HAVE YOU REALLY MASTERED FOREX TRADING?

FIND OUT IF YOU COULD IMPROVE!

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WHAT'S ESSENTIAL FOR TRADING SUCCESS?

There are at least three crucial factors. It's impossible to trade successfully in the long term without a system that tells you when to enter and when to exit the market – a trading system. Second because you're a risk taker, you need to manage risk, with written rules that cover stop-loss orders and position sizing.

The third factor is self-mastery. Considered more important than the other two combined, it's everything about you that enables you to build or define a workable trading system, set down written rules for risk management, and stick to the trading and risk management rules without fail. That last part – sticking to the rules – can be the hardest.

To see how far down the road to success you have travelled, ask yourself this vital question: Can I enter a trade without caring whether it makes a profit or a loss? It's surprisingly difficult to be so detached, but it's essential for success. As you calmly read this, it's hard to believe the power that emotion can have to wrest you away from your rational plan unless you have had that experience. The best traders focus on correct trades – those made according to their predetermined rules – rather than on whether a particular trade is making gains or losses.

Before attempting to trade using the technical tools illustrated here, you will need to study each of them in more detail and incorporate them into the trading system you are developing and back testing. It's not enough just to read the descriptions and then attempt a trade based only on what you've read here.

FX TRADING AND TECHNICAL ANALYSIS

The foreign exchange market is huge in terms of its turnover, estimated at $US4 trillion a day. Size, liquidity and 24-hour trading make the FX markets unique. The problem of gapping – where a share price can jump quickly without providing an opportunity to trade, where stop-loss orders can fail – is virtually nonexistent in FX markets.

These features make the FX market an excellent subject for technical analysis. It's not so much that they are more predictable, but the smooth continuity of trading tends to create fewer events – such as market closes – in which prices may reflect the risk of events to occur before the market re-opens. If you can get out any time (except at weekends) you don't have to scramble for the exit before the close, competing with everyone else who wants to quit.

FOUR TECHNICAL KEYS TO WINNING IN FX TRADING

1 TREND LINES

You can find a trend line on almost any chart you look at. It's the simplest chart formation, a sloping line that shows the market is clearly moving in an overall direction (up or down), although there will be movements against the trend as well as with it. Long-term trends are something of a feature of the FX markets, although this doesn't mean that you can just jump in and buy anywhere in an uptrend. Identifying the trend is important, because your trading strategy in an uptrend will have a long bias – you'll look for opportunities to buy after the market has moved back from a high and begins to recover. On the other hand, in a downtrend you will look for an upward bounce from a dip and sell as the market begins to fall. Markets move in cycles, which can often be more easily seen using moving averages in conjunction with trend lines.

2 BOLLINGER BANDS

This technical tool lets you see when a market move has taken the price of a currency beyond the bounds of probability. Look at a chart with Bollinger Bands and you'll see three lines – a moving average in the centre and a line of probability on either side. The probability bands come closer together when the price is moving more slowly (is less volatile). They move apart, away from the centre line, when volatility increases and prices are moving faster. Used in conjunction with other signals, they help let you know that a particular trend maybe about to undergo a reversal – that is, when prices move outside the probability bands, signalling a price that is unlikely given recent volatility.

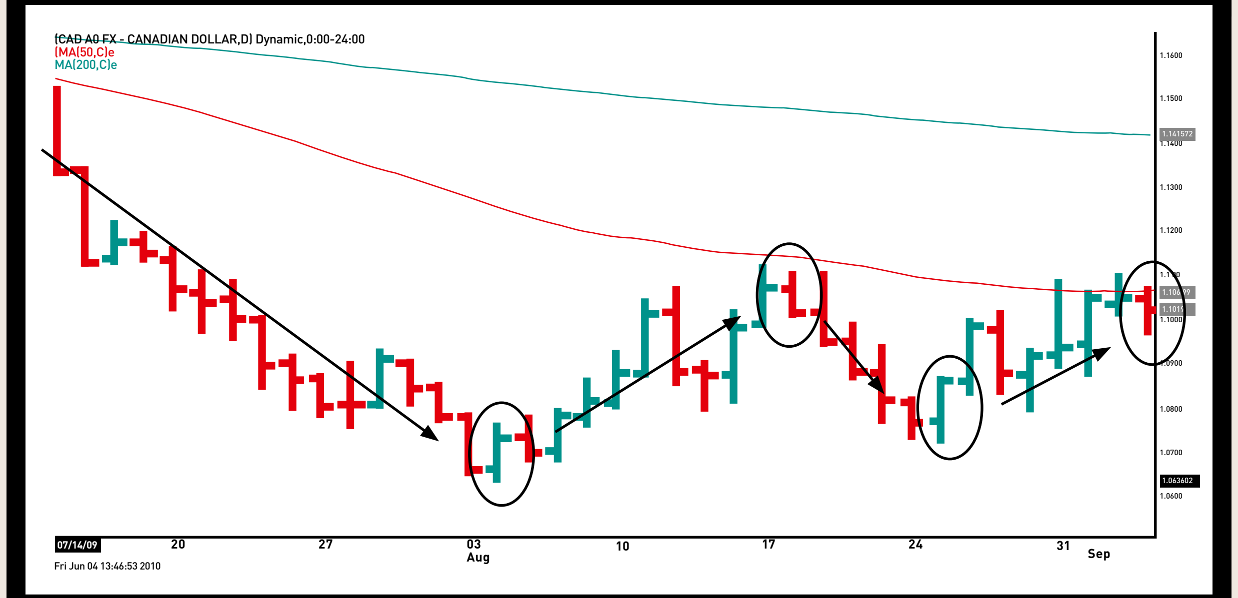
3 MACD (MOVING AVERAGE CONVERGENCE OR DIVERGENCE)

Market commentators will often tell you that a currency has moved above or below its long-term moving average. It's significant when it happens because it indicates that the price has crossed a line from moving up, on average, to moving down or vice versa. The problem with long-term moving averages is that they move slowly and give late signals, so it's useful instead to compare two short-term moving averages (12 and 26 days or periods is typical). One moving average crossing over another generally points to a trend change, if confirmed, but MACD will tell you when the crossover point is coming up by looking at how the distance between them is changing, and this in turn points up subtle changes in the strength of the trend. MACD has a number of elements and requires some study before it can be used with confidence.

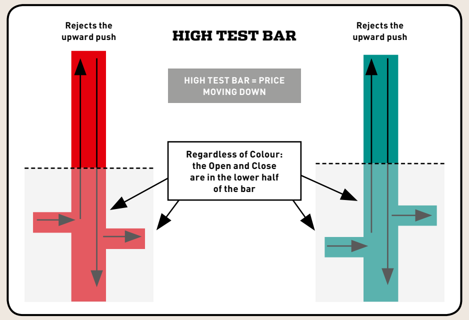
4 HIGH TEST BARS, LOW TEST BARS

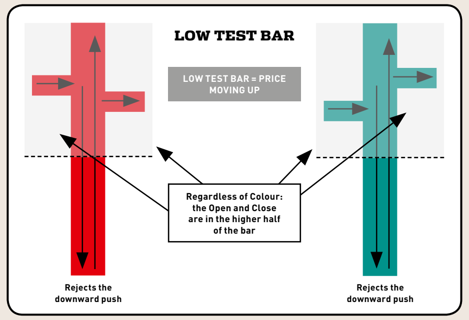
Think about a market that has been moving up and suddenly makes a big leap, then, near the end of the current trading period, suddenly falls back to near its opening price. The bar for the day will have both the opening and closing prices in the lower half of the daily bar and is called a high test bar. Each bar connects the highest and lowest prices vertically, with a short line to the left showing the first price and one to the right showing the last price of the session. Such a bar indicates that the most recent upward push has been firmly rejected and that there is a strong likelihood of a fall. Similarly, a low test bar, with the opening and closing prices both in the top half of the bar, tells us that the market has tried to push lower during the session but buyers have stepped in strongly, suggesting an imminent rise.

CASE STUDY: TRADE USING REVERSAL BARS



A reversal bar occurs when the market shows at least three up days (green bars) ahead of a down day (a red bar). The sudden change of direction after several consecutive upward moves is a sign of a coming sharp fall. If confirmed by other indicators, it is a clear sell signal. Its complement is a clear signal to buy if the market has at least three consecutive down days (red bars) ahead of an up day (a red bar).





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