they need to be watched.

A categorical ranking system for pivots exists that is similar to the categorical ranking given to storm systems. A tropical storm may
grow and become a category 1 or 2 hurricane, at which time people start paying attention out of concern for higher category systems that are forces to be reckoned with. Pivots, too, start small, and if price movements and trends grow, they can be assigned a higher categorical ranking, and pivots that garner major categorical rankings need to be given more consideration than pivots that are not as significant.

The categorical ranking of pivots ranges from minor to primary. There are four total categorical rankings: minor, intermediate, major, and primary. Minor pivots are common, and an excellent measure of short-term trends. Intermediate pivots are good measures of benchmark support and resistance levels, and are measures of intermediate position style trends. Major pivots are the pivots that stand out on a chart, the massive benchmark highs and lows that everybody and their dogs can see on the chart. All types of traders and investors, regardless of time frames, will recognize these types of pivots, due to their extremely obvious nature. Primary pivots are not that common on a chart because they are the pivots that mark all-time highs and all-time lows. Spotting primary pivots requires looking at long-term historical charts with enough time loaded on the chart to see those historically significant price levels that the chart has not revisited in quite some time.

Clarity on the ranking of pivots and how to use pivots to identify trends is essential. The ability to identify trends and trend cycles using pivots rather than any type of secondary indicator or moving averages will give you an express advantage because pivots happen in realtime. All other indicators are lagging.

**PIVOTS DEFINE TREND**

Price and pivots define trends. I’m sure you’ve heard the old Wall Street adage: the trend is your friend, or always trade the trend. This is good advice that we would be wise to follow; however, it is often easier said than done. In order to effectively trade trends, we need to understand and define them. You also have to realize that there are different types of trends and micro trends that form within the context of macro trends. Trends occur on all time frames, and what type of trader you are will help you determine which trends to trade. Trends can be categorically ranked and defined. The measure of a trend is based on the time frame you are measuring, and the type of pivots that define the trend. Let’s first define the direction of the trend.
**Notes**

**Pivots Are Rankable**  
Minor pivots mark minor shifts in supply and demand

**Pivots Are Rankable**  
Intermediate pivots mark intermediate shifts in supply and demand

**Pivots Are Rankable**  
Major pivots mark major shifts in supply and demand
**Uptrend**  = Higher Swing Highs /Higher Swing Lows  
Caused By Increasing Demand

**Downtrend**  = Lower Swing Lows/Lower Swing Highs  
Caused By increasing supply

**Trendless**  = Failure To Establish New Highs Or Lows  
Due To Stagnation/Complacency

**Trends**  = Are Rankable Based On Pivot Types

FIGURE 4.5

FIGURE 4.6 There are minor pivot trend lines drawn on the the minor pivots, an intermediate trend line drawn on intermediate pivots, and a major trend line drawn on the major pivots.
Trends are defined by pivots, so it would be logical to extend the categorical ranking system used for pivots to trends. Trends are rankable and based on pivots that are rankable. Many market technicians define trends based on time or duration of trend. Focus FX acknowledges that durations of trends is a viable measure of trends; however, this type of measurement relies on ballpark estimates, and is not specific enough to capture the essence of trends. Trend lines have been used by market technicians for eons as a dependable way to measure, identify, and forecast trends. Using the pivot ranking system to guide the plotting of trend lines helps us not only be better technicians, it opens up the eyes to see the various rise and run of the different trends. In Figure 4.6, there are minor pivot trend lines drawn on the minor pivots, an intermediate trend line drawn on intermediate pivots, and a major trend line drawn on the major pivots. To properly draw a trend line, two pivots are required. By connecting a minimum of two pivots, and then extending the line out to the right of the chart, you can predict a future forecast. Trend zones are places where pivots are likely to form, and changes in direction are likely to occur.

FIGURE 4.7 This technique, combined with good candle analysis, can help you identify forming pivots, and potential opportunities for profits.

SECONDARY INDICATORS

Secondary indicators are popular among technicians because they can potentially help a trader understand market conditions better. Much like a thermometer or barometer can help a meteorologist understand weather conditions, secondary indicators can help traders understand
market “temperatures” and “pressures.” Secondary indicators measure price movements and attempt to provide interpretation. Thousands and thousands of indicators have been developed, but only a select few have merited acclaim. A few of these more effective indicators have become very popular among traders, and are found in most trading software platforms. FocusFX MetaTrader has a multitude of indicators that are at your disposal. These indicators can be easily plotted on a chart and used to confirm or signal trading decisions.

There are three core types of indicators: trending indicators, oscillators, and envelopes. Figure 4.16 has two commonly used oscillators and moving averages, which are considered trending indicators. Trending indicators include moving averages, multiple moving average crossover systems, directional trending systems, and indicators like a DMI. Oscillating indicators include the ever popular MACD and Stochastic, as well as RSI’s and Money Flow Indicators. The list of oscillating indicators is quite long and extensive. Envelope systems are based on deviations and probable ranges of the tradable instrument. They include Bollinger bands, envelope indicators, keltner channels, etc. The aforementioned indicators have been written about ad nauseum, and it is not the intent of this manual to re-invent the wheel, so we will not go into an in-depth write up of these indicators. A good basic internet search will yield plenty of information on the topic. We will, however, discuss them in short, in order to prepare you for the next chapter. Secondary indicators are inherently flawed because they are

![Figure 4.8](image-url) This chart has a couple of commonly used moving averages, an RSI and a MACD.
lagging, and look at the past to try and determine the future. Although they can be helpful, all too often traders fall into the trap of basing trading decisions on indicators alone. Secondary indicators are also based on mathematical formulas that allow traders to adjust certain numbers within the formula to alter performance. The default settings in indicators may not actually fit the particular instruments personality, and thereby provide poor signals and indications. This is one of the core precepts of the FocusFX trading technology. Indicator performance can be enhanced dramatically through dynamic adaptation of the indicator to match the instruments personality, and automatically self adjust.

Trending indicators like moving averages, crossover systems, etc., work by tracking and averaging price movement over-time. They are lagging indicators, and despite what some people believe, do not define trends they follow and monitor them. They do not anticipate market movements; however, they can be sensitive to changes in momentum or rate of change.

When trends change, the lagging qualities of the indicator serve to signal changes in trend, as prices move the opposite direction, and the indicator’s slow response to changing prices causes the price to cross above or below the moving average respectively.
Crossover systems rely on lagging effect of two moving averages, usually a fast and a slow moving average either simple or exponential. The crossover systems come in many shapes and sizes, but at the end of the day, they are a lagging indicator that can confirm changes in trend, but do not define them. They look good on a chart, but typically give up too much money for confirmation, and in choppy or sideways markets, the lagging signals can be terrible. Traders have used them with varied levels of success. FocusFX methodologies consider crossover systems a less effective measure of trend and changes in trend.

**Oscillating Indicators** are indicators that fluctuate above and below a zero line or a centerline. Sometimes they oscillate between set levels as its value changes over-time. The breakdown of oscillator types begins with two types: centered oscillators which fluctuate above and below a center point or line, and banded oscillators which fluctuate between overbought and oversold extremes. There are even hybrid oscillators that combine both types of oscillators and some belong to more than one category. Generally, centered oscillators are best suited for analyzing the direction of price momentum, while banded oscillators are best suited for identifying overbought and oversold levels. **Centered oscillators** fluctuate above and below a zero line or central point. These types of oscillators are good for confirming the direction of a trend, strength or weakness, and some are particularly good at gauging the momentum of the underlying instrument. MACD (moving average convergence divergence) is an example of a centered oscillator that fluctuates above and below zero. The MACD measures the difference between two moving averages. A popular setting for the MACD is the 12-day EMA and 26-day EMA of the underlying instrument. The name of the indicator convergence divergence measures whether the two moving averages are moving further apart, or diverging, or if they are pinching together, or converging. Many people look for crosses of the moving averages, or crosses above or below the zero line. Figure 4.18 gives examples of this popular centered oscillator.
Indicator divergences are powerful signals that can help a trader identify potential changes in trend. In figure 4.12, you can see a MACD indicator bearish divergence on the left, and a bullish divergence on the right. Divergent conditions on indicators are usually an indication of decreasing momentum in a trend, and most oscillating indicators provide divergent signals which when properly identified can both warn a trader of potential danger and potential opportunities to capitalize on a change in trend.

**Banded oscillators** will rise above and fall below two bands that denote extreme price levels. Readings of the indicator above the upper band expresses overbought conditions and readings below the lower band correspond with oversold readings. The bands are typically set to a default, but can be adjusted either up or down. Most traders use the default settings on all instruments, giving the end user the consistent ability to identify overbought and oversold conditions. Perhaps the two most popular banded oscillators of all time are the **Stochastic Oscillator** and the **RSI (Relative Strength Index)**.

There are, of course, many additional oscillating indicators such as **MFI (Money Flow Index)** and **CCI (Commodity Channel Index)** to name a few. Due to the more complex formulas and rational that goes into these types of indicators, we will not go in depth on them, but if you are mathematically inclined, the formulas for these indicators are not too hard to come by. For this course, we will introduce you to the basic concepts, and cover the pros and cons of the use of some of these indicators.
The Stochastic Oscillator uses readings above 80 for overbought and readings below 20 oversold. The RSI uses different levels for the bands; overbought and oversold are usually set at 70 and 30 respectively. A reading greater than 70 would be considered overbought and a reading below 30 would be considered oversold. The Relative Strength Index (RSI) is range-bound by 0 and 100, and will never go higher than 100 nor lower than zero. The Commodity Channel Index (CCI) is not range bound, but extreme readings are considered overbought and oversold. There are many uses and many fans of these indicators. They certainly have their merits, but they also have their flaws and short comings, which we need to discuss in order to heighten your awareness.

**Pros and Cons of Oscillating Indicators**

Centered oscillators are best used to confirm the direction of underlying instrument, and are particularly good at measuring the strength or momentum of the underlying price move. Generally speaking, they can confirm trend by gauging if the reading is positive (above zero) or negative (below zero). They do not, however, define trend by any stretch of the imagination. They are easy to use, and because of this, traders tend to rely on them too heavily without ever achieving clarity.
on actual trends and price action. The number one problem with these indicators is that they are lagging indicators. There is one more kink in the works for these indicators. The mathematical settings typically used are software defaults, and they don’t necessarily match up with the underlying instrument’s personality. It is possible to adjust the indicators settings for enhanced or individualized performance that syncs up with the rhythm of that particular instrument. The biggest difference between centered oscillators and banded oscillators is the latter’s ability to identify extreme price levels. While it is possible to identify excessive price swings with centered oscillators, they are not ideal for this purpose. Banded oscillators are best suited to identify overbought and oversold conditions.

Oscillators have been used by technicians to generate buy and sell signals of various nature. The most commonly used signals are geared toward early entry, at forming tops and bottoms, or the formation of pivots. The nature of the formulas makes the indicators particularly good at identifying changes in sentiment and direction. One of the most powerful aspects of oscillating indicators is divergence. Bullish and Bearish divergence is a key concept behind many signals for oscillators as well as other indicators. Divergences can serve as a warning that the trend is about to change or set up a buy or sell signal. FocusFX methodology suggests that it is important to use these signals in conjunction with other aspects of technical analysis. Price patterns, pivots, trends, and volume should also be taken into consideration first.

Envelopes are commonly used indicators that are based on various measures of standard deviations in price. There are several types of envelope indicators that have been designed to overlay on top of a price chart. Envelopes are used to identify the statistically probably trading ranges. Ninety-five percent of trading activity will occur inside a properly placed band. When price extends beyond the bands, either up or down, it is considered overbought or oversold, respectively.

Bollinger Bands are a popular envelope system common to most technical software packages. Bollinger Bands were invented by John Bollinger in the 1980s. They originate from trading bands; Bollinger Bands can be used to measure volatility and probable trading ranges. Bollinger bands are based on a moving average with an upper band that is two standard deviations above the moving average, and a lower band that is two standard deviations below the moving average. The Bollinger Band is adjustable in a couple of
different ways; adjusting or changing the number of periods used in the moving average or by adjusting the number of deviations used to calculate the upper and lower bands. The use of Bollinger Bands varies wildly among traders, and various signals based on the bands have been developed. Bollinger Bands can help a trader measure volatility, when Bollinger Bands are far apart, volatility is high. It is the increasing volatility that causes the calculations of the bands to spread the upper and lower band apart. When the Bollinger Bands are close together, volatility is low, and caused by consolidations in price. In both instances, the expectancy is for the volatility to revert to normal levels, and the bands to return to typical widths, where the normal distribution of trading is more in sync with its typical expectancy.

Keltner channels are named after Chester W. Keltner who described his channels in his book *How to Make Money in Commodities*. Keltner based his channels on the well-known Ten-Day Trading Rule. That is why in classic Keltner Channels, the centre line is based on a 10-day simple moving average of typical price, (typical price = high + low + close divided by 3) The upper and lower bands or envelopes are plotted a distance from that centre line which is based on high low range of the same 10 periods. There are many benefits to using Keltner channels. They are not as sensitive to shifts in volatility, and therefore, give a more normalized range of probable

![FIGURE 4.15](image)
price range. There are many uses and applications of the Keltner channels from trading to buy and sell signals, to targeting methods and risk tolerances. The possible drawbacks of Keltner Channels are the one-size-fits-all hindrance most indicators have. Keltner Channels can be adjusted or customized, but otherwise, once placed on a chart are static, and do not adapt with the change in tempo of price movement.

CONCLUSION

It is important to have a rock-solid foundation in technical analysis. Understanding price movement is first and foremost. A solid understanding of candlesticks and pivot points will help you gain insight into market movement and psychology. Secondary indicators measure price and have many valuable uses. Because secondary indicators are based on basic price data, they are always lagging, despite what some publications claim. Because each individual trading instrument has its own unique personality and tempo, it is important to note that secondary indicators, can be improved if the settings used help sync the indicator with the instrument for improved performance and signals. The more clearly you understand the rational and interpretation of these secondary indicators, the more useful they can become. There are no magical indicators, or combination of indicators, but there are benefits of using indicators properly. We are about to delve into the world of advanced technical analysis which requires a good foundation in common technical analysis. Once you’ve learned how to walk… Running is not far off.